STRATLINK

MARKET UPDATE – PAKISTAN

FEBRUARY 2021

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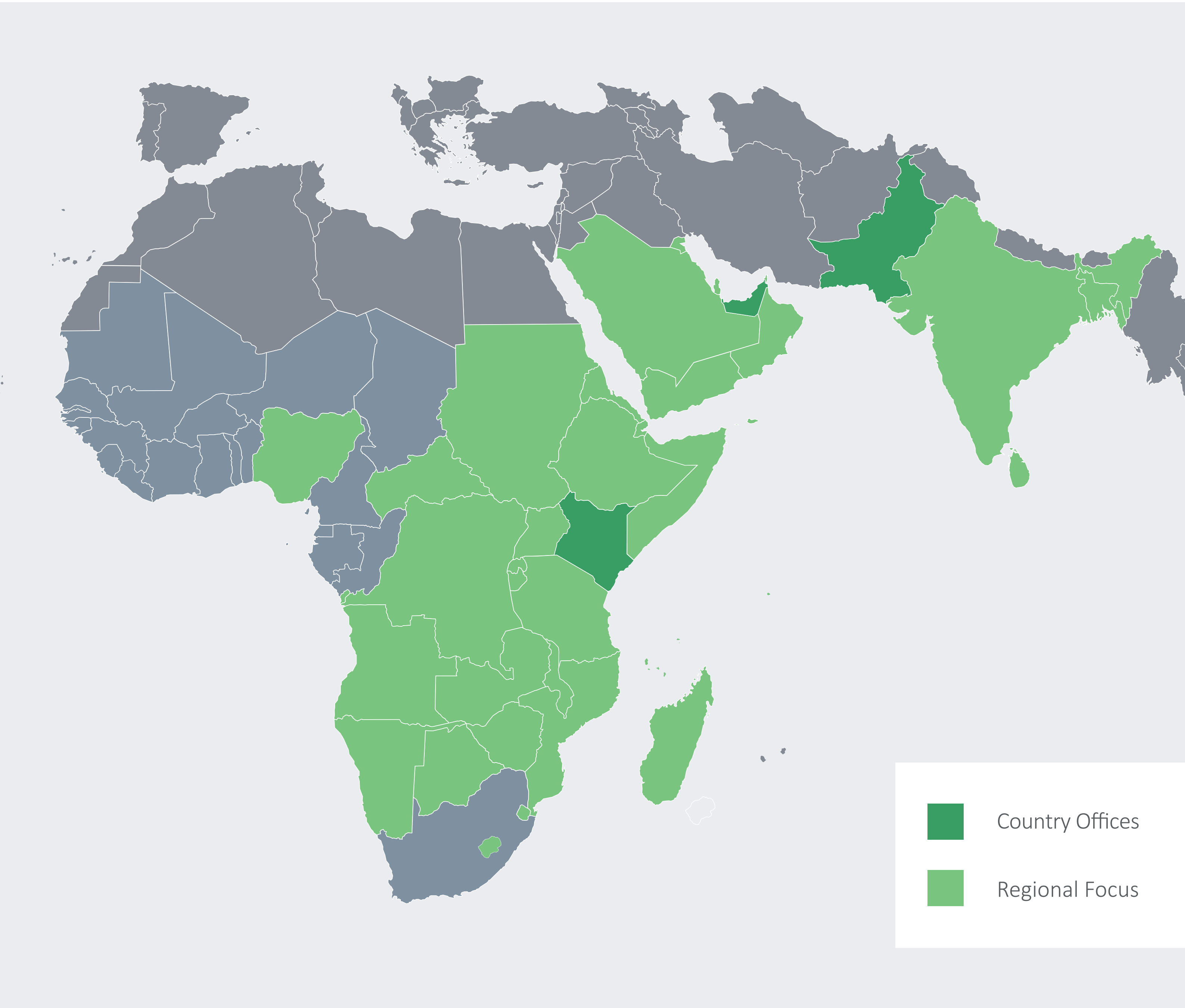
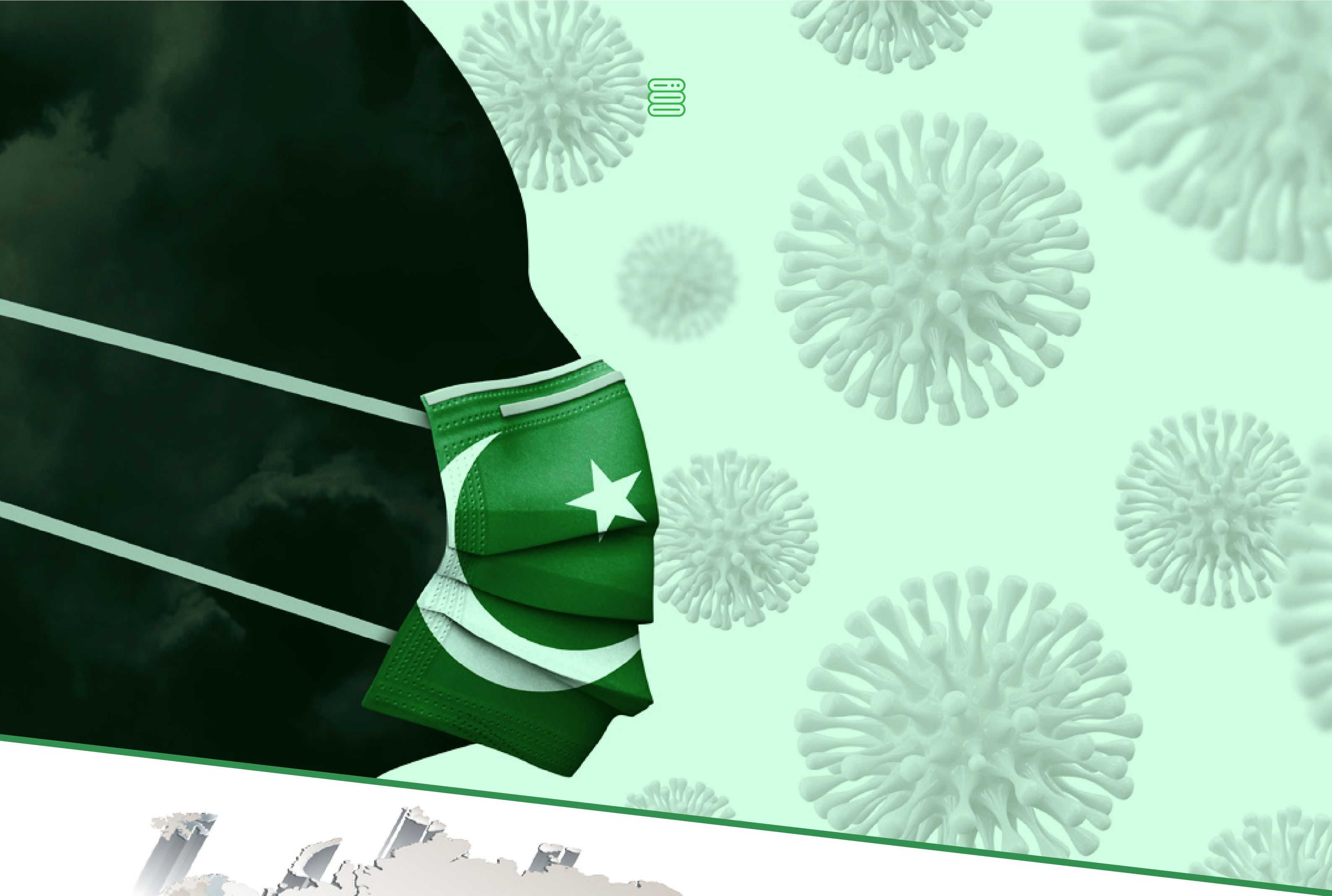




PAKISTAN MARKET UPDATE

| ECONOMIC RECOVERY PICKS PACE

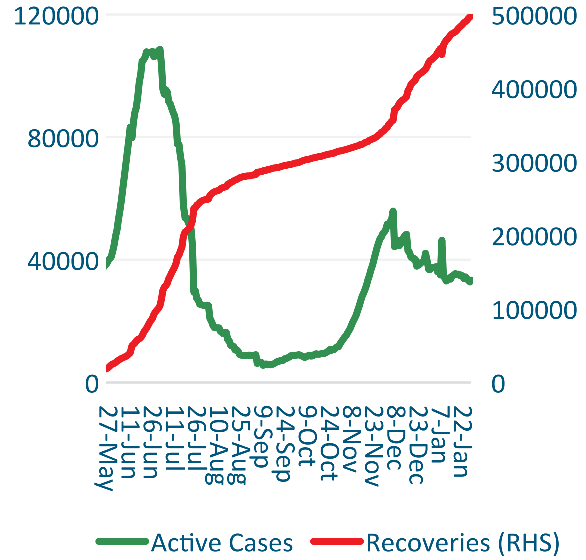
COVID-19 Watch

(These numbers are as of January 29, 2021 and are subject to change)

Second Wave Tames

The much-feared second wave of the novel coronavirus seems to have peaked in December 2020, as January 2021 saw the positivity rate drop from the second wave peak of 7%, to under 5%, and gradually declining.

