

Pakistan Economy

100bps hike; Highest ever policy rate of 21%

4-Apr-2023

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Monetary Policy Statement

100bps hike in policy rate to 21%

In the monetary policy meeting held today (4th Apr'23), the State Bank of Pakistan (SBP) has increased the benchmark policy rate by another 100bps to 21%, a record high. To recall, the last hike of 300bps was undertaken in Mar'23. The committee expects inflation to remain rangebound, albeit, at elevated levels, after arriving at 35.4% in Mar'23. While today's decision remains key in ensuring price stability, it is also an important step towards anchoring inflation to the medium term target.

Three key observations since the last MPC meeting:

The MPC highlighted the following three developments since the last meeting

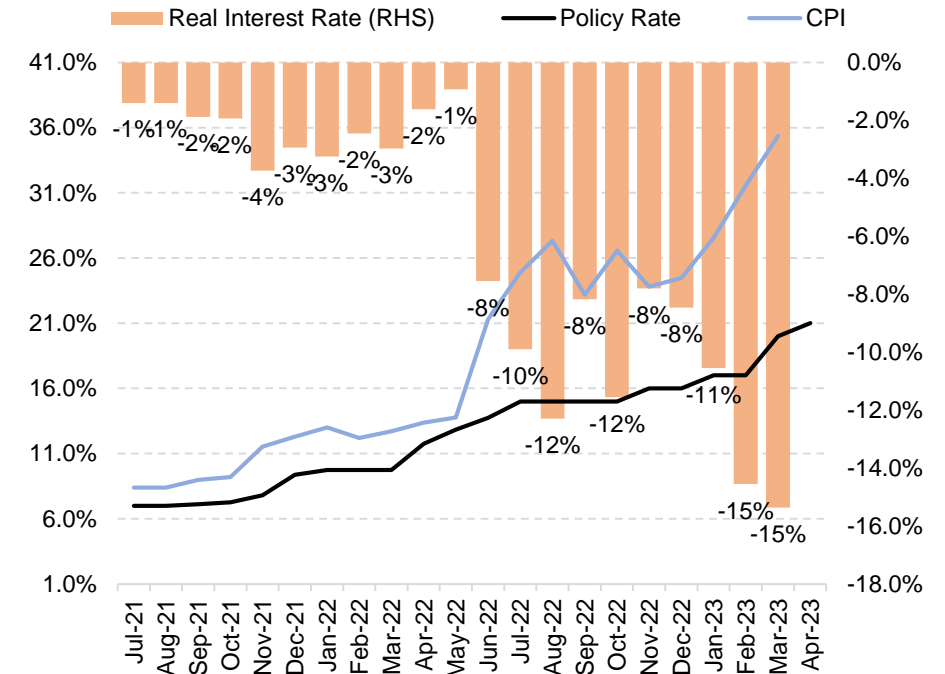
- CAD has compressed tremendously, in lieu of curbed imports. However, the overall balance of payments position continues to remain under stress, while FX reserves are still considerably low.
- The MPC notes significant progress has been made towards completion of the IMF's 9th review under EFF.
- Lastly, recent difficulties in the global banking system has triggered further tightening in liquidity and financial conditions, which poses problems for emerging markets like Pakistan to access international capital.

The MPC reiterated that the stance taken today remains appropriate to help achieve the medium term inflation target over the next 8 quarters. However, "the Committee noted that uncertainties attached with the global financial conditions as well as the domestic political situation, pose risks to this assessment."

Other observations

- Growth in FY23 is set to be lower than the post-floods assessment on the back of lower industrial activity coupled with lagged impact of recent monetary tightening and fresh fiscal measures undertaken since Mar'23.
- Slowdown can be observed in key economic activity indicators. Significant decline has been witnessed in volumetric sales of automobile and POL products. Contraction in LSM has accelerated in Jan'23 to 7.9% YoY, while down by 4.4% YoY during 7MFY23.

