

February 9, 2008

Monetary tightening to contain macro economic imbalances: Dr Akhtar

Dr Shamshad Akhtar, Governor, State Bank of Pakistan said today that recent monetary tightening by the State Bank was carried out to contain macro economic imbalances which are creating inflationary pressures in the economy.

She was addressing businessmen and industrialists on State Bank's Monetary Policy at the Federation of Pakistan Chambers of Commerce and Industry (FPCCI) in Karachi. The meeting was a part of SBP's efforts to apprise the business community of different aspects of the Monetary Policy.

It may be mentioned here that the State Bank released its Monetary Policy Statement on January 31, 2008 in which the SBP raised its discount rate by 50 basis points to 10.5%.

"Monetary tightening is a prerequisite to contain macro economic imbalances," Dr Akhtar said and added that the State Bank does not want to stifle growth. "We want to ensure adequate macro economic stability which is a prerequisite to attract investment," she emphasized. Dr Akhtar explained that rising fiscal and current account deficits along with excessive Government borrowing from the State Bank prompted the central bank to raise its key policy rate.

Dr Akhtar asserted that Monetary Policy is very much relevant in the context of Pakistani economy, as it has helped to contain 'inflation levels' in the country. She said that with the help of tight monetary policy adopted since April 2005, Pakistan managed to reduce inflation rate quite significantly over 2006 and up to May 2007. Headline inflation measured by Consumer Price Index (CPI) declined from 11.1% in April 2005 to 7.4% by May 2007 (even though inflation rate of 7.8% for FY07 was higher than original target of 6.5%). She said that monetary policy has more distinct impact on reducing core inflation defined to include non-food and non-energy items that have 51% weight in the CPI. It is notable that Pakistan was able to bring down the core inflation to 5.2% by May 2007 from local peak of 8.3% in October 2005. "If we had not tightened the monetary policy, inflation would have been in double digit or significantly higher than 10%," she added.

She said that while the demand side factors are playing the major role in aggravating macroeconomic imbalances and overall inflation, one of the reasons behind rising food inflation is supply-side constraints and added that these constraints are generated because of the behavior of industry, wholesalers and retailers that are creating artificial shortages.

Dr Akhtar said Government's reliance on State Bank for budgetary support is also fueling inflation and added that the Government has borrowed Rs 334 billion from the central bank upto 7th February in FY08. She said although the Government has assured the State Bank that it will retire this borrowing, further

monetary tightening was necessitated to offload part of this borrowing to commercial banks in order to curb inflationary pressures.

She said that the State Bank recognizes the problems being faced by the domestic industry and added that the central bank is taking a number of measures for the benefit of the industry, including the introduction of new Long Term Financing Scheme.

Regarding availability of working capital loans to exporters under EFS, the participants were apprised that the export refinance facilities extended by commercial banks to the exporters at 7.5% (including those granted by them from their own sources) during FY08 stood at Rs 140.3 billion as per the latest data available upto 26th January 2008 as against Rs 133.3 billion extended as on 26th January 2007.

It was also explained that the instructions regarding the provision of bank financing by the commercial banks for procurement of wheat by the functional flour mills during wheat procurement season 2008 shall be issued in consultation with Ministry of Food, Agriculture & Livestock. However, the borrowers from private sector who availed bank financing for procurement of wheat during last year, having failed to retire their loan by 31st January 2008 would be penalized.

The meeting was told that about main features of the recently announced long-term financing facilities and the Governor SBP encouraged industrialists to use this facility as funds under it would be available on competitive rates. She also disclosed that financing facilities under this scheme are available at less than market rate.

Some of the participants desired that the State Bank may also facilitate resolution of matters concerning the SME Rice exporters, financing for logistic and transport sector. The Governor advised them to bring their proposals to the State Bank.

She dispelled the impression that the consumer financing by banks is hurting financing activities to other sectors. She explained that unlike other countries where proportion of consumer financing to GDP is very high, in Pakistan this ratio is nominal. She also explained that though the State Bank has set limits for banks for extending consumer finance as a proportionate to their equity, banks will have to provide for the non-performing loans extended as a part of consumer finance. Dr Akhtar, however, commented that a large proportion of it has benefitted the automobile sector whose production has increased substantially with the assistance of consumer financing as banks have extended a substantial amounts for buying cars and motor cycles.

Earlier, Tanvir Ahmed Sheikh, President FPCCI, explained industry's viewpoint on the general economic conditions and congratulated the Governor on introducing new long-term financing scheme. The meeting was attended by businessmen, industrialists besides senior officials of the State Bank.
