HABIBMETRO
Financial Services

Economy Update

Jama Punji
www.jamapunji.pk

Thursday, July 4, 2019

Flash Note: Economy Update

Pakistan Finally Secures IMF's Extended Fund Facility

IMF's executive board granted approval of an "Extended Fund Facility" (EFF) of USD6.2bn for Pakistan on July 3, 2019. This financial assistance package will span a period of 39 months, with quarterly reviews to keep track of the country's economic performance and compliance with program guidelines. It is pertinent to note that Pakistan has approached the IMF for the 22nd time in its history for financial assistance. Following are the key features of the recently approved IMF package:

- The fund will disburse a sum of USD1bn, followed by equal quarterly installments which will total approximately USD433mn each.
- The most important feature to note is the fact that for the entire length of the IMF program, Pakistan will operate under a Flexible "Market Determined" exchange rate regime. Key government officials have continuously denied any agreement with IMF regarding either a target USD/PKR parity or any exchange rate regime. We believe improved flow of USD on account of IMF's 1st tranche and Qatar's friendly aid will help the PKR maintain ground, however any pressure on the Rupee in future will weigh down on its parity with the Greenback.
- The program aims to restore fiscal balance by achieving full cost recovery in the energy sector, this can only be accomplished if energy prices are increased swiftly especially in case of Gas.
- Expensive energy will likely propel cost push inflation, which the IMF program aims to contain through an autonomous central bank with a tight monetary policy stance. IMF has projected inflation to hover at 13% in FY20.
- There is stress on the need to completely eliminate deficit financing through borrowing from the central bank. This implies that GoP's deficit funding will be routed through borrowing from commercial banks which is comparatively very expensive and forces fiscal discipline.
- There should be increased focus on AML/CFT framework, especially within the financial system to tackle corruption and contain leakages. This implies continued tightening and regulatory controls on the financial system.
- The IMF program aims to restore the country on a path of sustainable growth, however corrective measures taken before the start of the program will significantly tone down growth prospects with IMF projecting the country's GDP growth to dial in at 2.4% For FY20
- Lastly as per IMF's estimates the EFF will unlock a potential sum of USD38bn from Pakistan's international partners over the length of the program and additionally pave way for fresh bond issues (Eurobonds, Sukuk etc) in the international bond markets thereby significantly easing pressure on the country's external account.

M.Sultan Mahmood, CFA

sultan.mahmood@hmfs.com.pk

Flash Note: Economy Update

Implications for the Equity Market

The country's stock market has historically rallied every time an IMF program has been entered into, this stems largely from 1) end to the uncertainty (negative rumors and overall noise) that the program's official approval brings, 2) inflow of foreign funds as each IMF program initiates economic reforms and aims to correct imbalances that are long overdue and 3) the highly alluring valuation levels which the market presents, mainly due to the economic chaos and the resulting contraction in equities that prevails before entering into an IMF program.

It's a Mixed Bag This Time

Although most of the conditions discussed above hold true for this fresh episode of Pakistan/IMF interaction, but tighter regulatory controls and an economy wide drive to document assets and a crackdown on illegal wealth will have a pronounced drag on growth and investor confidence. A combination of these elements alongside severe pressures on the cost front with shrinking growth due to an economic slowdown will keep a lid on corporate earnings. Clear indications of a tighter monetary policy until inflation cools-off and the currency stabilizes will also keep the charm of equities in check, thus transpiring into limited upside for the equity market.

Therefore we expect that equities will find it difficult to justify a fundamentals driven rally in the medium term, however any potent foreign inflows in to the stock market has the ability to drive stock prices higher as multiples re-rate. From an overall economy's point of view we believe most of the measures being taken (by the GoP as part of IMF program requirements and otherwise) were a long awaited necessity and can set the tone for sustainable growth in the long term and restore the country's export competitiveness, but it implies severe pain in the short term which will be an acid test both for the GoP and the country's economy.

