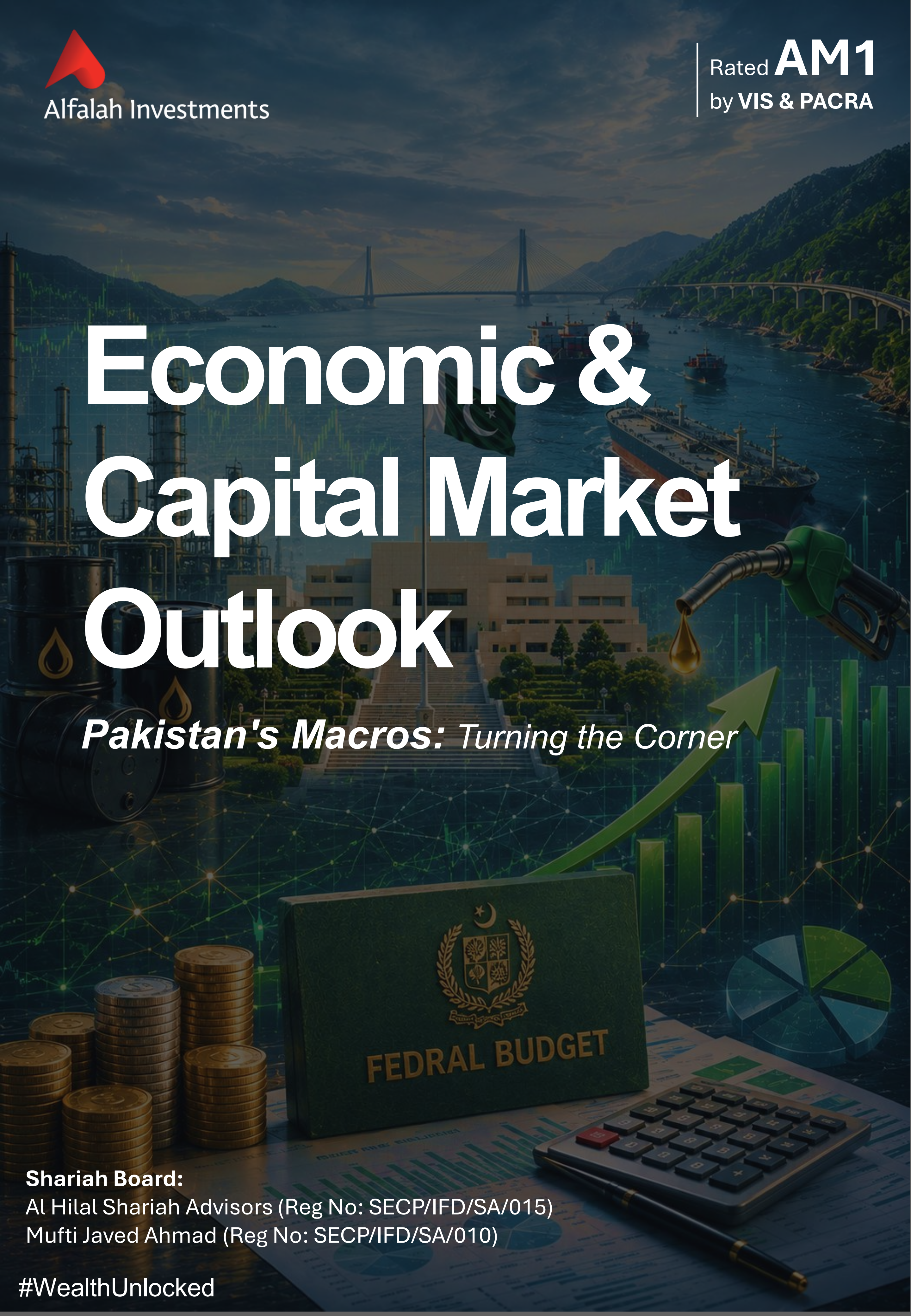

Alfalah Investments

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Economic & Capital Market Outlook

Pakistan's Macros: *Turning the Corner*

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From the CIO's Desk

If 3QFY26 was a quarter defined by external shock and price discovery, 4QFY26 has been a quarter of reversion, a swift, and at times disorderly, unwinding of the worst-case assumptions that gripped global and domestic markets just three months ago. The cycle has turned faster than many anticipated, and as we close the fiscal year, the operating environment for Pakistani investors looks materially more constructive than it did when we last published our quarterly.

The defining feature of the quarter has been the collapse in international crude prices. Brent has fallen from 4QFY26 peak of near USD 120/bbl to USD 73/bbl by the close of June 2026, a complete turnaround from the worst that oil importing nations experienced during these times. OPEC+ has resumed normal export quotas, Middle East production is back online, and US-Iran memorandum of understanding to reopen Strait of Hormuz traffic has been priced in by markets in real time. For a country where oil and gas imports drive roughly one-quarter of the total import bill, this is a first-order positive shock, the mirror image of the headwind we elaborated about in our last note.

On the domestic front, the picture is more nuanced. The SBP surprised markets in April with a 100bps policy rate hike to 11.50%, a defensive response to the March-April fuel shock that pushed transport CPI to 36.8% YoY in May 2026 and headline inflation to a 23-month high of 11.7%. That hike, viewed in hindsight, was the right call: it re-anchored the PKR, kept the IMF program on track, and gave the SBP credibility room ahead of the disinflation it can now reasonably expect. The FY27 federal budget, presented on 12 June, has done its part too, locking in a PKR 1.727 trillion PDL target and doubling the Climate Levy to PKR 5/L, absorbing some of the international decline as fiscal revenue rather than letting all of it pass straight through to pump prices.

