Foundation Securities
A Fauji Foundation Group Company
REP-095

PAKISTAN

Pakistan Economy

Upcoming MPS: Further increase in policy rate expected

Interest rate to increase by 50bps

The Central Bank has tightened the policy rate by a cumulative 275bps in the last three MPS in the wake of ballooning CAD, declining currency and rising inflation. We believe that persistent macro slippages would compel the Central Bank to again take action at the MPS on Jan'24, 2022. Thus, we expect the central bank to increase the interest rate by 50bps to 10.25% at the MPS scheduled next Monday.

Forward guidance points to end goal of mildly positive real interest rates close to being achieved

The last MPS stated that "the end goal of mildly positive real interest rates on a forward-looking basis was now close to being achieved. Looking ahead, the MPC expects monetary policy settings to remain broadly unchanged in the near-term." However, we believe that taking a pause in the tightening cycle at this point in time is unsuitable given (1) persistently high trade deficit of US$5.0/4.9bn (up 137/87% YoY) in Nov'21/Dec'21 and (2) elevated inflation of 11.5/12.3% YoY in Nov'21/Dec'21 despite 1.0% appreciation of Rs-US$ exchange rate since last MPS six weeks ago. As such, we expect the Central bank would be compelled to act again.

FSL forecasts interest rate of 10.75% by Jun'22.

Inflationary pressures to persist

Higher international oil prices being passed onto domestic consumers, electricity/gas tariff increase as required by IMF and elevated food inflation tracking higher international food prices amid supply chain disruptions coupled with sharp Rupee depreciation over last 6 months would keep FY22 inflation on the higher side. Thus, we see avg. inflation rising to 10.6% in FY22 compared to 8.9% YoY in FY21. We forecast that inflation would continue to remain in double digits till Aug'22.

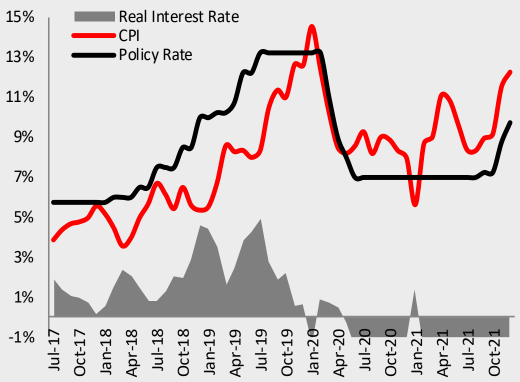
Recent upsurge in Core inflation (a relatively stable gauge of underlying inflationary pressures which excludes food and energy) shows a broad based increase in price levels (housing and clothing/footwear showing the largest rise) pointing to demand pull factors in play. We feel this would require further policy action to moderate.

Mounting concerns over CAD

Elevated current account deficit (US$7.1bn in 5MFY22 vs surplus of US$1.9bn in 5MFY21) is driven by higher commodity prices and robust domestic demand. It is mainly an outcome of higher imports (up 60% YoY in 5MFY22) despite support from higher exports (up 28% YoY) and higher remittances (up 10% YoY). During 2HFY22, we expect (1) some normalization of commodity prices given resolution of supply chain bottlenecks and (2) slowdown in domestic economic activity given Gov't policy tightening. Thus, full year deficit is expected to be US$14.6bn (4.7% of GDP).

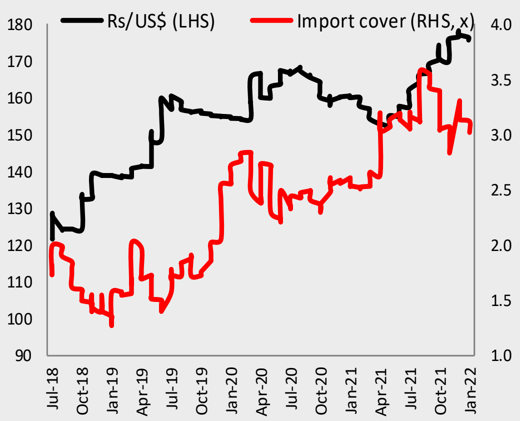
Gov't has complied with IMF pre conditions (SBP Amendment Bill, mini budget) for the 6th review of the EFF program. Thus, we feel IMF Board approval hopefully in end-Jan'22 should be a formality prior to disbursement of US$1.1bn. Further tranches of US$700mn are expected every quarter thereafter subject to meeting IMF conditionality which would ease concerns on repayments of maturing debt.

CPI vs policy rate



Source: SBP, Foundation Research, Jan 2022

Rupee against greenback



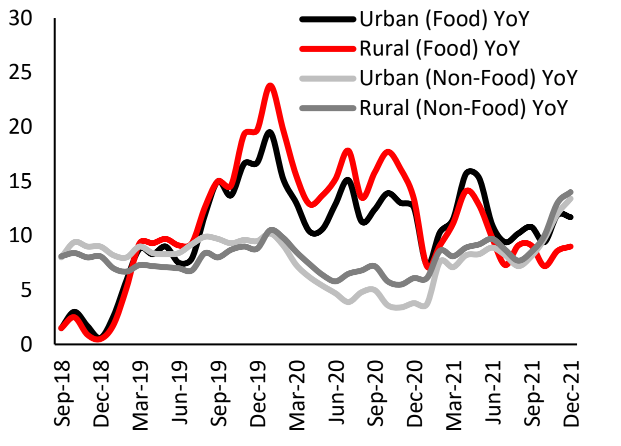
Source: SBP, Foundation Research, Jan 2022

