AKD Daily

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Today's Daily

Pakistan Economy: SBP reverses it's monetary stance

Beating market consensus, SBP opted to increase TR/DR by 25bps (TR/DR at 6.0%/6.5%) in Jan'18 MPS, marking the reversal of its accommodative stance (TR/DR static at 5.8/6.3%) . The surprise hike this early in the year came on the back of: 1) recent PKR depreciation by ~5% against dollar, 2) oil prices hovering near US$70/bbl (vs. avg. US$48.4/bbl in FY17), 3) a number of central banks have started to adjust their policy rates upward, adversely affecting PKR interest-rate differentials vis-à-vis their currencies and 4) multiple indicators showing that the output gap has significantly narrowed, indicating a buildup of demand pressures. Going forward, we maintain our stance of cumulative 75bps hike in CY18F (TR/DR ending at 6.5%/7.0%) based on IFB reaction model, where we highlight increasing pricing pressures and consequently falling real interest rates together with mounting external account pressures while higher oil prices strengthens our case. In the backdrop of an increasing interest rate scenario, the index heavy weight banking sector (17.1% as of Jan'25) should stand to benefit where a 25bps jump in TR enhances AKD Banking universe's earning by ~4%. On the other hand, historically leveraged sectors like Textile (subsidized financing) and Cements should also weather higher interest rate scenario given D/E ratios remaining under 20% as of Sep'17 (coming down from an avg. 45% in FY10).

KSE100 - Index	
Current	44,551.13
Previous	44,816.71
Chg.	-0.59%

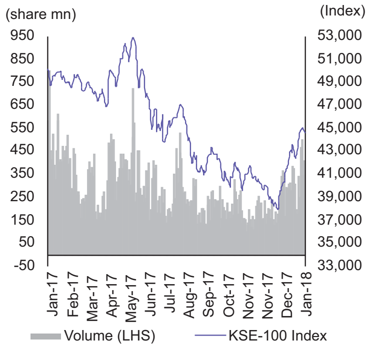
Mkt Cap. (PkRbn/US$bn)	
Current	9,218 / 83.39
Previous	9,245 / 83.64
Chg.	-0.30%

Daily Turnover (mn)	
Current	270.76
Previous	245.73
Chg.	10.2%

Value Traded (PkRmn/US$mn)	
Current	9,176 / 83.01
Previous	9,936 / 89.89
Chg.	-7.6%

News and Views

- While addressing a panel discussion, PM Advisor on Revenue, Finance and Economic Affairs, Miftah Ismail has said that the gov't would clear all sales tax refunds and customs rebates of exporters by Feb 15'18. The PM Advisor also hinted that the gov't is mulling withdrawal of regulatory duty (RD) on many items in the upcoming budget.
- The gov't has decided in principle to pay about PkR482mn to two leading oil marketing companies - Pakistan State Oil and Shell Pakistan - to clear compensation claims which had been pending for almost three years. The compensation claim is related to regulatory duty paid on imported HSD and MOGAS in Apr 2015. Of the total amount, PSO is entitled to receive PkR357mn, while duty claim for SHELL worked out to PkR125mn.
- Lahore High Court (LHC) has directed the Federal Board of Revenue (FBR) to stop charging final antidumping duties on the wall and floor tiles imported from China till further orders. Earlier, the National Tariff Commission (NTC) imposed antidumping duties on the wall and floor tiles imported from China in the range of 19.3-36.0%.



