COVID-19; A CHALLENGE FOR WORLD ECONOMY & PAKISTAN

Dear Investor,

25th March 2020

اَلسَّلامُ عَلَيْكُم وَ رَحْمَةُ اللهِ وَبَرَكَا تُه

As you are aware the global pandemic COVID-19 popularly known as Coronavirus has now spread in Pakistan. We pray for your health and hope you are taking appropriate precautions to safeguard yourself and your loved ones. As we speak now, it appears that a vaccine may take at least 12-18 months, cure from existing medicine is likely to be found much earlier. Success in containing the virus comes at the price of slowing economic activity, no matter whether social distancing and reduced mobility are voluntary or enforced.

The global count for Coronavirus cases has till now reached around 450,000 in at least 190 countries and territories while above 19,000 people have died from the virus which originated from China in December 2019. In Pakistan, the virus is now rising as being a densely populated country with inadequate medical facilities, it will affect thousands in coming weeks.

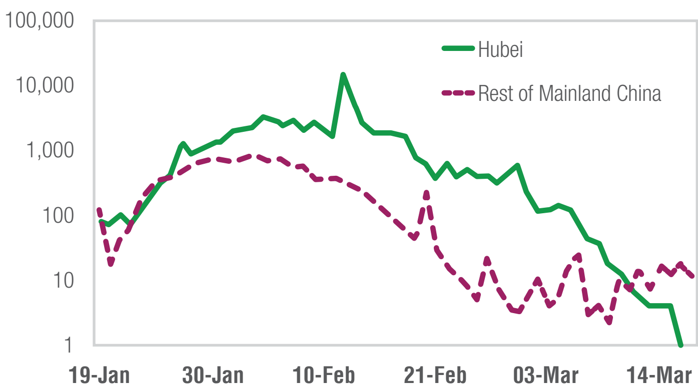
Impact on Global Economy

The impact of the coronavirus is having a profound and serious impact on the global economy and has sent policymakers looking for ways to respond. The virus originated from China which after suffering initially has successfully controlled it which shows that the right policies make a difference in fighting the disease and mitigating its impact. The impact of the coronavirus pandemic will be "quite severe," but a long expansionary period and high employment rates mean the global economy should weather the current shock, said a top IMF official who heads the IMF's strategy policy and review department. IMF was working to address the crisis through zero- and low-interest rate loans and grants, and was ready to help emerging markets deal with sharp capital outflows. Commodity prices, especially the sharp drop in oil prices, posed a further challenge for many countries, while aiding those countries that imported commodities.

Table of "two Chinas"

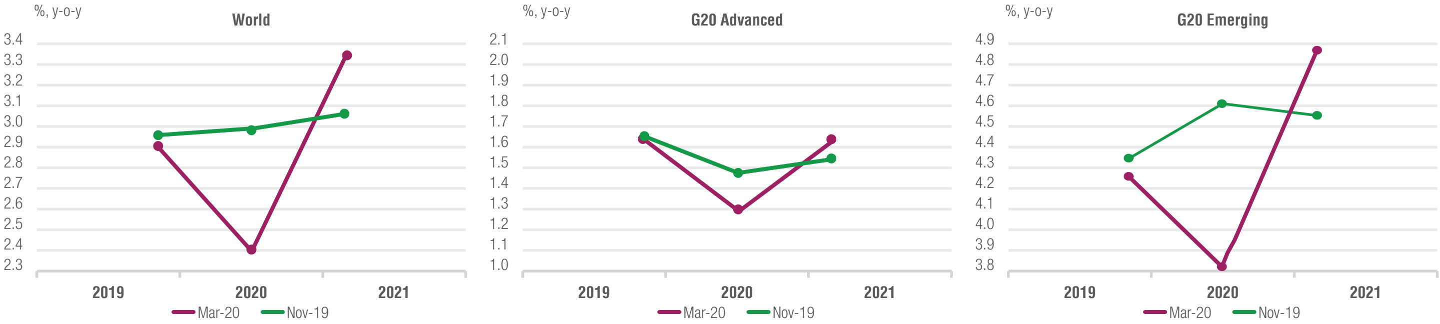
Strict containment measures in Hubei helped limit the vius's spread in the rest of Mainland China.

