

PAKISTAN



Pakistan Economy

Upcoming MPS: Status quo to be maintained

No change in interest rate

Amid a hit to the domestic economy activity by the devastating floods and a marked slowdown which was visible since Jul'22, along with the recent improvement in US\$-Rs parity and moderating CAD, we believe, would prevent the Central Bank from raising the interest rate at the 1st MPS since the record floods that is scheduled for Monday, Oct'10, 2022.

Domestic demand to be adversely impacted by supply side shock of devastating floods

Economic activity would be hampered by the devastating floods with the impact likely more acute in the agriculture sector which makes up ~20% of the GDP and ~40% of total employment. Cotton production has registered a decline of 24% YoY with roughly half of the crop already harvested. The floods come on the heels of a marked slowdown which was evident over the last few months amid steep monetary tightening (auto/cement sales fell by 50/66% YoY in Jul'22 and 46/24% YoY in Aug'22, and petroleum sales declined by 26/22/22% YoY in Jul/Aug/Sep 2022, whereas electricity production was down by 3/10/13% YoY in Jun/Jul/Aug 2022).

Fiscal position of the Gov't is also likely to worsen in FY23 with lower projected revenues given economic slowdown and higher expenditures amid infrastructure rebuilding drive post floods and spending on social support.

Inflation to remain high till May'23

Furthermore, avg. FY23 inflation would be ~23.1% YoY given (1) expected spike in food inflation amid supply shock from record floods, (2) hikes in fuel and energy prices along with their 2nd round effects amid higher international petroleum prices given Ukraine war and (3) lagged effects of recent sharp Rupee depreciation. However, likely recession in advanced economies would moderate commodity/oil prices which would be a drag on inflation. Whereas, 1-yr forward real interest rates are projected to remain deeply in negative territory.

FSL forecasts interest rate of 13.5% in Jun'23.

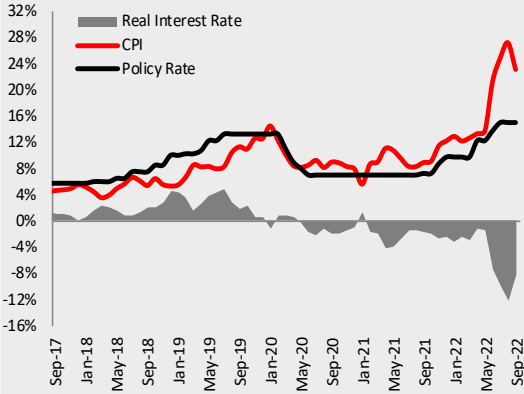
Moderating CAD to provide a breather

The slowdown in economic activity would also influence the current account deficit, which has declined in 2MFY23 to US\$1.9bn (down 19% YoY) despite petroleum imports increasing by US\$2.2bn (up 89% YoY). Timely Gov't action of monetary tightening (policy rate up by 800bps in 10 months from Sep'21 to Jul'22) and moderating commodity prices would aid in curtailing CAD going forward.

Funding for flood recovery to ease pressure on financial account

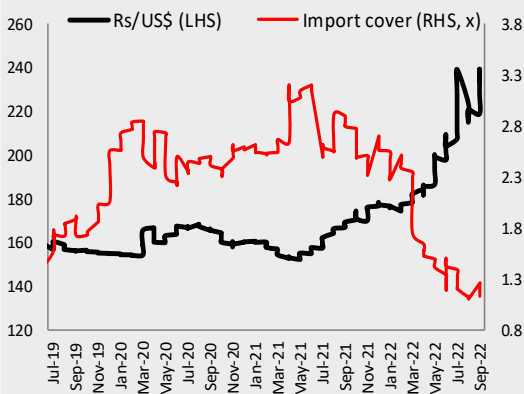
The World Bank and Asian Development bank are expected to provide flood support of ~US\$2.0bn and ~US\$2.5bn respectively which would go some way in bolstering SBP FX reserves and supporting the financial account during a time when tapping international bond markets is not feasible and inflows under RDA have declined by 19% in last 6M vs previous 6M.

CPI vs Policy rate



Source: PBS, SBP, Foundation Research, Oct 2022

Rupee vs Greenback



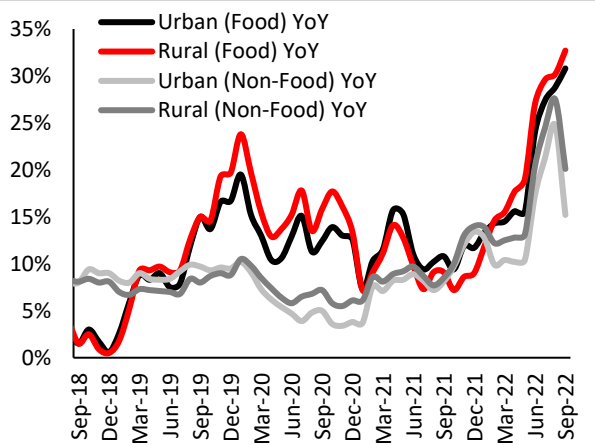
Source: SBP, Foundation Research, Oct 2022

