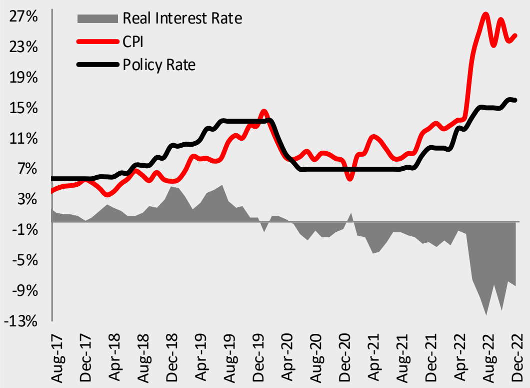
Foundation Securities
A Fauji Foundation Group Company
REP-095

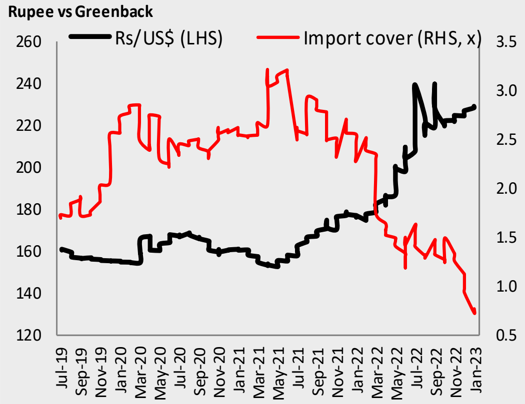
PAKISTAN

CPI vs Policy rate



Source: PBS, SBP, Foundation Research, Jan 2023

Rupee vs Greenback



Source: SBP, Foundation Research, Jan 2023

Analyst

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

Foundation Securities (Pvt) Ltd
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Pakistan Economy

MPS: Another 100bps hike!

Policy rate increased to 17.0%

The State Bank of Pakistan yesterday announced its monetary policy stance in which it decided to increase the policy rate by 100bps to 17.0%. The MPS noted that inflationary pressures are persisting and continue to be broad-based. If these remain unchecked, they could feed into higher inflation expectations over a longer than anticipated period. It stressed that it is critical to anchor inflation expectations and achieve the objective of price stability to support sustainable growth in the future.

On balance, MPS reiterated that the ST costs of bringing down inflation are lower than the LT costs of allowing it to become entrenched. The MPS also emphasized on the engagements with the multilateral and bilateral partners to overcome domestic uncertainty and to address the near-term external sector challenges.

The MPS also noted 3 important economic developments since the last meeting. (1) Despite some moderation in Nov'22/Dec'22, inflation continues to remain elevated. Importantly, core inflation has been on a rising trend for the past 10 months. Moreover, the recent pulse surveys show inchingup of consumers and business inflation expectations. (2) Near-term challenges for the external sector have increased despite the policy-induced contraction in the current account deficit. The lack of fresh financial inflows and ongoing debt repayments have led to a continuous drawdown in official reserves. (3) Global economic and financial conditions remain uncertain in the ST, leading to mixed implications for the domestic economy. The expected slowdown in global demand could negatively impact the outlook of exports and workers' remittances. This would partly offset the gains from the import contraction.

Inflation is persisting, especially core

NCPI remained at elevated levels despite some moderation in recent months where food inflation remains the major contributor to this persistence in inflation. Core inflation also rose due to increasing core goods prices, especially durables. However, the uncertainty on their future path and expected near-term adjustments remain the major upside risks to the inflation outlook. Reflecting these concerns, both the consumer and business inflation expectations have drifted upwards over the ST and MT. MPS views that anchoring of inflation expectations is important to achieve the MT inflation target of 5-7% by Dec'24 and requires coordinated monetary and fiscal policy efforts.

FSL sees avg. inflation of 23.7% in FY23 and interest rate of 17% at the end of FY23.

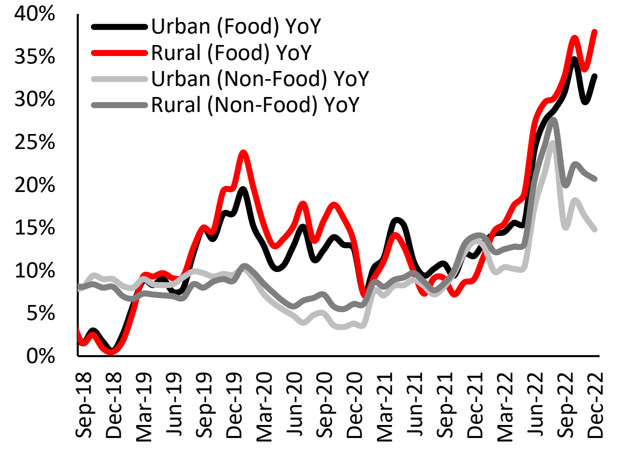
Growth slowdown, external sector stress and fiscal concerns

The incoming high-frequency data continues to suggest broad-based and sustained moderation in economic activity in response to policy tightening and exogenous shocks, like the 2022 floods.

