Economy

Exhibit: Monthly growth in Large-Scale Manufacturing Index

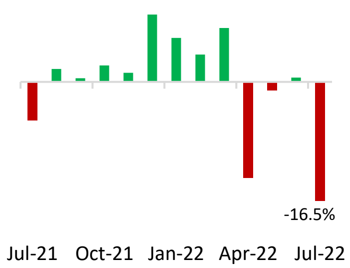
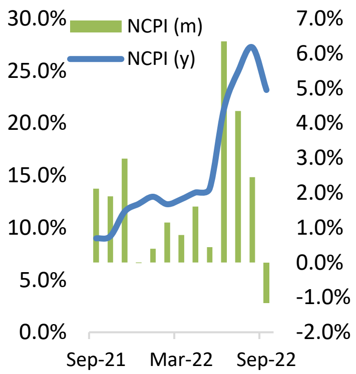


Exhibit: Monthly and yearly CPI numbers



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Monetary Policy Statement

Status Quo Expected; Inflation Risks Subsides

- We expect SBP to keep the key rate unchanged at 15% for the next 2 months. This is the second rate halt announced back in Aug-22. Our expectation is in line with market consensus of "unchanged" (80%). So far rates are up by 800bps since Sep-21.
- We base our premise on a) lower Spe-22 inflation reading, b) appreciating PKR and ease in external pressure, c) leading sales indicator suggest economy is cooling off substantially, and d) short term market yields suggestive of unchanged key rate
- Since the last monetary policy meeting, C/a balance position has materially improved, government efforts to bring down inflation has started to show-off and leading real sector data, suggests there is less room further increase in interest rates will achieve here.

The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) for the next 2 months on Monday 10th October, 2022. We present our view on the likely policy rate decision and reasons.

Expecting another Status Quo; Policy Rate to Remain Unchanged at 15%

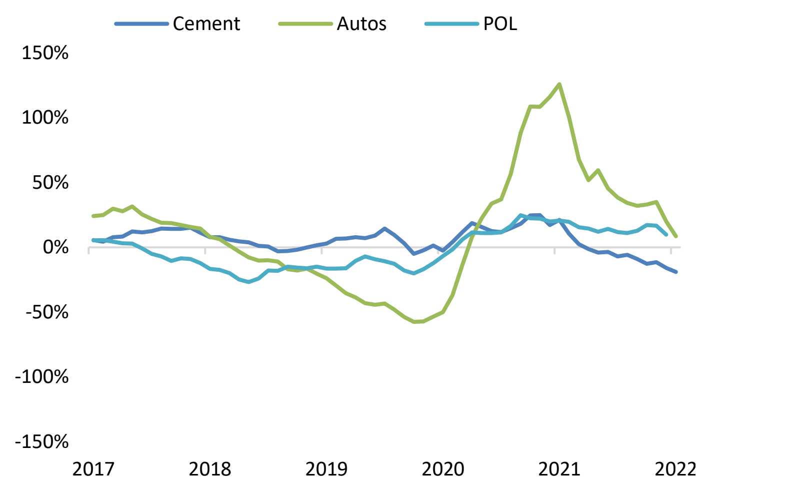
We expect SBP to keep the key rate unchanged at 15% for the next 2 months. This is the second rate halt announced back in Aug-22. Our expectation is in line with market consensus of "unchanged" (80%). So far rates are up by 800bps since Sep-21.

We base our premise on;

- **Sep-22 lower inflation reading has set the stage for keeping key rate constant and then gradually to come down:** Sep-22 headline inflation printed a surprisingly lower than market growth of +23.2%y (market consensus: +25.9%y on average) mainly due to a sharp drop of ~65%m/m under electricity head. This was due to government deferring Fuel Cost Adjustment (FCA). In addition the government has also reduced overall Petroleum Development Levy (PDL) component by 13% or PKR 5/ltr to PKR 32.5/ltr, subsequently lowering domestic POL retail prices. Hence government inflation targeted fiscal reliefs is likely to keep inflation reading low in the coming months, contrary to our early estimates (18-20% in FY23). As of recent media reports, government is looking to bring down inflation to 12-14%y in Fy23.
- **External Pressure Evades, PKR Elevates:** Current Account Deficit for the month of Aug-22 came at deficit of US$0.7bn, which was taken positively by the market as pressure on reserves significantly reduced and government takes administrative measures to reduce imports and keep exports elevated. PBS recently shared trade data for the month of Sep-22 where trade deficit has further narrowed down to US$2.9bn compared to US$ 3.6bn in previous month. Keeping everything else constant C/a deficit is likely to be contained under US$ 0.6bn for the month of Sep-22. This combined with already appreciating PKR/USD parity (PKR has appreciated by nearly ~7.5% against the US$ in the past 10 sessions) will be supportive of lower inflation reading in the coming months.

- **Demand Further Dampens since Last Monetary Policy:** Demand seems to have to an extent taken a full blow of rising inflation and monetary tightening.

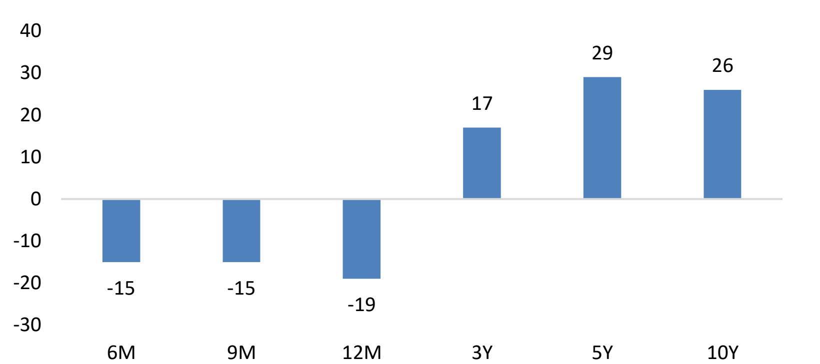
Exhibit: Leading Real sector Indicator (sales of POL, Autos, Cements)
As of recently leading data on real sector depicts sale of POL, Cements, automobile have dropped significantly.



Source: SBP, IGI Research

- **Short-term Yields Also on Downward Trend:** Since the last MPS in Aug-22, short term yields have declined by an average 15bps depicting market incorporating an unchanged stance.

Exhibit: Secondary market Yields
ST market yields coming-off



Source: SBP, IGI Research

Outlook

Since the last monetary policy meeting, C/a balance position has materially improved, government efforts to bring down inflation has started to show-off and leading real sector data, suggests there is less room further increase in interest rates will achieve here. Further demand destruction amid unanticipated floods also calls for softer approach in key rates as to ease credit and thus keeping economy liquid. Foreign aid for flood victims and infrastructural devastation will likely provide this much needed market liquidity.

Looking ahead, the MPC intends to remain data-dependent, paying close attention to month-on-month inflation, inflation expectations, developments on the fiscal and external fronts, as well as global commodity prices and interest rate decisions by major central banks.

- *-Monetary Policy Statement; Aug 2022.*

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