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SBP likely to leave policy rate unchanged

Pakistan's central bank is scheduled to meet on Monday (Nov 23) to determine the benchmark interest rate for the next two months at a time of rising Covid-19 cases in the country, dull economic activity, higher inflation reading and negative real interest rate.

Traditionally, the State Bank of Pakistan (SBP) revises its policy rate up or down, or keeps it unchanged in relation to the inflation reading and economic activities.

Low inflation mainly leads to a reduction in the policy rate for ramping up economic activities and vice versa. The rate is left unchanged at a higher level to tame inflation or on the lower side to support economic growth.

However, the world is quite different today where the pandemic is dominating decision-making in all walks of life and everything else has become less important.

In addition to this, Pakistan has invited the International Monetary Fund (IMF) to complete its second review of the country's economy under the $6 billion loan programme, which has been on hold since the Covid-19 outbreak in Pakistan in February. The Fund has asked Islamabad to meet loan conditions including hike in power tariff, additional measures for increase in tax collection and making the central bank autonomous.

Keeping this in view, experts said the central bank's monetary policy committee (MPC) is expected to leave the policy rate unchanged at 7% to let economic activities pick up pace despite a high inflation and spike in Covid-19 cases.

The Express Tribune conducted a brief survey to know the expectation of research houses about the policy rate. All the nine respondents foresaw no change in the prevailing rate. Earlier, the central bank slashed the policy rate by a cumulative 625 basis points in five revisions between March and June 2020 to support economic activities and help businesses and individuals stave off default on bank loans.

At present, the real interest rate (the benchmark interest rate minus inflation reading) is around 1% negative. Experts said MPC may find the prevailing policy rate appropriate for now, considering that inflation stood at an elevated level due to supply shocks in the food chain instead of demand pressure and higher foreign income of the government than its expenditure in the first four months (Jul-Oct) of FY21.

Going forward, the external economic indicators may come under pressure ahead of the reopening of world economies sometime around Feb-Mar 2021. It may encourage the SBP to increase the policy rate around that time.

“Though inflation has remained high at around 9%, focus on growth for now, especially with the onset of Covid’s second wave, should prompt the monetary policy committee to leave the rate unchanged,” said BMA Capital Executive Director Saad Hashmi. Shajar Capital Research Analyst Muhammad Saeed Khalid said “the SBP has kept the real interest rate at negative 1% in order to reach pre-pandemic growth levels. We believe the SBP will maintain the strategy till a Covid-19 vaccine is widely available in Pakistan.”

Topline Securities CEO Muhammad Sohail said “though inflation is rising but the SBP, considering the Covid-related risks and stable currency, may keep the rate at current level.”

Pak-Kuwait Investment Company (PKIC) Head of Research Samiullah Tariq said “the economy is still recovering from the impact of Covid-19 and the time is not suitable for an increase in the policy rate.”

Moreover, the government was comfortable on the balance of payments front, therefore, any rate increase did not seem possible, he said.

Arif Habib Research Head of Research Tahir Abbas said the challenge of reviving aggregate demand given the change in macros in the wake of Covid-19 may further push the SBP to stimulate the economy by not increasing the policy rate.

Tangent Capital Advisers CEO Muzammil Aslam said the economy was still running below potential and the current wave of food price-driven inflation was not the outcome of aggregate demand rather it was due to multiple factors, including locust attack, untimely rains and global staple food pressure.

Aba Ali Habib Securities Research Analyst Zubair Jatoi said considering the narrowing negative real interest rate gap, the research house expected the central bank to leave the policy rate unchanged at 7% for the next two months, prioritising economic growth by propping up recovery of the pandemic-hit economy.