

Market Outlook

Cheap valuations adequately reflect the risks

Top-down concerns lead to caution

The KSE-100 failed to hold on to interim gains and closed August with a small 0.8% return (down 1.6% in US\$). Volumes dipped and foreign selling outside of Technology continued, ahead of MSCI's decision on Pakistan's EM status. Although Fx reserves rose, the PKR remained weak on a large import bill and lack of conviction on the quick resumption of the IMF programme. The security situation remains vulnerable to unfolding events in Afghanistan. In the absence of top-down clarity, the equity market largely ignored the strong incoming corporate results (universe profits up c.50%yoy in 2Q21). That said, we continue to believe that the reforms theme remains intact, and while there may be a delay in IMF programme resumption, a premature exit appears unlikely. Attractive valuations suggest that the risk is greatly priced in already, and we retain our constructive stance on Pakistan equities.

September outlook - Track IMF, MSCI, and Afghanistan

IMF programme may be delayed but an exit is not a given

The receipt of c US\$2.8bn from the IMF's enhanced SDR allocation takes Fx reserves with the central bank to c US\$20bn, which equates to about 4m of import cover. This arguably reduces Pakistan's motivation to restart the IMF programme. With less than two years to go until general elections, some populist decision making is already coming through e.g. proposed price controls. However, we continue to believe that programme resumption will be delayed but not derailed, and that the reforms process remains in place. The finance minister has consistently stated his intention to remain in the IMF programme, and it is early to doubt his word. Talks with the IMF are expected to be held in late September, and continue into October in Washington.

A stable Afghanistan is a must for all

It is possible that Mr. Tarin is able to win some concessions from multilateral lenders such as the IMF by flagging Pakistan's geostrategic importance and the evolving situation in Afghanistan. The recent suicide attack at Kabul airport by IS-K underscores the acute need to contain transnational terrorists, which is only possible if the situation in Afghanistan stabilizes and an acceptable government is formed. Pakistan may yet work meaningfully with the international community, including the US, in containing the fallout in Afghanistan. This may potentially be accompanied with reduced pressure from the IMF and FATF.

MSCI to consider Pakistan's EM status

MSCI's decision on Pakistan's status (EM or FM) will be announced on September 7. With a weight of just 2bps in the EM Index and its three main constituents not meeting the size criteria, a downgrade appears probable. If this happens, the November implementation may see net outflows, concentrated in HBL, MCB and LUCK. That said, our liking for Pakistan equities - premised on continuing reforms, strong corporate profits (next 3yr CAGR: 19%) and attractive valuations - would remain unchanged.

Outlook: Top-down clarity can catalyze strong performance

Risks seem largely priced in, going by the forward P/E of 5.7x, which is 33% below the 10yr mean. We retain our Dec 2021 Index target of 54,500pts. An equal-weighted portfolio of our top picks returned 4.5% in August vs. a 0.8% gain for the KSE-100. Outperformance was mainly delivered by MEBL, SYS and INDU, while LUCK slipped ahead of the MSCI review. We make one change in our top picks, with HUBC replacing POL. International oil prices may struggle to lift from here which will affect POL, while there is now more conviction attached with HUBC's dividend outlook after its FY21 payout.

Raza Jafri, CFA

raza.jafri@imsecurities.com.pk
+92-21-111-467-000 Ext: 201

Market Snapshot – August 2021

KSE 100 Index (pts)	47,420
Market Cap (PKRbn)	8,290
Market Cap (US\$bn)	50
Avg. Daily Vol (mn shrs)*	364
Avg. Daily Td Val (PKR mn)*	12,786
Avg. Daily Td Val (US\$ mn)*	118

*Ready + Future

Summary

P/E (x)	5.72
P/B (x)	0.97
D/Y	7.4%
KSE 100 MTD (in PKR)	0.8%
KSE 100 CYTD (in PKR)	8.4%
KSE 100 MTD (in US\$)	-1.6%
KSE 100 CYTD (in US\$)	4.1%
Policy Rate	7.0%
PKR/US\$	166.38
CPI * yoy	8.4%

*Last reported

Top Picks – Valuations & Recommendations

Top Picks	Mkt Cap	6M ADTV	Price	TP	Total	EPS (PKR)			P/E (x)		P/B (x)		DY (%)	
	(US\$bn)	US\$m	(PKR/sh)	(PKR/sh)	Return	21a/f	22f	23f	21a/f	22f	21f	22f	21a/f	22f
LUCK	1.6	3.1	831	1,300	57%	70.7	126.2	145.5	11.7	6.6	2.7	2.4	0.0%	0.0%
KOHC	0.3	0.2	210	315	51%	17.4	32.4	33.1	12.1	6.5	2.3	1.9	0.0%	1.0%
SYS	0.6	0.5	720	950	32%	23.4	33.1	43.7	30.8	21.7	12.5	9.3	0.4%	0.6%
UBL	0.9	1.5	121	160	42%	21.3	24.8	28.2	5.7	4.9	0.7	0.7	9.9%	10.8%
MEBL	1.3	0.6	155	140	-6%	15.8	17.3	20.0	9.8	9.0	3.0	2.5	3.9%	3.9%
BAFL	0.3	0.4	33	45	50%	6.3	7.0	8.2	5.2	4.7	0.6	0.6	12.3%	9.2%
INDU	0.6	0.3	1,364	1,625	27%	163.2	149.4	191.3	8.4	9.1	2.6	2.3	2.2%	7.6%
MTL	0.4	0.2	1,110	1,460	41%	89.9	135.4	146.4	12.3	8.2	11.0	10.2	4.0%	9.9%
HUBC	0.6	1.6	80	125	71%	26.0	31.6	35.3	3.1	2.5	1.2	0.9	0.0%	15.0%
GATM	0.2	0.8	55	63	20%	10.7	8.9	10.5	5.1	6.2	1.7	1.6	0.0%	7.2%

