

Foundation Alert

MSCI reclassify Pakistan from Emerging Markets to Frontier Markets index

Event

- MSCI, the leading global provider of research-based indexes and analytics, announced that it will reclassify the MSCI Pakistan Index from Emerging Markets (EM) to Frontier Markets (FM) at the November 2021 Semi-Annual Index Review.

Impact

- This decision of reclassification from Emerging to Frontier market is based on feedback received from market participants from MSCI recent Consultation on a Market Reclassification Proposal for the MSCI Pakistan Index.
- MSCI will reclassify Pakistan from Emerging to Frontier market in one go at the November 2021 Semi Annual Index Review (SAIR).
- Based on index simulation using data as of August 31, 2021 four securities would be added to the MSCI Frontier Market Index with an estimated weight of 1.91%.
- There is potential inclusion of Pakistan in the MSCI FM100 index with 5.8% weight. However, MSCI has not mentioned anything on this front.
- Although the Pakistani equity market meets the requirement of Market Accessibility criteria of the MSCI Emerging Market Index but it doesn't classify for Size and Liquidity.
- The number of companies in the Pakistan equity universe that meet the relevant Size and Liquidity criterion of the MSCI Market Classification Framework has declined steadily since 2017.
- Due to declining market capitalizations, this number has consistently been below the minimum of 3 index constituents required for EM.
- Index continuity rules have been applied since the November 2018 review to artificially maintain 3 constituents in the MSCI Pakistan Index.
- Since the November 2019 review, there have been no companies in the MSCI Pakistan equity universe that meet the EM Size and Liquidity criterion under the MSCI Market Classification Framework.
- Starting with the November 2021 SAIR, the MSCI Pakistan Indexes will be rebalanced using Size and Liquidity requirements for Smaller, Average Liquidity Frontier Markets of the MSCI Global Investable Market Indexes Methodology.
- MSCI Pakistan index currently has weight of 0.02% in MSCI EM index and 3 constituents including LUCK, HBL and MCB.
- MSCI Pakistan FM (Mid Cap) index has potential weight of 1.9% in the MSCI FM index with four constituents.

Outlook

- We believe reclassification by MSCI to be a neutral event given the smaller size of foreign holding (19.6% of free float) due to continuous sell off by foreigners (~US\$2bn from 2016 to date).
- Any potential selling by foreigners triggered by this reclassification would be absorbed by local individual and local Institutional investors given their increased quantum of trading, in our view.

Fig 1: Simulated constituents of MSCI Pakistan FM (Mid Cap Index)

Company	Index Weight	Market Cap (USD mn)
LUCK	35.6%	1,811
MCB	23.1%	1,340
HBL	22.2%	1,128
OGDC	19.1%	2,767

Source: MSCI, PSX, Foundation Research, September 2021

Fig 2: Simulated constituents of MSCI Pakistan FM (Small Cap Index)

Company	Market Cap (USD mn)
PPL	1,514
MARI	1,411
ENGRO	1,099
UBL	953
FFC	872
POL	696
PSO	669
HUBC	660
INDU	577
EFERT	570
TRG	548
BAHL	462
ABOT	456
NBP	447
SYS	418
MTL	395
SEARL	376
BAFL	348
PKGS	269

Source: MSCI, PSX, Foundation Research, September 2021

Fig 3: MSCI FM100 index constituents

	Current Index		Simulated Index	
	No. of Securities	Index Weight	No. of Securities	Index Weight
Vietnam	34	31.0%	34	31.4%
Iceland	11	9.0%	9	8.6%
Morocco	8	9.0%	8	8.6%
Kenya	4	8.6%	4	7.7%
Romania	7	8.1%	7	7.3%
Bahrain	4	7.2%	4	6.4%
Kazakhstan	3	6.9%	3	6.2%
Bangladesh	10	6.5%	10	5.9%
Pakistan	0	0.0%	13	5.8%
Nigeria	7	6.4%	7	5.7%
Oman	3	2.3%	3	2.1%
Jordan	3	1.5%	3	1.3%
Sri Lanka	3	1.1%	3	1.0%
Estonia	3	0.9%	3	0.8%
Lithuania	2	0.9%	2	0.8%
Croatia	1	0.4%	1	0.3%
Mauritius	1	0.3%	1	0.3%
Kuwait	0	0.0%	0	0.0%
Total	104	100%	115	100%

Source: MSCI, Foundation Research September 2021

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Important disclosures:

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Recommendations definitions

If	
Expected return >+10%	Outperform.
Expected return from -10% to +10%	Neutral.
Expected return <-10%	Underperform.