COVID-19

April, 2020

IMPACT ASSESSMENT FOR PAKISTAN

Despite swift policy response by regulators, containment measures for global Covid-19 or coronavirus pandemic are having a severe impact on global and local economic activity with closure of businesses, compression in demand and impact on international trade. Severity of the impact can be gauged by most developed economies forecasted to enter into a recession. As of April 3rd 2020, the global count for coronavirus infected patients has crossed 1million with number of deaths being over 50,000[1] . Most experts believe that the number of infected patients and causalities is only expected to increase.

Pakistan's GDP growth, which has suffered over the last 2 years due to macroeconomic stabilization policies being pursued by the government, is expected to slow down further to around 2.5% for FY20. While the number of infected patients and causalities has crossed 2,400 and 35, respectively, risk of rapid spread remains given the sizeable and densely populated rural segment in the country. While rate of spread and timing of the peak of the Covid-19 outbreak are still uncertain in Pakistan, VIS expects varying degree of stress on financial profile of its rated universe which will continue to be monitored as the situation evolves. Regulatory relief from the central bank and recent 225bps cut in discount rate should provide some respite to corporates in these challenging times.

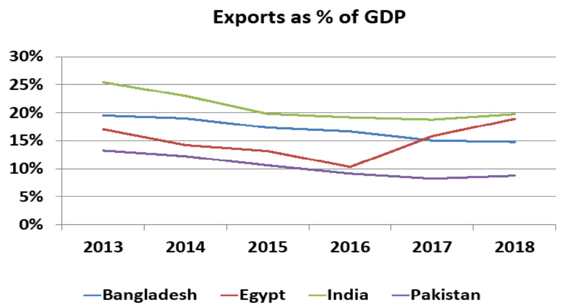
VIS is assessing the current situation closely with a view to understand its impact on the Pakistan economy as a whole and its variable impact on its major GDP sectors. Given the soft lock down situation all over the country the services and manufacturing sectors are being hit to significant extent as workers are not be able to reach workplaces leading to closures of businesses and loss of production of goods and services. On the external front, our major export markets have been impacted as most foreign countries which are our primary buyers are in lockdowns, cancellation of export orders have already started taking place. Demand compression particularly in fuel consumption in the wake of shut down of intra and intercity passenger traffic and domestic and international air routes; lockdowns of industrial and commercial establishments has also led to lower power consumption. As a consequence of sudden fall in consumption the revenue streams, by and large, of both primary producers of goods and services and their secondary users have been impacted.

Before we move to assess the impact on the economy and major sectors, let us estimate the time frame of the duration of the pandemic. By Chinese experiences this should be in control in three to four months, but then Chinese response to the pandemic was exemplary, and it is not seen to be replicated in other countries, hence it could last up to six months in certain jurisdictions. The financial impact of a sudden fall in consumption across major sectors of GDP is constrained cash flows for the duration of the unexpected event. While fixed costs needs to be serviced, the managers of resources have a tough choice distributing the available cash flows between operating the businesses and servicing the fixed costs, the most significant of the latter being debt servicing. However, generally in such crisis the Governments, Regulators and the lenders take practical view of the crisis situation and provide relief/support packages, inter alia, to the borrowers as well, this has been witnessed in most previous economic/financial crisis and has happened in Pakistan as well, as discussed ahead in this note.

1 *https://www.worldometers.info/coronavirus/*

Macroeconomic Impact

Exports



- Pakistan's export base has relatively remained low given the size of the economy. The country's export to GDP ratio has historically remained low in single digits[2] (only 5 other countries in the world have single digits exports to GDP ratio) over the last 4 years indicating relatively low reliance on exports.
- Pakistan's exports are heavily reliant on the textile sector which constitutes around 55% of the total exports. Given the lock down in major markets (US and Europe (Spain and Italy being significantly impacted)) and resultant closure of large retail stores, textile exports are expected to be adversely impacted. As per estimates of commerce ministry, overall export losses are estimated at around $2billion[3] (April to June 2020) over the next 3 months.

