Day Break

Monday, 01 October 2018

Economy

MPS rate hike

Exhibit: Macro Targets revised

	Previous	Current
Inflation Target	5.0-6.0%	6.5-7.5%
GDP Growth *	6.2%	5.0%
** Govt. Target*		

Exhibit: CPI and SBP discount rate

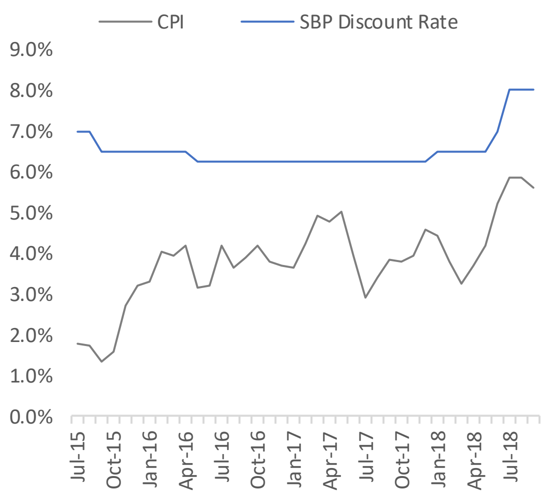
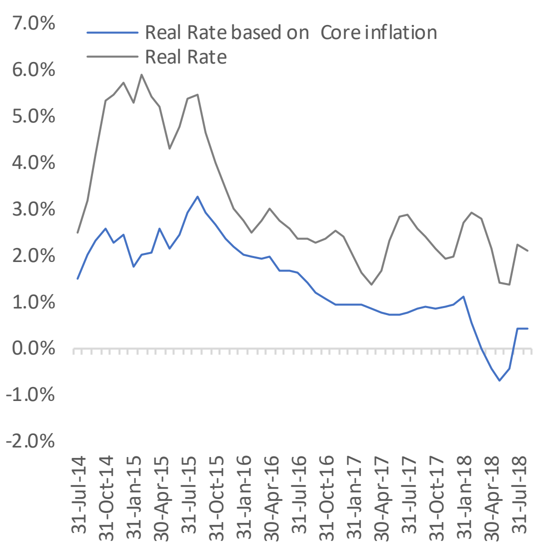


Exhibit: Real interest rate



Source: SBP & IGI Research

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Monetary Policy

Monetary tightening and fiscal consolidation; growth target revised down to 5.0%

- The State Bank of Pakistan (SBP) in its latest monetary policy statement raise the policy rate by 100bps to 8.5% and subsequently taking discount rate to 9.0%. Rates have now been raised by 275bp since the start of the year 2018, and are now at their highest level since 2015. The decision to raise interest rates by 100bp, came as no surprise and was in-line with market consensus of 100-150bps,
- In addition to rising inflationary pressure, SBP highlighted rise in oil imports as key threat on external accounts. As per the statement; "while non-oil imports are responding to the contractionary measures a surge in oil prices is masking this improvement, and as a result the current account deficit remain high",
- From the tone of monetary policy statement, we do not sense any positive development on economic front. However, we think rates have peaked and there is less chance of further tightening at least in 2018, but remain contingent on oil prices outlook. Market: 100bps should not come as a surprise for the market as it was much anticipated. (impact Neutral).

SBP hikes rate by 100bps…

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In response to rising inflationary pressure, higher current account deficit and tricky global environment

Monetary Policy committee highlighted two key factors for the rate hike consideration, a) persistently high current account deficit despite a slowdown witnessed in non-oil imports, b) rising inflation mean real interests have fallen and, c) uncomfortable macroeconomic management in times of tricky global environment particularly taking a view of rising oil prices and protectionist trade policies.

SBP raises its FY19 inflation forecast in range of 6.5-7.5%

Given a higher starting point (2MFY19 averaged 5.8%), upward revision in domestic rising gas prices, anticipated increase in oil prices, further increase in regulatory and import duties, and second round effect of earlier PKR depreciation are some key factors that feed into SBP forecasts.

Current account remains persistent on oil imports

In addition to rising inflationary pressure, SBP highlighted rise in oil imports as a key threat to external accounts. As per the statement; "while non-oil imports are responding to the contractionary measures a surge in oil prices is masking this improvement, and as a result the current account deficit remain high". In 2MFY19 total petroleum imports accounted for 32% of the total import bill, compared to 23% last year same period, depicting a +52%YoY growth. As a result of country's FX reserves have fallen to USD 9bn, leaving less than 2months of import cover.

