Day Break

Monday, 25 November 2019

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Economy

Exhibit: **Discount rate history**

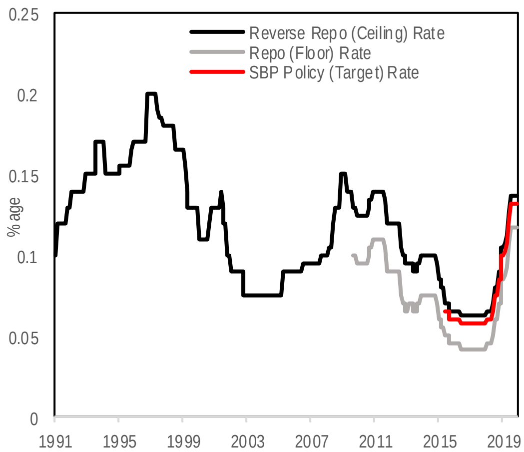

Exhibit: **Policy rate decision**

Date	Ceiling	Floor	Target Rate	Chg. (bps)
11'14	9.50%	7.00%		
01'15	8.50%	6.00%		
03'15	8.00%	5.50%		
05'15	7.00%	5.00%	6.50%	
09'15	6.50%	4.50%	6.00%	-50
05'16	6.25%	4.25%	5.75%	-25
01'18	6.50%	4.50%	6.00%	25
05'18	7.00%	5.00%	6.50%	50
07'18	8.00%	6.00%	7.50%	100
10'18	9.00%	7.00%	8.50%	100
12'18	10.50%	8.50%	10.00%	150
02'19	10.75%	8.75%	10.25%	25
04'19	11.25%	9.25%	10.75%	50
05'19	12.75%	10.75%	12.25%	150
07'19	13.75%	11.75%	13.25%	100
11'19	13.75%	11.75%	13.25%	0

Source: SBP, PBS, IGI Research

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Monetary Policy

Staying Cautious Policy Rate Kept Unchanged For Now; Monetary Easing Likely To Start From Mar-20 Onwards

- In latest Monetary Policy Committee (MPC) meeting held on 22nd Nov, 2019 the State Bank of Pakistan (SBP) left the policy rate unchanged at 13.25%.
- Nevertheless, the motivation behind the current decision is rather precautionary in nature, which comes despite mild improvements witnessed in general economic indicators. In addition to this SBP inflation projections remain relatively unchanged at 11-12% despite rebased and changed methodology in CPI index.
- On inflation outlook we expect headline CPI to average 10-10.5% compared to SBP target of 11-12% and IMF revised target of 11%. While from Mar-20 onwards, inflation is expected to drop close to single digit, henceforth we are of the view that SBP is likely to start policy rate reversal from Mar-20 onwards.

SBP left key policy rate unchanged at 13.25%

In latest Monetary Policy Committee (MPC) meeting held on 22nd Nov, 2019 the State Bank of Pakistan (SBP) left the policy rate unchanged at 13.25%. To recall, the current monetary tightening cycle had begun from Jan-18 at 6.0% to 13.25% currently, making it one of the prolonged monetary tightening cycle. Nevertheless, the motivation behind the current decision is rather precautionary in nature, which comes despite significant improvements witnessed in general economic indicators.

In addition to this SBP inflation projections remain unchanged at 11-12% despite rebased and changed methodology in CPI index. Moreover, future guidance on interest rates remain tilted toward anchoring down inflation and its expectations. In addition to MPC the SBP governor later held a meeting discussing country's current economic dynamics and the decision making at MPC. While addressing SBP governor notified on fiscal accounts

Inflation outlook remain benign…

- High m/m changes in headline inflation was largely fueled by 'temporary factors' led by food supply disruption and then partly due to second round effects of administrative price increases.

Exhibit: m/m Food Prices (%age)

	10'19	09'19	08'19	07'19	06'19	05'19	04'19	03'19	02'19	01'19	12'18	11'18	10'18
Food (Urban)	1.40	2.00	3.10	1.00	-0.30	1.30	1.30	2.50	2.30	0.30	-1.80	-0.20	2.60
Food (Rural)	2.60	1.80	2.90	1.70	0.70	0.60	0.60	3.30	1.70	0.00	-1.40	-0.70	3.00
WPI (food)	1.70	3.50	1.10	-0.30	0.10	1.60	2.90	2.40	1.00	0.70	-0.20	-0.70	1.80
SPI	2.20	1.50	2.50	2.80	0.80	0.70	0.70	2.30	2.00	-0.20	-0.20	0.00	3.30

Source: PBS, IGI Research

- SBP was of the view that these food prices in particularly perishable food items prices are likely to revert back going forward. However, these temporary factors are beyond control of monetary policy and what worry is that these could potentially lead to wage-price spiral.

