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SBP expected to raise interest rate on grim inflation outlook

KARACHI: The State Bank of Pakistan (SBP) is expected to push interest rate up over 100 basis points in the upcoming monetary policy announcement scheduled next week as the country is facing an imminent threat of a double digit inflation following freefall of rupee, analysts said on Thursday.

The SBP said it would announce monetary policy for the next two months on May 20 (Monday).

The analysts said the central bank would be focusing on reduction in inflation in the coming months, which clearly implies policy rate hike.

Topline Research Chief Executive Officer Mohammed Sohail said consumer inflation might “soon reach in double digit with likely increase in energy and fuel prices”.

“We expect 100 basis points rise in MPS (monetary policy statement),” Sohail added.

The central bank shunned soft monetary policy stance in January 2017 and since then kept pumping up interest corridor to cumulatively bring the key policy rate up 500 basis points to 10.75 percent.

Consumer inflation hit five-year high of 9.41 percent in March and slightly eased to 8.82 percent in April. Rupee has tumbled around 20 percent in the past year, “making it the worst performer in a basket of 13 currencies in Asia,” Bloomberg reported.

Analysts are fearing a wave of inflationary pressures with increase in cost of doing business and energy prices in the country that recently reached a six billion dollars bailout deal with the International Monetary Fund (IMF). The Fund’s board is yet to approve the deal with the approval linked with some ‘prior actions’ that include cost recovery in the energy sector, market-determined exchange rate and the central bank’s focus on reduction in inflation. Zeeshan Afzal, executive director at Insight Securities said the government is willing to take “quick decisions” to comply with the IMF conditions.

“It is a clear sign of submission to IMF demands,” said Afzal who believed the government’s bargaining power weakened as soon as it introduced major reshuffling in the finance ministry’s team. The government hastened to remove Asad Umar as the finance ministry’s head last month in the midst of IMF negotiation that took longer than usual on unmet demands.

Afzal expected a 200 basis points increase in interest rate with annual inflation forecast at double digit, “but that depends on how soon the government readies to nudge prices of utilities and petroleum products”.

Muhammad Faizan, head of foreign institutional sales at brokerage Next Capital termed the government’s haste as a move to get nod from the IMF bosses on the pending deal. “IMF program won’t be approved if the prior actions are not implemented,” Faizan said. He expected 150 to 200 basis points increase in interest rate in the upcoming policy.

Analysts said the government wants consumption to slow down and erode buying power through discouraging imports and that threatens to have negative fallout on growth.

IMF’s forecast growth to remain subdued at around 2.5 percent in the FY2019 with continued external and fiscal imbalances weighing on confidence.

“Pakistan is facing a challenging economic environment, with lacklustre growth, elevated inflation, high indebtedness, and a weak external position,” the IMF said in a statement after staff-level agreement on economic policies with Pakistan for a 3-year extended fund facility last Sunday.

“This reflects the legacy of uneven and procyclical economic policies in recent years aiming to boost growth, but at the expense of rising vulnerabilities and lingering structural and institutional weaknesses.”

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