

Conduct of Monetary Policy & Role of CB

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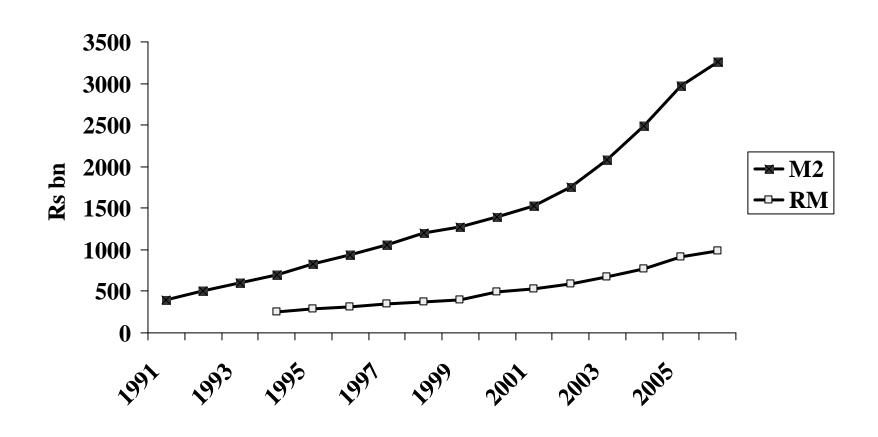


Roadmap

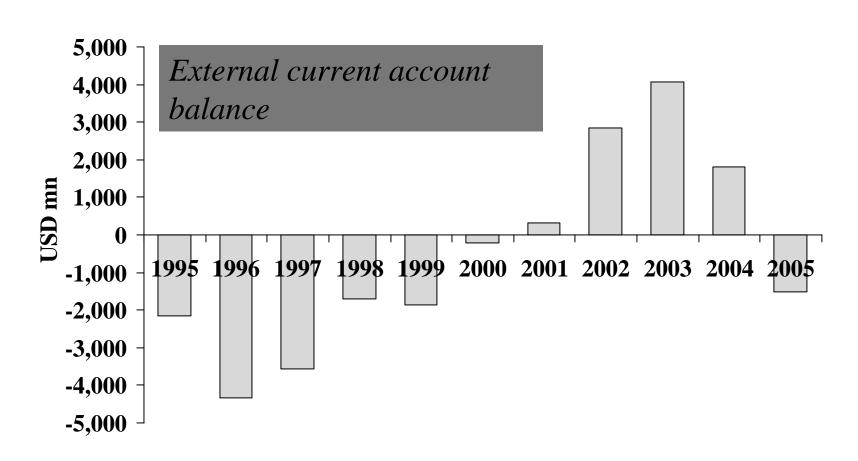
- Review monetary conditions
 - -2001 to 2004
 - Key driver(s)
 - Policy objective(s)
 - Outcomes (welcome + unwelcome)
 - 2004 to current
 - Key driver(s)
 - Policy objective(s)
 - Outcomes (welcome + unwelcome)
- Lessons/Issues Raised



