January 30, 2019

PAKISTAN
ECONOMY

REP-019
MARKET
VISTA

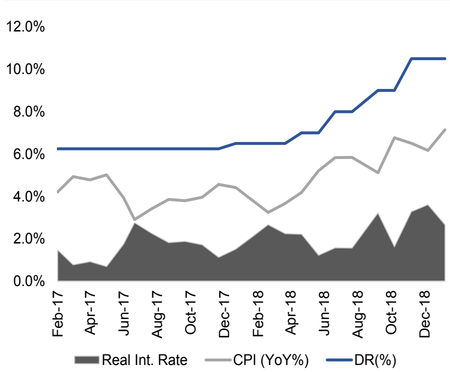
The tight rope to tightening

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

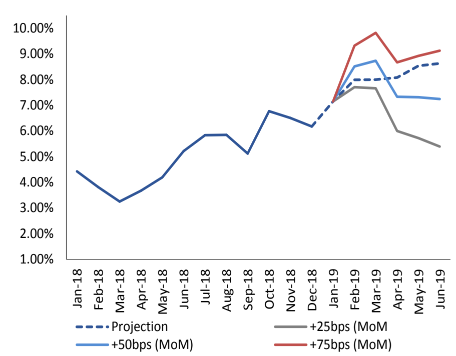
- **In the upcoming monetary policy announcement (tomorrow, 31st Jan), we expect the MPC to keep the policy rate unchanged at 10%, as the relatively benign inflationary back-drop and aggression in the previous year allow the committee to 'Pause' the rate hikes.**
- **However, a 'Pause' in Jan'19 does not mean the end of a monetary tightening cycle, where we expect the central bank to follow a more calibrated tightening path rather than preemptive tightening, adjusting the monetary policy in response to inflationary expectations and macro-imbalances.**
- **Headline inflation is once again likely to pick up, with expected Jan'19 reading of 7.15% YoY compared to 6.17%YoY in Dec'18 and 4.42%YoY in Jan'18. Several idiosyncratic factors (i.e. utility and drug price hike) coupled with quarterly revision in housing rent are at play, pushing monthly inflation higher.**
- **However, the reduction in fuel prices (transport index: -1.1%MoM) would keep a lid on the monthly inflation reading. Sequentially, CPI index is likely to jump 0.95%MoM.**
- **Core inflation – measured through NFNE index and better reflective of long-run inflationary trends – continues to steadily rise, with Jan'19 reading expected to reach 8.71%YoY (a level last seen in mid-2014).**

Inflation continues to tread higher: CPI inflation for the month of Jan'19 is likely to clock-in at 7.15%YoY vs. 6.17%YoY recorded in Dec'18 and 4.42%YoY in Jan'18, averaging to 6.2%YoY in 7MFY19. Several idiosyncratic factors (i.e. electricity and drug price hike: avg. ~6%/4%) coupled with quarterly revision in housing rent are at play, pushing monthly inflation higher. Additionally, heavyweight food index is likely to move up 0.4%MoM, with mix price trends in the food basket. However, the reduction in fuel prices (transport index: -1.1%MoM) would keep a lid on monthly inflation reading. Sequentially, CPI index is likely to jump 0.95%MoM. Core inflation – measured through NFNE index and better reflective of long-run inflationary trends – continues to steadily rise, with Jan'19 reading expected to reach 8.71%YoY (a level last seen in mid-2014).

Nominal vs. Real interest rate



CPI Projection - Sensitivity



Source: SBP, PBS & AKD Research

SBP likely to opt for Status Quo: Remarkably stable food price dynamics have partially offset the impact of supply-side inflationary pressures (i.e. high oil prices, gas rate hikes, and rising house rent), restraining 1HFY19 headline inflation close to the central bank annual target of 6.0%. In contrast, the central bank in a preemptive mode has aggressively hiked interest rates by 350bps to 10%, anchoring inflation expectations. This has pushed real interest rate to 3.6% in

AKD Securities Limited

Dec'18 vs. last 5yr average of 2.7%. While upside risks to inflation still outweigh the downside, inflationary pressures have been relatively tamed since the announcement of last monetary policy. Also, recently announced mini-budget remained largely inflation neutral vs. earlier expectations of potentially higher inflation as a result of new revenue measures (i.e. taxes and import duties). This suggests the authorities' intent to adopt a more gradual mode of adjustment. In this backdrop, we expect the MPC to keep the policy rate unchanged at 10% in the upcoming monetary policy announcement. However, 'Pause' in Jan'19 does not mean the end of a monetary tightening cycle, we expect the central bank to follow a more calibrated tightening path rather than preemptive tightening, adjusting the monetary policy in response to inflationary expectations and macro-imbalances. Presently, we expect three more 50bps hikes in rest of CY19, with TR/DR ending at 11.5/12%.

Investment perspective: From market vantage, status quo would be market neutral, however any token hike of 25/50bps could dent the sentiment. With 150bps rate hike expectations in CY19, we continue to like Banks, with preference for MCB & ABL. Other preferred plays include OGDC, INDU, and NML. The downstream energy chain could also come into limelight on account of partial clearance of circular debt.

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.

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.

Jama Punji

سرمایہ کاری سمجھداری کے ساتھ