Monetary Policy Statement

January 30, 2016

The major macroeconomic indicators continued to exhibit improvements in the first half of the current fiscal year. The inflationary environment stayed benign, LSM gained traction, and fiscal consolidation remained on track. In addition, successful completion of ninth review under IMF's EFF and disbursements from multilateral and bilateral sources added on to country's external buffers. With the pickup in private sector credit, for fixed investment in particular, along with improving security situation reflects strengthening of investor and consumer confidence.

Average CPI inflation has declined to 2.1 percent during July-December 2015, with perishable food items and motor fuel leading the way. Meanwhile trend in YoY CPI inflation has reversed; it rose for third consecutive month to 3.2 percent in December 2015. Keeping in view the benign outlook of global commodity prices, expectation of a moderate pickup in domestic demand and further ease in supply side constraints, SBP expects the average inflation in FY16 to remain in the range of 3 to 4 percent. However, global oil price trends and excess domestic food stocks (wheat, rice, and sugar) may exert downward pressures on inflation.

Large-scale manufacturing (LSM) grew by 4.4 percent during Jul-Nov FY16 as compared to 3.1 percent in the same period last year. LSM mainly benefitted from monetary easing, falling international prices of key inputs, better energy situation, increased domestic demand for consumer durables, and expansion of construction activities. There are challenges to overall economic performance from the declines in the production of cotton and rice. However, a part of these losses could be offset by better performance of other crops, especially from the upcoming wheat crop. In view of these developments, real GDP is set to maintain the previous year's growth momentum. The uptick in economic activity appears to continue beyond FY16 on the back of energy and infrastructure projects under CPEC.

Pakistan's overall balance of payment position continued to strengthen in H1-FY16. The external current account deficit narrowed down to almost half of the last year's level on account of persistent decline in international oil price and steady growth in workers' remittances. In the capital and financial accounts, besides strong official inflows, there is some improvement in foreign direct investment.

Given depressed outlook of international commodity prices, the external current account deficit is expected to remain lower than last year. With continuation of the IMF

EFF and expected disbursements from other official sources, the surplus in capital and financial accounts may increase in the second half of FY16. These are expected to have favorable impact on foreign exchange reserves. Furthermore, expected increase in FDI from China may help maintain an upward trajectory in foreign exchange reserves. Reversing of trends in exports, however, is dependent on external demand and cotton prices in international market. In addition, easing of domestic constraints with the completion of ongoing energy projects could help in improving export competitiveness.

Fiscal deficit was contained to 1.1 percent of GDP during Q1-FY16, compared to 1.2 percent in the same period last year. This reduction, despite substantial increase in development expenditures during Q1-FY16, was due to improvement in tax revenues and containment of current expenditures. The improvement in fiscal accounts may continue in the remaining months of FY16. While additional tax measures announced in October 2015 are expected to contribute to growth in FBR revenues, current spending is likely to remain within target.

The year-on-year growth in broad money (M2) accelerated largely due to substantial increase in Net Foreign Assets (NFA) of the banking system. The growth in Net Domestic Assets (NDA) of the banking system decelerated despite a pickup in private sector credit. On the liability side, deceleration in growth of deposits and acceleration in currency in circulation are source of concern.

The credit to private sector increased by Rs339.8 billion during H1-FY16 as compared to the Rs224.5 billion in same period last year. The impact of monetary easing, improved financial conditions of the major corporate sector and better business environment encouraged firms to avail credit not only for working capital requirements but also for fixed investments. Going forward, the improvements in LSM, expansion plans announced by major industries and favorable monetary conditions are expected to provide continued momentum in the demand for credit.

Some stress in liquidity noticed in Q1-FY16 due to increased government borrowing from the scheduled banks steadily eased in Q2-FY16 owing to improved revenue collection and timely receipt of foreign flows. Besides this, pressures in foreign exchange market also induced volatility in interbank liquidity requirements. This is also evident from movements in overnight repo rate which mostly remained slightly above the SBP target rate.

Given the above macroeconomic considerations, the Monetary Policy Committee (MPC) of the State bank of Pakistan has decided to keep the Policy Rate unchanged at 6.0 percent.