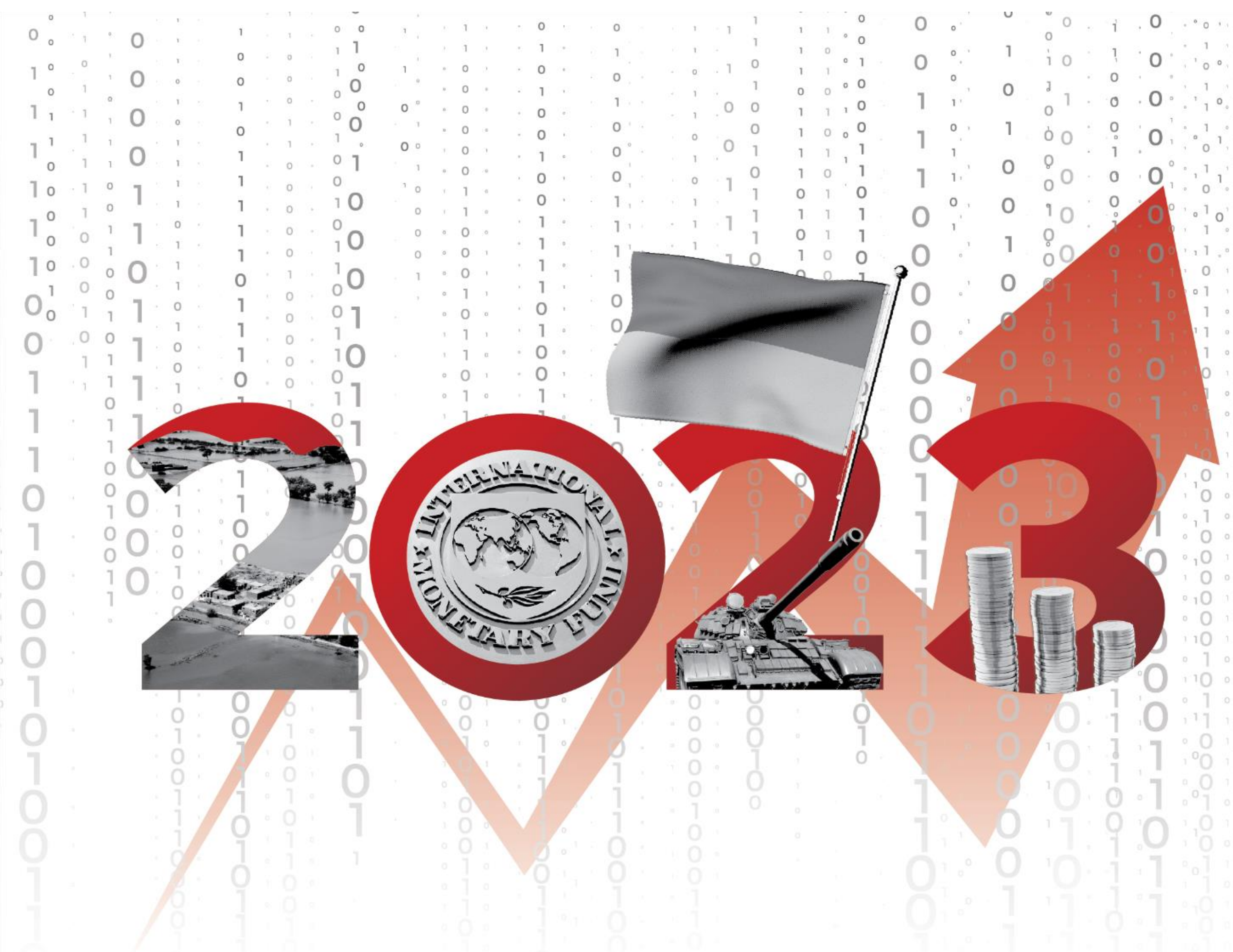

BMA CAPITAL

Saturday, December 31, 2022

2023:
A YEAR OF ADJUSTMENTS

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THINK INVESTMENTS, THINK BMA

EUROMONEY
Euromoney Market Leaders Investment Banking (Notable) - 2022

PAC Insider
Best Equity Market Consultants Pakistan 2022

Global Business Outlook
Most Innovative Corporate Finance Advisory Firm - Pakistan 2022
Fastest Growing Asset Manager - Pakistan 2022

CFA Society Pakistan
Best Brokerage House 2017
Best Brokerage House 2016 (Runner-up)
Best Analyst & Trader 2013 (Runner-up)

ASIAMONEY
Sector Coverage of Bank, Insurance, Power, Macroeconomics, Small Caps, Materials
Runner Up

Key considerations going into 2023

Keeping in mind the current economic challenges faced by the country and continued uncertainty on both political and macroeconomic fronts, we write this report with the view of providing our take on key subjects and how we see them shaping the new year.

- **Inflation:** We expect inflation to exceed the SBP defined range of 21-23% this fiscal year and average at 23.7%. PKR devaluation, international commodity prices and energy price increases pose potent risks to our assumptions. This situation could persist, albeit at a slower pace, going into FY24 with inflation expected to average at 12.5%.
- **Interest rate:** We expect an increase of 200bps in the policy rate until the end of the fiscal year with the two upcoming MPC meetings likely to result in increases of 100bps apiece. However, our assumption of a 200bps hike is premised upon some belt tightening fiscal measures, and inability to increase taxes and government revenues pose an upside risk to our thesis.
- **Fiscal deficit:** This fiscal year began with high expectations, with the government forecasting a fiscal surplus of PKR 152Bn. However, we see the Country running close to the highest deficit numbers as reported last year. Though our revenue target was geared up by ~15% compared to the previous year to PKR 7.5Trn, the chances of achieving this are slim.
- **Current Account Deficit:** We expect the full year CAD to settle at around USD 7.5Bn while basing our case on reduced imports accompanied by sticky exports. However, it will be interesting to note the agricultural output in the upcoming months as there are risks of major output cuts which could put pressure on the import bill and resultantly pilfer through CAD. We must also be mindful of remittance flows that have slowed down in this fiscal year on the back of parallel currency markets and high cost of living abroad.
- **Currency:** We expect the PKR to close the fiscal year at 256 against the USD. We opine the PKR has room for an upward adjustment of ~10-15% which will be triggered by a mix of slowing remittance flows, a weak forex position and meagre foreign assistance.
- **IMF:** We believe, after the conclusion of this programme in Jun'23, the incoming government will likely go for a bigger IMF programme in order to gauge the yawning external account. However, completion of this programme will be no smooth sailing and will require radical fiscal and structural reforms.
- **External funding gap:** We believe the funding shortfall for this year will be bridged as the IMF comes on board and multilateral/bilateral flows materialize. However, this issue will once again resurface as FY24's funding requirement is 20% higher than FY23 which essentially means that this problem will persist for a good few years. In our base case, we do not see Pakistan defaulting in the near term but will continue to run the risk in the coming years.
- **Politics:** We expect elections to be held on time and the current setup to complete its rightful tenure till Aug'23. The pressure from PTI's side will continue to build and could gather pace as the ex-government looks to dissolve the Punjab & KP assemblies. Nonetheless, we opine this election to be a fierce competition and PTI along with its allies to emerge victorious by a thin margin and form a hung parliament - however, PDM should not be taken lightly and individual parties will likely form a strategic alliance once again and give PTI stiff competition.
- **KSE-100:** We expect this year to be similar to the outgoing year and individual stocks and sectors with strong fundamentals to outperform the market while the index movement will be limited. That in the backdrop, we advise a *cautious* 'BUY' strategy with emphasis on key macroeconomic and political developments while having exposures in defensive, high yielding, low beta and mature sectors.

