

31st January, 2008

**STATE BANK REMAINS COMMITTED TO BRING
DOWN INFLATION: DR AKHTAR**

The State Bank of Pakistan issued its **Monetary Policy Statement** for the second 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.

Dr. Akhtar said that the monetary stance adopted since April, 2005 has had a visible impact. Core inflation came down during FY06 and FY07, albeit slowly and with the standard lag typically observed in developing countries. The Governor explained that the progress achieved in reducing core inflation has to be judged in context of the (i) significant and lingering monetary overhang brought about by earlier easing; (ii) excessive growth in reserve money in FY07 due to exceptional requirements of the textile industry for re-financing and budget's continued recourse during the fiscal year on central bank borrowings; and (iii) supply management problems affecting key food items and the significant rise in global commodity prices that has been generating new inflationary pressures in most economies. Due to the sizeable impact of the latter two items in particular, there has been a reversal, since May 2007, in core inflation. Trend headline inflation (Consumer Price Index) has stayed around the same level of the last two years, but this is much higher than the target of 6.5 percent.

The Governor elaborated that the developments in the first half of FY08 substantially deviated from the monetary policy framework. Most significant among these deviations is the behavior of the fiscal account. Slippages from the fiscal deficit target have, and will, cause complications for monetary management during the course of the year. During the course of the year, liquidity management was challenging as the commercial banks and central bank ended up together financing almost 60 percent of the budget deficit for the July 1 - January 29, FY08 period.

Notwithstanding the impact of the political uncertainty and pressures of government borrowings on the financial system, private sector credit managed to grow by 10.4 percent during July 1 -January 19, FY08 compared to 10.2 percent over corresponding period of the previous year. This was partly helped by the calibrated liquidity injections in the system and a decline in the effective Cash Reserve Requirement (CRR). Banks and SBP worked closely to ensure export financing was being provided in line with requirements. As of January 5, 2008 exporters benefited from Rs139.6 billion export credit against Rs131.6 billion at the same point in time in FY07.

Dr. Akhtar stressed that the tight monetary policy stance, especially since the previous policy rate increase, has begun to lose some of its steam. A moderate increase in KIBOR and banks' lending rates, almost flat Monetary Conditions Index, a fall in the effective

CRR, and persistently high annualized M2 growth rate are all manifestations of these developments. Further, there was a reversal in core inflation trends which rose to 8.7 percent on an year on year basis by December 2007; 2.3 percentage points above the last year level and 2.4 percentage points above the trough reached in May 2007. Headline CPI inflation reached 8.8 percent by December 2007 reflecting the undercurrents of core inflation and the food inflation (which hit double-digits, to reach 12.2 percent in December 2007).

She emphasized that the risks to inflation outweigh the risks to growth in the near future. The growth rate of real GDP has hovered around its target level for several years and exactly matched the target level of 7 percent for FY07.

The Governor then announced the following policy measures taken in the Monetary Policy Statement:

- (i) Effective from February 1, 2008, the SBP is raising its policy discount rate by 50 basis points to 10.5 percent.
- (ii) CRR is being raised by 100 basis points for deposits up to one year maturity while leaving term deposits of over a year zero rated. This will further incentivize the banks to mobilize long term deposits.
- (iii) Effective January 1, 2008 State Bank has already introduced a new Long Term Financing Facility (LTFF) to facilitate the exporters to increase exports. Under the new scheme banks /DFIs will provide long-term financing of up to 10 years to their borrowers for import of foreign machinery as well as purchase of locally manufactured machinery for setting up of export oriented projects. An amount of Rs8.0 billion has been earmarked for financing for the period between January - June 2008, which is well above the estimated demand received from the banks/DFIs for providing limits under the scheme. The State Bank shall provide 70 percent refinance to the banks/DFIs on their disbursements under the new scheme. The borrower has the option to borrow for three different tenors, i.e., for up to 3 years, 5 years and 10 years, at financing rates of 8 percent, 9 percent, and 10 percent respectively. The financing rates for end users shall remain locked in for the entire period, once the facility has been disbursed by the banks/DFIs. However, banks/DFIs have to keep the disbursements during a year in accordance with the limits sanctioned to them.
- (iv) The events of December 27, 2007 resulted into losses to various private and public sector enterprises. In order to assist such enterprises in revival of their activities, SBP has developed a relief package which includes: (i) moratorium on payment of principal and mark up in respect of the loans availed by the affected entities under Export Finance Scheme and relaxation in the shipment period under Part-I and performance requirements under Part-II; (ii) Permission to banks/DFIs to provide financing for reconstruction/rebuilding of

the factory premises by the affected borrowers under the recently announced Long Term Financing Facility (LTFF); and (iii) relaxation in respect of realization of export proceeds by the affected entities on case to case basis. The above reliefs under the package shall be subject to the findings of the commission set up by the Federal Government pursuant to the events of December 27, 2007.

The complete text of the Monetary Policy Statement (both in English and Urdu) is available at SBP website: www.sbp.org.pk
