ARIF HABIB LIMITED

REP-300

Pakistan Economy

Staff-level agreement reached on a USD 3bn SBA

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Deal sealed: SLA signed for a new SBA

Pakistan has achieved a significant breakthrough by signing a new nine-month Stand-By Arrangement (SBA) deal with the International Monetary Fund (IMF) worth USD 3bn (SDR 2.25bn). This significant achievement comes at a crucial juncture as the EFF program concludes today (30th Jun'23) which could not be completed as planned, emphasizing the urgency and importance of signing this new agreement. Furthermore, with the State Bank of Pakistan's reserve level standing at a critical USD 3.5bn (less than a month of import cover) while sizeable external repayments due until Dec'23 (USD 9bn including USD 4bn sovereign rollovers), the successful signing of SBA becomes even more crucial to address the country's pressing challenges especially on the external front. The staff-level agreement reached between Pakistan and the IMF for the new SBA is now subject to approval by the IMF Executive Board, which is expected by mid-Jul'23.

Key developments that led to a new SBA

As we await the comprehensive document from the IMF regarding the new agreement, the press release by the IMF highlights that in the past few weeks, three significant developments emerged that have played a vital role in facilitating the establishment of the new Standby Agreement (SBA) between Pakistan and the IMF. These developments have proven instrumental in shaping the agreement and signify important milestones in the process.

Exhibit: History of Lending Commitments

Facility	Date of Arrangement	Expiration Date	Amount Agreed *SDR mn*	Amount Drawn *SDR mn*
Standby Arrangement	Dec-58	Sep-59	25	-
Standby Arrangement	Mar-65	Mar-66	38	38
Standby Arrangement	Oct-68	Oct-69	75	75
Standby Arrangement	May-72	May-73	100	84
Standby Arrangement	Aug-73	Aug-74	75	75
Standby Arrangement	Nov-74	Nov-75	75	75
Standby Arrangement	Mar-77	Mar-78	80	80
Extended Fund Facility	Nov-80	Dec-81	1,268	349
Extended Fund Facility	Dec-81	Nov-83	919	730
Structural Adjustment Facility Commitment	Dec-88	Dec-91	382	382
Standby Arrangement	Dec-88	Nov-90	273	194
Standby Arrangement	Sep-93	Feb-94	265	88
Extended Credit Facility	Feb-94	Dec-95	607	172
Extended Fund Facility	Feb-94	Dec-95	379	123
Standby Arrangement	Dec-95	Sep-97	563	295
Extended Fund Facility	Oct-97	Oct-00	455	114
Extended Credit Facility	Oct-97	Oct-00	682	265
Standby Arrangement	Nov-00	Sep-01	465	465
Extended Credit Facility	Dec-01	Dec-04	1,034	861
Standby Arrangement	Nov-08	Sep-11	7,236	4,936
Extended Fund Facility	Sep-13	Sep-16	4,393	4,393
Extended Fund Facility	Jul-19	Jun-23	4,988	2,144
Standby Arrangement	Jun-23	Mar-24	2,250	
Total			**25,907**	**15,938**

Source (s): IMF, AHL Research

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Budget FY24 revision

- **Budget FY24 revision:** In an effort to secure a critical agreement with the IMF, the government recently reviewed the FY24's budget comprehensively. This extensive assessment reflected the government's determination to not leave any stone unturned and ensure deal successfully materializes between the Fund and Pakistan. Notable changes were made to budgetary allocations and targets to address the concerns raised by the IMF. Some key revisions undertaken in the budget include (but not limited to):
  1. Introduction of PKR 215bn worth new taxes
  2. PKR 85bn spending cut without reducing the federal development budget or salaries and pensions of government employees.
  3. Upward revision in revenue collection target of FBR to PKR 9.4trn
  4. Increased allocation for provincial shares to PKR 5.4trn
  5. Total expenditure adjusted to PKR 14.48trn

This revised new budget was in-line with the objectives of fiscal sustainability and revenue mobilization.

Exhibit: Revised Budgetary Estimates (FY24)

PKR bn	Previous	Revised	Absolute Change	% Change
Budget outlay	14,460	14,480	20	0.1%
FBR tax revenue	9,200	9,415	215	2.3%
Provinces' share	5,276	5,399	123	2.3%
Pension expense	761	801	40	5.3%
Subsidy	1,074	1,064	(10)	-1.0%
Grants	1,464	1,405	(59)	-4.0%

Source (s): Finance Bill, AHL Research

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Withdrawal of guidance on import prioritization & Mobilization of financial support

- **Withdrawal of guidance on import prioritization and market determined exchange rate:** SBP's recent decision to withdraw its general guidance to commercial banks on import prioritization also played an integral role in seizing the deal. To recall, in the recent (emergent) monetary policy statement on 26th Jun'23, SBP mentioned that the decision to withdraw guidance was influenced by the goal of meeting the obligations of the ongoing IMF program. Despite recognizing the importance of this measure, the Monetary Policy Committee (MPC) acknowledged that it has increased the potential risks to both inflation and the exchange rate. The IMF has also raised similar concerns in their press release.

