The Scorecard Mar07

March 8, 2007

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Overall 7mo FY07 economic indicators present strong growth prospects, although inflation and the twin deficits remain a concern. Headline inflation eased to 6.64% during Jan07, from a worrisome high of 8.9% a month earlier, however the 7mo average stood at 8.1%, far above the annual target of 6.5%. Although both trade and fiscal balances deteriorated by 16% and 24%, rising tax revenue collection and foreign inflows helped to plug the respective gaps.

- **Ministry of Finance tightens its belt to curb inflation**

As seasonal pressures tapered off, headline inflation moved into reverse gear. The government announced a much awaited oil price cut which also helped to ease the burden on the consumer price index, pulling headline inflation down to 6.5% for Jan07.

- **State Bank maintains a tough stance in its Jan-Jul07 policy statement**

The SBP released its Monetary Policy Statement for the period Jan-Jun07, reaffirming its vigilant stance and tight monetary approach.

- **Mar 5'07 PIB cut off yields dip**

The central bank shed a few bps on cut off yields of all tenures, however this was partially due to the maturities being linked to May 19'06 auction.

- **Foreign inflows cross USD 6bn mark for 7mo FY07**

Rising remittances, foreign direct investment, portfolio investment and inflows from GDR issues of Pakistani companies approached record highs in 7mo FY07 just under USD 7bn.

- **NFA boom could fuel inflationary pressure**

Inflow of foreign funds boosted NFA levels to PKR 17bn, which could fuel the reserve position of the SBP and boost aggregate demand.

Economy at a glance	Last reported	Year ago	Latest	Change	Previous month	Latest month	% Change
Monetary Indicators %				bps			bps
Discount Rate	Feb-07	9.0	9.5	50	9.5	9.5	-
6mo T-bill cut off yield	Feb-07	8.3	8.8	52	8.8	8.8	-
5yr PIB monthly average yield	Feb-07	9.2	9.8	63	9.9	9.8	(14)
6mo KIBOR offer rate	Feb-07	9.2	10.5	125	10.6	10.5	(6)
Headline Inflation	Jan-07	8.5	6.6	(186)	8.9	6.5	(238)
Lending and Deposit Spread	Jan-07	7.3	7.4	18	7.4	7.4	-
Monetary Aggregates PKR (mn)				%			%
Private Sector Credit	Feb 17'07	295,829	232,085	(22)			
Money Supply Growth (M2)	Feb 17'07	243,452	255,538	5			
Fiscal Deficit PKR (mn)							
Fiscal Deficit	1H FY07	(136,704)	(168,982)	24			
Fiscal Deficit as % of GDP	1H FY07	1.8	1.9				
External Sector USD (mn)				%			%
Exchange Rate PKR: USD	Feb-07	59.96	60.94	2	61.10	60.94	(0.3)
Forex Reserves	Feb 24'07	12,642	13,342	6	12,904	13,342	3
Trade Deficit	7mo FY07	(6,524)	(7,595)	16			
Workers Remittances	7mo FY07	2,436	2,958	21			
Net Foreign Private Investment	7mo FY07	1,645	2,793	70			
SCRAs Feb 28'07	8mo FY07	466	557	20			

Source: SBP

SBP Monetary Policy statement signals continuity of policy

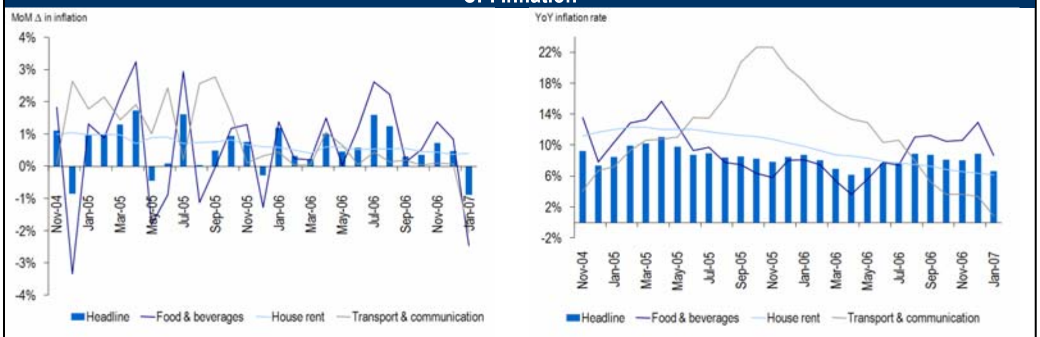
The central bank's tight monetary stance remains unchanged with the dual aim of maintaining growth momentum and yet curbing demand driven inflation. The only significant revision referred to a rise in the daily minimum Cash Reserve Requirement (CRR) to 2% for Time Liabilities (TL) and 6% for Demand Liabilities (DL), plus time liabilities with less than 6mo maturity, against a previous requirement of 1% and 4% respectively. Weekly average CRR remained the same at 3% and 7% for TL and DL respectively. This will effectively reduce the differential between the daily minimum and weekly average, thus limiting volatility in the inter bank market. Accordingly overnight market rates should be less variable on a week end basis. Statutory Liquidity Requirement (SLR) for banks will remain the same at 18% bringing total weekly reserve requirements to approximately 25% of bank's Demand and Time Liabilities (DTLs).

