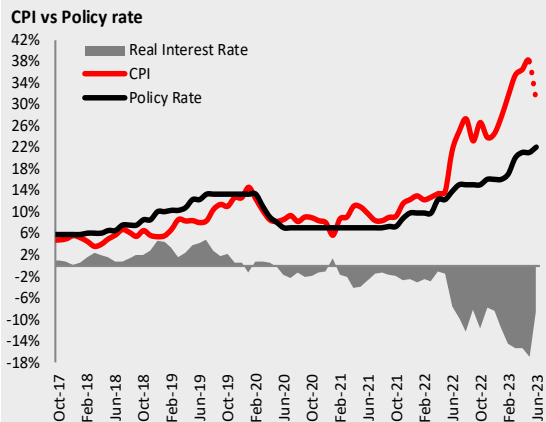
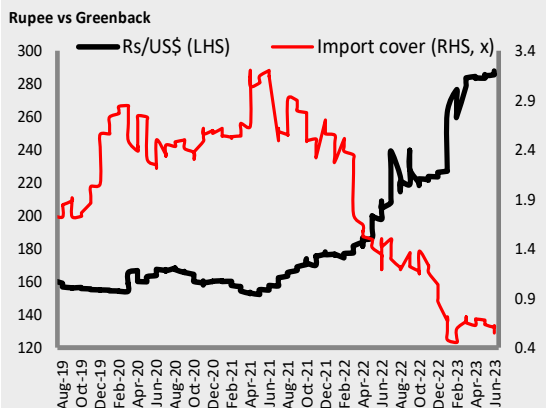


PAKISTAN



Source: PBS, SBP, Foundation Research, June 2023



Source: SBP, Foundation Research, June 2023

Analyst

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

Foundation Securities (Pvt) Ltd
Tuesday, June 27, 2023

Pakistan Economy

MPS: Surprise 100bps increase in interest rate to record 22.0%

Monetary policy stance changed in just 2 weeks due to unexpected shock

The State Bank of Pakistan (SBP) yesterday announced an unscheduled monetary policy meeting in which it decided to increase the policy rate by 100bps to 22.0%. The MPS noted that in the last MPS 2 weeks ago, it stated the then monetary policy stance as appropriate to achieve the objective of price stability “barring any unexpected domestic and external shocks.” The MPS had further noted that, this outlook was “contingent on effectively addressing the prevailing domestic uncertainty and external vulnerabilities.”

Completion of IMF program stated as reason behind increase in taxes and removal of import restrictions

MPS has now noted two important domestic developments since the last MPS that have slightly deteriorated inflation outlook and which could potentially increase pressure on the already stressed external account. First, there are certain upward revisions in taxes, duties and PDL rate in FY24 budget as approved by the National Assembly on Jun’25, 2023. Second, the SBP, on Jun’23, 2023, withdrew its general guidance for commercial banks on prioritization of imports.

While the MPS views these measures as necessary in the context of completion of the ongoing IMF program, they have increased the upside risks to the inflation outlook. The Committee views that additional tax measures are likely to contribute to inflation both directly and indirectly, while the relaxation in imports may exert pressures in the foreign exchange market. The latter may result in higher-than-earlier anticipated exchange rate pass-through to domestic prices.

Hike necessary to keep real interest rate in positive territory on forward looking basis

With this background, the MPS convened an emergency meeting to respond to these developments. The MPS decided to raise the policy rate by 100 bps to 22.0%, effective Jun’27, 2023. The MPS views this action as necessary to keep real interest rate firmly in the positive territory on a forward-looking basis. This would help further anchor inflation expectations – which are already moderating over the last few months, and support bringing down inflation towards the medium term target of 5-7% by the end of FY25, barring any unforeseen developments.

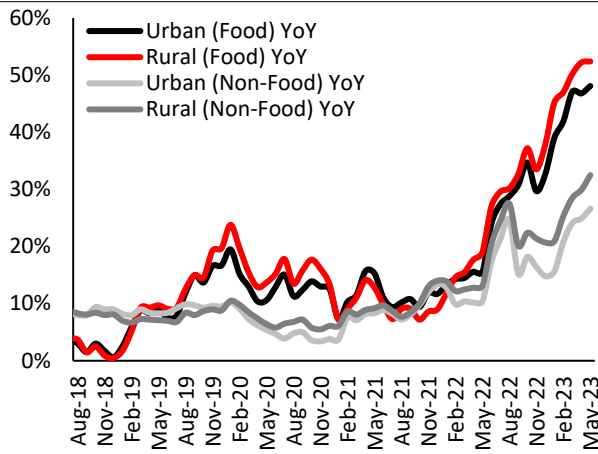
FSL sees avg. inflation of 20.5% in FY24 and interest rate of 22% in Dec’23.