(New infections in Mainland China, per day, logarithmic scale)



Source: CEIC; and IMF staff calculations.

There's now a consensus that the shock of the coronavirus outbreak will push the US into a recession temporarily, ending the longest-ever economic expansion on record. Projections that US GDP would falter have come from firms such as Goldman Sachs, Deutsche Bank, JPMorgan, Bank of America, and more. According to OECD, annual global GDP growth is projected to drop to 2.4% in 2020 as a whole, from an already weak 2.9% in 2019, with growth possibly even being negative in the first quarter of 2020. Provided the effects of the virus outbreak fade as assumed, the impact on confidence and incomes of well-targeted policy actions in the most exposed economies could help global GDP growth recover to 3.25% in 2021. A longer lasting and more intensive coronavirus outbreak, spreading widely throughout the Asia-Pacific region, Europe and North America, would weaken prospects considerably. In this event, global growth could drop to 1.5% in 2020, half the rate projected prior to the virus outbreak. Thus, it is clear that we will likely witness a "V" shaped economic recovery whereby as world economic growth drops in 2020, it is expected to quickly recover in the subsequent year.



Note: Projections from the current Interim Economic Outlook and the November 2019 OECD Economic Outlook.
Source: OECD Economic Outlook database.

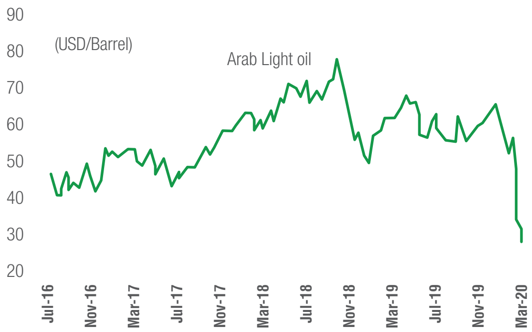
Impact on Pakistan Economy

The impact of coronavirus is expected to be a mixed bag for Pakistan's economy as it will result in slowdown in economic growth due to reduced domestic and external demand. However decline in commodities prices especially Crude oil will help to lower the trade deficit and inflation outlook even more. With decline in inflation, the interest rates are also expected to further ease which bodes well for both government & private sector borrowers. Eventually if oil prices remain at current low levels, remittances from the Middle East can witness a slowdown.

Pakistan imported crude oil at average price of around USD61/barrel during 8MFY20. While after the breakup of OPEC+ cartel this month and impact of Corona pandemic, Arab light oil has fallen to USD31/barrel (down 55% in CY20TD). To put this in context, every USD10/barrel decline in crude oil price results in import bill savings of around USD1.8 Billion per annum based on current consumption. Thus if oil prices remain at current level, we can potentially witness annual import bill saving in excess of USD5 billion. Since the current oil prices reflect slowdown in world economy and extra production by oil producers, eventually it is projected to improve gradually and consequently we have assumed oil prices in range of around USD 40/barrel in our models going forward, which will still reflect decent savings in import bill.

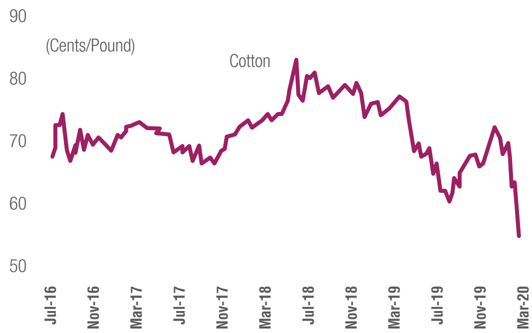
While drop in oil prices and other imported commodities prices such as steel, chemical, plastic, coal etc. is beneficial for Pakistan, our exports will also witness a drop mainly in textile. Due to closure of retail stores in EU and USA, textile orders for the next few months will witness a slowdown. Apart from drop in volume, international cotton prices have also dropped and are down by 24% in CY20TD, thus textile exports in value terms will remain under pressure for at least a couple of quarters but are likely to regain growth once things normalize. It must be noted that since the hefty devaluation witnessed in last couple of years, our exports have regained competitiveness and textile volumes have increased.

