

Economics & Strategy

The Year of the Bail Out

The nation's ills appear far from over with headline CPI inflation expected at 26% in Aug08 and a minimum 19% average in FY09. Foreign reserves have been declining by an average USD 500mn per month since Oct07 while the external account position in Jul08 indicates build up of a severe USD crunch by Jun09. Pressure on the PKR could push the currency towards the PKR 91 level against the USD, if reserves continue to diminish at this rate. With the fiscal deficit at 7.4% of GDP in FY08, the target of 4.7% this year suffers from obvious challenges; plans to retire PKR 21bn of central bank borrowings in 1Q FY09 also seem unlikely.

Recovery road map

In view of Pakistan's increasing vulnerability we expect the government to embark on a fund raising mission encompassing further externalization of debt and loan facilities with friendly countries such as USA, Saudi Arabia and China. The key risk to the economy is political; we feel the administration will initiate a course of action to stabilize the economy. However the process may face delays and indecision if the political environment deteriorates further.

Who you gonna call?

Of Pakistan's two key regional allies, Saudi Arabia and China, the former has already agreed in principle to provide 110,000 barrels a day over a 3yr period with deferred payment. Chinese support to Pakistan would likely appear in the form of higher or other Aid and increased deposits. The US has already committed USD 7.5bn in non-military aid to Pakistan while tactical aid for border security continues. Amongst its multi-lateral donors Pakistan's reliance on the Paris Club and IMF is likely to increase substantially with total foreign assistance rising by 50% against FY09 Budget targets towards the PKR 450bn mark.

Liquidity risk to supersede inflation hazard

Despite the aggressive tone taken by the SBP Governor in her recent Monetary Policy Announcement, the discount rate was only tightened by 100bps to 13% against our expectations of 150bp hike. Prior to the monetary policy announcement the SBP also decided to rap the banking sector on the knuckles for allowing 6M KIBOR offer rates to reach as high as 14.5%; a move in complete conflict with its tightening monetary stance. It appears the threat of capital flight and diminishing liquidity both external and domestic is a primary concern; the growth-inflation trade off is likely to compel policy makers to compromise on responses to inflationary pressure.

Fractured political focus on economic challenges

The federal government coalition between the PPP and PML-N ended on a sour note with the PML-N heading to the Opposition bench on Aug 25'08. After the resignation of President Musharraf it was hoped the two parties would become stronger allies, however differences on the issue of the Judges' restoration and the PPP's nomination of Mr. Asif Ali Zardari for President for the Sep 6'08 elections, without PML-N's approval, led the latter to abandon the federal core. Although the PPP, in association with the MQM, ANP and JUI-F led MMA, is able to maintain a majority in Parliament, it's domination of the federal core has weakened considerably.

State intervention in financial markets a problematic policy choice

The government's bail out strategy has extended to the stock market with the GoP's state owned Mutual Fund arm NITL, injecting more than PKR 20bn via the Equity Market Opportunity Fund. This followed the announcement of a 1% lower lock in Jul08 and recently the KSE BoD approved a 0% lower lock on closing stock prices of Aug 27'08. We believe the KSE indices should be allowed to decelerate to the oversold level close of 7,300 points, as per real demand cycles. Although this will cause sharp asset price deterioration in the short term it will allow the market to absorb the interest rate, exchange rate and commodity price risks and consolidate for future gains. Opportunities below the 7,300 mark on the KSE 100 index indicate room for gains on our top picks which include, PPL, KAPCO, LUCKY, UBL and BAFL.

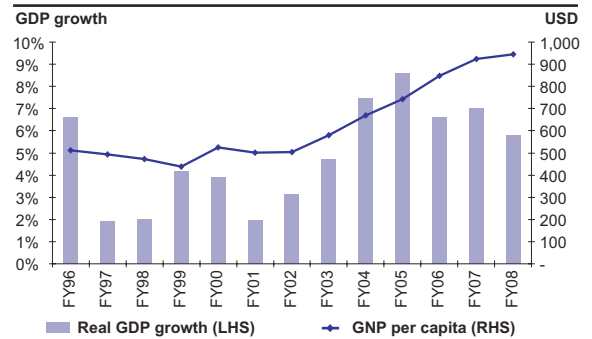
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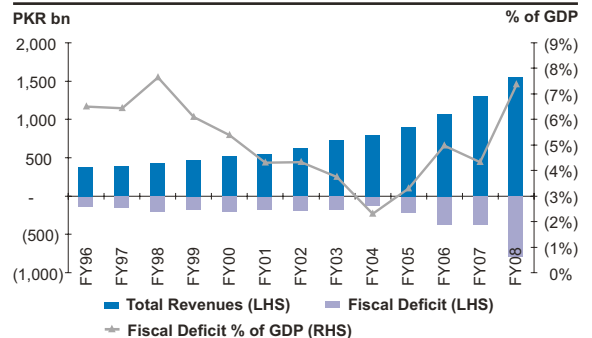
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Chart 1: GDP growth and Per Capita Income