Exports of Pakistan								
USD in Millions	**FY17**	**%**	**FY18**	**%**	**FY19**	**%**	**8MFY20**	**%**
Food Group	3,618	16%	4,818	19%	4,639	19%	3,082	19%
Textile Group	12,457	57%	13,377	54%	13,565	56%	9,098	55%
Petroleum Group	411	2%	575	2%	676	3%	309	2%
Other Manu-facture	3,659	17%	4,134	17%	3,811	16%	2,488	15%
All Other	1,859	8%	1,865	8%	1,532	6%	1,616	10%
Total Exports	**22,003**		**24,768**		**24,223**		**16,593**	

Imports

- On the import front, soft commodity prices (coal, steel & chemicals) and sharp decline in crude and edible oil prices are expected to significantly reduce import bill. Petroleum imports represent around one-fourth of country's import. As per estimates, every $5 decline in oil prices reduces import bill by around a $1billion. Brent crude prices have declined by 62% [4] since the start of the year with a major chunk of the decline happening in March 2020 which is expected to result in a decline in import bill from 2nd quarter of the ongoing calendar year.

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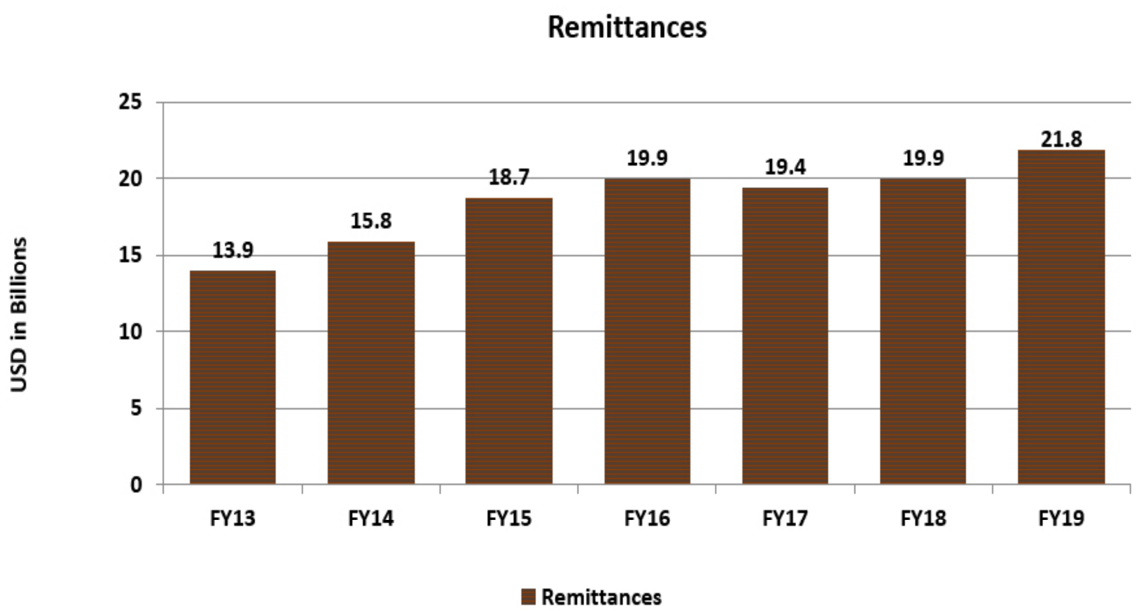
2 *https://data.worldbank.org/indicator/ne.exp.gnfs.zs*
3 *https://www.brecorder.com/2020/04/01/585517/two-billion-export-losses-feared/*
4 *https://oilprice.com/oil-price-charts*

