Policy rate raised by 100bps amid inflationary Pressures

Economy

April 5, 2023

Pakistan Equities
Economy

Key Points

- The Monetary Policy Committee (MPC) of the SBP has decided to increase the policy rate further by 100bps bringing the CY23TD and cumulative increase since Sep'21 to 500bps and 1,400bps, respectively.
- Despite improving current account deficits amid import containment, external debt servicing is the key challenge that has been eroding SBP's FX reserves.
- During 4QFY23, USD4.5bn is to be repaid to external creditors out of which, USD2.2bn are expected to be rolled over.
- SBP has completed all prior actions of the IMF and an early completion of the 9th review of the IMF EFF would help in bringing SBP's FX reserves to USD10bn by the end of FY23.
- Anchoring inflation expectations is cited as the major reason for the recent policy decision by the MPC, which expects inflation plateauing, albeit at elevated levels.
- MPC expects achieving its medium term inflation target of 5%-7% over the next 8 quarters where real interest rates on a forward looking basis are in positive territory with uncertainties on global financial conditions and local political environment posing risks.
- We expect inflation readings to start coming down from Jun'23 due to a high base effect making forward looking real interest rates positive then, which we believe are currently in the negative territory.

Policy Rate increased by another 100bps to 21%

In its meeting yesterday (April 4th, 2023) the Monetary Policy Committee (MPC) of the SBP decided to increase the policy rate further by 100bps to 21%, an increase of 400bps in just over a month's time, which was reportedly a requirement of the IMF. To recall, since the initiation of a tightening monetary stance in Sep'21 after a steep recovery of growth from the slowdown during the COVID-19 pandemic, the MPC has cumulatively increased the policy rate by 1,400bps from 7%. While the recent hike will shift the interest rate corridor 100bps upwards (20%-22%) along with the minimum deposit rate on Savings Deposits (19.5%), rates on Export Refinance Schemes and Long Term Financing Facility have also increased to 18%. Despite significant improvements in Current Account of the Balance of Payments, and slowdown in economic activities, the MPC emphasized anchoring inflation expectations around the medium term target (5%-7%), as the key objective for the decision taken. The rate hike by MPC was lower than the general market expectations as reported in various surveys majority of which were expecting 200bps increase.

MPC sees inflation plateauing with positive real interest rates

Reading for Mar'23 NCPI inflation was at 35.4% compared to 31.2% of the previous month and 12.7% of the same month last year. Average inflation for 9MFY23 stood at 27.3% compared to 10.8% of the same period last year. While food inflation continued to increase in Mar'23, NFNE inflation in urban/rural centers further increased to 18.6%/23.1% compared to 17.1%/21.5% of the previous month. MPC believes that inflation is expected to plateau, albeit at elevated levels going forward. The MPC believes that the current monetary policy settings will help in achieving the medium term inflation target over the next 8 quarters (around 3QFY25), as it estimates that real interest rates on a 12-month forward looking basis have turned positive. However, uncertainties on global financial conditions and domestic political environment pose risks to this assessment.

Slowdown in economic activities

With LSM output down by 4.4% in 7MFY23, MPC noted that incoming data on economic activity continues to reflect a broad-based slow down, along with significant decline in sales volumes of automobiles, petroleum products and cement, and electricity generation. With these factors and the lagged impacts of monetary tightening and fiscal measures recently implemented, MPC believes that FY23 growth will be significantly lower than the post-floods assessment of 2% in Nov'22.

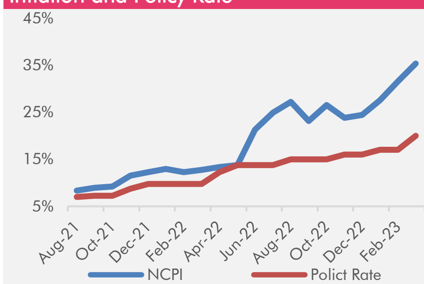
External Account and IMF

Despite a significant improvement in the Current Account mainly due to import containment with FX reserves at critically low levels, higher external debt repayments are maintaining pressure on FX reserves. As per the SBP, out of the total external debt servicing requirements of USD23bn at the start of FY23, majority have been either repaid, rolled over or refinanced. For 4QFY23 a total of USD4.5bn needs to be repaid to external creditors, out of which, USD2.2bn is expected to be rolled over. SBP further highlighted that all prior actions have already been taken by the SBP and an early conclusion of the 9th review would help in bringing SBP's FX reserves to USD10bn by the end of FY23.

