Day Break

Monday, 21 September 2020

Economy

Monetary Policy Statement

SBP to hold policy rate

- The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) for the next two months on 21st September, 2020. We expect policy rate to remain unchanged at current level of 7.0%.
- Domestic demand has responded sharply to form a 'V' Shape recovery. However, this has also led to a sharp respond in national CPI which by Jul-20, that went up by nearly +2.50%m/m (highest m/m gains since Aug-16) and with latest Aug-20 inflation settling at +8.2%.
- The implied uncertainty and unpredictability surrounding the oncoming Covid-19 'Second Wave' may well keep SBP to continue its preemptive footing in current scenario. Seconded by, reduced Oil prices (Brent: down by ~16% in second week of Sep-20, to USD 39/bbl) as demand lingers on Covid-19 easing cases, domestic inflation could potentially leave further room for SBP to cut rates.

SBP likely to hold interest rates for now…

The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) for the next two months on 21st September, 2020. 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 reduction and less than 5% view policy rate hike.

Exhibit: September, 2020 Monetary Policy Statement Expectation

	Expected	Previous	Chg. (bps)
Target Policy Rate	**7.00%**	**7.00%**	**0**
Discount rate (Ceiling Rate)	9.00%	9.00%	0
Floor Rate	7.00%	7.00%	0
Minimum Saving Deposit Rate	6.50%	6.50%	0
Interest Rate Corridor	2.00%	2.00%	0

Source: SBP, IGI Research

Domestic demand has responded sharply to form a 'V' Shape recovery

So far for the months leading up to Sep-20, key consumer spending leading indicators, Auto, Cements and OMC sales have been rather optimistic and are back on pre-Covid level, suggesting a reduced drag on overall economy. Both monetary and fiscal responses by the government and SBP have also been swift and meaningful - the key policy response from SBP a 625bps rate cut and PKR 1.2trn (~3% of the GDP) Fiscal Stimulus Package.

However, this has also led to a sharp respond in national CPI which by Jul-20 went up by nearly +2.50%m/m (highest m/m gains since Aug-16) and with latest Aug-20 inflation settling at +8.2%. In our view, these monthly increases in headline prices reflect a combination of factors. A relatively strong comeback of domestic demand followed by supply shocks –in the form of higher commodity prices – both from

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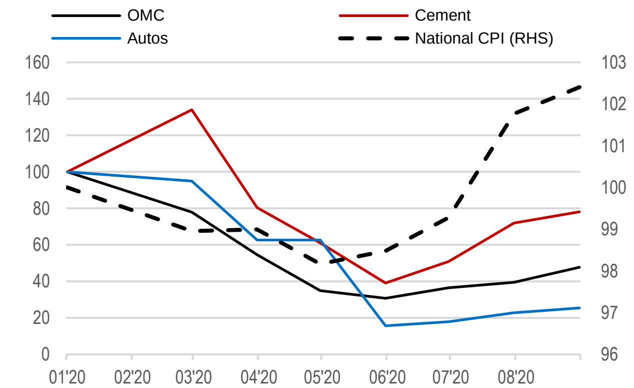
domestic food chain and international oil. Since these are externally driven price shocks and to which SBP has little or no control and thus put policymakers in a rather uneasy position.

Exhibit: Pakistan key consumer sales growth and CPI

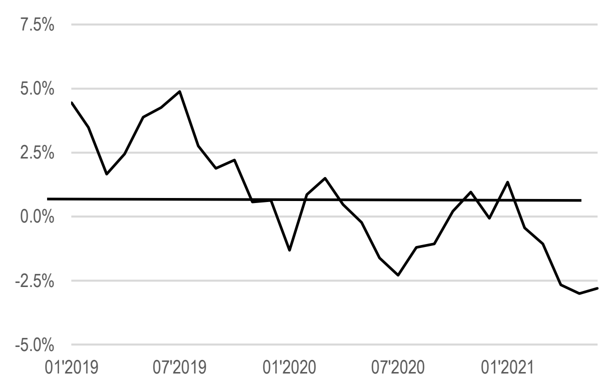
Base (Jan, 2020)



Source: IGI Research, Bloomberg, SBP

Exhibit: Pakistan 3mFwd Real rates

FY 21 National CPI estimated to average 8.0%



In Fy21 SBP has set an inflation target of 7-9%, with lower bound range based on 'absence of demand pressure'. While we agree that inflation is likely to settle in the said range of SBP, but given the recent demand come back and along with it inflation the possibility of further rate cut seems far-fetched idea as of now.