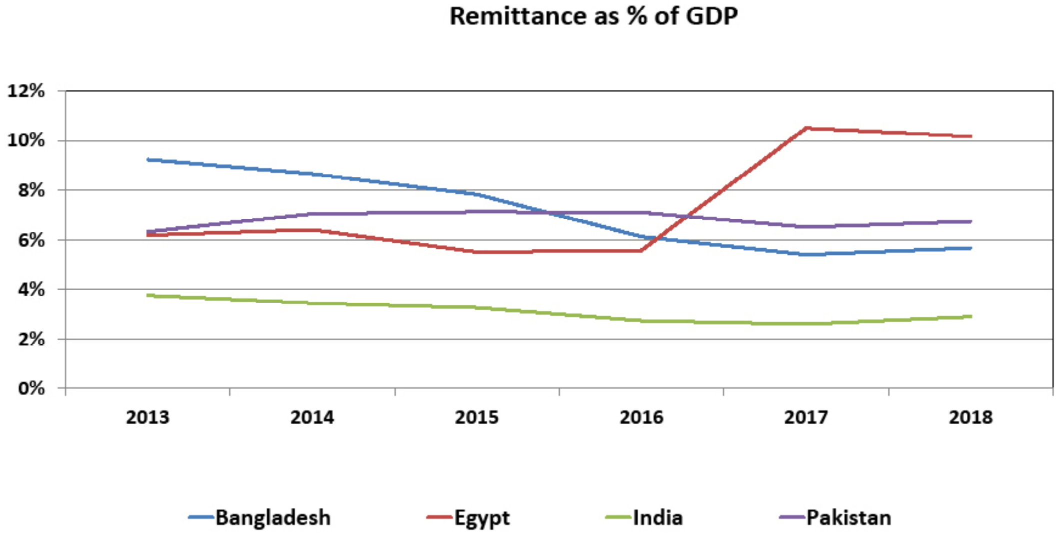
Imports by Pakistan								
USD in Millions	**FY17**	**%**	**FY18**	**%**	**FY19**	**%**	**8MFY20**	**%**
Food Group	5,417	11%	5,502	10%	4,750	9%	3,042	10%
Machinery Group	7,410	15%	8,785	16%	6,767	13%	4,353	14%
Transport Group	2,643	5%	3,207	6%	2,315	4%	1,017	3%
Petroleum Group	10,607	22%	13,263	23%	13,921	27%	7,064	23%
Textile Group	3,589	7%	4,091	7%	3,846	7%	2,233	7%
Agri. & Other Chemical	7,123	15%	8,315	15%	8,392	16%	4,812	16%
Metal Group	3,674	8%	4,762	8%	3,905	7%	2,184	7%
Miscellaneous Group	1,196	2%	1,256	2%	1,029	2%	553	2%
All others	7,024	14%	7,412	13%	7,466	14%	5,162	17%
Total Imports	48,683		56,592		52,390		30,420	
Total Exports	22,003		24,768		24,223		16,593	

Remittances

- Strong remittances have been the backbone of Pakistan's economy and have grown at a CAGR of 7.1% over the last 6 years (FY13-FY19). Growth in remittances has continued in the ongoing year with inflows increasing by 5.37%[5] during 8MFY20 vis-à-vis corresponding period last year. Remittance to GDP ratio is on the higher side vis-à-vis regional peers[6] .



5 *http://www.sbp.org.pk/ecodata/Homeremit.pdf?&NMW_TRANS=ext*
6 *https://data.worldbank.org/indicator/BX.TRF.PWKR.DT.GD.ZS*



- In terms of geographical breakup of inflows, GCC (Saudi Arabia and UAE are the major contributors) accounts for 54% of the total remittances with US and UK being other major markets. Cumulatively, Saudi Arabia, UAE, USA and UK account for three-fourth of the total remittances. In case oil prices continue to persist at current low levels and continued lockdown due to coronavirus is expected to impact a sizable chunk of Pakistan's work force particularly in GCC which will face income constraints and adversely affect quantum of remittances.

External Position

- Overall country's current account position is expected to depict slight improvement given the higher expected decline in imports as compared to exports & remittances. Petroleum group imports which had already started to decline in the ongoing fiscal year will be a key determinant of country's current account position. However, any agreement by OPEC+ for a sharp reduction in output and resultant increase in oil prices which compounded with decline in exports and remittances may weigh on the current account. Nevertheless, given the weak demand dynamics increase in oil prices is expected to be limited and current account position is expected to remain manageable.

