

Day Break

Monday, 02 October 2017

Economy

Exhibit: YoY inflation (%)

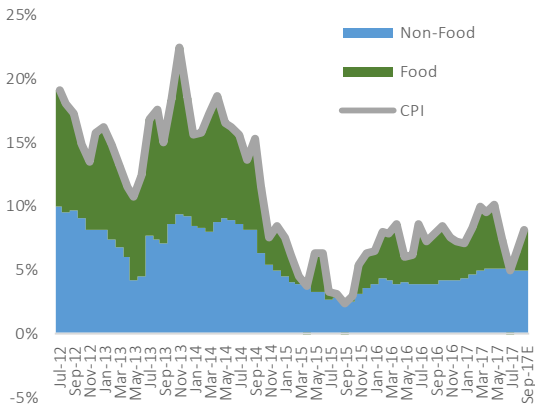


Exhibit: 3 month moving average real interest rate

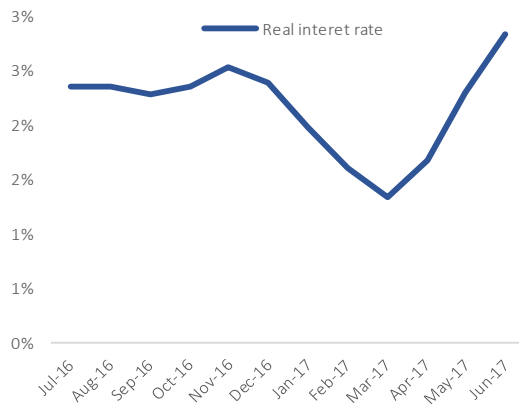
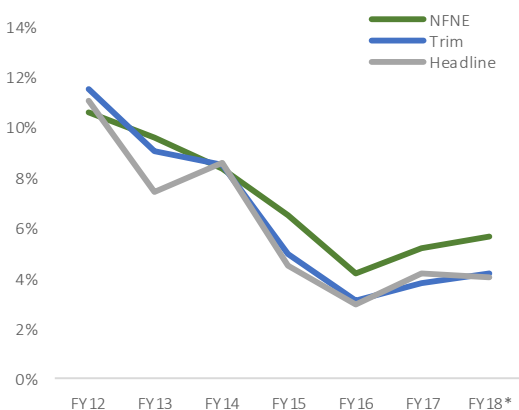


Exhibit: Core and headline inflation trend



Source: PBS & IGI Research

Syed Daniyal Adil

Research Analyst

daniyal.adil@igi.com.pk

Tel: (+92-21) 111-234-234 Ext.: 973

Inflation & Monetary Policy

Monetary policy to remain unchanged while inflation to post a modest growth

- We expect SBP to keep the policy/discount rate steady at 5.75%/6.25% while Sep-17 headline inflation is expected to print +4.2%YoY growth.
- Inclusive of Sep-17 estimates, 1QFY18 inflation will average +3.5%YoY, 40bps lower than same period preceding year's average of +3.9%YoY.
- Two key macroeconomic factors will keep the upcoming monetary policy unchanged, namely a) the low inflation reading in 1QFY18E and b) the low level of current account (C/a) deficit in Aug-17.
- In addition to macroeconomic factors, there is political consideration in keeping interest rate low, wherein, as election nears, government's key priority remains highlighting pro-growth policies. Henceforth, we expect monetary policy decision as Status Quo.

Policy rate expected to remain unchanged despite Sep-17 inflation pointing to an upward trend

The State Bank of Pakistan (SBP) is scheduled to announce its monetary policy on Friday (29-Sep-17) while the Pakistan Bureau of Statistics is expected to release its monthly data on inflation next week. We expect SBP to keep the policy/discount rate steady at 5.75%/6.25%, while Sep-17 headline inflation is expected to print +4.2%YoY (+0.93%MoM) growth compared to +3.9%YoY (+0.20%MoM) in the same month last year.

Inflation to grow modestly on the back of HRI and rebounding food prices

After a subdued start in FY18, wherein CPI inflation recorded 2MFY18 average of +3.2%YoY (+3.91% last year), we expect headline inflation to pick up pace in Sep-17 and register a growth of +4.2%YoY (+3.4% and +2.9% YoY in Aug-17 and Jul-17 respectively). Inclusive of Sep-17 estimates, 1QFY18 inflation will average +3.5%YoY, 40bps lower than same period preceding year's average of +3.9%YoY. Key reason for monthly uptick in inflation is expected to be non-food basket, wherein, the prices are expected to rise by +4.9%YoY on the back of +7.2%YoY uptick in House rent index (HRI; last revised in Jul-17). Simultaneously, food basket is expected to pick up pace as depicted by +2.12%MoM growth recorded in Sensitivity Price Index (SPI) – a proxy index for food prices. We estimate food basket to grow by +3.2%YoY leading to a ppt impact of 1.2 despite 20.9%YoY decline in prices of cigarettes acting as a drag.

