

PAKISTAN



Pakistan Strategy

SBP continue with monetary tightening

Policy rate rises by 100bps to address higher inflation & CAD

The central bank has decided to increase the policy rate by 100bps to 9.75% with the aim to contain the inflationary pressures and ensures the sustainability of economic growth. State Bank of Pakistan continues with the monetary tightening cumulating into increase of 275bps since Sep'21 citing inflationary and balance of payment pressures given (1) higher import bill, (2) emerging signs of demand side pressures and (3) higher global and domestic oil/commodity prices.

Monetary policy setting to remain unchanged in the near term

The MPC noted that the recent data confirms the results of monetary policy for moderating inflation and CAD remains appropriate. Increase of 275bps since Sep'21 MPC and foreseeing economic outlook, in particular for inflation and current account, the MPC opine that the end goal of achieving mildly positive real interests on a forward looking basis was now close to being achieved. Looking ahead, the MPC expects monetary policy settings to remain broadly unchanged in the near term.

Pressure on Rs-US\$ should moderate

The MPS noted that the current account deficit is expected to be fully financed from external flows despite increase in SBP assumption for current account deficit from 2-3% to 4% of GDP. At the same time, foreign exchange reserves should remain at the adequate levels through the rest of this fiscal year and would start building up once global commodity prices ease and demand moderates.

Change in forward looking guidance to restore sentiment

From stock market perspective, the change in stance of central bank from faster adjustments to achieving goal of mildly positive real interest rates would restore investor confidence. However, this may prove to be short lived given expected fiscal tightening (mini budget) and the level of interest rates where they are likely to cause a reversal of flows to fixed-income instruments. Moreover, from valuation perspective the development is neutral as market has already priced in the rise in policy rate, in our view.

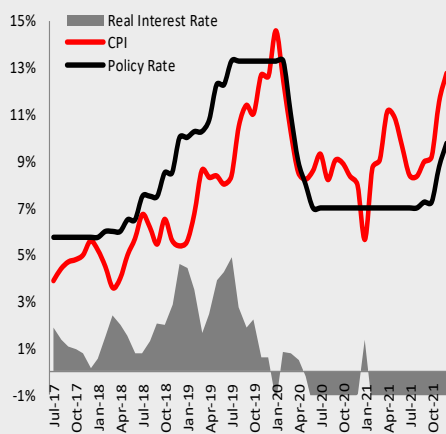
Sector specific impact suggests Banks would be a winner given improvement in NIMs, however the impact would be diluted by NPL formations. This will be non-event for Power while higher other income would be mildly positive for E&Ps. This will be majorly negative for cement and steel sector as ongoing expansionary bandwidth has highly leveraged their books (LT & ST) with more profound impacts on DGKC, PIOC and CHCC.

On the other hand, Fertilizer would also be partially impacted (particularly EFERT, FATIMA and FFBL given their leveraged balance sheet). For oil downstream (OMCs + refineries) it is negative (ex-APL) where circular debt continues to hamper PSO balance sheet. Consumer durables (autos + electronics) would have -ve implications on demand due to increasing consumer financing rate (+ve for INDU/PSMC other income). For textile it would be -ve, only if Gov't decides to revisit its stance on the ERF rates.

Outlook

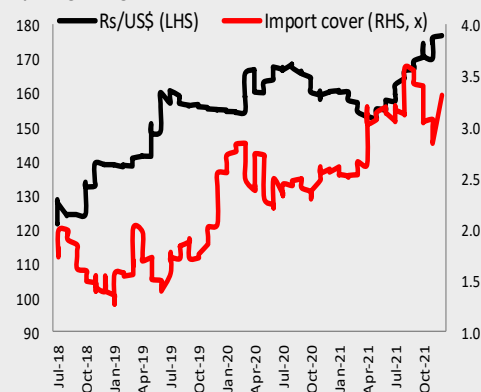
Future path of policy rate would be contingent upon controlling inflation and CAD. Therefore, we advise to go long on sectors that are beneficiary of (1) hike in interest rates and (2) least affected by fiscal consolidation. We have our liking for E&Ps, Banks, Fertilizers and Conglomerates while advice caution towards Cements, Auto and Steel. We prefer OGDC, PPL, HBL, UBL, PSO, MARI, LUCK, FFC, FFBL & APL.

