NBP Fullerton Asset Management Ltd.
A Subsidiary of National Bank of Pakistan

# Impact of Upcoming Elections on the Investment Climate of the Country

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In the last couple of reports we have raised concerns that the economic and investment outlook of the country may deteriorate in the coming months ensuing from expected uptick in inflation and interest rates, and devaluation of the currency. The reasons for such expected deterioration of the economy in our view are (i) rising budget deficit and current account deficit; (ii) large scheduled payments to IMF and other lenders in the coming months; (iii) substantial decline in foreign direct investment and assistance from donor agencies; and (iv) declining foreign exchange reserves that may fall to around US$7.5 billion by June 2013.

Some of our investors have inquired if it is possible for Pakistan to mitigate such expected economic and investment risks. In our view, it is very much possible to do so. Declining foreign exchange reserves is a key risk facing the economy. This can be addressed by approaching IMF, other donor agencies and friendly countries for some type of bridge financing to the tune of a couple of billion dollars till a new government is in place after the elections, possibly in May 2013. The present government, in an election year, does not seem willing to approach IMF for a new package and accept the tough conditionalities linked to it. Likewise, IMF does not want to enter into an agreement on a new financing package with the interim government. However, the present or the interim government can possibly arrange some interim financing from the IMF, the World Bank and/or the Asian Development Bank. With Pakistan being an important coalition partner in the war against terrorism and economic conditions deteriorating, the West, China and the Arab World may be willing to provide some breathing space to the country by either directly funding Pakistan, or persuading donor agencies to do so. In addition to this, materialization of targeted receipts on account of auction of 3G licence, proceeds from Etisalat, and Coalition Support Fund will lend the much needed support to the external account.

Another million dollar question is whether economic and investment situation is expected to improve post the forthcoming elections. In our view there is a very good chance that the economic conditions will start improving after the elections. However, Pakistan will have to go through a difficult transition period of about five years before the tough policy changes bear fruits. The policy measures needed to put the economy back on track include: (i) reforming state-owned enterprises that are currently costing the tax payers over Rs 400 billion per annum; (ii) implementation of value-added tax, and taxing all sources of income; (iii) rationalizing government spending; (iv) resolving structural issues of the energy sector; (v) and increasing social spending on education, health care, etc. If the present coalition continues in power after the elections, it will be more willing to undertake the above difficult steps that it is not taking at present being an election year. The new regime will be hopeful that once the results of these policy changes start materializing in a few years, people will forget the tough policy measures taken by the government in the early years of its term. Even if an alternative coalition setup comes in power in the upcoming elections, it will also embark on pretty much the same policy measures to improve the economic situation of the country. The stock market is expected to rally before election time in anticipation of better governance and bold economic initiatives by the newly elected government.