

Pakistan Economy

Policy rate likely to increase by 100bps

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Sana Tawfik

D: +92 21 32462589

UAN: +92 21 111 245 111, Ext: 248

F: +92 21 32420742

E: sana.tawfik@arifhabibltd.com

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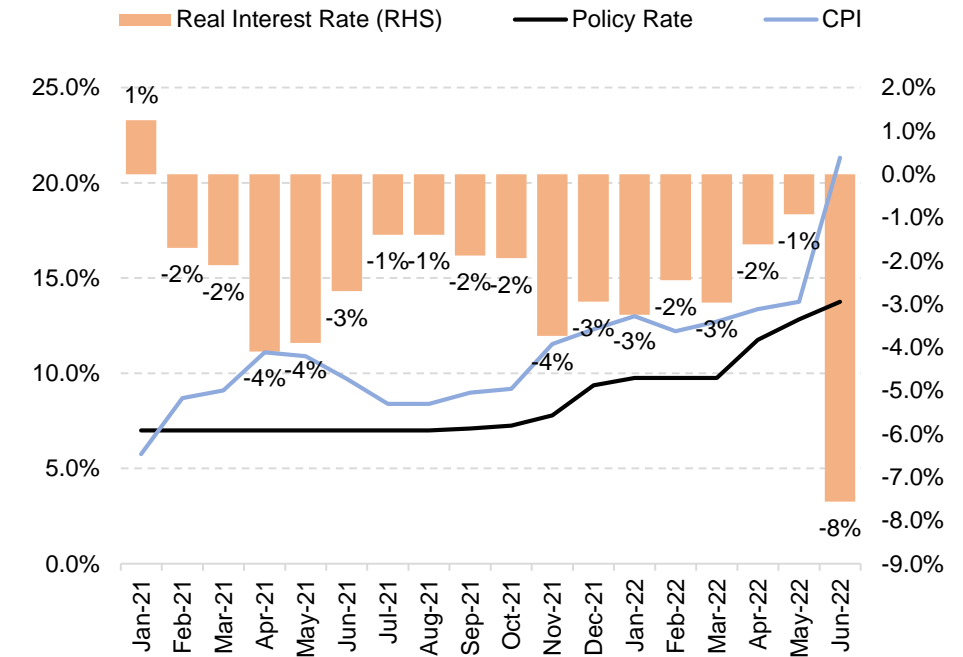
Best Equity Research
Analyst: 2021

Monetary Policy

Policy rate likely to increase by 100bps

- The monetary policy committee of SBP will convene on Thursday (July 07, 2022) to announce the first scheduled monetary policy of FY23. **We expect SBP to increase the policy rate by 100bps to 14.75% in the upcoming monetary policy.** To recall, in the monetary policy meeting held in May'22, the State Bank of Pakistan (SBP) increased the benchmark policy rate by 150bps to 13.75% (highest since Jun'11 – 14%). The MPC stated that it believed since the last monetary policy meeting held in Apr'22, growth projection appeared stronger than earlier estimates. Whereas risks to external stability remained elevated and the outlook for inflation deteriorated led by domestic and international factors. Therefore, this policy response is expected to help moderate demand.
- **Other possible measures:** In addition to policy rate hike, the MPC might also take further actions to anchor inflation expectations and maintain external account stability. These include:
 - An increase in the interest rate on the export finance scheme (EFS) and long term financing facility (LTFF) loans and;
 - Implementation of linking of these rates to the policy rate, as decided in the last (May'22) MPS, and observe adjustment thereafter, while remaining below the policy rate so as to incentivize exports.

