Day Break

Monday, 01 April 2019

IGI Securities

ECONOMY

Exhibit: Interest Rate Structure

	Policy	Chg (bps)	Floor	Ceiling
Mar-19	**10.75%**	**50**	**9.25%**	11.25%
Jan-19	10.25%	25	8.75%	10.75%
Nov-18	10.00%	100	8.50%	10.50%
Sep-18	9.00%	100	7.50%	9.50%
Jul-18	8.00%	100	6.50%	8.50%
May-18	7.00%	-	5.50%	7.50%
Mar-18	7.00%	50	5.50%	7.50%
Jan-18	6.50%	25	5.00%	7.00%

Exhibit: Inflation Break-up

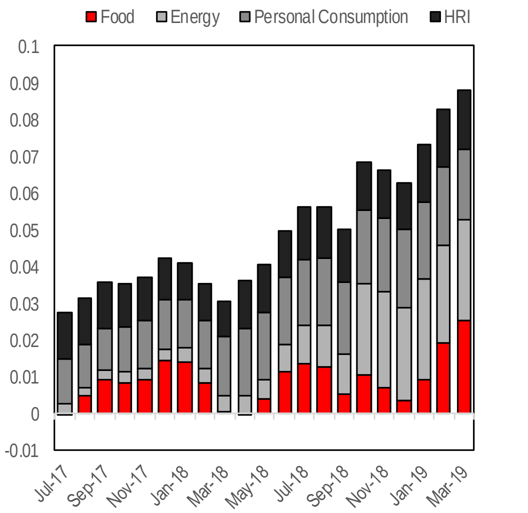
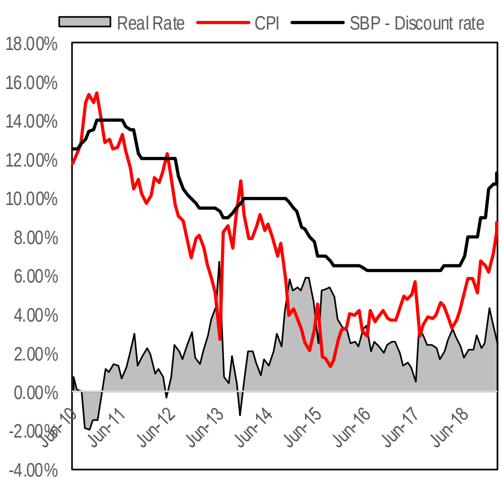


Exhibit: Food prices on a loose



Source:SBP, PBS & IGI Research

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Monetary Policy Statement

Monetary Tigetinging Continued With A Another 50bps Increase to 10.75%; In-Line With Broader Market Consensus

- In its recently announced Monetary Policy Statement (MPS), the State Bank of Pakistan (SBP) increased policy rate by +50bps to 10.75%
- 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 AKBL) preferred over large banks, due to their positive fund gap.

Policy rate increased by 50bps to 10.75%; discount rate 11.25%

In its recently announced Monetary Policy Statement (MPS), the State Bank of Pakistan (SBP) has increased policy rate by +50bps in-line with market consensus of 25-50bps, taking policy rate to 10.75% and discount rate to 11.25%. Moreover, the SBP has again revised its growth target from previous (Jan-19) GDP growth target of 4.0% to 3.5% (6.2% FY19 budget target), while inflation target remains unchanged.

Exhibit: **Key Changes in SBP projected macros for FY19**

	Current (MPS)	Previous (MPS)	Annual Target
SBP Policy Rate	10.75%	10.25%	-
GDP Growth	3.5%	4.0%	6.2%
Inflation - Period Average	6.5-7.5%	6.5-7.5%	6.0%

Source: SBP Monetary Policy Statement

The monetary policy committee acknowledges gradual improvement in key macroeconomic data points in particularly curret accound balance (C/a), however it remain skeptical of elevated levels 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.

