Interim Monetary Policy Measures

November 2008

STATE BANK OF PAKISTAN

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Executive Summary

Recognizing the continuing economic challenges and complexities, Pakistan has launched a comprehensive macroeconomic stabilization package for the medium term. This program is aimed to curb the growing macroeconomic imbalances and strengthen the fiscal and monetary coordination. It is also expected to facilitate official and private foreign inflows which are critical to stabilize and build the foreign exchange reserves to an adequate level. The crux of this program revolves around reducing the external current account deficit supported with appropriate exchange rate policy and bringing the fiscal deficit to sustainable levels by rationalizing expenditures and strengthening tax revenue generation. In developing this macroeconomic stabilization package, the Government and SBP have stepped up their consultations mutually and with other stakeholders over the last few months. This stabilization package provided it is adhered to strictly by all stakeholders, will help to proactively manage supply and demand pressures which are critical to restoring economic confidence and stability.

The need for an effective macroeconomic stabilization package had heightened early in the year as the economic indicators came under stress because of the impact of global commodity price hikes combined with a persistent rise in aggregate demand pressures. Both factors have resulted in rising fiscal and external account deficits during FY08 beyond sustainable levels. These trends not only derailed hard earned economic gains of previous years, but generated inflationary pressures that are hurting public and industry at large. Challenges and risks have magnified as the unanticipated adverse macroeconomic outcome of FY08 persisted and spilled over into FY09.

Policy Measures Taken. Being at the forefront of demand and foreign exchange management policies, SBP has taken a range of timely measures to proactively address the challenges as and when they emerged. Since the beginning of FY08, corrective policy measures taken by SBP include:

(i) Staggered increase in the SBP policy rate to 13 percent;

(ii) Timely changes in Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR) for effective liquidity management;

(iii) Encouraging aggressive resource mobilization in private sector by catalyzing banks to raise more deposits through imposition of minimum

deposit rate and exempting long tenor deposits from reserve ratios– later not only allowed banks to encourage savings but address their asset-liability mismatches;

(iv) Steps to stabilize and curb excessive volatility in foreign exchange markets – though macroeconomic fundamentals rendered depreciation in currency inevitable and needed; and

(v) Assessing and monitoring closely the liquidity in the financial system and ensuring the release of desired level of liquidity through all monetary tools available at hand. Competing demand for liquidity by both public and private sector has been high given the demands of Government borrowings as well as the high credit requirements factoring in the inflationary impact.

On its part, the Government resolved to scale the exceptionally high deficit of FY08 to a more manageable level and took a host of budgetary policy measures. Specifically, subsidies on domestic petroleum products and the electricity tariffs have been eliminated over the past few months. The general sales tax (GST) rate was raised by one percentage point to 16 percent and the efforts to increase tax revenue collection have been enhanced. Also the Government has raised the wheat procurement price to stimulate production. There is a resolution to assess and solve the problem of circular debt issue. The budget for FY09 included an explicit commitment to limit the inflationary borrowings from the SBP at zero on a cumulative basis during the remaining fiscal year.

Further there has been a change in Government strategy for domestic borrowing. The steps in this regard include: (i) a cumulative increase in the interest rates for the National Savings Schemes between 200 bps to 400 bps in two phases since end June 2008, (ii) rise in the 3-month T-bill cut-off rate to 13.53 percent, which was allowed to move up the policy discount rate to attract higher financing for Government, and (iii) introducing greater flexibility to use a part of the foreign official development assistance to retire the stock of government borrowings from the SBP. It is anticipated that fiscal tightening of the desired level will be in place to ensure that monetary tightening stance is not undermined.

Economic Outcome for Jul-October FY09 has deviated from expectations. Notwithstanding these measures, additional unanticipated developments emerged and the outcome during the first four months of FY09 deviated substantially from

expectations. Among others, three principal factors complicating macroeconomic management are:

- **One,** continued growth in public sector spending beyond resource availability as indicated by excessive recourse to inflationary borrowing from the SBP, which reached to Rs369 billion during 1st July to 8th November 2008; of this Rs128 billion is on account of maturing T-bills, which commercial banks did not subscribe to in the auctions conducted over this period. Also Rs21.1 billion is on account of accrued profits on SBP holding of T-bills.

- **Two,** surge in import bill by 35.2 percent during Jul-Oct, FY09 is unsustainable given the low level of financial inflows and depleting reserves. The import bill would have had a more severe impact on the external imbalances had exports and remittances not been buoyant.

- **Three**, inflation accelerated and its expectations strengthened due to pass through of international oil prices to domestic market, increases in the electricity tariff and the general sales tax, and rising exchange rate depreciation. These developments resulted in a further rise in headline as well as core inflation (20 percent weighted trimmed measure) to 25 percent and 21.7 percent respectively in October 2008.

The growing and magnified economic stress has impacted key segments of the economy. Adverse expectations and sentiments have also played their role in shaping industry and public behavior. These developments have generated multiple and diverse set of debates.

Diagnostics of Pakistan economic situation is different from global and regional developments, therefore, policy responses have to be different. With the world in grip of the worst financial crisis, some sections of the society have argued for fiscal stimulus and monetary easing in Pakistan drawing parallels between the global and the Pakistan economy. It is critical to recognize that the magnitude, depth, and impact of this global crisis vary across regions and countries and that the domestic macroeconomic situation differs in each country. While a number of advanced countries are facing severe liquidity crisis, which transformed into an insolvency crisis, the macroeconomic fundamentals of these countries, to start with,

were in order. At the same time other large Asian countries, while being impacted by the global events, have been able to weather the storm given their strong reserve positions.

In contrast, Pakistan, hit by the global commodity price shock and given the delays in pass through of this price effect, witnessed a growth in its fiscal and external current account deficits that reached unsustainable levels and alarmingly high inflation. With stagnating tax to GDP ratio, this not only enhanced recourse to borrowings from the SBP but also resulted in a fall in foreign exchange reserves, triggering depreciation in the exchange rate. Since there are significant differences in 'diagnostics' among Pakistan and other countries it must be recognized that the policy solutions will also be different.

Considering the size of macroeconomic imbalances, the SBP remains committed to achieve price stability over the medium term and thus have to launch steeper monetary tightening to tame the demand pressures and restore macroeconomic stability in FY09. Monetary tightening is warranted to:

Reduce the external current account imbalance. Despite proceeds from workers' remittances and exports of $2.3 billion and $7.1 billion respectively, the import bill of $12.9 billion has raised external current account deficit to $5.9 billion during Jul-Oct, FY09. Underlying this sharp growth in imports (35.2 percent) is the rising oil bill that reached $4.9 billion (close to $1.23 billion per month) as the international oil prices for this period averages to $123 per barrel; well above the FY08 average of $87.4 per barrel. Consequently, the share of oil bill in the total import bill has increased to 38 percent as compared with 30 percent in FY08. Non-food-non-oil imports also grew by 6.8 percent during Jul-Oct, FY09, adding to the pressures. With financial inflows slowing down ($1.1 billion only in Jul-Oct, FY09), the external current account deficit had to be financed by drawdown of SBP's foreign exchange reserves – this involved depletion of reserves by $5.0 billion since the beginning of this fiscal year up to 10th Nov, 2008. The recent decline in international oil and other commodity prices bodes well for the external sector; however a sustained decline in overall import demand is critical to avoid further reserve loss after its expected build up.

