

1 Maintaining Price Stability with Growth

1.1 Monetary Policy Formulation

Monetary policy of SBP during FY12 remained focused on maintaining an appropriate balance among the objectives of controlling inflation, promoting private investments, keeping financial markets stable, and building foreign exchange reserves of the country. There were, however, trade-offs involved among these competing considerations.

In the first half of FY12, SBP lowered its policy rate by a cumulative 200 basis points (bps) to 12 percent; 50 bps in July 2011 and 150 bps in October 2011. The decision was primarily motivated by a high probability of meeting the 12 percent CPI inflation target for the year and the need to revive the private investment demand in the economy. The initial projections of a moderate external current account deficit and controlled government borrowings from SBP in Q1FY12 also helped in introducing these reductions in the policy rate.

SBP kept the policy rate unchanged in H2FY12. This cautious approach was followed despite expectations of meeting the FY12 inflation target and concerns of declining private investment in the economy. The main reasons were increasing risks to macroeconomic stability due to lack of foreign financial inflows and rising fiscal borrowings from the banking system. Similarly, inflation followed a gradually rising trend and was expected to remain in early double digits in FY13 against the target of 9.5 percent.

In order to promote competition in the banking system, incentivize savings in the economy, and lower the currency in circulation, SBP also encouraged depositors to invest in government securities through Investor's Portfolio Securities (IPS) accounts. Moreover, with effect from 1st May 2012, SBP required all banks to pay a minimum profit rate of 6.0 percent on PKR saving/PLS saving deposits.

A significant development during FY12 that will help in improving the formulation and implementation of monetary policy are amendments in SBP's Act legislated in March 2012. An important feature of these amendments is the restriction on government borrowings from the central bank. The fiscal authority not only has to ensure no further accumulation of their debt owed to the SBP (keeping the quarterly flow of borrowings at zero) but also take steps to retire their borrowings from SBP over the course of next seven years.

1.2 Monetary Policy Department (MPD)

Monetary Policy Department (MPD), one of the core departments of SBP, is responsible for providing the intellectual, analytical, and information support in the formulation, implementation, and dissemination of monetary policy of SBP. In this regard, the department is contributing by drafting monetary policy statements (MPS); compiling monetary policy information compendium; preparing outlooks for inflation, trade and monetary aggregates; and combining these forecasts into macroeconomic framework for preparing consistent projections of key macroeconomic indicators. In addition, pursuing the bank's strategic plan, the department is also conducting various research based studies with the aim to improve the formulation and implementation of monetary policy in Pakistan.

Keeping in view the important role of communication in making monetary policy effective, the department dedicates significant effort for effective dissemination of its monetary policy stance. In

order to provide timely direction to the stakeholders, SBP announces its monetary policy stance six times in a year. The two monetary policy statements, produced in February and August, provide detailed analytical and forward-looking assessment of the economy that sheds light on factors determining the monetary policy stance by SBP. While brief statements are issued in April, June, October and December. The department also participates in various forums, such as interviews and discussions on the electronic media, to explain the monetary policy stance and answer queries of the various stakeholders.

Besides performing these regular assignments, in FY12 the department also organized discussion forums and workshops for financial market analysts and journalists to share knowledge on concepts, procedures, and issues relating to monetary policy implementation in Pakistan. Moreover, the department has made significant progress in developing a webpage on monetary policy that is expected to be placed on the main SBP website in FY13.

In preparing outlook of various macroeconomic indicators, the department uses up to date statistical techniques, keeping in view the suitability of data available for the Pakistan's economy. Moreover, reviewing and improving the forecasting suites and macroeconomic framework is a continuous affair. In the past couple of years, inflation forecasting exercise has been further enhanced by analyzing and forecasting consumer prices at more disaggregate levels, preparing fan charts to measure the degree of uncertainty around inflation projections, and computing impulse responses that capture the impact of unanticipated shocks to the system. Moreover, the suite of external trade has been improved further by incorporating disaggregated trend analysis and determining trade elasticities. Similarly, the macroeconomic framework has evolved quite significantly over the past few years with more improvements still on cards. The scenario analyses that were developed in FY11 have been further strengthened during FY12. In addition, preparing medium-term macroeconomic projection scenarios, which help assess the macroeconomic conditions under various assumptions over a longer period, has been made a regular exercise.

Another important achievement of the department, during FY12, is the completion of Framework Consistent Macroeconometric Model (FCMM). FCMM includes 33 behavioral equations, 59 identities and 197 macroeconomic variables that effectively merge the stochastic and deterministic characteristics of the economic modeling. Behavioral equations explore the stochastic relationships among economic time series while identities of macroeconomic framework capture the deterministic part. FCMM was passed onto the Research department for further refinement and use for simulation and response analysis.

