Oil Price Downturn – A familiar safety net?

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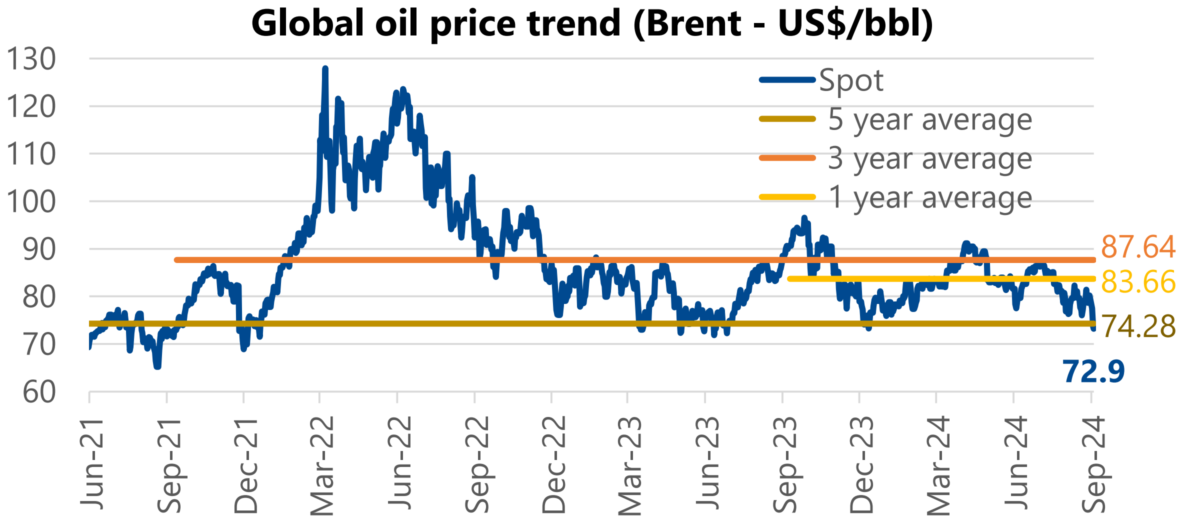
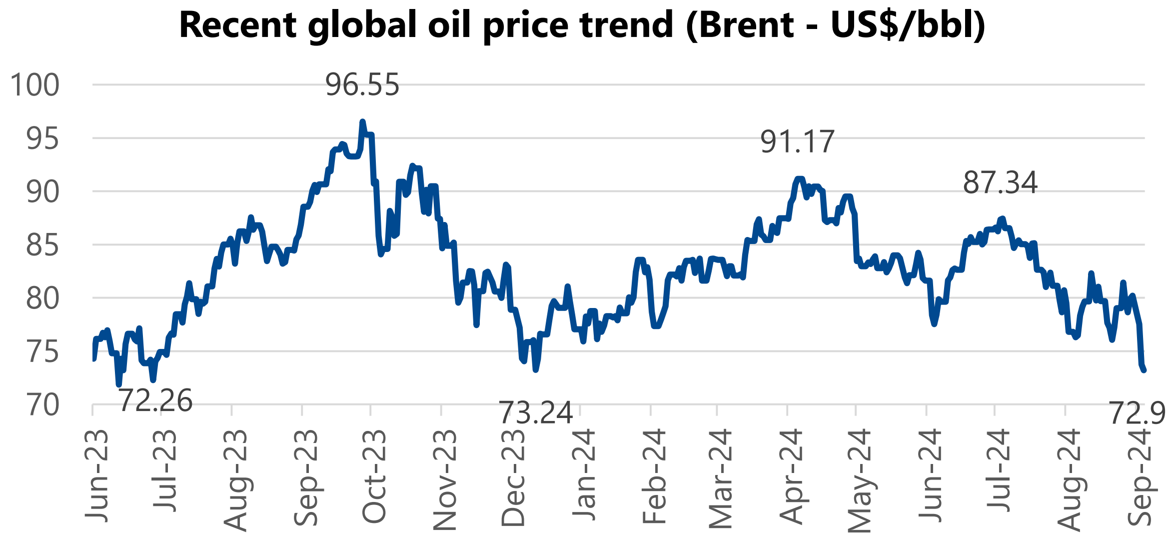
Global oil prices reflect a softening trend