Reinforce fiscal tightening and discipline. The government is planning to curb its expenditures and adhere to a desirable borrowing program for FY09 which aims

to renew efforts to reduce its reliance on inflationary borrowings from the central bank. The fiscal pressures have resulted in cumulative borrowings from the SBP of almost Rs1.4 trillion as on 8th November 2008, of which Rs369 billion (inclusive of the need for financing the rollover of Treasury Bills maturing) were required during 1st July to 8th November 2008. These trends in SBP borrowing underscore the need for aligning fiscal management in accordance with the overall resource availability to avoid further crowding out of private sector credit and prevent further stress on core inflation. Besides rising inflationary pressures, the prevailing trends have posed complications and conflicting demands on monetary management. At present interest rate levels, the banks have undersubscribed to the government securities and the resulting reduction in banks' T-bill holdings has had to be transferred to SBP and has strained the functioning of the repo interbank market necessitating banks frequent recourse to discount window. These developments, straining banks' liquidity position, disrupted the trends in overnight call rates that experienced high degree of volatility and increased sharply posing difficulty for business decisions in the economy. Recent liquidity injections through Open Market Operations (OMOs), discount window, and lowering of reserve ratios have, however, helped in moderating these pressures.

Arrest rising inflationary pressures. A persistently high inflation hurts industry through rise in input costs and lowers purchasing power of the public. Developments since the beginning of FY08 wiped out the price stability that was visible in the decline of core inflation to 5.2 percent in May 2007. Since then, there has been a persistent rise in headline as well as core inflation. The CPI inflation, particularly the food inflation, rose to record highs of 25.3 percent and 34.1 percent respectively in August 2008. Though food inflation is expected to come down with easing of supply shortages and imported food prices, the persisting acceleration in core inflation and its stubbornness is evident in all indicators of core inflation. By October 2008, year on year (YOY) non-food-non-energy core inflation rose to 18.3 percent (from 13 percent in June 2008) while the 20-percent weighted trimmed measure of core inflation reflected steeper inflationary pressure as it rose to 21.7 percent in October 2008 from 17.2 percent in June 2008. With these trends continuing, the FY09 inflation could reach 21 percent (which is above the target of 11 percent set for the fiscal year) especially in the face of phasing out of subsidies, rise in administered prices, and depreciating exchange rate. Even more important is the need to rein-in inflation expectations as is evident from the increasing number of CPI items with double digit inflation.

Building up the foreign exchange reserves and calming the foreign exchange market. There is a need to arrest the depletion in reserves (gross reserves are now close to $6.9 billion or equivalent to 9 weeks of imports) and restore international players and market confidence to build the country's foreign exchange reserves. Weakening macroeconomic fundaments along with reserve depletion prompted depreciation in the domestic currency despite supportive foreign exchange interventions by the SBP. More specifically, sentiments in exchange markets were impacted by: (i) substantial demand for dollars emanating from increased imports and other payment requirements; (ii) drying up of financial inflows and the supply of dollars coming from export revenues and workers' remittances; (iii) the law and order situation, lowering of Pakistan's credit ratings, and low risk-adjusted rate of return on investments altogether triggered self-fulfilling expectations of erosion in the rupee value; (iv) much lower return on domestic assets as well as high inflation has led to a substitution in favour of foreign assets; and (v) central bank's limited ability to intervene in the foreign exchange market given its falling foreign exchange reserves.

Restore confidence and stability in money markets. Combined shock of the pressures on rupee and external liquidity had disrupted the money markets. Pressures grew as the foreign exchange outflows for payment obligations increased but the anticipated foreign financial inflows did not come through. Liquidity situation was further complicated by the seasonal Eid-related and rumor-induced deposit withdrawals by the public. It has to be recognized that the liquidity constraints emerging in Pakistan are quite different in nature and milder relative to trends prevailing in advanced countries' financial markets.

Steepening demand pressures due to a confluence of events and factors has muted the impact of last few rounds of monetary tightening as evident from unabated rise in inflation. These factors include: (i) the exogenous shock of international commodity prices whose lingering impact turned out to be much stronger than anticipated; more recently, these price pressures have subsided, the benefits of which will be realized in the coming months; (ii) fiscal slippages were more acute and the financing mix was skewed towards inflationary borrowings from the SBP; the same trend continues in FY09; (iii) the negative sentiments prevailing in the foreign currency market magnified the depreciation of the exchange rate which increased the rupee cost of imports, adding to the inflationary pressures; and (iv)

recent fiscal measures introduced to reduce subsidies and fiscal deficit, though necessary, have initiated another round of inflation. Thus, going forward, there is a need for further monetary policy tightening to pin down inflation expectations and restore macroeconomic stability.

In the context of SBP's current tight monetary policy stance the dynamics of exchange rate management and behavior of real interest rate need some elaboration. Towards the end of FY08, the SBP introduced several measures to smooth adjustments in rupee in a calibrated manner, which was inevitable in the wake of growing macroeconomic imbalances. This allowed the gradual pass-on of the impact of imported inflation at a time when overall inflation was rising quickly due to international commodity prices. A gradual depreciation was also in line with market fundamentals so as not to have a sudden impact on business firms which rely on imported intermediate goods and to provide an impetus to exports. The trade data shows that more than 50 percent of imports are intermediate goods for production.

At the same time, the rupee depreciation was inevitable and necessary when distortion in economic fundamentals emerge, in particular the external sector imbalances. While the emerging nominal exchange rate may erode the purchasing power of the rupee for foreign goods and services, the appreciation in real exchange rate in wake of rising Pakistan's inflation rate relative to the average inflation of key trading partners during most of the FY08 requires flexible exchange rate management. The rise in prices of Pakistani products relative to key trading partners encourages residents to prefer imported goods and discourages exports, contributing to the ballooning of external current account deficit. The resulting market correction in nominal exchange rate and the consequent adjustment in the real exchange rate, which started in Q3-FY08 and continued in FY09, are in line with the fundamentals.

Owing to high inflation and inflationary expectations, the current levels of real interest rates have turned negative. Thus controlling inflation is crucial to curtail excessive domestic credit growth and aggregate demand and encourage savings. Banks have been proactively raising the interest rates on incremental deposits which have reached 8.7 percent on average in September 2008 from 5.3 percent in June 2007, of which, the term deposits are also being offered at higher rates. Domestic resource mobilization is now critical to facilitate the investment demand to enhance the productive capacity of the economy which will help reduce aggregate demand-supply gap. In addition, this would discourage speculation in commodity as well as

foreign currency markets, which are being exploited for earning returns on savings instead of productive real economic activities.

Recognizing the above challenges and given the macroeconomic outcome is likely to be different from the sustainable levels, there is a need to augment the macroeconomic stabilization program to mitigate the emerging risks. Specifically, despite the expected deceleration in domestic inflation in Q2-FY09 due to a fall in international commodity prices and the lagged impact of monetary tightening measures adopted in May and July, the average headline inflation for the year will be around 21 percent; well above the 11 percent target for the year. It has to be recognized that Pakistan's macroeconomic scenario will improve as the international prices decelerate and the monetary transmission dampen effect on aggregate demand is realized.

Similarly, though import growth is expected to significantly slow down to 2.0 percent (and may even turn negative) due to falling international prices and exchange rate induced domestic demand moderation, the external current account deficit is projected to lie between 6.2 to 6.8 percent of GDP. This includes the effect of continuing strong trends in home remittances and an export growth of around 10 percent. Given the uncertainty regarding the foreign inflows and the need to build up the country's foreign exchange reserves to end-June 2008 levels, the 'financing gap' is expected to be around $4.5 billion.

In conclusion, post-July 2008, the SBP took a number of measures at appropriate times and in phases to avoid other attendant risks (see **Annexure** which presents measures and their timeline). Cumulatively, SBP has released close to Rs270 billion through lowering of reserve ratios as well as around Rs10 billion by providing 100 percent refinancing to banks under Part I of Export Finance Scheme (EFS) to meet the growing working capital financing requirements of the exporters. Furthermore, 100 percent finance will also be provided against Part II of EFS and Long-Term Financing Facility (LTFF) to promote real investment in the country. This will inject an additional amount of Rs39.5 billion in money market, making the cumulative size of liquidity comfort provided to commercial banks to Rs319.5 billion. These measures, aimed at accommodating exceptional liquidity requirements of the banking system, must not be construed as a change in the SBP's monetary policy stance. Active and calibrated liquidity management is a part of a prudent monetary management necessary to ensure effective monetary transmission mechanism which

is critical to achieving financial as well as overall macroeconomic stability. Flexible application of reserve ratios and open market operations helps effective monetary management.