USD in Millions	FY13	FY14	FY15	FY16	FY17	FY18	FY19	8MFY20
Exports	24,802	25,078	24,090	21,972	22,003	24,768	24,224	16,434
Imports	40,157	41,668	41,357	41,255	48,683	56,592	52,388	29,651
Trade deficit	(15,355)	(16,590)	(17,267)	(19,283)	(26,680)	(31,824)	(28,164)	(13,217)
Remit-tances	13,922	15,837	18,721	19,917	19,351	19,914	31,841	15,126
Current Account	(2,496)	(3,130)	(2,795)	(4,867)	(12,621)	(19,897)	(13,508)	(2,843)

- While foreign currency outflows have been significant (around 60% of the outflows from government paper have happened in March 2020) and slowdown in FDI is anticipated, reserve position is expected to be supported by sizeable expected inflows from IMF and other bilateral & multilateral agencies as part of the coronavirus support initiative.

Debt metrics and fiscal position

Rs 17.3 trn $ 106.3B	45%	Rs 22.8 trn	59.3%	Rs 40.2 trn	104.3%
External Debt & Liabilities	(% GDP)	Domestic Debt & Liabilities	(% GDP)	Total Debt & Liabilities	(% GDP)

- Debt metrics are expected to weaken given that fiscal deficit is expected to be on the higher side vis-à-vis projections. Revenue collections are expected to be well below the revised budgeted target due to slowdown in GDP growth, weakening in corporate earnings and higher expenditures primarily due to excess spending on coronavirus outbreak. Pakistan's narrow revenue base will continue to be a challenge. Resultantly, deficits will need to be financed through borrowings resulting in a weakening in debt metrics. Recent rupee devaluation will also increase the debt burden. However, interest servicing cost is expected to be lower given the recent decline in discount rate by 225bps. Pakistan's debt to GDP and interest payments as a proportion of government revenue compare unfavorably to regional and similar rated peers[7].

Sectoral Impact

Automobile and Auto part manufacturers

- Challenged by already weak growth due to macroeconomic stabilization and import compression policies being pursued by the government, automobile sales are expected to slow down further amidst lock down.
- Decline in interest rate during March 2020 and further reductions expected in the ongoing calendar year may provide some support to auto sales once lock down is lifted; nevertheless overall auto sales are expected to remain depressed.
- Liquidity of auto part manufacturers is expected to come under pressure given the strong dependence on volumetric sales of car manufacturers.
- The commercial transport sector which is operating at negligible capacities may find some respite with the opening up of the goods transport activity. The demand for passenger vehicles would remain subdued for some time, post crisis, as the priority of revenues would go towards business operations and low or zero yielding assets may fall lower. This impact would be carried to their vendor industries where order shrinkage from OEMs would impact turnover and bottom lines. The segment of engineering sector related to Transport and Automobile would remain subdued, however, that segment falling in the supply chain of construction and infrastructure would be activated with the easing of lockdowns well before they are completely lifted.

Oil Marketing Companies

- The sudden fall in consumption of industrial and transportation fuels has contracted their revenues, given a fixed margin on sale of products pressures on their bottom line would emerge, added to it would be the one time loss on inventory valuations due to steep fall in international oil prices. However some mitigation would come due to lower inventory carrying costs as a result of significant fall in prices. The post crisis scenario here is also positive as the pent up demand for travel would emerge at a higher pace in the wake of lower fuel prices.

Refineries

- Weak demand from OMCs and the industrial consumers has already forced some towards closure, they would have to weather out the crisis period with the support of the Government to provide them with the space to utilize their capacity and curtail imported refined products. The sector along with demand compression is also facing low refining margins in the wake of historically low oil prices. While the demand compression may end with the crisis, the overall economics of refining particularly of those refineries having low volumes of higher distillates would

7 *https://epaper.brecorder.com/2020/03/31/90-page/831969-news.html*

remain weak.

Textile

- Covid-19 has had a significant impact on major export markets of textile sector with a number of countries under partial or complete lockdown. Given the closure of large retail stores, risk of withheld shipment and future orders, delays or extension of payment timelines, and even cancelled orders remains.
- In the local market, risk includes continued shut down which will impact revenues and may extend to Ramazan which constitutes a major sales period. A sizeable chunk of sales undertaken for prior months are on credit and delays in collections is expected to adversely impact cash flows.
- The demand compression is for the entire chain i.e. spinning, weaving and finishing covering basic, fashion or home textile. The predominant export players would be impacted more than domestic ones, however, post crisis period the export players may witness a surge in demand owing to the relief packages being planned by the foreign governments to boost consumption in European and American markets.

