Day Break

Monday, 22 March 2021

Economy

Monetary Policy Statement

Rate Remains Unchanged as Economic Recovery Lacks Durability

- The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement for the next two months on Friday 19th March, 2021 kept policy rate 'unchanged'.
- Outlook for growth and inflation outlook remains favourable.
- Monetary policy to remain unchanged in the near term as SBP waits for economic recovery to become more durable and for the economy to return to full capacity. Moreover, any potential adjustments will be introduced in a 'gradual' fashion to achieve positive real interest rates.
- Going forward we expect inflation to stay upbeat in upcoming months but we do not expect a rate hike anytime sooner as SBP will remain vigilant of supply and demand side shocks while maintaining accommodative stance on its policy making.

Status quo maintained

The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement for the next two months on Friday 19th March, 2021 kept rate '**unchanged**'.

The decision is in-line with market participants, with majority expecting an unchanged status.

Amid favourable growth and inflation outlook

The press release (Link) on monetary policy; highlighted favourable growth and inflation outlook amid recent key data from Jan-21 to Feb-21. Having said that, SBP remained cognizant over uncertainties surrounding Covid19 pandemic third wave and possible second round effects of recently increased utility prices.

Outlook

For the remainder of FY21, we view SBP is likely to carry on this new path of policymaking, overlooking inflation, supporting economic recovery and facilitating the government in much needed fiscal space, by keeping the monetary policy accommodative if not ultra-accommodative.

SBP clearly laid possible changes on monetary front on account of; supply shocks with the coming of Covid-19 "third wave", when economic recovery displays signs of durability, leading to a potential economy overheating.

However, in our view economy overheating scenario can easily be ruled at least till the Fy21 ends, unless we see major international commodity spike or domestic supply shock leading to a potential permanent dent on headline inflation.

Policy rate likely to remain unchanged in the remainder of FY21

Hence, we are of the view that SBP will continue to keep policy rate unchanged at current level of 7% at least till the remainder of FY21 (consensus 50-150bps increase) and is likely make the first move of 50- 100bps to 7.5-8.0% starting Sept-21 (1qFY22) onwards., hence expecting a no change.

Source: Bloomberg, SBP, MOF, PSX

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Exhibit: Monetary Policy Statement key extracts and outlook

	Outlook	Segment	Comments
Inflation	**SBP's projection for average inflation remained broadly unchanged at 7-9%** for Fy21 and medium-term range of 5-7%.		**Recent (Jan-Feb) uptick in prices has mainly to do with** supply side shocks from utility (electricity) and food (Wheat, Sugar) prices cumulatively adding with 1.5% pp of the total +3%pp increase in Headline inflation. **Inflation remain well within estimates of SBP** and inflation expectations of both businesses and consumers remain well-anchored and business sentiments are at an all-time high. **However, SBP stands vigilant over possible** resurgence of inflation owing to i) third wave of Covid19 leading to potential supply-side shocks, ii) recent increase in administrative energy prices, and iii) domino effect of US economy rebounding.
Interest Rates	**Rates to remain unchanged in near-term**	Real-rates	**Rate hike depends on durability of economic recovery:** As per MPC, the policy rate will remain accommodative in once economy recovery more durable. Going forward any adjustments in the policy rate would be in gradual.
Real Sector	**Growth projection raised from earlier 2% to 3% in FY21:** "While still modest, at around 3 percent, growth in FY21 is now projected to be higher than previously anticipated due to improved prospects for manufacturing and reflecting in part the monetary and fiscal stimulus provided during Covid."	Agricultural	**Strong prospects for wheat** are evident in indicators of agricultural conditions such as fertilizer usage, enhanced water availability, tractor sales and more. Other than that, excluding cotton nearly all major Kharif crops have surpassed production targets for FY21.
		Large Scale Manufacturing (LSM)	**Manufacturing index showing signs of recovery:** LSM exhibited strong growth of +7.9% in contrast to a 3.2% contraction in the same period last year. With that being said the FMCG, Cement and Automobile industry point out towards strong growth in terms of sales trends. **Capacities remains under-utilised and less risk of wage-spiral on the horizon** keeping any signs of overheating of economy at bay.
		Private Sector Credit	Private Sector Credit has picked up since last year buttressed by strengthened consumer confidence and SBP's loans facilities which boosted levels of new fixed investment loans
External Accounts	**C/a balance FY21 projected at >-1% of the GDP**	Current Account Balance	**On the outlook current account deficit is projected to remain below 1% of GDP for FY21.** Positive trend in Exports and Remittances continues. Exports display recovery with current Average level of Exports (Aug-Feb 21) is higher than last 2 period averages. Remittances continue to exhibit robust growth as situation surrounding Covid -19 experienced some stability hence maintaining c/a balance surplus.
Fiscal Sector	**Fiscal consolidation underway:** "Fiscal policy is expected to remain contractionary to reduce public debt"	Revenue	**Fiscal consolidation continue to team-up with monetary policy:** Fiscal deficit remains largely contained at 2.5% of GDP (1HFY21) not exhibiting any broad y/y changes while FBR tax and non-tax revenues exhibited growth of 6% and 16.8% y/y. Primary balance currently stands at a surplus of 0.7% of GDP.

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