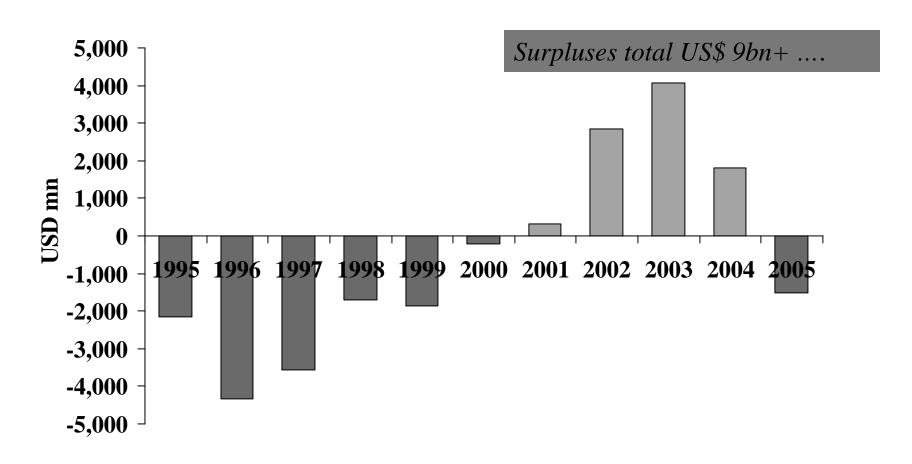




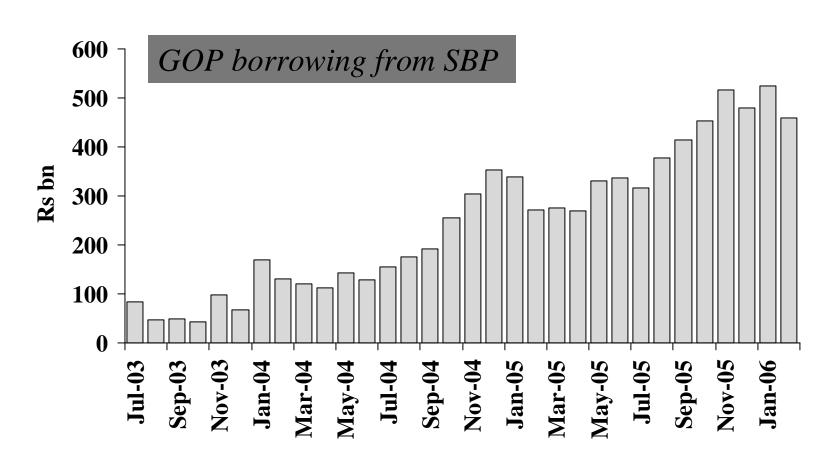




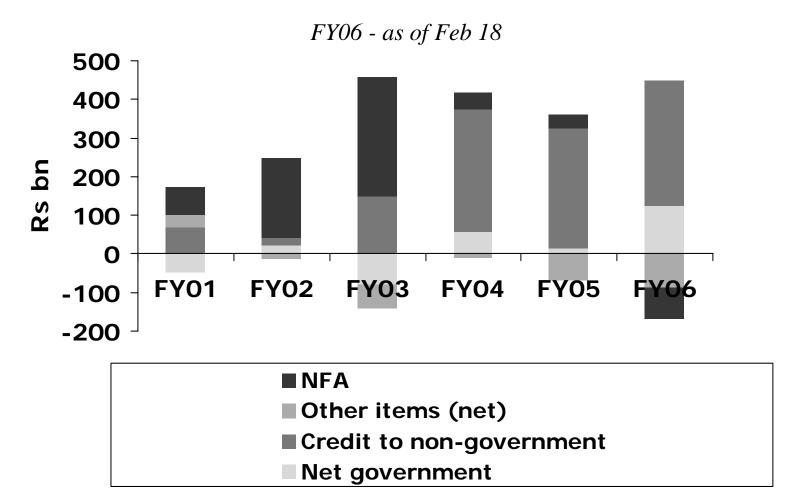






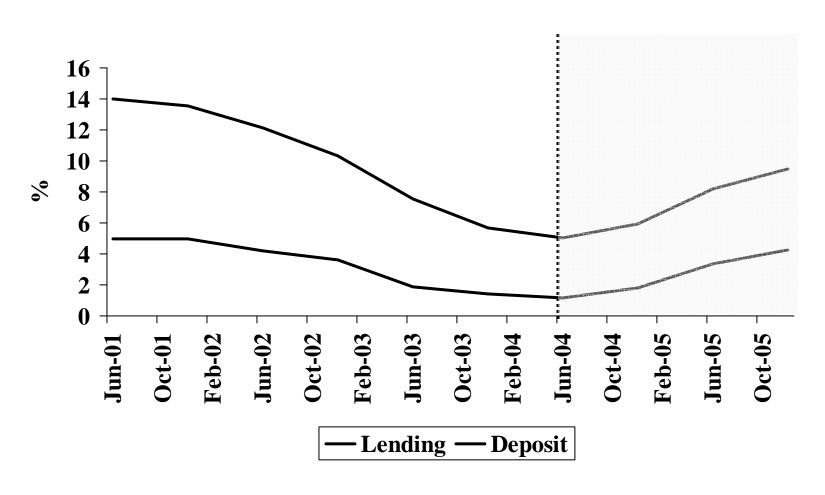






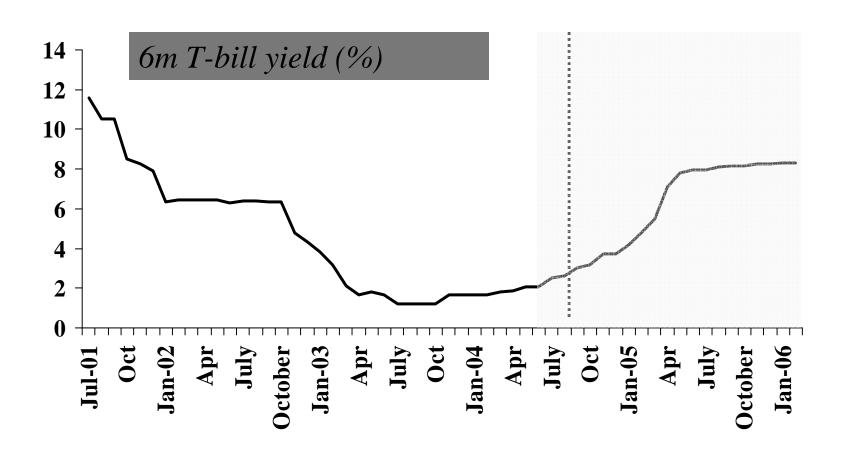
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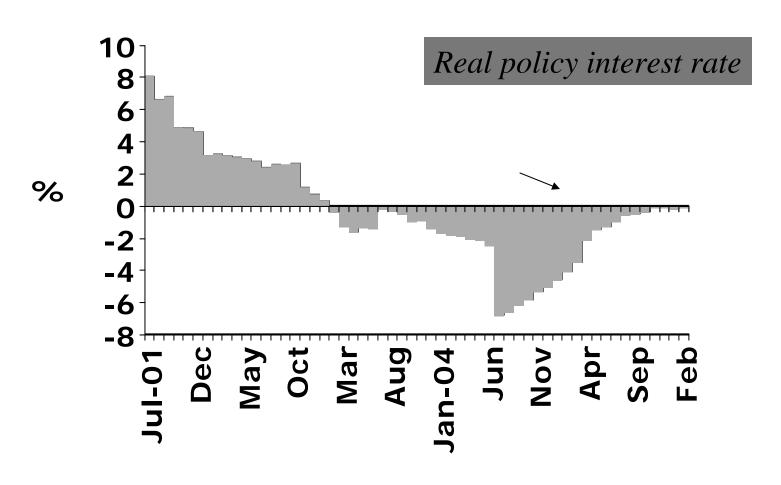


