

MONTHLY REPORT

DEC 2023



**Economic Harmony: The
Imperative for Pakistan's
Financial Balance**



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SYNOPSIS

In fiscal year 2024, Pakistan's economy grapples with significant challenges amid a few positive developments.

Foreign exchange reserves are expected to remain low, and a decrease in remittances is anticipated, although Foreign Direct Investment might see an uptick. Inflation rates have spiked, hitting urban centers the hardest, primarily due to rising gas prices. The trade deficit has shown improvement due to decreased imports and slightly growing exports.

The Pakistani Rupee has marginally appreciated against the dollar, following support from the IMF and a financial boost from Saudi Arabia. The Federal Reserve's indications of a pause in interest rate hikes amid higher-than-target inflation could delay the easing cycle. The stock market, in contrast, has surged, reflecting investor optimism and the prospect of policy rate stability from the State Bank of Pakistan.

Lastly, the stabilization of the Rupee and the rollover of a sizeable Saudi deposit have provided some respite to the pressured external sector, painting a complex but not entirely bleak economic picture for Pakistan.

THE IMF'S INVOLVEMENT WITH PAKISTAN'S ECONOMIC PATHWAY

IMF has provided a comprehensive analysis of Pakistan's economy for the fiscal year ending June 30, 2024, highlighting several critical economic indicators. According to the IMF, Pakistan's foreign exchange reserves are expected to stand at US\$9bn, while the Net International Reserves (NIR) are projected to reach a negative US\$11bn by the end of June 2024.

A notable concern is the anticipated decline in remittances, expected to decrease by US\$3.5bn, setting the new target at US\$29.4bn. However, remittances are projected to slightly recover to US\$31 bn, accounting for 8.4% of the GDP, in the following fiscal year 2024-25.

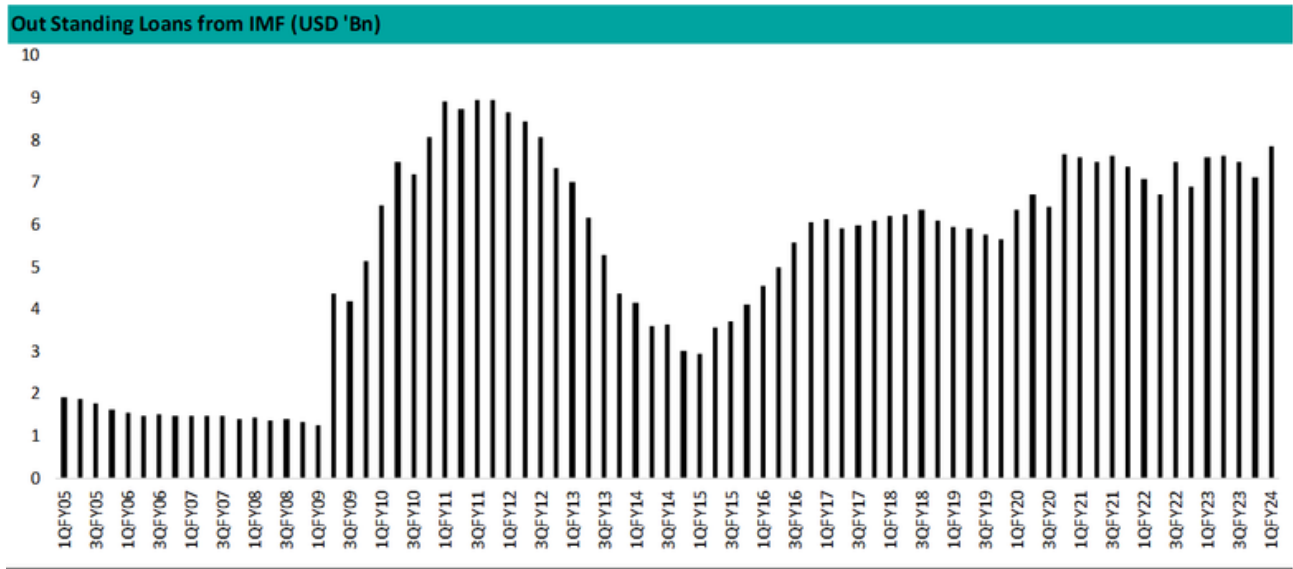
The Current Account Deficit (CAD) forecast has been positively adjusted, decreasing from US\$6.4bn to US\$5.6bn.

