

## Pakistan Economy

### Consolidating the external & fiscal account is the way to go

The long-awaited elections and the smooth transition of power to a new political setup have finally concluded. At the center, a coalition government has been formed, with PMLN joining forces with PPP and other smaller parties. The appointment of the finance minister remains the talk of the town, given the country's need for a strong leader capable of steering it through economic challenges towards a sustainable path. After several days of deliberation, Mr. Aurangzeb, a renowned banker, has taken on the role of finance minister. His primary task is to maintain the path of economic stability and negotiate another long-term IMF program by undertaking much-needed structural reforms.

In this backdrop, we believe that key triggers for equity market in the next six months include: i) Maintaining a contained current account balance, ii) Clarity regarding the next IMF program, iii) The highly anticipated reduction in the policy rate, and iv) Reduced political noise.

#### Running a manageable current account balance

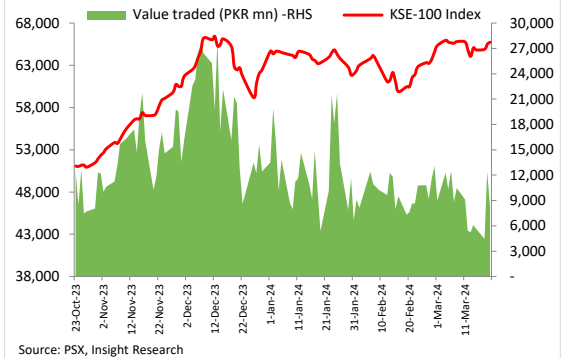
The current account deficit has recorded a sharp improvement of ~74% in 8MFY24, clocking in at US\$0.99bn compared to US\$3.8bn in SPLY. This significant decline is primarily driven by a lower trade deficit, with imports decreasing by ~9% and the country's exports increasing by ~10%. Given the economic hardships faced by the country and low FX reserves, there is a pressing need to maintain a contained current account balance for at least the next 10-12 months. Doing so will not only help bolster the reserves but also facilitate negotiations for a new IMF deal.

Regarding imports, we anticipate that they will continue to be influenced by commodity prices, as weak domestic demand is expected to keep the import bill under control. Local industries are currently operating below their historical utilization levels, as indicated by high-frequency indicators. Therefore, there will be less pressure stemming from machinery imports over the next couple of years as industries gradually ramp up their production levels.

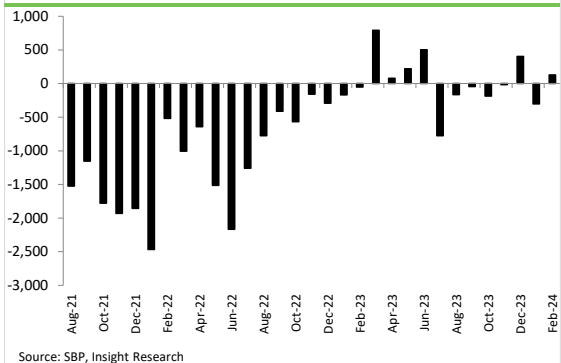
Moreover, we have witnessed higher than average remittances in the month of Ramadan. Consequently, we opine that country is likely to post current account surplus in next couple of months amid higher remittances flow and muted domestic demand which has helped in arresting current account deficit.

Maintaining a contained current account balance will not only instill confidence in the market but also contribute to keeping the domestic currency stable, especially considering the country's obligation to repay loans worth US\$3.5 billion in the remaining part of the fiscal year. The country has reached staff level agreement for the final tranche of US\$1.1bn under 9-month long SBA which will shore up country's FX position.

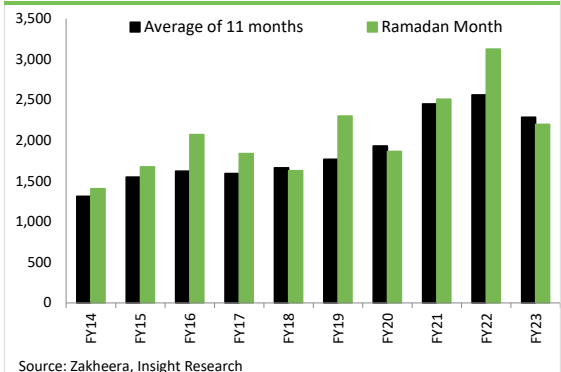
KSE-100 Index performance in last 6 months



Economy : Current Account Balance (mn US\$)



Worker's Remittance: Ramadan vs. Rest of the year (US\$mn)



