PAKISTAN ECONOMIC RESEARCH

Economy In Focus

CAPITAL

MONETARY POLICY

SBP keeps Policy rate on hold but revises down growth estimates and jacks up inflation forecasts

Monday, October 10, 2022

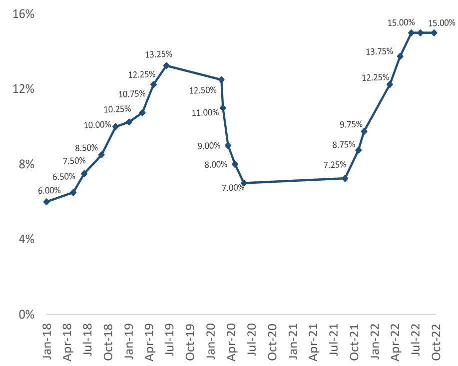
- **The SBP maintained policy rate at 15% for the second time running on the back of slowing economic activity, softer headline inflation and easing Current Account Deficit (CAD).**
- **The MPC preserved its CAD forecast at 3% of GDP while citing that the adverse impact of higher imports (wheat, cotton etc.) to be nullified by softer domestic demand and cooling global commodity prices.**
- **GDP forecast, however was trimmed to 2% compared to earlier expectation of 3-4%, in the light of flash floods across the country that are particularly expected to hamper agricultural output.**
- **As for inflation, the MPC upwards adjusted its earlier estimate of 18-20% in the wake of supply side pressures arising from availability of essential items and also revision in energy prices/tariffs.**
- **The SBP remained confident of bridging the yawning external funding gap which stands at over USD 30Bn for the fiscal year and reaffirmed available financing of USD 37Bn. The SBP also noted that the country has thus far made international payments of USD 4.6Bn in FY23 and hence there stands no risk of being unable to honor its short term commitments.**
- **The SBP expects to receive ~USD 4.0Bn from multilateral/bilateral sources for budgetary support/flood assistance by the end of the calendar year including ADB, AIIB, UN & WB with the funds from ADB expected to materialize by the end of the month.**
- **In the light of today's announcement and recent developments related to PKR performance against the USD, peaking inflation and shrinking trade deficit, we reiterate our stance that interest rates have peaked.**
- **Going forward, we can expect softer inflation readings (hinging upon the outcome of floods), stable PKR and easing external concerns to pave the way for market performance and improve investor sentiment. We remain overweight in Banks, E&P's, Cements, Fertilizers and IT.**

CPI forecast revised upwards while GDP estimates are slashed: The MPC revised down its earlier forecast of 3-4% GDP growth in FY23 to only 2% on the back of flash floods across the country and easing domestic demand. Earlier, the MPC was expecting agriculture sector to undergo a 3.1% YoY accretion however, that is set to be hampered by above expected monsoon rains particularly in Sindh and Punjab that have seriously impacted major crops including cotton and wheat. Similarly, the MPC jacked up its earlier expected inflation target of 18-20% in the wake of supply side pressures however, no target was provided as the impacts are still being evaluated.

Reaffirming debt sustainability: The MPC once again calmed nerves with questions arising about the country's weak forex reserves position citing available funding of USD 37Bn against a requirement of ~USD 31Bn. The SBP also assured that assistance of ~USD 4Bn is expected to be received by the end of the calendar year while the central bank has made external payments of USD 4.6Bn in 1QFY23 thus downplaying any ifs and buts about the country's financial health.

Market vantage point: As for performance of the local bourse, we do not see today's decision to spark excitement as status quo was largely expected. However, two consecutive MPC meetings that led to an unchanged policy rate seem to be good omen for the market. We can expect things to improve on the economic front from here on as inflation eases further, PKR maintains its strong hold and trade numbers consolidate however, flag that the external funding will continue to be of fundamental importance and earlier fruition of external assistance will further boost investor confidence.

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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