Foundation Securities
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PAKISTAN **July 7, 2022**

Foundation Alert

Governor SBP meeting takeaways

Event

- Governor of State Bank of Pakistan (SBP) held a meeting with the investment community today to discuss the Monetary Policy Statement. The Governor also shed light on events that resulted in MPC to go for interest rate hike. Following are the key takeaways of the briefing.

Impact

- Monetary Policy Committee (MPC) in its meeting held on July 7'2022 decided to increase the policy rate by 125bps to 15.0% to control higher inflation amid lower tradeoff between growth and inflation for Pakistan.
- In addition, the interest rates on EFS and LTFF loans are also being raised to 10%. Both these rates will now be linked with policy rate by keeping these rates currently 5% below Policy Rate. This will strengthen monetary policy transmission.
- The Governor said in actual we have tighten monetary policy by 175 bps which is more than the actual policy rate increase as EFF and LTFF forms 16% of the private sector credit.
- These measures should help to cool economic activity, prevent a de-anchoring of inflation expectations with stability to Rupee in the wake of multiyear high inflation and imports.
- On IMF program, Governor said hard part of IMF has been done and we are now closer to the completion of review. Government has withdrawn unsustainable energy subsidy package which has paved the way for the IMF program. Resumption of IMF program will ensure that tail risk with meeting Pakistan's external financing needs are averted.
- At the moment, Pakistan is facing large negative income shock due to high inflation and necessary increase in utility prices. Without aggressive and decisive policy measures this could create price and financial instability and compromise growth.
- SBP expects average inflation to remain in the range of 18% to 20% for FY23 before start coming down to a range of 5-7% by the end of FY24.
- Governor said, SBP expects growth to moderate towards 3-4% range in FY23 due to monetary tightening and fiscal consolidation. This will help to close the positive output gap and diminish demand side pressures on inflation.
- Lack of additional measures such as early closure of markets, reduced electricity usage, encouragement of work from home culture and carpooling could make it challenging to control trade deficit.
- Current Account Deficit level of 3% is reasonable assuming resumption of IMF program under current circumstances.
- The new taxes should be progressive and their burden mainly be observed by the relatively better off and food inflation should be curbed through supply side measures aimed at boosting output and resolving supply chain issues.

Outlook

- Resumption of IMF program would catalyze important additional funding from external sources that would attenuate pressure on Rupee and helps to build forex reserves, in our view. This along with prudent monetary tightening and fiscal consolidation would help in restoring macroeconomic stability. Thus, for the time being we recommend to remain in defensive sectors.

Table 1: Impact of 125bps hike in policy rate on company profitability

Company/Sector	Total Debt	Cash & ST investment	Impact	Comment/Outlook
E&P			**Positive**	
OGDC	-	188,434	0.43	Strong cash position to yields positive results
POL	-	56,068	1.93	Strong cash position to yields positive results
PPL	-	52,279	0.19	Strong cash position to yields positive results
MARI	-	31,372	2.29	Strong cash position to yields positive results
Banks			**Positive**	
HBL	-	-	0.88	Uptick in interest rates to increase NII
UBL	-	-	1.50	Uptick in interest rates to increase NII
MCB	-	-	2.27	Uptick in interest rates to increase NII
MEBL	-	-	2.12	Aggressive lending may increase NPL
BAFL	-	-	0.99	Aggressive lending may increase NPL
AKBL	-	-	0.54	Uptick in interest rates to increase NII
FABL	-	-	0.88	Aggressive lending may increase NPL
Fertilizer			**Neutral**	
ENGRO	186,266	138,304	(0.72)	Includes ENGRO standalone, EFERT, Engro Enfrashare and EPCL debt
FATIMA	12,356	6,221	(0.03)	Profitability to further reduce in case of concessionary GIDC payment
FFBL	57,718	32,390	(0.17)	Debt adjusted for FFBL Power Supply to KEL
FFC	54,277	87,123	0.25	Strong cash position to yield positive results
EFERT	13,164	16,063	0.02	Increased working capital to hurt trading business profitability
Steel			**Negative**	
ISL	10,868	327	(0.21)	Elevated interest rates hit steel sector demand
ASTL	19,538	267	(0.56)	Elevated interest rates hit steel sector demand
ASL	15,448	952	(0.14)	Elevated interest rates hit steel sector demand
MUGHAL	27,556	2,077	(0.65)	Elevated interest rates hit steel sector demand
AGHA	21,908	210	(0.31)	Elevated interest rates hit steel sector demand
Cements			**Negative**	
LUCK	22,943	34,705	0.35	Higher cash availability and Income from investments to reduce the impact
KOHC	4,982	9,598	0.22	Strong cash position to yield positive results
BWCL	21,885	2,626	(0.28)	New expasnion to further hurt profitability due to higher interest rates
ACPL	10,437	1,630	(0.55)	New expansion to further hurt profitability due to higher interest rates
FCCL	3,534	7,604	0.03	Strong cash position to yield positive results
POWER	26,913	225	(0.22)	Negative impact due to higher leverage
MLCF	22,355	827	(0.17)	New expasnion to further hurt profitability due to higher interest rates
DGKC	42,325	12,348	(0.59)	Negative impact due to higher leverage
PIOC	24,847	1,445	(0.89)	Negative impact due to higher leverage
CHCC	15,233	125	(0.67)	New expasnion to further hurt profitability due to higher interest rates
Refinery			**Negative**	
ATRL	9,202	10,948	0.16	Lower impact given strong cash position and reliance on local crude oil
NRL	36,993	1,193	(3.86)	Would increase finance cost due to high leverage
PRL	20,625	10,946	(0.13)	Would increase finance cost due to high leverage
BYCO	42,025	1,065	(0.07)	Would increase finance cost due to high leverage
Autos			**Positive**	
HCAR	2,831	17,687	1.01	Autos demand to be hit by higher policy rate
PSMC	1,753	20,548	2.23	Autos demand to be hit by higher policy rate
MTL	4,115	1,033	(0.27)	Demand to be hit by higher policy rate
INDU	686	130,836	16.14	Autos demand to be hit by higher policy rate

