

Economy

Monetary Policy Statement

Monetary Policy to Remain 'Accommodative'; Expecting A Status Quo

- The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) for the next two months on Friday 22nd January, 2021. We expect policy rate to remain unchanged at current level of 7.0%.
- Monthly inflation has started to descend with the latest numbers in Dec-20, showing a trend break; down by 0.7% m/m since Apr-20 thanks a swift decline in food prices (food prices down by 2.1% m/m).
- 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 its policy making.

Status quo expected in upcoming monetary policy announcement

The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) for the next two months on Friday 22nd January, 2021.

We expect policy rate to remain unchanged at current level of 7.0%. As per market survey, 75-80% respondents maintain an 'unchanged' view on upcoming monetary policy whereas a less than 10-15% were of the view of a 'hike' and less than 5% view policy rate 'cut' in upcoming monetary policy decision.

Looking at Dec-20 numbers, inflation seems to have moderated

Monthly inflation has started to descend with the latest numbers in Dec-20, showing a trend break; down by 0.7% m/m since Apr-20 thanks a swift decline in food prices (food prices down by 2.1% m/m). Moreover on a y/y basis, Dec-20 inflation came down to nearly a 21-mth low; +7.97% (last Feb-19; 6.8%).

Real Interest rate are slightly higher than SBP comfort zone

Rates adjusted for 3m forward inflation (CPI: +7.9%e) as for now remains slightly out of SBP comfort target of 0%, at negative 0.9%. This in upcoming months is likely to get even more uncomfortable topping at 2.0-2.5% by Mar-20 onwards.

Industrial growth has picked pace post Covid19

Domestic industrial demand has so far responded sharply to form a 'V' shape recovery. In months leading up to Nov-20, key consumer spending leading indicators, Auto, Cements and OMC sales are showing up promising growth numbers. The Large-scale Manufacturing (LSM) index by November is up by nearly +14.5%, suggesting a reduced drag on overall economy.

Credit growth however remain relatively stuck

However, credit growth still remain anaemic. Despite the monetary easing, SBP loan restructuring/deferred incentives and government fiscal relief packages, by Nov-20, overall credit to private sector business stood at PKR 6.02trn which roughly equally to Feb-20 outstanding balance.

Outlook: Inflation to stay upbeat in coming months

Going forward we expect inflation to stay upbeat in coming months, owing to electricity tariff revision, rising trend in international commodity prices, and moreover with recent c/a deficit of USD 0.6bn for the month of Dec-20 will start putting pressure on PKR/USD parity going forward.

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But poses less chances of rate hike anytime sooner

In FY21 SBP has set an inflation target of 7-9%, with lower bound range based on ‘absence of demand pressure’, and our assumption is close to SBP range at 8.8%. While admittedly inflation is likely to settle in the said range of SBP, but given the recent demand come back and along with it non-food inflation the possibility of further rate cut seems far-fetched idea as of now. Having said that we also do not expect a rate hike anytime sooner, and SBP will remain accommodative in its policy making.

Exhibit: Policy Rate

Policy rate slashed by 625bps in 2020

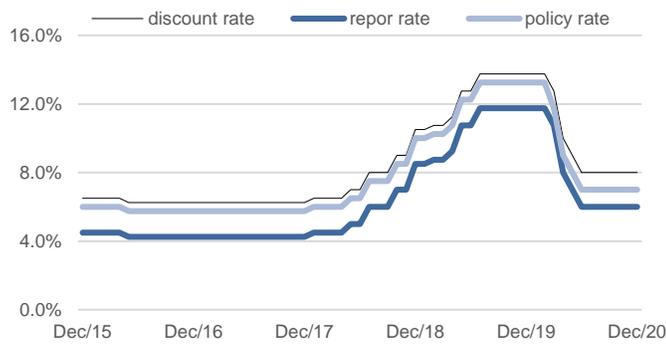


Exhibit: Monthly inflation and Real rate

Monthly Inflation (national) depicted an 8% y/y growth in Dec-20 down from a high of 14.6% in Jan-20