- **Mobilization of financial support from multilateral institutions and bilateral partners:** Lastly, the IMF acknowledged the ongoing efforts by the authorities in seeking financial support from both multilateral institutions and bilateral partners. To highlight, in addition to commitments made at the Geneva Conference (Climate Resilient Pakistan), Pakistan has so far received USD 1bn financing commitment from the United Arab Emirates (UAE) and around USD 2bn commitment from Saudi Arabia. Moreover, the IMF also stated in their press release that Pakistan's focus has been on obtaining fresh financing and ensuring the extension of maturing debt. These endeavours aim to bolster short-term policy initiatives and replenish gross reserves, ultimately striving to achieve a more satisfactory level of reserves.

Exhibit: PSX and Currency Performance under IMF Programs

From	To	PKR Depreciation		KSE100 Return	
IMF Period		**Total**	**Annualized**	**Total**	**Annualized**
Sep-93	Feb-94	-1.3%	-2.9%	84.4%	307.6%
Feb-94	Dec-95	-12.9%	-7.5%	-41.2%	-25.7%
Dec-95	Sep-97	-15.3%	-8.8%	30.1%	15.7%
Oct-97	Oct-00	-22.4%	-8.1%	-24.2%	-8.8%
Nov-00	Sep-01	-8.5%	-10.1%	-13.3%	-15.8%
Dec-01	Dec-04	2.0%	0.7%	303.9%	59.4%
Nov-08	Sep-11	-11.8%	-4.3%	28.0%	9.1%
Sep-13	Sep-16	0.0%	0.0%	85.3%	22.2%
Jul-19	Jun-23	-44.9%	-13.9%	18.8%	4.4%
Average		**-12.8%**	**-6.1%**	**52.4%**	**40.9%**
Non-IMF Period					
Sep-97	Oct-97	-8.2%	-78.9%	8.6%	351.6%
Oct-00	Nov-00	0.2%	1.6%	-14.2%	-74.4%
Sep-01	Dec-01	8.9%	57.0%	21.8%	183.8%
Dec-04	Nov-08	-23.2%	-6.4%	64.8%	13.4%
Sep-11	Sep-13	-15.8%	-8.5%	86.0%	37.9%
Sep-16	Jul-19	-33.2%	-13.6%	-13.9%	-5.3%
Average		**-11.9%**	**-8.1%**	**25.5%**	**84.5%**

Source (s): SBP, PSX, AHL Research

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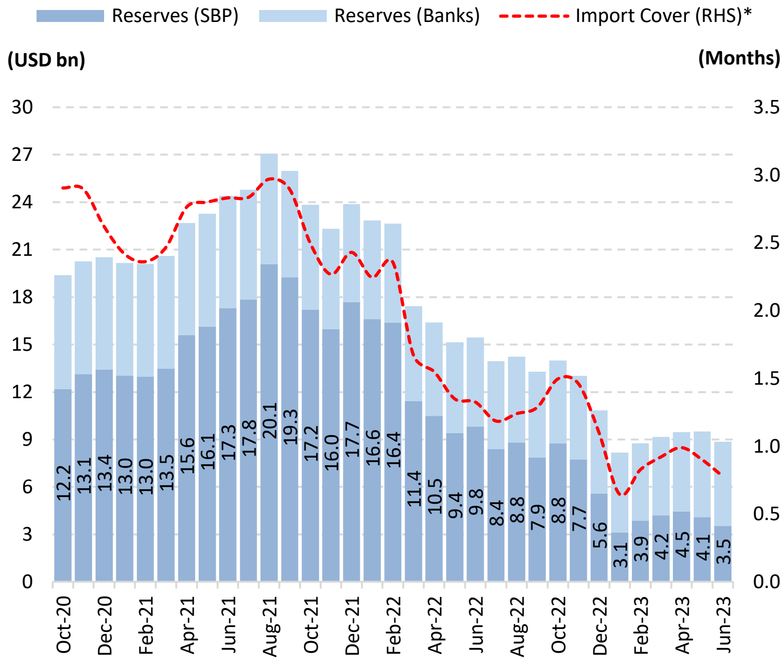
Outlook

- The signing of the new SBA program has emerged as a significant and positive development, given the heightened concerns surrounding the short-term external account outlook. As stated earlier in the report, with SBP's foreign exchange reserves standing at a mere USD 3.5bn, providing less than one month of import cover, and substantial external repayments of USD 9bn including USD 4bn in sovereign rollovers, until Dec'23, the agreement will instill confidence and removed uncertainties for now. This strategic move to secure a short-term program not only provides a well-defined framework for economic decision-making over the next two to three quarters but also ensures that the caretaker administration, slated to assume power prior to elections in Nov'23, will have a clear policy roadmap to follow. By doing so, it ensures a smooth transition of economic policies during this transitional period.

