REP-300

Pakistan Economy

IMF EFF Resumption – More Oxygen for the economy

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IMF- Extended Fund Facility (EFF)

IMF and Pakistan reach Staff-Level Agreement

On Tuesday February 16, 2021, IMF staff team and Pakistani authorities reached a staff-level agreement on the second to fifth reviews of the IMF Extended Fund Facility (EFF) program, enabling the final disbursement of USD 500mn (of the total USD 6bn) subject to approval of the IMF's Executive Board.

To recall, the second review for the release of a third loan tranche of ~USD 500 million was postponed in April 2020 due to the outbreak of the pandemic, following which Pakistan applied for another facility namely 'Rapid Financing Instrument' (RFI), that aims to provide rapid financial assistance to all member countries facing an urgent balance of payments need. An amount of ~USD 1.4bn was disbursed under this facility.

Exhibit: IMF Timeline

3-Jul-19	IMF Executive Board approves USD 6bn EFF (39 months)
20-Sep-19	IMF staff concludes visit to Pakistan
8-Nov-19	Staff level agreement on First Review under EFF
19-Dec-19	IMF Executive Board completes First Review of Pakistan's EFF
14-Feb-20	Statement at conclusion of IMF Mission to Pakistan
27-Feb-20	Staff level agreement on Second Review under EFF
26-Mar-20	Statement by IMF Managing Director on Pakistan
16-Apr-20	IMF Executive Board approves USD 1.386bn disbursement under RFI
16-Feb-21	Staff level agreement on pending reviews under EFF

Source (s): IMF, AHL Research

Exhibit: History of Lending Commitments

Facility	Date of Arrangement	Expiration Date	Amount Agreed *SDR mn*	Amount Drawn *SDR mn*
Standby Arrangement	8-Dec-58	22-Sep-59	25	-
Standby Arrangement	16-Mar-65	15-Mar-66	38	38
Standby Arrangement	17-Oct-68	16-Oct-69	75	75
Standby Arrangement	18-May-72	17-May-73	100	84
Standby Arrangement	11-Aug-73	10-Aug-74	75	75
Standby Arrangement	11-Nov-74	10-Nov-75	75	75
Standby Arrangement	9-Mar-77	8-Mar-78	80	80
Extended Fund Facility	24-Nov-80	1-Dec-81	1,268	349
Extended Fund Facility	2-Dec-81	23-Nov-83	919	730
Structural Adjustment Facility Commitment	28-Dec-88	27-Dec-91	382	382
Standby Arrangement	28-Dec-88	30-Nov-90	273	194
Standby Arrangement	16-Sep-93	22-Feb-94	265	88
Extended Credit Facility	22-Feb-94	13-Dec-95	607	172
Extended Fund Facility	22-Feb-94	4-Dec-95	379	123
Standby Arrangement	13-Dec-95	30-Sep-97	563	295
Extended Fund Facility	20-Oct-97	19-Oct-00	455	114
Extended Credit Facility	20-Oct-97	19-Oct-00	682	265
Standby Arrangement	29-Nov-00	30-Sep-01	465	465
Extended Credit Facility	6-Dec-01	5-Dec-04	1,034	861
Standby Arrangement	24-Nov-08	30-Sep-11	7,236	4,936
Extended Fund Facility	4-Sep-13	30-Sep-16	4,393	4,393
Extended Fund Facility	3-Jul-19	2-Oct-22	4,268	1,044
Total			**23,657**	**14,839**

Source (s): IMF, AHL Research

IMF- Extended Fund Facility (EFF)

IMF Staff Commended Progress on Policies and Reforms

IMF staff commended the continued progress Pakistani economy has achieved over the course of the program, stating that most of the targets under the EFF-supported program were on track. While we await IMF's detailed document on the review, a few key areas mentioned in IMF press release were:

i. Measures taken to counter the ill effects of the pandemic helped government to reduce the impact on the economy.
ii. GDP growth is projected to be 1.5% in FY21 as compared to -0.4% recorded in FY20.
iii. Fiscal targets are well-supported by cautious spending by the government and revenue measures.
iv. International reserves held by the SBP strengthened and reached USD 13bn (as at Jan'21) and net international reserves (NIR) increased by over USD 9bn (as at Dec'20).
v. IMF also highlights that the external current account position improved mainly on the back of: stronger-than-expected remittances, import curtailment, and a slight recovery in exports.
vi. IMF acknowledged that the authorities are moving steadfastly on a number of important reforms such as: strengthening regulatory agencies' legal frameworks (NEPRA and OGRA Acts), consolidation of the SBP's autonomy (SBP Act), and improvement of state owned enterprises (SOE) management (SOE Law).
vii. The statement also highlights that Pakistan continues to enhance the effectiveness of their anti-monetary laundering/counter financing of terrorism (AML/CFT) framework and is progressing towards completion of their action plan with the Financial Action Task Force (FATF).

