

## Economy: SBP cuts policy rate for the first time since Jun-20

The Monetary Policy Committee held its meeting on June 10, 2024 wherein it initiated the monetary easing by cutting the policy rate by 150bps to 20.5%, mainly due to the declining inflation trajectory. Contrary to the market expectation of 100bps rate cut, the SBP went for a higher rate cut. Going forward, upside risks to inflation outlook include measures under the upcoming budget and energy price adjustments. The real interest rate is still considerably positive at 8.7%.

On the external front, SBP governor highlighted that USD12bn repayments will be made in FY24 (USD1bn due in Jun-24) in addition to USD12bn rollovers. Moreover, the backlog of dividend repatriation is being cleared swiftly.

### Core inflation likely to gain prominence

Headline inflation decelerated to 11.8% YoY in May-24 from 17.3% YoY in Apr-24 driven by a sizeable decline in the prices of wheat/wheat flour, along with the downward adjustment in energy charges. However, inflation is expected to rise in Jul-24 from existing levels, before trending down gradually in 2025F. The MPC expects the sharp wheat price reductions to trend upwards in-line with the historic mean reversion. To highlight, we expect the MPC to rely more on core inflation going forward which is insulated to the volatile trend in food and energy prices. Core inflation decelerated to 14.2% YoY in May-24.

### Budgetary measures and adjustments in electricity/gas tariffs to be key

The MPC will closely monitor the inflation trajectory, upcoming budgetary measures, and the outcome of IMF discussions for setting the upcoming monetary policy. Meanwhile, the external position has considerably improved despite hefty debt repayments, as reflected by higher FX reserves (+USD1.1bn increase since Apr-24 MPC meeting).

### Buildup in FX reserves crucial for sustainable economic growth

Lower current account deficit, along with improved FDI and the disbursement of SBA tranche in April, has facilitated ongoing large debt repayments and supported the FX reserves. Going forward, timely mobilization of financial inflows is essential to meet the external financing requirements to effectively respond to any external shocks and support sustainable economic growth. The government has approached the IMF for another EFF program, which is likely to unlock financial inflows that will help sustain the build-up in FX buffers. As per the SBP governor in the post MPS briefing, USD2.0bn out of the USD10.2bn due in Jun-24 and Jul-24 will be paid, suggesting that the remaining amount of USD8.2bn will be rolled over.

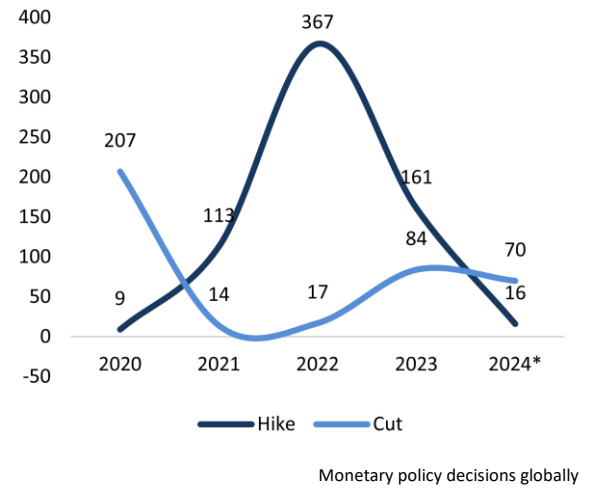
### Rate based increase expected in the upcoming budget

Limited progress in addressing the structural weaknesses to broaden the tax base and initiate energy sector reforms signals that the 2024/25 budgetary measures are expected to be largely rate-based. Fiscal indicators continued to show improvement during 10MFY24. The primary surplus increased to 1.5% of GDP, while the overall deficit remained almost at last year's level. The MPC expects economic growth to remain moderate after accounting for the impact of expected moderation in agriculture output and ongoing stabilization policies.

### Outlook

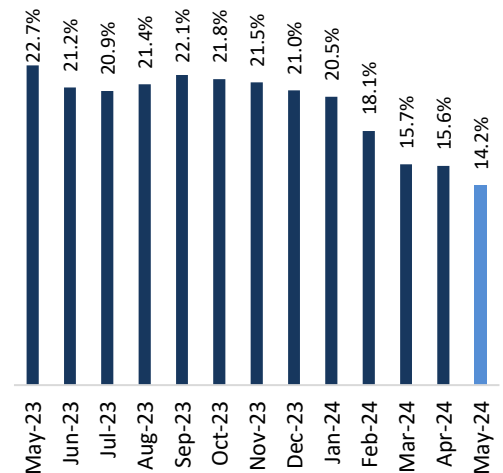
As the SBP carefully curates its data driven policy, we expect the discourse on the boom-bust cycle to pick up as monetary easing in FY25F would gradually promote economic growth but put pressure on imports and the exchange rate. In addition, with budget 2024/25 around the corner, creation of additional revenue space through highly inflationary taxes on fuel and GST can outweigh the gains from lower policy rate and the ensuing decline in debt servicing.

### Monetary easing in line with rate cuts globally



Source: cbrates, Akseer Research  
\*Till date

### Declining trend visible in core inflation



Source: PBS, Akseer Research

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