Construction and Allied Sectors

- Cement & its packing, all building materials, iron & steel, cables & wires: this sector has been severely impacted by the lockdowns as most construction activity has come to a halt. The revenue crunch here is large as almost the entire chain is impacted. However, post crisis period this would be early riser given the volume of construction/ infrastructure activity which was on going and the emphasis of the government on this sector.
- Steel: China's steel inventories have depicted significant jump and are estimated to have tripled[8] as at end-March 2020 vis-à-vis similar period. This has resulted in a double digit decline in prices of steel scrap and rebar in the ongoing calendar year. The Chinese government has announced increase in rebates on steel products in order to facilitate in normalizing inventory levels which may result in a cut in export prices. Future steel prices will depend on recovery of economic growth in key markets across the globe.
- Cement: Cement dispatches have witnessed a significant hit due to lock down implemented by the government. As per industry estimates, cement dispatches have declined by around 80%[9] since the lock down commenced. However, this is expected to be a short-term phenomenon with government announcing a special incentive package for the construction sector and resumption of construction activities in the country.

Pharmaceutical or Healthcare Facilities

- Pharmaceutical companies are expected to depict stable business risk profile in the backdrop of coronavirus outbreak. However, Pakistani pharmaceutical companies are primarily generic drug companies and are exposed to supply chain disruption for Active Pharmaceutical Ingredients (API). Moreover, new product launches are also expected to face delays. However, companies that have products or services that are effective in prevention of spread of COVID-19 are expected to depict temporary improvement in revenues and financial profile. Hospitals or health care facilities are expected to witness increase in patients and occupancies and will benefit financially.

Consumer goods, packaging, dairy

- These sectors are the ones which have been least impacted largely being essential in nature leading to their demand inelasticity. Here to, the consumer durables have been impacted more than convenience goods and would take time to consolidate them in post crisis scenario.

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8 https://www.spglobal.com/platts/en/market-insights/latest-news/metals/032320-analysis-chinas-steel-inventories-almost-triple-on-year-to-100-mil-mt-posing-big-challenge-for-q2

9 https://www.thenews.com.pk/print/637079-cement-offtakes-fall-80-percent-rs450mln-tax-revenue-lost

Wholesale and Retail Trade

- This significant service sector of GDP has been greatly impacted due to lockdowns, barring the ones dealing in consumer convenience goods and groceries. However, as a large portion of this sector, except a few large distribution companies, are in the unorganized sector their relative borrowing from the financial sector are low. The level of revival of their activities would be directly linked with phased lifting of lockdown status.

Banking Sector

- The asset and capital base of large banks having major share of the financial market is sound. This is further supported by the composition of their assets which are largely in government issued or guaranteed investments/ loans. With around 40-45 percent lending in real private sector their risk to catastrophe is low given the level of collateralization they have against these loans/advances. Further, the low leveraging of the economy with credit to private sector at around 20 percent of GDP makes our financial sector less vulnerable to shocks than many other countries where this ratio is much higher. They have been further supported by the regulatory relaxations granted by SBP in classification of their loans/advances portfolio. As the lockdowns are expected to be gradually lifted, the rush to withdraw deposits for business operations would be mitigated.

General Insurance

- Given the increase in patients and occupancies across the country and absence of reinsurance cover in the health segment for most industry players, claims ratios for the health segment which were already on the higher side will increase further. Overall impact on financial profile will vary and depend on the proportion of health segment contribution in overall business mix.

Addressing the Crisis

Relief Package: The federal government has put in place a significant relief package comprising of funded reliefs to various segments of the economy. The package valuing Rs 1.2 trillion is unprecedented and covers segments from all walks of economy/society including the underprivileged , SME and Agriculture, export industry, wheat procurement, utility stores, etc. along with reduction in fuel prices. This spending by the government is focused towards the poverty level and is expected to facilitate employment creation and price stability.