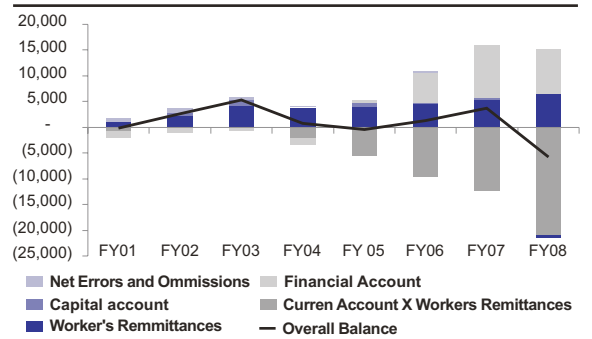
Source: Economic Survey, IGI Research

Chart 2: Fiscal Management



Source: Economic Survey, IGI Research

Chart 3: Balance of Payments (USD mn)



Source: SBP & IGI Research



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Capital Call

The key economic themes of the past month have been the continued slide of the PKR and depletion of foreign reserves. Are policy makers doing enough to arrest this slippage? The Finance Ministry has stated that it has a clear road map to recovery; these include strategic sales of public assets, temporary assistance from allies including Saudi Arabia and China and accelerated external borrowing activity.

Vulnerability ratios reflect fiscal and monetary contradictions

Discord between fiscal and monetary policy markers is evident and has been diluting the impact of policy decisions in the past year. Troubling economic indicators including high inflation and record twin deficits could have presented an improved outlook had both government institutions been able to formulate a clear strategy. At current levels SBP foreign reserves present just 7 weeks of imports against 17 weeks a year ago while EDL/Export Receipts ratio has little improved from 2.4x a decade ago. The trade deficit has reached a high of 14% of GDP while Tax Revenues remain range bound at just 10% of GDP. Minimization of discord between fiscal and monetary elements is imperative to future economic success.

Strategic sales on the horizon

The government's Privatization target for FY09 is PKR 25bn, encompassing a long list of shelved transactions which include OGDC's exchangeable bond issue as well as GDRs of KAPCO, PPL and NBP. Obstacles to privatization plans include depressed global credit and equity market conditions and political will to carry through transactions at potentially lower valuations. However we feel the government has no choice but to go forth and try its luck on the global scale.

Qadirpur an indication of things to come

The Privatization Commission recently directed the financial advisor of the Oil and Gas Development Company (OGDC) to prepare case-events of the company's privatization options. This along with sale of shares could involve liquidation of strategic assets of the company including the Qadirpur gas field. According to unconfirmed sources, the Government of Pakistan (GoP) is considering the sale of Qadirpur which would give a substantial one-off boost to depleting foreign exchange reserves and FDI of the country. However the future cash flows of the company would be severely compromised as Qadirpur represents 34% gas production for the company which owns a 75% stake in the field. Following this announcement the BoD of OGDC was dissolved and the Chairman Arshad Nasser replaced with former CAA Director Mr. Farouk Rehmatullah.

Interim support to be drawn from Saudi Arabia and China

The Saudi Oil Facility (SOF) was terminated in CY04 after which IDB has provided short term financing to Pakistan for oil and fertilizer payments. With oil prices averaging USD 110 in CY08 the government has again sought the help of its Saudi friends for oil with deferred payment. Riyadh has reportedly agreed in principle to supply 110,000 barrels a day for a 3yr period which could translate into USD 2bn in import payment relief a year. China meanwhile is expected to continue its support of Pakistan via increased Other Aid, which amounted to over PKR 31bn in FY08.

Emergency funding request receives a frosty response

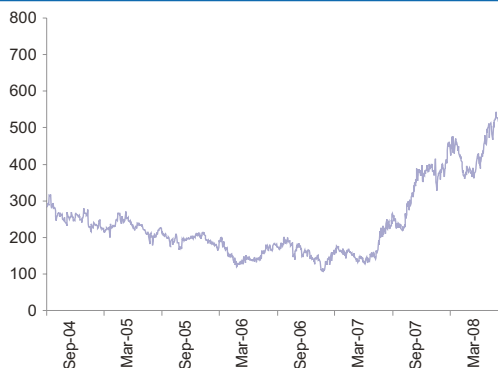
The new PPP-PML N government quickly attended to criticisms from multi-lateral donor agencies regarding the oil subsidy and electricity price control regime. Within 90 days of its instatement controlled gas tariffs were raised by 31-121% and fuel oil prices increased by 62-82% over Jul07 levels. But the World Bank for one was not impressed and unresponsive to a request for emergency funds of USD 500mn.