2023: Notable Events

BMA CAPITAL

January
- World Economic Forum Annual Meeting
- Paris Club meeting
- International Conference on Climate Resilient Pakistan to be held in Geneva
- Chinese New Year
- SBP Monetary Policy Meeting

February
- FOMC Meeting
- FATF Plenary & Working Group Meetings, Paris
- MSCI: Quarterly Index Review
- OPEC: Joint Ministerial Monitoring Committee (JMMC) meeting

March
- FOMC Meeting
- Paris Club meeting
- SBP Monetary Policy Meeting

April
- Paris Club meeting
- SBP Monetary Policy Meeting

May
- FOMC Meeting
- MSCI: Semi-Annual Index Review
- Paris Club meeting
- Japan to host G7 Summit in Hiroshima

June
- Federal Budget FY24 announcement*
- FOMC Meeting
- FATF Plenary & Working Group Meetings, Paris
- 35th OPEC and non-OPEC Ministerial Meeting
- Global Economic Summit '23
- Paris Club meeting
- SBP Monetary Policy Meeting

July
- FOMC Meeting
- Paris Club meeting
- SBP Monetary Policy Meeting*

August
- End of PDM's Govt. tenure*
- MSCI: Quarterly Index Review

September
- Retirement of CJP Umar Ata Bandial
- Appointment of CJP Qazi Faez Isa
- FOMC Meeting
- India to host 18th G20 Heads of State and Govt. Summit
- UN: 2023 Sustainable Development Goals Summit
- Paris Club meeting
- SBP Monetary Policy Meeting*

October
- General Elections*
- FATF Plenary & Working Group Meetings, Paris
- Paris Club meeting
- SBP Monetary Policy Meeting*

November
- FOMC Meeting
- MSCI: Semi-Annual Index Review
- Paris Club meeting

December
- FOMC Meeting
- Paris Club meeting
- GSP+ scheme to expire
- SBP Monetary Policy Meeting*

*tentatively

Pakistan Economy

At crossroads yet again

The Pakistan economy continues to be at crossroads having been marred by challenges posed by a nosediving PKR, runaway inflation, fiscal slippages, weakening forex reserves, external account concerns and political upheaval. Recent flash floods across the country have further raised concerns about growth prospects, tax collection and CAD. However, being a part of the IMF programme in these challenging times has given some comfort though it remains to be seen how the country will meet the plan of action put forward by the international agency. The IMF programme seems to be put on hold for now as there have been repeated delays in the start of the 9th review which was initially supposed to start in Sep'22. It will also be important to see the amount of foreign funding the country is able to arrange in these challenging times and the amount of relief that can be generated, be it in the form of waivers from the IMF or restructuring/rescheduling of outstanding debt.

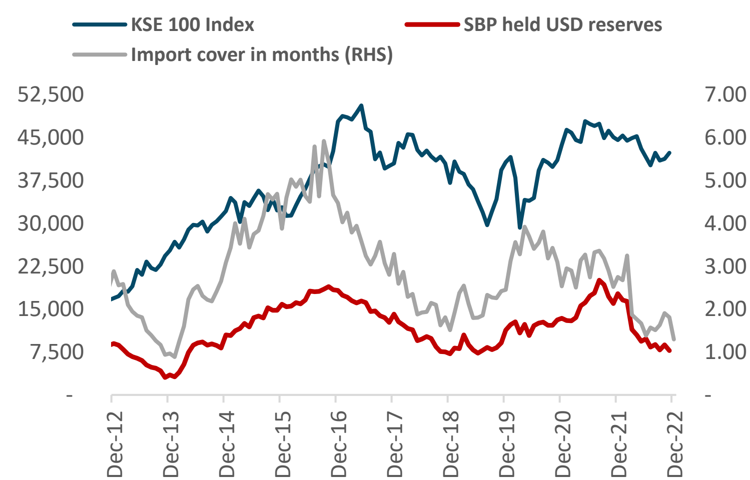
- Keeping in mind the multiple challenges at hand on the economic front, we opine the run up to the elections will be a tricky period and the incoming government will have to hit the ground running from day one. That said, the biggest single loser in this regard would likely be the PKR, which we opine could slide by ~10-15% as import based restrictions are rolled back. Similarly interest rates, which in our view are yet to peak and could well undergo an increase of 200bps depending largely upon inflation readings and PKR depreciation. Upwards revision in energy tariffs, food inflation, faltering tax revenue and slowing remittance flows could possibly make a strong case for rate hikes going forward.
- The external funding gap is another area that is of particular interest as it continues to swell from year to year. Given average servicing of USD 25Bn (ex-CAD) over the next 5 years, it looks increasingly likely that Pakistan will have to go into a bigger and possibly longer IMF programme right after the conclusion of the current program in Jun'23. However, going into a new IMF programme will bring its own challenges including further fiscal discipline, a tight monetary policy stance, roll back of subsidies and revision in energy tariffs which will keep inflation elevated over the near term and the PKR under pressure. That said, we opine the next 12-18 months will be particularly important to watch and economic developments will shape KSE-100 performance going into 2023.

Macro assumptions

	FY22	FY23E	FY24E
Total GDP (PKR Bn)	66,950	85,361	96,714
GDP growth	6.0%	2.0%	3.0%
Fiscal Deficit (PKR Bn)	5,289	5,122	4,836
Fiscal Deficit (as a % of GDP)	-7.9%	-6.0%	-5.0%
Current Account Deficit (USD Bn)*	17.4	7.5	8.5
Current Account Deficit (as a % of GDP)	-4.5%	-1.9%	-2.1%
CPI Inflation (average)	12.1%	23.7%	12.5%
PKR/USD (period end)	204.9	256.1	281.7
Policy rate (period end)	13.8%	18.0%	13.0%

Source: IMF, BMA Research

KSE-100 Index vs. SBP Held Reserves



Source: SBP, BMA Research

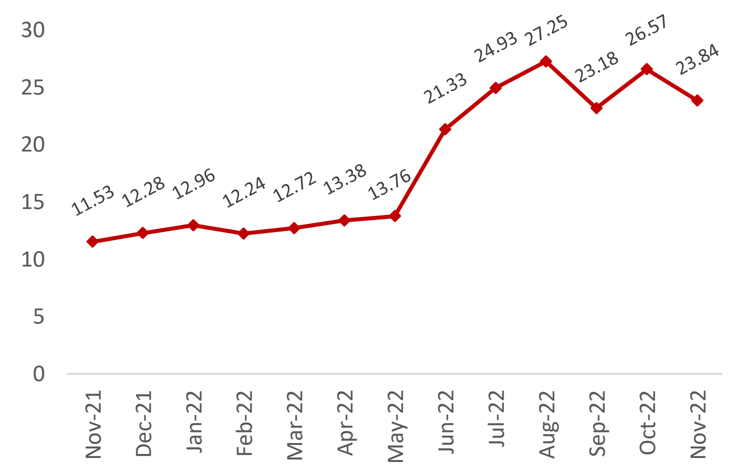
Double digits for the foreseeable future

Inflation: High international commodity prices pursuant to the military operation in Ukraine, global supply chain disruptions, weakening PKR and lower than expected agriculture output have been the primary proponents to the runaway inflation observed over the past 6 odd months. Street consensus forecasts inflation to average at least 23% for the fiscal year primarily led by food inflation and high transportation. It is interesting to note that despite major international commodities having backtracked considerably from their peaks, the benefit is yet to translate to the final consumer due to 1) sizable PKR devaluation which has kept cost of imported goods/commodities on the higher side, 2) hefty imposition of government taxes, PDL being a prime example that has reversed the gains on the pricing side and 3) upwards revision in energy tariffs.

