MINUTES OF THE MEETING OF THE
MONETARY POLICY COMMITTEE (MPC)
HELD ON MAY 15, 2020

P R E S E N T

Dr. Reza Baqir	Chairman & Governor SBP
Mr. Jameel Ahmad	Deputy Governor (Banking & FMRM)
Dr. Murtaza Syed	Deputy Governor (Policy)
Dr. Inayat Hussain	Executive Director (FS&BSG)
Mr. Azam Faruque	Director SBP Board
Dr. Tariq Hassan	Director SBP Board
Dr. Asad Zaman	External Member
Dr. Hanid Mukhtar	External Member
Dr. Naved Hamid	External Member
Mr. Mohammad Mansoor Ali	Corporate Secretary/Director OCS

Review of Current Economic Conditions and Outlook for FY20

1. The staff apprised the Monetary Policy Committee (MPC) on the developments in key macroeconomic variables since the last Monetary Policy decision, along with an assessment of evolving trends in global and domestic economic conditions in general and in the wake of the Covid-19 pandemic in particular.

2. Firstly, the staff apprised about the impact of 'the great global lockdown' on the world economies. It was mentioned that the Q/Q (annualized) growth rate of major economies indicates a significant decline in economic activity and informed that analysts foresee a contraction in the global economy that is expected to be much worse than that witnessed during the Global Financial Crisis (GFC) of 2008-09. Across the world, manufacturing Purchasing Manager Indices (PMIs) plummeted during the last two months and the trend may continue in the second quarter of CY20. The slowdown in economic activities has led to an increase in the unemployment - in case of the USA, it is estimated to rise between 15 to 20 percentage points. Further, it was explained that the decline in all major commodity prices intensified during the past two months, mainly driven by industrial metals and energy.

3. Afterwards, discussing trends in the global capital markets, it was explained that on an overall basis, volatility in global financial markets remain elevated during Feb–Mar CY20, despite a slight improvement as compared to the peak level of uncertainty during early March 2020. It was elaborated that one of the factors which explains the volatility in the capital market is the significant flight of capital from Emerging Markets (EMs), which surpassed the outflows witnessed during the Global Financial Crisis 2008-09. The domestic market was also affected in line with these global trends and witnessed an outflow of USD 2.4 billion during March-April 2020 due to COVID-19 related uncertainties. It was highlighted that the reversal of capital flows has put pressure on the exchange rate and contributed to a decline in foreign exchange reserves. It was also highlighted that the exchange rate recovered some losses after disbursement of $1.4 billion from IMF under Rapid Financing Instrument. However, it was apprised that the depreciation in PKR is far less than in many other EM currencies. Giving an overview of the domestic equity market, it was observed that after a steep decline in the benchmark KSE-100 index during March 2020, the market seemed to be showing signs of recovery during the last month. The uptick in the KSE-100 index appears to reflect improved confidence in the domestic market, following the fiscal stimulus as well as the monetary measures taken by the SBP to support businesses in these challenging times. The staff briefly discussed several measures taken by SBP to maintain liquidity in the financial markets, allowing businesses to defer the repayment of principal, restructure their loans and reduce borrowing costs. Discussing the credit default

swap (CDS) spread, it was mentioned that Pakistan's sovereign bond and CDS spreads have also risen but this increase is relatively moderate as compared to that seen for other EMs.

4. Discussing the adverse impact of COVID-19 on global growth projections, it was explained that during the Global Financial Crisis, 91 countries experienced a contraction in economic activity. This time, as per the latest World Economic Outlook released by IMF in April 2020, growth in 154 countries is expected to fall into negative territory. Moreover, it was informed that with the uncertainties associated with the economic impact of the COVID-19 pandemic, economists across the globe are losing hope for a V-shaped recovery, and are now projecting more of a U-shaped or Nike swoosh typed gradual pick up in the global economy.

5. After concluding the discussion on the global economy, the staff presented the 'domestic economic developments and outlook'. Firstly, it was apprised that the current account deficit (CAD) continued to narrow and was recorded at USD 6.0 million during March 2020 as compared to USD 198 million in February 2020, and USD 823 million in the same month last year. On a cumulative basis, the current account deficit was 73 percent lower during Jul-Mar FY20 as compared to the same period last year. Further, it was explained that in contrast to the outflows witnessed in net portfolio investments, Foreign Direct Investment (FDI) registered a net inflow of USD 279 million in March 2020. On a cumulative basis, FDI increased to USD 2.1 billion during Jul-Mar FY20 from USD 0.9 billion during the same period last year. This increase in FDI is mainly attributed to inflows from China pertaining to CPEC projects.

