Day Break

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Economy

SBP Cuts Interest Rate by 150bps to 20.5%

- In the latest Monetary Policy Announcement (link) the State Bank of Pakistan (SBP) decided to reduce policy rate by 150bps to 20.5%. This is the first rate cut since Jun-20. The Committee noted that inflationary pressures continue to subside amid tight monetary policy and fiscal consolidation. This has led to moderation in core inflation. MPC also assessed the budgetary measure and uncertainty regarding energy price adjustments and its impact on inflation outlook. Considering these factors, MPC viewed that it was appropriate to cut interest rates as real rates remain significantly positive, which is critical to guide inflation to medium term target of 5-7%.
- The Committee noted that few key developments since last MPC meeting which include subdued recovery in industry and services sector partly offset by strong growth in agriculture leading to moderate growth of 2.4% in FY24 as per provisional data. Moreover, significant reduction in C/a deficit has helped improve FX reserves despite large debt repayments and official outflows with likely new IMF program to further strengthen FX reserves.
- In our view, SBP is likely to further monitor impact of budgetary measures and energy price adjustments before deciding on Policy Rates in its next meeting in Jul-24.

SBP Cuts Interest Rates by 150bps

In the latest Monetary Policy Announcement (link) the State Bank of Pakistan (SBP) decided to reduce policy rate by 150bps to 20.5%. This is the first rate cut since Jun-20. The Committee noted that decline in May-24 inflation was in line with expectation and inflationary pressures continue to subside amid tight monetary policy and fiscal consolidation. This has led to moderation in core inflation. MPC also assessed the upcoming budgetary measure and uncertainty regarding energy price adjustments and its impact on near-term inflation outlook. Considering these factors, MPC viewed that it was appropriate to cut interest rates as real rates remain significantly positive, which is critical to continue to guide inflation to medium term target of 5-7%. For forward guidance, SBP stated that future monetary policy would be data-driven and responsive to any developments related to inflation outlook.

Analyst

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Exhibit: Monetary Policy Rate Decision

	Current	Previous	Chg. (bps)
Target Policy Rate	**20.50%**	**22.00%**	**(150)**
Discount rate (Ceiling Rate)	21.50%	23.00%	(150)
Floor Rate	19.50%	21.00%	(150)

Source: SBP, IGI Research

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Exhibit: National CPI Heat Map

	May-24	Apr-24	Mar-24	Feb-24	Jan-24	Dec-23	Nov-23	Oct-23	Sep-23	Aug-23	Jul-23	Jun-23
General	**11.8**	**17.3**	**20.7**	**23.1**	**28.3**	**29.7**	**29.2**	**26.8**	**31.4**	**27.4**	**28.3**	**29.4**
Food	-0.2	9.7	17.2	18.1	25.0	27.5	28.0	26.8	33.1	38.5	39.5	39.5
Transport	10.4	12.5	11.2	15.0	26.2	28.6	26.5	30.1	31.3	23.0	13.6	20.3
Utility/Rent	33.0	35.7	36.6	36.1	38.6	37.7	33.0	20.5	29.7	6.2	10.8	11.6
Essentials	17.5	17.9	15.8	18.4	19.5	18.6	18.9	18.6	18.2	16.5	16.7	16.7
Disc.	12.6	17.1	19.2	26.5	32.4	34.9	37.4	39.2	40.8	43.1	43.5	44.9

Source: SBP, IGI Research

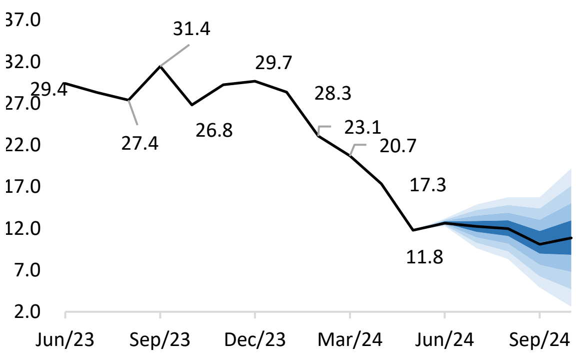
Key takeaways from analyst briefing

SBP in its post MPS briefing highlighted key updates on CAD, debt repayments and foreign exchange reserves which included:

- C/a balance recorded a third consecutive surplus in Apr-24 of US$ 0.2bn driven by higher remittances and exports, more than offsetting rise in imports. As a result C/a deficit stands US$ 0.5bn in 9MFY24 down by 87.5%y/y. Exports also continue to grow led by higher rice and HVA textile exports. This significant reduction in C/a along with increase in FDI and disbursement of IMF tranche in Apr-24 has allowed SBP to make substantial debt repayments while sustaining FX reserves. The MPC highlighted that timely mobilization of financial inflows is critical to meet external financing needs and further strengthen reserves to absorb external shocks and support sustainable growth.
- SBP stated that taking in to account the developments in 9MFY24, GDP growth for FY24 is provisionally expected at 2.4% by PBS. More than 2/3 of the recovery is led by agriculture sector while industry also witnessed positive growth in 3QFY24. SBP noted that these developments are in line with its expectations. The MPC expects GDP growth to remain moderate in FY25 owing to moderation in agriculture sector and stabilization policies.
- Total debt repayment for FY24 stood at US$ 24.3bn (US$ 20.4bn in principle and US$ 3.9bn in interest). SBP stated that most of these payments have been settled and only US$ 1.0bn in principal is to be paid in the remaining months of FY24.

