Economy

Monetary Policy Statement

SBP Raises policy by 250bps; reacting to rising global macro-economic risks

- The State Bank of Pakistan (SBP) in an emergent Monetary Policy Statement (MPS) announcement on Thursday April 7th, 2022 increased policy rate by 250bps taking it to 12.25%.
- Moreover along with monetary policy statement SBP also have revised up rates of Export Re-Finance Scheme (EFS) and have further extended the scope to include additional import items (mainly luxury items but excludes raw material items) under cash margin requirement.
- As per the statement, inflation has been on a rise much quicker than initially anticipated. Hence, SBP has revised up its inflation forecasts. For FY22 SBP foresee inflation to remain in double-digit averaging ~<11%; before moderating in FY23.
- In addition to vulnerabilities faced on the price front, external account has been under the bout of rising international commodity prices.

SBP increased policy rate by 250 bps to 12.25%...

The State Bank of Pakistan (SBP) in an emergent Monetary Policy Statement (MPS) announcement on Thursday April 7th, 2022 increased policy rate by 250bps taking it to 12.25%. To recall, this takes cumulative rate increase to 5.25% in span of past 6months.

Along with monetary policy statement, SBP also have revised up rates of Export Re-Finance Scheme (EFS) and have further extended the scope to include additional import items (mainly luxury items but excludes raw material items) under cash margin requirement.

Global Macro-economic risks have increased significantly over the past month

As per the monetary policy statement reads; since the last monetary policy committee meeting held on 8th of March, global macro-economic risks, led by rise in commodity prices and global financial conditions exacerbated by the Russia-Ukraine conflict, have increased significantly and are now casting negative implication on domestic economy.

Domestic Inflation rose quicker than anticipated

As per the statement, inflation has been on a rise much quicker than initially anticipated. MPS notes Mar-22 inflation reading which was rather unexpected rising to +12.1%y (+0.79%m). This along with rise in core inflation which rose to print 8.9%y and 10.3%y growth for Urban and Rural NFNE (non-food, non-energy) inflation.

On the outlook SBP views risks on inflation remain elevated and as a result International commodity futures market suggest that international commodity prices particularly oil prices are likely to remain uplifted for some

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time due to geo-political crisis. All that developments forced SBP to revise average inflation forecasts. Hence, SBP has revised up its inflation forecasts. For FY22 SBP foresee inflation to remain in double-digit averaging ~>11%; before moderating in FY23.

Risks on external account has increased

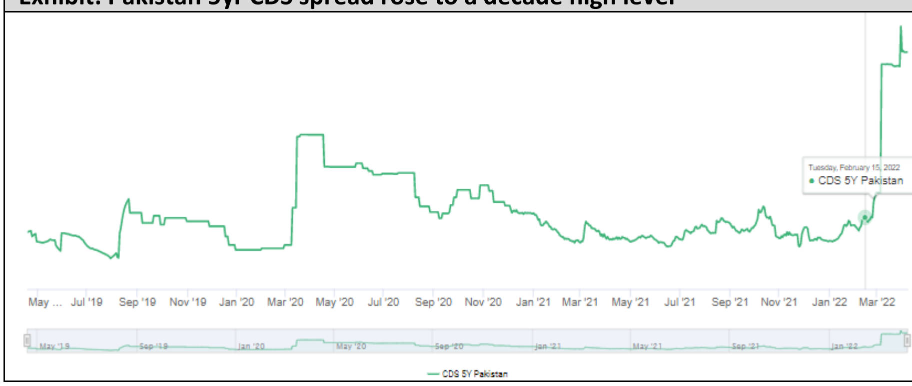
In addition to vulnerabilities faced on the price front, external account has been under the bout of rising international commodity prices. Oil prices have remained elevated averaging above US$ 100/bbl in the past month. Ex-oil current account balance continue to show improvement. On top of widening current account deficit, external debt repayments and one-off arbitration settlement (Reko-Diq) will continue to keep country foreign exchange reserves under pressure. As result of this depleting factors on foreign exchange reserves, PKR has lost nearly ~7% of its value against US$ since Jan-22 starting from 176 rate to recent high of 189.

Heightened domestic political unrest

Having said that, the majority of PKR depreciation (nearly 5% out of the total 7%) came during the on-going domestic political uncertainty surrounding the no-confidence motion, which halted the 7th IMF review under EFF program.

Moreover, Pakistan domestic secondary market yields, Eurobond yields and international CDS (credit default swaps) spread rose significantly sharper during the current political unrest.

Exhibit: Pakistan 5yr CDS spread rose to a decade high level



Source: CBonds.com, IGI Research

Outlook: End of FY22 rate tightening cycle

Prior to rate decision secondary market yields had already incorporated the rising inflation with yields showing an average of 30-50bps increase in last held auction by Mar-22 end. Nevertheless, SBP expects with current rate hike forward real interest rate gap is likely to shrink, SBP expects current rate rise will in turn achieve mildly positive forward real interest rates. This will safeguard and ensure price stability. We think this is the end of FY22 rate tightening cycle, as international commodity prices seems to reverting back.

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