Day Break

Friday, 19 November 2021

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Economy

Monetary Policy Statement

Expecting a 75bps hike as commodity upclcye seems to loose traction

- The State Bank of Pakistan (SBP) will be announcing monetary policy today, 19th Friday for the next two months.
- We expect policy rate hike of 75-100bps below market consensus hike of 100-200bps. This will take current prevailing rate of 7.25% to 7.75-8.0%.
- SBP has remained rather optimistic and have adopted a more soft approach, laying a greater emphasis on post-covid19 growth recovery. This soft approach has meant real rates have so far been kept in the negative and below 2% mark on average.
- As of recent, commodity prices have in fact started to taper off suggesting the cycle to be more of transitory in nature. Nevertheless, the risks of inflation overshooting and becoming permanent; this outcome may prove far worse than expected; hence caution is warranted.

Rate hiked expected by 75-100 bps

The State Bank of Pakistan (SBP) prior to its scheduled announcement of Monetary Policy Statement (MPS) on 26th November, 2021 the Monetary Policy Committee (MPC) decided to release MPS earlier for the next two months on Friday 19th November, 2021. As per the press release the reasons for this move is to reduced prevailing market uncertainty over monetary setting in the wake of recent unforeseen developments on inflation and balance of payments.

Nevertheless, we expect policy rate hike of 75-100bps below market consensus hike of 100-200bps. This will take current prevailing rate of 7.25% to 7.75-8.0%.

Some of the forward guidance in monetary policy statement we would be looking at;

1 #. Outlook global commodity prices cycle whether transitory or permanent

2 #. Outlook on exchange rate and government fiscal operations

Surging inflation…

Monthly inflation has picked up considerably since Aug-21, onwards averaging ~2.0% on a monthly basis. Continuing with this trend, expected inflation for the reminder of the months leading to CY21, is likely to settle in double digit territory which will take 1HFY22 average inflation close to +~9.0%. Hence moving forward in 2HFY22, double digit inflation is likely to persist averaging 11-12%.

…fuelled by global commodities and weak PKR

Having said that, uptick in recent inflation is partially down to weakening PKR and rising global commodity prices. Since June-21, PKR has almost lost 11% against USD to reach at 173 level. In addition global commodity prices, including edible oil, food, energy items have all seen a rapid increase amid tight global supply situation. GSCI index is up nearly 13% since Jun-21, (+50% since Dec-20), led primarily by rise in food and energy prices.

Sourc: PBS, Bloomberg, SBP

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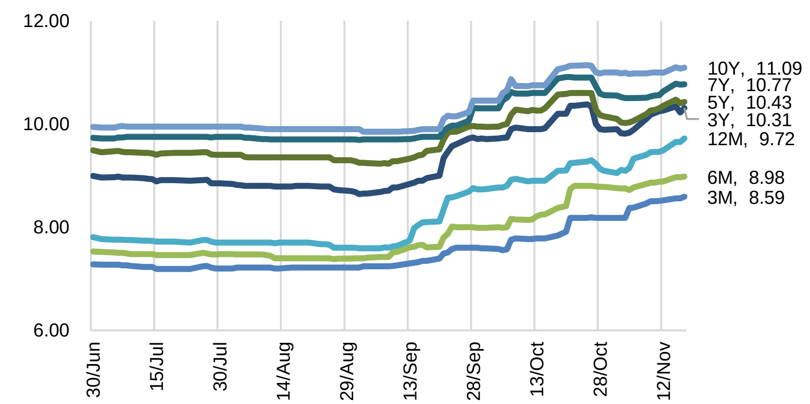
Reflecting that country's Wholesale Price Index (index tracking prices for manufacturers and producers) and Sensitive Price index (index tracking prices of essential items) have averaged +19% and +16% y/y respectively during the ongoing FY22, compared to +4% and +12% y/y last year same period.

…yields have risen sharply

Market participants for months have been directing towards widening negative real rates and weakening exchange rate spiral. Secondary market yields on average have gone up by ~130bps or 1.3% since FY22 start.

