MINUTES OF THE 6th MEETING[1] OF
THE MONETARY POLICY COMMITTEE (MPC)
Held on November 24, 2017

P R E S E N T

Mr. Riaz Riazuddin	Chairman (A)/ Deputy Governor (Policy)
Mr. Jameel Ahmad	Deputy Governor (Banking & FMRM)
Mr. Inayat Hussain	Executive Director (FS & BSG)
Khawaja Iqbal Hassan	Director SBP Board
Mr. Ardeshir Khursheed Marker	Director SBP Board
Mr. Mohammad Riaz	Director SBP Board
Dr. Asad Zaman	External Member
Dr. Qazi Masood Ahmed	External Member
Dr. Aliya Hashmi Khan	External Member
Mr. Mohammad Mansoor Ali	Secretary to the Committee/Corporate Secretary

Review of Current Economic Conditions and Outlook for FY18

1. Monetary Policy Department staff apprised the Committee on developments in key macroeconomic indicators since the September 2017 Monetary Policy decision, along with the assessment of evolving trends.

2. CPI on year-on-year (YoY) basis decreased to 3.8 percent in October FY18 as compared to 4.2 percent a year earlier, whereas average inflation for Jul-Oct FY18 decreased to 3.5 percent, as compared to 3.9 percent for Jul-Oct FY17. The decrease in inflation can be attributed to food inflation which on YoY basis fell to 2.2 percent in October FY18 from 4.4 percent a year earlier. Non-food non energy (NFNE) inflation slightly increased to 5.3 percent in October FY18 from 5.1 percent in the corresponding month of the previous year. The marginal increase in core inflation can be attributed to rising cost of services, mainly house rent, education and medical services. Overall, benign inflation despite strong GDP growth indicates that supply side is responding well to increasing demand.

3. On 12-month moving average basis, CPI headline inflation stood at 4.0 percent in October FY18 as compared to 3.6 percent in October FY17. The scenario analysis, in order to ascertain the impact of various risks, shows that even after incorporating various possible shocks such as an increase in energy price, higher government borrowings and adjustment in the exchange rate, headline inflation will be well within the projected range estimates of 4.5-5.5 percent for FY18. However, barring these shocks, headline inflation is expected to remain close to the lower bound of this forecasted range in FY18. Furthermore, this outlook accounts for the latest increase in administered prices of petroleum products in November FY18 and recent imposition of regulatory duties on certain non-essential import items.

4. Broad money (M2) registered a contraction of 0.3 percent during Jul 01 - Nov 03, FY18 as compared with a growth of 0.8 percent in the corresponding period of FY17. On a YoY basis, M2 registered a growth of 12.4 percent as on November 3, FY17 as against growth of 14.3 percent a

[1] Meetings are numbered on a calendar year basis.

year ago. Lower expansion in M2 was mainly due to contraction in NFA, as the current account deficit widened. The decrease in NFA was mostly offset by an increase in NDA, which was contributed by higher government borrowing from SBP and scheduled banks, as well as increased credit to private sector. Despite increased reliance on the Central Bank rather than scheduled banks for budgetary support, the government borrowings from the SBP remained lower at Rs. 324 billion for Jul 01 - Nov 03 FY18 as compared to Rs. 878 billion in the corresponding period last year. Contraction in M2 was matched by a decline in deposits of banks during Jul 01-Nov 03, FY18, although currency in circulation (CiC) showed a marginal increase. However, the volume of CiC remained the lowest for the corresponding period of any year since FY09. The currency-to-deposit ratio remained stable at 37.0 percent since last year.

5. Credit to private sector (PSC) registered an increase of Rs.20 billion during Jul 01- Nov 03, FY18, as against a contraction of Rs. 28 billion observed in the corresponding period of last year. On YoY basis, PSC recorded a robust growth of 18.0 percent as on November 03, 2017, as compared to 11.5 percent growth on the corresponding point of the last year. The YoY flow for September FY18 shows credit uptake of Rs. 834.7 billion as compared with Rs. 348.0 billion for September FY17. The credit demand for consumer financing also remains strong as shown by a YoY growth of 20.2 percent in September FY18. However, credit to public sector enterprises exhibited a contraction of Rs.19 billion during 01 Jul - 03 Nov, FY18, as against an expansion of Rs. 53 billion in the corresponding period of last year. Going forward, private sector credit off-take is expected to remain strong in the remaining period of FY18 owing to strengthening of aggregate demand, optimistic business outlook, and buoyant demand for fixed and working capital investments loans.

6. Fiscal deficit in Q1-FY18 is estimated at 1.2 percent of GDP compared to 1.4 percent in the corresponding period of the previous year. The contraction in the fiscal deficit is due to strong revenue generation and was likely supported by curtailed current expenditures. Both direct and indirect taxes have contributed to higher revenue. The direct and indirect taxes increased to Rs. 282.9 billion and Rs. 482.1 billion in Q1-FY18 from Rs. 233.7 billion and Rs. 393.1 billion respectively, in the corresponding period of the previous year. Higher revenue generation was supported by increased tax collection by FBR which posted a growth of 22.0 percent in Q1-FY18 as compared to 6.3 percent in the corresponding period of the previous year.

