8th October 2008

SBP GOVERNOR DR. SHAMSHAD AKHTAR'S PRESS STATEMENT

The following is the text of the statement of the Governor, State Bank of Pakistan, Dr. Shamshad Akhtar, issued to the press tonight:

"SBP has been monitoring closely the recent developments regarding the overall and bank specific liquidity position. After a measured assessment, SBP has decided to take the following action to ease the liquidity situation of the market:

- Reduction in the Cash Reserve Requirement (CRR) for all deposits up to one year maturity by 100bps to 8.00 percent w.e.f. from 11th October 2008 and by another 100bps to 7.00 percent w.e.f. 15th November 2008. As a result of this cumulative decrease of 200bps, Rs61 billion will be released into the system. The liquidity situation will be monitored on a continuous basis and the change in the CRR may be reviewed accordingly.

It must be remembered that this is a temporary measure aimed at accommodating extraordinary liquidity requirements of the banking system and, therefore, should not be construed as a change in the monetary policy stance. Active and calibrated liquidity management is a part of a prudent monetary policy management necessary to achieve financial as well as overall macroeconomic stability. The SBP's assessment of risks to inflation outweighing the risks to growth still holds and therefore it remains committed to check the snowball impact on inflation expectations of persistently high fiscal and external current account deficit and overall aggregate demand pressures in order to achieve price stability over the medium term.

As a result of global financial crises central banks across the globe have now further stepped up their interventions in the financial markets to shore up confidence and to ease the liquidity situation. However the domestic macroeconomic situation differs across countries and regions. Macroeconomic stability in Pakistan continues to be under stress on account of both domestic and external vulnerabilities. The fiscal stress continues to be high. After registering an all time record borrowings of Rs689 billion from the SBP in FY08, the Government borrowings have continued to rise unabated in FY09 also. This excessive recourse on the banking system borrowings is straining the credit availability for the private sector and is also causing complications for effective liquidity management. The weaknesses in the external sector, in particular, constitute a major source of concern at the moment. Despite strong inflow of workers' remittances and a decent export performance the external current account deficit remained at an unsustainable level of 8.4 percent of GDP in FY08. With considerable slowdown in private as well as public financial inflows, the financing gap has widened and consequent outflow of foreign exchange has drained the rupee liquidity from the system straining the domestic money market; the Net Foreign Assets (NFA) of the banking system have depleted by Rs166.5 billion during 1st July- 20th September FY09.

Demand for credit from both the government and the private sector has further tightened the liquidity conditions. The market expectations that the Government is planning to pull out the public sector/Government deposits from the commercial banks is causing further anxiety in the market from the liquidity perspective. Adding to the pressures of the market liquidity conditions is reduction in total deposits of the banking system and an increase in the currency in circulation. These trends in banking system liquidity partly reflect seasonality as the currency in circulation normally increases around the Eid festival period putting temporary pressure on the interbank liquidity. The strains in liquidity some individual banks face is because of their weak deposit mobilization campaigns and low interest rates they offer on deposits in view of maintaining their high profitability. Additional complications have risen because of the Government and public sector organizations' excessive borrowings from the banking system.

The liquidity constraint in the system has resulted in a rising trend in overnight call rates, reduction in excess liquidity held by banks over and above the required amount, and the lack of availability of liquid assets eligible as collateral for borrowings under OMOs/discounting.

State Bank of Pakistan takes strict notice of the unwarranted recent increase in overnight call rates. In its communications with the PBA central bank has advised that the banks act prudently in sharing the liquidity in the system and ensure that call rates are reflective of the fundamentals in the money market. SBP on its part has injected regular liquidity in the financial system. Since Aug'08 SBP has conducted 13 OMO injections and have injected temporary liquidity in excess of PKR 300 billion and banks have been facilitated effectively on discount window. Banks are advised to launch more aggressive efforts to mobilize deposits including extending their outreach in rural areas. Offering adequate real returns on deposits would help banks alleviate any bank specific liquidity shortages."