

**PAKISTAN**



# Pakistan Economy

## Upcoming MPS: Focus on growth to keep policy rate unchanged

### Interest rate status quo

The Central Bank has kept the policy rate unchanged for the last 13 months to support growth in the wake of COVID-induced lockdown. We expect the central bank to keep the interest rate unchanged at 7% at the MPS scheduled on 27 July 2021. Our stance is based on (1) SBP's forward guidance from last MPS wherein it stated that "In the absence of unforeseen developments, the MPS expects monetary policy to remain accommodative in the near term, and any adjustments in the policy rate to be measured and gradual to achieve mildly positive real interest rates over time", (2) voting pattern at last MPS where 8 out of 9 members voted to keep the policy rate unchanged and only 1 voted to increase by 100bps, and (3) manageable current account deficit. We expect status quo despite (1) mildly negative projected real interest rates and (2) positive surprise in GDP growth rate for FY21.

### Central bank guidance points to waiting for recovery to become more sustainable

SBP has been providing forward guidance on monetary policy in MPS since January 2021 and at the last MPS nearly 2 months ago it stated that the MPS expects monetary policy to remain accommodative in the near term, and any adjustments in the policy rate to be measured and gradual to achieve mildly positive real interest rates over time. If demand side pressures emerge as the recovery becomes more durable and the economy returns to full capacity, the MPS noted that it would be prudent for monetary policy to begin to normalize through a gradual reduction in the degree of accommodation.

### Inflationary pressures to persist

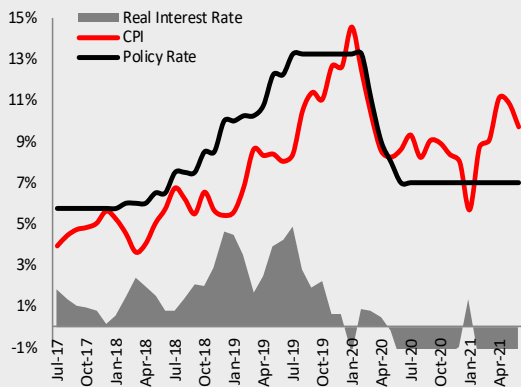
We foresee average inflation of 8.1% in FY22 given higher forecasted YoY International oil prices in our base case of no increase in electricity tariff. In case electricity tariff is increased as per IMF requirements, it would take up average inflation to ~9.3% YoY in FY22.

### GDP growth to accelerate in FY22 building pressure on CAD

Pakistan's GDP growth of 3.9% in FY21 is stellar given the COVID restrained environment. Services sector remained the major growth driver with growth of 4.4% where wholesale and retail trade/transport/finance and insurance/housing/general government/other private services changed by 8.4/-0.6/7.8/4.0/2.2/4.6%. Industrial sector witnessed growth of 3.6% driven by large scale manufacturing (LSM) posting an unprecedented healthy growth of 9.3%. Construction activity increased by 8.3% mainly due to government incentives to construction sector. Agriculture sector grew by 2.8% in FY21 as against 3.3% in FY20. Outlook for growth remains positive given that broad based growth evidenced in FY21 is likely to accelerate.

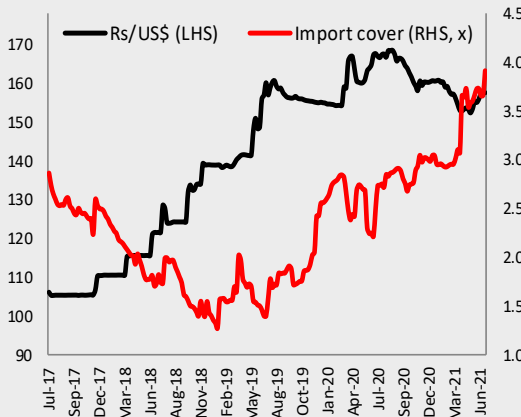
CAD was US\$1.6bn in Jun'21 which included some year-end one-offs. Normalizing for these one-offs would give a figure of ~US\$1.0bn and if CAD remains at this level during Q1FY22 given higher int'l commodity prices and robust domestic demand, we believe the SBP would reconsider its stance at the MPC meeting in Sept'21. For the time being, we believe SBP would use exchange rate to rein in imports and we don't foresee immediate pressure on financial account given ample FX reserves.

**CPI vs policy rate**



Source: SBP, Foundation Research, July 2021

**Rupee against greenback**



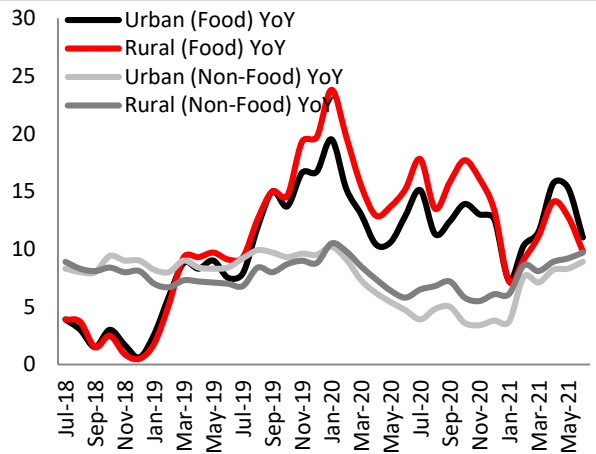
Source: SBP, Foundation Research, July 2021