- It is important to note now that core inflation, which usually tends to be sticky, has started to inch up. In Nov'22, it was reported at 14.6% YoY and 18.5% YoY in urban and rural areas respectively. Taking cues from this, we expect inflation to remain in double digits as an increase in core inflation usually takes 18-24 months to cool off and revert to long term means. That said, we expect inflation to exceed the SBP defined range of 21-23% this fiscal year and average at 23.7% for the least with PKR devaluation, international commodity prices and energy price increases posing potent upside risks to our assumptions. The situation would persist, albeit at a slower pace going into FY24 with inflation expected to average 12.5%.
- We expect the State Bank to maintain a hawkish stance at least in the nearer term, maintaining policy rates in the high teens unless there is a clear shift in patterns in terms of inflation readings. Similarly, it will be important to note the availability of essential food items whose output was severely impacted by the recent flash floods and caused a spiralling effect across the food chain. If the upcoming Rabi season, from which the SBP has high hopes, fares better than expected, food inflation can come down sharply and resultantly the SBP might adopt a softer stance - though the primary concern will continue to remain core inflation.

CPI Inflation	Nov-22	Nov-21	% YoY
General	**195.9**	**158.2**	**23.8%**
Food & Non-alcoholic Bev.	221.1	168.6	31.2%
Alcoholic Bev. & Tobacco	198.5	146.0	35.9%
Clothing & Footwear	182.3	153.8	18.6%
Housing, Water, Electricity, Gas & Fuels	167.5	152.4	9.9%
Furnishing & Household	191.8	148.6	29.1%
Health	186.0	158.9	17.1%
Transport	245.3	170.1	44.2%
Communication	111.9	110.1	1.6%
Recreation & Culture	166.8	132.9	25.6%
Education	163.5	147.2	11.1%
Restaurants & Hotels	196.5	153.1	28.4%
Miscellaneous	199.0	161.8	23.0%

National Consumer Price Index (% - YoY)



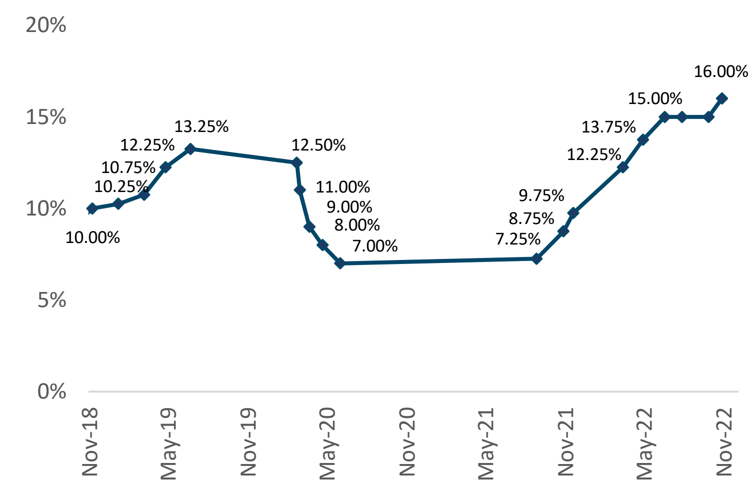
Source: PBS, BMA Research

Room for 200bps

Interest rate: Consistent pressure on the PKR and upwelling inflation have been the main drivers behind the 900bps increase in the policy rate (7% to 16%) over the past 12-18 months. The SBP has repeatedly stressed upon its core responsibility to keep inflation under wraps while using the PKR as the first line of defense since 2019 when the regime was changed to a free float exchange rate at the start of the ongoing IMF programme. Resultantly, the above average GDP growth in last two consecutive fiscal years (5.7%/6.0% in FY21/22 respectively) led to a sharp increase in twin deficits and as mentioned earlier, PKR felt the heat. However, the adjustment in PKR and tighter fiscal measures did not prove enough to curb the robust domestic demand and the SBP had to tighten the noose. As things stand, the measures taken by the SBP to slow down demand from the local end and to control foreign currency pilferage have borne some fruit. However, weak forex reserves and mounting external debt pressures suggest there is more to be done.

- We expect the SBP to maintain a tight monetary policy stance at least until the conclusion of the IMF programme which was initially expected to be completed in Jun'23. Given the delay in the 9th review, we opine the conclusion will likely be extended further. We expect the SBP to follow a data driven approach where key economic metrics will be closely watched while there will also be one eye glued to the fiscal side which, if in case starts to falter (seems to be increasingly likely) then there will be no room for the MPC to loosen the grip. Linking policy rate to inflation, which we expect to average over 12% in FY24, SBP will continue to maintain a hawkish stance and resultantly, we may not see a major downward revision in the policy rate.
- We expect an increase of 200bps in the policy rate until the end of the fiscal year with the two upcoming MPC meetings likely to result in increases of 100bps apiece. However, our assumption of a 200bps increase is premised upon some belt tightening fiscal measures and inability to increase taxes or government revenues poses an upside risk to our thesis. On the brighter side, SBP can gain relief from the fact that the CAD has undergone a swift decline over the course of the fiscal year and if commodity prices correct further, the situation could improve and enable the central bank to adopt a more accommodative stance.

Policy Rate history



Advance Calendar of MPC Meetings

Monday 23	January 2023
Thursday 16	March 2023
Thursday 27	April 2023
Monday 12	June 2023

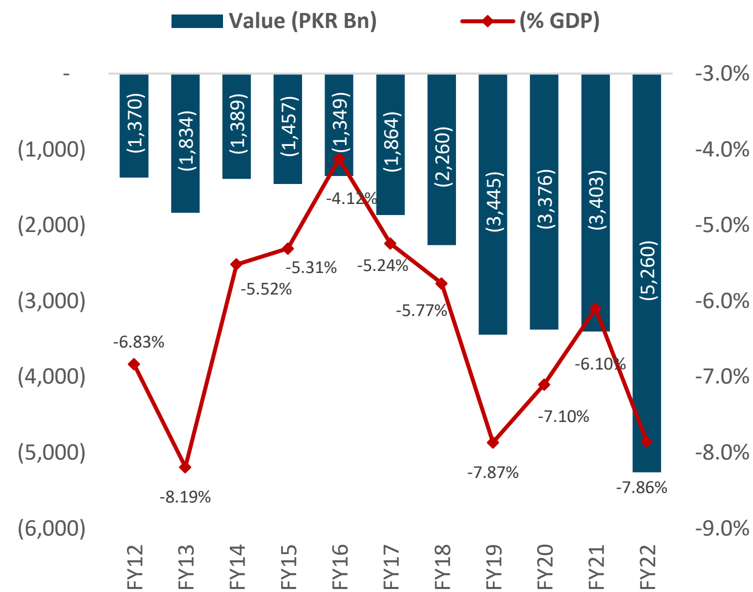
Source: SBP, BMA Research

Consistent slippages piling on pressure

Fiscal deficit: Energy subsidies announced in the last fiscal year by the ex-premier worsened the economic landscape significantly and only added to the three previous deficits of over 6%. The results are apparent.

