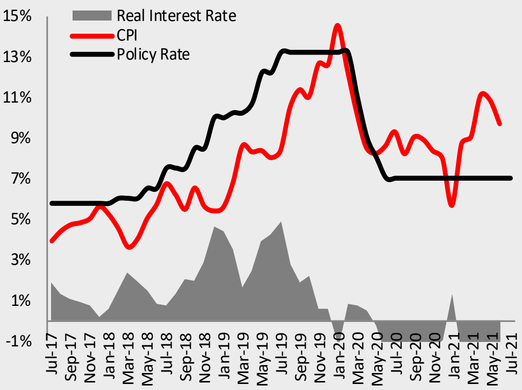
Foundation Securities
A Fauji Foundation Group Company
REP-095

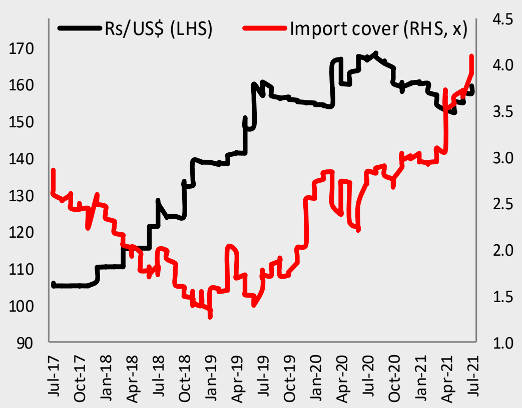
PAKISTAN

CPI vs policy rate



Source: SBP, Foundation Research, July 2021

Rupee against greenback



Source: SBP, Foundation Research, July 2021

Analyst

Zeeshan Azhar zeeshan@fs.com.pk
+92 213 5612290 Ext 331

Foundation Securities (Pvt) Ltd
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Pakistan Economy

MPS: Policy rate left unchanged

Policy rate kept at 7%

The State Bank of Pakistan (SBP) today announced its monetary policy stance for the next 2 months in which it decided to keep the policy rate unchanged at 7%. The MPS noted that since the last MPS 2 months ago, the MPC was encouraged by the continued domestic recovery and improved inflation outlook following the recent decline in food prices and core inflation. In addition, consumer and business confidence have risen to multi-year highs and inflation expectations have fallen. As a result of these positive developments, growth is projected to rise from 3.9% in FY21 to 4-5% this year, and average inflation to moderate to 7-9% this year.

The MPC noted that the market-based flexible exchange rate system, resilience in remittances, an improving outlook for exports, and appropriate macroeconomic policy settings should help contain the current account deficit in a sustainable range of 2-3% of GDP in FY22. Against this backdrop, the MPC felt that the uncertainty created by the on-going fourth Covid wave in Pakistan and the global spread of new variants warrants a continued emphasis on supporting the recovery through accommodative monetary policy.

Monetary policy to remain accommodative in near term

MPS also provided forward guidance on monetary policy. In the absence of unforeseen circumstances, 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 signs emerge of demand-led pressures on inflation or of vulnerabilities in the current account, the MPC noted that it would be prudent for monetary policy to begin to normalize through a gradual reduction in the degree of accommodation.

Growth to accelerate supported by Gov't policies

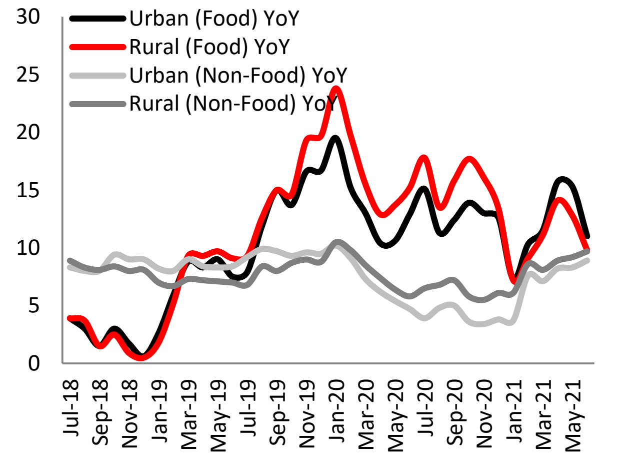
In FY22, growth is expected to pick up further, supported by measures announced in the budget, accommodative monetary conditions, and disbursements under the SBP's TERF facility for investment and other refinance facilities. Key budgetary measures include increased development spending and reduced regulatory duties, custom duties, FED and sales tax on the import of raw materials and capital goods. These measures will directly benefit construction and allied industries, as well as export-oriented industries.

External accounts and inflation to remain stable

The MPS noted that there were good reasons to expect that, unlike several previous growth upturns in Pakistan, the current economic recovery would be accompanied by external stability. Given expected resilience in remittances and an improving outlook for exports, the current account deficit is expected to converge toward a sustainable range of 2-3% of GDP in FY22. This is much lower than in FY17 and FY18, when CAD increased to around 4% and 6% of GDP, respectively, and FX reserves fell by US$2bn and US$6.4bn, respectively. Moreover, imports this year are expected to be more skewed toward machinery rather than consumption compared to FY17, and machinery imports are projected to be better distributed across sectors than in FY18, when power and telecommunications dominated.