YoY CPI drops to 6.64% in Jan07

In early Jan07 the central bank governor stated that inflation was unlikely to meet the annual FY07 target of 6.5%. She attributed this to persistent food inflation and the government's inability to pass on the benefits of falling international oil prices via domestic price cuts. In line with expectations of the central bank, 7mo FY07 inflation averaged at 8.1%.

Following the SBP governor's statement the Ministry of Finance announced a price cut in MS and HSD by PKR 4/liter and PKR 1/liter respectively on Jan 16'07. Oil prices had remained unchanged over the precious 6 months, however with pressures rising to meet fiscal year inflation targets, an oil price cut was imminent.

CPI inflation



Source: FBS

During 1H FY07 all major components of headline inflation posted MoM increases. For the first time in the current fiscal period, MoM transport and communication inflation declined to (2.0%) however most significant was the drop in food inflation which declined to (2.5%).

T-bill rates remain flat

T-bill cut off yields remained unchanged at recent highs of 8.6%, 8.8% and 9.0% for 3, 6 and 12mo paper in Feb07, primarily due to continuing inflation concerns. During the month SBP sold just under PKR 100bn in T-bills, with the 1yr paper being the most active and generating PKR 89.7bn of investment. The SBP conducted 2 OMOs during Feb07 to siphon out excess liquidity for 2, 5, 10, 13 and 27 days at variable rates. If inflation continues its downward trend, SBP may ease up on its monetary stance by 1H FY08.

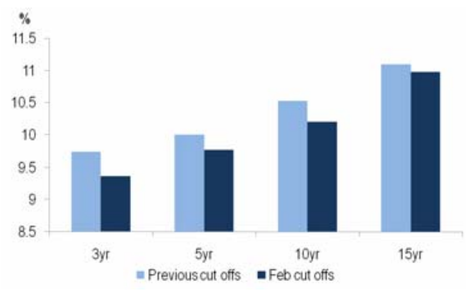
PIB auction with a twist

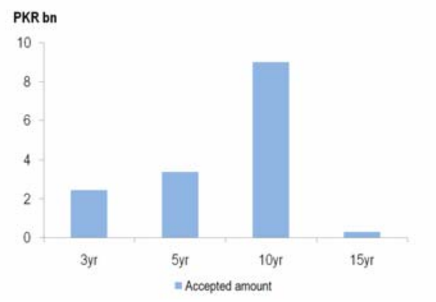
The recent PIB auction was by all means the most exciting auction to hit the government bond market in months. With inflation heading downward, the annualized FY07 fiscal deficit within a comfortable margin of 3.8% of projected FY07 GDP and foreign inflows continuing to support the fiscal bottom line, the market was enthusiastic about the Mar 5'07 auction. To top it all off, secondary market yields on PIBs had been trading nearly 20bps lower than the last cut off yields on most tenures, suggesting the market was expecting the central bank to shed a few bps on cut off yields

In line with predictions, the SBP received a phenomenal response of PKR 55.8bn against a target of PKR 15bn. However the central bank only accepted PKR 15.9bn worth of interest, but reduced cut off yields as expected on all tenures except the 15yr and 20yr paper, bids for which, were rejected.

The 3, 5, 10 and 15yr notes were priced at cut off yields of 9.37%, 9.77%, 10.20% and 10.98%. It is pertinent to note that the recent auction was a reissue of the previous auction of May 19'06 bonds. Consequently all PIBs being auctioned will mature as per the May 19'06 issue date.

PIB Auction Mar 5'07





SBP keeps a tight noose around Net Domestic Assets

As of Feb 17'07, government budgetary borrowing rose by only PKR 45.3bn compared to PKR 121.9bn a year earlier. Privatization receipts, GDR inflows and greater reliance on PIB flows have helped to stem bank borrowing by the government. Credit to private sector remained on the lower side at PKR 232.0bn compared to a high of PKR 243.6mn during Dec06 year end closing. NFA posted the most significant increase to PKR 17.1bn against a fiscal year target of PKR 9.8bn bringing overall broad money growth to 7.5% against a target of 13.5% for FY07.