- Following a surge in 1HCY24, **global oil prices have retreated by approximately 20% (US$17/bbl)** in the past 5 months, reaching their **lowest point in 15 months at US$72.9.** In essence, the said price has hardly sustained below US$73/bbl since 4QCY21, making the prevailing pricing among the lowest in 3 years. This decline also aligns with the average oil price over the last 5 years (US$74/bbl).

- **The combination of increased supply, built-up inventory, and reduced demand has pushed oil prices**. OPEC+ production cuts, coupled with concerns over China's economic growth and the potential for a global recession are some of the key factors.





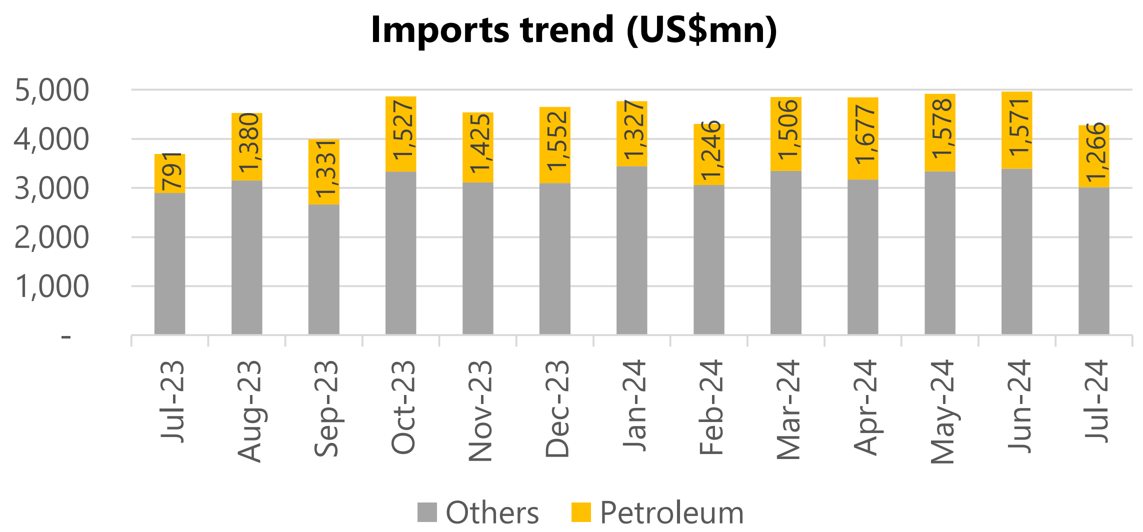
Source: Bloomberg, JS Research

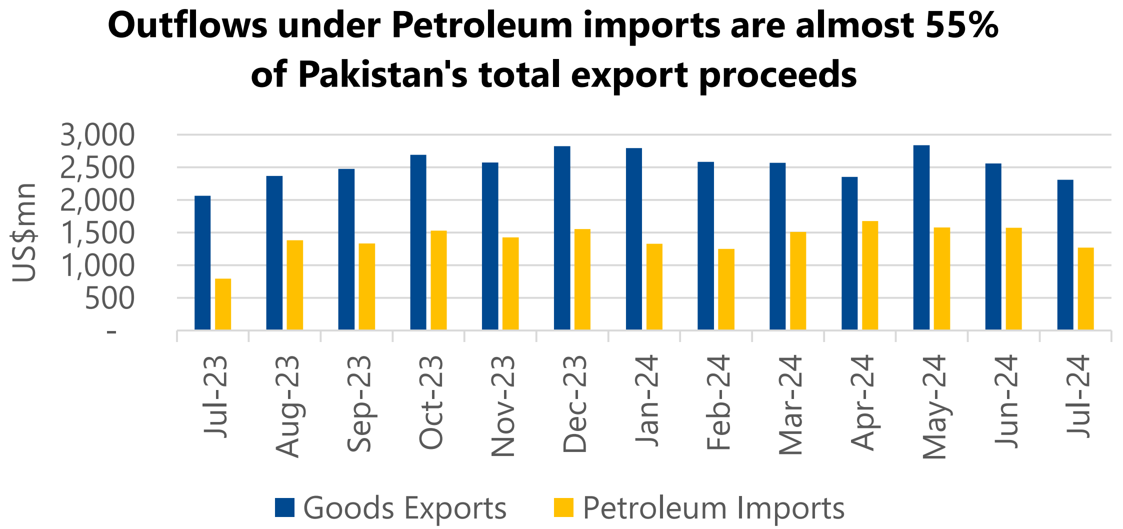
Pakistan's economic landscape: Segments benefiting from lower oil prices

- Pakistan being a net oil importer is on the favourable end of ongoing oil price correction. This commodity plays **a pivotal role in the country's two most critical economic indicators**:

  1. **Trade Balance:** Petroleum imports account for ~**30% of total imports** and ~55% of total export proceeds, making them a significant driver of the trade deficit, and
  2. **Inflation**: Oil prices directly impact the **6%-weighted transport segment of the inflation basket.**

- We present historical **data to illustrate the relationship between oil prices and inflation**, alongside import data. It is important to note that **other factors also influence these trends** during different time periods, but the graphs are only for **some perspective**.





Source: PBS, JS Research

CAD: Further improvement from contracting trade deficit...

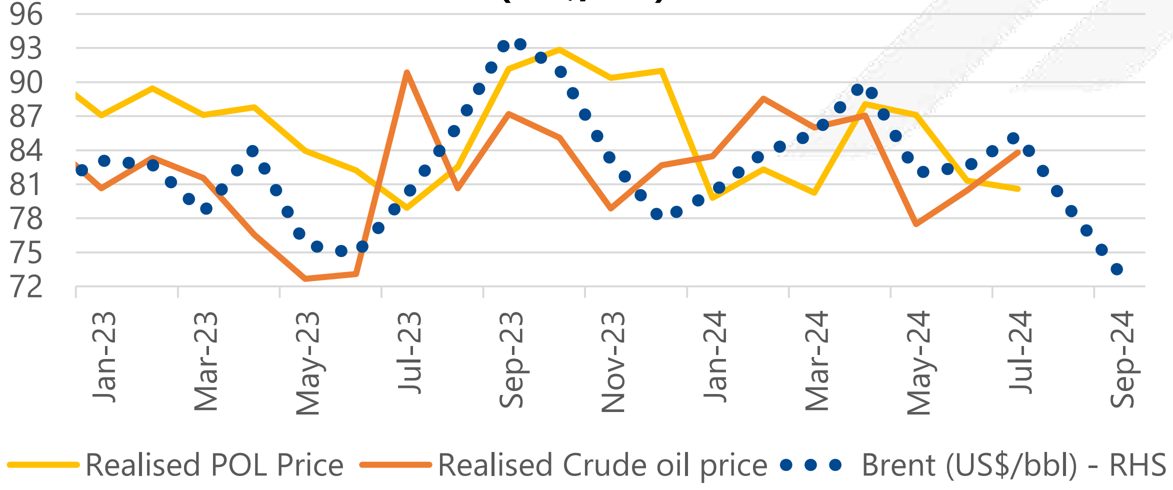
- While current account deficit (CAD) has been relatively controlled with trade deficit reducing to 11-month low in Aug-2024 and contracting 4% YoY in 2MFY25, the decline is largely contributed from prioritizing essential imports, and reduced demand in the current macroeconomic landscape.

