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PAKISTAN STRATEGY

REP-019
MARKET VISTA

Brexit two years on - still calm & carrying on

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- **With an increasing likelihood of a 'hard' or 'no-deal' Brexit on the cards, we present possible implications on exports of key domestic segments, underpinned by the GSP+ arrangement under which we secure concessionary export terms (tariff concessions, mostly 0% on imports) to the world's largest trading bloc**
- **Additionally we look at possible repercussions on Pakistan's growth cap (scheme allows maximum export growth of 14.5% p.a.) where UK's exit could inhibit growth in textile (particularly apparel) and food commodity exports to the EU (export growth now limited to remaining EU countries)**
- **Lastly we look at UK's role in Pakistan's remittance mix, where its rising share has been a factor of declines witnessed in MENA sourced inbound remittances, where clear risks from a cliff-edge or hard Brexit remain (no-deal or without modified withdrawal agreement, pulling UK economy into a general slowdown)**
- **While Governments on all sides of the English Channel are faced with stark choices, we opine that trading arrangements with Pakistan and the UK are likely to remain stable, with possible tailwinds arising under a UK approved GSP or liberal MFN regime**

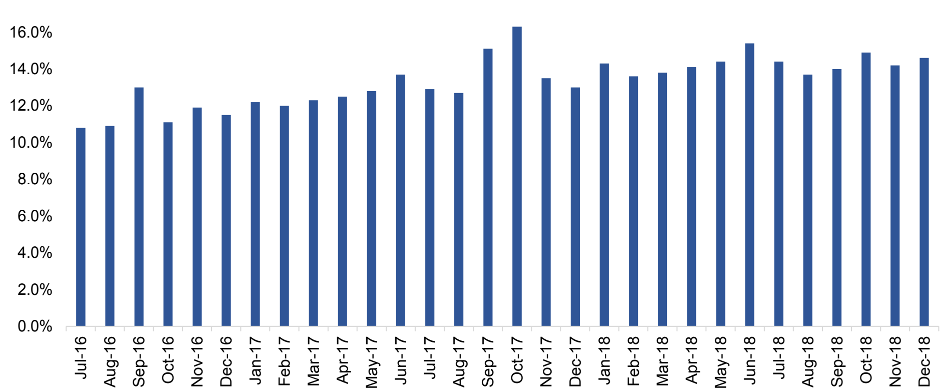
Pakistan could gain in the UK from Brexit: The recent unfolding of events relating to UK's Brexit deal could bring about economic fickleness where the Government weighs possible options varying from, second referendum on Brexit, PM presenting Plan B for Brexit deal or in extreme circumstances 'no deal'. Though much is dependent on the final 'chosen path', Pakistan's exports to UK (accounting for 7.3% of Pakistan's total exports) could face slow down at least in the short to medium run as the country and its currency wobbles with new realities. In the long run, in case of a Brexit (either with deal or no deal), Pakistan could gain increased penetration in the market where UK has indicated GSP+ like incentives for Pakistan. To highlight, 4y CAGR for Pakistan's top 10 exports to UK stands at around 11.1% vs. 10.0% to the rest of the world indicating higher acceptability of Pakistan's products particularly in home segment and Rice (not covered in GSP+). To recall, GSP+ is additional import facilitation agreement (applicable on 9 vulnerable economies) to support sustainable development (terms of arrangement tied to bi-annual review by EU Parliament), and set to expire by 2023. Export potential is also visible where share of top 10 products stands negligible in total UK imports (other than in certain men's garment category (~12%) and bed sheet category (~9%)). Amongst the major listed players, Nishat Mills (NML), Nishat Chunian (NCL) and Gul Ahmed (GATM) have 28.1%, 13.0% and 37.2% exposure in the European markets, respectively.

Top 10 exports by type to UK FY14-18 CAGRs

Code		UK	All countries
620322	Men/Boy clothing not knitted	53.40%	76.00%
630239	Bedlinen of flax or ramie	20.40%	24.60%
610590	Men/Boy clothing knitted	6.40%	9.30%
630260	Towels Mill-made	6.10%	2.10%
100630	Rice Basmati	6.50%	-4.80%
630239	Bedlinen of silk	6.70%	-1.00%
630210	Bedlinen of cotton	-0.80%	4.50%
610349	Men/Boy clothing knitted (Exc. wool etc)	21.90%	21.10%
611090	Jerseys etc.	22.60%	23.30%
620342	Men/Boy clothing knitted (cotton)	-15.10%	-10.20%

Source: PBS & AKD Research

Britain's share in total monthly in-bound remittances



Source: SBP & AKD Research

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GSP+ quotas when the UK leaves: GSP Plus limits the annual growth in textiles at 14.5% where, as per data provided by ITC, for some categories like 'Articles of apparel and clothing accessories, knitted or crocheted' (HS61) the pre-Brexit scenario shows a comfortable Average growth rate of ~14.5% from 2015-17, however, if we exclude the imports of UK from EU's imports from Pakistan, the average growth rate increases to ~21.4%. Therefore, we opine a slowdown in exports' growth rate if the Brexit happens while the same can be same for the reason why, despite the rupee depreciation, we have not seen a pickup in Pakistan's textile exports.

Remittances remain a sticking point: The share from remittances from UK has been on the rising trend since 2HFY17 (Dec'18: 14.6% vs. 11.5% in 1HFY17) taking over fall in remittances from the middle-eastern countries, where a large Pakistani diaspora remit funds back home. However, we do not rule out potential slowdown in remittances from the region as possible economic slowdown begins to hurt local population where our remittances forecast for FY19/20F stands at US$20.8/22.0bn. Additionally a falling GBP relative to international pairs (GBP/US$ depreciation of 5.6%in CY18), has factored into dampened moves against the PkR as well (GBP/EUR/USD vs. PkR appreciated 25.7/20.1/18.7% in CY18), slowing currency translation effect. As such, we might see CAD (FY19/20F: US$14.0/10.1bn) additionally stubbed from events in the EU region altogether.

Outlook: Based on political developments, accompanied by statements from key leaders in the EU member states and the UK, we believe a hard-Brexit without a modified withdrawal agreement is highly unlikely. Additionally possible options available for UK policy makers to continue liberal trading regimes include a UK GSP regime (indicated by UK PM's envoy to Pakistan on Sept'18) or liberal MFN based regimes (under WTO guidelines), both of which could have varying impact. Recalling trade arrangements with the EU (and UK) before the GSP+ status, about 75 tariff lines (including rice, surgical instruments, spices) were falling under Special Autonomous Trade Preference Scheme (similar to MFN) and were entitled to concessionary tariffs. A similar arrangement would likely be carved out between the UK and Pakistan, where 0% duties on specific tariff lines, could give an edge to Pakistan's textile exports when competing with non-GSP+ countries (Vietnam, China, India), not in the running for concessionary terms in a post Brexit UK.

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Not Rated	**No investment opinion or recommendation**

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