Day Break

Monday, 03 December 2018

IGI Securities

Economy

MPS rate hike

Exhibit: Macro Targets revised

	Previous	Current
Inflation Target	5.0-6.0%	6.5-7.5%
GDP Growth *	5.8%	4.0%
** Govt. Target*		

Exhibit: Policy Rate

Date	Reverse Repo	Repo	Policy Target	Change (BPS)
25-May-15	7.0	5.0	6.5	-
14-Sep-15	6.5	4.5	6.0	(50)
23-May-16	6.3	4.3	5.8	(25)
29-Jan-18	6.5	4.5	6.0	25
28-May-18	7.0	5.0	6.5	50
16-Jul-18	8.0	6.0	7.5	100
1-Oct-18	9.0	7.0	8.5	100
3-Dec-18	10.5	8.5	10.0	150

Exhibit: Discount rate and inflation trend

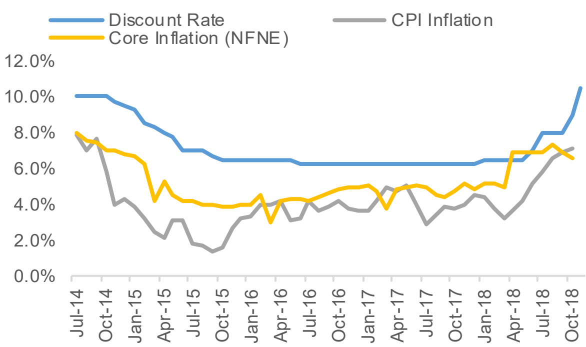
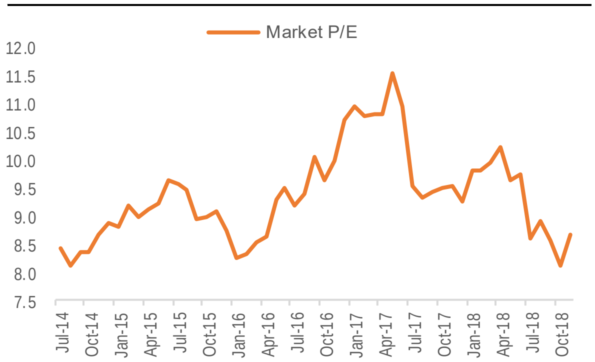


Exhibit: KSE100 Index PE



Source: SBP & IGI Research

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Monetary Policy Statement

SBP raised policy rate by 150bps as external weakness and inflation pressure builds up

- In the latest round of monetary policy decision, the State Bank of Pakistan (SBP) increased the target policy rate by 150bps to 10.0%, effectively taking the discount rate to 10.5%, compared to market consensus of 50-100bps.
- On the outlook SBP's proactive monetary contraction decision is likely to herd down multiple of demand pressure in economy whereby SBP expects growth to slow down to 4.0% from 5.8% previously.
- On external side, SBP notes recent drop in international oil prices is encouraging for both current account balance and anchoring down inflation expectations.
- From stock market perspective, market consensus of 50-100bps was already built in, the additional 50bps rate hike was somewhat of a surprise for the market in our view.
- We recommend investors go long on Banks, Fertilisers and E&Ps with UBL, BAFL, AKBL, PPL, EFERT, FFC, HUBC and LUCK as our preferred picks.

Policy rate hike by 150bps on rising twin deficits

In the latest round of monetary policy decision, the State Bank of Pakistan (SBP) increased the target policy rate by 150bps to 10.0%, effectively taking the discount rate to 10.5%, compared to market consensus of 50-100bps. SBP cited rising inflationary pressure, elevated fiscal deficit and still recovering external side as the key factors for this rate hike. Nevertheless, this rate hike adds to a total of 425bps increase during CY18.

"The Monetary Policy Committee noted that: (i) continued inflationary pressure (and rising inflationary expectations) needs to be checked; (ii) real interest rates remain low; (iii) although narrowing, the current account deficit is still high and the fiscal deficit remains elevated; and (iv) unfolding global developments, particularly the gradual but consistent normalization of monetary policy in the developed economies demands proactive domestic monetary management." – MPS Nov-18

SBP view on upcoming macro challenges

On the outlook SBP's proactive monetary contraction decision is likely to herd down multiple of demand pressure in economy, whereby SBP expects growth to slow down to 4.0% from 5.8% previously. Early casualty of rate hike is large scale manufacturing index which is still moderating from the previous 275bps. Moreover, production of major crops except wheat is likely to fall short which will keep overall agricultural sector growth tepid.

On external side, SBP notes 4MFY19 import growth decelerated to 5.8% compared to 26.3%, largely owing to contraction in non-oil imports. This along with higher remittances and stable export growth helped contain country's current account balance to USD 4.8bn compared to USD 5.1bn. Recent drop in international oil prices is encouraging for both current account balance and anchoring down inflation expectations. Moreover, expected foreign inflow in 2HFY19 combined with deferred oil facility will facilitate to easing pressure on country's liquid dwindling foreign exchange reserves. Nevertheless, SBP believes these combined factors will instill a confidence in foreign exchange market and should also aid towards lower inflation expectations. SBP revised target for FY19 average inflation stands at 6.5-7.5% while current average of 4.9% in 4MFY19.

What do we expect

Looking ahead we expect external account weaknesses particularly when viewed with a single eye on oil prices could easily spell difficulties for monetary policy makers in coming month. We expect inflation to moderate 7.5-8.0% in FY19, which at current discount rate of 10.5% will keep real interest rate in positive territory, hence we do not expect further rate hike in the reminder of FY19.

Outlook

From stock market perspective, market consensus of 50-100bps was already built in, the additional 50bps rate hike was somewhat of a surprise for the market in our view.

Sector wise rising interest rates will benefit financial sectors' interest income but also raises concerns of deteriorating macro fundamental leading to lower non-performing loan recovery. We view BAHL, AKBL, MCB and BAFL investment portfolio most suited to rate hike. Amongst cement DGKC, CHCC and PIOC as most affected due to higher debt levels, for steel sector ASL and for fertilizer FFBL will be most affected. For automobile assemblers we expect neutral impact of rate hike however higher investment income for INDU will be earnings accretive. For Power and E&Ps sector impact will be rather neutral. Under OMCs PSO is likely to get impact the most.

We recommend investors go long on Banks, Fertilisers and E&Ps with UBL, BAFL, AKBL, PPL, EFERT, FFC, HUBC and LUCK as our preferred picks.

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