Day Break

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Economy

Monetary Policy Statement

Policy Rates Maintained at 7.0% to Support Growth; Amid Improved Inflation Outlook

- The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement for the next two months on Tuesday 28th July, 2021 kept policy rate 'unchanged'.
- Outlook for growth remains favourable as indicated by external balance and recovering industry statistics.
- Monetary policy to remain unchanged in the near term as SBP waits for economic recovery to consolidate. Moreover, any potential adjustments will be introduced in a 'gradual' fashion to achieve mildly positive real interest rates.
- Going forward we expect inflation to moderate between 5-7% by 1HFY22 however we do not expect a rate hike anytime sooner as SBP continues to exercise vigilance over supply and demand side shocks led by new Covid 19 virus strains as well as Balance of Payment situation.

Status quo maintained

The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement for the next two months on Tuesday 28th July, 2021 kept rate '**Unchanged**' at 7.0%.

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

Inflation to dissipate in medium term

The press release (link) on monetary policy highlighted favourable growth trends amid well contained inflationary pressures which has largely been driven by supply side pressures from food sector and administrative decisions on the energy sector.

Medium term inflation is expected to fall in the target range of 5-7% by 1HFY 22 with a visible decline in essential food commodity prices since Jun-21 and elimination of high base effect of electricity tariff Feb-22 onwards. Growth projections have enhanced to 4-5% from 3.9% in FY21

Comfortable outlook on current account balance in FY22

Current account deficit is expected to remain in a sustainable range of 2-3% of GDP in FY22 as compared to much higher deficits of 4% and 6% in FY17 and FY18 respectively. This coupled with a projection of a rise in FX reserves owing to continued inflows from overseas Pakistanis, recent inflow of USD 1bn from issuance of international bonds with previous inflow brought in by the same of USD 2.5bn, expected addition of USD 2.8bn from IMFs SDR collection in Aug-21 and support from moderately stable exports volume is expected to maintain external stability for the economy.

Outlook

For the remainder of FY22, we view SBP is likely to maintain an accommodative stance in policymaking in order to provide room for both fiscal consolidation and recovery durability. However will remain cautious with

Source: Bloomberg, SBP, MOF, PSX

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respect to any indication of overheating in the economy and balance of payment crisis alongside any inflationary pressures due to supply side shocks arising from new strains of Covid-19 on the domestic and international front.

Hence, we are of the view that SBP will continue to keep policy rate unchanged at current level of 7% at least till 1hFY22 and is likely to make the first move of 50- 100bps to 7.5-8.0%.

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%.		**Headline Inflation expected to dissipate 2HFY22 onwards:** Any spike in headline inflation can deemed as transient as it has largely been driven by supply side pressures causing prices of certain food commodities to rise as well as electricity tariff hike in the preceding months. As it is, June onwards food prices have been on a downward trend owing to prudent government measures and timely imports of sugar and wheat while rural and urban CPI trends bear witness to inflation expectation remaining well anchored as well with food and energy prices not having transfused in general prices.
			Inflation rate is likely to remain elevated in the coming months for FY22 close to the upper end of the announced range of 7-9%.
			Medium-Term: In the medium term inflation is expected to fall in 5-7% target range as the February electricity tariff increase drops out of the base.
			However, SBP stands vigilant over possible resurgence of inflation which will remain affected by i) the path of global commodity prices, ii) upward adjustments in the PDL or domestic energy tariffs iii) Fiscal slippages and iv) Overall build up in demand side pressures.
Interest Rates	**Rates to remain unchanged in near-term,** Over-time rate increase will be gradual to achieve positive real rates.	Economic Recovery	**Any uptick in rates is dependent upon demand side inflationary pressures as well as current Account slippages.** An accommodative monetary policy remains appropriate in the short term to ensure sustainable economic growth in light of demand side pressures remaining subdued.
		Real-rates	Moreover, assuring the accommodative near-term outlook, SBP future guidance on rate change will be **gradual to achieve mildly positive real interest rates over time.**
Real Sector	**Growth projection calibrated to that of NIA data at 3.94% for FY21**	Industrial Sector	While key high frequency indicators such as FMCG sales, steel production and POL sales and electricity generation demonstrate strong growth on a yearly basis and recent month on month decline in few indicators deemed as seasonal, capacity utilization continues to lag behind the upsurge in industrial activity.
		Agri. Sector	The agriculture sector is expected to make positive contributions despite the threats faced by the Kharif crops stemming from reported water shortages at the start of the season. Key risks posed remain from the growing local and international new strain of the Covid 19 virus coupled with low vaccination rates.
		Service Sector	COVID 19 led mobility restriction continue to hurt the service sector keeping it well below capacity.
Fiscal Sector	**Fiscal consolidation progresses well**		**Fiscal consolidation continue to team-up with monetary policy:** Strong growth in tax and non-tax revenue of 24.6% and 24.7% respectively contributed by income and sales tax as well as Petroleum Development Levy (PDL) is expected to drag the fiscal deficit to 6.3% of GDP in FY22

		from 7.1% last year. The government projects a favorable decline in public debt to 81.8% of GDP in FY 22 as compared to 87.6% and 83.1% in FY 20 and FY 21 respectively.
IMF and FATF	**Shared Goals surrounding Structural reforms**	On matters related to FATF, SBP highlighted considerable progress has been made by Pakistan whereby meeting 26 of the 27 action plans laid out. While geo-political influences hindered the removal from the grey list, the country's improvement across FATF requirements and successful dealing of geopolitical matters ensures threat of staying on the black list remains at bay. Broaching upon the IMF matters, the governor highlighted ongoing discussions with the organization surrounding the issue of circular debt and high debt to GDP ratio. Dr. Raza Baqir pointed out measures to achieve high tax collection, reducing debt to GDP ratio and countering power sector would be laid down.

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