

November 25, 2009

Pakistan Market**Monetary Policy review (Dec-Jan): 50bps cut****MORNING BRIEFING**

KSE100 Index: Closing 9233.70 ↑ (+11.74)

Broadly in line with consensus estimates, the State Bank of Pakistan (SBP) has cut the Policy rate by 50bps to 12.5%. The 'cautious' approach undertaken by the central bank was driven by consideration of inflationary risks, revision in electricity & gas tariffs on account of fiscal consolidation and timing of foreign inflows. Hence, the SBP has tried to strike a balance between monetary & financial stability and economic growth.

Since the money market had already anticipated a rate cut, subsequent impact on market interest rates is likely to be muted, with a 10-15bps decline expected across all tenors. However, improved activity is expected in the equity markets after the dullness that had prevailed during the last few trading sessions.

MPS: Key facts

- Economic indicators have shown substantial improvement with inflation falling to 8.9% in Oct 09 while the balance of payment (BoP) position has improved considerably (current a/c deficit narrowed to US\$1bn in 4MFY10).
- However, a reversal in commodity prices and electricity and gas price adjustments necessary for fiscal consolidation, remains a source of concern for the inflation outlook which SBP estimates at 11% in FY10.
- Fiscal and real sector performance remains weak despite an improving trend particularly on the LSM front.
- The fragile nature of the real sector is reflected in weak credit disbursements to the private sector. Moreover, the deteriorating law and order situation & uncertainties on the fiscal front have forced SBP to view the macroeconomic reversals with caution.
- Though IMF's disbursement has helped strengthen reserves to US\$14.3bn, the sustainability of the BoP situation rests with the resumption of foreign flows.

Uncertainty with regard to the timing of such flows increases risk for liquidity management and budgetary financing.

The impact:

1. Neutral to positive impact on equity markets particularly on the volumes which are likely to pick up after wariness shown by investors in the last few sessions because of uncertainty felt on SBP's stance.
2. Reversal of interest rates expectation though remains intact, the speed of reversal in fix investments would slow down.
3. Yields on govt. securities to decline by 10-15bps across all maturities, with a 10bps decline already witnessed in the early morning trades.
4. No major respite for the highly leveraged corporates with risk of defaults amid higher financial charges, broadly staying intact.

Table: Historical discount rate

Date	Rate	Date	Rate
5-Jan-00	11.0	29-Jul-06	9.5
19-Sep-00	12.0	1-Aug-07	10.0
5-Oct-00	13.0	31-Jan-08	10.5
7-Jun-01	14.0	23-May-08	12.0
19-Jul-01	13.0	30-Jul-08	13.0
17-Aug-01	12.0	12-Nov-08	15.0
20-Oct-01	10.0	21-Apr-09	14.0
23-Jan-02	9.0	15-Aug-09	13.0
18-Nov-02	7.5	25-Nov-09	12.5
11-Apr-05	9.0		

*Source: SBP***JS interest rate outlook**

Differing with SBP on inflation, we rule out the fact that the threat of inflation will be mitigated by keeping rates higher. We believe the country's inflationary woes are expected to increase further, unless we focus on the supply side of the economy. This can only be achieved through a rise in real

investments in agriculture, power and infrastructure. The disbursements of approximately US\$1.0bn from Friends of Democratic Pakistan and continuation of foreign portfolio investments should ease the liquidity concerns and prompt SBP to ease its monetary stance. We expect a 100-150bps cut in the January policy review.

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Also in focus**Production from Manzalai rise further**

According to PPIS (Pakistan Petroleum Information Services), oil and gas production from Manzalai field during the week ending on Nov 17, 2009 stood at 2,428bpd and 155mmcf, respectively. This is an increase of 269bpd and 25mmcf versus the numbers reported last week. Production from the field would rise further in coming weeks and is expected to reach 4,000bpd of oil and 250mmcf of gas by the end of Dec 2009. To recall, OGDC and PPL each have a 27% stake in the field, while POL holds a 22% share.

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