ARIF HABIB LIMITED

REP-300

Pakistan Economy

Monetary easing continues with 100bps rate cut

27-Jan-2025

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Monetary Policy Statement
Easing continues with 100bps rate cut

- The Monetary Policy Committee (MPC) held its first meeting for CY25 on 27th Jan'25 (today), where it decided to reduce the policy rate by 100bps to 12%.
- The MPC acknowledged that inflation maintained its downward trajectory, aligning with expectations, and declined to 4.1% YoY in Dec'24.
- The deceleration in inflationary pressures was attributed to i) moderate domestic demand, ii) favorable supply-side conditions, and iii) a supportive base effect.
- The committee expects inflation to decrease further in Jan'25 before increasing slightly in the upcoming months. Additionally, the Committee highlighted that, despite easing, core inflation remains elevated.
- The MPC noted that the significant 1,000bps reduction in the policy rate since Jun'24 is expected to continue supporting economic growth in the coming period.
- MPC assessed that the real policy rate must remain sufficiently positive on a forward-looking basis to stabilize inflation within the target range of 5% –7%.
- For sustainable economic growth, the Committee believes that maintaining a cautious monetary policy stance is essential to ensure stability.

Key observations since the last MPC meeting:

The MPC highlighted the following developments since the last meeting:

I. Real GDP growth in 1QFY25 was slightly lower than MPC's earlier projections.

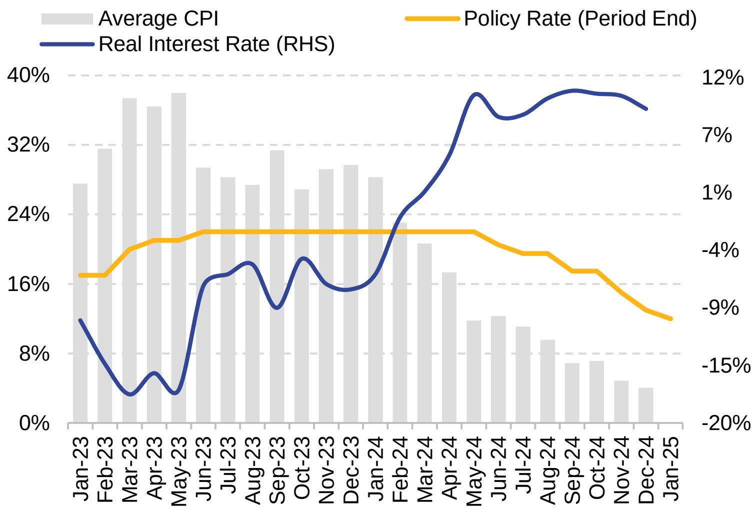
II. Current account remained surplus in Dec'24, while the the SBP's foreign exchange reserves declined due to subdued financial inflows and high debt repayments.

III. Tax revenues in 1HFY25 fell short of the target despite substantial increase in Dec'24.

IV. The international oil prices witnessed heightened volatility in recent weeks.

V. Lastly, increasing uncertainty in the global economic policy landscape has led central banks to adopt a more cautious stance.

Figure: CPI and Policy Rate



Source (s): SBP, PBS, AHL Research

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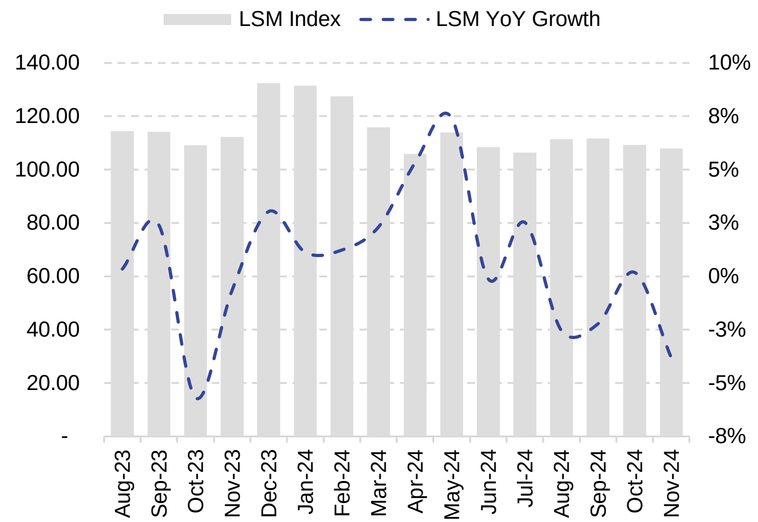
Real sector

- Latest data signals continuing momentum in economic activity, which is evident from increase in sales of automobiles, petroleum products (POL), and fertilizers, along with import volumes, electricity generation, and credit disbursements to the private sector.
- Provisional data for 1QFY25 indicated modest GDP growth of 0.9%, compared to 2.3% in SPLY, which was largely due to an expected sharp deceleration in agriculture sector growth to 1.2% in 1QFY25 (8.1%YoY in 1QFY24).
- Meanwhile, the decline in industrial sector growth in 1QFY25 was moderate.
- The MPC noted that the downtrend in LSM was primarily attributed to a few low-weight items, such as furniture, while key industrial sectors, including textiles, food and beverages, and automobiles, showcased noticeable improvements.
- Going forward, MPC anticipates further traction in economic activity.
- The business confidence index continues to depict positive sentiments
- The MPC expects real GDP growth to remain within the earlier projected range of 2.5% to 3.5%.

