AKD Daily

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Today's Daily

Pakistan Economy: CAD sequentially improved; challenges remain

Current account deficit for Dec'17 recorded at US$1.13bn, lower than US$1.41 for Nov'17 (vs. US$1.352bn in Dec'16) on the back of: 1) healthy remittances flow for the month (US$1.723bn in Dec'17, up 9.3%MoM) and 2) improvement in trade deficit (US$2.68bn, down 4.0%MoM). However, cumulatively current account marks a deficit of US$7.41bn in 1HFY18, up by 59.1%YoY reflecting an expanding trade deficit (+24.2%YoY) where higher imports (particularly oil and machinery) outpaced relatively lower recovery in exports. On the positive side, foreign investments dynamics have been encouraging so far, with Net FDI standing at US$1.38bn (ex.acquisition of EFOOD's in Dec'16, cumulative FDI is up 44%YoY), while relief has also come from recent issuance of Eurobond (US$1.5bn) and Sukuk (US$1.0bn) in Dec'17 taking total net investment flows to US$3.621bn in 1HFY18. Going forward, current account weakness is expected to continue where we estimate CAD to clock in at ~US$15.627bn (4.9% of GDP) in FY18F underpinned by: 1) weak trade outlook (FY18F trade deficit: 13.7% YoY) and 2) plateaued remittance flows.

KSE100 - Index

Current	44,178.83
Previous	43,580.88
Chg.	1.37%

Mkt Cap. (PkRbn/US$bn)

Current	9,093 / 82.27
Previous	8,988 / 81.32
Chg.	1.17%

Daily Turnover (mn)

Current	209.47
Previous	268.46
Chg.	-22.0%

Value Traded (PkRmn/US$mn)

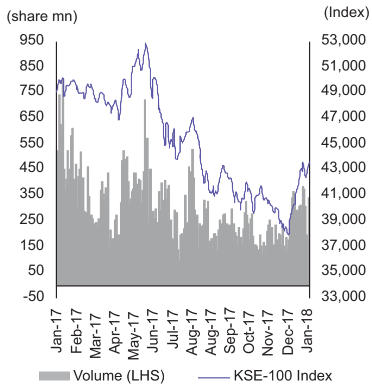
Current	10,748 / 97.24
Previous	13,670 / 123.68
Chg.	-21.4%

News and Views

- In its quarterly report on the state of the economy, the State Bank of Pakistan (SBP) said that prospects for economic growth remain strong and the economy is poised to achieve the FY18 growth target of 6%. The central bank's report also highlighted the emerging risks on external front (CAD: +59%YoY in 1HFY18), hinting the said risks could restrict economic growth phenomenon.

- The government has hinted at lowering tax rates on the import of Liquefied Natural Gas (LNG) and its equipment, a move aimed at addressing concerns of the private sector about inconsistencies in tax policies. LNG importers are seeking reduction of the withholding tax rates from 5.5% to 1%, bringing it at par with the rates being charged to the public sector.

- As per recent data released by PBS, the large-scale manufacturing (LSM) sector posted a negative growth of 2.02%YoY in Nov'17 after rising for a few successive months. However on a cumulative basis, LSM production during 5MFY18 stood 7.19%YoY higher.



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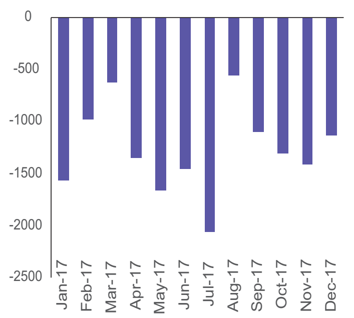
Current Account deficit (US$mn)



