Day Break

Monday, 28 May 2018

Economy

Exhibit: SBP Interest rate corridor

Date	SBP Reverse Repo Rate (%)	SBP Repo Rate (%)	SBP Policy (Target Rate) (%)
Nov-13	10.00	7.50	-
Nov-14	9.50	7.00	-
Jan-15	8.50	6.00	-
Mar-15	8.00	5.50	-
May-15	7.00	5.00	6.50
Sep-15	6.50	4.50	6.00
May-16	6.25	4.25	5.75
Jan-18	6.50	4.50	6.00
May-18	7.00	5.00	6.50

Source: SBP, IGI Research

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Saad Khan
Head of Research
saad.khan@igi.com.pk
Tel: (+92-21) 111-234-234 Ext.: 810

Monetary Policy

SBP delivers a 50bps hike; Rate hike cycle to slowdown in CY18

- Exceeding market consensus as well as our estimates, State Bank of Pakistan (SBP) in latest Monetary Policy Statement, delivered a 50bps hike in policy rate to 6.5%
- In view of SBP, the widening current account deficit of growing imports as well as the recent increase in oil prices is expected to further push current account deficit to a higher level
- Although the risk in external accounts is imminent, but we view widening trade deficit as indicative of 'temporary' demand supply imbalances arising to support higher economic activity
- Going forward we do not expect rate hike to accelerate, in fact we now expect a maximum of 25bps before CY18 end compared to market consensus of 50-75bps additional rate hike
- The overall negative valuations impact for the policy rate increase stands marginal at ~3-4% (for IGI coverage companies excluding banks), we expect the event to be relatively a non-mover for the market. For banks, we view current prices to have already incorporated rate hike to a certain extent

SBP proactively delivered a 50bps hike

Exceeding market consensus as well as our estimates, State Bank of Pakistan (SBP) in latest Monetary Policy Statement, delivered a 50bps hike in policy rate to 6.5%, with subsequent increase in discount rate to 7.0%. Given the linguistic tone of the statement, we sense a rather bleak outlook. Chiefly, the decision to increase policy rate is based on changes in SBP assessment from its last issued monetary policy meeting held 2months back. SBP notes,

" […] since the last meeting, in MPC's assessment the balance-of-risks to the sustainability of the healthy-growth-low-inflation nexus have shifted […]''

Here the assessment criteria primarily mean, escalated risk of balance of payments (BOP) in the wake of a) higher international oil prices and, b) limited financial inflows. Additionally, higher than initial estimated fiscal deficit at 5.5% of GDP (compared to 4.1% target) has also led to change in SBP assessment criteria.

The view forward

Having said that, SBP showed confidence on achieving inflation target of below 6.0% for FY18. However, the regulator is not so confident on government achieving its GDP growth target of FY19 at >6%, primarily given challenges on external account and its subsequent impact on PKR. All in all, SBP indicated that the reduction in external account risk will be a key guidance for monetary policy going forward.

"[…] SBP's assessment of overall macroeconomic picture suggests that this target is ambitious and would critically depend on managing the growing pressures on the external account […]"

Should we be expecting faster rate hike in coming months?

In view of SBP, the widening current account deficit of growing imports as well as the recent increase in oil prices is expected to further push current account deficit to a higher level. And with insufficient financial inflows, this could be a drain on overall country's FX reserves, which are down to USD 10.3bn witnessing a reduction of nearly USD 5.8bn. Although the risk in external accounts is imminent, but we view widening trade deficit as indicative of 'temporary' demand supply imbalances arising to support higher economic activity. Moreover, on oil prices, since the monetary policy statement issued on 30th march 2018 Arab light was trading at ~USD 67/bbl which is less deviant from today's trading price of ~USD 70/bbl. Our outlook for oil prices remains bearish in the near-to medium term. Since both key factors seem temporary rather than structural in nature, a quick fix will be hard to come by. Earlier, to restrict imports, government imposed regulatory duties and increased custom duties on import of luxury goods, while to induce export growth the government unveiled export packages. However, as we argued earlier, this will be of less benefit.

Nevertheless, going forward we do not expect rate hike to accelerate, in fact we now expect a maximum of 25bps before CY18 end compared to market consensus of 50-75bps additional rate hike.

Minimal impact for the market; for banks rate hike to an extent already incorporated

The overall negative valuations impact for the policy rate increase stands marginal at ~3-4% (for IGI coverage companies excluding banks), we expect the event to be relatively a non-mover for the market. For banks, we view current prices to have already incorporated rate hike to a certain extent. Having said that, our banking universe valuations are impacted only marginally by 4-5% on a 50bps rise in discount rate. Currently, equities are trading at a forward PE 8.5x, with a dividend yield of 5.3%.

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

IGI Securities

Contact Details

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
Syed Daniyal Adil	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	daniyal.adil@igi.com.pk
Suleman Ashraf	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 957	suleman.ashraf@igi.com.pk
Muhammad Saad	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 816	muhammad.saad@igi.com.pk
Umesh Solanki	Database Manager	Tel: (+92-21) 111-234-234 Ext: 974	umesh.solanki@igi.com.pk

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) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Irfan Ali	Regional Manager (Faisalabad)	Tel: (+92-41) 2540843-45	irfan.ali@igi.com.pk
Asif Saleem	Branch Manager (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Branch Manager (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk
Zeeshan Kayani	Branch Manager (Abbottabad)	Tel: (+92-992) 408243-44	zeeshan.kayani@igi.com.pk
Ihsan Mohammad	Branch Manager (Peshawar)	Tel: (92-91) 5253035	ihsan.mohammad@igi.com.pk

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Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

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
Website: www.igisecurities.com.pk

Stock Exchange Office
Room # 719, 7th Floor, PSX Building,
Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2 ,
Fax: (+92-21) 32429607

Lahore Office 5-F.C.C. Ground Floor, Syed Maratib Ali Road, Gulberg II Tel: (+92-42) 35777863-70, 35876075-76 Fax: (+92-42) 35763542	**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 Room #: 515-516, 5th Floor, State Life Building, 2- Liaqat Road Tel: (+92-41) 2540843-45 Fax: (+92-41) 2540815	**Rahim Yar Khan Office** Plot # 12, Basement of Khalid Market, Model Town, Town Hall Road Tel: (+92-68) 5871653-6, 5871652 Fax: (+92-68) 5871651
Multan Office Mezzanine Floor, Abdali Tower, Abdali Road Tel: (92-992) 408243 - 44	**Abbottabad Office** Ground Floor, Al Fatah Shoppinig Center , Opp. Radio Station, Mansehra Road Tel: (+92-99) 2408243 - 44
Peshawar Office 2nd Floor, The Mall Tower, 35 The Mall Peshawar Cantt. Tel: (92-91) 5253035, 5278448	**Sialkot Office** Suite No. 10 & 11, 1st Floor, Soni Square, Mubarik Pura Tel: (+92-52) 3258437, 3258762

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