INTERMARKET SECURITIES LTD
Tellimer

Pakistan Economy

7 July 2022

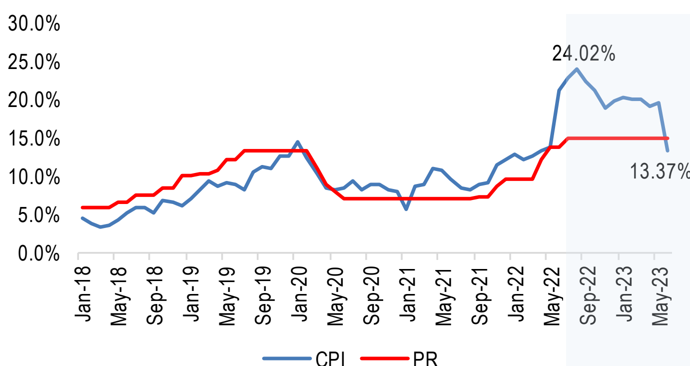
Monetary Policy

Policy rate increased by 125bps to 15%

SBP has increased the policy rate by 125bps to 15%, with the increase coming in slightly higher than our expected 100bps hike, as second round effects become visible in inflation readings. Moderation in domestic demand and imports remains slow, and nearly all renditions of inflation readings have risen sharply recently. This warranted further monetary tightening, to barricade against any de-anchoring of inflationary expectations. Even though the new monetary settings are complemented by the recently undertaken fiscal tightening in Budget FY23, we believe a vulnerable exchange rate will continue to keep the SBP on tenterhooks, at least until the IMF programme is secured.

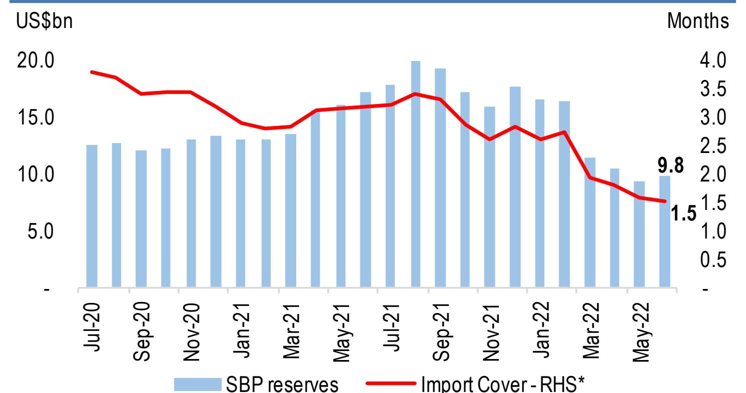
- Fiscal expansion earlier in the year was unwarranted, and the subsequent unreeling of energy subsidies is turning into biting inflation. The SBP now expects FY23 inflation to average 18-20%, broadly in line with our expectations as well. In raising interest rates, the SBP has recognized that nearly all cohorts of consumption groups saw a sizeable spike. In particular, core inflation – which tends to be sticky has recently ticked up sharply and entered the teens in rural areas. There is a silver lining though - the high base leads the SBP to project CPI coming down towards the medium-term target range of 5-7% by end FY24.
- Growth remains broadly intact. Pakistan is back to its pre-COVID growth trajectory, going by High Frequency Indicators, such as automobile, cement and FMCG demand. Private sector credit has seen a broad-based rise where cumulative rise in flows has tripled to PKR1.5tn during 9MFY22. Some of this rise is related to higher input costs but some is driven by the stimuli provided to overcome the effects of COVID-19 e.g. TERF. Nevertheless, as the impact of higher interest rates and fiscal discipline transmits through, the SBP expects GDP growth to moderate to 3-4% during FY23 (previous: 3.5%-4.5%). Monetary transmission should also improve by the linking of EFS/LTFF loans to the benchmark rate, with the current gap being 500bps.
- The recent shifts in energy demand, visible from May's current account deficit of USD1.4bn, has made it challenging to control the widening of trade deficit. This may keep up the pressure on the PKR especially if the resumption of the IMF programme stretches into August. Risks are highlighted by Fx reserves with the SBP again falling to below US$10bn. Unusually, but understandably, the SBP has highlighted the importance of energy conservation, calling for pandemic-style work from home, car-pooling etc.
- The policy change is higher than market expectations but not by much. The SBP has indicated that IMF programme resumption is "very close" but market conviction on quick resumption remains low. The central bank has also refrained from giving forward guidance, citing elevated uncertainties and risks. We believe the return of data-dependent decision making is good. While we remain constructive on Pakistan equities, our preference is tilted towards defensive plays such as POL, EFERT, and UBL.

Negative Real Interest Rate may likely persist for another year



Source: SBP, PBS, IMS Research

Import cover still stands abysmally low despite Chinese loan rollover



Source: SBP, PBS, IMS Research, *using 3MMA

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Buy	Total return expectation of ≥ 15% or expected to outperform the KSE-100 index
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*Based on 12 month horizon unless stated otherwise in the report.

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Risks: (i)) Exacerbating second-round effects of supply shocks, (ii) further increase in international commodity prices, and (iii) sharper than expected tightening of global monetary settings

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