

Economy

SBP Likely to Raise Policy Rate by +100bps; as Core-Inflation gather pace

- We expect policy rate to increase by +100bps to 17%. We base our view; persistent inflation outlook, and market participants surveys and secondary market yields, and c) on the likely policy rate decision and reasons.
- Stepping in Dec-22, headline inflation rose modestly by +0.5% (+0.8% in Nov-22) to reach +24.5%y, driven by higher food prices. However, more importantly, core inflation (NFNE) increased even more
- Taking the recent surveys, nearly 90% of the participants expect SBP to increase rate. With respect to increase 63% expect rate to increase by +100bps.

The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) on Monday 23rd January, 2022 for the next two months.

SBP to increase policy rate by 100bps...

We expect policy rate to increase by +100bps to 17%. We base our view; persistent inflation outlook, market participants' surveys and secondary market yields dictating the similar.

...as core inflation gathers pace

In its latest monetary policy statement issued in November 2022, the State Bank of Pakistan (SBP) increased its inflation estimates for FY23 from 18-20% to 21-23%. This was due to the Oct-22 month-on-month inflation growth of +4.7% and a corresponding increase in core non-food, non-energy (NFNE) inflation to +16.2% year-on-year.

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Stepping in Dec-22, headline inflation rose modestly by +0.5% (+0.8% in Nov-22) to reach +24.5%y, driven by higher food prices. However, more importantly, core inflation (NFNE) increased even more, rising by +1.2% in urban areas and +1.5% in rural areas, compared to the previous month. This indicates strong underlying price pressures for goods and services, excluding food and energy.

This trend is also reflected in the SBP's survey of inflation expectations for the next six months, which indicates that nearly all categories of manufacturing, services, and wholesale and retail expect prices to remain high, resulting in a downward stickiness of core inflation.

For Jan-22 our inflation estimates hover close to 24.9%y (+0.7%m) as food prices continue to soar. We also expect core inflation to maintain its current trend or even increase sharply. In the medium-term, there is a possibility of an increase in energy prices (gas tariffs) and the government's decision to maintain domestic prices for petroleum products, which could result in a sharp increase in core-inflation in the upcoming months, inevitably making headline inflation persistent.

Exhibit: National Core-inflation measures													
	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22	Apr-22	Mar-22	Feb-22	Jan-22	Dec-21
CPI	24.5	23.8	26.6	23.2	27.3	24.9	21.3	13.8	13.4	12.7	12.2	13.0	12.3
SPI	29.7	29.7	28.6	35.9	40.6	34.3	26.5	16.1	16.5	15.8	18.1	19.5	19.3
WPI	27.1	27.7	32.6	38.9	41.2	38.5	38.9	29.6	28.1	23.8	23.6	24.0	26.2
NFNE	16.4	16.2	16.2	15.7	14.9	13.0	12.3	10.4	9.8	9.5	8.4	8.5	8.5
Trimmed	22.2	22.0	23.9	21.5	22.4	20.1	17.7	12.1	11.4	11.0	10.4	10.7	10.6

Market participants' moot similar

Taking the recent surveys, nearly 90% of the participants expect SBP to increase rate. With respect to increase 63% expect rate to increase by +100bps. A similar trend has been seen in secondary market yields whereby short-term and long-term yields have increased over 100bps since the last monetary policy announcement.

Exhibit: Market Survey of Monetary Policy decision

~90% of the participants' surveyed, CFA Society of Pakistan expect rate to increase (Source: CFA Society Pakistan)

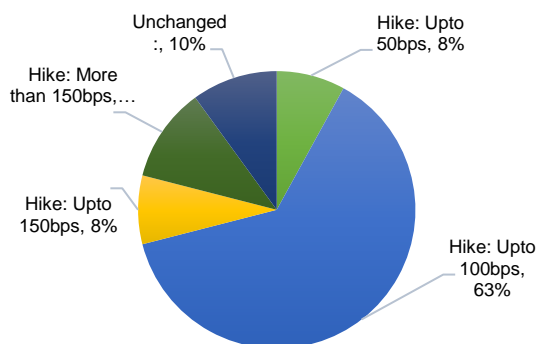
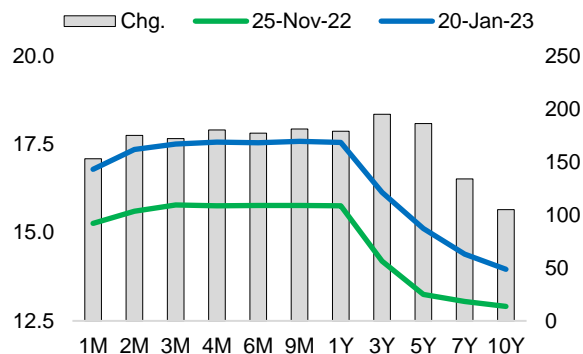


