



February 2012

## Stock Market Review

During the month under review the stock market extended the gains of the previous month, reaching at the highest level since June 2008. The key drivers of the market were improved liquidity situation, positive development on implementation of newly announced CGT regime, improvement in PAK-US diplomatic relations. Better-than-expected results announcement by the majority of the companies along with heavy payouts buoyed investors' sentiment in the market. Foreign investors took fresh positions in the market amid healthy trading volumes and worldwide optimism in equities. Recently introduced relaxation in the Margin Trading system (MTS) during the outgoing month was an other positive trigger for the market. The month started with KSE-30 Index at 11,173 levels and closed at the highest level of the month at 11,906 levels. Overall, during the month KSE-30 Index advanced around 6.56%.

State Bank of Pakistan followed a cautious approach and held the discount rate at 12% in its monetary policy review in February 2011. Key consideration for this decision was imminent upside risk to the inflation expectations emanating from unpredictable and large government borrowing, widening current account deficit and rising energy prices. Slippages on the fiscal front and absence of foreign flows have forced the government to borrow heavily from the banking system. Moreover, dwindling foreign exchange reserves has on the one hand drained liquidity from the market and put pressure on the currency on the other hand. A talk of the availability of oil on deferred payment from Iran is positive from the external account perspective. Moreover, materialization of Coalition Support Fund following the restoration of NATO Supply and improvement in Pak-US relations will augment the FX reserves.

Banking, Industrial Engineering, and Construction and Material sectors performed better than the market. On the other hand, Fixed Line Communication, Food Producers and Chemicals sectors were among the laggards. Banking and Chemicals sectors out-performed due to sanguine valuations and healthy earnings announcements and payouts by the majority of companies. Rally in the Cement sub-sector continued during the month amid healthy profits announcements driven by improved operating margins and better earnings expectations. Reduction of sales tax on tractors, revived investors' interest in the Industrial Engineering sector.

Foreign Portfolio Investment (FPI) activity, Pak-US diplomatic relations, Economic and interest rates outlook, Current account position, and domestic political situation will be the key drivers of the market going forward.

## Fixed Income Review

The State Bank of Pakistan kept the Discount Rate unchanged at 12% in its Monetary Policy announcement on February 11, 2012. SBP cited concerns on materialization of budgeted foreign inflows, expected uptick in inflation in remaining five months of the fiscal year, excessive Government borrowing to finance fiscal deficit, and potential deterioration in current account. On the other hand, two positive developments are lower inflation numbers and increase in workers' remittances during FY12.

The Government is increasingly relying on banks to fund its fiscal deficit. This is also being supported by Banks' risk aversion as evident from the fact that Banks are holding eligible Government Securities worth Rs 2.66 trillion against their statutory requirement of Rs 1.03 trillion (as of November-end 2011). The below data depicts how SBP is supporting tight liquidity situation in inter-bank market by regular monetary injection.

Open Market Operation by SBP - Purchase (Injections) (Billion Rupees)					
					(July-Dec)
	2007-08	2008-09	2009-10	2010-11	2011-12
Total	232.8	1,131.6	3,621.6	1,243.2	5,932.8
Monthly average	19.4	94.3	301.8	103.6	988.8
Daily average	0.7	3.1	10.1	3.5	33.0

Trading volumes of TFCs reported by MUFAP appreciated in February 2012. Total traded value reported by MUFAP for February 2012 was Rs. 1,007 mln, as against Rs. 682 mln in January 2012. Banking sector bonds accounted for 78.38% of the traded value. This is 38% more than the average of the first seven months in FY 12. Search for yields after stabilization of interest rates is the key factor in this positive development.

NAFA Government Securities Liquid Fund is the only 'AAA(f)' rated money market fund in Pakistan greater than Rs 10 billion in size. The last four funds in fixed income category launched by NAFA, namely NAFA Savings Plus Fund, NAFA Riba Free Savings Fund, NAFA Financial Sector Income Fund and NAFA Money Market Fund are also performing well posting double digit returns. In the current economic environment as mentioned above, the returns of these funds are expected to remain attractive, considering their very low credit risk profile and short maturities or floating rate linked investments.

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