

**PAKISTAN**



# Pakistan Strategy

## Tariff adjustments paving way for IMF

### Energy price hike to meet IMF conditionality would reopen funding channels

In a positive development, NEPRA has notified increase of Rs7.91 per unit in electricity prices from July 2022 and further increase of Rs30 per liter in petrol and diesel prices. We believe these steps along with (1) further expected increase of Rs9.32/23.05/liter in MS/HSD prices to fully remove subsidy, (2) anticipated 30% increase in gas prices and (3) FY23 budget as per IMF demands would enable Gov't to meet the conditionality for IMF 7th review. This would result in the release of ~US\$1.0bn tranche from IMF, enable rollovers by bilateral creditors and new lending from multilateral creditors which along with a combination of bond issuances, FDI and portfolio inflows would allow Pakistan to meet its FY23 external financing needs, replenish forex reserves and restore Rs-US\$ parity to 185-190.

### Inflation to remain elevated in FY23

Energy price increase and elevated food inflation tracking higher international food prices amid supply chain disruptions coupled with sharp Rupee depreciation of 10.7/20.0% during CY22TD/FY22TD would keep inflation on the higher side. Thus, we have revised our FY23 average inflation forecast. Along with the announced increase in electricity tariff (1) if all the fuel subsidy is removed, FY23 inflation would be 14.2%, (2) if PDL/GST is also charged on fuel, FY23 inflation would be 15.1% and (3) if gas prices are also increased then FY23 inflation would be 15.3%, our base case. To highlight, if Gov't enhances subsidy in budget to protect users at lower end, it would lower the inflation trajectory.

### Final hike of monetary tightening cycle expected in July

Premised on the higher inflation trajectory, we expect a 50bps hike in the policy rate by the central bank next month which would take the policy rate to 14.25%.

### Effective increase in electricity tariff lower than Rs7.91

Gov't has notified increase in electricity prices of Rs7.91/unit to pass on the increase in capacity payments, US\$ indexation and fuel charges adjustment (FCA). However, companies are already paying an average FCA of ~Rs3.3/unit over the last 10 months. Therefore we believe that the actual increase in electricity tariff would be Rs4.61/unit.

### Cement and Steel companies to bear the brunt

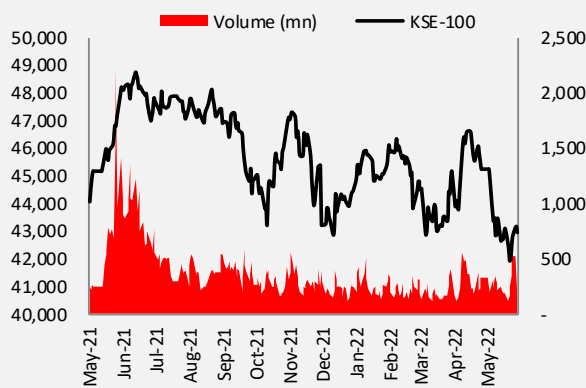
The cost of generating electricity from coal, furnace oil, RLNG and HSD is higher than the increased grid electricity rates (see Fig 8 below), as per our calculations. Only cost of generating electricity from system gas, both for local and exports, and RLNG provided to export orientated sectors is cheaper than grid electricity rate. Thus, we believe it would be more profitable for most companies to switch to grid electricity.

FSL steel and cement universe profitability is expected to further come under pressure given increase in base tariff as it would be difficult for companies to pass on the impact of hike in tariff to the consumers given slowdown in economic activity. In steel sector long steel manufacturers would be affected more due to higher energy requirement and significant reliance on national grid.

### Advise to remain in Defensive

We look for stock that are beneficiary of currency depreciation, import substitution and elevated commodity prices while immune to higher interest rates. We advise to remain in Banks, E&P, Fertilizer, OMCs and Textile while advice caution on construction and consumer stocks. We are 'Under Weight' on Technology as we expect multiple to re-adjust according to sectors earning growth.

