

1 Maintaining Price Stability with Growth

1.1 Monetary Policy Formulation

Within the broader mandate of securing monetary stability, as laid down in Section 9A of the revised SBP Act 1956, the central bank aims to keep inflation low and stable. Specifically, SBP pursues its monetary policy to achieve the inflation target set by the government, without prejudice to growth target.

The key instrument for monetary policy is the SBP reverse repo rate – adjustments in this rate signal policy changes. SBP considers a range of macroeconomic variables and their likely impact on near-term inflation path and inflation expectations before determining the monetary policy stance.

Furthermore, SBP manages liquidity in the money market since the monetary policy is effective only when the market interest rates are responsive to changes in policy rates. This requires SBP to align the inter-bank overnight repo rate with the policy stance. For this purpose, SBP frequently uses Open Market Operations (OMOs). However, Cash Reserve Requirement and Statutory Liquidity Requirement are also used (though infrequently) to adjust liquidity conditions in the interbank market.

The Central Board of Directors is responsible for deciding the monetary policy stance of SBP. Generally, the Board meets six times a year, in the last week of July, September, November, January, March and May, to review the monetary policy stance. The Board is assisted by its Committee - the Monetary Policy Committee (MPC).

The policy decision making is a consultative process. Before each Board meeting, senior management of SBP including Governor holds several in-house meetings to build consensus on likely monetary policy stance. The SBP's views on policy stance are then presented to the Board where the decision is taken by developing a consensus after a thorough review of economic conditions and forecasts.

To make monetary policy more effective, the central bank has suggested a number of amendments in the SBP Act. Besides recommending a cap on government borrowing from SBP, it proposed to upgrade the Monetary Policy Committee as an independent decision making body that also includes two experts from outside SBP. This committee was expected to replace the existing Monetary and Fiscal Policies Coordination Board (MFPCB) which was formed under Section 9B of the SBP Act.

Although these amendments were passed by the National Assembly Committee, the Senate Committee, which met in February 2011, has recommended to keep MFPCB operational and declined the proposal to make the MPC a fully independent decision-making body. The amendments will be finalized after consensus of the two houses in a joint Committee of the National Assembly and Senate. After an agreed version, the amendments to the SBP Act will be placed before the two houses for approval.

In the meanwhile, MPC has been reconstituted as the Advisory Committee on Monetary Policy (ACMP) on July 9, 2011. The ACMP bears the same structure and mandate as of MPC but has not initiated its deliberations as nomination of independent experts on the Committee is under finalization.

1.2 Role of Policy Research Cluster

The Policy Research Cluster is playing an important role not only in monetary policy formulation, but also in providing key inputs for broader economic and financial policy formulation through its economic reports, research work, analytical and financial reviews, and data compilation and dissemination. This cluster has two groups of departments (a) Monetary Policy and Research Group consisting of Monetary Policy Department, and Statistics and Data Warehouse Department, and (b) Policy Development Group consisting of Economic Policy Review Department and Research Department.

1.3 Monetary Policy Department (MPD)

This is the focal department that provides its own assessment of the economic situation and a detailed macroeconomic forecast to facilitate the management in formulating a forward looking policy view.

The MPD regularly prepares outlook for inflation, trade, monetary aggregates and exchange rate misalignments using various statistical techniques that are consistent with the macroeconomic theory. The outlook is also disseminated in SBP's annual and quarterly reports. In addition to these forecasts, MPD regularly writes policy notes that analyze various issues related to monetary policy. In FY11, a more disaggregated data on consumer prices and external trade was incorporated into the analysis. Furthermore, new techniques (e.g. fan charts) were introduced to get a better handle on the degree of uncertainty around projections. In some areas, new models were included in the analytical framework.

These forecasts apart from being a direct input to policy making, becomes an important input for the financial programming based macroeconomic framework (MF) of SBP. The MF is an illustration of macroeconomic accounts covering four sectors – real, external, fiscal, and monetary – of Pakistan's economy. In FY11, detailed information on Pakistan's total debt has also been added as an integral part of the MF. Moreover, the MF now offers a platform to compare baseline and program scenarios. The baseline shows the future economic course with no policy intervention, whereas the program scenario incorporates policy measures needed to keep the economy on desired path.

During FY11, MPD also developed a Framework Consistent Macroeconometric Model (FCMM) which effectively merges the stochastic and deterministic characteristics of the economic modeling. This model provides useful tool for policy simulation and response analysis.

1.4 Research Department

This department is in the process of developing a theoretical macroeconomic model that incorporates microeconomic features as well as information on the informal sector of Pakistan economy. To support this model, price and wage setting behavior of firms was assessed through primary surveys of entities in the manufacturing and services sectors. In the first stage, surveys for the firms in the formal sector have been completed¹ and the work on firms in the informal sector is in progress.