Source: IMS Research

IMS Top Covered Stocks
Stocks Thesis

LUCK Higher profitability from Kia-Lucky and commissioning of Lucky Power will increase consolidated earnings significantly. Core profitability will also rise amid better local demand and cement prices. LUCK has also recently partnered with Samsung and offers the best one-shot exposure to Pakistan.

KOHC Rise in cement prices and local demand along with new expansion and shift to coal based CPP will increase the margins and profitability of the company. KOHC has also lower exposure to interest bearing debt. Hence, the future earnings would not be exposed to an upsurge in interest rates.

SYS Higher revenue and profitability CAGR of 27%/35% in next 5 years amid growth from cloud, data and software implementation services coupled with increase in margins due to more exports to USA and Europe are key catalysts behind the sustained high growth.

UBL UBL's domestic franchise is strong and asset quality in the Middle East appears to have turned the corner. Potential cost efficiencies can emerge under the new CEO (C/I: 47% in 2Q). We see ROE rising from 11.7% in CY21f to c.16% by CY25f. Capital buffers remain strong

MEBL MEBL is delivering on all fronts where aggressive balance sheet expansion, superior asset quality, and leverage to rising interest rates amidst a unique low cost depositor base round up our liking for the bank. 2Q numbers suggest MEBL's estimates and TP have room to increase.

BAFL BAFL is a good post-Covid play. This is based on its higher margin sensitivity to rising interest rates (CA: 45%, TBills: 40%). Asset quality is decent and ROE has bottomed. Focus on growing its digital footprint is also a positive.

INDU Our liking for INDU stems healthy cash balances (PKR72bn) which may lead to new car launches, and better rural demand on improving farmer dynamics. We estimate 3yr earnings CAGR of c.40%.

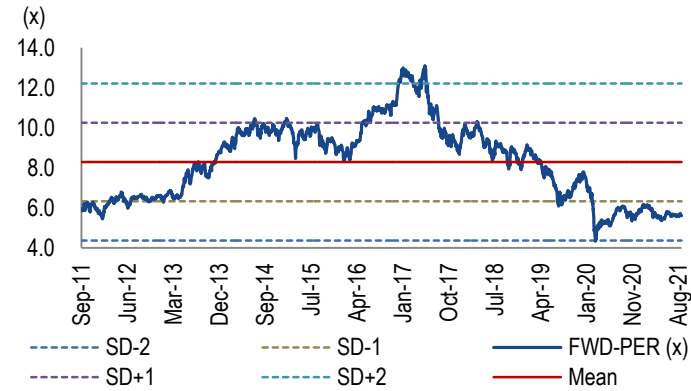
MTL MTL has raised its market share to c.70% following recent improvement in farmer dynamics amid improvement in commodity prices and incentives during FY21. A renewed focus on the sector and solid dividend policy (payout: 95%) and high ROEs (5yr average of 70%) firm up our liking.

HUBC Receipt of the remaining 60% (c. PKR34bn) of its overdue receivables from the GoP should ensure continuity of dividend payouts in FY22f. Several expansion projects, an improved cash flow cycle, and dividends from CPHGC affirm our liking for HUBC.

GATM Our liking for GATM emanates from the sharp rise in revenues (now the largest among listed scrips) and extensive capacity enhancements in both Spinning and Home Textile segments. The filling of order books for the next year and planned Ideas IPO further strengthen our Buy stance.

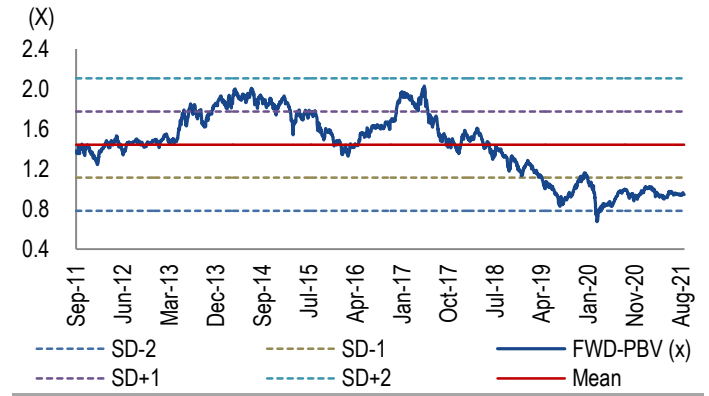
Valuations Snapshot

Price-to-Earnings remains below 6x, less than 1 standard deviation below the mean despite relatively soft interest rates and strong earnings growth



