

PAKISTAN
ECONOMY

REP-019
**MARKET
VISTA**

MPS outlook: 100bps hike

- CPI inflation in Sep'18 is expected to clock in at 5.1%YoY, significantly lower than 5.8% YoY in Aug'18, where weakening of food index and reduction in petroleum prices during the month remained key facilitators.
- We expect a 100bps hike in the upcoming Monetary Policy Committee meeting, set to be held by the end of month. Taking a proactive stance, we foresee TR/DR to settle at 8.5%/9.0% post-hike.
- Our expectations for persistent price pressures are emboldened by pass-through impact of FX swings, higher oil prices, increase RDs and expected increase in utility prices
- We expect CPI inflation to reach 8.6%YoY by FY19F-end with average of 7.4%/8.0%YoY in FY19F/CF19F. Subsequently, SBP is expected to raise benchmark interest rate by a cumulative 275bps in FY19.

CPI at 5.1%YoY: Based on weekly SPI trends, headline inflation for the month of Sep'18 is expected to clock in at 5.1%YoY, significantly lower than 5.84%YoY observed in the previous month. Key catalysts include weakening of the heavy-weight food index (down 0.3%MoM), softened by perishable food items while base effect from last year (rising 1.42%MoM) remains in play. Additionally, reduction in petroleum product prices during the month (2.4%/5.6% decline in Mogas/HSD) due to lower procurement cost is likely to drive the transportation index down 1.5%MoM. On a MoM basis CPI reading is expected to remain limited at -0.06% vs. 0.2%/0.6% MoM in Aug'18/Sep'17. That said, core inflation as measure by NFNE is expected to continue its upward trajectory to reach 7.8%YoY vs. 7.6%/5.4%YoY in Aug'18/Sep'17.

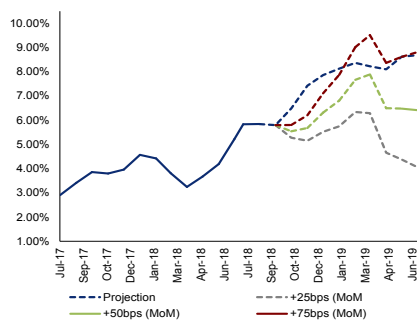
Haris Imtiaz
haris.imtiaz@akdsecurities.net
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Banking sector Sensitivity

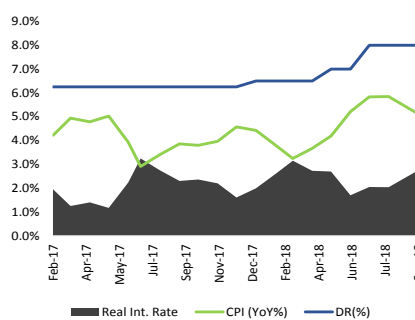
	IR sensitivity	P/B	1HCY18 ROE (annualized)
FABL	1.28	0.98	10.4%
BAFL	1.26	.12	9.1%
BAHL	1.26	1.88	18.1%
MCB	1.18	1.58	12.8%
ABL	1.13	1.05	13.3%
HBL	1.07	1.23	8.6%
MEBL	1.06	2.47	20.0%
AKBL	1.03	0.90	13.0%
UBL	0.97	1.13	7.2%
NBP	0.93	0.57	13.7%
HMB	0.92	1.24	14.4%

Source: Company reports & AKD Research

CPI estimates (%)



CPI vs. DR (%)



Source: PBS & AKD Research

MPS outlook: Monetary Policy Committee is expected to announce monetary policy by the end of the month (date not announced yet), where MPC should likely take a proactive stance in setting the benchmark interest rate in light of gas price hikes (yet to be approved by Cabinet/PM) and subsequent buildup of price pressures. In this regard, we expect up to 100bps hike in interest rate with TR/DR to settle at 8.5%/9.0%. Despite the recent slowdown in CPI inflation, heightened NFNE readings remain indicative of inflationary pressures in the economy. Hence we maintain our estimate of CPI inflation to average out at 7.4%/8.04% in FY19F/CY19F considering lagged pass through impact of FX swings, higher international oil prices, increased regulatory duties on imported goods and expected increase in utility prices. Subsequently, interest rates are expected to be raised a cumulative 275bps with TR/DR ending at 10.25%/10.75% by Jun'19. Additional factors supporting hawkish stance include: i) global monetary tightening, ii) persistent external imbalance and iii) increased budgetary borrowing (GoP has already raised Pkr1.11trn from SBP in FYTD).

Investment Perspective: Steep upward trajectory of interest rates holds negative for equities especially for leveraged sectors including cements, fertilizer and Textile (despite subsidized financing) in form of higher finance cost. However, index heavy weight banking sector could garner traction with upward interest rate profile where our top picks include MCB, ABL, & BAFL.

Interest rate sensitivity for 100bps hike

	EPS	% impact on FY19F/ CY18F earnings
Cements		
DGKC	(0.76)	5.0%
MLCF	(0.28)	5.4%
FCCL	(0.02)	0.8%
CHCC	(0.89)	12.2%
PIOC	(0.37)	5.8%
GWLC	(0.12)	5.3%
Fertilizers		
EFERT	(0.22)	2.3%
FFC	(0.17)	2.0%
FFBL	(0.38)	14.7%
FATIMA	(0.08)	1.5%
Steels		
ASTL	(0.25)	2%
Textiles*		
NCL	(0.46)	6%
NML	(0.16)	1%
OMCs		
HASCOL	(0.06)	0.32%
PSO	(0.83)	1.80%
Cable & Electrical		
PAEL	(0.28)	3.63%

Source: Co reports & AKD Research

*limited earnings impact due to subsidized financing



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Buy	> 16% expected total return (Rf: 10% + Rp: 6%)
Neutral	> 10% to < 16% expected total return
Sell	< 10% expected total return (Rf: 10%)

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

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

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

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