In addition, the department is developing a (preliminary) dynamic stochastic general equilibrium (DSGE) model of Pakistan's economy. This model needs to be validated before it is used for (monetary) policy analysis and other purposes.

¹ A part of the findings of the completed surveys has been published as SBP Working Paper No. 42 titled: "Formal Sector Price Discoveries: Preliminary Results from a Developing Country." A more recent version of the paper is also available at http://www.surrey.ac.uk/economics/news/stories/2011/53159_working_papers.htm. Paper on wage setting behaviour will be released soon.

In order to facilitate forward looking view of the monetary policy, the department is developing consumer confidence index based on telephonic surveys. A pilot survey has been conducted and formal survey will be launched in FY12. Furthermore, to understand how monetary policy changes affect pricing of loans at gross root level, the department has analyzed the transmission of money market interest rates (such as KIBOR) to individual corporate loans. In the next stage, transmission to consumer loans will also be assessed.

The Research Department also organized a number of seminars and lectures during FY11.

- The 6th SAARCFINANCE Seminar on “Basel II Enhancements and Policy Responses of SAARC Countries” was organized by the SBP at NIBAF, Islamabad during April 11-13, 2011. Renowned scholars like Mr. W. Jason George, Mr. Ali Samad Khan, and Mr. Faraz Anwar were the resource persons. Delegates from most of the SAARC member countries presented their country papers in the seminar.
- State Bank of Pakistan organizes a seminar on Pakistan & World Economy every quarter at Karachi to get benefit of the ideas and contemporary research work of renowned scholars. Last year, Dr. Asad Zaman, and Dr. Parvez Hasan spoke on their research work on different economic issues. In addition, reputed economists like Dr. Zubair Iqbal, Dr. Iqbal Zaidi, Dr. Atif Mian and Dr. Hafiz Khalil Ahmad also spoke on contemporary economic issues for the benefit of young economists in the Bank.
- The 17th Zahid Husain Memorial Lecture was held on October 23, 2010, wherein Professor Kent Matthews (Cardiff Business School, UK) delivered a lecture on “Banking Efficiency in Emerging Market Economies”. The lecture was attended by prominent economists, bankers, diplomats, and government officials.

1.5 Economic Policy Review Department

This department came into existence as a part of large re-organization of the Research Cluster. The key aim was to make SBP’s flagship publications (The Annual and Quarterly Reports on the State of the Economy) more insightful and to put greater focus on sector specific studies. Hence, the major work of EPRD centers around developing sector specialists and improving publications. This work is also reflected in the Annual Report for this year (FY11) as it includes two new chapters: one on energy and other chapter covering insightful discussion on a selected sector. The department also provides input on various policy issues and challenges faced by the SBP.

1.6 Statistics and Data Warehouse Department (S&DWHD)

This department compiles and publishes authenticated and reliable statistics on a wide range of economic variables for usage in various SBP reports and publications with different frequency. These publications are also posted on SBP website for easy access of external users.

These statistics are compiled according to international compilation standards. Efforts are underway to implement the guidelines of Balance of Payments Manual – BPM 6 (recently released by IMF) for compilation of BoP by July 2013. To increase the credibility of statistics compiled by SBP in the international community, SBP follows the General Data Dissemination System (GDDS) and Special Data Dissemination Standards (SDDS).

With the recent advancements in the IT, most of the compilation processes has been automated, which has significantly enhanced the efficiency, quality and timeliness of the statistics. The quality of statistics is frequently assessed by the Reports on Observance of Standards and Codes (ROSC) missions of the international agencies under the Data Quality Assessment Framework (DQAF).

1.7 Library Services

SBP Library is providing quality information services to its patrons with particular focus on promoting access to electronic information resources. A major step in this regard was launching of library 2.0 – the new library portal based on Web 2.0 technologies, had been a milestone success. With enhanced interactive tools, this portal offers various features. For example, users can check status of their library accounts, new arrivals are reflected on the portal in real time and users can subscribe to RSS Feeds to stay updated of the new acquisitions, searching options have been enhanced, members can even write book reviews and communicate with the library through social networking sites like twitter, facebook, etc.

Furthermore, *Online Reference and Document Delivery Services* is the most notable services under which over 1,500 reference queries of users from various cities were answered and 2,621 documents/data sets were sent off to users either through email or courier.

Moreover, under an outreach program, library orientation workshops were conducted for SBP-BSC employees, commercial bankers, and academia (Librarians, professors, research scholars etc of local universities). The workshops proved useful in creating awareness about remote access to library resources.