6. The staff then apprised the Committee that due to a substantial fall in financial inflows, the country's foreign exchange buffer reduced in March 2020, with SBP foreign exchange reserves fell to USD 10.8 billion at end of March 2020. However, after receiving USD 1.4 billion under IMF's RFI, the SBP foreign exchange reserve increased to USD 12.3 billion as of May 5, 2020. Further, it was apprised that although the number of overseas Pakistanis have declined significantly after the Coronavirus outbreak, remittances have so far remained resilient, recording an increase of 5.2 percent on an y/y basis during Mar-Apr 2020. However, with the expected decline in number of overseas Pakistanis and contraction in the global economic activity, remittance flows could decline in the months ahead.

7. Presenting developments on the fiscal side, it was apprised that the fiscal deficit narrowed to 3.8 percent of GDP in Jul-Mar FY20 as compared to 5.0 percent in the corresponding period last year. More importantly, for the first time since 2016, the primary balance recorded a surplus of 0.4 percent of GDP. The improvement on the fiscal side was mainly led by a significant increase in FBR revenues, which witnessed a growth of 17.5 percent during Jul-Feb FY20 against 3.3 percent increase in the same period last year. However, in the post-COVID-19 period, revenue growth weakened, declined by more than 15.0 percent each in March and April 2020. Further, it was highlighted that contrary to the historical trend of high inflows during May and June, a significant contraction in FBR revenues is expected in these month of FY20 due to COVID-19.

8. Further, it was apprised that the financial results of listed companies for Q1-CY20 suggested a broad based decline in overall profitability that also indicates slowdown in economic activity. The worrisome factor is that a significant decline was already registered in the first quarter, although the domestic lockdown only began in late March. The accumulated profit of corporates declined to Rs. 106.8 billion in Q1-CY20 as compared to Rs. 138.7 billion in the same period last year, showing a 23.0 percent decline on y/y basis. The slowdown in economic activity was also evident from Google's Community Mobility Reports, which suggest a significant slowdown in most sectors of the economy in recent weeks.

9. Discussing sales of the automobile sector, it was informed that Auto sales declined by almost 100 percent with no sales of cars and jeeps during April 2020, the highest monthly decline since 2008. Apart from decline in auto sales, domestic cement sales also dropped by 19 percent

in April, depicting weaker investment spending. Similarly, POL sales, declined by over 37.0 percent due to a fall in the industrial and transport activities amid lockdown. Moreover, the analysis of consumer spending patterns during March and April 2020 showed that consumption is largely skewed towards grocery stores and department stores.

10. Later, it was highlighted that before COVID-19, the domestic economy was on track to achieve macroeconomic stability. However, after the outbreak of the COVID-19 Pandemic, it is expected to contract significantly during Q4-FY20. Elaborating the real GDP growth projection of FY20, it was opined that the Agriculture sector largely remain unaffected due to the Pandemic. However, during FY20, the Industry and Services sectors are expected to witness sharp contraction in the last quarter of FY20. It was highlighted that real GDP growth is expected to somewhat recover in FY21, mainly supported by agriculture sector and opening up of businesses.

11. Afterwards, the Committee took note of the policy measures taken by other central banks and governments across the globe. It was highlighted that due to extreme uncertainty, the global outlook is subject to change and this is causing a parallel shift in the policies to counter this crisis. Discussing the fiscal stimulus packages announced worldwide, it was observed that the response of the advanced economies was more aggressive than that of developing economies, which might be attributed to the greater fiscal space available with the former. Further, it was informed that, in general, an expansionary monetary policy stance is observed across the globe during post COVID-19. Moreover, some countries have cut the policy rates more than once. Pakistan has also cut the policy rate significantly, mainly reflecting the expectations of a sharp decline in projected inflation in the country. In addition, SBP had extended the ambit of several refinance schemes to facilitate the borrowers and to ensure the availability of liquidity in the market. The credit to private sector recorded an increase of only Rs. 319.8 billion during Jul-1st May FY20, as compared to the expansion of Rs. 587.7 billion witnessed in the corresponding period last year. It was highlighted that SBP refinance schemes remained the key driver of private sector credit in FY20, accounting for 44.8 percent of the total increase in credit to the private sector during the year so far.

12. The staff then apprised the MPC about recent developments in inflation. It was explained that inflation has declined substantially in the last few months. On a y/y basis the national CPI inflation declined from 14.6 percent in January 2020 to 8.5 percent in April 2020. The sharp decline in inflation is primarily attributed to a significant reduction in international oil prices, slowdown in domestic economic activity (due to COVID-19) and effective administrative measures for price controls. Further, it was informed that headline inflation in both urban and rural areas has declined. The decline was more pronounced in Urban CPI due to relatively higher share of services. In addition, the food component accounts for 37 percent of the urban basket and 46 percent of the rural baskets.