Exhibit:

Inflation Break-up; Non-food (utilities & HRI pulling up inflation)

(ppt)	Sep-17E	Aug-17	Jul-17	1QFY18E	Sep-16	Aug-16	Jul-16	1QFY17
Food	1.3	0.5	-0.0	0.6	1.7	1.4	2.0	1.7
Non-Food	2.9	2.9	3.0	2.9	2.2	2.2	2.2	2.2
- Energy	0.3	0.3	0.3	0.3	-0.1	-0.0	0.0	-0.0
-Utilities	1.2	1.3	1.4	1.3	1.3	1.2	1.1	1.2
-HRI	1.4	1.4	1.4	1.4	1.1	1.1	1.1	1.1
Total	4.2	3.4	3.0	3.5	3.9	3.6	4.2	3.9

Source: IGI Research, SBP, PBS

Muted headline inflation and upcoming elections to encourage 'Status Quo' in monetary policy

Two key macroeconomic factors will keep the upcoming monetary policy unchanged, in our view. First is the low inflation reading in 1QFY18E (avg. +3.5%YoY) and second is the low level of current account (C/a) deficit in Aug-17; dissenting views on sharp PKR depreciation.

Based on Sep-17E inflation, real interest rates would stand at 2.75%, unlikely to pose a meaningful risk. However, rising core inflation pattern (+5.6%YoY in 1QFY18E compared to +5.2%YoY in FY17) indicates a brewing demand pull inflation, going forward. Consequently, given the rising core inflation, headline inflation could see a jump in coming months leading to downward pressure on real interest rates (1.75% by 2QFY18 end).

To recall, Aug-17 C/a deficit clocked in at USD 550mn compared to Jul-17 number of USD 2.1bn, owing to narrower trade deficit and higher remittances received. As a result, market expectations of sharp PKR depreciation dissented, albeit on a temporary basis, as Aug-17 C/a deficit number was low due to one-off factors, namely a) strong growth in remittances (USD 1.95bn vs. USD 1.5bn in Jul-17 was noted due to Eid (seasonal factor) and, b) lower import of food and transport products. We highlight that foreign inflows are still the primary factor to keep C/a deficit at a sustainable level, as opposed to government introducing tax to curb imports.

In addition to macroeconomic factors, there is political consideration in keeping interest rate low, wherein, as election nears, government's key priority remains highlighting pro-growth policies. Henceforth, we expect monetary policy decision as Status Quo.

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IGI Finex Securities Limited

Research Analyst(s)

Research Identity Number: BRP009

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Contact Details

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Syed Daniyal Adil	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	daniyal.adil@igi.com.pk
Suleman Ashraf	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 957	suleman.ashraf@igi.com.pk
Muhammad Saad	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	muhammad.saad@igi.com.pk
Tanweer Kabbeer	Research/Fund Select	Tel: (+92-21) 111-234-234 Ext: 966	tanweer.kabbeer@igi.com.pk
Umesh Solanki	Database Manager	Tel: (+92-21) 111-234-234 Ext: 974	umesh.solanki@igi.com.pk

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Ejaz Rana	Regional Manager (Faisalabad)	Tel: (+92-41) 2540843-45	ejaz.rana@igi.com.pk
Asif Saleem	Branch Manager (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Branch Manager (Multan)	Tel: (+92-61) 4512003	mehtab.ali@igi.com.pk
Zeeshan Kayani	Branch Manager (Abbottabad)	Tel: (+92-992) 408243-44	zeeshan.kayani@igi.com.pk
Ihsan Mohammad	Branch Manager (Peshawar)	Tel: (92-91) 5253035	ihsan.mohammad@igi.com.pk

IGI Finex Securities Limited

Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

Head Office

Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780
Website: www.igisecurities.com.pk

Stock Exchange Office

Room # 719, 7th Floor, PSX Building, Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2, Fax: (+92-21) 32429607

Lahore Office

5-F.C.C. Ground Floor, Syed Maratib Ali Road,
Gulberg II, Lahore
Tel: (+92-42) 35777863-70, 35876075-76
Fax: (+92-42) 35763542

Faisalabad Office

Room #: 515-516, 5th Floor, State Life
Building, 2- Liaqat Road, Faisalabad
Tel: (+92-41) 2540843-45
Fax: (+92-41) 2540815

Multan Office

Mezzanine Floor, Abdali Tower,
Abdali Road, Multan
Tel: (92-992) 408243 - 44

Peshawar Office

2nd Floor, The Mall Tower,
35 The Mall Peshawar Cantt.
Tel: (92-91) 5253035, 5278448

Islamabad Office

Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
Block- B, Jinnah Avenue, Blue Area, Islamabad
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861

Rahim Yar Khan Office

Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road, Rahim Yar Khan
Tel: (+92-68) 5871653-6, 5871652
Fax: (+92-68) 5871651

Abbottabad Office

Ground Floor, Al Fatah Shopping Center, Opp. Rad
Station, Mansehra Road, Abbottabad
Tel: (+92-99) 2408243 - 44

Sialkot Office

Suite No. 10 & 11, 1st Floor, Soni Square,
Mubarak Pura, Sialkot.
Tel: (+92-52) 3258437, 3258762