

Equity Research Pakistan

In Focus

Economy and Strategy

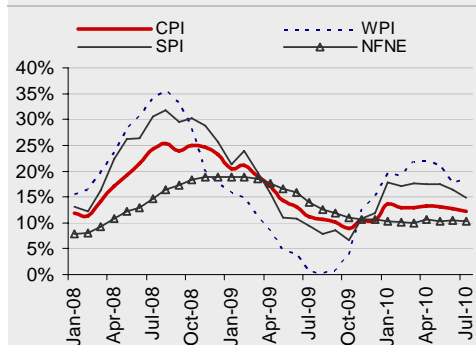
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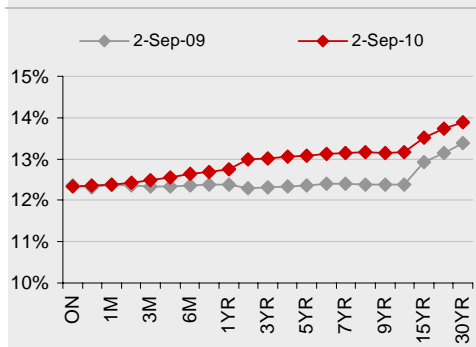
Economy Numbers

CPI Inflation	Jun10 YoY	12.3%
SPI Inflation	Jun10 YoY	14.9%
NFNE Inflation	Jun10 YoY	10.3%
Reserves	As 03-Sep-10	USD16.2bn
Remittances	FY10	USD8.9bn
Trade Balance	FY10	USD(11.2bn)
Current A/c deficit	FY10	USD(3.5bn)
6 Month KIBOR	02-Sep-10	12.7%
10 Year PIB	01-Sep -10	13.2%
Discount Rate		13.0%

Inflation



Yield Curve



Pakistan Fights to Stay Afloat

- According to estimates from Ministry of Agriculture, assessed losses may cross PKR240bn (USD2.9bn). Value erosion from major crops alone sums to PKR180bn or 3% of GDP (initially expected growth of 4.5% was to add PKR255bn to GDP during FY11)
- We thus expect GDP to grow by 2.1% in FY10 followed by 4.1% in FY10 while inflation to peak at 17-18% during FY11
- In Pre-flood scenario, govt. was estimating fiscal deficit of PKR780bn for FY11 - 4% of GDP. Potential shortfall in tax collection is estimated at PKR60bn in the current scenario which is expected to curtail tax to GDP under 10%
- IMF is to provide USD450mn in Immediate Emergency Assistance to Pakistan and seems committed to work towards Completion of Stand-By Arrangement Program Review. Other expected outcome of the ongoing review include 200bps relaxation in fiscal deficit
- Overall investment theme for Pakistan equities stay intact which is largely driven by domestic demand, favorable demographics and rich natural resources
- For the rest of the 2010 however, equity markets may continue to remain hostage to negative news flow emanating from the situation. Moreover, concerns on rising inflation and fiscal deficit and consequent risk of SBP further tightening the monetary environment will continue to loom over investor sentiments
- We thus believe that our initially set KSE100 target of 11,500 may not be met during 2010 while upside risks to this thesis largely rest on introduction of a timely and effective leverage tool i.e. Margin Trading System
- Kindly refer to our detailed report to be released shortly

Damage to the country's overall economic recovery has been massive in the aftermath of the floods. According to estimates from Ministry of Agriculture, assessed losses may cross PKR240bn (USD2.9bn). Value erosion from major crops alone sums to PKR180bn or 3% of GDP (initially expected growth of 4.5% was to add PKR255bn to GDP during FY11). We thus expect GDP to grow by 2.1% in FY10 followed by 4.1% in FY10 while inflation to peak at 17-18% during FY11.

Fiscal outlays surpassing targets: Hinged on financing

Flood poured uncertainty into shaky fiscal position as water devastated a significant portion of cropped area, disrupted transportation means and choked economic activities. In Pre-flood scenario, govt. was estimating fiscal deficit of PKR780bn for FY11 - 4% of GDP. Potential shortfall in tax collection is estimated at PKR60bn in the current scenario which is expected to curtail tax to GDP under 10%.

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Key Economic Indicators

	FY11 previous	FY11F revised
Growth		
Agriculture	3.80%	-1.40%
Manufacturing	5.60%	2.10%
Services	4.70%	3.50%
GDP	4.50%	2.10%
Inflation	11.40%	16-18%
Fiscal deficit to GDP	4%	6.20%
USD bn		
Exports	21	20.6
Imports	30	34.7
Trade deficit	-9	-14.1
Remittances	9.5	10
CA deficit	3	5.6

Govt. thus plans to abandon all development projects and reallocate funds to rehabilitation. In addition, trend reversal in subsidies is likely amidst higher import requirements for sugar and pesticide, whereas subsidy elimination from energy chain is likely to continue as it would help save ~PKR109bn during FY11.

IMF unveils Emergency Loan Plan for Usd450mn

According to a press release issued yesterday, IMF is to provide USD450mn in Immediate Emergency Assistance to Pakistan and seems committed to work towards Completion of Stand-By Arrangement Program Review. Following are the likely outcomes of ongoing review:

- IMF is expected to relax condition for fiscal deficit by 200bps together with enhancing borrowing limit for budgetary borrowing from SBP
- As Pakistan authorities show willingness to adopt suggested economic stability measures, the ongoing review is likely to end up with securing next tranche of USD1.7bn
- IMF disbursements (including emergency assistance) is expected to clock in at USD2.2bn by Dec10

Materialization of external flows for budgetary spending would help mitigate liquidity risks. Reallocation of funds from current programs to rehabilitation suggests no additional funding increase of World Bank.

As the IFIs are conducting loss assessment, materialization of funds for rehabilitation seems to be taking place in post Sep-Oct10. Therefore, government's reliance on banking system is a likely case for deficit financing. Emergency funding of USD450mn in Sep10 may however help mitigate liquidity issues to some extent.

Takeaway for equities; KSE100 target may not be met

While most of the listed sector has remained secured from the ongoing floods, the crop losses alone paint a bleak economic outlook for FY10. Needless to mention however, that most of the downward revision in economic growth stems from one-off crop losses while shrinkage in demand for other industries (eg autos) should start to recover in FY12.

We thus highlight that overall investment theme for Pakistan equities stay intact which is largely driven by domestic demand, favorable demographics and rich natural resources. We however reiterate that current situation warrants an even closer adherence to screening criteria based on companies with pricing power, devaluation positive revenue stream and attractive dividend yields.

For the rest of the 2010 however, equity markets may continue to remain hostage to negative news flow emanating from the situation. Moreover, concerns on rising inflation and fiscal deficit and consequent risk of SBP further tightening the monetary environment will continue to loom over investor sentiments. We thus believe that our initially set KSE100 target of 11,500 may not be met during 2010 while upside risks to this thesis largely rest on introduction of a timely and effective leverage tool i.e. Margin Trading System.