"[…] the (monetary Policy Committee) MPC noted that sustainable growth and overall macroeconomic stability requires further policy measures as: (i) underlying inflationary pressures continue; (ii) the fiscal deficit is elevated, and (iii) despite an improvement, the current account deficit is still high."

Growth target further revised down to 3.5% as 'stabilisation' measures pick-up pace…

Amid contracting Large Scale Manufacturing (LSM) – 2.3% decline during first 7MFY19 compared to a growth of 7.2% expansion in 7MFY18, subpar Kharif production, restricted capital investments owing to cut in public sector development programs (PSDP) and slowing domestic demand due to higher cost energy and financing cost hints to slower growth in commodity producing sector. As a result, growth has been revised down further to 3.5% from previous MPS 4.0% and 6.2% target.

Exhibit: **GDP growth coming rather sharply in FY19-23 mainly as govt. steps up its 'stabilisation' measures, making Pakistan one of the slowest amongst developing Asian economies**

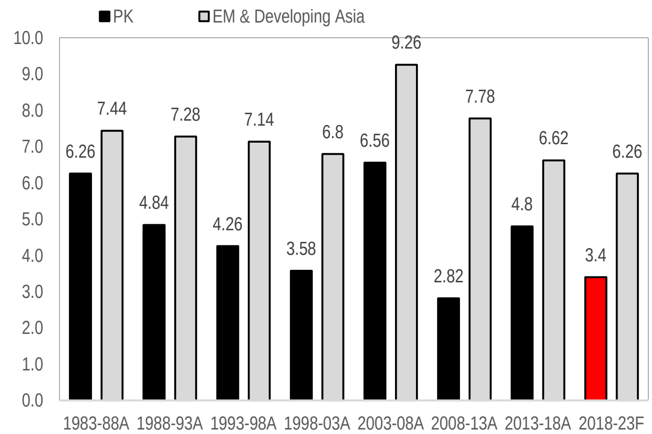
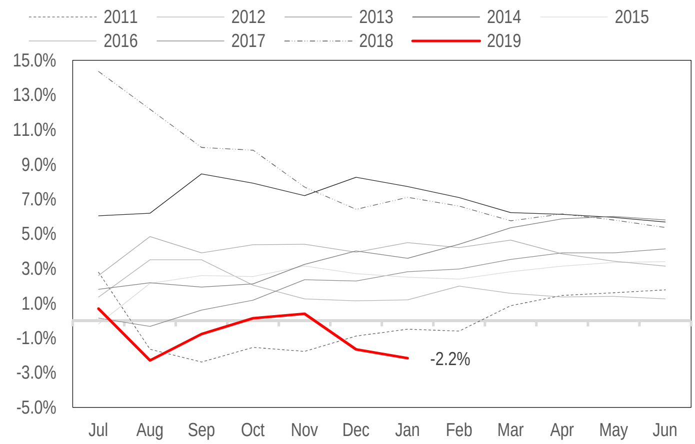


Exhibit: **LSM growth; a slow start getting even slower**



Source: IMF, SBP, IGI Research

External challenges though partially dealt with; vulnerability still exists

Outlining the external sector challenges, the MPS highlights improvement in exports and foreign inflows, but remain insufficient to finance country's external deficit. Owing to stabilization measures under taken, the current account (C/a) deficit narrowed to USD 8.8bn for 10MFY19, compared to a deficit of USD 11.4bn last year same period – a decline of 22.6%, thanks to a sharp decline in country's trade deficit. However the MPS note, the trade deficit impact could have been more pronounced had oil prices stayed lower.

