MONETARY POLICY

SBP jacks up policy rate by a further 300bps with the optimism that forward-looking real rates have turned positive

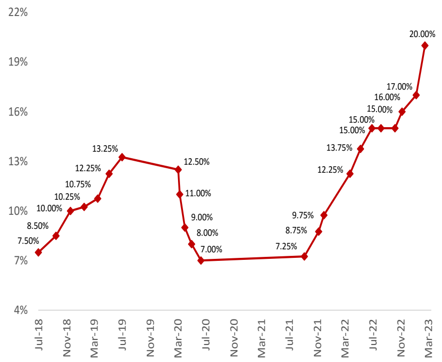
Friday, March 3, 2023

- **To little surprise, MPC of the SBP jacked up policy rate by a sizable 300bps to 20%. Note that secondary market yields had already incorporated an increase of almost the same amount and recent money market auctions were also indicative of the same.**
- **Interestingly, the MPC remained adamant despite the weak forex reserves position and upwelling external account obligations that the country is not seeking any sort of re-profiling/restructuring of external debt with its multilateral/ bilateral partners and will honor all commitments as they fall due.**
- **The SBP highlighted that of the total USD 23Bn external financing (ex-CAD) requirement for FY23, USD 15.8Bn has been settled (USD 9.8Bn repayment + USD 6.0Bn rollover) while the remaining USD 7.2Bn will be sorted in coming months.**
- **In line with the direction given by the SBP in the previous meetings, containing inflation is the top priority and the move is aimed to further dampen demand amidst a flurry of cost push factors that have escalated the recent readings.**
- **The SBP reiterated that the opportunity cost of short term policy action was lower compared to the longer-term and interestingly, it opines that recent measures have pushed real interest rates to positive territory on a forward-looking basis.**
- **Without emphasizing on the GDP forecast for the current fiscal or the revised Current Account Deficit (CAD) target, the SBP only shed light on CPI inflation whereby the MPC upwards adjusted its target to 27-29% from 21-23% in Nov'22.**
- **The MPC noted that recent runaway inflation readings have been in part a resultant of recently adopted fiscal measures which included upwards adjustment in energy tariffs, increased duty imposition and addition GST alongside slashed subsidies.**
- **Going forward, the MPC highlighted that near term economic challenges require a mix of corrective fiscal and monetary action and fiscal slippages will need to be contained in order to realize the benefit of monetary tightening.**
- **Given this development and the bleak near-term macroeconomic outlook, we expect index performance to remain range-bound however, successful resumption of the IMF program could bring some excitement. Until then, we recommend a 'play it safe' strategy with exposures in high yielding, low-beta and mature sectors. We prefer Banks, E&P's, Fertilizer and Power.**

Inflation outlook worsens; expected to increase further in the next few months: Inflation surged to 31.5% YoY in Feb'23 and the SBP expects the upcoming months to be even more challenging as the delayed impact of the recently adopted fiscal measures flows through. In this backdrop, annual targets were revised up to 27-29% for FY23 from 21-23% previously. It is important to note that core-inflation surged to 17.1% & 21.5% YoY in urban and rural areas respectively thereby re-emphasizing that it would take a good 24-30 months before settling to its longer-term SBP defined range of 5-7%.

The external account conundrum: The SBP remained adamant that the committee is not considering any sort of re-profiling/restructuring with any of its bilateral/ multilateral partners despite the precariously weak reserve position and upwelling external financing requirements. They in fact were optimistic that the current situation will improve as the IMF program resumes. As for debt servicing to date, the SBP confirmed that USD 15.8Bn have been settled so far by way of repayments of USD 9.8Bn and rollovers of USD 6.0Bn. The remainder (USD 7.2Bn) is to be settled in the remaining months of the fiscal of which the SBP expects further rollovers of USD 3.0Bn and refinancing of USD 1.3Bn thus implying an adjusted outflow of only USD 2.9Bn. Though on the outset it seems manageable as the IMF program resumes however, piling rollovers will only add to the huge ~USD 25Bn external financing requirements in the upcoming year and an extended period of stifled CAD particularly the imports which will likely hamper growth going forward. In this backdrop, earliest resumption of the IMF program and inflows from multilateral/bilateral partners are imperative.

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
Marketweight	Expected market return
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