Day Break

Monday, 25 January 2021

Economy

Monetary Policy Statement

Rate Hike Delayed Until Economy Finds its Firm Footing

- The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement for the next two months on Friday 22nd January, 2021 kept rate 'unchanged'
- Both growth and inflation outlook remain favourable
- Monetary policy to remain unchanged in the near term as SBP wait for economy recovery to become more durable and the economy returns to full capacity. Moreover, potential adjustments if necessary will be done on much 'gradual' way to achieve positive real interest rates.
- Going forward we expect inflation to stay upbeat in coming months but we do not expect a rate hike anytime sooner, and SBP will remain accommodative in it policy making.

Status quo maintained

The State Bank of Pakistan (SBP) in its latest Monetary Policy Statement (MPS) announcement for the next two months on Friday 22nd January, 2021 kept rate '**unchanged**'.

The decision is in-line with market participants, with majority expecting an unchanged status.

Amid favourable growth and inflation outlook

The press release (Link) on monetary policy; highlighted favourable growth and inflation outlook amid recent key data from Nov-20. Having said that, SBP remained cognizant over uncertainties surrounding Covid19 pandemic mainly as elevated global cases, emergence of new strain of Covid19, and finally the roll-out of vaccine globally. Hence SBP felt the need to provide forward guidance on monetary policy.

- Monetary policy to remain unchanged in the near term as SBP wait for economy recovery to become more durable and the economy returns to full capacity.
- Moreover, potential adjustments if necessary will be done on much 'gradual' way to achieve positive real interest rates.

Outlook and Recommendation

Looking ahead in 2021, we view SBP is likely to carry on this new path of policymaking, overlooking inflation and facilitating the government in much needed fiscal space, by keeping the monetary policy accommodative if not ultra-accommodative. A change in policy, we think, is most likely to come around if there is a visible downplay shift in Covid19 pandemic or the output is back to pre-Covid19 levels (similar to SBP statement), leading to possible emergence of risks of over-heating.

However, this scenario seems unlikely to come by anytime soon but pressure from rising inflation will build-in which may influence tightening temptations. Hence, we are of the view that SBP will continue to keep policy rate unchanged at current level of 7% at least till the remainder of FY21 (consensus 50-150bps increase)

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and is likely make the first move of 50- 100bps to 7.5-8.0% starting Sept-21 (1qFY22) onwards.

Exhibit: Monetary Policy Statement key extracts and outlook

	Outlook	Segment	Comments
Inflation	**SBP's projection for average inflation remained broadly unchanged at 7-9%** for Fy21 and medium-term range of 5-7%.		Inflation expectations of both businesses and consumers remain well-anchored and have declined in recent months. As a result, at this stage of the recovery, any further supply-side shocks from food or utility tariffs are unlikely to have a lasting inflationary impact through second-round effects.
Interest Rates	**Rates to remain unchanged in near-term**	Real-rates	Financial conditions remain appropriately accommodative at this early stage of the recovery, with the real policy rate in slightly negative territory on a forward-looking basis. As the recovery becomes more durable and the economy returns to full capacity, the MPC expects any adjustments in the policy rate to be measured and gradual to achieve mildly positive real interest rates.
Real Sector	**Growth projected to surpass 2% target in FY21**	Agricultural	Cotton output is likely to decline, however growth in major crops owing to higher wheat production (WSP), subsidies on fertilisers and pesticides for Rabi crops will to an extent make up for it.
		Large Scale Manufacturing (LSM)	LSM grew by 14.5%y/y in Nov-20 and 12 out of 15 subsectors registering positive growth in November and employment beginning to recover. The level of manufacturing activity generally remained below average levels in FY19, pointing to continued spare capacity in the economy.
		Private Sector Credit	Private Sector Credit is driven by a continued rise in consumer and fixed investment loans on the back of SBP's refinance facilities. On the outlook, as demand recovers and inventories fall in some sectors, working capital loans have also picked up for the first time since the onset of the Covid pandemic, although their level remains lower than last year
External Accounts	**C/a FY21 projected >-1% of the GDP**	Current Account Balance	Recovery in exports and remittances have more than make up for imports growth, keeping the c/a balance in surplus. On the outlook current account deficit is projected to remain below 1 percent of GDP for FY21.
Fiscal Sector	**Achieving revenue targets looks possible**	Revenue	Healthy growth in revenues (Driven by a rebound in direct taxes and the sales tax) has contained the fiscal deficit during the fiscal year so far.

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