- This fiscal year began with high expectations, with the government forecasting a fiscal surplus of PKR 152Bn. However, we see the Country running close to the highest deficit numbers as reported last year. Though our revenue target was geared up by ~15% compared to the previous year to PKR 7.5Trn, the chances of achieving this are slim.
- Our expectation is premised upon: 1) sizable slowdown in imports which has led to a sharp decline in import stage revenues (note that ~50% of the Country's tax revenues come from import level collection), 2) decreasing petroleum sales that have impacted indirect revenue and hence PDL collection target of PKR 750Bn seems like a far-fetched idea, 3) devastation caused by flash floods that have significantly impacted cotton, rice and sugarcane crops and resulted in higher circular debt alongside the need of other subsidies in affected areas; 4) reduced economic activity and 5) upwelling inflation that has impacted overall household spending power.
- PKR 340Bn (USD 1.5Bn) spent so far on flood rehabilitation and relief has further dented the Country's ambitious targets and as per news flow, another USD 1.5Bn is to be spent later in the fiscal year which will only deepen the decline. Although government officials have reached out to the IMF to take this much needed expenditure into account and allow the government some relief, we opine chances of this happening are low. Furthermore, the relief received so far has been less than a third of what was initially committed by international partners/lenders at the UN General Assembly session held earlier this year and hence the onus fell back on the local government. However, there is another international summit lined up in Geneva, Switzerland on climate change early next month which is to be attended by world leaders and the government has high hopes that they can use this opportunity to generate some flows.
- Nonetheless, the situation is precarious and the government has no option but to reduce its expenditures and tighten subsidy schemes. We opine this fiscal consolidation is much needed and the government will have to maintain a prudent stance on expenditures in the near term along with coordinated efforts from provincial governments.

Fiscal Balance



Source: Zakheera, BMA Research

Is a sharp decrease enough?

Current Account Deficit: CAD almost touched historic highs in the last fiscal year having been reported at north of USD 17.4Bn (4.5% of GDP). Going into FY23, the situation has improved considerably as restrictive measures taken by the SBP, poor performing PKR, softening commodity prices and inflationary pressures have reduced the import bill. However, demand has been scaled back due to tighter monetary/fiscal policy alongside the impact of the overall inflationary environment.

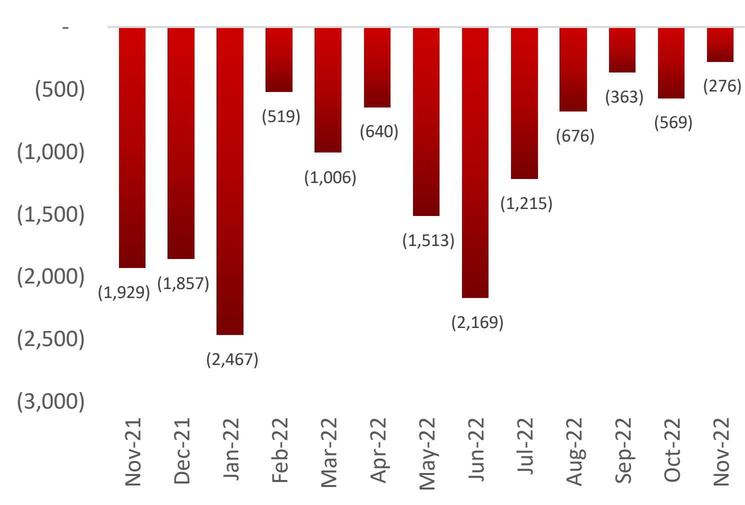
- Thus far, CAD has been reported at USD 3Bn in 5MFY23 (↓57% YoY) primarily cushioned by a 16.2% YoY decline in imports while exports have undergone a mild attrition of 2.0% YoY over the same period. It is interesting to note that despite the ~30% devaluation in FY22 and a further ~10% FYTD, a cheaper PKR has not enticed importers to increase orders to Pakistan - our major exporting partners, particularly the US and Europe, are marred with high inflation and low savings. In fact, already placed textile orders (which make up almost 2/3 of total exports) have been delayed or in some cases cancelled as importers seek greater economic clarity.
- We expect the full year CAD to settle at around USD 7.5Bn while basing our case on reduced imports accompanied by relatively sticky exports. However, it will be interesting to note the agricultural output in the upcoming months as there are risks that major output cuts could put pressure on the import bill and resultantly pilfer through CAD. Import of essential food items would not only increase our import bill but also weigh-in on our precarious forex position while also posing risks to food inflation which has, of late been the primary culprit for the upwelling readings. The biggest hit has been taken by the cotton crop however, rice and wheat have fared better than initial estimates thus giving SBP some breathing space.
- It is also important to note that ongoing talks with countries including Russia, KSA and Qatar for the import of commodities either at discounted rates, long term contract agreements or deferred payment basis could also cushion the CAD in the near term.

Current Account Balance (USD Bn)

Current Account Deficit	FY22	FY23E	FY24E
Import (goods)	(72.0)	(60.0)	(65.0)
Export (goods)	32.4	30.0	32.0
Trade deficit	(39.6)	(30.0)	(33.0)
Services deficit	(5.2)	(4.0)	(5.0)
Total trade deficit	(44.8)	(34.0)	(38.0)
Balance on Primary income	(3.8)	(2.5)	(2.5)
Balance on Goods, Services & Primary income	(48.6)	(36.5)	(40.5)
Remittances	31.2	29.0	32.0
Current Account Balance	**(17.4)**	**(7.5)**	**(8.5)**

Source: SBP, BMA Research

Current Account Balance (USD Mn)



