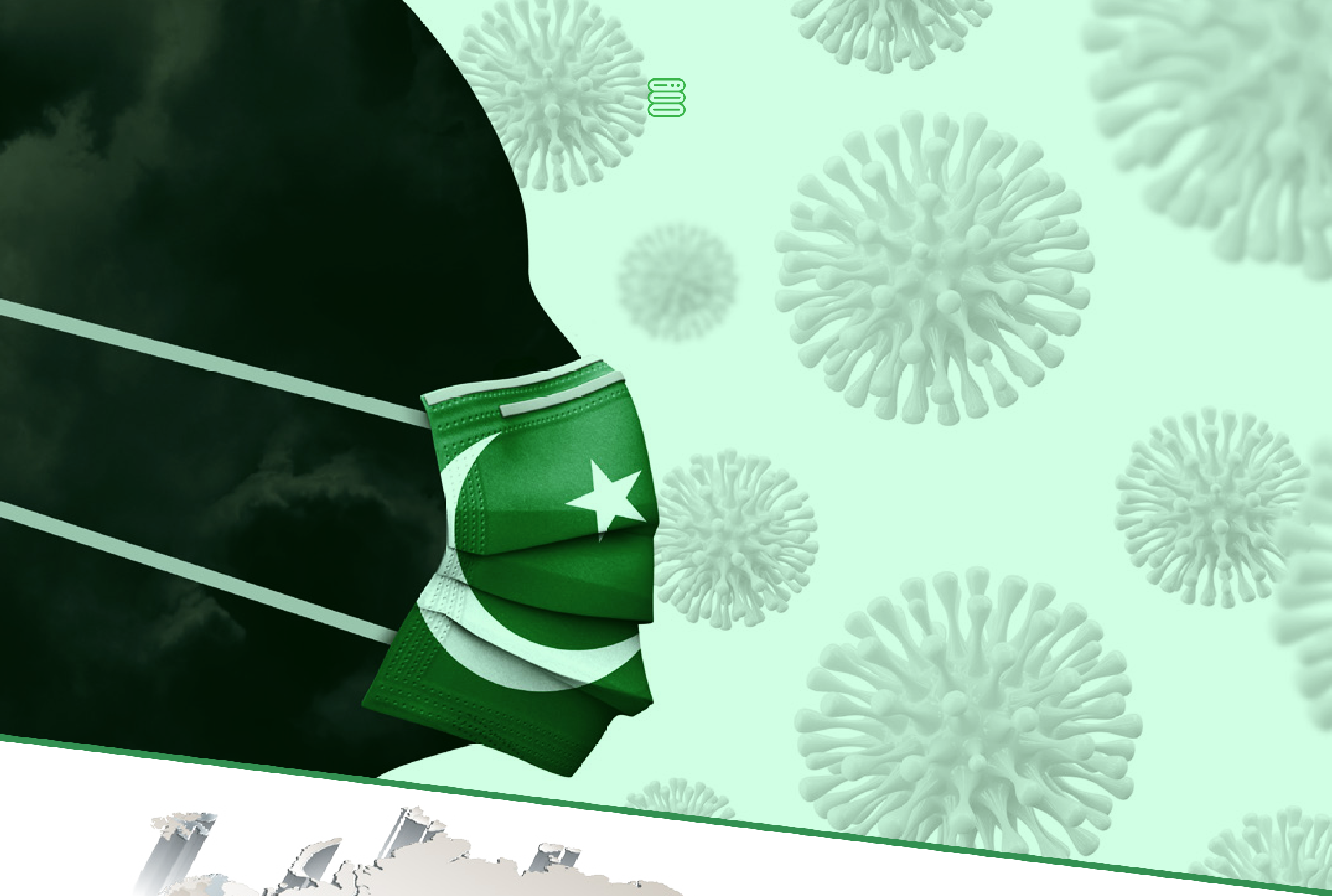
MARKET UPDATE – PAKISTAN

APRIL 2020



PAKISTAN MARKET UPDATE

| CORONAVIRUS TO HIT PAKISTAN HARD

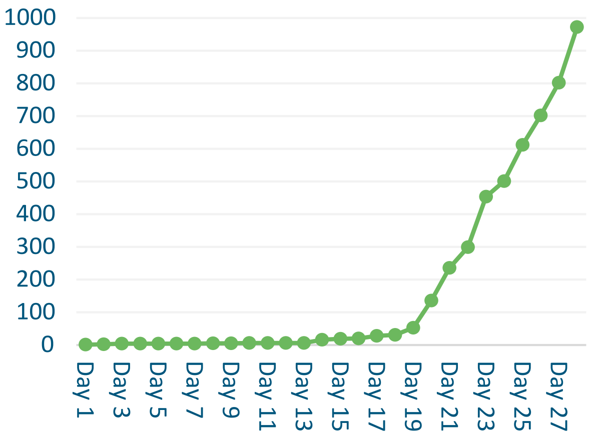
COVID-19 SITUATIONER

(These numbers are as of March 25, 2020 and may have changed substantially by the time the report is published)