Active Cases & Recovery



Source: Government of Pakistan

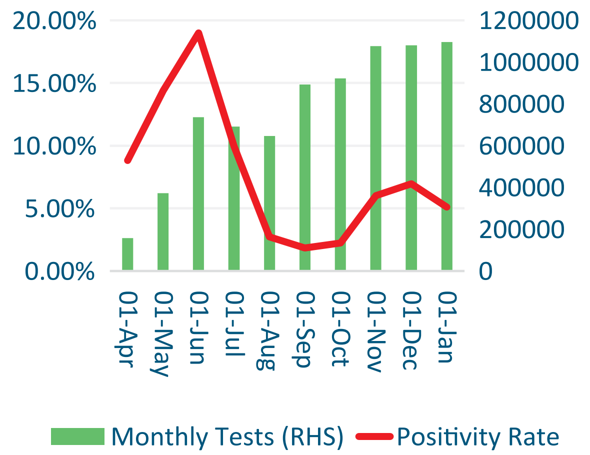
The second wave curve is still nowhere near flattening, and the spread remains what the WHO categorized as 'out-of-control'. Authorities in Pakistan have gradually eased all movement restrictions.

Educational institutes were the last to be allowed to commence full-scale operations, and now virtually the entire economy is running at pre-Covid levels, with minimal restriction protocols.

Pakistan has been late to procure the vaccines in large numbers, which has raised eyebrows. The bureaucratic hurdles in approvals of vaccines have only recently allowed the government to approve two vaccine varieties. Pakistan plans to vaccinate 8-10% of the population by the end of FY 2021, through the government program.

Clarity is yet to emerge if the government will arrange for a vaccination drive at a larger scale. Private sector has yet to plan any vaccine arrangements, which is causing anxiety amongst masses.

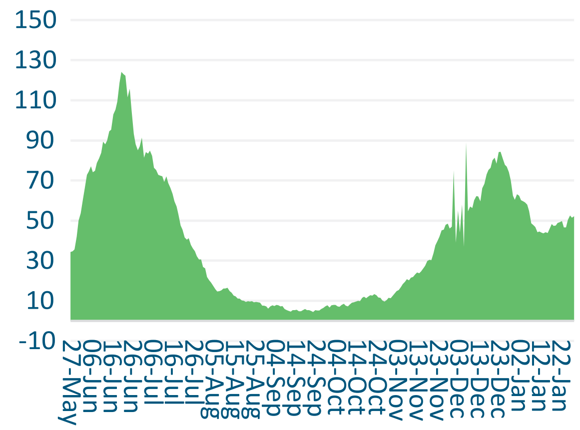
Second Wave Tames



Source: Government of Pakistan

The public and private healthcare infrastructure has coped rather well in the second wave. Pakistan has invested heavily in basic healthcare facilities during the pandemic and use its extensive polio care machinery to combat the virus, as acknowledged by the WHO.

Daily Deaths Still Over 50



Source: Government of Pakistan

While the second wave seems to have already peaked, the delay in vaccination could keep Pakistan at the brink, especially in terms of foreign travel, which could potentially take a toll on tourism and foreign investment.

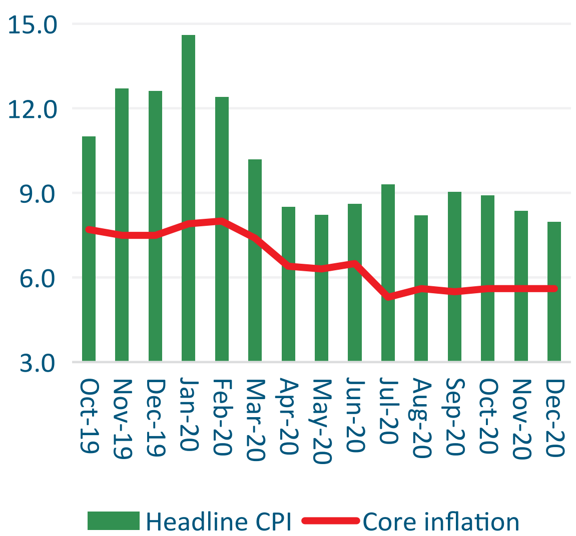
ECONOMIC OUTLOOK

Inflation Cooling Off

National Consumer Price Inflation (CPI) Index was recorded under 8% for December 2020, the lowest in 24 months. The average CPI for H1 FY2021 at 8.63% is significantly reduced from 11.11% in the same period last year.

Inflation has been a bane for the current government for quite some time, with supply shocks, and administrative price control failures, leading to price upward spirals in one form or the other. It seems the tide has bene arrested somewhat for now, but the current inflation cooling down is by no means an indication of a trend just yet.

Inflation Tames



Source: Pakistan Bureau of Statistics

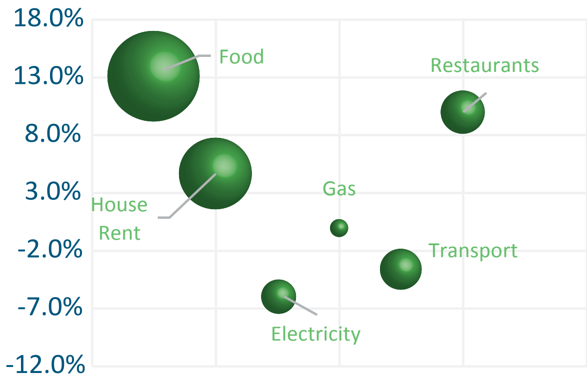
The overall national inflation continues to be headlined by food prices. Food inflation in 1H FY2021 has averaged 14.1%, slightly lower than 14.8% recorded in 2H FY2020, and in at par with 14.1% in 2H FY2020. The combination within has changed of late, with perishable food prices coming down, with improved supply chain.

That said, overall food inflation at 14% is still on the higher side, as non-perishable food prices continue to increase. Pakistan saw subpar domestic crops of staple items, primarily wheat, which has led to a significant round of flour inflation.

Wheat flour has the single highest consumption weight in grains and has thus led to significant impact on overall food sub-index.

The non-food non-energy (NFNE) core inflation has stayed static at a manageable 5% throughout H1 FY2021. The revival of economic activities has yet not led to a demand driven inflation drive, as the government has attempted to manage electricity, gas, and fuel prices.

Urban CPI break-up



Source: Pakistan Bureau of Statistics

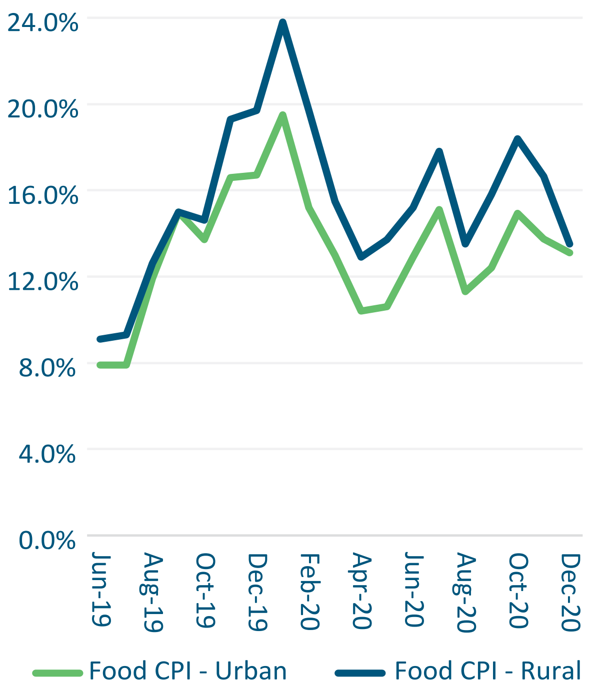
Since the first reported case of Covid-19 back in February 2020, the central bank has slashed the interest rates to half, in a bid to revive domestic demand. The government has so far resisted the IMF pressure on rationalizing electricity and gas tariffs, delaying the tariff notifications, much to the dismay of the IMF.

The low international crude oil prices have also offered enough cushion to the government in terms of keeping the petroleum products' prices low, without taking a hit on taxation revenues. Levies and taxes on petroleum are the single largest source of indirect tax revenue in Pakistan, and low prices have allowed the government to impose maximum levies without having to increase prices.