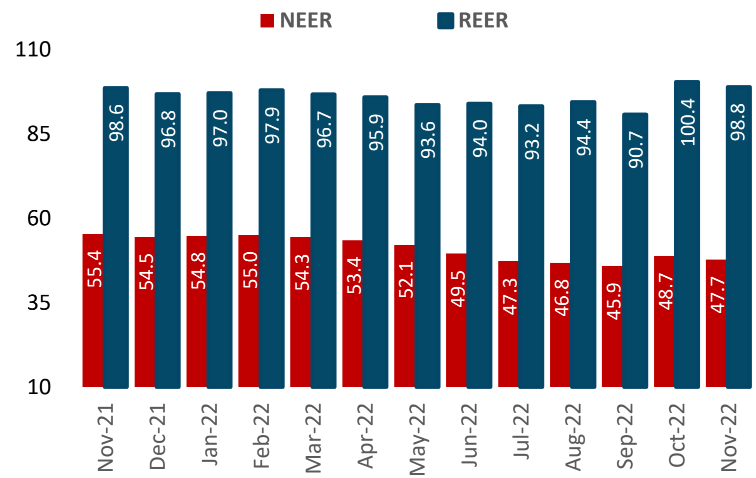
Source: SBP, BMA Research

The first line of defense

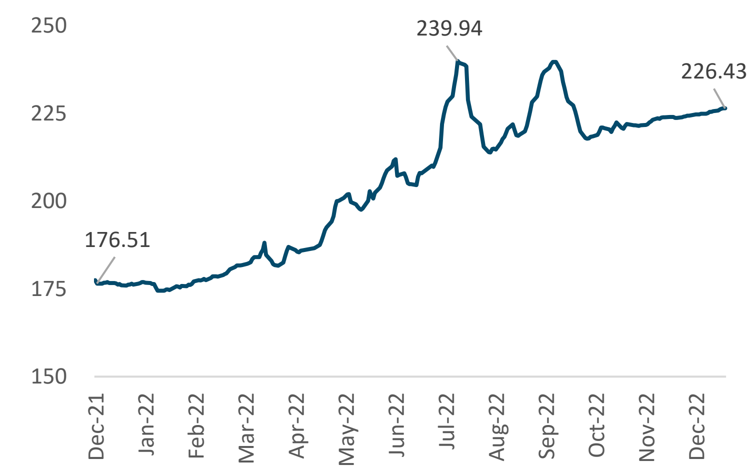
Currency: **Weak forex position, political instability and solvency concerns have kept the PKR under increased pressure over the past 18 months. Over this period, the PKR has shed ~40% value and still appears susceptible to external shocks. Having served as the first line of defense ever since the inception of the ongoing IMF programme in 2019, the PKR has been exposed to faltering twin deficits, political upheaval and economic uncertainty. Weak forex reserves position has raised question marks about the country's ability to meet its sovereign obligations in the near term and resultantly, international sovereign bond yields have gone through the roof and Pakistani bonds are now trading at less than 50 cents to the Dollar. Though, we highlight that the currency situation has also been to a certain extent impacted by speculative trading and hoarding which has been on the rise recently given limited availability of forex in the country and active parallel markets.**

- We opine the recent fundamental adjustment in the value of PKR has incorporated the negatives on the economic front to some extent. There remains room for another 10-15% devaluation over the next 6 months if external risks persist. Welcome news regarding the resumption of the IMF programme or inflows from bilateral or multilateral sources could reduce the pressure in the near term though balance of trade, and remittance flows will also need to be closely monitored.
- It is also important to remain mindful of remittance flows that have taken a beating in the recent months (↓10% in 5MFY23 to USD 12Bn) as parallel markets have become more active and unofficial flows are on the rise. To name a few, remittances from KSA and UAE which average ~45% of the total inflow into Pakistan have declined materially and now stand at close to 3-year lows owed to a combination of higher inflation thus lower savings and also translation gains which now require a decreased dollar outflow. The government had initially targeted USD 33.2Bn from remittances in FY23 but given the situation at hand, we believe the cumulative number to be around USD 29Bn and could hence create a gap of USD 4-5Bn. As a result, CAD will become all the more imperative and hence trade deficit will have to adjust by at least 10-20% on an annualized basis to bridge the shortfall.

Effective Exchange Rate Indices



PKR/USD Exchange Rate parity



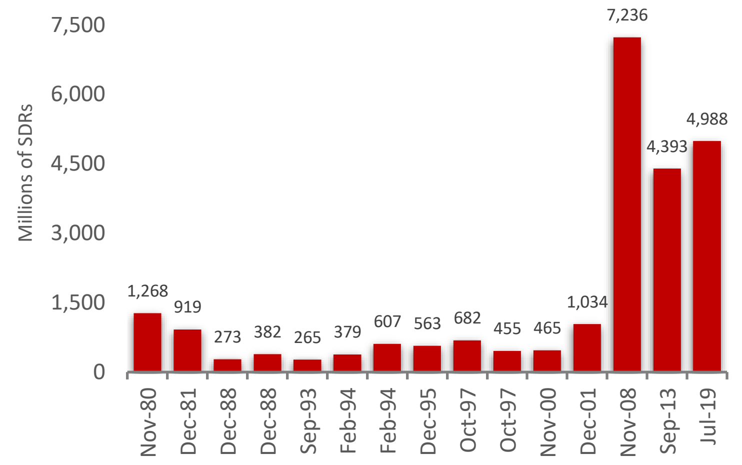
Source: SBP, BMA Research

Prioritising the IMF

IMF: In the current economic backdrop, being in the IMF programme becomes all the more significant. Although the programme is progressing and size of the initial programme has been scaled up to USD 7Bn from USD 6Bn, fiscal imbalances, lingering circular debt issues, recent flash floods and governance concerns have made it an uphill task for the government to get the IMF's nod. As things stand, IMF has serious reservations about the country's fiscal slippages, GDP growth expectations and implementation of prior actions including but not limited to circular debt settlement, TSA Phase II and revision in energy tariffs.

- It is worth highlighting that the country has made some progress on the prior actions including the rebuttal of energy subsidies, adopting a tight monetary policy stance, doing away with targeted subsidies and a successful exit from the FATF grey list. Meanwhile, there still remain some key decisions to take including revision in gas tariffs, uniform imposition of Petroleum development levy, import substitution and increasing direct revenue. The government has stuck to its initial revenue target, scaled down its GDP target, which we opine is still optimistic, and asked for further relief pertaining to the ~USD 1.5Bn spent on flood relief and rehabilitation. In spite of the economic situation at hand and the unpopular decisions that still need addressing, it seems increasingly likely that the government will reach some sort of an agreement with the global lender or see financial assistance from elsewhere dry up as a number of multilateral and bilateral flows including from friendly countries are based upon the resumption of the program which runs till Jun'23. Earlier, there was also a hint that the upcoming IMF reviews (9th and 10th) might be combined so that the ~USD 2.5Bn can be received in one go. We opine the current economic backdrop does not allow for the two to be put together and the delays in resumption of the program could work against the interest of the Country and add to economic uncertainty.
- We believe, right after the conclusion of this programme in Jun'23, the incoming government will likely go for a bigger programme in order to gauge the yawning external account. Pakistan has external debt repayments of ~USD 70Bn over the next 3 years while forex reserves stand at less than 6 weeks of import cover. Hence, timely repayments will eventually become too big an ask for the country unless the IMF comes on board and funds from other multilateral/bilateral sources & international debt markets materialize.

IMF programmes since 1980



Source: IMF, BMA Research

Widening by the day

External funding gap: The biggest conundrum faced by Pakistan at the moment is the piling external financing requirements which amount to a staggering USD 180Bn over the next 5 years (averaged USD 26Bn over the past 4 years). This equates to an average 8.5% of GDP each year. Even barring the CAD, the shortfall stands at close to USD 25Bn per year (averaged USD 17Bn over the past 4 years) while our Central Bank held forex reserves have slid to only ~USD 6Bn which in import terms is only enough to cover 5 weeks of imports. Though, it is not all doom and gloom for the country as slowing CAD has provided much needed respite and could save the country around USD 2-3Bn from budgeted estimates and bring the funding requirement for the current fiscal year to USD 27-28Bn. As per our understanding, Pakistan has retired over 25% of the this year's external payables to date while talks are ongoing for roll-overs, though the bigger outflows will actually take place later in the year. The leadership's initial plan to raise debt from the international market is now no more feasible given the tight global monetary stance, hence it becomes all the more interesting to see to what extent we can get support from friendly countries in the form of roll-overs or fresh disbursements.

- We believe the funding shortfall for this year will be bridged as the IMF comes on board and multilateral/bilateral flows materialize, however, this issue will once again resurface as FY24's funding requirement is 20% higher than FY23 which essentially means that this problem will persist for a good few years. This brings us back to the question: Will Pakistan be able to honor its external commitments, or risk default? As per our understanding, we believe Pakistan will be able to meet it's funding gap for this year which is also evident by the risk of default that has gone down considerably thanks in part to the settling current account. However, in order to look for a longer term fix, the country will at first need a bigger IMF programme right after the conclusion of this programme in Jun'23 and the onus will be on the new government setup (possibly taking over from Oct'23). Secondly, the role of prominent friendly countries will become more important particularly China and KSA to reschedule the loans or at least soften the terms and conditions. Similarly, the country will be requiring constant support from multilateral sources in the form of economic aid and project based funding to keep the wheel of the economy moving.

