Day Break

Monday, 02 October 2017

Economy

Exhibit: Policy rate and inflation

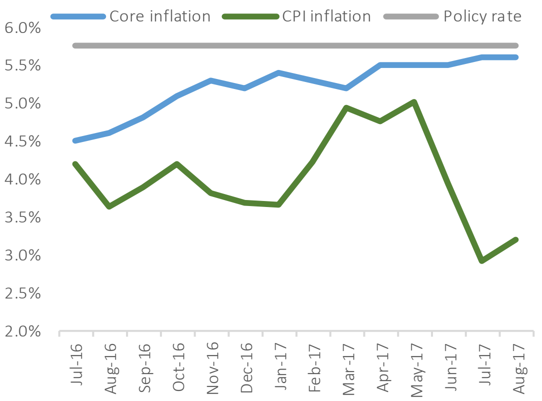


Exhibit: Headline inflation

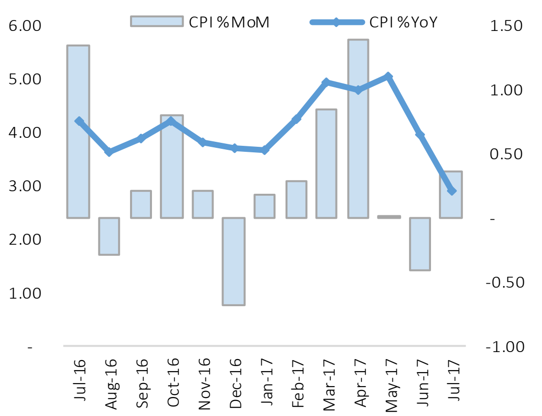
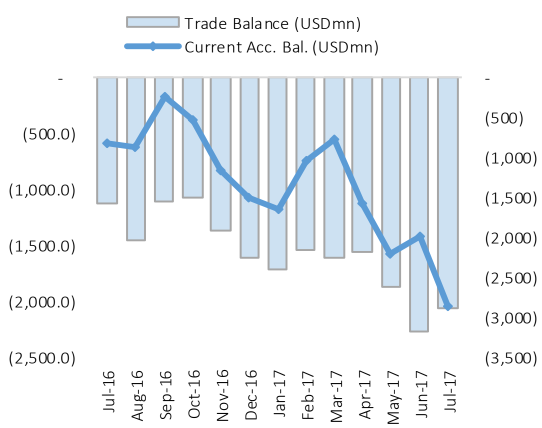


Exhibit: Trade balance & current account balance



Source: PBS, SBP & IGI Research

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Monetary Policy Statement

Policy rate maintained at 5.75%; external account imbalance a key risk to stability

- As per the latest monetary policy statement, the State Bank of Pakistan (SBP) kept its monetary policy stance unchanged, keeping policy rate at 5.75% and discount rate at 6.25%.
- On real sector, SBP highlighted the rapid growth in Large Scale Manufacturing (LSM) during Jul-17 (up +13%).
- SBP pointed out the sluggish growth in prices during 2MFY18 (+3.2%YoY) with subdued outlook.
- The external sector vulnerabilities were highlighted yet again, with pro-growth nature of external accounts imbalance emphasized.
- On the outlook, SBP declared timely realization of official inflows as key to sustaining external account and foreign exchange reserves.
- Going forward, despite witnessing a rising trend in inflation, we expect Policy Rate to remain unchanged in CY17 and in 1HCY18.

Monetary Policy Statement: Status Quo Maintained

As per the latest monetary policy statement, the State Bank of Pakistan (SBP) kept its monetary policy stance unchanged, keeping policy rate at 5.75% and discount rate at 6.25%. SBP highlighted external sector as one area of concern, pointing out the need for timely inflow of external funds. Judging from the SBP language, monetary tightening seems improbable with status-quo likely to continue in coming months.

Robust real sector growth foreseen…

On real sector, SBP highlighted the rapid growth in Large Scale Manufacturing (LSM) during Jul-17 (up +13%), picking up pace from already robust growth of +5.7% in FY17 (against an estimate of +4.7% in FY17). The growth momentum is expected to continue its ascend due to higher investments and higher development spending combined with low cost of borrowing. Moreover, the central bank expects the economy to achieve its growth target of 6% based on current projections of agriculture sector coupled with positive outlook on industrial production and its impact on services sector.

… With stable/subdued outlook on CPI

SBP pointed out the sluggish growth in prices during 2MFY18 (+3.2%YoY) with subdued outlook based on sufficient wheat and sugar stocks keeping supply side shocks in check. However, the central bank also noted the rising demand pull inflationary pressure as reflected in core inflation (up by +5.6% in 2MFY18). Yet SBP sees CPI inflation to remain below its target for FY18 of +6%.

Monetary aggregates seen pointing to an uptick in demand…

Monetary aggregates were also noted to show rising demand in the economy. The central bank pointed out +21.1%YoY growth in credit to private sector up until 15th Sep-17. This was a result of low interest rates with ample availability of loanable funds due to robust deposit growth as well as demand from increasing construction activity and consumer durable goods.

… While external sector is observed to challenge stability

The external sector vulnerabilities were highlighted yet again, with pro-growth nature of external accounts imbalance emphasized. Commenting on the external sector, SBP pointed out that the USD 2.1bn current account (C/a) deficit is primarily driven by rising imports of machinery, metal and petroleum, overpowering growth in exports and remittances. On financial account front, SBP mentioned the rapid growth in 2MFY18 but maintained that this was not enough to manage the current account deficit. On the outlook, SBP registered its concern over higher imports compared to exports and remittances while declaring timely realization of official inflows as well as structural reforms as key to sustaining external account and foreign exchange reserves.

Outlook: External account pressures may lead to uptick in prices

Going forward, despite witnessing a rising trend in inflation, we expect Policy Rate to remain unchanged in CY17 and in 1HCY18. However, we flag sharp PKR depreciation in wake of widening C/a deficit and subsequent pressure on FX reserves as a key risk to our call. Nevertheless, our FY18 headline inflation target stands at 4.5-5.0% compared to +4.16% achieved in FY17.

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