CHASE SECURITIES
Pakistan (Private) Limited

Pakistan Economy

Inflation: The Worst is Behind Us!

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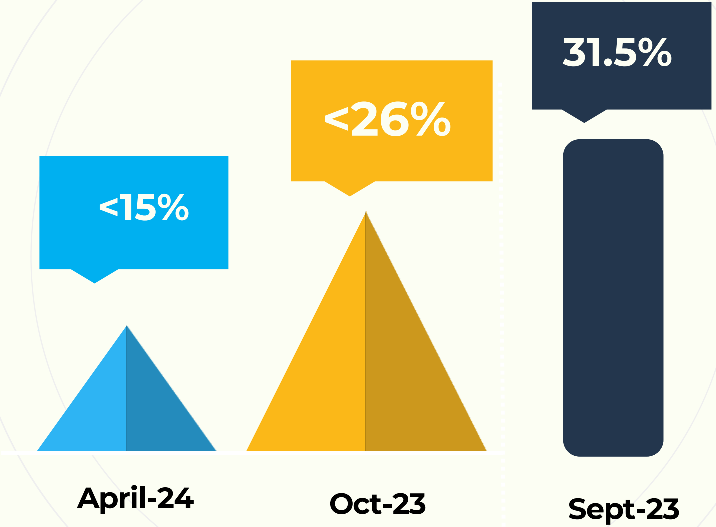
The Worst is Behind Us!

We believe inflation in Pakistan has peaked and will sharply decline in 2HFY24.

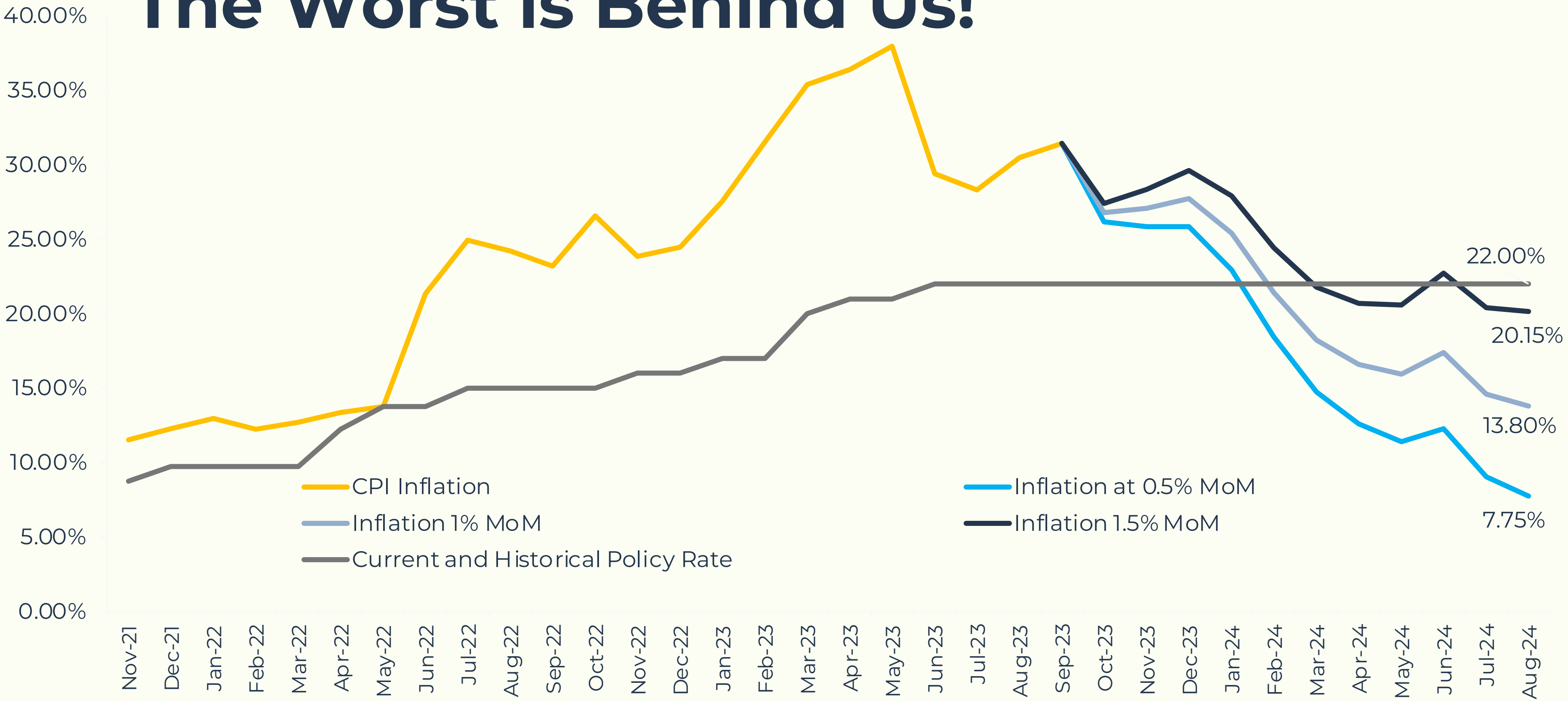
CPI Inflation is expected to drop sharply from 31.44% in September 2023 to under 26% in October 2023.

CPI Inflation could drop below 20% in February 2024 and below 15% in April 2024 due to base effect.

We believe the SBP will be in a position to cut interest rates in 2HFY24.



The Worst is Behind Us!



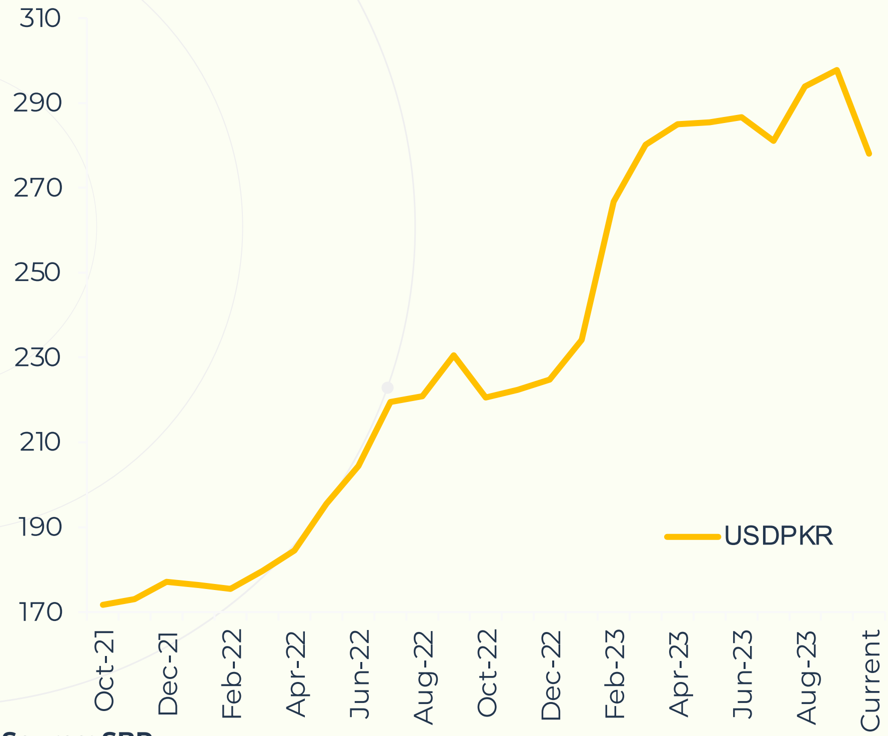
Source: PBS, Chase Securities

PKR has appreciated 10% from its peak

A muted current account deficit, relative certainty on external funding on the back of an IMF program, crackdown on smuggling and illicit activities in the open market have led to PKR appreciation.

This PKR appreciation along with a decrease in international oil prices has led to a large drop in fuel prices which would further soften inflation going forward.

The political situation in the Middle East remains a major upside risk to inflation in Pakistan.