Crisis Management

Recognizing the unpredictability in the spread of the pandemic the government mobilized National Disaster Management Authority (NDMA) very soon after the discovery of the first few cases. NDMA is fully activated and coordinating with the federal and provincial governments in the treatment management and spread control of the pandemic. In this direction, by March end all over Pakistan, it has designated over 30 hospitals, arranged/established over 100 quarantine centers with approx 25000 beds, set up 15 testing facilities and around 200 isolation facilities with nearly 3000 beds. These are expected to be further increased. All functionaries are now gearing up to increase the quantum of testing facilities and life support systems for critical patients. In this regard concerted efforts have been made for supply of critical equipment from friendly countries including China, which is a major donor.

All provinces have put in place soft lockdowns restricting people movements outside homes except for emergencies and purchase of food items, medicines in few designated hours. This is being enforced all over Pakistan by civil administration with the full support of the armed forces deployed for this purpose. All necessary services and factories providing transport fuel, banks, hospitals, pharma companies and medical stores, utilities, cellular services, port and airport(where permitted) are operational. It is expected that in the coming week or so as arrangements for operation of important industries/facilities are worked out some production would begin there.

Regulatory Relaxations

State Bank of Pakistan (SBP) role in the crisis has been very proactive and recognizing the urgency of the situations it held various discussions with the stake holders, it has announced a number of regulatory relaxations for the borrowers which would facilitate the banks in providing them relief as well as maintain their portfolio quality, within permissible guidelines of the SBP. These relaxations cover most segments of the borrower from corporate, commercial to consumer and export oriented borrowers. SBP has also taken actions to increase the overall pool of loanable funds by the banks. The policy rate has also been revised downward by SBP to provide more space in cost of doing business.

In the backdrop of the above stated position, VIS considers that the situation particularly in the financial sector, though quite uncertain, seems to have been addressed in the right direction. It is not possible at this juncture to predict the direction of extent of meeting financial commitments by the borrowers, however, from the foregoing it appears that some slippages would occur. VIS, however, understands the criticality of the current situation and appreciates the efforts taken in general and towards financial sector to mitigate the impact of financial stress. VIS would review ratings as they fall due for review or earlier on occurrence of certain events and determine its ratings in the light of the regulatory relaxations granted by the SBP, unless there are reasons to believe that such ratings need to be differently treated. It would generally, in determining ratings, endeavor to seek the financial impact of the current crisis over a time period commensurate with the business and product cycle of the product. However, given the uncertainties in the ongoing scenario, outlooks may be changed for and in shorter periods of time.

Summary of Regulatory Relief[10]

RELIEF FOR BUSINESSES & COMPANIES	
Deferment of payment of Principal for 1 Year	Financial Institutions can defer the payment of principal on loans for obligor by one year but mark-up needs to be serviced in a timely manner. The deferment will not affect the credit history of the obligor & will not be reported in the eCIB as restructuring. Such deferment by financial institutions cannot be availed on non-performing loans as of 31-Dec-2019.
Relaxation in criteria for Restructuring/Rescheduling of Loans	For borrowers/obligors whose financial conditions require relief beyond the extension of principal repayment for one year, SBP has relaxed the regulatory criteria for restructuring/rescheduling of loans. The loans that are re-scheduled/restructured within 180 days from the due date of payment will not be treated as defaults. Banks would also not be required to suspend the unrealized mark-up against such loans.
Facilitating New Investment	A Temporary Economic Refinance Facility (TERF) has been announced which will provide concessionary refinance for setting up new industrial units. The facility caters to the post-pandemic scenario and is available at Banks/DFIs. Maximum limit is Rs. 5 billion per project.
Margin Call Requirements	Considering the volatility in the stock market, the margin requirement has temporarily been reduced from 30 percent to 20 percent for exposure against shares of listed companies. The margin calls have been reduced from 30 percent to 10 percent for exposure against shares of listed companies. The above margin call requirements are reduced temporarily till September 26, 2020.

