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PAKISTAN ECONOMY

MARKET VISTA

Rate hike paves way for Staff Level Agreement

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- **In a move that surprised the market's expectations on the higher side, SBP raised the benchmark interest rates by 150bps. The move marks a structural shift in central bank's policy from stimulating growth to now targeting stabilization amid rising risks emanating on the external account.**
- **The rate hike brings real interest rates closer to ZERO, having stayed well below -2% mark during the pandemic as SBP strived to protect economy from the negative impact of the COVID-19.**
- **With rate hike in the bag, the Pakistan has broadly met all the requirements raised by the IMF paving way for the revival of loan program. To this end, the news of country reaching staff level agreement finally broke this morning, notwithstanding any last minute hiccups, country is expected to receive US$1.1bn and unlocking further funding from other bilateral partners.**
- **A hike of 150bps was higher than our forecast of 100bps and may set ground for further rate hikes in the coming months as focus shifts back to stabilization amid mounting risks to external account and as SBP may look to target mildly positive real interest rates.**
- **Money market yields had already peaked at 9% before the MPS and ordinarily the equity markets may have seen a heavy correction in today's trading session as the news of higher than anticipated rate hike was further compounded by soaring CAD. However, the staff level agreement with IMF is likely to be positively received by the market and may keep downside in check.**

Monetary Policy Announcements

	Stance	Policy Rate
15-May-20	-100bps	8.00%
25-Jun-20	-100bps	7.00%
21-Sep-20	Unchanged	7.00%
23-Nov-20	Unchanged	7.00%
22-Jan-21	Unchanged	7.00%
19-Mar-21	Unchanged	7.00%
28-May-21	Unchanged	7.00%
27-Jul-21	Unchanged	7.00%
20-Sep-21	+25bps	7.25%
19-Nov-21	+150bps	8.75%

Source: SBP & AKD Research

Interest rate hike of 150bps amid rising external risks: After the trading closed on the last working day of the week, the news of central bank raising the policy rate by 150bps to 8.75% broke which surprised our and market consensus on the higher side. The key reason behind the decision were risks of high inflation and current account deficit outpacing expectations. Though the rate hike surprised our estimates, a larger move was largely merited as it aimed at reducing uncertainty in the markets. The growth outlook of 4-5% GDP for FY22 remains largely intact, owing to higher contribution from agriculture sector, however, LSM is expected to slow down owing to the tightening measures and rising input costs. CPI, which has averaged ~8.8% during 4MFY22, faces a risk of slippages amid higher commodity prices and may breach the officially stated SBP target of 7-9%.

CAD starting to get troublesome once again: Soaring CAD may be the other major concern that forced a larger than anticipated hike. To this end, CAD during 4MFY22 has crossed US$5.0bn mark (US$1.66bn in Oct'21) due to significantly higher imports of goods and services owing to soaring global commodity prices. So far, the burden has fallen majorly on the exchange rate as the PKR has depreciated more than 9%FYTD. These adjustments in exchange rates and cost of borrowing may help curtail the consumer demand and may alleviate pressure on CAD, however, will strain the fiscal side. To this end. fiscal deficit moderated to 0.8% of GDP in 1QFY22 compared to 1.1% same period last year, may make the gains short-lived as the cost of debt servicing will again drain fiscal space. However, withdrawal of tax exemptions (still in place on certain essential food and healthcare items), mandated by the IMF as a pre-condition for program resumption may help smoothen the impact somewhat.

Revival of IMF program finally in sight: The news of country reaching a staff level agreement broke earlier today. The agreement is subject to approval by the Executive Board, following the implementation of prior actions (which included SBP's autonomy bill and hike in utility rates, both already achieved) notably on fiscal and institutional reforms. Completion of the review would make available SDR750mn (about US$1.06bn), bringing total disbursements under the EFF to about US$3.03bn and helping unlock significant funding from bilateral and multilateral partners. The news is a welcome boost for the authorities who had been locked in heated nego-

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tiations with the fund over the pace and methods of structural reforms but faced with a pressing need to roll-over the maturing foreign debt.

Investment perspective: Ordinarily, a higher-than-expected increase in policy rate would have dampen the market sentiment, as it made the equity market less of a preferred investment avenue. However, the news of revival of IMF program is likely to lift doom and gloom in the market owing to a hefty jump in interest rates. The jump in interest rates is likely to bring banking sector in the focus again which had underperformed the index by ~5%. We flag UBL, BAFL, MEBL and BAHL as potential outperformers owing to their favorable deposit mix and higher concentration in shorter tenor investments.

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