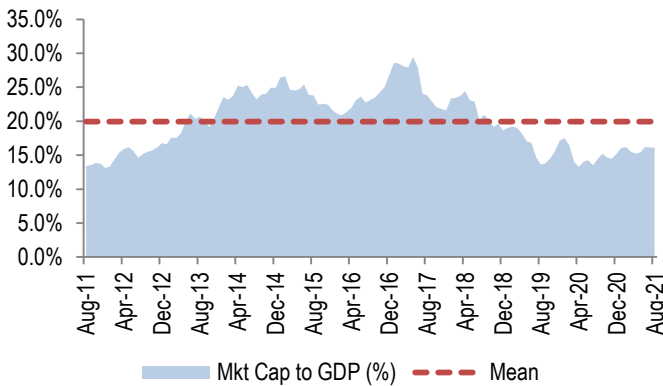
Source: IMS Research

Price-to-Book is still shy of 1x. Better payouts from the Energy chain and higher ROE from the big banks going forward may spur re-rating.



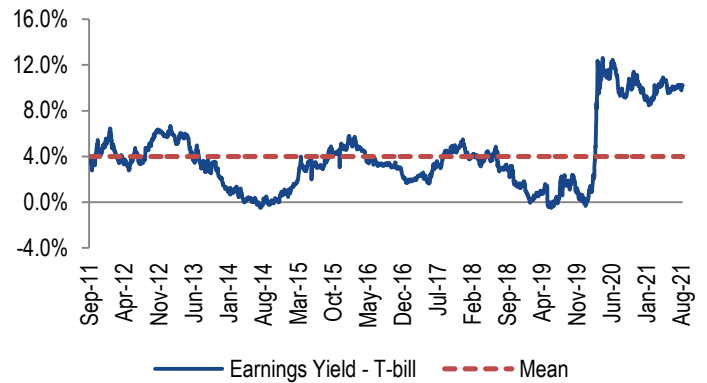
Source: IMS Research

Pakistan is attractive on the "Buffet metric" but GDP growth needs to be more sustainable (this may require staying in the IMF programme)



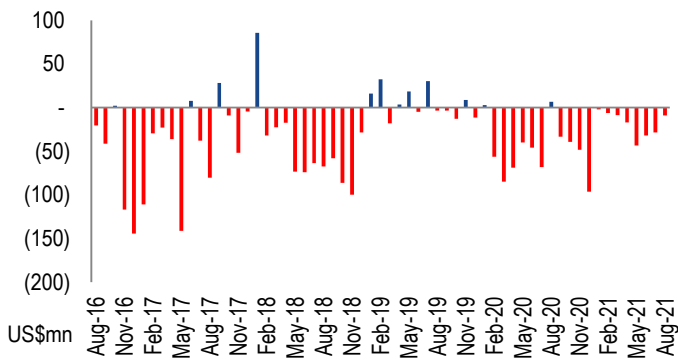
Source: Ministry of Finance, IMS Research

An increase in interest rates, by at least 2ppt, appears to already be priced in even though interest rates may take till 4Q21 or later to lift



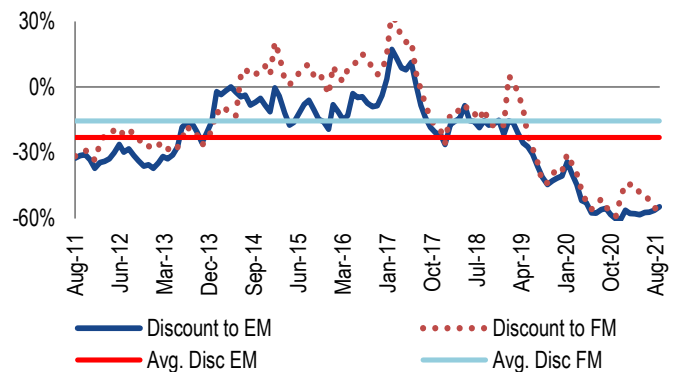
Source: SBP, IMS Research

Foreign selling continued in August (Technology saw inflow). With Pakistan on watch for potential downgrade to FM, foreign outflows can continue



Source: NCCPL, IMS Research

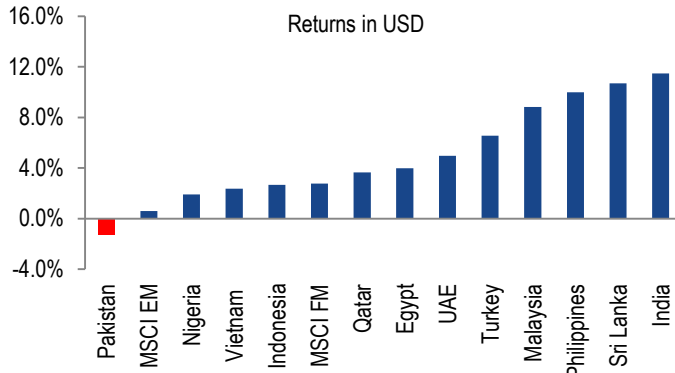
Acute discount to regional markets seems to already be pricing in top-down risks such as Afghanistan and reforms continuity



