MINUTES OF THE 6th MEETING[1] OF
THE MONETARY POLICY COMMITTEE (MPC)
HELD ON FRIDAY, NOVEMBER 22, 2019

PRESENT

Dr. Reza Baqir	Chairman & Governor SBP
Mr. Jameel Ahmad	Deputy Governor (Banking & FMRM)
Dr. Inayat Hussain	Executive Director (FS&BSG)
Dr. Saeed Ahmed	Chief Economist
Mr. Azam Faruque	Director SBP Board
Mr. Atif R. Bokhari	Director SBP Board
Dr. Tariq Hassan	Director SBP Board
Dr. Asad Zaman	External Member
Dr. Hanid Mukhtar	External Member
Dr. Naved Hamid	External Member
Mr. Mohammad Mansoor Ali	Secretary to the Committee/Corporate Secretary

Review of Current Economic Conditions and Outlook for FY20

1. The Monetary Policy Department staff apprised the Committee on developments in key macroeconomic indicators since the September 2019 Monetary Policy decision, along with an assessment of evolving trends.

2. While discussing inflation, the Committee was apprised that PBS has released a new data series on national CPI, which is a weighted average of urban CPI, and rural CPI. The Staff explained the issues pertaining to rural CPI and the statistical techniques used to address them.

3. It was stated that YoY National CPI inflation in October 2019 was 11.0 percent. Similarly, the Urban CPI inflation was recorded at 10.9 percent whereas rural CPI inflation was 11.3 percent. This uptick in CPI inflation is due to higher food and energy prices. Presenting the heat-map of CPI inflation, it was explained that food inflation became the major contributor to headline inflation in all indices of the new base as well as in old base numbers followed by the core inflation and energy inflation. It was highlighted that the food inflation was contributed by both perishable and non-perishable food items. While discussing MoM changes in CPI inflation, it was informed that MoM inflation recorded an increase of 0.8 and 1.8 percent in September and October 2019 respectively. It was added that the October2019 inflation was high due to an increase in food prices and house rents. Discussing the outlook for inflation, staff apprised that the average CPI inflation is expected to remain within the range of 11 to 12 percent.

4. The SBP staff apprised that there was a contraction in the SBP's NDA of Rs.367 billion during Jul 01-Nov 01 FY20 against an expansion of Rs.181 billion during the same period last year, which is mainly due to net retirement of government borrowing. Similarly, there is an expansion of Rs.258 billion in the SBP's NFA during Jul 01-Nov 01 FY20 as compared to a contraction of Rs.186.0 billion in the corresponding period of FY19, primarily driven by an improvement in the country's external accounts. However, broad money (M2) grew by 12.8 percent YoY as of 1st November 2019 as compared to YoY growth of 9.7 percent at the same time last year. It was also observed that the composition of M2 has also changed during FY20 with growth coming from NFA of the banking system, mainly due to improvement in the country's external account. Discussing the government's budgetary borrowing, it was apprised that government borrowed entirely from scheduled banks. Last year during Jul 01-Nov 01, the

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

government borrowed Rs. 2.8 trillion from SBP whereas this year, the government retired Rs. 57 during the same period, which is also a key reason for the decrease in the SBP's NDA.

5. Discussing trends in Monetary Aggregates, it was highlighted that the NDA of the banking system fell by Rs.136 billion during Jul 01-Nov 01 FY20 as compared to an increase of Rs.197 billion in the same period last year. Most of the contraction in the NDA was due to net retirement of credit by the private sector and significant decline in credit to PSEs. During Jul 01-Nov 01 FY20, private sector credit witnessed a net retirement of Rs.4 billion against an expansion of Rs.223 billion in the corresponding period last year. The reason behind the contraction in private sector credit is the increased cost of borrowing along with slowdown in overall economic activity. It was added that the trends in private sector credit depends on the supply and demand conditions. On the supply side, on cumulative basis the bank deposits witnessed a decline during first four month of FY20, however, on YoY basis the deposits grew by 10.3 percent as of November 1, FY20 as compared to 8.1 percent at the same time last year. Moreover, it was highlighted that there is a shift in personal deposits from non-remunerative to remunerative deposits, attributed to increase in interest rates. However, the SCRA flows had a positive impact on the supply side, recording an inflow USD 434.2 million during Jul-Oct FY20, as compared to an outflows of USD 291.5 million during the same period last year. Further, it was observed that although NPL are slightly high but on an overall basis, aggregate supply conditions are favourable for private sector credit.

