NBP Fullerton Asset Management Ltd.
A Subsidiary of National Bank of Pakistan

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Economic and Stock Market Outlook

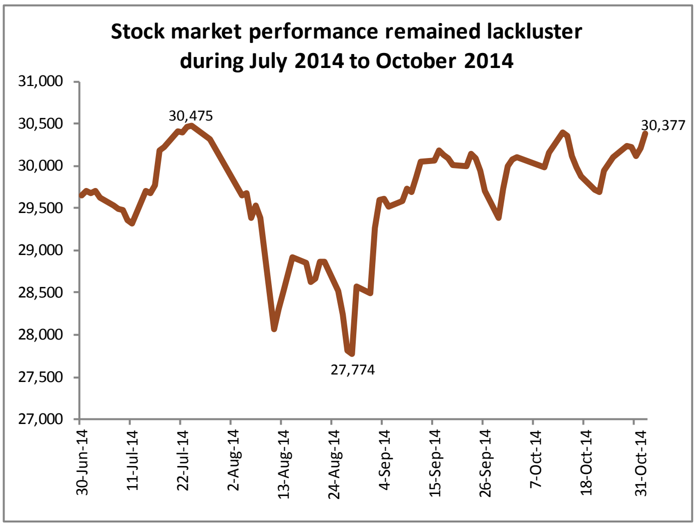
Macroeconomic indicators so far paint a mixed picture of the local economy. Inflation continues to remain benign, clocking at 7.1% p.a, on average, during the first four months of the fiscal year, driven down by lower commodity prices and restricted money supply growth. First quarter fiscal deficit of 1.2% of GDP was well contained due to very little development spending and surpluses recorded by the provinces. However, external account has exhibited weakness due to a rising trade deficit, caused by an overvalued exchange rate, and non-materalization of foreign inflows amid uncertainty in domestic politics. The IMF has also delayed its fourth review of the economy in view of government's failure to meet some key performance benchmarks under the EFF loan agreement. Energy shortages also continue to beset economic growth as captured in below-potential Large Scale Manufacturing (LSM) growth of 3.2% during July-August. The above has also impacted stock market performance with the benchmark KSE-100 Index rising by a nominal 2.4% during the first four months of the fiscal year.

We expect country's macroeconomic situation to take a turn for the better from hereon based on the following positive developments:

- Political tensions have subsided in the recent few weeks, putting to rest fears of mass social unrest, military intervention or complete paralysis of the government. This has enabled the government to refocus on economic issues. For instance, Secondary Public Offering (SPO) of OGDC and Sovereign Sukkuk offering are scheduled to happen in November. The government is also in talks with the IMF for completion of the fourth and fifth reviews in time to secure release of USD1.1 billion loan installment in December. The above are expected to result in sizable jump in foreign exchange reserves to USD17-18 billion by December-end, allaying external account pressures currently faced by the economy, and improving external vulnerability.

- Due to slowdown in global economic growth and a supply glut, global crude oil prices have declined by 20% - 25% in October. Lower oil prices would benefit the domestic economy in multiple ways. It would result in further reduction in inflationary pressure, giving the central bank more room to cut interest rates. As crude oil imports comprise a sizable chunk (33%) of the import bill, lower prices would reduce trade and current account deficits. According to our estimate, every USD10/bbl reduction in oil prices would shrink the trade deficit by USD1.4 billion. Thus, lower oil prices should strengthen the external accounts position. At present, Pakistan's power generation mix is skewed towards imported residual furnace oil (RFO), which is very expensive. This high generation cost has strained fiscal balance due to heavy subsidies, impacting industry competitiveness and creating circular debt problem in the energy chain. The recent decline in RFO prices should lessen blended generation cost, reduce the subsidy burden & accumulation of circular debt, and improve the competitiveness of our exports.

Key Economic Indicators		
	Sep-14	Jun-14
SBP Foreign Exchange Reserve	US$ 8,943 Million	US$ 9,095 Million
Import Cover	9 Weeks	10 Weeks
Current Account Balance (Quarterly)	US$ -1,330 Million	US$ -378 Million
Financial Account (Quarterly)	US$ 741 Million	US$ 4,179 Million
Budget Deficit (Quarterly)	PKR 357 Billion	PKR 577 Billion
Balance of Trade (Quarterly)	US$ -6,504 Million	US$ -6,021 Million
Consumer Price Index (CPI)	7.7%	8.2%
CPI (12 Month Average)	8.5%	8.6%
Interest Rate	10.0%	10.0%
GDP Growth (Fiscal Year)	N/A	4.1%



Based on our estimates, the stock market is trading at 8.5 times 12-months forward earnings, and offers around 6% dividend yield. The corporate earnings are expected to grow by 12% for the next 4 quarters. We expect that the improvement in the political and macroeconomic situation, along with expected double digit earnings growth should result in good performance of the stock market during the rest of the fiscal year.