22 November 2021

IMF Program Resumption

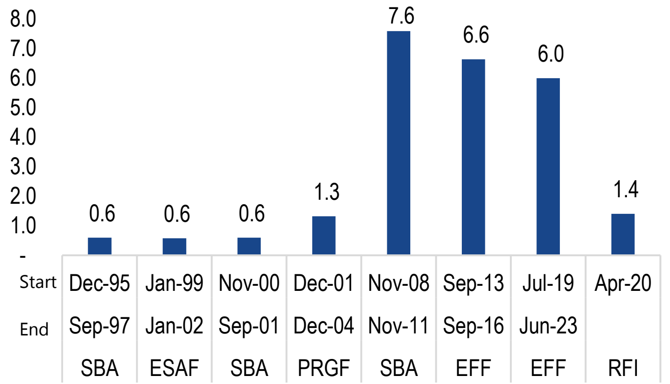
Staff-level talks conclude successfully: Promises greater macro stability and market rerating

Pakistan has successfully concluded staff level agreement with the IMF, paving way for the resumption of the EFF Program (stalled since May 2021), subject to the approval of the IMF's Board. Formal program resumption should now be a matter of when not if, going by precedence, and will lead to a disbursement of US$1.0bn tranche, taking the cumulative disbursement to around US$3.0bn out of the total US$6.0bn. Before the BoD approval, however, Pakistan will likely have to pass: (i) certain tax measures (predominantly removal of tax exemptions) and (ii) the revised SBP Act in the Parliament (which will make the SBP more independent).

The staff level agreement has come after Pakistan completed all the structural benchmarks that IMF had set out in its review in February-March 2021 (except for containing the primary deficit to c.0.3% of GDP):

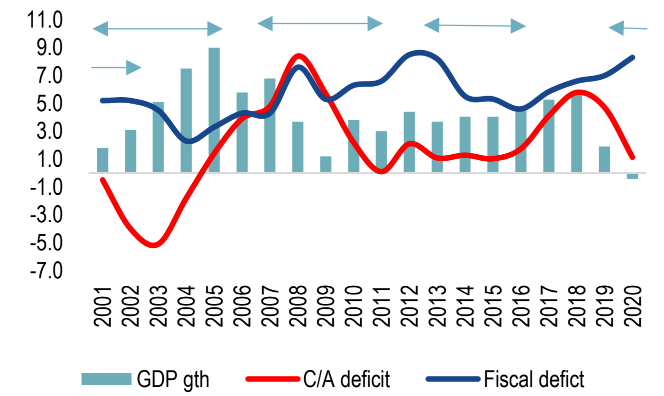
- Power tariff hikes (most recently by PKR1.39/kWh, following a PKR1.95/kWh increase in Mar'2021)
- Payment of the second tranche of settlement to IPPs
- NEPRA Act was passed in the Parliament
- Pakistan availed bilateral assistance from Saudi Arabia worth US$3bn
- Monetary tightening has commenced (200bps increase since September), and there has been limited SBP intervention in the exchange rate lately (PKR/USD down 10% since June 2021).

Pakistan has been under an IMF Program for most of past 20yrs…



Source: IMF, IMS Research

…but has tamed the twin deficits in each program (denoted by arrows)



Source: IMF, IMS Research

Pending tasks before BoD approval

The remaining preconditions include removal of any remaining tax exemptions. Some sectors that could potentially be affected if exemptions are withdrawn could be Dairy (presently zero-rated) and Tractors (notified GST is much lower than the benchmark 17%). The Fertilizer sector could potentially also be impacted – GST on urea is just 2% - but it should be able to pass on the impact given higher international prices and strong farmer incomes. Note that to pass any new tax measures, the government coalition needs it to be approved by the National Assembly only, where it enjoys a majority. However, both the NA and Senate may be needed to pass the SBP Act for greater central bank autonomy.

What can follow?

IMF program resumption should lead to an improved outlook for balance-of-payment stability and, together with the commencement of interest rate hikes, alleviate the pressure on the exchange rate. The SBP's forex reserves have recently fallen to less than US$17bn (just under 3mth import cover) but should rebuild now – other than the next IMF tranche and other multilaterals' disbursements after program resumption, Pakistan will soon receive US$3bn from Saudi Arabia and another Eurobond or international Sukuk issue (of US$1-2bn) is also on the cards, in our view.

Continued on the next page…

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Positives for the economy and markets

The event is another sign of the Pakistan government's commitment to long-term macroeconomic reforms, Pakistan remains among the cheapest markets in the Asia Pacific region, where we believe the effective handling of the Covid-19 pandemic and accelerating GDP growth ahead of other countries, have not yet been priced in.

We highlight that Pakistan has already passed most of the preconditions ahead of the program resumption, which now promises mostly positive implications for the equity market from a forward looking perspective, in our view.

- The resumption of IMF program will restore market's confidence in the macroeconomic management – ahead of the general elections due in 2023 – particularly on the external imbalances and inflation.
- The equity market should rerate from a forward P/E of just c.5.5x – well below its long-term mean P/E of 9.0x (IMS Universe). This could enable the KSE 100 Index to reach 50,000pts by early 2022, in our view. Monetary tightening has rejuvenated the largest sector on the KSE-100 Index i.e. Banks.
- The PKR should appreciate to 165-170 vs. the US$, from a recent high of 176, for the next few months, due to the materialization of the aforementioned capital flows. This will offer some respite from inflationary pressures and restore business confidence (some corporates have planned expansion projects).

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Neutral	Total return expectation of > -5% or expected to match the return of KSE-100 index
Sell	Expected downside of more than 5% or expected to underperform the KSE-100 index

*Based on 12 month horizon unless stated otherwise in the report.

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