

TUNDRA  FONDER

Tundra comment
Pakistan's political challenge
August 11 2014



Tundra comment – Pakistan's political challenge

The Karachi Stock Exchange fell 4.5% on August 11. The reason is increased political noise, a risk that as the macro backdrop has improved now is the single largest hurdle for a continued revaluation of Pakistani equities. This comment aims to explain what has happened and the most likely outcome.

Background

Immediately after May-13 elections which brought PML-N into power, noise of rigging in elections started to air by opposition parties with PTI being the loudest. This in itself is normal in Pakistan. Several hundred complaints were filed, not only by PTI but also by PML-N, PPP and other major parties, giving the elections tribunals some significant work. The initial 120 days deadline was not met and after more than a year only 73% of petitions have been decided upon. It is 4 of the undecided petitions that each represent one seat in National Assembly that PTI is focussing its efforts on at this stage (I.e. little more than 1% of seats in NA). After one year of unfruitful mild protests PTI led by Imran Khan has finally decided to launch an agitation march towards the capital on August 14th, 2014. PTI is the third largest in terms of seats with around 10% and has significant support primarily among the younger generation and the elite. This makes PTI well capable of bringing hundreds of thousands people together in Islamabad. Although it was widely expected that both the government and PTI would show maturity in finding a resolution through negotiations well before August 14, however no retreat from either side has brought the date around the corner. Dr. Tahir-ul-Qadri led Pakistan Awami Tehreek (PAT) observed his 'Martyr's day' on August 10th, 2014 to protest against the loss of lives in clashes between the workers of PAT and Lahore police earlier June. The meeting was quiet and without any violence but Qadri's statement that himself and his followers will join the August 14 march caused renewed worries as the risks of violence (similar to the Lahore incidents in June) thus increased.

The way forward

Accusations of vote rigging in Pakistan is nothing new. Whether it is more frequent than in any other young democracies is better left unsaid. The fact that these accusations are being heard through a very vocal media and followed up by an independent authority is a sign of an at least somewhat functioning democracy. The likelihood any rigging significantly altered the outcome is obviously very low given that PML-N gained more than 50% of NA-seats and has been as vigorous in its

contesting vote rigging as any of the other major parties. But obviously no democracy should leave questions regarding the legitimacy of its elections unanswered.

In practice it will be very hard, in fact impossible through democratic channels, to force PML-N to give in to PTI's demands. As PML-N controls more than 50% of votes in National Assembly and holds the Prime Minister post it can stop dissolution of parliament and vote down any attempts for early elections. If we take on our bearish glasses for a minute we have two major negative scenarios that could come into play.

- The major short term risk is that the protests get out of control with significant violence giving the impression the government has lost control of the situation. In such a scenario there is a distant possibility that the army would step in and temporarily take over pending new elections. This would however be a very strong statement from the military which given recent years of signals of less political interference is very improbable. For this to happen we believe the government needs to take a number of apparent serious mis-steps alternatively a conspiracy with the ambition to throw them out is already in place. We believe this scenario is unlikely. Given that the army has already been appointed to handle the security in Islamabad – even more so.
- The second risk is more of a drawn out scenario where a compromise is reached, the probe into the four contested seats is finalized, and to PTI's advantage. PTI however as a result goes further, the rationale being "If these were flawed, what about others?". If PTI gains enough momentum this could raise broader calls for new elections. Given that the election tribunals which supposedly are unbiased functions already have finalized their work on almost ¾ of filed petitions, there is not many seats left to fight for. A couple of additional seats could be lost by the ruling party which could weaken the government but the process would still be within boundaries of the democratic process. It would create a couple of months of political squabbling but the negative effects are likely to be relatively mild.

The most likely outcome

Thursday's march will be complicated and there is a risk of violence. For anyone who has been in Islamabad – it is a small city with little above 1 million people. The main road where protesters are to be gathered will be filled at 100 000 people showing up and it is likely more

Tundra comment – Pakistan's political challenge

than that will show up. In addition – Islamabad being also the political headquarter of Pakistan, security controls are rigorous. This will by default mean a very tough administrative task letting that many people into its streets. Risk of quarrelling leading to violence is clear and present. As long as authorities handle the security measures in a constructive way and communicate transparently all along there is no need for things to go out of hand.

We believe some kind of compromise bearable for both the incumbent government and PTI will be found sometime during the next days or just after the march. It is likely to be in a way such as it does not alter Pakistans democratic functions (we don't believe in a shortening mandate for example) but it will also give PTI's Imran Khan something to show for his quest which we assume is still about improving democratic functions in Pakistan. If this scenario plays out we will see a sigh of relief in the market. Combined with recent panic selling, high cash levels of local players and foreigners' continued appetite the autumn could see a continuation of the revaluation of the equity market and renewed focus on the opportunities ahead. Before that we will see a couple of more days with nervous trading.

Please feel free to contact us at any time if any further questions.

Meanwhile we will keep updating on our facebook page for the latest development:

<https://www.facebook.com/pages/Tundra-Fonder-AB/177848998939203>