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State Bank keeps interest rate unchanged at 7 percent

KARACHI: The central bank kept the benchmark interest rate unchanged at 7 percent on Monday while viewing growth and inflation expectations as well-anchored, although it says COVID-19 is still posing challenges to economic outlook.

“The monetary policy committee decided to maintain the policy rate at 7 percent,” the State Bank of Pakistan (SBP) said in a statement. “[S]ince the last meeting in September, the domestic recovery has gradually gained traction, in line with expectations for growth of slightly above 2 percent in FY21, and business sentiment has improved further.”

Though inflation numbers have been on the higher side primarily due to increases in food prices, these supply-side pressures are likely to be temporary and average inflation is expected to fall within the previously announced range of 7-9 percent for FY21.

“Taken together, risks to the outlook for both growth and inflation appear balanced,” it said. “Nevertheless, there are risks to the outlook. The recent rise in Covid cases in Pakistan and many other countries presents considerable downside risks.”

The SBP said after falling sharply since January, headline inflation has remained close to 9 percent during the last two months, primarily driven by sharp increases in selected food items due to supply-side issues. Core inflation has been relatively moderate and stable, in line with subdued underlying demand in the economy, it said.

The SBP’s decision was according the market expectation as the SBP already delivered rate cuts of 625 basis points between March and June to bolster economy severely hit by lockdown related to coronavirus.

SBP told analysts it followed a proactive approach and tried to keep an accommodative policy stance with real interest rates being slightly negative on a forward looking basis. “Being data dependent and forward looking, SBP reiterated its stance on acting according to the changing dynamics of the economy, as and when needed,” brokerage Arif Habib Limited said in a flash note on analyst briefing. “At the moment, the primary focus of SBP is on the growth of the economy followed by other indicators such as external account and overall financial stability.”

The SBP said the existing stance of monetary policy is appropriate to support the nascent recovery and inflation expectations well-anchored. “The lagged effects of the significant fiscal, monetary and credit stimulus injected during the pandemic should continue to shore up growth in coming quarters,” said the SBP.

Recent data suggest a further strengthening and broadening of the recovery observed since July, led by construction and manufacturing. Sales of fast moving consumer goods rebounded in FY21 Q1, average sales volumes of petroleum products and automobiles have surpassed their pre-Covid levels of FY20, and cement sales are at an all-time high. Large scale manufacturing continues to rebound, expanding by 4.8 percent in FY21 Q1, against a contraction of 5.5 percent in the same quarter last year. Nine out of fifteen major manufacturing sectors have shown gains, including textiles, food and beverages, petroleum products, paper and board, pharmaceuticals, chemicals, cement, fertiliser, and rubber products.

"The recovery was being supported by stimulus provided by the government, the round of policy rate cuts and the SBP's timely measures to mitigate the impact of the COVID pandemic," said the SBP.

The SBP said external sector continues to strengthen, with the current account in FY21 Q1 recording the first quarterly surplus in more than five years. After remaining in positive territory for all four months of this fiscal year, the cumulative current account through October reached a surplus of $1.2 billion against a deficit of $1.4 billion in the same period last year. This turnaround was supported by an improvement in the trade balance and record remittances. Exports have recovered to their pre-COVID monthly level of around $2 billion in September and October, with the strongest recovery in textiles, rice, cement, chemicals, and pharmaceuticals. Remittances recorded strong growth of 26.5 percent during July-October, primarily due to orderly exchange rate conditions, supportive policy measures taken by the government and SBP, travel restrictions, and increased use of formal channels. Meanwhile, subdued domestic demand and low global oil prices have kept imports in check.

"The sizable current account surplus and improving outlook and sentiment for the economy have supported a 3½ percent appreciation in the rupee since [September] and further strengthened external buffers, with SBP's foreign exchange reserves increasing to $12.9 billion, their highest level since February 2018," said the SBP.

"Based on the performance to date, the outlook for the external sector has improved further and the current account deficit for FY21 is now projected to be below 2 percent of GDP." The SBP said the primary balance posted a surplus of 0.6 percent of GDP in FY21 Q1, similar to the levels achieved during the same period last year, despite lower non-tax revenue.

"However, the higher overall budget deficit due to larger domestic interest payments should taper as the benefits of recent interest rate cuts filter through. PSDP-releases, which are an important stimulant of economic activity, recorded an increase of 12.8 percent during the first four months of this year," it said. "On the revenue side, despite a fast-tracking of refunds to help businesses during the pandemic, FBR tax collections continued to record positive growth, at 4.5 percent in July-October, to come in close to target levels."

The SBP said while private sector credit growth is moderate on a year-on-year basis, its month-on-month momentum is reverting to pre-Covid trends. "With higher risk aversion on the part of commercial banks, the expansion in credit to the private sector has been supported by SBP's temporary and targeted refinance schemes introduced in the aftermath of the Covid-19 shock."