Source: Bloomberg, IMS Research

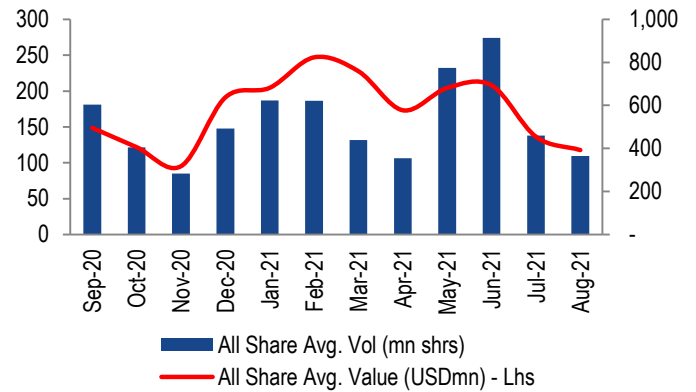
Market Review (August 2021)

Top-down concerns sparked by events in Afghanistan and continued PKR weakness led to Pakistan underperforming



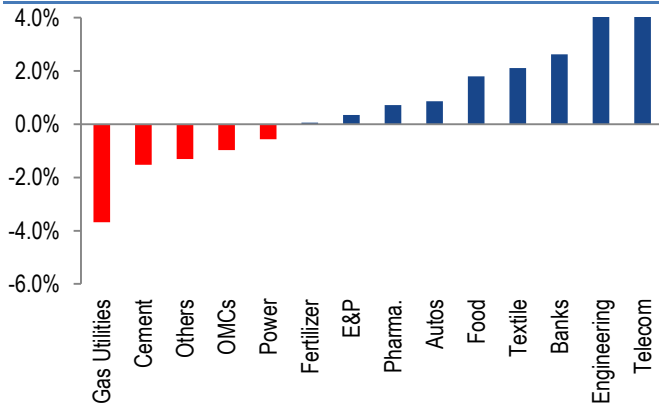
Source: Bloomberg

Cautious sentiment was captured by thinner volumes, which failed to increase despite the result season



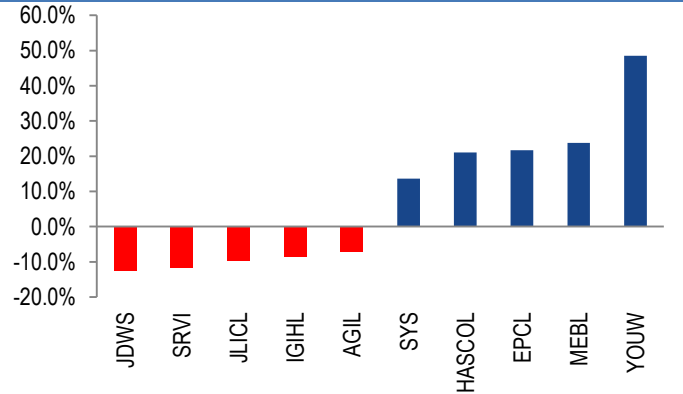
Source: PSX, IMS Research

Outperform: Technology remained strong. Steel results were strong
Underperform: Weak results for Cements led to profit taking



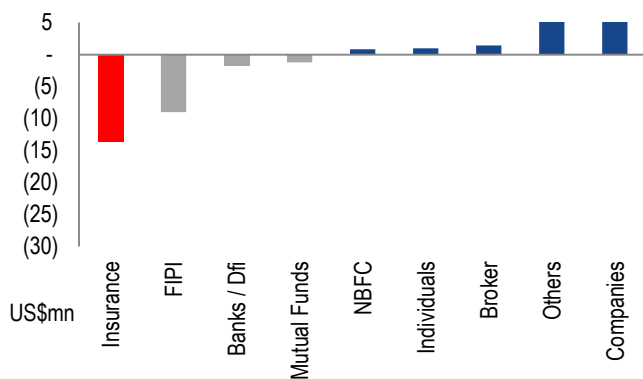
Source: PSX, IMS Research

KSE-100 Leaders & Laggards: Strong results push up MEBL and EPCL.
JLICL fall may be due to stricter guidelines on bancassurance



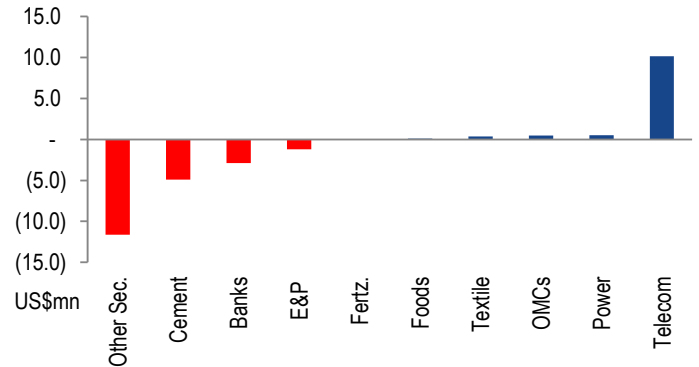
Source: PSX, IMS Research

FIPI & LIPI: Foreigners continued to exit (ex-Technology) and so did the Insurance giants. Individuals appeared undecided.