PR increased to address external sector vulnerabilities and reduce economic uncertainty

The MPS views that today’s decision - along with the expected completion of the ongoing IMF program and the government adhering to the target of generating a primary surplus in FY24 would help in addressing external sector vulnerabilities and reduce economic uncertainty.

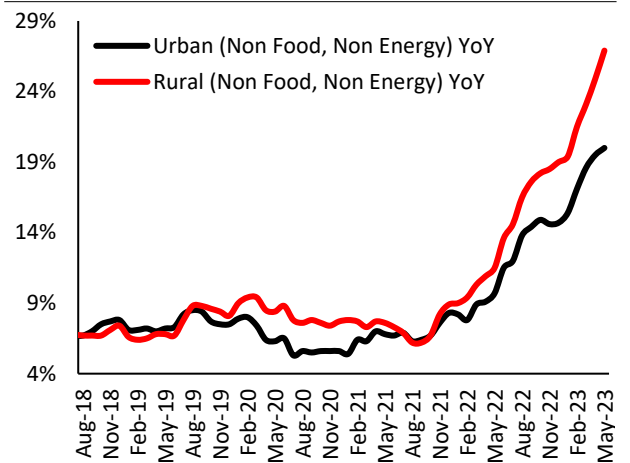
MPS reiterated that it would continue to carefully monitor evolving economic developments and stands ready, if necessary, to take appropriate action to achieve the objective of price stability over the medium term.

Fig 1: Food and non-food CPI ↑



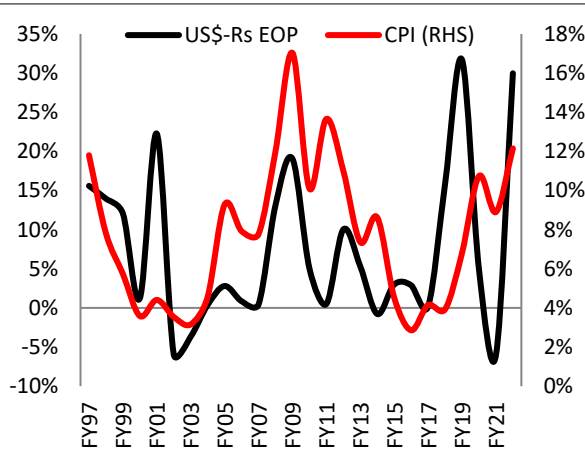
Source: PBS, FSL Research, Jun 2023

Fig 2: Core inflation escalating sharply...



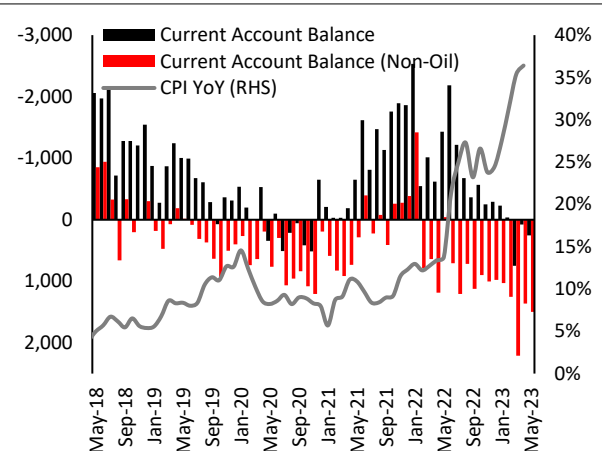
Source: PBS, FSL Research, Jun 2023

Fig 3: Inflation and exchange rate move in tandem...