Oil price drop to substantially lower import bill



Source: Bloomberg

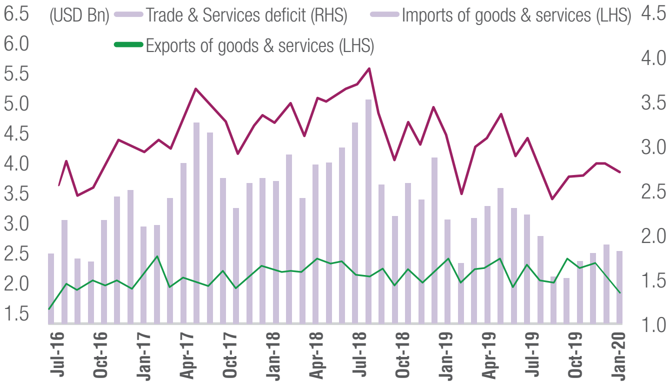
Cotton price fall to adversely impact exports



Source: Bloomberg

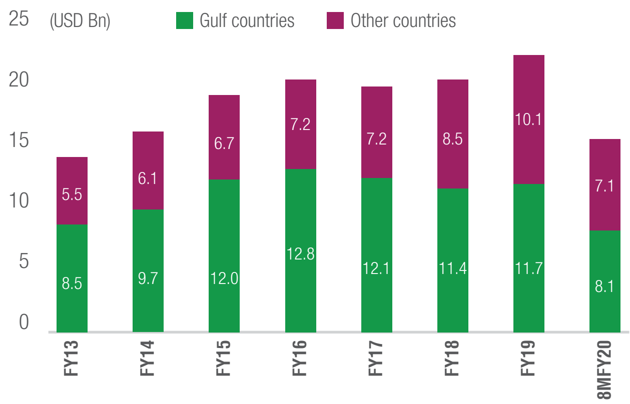
Since our imports of services which stood at USD6.1 Billion during 8MFY20 also outweigh exports of services which clocked in at USD3.7 Billion, slowdown in transport freight and travelling is also likely to reduce the services deficit which has increased in recent years. Thus, overall the fall in commodities prices and services is expected to positively impact Pakistan's external account balance and should lead to drop in both goods and services deficit. Remittance from Gulf countries however are at risk of falling under this oil price scenario. Proportion of remittance from Gulf countries stood at 63% of total between FY13-16 but has since dropped to 54% in FY19 as impact of lower oil prices after FY15 weighed in on economic activities in the region. Surprisingly, despite the hefty fall in oil prices, remittances from Gulf countries have remained rather sturdy while growth has been witnessed from other countries especially USA & UK. Even in 8MFY20, we have witnessed 5.4% growth to reach USD 15.1 Billion, with remittance from Gulf countries rising by 4%. Nonetheless lower oil prices are likely to lead to some decline in remittance from Gulf countries and we have built that in our projections. After accounting for decline in the Good & Services deficit and subsequent decline in remittances, we are of the view that on a net basis, Current Account Deficit (CAD) should decline from the latest developments.

Imports drop to outweigh exports fall



Source: SBP

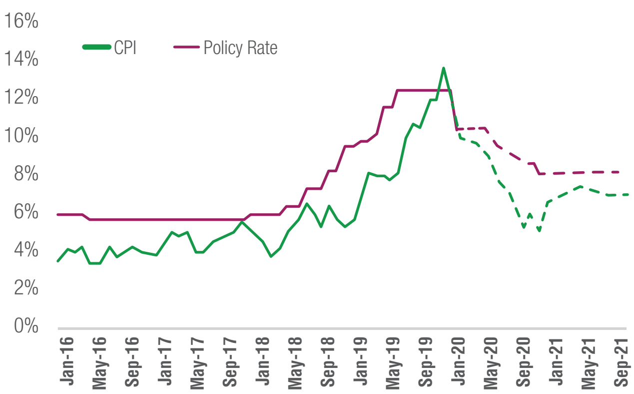
Remittances from Gulf countries can also fall