Source: SBP & AKD Research

Deficit lower for the month: Posting slight recovery, CAD stood at US$1.13bn in Dec'17 vs US$1.44bn in the preceding month, down 21.6%MoM/16.4%YoY. The recovery is primarily on the back of uptick in remittances (up 9.3%MoM/8.7%YoY to US$1.732bn in Dec'17) alongwith improvement in trade deficit standing at US$2.676bn (down by 4.0%MoM/5.4%YoY). Regarding the latter, trade activity witnessed a slowdown where both exports and imports of goods slumped by 7.2%MoM/5.5%MoM respectively. For imports, the dip is attributable to petroleum/machinery/food groups which went down by 10%/8%/16% MoM on account of recent imposition of RD and closure of FO based power plants, while decrease in textile exports (down 6.4%MoM), adversely affected overall exports. However, cumulatively the current account situation has worsened significantly in 1HFY18 with the deficit increasing to US$7.413bn (4.4% of GDP) vs US$4.660 in 1HFY17 (3.1% of GDP), up 59.1%YoY. Rising trade deficit continues to be the major drain where higher oil prices (avg. Arablight at US$55/bbl up by 21% YoY in 2HFY18) together with uptick in machinery imports (up 19.1%YoY) primarily comprising of power generating machinery, pushed imports to US$26.094bn (up 18.8%YoY). On the other hand, while exports recovered (+10.8%YoY to US$11.776bn) benefitting from the incentive package, it still fell short of the growth in imports.

Trade Deficit (US$mn)

Source: SBP & AKD Research

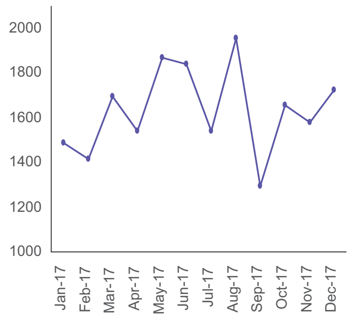
Remittances - a minor relief: Remittances for Dec'17 recovered sharply from the last month, recording at US$1.723bn (up 8.72%MoM/9.3%YoY) on account of robust growth in flows from GCC states (up 6.7%YoY). Cumulatively, remittances for the 1HFY18 amount to US$9.744bn

(US$9.505bn in 1HFY17), growing nominally by 2.5%YoY, where decline from GCC states (labor market challenges) was offset by flows from UK. That said, the recent imposition of VAT by GCC states from Jan'18 can keep remittances under pressure (contribution from GCC at 60%).

Foreign investments supporting the current account: Net FDI flows for the month stood at US$197.4mn taking the cumulative net inflows during 1HFY18 to US$1.38bn vs US$1.42bn during 1HFY17 (down 2.8%YoY). However, this is on the back of one-time investment flow of US$462.3mn from EFOOD's acquisition in Dec'16 where ex-EFOODS investment, net FDI cumulatively grew by 44% YoY. This growth is reflective of hefty inflows in power sector (standing at US$535.3mn/US$339.2mn in 1HFY18/1HFY17) and uptick in construction investments (~4.2x higher at US$349.8mn) with GoP considering fast track completion of infrastructure projects before elections 2018. On the other hand cumulatively, net portfolio investments strengthened to US$2.244bn reflecting the issuance of US$1.5bn Eurodollar bond and US$1.0bn in Sukuk in Dec'17. Meanwhile, portfolio investment in equities persisted its trend with a net outflow of US$124mn during 1HFY18.

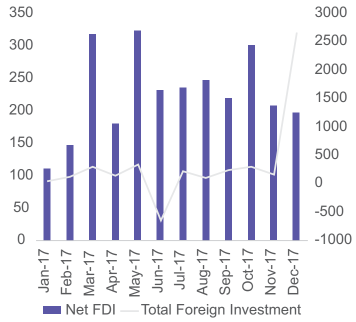
BOP outlook: We expect current account weakness to persist during the year (FY18F: 4.9% of GDP, clocking in at ~US$15.63bn) on the back of: 1) recovery in oil prices (we assume Arablight to avg. at US$57/bbl in FY18F), 2) higher machinery and development related imports and 3) plateaued remittances (FY18F growth of 1%YoY). While total exports are expected to post a growth of ~9% on the back of currency devaluation and the textile incentive package, the growth is expected to fall short of growth in imports (FY18F import growth of 11.5%YoY). In this backdrop, we expect FX reserves to come down significantly by Jun'18 (SBP reserves at ~US$10.855bn) along with additional debt servicing estimated at ~US$3.742bn during 2HFY18F. That said, positive surprises could emanate from: 1) anticipated tax amnesty scheme on offshore assets (though previously such schemes met with little success), 2) bailout grant from Saudi Arabia (akin to 2014 when US$1.5bn was received), 3) additional issuance of Eurodollar bonds, and 4) currency swap arrangement for financing bilateral trade (akin to similar agreements with China and Turkey in FY12) can reduce reliance on third party currency (USD in our case).

Remittances (US$mn)



Source: SBP & AKD Research

Foreign Investment (US$mn)



Source: SBP & AKD Research

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