Pakistan Locked Down

Pakistan's rapid rise in number of confirmed Vocid-19 cases has alarmed many. From 50 positive cases on Day 19, to over 1000 by Day 27, is reflective of the kind of exponential growth witnessed for the first two weeks in Spain and Italy. Pakistan has the highest Covid-19 cases in South Asia.

Corona Cases Rise Rapidly



Source: Government of Pakistan

The entire country is under a lockdown since March 23, 2020, which is scheduled to last for two weeks. Experts have warned that the curve is on a dangerous trend, and the numbers may explode to tens of thousands in the next two weeks.

While the lockdown has paralyzed most activities around the country, it has not yet resulted in a ban on daily mass gatherings in mosques.

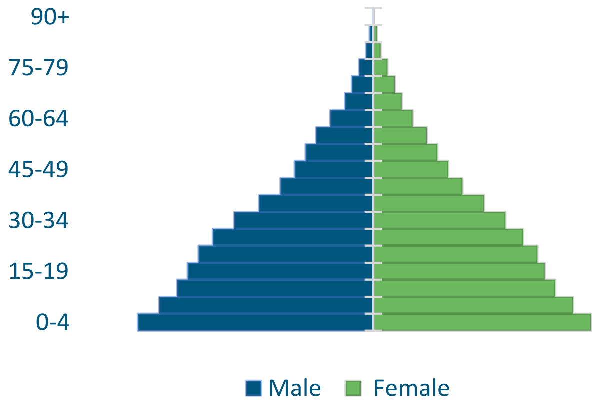
A blanket ban on mosque gatherings is unlikely, given the sensitive nature of the subject in Pakistan, which leaves the risk of further spread high. A worrying sign is an almost negligible focus on overcrowded rural areas, where hygiene standards are below average.

Young Population Offers Hope

Credible research on Covi-19 patients has revealed that the elderly are more susceptible to the virus. Fatality rates for people under 60 years of age, is under 1.5%, which increases by age bracket.

Pakistan's youth bulge is its best kept secret and may come handy in terms of restricting the exponential growth. Secondly, local transmission in Pakistan thus far has been 5%, as most cases have been imported from neighboring Iran and elsewhere.

Pakistan's Population Pyramid



Source: Pakistan Bureau of Statistics

Worryingly Weak Healthcare Infrastructure

Pakistan's annual healthcare spending is 2.7% of GDP, as against global average of 10%. The public sector healthcare facilities across the four provinces, are at varying degrees of worrisome.

The inadequate healthcare system puts Pakistan at a greater risk than the much advances European countries with the best healthcare systems in the world.

The healthcare system has so far coped alright with the situation, as it has not yet become an outbreak. It must be mentioned that Pakistan has so far opted for selective testing, more by design than by choice.

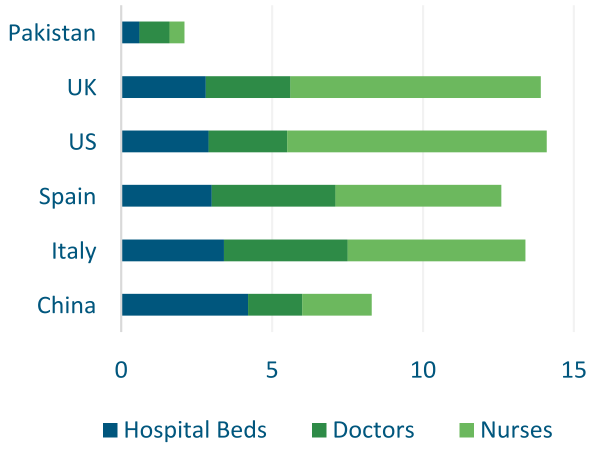
Aggressive testing does not seem an option in Pakistan, as the availability of testing kits has been an issue.

