March 26, 2019

PAKISTAN ECONOMY

REP-019

MARKET VISTA

Headline inflation to hit ~5yr high, expect 25-50bps rate hike

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

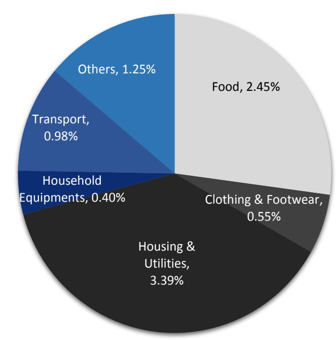
- **Headline inflation continues to gain momentum, with the upcoming Mar'19 reading expected to round up at 9.01%YoY vs. 8.21%YoY in Feb'19 and 3.24%YoY in Mar'18. Sequentially, the CPI index is expected to move up 1.04%MoM.**
- **Rising food prices particularly perishable items (food index: up 2.01%MoM) and higher fuel cost (up 3.7%MoM on avg.) as a result of higher international oil prices are the key driving factors, lifting the monthly read higher.**
- **Importantly, core inflation is likely to see some moderation, with Mar'19 NFNE reading of 8.43%YoY vs. 8.73%YoY in Feb'19, a potential indication of cost-push inflationary pressures (i.e. pass-through of rupee depreciation) losing steam.**
- **Awaiting forthcoming monthly inflation to confirm our stance, we flag moderation in core inflation as being unsustainable, with the second round of utility price hike (i.e. gas & electricity) expected to keep both core and headline inflation elevated over the medium term.**
- **With real interest rates once again narrowing to 1.1% (a level last seen in Dec'17) and lack of parallel fiscal adjustment, we continue to see further need for monetary adjustment and expect the MPC to raise the policy rate by 25-50bps in the upcoming monetary policy announcement due later this month.**

CPI-based inflation to hit ~5yr high: Headline inflation continues to gain momentum, with the upcoming Mar'19 reading expected to clock in at 9.01%YoY vs. 8.21%YoY in Feb'19 and 3.24% YoY in Mar'18. This would mark a ~5yr high – levels last seen in Apr'14. Sequentially, the CPI index is expected to move up 1.04%MoM. The headline inflation is primarily driven by rising food prices (food index: up 2.01%MoM), higher transport and fuel costs (up 3.7%MoM on avg.) , a result of pass-through of higher international oil prices. Food inflation - which remained benign until Jan'19 (7MFY19 avg. 1.79%YoY vs. 3.36%YoY in 7MFY18) and helped in containing overall inflation - has recently gained momentum following the idiosyncratic rise in prices of certain perishables (i.e. tomatoes). For Mar'19, food inflation is likely to further tick up to 7.02% YoY vs. 4.94%YoY in Feb'19 and 0.97%YoY in Mar'18. We foresee a continuation of this trend until May'19, as the seasonal impact of Ramadan would keep food prices elevated.

Core inflation to slightly moderate in Mar'19: Contrary to headline inflation, core inflation – which has shown rising trend each month since Mar'18 – will likely witness some moderation in Mar'19 (NFNE inflation: 8.43%YoY vs. 8.73%YoY in Feb'19). This potentially signifies that the impact of the cost-push inflationary pressures (i.e. pass-through of rupee depreciation) is losing steam. While we look forward to forthcoming monthly inflation to see any evidence of the same, we highlight the moderation in core inflation is unsustainable, as the inflationary impact of the second round of utility price hikes would keep both core and headline inflation elevated going forward. To note, the GoP is reportedly mulling to further increase the gas & electricity rates in order to meet revenue shortfall in the energy chain. We highlight avg. 10% increase in both utility prices (i.e. electricity & gas) would raise our avg. inflation estimates by 60bps.

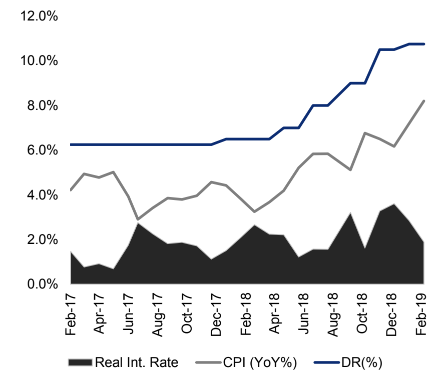
Monetary policy outlook: While recent economic data particularly on external account (CAD improved 54%/73%YoY in Jan'19/Feb'19 primarily driven by imports decline, signifying the general slowdown in domestic economy) lends some credence to the argument that MPC should skip rate hike in the upcoming monetary policy, we however continue to see further need for monetary adjustment based on: i) lack of parallel fiscal adjustment leaving the monetary policy as the only lever to address macro-challenges, and ii) real interest rates are once again narrowing to a level last seen in Dec'17 (with Mar'19 inflation of 9.01%, real interest rate stands at mere 1.1%). Hence, we expect the monetary policy committee to raise the policy rate by 25-50bps to 10.5%-10.75% (DR: 11.0%-11.25%).

Inflation contribution from various categories



Source: PBS & AKD Research

Nominal vs. Real interest rate



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.

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.