December 2020 was the first instance in over 15 months where urban and rural food price increase converged. Rural food index had been consistently registering a higher increase than urban food prices, primarily due to a surge in non-perishable food prices, especially wheat and sugar.

Food consumption has a 40% weight in rural CPI basket, versus 30% that in urban basket. The government has imported the two commodities in huge sums to bring the domestic prices down, and that seems to have worked so far.

Rural-Urban Food Inflation Coverges



Source: Pakistan Bureau of Statistics

We believe the double-digit inflation may not return anytime soon, as core inflation stays well under control. That said, upside risk has increased on international crude oil price front, and that could lead to a cascading impact on overall inflation.

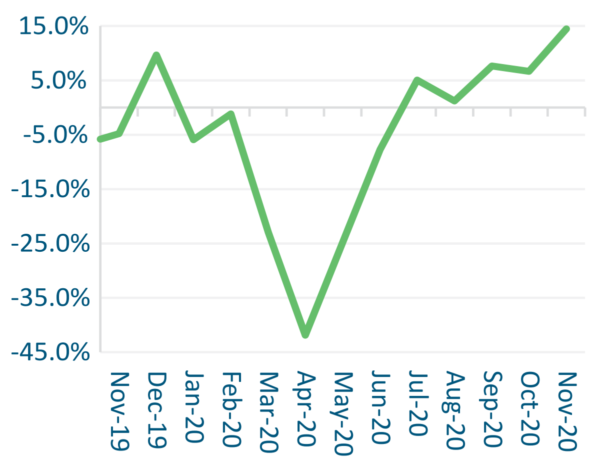
The central bank and the federal government are confident of keeping FY 2021 inflation within the target of 7-8%. We believe, the return to the IMF fold may lead to full-year inflation averaging slightly higher than the target but will still be lower than last year's average of 10.9%.

Industrial Manufacturing Registers New High

The government's visibly increased focus on the revival of industrial activity seems to be yielding the desired results. Large Scale Manufacturing Index (LSM) that captures more than one-third of all industrial production in the country, registered 7.4% growth for Jul-Nov 2020, which is the fastest 5-month LSM growth in over ten years.

The LSM jumped 14.5% in November 2020, which is comfortably the highest ever monthly growth in recorded history. The LSM growth, which was previously lacking breadth has now shown higher breadth of recovery, with a sharp decline in items that showed contraction.

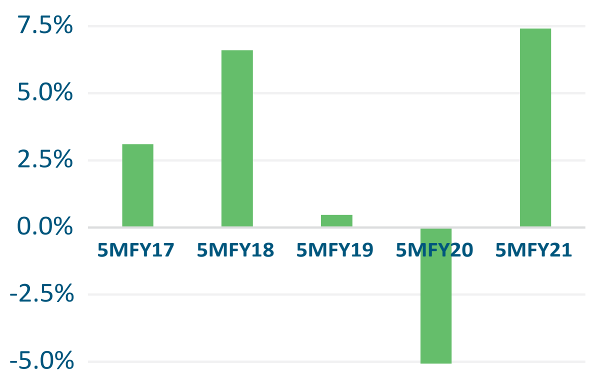
Large Scale Manufacuting (YoY Growth)



Source: Pakistan Bureau of Statistics

The single-largest contribution to LSM growth has come from the food & beverages segment, which has the second-highest weight in LSM base. There has been significant growth in wheat & grain milling, cooking oil, and beverages, as Pakistan's resilient demand-driven economy was quick to rebound from the depth of Covid-19.

LSM Growth

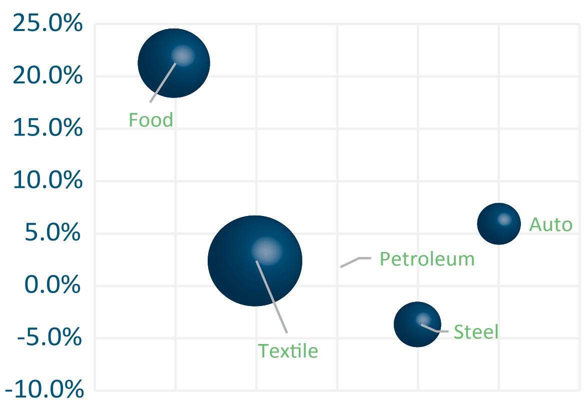


Source: Pakistan Bureau of Statistics

Recall that Pakistan's large-scale industrial sector underwent recession having contracted for eight consecutive quarters. The revival that started in Q1 FY2021 seems to have gathered more steam and has started to look more broad-based and sustainable.

Significantly improved electricity and gas supply, subsidized tariffs for export-oriented industry, concessional long-term financing, reduced interest rates, and improvement in ease of doing business indicators, have all contributed towards the gradual LSM recovery.

LSM breakdown (Jul-Nov 2020)



Source: Pakistan Bureau of Statistics

The country's textile sector has the highest share in LSM and is by far the largest non-agricultural employer in Pakistan. Textile production growth has steadily increased, but LSM is not necessarily the best barometer to gauge the textile sector's performance, due to methodology constraints.

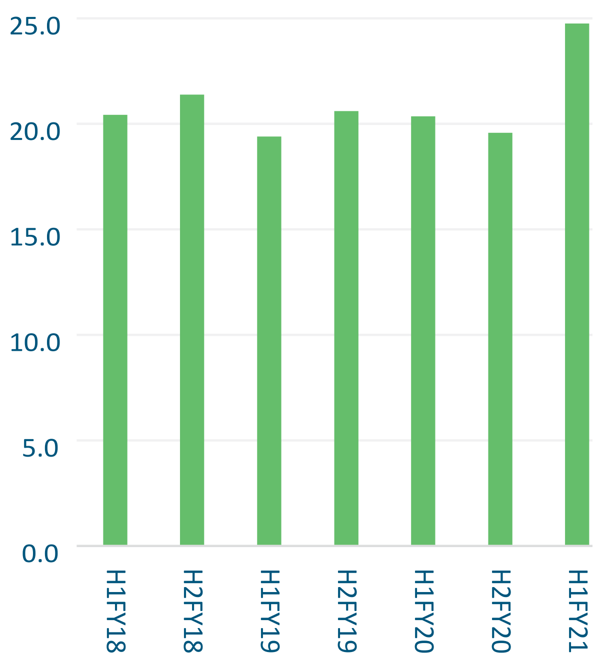
The government's concessional long-term financing policy for export-oriented textile sector and provisions of electricity and gas at concessional rates, have gone a long way in reviving the textile sector. An extremely poor cotton crop this season has put pressure on raw material imports, but early reopening of the economy, has helped gain momentum.

Market intelligence suggests many large textile manufacturers are currently at various advanced stages of expansion, as both domestic and export markets have shown decent surge despite Covid-19. The LSM growth does not capture the value addition that takes place in the textile chain. Value-added high end readymade garments, knitwear and bedwear have of late been the catalyst to Pakistan's textile growth and we expect the trend to continue.

The construction industry has been singled out by the Prime Minister as the one that would be the engine of growth in the next five years. Efforts have been made to create an enabling environment, through various amnesty schemes offered to investors, and taxation breaks announced on construction schemes.

The central bank has also directed the banks to ensure a minimum of 5% of their respective loan portfolio is aimed at construction industry. Subsidized mortgage schemes are now in abundance, as the government's low-cost housing plan that aims to construct 5 million houses in five years is well and truly underway.

Cement Half-Yearly Sales (Mln tons)

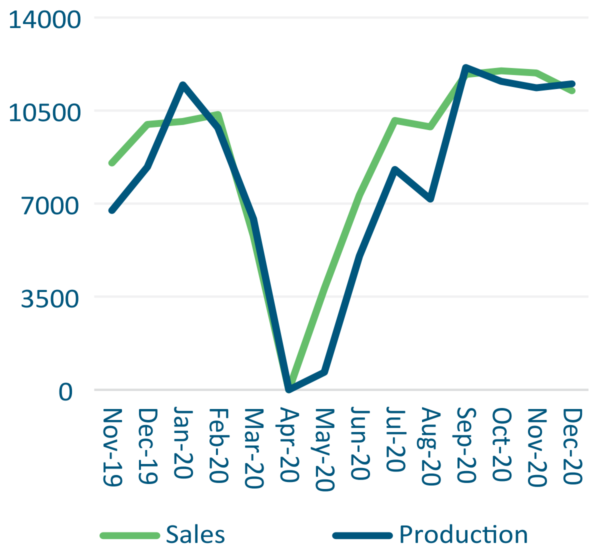


Source: Pakistan Bureau of Statistics

The construction boom is evident from the spike in cement sales. Pakistan's cement production and local dispatches have recorded the highest ever numbers during H1 FY21. Cement local dispatches at 25 million tons for 1H FY21 is 25% higher YoY.

