Day Break

Tuesday, 22 September 2020

IGI Securities

Economy

Monetary Policy Statement

SBP Kept Policy Rate Unchanged; Future Rate Cuts Remain Contingent on Domestic Covid-19 Situation

- State Bank of Pakistan (SBP) kept the key policy rate unchanged at 7% in line with market consensus. Decision to keep policy rate at hold surrounds SBP comfort on domestic activity pick-up and inflation target of 7-9% for FY21.
- The implied uncertainty and unpredictability surrounding the oncoming Covid-19 'Second Wave' may well keep SBP to continue its preemptive footing in current scenario. Seconded by, reduced Oil prices (Brent: down by ~16% in second week of Sep-20, to USD 39/bbl) as demand lingers on Covid-19 easing cases, domestic inflation could potentially leave further room for SBP to cut rates. In fact SBP in its briefing held after the monetary policy statement referred to staying vigilant over potential deterioration in domestic Covid-19 situation and will take appropriate actions as and when needed.

SBP kept policy rate unchanged at 7.0%

In its latest monetary policy announcement, State Bank of Pakistan (SBP) kept the key policy rate unchanged at 7% in line with market consensus. Decision to keep policy rate at hold surrounds SBP comfort on domestic activity pick-up and inflation target of 7-9% for FY21.

Exhibit: September, 2020 Monetary Policy Statement

	Current	Previous	Chg. (bps)
Target Policy Rate	**7.00%**	**7.00%**	**0**
Discount rate (Ceiling Rate)	8.00%	8.00%	0
Floor Rate	6.00%	6.00%	0
Minimum Saving Deposit Rate	5.50%	5.50%	0
Interest Rate Corridor	2.00%	2.00%	0

Source: SBP, IGI Research

- **Inflation – Prices have contained so far, however risks remain plentiful:** Post uptick in headline inflation during June and July 2020, core inflation remain relatively stable owing to contained demand side risks. However, recent flooding and damages from Locust attack could potentially impact food prices in the short to medium term. Nevertheless, international oil prices have remained depressed and its outlook bodes well for Pakistan domestic prices.
- **Private sector credit – Banking sector risk aversion keeping a lid on overall growth of private credit growth:** : Credit conditions have eased up with interest rates down by 625bps and other refinancing facilities. However, risk aversion by bank amid Covid-19 pandemic has kept overall credit growth rather tepid.
- **Fiscal accounts – Government likely to miss out on fiscal its yearly revenue targets:** Despite a heavy stimulus disbursement on account of Covid-19, fiscal deficit ended lower in Fy20 compared to Fy19 and overall debt increase has been

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contained. Moreover, so far in 1q Fy21 revenue growth looks promising when compared to 4qFy20, thanks to pick-up in economic activity, up by +1.2%y/y but remain well below the pre-Covid levels. However, in an attempt to rejuvenate economy funds under Public Sector Development Projects (PSDP) has picked up pace. Overall the fiscal consolidation depends on resumption of economic activity in coming quarters.

- **External Accounts – Improvements have been two-way, lower trade deficit and higher remittances:** Thanks to a depressed domestic demand and reduced oil prices kept overall trade balance in check, leading to improved current account balance (c/a). Moreover, a strong remittances performance along with a support of exports, also played a crucial part in keeping c/a deficit under 2% of the GDP. On the outlook, gradual recovery is expected in exports along with remittances (Pakistan remittances initiative (PRI)). This combined with subdued oil prices outlook should keep overall c/a balance situation manageable under 2% of the GDP in Fy21.

- **Exchange Rate – build-up in FX reserves should ward off potential sharp movements in PKR:** This improvement in c/a balance is reflected on Pakistan FX reserves, which stand above global benchmark of 3months import cover. More so, expected private inflows under various schemes introduced recently should cater well for FX reserves build-up and thus lend its support to PKR.

- **Growth – Risks of Second Covid-19 wave could potentially derail growth estimates of 2.0% in FY21:** Large Scale manufacturing index (LSM) expanded by 5% and high-frequency demand indicators (cements, POL, Autos sales and electricity consumption) reflect encouraging pick-up in economic activity, but remain uneven across other industries. However, SBP remain hopeful of achieving 2.0% growth target which is also in line with SBP industry survey conducted (38% participants projected a growth range of 2.0-2.9% while 36% for 1.0-1.9% and less 4% project growth to fall below 0.0% in Fy21). A potential second Wave of Covid -19 domestically and rising cases as being witnessed in US and EU can potentially derail country's growth path. On contrary a faster than expected recovery in global activity could uplift current growth estimates.

Covid-19 and its unpredictability

As mentioned earlier the growth of infection in Pakistan compared to its Asian peers have remained relatively manageable. Having said that, recent rise in global Covid-19 cases particularly in Europe, US and India setting up new records on daily basis, a rising trend of cases in Pakistan has also started to reappear.

