Today's Daily

AKD Daily

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Pakistan ECONOMY: IMF or no IMF, that is the question

Escalated CAD along with hefty debt repayments have led to an inflated gross external financing gap (US$20.42bn in FY18) as insufficient external inflows (US$14.35bn loans in FY18) pulled SBP FX reserves to US$9.79bn (down US$6.34bn during FY18). Looking ahead, a heightened CAD (US$17.8bn in FY19F) with additional drags from upcoming redemption of Eurobond and commercial borrowing repayments are likely to push gross external financing to US$22.44bn in FY19. In this regard, inadequate external inflows estimated at US$13.45bn (ex. bailout financing) should translate into a net shortfall of ~US$8.84bn by FY19-end (ex of budgeted short term loans & Eurobond net financing gap stands at US$15.34bn) which would strain FX reserves to unsustainable levels. Moreover, for recent policy makers, the path to possible remedies for the prevailing BoP shortfall include: i) approaching international debt market, ii) investments from non-residential Pakistanis, iii) Chinese bailout, iv) 'gifts' from friendly countries, and v) eventual IMF financing facility. With each mode of financing carrying inherent benefits and associated risks, in our view GoP hands are tied to another IMF financing facility along with accompanying caveats (with the sole purpose of improving on external vulnerabilities). While under an IMF facility, GoP could likely tap in other external avenues (bilateral facilities) as well as fetch better yields in international debt market to create a blend of financing to fill the external gap.

KSE100 - Index

Current	41,753.89
Previous	41,581.96
Chg.	0.41%

Mkt Cap. (PkRbn/US$bn)

Current	8,688 / 69.93
Previous	8,647 / 69.60
Chg.	0.48%

Daily Turnover (mn)

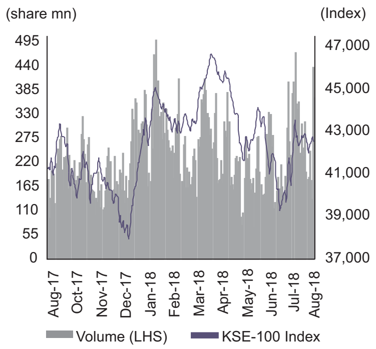
Current	126.57
Previous	159.21
Chg.	-20.5%

Value Traded (PkRmn/US$mn)

Current	4,097 / 32.98
Previous	5,239 / 42.17
Chg.	-21.8%

News and Views

- US Secretary of State Mike Pompeo and chairman of the Joint Chiefs of Staff General Joseph Dunford will arrive today (Wednesday) to hold crucial talks on Trump administration's 'term of engagement' with the new government.
- Textile division identified three pressing export impediments, including pending liabilities of PkR115bn with the Federal Board of Revenue (FBR), cost/ease of doing business and the levy of custom duty on import of cotton for failing to achieve targets.
- PM Imran Khan on Tuesday gave a go-ahead for increasing natural gas rates by an average of 46% (prescribed prices) as determined by the Oil and Gas Regulatory Authority (Ogra) in June and ordered steps to control annual gas theft of PkR50bn. A summary will be taken up with the ECC for approval before the issuance of a formal notification of the consumer-end gas price with the endorsement of the federal cabinet.



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External Flows Projection (US$bn)

	FY15A	FY16A	FY17A	FY18F	FY19F	FY20F
Debt Repayments	(4.17)	(3.71)	(6.52)	(5.19)	(7.45)	(8.62)
Current Account	(2.80)	(4.87)	(12.62)	(18.13)	(17.84)	(13.44)
of which: Interest Payments	(1.17)	(1.34)	(1.62)	(2.29)	(2.69)	(3.02)
Foreign Investment	1.91	1.99	2.22	2.53	2.70	3.70
Capital Account	0.38	0.27	0.38	0.38	0.30	0.35
External Financing	(4.68)	(6.32)	(16.55)	(20.42)	(22.29)	(18.01)
Eurobond/Sukuk	1.00	0.50	1.00	2.50	2.50	-
Paris Club	0.15	0.14	0.19	0.12	0.20	0.30
Multilateral/Bilateral	2.82	3.74	2.97	2.77	3.21	4.00
IMF	1.95	2.01	0.10	-	-	-
Commercial loans	0.15	1.38	4.37	3.72	4.00	-
Private sector external	1.01	2.39	4.14	3.44	2.50	2.00
China	1.16	0.96	1.59	1.81	1.04	2.00
Debt Inflows	8.24	11.12	14.36	14.35	13.45	8.30

