

25bps hike speaks volume

- Against the consensus expectations of the status quo, the Monetary Policy Committee (MPC) has raised the policy rate by 25bps to 10.25%. The token rate hike of 25bps marks a more calibrated policy response from the Central Bank, striking a balance between growth and macro-imbalances.
- Also, the rate hike signifies a continuation of ongoing monetary tightening but in a more staggered manner, and in line with our earlier expectations of calibrated tightening.
- Considering the creeping up inflationary pressures amidst elevated macro-imbalances, we expect tightening to continue, with a further 125bps hike in CY19. A more measured policy response from the Central Bank is likely to be undertaken going forward, dispensing relatively moderate 25-50bps hikes.
- From market vantage, this hike is not a deal-breaker in terms of raised cost of borrowing (0.32% dip in AKD Universe ex Banks annual earnings), mostly in Cements (dip of 1.1%) Fertilizers (0.9%) and OMCs (0.8%), whereas index heavy Banks (interest rate sensitivity of 1.1x) and E&Ps (other income gains from PIBs) stand to gain

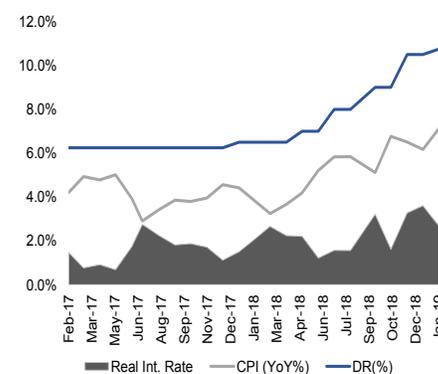
25bps rate hike – a calibrated policy response: Contrary to street expectations, the MPC has raised policy rate by 25bps to 10.25% in the monetary policy announcement yesterday. The token rate hike of 25bps marks a more calibrated policy response from the central bank, striking a balance between growth and macro-imbalances. Also, the rate hike signifies a continuation of ongoing monetary tightening but in a more gradual manner, and in line with our earlier expectations of calibrated tightening. While acknowledging the impact of stabilization measures implemented in taming aggregate demand, the MPC recognized the need for further macro adjustment, as the macro-imbalances remain elevated. Lack of concrete policy action on the fiscal side also necessitated a policy response from the central bank, leaving monetary tightening as the only policy tool to address challenges.

Outlook – a relatively modest tightening cycle ahead: From here on, the monthly inflation readings are likely to be on a higher side, as the impact of utility rate hikes, latest round of rupee depreciation and higher gov't borrowing from SBP fully sets in. Our expectation for the headline inflation in 2HFY19F is 8.06%YoY vs. actual 6.04% in 1HFY19. Considering the creeping up inflationary pressures amidst elevated macro-imbalances, we see continued monetary tightening, with a further rate hike of 125bps in CY19. A more measured policy response from the Central Bank is likely to be undertaken, as aggressive rate hikes in the previous year allow it to now follow a more a calibrated tightening path. In addition, Fed's more dovish stance has set the stage for a more modest hike cycle for emerging economies including Pakistan. The main risk to our view is how developments on macro-imbalances unfold, particularly on the fiscal side.

Calibrated hike has controlled impact, flows could suffer: For profitability, this hike is not a deal-breaker in terms of raised cost of borrowing (0.32% dip in AKD Universe ex Banks annual earnings), mostly in Cements (dip of 1.1%) and Fertilizers (0.9%), whereas index heavy Banks (interest rate sensitivity of 1.1x with yield curve steepening) and E&Ps (other income gains from PIBs) stand to gain. Apart from profitability, this cycle of tightening raises risk free rate assumptions, essentially pushing up the required rate of return for equity investors. From an investment perspective, funds flows away from equity and towards risk-free debt instruments could hasten (between June'17 and Nov'18, PkR109.1bn inflows into money market funds and PkR74.36bn out of equity funds were recorded).

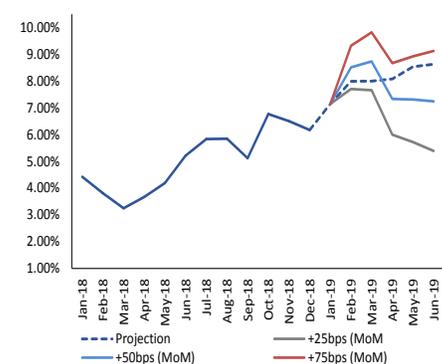
Umer Farooq
 umer.farooq@akdsecurities.net
 111-253-111 Ext: 602

Nominal vs. Real interest rate



Source: SBP, PBS & AKD Research

CPI Projection - Sensitivity



Source: SBP, PBS & AKD Research



AKD Securities Limited

Disclosure Section

Neither the information nor any opinion expressed herein constitutes an offer or a solicitation of an offer to transact in any securities or other financial instrument and is for the personal information of the recipient containing general information only. AKD Securities Limited (hereinafter referred as AKDS) is not soliciting any action based upon it. This report is not intended to provide personal investment advice nor does it provide individually tailored investment advice. This report does not take into account the specific investment objectives, financial situation/financial circumstances and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. AKDS recommends that investors independently evaluate particular investments and strategies and it encourages investors to seek the advice of a financial advisor.

