Day Break

Wednesday, March 1, 2023

Exhibit: Moody's Pakistan Credit rating history

Date	Rating	Outlook
28-Feb-22	**Caa3**	**Stable**
6-Oct-22	Caa1	Negative
2-Jun-22	B3	Negative
8-Aug-20	B3	Stable
14-May-20	B3	Under Review
2-Dec-19	B3	Stable
20-Jun-18	B3	Negative
11-Jun-15	B3	Stable
25-Mar-15	Caa2	Positive
14-Jul-14	Caa2	Stable
13-Jul-12	Caa2	Negative
17-Aug-09	B3	Stable
12-Dec-08	B3	Negative
28-Oct-08	B3	Negative Watch
23-Sep-08	B3	Negative
21-May-08	B3	Stable
5-Nov-07	B2	Negative
22-Nov-06	B1	Stable
8-Nov-06	B2	Positive Watch
20-Jan-05	B2	Positive
20-Oct-03	B2	Stable
13-Feb-02	B3	Stable
29-Oct-01	Caa1	Stable
23-Oct-98	Caa1	Negative
28-May-98	B3	Negative
6-Nov-96	B2	Negative
23-Sep-96	B1	Negative Watch
11-Jul-95	B1	Stable
23-Nov-94	Ba3	Stable

Analyst

Abdullah Farhan
Abdullah.farhan@igi.com.pk

Aariz Raza Khan
Aariz.raza@igi.com.pk

Pakistan Sovereign Rating

Moody's Further Downgrades Pakistan Sovereign Rating to Caa3; Fragile Liquidity and External Position Raises Default Risk

Moody's Investors Service (Moody's) yesterday downgraded the Pakistan's local and foreign debt ratings to Caa3 from earlier Caa1 (06th Oct, 2022). Concurrently, outlook has been revised to "Stable" from previous "Negative". The rationale behind the stable outlook given by the rating agency is that outlook is consistent with rating assigned with broadly balanced risk.

Further in the report Moody's has also highlighted that if IMF engagement beyond the current program is not achieved and government is not able to secure additional financing from multilateral and bilateral partners, then given the extremely low foreign exchange reserves, could lead to a default.CPI likely to remain high in the near term before base effect kicks by the end of this FY23.

To recall, this is the first time in nearly 3 decades Pakistan has been assigned Caa3 rating by the rating agency. The lowest rating previously assigned by Moody's was Caa2 which was between Jul-12 to Mar-15.

Moody's revise down Pakistan sovereign rating.

Moody's further downgrades Pakistan's Sovereign Rating to Caa3

Moody's Investors Service (Moody's) yesterday downgraded the Pakistan's local and foreign debt ratings to Caa3 from earlier Caa1 (06^{th} Oct, 2022). Moody's has also downgraded the rating for the senior unsecured MTN programme to (P)Caa3 from (P)Caa1. Concurrently, outlook has been revised to "Stable" from previous "Negative". The downgrade to Caa3 from Caa1 rating also applies to the backed foreign currency senior unsecured ratings for The Pakistan Global Sukuk Programme Co Ltd. The associated payment obligations are, in Moody's view, direct obligations of the Government of Pakistan.

The rationale behind the stable outlook given by the rating agency is that outlook is consistent with rating assigned with broadly balanced risk. As per Moody's report (link):

> *"The stable outlook reflects Moody's assessment that the pressures that Pakistan faces are consistent with a Caa3 rating level, with broadly balanced risks."*

Exhibit: Pakistan Current Credit rating				
Rating Agency	**Rating**	**Outlook**	**Last Update**	**Action**
Moody's Investors Service	Caa3	stable	28-Feb-23	Rating downgrade
Fitch Ratings	CCC-	n/a*	14-Feb-23	Rating downgrade
Standard & Poor's	CCC+	stable	22-Dec-22	Rating downgrade