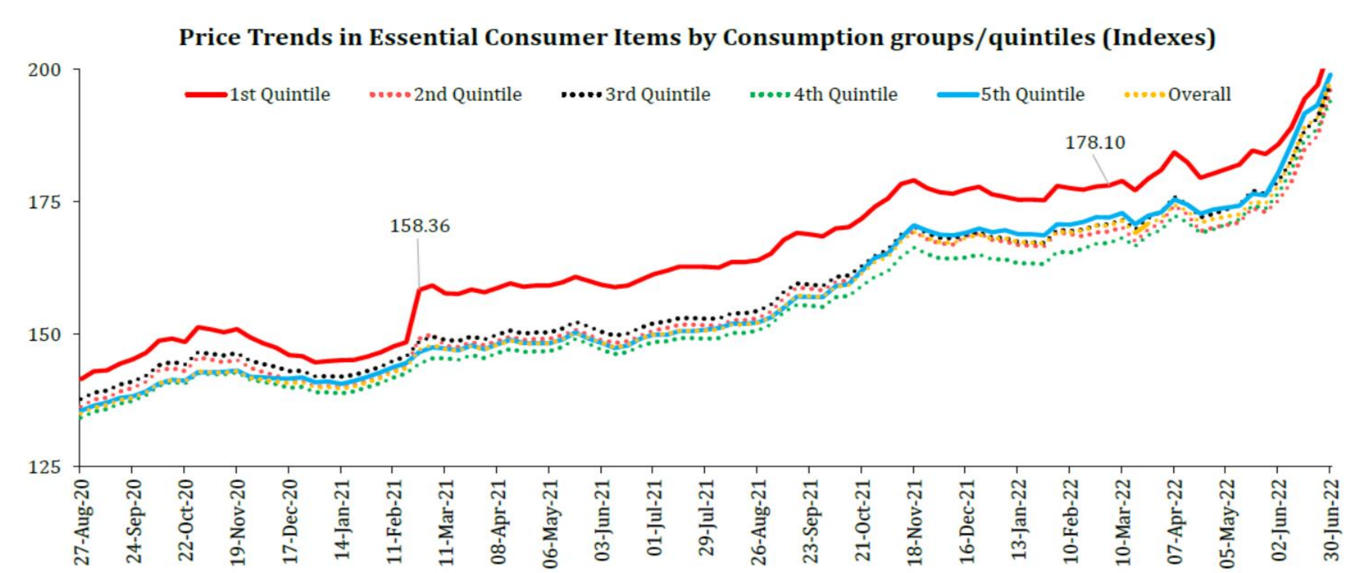
Source: Company Accounts, Foundation Research, July 2022

…continued Table 1: Impact of 125bps hike in policy rate on company profitability