7. The external current account deficit was recorded at USD 5.0 billion in Jul–Oct FY18 as compared to USD 2.26 billion during the corresponding period of the previous year. Contributing factors in this higher deficit were higher oil and non-oil imports and absence of CSF inflows during the aforesaid period. The workers' remittances recovered from anticipated slow down of post Eid period to reach USD 6.44 billion during July-October FY18, as compared to USD 6.30 billion during the corresponding period last year. This increase in remittances emerged mostly from advanced economies that compensated for the lower remittances from GCC region. The net FDI flows hit a 9-year high to reach USD 937 million during Jul-Oct FY18, as compared to USD 501 million in the corresponding period of the previous year. China, Malaysia, France, Hungary and UAE were the major contributors to the net FDI inflows. Foreign Portfolio Investment (FPI) flows recorded net outflows of USD 176 million in this period as compared to inflows of USD 1,168 million in the corresponding period of the previous year. The overall balance of payments posted a deficit of USD 2.5 billion for Jul-Oct FY18 as compared to a surplus of USD 797 million in the corresponding period of the previous year. Consequently, SBP's net liquid reserves stood at USD 13.49 billion on end October 2017, providing coverage for almost 2.7 months of import payments. Going forward, progress on CPEC related projects and other official proceeds will be instrumental in managing the overall balance-of-payments deficit in FY18.

8. The growth momentum remained strong across the board, providing higher confidence in attaining growth target of 6.0 percent for FY18. LSM growth for Jul-Sep FY18 remained at 8.4 percent which is in contrast to a seasonal trend of lower growth usually seen during this period. Main contributors in LSM growth were automobiles, steel, cement, food and petroleum products due to both, favorable supply and demand conditions. However, growth in textile and fertilizer sectors remained subdued, which along with relatively lower performance in mining and quarrying, may limit industry growth to 7.0 percent against the year-end target of 7.3 percent. However, healthy trends in services and agriculture sector are expected to keep the overall GDP growth target attainable. Crop estimates released by the government in October FY17 reaffirmed an increase in cultivation area for cotton, sugarcane and rice by 10.7, 7.7 and 5.8 percent respectively. This, amid other favorable conditions, supports the projections that agriculture will surpass the 3.5 percent growth target for FY18.

Financial Markets and Reserve Management

9. The staff informed the MPC that the average overnight rate has hovered close to the policy rate of 5.75 percent since the monetary policy review in September 2017. The overnight weighted average repo rate stayed at 5.78 percent, though its volatility increased slightly due to deviation from the pre-announced auction targets of the government securities, particularly rejection of PIB auctions. Non-issuance of long term securities by the government also resulted in lack of liquidity in long tenors with resultant marginal downward shift in the yield curve of longer tenors. This shift cannot be attributed to any change in market expectations as current yields of all tenors remained higher than the respective point in time last year. Consequently, the share of shorter-tenor government securities continued to increase. The outstanding stock of SBP's liquidity injections also remained relatively unchanged at Rs. 1.5 trillion.

Model-Based Assessment

10. Research Department staff apprised the MPC on the latest projections of the Forecasting and Policy Analysis System (FPAS).

11. The MPC was informed about the main assumptions of the FPAS model output which includes assumptions on oil prices for the next quarter, the latest FOMC projections for the US Federal Funds rate path and US inflation for the next 8 quarters, in addition to now-casting of domestic headline, food and core inflation for December 2017, fiscal deficit to GDP for H1-FY18 and output gap consistent with annual target growth rate of 6.0 percent in FY18.

12. Conditional on the latest data and aforementioned now-casting assumptions, the extended FPAS model suggests a relatively smaller policy interest rate cut than the September 2017 MPC meeting. The smaller policy rate adjustment is mainly driven by an expected increase in inflation and inflation expectations which could be attributed to recent impositions of regulatory duties, upward adjustments in administered oil prices and an improvement in output gap. This will be off-set somewhat by the likely reduction in aggregate demand due to lower fiscal impulse recorded during Q1-FY18 from the corresponding period last year. A restraint on government expenditures and a robust tax collection explain the lower fiscal impulse during Q1-FY18.

13. In terms of FPAS projections, average headline inflation projections for FY18 is revised upward to 4.7 percent from 4.6 percent reported in the last MPC meeting. The core inflation projection for FY18 has been revised upward to 5.6 percent from 4.7 percent reported earlier

which is in line with the latest reading of IBA-SBP's Consumer Confidence Survey showing an increase in inflation expectations compared to the previous survey conducted in September 2017.

14. Despite the lower fiscal impulse, the output gap for Q2-FY18 is set at a positive level to reflect an uptrend in LSM, witnessed during the first three months of FY18, an increase in the private sector credit and other real sector activities. The improved output forecast ties up with encouraging trends in textile sector, which recorded a growth of 0.68 percent during Jul-Sep, 2017, despite the continued loss of competiveness as indicated by persistent bilateral real exchange rate gap.

15. At the end, staff explained different alternative scenarios of policy rate and its impact on the output gap, inflation and real interest rate. It was explained that with the incorporation of relatively higher fiscal deficit (which is expected due to political budget cycles) and higher international oil prices, the model suggests even a smaller cut in the policy rate.

Result of Surveys on Monetary Policy

16. Results of surveys on consumer confidence index (CCI), and inflation expectations were also shared with the Committee. MPC was informed that overall CCI was slightly lower and expected inflation was slightly higher than the level recorded two months ago.

Monetary Policy Deliberations and Decision Vote

17. After conclusion of the presentation and the discussion with staff, the MPC voted on the policy rate decision. Deliberations led to formulation of views for keeping the policy rate unchanged.

18. Voting in favor of maintaining status quo, members were of the view that the present level of the policy rate is yielding positive results in terms of supporting growth amid below-target inflation, though there is a need to remain cautious of the weakness in the external account.

19. In conclusion, the Committee decided to maintain the policy rate at its present level of 5.75 percent with a unanimous vote of all 9 members present and voting.

20. The Committee then reviewed the draft Monetary Policy Statement and advised some amendments.

21. The MPC decided as follows:

DECISIONS:

- *The policy rate is kept unchanged at 5.75 percent.*
- *The Monetary Policy Statement – November, 2017 is approved.*