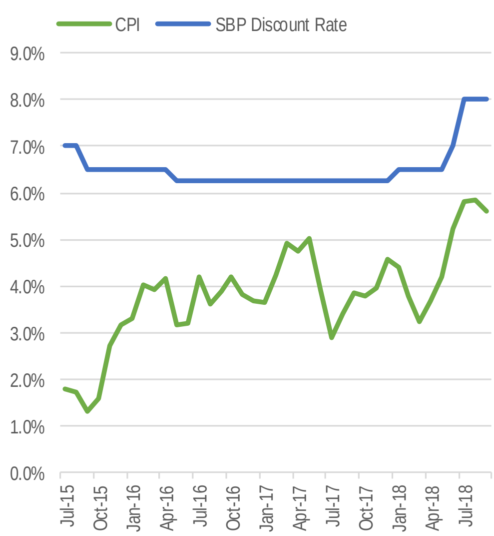
Day Break

Friday, 28 September 2018

Economy

SBP Discount rate and inflation



Monetary Policy

25-50bps Rate Hike Expected, Despite Risks Flagged Around Inflation And External Accounts

- SBP is scheduled to announce its monetary policy tomorrow, whereby we expect 25-50bps rate hike contrary to market consensus of 100-150bps. So far SBP has raised the discount rate by 175bps to 8.0% starting CY18 citing fragile external account, volatile global commodity markets and rising domestic inflation; a recipe factor for these rate hike.
- CPI to clock in 5.52% for the month of Sep-18, with core inflation likely to soften up owing to high base effect
- Soft pinch of austerity measures should start reaping benefits, but given the dull growth outlook in FY19 owing largely to ballooning external imbalances, hard contractionary fiscal measures could have a greater sinking impact on overall growth.

Expecting a 25-50bps rate hike in upcoming monetary policy statement

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We see 3months forward real interest rate remaining in positive territory close to its historic average of ~2.0%, despite incorporating recent administrative gas tariff increase of 50-140% inflation is likely to stay close to ~6.0% till Dec-18. Moreover, with fiscal consolidation new government's upmost priority we see combining this with aggressive monetary tightening unlikely merits government decision at this time. Finally, external account has largely been the key factor dictating monetary policy in recent times. However, latest c/a deficit says the otherwise.

CPI to clock in 5.52% for the month of Sep-18, with core inflation likely to soften up owing to high base effect

For the month of Sep-18, we expect headline inflation to print 5.6%YoY translating into a +0.4% monthly growth compared to 0.6% monthly growth recorded in past three months. Key contributing factors for lower estimates include slowdown in perishable food inflation and lower domestic POL prices.

Upcoming month of Oct-18, is likely to see rather more upbeat monthly growth, whereby we expect expected increase in POL prices along with recent increase in gas price tariff and quarterly adjustment in house rental index will lead to over >+1.6% monthly increase in headline inflation. However, even with this increase, 3months forward average inflation comes just above 6%. Moreover, core inflation which has shown a rising trend in the recent months averaging +7%YoY in the past 6months is likely to show signs of slowdown owing to higher base effect.

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Exhibit: Headline CPI Inflation

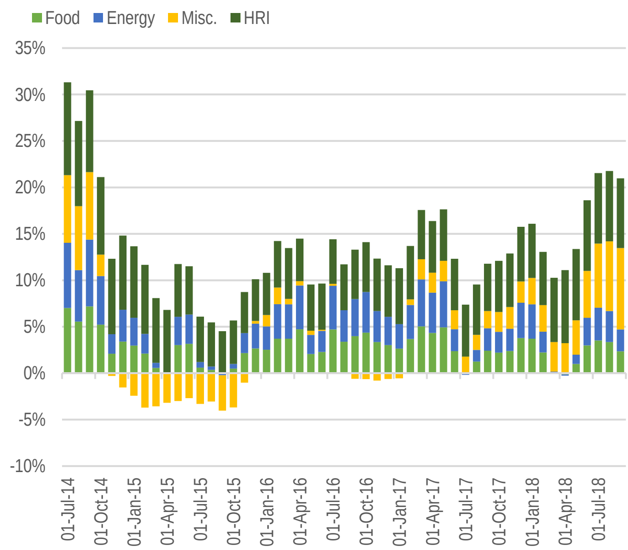
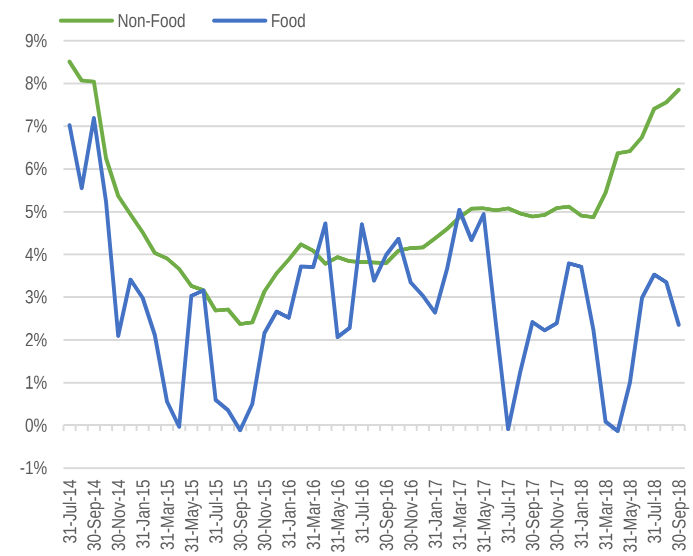


