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Sardar Hassan Ali | 2 December 2021

Pakistan Market Outlook

It's getting hotter earlier than anticipated

Economic recovery is likely to gain further momentum in FY22 compared to last fiscal year. SBP expects the GDP growth between 4-5 percent in FY22

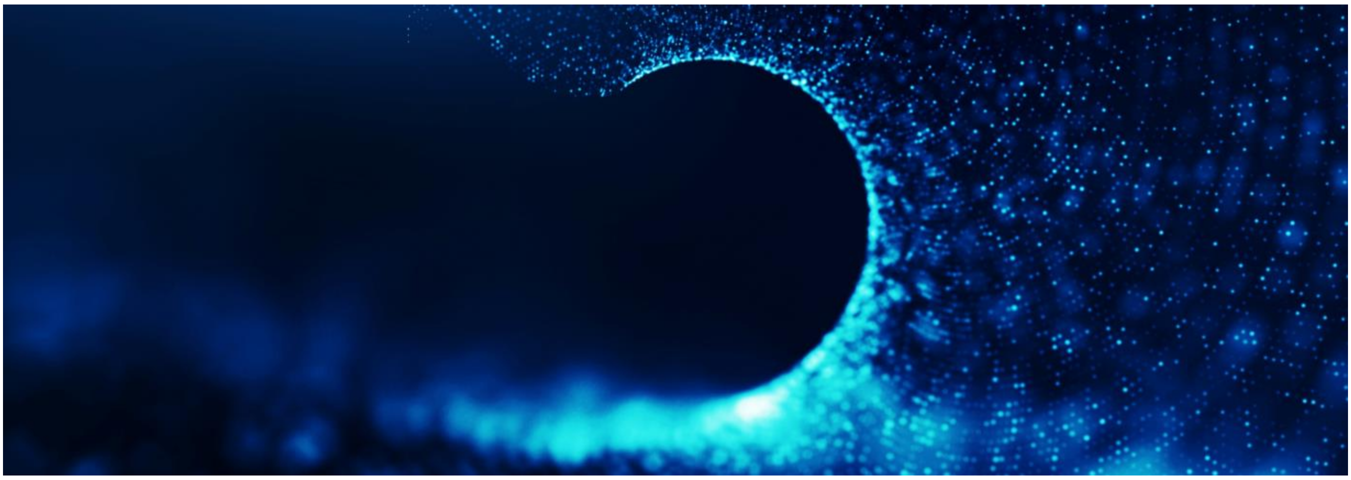
State Bank of Pakistan likely to remain on course of monetary tightening in FY22. We continue our liking for floating fixed income instruments and short tenor bonds.

We see further PKR adjustments due to ballooning current account deficit

How to build fixed income exposure in a rising interest rates environment?

Investment strategy

Sardar Hassan Ali
Investment Strategist



Implications for investors

SBP's hawkish stance may weigh on economic activities. However, a view of 4-5 percent of GDP growth in FY22 is very much intact

Strong domestic demand will positively continue to drive the business sentiment.

PKR likely to remain under pressure.

It's getting hotter earlier than anticipated

The government is putting reins on growth as deteriorating current account, deprecating PKR exchange rate and fiscal deficit pose challenge to the macroeconomic environment.

In the recent monetary policy meeting held on 19th Nov-2021 State Bank of Pakistan (SBP) decided to raise interest rate by 150bps almost double of what most of the market participants were expecting. Taking the policy rate to 8.75% and accumulative hikes in the past three months to 175bps. This decision was taken considering widening current account deficit and rising inflation while the outlook on growth relatively remains strong.

Global supply chain issues, higher energy prices are pushing the inflation significantly higher and pose upside risk to the previously anticipated 7-9% range in FY22 hence an appropriate policy mix is required to keep the inflation in check.

Moreover, higher than anticipated deterioration in current account (CA) in the first four months of the fiscal year FY22 pose a threat to the previous forecast of 2-3% of CA deficit in the ongoing fiscal year and is a serious concern for the authorities. Going forward higher imports and rising oil prices will likely continue to weigh on the current account. Support packages from foreign countries and IMF may only release the near-term pressure.

We have been arguing the possibility of rate hike in our previous publications also. Under an IMF programme the policy makers are willing to raise interest rates to ensure economic stability, minimize the rupee deprecation and rebuild strong FX reserves. Hence, we cannot rule out further monetary tightening in FY22.

How to build fixed income exposure in a rising interest rates environment?

Central Banks hawkish policy are driving yields significantly higher in CY21 and likely will be the case in FY22. We view floaters and short to medium tenor bonds as preferred holdings as they yield a fixed return and provide some hedge against the interest rate risk. However, we anticipate the SBP will continue hiking rates to achieve its target of mildly positive real interest rates, which makes the long-term Pakistan Investment Bonds (PIBs) our least preferred asset class.

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