Allied industries such as steel, paint, glass, and pipes have also reported double-digit growth numbers in Q2 FY21. We believe the construction allied industries will continue the strong performance as the government's infrastructure, and low-cost housing schemes gather more steam.

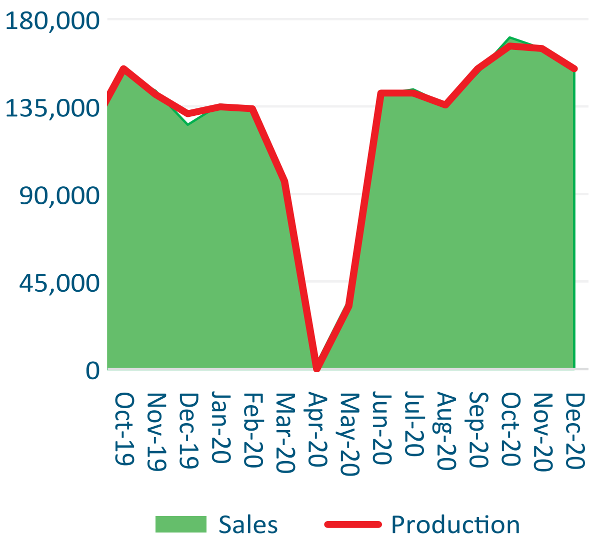
Autombile Demand Rebounds



Source: Pakistan Auto Manufacturers Association

Nowhere close to the all-time highs seen in FY18, automobile sales have registered a tremendous comeback from the abyss. Having nosedived to virtually zero production and sales, the passenger cars demand has been consistently strong, across all categories.

Motorbikes Show Resilience



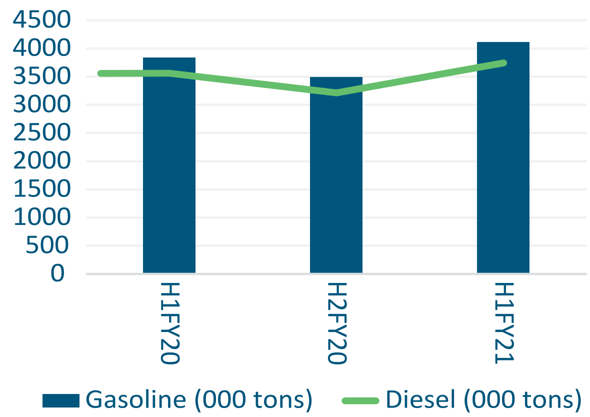
Source: Pakistan Auto Manufacturers Association

Automobile industry has seen several new entrants in the higher end segment, breaking the 30-year-old capture of the big three Japanese players. A new automobile policy that offers investment incentives has led to Chinese, Japanese, and British car manufacturers setting up shop in Pakistan, drawing considerable interest.

More than two-thirds of all incremental automobiles in Pakistan are bank financed. The significantly reduced interest rate has led to bank auto financing quadruple from last year. The buyers now have more options available than ever before, and price competition is expected to be stiff going forward.

We believe, the four-wheeler segment of the automobile sector is all poised to set new production and sales record in the next fiscal year, given strong demand growth and low interest rates.

Petroleum Sales Remain Bouyant



Source: Oil Companies Advisory Committee

Pakistan has seen its oil refineries operating at the highest capacity in over five years during H1 FY2021. It must be noted that the pandemic did not hit the demand of petroleum products, as highest ever monthly sales were recorded at the peak of Covid-19 back in June 2020.

One plausible reason for higher refinery production is the crackdown on smuggled petroleum products. As per government estimates, 25% of all petroleum products get smuggled in Pakistan from the porous borders. That has now been brought under control to some extent and is a big reason why the local refinery throughput has increase.

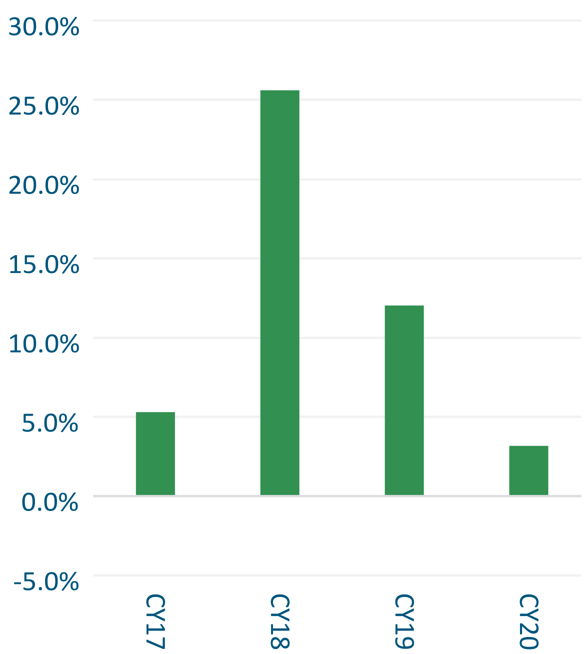
Considerably lower international oil prices have also helped to keep the demand up. The government has utilized the opportunity to maximize its tax revenue on petroleum products, without increasing the consumer price. The tax revenue on petroleum has increased by 60% in H1 FY2021.

Other industrial sectors such as fertilizer, tobacco, paper, chemicals, paint, and electronic appliances have also shown decent recovery in H1 FY2021. Purchasing power of the middle-income class is expected to recover swiftly, as pointed out by the central bank in its latest report, which bodes well for growth in industrial sector growth aimed at domestic consumption.

Pakistan Rupee Finds Stability

Having fared relatively stable for three months, the December 2020 current account deficit raised some read flags in the currency market. The foreign exchange interbank market went abuzz with all sorts of speculations, as the IMF program is all but ready to reboot.

PKR Yearly Depreciation

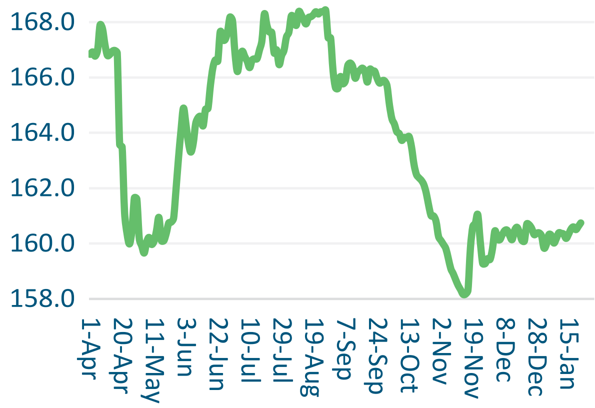


Source: State Bank of Pakistan

The current account deficit after five months did not lead to any significant depreciation in PKR versus the greenback.

The stability underscores the inherent strength of the fundamentals, and also shows how the central bank's market-based foreign exchange mechanism is well and truly in play, as the PKR has of late been responding very well to market supply and demand dynamics.

PKR Finds Stability

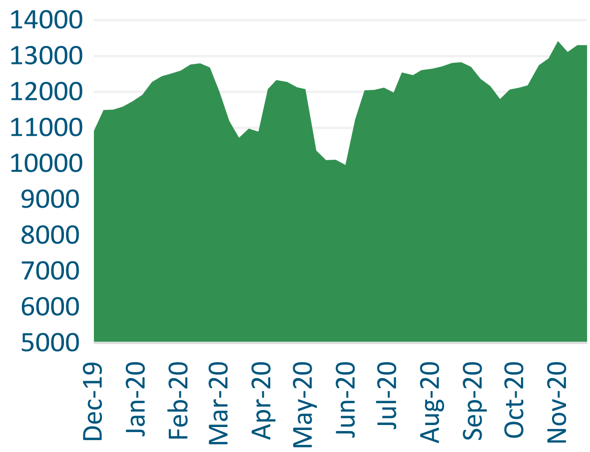


Source: State Bank of Pakistan

The gauge to determine the equilibrium level for currency, Real Effective Exchange Rate (REER) had moved from the lows of 90 in July 2020 to 99 in December 2020. There appear no immediate chances of PKR losing significant value against the USD, due to current account adjustments.

Pakistan's ability to finance to deficit is considerably improved from last year. The dollar inflow through various lending and grant programs are under no threat either, and should keep the reserves buffer well in place.

Foriegn Reserves (USD Mln)



Source: State Bank of Pakistan

We expect the PKR to hover in a broad range of 160-170 for most of 2021, and continue the resilience shown in 2020, which turned out one of the most stable years in the last decade, in terms of PKR value against the USD.

