PAKISTAN ECONOMIC RESEARCH

Economy In Focus

BMA CAPITAL

MONETARY POLICY

SBP hikes policy rate by 100 bps to 16% citing inflationary pressures & external account concerns

Friday, November 25, 2022

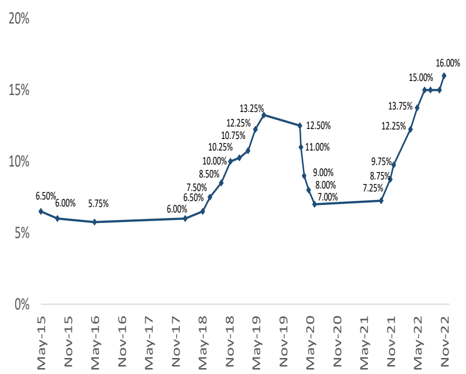
- **In a surprise move, the MPC of the SBP raised policy rate by 100bps to 16% against the broader consensus of status quo. The SBP cited three primary reasons behind the hike which included 1) sharp increase in inflation in Oct'22 (26.6% YoY; 4.7% MoM), 2) challenging external account position and 3) upward revision in inflation forecast to 21-23% for FY23 from 18-20%.**
- **The SBP highlighted that this was a pre-emptive move to keep core inflation which has escalated sharply due to surge in food and energy prices in check before it further steepens pressure on the PKR or the external account.**
- **Though inflation targets were upwards revised, growth and CAD targets were maintained at 2% and 3% of GDP respectively.**
- **SBP noted that remittances flow has taken a hit due to rising cost of living in the Middle East while widening exchange rate gap between official and unofficial channels and normalization of travel have also played a part. The SBP expects remittances to remain largely flat compared to the previous fiscal year.**
- **With regards to the external funding gap, the SBP maintained that they are in the process of making payments as they fall due and USD 1.8Bn have been retired in Nov'22 alone. Loans to the tune of USD 7Bn have been rolled over so far and talks are ongoing for a few others as well. Bond issuances maturing in the near term will be paid in full and as they fall due.**
- **The SBP further stated that USD 500Mn from the AIIB will likely be received in the coming week while it awaits inflows from other multilateral/bilateral sources to shore up foreign reserves.**
- **Though cotton and rice output will be severely hampered by the recent floods, wheat sowing has been better than expected thus cushioning the impact on agriculture growth to a certain extent.**
- **We expect this development to ease domestic demand further and cushion the PKR slightly however, external account pressures, high inflation and faltering growth numbers will likely keep index performance in check.**

SBP cites rising core inflation as the main reason behind the 100bps hike: The SBP linked 100bps hike in policy rate primarily to sharp increase in core inflation that has been severely impacted by runaway food and energy price inflation. The SBP hinted that this was a pre-emptive measure to control the situation before it worsens any further. Resultantly, forecast for inflation in FY23 was revised up to 21-23% from previous estimates of 18-20%. Furthermore, the external side continues to remain a challenge despite the welcome decline in CAD as inflows from multilateral/bilateral sources have not fully materialized thus pinning down reserves and mounting pressure on the PKR.

Managing flows to avoid pressure on forex reserves: In addition to the ~USD 4.6Bn repayment made in 1QFY23, the SBP stated that repayments of USD 1.8Bn have been made in the ongoing month. The SBP is managing foreign currency inflows and outflows to maintain adequate level of reserves going forward and highlighted that USD 7Bn have already been rolled over while further roll-overs are being discussed. It further pointed out that arrangements are in place for the upcoming international Sukuk bond maturity of USD 1Bn which becomes due in the first week of December.

Market vantage point: As repeatedly highlighted, external account and runaway inflation continue to remain primary concerns for the economy and timely flows of external assistance are fundamental to restore some confidence. Though the market multiples remain cheap and fundamentals are sound, record interest rates will likely result in a shuffle between asset classes as debt becomes more attractive and hence keep equity market performance in check. Exposures should be maintained in high-yielding, defensive and dollar friendly stocks while shying away from high beta plays and cyclicals.

Chart 1: Policy Rate history



Source: SBP, BMA Research

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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
Underweight	Total stock return < expected market return

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)