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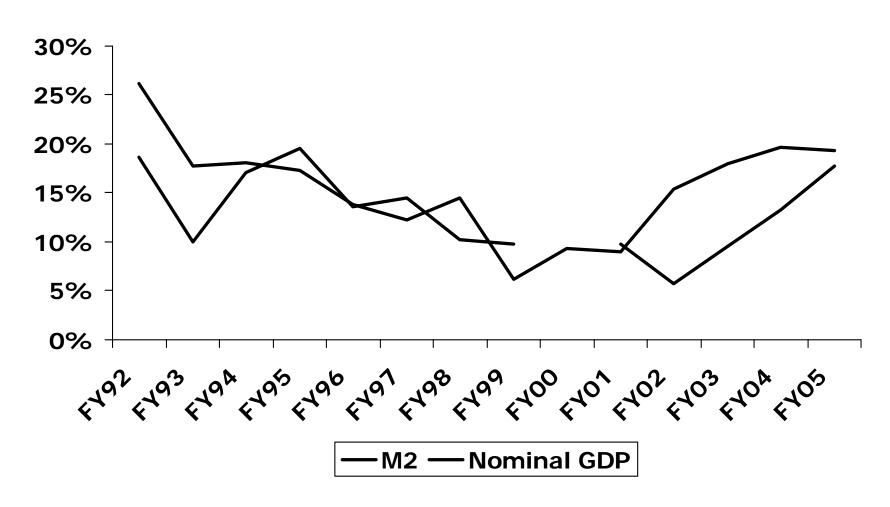






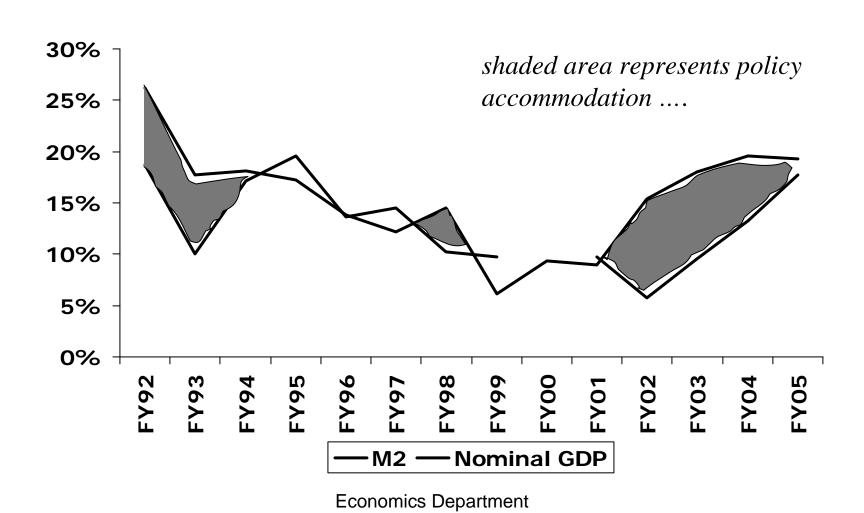
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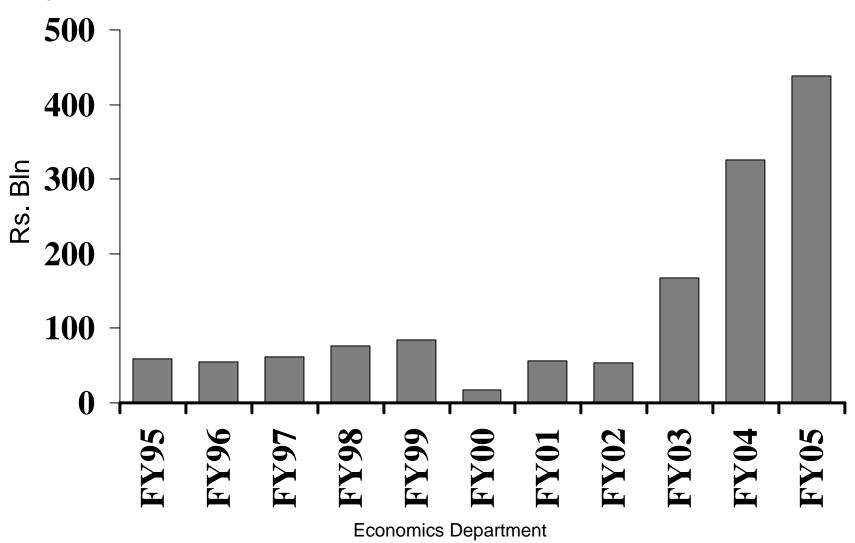






