Day Break

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IGI Securities
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Economy

Sourc: PBS, Bloomberg, SBP

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Monetary Policy Statement

SBP: That's All For Now 150bps; More In The Offing and that too somewhat quickly

- The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement for the Friday 19th November, 2021 raised the key policy rate by 150bps to 8.75% and subsequently reverse repo and reo rate to 9.75% and 8.75%.
- In addition, the SBP has also increased its Monetary Policy Committee meeting frequency from earlier 6 every year to now 8 every year.
- Looking ahead, if arresting further PKR depreciation and subsequently reduce the size of current account deficit is the new objective that SBP will work on, than we most likely to see further monetary tightening in the coming months.
- IMF highlighted the need to adopt adequate monetary policies as to anchor down inflation, preserve flexible exchange rate regime, and subsequently build-up FX reserves

Rate hiked by 150bps, as to counter rising inflation

The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement for the Friday 19th November, 2021 raised the key policy rate by 150bps to 8.75% and subsequently reverse repo and reo rate to 9.75% and 8.75%. The decision is in-line with market participants, with majority expecting a 100-200bps raise. In addition, the SBP has also increased its Monetary Policy Committee meeting frequency from earlier 6 every year to now 8 every year.

Back on the monetary policy statement, the release (link) highlighted reasons to raise the rates;

1 #. Rising inflation,
2 #. Widening current account deficit, and
3 #. Weakening Exchange rate

Inflation worries takes the front seat, as global issues became more permanent at home

To what started off as a global supply-chain disruptions, combined with PKR devaluation have fed into domestic inflation. Nearly all indices including CPI, SPI and core have shown an upward trend. And more so on the domestic front, demand side plus supply side misbalance is further keeping businesses inflation expectations on the higher side, as they factor in higher administrated costs in months ahead. These supply-side issues were initially thought of transitory nature on domestic inflation. However what follows it was widening current account deficit and subsequently devaluing of PKR further exacerbating its impact on domestic inflation, and such making these transitory factor in to more of a permanent in nature. Nevertheless, the burden of these risks have caused SBP to swiftly shift away from its previous stance of growth-over-inflation to inflation-over-growth.

Double-digit Inflation needs to be tackled with a double-digit Interest rate

Looking ahead, if arresting further PKR depreciation and subsequently reduce the size of current account deficit is the new objective that SBP will work on, than we most likely to see further monetary tightening in the coming months. Inflation is likely to hit a double-digit growth starting this month Nov-21, projected ~10.2%y/y and will continue to do so till 3QFY22, until effects of monetary transmission becomes visible. Hence given the divergence between interest rates and inflation on the horizon will further widen up. As per SBP guidance, future rate hikes will be done to bring the real rates in positive territory.

"Accordingly, the MPC was of the view that there is now a need to proceed faster to normalize monetary policy to counter inflationary pressures and preserve stability with growth. Today's rate increase is a material move in this direction. Looking ahead, the MPC re-iterated that the end goal of mildly positive real interest rates remains unchanged and, given today's move, expects to take measured steps to that end."

In continuation of SBP's new objective to arrest PKR devaluation and reduce current account deficit, some positive news received earlier today on 22nd November, 2021 whereby IMF released a statement stating staff level agreement has finally been reached which post final approval from executive will lead to disbursement of USD 1.0bn under its USD 6.0bn Extended Fund Facility (EFF) program 6th review tranche. While we await the full document (press release: link), among other things more surprisingly IMF highlighted the need to adopt adequate monetary policies as to anchor down inflation, preserve flexible exchange rate regime, and subsequently build-up FX reserves.

"Monetary policy needs to remain focused on curbing inflation, preserving exchange rate flexibility, and strengthening international reserves."

Considering the aforementioned developments and SBP guidance, we think rate hikes are likely to come by and this quicker and more significant. We believe to counter double-digit inflation rates too will be pushed in a double-digit. For that matter we expect 100-150bps rise much likely in the reminder of the FY22.

Exhibit: Monetary Policy Statement key extracts and outlook

	Outlook	Segment	Comments
Inflation	**SBP's projection for FY22 average inflation remained broadly unchanged at 7-9%.**		Core inflation has also picked up in the last two months, rising to 6.7 percent (y/y) in both urban and rural areas on the back of house rents, cloth and garments, medicines, footwear, and other components.
			In addition, inflation expectations of households remain elevated and those of businesses have risen sharply.
			Looking ahead, global commodity prices and potential further upward adjustments in administered prices of energy pose upside risks to the average inflation
			Forecast of 7-9 percent in FY22
Interest Rates	Over-time rates will increase to achieve positive real rates.	Real-rates	MPC re-iterated that the end goal of mildly positive real interest rates remains unchanged and, given today's move, expects to take measured steps to that end.
Real Sector	**Growth forecast of 4-5 percent in FY22 are tilted to the upside**: Overall, the economic recovery appears increasingly durable and self-sustaining, against the backdrop of rapidly falling Covid cases and the government's vigorous vaccination roll-out.	Industrial Sector	The economic recovery underway since the start of FY21 continues. Notwithstanding some moderation in September due to a high-base effect and some supply chain disruptions, LSM registered broad-based growth of 5.2 percent (y/y) in Q1-FY22,
		Agri. Sector	In agriculture, production levels of all major Kharif crops except cotton are estimated to have reached all-time highs. Cotton production has also rebounded, with arrivals at ginneries growing by 80 percent as of 1st November compared to the same period last season.
		Key Risks	Looking ahead, rising input costs and normalization of macroeconomic policies are likely to lead to some moderation in the growth of industrial activity.
Current account balance	The current account deficit for FY22 is expected to modestly **exceed the previous forecast of 2-3 percent of GDP**.		Persistently high international commodity prices and strong domestic activity kept the current account deficit elevated at $3.4 billion in Q1-FY22.
Exchange rate	As other adjustment tools normalize, including interest rates and fiscal policy, pressures on the rupee should abate.		While the market-based exchange rate has played its due role as a shock absorber, it has borne a considerable burden in terms of adjusting to the widening current account deficit.

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