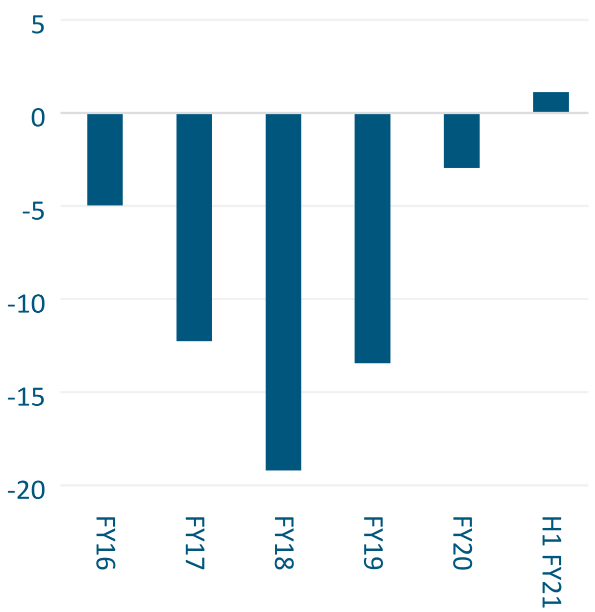
Pakistan has made swift arrangements to keep the foreign exchange safe deposits high. The payments of over USD 1.5 Bln to Saudi Arabia were offset by an equal amount of deposit from China. The back-on-track IMF program should also further unlock more multilateral funding for Pakistan, and that should a long way in keeping PKR on firm grounds.

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.

Balance of Payment Honeymoon Over

After a five-month long streak of current account surplus, December 2020 resulted in deficit. The current account deficit at USD 662 Mln was at 18-month high, and perhaps the first signs of the economy returning to normalcy. Unlike massive current account deficits of yesteryears, this one so far looks easier to be financed.

Current Account Balance (USD in Bln)



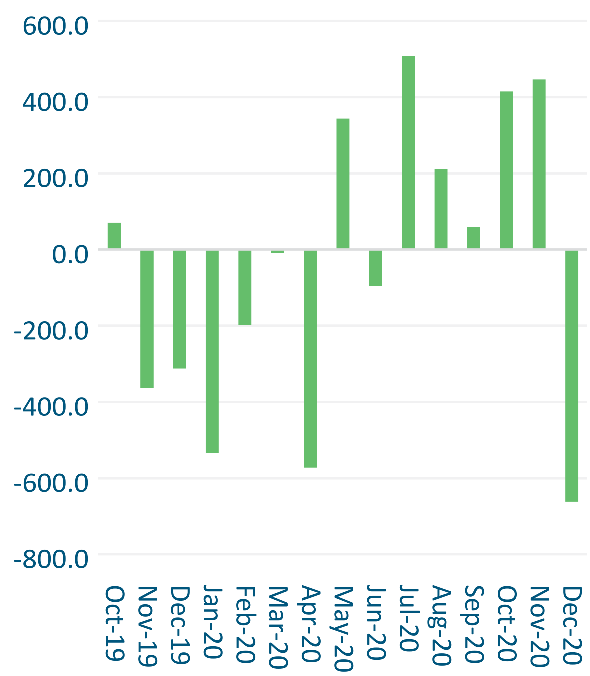
Source: State Bank of Pakistan

The cumulative current account surplus for H1 FY2021 was recorded at USD 1.13 Bln, up from a massive deficit of USD 2 Bln in H1 FY2020. The cumulative deficit comes mainly at the back of improvement in service trade balance, and sharp surge in remittances.

December 2020 current account deficit shows that goods' imports are increasing at a faster pace, and remittance growth alone may not stop current account turn all red in H2 FY2021, should December imports turn into a trend.

The trade deficit for goods has increased by 17% in H1 FY2021 to USD 11.4 Bln. Exports as computed by the central bank, which tracks actual dollar receipts, have gone down by 7%, whereas the imports have gone up by a similar magnitude. The trade deficit is already the highest since FY18 and could well be on its way to match the all-time highs of 2018.

Current Account Goes South (USD in Mln)



Source: State Bank of Pakistan

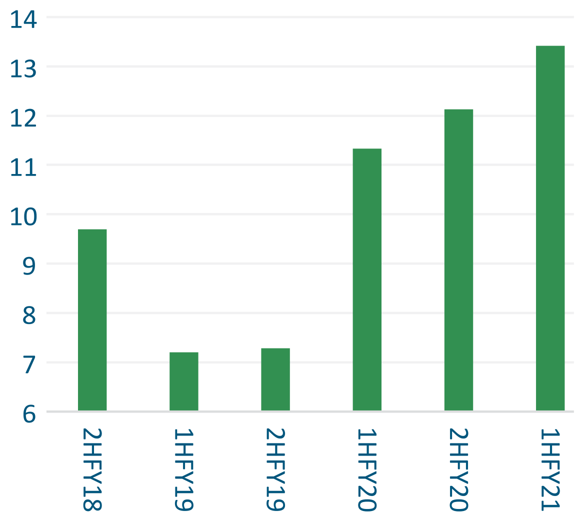
The respite has been offered by significant improvement in services trade balance. Pakistan's IT exports have soared by 50% YoY in H1 FY2021, having averaged USD 210 Mln per month since the beginning of Covid.

The service trade imports have substantially reduced, aiding the current account. Much of the reduction has been possible due to substantially reduced work, business, leisure, and religious travel, leading to restricted dollar outflow, for purposes of travel and lodging.

Nearly two-fifth of the improvement in current account deficit during 1H FY2021 has been possible due to the service trade savings. Pakistan has the world's largest number of pilgrimage travelers to Saudi Arabia every year, which is the single largest source of hospitality related dollar outflow.

The pent-up demand had been building gradually after 9 months of partial ban on religious travel to Saudi Arabia. The Kingdom is gradually opening up the space for pilgrims and that should lead to a gradual increase in service-related dollar outflow, and resultantly put pressure on current account going forward.

Pakistan's Forex Reserves Grow (USD in Bln)



Source: State Bank of Pakistan

Home remittances remain the biggest source of inspiration for the current account to no go out of bound. The monthly average remittances have gone up by over one-fourth from last year, and experts opine the growth may slow, but the new base should serve the purpose of keeping the dollar inflow coming, even after the pandemic, with increased chances of air travel.

The December current account deficit after six months shows the tides are changing, as goods' trade deficit is growing by the clock. A lot of eyes will be on export performance, which has been satisfactory, but has not grown enough to mitigate import growth. We believe, current account will end in deficit in H2 FY2021.

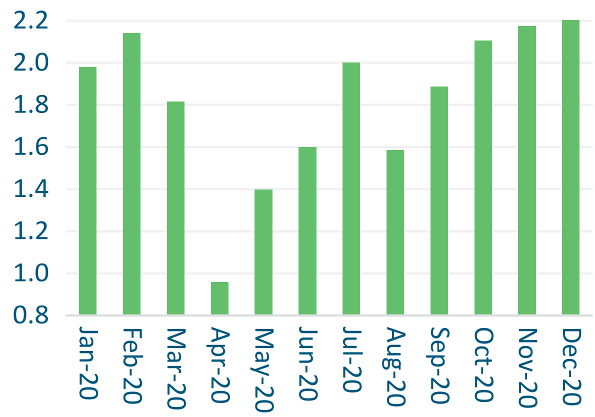
That said, the reserve buffer and Pakistan's expected dollar inflow to finance the current account seems adequate.

Monthly Exports Hit Multiyear High

Goods' exports have been the silver lining in Pakistan's economic turnaround story. December 2020 exports were recorded at 100-month high, and Q2 FY2021 exports were the highest in over five years.

H1 FY2021 exports sit 6% higher YoY and are slated to show significantly higher growth numbers in the second half, as the low base effect will now come into play. Recall that Pakistan's exports had shattered to historic lows during March-June 2020 owing to the pandemic.

8-Year High Exports (USD in Bln)



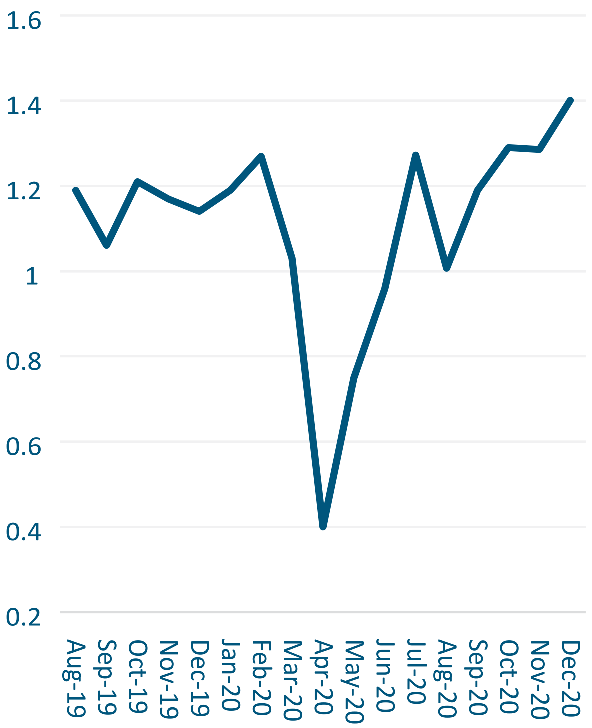
Source: Pakistan Bureau of Statistics

The growth story has been all about the textile sector. Textile has long been the torchbearer of Pakistan's export earnings, and FY 2021 has seen Pakistan further consolidating its status. The share of textile in overall exports has increased now to 63% in H1 FY 2021, up from an average of 58% in the last five years. Textile exports at USD 1.4 Bln for December 2020 are the highest ever monthly category imports.

