



External Relations Department

Liquidity management: SBP View

Liquidity management operations of SBP aim to achieve monetary policy objectives of price stability so as to provide a facilitating environment for economic growth. In particular, the intermediate goal is to contain the overall monetary expansion (M2 growth) within safe limits; consistent with price stability objective. This is ensured by management of day to day liquidity in the banking system with a view to keep the overnight money market repo rate within the interest rate corridor specified by SBP Repo and Reverse Repo rates. This requires liquidity injections or mop ups at appropriate periods in time.

In recent times the liquidity injections by the SBP have increased considerably relative to its past trends. Noticing these unusual changes, various market analysts perceive the SBP liquidity management to be favoring the banks in making profit or supporting the government to meet its borrowing needs. These perceptions are based on misconceptions and partial analysis of monetary variables. The SBP considers it important to address these misconceptions to avoid misguided conclusions and expectations on the basis of such analysis.

While assessing the liquidity conditions and analyzing the open market operations, it is important to keep in view the overall growth of money supply in the system and its composition. Liquidity injections are considered counterproductive only when given the inflationary outlook and monetary policy stance, they are contributing towards excessive monetary expansion. Further, a lopsided contribution in growth in money supply complicates monetary management. For instance, despite a contraction in net foreign assets, high monetary growth led by government borrowing reflects external as well as fiscal imbalances, which had been the case during last few years.

From the recent monetary aggregates data it can be observed that the overall monetary expansion (M2 growth) is not excessive; in fact it has decelerated compared to past few years. More importantly, the composition of money supply is reflecting the positive changes occurring in the real economy. For instance, the growth in M2 is being contributed significantly by an expansion in net foreign assets of SBP owing to improvement in external sector. Moreover, the growth in private sector credit, albeit lower than last year, has a reasonable contribution in monetary expansion.

Moreover, the improved fiscal discipline has resulted in lower government borrowing from the banking system and changed its composition between the commercial banks and SBP considerably. The government has in fact been retiring its borrowings from SBP. As a result, the liquidity shortage in the system has increased considerably. To meet this, the SBP has been injecting liquidity, through its open market operations, consistent with its monetary policy stance. If the SBP refrains from injecting liquidity in the system, it could retard broad money growth leading to stifling of economic activities and thus a recovery in growth.

Hence the quantum and frequency of liquidity injections through OMOs of SBP, even when they seem excessive in isolation, are in fact necessary to keep money supply consistent with keeping inflation low and provide support to growth.