Source: SBP

Large PKR Devaluation Unlikely

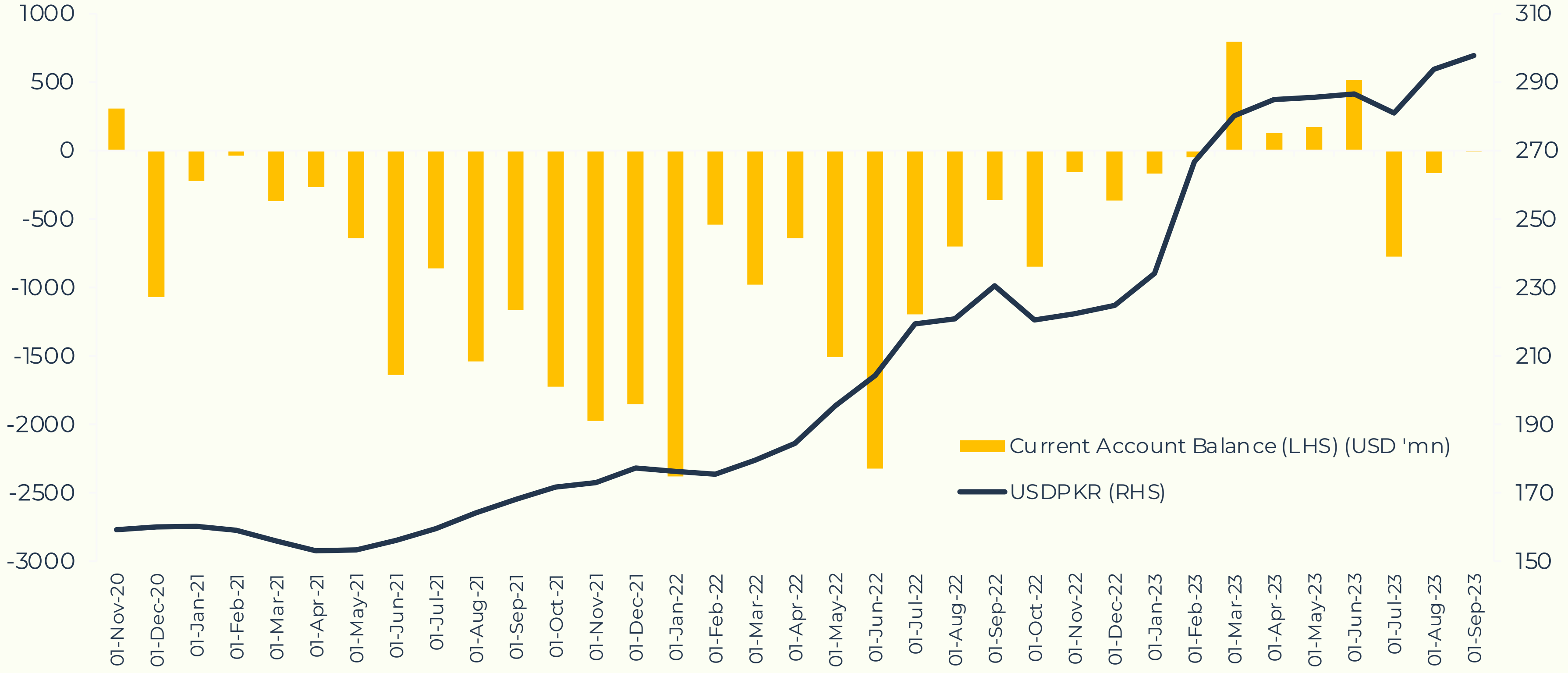
Large rounds of currency devaluation along with massive interest rate hikes have improved Pakistan's current account position

Current Account Deficit has remained muted despite removal of import restrictions and we believe that the chances of another round of large devaluation (>10%) in FY24 is low

A relatively stable PKR should lead to softening inflation going forward

Fiscal indiscipline, inability to rollover external debt, external shocks remain the major risk to this thesis.

Current Account Deficit under control



Source: SBP, Chase Securities

Trade Deficit has contracted

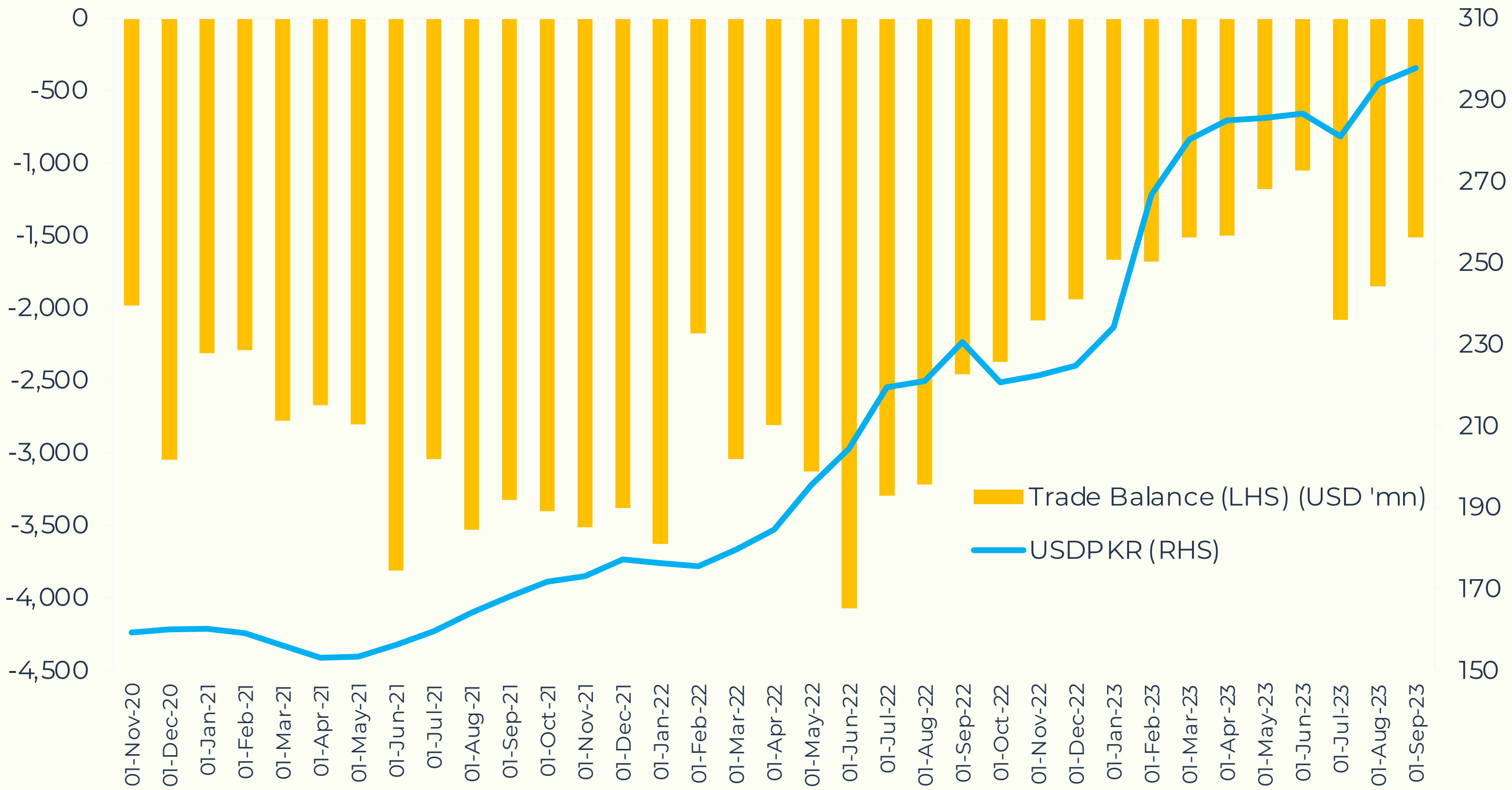
Pakistan’s trade deficit has declined to manageable levels majorly on the back of contraction in imports.

Moreover better agricultural output is expected to keep imports for cotton and food relatively muted in FY24.

