Day Break

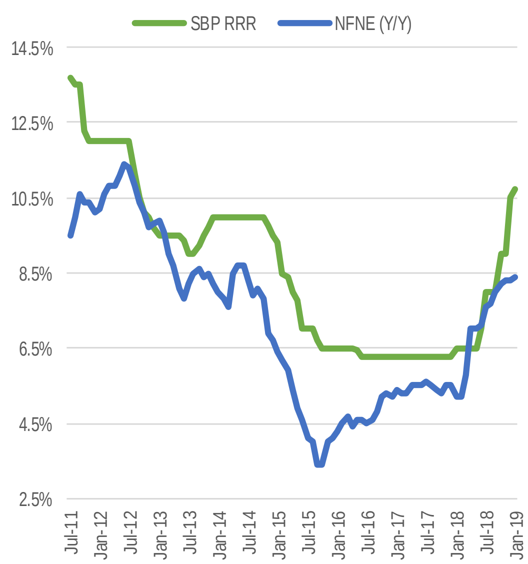
Friday, 01 February 2019

Economy

Exhibit: Historic Interest Rate

Date	RRR	RR	Policy Rate	Chg. BPS
Nov-13	10.00	7.50	-	
Nov-14	9.50	7.00	-	(50)
Jan-15	8.50	6.00	-	(100)
Mar-15	8.00	5.50	-	(50)
May-15	7.00	5.00	6.50	(100)
Sep-15	6.50	4.50	6.00	(50)
May-16	6.25	4.25	5.75	(25)
Jan-18	6.50	4.50	6.00	25
May-18	7.00	5.00	6.50	50
Jul-18	8.00	6.00	7.50	100
Oct-18	9.00	7.00	8.50	100
Dec-18	10.50	8.50	10.00	150
Jan-19	10.75	8.75	10.25	25

Exhibit: Core Inflation and SBP Reverse Repo Rate



Source: SBP, PBS & IGI Research

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Monetary Policy Statement

Monetary Policy Tightened Further by 25bps (+450bps Hike Cycle), Against Broader Market Consensus

- In its recently announced Monetary Policy Statement (MPS), the State Bank of Pakistan (SBP) has increased policy rate by +25bps
- We see Steel, followed by Fertilizer, as most effected on earning basis given high debt levels while positive implication holds for Banks, with mid-tier banks (BAHL, BAFL and FABL) preferred over large banks, due to their positive fund gap.

Policy rate increased by +25bps

In its recently announced Monetary Policy Statement (MPS), the State Bank of Pakistan (SBP) has increased policy rate by +25bps (compared to market consensus of status quo), taking policy rate to 10.25% and discount rate to 10.75%.

The monetary policy committee acknowledges gradual improvement in key macroeconomic data points, C/a balance and headline inflation, however remain skeptical of elevated levels and of oncoming fiscal deficit for FY19 and core inflation. As per the statement, the rate increase decision came amid elevated level of a) current account deficit, b) core inflation and c) fiscal deficit.

"However, challenges to Pakistan's economy persist: (a) despite narrowing, the current account deficit remains high; (b) fiscal deficit is elevated; and (c) core inflation is persistently high. This situation calls for continued consolidation efforts." - SBP monetary Policy Statement, Jan 2019

Core inflation outlook changed from benign to bullish

On inflation, SBP pointed out the rising trend in core inflation (non-food, non-energy), wherein, core inflation clocked in at +8.3% by Dec-18, compared to +5.5% last year. Furthermore, increase energy prices (gas and electricity tariff), PKR depreciation and persistently higher government borrowing from SBP is expected to have a second round impact, which keep overall core inflation downward sticky in near-to-medium term. However, headline inflation range remain unaffected at 6.5-7.5% in FY19.

Growth revised down to 4.0%; external challenges still remain

A net contraction of ~1% witnessed in Large Scale Manufacturing (LSM) during first 5MFY19 and lower Kharif production in FY19, hints to slower growth in commodity producing sector. As a result, growth has been revised down to 4.0% from earlier target of 6.2%. Outlining the external sector challenges, the committee highlights improvement in exports and foreign inflows, but remain insufficient to finance country's external deficit.

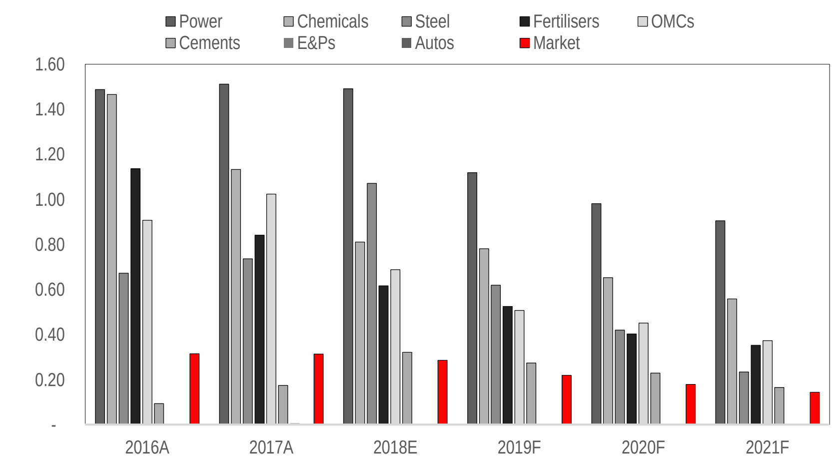
Outlook

Given the macroeconomic environment, the impact on headline inflation of +25bps rate hike will be minimal, with real interest rates hovering near all-time high 3.25%. In terms of central objective, this move is rather peculiar in our view, nor it is complementing growth and neither its helping to slowdown down inflation. Policy measures to address external accounts have been put in place repeatedly by the government through various mini-budgets, however monetary policy as tool is of little help in curbing overall import demand and moreover, least useful in fixing fiscal issues. Nevertheless, we maintain our no further rate hike expectation in FY19.

Corporate earnings impact to be limited; Fertilizer and Steel most affected

In line with the rate change, interbank lending rate (KIBOR), treasury yields and cost of equity will be adjusted subsequently to reflect 25bps increase. From a market perspective, given low debt to equity ratio (IGI universe companies), we see minimal negative impact on earnings resulting from a policy rate hike, with steel and fertilizer being most affected on earning given high debt levels. Positive implication holds for Banks, with mid-tier banks (BAHL, BAFL and FABL) preferred over large banks, due to their positive fund gap.

Exhibit: Debt to equity of individual sectors (IGI universe); Fertilizer and Steel most affected



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