December 29, 2020

REP-019

MARKET VISTA

PAKISTAN STRATEGY

Much needed ‘tabdeeli’ for policy making in 2020

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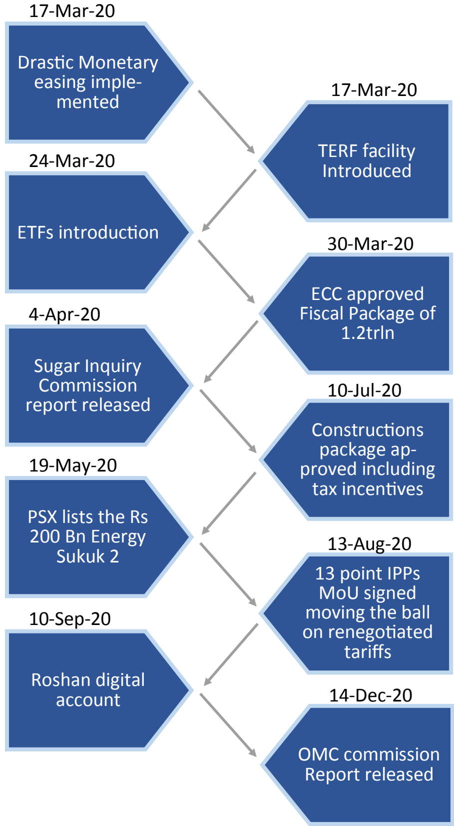
- **Regulatory and public policy process quickened pace under the PTI-led GoP’s second full year as the COVID pandemic dominated headlines with measures to address the same remaining prominent. In this note, we recap major investor market reforms launched during 2020, while commenting on sectoral initiatives undertaken and key appointments underpinning a proactive year for reforms in the country (table on next page).**
- **Despite the absence of major legislative endeavors (apart from FATF mandated AML legislation), we highlight the role played by inquiry commission reports probing the workings of three major sectors, namely Sugar, Power/IPPs and downstream Oil where the traditional process of policy making was side-stepped for a relatively unbiased and holistic overview of respective sectors with observations made public.**
- **Heading into 2021, with the Senate elections right around the corner and armed with recommendations of inquiry commissions, the PTI-led Govt looks poised to extend its majority to the Upper House, where we await a roadmap for legislative initiatives to be undertaken, likely to foreshadow a comprehensive overhaul of regulations.**
- **On a qualitative note, the tilt to improved information sharing, quantitative guidance and forward looking statements is evident in the improved quality of publications released by state organs, entities and regulators (SBPs State of the Economy, NEPRAs State of the Industry, to name a few). For market participants and analysts informing the same, this is a much-welcomed move to curb information asymmetries and improving the quality of forecasts over the long term.**

Doing well for the market: Continuing on the path of consolidating the regulatory infrastructure, appointments to major market and financial regulators i.e. SBP, SECP & PSX continued during the year. Despite the unruly year and in the midst of uncertainty, the Govt. approved appointments of senior personnel, with two themes remaining prominent, namely: 1) individuals with academic backgrounds included in senior policy and decision making, while the majority of appointments remained industry stalwarts and 2) supporting top-level appointments (mostly made last year) with competent deputy and director level postings, where the same was prominently on display at the SBP (appointment of Ms. Kamil, Dr. Syed as DG) and SECP (Policy Board Chairman and Commissioners appointed). While some of these appointments remained unconventional (absence of academics from SBP DG post in last two decades at least), they remained effective, with the launch and subsequent success of Roshan Digital Accounts initiative has proven to be a robust litmus test for this overhauled regulatory regime. Additionally, in terms of the independently run PSX, a new CEO was appointed during the year while the SECP also enacted the most sweeping reforms to the Securities Brokerage Licensing Regulations, bifurcating capital requirements based on three major categories for brokers. Additionally, the PSX also brought to fruition four new ETFs during the year, where accompanying reforms to trading mechanisms were front and center (raising of intra-day market cap and index halt implementation, min lot sizes).

