Economy

Exhibit: Historical policy rates

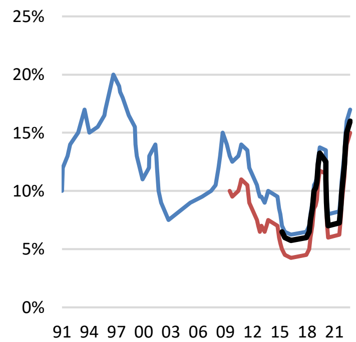
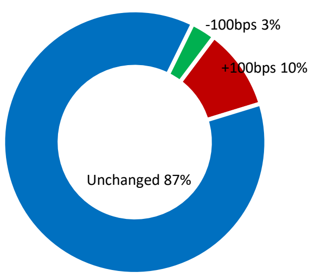
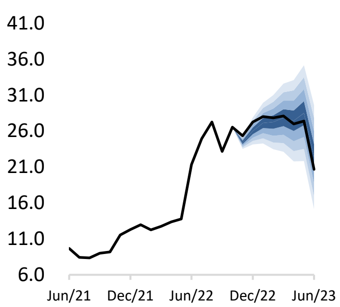


Exhibit: Market Consensus on monetary policy skewed on 'Status Quo'



Source: CFA Soceity Pakistan, IGI Research.

Exhibits: CPI printed a +26.6%y/y during the month of Oct-22 and likely to remain above 20%y/y throughout FY23



Source: PBS, IGI Research.

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Monetary Policy Statement

MPS: SBP Delivers a Surprise Rate Hike; Puts Weight Behind Non-Action By Government

- State Bank of Pakistan (SBP) in its latest round of monetary policy statement (link) increased the policy rate by 100bps to now 16%
- The rate hike was rather unexpected given larger share of market consensus prior to rate announcement remained skewed on the unchanged stance. For support data, SBP pointed towards rising trend of core inflation, which after a sharp month-on-month increase in headline CPI for the month of Oct-22.
- A look back at previous monetary policy statement there has been quite a diverging view. October, 2022 monetary policy 'unchanged' view dwelled particularly on demand side of things whereas in November, 2022 focus has been on the supply side
- Gauging from the tone of monetary policy statement, it is difficult to assess whether SBP will bend towards further rate hikes or not, striking a balance between growth and inflation will not come easy. But as of now it seems SBP decision is more tilted towards curbing inflation.

We review monetary policy statement and post announcement key highlights of analyst briefing session held.

SBP delivers a 100bps policy rate hike as core-inflation trend upwards

State Bank of Pakistan (SBP) in its latest round of monetary policy statement (link) increased the policy rate by 100bps to now 16% keeping the ceiling and floor spread unchanged at 17% and 15%, respectively. The rate hike was rather unexpected given larger share of market consensus prior to rate announcement remained skewed on the unchanged stance.

Exhibit: Monetary Policy Rate Decision

	Current	Previous	Change (bps)
Target Policy Rate	**16.0%**	**15.0%**	**100bps**
Discount Rate	17.0%	16.0%	100bps
Floor Rate	15.0%	14.0%	100bps

SBP puts weight behind non-action by government in easing up supply chain concerns

As per the press release SBP highlighted inflation becoming 'entrenched' which is having a spill-over effects on broader prices causing de-anchoring of inflation expectations. Hence this view necessitated a rate hike. For support data, SBP pointed towards rising trend of core inflation, which after a sharp month-on-month increase in headline CPI for the month of Oct-22 (+26.6%y/y or +4.7%m/m) settled at 16.2%y/y and 23.9%y/y respectively for NFNE (non-food, non-energy) and trimmed. NFNE core inflation measure surpassed discount rate of 16% in October, 2022.

Exhibit: National Core-inflation measures

	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22	Apr-22	Mar-22	Feb-22	Jan-22	Dec-21	Nov-21	Oct-21
CPI	**26.6**	**23.2**	**27.3**	**24.9**	**21.3**	**13.8**	**13.4**	**12.7**	**12.2**	**13.0**	**12.3**	**11.5**	**9.2**
SPI	28.6	35.9	40.6	34.3	26.5	16.1	16.5	15.8	18.1	19.5	19.3	17.4	14.0
WPI	32.6	38.9	41.2	38.5	38.9	29.6	28.1	23.8	23.6	24.0	26.2	27.0	21.2
NFNE	16.2	15.7	14.9	13.0	12.3	10.4	9.8	9.5	8.4	8.5	8.5	7.8	6.7
Trimmed	23.9	21.5	22.4	20.1	17.7	12.1	11.4	11.0	10.4	10.7	10.6	9.7	8.5

A key idea presented by SBP for establishing this worrying factor of long-term entrenched inflation primarily rests on government's ability to ease up supply chain bottlenecks in particularly for the food chain via loosening up imports. To put in perspective only recently the government has managed to approve import of key crop items such as rice, wheat, and other, since the flood damaged major crops during the months of July and August.

At the same time, curbing food inflation through administrative measures to resolve supply-chain bottlenecks and any necessary imports remains a high priority. – Monetary Policy Statement (November, 2022)

Exhibit: National CPI Food components Heat Map

	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22	Apr-22	Mar-22	Feb-22	Jan-22	Dec-21	Nov-21	Oct-21
Food	36.3	31.7	29.5	28.8	25.9	17.3	17.0	15.3	14.7	12.8	10.3	10.5	8.3
Non-Perishable Food	30.6	28.8	28.9	28.1	24.4	15.9	15.0	13.3	12.1	13.8	14.2	13.6	12.3
Perishable Food	70.8	50.3	33.9	32.9	36.3	26.4	29.6	30.1	34.9	6.4	-10.2	-3.6	-10.8

What has changed since last month?