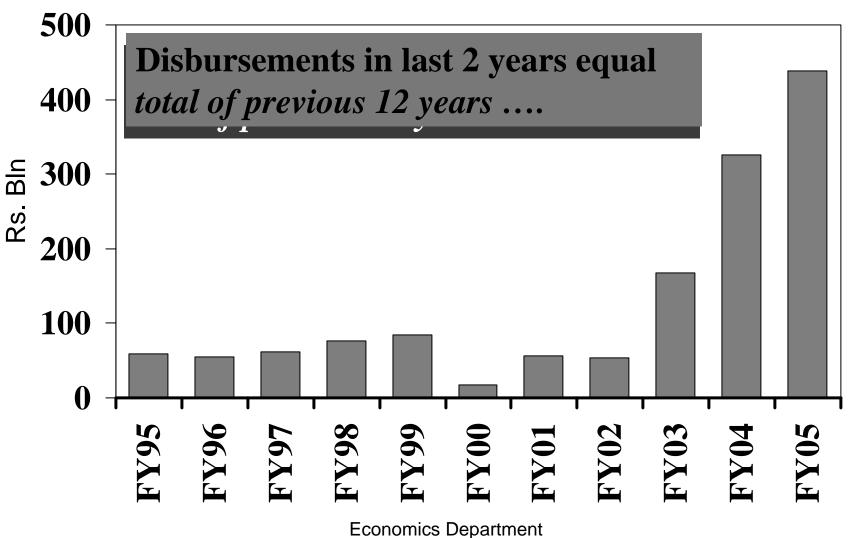


Credit to Pvt Sector



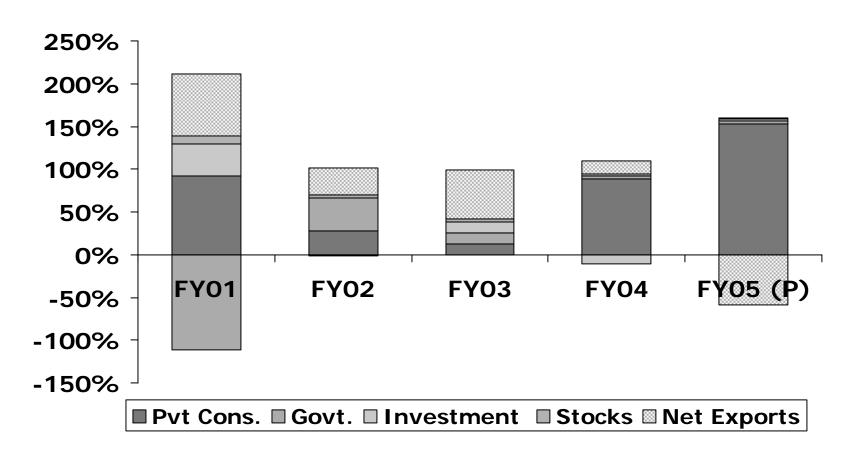


Credit to Pvt Sector



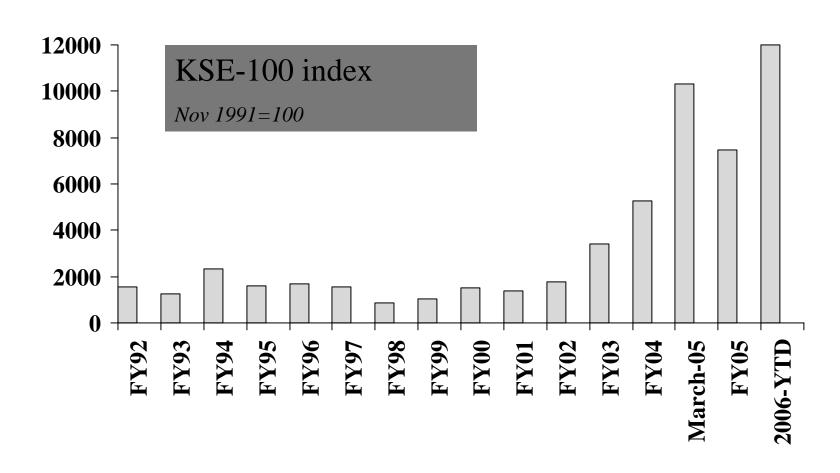


Sources of growth



