STRATLINK

MARKET UPDATE – PAKISTAN

JANUARY 2021

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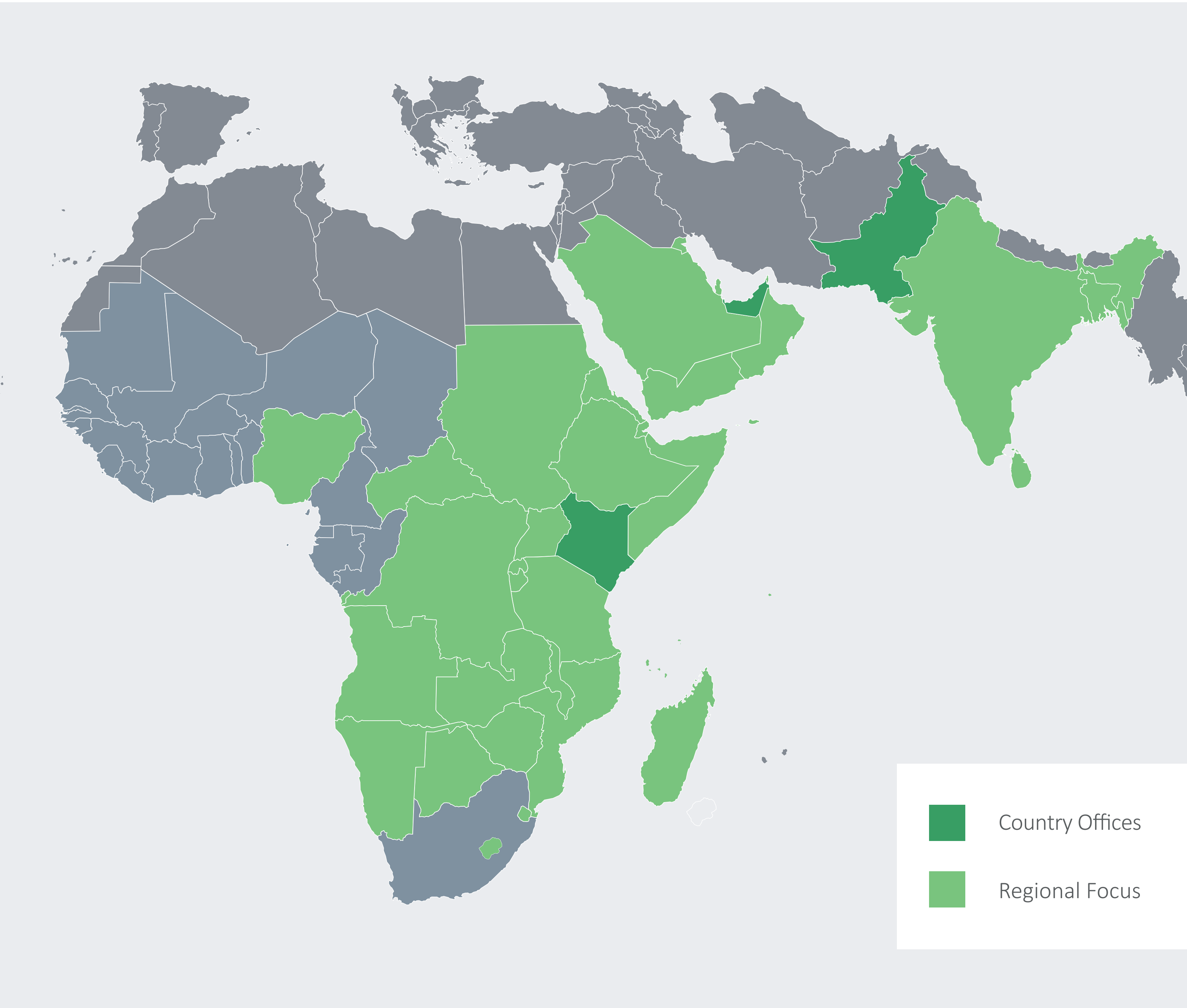

