REP-300

Pakistan Economy

MPS Preview (Jul'24) – 100bps reduction expected

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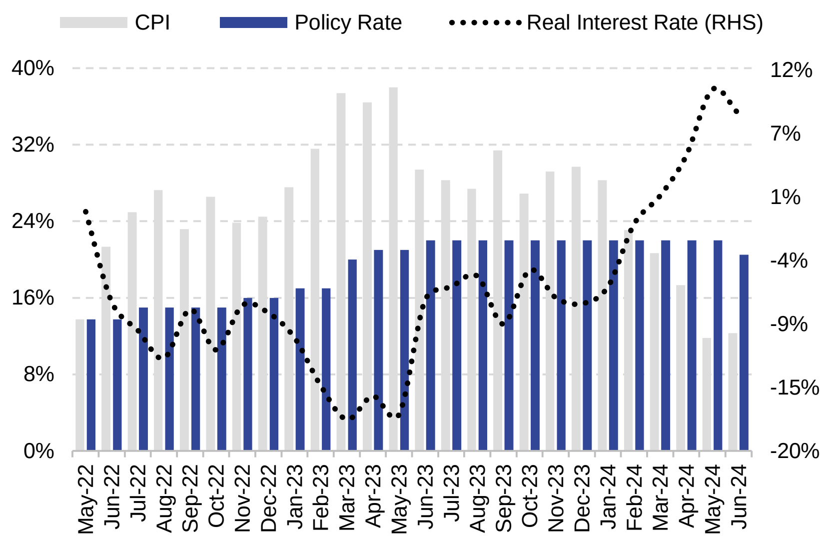
MPS Preview
100bps reduction expected

- As the State Bank of Pakistan's monetary policy meeting on July 29th, 2024 approaches, speculation is rife: will the SBP extend its recent easing policy or hold steady?
- **We're expecting a 100bps cut that could lower the policy rate to 19.5%, a level not seen since Mar'23.**
- To highlight, the last monetary policy was held on June 10th, 2024, after which two significant events occurred: the announcement of the FY25 Budget and Pakistan's entry into a new 37-month IMF EFF program worth USD 7bn.
- Some key improvements in macroeconomic indicators of late that bolster our expectation of a rate cut are as follows:
- First and foremost, a key factor bolstering the expectation of a rate cut is the major decline in Pakistan's inflation rates. Both headline and core inflation have significantly improved. For FY24, the average headline inflation has dropped to 23.4% from 29.2% in the same period last year. Jul'24 is projected to see inflation fall further to around 10.5%, which would result in a real interest rate of 1,000bps—far surpassing the historic 10-year average of -44bps.
- Moreover, the current account deficit for FY24 has substantially decreased to USD 681mn, marking the lowest deficit in 13 years. This represents a significant improvement compared to the USD 3.3bn deficit recorded in FY23. The sharp reduction in the deficit has been driven primarily by a decrease in the trade deficit and an increase in remittances. This positive trend has contributed to the stabilization of the PKR, which saw a modest appreciation of 0.1% against the US dollar in FY24.

Exhibit: CPI and Policy Rate



Source (s): SBP,PBS, AHL Research

MPS Preview
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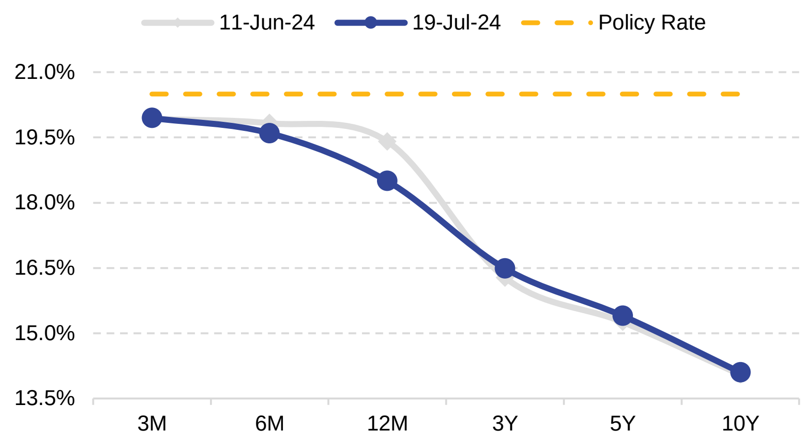
- In addition to the improvement in the current account, the State Bank of Pakistan's reserves have also seen a substantial increase. By the end of FY24, reserves had risen to USD 9.4bn, up from USD 4.4bn a year earlier. This boost in reserves not only enhances the country's financial stability but also provides additional flexibility for monetary policy adjustments.
- Furthermore, the performance of Large Scale Manufacturing Industries (LSMI) has improved. The LSMI reported a 7.3% YoY increase in production for May'24, the highest growth rate in 23 months.
- Lastly, the IMF's staff-level agreement emphasizes a commitment to supporting disinflation, which aims to protect real incomes, particularly for the most vulnerable segments of the population. This focus aligns with our expectation of continuation of easing policy. Such a reduction would be consistent with the IMF's policy stance and would further support the ongoing efforts to stabilize the economy and foster growth.