While there has been some improvement in export quantities, lower commodity prices have hit growth in USD terms.

We expect growth to be more evident in published numbers in the coming months due to base effect.

Trade Deficit has contracted



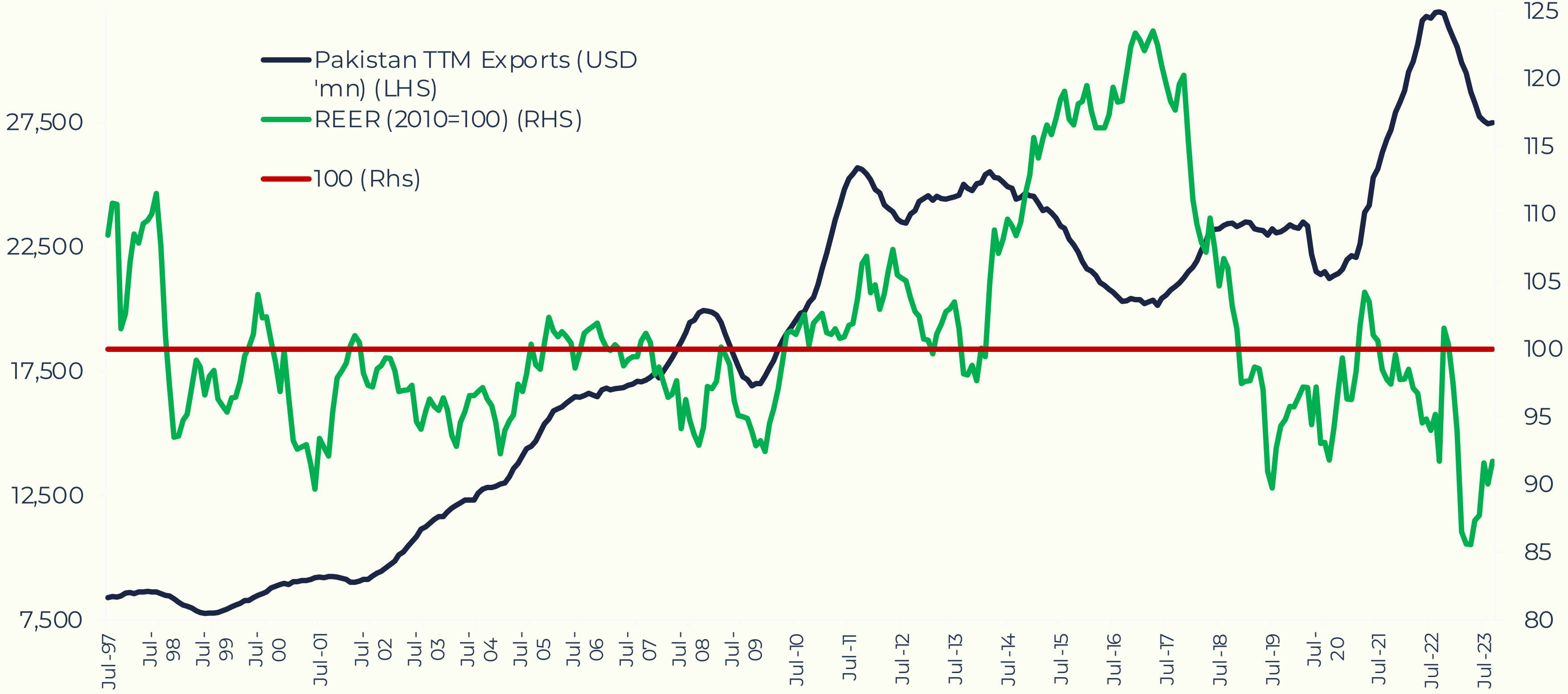
Relatively weaker currency should help exports

REER clocked in at 91.72 for September 2023 and we expect exports to pick up going forward.

While this increase in exports might not provide any space in the current account in the short term, export growth could help the current account to stay muted in the medium term.

The power sector remains a hurdle in export growth.

Relatively weaker currency should help exports



Source: SBP, PBS, Chase Securities

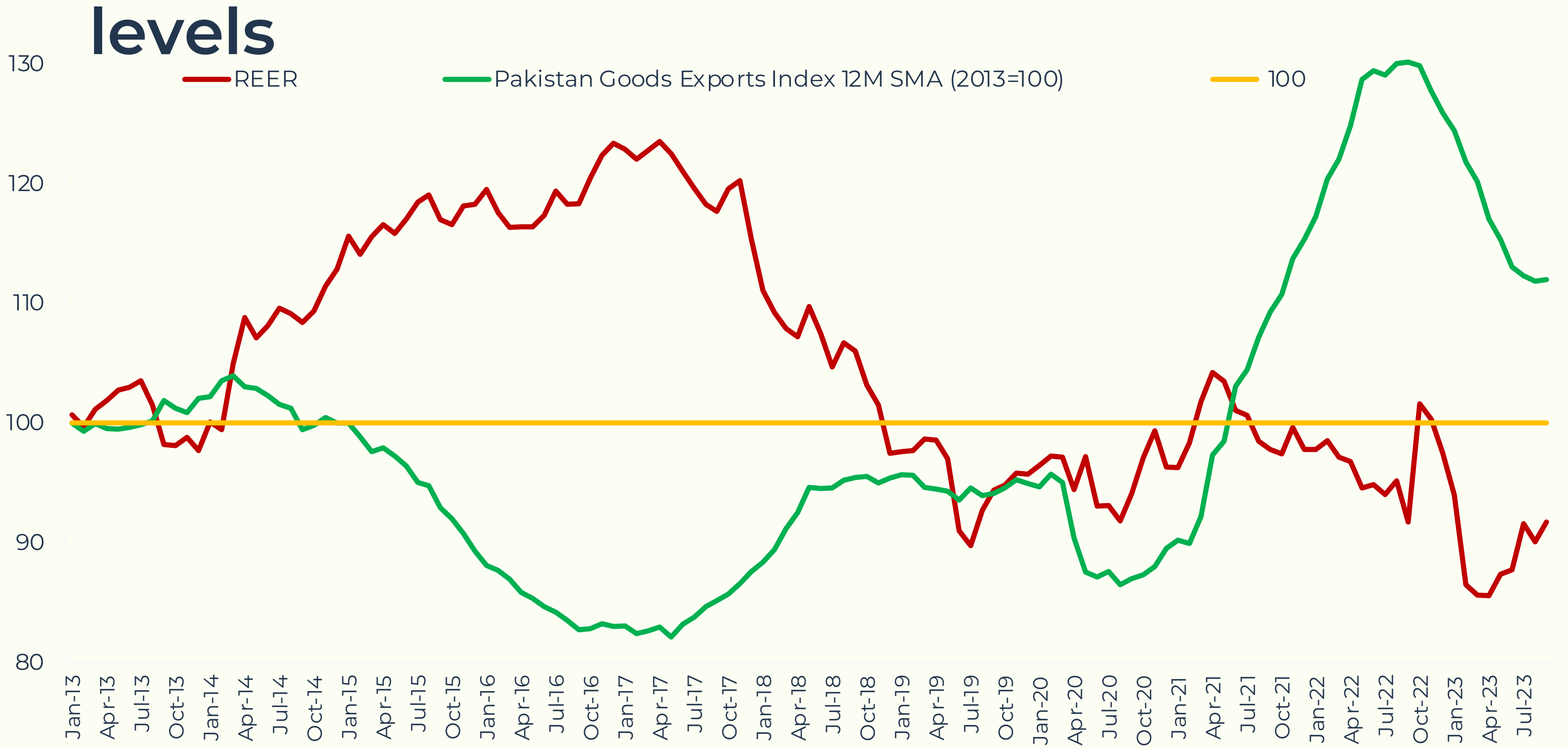
Pakistan’s currency is now at reasonable levels

Growth in exports has remained negligible in the last decade with a stronger currency, covid, floods and import bans being major hurdles to growth

With REER at more normalized levels, exports could increase going forward

We expect growth in exports to come from Garments, Knits and food exports and also expect growth in the footwear segment