Disclaimer

This research report is for information purposes only and does not constitute nor is it intended as an offer or solicitation for the purchase or sale of securities or other financial instruments. Neither the information contained in this research report nor any future information made available with the subject matter contained herein will form the basis of any contract. Information and opinions contained herein have been compiled or arrived at by Habib Metropolitan Financial Services (HMFS) from publicly available information and sources that HMFS believed to be reliable. Whilst every care has been taken in preparing this research report, no research analyst, director, officer, employee, agent or adviser of any member of HMFS gives or makes any representation, warranty or undertaking, whether express or implied, and accepts no responsibility or liability as to the reliability, accuracy or completeness of the information set out in this research report. Any responsibility or liability for any information contained herein is expressly disclaimed. All information contained herein is subject to change at any time without notice. No member of HMFS has an obligation to update, modify or amend this research report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate, or if research on the subject company is withdrawn. Furthermore, past performance is not indicative of future results.

The investments and strategies discussed herein may not be suitable for all investors or any particular class of investor. Investors should make their own investment decisions using their own independent advisors as they believe necessary and based upon their specific financial situations and investment objectives when investing. Investors should consult their independent advisors if they have any doubts as to the applicability to their business or investment objectives of the information and the strategies discussed herein. This research report is being furnished to certain persons as permitted by applicable law, and accordingly may not be reproduced or circulated to any other person without the prior written consent of a member of HMFS. This research report may not be relied upon by any retail customers or person to whom this research report may not be provided by law. Unauthorized use or disclosure of this research report is strictly prohibited. Members of HMFS and/or their respective principals, directors, officers, and employees and their families may own, have positions or affect transactions in the securities or financial instruments referred herein or in the investments of any issuers discussed herein, may engage in securities transactions in a manner inconsistent with the research contained in this research report and with respect to securities or financial instruments covered by this research report, may sell to or buy from customers on a principal basis and may serve or act as director, placement agent, advisor or lender, or make a market in, or may have been a manager or a co-manager of the most recent public offering in respect of any investments or issuers of such securities or financial instruments referenced in this research report or may perform any other investment banking or other services for, or solicit investment banking or other business from any company mentioned in this research report. Investing in Pakistan involves a high degree of risk and many persons, physical and legal, may be restricted from dealing in the securities market of Pakistan. Investors should perform their own due diligence before investing. No part of the compensation of the authors of this research report was, is or will be directly or indirectly related to the specific recommendations or views contained in the research report. By accepting this research report, you agree to be bound by the foregoing limitations.

HMFS and / or any of its affiliates, which operate outside Pakistan, do and seek to do business with the company(s) covered in this research document. Investors should consider this research report as only a single factor in making their investment decision. HMFS prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer/company prior to the publication of a research report containing such rating, recommendation or investment thesis.

HMFS endeavors to make all reasonable efforts to disseminate its publication to all eligible clients in a timely manner through either physical or electronic distribution such as mail, fax and/or email. Nevertheless, not all clients may receive the material at the same time.

HMFS Stock Ratings System

Investors should carefully read the definitions of all rating used within every research reports. In addition, research reports carry an analyst's independent view and investors should ensure careful reading of the entire research reports and not infer its contents from the rating ascribed by the analyst. Ratings should not be used or relied upon as investment advice. An investor's decision to buy, hold or sell a stock should depend on said individual's circumstances and other considerations. HMFS uses a three tier rating system: i) Buy, ii) Hold and iii) Sell with our rating being based on total stock returns. A table presenting HMFS' rating definitions is given below:

Valuation Methodology

To arrive at our fair value estimates, HMFS uses different valuation methodologies including but not limited to:

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

HMFS RATING GUIDE	
BUY	*More than 15% Upside*
HOLD	*Between 15% Upside & 15% Downside*
SELL	*More than 15% Downside*

Note: All fair value estimates are for a twelve month time horizon unless specified otherwise in the report
Upside/Downside represents the difference between the stated "Fair Value" & the prevailing "Market Price"
Total Return is based on both the Capital Gains return & the Dividend Yield & is exclusive of all applicable taxes