Policy rate kept unchanged, beating expectations of a hike

- In a surprise move, the Monetary Policy Committee (MPC) of the SBP decided to keep policy rate unchanged at 22%, contrary to general expectations of an increase in the range of 100-200bps to 23-24%.
- Key reasons for the status-quo was cited as 1) the expected deceleration in the pace of inflation readings from Oct'23 particularly during the 2nd half of the ongoing fiscal year, 2) the recent appreciation in PKR against the USD with the administrative and regulatory measures taken, and 3) growth trajectory and trends in CAD largely falling in line with expectations of the MPC. Key takeaways from the Monetary Policy Statement and briefing by the SBP include:
  - The Governor SBP highlighted that the country needs to repay debt of USD24.6bn (USD21.2 principal and USD3.4bn interest), out of which, USD2.2bn (principal) and USD0.6bn (interest) has already been paid during FY24TD, leaving USD19bn principal outstanding for the remaining of FY24. Excluding total roll-over commitments of USD11bn, Pakistan needs to arrange for a net repayment of principal amounting to USD8bn during the remaining FY224.
  - Current reserves with the SBP stand at USD7.6bn with USD14bn as committed inflows during the year, SBP sees Pakistan external debt repayment capacity adequate for the current year including an estimated current account deficit of 0.5-1.5% of GDP (a CAD of approximately USD1.5-5.5bn).
  - The Governor SBP also highlighted that for the Sep-end quantitative targets of the SBP by the IMF are all met, which include, ceiling on forward swap of USD4.2bn, floor on net international reserves of USD-14.5bn, ceiling on NDA of SBP of PKR15tn, and ceiling on GoP's borrowing for budgetary support from the SBP of PKR4.7tn. The structural benchmark of average spread of 1.25% between interbank and open market exchange rate has also been met.
- Based on our estimates, inflation is expected to average above 27% from Sep'23 to Jan'24 (preliminary estimate for Sep'23 inflation is ~31%) before gradually going down to an estimated average of around 20% for Feb-Jun'24. We have however not incorporated any major hike in gas and electricity prices from here.
- With this status quo, the market may see interest rate topping-out at current level with the current inflation expectations, appreciation of PKR against USD in both open and interbank markets, and overall macroeconomic indicators remaining within SBP projections.
- Surge in international commodities prices particularly oil, rising trend in imports with removal of restrictions, continued slowdown in exports and remittances, and delays in materialization of planned USD inflows are key risks to external account, exchange rate parity, inflation expectations and hence outlook for interest rates. However, potential improvement in exports and remittances are the major silver-lining.
- Therefore, while we tend to agree that interest rates may have peaked at current level, data for the next couple of months is critical to support this view with impending hikes in fuel (petrol, diesel and gas) and energy (electricity) prices to pass on international prices and exchange loses and their ripple effects, are yet to be incorporated.
- The stock market is likely to react positively to this development and we highlight stocks of high leverage companies, and high dividend yielding stocks as out-performers in the post-MPC rally.

Annexure

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* Total stock return = capital gains + dividend yield

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