20 September 2021

Economy

Monetary Policy

Alfa Adhi Securities REN # REP-004

AKSEER RESEARCH REN # REP-400R

Pakistan Research

Sept-21 MPS: Policy Rate up by 25 bps to 7.25%

- **The SBP, initiating the tapering of the stimulus provided to the COVID-19 affected economy, reversed the interest rate cycle and increased the Policy Rate by 25bps to 7.25% in its Sept-21 Monetary Policy (MP) decision.**
- **The central bank cited noticeable surge in the domestic demand coupled with higher international commodity prices leading to a strong pickup in import bill and resultantly burgeoning current account deficit as reasons behind the contractionary cycle.**
- **Inflationary pressures to reemerge later in the current fiscal year on the back of rising demand pressures. In the preceding months, the committee was optimistic that inflation would settle at the upper end of the targeted range of 7-9%.**
- **The MPS's future guidance remains 'accommodative' in the near term with a possibility of achieving positive real interest rates over time. The rebalancing could be easily achieved by slightly narrowing significant monetary stimulus provided last year.**

Policy Rate increased to 7.25% after maintaining status quo for 6 meetings

The SBP, tapering the economic stimulus, in its today's Monetary Policy meeting increased policy rate by 25bps to 7.25%. The pace of economic recovery has exceeded expectations and turned the output gap positive (+0.1% of GDP) for the first time since FY18 when it was 0.6% of the GDP. The central bank also does not foresee any further risk on economic recovery from pandemic related uncertainty as earlier the bank viewed fourth wave of COVID-19 posing a downside pressure on the economic recovery.

Current Account Balance (CAB), a cause of concern

With a strong economic pickup, the country's current account deficit also skyrocketed to USD 2.3bn during the 2MFY22 as against a surplus of USD 838mn in the same period last year. Import bill touched USD 11.4bn, +68% YoY, whereas the exports grew at a lesser pace of 35% YoY to USD 4.6bn in 2MFY22. Remittances, though up 10% YoY to USD 5.4bn could not support the foreign currency quantum required cover the import bill and led to PKR depreciation of 7.1% FY22 to date.

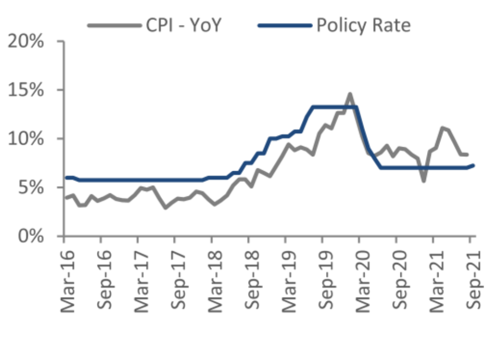
Inflationary pressures to persist

Despite a little slowdown in inflation surge where 2MFY22 CPI grew 8.4% YoY largely on the back of increase in food basket prices and supply-side shocks, the rising demand along with higher commodity and energy prices will likely keep the inflation elevated in the remaining current fiscal year. Earlier in the last meeting, central bank estimated the average CPI will settle in the upper end range of 7-9%.

MPS to be accommodative with mild tapering

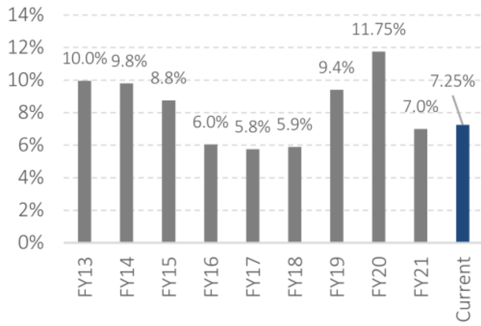
The stimulus led economic growth has gradually started entering the sustainable growth phase, evident from the SBP's Economic Activity Index (comprising of cement, POL, autos and fertilizers sales). Hence, a macroprudential tightening is necessary to modest demand growth as part of the move towards gradually normalizing monetary conditions. The MPS's future guidance remains 'accommodative' in the near term with a possibility of achieving positive real interest rates over time.

Chart–1: Policy Rate vs CPI inflation



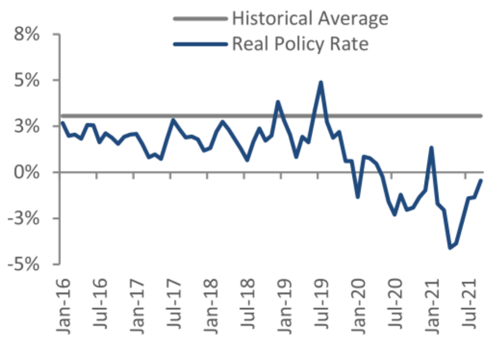
Source: PBS, SBP, Akseer Research

Chart–2: Policy rate



Source: SBP, Akseer Research

Chart–3: Real Interest Rate



Source: PBS, Akseer Research

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To arrive at our 12-months Price Target, the JV uses different valuation methods which include: 1). DCF methodology, 2). Relative valuation methodology, and 3). Asset-based valuation methodology.

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Buy	Greater than or equal to +15%
Hold	Between -5% and +15%
Sell	Less than or equal to -5%

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