Company/Sector	Total Debt	Cash & ST investment	Impact	Comment/Outlook
OMCs			**Negative**	
APL	4,014	2,278	(0.15)	Working capital cost to increase
PSO	187,055	18,203	(3.10)	Would increase finance cost due to high leverage
SHEL	-	2,077	0.09	-
HTL	2,755	599	(0.13)	Working capital cost to increase
Chemical			**Neutral**	
EPCL	20,836	19,686	(0.01)	Slowdown in construction could affect sales
LOTCHEM	-	15,771	0.10	Earnings to increase due to strong cash position
ICI	13,654	246	(1.25)	Working capital cost to increase
FMCG			**Negative**	
FCEPL	5,625	357	(0.06)	Consumer may switch to non-branded products
MFL	7,573	536	(0.50)	Working capital cost to increase
FFL	8,034	1,447	(0.04)	Consumer may switch to non-branded products
Textile			**Negative**	
NML	53,143	1,840	(1.26)	High leverage to increase finance cost
ILP	50,370	788	(0.48)	High leverage to increase finance cost
Cable & Electrical Goods			**Negative**	
PAEL	21,032	679	(0.21)	Consumer disposable income to be hit affecting demand
PCAL	4,887	94	(1.16)	Elevated interest rates hit construction sector demand
WAVES	6,360	125	(0.19)	Working capital cost to increase
Technology			**Positive**	
SYS	2,802	7,358	0.16	Earnings to increase due to strong cash position
AVN	1,247	739	(0.01)	Working capital cost to increase
NETSOL	1,738	4,343	0.28	Earnings to increase due to strong cash position
TELE	1,083	179	(0.02)	Working capital cost to increase
TPLT	2,075	174	(0.09)	Working capital cost to increase
AIRLINK	5,375	1,608	(0.08)	Working capital cost to increase
HUMNL	564	1,330	0.01	Advertising revenue to be hit due to economic slowdown

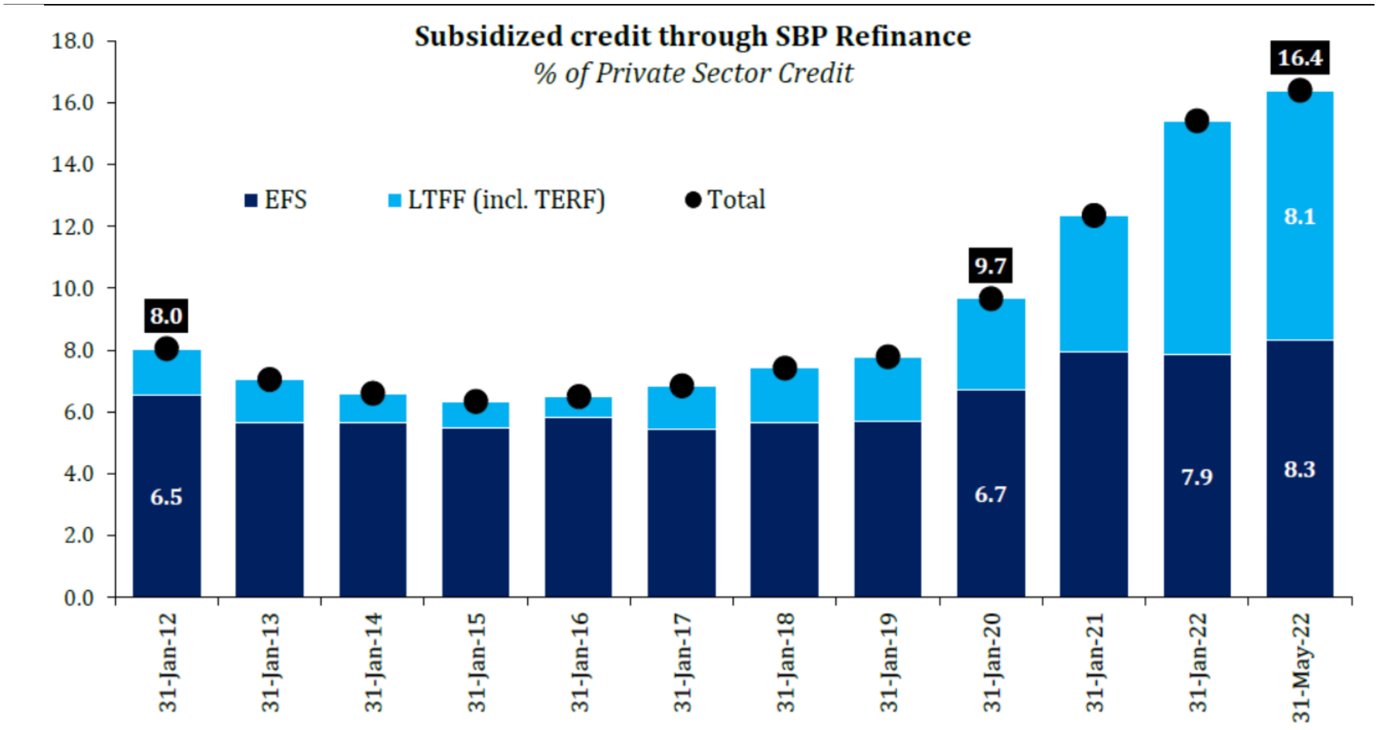
Source: Company Accounts, Foundation Research, July 2022