- The trade data for **Jul-2024 indicates that crude oil and petroleum product prices were purchased at an average of ~US$83/bbl, where global oil prices have reduced 12% (US$10/bbl) from those levels.**

- Decrease in realized oil import prices would positively impact the import bill, potentially reducing our CAD estimate for FY25 by of US$~800mn (0.2% of GDP).

- **A drop of US$5/bbl reduces the annual import bill by ~US$900mn (0.25% of GDP) – almost 10% of our existing SBP FX reserves of US$9.4bn.**

Realised imported oil prices versus global oil prices (US$/bbl)



Sensitivity of oil price movement on FY25E Current account balance

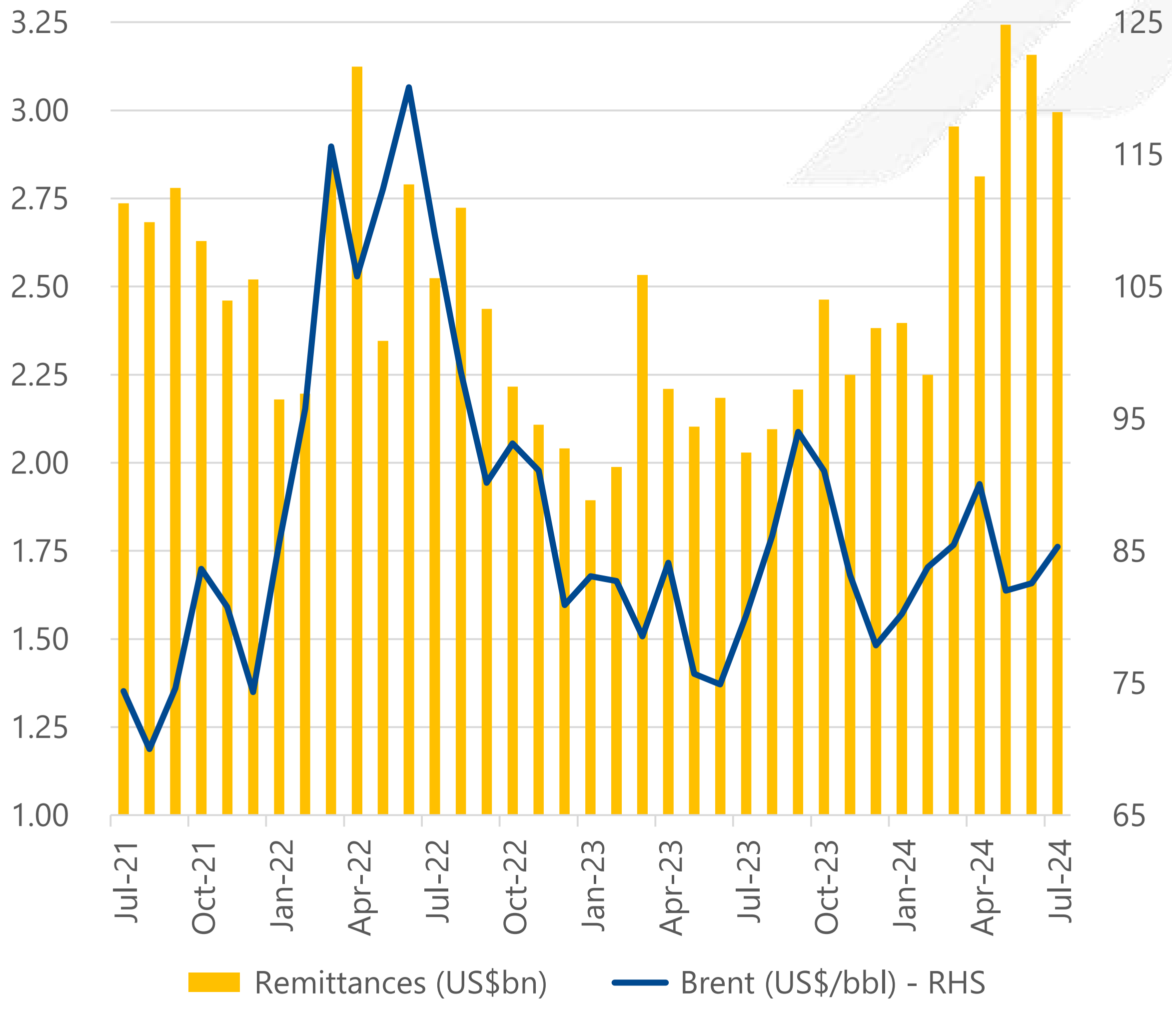
Average oil price for remaining months of FY25	Current account balance (US$bn)	*% of GDP*
US$72/bbl	789	*0.20%*
Base Case (US$83/bbl)	(826)	*-0.20%*
US$93/bbl	(2,442)	*-0.60%*