Real Interest Rate is in negative territory



Source: SBP, PBS, Foundation Research, Dec 2021

Rupee against green back



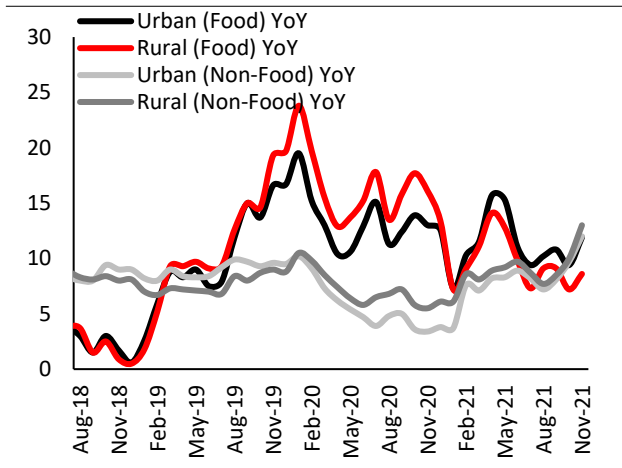
Source: SBP, Foundation Research, December 2021

Analyst

Foundation Research Research@fs.com.pk
+92 213 5612290 Ext 312

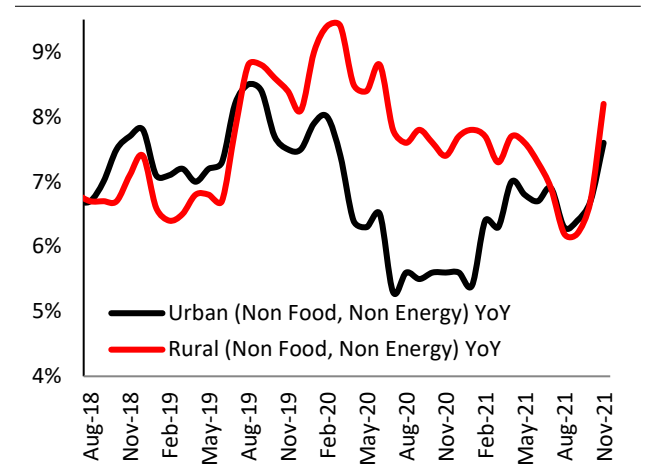
Foundation Securities (Pvt) Ltd
Tuesday, December 14, 2021

Fig 1: Food and non-food CPI on upwards trajectory ...



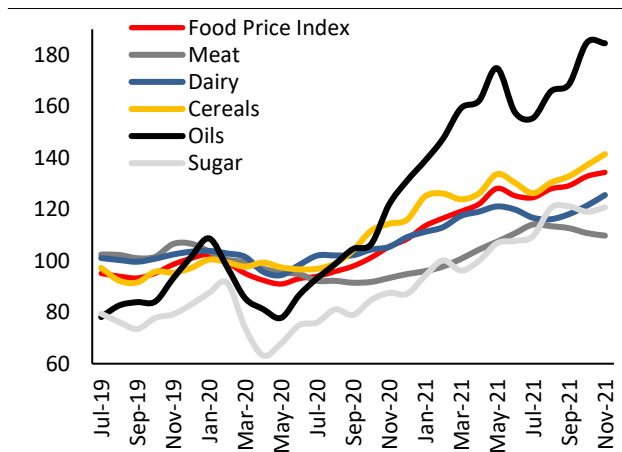
Source: PBS, Foundation Research, December 2021

Fig 2: Core inflation rebounding sharply...



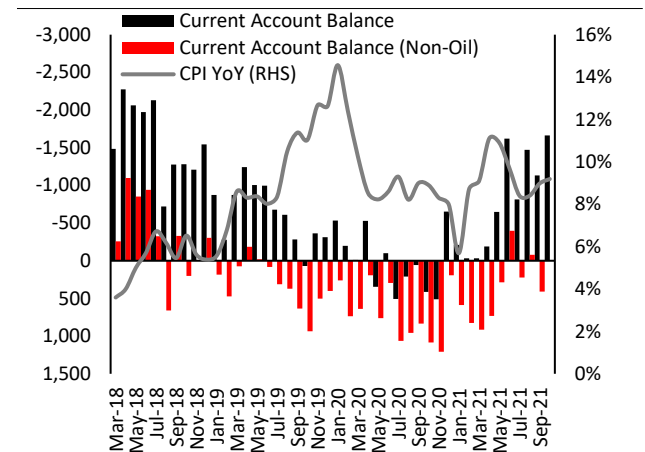
Source: PBS, Foundation Research, December 2021

Fig 3: Int'l food prices mostly going upwards...