The respective provincial governments have asked people without travel history or mild symptoms, to practice social distancing, in order to save the precious testing kits for the deserving.

The authorities have sped up efforts to add to the system's existing capacity. Large field hospitals have been set up in all provinces, enough to cater more than 4000 patents.

Pakistan is also working closely with China, through its National Disaster Management Authority (NDMA), to procure medical equipment. The country is set to receive several ventilators, and protective medical equipment for the frontline medical staff

Pakistan's Worrying Healthcare (number in per 1000)



Source: Government of Pakistan

Pakistan stands to face serious challenges in case of a massive outbreak. Hospital beds may not be the biggest challenge, but medical staff shortage could be a serious headache.

Pakistan has the fewest number of nurses and paramedics per 1000 people in the region, and that could be a serious hindrance in dealing with potentially large number of Covid-19 patients.

Pakistan's best bet is to enforce strict lockdown across country, as the healthcare system, even with all the efforts to improve capacity, can simply not handle the situation of an outbreak.

PKR 1400 Bln Stimulus

The government on March 24, announced a multibillion rupees package to keep the economy afloat. The relief package is a mix of direct cash transfer to the poorest quintile, cut in petroleum prices, installment payments of utility bills, reduction in discount rate amongst others.

Salient Features of Relief Package

- *PKR 100 Bln tax refunds to export-oriented industries.*
- *PKR 150 Bln as direct cash payment to poor household for four months.*
- *PKR 100 Bln to facilitate SMEs.*
- *PKR 150 Bln for utility stores to ensure lower food prices.*
- *PKR 25 Bln for National Disaster Management Authority for procumbent of medical equipment.*
- *10% reduction in petroleum prices*
- *Gas & power bills to be paid in three-month installments.*
- *Reduction in discount rate by 150 bps.*
- *Duty waived on essential food items.*
- *PKR 100+ Bln support package for construction and allied industries.*

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ECONOMIC OUTLOOK

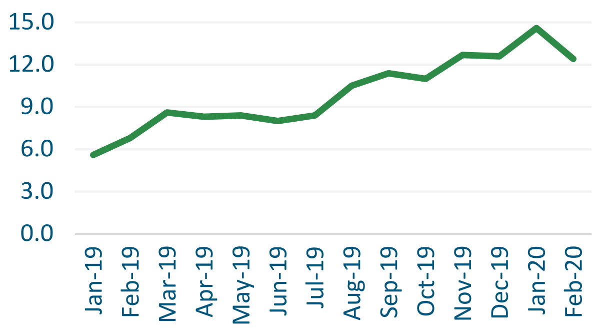
Inflation Heading to Single Digit

Headline CPI inflation eased considerably from the peak of 14.6 percent in February 2020. The perishable food price sub-index had been leading the rally, till the government decided to come hard on price control.

Various measures such as provision of discounted food items nationwide at utility stores, crackdowns on hoarders and profiteers, improved supply chain, and a better vegetable crop all combined to yield a much lower CPI.

The government had also passed on partial benefit of global oil price decline to the consumers, resulting in lower petroleum product prices.

Inflation Peaked - Starts Reversal



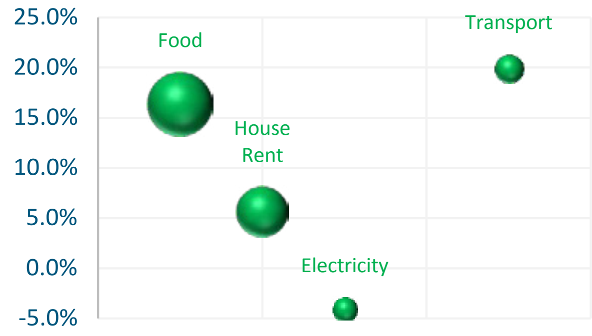
Source: Pakistan Bureau of Statistics

Pouncing on the opportunity on offer, the taxes on petroleum were jacked to record high, as the government struggles to keep up with the steep tax collection target.

We believe the pass on of petrol prices would be bigger for April 2020, as the partial pass on invited criticism from all corners. The sharp fall in global crude oil price offers an opportunity to substantially lower the price (30-40%) month-on-month, even with the maximum allowed constitutional taxation limit.

We believe the March CPI would fall gradually, as the weekly indices show downward trend in essential good items' prices. The CPI decline could be faster after March, likely to be led by petroleum index, which has a sizeable weightage in the consumption basket.