Exhibit: Household Income expectations in the next year are at record low since survey begin back in 2012

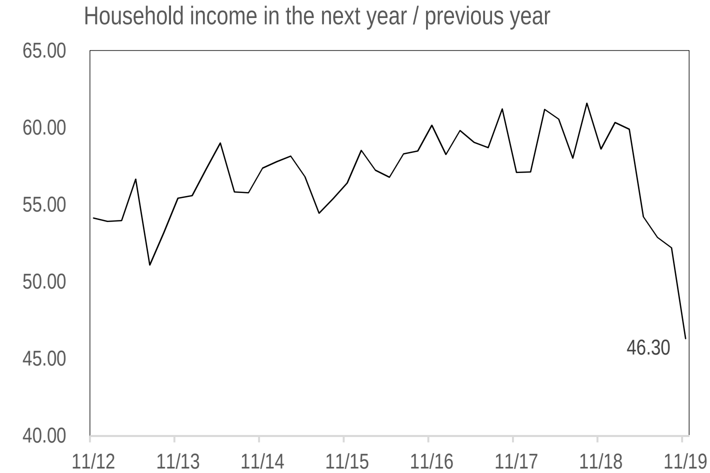
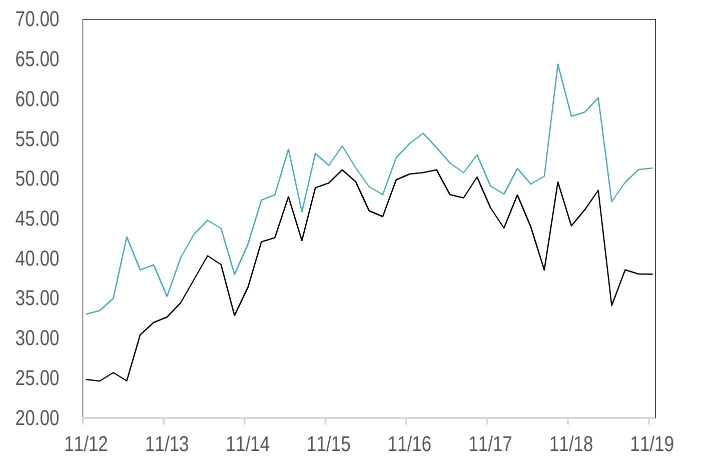


Exhibit: …while business confidence index is somewhat improved, meagerly (economic conditions in next 6-months)



Source: SBP, IGI Research

Both fiscal and external accounts data points to a supportive monetary regime going forward

- While there has been some improvement witnessed, particularly on external account; such as i) C/a balance turned to a surplus (USD 99mn in Oct-19), ii) country's import cover have significantly improved starting FY20 and overall REER (Real-effective Exchange Rate) is close to competitor and SBP comfort zone, which aid wells towards exports growth going forward.
- In addition, Pakistan has been able to attract foreign inflows both in form of portfolio and direct, which along with reduced forward FX liabilities have helped build-up FX reserves, causing some stability to PKR. Steady PKR has also induced de-dollarisation in the economy depicted by reduced foreign currency deposits.
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Exhibit: Cumulative investment in FDI and PI reached PKR 1.0bn by Oct-19

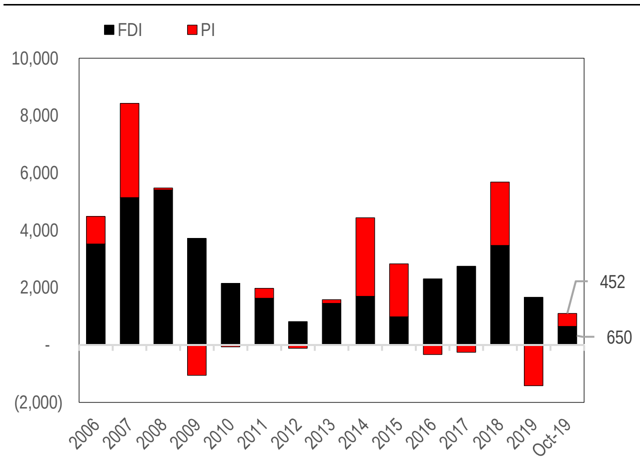
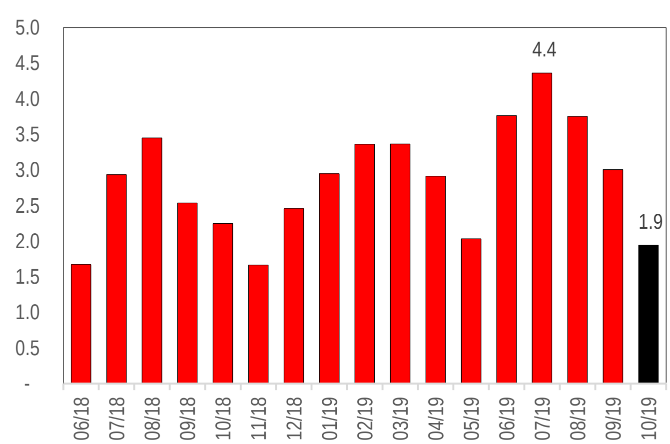


