

Day Break

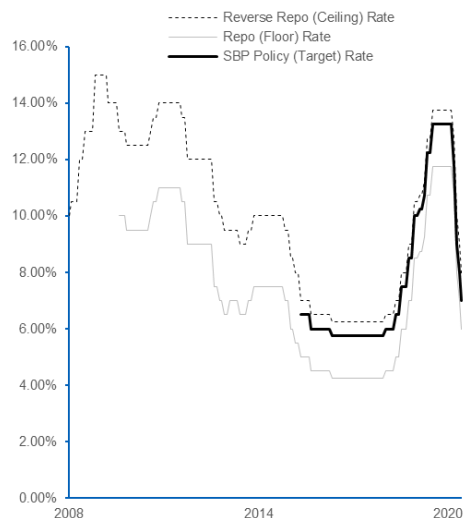
Friday, 26 June 2020

Economy

Exhibit: Historic Discount rates

Date	Reverse			Chg. Bps
	Repo Rate	Repo Rate	Policy Rate	
28-May-18	7.00%	5.00%	6.50%	50
16-Jul-18	8.00%	6.00%	7.50%	100
1-Oct-18	9.00%	7.00%	8.50%	100
3-Dec-18	10.50%	8.50%	10.00%	150
1-Feb-19	10.75%	8.75%	10.25%	25
1-Apr-19	11.25%	9.25%	10.75%	50
21-May-19	12.75%	10.75%	12.25%	150
17-Jul-19	13.75%	11.75%	13.25%	100
18-Mar-20	13.50%	11.50%	12.50%	-75
24-Mar-20	12.00%	10.00%	11.00%	-150
16-Apr-20	10.00%	8.00%	9.00%	-200
15-May-20	9.00%	7.00%	8.00%	-100
25-Jun-20	8.00%	6.00%	7.00%	-100

Exhibit: Monetary Policy historic trend



Source: Bloomberg, PSX 100 & IGI Research

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Monetary Policy Statement

SBP delivers a 100bps rate cut; more likely to come as Growth agenda takeovers

- ✓ In its latest unscheduled monetary policy committee meeting held yesterday, the State Bank of Pakistan (SBP) reduced the policy rate by 100bps to 7.0%.
- ✓ The current decision is primarily reflective of monetary policy committee view of forward inflation, which has improved significantly amid recent decline in POL prices despite expectation of seasonal pressure on food on account of Eid.
- ✓ From market standpoint this will come as surprise relief, as it lacked material triggers. However once over, we think all eyes would be on corporate earnings performance in the next two quarters.

SBP delivers yet another rate cut of 100bps, taking policy rate to its lowest in past 2years

In its latest unscheduled monetary policy committee meeting held yesterday, the State Bank of Pakistan (SBP) reduced the policy rate by 100bps to 7.0%. This is the fifth policy rate cut starting 2020 triggered by reduced aggregate demand and inflation, amid Covid-19. Nevertheless, including the recent cut of 100bps cumulative policy rate cut in now stand at 625bps since Mar-20.

Exhibit: Monetary Policy Statement

	Current	Previous	Chg. (bps)
Target Policy Rate	8.00%	9.00%	(100)
Discount rate (Ceiling Rate)	9.00%	10.00%	(100)
Floor Rate	7.00%	8.00%	(100)
Minimum Saving Deposit Rate	6.50%	7.50%	(100)
Interest Rate Corridor	2.00%	2.00%	0

Source: SBP, IGI Research

The current decision reflects improved inflation outlook

The current decision is primarily reflective of monetary policy committee view of forward inflation, which has improved significantly amid recent decline in POL prices despite expectation of seasonal pressure on food on account of Eid. However, there hasn't been much of a change in SBP inflation expectations from last Monetary policy announcement on 18th May, 2020. SBP inflation forecast for Fy 2021 stands unchanged at 7-9%.

Current circumstances imply adopting a 'Zero' real rate regime

Moreover, as a guidance SBP asserted this rate cut aligns with Monetary Policy Committee (MPC) view of keeping forward real rates close to 'Zero'. This 7% rate comes at lower bound of inflation expectation. While SBP acknowledges multiple supply-side risks could potentially ramp up inflation but these shocks would be temporary and thus would more or less be overlooked. Nevertheless, this however also reduces future rate cut possibilities.

Demand remain stifle and growth likely to take an extended ‘U’ shape recovery; Further rate cut could be a possibility

Having a policy rates close to lower bound of inflation expectation also reduces future rate cut possibilities. Moreover, SBP expects ‘U’ shape economy recovery in-line with IMF view. But this view is still too early to judge and somewhat optimistic. However, domestic demand remains relatively stifle at current and risks of Covid-19 second wave has already led to ‘smart-lockdown’ in major cities of Pakistan. Thus cautiously we think growth will likely take an ‘Extended-U’ shape recovery which could prompt possible further rate cuts could come. Whereby SBP weighs growth over inflation.