6. While discussing demand conditions in private sector credit, it was informed that WALR has increased by around 600 bps since June 2018. This increase in the WALR and higher risk premium have contributed to lower credit demand. Lower demand for private sector credit is also visible from the continued decline in the loan applications. Further, discussing the reduction in demand conditions that may be due to firm constraints, it was informed that inventories are rising and sales are decreasing, reducing profits.

7. On the outlook of private sector credit, it was informed that the expected growth in private credit for FY20 has been revised upwards to incorporate the impact of significant increase in credit limits and relatively higher anticipated utilization of exports financing (EFS) and Long-term Financing Facility (LTFF).

8. While discussing the fiscal deficit, it was informed that the fiscal data for first quarter is yet to be released, however, from financing side the deficit for Q1-FY20 is estimated to be significantly lower than 1.4 percent of GDP in Q1-FY19. The improvement is primarily due to austerity measures, a recovery in FBR tax collection and non-tax revenues. The primary contribution to FBR taxes came from indirect taxes, which grew by 14.2 percent in first four months of FY20 as compared to same period last year. This improvement is an outcome of a rebound in sales tax collection from both domestic as well as imported goods. However, it was highlighted that as result of a contraction in import of vehicles, iron and steel goods there is a small decline in collection of custom duties.

9. Discussing the interest payments on debt, staff apprised the Committee that the provisional data indicate that overall interest payments increased by 16.3 percent during Q1-FY20 as compared to the same period last year. It was informed that external interest payments grew by over 60.0 percent, which was mainly attributed to a rise in interest rates, exchange rate depreciation and an increase in external financing. The development budget (PSDP releases) witnessed a growth of 143.8 percent in the first four month of FY20 as compared to the corresponding period last year. Highlighting the fiscal outlook for FY20, it was stated that the budget deficit is projected to remain close to the budget estimates.

10. While presenting the global economic conditions, staff informed that the IMF has again revised downward its global growth projections for 2019 to 3.0 percent. The global trade growth

is projected at 1.1 percent in 2019 and expected to recover to 3.2 percent in 2020. Further, the committee was apprised that keeping in view the subdued global growth and low inflation, many central banks are opting for an expansionary monetary policy stance. Further, it was highlighted that the decline in international oil prices during FY20 along with increase in prices of sugar, wheat and rice would have a positive impact on Pakistan's Balance of Payment (BoP).

11. While presenting the developments in the Balance of Payment (BoP) position since September 2019 MPC, it was informed that current account balance continued to improve and turned into a surplus in October 2019. This improvement was mainly driven by a contraction in the trade deficit of goods and services. It was informed that imports maintained their declining trend, whereas exports witnessed a modest recovery.

12. It was further explained that favourable trends in the trade balance show the unfolding impact of stabilization measures, with major contribution coming from exchange rate depreciation during the last year as well as other administrative measures. It was informed that exports recorded a YoY growth of 7.3 percent in October 2019 as compared to 5.1 percent growth in the same month last year. The increase in exports is not only contributed by higher volumes of textile goods but also attributed to non-traditional items such as small ships, food, chemicals, tractors and spare parts. The imports declined by 23.5 percent in October 2019, against 6.4 percent increase in October 2018. On the other hand, worker's remittances grew by 17.6 percent on YoY basis in September 2019, after showing a decline in the last two months. This increase was attributed to growth in remittances from Saudi Arabia, the United States, United Kingdom, United Arab Emirates, and other GCC countries. In the month of October 2019, there was a YoY decline of 2.9 percent. Further, the Committee was apprised that the SBP has revised the incentive structure to compensate the commercial banks for their efforts to increase remittances.

