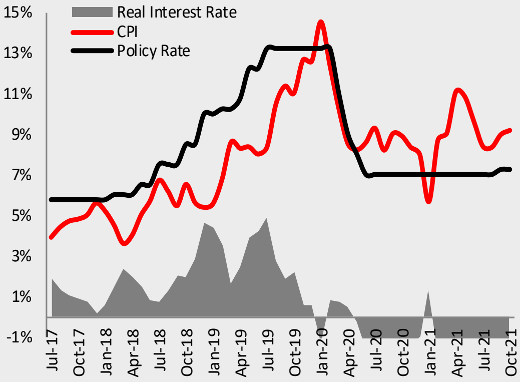
Foundation Securities
A Fauji Foundation Group Company
REP-095

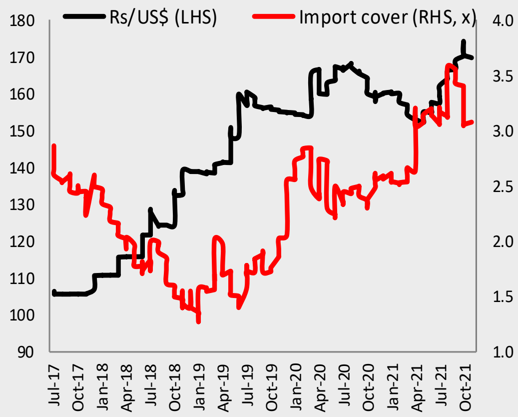
PAKISTAN

CPI vs policy rate



Source: SBP, Foundation Research, Nov 2021

Rupee against greenback



Source: SBP, Foundation Research, Nov 2021

Analyst

Zeeshan Azhar zeeshan@fs.com.pk

+92 213 5612290 Ext 331

Foundation Securities (Pvt) Ltd

Wednesday, November 17, 2021

Pakistan Economy

MPS brought forward by 1 week amid likely large hike in policy rate

Interest rate to increase by 100bps

The Central Bank has brought forward the MPS by one week amid recent unforeseen developments that have affected the outlook for inflation and the balance of payments, and to help reduce the uncertainty about monetary settings prevailing in the market. The SBP had started the tightening cycle at the last MPS nearly 2 months ago by raising the policy rate by 25bps after keeping it unchanged for the prior 15 months in the aftermath of the COVID-induced lockdown. SBP forward guidance in the last MPS stated that they would deviate from gradual tapering of stimulus if there are unforeseen circumstances. We expect the central bank to increase the interest rate by 100bps to 8.25% at the MPS scheduled on Nov'19, 2021. Our stance is based on unforeseen surge in inflation and current account outlook given (1) volatility in Rs-US$ exchange rate with record low of 175.73 hit last Friday (depreciation of 4.1% since last MPS) and (2) FY22 inflation forecast of 9.3% given elevated oil/commodity prices, increase in energy tariff amid IMF program resumption and higher Rs-US$ exchange rate.

Central bank guidance points to making recovery sustainable

The last MPS noted that at this more mature stage of the recovery, the priority of monetary policy also needed to gradually pivot from catalyzing the recovery after the Covid shock toward sustaining it. The MPS also noted that this rebalancing would be best achieved by gradually tapering the significant monetary stimulus provided over the last 18 months. The MPS noted that over the last few months the burden of adjusting to the rising current account deficit had fallen primarily on the exchange rate and it was appropriate for other adjustment tools, including interest rates, to also play their due role.

Inflationary pressures to persist

We foresee average inflation of 9.3% in FY22 given (1) higher international oil/commodity prices being passed onto domestic consumers, (2) higher Rs-US$ depreciation and (3) energy tariff increase amid likely IMF program resumption. We forecast that inflation would be in double digit during Dec'21 and Jan'22.

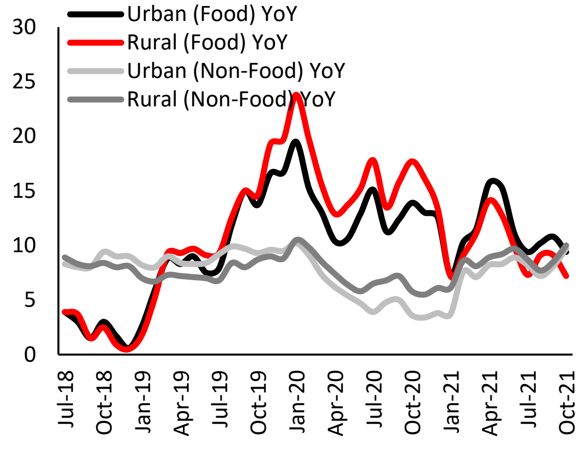
Mounting concerns over CAD

Elevated current account deficit is mainly an outcome of higher imports (up 8% in last 3 months vs prior 3 months) despite support from higher remittances of ~US$2.5bn per month. The increase in imports is concerning given that goods imports have exceeded levels last seen during FY18 balance of payments crisis (see Fig 5).

CAD outlook remains susceptible to upside risks if (1) import volumes increase as domestic demand remains robust or (2) commodity prices rise further given onset of winter and supply shortages/disruptions or (3) remittances normalize to pre COVID level as travel restrictions ease amid decline in COVID cases globally.