Source: Moodys, S&P, Fitch, IGI Research

** Fitch typically doesn't assign outlook for rating below CCC+*

Country	Rating
Barbados	Caa1
Gabon	Caa1
Iraq	Caa1
Maldives	Caa1
Nigeria	Caa1
Solomon Islands	Caa1
Republic of the Congo	Caa2
Belize	Caa2
Mali	Caa2
Mozambique	Caa2
Ethiopia	Caa2
Tunisia	Caa2
Pakistan	Caa3
Ecuador	Caa3
El Salvador	Caa3
Laos	Caa3
Suriname	Caa3
Argentina	Ca
Belarus	Ca
Cuba	Ca
Ghana	Ca
Zambia	Ca
Sri Lanka	Ca
Ukraine	Ca
Venezuela	C
Lebanon	C

Moodys highlight default risk if Pakistan is unable to secure financing

Further in the report Moody's has also highlighted that if IMF engagement beyond the current program is not achieved and government is not able to secure additional financing from multilateral and bilateral partners, then given the extremely low foreign exchange reserves, could lead to a default.

"Continued IMF engagement, including beyond the current programme, would likely help to support additional financing from other multilateral and bilateral partners, which could reduce default risk, if this is achieved urgently and without further raising social pressures. Conversely, this fiscal year or beyond, financing from the IMF and other partners may not be disbursed in time, which, given the extremely low reserves position, could lead to default."

In the last assessment done by Moodys in Oct-22, the negative outlook was in relation to that rating. As per the Oct-22 Moody's report (link):

"The negative outlook captures the downside risks beyond what would be consistent with a Caa1 rating.
Pakistan faces risks of a balance of payments crisis, which would increase if its external payments needs are higher than currently expected, for instance because of larger imports needs, while access to external financing is more restricted. Moreover, while Moody's assumes that access to official sector financing will be maintained and will be enough to meet Pakistan's needs, lower financing and/ or higher needs would raise the risk of default to a level no longer consistent with a Caa1 rating. The negative outlook also captures risks that, should a debt restructuring be sought, it may extend to private sector creditors, despite assurances by the government late September that it is not seeking debt relief from commercial banks or eurobond holders. In this case, it would likely constitute a default under Moody's definition."

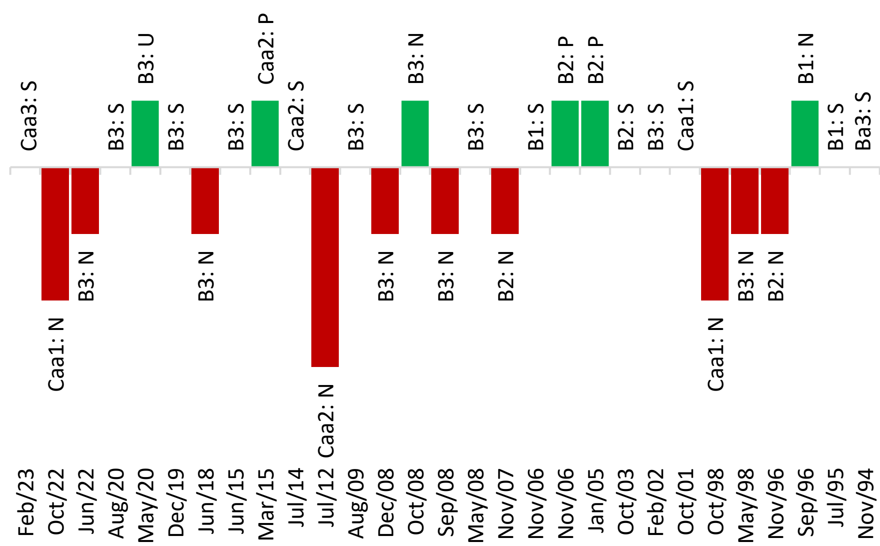
Moody's has revised rating and outlook 3 times in the last 12 months

To recall, this is the first time in nearly 3 decades Pakistan has been assigned Caa3 rating by the rating agency. The lowest rating previously assigned by Moody's was Caa2 which was between Jul-12 to Mar-15. Within the last 12 months, Moody's has revised Pakistan's rating and outlook 3 times where outlook was firstly revised to negative for B3 rating in Jun-22, followed by rating downgrade to Caa1 in Oct-22.

