MONETARY POLICY

SBP jacks up Policy Rate by another 125bps on the back of inflation concerns

Thursday, July 7, 2022

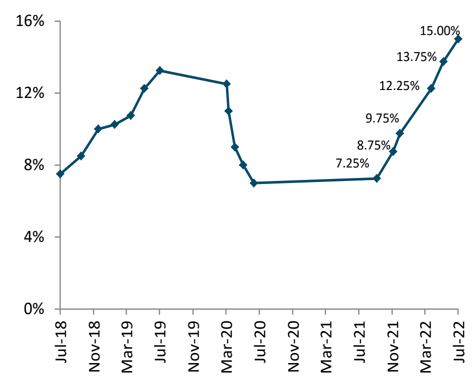
- **The MPC, in its meeting held today increased Policy rate by another 125bps to pull it to 15%, last seen post the 2008 global financial crisis. The decision was primarily based on multi-year high inflation readings (Jun-22 CPI: 21.3%), which are expected to remain at elevated levels for the next fiscal year.**
- **The SBP committee cited that FY23 will be a year of consolidation where a mix of fiscal and monetary tools will be used to dampen demand, increase tax collection, reduce the import bill and ease off pressure building on the PKR.**
- **The committee expects inflation to average at around 18-20% in FY23 where we can expect moderation from the second half of the fiscal year before declining sharply to 5-7% towards the end of FY24.**
- **GDP growth targets have been trimmed slightly from 3.5-4.5% to 3-4% compared to ~6% in FY22 to make it more sustainable going forward.**
- **The MPC shared optimism with regards to successful resumption of the IMF program and highlighted that the harder part (reversals of energy subsidies and approval of the Federal Budget) of getting the program back on the track has been completed. The committee expects Staff Level Agreement to be reached in the next few weeks.**
- **As for fiscal, the MPC expects a strong comeback in FY23 and forecasts a surplus of 0.2% of GDP on the back of improved tax collection against 2.4% deficit noted in FY22. While for CAD, the committee expects it to slow down to 3% of GDP in FY23.**
- **In the light of the above developments, we recommend a low risk investment strategy with primary exposure in cash rich, low-beta and high yielding scrips in the Banks, E&P's and Fertilizers space while shying away from high beta, leveraged and cyclical plays.**

Inflation continues to be the main concern: MPC cited expectations of high teens average inflation in FY23 to be the main reason behind the 125bps rate hike. SBP was of the view that global economic conditions continue to remain dynamic and multi-decade high commodity prices will dictate inflation readings going forward. The move is aimed at moderating domestic growth which has now surpassed pre-Covid levels and consistent ~6% annual GDP growth in the previous two fiscal years is not sustainable for Pakistan as it leads to inflationary pressures, high import bill and PKR devaluation. SBP expects a combination of fiscal consolidation and monetary tightening tools to address the situation alongside support from exports and remittances flow. On the brighter side, the SBP expects inflation readings to come off drastically from the next fiscal year to a more sustainable rate of 5-7%.

Staff Level Agreement with the IMF is not a long way off: The committee reiterated that IMF negotiations have been progressing fruitfully and major adjustments which included the roll-back of energy subsidies and modifications to the Federal Budget have been addressed. Hence, the regulator expects Staff Level Agreement to be reached soon which will pave the way for inflows from other bilateral/multilateral/commercial sources, which will not only help in bridging the external funding gap but also shore up forex reserves.

SBP's take on the PKR: Apart from the monetary action taken by the SBP to stabilize the PKR, the MPC expects fiscal surplus on the back of improved tax collection, reduced energy imports as domestic demand tapers off and support from both exports & remittances flow to strengthen the PKR going forward.

Chart 1: Policy Rate history



Source: SBP, BMA Research

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Buy	>15% expected total return
Hold	10%-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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