Pakistan Economy

Sarah Rehman, CFA
sarah.rehman@alfalahclsa.com
+92-21-35645090-95 (Ext:338)

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Policy rate cut to 19.5%

Inflation expected to be in the range of 11.5 to 13.5% in FY25

SBP announced monetary policy yesterday, cutting the interest rates by 100bps to 19.5%. This decision was in line with analyst expectations. Positive real interest rates and improvement in external account were the main factors behind the decision. Going forward, SBP expects inflation to be in the range of 11.5 to 13.5% in FY25, while the target of 5-7% medium-term inflation was maintained. We opine that market would remain neutral to positive in response to this decision.

Decision: The monetary policy committee (MPC) of SBP has decided to cut interest rates by 100 bps to 19.5% in its latest monetary policy meeting. The decision is line with broader market expectations.

Medium-term inflation target maintained: Positive real interest rates, conclusion of Staff-level IMF agreement and improvement in external account were key anchors behind the decision. Moreover, developed and emerging economies have also started rate cuts. The committee assessed that the policy stance is tight enough to achieve the medium-term target of 5-7% inflation. For FY25, average inflation is expected to remain in the range of 11.5-13.5%.

The MPC stated that the inflationary impact of the FY25 budget is largely in line with earlier expectations. Moreover, the complete impact of these measures may take some time to fully reflect in domestic prices.

Economic indicators look encouraging: SBP expects the GDP to grow in the range of 2.5-3.5% (FY24: 2.4%); led by improvement in industrial and services sector growth. On the other hand, agricultural growth is expected to slow down.

The MPC also floated expectations of current account for FY25, wherein, it estimates a modest increase in imports, robust growth in workers' remittances and containing the current account deficit within the range 0 to 1% of GDP. Moreover, the governor also highlighted that all profit repatriation and pending dividend payments have been made (FY24: USD2.2bn vs FY23: USD300Mn), provided they have been supplied with the required documents.

On the fiscal side, SBP expects a primary surplus target of 2% for FY25, while relying on realization of external inflows. The committee also expressed concern on over-reliance on bank borrowings.

Forex position & Gross financing requirements: SBP projected that foreign exchange reserves by June-25 shall move up to end at USD13.0bn. The SBP is also of the view that the quality of these reserves is better than the previous years.

Regarding gross financing requirement, the Governor stated that total amount for the year is ~USD26bn, out of which, USD4bn is on account of interest, and USD22bn is principal repayment. Out of this USD22bn, USD16bn is expected to be rolled over; thus, USD10bn is left to be repaid, out of which USD1bn was repaid in the outgoing month.

Outlook: We maintain our view that rates shall further decline in upcoming monetary policy meetings (17% by Dec-2024 and 14% by Dec-2025). Market is expected to be neutral to positive to this decision as some pressure was seen in previous trading sessions.

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