Press Release on Monetary Policy Decision
15th November 2014

SBP reduces the policy rate by 50 bps

The State Bank of Pakistan has decided to reduce the policy rate by 50 bps to 9.5 percent. The decision was taken by the Central Board of Directors of SBP at its meeting held under the chairmanship of Governor Mr. Ashraf Mahmood Wathra in Karachi today.

The complete text of the decision is as follows:

Limited impact of floods and a favorable trend in global commodity prices are the major highlights of the post-September monetary policy decision. Indeed, CPI inflation (YoY) in October 2014 has come down sharply to 5.8 percent. This decline is explained by: smooth food supplies, which contained the price of perishable items; falling administered prices, which incorporate the fall in international commodity prices, especially oil; low inflation expectations, as witnessed by IBA-SBP consumer confidence surveys; and a significant base effect. These developments bode well for the outlook of other macroeconomic variables in general.

Given its recent downward trend, the likelihood for inflation to end the current fiscal year on a lower plateau is high. But, there are risks. First, downward trend over the medium to long term remains to be seen because it is based on volatile prices of "perishable items" and "oil". Second, other risks identified in the previous statement, such as cut in subsidy to electricity and levying of Gas Infrastructure Development Cess, still hold and if materialized can alter the inflation outlook on a higher side. Third, underlying inflationary pressures on core inflation remain.

The current low oil price could salvage some of the lost growth momentum. Broadly, however, growth in Large-scale manufacturing would remain constrained due to energy bottlenecks. Thus the main thrust to the growth momentum would come from agriculture outcomes in the remaining months of FY15. Barring the limited flood-related damage to some *kharif* crops, agriculture output is expected to perform better than the previous year especially now when incentive for *Rabbi* season crops has been announced; such as, the recent increase of Rs100 in wheat support price.

Government has shown a significant progress in curtailing budgetary imbalances. It seems on course to achieve further fiscal consolidation, given its current management of expenditures and borrowing pattern. This has positive implications for the monetary management of the SBP and more importantly, in the coming months, it would have a favorable impact on the private sector credit cycle. However, to achieve fiscal consolidation in the long run, structural reforms to broaden the tax base remain imperative.

Low oil price along with falling inflation can improve competitiveness of Pakistani exports. Imports, on the other hand, might take advantage of low global commodity prices and increase further in the rest of FY15. This, at the same time, given the significant imports intensity for exports sector in Pakistan, could add to exports competitiveness and improve its outlook towards the end of the current fiscal year. In the mean time, current slowdown in exports is further challenged by falling international cotton prices and stiff competition in low value-added textile products in an environment of weak global demand. Thus, trade deficit is expected to remain under pressure and the healthy growth in workers' remittances would continue to assuage the weaknesses in current account deficit, to some extent.

It is also important to note the role of foreign exchange inflows in domestic liquidity creation and helping the banks to extend more credit to the private sector. This happens as government gets the space to borrow less from the banks, thereby leaving more liquidity with the banks for credit expansion. In response to various recent and ongoing efforts of the government, foreign exchange inflows would remain on track.

Based on these considerations, the Board of Directors, State Bank of Pakistan, has decided to reduce the policy rate by 50 basis points to 9.5 percent with effect from 17 November 2014.