At the same time, given the persisting demand pressures, the SBP is raising policy rate from 13 to 15 percent. This will not only help in aligning aggregate demand with supply but will also provide room to accommodate government's financing requirements from the commercial banks. In addition, this will help calm the sentiments in the foreign exchange market and will also stem the second round impact of high inflation from spreading further. Appropriate monetary policy stance is only one ingredient of the macroeconomic stabilization program and as such its effectiveness depends on coordinated fiscal and external sector actions to ensure swift and sustainable stability.

A. Recent Economic Environment and Emerging Challenges

The impact of global financial crisis varies across countries…

1. Global financial crisis that has been brewing for over 18 months has deepened. From being a small sector problem, the crisis has widened with US and Europe's financial sectors experiencing acute liquidity crunch and falling stock prices (see **Table 1**). In the last two months, the financial crisis magnified and surfaced as an insolvency crisis as evident from the collapse of large global finance houses, which had to be restructured. Given the size and dimension of the problem, the advanced countries have provided a fiscal and monetary stimulus to rescue the financial system. Central banks of major economies including the US Federal Reserve, Bank of England, and the European Central Bank stepped up their interventions infusing liquidity in the system, structuring bailout package for financial institutions with provisions for capital injections, interest rate cuts, lending and deposit guarantees, etc.

Table 1: Global Financial Indicators

Global equity markets	% change from 31st Dec 2007 to 3rd Sep 2008	% change from 3rd Sep 2008 5th Nov 2008
World Developed (MSCI[1])	-17	-25.4
Emerging Markets (MSCI)	-26.8	-34.2
World, all (MSCI)	-18.2	-26.4
US (DJIA)	-13.1	-20.8
Japan (Nikkei 225)	-14.8	-25.0
Euro Area (FTSE Euro 100)	-24.5	-21.4
India (BSE)	-34.2	-32.8

Money market spread	**Jul-08**	**Dec-08**	**10-Nov-08**
TED Spread[2]	0.42	1.47	2.67

Losses and injections in financial institutions since July 2007 (US$ billions)	**Losses[3]**	**Capital raised**	**# of institutions affected**
Worldwide	920.5	827.6	111
Region-wise			
Americas	628.7	483.4	52
Europe	263.2	309.6	44
Asia	28.6	34.6	15

Sources: Bloomberg

[1] Morgan Stanley Capital International

[2] Spread between 3-month US T-bill and 3-month $ denominated LIBOR; usually around 0.5%

[3] losses from write downs: subprime NPLs, margin call defaults, revaluations, leveraged loan commitments

2. Latest forecast suggest that the financial crisis has now impacted the prospects of global economic growth and it will take some time for financial markets to fully stabilize. As the financial crisis unfolded, it has caused enormous stress, uncertainty, and the fear of contagion. It initially impacted the equity and money markets and is now likely to dampen the growth prospects of Asian economies. With the US and the Europe as their key markets, this is particularly true for the export oriented Asian economies; the concept of decoupling has turned out to be quite illusive.

3. However, the magnitude, depth, and impact of the financial crisis vary in accordance with the domestic macroeconomic situation in individual countries across regions. While macroeconomic fundamentals are broadly adequate in advanced economies, the liquidity crisis brought the financial system to a halt and turned into a solvency crisis. For example, in the US, macroeconomic indicators such as the external current account and fiscal deficits as percentage of GDP and inflation are at comfortable levels but the financial sector stress is affecting the growth prospects. Same is the case in other major economies like the UK and the euro zone (see **Table 2**). Asian economies that had adopted sound macroeconomic policies and built foreign exchange reserves aggressively over the years were also able to mitigate the consequences of spill over of the global financial crises by launching monetary and fiscal stimulus.

Table 2: Economic Indicators of Selected Economies (Q2-2008)

	CAB[1]	Fiscal balance[1]	GDP Growth	CPI (YoY)[2]
US	-4.9	-3.0 [3]	0.8 [3]	4.9
UK	-2.9	-1.88	0.3 [3]	5.2
Euro Area	-1.1	0.4	1.8	3.6
Canada	0.9	1.4 [5]	0.7	3.4
Australia	-6.2	1.6 [5]	2.7	5.0
Switzerland	10	2.5 [5]	2.4	2.9
Sweden	7.8	3.4 [5]	0.7	4.2
China	11.3 [5]	0.7 [5]	9.0 [3]	4.6
India	-1.4 [5]	-2.3	7.9	9.8
Korea	0.2	3.8 [5]	3.9 [3]	4.8 [4]
Pakistan	**-8.4 [6]**	**-7.4 [6]**	**5.8 [6]**	**25.0 [4]**

Source: Bloomberg, WEO-Oct 08 & Central Bank Websites
[1] % of GDP; [2] September 2008; [3] Q3-2008; [4] Oct-08; [5] 2007; [6] FY08.

The macroeconomic situation and the policy response in Pakistan remain different…

4. While there has been a debate that Pakistan should emulate other economies and ease fiscal and monetary policies, this is not an option. The economic situation and dynamics of the problem in Pakistan is completely different from what has transpired in other economies. Origins of Pakistan's economic stress lies in the country's growing weaknesses in macroeconomic fundamentals rather than the financial sector. Nevertheless, the timing of these global developments could not have been worse for Pakistan as the domestic macroeconomic stability is already under a lot of stress. The result has been deterioration in a number of variables such as depletion of foreign exchange reserves, weakening of rupee, rising inflation, slowdown in economic activity, and increased uncertainty.

5. In view of this, not only does Pakistan have to craft its economic policies in line with proper diagnostics, there is also a need to develop responses which do not hurt financial markets. It has to be further recognized that the nature and extent of

the liquidity constraint is quite different and remains relatively milder than in the advanced countries. Finding an optimal solution to complex and multiple issues is challenging for Pakistan given the scale of the problems and the need to tackle the intricate policy trade-offs. Therefore, while the advanced economies have an urgent need to address the financial market turmoil to secure growth prospects, the priorities for Pakistan are to achieve macroeconomic stabilization through hard core short term supply and demand measures, which would help alleviate inflationary pressures over time.

6. To restore macroeconomic stability and shore up the dwindling confidence in the economy, SBP has been vigilant and continuously been taking a number of corrective measures. These measures, taken during the course of 2008, were meant to rein-in emerging aggregate demand pressures and fight inflationary trends:

- Two rounds of increases in SBP's policy rate,
- Changes in the cash reserve ratio (CRR) and statutory liquidity reserve (SLR) for effective liquidity management,
- Administrative measures to address the foreign exchange market issues,
- Imposition of floor on deposit rates to improve the return on savings,
- Tightening of letter of credit (LC) margin requirements to compress import demand of non-essentials.

In addition, the government took the following steps:

- Rise in the domestic prices of POL products to reduce the subsidy burden, rationalization of electricity tariffs, and commitment to address the circular debt issue; and
- In the budget for FY09 Government committed to net zero borrowings during FY09, though SBP, for some time, has been advocating the need for retirement of stock of government borrowings from the central bank.

