MPS - Prioritizing growth

- In a monetary policy announcement yesterday, the MPC of the SBP has decided to keep the policy rate unchanged at 7.0%, striking a balance between the need to support the nascent economic recovery and to keep the inflation expectations anchored. The committee now expects average inflation in FY21 to be marginally higher than previously, however, it remains within the previously announced range of 7.0-9.0%.

- MPC’s accommodative bias further affirms our earlier view of rate remaining on hold in the near to medium term. We think the economic growth will continue to be a top priority in setting monetary policy in the months ahead, however, the recent buildup of inflationary pressures coupled with potential upside risks (i.e. utility adjustments, oil prices, and the spike in food prices due to flooding & potential locust attack) will likely push the MPC to keep the policy rate unchanged at the current level.

- Since the decision was in line with the wider market expectations, the event should be market neutral in our view. Market is expected to remain range bound in the short term with valuations stretched across the sectors whereas liquidity could cushion the market from downward risks. Developments on political front is a key risk to market performance in our view.

- At current levels, stock picking holds the key for generating alpha while for longer term horizon, heavy weights Banks and E&P’s offer attractive entry points. Within Banks, we like HBL and UBL whereas in the E&P space OGDC is our top pick.

SBP holds policy rate at 7.0%: In a monetary policy announcement yesterday, the MPC of the SBP has decided to keep the policy rate unchanged at 7.0%, striking a balance between the need to support the nascent economic recovery and to keep the inflation expectations anchored. The committee sees tangible improvement in the economic activity compared to Jun’20, with the recovery driven by i) policy support provided by the authorities (i.e. SBP (3.8% of GDP) & the govt (2.5% of GDP) and ii) easing of lockdowns following a decline in COVID-19 case count. It projects the economic growth to be slightly above 2.0% in FY21 (vs. -0.4% in FY20), with the path to recovery subject to many ‘ifs and buts’. The committee now expects average inflation in FY21 to be marginally higher than previously, however, it remains within the previously announced range of 7.0-9.0%. On the external front, the MPC views the country’s external account position as largely stable, with the resilient remittance flows, weak domestic demand, and soft oil prices will likely keep CAD in check, expected to average around 2% of GDP in FY21.

Outlook - SBP to remain accommodative in the near term: MPC’s accommodative bias further affirms our earlier view of rate remaining on hold in the near to medium term. We think the economic growth will continue to be a top priority in setting monetary policy in the months ahead, however, the recent buildup of inflationary pressures coupled with potential upside risks (i.e. utility adjustments, oil prices, and the spike in food prices due to flooding & potential locust attack) will likely push the MPC to keep the policy rate unchanged at the current level. In terms of reversing its monetary course, we will be keenly watching developments on the external front and inflation readings in the upcoming months. In our base case, we expect the inflation to average around 8.2% YoY assuming 20%/10% upward adjustments in electricity and gas tariffs in Mar’20.

Investment perspective: Since the decision was in line with the wider market expectations, the event should be market neutral in our view. Market is expected to remain range bound in the short term with valuations stretched across the sectors whereas liquidity should cushion the market from downward risks. Developments on political front is a key risk to market performance in our view. Stock picking holds the key for generating alpha while for longer term horizon, heavy weights Banks and E&P’s offer attractive entry points. Within Banks we like HBL and UBL particularly with risks somewhat priced-in valuations and subsiding of foreign outflows whereas in the E&P space we have preference for OGDC. Other likings include, LUCK, MLCF and HUBC.
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