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Economic Assessment: YEAR-END REVIEW

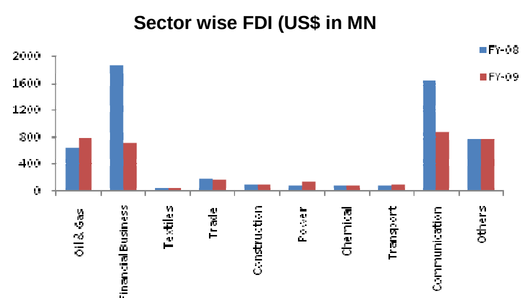
2009 was a year where deterioration in the security and law and order situation in the country has adversely affected the economic and investment climate, and has resulted in shrinking of overseas demand and the investment inflow in the country. Although Pakistan moved towards stability under the IMF stand-by-facility program, IMF approved a 23-month loan of $7.6 billion in 2008 to help Pakistan to cope with the global financial crisis and balance of payment crisis. IMF support has had a positive effect on certain areas, for e.g. macroeconomic imbalances have been shrinking, inflation has declined and the exchange rate has become more flexible as foreign currency reserves have increased. SBP expects a gradual revival during FY10, and expects real GDP growth to be close to the target of 3.3 per cent in 2010. Signs of economic recovery include,

- A rise in imports during July 2009, which points towards a possible pick up in domestic demand,
- Easing of LSM contraction and
- Resolution of circular debt problem would also support production activities in oil and energy sectors.

(Us $ mn)	2Q-09	2Q-08
Exports	3057	2941
Imports	4945	5476
Remittances	1501.08	1086.6
FDI	302.4	504.4

In the vein of, S&P upgraded Pakistan Rating/outlook to B- stable in Aug-09 after amplification of IMF standby facility. Chief indicators such as inflation, forex reserves, currency risk and twin deficit showed substantial step up compared to 2008. CPI declined to 10.5% YoY in Nov-09 from its max out of 25% YoY in Oct-08 whilst forex reserves increased to US$11.1bn by end 2009 (US$3.5bn Dec-08). Correspondingly, CAD declined to US$3.2bn in 11 months of 2009 as compared to US$15bn in 2008.

FDI : Lackluster doings



The inflows of foreign direct investment (FDI) in Pakistan declined 52.2 % during the first four months of the current FY 2009-10. Pakistan received a total of 774.0 mn dollars worth foreign direct investment during July-November FY10 against 1.620 bn dollars in the corresponding period of the last fiscal year. The scenario is stirring from bad to worse with each passing year, as the FDI during the last fiscal year 2008-09 remained almost half as compared with the FY 2007-08. Foreign investment registered a slight net inflow of $1.085 bn during July-November 2009-10 against $1.457 bn in the same period last year. However, portfolio investment at local bourses posted a moderate growth of 291.1 % as it stood at $311.3 mn in July-Nov FY10 against $162.9 mn in the same period FY09. The total foreign private investment inflow with privatization and without privatization proceeds declined to $1.092 billion during the reported five months of FY10 from $1.476 bn in the same course of FY09 by depicting 25.9 % negative growth. Foreign private investment received from developed countries increased 44.2 % as it stood at $846.5 mn during July-November FY10 against $586.9 mn in the five months of last year.

Subsequent is very brief synopsis and performance assessment of some imperative sectors for underlining intention.

Power Sector

During the year, supply and consumption of energy remained lower than previous years. The consumption of energy remained low due to slowdown of the economy, although the major cause behind the low energy supplies remained circular debt issue in the energy sector. Energy shortages undermined the performance of the overall economy especially large scale manufacturing sector. The consumption of petroleum products, gas and coal during July-Mar 2008-09 decreased 3.4%, 2.5%, and 26.5%, respectively over the corresponding period of the previous year. On the other hand, supply of crude oil, petroleum products, coal, and electricity during the first nine months of the fiscal 2008-09 decreased 5.5%, 2.8%, 26.5% and 17.9%, respectively over FY08.

Foremost subject

The other most important issue that of circular debt is compromising the capacity of the sector to import crude due to lack of liquidity and remains unresolved. The government's earlier efforts, through the issuance of Term Finance Certificates (TFCs), to resolve it have not been sustained. Furthermore, the increasing power tariff and abolishing the slit between tariffs and generation cost were the spotlight elements of 2009. Moreover, debt issue is still lingering on and out of the posture. While, 4.5% tariff ramble in Oct-09 has been pursued by 12% Jan-10 hike but still needs to be backed up by additional duty hikes in 2010.