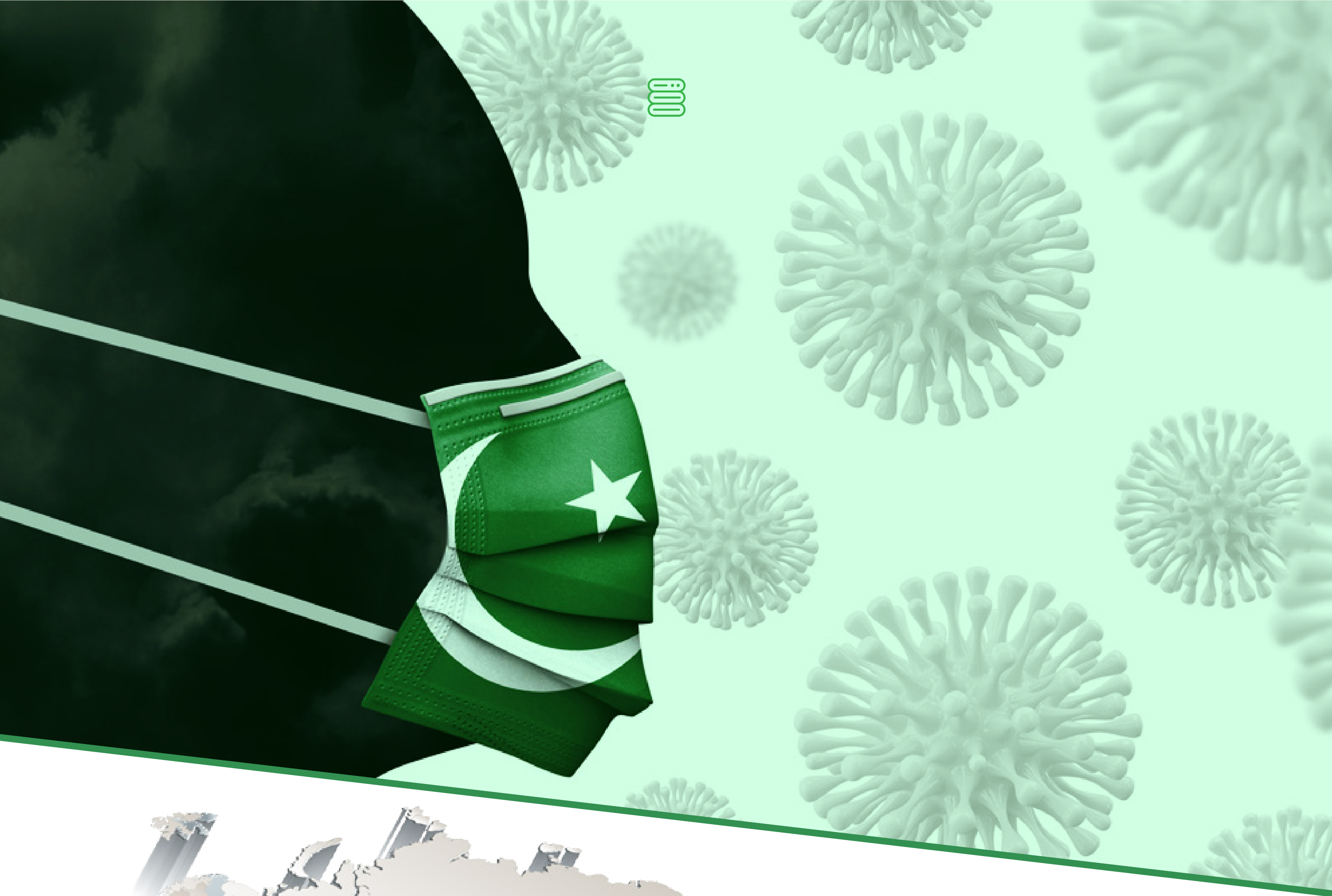

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PAKISTAN MARKET UPDATE

| ECONOMY LOOKING UP

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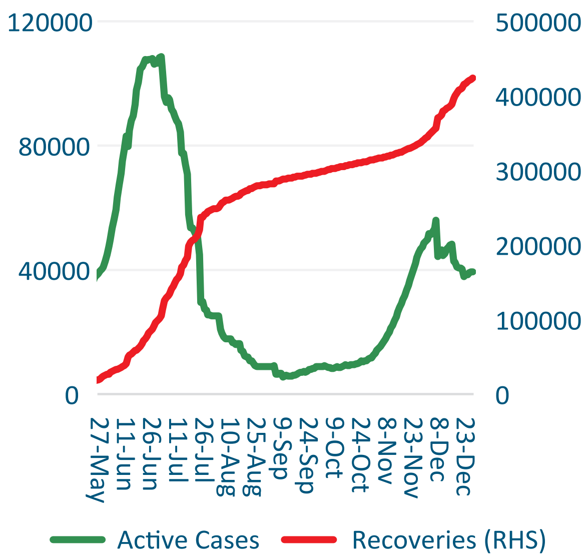
COVID-19 Watch

(These numbers are as of December 29, 2020 and are subject to change)

Pakistan Battles Rising COVID Cases

The battle against coronavirus which was thought to have been won by Pakistan before the winters, has started again. The positivity rate has inched up to 7%, up from the lows of 2% during three months from August and October.

Active Cases & Recovery



Source: Government of Pakistan

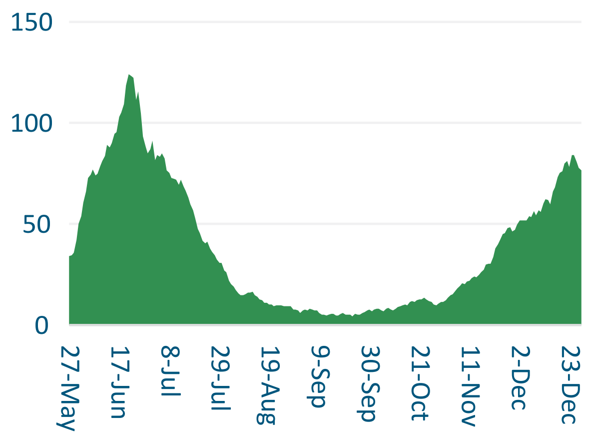
Although, the positivity rate has not quite seen the highs of the firsts wave, the rate of spread is in the 'out-of-control' category. The fact that the first wave peak at 24% was one of the highest in the region, also gives a false impression that the second week is not as bad.

What has made matters worse is a combination of rise in temperatures, mass religious and political gatherings, and a general disregard for social distancing measures. Pakistan's strategy seems to have moved to hoping to acquire herd immunity or vaccination, whichever arrives first.

The number of active cases has been under control, in terms of capacity. Pakistan has beefed up the medical capacity during the first wave, and now has enough bed space and ventilators to cater for an outbreak much more severe than its current shape.

There is no immediate threat in terms of the health system collapse, in sharp contrast to fears at the start of the pandemic.

Daily Deaths on the Rise

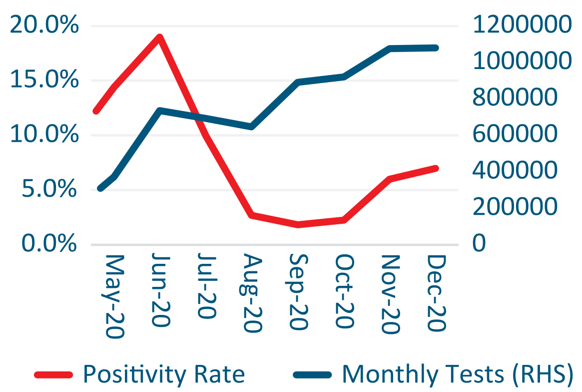


Source: Government of Pakistan

Pakistan authorities have entirely ruled out a complete lockdown, and the businesses will continue to keep running as usual. There are additional fiscal measures in the plans given the fiscal constraints, which have a bearing on lockdown calls.

The cause of concern with the current wave is a significantly higher rate of death. More people as percentage of active cases are now dying than the first wave. Pakistan has nearly seen the death rate double from the first peak in June. It looks like the battle with COVID will go on for more months to come, as Pakistan will not be among the first recipients of the COVID vaccines, given their financial stature.

The Second Wave Steadies



Source: Government of Pakistan

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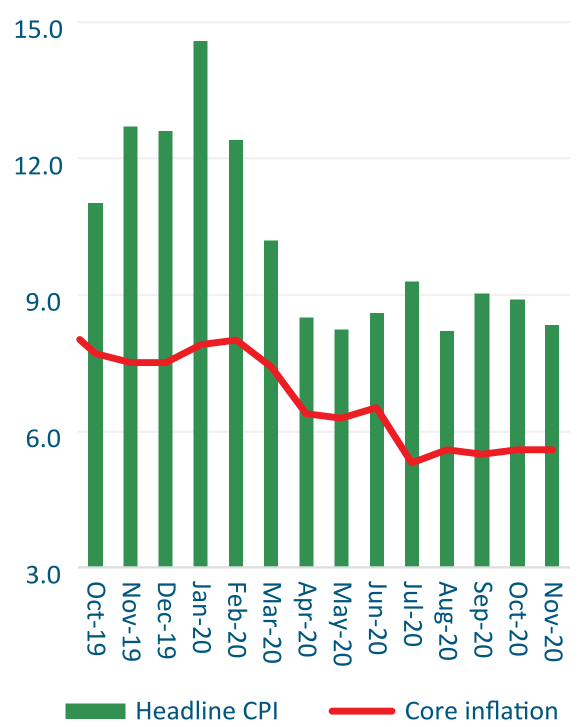
ECONOMIC OUTLOOK

Inflation Cooling Off

Having earlier threatened to disrupt the rapid economic recovery, consumer inflation as measured by the CPI seems to have tamed. November 2020 national average inflation at 8.3% is the joint lowest in five months of FY 2021.

The five-month FY 2021 benchmark CPI inflation has averaged 8.8%, 200 bps lower than 10.8% in the same period last year. The headline inflation continues to be dominated by unbated food inflation, which stayed at 13% in November 2020, much in line with July-November average food inflation of 12.8%.

