Monetary Policy Statement
May 21, 2016

Towards the end of FY16, macroeconomic conditions continue to improve. Headline CPI inflation, despite its continuous increase on Year-on-Year (YoY) basis, would remain below its FY16 annual average target of 6 percent. Real GDP growth is set to exceed its FY15 outcome of 4.2 percent, while remaining below its target of 5.5 percent. Current account deficit is likely to shrink to the previous year's level of around 1 percent of GDP and the expected surplus in balance of payments would be marginally less than the FY15 level. Foreign exchange reserves are still projected to maintain upward trajectory.

As expected, headline CPI inflation sustained its rising trend for the seventh consecutive month and on YoY basis rose to 4.2 percent in April 2016 from the low of 1.3 percent in September 2015. In addition to the seasonal impact of perishable food items and services, this increase owes to further waning of the base effect and second round impact of decline in oil prices. Similarly, core inflation measures have broadly followed a rising trend in this fiscal year indicating buildup of underlying inflationary tendencies. Despite these trends and developments, the inflation outlook for FY16 is low.

However, going into FY17 inflation is likely to attain a higher plateau.
Major sources that would determine this path are as follows. First, relatively faster pickup in demand compared to its gradually improving supply dynamics could lead inflation on a higher side. Second, rising global oil price along with modest recovery in non-energy commodity prices will pass on to the domestic consumer prices. Third, some risks, such as imposition of new taxation measures and increase in electricity and gas tariffs, if realized would put upward pressure on CPI inflation.

Expansion in industrial activities and services sector would salvage some of the lost momentum to GDP growth due to the losses from cotton and rice crops. Recovery in Large-scale Manufacturing, which grew by 4.7 percent during Jul-Mar FY16 compared to 2.8 percent in Jul-Mar FY15, is expected to continue further on account of improving energy and security conditions. At the same time, buoyant growth in construction and improved demand for consumer durables has persistently indicated revival in domestic demand in the current fiscal year. This is also reflected in uptake in credit to private sector which increased by Rs314.7 billion during Jul-Mar FY16 compared to Rs206.0

billion during the same period of FY15. Thus, GDP growth in FY16 is expected to provide the needed sustainability in growth trajectory and the basis for further improvement in FY17.

On the external front, stability in the balance of payments and upward trajectory in foreign exchange reserves mainly owes to a combination of favorable developments both in the current and financial accounts. Steady workers' remittances and low oil prices have helped contain the current account deficits at manageable levels, while multilateral and bilateral inflows have largely contributed to the surpluses in the financial account.

In the current fiscal year as well, favorable trends in these factors are expected to yield an overall surplus in the balance of payments with SBP's foreign exchange reserves estimated to increase to over 4 months of import coverage; up from around 3 months at end-FY15. Going forward, foreign direct investment is projected to increase as the work on projects under China Pakistan Economic Corridor gains momentum. On the other hand, owing to some anticipated uptick in commodity prices along with improvements in domestic energy supplies exports receipts are likely to recover marginally. However, with weaknesses in private capital inflows persisting for some time now, uncertainty may arise if there is an adverse change in oil price or workers' remittances.

Monetary Policy Committee, after detailed deliberations, has decided to reduce the policy rate by 25 basis points from 6.0 percent to 5.75 percent.