Source: NCCPL, IMS Research

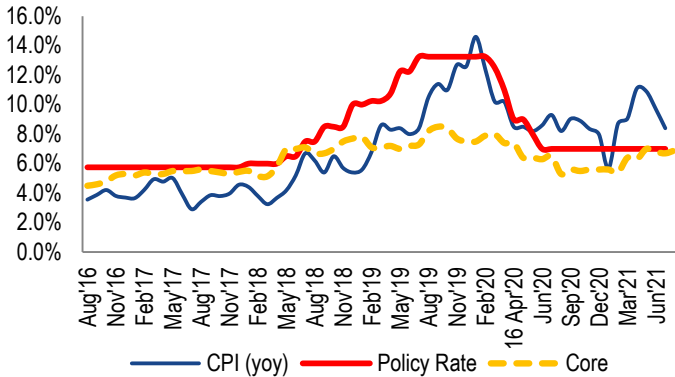
Foreign selling was seen in the mainstream sectors ahead of MSCI review for possible downgrade to FM. Tech bucked the trend



Source: NCCPL, IMS Research

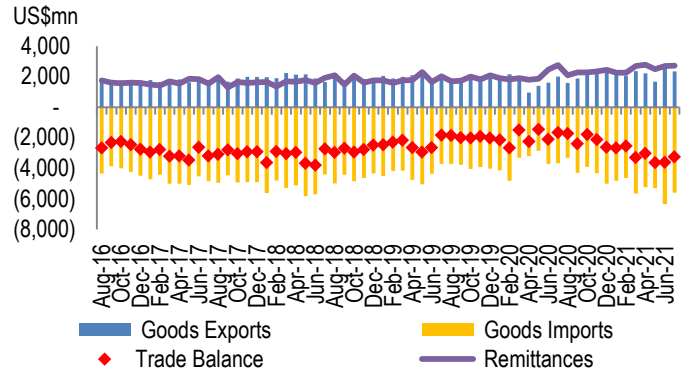
Economic Trends

Real interest rates remain negative relative to headline CPI. The SBP appears unlikely to raise rates this quarter



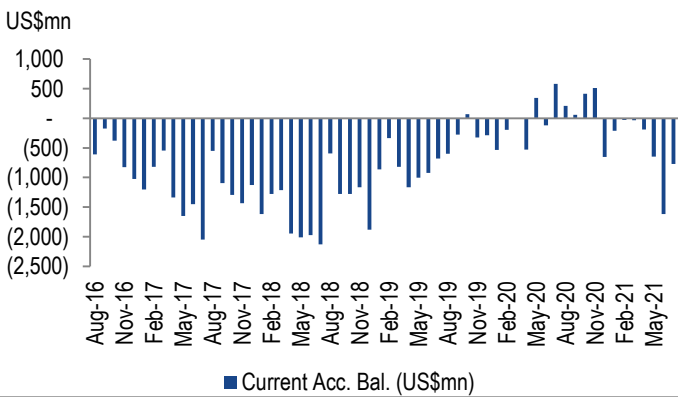
Source: PBS, SBP, IMS Research

Upcoming TERF drawdowns may keep imports elevated in 1QFY22, which may keep the trade deficit under pressure



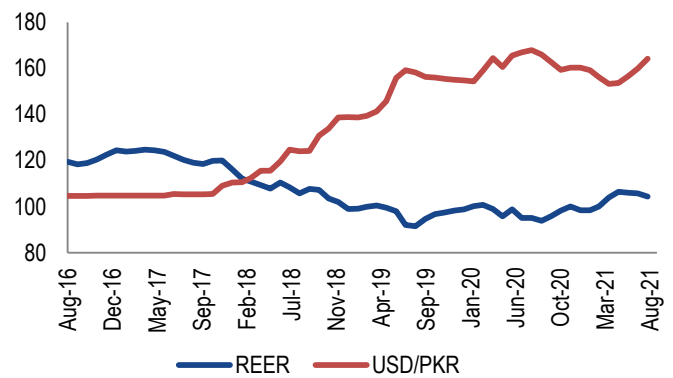
Source: PBS, SBP, IMS Research

The current account deficit reduced in July, to within the 2-3% of GDP band, which the SBP seems to be comfortable with



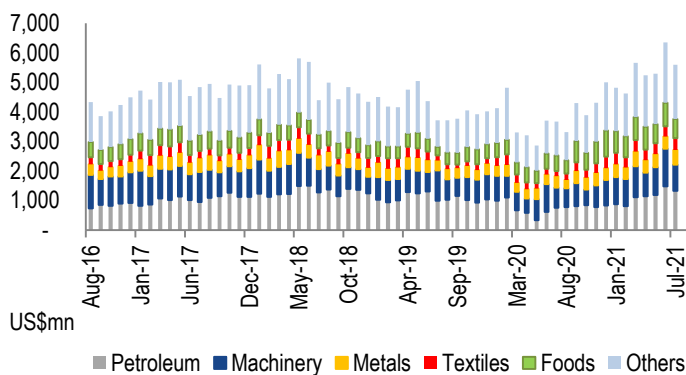
Source: SBP

The PKR appears to have stabilized but remains vulnerable to possible high CAD prints in coming months