Three forces now line up to pull headline inflation back to single digits much faster than the current 11.1% reading suggests: the international oil price collapse, the FY27 budget's fiscal absorption, and most importantly the favorable base effect from the September-November 2025 flood shock, when monthly prints ran at +2.0% / +1.8% MoM as perishable food prices spiked by double digits YoY. Our base case sees headline inflation falling from 11.1% in June to 8.5% in July, and to 6.5% by November, to bring the FY27 average inflation squarely back inside the SBP's 7.0% - 8.5% target band.

Equity markets have begun to reflect this turn. The KSE-100, which troughed near 148,743 at end-March on Israel-Iran escalation fears, has staged a partial recovery, supported by the oil decline, the IMF disbursement, and growing confidence that the SBP's hawkish hold is the cycle peak. PSX closed yet another positive year, by gaining 43.5% in FY26. Valuations remain compelling at a forward P/E still remains meaningfully below the 10x historical average. For fixed income, the story is even cleaner: real yields turn sharply positive from August, the September MPC becomes a high-conviction cut.

The risks have not disappeared. The US-Iran MoU is signed, but the 60-day period following it remains critical. Pakistan is entering monsoon season with the FY26 flood experience still fresh. The OGRA gas tariff review in July could surprise. And core inflation, sticky at 9.0% urban, has not yet broken decisively. But the asymmetry has shifted. Three months ago, every macro variable was skewed to the downside; today, the bull case for both equities and fixed income has tangible drivers behind it.

Our message to investors in Alfalah Investments' suite of funds is the same one we made last quarter, i.e. disciplined patience and selective accumulation, but with a meaningfully higher conviction level at this point in time. The disinflation tailwind has returned. Position for it.

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FY26 – Pakistan Macro Review

Crude Collapse

Inflation to Retreat !

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Executive Summary

Pakistan's economy is exiting FY26 on a far stronger footing than appeared likely at the end of 3QFY26. The Middle East energy shock that drove our last outlook has reversed: Brent crude has fallen 29.7% in four weeks to USD 73/bbl by the close of June 2026, OPEC+ has restored export quotas, and US-Iran Memorandum of Understanding to reopen the Strait of Hormuz could take prices to USD 68-70, best case. OGRA has begun passing the decline to the pumps, petrol is now Rs 299.5/ltr, down from a peak of Rs 399.86/L on 1 May. The structural vulnerability that defined the prior quarter has converted into a tactical tailwind.

NCPI peaked at 11.7% YoY in May 2026, a 23-month high, driven almost entirely by the transport index (+36.8% YoY) as the March 7 fuel price hike of Rs 55/L finally passed through to bus fares and freight. Headline inflation stood in double digits in June, but three forces then take it sharply lower going forward: the international crude collapse, the FY27 budget's fiscal absorption of part of that decline (PDL target raised to Rs 1.727 trillion, Climate Levy doubled to Rs 5/L), and a highly favorable base effect from the September-November 2025 monsoon flood spike. Our base case sees headline at 8.5% in July, 7.8% in September, and 6.5% by November, back inside the SBP's 7%-8% target band.

The SBP raised the policy rate by 100bps to 11.50% in the April 2026 MPC announcement, a defensive response to the fuel shock. With the disinflation path now visible, the case for further tightening is gone. Our base case sees the SBP holding through the July MPC and beginning a cutting cycle at the September MPC, a 50bps cut becomes the central expectation if the August inflation print confirms our trajectory.

Equity markets bottomed near 148,743 points on the KSE-100 at end-March and have since staged a meaningful recovery of 21% by 30th June 2026. Moreover, PSX closed another stellar year, with a return of 43.5%. The forward P/E still remains well below the 10x historical average, and dividend yields near 6% are compelling. The disinflation narrative provides a clean catalyst for a re-rating into 3QCY26. We move to a more constructive stance: accumulate on weakness in banks (rate-cut sensitivity), consumer discretionary and autos (real income recovery), cement (duration play), and remain selectively exposed to E&P based on production growth triggers.

Economic Snapshot

Indicator		Jun’26	Mar’26	SBP / Consensus View
NCPI (YoY)	%	11.1%	7.3%	Peaked in May; falls to 6.5% by Nov-26
Core Inflation (YoY)	%	8.4%	7.4%	Sticky but no second-round
Policy Rate	%	11.50%	10.50%	Cuts expected from Sep-26
10Yr PIB Yield	%	12.19%	12.28%	Downward bias on disinflation
PKR / USD	PKR	278.16	279.30	Stable on IMF flows
SBP FX Reserves	USD mn	15,916	16,375	On Target
Brent Crude (Closing)	USD / bbl	71.50	118.35	Ideal case for Pakistan USD 65-70

