

May 25, 2010

**Pakistan Market****SBP 4QFY10 Policy: Status quo maintained****MORNING BRIEFING**

KSE100 Index: Closing 9687.41 ↓ (-183.75)

SBP concluded its 4QFY10 policy review as, "with inflation on the rise and fiscal position not responding to the current monetary policy stance, SBP will closely monitor developments to ensure stability of aggregate prices and support nascent recovery of private economic activity. Therefore, SBP has decided to maintain the policy rate at 12.5%"

**'SBP concerns'**

SBP's prime concern is the fiscal deficit, led by rising revenue deficit and in turn inflation. In its statement, SBP has not discussed the commodity price shocks and the resultant price pass through, nor has it touched the recent commodity price meltdown. We believe this is vital in shaping up the inflationary expectation for the next year. Additionally, we believe, SBP has put a lot of weight behind the deficit financing concern and ignored the limitations of a 'war economy', where unexpected surge in deficit is warranted and economic recovery remains in a nascent stage. As a result of higher fiscal deficit concerns, SBP believes that borrowing from the banking system for budgetary support coupled with expected borrowing for commodity operations in 4QFY10 is jeopardizing space for private sector credit, causing inertia in market interest rates, creating excess domestic credit, and raising the debt burden for future generations.

**'SBP easing concerns'**

The SBP is of the view, that the economy is recovering but not at the required pace, as lack of infrastructure development owing to the power crisis has dampened the momentum. Stabilization efforts of the past have borne fruit; reflective from the contraction in external deficit, containment of excessive money growth, and reduction in inflation. Exports and remittances are encouragingly depicting a positive trend, while the currency remained stable throughout, led by higher NFA and an improved ratio of outstanding NDA to NFA. We believe, if the one-off hike in security personnel salaries and higher security related expenditures is adjusted, the current year fiscal position is also an achievement.

**JS macro view**

The balance of macroeconomic variables is clearly indicating the reversal of headwinds, fiscal deficit is a concern but not to a large extent - if we adjust the security related expenses - and external deficit will continue to remain under control primarily owing to the commodity price meltdown. The money growth for the first ten months is hovering around 8.66%, compared to the nominal GDP growth of 15% in expected FY10. We believe, it is high time for the SBP to begin easing its stance, albeit gradually, as the macroeconomic recovery is purely organic led by policy tightening, unlike rest of the world.

**Monetary aggregates**

(Rs mn)	30-Jun-09	since 1st July to	
		14-May-10	16-May-09
<b>Components</b>			
Currency in circulation	1,152,173	190,505	208,870
Other deposits with SBP	4,662	1,755	607
Total Demand & Time Deposits	3,980,384	254,327	6,942
<b>Factor Affecting M2</b>			
Net foreign assets	517,330	90,292	(227,336)
Net domestic assets	4,619,888	356,295	443,755
Borrowings for budgetary support from SBP	1,681,022	379,484	332,239
Credit to private sector	2,906,897	125,663	25,070
Credit to public sector enterprises	290,005	62,038	146,153
Broad Money (M2)	5,137,218	446,587	216,418

Source: SBP

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**Also in focus****RBS deal yet to be finalized**

In separate notices issued to the exchange, RBS Pakistan and Faysal Bank (FABL) have refuted claims of the acquisition bid from RBS having been won by FABL. Both the banks have informed that the transaction is in final stages and any conclusion reached on the deal will be appropriately disclosed to the bourse.

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