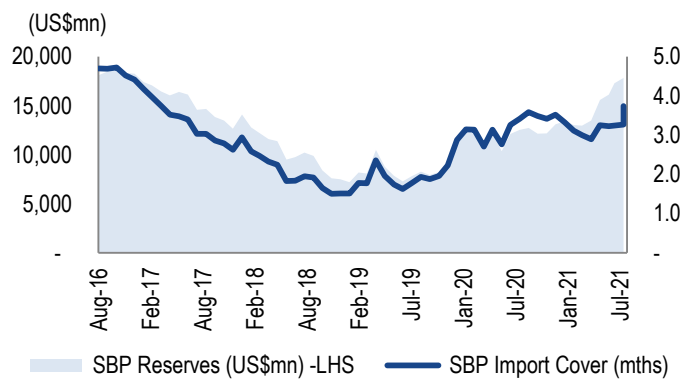
Source: Bloomberg, IMS Research

Machinery imports came down sequentially in July, but may rise again in coming months as TERF drawdowns continue



Source: PBS

The SBP expects FX reserves to increase across FY22f, aided in part by the IMF's higher SDR allocation (US\$2.8bn)



Source: SBP, IMS Research

Annual Economic Estimates	FY19	FY20	FY21	FY22f	FY23f
Real Sector					
GDP Size (PKRbn)	38,559	41,727	45,567	51,564	58,195
GDP Size (US\$bn)	276	263	286	303	333
GDP Growth	1.9%	-0.4%	3.9%	4.2%	4.5%
GDP Per Capita (US\$)	1,349	1,260	1,323	1,376	1,479
Population (mn)	208	212	216	220	225
External Sector					
Exports (US\$bn)	23.0	21.4	25.6	28.0	30.2
Imports (US\$bn)	54.8	44.6	53.8	60.5	63.4
Services Balance (US\$bn)	(4.3)	(2.9)	(1.9)	(2.1)	(2.3)
Remittances (US\$bn)	21.7	23.1	29.4	28.9	30.2
Current Account Balance (US\$bn)	(13.4)	(4.4)	(1.9)	(7.0)	(7.2)
CA Balance % of GDP	-4.9%	-1.7%	-0.6%	-2.3%	-2.2%
Net FDI (US\$bn)	1.4	2.6	1.8	2.0	2.5
Fiscal Sector					
Tax Revenue (PKRbn)	4,473	4,432	5,273	6,058	6,814
Non Tax Revenue (PKRbn)	427	1,524	1,631	1,439	1,583
Total Expenditure (PKRbn)	8,346	9,648	10,307	11,089	12,596
Tax Revenue % of GDP	11.8%	10.6%	11.1%	11.7%	11.7%
Interest Payments (PKRbn)	2,091	2,620	2,750	3,000	3,275
Primary Balance % of GDP	-3.5%	-1.8%	-1.4%	-0.6%	-0.8%
Fiscal Balance (PKRbn)	-3,445	-3,376	-3,403	-3,103	-3,685
Fiscal Balance % of GDP	-8.9%	-8.1%	-7.1%	-6.0%	-6.3%
Monetary Sector					
CPI Inflation (average)	6.8%	10.8%	9.0%	8.6%	8.0%
Policy Rate (average)	9.4%	12.0%	7.0%	7.9%	9.3%
Policy Rate (period end)	12.3%	8.0%	7.0%	9.0%	9.3%
Private Sector Credit Growth	17.4%	4.9%	3.7%	13.0%	13.6%
SBP Fx Reserves (US\$bn)	7.3	12.1	16.1	17.1	16.0
Import Cover (months)	1.6	3.3	3.6	3.4	3.0
PKR/USD (average)	136.2	158.3	159.6	165.7	174.9
PKR/USD (period end)	156.0	168.1	157.6	172.0	177.0

Source: Ministry of Finance, SBP, PBS & IMS Research

Key Notes

Strategy & Economy

Pakistan Economy: July 2021: CPI falls for the third consecutive month to 8.4% yoy in July

Strategy - Afghanistan regime change - Implications for Pakistan

Economy: Balance of Payments - July 2021: CAD normalizes to a more manageable level in July

Sectors

Steel: 4QFY21 Preview - Profitability to rise despite weaker volumes qoq

Cements: Price Update - Cement prices have surpassed expectations, and more hikes are likely

Oil Marketing: Sales growth slows down in July ahead of lockdowns

Textiles: 4QFY21 Previews - Expect profits to sustain upwards trajectory

E&Ps: 4QFY21 Result Preview - Earnings growth to continue in 4Q; payouts can excite