Exhibit: Since Jun-21, secondary market yields have risen by almost 130bps



Source: Bloomberg

Real rates in negative

Following the rising inflation, SBP has remained rather optimistic and have adopted a more soft approach, laying a greater emphasis on post-covid19 growth recovery. This soft approach has meant real rates have so far been kept in the negative and below 2% mark on average. Forward to Sep-21 and as of today, rates adjusted for 3m forward inflation (CPI: +11%e) as for now remains well above SBP comfort target of negative 2%, close to 3.5-4.0%, and is likely to get even more uncomfortable in 2HFY22.

Exhibit: Potential Rate hike given monthly rise in national CPI.

Monthly CPI increase	1q (actual)	2q	3q	4q	FY22E	Real Rates	Potential Rate Hike	Policy Rate
0.50%	8.6%	9.4%	10.0%	9.7%	9.4%	-2.2%	0	7.3%
0.75%	8.6%	9.7%	11.1%	11.6%	10.2%	-3.0%	75	8.0%
1.00%	8.6%	9.9%	12.2%	13.5%	11.1%	-3.8%	100	8.3%
1.25%	8.6%	10.2%	13.4%	15.5%	11.9%	-4.7%	150	8.8%
1.50%	8.6%	10.5%	14.5%	17.5%	12.8%	-5.5%	250	9.8%
1.75%	8.6%	10.8%	15.6%	19.6%	13.6%	-6.4%	350	10.8%

Source: IGI Research, PBS, SBP

Rise in commodity prices a tipping point

Previously, since Mar-21, nearly all major economies were locked into growth emphasis policy settings owing to Covid19 induced panic. Similarly to global central banks, Pakistan kept real rates in negative, as to support government Covid19 related funding. That has been so far fared well in inducing a rapid demand and thus sustaining growth. But these came with risks, fuelled by supply constraints, large fiscal spending, and triggered by commodities prices; "overheating" was inevitable. Developed and emerging market central banks have already started to respond to rising inflation, as negative real rates goes deep into +4-5% range.

Exhibit: Global Central as of late have been increasing rates, at faster rate

Country	Current	Previous	Last Change	Real Rates
Turkey	15.0%	16.0%	Nov/21	4.9%
Hungary	2.1%	1.8%	Nov/21	4.4%
Mexico	5.0%	4.8%	Nov/21	1.2%
Czech Republic	2.8%	1.5%	Nov/21	2.2%
Poland	1.3%	0.5%	Nov/21	5.6%
Brazil	7.8%	6.3%	Oct/21	2.9%
Russia	7.5%	6.8%	Oct/21	-0.1%
Chile	2.8%	1.5%	Oct/21	3.3%
New Zealand	0.5%	0.3%	Oct/21	2.7%
Norway	0.3%	0.0%	Sep/21	3.3%
South Korea	0.8%	0.5%	Aug/21	2.4%
South Africa	3.5%	3.8%	Jul/20	1.6%
India	4.0%	4.4%	May/20	0.4%
China	3.9%	4.1%	Apr/20	-2.4%
Israel	0.1%	0.3%	Apr/20	2.2%
Canada	0.3%	0.8%	Mar/20	4.4%
Great Britain	0.1%	0.3%	Mar/20	2.8%
Saudi Arabia	1.0%	1.8%	Mar/20	n.a
United States	0.3%	1.3%	Mar/20	6.0%
Indonesia	6.5%	6.8%	Jun/16	-4.8%
Europe	0.0%	0.1%	Mar/16	3.9%
Japan	-0.1%	0.0%	Feb/16	0.3%

Source: Central Banks Rates

Outlook: Commodity prices taper-off but caution warranted

Rising commodity prices which act as a tipping factor for widening negative real rates. More so whether the commodity upcycle will be transitory in nature and how long this trend will take to taper off is yet to be seen and surely will be SBP key look out factor. As it will determine the outlook on inflation, the exponential rise seen in country's import bills, and subsequently current account balance which starting FY22 remains in precarious situation. As of recent, commodity prices have in fact started to taper off suggesting the cycle to be more of transitory in nature. Nevertheless, the risks of inflation overshooting and becoming permanent; that outcomes may prove far worse than expected; hence caution is warranted.

Exhibit: Commodity Prices finally tapping off

Source: Trading Economics

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