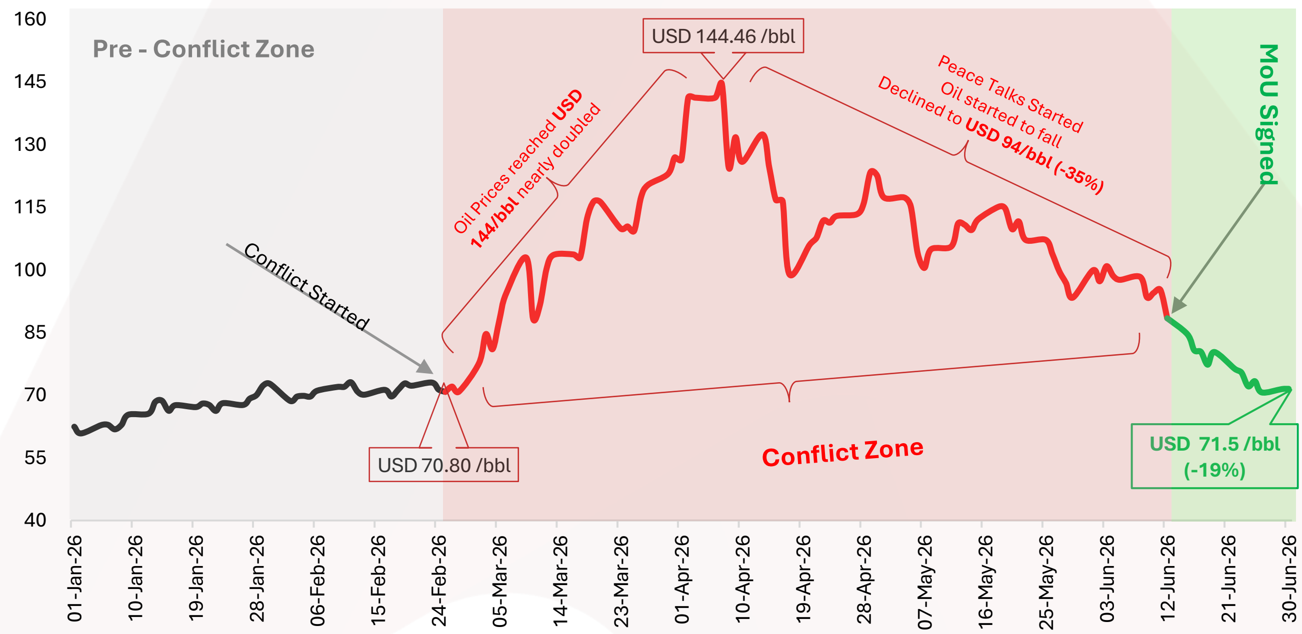
Source (s): SBP, MOF, PBS, AAML Research

International Oil Prices: From Spike to Slide

The dominant macro variable for Pakistan in 4QFY26 has been the round trip in international crude. Brent peaked above USD 120/bbl through Apr on US-Iran escalation fears and the threat of Strait of Hormuz disruption. By end of June, that picture has inverted. Brent closed at USD 73/bbl, a 39% decline from peak on the back of two developments: OPEC+ raising export quotas as Middle East production resumed, and market positioning ahead of a prospective US-Iran memorandum of understanding to reopen the Strait of Hormuz.

For Pakistan, which imports approximately 75% of its oil and gas requirement and where 25% of national electricity generation still depends on oil and RLNG-fed thermal plants, this is a first-order positive. The 4QFY26 average monthly import bill is currently running approximately USD 600-700mn higher than the 8MFY26 average, mainly due to the lagged impact of higher Arab Light Crude prices. Higher Remittances, however, lent meaningful contribution to current account stabilization. Starting June, OGRA has begun passing the decline to the pump in weekly revisions, petrol has been reduced, from a peak of PKR 458.41/ltr on 3 Apr 26 to PKR 299.50 on 27 June 26. HSD now sits at PKR 311.47/L, well below its early-April peak of PKR 520.35.

Brent Oil Trend (USD/bbl)



Brent move from the April peak (USD 120+) to our base case (USD 72) is worth roughly Rs 260-270/L at the retail level, assuming full Petroleum Development Levy (PDL) being charged as per budget, accounting for Long Term MS refining margin and freight, calculated at USD/PKR parity of 280). To recall, when the Crude peaked at over USD 120/bbl, the spreads on refined products had also widened, translating into higher ex-refinery prices for refined products. This translated into local fuel prices peaking at PKR 458.41/ltr and PKR 520.35/ltr respectively in April 2026. The FY27 federal budget captures approximately PKR 89/ litre of that via the annual PDL target. PDL at present on both HSD and petrol price stands at PKR 66.64/ltr and PKR 79.54/ltr respectively. Consumers should see retail prices drift toward Rs 260-270/ltr for petrol by 3Q CY26 we believe, considering our base case for Brent Crude holds. The transport CPI consequence is large, and this is what drives the bulk of the inflation retreat.

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US-Iran Sanctions Relief — And Implications on Pakistan Trade

Following the US-Iran ceasefire announcement, markets are pricing in a probability of US sanctions relief on Iran, which would reopen bilateral trade corridors dormant since 2012. The sanctions framework traces back to the 1979 Revolution, which was multi-lateralzed via a 2006 UN resolution, and was materially tightened in 2012 when Iranian banks were severed from SWIFT. A full or partial unwind would mark Iran's first meaningful re-entry into global trade in over a decade.

The Historical Baseline

FY09-FY10 remains the most relevant reference point for Pakistan-Iran trade. Pakistan's exports to Iran peaked at USD 203mn in FY10, against imports of USD 1,017mn, a trade deficit of USD 813mn. The composition was concentrated: rice made up ~80% of exports, while crude oil and hydrocarbons accounted for 88% of imports. In its simplest form, this was a rice-for-crude corridor.

