Monetary Policy Statement

September 29, 2018

Since the last meeting of the Monetary Policy Committee in July 2018, Pakistan has witnessed notable changes on the political front. This has had a positive impact on the business and consumer confidence in the country as reflected in multiple surveys. The smooth transition between governments addresses the political uncertainty observed hitherto, but concerns on the economic front continue to persist on the back of rising inflation and large twin deficits, that are likely to compromise the sustainability of the high real economic growth path.

Inflation is inching up, particularly from March 2018 onwards. So far, in the first two months of FY19, headline CPI inflation has averaged 5.8 percent as compared to 3.2 percent for the corresponding months of FY18, and an average of 3.9 for all of FY18. The jump is even more pronounced in core inflation- a key measure reflecting the underlying inflationary pressures in the economy.

For FY19, SBP's inflation projections show that the average headline inflation is expected to fall in the revised forecast range of 6.5-7.5 percent. This assessment takes stock of the following factors: (i) a higher than anticipated increase in international oil prices; (ii) an upward revision in domestic gas prices; (iii) a further increase in regulatory duties on imports; and (iv) the continuing second round impact of previous exchange rate depreciations.

Following a healthy growth of 5.8 percent in FY18, economic activity is likely to slowdown in FY19 as the general macroeconomic policy mix is focusing towards stabilization. Specifically, the transmission of SBP's policy rate hikes by 175 bps since January 2018 is still unfolding. The government is also now pursuing a fiscal consolidation program and has further announced regulatory measures to slowdown the growing pressures on the external front. As a result, domestic demand is projected to decelerate in the coming months of FY19.

The recent monetary and fiscal measures are likely to affect Large Scale Manufacturing. Furthermore, the latest information shows that cotton production is expected to miss its FY19 target of 14.4 million bales with downside implications for agriculture sector growth. The ancillary services sector is expected to miss its FY19 target as well. Some positive impact is expected from the contribution of exports led production and higher fertilizer production amidst depleting stocks and better availability of energy. After incorporating the latest information on both demand and supply, SBP projects the real GDP growth for FY19 at around 5.0 percent.

The current account deficit continues to pose a challenge. Despite some growth in workers' remittances and exports in the first two months of FY19, a notable increase in the value of oil imports has kept the current account deficit at US$2.7 billion, as compared to US$2.5 billion, in the corresponding period last year despite non-oil imports declining during the period. Owing to these developments SBP's net liquid FX reserves have declined to US$ 9.0 billion as of 19th September, 2018 compared to US$ 9.8 billion at the end of FY18.

Broad money supply saw a seasonal contraction of 1.2 percent during 1st July to 14th September FY19 as compared to the contraction of 0.9 percent during the same period last year. During this period, however, Private Sector Credit (PSC) performed relatively better. The main reasons for the continuing growth of PSC involve: (i) the improved availability of energy; (ii) relatively conducive exports demand amid GSP plus status; and (iii) the higher working capital needs due to capacity additions in the last three years. Accordingly, PSC growth is expected to continue, but at a slower pace than in FY18. Similarly, monetary growth is expected to remain between 10.5 to 11.5 percent in FY19.

In this backdrop, the Monetary Policy Committee noted that: (i) while non-oil imports are responding to the contractionary measures a surge in oil prices is masking this improvement, and as a result the current account deficit remains high; (ii) rising trends in inflation mean that real interest rates have fallen and further; (iii) the unfolding global developments, whether in terms of oil-price shocks, protectionist trade policies and/or falling flows to the emerging markets, all pose challenges to macroeconomic management in Pakistan.

In light of the current and evolving macroeconomic situation discussed above, the MPC is of the view that further consolidation efforts are required to ensure macroeconomic stability and therefore has decided to raise the SBP target policy rate by 100 bps to 8.5 percent effective from 1st October 2018.