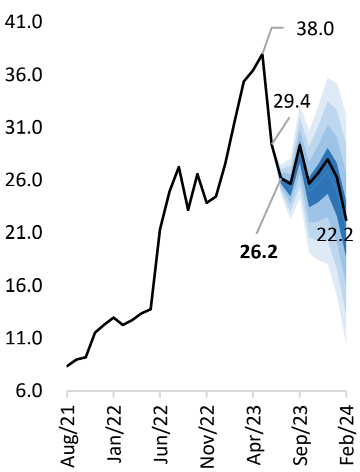
Day Break

Thursday, July 27, 2023

Exhibit: Fan chart indicates CPI has peaked out and likely to drop sharply in the near term



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Monetary Policy Statement

MPC Expected to Put Brakes on Key Rates Hikes

- We expect the policy rate to remain unchanged at 22% as SBP is likely to view projected CPI as headed south during the month of Jul-23.
- Since the last monetary policy meeting on the 26th of June, short-term secondary market yields have negligibly adjusted
- Import relaxation along with a softer policy rate approach would be required to support the growth view.
- In our opinion, SBP may likely put some breaks on the hikes and review for further increases required during its next meeting in Sept-23 when we believe CPI would likely bounce back

The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) on Monday 31st July 2023.

Expecting status quo in the upcoming meeting as CPI likely to further drop to +26%y

We expect the policy rate to remain unchanged at 22% as SBP is likely to view projected CPI as headed south during the month of Jul-23.

CPI elevated and to remain sticky for the next 6-8 months

SBP in the last emergent MPS in late Jun-23 increased the policy rate by +100bps as inflationary expectations deteriorated as govt. passed some fiscal adjustments through budget FY24 and SBP withdrew its general guidance for commercial banks on import prioritization which would contribute to inflation directly and indirectly. In addition, the recent CPI release by PBS for the month of Jun-23 arrived at 29.4%y, and we think this downward trend will continue till Aug-23 before bouncing back in Sept-23.

Exhibit: National CPI Heat Map

	Jul-23	Jun-23	May-23	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22
General	**26.2**	**29.4**	**38.0**	**36.4**	**35.4**	**31.5**	**27.6**	**24.5**	**23.8**	**26.6**	**23.2**	**27.3**
Food	36.3	39.5	48.7	48.1	47.2	45.1	42.9	35.5	31.2	36.3	31.7	29.5
Transport	14.0	20.3	52.9	56.8	54.9	50.4	39.1	41.2	44.2	53.4	64.5	63.1
Utility/Rent	6.2	11.6	20.5	16.9	17.5	13.6	7.8	6.9	9.9	11.9	3.4	27.6
Essentials	16.8	16.7	17.5	16.9	16.7	14.7	14.4	14.4	15.1	14.7	13.7	13.4
Disc.	43.8	44.9	49.4	46.4	43.5	35.8	31.0	28.6	27.2	27.2	26.1	23.6

Source: PBS, S&P Global, IGI Research

Exhibit: Secondary Market Yields

Short-term secondary market yields have negligibly adjusted upward by almost +3-8bps, suggesting no hike in the policy rate.

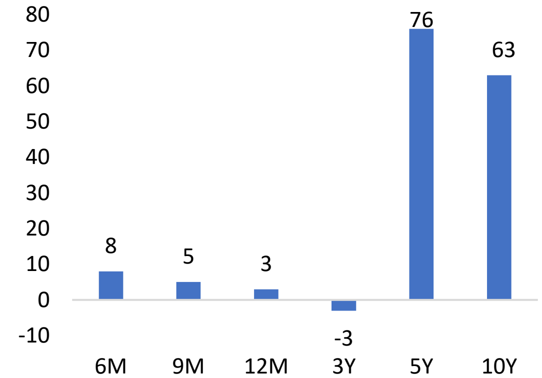
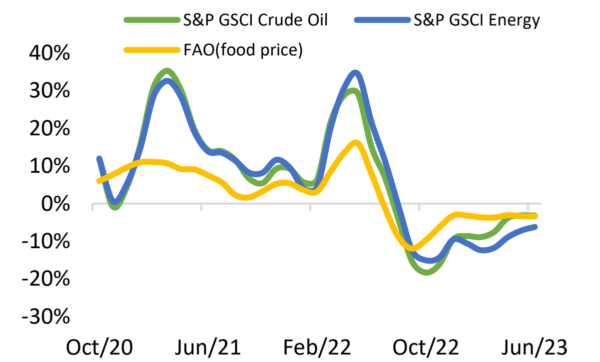


Exhibit: S&P GSCI Commodity Indexes

Global hikes in key central bank rates have begun to induce a dampening demand effect pushing key commodity indexes downward



Source: PBS, S&P Global, IGI Research

Although the latest policy rate move from the SBP is a welcome step, the authorities have generally been sanguine about inflationary pressures quickly receding and returning to their 5–7 percent inflation target range by end-FY25. Staff emphasized that the SBP will need to continue its tightening cycle to re-anchor expectations given that inflationary pressures are expected to persist over the coming year, including because the impact of exchange rate corrections will continue to reverberate through the economy.

The recent increase in the policy rate by the SBP is appropriate given the very high inflationary pressures, which disproportionately impact the most vulnerable. A continued tight, proactive, and data-driven monetary policy is warranted going forward.

IMF SBA Country Report-Jul 2023

Secondary market yields remain muted for short-term maturities

Since the last monetary policy meeting on the 26th of June, short-term secondary market yields have negligibly adjusted upward by almost +3-8bps, suggesting no hike in the policy rate. Long-term yields adjust upward slightly.

2-3% Real GDP Growth target in the upcoming FY24 calls the softer approach

Though the govt. aim to lift the economy by 3.5% growth for FY24, IMF sees a slightly downward figure of 2.5%. In either case, import relaxation along with a softer policy rate approach would be required to support that growth view.

Outlook:

In our opinion, SBP may likely put some breaks on the hikes and review for further increases required during its next meeting in Sept-23 when we believe CPI would likely bounce back owing to low base effects because last year government postponed FPA surcharges in the aftermath of floods and also reflect recent surges in energy prices. CPI is to remain sticky on average close to +26% for the next 6-8 months and may compel the central bank to go for another increase in key rates in order to anchor medium run inflationary expectations of 5-7% by the end of FY25.

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