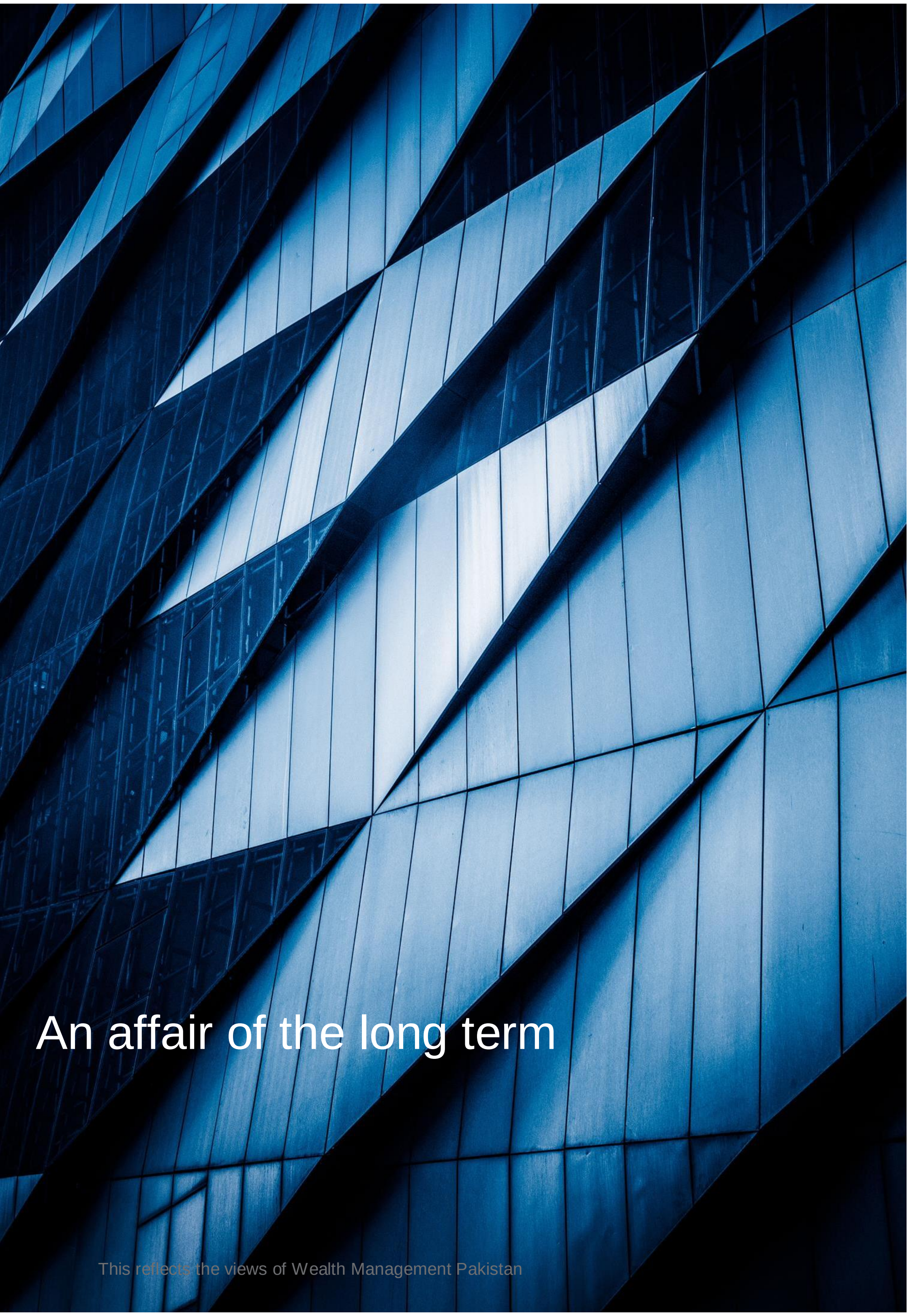
Wealth Management Advisory
Sardar Hassan Ali | 24 June 2019

Pakistan Market Outlook



An affair of the long term

State Bank hiked its policy rate 150bps to 12.25% in May. We continue our liking for short to medium tenor government bonds.

On a month on month basis, the KSE-100 index declined by 2.20% to close at 35,975 pts. Higher bond yields & slowing GDP growth make equities an affair of the long term.

Pakistan & IMF reach a staff level agreement for $6 billion. PKR likely to remain under pressure as IMF demands more market determined exchange rate.

Macro overview

An affair of the long term

- Provisional GDP growth rate is estimated at 3.3% in FY19, lowest in 9 years compared to 5.5% in FY18.
- Lackluster GDP growth can be attributed to significant fiscal and monetary tightening by the local authorities to curb aggregate demand.
- Going forward we do not rule out the risk of additional monetary tightening and further PKR adjustments under an IMF program.
- PK equities remain subdued owing to increasing interest rates and bond yields along with deceleration of economic activities, however after effects of IMF bailout and signs of improvement in macroeconomic indicators may turn out to be a catalyst for the local bourse.

Asset Classes (benchmarks)	View	Rates policy	Macro factors
2 Year bond	▲	●	●
10 Year bond	▼	●	●
KSE 100 Index	▲	●	●

Source: Standard Chartered Wealth Management Pakistan Investment Committee

Legend: ● Supportive ● Neutral ● Not Supportive ▲ Preferred ▼ Less Preferred ◆ Core

Measures for economic stabilization

After several months of negotiations the Pakistani government and the IMF team have reached a staff level agreement for $6 billion Extended Fund Facility (EFF). This agreement is subject to timely implementation of reforms and corrective measures advised by the IMF management. However we believe these IMF driven reforms and corrective measures may slow down economic growth in the near term.