- In the short term, we anticipate the Pakistani Rupee (PKR) to strengthen, driven by a positive sentiment arising from the new Standby Agreement (SBA). However, we expect any recovery to be temporary due to the anticipated opening up of forex markets and the easing of import restrictions, which will exert pressure on the currency. While the specific details of the new SBA are yet to be revealed, it is highly likely that energy sector reforms, including tariff hikes, will be implemented to address the circular debt issue. These reforms are expected to contribute to elevated inflation levels. Given this context, the SBP is likely to maintain its current tight monetary policy stance to manage inflationary pressures effectively.

Figure: FX Reserves and Import Cover



Source (s): SBP, AHL Research, *based on average imports of last 3 months

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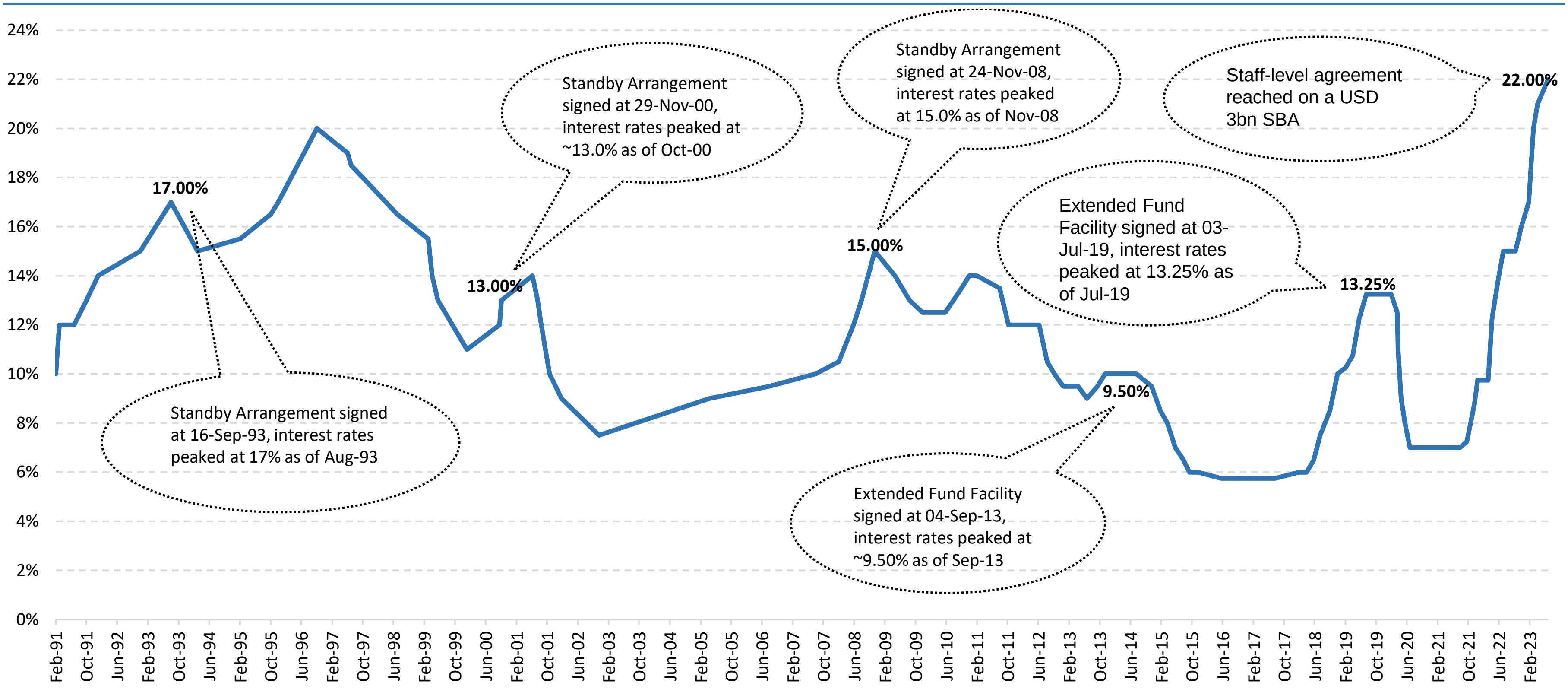
IMF Programs and Interest Rates

Figure: IMF Programs and Interest Rates



Source (s): SBP, IMF, AHL Research

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Pakistan's International bonds react

