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Weekly Stock Market Commentary

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During the outgoing week ending 9th June, the stock market gained on a week-on-week basis, as the benchmark KSE-100 increased by 551 points (up by 1.33%). Bulk of the index gain was contributed by Oil & Gas Exploration, Oil & Gas marketing and Technology sector stocks. Banks came under pressure during the week, in anticipation of higher tax burden, ahead of the budget.

Ahead of the federal budget, the news-flow surrounding the budget shaped the direction of the market during the week. The outgoing week started in the positive trajectory amid optimism over proposed budget measures. This optimism continued when encouraging news related to expected resumption of IMF program in the ongoing month motivated investors to make fresh purchases. On Wednesday, the index surpassed 42,000 mark, with technology & telecom sectors remaining in spotlight as PM suggested incentives for the sectors in upcoming budget. The PM also decided to extend the facility to IT sector, allowing them to keep 35% of its income for 3 years in foreign currency accounts for improving operational efficiencies. The positive streak ended on Thursday when index turned negative & shed more than 450 points. Investors exercised caution ahead of budget announcement amidst uncertainty surrounding resumption of IMF program. The participants were jittery because on one hand, the government appeared eager to present a populist budget while on the other hand, IMF reiterated that release of the tranche will hinge on fulfilment of three conditions including proper functioning of the FX market, passing an FY24 budget consistent with program objectives, and secure firm & credible financing commitments to close the USD 6 bn gap ahead of the board meeting. The Pakistan Economic Survey 2022-23 was also revealed during the week revealing that the government failed to achieve most of the macroeconomic targets, including GDP growth rate, inflation, per capita income, fiscal slippages, public debt, exports, investment and savings.

Looking ahead, there is no denying that country is facing serious macro-economic challenges emanating from record high inflation, unsustainable fiscal deficits and woefully inadequate SBP FX reserves with little clarity on resumption of IMF program. Moreover, with near end to the ongoing IMF program, meeting short-term debt obligations will lead to further erosion in FX reserves. Although the government has underlined that bulk of these loans will be rolled over, meeting the estimated gross external loan repayments of around USD 20-22 billion in FY24 without umbrella of IMF is certainly out of question. On inflation front, though it is expected to cool off in June, given high base in same period last year, much depends on commodity cycle especially oil prices, and the USD/PKR parity. Investors will be keenly following the outcome of budget if it will gain approval of the IMF. The recently announced budget is very ambitious in terms of revenue collection due to absence of major tax measures, that will come under scrutiny of IMF. The lender will also size up massive 80% growth in non-tax revenues. Expenditures, in particular the debt servicing cost will also difficult to limit within estimates given the prevailing interest rates. Even more challenging will be the funding of this mammoth budget deficit of around PKR 7 trillion.

In terms of various budgetary measures, we reckon it is slightly negative for corporates and will also dampen sentiments. Incidence of super tax has been increased. Previously it was capped at 4%, however, now the tax incidence has been raised to 10% in a progressive manner. Withholding Tax on the bonus shares has been re-imposed @ 10% (for filers) and @ 20% (for non-filers), which will limit the bonus share issuance on the bourse. Although it does not affect the profitability, it will slightly hurt the sentiments of investors. An unusual tax to the extent to 50% has also been slapped on income, profit and gains arisen to person or class of persons, due to any economic factor(s) resulting into unexpected income, profits and gains. The government has desisted from imposing any tax on retained earnings, against many proposals floating before the budget, which should be a major relief for the companies. Although these proposals will trim earnings of companies in our universe, the market valuations are still too cheap to ignore.

Looking at fundamentals, Price-to-Earnings Ratio (P/E) of market is at multi-year low of around 3.8 times (earnings yield of around 26.3% as against 10-yr PIB yield of 15.1%). Therefore, we advise investors with medium to long-term investment horizon to build position in stock market through our NBP stock funds.