Inflation Consolidates



Source: Pakistan Bureau of Statistics

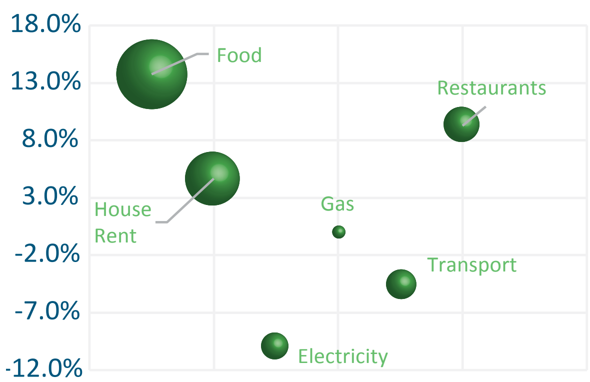
What remains consistent is the pattern of inflation, which remains heavily supply-side centric. Much against earlier fears of a fresh round of demand driven and cost push inflation, core inflation has stayed range bound at 5.5%, for most part of the fiscal year 2021.

The core inflation has stayed largely in check as the government has made a conscious effort to delay major price rationalization decisions.

The government has so far resisted the IMF's pressure and deferred electricity and gas tariff decisions for another quarter, fearing a political backlash, as the opposition parties have also upped the antre on rising inflation.

Persistently low international crude oil prices have also contributed to keep the non-food inflation in check. The transport sub-index has been a major relief for consumers, as the government has continued to keep petroleum product prices lower than last year, and at the same time pocketing maximum possible revenue, all thanks to low crude oil price.

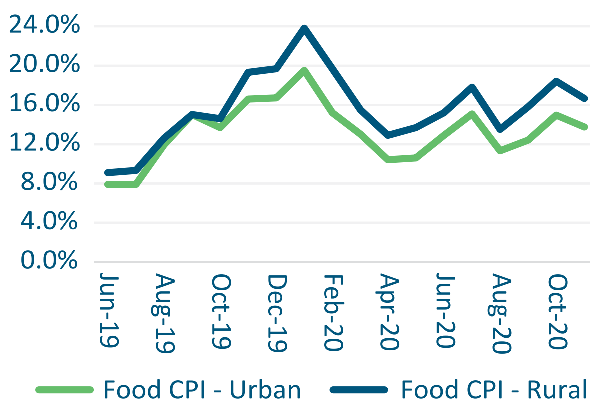
Urban CPI break-up



Source: Pakistan Bureau of Statistics

What remains a big worry is the rural food inflation, which has impacted the lower-income segments of the rural population disproportionately. A bad crop year has led to a below par farm economy, and food price shave resultantly increased, and the supply chain disruptions have further compounded the problem for rural consumers.

Rural-Urban Inflation Disparity



Source: Pakistan Bureau of Statistics

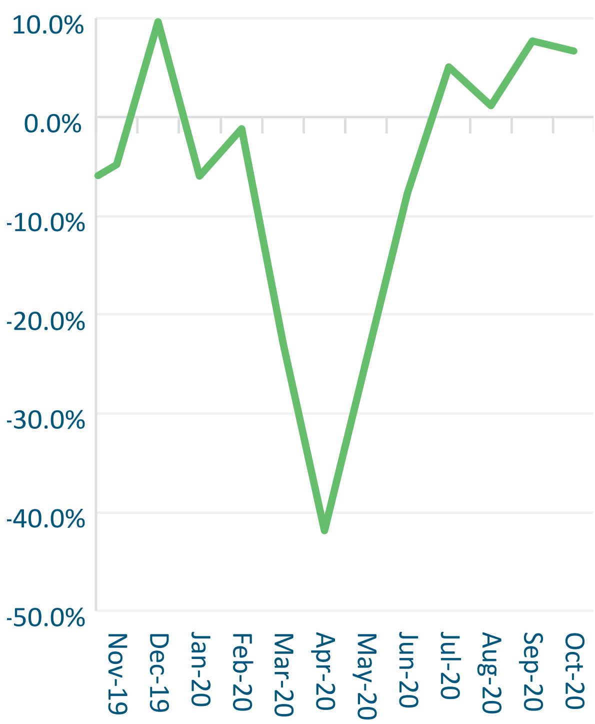
The government has acted with considerable delay in arranging imported wheat and sugar, and prices have started to come down. But bad crops of maize and reduced livestock production have also increased poultry and milk costs, which could lead to another round of food inflation in 2021.

Manufacturing Gathers Momentum

From being in a long manufacturing recession for eight consecutive quarters, Pakistan is now well on its way towards the second consecutive quarter of positive large-scale manufacturing (LSM) growth.

The cumulative July to October four months FY 2021 LSM growth has further consolidated at 5.2%, in stark contrast to last year's negative 6% in the same period. Recall, that COVID had only inflated the rate of contraction, as the manufacturing sector had been underperforming from pre-COVID days.

Large Scale Manufacuting (YoY Growth)



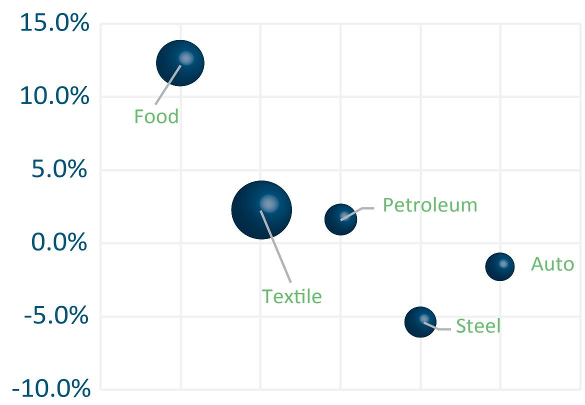
Source: Pakistan Bureau of Statistics

After slight recovery in the previous quarter, Q2 FY 2021 started on a positive note, with the LSM registering a healthy 8% growth. The high LSM growth is due to a confluence of factors, ranging from the low base effect of last year to early opening of the economy.

At the heart of the revival is a double-digit growth in large-scale food manufacturing, which has continued unbated, as Pakistan's demand-driven economy was quick to be back on its feet after stuttering for two months during the first COVID wave.

A combination of factors has contributed towards rather swift industrial recovery in Pakistan. The State Bank of Pakistan was fast to respond to government's early lifting of lockdown restrictions with speedy reversal in interest rates and several easy loan schemes and debt relief structures for big and small businesses. These actions have undoubtedly played a big role in Pakistan registering speedy LSM recovery.

LSM breakdown (Jul-Oct 2020)



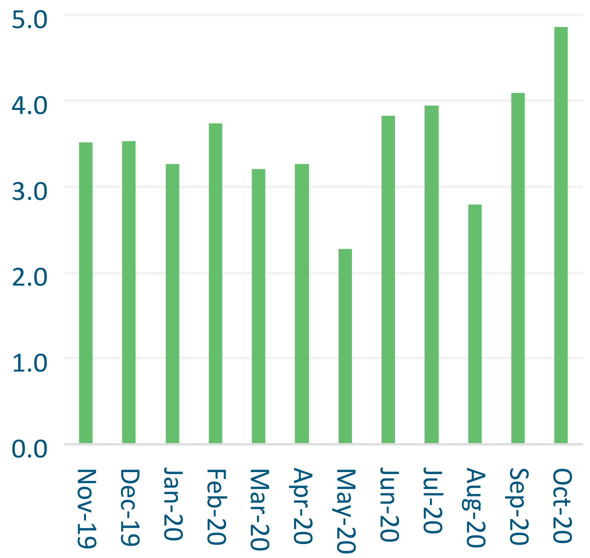
Source: Pakistan Bureau of Statistics

Textile has the biggest share in Pakistan's LSM production, despite being underreported. The signs are clearly visible in surging export numbers, and anecdote suggests Pakistan's textile hubs are flooded with fresh orders, and all units are running at full capacity – which is a big reversal from the lows seen in COVID and pre-COVID days.