Banks: COVID-19 prompted extraordinary response from the Central Bank with focus to stimulate economy as well as to guard banking industry against macro headwinds. In this regard, major macro level policy changes include, i) c. cut of 625bps in interest rates (that kindled repricing gains for the banking sector resulting in NII +22.5%YoY during 9MCY20), ii) decreasing Floor to 100bps below policy rate from 150bps previously to establish Interest Rate Corridor (IRC) symmetrical around the policy rate (MCB and BOP most impact due to +50% share of SA in the deposit mix), iii) introduction of various subsidized schemes for financing notably TERF under which PkR263.8bn has already been approved and setting banks to direct 5% of private sector lending to housing and construction sectors, and iv) introduction of risk-sharing mechanism on SME loans. On structural side, SBP exempted loans that are rescheduled/ restructured within 180days from classification requirement and permitted principal deferral that resulted in muted impact from problem segments during the year (NPLs increased 2.1%CYTD vs. 3.3% in CY19).

Major Policy Events/Interventions in 2020



Source: News Reports & AKD Research

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Moreover, the Central Bank lowered CCB requirement to 1.5% from 2.5% previously while placing a 2Q moratorium of dividend payouts that enhanced risk absorption ability of the sector.

Cement: After a tough FY20 where margins of our universe stood at 5.3% against 22% in FY19, federal government in FY21 budget decreased FED on cement bags from PkR100/bag to PkR75/bag. Govt. in 4QFY21 also announced a construction sector package where various relaxations are being provided to construction sector in order to spur activity in the economy and results are already visible with local cement demand increasing by 18.7%YoY for 1QFY21. Progress was also witnessed on government's flagship project, Naya Pakistan Housing Scheme through which government plans to provide 5 million affordable houses. However, the most major regulatory action was Competition Commission of Pakistan (CCP) initiating an inquiry against increase in cement prices during 4QFY20 where initial enquiry report has recommended action against cement manufacturers.

OMC: After witnessing a disastrous 4QFY20 where volatile oil prices drove profitability deep into red for the OMC sector, number of regulatory changes were introduced including a shift away from monthly pricing towards fortnightly pricing in a bid to reduce exposure to oil price volatility while exchange gains/losses are also being incorporated in the pricing formula. However, the most significant event from a regulatory perspective was release of report of an inquiry commission which was investigating the oil crisis during Jun'20. The commission recommended a number of actions including suspension of provisional marketing licenses, closure of illegal retail outlets and PSO being compensated for the loss made while selling product during Jun'20.

