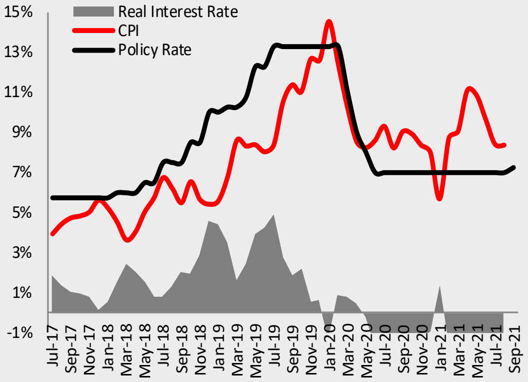
Foundation Securities
A Fauji Foundation Group Company
REP-095

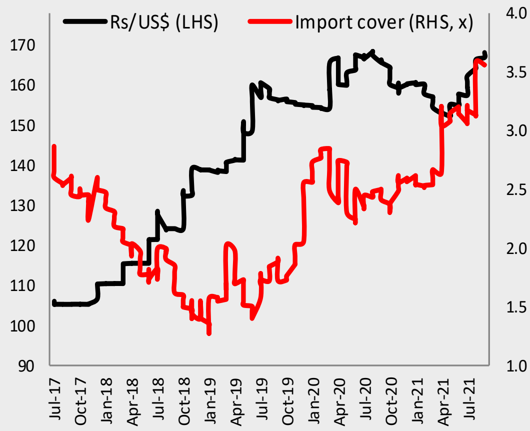
PAKISTAN

CPI vs policy rate



Source: SBP, Foundation Research, Sept 2021

Rupee against greenback



Source: SBP, Foundation Research, Sept 2021

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Foundation Securities (Pvt) Ltd
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Pakistan Economy

MPS: Monetary tightening begins!

Policy rate increased by 25bps to 7.25 %

The State Bank of Pakistan (SBP) today announced its monetary policy stance for the next 2 months in which it decided to increase the policy rate by 25bps to 7.25%. The MPS noted that since the last interest rate decision 2 months ago, the pace of the economic recovery has exceeded expectations. This robust recovery in domestic demand, coupled with higher international commodity prices, is leading to a strong pick-up in imports and a rise in the current account deficit. While inflation has declined since June, rising demand pressures together with higher imported inflation could begin to manifest in inflation readings later in the fiscal year. With growing signs that the latest Covid wave in Pakistan remains contained, the economic recovery now appears less vulnerable to pandemic-related uncertainty. As a result, at this more mature stage of the recovery, a greater emphasis is needed on ensuring the appropriate policy mix to protect the longevity of growth, keep inflation expectations anchored, and slow the growth in the current account deficit.

Monetary policy to remain accommodative in near term with further gradual tapering of stimulus

In line with this shift in the economic outlook, the MPS noted that the priority of monetary policy also needed to gradually pivot from catalyzing the recovery after the Covid shock towards sustaining it by gradually tapering the significant monetary stimulus provided over the last 18 months. The MPS noted that the stance of monetary policy is still appropriately supportive of growth, with real interest rates remaining negative on a forward-looking basis. Looking ahead, in the absence of unforeseen circumstances, the MPS expects monetary policy to remain accommodative in the near term, with possible further gradual tapering of stimulus to achieve mildly positive real interest rates over time.

External account concerns played key role in rate rise

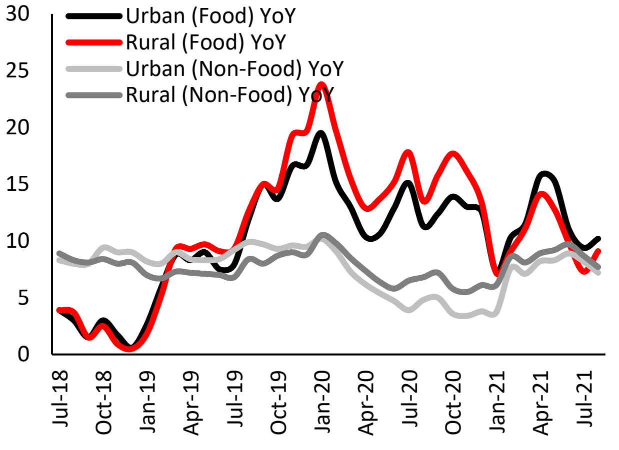
The current account deficit rose to US$0.8bn in July and US$1.5bn in August, reflecting both vigorous domestic demand and high global commodity prices. In response, the rupee depreciated by 4.1% since the last MPS. The MPS noted that the flexible market-based exchange rate regime has performed well since its introduction in June 2019, including through the Covid shock. Under this regime, the SBP does not suppress an underlying trend in the exchange rate and any interventions are limited to address disorderly market conditions. Since its floatation, the Rs-US$ rate has moved in an orderly manner in both directions and has depreciated by only 4.8% to date, much less than many other emerging market currencies over the same period.

Inflation outlook also mattered

MPS noted that macro prudential tightening of consumer finance may also be appropriate to moderate demand growth as part of the move toward gradually normalizing monetary conditions. Interestingly, Federal PSDP releases in 2MFY22 were 44% of FY22 budgeted amount! Inflation fell from 9.7% YoY in June to 8.4% in July/August but prices remain relatively elevated, with MoM increases of 1.3/0.6% in July/August. In addition, inflation expectations of both households and businesses have drifted up and wage growth has picked up as the recovery has strengthened.