## Fiscal consolidation is essential

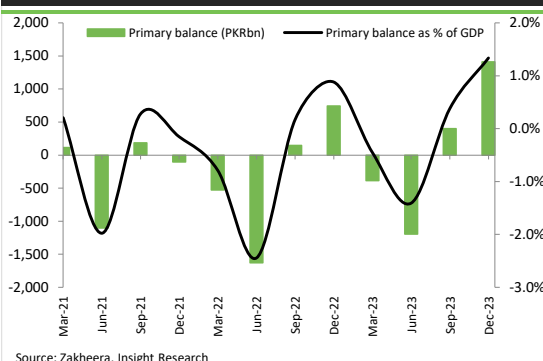
The fiscal accounts have shown some improvement in 1HFY24, with the primary surplus inching up to 1.7% of GDP compared to 1.1% in SPLY. However, ballooning interest payments, fueled by high debt levels and costly domestic financing, continue to weigh on the fiscal accounts. As the country prepares for a new IMF program, tax collection authorities are expected to explore new avenues for generating revenues, with the imposition of sales tax on POL products and other exempted categories being the low-hanging fruit for authorities. Furthermore, in its previous communications, the IMF emphasized the importance of bringing retailers under the umbrella of tax authorities. In its latest press release, the IMF has again stressed the need to broaden the tax base, especially in undertaxed sectors. We believe that any favorable developments regarding the taxation of retailers, agriculture and real estate sectors are likely to yield results in the medium to long term.

## Real interest rate likely to turn positive in Mar'24

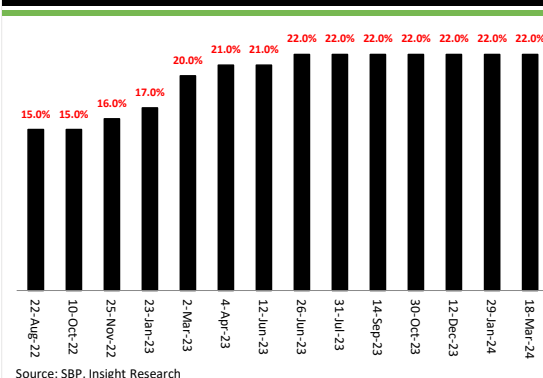
Over the past few months, headline inflation has begun to taper off, primarily due to the high base effect, alongside a MoM decline in food basket prices and a stable domestic currency. In Feb'24, CPI stood at ~23.0%, compared to ~31.5% during the SPLY. Similarly, core inflation is showing signs of cooling down and recorded at 15.5% and 21.9% for urban and rural baskets, respectively. Based on our projections, inflation for Mar'24 is expected to hover around 21% mark, indicating a positive real interest rate for the first time in almost 3 years. We believe that the downward trend in headline inflation and the relatively stable domestic currency could serve as catalysts for the central bank to consider initiating monetary easing.

However, in its latest meeting, the MPC has kept the benchmark rate unchanged at 22%. Interestingly, the monetary policy statement sounded more cautious this time compared to the last couple of statements. The central bank highlighted that although inflation is on a declining path, upside risks to the inflation outlook still persist, and it is essential to maintain a cautious approach. As per our estimates, the decline in headline inflation will be more pronounced in 2HCY24 and the central bank will initiate monetary easing from the next MPC meeting scheduled for 29th April, however the pace of decline in policy rate will be cautious and gradual.

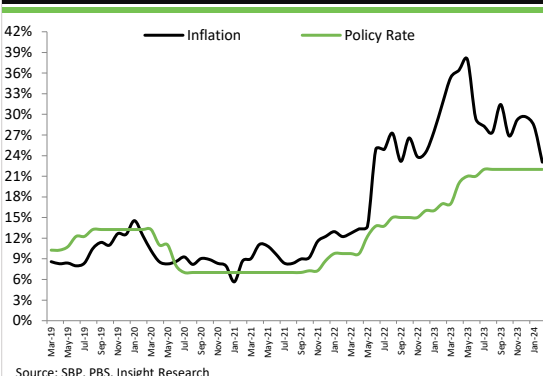
Improving primary fiscal balance



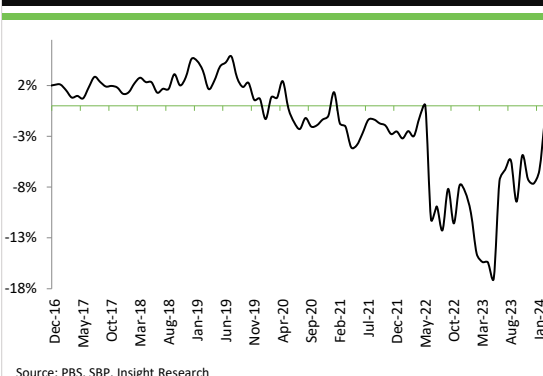
Recent MPC decisions



Economy: Policy rate vs. Inflation



Economy: Real Interest rate (%)



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### Frequently Used Acronyms

<b>TP</b>	Target Price	<b>DCF</b>	Discounted Cash Flows	<b>FCF</b>	Free Cash Flows
<b>FCFE</b>	Free Cash Flows to Equity	<b>FCFF</b>	Free Cash Flows to Firm	<b>DDM</b>	Dividend Discount Model
<b>SOTP</b>	Sum of the Parts	<b>P/E</b>	Price to Earnings ratio	<b>P/Bv</b>	Price to Book ratio
<b>P/S</b>	Price to Sales	<b>EVA</b>	Economic Valued Added	<b>BVPS</b>	Book Value per Share
<b>EPS</b>	Earnings per Share	<b>DPS</b>	Dividend per Share	<b>DY</b>	Dividend Yield
<b>ROE</b>	Return on Equity	<b>ROA</b>	Return on Assets	<b>CAGR</b>	Compounded Annual Growth Rate

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