MONETARY POLICY

Tough times call for tough measures—SBP increases Policy Rate by 150bps

Friday, November 19, 2021

- **MPC of the State Bank of Pakistan (SBP) raised policy rate by 150bps to 8.75% in its meeting held today against market consensus of around 100bps with the Central Bank stressing on ominous risks pertaining to inflation and balance of payments.**
- **Note that, this hike comes in addition to the two major moves made by the State Bank earlier this week which included a 100bps increase in Cash Reserve Requirement held by banks to 6% and preponing of the said MPC by 7 days as uncertainty was becoming more visible with pressure growing on the external account, inflation exceeding said targets and delay in the ongoing IMF review.**
- **The Central bank highlighted that now the focus has shifted away from growth and more towards arresting inflation and CAD. The economy is showing signs of overheating and swift action was needed otherwise external pressures would have trickled down to FX reserves.**
- **It is pertinent to note that the regulator did not share any forward looking guidance with regards to inflation outlook while stating that international commodity prices alongside upwards adjustment in energy tariffs pose potent threats to their initial estimate of 7-9% for FY22.**
- **In the light of ~USD 5.1Bn current account deficit reported in 4MFY22, the SBP opines revised forecast for FY22 would be mildly higher than previous expectation of 2-3% of GDP.**
- **Today's move will likely result in moderating the pace of industrial growth to a certain extent however, promising numbers from agriculture will likely keep the growth target of 4-5% intact for FY22.**
- **In light of the above, we maintain our liking for relatively better positioned sectors like Banks, E&Ps, Fertilizers, Textile and Technology while recommending a move away from high beta, leveraged and cyclical plays.**

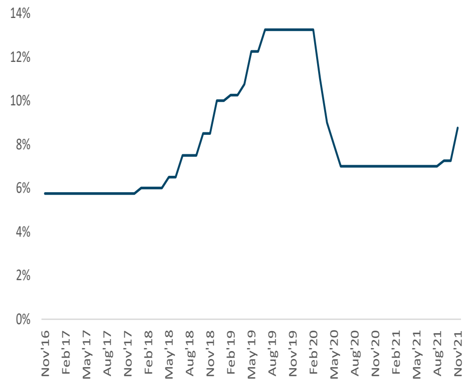
Big move addresses concerns for now: The Central Bank believes that this move has allowed them to arrest the worsening situation to a large extent for now and they will continue to monitor developments both locally and internationally over the next few weeks before the next meeting scheduled to take place on December 14th, 2021.

Surging CAD putting the PKR under pressure: The Central Bank further highlighted that high international commodity prices coupled with surging domestic demand have resulted in higher than expected increase in inflation previously anticipated to range between 7-9%. The same two factors have translated into concern on the Current Account front which has come under pressure over the last couple of months (USD 1.1/1.7Bn in Sep/Oct 2021) which in turn has led to the PKR losing another 3.4% against the USD since the last MPC.

Increasing CRR to gauge money supply growth: Recent 100bps hike in CRR to 6% serves as a tool to slightly slow down money supply growth which has surpassed expectations of late. Furthermore, it is expected to promote a culture of savings and resultantly a slowdown in domestic demand that has surged past pre-Covid levels.

What can be expected going forward? We believe, today's hike has addressed the situation for the time being and moving forward, any rate hikes hereon will be milder and depend on how external factors play out over the next few months. External pressures persist on the back of strong demand and high commodity prices which are expected to remain elevated in the near term, hence we expect CAD to range between USD 12-14Bn in FY22.The Central Bank continues to highlight that they see moderately positive real interest rates over the next 12 months.

Chart 1: Policy Rate history



Source: SBP, BMA Research

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Buy	>15% expected total return
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*Total stock return = capital gain + dividend yield	

Old rating system

Overweight	Total sector return > expected market return
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