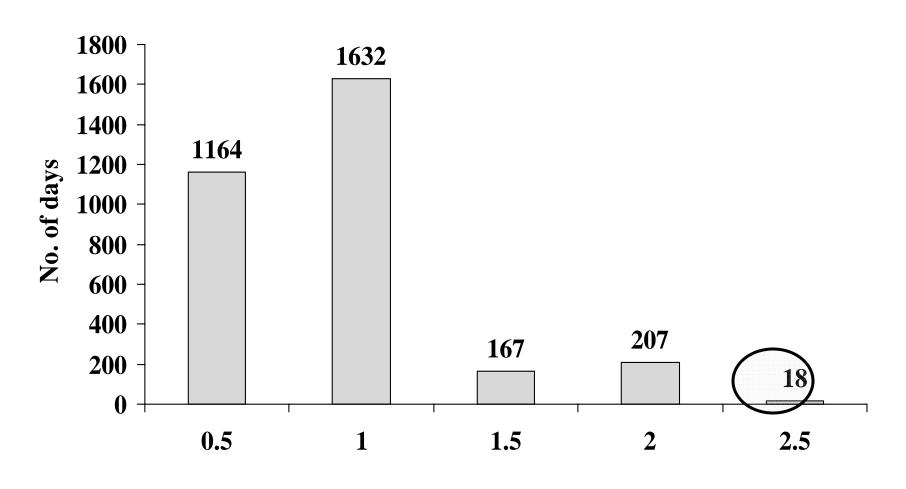


Asset Markets





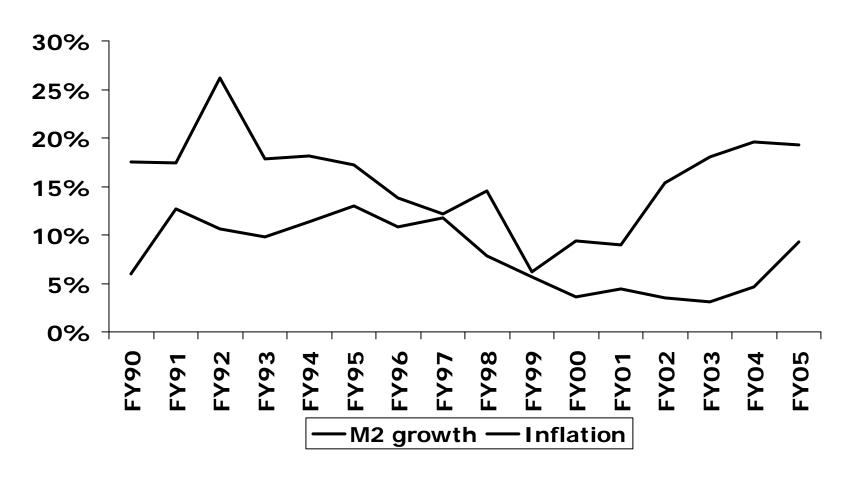
Asset Markets



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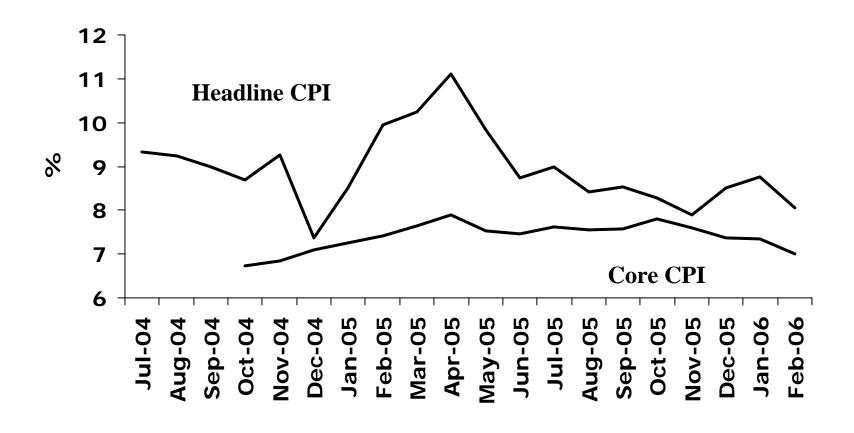