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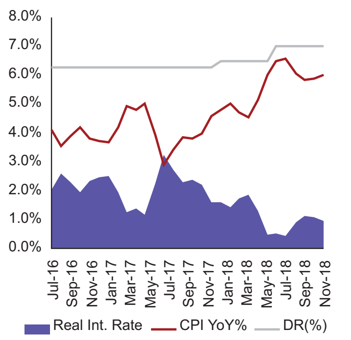
SBP beating market consensus: Against market expectations of a status quo, SBP opted to increase TR/DR by 25bps (TR/DR at 6.0%/6.5%) in Jan'18 MPS, marking the reversal of its accommodative stance (TR/DR static at 5.8/6.3%). Whereas, SBP optimistic stance regarding exports growth backed by lagged impact of RD imposition, recent PkR devaluation, and favorable export package is countered by higher oil prices and timely realization of financial flows which remains key risk in managing BOP and consequently the country's FX reserves. In our view, 25bps rise seems primitive given 1HFY18 avg. CPI inflation of 3.8%YoY, implying real interest rates at +2.3% (+1.1% in 2HFY18F vs 8yrs avg. of +2.1%). That said, with increasing pricing pressure, resulting falling real interest rates,PkR devaluation and mounting external account pressures, we maintain our stance of cumulative 75bps hike in CY18F (TR/DR ending at 6.5%/7.0%) based on our IFB reaction model.

CPI & DR



Source: PBS, SBP & AKD Research

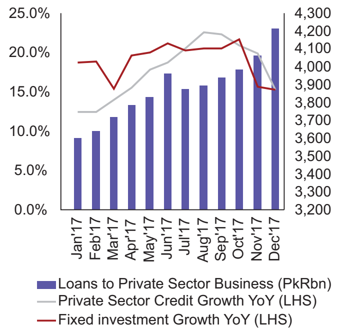
Inflation Outlook: Price pressures are likely to build up during the year on the back of: 1) food related inflation in line with seasonal trends of Ramadan/Eid (Due in 4QFY18), 2) higher global oil prices (Arablight avg. at US$55/bbl in 1HFY18 vs US$45.7/bbl 1HFY17) and 3) lagged impact of PkR devaluation resulting from pass through inflation. Inline with SBP forecast, we project CPI inflation to clock in at 4.4%YoY in FY18 (SBP estimates CPI at 4.5-5.0%), with pressures becoming more prominent by end of the ongoing fiscal year (while NFNE has been so far sticky at

5.5%YoY in 1HFY18).

Output gap: Credit to the private sector has grown at an exceptional run rate averaging 20.2%YoY in 1HFY18 vs 9.7%YoY in 1HFY17 on the back of low interest rates and higher power availability (LSM avg. growth in 5MFY18 at 7.4%YoY vs 3.1%YoY in comparable period). In this backdrop, we expect the current trend to persist given increasing appetite for borrowing primarily driven by investment activities under CPEC (a 25bps hike to have a nominal impact). Additionally, with growth in agriculture sector and higher construction activities under CPEC, SBP projects real GDP growth at 5.8% (AKD estimate of 5.5%) marginally missing the FY18 target of 6%.

Investment Perspective: Although an interest rate hike is termed as negative for equities, the structure and weightages of KSE100 Index constituents should actually benefit. In this regard, the index heavy weight banking sector (17.1% as of Jan'25) should stand to benefit where a 25bps jump in TR enhances AKD Banking universe's earning by ~4%. We prefer banks with a 1) higher proportion of CA deposits, 2) higher push towards lending particularly consumer and 3) adequate diversification of income sources via a strong NFI profile to fare well than the rest. On the other hand, historically leveraged sectors like Textile (subsidized financing), Cements should also weather higher interest rate scenario given D/E ratios remaining under 20% as of Sep'17 (coming down from an avg. 45% in FY10).

Private Sector Credit



Source: SBP & AKD Research

Banks to benefit from rate hike

Sep'17	C/A mix	ADR	NFI/inc.
MCB	38.0%	46.0%	29.4%
HBL	36.7%	41.6%	28.7%
UBL	43.4%	45.1%	27.6%
ABL	36.9%	42.0%	21.5%
NBP	39.9%	40.4%	37.1%
BAFL	42.0%	60.2%	27.6%

Source: Co. Report & AKD Research

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Neutral	≤ 5% to ≥ -5% potential
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Sell	≤ -20% downside potential

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