Day Break

Friday, March 3, 2023

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Economy

SBP Raises Policy Rate by 300bps to 20%; Inflation to Remain High in Near-Term

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The Monetary Policy Committee (MPC) in its meeting held on 02nd-Mar-23 decided to increase the policy rate by 300 basis points to 20%, which stands above consensus. To note, MPC preponed its meeting which was scheduled to be held 16th-Mar-23. Next MPC meeting will now be held on 04th-Apr-23.

Exhibit: Monetary Policy Rate Decision

	Current	Previous	Chg. (bps)
Target Policy Rate	**20.00%**	**17.00%**	**300**
Discount rate (Ceiling Rate)	21.00%	18.00%	300
Floor Rate	19.00%	16.00%	300

Source: SBP, IGI Research

Key Highlights

- MPC in its last meeting in Jan-23 highlighted near-term risks to the inflation outlook from external and fiscal adjustments. Most of these risks have materialized and are partially reflected in Feb-23 inflation.
- The Committee expects inflation to rise further in the next few months as result of the recent fiscal measures and energy prices adjustments before it begins to fall, albeit at a gradual pace.
- The average inflation for FY23 now expected to fall in the range of 27-29% against previous estimate of 21–23% highlighted in Nov-22.
- MPC emphasized that FX reserves are critically low and in this regard, conclusion of IMF 9th Review will help address near-term external challenges. MPC also noted that there is an urgent need for energy conservation measure to ease pressure on external accounts and meet import requirement of other sectors.
- From growth perspective, MPC assessed impact of monetary policy on financial stability and near-term growth outlook and is of the view that financial stability is contained while short-term cost of bringing down inflation is less that long-term cost of allowing it to entrench. MPC expects medium-term inflation to settle between 5-7% by end of FY25.

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Exhibit: Market Survey of Monetary Policy decision

~57% of the participants' surveyed by CFA Society of Pakistan expect rate to increase (Source: CFA Society Pakistan)

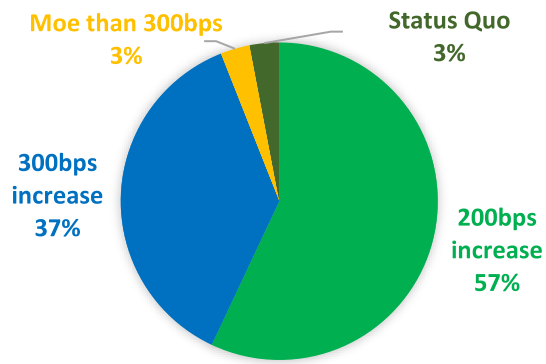
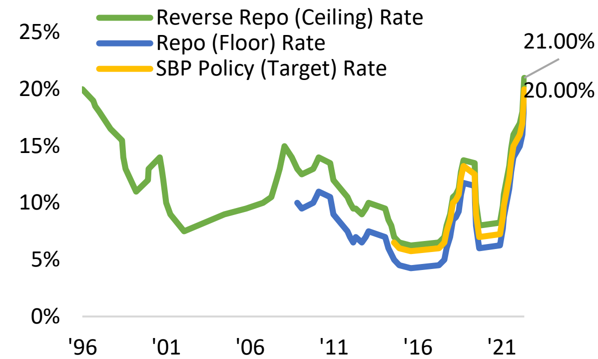


Exhibit: Pakistan Policy Rate (historical)

Discount rate of 21% breaks previous high of 20% back in 1996. (Source: SBP)



External Sector: Conclusion of IMF EFF 9th Review critical in easing pressure on external side

- MPC noted that despite a substantial reduction in the current account deficit (CAD), vulnerabilities continue to persist. CAD squeezed to USD 0.24bn primarily due to drop in imports, however, decline in exports and remittances has diluted the impact.
- External sector remains under stress due to scheduled debt repayments and decline in financial inflows amid rise in global interest rates and domestic uncertainties. As a result, FX reserves and exchange rate remain under pressure.
- To address these issue, MPC highlighted that successful conclusion of IMF EFF 9th Review will be critical in easing pressure from external accounts. MPC noted that there is an urgent need for energy conservation measures to ease pressure on external accounts and meet import requirement of other sectors.
- SBP Governor stated that net external payment for remaining 4 months of FY23 stands at USD 3bn as USD 1.2bn out of total USD 4.2bn is likely to be rolled-over.