The department has also made significant progress during FY12, in producing initial drafts of various research based studies. These studies mainly include investigating effectiveness of monetary policy transmission mechanism through various channels, documenting existing monetary policy framework, and identifying weakness and constraints of monetary policy in Pakistan.

1.3 Research Department

Research Department (RD) has made significant progress in the development of a theoretical macroeconomic model incorporating the microeconomic features and the informal sector of Pakistan economy. Using the results from the formal and informal sector surveys as well as those decoded from data acquired from secondary sources, e.g. Labor Force Survey by Pakistan Bureau of Statistics, this Department has completed its first dynamic stochastic general equilibrium (DSGE) model. Although the model is in annual setting and deals with an economy as a closed one, it still has been successful in replicating the empirical moments of the Pakistani data including the informal labor and

production sectors. We have, as well, moved forward by converting the very first model to quarterly frequency so that it can provide policy related insights as well as we have been successful in calibration/ estimation of parameters through Bayesian methodology, bringing in more legitimacy to our results.

Moving ahead on micro level research agenda and to facilitate the forward-looking view of monetary policy, Research Department has started constructing , in collaboration with Institute of Business Administration, consumer confidence index (CCI) through telephonic surveys after rigorous research and adopting the scientific approach. Announcement of this survey observations will start after completion of the data validation process. In order to carry out CCI survey and other surveys for micro founded research, this department has set up a state of the art Centre for Survey Research (CSR) at State Bank of Pakistan Karachi. In order to assess the satisfaction level, a banking sentiments survey of the customers of commercial banks in Pakistan was the first study completed by the CSR for the senior management of SBP.

Pakistan Bureau of Statistics regularly provides Annual National Income Accounts (ANIA) for the country, based on UN System of National Accounts. PBS does not disseminate Quarterly National Income Accounts (QNIA) which can provide timelier picture than ANIAs and more comprehensive than provided by the indicators like LSM index & merchandise imports/exports. To meet the QNIA requirements (of the researchers), RD has estimated the quarterly GDP from production as well as expenditures side (both on current prices and on the prices of 1999-2000) and it's various subsectors/components since 1972-73.

Research Department organized a number of seminars and lectures during FY12.

- The 18th Zahid Husain Memorial Lecture was held on December 22, 2011 wherein Professor Abhijit Vinayak Banerjee (the Ford Foundation International Professor of Economics at the Massachusetts Institute of Technology) delivered a lecture on "Micro-Credit and the Financing of Small Businesses". The lecture was presided by the SBP Governor and attended by ex SBP governors, prominent economists, diplomats, bankers, and government officials.
- The 7th SAARCFINANCE Regional Seminar on 'Monetary Policy Framework in the SAARC Region' was organized by SBP at National Institute of Banking & Finance (NIBAF), Islamabad during June 14-16, 2012. Mr. Riaz Riazuddin, Chief Economic Adviser, State Bank of Pakistan and Dr. Athar Maqsood Ahmed, Head, Department of Economics, NUST Business School, Islamabad, were the key Speakers of the event. Mr. Abid Qamar, Additional Director, SBP presented findings of the SAARCFINANCE Study undertaken by SBP on the Seminar theme. The delegates from most of the SAARC member countries presented their country papers in the seminar.
- State Bank of Pakistan organizes seminars on Pakistan & World Economy mainly to get benefit of the ideas and contemporary research work of renowned scholars. Last year, Dr. Basit Zafar, Economist, Federal Reserve Bank of New York, USA, spoke on the research paper titled "The Price is Right: Updating on Inflation Expectations in Randomized Information Experiment".

1.4 Economic Policy Review Department

The key role of the Economic Policy Review Department is to evaluate the performance of different sectors of the economy, provide a comprehensive assessment of prevailing economic situation, and assist in economic policy formulation. The analysis undertaken in the department is disseminated through the flagship publications of SBP i.e. the Annual and Quarterly reports, as well as through

working papers and internal position papers. Over the last year, the department has improved its profile through increased focus on sector-specific research, improved policy input on key macro issues, and enhanced quality of its publications.

1.5 Statistics and Data Warehouse Department (S&DWHD)

Statistics and Data Warehouse Department is responsible for collection, compilation and dissemination of statistics on economic, financial and monetary aspects most pertinent to the central banking. The Department is primarily engaged in collecting and compiling data with different periodicities on money and banking, international trade, monetary accounts, balance of payments, international investment position, exchange rates, foreign exchange reserves, foreign investment, private external debt, flow of funds, inflation etc. and data on these variables are disseminated through SBP website and also in the form of publications. The department regularly brings out two monthly, two quarterly, one bi-annual and eight annual publications.

