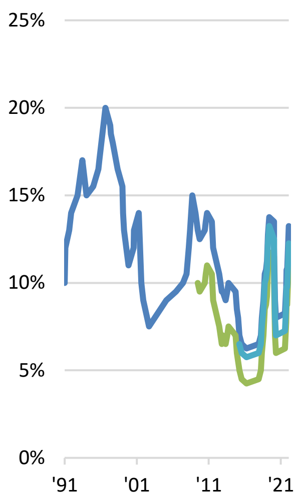
Economy

Exhibit: Pakistan Historic Central Bank Rates
With a 200bps hike Pakistan Reverse repo rate will be close to 2008 levels



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Monetary Policy Statement

Rate Hikes on Cards; Expecting a 150-200bps Rate Hike

- The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) for the next two months on Monday 23rd May, 2022. We expect policy rate rise by 150 to 200bps taking the current level of policy rate from 12.25% to 13.75% - 14.25%.
- Inflation risks to rise significantly amid roll-back of fiscal subsidies we estimate could easily push domestic headline inflation 17-18% on average for the next 3 months that as of current policy rate translates to negative real interest rate close to 5%. Meanwhile recently taken measures to address external account imbalances, in our view are insufficient.
- Market embracing rate hike with short-term rates up 200bps.
- Global macro-economic risks have further increased, with Pakistan heavily reliant on imported energy this does not look good on domestic inflation and fixing external account imbalances.

Policy rate to go up by 150-200bps; Higher than market consensus

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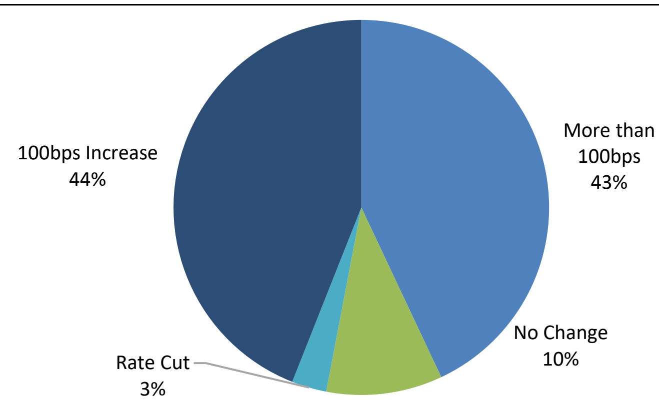
As per a market survey conducted, around 87% participants expect a rate rise of 100bps and more than 100bps in upcoming monetary policy statement. Whereas 13% expect less than 100bps and no change.

Exhibit: Market Consensus
43% market participants expect a rate rise more than 100bps whereas 44% expect a rate increase of 100bps. Whereas fewer than 13% expect a rate to remain unchanged or expect a change less than 100bps.



Source: IGI Research, CFA Pakistan Survey

Tightening Global Financial conditions amid rise in commodity prices

Last month, on 7th of Apr-22 SBP held an unscheduled meeting held, raised the policy rate by 250bps (link) citing global growing global macro-economic risks is exerting pressure on domestic inflation and external balances.

"Since the last MPC meeting, the outlook for inflation has deteriorated and risks to external stability have risen. […] global commodity prices, including oil, are likely to remain elevated for longer and the Federal Reserve is likely to increase interest rates more quickly than previously anticipated, likely leading to a sharper tightening of global financial conditions"

– Monetary policy statement 7th of April 2022

Inflation risks to rise significantly amid roll-back of fiscal subsidies

The outgoing government, in a bid to reduce inflation burden announced a PKR 300bn Prime Minister Relief package (link) that included keeping prices of domestic petroleum prices unchanged and reducing the electricity prices.

However, since then rise in global oil prices and subsequent depreciation of US$/PKR has put considerable stress on the newly formed government to remove such subsidy in order to elevate pressure on both fiscal and external side.

Now with increasing probability of government approaching for an extended bailout from IMF and other global agencies to arrest country's fast declining foreign exchange reserves – foreign reserves held by both SBP and Commercial Banks have come down from US$ 23.9bn at the start of year 2022 to US$ 16.2bn as of current 16 May-22; almost losing US$ 1.5bn per month since 2022 start, the prospects of reversal of POL and Electricity subsidy is becoming more and more likely. This reversal of subsidy along with recent 9% deprecation of PKR against US$ (since Apr-22), we estimate, could easily push domestic headline inflation to 17-18% on average for the next 3 months that as of current policy rate translates to negative real interest rate close to 4-5%.

