Fitch Affirms Pakistan at 'B-', Outlook Stable

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- Fitch Ratings has affirmed Pakistan's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'B-' with a Stable Outlook. Pakistan's ratings reflect challenging external finances and low reserve coverage, high public debt, and weak governance indicators. According to Fitch, recent policy actions, including an agreement with IMF staff on a forthcoming program, should ease external finance risks, but reserve levels will take time to rise and the program will face significant implementation risks.
- Fitch forecasts the current account deficit to narrow to 3.0% of GDP in the fiscal year ending June 2020 (FY20) from a peak of 6.3% in FY18, largely through import compression. The State Bank of Pakistan (SBP) has raised its policy rate by 650bp since January 2018, including a 150bp hike on 20 May 2019, and has allowed the rupee to depreciate by nearly 30% against the US dollar since mid-December 2017.
- These developments have lowered the trajectory of gross external financing needs and improved the external finance outlook. However, Fitch expects external debt repayments to remain high over the medium term i.e. sovereign external debt service alone to be around USD8 billion-9 billion per annum in the coming years, particularly in light of the recent large upswing in external borrowing. In addition, repayments related to loans under the China-Pakistan Economic Corridor are set to pick up in the early 2020s.
- Fitch forecasts reserves to begin rising during FY20 on the back of the improved access to external financing. The SBP's move to devalue the exchange rate since late-2017 will also support the rebuilding of reserves.
- Fitch estimates the general government deficit widened to 7.3% of GDP in FY19 primarily due to a significant underperformance of revenues. For FY20, it is estimated at 7.1% of GDP.
- The government's FY20 budget, released on 11 June, outlined a consolidation plan primarily based on revenue-raising measures, including removing tax exemptions, tax increases, and improved tax administration. Expenditure will rise on higher interest payments and the government plans to support social and development spending to offset the negative effects of macroeconomic adjustment.
- Fitch estimates that general government debt to GDP will rise to 77.4% by end-FY19, from 71.7% a year earlier. The substantial rise in the debt ratio reflects the impact of rupee depreciation on external debt and the wider fiscal deficit.
- The GDP growth to rise slightly to 3.5% in FY20 as compared to 3.3% in FY19, although it will be constrained by fiscal consolidation and tighter monetary policy. Moreover, inflation is set to remain high at 9% on the back of past rupee depreciation and tax and energy tariff increases.
- According to fitch report, domestic security has improved over the past couple of years, measured by a decline in terrorist incidents and casualties. Nevertheless, ongoing domestic threats and geopolitical tensions with neighboring countries continue to weigh on investor sentiment.
- The Fitch report concluded at the note that Pakistan's rating is constrained by structural weaknesses in its development and governance indicators. Its per capita GDP of USD1,566 is well below the USD3,489 median of 'B' rated peers. Governance quality is also low as its World Bank governance indicator score is in the 23rd percentile, compared with the 'B' median's 38th percentile.

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DEFINITION OF TERMS

TP	Target Price	DDM	Dividend Discount Model	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DCF	Discounted Cash Flows
PE	Price to Earnings Ratio	PB	Price to Book Ratio	BVPS	Book Value Per Share
EPS	Earnings Per Share	DPS	Dividend Per Share	ROE	Return of Equity
ROA	Return on Assets	SOTP	Sum of the Parts	JPB	Justified Price to Book

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I. Discounted Cash Flow Model
II. Dividend Discount Model
III. Relative Valuation Model
IV. Sum of Parts Valuation

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Stock Rating	Expected Total Return
BUY	Greater than 15%
HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

Sector Rating	Sector Outlook
Overweight	Positive
Market Weight	Neutral
Underweight	Negative

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