CPI break-up



Source: Pakistan Bureau of Statistics

The coronavirus is the new unknown, and could pose upwards risks too, in the form of supply disruptions. There is no immediate threat of a demand driven inflation, as the economic activities are likely to come to a grinding halt, given the massive spread of the virus in Pakistan.

Business Confidence Dwindles Again

The SBP confidence survey, having shown a good leap in the previous wave, fell back to the negative territory. The likely reason could be much higher than anticipated inflation in February and the then inconclusive talks with the IMF, which ended abruptly.

Both the variables have since changed for the better, but the business confidence, especially in the "Expected" category may take a big hit, given the Covid-19 scenario, which stands to bring the entire economy to a standstill.

The government has reached out to the business community, offering industrial support packages to the tune of PKR 200 Bln.

The central bank has also introduced concessionary loan schemes with repayment waivers up to six months. Whether these efforts culminate into rejuvenated business confidence will largely depends how hard Covid-19 hits Pakistan's economy.

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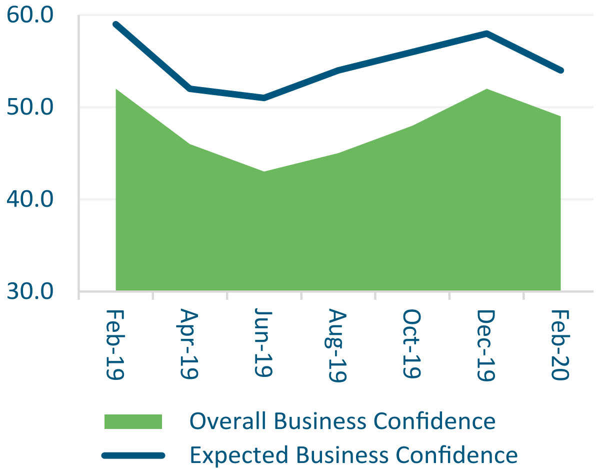
Business Confidence Jittery

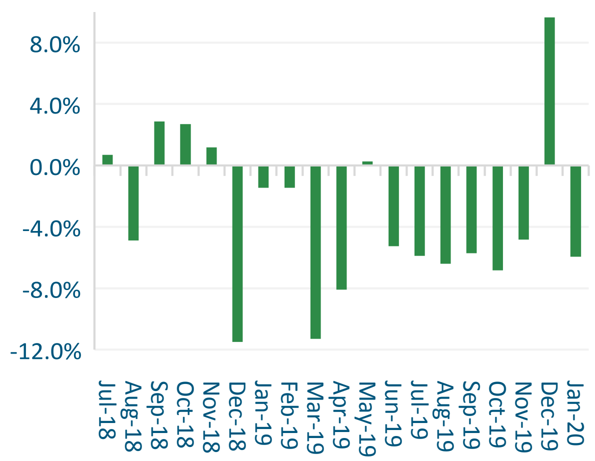


Source: State Bank of Pakistan

Manufacturing Refuses to Rise

December 2019 offered hope for large scale manufacturing. January 2020 told it was a false dawn. Pakistan's economy, having contracted for five consecutive quarters, could well be on its way for the sixth one. This is hands down the worst-ever run in the country's history.

Large Scale Manufacuting (YoY Growth)

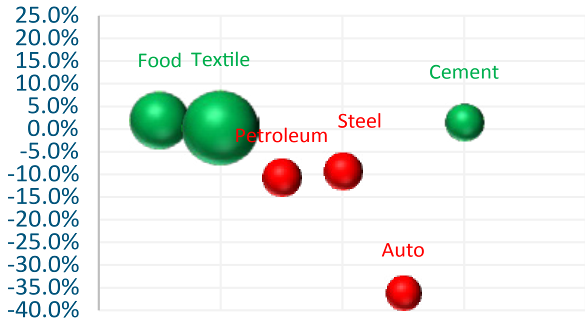


Source: State Bank of Pakistan

The cumulative 7MFY20 LSM has contracted by 3.2%. The FY20 target of 1.3% looks increasingly difficult. The Covid-19 is going to be particularly tough on automobile, cement and textile sectors, which make a considerably chunk of the LSM composition.

Food and pharmaceutical industries could possibly see through the tough times swiftly, with a likely increase in demand, as the government extends support to the daily wagers.

