INTERMARKET SECURITIES LTD
Tellimer

Pakistan Economy

30 October 2024

Monetary Policy Preview

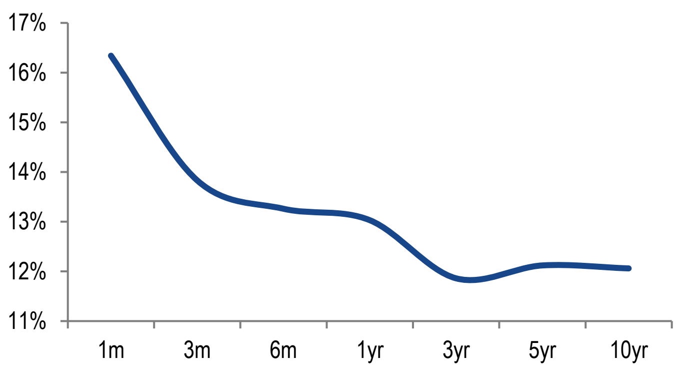
Expect a 200bps cut in the policy rate to 15.5%

We expect the SBP to cut the policy rate by 200bps to 15.5% in the MPC due 4 November, taking cumulative easing since June 2024 to 650bps.

Key reasons for our expectation:

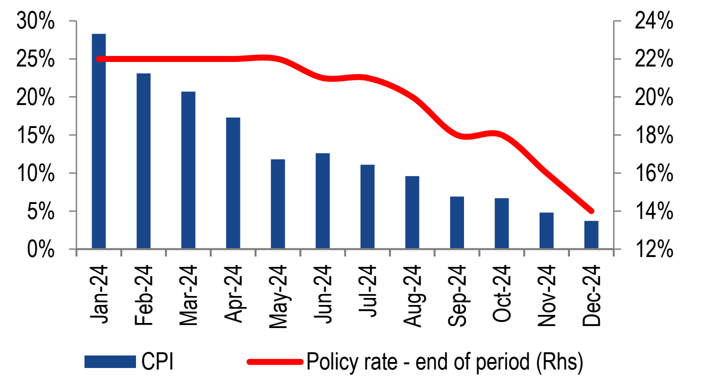
- **Significant disinflation:** October CPI is expected at 6.7%, similar to 6.9% in September. Inflation over the next 12 months is likely to average much lower than the SBP's projected range of 11.5%-13.5% for FY25, in our view – thanks to negligible food inflation, sharp decline in global oil prices and incremental increase in energy tariffs likely to be relatively moderate.
- **CA balance remains encouraging…** CA balance during 1QFY25 was a meagre deficit of US$98mn compared with a deficit of US$1.2bn in the corresponding period last year. This has been driven by strong remittances (up c.40% YoY) and still soft goods imports. The latter might reverse in 2HFY25; imports should be propelled by sharply lower interest rates (PR could stand around 14% by end-2024).
- **…while FX reserves continue to build up:** SBP's FX reserves have shot up to US$11bn (highest level in the past two years) thanks to the start of IMF EFF program in October 2024. Presently, the FX reserves is equivalent to less than three months' imports, but the pipeline of further external inflows – potentially including a US$1bn Climate Finance facility from the IMF – would maintain the build-up of FX reserves.
- **Pressure on GDP growth amid fiscal tightening.** Perhaps the more pertinent reason to pace-up the easing cycle, at this juncture, is the outlook for GDP growth. Agriculture sector is having a tough year given reports of output/pricing issues with almost all major crops. Lower interest rates may spur greater demand for industries, such as for automobiles and construction sectors. Future paths for inflation and FX reserves both support accelerated easing, in our view.

Secondary market yields suggest that interest rates may fall to c.13% within a year (YTM as of 30 Oct 2024)



Source: KHISTOCKS, IMS Research

Sharp disinflation creates ample room for further rate cuts



Source: SBP, PBS, IMS Research

Implications for the Equity market

The KSE100 index has risen 16% since July 2024, partly led by monetary easing (further aided by the onset of a new IMF program and favorable political developments). Increased institutional buying has rejuvenated the market with fresh liquidity and lifted the KSE100 index to new all-time highs. An accelerated easing cycle – say, in which the policy rate falls to 12-13% by end 3QFY25 – will not only maintain the present liquidity boost, but also elevate demand and earnings growth for cyclical sectors. Note that the Pakistan market still trades at a Fwd PE of less than 5.0x vs LT average of 7.5x. Our top picks are HBL, BAFL, INDU, HCAR, LUCK, MUGHAL, OGDC, POL and SYS.

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Ratings Guide*	Criteria
Buy	Total return expectation of ≥ 15% or expected to outperform the KSE-100 index
Neutral	Total return expectation of > -5% or expected to match the return of KSE-100 index
Sell	Expected downside of more than 5% or expected to underperform the KSE-100 index

*Based on 12 month horizon unless stated otherwise in the report.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Risks: (i) Political uncertainty, (ii) disruption in the IMF program as targets are lapsed, and (iii) resurgent food inflation and global energy prices.

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