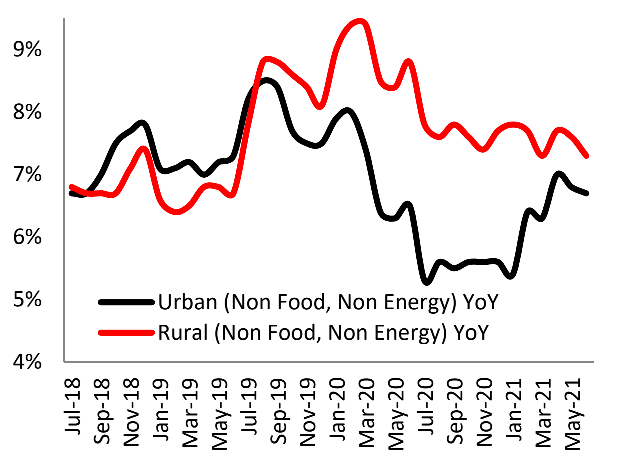
FSL sees avg inflation of 8.1% in FY22 in our base case of no increase in electricity tariff and interest rate of 8/9% at end of CY21/FY22.

Fig 1: Core inflation on upward trajectory…



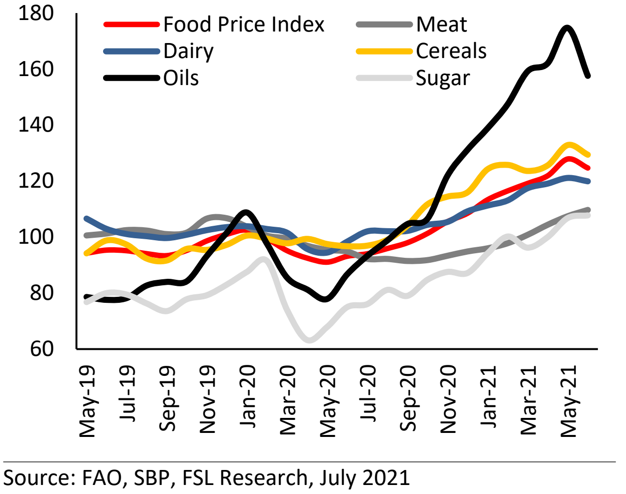
Source: PBS, FSL Research, July 2021

Fig 2: Urban core inflation nearing rural core inflation



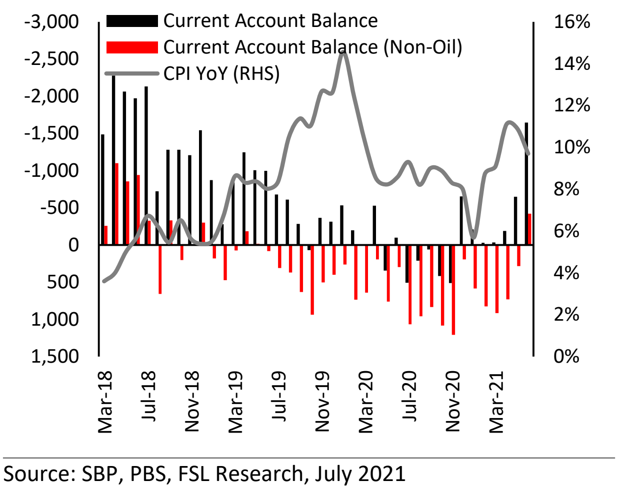
Source: PBS, FSL Research, July 2021

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



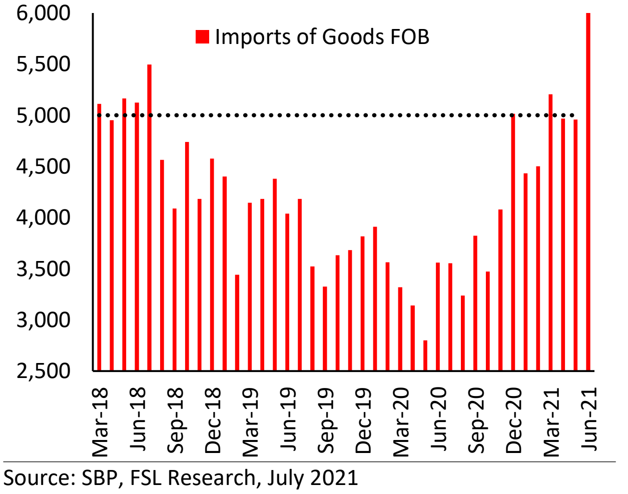
Source: FAO, SBP, FSL Research, July 2021

Fig 4: Current account and CPI…



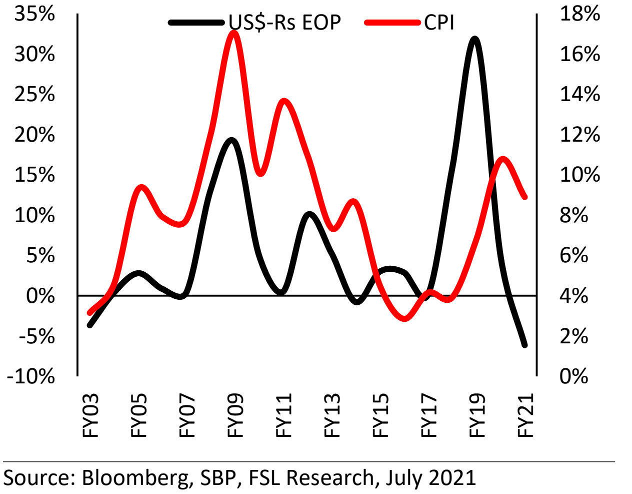
Source: SBP, PBS, FSL Research, July 2021

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
MPC	Monetary Policy Committee
MPS	Monetary Policy Statement
PR	Policy Rate
RIR	Real Interest Rate
SBP	State Bank of Pakistan
YoY	Year on Year

Important disclosures:

Recommendations definitions

If

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