Macroeconomic stress however deepened as newer complications arose…

7. Despite all these measures the impact on aggregate demand pressures was muted and the outcome for Jul-Oct, FY09 sharply deviated from expectations. Both the balance of payments and fiscal deficit have come under renewed strain as evident from the sharp depletion of reserves and the higher than expected recourse of the government to borrowings from the central bank. These developments underscore the need for adopting coherent and substantive macroeconomic

stabilization program with coordinated fiscal and monetary policies to bring the economy on a stable path.

Balance of payments position condition is precarious as evident from the depleting reserves and depreciating rupee…

8. Despite strong inflow of workers' remittances and a robust export performance (14.2 percent in Jul-Oct, FY09) the external current account deficit continues to remain on an unsustainable trajectory in FY09 after registering a deficit at 8.4 percent of GDP in FY08 (see **Table 3**). This is largely due to rise in the import bill by 35.2 percent during Jul-Oct, FY09 compared to a negligible 4.4 percent growth in the corresponding period of last year. Strong import demand in the country and the rising international commodity prices have widened the external current account deficit to $5.9 billion ($3.0 billion during the comparable period of last year). While the decline in quantum is quite visible in many of the importable commodities, its impact has been dampened due to higher prices relative to last year, as shown in **Table 4**. More importantly, the oil demand has not declined and the oil import bill is still a major source of growth in the overall import bill.

Table 3: Balance of Payment Statistics (in billion US$)

		July - October	
	FY08	**FY08**	**FY09**
i. CA balance	**-14.0**	**-3.0**	**-5.9**
Trade balance	-15.3	-3.4	-5.8
Exports	20.1	6.2	7.1
Growth rate	*16.5*	*13.3*	*14.2*
Imports	35.4	9.5	12.9
Growth rate	*31.2*	*4.4*	*35.2*
Non-food non-oil	20.6	6.1	6.8
Growth rate	*20.9*	*13.4*	*11.9*
Services net	-6.3	-2.1	-1.7
Income net	-3.9	-1.2	-1.5
Current transfers	11.5	3.7	3.1
Remittances	6.5	2.1	2.3
ii. Capital account	**0.1**	**0.0**	**0.0**
iii. Financial account	**8.7**	**3.1**	**1.1**
of which			
Direct investment	5.2	1.3	1.3
Portfolio investment	0	0.3	-0.2
iv. Errors and omissions	**-0.5**	**-0.2**	**-0.2**
Overall balance	**-5.8**	**-0.1**	**-5.1**

Source: SBP

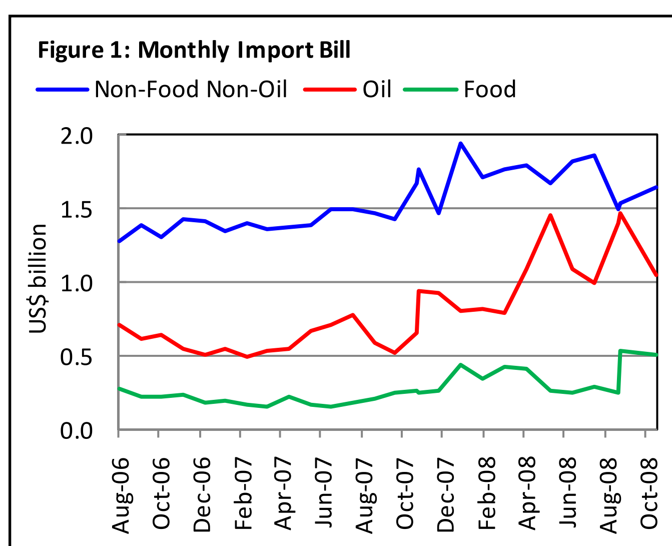
Table 4: Major Imports with Decrease/Increase in Quantum

million US$

		Abs. Change from Q1-FY08		
	Q1-FY09	Total	Quantum impact	Price impact
Total Imports	**10819**	**2762**		
Major items with Decreases/Increase in Quantum				
Iron and Steel	303.1	-9.5	-150.8	141.4
Fertilizer	257.4	55.9	-98.2	154.1
Iron and Steel Scrap	117.9	-54.5	-97.0	42.5
Raw Cotton	157.0	-74.1	-90.6	16.5
Palm Oil	529.0	195.4	-60.1	255.5
Soyabean oil	14.9	-7.6	-16.5	8.9
Worn Clothing	26.3	11.3	11.2	0.1
Tea	62.9	17.3	12.2	5.2
Plastic Material	341.0	40.9	23.3	17.6
Synthetic Fibre	88.0	33.2	33.1	0.1
Petroleum Crude	1892.4	873.8	51.7	822.1
Petroleum Products	1959.3	971.8	67.4	904.4
Wheat Un-milled	285.2	280.0	362.3	-82.4

Source: Federal Bureau of Statistics

9. Pressures on the external current account deficit could recede with the help of appropriate demand management steps and the falling international oil prices that are hovering around $60 per barrel. However, the benefits of this decline have not yet been realized since the average POL price paid in FY09 so far is around $123 per barrel which is still well above the FY08 average level of $87.4 per barrel. Oil bill is likely to fall in the coming months as the future contracts are structured at lower prices. The withdrawal of subsidy in the form of transfer of international oil prices to domestic market is expected to dent the domestic oil consumption. These two factors could provide a much needed respite on the trade account. However, the perceived gains might be diluted if the current strong growth in non-oil non-food (NONF) imports continues (see **Figure 1**). Therefore it is imperative to check this trend to bring the trade account and thus external current account deficit to a manageable level.



10. During Jul-Oct, FY09, the financial and capital account balance shows a net inflow of only $1.1 billion (compared with $3.1 billion in the corresponding period of FY08) as both public and private flows were lower than expectations. Consequently, the SBP's foreign exchange reserves have depleted by $5.0 billion with a cumulative depletion of $10.7 billion up to 10th November 2008 since end October 2007 when SBP's reserves were at their peak of $14.3 billion. The dollar-rupee exchange rate has depreciated by 15.3 percent since the beginning of FY09 (see **Table 5**).

Table 5: Trends in Exchange Rate

	End month exchange rate (Rs/US$)*	App./Dep. (%)	
		Monthly	Cumulative since end December 2007
Dec-07	61.75	-	-
Jan-08	62.61	-1.4	-1.4
Feb-08	62.50	0.2	-1.2
Mar-08	62.72	-0.3	-1.5
Apr-08	64.52	-2.8	-4.3
May-08	66.56	-3.1	-7.2
Jun-08	68.28	-2.5	-9.6
Jul-08	71.49	-4.5	-13.6
Aug-08	76.25	-6.2	-19.0
Sep-08	78.04	-2.3	-20.9
11-Nov-08	80.62	-3.2	-23.4
July - November 11 FY09			-15.3

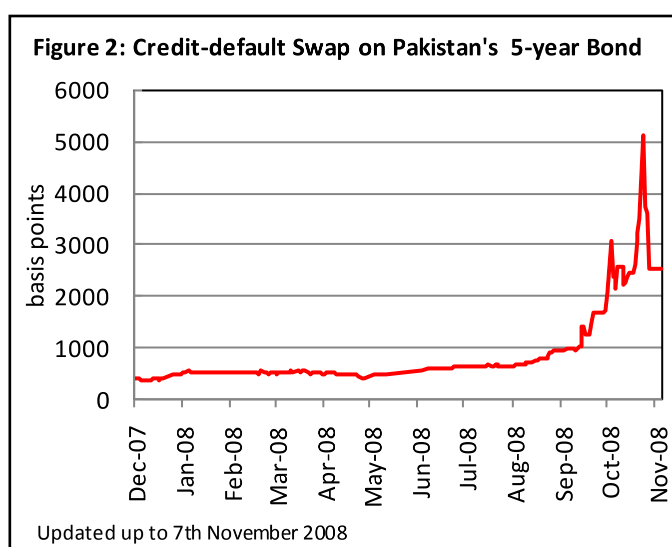
* Weighted average mid rates

11. Rupee depreciation and fast falling reserves have generated concerns regarding the viability of the balance of payments position. Thus, calming the sentiments in the foreign exchange market through correcting the external current account imbalance is of utmost importance to ensure smooth flow of foreign inflows in the country. The continued exchange rate depreciation, which is both a consequence (through falling reserves) and partially a cause of reduced net foreign inflows, would be addressed in the process. The solution out of this vicious cycle necessitates:

- curtailing the external current account deficit in general and import growth in particular to sustainable levels, which in turn would ease the financing requirements substantially;
- curbing the unnecessary outflows from the foreign exchange market both within and outside the economy due to prevailing uncertainty;
- curtailing fiscal deficit and eliminating subsidy in imported consumption in a calibrated manner to discourage the demand for imports;
- reducing the support to the market provided on oil imports through SBP's provision of foreign exchange would also be a requirement going forward. This type of intervention, though necessary at times, is a major source of strain on the foreign exchange reserve position. It also artificially and temporarily dilutes the real adjustments in the exchange rate that are required in the face of the fast changing macroeconomic picture.