Moving forward we are either likely to see further spending cuts on the fiscal front, import controls and formal recourse to IMF funding. Given the dilution of the former approach through unsynchronized policies we feel IMF support would be a better alternative in order to achieve economic targets. In a telling move on Sep 10'08 the GoP announced an increase in power tariff for domestic consumers using 1 to 300 units by 20%, to PKR 4.43 from PKR 4.08, per unit. Consumers who use 1 to 700 units per month will pay Rs 5.65 instead of Rs 6.53 per unit. The reduction of power subsidies precedes meetings with the IMF this coming week.

Eurobond 2009: They could default but they won't

The question of default rests on the GoP's capacity to stick to the recovery roadmap which includes privatization plans, spending cuts, temporary assistance from friendly countries and increased multi-lateral agency debt. ADB has already approved a USD 500mn tranche of support in Aug08 although the WB has refused Pakistan's request for emergency funds. If political road blocks prevent the GoP from achieving economic targets we foresee a heightened risk of default on the PKSTAN'09 Eurobond worth USD 500mn plus interest payments. In all likelihood however the GoP should manage to secure adequate funding from its external borrowing base in order to meet its debt obligations.

Chart 4: Eurobond 2009 Spread (bps)



Source: Bloomberg

US yo-yo

Historically the US has served to both stabilize and destabilize Pakistan; as it takes it upon itself to intervene in border areas with Afghanistan it raises the stakes against the current political regime. However Pakistan has also received substantial external financing at the behest of its relationship with the US during past military regimes of General Zia ul Haq and General Pervez Musharraf. Recently Joe Biden, Chairman of the Senate's Foreign Relations Committee, drew up an impressive non-military aid plan for Pakistan worth USD 7.5bn over a 5yr period, reaffirming the US's friendly stance on Pakistan. However its continued presence on Pakistan's borders with Afghanistan presents a strain on the current political framework which is striving to exert its control over the deteriorating security situation.

Securitization of remittances worth USD 700mn in the works

According to news reports, the government is planning securitization of USD 700mn of workers remittances. In the past few years, remittances have grown at a double digit pace and have served to increase both consumption and investment and therefore contributed to economic development. The EDL to Exports receipts ratio, a key vulnerability indicator, currently at 2.4x improves significantly to just 1.8x when remittances are included.

During FY08, Pakistan received record remittances of USD 6.5bn and was one of the top ten developing country recipients. In the last few months vulnerability ratios have been deteriorating rapidly including Current Account Deficit/GDP at 9%, Trade Deficit to GDP at 14% and Fiscal Deficit to GDP at 7.4%. However remittances still present an upside on account of geo-political realities and the increasing number of Pakistan emigrant workers in the US, UK and Middle East. Securitization of remittances would allow the funds to be utilized as collateral for the issuance of bonds which may improve sovereign credit ratings currently at 5yr lows below investment grade. With regards to the launch of the exchangeable bond of OGDC and international capital market entries of NBP, KAPCO and PPL this move may also support pricing of the issues.

The key risk to future remittance flows are continued currency weakness as USD:PKR parity has depreciated 26.6% since Oct07 level of PKR 60.8. If the PKR continues to decline we could see a marginal roll back in remittance flows however this is likely to be mitigated by geo-political constraints.

Paris and Beyond

In the last few years Pakistan's EDL/GDP ratio had improved dramatically to under 30%, with the share of Medium to Long Term Financing also rose as a % of total EDLs. This mainly comprises debt from Multi-lateral donor agencies and the Paris Club, an informal group of 19 of the world's richest countries, which provides financial services such as debt restructuring, debt relief, and debt cancellation to indebted countries and their creditors. Given Pakistan's widening balance of payments gap, we could see the Paris Club and IMF playing a greater role in its restructuring in FY09.

By Jun08 the EDL base expanded by 10% to USD 46.284bn; both Multi-lateral and Paris Club funding rose by 15-16% adding USD 4.8bn worth of funds to the base. However this also accounts for extensive depreciation of the USD against the Euro and JPY of which most of the Paris Club debt burden is denominated in.

With Pakistan in the limelight due to its geopolitical significance on the Afghan border, we feel the GoP will be able to secure global support. However in view of constrained global liquidity and limited cross-border flows in the last year, funding is likely to be made available under tighter terms and conditions.

