Day Break

Monday, 24 July 2017

Economy

Exhibit: Inflation and policy rate

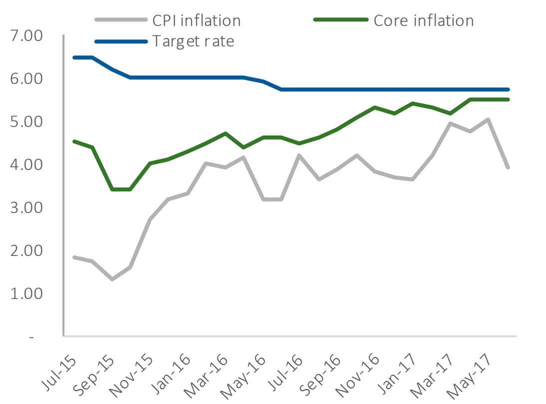


Exhibit: External Account (USDbn)

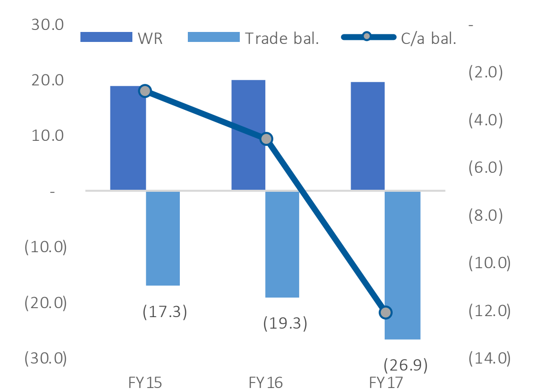
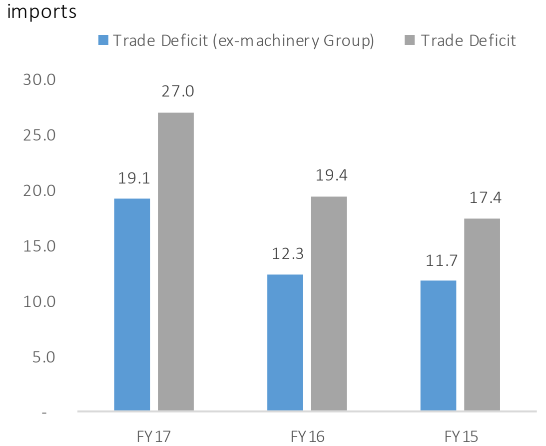


Exhibit: Widening trade deficit with and without machinery imports



Source: Bloomberg, KSE 100 & IGI Research

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Monetary Policy Statement

Status quo maintained and likely to continue in near-term

- In the recently announced monetary policy statement, the State Bank of Pakistan (SBP) maintained the status quo stance, keeping policy rate at 5.75% and discount rate at 6.25%.
- With no major oil price increase foreseen and better supply conditions likely to continue in FY18 onwards, SBP projects headline CPI inflation to range bound 4.5–5.5%.
- SBP highlighted growth momentum picking up pace, with 11MFY17 large scale manufacturing (LSM) growth of +5.7% compared to a growth of +3.4% in FY16.
- Stability of balance of payment and subsequent build-up in country's FX reserves is mainly dependent upon timely foreign financial inflows.

Monetary Policy Statement: Status Quo Maintained

In the recently announced monetary policy statement, the State Bank of Pakistan (SBP) maintained the status quo stance, keeping policy rate at 5.75% and discount rate at 6.25%. SBP highlighted key parameter outlook including Inflation, External account and Real sector. Gauging from the SBP language, monetary tightening seems rather improbable in the near future. However, SBP highlights timely foreign inflows would be crucial in keeping external account outlook manageable.

Benign outlook on CPI

On inflation, SBP pointed out the subdued nature of price level during FY17 with CPI clocking in at +3.9%; despite rising pressure on domestic demand as indicated by core inflation printing a growth of +5.5% during the year. The central bank cited favorable supply conditions during the year along with lower oil prices as a key reason for anchoring down inflation. With no major oil price increase foreseen and better supply conditions likely to continue in FY18 onwards, SBP projects headline CPI inflation to range bound 4.5–5.5%.

Growth momentum of real sector to continue

SBP highlighted growth momentum picking up pace, with 11MFY17 large scale manufacturing (LSM) growth of +5.7% compared to a growth of +3.4% in FY16. More encouragingly, SBP identifies gross fixed investment as a percentage of GDP has increased to 14.2% from 13.9% in FY15. As a result, domestic demand is likely to stay upbeat in FY18 going forward, keeping the current credit growth trend intact.

Market liquidity noted for its ability to absorb credit uptick

On supply side factors, market liquidity was commended for its ability to service the uptick in private sector credit, wherein, due to improving economic activity, rising bank deposits and easy monetary policy, private sector credit flows posited a decade high figure of PKR 748bn or +16.8%YoY growth compared to +11.2%YoY recorded in FY16. Henceforth, improving supply conditions would be well able to cater rising demand; anchoring down overall inflation expectations.

External sector challenges to poise risks to stability

Commenting on the external sector, SBP highlighted USD 12.1bn current account (C/a) deficit is mainly a factor of rising machinery imports both for CPEC and non-CPEC energy/infra projects, while some pressure was also added due to government announcement of textile sectors export package. However, the central bank noted that the decline in exports has bottomed out and a reversal is in sight given positive global growth outlook and improving international trade. On the other hand, imports are expected to continue their rising trend, though at a slower pace, on account of continuing CEPC related projects. State of remittances remain undecided due to subdued growth in middle east region. Henceforth, stability of balance of payment and subsequent build-up in country's FX reserves is mainly dependent upon timely foreign financial inflows.

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