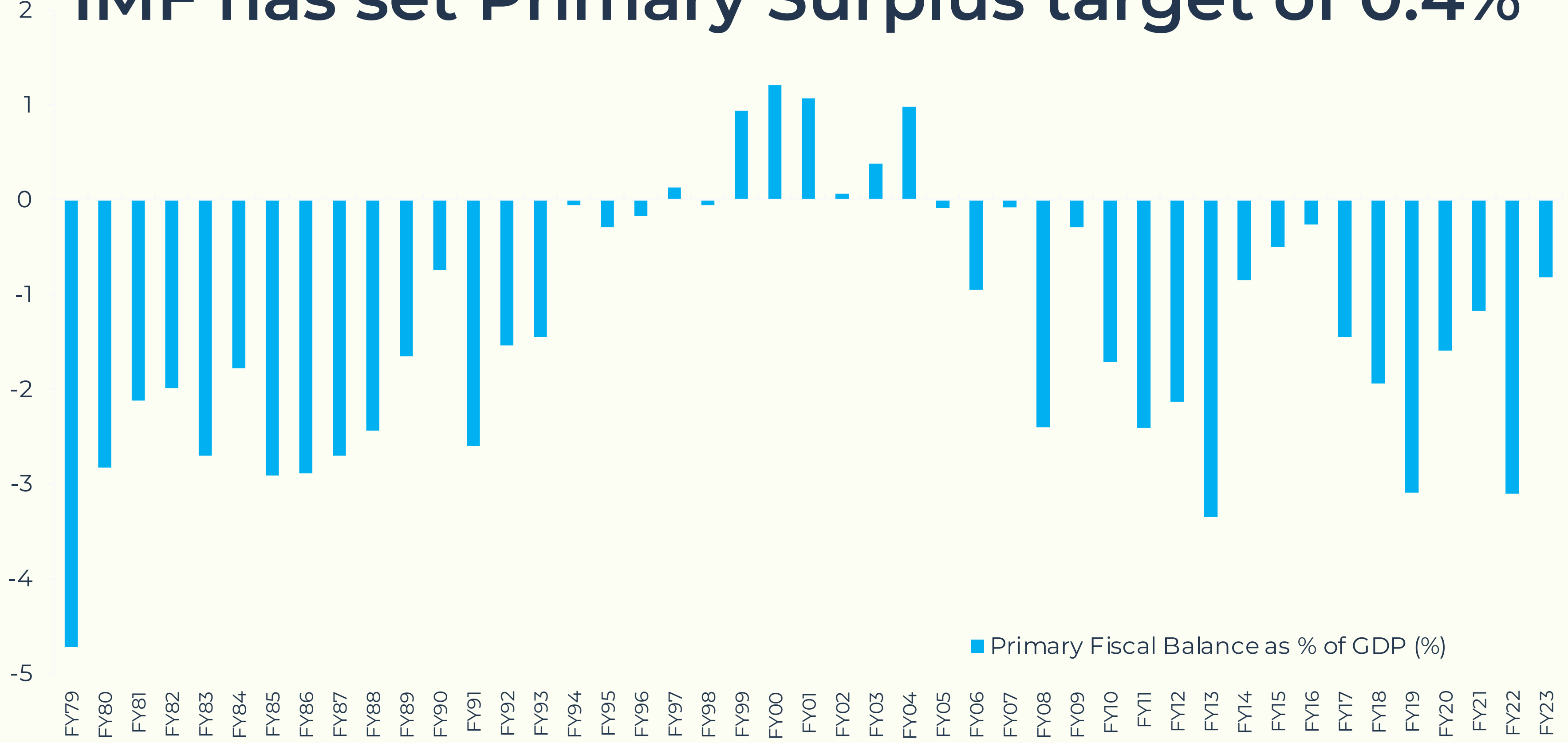
Pakistan's currency is now at reasonable levels



Source: PBS, SBP, Chase Securities

Fiscal indiscipline remains the greatest risk!

IMF has set Primary Surplus target of 0.4%



Source: Ministry of Finance, Chase Securities

Strict Fiscal Control Necessary

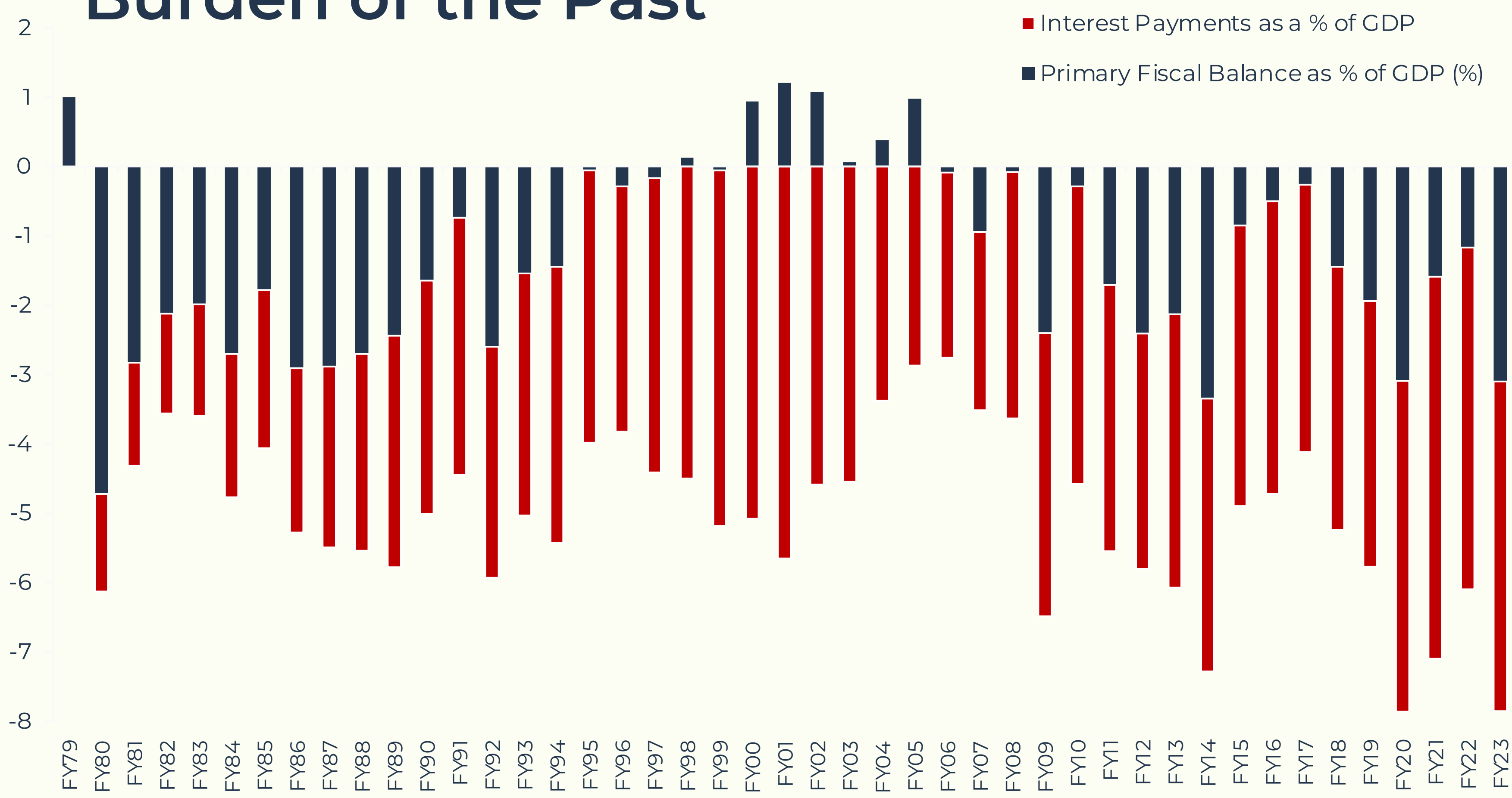
The IMF has set a primary surplus target of 0.4% of GDP for Pakistan for FY24