13. Further, discussing the financial inflows, it was explained that the financial account (net) was in surplus in September FY20 with USD112 million of inflows against net outflow of USD 292 million in the same month last year. The Foreign Direct Investment (FDI) on YoY basis doubled to USD 385.3 million in September FY20, which was mainly attributed to license renewal fee paid by Telenor Pakistan. On portfolio investment, staff apprised that in September FY20 it recorded an inflow of USD 292.0 million as compared to outflow of USD 15.0 million in same month last year. This inflow was largely due to investment in debt securities. As a result of these developments the foreign exchange reserves rose to USD 8.4 billion by mid of November 2019.

14. The staff apprised the committee that real GDP projections in November 2019, broadly remain close to 3.5 percent as discussed in September 2019 MPC. It was elaborated that there are slight revisions in sectoral growth to incorporate the impact of latest numbers, especially of LSM and crop estimates. Further, the projected growth in Services is adjusted to account for the knock on impact of small changes in the commodity producing sector.

15. During the first two months of FY20 the sales of automobile industry declined by 30.3 percent as compared to 2.8 percent in the same period last year. The decline is mainly attributable to rising prices, increasing cost of consumer finance and decline in real incomes. However, as a result of restrictions on imported vehicles the production of small cars having engine capacity below 1000cc witnessed growth in first four months of FY20 as compared to same period in FY19. The POL (Petroleum, Oil, & Lubricants) sales continued to decline due to change in the energy mix and a general economic slowdown. The pharmaceuticals witnessed a broad based decline of 14.4 percent during Jul-Aug FY20, compared to 11.5 percent decline in the corresponding period last year. However, the cement sector has not only witnessed a growth in exports during August FY20 but the local sales has also started to pick-up in the last two months.

16. The downside risks pertaining to forecast for GDP growth in FY20 includes: (1) supply shocks in the form of pest attacks and weather related calamities; (2) increase in input prices in industry; (3) fiscal constraints regarding budgeted public spending. The upsides for GDP growth in FY20 would be: (1) rebound in agriculture activities; and (2) initiation of work on planned infrastructure projects.

Financial Markets and Reserve Management

17. While apprising the committee on monetary policy implementation, ED-FMRM stated that overnight repo rate remained at 13.21 percent against the policy rate of 13.25 percent with volatility of 0.35 percent. Discussing the developments on the monetary side, he explained that in last two months the injections of SBP had declined substantially from more than Rs. 2.0 trillion in September FY20 to Rs. 575 billion in November FY20. The decline is mainly attributed to better fiscal management by the government and the rupee impact of new FX inflows in the market.

18. Further, it was informed that due to limit on budgetary borrowing from SBP in FY20, the Government has borrowed from scheduled banks to build buffers with SBP to meet its day-to-day cash needs and build buffers for large maturities. These buffers were more than Rs. 2.5 trillion in September FY20, which declined to Rs. 1.0 trillion in November FY20, indicating better cash management by the Government.

19. Discussing the trend in the residual maturity of GOP securities, ED-FMRM highlighted that in September FY20, almost 50.0 percent of the government debt has maturity period less than three months, which in November FY20 has shifted to tenors upto one year. This change in composition of MTBs will reduce the rollover risk which is important in the context of zero budgetary borrowings from the SBP. However, he stated that government is still accepting nominal amount in auctions of long dated PIBs, which is adversely impacting the liquidity in long tenors. The yield of 10- year bond has declined sharply to around 11.40 percent from 12.48 percent since MPC September 2019. This decline in 10 year bond yields reflects expectations and also the nominal supply in long tenors.

20. While presenting the data of SBP's liquid foreign exchange reserves and swaps / forward liabilities it was observed that in the last four months, reserves have increased by USD 1.2 billion while the swap/forward liabilities have declined by USD 2.0 billion. Accordingly, net non-borrowed reserves have started to increase, enabling SBP to build FX buffer worth USD 3.2 billion.

21. At the end apprising the committee about the market expectations regarding policy rate, it was informed that market is expecting a status quo.

Result of Surveys on Monetary Policy

22. The Research staff presented the results of different surveys to MPC. It was apprised that there is a marginal decline in the Consumer Confidence Index (CCI) in November 2019 as compared to September 2019. The Expected Economic Conditions Index (EECI) also decreased moderately and continues to remain in negative territory. The Current Economic Conditions Index (CECI) also declined between the last two waves and reaching the lowest level of the last few years in November 2019. While giving the possible explanations for consistent decline in CECI over the last six months that is also driving the decline in CCI, the Committee was apprised of the significant correlation found between the CECI and perception of households regarding current food prices. Whereas, the moderate correlation was found between CCI and perception regarding food prices.