OMCs: June 2021 Result Preview - The beginning of weak earnings

Autos: Sales Update - July 2021 - Highest monthly sales since October 2018

Fertilizers: July 2021 - Higher offtake before the Urea price hike in August

Textiles: July 2021 - Exports off to an impressive start in FY22

Companies

United Bank Ltd: 2QCY21 Analyst Briefing Takeaways

Lucky Cement Ltd: FY21 Analyst Briefing Takeaways

Kohinoor Textile Mills Ltd: Well-positioned but significantly mispriced; Buy

Meezan Bank Ltd: 2QCY21 Analyst Briefing Takeaways

Pakistan State Oil: FY21 Review: Earnings beat expectations on inventory gains and large penal income

Air Link Communication Ltd: New IPO- Dominant player in the high-growth mobile market

Systems Ltd: Delivering handsome growth; upgrade estimates

IMS Universe

As of	August 31, 2021					EPS (PKR)			PER (x)		EPS Growth (%)		PBV (x)		DY (%)	
	Mkt Cap (US\$Bn)	Price (PKR)	TP (PKR)	Upside (%)	Stance	21f	22f	23f	21f	22f	21f	22f	21f	22f	21f	22f
E&P									4.6	3.6	-5%	29%	0.6	0.6	8%	10%
OGDC	2.4	93	164	77	Buy	21.80	28.17	27.18	4.3	3.3	-6%	29%	0.5	0.5	9%	12%
PPL	1.3	82	146	79	Buy	18.61	23.79	21.27	4.4	3.4	2%	28%	0.6	0.5	4%	6%
POL	0.7	391	459	17	Buy	47.14	64.12	59.10	8.3	6.1	-18%	36%	2.6	2.5	13%	14%
Banks									6.2	5.7	3%	9%	0.9	0.8	8%	8%
ABL	0.5	70	110	56	Buy	14.21	16.26	18.43	5.0	4.3	-11%	14%	0.6	0.6	11%	11%
MCB	1.2	165	220	33	Buy	25.05	25.95	28.53	6.6	6.4	1%	4%	1.1	1.0	11%	11%
HBL	1.1	125	160	28	Buy	22.97	24.82	30.19	5.5	5.0	9%	8%	0.7	0.6	5%	5%
UBL	0.9	121	160	32	Buy	21.30	24.78	28.20	5.7	4.9	25%	16%	0.7	0.7	11%	11%
BAFL	0.3	33	45	38	Buy	6.30	7.00	8.16	5.2	4.7	3%	11%	0.6	0.56	9%	9%
MEBL	1.3	155	140	(9)	Neutral	15.75	17.25	19.99	9.8	9.0	-1%	10%	2.5	2.1	4%	4%
BAHL	0.5	68	89	31	Buy	15.05	15.31	16.79	4.5	4.4	-7%	2%	0.8	0.7	6%	6%
Cement									10.9	6.4	n.m	70%	1.7	1.5	1%	1%
DGKC	0.3	106.94	185	73	Buy	8.71	17.78	22.00	12.3	6.0	n.m	104%	0.6	0.6	0%	3%
LUCK	1.6	831	1,300	57	Buy	70.69	126.24	145.48	11.7	6.6	273%	79%	2.4	2.3	0%	3%
MLCF	0.3	43	60	38	Buy	5.69	6.10	6.71	7.6	7.1	n.m	7%	1.3	1.1	0%	0%
CHCC	0.2	174	225	29	Buy	16.50	27.56	34.17	10.6	6.32	n.m	67%	2.5	1.8	1%	3%
FCCL	0.2	21	38	82	Buy	2.60	3.77	4.33	8.0	5.5	n.m	45%	1.3	1.2	10%	10%
KOHC	0.3	210	315	50	Buy	17.42	32.45	33.07	12.1	6.5	n.m	86%	1.9	1.7	0%	8%
PIOC	0.2	118	190	61	Buy	9.11	20.20	28.75	13.0	5.8	n.m	122%	1.7	1.4	2%	3%
Fertilizer									6.6	7.4	-4%	-10%	1.1	1.0	10.6%	10.6%
FFC	0.8	106	136	29	Buy	13.94	14.56	14.81	7.6	7.3	-15%	4%	3.1	2.9	12.2%	11%
EFERT	0.6	77	75	(3)	Buy	12.45	9.11	9.17	6.2	8.5	-8%	-27%	2.2	2.2	15.2%	12%
FFBL	0.2	25	35	38	Buy	4.54	3.23	3.25	5.6	7.8	205%	-29%	1.7	1.5	0.0%	5%
FATIMA	0.4	29	30	2	Neutral	4.32	3.99	3.83	6.8	7.4	-32%	-8%	0.7	0.7	4.2%	3%
ENGRO	1.0	294	380	29	Buy	46.21	42.92	44.67	6.4	6.8	6%	-7%	0.7	0.6	10.9%	11%

