September 28, 2018

PAKISTAN STRATEGY

REP-019

MARKET VISTA

Checkpoints on the road to the IMF

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- **News reports on comments by GoP authorities and our own analysis increasingly make Pakistan's entry to another IMF program (12 programs since 1988) more imminent**
- **The IMF team visiting Pakistan for Article IV review (of previous facility) offers an opportunity to initiate discussions regarding specific stabilization measures and long term structural reforms prior to a formal Letter of Intent submitted to the Fund, for entering another program**
- **Re-iterating possible benchmarks the Fund may set and contrasting the same with the last EFF facility (from Sept'13 to Sept'16) we believe onerous structural reforms are likely to focus on fiscal federalism (possible pressures from IMF for likely amendments to NFC award), fiscal disciple, privatization of SOEs and reforming the trade regime all in a bid to limit external imbalance**
- **From a macro-perspective, currency adjustments (we expect PkR to weaken ~6.5% vs. US$ by CY18 end), monetary tightening (275bps hike forecasted for FY19) and curtailed spending are areas of contention which the PTI-led Government is primed to tackle**
- **Historical performance of the KSE-100 index 1/2/3months before and after commencing an IMF program indicate a minor relief rally 2-3months before starting (+3.1/+3.6% returns 2/3 months before), softening soon after (-1.9/-7.9% return 1/3 months after), while returning 21.2% on average over the term of the program**

IMF Consultations get the ball rolling: Currently, an IMF team has arrived in Pakistan for Article IV consultation (a regular process usually conducted annually) with the authorities to assess economic developments. Though not its core agenda, the authorities could likely take the opportunity to initiate discussion for a possible financing facility. In this regard, the widening financing gap (gross external financing gap estimated at US$22.3bn) against a dearth of sizable external financing resources is likely to lead the country to the fold of IMF. Moreover, any financing facility should immediately focus on stabilization measures and advancing structural reforms in order to address persistent twin deficits. Taking conviction from the previous program, these structural reforms are likely to focus on fiscal federalism (likely amendments to NFC award), fiscal disciple, privatization of SOEs and reforming the trade regime (see table).

Macros in the crosshairs: With regards to economic indicators, our view emanates from significant weakness on the external front. Another round of currency adjustment remains likely considering sizable current account deficit (standing at 5.3% of GDP in 2MFY19) along with low FX reserves (import cover at <2 months). We expect a further ~6.5% currency depreciation against the greenback from current levels. Additionally, monetary tightening would remain in place while IMF is likely to push for more aggressive stance to curb price pressures and restore external imbalances. We maintain our expectation of a cumulative 275bps hike in benchmark interest rates with TR/DR ending at 10.25%/10.75%. The nascent PTI-led economic setup has already presented measures for fiscal tweaks to target deficit at 5.1% of GDP while it will likely be asked to further reduce outlays (possibly below 3% mark) over the course of program.

Investment Perspective: We contrast past IMF programs since 1993 (ex-Standby arrangement of Nov'08 as extraneous variables were at play due to trading freeze) with KSE-100 index performance. Results of this exercise highlight historical performance of the KSE-100 index 1/2/3months before and after commencing an IMF program indicate a minor relief rally 2-3months before commencement of any program. These gains seem to be surrendered soon after (-1.9/-7.9% return 1/3 months after), as corresponding measures for reform are implemented. That said, over the course of the program, the index climbs 21.2% on average, signifying long term benefits of implementing structural reforms and bullish sentiment of market participants.

Potential Pak IMF Action Plan

Primary focus:
Monetary tightening and currency adjustment to address external imbalance
More focus on revenue collection both via direct & indirect taxes
Ceiling on net domestic assets (NDA) to limit artificial aggregate demand
Reduce reliance on SBP lending to mobilize domestic resources (i.e. savings)
Floor on net international reserves (NIR) accompanied by ceiling on swap positions
Re-initiation of privatization program (i.e. DISCOs & PSEs)
Unbundling of gas utilities into separate transmission & distribution entities
Trade liberalization through tariff reduction (i.e. custom & regulatory duty)
Further reduction in subsidy on utilities
Mechanism to ensure transparency of bilateral arrangements
Further tightening of anti-money laundering (AML) regulations
Secondary focus:
Regulatory framework of the SBP and SECP to effectively supervise risks in financial system
Reforms in PSEs to stop further bleeding
More autonomy for regulators
Effective framework to ensure debt sustainability (i.e. MTDS)

Source: IMF & AKD Research

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KSE-100 & IMF Program Historic Performance Matrix

Facility	Start	End	During Program	KSE -100 Return Before Start of Program			KSE -100 Return After Start of Program		
				1 Month	2 Mth	3 Mth	1 Month	2 Mth	3 Mth
Extended Fund Facility	Sep-13	Sep-16	85.3%	-3.64%	-1.36%	-1.80%	-0.95%	-3.41%	-11.03%
Standby Arrangement	Nov-08	Sep-11	28.0%	0.05%	0.03%	-2.58%	37.94%	86.37%	53.91%
Extended Credit Facility	Dec-01	Dec-04	304.0%	2.95%	20.97%	10.72%	1.30%	-17.94%	-24.52%
Standby Arrangement	Nov-00	Sep-01	-13.3%	-11.20%	-16.46%	-13.91%	-13.30%	-7.79%	-9.11%
Extended Credit Facility/ Extended Fund Facility	Oct-97	Oct-00	-25.0%	8.49%	8.32%	-0.37%	18.03%	16.50%	30.81%
Standby Arrangement	Dec-95	Sep-97	30.1%	-3.84%	-11.02%	-18.71%	-3.67%	-15.83%	-12.49%
Extended Credit Facility/ Extended Fund Facility	Feb-94	Dec-95	-40.9%	0.34%	18.51%	41.21%	-8.20%	-2.98%	7.26%
Standby Arrangement	Sep-93	Feb-94	84.4%	-3.23%	2.93%	8.30%	-6.43%	-23.98%	-33.26%
Structural Adjustment Facility Commitment	Dec-88	Dec-91	-	-	-	-	-	-	-
Standby Arrangement	Dec-88	Nov-90	-	-	-	-	-	-	-
Average Returns (ex-2008-2011 arrangement)	- -	- -	**21.2%**	**-1.4%**	**3.1%**	**3.6%**	**-1.9%**	**-7.9%**	**-7.5%**

Source: Bloomberg & AKD Research

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Accumulate	> 5% to < 20% upside potential
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Not Rated	No investment opinion or recommendation

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