On the flipside, IMF pointed out the necessity to continue the momentum of overall progress amidst a challenging global socio-economic environment.

Exhibit: Currency Performance during IMF and Non-IMF Periods

Currency Performance during IMF Periods

Start		End		PKR
Date	PKR/USD	Date	PKR/USD	Depreciation
16-Sep-93	29.85	22-Feb-94	30.23	-1.3%
22-Feb-94	30.23	4-Dec-95	34.70	-12.9%
13-Dec-95	34.25	30-Sep-97	40.45	-15.3%
20-Oct-97	44.05	19-Oct-00	57.00	-22.7%
29-Nov-00	58.08	30-Sep-01	64.20	-9.5%
6-Dec-01	60.90	5-Dec-04	59.51	2.3%
24-Nov-08	79.10	30-Sep-11	87.51	-9.6%
4-Sep-13	104.90	30-Sep-16	104.49	0.4%
3-Jul-19	157.61	16-Feb-21	159.54	-1.2%
Average Depreciation				**-7.8%**

Currency Performance during Non-IMF Periods

Start		End		PKR
Date	PKR/USD	Date	PKR/USD	Depreciation
30-Sep-97	40.45	20-Oct-97	44.05	-8.2%
19-Oct-00	57.00	29-Nov-00	58.08	-1.9%
28-Sep-01	64.20	6-Dec-01	60.90	5.4%
3-Dec-04	59.51	24-Nov-08	79.10	-24.8%
30-Sep-11	87.51	4-Sep-13	104.90	-16.6%
30-Sep-16	104.49	2-Jul-19	158.06	-33.9%
Average Depreciation				**-13.3%**

Source (s): PSX, AHL Research

IMF- Extended Fund Facility (EFF)

Macroeconomic Implications

Banking System: The IMF has commended the efforts of the SBP/GoP to proactively support the economy during the daunting COVID times. The banking system has been described as "healthy". We highlight that unlike the 2008 crisis, banks in Pakistan entered the current crisis posed by the COVID-19 pandemic with strong balance sheets. In CY08 and CY09, CAR for the banking sector stood at 12.2% and 14.0%, respectively. CAR for the industry is currently at a concrete 19.5% against 17.1% SPLY (vs. requirement of 11.5%), while Common Equity Tier 1 (CET1) ratio stands at 14.8% against a requirement of 9%. However, the IMF noted that the SBP will have to "continue to remain vigilant and prevent possible financial stability stress as the temporary support is phased out". We view that facilities to support credit flow in the economy such as the loan deferment facility are not likely to be extended unless there is an unfortunate and serious development on the COVID front. While the impact on NPLs will be seen once the facility expires, banks' aggressive general provisioning have created ample cushion to absorb any adverse impact.

Regulatory bodies: Moreover, the IMF has highlighted the government's efforts towards "strengthening regulatory agencies' legal frameworks" such as those of NEPRA and OGRA. We view that going forward these regulatory bodies will achieve more autonomy towards tariff determination.

Fiscal: Fiscal discipline is an area that will require enhanced focus particularly through expenditure control. While tax revenue measures have been encouraging (FBR tax revenue up 6% YoY during 1HFY21), total expenditure during 1HFY21 is up 6% YoY. We view that as part of the EFF resumption, the government will control its expenditures while also continue its focus towards enhancing the tax revenue base. Fiscal consolidation is likely to be a key focus of the economic roadmap ahead for the government.

Energy Chain: Reforms in the energy chain are likely to continue. Circular debt resolution is underway. The said plan involves the first installment (40%) to be paid in February (33% cash, 33% Sukuk and 33% floater PIBs) while the remaining is expected to be paid in 6 months with same structure. Tariff hike has already been announced of PKR 1.95/KWh. We expect added focus of the government towards curtailing Transmission and Distribution (T&D) Losses while structural issues of DISCOs are likely to be addressed as well.

IMF- Extended Fund Facility (EFF)

Macroeconomic Implications

Unlocking of financial resources: Resumption of IMF Program is likely to give a boost to the confidence of all the stakeholders including multilateral institutions such as ADB, World Bank and other direct investors (interested in investing in Pakistan). Moreover, this will help Pakistan tap capital markets for issuance of Sukuks and Eurobonds at 'Terms and Conditions' favoring the country. Pakistan is already targeting Eurobonds/Sukuks worth USD 1-2bn in the coming months. Therefore, with this positive development and lower interest rate scenario, we believe Pakistan will be able to issue these instruments at rate lower than the previous issues.