Of late, Statistics & DWH department is expanding its role to serve as focal point for all statistical activities of SBP. Most of the data are collected electronically and processed using specifically designed software for the purpose. The department also coordinates for data warehousing of the bank.

The Statistics & Data Warehouse Department endeavors to provide quality and timely statistics to users on regular basis. A number of steps have been taken in the recent past to bring improvements in the compilation and dissemination procedures and to bring it in line with the international standards (see **Box 1.1**).

Box 1.1: Major Steps taken by the S&DWH Department for Improvements in Data Compilation and Dissemination Procedures

Statistics & Data Warehouse Department has brought many improvements in compilation of data, dissemination procedures, and bringing as per international standards by taking a number of steps in recent time. Some of the achievements in this direction include:

- Implementation of the guidelines of IMF 5th Manual of Balance of Payments Statistics (BPM5) and work on implementation of the 6th edition (BPM6) is in progress.
- Adoption of latest classification systems such as Harmonized coding system (HS) for classification of trade data and International Standard Industrial Classification (ISIC 3.1) for private sector business.
- Acquisition and compilation of data initiated from Non-bank financial institutions.
- Compilation of International Investment Position (IIP) of Pakistan initiated as per international standards
- Compilation of Foreign Direct investment statistics according to the concepts of Ultimate Controlling Parent (UCP).
- Implementation of System of National Accounts 93 (SNA 93) for compilation of Flow of Funds Accounts of Pakistan and implementation of the 2008 SNA is in progress.
- Adoption of the methodology of Manual of Financial & Monetary Statistics 2000 (MFSM 200) for compilation of monetary statistics.
- Seasonal adjustment of important data series likely to be affected by the seasonal effects initiated on regular basis.
- A compendium of historical data series (from 1947) prepared and published in form of a publication “A handbook of statistics on Pak economy”.
- Financial statement analysis initiated for the financial sector of Pakistan.
- Data archives developed on SBP web to facilitate users in undertaking statistical and economic analysis.
- Scope, coverage and timeliness of all important statistics compiled at SBP significantly improved.
- The Coordinated Direct Investment Survey (CDIS) initiated in Pakistan.
- Efficiency of statistics improved through automation under Data Warehousing.
- Implementation of the recommendations made by the ROSC missions of IMF.
- Users are informed about the release of all important categories of statistics in advance through Advance Release Calendar placed on SBP web.

All data are compiled according to the international compilation standards prescribed in the users' manuals such as the IMF's Balance of Payments Manual, 5th edition (BPM5) and Monetary and Financial Statistics Manual 2000 (MFSM) of the IMF. Statistics & DWH department is committed to producing high quality statistics with reliability and timeliness. The department follows General Data Dissemination System (GDDS) of the IMF and also fulfills the requirements of Special Data Dissemination Standard (SDDS).

The department plays active role in improving the statistical systems in Pakistan and has held various users-producers workshops / seminars for having a close coordination and interaction among compilers and users of statistics. Outreach seminars are frequently organized for academia and researchers to create awareness about the available statistics and to identify data gaps on the basis of their feedback.

1.6 Library Services

During FY12, SBP Library continued its mission of catering to the information and research requirements of its patrons through acquiring up-to-date information resources and delivering efficient readers' services. Responding to 482 purchase requisitions, around 2,183 books were acquired during the year, besides subscription of 137 journals and 16 online databases. In order to update the patrons about new acquisitions, publishing of monthly *Fresh Arrivals Bulletin* and *Current Contents Bulletin* on SBP website and Electronic Board remained regular feature of the Library.

While numerous reference queries of the library visitors were answered at the Library's reference desk, information queries of remote users from across the country were entertained through *Online Reference and Document Delivery Service*, under which 2,571 articles/datasets were dispatched to the concerned users. Library's circulation section recorded 229 new members, 26,747 visitors, and 28,787 checked out books, as against previous year's figures of 285; 26,529; and 29,381 respectively.

Highlights of the major developmental tasks undertaken during FY12 are summarized below:

- Bidding process for *Digitization of Library Resources* was completed with the award of contract to M/S National Institutional Facilitation Technologies (Pvt.) Ltd. Objective of this project is to digitize important published documents.
- The 2nd phase of *Library Outreach Program* was accomplished with the successful conduct of orientation workshops at SBP-BSC field offices in Sialkot, Bahawalpur, and Islamabad.
- The indexing scheme for the periodicals was thoroughly revised in order to incorporate new disciplines.
- Library Portal was enriched with *Table of Contents Search* and attractive books cover displays.