May 12, 2008

SBP Governor's Press Statement

The Governor, State Bank of Pakistan, Dr Shamshad Akhtar today issued the following press statement:

"Pakistan is committed to exchange rate stability. There is no doubt that demand pressures have been high in the economy as manifested by the high fiscal and external current account deficits.

Since Pakistan has a managed floating exchange rate regime, the demand and supply of foreign currency sets the market exchange rate. Over the last few weeks, there has been slowdown in inflows relative to outflows. Central bank has been supporting the oil payments and other obligations of the Government as well as providing the necessary support to the market as and when required. However, the central bank is not in businesses of distorting markets by setting one level of exchange rate. As such our interventions have to be calibrated in line with the level of volatility.

In the last few days, volatility in exchange rate has undoubtedly been enhanced, but we need to fully understand what is really happening. The inter-bank and kerb markets' behavior have not been in line with market fundamentals but reflects distortions created by trading and speculative practices which often do creep in under circumstances like this. It is important to reiterate that SBP is committed to exchange rate stability and does take appropriate actions against any irregular practices, which are aimed to destabilize the markets for personal gains. However, it is important for me to outline sequentially how SBP has attempted to stabilize the exchange rate.

- First, the central bank has been working closely with the Government to set in place a macroeconomic framework to ensure its sustainability. In addition, we are taking concrete steps to ensure effective supply of foreign inflows. In discussions with multilateral agencies and other sources, there is a broad agreement for their support which should be able to bring in quick disbursement of foreign exchange inflows. Furthermore, the Government is looking at other options to attract foreign inflows. We are optimistic that these inflows will start pouring in the next few weeks which should settle the supply and demand dynamics more sustainably in the markets.

- Second, we have been and are ready to supply the necessary liquidity and lubrication to the markets through calibrated intervention.

- Third, we have enhanced our vigilance of the interbank and kerb markets. This vigilance is unearthing some issues which are being addressed. At one point since the kerb and interbank market rate differential rate was higher, in consultation with the exchange companies; we agreed to provide them with some liquidity which was received well by markets. Now, we are working with the exchange companies and have kicked off reforms to ensure that they serve Pakistan's interest effectively.

Let me now list some of the measures the central bank has taken in the past few days.

* Exchange companies have been directed to transfer foreign currency from their nostro accounts held outside Pakistan to commercial banks in Pakistan and henceforth exchange companies will have to close all nostro accounts abroad.

* Exchange companies have been encouraged to focus on promoting home remittances and companies can only effect outward remittances to the extent of 75% of the home remittances mobilized by the respective company.

* In order to meet the demand of foreign currencies within Pakistan, the exchange companies have been directed to surrender their surplus foreign currency to State Bank. Earlier, exchange companies were exporting most of the foreign currency, except dollars abroad. Now exchange companies, besides dollar, will not be able to export Pound Sterling, Euro and UAE Dirham.

* Exchange companies have been required to surrender a minimum of 15%, instead of earlier 10%, of foreign currencies received by them from home remittances to the interbank market.

* Limits on advance payments that were relaxed last year have been tightened. Now advance import payments will only be allowed against letter of credits and that too only to the extent of 50%. Advance payments against contracts are now not allowed. Last year, advance payments against letter of credits and firm registered contracts were allowed to importers via banks to the extent of 100%.

* Some reforms of the forward hedging mechanism available to importers exporters have been introduced to ensure that there is no misuse of the facility other than true hedging."

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