Textile exports have consistently been raking north of USD 1 Bln, and December 2020 sees Pakistan's textile exports in never seen before territory. What makes the textile growth ever so impressive is the fact that the rebound has happened during a pandemic, in a product category that is marketed mainly in the worst hit countries by Covid-19.

The government has singled out the export-oriented sector for concessional rates of financing, coupled with extension in the industrial support package that ensures provisions of electricity and gas at regionally competitive rates.

Textile Exports (USD in Bln)



Source: Pakistan Bureau of Statistics

Opening the industrial sector earlier than its competitors, has extended a sizeable early-movers advantage in the pandemic scenario. Pakistan's textile exporters have clearly managed to penetrate deeper in the US and European markets.

The composition of textile exports has also titled towards value-added segments. The readymade garment exports reached the highest monthly toll at USD 300 Mln in December 2020. Other conventional segments such as bedwear and knitwear have also raked in the highest-ever monthly exports, as the local textile machinery is operating near full throttle.

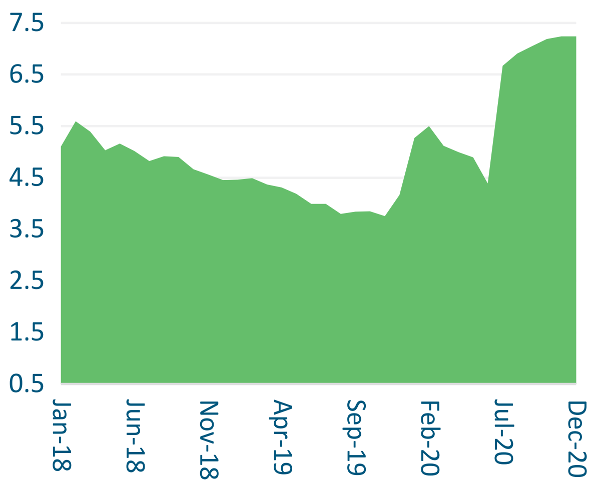
Although the quantities have not come back to pre-Covid levels, except for knitwear, Pakistan's exports have entered in readymade garments and cotton cloth.

The overall exports in value terms have only increased in single digits, but this is with a low base, and Pakistan is expected to hold on to some of the incremental market share, when things return to normalcy.

The volume of readymade garments has stayed 40% lower YoY in H1 FY2021. The demand from Pakistan's major export markets has been rather subdued, as European region continues to battle with Covid-19.

What has changed is the composition within the readymade garment segment, as evident from 90% YoY increase in unit price. The average dollar price per piece of readymade garment has gone up from USD 4 to USD 7.2 in H1 FY2021. A number of high-end international brands have placed orders with Pakistani exporters.

Value Added Exports Rise (USD/piece)

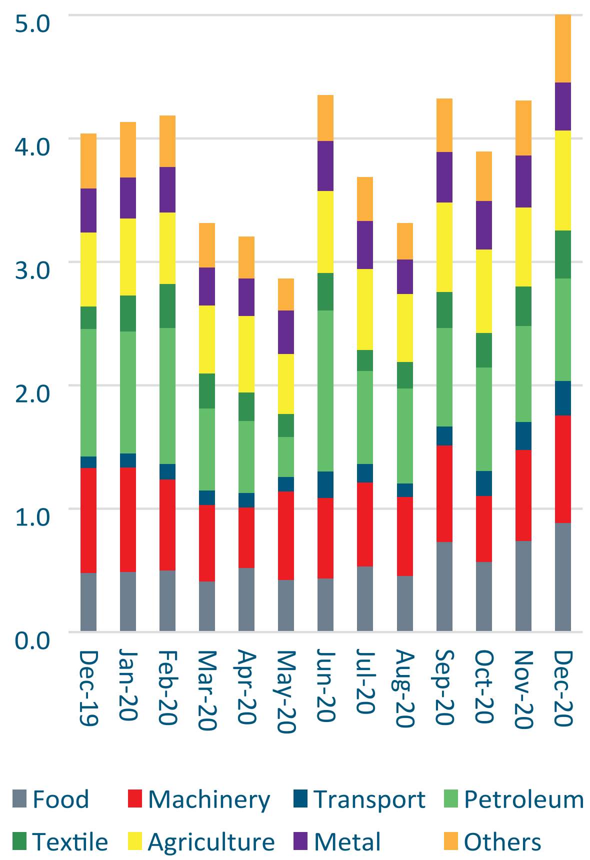


Source: Pakistan Bureau of Statistics

Industry intelligence suggests textile exporters are booked for next five to six months with the big brands. This should ideally keep the unit dollar value high, and the volumes should pick up gradually.

We believe the export momentum should carry on in H2 FY2021 as the government has offered extension of the support package, and things have started to ease in terms of the pandemic impact. Pakistan's overall exports in FY 2021 could well be on the way to record the second highest ever yearly figure crossing USD 24 Bln.

Monthly Imports (USD in Bln)



Source: Pakistan Bureau of Statistics

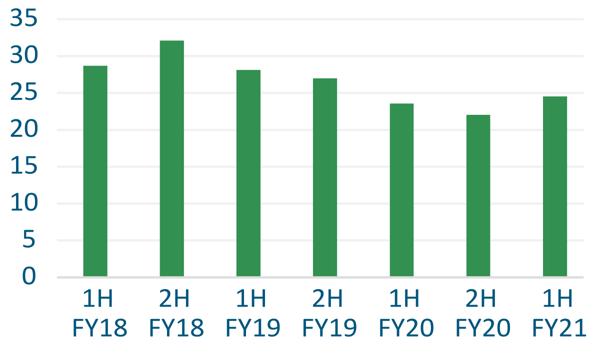
Goods' imports, on the other hand crossed USD 5 Bln for the first time in 20 months. The slowdown that had started early FY 2019 had kept the imports well before Covid-19 hot the shores. The average monthly import had stayed around USD 4 Bln for most of FY 2019 and pre-Covid FY 2020.

The composition of imports shows signs of the economy starting to heat up, as the magnitude of increase is evident in consumption driven items, such as food, mobile phones, appliances, and automobiles.

The H1 FY2021 imports at USD 24.4 Bln are 5.51% higher YoY, and almost singlehandedly caused by the unprecedented surge in food imports. Food imports have increased by a massive 52% YoY in H1 FY2021.

As oil prices stayed down for most part of H! FY2021, Pakistan's energy import bill stayed within manageable levels., constituting just 20% of all imports, down from 5-year average of 26%.

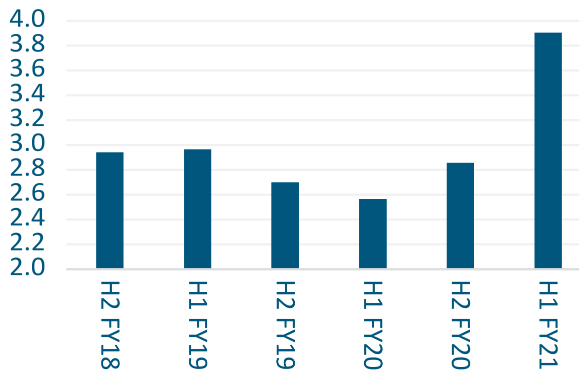
Half-Yearly Imports (USD Bln)



Source: Pakistan Bureau of Statistics

Pakistan has historically been self-sufficient in food, but last two crops of wheat and sugar have missed the target, which started a domestic price war. Food imports have constituted 16% of all imports in H1 FY2021, which is the highest half-yearly share, beating the previous high of 13%

Food Imports Surge



Source: Pakistan Bureau of Statistics

Both wheat and sugar carry a significant weight in national food consumption basket, and the short supply led to a round of massive price increase, which forced the government to intervene through imports. Supply side constraints persist in a few cases, and sporadic imports going forward, cannot be ruled out.

Food imports should cool down in H2 FY2021, as sufficient wheat and sugar stocks have bene built to keep prices in check. Palm oil and pulses have shown an increasing trend, but overall H2 FY2021 food imports are expected to be significantly lower than H1.