Inflation



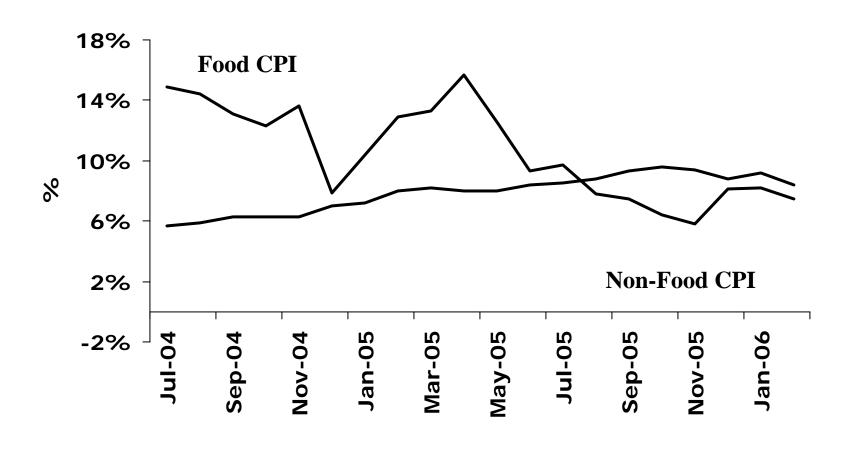


Inflation



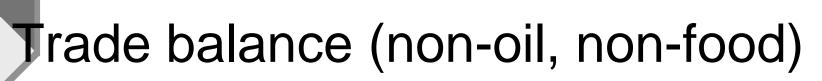


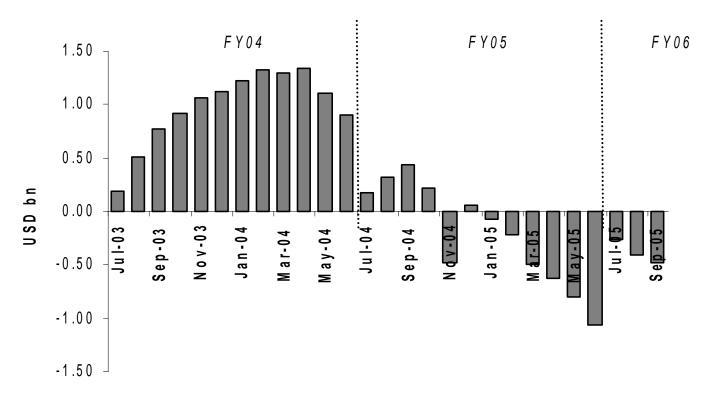
Inflation





External Sector

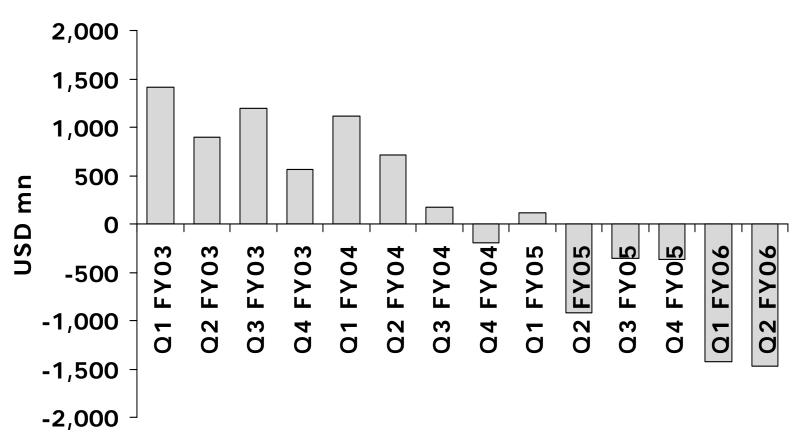




Bottom-line: Non-oil, non-food trade balance is at record deficit.

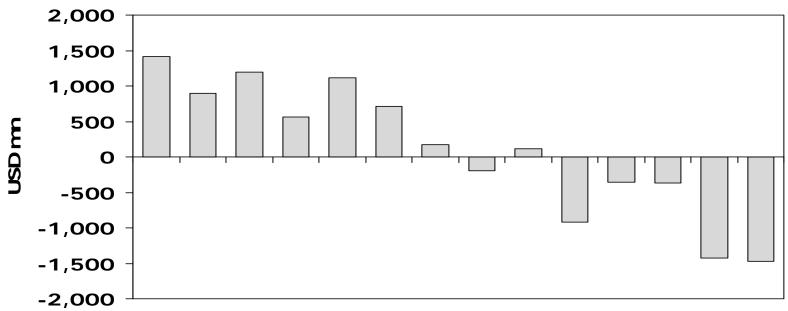


Current account





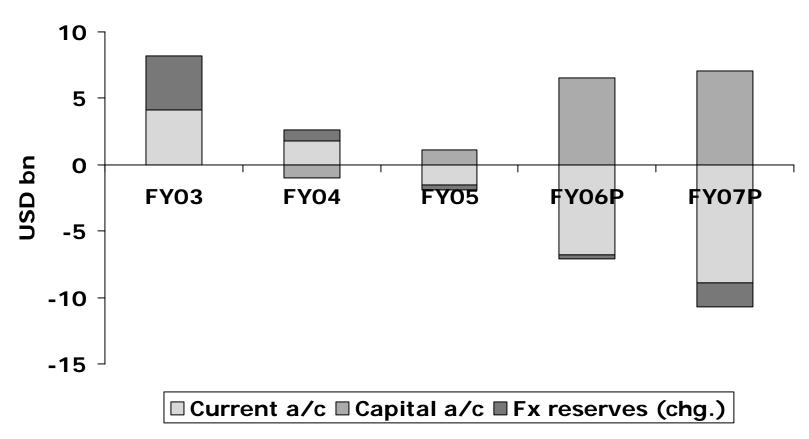
Current account



Bottom-line: Current account deficit to increase from USD 1.6bn in FY05, to \$6bn (FY06) and \$7bn+ (FY07). This is under policy *status quo*.

