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Monetary Policy

Monetary tightening resumes on high inflation

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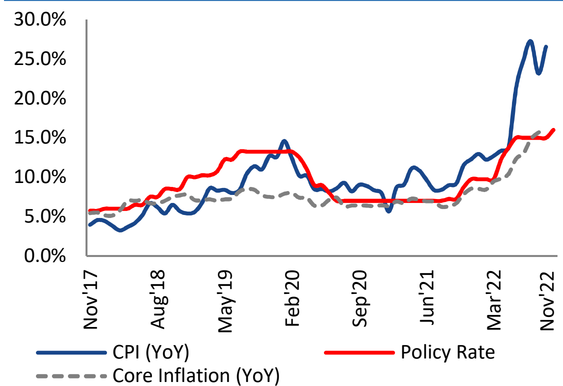
The SBP has increased the Policy Rate by 100bps to 16%, the first rate hike since July. Consensus expectations of unchanged rates were perhaps swayed by status quo in the last two monetary policies and flattish money market yields in the run-up to the MPS announcement. With the latest rate hike, the SBP has returned to "data dependent" decision making, while clearly prioritizing inflation and the external position over near-term economic growth. We believe a return to prudent policies by the SBP adds confidence to Pakistan sticking to the IMF programme and the tough measures it will likely entail.

- The need to focus on inflation wins out over weak GDP growth in the near-term (just 2% in FY23 vs. 6% in FY22). The rate hike has primarily been driven by the recent uptick in the October inflation readings (headline: 26.6%; core: 14.9-18.2%), with a response needed to prevent higher inflationary expectations from becoming entrenched. The SBP now expects CPI to average 21-23% across FY23, although it still expects it to moderate to less than 7% by end-FY24.
- External account vulnerabilities remain, going by the thin import cover of about 1.6 months, with debt repayment obligations outweighing expectations of a moderate current account deficit (3% of GDP in FY23). That said, the central bank has encouragingly stated that it expects Fx reserves to be “significantly higher” by June 2023 compared to the present c US$8bn. Reserves buildup will be a function of planned inflows and bilateral rollovers. Importantly, Pakistan intends to repay its maturing Sukuk on December 2nd, a few days ahead of schedule, with partial offsetting funding from the AIDB expected to be received next week.
- The Ministry of Finance continues to be in touch with the IMF for scheduling the 9th programme review. As per news reports, the delay mainly pertains to the need to revise FY23 projections post the mega floods earlier in the year. In case there is a material revenue shortfall (the fiscal deficit was 1% of GDP in 1QFY23 and FBR tax collection is decelerating), the IMF may require additional taxation to fill the gap e.g. imposition of GST on petroleum products and currently exempted sectors. This will likely be politically tough, but we believe today’s rate hike shores up confidence that Pakistan will do what is needed to preserve macroeconomic stability.

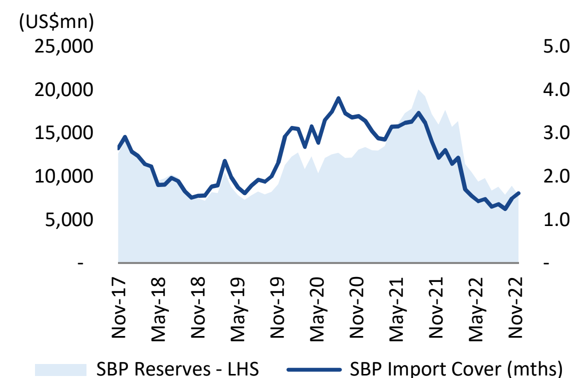
The surprise rate hike may put equities under pressure in the near-term, but we would take this an opportunity to add quality stocks. The appointment of the new army chief was smooth, lowering the political temperature, while it appears that Pakistan’s macroeconomic policies will likely be responsible with the 9th IMF review of key importance. To us, this matters more than a high interest rate environment in the near-term. Pakistan trades at ultra-cheap valuations (forward P/E is less than 4x vs. a 10yr average of 8x), with risks already in the price, in our view. Some names we like include MEBL, UBL, SYS, ENGRO and ILP.

Policy rate tracking core inflation



Source: SBP, PBS, IMS Research

Low import cover highlights vulnerabilities



Source: SBP, IMS Research

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*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) Global commodity prices remain up-trending, (ii) second-round effects on food prices and wages demand, (iii) delay in disbursement of IMF tranche, and (iv) return to imprudent macro-economic policies

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