Exhibit: Real Interest Rate



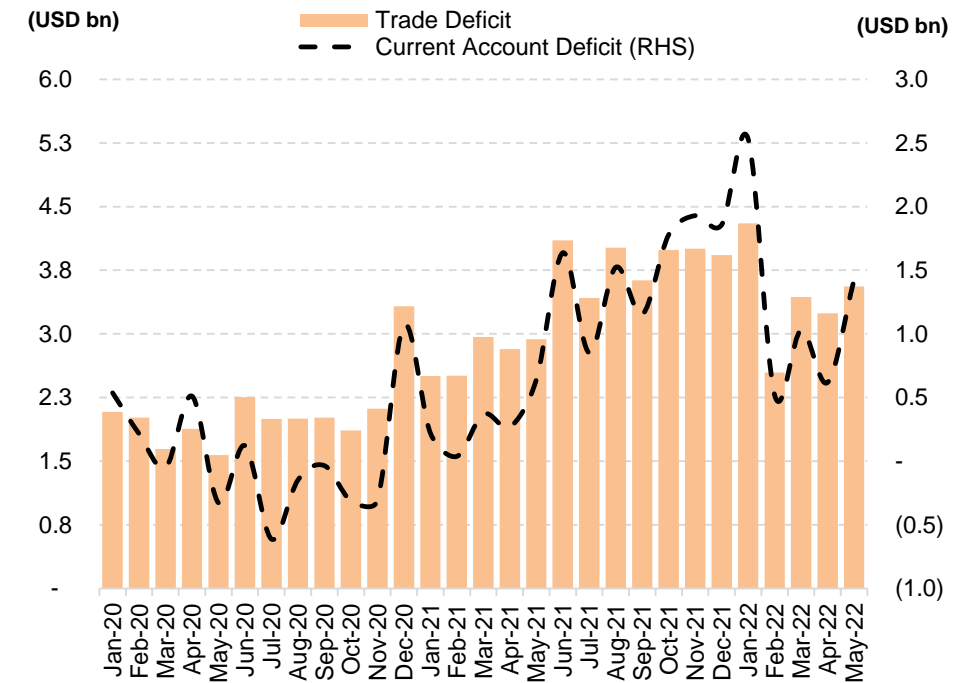
Source (s): SBP, PBS, AHL Research

Monetary Policy

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- On the inflationary front, the headline inflation continues to remain in the double digit since Nov'21 mainly on the back of uptick in food and energy prices. In the month of Jun'22, headline inflation touched 13-year high of 21.3%, taking FY22 average to 12.1%. This phenomenon of higher headline inflation is likely to continue in the near term with pressure mainly emanating from higher commodity prices, rolling back of subsidies, budgetary measures taken by the fiscal authorities and low base effect. Moreover, the global inflationary reading has also witnessed exacerbation led by the ongoing Russia-Ukraine conflict and as a result, central banks across the world now face multi-year high inflation and ensuing challenges.
- A few other developments in the economy such as the ones on the external account, are likely to be taken into consideration while deciding the policy rate. Pakistan posted a CAD of USD 1.4bn for the month of May'22, up 123% YoY. With this, during 11MFY22, country's deficit reached to USD 15.2bn compared with deficit of USD 1.2bn during same period last year. This huge jump in CAD was led by 48% YoY increase in trade deficit during the period. Another major concern on the external front remains the SBP reserve position which stands at USD 10.3bn as of 24th Jun'22, resulting in depreciation of currency (-16% against the greenback CY22TD).

Exhibit: Current Account Balance and Trade Deficit



Source (s): SBP, AHL Research

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Money Market yields up: Meanwhile, if we look at the shape of the yield curve to extrapolate markets' expectations for monetary policy, we see a jump in the yields since last monetary policy of May'22. The yield on the treasury bills of 3M, 6M and 12M in the secondary market, since last (May'22) MPS, are up 40ps, 55bps and 79bps (respectively) clocking-in at 14.50%, 14.62% and 14.65% (respectively). It can be assumed that expectation of further increase in inflation leading to a rate hike has pushed yields higher.

AHL Survey Poll Results:

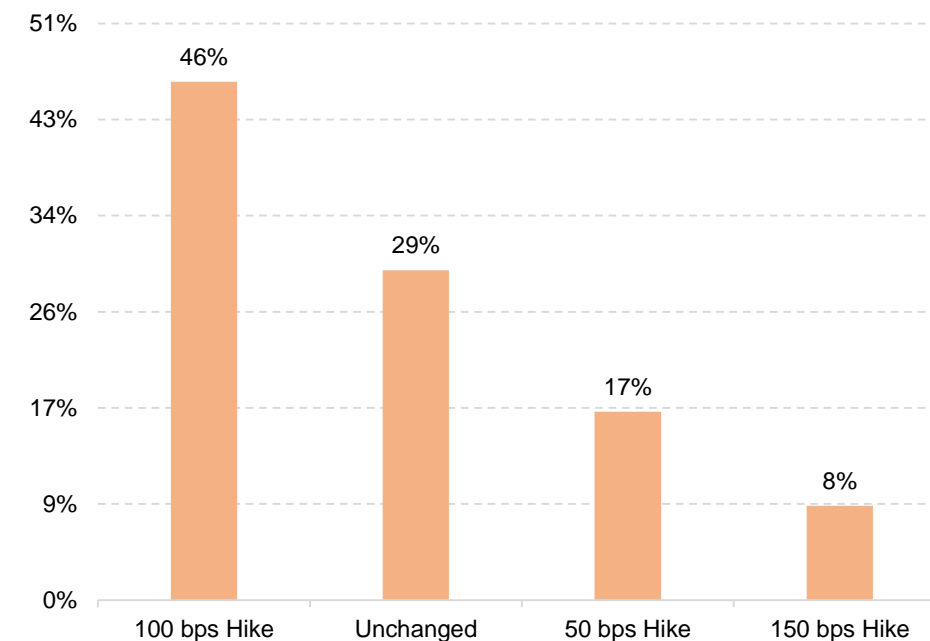
In order to find out what the market is expecting in the upcoming monetary policy to be held on 07-Jul-22, we conducted a survey (poll) taking feedback from various sectors. Our respondents belong to sectors such as:

- Financial services: Banks, AMCs, Insurance, and DFIs
- Non Financial Services/Manufacturing: E&Ps, Cements, Fertilizers, Steel, Textiles and Pharmaceuticals.

Following are the results of the survey (poll):

- 71% of the total respondents are of the view that the SBP will increase the policy rate in Jul-22's MPS while 29% eyeing no change.
- Of the 71% respondents expecting a hike: 46% (majority) is anticipating a rate hike of 100 bps, 17% expect a rate hike of 50 bps, 8% expect a rate hike of 150 bps.

Exhibit: AHL Survey Poll Results

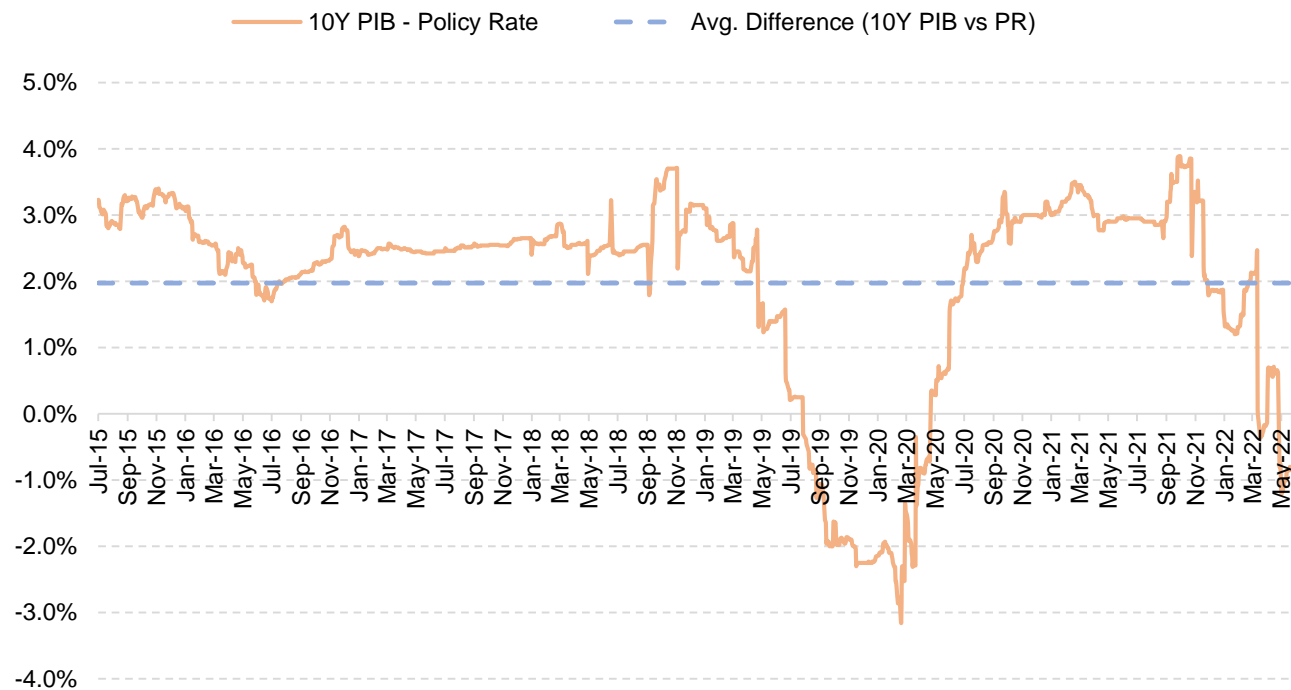


Source (s): AHL Research

Monetary Policy

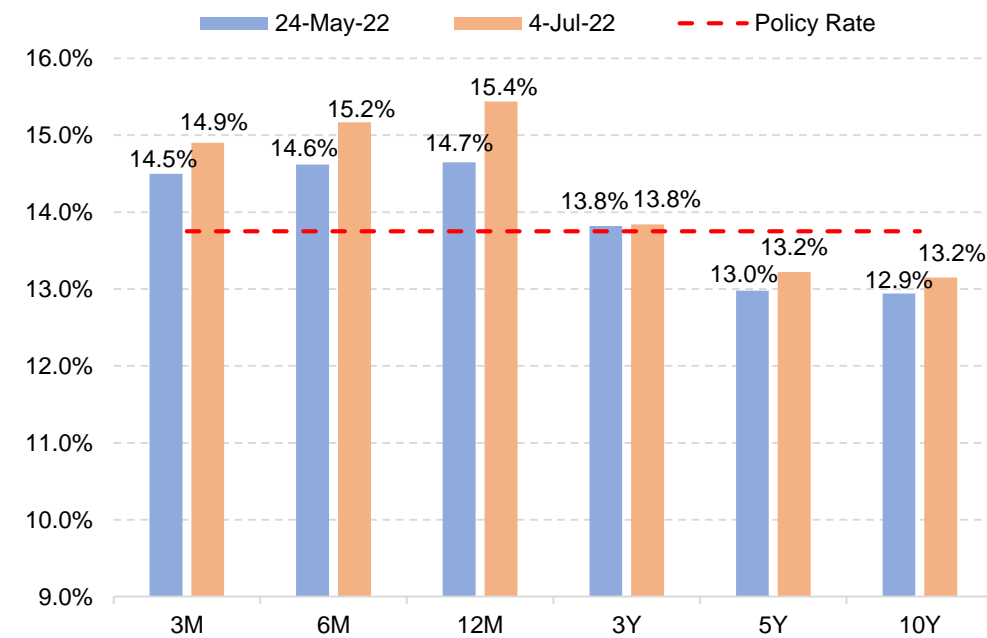
Policy Rate vs. Money Market Yields

Exhibit: Historical Difference between 10Y PIB and Policy Rate



Source (s): Bloomberg, SBP, AHL Research

Exhibit: Policy Rate vs Primary market Yields



Source (s): Bloomberg, AHL Research

Monetary Policy

Interest rates on Incentive Schemes vs. Policy Rate

Exhibit: Structure of Interest Rates

Date	Policy Rate	Export Finance Scheme Rate	LTFF: 03Y >= Time Period	LTFF: 03Y < Time Period <= 05Y	LTFF: 05Y < Time Period <= 10Y
