



MONETARY POLICY COMMITTEE STATE BANK OF PAKISTAN

Monetary Policy Statement

April 09, 2016

After bottoming out in September 2015, both the Year-on-Year (YoY) headline CPI and period average inflation are on a rising trend. While the YoY inflation rose from 1.3 percent in September 2015 to 3.9 percent in March 2016, the period average inflation increased from 1.7 percent to 2.6 percent during this period. Similarly, the YoY core inflation measures kept their increasing trends; Non Food-Non Energy increased for the fifth consecutive month and the Trimmed Mean for the third month. Nevertheless, this rise in inflation was anticipated and the benign inflation outlook for the remaining months of FY16 remains largely unchanged.

However, these trends in inflation indicate pickup in aggregate demand, amid both improved security situation and real incomes. This is reflected in rising demand for consumer durables, acceleration in construction activities, and expansion in services sector. Further, uptick in credit to private sector, mainly owing to lower cost of borrowing, also supports this. Continuing increase in fixed investments for the fifth quarter remains noteworthy. With positive consumer sentiments and incremental lending rates at considerably lower levels, the uptake in credit to private sector is expected to end FY16 on a higher level than that of FY15.

At the same time, with improved business sentiments, lower input prices, and better energy availability, supply conditions have improved as well. Largely contributed by automobile, cement, and fertilizer sectors, large-scale manufacturing grew by 4.1 percent in Jul-Jan FY16, compared to 2.5 percent growth in Jul-Jan FY15. The improving large-scale manufacturing and industrial growth trends are expected to continue despite sector specific issues in steel, paper and board, and sluggish textile sector. Furthermore, excess stock of major food items and the February 2016 pass-on of lower oil prices to domestic consumers are expected to keep downward pressure on inflation. This is also corroborated by a decline in inflation expectations in the latest wave of IBA-SBP consumer confidence survey.

In line with these developments, both money and foreign exchange markets exhibited relative tranquility in recent months. The cushion provided by decline in oil prices, inflow of remittances, and calmer international capital markets improved sentiments in the foreign exchange market. As a result, in post January 2016 monetary policy period, PKR has remained stable in the interbank market.

In the money market, volatility in the overnight repo rate was contained. The weighted average overnight repo rate stood at 3 basis points above the policy rate in post January 2016 monetary policy period compared to being 21 basis points above in the post November 2015 monetary policy period. Thus, KIBOR and market interest rates have declined depicting low inflation expectations for an extended period of time. However, market's liquidity requirements



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increased on account of continuing trend in retirement of government debt from SBP through enhanced borrowing from scheduled banks and higher private sector requirements.

Despite an increase in development expenditures, budget deficit remained manageable in the first half of FY16. The improvement came from containment of current expenditures and sharp increase in tax revenues. Specifically, the uptick of 14.6 percent has been recorded in federal tax revenues during first half of FY16 as compared to the marginal growth of 3.9 percent in the first half of FY15.

Notwithstanding the pickup in quantum of oil imports along with high imports of machinery and transport equipment, trade balance stood at last year's level in Jul-Feb FY16. Even with rise in imports of machinery for some time and improvements in domestic conditions, exports continued to decline. However, moderating growth in foreign remittances resulted in marginally narrowing down of the current account deficit. The increases in net flow of foreign direct investment and net foreign assistance during Jul-Feb FY16 kept the capital and financial account at nearly the same level as of last year. These developments resulted in keeping the overall balance of payments in surplus during this period and added to the official foreign exchange reserves. These trends are expected to persist and thus the balance of payments outlook for the remaining months of FY16 remains positive. However, low private capital inflows pose challenge for medium term external sector sustainability.

While the current macroeconomic stability, improved law and order, and China Pakistan Economic Corridor related investments bode well for the future prospects for foreign direct investments, it is the decline in exports receipts that is worrisome. General weakness in global trade further accentuates this risk. Hence, the current improved domestic environment provides for the necessary conditions to inculcate better value addition and diversify products and markets for sustainable growth of exports.

In view of the foregoing, the Monetary Policy Committee of the State bank of Pakistan has decided to maintain the policy rate at 6.0 percent.