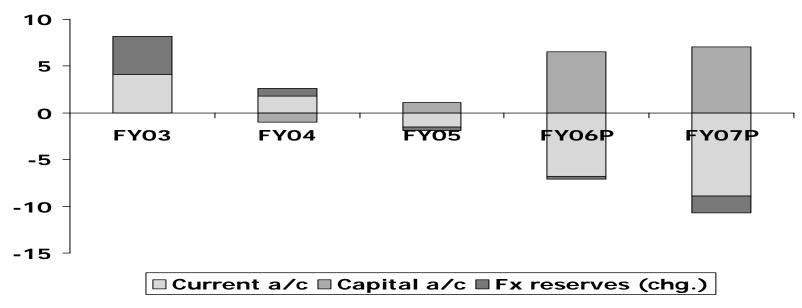


Balance of Payments



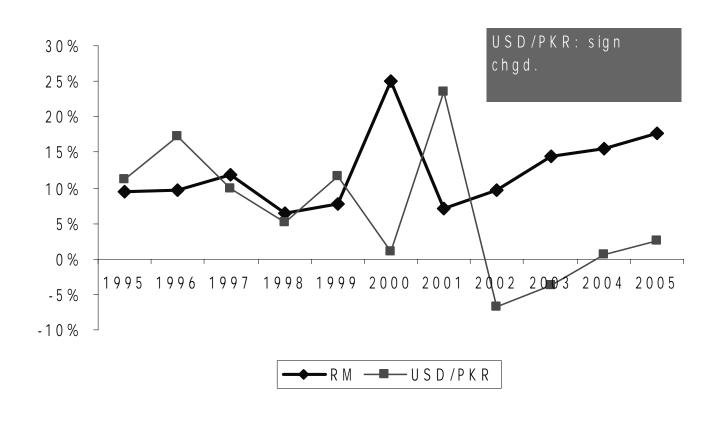


Balance of Payments



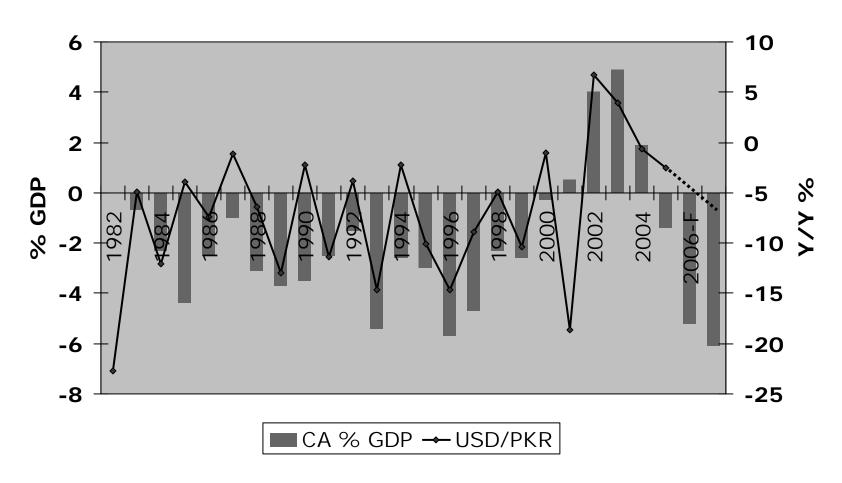
Bottom-line: Even under fairly generous assumptions on inflows, Fx reserves decline in FY07







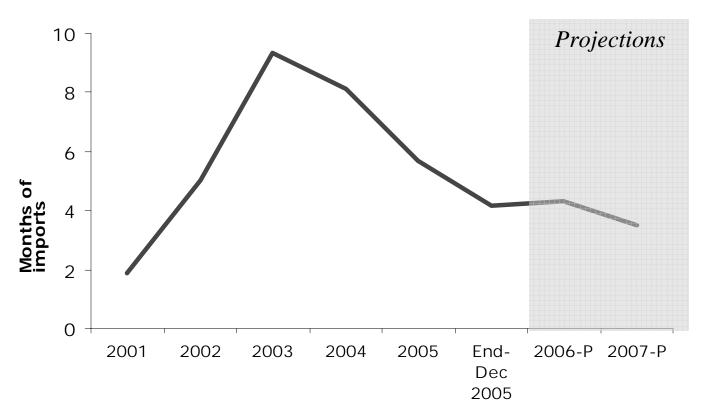
Exchange rate



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Import cover

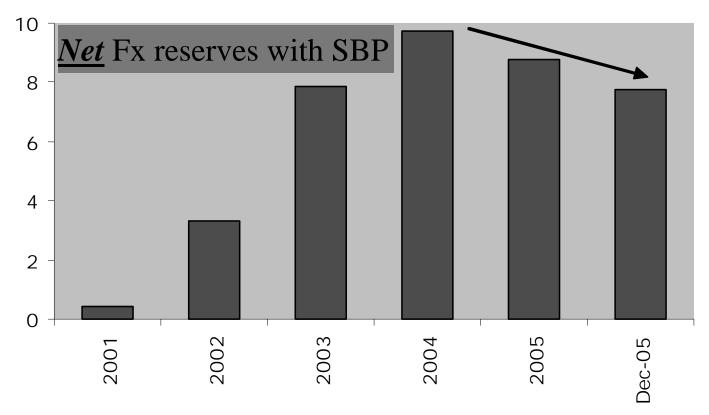


Bottom-line: Import cover (Fx reserves to imports of goods) has declined rapidly

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Fx Reserves (USD bn)



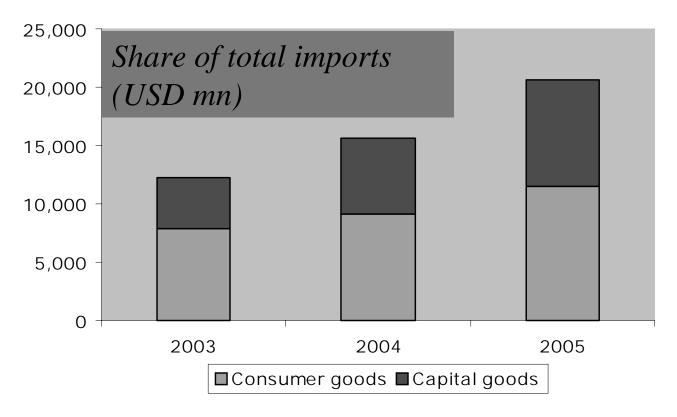
Source: SBP

Bottom-line: While still comfortable, net Fx reserves have slipped by USD 2bn from peak (& 11% in Jun-Dec) Economics Department