Exhibit: **C/a deficit finally started to recede; lower oil prices could have meant a larger decline in trade deficit**

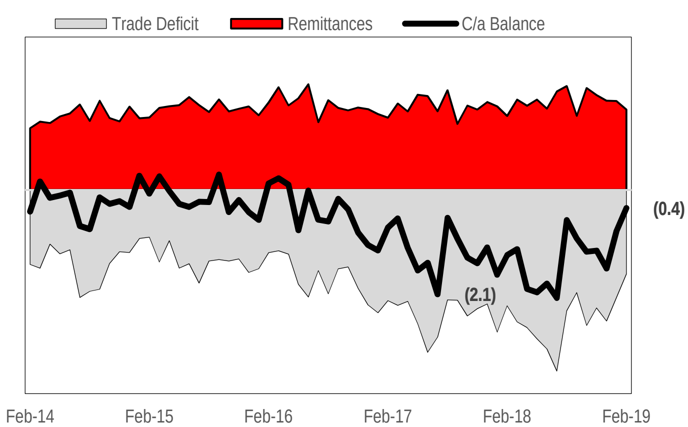
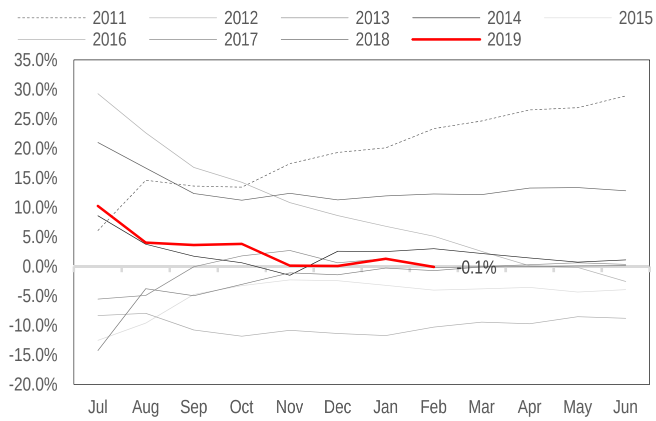


Exhibit: **Exports growth showed flattish growth**



Source: IMF, SBP, IGI Research

Headline inflation to average 7.5% in FY19; administrative prices to keep forward core inflation elevated

On inflation, SBP pointed out rising trend in inflation are explained by explained increase energy prices (gas and electricity tariff), PKR depreciation, persistently higher government borrowing from SBP and significant increase in perishable food prices.

Core inflation (NFNE) clocked in at +8.8% by Feb-18, compared to +5.2% last year. Looking forward, rising input cost and laggard impact of exchange rate are likely to keep prices elevated in the coming months. However, headline inflation range remain unaffected at 6.5-7.5% in FY19.

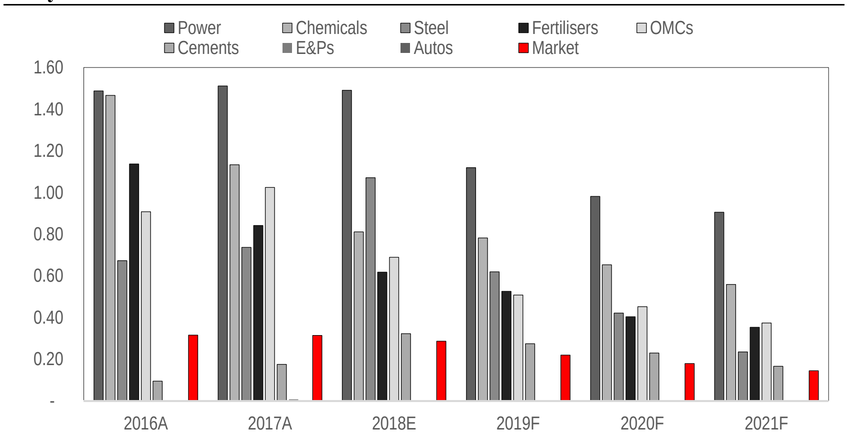
Outlook

Given the macroeconomic environment, the impact on headline inflation of +50bps rate hike will be minimal, with real interest rates hovering near all-time high 3.75%. In terms of central objective, monetary tirghteing is not 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 as data suggests country's exports are yet to show meaningful growth. Monetary policy as tool is of little help in curbing overall import demand as much of the import is dependednt on oil, and is 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 AKBL) preferred over large banks, due to their positive fund gap.

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



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