Exhibit: SBP outlook and comments on key economic indicators from June, 2020

Indicators	Expectations		Outlook and comments
Inflation	7-9% expected inflation for Fy 2021	-	**Prices have moderated more than SBP's comfort zone**: Monthly inflation observed in past few months, continues to remain low. Reduction in oil prices have been keen in bringing down underlying inflationary pressure, despite expectation of seasonal uptick in food prices associated with the Eid holiday.
		-	**Budgetary impact negligible**: Moreover, Budget 2020-21 is also expected to be 'neutral' for inflation mainly due to a) freeze on government salaries, b) absence of new taxes, and c) lower production cost from reduced import duties should offset the decline in subsidies in some sectors.
		-	**Supply-side disruption possible, but we will pass it:** Monetary Policy Committee (MPC) highlights risk of inflation through a possible 'supply disruption'. However, these supply shocks are transitory in nature given weak domestic demand and that monetary policy should simply look past them.
		-	7**-9% inflation in Fy 2021**, unchanged from previous estimates: Given the absence of demand-side pressures, average inflation could fall below the previously announced range of 7-9% percent for Fy 2021.
Real Rates	Real-rates to remain close to 'Zero'	-	**Real rates to remain close to 'Zero'**: Given the benign outlook of inflation and current circumstances SBP put down forward guidance for real rates, keeping it close to 'zero'. With forward CPI inflation
Growth	Growth to take a 'U' shape recovery	-	**Muted recovery**: Large-scale manufacturing data for the month of Arp-20, contracted by 42% y/y, with few sectors showing a slight and muted recovery.
		-	**Growth more of 'U' recovery**: Citing IMF recent published report "*A Crisis Like No Other, An Uncertain Recovery*" (link), SBP highlights Global and Pakistan growth outlook heavily skewed to the downside and recovery seems more gradual at this point. However, this remain highly contingent on easing-lockdowns, supportive macroeconomic policies and a pick-up in global growth.
		-	**Covid19 more social and economic pain:** Pakistan like other countries is possible to experience second-wave of Covid-19. This has led to government further extending selective area specific lockdown dubbed 'Smart-Lockdown'.

Covid-19 and its unpredictability

The growth of infection in Pakistan compared to its Asian peers have remained relatively manageable. Having said that, recent rise in global Covid-19 cases in particularly Europe, US and India setting up new records on daily basis, a rising trend of cases in Pakistan has also started to reappear. This unpredictable path of pandemic remains a key risks to our forecasts. Recent opening up of public schools and other public gathering places in parts of EU and US have ignited overall cases and a similar path is being followed by Pakistan authorities to reduce or recover the Covid-19 led economic loss. Learning from experiences, we do believe that this time around as well, Pakistan handling of Covid-19 will remain relatively manageable, however the same cannot be said about reviving overall domestic demand. More so, given limited room to maneuver further relaxed fiscal policy will be least preferable choice of policy makers.

SBP could potentially lower rates

Thus in our opinion this new implied uncertainty and unpredictability surrounding the oncoming Covid-19 'Second Wave' may well keep SBP to continue its preemptive footing in current scenario. Seconded by, reduced Oil prices (Brent: down by ~16% in second week of Sep-20, to USD 39/bbl) as demand lingers on Covid-19 easing cases, domestic inflation could potentially leave significant room for SBP to cut rates.

Exhibit: Global Central Bank Rates and inflation

Countries	Real Rates (Bps)	Headline Inflation	CB Rates
Turkey	-352	11.77	8.25
Hungary	-332	3.92	0.60
Czech Republic	-305	3.30	0.25
Poland	-282	2.92	0.10
Chile	-195	2.45	0.50
Norway	-172	1.72	0.00
India	-133	5.33	4.00
Pakistan	**-120**	**8.20**	**7.00**
United States	-106	1.31	0.25
Sweden	-80	0.80	0.00
Denmark	-44	0.49	0.05
Japan	-40	0.30	-0.10
Great Britain	-36	0.46	0.10
Brazil	-31	2.31	2.00
South Korea	-16	0.66	0.50
Canada	10	0.15	0.25
Switzerland	11	-0.86	-0.75
South Africa	30	3.20	3.50
Mexico	45	4.05	4.50
Russia	88	3.37	4.25
Israel	89	-0.79	0.10
China	117	2.68	3.85
Indonesia	543	1.07	6.50

Source, IGI Research, CB-rates.com

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