October 31, 2024

PAKISTAN ECONOMY

REP-019

MARKET VISTA

SBP to cut policy rate by 200bps

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- **We expect SBP to cut policy rate by 200bps in the upcoming MPC due to higher real interest rates in disinflationary environment and subdued economic activity.**
- **Inflation is expected to fall to 6.7% in Oct'24 from 6.9% in previous month on the back of deflation in Food and Transport prices, in our view.**
- **High frequency economic activity indicators continued to reflect weak economic activity as all leading indicators barring OMC sales depict negative trend during Sep'24.**
- **Monetary easing on the back of improving macroeconomic situation and IMF Extended Fund Facility would increase appeal for equities, in our view.**

SBP to continue with monetary easing: We expect the SBP to continue monetary easing, given the high positive real interest rates in disinflationary environment, a controlled Current Account Balance with stable currency, deceleration in M2 growth, a subdued growth in advances to the private sector, weak economic activity and emerging threat to GDP growth due to lower than expected cotton output. Inflation is expected to continue disinflationary trend in Oct'24 due to deflation in food and transport prices. Consequently, our positive real interest rates increased to 10.8% for Oct'24 and over 10.0% based on our 12-M forward inflation projection. Subsequently, we expect the MPC to cut interest rates by 200bps to 15.5% followed by an additional 400 basis points easing in the remainder of FY25. These levels of real interest rates sufficiently cover any upside risk to our inflation projection arising from a potential hike in tax rates to address the shortfall in FBR tax revenue. However, sustaining global oil prices at these levels would be positive for our inflation projections.

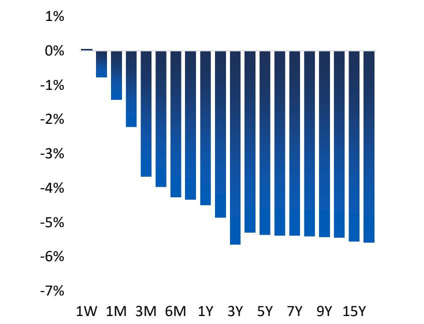
Inflation to ease to 6.7% in Oct'24: We expect inflation to fall to 6.7% in Oct'24 from 6.9% in previous month on the back of deflation in Food and Transport prices. However, on sequential basis, inflation is anticipated to ascend by 0.8%MoM due to surge in Housing and Food prices Index on the back of end of electricity subsidy to consumers and quarterly rent adjustments. Food prices are likely to increase by 0.9%MoM due to higher prices for tomato (up 16.6%MoM), Onion (7.9%MoM), Chicken (5.4%MoM) and wheat (4.8%MoM). We expect average inflation to drop to 7.0% for FY25E compared to 23.4% for FY24.

Economic activity remains weak: High frequency economic activity indicators continued to reflect weak economic activity as all leading indicators barring OMC sales depict negative trend during Sep'24. Cement domestic sales, Fertilizer sales, Electricity generation and Auto sales are down by 24.1%YoY, 35.1%YoY, 6.4%YoY and 16.1%YoY, respectively. However, petroleum sales showed first uptick in FY25 during Sep'24 due to crackdown on smuggling and low base effect. At the same time, a 48.3% YoY decline in cotton arrival to 3.1mn bales as on Oct 31, 2024 would drag agriculture output, which is already expected to moderate due to the high base effect and relatively less favorable conditions. Additionally, negative growth in M2 (down 2%FYTD) and slow uptick in private sector credit despite higher net budgetary borrowing and a 450bps cut in the policy rate would make a case for further easing.

External account remains funded: External sector position largely remains under control given minimal CAD on the back of robust exports and remittances amid rising forex reserves. Moreover, entry into the IMF program along with support from multilateral and bilateral creditors would sufficiently covers external financing requirements and helps to build forex reserves.

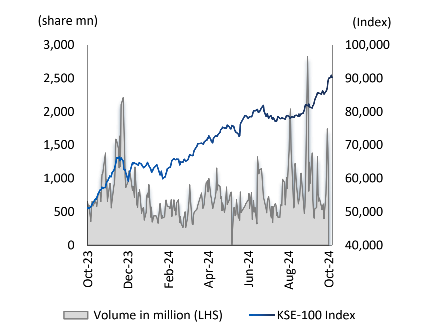
Investment Case: Monetary easing on the back of improving macroeconomic situation and IMF Extended Fund Facility would increase appeal for equities, in our view. We expect foreign investors to increase their exposure to Pakistani equities, supported by the stability of the rupee due to fully funded external account position. We recommend focusing on sectors that stand to benefit from monetary easing and structural reforms. Our top picks include, OGDC, PPL, MCB, UBL, MEBL, FFC, PSO, LUCK, MLCF, FCCL and INDU.