Exhibit: Monthly Current Account Balance

US$ mn	Jan-23	Dec-22	m/m	Jan-22	y/y	7MFY23	7MFY22	y/y
Exports (G)	2,207	2,306	-4%	2,500	-12%	16,429	17,742	-7%
Imports (G)	3,924	4,236	-7%	6,203	-37%	33,452	42,298	-21%
Trade Bal.	(1,717)	(1,930)	-11%	(3,703)	-54%	(17,023)	(24,556)	-31%
Services Bal.	18	86	-79%	(597)	-103%	(301)	(2,736)	-89%
Remittances	1,894	2,102	-10%	2,180	-13%	16,006	17,988	-11%
Income Bal.	1,457	1,554	-6%	1,833	-21%	13,525	15,734	-14%
C/a Bal.	**(242)**	**(290)**	**-17%**	**(2,467)**	**-90%**	**(3,799)**	**(11,558)**	**-67%**
C/a Bal. (x-oil)	**1,018**	**975**	**4%**	**(1,359)**	**-75%**	**6,306**	**(1,878)**	**-336%**

Source: SBP, IGI Research

Fiscal Sector: Fiscal Consolidation key for economic stability

- As earlier highlighted by MPC, fiscal consolidation is crucial for economic stability and will complement the ongoing monetary tightening in bringing down inflation over the medium-term.
- Recently fiscal measure taken by the Government, which includes increase in GST and excise duties, reduction in subsidies, adjustment in energy prices and the austerity measure, are expected to help contain the otherwise widening fiscal and primary deficit.
- MPC emphasized that any significant fiscal slippages will undermine monetary policy effectiveness in the context of achieving the price stability objective.

On Inflation: Near-term adjustments and fuel prices remain a key risk

- Most of the external and fiscal adjustments risks on inflation have materialized and partially reflected in Feb-23 inflation.
- Recent fiscal adjustments and exchange rate depreciation have led to a significant deterioration in the near term inflation outlook and a further upward drift in inflation expectations.
- In the near-term, inflation is expected to rise further in the next few months as the impact of these adjustments unfolds before it begins to fall at a gradual pace.
- The Committee expects inflation for FY23 to fall in the range of 27-29% as against previous estimate of 21-23% as stated in Nov-22.
- MPC noted that today's decision has pushed the real interest rate in positive territory on a forward-looking basis, if no unexpected future shocks happen. This will help anchor inflation expectations and steer inflation to the medium-term target of 5–7% by end of FY25.

Exhibit: National Core-inflation measures

	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22	Apr-22	Mar-22	Feb-22
CPI	**31.5**	**27.6**	**24.5**	**23.8**	**26.6**	**23.2**	**27.3**	**24.9**	**21.3**	**13.8**	**13.4**	**12.7**	**12.2**
SPI	33.6	30.5	29.7	29.7	28.6	35.9	40.6	34.3	26.5	16.1	16.5	15.8	18.1
WPI	36.5	28.5	27.1	27.7	32.6	38.9	41.2	38.5	38.9	29.6	28.1	23.8	23.6
NFNE	18.9	17.0	16.4	16.2	16.2	15.7	14.9	13.0	12.3	10.4	9.8	9.5	8.4
Trimmed	27.7	23.7	22.2	22.0	23.9	21.5	22.4	20.1	17.7	12.1	11.4	11.0	10.4

Source: PBS, IGI Research

How will the market react?

MPC's decision to hike Policy Rate by 300bps was higher than consensus of 200bps should have a negative impact on the market. Although banks are prime beneficiary of rate hike as NIMs will expand and E&P sector in terms of no debt on books, nevertheless, uncertainty regarding conclusion of IMF review may initially keep overall market depressed. Increase in interest rate is likely to further diminish demand and bring additional burden on finance cost.

For sectors such as cements, steel, textile and fertilizer, which are highly leveraged, will be most impacted by rate hike, however, companies that have availed financing under TERF may not see a sharp rise in finance cost. Automobile assemblers may witness further drop in demand as auto financing will further drop.

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