Key Economic Statistics				
Monthly	Unit	Latest	Oct-23	Sep-23
PKR USD	PKR	284.38	281.47	287.74
Current Account Balance	USDmn	NA	(74)	(46)
FDI	USDmn	NA	122	173
Imports	USDmn	NA	4,346	3,970
Exports	USDmn	NA	2,762	2,470
Trade Deficit	USDmn	NA	(1,584)	(1,500)
Remittances	USDmn	NA	2,463	2,208
FX reserves	USDmn	12,393	11,992	12,393
Headline Inflation	%	29.23	26.79	31.44
Core Inflation	%	21.52	21.76	22.06
Food Inflation	%	29.57	28.75	34.47
Policy Rate	%	22.00	22.00	22.00
3M PKRV	%	21.59	21.65	22.46
6M PKRV	%	21.48	21.70	22.81
12M PKRV	%	21.41	21.76	22.90
3 Year PKRV	%	16.48	17.82	19.11
5 Year PKRV	%	15.90	15.46	17.23
10 Year PKRV	%	14.99	15.15	16.12
Quarterly		FY21	FY22	FY23
GDP growth	%	5.77	6.17	-0.17
Agriculture Growth	%	3.52	4.28	2.25
Industrial Growth	%	8.2	6.95	-3.76
Services Growth	%	5.91	6.66	0.07

Source: PBS, SBP, HBFC Research

In terms of trade, export targets are set at US\$30.6bn, and imports are expected to reduce from US\$64.7bn to US\$58.4bn, though the oil import bill is projected to rise from US\$15.3bn to US\$17.63 bn. Encouragingly, Foreign Direct Investment (FDI) is anticipated to increase from US\$847mn to US\$1.07bn. The external debt is also expected to decrease from US\$130.8bn to US\$123.5bn, with gross external financing needs projected to fall from US\$28.4bn to US\$24.9bn.

Despite these mixed indicators, Pakistan is likely to negotiate another medium-term IMF program after the current US\$3 bn Standby Arrangement ends, before entering the next fiscal year 2024-25. This assessment underlines the challenges faced by Pakistan, such as decreasing remittances and increasing oil import bills, while also acknowledging positive trends like rising FDI and reducing external debt.



Source: SBP

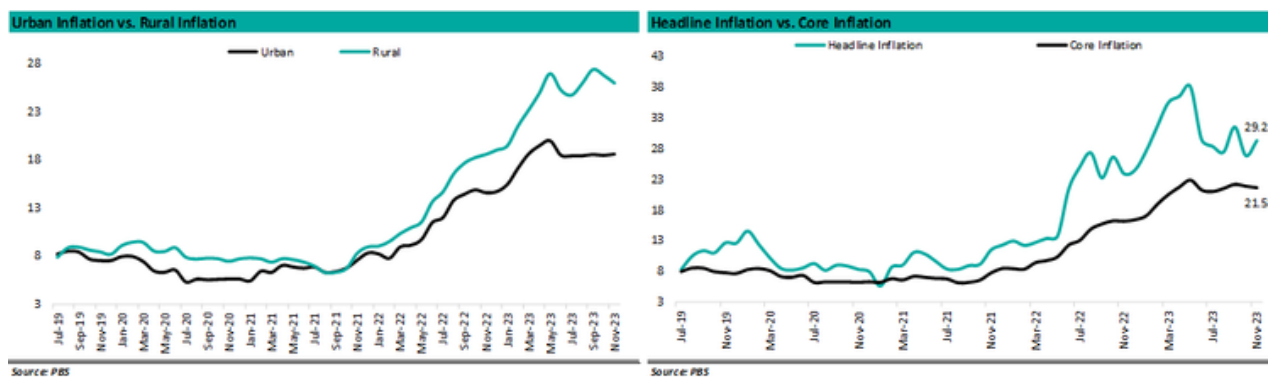
PERSISTENT CONCERNS OVER INFLATION TRENDS

Inflation in Pakistan reveals a complex scenario with significant variations across regions and economic sectors. As of Nov 2023, the overall inflation rate hit 29.2%, marking a substantial monthly increase of 2.7% and reaching the highest point since July 2023. A key factor in this inflation surge is the significant rise in gas prices, particularly in urban areas, where they escalated by 280% month-on-month and 520% year-on-year.

Consequently, inflation estimates for the next twelve months have been revised upwards with the first five months of FY24 recording 28.6%. In response to these trends, the State Bank of Pakistan (SBP) might maintain current rates to ensure currency market stability. On the other hand, A notable shift is observed in urban versus rural inflation: urban inflation, at 30.4%, has surpassed rural inflation, which is at 27.5%. This reversal of trends since 2021 is significant. Food inflation has seen a 1% increase, mainly due to higher prices of perishables like tomatoes, potatoes, and onions.

