REP-300

Pakistan Economy

Fitch upgrades Pakistan to CCC+

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Fitch upgrades Pakistan to CCC+

Fitch Ratings has raised Pakistan's Long-Term Foreign-Currency Issuer Default Rating (IDR) from 'CCC' to 'CCC+'. It is almost after a gap of seven months (Dec'23: CCC) that Fitch has upgraded this rating of Pakistan. Following factors led to the upgrade:

Enhanced external funding prospects

- The upgrade signifies improved access to external funding, supported by a new 37-month, USD7bn EFF agreement with the IMF.
- To recall, in Jul'24, Pakistan reached a staff-level agreement with the IMF.
- Before the IMF Board's expected approval by end-Aug, Pakistan needs to secure funding assurances from bilateral partners, including Saudi Arabia, the UAE, and China, totaling USD 4-5bn. This is considered achievable given past support and recent fiscal measures.
- Strong performance under the previous IMF arrangement helped reduce fiscal deficits and boost foreign exchange reserves.
- However, significant funding needs mean Pakistan remains vulnerable if key reforms are not implemented.

Structural reforms

- The new EFF aims to address structural issues in taxation, energy, and state-owned enterprises.
- It includes a goal to raise tax revenues by 3% of GDP, from under 9% in FY24, with higher taxes on the agricultural sector to be legislated at the provincial level.

Recent policy successes

- Pakistan completed a 9M Stand-by Arrangement with the IMF in Apr'24.
- Over the past year, it has increased taxes, reduced spending, and raised prices for electricity, gas, and petrol.
- Efforts to close the gap between official and parallel market exchange rates have been effective.

Exhibit: Pakistan - Credit Rating (Fitch)

Date	Rating	Outlook
Sep-15	B	Stable
Jan-18	B	Negative
Dec-18	B-	Stable
Jul-22	B-	Negative
Oct-22	CCC+	na
Feb-23	CCC-	na
Jul-23	CCC	na
Dec-23	CCC	na
Jul-24	**CCC+**	**na**

Source: Bloomberg, AHL Research

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Reduced external deficit

- The current account deficit (CAD) is forecast to remain around USD 4bn (1% of GDP) in FY25,. up from USD 700mn in FY24.
- Economic and fiscal policies, lower commodity prices, and rupee depreciation have contributed to this narrowing.
- FX shortages have eased with remittance inflows returning to official channels.

Significant funding requirements

- Pakistan faces over USD 22bn in external public debt maturities in FY25, including bilateral deposits and loans, Chinese commercial bank debt, and multilateral creditor obligations.
- The government has identified over USD 24bn in gross external financing, mainly from bilateral and multilateral sources.

Improved Reserves

- The SBP is rebuilding foreign exchange reserves, estimated at over USD 15bn in Jun'24, and expected to rise to nearly USD 22bn by FY26.
- The SBP's net liquid FX reserves also improved to over USD 9bn by Jun'24.

Fiscal Policy and Budget

- The FY25 budget, developed with IMF staff, aims for a 5.9% of GDP deficit and a 2.0% primary surplus.
- Forecasts assume partial implementation, projecting a primary surplus of 0.8% of GDP and an overall fiscal deficit of 6.9% of GDP in FY25.
- The budget includes tax measures, increased SBP dividends, and larger provincial surpluses.

Exhibit: Fitch Rating Actions

Entry/Debt	Rating	Action
Long Term Issuer Default Rating	CCC+	Upgrade
Short Term Issuer Default Rating	C	Affirmed
Local Currency Long Term Issuer Default Rating	CCC+	Upgrade
Local Currency Short Term Issuer Default Rating	C	Affirmed
Country Ceiling	B-	Affirmed

Source: Bloomberg, AHL Research

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What does ‘CCC+' reflect?

'CCC+' Long-Term Foreign Currency IDR reflects:

Political Challenges

- The February elections resulted in Prime Minister Shehbaz Sharif's party holding only a slim majority in the National Assembly.

Implementation hurdles

- Pakistan has historically faced challenges in consistently adhering to IMF programs, often falling short in implementing required reforms.
- While there is currently an agreement on the need for reform, this resolve may weaken as economic conditions improve.

Debt levels and stability

- Government debt decreased to 68% of GDP by FY24 due to high inflation, even with rising domestic interest costs.
- Debt levels are expected to gradually decline with better economic growth and fiscal surpluses.

ESG – Governance Challenges

- Pakistan has an ESG Relevance Score of '5' for political stability and governance, indicating significant challenges in these areas according to the World Bank Governance Indicators.

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Equity Research Ratings

Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as June 2025 for Target Price. In addition, return excludes all type of taxes. For more details, kindly refer the following table;

Rating	Description
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)
SELL	Upside* of subject security(ies) is less than -15% from last closing of market price(s)

Equity Valuation Methodology

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)

Risks: The following risks may potentially impact our valuations of subject security (ies);

- Market risk
- Interest Rate Risk
- Exchange Rate (Currency) Risk