REN # REP-004 REN # REP-400R

ECONOMY

MPC Review

Pakistan Research

Economy: MPC sticks to status quo on susceptible inflation outlook

The Monetary Policy Committee held its bi-monthly meeting wherein it decided to hold the status quo for the sixth consecutive time to bring down inflation to its target range of 5-7% by Sep-25. The verdict was primarily based on unanchored inflation expectations, emanating from i) upward adjustments in energy prices, ii) IMF warranted fiscal measures and iii) enhanced volatility in global oil markets. However, looking ahead i) agriculture-led recovery in GDP growth, ii) containment of the Current A/c Deficit, iii) consolidation of fiscal position and iv) a maintenance of FX buffers despite weak inflows bear promising signs as per the MPC.

Tight stance crucial to guide inflation towards targets

To recall, SBP had revised its NCPI forecast upwards from 20-22% YoY to 23-25% YoY for FY24 on the back of substantial electricity/gas price adjustments. Semiannual gas tariff adjustments as warranted by IMF coupled with a higher FCA reading in Mar-24 are likely to further slow the pace of disinflation through second round effects. These developments have kept inflation expectations elevated for both consumers and businesses. We highlight that unanchored inflation expectations coupled with a cautious stance by major central banks in advanced and emerging economies, was a crucial factor in guiding SBP's decision to keep the policy rate unchanged.

Recovery in GDP growth; no change in projection

GDP forecast is estimated to fall between 2.0-3.0% YoY for FY24 mainly due to higher agricultural output emanating from favorable weather conditions. A strong rice and cotton crop is likely to be followed up by the wheat harvest due to better input conditions and favorable output prices. Moreover, the MPC expects LSM to recover in the upcoming months due to higher capacity utilization and employment conditions, complemented by a low base effect. We expect, these developments to have a positive spill over on the services sector as well.

CAD likely to fall on lower band of 0.5-1.5% of GDP forecast

On the external front, CAD continues to remain in check mainly due to (i) lagged impact of PKR depreciation which continues to moderate import demand, (ii) lower int'l commodity prices, (iii) improved domestic supply conditions and iv) recovery in food & textile exports. To recall, CA remained relatively balanced (USD -269mn) in Jan-24, taking the 7MFY24 CAD to USD 1.1bn (-71.2% YoY). The CA was also backed by the flow of remittances which have been rising on a YoY basis since Oct-23. The MPC stated that the CAD is likely to remain in the lower bound of its forecast of 0.5-1.5% of GDP for FY24 which would further support the FX reserves position.

Sustained fiscal consolidation to complement the tight monetary stance

The MPC highlighted that the fiscal position has considerably improved in 1HFY24 on the back of increasing primary surplus from 1.1% of GDP (1HFY23) to 1.7% of GDP (1HFY24). The improved position was mainly driven by a 2.2x increase in non-tax revenue and contained non-interest spending.

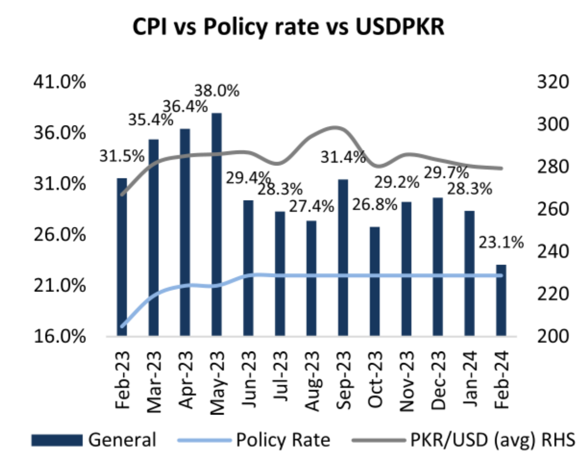
Contracting currency in circulation could alleviate demand side pressures

The growth in broad money (M2) moderated to 16.1% YoY in Feb-24, down from 17.8% YoY last month mainly due to decelerating growth in net domestic assets of the banking system emanating from a decline in private sector credit and commodity finance operations. Additionally, the MPC noted that the growth in reserve money decelerated to 8.2% YoY in Feb-24, down from 10.4% YoY last month and that the CiC continued its downward trajectory. Given the consumption driven nature of our economy, these trends in monetary aggregates are positive developments for the inflation trajectory.

Outlook

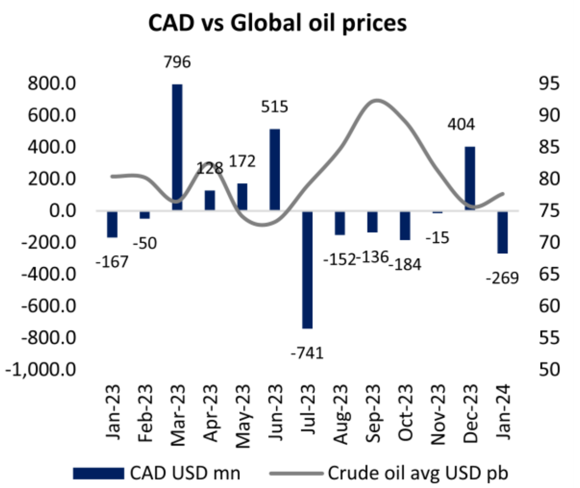
Looking ahead, the MPC highlighted that adjustments in administered energy prices are likely to drive further inflationary pressures through direct and indirect effects in the short and medium term. In addition, continued fiscal prudence and meeting targeted fiscal consolidation has been emphasized as imperative for alleviating inflationary pressures and ensuring overall macroeconomic stability. On upside risks to inflation, the MPC views the implementation of new fiscal measures could exert upward pressure on NCPI.

Stable currency and tight monetary stance key to reaching long-term inflation targets



Source: PBS, Akseer Research

Lower oil prices compared to CY22 assisted in restraining CAD



Source: SBP, World Bank, Akseer Research

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