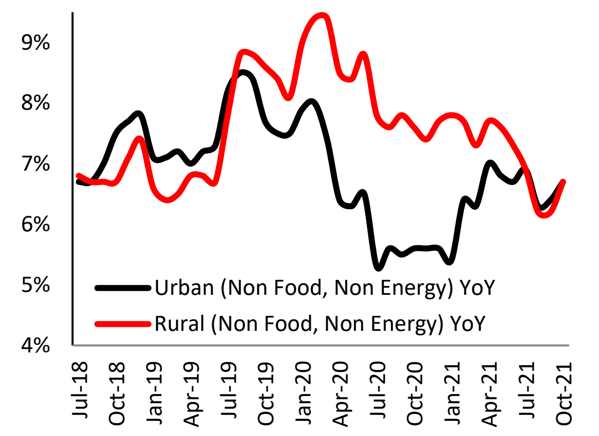
FSL estimates that in FY22 current account deficit would be ~2.8% of GDP (US$8.4bn) versus SBP forecast of 2-3% of GDP (US$6.2-9.5bn). We forecast interest rate of 8.25/9.0% at the end of CY21/FY22.

Fig 1: Food and non-food inflation has converged…



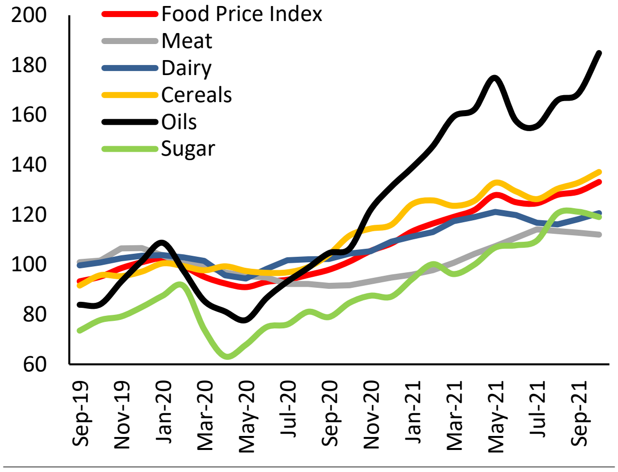
Source: PBS, FSL Research, Nov 2021

Fig 2: Core inflation bouncing back…



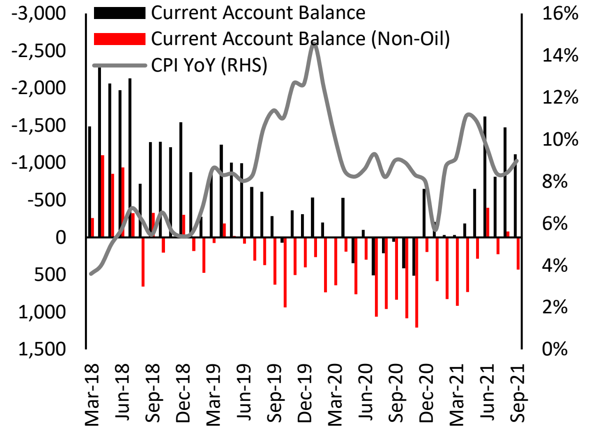
Source: PBS, FSL Research, Nov 2021

Fig 3: Int'l food prices marching upwards…



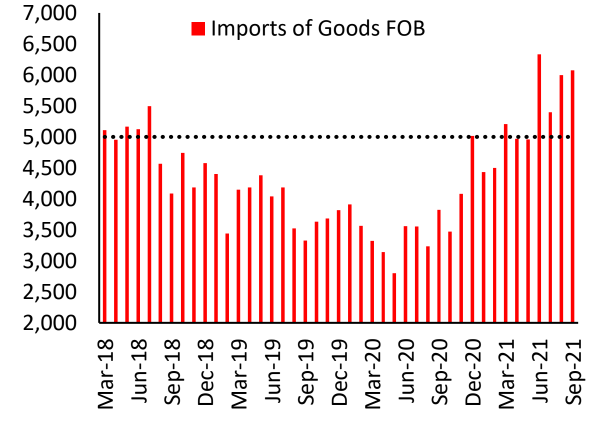
Source: FAO, FSL Research, Nov 2021

Fig 4: Current account and CPI…



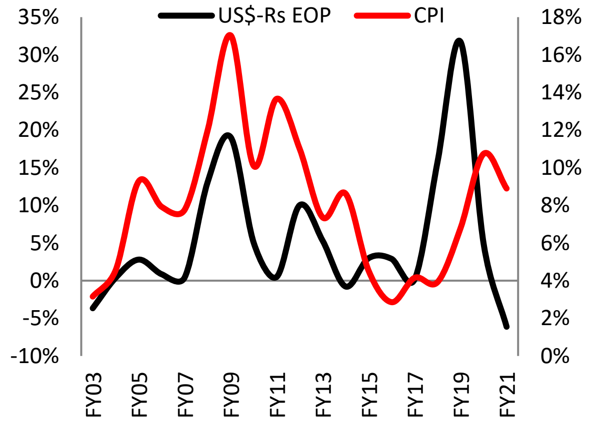
Source: SBP, PBS, FSL Research, Nov 2021

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



Source: SBP, FSL Research, Nov 2021

Fig 6: Exchange rate and inflation move in tandem



Source: Bloomberg, SBP, FSL Research, Nov 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