7 February 2022

IMF Program

Details of pending measures point to greater fiscal tightening

As per the IMF Article IV Consultation report, Pakistan has to deliver more fiscal and structural targets until the end of the EFF Program by September 2022 (six new structural benchmarks). Additional tax measures – including some which were skipped in the recently passed Mini Budget – have been penciled in for the FY23 Budget by the government (details below). Some of these measures worsen outlook for inflation, which has already been around 11-13% in recent months.

On the positive side, however, Pakistan is set to receive another US$3bn from the IMF until September (upon fulfillment of new SBs), in addition to significant external flows committed by bilateral and multilateral sources.

Tax Measures: FY23 Budget Preview

- The government will reform the personal income tax structure (PIT), by reducing tax slabs and credits, on top of expanding the tax net. A PIT legislation will come into effect under the next Federal Budget (*new SB for February 2022*).
- The government has agreed to remove tax exemptions on fertilizer and tractors – which were skipped in the Mini Budget – bring GST on them to 17% (from 2-5% presently) but offsetting the price impact on farmers through fresh subsidies. We think that this will be broadly neutral; as both industries will be able to pass on the increase in GST, and demand will be protected by new subsidies. However, if the subsidy mechanism is not efficient, it could potentially impact tractor sales (negative for MTL and AGTL). In the past, higher GST on tractors, not matched by commensurate subsidies, has been seen to significantly dampen tractor sales.

Monetary Policy: Adopt a data-driven policy

- The IMF has recommended that the SBP continue to determine monetary policy based on forward looking data, without directly hinting that more interest rate hikes are needed in the near future, in our view. At present, interest rates are "broadly neutral from a 12 month forward basis."
- The IMF has recommended that the SBP unwind refinancing facilities (concessionary borrowing largely availed by exporters) and establish a new Development Financial Institution to do the same (*a new SB for end-April 2022).* As per our discussions with certain exporters, the government has increased the rates on these facilities in the past (not a very worrisome measure in the short term), and the guideline does not seem to affect the more important long term financing facilities (LTFF).
- It has dissuaded from excessive SBP intervention in the currency market and pushed for withdrawing restrictions on exchange companies and cash-margin requirements for importers, once the balance of payment situation is more stable.
- The IMF has also discouraged from pushing commercial banks for housing finance, to avoid misallocation of credit, and instating amnesties for construction companies. If implemented, this is likely to dampen construction activity and demand for materials beyond FY22, in our view.
- The IMF has required the completion of first stage of recapitalization of two private banks (a new SB for end-May).

Energy sector reforms: Tariff hikes and circular debt reduction

- The government will increase the base power tariff again by February. Pakistan has already increased the base tariff by a cumulative PKR3.34/kWh (by c.25%) since January 2021; we think another PKR1.5-2.0/kWh (by c.9-12%) is likely which by itself is estimated to increase inflation by 0.5ppt. Note that an increase in gas tariff is also on the cards.
- The government will aim to privatize two RLNG based power plants by end-June 2022 and use the proceeds partially to reduce the balance of outstanding circular debt. Reportedly Qatari investors are interested in buying the plants for around US$2.0bn (c.PKR350bn). Circular debt balance stood at PKR2.47tn by end-December 2021 (c.5% of GDP).
- In order to ensure full cost recovery through timely OGRA notifications, the government will pass the OGRA Act in the Parliament by June 2022 (a SB). In our view, this will be a long-term positive for the Energy sector (particularly fuel suppliers), as it will make the cost recovery process more nimble, but could disarm the government from the ability to contain increase in consumer fuel prices to moderate inflation.
- The government has already adopted the second step of energy subsidy reform for residential consumers in December 2021 (a new SB for Jan 2022), which will limit power subsidies to the most vulnerable consumers.

Continued on the next page…

Muhammad Saad Ali, CFA
saad.ali@imsecurities.com.pk
+92-21-37131610

Copyright©2022 Intermarket Securities Limited (Local Research Partner of Tellimer). All rights reserved. The information provided on this document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Intermarket Securities or its affiliates to any registration requirement within such jurisdiction or country. Neither the information, nor any opinion contained in this document constitutes a solicitation or offer by Intermarket Securities or its affiliates to buy or sell any securities or provide any investment advice or service.

Structural reforms: Legislation for SOE transformation

- The IMF has required the parliamentary approval of SOE law until June 2022 (new SB), which will develop a framework for better governance and oversight of SOEs, in order to reduce their losses and in turn the fiscal burden they entail. Since, like the amended SBP Act, this law will pass through both houses of Parliament (PTI lacks majority in the Senate), it will likely be another uphill task for the incumbent government.