The housing and utilities sector, especially in urban areas, experienced a significant monthly increase of 17% due to soaring gas prices. The transport sector, however, records a decrease of 2.8% month-on-month, thanks to falling petroleum prices and a stable currency.

Looking ahead, overall inflation is expected to stabilize over the next 12 months, assuming international commodity prices and the currency remain steady. This stabilization could align inflation closer to the SBP's medium-term target in FY25. In summary, Pakistan's current inflation landscape is characterized by high rates, especially in urban areas due to soaring utility costs, with fluctuating impacts across different sectors. The SBP's monetary policy and external economic factors like global commodity prices and currency stability will be key in shaping the inflation trajectory in the upcoming months.

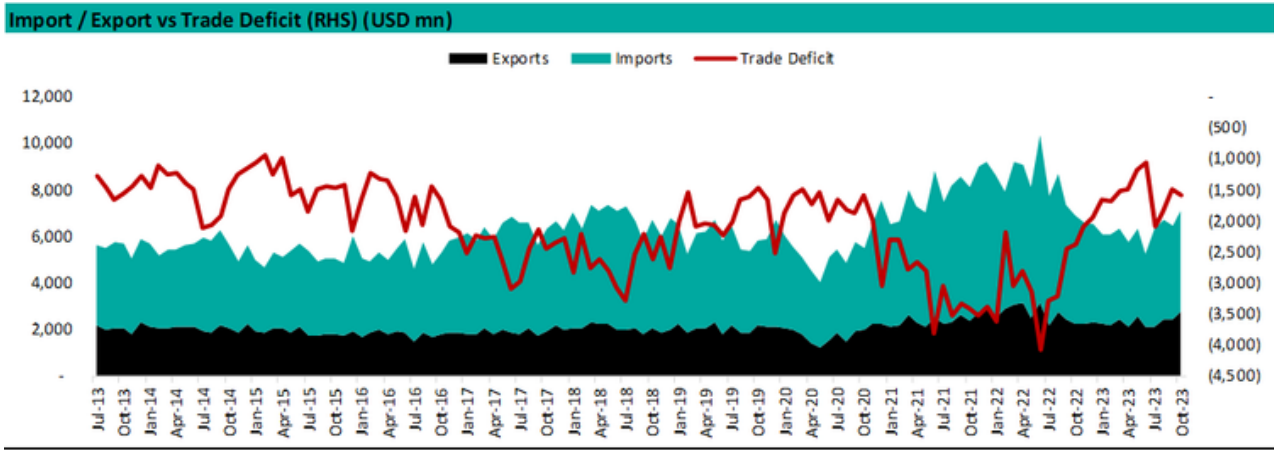


TRADE DEFICIT AND QUESTIONS OF SUSTAINABILITY

The recent trade data for Pakistan from July to Nov 2023, as reported by the Pakistan Bureau of Statistics (PBS), showcases a mixed but overall positive trend in the country's trade dynamics. During this period, the trade deficit experienced a notable decrease of 33.59%, shrinking to US\$9.4bn compared to US\$14.1bn in the same timeframe of the previous year. Specifically, in Nov 2023, the trade deficit narrowed by 13.16% to US\$1.9bn from US\$2.2bn in October, and when compared to Nov-22, the deficit decreased by 31.7%.

On the export front, there was an overall growth of 1.9% with exports rising to US\$12.2bn from US\$11.9bn year-on-year. Despite a month-on-month decrease in Nov 2023, exports were higher by 7.66% compared to Nov-22, indicating a positive trajectory since Sep-23. Conversely, imports saw a significant decrease of 17.32%, dropping to US\$21.5bn from US\$26bn in the corresponding period last year. This decline was evident both on a monthly and yearly basis in Nov 2023. Looking forward, the current trends suggest that Pakistan's exports could potentially reach nearly US\$29bn by the end of the fiscal year, with imports anticipated around US\$52bn.

This overall improvement in Pakistan's trade balance, marked by a significant reduction in imports and a modest increase in exports, points towards effective economic management. However, the increase in the services trade deficit and fluctuating monthly export and import figures indicate areas that require ongoing attention in trade policies.

