Economy

Monetary Policy Statement

SBP Raises Policy Rate to 13.75%; Fiscal Consolidation and IMF EFF Resumption Critical for Policy Effectiveness

- The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement on Monday May 23rd, 2022 further raised policy rate by 150 bps to 13.75%. This is in line with our expectations albeit on the lower side of 150-200 bps hike expectation. Interest corridor now comes at ceiling (Reverse Repo) 14.75% and floor (repo) rate of 12.75%.
- On external side, major issue is coming from depleting reserves that currently stands less than $10 bn in SBP, and $6 bn with the banks. With constant current account deficit averaging US$ 1.3bn per month since start of FY22, upcoming debt repayments of almost US$5 bn in Jun-22, and limited external borrowing amid hovering uncertainty of IMF program, overall external balance situation seems rather precarious at the moment.
- Arguably since last monetary policy statement in 7th Apr-22 global macro-economic and domestic risks have further increased. Moreover, fiscal consolidation at current economic juncture will to an extent ease up Pakistan hard landing, we see less chance of fiscal sense forming up given the non-populistic political outcomes. Hence all eyes on IMF.

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Exhibit: Monetary Policy rate decision	Current	Previous	Chg. (bps)
Target Policy Rate	**13.75%**	**12.25%**	**150**
Discount rate (Ceiling Rate)	14.75%	13.25%	150
Floor Rate	12.75%	11.25%	150

Infrastructure, Housing & SME Financing Rates also raised by 200bps

Along with the policy rate decision the interest rates on Export Finance Scheme (EFS)/Islamic Export Refinance Scheme (IERS) and Long Term Financing Facility (LTFF)/Islamic Long Term Financing Facility (ILTFF) loans (link) are also being raised and are being linked to the policy rate and will be adjusted respectively, but will continue to remain below the policy rate.

Exhibit: Infrastructure, Housing & SME Financing Rates	Current	Previous	Chg. (bps)
Export Finance Scheme (EFS)	7.50%	5.50%	200
Long Term Financing Facility (LTFF)	7.00%	5.00%	200

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Key reasons for the rate hike decision:

As per the statement key the decision to raise the interest rate incorporates;

- Fiscal consolidation along with recent monetary tightening will moderate demand and eventually anchor down inflation expectations
- Economic rebound has been much stronger than initially anticipated, growing by 5.7% last year and accelerating to 5.97% this year, as per provisional estimates
- Global central banks are also raising the central bank rates to counter rising inflation
- Vulnerability in external position

SBP in moderate contractionary mode; blames weak fiscal side of affairs

SBP in its MPS clearly stated fiscal consolidation is much needed to have full monetary effect on curbing domestic inflation. CPI clocked in at 13.4%y in the month of Apr-22, and is now projected to average +14%y for the next 3 months assuming continuation of POL & electricity subsidy, excluding which we project inflation could easily jump to 16-17%y taking in recent PKR depreciation.

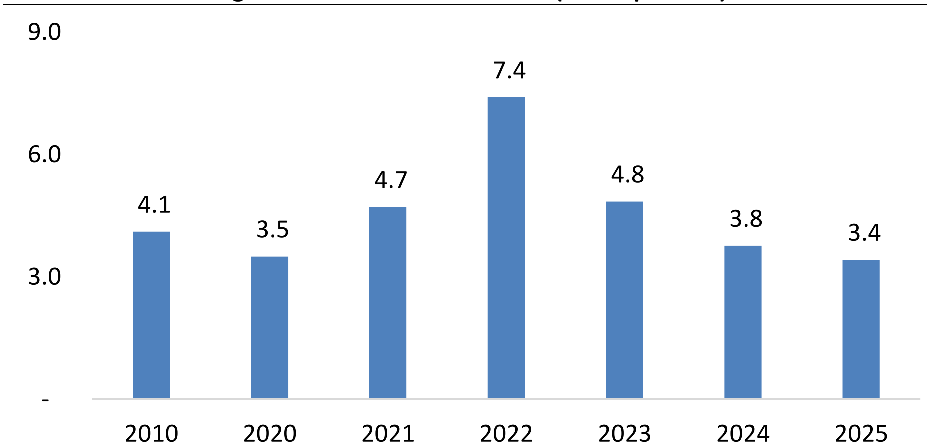
Hence, this expansionary fiscal stance is contradicting with monetary stance and will distort the monetary mechanism in controlling inflation, which needs to adjust that rather quickly.

Globally too inflation pain is been felt elsewhere, with major economies having decade high inflation level and contractionary fiscal policies scaling back subsidies that were previously adopted to counter demand deficiencies during Covid-19 pandemic.

Hawkish stance by central banks around the globe to curb rising inflation;

Along with the contractionary fiscal policies global overheating phenomenon that pumped the prices of commodities exacerbated by spillover effects of Russia-Ukraine tensions and lockdowns effect in China have led central banks taking a hawkish stance.

Exhibit: Global average annual CPI Inflation trend (IMF- apr-2022)



Source: IMF, IGI Research

In particularly, the pain of this global central bank tightening is being felt on PKR. Departing from domestic uncertainty, strengthening of US$ against all major currencies amid anticipated rise in the Federal Reserve rates is further complicating the Pakistan inflation problems.

Addressing the External account vulnerabilities

On external side, major issue is coming from depleting reserves that currently stands less than $10 bn in SBP, and $6 bn with the banks. With constant current account deficit averaging US$ 1.3bn per month since start of FY22, upcoming debt repayments of almost US$5 bn in Jun-22, and limited external borrowing amid hovering uncertainty of IMF program, overall external balance situation seems rather precarious at the moment. However, SBP remain relatively comfortable on current account balance position, projecting under 3% of gdp deficit in FY23. Moreover, SBP eyes nearly US$ 51.4bn worth of inflows versus US$ 44.9bn worth of outflows starting 4qFy22 till FY23, easing Pakistan external financing requirement pressure on FX reserves.

Outlook

Arguably since last monetary policy statement in 7th Apr-22 global macro-economic and domestic risks have further increased. Moreover, fiscal consolidation at current economic juncture will to an extent ease up Pakistan hard landing, we see less chance of fiscal sense forming up given the non-populistic political outcomes. Hence all eyes on IMF. A successful negotiation with the IMF in our view is only possible either via further rate tightening or contractionary fiscal policies, the outcome of either is growth dampening.

Equity market impact: Nothing short of expectation

150bps rate rise shouldn't come as a surprise for equity market and to extent has already been incorporated, given the market PE adjusting to a low of 4.7x as of late. Sector-wise, positive earnings impact remain for banking sector, followed by E&Ps. Where high debt companies along with textile companies will suffer the burnt.

Exhibit: Sector wise positive and negative earnings implication of rise in interest rates

Sector	Positive	Neutral	Negative
Autos	HCAR, INDU, PSMC	-- Nil --	-- Nil --
E&PS	OGDC, PPL, POL, MARI	-- Nil --	-- Nil --
Banks	HBL, UBL, ABL, MCB, AKBL, BAHL, BAFL, FABL, NBP	-- Nil --	-- Nil --
Cements	FCCL	-- Nil --	LUCK, MLCF, ACPL, CHCC, PIOC, DGKC, KOHC
Fertiliser	FFC	-- Nil --	EFERT, FFBL
Power	-- Nil --	-- Nil --	HUBC, NCPL
Engineering	-- Nil --	-- Nil --	ASTL, MUGHAL
OMC	-- Nil --	-- Nil --	PSO, APL
Chemical	-- Nil --	-- Nil --	EPCL, ICI
Glass & Ceramics	-- Nil --	-- Nil --	TGL

Source: IGI Research

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