All in all, the new measures required by the IMF – additional tax measures and new structural targets such as the SOE law and OGRA Act – will be tough to achieve for the government, in our view. Nonetheless, we reiterate that the resumption of IMF program ensures balance of payment stability of Pakistan and continued commitment to reforms until the end of the present government's term.

Key sectors for which there are some negative implications, include Fertilizer, Tractors and Textiles, albeit any earnings impact will be moderate for these industries, in our view. On the other hand, the continuation of IMF Program is a big boost for the entire Energy sector, as it promises measures that can stall circular debt buildup in the medium term. Thus, it should serve to revive stock price performance of OGDC, PPL, PSO, HUBC and gas utilities, all else the same.

Key Macro Projections of IMF

Pakistan		FY20	FY21e	FY22f	FY23f	FY24f	FY25f	FY26f
GDP growth	yoy	-0.5%	3.9%	4.0%	4.5%	5.0%	5.0%	5.0%
CPI	yoy	10.7%	8.9%	9.4%	7.8%	6.5%	6.5%	6.5%
C/A balance	% of GDP	-1.7%	-0.6%	-4.0%	-3.5%	-3.3%	-3.0%	-2.7%
Fiscal balance	% of GDP	-8.0%	-7.1%	-6.9%	-4.5%	-4.5%	-3.9%	-3.5%
Primary balance	% of GDP	-1.8%	-1.4%	-1.3%	1.2%	1.3%	1.4%	1.5%
Revenue	% of GDP	15.2%	14.5%	15.9%	16.7%	16.7%	16.8%	16.9%
Expenditure	% of GDP	23.2%	21.6%	22.8%	21.1%	21.1%	20.6%	20.4%
SBP Fx reserves	US$bn	12.2	17.3	21.2	20.7	20.1	20.9	23.1

Source: IMF, IMS Research

Timeline of IMF disbursements

	Amount of Purchase		Conditions
Availability Date	SDRs (mn)	USDmn	
July 3, 2019	716	1,000	Approval of arrangement
December 6, 2019	328	460	First review and end-September 2019 PC
March 5, 2021	350	500	Second, Third, Fourth and Fifth reviews PC
September 3, 2021	750	1,050	Sixth review and end-June 2021 PC
March 4, 2022	687	960	Seventh review and end-December 2021 PC
June 3, 2022	687	960	Eighth review and end-March 2022 PC
September 2, 2022	750	1,050	Ninth review and end-June 2022 PC
Total	**4,268**	**6,000**	

Source: IMF

* PC: Performance/Continuous Criteria

Continued on the next page…

List of selected structural benchmarks

Actions	Timeline
Prior actions	
Supplementary Finance Bill passed in the Parliament	Completed
Increase in Petroleum levy on petrol and diesel by PKR8.0/liter	Completed
SBP Act passed in the Parliament	Completed
Publication of Covid-related procurement contracts on PPRA	Completed
Ex-post audit of Covid-related expenditure	Completed
Selected Structural benchmarks	
Adopt measures to strengthen effectiveness of AML/CFT framework	end-Mar 2022
Adoption of OGRA Act	end-Jun 2022
New Structural benchmarks	
1. Preparation of personal income tax (PIT) legislation	end-Feb 2022
2. Establish an DFI and eventual phase out of SBP refinance facilities	end-Apr 2022
3. Completion of first stage of recapitalization of two private banks	end-May 2022
4. Cabinet decision on second step of energy subsidy reform for residential consumers	end-Jan 2022
5. Parliamentary approval of SOE law	end-Jun 2022
6. Issuance of regulation by PPRA to require ownership documentation for contracts above PKR50mn	end-Mar 2022

Source: IMF

I, Muhammad Saad Ali, CFA certify that the views expressed in the report reflect my personal views about the subject securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations made in this report. I further certify that I do not have any beneficial holding of the specific securities that I have recommendations on in this report.

Ratings Guide*	Criteria
Buy	Total return expectation of ≥ 15% or expected to outperform the KSE-100 index
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.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Risks: (i) Difficulty in meeting SBs, especially those that have to pass through the Senate, and (ii) IMF pushes for greater monetary tightening until the end of the program

Disclaimer: Intermarket Securities Limited has produced this report for private circulation only. The information, opinions, and estimates herein are not direct at, or intended for distribution to or use by, any person or entity in any jurisdiction where doing so would be contrary to law or regulation or which would subject Intermarket Securities Limited to any additional registration or licensing requirement within such jurisdiction. The information and statistical data herein have been obtained from sources we believe to be reliable where such information has not been independently verified and we make no representation or warranty as to its accuracy, completeness, and correctness. This report makes use of forward looking statements that are based on assumptions made and information currently available to us and those are subject to certain risks and uncertainties that could cause the actual results to differ materially. No part of the compensation of the author(s) of this report is related to the specific recommendations or views contained in this report.