Much of Pakistan's textile export resurgence is not reflected in LSM numbers, as it only captures baseline production. Pakistan has visibly made new inroads in the value-added readymade garments sector, and the impact on jobs has been positive in the last few months. We believe the recovery is going to gather more steam in 2021, as Pakistan captures new markets.

The government singled out construction industry as the key driver for economic growth and was the first sector allowed to open during lockdown. The Prime Minister's low-cost housing scheme, aimed at constructing 5 million houses in five years, has gathered traction, and the impact is visible in skyrocketing cement sales.

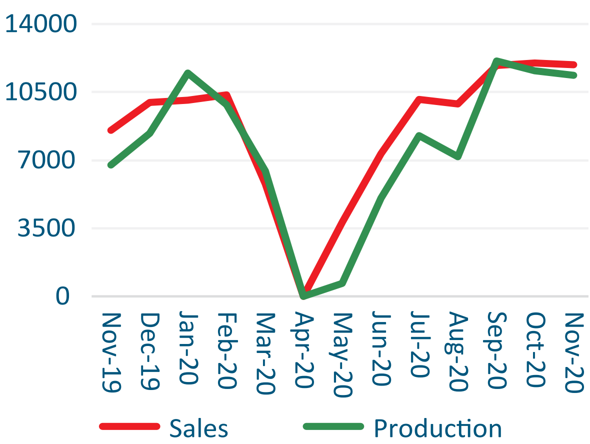
Cement Sales (Mln tons)



Source: Pakistan Bureau of Statistics

The cement sector has reported highest ever monthly sales in the last few months, and all cement manufactures are at advances stages of further expansion, given the demand for housing, backed by government's housing finance schemes and central bank's mandatory construction financing arrangements.

Autombile Sales Make Swift Recovery

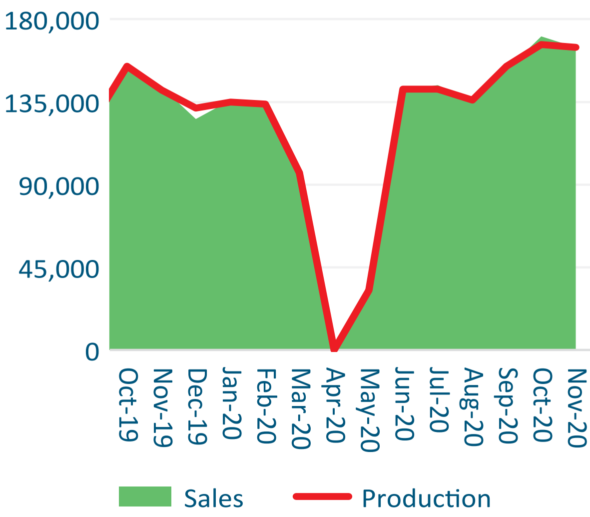


Source: Pakistan Auto Manufacturers Association

Pakistan's automobile space has received tremendous interest in 2020. From virtually going to a standstill during the first wave, the monthly sales and production are back to almost all-time highs. New players have entered the automobile market, and the actual monthly sales numbers are higher than those officially reported.

Much reduced interest rate has had the single largest impact on automobile sales, as the car financing has jumped by 3 times from last year. More foreign investment has been attracted in the automobile space, as Pakistan's new Electronic Vehicles policy has been received with a fair amount of interest.

Two-Wheelers Make Strong Comeback



Source: Pakistan Auto Manufacturers Association

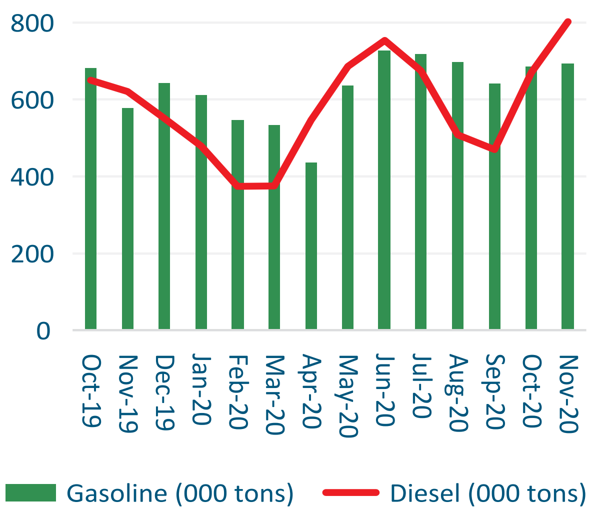
Another area of strong growth is the petroleum products, which has shown immense resilience, even during the peak of COVID. Local oil refineries have been able to stay afloat due to increased petroleum demand, arising from organic growth and reduced instance of smuggled oil products into Pakistan due to the pandemic related border restrictions.

The government has played its role in keeping the prices low, to encourage higher use of petroleum products, which is also the largest source of indirect tax collection to the kitty. Higher consumption has so far contributed to 30% of the rise in petroleum-related sales tax in FY 2021 so far.

Farm economy has also stayed afloat despite earlier challenges, evident from considerable increase in High-Speed Diesel (HSD) demand. Varying degree of restrictions on air and train travel, have also aided inter0city travel via roads, creating more HSD demand.

Various other sectors such as fertilizer, cigarettes, paint, glass, and electronics have also come out of the negative growth territory, as domestic demand has shown signs of resurgence. Low interest rates continue to support appliances demand, coupled with government's efforts to provide uninterrupted electricity for industrial consumption, at unchanged prices, to boost production.

Petroleum Sales Remain Bouyant



Source: Oil Companies Advisory Committee

PKR Stabilizes

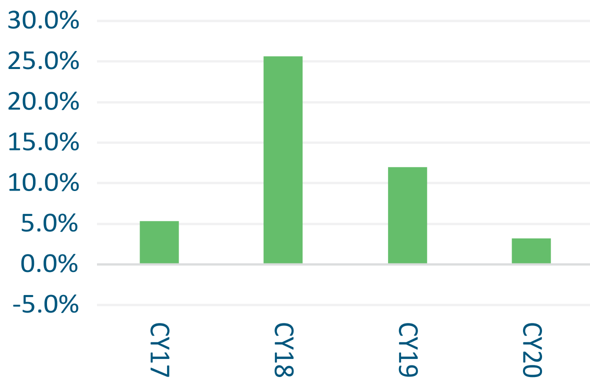
The Pakistani Rupee (PKR) has had a rollercoaster 2020, touching all-time highs of 170 per USD, and then making a sharp recovery in the later part of the year, closing at 160 per USD. The currency has registered the most stable year in 5-years in terms of currency depreciation versus the greenback, having lost considerable value in 2018 and 2019, after the IMF program.

Recall that the new central bank leadership under the government has outlined market-based exchange rate regime.

And the currency movement in the last 18 months has started to closely mirror the macroeconomic realties, and the demand and supply foreign exchange situation has come into play, in determining the market value of PKR.

