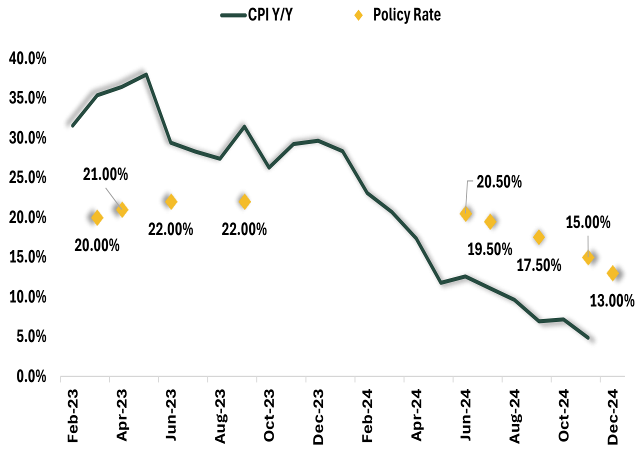
HABIBMETRO Financial Services

Economy

Monday, December 16, 2024

13% Benchmark Rate - SBP Drops Rates Amid Growth Hopes

CPI vs Interest Rate



Source: SBP, PBS, HMFS Research

The State Bank of Pakistan (SBP) has announced to reduce the policy rate by 200bps to 13% effective from December 17, 2024, following the stability of inflation in single digits and real interest rate resting in positive values. This marks the fifth consecutive rate cut by SBP since June, totaling a 900bps drop in 2024—a year that began with a steep 22% policy rate.

The SBP recent policy rate cut reflects improving macroeconomic fundamentals following a prolonged period of economic strain last year. November 2024 marked significant milestones, with inflation fell to 4.9%, remittances increased by 29% y/y to USD 2.92bn, and Roshan Digital Account inflows reached USD 9.1bn. Total Foreign exchange reserves stood at USD 16.6bn, while a current account surplus of USD 218mn was recorded in the 4MFY25. These indicators, coupled with a 52% y/y surge in automobile sales and an improved advance-to-deposit ratio of 47.8% in the banking sector, signal a recovery in consumer confidence and economic activity.

Furthermore, Pakistan's economic revival is bolstered by strategic multilateral support, including USD 330mn from the Asian Development Bank for social protection programs and USD 200mn for power distribution upgrades. These efforts, alongside stabilized reserves and improved external accounts, signal a cautiously optimistic outlook for economic resilience.

Sectorial Impact:

The recent policy rate cut may weigh on the Commercial Banking sector by reducing interest income. However, its impact on Fertilizers and Automobiles will vary based on individual leverage positions, creating mixed outcomes. In contrast, sectors like Cement, Engineering, and Textiles stand to gain significantly from lower financing costs on their high-leverage accounts.

HMFS Research

research@hmfs.com.pk

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Outlook:

In today's meeting, the SBP opted to reduce the interest rate in line with the market expectations, and signaled a cautious optimism for economic recovery. While this decision indicates a forward step, the Monetary Policy Committee (MPC) is likely to adopt a vigilant stance in its upcoming meetings, from January 2025 onward. Given the recent decline in CPI inflation to single digits, there is potential for another modest rate cut in January. However, sustaining this trajectory would require a pause thereafter to assess the economic landscape. Inflation, projected to stabilize around avg. of 8-9% in the 1HFY25, underscores the need for a measured approach to ensure price stability and economic resilience.

The current real interest rate provides room for further monetary easing, but a rapid reduction to single digits could undermine economic stability. A more gradual approach would allow the SBP to maintain positive real interest rates, aligning with forward-looking inflation trends and fostering sustainable growth. Sudden rate cuts could inadvertently stimulate import-driven demand, exacerbating risks to the current account and exchange rate, which are critical for meeting IMF benchmarks. As Pakistan works to qualify for the next tranche of IMF funding, caution in monetary policy adjustments remains imperative to uphold economic credibility and external sector stability. The SBP is likely to tread carefully with rate cuts to avoid a hasty reversal, as further normalization of rates is expected by February, while inflationary pressures may rise as the high base effect erodes by April 2025.

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HMFS RATING GUIDE	
BUY	*More than 15% Upside*
HOLD	*Between 15% Upside & 15% Downside*
SELL	*More than 15% Downside*

Note: All fair value estimates are for a twelve month time horizon unless specified otherwise in the report
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