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An interview with Adnan Afridi, Managing Director, National Investment Trust

'Central banks should be less vocal and less visible'

NATIONAL INVESTMENT TRUST LIMITED
Invest in Trust

Adnan Afridi, graduate with highest distinction from Harvard University with a degree in Macro-Economics and a Doctorate in Jurisprudence with a focus on Islamic & financial markets regulation. He has over 26 years global and local experience in senior leadership positions in banking, capital markets and financial services. Currently serving as Managing Director of National Investment Trust Limited (NITL), Afridi is also a member of the SECP Policy Board. His expertise and governance have also led to being nominated on six public listed companies' boards that feature consistently amongst PSX top 20. Afridi regularly contributes to macro and sector advisory committees of the Government and State Bank of Pakistan.

BR Research recently sat down with Afridi and discussed matters surrounding the mutual fund industry, NIT, macroeconomic situation in the country, and the role of central bank, among other things. Following is an edited excerpt of the conversation.

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BR Research: How have things been at NIT since you took over?

Adnan Afridi: I took over NIT about three and a half years ago. And when I came in what I saw was not different to what you see in a lot of public sector organizations. Although I must emphasize that it is not a classic public sector organization. It has government shareholding of indirect and direct combined about 40 percent.

But it is supposed to be run as a private sector with its own board and so on. However, the culture wasvery much of a public sector organization with a legacy sort of staff, and very limited technology.

There were multiple years where we saw assets under management declining. The one thing that NIT had going for it was that there were no major scandals associated with it. There was no issue in terms of management of funds.

So, when I came in my first order of business was to invest in technology. We were far behind our peer group. Most people will not realize in 2019, we did not even have a call center. So, from there to now, not only do we have a call center, but we also have one of the best mobile applications in the business. We have a portal where you can invest disinvest, move your funds all from wherever you are. You never have to visit us.

We now offer a complete digital solution. Along with that, of course, we did some talent acquisition. No rocket science, but obviously just ran it with a professional private sector mindset and started getting involved in new products.

NIT back in its heydays in the 1960s was really known to be a market leader but had lost that at that age, so when I came in, we tried to go back to our roots.We developed the first exchange traded fund in Pakistan. We are also launching the country's first social impact fund, which will focus on the microfinance sector of Pakistan. We will be the first asset management company doing that.

We wanted to return to be the leader in our in our industry, so a combination of those things led to NIT gaining AM-1 ranking about 12 or 14 months ago. It is the highest management rating you can get in the asset management industry. Throughout its 60 years we had never achieved it, but we bought it for the first time and that summarizes or encapsulates everything that management can and be held accountable for. It includes performance of course, in terms of how well your funds are performing, governance, innovation and oversight.

So, all those things get encapsulated into a rating, which is done by private sector rating agencies and public sector like PACRA and both the private and the public sector rating agencies both have given us high ratings.

BRR: In terms of performance, as far as returns go, were you at par with the industry?

Adnan Afridi: It is interesting you ask that.Historically NIT has been largely an equity-based AMC, as we managed the largest equity fund in the market called NIUT, which represents more than 60 percent of the total universe. It was the flagship fund, and its performance historically has been excellent.

It has outperformed not only the peer group it has outperformed other asset classes as well. If you take a 20 year or a 15-year horizon, it beats benchmark index, it beats gold, it beats real estate, but people do not know about it.

Most of the industry over the last five years has actually not focused on equity. It has focused on fixed income, money market funds and income funds.

So, you would be surprised to know that in 2019 we did not have a money market fund. We put together a money market fund which has grown from nothing to now over Rs20 billion. And historically, over the last 24 months we are never too far outside the top five, sometimes we end in the top three.

Our government bond fund is in fact the largest in its category and last year was the number one performing. NIUT continues to be in the top five, but because it is a very large fund, you cannot really trade it very actively, therefore its performance cannot be really benchmarked against a very small fund which can be in and out of stocks.

But if you benchmark it against the index, we will always do quite well against it. It is more about communicating this more effectively to investors.