Pakistan: Gross Financing Requirements and Sources

(USD in Mn)	FY23	FY24	FY25
Gross External Financing Requirements	30,757	36,621	35,717
In percent of GDP	8.4	9.2	8.4
Current account deficit	9,280	9,959	10,598
In percent of GDP	2.5	2.5	2.5
Available Financing	33,334	37,832	37,425
Remaining Financing Needs	(2,577)	(1,211)	(1,707)

Source: IMF estimates

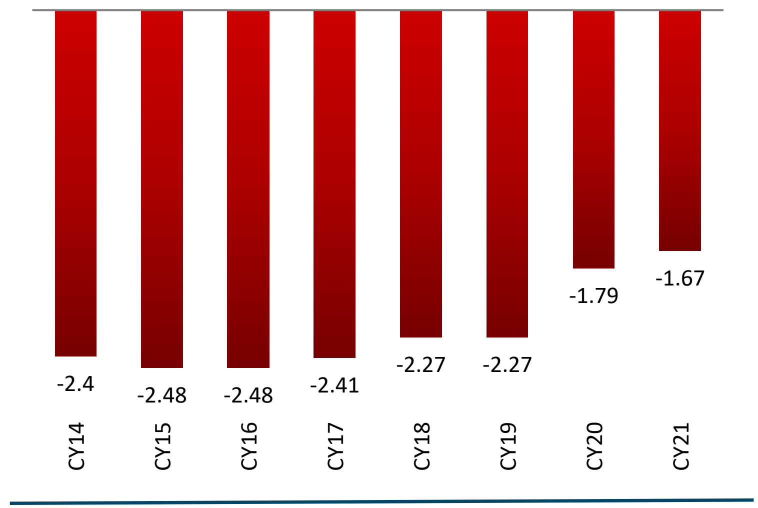
Pakistan Politics

Never fails to surprise

Politics: Ever since the VoNC was tabled against the former Premier, political noise has been on the rise and never fails to surprise. Ex-PM Imran Khan continues to call for an early election while the PDM maintains its stance of completing the term while steering through the economic mess. With Ishaq Dar coming back to take over the reigns of the Finance Ministry, there were huge expectations that he could steady the ship and bring some sort of clarity to the fore however, that is something that is yet to be seen. PKR continues to feel the heat while business confidence has ebbed. Furthermore, the PDM realizes that there are still challenges at hand with some unfavorable decisions yet to be taken by the government which can potentially further hamper political mileage and reduce their popularity going into the new year.

- Despite talk about movements in key positions at the top over the past few months, it has been smooth sailing for the current government. Regardless, this has not settled the rising noise. The focus has now moved to general elections which as per the 5-year tenure of the incumbent will mature in Aug’23 and then following that an interim setup will take over for a period of 60-90 days. We expect elections to be held on time and the current setup to complete its rightful tenure. Though the pressure from PTI’s side will continue to build and could gather pace as PTI looks to dissolve the Punjab & KP assemblies, we opine the government will conduct fresh elections on the empty seats and try to establish its own majority as it is a game of fine margins at least in Punjab, which the PML-N has long held as its forte and could prove to be the game changer going into the next elections.
- If street power is to be taken as a matrix to predict the outcome of general elections, then clearly PTI has the lead, however, dissolution of Punjab & KP assemblies and re-election on the same could make the end result interesting. Nonetheless, we opine this election to be a fierce competition and PTI along with its allies to emerge victorious by a thin margin and form a hung parliament. However, PDM should not be taken lightly and individual parties will likely form a strategic alliance once again and give PTI stiff competition. On the brighter side, given how much stick ‘neutrals’ have got from their ‘apparent involvement’ in the VoNC ouster, there will likely be limited involvement from that side.

Pakistan Political stability index



Source: World Bank, BMA Research

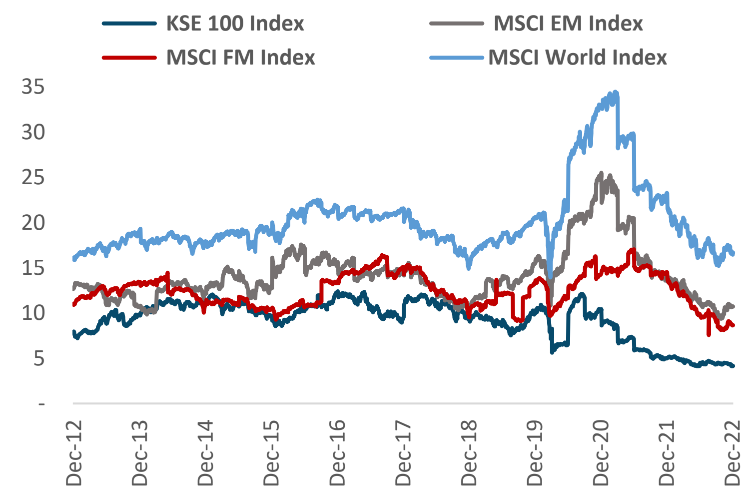
Pakistan Equity Market

Marred by economic challenges & political upheaval

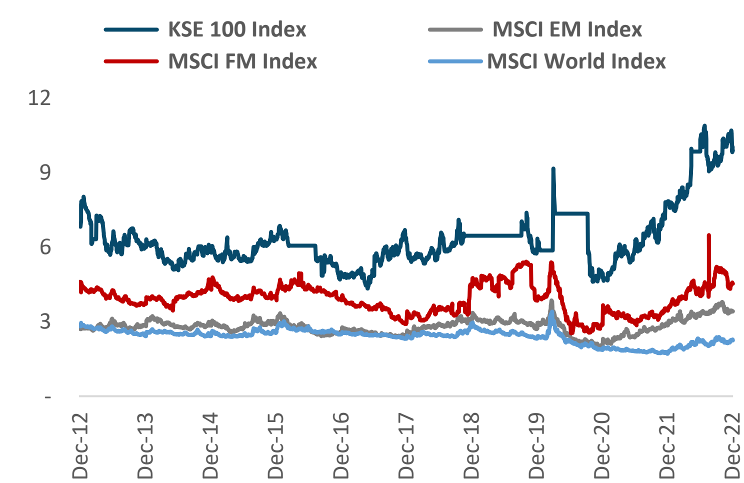
In the light of the economic upheaval and political noise over the past 12 odd months, the KSE-100 market performance has remained subdued while volumes have been shallow amid thin investor participation. There is no question about the cheap multiples we continue to trade at (FY23E P/E of ~3.5x), the double digit dividend yields on offer (FY23E D/Y of ~10.1%) and the widening discount to historical averages (~55%) however, it is the economic challenges the country faces that has dampened investor sentiment and kept major participants on the back-foot. Secondly, there has been a sizable switch of funds between the asset classes due to high interest rates with the policy rate standing at 16% and not showing any signs of easing in the near term. Thirdly, drawdown of forex reserves and persistent external account concerns have made the risk of default a topic of much interest which we opine will continue to play on the investor's mind until forecasted inflows actually materialize.