Clouds over the Currency

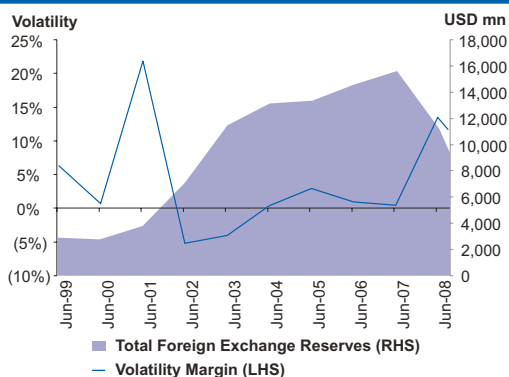
PKR spike is temporary

In the first week of Sep08, the country received some positive news which eased the PKR towards the PKR 76.20 against the USD. The currency temporarily dipped below PKR 76 level to PKR 75.98 on Sep 4'08 compared to a recent high of PKR 77.60. News of the SOF and release of an ADB tranche of USD 500mn buoyed the currency as did a 76% increase in FDI to USD 341mn and 27% increase in remittances to USD 627mn during the month of Jul08.

Further depreciation could be on the horizon

Despite positive news bytes we feel the PKR will remain under pressure in FY09. The current pace of foreign reserve depletion at an average of USD 500mn a month since Oct07 suggests the PKR could hit the PKR 91 level soon against the USD. Portfolio outflows have gained momentum while FDI and remittances in Jul08 could be misleading in terms of year long trends.

Chart 5: Exchange Rate Volatility



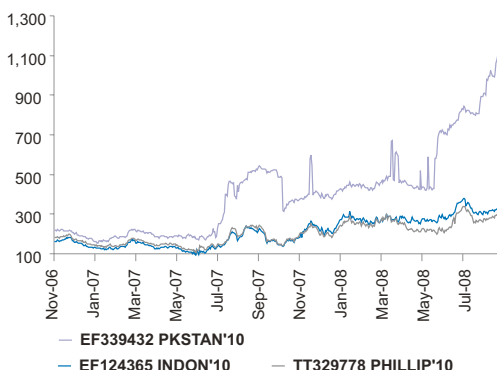
Source: SBP

Remittances could diminish if currency weakness persists while FDI is largely reliant on investor confidence in political and economic strength. With both variables showing fragility, FDI expectations may also have to be revised downward from USD 5bn later in FY09. We expect the trade deficit to remain in the current range of USD 20bn during FY09 leaving the Current Account Deficit in much the same position close to 9% of GDP.

Eurobond and CDS spreads compounding negative perceptions

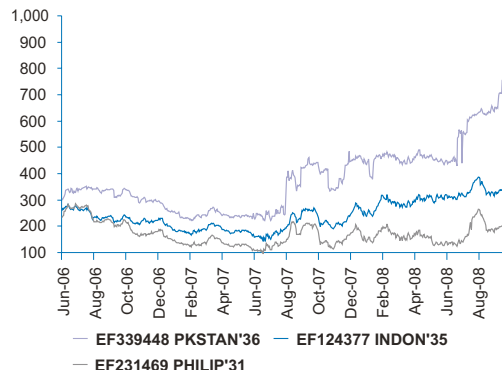
Persistent economic stress and political challenges have translated into severely undermined foreign investor confidence. Recently the Eurobond and CDS spreads have traded at nearly 1000bps more than double their values in the corresponding period last year. We feel Pakistan's portfolio investment position will decline significantly in the next 6-12mo, if these spreads are anything to go by. The government is unlikely to resolve political and economic challenges quickly – on the flipside investors with an opportunist stance may be able to pick up substantial value advantages on both equities and debt which may translate into long term gains.

Chart 6: Eurobond 10yr Spread (bps)



Source: Bloomberg

Chart 7: Eurobond 30yr Spread (bps)

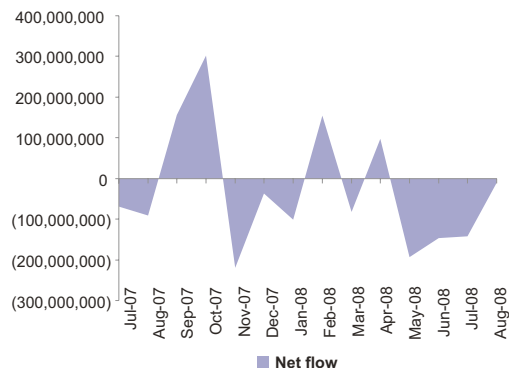


Source: Bloomberg

SCRAs show net outflow of USD 227mn in FY09

Net transaction value of SCRAs remains above USD 700mn however equity outflows have been significant in the current fiscal period at USD 472mn. Pressure on the SCRAs is likely to buildup as floor locks on the KSE are released and the KSE absorbs the shocks from deteriorating macro indicators and diminished corporate earnings.