Strict fiscal control including but not limited to cutting expenditures in necessary to achieve a primary surplus along with keeping money supply under control

Large Fiscal deficits have led to large increases in money supply which have in turn caused pressure on the PKR and inflation

Despite a primary surplus, overall fiscal deficit is expected to remain high due to high interest payments

Burden of the Past



Source: Ministry of Finance, Chase Securities

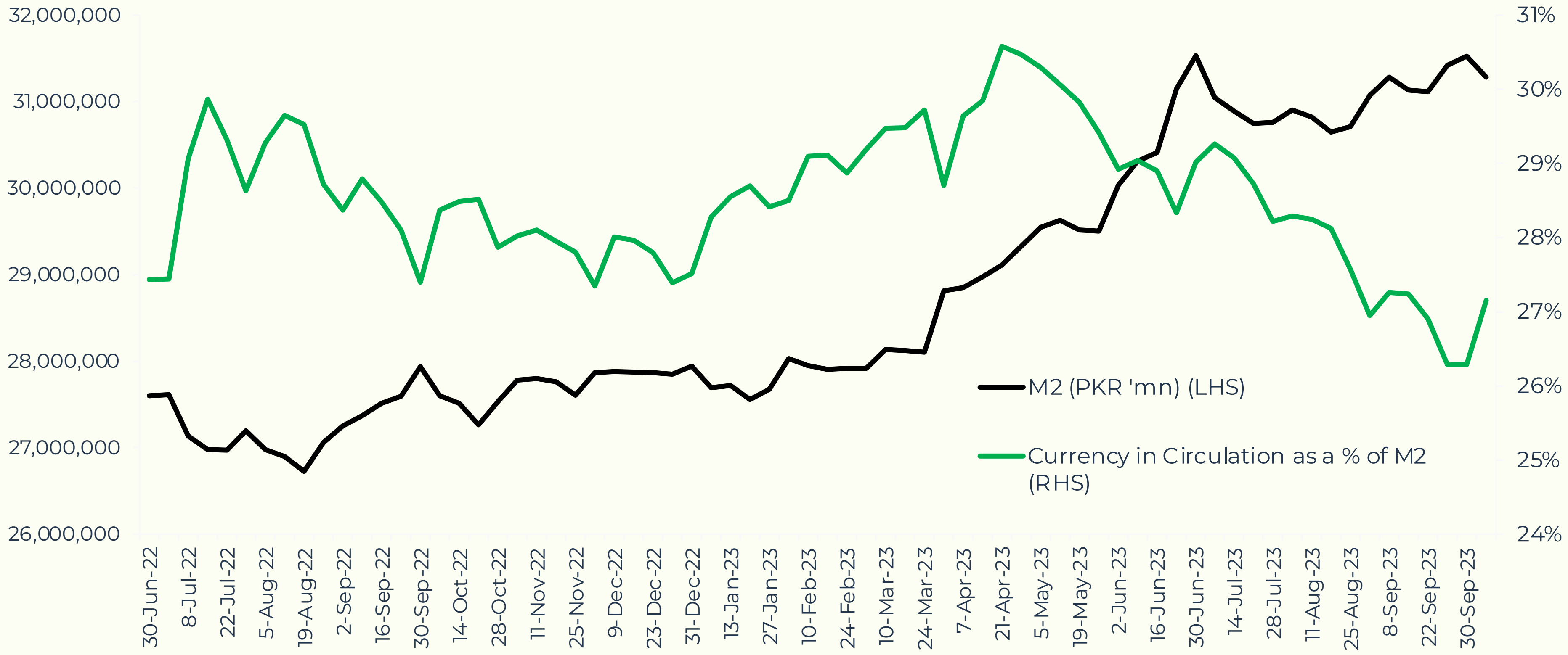
M2 growth is muted, at least for now

In the short term on the back of an increase in interest rates, currency in circulation as a percentage of total money supply has reduced from 30.5% in April 2023 to 27.1% in October 2023

Overall Money Supply Growth is muted since June 2023

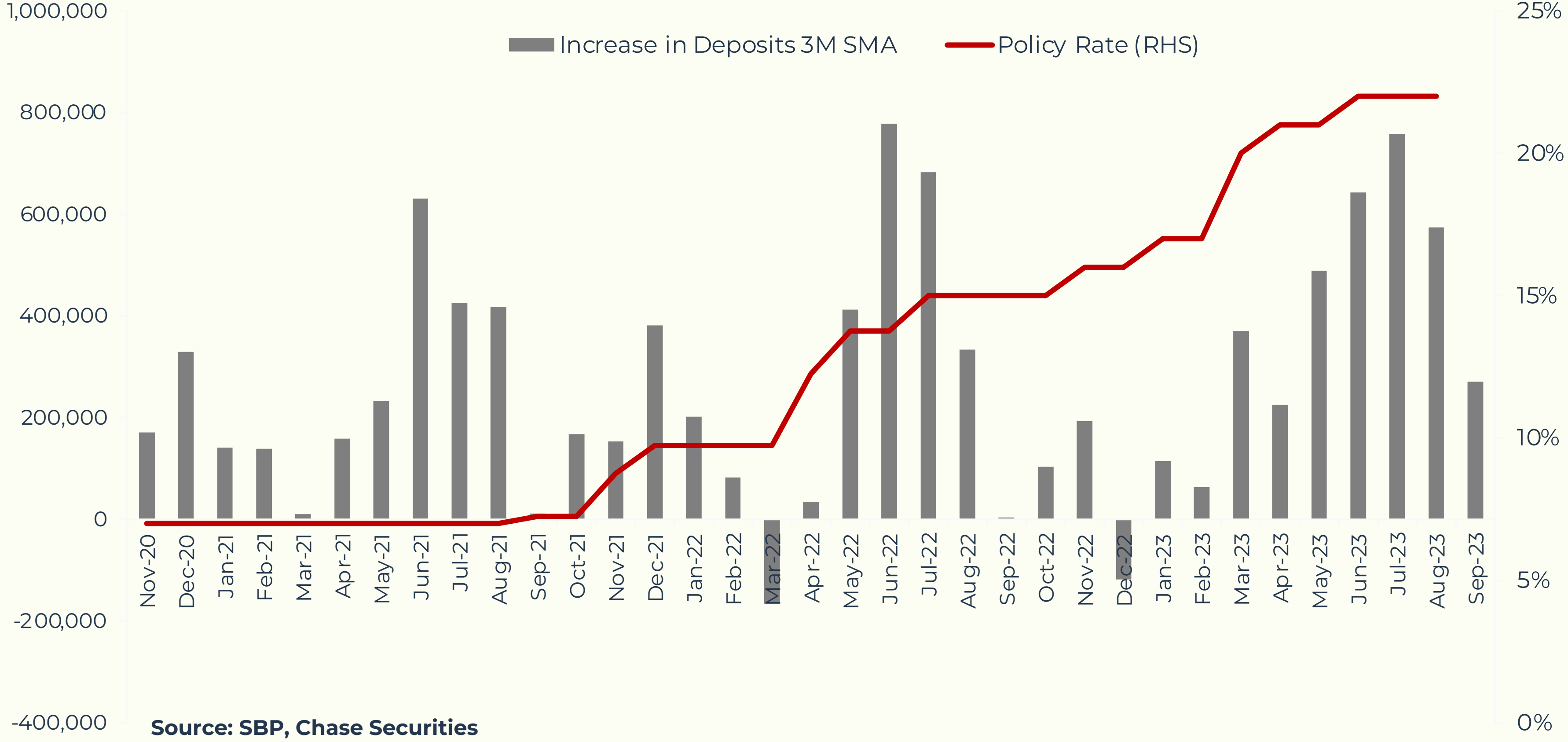
Lower growth in Deposits from a decrease in interest rates or an increase in advances along with fiscal indiscipline remain risks and could cause inflation to start increasing again