The State Bank of Pakistan (SBP) raised it policy rate by 150bps to 12.25% on 20th May. So far SBP has raised 600bps since Jan 2018 & 225bps in CY 2019 alone. We believe SBP will remain on course of gradual monetary tightening until macroeconomic indicators like inflation, current account and fiscal deficit show signs of easing.

According to Pakistan's economic survey country's provisional GDP grew by 3.3% in FY19 lowest in 9 years compared to 5.8% in FY18. In the current economic environment its is most likely that Pakistan's GDP will grow modestly in FY20.

IMPLICATIONS
FOR INVESTORS

GDP growth slow down to 3.3% in FY19 from 5.8% in FY18 as authorities take measures for macroeconomic adjustments

IMF $6 billion Extended Fund Facility (EFF) arrangement is expected to support growth over the long term by reducing domestic and external imbalances

CPEC related projects and domestic demand will continue to positively drive the business sentiment and economic activities

Figure 1

Provisional GDP growth rate is estimated at 3.3% in FY19

Pakistan real GDP, manufacturing and services growth and consensus forecasts (Bloomberg consensus)

Source: Bloomberg, Standard Chartered

PTI (Movement for Justice Party) led by Imran Khan (Former cricketer) unveiled an austere budget for FY20. This budget broadly aims to ease economic pressures by tightening of monetary and fiscal policies in light of the bailout conditions set by the IMF. The government has taken various austerity measures to control country's fiscal deficit by imposing direct and indirect taxes. Big tax breaks which were handed out to individual tax payers in budget FY19 have also been reversed.

Over all Pakistan macroeconomic indicators have deteriorated in the past one year and the new government is taking measures to battle the ongoing economic crisis, as a result we expect the growth to slow down in FY20.

Bond yields increasingly attractive

The State Bank of Pakistan (SBP) its policy rate by 150bps to 12.25% last month (May). We have been arguing on possibility of rate hike in our previous publications also. Under an IMF programme the policymakers are increasingly willing to raise interest rates to ensure economic sustainability and rebuild depleted FX reserves hence we cannot rule out further monetary tightening in FY20.

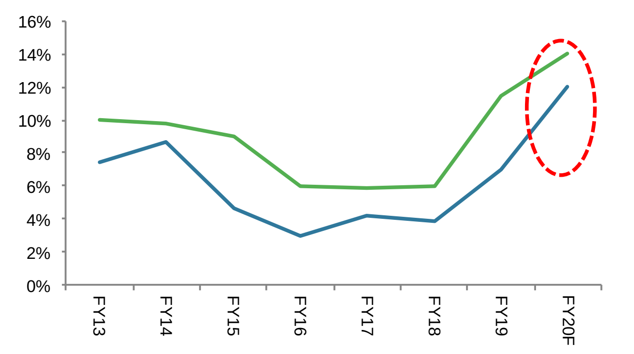
Domestic inflation has been on the rise and is anticipated to average around 7.5% in FY19 (11M-FY19 clocked in at 7.2%) and above governments target of 6%. In FY20 Inflation may continue to rise on the back of increased customs and regulatory duty on a range of imported items, rising oil prices and PKR deprecation.

We maintain our view that the pace of rising inflation and interest rates may gradually slow down in the second half of the fiscal year FY20 as policy makers engineer a soft landing for the economy. However acceleration to the pace of inflation and/or higher oil prices and widening fiscal deficit are key risks to the bond markets.

Figure 2

Inflation continues to gather pace

Pakistan CPI y/y and SBP discount rate (FY average)



Source: PBS, SBP, Bloomberg, Standard Chartered

PK Equities: attractively priced but we prefer to be cautiously bullish

On a MoM basis KSE100 Index declined by 2.2% in the month of May mainly due to PKR deprecation and expectations of increased taxation and subsidy removal in the upcoming budget FY20 suggested by the IMF.

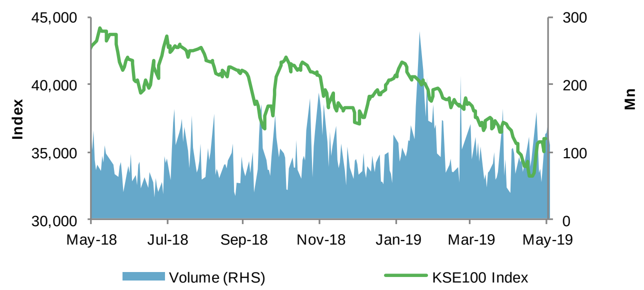
A key development which took place last month in May was government's initiative to launch a Rs.20 billion support fund to stabilise the local bourse. The fund is likely to restore investor confidence and boost trading activity.

PK equities are trading at attractive valuations fwd P/E multiple of 6.6X but slowing economic growth and austerity measures taken by the government are keeping the gains in check. However we prefer to be cautiously bullish in the current scenario and expect PK equities to perform in the long run.

Figure 3

KSE100 Index remains subdued

KSE100 index and Volume (RHS)



Source: Bloomberg, Standard Chartered

PKR- Likely to weaken further as IMF demands for greater flexibility

Pakistan's current account deficit narrowed 29% to US$12.68 billion during the first eleven months (Jul-May) of the current fiscal year of 2019 due growth in remittance inflows and contraction in imports.

Current account deficit plunged by almost fifty percent to US$1.09 billion in the month of May 2019 compared to US$2.06 billion during the corresponding period a year earlier.

Despite significant improvement in the current account deficit and PKR deprecation of 26.9% in the past 12 months, we believe that the pressure on PKR is far from over and the local currency may continue to slide as IMF demands for a more market determined exchange rate.

Disclosure appendix

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