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State Bank to issue Monetary Policy Statement on quarterly basis

Syed Salim Raza, Governor State Bank of Pakistan, disclosed today that the SBP Central Board of Directors has decided that the central bank will issue monetary policy statement on quarterly basis.

Unveiling the Monetary Policy Statement at a press conference held at State Bank, Mr. Raza said that the next monetary policy statement will be issued by the end April 2009.

He said that extent of risks and vulnerabilities, which the economy had faced during 2008, have moderated but we would need to remain watchful of the emerging risks and challenges. He pointed out that factors such as the vulnerability of the external sector due to high oil and other commodity prices; persistence of high imports and weak prospects of foreign investment, have all moderated considerably owing to improvements related to each area.

Mr. Raza said that progress has been made with inflation, over the last four months, but it is very stubborn in the core inflation (i.e. non-food & non-energy). The slow improvement in core inflation, while it has a structural element, is primarily owing to the fact that non fuel and non food items, such as wages and rents and fares etc. continue rising after the supply side shocks recede. This more entrenched trend is because inflationary expectations remain; for the good reason that we have had 12 months of high inflation and several preceding years during which the potential for inflation breaking out in a substantial way was being developed, he added.

He said that by the end of FY09 there will be some reduction in both the fiscal and external current account deficits relative to FY08. However, not only is the expected magnitude of these deficits high but also there are risks of slippages. “This signifies that the demand pressures have not completely dissipated despite a slowdown in economic activity,” he said and added that the high expected average CPI inflation of 20 percent for FY09 (significantly higher than the FY09 target of 11 percent) and its persistence, reflected by core inflation measures, clearly reflect the risk on this front.

“To mitigate the implications of these risks it is important to continue with the current monetary policy stance,” he said and added, therefore, the SBP has decided to keep the policy discount rate unchanged at 15 percent.

While elaborating on the more recent liquidity issues, he said that the present pressure on interest rates would have come irrespective of the discount rate as we have seen an unprecedented fall in banking liquidity post June, between July 1 and Jan 10, deposits have shrunk by 3.4%, or Rs 128 billion, while total credit has grown by 11% or Rs 500bn., putting a strain of Rs 628 bn. on the system, or shrinking available liquidity by about 14%. This was the simple counterpart of the CA deficit, and this level of contraction of liquidity would have raised interest rates in and of itself, regardless of where the discount rate was.

Mr. Raza said the State Bank has taken several measures to further strengthen and segregate the responsibilities of debt and monetary management including: (i)- prior announcement of the auction calendar for Treasury Bills (T-bills) and Pakistan Investment Bonds (PIBs) and a volume based approach to determine the auction result. These are positive steps in the development of a liquid government debt market; (ii)- Ministry of Finance will henceforth be responsible for deciding the cut off yields of the primary auctions of T-bills and PIBs on the above premise.

He said the State Bank will continue to manage the operational aspect of the auctions and there will be no change in the process as far as the market is concerned and added next step in the segregation of debt and monetary management would be to work toward introducing limits on the direct government borrowings from the SBP and along with a plan to eliminate the same in a phased manner over next several years.

SBP Governor said that in order to facilitate banks in providing finance to exporters and support the industry, the State Bank has decided to further enhance banks' limits both under EFS and LTFF Schemes by Rs35 billion. As a result total limits under EFS will increase by Rs25 billion from Rs181.3 billion to Rs206.3 billion. Resultantly, cushion of Rs46.4 billion will be available with the banks over and above their current utilization of facility for meeting the requirements of the industry. Further in order to support long term investment in New Plant & Machinery, the limits under LTFF have also been enhanced by Rs10 billion from Rs9.5 billion to Rs19.5 billion, he added.

Mr. Raza said that some of the important policy measures and adjustments, which are a part of the macroeconomic stabilization package, have already been working their way through the economy and are likely to contribute towards achieving stability by the end of FY09. These include: (i)- frequent and timely adjustments in the policy interest rate that resulted in a cumulative increase of 500 bps during 2008 kept the aggregate demand and inflation expectations from spiraling out of control; (ii)- rationalization/elimination of subsidies, especially on petroleum products, that created problems for the government's budget of FY08; and (iii)- an inevitable yet needed and market driven adjustment in the exchange rate helped in putting a dent in an otherwise unsustainable growth rate of imports.

SBP Governor noted that two phenomena that had hitherto diluted the effects of the tight monetary policy have changed their direction that bodes well for macroeconomic stability. He explained that there has been a noticeable decline in the volume of government borrowings from the SBP for budgetary support. "This has been made possible because preference for subsidy took a back seat, especially after the confidence-invoking and discipline-inducing home grown stabilization package that also paved the way for successful conclusion of Stand-by Arrangement (SBA) with the IMF," he added. Secondly, after touching a record high of $147.3/bbl on 11th July 2008, oil prices have slumped to around $40/bbl as on 27th January 2009; a fall beyond national and international expectations and projections. "This drastic fall in international prices will provide a much needed respite for the trade account and coupled with tight monetary policy and prudent exchange rate management will strengthen the balance of payment position. CPI inflation is also likely to benefit from this development," he asserted.

However, Mr. Raza asserted that despite some preliminary positive indications it would be imprudent to lower the guard at this stage. He said that the macroeconomic indicators that have recovered and the ones likely to post improvement in the next six months justify guarded optimism on close inspection. Furthermore, the full impact of demand and liquidity management measures taken by the SBP during 2008 have yet to materialize. SBP Governor said that there are indications of an improvement in the current account balance due to falling international commodity prices and strong remittances; the balance of payments position is still exposed to several risks. First, the decline in trade deficit, which is anticipated on account of a fall in imports, may prove to be less than expectations for two reasons: (i) there may be deceleration in growth of exports due to global recession and the domestic structural bottlenecks featuring intermittent power and gas supplies; (ii) the anticipated decline in oil import bill may turn out to be less than the current projections, he said.

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