BRR: Do most of your funds remain invested at all times?

Adnan Afridi: Unlike a lot of other funds, NIT is invariably fully invested at all times. We are almost never sitting on cash.

BRR: Have we seen a reduction in number of unitholders and a change in redemption patterns during or post Covid?

Adnan Afridi: No, we have actually seen an increase, so we have seen an increase in our number of unit holders, and I think these digital initiatives that are taking place in the industry, have helped. In fact, what happened is that COVID we saw net inflows and the reason it was happening as that people were traveling and spending less. So, there was more savings, more disposable income, and therefore they were able to invest more in savings products, so banking deposits also went up.

But it is interesting that in this past quarter that has just ended, banking deposits have gone down significantly.

So, two things are happening. People are taking money out of bank deposits and putting it into money market funds, which is just competition. That is a good thing, but I think the other thing that has happened is that your cash in circulation has increased a lot, and that is a bad thing, and the reason for that, I think, is the dollar. When your rupee becomes so volatile people start putting money under your pillows. Just because you keep cash in your account, you are essentially losing value. So that trend is worrisome.

BRR: Is the economic situation in Pakistan as dire as some circles say it is?

Adnan Afridi: There is a dichotomy between the micro and the macro level. The economy or pockets of the economy are still quite strong as corporate profitability continues to be very robust, our domestic demand continues to be quite robust. Now there is a separate argument as to that leading to inflation.

BRR: Is that a problem?

Adnan Afridi: It is better to have domestic demand than not. The issue is at the macro level. The situation is difficult, more so because typically we have these boom bust cycles, but we have been fortunate that those cycles have always somehow been mitigated by exogenous positive shocks to Pakistan. Either we have received financial aid or oil prices have crashed.

This time it is the perfect storm. We have our own macro issues which have been aggravated by global shock. Our real pain point is stemming with the commodity super cycle which is oil as well as the other major commodities. If this sustains for significantly longer, then the situation could indeed be severe.

However, if this starts to taper off, then it is manageable. When I say it is manageable, there is a caveat, and that is where I will bring a general point for policymaking. Our policymaking is typically correct but untimely. We tend to take the right decisions, but we take them very lateand that is only when they are forced on you.

Everybody knows what needs to be done, but unfortunately our economic debate has also become very polarized, which is very unfortunate. We live in the real world. Political governments have political compulsions and that leads to these delays, but those have very real consequences on the economy.

BRR: You mentioned it could be severe if commodity prices sustain for a significantly longer time. How much is significant in your view?

Adnan Afridi: I do not want to put a hard number on it because, that is influenced by what else we do. I think we can do a lot more in a lot shorter period than we have done so far, on curbing imports, especially non-essential luxury imports.

BRR: Do we really have that much room on our imports that could make a meaningful dent to the total bill?

Adnan Afridi: Yes, I think those numbers do tend to add up. But it is not only about curbing imports, but it is also about curbing our domestic fiscal deficit. That is something certainly which is in our hands. If you have a large fiscal deficit that is going to then mirror on the other side in your foreign funding gap.

You know not much has been done on privatization. Your circular debt and these are all linked issues. Let us forget the PIA and the Steel Mills and those for one moment, we can start with power distribution companies. That has an immediate impact on your circular debt.

BRR: From a policy perspective, what in your view is the way that Pakistan could stop going back into that frequent boom bust cycle?

Adnan Afridi: We have some deep structural issues in our economy. We have an extremely narrow export base, whichhas to be diversified, that is not a short-term solution, but you have to start somewhere. Let me give you an example. I know that a lot of credit, and rightfully so, has been given to the State Bank for the TERF facility that was announced, but if you dig deeper, TERF has gone to the same narrow textile base.

Textiles form a very important part of our economy, but within textiles, the TERF went way to the low value-added spinning segment. We have essentially given a subsidy to low value-added segment. Now imagine that same subsidy had been given to a higher value segment within textiles. What would that do to our export potential?

BRR: But that is also the reality of where the textile industry stands and not by choice. Also, where exactly is Pakistan's export diversification potential?