Regulatory developments 2020

Sector	Regulatory Action	Impact
Market	Launch of Roshan Digital Account initiative to mobilize expatriate savings in an integrated portal	Positive
	Curbs imposed on NSS scheme investment by corporates	Positive
	Gradual rise in intraday circuit breaker for individual stocks from 5% to 7.5%	Positive
	Index halt regime affirmed and pegged to KSE-30 index moves	Positive
	Launch of four ETFs during the year	Positive
	Major overhaul of Securities Brokerage Licensing regulations categorizing based on settlement, clearance obligations	Positive
	Guidelines drafted to implement FATF mandated upgrade to AML regulations	Positive
Banks	Reduction of Capital Conservation Buffer (CCB) to 1.5% from 2.5%	Positive
	Rescheduling/Restructuring criteria relaxed till 31st March 2021	Positive
	Borrowing limits increased and deferral of principal payments	Positive
	Setting banks to direct 5% of private sector lending to housing and construction sector	Neutral
	Margin call requirement against bank financing reduced to 10% from 30%	Neutral
	Moratorium on dividend payouts for 2Qs	Neutral
	Altering interest rate corridor to become symmetrical around policy rate (floor rate discount stands at 100bps)	Negative
Power	Energy Sukuk II released (PkR200bn) with dues to Coal Power Projects prioritized	Neutral
	MoUs signed with 2002 and 1994 IPPs - first step to major downward revisions to IPPs applicable tarriffs	Negative
	Introduction of roadmap for competitive trading bilateral contract market for DISCOs	Neutral
	Appointment of industry stalwart Mr. Tabish Gauhar as SAPM on Power to negotiate with IPPs	Positive
Textile	SBP relaxed the condition of 100% cash margin requirement on import of raw materials to support manufacturing	Positive
	Incentivized power & gas tariff for exports	Positive
	Rationalization of tariff lines for raw materials	Positive
OMCs	Incorporation of exchange losses into the pricing mechanism	Positive
	Shift away from monthly pricing towards fortnightly pricing	Positive
	Report of enquiry commission investigating Jun'20 petrol availability crisis released	Negative
	Major Oil & Gas policy overhaul in process with unofficial draft showing moves to regulate pricing, implement reserve	Positive
	MD & CEO of state run PSO appointed	Positive
Cement	FED reduced to PkR75/bag from PkR100/bag	Positive
	CCP initiated an enquiry against increase in cement prices during 4QFY20	Negative
	Various incentives (including tax exemptions) extended to construction sector under construction sector package	Positive
	Construction sector prioritized under COVID lockdown, funds earmarked for low cost housing outlays	Positive
Fertilizer	GIDC elimination on feed and fuel gas	Positive
	Removal of input sales tax adjustment on sales to unregistered dealers (subsequently removed in Dec'20)	Neutral
	Disallowance of 10% expense reduction for taxation purpose on sales to unregistered dealers (effective from Oct'20)	Negative
E&Ps	20 new blocks expected to be auctioned in the near term	Positive
	State giant and largest domestic E&P, OGDC gets new MD & CEO after approval by Federal Cabinet	Positive
	Mid-year vacancy of OGRA Chair yet to be filled	Negative
Autos	Sunset on AIDP-II incentives for new entrants remains at FY21	Positive
	EV policy launched with incentives for import of electric vehicles across major segments including HCVs	Positive
	Sales tax and WHT imposed on used car sales, dis-incentivizing speculators from re-selling	Positive
Pharmaceutical	SBP introduced regulatory measures to facilitate import of COVID-19-related medical equipment and medicine	Positive
Steel	Incremental energy consumption at 25/50% discount for industry/SMEs through industrial support package	Neutral

Source: Budget Documents, News Reports & AKD Research

Fertz: CY20 remained an eventful year for Fertilizer sector, with removal of GIDC on feed and fuel gas in Jan'20, translating into urea price reduction by PkR400/bag. To recall, the incumbent government has increased gas prices in multiple rounds over CY18-20, where the same was passed on to the end consumers, increasing urea prices for farmers. The GIDC elimination move and consequent reduction in urea price negated the cost pressure pass-on to some extent; urea offtake improved 6%YoY in 11MCY20. GIDC elimination proved beneficial for FFBL, the sole local DAP manufacturer, which struggled to pass on the previous rounds of gas price hikes due to import parity based pricing of DAP. In a similar vein, Supreme Court also announced its verdict of recovery outstanding GIDC receivables from the industry in monthly installments over a period of 2 years, which was later increased to 4 years, based on Fertilizer sector's request. Budget 2021 introduced changes in sales tax and income tax regulations as part of increasing tax net. Earlier, the fertilizer sector was allowed to claim sales tax refunds on the basis of disparity between sales tax on end-product and that on inputs. However, this was removed in case of sales to unregistered dealers w.e.f Jul'20. Additionally, the GoP disallowed 10% expense reduction for taxation purpose on sales to unregistered dealers (effective from Oct'20; PkR45-50 per bag impact for FFC and EFERT). While the sector has been provided relief on sales tax measure, contingent on certain conditions, a similar relief on income tax measures is also on cards.

Power: Key policy areas that came into highlight for power sector included (i) piecemeal payments to energy chain to reduce existing stock of circular debt, (ii) entering into agreements with IPPs to convert dollar hedged returns to PkR based returns and, (iii) progress on competitive trading bilateral market (CTBCM), after which 2002 PP IPPs will operate on 'Take and Pay' model vs. 'Take or Pay'. Going forward, conversion of these MoUs into amended PPAs would be a major shift in the power sector dynamics (expected by Feb'21 latest), where GoP intends to settle the outstanding receivables of the signatory IPPs in three installments, contingent on a nod from the IMF. Meanwhile, industry support package, which entails incremental power consumption in industrial and SME sector at PkR8/KWh till Jun'21, could result in circular debt accumulation in near term.

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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