Historical performance of KSE-100 Index



Source: PSX, Foundation Research, June 2022

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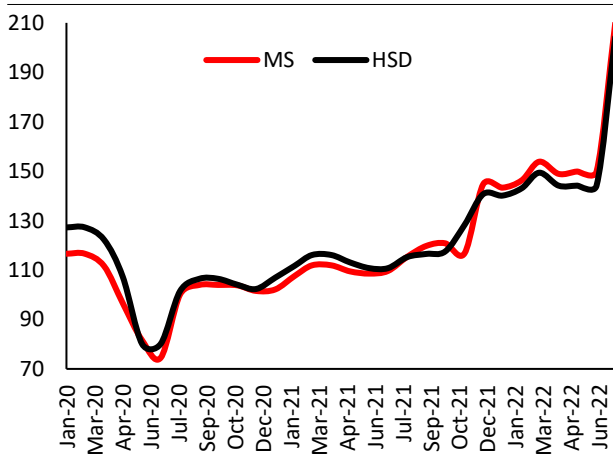
Foundation Securities (Pvt) Ltd.  
Friday, June 3, 2022

**Table 1: Impact of hike in electricity prices**

Sector/Stock	Power tariff hike Impact	Captive Power Impact Severity	Neutralizing factor
<b>More Sensitive</b>			
<b>Economy</b>			
Inflation	Negative	High	na
Fiscal	Positive	High	na
<b>Moderate Sensitive</b>			
<b>Cement</b>			
LUCK	(2.2)	Low	Rs8/bag increase in cement bag price
DGKC	(1.4)	High	Rs12/bag increase in cement bag price
KOHC	(2.6)	Low	Rs13/bag increase in cement bag price
CHCC	(2.0)	High	Rs11/bag increase in cement bag price
FCCL	(0.6)	Low	Rs23/bag increase in cement bag price
ACPL	(3.2)	High	Rs22/bag increase in cement bag price
PIOC	(1.0)	Low	Rs7/bag increase in cement bag price
<b>Steel</b>			
ISL	(0.4)	Low	Rs673 per ton increase in price
ASTL	(2.6)	High	Rs3,929 per ton of rebar
MUGHAL	(2.3)	High	Rs4,037 per ton of rebar
AGHA	(0.5)	Low	Rs2,960 per ton of rebar
ASL	(0.2)	Low	Rs673 per ton increase in price

