

Monetary Policy Preview

No change expected as easing likely after elections

The State Bank of Pakistan (SBP)'s monetary policy committee will likely convene in late January or early February to set interest rates for the next six weeks. We anticipate the central bank will keep the policy rate unchanged at 22%, with our stance based on high inflation readings and the volatile geopolitical landscape.

Inflation readings are likely to remain high till February 2024: Inflation readings will likely remain elevated till February 2024 because of higher food and energy prices. Notably, the inflation trajectory was influenced by the impact of the gas price hike. Moreover, supply issues have caused sharp price hikes in many constituents of the food basket. The impact of these trends was evident in the most recent SPI reading, which saw **weekly inflation figures cross the 44% mark**.

Pakistan's inflation readings may slow down from March 2024: From March 2024, the **high inflation base will kick in** and bring real interest rates into **positive territory**. Notably, average monthly inflation for 2HFY24 may touch 22.1% against 28.8% registered during 1HFY24. With an absence of any inflationary catalysts on the horizon, we see **monthly inflationary readings falling below the 20% mark by April 2024**.

The geopolitical landscape is increasingly volatile: Recent weeks have seen the escalation of geopolitical volatility marked by conflicts in the Middle Eastern region. These conflicts have raised concerns about the potential disruption of global trade routes and its impact on global commodity prices. Oil prices have exhibited heightened volatility as investors weigh **potential supply disruptions with demand concerns**.

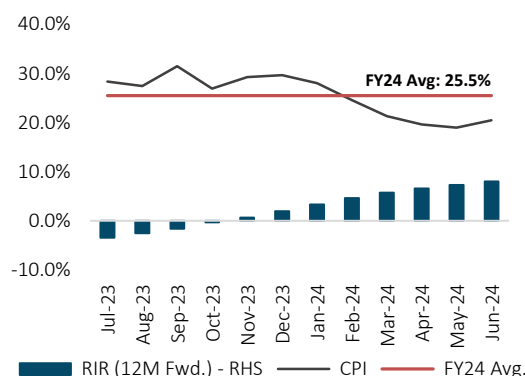
Pakistan is also embroiled in conflict with Iran, evident by cross-border skirmishes targeting militant groups. Recent developments, however, suggest that the escalation was a one-off event, and both countries are actively making efforts to de-escalate the situation. Investors, nevertheless, **remain wary of potential delays in the general elections** due to security concerns and the possible impact on Pakistan's investment climate, particularly in the context of the SIFC.

Global monetary easing cycles may also be pushed back: Sticky inflation amidst heightened geopolitical volatility has the potential to push back global monetary easing cycles. The US's recent monthly CPI reading (3.4%), which registered higher than industry expectations (3.2%), compelled many to revise their timelines of the US Fed's rate cut cycle. Late in December, investors had priced a **74% probability of a rate cut** in March 2024's FOMC. **The probability has now lowered to 54%** after the country's CPI reading, robust economic data, and heightened geopolitical volatility.

Moreover, the EU region is also facing a reversal in its inflation trajectory, **with recent figures rebounding after seven consecutive monthly declines**. Conflicts at the Red Sea and the consequent disruption of trade routes can fuel the region's inflation and likely compel the ECB to push back the monetary easing cycle.