Addressing the External account vulnerabilities

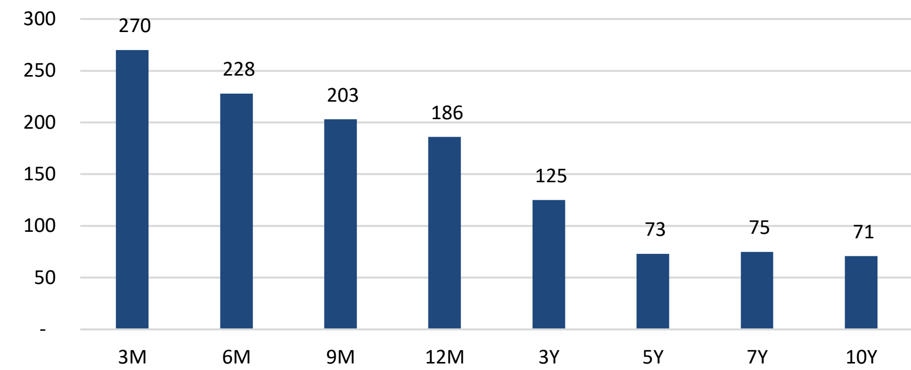
With respect to curtailing country's current account deficit that as of latest reached US$ 13.8bn in the 10m FY22 compared to US$ 0.5bn during the same period; the government has lately taken up measures to cut down imports that reached US$ 59.8bn (vs. US$ 43bn last year). These measures include posing an import ban of luxury items and other non-essential items. The aforesaid measures are likely to bring in a reduction of US$ 100-120mn on average per month in country's import bill, which in our view is insufficient (link).

Market embracing rate hike

PKRV rates have climbed up nearly 200bps on average to 15.14/15.18/14.98/14.91% for 3m/6m/9m/12m since last monetary policy announcement on 7th Apr-22. However, the long-term rates of 3yr/5yr/7yr/10yr have gone up on average 85bps; suggestive of market approach to long-term downward inflationary trend possibly owing to a) current rise in domestic prices temporary as global prices could potentially fall back as supply eases, or b) SBP contractionary monetary policy will eventually curtail domestic inflation.

Exhibit: Market Yields – Higher on Short lower on Long

Changes in PKRV rates since 8th Apr-22 to current 19th May-22 depicts market incorporating a minimum of 200bps rise in rates in short-term while



Source: IGI Research, Bloomberg

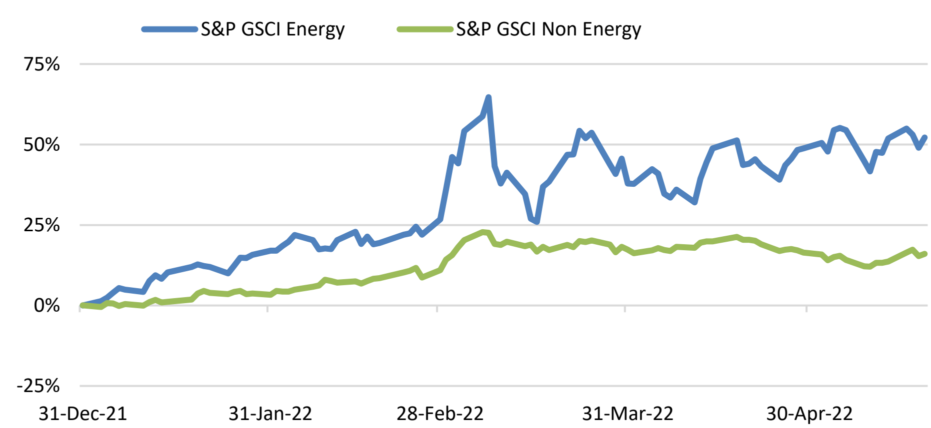
Outlook

Arguably since last monetary policy statement in 7th Apr-22 global macro-economic risks have further increased. GSCI energy index (a global proxy index of energy prices) has gone up by +12% since then and with Pakistan heavily reliant on imported energy this does not look good on domestic inflation and fixing external account imbalances.

Prior to our earlier note published on last monetary policy statement, where we held the view that rate tightening cycle for FY22 has ended, we think this time around SBP will likely go aggressive on tightening in order to curb down inflationary expectation in the coming months.

Exhibit: Energy index on the rise up; Posing significant risks to global macro-economic stability

GSCI Energy index up nearly 12% since last monetary policy announcement



Source: IGI Research, SPGlobal.com

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