This unpredictable path of pandemic remains a key risks to our forecasts and as highlighted by SBP. Recent opening up of public schools and other public gathering places in parts of EU and US have ignited overall cases and a similar path is being followed by Pakistan authorities to reduce or recover the Covid-19 led economic loss. Learning from experiences, we do believe that this time around as well, Pakistan handling of Covid-19 will remain relatively manageable, however the same cannot be said about reviving overall domestic demand. More so, given limited room to maneuver further relaxed fiscal policy will be least preferable choice for the policy makers.

SBP could potentially lower rates if Covid-19 situation further deteriorates
Thus in our opinion new implied uncertainty and unpredictability surrounding the looming Covid-19 'Second Wave' may well keep SBP to continue its preemptive footing in current scenario. Seconded by, benign oil prices outlook (Brent: down by ~16% in second week of Sep-20, to USD 39/bbl) as demand lingers on Covid-19 easing cases, domestic inflation could potentially leave significant room for SBP to cut rates.

In fact SBP in its briefing held after the monetary policy statement referred to staying vigilant over potential deterioration in domestic Covid-19 situation and will take appropriate actions as and when needed.

Exhibit: Pakistan key consumer sales growth and CPI
Base (Jan, 2020)

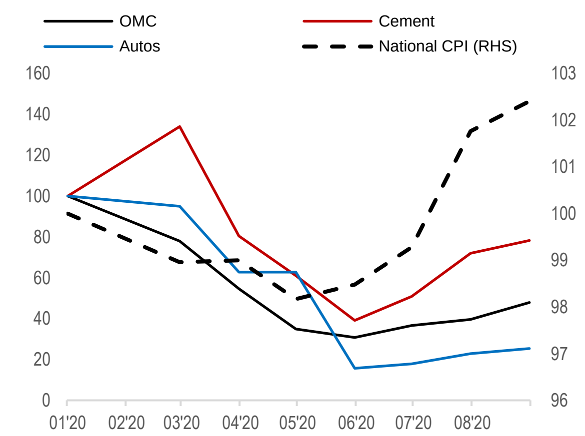


Exhibit: Pakistan GDP projection for Fy21 (SBP Survey)
74% of the responded now see Pakistan GDP to range in between 1.0%-3.0%

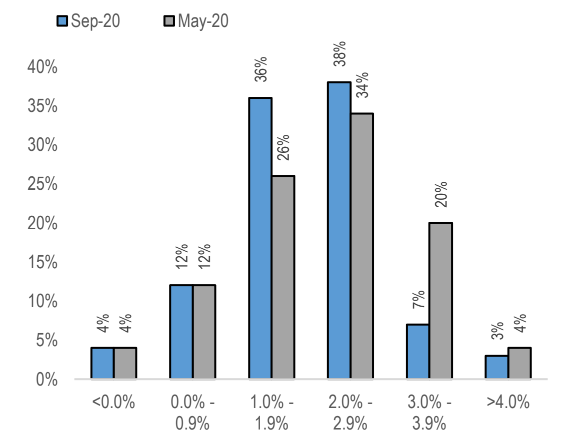


Exhibit: SBP Covid-19 support under various categories
Loans deferred occupies the major support for Covid-19. Total PKR 1.58trn has been disbursed which comes to 3.8% of the GDP

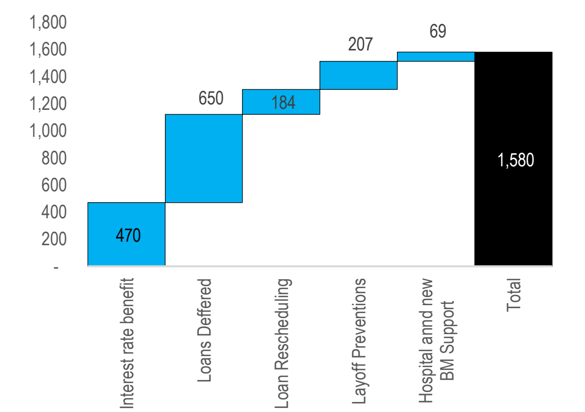
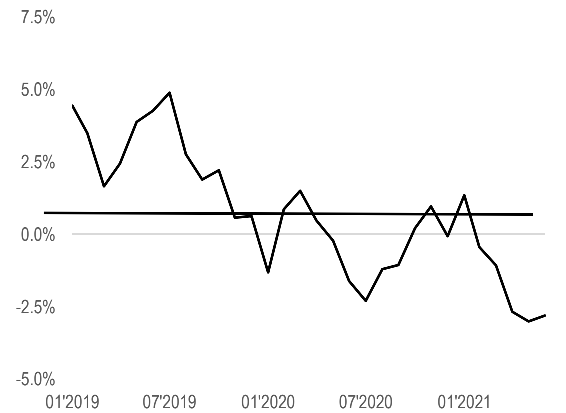


Exhibit: Pakistan 3mFwd Real rates
FY 21 National CPI estimated to average 8.0%



Source: IGI Research, Bloomberg, SBP

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