The Policy Rate cut: Why should the SBP consider a 3.0% to 5.5% reduction in the interest rates.

In its forthcoming monetary policy meeting on Thursday, September 12, the SBP's Monetary Policy Committee ("MPC") is projected to conduct a third successive reduction in its benchmark policy rate. The anticipated cut, ranging from 3.0% to 5.5%, follows a deceleration in the inflation to a single digit in August 2024.

The data provided in the table hereinbelow reflects the trend in the past decisions taken by the MPC:

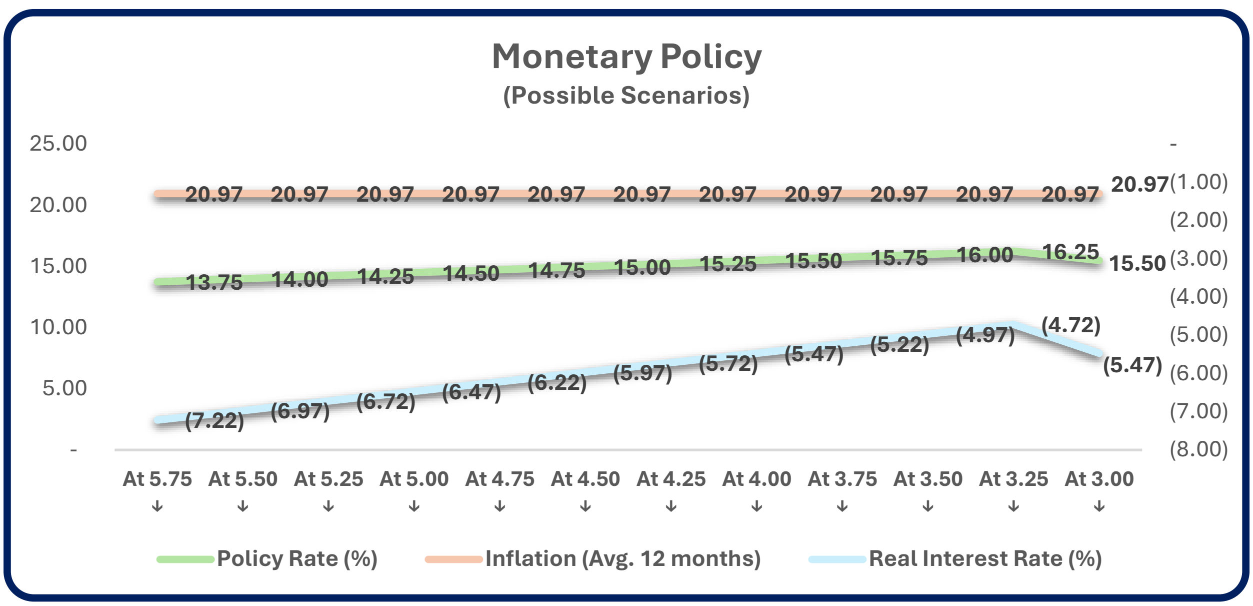
Monetary Policy Meetings	Interest rate	Inflation	Real interest rate
18-Mar-24	22.00	30.28	(8.28)
29-Apr-24	22.00	29.06	(7.06)
10-Jun-24	20.50	25.28	(4.78)
29-Jul-24	19.50	22.45	(2.95)
Avg. Real Interest rate		**(5.75)**	

The average real interest rate over the last four meetings is approximately -5.75%, while the average inflation for the past 12 months is 20.97%. This indicates that the current policy rate of 19.5% remains too high in relation to prevailing inflation trends.

To bring the policy rate in line with the appropriate real interest rate that matches the current inflationary environment, a reduction of **3.0% to 5.5%** is **recommended**.

Moreover, the inflation could decrease further if currency parity reflects its true value, potentially lowering inflation to 7-8%. For a detailed understanding please click here.

The chart *infra* illustrates possible scenarios of policy rate cut in the range of 3.0% to 5.5%.



In our humble view, the SBP should cut the policy rate by at least 3% to 5.5%. Lastly, the Monetary policy should be part of the solution, not part of the problem. By reducing the policy rate, the SBP will facilitate economic recovery and help mitigate the existing cost-push inflation.