Source: PBS, Bloomberg, JS Research

...while balancing rewards and risks on overall external account

- Reducing imports, and hence building reserves, is welcoming at a time when import cover is ~2x and the country is burdened with tall US$22bn debt obligations for FY25 - dependent on rollover commitments of US$12bn and new lending of US$10bn.
- Lower oil imports may also spare room for some non-essential imports, keeping current account balance close to breakeven.
- There could, however, be a potential counterbalancing effect of lower oil prices on remittances. Since 55% of Pakistan's remittances originate from Middle East - a region heavily reliant on oil income, any prolonged decline in oil prices could negatively impact economies of these countries and hence weaken remittance flows from current levels.
- However, **historical data suggests a weaker correlation between oil prices and remittances, reducing possibility of any notable impact.**

Remittances and global oil prices

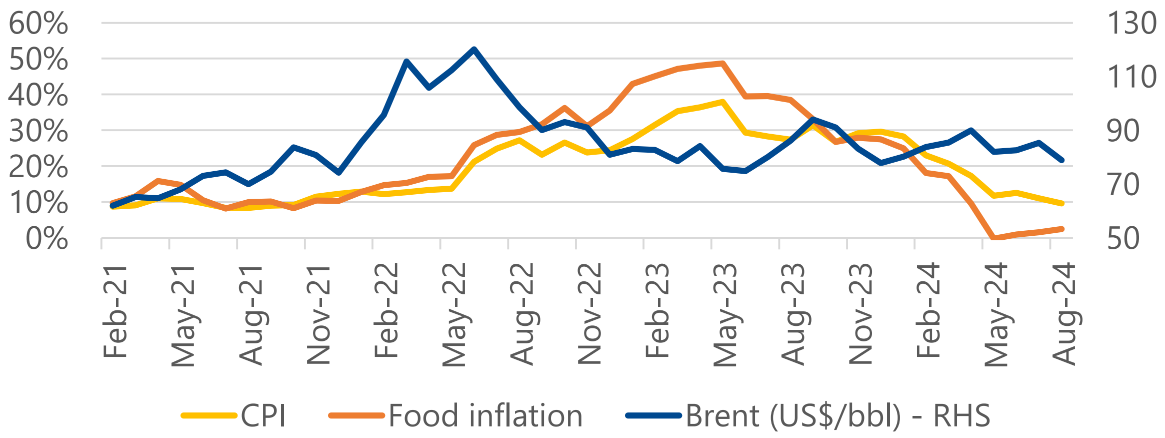


Source: SBP, Bloomberg, JS Research

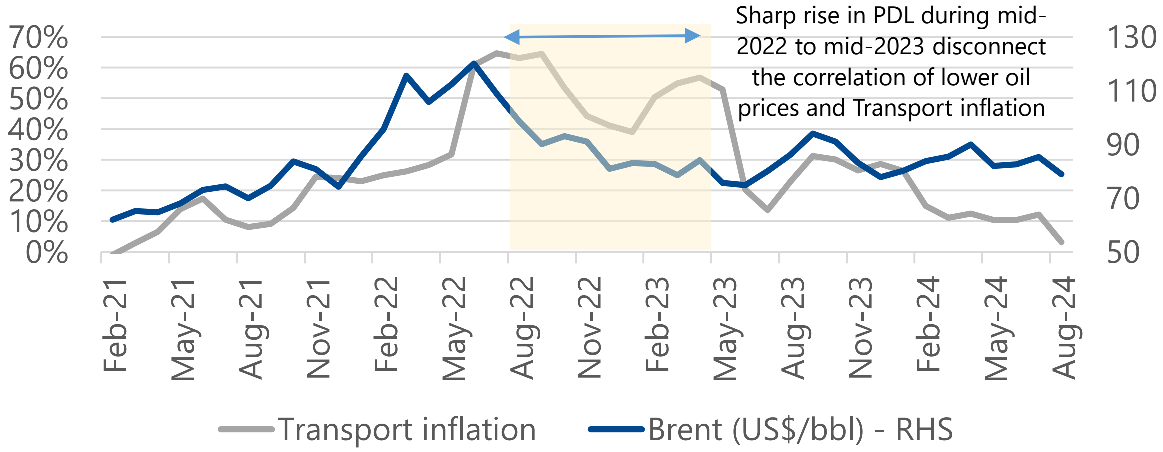
Oil price drop – a slight push to the ongoing disinflation trend

- The ongoing disinflation trend, bringing headline CPI back to single-digit after 3 years, has been one of the key reliefs for the country – resulting in initiation of a monetary easing cycle after 4 years.
- Recent softening oil price has begun to contribute to CPI, with ~5% reduction in POL product prices in the last 6 months. Second-round effects have yet to be seen in numbers.
- While we expect FY25F average CPI to clock in at 9%, **lower oil prices may slightly revise our estimates as transportation segment is only 6% of the CPI basket. Any second-round impact may remain limited as witnessed in historical trend during a downward oil price trend.**

Headline inflation more correlated to food prices, compared to oil prices



Higher correlation of oil prices with Transport inflation (6% of CPI basket)