No.	PKR mn	Credit Plan FY07	Stock end Jun06	Feb 18'06	Feb 17'07
1	Net Govt Sector Borrowing	130,100		121,905	45,289
2	Credit to Non- Govt Sector	395,000		295,870	227,068
2a.	Credit to Private Sector	390,000		295,829	232,085
3	Other Items	(75,000)		(78,387)	(33,829)
4	NDA 1+2+3	450,100		339,388	238,528
5	NFA	9,800		(95,936)	17,010
6	Broad Money M2	459,900	3,416,500	243,452	255,538
	M2 Growth				7.5%

Source: SBP

Higher capital inflows boost the reserve position of the SBP

Expansion of Net Domestic Assets (NDA) is somewhat slower compared to the same period last year, since the central bank has been actively targeting monetary aggregates to control demand growth. Meanwhile current inflows have boosted NFA to PKR 17.1bn already, against a FY07 target of only PKR 9.8bn.

Monetary Aggregates

Source: SBP

Rising monetary aggregates impact the SBP's reserve position (currency in circulation, in tills of scheduled banks and bank's deposits with the central bank) and consequently the Money Multiplier (MM). Although the SBP can control NDA to some extent, it cannot influence the NFA variable. Therefore rising NFA is a cause of concern in terms of the ability of the central bank to effectively transmit monetary policy

From a peak of 3.4 in FY06, the MM decreased to 3.05 in Oct06 after the SBP increased CRR and SLR requirements. However as inflows from GDRs, remittances and foreign investment picked up pace in Dec06, the MM again increased marginally to 3.09, indicative of the constraint faced by the central bank moving forward.

Nevertheless we feel the SBP is in a strong position to manage the impact of foreign inflows moving forward; firstly because its foreign exchange reserves can be leveraged to stabilize large movements in the exchange rate, and secondly, because it has effectively controlled NDA expansion and consequently contained aggregate demand.

Annualized fiscal deficit within a manageable range of 3.8% of projected FY07 GDP

According to data released by the Ministry of Finance, the fiscal deficit for 1H FY07 rose by 24% to PKR 168.9bn over the same period last year. This brings the current budget deficit to an annualized 3.8% of projected GDP of 8.8tn for FY07, below the preceding year's levels.

Fiscal Operations (PKR mn)	1H FY06	1H FY07	%∆
Total Revenue	**497,829**	**614,771**	**23%**
Tax Revenue	343,266	433,448	26%
Non-Tax Revenue	135,344	181,323	34%
Total Expenditure	**634,533**	**783,753**	**24%**
Current	525,339	581,399	11%
Development Expenditure & net lending	127,842	147,927	16%
Unidentified Expenditure	(18,648)	54,427	-392%
Fiscal Balance	**(136,704)**	**(168,982)**	**24%**

Source: SBP

Total revenues posted substantial growth of 23% to PKR 614.8bn, just under expenditure growth of 24%. This was primarily due to impressive CBR collection growth of 26% on the back of a rise in Direct, Excise and Sales tax by 70%, 11% and 22% respectively, an important indicator of economic activity in Pakistan.

Another distinctive feature of revenue growth in the current fiscal period is the growth in surcharges on petroleum and gas, which rose to PKR 18.0bn and PKR 15.8bn respectively from PKR 9.9bn and PKR 9.4bn in the corresponding period last year. Royalties on oil and gas also increased to PKR 14.1bn from PKR 10.2bn last year.

In addition revenue growth was supported by the central bank which allocated a greater proportion of its revenues to the government's balance sheet this year, posting a profit of PKR 39.2bn compared to PKR 3.9bn last year. However taxes on international trade, a significant component of CBR earnings, declined by 1.4% to PKR 60.7bn. In view of expansionary government policy and relief measures such as subsidies on imports and exemptions on exports, it is possible that taxes from international trade will remain restricted in FY07.

Current expenses rose by 11% over the same period last year, of which domestic debt servicing and foreign debt servicing increased by 46% and 13% to PKR 131.3bn and PKR 24.5bn respectively. Nevertheless as a % of current expenses, debt servicing has been on the decline in the past 5yrs, while Pakistan's capacity to meet its obligations has improved.