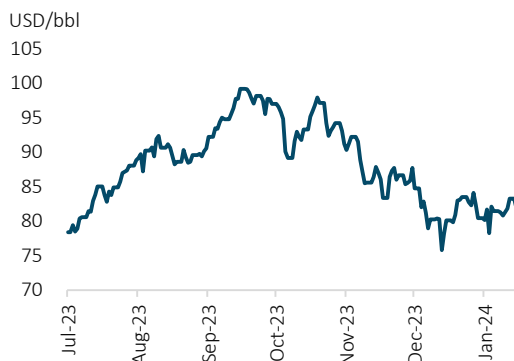
Sunday, January 21, 2024

FY24's Inflationary Projections



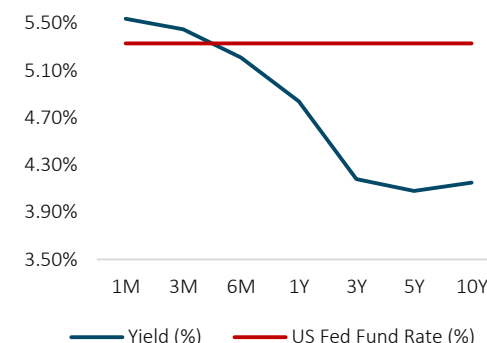
Source: PBS, BMA Research

Arab Light (USD/bbl)



Source: Bloomberg, BMA Research

US Treasury Yield Curve



Source: US Fed, BMA Research

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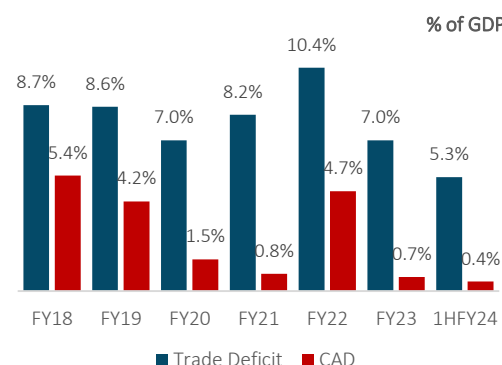
External accounts largely under control: Pakistan's external accounts are largely under control, evident by subdued trade and current account imbalances. Notably, 1HFY24 saw the **trade deficit fall to 5.3% of GDP** as against 10.4% of GDP recorded back in FY22. Moreover, the country's **current account deficit (CAD) is registered at 0.4% of GDP** during 1HFY24 as against 4.7% of GDP recorded during FY22. Improvements in external accounts were largely driven by the general economic slowdown, limiting demand for imported commodities. Moreover, falling global commodity prices further supported the country's external imbalances.

Pak Rupee finding strength: The Pak Rupee has continued to gain ground over the past two months as the currency has appreciated below the 280 per USD mark, a level last seen back in October 2023. Materialization of US Dollar inflows amidst declining demand for the currency has caused the Pak Rupee to gain 3% of its value since November 2023. Moreover, administrative efforts to limit the outflow of US Dollars through illicit channels have further strengthened the currency's prospects. Notably, the **Pak Rupee's REER has increased to 98.9** as of December 2023 compared with 85.6 witnessed back in April 2023.

The next few months may witness **REER inch past the 100 mark**, supported by US Dollar inflows and limited outflows. Onwards, however, we see the Pak Rupee depreciating as the monetary easing cycle commences and economic activity picks pace. The currency **may touch 300 per USD by June 2024 and 320 per USD by December 2024**.

Secondary market yields on the decline: Over the past month, short-term yields have declined by 70bps, and longer-tenor yields are down by 60bps. The decline in yields indicates an expectation of an eventual monetary easing cycle as **short-term yields are trading around 170bps below** the prevalent policy rate. Moreover, trends witnessed in recent treasury auctions further substantiate the market's expectation of an eventual easing as the bulk of the bids has been tilted toward longer tenor securities.

Pakistan External Account Statistics



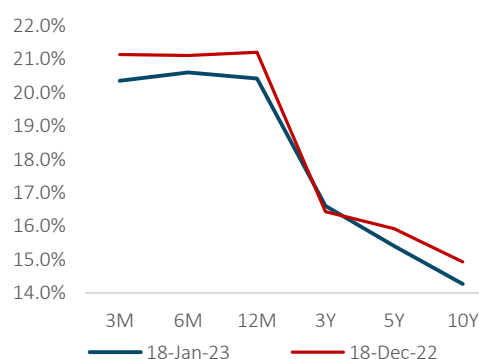
Source: SBP, BMA Research

Pak Rupee REER



Source: SBP, BMA Research

Secondary Market Yields



Source: SBP, BMA Research

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Old rating system

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)