



External Relations Department

Press Release

25 July 2015

SBP Policy Rate unchanged at 6.5 percent

1. Improvements in macroeconomic indicators led SBP to continue with its accommodative monetary policy stance and slash the policy rate by a cumulative 300 bps in FY15. The key factors facilitating the decisions can be pinned down to a sharp decline in CPI inflation, along with its benign outlook, and improvement in external account. In addition to this, narrowing of fiscal deficit and continuation of Extended Fund Facility (EFF) improved the market sentiments. These developments also led to an upgrade of Pakistan's sovereign ratings by international rating agencies in recent months. Macroeconomic stability thus achieved should reflect positively on real economic activity going forward.
2. Following its declining trend in nearly every month of FY15, average CPI inflation came down from 8.6 percent in July FY15 to 4.5 percent in June FY15. Some recent developments such as lagged impact of monetary easing in FY15, expected higher monetary expansion in FY16, bottoming out of inflationary expectations,¹ and the base effect of historically low inflation during the second half of FY15 might suggest slight deviation in the disinflationary trend of FY15 going into FY16. However, there is no major change in SBP's previous inflation forecast.
3. There is a possibility of upward revision in energy tariffs in FY16 and an adverse impact of floods on production of perishable food items going forward that could have an upward pressure on inflation. Meanwhile, projections of high oil production and weak global demand suggest that international oil price might not have bottomed out yet. Given the recent behavior of Pakistani CPI inflation amid falling international oil prices, this could result in keeping inflation on the lower side.
4. While GDP growth in FY15 at 4.2 percent was slightly higher than that of FY14, it remained lower than the target. In particular, industrial sector missed the target due to lower growth in Large-scale Manufacturing (LSM) and electricity generation; however, the activities in construction and mining and quarrying remained buoyant. Agriculture sector despite some losses to major crops from untimely and heavy rains did manage to record some improvement. Noticeable increase in growth, as in the previous few years, came in the services sector.

¹ As indicated in IBA-SBP Consumer Confidence Survey of July, 2015.



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5. Going forward, expected higher consumption in low interest rate environment, planned increase in development spending, and budgetary incentives for construction sector could provide some thrust to growth. Moreover, implementation of infrastructure projects planned under the China-Pakistan Economic Corridor (CPEC) and addressing structural issues especially related to energy and security would create favorable investment environment which is necessary to sustain economic growth over the medium to long term.
6. The balance of payments position continued to improve in the second half of FY15. Reduction in external current account deficit due to decline in import bill and steady growth in workers' remittances are key factors behind the improved external position. Successful completion of reviews under EFF program, issuance of international *Sukuk* and disbursement of program related funding continue to support reserves building besides instilling stability in the foreign exchange market. The net SBP foreign exchange reserves rose from \$10.5 billion at end-December 2014 to \$13.5 billion as of 30th June 2015.
7. Despite these positive developments, due to structural bottlenecks, sluggish global demand, and lower commodity prices, exports contracted by 3.7 percent in FY15. Moreover, net Foreign Direct Investment (FDI) declined to 0.3 percent of GDP in FY15. More work therefore needs to be done in the coming years to attract investments.
8. In the short-to-medium term, nonetheless, the disbursements of program related funding and planned issuance of Eurobonds are expected to support an upward trajectory in foreign exchange reserves. Therefore, net SBP reserves are projected to increase slightly above 4 months of imports by end-June 2016. Having said this, the need to revive private inflows and exports to sustain this trajectory in foreign exchange reserves remains there.
9. The revised FY15 budget estimates show fiscal deficit of 5.0 percent, lower than the previous year. The estimated reduction in fiscal deficit in FY15 is primarily due to improvement in tax revenues. Total expenditures, on the other hand, are estimated to remain higher than the budget estimates despite reduction in subsidies and lower interest payments. Achieving the FY16 fiscal deficit target of 4.3 percent depends on collection of estimated Rs145 billion from Gas Infrastructure Development Cess and FBR revenue target of Rs3104 billion.
10. The deceleration in broad money (M2) growth from 15.9 percent in FY13 to 12.5 percent in FY14 has slightly reversed in FY15 to 13.2 percent. While Net Domestic Assets (NDA) led the growth in M2, Net Foreign Assets (NFA) decelerated in FY15. Despite better current account balance, deceleration in NFA of the banking system was a result of lower capital and financial inflows. Government reliance on banking system, specifically on scheduled banks, for its financing needs boosted the NDA of the banking system.



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Scheduled banks' financing of both commodity operations and PSEs also witnessed higher flow in FY15 against FY14.

11. Private Sector Credit (PSC) increased by Rs 208.7 billion during FY15 as compared to Rs 371.4 billion in FY14. The major drag for PSC remains the structural bottlenecks and low commodity prices. In FY16, construction and real estate sectors show promise as indicated by their continued credit uptake. The lagged impact of easy monetary policy of FY15 is also expected to positively affect the credit growth in the upcoming credit cycle in the first half of FY16. On supply side, possibly making lending slightly more attractive is the spread between WALR and 3-month T-bill rates) that has edged up from 113bps (on average) in FY14 to 131bps (on average) in FY15.
12. The liquidity conditions in the Q3-FY15 remained stressed but later in Q4-FY15 due to net retirement of government borrowing from banking system it eased a bit. Following the easy monetary policy stance other market interest rates also posted decline almost throughout the second half of FY15. However, a change has been observed in the market sentiments since the release of inflation numbers for May 2015.
13. Following the improvements in the Interest Rate Corridor (IRC) framework in May 2015, SBP has ensured that the money market average overnight rate remains close to the newly introduced Target (Policy) Rate at 6.5 percent. This led to an increase in both volume and frequency of open market operations (OMO). As a result, the overnight repo rate remained (on average) 2 bps below the policy rate of 6.5 percent in the post May 2015 monetary policy decision period. Furthermore, there has been less volatility in the overnight rate.
14. Given the above macroeconomic considerations, SBP Board of Directors has decided to keep the SBP Policy Rate unchanged at 6.5 percent.