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REP-019

PAKISTAN ECONOMY

MARKET VISTA

100bps hike expected in upcoming MPS

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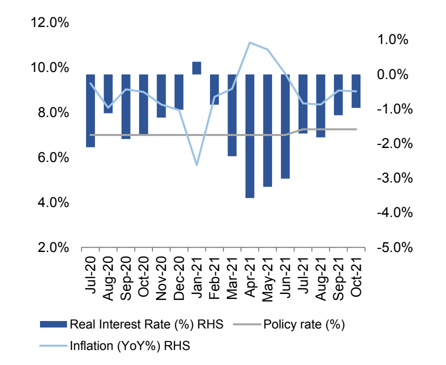
- **In a bid to reduce uncertainty about monetary settings prevailing in the country, the central bank has brought the MPS date forward by a week to 19th Nov'21.**
- **We expect the central bank to raise the benchmark interest rates by 100bps, a text book measure , in confluence with other non conventional measures to curtail consumer demand.**
- **Secondary market yields have already gone up on average by 120bps since the last MPS which also give credence to our forecast. To this end, the yields on 3M, 6M and 12M papers currently stand at 8.52% (up 126bps), 8.89% (up 144bps) and 9.49% (up 75bps).**
- **Real interest rates have been kept negative since Jul'20 as SBP went out of the way to protect economy from the impact of pandemic. However, as the risk of virus subsides, we can expect to witness SBP raising interest rates again, thereby bringing real interest rates in positive territory again.**
- **Market has remained jittery as the lack of clarity regarding the revival of IMF program has kept investor sentiments in check. Consequently the market has shed ~3% in value since Jul'21. We opine that the market has already priced in some of the impact of 100bps hike in interest rates and moving forward, the focus will remain on revival of IMF plan. From the stand point of valuations, every 100bps jump in DR results in valuations coming off by ~6%, however, our valuations already incorporate RF rate of 10%.**

Nominal vs. Real interest rates



Source: PBS, SBP & AKD Research

Interest rate likely to rise by 100bps in the upcoming MPS: Citing a need to bring more clarity regarding monetary settings in the country, the central bank moved forward the official MPS date to 19th Nov'21. We expect SBP to raise the benchmark interest rate by 100bps in the upcoming MPS, thereby taking DR to 8.25%. This will also bring the real interest rates close to ZERO, having stayed in the negative territory for over a year as the country combatted the economic shocks resulting from pandemic outbreak. However, with the risks of pandemic subsiding to a great extent and country experiencing both cost push (booming commodities prices) and demand pull inflation (as reflected by growth in consumer financing which is up 34%YoY as of Sept'21), the unwinding of expansionary monetary policy makes sense.

SBP taking conventional and unconventional measures to curb consumer demand: Boom in consumer financing started creating a stress on external account which had slipped to US$3.4bn in deficit during 1QFY22 as opposed to a surplus of US$865mn SPLY. To this end, imports of consumer items such as cars had jumped by 194% to US$760mn during 1QFY22 which rang alarm bells. SBP intervened by increasing the requirements for bank financing for automobile purchase in order to curb demand but the same hasn't yielded desired results so far as the demand continues to remain robust. Another measure to curtail consumer spending was to increase CRR requirements for banks to 6% (from 5% earlier) which is also unlikely to create much of a dent. However, consumer borrowing is very sensitive to interest rates and a pick up in DR is likely to dampen the growth in consumer financing and thus alleviate pressure on external account.

Inflation risks however likely to persist: With international commodity prices remaining downward sticky, the cost push pressures will continue to remain significant. This in confluence with a weakening PkR (down by ~11% since 1st July) and a likely revision in utility tariffs may likely push inflation in double digits in coming months. Consequently, we may see further hikes in interest rates going forward where we expect FY22 to close with DR at 9.25%.

DR hike to set grounds for a revival in IMF program : Country has historically maintained real interest rates corridor of 250bps to 300bps during the time it has remained under IMF program. Advent of pandemic and a need to protect economy from likely fallouts of the pandemic forced SBP to bring the real interest rates to –ve 1.5%, in line with what we had seen throughout the region and globally. However, with risks of pandemic subsiding we expect normalcy to return, specially as the government strives to strike a deal with IMF over the revival of US$6.0bn sup-

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port program.

Investment perspective: Market has remained jittery as the lack of clarity regarding the revival of IMF program has kept investor sentiments in check. Consequently the market has shed ~3% in value since Jul'21. In our opinion, the market has already priced in 100bps hike in interest rates and moving forward, the focus will remain on revival of IMF plan. From the stand point of valuations, every 100bps jump in DR results in valuations coming off by ~6%, however, our valuations already incorporate RF rate of 10%.

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