As of	August 31, 2021					EPS (PKR)			PER (x)		EPS Growth (%)		PBV (x)		DY (%)	
	Mkt Cap (US\$Bn)	Price (PKR)	TP (PKR)	Upside (%)	Stance	21a/f	22f	23f	21a/f	22f	21a/f	22f	21f	22f	21a/f	22f
OMCs									4.7	6.4	n.m	-26%	1.1	0.97	7%	6%
PSO	0.6	217	300	38	Buy	62.07	42.00	45.03	3.5	5.2	n.m	-32%	0.8	0.70	7%	5%
APL	0.2	328	400	22	Buy	49.43	46.26	53.73	6.6	7.1	388%	-6%	1.7	1.60	8%	10%
SHEL	0.2	152	108	(29)	Sell	6.30	8.35	11.66	24.1	18.2	-128%	33%	5.4	4.81	5%	7%
Steel									7.1	6.8	n.m	4%	2.2	1.9	7%	5%
ASTL	0.1	45	60	33	Buy	4.61	6.13	8.76	9.8	7.4	n.m	33%	1.1	1.0	2%	4%
MUGHAL	0.2	115	142	23	Buy	13.15	16.60	20.50	8.8	7.0	548%	26%	2.9	2.5	5%	4%
ISL	0.3	97	130	34	Buy	17.16	15.07	16.12	5.7	6.5	1409%	-12%	2.6	2.1	10%	6%
Power									3.1	2.5	35%	22%	0.9	0.7	15%	13%
HUBC	0.6	80	125	56	Buy	25.97	31.59	35.27	3.1	2.5	35%	22%	0.9	0.7	15%	13%
Autos									9.4	7.6	366%	24%	1.9	1.7	5%	6%
PSMC	0.2	321	450	40	Buy	58.54	70.75	87.13	5.5	4.5	-403%	21%	0.9	0.8	0%	4%
HCAR	0.3	343	500	46	Buy	12.56	45.22	62.46	27.3	7.6	163%	260%	2.7	2.2	1%	5%
INDU	0.6	1,364	1,625	19	Buy	163.21	149.38	191.25	8.4	9.1	152%	-8%	2.3	2.2	8%	7%
Tractors									11.1	7.9	130%	40%	9.8	8.6	10%	11%
MTL	0.4	1,110	1,460	32	Buy	89.92	135.37	146.37	12.3	8.2	157%	51%	10.2	8.8	10%	11%
AGTL	0.1	379	490	29	Buy	44.30	53.37	55.16	8.6	7.1	90%	20%	8.8	8.0	11%	13%
Pharma									17.8	14.0	21%	27%	3.7	3.3	3%	4%
AGP	0.2	119	142	19	Neutral	6.72	8.52	9.51	17.7	14.0	19%	27%	3.5	3.1	3%	3%
SEARL	0.3	228			Under - Review											
Tech																
SYS	0.6	720	950	32	Buy	23.36	33.14	43.67	30.8	21.7	49%	42%	9.3	6.9	1%	1%
Chemical									7.4	12.7	104%	-42%	2.1	1.9	4%	3%
ICI	0.5	838	900	7	Neutral	60.30	39.93	44.12	13.9	21.0	114%	-34%	3.4	3.2	5%	2%
LOTCHEM	0.1	15	18	22	Buy	1.94	1.85	1.88	7.6	8.0	38%	-5%	1.2	1.0	3%	4%
EPCL	0.3	63	62	(1)	Buy	14.06	6.50	6.63	4.5	9.7	124%	-54%	1.7	1.5	2%	3%
Textiles									6.6	7.1	328%	-6%	1.1	1.0	5%	6%
NML	0.2	98	140	44	Buy	14.24	15.69	15.72	6.9	6.2	43%	10%	0.5	0.4	5%	6%
GATM	0.2	55	63	13	Buy	10.75	8.89	10.49	5.1	6.2	n.m	-17%	1.6	1.4	7%	7%
NCL	0.1	52	70	35	Buy	21.34	13.48	13.75	2.4	3.8	n.m	-37%	0.8	0.7	10%	8%
ILP	0.4	75	90	21	Buy	7.35	8.40	9.92	10.1	8.9	469%	14%	3.4	2.8	4.4%	5.4%
KTML	0.1	82	145	77	Buy	9.21	8.75	9.02	8.9	9.4	80%	-5%	1.3	1.2	2.4%	4.9%
Consumers																
FCEPL	0.5	115	110	(4)	Neutral	2.40	4.50	6.34	47.8	25.5	941%	87%	9.1	7.3	0.9%	1.3%
IMS-Universe									6.5	5.7	37%	14%	1.1	1.0	7%	7%

I, Raza Jafri, CFA certify that the views expressed in the report reflect my personal views about the subject securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations made in this report. I further certify that I do not have any beneficial holding of the specific securities that I have recommendations on in this report.

Ratings Guide*	Upside
Buy	Total return expectation of $\geq 15\%$ or expected to outperform the KSE-100 index
Neutral	Total return expectation of $> -5\%$ or expected to match the return of KSE-100 index
Sell	Expected downside of more than 5% or expected to underperform the KSE-100 index

*Based on 12 month horizon unless stated otherwise in the report. Upside is the percentage difference between the Target Price and Market Price.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Risks: (i) Emergence of fourth Covid-19 wave and complete lockdowns, (ii) unexpected macroeconomic deterioration, (iii) end to structural reforms leading to failure to complete the IMF program.

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