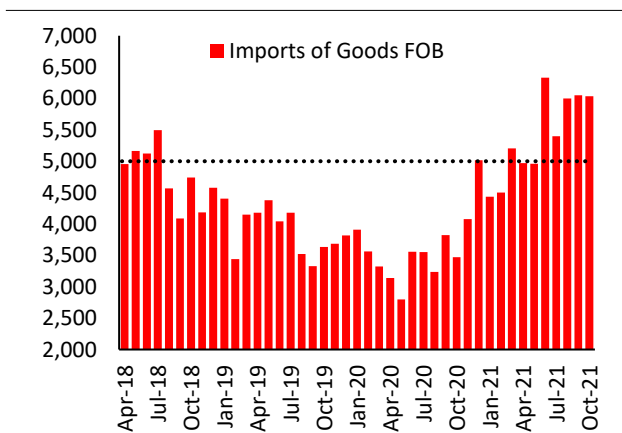
Source: FAO, Foundation Research, December 2021

Fig 4: Current account and CPI...



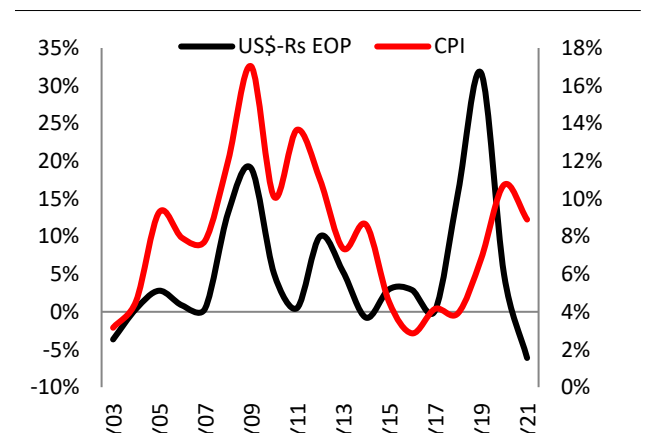
Source: SBP, PBS, Foundation Research, December 2021

Fig 5: Goods import rise above FY18 levels (US\$ bn)



Source: SBP, Foundation Research, December 2021

Fig 6: Exchange rate and inflation move in tandem



Source: Bloomberg, SBP, FSL Research, December 2021

Table 01: Cumulative impact of 275bps increase in policy rate since Sep'21 on companies profitability (Rs mn)

Company/Sector	Total Debt	Cash & ST investment	Impact Rs/sh	Comment
E&P				
Positive				
OGDC	-	152,803	0.76	Strong cash position to yields positive results
POL	-	53,120	4.01	Strong cash position to yields positive results
PPL	-	61,321	0.48	Strong cash position to yields positive results
MARI	374	43,354	6.91	Strong cash position to yields positive results
Banks				
Positive				
HBL	-	-	5.79	Uptick in interest rates to increase NII
UBL	-	-	5.39	Uptick in interest rates to increase NII
MCB	-	-	3.78	Uptick in interest rates to increase NII
MEBL	-	-	4.17	Uptick in interest rates to increase NII
BAFL	-	-	2.54	Uptick in interest rates to increase NII
AKBL	-	-	1.14	Uptick in interest rates to increase NII
FABL	-	-	2.01	Uptick in interest rates to increase NII
Fertilizer				
Neutral				
ENGRO	50,468	113,262	2.34	Includes ENGRO standalone, EFERT and EPCL debt
FATIMA	13,915	2,539	(0.10)	Profitability to further reduce in case of concessionary GIDC payment
FFBL	35,604	20,543	(0.21)	Debt adjusted for FFBL Power Supply to KEL
FFC	70,018	87,392	0.37	Strong cash position to yields positive results
EFERT	19,744	11,894	(0.11)	Increased working WCC to hurt trading business profitability
Steel				
Negative				
ISL	11,793	220	(0.48)	Working capital cost to increase
ASTL	18,867	215	(1.12)	Working capital cost to increase
ASL	18,363	2,287	(0.38)	Working capital cost to increase
MUGHAL	24,109	2,809	(1.13)	Working capital cost to increase
AGHA	18,362	516	(0.53)	Working capital cost to increase
INIL	26,091	636	(3.45)	Working capital cost to increase
Cements				
Negative				
LUCK	27,896	26,888	(0.06)	Higher cash availability and Income from investments to reduce the impact
GWLC	2,330	881	(0.06)	New expansion to further hurt profitability due to higher interest rates
KOHC	7,628	5,334	(0.20)	New expansion to further hurt profitability due to higher interest rates
BWCL	15,829	1,942	(0.42)	New expansion to further hurt profitability due to higher interest rates
ACPL	7,590	2,111	(0.71)	New expansion to further hurt profitability due to higher interest rates
FCCL	1,179	6,449	0.08	Strong cash position to yields positive results
POWER	29,959	245	(0.50)	Negative impact due to higher leverage
FLYNG	6,005	56	(0.27)	Negative impact due to higher leverage
MLCF	18,318	684	(0.29)	New expansion to further hurt profitability due to higher interest rates
DGKC	49,498	312	(2.01)	Negative impact due to higher leverage
PIOC	27,035	1,339	(2.02)	Negative impact due to higher leverage
CHCC	16,080	632	(1.42)	New expansion to further hurt profitability due to higher interest rates
Refinery				
Negative				
ATRL	9,400	9,285	(0.02)	Lower impact given strong cash position and reliance on local crude oil
NRL	31,281	608	(6.86)	Would increase finance cost due to high leverage
PRL	11,131	274	(0.31)	Would increase finance cost due to high leverage
BYCO	43,073	1,065	(0.14)	Would increase finance cost due to high leverage
Autos				
Positive				
HCAR	2,448	25,089	3.40	Impact would be diluted by decline in auto financing
PSMC	2,028	31,396	7.65	Earnings to increase due to strong cash position
AGTL	-	2,619	0.97	Earnings to increase due to strong cash position
MTL	254	4,477	1.35	Earnings to increase due to strong cash position
INDU	873	107,484	29.09	Earnings to increase due to strong cash position