M2 growth is muted, at least for now



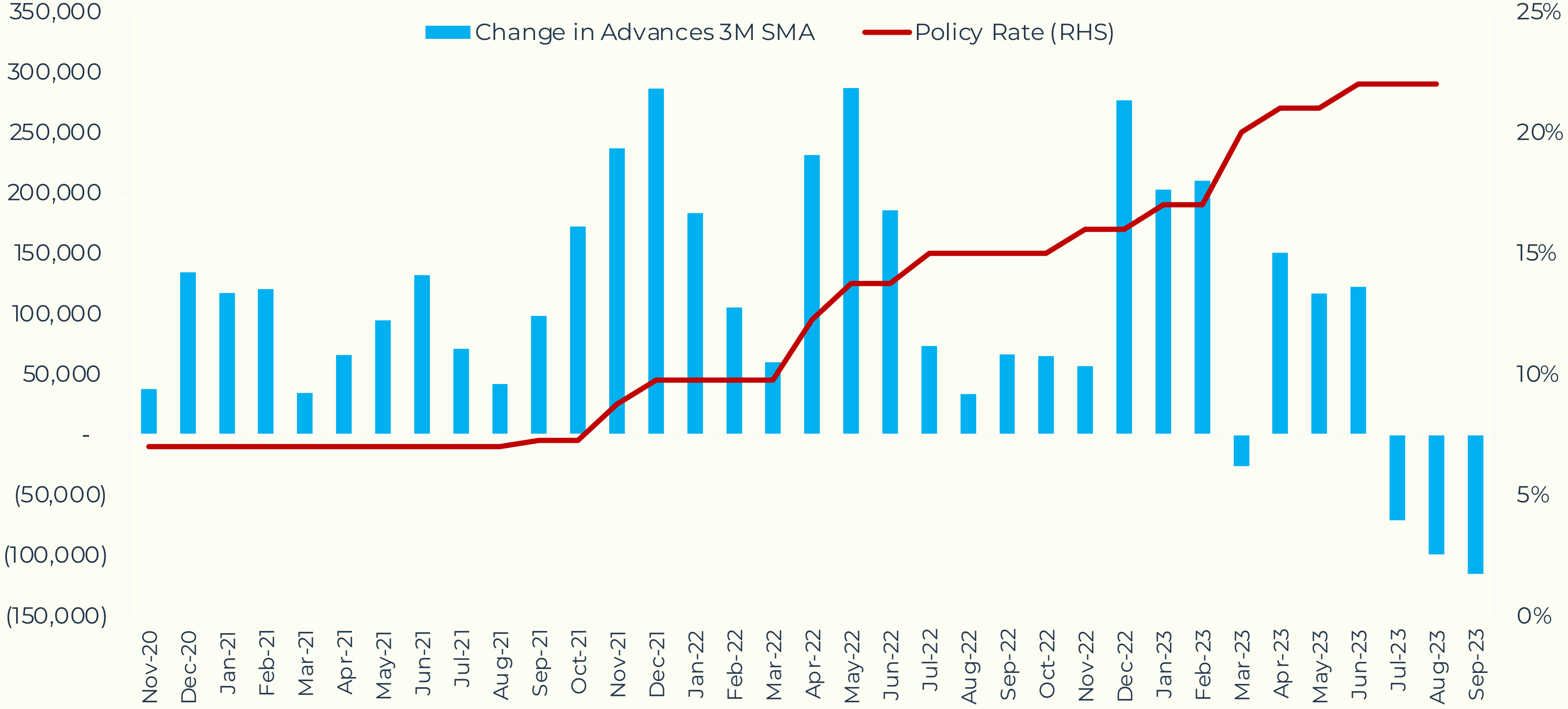
Source: SBP, Chase Securities

Deposits have increased



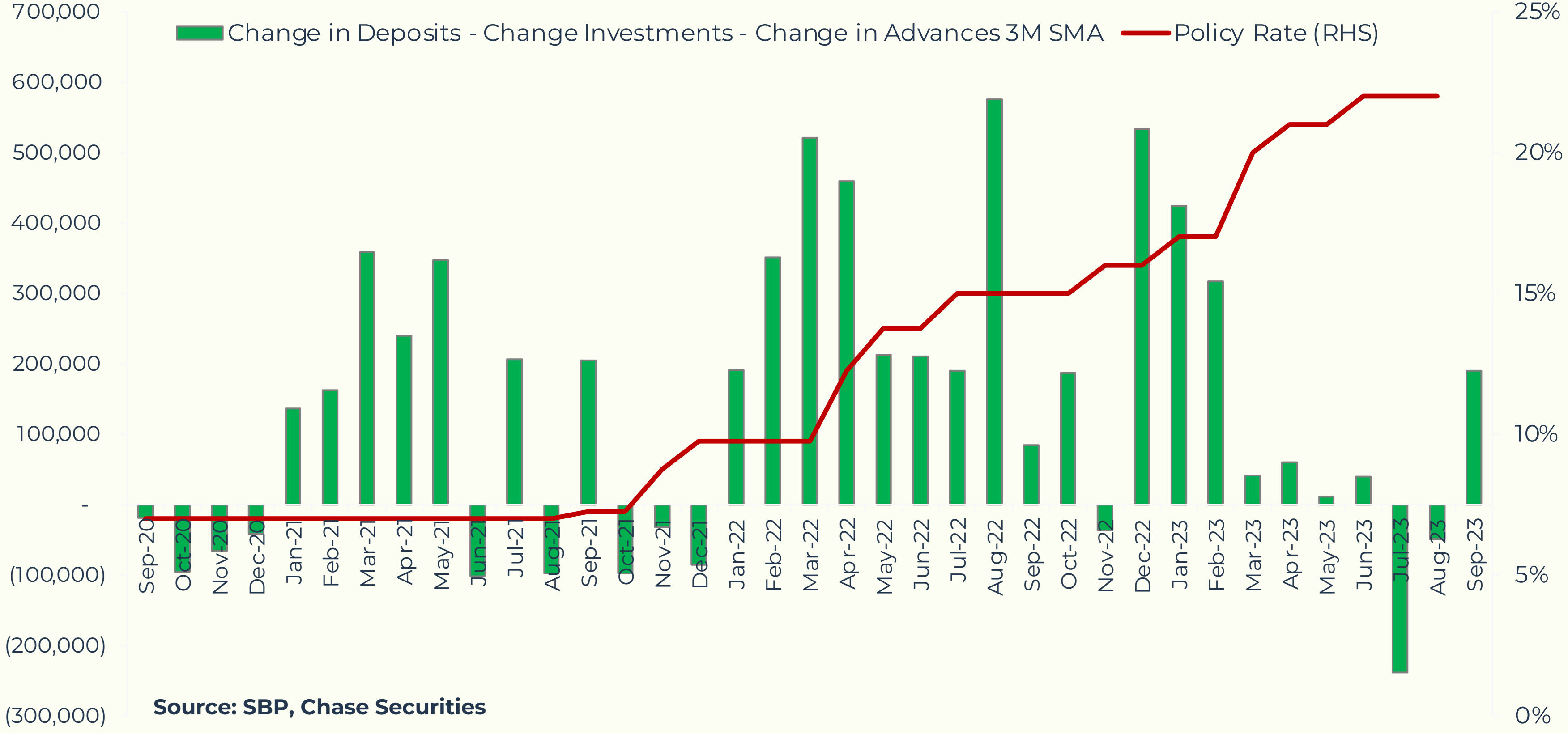
Source: SBP, Chase Securities

Growth in Advances remains Muted



Source: SBP, Chase Securities

Requirement for cash injections has reduced



Source: SBP, Chase Securities

OMO growth has stalled

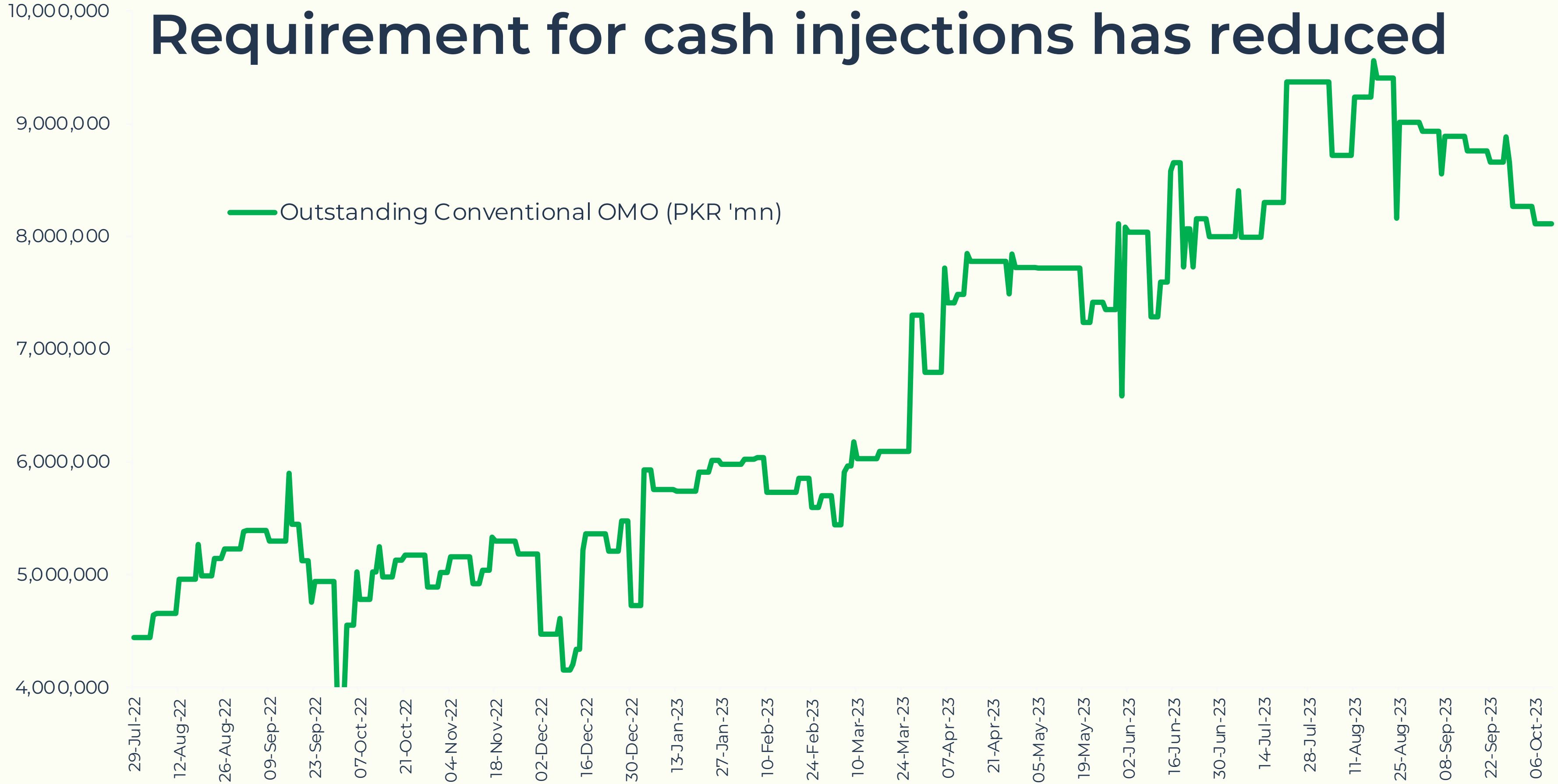
The government of Pakistan has been borrowing amounts that have been higher than the increase in bank deposits

To fill the gap, the central bank injects cash into the system through Open Market Operations, increasing money supply.

