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High interest rates choke off business borrowing

KARACHI: The private sector is becoming increasingly averse to bank borrowing with successive interest rate hikes, a development that could portend further slowdown in the economy.

The latest data for private sector credit offtake covers the period till May 24 and shows a declining trend from last year.

In the same period last year the private sector picked up Rs558 billion in credit whereas this year the figure has dropped to Rs552bn. This decline comes despite a massive 30pc devaluation in the one-year in between and a sharp spike in inflation.

The State Bank of Pakistan in the last monetary policy increased the interest rate to 12.25 per cent from 6pc in January last year, which is the fastest single-year increase in interest rates ever in Pakistan`s history.

Just after agreement with the IMF the interest rate was further increased while the IMF slashed the economic growth estimate to 2.9 per cent. State Bank forecasts growth as 3.5 to 4pc.

However, the latest data shows that the private sector is retiring itsdebt instead of borrowing for investment.

In the nrst half of this nscalyear the private sector borrowing saw robust growth. The borrowing during the first five months was 5.5 times higher than the same period last year as the amount jumped to Rs245bn compared to Rs44bn. The interest rate had been increased to 8.5pc during this period.

In the first 9 months of this fiscal year, the private sector borrowing kept increasing and it witnessed 30pc jump to Rs577bn compared to the last year.

Asad Umar, the then finance minister, used to point to this uptick in private sector credit offtake in those days to argue that the economy has turned a corner and growth is now returning. But in its second quarterly report, the State Bank said that much of this increase in credit utilisation by the private sector was because business entities had intensified their borrowing activity due to a rising cost of doing business.

`This trend is largely due to the rising cost of imported inputs and higher energy prices on account of rupee depreciation and liquidity constraints owing to a higher level of unsold inventories (in POL, steel, autos, fertilisers, electronics andsugar sectors) along with circular debt in the energy sector,` the report said.

Now it seems that the cost of borrowing is so high that both borrowing and lending became risky. The 12.25pc discount rate means the borrower could get money not less than 16pc to 18pc from banks. The rate is too risky for lenders as the chances of default have increased.

Banks are once again in queue to invest their money in government papers. After increase in interest rate the government papers like Pakistan Investment Bonds became highly attractive for the banks. In the last auction the government of fered 13.67pc and 13.8pc return on 3-year and 5-year PIBs. This is highly attractive for banks as it is risk-free but they still want more return anticipating further increase in the interest rate.

During the first two years, the Nawaz Sharif government offered over 12per cent return on PIBs resulted in drastic cut in the lending to the private sector.

The current situation is more critical since the banks are focused on government papers for its high-yield and risk-free nature and the private sector is in retreat due to very high interest rate and shrinl(ing demand.

By Shahid Iqbal