Key Data	
KSE100 Index	39,687
KSE-All Share Value (PKRmn)	2,187
KSE-All Share Value (USDmn)	7.6
KSE-All Share Volume (Shmn)	83.3
Market Capitalization (PKRtn)	6.1
Market Capitalization (USDbn)	21.1
1Year High	46,970
1 Year Low	38,136

Source: PSX, Next Research

Inflation and Policy Rate



Source: PBS, SBP, Next Research

Shahab Farooq
+92-21-35222204
shahab.farooq@nextcapital.com.pk

Outlook

With tight global liquidity position and low credit rating of Pakistan, accessing global capital markets is very difficult. With very limited options left with Pakistan for build-up of FX reserves, resuming the IMF program as soon as possible along with steps towards restructuring of external debt including the G20 Common Framework for Debt Treatment, for medium term sustainability are very critical. As far as inflation and interest rates are concerned, based on our estimates of 12-month forward inflation from Apr'23, real interest rates are still in the negative territory. However, as a result of a high base effect, inflation reading for Jun'23 is expected to come down by around 700bps making real interest rates positive on a forward looking basis then. We estimate FY23 average inflation at 29%. With risks of persistent food and energy inflation, impacts of fiscal measures recently implemented along with their chain impacts, and depreciating local currency, inflation for FY24 is also expected to remain at elevated levels while coming down from average for FY23. We expect interest rates to remain stable during the rest of CY23.

Analyst Certification, Disclosures & Contacts

Analyst Certification

All of the views expressed in this report accurately reflect the personal views of the responsible analyst(s) about any and all of the subject securities or issuers. No part of the compensation of the responsible analyst(s) named herein is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the responsible analyst(s) in this report.

Disclaimer

This information and opinion contained in this report have been compiled by our research department from sources believed by it to be reliable and in good faith, but no representation or warranty, express or implied, is made as to their accuracy, completeness or correctness. All opinions and estimates contained in the document constitute the department's judgment as of the date of this document and are subject to change without notice and are provided in good faith but without legal responsibility.

This report is not, and should not be construed as, an offer to sell or a solicitation of an offer to buy any securities. Next Capital Limited (the company) or persons connected with it may from time to time have an investment banking or other relationship, including but not limited to, the participation or investment in commercial banking transactions (including loans) with some or all of the issuers mentioned therein, either for their own account or the ac- count of their customers. Persons connected with the company may provide or have provided corporate finance and other services to the issuer of the securities mentioned herein, including the issuance of options on securities mentioned herein or any related investment and may make a purchase and/or sale, or offer to make a purchase and/or sale of the securities or any related investment from time to time in the open market or otherwise, in each case either as principal or agent.

This report may contain forward looking statements which are often but not always identified by the use of words such as "anticipate", "believe", "estimate", "intend", "plan", "expect", "forecast", "predict" and "project" and statements that an event or result "may", "will", "can", "should", "could" or "might" occur or be achieved and other similar expressions. Such forward looking statements are based on assumptions made and information currently available to us and are subject to certain risks and uncertainties that could cause the actual results to differ materially from those expressed in any forward looking statements. Readers are cautioned not to place undue relevance on these forward looking statements. NCEL expressly disclaims any obligation to update or revise any such forward looking statements to reflect new information, events or circumstances after the date of this publication or to reflect the occurrence of unanticipated events.

Next Capital Limited, its respective affiliate companies, associates, directors and/or employees may have investments in securities or derivatives of securities of companies mentioned in this report, and may make investment decisions that are inconsistent with the views expressed in this report.

Rating System

Next Capital Limited employs a three tier rating system depending upon sector's proposed weight in the portfolio as compared to sectors weight in KSE-100 index, as follows:

Rating	Sector's proposed weight in the portfolio
Over Weight	> Weight in KSE 100 index
Market Weight	= Weight in KSE 100 Index
Under Weight	< Weight in KSE 100 Index

Next Capital Limited also employs a three tier rating system, depending upon expected total return (R) of the stock, as follows:

Rating	Expected Total Return
Buy	R ≥ 15%
Neutral	0% ≥ R < 15%
Sell	R < 0%

Where;
R = Expected Dividend Yield + Expected Capital Gain
R' is before tax
Investment horizon is between six months to twelve months

Ratings are updated regularly based on the latest developments in the economy/sector/company, changes in stock prices, and changes in analyst's assumptions.

Karachi Head Office
2nd Floor Imperial Court Building,
Dr. Ziauddin Ahmed Road,
Karachi75530 , Pakistan

☏: +92-21-111-639-825
🖶: +92-21-35632321

Lahore Office
63-A, Agora Eden City
DHA Phase VIII,
Lahore, Pakistan

☏: +92-42-37135843-8
🖶: +92-42-37135840

Research
☏: 92-21-111-639-825 (Ext:109, 129)
✉: research@nextcapital.com.pk

Sales and Trading
☏: 92-21-111-639-825 (Ext: 106)
✉: equitysales@nextcapital.com.pk

Corporate Finance & Advisory
☏: 92-21-111-639-825 (Ext: 131)
✉: cf@nextcapital.com.pk

www.nextcapital.com.pk