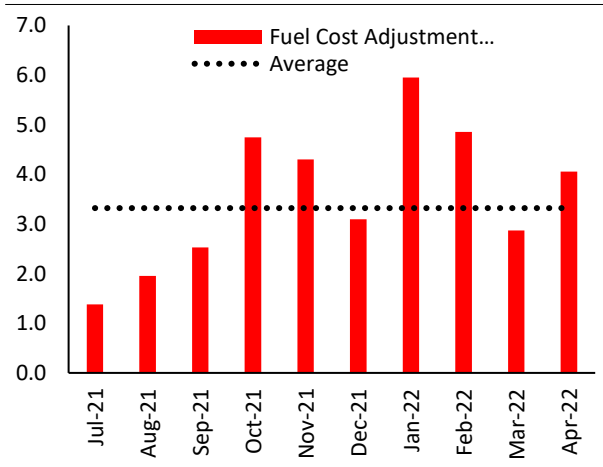
Source: Foundation Research, June 2022

**Fig 1: MS/HSD prices rose on removal of subsidies**



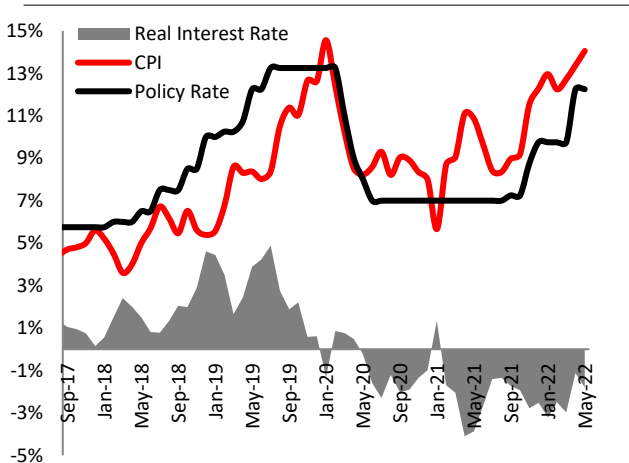
Source: OGRA, FSL Research, June 2022

**Fig 2: Fuel cost adjustment remained high over last yr**



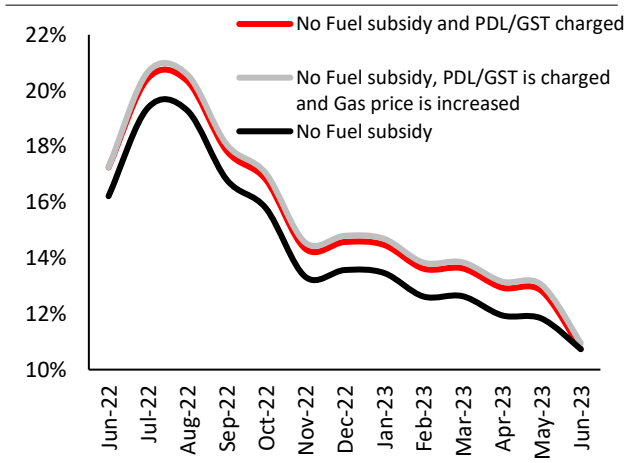
Source: SBP, PBS, FSL Research, June 2022

**Fig 3: -ve RIR recently as CPI exceeded Policy Rate**



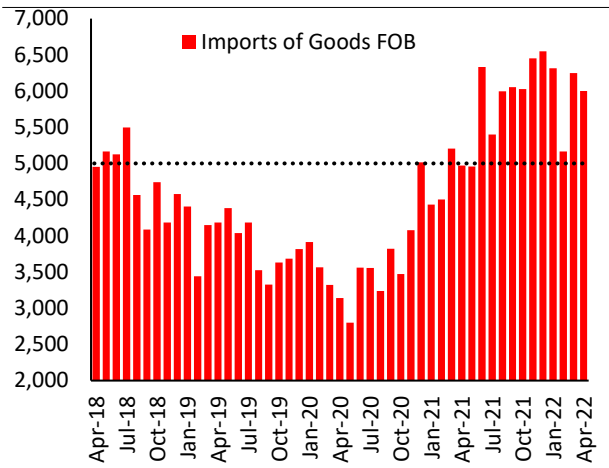
Source: PBS, SBP, FSL Research, June 2022

**Fig 4: CPI forecast in various subsidy scenarios**



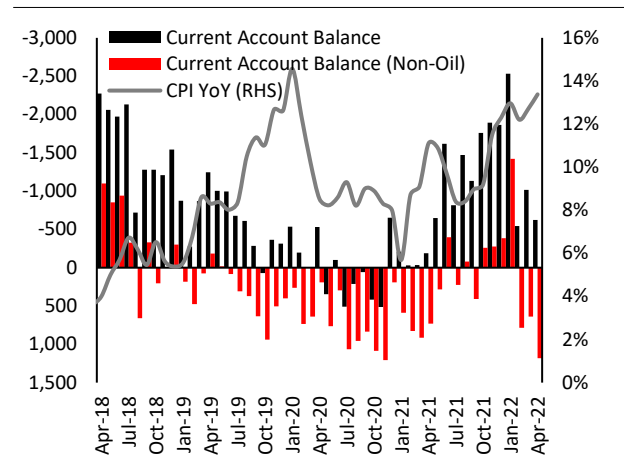
Source: PBS, FSL Research, June 2022

Fig 5: Goods import remain elevated (US\$ bn)