The largest increase in expenses was evident in the 'unidentified' segment which rose to PKR 54.4bn in 1H FY07 compared to PKR (18.7)bn in the same period last year, while defense spending posted a decline of 3.4%. Development spending increased by only 16% to PKR 147.9bn suggesting a slower pace of development outlays against a FY07 target of PKR 435bn. To meet development targets the government would have to spend PKR 144bn per quarter for the remaining quarters of FY07, which presents a challenge.

Public debt profile improving in accord with FRDL Act 2005

Total domestic debt rose by 3% in 1H FY07 to PKR 2.3tn, roughly 26% of projected FY07 GDP of PKR 8.8tn. The increase in domestic debt resulted from a marginal increase in activity across all debt instruments particularly floating debt. PIBs posted an increase in stock by 3.5% to 517.7bn while investment in NSS also increased by 2.5%. Floating debt however dominates the public debt profile at just under a trillion PKR and an increase of 2.65% over stock ending Jun06. Total External Debts and Liabilities (EDLs) have also increased by 3.1% in 1H FY07 over stock of external debt ending Jun06. However as a % of projected FY07 GDP it has declined to 27% from 29.6% in FY06.

In accordance with the rules and regulations of the Fiscal Responsibility and Debt Limitation Act 2005 (FRDL), the Ministry of Finance published the Debt Policy and Fiscal Policy Statements 2007. In its debt policy review the Ministry of Finance stated that the total public debt to GDP ratio had declined to 56% in FY06 from 80% in FY02. Although high, domestic debt as a % of total revenue, declined to 394% from 562% during the same period. The report also highlighted that servicing of public debt had fallen to 27% of current expenses from an earlier 44% in FY02.

1H FY07 external balance improves on the back of rising external inflows

According to data released by the SBP, 1H FY07 current account deficit (without official transfers) worsened by 42% to USD 4.4bn over the same period last year. This was primarily due to the deteriorating goods, services & income balance, which weakened by 24%. However on a positive note, remittances were up by 25% to USD 2.5bn while the financial and capital account reflected increases of 59% and 85% respectively during the period. The overall balance got a further boost from net errors and omissions which rose to USD 313mn from USD 158mn last year.

USD (mn)	FY07 Target	1H FY06	1H FY07	Growth(%)
Current Account balance	**(6,288)**	**(2,877)**	**(4,209)**	**46%**
Current account balance w/o off transfers		(3,094)	(4,385)	42%
Balance on G&S & Income		(7,428)	(9,220)	24%
Current Transfers		4,599	5,042	10%
Of which Worker's Remittances	4,500	2,055	2,568	25%
Capital Account	**8,175**	**71**	**131**	**85%**
Financial Account		**2,357**	**3,742**	**59%**
Net Errors and Omissions		158	313	98%
Overall Balance	**1,887**	**(291)**	**(23)**	**-92%**

Source : SBP

Petroleum group still leading import growth during 7mo FY07

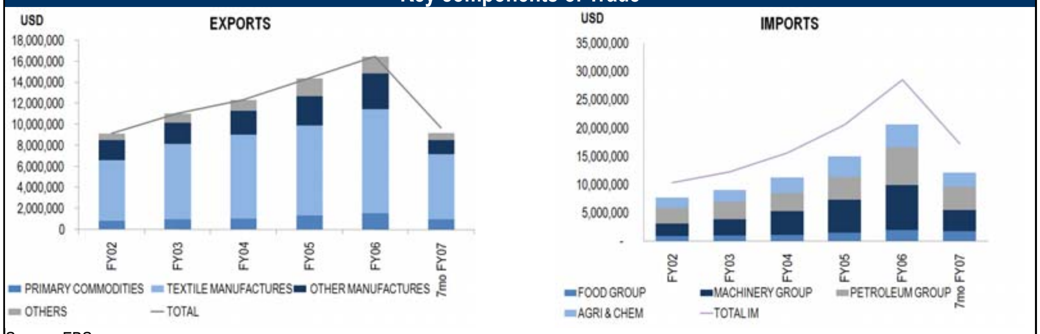
Total imports rose by 9%, fueled by petroleum and machinery segments, outpacing laggard export growth of 4% for 7mo FY07. Data on petroleum products import reflects an increase in both USD value and quantities in MT. Meanwhile total quantities of crude imported have declined over the same period last year. With the economy projected to grow at the current pace of 7% we expect petroleum products imports to continue their upward trajectory moving forward.