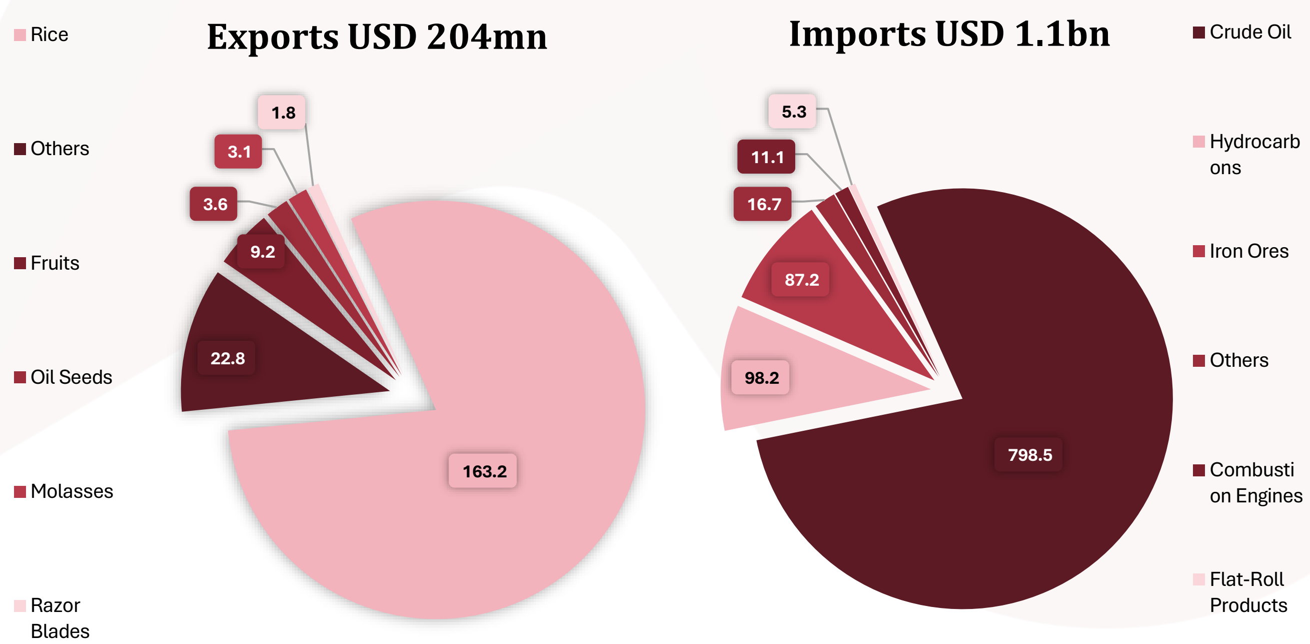
Investment Implication — Incremental Positive, Not a Macro Catalyst

We view sanctions relief as a modest trade diversification event rather than a structural shift for Pakistan's external account.

Rice exports: Pakistan produces ~9 MMT annually, exporting roughly half. Iran would add an incremental buyer within existing exportable surplus rather than trigger a demand shock. As a globally priced commodity, Pakistan remains a price-taker — the benefit here is logistical proximity, not pricing uplift.

Crude imports: The long-run spread between Iranian Light and Arab Light has averaged just USD 3-3.5/bbl, leaving Pakistan largely indifferent on price. The tangible gain is lower transportation cost and shorter delivery timelines.

Trade with Iran Peaked in FY10 (USD mn)



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Iran-Pakistan Gas Pipeline

This proposed 2,775 km cross-border project has been stalled for over a decade. Pakistan has formally placed it on hold, pursuing an out-of-court settlement while tying revival to sanctions easing and commercial renegotiation. The reluctance is straightforward, current gas needs are met through local production and Qatari LNG, with the Qatar contract running until 2031 and domestic E&P activity picking up recently. Pricing is also a deterrent: the Iran agreement is benchmarked at ~78% of crude oil parity at USD 80/bbl, implying roughly USD 11.3/MMBtu, well above Qatari LNG at USD 5-6/MMBtu. The deal would provide 78 mmcfd on a take-or-pay basis, but near-term progress remains ambiguous. Longer term, it retains potential to serve Pakistan's hydrocarbon needs and will likely be revisited as conditions warrant.

Bottom Line

Sanctions relief is a modest, incremental positive, widening rice export destinations, marginally lowering crude import costs, and reopening a corridor with spillover potential for sectors like steel and pharma. Any concessionary pricing on Iranian crude below spot would offer a modest current account buffer, though this remains speculative. We'd caution against reading this as a structural macro catalyst: the correct framing is trade diversification at the margin, not a step-change in Pakistan's external account dynamics.

Current Account — Stress Behind, Stability Ahead

Pakistan's external account weathered the March-May energy spike better than our initial expectations. The cumulative trade deficit widened through 3QFY26 on the oil shock, but remittance inflows remained resilient and IMF disbursements continued on schedule. With Brent now retreating sharply, the residual stress on the current account dissipates going into FY27. Pakistan has managed to post a current account surplus of USD 255mn in 11MFY26. We believe FY26 current account deficit will remain well inside the SBP's 0-1% target band and the IMF program parameters. For FY27, the lower oil price path materially improves the trajectory: if Brent averages USD 72/bbl through 1H FY27 (our base case), the CAD could remain manageable.