13. It was also explained that M/M inflation fell by 0.8 percent in April 2020. Similarly, there was M/M decline of 0.7 percent in urban and 1.1 percent in rural CPI during the month of April 2020 owing to overall fall in food and energy prices. Lastly, it was informed that the recent impact of PKR depreciation on inflation has been offset by a decline in international commodity prices, and especially the decline in the import prices of crude oil and edible oil.

14. Concluding the presentation, the MPD staff presented various projections based on alternative scenarios for: (i) average exchange rate, (ii) GDP growth (iii) LSM growth (iv) crude oil prices (v) broad money growth and (vi) utility tariffs. In particular, the staff highlighted that the recent waning price momentum is expected to be complemented by the recent cut in domestic petrol and diesel prices.

Result of Surveys on Monetary Policy

15. The staff apprised the Committee that the last wave of the Consumer Confidence Survey (CCS) was conducted during the first week of May 2020. The results suggested that consumer confidence had deteriorated significantly, falling to a six-year low. Further, it was highlighted that although consumer inflation expectations have picked up slightly since the last wave of the survey, they have remained below the historical median level, suggesting that consumers are expecting inflation to remain manageable.

16. Discussing the results of the Business Confidence Survey (BCS), it was informed that the latest wave of the survey was conducted in the second half of April 2020. The results showed a broad based decline in business confidence for across Industry and Services sector firms. Moreover, the current level of business confidence is the lowest since the start of the survey in 2017.

17. Furthermore, presenting the inflation expectations of businesses, it was highlighted that in contrast to consumers, businesses are expecting low inflation in input prices as well as finished goods due to an expected slowdown in demand because of the ongoing COVID-19 pandemic.

18. Further, discussing Bank Lending Survey, it was informed that the latest wave of this quarterly survey was conducted at the start of April 2020. The results suggested that Senior Loan Officers of commercial banks are expecting a significant decline in both demand of credit and availability of funds in Q4-FY20.

Model-Based Assessment

19. While discussing the model-based assessment, it was highlighted that the model was suggesting a sharp downward revision in the inflation path in the medium term. However, the model is also suggesting a slight uptick in inflation in Q4-FY21, attributed to four factors. *First*, the sharp decline in inflation in Q4-FY20 and expected decline in next three quarters has led to a base effect. *Second*, expected increase in growth. *Third*, an increase in international oil prices (due to assumed V-shaped or U-shaped recovery in global economy). *Fourth*, the expected rising path of utility tariffs.

20. After discussing the future inflation path, the staff also discussed the projected growth pattern in detail to analyse the potential path of the policy rate.

21. Indeed, staff presented various projections based on alternative scenarios of high and low growth for FY21. The Committee then deliberated on all the scenarios and their possible implications for the policy rate. In doing so, the staff also discussed the specification of SBP's reaction function in the FPAS model to explain the role of output-gap and forward-looking inflation underpinning the model-suggested by policy interest rate path.

Financial Markets and Reserve Management

22. Apprising the committee on monetary policy implementation, the staff stated that the overnight interbank repo rate remained around 8.95 percent on average against the policy target rate of 9.0 percent. It was explained that in order to ensure effective implementation of the monetary policy stance decided by MPC, SBP has to increase its liquidity injections; primarily due to a surge in currency in circulation. The average outstanding net injection since last MPC (Apr 17- May 11, 2020) had increased to around Rs. 1.3 trillion.

23. It was explained that for tenors up to two years the yield curve was still inverted, reflecting market expectations of a further moderate cut in the policy rate. However, the yield curve had turned upward sloping for higher tenors; indicating expectations that monetary easing cycle may be approaching its end. The staff stated that the market's view of a further cut in the policy rate had helped GoP in mobilizing funding through MTB and PIB auctions below the policy rate. It was highlighted that the current interest rate environment was offering a good opportunity to GOP to mobilize long-term funding.

Monetary Policy Deliberations and Decision Vote

24. Following a detailed discussion, the MPC decided to reduce the policy rate by 100bps with a majority vote of 5 out of 9 members, three members voted for 150bps reduction, while one member voted for reducing the policy rate by 50bps.

25. The Committee then scripted the Monetary Policy Statement.

26. The Committee decided as follows:

DECISION:

- *The policy rate is reduced by 100bps to 8.0 percent.*
- *The Monetary Policy Statement – May 15, 2020 is approved.*