INTERVIEW: Pakistan Ctrl Bk -2: Comfortable Reserves

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KARACHI (Dow Jones)--Pakistan won't need fresh aid from the International Monetary Program after the current program ends in 2004, thanks to a surge in remittances and debt rescheduling, central bank Governor Ishrat Hussain said Thursday.

"I am quite convinced that by 2004 there will be no need for balance of payment support from the International Monetary Fund and this should be the last program," Hussain told Dow Jones Newswires in an interview.
The rise in foreign exchange reserves toward $9 billion - a record for Pakistan - has enabled the country to have "a very comfortable external

The current three-year $1.3 billion IMF lending program began in December last year and is slated to end by December 2004.

Hussain said improving remittances from Pakistani workers living overseas and a debt rescheduling by the Paris Club of official creditors earlier this year have substantially improved Pakistan's external liquidity.

In January, Pakistan inked a $12.5 billion 38-year foreign-debt restructuring pact with the Paris Club.

"The reason we approached the IMF was to obtain a basic restructuring of our external debt and that we have been able to obtain," he said.

"Secondly we have a very comfortable external liquidity position, and thirdly our autonomous flows are non-debt creating foreign exchange flows like the workers remittances flowing in," he said.

Remittances to Pakistan through banks rose to $1.431 billion in the first four months of the fiscal year that began July 1, against $529 million in the same period a year earlier.

Remittances through formal banking channels surged after the U.S. announced a crackdown on the financing of terrorist groups following the Sept. 11 attacks, which discouraged transfers through the informal money exchange or 'Hawala' system, bankers said.

Pakistan's foreign exchange reserves are expected to hit $10 billion by the end of the fiscal year.

Hussain said the central bank will continue to buy dollars to boost its reserves to better equip the country to absorb external shocks and reduce the country's dependence on outside financing.

"If you want to eliminate the dependence on external donors all you have to do is build up a significant cushion...reserve building is part of providing that cushion to boost the confidence of foreign and domestic investors," he said.

Pakistan faced a serious financial crisis following its nuclear weapons tests in May 1998 when a shortage of dollars forced the government to freeze foreign currency accounts.

He said Pakistan's credit worthiness will also improve because of the higher reserve levels, citing the recent case when Moody's Investors Service decided to lift Pakistan's sovereign ratings outlook to positive from stable.

But Hussain said the central bank wasn't targeting how much more it can boost its foreign exchange reserves, which he said will be determined by market needs.

He explained that if the market is short of funds the central bank will provide it with dollar liquidity, while if there's an excess it may mop up liquidity as it has done recently.

"The main objective of monetary and exchange policy is for stability...the last decade or so there was so much instability and unpredictability that our businessmen were confused over their pricing," he said.

"What hurts them is the volatility...so stability is the objective of the State Bank."

But Hussain said Pakistan has repaid a net $2 billion in international debt in the last three years and is on track to meet payments in the future.

"We will use part of the reserves to pay our debt...we are negotiating with creditors to repay some of our debt," he said.

Hussain said the first installment of principal and interest on Pakistan's Eurobond of $155 million is due in December.

He said the central bank hasn't decided whether the payment will go through the interbank market or if it will make the payment through its own reserves.

Hussain said the central bank plans to issue a detailed monetary policy outlook paper in December that will determine the direction in the months ahead.

This is the first time that such a paper is being issued and will be a regular feature, he said.

He said the recent decision to cut the central bank's benchmark discount rate - at which it lends money to banks - by a wide 1.5 percentage points to 7.5%, was driven by the rate cut by the U.S. Federal Reserve, similar cuts by countries competing with Pakistan in exports, and low inflation.

"When the Federal Reserve cut rates we had to change monetary policy. When you have an appreciating exchange rate then you have to keep the rupee and dollar" interest-rate differential at a certain level, he said.

Hussain added:"We observed the behavior of inflation for the last 10 months and when we saw there was no threat then we moved ahead (with the rate cut)."

Inflation is still below the central bank's target of 4%.

This is the first formal explanation on why the central bank cut its benchmark rate - the first cut since January.

The central bank went through an aggressive easing phase between July last year and January 2002, when it cut the discount rate four times by a total of 500 basis points to try and cushion the domestic economy from the global slowdown caused by the Sept. 11 attacks on the U.S. and war in neighboring Afghanistan.

Hussain said he expects the bank lending rate to fall because of the likely decline in the Treasury bill rate in the auction next week following the discount cut. Government securities will then become a less attractive investment option.

He said the reduction in lending rates - which averaged 11.8% in September, according to the latest data - will help exporters hit by the surging rupee and facing competition from regional exporters.

Hussain said the central bank, which has been buying dollars and soaking up excess rupees from the market, will continue to "sterilize" the liquidity to keep money supply in check.

But he said the rate cut is a signal from the central bank that it wants an improvement in lending to the private sector for use in investment to bolster economic growth, which is targeted at 4.5% in the current fiscal year that ends June 30.

"First we have to see how this particular discount rate cut works itself out through the financial system before we move any other way because the purpose is to provide a stimulus to private sector investment in the country," Hussain said.

"We have now achieved macroeconomic stability, we are now entering the phase where we want to accelerate private sector investment because there is larger production and employment generation in the economy."

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