Current Account Estimates

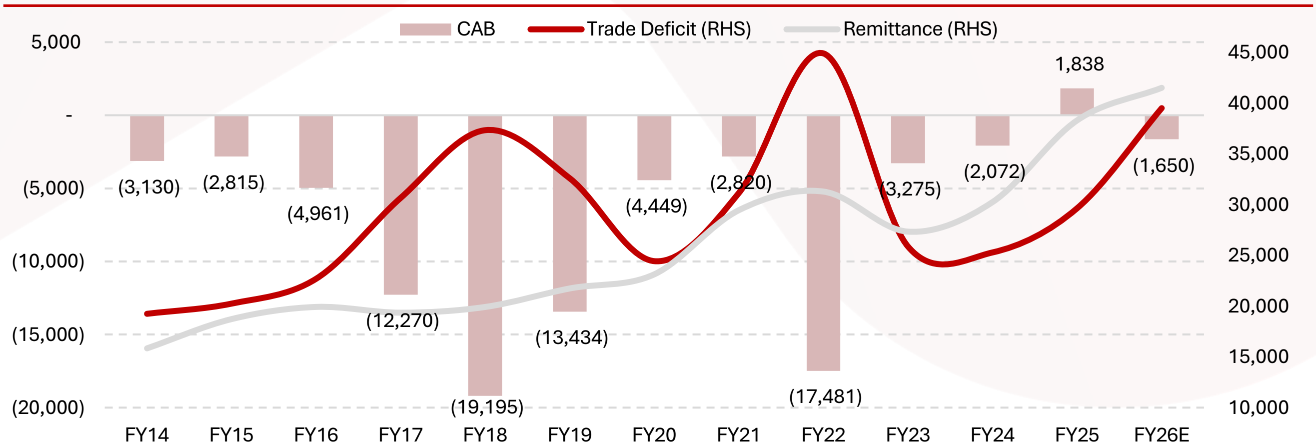
USD mn	FY25	FY26E
Current account balance	**1,838**	**(1,000)**
Exports of goods FOB	32,343	30,500
Imports of goods FOB	59,146	65,000
Balance on trade in goods	(26,803)	(34,500)
Balance on trade in goods and services	(29,639)	(36,400)
Workers' remittances	38,300	41,500

Source (s): SBP, AAML Research

Residual Risks to the External Account

- US-Iran deal collapse or implementation delay beyond 3Q 2026, Brent rebounds to USD 85+ and import bill widens by USD 2 - 3bn versus base.
- GCC remittance softness if oil-dependent GCC economies slow on lower oil prices, 55% of remittances originate from these economies and remain a sensitivity point even in the bull case.
- Monsoon flood event, Pakistan is entering monsoon season; the FY26 flood experience caused significant disruption to food and logistics.
- PKR depreciation, anything beyond 4% per annum

Current Account, Remittances, Trade Deficit (USD mn)



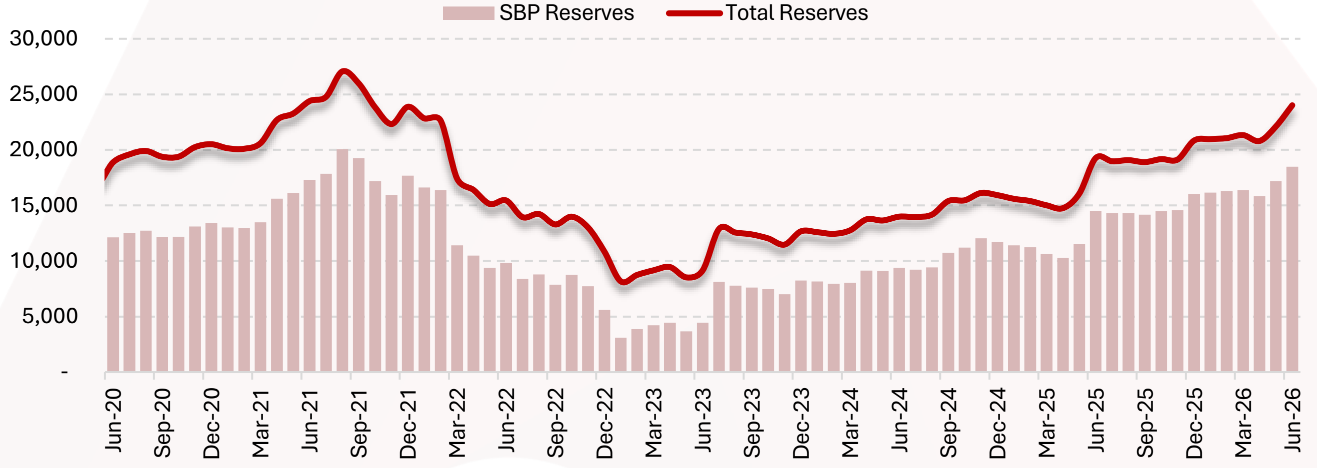
FX Reserves

FX reserves have continued to build. SBP-held reserves stood at approximately USD 16.8 billion by mid-June 2026, up from USD 16.4bn at end-March and USD 2.9bn at the FY23 trough, providing roughly 3x import cover. SBP reserves are expected to increase in the final two weeks of June, to close at USD 18bn on June 2026, right on SBP's FY26 target. The IMF disbursement received during the quarter, combined with sustained remittance inflows of approximately USD 3.5bn per month, has supported the buffer through the oil-shock period without forcing the SBP into PKR defense.

