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'No rate move next week but cuts possible later in 2019'

KARACHI: Central bank is expected to hold its key policy rate steady next week to assess the effects of a rate hike in July, but analysts believe a rate cut is now possible by the end of the year as measures to curtail twin deficits faltered economic growth.

"We expect the SBP (State Bank of Pakistan) to hold the policy rate at 13.25 percent," Bilal Khan, a senior economist at Standard Chartered Bank said. The SBP is scheduled to announce monetary policy for two months on Monday (tomorrow).

"A decision to maintain the status quo would strike the balance between softening domestic demand and the need to anchor inflationary expectations and rebuild foreign exchange reserves," Khan added.

SBP raised policy rates by a cumulative 750 basis points since January 2018 to contain demand and address external account pressures.

"No change is likely in this monetary policy statement," Mohammed Sohail, chief executive officer at brokerage Topline Securities said, agreeing to the status-quo forecast.

Faizan Ahmed, head of research at Optimus Capital Management said there are grounds for keeping rate unchanged in the (upcoming) monetary policy. "The current account deficit is intact and the exchange rate is stable."

SBP Governor Reza Baqir said early results from the reforms are promising. "The current account deficit, which was one of the principal causes of our economic problems, has halved, export volumes have been growing, non-borrowed reserves have stopped falling and in fact begun to grow, and inflation is projected to start falling from the second half of the current fiscal year," Baqir said, addressing industrialists in Lahore last week.

Annual consumer inflation slightly edged up to 10.5 percent for August compared to 10.3 percent in July, after rebasing of the year to calculate consumer price index inflation to 2015/16 from 2007/8. Under the old method, annual consumer inflation for August stood at 11.63 percent. The year rebalancing turned up July inflation at 8.4 percent. The SBP projected inflation to average 11 to 12 percent and GDP growth of 3.5 percent for the fiscal year 2019/20.

A banking sector analyst said a mandate of the monetary policy committee (MPC) is to consider inflation. "If inflation is below the target it must cut the policy rate, but if there is an upside risk to inflation, it will be careful and to be restrained in softening monetary policy." Alfalah Securities expects unchanged interest rates in the remaining CY2019 and monetary easing to begin from 1HCY20 when the high-base effect kicks in.

Ahmed of Optimus Capital Management also foresees a rate cut later this year “as growth falters”. “There is a scope for 25 basis points cut in the November monetary policy meeting as the government wants to prop up ailing economy.”

Analysts said the market is betting on an earlier than expected rate cut. This was reflective in the secondary market yields, which have come down in the last few treasury bills’ auctions.

“It would be a difficult decision for the MPC to take this time,” a top banker said. “However, slowdown in growth, dull business activities and sliding inflation outlook are encouraging expectations of a marginal 25 percent reduction in interest rates in near-term.”

Economist Ashfaque Hasan Khan wants an immediate rate cut – that is in the September’s monetary policy. “The slowing economy needs a stimulus,” he reasoned.

Khan believed that the SBP ‘unnecessarily’ raised rates to 13.25 percent.

“Discount and inflation has no link in Pakistan. The discount rate is demand management instrument, while inflation in Pakistan is a supply-side phenomenon along with government-administered prices,” Khan, who is a member of the Prime Minister Imran Khan’s economic advisory council, said. “This demand instrument has nothing to do with the government-administrated actions. It’s simply increased the cost of capital which has chocked the economic activity in the country.”

Khan further said hike in interest rates has caused more harm to the economy than it benefited. “It’s simply increased interest payments and created serious budgetary problem,” he added. “The SBP should follow a principal that discount rate would be 1 to 1.5 percent above the core inflation.”