Concurrent to this action, Moody's has lowered Pakistan's local and foreign currency country ceilings to Caa1 and Caa3 from B2 and Caa1, respectively. The two-notch gap between the local currency ceiling and sovereign rating is driven by the government's relatively large footprint in the economy, weak institutions, and relatively high political and external vulnerability risk. The two-notch gap between the foreign currency ceiling and the local currency ceiling reflects incomplete capital account convertibility and relatively weak policy effectiveness.

Exhibit: Pakistan Rating History, by Moody's

Current Caa3 rating lowest in last 3 decades



Source: Moody's, IGI Research, *N=Negative, P=Positive, S=Stable, U=Under Review*

Rationale behind rating downgrade

As per Moody's report, decision to downgrade Pakistan further came amid heightened liquidity and external position risk which has substantially raised default risk to a level consistent with Caa3 rating. According to the report, extremely low foreign exchange reserves, which are far lower than necessary to cover its import and external debt obligations over immediate and medium term. Moody's has also highlighted that if external financing becomes available in the near term through disbursement of next tranches under IMF program and related financing, that would reduce default risk and lead to rating upgrade. However, under current economic condition especially balance of payment, Pakistan may not be able to secure IMF disbursement and thus there is limited clarity on Pakistan's source of financing for its sizeable external payments post program completion in Jun-23.

"Significant external financing becoming available in the very near term, such as through the disbursement of the next tranches under the current IMF programme and related financing, would reduce default risk potentially to a level consistent with a higher rating. However, in the current extremely fragile balance of payments situation, disbursements may not be secured in time to avoid a default. Moreover, beyond the life of the current IMF programme that ends in June 2023, there is very limited visibility on Pakistan's sources of financing for its sizeable external payments needs."

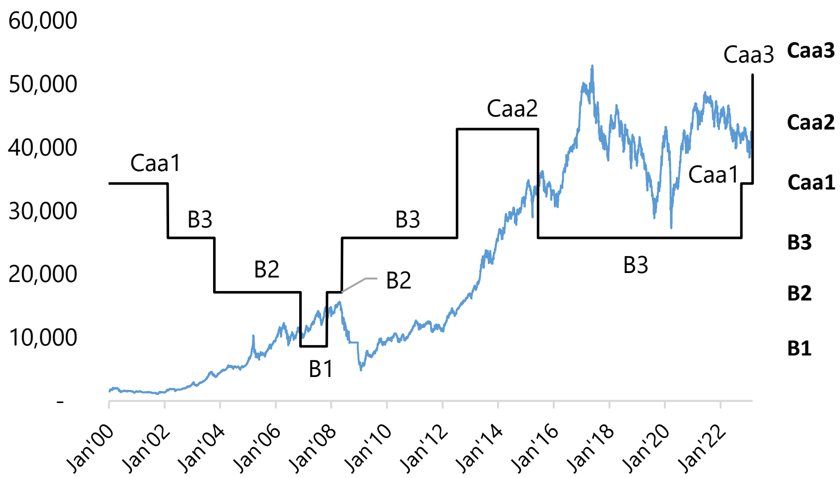
Key estimates regarding debt obligation by Moody's;

- Moody's estimates that Pakistan's external financing needs for the rest of the fiscal year ending June 2023 to be around $11 billion, including the outstanding $7 billion external debt payments due. The remainder includes the current account deficit, taking into account a sharp narrowing as imports have contracted markedly.
- To meet these financing needs, Pakistan will need to secure financing from the IMF and other multilateral and bilateral partners. Despite recent delays, Moody's assumes successful completion of the ninth review of the existing IMF programme, although this is not secured yet. This would in turn catalyse financing from other multilateral and bilateral partners.
- At the same time, the government will also need to obtain the roll-over of the $3 billion China SAFE deposits and secure $3.3 billion worth of refinancing from Chinese commercial banks for the rest of this fiscal year. Of this $3.3 billion, Pakistan has already received a deposit of $700 million from the China Development Bank on 24 February 2023.
- Moody's estimates Pakistan's external financing needs for fiscal 2024 are around $35-36 billion. Pakistan has about $25-26 billion worth of external debt repayments (including interest payments) to make in fiscal 2024, including a $1 billion Eurobond due in April 2024. In addition, Moody's estimates Pakistan's current account deficit at around $10 billion.