Accommodative Monetary Policy to continue: Unlike the previous programs, IMF this time around has not only supported the easing monetary policy stance of the SBP but also acknowledged the measures taken by the SBP (such as shrinking policy rate to 7%, TERF, loan deferment etc.) to navigate the effects of the pandemic. We believe, SBP will continue with this accommodative strategy till the economy and aggregate demand return to pre-COVID levels. However, with inflation expected to slightly pick up in the 4QFY21, there is a room for the SBP to increase the policy rate, hence we expect SBP to increase it by 50bps in May's MPS. To recall, SBP in its January'21 MPS also hinted at a very gradual and measured monetary tightening stance when the need arises.

IMF- Extended Fund Facility (EFF)

Implications for Pakistan's Equity Market

Certainty cultivates the equity market, and with a nod from the IMF, we believe that the market will celebrate the resumption of the program. The KSE 100 index is up 7.1% during CY21TD. However we believe that strong corporate earnings growth (+18%) in 2021, lower interest rates (7.5% by end 2021), revival of the economy along with higher than expected GDP growth, stable external position supported by robust remittances and RDA inflows, and buoyant domestic liquidity will keep the momentum of market northward and we expect the index to surpass its all-time high level of 52,876, during this year. The market is currently trading at forward PE of 7.6x as compared to historic mean average PE of 8.6x. Additionally, the current market capitalization to GDP is at 18% as compared to 23% during last 5-years.

Banks: While we have seen the banking sector to be a laggard as compared to the index in recent months, we believe that the resumption of the EFF adds significant certainty to the economic outlook which should help unlock value in banking scrips. Valuations across the banking sector continue to remain at attractive levels, while ROEs are expected to creep up steadily with monetary tightening expected to initiate this year. Currently, the banking sector is trading at a P/B of 0.78x, which is a 32% discount to last 10-Yr average of 1.15xWhile lower interest rates are likely to compress NIMs and lead to lower earnings, we highlight that higher than expected recovery in credit demand, lower than expected NPL accretion, and dirt cheap valuations can fuel price performance of banking scrips. With economic activity in full swing across the country as various cyclical indicators depict a sharp V-shaped recovery, we expect credit demand to portray a significant surge going forward. Furthermore, banks have solidified their coverage ratios to build buffers to absorb any potential losses by booking substantial general provisioning. Average coverage ratios of the banking sector are currently at ~101% as at Sep'20 against ~94% as at Dec'19. Our top picks in banking sectors are HBL and MCB.

Exhibit: KSE100 Performance during IMF and Non-IMF Periods

KSE100 Performance during IMF Periods

Start		End		
Date	**Index**	**Date**	**Index**	**Return**
16-Sep-93	1,305	22-Feb-94	2,408	84.4%
22-Feb-94	2,408	4-Dec-95	1,417	-41.2%
13-Dec-95	1,422	30-Sep-97	1,850	30.1%
20-Oct-97	2,009	19-Oct-00	1,506	-25.0%
29-Nov-00	1,307	30-Sep-01	1,133	-13.3%
6-Dec-01	1,380	5-Dec-04	5,576	303.9%
24-Nov-08	9,187	30-Sep-11	11,762	28.0%
4-Sep-13	21,876	30-Sep-16	40,542	85.3%
3-Jul-19	34,897	16-Feb-21	46,868	34.3%
Average Return				**54.1%**

KSE100 Performance during Non-IMF Periods

Start		End		
Date	**Index**	**Date**	**Index**	**Return**
30-Sep-97	1,850	20-Oct-97	2,009	8.6%
19-Oct-00	1,506	29-Nov-00	1,307	-13.2%
28-Sep-01	1,133	6-Dec-01	1,380	21.8%
3-Dec-04	5,576	24-Nov-08	9,187	64.8%
30-Sep-11	11,762	4-Sep-13	21,876	86.0%
30-Sep-16	40,542	2-Jul-19	34,307	-15.4%
Average Return				**25.4%**

Source (s): PSX, AHL Research

IMF- Extended Fund Facility (EFF)

Implications for Pakistan's Equity Market

Energy Chain: With the resumption of the IMF program the energy chain companies are expected to be in the limelight as the fund's focus remains with the structural changes in the energy sector which the incumbent government has already initiated, starting with renegotiating the power purchase agreements (PPA) with the IPPs along with clearance of circular debt. Moreover, reduction in transmission and distribution losses along with increasing recoveries are the two major areas where the government needs to focus on, in addition to the structural changes in DISCOs. Our top picks within the energy chain companies include OGDC, PPL, KAPCO and PSO.

Cyclicals: Higher GDP growth and low interest rate regime will enhance the appeal for cyclical stocks including Cement, Steel, Autos and Textiles as consumer demand is expected to remain elevated. Our top picks include LUCK, DGKC, MLCF, INDU NML and ILP

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