DAWN

Mohiuddin Aazim

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SBP's traditional response to high inflation

The State Bank of Pakistan (SBP) insists its monetary policy stance "is appropriate to bring inflation down to the medium-term target (in the) range of 5-7 per cent over the next six to eight quarters".

On Jan 28, the central bank decided to keep its policy rate unchanged — for the third time — at 13.25pc for the next two months. In 2018-19, the SBP jacked up its policy rate from 6.5pc to 12.25pc — in instalments. Despite that, annual consumer inflation rose to 7.3pc from 3.9pc in 2017-18.

At the beginning of this fiscal year, the SBP increased the rate once again by a full percentage point to 13.25pc — before putting brakes on interest rate tightening. But in the first half of 2019-20, CPI inflation rose 11.1pc year-on-year. The increase in inflation in December alone was even sharper — 12.6pc.

The fact that the SBP refuses to accept that currently inflation in Pakistan is, at least partly, cost-push has added to the miseries of the private sector. Had inflation been really as demand-driven as the SBP believed, it would have subsided somewhat after so much policy rate hikes. But inflation is galloping. And many independent economists and business leaders insist costlier finance is now fuelling it.

The tightening of interest rates should ideally lead to slower growth in the currency in circulation if the transmission of monetary policy is flawless. But its flows grew in 2018-19 to Rs562 billion from Rs476bn in 2017-18.

Economic activities of the fund-starved private sector have slumped, dragging down GDP growth

And, in less than seven months of 2019-20, the currency in circulation has already crossed the Rs500bn barrier, according to the SBP. Faster growth in the currency in circulation, or money circulating outside the banking system, fuels the assumption that the informal economy is growing despite the PTI's tall claims.

The IMF says the economy in 2019-20 is expected to grow weaker than it did last year. SBP Governor Dr Reza Baqir also admitted in his press conference on Jan 28 that GDP growth could be lower than the projected 3.5pc, "primarily on account of adverse supply-side shocks to cotton production and contraction in large-scale manufacturing (LSM)".

Lower economic growth in 2018-19 (3.3pc against 5.5pc in 2017-18) has already rendered hundreds of thousands of people jobless — and many more continue to lose jobs daily as the formal economy is not picking up pace. Inflation, meanwhile, remains stubbornly high. We need out-of-the-box solutions for curbing inflation before occasional reports of poverty-related suicides become a routine. It is up to our learned policymakers to find out such solutions.

What else puts a question mark on the much-trumpeted "fiscal consolidation" is the excessive government borrowing from commercial banks

More policy focus on price stability is must as the SBP has warned of near-term risks to inflation "primarily from food price shocks and potential increases in utility prices" though it has also identified some factors that can gradually moderate inflationary pressure. "These include the recent appreciation of the exchange rate after the introduction of the market-based exchange rate and ongoing fiscal consolidation."

But who doesn't know the exchange rate remains stable mainly due to the borrowing from the IMF and other foreign creditors (that the country will have to repay), slashed import bills and accelerated inflows of somewhat risky investment in short-term government debt. Governor Baqir, however, does not think this investment is risky. He insisted during his press conference that such inflows currently constitute only "3.8pc of total marketable government debt". The point that our learned governor seemingly ignored is that what makes such inflows risky is not their share in the stock of marketable government debt: rather, it is the very nature of such inflows that they might fly away once interest rates start falling.

The PTI government takes much pride in — and the SBP chief also highlighted this fact — that tax revenue during the first half of 2019-20 grew by 16pc. And that together with the brakes that the federal government claims to have applied on day-to-day expenditures — forms the core of "fiscal consolidation" — referred to in the SBP's Jan 28 press release.

One will have to wait for the second quarterly fiscal operations report to see where exactly the government expenses are. But taking pride in 16pc tax revenue generation seems a bit outrageous. Inflation during the first half of 2019-20 was 11.1pc. So net revenue growth comes to just 4.9pc. This polite reminder seems in order as economic managers keep reminding the nation that the net interest rate (interest rate minus inflation) is actually low.

What else puts a question mark on the much-trumpeted "fiscal consolidation" is the excessive government borrowing from commercial banks. (Between July 1, 2019 and Jan 17, the federal government borrowed Rs825.5bn). It is true that this borrowing from commercial banks is being used entirely for retiring the central bank's debt. But the problem is that excessive government borrowing has crowded out the private sector. And, fund-starved private sector's economic activities have slumped — dragging down GDP growth.

To mitigate the ill effects of persistently high interest rates, the SBP has balanced its decision of keeping the policy rate unchanged by announcing Rs200bn concessional financing for the export sector. Though it is apparently a commendable right step in the right direction, concessional financing alone cannot immediately boost exports.

Our agricultural output is not growing and industrial production is down. That means no big addition can be expected in the exportable surpluses — not, at least, in the near term.