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KSE 100 Index: 11,853.84

Pre-Monetary Policy – Oct 2011

State Bank of Pakistan (SBP) is due to announce its Monetary Policy statement for the month of October and November on October 08, 2011. Many analysts expect that SBP will cut the key policy rate by 50 basis points to 13%, however, we are assuming that SBP will cut policy rates by 100-150 basis points.

We are expecting that improvement in the current account deficit and lower base inflation will become the cause of cut in the discount rate. The decline in inflation is mainly due to the calibration of CPI basket weightages and base year. However, inflation during the previous month stood at lower as compared to same month last year. Government is trying to boost the economic growth through monetary policy tools rather than broadening the tax base further or reducing subsidies.

The upcoming monetary policy will be the first monetary policy announcement after the completion of USD11bn International Monetary Fund (IMF) loan program on September 30, 2011. The decline in the government borrowings from the State Bank is also expected to play a major role towards expanding monetary policy.

Interest rate cut will project increase in lending and economic growth but the problem arises that Pakistan's looming energy crisis poses obstacles and hurdles towards growth. The country is going through a power crisis. The current shortage of gas is nearly 2.0 billion cubic feet per day and the total electricity demand in summer month outstrips by 22% during the peak hours. The government still needs to cut energy subsidies, especially on electricity and natural gas, which is also expected to leave an inflationary impact.

As per our expectations, this decline in key policy rate will pose positive impact on the equity market as more leveraged companies will get more benefit through enjoying the lower borrowing cost. But this rate cut will also lead towards increase in inflation in the upcoming months as lower inflation during the last two months was mainly due to the effect of base year and CPI basket calibration.

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