AKD Daily

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Today's Daily

Pak Economy: External financing pressures come to the fore

IMF in its recent PPM report highlighted risks to Pakistan's debt sustainability in medium-term and capacity to mobilize additional financing at favorable rates (on account of rising global interest rates). In this regard, the fund projects gross financing needs at US$24.5bn for FY18F (7.5% of GDP) with external debt to reach US$93.3bn by Jun'18 (28.5% of GDP vs 27.3% in FY17), primarily on the back of: 1) rising CAD projected at US$15.7bn in FY18F (4.8% of GDP) driven by CPEC related outflows, 2) increasing external debt servicing at US$6.3bn (26.2% of exports vs 30.2/22.2% in FY17/16) and 3) declining FX reserves despite borrowing from the international markets. Additionally, IMF estimates gross FX reserves at US$12.1bn (2.7x import cover) by Jun'18 against SBP target of US$12.5bn. However, based on Assessing Reserves Adequacy matric (ARA EM), Pakistan's total liquid reserves stand at 50% of ARA vs. IMF's benchmark of 100-150% signifying reserves' inability to provide adequate capacity for the country to respond to adverse economic shocks. On the other hand however, the market implied risk-neutral sovereign probability of default stands quite low at ~6.5% (CDS spread at 342bps vs avg. spread of 1100bps in CY11 when debt to GDP stood at 30%). Going forward, with declining FX reserves we believe capacity to maintain US$/PkR parity remains limited where using time-series econometric analysis we forecast currency to depreciate by 7% by end CY18.

KSE100 - Index

Current	43,363.21
Previous	43,495.07
Chg.	-0.30%

Mkt Cap. (PkRbn/US$bn)

Current	9,065 / 81.98
Previous	9,091 / 82.22
Chg.	-0.29%

Daily Turnover (mn)

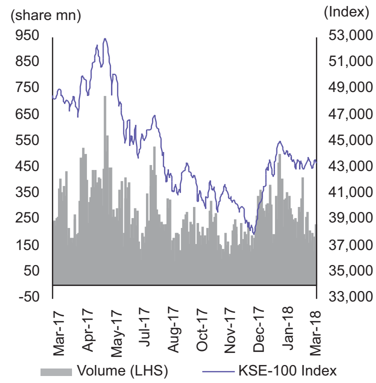
Current	193.40
Previous	220.44
Chg.	-12.3%

Value Traded (PkRmn/US$mn)

Current	6,700 / 60.59
Previous	5,733 / 51.85
Chg.	16.9%

News and Views

- The gov't is reportedly in contact with friendly countries to raise US$2/US$3bn to meet international obligations. In this regard, initially two friendly countries have been contacted and the response was optimistic. As per the arrangement being negotiated with a friendly country, a trusted friend of Pakistan has assured of depositing about US$2bn in its account as safe deposit as was done in 2000.
- The gov't is planning to withdraw certain regulatory duties on the import of items under SRO # 1035(1)/2017 issued by the Federal Board of Revenue (FBR) on the recommendations of the stakeholders and review committee.
- As per latest PBS data, large scale manufacturing (LSM) sector in Jan'18 registered a robust 9.44%YoY growth on the back of increasing cement and steel consumption along with rising auto sale.
- As per latest data reported by SBP, net foreign direct investment (FDI) in Feb'18 has increased to US$340.8mn (+132%YoY). Cumulatively, net FDI during 8MFY18 rose 15.6%YoY to US$1.94bn.



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Debt sustainability at risk: IMF highlighted Pakistan debt sustainability as a key macroeconomic challenge on: 1) rising CAD projected at US$15.7bn in FY18F (4.8% of GDP) driven by CPEC related outflows, 2) increasing external debt servicing at US$6.3bn in FY18F (26.2% of exports vs 30.2%/22.2 in FY17/16), and 3) declining FX reserves despite borrowing from the international markets. In this backdrop, the fund estimates gross external financing need for FY18F at US$24.5bn (7.5% of GDP) and external debt to reach US$93.3bn (28.5% of GDP) by Jun'18. With these estimates, IMF expects SBP FX reserves to reach US$12.1bn (2.7x import cover) against the SBP target of maintaining reserves at US$12.5bn. In this regard we expect gross external financing to stand at US$21.2bn given CAD estimate of US$15.7bn (in line with the IMF) and total external debt servicing US$6.4bn (with remaining debt serving of US$3.7bn in 2HFY18). Moreover, subject to timely materialization of foreign inflows estimated at ~US$11.8bn, SBP FX reserves are expected to clock at US$10.9bn (2.4x of import cover).

Reserves adequacy matric: IMF employs ARR EM matric in order to estimate the level of reserves to provide adequate capacity for the country to respond to adverse economic shocks and prevent disorderly market

AKD External Flows Projection (US$bn)

	FY17A	1HFY18	FY18F
Debt Repayments	(6.54)	(2.64)	(6.35)
Interest Payments	(1.62)	(0.99)	(1.86)
Current Account	(12.10)	(7.67)	(15.73)
Foreign Investment	2.16	1.38	2.70
External Financing	**(18.10)**	**(9.92)**	**(21.24)**
Eurobond/Sukuk	1.00	2.50	2.50
Multilateral/Bilateral	2.97	1.63	3.50
IMF	0.10	-	-
Commercial loans	4.37	1.25	4.00
Private sector external	4.17	1.13	3.80
China	1.59	0.54	1.60
Debt Inflows	**14.21**	**7.05**	**15.40**

Source: EAD, SBP, AKD Research

IMF ARA EM Matric

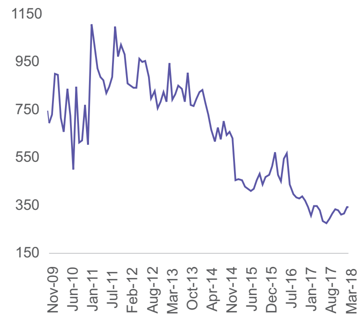
	Reserves/ARA Matric
Pakistan	50%
India*	156%
Indonesia*	140%
Malaysia*	90%
Thailand*	170%
Turkey*	271%

* These are IMF estimates for 2017
Source: IMF & AKD Research

conditions under economic distress making use of: 1) short term external debt, 2) other external liabilities, 3) broad money and 4) exports earnings. Under this methodology, Pakistan's total liquid reserves stand at 50% of ARA vs. IMF's benchmark of 100-150% signifying reserves' inability to limit the risk of market dysfunction from shortage of FX currency. That said, market implied risk neutral sovereign probability of defaults remains quite low at ~6.5% estimated from CDS spread standing at 342bps (vs avg. spread of 1100bps in CY11 when debt to GDP stood at 30%).

Outlook: Going forward, IMF highlights vulnerability of external debt sustainability to current account and exchange rate shocks. Moreover, mobilization of additional external financing at favorable rates remains challenging, in the backdrop of rising international interest rates. On the other hand, with declining FX reserves, we believe the capacity of SBP to maintain US$/PkR parity remains limited. In this regard, using time-series econometric analysis accounting for key drivers including: 1) FX reserves, 2) inflation differential and 3) interest rates, we estimate US$/PkR parity to depreciate by 7% by the end CY18.

CDS spreads remain relatively low (bps)



Source: Bloomberg & AKD Research

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