Exhibit: Policy Rate vs. Inflation



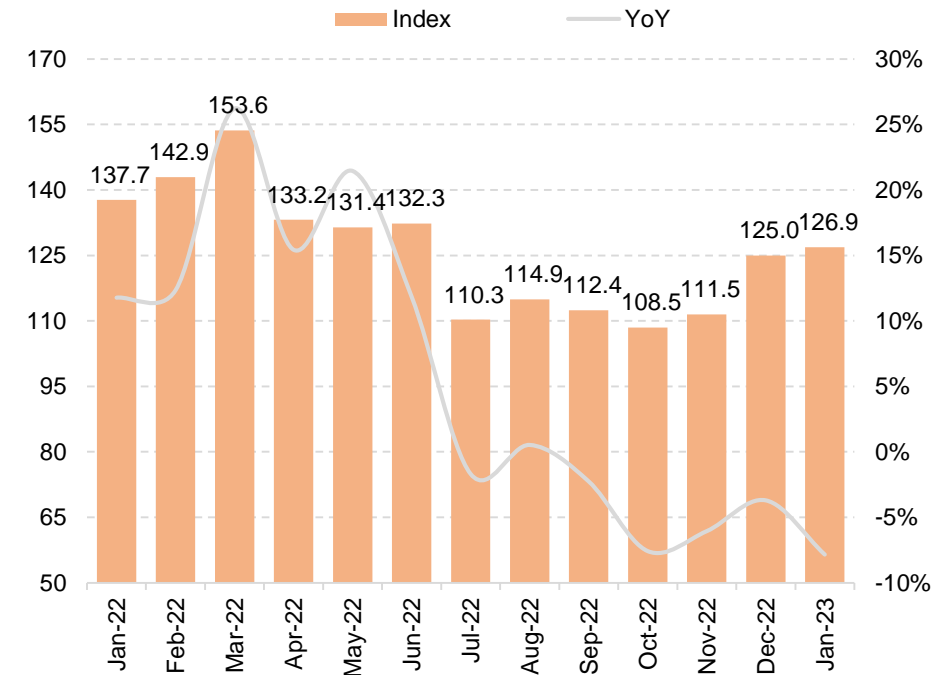
Source (s): SBP, PBS, AHL Research

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- Similarly, electricity generation declined for the ninth consecutive month in Feb'23.
- Agriculture data revealed that cotton arrivals have met expectations but it is likely that wheat production will miss its target.
- On the external front, CAD shrunk to USD 74mn in Feb'23, with the cumulative 8MFY23 deficit down by 68% YoY at USD 3.9bn. This reflects the contraction in imports which offset the impact of decline in remittances and exports. Remittances in Feb'23 posted some improvement over the prior month and the momentum should continue in upcoming months.
- Albeit, higher loan repayments relative to disbursements will keep the FX position under pressure, despite a lower CAD. Based on this, the MPC exaggerates the need to conclude the IMF's 9th review at the earliest.
- Fiscal consolidation has remained encouraging; deficit has narrowed to 2.3% of GDP in Jul'22-Jan'23 against 2.8% in SPLY. While the primary balance posted a surplus of 1.1% of GDP against a deficit of 0.3% last year led by restricted subsidies, grants and development spending.
- Pertinently though, tax revenue has not grown adequately given compressed economic activity, lower imports, and little focus on improving the tax net, whereas debt servicing has increased.
- The committee reiterated that achieving the envisaged fiscal consolidation is critical to complement the ongoing monetary tightening.
- Broad money has shown a slight uptick in Feb'23 given notable growth in net domestic assets of the banking system. This is owed to higher public sector borrowing, whereas private sector credit has contracted for a second consecutive month (down 11.1% in Feb'23 vs. 18.6% in Feb'22).
- Contraction in private sector credit is on the back of "retirement in fixed investment and consumer loans, while working capital loans saw a marginal seasonal uptick during the month."