Pakistan's current account surplus in the last six months has contributed heavily towards the recovery in Q3 FY2021 and the stability thereon. Dollar outflow has been contained, and the foreign exchange reserves by December end stood at a 3-year high, signaling good cushion for the months to come, even if imports rise in H2 FY2021, as widely anticipated.

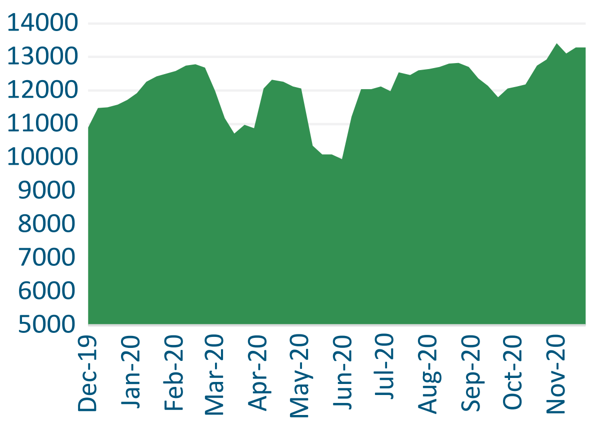
PKR Yearly Depreciation



Source: State Bank of Pakistan

The foreign exchange dealers have of late reported a surge in dollar liquidity, as the sharp fall in dollar value led people to cash in on the dollar holdings in banks and safe deposits. The central bank has also ensured enough buying in the market to keep the exporters at ease.

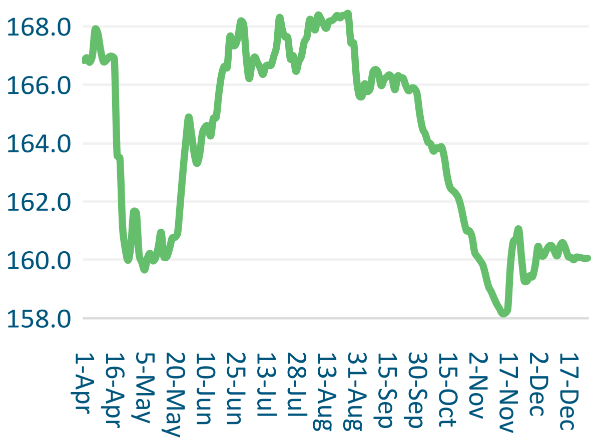
Foriegn Reserves Strengthen (USD Mln)



Source: State Bank of Pakistan

The loan repayment of USD 1 Bln to Saudi Arabia did not lead to PKR depreciation, as Pakistan swiftly managed to secure a similar amount from China. More good news has arrived from Paris Club, which has agreed to defer Pakistan's principal and interest payments to the tune of USD 1.5 Bln.

PKR Recovers & Stabilizes

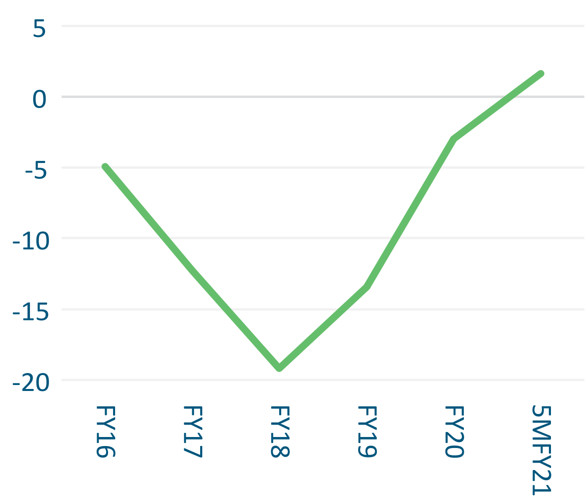


Source: State Bank of Pakistan

Balance of Payment Stays Favorable

The only bright spot in the macroeconomic scenario is the continued current account surplus. Current account hit surplus of USD 447 Mln in November 2020, up from a deficit of USD 326 Mln in November 2019. November marked the fifth consecutive month of current account surplus, which is a first such occurrence in over five years.

Current Account Balance (USD in Bln)



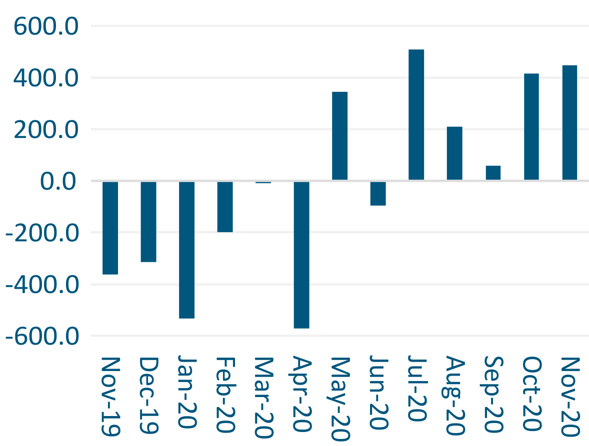
Source: State Bank of Pakistan

The cumulative current account surplus for Jul-Nov 2020 stood at USD 1.64 Bln, up from a deficit of similar magnitude in the same period last year. The surplus stands mainly on high remittances and savings occurring from COVID related travel restrictions.

The goods' trade deficit has worsened by 7% YoY, as import growth has outpaced exports. In all likelihood, imports are likely to grow even faster as the energy needs grow and industrial expansion is underway, and the trade deficit is expected to grow sharply in H2 FY 2021.

The remittances have been up continuously despite all odds, having grown 27% YoY averaging over USD 2.2 Bln per month, comfortably beating monthly exports. The other major difference has been the services trade balance, as the travel related dollar outflow has been much restricted due to the pandemic.

Current Account Surplus (USD in Mln)



Source: State Bank of Pakistan

The improvement in services trade balance contributes more than 40% to the overall current account surplus. The service imports have declined by USD 800 Mln in five months of FY 2021, as religious, personal, and business tourism have all reduced significantly.

As religious pilgrimage travel to Saudi Arabia, which is by far the single-largest travel related import of Pakistan, has not yet returned to normalcy, it has led to savings of more than USD 225 Mln on account hotel booking, and air ticketing alone.

With the likelihood of restrictions easing, religious and leisure travel, with a massive pent-up demand, could grow quicker than earlier anticipated, and could pressure on service trade balance by Q4 FY 2021.

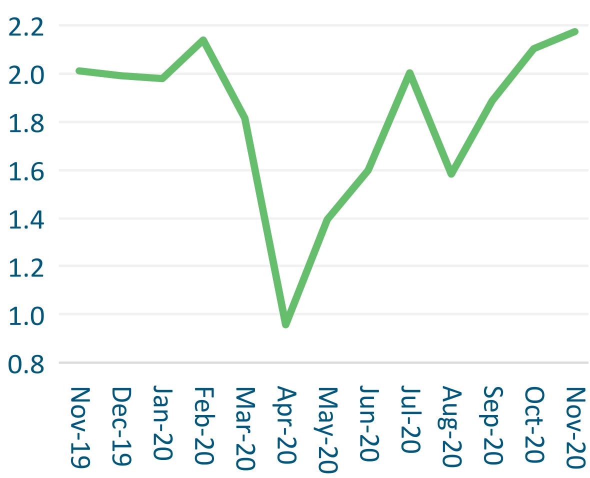
The likelihood of higher travel will also lead to some pressure on remittances routed through formal channels, as a significant home remittance chunk has historically been carried by air travel.