Notwithstanding the reduction in CAD (down 60% to US$3.7bn in 1HFY23), the external sector remains under stress due to delay in realization of official financial inflows, debt repayments and ongoing political uncertainty. The MPS views that the completion of the pending 9th review under the IMF's EFF is critical for reducing uncertainty and unlocking multilateral and bilateral inflows.

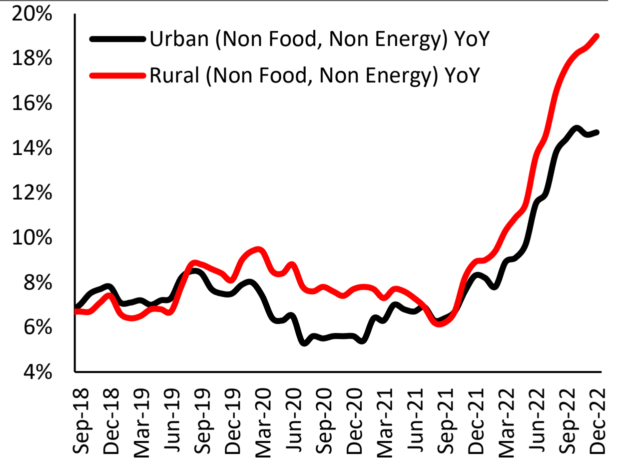
The MPS noted that the current fiscal stance is inconsistent with monetary tightening. Thus, given the evolving macroeconomic challenges, it is important for the fiscal policy to achieve the planned consolidation in order to help contain inflation and pave the way for sustainable growth.