This government borrowing being financed by new money has caused inflation

Total amount injected through OMO has stalled and declined after peaking in August 2023

Requirement for cash injections has reduced



Source: SBP, Chase Securities

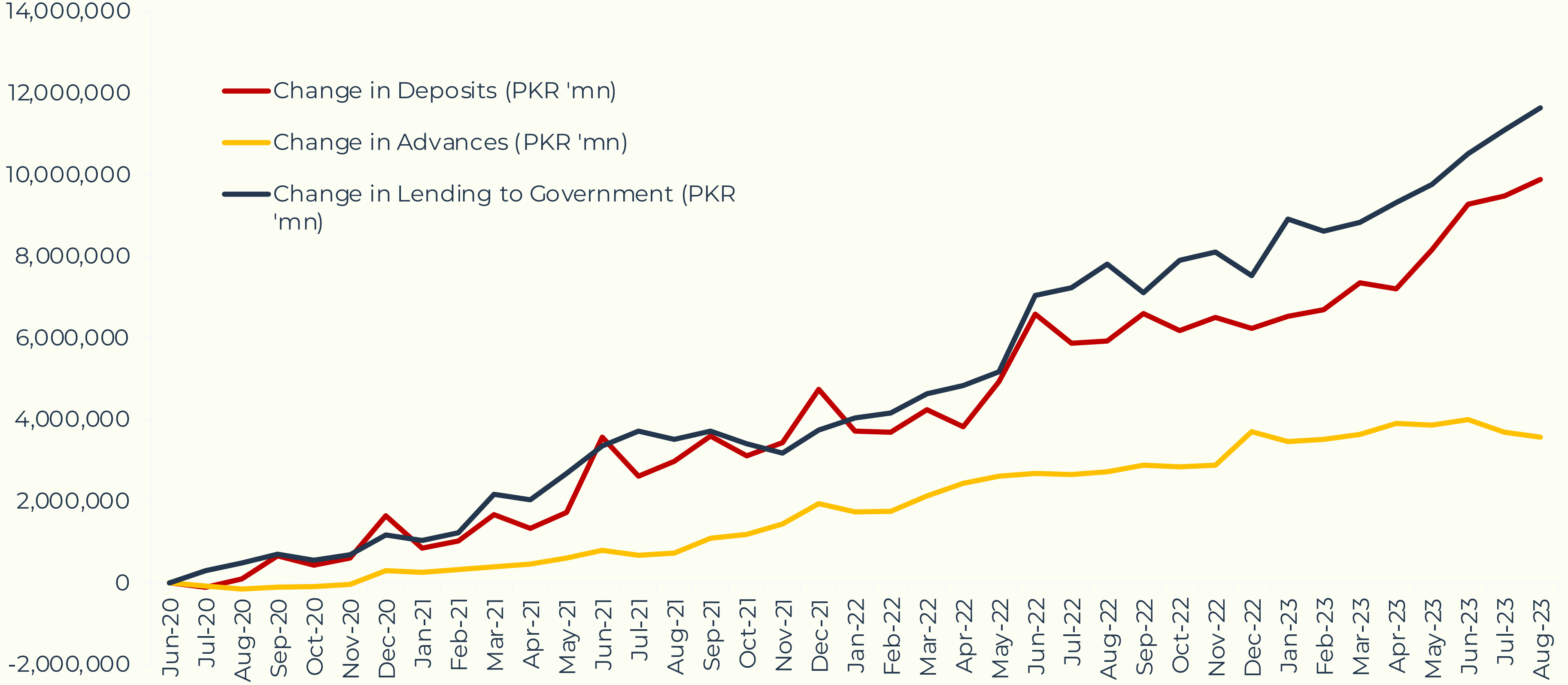
No growth in Advances in the last 6 months

Higher interest rates have helped increase deposits and stall growth in advances, creating space for the government to borrow

On the other hand, high interest rates have increased the cost of government borrowing