Auto Leads Manufacuting Downturn

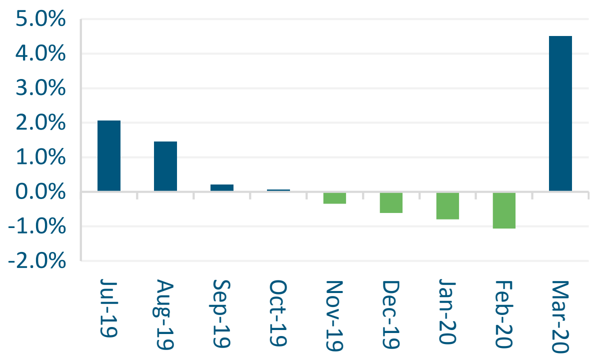


Source: Pakistan Bureau of Statistics

Having depreciated sharply right after the IMF programme was signed in July 2019, the rupee had shown commendable strength in the latter half of 2019.

The central bank has adopted a market-based regime for exchange rate determination, with minimum intervention. The slide in March 2020 had to be halted by the SBP, as it intervened by buying dollars.

Rupee Loses Value (MoM Growth)



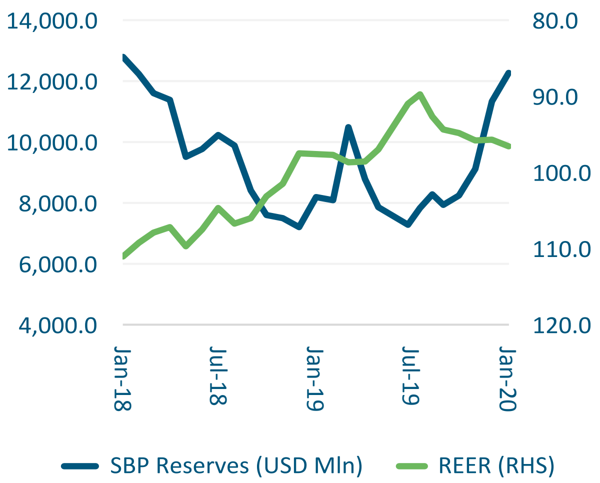
Source: Federal Board of Revenue

The outbreak of Covid-19 led to a global capital outflow, putting pressure on Emerging Market currencies. Pakistan's rupee had lost nearly 4% value in a single trading session, which was pulled back later as the SBP intervened citing extreme circumstances.

The Real Effective Exchange Rate (REER) had also been indicating some heat, inching towards 100. A slight correction was fundamentally overdue, irrespective of Covid-19.

Foreign exchange reserves have continued to grow steadily. The central bank reserves are nearing USD 13 Bln, improving the import cover to 3 months. The reserve composition has also improved considerably, as the forward liabilities have come down from a high of USD 9 Bln last year, to less than USD 3 Bln.

Central Bank Builds FX Reserves



Source: State Bank of Pakistan

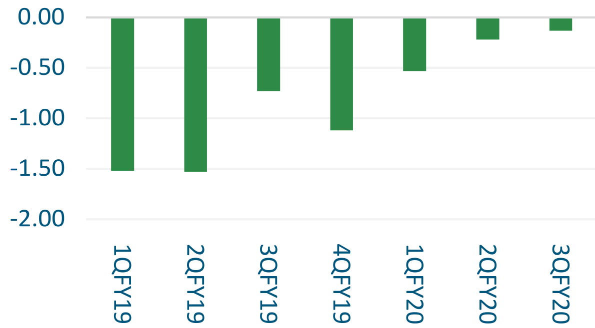
Current Account Nearing Surplus

Pakistan's focus on external sector seems to have paid off. The authorities were criticized for being solely focused on external balance, ignoring the fiscal front.

The current account deficit has now trimmed from historic highs six quarters ago, to nearing a surplus. A significant chunk of the improvement is owed to massive 16% YoY reduction in imports.

Ongoing economic slowdown, monetary tightening leading to demand compression, and efforts to discourage non-essential imports, have all led to a drastic reduction in total imports.