Source: SBP

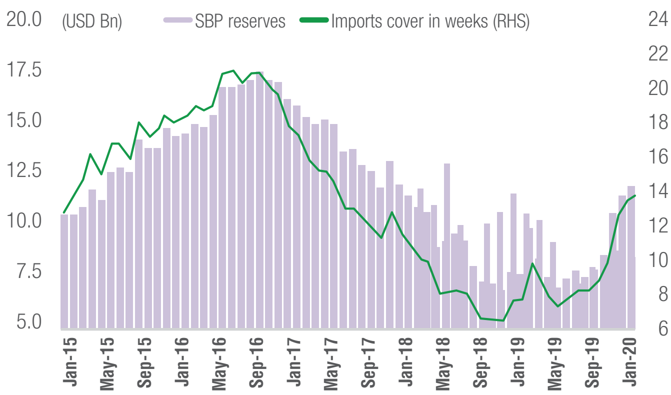
SBP in its monetary policy meeting held last week projected real GDP growth for FY20 of around 3.0% down from earlier expectation of 3.5%. With the number of COVID-19 cases increasing considerably in Pakistan, prompting social distancing and curtailment of activity, SBP now expects growth to be revised down further. While expecting a modest recovery next year provided that the spillover impact of the Coronavirus outbreak on global trade and financial markets is moderate and short-lived. In such a scenario, the export slowdown and market volatility should be contained while the benign growth and inflation impacts of lower global commodity prices would dominate. Under an adverse scenario, a more prolonged and severe phase of weak demand in Pakistan's major export and remittance markets and depressed sentiment among domestic consumers and businesses could have a more material impact on growth. In both these scenarios, the impact on the current account was expected to be mildly positive as the savings from low oil prices were expected to offset potential weaknesses in net exports and remittances.

Inflation & Interest rates to further ease



Source: SBP, PSB, AMIM ESTIMATES

SBP reserves & Import cover are gradually improving



Source: SBP

The outlook for inflation has improved in light of the recent deceleration in domestic food prices, sharp fall in global oil prices, and slowdown in external and domestic demand due to the Coronavirus pandemic. Average headline inflation is expected to remain around 11.2% and will likely witness significant fall next year to around 7%. From this month we have seen the start of monetary policy easing with a policy rate of cut of 75bps bringing it to 12.5% in scheduled central bank meeting held last week, citing that it stood ready to take further actions if and when needed as more information becomes available on the outlook for inflation and growth. Since inflation is projected to witness a substantial decline within the next twelve months and external account prospects remain positive, the MPC in its emergency meeting held yesterday has decided to cut the policy rate by a further 150bps to 11%, bringing the cumulative easing to 2.25%. We expect further easing to continue in the coming quarters and anticipate policy rate to reach single digit by calendar year end. SBP also announced that it is in the process of taking necessary regulatory measures in coordination with banks to address pressures on cash flows of borrowers affected by Coronavirus related disruptions through facilitating deferment and restructuring of their loans.

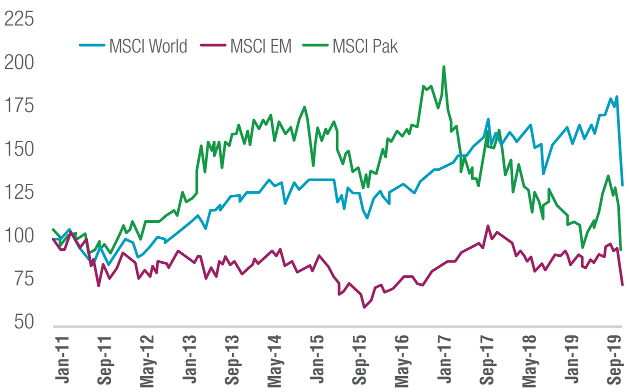
Due to unsustainable CAD during FY17-FY19 when it clocked in at average USD 15.4 Billion per annum, Foreign exchange reserves held by SBP dropped from USD 18.9 Billion in Oct-16 to recent low of USD 7.2 billion in Dec-18. Post devaluation which brought PKR near its equilibrium level as measure by Real Effective Exchange Rate, we have witnessed a substantial drop of 72% in CAD for 8MFY20 to reach a more manageable level of USD2.7 Billion. After entering a new IMF program in FY20, lending from multilateral agencies has resumed which has resulted in SBP reserves climbing to USD 12.7 Billion and import cover also increasing to around 15 weeks.

