PAKISTAN ECONOMIC RESEARCH

Economy In Focus

MONETARY POLICY

No surprises this time around as SBP jacks up Policy Rate by 100bps

Tuesday, December 14, 2021

- **Monetary Policy Committee of the SBP increased Policy Rate by 100bps to 9.75% in the session held today largely in line with market expectations. The Central bank cited combating inflation and ensuring durable growth as the primary reasons behind the move.**
- **Contrary to the previous MPS, the State Bank clearly highlighted that with this move, their ultimate objective of maintaining mildly positive interest rates seems in sight with monetary tools largely expected to remain stable in the near term.**
- **The Central Bank also revised upwards their previous expectations with regards to inflation and Current Account Deficit (CAD) which now stand at 9-11% and 4% of GDP (USD 13Bn) from 7-9% and 2-3% of GDP respectively.**
- **The State Bank also expressed comfort over the forecasted CAD (4% of GDP) and with bridging the shortfall through external inflows (IMF releases, SDR allocation, financing from multilateral & bilateral sources) without pressure weighing down on forex reserves.**
- **The State Bank also addressed concerns with regards to delays in the IMF program with the regulator highlighting that the program remains well on track with the Government working on the prior action (roll-back of exemptions, SBP autonomy etc.) to be taken on its part before the Executive Board Meeting.**
- **From the market's point of view, we believe today's outcome is a welcome sign for the investors as we opine recent lackluster performance on the local bourse had largely incorporated the rate hike.**
- **We reiterate our liking for value driven, high yielding & low P/E sectors (Banks, E&Ps, Fertilizers & Textiles) while remaining cautious on high beta, cyclical and leveraged plays.**

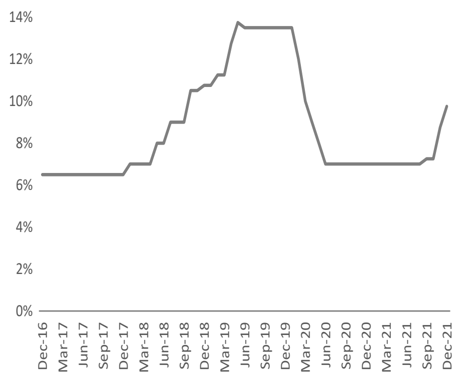
CAD to remain at elevated levels in the near term but ease off going forward: The State Bank believes that pressure on the external account is expected to continue to build in the near term but mellow down following the turn of the year as global commodity prices ease off aided by subsiding demand from the domestic end. The regulator highlighted that ~70% of the surge in imports to be attributable to high commodity prices while the remainder to be driven by robust domestic demand.

Fiscal tightening to facilitate monetary policy stance: The MPC further pointed out that measures being taken on the fiscal side will ease their target of arresting CAD by way of roll-back of previously provided tax exemptions and curtailment in public expenditures which will likely have a knock on effect on domestic demand.

GDP growth target remains intact at 4-5%: In spite of the monetary tightening stance, the SBP stuck to its FY22 GDP growth target of 4-5% with the Central Bank noting that while the actions taken to date might pull the plug on LSM growth to a certain extent, healthy contributions from the agriculture and service sectors will continue to support their initial view.

What can be expected going forward? Though, we agree that with the past two rate hikes cumulating to 250bps, the Central Bank has arrested the worsening external situation at hand to a large extent, we still believe international commodity prices could dictate monetary policy action going forward. We might well be peaking in terms of interest rates and hence no major spike is expected hereon however, we do recommend a cautious stance as monetary policy stance will likely be dependent on how the external account plays out over the next few months.

Chart 1: Policy Rate history



Source: SBP, BMA Research

Abdul Rehman Siddiqui
Deputy Head of Research
Tel: 111-262-111 ext. 2056
E-mail: abdul.rehman@bmacapital.com

BMA Capital Management Ltd.

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Buy	>15% expected total return
Hold	10%-15% expected total return
Underperform	<10% expected total return
*Total stock return = capital gain + dividend yield	

Old rating system

Overweight	Total sector return > expected market return
Marketweight	Expected market return
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