12. Ensuring unhindered and substantial inflow of external financing poses the foremost challenge for the economy. Initially, these much needed foreign inflows will have to come through official sources; the private inflows will follow later once overall stability resumes in the country. There are three issues regarding their prospects. First, the global financial markets are in the midst of a once-in-a-life-time crisis and consequently the global investors have become extremely risk-averse. The prevailing complex law and order situation in Pakistan is not helping either. This risk aversion is evident from the sharp rise in Credit-default Swap (CDS) points on

Figure 2: Credit-default Swap on Pakistan's 5-year Bond



Updated up to 7th November 2008

Pakistan's 5-year sovereign bond which touched 5000 bps during October 2008 (see **Figure 2**).[1] Second, the rating agencies like Moody's and S&P have recently downgraded Pakistan's bond ratings further. Third, the instability in the exchange rate is keeping investors at bay.

The resulting fall in net foreign assets along with strong credit demand and seasonal factors caused liquidity shortages in the system…

13. These external sector developments have resulted in excessive drain of rupee liquidity from the system by Rs92.7 billion during 1st July to 1st November FY09 (see **Table 6)**. The net foreign assets (NFA) of the banking system have contracted by Rs327.3 billion during this period. Despite preemption of SBP resources by the government, the strong demand for credit from both the Public Sector Enterprises (PSEs) and the private sector has further tightened the liquidity conditions. Credit requirement of PSEs has increased enormously (Rs62.8 billion during 1st July to 1st November FY09) mostly due to the issue of circular debt among the PSEs and the oil companies, while the demand for credit from the private sector has also increased sharply (Rs125.6 billion during 1st July to 1st November FY09 as opposed to an expansion of Rs60.5 billion during the corresponding period last year). The increase in the latter is probably due to the beginning of the credit cycle and may also be a reflection of: one, companies are hoarding cash in light of the liquidity concerns; and two, the risk that this credit is being used in speculative activities.

Table 6: Monetary Aggregates (Flows)
billion rupees

		1st July-1st Nov	
	FY08	**FY08**	**FY09**
NDA	941.4	115.2	234.6
of which			
Govt. sector*	583.8	91.6	179.3
Private sector credit	408.4	60.5	125.6
Credit to PSEs	33.0	-0.7	62.8
NFA	-317.4	-34.3	-327.3
SBP	-308.0	18.7	-313.0
Sch. banks	-9.4	-53.0	-14.3
Money supply (M2)	624.0	80.9	-92.7
YoY growth	*15.3*	*18.6*	*11.2*
Memorandum items			
Net budgetary support	554.6	107.6	170.9
from SBP	*688.7*	*44.2*	*289.6*
from Sch. banks	*-134.2*	*63.4*	*-118.7*
Currency in circulation	142.1	87.1	131.1
Total deposits	484.6	-4.3	-224.7
Reserve money	269.7	49.3	-32.9
YoY growth	*22.3*	*12.5*	*14.9*

*Includes credit for commodity operations, net budgetary support and net effect of Zakat fund etc.
Source: SBP

[1] CDS is a swap contract in which a buyer makes a series of payments to a seller, and in exchange receives the right to a payoff if a credit instrument goes into default.

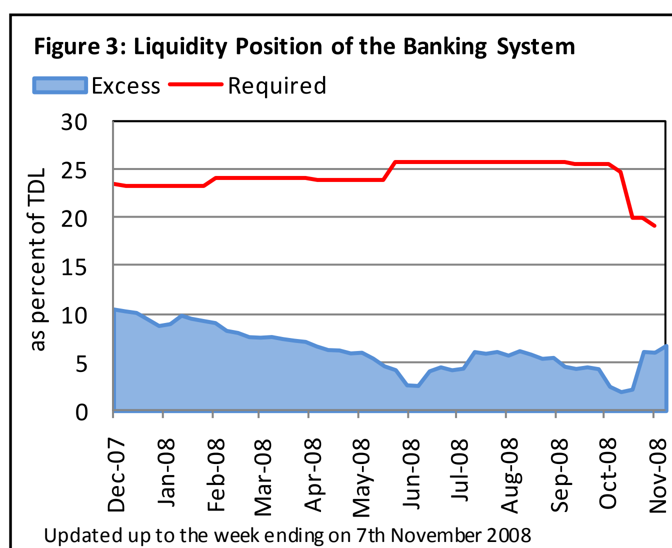
14. The market expectations that the government is planning to pull out the public sector/government deposits from the commercial banks is causing further anxiety in the market from the liquidity perspective. Adding to the pressures of the market liquidity conditions is the conversion of deposits into cash. During 1st July to 1st November FY09, there was a sharp reduction of Rs224.7 billion in total deposits of the banking system and an increase of Rs131.1 billion in currency in circulation. These trends in banking system liquidity partly reflect seasonality as the currency in circulation normally increases around the Eid festival putting temporary pressure on inter-bank liquidity. Also, liquidity constraints vary by bank; being steeper for banks with weak deposit mobilization and relatively higher withdrawals.

The liquidity pressures became visible in sharp increase in overnight call rates…

15. The liquidity constraint in the system has resulted in a rising trend in overnight call rates and reduction in excess liquidity held by banks over and above the required amount. In addition, the lack of liquid assets eligible as collateral for borrowing under Open Market Operations (OMOs)/discounting with some banks shot up the call rate to abnormally high levels.

16. Initially, the banks met liquidity requirements by reducing excess reserves maintained in the form of government securities. As a result, the excess liquid assets (mainly T-bills) with the banks declined to the lowest level of 2.2 percent of the time and demand liabilities (TDL) by 11th October 2008 (see **Figure 3**). These have now improved to 6.7 percent of TDL by 1st November 2008.

Figure 3: Liquidity Position of the Banking System



Updated up to the week ending on 7th November 2008

17. Reduction in T-bill stock (see **Figure 4**) has limited banks' ability to access the discount window and participate in OMOs, forcing them to borrow funds from the call interbank market. Consequently, the activity in the call market increased relative to the repo market and the overnight call rates rose to as high as 45 percent during the period from 4th-11th October 2008, resulting in the widening of liquidity spread

in the overnight market (see **Figure 5**). Similarly, KIBOR of all tenors have been rising consistently over the past three months. For example, the 6-month KIBOR has reached to 15.76 percent on 11th November 2008.