*See <u>Appendix</u>



Composition of imports

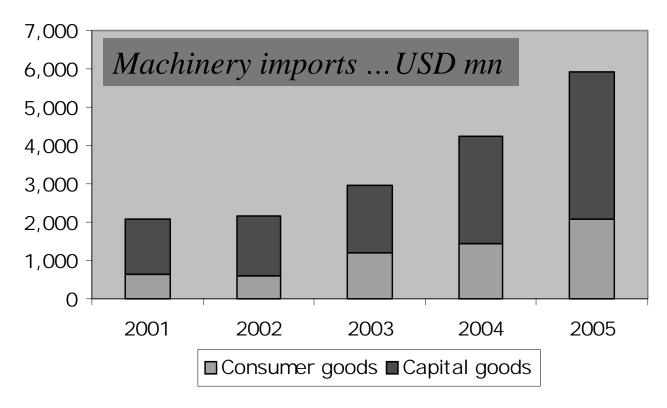


Source: SBP

Bottom-line: Share of consumer goods (raw material + finished goods) in total imports = 56%



Composition of imports



Source: SBP

Bottom-line: Share of consumer goods in machinery imports = 35%

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Composition of imports

| Consumer goods included under ". | Machinery" |
|----------------------------------|------------|
| חבח million | F Y U 5 |
| Cars (for personal use) | 919 |
| Consumer durables (electronics) | 356 |
| Mobile phone handsets | 790 |
| Total | 2,065 |

Source: SBP



Economy: Tactical View

 Economy "over-heating" after rapid acceleration in growth



Economy: Tactical View

- Economy "over-heating" after rapid acceleration in growth
- Domestic demand to continue as major driver



Economy: Tactical View

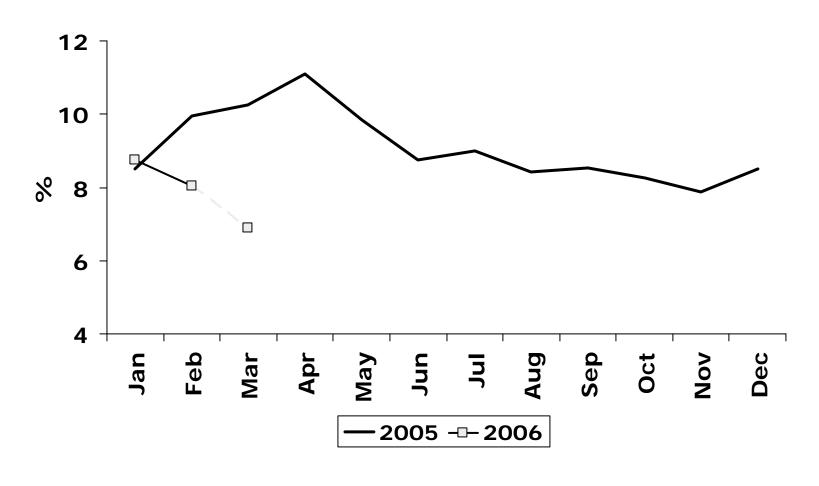
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- Domestic demand to continue as major driver
- Policy settings tuned to 2007 election ...



Economy: Tactical View

- Economy "over-heating" after rapid acceleration in growth
- Domestic demand to continue as major driver
- Policy settings tuned to 2007 election ...
- and a source of worsening imbalances





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Monetary overhang to persist



- Monetary overhang to persist
- Near-term, inflation may stabilise



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- Near-term, inflation may stabilise
- Fiscal stimulus in pipeline



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- Monetary overhang to persist
- Near-term, inflation may stabilise
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- Pressure on Rupee
- Output gap



- Monetary overhang to persist
- Near-term, inflation may stabilise
- Pressure on Rupee
- Output gap
- Commodity prices outlook?



Lessons/Issues



Independence of Central Bank (CB)



- Independence of Central Bank (CB)
 - Who heads it (+ terms of tenure)



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 - Who heads it (+ terms of tenure)
 - Under what legal cover (statutory)



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 - Fiscal domination



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- Policy objectives



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 - Who heads it (+ terms of tenure)
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- Policy objectives
 - Single (price stability) or multiple



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- Independence of Central Bank (CB)
 - Who heads it (+ terms of tenure)
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 - Pro-active or Reactive



- Independence of Central Bank (CB)
 - Who heads it (+ terms of tenure)
 - Under what legal cover (statutory)
 - Fiscal domination
- Policy objectives
 - Single (price stability) or multiple
 - Inflation-targeting
 - Pro-active or Reactive
 - "Rules-based" versus "Judgmental"



Asset "bubbles" part of domain?



- Asset "bubbles" part of domain?
- Response to exogenous shocks



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- Credibility



- Asset "bubbles" part of domain?
- Response to exogenous shocks
- Credibility
 - Success with anchoring market's inflationary expectations



- Asset "bubbles" part of domain?
- Response to exogenous shocks
- Credibility
 - Success with anchoring market's inflationary expectations
- Transparency



- Asset "bubbles" part of domain?
- Response to exogenous shocks
- Credibility
 - Success with anchoring market's inflationary expectations
- Transparency
 - Extent & frequency of disclosure



- Asset "bubbles" part of domain?
- Response to exogenous shocks
- Credibility
 - Success with anchoring market's inflationary expectations
- Transparency
 - Extent & frequency of disclosure
 - Forward-looking or current