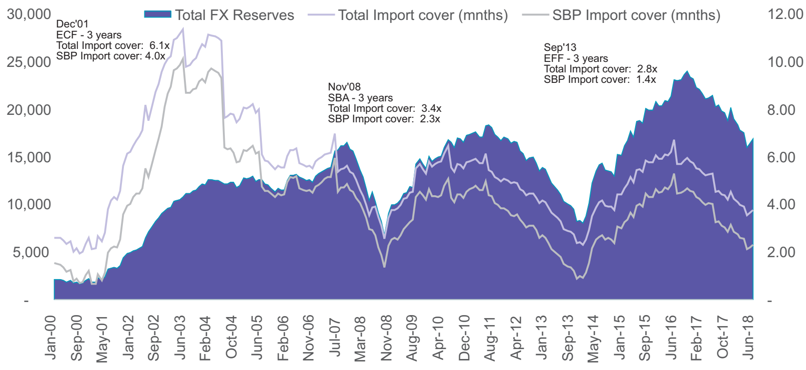
Source: EAD, SBP, AKD Research

FY18 External Financing: Mapping out the country's BoP reveals a growing gross external financing gap standing at US$20.42bn in FY18 (vs. US$16.55bn in FY17) where key factors were: i) escalating current account deficit (US$18.13bn in FY18 - up 44%YoY) - primarily a function of the widening trade deficit and ii) hefty debt repayments of US$5.18bn, where stagnant foreign direct investment (US$2.77bn) provided no relief. Additionally, with total external loan inflows of US$14.35bn (including

US$2.5bn raised through Eurodollar/Sukuk and US$3.72bn in commercial borrowing), the net financing gap stood at ~US$6.34bn, filled through SBP's FX reserves (at US$9.79bn by Jun'18 implying import cover of 2.2 months). Consequently, with sharp drawdowns in FX reserves the SBP let currency parity slip 13.7% in FY18 (along with the failed intent of restoring CAD dynamics).

Bailout remains inevitable: Elevated CAD (US$17.8bn in FY19F - 5.5% of GDP) along with sizable debt repayments (including US$1bn Eurodollar bond and US$379mn to IMF & commercial loans) is likely to continue inflating gross external financing to US$22.29bn in FY19F. Additionally, with inadequate external resources at its disposal estimated at US$13.45bn (ex. financing facility) should translate net financing gap to ~US$8.84bn by FY19-end (exclusive of budgeted short term commercial loans & Eurodollar bond net financing gap amounts to US$15.34bn). Untimely outflows in the presence of insufficient external resources could further strain FX reserves to unsustainable levels (in absence of financing facility SBP FX reserves could likely shrink to <1 month of import cover). Considering the critical reserves outlook, Pakistan remains in utmost need of a financing facility to stabilize its external position, where in our view the bailout of up to US$18.5bn (Inclusive of budgeted bond receipts) is imminent.

IMF Fianancing Facility vs. FX reserves



Source: IMF & AKD Research

External resource avenues: For the new economic setup, it remains unclear pertaining to the roadmap it's willing to adopt while it mulls over possible options. In this regard, possible sources of external inflows include: i) tapping the international money market (instruments include Eurodollar, Sukuk & Panda bonds), ii) investments from expatriates & non-residential Pakistanis (diaspora bonds), iii) bailout loan from China (~US$2bn already disbursed in Jul'18), iv) 'gifts' from friendly countries (K.S.A gifted US$1.5bn in FY14 in form of investment development fund), and v) an eventual IMF financing facility. Each mode of financing carries inherent benefits (repayment terms, costs) and associated (often tacit) risks. International debt market stands out as the most expensive option, exerting undue burden on the fiscal side considering the ongoing regime of global monetary tightening (last Eurodollar/Sukuk yielded coupon of 6.875%/6.75% while US benchmark rates have seen 75bps hike since). While, for diaspora investments despite its vast potential, would require measures to address the trust deficit (GoP's austerity drive could build confidence) as well as restraining informal channels (hawala & Hundi) which is largely infeasible in the current scenario of urgency.

China is not a lender of last resort: Additionally, despite China's lending capacity (FX reserves of ~US$3.12trn - import cover of ~19.5 months) and concessionary arrangements under CPEC (between 2-5% with 20-year term), another such bailout (Chinese bilateral loans constitutes ~10% - being the largest lender) could possibly weaken the country's strategic position. We believe the GoP might weigh its options closely, considering the negative repercussions from substantial reliance on a single lender in the backdrop of CPEC financing.

IMF remains foreseeable: Based on these fundamentals, in our view the GoP's hands are tied, with another IMF financing facility the least worst option, despite accompanying caveats to qualify for tranche disbursement (with the sole purpose of improving on external vulnerabilities). However, recent pressures from US (having IMF executive council voting right of 16.52%) is unlikely to change the very mandate the agency stands on (lender of last resort for maintaining the neo-liberal economic order). Additionally, such facility remains amongst the cheapest source where incremental disbursement would be charged at the SDR interest rate + 200bps (currently stands at 2.96% - linked to benchmark yields of China, Euro, Japan, UK & US treasury instruments). Moreover, under IMF financing facility along with its ancillary reforms, other external avenues (bilateral facility) could open up as well as drive down yields.

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