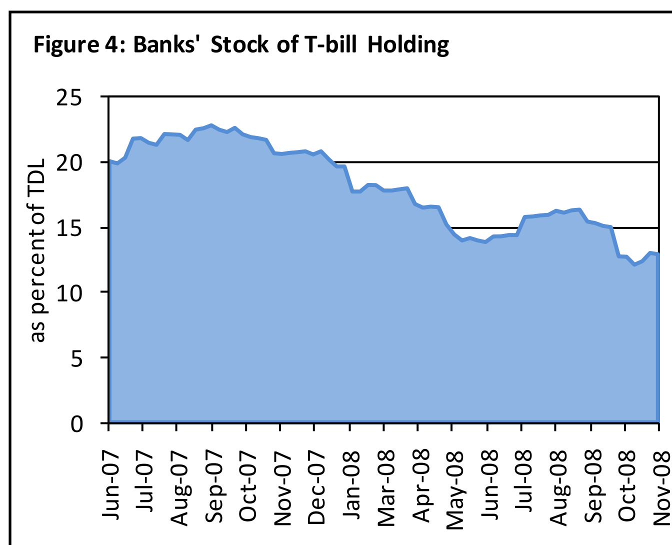


Figure 4: Banks' Stock of T-bill Holding

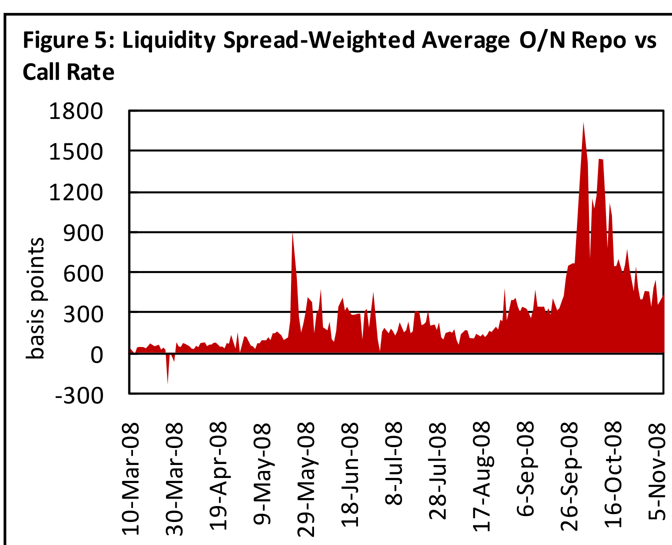


Figure 5: Liquidity Spread-Weighted Average O/N Repo vs Call Rate

18. SBP has been closely monitoring these developments in monetary aggregates and the interbank liquidity position. Acting proactively, SBP made a net injection of Rs272 billion in the system through 35 OMOs conducted during 1st August to 11th November, FY09. In addition, banks have been allowed effective and liberal access to the discount window that resulted in availing of Rs387 billion during this period (see **Table 7**).

19. To ease the liquidity conditions further, SBP has taken a series of additional measures (see **Annexure** for details). These measures are specifically aimed at accommodating the extraordinary liquidity requirements of the banking system and not intended for any change in the monetary policy stance. Having said that, SBP stands ready to take all necessary actions to

Table 7: Activity in Interbank Market

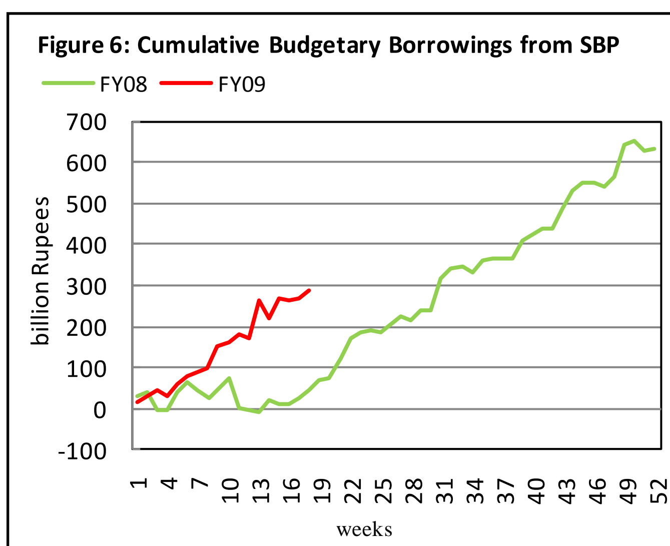
	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08*	Aug-Nov 08
OMOs (billion rupees)						
Injection	-	78.2	176.4	187.3	39.4	481.3
Mop up	359.9	41.2	27.0	36.0	105.3	209.5
Frequency (#s)	14	7	11	12	5	35
Discounting (billion rupees)						
Amount	23.5	42.9	247.4	37.2	59.6	387.0
# of visits	6	5	13	10	8	36
Market interest rates (end of month)						
O/N Repo (WA)	9.1	11.3	12.6	12.3	10.5	-
Call rate	10.3	13.7	19.2	16.3	14.9	-
KIBOR (6-m)	13.5	13.8	14.5	15.1	15.7	-

* 10th November 2008

address the overall and bank specific liquidity problems in the banking system.

Government borrowing from SBP continues to increase unabated causing further complications for monetary management…

20. The emerging liquidity issue has somewhat over-shadowed the issue of government borrowings from the SBP. After clocking an all-time record borrowings of Rs689 billion from the SBP in FY08, government borrowings have continued to rise unabated in FY09 also (see **Figure 6**). From 1st July to 8th November 2008, the government has borrowed Rs369 billion from the SBP against a quarterly retirement of Rs21 billion in FY09 as proposed in the last monetary policy statement and zero borrowing commitment of the Ministry of Finance. The non realization of the desired external inflows and non-bank borrowings for budgetary financing is not helping the government's reliance on SBP borrowings.[2] In the present circumstances, where NFA of the banking system are declining and there are liquidity problems in the market, this heavy borrowing from the SBP, though injecting liquidity in the system entails complications for monetary management and does not bode well for the overall macroeconomic stability on various fronts.



21. First, continued monetization of fiscal deficit indicates unfettered increase in the budget deficit, which is an imprudent policy stance under the present precarious situation of our economy. This expansionary fiscal stance has stoked up aggregate demand and thus inflationary pressures. It also represents rising dis-savings, which the economy can ill-afford given the burgeoning size of the fiscal deficit and its consequences on external current account deficit.

[2] During July-August, the government was able to raise only Rs6.6 billion on net basis through NSS, despite a rate hike w.e.f. 1st July, 2008. A further rate increase has been implemented from October 1, 2008.

22. Second, the borrowings from the SBP lead to expansion in reserve money, which makes it difficult to meet the indicative monetary expansion target consistent with the overall macroeconomic framework. If the current trend continues, the broad money expansion target for FY09 may also be missed, as was the case in FY08, despite a contraction in the NFA. Even if the M2 expansion turns out to be close to the projected growth, it should not be construed as a positive development as it reflects weaknesses in the external and fiscal sectors. More importantly, a change in the composition of monetary aggregates causes a disproportionate increase in rupee liquidity relative to the availability of foreign exchange. This in turn puts pressure on domestic prices and erodes the external value of the currency.

23. Third, part of the adjustment in the policy rate announced since the beginning of FY08 was to accommodate government borrowing requirements from the market through the auction mechanism. However, the persistent and higher-than-projected increase in government borrowings and the inflationary expectations have resulted in a sharp increase in T-bill rates during a very short time span, which is not in line with SBP's assessment of the issue at the time of the last monetary policy statement announced for the next six months. At the same time, due to tight liquidity conditions, banks have shown reluctance to participate in the auctions and are positioning to seek higher returns in line with demand for borrowings. This has rendered the securities held by banks over and above the reserve requirements (to participate in the inter-bank market) to fall making it difficult for the SBP to address the liquidity shortage in the market through its collateral based OMOs and discount window.

