

8<sup>th</sup> July, 2008

### **Recent Slide in the Rupee's External Value**

Governor SBP has indicated that SBP is continuing to support the rupee to ensure exchange rate stability. As a step in this direction, SBP had tightened monetary policy on 22 May 2008 and this was packaged with the imposition of 35% L/C margin on nonoil and nonfood imports. These measures helped infuse a degree of exchange rate stability. In the last few weeks of FY08 exchange rate stabilized to an average of Rs.67.50.

Industry however appealed for withdrawal of the L/C margins to allow for import of raw material and intermediate goods for a number of industries. SBP had requested the Industry and Commerce Chambers that the withdrawal of L/Cs was being accommodated on the basis of understanding that industry would import the most vital and essential imports for their industry and will refrain from forward booking of imports. However, in the last few days the level of forward booking for imports has been high while the export proceeds have been delayed. The posture of market participants is causing complications in the smooth functioning of foreign exchange market. In general, the import demand and other requirements have resulted in significant outflow of foreign exchange from the market, while inflows & supply of foreign exchange remained low.

Exchange rate is mainly determined by market forces of demand & supply without any specific target level of the exchange rate; however, SBP does and has intervened in the foreign exchange market to reduce excess volatility, prevent the emergence of destabilizing speculative activities and develop an orderly foreign exchange market.

Demand for the dollar has increased mainly due to the tremendous increase in imports. January-May 2008 saw imports increase by 51% over the corresponding period last year. On the supply side of foreign exchange market, Pakistan received less inflows than expected. Between January and May 2008, exports rose by only 22% while foreign direct investment and portfolio investment also fell compared to the same period in 2007.

In May 08, speculative activities came to a head, leading to a quick decline in the value of the rupee. The SBP took a number of interim monetary policy measures in response, including the imposition of higher interest rates, stricter LC margins, increased reserve requirements, and enhanced regulation of foreign exchange companies, which stabilized the exchange rate to an extent, with the rupee witnessing some appreciation.

However, on account of the 1) continued political uncertainty, 2) shortfall in the foreign exchange receipts in the last quarter of FY08 and the 3) exemption of several items from L/C cash margin requirement; pressure on the exchange rate has re-emerged in the first week of July. In the first eight days of the current fiscal year PKR has depreciated by 6.6%. Consequently, in order to arrest this recent fall in the value of the rupee, which is largely a reflection of market sentiments, SBP has taken the following measures with immediate impact: 1) Forward booking against all types of imports have been suspended temporarily 2) Advance payments against import Letter of credit has been reduced from

50% to 25%, 3) All foreign exchange for oil payments will now be made available from State Bank of Pakistan 4) Foreign exchange dealing time for customer and interbank transactions has been reduced from 4.30 pm to 2.00 pm, 5) In order to further strengthen monitoring mechanism of transactions made through Exchange Companies, it has been decided that henceforth Exchange Companies will be required to take prior approval of State Bank for all transactions of US \$ 50,000 or above on account of outward remittances or sale of foreign currencies to the customers. However, this requirement will not be applicable on sale of foreign currency to the banks/exchange companies.