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Pakistan's emerging-market status just got into big trouble: Bloomberg

KARACHI: Pakistan's inclusion in the MSCI Inc.'s emerging-market indexes has come under a cloud as the nation's stocks fall below the market-size threshold, Bloomberg reported.

The South Asian nation, which got promoted from a frontier nation in June 2017, has erased about $44 billion of equity value since then. That has narrowed its weight in the MSCI Emerging Markets Index to just above 3 basis points, lower than the 8 basis points Morocco and Jordan had when they were downgraded, according to EFG-Hermes Holding.

That's not all: Habib Bank Ltd., one of the three stocks in the MSCI's Pakistan gauge, now has a market capitalization below $1.6 billion. The MSCI usually requires at least three stocks to remain above that level for a country to maintain the emerging-market status. Also, none of the three stocks fulfills the free-float requirement.

All this means there is a "50 percent probability Pakistan will be put on review in June" for a downgrade, Mohamad Al Hajj, an equities strategist at EFG-Hermes, said by phone. "If it happens, it will be the fastest upgrade and downgrade."

This does not mean a demotion is imminent. MSCI, whose indexes are tracked by global investors to make investment decisions, doesn't react to every change in market value or take decisions based on a single characteristic.

"MSCI may decide to keep the market for some time within the same status, while keeping three constituents using the index continuity rule," the index provider said in an emailed response to questions. "Secondly, the final decision to reclassify could be made following a public consultation."

Pakistan gained back its emerging-market status after convincing global investors of its economic reforms and market access. Even though investors including Mark Mobius expressed skepticism about the promotion, the nation's policy makers expected it to help attract global capital and deepen funding access for local businesses.

It turned out to be a case of small fish in a big pond for Pakistan. With a negligible weight, Pakistan failed to attract the much-touted investment flows. The upgrade was followed by the Karachi market witnessing the worst foreign selling since the 2008 financial crisis and a currency depreciation that pushed its benchmark index to the world's second-worst performer.

The nation had been added to MSCI Emerging Markets Index with six companies but three were removed after falling below the market-value threshold.

"When an index contains less than three securities, then the next largest securities

by free float-adjusted market capitalization may be added to the Standard Index," MSCI said.

Some investors point out that Peru and Egypt had been in a similar situation in the past and MSCI didn’t downgrade them.

“I believe there will be some kind of relaxation,” said Shamoon Tariq, deputy chief investment officer at Stockholm-based Tundra Fonder AB. “MSCI would not want to keep bouncing a nation between frontier and emerging market.”

The South Asian nation’s economy is going through its latest boom and bust cycle that has led to a deficit blowout. The nation resorted to one of the most extreme currency devaluations and interest rate hike cycles in Asia to control the economy. Pakistan’s credit score was downgraded by S&P Global Ratings last month month citing a worsening economic outlook.

"We are disappointed to see Pakistan faces a risk of downgrade as we traveled on global road shows for Pakistan’s upgrade not long ago,” said Tariq.

“The new government has been indifferent towards the capital market that needs support.”

The nation’s benchmark KSE-100 Index fell 1.1 percent on Thursday, the most in almost two weeks.

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