Monetary Policy Statement

May 20, 2017

Real GDP growth in FY17 is provisionally estimated at 5.3 percent representing a 10 year high. Specifically, the revival of domestic demand has been instrumental in the current upturn. The major thrust has come from the ongoing public and private investment particularly in infrastructure and power sector. Furthermore, consumer spending has also expanded with a stable inflationary environment and banks' renewed interest in consumer financing. On the supply side, recovery in major crops from last year, better energy supplies, and a broad based increase in Large-scale Manufacturing have facilitated this expansion.

With further improvement in economic activity along with pass through of the recovering global oil prices to domestic motor fuel cost, headline CPI inflation has also edged up in recent months. Going forward in FY18, current trends of rising income, surge in imports, and accelerating credit to private sector are expected to increase the CPI inflation; however, it is likely to remain within the target.

The upbeat economic sentiments and low interest rates have encouraged the private sector to undertake capacity expansions. Private sector credit posted a net expansion of Rs 503 billion during Jul-Apr FY17, which is significantly higher than the uptick of Rs 334 billion in the corresponding period of last year. This was led by an increase in both the working capital and fixed investment loans; whereas, consumer financing also maintained the uptrend seen in the past few months. Notably, the credit flow to private businesses remained broad-based with major impetus from textile & garments, chemicals, sugar, construction, and power sectors. In tandem with the expansion in the economic activity, private sector credit uptake is expected to continue in FY18.

The supply of credit remained at ease because of the healthy growth in bank deposits and government's reliance on central bank financing along with net retirement to commercial banks. Also, calibrated open market operations by the SBP to manage residual liquidity demand played its part, besides keeping the overnight repo rate generally close to the policy rate. Reflecting these developments, money supply (M2) grew by 13.8 percent (YoY) in Apr FY17as compared to 13.0 percent (YoY) during the same month last year.

The expansion in economic activity has led to a concomitant surge in import payments during Jul-Apr FY17. On the other hand, exports have posted only a marginal recovery; whereas, workers' remittances also slowed down this year mainly owing to the changing labor market dynamics in the GCC region. All these factors led to a sharp widening of the current account deficit during Jul-Apr FY17, compared to the same period last year. As the financial inflows did not entirely cover the current account imbalance, the overall balance of payments turned into deficit from a surplus in the same period last year.

Going forward, official inflows are expected to provide support to foreign exchange reserves. A sustained increase in other private inflows – foreign direct investments and export earnings in particular – is required to fully finance the surge in imports. In this regard, accompanied with expected improvements in global demand, the current composition of imports, mainly machinery, bodes well for the future economic activities. Furthermore, the current growth momentum led by CPEC related investments is likely to boost foreign direct investment inflows.

Keeping these factors in view, the Monetary Policy Committee of SBP has decided to keep the policy rate unchanged at 5.75 percent.