Exhibit: Secondary market Yields

Secondary market yields have gone up by nearly 100bps across all tenors since last monetary policy announced (Source: FMA Pakistan)



Outlook

With core-inflation expected to stay downward sticky in the near-to-medium term we expect SBP to deliver another 50-100bps increase in policy rate before FY23 end. The reasons for core-inflation to stay elevated is we foresee post-IMF, probable PKR adjustments will keep domestic prices on the high, despite country's current account balance improving (US\$ 3.7bn deficit in 1HFY23 compared to US\$ 9.1bn deficit last year same period). Similarly tax adjustments on domestic POL products and increase in gas tariff or energy prices have the potential to uplift core-inflation.

Exhibit: SBP Foreign Exchange (FX) reserves and Import coverage

SBP FX reserves declined to a multi-year low US\$ 4.6bn, leaving close to a month of import cover. (Source: SBP, IGI Research)

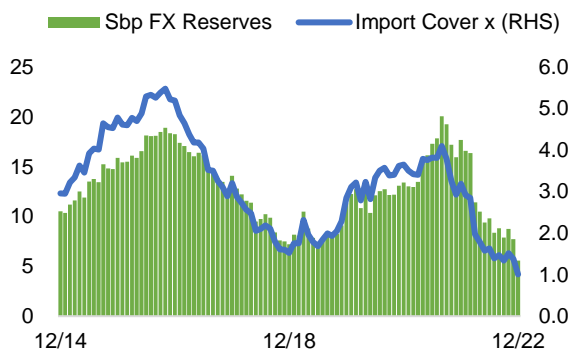


Exhibit: Headline and Core Inflation (6 month moving averages)

Since Sep-20, nearly all inflation indices have gone up significantly. (Source: PBS, IGI Research)

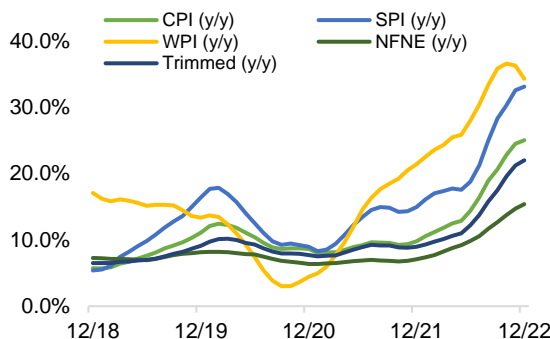


Exhibit: Pakistan CPI Historical

(BASE=2015-16) Headline Inflation Pakistan hit close to an all-time high in Oct-22 (27%/y/y). (Source: PBS, IGI Research)

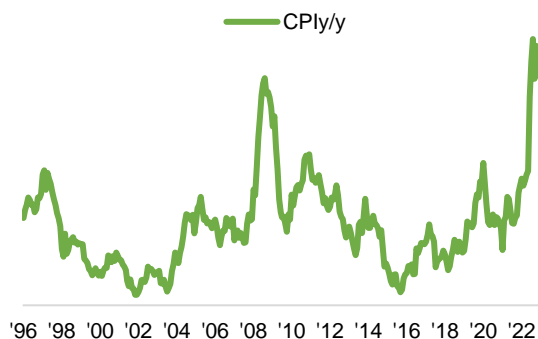
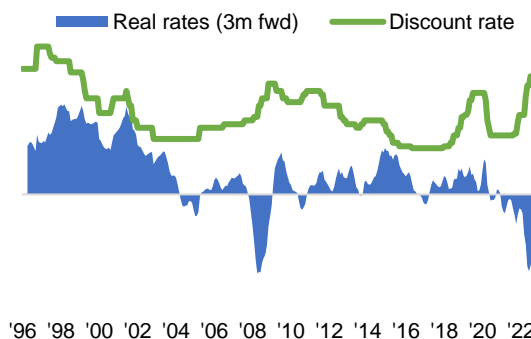


Exhibit: Policy rate

Policy rates are at all-time high level, but despite this, higher inflation is keeping real-rates in negative territory. (Source: PBS, SBP, IGI Research)



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