- In our Strategy note last year, we highlighted the significance of economic concerns and mentioned that it would be a tricky year for the local bourse. Our expectation was that things would improve from the 2HCY22. Fast forward, we single out 4 particular factors which worsened the macroeconomic outlook for Pakistan including (i) multi-year high twin deficits, (ii) commodity super cycle courtesy of the Ukraine Russia war and (iii) flash floods and (iv) PKR devaluation. The same was reflective in the broader index which underwent an attrition of over 4,000pts (~9.4%) YoY to close at ~40k pts. Major sellers in the index (by size) were Mutual funds (USD 181Mn), Insurance (USD 130Mn) and Foreigners (USD 48Mn) while major buying interest came from Banks/DFI's (USD 137Mn) and Individuals (USD 133Mn). Sectors which took the beating included Engineering, Pharmaceuticals & Cements.
- Going into CY23, we opine not much has changed from the beginning of CY22 as we fight multi-year high CPI inflation, fiscal over-runs, a burgeoning external account and the risk of further PKR depreciation. The fact that the country has reserves that offer less than 5 weeks of import cover shows that we are running a tight rope and there is an urgent need for economic action with barely any room for error. Furthermore, the political angle cannot be discounted at any cost and could derail market performance further if there is continued ambiguity.

KSE-100 vs. MSCI EM & FM P/E ratio



KSE-100 vs. MSCI EM & FM Best Dividend Yield



Source: Bloomberg, BMA Research

Playing it safe

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Though we agree that cross country general elections will provide some answers, it is the distressed economy that needs particular attention. For that matter, it is imperative that the major political parties sign a 'Charter of Economy' that could be the answer to the IMF and its concerns about political stability and policy formation.

- Similar to last year, we decide against giving an index target and believe market performance will be driven by economic indicators and developments on the political/geopolitical front rather than solely on fundamentals. In the short term, we can expect relief from international agencies due to floods, relaxations from the IMF regarding the adoption of some tough economic policies, clarity on the political front, stabilizing PKR and easing inflation readings to be fundamental to market performance.
- Keeping the aforementioned points in mind, we believe the negatives have largely been priced in by the market and are well reflected by cheap trading multiples, poor investor sentiment and thin participation. However, the element of uncertainty still remains and a pro-active approach is the need of the hour to aid the ailing economy or else we can see more corrective pressure in the local bourse.
- The Pakistan market now trades at a 55% discount to its historical P/E average of ~8x. Similarly, the differential between peer markets has escalated to ~60% which previously used to be ~40%. However, we highlight this widening difference to be triggered by weak economic indicators, political instability and lack of governance structure rather than timid earnings or faltering fundamentals. That said, we expect this year to be similar to the outgoing year and individual stocks and sectors with strong fundamentals to outperform the market while the index movement will be limited. That in the backdrop, we advise a *cautious* 'BUY' strategy with emphasis on key macroeconomic and political developments while having exposures in defensive, high yielding, low beta and mature sectors. Our preference are Banks, E&P's, IPP's & Fertilizers. However, as things improve on the macroeconomic front a more aggressive position can be adopted with exposures in cyclicals and IT.

KSE-100 performance in CY22

SYMBOL	30-Dec-22	31-Dec-21	Change	% Chg.
KSE-100 Index	40,420	44,596	(4,176)	-9.4%
Avg. Vol. (Mn)	100	191	(91)	-47.8%
Avg. Val. (PKR Mn)	5,192	10,889	(5,697)	-52.3%
Value (USD Mn)	26	68	(42)	-62.2%
M.Cap (PKR Bn)	5,269	6,043	(774)	-12.8%
M.Cap (USD Bn)	23	34	(11)	-32.0%

Market cap wise performance of major sectors

Date	30-Dec-22	31-Dec-21	% Change
Sugar & Allied Industries	76.49	70.75	8.1%
Technology & Communication	290.68	290.99	-0.1%
Food & Personal Care Products	679.68	690.11	-1.5%
Fertilizer	483.63	508.32	-4.9%
Oil & Gas Exploration Companies	845.90	908.00	-6.8%
Chemical	359.75	389.13	-7.6%
Oil & Gas Marketing Companies	168.34	184.77	-8.9%
Power Generation & Distribution	236.32	271.46	-12.9%
Textile	314.33	364.22	-13.7%
Automobile	281.96	368.04	-23.4%
Commercial Banks	1,027.52	1,394.86	-26.3%
Refinery	57.22	83.49	-31.5%
Cement	389.75	572.66	-31.9%
Pharmaceuticals	185.35	282.08	-34.3%
Engineering	78.95	139.28	-43.3%

