Monetary policy statement – our estimations based on economic correlation

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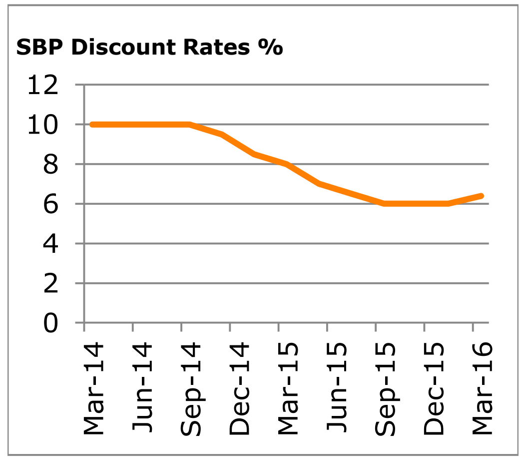

Overall investment conditions in Pakistan has improved given ongoing regional alliances and we expect foreign direct investment (FDI) will increase with growing political stability. FDIs could spur economic growth which has eluded the country for the time. Given weak real economic indicators due to energy shortage & subsequent demand for foreign loans, we have seen stagnant exports and thus increase in trade deficit to USD12bn.

In the upcoming Monetary Policy Statement (MPS) we expect SBP will increase benchmark interest rates from present level of 6% by 40 basis – 50 basis point for March 2016 bimonthly report. SBP set floor for Repo rates to 4.5 % with maximum allowable spread to 1 %. Current Real interest rate is 1.18 % while target rate for FY16 is 6 %.

Energy, Transportation and Connectivity Projects

Government with the aid of planning commission & Board of Investment (BoI) is finding all possible solutions to invite FDIs in the country. Ministry of Finance (MoF) is vying to improve depleting revenues wherein efforts not bearing fruit to stop swelling trade deficit which is mainly due to decreasing exports.

In order to sort this, government is finding cheaper sources of energy and recently Pakistan has signed LNG deal with Qatar which is worth USD 16bn. According to this deal Qatar will provide 3.75mn tons LNG to Pakistan for 16 years which would meet 20% of energy needs. For transportation of LNG from port terminal, a Russian company is laying 1100 km pipeline which will cost USD 2bn and will help supplying LNG to power-plants and other industries.

Government is also building new power plants and converting oil and coal based plants to LNG plants. On the other hand poor performance of transportation sector has caused government loss of 5% of GDP. Government has planned to spend USD 147mn for Orange line metro project and other transportation projects like metro bus project for Karachi.

Thus we expect demand for loans from government to increase.

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Increase in Inflation

In Pakistan as more than 70% of workers are related to informal sector thus revenue collection through direct taxation is difficult for government thus increase in indirect taxation helps in revenue collection however it has a negative impact on inflation. As a result Y-o-Y inflation for 8MFY16 increased to 4% and once again inflation has shown increasing trend while SBP targeted 6% inflation for FY16.

Growth in Large manufacturing Industries

Large scale manufacturing Industries growth rate for 6MFY16 is 3.89% which was 2.71% for 6MFY15. Increase in growth is mainly due to decreasing oil prices as well as increase in confidence of investors due to improving security situation and China Pakistan Economic Corridor Project (CPEC).

Trade Deficit

Trade Deficit has increased to USD 12bn for 7MFY16 in which Jan16 contribution is USD 1.8bn as a result Pakistan missed its GDP target. Increase in deficit is mostly due to Import of machinery that has increased to USD 4.8bn. Mostly it's related to energy, transportation and connectivity sector given CPEC related projects.

FDI Inflow

In 7MFY16 FDI in power and transportation increased by 66% and 384% respectively. In financial business there was no FDI inflow for 7MFY16 as compared to USD 256mn in FY15. In country wise comparison of FDI during 7MFY16, there is no FDI inflow from USA as compared to USD 209mn in 7MFY15.

Fiscal Deficit

Fiscal Deficit increased by 3% to USD 5bn for 7MFY16 which was USD 2.28bn in previous corresponding year. For improving it government has announced tax immensity scheme and other indirect taxes. While credit to private sector has increased to USD 46bn which shows business conditions in Pakistan are improving.

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