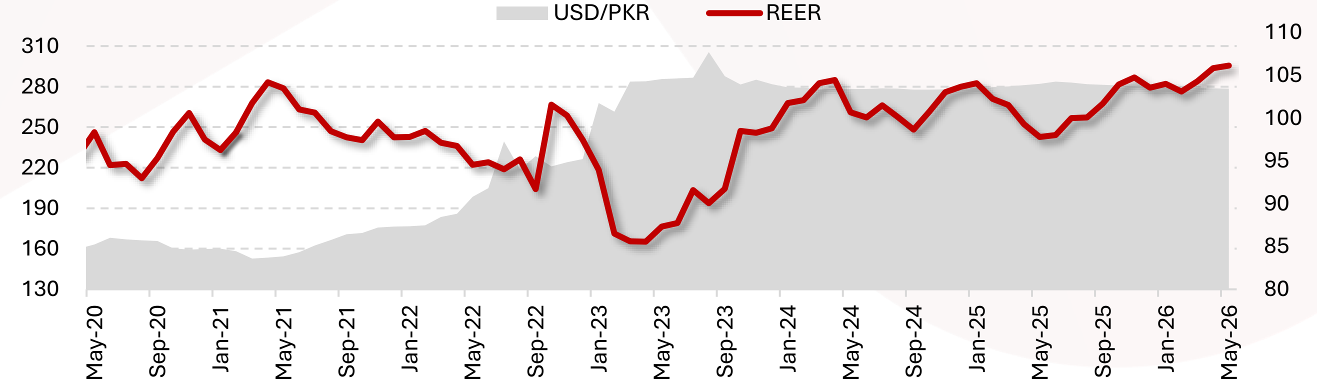
The trajectory into FY27 looks materially better than it did three months ago. The SBP's USD 18 billion FY26-end reserves target now appears comfortably achievable. The IMF program review scheduled for December 2026 remains the key external anchor; Pakistan's management of the oil shock, both the spike and the unwind, strengthens the country's standing ahead of that review. We expect the IMF to acknowledge improved external buffers and to permit modest fiscal flexibility on development spending in 1HFY27.

USD/PKR has held near PKR 278-279 through the quarter, with modest depreciation on the back of the April rate hike communication and the broader EM dollar strength. The Real Effective Exchange Rate (REER) remains in a competitive range, supportive of export momentum. We do not expect material PKR depreciation through 1H FY27 in our base case.

Foreign Exchange Reserves: (USD mn)



USD/PKR vs REER:



Inflation — Peak Behind Us, Single Digits Ahead

Headline NCPI hit 11.7% YoY in May 2026, the highest print in 23 months, driven entirely by transport (+36.8% YoY) following the March-April fuel shock. The June 2026 NCPI also stood at 11.1%, as the lagged pass-through of April's pump prices continued to feed into freight and transport fares. Post June, two forces have lined up to pull inflation back into single digits much faster than the headline alone suggests.

First, the international oil price is collapsing, Brent has fallen from the mid-USD 90s in early June to USD 73.0 by the end of the month. Second and most importantly, the base effect turns sharply favorable from July onwards because mid-to-late 2025 had highly elevated MoM prints (Jul-25: +2.9%, Sep-25: +2.0%, Oct-25: +1.8%) driven by monsoon floods that spiked perishable food prices.

The Base Effect — Single Biggest Driver of the Disinflation Story

Pakistan's CPI index moved erratically through mid-to-late 2025 because of two specific shocks: the August 2025 perishable food crash (a delayed market normalization that took the index down 0.65% MoM), and the September-November 2025 flood spike that pushed monthly inflation to +2.0% / +1.8% / +0.4% MoM. The combined effect is a base period that is unusually high relative to where it would have been on a trend basis. This matters mechanically: even if our forward MoM assumptions are roughly flat through Q3 2026, the YoY collapses simply because the comparison period was elevated by one-off shocks that won't repeat.

Month	CPI Index	2025 MoM %	2025 Driver	2026 YoY (Base)
June	264.26	+0.3%	Pre-flood; low base	11.1%
July	271.92	+2.9%	Early monsoon, fuel hike	8.5%
August	270.15	−0.7%	Perishable food crash (−12%)	9.5%
September	275.55	+2.0%	Flood impact begins	7.8%
October	280.51	+1.8%	Tomato +127%, sugar +35% YoY	6.2%
November	281.63	+0.4%	Flood impact moderates	6.5%

Core (NFNE): The sticky component. At 8.7% urban / 7.9% rural in Jun, core has not responded materially to the headline acceleration, which is reassuring, as it suggests no second-round effects. We expect core to ease toward 7-8% by November as wage growth moderates and the pass-through from the fuel shock matures.

Monetary Policy — From Hike to Hold to Cut

The State Bank of Pakistan raised the policy rate by 100bps to 11.50% at the April 2026 MPC, breaking from the prolonged pause that had defined the December 2025 - March 2026 stance. The hike was a defensive response to the March-April fuel shock and the threat of de-anchored inflation expectations, and, viewed in hindsight today, looks like the right call. It re-anchored the PKR, kept the IMF program on track, and gave the SBP credibility room ahead of the disinflation it can now reasonably expect.

With headline inflation now on a clear disinflationary path, peaking in May 2026, we anticipate it breaking 8% in July, and decelerating to ~5.7% by November, the case for further hikes is gone. Our base case sees the SBP holding through the July MPC and beginning a cutting cycle as early as September MPC announcement. A 50-100bps cut by December 2026 becomes the central expectation if the October print confirms our trajectory. The Governor's recent guidance that inflation will return to the 5-7% target band over the medium term is consistent with our base path.

Alfalah Investments — Policy Rate Forecast

MPC Meeting	Our Forecast	Rationale
April 2026 (actual)	+100bps to 11.50%	Defensive response to fuel shock; inflation re-anchoring
July 2026	Hold at 11.50%	Inflation peak passing; await disinflation confirmation
September 2026	Cut to 11.0%	Confirm Aug-Sep CPI prints in 7-9% range
November 2026	Cut 50 - 100bps to 10.5% - 10.0%	Disinflation to 6 - 7% confirmed; real rates well positive
January 2027	Further gradual cuts	Path to 9.0% by end FY27

Three conditions must be met for the rate-cut cycle to proceed as forecast. Inflation must trend back toward the SBP's 5-7% target band, our base case is that it will fall within the band by November. The current account must remain within IMF program parameters, PKR must remain broadly stable, avoiding pass-through from currency depreciation into import prices and remain stable near PKR 280/USD with no signs of stress.