Adnan Afridi: You have to go back in the value chain and ask where the seed technology is. Where is the investment in the crops? And it is linked to our agricultural policy. So those are again structural issues, so one is to do with our narrow export base.

The core expertise is ease of doing business, cost of doing business competitiveness, use of technology, and free trade. So, you just try and focus on removing all these all these barriers.

There is a tremendous export potential in IT. We are growing already at 40-50 percent. We are at about $2 billion right now. You reach an inflection point and then it is exponential growth. So certainly, you could see this $2 billion going to $10 billion in three years or so. The other one, is agriculture. Technology and agriculture are both areas where you do not need expensive imports to make your export products.

A large part of that value chain we are importing first, including textile. Your thread, your cotton, everything is getting imported. So, when your rupee depreciates, we get very happy that our exporters are going to gain, but your value add is so low you are getting hurt. So, you need to focus on those export sectors where you are not importing the inputs.

BRR: Does the business community not have enough interactions with the policymakers at that level, as these things do not get discussed as much as they deserve.

Adnan Afridi: Access has never been the issue. You must give credit to all governments that have come in, including the present one, that they are very proactive. Again, I will go back to structural issues.

I think business community in general as a mindset is very used to making money, sort of the easy way. What I mean by that is we have such a rent seeking culture because we are protected in a lot of ways, we can make money by selling in our own market.

We do not have to compete with the rest of the world to some extent. And we make enough money we do not aspire to really be globally competitive. Let us face it, which one of our businesses is globally competitive on its own? Very few, if any. Which one of our companies can be considered of a global size, not many, right?

We have this ceiling of $300 million. We are still suffering from the nationalization syndrome of 40 years.We now need to move on, why don't we have a billion-dollar company? Some of it has to do with our own mindset, which is the business community mindset.The other thing is that most of the time business community's dialogue with policymakers is not about strategy. It is not about policy. It is about very petty specific firefighting.

BRR: What is your view on policy rate going forward?

Adnan Afridi: The market seems to suggest that it still has room to grow. But what is a bit disconcerting to me is that the gap between the policy rate and the market rate is exceptionally large, and I think the State Bank of Pakistan should be playing a more proactive role. The market knows that the government cannot borrow from the State Bank. So, banks have become the lender of last resort. The commercial banks know that the government is desperate so it goes and buys at whatever rate it can.

Banks are getting funded at a lower rate, lending at a higher rate to the government, so it is great for the banks. Something is certainly wrong here, and better coordination is required between State Bank and Ministry of Finance.

We talk a lot about State Bank autonomy and so on, but I think autonomy does not mean that you cannot have some coordination, and this is a glaring example.

It is a fact that both the policymakers in Ministry of Finance and the State Bank have been busy with the IMF related discussions. But certainly, there is a debt office in place in the Ministry of Finance and certainly there are people in the State Bank would be looking at this, so there should not really be a reason that this keeps happening.

In the past, State Bank used to be less vocal and less visible. It was more of doing more and saying less, and in the recent past it has been the reverse. That allows people to read too much. The more you say, the more people can read into it or not.

I would say that when things are uncertain then perhaps it is best not to comment on something. I think forward guidance, of course is a very essential tool, but one has to be as circumspect as possible, unless you are absolutely certain.

BRR: Yes, and forward guidance should not change, 180 degrees twice in four months.

Adnan Afridi: That is true. And the reason it changed is because you made such a definitive statement in the light of uncertainty, and that is where the issue is. In my view, central banks in general should be less vocal and less visible because at the end of the day they are policymakers, and regulators.

So, what is a central bank? It has really two roles. It is the primary apex regulator of your banking sector, and it is also obviously looking after your monetary policy, price, stability, and so on. And in both those roles, it has to play a very guarded role. When it comes to making public statements, you have the Ministry of Finance. They are the ones who are responsible for the overall economy, and they have the right to, and they are the political representatives, and they have the right to make the statements.