The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. The securities or strategies discussed in this report may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them.

Reports prepared by AKDS research personnel are based on public information. AKDS makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. Facts and views presented in this report have not been reviewed by and may not reflect information known to professionals in other business areas of AKDS including investment banking personnel. AKDS has established information barriers between certain business groups maintaining complete independence of this research report.

This report has been prepared independently of any issuer of securities mentioned herein and not in connection with any proposed offering of securities or as agent of any issuer of any securities. Neither AKDS, nor any of its affiliates or their research analysts have any authority whatsoever to make any representation or warranty on behalf of the issuer(s). AKDS Research Policy prohibits research personnel from disclosing a recommendation, investment rating, or investment thesis for review by an issuer prior to the publication of a research report containing such rating, recommendation or investment thesis.

We have taken all reasonable care to ensure that the information contained herein is accurate, up to date, and complies with all prevailing Pakistani legislations. However, no liability can be accepted for any errors or omissions, or for any loss resulting from the use of the information provided as any data and research material provided ahead of an investment decision are for information purposes only. We shall not be liable for any errors in the provision of this information, or for any actions taken in reliance thereon. We reserve the right to amend, alter, or withdraw any of the information contained in these pages at any time and without notice. No liability is accepted for such changes.

Stock Ratings

Investors should carefully read the definitions of all ratings used in each research report. In addition, research reports contain information carrying the analyst's view and investors should carefully read the entire research report and not infer its contents from the rating ascribed by the analyst. In any case, ratings or research should not be used or relied upon as investment advice. An investor's decision to buy, sell or hold a stock should depend on individual circumstances and other considerations. AKDS uses a three tier rating system: i) Buy, ii) Neutral and iii) Sell (new rating system effective Sep 10'18) with total returns (capital upside + dividend yield) benchmarked against the expected one year forward floating (variable) risk free rate (10yr PIB) plus risk premium.

New Rating Definitions

Buy	> 19% expected total return (Rf: 13% + Rp: 6%)
Neutral	> 13% to < 19% expected total return
Sell	< 13% expected total return (Rf: 13%)

Old Rating Definitions (Discontinued)

Buy	> 20% upside potential
Accumulate	> 5% to < 20% upside potential
Neutral	< 5% to > -5% potential
Reduce	< -5% to > -20% downside potential
Sell	< -20% downside potential
Not Rated	No investment opinion or recommendation

Valuation Methodology

To arrive at our period end target prices, AKDS uses different valuation techniques including:

- Discounted Cash Flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)

Analyst Certification of Independence

The analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

The research analysts, strategists or research associates principally having received compensation responsible for the preparation of this AKDS research report based upon various factors including quality of research, investor client feedback, stock picking, competitive factors and firm revenues.

Disclosure of Interest Area

AKDS and the authoring analyst do not have any interest in any companies recommended in this research report irrespective of the fact that AKD Securities Limited may have, within the last three years, served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this report or may be providing, or have provided within the previous 12 months, significant advice or investment services in relation to the investment concerned or a related investment.

Regional Disclosures (Outside Pakistan)

The information provided in this report and the report itself is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject AKDS or its affiliates to any registration or licensing requirements within such jurisdiction or country.

Furthermore, all copyrights, patents, intellectual and other property in the information contained in this report are held by AKDS. No rights of any kind are licensed or assigned or shall otherwise pass to persons accessing this information. You may print copies of the report or information contained within herein for your own private non-commercial use only, provided that you do not change any copyright, trade mark or other proprietary notices. All other copying, reproducing, transmitting, distributing or displaying of material in this report (by any means and in whole or in part) is prohibited.

For the United States

Compliance Notice.

This research report prepared by AKD Securities Limited is distributed in the United States to Major US Institutional Investors (as defined in Rule 15a-6 under the Securities Exchange Act of 1934, as amended) only by Decker & Co, LLC, a broker-dealer registered in the US (registered under Section 15 of Securities Exchange Act of 1934, as amended). All responsibility for the distribution of this report by Decker & Co, LLC in the US shall be borne by Decker & Co, LLC. All resulting transactions by a US person or entity should be effected through a registered broker-dealer in the US. This report is not directed at you if AKD Securities Limited or Decker & Co, LLC is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that Decker & Co, LLC and AKD Securities Limited are permitted to provide research material concerning investment to you under relevant applicable legislations and regulations.