Exhibit:

FY19 Import bill risies on higer oil prices

	2MFY18	2MFY19	YoY% Growth
Food	1,005	863	-14%
Transport and Machinary	2,037	1,593	-22%
Petroleum	2,094	3,183	52%
- POL Products	1,321	1,550	17%
- Crude Oil	491	1,025	109%
- LNG	267	598	124%
Total imports	8,972	9,959	11%

Source: SBP, IGI Research

As per SBP; "The current account deficit continues to pose a challenge. Despite some growth in worker's remittance and exports in the first two months of FY19, a notable increase in the value of oil imports has kept the current account deficit at US$2.7 billion, as compared to US$2.5 billion, in the corresponding period last year despite non-oil imports declining during the period."

Fiscal consolidation underway

SBP notes government is undergoing fiscal consolidation program, including increase in domestic gas tariff hike and imposing further import and regulatory duties to tame down current account deficit and improve government revenue stream, which is likely to reduce overall domestic demand in coming months.

Fiscal and Monetary measures to hurt growth; SBP lowers its projection to 5.0%

Combining the fiscal consolidation and monetary tightening SBP expects growth to slow down at 5.0% compared to previous ~5.5%. Moreover, cotton production is also expected to miss FY19 target of 14.4mn bales along with service sector.

Outlook

We were of the opinion; current account position is worrisome but worst might be over. Recent government steps to increase import and regulatory duty on non-essential items will start to bring down overall import bill in coming months which is reflected by reduced non-oil import bill in 2MFY19. However, the same cannot be said of petroleum, and monetary policy comes as a little help to defuse overall trade deficit. Moreover, we had also opine combining monetary tightening with fiscal consolidation is calling for hard landing on overall economic growth. Rightly so SBP lowered its growth projection to 5.0%.

From the tone of monetary policy statement, we do not sense any positive development on economic front. However, we think rates have peaked and there is less chance of further tightening at least in 2018, but remain contingent on oil prices outlook.

Market: 100bps should not come as a surprise for the market as it was much anticipated. (impact Neutral)

Commercial Banks: Rising in interest rates will certainly improve sector NIMs, however banks with high ADR also faces risk of NPL accretion and a slowdown in overall advances growth owing to revised growth target of 5.0%. Banks with a combination of high current account deposits, low infection ratio and high shorter maturity investment portfolio, will benefit the most. We highlight BAHL, ABL, MCB and HBL to most beneficiary amongst our coverage banking stocks. (Positive).

Exploration and Production: Oil & Gas Exploration companies will face dual impact of rise in interest cost on short term borrowing and investments in T-bills/TDRs. As E&P companies are long-term debt free except for MARI, we estimate positive EPS impact for PPL and OGDC due to investment in TDR while MARI will face earnings accretion due to long term debt and lower investments in TDR for POL. As a result, we highlight OGDC and PPL to benefit on net basis due to heavy investments in TDR. (Neutral - Positive)

Cements: The increase in interest rates will have a negative impact over the sector given that it is already involved in an expansion phase. We highlight CHCC to be the most affected Company in our coverage, given it is carrying out a back to back expansion with huge amount of external financing (D/E : 1.44) followed with DGKC, MLCF and PIOC who have also obtained considerable sums to fuel their expansion plans. However, LUCK and KOHC having huge cash resources and no debt portfolio (negligible for KOHC) on its balance sheet will benefit in this scenario due to enhanced other income followed by FCCL (no expansion initiated yet), and ACPL. (Negative)

Fertilisers: The recent interest rate hike will increase finance costs for the fertilizer companies given they are highly leveraged. Hence, earnings will squeeze for the companies which have high debt structure. However, companies which have liquidity tied up in investments such as FFC and EFERT will have the impact partially offset. Amongst our coverage companies we estimate FFBL to suffer the most followed by FFC, EFERT and FATIMA. (Negative)

Oil & Marketing Companies: OMC sector due to heavily impacted by circular debt, is likely take a hit on the back of substantial short term borrowings. On the other hand, some respite may come from income on cash deposit with bank. However, we highlight PSO remain highly effected due to rise in interest rate as the Company stood at Short term borrowing of PKR 89.9bn as at Jun-18. Similarly, HASCOL will also face rise in interest cost due to long term debt of PKR 2.2bn and ST borrowing of PKR 6.9bn leading to D/E ratio of 0.9x. APL in our view would remain least effected as it is debt free and holds cash deposits with bank contributing nearly 8.7% of total earnings. (Negative)

Power Sector: The Power sector will be negatively effected owing to heavy reliance on short term borrowings as circular debt is touching PKR 1.3tr mark. As a result, we highlight HUBC and NCPL to be most effected while for KAPCO, income on overdue receivables is expected to dilute the impact to some extend. Thus overall, we highlight negative impact on power sector as rise in interest rates will increase interest cost thus leading to earnings contraction. (Negative)

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