AKD Daily

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Today's Daily

Pakistan Economy: IMF report highlights risks

Following from the annual article IV consultation earlier in Apr'17, the IMF issued its review report on Pakistan stressing on management of emerging macro risks to realize expected benefits of CPEC initiatives. While significant macro consolidation was witnessed under the 3yr EFF program, emergent risks are reflected in external a/c deterioration (11MFY17 CAD up 132%YoY), lower fx reserves (down US$1.75bn CYTD) and circular debt accumulation (up PkR53bn in 1HFY17). While the report remains optimistic on growth prospects (FY18 GDP growth estimated 5.5%, similar to our estimate) on energy and infrastructural development, these initiatives are expected to be accompanied with significant build up in BoP vulnerabilities due to considerable dependence on foreign investment and imports. In this regard, related foreign outflows are estimated to reach US$3.5-4.5bn annually by FY25. Counter measures have been advised through greater exchange rate flexibility (REER 10-20% overvalued) and continued reforms in the energy sector. Largely agreeing with the IMF's view, we expect sharp deterioration in external a/c liquidity, projecting FY18F CAD at 4.5% of GDP and 4.9% depreciation in the PkR/US$ parity.

KSE100 - Index

Current	43,783.55
Previous	43,792.19
Chg.	-0.02%

Mkt Cap. (PkRbn/US$bn)

Current	9,025 / 85.69
Previous	9,035 / 85.79
Chg.	-0.11%

Daily Turnover (mn)

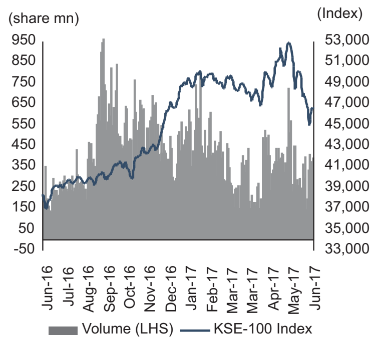
Current	125.52
Previous	215.17
Chg.	-41.7%

Value Traded (PkRmn/US$mn)

Current	7,299 / 69.30
Previous	12,604 / 119.67
Chg.	-42.1%

News and Views

- Pakistan has asked China to remove non-tariff barriers (NTBs) and create demand for its goods to multi-billion dollar China-Pakistan Economic Corridor (CPEC) equally successful for the two countries.
- Pakistan's foreign exchange reserves inched up to US$21.15bn (+0.37%WoW) during the week ended Jul 07'17, where SBP reserves rose US$54mn to stand at US$16.197bn, while commercial banks reserves increased by US$26mn to US$5.250bn.
- After the reconciliation with Accountant General of Pakistan Revenues (AGPR), country's fiscal deficit is expected to turn up 5% of GDP against the desired target of 4.3% for the FY17. FBR's tax collection during the FY17 stands at PkR3,372bn



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CPEC - saving grace: Projecting 5.5% GDP growth in FY18, the IMF's outlook on Pakistan's growth potential remains positive - though primarily formed by planned energy and infrastructure projects under the umbrella of CPEC. In this regard, the Fund has estimated value addition of US$13bn to the country's GDP over next 7yrs from 28 CPEC and non-CPEC energy projects. Further, indirect benefits are expected in the form of improved energy availability with likely reduction in power deficit (Fund sees a minimal surplus in 2018) and low-cost electricity. However, the optimism is accompanied with caution where the planned projects will create risks against macro stability including worsening external liquidity, lack of reforms and poor fiscal management.

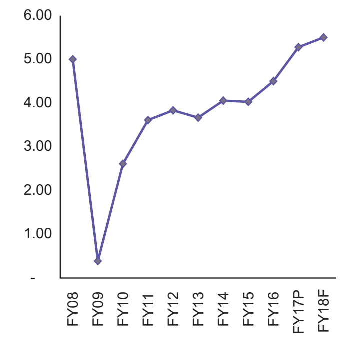
External account risks prominent: IMF has pointed out acceleration in foreign outflows associated with investments in energy projects taking the form of higher imports, debt repayment and repatriation with estimated annual outflows reaching US$3.5-4.5bn by FY25. These additional outflows are projected to increase external financing needs to ~7.5% of GDP over the medium term, compared to ~6% currently. BoP concerns are also prominent over the short term where imports have already risen sharply (+16.7%YoY in 11MFY17) taking CAD to its highest levels since FY09. In the context of underlying weakness in the external sector, the Fund has stressed greater flexibility in the currency, rather than ad-hoc measures to promote exports where the PkR REER is estimated to be overvalued in the range of 10-20%. This in our view, creates room for increased vulnerabilities to external shocks with the recent episodic dip in the PkR/US$

Major Economic Indicators

	FY17	FY18 Projection		
		GoP	IMF	AKD
GDP Growth Rate (%)	5.3	6.0	5.5	5.5
Fiscal Deficit (% of GDP)	4.2	4.1	4.2	4.9
CPI Inflation (%YoY)	2.9	6.0	5.0	5.1

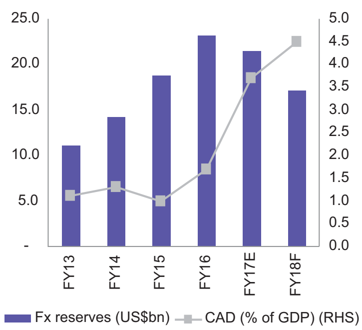
Source: MoF,IMF & AKD Research

GDP Growth trend (%)



Source: MoF & AKD Research

CAD vs. Reserves



Source: SBP & AKD Research

parity (3% depreciation to PkR108.1/US$) reflecting underlying BoP weakness. The fund however expects SBP fx reserves at US$18.9bn in FY18, which remains optimistic than our estimate of US$17-17.5bn, reflecting expectations of a wider CA deficit. Key risks linger in the form of higher oil prices, lack of recovery in the exports sector and low support from remittances.

Structural Reforms for stability: The report also draws attention to sluggish progress on the reforms front where the need to address re-accumulation of circular debt (stock at PkR709bn at end of CY16) is considerably stressed. Other recommended measures included for power and gas tariff rationalization, restructuring of PSEs (particularly DISCOs) and improving collections to allow greater benefits from planned energy generation additions.

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