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State Bank cuts policy rate by 150 bps to 10.5%: Yaseen Anwar

Mr. Yaseen Anwar, Governor, State Bank of Pakistan (SBP) has announced a cut of 150 basis points in policy rate with effect from August 13, 2012. While unveiling the Monetary Policy Statement (MPS) for the next two months at a press conference at SBP Learning Resource Centre, Karachi, he said the decision to slash policy rate to 10.5 percent from 12.0 percent was taken at a meeting of the Central Board of Directors of SBP held under his chairmanship in Karachi today.

Mr. Anwar said that inflation outlook has improved with a projection of 10.5 percent for FY13 and loans to private sector businesses have sharply decreased. This has led to an increase in real interest rates. 'The Central Board of Directors of SBP has decided to give a relatively higher weight to the state of private sector credit and investment in the economy, knowing that the projected inflation for FY13 could remain slightly higher than the target,' he added.

Mr. Anwar said that SBP projects average CPI inflation for FY13 to remain in the range of 10 to 11 percent, which is higher than the announced target of 9.5 percent for FY13. 'However, much would depend on fiscal restraint on borrowings from SBP, realization of estimated foreign financial inflows, and improvement in energy shortages to increase the utilization of installed capacity,' he added.

The contraction in private investment, for the fourth consecutive year, at 13 percent is particularly of concern, he said, adding that the total investment, as a percentage of GDP, has fallen to 12.5 percent in FY12, which does not bode well for the future productive capacity of the economy.

SBP projects growth in real GDP for FY13 to remain between 3 and 4 percent; well below the target for the year and country's economic potential,' he said and added that in order to revive economic growth, the focus must be on an endogenous reform process that focuses on improving infrastructure, productivity, and governance.

Mr. Anwar said that the utilization of credit by private businesses is one of the important ingredients of investment. 'Given the desired expansion in the private sector credit and the growing need of the public sector to borrow from the banking system, a consistent increase in deposits and improvement in overall financial depth is imperative,' he emphasized.

SBP Governor said the fiscal borrowings from the scheduled banks grew by 50 percent in FY12 and contributed 67 percent to the overall increase of 14.1 percent in M2. 'Apart from crowding out the private sector, these substantial and, at times, unpredictable fiscal borrowings created substantial challenges for monetary management,' he added.

He said that given a retirement of Rs198 billion during the first month of FY13, it seems that the fiscal authority is beginning to make efforts to reduce its borrowings from SBP. 'This was made possible due to considerably higher borrowings from the market in the two T-bill auctions in July 2012. The injection of liquidity by the SBP has also increased to Rs423 billion by 7th August 2012 as a consequence, he said and added: 'It should be clear that a prudent approach in consistently implementing the requirements of the SBP Act, without adverse implications for the economy in terms of excessive borrowings from the scheduled banks, would require a consistent decline in the fiscal deficit through comprehensive fiscal reforms.'

‘The recent receipt of Coalition Support Fund (CSF) will provide some cushion to the FY13 budget. However, concerted efforts to bridge the gap between revenues and expenditures through structural reforms are necessary to bring monetary stability and economic growth on sustainable basis, he added.

A quantum-led decline of 3.2 percent in export receipts and a price-driven increase of 12.3 percent in import payments pushed the trade deficit to 6.7 percent of GDP or $15.4 billion in FY12, he said, adding that an impressive inflow of $13.2 billion of remittances, however, contributed significantly in limiting the external current account deficit to $4.5 billion or 2 percent of GDP. ‘This is rather small compared to both Pakistan’s own history and in comparison with other emerging and developing economies,’ he added.

Mr. Anwar said that the net capital and financial flows, required to finance the external current account deficit remained sparse; $1.5 billion only. ‘More disturbingly, the net private investment inflows, foreign direct and portfolio investments, have come down to only $590 million in FY12,’ the Governor added.

SBP Governor emphasized that the real focus would need to be on the prospects of financial inflows so that the economy can build foreign exchange reserves to meet the rising debt obligations in the next few years.

‘Improvement in key economic indicators would require comprehensive and credible reforms in the energy and fiscal sectors. Adherence to the legal framework(s) of economic policy making – The State Bank of Pakistan Act (1956) and The Fiscal Responsibility and Debt Limitation (FRDL) Act (2005) – is important as well. A drive for economic reform and adherence to laws can go a long way in moving the economy towards a better equilibrium with low and stable inflation and high and sustainable growth,’ Mr. Anwar added.

(Full text of MPS is available at SBP website: www.sbp.org.pk)

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