Source: Company Accounts, Foundation Research, December 2021

Table 01: Impact of 275bps on companies profitability (Rs mn)

Company/Sector	Total Debt	Cash & ST investment	Impact Rs/sh	Comment
OMCs			Negative	
APL	6,858	10,536	0.79	Net positive impact due to higher cash position
PSO	93,182	44,461	(1.86)	Would increase finance cost due to high leverage
SHEL	7,467	2,442	(0.42)	Working capital cost to increase
HTL	1,349	682	(0.09)	Working capital cost to increase
HASCOL	47,256	3,178	(0.79)	Would increase finance cost due to high leverage
Chemical			Negative	
EPCL	17,889	5,206	(0.25)	Would increase finance cost due to high leverage
LOTCHEM	1,748	15,924	0.20	Earnings to increase due to strong cash position
ICI	12,754	241	(2.42)	Working capital cost to increase
FMCG			Negative	
FCEPL	6,184	3,327	(0.07)	Working capital cost to increase
MFL	7,283	126	(1.05)	Working capital cost to increase
FFL	14,127	261	(0.31)	Working capital cost to increase
ASC	1,718	75	(0.10)	Working capital cost to increase
TOMCL	828	164	(0.10)	Working capital cost to increase
PREMA	913	187	(0.07)	Working capital cost to increase
UNITY	17,769	9,898	(0.14)	Working capital cost to increase
Cable & Electrical Goods			Negative	
PAEL	19,003	589	(0.66)	Take toll of reduction in consumer financing
PCAL	4,278	120	(2.09)	Take toll of reduction in consumer financing
WAVES	6,090	125	(0.38)	Working capital cost to increase
Technology			Neutral	
SYS	580	5,980	0.84	Earnings to increase due to strong cash position
AVN	539	1,315	0.06	Earnings to increase due to net cash position
NETSOL	242	3,450	0.77	Earnings to increase due to net cash position
TPLT	3,198	239	(0.28)	Working capital cost to increase
AIRLINK	6,906	2,326	(0.21)	Working capital cost to increase
HUMNL	744	438	(0.01)	Working capital cost to increase

Source: Company Accounts, Foundation Research, December 2021

Abbreviations

bbl	barrel
Bn	billion
bps	basis points
CAD	Current Account Deficit
CPI	Consumer Price Index
DR	Discount Rate
MPC	Monetary Policy Committee
MPS	Monetary Policy Statement
MTB	Market Treasury Bill
PIB	Pakistan Investment Bond
RIR	Real Interest Rate
SBP	State Bank of Pakistan
SPLY	Same Period Last Year
YoY	Year on Year

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