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State Bank surprises market with policy rate hike

KARACHI: The State Bank of Pakistan (SBP) on Thursday took markets by surprise with a policy rate rise of 25 basis points, though analysts conceded that continued monetary tightening was 'necessary' for maintaining macroeconomic stability, since inflation and twin deficits remain high.

The SBP raised its key policy rate by 25 basis points to 10.25 percent, touching six-year high. The central bank increased the policy rate by a cumulative 4.5 percentage points since January 2018.

"This was above market expectations. In a poll of 30 respondents by Bloomberg, 25 respondents expected status quo, four expected a hike of 50 basis points, while one expected 100 basis points hike," Topline Securities said in its research note.

"The above is a signal by the central bank that the macroeconomic situation of the country remains constrained. Nonetheless, this increase is much lower than the 150 basis points increase in previous monetary policy meeting in November 2018."

The current account deficit was narrowing, albeit gradually. This, along with an increase in financial inflows was contributing to reduced pressures on the country's external accounts.

These developments were encouraging and have served to reduce some economic uncertainty, the SBP's monetary policy document said.

However, the central bank policymakers believe, challenges to Pakistan's economy persist, as pace of the contraction in the current account deficit was below than desired.

Moreover, budget deficit was elevated and core inflation was persistently high.

"This situation calls for continued consolidation efforts," it said.

Abdul Rehman, an analyst at Alfalah Securities, said a 25bps rise in interest rates by the SBP was a bit of a surprise.

"The future course of the monetary policy will be depending on how the economic conditions unfold and when and how the government moves in the bailout negotiations with the IMF," he added.

The SBP expects the projected range of inflation to remain unchanged at 6.5 to 7.5 percent.

It said the second round impacts of the exchange rate movements, upward adjustments in gas and electricity tariffs, and higher government borrowings from SBP were likely to be offset by the lagged impact of the increase in policy rates and the fall in international oil prices, on inflation.

"We expected the SBP to hike today, and we expect it to hike again this fiscal year. We think tighter fiscal and monetary policies are needed in the context of macroeconomic stabilisation," said Bilal Khan, a senior economist at Standard Chartered Bank.

The SBP sees real GDP growth for FY19 to around 4.0 percent, well below both the annual target of 6.2 percent and the 5.8 percent growth realised in the previous year.

Yaqoob Abubakar from Tresmark Research said the SBP has increased policy rate by 25bps, which represents further tightening in the economy.

“It is an indication that SBP is optimistic to stabilise macroeconomic indicators to achieve improvement in the economy. Though market sentiments were that SBP would keep the policy rates unchanged, and would adopt a wait and see policy this time to observe the impact of the last 1.5 percent rate hike,” Abubakar said.

Dr Salman Shah, former finance minister, said the hike in the interest rates was an unnecessary move.

Inflation numbers were reasonable.

The government had already taken some administrative measures and made exchange rate adjustments to curb imports.

It had already implemented fiscal consolidation measures.

“The domestic economy will come to a standstill in response to increase in interest rates,” the former finance minister said.

Erum Zaidi