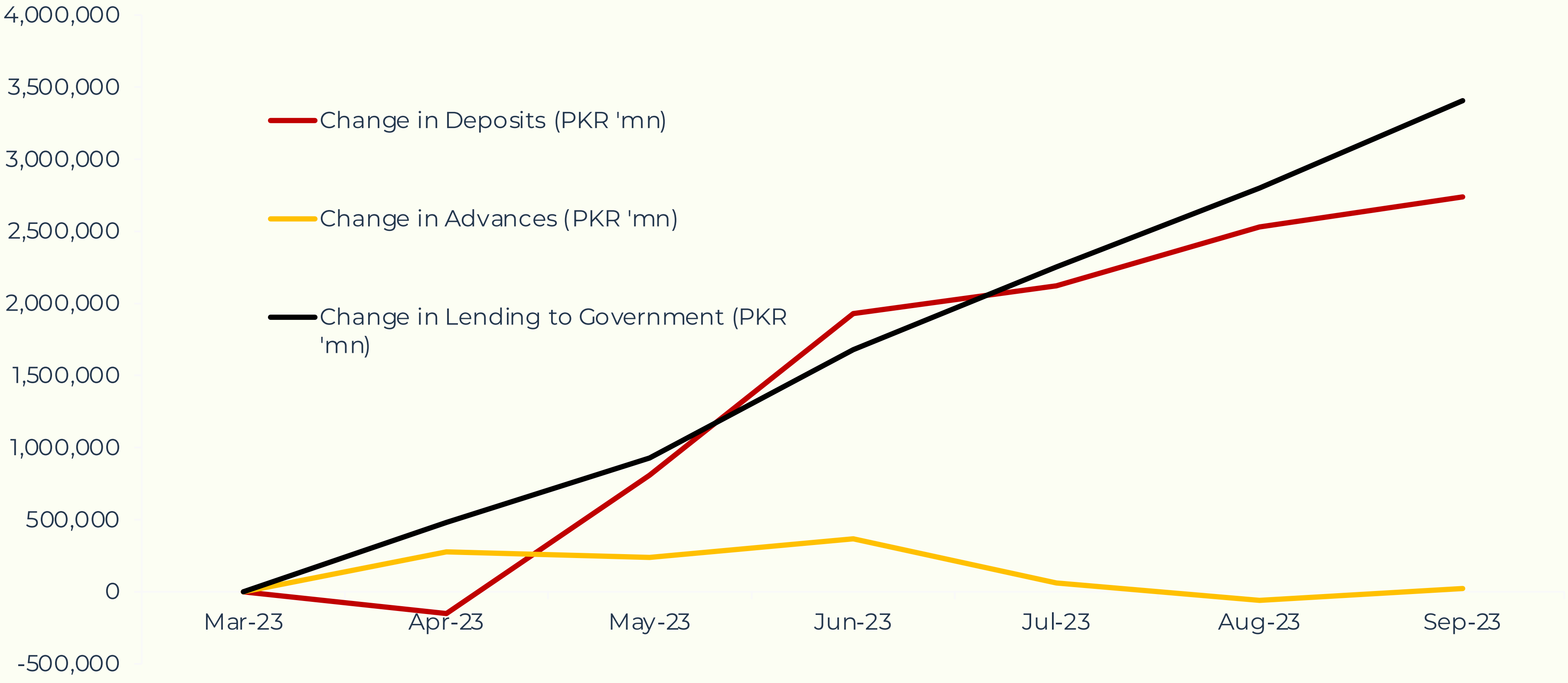
Over the last 6 months, there has been no growth in Advances and all new deposits and cash injected into the system through OMOs have been lent to the government

Change in Deposits, Advances and Investments



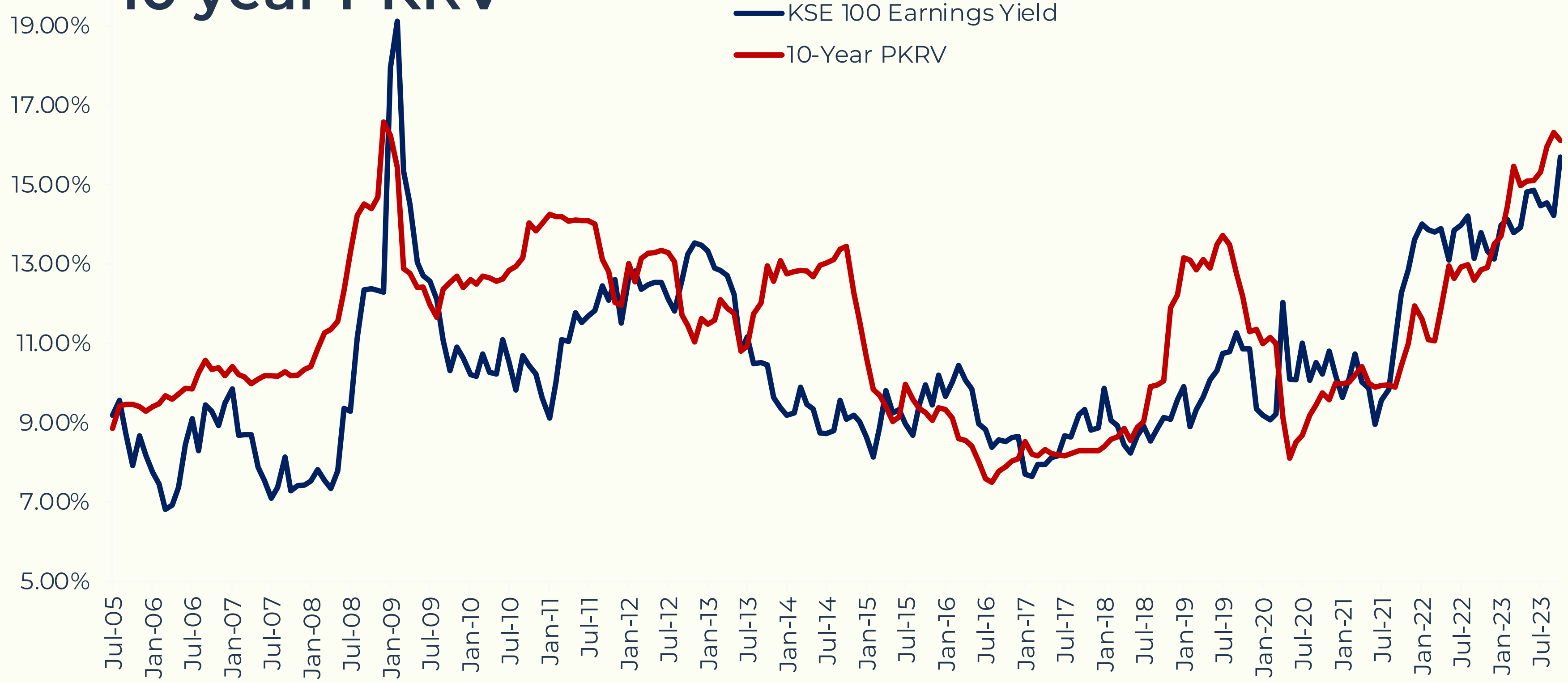
Source: SBP, Chase Securities

Change in Deposits, Advances and Investments



Source: SBP, Chase Securities

KSE 100 earnings yields have historically tracked 10 year PKRV



Source: SBP, Chase Securities

Anticipating broad based index rerating

Historically, the earnings yield of the KSE 100 has shown a strong correlation with the yield of 10-year PIBs. This correlation implies that as PIB yields decrease, the earnings yield of the KSE 100 tends to follow suit.

Considering the historical relationship between KSE 100 earnings yield and 10-year PIB yields, as well as the expected decline in interest rates, we project a broad-based upward re-rating of the KSE 100 index over the next year. This re-rating implies that stock prices are likely to experience an upward adjustment in valuation. Consequently, we recommend increasing allocations to stocks within the PSX.

Risks Remain

On the back of the aforementioned factors, we believe inflation will reduce in FY24.

But risks remain!

The political situation in the Middle East could cause a major hike in fuel prices which could hamper the decline in inflation

Moreover any issues in rolling over debt external debt, fiscal slippages or political upheaval could cause inflation to rise again.

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Rating Definition	
Buy	Total stock return > 15%
Neutral	Total stock return between 0% -15%
Sell	Total Stock return < 0%

* Total stock return = capital gains + dividend yield

Valuation Methodology:

- Period end target prices, Chase Securities Pakistan Private Limited uses different valuation methodologies including but not limited to:
- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return o arrive at our based methodologies (EVA, Residual Income etc.)

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