

31st July, 2007

**STATE BANK INTRODUCES STRATEGIC CHANGES IN
MONETARY POLICY FORMULATION: DR AKHTAR**

The State Bank of Pakistan issued its **Monetary Policy Statement** for the first half of FY08, which was approved by the Central Board of Directors of SBP at its meeting held in Karachi today, with Governor, Dr Shamshad Akhtar in the Chair.

The State Bank Governor briefed the newsmen about the salient features of the Monetary Policy at a press conference held after the Board meeting. The Governor, State Bank of Pakistan said that despite the risks and challenges identified for FY08 and the carry forward stress of monetary developments of FY07, SBP is determined to achieve the CPI inflation target of 6.5 percent in FY08. Therefore, SBP would actively make use of its policy instruments to bring CPI inflation down to its target level, she added.

Dr Akhtar said that keeping in view the challenges and allowing greater scope for private sector credit growth, SBP has introduced some strategic changes in monetary policy formulation and its conduct. Monetary policy is undergoing qualitative changes following the abandonment of the Annual Credit Plan (which prescribed targets for broad monetary aggregates) and recognition that there is a need for adopting a more sustainable approach to deal with the two principal sources of reserve money growth, i.e., the government's reliance on central bank borrowings and the refinancing operations which dilute the central bank's monetary stance, she added.

The SBP Governor said in line with this monetary policy framework and assuming real GDP growth target of 7.2 percent and inflation target of 6.5 percent, broad money supply growth should be 13.7 percent for FY08.

She said the State Bank has recommended to the Government that for FY08 it would be prudent to: (i) retire borrowings from SBP by Rs 62.3 billion, (ii) adopt quarterly ceilings on budget borrowings from SBP, and (iii) adopt a more balanced domestic debt strategy whereby budget is financed from long-term financing sources (that are relatively less inflationary).

Another significant strategic change in the monetary policy is SBP's decision to gradually reduce commercial banks' reliance on refinancing facilities and encourage them to mobilize the desired level of resources to fully accommodate private sector and export credit requirement, the Governor added.

The following are the policy measures announced in the Monetary Policy Statement:

- (i) Effective from 1st August 2007 SBP will raise policy discount rate from 9.5 percent to 10 percent.
- (ii) Zero rating of Cash Reserve Requirement (CRR) for all deposits of one-year and above maturity (to encourage greater resource mobilization of longer tenor) and 7 percent CRR for other demand and time liabilities.

- (iii) Recognizing the shortage of Shariah-compatible papers that are used by Islamic Banks to meet SLR requirements, their cash in hand and balances with NBP are being allowed to count towards SLR.
- (iv) **Introduction of modifications in the refinancing limits and resource sharing arrangements for EFS to reduce its consequences for reserve money growth and promote efficient utilization.** Under the revised scheme, the export finance limits of banks for the year FY08 shall be fixed at the level of outstanding amounts as of 30th June, 2007. For ensuring phased transformation of export financing regime, SBP shall allow only 70 percent refinance against such limits based on actual 100 percent draw down of export finance by the exporters with their respective banks; the balance 30 percent shall be funded by the banks out of their own resources. Exporters will continue to get the financing from banks for 100 percent of their entitlement to borrow under the existing Scheme. The banks will be required to ensure that their total outstanding refinance from SBP as of 30th June, 2007 is reduced steadily by 30 percent latest by 30th June, 2008. During the transition period as an interim support, the amount of export finance provided by banks from their own sources would be eligible for deduction from their demand liabilities for the purpose of determining their CRR. The other terms and conditions of revised EFS would remain the same. In particular, the refinance rate to banks will remain below the benchmark 6-month T-bill and similarly the banks lending rate to exporters will not exceed 7.5 percent per annum.
- (v) **The SBP is introducing a new Long Term Financing Facility (LTFF) to promote export led industrial growth in the country.** This facility will be available through approved Participating Financial Institutions (PFIs) including banks and DFIs. Under this facility, the exporters can avail financing for fresh procurement of new imported and locally manufactured plant and machinery. The facility will be available to the export oriented projects with at least 50 percent of their sales constituting exports or if their annual exports are equivalent to US\$ 5 million, whichever is lower. SBP will provide refinance up to 70 percent of the sanctioned facility and the PFIs will finance 30 percent of LTFF from their own resources. LTFF will be guided by an overall yearly limit with which PFI limits will be set based on their financial capacity and strengths. PFIs will serve exporters on a first come first serve basis subject to meeting the prescribed eligibility criteria. Lending under the facility shall be subject to compliance of the relevant Prudential Regulations and the prescribed Debt-Equity Ratio. Other terms and conditions will be released separately.
- (vi) **Simplification and Liberalization of External Commercial Borrowing (ECB).** Consistent with the growing trend in corporate sector of Pakistan to access international markets for funding requirements, SBP is issuing instructions to further liberalize and rationalize the ECB. Industry and exporter will be able to secure their foreign currency requirements based on different product structures and maturities; if within stipulated pricing range these transactions can be approved by the commercial banks/DFIs without seeking SBP's approval. In order to liberalize hedging of exchange exposures

arising out of foreign currency borrowings, forward cover facility will now be available in all categories of ECBs. Subject to the compliance of prescribed conditions, SBP is also in the process of formulating guidelines and procedures to allow Authorized Derivative Dealers to provide this facility to the exporters without seeking SBP's approval.

(vii) **Augmenting Financial Penetration.** To encourage the public to open Basic Banking Accounts (BBAs), banks are being advised not to recover any charges from customers for operating BBA or for conversion of regular full service bank accounts. Furthermore, banks are also being advised not to recover service charges of more than Rs.50/- per month from their regular account holders on maintaining balance below the minimum monthly average balance. Further, to enhance the financial penetration of banking system, all banks will henceforth be required as a minimum to open 20 percent of their new branch network in rural / underserved areas under Annual Branch Expansion Plan (ABEP). Appropriate flexibility is being built in to open sub-offices and other arrangements to offer the financial services to rural population.

(viii) **Procedural Streamlining of Lending Rates.** Recognizing concerns of borrowers and in order to ensure transparency in the pricing and documentation of bank loans, SBP is issuing detailed instructions to the banks/DFIs that restrict them from making unilateral changes in the rates of fixed rate loans, recommending adhering to the specified margins in case of variable rate loans, and to clearly spell out the pricing and re-pricing frequency explicitly in the loan document. All charges including fee, repayment penalties etc., to be recovered by the banks/DFIs, should be determined and clearly disclosed to the customers at the time of the contract. In addition, a complete amortization schedule covering principal and mark up and a revised amortization plan in the case of revision in the floating rate should be provided to the customers.

The complete text of the Monetary Policy Statement is available at SBP website: www.sbp.org.pk
