Economy

Monetary Policy Statement

SBP Pauses Rate Hikes as Economy Falters

- In the latest Monetary Policy Announcement (link) the State Bank of Pakistan (SBP) kept the policy rate unchanged at 15%.; in-line with our status qou expectation (link).
- From global standpoint, some economies are gearing up for disinflationary trend in 2QFY23 by slowing down the pace of rate hikes or keeping it constant for some time.
- MPC expects the economic growth to moderate at 3-4% in FY23, owing to lagged effects of recent bumper hikes, fiscal consolidation, and prolonged monsoon rains striking agricultural production that can potentially have ripple effects of related and dependent industries.

SBP decided to keep the policy rate unchanged

In the latest Monetary Policy Announcement (Link) the State Bank of Pakistan (SBP) kept the policy rate unchanged at 15%.; in-line with our status qou expectation (Link). Interest rate corridor stays at ceiling (Reverse Repo) 16% and floor (repo) rate at 14%. Cumulatively speaking, the SBP has raised the policy rate by 800 bps since September 2021 to restore equilibrium by cooling down economy and contain current account deficit.

Exhibit: Monetary Policy Rate Decision

	Current	Previous	Change (bps)
Target Policy Rate	**15.0%**	**15.0%**	**No change**
Discount Rate	16.0%	16.0%	No change
Floor Rate	14.0%	14.0%	No change

Key reasons for keeping the rate constant

- SBP decided to pause the rising rates for now as leading demand indicators show signs of weakening economy after a robust growth witnessed in FY-22 of nearly 6%.
- Inflation yet to peak as effects of planned gas and gradual increase in electricity prices will likely be reflected fully in coming months.
- Board meeting of IMF to be take place on 29th of August, and release of US$ 1.2bn tranche is expected thereafter.
- Pakistan additionally secured US$ 4bn from friendly countries over and above its external financing needs in FY23.
- Global central banks are also holding Policy Rates which indicates risk shifting from inflation toward growth.

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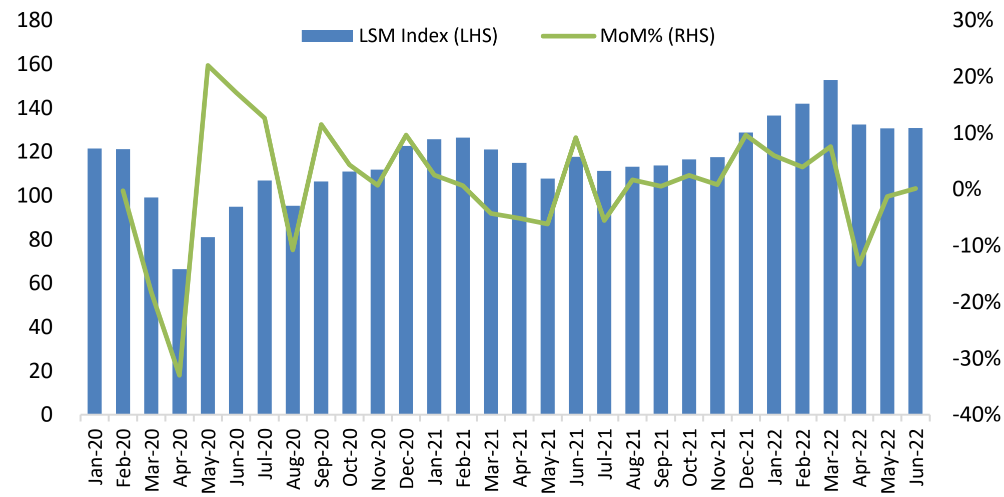
Global central banks now shifting focus from inflation to economy

From global standpoint, some economies are gearing up for disinflationary trend in 2QFY23 by slowing down the pace of rate hikes or keeping it constant for some time. To some extent interest rate helps to contain surge in inflation, beyond certain point economic activities dampen that create the stagflationary environment that central banks try to avoid.

"Major central banks have responded to high inflation by raising interest rates. But the exact amount of policy tightening required to lower inflation without inducing a recession is difficult to ascertain"- IMF WEO, July-22 (link).

Exhibit: LSM index stalls in June-22, leading indicators show major decline in July



To recall, LSM index, which is a quantum index of large scale manufacturing industries, gained momentum after the reopening of industries since the Covid-19 crisis in April-20; however, manufacturing steam ran out in April-22 when political crisis struck the economy, sudden hiked of 225bps by MPC and super commodity cycle elevated the CAD due to geopolitical turmoil.

For the month of July-22, we consider the significant drop witnessed in sales number of Automobile (down by 48% since Apr-22), Cement (down by 44% since Apr-22) and POL (down by 35% since Apr-22). This significant blow to sales numbers is in part due to sharp rise in product prices, a factor of elevated global commodity prices, administrative energy price increases, local currency depreciation, and due to previous monetary tightening.

SBP sees inflation peaking in Sep-22

Inflation surged to +24.9%y in July-22, with more energy price hikes planned especially gas and electricity, which will likely reflect in coming months. Food inflation has also been key driver behind surging inflation, and has gained by further 6% since last month. Furthermore, SBP stresses to contain food inflation through additional output related measures to reduce the impact on overall inflation.

"In coming months, curbing food inflation through supply-side measures that boost output and resolve supply-chain bottlenecks should be a high priority."

Some respite from friendly countries have cushioned external vulnerabilities

Pakistan has successfully managed to secure additional funding of USD 4bn from friendly nations. In addition, SBP expects release of USD 1.18bn tranche from the IMF in upcoming months. Moreover, the IMF board may also consider extending the EFF program in upcoming meeting on 29th of August and making additional USD 2.8bn funds available for FY23 financial needs. Possible support of USD $2bn from Qatar may further cushion external financing requirements. As a result, FX reserves to be further build up through the course of the year and help meet financing needs in FY23. Based on these positive developments, PKR has appreciated by 10% against USD from its peak of 239 witnessed during first week Aug-22.

Outlook

MPC expects the economic growth to moderate at 3-4% in FY23, owing to lagged effects of recent bumper hikes, fiscal consolidation, and prolonged monsoon rains striking agricultural production that can potentially have ripple effects on related and dependent industries. Moreover, SBP projects headline inflation to peak in the first quarter before declining gradually through the rest of the FY23 and falling in the SBP target range of 5-7% by end of FY24.

"To cool the overheating economy and contain the current account deficit, the policy rate has been raised by a cumulative 800 basis points since last September, some temporary administrative steps have recently been taken to curtail imports, and strong fiscal consolidation is planned for FY23. These actions are expected to work their way through the system over the coming months."- MPS, August 22 (link).

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