External sector

- In Dec'24, the current account posted a surplus of USD 0.6bn, bringing the cumulative surplus for 1HFY25 to USD 1.2bn.
- Exports maintained strong momentum amid higher exports of HVA textiles.
- Imports experienced broad-based growth due to higher volumes, signalling an improvement in economic activity.
- Despite the import bill outpacing export earnings, the trade deficit was offset by robust remittance inflows.
- Going forward, the current account balance is projected to range between a surplus and a deficit of 0.5% of GDP in FY25.
- The MPC expects net financial inflows are expected to improve in the coming months as a significant portion of official debt repayments has already been completed.
- The SBP's FX reserves are projected to exceed USD 13bn by Jun'25.

Figure: Quantum index of manufacturing



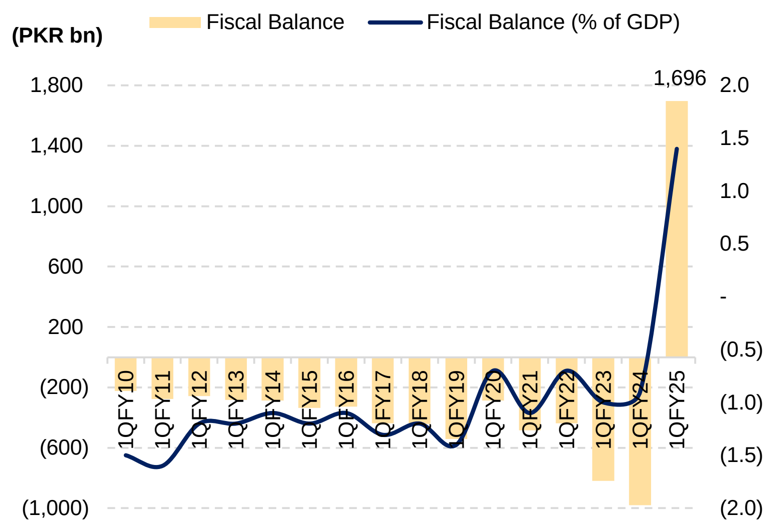
Source (s): PBS, AHL Research

Fiscal sector

- FBR revenues recorded an increase of ~26% during 1HFY25.
- Despite the revenue growth, the shortfall in tax collection from the target has expanded.
- A significant acceleration in tax revenue growth will be required to meet the annual target.
- Estimates from the financing side indicate an improvement in the fiscal balance during 1HFY25, reflecting relatively controlled expenditures.
- The anticipated lower interest payments than the budgeted amount are expected to help contain the overall fiscal deficit within its target.
- Achieving the target for the primary balance, however, is likely to be challenging.

- **Money and credit**
- Broad money (M2) growth decelerated to 11.3% YoY as of 17th Jan'25, down from 13.3% at the last MPC meeting.
- The decline in M2 growth was primarily due to a significant deceleration in NDA (Net Domestic Assets) growth.
- Government borrowing from the banking system remained contained, shifting more towards non-bank sources.
- Banks' credit to the private sector increased sharply, driven by economic recovery, easier financial conditions, and efforts to meet advances to deposit ratio (ADR) targets.
- Bank deposits declined noticeably since the last MPC meeting, while there was some increase in currency in circulation.

Figure: Historical Fiscal Balances



Source (s): MoF, AHL Research

Inflation outlook

- Headline inflation decreased to 4.1% YoY in Dec’24 from 4.9% in Nov’24, continuing its downward trend.
- The decline in inflation was mainly driven by lower electricity tariffs, a sufficient supply of key food items, exchange rate stability, and a favorable base effect.
- Core inflation, which reflects underlying inflationary pressures, moderated due to contained domestic demand, though it remains elevated.
- Inflation expectations remained volatile, with the MPC forecasting near-term inflation to be volatile and expected to rise towards the upper bound of the target range by the end of FY25.
- The MPC expects FY25 average headline inflation to be between 5.5% and 7.5%.
- The inflation outlook is subject to risks from volatile global commodity prices, protectionist policies, energy tariff adjustments, perishable food price fluctuations, and additional measures to meet revenue targets.

Monetary Policy Statement
KSE-100 performance post rate cut

Exhibit: KSE-100 performance post rate cut

Date	MPC Decision	KSE100 Index	KSE100 Change			
			Next Working Day	15 Day	30 Day	60 Day
18-Jun-97	100 bps decrease	1,567	1.30%	5.20%	17.70%	22.10%
04-Mar-99	100 bps decrease	971	1.40%	8.30%	8.40%	15.30%
19-May-99	100 bps decrease	1,269	2.40%	-10.50%	-17.10%	-10.60%
19-Jul-01	100 bps decrease	1,284	-1.80%	-2.40%	0.50%	-11.20%
17-Aug-01	100 bps decrease	1,290	-0.70%	-2.50%	-11.70%	-4.60%
23-Jan-02	100 bps decrease	1,501	1.70%	14.80%	14.80%	26.20%
20-Apr-09	100 bps decrease	7,902	-0.90%	-10.40%	-10.70%	-10.90%
13-Aug-09	100 bps decrease	8,011	-1.00%	6.60%	13.10%	20.40%
23-Jan-15	100 bps decrease	34,027	1.30%	1.90%	-0.10%	-8.00%
22-May-15	100 bps decrease	32,606	0.30%	4.30%	5.90%	10.10%
15-May-20	100 bps decrease	34,008	-0.60%	-0.20%	1.80%	8.00%
25-Jun-20	100 bps decrease	33,710	0.68%	7.36%	11.56%	18.07%
29-Jul-24	100 bps decrease	78,828	-0.25%	-1.21%	-1.06%	3.13%
27-Jan-25	100 bps decrease	113,520				
Average return			**0.29%**	**1.63%**	**2.55%**	**6.00%**

Source (s): PSX, SBP, AHL Research

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HOLD	Upside* of subject security(ies) is between 0% and +15% from last closing of market price(s)
SELL	Upside* of subject security(ies) is less than 0% 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)

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- Interest Rate Risk
- Exchange Rate (Currency) Risk

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