## Economy

**Exhibit:** Pakistan Historic Central Bank Discount Rate Peaked at 15%, during Previous Super Inflationary Cycle In 2008

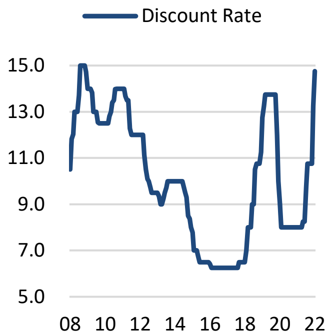



**Exhibit:** Participants expectation of Policy rate change (bps)
Source: CFA, Pakistan

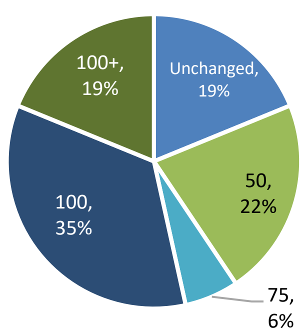
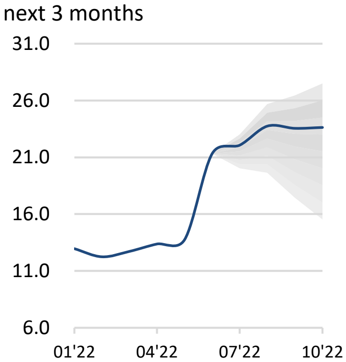



**Exhibit:** Projected inflation for the next 3 months

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Monetary Policy Statement

# 125bps Rate Hike Expected, Extending the Current Tightening Cycle to 675bps

- We expect SBP to raise the policy rate by 125bps taking the key rate to 15%, which is close to historic high of 15% back in 2008.
- As per a market survey conducted by CFA Society of Pakistan, less than 20% expect rates to remain unchanged whereas the rest expect a rate hike.
- Recent inflation marking printed a +21.3%y growth (25% peak CPI witnessed in 2008) led by hike in petroleum prices, electricity and food prices.
- In addition to rising inflationary pressure country's current account deficit has continue to widen up with latest May-22 deficit now at US$ 1.4bn.
- Since last monetary policy announced on 23rd May-22, Secondary market yields have gone up by nearly 40bps on average. More importantly, longer-tenure yields are trading lower than short-term yields causing yield curve inversion, which is suggestive of slower growth higher inflation.
- Given the current inflation problem, SBP may need to keep raising rates even at risk of slowing down economic activity.

The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) for the next two months on Thursday 7th July, 2022.

**Expecting a 125bps rate hike**

We expect SBP to raise the policy rate by 125bps taking the key rate to 15%, which is close to historic high of 15% back in 2008. As per a market survey conducted by CFA Society of Pakistan, less than 20% expect rates to remain unchanged whereas the rest expect a rate hike. Of this, nearly 54% of the respondents expect a 100bps or more than 100bps increase in policy rate.

We base our premise on;

**Rising Inflationary Pressure…**

Recent inflation marking printed a +21.3%y growth (25% peak CPI witnessed in 2008) led by hike in petroleum prices, electricity and food prices. Moreover, on the outlook, further administrative energy price hikes are on the cards including, housing utility, petroleum products, and house rent. As more and more energy price increases, we suspect second round inflationary pressures building up, skewing the outlook towards higher inflation in coming months. Based on our conservative view we expect next three months inflation is likely to average 23% and peak range of 25%.

**…And, Widening External Accounts Fueling Inflation Misery**

In addition to rising inflationary pressure country's current account deficit has continue to widen up with latest May-22 deficit now at US$ 1.4bn. For a perspective, 11m2022 total deficit now stand at US$ 15.2bn compared to last year US$ 1.2bn. With this widening PKR has lost almost 16% against the USD greenback starting FY22 to reach 207 as of latest. Globally central banks tightening, and Pakistan widening negative real interest rate gap is putting further pressure on PKR USD parity.

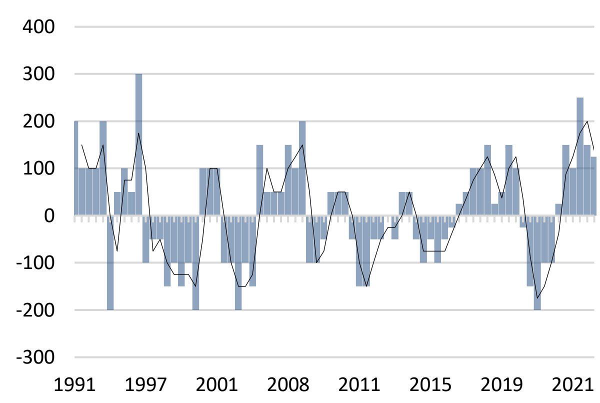
### Yield Curve Inversion Pretty Much Gives it Away

Since last monetary policy announced on 23rd May-22, Secondary market yields have gone up by nearly 40bps on average. More importantly, longer-tenure yields are trading lower than short-term yields causing yield curve inversion, which is suggestive of slower growth higher inflation. In fact recent budgetary measures along with rising prices is projected to dampen overall aggregate demand, and with little or less relief coming from intl. commodities, yields are likely to remain inverted for some time.

### Outlook

Given the current inflation problem, SBP may need to keep raising rates even at risk of slowing down economic activity. In our earlier note published on last monetary policy statement (link), we opine more proactive approach to dealing with inflation. However, our expectations fell short as SBP reverted to more of a wait-and-see approach. This time too, we expect SBP to adopt more proactive approach in monetary policy decision rather than reactionary. This in our view is only way to bring inflation back under control instead of choosing to go aggressively on rate hike and ending up with a bigger economic slowdown.

**Exhibit: Pakistan historic rate change (bps)**



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