NBP FUNDS
Managing Your Savings

Dr. Amjad Waheed, CFA
Chief Executive Officer

Pakistan's Economy & Market Outlook

Pakistan's economic growth outlook remains broadly positive as manifested by a strong growth in both private and public sector spending. Amid contained inflation and benign interest rates, GDP growth of 5.3% in FY2017 is expected to accelerate to 5.6% for FY2018, supported by robust public sector investment activity under CPEC; capacity expansions & higher utilization by the private sector; and better performance of the agriculture sector. However, the consequent rise in demand for imported machinery, industrial raw material, food items, and fuel products has resurfaced a critical issue of Balance of Payment (BoP) amid meager growth in exports, muted remittances growth, and paucity of Foreign Direct Investment (FDI).

Balance of Payment (BoP) Position: To address the risks to the BoP position, initially, the government took some policy measures such as increasing levies and duties on non-essential imports, and improving incentive package for exports. To augment the above policy measures and to discourage non-essential imports and boost exports, the Central Bank in coordination with the Finance Ministry has responded with controlled devaluation in December 2017 and again in March 2018. To contain the building demand pressures, the central bank also began monetary policy tightening cycle with 25 bps increase in policy rate in its monetary policy review in January 2018. The government is also working with all the relevant stakeholders to bring a foreign assets amnesty scheme that is likely to be announced alongside the federal budget in the last week of April. To fill the remaining gap, we also anticipate Pakistan to return to IMF in FY19. This will also bring the much needed fiscal consolidation through broadening of tax base, rationalizing of government expenditures, and privatization/restructuring of loss making Public Sector Enterprises.

Currency Devaluation: We would like to highlight that currency devaluation by and large is positive for the stock market through its impact on corporate earnings as profitability of the major listed sectors such as Oil & Gas Exploration, Banks, Textiles, IPPs tends to rise. On the other hand, some sectors such as Cement, Steel, Autos & Pharmaceuticals, etc. that use imported raw material can potentially witness some margin contraction. We have seen that these sectors have responded to the cost hike by raising their end product prices. The stock market has reacted positively to the latest round of devaluation as witnessed by 4.6% bounce back post the recent devaluation in March and an overall 17.5% rise since the December round of devaluation. Despite the challenges of somewhat strained Pak-US relations and negative news flow surrounding Financial Action Task Force (FATF), we believe that if timely steps are taken, the risks to the external account can be mitigated without jeopardizing the economic growth trajectory as business sentiments have improved considerably in the last couple of years, and corporate earnings are set to continue their double digit growth in the medium-term.

Federal Budget 2018-19: The federal budget 2018-19 will be the last budget of the current government under this tenure. It is widely expected from the media reports that it will be a friendly budget with no new major taxes likely. However taxes/penalties on non-filers will likely increase. We expect some of the recommendations of PSX to be accepted by the government which will have a nominal taxation impact but will surely boost investor sentiments. Key recommendations given by the PSX include abolishment of tax on bonus shares, relaxation in Capital Gains Tax (CGT) rates, and its removal on long term holding in line with CGT applied on immovable property, exemptions of foreigners from CGT, reduction in advance tax rate on transaction of shares, exemption of tax on inter-corporate dividends, enhanced tax credit tenure for newly listed companies, along with a request for consistent and long term policies for the capital market to enhance the confidence of both local and foreign investors.

Stock Market: Heightened political noise is likely to continue in the near-term ahead of the national elections. However, once elections are held, that would give the new government a fresh mandate to restart the waning structural reforms agenda. We expect long-term economic growth of around 5% driven by strong domestic consumption, rising business investment activity, and continued public sector development. Precarious security situation and chronic power shortages are no longer being mentioned as the key business risks by investors, and are now overtaken by more manageable issues like taxation burden and bureaucratic red tapes.

From a valuation perspective, PSX is trading at a forward Price-to-Earning (P/E) multiples of 10.3, which is a deep discount to the Emerging Market peers. We feel that there is a high probability of substantial foreign portfolio inflows in the stock market as the currency is near its fair price, and revival of local market participants' interest in the market post the foreign assets amnesty scheme. In our view, given attractive valuations, healthy economic growth rate, and abundant liquidity, the market is well-poised to deliver strong performance over the next 12-months.