Chart 8: SCRA (USD)

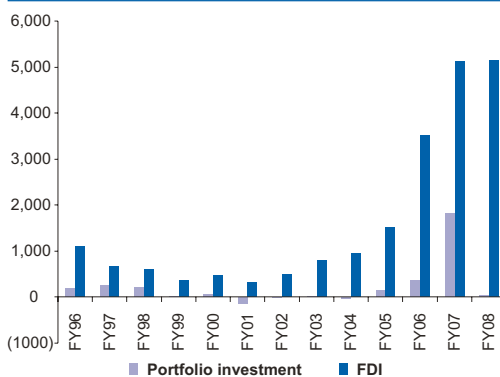


Source: SBP

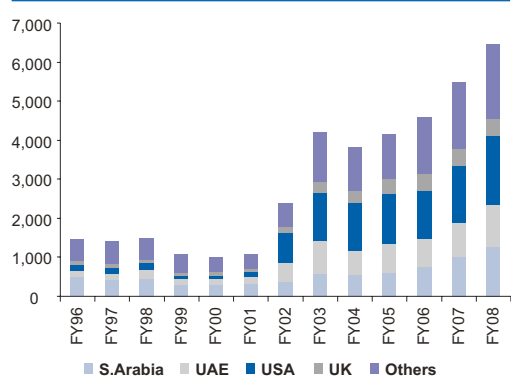
FDI and remittances at a crucial juncture

Jul08 figures for FDI and remittances reflect robust growth with 76% increase in FDI to USD 341mn and 27% increase in remittances to USD 627mn. However both components of the balance of payments may suffer the brunt of shaky investor confidence moving forward if the GoP is unable to control economic variables, contain security slippages and manage political challenges.

Chart 9: NFPI (USD mn) **Chart 10: Remittances (USD mn)**



Source: SBP



Source: SBP

Import pressure to outpace exporter's depreciation gains

Exporters are likely to gain from significant depreciation of more than 26% over Jun07 levels. However import pressures will also be sustained into FY09; total imports ex-oil and food still showed robust growth of 24% over FY07 levels and are likely to do so this year as well.

We could see some compression in imports of raw cotton, vehicles and telecommunication equipment, due to SBP restrictions on advances against imports however the impact of this gesture on demand growth is likely to be somewhat diluted as increases in import duties were a watered down 5-10% on the latter two components. With the export base still dominated by textile manufacturers receipts are unlikely to show a major change after accounting for the positive impact of depreciation which we feel will be largely discounted by a slowdown in volumetric growth.

Supply shocks to persist

As we have mentioned in our monetary policy review Aug08, the economy is faced with multiple shocks of aggregate demand, money demand and aggregate supply which have all combined to fuel inflation to the highest level in 30yrs. Monetary policy responses although pro-active have not been pre-emptive and in some cases powerless to influence these three variables. Rate stability or easing coupled with supply shocks is unlikely to trim demand growth. On the contrary excess money demand could continue to prop up Net Domestic Assets (NDA) and Reserve Money (RM) growth which will buoy consumption and therefore inflation.

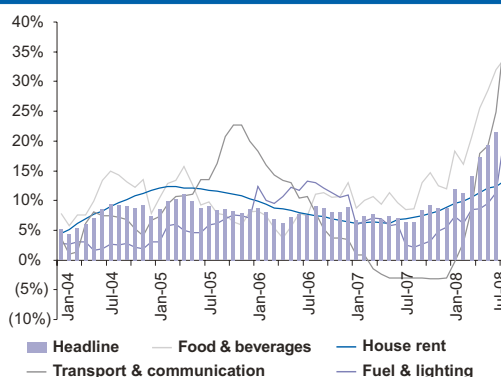
Jul08 CPI inflation crosses 24%

According to Federal Bureau of Statistics (FBS) data, CPI inflation has accelerated to a 30-year high to reach 24.33% YoY and 3.34% MoM in Jul08. Food inflation was the key driver with prices increasing by nearly 34% over the same period last year. Fuel & Lighting and Transport & Communication also reflected increasing pressure, rising by 21% and 37% respectively. Inflation pressures have been exacerbated largely due to the compelling need to reduce oil price subsidies which constitute nearly PKR 34/litre on HSD and LDO as of Jul08.

Headline CPI Inflation expected at 26% in Aug08

If the Sensitive Price indicator and Jul08 CPI figures are anything to go by we estimate Aug08 CPI inflation to hit 26%. Key pressures are likely to arise from Food and Beverage, Fuel and Lighting and Transport and Communication inflation of between 25-43% respectively.