Real interest rates, currently near 40bps on the headline June print, turn sharply positive from July onwards. By the November MPC, real rates on the base case will exceed 550bps, significantly above the SBP's medium-term equilibrium of ~100-200bps and providing ample room for cuts.

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FY26 – Pakistan Equity Market Review

Positioning for the Turn

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Capital Market Review:

The KSE-100 entered 4QFY26 near 148,743, its low point following the 21.4% drawdown from the January 2026 all-time high of 189,167. The Israel-Iran escalation, oil spike, and the April SBP rate hike combined to produce a deep but ultimately temporary correction. Through the quarter, the index has staged a partial recovery as the oil price reversed, the IMF disbursement was received, and disinflation visibility improved. At the close of June, the index was trading at 180,301, still below the January peak but with the worst clearly behind us.

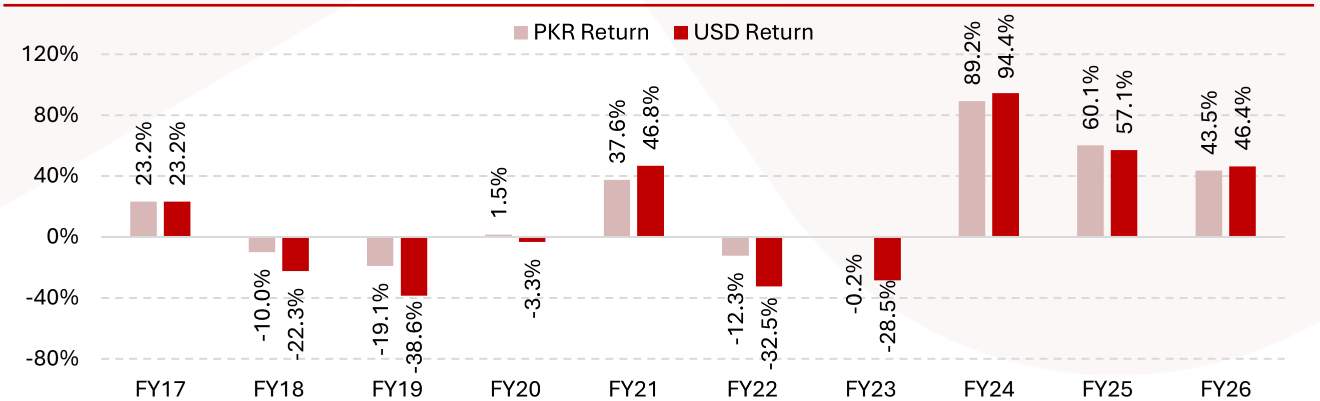
The forward P/E multiple has expanded modestly from the 5.7x trough but still remains at 6.8x, a meaningful discount to the 10x long-term average and to regional peers. Dividend yields near 6% are compelling in both regional and historical contexts. Foreign outflows that pressured the market through 1QCY26 have moderated, and we see early signs of selective foreign accumulation in banks and consumer names.

The fundamental picture supporting Pakistan equities, macro stabilization, IMF backstop, structural reform momentum (privatization, taxation), and resilient corporate earnings, remains intact. The recent correction was sentiment-driven, not fundamentally driven. With the principal external risk (oil) now resolving favorably and the disinflation path clearly visible, the conditions for a re-rating are in place.

Key Market Catalysts — 1HFY27

- IMF program review (December 2026), successful outcome unlocks further inflows and reinforces sovereign confidence.
- September 2026 MPC, initiation of the rate-cut cycle. Historically a strong catalyst for re-rating of rate-sensitive sectors.
- CPI prints (Jul/Aug/Sep), sequential confirmation of the disinflation path. Each in-line print compresses the equity risk premium.
- Corporate earnings (1QFY27 results, Oct-Nov 2026)- banks face NIM compression but volume growth; consumer and cyclicals benefit from real income recovery.
- Privatization milestones- PIA divestment progress and potential SOE listings remain medium-term positives.

KSE-100 Index Return:



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Equity Market Outlook

Since March 2026, KSE100 has recovered meaningfully to 180,301 with a gain of 21.2% from its trough. The oil dividend, if sustained, as current US-Iran framework terms suggests it will be, sets the stage for the second and more fundamental leg of that recovery: one driven not only by sentiment reversal but by improving earnings, lower rates, and a macro backdrop that is for the first time in years, genuinely supportive of sustained economic growth.

The Second Leg: From Inflection to Acceleration

Looking ahead to 1HFY27, market direction will be shaped by the convergence of three positive catalysts: the disinflation path, the September rate-cut decision, and the December IMF review. The trajectory is constructive but not linear, we expect continued volatility around macro prints and geopolitical news flow. The recent correction in our view represented a healthy reset rather than a trend reversal, offering a compelling opportunity for selective and disciplined accumulation.

Pakistan's equity market, still trading at a forward P/E of 6.8x, a 34% discount to the MSCI EM Index, now benefits from a compounding re-rating dynamic. The earnings base grows as input costs fall across the industrial, consumer, and financial economy and the discount rate falls simultaneously as monetary easing accelerates. When both the numerator and denominator of equity valuation move in the right direction at the same time, the outcome is not incremental. It is transformational.