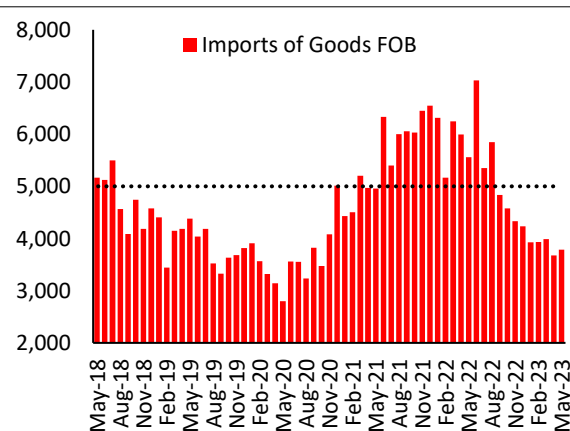
Source: PBS, FSL Research, Jun 2023

Fig 4: Current account restricted amid import curbs



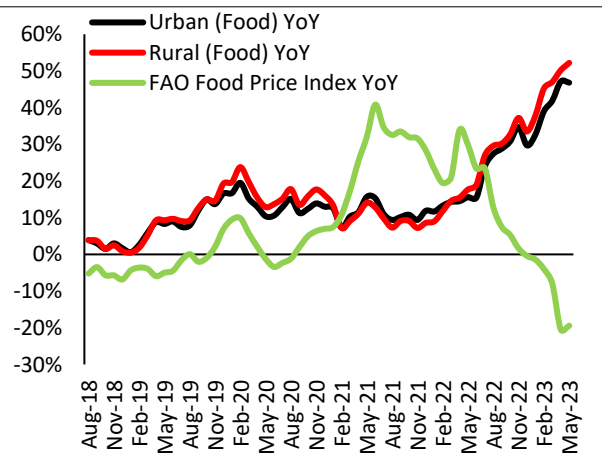
Source: SBP, PBS, FSL Research, Jun 2023

Fig 5: Import compression underway (US\$ bn)



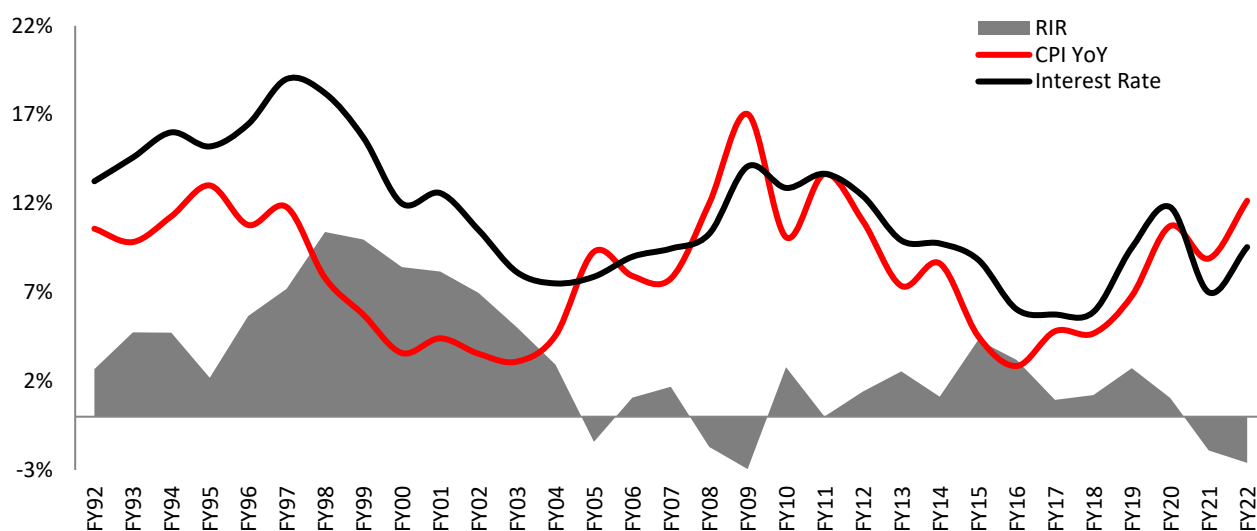
Source: SBP, FSL Research, Jun 2023

Fig 6: Int'l food prices ↓ while domestic food prices ↑



Source: PBS, FAO, FSL Research, Jun 2023

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



Source: PBS, SBP, Foundation Research, Jun 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

Important disclosures:

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Recommendations definitions

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