

Economic Reality — Better than it seems

Cue the naysayers – the below numbers speak all, not myth or fiction, but pure quantifiable data. The PTI's performance contrasts favorably with both its predecessors the PML-N and the PPP, yet faces the unique situation of relentless criticism. The government has caught itself juggling different aspects, where finding the sweet spot between austerity and growth remains a key challenge. Economic uncertainty, delays in legislation and flip flops on decision making are some of PTI's biggest challenges and have manifested in an economic slowdown with demand subsiding. The country's benchmark index, a barometer of economic performance, has suffered as a consequence with the KSE-100 down 13% since Aug'18 and participation at record low levels. The key question remains whether the steps undertaken are enough or more needs to be done. We believe in the former where the worst may potentially be behind. An IMF program entry, albeit delayed, may serve as the catalyst with Budget'20 holding further sway while pace of currency and interest rate adjustments may begin to wane. From market's vantage, while near term outlook appears tricky, we believe staggered buying in lieu of pent up valuations (P/E: 7.9x, P/B: 1.19x, D/Y: 7.7%) ala a buy and hold strategy should be adopted, keeping in view a two year horizon. Our preferred plays tread towards the Banking and Energy sectors where top picks include MCB, MEBL, HUBC and OGDC.

(Detailed report to be released soon)

Comparative Economic Performance

Economic Indicators		Previous 3 months PPP Gov't		Previous 3 months PML-N Gov't		Previous 3 months PTI Gov't	
		Jan'08-Mar'08	Apr'08-Oct'08	Apr'13-Jun'13	Jul'13-Jan'14	Jun'18-Aug'18	Sep'18-Mar'19
Policy Rate - Period End	%	10.50	13.00	9.00	10.00	8.00	10.75
Headline Inflation - Avg.	%	12.40	22.40	5.59	8.80	5.63	7.10
Exports - Monthly avg.*	US\$m	1,723	1,946	2,152	2,078	2,326	2,050
Imports - Monthly avg.*	US\$m	3,249	3,390	3,409	3,519	5,569	4,326
Trade Deficit - Monthly avg.*	US\$m	1,527	1,444	1,256	1,442	3,243	2,275
CAD - Monthly avg.*	US\$m	1,212	1,399	414	334	1,607	988
CAD % of GDP - FY End	%	(8.16)	(5.55)	(1.08)	(1.28)	(6.05)	(4.40)
Fiscal Deficit % of GDP - FY End	%	7.40	5.20	8.00	5.50	6.60	6.90
SBP FX Reserves - Period End	US\$m	11,085	3,534	6,008	3,180	9,885	10,492
PKR/USD - Period End	PKR/US\$	62.75	80.59	98.69	105.49	124.05	138.46
Currency Devaluation	%	1.70	28.40	1.20	6.90	7.40	11.60
REER — Period End	Index	99.5	95.8	103.6	100.2	109.1	98.7

* Based on 6 months data

Source: Bloomberg, PBS, SBP, MoF & AKD Research

.. **So how did we get here?** One word – Dar-o-nomics! Encouraging consumption via external funding while keeping the PKR artificially overvalued was always a recipe for disaster and that is exactly what transpired in Pakistan. The country's REER peaked at 126 in May'17 while development spending failed to account for expenditure overruns with the country registering FY18 primary and fiscal deficits at 2.2% and 6.6% of GDP, respectively. Artificially maintaining the exchange rate resulted in monumental trade (9.9% of GDP) and CA (6.05% of GDP) deficits, contrasting unfavorably with PML-N inherited figures of CAD at 1.1% and trade deficit at 6.6% of GDP in FY13.

What have we done thus far? Better sense in the latter part of PML-N tenure as well as subsequent governments (Caretaker; PTI) resulted in devaluation of PKR, bringing it close to equilibrium. At the same time, with a view to contain primary deficit and sapping demand pressures, the SBP has already raised interest rates by a cumulative 500bps since Jan'18. Pressures on the external front have been allayed via diplomatic success with friendly countries – Saudi Arabia and UAE have provided cumulative US\$5bn thus far with a further US\$1bn expected this month while China has provided US\$4.2 (BOP support + GoP loan). Simultaneously, Pakistan has kept itself engaged with the IMF where we believe an agreement to this end will likely be reached before Budget'20.

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Where do we go from here? With majority of the painful decisions already undertaken (gas & electricity tariff increases, monetary tightening, currency devaluation), we believe the situation has likely entered its trough phase where tapering pace of corrective measures will lend further credence to our thesis. That said, conditionalities of the IMF program remain a key check point while from market's vantage, resolution of the FATF issue and Budget'20 will hold sway over future course. With market P/E at 7.9x and D/Y of 7.7%, cherry picking remains the order of the day with focus on scrips offering below median valuations.

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Buy	> 19% expected total return (Rf: 13% + Rp: 6%)
Neutral	> 13% to < 19% expected total return
Sell	< 13% expected total return (Rf: 13%)

Old Rating Definitions (Discontinued)

Buy	> 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	< 5% to > -5% potential
Reduce	< -5% to > -20% downside potential
Sell	< -20% downside potential
Not Rated	No investment opinion or recommendation

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To arrive at our period end target prices, AKDS uses different valuation techniques including:

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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