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State Bank raises policy rate by 50 basis points to 9.5 percent

The State Bank of Pakistan has raised the policy rate by 50 basis points to 9.5 percent with effect from 16th September, 2013. This was announced by the Governor, State Bank of Pakistan, Mr. Yaseen Anwar while unveiling the Monetary Policy Statement (MPS) for the next two months at a press conference at SBP Learning Resource Centre, Karachi. The decision to raise the policy rate was taken at a meeting of the Central Board of Directors of SBP held under his chairmanship in Karachi today.

Mr. Anwar said that the fundamental issues for sluggish long-term economic growth in Pakistan such as weak economic management and low productivity had largely remained unaddressed. He added that the "economy has experienced bouts of growth and stable inflation but a sustainable performance has remained largely elusive."

According to Governor SBP, a relentless increase in fiscal borrowings and a secular decline in both domestic and foreign investments are only symptoms of structural issues. "The role of monetary policy was always going to be limited in this environment; both in terms of keeping inflation low and stable and supporting private investment activity. However, in the wake of considerable deceleration in inflation over the last two years, the SBP did lower its policy rate by 500 basis points."

Mr. Anwar said that the SBP also intervened in financial markets by imposing a minimum savings deposit rate at 6 percent and containing volatility in the foreign exchange market. It also calibrated its liquidity operations in a manner that balanced financial stability considerations and medium-term inflation risks. He added that as a result of these actions, "the weighted average lending rate has declined by 423 basis points by end-July 2013 while deposits of the banking system grew by 15.9 percent and the depreciation of exchange rate was limited to 5.1 percent in FY13."

Governor SBP said that a declining interest rate environment did contribute in a marginal pick up in loans to some sectors of private businesses in FY13 but "most of the loans were used to fulfill the working capital requirements only". He added that the "real private investment expenditures have declined for the fifth consecutive year, reaching 8.7 as percent of GDP in FY13."

He said that higher interest rates were not the major constraining reason for the private sector credit off-take adding that two "fundamental factors responsible for the lackluster increase in credit demand are: persistence of energy shortages and deterioration in law and order conditions."

Governor SBP said that the increase of Rs1446 billion in budgetary borrowings from the banking system during FY13 was almost Rs1 trillion higher than the original target and was even higher than the total expansion in M2. “Deviation of this scale has significantly constrained effective monetary management, disrupted financial intermediation in the economy, and has led to a sharp increase in domestic debt,” he added.

Mr. Anwar said that the inability to raise the tax-GDP ratio was the fundamental source of large fiscal deficits, high borrowings, and rising debt.

He further said that with “swift settlement of the outstanding stock of energy sector circular debt, reduction in electricity tariff related subsidies, and introduction of some taxation measures the new government has shown intentions to address deeper issues afflicting the fiscal accounts.”

Regarding the external sector, the Governor SBP said that the stress “has gradually increased with every passing month of 2013 due to shrinking net capital and financial flows and high loan repayments to the IMF.”

Mr. Anwar said despite these pressures and speculations of a drop in the value of the Pak rupee the foreign exchange market had largely remained stable in FY13. He added that the “likelihood of receiving higher financial flows has increased given that a new IMF program has been approved for Pakistan in September 2013. This would ease pressure in the foreign exchange market.”

Governor SBP said that “clarity on the political front together with newly-initiated fiscal consolidation efforts of the government could boost offshore investors’ confidence and announce Pakistan’s return to international capital markets.”

Mr. Anwar said “the impact of upward adjustments in energy prices on inflation outlook cannot be under-estimated. In addition to having a direct effect on CPI inflation, there is a high likelihood of considerable indirect effects as well. Similarly, an increase in the GST together with the removal of certain exemptions could put further pressure on inflation in the coming months. The outlook of oil prices may deteriorate as well given escalating political tensions in the Middle East.”

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

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