Fig 1: Lower quintiles are generally experiencing higher inflation



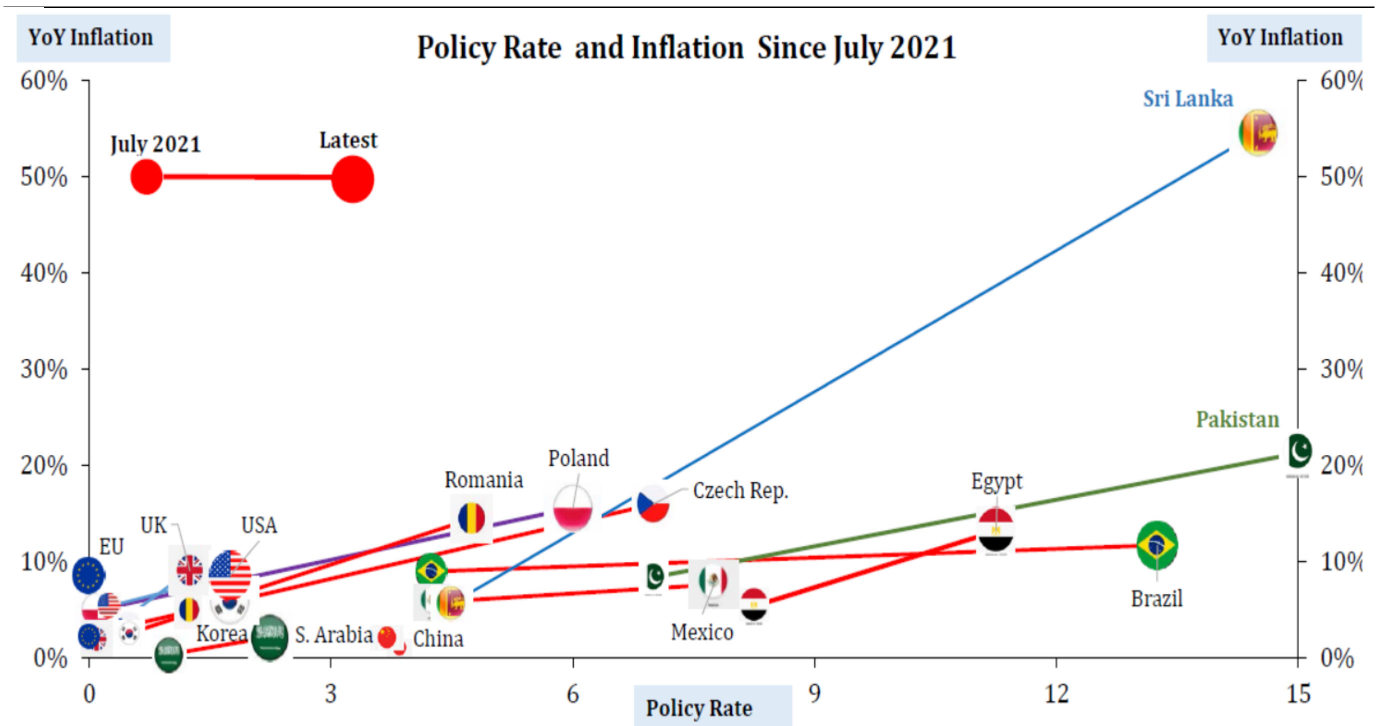
Source: SBP, Foundation Research, July 2022

Fig 2: Share of Refinance amount in total private sector credit has been less than 10%; though increased recently



Source: SBP, Foundation Research, July 2022

Fig 3: Pakistan is ahead of the curve and has responded early to inflation pressures compared to most countries in the world



Source: SBP, Foundation Research, July 2022

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Recommendations definitions

If

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