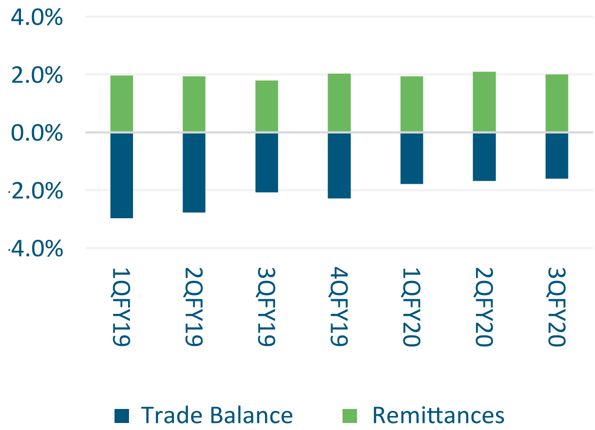
Current Account Deficit Shrinks (% of GDP)



Source: State Bank of Pakistan

Exports, on the other hand, have grown at a much modest 3% YoY. That said, exports have grown considerably in volume terms. Textile, which is Pakistan's export lifeline, has seen double-digit volume growth across categories. Rice exports have also seen a comeback having grown by 15% YoY.

Trade Balance Improves (% of GDP)



Source: State Bank of Pakistan, Pakistan Bureau of Statistics

Oil prices have tanked globally, shedding one-third of the value in less than a month. This bodes well for Pakistan's energy import bill, which constitutes one-third of total imports.

That said, the slowdown in demand at home and supply disruptions due to Covid-19 outbreak are likely to lead to a considerable decline in industrial activity and exports.

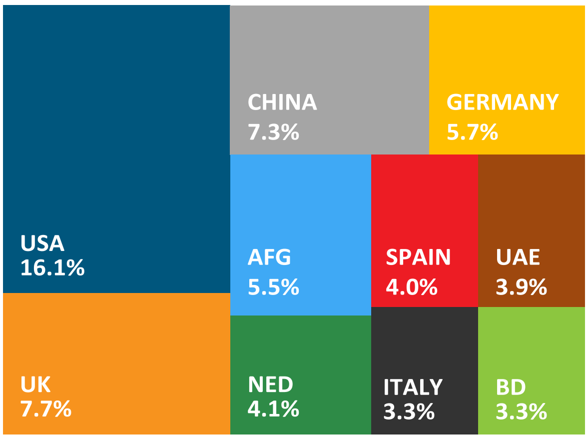
Export oriented sector has been given a sizable relief package in a bid to keep the ship afloat.

Concessionary long-term loans, waiver of several procedural requirements to fast-track shipment, tax breaks, and provision of energy at subsidized rates are some of the relief measures extended to the export sector.

We believe, Pakistan would be racing against hope to find its feet in the export market. The impact of Covid-19 remains unquantifiable as of now, but the magnitude is clearly humungous.

Most of Pakistan's major export destinations are facing massive Corona outbreak. Nearly half the world is under lockdown, and demand for readymade apparel would be low on priority list in such times.

Paksitan's Top Export Destinations



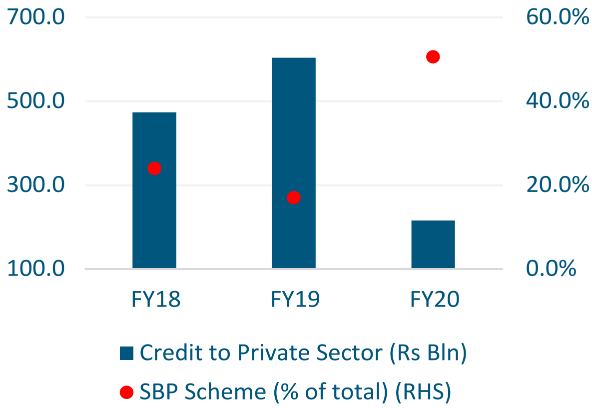
Source: ITC Trade Map

Pakistan's two key export categories in bedwear and towels would be the most hit, given the ongoing slump in global hospitality business.

Both inbound and outbound traffic at Pakistan's two ports, has gone down by one-third in the last two weeks, indicating demand compression and disruption.

We believe the current account could well be under massive pressure in Q4FY2. Remittance growth is likely to be hit as the global economy enters recession.

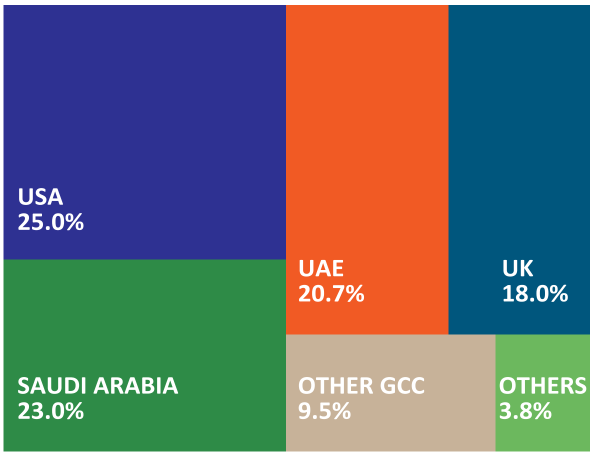
Credit Off-Take Dips



Source: State Bank of Pakistan

Worse still, more than 50% of Pakistan's home remittances originate from the Gulf states, where economies face added pressure in the ongoing oil price war. We believe the Covid-19 could severely hamper the remittances, especially in the upcoming peak season of Ramadan and Eid festival.

