Investment Outlook

National Fullerton
Asset Management Limited

Dr. Amjad Waheed, CFA
Chief Executive Officer

Has the Economic Recovery Commenced?

Pakistan's economy has faced tough challenges over the last couple of years. In FY09, the economic growth rate declined to 2% from around 7% in FY07. An important question is whether the economy is on the verge of a recovery or will we continue with economic growth rates which are lower than our annual population growth rate of around 2%?

Before we discuss growth, let us examine whether economic stabilization has already taken place. Average inflation (CPI) has declined from 24.5% in 1Q FY09 to 10.7% in 1Q FY10. During the same period, current account deficit has improved from US$ 4.3 billion to US$ 0.46 billion, and foreign exchange reserves have improved from US$ 7.4 billion to US$13.8 billion. Thus, there are signs of economic stabilization. Government budget deficit figures for 1Q FY10 have not been published, however, projections are that it crossed 2% of GDP, which is a matter of concern.

The economic recovery is dependent on several factors. First, for the recovery to commence, it is critical that we win the war on terror, and in the shortest possible period. This war has so far cost Pakistan roughly US$ 8 billion (Rs 680 billion) based on Government estimates, which is around 5% of GDP. This includes increased costs of defense, law & order, damage to property and infrastructure, loss of economic growth in NWFP & FATA, cost of rehabilitating the IDPs, fall in private investment etc.

Secondly, the global economic recovery is important because of the sheer dependency of our exports and foreign direct investments on it. However, this also carries a risk that global oil and commodity prices may rise, which may negatively impact our trade balance. Third, interest rates have to decline from around 13% p.a. at present to the pre-crises level of 10% p.a., for businesses to start borrowing and expanding again. This seems difficult in the short run due to the Government's excessive borrowing, which has completely crowded out the private sector. Credit to the private sector has declined from Rs 67 billon in 1Q FY09 to a negative Rs 134 billion in 1Q FY10. Substantial aid from international countries and donor agencies is required to reduce the Government's reliance on domestic borrowing. In addition, the Government needs to devise a concrete plan to cut its expenses, especially non-productive expenses. Reduction in the Government revenues and foreign direct investment do not bode well for a quick economic recovery (see Table below).

When we talk to our investors in the auto, steel, textile, and construction sectors, they tell us that their sales have picked up over the last few months. However, it will take some time before this improvement gets reflected in overall economic numbers. To conclude, whereas we see signs of improvement, it is too early to say that economic growth is back on track. Improvement in law & order situation and reduction in interest rates are a must before we can say that economic recovery has commenced.

Key Economic Variables

	1QFY09	1QFY10	%Change
Average Inflation (CPI)	24.5%	10.7%	-56.3%
6 Month KIBOR (Avg)	13.7%	12.3%	-10.1%
Current Account Balance (mn US$)	(4,258)	(462)	-89.1%
~Liquid Foreign Exchange Reserves (mn US$)	7,394	13,761	86.1%
Credit to the Private Sector (Rs. in bn)	67	(134)	NM
Government Revenue Collection (Rs. in bn)	262	259	-1.3%
Exports (mn US$)	5,711	4,635	-18.8%
Foreign Direct Investment (mn US$)	1,117	463	-58.5%
Foreign Portfolio Investment (mn US$)	(174)	208	NM
Worker Remmitances	1,879	2,331	24.1%
*Change in Large Scale Manufacturing Index	-6.3%	0.9%	NM

NM Not Meaningful
~The data corresponds to YoY percentage change in Index for the month of August
**The data corresponds to FX position at the end of September*