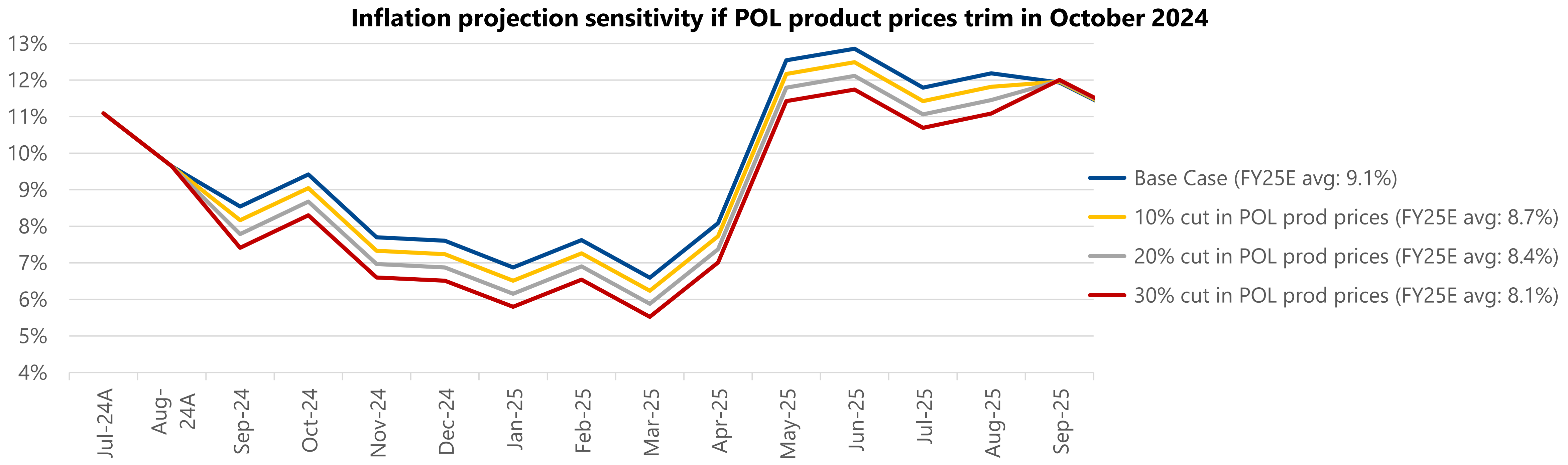


Source: PBS, Bloomberg, JS Research

Sensitivity on inflation

- Running similar sensitivities as before, **a US$5/bbl (+7%) drop in oil prices would trim 35bps from our headline inflation estimates for FY25E.**

- **We present sensitivities of cut in POL product prices in inflation projections, which reflects notable change only when a sizable movement in POL product prices is factored in.**



Source: JS Research

Opportunity to increase PDL collection on the cards?

- As any lesser notable decline in POL product prices bear limited impact on inflation outlook, **the government may seize this opportunity to increase the Petroleum Levy (PDL) by Rs10/ltr (~4% of present POL product price level) to its revised cap of Rs70/ltr, helping to offset the shortfall in PDL collection due to sluggish OMC sales.**

- We present a sensitivity of increase in PDL on various OMC sale growth assumptions to gauge the impact of Rs10/ltr PDL charge on the PDL collection for FY25.

PDL target for FY25 (Rsbn)	**1,281**
Required OMC YoY sales growth in FY25 at start of the year to achieve target	7%
OMC YoY sales growth in 2MFY25	-12%
Required OMC sales growth in remainder of FY25 - on Rs60/ltr PDL	35%
Required OMC sales growth in remainder of FY25 - on Rs70/ltr PDL from 1 Oct	17%

Sensitivity in expected PDL collection from YoY growth required for the remaining months of FY25:

YoY Volume growth	**Collection on Rs60/ltr PDL**	**Shortfall from FY25 target**	***Impact on Fiscal Balance (% of GDP)***	**Collection on Rs70/ltr PDL from 1st Oct**	**Shortfall from FY25 target**	***Impact on Fiscal Balance (% of GDP)***
-15%	868	(413)	*-0.33%*	975	(306)	*-0.25%*
-10%	909	(372)	*-0.30%*	1,023	(258)	*-0.21%*
-5%	951	(330)	*-0.27%*	1,071	(210)	*-0.17%*
0%	992	(289)	*-0.23%*	1,119	(162)	*-0.13%*
10%	1,075	(206)	*-0.17%*	1,215	(66)	*-0.05%*
15%	1,117	(164)	*-0.13%*	1,263	(18)	*-0.01%*
35%	1,283	2	*0.00%*	1,454	173	*0.14%*