24. Fourth, the sheer size of the MRTBs (Rs1.4 trillion), the instrument through which the government borrows from the SBP on tap, government's continued recourse on central bank borrowings, the overall liquidity position, and banks' behavior in the T-bill auctions have made the overnight interest rate quite volatile. This has complicated monetary management considerably and has diluted the monetary policy transmission mechanism. Uncertainty regarding other market interest rates hampers the liquidity as well as business decision making process in the economy.

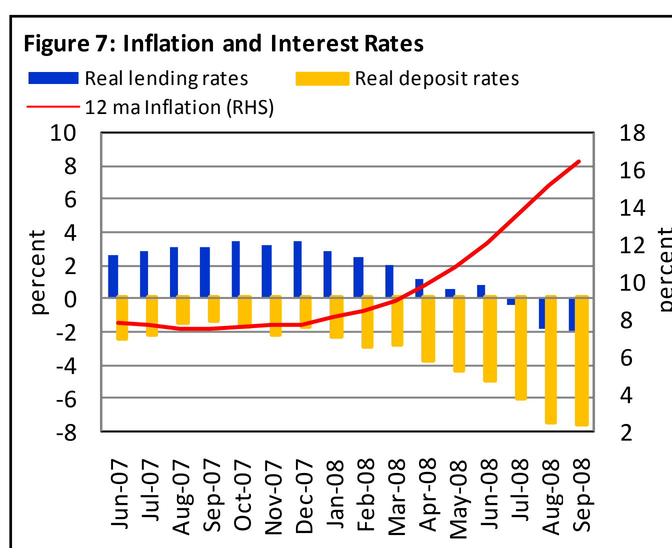
25. In light of these factors, greater fiscal adjustment is warranted in order to support the required monetary tightening. These measures include, but are not limited to, rationalizing expenditures, increasing revenues, and diversifying

borrowing sources. Recent adjustments in the domestic prices of POL products and electricity tariffs to reduce the subsidy burden are steps in the right direction.

Inflation expectations and falling real interest rates are disincentives to save, aggravating aggregate demand pressures…

26. It is not only the government's credit requirements that are quite high but the private sector credit demand also remains strong. During 1st July to 1st November, FY09 the credit utilized by the private sector stood at Rs125.6 billion compared to an expansion of Rs60.5 billion in the comparable period of last year. This strong growth partly reflects the higher input prices that the businesses have to pay. Although the nominal weighted average lending rates (marginal) have risen by 352 basis points since April 2008 due to the two rounds of monetary tightening in May and July 2008, the strong demand at the current productive capacity of the economy is fuelling inflationary pressures. A key reason for this behavior is the prevailing negative real interest rates and expectations of continued high inflation (see **Figure 7**). Both these factors indicate strong incentives to borrow. Thus it is of utmost importance to stem these inflation expectations and raise the real cost of borrowings.

Figure 7: Inflation and Interest Rates



Controlling inflation, therefore, has become all the more important to restore macroeconomic stability…

27. The tight monetary policy stance of the SBP is essentially aimed at managing these inflation expectations at levels that ensure price stability over the medium term. However, there are several challenges faced by the SBP in this context. First, high inflation during last year will have a strong inertial impact on inflation during FY09. For example, even if consumer prices remain constant (i.e. monthly inflation change is zero) at October 2008's level from November onwards, average inflation will be close to 20 percent for FY09.

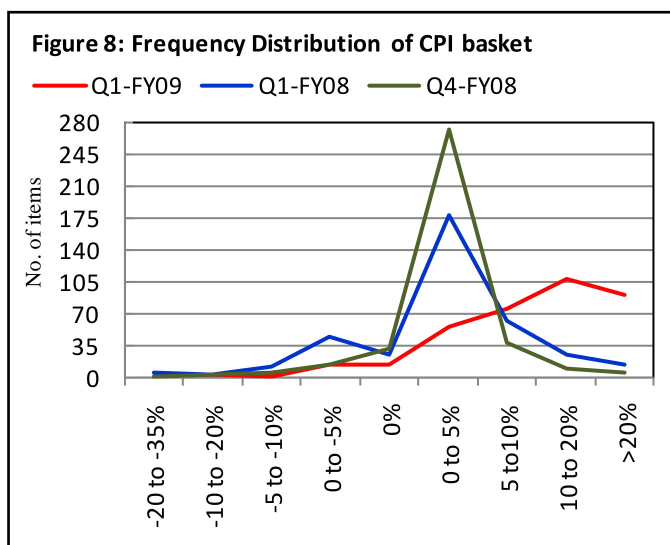
28. Second, the pass-on of international oil prices to domestic consumers, adjustment in power tariffs, revisions in GST and import duties, depreciation of rupee, and expectations of higher wages due to high inflation are all likely to add to the inertial effect of last year's inflation. The actual 12-month moving average CPI inflation has already reached 17.7 percent in October 2008, while YoY CPI Inflation is standing at 25 percent. This clearly indicates that average inflation for FY09 could easily exceed 20 percent (see **Table 8**).

Table 8: Inflation Indicators

	YoY inflation		
	Jun-08	Oct-07	Oct-08
CPI	21.5	9.3	25.0
Food group	32.0	14.7	31.7
Non-food group	13.8	5.4	19.7
Non-food non-energy	13.0	6.5	18.3
20% Trimmed	17.2	8.3	21.7
	Average inflation		
	Jul-Jun	Jul-Oct	
	FY08	FY08	FY09
Headline CPI	12.0	7.6	24.6
Food group	17.6	11.2	32.3
Non-food group	7.9	5.1	18.8
Non-food non-energy	8.4	6.2	16.7
20% Trimmed	10.2	7.4	20.8
	12m MA inflation		
	Jul-Jun	Sep-07 to Oct-08	
	FY08	FY08	FY09
Headline CPI	12.0	7.5	17.7
Food group	17.6	10.7	24.8
Non-food group	7.9	5.3	12.5
Non-food non-energy	8.4	5.9	11.9
20% Trimmed	10.2	6.9	14.7

29. Third, an even more disturbing aspect of these inflation dynamics is that it has become wide spread. This is evident from the large number of CPI items witnessing double digit rise in prices. Out of a total of 374 items in the CPI basket, 201 items rose by more than 10 percent in Q1-FY09 compared to only 13 items in Q4-FY08 (see **Figure 8**). This is being reflected in continued acceleration in core inflation measures. The Non-food Non- energy (NFNE) measure of core inflation rose to 18.3 percent in October 2008 from 13.0 percent in June 2008. Similarly, the 20-percent trim measure jumped to 21.7 percent from 17.2 percent in June 2008.

Figure 8: Frequency Distribution of CPI basket

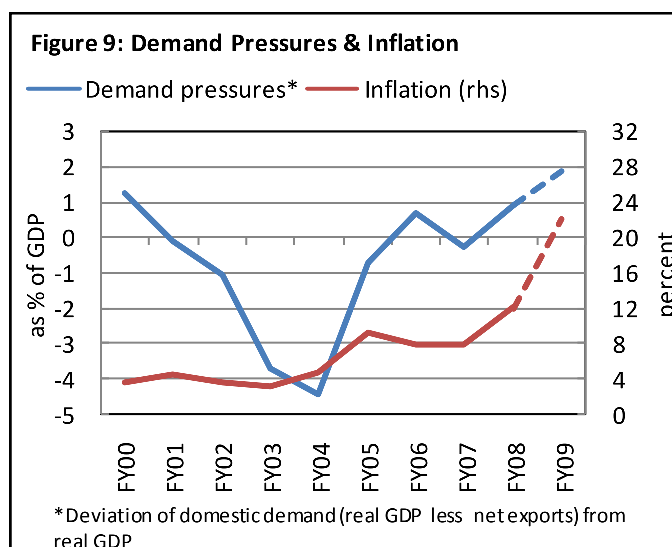


30. Fourth, empirical evidence clearly suggests that inflation of the magnitude that is currently prevailing is detrimental for growth prospects of the country. Thus,

bringing inflation down over the medium-term is essential for restoring and sustaining the growth prospects. It would be prudent to consolidate growth at a relatively low level for couple of years to ease the inflationary pressures.