Growth vs Demand supply deficit

Regardless of the governments assurance to obliterate electricity load shedding by Dec-09, increase in power capacity is negligible of 590MW (3% raise in country capacity) vs supply deficit of ~3,000MW in 2009 despite the fact that the providence of RPPs is still vague.

Insurance Sector:

Insurance sector could not remain impervious to economic depression. As against track record of growth of more than 10% per annum, this is not likely to achieve more than 6% growth in 2009. Insurance companies were able to overcome the decline in premium by prudent underwriting, resulting in lower claims. Additionally, Insurance companies were also blessed because incidents alike to those of 2007 and 2008 did not take place. The cases of fire outbreaks were also low. Growing activities of terrorists in the country have highlighted the importance of getting terrorism cover, predominantly for the hotels and mega shopping malls. Earnings of insurance companies were affected badly in 2008 due to provisions against impairment cost of investment. However, they do not face similar threat this year; in fact some of them may be writing back the provisions made in 2008.

Banking Sector:

Banks experienced a roller coaster ride in 2009 where stiff monetary conditions and demand demolition manifested in moderate asset but tepid earnings growth, +10% & -20% YoY respectively in 9M09. Credit offtake gained ground in the final quarter of 2009 to post an annual growth of 4.2% to Rs3.27trn, still its worst performance since 2002. Asset risk increased substantially while growth remained under pressure on the back of record decline in manufacturing sector (40% of total loans) coupled with corrosion in domestic liquidity which means high refinancing risk. High asset yields kept pre-provisioning profit growth intact, up 10% YoY in 9M09.Given high interest rates and mounting NPLs, banks preferred to invest in government securities as investment surged by 68% to Rs1.64tn. Government borrowings from banks stood at Rs411bn (US$4.9bn) during the year. A relief in the quantum of provisions for Non Performing Loans, as relaxation in FSV regulation helped provisions decline by 1%. Resultantly, provisions for year 2009 arrived at Rs55bn up 26%YoY. The quantum of provisions are expected to go up once banks take up audit and year end adjustments. Going forward, amid expected external flows from donations, we anticipate the SBP to go ahead with quantitative easing along the policy rate cut. Thus the expected decline in KIBOR should help boost private sector offtake. As a result, advances are likely to post double digit growth in 2010. Meanwhile Banks apex regulator, State Bank of Pakistan, took a holistic approach in managing sector headwinds in 2009. Three important steps it took include

1) relaxing minimum paid-up capital requirement, 2) allowing benefit of collateral partially against NPLs provisions and 3) relaxing regulations on rescheduling of NPLs.

Fertilizer Sector:

It has been an astonishing year so far for the fertilizers. Especially DAP have performed exceptionally well this year. The offtake figures for Urea and DAP till November stood at 5,564,995 Tonnes and 1,513,976 tonnes respectively. We expect these figures to close for the year end December around 06 million tones for Urea and 1.6 million tones for DAP. The following table gives a synopsis of the fertilizer offtake during the year Jan-Nov 2009:

9M09 MT	Offtake	YOYGrowth
Urea	5,564,995	13%
DAP	1,513,976	120%
Total	7,078,971	26%

DAP: Greater crop value for the farmers, improved farmers' liquidity and lower DAP prices led to the vigorous DAP offtake this year. Offtake till November stood at 1.5 million tonnes which is almost 120% higher than last years' figures. We are expecting DAP demand to stand at 1.6 million tonnes for the current year end 2009.

Urea: Smooth availability of Urea during the year helped it to maintain its upward trend despite of higher prices. The total offtake during the 11 month period under review stood at 5.5 million tonnes which is 13% higher YOY basis. We expect urea demand to close at 6 million tonnes, higher 10% YOY for CY09.

Capital Market:

The ongoing war in northern areas of Pakistan and resulting terrorist attacks, political uncertainty amid PPP regime's tussle with judiciary, army and media are the major factors driving national stock exchanges. However, purposeful progress in ongoing war and an end to the political confrontations through a consensus formula would handsomely reduce the risk premium of the Pakistani Capital Markets. Despite handsome gain of 61% in 2009, market is still down by 40% from its all time high of 15,767 points. We expect Karachi Stock Exchange to cross 11,500 level in 2010 on the basis of 10% discount to last 10 year average PE of the market thus providing 22% expected gains.

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