Source: State Bank of Pakistan

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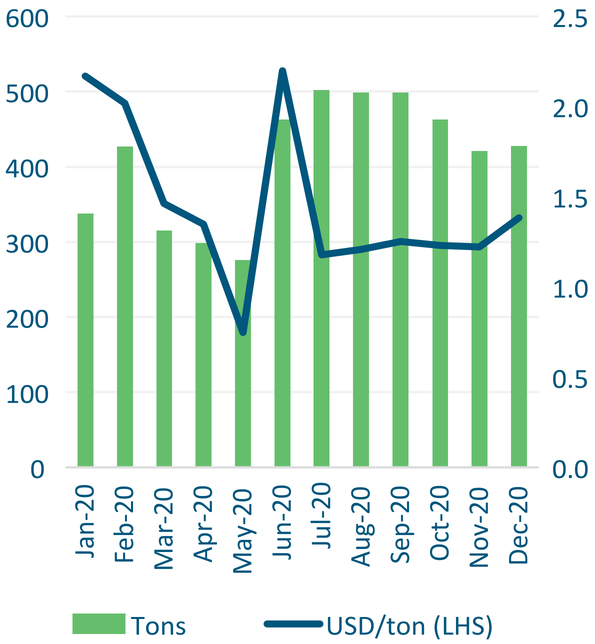
The import quantity of petroleum products is gradually returning to normalcy. With international crude oil prices slowly inching up, and the industrial activity back to full steam, energy imports are slated to go significantly higher in H2 of the fiscal year.

Pakistan also intends to run more power plants on imported LNG, the imports of which are slated to go up. With grid electricity getting more expensive, consortium of big textile players is also exploring options to privately arrange LNG imports, which could put more pressure on energy imports.

Petroleum Products' Imports



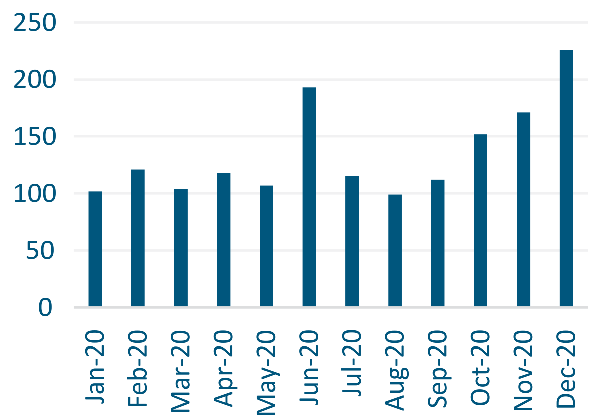
Source: Pakistan Stock Exchange

The government has principally approved the plan to allow use of imported liquified natural gas for transport sector through private sector imports. Given the price differential of LNG with gasoline, we believe Pakistan's gas import bill will go up by USD 1-1.5 Bln annually.

Another area of high imports is the automobile sector as the demand revives. Recall that Pakistan's automobile manufacturing is heavily dependent on imported components, as localization levels are under 40% for the established players. Imported used cars are also in high demand as car financing becomes more affordable with lower financing rates.

There has been gradual uptick observed in machinery imports, as textile, power plants, cement, and steel sectors have demonstrated expansion plans, and this is expected to pick pace in the coming quarters.

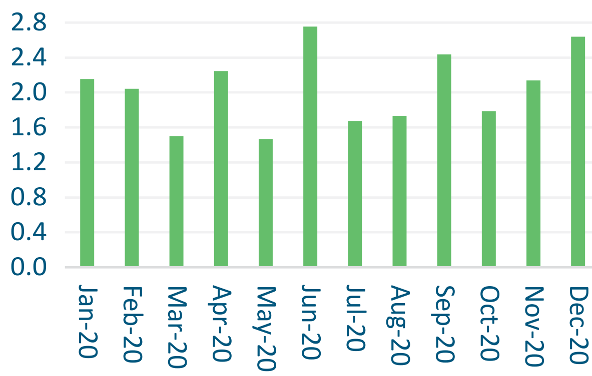
Vehicle Imports (USD Mln)



Source: Pakistan Stock Exchange

Further policy measures have led to increased usage of mobile phones. Pakistan's mobile phone imports have surpassed vehicle imports in the last year, having doubled in the last 12 months to USD 1 Bln.

Trade Deficit Rises (USD in Bln)



Source: Pakistan Bureau of Statistics

Mobile phone manufacturing in Pakistan is in works, and should lead to higher raw material imports, due to low localization. The authorities' implementation of revised policy which requires verification and registration of all mobile phones with the Pakistan Telecom Authority has resulted in substantial decline in smuggling of high-end phone sets.

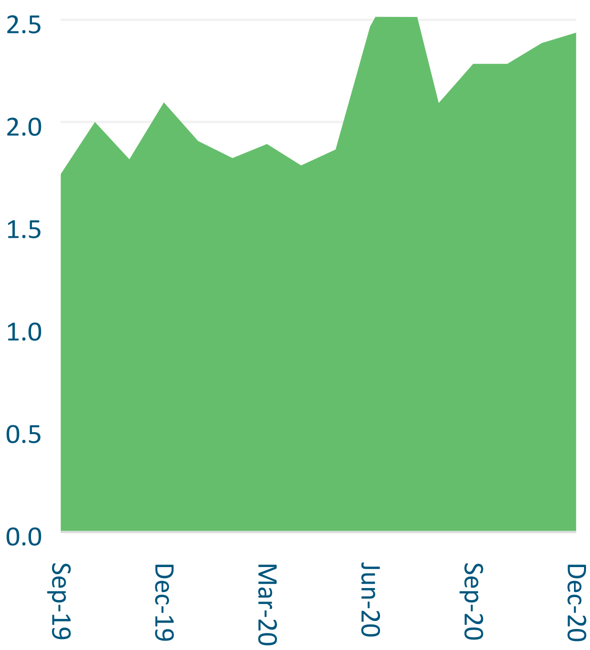
The trade deficit has started to widen again up by 6% YoY in H1 FY2021 to over USD 12 Bln. We believe the increase in imports will outpace the export growth in the second half, as consumption continues to rebound. We expect the trade deficit for FY 2021 to increase by 10-12% YoY.

Remittances Galore

Whatever the reason, Pakistan's workers' home remittances dollar stream continues to be the mainstay of macroeconomic recovery. For the seventh month running, remittances recorded north of USD 2 Bln. Monthly workers' remittances in H1 FY2021 have averaged USD 2.38 Bln, up from USD 1.83 Bln in the same period last year.

Cumulative H1 FY2021 remittances at USD 14.2 Bln are 25% higher YoY, as the growth continues unbated despite the onslaught of the pandemic. Recall that the World Bank and other observers had warned of a serious drop in remittances for emerging markets as Covid intensified back in April 2020.

Home Remittances Stay High (USD in Bln)



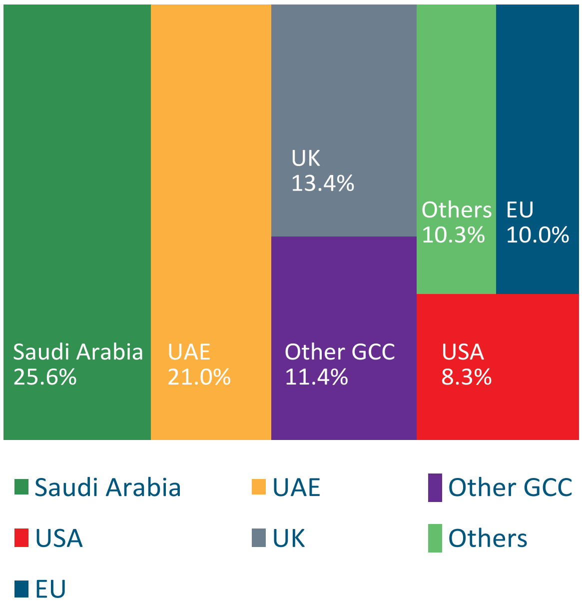
Source: State Bank of Pakistan

But what has since transpired is mind boggling, as the South Asian countries have recorded double digit remittance growth during Covid.

Several factors may be at play here, as the central bank has attempted to understand the bull-run, and has conducted a survey, the findings of which will be known soon.

As the average ticket size has only increased by 4-5% from pre-Covid days, the theory of workers losing their jobs and returning back home, sending lifelong savings could be ruled out.

Pakistan Home Remittance Composition



Source: State Bank of Pakistan

There is more anecdotal evidence that suggests that the crackdown on illegal remittance channels alongside travel restrictions due to Covid, have contributed more significantly towards higher use of formal banking channels.

Attractive incentives offered by the central bank on the use of formal channels, through Pakistan Remittance Initiative have reduced the cost of sending remittance through formal channels and could go a long way to establish PRI as the first-choice channel going forward.

