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PAKISTAN ECONOMY

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MARKET VISTA

IMF Negotiations— Searching for common ground

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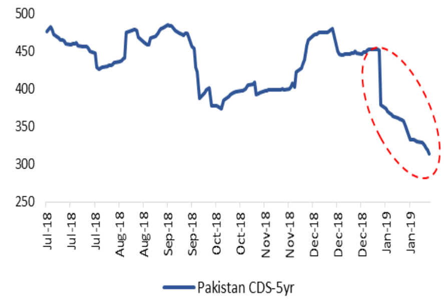
- **Recent headlines suggest that the GoP and the IMF have reached a broad level consensus with regards to potential bailout package amounting to US$6bn. The final agreement however is expected to be inked by Apr'19, with flows likely to materialize Jun'19 onwards.**
- **The said development is broadly positive with additional spillovers for building confidence, with critical implications on unlocking funding flows from other multilateral agencies, where adherence to IMF imposed structural benchmarks raises creditworthiness.**
- **While we await details of any finalized agreement, initial policy focus would be on the fiscal side, in our view, with other macro adjustments including further tightening and market based currency depreciation complementing the adjustment process.**
- **Initial market reaction is observed to be mixed given the statement of commitment from the IMF is tempered with hints of 'do more'. Eyeing continued interest rate up-cycle, we stick to our preference for the Banking sector where top picks include UBL and MCB.**
- **Sectors including E&Ps, Textiles, and Power that favorably play on macro-theme of consolidation are also part of our preference list, with particular liking for NML, HUBC, and OGDC.**

Knocking on IMF's door: Recent news headlines suggest that the GoP and the IMF have reached broad level consensus with regards to potential bailout package amounting to US$6bn. This followed the highest level engagement between the both sides, where PM Imran Khan met with IMF Chief Christine Lagarde, reiterating continued engagement over the reform package. The final agreement however is expected to be inked by Apr'19, with flows likely to materialize Jun'19 onwards. The said development holds broader positive implications for the economy and the market in general, as entry into IMF program would restore the broader confidence. This is also reflected in improved country's risk perception as evident from CDS movement (see chart on rhs) over the past few weeks, ensuing positive developments w.r.t engagement. The entry into program would also unlock other funding sources including the multilateral lending agencies, where disbursements have so far remained well below the expectations (~23% of the total budgeted).

Country's risk perception improves as negotiations enter final stage



Source: Bloomberg & AKD Research

Policy focus: While we await details of any finalized agreement, initial policy focus (and possible contention) would be on the fiscal side, in our view, considering the fiscal side of equation remains largely unaddressed (we expect fiscal deficit to clock in at 6.3% of GDP in FY19 vs. 6.6% of GDP in FY18). Upcoming budget would be key checkpoint in this regard. Macro adjustments including the monetary tightening and market based exchange rate movements would continue in line with the IMF's prescription, where we expect the central bank to further raise interest rate by 125bps in CY19. From structural standpoint, deep rooted reforms in PSEs, further autonomy to the SBP, and concrete plan to address energy sector issues (i.e. circular debt) are likely to be part of upcoming assistance package from the IMF.

Investment Perspective : Initial market reaction is likely to be mixed given statement of commitment from the IMF is tempered with hints of 'do more'. With stringent fiscal measures likely the key sticking point, we believe an imminent demand slowdown may play heavy on sectoral performances where cyclicals are likely to bear the brunt. That said, eyeing continued interest rate upcycle, we stick to our preference for the Banking sector where top picks include UBL and MCB. Impacts of currency devaluation are also likely to be witnessed in upcoming quarters where we like currency sensitive plays including Power (HUBC), Textiles (NML and NCL) and E&Ps (OGDC, PPL).

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Neutral	**< 5% to > -5% potential**
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Sell	**< -20% downside potential**
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