Moodys highlight factors that could lead to an upgrade/downgrade

The rating would likely be upgraded if Pakistan's government liquidity and external vulnerability risks decreased materially and durably. This could come with a sustainable increase in foreign exchange reserves. A resumption of fiscal consolidation, including through implementing revenue-raising measures, pointing to a meaningful improvement in debt affordability would also be credit positive. The rating would likely be downgraded if Pakistan were to default on its debt obligations to private-sector creditors and the expected losses to creditors as a result of any restructuring were larger than consistent with a Caa3 rating.

Exhibit: KSE100 Performance during different rating periods



Source: Bloomberg, IGI Research, Moody's

A downgrade on country's sovereign rating bears negative consequences for country's financial markets including equity market as it raises the risk premiums and lead to downward re-rating in market multiples. In addition, Sovereign credit rating plays an influential role to determine the conditions in which countries can access and attract flows from international financial markets. However, rating below Caa3 would fall under default category.

Exhibit: Moody's Rating Guide	
Rating	**Long-term ratings**
	Investment Grade
Aaa	Rated as the highest quality and lowest credit risk.
Aa1	Rated as high quality and very low credit risk.
Aa2	
Aa3	
A1	Rated as upper-medium grade and low credit risk.
A2	
A3	
Baa1	Rated as medium grade, with some speculative elements and moderate credit risk.
Baa2	
Baa3	
	Speculative grade
Ba1	Judged to have speculative elements and a significant credit risk.
Ba2	
Ba3	
B1	Judged as being speculative and a high credit risk.
B2	
B3	
Caa1	Rated as poor quality and very high credit risk.
Caa2	
Caa3	
Ca	Judged to be highly speculative and with likelihood of being near or in default, but some possibility of recovering principal and interest.
C	Rated as the lowest quality, usually in default and low likelihood of recovering principal or interest.

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Recommendation Rating System
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Sell if target price on aforementioned security (ies) is less than -10%, from its last closing price(s)

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Basic Definitions and Terminologies used: Target Price: A price target is the projected price level of a financial security stated by an investment analyst or advisor. It represents a security's price that, if achieved, results in a trader recognizing the best possible outcome for his investment, **Last Closing:** Latest closing price, **Market Cap.:** Market capitalization is calculated by multiplying a company's shares outstanding by current trading price. **EPS:** Earnings per Share. **DPS:** Dividend per Share. **ROE:** Return on equity is the amount of net income returned as a percentage of shareholders' equity. **P/E:** Price to Earnings ratio of a company's share price to its per-share earnings. **P/B:** Price to Book ratio used to compare a stock's market value to its book value. **DY:** The dividend yield is dividend per share, divided by the price per share.

IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009

Contact Details

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 38303559-68	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Syeda Mahrukh Hameed	Branch Manager (Lahore)	Tel: (+92-42) 38303564	mahrukh.hameed@igi.com.pk
Shakeel Ahmad	Branch Manager (Faisalabad)	Tel: (+92-41) 2540843-45	shakeel.ahmad1@igi.com.pk
Asif Saleem	Equity Sales (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Equity Sales (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Aariz Raza	Analyst	Tel: (+92-21) 111-234-234 Ext: 810	Aariz.raza@igi.com.pk

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited
Website: www.igisecurities.com.pk

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780

Stock Exchange Office
Room # 134, 3rd Floor, Stock Exchange Building,
Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2
Fax: (+92-21) 32429607

Lahore Office
Shop # G-009, Ground Floor,
Packages Mall
Tel: (+92-42) 38303560-69
Fax: (+92-42) 38303559

Islamabad Office
Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
Block- B, Jinnah Avenue, Blue Area
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861

Faisalabad Office
Office No. 2, 5 & 8, Ground Floor, The
Regency International 949, The Mall
Faisalabad
Tel: (+92-41) 2540843-45

Rahim Yar Khan Office
Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road
Tel: (+92-68) 5871652-3
Fax: (+92-68) 5871651

Multan Office
Mezzanine Floor, Abdali Tower,
Abdali Road
Tel: (92-61) 4512003, 4571183

IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009