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SBP links further rate cut with unfolding situation

KARACHI: The State Bank of Pakistan (SBP) has not ruled out a possibility of further rate cut after swiftly reducing the benchmark interest rates by a cumulative 525 basis points in an unprecedented short span of two months, analysts said on Saturday.

People close to the SBP's monetary policy committee (MPC) said interest rate came down to the present level mainly due to soft inflation.

"If further evidence comes up, MPC would react accordingly," said an analyst who attended a post-rate cut central bank briefing.

But, currently the uncertainty is "too high," the SBP Governor Reza Baqir was quoted as saying. "So, it would be wrong to commit to any level of interest rates."

On Friday, the SBP lowered its policy rate by another 100 basis points to 8 percent – largely in line with the market expectations. This was the fourth reduction in the rate since March 17 this year, taking cumulative easing of 5.25 percent from 13.25 percent, to address the worsening outlook of domestic economic activity in the wake of economic halt after COVID-19 outbreak.

In the monetary policy statement, the SBP said petrol and diesel prices were down 30-40 percent, while initial volatility observed in domestic financial and foreign exchange markets has somewhat subsided in the recent weeks. The inflation outlook has improved further because of recent cut in domestic fuel prices. SBP expected inflation to fall closer to the lower end of both the previously announced ranges of 11-12 percent and 7-9 percent for FY2020.

Analysts said the meeting noted that the country already witnessed the largest interest rate cuts among the emerging markets, in response to COVID-19.

The analysts said the SBP governor believed two factors would be under consideration to make a policy decision.

"Controlling current account deficit and inflation rate would give more comfort for keeping interest rates low," he was cited as saying.

The current account deficit continued to narrow, even though both exports and imports fell sharply since the coronavirus outbreak. Remittances have been surprisingly good so far.

The meeting agreed that it would be important to see remittances beyond Ramazan and Eid, which is usually a high inflow season.

The SBP governor said the country is in talks with the IMF over the extended fund facility program and "one can expect a staff level agreement soon". In April, the International Monetary Fund deferred second review of its $6 billion loan program with Pakistan and that stopped release of the third loan tranche.

The analysts said the SBP wants to ease the pain for the businesses that favor interest rate in the range of 4 to 5 percent.

It was told that economic activity fails to pick up as a key downside risk to inflation, while potential food price shocks pose some upside risks. However, the SBP governor believes inflation is not a concern and focus of the central bank remains more on financial stability.

The SBP does not see a liquidity stress on banking sector so far. Deposit withdrawals due to prevailing uncertainty are also not abnormal, the meeting was told.