For equity allocations, the sectoral implications are clear and actionable. Banks benefit from accelerating credit demand, lower provisioning requirements, and the steepening rate-easing cycle that lower inflation enables. Textiles, Pakistan's largest export earner, see energy input costs compress the cost of production and improve export competitiveness simultaneously. Cement, fertilizers, and consumer-facing businesses see margin expansion as energy-intensive production costs decline. The oil and gas exploration sector will face wellhead price headwinds.

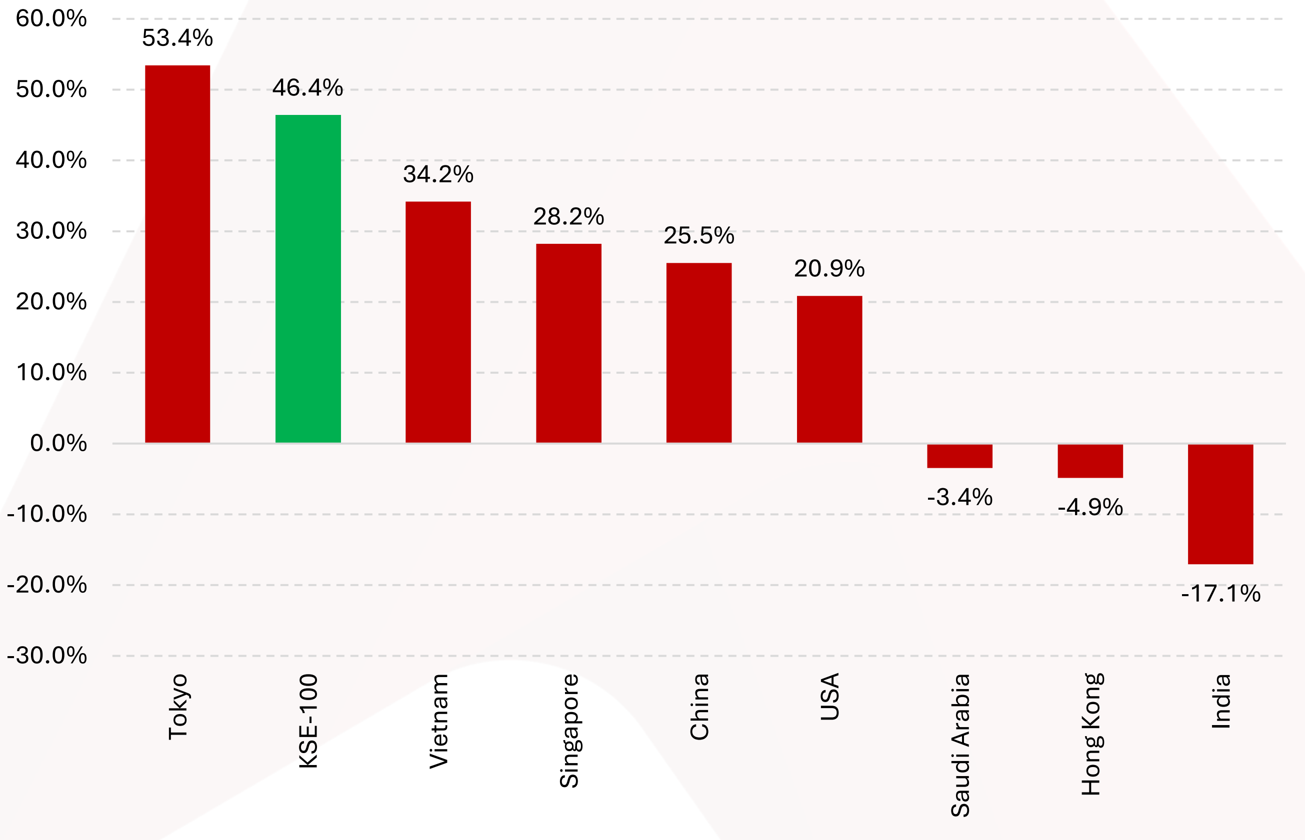
Sector	Stance	View
Banks	Overweight	Rate-cut beneficiary on re-rating; volume growth offsets NIMs compression
Consumer Discretionary	Overweight	Real income recovery on disinflation; pent-up demand from 2024-25
Autos	Overweight	Volume recovery + rate-cut sensitivity + lower input costs
Cement	Overweight	Duration play; PSDP recovery; coal price normalisation
Fertilizer	Neutral	Gas pricing uncertainty offset by sustained pricing power
E&P	Neutral / Selective	Lower oil offset by GoP circular debt relief; dividend yield support
Power	Neutral	Capacity payment overhang; selective IPP names on debt resolution
Textiles	Underweight	Energy cost relief partial; demand uncertainty in key export markets

Equity Market Strategy

We retain our 12-month KSE-100 target of 237,000, representing approximately 25% upside from June closing. This assumes the September rate cut, headline inflation reaching the SBP target band, and a forward P/E re-rating toward 8.5x as the disinflation narrative consolidates. 4QFY26 has been a quarter of meaningful reversal. The oil shock that defined our previous outlook has unwound far faster than most expected, taking the inflation peak with it. What remains is a disinflation path with high visibility, a fixed income trade with clear catalysts, and an equity market trading at compelling valuations with a clean re-rating story ahead.

The US-Iran MoU has been signed, monsoon season is underway, and core inflation continues to hold. Risks remain, but for the first time in several quarters, the dominant macro variables are aligning in Pakistan's favour. We believe accumulating quality equities on weakness and staying patient through near-term noise are the best strategies to capture this turn.

FY26 International Market Returns (USD based):



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