Exhibit: 3-month forward FX liability reduced significantly over the period, with Oct-19 at USD 1.95bn from a high of USD 4.44bn



Source: SBP, IGI Research

- Similarly, on fiscal side provisional tax collection data also suggests broad-based improvements. FBR tax collection grew by ~16%y/y in 5m FY20 compared to 6.4% y/y last year same period and non-development spending has been curtailed which allowed FBR to meet its deficit target.

- Moreover, better fiscal discipline has allowed for not only higher disbursement of development expenditure which more than doubled during 5m Fy20 to PKR 257bn (compared to PKR 105bn 5m FY19) but also zero fresh borrowing from SBP. In future, SBP governor said they will ensure zero fresh borrowing from SBP to continue which will certainly anchor down inflation expectations.

When can we see monetary rate cycle reversal?
However, keeping in mind, SBP also highlighted an ill but closely monitor area, the real sector. As per the MPC report, SBP expects no change in growth outlook; 3.5% in FY20 regardless of contracting LSM (Large-Scale Manufacturing) growth – LSM contracted by 6.04% in Jul-Aug 2020, SBP view 2h 2020 with help of higher PSDP disbursement should allow for LSM growth to normalize.

Moreover, private sector contraction has been limited than initially feared at PKR 4.1bn during 4m 2020 compared to an expansion of PKR 223bn last year same period. However, we note much of the credit disbursement starting FY20 is largely explained by working capital management but fixed investments have also started to show some meagre growth points thanks to LT financing facility.

Nonetheless, this is one area where we think a faster contraction in aggregate demand could potentially trigger an earlier rate reversal cycle.

Inflation target remain at 10.0-10.5%, leading to 3m fwd real rates of +2.0%
On inflation outlook we expect headline CPI to average 10-10.5% compared to SBP target of 11-12% and IMF revised target of 11%.

Based on this 3m forward real interest rates are likely to remain in positive territory close to +2.0% which in-line with historical average of ~2.0%. While Mar-20 onwards, inflation is expected to drop close to single digit, leaving sufficient room for authorities to cut key policy rate.

Outlook: Rate cycle to expected reverse from Mar-20 onwards
Henceforth we are of the view that SBP is likely to start policy rate reversal from Mar-20 onwards.

Exhibit: 3m forward and trailing Real rates

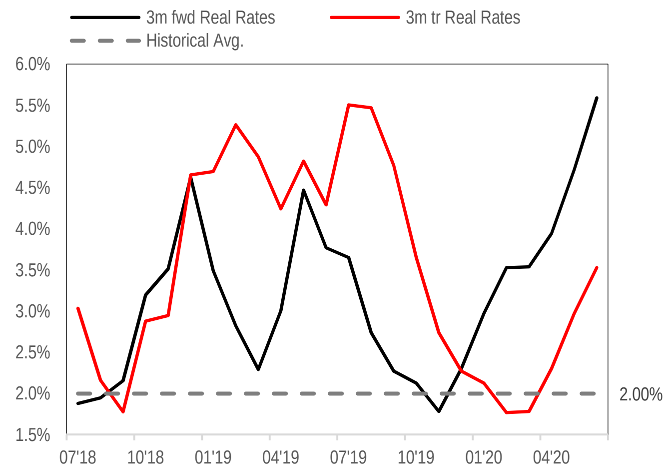
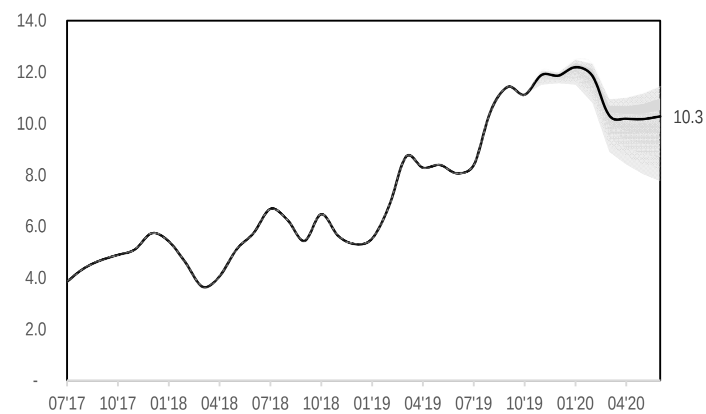


Exhibit: Inflation expected to average +10-10.5% in FY20; compared to SBP target of 11-12%



Source: PBS, SBP, IGI Research

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