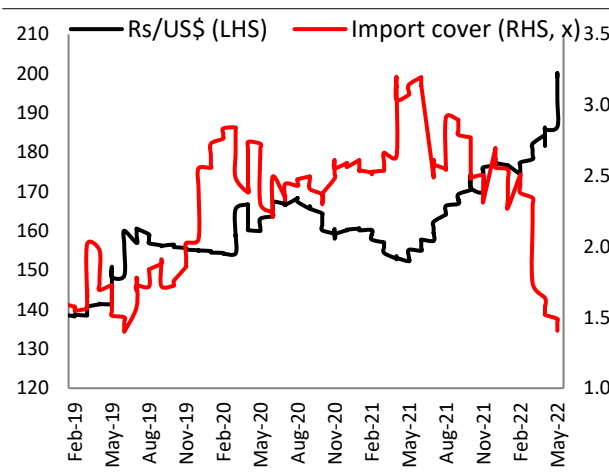
Source: PBS, FSL Research, June 2022

Fig 6: CAD showed marked decline since Feb'22



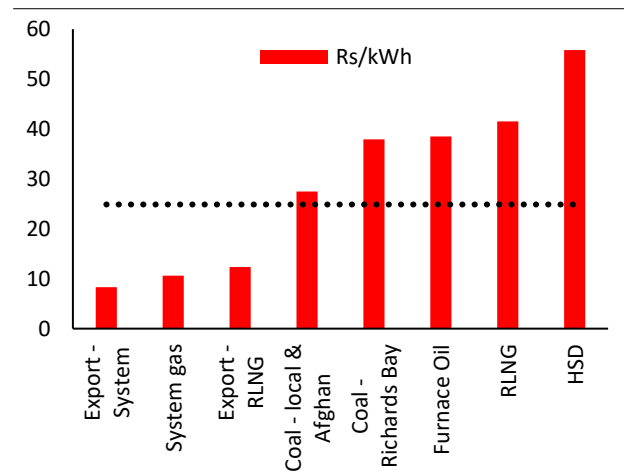
Source: PBS, FSL Research, June 2022

Fig 7: Rs-US\$ has fallen as SBP FX reserves declined



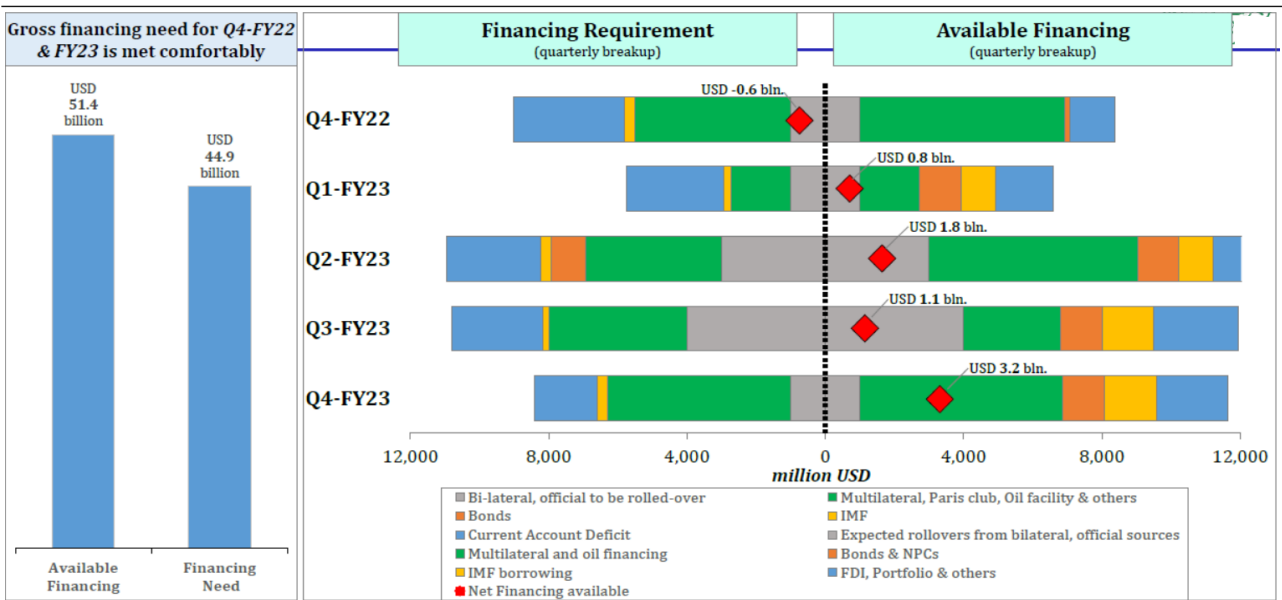
Source: Bloomberg, OGRA, FSL Research, June 2022

Fig 8: Cost of generating electricity from various fuels



Source: Bloomberg, OGRA, FSL Research, June 2022

Fig 9: Pakistan in a comfortable position to meet its external financing requirements if IMF program resumes



Source: SBP, Foundation Research, June 2022

**Abbreviations**

FX	Foreign Exchange
MoM	Month on Month
YoY	Year on Year

**Important disclosures:**

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**Recommendations definitions**

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