BRR: Do you have a view on the kind of products the Central Bank launched, particularly for the overseas. Some circles have raised concerns on the rate of return on offer. How do you see that?

Adnan Afridi: Innovation is a good thing. I would commend the Central Bank for these initiatives, and I think it has been helpful. I would prefer not to comment on any specific rate, I am sure that there must be reasons for that.

I would say, however, on a broader point that product development should be left to the private sector. It should be the banks who should come up with products under the guidance of State Bank, which should be providing the framework. They should ensure that that regulatory framework is progressive, light in nature, incentivizes players to come in and compete and provide effective service to customers. But it should not be competing with banks by launching products.

BRR: Where do you see the PKR settling around?

Adnan Afridi: I could not hazard a guess on that, but I have a view on the currency which is that while I fully appreciate and acknowledge the need for a flexible exchange rate. I will draw a parallel here. Just like we said that State Bank autonomy does not preclude coordination. Just like that a flexible market-oriented exchange rate does not necessarily mean volatility.

The volatility should and could have been managed a lot better.

BRR: Would you rather have a flexible exchange regime or a managed one?

Adnan Afridi: We are in a flexible exchange regime with we do not have a choice otherwise, but within that I think I will focus on volatility. I think the volatility can be managed better because it hurts both importers and exporters. And more than that, it hurts your domestic investor.

When the rupee initially started depreciating about six months ago, it was common knowledge that a lot of this was happening because of the Afghan border. There was a lot of dollars flowing into the Afghan side. That was an administrative issue, and they should have had a more coordinated effort.

Another area of focus would be much closer and stricter discipline with the exporters for bringing their funds in on a timely basis. The incentives that we are giving to our remitters to bring money in, we can do even more there so that your official remittances go up.

These are things that, in the short term would have actually stabilized the exchange rate. I am certainly not advocating that we use up our reserves but doing the right things in a timely manner.

When this commodity cycle hit us, you could have intervened the way you do anyway from time to time, and the volatility would have been a fraction of what it has been today.

BRR: What is the outlook for the stock market?

Adnan Afridi: The challenge that PSX is facing is that the liquidity has been declining over a period of time. There are two reasons for that. One is a good reason, and one is a bad deal, but the good reason has been that overtime because of various requirements, PSX was at the forefront of tightening the regulations as to the type of money that could go into the system.

So, the regulations required when you open an account and so on, only completely documented funds can come into the sector. So that meant that the amount of liquidity compared to real estate where you have amnesty, would be less.

However, the second part, which is not the good part, is that a very important part of our market was foreign participation. We used to have foreign funds for it and that has almost dried to negligible.There is a country risk. It is again a function of our exchange rate. Investors are not going to come in and say they want to take an exposure on OGDC and then take an exposure on the rupee as well. That is just a bridge too far for them.

When I was CEO of the Stock Exchange, which is about 12 years ago, our average daily volume traded used to be about $200 million. Now it is less than $20 million, there is no price discovery. Not enough buyers or sellers in the market at any given time, so the outlook to the market is really all dependent on how we increase liquidity.

It can only be increased through two ways. One is you need to keep adding supply via IPOs. The other is that we need to encourage our domestic investors, whether it is institutional investors, insurance companies, banks not to be short term in their thinking and they need to allocate long term funds to the market, either directly or through mutual funds.

You need to start digital onboarding on retail level, you do not need to go and set up a branch in other cities and towns, you can reach people through their mobile phones. But for that you need some basic financial literacy tools.

BRR: Could you share a bit around your experience with the SECP as a board member?

Adnan Afridi: I am a member of the CCP Policy Board for the last four years. That has been quite an involved experience and a lot of reforms have also taken place at the CCP, one of which I think come meets the public eye, which is this inflow that we have seen in venture capital fund.

We worked on framing new VC regulations, and I was the principal author of that which would allow these funds to come in and operate freely.

And then also digitizing CCP itself has been a wonderful experience. That is also something that has happened in the last three years, so now everything is digital. In terms of our ease of doing business, we improved significantly over in the last couple of years.