23. Discussing the inflation expectation indices, it was apprised that overall, food and NFNE inflation expectations were hovering at almost the same level in November 2019 as they were back in September 2019. However, there was slight increase in energy inflation expectations index between the last two waves. On the quantitative measure of inflation expectations, it was informed that 6-months forward household inflation expectations have witnessed a minor uptick in November 2019 relative to September 2019.

24. Discussing the Business Confidence survey, it was stated that there is an improvement in overall business confidence, current business confidence, and expected business confidence in the latest wave of survey conducted in October, 2019 relative to August 2019. The results also suggests that positive sentiments are more predominant in the services sector compared to the industry sector. The improvements are visible the results. Further, it was apprised that after a decline in the Purchasing Managers Index (PMI) in last five waves of the survey, the PMI has started to pick up. Finally, relative to previous wave six-month ahead inflation expectations of businesses have fallen.

25. Further, the results of a new 'Survey of other Forecasters' were shared with the Committee. The staff apprised the Committee that the survey was conducted for the first time on the advice of the Governor. The survey methodology and results were shared with the members. The results of the survey suggest that expectation of external forecasters regarding GDP growth in FY21 is higher than the expected growth for FY20. Whereas, the average inflation in FY20 is expected to be around 12.0 percent.

26. The staff also apprised the Committee that for the first time in last six quarters results of 'Bank Lending Survey' show a decline in the expected cost of borrowing from previously elevated levels. Finally, the result of Internal Monetary Policy Poll' were shared with Committee.

Model-Based Assessment

27. Research staff apprised the Committee about the adjustments in the model to reflect the changes in CPI index. The staff also presented a comparison of the now-casting assumptions of the FPAS used in the September 2019 meeting of the MPC and the actual realization of Q4-FY19 data. MPC was also apprised about the main assumptions of the latest FPAS output that included: (i) upward adjustment in electricity tariffs, (ii) international oil prices for FY20, (iii) fiscal deficit for FY20 and FY21, and (iv) the latest FOMC projections for the US policy rate & inflation.

28. Discussing the baseline assumptions, the staff apprised the committee that the now casting of headline inflation for FY20 has been revised downwards in November 2019. This downward revision is mainly attributed to a lower than projected inflation during Q1FY20, weaker fiscal impulse due to improvement on fiscal side and appreciation in nominal exchange rate. Updates on the assumption for FY20 about exchange rate, oil prices and fiscal deficit were also discussed.

29. Given the aforementioned assumptions, the model suggested a moderation in the upward revision of the policy rate by Q2-FY20 compared to the output of September 2019. It was elaborated that the proposed moderate adjustment in the policy rate would reflect consistency with the modified uncovered interest rate parity condition, decline in projected headline and core inflation for FY20 along with stable oil prices and slight appreciation in the exchange rate.

30. At the end, staff presented various projections based on alternative scenarios for: (i) nominal exchange rate, (ii) international oil prices, (iii) fiscal deficit, and (iv) output gap. The committee had detailed deliberations on all the scenarios and their possible implications for the policy rate.

Monetary Policy Deliberations and Decision Vote

31. While deciding about the monetary policy stance for the next two months, the Committee considered the following points: (i) aggregate demand and supply situation; (ii) sentiments in foreign exchange market and overall expectations ; (iii) stabilizing external sector (iv) potential adjustments in utility tariffs and (v) higher recent month-on-month headline.

32. Concluding the deliberations, the members voted on the policy rate decision.

33. The MPC decided to maintain the policy rate at status quo with a majority vote of 8 out of 10 members, with two votes for decreasing the policy rate by 25 bps.

34. The Committee then scripted the Monetary Policy Statement.

35. The Committee decided as follows:

DECISION:

- *The policy interest rate is kept unchanged at 13.25 percent.*
- *The Monetary Policy Statement –November 2019 is approved.*