25-May-15	6.50%	6.00%	7.50%	7.50%	7.50%
14-Sep-15	6.00%	4.50%	6.00%	6.00%	6.00%
23-May-16	5.75%	4.50%	6.00%	6.00%	6.00%
29-Jan-18	6.00%	3.00%	6.00%	6.00%	6.00%
28-May-18	6.50%	3.00%	6.00%	6.00%	6.00%
16-Jul-18	7.50%	3.00%	6.00%	6.00%	6.00%
1-Oct-18	8.50%	3.00%	6.00%	6.00%	6.00%
3-Dec-18	10.00%	3.00%	6.00%	6.00%	6.00%
1-Feb-19	10.25%	3.00%	6.00%	6.00%	6.00%
1-Apr-19	10.75%	3.00%	6.00%	6.00%	6.00%
21-May-19	12.25%	3.00%	6.00%	6.00%	6.00%
17-Jul-19	13.25%	3.00%	6.00%	6.00%	6.00%
18-Mar-20	12.50%	3.00%	6.00%	6.00%	6.00%
25-Mar-20	11.00%	3.00%	6.00%	6.00%	6.00%
16-Apr-20	9.00%	3.00%	6.00%	6.00%	6.00%
17-Apr-20	9.00%	3.00%	6.00%	6.00%	6.00%
16-May-20	8.00%	3.00%	6.00%	6.00%	6.00%
18-May-20	8.00%	3.00%	6.00%	6.00%	6.00%
26-Jun-20	7.00%	3.00%	6.00%	6.00%	6.00%
21-Sep-21	7.25%	3.00%	5.00%	5.00%	5.00%
22-Nov-21	8.75%	3.00%	5.00%	5.00%	5.00%
15-Dec-21	9.75%	3.00%	5.00%	5.00%	5.00%
8-Apr-22	12.25%	5.50%	5.00%	5.00%	5.00%
24-May-22	13.75%	7.50%	7.00%	7.00%	7.00%

Source (s): SBP, AHL Research

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