CAPITAL

MONETARY POLICY

Lower than expected increase of 100bps to be welcomed by the market

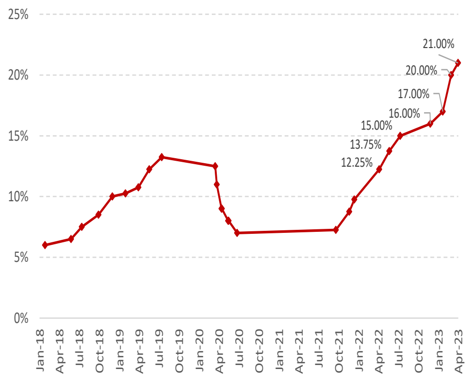
Wednesday, April 5, 2023

- **The MPC of the SBP raised policy rate by a further 100bps to 21% in its meeting held yesterday. The adjustment is lower than market consensus of an up to 200bps increase which we believe will be welcomed by the market participants.**
- **The increase was primarily owed to the high recent inflation readings which are expected to remain elevated in the short term. However, there were hints that inflation particularly NFNE (currently at 20%) will hit a tipping point in the coming months.**
- **The SBP noted that total repayments due in the 4Q stand at USD 4.5Bn of which USD 2.3Bn is expected to be rolled over while net outflow will only be USD 2.2Bn. Out of the total expected outflow of USD 2.2Bn, only USD 100Mn pertains to commercial lending while the rest is owed to multilateral/bilateral partners.**
- **Fiscal deficit which stands at 2.3% of GDP in 7MFY23 has improved compared to last year (2.8%) and the primary balance is in surplus (1.1%) against a deficit (0.3%) in the SPLY. However, economic slowdown and restrictive imports are expected to keep tax revenues in check. Though recent amendments in the Finance Bill will provide some cushion.**
- **The MPC expects forex reserves (currently at USD 4.2Bn) to jack up to USD 10Bn by the end of the fiscal as the SLA with IMF is signed thereby unlocking other multilateral and bilateral flows.**
- **Restricted imports have kept the CAD at manageable levels and the MPC expects to close the year with a shortfall of less than USD 6Bn. Expectation of higher CAD in 4Q is on the back of easing imports flow.**
- **The lagged impact of recent policy decisions has started to materialize and is reflective in the LSM readings that have contracted by 4.4% YoY in 7MFY23. The readings would moderate further as the cumulative impact of the 400bps increase in the past 4 weeks flows through.**
- **We opine lower than expected rate hike will be cheered by the market in the short term however, the elusive IMF SLA and the ongoing political noise will keep gains limited. Highly leveraged companies could be targeted for short term gains though for the longer term, we maintain a defensive investment strategy.**

Real rates have turned positive on a forward looking basis: In line with the guidance shared by SBP, we opine the recent two rate hikes cumulating to 400bps have pushed real rates to positive trajectory. That said, with the high base effect kicking in from Jun'23, inflation readings are expected to top out in Apr/May'23 thereby allowing the MPC to adopt a softer monetary stance in the future. However, resumption of the long delayed IMF program, fiscal imbalances and political developments need to be closely monitored in the near term and could pose potent threats to monetary policy setting going forward.

Pulling along for now but IMF program revival is imperative: Given the asset/liability matching strategy adopted by the SBP in the recent months, we believe the USD 2.2Bn foreign repayments due in the running quarter will not be much of a concern. However, earliest resumption of the IMF program is imperative to bring back waning confidence in the economy and to ease pressure on the PKR. Though, almost all major IMF highlighted prerequisites have been completed by the govt., foreign commitments are yet to be received and the upcoming PM/FM visit to the Middle East will be of fundamental importance in this regard. Any concrete inflows as a result could give the country some breathing space in the short term however, structural reforms and the need for a bigger and possibly longer IMF program will hold the key for any sort of economic revival.

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
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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
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)
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