Business Recorder published following Editorial "clarification" on November 24, 2021 titled 'Monetary Policy Statement': clarification by SBP

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Monetary Policy Statement

The Monetary Policy Committee (MPC) raised the discount rate by 150 basis points to 8.75 – widening the difference with other regional countries (against India's 4 percent, Sri Lanka's 5 percent and Bangladesh's 4.75 percent) as well as the prevalent rate in our major trading partners in Europe and the US. The reason for the rise as per the Monetary Policy Statement (MPS) is "risks related to inflation and the balance of payments, have increased while the outlook on growth has continued to improve."

The raise has come as no surprise as the pervasive market perception was that the discount rate would be raised, a perception further strengthened by the tweet on the State Bank of Pakistan's (SBP's) official account on 16 November 2021 at 5:31pm that "the Monetary Policy Committee has decided to bring forward its upcoming meeting to Nov 19th, from the previously announced date of Nov 26th, in order to help reduce uncertainty about monetary settings prevailing in the market." The uncertainty clearly was due to the rupee erosion – from 152 rupees to the dollar when the budget for the current year was under preparation in May 2021 to 174.67 rupees to the dollar interbank rate on 18 November 2021 as per an SBP tweet – negative 0.52 percent from the day before – a rise finally acknowledged by the MPS as "comparatively large."

Critics of the monetary policy decisions during the ongoing International Monetary Fund (IMF) programme have consistently accused the SBP and the MPC of following the Fund's dictates without providing an appropriate in-house context (including the fact that before May 2019 the discount rate was linked to core inflation as opposed to the Consumer Price Index). It is important to note that the market perception was that the rate would be raised from between 75 and 100 basis points in view of the raise of 1 percent in CRR (cash reserve ratio) just a week earlier, and the rise of 150 basis points, they argue, reflects the tendency of the MPC to ask how high when the Fund says jump.

With respect to the MPS, five observations are relevant. First, the MPS argues that "inflation is not only due to across the world Covid-induced disruptions to supply chains and higher energy prices but emerging signs of demand side pressures on inflation and inflation expectations of businesses have risen on account of further upside risks from domestic administered prices. The burden of adjusting to these external pressures has largely fallen on the rupee." Administered prices are a reference to the IMF (International Monetary Fund) condition to raise base electricity tariffs (implemented last month), and to meet the budgeted petroleum levy target of 610 billion rupees (not yet implemented as

only around 23 billion rupees has so far been collected under this head); however, the claim that the burden of adjusting to external pressures has largely fallen on the rupee is stretching the truth because the rupee is also burdened by two other factors: (i) Pakistan's inflation rate is higher than those of other regional countries (India under 5 percent, Bangladesh 6.4 percent and Sri Lanka 7.6 percent last month) as well as our trading partners (the EU 4.1 percent and the US 5.1 percent); and (ii) Pakistan's higher interest rates vis-a-vis the rest of the world are not attracting foreign investment or portfolio investment (negative 948 million dollars in the first quarter of this year against plus 179 million dollars in the comparable period of last year) because of not only the stalled sixth review but also the massive rise in public debt with net incurrence of liabilities, as a component of current account, rising to 4.521 billion dollars in the first quarter of Fiscal Year 2022 as opposed to 4.104 million dollars during the entire 2021 fiscal year.
In this context, it is relevant to note that while in principle we may advocate greater autonomy for the SBP to preclude the possibility of economically unsound interference by the Ministry of Finance for example Ishaq Dar's pressure to keep the rupee massively overvalued during his tenure; at the same time, however, we would like the SBP to take a more proactive approach to deal with inflation by, amongst other things, setting a specific target each year that would require appropriate monetary policy interventions.
Second, the MPS notes rising input costs, (attributable to not only administered prices though not mentioned is the higher borrowing costs as a consequence of the announced rise in the discount rate), and normalization of macroeconomic policies (assuming that this implies severe contractionary monetary and fiscal policies agreed with the Fund during the previous review in February 2021, (normalization that brings to mind Shaukat Tarin's initial opposition to the raise in the base tariff, an alternate phased out circular debt management plan acceptable to the World Bank, and the passage of a money bill instead of the promulgation of an ordinance that would end 330 billion rupee exemptions) are likely to lead to some moderation in the growth of the industrial sector. This projection, albeit backed by macroeconomic policy decisions, compromises Tarin's stated objective of raising the industrial growth rate.
Third, perhaps to assuage the supporters of higher growth rate within the government, the MPS states that the reduction in industrial output would be more than offset by the improved outlook for agriculture that would mitigate the risks of adverse impact on the growth forecast of 4-5 percent in FY22. The SBP needs reminding of a recent report published by this newspaper in which a senior official of the Ministry of National Food Security and Research has been quoted as saying that not only is it too early to project whether production targets for wheat, sugarcane, maize and other products would be achieved as data is not yet available but also that the country is unlikely to achieve the 3.5 percent projected growth target set for the current year after revising the cotton output target from 10.5 million bales to 8.46 million bales.
Fourth, the MPS noted that primary surplus (minus debt servicing and repayments) was 28.6 percent lower than in the first quarter of 2021 fiscal year due to a 33 percent (year-on-year) growth in non-interest spending. This is emphasising the Ministry of Finance's decision to massively raise non-interest-based expenditure, by 33 percent. A higher than planned primary fiscal deficit would likely worsen the outlook for inflation and the current