Fig 1: Food CPI ↑and non-food CPI ↓



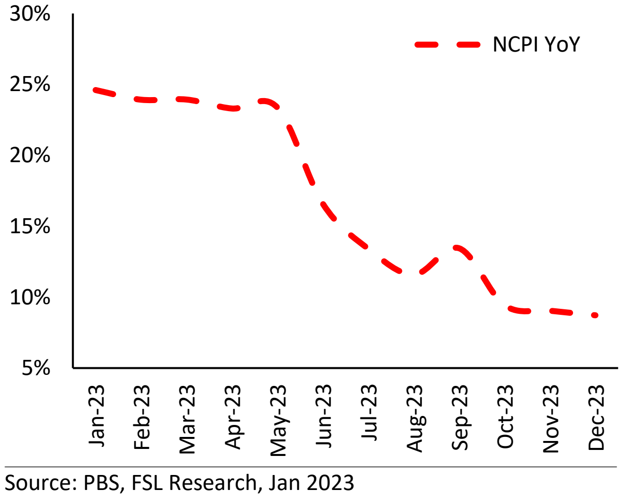
Source: PBS, FSL Research, Jan 2023

Fig 2: Core inflation escalating sharply…



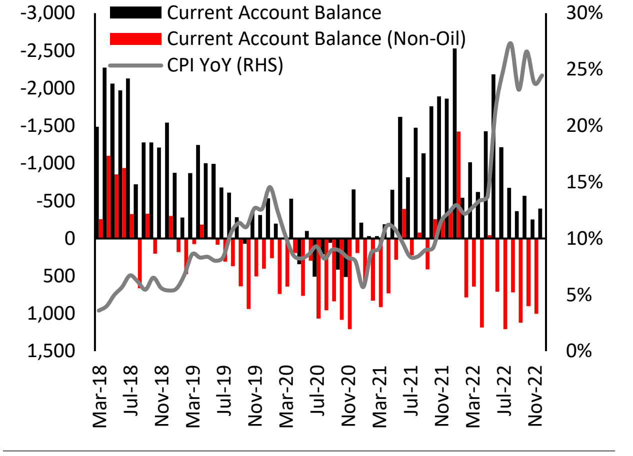
Source: PBS, FSL Research, Jan 2023

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



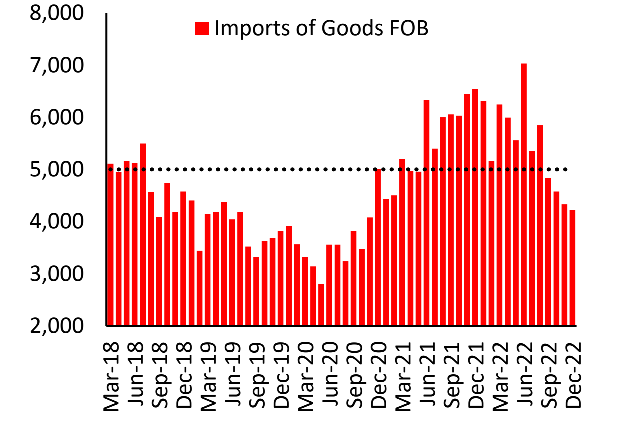
Source: PBS, FSL Research, Jan 2023

Fig 4: Current account and CPI…



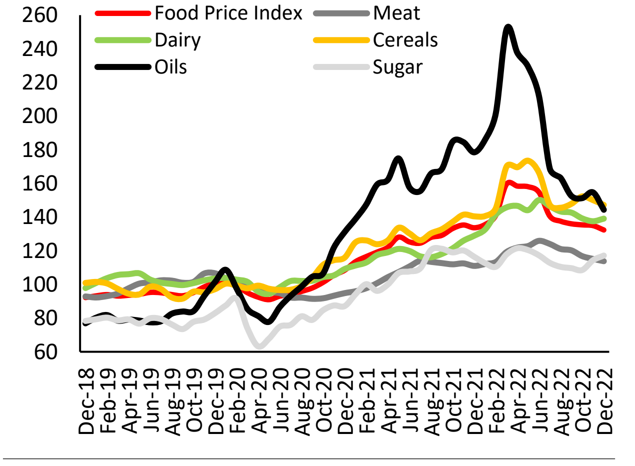
Source: SBP, PBS, FSL Research, Jan 2023

Fig 5: Import compression underway (US$ bn)



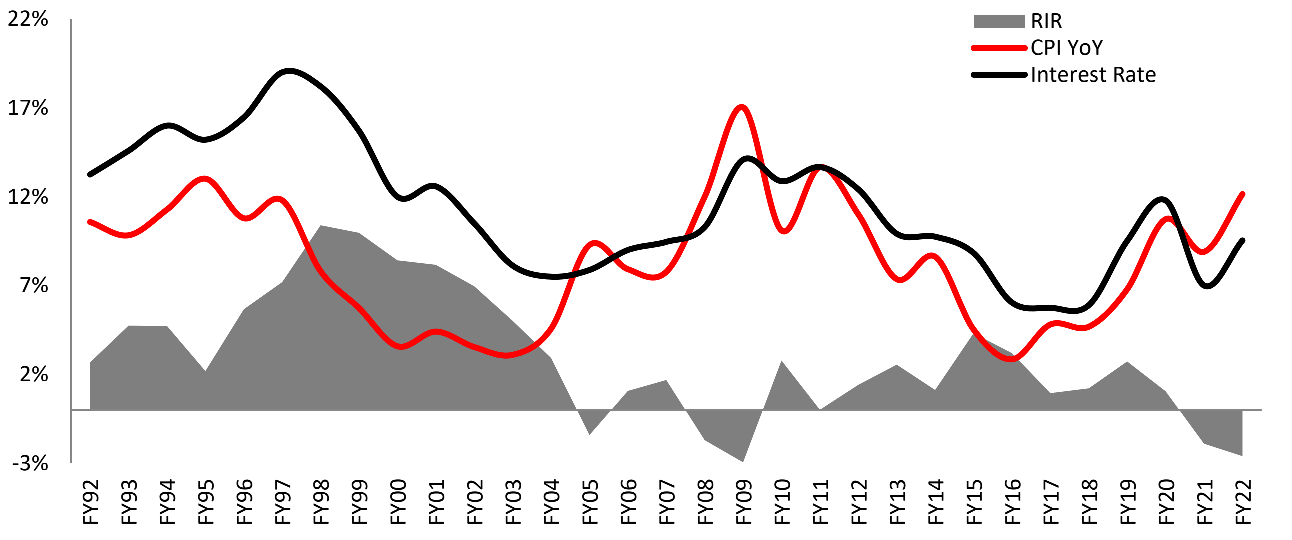
Source: SBP, FSL Research, Jan 2023

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



Source: FAO, FSL Research, Jan 2023

Fig 7: Inflation and Interest Rates over the last 30 years



Source: PBS, SBP, Foundation Research, January 2023

Abbreviations

CAD	Current Account Deficit
MoM	Month on Month
MPS	Monetary Policy Statement
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.