USD (mn)	Jul-Jan FY06	Jul-Jan FY07	% change
Exports	9,271	9,630	4%
Imports	15,795	17,225	9%
Trade balance	(6,524)	(7,595)	16%

Source: FBS

During 7mo FY07 machinery imports rose by 12% to USD 3.8bn, due to an increase in telecom imports by 23% to USD 1.3bn, transport group by 19% to USD 1.2bn and power generation machinery by 51% to USD 434.3mn. Meanwhile agriculture products and chemical segment declined due to declining quantities of fertilizer and insecticides imported.

Key components of Trade



Source: FBS

Textile group, the largest component of exports, rose marginally by 5% to USD 6.2bn from USD 5.9bn in the corresponding period last year. The second major component of exports, the food group, lost 10% in value to USD 1.0bn from USD 1.1bn a year earlier, while carpets and leather manufactures declined by 14% and 33%. 'Other' exports which include miscellaneous items however increased by 156% to USD 709.6mn during 7mo FY07, providing support to the bottom line trade figure.

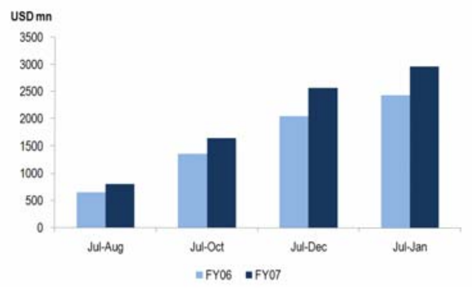
It is evident that exports have suffered significantly as diversification of the product base has not been achieved. We expect export growth to remain in line with textile sector growth at an average growth rate of 4-5% per month for the remaining months of the fiscal period. This would bring exports to an estimated level of USD 17bn by end Jun07, significantly below the estimated target of USD 19.8bn.

Although the narrowing output gap has marginally eased upward pressure on imports, we expect the trade deficit to deteriorate as imports are likely to increase by roughly the same pace of 9-10% per month during the remainder of FY07.

Remittances increase by 21% in 7mo FY07

The country received almost USD 3bn in remittances during 7mo FY07 compared to USD 2.4bn the previous year. At the current pace, remittances are expected to surpass the USD 5bn mark. US was the largest contributor with inflows amounting to USD 659.3mn followed by Saudi Arabia at USD 483.2mn during the period under review.

Remittances



Source: SBP

Net Foreign Investment (NFI) crosses the USD 2.7bn mark for 7mo FY07

Of FDI, privatization proceeds totaled USD 133.2mn for FY07 to date. Countries with the largest total investment were USA, UK and UAE at USD 917.6, USD 734.1 and USD 310.1mn. Both portfolio and direct investment were led by USA and UK with Singapore the 3rd largest portfolio investor and UAE the 3rd largest direct investor.

Key areas of investment were financial business at USD 554mn, communications & telecom at USD 512mn, followed by oil & gas at USD 329mn and power (thermal) at USD 102mn.

The stated USD 697mn portfolio investment also includes foreign investment in unlisted companies which is not captured in SCRA account.

Net Private Foreign Investment			
USD (mn)	7mo FY06	7mo FY07	% change
FDI	1,245	2,096	68%
Portfolio Investment	401	697	74%
NFPI	1,645	2,793	70%

Source: SBP

SCRAs hit a new record of 557.1mn during 8mo FY07

Cumulative net inflows in Feb07 rose to USD 176mn with the largest injections of USD 136.8mn and USD 71.1mn from USA and UK respectively. The leading investors for FY07 to date are USA at USD 378.1mn, UK at USD 100.3mn and Singapore at USD 99.1mn.

				Cumulative Net flow	
USD	Inflow	Outflow	Net	Feb07	Jul-06 to date
Feb27'07	18,328,883	6,238,647	12,090,236	161,677,339	543,235,676
Feb28'07	20,320,656	6,376,185	13,944,471	175,621,810	557,180,147

Source SBP

International credit ratings agency labels Pakistan's banking sector stable

In early Jan07, Moodys released its Banking System Outlook, which qualified Pakistan's banking sector as stable with potential for robust growth. It attributes the strengthening fundamentals to privatization, consolidation and structural change. Today 80% of banking assets are in private hands against 43% in 2000, which will boost the effective deployment of capital and stimulate competition. Diversification of bank's loan portfolio has also been welcomed by the ratings agency; however they remain cautious about the credit profile of banks in the event of an economic slowdown.

Moodys also lauded the role of the central bank in strengthening the regulatory environment, increasing data dissemination and transparency and effectively managing liquidity. The ratings agency stated that Pakistan's banking sector was benefiting from a peak in the business cycle and in the event of a slowdown, the country's narrow capital market base could pose a challenge to the banking sector.

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