We believe the remittance growth could well be challenged once frequent travel to and from Pakistan resumes as the world opens. That said, enough steps have been taken to ensure the incremental flows will not evaporate at once.

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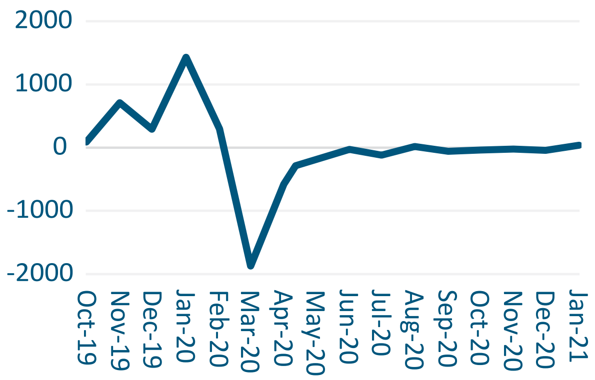
DEBT MARKET UPDATE

Having witnessed a massive exodus to the tune of USD 450 Mln in H1 FY2021, the Foreign Portfolio Investment (FPI) for the first time since the pandemic slide began, ended with a net inflow in January 2021.

Not that the net FPI flows are massive by any stretch of imagination, but it appears that there is little juice left now to be extracted, as interest rates remain low, and most foreign investors have not yet reprofiled the investment strategy for Pakistan in the post-pandemic scenario.

Foriegn Portfolio Investment (USD in Mln)



Source: State Bank of Pakistan

Some of the interest in the debt market has come at the back of central bank's initiative targeting expatriates, offering investment via digital banking account, with lucrative return in PKR on investments in USD. The scheme is new, and initial results are encouraging, and could well lead to even greater interests in FPI in the months to come, as Pakistan intends to buffer its foreign exchange reserves.

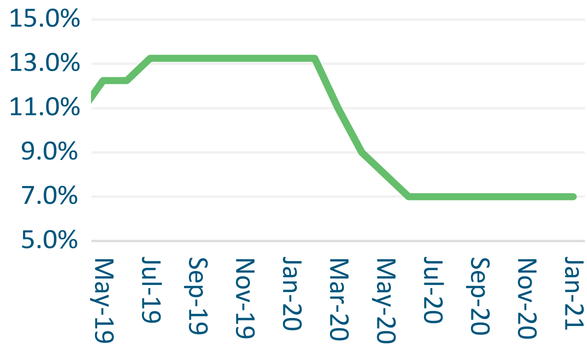
The monetary easing that started with the onset of Covid-19 continues. For the fourth policy running, the central bank Monetary Policy Committee decided to maintain status quo with the policy rate at 7%. This is nearly half from the highs seen in March 2020.

For the first-time ever in the country's monetary policy recorded history, the central bank opted to give a detailed forward guidance on monetary policy.

The stated aim is to encourage improved decision making, and to spur growth, and investment decisions particularly related to manufacturing sector, and housing industry.

Recall that the onslaught of high food prices had triggered panic in the market that the SBP may not be able to run negative real interest rates for much longer. The IMF program is also back on track, and that usually comes with speculation of the Fund pressurizing the government for tighter monetary policy stance.

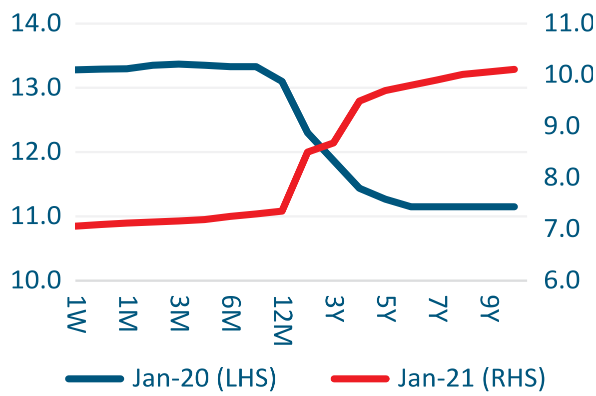
Interest Rates



Source: State Bank of Pakistan

The central bank has dispelled the notion of being under pressure from the IMF. This should calm some nerves as the SBP maintains its inflation outlook for medium-term, despite energy price revisions, which it believes, will not significantly alter the outlook. The negative real interest rates between 1.5%-2% are now considered the new-normal at the SBP.

Yield Curve



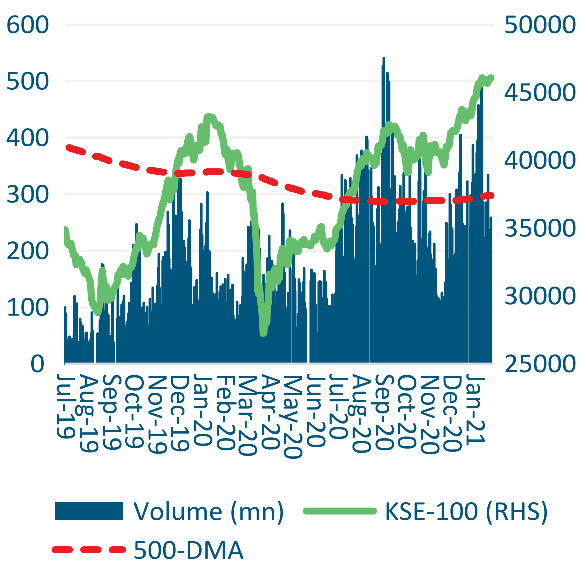
Source: State Bank of Pakistan

EQUITY MARKET UPDATE

Having returned an annual return of a paltry 5% in CY 2020, the Pakistan Stock exchange's benchmark KSE-100 index started on a sharp note. The monthly return closed at 6% for January 2021, as Pakistan's macroeconomic indicators continued to consolidate from the position of relative strength.

The KSE-100 index at over 46,000 points is the highest in three years, as continuity of policy and political stability contribute towards higher confidence amongst investors. The KSE-100 index saw one of the sharpest recoveries after the peak Covid-dip and was regarded one of the best performing emerging market earlier in 2020.

KSE-100 Index - Resistance at 40k



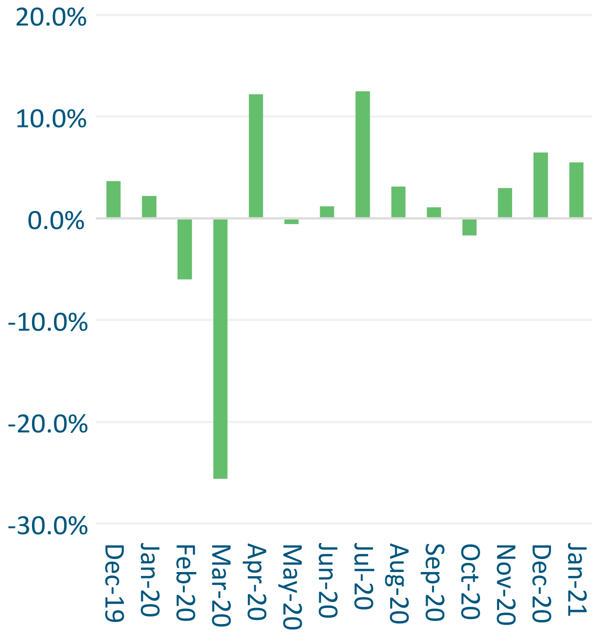
Source: Pakistan Stock Exchange

Market volumes have stayed north of 300 million per day for much of H1 FY2020, as the market brims with liquidity. That said, the bull run is being spearheaded by local banks, mutual funds and retail investors, as foreign investors continue to stay shy. The market has seen foreign pulling out more than USD 500 Mln in the last six months from the bourses.

The corporate earnings season is yet to start and that should keep the momentum going, as street consensus has most of the high weightage sectors on the listed index, to beat earnings growth considerably from previous year.

The reduced interest rates have been instrumental in propelling the bottom lines for highly leveraged listed sector such as textile, power, E&P, fertilizer, and chemical. The increased economic activity has ended a two-year long flat growth cycle for consumption driven sectors such as food, cement, and banking. Together, the factors should translate into double-digit profit growth for Q2 FY2021.

KSE-100 Monthly Returns



Source: Pakistan Stock Exchange

The central bank's latest monetary policy announcement should serve as a morale booster for the stock market. For the first time ever, the monetary policy has come with a forward looking statement indicating no change in rates in the medium term. This will offer stability, which is something that was largely missing for the last 12 months.

Save for the unlikely unfavorable outcome on the outcome of FATF and its adverse implications for Pakistan, the overall macroeconomic situation has improved. The political noise has also died down considerably, as the opposition parties are not on the same page, as regards staging a well coordinate movement in a bid to oust the government, which should provide fresh impetus to the stock market.

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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