

SUMMARY MINUTES OF THE 2nd MEETING OF THE ADVISORY COMMITTEE ON THE MONETARY POLICY ¹

November 15, 2014

PRESENT

- Mr. Ashraf Mahmood Wathra Chairman & Governor SBP
- Mr. M. Hidayatullah Director
- Mr. Zafar Masud Director
- Dr. Asad Zaman External Member
- Dr. Qazi Masood Ahmed External Member
- Mr. Riaz Riazuddin Chief Economic Advisor, Monetary Policy, SBP (CEA-MP)
- Dr. Mushtaq A. Khan Chief Economic Advisor, Policy Development, SBP (CEA-PD)
- Mr. Muhammad Ali Malik Director – Financial Markets and Reserve Management, SBP

1. Reviewing the current developments in the economy, the Committee observed the noticeable decline in inflation which ebbed to a 17 month low at a YoY 5.8 percent in October 2014 led by declining trend in administrative prices of petroleum products and perishable food items, subsided political activities to a considerable extent, and less than expected damages from recent floods. The Committee also observed that further decline in prices of petroleum products and other commodities may continue to keep inflation at low level and the persistence in inflationary trend in non-food-non-energy items may also ease after second round of price adjustment.

2. Discussing external sector, the Committee observed that although present trend in trade account with 5 percent decline in exports and 11 percent increase in imports needs to be watched closely, expected external inflows related to IMF tranche and issuance of dollar denominated bonds/Sukuk will support the balance of payments position. It was noted that lower inflation may increase competitiveness of exports though it is facing challenges of lower prices, such as that of cotton, in international markets. The Committee also noted that materialization of external flows will reduce government's borrowing need and create extra liquidity to facilitate flow of credit to private sector.

3. Weighing options for its recommendation, the Committee extensively discussed pros and cons of maintaining the status quo and reducing the policy rate. Members in favour of maintaining status quo highlighted the need to observe greater caution for the time being as to wait for materializing foreign flows expected within the next couple of months and savings from lower prices of oil may be subsided by broad based increase in imports. Highlighting that positive sentiments for the economy are largely driven by the anticipation of aforementioned external

¹ Constituted by the SBP Board as an interim body which is expected to be replaced by statutory Monetary Policy Committee, as envisaged under the proposed amendments in the SBP Act, 1956.

inflows, they suggested to re-evaluate the options for the policy rate in the next monetary policy decision meeting when there is more comfort for the materialization of these inflows. Continued energy shortages, persistence in some inflationary trends and the fact that lower cost of import could arguably affect related revenue collection were also discussed.

4. Arguments favouring a reduction in the policy rate were dominated with observations on high level of real interest rate due to unchanged policy rate for the last 12 months despite significant decline in inflation. Proponents of the cut were of the view that expected external inflows will take care of certain possible difficulties for the external sector. They further emphasized the role of lower policy rate for boosting growth, setting the right environment for attracting FDI and to facilitate flow of credit to private sector. Positive sentiments about the economy led by successful negotiations with IMF, subsided political uncertainty to a greater extent, vibrancy in equity market with noticeable external portfolio investment, impact of reduced oil prices going-forth and outlook of reduced commodity prices were also highlighted. However, considering caution in easing the monetary policy, support for decreasing the policy rate varied from 50 to 100 bps cut.

5. After the round of voting, it emerged that members' support is split equally for reducing the policy rate and keeping it unchanged, with 4 votes in favour of each option. The support for reducing the policy rate was further split between 50 and 100 bps cut, each supported by 2 votes. In view of diverse opinion of the members, the Committee decided to present its split recommendation for the Board's consideration.

6. The Committee decided as follows:

RECOMMENDATION:

The Board is apprised of the 4/4 split in votes for maintaining the status quo and reducing the policy rate. The support for reducing the policy rate was further divided into a 50 bps and 100 bps cut with 2 votes in favour of each option.

SUMMARY MINUTES OF THE MEETING OF THE CENTRAL BOARD ON MONETARY POLICY DECISION – NOVEMBER 2014

NOVEMBER 15, 2014

PRESENT

- Mr. Ashraf Mahmood Wathra Chairman & Governor SBP
- Dr. Waqar Masood Khan Secretary Finance
- Mr. M. Nawaz Tiwana Director
- Mr. Mehmood Mandviwalla Director
- Mr. M. Hidayatullah Director
- Mr. Zafar Masud Director

1. After a briefing on the current developments in the economy, the Board was apprised that ACMP has decided to present its diverse views to the Board as there was 4/4 split between maintaining the status quo and reducing the policy rate, the support for reducing the rate was further divided equally in to a 50 or 100 bps cut.

2. The Board was also apprised that the members of ACMP in favour of reducing the policy rate anchored their arguments on higher real interest rate while those supporting status quo suggested to wait for materializing of external inflows expected in the next couple of months. They were inclined to re-evaluate options for the policy rate in the next monetary policy decision meeting to have more comfort for the inflows related to next IMF tranche, privatization proceeds and issuance of dollar denominated Sukuk.

3. Members of the Board were then invited to discuss options for the monetary policy decision. After initial round of deliberations, members supporting status quo highlighted possible difficulties for the external sector where higher and broad based imports are likely to take away the gains from low prices of oil. They also highlighted that continued energy shortages faced by the industry and lower prices of cash crops in international markets will keep posing challenges for the exports. Acknowledging the differential in policy rate and inflation, they suggested to wait for achieving a more comfortable position for the external sector.

4. The members favouring reduction in policy rate were of the view that sizable gap between policy and inflation rates amid downward trend in international prices of oil and other commodities warrant an immediate cut in policy rate. Highlighting weak relationship of interest rate with external sector in our economy, one of the members opined that certain expected disadvantages for the external sector should not prevent addressing larger issue of prevailing high real interest rate that also has implications for the growth. On external account, another member opined that difficulties are likely to ease as successful negotiations with IMF are expected to result in disbursement of USD 1.1 billion tranche while inflows related to privatization and issuance of Sukuk are likely to materialize when the government is ready to pursue these initiatives. However,

to move conservatively, the support for reducing the rate was limited to the extent of signaling positive developments to the economy.

5. Some of the members supporting no change in the policy rate suggested to weigh the external sector situation and the benefits from a possible rate cut. They were of the view that manageable difficulties about external sectors should not overshadow the monetary policy decision which is more related with inflation, given the structure of our economy.

6. Having no clear majority in favour of any one option, the members decided to review arguments in favour of each recommendation to have a clearer voting pattern. After another round of extensive deliberations, a consensus emerged where the Board decided to reduce the policy rate by 50 bps to 9.5 percent.