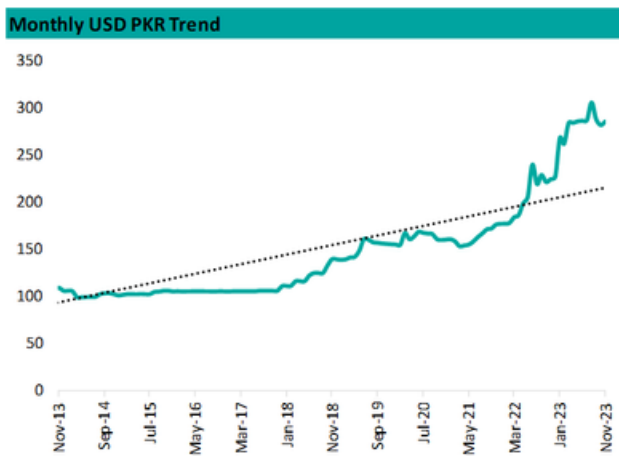


Source: PBS

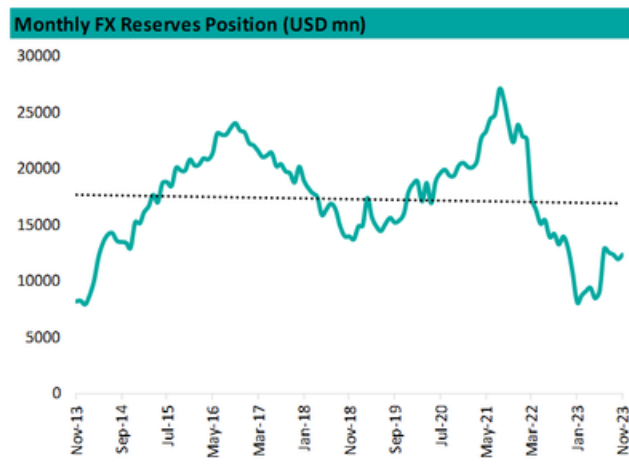
PAKISTANI RUPEE'S PERFORMANCE AMID DECLINING RESERVES

The latest report on the Pakistani Rupee (PKR) shows marginal improvements against various currencies, particularly the US Dollar (US\$). In the inter-bank market, the PKR remain strong appreciated by 0.8% MoM or PKR 2.2 against the US\$ to stand at 284.11. This positive trend is partly attributed to the staff-level agreement (SLA) between Pakistan and the International Monetary Fund (IMF) regarding the first review of the US\$3 bn Stand-by Arrangement (SBA). Additionally, Saudi Arabia’s decision to extend a US\$3bn deposit with Pakistan for another year has provided significant support.

However, The State Bank of Pakistan’s (SBP) total liquid foreign exchange reserves saw a decline of US\$807mn (in the past four months), reaching US\$7 bn as of Dec 01, 2023. This decrease is consistent with substantial debt repayments, coupled with restrained foreign capital inflows and a modest relaxation of import limitations to a degree. Consequently, the diminishing reserves continue to be a major worry for policymakers, and the rupee may experience volatility if this trend persists.



Source: SBP



Source: SBP

PAKISTAN'S CURRENT POSITION ON THE IMF'S AGENDA

The IMF's executive board has scheduled a meeting for January 11, 2024, to decide on the final approval for releasing the forthcoming US\$700mn segment from its ongoing loan agreement, which is part of the larger US\$3bn Standby Arrangement (SBA).

The consideration of this disbursement has been postponed due to the IMF's continued efforts to obtain renewed commitments from both multilateral and bilateral creditors to fulfill Pakistan's substantial financing requirements for the fiscal year, amounting to US\$24.9 bn.

Adding to the complexity is the approaching expiration of the current SBA program on April 14, 2024, and the pending finalization of Pakistan's request for the second installment, which was provisionally agreed upon during the Staff Level Agreement on November 15, 2023. The IMF Board's decision is critical, as it may impact Pakistan's prospects of securing essential foreign loans in the forthcoming months.

THE FEDERAL RESERVE'S GRADUAL TIGHTENING AND IMPLICATIONS

In Dec-23, the Federal Reserve is signaling a potential pause in interest rate hikes, with the federal funds rate steady between 5.25% and 5.5%, despite inflation indicators remaining above the 2% target.

The central bank is navigating how to communicate the possibility of future rate cuts that markets and the public may anticipate, especially in the context of the upcoming presidential election scheduled in Nov-24. This political event adds a layer of complexity to the Fed's decision-making process, which will be a focal point during the Federal Open Market Committee meeting on December 12-13, crucial for setting current and future interest rate expectations.

The Fed is weighing the risk of inflation resurgence against the potential for economic deceleration, aiming to avoid premature easing that could have long-term inflationary consequences. Expressing a cautious optimism, the Fed anticipates that inflation will subside without further hikes, suggesting a prudent approach towards a gradual reduction in rates as the economic situation aligns with their long-term targets.

