

Economy

Jun 02, 2022

Pakistan Equities
Economy

Key Points

- Inflation reading for May'22 stood at 13.8%, which came slightly lower than expectations due to lower than expected food inflation.
- Urban/Rural core-NFNE inflation for May'22 increased to 9.7%/11.5% from 9.1%/10.9% a month earlier and 6.8%/7.6% of May'21. This can be attributed to spill-over impacts of higher food and energy inflation.
- Going forward, incorporating elimination of PDC in petrol and diesel, higher electricity and gas tariffs, and higher food prices, our estimates for inflation readings are over 16% for Jun'22 and close to 20%YoY during the following few months.
- Our FY22/23 our inflation estimates stand at 11.6%/16%. Key risks include delays in elimination/reduction in energy subsidies, significant fall in international oil prices, and efficient management of food prices by the government.
- The next meeting of the Monetary Policy Committee (MPC) of SBP is scheduled on Jul. 7th 2022, where based on current estimates for inflation, we believe that the MPC would raise policy rate further by 100-150bps taking it to 14.75%-15.25%, taking the discount rate to 15.75%-16.25%, the highest level of at least the past 23 years.
- Pakistan equities market is trading at a forward PER of 4.2x, which is lower than the historic low multiples and at a significant discount to 1) its own cross-cycle average, and 2) regional market average multiples. Having said that, considering the outlook for inflation and interest rates, we recommend investors to focus on banks along with oil & gas E&P, IPPs, textiles, and fertilizers.

May'22 inflation came slightly lower than expectations

NCPI inflation reading for May'22 came at 0.4%MoM/13.8%YoY that is slightly lower than our and general market expectations that were hovering around 14.3%YoY. Urban and Rural break-up of May'22 NCPI inflation is 0.3%MoM/12.4%YoY and 0.6%MoM/15.9%YoY, respectively. The cumulative 11MFY22 now stands at 11.3% compared to 8.8% of the same period last year. Food inflation that registered increase of 0.9%MoM/17.3%YoY came in lower than expectation bring down the overall inflation number. Index of perishable food items dropped 10.8%MoM while increasing 26.4%YoY whereas that of non-perishable food items increased by 3%MoM/15.9%YoY. Other important changes include 15.5% lower electricity charges (in-line with expectations), and MoM increase of 2.9%/2.5% in Urban/Rural Transport index led by motor fuel, transport services and motor vehicles.

Reduction of subsidy on energy, and higher food prices to drive inflation upwards

Resumption of the IMF EFF is critical for sustainability of external account of the country and one of the major points of contention between the two parties is the elimination of fuel subsidies that were announced by the former Prime Minister in Feb'22. The incumbent government with reluctance has already initiated the process of eliminating subsidy on petrol and diesel with an increase of PKR30/liter. However, based on latest numbers, PDC of around PKR39/liter on petrol and PKR53/liter on diesel are still pending to be passed on in prices, which we believe would be done in mid-June price review. Furthermore, the pending upward quarterly and fuel cost adjustments in electricity tariffs coupled with reversal of reduction electricity tariffs announced in the relief package by the former Prime Minister are also expected to be implemented in reviews of Jun. and Jul. putting further pressure on inflation. Moreover, gas prices are also proposed to be increased by 50% from Jul'22 (incorporated 30%) that would add on to inflationary pressures going forward. Although food inflation was lower than expected in May'22, these continue to head north led by prices of wheat and flour, cooking oils, pulses. These are expected to head north in the near term based on global inflation outlook and food security. Overall, incorporating elimination of PDC in petrol and diesel, higher electricity and gas tariffs, and higher food prices, our estimates for inflation readings are over 16% for Jun'22 and close to 20%YoY during the following few months. Our FY22/23 inflation estimates stand at 11.6%/16%. Key risks include delays in elimination/reduction in energy subsidies, significant fall in international oil prices, and efficient management of food prices by the government. Another key risk on inflationary outlook would be the budgetary measures that are due to be announced on Jun. 10th, which we believe would be contractionary in nature under the guideline of the IMF.

Core-NFNE inflation inching upwards

Urban/Rural core-NFNE inflation for May'22 increased to 9.7%/11.5% from 9.1%/10.9% a month earlier and 6.8%/7.6% of May'21. This can be attributed to spill-over impacts of higher food and energy inflation and steep PKR devaluation. Increase in core inflation is led by housing and equipment, segments of transport, restaurants & hotels, and misc. segments. We believe that with continued inflationary pressures from energy and food prices, core-inflation is also expected rise gradually going forward.

More increase in policy rate expected

Since Sep'21, Monetary Policy Committee of SBP has increased interest rates from 7% to 13.75%, an increase of 675bps with the most recent increase in May'22 (+150bps). Inflation outturns have increased

Key Data

KSE100 Index	42,756
KSE-All Share Value (PKRmn)	5,349
KSE-All Share Value (USDmn)	27.0
KSE-All Share Volume (Shmn)	194.4
Market Capitalization (PKRtn)	7.1
Market Capitalization (USDbn)	36.0
1 Year High	48,726
1 Year Low	41,950

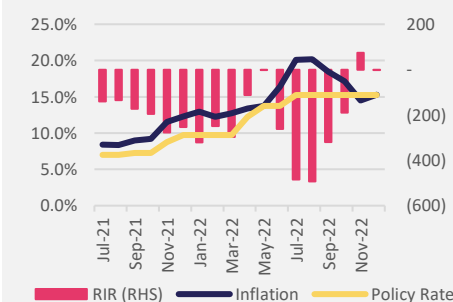
Source: PSX, Next Research

KSE100 1 Year Performance



Source: PSX, Next Research

Inflation and Policy Rate



Source: PBS, Next Research

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from 8.4% in Aug'21 to 13.4% in Apr'22. On forward-looking basis, real interest rates are still in the negative territory where FY23 average inflation is estimated at around 16%. In the T-Bills auction held yesterday, the government increased cut-off yields of 3, 6 and 12 month papers by 75, 55 and 75 bps, respectively where 6 and 12 month yields now standing at 15.25% and 15.5%, respectively. The secondary market yields of these papers before the auction were 14.5% and 14.62%, respectively. The next MPC meeting is scheduled on Jul. 7th 2022, where based on current estimates, we believe that the MPC would raise policy rate further by 100-150bps taking it to 14.75%-15.25%, taking the discount rate to 15.75%-16.25%, the highest level of at least the past 23 years.

Recommendation

Pakistan equities market is trading at a forward PER of 4.2x, which is lower than the historic low multiples and at a significant discount to 1) its own cross-cycle average, and 2) regional market average multiples. Having said that, considering the outlook for inflation and interest rates, we recommend investors to focus on banks along with oil & gas E&P, IPPs, textiles, and fertilizers.



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Where;

R = Expected Dividend Yield + Expected Capital Gain

R' is before tax

Investment horizon is between six months to twelve months

Ratings are updated regularly based on the latest developments in the economy/sector/company, changes in stock prices, and changes in analyst's assumptions.

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