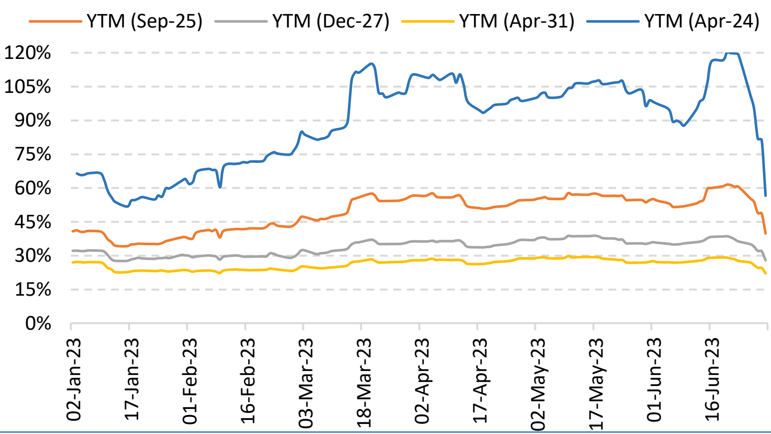
- The signing of the SBA between Pakistan and the IMF has had a positive impact on the international Pakistan bonds market. Following the news of the agreement, the market sentiment towards Pakistan's bonds has improved, leading to a favorable reaction among international investors. To highlight, over the past week, there has been a significant rally in Pakistan's Eurobond market, leading to a decline in yields across all bonds. This decline in yields can be attributed to the market's anticipation of a breakthrough with the International Monetary Fund (IMF). Investors have been anticipating positive developments in the ongoing negotiations with the Fund, which is reflected in the WoW change in bond yields. Yields have experienced a decline ranging from 4% to 42%, with the highest decline seen in the nearest maturity bond (Apr'24).
- The significant upward movement in bond prices demonstrates growing optimism among investors regarding Pakistan's ability to address its economic challenges and implement necessary reforms under the IMF-supported program. While the signing of the SBA has generated positive momentum, ongoing developments and prevailing market conditions will continue to impact bond prices in the future.

Exhibit: Pakistan International Bonds and SUKUKs

Tenor	Maturity	Issue Size ($ mn)	Price	YTM	DoD	WoW	MTD
10 Years	Apr-24	1,000	72.42	56.6%	-24.6%	-62.4%	-42.2%
10 Years	Sep-25	500	55.80	39.8%	-8.8%	-20.7%	-14.7%
5 Years	Apr-26	1,300	49.08	36.9%	-5.9%	-12.4%	-10.7%
10 Years	Dec-27	1,500	48.38	27.9%	-4.0%	-8.4%	-7.7%
7 Years	Jan-29	1,000	56.97	21.6%	-2.3%	-5.4%	-5.6%
10 Years	Apr-31	1,400	46.41	22.1%	-2.4%	-5.5%	-5.1%
30 Years	Mar-36	300	46.33	19.3%	-2.0%	-4.4%	-4.7%
30 Years	Apr-51	800	44.51	20.0%	-2.2%	-5.1%	-5.3%

Source (s): Bloomberg, AHL Research

Figure: Pakistan International Bonds and SUKUKs



Source (s): Bloomberg, AHL Research

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Stock Market

- The successful achievement of a staff-level agreement with the IMF will create a favorable environment for financial inflows from other multilateral institutions, bilateral partners, and friendly countries. These inflows are expected to contribute to an increase in the country's foreign exchange (FX) reserves and help alleviate external pressures. Additionally, the program will provide much-needed clarity and certainty regarding the economic roadmap for the next nine months which is the crucial period given general elections around the corner alongside formation of the new government. This will be beneficial for the markets as it offers a clear direction for economic policies and allows investors to make informed decisions based on the outlined framework.

- Moreover, with respect to sectoral impacts, we believe that energy being one of the top priorities of the IMF, the E&P, OGMCs and Power sector particularly OGDC, PPL, PSO, SNGP, SSGC, HUBC, ENGRO and LUCK are expected to remain in the limelight for the investors. The focus of the government will remain restricting further accumulation of circular debt via timely tariff resets while clearance of circular debt arrears cannot be ruled out particularly in the gas sector. In addition, we view that the sectors depriving from low utilization including Autos, Steel, Chemicals and Pharma, amid imports restrictions would seek a sigh of relief and utilization levels are expected to improve.

- To note, KSE-100 is currently trading at a PER of 3.4x (2024) compared to the last five years average PE of 5.5x while offering a dividend yield of ~11.1%. Our preferred stocks are OGDC, PPL, MARI, MCB, MEBL, BAFL, LUCK, MLCF, FCCL, ENGRO, FFC, SNGP and, HUBC.

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BUY	Upside* of subject security(ies) is more than +15% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between -15% and +15% from last closing of market price(s)
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AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

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- Interest Rate Risk
- Exchange Rate (Currency) Risk

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