We believe, Pakistan's current account surplus may not last beyond H1 FY 2021, as trade deficit widens, remittance may face pressure, and travel expenses will go up. That said, a monthly trade deficit in the vicinity of USD 550 Mln should be manageable given Pakistan's reserve strength built of late.

Exports Hit Multi-month High

Against all odds, Pakistan's export earnings have continued to grow, registering a 33-month high at USD 2.2 Bln in November 2020. Five-month FY 2021 goods exports have stayed up by 5% year-on-year, and the impact will start to be more pronounced once the COVID base effect starts to come in play in the latter half of FY 2021.

Strong Exports (USD in Bln)

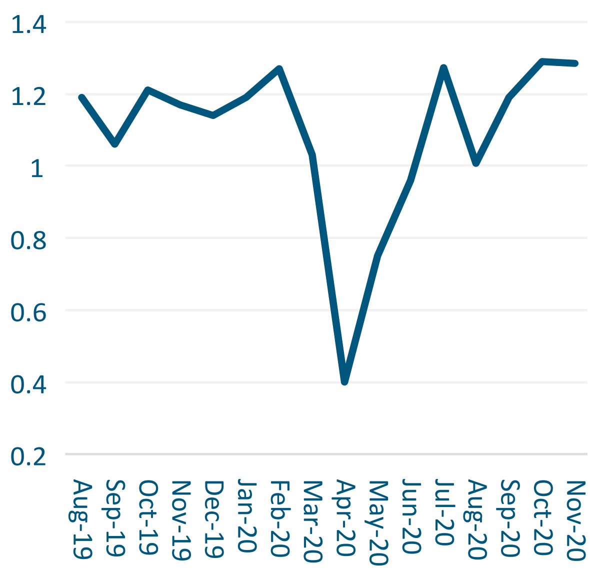


Source: Pakistan Bureau of Statistics

The 12-month moving average at USD 1.8 Bln is also indicative of exports moving the right way. Unsurprisingly, the march is led by the flagbearer textile segment, the share of which has soared to 62%, up from previous 5-year average of 58%.

Textile exports have been recorded at USD 1.28 Bln for two consecutive months, which is comfortably the highest in over five years. What makes the numbers so impressive is the fact that the growth had started to pick up in the middle of the pandemic when most of Pakistan's regional competitors were struggling with a substantial drop in demand from the West.

Textile Exports (USD in Bln)



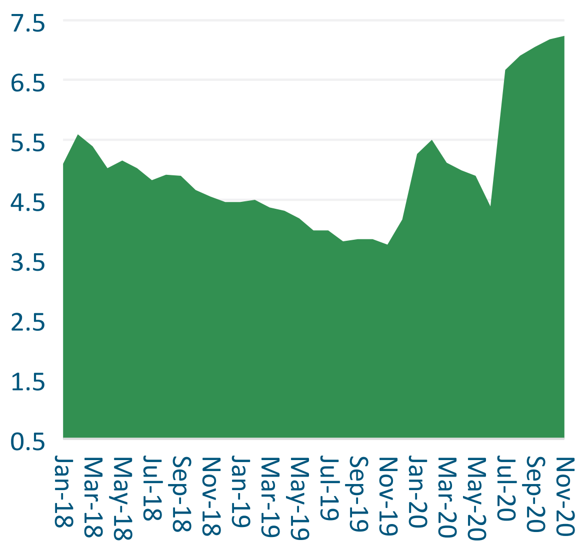
Source: Pakistan Bureau of Statistics

Pakistan's broader strategy to lift lockdown restrictions on industrial sector seems to have yielded the desired results. Not only has Pakistan been able to ramp up textile exports, but it has also managed to tap new markets, making an inroad towards higher value-added goods, at the expense of Bangladesh and Turkey, where the economy took more time to reopen.

Pakistan's resolve to provide electricity, natural gas, and long-term financing at concessional rates to the export-oriented sector, has also contributed to make Pakistan more competitive.

The share of value-added readymade garment segment has gradually increased. Despite a significant decline in export quantity in the readymade garment sector by over 40% in FY 2021 so far, the export value has remained intact. The major difference has been made by a considerable surge in unit prices, which have almost doubled from last year.

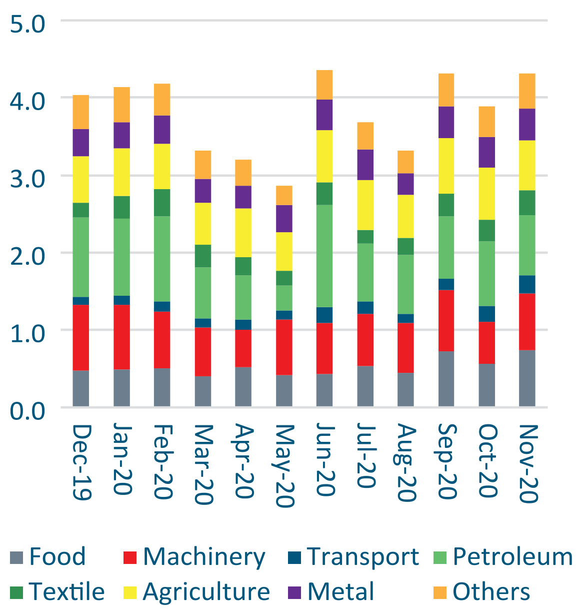
Readymade Garments Add Value (USD/piece)



Source: Pakistan Bureau of Statistics

The move has been made within the readymade garments, where Pakistan has secured orders from high-end fashion brands in the USA and Europe – as evident by a massive jump in unit prices within the category, which have jumped from under $4 per piece to well over $7 per piece and growing.

Monthly Imports (USD in Bln)



Source: Pakistan Bureau of Statistics

Industry insiders have stated that the industry's value-added segment is overbooked for the next six to eight months.

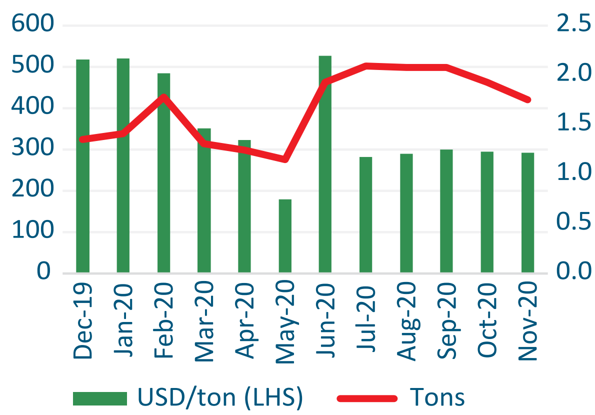
There is evidence of robust projected demand as most big textile players have entered rapid expansion. We believe, the textile export volumes should also bounce back once COVID second wave recedes.

Pakistan would do well to retain some of the newly captured market, which could go a long way in helping its target of annual exports of USD 25 Bln by 2023.

On the other hand, imports have also started to show signs of resurgence. Jul-Nov imports at USD 19.5 Bln are 1.6% higher YoY, as pre-COVID levels are returning to the import bill.

International oil prices have historically dictated the movement of Pakistan's import bill. The oil related imports in FY 2021 have been cut to size as crude oil prices have stayed low for most part. But that has not necessarily translated into overall import reduction, as food imports have emerged strongly.

