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State Bank decides to keep the policy rate unchanged at 12.5 percent: Syed Salim Raza

The State Bank of Pakistan has decided to keep the policy rate unchanged at 12.5 percent. This was announced by the Governor, State Bank of Pakistan, Syed Salim Raza while unveiling the Monetary Policy Statement at a press conference held at SBP, Karachi this afternoon.

Mr. Raza said that macroeconomic stability has proceeded apace, as evident in the considerable decline in average Consumer Price Index inflation – which is the primary objective of monetary policy. In the first half of the current 2009-10 fiscal year (FY10) inflation recorded at 10.3 percent, compared to 24.4 percent during H1-FY09, he said and added that this decline is visible across almost all the subgroups of CPI.

"The inflation outlook for full FY10, nevertheless, remains somewhat vulnerable to the effects of fiscal consolidation efforts and to incipient international commodity price pressures," he said and added that the State Bank expects the average CPI inflation for FY10 to remain between 11 and 12 percent, still much lower than the 20.8 percent inflation of last year, but higher than the 10.3 percent recorded in the first half of FY10.

Talking about the real economy, Mr. Raza said that the agriculture sector has shown improvement and the wheat crop was good with higher prices stimulating demand for consumer goods, and the cotton crop higher than last year improving textile production and corresponding exports. Modest but consistent recovery in Large-scale Manufacturing (LSM) is also encouraging, he said and added that the LSM grew by 0.7 percent in November 2009 compared to a low of negative 20 percent in March 2009. "Revival in private sector credit and better-than-expected global recovery should further support economic growth," he added.

Assuming that the current trend in LSM growth continues, the Governor said and added that the overall real Gross Domestic Product growth is expected to be 3.0 – 3.5 percent in FY10, as compared to 2.0 percent in FY09.

Referring to external current account, Mr. Raza said that progress in the external sector is also encouraging. The external current account deficit has declined to $2 billion during H1-FY10 from $7.8 billion in H1-FY09. A small decline in exports was substantially offset by a higher decline in imports resulting in significant reduction in the trade deficit, he said and added that the sustained flow of workers' remittances ($4.5 billion during H1-FY10) has further contributed to the reduction of the external current account deficit.

"External current account deficit is projected at 3.4 percent of GDP for FY10 - a significant improvement over last year's deficit of 5.6 percent and earlier projections of close to 5 percent," he emphasized.

SBP Governor said that as a result of significant contraction in the external current account deficit, the overall balance of payments has posted a surplus of $1.4 billion during H1-FY10 compared to a deficit of $4.8 billion in H1-FY09. A modest increase in foreign portfolio investment, additional SDR allocation, and SBA flows from IMF, more than compensated for the decline in foeign direct investment, he added.

However, he said sustained improvement in the balance of payments would depend significantly on the timing and scale of projected foreign inflows, especially the official flows pledged in Tokyo by the Friends of Democratic Pakistan. "Assuming the revised financial inflows are realized, the SBP's foreign exchange reserves are projected to reach close to $15 billion by the end of FY10," he added.

On the fiscal front, Mr. Raza said that the Federal Government has continued efforts for rationalizing expenditures, by phasing out subsidies and by adjusting the administered energy prices. "It has also taken in hand the organizational and administrative measures to bolster tax administration and revenue collection," he added.

Mr. Raza said the State Bank has managed system's liquidity to both support smooth functioning of the market and to do this consistent with the monetary policy stance. As a consequence, volatility in the interbank overnight money market Repo Rate – the operational target of SBP – has come down substantially and market interest rates have gradually eased in line with reduction in the Policy Rate," he added.

"Integrating projections for balance of payments, fiscal accounts, and credit growth and given their interrelationships with inflation and real GDP projections, the equilibrium M2 growth is forecasted to be around 14.5 percent for FY10," he added.

While summing up the overall macroeconomic scenario, Mr. Raza said that much has been gained with respect to macroeconomic stability front on a challenging economic and security environment. Difficult decisions have been taken and adjustments were made to address a host of structural constraints, he said.

“However, work remains to be done to consolidate this stability and set the stage for sustainable recovery. At the short term, we would want to see a reversion of the current inflationary uptick, and a more certain outlook for system’s liquidity,” Mr. Raza asserted.

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