Chart 11: CPI Inflation

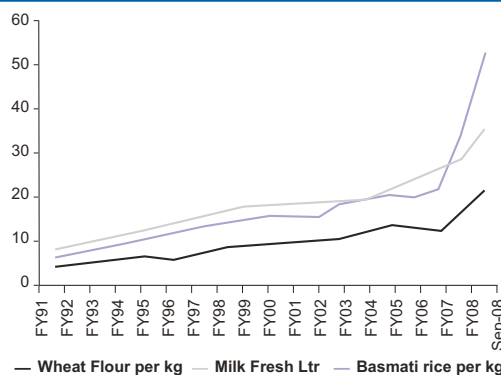


Source: SBP & FBS

SPI data for Sep 4'08 indicates Petrol and Diesel (HSD) prices are up by 62% and 71% respectively over the corresponding week last year. This is coupled with an increased in LPG prices by 61%, Kerosene by 85% and Electricity by 16% compared to the same period last year. SPI inflation for 53 essential items showed an increase of 33% over the same period last year for combined income groups with the heaviest burden of 33.45% falling on the lowest income group.

Chart 12: Prices of Essential Item

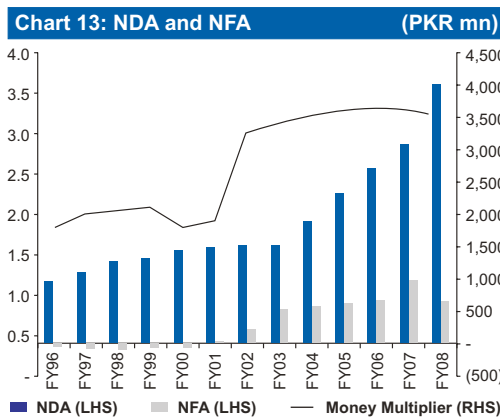
(PKR)



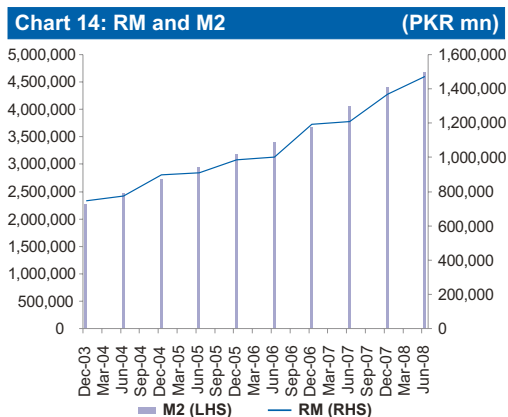
Source: Economic Survey & FBS

Current pace of RM and NDA growth to buoy demand

By keeping the money stock stable policy makers should be able to avoid recessionary signals. However if money stock and particularly reserve money stock, continues to increase at such a rapid pace inflationary pressures are unlikely to abate. Reserve money rose by 21.6% in FY08 similar to FY07 levels but for different reasons. In FY08 excess central bank borrowing fueled NDA growth while the previous year SBP sterilization of foreign inflows was responsible for RM growth.



Source: SBP



Source: SBP

Food inflation spiral may have more room to grow

According to a recent USDA report Jul08 quoting IMF statistics, between 1999 and 2008, international prices of food commodities rose by just 98%, commodities including food and fuel increased by 286% while the index for crude oil has increased by a massive 547%. This suggests food commodity prices may have room for further expansion as they catch up with the impact of fuel price increases.

Given Pakistan is itself facing output constraints of key food items, and supply bottlenecks are encumbered by minimum support pricing, hoarding and smuggling, we expect the impact of a continuing global food price run to be particularly severe. Unless the commodity price spiral unravels sooner than expected and the government is able to respond to administrative loopholes swiftly, food inflation is likely to sustain pressure on the CPI. We are already witnessing distress signals; according to reports the country's wheat stocks have declined YoY to 3.783mn MT Jul 6'08 compared to 4.783mn MT during the same period last.

Market anticipates higher base rate

The SBP will auction T-Bills worth PKR 35bn this week against earlier auction targets of PKR 75bn. We expect auctions bids to rise in line with market expectations of a base rate hike from 13%. In the last 3 auctions SBP auction targets were unmet as bids for longer term T-bills were rejected or not received.

