July 19, 2014

SBP keeps policy rate unchanged

The State Bank of Pakistan has decided to keep the policy rate unchanged at 10.0 percent. This was announced by the Governor SBP, Mr. Ashraf Mahmood Wathra while unveiling the Monetary Policy Statement (MPS) for the next two months at a press conference held at SBP head office, Karachi. The decision was taken during a meeting of the Central Board of Directors of SBP held under his chairmanship in Karachi today. Henceforth, the Board has also decided to publish the summary of minutes of monetary policy proceedings of the Board meeting in four weeks.

According to Mr. Wathra, economic conditions are certainly better at the beginning of FY15 than a year ago but a detailed assessment of the economy indicates that challenges and vulnerabilities remain. Continuation of prudent policies and reforms are needed to build on positive developments and to achieve protracted stability.

Governor SBP stated that SBP is effectively managing market sentiments by supplementing the monetary policy stance with calibrated liquidity operations in the interbank market, adding that “this has contributed in achieving stability in the foreign exchange market and in building foreign exchange reserves.” This has also facilitated the shift in banks’ investment from T-bills to PIBs, improving domestic debt maturity profile of the government.

Mr. Wathra informed the audience that, despite significant injections by SBP, appetite for liquidity remained sufficiently high in the market. It resulted in higher short-term interest rates, making rupee liquidity more expensive. “This reduced pressure on exchange rate as it discouraged speculative holdings of foreign exchange and made trade financing through foreign currency deposits held by banks more attractive, ” said Mr. Wathra.

He said that a significant reduction in government borrowings from the banking system is contributing towards low inflationary expectations and has provided necessary space to the private sector to borrow from the banking system. However, persistent energy shortages and deteriorating security conditions hint towards some risks to credit demand.

Governor SBP maintained that sustainability of lower government borrowings from the banking system, including SBP, is contingent upon further reduction in the fiscal deficit and continuation of external financing, adding that government needs to watch the fiscal position of FY15 i.e. the revenue side caustiously.

Mr. Wathra told the audience that the growth in domestic debt during FY14 had decelerated to 14.5 percent, which was significantly lower than the average growth of around 27 percent during the last three years. “This bodes well from the point of view of country’s risk perception and could help in attracting investment in the economy.”

Governor SBP reminded the audience that the increase in external borrowings since February 2014 had provided a much needed respite and short term stability to the balance of payments position. These foreign inflows resulted in a capital and financial account surplus of $6.1 billion which comfortably financed the current account deficit of $2.6 billion and led to a significant increase in SBP’s foreign exchange reserves. By 4th July, SBP’s foreign exchange reserves have increased to $9.6 billion.

He said that the increase in SBP’s foreign exchange reserves brought about a shift in sentiments in the foreign exchange market and stabilized the exchange rate. “Moody's Investors Service has revised the outlook on Pakistan's foreign currency government bond rating to stable from negative.”

According to Governor SBP, the impetus of positive sentiments together with continuation of IMF program and government’s privatization plan is expected to result in further strengthening of the external position in FY15. However, sustaining this trend in the medium term, especially in the post IMF program years, would require additional efforts and reforms.

Governor SBP said that despite challenging security conditions and energy shortages, the real GDP grew by 4.1 percent in FY14. However, investment expenditures as a percent of GDP have declined, which indicates erosion in economy’s future productive capacity, he added.

Mr. Wathra told the audience that the average CPI inflation in FY14, 8.6 percent, was in single digits for the second consecutive year. For FY15, the SBP expects average CPI inflation to remain in the range of 7.5 percent to 8.5 percent. “However, international oil price uncertainty and unanticipated price shocks pose risks to the inflation outlook,” he concluded.

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

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