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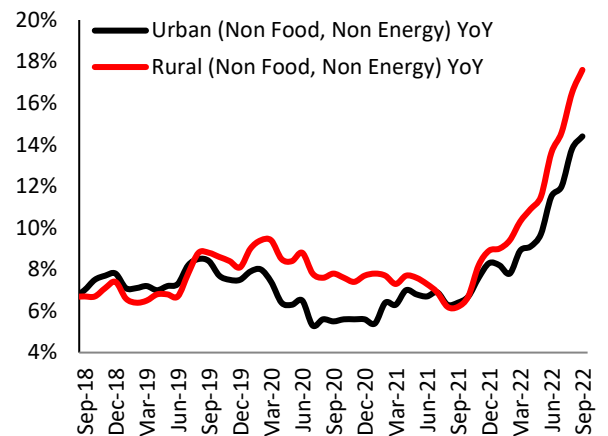
Foundation Securities (Pvt) Ltd
Friday, October 7, 2022

Fig 1: Food CPI ↑ and non-food CPI ↓



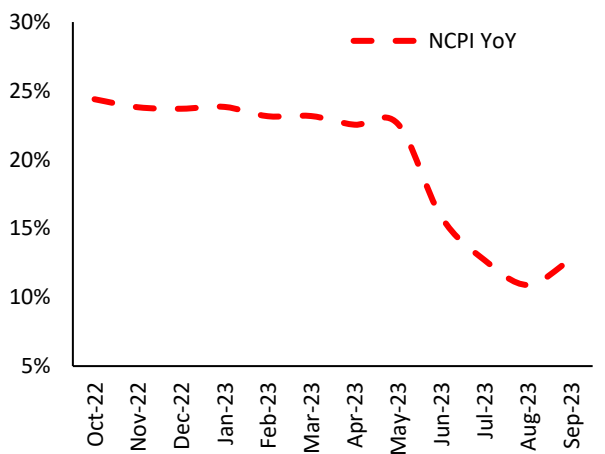
Source: PBS, FSL Research, Oct 2022

Fig 2: Core inflation escalating sharply...



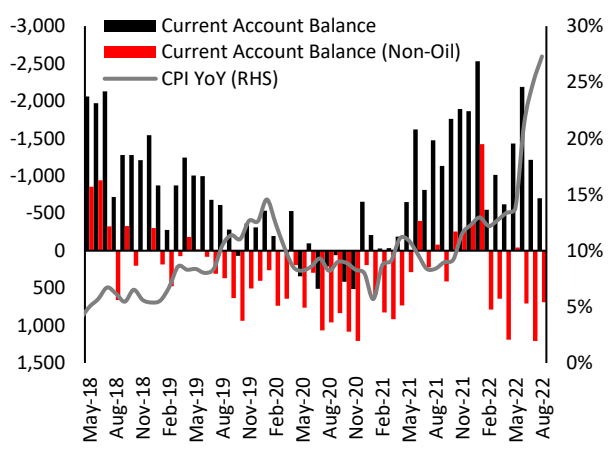
Source: PBS, FSL Research, Oct 2022

Fig 3: Inflation is projected to be on declining path...



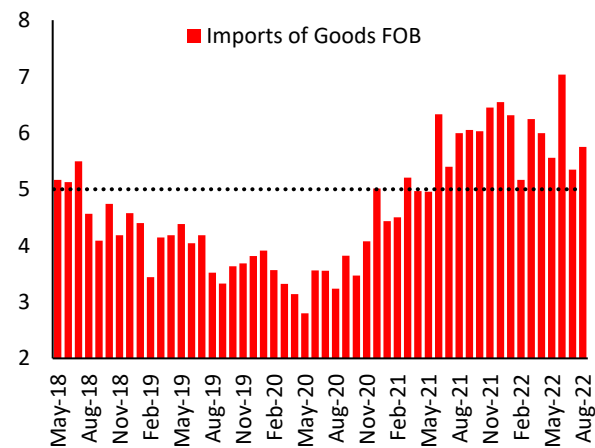
Source: PBS, FSL Research, Oct 2022

Fig 4: Current account and CPI...



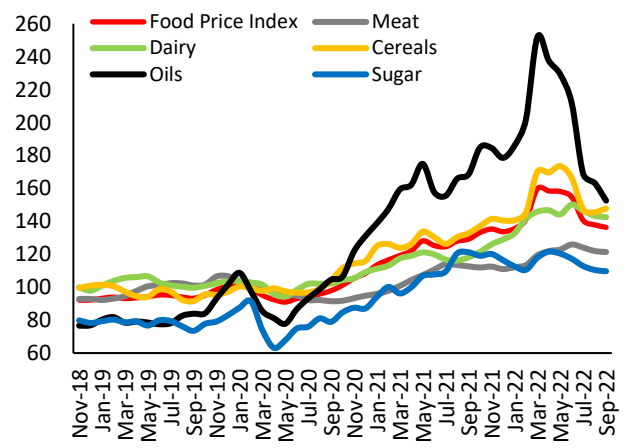
Source: SBP, PBS, FSL Research, Oct 2022

Fig 5: Goods import at elevated levels (US\$ bn)



Source: SBP, FSL Research, Oct 2022

Fig 6: Int'l food prices declined but still elevated



Source: FAO, FSL Research, Oct 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

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Recommendations definitions

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