Outlook for PSX

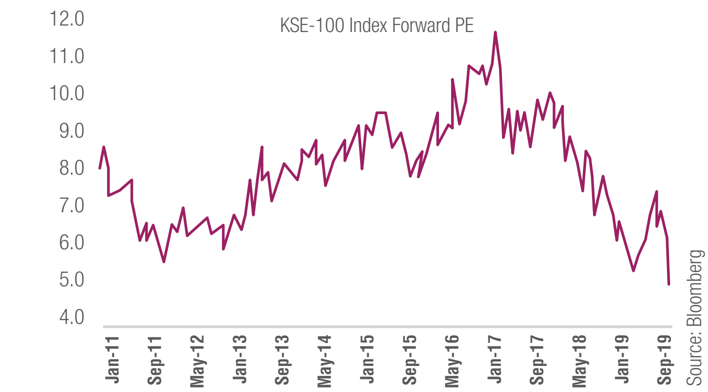
KSE-100 index after suffering a hefty fall in FY08 & FY09 went on to give eight consecutive years of positive return till FY17. The market P/E of KSE-100 rerated from 5.6x in Jan-12 to reach 12.0x in May-17. After reaching its peak of 52,876 points in May-17, it declined by 46% in Aug-19 due to worsening external account and doubling of interest rates. However since its recent low, the market made strong comeback due improving external account prospects and drop in secondary market yields, climbing to 43,219 points till Jan-20. However since then, the market has given up all the gains it made recently due to aggressive foreign selling and the impact of corona pandemic negatively impacted the equities globally.

The point to consider in our view is that globally especially in the USA, the markets have done really well in the last ten years due to low interest rates and massive quantitative easing. Whilst in the case of Pakistan, the last five years return of stock market has been -12% due to economic crises. MSCI Pakistan after outperforming global indices till 2017 has badly underperformed then, showing that it has decoupled from them to a large extent. However with start of decline in interest rates, there are strong chances of PSX rerating upwards from its current trough valuation of 5.0x to at least near its long term average of 8.2x while globally valuation of many indices are above their long term P/E. Fundamental analysis favors an upward trajectory in the local equity market on the back of structural reforms and the entailing macroeconomic recovery, the re-rating of the market, and the mean reversion of the index in the near term.

PSX has underperformed in recent years…



… and is now trading at trough valuations



As the cure for this pandemic will eventually be found, global growth is expected to witness rise and we expect the same for equities. We therefore, recommend all investors with a long-term horizon to remain invested in equities based on their risk profile and appetite. Meanwhile for investors with a short term horizon, we offer a complete suite of income and money market funds which offer competitive returns and low risk investments.

Prevention is Better than Cure, Practice Social distancing

To learn more about basic protective measures against the coronavirus, please visit WHO website:
https://www.who.int/emergencies/diseases/novel-coronavirus-2019/advice-for-public.

We as a nation need to play a role in flattening the curve by staying at home, practicing social distancing and following the instructions given by the government. We therefore highly recommend our investors to carry out all their transactions (Investments, Conversion, Redemption) digitally through our robust Mobile Application (https://play.google.com/store/apps/details?id=com.pc.app.almeezan) & Member Service Area (https://members.almeezangroup.com/), instead of visiting branches.

Mobile Applications:

Download on the App Store

GET IT ON Google Play