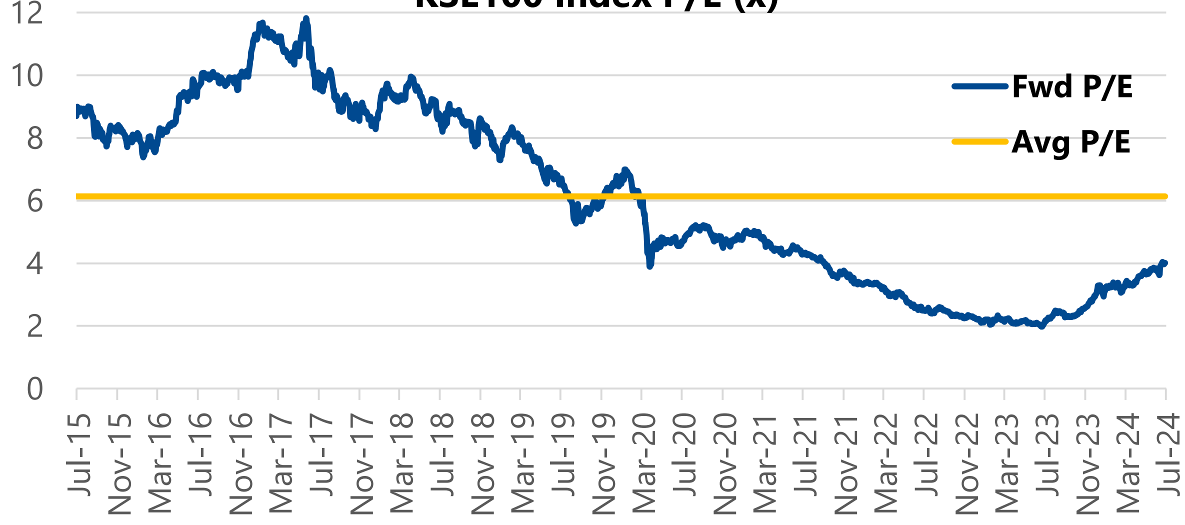
Source: JS Research

Equity markets - An added momentum to the ongoing confidence revival

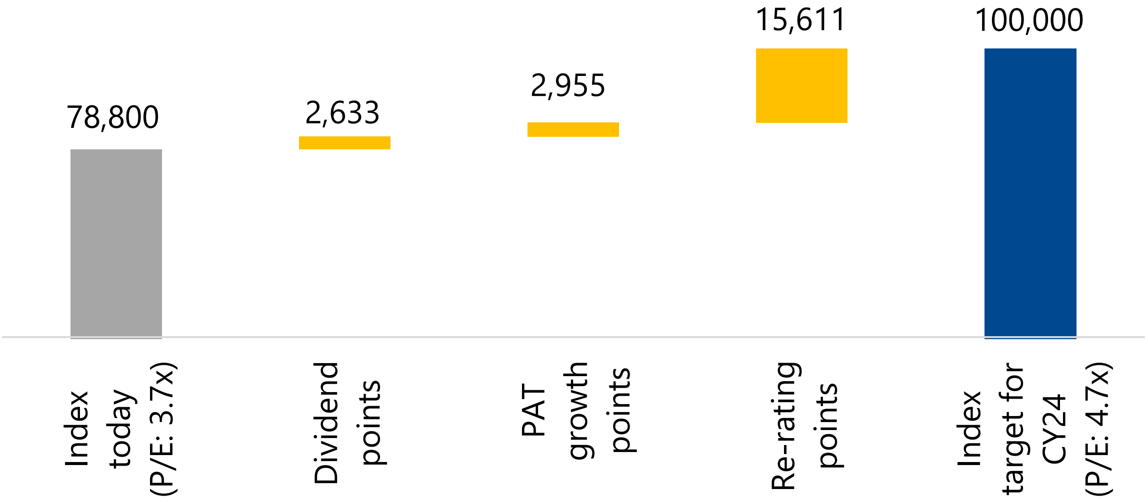
- The new IMF program and expectation of inflation easing off have helped lower macro noise, where continued steps taken towards some key reforms have revived investor confidence and supported a rerating cycle in the equity markets since Jun-2023. Having said that, tasks regarding debt profile may continue as a challenge. **Prospects of further improvement in external balance data points from lower oil prices may provide an additional momentum for this year, unlocking valuations from its forward P/E of 3.7x.**

- P/E multiples average 6x in the last 10 years. In this span of time, 70% of the period witnessed de-rating, while 5 years consistently reflect sub-5x P/E amid consistent profit growth and lull index movement. **We reiterate our 100,000 Index level view released at the start of the year, which reflects a P/E of 4.7x, and is still 20% below the distressed average P/E. These assumptions do not factor the recent dip in global oil prices.**

KSE100 Index P/E (x)



Remaining potential to reach CY24 target of 100,000



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