Pakistan Home Remittance Composition



Source: State Bank of Pakistan

The Foreign Direct Investment (FDI) is nothing to write home about either, hovering around less than 1 percent of GDP. The one-time FDI from the telecom sector in the form of license fee has already arrived. The outcome of Covid-19 would determine the capital flow into Pakistan. As things stand, Pakistan is not likely to attract sizable FDI in the near term.

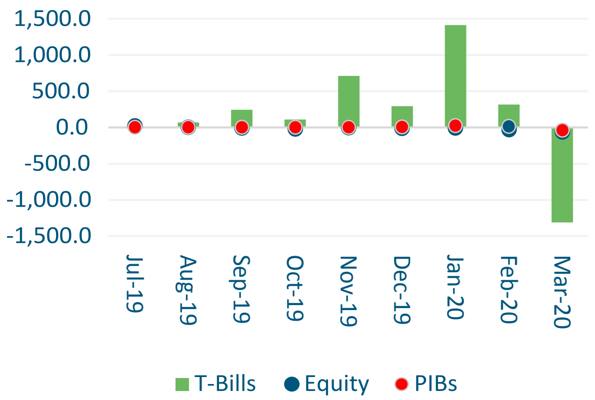
DEBT MARKET UPDATE

The bonanza of Foreign Portfolio Investment (FPI) seems to be coming to a premature halt. Last two months have seen debt investment flown out of the country, for a variety of reasons.

More than USD 1.5 Bln have been taken out of the treasury bills and Pakistan Investment Bonds, in March 2020 alone – leaving the net FPI little over USD 1 Bln. Some of the outflow could be credited to post-Covid-19 scenario. The emerging markets have witnessed near 7% MoM capital outflow in March 2020.

The interest rate cut by 75 bps earlier and 150 bps later, by the central bank could also exacerbate the outflow. Most of the FPI outflow had been recorded before the interest rate cut.

Portfolio Invesmtent Flies Out (USD in Mln)



Source: State Bank of Pakistan

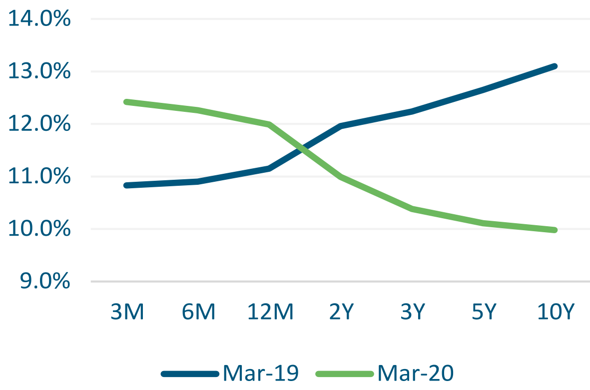
In pure fundamental terms, the return that Pakistan's short-term debt offers today is still lucrative for foreign investors. Other central banks around the world have also slashed the rates, maintaining the historical differential.

We believe the uncertainty attached to the fallout of Covid-19 will keep foreign investment portfolio at bay, regardless of the return.

The policy discount rate after 75 bps reduction stands at 12.5%. The cut-off yields in the latest treasury bill auction have come down as a result, where banks actively participated.

The interest rate cycle is expected to reverse as inflation outlook signals single digit inflation before the fiscal year ends. Debt market participants have sensed the upcoming change, which is evident in the shift from short-term T-bills to longer tenor PIBs.

Yield Curve



Source: State Bank of Pakistan

The yield curve has stayed inverted for quite some time. But recent trends show that this may al change soon, as the government under the IMF programme would want to build a longer-term yield curve.

Covid-19 poses no immediate threat of spike in inflation. After receiving heavy criticism on a paltry 75 bps cut mid-March, the SBP called on an emergency meeting of the Monetary Policy Committee (MPC) on March 24.

