

PAKISTAN ECONOMY

Apr'21 inflation to reach 11.2%YoY

- Double-digit inflation is expected to make a comeback in Apr'21 with inflation for the month likely to clock in at 11.2%YoY (13M high), primarily a factor of low base effect. On sequential basis, inflation is likely to be +1.1%MoM (Urban/Rural: 1.15%MoM/1.11% MoM) with food inflation picking up pace for the fourth consecutive month potentially aided by the Ramadan factor, compounded by quarterly revision in housing index.
- While double digit inflation release in 4QFY21 was widely expected, key near term checkpoints defining inflation outlook would be i) FY22 budget, ii) commodity bull-cycle, particularly when major economies consider lockdown as vaccine supply side issues and COVID new variants pose a renewed threat for social costs, and iii) outcome of Govt. negotiations with multilateral/bilateral lending agencies on path of electricity hikes.
- Market is likely to remain volatile in the short term with attention likely to be centered around, i) COVID's third wave and consequent business disruptions, and ii) budget related news flows.
- We advocate for sectors that fall on structural theme metrics where our preferred sectors are Cements, Steel, and Construction-Allied on construction theme, and Power and select -OMCs (PSO) on possible circular debt clearance.

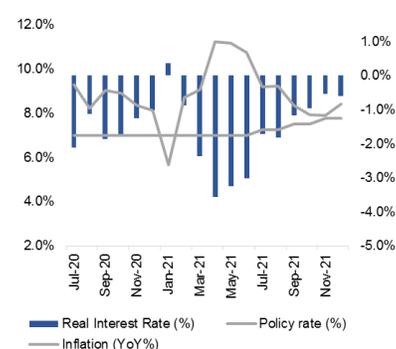
Apr'21 inflation likely to clock in at 11.2% - a 13M high: Double-digit inflation numbers would be back in Apr'21 with inflation for the month likely clocking in at 11.2%YoY (13M high), primarily a factor of low base effect. On a monthly basis, inflation is likely to be +1.1%MoM (Urban/Rural: 1.15%MoM/1.11%MoM) with food inflation picking up pace for the fourth consecutive month potentially aided by the Ramadan factor. Amongst the food commodities, fresh fruits (+18.0%MoM) and chicken (+7.4%MoM) contributed the most to inflation in urban centers while all categories of pulses were down 0.5-2.0%MoM potentially attributable to rupee appreciation. Additional pressure on inflation emanates from quarterly adjustments in housing index (Apr'21E: 0.84%). That said, negative fuel price adjustments for Feb'21 and downtick in petroleum prices (MS/HSD down 2.56%MoM/4.1%MoM) offset some of the inflationary pressures highlighted above. Consequently, Urban inflation is expected to clock in at 10.75%YoY in the current month compared to 8.75%YoY in Mar'21 whereas rural inflation is likely to stand at 11.92%YoY in Apr'21 vs. 9.51%YoY in Mar'21. For 10MFY21, inflation is expected to stand at 8.63% vs. 11.23%YoY in the same period last year.

Budget, commodity bull cycle, and electricity tariff hikes to define interest rate outlook: While double digit inflation release in 4QFY21 was widely expected, key near term checkpoints defining inflation outlook would be i)FY22 budget, ii) commodity bull-cycle, particularly when major economies consider lockdown as vaccine supply side issues and COVID new variants pose a renewed threat for social costs, and iii) outcome of Govt. negotiations with multilateral/bilateral lending agencies on path of electricity hikes. To highlight, as per news reports, Govt ought to increase electricity tariff by Pkr/unit 1.39/2.21 in Jun'21/Jul'21. On the fiscal side, Govt. has planned aggressive tax reform, targeting to raise FBR tax collection to Pkr5.96trn (+26.8%YoY) which entails withdrawing/streamlining sales tax exemption regime (c. sales tax exemptions stand at Pkr519bn) and in turn pulling up inflationary pressures. However, third wave of COVID has increased the possibility of relaxation in timeline of these measures in our view.

KSE-100 index to remain volatile with all eyes on COVID and FY22 budget: Market is likely to remain volatile in the short term with attention likely to be centered around, i) COVID third wave and consequent business disruptions, and ii) budget related news flows. Mounting inflationary pressures present a risk of monetary adjustments in the upcoming MPC meeting however, increasing uncertainty around COVID-19's third wave and Central Bank's preference for sustaining economic growth tilts market expectation for a status quo in May'21. Hence, we advocate for sectors that fall on structural theme metrics where our preferred sectors are Cements, Steel, and Construction-Allied on construction theme, and Power and select-OMCs (PSO) on possible circular debt clearance. Further, investors can look for select positions in tech and textiles (particularly spinning players) for alpha generation.

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Nominal vs. Real interest rates



Source: PBS, SBP, & AKD Research



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Neutral	> 8.5% to < 14.5% expected total return
Sell	< 8.5% expected total return (Rf: 8.5%)



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