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"Davos in the Desert" offers a breather to Pakistan

During the month of October, the KSE-100 index performance had been marred due to various concerns arising from the country's imminent entry into another IMF program; just 2 years after the last program had expired in September 2016. It was announced by the government earlier that the decision to approach the IMF had been made.

In the absence of any material support from the friendly countries that Pakistan was hoping for, and a rapidly evolving geo-political environment (where initially statements from the U.S. Secretary of State Mike Pompeo hinted at politicizing any IMF bailout), it was feared that the IMF would impose stringent conditions on Pakistan which would adversely affect the growth trajectory of the country. Some earlier information suggested that the IMF would require the country to adopt a free floating currency regime and raise the interest rates considerably to arrest excess spending. Pakistan's SBP had already hiked the interest rates by 275 bps during the current calendar year and the PKR has already depreciated by approx. 20% against the greenback during the same period.

The weakened state of economy had taken its toll on the KSE-100 Index which had plummeted -9.41% on calendar year basis, -12.5% on YTD basis and -30.6% from its high in May 2017, on October 16, 2018 where the index made it low for the period. The weakening global equities outlook and constant selling from foreign investors had further dented PSX performance. This is despite a drop in the forward price-earnings multiple of the country from PER 12x in May 2017 to PER 7x in October 2018; while select sectors and stocks looked considerably undervalued and attractive yet the lack of confidence kept investors largely sidelined.

Under such circumstances the Prime Minister of Pakistan scheduled a visit to Saudi Arabia while the host country was organizing an investment conference "Davos in the Desert". In a significant development, PM Imran Khan and his team have secured the following for the country:

- It was agreed Saudi Arabia will place a deposit of USD 3 Billion for a period of one year as balance of payment support.
- A one year deferred payment facility for import of oil, up to USD 3 Billion, will be provided by Saudi Arabia. This arrangement will be in place for three years, which will be reviewed thereafter.
- The Crown Prince had agreed to PM Khan's suggestion to reduce the visa fee for Pakistani workers.
- Saudi Arabia also confirmed its interest in setting up an oil refinery and a MoU will be signed after the cabinet's approval.

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Till date, this has been the biggest support the Saudis have provided to Pakistan at any one time. The Prime Minister in his address to the nation yesterday highlighted the possibility of further support by friendly countries, the details of which may be announced in due course of time as the PM visits China and Malaysia in coming weeks.

While we cannot anticipate the type and terms of such assistance, we believe that any further inflow of up to USD 2-3 Billion would greatly reduce Pakistan's dependence on the IMF and hence terms may not be as stringent as was previously imagined. This should give the government a good degree of leverage and much better footing to negotiate terms with the international lender.

Further, this show of support from Saudi Arabia will give a boost to Pakistan's relations with other relevant countries and helps its broad standing in the world community. This would be further enhanced should other countries also provide some assistance.

That said, the challenges for the economy aren't over yet and all the aforementioned developments will temporary contain the Balance of Payments crisis at hand. The country still needs to enter a fiscal consolidation state and take necessary structural reform measures related to tax, circular debt, energy prices and state owned enterprises to control its fiscal deficit and enhance exports.

The sort of structural reforms needed are not simple. As the Prime Minister suggested in his speech last night, the road to recovery is in sight, but the journey may not be an easy one.

The KSE-100 index has reacted very positively to the Saudi package and staged a strong comeback since the announcement and is expected to remain buoyant in case news of further inflows from friendly countries materialize.

We highlight that valuations are attractive and while there will be a marked slow-down in economic activity next year, entry into stock funds on dips would pay off well on a 2 -3 year timeframe. Further, 'averaging' at current levels on past investments should also be considered. Investors with a moderate to high risk profile may diversify their risk by allocations into our Asset Allocation funds/plans that limit the downside risk from stable returns that emanate from their fixed income portfolio. For low risk profile investors we encourage them to invest in our pure fixed income/money market funds that are positioned well to benefit from a rising interest rate scenario.