Source: PSX, BMA Research

Key highlights of 2022 & index performance

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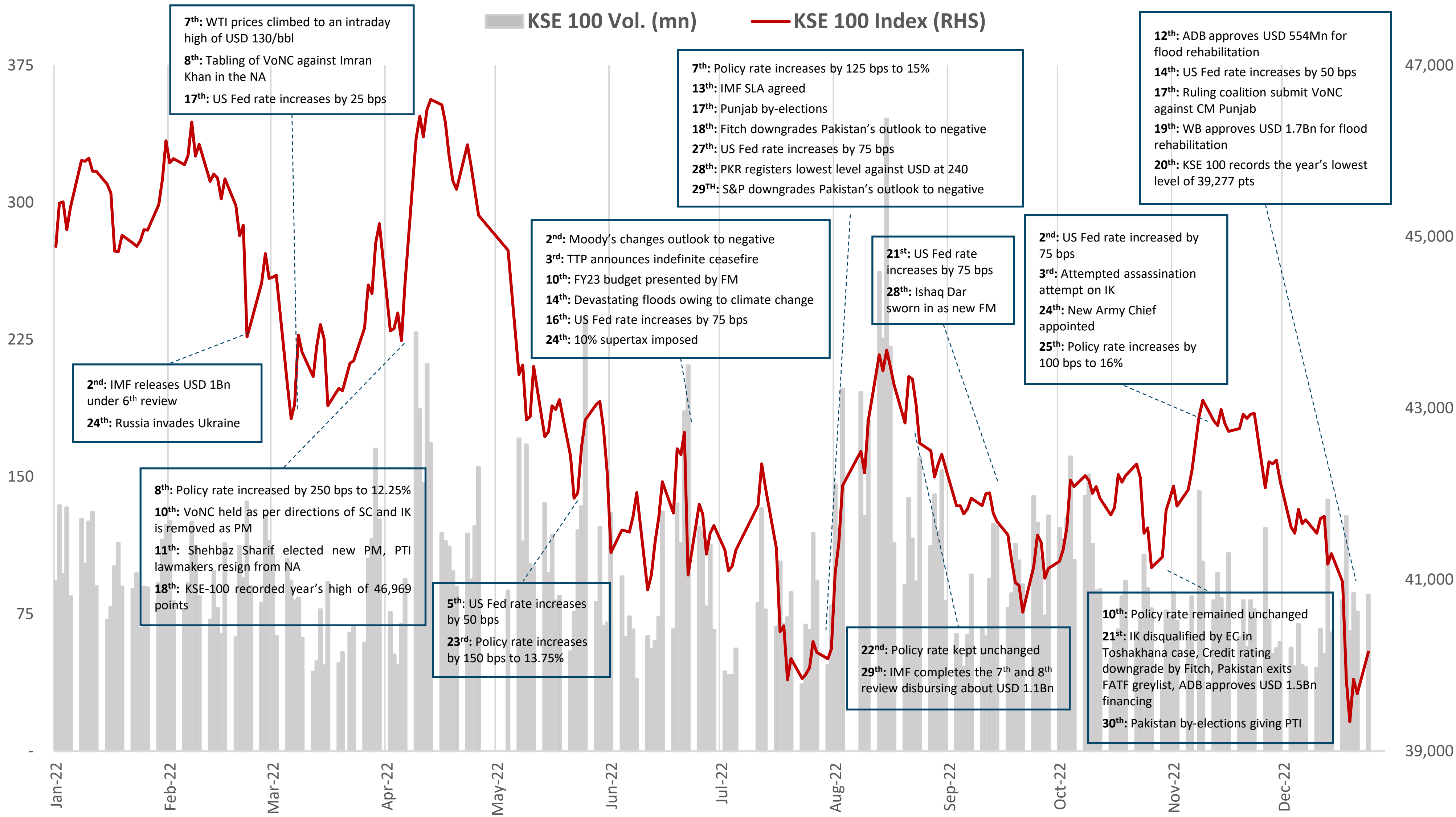
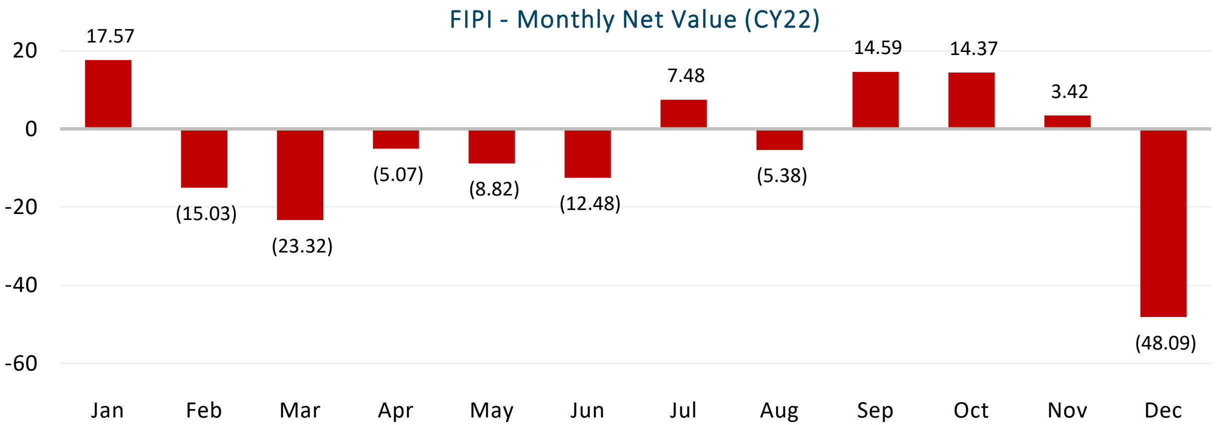


FIPI/LIPI Data (CY22)

FIPI				
Value (PKR Mn)	**Gross Buy**	**Gross Sell**	**Net Buy/Sell**	**NET BUY/SELL (USD Mn)**
Foreign Individual	12,067	(6,637)	5,430	23
Foreign Corporates	48,500	(75,011)	(26,511)	(128)
Overseas Pakistani	133,003	(121,000)	12,003	56
FIPI Net	**193,570**	**(202,648)**	**(9,078)**	**(48)**



LIPI				
Value (PKR Mn)	**Gross Buy**	**Gross Sell**	**Net Buy/Sell**	**NET BUY/SELL (USD Mn)**
Individuals	1,700,020	(1,673,159)	26,861	133
Companies	136,481	(121,665)	14,816	74
Banks / DFI	107,982	(80,263)	27,719	137
NBFC	2,157	(2,860)	(703)	(3)
Mutual Funds	103,154	(139,191)	(36,038)	(181)
Other Organization	30,694	(23,832)	6,862	34
Broker Proprietary	450,756	(453,864)	(3,108)	(15)
Insurance Companies	22,943	(50,266)	(27,323)	(130)
LIPI Net	2,554,187	(2,545,101)	9,086	48

Source: NCCPL, BMA Research

KSE-100 Top 10 Gainers			
	30-12-22	**31-12-21**	**% Chg.**
LOTCHEM	25.90	13.66	89.6%
UPFL	25,000.00	19,000.00	31.6%
IBFL	215.00	165.00	30.3%
FABL	25.83	23.00	12.3%
SNGP	37.55	33.45	12.3%
DCR	13.64	12.16	12.2%
PSEL	1,666.21	1,497.00	11.3%
POL	392.85	357.62	9.9%
NESTLE	5,870.00	5,725.49	2.5%
PGLC	6.60	6.50	1.5%
KSE-100 Top 10 Losers			
SEARL	55.78	143.72	-61.2%
MUGHAL	47.16	104.11	-54.7%
AIRLINK	27.19	58.06	-53.2%
GATM	22.14	47.06	-53.0%
NCL	22.87	45.55	-49.8%
INIL	69.84	138.81	-49.7%
HBL	62.63	116.62	-46.3%
UNITY	14.24	26.47	-46.2%
PAEL	12.19	22.52	-45.9%
THALL	207.68	382.69	-45.7%

Source: PSX, BMA Research

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Old rating system

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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Tel: (021) 32410617

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Office # 3, Mezzanine Floor,
Akber Manzil, Main Bahadurabad
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Tel: (021) 3486 0393-98
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Tel: (021) 36672301-00.

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Main Cavalry Ground, Lahore Cantt, Lahore.
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Lahore Gulberg Branch:
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Mega Tower 63-B, Main Boulevard,
Gulberg II, Lahore.
Tel: (042) 35762953-57

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19- Khayaban-e-Aiwan-e-Iqbal, Lahore.
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Muhammad Gulistan Khan House,
Fazel e Haq, Blue Area, Islamabad.
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Centre, Paris Road, Sialkot, Adjacent to
Sialkot Chamber of Commerce.
Tel: (052) 4260091-94

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Abdali Road, Multan.
Tel: (061) 457 6611-15
Fax: (061) 457 6615

Sargodha Branch:
Ground floor, Shan Plaza, Block No 16,
Main Khushab Road, Near Allied Bank
Limited, Sargodha.
Tel: (048) 3767 817-18

Faisalabad Branch:
Mezzanine Floor, State Life Building #2,
Plot No. 833 Liaquat Road, Faisalabad.
Tel: (041) 2612261-5.

Gujranwala Branch:
51-H Block, Near Standard Chartered Bank,
Trust Plaza, GT Road, Gujranwala.
Tel: (055) 3848501-05

Chakwal Branch:
Office No. 12, 1st Floor, Ejaz Plaza,
Talagang Road, Chakwal.
Tel: (0543) 553850, 0543-543720,0543-543721.

Jhelum:
2nd Floor, Khalid Plaza, Plot#7/89,
Kazim Kamal Road, Jhelum.
Tel: (054) 4620594-97

Peshawar Branch:
Shop No.F1 & F2, 1st Floor Mall Tower 35,
The Mall Peshawar Cantt.
Tel: (091) 5274770-72

Abbottabad Branch:
Gohar Son’s Arcade, 1st Floor, Office# 4,
Supply Bazar, Sikandarabad, Abbottabad.
Tel: (0992) 400346-47

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1st Floor, Office# 101 & 102, Akbar Kayani
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