- Fiscal indicators have reflected some improvement in 9MFY24 as primary surplus increased to 1.5% of the GDP whereas fiscal deficit remain at similar level to last year. Higher PDL collection, taxes, SBP profits and lower energy subsidies have contributed to this improvement. As there has been limited progress on expanding the tax base, MPC expects budgetary measures to be more inclined towards rate increase. MPC highlighted that fiscal consolidation through broadening tax net and reforming SOEs would facilitate achieving fiscal sustainability on a durable basis.
- M2 growth decreased to 15.2%y/y in May-24 compared to 17.1%y/y in Mar-24. This was mainly due to slowdown in growth of net domestic assets of banks. Growth contribution of net foreign assets in M2 remained positive. While currency in circulation decelerated, deposits remained key contributor to M2 growth. As a result, reserve money growth declined sharply to 4.3%. This underlying compositional change in M2 is consistent with tight monetary stance and is likely to bode well for inflation outlook.
- SBP also clarified that it does not set a specific target Real Interest Rates (RIR).
- During FY24, dividend and profits repatriated stood at US$ 1.5bn and FY25 is likely to start with no backlog.
- SBP expects forex reserves to remain above US$ 9bn by end of Jun-24 despite US$ 1bn in repayments.
- SBP noted that it expect inflation to average between 23-25% for FY24. SBP has already taken in to account the budgetary measures for its inflation outlook for FY25. The Governor stated that SBP will continue to monitor and assess the budgetary measures before deciding on Monetary policy.

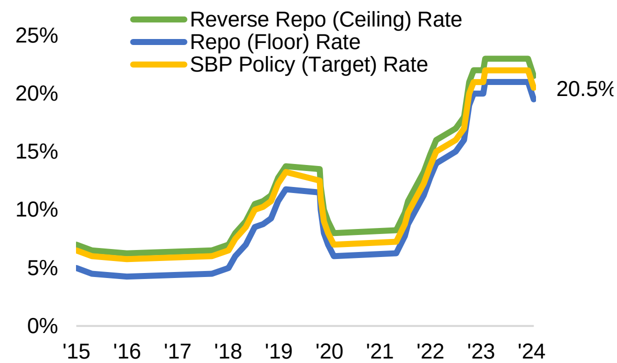
Exhibit: CPI likely to continue its downward trajectory with real rates also significantly positive on a 12m forward basis.



Source: SBP, PBS, IGI Research

Exhibit: Pakistan Policy Rate (historical)

SBP cuts for the first time since 2020. (Source: SBP)



Outlook

Decline in inflation during May-24 had turned real rates significantly positive on spot basis, which prompted SBP to cut rates by 150bps. SBP also assessed the near term upside risk to inflation outlook and stated that cumulative impact of earlier monetary tightening was sufficient enough to keep inflationary pressures in check. In our view, SBP is likely to further monitor impact of budgetary measures and energy price adjustments before deciding on Policy Rates in its next meeting in Jul-24.

Although SBP has initiated easing cycle, however, forward guidance by SBP remains cautious and dependent on impact on potential upside risks such as upcoming budgetary measures and energy price adjustments. Thus, market awaits announcement of Budget 2025 for further clarity on forward outlook on inflation and monetary policy.

Highly leveraged sectors such as textile, steel, cements and chemicals are likely to benefit from interest rate cut. Few highly leverage companies such as MUGHAL, ASTL, FCCL, DGKC, EPCL, PSO, NCL and ILP are likely to benefit most from interest rate cuts whereas Banks and E&Ps are likely to have a negative impact. Within Banks, MEBL, HBL and UBL are likely to impacted most by decline in interest rate.

Exhibit: Impact of 150 bps rate cuts on companies under our coverage

Company	EPS Impact	% of Earnings		Company	EPS Impact	% of Earnings
Banks				**Autos**		
BAFL	(1.9)	-7.1%		INDU	(9.8)	-5.8%
HBL	(3.0)	-6.0%		HCAR	0.8	3.9%
BAHL	(1.8)	-4.8%		**Cements**		
UBL	(3.2)	-5.7%		KOHC	(0.7)	-1.7%
FABL	(0.8)	-4.6%		LUCK	(0.2)	-0.2%
ABL	(1.6)	-4.0%		CHCC	0.2	0.6%
MCB	(2.4)	-4.4%		MLCF	0.1	1.7%
				PIOC	0.4	2.5%
Fertilizer				FCCL	0.1	2.6%
FFBL	(0.3)	-2.7%		DGKC	0.8	7.9%
FFC	(0.5)	-1.9%		**Chemicals**		
EFERT	(0.1)	-0.4%		LCI	2.3	2.6%
E&Ps				EPCL	0.3	2.9%
POL	(2.6)	-2.2%		**Steel**		
MARI	(4.3)	-0.8%		ISL	0.0	0.2%
PPL	(0.3)	-0.7%		ASTL	0.7	8.7%
OGDC	(0.2)	-0.5%		MUGHAL	0.6	4.7%
POWER				**OMCs**		
HUBC	0.4	0.8%		PSO	7.5	10.6%

Source: Company Accounts, IGI Research

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