Day Break

Wednesday, 15 December 2021

Economy

Monetary Policy Statement

SBP: 100bps rate hike; Expect No Further Change in Near–Term

- The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement raised the key policy rate by 100bps to 9.75% and subsequently reverse repo and reo rate to 10.75% and 7.75%.
- The decision is in-line with market participants, with majority expecting a 100bps raise. This is the third consecutive raise in policy rate since FY22 start, taking the cumulative hike of 275bps.
- The decision to raise the rates comes in the line with SBP previous guidance that is; Rising inflation, and widening current account deficit.
- Given SBP forward guidance of setting monetary policy unchanged in the near-term owing to forward-looking global prices, and domestic fiscal measures which will help anchor down inflationary pressure. Combined this SBP reserves outlook PKR is expected to show some stability going forward. Hence we think monetary tightening cycle seems to have run its course.

Rate hiked by 100bps, as to counter rising inflation and widening current account deficit

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The decision (link) to raise the rates comes in the line with SBP previous guidance that is;

1 #. Rising inflation, and
2 #. Widening current account deficit

Inflation and current account deficit targets revised upward

As a result of the latest development on inflation and current account balance, SBP has revised upward its inflation targets for FY22 from earlier 7-9% to now 9-11%, and so has revised its current account deficit projection to 4% of the gdp (previous 2-3%).

Inflation worries staying put in the near-term;

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. And rightly so, SBP points towards the expected path of energy tariffs, inflation is likely to stay put in the near term. Hence the revision in headline inflation from 7-9% to now 9-11%.

Sourc: PBS, Bloomberg, SBP

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…however medium term SBP expects moderating prices

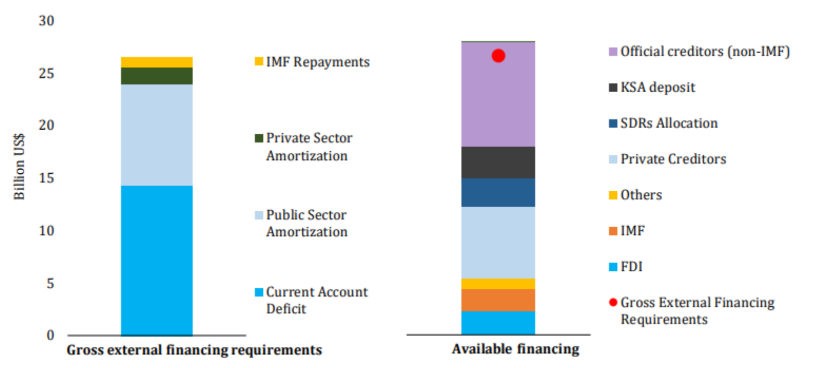
But moving forwards, domestic demand is likely to moderate as policies undertaken materialises, keeping in view i) fiscal tightening mini-budget expected before 2022 starts, ii) expecting mean reverting global commodity prices, and iii) reduction in import bill subsequently a stable a PKR. Henceforth, SBP is targeting a medium term 5-7% inflation, while 2HFY22 headline inflation is expected to remain in double digit.

… And so is the case for current account deficit

As per PBS data released total imports reached USD 32.9bn in 5MFY22, compared to USD 19.5bn last year same period. Despite seeing an uptick in exports and remittances, these runaway import bill has led to widening current account deficit reaching USD 5.2bn or 4.7% of the GDP, suggesting if the current trend continues FY22 cumulative current account deficit would have landed in the region of USD 15-16bn. As per SBP estimates nearly 70% of the increase in import bill is down to increase in global commodity prices, excluding that country’s import bill would have been limited to USD 19.35bn (showing a mere 0.8% y/y decline when compared to last year). Nevertheless, current account deficit is expected to stay high in the near-term but will eventually subside as expected normalisation of global prices in 2HFY22 both from supply and demand side. Easing global supply concerns together tightening monetary policy by major centrals banks will keep demand overall restricted, leading to easing global commodity prices while domestic fiscal measures will help moderate import bill going forward.

Even with the revised current account deficit expected at 4% SBP expects it to be fully financed through external financing.

Exhibit: Even with a slightly larger than anticipated current account deficit in FY22, Pakistan’s external position is more than fully financed



Note: Rollover amount of China SAFE deposit ($ 4.0 billion) is taken off from both financing needs as well as from available financing
Source: SBP, MoF

Source: Monetary Policy meeting Presentation

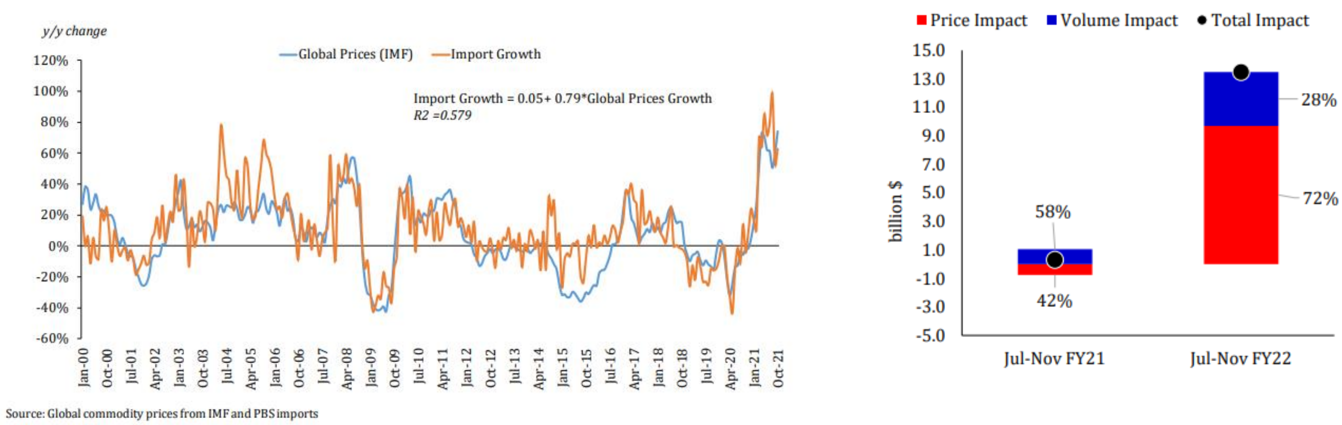
Hence expecting monetary policy setting to remain broadly unchanged

Nevertheless, with this increase SBP expects monetary policy setting to remain broadly unchanged in the near future, as such the goal of achieving mildly positive real rates on forward-looking basis seems close.

Outlook

Given SBP forward guidance of setting monetary policy unchanged in the near-term owing to forward-looking global prices, and domestic fiscal measures which will help anchor down inflationary pressure. Combined this SBP reserves outlook PKR is expected to show some stability going forward. Hence we think monetary tightening cycle seems to have run its course. Unless i) global commodity prices reverse its downward trend, ii) more pain on administrative energy price increase and iii) fiscal measures fail to address demand side pressures.

Exhibit: Domestic import bill mved in tandem with global commodity prices; accounting for around 70% of the increase in imports this fiscal year



Source: Monetary Policy meeting Presentation

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