31. Fifth, whereas the aggregate demand pressures have not yet subsided, productive capacity as reflected by data on large-scale manufacturing is declining due to the law and order situation and structural weaknesses such as power shortages etc. reflecting a widening output gap (the difference between aggregate demand and productive capacity. If the domestic demand grows at 5.0 percent (which is less than the last five year average of 6.6 percent) and the real GDP grows by 4.0 percent in FY09, the difference between domestic demand and supply is expected to widen further (see **Figure 9**). Therefore, the output gap is likely to remain more or less unchanged, if not increased. As a consequence, the anticipated effect on inflation through this channel may not be realized. Thus the need to curb aggregate demand has heightened and the role of fiscal as well as monetary policy in addressing this predicament has become all the more important.

Figure 9: Demand Pressures & Inflation



*Deviation of domestic demand (real GDP less net exports) from real GDP

32. At the same time all necessary steps should be taken to enhance the productive capacity of the economy. One key input in this regard is the substantial increase in investments for this purpose. In the wake of dwindling availability of foreign savings, generating and channeling domestic savings – public as well as private – can play a significant role in meeting the investment requirements. Thus, curtailing this output gap would in fact help in reducing the saving investment gap in the economy, thereby reducing the reliance on external resources. To encourage savings the real returns will have to be increased significantly.

B. Outlook for FY09

33. The importance of coping with the above mentioned challenges and mitigating the risks appear all the more important given the fact that even if the current encouraging trends in international prices and domestic demand pressures continue, the end of the year situation though shows improvement over the current and the FY08 levels, the outcome appears still away from the desirable and sustainable levels.

34. Specifically, inflation is expected to decelerate during H2-FY09 as the global commodity prices are declining and the monetary tightening measures adopted in May and July 2008 are anticipated to have a lagged impact on inflation. Thus, the YoY headline inflation is projected to come down from 25.0 percent in October 2008 to around 14 percent by June 2009, while on average basis, inflation will be closed to 21 percent for FY09; well above the 11 percent target for the year.[3] Although the deceleration in inflationary pressures are encouraging, the need to bring it down to single digit level remains a top priority as the level of inflation consistent with sustainable growth is estimated at 4-6 percent for the Pakistan's economy. Achieving this objective in the medium-term requires aligning aggregate demand in the economy in line with the aggregate supply.

35. Imports are anticipated to slow down considerably owing to the falling international commodity prices and domestic demand moderation. Assuming the current level of international oil prices continue for the remainder of the current fiscal year and a slowdown in domestic demand is realized due to a depreciated rupee, import growth for FY09 is expected to be around 2.0 percent and may even turn negative. On the other hand, the growth slowdown/recession in Pakistan's major trading partner countries, particularly US, EU, and Japan, is likely to have an adverse effect on our exports. It is projected that exports earnings may register a growth of around 10 percent during FY09. Based on these projected imports and exports and assuming a continuation of existing trend in workers' remittances, the external current account deficit is estimated to lie between 6.2 to 6.8 percent of GDP. Although this deficit is showing improvement over the last year, it is still

[3] Even if consumer prices remain constant (i.e. monthly inflation change is zero) at October 2008's level from November 2008 onwards, average inflation will be close to 20 percent for FY09.

unsustainable. Given the uncertainty regarding the foreign inflows and the need to build up the country's foreign exchange reserves to end-June 2008 levels, the 'financing gap' is expected to be around $4.5 billion.

36. Given the urgency and commitment of government to eliminate reliance on borrowing from the SBP to finance the fiscal deficit and the lower availability of external financing, the fiscal deficit will have to be cut considerably, even lower than the projected 4.7 percent of GDP target for FY09. This translates into a very well defined prioritization of expenditures and strong revenue mobilization efforts.

37. The impact on the monetary sector of these expected developments in the external and fiscal sector will be reflected in a monetary growth of around 12 to 13 percent. The projected improvement in the external current account deficit and the government efforts in further reducing its fiscal deficit than initially planned, will not only allow monetary growth to remain within this desirable limit, but also help in improving the composition of M2 – i.e. by increasing the share of Net Foreign Assets (NFA) and containing the growth in Net Domestic Assets (NDA). Moreover, the lower government financing requirement from domestic sources will allow higher credit to private sector.

38. With a slowdown in aggregate demand as expected due to declining external current account and the fiscal deficit, the overall growth in the economy is expected to trim down to 4 percent during FY09. Worsened law and order situation and structural weaknesses such as power shortages etc. are mainly responsible for this slowing economic growth. An economic growth of 4 percent is consistent with the expected developments in the fiscal, external, and monetary sectors and inflation outlook. While removing these bottlenecks is imperative in achieving sustainable economic growth, in the interim period focus of macroeconomic policies should remain on curtailing domestic demand. Though this growth is lower than the target of 5.5 percent and actual estimated growth of 5.8 percent in FY08, decision whether this growth should be maintained or even sacrificed depends on the evaluation of the trade-off between inflation and growth.

39. In conclusion, it must be remembered that tight monetary policy is only one ingredient of the macroeconomic stabilization program. Several stabilization and structural adjustments in the fiscal, external, and financial sector are required immediately and in the medium term to put the economy back on a stable path. The

crux of this program revolves around building the country's foreign exchange reserves supported with appropriate exchange rate policy and bringing the fiscal deficit to sustainable levels by rationalizing expenditures and strengthening tax revenue generation. It is anticipated that fiscal tightening of the desired level will ensure that monetary tightening stance is not undermined.

Annexure: Measures Taken to Improve Liquidity and Restore Stability in the Money Market

Besides injection through OMOs and increase in banks' effective access to discount window, SBP took a series of steps to ease the liquidity situation and restore stability in the market. These are given as follows:

- During 11th October to 1st November 2008, SBP reduced the Cash Reserve Requirement (CRR) by 400 bps to 5 percent of the time and demand liabilities (TDL) in a phased manner: a reduction of 100 bps effective from 11th October; a 200 bps effective from 18th October and; another 100 bps effective from 1st November 2008.
- Effective from 18th October 2008, SBP exempted the time deposits of one year and higher tenor from Statutory Liquidity requirements (SLR); however, SLR ratio for commercial banks and Islamic banks remained unchanged at 19 and 9 percent respectively.
- Effective from 18th October 2008, SBP allowed securities categorized as "Held-to-Maturity" for borrowing from SBP under SBP's 3-day repo facility/OMOs.
- Effective from 18th October 2008, SBP increased the SLR eligibility limit of the PIBs and TFCs from 5 percent to 10 percent of the TDL. Earlier, effective from 27th August 2008, SBP had notified TFCs of various electricity distribution companies as approved securities for the purpose of SLR.
- On 18th October 2008, SBP decided that advances to deposits ratio (ADR) of any bank shall not exceed 70 percent at any time to ensure prudent liquidity management by banks, where 'advances' were defined as all types of loans less refinance availed from SBP under EFS and 'deposits' were defined as all types of demand, savings and time deposits less deposits/placements with other banks. Later, on 26th October 2008, the 'advances' were redefined as all types of loans less refinance availed under EFS, lending for commodity operations, lending for power generation and distribution, and lending/placements with other banks.
- On 5th November 2008, SBP decided to provide 100 percent refinancing to banks against amount disbursed under Part-I of EFS, however, banks will continue to provide 30 percent of financing under Part-II from their own sources. The SBP also decided to refinance the already disbursed amount by banks under Part-I of EFS (from their own sources at the ratio of 30 percent) and outstanding as on 31st October 2008.