Money market yields:

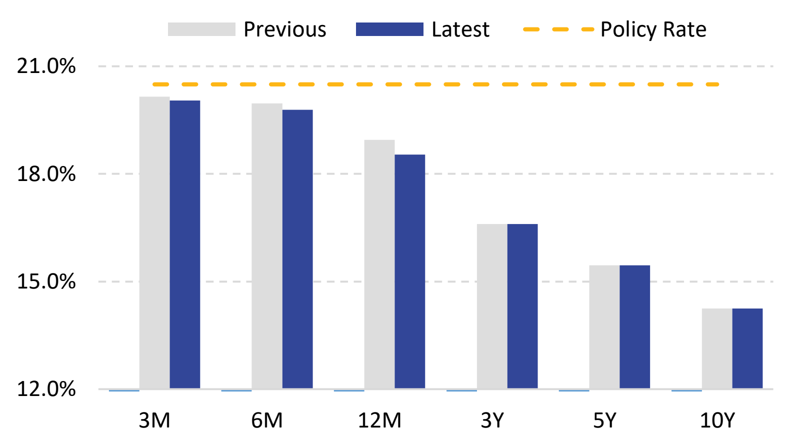
- Since the last monetary policy announcement in Jun'24, yields for short-term government securities have declined in both primary and secondary markets.
- In the primary market, yields for 3-month, 6-month, and 12-month tenors decreased by 0.1%, 0.18%, and 0.41% respectively.
- In the secondary market, while the 3-month yield was up slightly by 0.02%, the 6-month and 12-month yields dropped by 0.23% and 0.91%.
- However, yields for longer-term PIBs in the secondary market have risen, with the 3-year yield up by 0.21%, the 5-year by 0.14%, and the 10-year by 0.05%. This rise in longer-term yields suggests that the market is locking in higher yields now, anticipating that rates will decrease in the near future.

Exhibit: Secondary market yield curve (Current vs. Previous)



Source (s): SBP, AHL Research

Exhibit: Auction cutoffs (Latest vs. Previous)

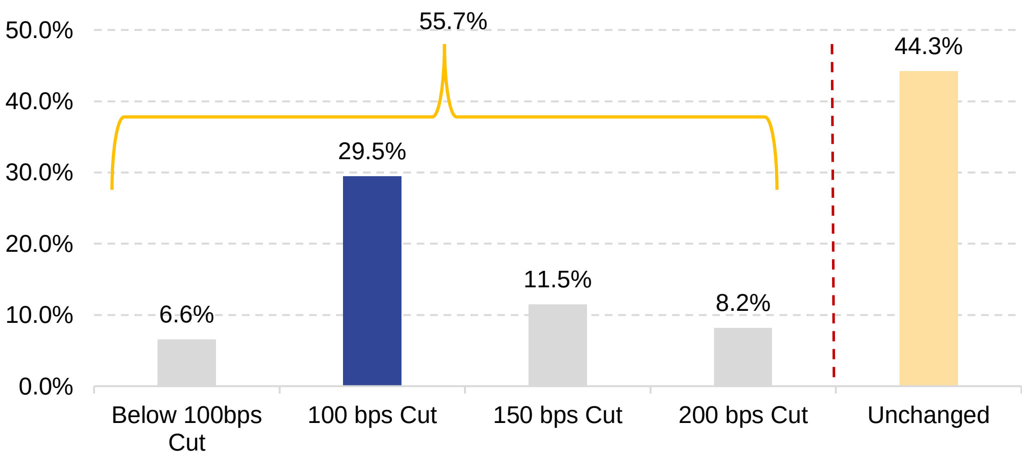


Source (s): SBP, AHL Research

MPS Preview
AHL Survey

- In order to find out what the market is expecting in the upcoming monetary policy scheduled in the current month (Jul'24), we conducted a survey (poll) taking feedback from various sectors. Our respondents belong to sectors such as:
  - Financial services: Banks, AMCs, Insurance, and DFIs
  - Non-Financial Services/Manufacturing: E&Ps, Cement, Fertilizers, Steel, Textiles, and Pharmaceuticals.
- Market sentiment evident from our poll regarding the upcoming MPS also suggests expectations of a rate cut. Here are the results of our survey (poll):
  - Our poll suggests that 55.7% of respondents expect the SBP to reduce the policy rate, while 44.3% anticipate the policy rate to remain unchanged.
  - Among those expecting a rate cut, 29.5% foresee a reduction of 100bps, 11.5% anticipate a 150bps cut, 8.2% expect a 200bps cut, and 6.6% predict a cut of less than 100bps.

Exhibit: AHL Survey Poll Result



Source (s): AHL Research

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Rating	Description
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HOLD	Upside* of subject security(ies) is between -15% and +15% from last closing of market price(s)
SELL	Upside* of subject security(ies) is less than -15% from last closing of market price(s)

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AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

Risks: The following risks may potentially impact our valuations of subject security (ies);

- Market risk
- Interest Rate Risk
- Exchange Rate (Currency) Risk