Exhibit: SBP outlook and comments on key economic indicators

Indicators	Expectations	Outlook and comments
Inflation	7-9% expected inflation for Fy 2021	<p>Prices have moderated more than SBP's comfort zone: Monthly inflation observed in past few months, continues to remain low. Reduction in oil prices have been keen in bringing down underlying inflationary pressure, despite expectation of seasonal uptick in food prices associated with the Eid holiday.</p> <p>Budgetary impact negligible: Moreover, Budget 2020-21 is also expected to be 'neutral' for inflation mainly due to a) freeze on government salaries, b) absence of new taxes, and c) lower production cost from reduced import duties should offset the decline in subsidies in some sectors.</p> <p>Supply-side disruption possible, but we will pass it: Monetary Policy Committee (MPC) highlights risk of inflation through a possible 'supply disruption'. However, these supply shocks are transitory in nature given weak domestic demand and that monetary policy should simply look past them.</p> <p>7-9% inflation in Fy 2021, unchanged from previous estimates: Given the absence of demand-side pressures, average inflation could fall below the previously announced range of 7-9% percent for Fy 2021.</p>
Real Rates	Real-rates to remain close to 'Zero'	<p>Real rates to remain close to 'Zero': Given the benign outlook of inflation and current circumstances SBP put down forward guidance for real rates, keeping it close to 'zero'. With forward CPI inflation</p>
Growth	Growth to take a 'U' shape recovery	<p>Muted recovery: Large-scale manufacturing data for the month of Apr-20, contracted by 42% y/y, with few sectors showing a slight and muted recovery.</p> <p>Growth more of 'U' recovery: Citing IMF recent published report "A Crisis Like No Other, An Uncertain Recovery" (link), SBP highlights Global and Pakistan growth outlook heavily skewed to the downside and recovery seems more gradual at this point. However, this remain highly contingent on easing-lockdowns, supportive macroeconomic policies and a pick-up in global growth.</p> <p>Covid19 more social and economic pain: Pakistan like other countries is possible to experience second-wave of Covid-19. This has led to government further extending selective area specific lockdown dubbed 'Smart-Lockdown'.</p>
External Accounts	Foreign inflows to ensure less pressure on PKR	<p>Stable outlook on country's current account: Despite challenging global conditions, the outlook for external sector broadly remains stable mainly as oil prices stay depressed. Remittances have picked-up in albeit due to Eid inflows and Foreign Direct Investments (FDI) have been resilient nearly doubling from last year to USD 2.4bn.</p> <p>Recent foreign inflows have been key in filling FX reserves gap: As highlighted in its previous statement, SBP official flows committed by the international community received during the month of Jun-20 have more or less averted a pressure on country's Foreign Exchange (FX) reserves which dropped below USD 10bn by 19th June, 2020 (Jan-20 end SBP reserves stood at USD 12.75bn) owing to foreign debt re-payments. So far USD 725mn and USD 500mn have been received from World Bank and Asia Development Bank (ADB) and roughly USD 500mn is further expected Asian Infrastructure Investment Bank (AIIB).</p> <p>...and has been vital in PKR stability: These projected foreign inflows both private and official will continue to support PKR stability as it has been witnessed since SBP has adopted flexible market driven exchange rate regime. PKR volatility has been less than its counter emerging market countries.</p>

A surprise relief for the market; all eyes on corporate earnings performance

From market standpoint this will come as surprise relief, as it lacked material triggers. However once over, we think all eyes would be on corporate earnings performance in the next two quarters.

Nevertheless, conventional banks will face NIMs compression due to reduced interest rates and deferment of loan for SME and Agri-sector will further hurt margins but will also delay provisioning charge in arising from these two groups. We have preference for HBL, BAML and MCB as these would be least impacted amongst our coverage banks, but recommend cautious accumulation as overall pressure on sector can well orchestrate on these stocks.

Exhibit: 100bps point cut impact on company's profitability (PKR/share)

Sym.	EPS (impact)	Company
Automobile Assembler		
INDU	(0.3)	Indus Motor Company Limited
HCAR	0.5	Honda Atlas Cars (Pakistan) Limited
PSMC	1.4	Pak Suzuki Motor Company Limited
Cement		
LUCK	(0.2)	Lucky Cement Limited
FCCL	0.0	Fauji Cement Company Limited
MLCF	0.2	Maple Leaf Cement Factory Limited
KOHC	0.3	Kohat Cement Company Limited
ACPL	0.4	Attock Cement Pakistan Limited
DGKC	1.0	D.G. Khan Cement Company Limited
CHCC	1.0	Cherat Cement Company Limited
PIOC	1.1	Pioneer Cement Limited
Chemical		
EPCL	0.0	Engro Polymer & Chemicals Limited
LOTCEM	(0.0)	Lotte Chemical Pakistan Limited
Engineering		
ISL	0.4	International Steels Limited
ASTL	0.5	Amreli Steels Limited
Fertilizer		
FATIMA	0.1	Fatima Fertilizer Company Limited
EFERT	0.0	Engro Fertilizers Limited
FFC	(0.0)	Fauji Fertilizer Company Limited
FFBL	0.0	Fauji Fertilizer Bin Qasim Limited
Oil & Gas Exploration Companies		
MARI	(2.1)	Mari Petroleum Company Limited
POL	(1.6)	Pakistan Oilfields Limited
OGDC	(0.1)	Oil & Gas Development Company Limited
PPL	(0.1)	Pakistan Petroleum Limited
Oil & Gas Marketing Companies		
HASCOL	0.2	Hascol Petroleum Limited
PSO	1.4	Pakistan State Oil Company Limited
Power Generation & Distribution		
HUBC	0.7	The Hub Power Company Limited

Source: IGI Research, Company Accounts, PSX

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