State Bank cuts policy rate by 100 basis points

The State Bank of Pakistan has decided to reduce the policy rate by 100 basis points from 9.5 percent to 8.5 percent effective from 26th January 2015. 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.

Mr. Wathra said that some of the key macroeconomic indicators had improved further since the last Monetary Policy decision of November 2014. “CPI inflation and its expectations continue to follow a downward trajectory. In the last two months of November and December 2014, trade deficit has declined, though it has increased in H1-FY15 when compared to H1-FY14. Moreover, considerable foreign exchange inflows have contributed in maintaining an upward trajectory in foreign exchange reserves.”

According to Governor SBP, containment of fiscal deficit thus far is also encouraging and bodes well for the credibility of consistent and coherent policies of the government and for the continuation of official and private capital inflows. With these positive developments, first half of the current fiscal year ended on a better macroeconomic outlook for the remaining months of FY15.

Mr. Wathra termed the decline in inflation broad based since both food and non-food inflation were declining. The deceleration in the former is mainly the result of better supply conditions, while the latter is explained by a combination of factors including plummeting international oil price as well as decline in other global commodity prices; lagged impact of earlier conservative monetary policy stance and moderating aggregate demand; and stable exchange rate, he added.

He told the audience that the SBP has revised downwards its forecast range for average CPI inflation to 4.5 – 5.5 percent for FY15, well below the annual target of 8 percent.

Referring to international oil price decrease, Mr. Wathra said that through its expected favorable impact on trade balance, it contributed in improving the external sector outlook in recent months. In addition to this, successful completion of fourth and fifth review under IMF’s EFF and issuance of International Sukuk have also contributed to improvement in overall balance of payment position. “In effect, these developments have been instrumental in improving
sentiments in the foreign exchange market and have supported SBP in its reserve building efforts,” he added.

With IMF program on track and expected proceeds from privatization and official flows, the net SBP reserves are projected to increase further. “However, non realization of planned privatization proceeds and lack of private inflows could pose risks in achieving a sustainable BoP position.”

Mr. Wathra said that fiscal deficit was contained despite substantial increase in interest payments in Q1-FY15 and government borrowing from SBP remained below the agreed targets. As government managed to contain expenditures related to PSEs, it increased the development spending compared to last year. However, growth in FBR revenue collection moderated due to downward adjustment in petroleum prices and slowdown in large-scale manufacturing. Going forward, overall expenditures could increase due to higher security related expenditures. This along with expected shortfall in FBR revenues may make meeting the fiscal deficit target challenging.

According to Governor SBP, the credit to private sector uptake during H1-FY15 is lower than the level witnessed during the same period last year. “This slowdown in credit growth could be attributed to both demand and supply side issues such as weak corporate profitability of major industries till September 2014, shift in government borrowings away from SBP to commercial banks amid slower deposit growth, challenging security situation, falling commodity prices, and continued energy/gas shortages for the industry. However, the momentum of credit off-take is likely to pick up with the realization of the lagged impact of November 2014 policy rate cut.”

Mr. Wathra informed the audience that the interbank market remained tight almost throughout H1-FY15, despite the cut in policy rate, adding that, in Q2-FY15, while pressures in FX market eased substantially, government shifted its borrowing from SBP to the commercial banks. “The continued decline in inflation retained scheduled banks’ appetite for investment in long-term securities in the Q2-FY15 as the expectation of further cut in interest rate strengthened. Going forward, the realization of expected external inflows is likely to reduce the budgetary borrowing requirements from scheduled banks and improve liquidity conditions in money market.”

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