The MPC decided to cut the rates by a further 150 bps, taking the rates to 11%, lowest in more than a year. We believe the decision was much needed to boost the economy facing fiscal crunch. The rate cut would create a room of PKR 130-150 Bln on the fiscal side, on account of savings on domestic debt servicing.

The construction sector is all set to be a major beneficiary of the rate cut, as the Prime Minister has also announced a special relief package for the construction and allied industries to the tune of PKR 200 Bln. Further emergency rate cuts cannot be ruled out, should the situation worsen.

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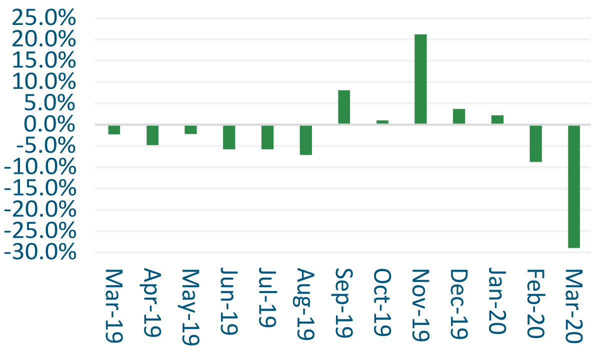
EQUITY MARKET UPDATE

The Pakistan Stock Exchange (PSX) slid to a 6-year low – wiping out the 40% gain in four months leading to February 2020. In March alone, the benchmark KSE-100 index shed 29% (as of Mar 25, 2020).

The seeds were sown well before Covid-19 was declared a pandemic. Some correction had become due as price-to-earnings multiples in leading sectors, were nearing 12-month high.

Sharp losses at KSE-100 (monthly returns)



Source: Pakistan Stock Exchange

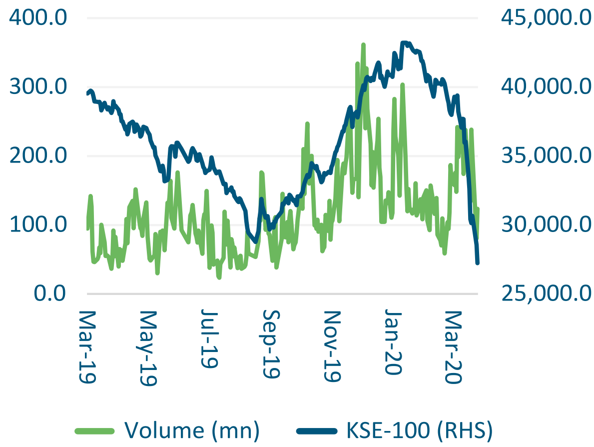
Then, the Covid-19 came and wiped out all the gains that were out there. The KSE-100 index has now yielded negative monthly returns for two months running. This is of note that the PSX has largely followed the global capital markets.

The emergency interest rate cut should ease some pressure off, and the multiples should be more attractive. The leading stock market brokers had been asking for a sizable rate cut, which they have now.

We believe, the rate cut will not be enough of a trigger for the market to make a sustained rebound. Recall that the US and European markets too, could not be overly enticed by much bigger cuts and mammoth relief packages.

Foreign investors have been net sellers since January 2020. Capital market outflow is a global phenomenon, and the emerging markets have faced capital exodus in these uncertain times.

Stock market crashes



Source: Pakistan Stock Exchange

The trading activity has also fallen sharply, much in line with the index. Mutual funds, insurance companies and foreign investors have all been found parking excess liquidity in the debt market.

With the debt market returns now receding, one will have to wait and see if the local investors have the courage to be buyers in the uncertain market.

The upcoming month of Ramadan has traditionally been a low activity period, where volumes are cut by one-third of yearly average. The situation around Covid-19 is still fluid, and the technical chartists have stopped charting the bottom.

The benchmark index is heavily constituted of banking and energy stocks. Reduced economic activity, and sharply falling oil prices, have led to significant re-rating of sector valuations.

We believe, KSE-100 index may find some hope in the Prime Minister's relief package. But the Pandemic is yet to peak in Pakistan, and the ensuing panic could well send the index to lows that were last seen in 2008-09 financial crisis.

STRATLINK ADVISORY GROUP - WHO WE ARE

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Where we are based

StratLink Advisory Group's head office is located in Dubai. The company has its Africa headquarters in Nairobi, Kenya, and its Asia headquarters in Karachi, Pakistan.

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