

Economy

Monetary Policy Statement

Expecting a Status Quo in Upcoming Monetary Policy Statement

- The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) for the next two months on Tuesday 8th March, 2022. We expect policy rate to remain 'Unchanged' at current level of 9.75%
- Larger portion (~53%) of market participants expects policy rate to remain unchanged.
- While we consider rates to remain unchanged in the upcoming Mar-22 MPS, we expect SBP to raise rates in subsequent MPC meetings (May and July-22). However, this is hinged on how long the Russia-Ukraine conflict continues and its impact on international oil prices.

Status quo expected in upcoming monetary policy announcement

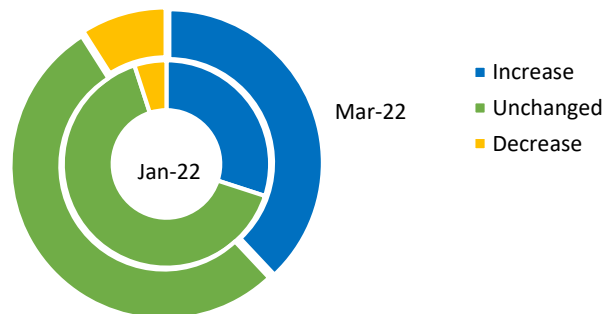
The State Bank of Pakistan (SBP) is scheduled to announce Monetary Policy Statement (MPS) for the next two months on Tuesday 8th March, 2022. We expect policy rate to remain 'Unchanged' at current level of 9.75% based on accommodative approach adopted by MPC and measures recently take to curb imported inflation. However, if Russia-Ukraine conflict is prolonged, MPC may increase Policy Rates from May-22.

Market consensus remains slightly skewed to "unchanged" status

SBP forward guidance on keeping near-term rates unchanged back in Dec-21 monetary policy statement, has meant a larger portion (~53%) of market participants expects policy rate to remain unchanged, ~38% expects rate hike.

Exhibit: Market Consensus

Around ~53% of the participants we talked have an 'unchanged' stance, while 38% expect a rate increase and 9% expect a decline in rate



Looking at Feb-22 numbers, Inflation seems to be moderating on y/y basis but surge on mm basis ...

Feb-21, monthly inflation shown sign of surging with m/m increase of +1.15% compared to previous 3months average of +0.51%/m. The headline inflation recorded a +12.2%y growth during the month compared to previous, Jan-22, +13%y and +12.3%y in Dec-21.

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... However, recent fiscal support in later 2HFY22 suggests some breaks on surging domestic inflation

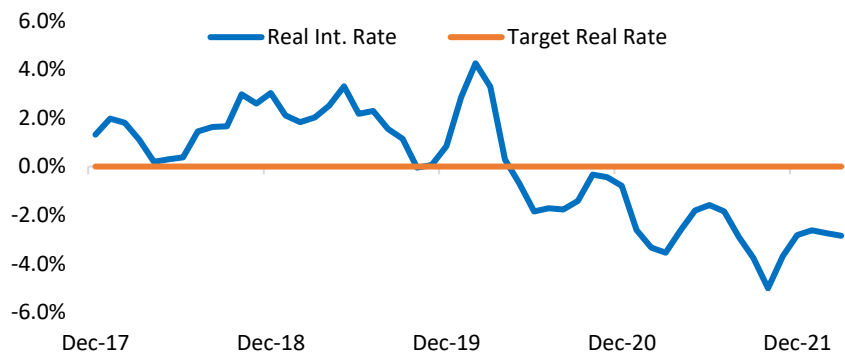
Recent fiscal support by government in the form of cutting fuel prices and power tariff until next budget suggests some breaks on surging domestic inflation; however, this will come at cost of higher fiscal deficit if buffer burns out quickly than expected and strain on foreign reserves to pay for higher commodities bill. An exchange rate instability suggest hike in play.

Real Interest rate seems far from mildly positive

Looking at 3months forward inflation (Mar-to-May) we forecasts average headline inflation would likely come in at +12.5%, bringing, and current real rates just under ~ 2.5%. This leaves significant room for policy rates to re-adjust upward, considering SBP targeting a gradual positive real rates.

Exhibit: Real interests rates

Using a 3 Month forward inflation forecast and 0% real interest rate target; current real rates comes close to ~3.0%



Source: SBP, IGI Research

Outlook: Rates to tighten as inflation surges and external position weakens

While we consider rates to remain unchanged in the upcoming Mar-22 MPS, we expect SBP to raise rates in subsequent MPC meetings (May and July-22). However, this is hinged on how long the Russia-Ukraine conflict continues and its impact on international oil prices. On a cumulative basis we expect a 150bps further rise in policy rate from 9.75% to 11.25%. Drawing parallels from the 2008 crisis, raising interest rates too quickly may impact economic growth. Thus a balanced approach would be appropriate for a quicker economic recovery which may temporarily clip inflation outruns and a potential fall out in the external balance.

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