Exhibit: Subsiding Food inflation



Source: SBP, PBS, IGI Research

With 3months forward headline inflation staying close to 6%; real interest rate remains positive at ~2%

With 3months forward headline inflation staying close to 6%, at current discount rate of 8% real interest rate are expected to remain close to +1.8% territory, compared to historic average ~2.0% average 3months forward real rate.

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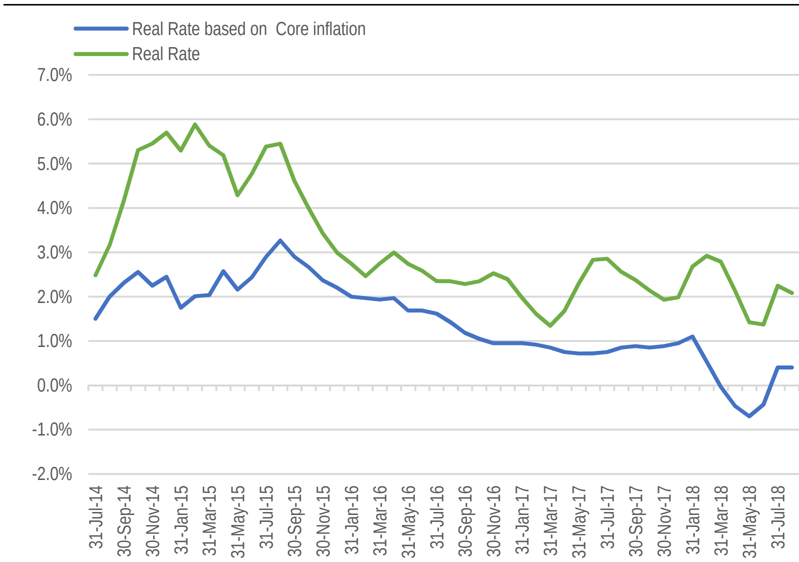

Source: SBP, PBS, IGI Research

Seeking a balance: Soft pinch of austerity measures should start reaping benefits, keeping monetary tightening temptations at bay

Recent budgetary measures taken up by incumbent government led by PTI has introduced some soft austerity measures, including increase in much awaited gas prices, increase in income tax and reduction in government PSDP. Although, this is more of soft pinch of austerity measures in our view, but given the dull growth outlook in FY19 owing largely to ballooning external imbalances, hard contractionary fiscal measures could have a greater sinking impact on overall growth. Hence, the possibility of combining aggressive monetary tightening (175bps increase since Jan-18) with fiscal contractionary measures unlikely merits government decision at this time.

External Fragilities: External Account situation improved in Aug-18; more foreign funding likely to keep Exchange rate stable

For Aug-18, current account (c/a) deficit number was encouraging at USD 600mn compare to USD ~1.5bn monthly average deficit witnessed in nearly all of FY18. Most importantly, imports which have recorded on average >18% annual growth in FY18, slowed down to 5% in Aug-18, bringing goods monthly trade deficit under USD 2.5bn after a period of nearly 5months. In addition to this, country's REER have finally started to come down to ~108 (as of Jul-18) from a high of 124 back in Nov-17.

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