Fixed income instrument's YTM difference from policy rate (%)



Source: MUFAP, SBP & AKD Research

KSE100 Index Performance



Source: PSX & AKD Research

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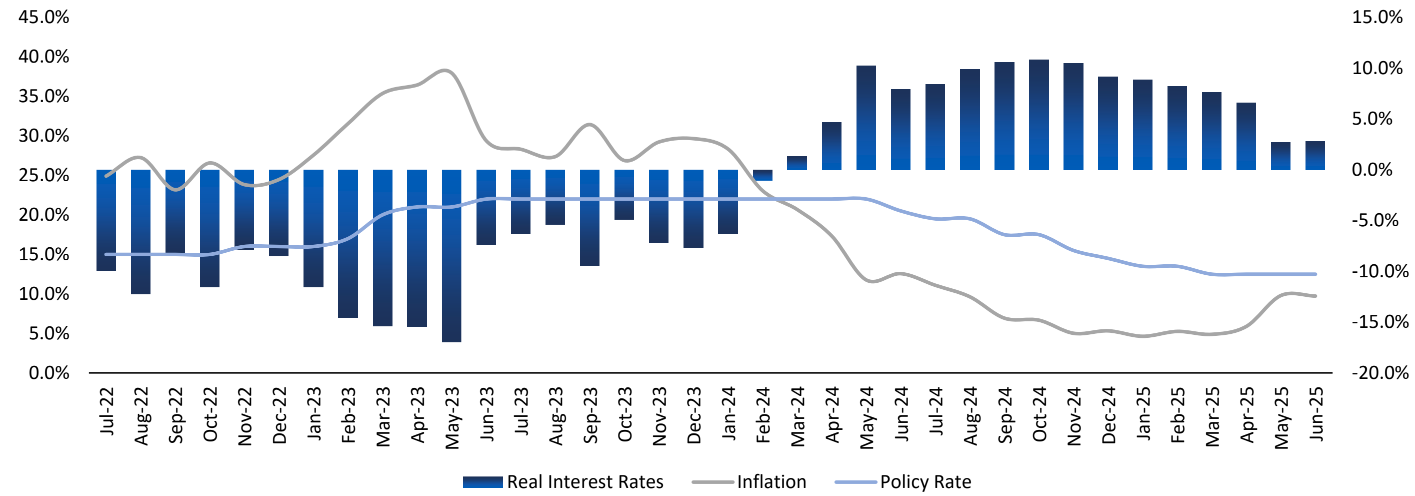
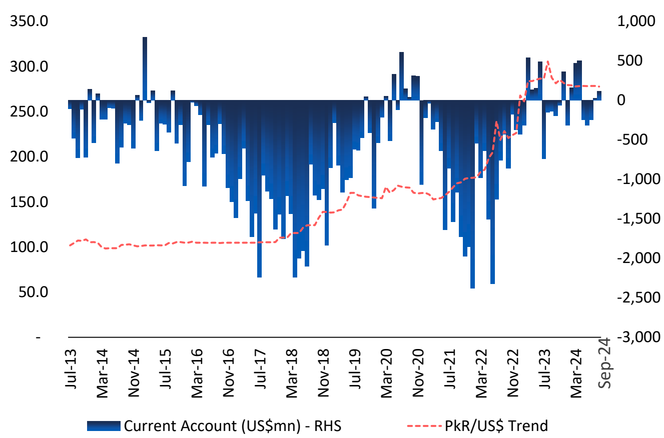
Real interest rates are substantially positive

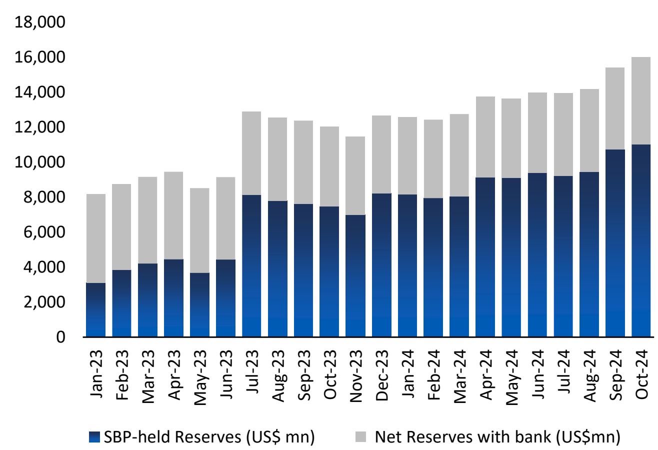
Real interest rates are projected to remain positive in FY25 with monetary easing



Current Account balance appears to be under-control



...SBP FX Reserves near 2-year highs



High frequency economic indicators shows weakness in the economy (ΔYoY)

	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24
Cement	-9.2%	-28.7%	-25.1%	9.0%	-30.0%	47.2%	30.7%	-6.9%	-15.4%	-15.5%	-3.8%	-17.3%	-20.2%	-0.6%	-8.0%	-2.2%	-11.7%	-11.3%	-27.5%	-24.1%
Fertilizer	3.1%	-8.1%	-17.2%	2.6%	-12.9%	40.0%	57.9%	69.6%	23.3%	8.5%	10.2%	-6.5%	9.7%	43.8%	-8.4%	-16.1%	-21.2%	4.4%	-43.9%	-35.1%
Petroleum Sales	-20.9%	-39.3%	-47.2%	-40.4%	-30.5%	-6.4%	-7.9%	-30.6%	-23.9%	-11.2%	-7.4%	-4.2%	-8.2%	4.3%	-5.7%	7.2%	7.6%	-11.4%	-13.5%	20.0%
Power Generation	-4.1%	-16.1%	-22.8%	-16.2%	-1.2%	4.8%	13.6%	3.6%	-10.6%	-9.8%	-9.4%	-2.4%	-8.2%	-8.2%	-13.7%	2.7%	-1.9%	0.3%	-17.4%	-6.4%
Autos	-61.9%	-61.8%	-71.8%	-67.7%	-75.0%	-44.9%	-22.4%	0.9%	-26.7%	-49.6%	-53.4%	-2.7%	32.0%	12.0%	76.2%	56.4%	93.6%	30.0%	-0.4%	-16.1%

Source: APCMA, NFDC, OCAC, NEPRA, PAMA, SBP, MoF, PBS & AKD Research

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