

### **Credit Suisse sees 100-200bps rate cut in second half of 2020**

KARACHI: Financial services company Credit Suisse is expecting the State Bank of Pakistan (SBP) to slash interest rates in the range of 100 to 200 basis points in the second half of this year as the IMF-driven rupee stepped back to stability path.

The financial services firm said it seems too early for a rate cut and “we believe the SBP will most likely await firm signs of disinflation before doing so”.

“In addition, real rates remain low implying limited pressure for rates to be reduced in the near term,” Switzerland-based Credit Suisse said in a latest research alert, “Pakistan: On the path to recovery”.

“We believe Pakistan’s rate cuts are weighed toward H2 given that inflation has yet to peak and the SBP would likely wait for 2–3 months of disinflation before considering rate cuts. We believe the central bank is likely to cut rates by 100–150 bps.”

Credit Suisse pins hope on IMF-backed reforms that it said are injecting a dose of stability into the battered rupee that resiliently recovered four percent following the loan program.

“We expect the PKR (rupee) to remain stable going forward, supported by Pakistan’s commitment to the EFF (extended fund facility) program,” it said in the report authored by the firm’s Head of Middle East Research Fahd Iqbal.

In July last year, Pakistan agreed to International Monetary Fund’s (IMF) six billion dollars extended fund facility program to overcome its balance of payments crisis.

“A continuation and improvement in this trend could support a modest overshoot on the REER (real effective exchange rate),” Credit Suisse said with the reference to the positive progress of IMF’s assessment on its extended fund facility (EFF) in Pakistan.

“We note that a move in the REER back to 105 (in line with levels seen prior to 2014) would correspond to a further 2–4 percent appreciation in the PKR, according to our estimates,” it added. Credit Suisse said the rupee had become extremely overvalued, as measured by the REER prior to devaluations.

“The policy to weaken the PKR aggressively erased the overvaluation completely and in fact left the currency looking historically cheap,” it said. “The appreciation since then has neutralised the PKR’s valuation.”

Rupee was devalued by around 33 percent from December 2017 to July 2019, in parallel with the sharp increase in base rates.

“Most of the devaluations were undertaken in a series of 5–6 percent steps and occurred against the backdrop of the government’s negotiations with international donors to bridge its estimated \$12 billion financing gap,” Credit Suisse said.

“The run-up to the EFF approval saw a disorderly weakening of the PKR (rupee) by a further around 15 percent, which we believe was driven by moves to comply with the IMF’s final prerequisites for the funding arrangement.”

The foreign company drew the analogy for this from Egypt where, it said the central bank governor was previously the IMF’s senior representative and he oversaw similar policy initiatives. But, it said Pakistan had to devalue rupee in a disorderly manner in the run-up to IMF’s loan program.

“Importantly, however, the approval of the EFF arrangement triggered a slow and steady four percent appreciation in the PKR, with extremely low levels of volatility,” it said.

“In our view, this points to the currency being brought back under control and suggests limited downside risk, going forward.” Credit Suisse said the rupee has stabilised after a lengthy period of depreciation and foreign investors have started to take notice, with portfolio inflows sharply accelerating over the past six months.

The financial services firm further said equities are likely to remain range-bound after a strong rally, but the long-term upside potential remains significant.

“As the PKR has stabilised, and there is potential for further modest appreciation, we believe the carry trade offers a compelling risk/reward opportunity and recommend short duration t (treasury)-bills.”

Credit Suisse, however, said a key drawback for international investors is low liquidity in the index.

“The primary risk for investors is the potential for a renewed devaluation,” it added. “However, with Pakistan still at the early stages of an IMF program, and the build-up in reserves ahead of expectations, we believe this risk is low. Indeed, as we mentioned earlier, we see the potential for a further modest revaluation in the PKR.”