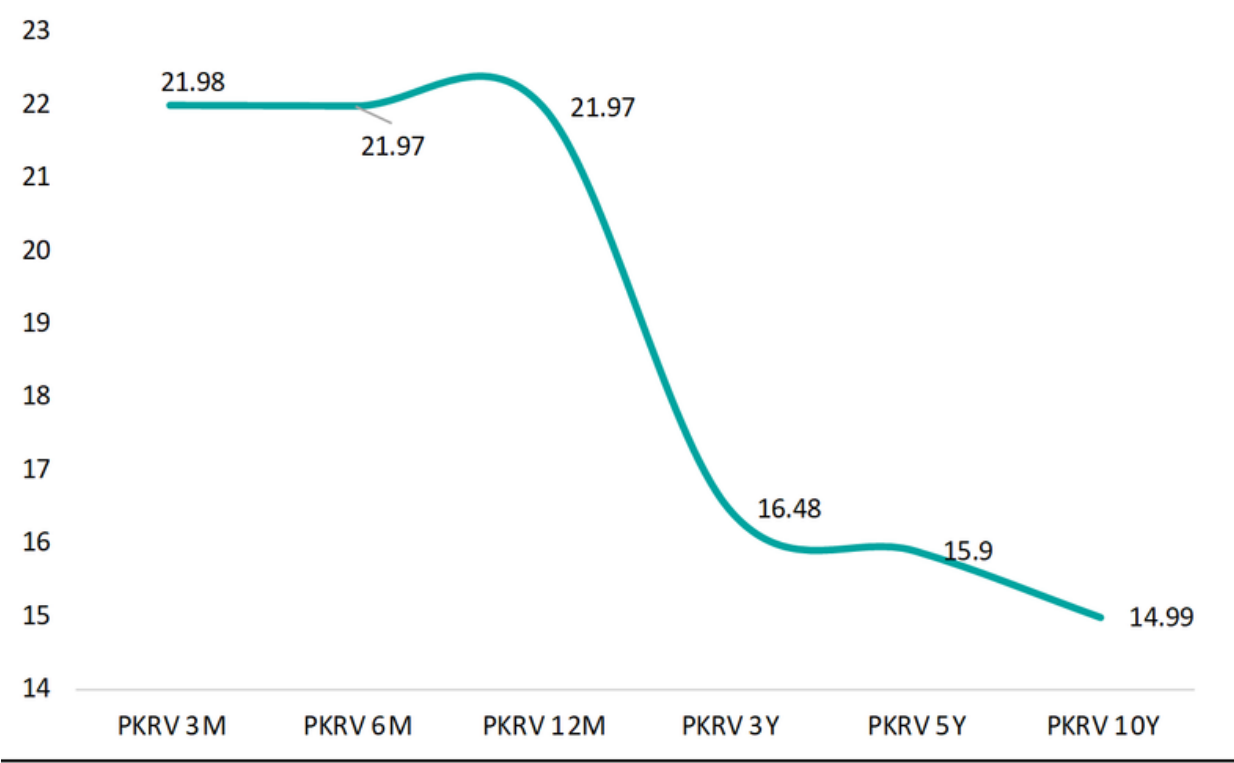
YIELD CURVE ANALYSIS: INDICATIONS OF IMMINENT RATE CUTS

The positioning of Pakistan's PKRV rates below the State Bank of Pakistan's (SBP) policy rate of 22.00% potentially indicates market expectations of a forthcoming rate cut. This scenario often

emerges when market participants anticipate a shift in the central bank's monetary policy, possibly due to expectations of achieving inflation targets sooner or a change in the economic outlook warranting a reduction in rates. Such market behavior suggests a sentiment that the peak of the tightening cycle might have been reached, with the SBP possibly pivoting towards a more accommodative stance in the near future.

This anticipation could be influenced by various factors, including recent economic data pointing to easing inflation, the need for economic stimulation, or broader global economic conditions such as international commodity price trends and monetary policy shifts in major economies. However, it's crucial to interpret these market signals with caution, as they are subject to change based on a myriad of dynamic and sometimes unpredictable factors. Overall, the current PKRV rates below the policy rate seem to reflect a market expectation of a potential easing in the SBP's monetary policy in the not-too-distant future.

Yield Curve (%)



Source: MUFAP

INTEREST RATES TO REMAIN ON HOLD

As we approach the upcoming Monetary Policy Committee (MPC) meeting on December 12, market expectations are that the State Bank of Pakistan (SBP) will maintain the policy rate at its current level of 22%. This is despite projections indicating that average inflation is expected to drop below 20% in 2024. Recent trends in treasury bill and bond yields suggest that market participants anticipate a reduction in interest rates in the near term. The SBP is likely to signal a cautious approach to future policy rate cuts, considering the need to manage imports and the existing low foreign exchange reserves, which currently stand at approximately US\$8bn.

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