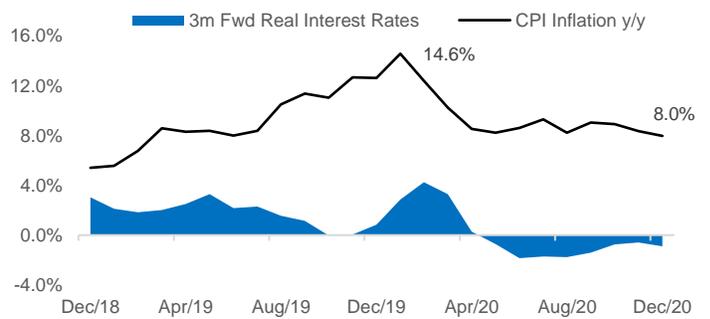


Exhibit: Global Commodity prices

Global Commodity prices in up-cycle

S&P GSCI
INDEXSP: SPGSCI

433.27 +0.94 (0.22%) ↑
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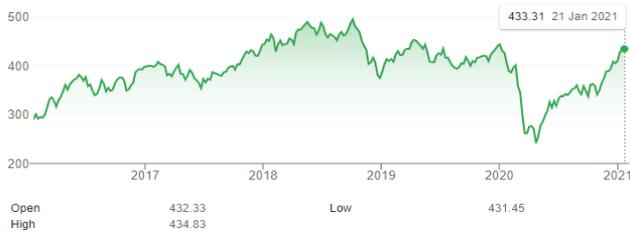


Exhibit: Yield Curve

From a yield curve inversion in Jan-20, to yield curve have started to incorporate rate hike, with LT 10yr bond now at 10%

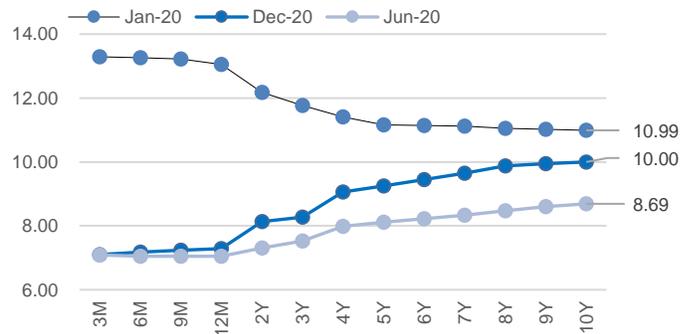


Exhibit: Credit to Private Sector

Private sector credit on 3m trailing basis have shown little or no movement, with Nov-20 outstanding credit up by +2% y/y to PKR 6.0trn (~13% of the GDP)

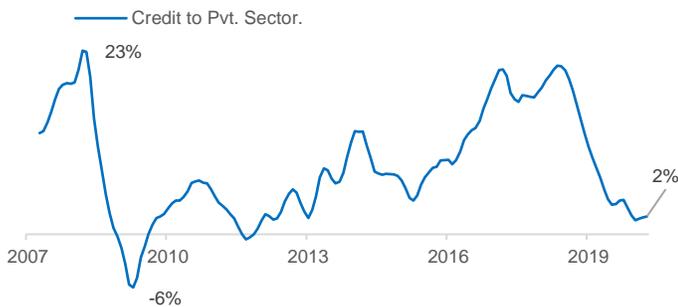
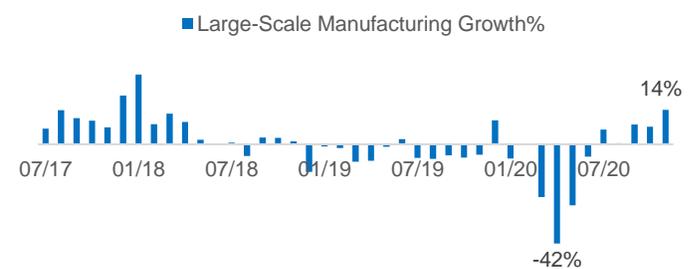


Exhibit: Large-Scale Manufacturing

Promising start of Covid19 recovery, Nov-20 LSM index up by 14%



Source: SBP, PBS, IGI Research

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