Petroleum Products' Imports



Source: Oil Companies Advisory Committee

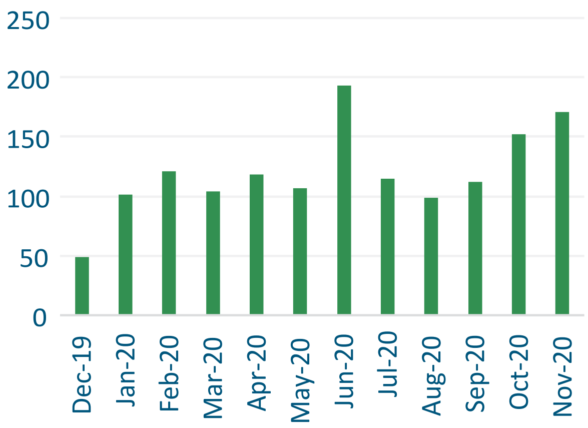
Pakistan's food imports have historically constituted 10% of the total, but the share in 5M FY 2021 is up to 16%, as food imports have increased by more than USD 1 Bln or 44% in the five months so far versus the corresponding period last year.

The rise in food import for a country that prides itself has put the authorities on backfoot, as a bad crop season and spiraling staple prices due to hoarding and supply chocks, led the government to import wheat and sugar in sizeable quantities after a very long time.

As Pakistan's transport sector attracts fresh investments, and automobile demand is back in full swing due to lower interest rates, transport group imports have significantly increased, as used imported cars constitute a large chunk of vehicle imports.

Machinery imports should also go up, as expansion projects are underway or in pipeline for big ticket sectors such as cement, steel, automobile, electronics, and textile.

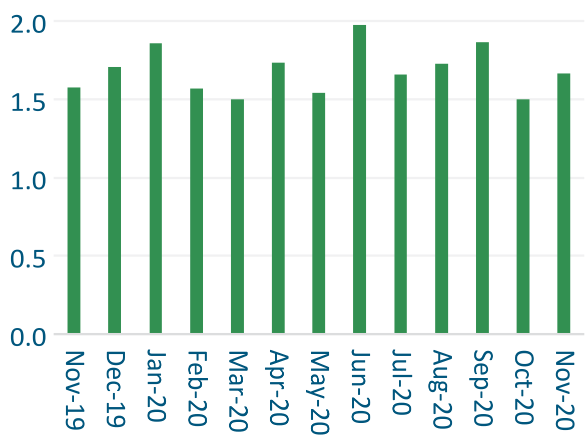
Vehicle Imports (USD Mln)



Source: Pakistan Bureau of Statistics

Pakistan's policy actions have also led to higher incidence of mobile phone imports, which are expected to breach USD 1 Bln for FY 2021. As Pakistan is expanding capacity to manufacture smartphones at home, raw material imports are likely to stay north going forward.

Trade Deficit Stays Manageable (USD in Bln)



Source: Pakistan Bureau of Statistics

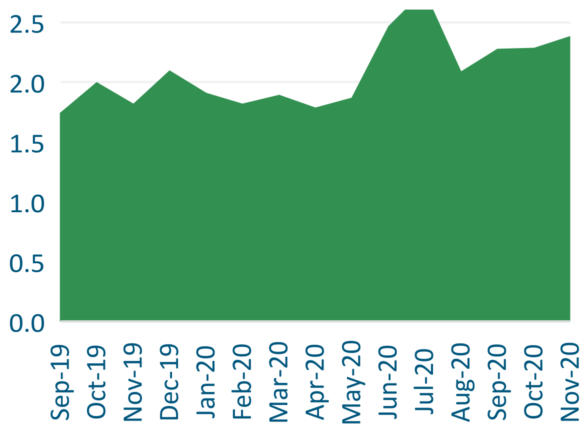
Petroleum consumption is also going to take a toll on overall imports. The quantity has visibly increased since the start of FY 2021. Pakistan is also planning more power generation on imported fuel, mainly RLNG and coal, which are all set to inflate the energy import bill.

We believe the trade deficit is on its way to widen over the course of 2021. That said, the quality of trade deficit could be better than the one seen in yesteryears, as a significant chunk is anticipated in industrial investment.

Steady Remittances

Pakistan's steady macroeconomic indicators in FY 2021 have been built around phenomenal resilience shown by workers' home remittances. For the sixth consecutive month, home remittances remained north of USD 2 Bln, registering a staggering 18% increase YoY in Jul-Nov 2020.

Home Remittances Stay Upbeat (USD in Bln)



Source: State Bank of Pakistan

The alternate explanation is those returning home sending lifelong savings back home, but data shows that average ticket size has remained at similar levels as that of pre-COVID days. A much fathomable reason is the crackdown on illegal channels and reduced travel, both of which used to be significant carriers of money back home.

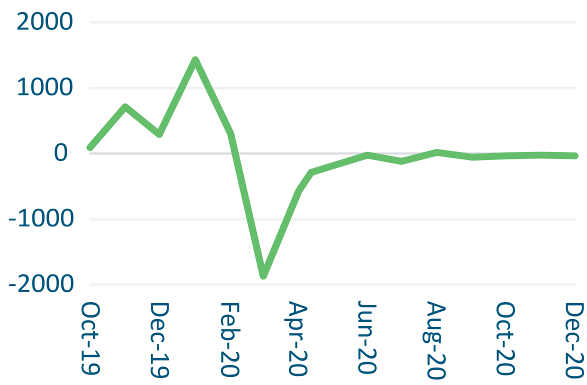
We believe, the remittance growth story may slow down once the pandemic is over and frequent travel restarts. That said, enough inroads have been made to incentivize sending money through formal channels, and some of it should remain onboard even after COVID.

DEBT MARKET UPDATE

More than half a billion dollars have evaporated from the Pakistan debt market, as Foreign Portfolio Investment continues the flight ever since the first signs of pandemic in March 2020, triggered a global investor pullout from emerging markets.

The interest rate reversal that started in March 2020 seems to have halted, but there is no monetary tightening in sight. Although the central bank is allowed to run the monetary policy independently, there have been growing voices over further easing from policy circles.

Foriegn Portfolio Investment (USD in Mln)



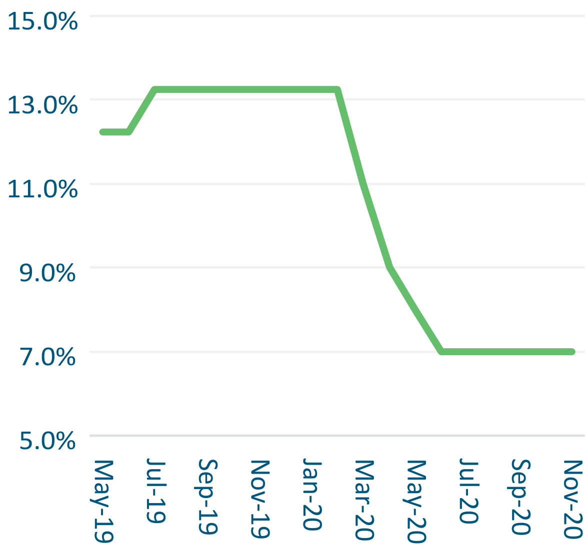
Source: State Bank of Pakistan

This may put pressure on the monetary policy committee and any rate increase can be ruled out for at least one more quarter. This should keep FPI at bay, given the discount with the region has also narrowed down, from the earlier lucrative rates on offer.

