January 17, 2014

State Bank keeps Policy Rate unchanged at 10.0 percent

State Bank of Pakistan (SBP) has decided to keep the policy rate unchanged at 10.0 percent. This was announced by the Governor, State Bank of Pakistan Mr. Yaseen Anwar while unveiling the Monetary Policy Statement (MPS) at a press conference at SBP, Karachi. The decision was taken at a meeting of the Central Board of Directors of SBP held under his chairmanship in Karachi today.

According to the Statement the SBP increased the policy rate by 50 basis points (bps) each in September and November 2013 mainly on account of two concerns. One was the continued deterioration in the balance of payments position while the other was worsening of inflation outlook.

The Statement said that the fundamental weakness in the balance of payments position is persistent contraction in net financial flows since FY08. Substantial repayments of IMF loans during the last two and a half years have only increased the pressure.

According to the Statement there is no room for complacency and considerable effort is required to bring a sustainable improvement in the outlook of external accounts.

The CPI inflation has increased during first half of FY 14. The important point is that the risk of demand-driven inflation is still rather moderate. It added that international commodity prices have also either remained stable or declined since the beginning of FY14. This has neutralized to some extent the direct impact of exchange rate volatility on CPI inflation. Taking into account these factors, SBP has accordingly revised its inflation projection downward.

The Statement said that the SBP linked the minimum rate of return on average balances held in saving deposits with the floor of the interest rate corridor. This policy intervention ensures that deposit rates respond more strongly to policy rate changes.

The Statement said that the quarterly flow of fiscal borrowings from the SBP has remained positive in both quarters of H1-FY14. This does not bode well for the effectiveness of monetary policy. The SBP expects that government will keep these borrowings in check in H2-FY14 and lower outstanding stock gradually as stipulated in the new IMF program.

According to the Statement, a risk to the fiscal position is a possible shortfall in tax revenues, recurrence of energy sector circular debt, and delays in budgeted foreign inflows. Such deviations could lead to increase in borrowings from the banking system, further accumulation of domestic debt and higher inflation.

Although there are some risks to the balance of payments position due to uncertainty surrounding expected foreign inflows, expected increase in inflation is slightly lower than anticipated earlier. In view of the above, the Board of Directors of SBP has decided to keep the policy rate unchanged at 10.0 percent. *