A look back at previous monetary policy statement there has been quite a diverging view. Foremostly October, 2022 monetary policy 'unchanged' view dwelled particularly on demand side of things, leading to suppressed inflation expectation, whereas in November, 2022 focus has been on the supply side of things leading to increase inflation expectations. Other than that, lower growth post flood 2022 and curtailed current account deficit remains relatively unchanged.

Exhibit: Changes in key economic indicators in current and previous monetary policy statements announced

	October, 2022	**November, 2022**	**Stance**
Real Sector	- FY23 growth projections 2%	- FY23 growth projections 2%	Unchanged
External Accounts	- 3% of the GDP	- 3% of the GDP	Unchanged
Inflation	- FY23 inflation above 18-20%	- FY23 inflation up to 21-23%	Changed
Inflation (long-term)	- Upper range of 5-7% medium term target by the end of FY24	- Upper range of 5-7% medium term target by the end of FY24	Unchanged

Amid the on-going economic slowdown, inflation is increasingly being driven by persistent global and domestic supply shocks that are raising costs. In turn, these shocks are spilling over into broader prices and wages, which could de-anchor inflation expectations and undermine medium-term growth. As a result, the rise in cost-push inflation cannot be overlooked and necessitates a monetary policy response.

More rate hikes likely?

Gauging from the tone of monetary policy statement, it is difficult to assess whether SBP will bend towards further rate hikes or not, striking a balance between growth and inflation will not come easy.

But as of now it seems SBP decision is more tilted towards curbing inflation. Hence in that scope, upward revision in inflation target to 20-23%, pretty much affirms that rates are unlikely to come down any time soon.

However, how much further they can rise depends on a multitude of scenarios. For a start, concerns surrounding higher readings of core-inflation was a key barometer to raise the rates. Looking at the trend, it is unlikely, that we would see core-inflation trend reversing, primarily as administrative energy price increase is still very much on cards. Whether the government will opt to increase it or not this is undecided. Secondly, on global level, how long will the international commodity prices will take to revert back to normalization is unsure at this stage and subsequently lending stability to exchange rates.

Exhibit: Pakistan C/a deficit tapering

Since july-22 C/a has averaged US$ 0.7bn for the past 4 months compared to last year monthly average C/a deficit of US$ 1.45bn.

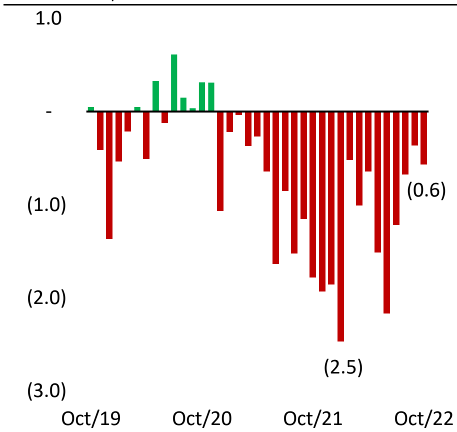
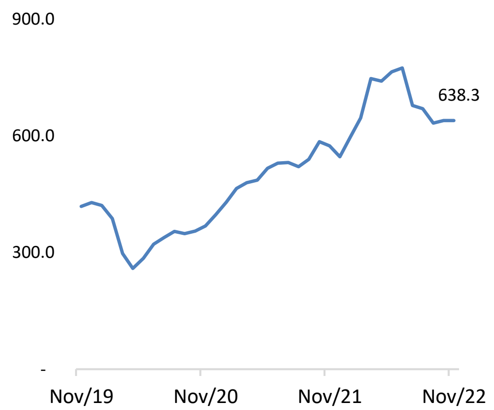


Exhibit: Global commodity prices

Global Commodity continue to trend downward as economies' across take hard landing.



Source: SBP, S&P Global, IGI Research

How will the market react?

A further 100bps increase in policy rate will be an additional burden on companies finance cost and subsequently corporate earnings (ex-banks), which are already dealing with ailing economic environment, reduced sales (demand), shrinking margins (elevated energy cost), higher taxation and now even higher finance costs. The impact on corporates will vary depending on their balance sheet, companies with higher cash & cash equivalents may likely offset increased finance costs and thus end up with net positive interest income. For others debt profile and rates vary, companies who previously availed reduced financing rates (TERF) may not see a bigger jump in financing costs. For cyclical companies, will now

Under cements, LUCK, DGKC, MLCF and FCCL all have high debt/equity and will likely be subjected to higher costs, despite LUCK sitting on pile of cash & cash Equivalents. For steel, nearly all our coverage companies (ASTL & MUGHAL) will be negatively affected. Fertiliser other than FFBL, will remain net neutral given unlevered balance sheets. For Oil & Gas sector, exploration will have a neutral impact whereas for marketing company PSO, will have a negative impact. Under power sector, rise in interest rates will have negative bearing for HUBC given its highly leveraged balance sheet. Under automobile assemblers, INDU having a ward full of cash & Cash equivalents and unlevered balance will have a positive bearing on profitability, whereas HCAR and PSMC will likely suffer. Not only this, automobile assemblers will face further reduction in demand amid higher lending rates. For banks, with higher exposure to short-term investments will see a quicker net interest margins (NIM) expansion.

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