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SBP keeps policy rate unchanged at 13.25pc

KARACHI: The Monetary Policy Committee (MPC) on Tuesday decided to keep the policy rate unchanged at 13.25 percent for next two months as the inflation outlook is remained unchanged.

Governor State Bank of Pakistan (SBP) Dr. Reza Baqir announced the decision at a press conference at SBP head office after the meeting of MPC.

Governor SBP said that MPC believed that the current monetary policy stance is appropriate to bring inflation down to the medium-term target range of 5-7 percent over the next six to eight quarters.

"On balance, the SBP's projection for average inflation remained broadly unchanged at 11-12 percent for FY20, therefore the committee has decided to maintain the policy rate unchanged at 13.25 percent," he added.

On the one hand, recent inflation outturns have been on the high side and there remain near term risks to inflation primarily from food price shocks and potential increases in utility prices. On the other hand, several factors are expected to gradually moderate the pressure on inflation due to recent appreciation of the exchange rate after the introduction of the market-based exchange rate and ongoing fiscal consolidation.

He said that although inflation has increased since the last hike in key policy rate, on positive note its projection for this fiscal year is still 11-12 percent. Previously, food and utility prices and supply chain issues were the chief reason behind the hike in inflation, however now it is being expected that that inflation rate will reduce in coming months.

He said that despite a tight monetary policy stance, Pakistan's real interest rate is less than other countries'. Pakistan's real interest rate is still 1-2 percent, while in the past some time it was as high as 3 percent.

Baqir said that recent inflation outturns have been on the higher side. National CPI inflation rose to 12.7 and 12.6 percent (on y/y basis) in November and December 2019, largely reflecting sharp increases in selected food items on account of temporary supply disruptions and upward adjustments in administered prices.

If sustained, high food price inflation could lead to demands for faster wage growth and to possible risks of a wage-price inflation spiral, he added.

However, available evidence suggests that such second-round effects on inflation from supply side shocks have not materialized and inflation expectations remain broadly anchored, he mentioned.

Consequently, the MPC viewed the latest increases in CPI as primarily transitory in nature. The MPC noted that real interest rates on a forward-looking basis were not high compared to other emerging markets and from the perspective of Pakistan's own experience.

According to monetary policy statement, the MPC considered key developments in the real, external and fiscal sectors along with their projections, and the resulting outlook for monetary conditions and inflation.

The MPC noted three key developments since the last meeting on 22nd November 2019. First, the ongoing and substantial reduction in the current account deficit and the orderly conditions in the foreign exchange market after the transition to a market-based exchange rate system continued to strengthen the country's external accounts.

Second, the IBA-SBP survey of business confidence showed an improvement in the business community's outlook for economic activity for a third successive wave. Third, fiscal developments remained on track and in line with commitments made under the IMF-supported program, buoying the overall economic reform sentiment.

On Real sector, the latest production estimates of major crops indicate that all Kharif crops, except cotton, grew in line with expectations. Cotton production has been revised downward due to adverse supply side shocks.

Large scale manufacturing (LSM) indicates that economic activity is strengthening in export-oriented and import-competing industries, while inward-oriented industries continue to slow down.

Specifically, LSM showed gains in textiles, leather products, engineering goods, rubber products, cement and fertilizer, and declines in auto, electronics, food, chemicals, and petroleum products.

Primarily on account of adverse supply side shocks to cotton production as well as the contraction in LSM to date, SBP's projection for real GDP growth for FY20 is likely to be revised downward.

Nevertheless, available monthly indicators of activity show that the slowdown in most economic sectors appears to have bottomed-out, and a gradual recovery is expected in the coming months.

On external sector side, the current account deficit contracted by 75 percent to $ 2.15 billion during the first half of FY20 due to a notable reduction in imports and modest growth in both exports and workers' remittances.

The MPC noted that monetary policy would continue to be based on the medium-term outlook for inflation.

Fiscal consolidation has remained on track during the year to date and has supported a qualitative improvement in the inflation outlook. During the first half of FY20, tax revenue collections showed a healthy increase of 16 percent over the same period last year.

On the expenditure side, while non-interest current expenditures have been strictly controlled, the federal releases for public sector development programs (PSDP) stood at Rs 300 billion in first half of FY20 as compared to Rs 187 billion in the same period of last year.

This increased public spending is expected to support business activity, especially in construction-allied industries. From the monetary policy perspective, the MPC emphasized that the continuation of fiscal prudence would remain critical for effective anchoring of market sentiment and improving the inflation outlook.

Private sector credit (PSC) grew by 2.2 percent during 1st Jul - 17th Jan FY20 as compared to 8.5 percent in the same period last year. This deceleration broadly reflects a soft economic activity.