This report is not a solicitation or any offer to buy or sell any of the securities mentioned herein. It is meant for information purposes only and does not take into account the particular investment objectives, financial situation or needs of individual recipients. Before acting on any information in this report, you should consider whether it is suitable for your particular circumstances and, if appropriate, seek professional advice. Neither Intermarket Securities Limited nor any of its affiliates or any other person associated with the company directly or indirectly accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein.

Subject to any applicable law and regulations, Intermarket Securities Limited, its affiliates or group companies or individuals connected with Intermarket Securities Limited directly or indirectly may have used the information contained herein before publication and may have positions in, or may from time to time purchase or sell or have a material interest in any of the securities mentioned or may currently or in future have or have had a relationship with, or may provide investment banking, capital markets and/or other services to, the entities mentioned herein, their advisors and/or any other connected parties.

RESEARCH DISCLOSURES

Third Party Research

This is third party research. It was prepared by Intermarket Securities Limited (IMS), with headquarters in Karachi, Pakistan. Intermarket Securities Limited (IMS) is authorized to engage in securities activities according to its domestic legislation. Intermarket Securities Limited (IMS) has sole control over the contents of this research report.

Intermarket Securities Limited (IMS) is the employer of the research analyst(s) responsible for the content of this report and research analysts preparing this report are resident outside the U.S. and are not associated persons of any U.S. regulated broker-dealer. The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

None of the materials provided in this report may be used, reproduced, or transmitted, in any form or by any means, electronic or mechanical, including recording or the use of any information storage and retrieval system, without written permission.

Disclaimers

Investing in any non-U.S. securities or related financial instruments (including ADRs) discussed in this report may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the U.S. Securities and Exchange Commission. Information on such non-U.S. securities or related financial instruments may be limited. Foreign companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect within the United States. The value of any investment or income from any securities or related financial instruments discussed in this report denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related financial instruments.

Frontier and Emerging Market laws and regulations governing investments in securities markets may not be sufficiently developed or may be subject to inconsistent or arbitrary interpretation or application. Frontier and Emerging Market securities are often not issued in physical form and registration of ownership may not be subject to a centralized system. Registration of ownership of certain types of securities may not be subject to standardized procedures and may even be effected on an ad hoc basis. The value of investments in Frontier and Emerging Market securities may also be affected by fluctuations in available currency rates and exchange control regulations. Not all of these or other risks associated with the relevant company, market or instrument which are the subject matter of the report are necessarily considered.

US Distribution

This Report is considered independent third-party research and was prepared by **Intermarket Securities Limited (FBD)**, with headquarters in **Pakistan**. The distribution of this Research is provided pursuant to the exemption under Rule 15a-6(a)(2) and is only intended for an audience of Major U.S. Institutional Investors (MUSIIs) as defined by Rule 15a-6(b)(4). This research is not a product of **StoneX Financial Inc.**. **Intermarket Securities Limited** has sole control over the contents of this research report. **StoneX Financial Inc.** does not exercise any control over the contents of, or the views expressed in, any research reports prepared by **Intermarket Securities Limited** and under Rule 15a-6(a)(3), any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through **StoneX Financial Inc.** For any information, please contact Gene Turok. Under no circumstances should any U.S. recipient of this research report effect any transaction to buy or sell securities or related financial instruments through **Intermarket Securities Limited.**

Intermarket Securities Limited (IMS) is not registered as a broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution to "major U.S. institutional investors" and other "U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act").

Distribution outside US

This report is not intended for distribution to the public and may not be reproduced, redistributed or published, in whole or in part, for any purpose without the written permission of Tellimer. Tellimer shall accept no liability whatsoever for the actions of third parties in this respect. This report is for distribution only under such circumstances as may be permitted by applicable law.

This report may not be used to create any financial instruments or products or any indices. Neither Tellimer, nor its members, directors, representatives, or employees accept any liability for any direct or consequential loss or damage arising out of the use of all or any part of the information herein.

United Kingdom: Distributed by Exotix Partners LLP only to Eligible Counterparties or Professional Clients (as defined in the FCA Handbook). The information herein does not apply to, and should not be relied upon by, Retail Clients (as defined in the FCA Handbook); neither the FCA's protection rules nor compensation scheme may be applied.

UAE: Distributed in the Dubai International Financial Centre by Exotix Partners LLP (Dubai) which is regulated by the Dubai Financial Services Authority ("DFSA"). Material is intended only for persons who meet the criteria for Professional Clients under the Rules of the DFSA and no other person should act upon it.

Other distribution: The distribution of this report in other jurisdictions may be restricted by law and persons into whose possession this document comes should inform themselves about, and observe, any such restriction