The outflow has been consistent across the major categories of equity, treasury bills and Pakistan Investment Bonds. There has been negligible activity in FPI ever since the massive pullout in late March 2020. Pakistan's risk profile is believed to have raised as an investment decision by international agencies, adding further risk premium to already lower yields.

Pakistan has been trying to lure in expatriates to invest in debt market, offering one-window operations, but the efforts have so far not yielded the desired results, with insignificant participation recorded in the flagship Pakistan Banao Certificates, targeted at Pakistani community living abroad.

Interst Rates

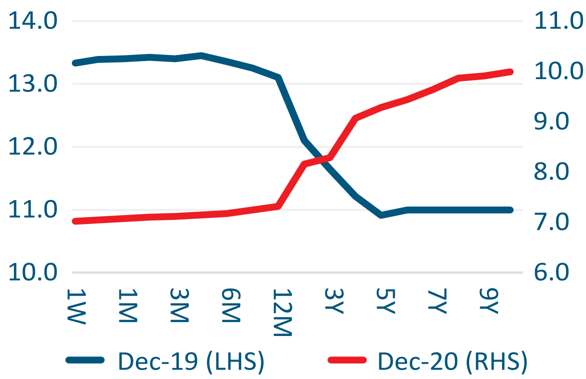


Source: State Bank of Pakistan

The interest rates are expected to be maintained, or in an outside chance reduced further to provide growth stimulus. The central bank has made a shift in stance from the earlier stated policy of positive interest rates. The pandemic has brought about the forced change, as the SBP is accommodating a negative real interest rate, in a bid to keep the economy afloat.

The bond market yields of late, have suggested there is no expectations of a rate hike anytime further, as near-term yields remain on the lower side. The government, in agreement with the IMF, has opted for a long-term debt maturity profile aimed at better price discovery.

Yield Curve



Source: State Bank of Pakistan

Source: State Bank of Pakistan

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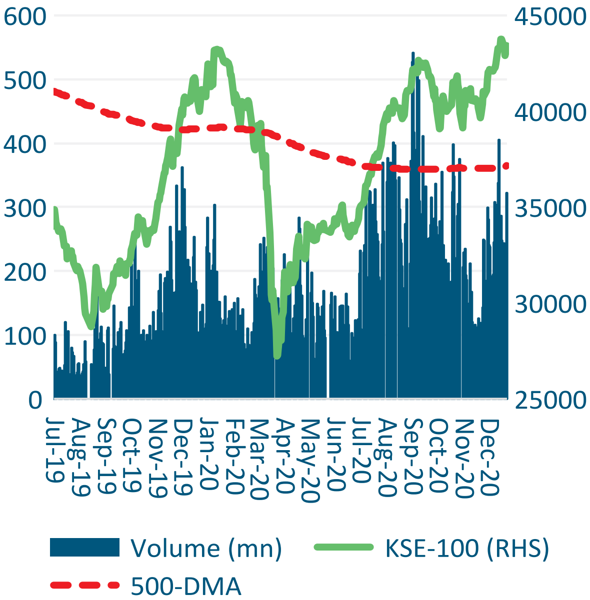
EQUITY MARKET UPDATE

The year ended with the KSE-100 index making a sharp recovery in December 2020, ensuring the benchmark index does not end up offering negative yearly returns. Even the late bull rally, has only limited the 12-month upside to a paltry 5%, in line with the sedate performance of the stock market since 2017.

The yearend closing index reads a high of 30 months, but in between there have been plenty of ebbs and flows, and a resounding comeback after the first COVID wave. Pakistan Stock Exchange was widely regarded as one of the best performing markets when it staged a sharp V-shaped recovery after the multiyear lows of March 2020, as global selloff triggered panic.

KSE-100 Index - Resistance at 40k



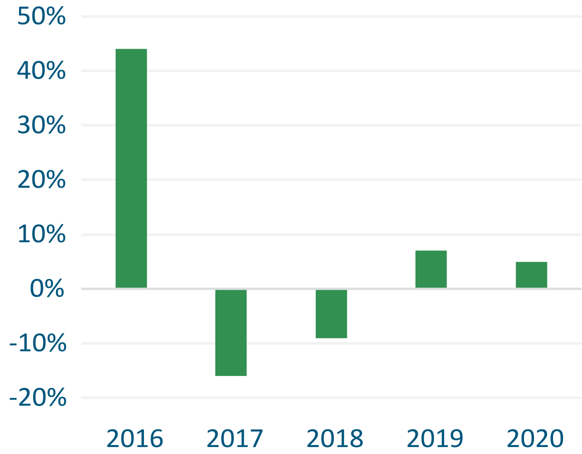
Source: Pakistan Stock Exchange

Foreign investors have been net sellers at the PSX in 2020 with net selling in excess of USD 500 Mln. Majority of activity has been spearheaded by mutual funds and banks, as they turned towards equity and debt markets in days of sharply reduced interest rates.

The corporate earnings have been rather steady, despite the onslaught of COVID, as most sectors including textile, food, banking, steel, fertilizer, power, and cement showed immense resilience and posted double-digit YoY earnings growth.

That said, the dividend yields were significantly impacted, as most companies cut short on payouts in the wake of pandemic. Commercial banks were restricted by the central banks to announce dividends, in a bid to ensure prudence given the COVID related impact. The price-earnings multiple hovered around 7-8X, in line with the historic regional discount of 20-25%.

KSE-100 Yearly Return



Source: Pakistan Stock Exchange

The political upheaval has added a fresh risk dimension entering 2021, compounded by the second wave of COVID. That said, the stock market has shown confidence in the market-based exchange rate regime and improving macroeconomic indicators.

Going forward, the current account surplus is not expected to last long and that could put mor pressure on the currency. On the other hand, industrial activity is picking up and should keep the earnings strong, given inflation outlook is also stable for H2 FY2021.

There are concerns around Pakistan's fate on the Financial Action Task Force listing, where it continues to hang by a threat to the grey list. Should Pakistan manage to get out of the grey list in February 2021, that could unlock more foreign interest. A decision against, on the other hand, carries the likelihood of higher country risk premium, which could put the KSE-100 index under more pressure.

STRATLINK ADVISORY GROUP - WHO WE ARE

StratLink is an emerging markets focused financial advisory company with Capital Raising Advisory, Corporate Advisory and Market Research as our core business lines. We believe in the growth potential of emerging markets and partner with our clients to execute their vision by providing quality services and access to capital. We recognize opportunities in the region and connect the fastest growing middle market companies with leading global investment banks, private equity firms and family offices. We value the importance of making informed decisions and leverage our regional knowledge to the advantage of our clients.

Our guarantee: Competent team, reliable data

Our research is anchored in a competent and versatile team traversing the fields of economics and finance with qualifications from globally recognized institutions. The team is backed by subscription to reliable databases such as Business Monitor International, Bloomberg, Thomson One Research, World Economics and The World Today. As such, our guarantee is reliable and up to date data in an increasingly dynamic region. Further, we reach out to relevant bodies in concerned markets including Central Banks, ministries and state departments.

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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