10 *SBP measures for COVID-19 by ABS&Co*

Taking Exposure on Borrowers against the Shares of their Group Companies	Due to market volatility, Banks/DFIs have been permitted to take exposure on any person against the shares issued by its group companies, provided the tenor of the financing facilities does not exceed one year. Such exposure is temporarily available until September 26, 2020.
Relaxation in CCB requirement	Banks can now supply additional loans to businesses and households. The Capital Conservation Buffer (CCB) has been reduced from its current level of 2.50% to 1.50%. Now banks can lend an additional amount of around Rs. 800 billion, an amount equivalent to about 10% of their current outstanding loans.
Banks' Overall Pool of Loanable Funds Increased	To incentivize banks to provide additional loans to retail SMEs the existing regulatory retail limit of Rs. 125 Million per SME has been permanently enhanced to Rs. 180 Million.
REQUIREMENTS FOR EXPORTERS & IMPORTERS	
Relaxation in Conditions for LTFF	Previously, exporters who wanted to avail credit under Long Term Financing Facility (LTFF) were required to have exports worth 50 percent of total sales, or USD 5 million of exports to become eligible. This limit has been reduced to 40 percent or USD 4 million for all the borrowings under LTTF during the period January 01, 2020, to September 30, 2020. Another period of one year has also been granted to meet export performance requirements. Applies to ILTFF as well.
Relaxation of Performance Requirement under EFS (Part II)	To avail cheaper credit under EFS (Part II), exporters were required to export twice the amount of borrowed funds during FY 2019-20 on a daily average product basis. SBP has now reduced the performance requirement from twice to one-and-a-half times that will be effective for the current year as well as for FY21.
Extension of Time to Meet Performance Requirements for EFS (Part II)	SBP has allowed six more months for exporters under EFS (Part II) to meet required export performance. Previously, performance was considered until end June 2020. This period has been extended by six months to Dec. 2020. Since the additional period will also be counted towards setting new limits, this will help the exporters in availing higher limits for FY21.
Extension in Time for Realization of Exports Proceeds	For exporters, SBP has allowed banks to enhance the time period for realization of exports proceeds from the existing requirement of 180 days to 270 days on a case by case basis where the delay is related to COVID-19.
RELIEF FOR INDIVIDUALS	
Payment of Principal Amount for Borrowers Deferred for 1 year	Banks and development finance institutions (DFIs) can defer the payment of principal comportment of installments at no fee or increase in mark-up rate provided the borrower continues to service the mark-up amount as per agreed terms and conditions. A written request must be made to the bank(s) before 30th June 2020 to avail this relief.

Borrowing Limits for Individuals Increased for 1 Year	The capacity to borrow from banks for individuals is limited by their capacity to bear the burden of debt, defined in terms of Debt Burden Ratio. SBP has temporarily relaxed the Debt Burden Ratio (DBR) for consumer loans from 50% to 60%.
RELIEF BY SECP	
Extension in timeline for AGM	All companies which are facing difficulties in timely holding the annual general meeting (AGM) for the year ended on December 31, 2019, are allowed a general extension for a period of 30 days as provided in section 132 of the Act for holding their AGMs. The companies can now hold their AGM for the year ended on December 31, 2019 on or before May 29, 2020.
Election of Directors	The companies, whose election of directors is due before or in the aforesaid AGM, may file impediment reports with the concerned registrar under section 158(2) of the Act citing the reasons for delay in holding the election of directors.
Filing of Statutory Return	Statutory returns which are required to be filed on or after 24th March, 2020 may be filed with the concerned registrar with the delay of 30 days of occurrence of any event without any additional filing fee as no penal action shall be taken for the late filing
Extension in filing of 1st quarter financial statements	SECP shall facilitate companies for grant of extension in filing of first quarter financial statements on application sent to SECP via email.
Requirement to hold a Board of Director (BOD) meeting once in every quarter	The law does not provide for any specific relaxation in requirement of holding BOD meeting once in every quarter. However, in term of Section 179 of the Act companies are encouraged to pass resolution by the directors through circulation. Given the extraordinary circumstances, companies are advised to prioritize public safety, while ensuring corporate compliance, and the SECP shall give due consideration to all underling circumstances while enforcing regulatory compliance.
Requirement of disseminating information to shareholders through post	Pursuant to Section 55 and Section 223(6) of the Act, the companies can circulate the notices of general meeting and annual reports to members, by post or electronically.

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