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Economy: Government initiates first debt buyback

The Ministry of Finance conducted its first-ever debt buyback auction (target: PKR 500bn) following the rejection of all bids in the recent T-bills auction (Sep 18, 2024). This will enable the government to retire a portion of its outstanding domestic debt before its maturity. The development offers a unique opportunity for the country to (i) partially reduce the debt buildup and dilute the debt servicing cost (fiscal), (ii) put downward pressure on secondary market yields (interest rate), and (iii) dilute the ever-increasing OMO size (money supply). From an equity market perspective, this offers a re-rating prospect as the government looks to utilize the record PKR 2.74tn profits from the SBP.

A unique opportunity; record SBP profit to provide much-needed fiscal space

The unprecedented rise in the interest rate, coupled with a stable exchange rate, translated to record high profits of PKR 3.42tn for the SBP in FY24, a 3x YoY increase. Consequently, the transferrable income of PKR 2.74tn to the government (80%) would be higher than the budgeted amount of PKR 2.5tn. Assuming the government rejects the upcoming T-bill auctions on Oct 3, 2024 and Oct 17, 2024 (cumulative maturity: PKR1.4tn), in addition to the already matured (not rolled over) T-bills and PIBs worth PKR 113bn and PKR 512bn, the government will still be left with PKR 324bn buffer stock to fund the core fiscal requirements. To highlight, the government bought back PKR 351bn T-bills on Sep 30,2024.

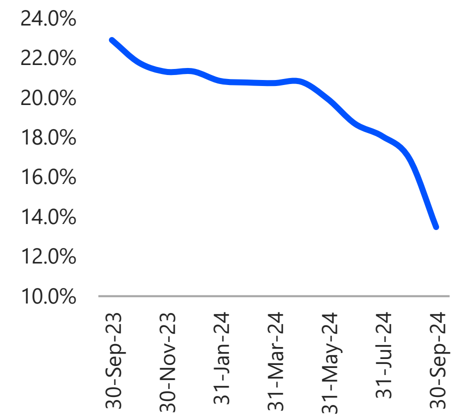
Impact of buyback decision for banks; lower investment size vs yield erosion

We anticipate that GOP's decision to buy back T-bills will result in (i) lower investment in GOP securities corresponding with lower borrowing requirements, thereby diluting the buildup of OMOs or (ii) asset yield erosion by deploying surplus cash in the declining secondary market. To highlight, 12M PKRV has decreased by 347bps to 13.48% in Sep-24.

Strong prospects for monetary easing

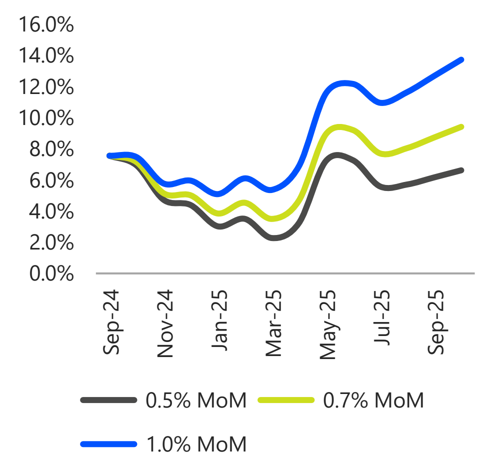
The recent inflation readings have remained subdued, wherein average MoM inflation has been recorded at 0.13% (cumulative 0.9%) since Jan-24. Using an average run rate of 0.5% MoM, 0.7% MoM and 1% MoM, we have explored three possible scenarios where headline inflation for the next 12M (post Sep-24) translates to a range of 6.2% YoY - 12.7% YoY. Extrapolating the 2013-2019 RIR average of 270bps, the policy rate comes out at 8.9%, 11.4%, and 15.4%, signaling strong prospects of monetary easing in the upcoming MPC meetings.

12M PKRV



Source: MUFAP, Akseer Research

NCPI (YoY)



Source: PBS, Akseer Research

Exploring equity market's re-rating potential

Falling yields present a favorable proposition for equities valuation, making room for market re-rating. The 12M PKRV has dropped to 13.5%; however, the earnings yield still stands at 26.2%, translating to a spread of 12.8%. We explore four cases in our analysis using 1-year average EY differential of 7.8% with (i) spot 12M PKRV (Case A) and (ii) projected policy rates in Cases B-D. Cases B and C exhibit significant re-rating potential for the market with a resultant P/E of 6.0x and 5.2x. This results in a capital upside of 57.2% and 36.7%, respectively.

Exploring Market Re-Rating Potential

Cases	Spot	A	B	C	D
P/E	3.8	4.7	6.0	5.2	4.3
EY	26.2%	21.3%	16.7%	19.2%	23.2%
12M PKRV/ policy rate	13.5%	13.5%	8.9%	11.4%	15.4%
EY differential	12.8%	7.8%	7.8%	7.8%	7.8%
Re-rating		**23.3%**	**57.2%**	**36.7%**	**13.1%**

Source: Bloomberg, MUFAP, Akseer Research

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Valuation Methodology

To arrive at our 12-months Price Target, the JV uses different valuation methods which include: 1). DCF methodology, 2). Relative valuation methodology, and 3). Asset-based valuation methodology.

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Hold	Between -5% and +15%
Sell	Less than or equal to -5%

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