For upcoming MPC, keep calm and carry on

- The MPC of the SBP is slated to announce its monetary policy on Sep 21’20 (Monday), where consistent improvement in keep account coupled with a need to support domestic economic activity should keep the MPC to maintain its accommodative bias. We expect the committee to keep its policy rate on hold at 7.0%.

- Inflation outlook remains uncertain due to low visibility on the timing and scale of potential utility rate adjustments. In our base case, we expect inflation to average at 8.25% YoY in FY21, modeling a 20%/10% hike in electricity/gas rates in Mar’21.

- For Sep’20, we expect the headline inflation to marginally increase to 8.30% YoY vs. 8.21% YoY in Aug’20 and 11.38% YoY in the SPLY, with a favorable base effect keeping headline reading in check. On a MoM basis, the inflation is likely to accelerate to 0.85% MoM (vs. 0.63% in the preceding month), where price increase in certain food items remain key drivers.

Favorable base effect to keep inflation in check: Preliminary price trends for Sep’20 indicate the headline inflation slightly going up to 8.30% YoY in Sep’20 vs. 8.21% YoY in the last month and 11.38% YoY in the SPLY, with the favorable base effect keeping the headline reading in check. On a MoM basis, inflation is likely to increase to 0.85% MoM (vs. 0.63% in the preceding month), where price increase in certain food items being the key driving force. Food inflation after a brief respite in Aug’20 is once again likely to accelerate by 1.87% MoM driven by price surge in certain perishables (i.e. chicken and fresh vegetables) and pulses (up 2-5% MoM). Lower fuel charge adjustment (FCA) in the outgoing month (net PKR1.09 per KWH vs. PKR1.17 per KWH in Aug’20) coupled with declining domestic fuel prices would likely drive the housing and utility index lower. Market wise, urban inflation is expected to slightly increase to 7.17% YoY vs. 7.14% YoY in Aug’20 and 11.57% YoY in Sep’19, while rural inflation – with relatively more weight of food items – is likely to clock in at 10.03% YoY vs. 9.86% YoY in Aug’20 and 11.09% YoY in Sep’19. Over the medium term, the inflation outlook remains uncertain due to low visibility on the timing and scale of potential utility rate adjustments. In our base case, we expect inflation to average at 8.25% YoY in FY21, modeling 20%/10% hike in electricity/gas rates in Mar’21.

SBP expected to keep rates unchanged: The MPC of the SBP is slated to announce monetary policy on Sep 21’20 (Monday), where we expect it to hold rates steady for two reasons. First, although high-frequency data for the month of Jul’20 indicate sharp economic recovery, the momentum has somewhat slowed in Aug’20 (HSD/cement/passenger cars: down 25%/29%/19% MoM), putting a question mark on rebound back to pre-COVID levels. It is unclear yet whether the surge in volumes was due to “pent-up” demand or a genuine increase in economic activity. Considering the early phase of recovery we are currently in, a rate hike at this stage would be akin to throwing a “spanner in the works”. Secondly, on the face of it, the external account continued to exhibit significant improvement, providing policy space to the central bank in maintaining its accommodative bias. The current account swung into surplus in Jul’20 (US$424mn (1.68% of GDP) vs. deficit of US$100/US$613mn (0.48/2.81% of GDP) in Jun’20/Jul’19) on the back of record-high remittances and reduction in the trade deficit. FX reserves held by the SBP saw a net accumulation of US$2.45bn since May’20. That said, we remain concerned about the sustainability of the current trend, as remittances are expected to soften due to rising unemployment in source countries, re-emergence of informal channels, and the trade balance is expected to come under pressure from any pick up in domestic demand, recovery in oil prices.
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