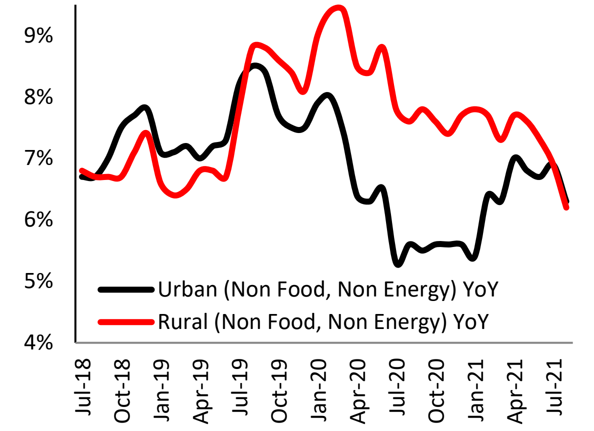
FSL sees avg inflation of 8.1% in FY22 in our base case of no increase in electricity tariff and interest rate of 7.5/9% at end of CY21/FY22.

Fig 1: Food and non-food inflation converging…



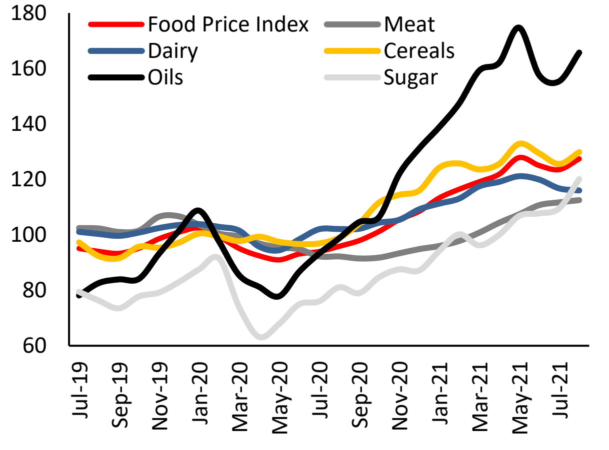
Source: PBS, FSL Research, Sept 2021

Fig 2: Core inflation trending sharply lower…



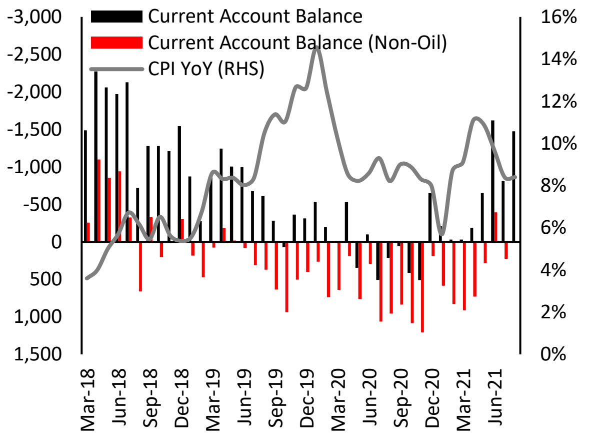
Source: PBS, FSL Research, Sept 2021

Fig 3: Int'l food prices marching upwards…



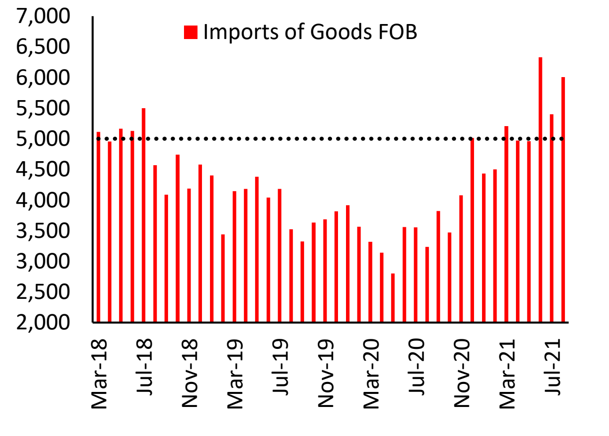
Source: FAO, FSL Research, Sept 2021

Fig 4: Current account and CPI…



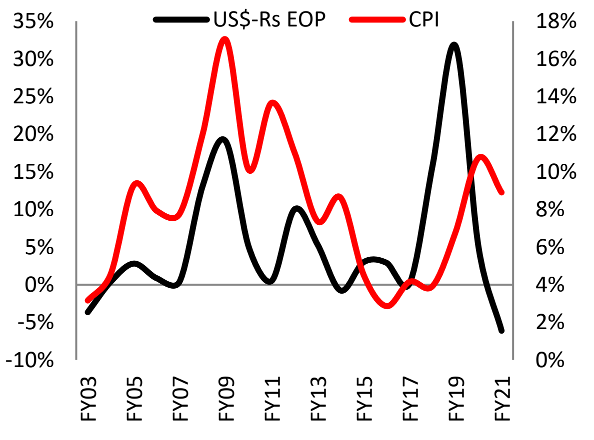
Source: SBP, PBS, FSL Research, Sept 2021

Fig 5: Goods import rise above FY18 levels (US$ bn)



Source: SBP, FSL Research, Sept 2021

Fig 6: Exchange rate and inflation move in tandem



Source: Bloomberg, SBP, FSL Research, Sept 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

Recommendations definitions

If

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