account, and would undermine the durability of recovery, so correctly argued the MPS. And finally, the MPS notes that the "real money supply growth has accelerated in recent months...with economic recovery on a sound footing, there is a need to pare back this growth...the recent rise in banks' cash reserve requirements would help in this regard." Domestic borrowing largely through issuance of Pakistan Investment Bonds to fund the over a trillion rupee rise in outlay in the current year compared to the year before at a higher rate now would fuel not reduce inflation.

Following clarification/rebuttal was issued to Business Recorder in response to an Editorial published on November 22, 2021 titled 'Monetary Policy Statement'.

Rebuttal for Business Recorder Editorial on Monetary Policy Decision

With regard to the editorial in Business Recorded dated November 22, 2021 titled "Monetary Policy Statement", the State Bank of Pakistan would like to clarify some of the points raised.

First, the editorial appears to opine that the Monetary Policy Committee's decision to raise interest rates by 150 basis points was higher than the market's perception of a "75-100 bps" increase. In this regard, the SBP would like to refer to a BR report dated November 17, 2021, titled "MPC to meet ahead of schedule: 100-200bps hike in policy rate expected". In addition to the headline, the report points out that "the committee is expected to further tighten the monetary policy due to rising inflationary pressure on the economy and higher current account deficit. The market is expecting an increase of 100 to 200 basis points in the key policy rate in its rescheduled meeting to be held on Friday." In another report, dated November 19, 2021, the BR pointed out that "the secondary market yields in the money market have already moved up by 100-125 bps over the last policy rate change and any change in the policy rate (up to 100-125 bps) is already priced in". As such, the decision to raise the policy rate by 150 bps was not as far out of line with the market's expectations as the article implies.

Second, the editorial seems to associate the reference to monetary policy normalization by the MPC with supposed commitments with the IMF. Here, it is worth noting that the SBP, like many central banks across the advanced and developing economies, has kept real interest rates in negative territory for a prolonged period after the Covid-19 outbreak. This policy stance was quite necessary and eventually proved crucial in the economic rebound witnessed from the start of FY21. At the same time, such an accommodative stance and negative real interest rates were going to be eventually phased out. In the January 2021 MPS, the SBP had implicitly referred to the reversal of the accommodative policy stance "as the recovery becomes more durable and the economy returns to full capacity". This was then made much more prominent in the September 2021 MPS, which noted that "the priority of monetary policy also needed to gradually pivot from catalyzing the recovery after the Covid shock toward sustaining it" by "gradually tapering the significant monetary stimulus provided over the last 18 months". Subsequently, with growth prospects continuing to improve and risks rotating towards inflation and the current account somewhat quicker than anticipated, it was appropriate for this reversal to be accelerated.

Third, the editorial points out that "…critics of the monetary policy decisions during the ongoing International Monetary Fund (IMF) program have consistently accused the SBP and the MPC of following the Fund's dictates without providing an appropriate in-house context (including the fact that before May 2019 the discount rate was linked to core inflation as opposed to the Consumer Price Index)." Here, it is important to note that while the SBP has always analyzed trends in core inflation, it has never explicitly stated in any of its monetary policy statements or the State of the Economy Reports, that it sets the policy rate based *solely* on the trends in core inflation. Though, a high core inflation is

always a source of concern for the central bank. The November 2021 MPS also notes that "core inflation has also picked up in the last two months, rising to 6.7 percent (y/y) in both urban and rural areas on the back of house rents, cloth and garments, medicines, footwear, and other components". Importantly, core inflation is one of the indicators to gauge the underlying inflationary pressures. Note that the inflation target announced by the government corresponds to the National CPI inflation which is currently set at 5-7 percent, to be achieved over the medium-term.

Following clarification was published in Business Recorder, Karachi on November 24, 2021

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Karachi, Wednesday 24 November 2021, 18 Rabi-us-Sani 1443

'Monetary Policy Statement': clarification by SBP

KARACHI: With regard to the editorial in Business Recorder dated November 22, 2021 titled "Monetary Policy Statement", the State Bank of Pakistan would like to clarify some of the points raised.

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