PAKISTAN
ECONOMY

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MARKET
VISTA

SBP moving interest rate needle by 25bps

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- **In yesterday's meeting, the Monetary Policy Committee (MPC) of the SBP delivered a 25bps hike in policy rate to 7.25% - the third Asian Bank demonstrating the need to begin tapering-off accommodative policies as the country's economic recovery becomes more entrenched (FY22 GDPg forecast at 5%).**
- **The SBP noted that demand-side pressures have become more noticeable since the last MPC where imports have surged 67.7%YoY in 2MFY22 to US$11.4bn, flaring up concerns on external account and resulting in PkRUS$ parity depreciating by 4.6% since last MPC meeting.**
- **The rate increase was against our expectation of Status Quo, where by moving the interest rate needle, the Central Bank has given credence to strong economic performance carrying through in FY22, while suggested gains achieved on external side are likely to remain intact, along with currency consolidating at current levels.**
- **With further monetary policy interventions not being ruled out, we expect return of long-gone interest in Banks where we like mid-plays given their higher exposure to lending arrangements. IMF review would be the key near-term checkpoint for market's performance while we advocate building positions in Techs and Textiles.**

MPC increasing interest rate by 25bps to 7.25%: In yesterday's meeting, the Monetary Policy Committee (MPC) of the SBP delivered a 25bps hike in policy rate to 7.25% - the third Asian Bank demonstrating the need to begin tapering-off accommodative policies as the country's economic recovery becomes more entrenched (FY22 GDPg forecast at 5%) and policies should be focused on sustaining it. The SBP noted that demand-side pressures have become more noticeable since the last MPC where imports have surged 67.7%YoY in 2MFY22 to US$11.4bn, flaring up concerns over repeat of FY18 external account episode and resulting in PkRUS$ parity depreciating by 4.6% since last MPC meeting. However, the pressure on external account from volumetric increase in imports amid stronger commodity prices could not be managed only through adjustment in currency market, hence interest rate hike was considered mandatory to ensure demand-side pressures are not left unchecked. The authorities also signaled macroprudential tightening of consumer finance to moderate demand growth, which along with outturns on fiscal front would be driving factors on which future monetary course be built.

Our take from Monetary Policy announcement: The rate increase was against our expectation of Status Quo, whereby moving the interest rate needle, the Central Bank has given credence to strong economic performance carrying through in FY22 while gradual roll back of accommodative measures by SBP would only lead to a more sustainable growth. Furthermore, it suggested that structural gains achieved in the external account are likely to remain intact as compared to previous cycles when Pakistan pushes for growth, and lastly currency possibly consolidating at current levels in the near term, putting an end to speculative forces at play. On IMF, the Central Bank highlighted that progress is ongoing to achieve positive outcomes in the upcoming review where some headway in structural benchmarks can not be ruled out. Going forward, we do not rule monetary policy interventions in the near term where key variable would be the external account performance. However, seasonal slowdown normally associated with Nov-Feb/Mar could possibly delay such interventions. Real interest rates are likely to remain in negative in the near term as also seen in other markets including developed markets.

Investment perspective: The increase in policy rate is likely to be a non-event for the market where subsidized schemes have already diluted impact of changes in interest rate on profitability. However, it has opened up expectations of future rate hikes which could bring back long-gone interest in Banks where we like mid-plays given their higher exposure to lending arrangements. Overall, we expect market to remain jittery in the near term governed by news flow relating to IMF review where possible pre-actions cannot be ruled out (Govt. is considering to increase gas price by up to 37%). Successful outcome of the same could act as a much needed catalyst for equity performance where we continue to advocate accumulation in Techs and Textiles.

CA Balance

US$bn	Aug'21	Jul'21	MoM (%)	Jan'21-Jun'21 Avg.	%Chg
CA Deficit	(1.48)	(0.81)	81.3%	(0.47)	217.4%
Exports of Goods	2.35	2.25	4.4%	2.30	2.0%
Textiles	1.35	1.36	-0.4%	1.30	4.1%
Non Value	0.26	0.27	-2.7%	0.26	1.6%
Value Added	1.09	1.09	0.1%	1.04	4.7%
Imports of Goods	6.01	5.40	11.3%	5.10	17.8%
Food	0.69	0.59	16.4%	0.66	4.8%
Machinery (Ex. Mobiles)	0.68	0.62	8.8%	0.59	15.3%
Out of which: TERF*	0.22	0.16	37.8%	0.14	52.1%
Petroleum	1.39	1.04	34.2%	0.91	52.9%
Oth. imports**	0.63	0.54	15.5%	0.33	90.2%
Balance on Trade	(3.66)	(3.15)	16.2%	(2.80)	30.8%
Balance on Trade	(0.36)	(0.26)	34.5%	(0.15)	138.8%
Remittances	2.66	2.71	-1.8%	2.54	4.8%
CA % of GDP	-5.4%	-2.9%	-	n.a	-

Source: SBP & AKD Research

*Est. for Jul'21 and Aug'21 based on historical extrapolation of machinery imports

**Imports under economic assistance, deferred payment facilities etc.

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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