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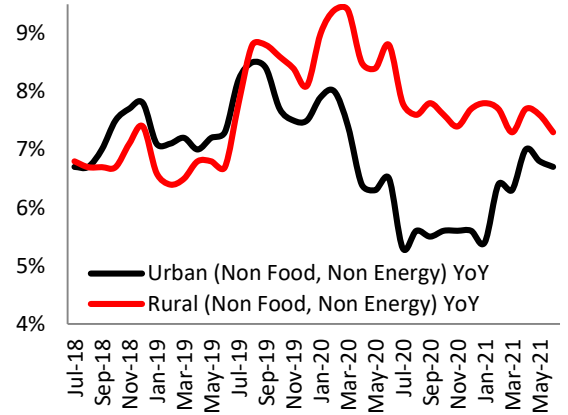
Foundation Securities (Pvt) Ltd  
Friday, July 23, 2021

**Fig 1: Core inflation on upward trajectory...**



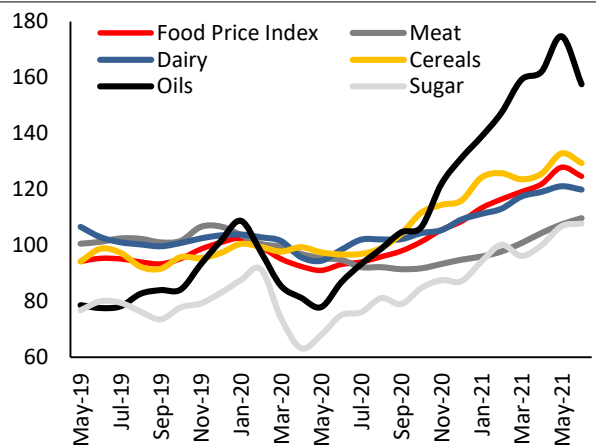
Source: PBS, FSL Research, July 2021

**Fig 2: Urban core inflation nearing rural core inflation**



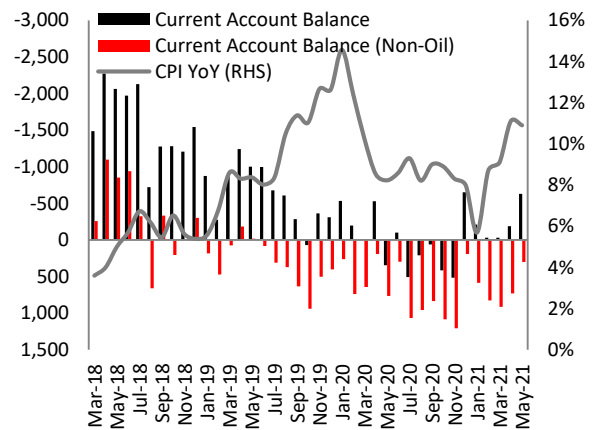
Source: PBS, FSL Research, July 2021

**Fig 3: Int'l food prices dipped in Jun'21...**



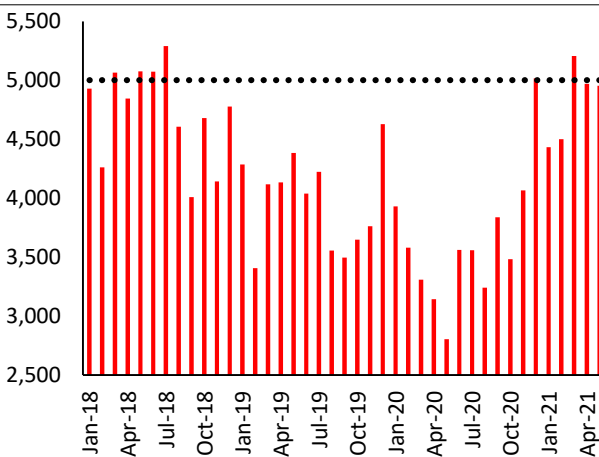
Source: FAO, SBP, FSL Research, July 2021

**Fig 4: Current account and CPI...**



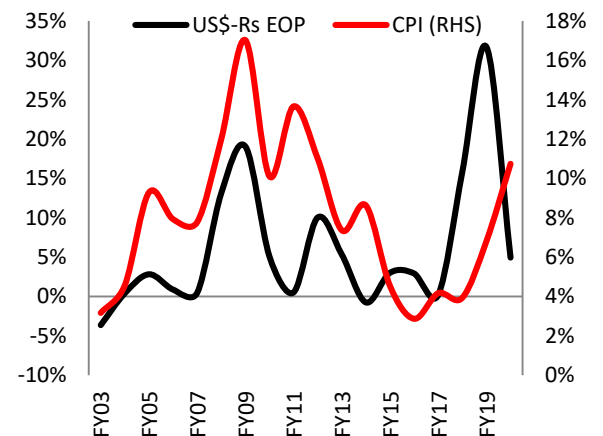
Source: SBP, PBS, FSL Research, July 2021

**Fig 5: Goods import rise to FY18 levels (US\$ bn)**



Source: SBP, FSL Research, July 2021

**Fig 6: Exchange rate and inflation move in tandem**



Source: Bloomberg, SBP, FSL Research, July 2021

**Abbreviations**

CAD	Current Account Deficit
FX	Foreign Exchange
MoM	Month on Month
MPS	Monetary Policy Statement
PR	Policy Rate
RIR	Real Interest Rate
SBP	State Bank of Pakistan
YoY	Year on Year

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If	
Expected return >+10%	Outperform.
Expected return from -10% to +10%	Neutral.
Expected return <-10%	Underperform.