BUSINESS RECORDER
Founded by M.A. Zuberi

25th November, 2020

Editorial

MPS: Nothing profound

Monetary Policy Statement issued on 23 November 2020 decided to keep the discount rate unchanged at 7 percent – a decision that is baffling to independent economists given that the rate is clearly neither linked to core inflation (5.6 percent in October – a linkage supported by previous governors and a research paper uploaded on the State Bank of Pakistan (SBP) website dated 2006) nor the Consumer Price Index (CPI) of 8.9 percent in October (a linkage supported by Governor SBP from 6 May 2019 till March 2020). It is reasonable to have expected the SBP to clarify, through a research paper, as to why this change was considered appropriate. However, disturbingly, the SBP research wing has not uploaded any research on the SBP website to date to explain why the discount rate began to be linked to the CPI last year, why today that is no longer a consideration as well as why the SBP no longer considers it appropriate to use its own calculations of the real effective exchange rate (REER) to determine whether the rupee is undervalued, as indicated, or not.

It is precisely this lack of a coherent linkage of the discount rate with the primary responsibilities of the SBP – notably checking inflation and unemployment – that accounts for the perception that the rate is sustained at 7 percent due to political as opposed to economic considerations. SBP's MPS notes that since its last meeting on 21 September 2020, when the discount rate was sustained at 7 percent, a positive outlook has been evident on a number of significant fronts. Firstly, the economy has gained traction in line with expectations for growth of slightly above 2 percent in the current fiscal year, an expectation not supported by any of the multilaterals who have unanimously projected a 1 percent growth in the current year.

Secondly, the MPS claims that the rise in inflation is due entirely to an increase in food prices and that these supply side pressures are likely to be temporary and average inflation is expected to fall within the range of 7 to 9 percent. The recently - released data by the Pakistan Bureau of Statistics (PBS) notes large scale manufacturing index (LSMI) of food/beverages/tobacco increased from negative 8.9 percent to positive 12.9 percent and yet this massive increase had little impact on containing food inflation. In addition, the international prices of oil are on an upward trajectory which would raise input costs across the board and the expected shortfall in the unrealistic revenue target of 4.9 trillion rupees will put pressure on the government to raise taxes on items that are easy to collect.

The MPS refers to 'nascent recovery' and refers to large scale manufacturing output continuing to rebound, expanding by 4.8 percent; however, like exports the base was so low in previous months that while percentages show a very healthy growth yet the actual numbers do not present a comfort level. The LSMI shows that iron and steel, items used in construction sector, declined during the first quarter of the current year, while the PBS did not record cement sales reflecting no major increase as claimed by the Prime Minister and his economic team leaders.

Thirdly, the MPS yet again reports a current account surplus; however, the major contributor to this has been an increase in remittance inflows that have perhaps more to do with 'travel restrictions' due to Covid-19 than due to what the MPS claims 'orderly' exchange rate conditions, supportive policy measures taken by the government and SBP. The 'orderly' exchange conditions emphasized by the MPS may be attributed to the warning by the Fund in Rapid Financing Instrument documents (April 2020) wherein "staff stress that intervention in the foreign exchange market should remain limited to prevent disorderly market conditions;" a warning that without doubt must have been restated during the ongoing talks with the Fund on the second mandatory review and may perhaps account for the recent rise in the rupee rate from under 157 rupees to the dollar to 161 rupees to the dollar.

Of serious concern should be the fact that the contractionary monetary policy (7 percent discount rate is higher than the rate in our regional competitors with India and Bangladesh at 4 percent, Sri Lanka at 4.5 percent and China at 2 percent) and fiscal policy continue to this day stifling growth just like last year.

There is, therefore, an urgent need for the SBP to set targets for its research wing and at the same time revisit its discount rate policy that appears to be neither balanced nor well-anchored – words used a number of times in the 23 November MPS statement to indicate that all is satisfactory on the inflation and unemployment front.