

December 30, 2009  
Pakistan Market

MORNING BRIEFING



## IMF tranche and interest rate outlook

KSE100 Index: Closing 9410.66 ↓ (-11.57)

IMF's Pakistan Mission Chief briefed the media on the findings of its third review yesterday, and hailed the progress of Pakistan's stabilization program for the first time. We believe, the release of US\$1.2bn (including US\$400mn for budgetary support) will boost investor confidence leading to a stable rupee exchange parity. Additionally, we believe, with this tranche, the government would comfortably be able to meet the December ending IMF quantitative targets. This would pave way for domestic liquidity easing and prompt the SBP to ease the monetary policy further. We expect the SBP to reduce the DR further by 100bps in its January review.

The key takeaways of the conference call with the Chief:

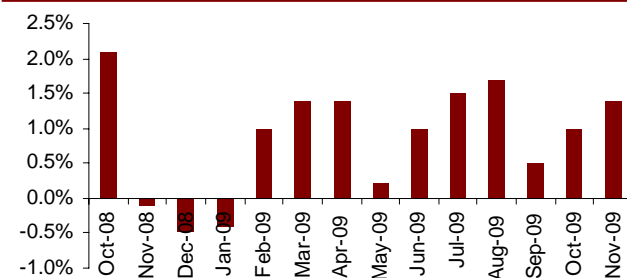
- *The welcome news on the macro front is that stabilization is progressing. The budget and external current account deficits have declined. Reserves have increased to over three months of imports, and, importantly, inflation has declined from 25 to 10 percent, reducing the tax on poor.*
- *As inflation continues to decline, monetary policy could become more flexible and allow interest rates to come down further. The uncertainties about the financing needs of the government are limiting the central bank's ability to lower interest rates.*
- *The government has also taken important steps towards structural reform, improving tax administration, and also strengthening the central bank to conduct the monetary policy more independently.*
- *Nevertheless, there are significant challenges that remain. Significantly, the budget needs to be managed better to avoid future over runs to keep inflation low and build economic confidence.*

### Our interest rate outlook – above consensus

As highlighted above, we expect another 100bps cut in the DR in the forthcoming January review, keeping in mind the following justifications:

- Pakistan's headline and core inflation is expected to be around 10% for FY10. The low base effect will diminish January 2010 onwards. (Refer to the graph below).

Graph: CPI (monthly)



Source: SBP

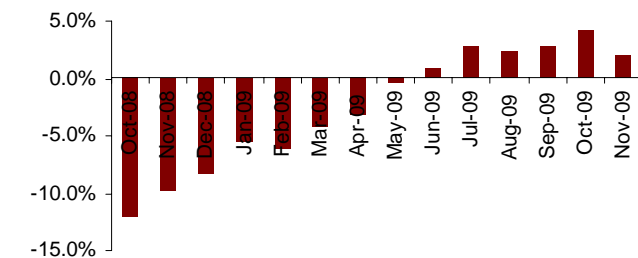
- The twin deficit is likely to be contained further, on the back of improved remittances, and higher electricity pass through.
- The US\$400 IMF disbursement for budgetary support should stimulate NFA and curtail GoP's borrowing in turn. Additionally, disbursements from the Kerry-Lugar Bill and Friends of Pakistan will generate additional room for GoP to fund its budget deficit.
- On the back of improved inflationary expectations and government finances, we expect the SBP to ease its stance to accommodative (neutral) from aggressive.
- The bench mark policy is expected to be around 10% by Dec 2010, and hence the SBP will bring the real interest rates to zero from the current 2.0%. (Refer to the graph below for the real interest rate trend).

### Investment perspective

With improved liquidity, we expect bond markets to rally. With anticipation of further rate cut, we expect the treasury and KIBOR yields to come down more. This should prove to be a positive for quality leverage plays like Engro, DGKC, and

NML etc. With expectation of the resolution of inter-corporate debt in the near future, we expect PSO and HUBCO to perform as well.

Graph: Real Interest Rate



Source: SBP

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### Also in focus

#### Etisalat committed to the SPA with PTCL

There have been various news flows in the past couple of days regarding Etisalat's commitment to the share purchase agreement (SPA) with PTCL. Yesterday, one of UAE's local newspapers, cited that Etisalat had retained its payment of US\$1.0bn (out of the total US\$2.6bn) to PTCL over land dispute which was part of the SPA with PTCL. However, in a clarifying email statement to Bloomberg today, Etisalat has confirmed its commitment to agreement, despite 'certain issues and challenges that have impeded the implementation of certain conditions in the agreement'. With a massive amount at stake and the government in needs of funds, we believe a speedy resolution on the matter by the GoP is highly probable.

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