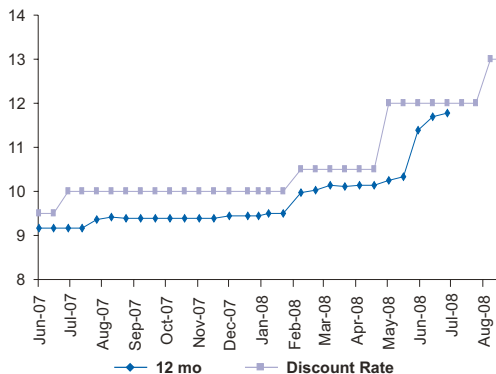
Table 1: T-bill auction

	Amount Accepted (PKR mn)			Cut-Off Yield (%)		
	3 mo	6 mo	12 mo	3 mo	6 mo	12 mo
30-Jul-08	41,070	No Participation	Rejected	12.1565	No Participation	Rejected
13-Aug-08	37,000	No Bids	Rejected	12.2205	No Bids	Rejected
27-Aug-08	37,300	No Bids	No Bids	12.3832	No Bids	No Bids

Source: SBP & FBS

In the last T-bill auction of Aug 27'08 the central bank accepted PKR 37.3bn worth of 3mo T-bills at the cut-off yield of 12.3832%. Given the SBP has maintained a desirable margin between T-bill yields and the DR we feel the central bank will continue to reject bids for 1yr notes until it is in a position to raise the base rate in its next monetary policy announcement. During CY08 cut off yields on 3mo paper rose by nearly 330bps.

Chart 15: 12M T-bill and DR (%)



Source: SBP

Tumultuous Politics

Political coordinates have changed dramatically in the last few months; President Musharraf has resigned, the coalition has formally parted ways with the PML N crossing over to the Opposition bench and the PPP now commands a smaller majority in Parliament with the support of the MQM, ANP and JUI-F.

Coalition makes a break

In a surprise move on Monday Aug 22'08, Mian Nawaz Sharif, Chairman of PML N, announced his decision to quit the fragile 5mo old ruling coalition government with the PPP. According to the former PM, the decision to walk out of the Federal core was motivated by the PPP's vacillation on the reinstatement of deposed judges and the PPP's unilateral nomination of Mr. Asif Ali Zardari as Presidential candidate.

Nawaz Sharif had earlier stated that he would only back Mr. Zardari if the 17th Amendment to the Constitution were to be scrapped. After the resignation of President Musharraf last week, the PML N had demanded immediate and unconditional restoration of all deposed judges. The PPP meanwhile appeared to be taking a flexible approach, with a decision to debate the issue in the National Assemblies and no firm deadline for a resolution.

Fallout for both parties to be negative

Although we had anticipated a severing of ties between the PPP and PML N, this development came earlier than expected and at a time when the PML N appeared to be in a conciliatory mood; extending a deadline to restore judges from Monday Aug 22'08 to Wednesday Aug 24'08 this week. With the the resignation of President Musharraf behind them, it appeared PML N was even contemplating a return to the Federal Cabinet, from which it staged a walkout earlier this year.

The fallout for both parties is likely to be negative; the PPP held a 37% position in the National Assemblies and dominated the federal core with 27% support from the PML N. With the PML N out of the ball game, the federal core would require the support of the MQM, JUI-F and ANP which constitute 7%, 2% and 4% of the National Assembly position. Although all three parties have reiterated their support to the dominant PPP, fissures between them could result in the need for fresh elections which will heighten political uncertainty.

PPP still dominates Parliament

At present the PPP, with the support of these 3 parties and independent candidates, can maintain a new coalition government without the PML N, however it is likely to remain under pressure from the now broader Opposition bench. The PML N meanwhile would find an alliance with the hostile PML Q a challenge. Although PML N could dominate the Punjab Provincial Assembly with 46% control and a potential linkage with the PML Q holding 23% Provincial Assembly position in Punjab, the loss of 30% support from the PPP in Punjab could remain a destabilizing factor even at the provincial level.

Presidential elections a sure shot for Mr. Zardari

In this backdrop, plans to hold the presidential election on Sept 6'08 were announced. PML-N promulgated its own choice of candidate; retired Chief Justice Saeed uz Zaman Siddiqui. The PML-Q on the other hand has nominated party's Secretary General Mushahid Hussain Syed as their candidate. However Mr. Zardari won the Sep 06'08 presidential elections by securing 481 votes out of Electoral College of 702, with 342, 100 and 65 votes in the Senate, National Assembly and the Provincial Assemblies respectively. Meanwhile opponents Saeed-uz-Zaman Siddiqui and Mushahid Hussain Syed managed to secure only a total of 153 and 44 votes respectively.

Power of the President

Mr. Asif Ali Zardari is now one of the most powerful civilian Presidents in Pakistan's political history due to the powers given to the President under the 17th Constitutional Amendment. These powers include the authority to dissolve the National Assembly under 58 (2)jib, a seat on the National Security Council and the right to appoint Supreme Court Judges. At his oath taking ceremony President Zardari made no mention of revoking the 17th Constitutional Amendment on which PML N's support for his candidacy was conditional.