Analyst

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

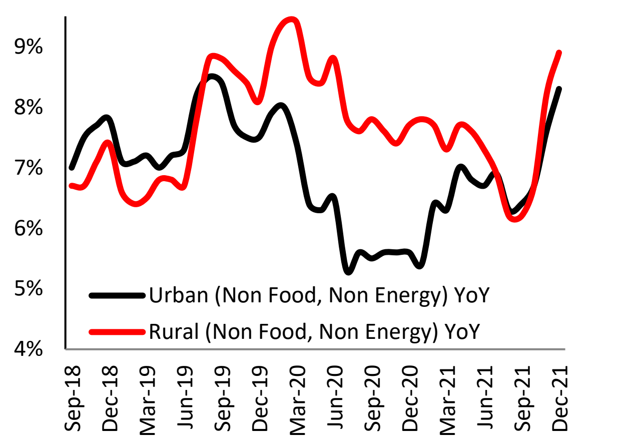
Foundation Securities (Pvt) Ltd
Friday, January 21, 2022

Fig 1: Non-Food CPI on upwards trajectory…



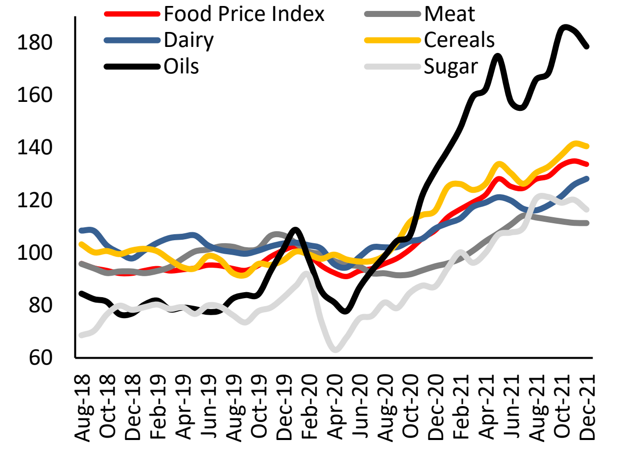
Source: PBS, FSL Research, Jan 2022

Fig 2: Core inflation rising sharply…



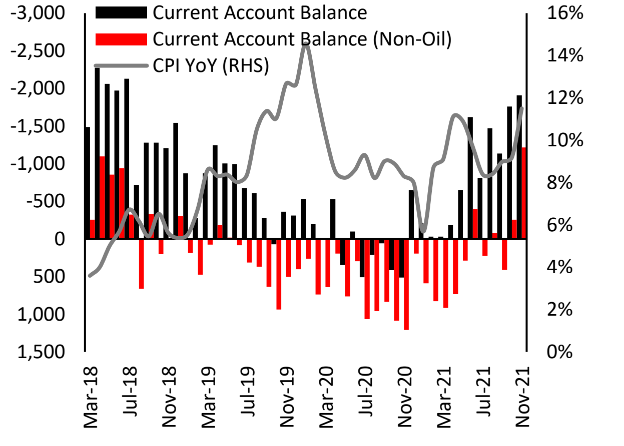
Source: PBS, FSL Research, Jan 2022

Fig 3: Int'l food prices mostly going upwards…



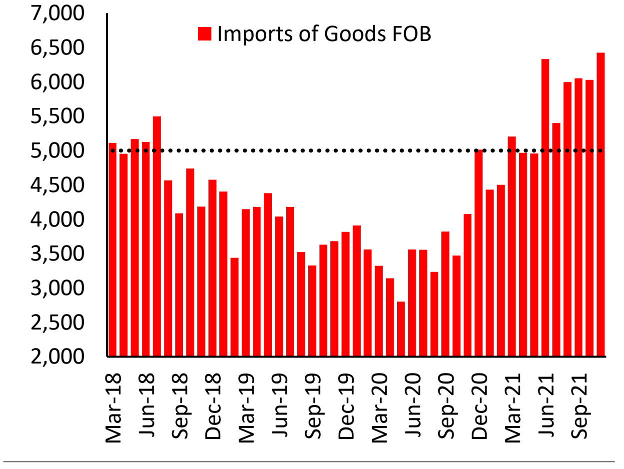
Source: FAO, FSL Research, Jan 2022

Fig 4: Current account and CPI…



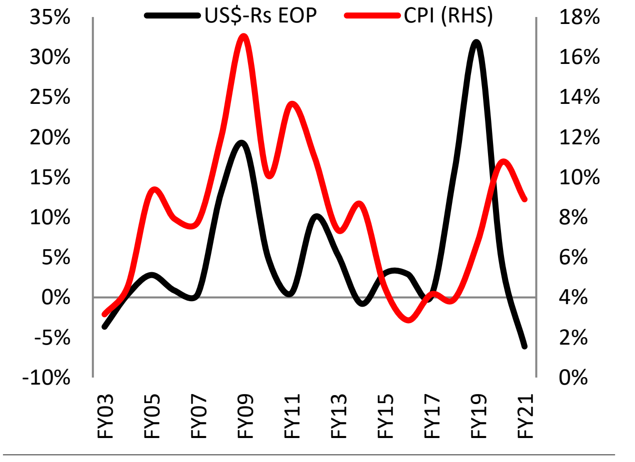
Source: SBP, PBS, FSL Research, Jan 2022

Fig 5: Goods import remain elevated (US$ bn)



Source: SBP, FSL Research, Jan 2022

Fig 6: Exchange rate and inflation move in tandem



Source: Bloomberg, SBP, FSL Research, Jan 2022

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.