Exhibit: Jan'23: LSMI output down 7.9% YoY



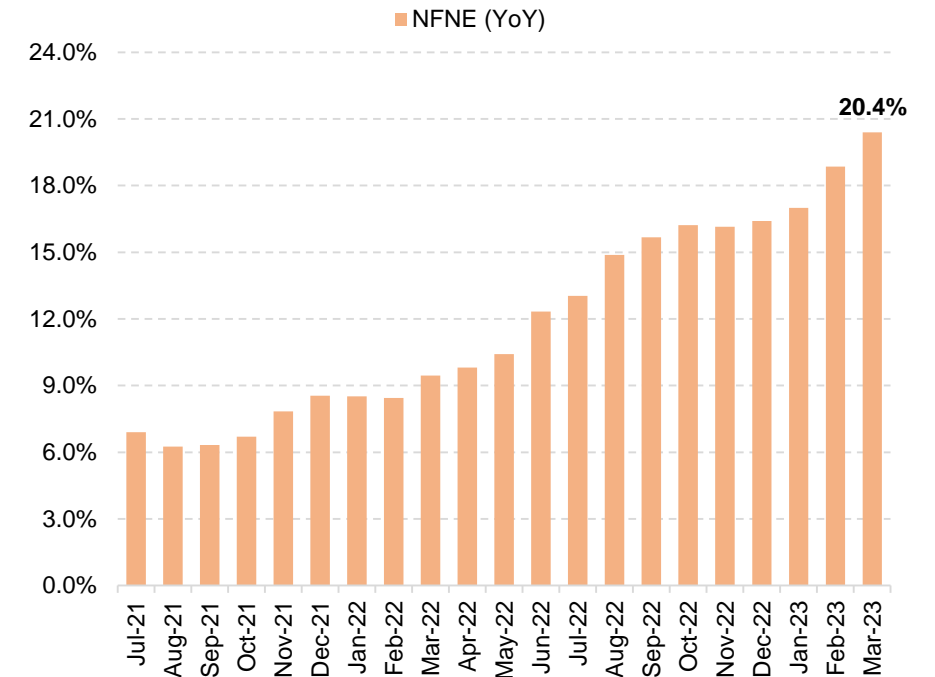
Source (s): PBS, AHL Research

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- Inflationary reading suggests that the pass through of higher taxes and duties, tapering off of untargeted subsidies and recent exchange rate depreciation, became reflective in CPI, where a large jump was seen in food and energy components.
- Moreover, second round impacts of the aforementioned are visible in core inflation, which has risen to 18.6% in urban and 23.1% in rural baskets.
- In order to anchor expectations of elevated inflation, the MPC views the current stance remains “appropriate to keep the real interest rate in positive territory on a forward-looking basis.”

Exhibit: NFNE



Source (s): PBS, AHL Research

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Exhibit: Policy rate increase and KSE100 performance

Date	MPC Decision	KSE100 Index	Next Working Day	KSE100 Change		
				15 Day	30 Day	60 Day
1-Jan-92	100 bps Increase	1,686	1.6%	0.4%	-17.2%	-26.4%
1-Dec-92	100 bps Increase	1,225	0.2%	-1.5%	1.5%	1.0%
1-Aug-93	200 bps Increase	1,378	-0.3%	-1.7%	-6.1%	-2.8%
1-Oct-95	100 bps Increase	1,656	-0.4%	-8.6%	-5.3%	-17.3%
1-Oct-96	300 bps Increase	1,385	2.0%	-1.7%	4.8%	7.7%
19-Sep-00	100 bps Increase	1,555	0.6%	3.2%	-3.2%	-9.4%
5-Oct-00	100 bps Increase	1,587	-0.4%	-5.4%	-4.3%	-17.8%
7-Jun-01	100 bps Increase	1,375	-0.6%	-1.6%	-5.0%	-9.7%
12-Apr-05	150 bps Increase	6,939	2.7%	4.9%	5.0%	5.9%
26-May-08	150 bps Increase	12,585	1.9%	2.3%	-1.2%	-12.3%
29-Jul-08	100 bps Increase	10,448	3.9%	-5.2%	-11.9%	-12.1%
12-Nov-08	200 bps Increase	9,183	0.0%	0.0%	0.0%	-33.1%
14-Jul-18	100 bps Increase	40,271	-1.5%	6.2%	5.9%	0.6%
29-Sep-18	100 bps Increase	40,999	-0.2%	-8.5%	1.1%	-0.7%
30-Nov-18	150 bps Increase	40,496	-3.3%	-4.7%	-8.2%	0.3%
20-May-19	150 bps Increase	33,251	0.6%	6.8%	4.2%	-2.4%
16-Jul-19	100 bps Increase	32,972	0.0%	-3.1%	-10.7%	-4.5%
19-Nov-21	150 bps Increase	46,489	-1.6%	-7.0%	-5.6%	-2.1%
14-Dec-21	100 bps Increase	43,247	2.6%	2.3%	5.8%	6.6%
7-Apr-22	250 bps Increase	43,787	1.5%	4.0%	2.4%	-5.0%
23-May-22	150 bps Increase	42,440	-1.2%	-2.1%	0.0%	-5.6%
7-Jul-22	125 bps Increase	41,344	1.3%	-3.1%	1.8%	1.2%
25-Nov-22	100 bps Increase	42,937	-2.0%	-2.9%	-7.6%	-9.0%
23-Jan-23	100 bps Increase	38,444	1.6%	8.0%	7.1%	3.9%
2-Mar-23	300 bps Increase	40,671	1.6%	1.6%	-1.6%	n.a
4-Apr-23	100 bps Increase	39,687	-	-	-	-
Average						
Total			0.43%	-0.69%	-1.93%	-5.96%
100 bps Increase			0.43%	-1.27%	-3.37%	-7.30%

Source (s): PSX, SBP, AHL Research

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- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

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