Multiple challenges present heightened political risk

President Zardari is faced with country wide economic instability and security slippages at the Pak-Afghan border which have threatened to seep into urban areas. These challenges have been exacerbated by US demands on Pakistan's administration and fragile politics with a broader Opposition bench. On the flipside political maneuvering may allow the PPP to consolidate its position to attend the immediate challenges without delay.

Cards already on the table

The threat of federal disintegration and a cross-floor movement of the PML-N to the Opposition bench of the National Assembly have already come into play. This could be amplified by internal rifts within the PPP or current coalition members including MQM, ANP and JUI-F. Given the fast pace of political developments in the last few months, we remain cautious with regards to our political stance.

US ups the ante

Accelerating militant activity in tribal areas bordering Afghanistan continues to present a nuisance factor. US direct intervention in this matter although inevitable is likely to fan the flames of militant activity and resentment against the current political regime. Negotiations have slipped into clashes between militants, tribal factions and the military with significant loss of life on both ends. We feel increasing intercession by the US will present a serious threat to the democratic agenda in Pakistan while US non-military assistance for impoverished border areas comes too little too late.

Buoying the market

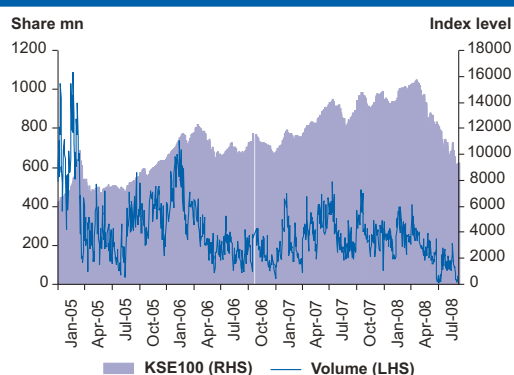
Have the markets failed?

State intervention comes at a cost; we will never truly know if the private sector has employed all possible means and avenues to salvage a failing financial market. In our opinion the KSE indices are drifting farther and farther away from an efficient market hypothesis because the state continues to intervene. The obvious challenge to this situation is whether the state has the financial capacity to do so, or is it getting itself into a dead-lock.

Sealed exit opportunities raises KSE risk premium

On Sep 9'08 KSE members unanimously demanded the Board of Directors maintain the floor on share prices of Aug 27'08 closing level for indefinite period. We feel this is a clear admission that risk management systems have failed; the consequences of lax risk management have not been realized by the broker community as the KSE is unsurprisingly committed to protect its members. Rather than making an example of mismanaged exposure levels, the KSE has chosen to freeze the index and allow stakeholders to consolidate their positions.

Chart 16: KSE Analysis



Source: KSE

Although this approach provides vulnerable stakeholders an advantage, in the long run it will exacerbate systemic challenges. Investor sentiment has already been hurt as exit opportunities have been limited and market players compelled to resort to off market broker transactions in order to re allocate their capital. Given the heightened risk premium now attached to Pakistan, we feel bringing the foreign investor back to Pakistan may be difficult moving forward.

Breathing space for now

Given the substantial liquidity crunch facing the financial markets the KSE BoD and SECP may have had no choice but to provide market players some room to settle their dues. The 0% lower lock on the KSE commencing Aug 27'08 may be seen as the lesser evil in a situation where broker default is a very real prospect.

The current environment also allows for listed companies to exercise a share-buy back option to salvage their deteriorating share prices. An example of this is NBP, which has a free float of 24% and is trading at 2008E PE and PB multiples of 5.4x and 0.8x respectively. The bank recently announced its intention to review a proposal to buy back shares to arrest a free fall in its stock price.

State Intervention to continue

The KSE BoD has repeatedly intervened in the stock market with the support of brokers and the Securities and Exchange Commission. On Jun 24'08 the board established a temporary 1% lower lock and 10% upper lock on stock prices. Market buoyancy was short lived as the KSE slipped into the red again. Lower and upper circuits were later removed in the 2nd week of Jul08 to revert to the original 5% upper and lower limits. Following this PKR 20bn were injected into the market by NIT PKR 20bn however a couple of days after the funds propped up the market, the KSE 100 again dipped into the red.

Indications from the KSE and SECP suggest intervention will continue to ease pressures as they build up. In the aftermath however this may contribute to further complication of exposure levels. If state intervention is no longer possible the KSE is likely to see a sharp decline that may hurt investor sentiment far more than a real demand cycle.

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