Monetary Policy Statement

September 24, 2016

The year-on-year CPI inflation rose to 3.6 percent in August 2016 from 1.8 percent in August 2015, while the average inflation during the first two months of the current fiscal year was more than double the same period last year. Similarly, the core inflation (measured as both non-food non-energy and 20 percent trimmed mean) during this period was also higher than the last year.

The expected pick up in domestic demand is largely going to determine the inflation path in the remaining months of FY17. This is also reflected in the IBA-SBP Consumer Confidence Survey of September 2016 which shows improvements in current and expected economic conditions and a major rise in consumer confidence. Uncertain global oil price continues to remain a major determining risk.

While year-on-year increase in monetary aggregates (M2) was 13.9 percent on 09 September, 2016 compared to 13.5 percent on 11 September 2015, it recorded seasonal contraction of 1.1 percent in 01 Jul-09 September FY17 as against a 1.3 percent contraction in the comparable period of FY16. Liquidity conditions in the money market remained broadly comfortable mainly due to retirement of government borrowing to the scheduled banks. Resultantly, volatility in the interbank market was low as the overnight money market repo rate mostly remained close to the policy rate. Thus, the ongoing stability in the market interest rates, with weighted average lending rates already at 12 year low in July 2016, is going to be instrumental during the start of the upcoming credit cycle for working capital and also for fixed investment.

While the global growth outlook for 2016 is subdued, trend in international oil prices remains uncertain. Similarly, anticipations of the impact of interest rate hike by the US-Fed, slowdown in the Chinese economy, and aftermath of Brexit on international financial and commodity markets is building up on this prevalent uncertainty.

Pakistan has fared well so far owing to supporting macroeconomic environment and the record-high foreign exchange reserves have supported stability in the foreign exchange market. However, the current account deficit is at the risk of widening further owing to declining exports and rising imports. As CPEC related projects are gathering momentum, the economy is projected to further expand at the back of improving industrial activity, especially construction and power generation, and rising demand for allied services. Relatively lower import prices of inputs, low interest rates, and better energy supplies are expected to boost manufacturing sector. Improved security situation would help in attracting foreign investment thus adding on to the sustainability of growth.

Based on above macroeconomic considerations and after detailed deliberations, the Monetary Policy Committee has decided to maintain the policy rate at 5.75 percent.