MINUTES OF THE MONETARY POLICY COMMITTEE (MPC) MEETING
HELD ON MARCH 17, 2020

P R E S E N T

Dr. Reza Baqir	Chairman & Governor SBP
Mr. Jameel Ahmad	Deputy Governor (Banking & FMRM)
Dr. Murtaza Syed	Deputy Governor (Policy)
Dr. Inayat Hussain	Executive Director (FS&BSG)
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. Haroon ur Rehman	Secretary to the Committee

Review of Current Economic Conditions and Outlook for FY20

1. The staff apprised the Monetary Policy Committee (MPC) on the developments in key macroeconomic indicators since the January 28, 2020 Monetary Policy decision, along with an assessment of evolving trends in global and domestic indicators in general and in the wake of Covid-19 in particular.

2. In the start, the Committee was appraised that presentations have been tailored according to recent coronavirus outbreak, starting with an overview of economic developments before the outbreak, the impact of the outbreak on global economies with a particular focus on Pakistan and an outlook of global and domestic macroeconomic conditions, as well as various scenarios that encompassed the pre and post Covid-19 analysis.

3. Giving an overview of the real sector developments, the staff apprised the Committee that the agriculture growth projection has been revised downward from 2.9 percent in January FY20, mainly due to downward revision in area under wheat cultivation and rice production estimate. Discussing the Large-scale Manufacturing (LSM), it was explained that the LSM production grew by 16.0 percent on M/M basis and 9.4 percent on Y/Y basis in December 2019, major contribution coming from increase in sugar production. It was also explained that excluding the impact of sugar production, the decline in LSM was much lower in December 2019 compared to December 2018, this shows that LSM growth in December was relatively broad-based and was also supported by higher production of export-oriented sectors of textile and leather, uptick in cement demand and bottoming out of contractionary trends in sectors like food, electronics, steel, etc..

4. Further, it was explained that the analysis of demand side indicators shows that sales numbers have been bottoming out, though these still remain in negative territory in some cases. Discussing the automobile sales, it was pointed out that sales of below 1000 cc cars and three wheelers have started to increase. However, on an overall basis, the automobile sector witnessed a decline, which can be attributed to several factors, including high cost of borrowing, a decline in the real disposable income, exchange rate depreciation and increase in the Federal Excise Duty (FED). Further, the staff apprised that the import of machinery has increased as of December FY20, mainly due to the electrical, construction and power sectors. Moreover, it was highlighted that the import of textile machinery has increased by 29.0 percent on M/M basis in January 2020. The Committee observed that the increase in machinery imports suggest an increase in the investments among the aforesaid sectors of the economy. In the same vein, it was explained that

gradually rising demand for POL from industry and transport sectors was also pointing to gradual uptick in real economic activity.

5. The staff apprised that another important development was a persistent increase in the domestic cement sales since September FY20, which is supported by construction activity in both the private and the public sector. Further, it was informed that the significant increase in PSDP spending during H1-FY20 has not only benefited the cement sector but it has also boosted construction-allied activities.

6. Finally, an assessment of employment conditions in LSM industries reflects that after showing a steep decline during Mar-June FY19, the trend has reversed especially in case of employment in textile sector, which is consistent with rising export volumes.

7. While giving an overview of developments in financial market, the staff apprised that the pace of accumulation in SBP's foreign exchange reserves continued during December – February FY20, with contributions coming from the contraction in the current account deficit and portfolio inflows in debt securities. It was also highlighted that the build-up in foreign exchange reserves was accompanied by a substantial reduction in SBP's forward liabilities reflecting increased build-up of FX buffers. However, it was highlighted that although, portfolio investment registered an inflow of USD 1.4 billion in January FY20 but during March 2020 so far portfolio investment witnessed outflows primarily due to the coronavirus outbreak.

8. Discussing the details of the Private Sector Credit (PSC), it was informed that PSC witnessed an increase of Rs. 243 billion during Jul 01 – Mar 06 FY20, as compared to Rs. 554 billion in the corresponding period last year. Both, working capital and fixed investment components of private credit continued to decelerate. The working capital loans decelerated to Rs. 63.8 billion during Jul-Jan FY20 as compared to Rs. 453.0 billion in the corresponding period last year. Similarly, fixed investment loans witnessed a net contraction of Rs. 5.6 billion during Jul-Jan FY20 as compared to an expansion of Rs. 48.3 billion in the same period last year. Further, it was highlighted that the PSC during FY20 is largely driven by SBP refinancing schemes. On a query, it was explained that the share of credit availed through SBP refinancing schemes in overall private sector credit off-take increased to 50.1 percent during Jul-Mar FY20 as compared to 17.1 percent in the corresponding period last year.

9. The staff then apprised the Committee about post COVID-19 developments. It was explained that the biggest problem associated with this shock is the level of uncertainty it has created in the world markets. As it is related to human health, so, it is unlike traditional shocks which stem from either financial markets or the real sectors of the economy. Thus, keeping in view the COVID-19 pandemic the global economic outlook is quite uncertain. Further, it was explained that risks of slowing down of the global economy is evident from a declining trend in commodity prices, international oil prices, world equities and low business and consumer confidence. It was further highlighted that global manufacturing Purchasing Manager Index (PMI) has declined significantly from 50.4 in January FY20 to 47.2 in February FY20, mainly due to a steep decline in PMI of China. On an overall basis, the volatility in the financial markets has increased, however, it is still lower than the volatility experienced at the time of Global Financial Crisis of 2008.

10. Discussing global developments, it was further explained that the Organization for Economic Co-operation and Development (OECD) has cut its global GDP growth projection by half percentage points for CY20, keeping in view the global economic conditions. Similarly, according to the assessment of Asian Development Bank (ADB), the decline in global GDP may range from 0.1 to 0.4 percentage points depending upon the intensity of COVID-19 pandemic. Further, based on ADB's assessment, it was explained that Pakistan's economy is relatively less vulnerable as compared to other Asian economies.

11. Further, the Committee was apprised regarding the decline in global stock markets. It was explained that coronavirus outbreak has resulted in a 8.2 percent decline in world equity index during February FY20. All equity markets across the globe have suffered losses and Pakistan's equity market is no exception.

12. Giving an overview of global currencies, it was explained that the Japanese Yen, Euro and Egyptian Pound have appreciated against USD since last MPC meeting held in January FY20. However, most of the emerging market currencies have depreciated against the USD during the last two months. Similarly, after the rising impact of coronavirus on global economy, Pak rupee has also depreciated by 2.9 percent (since MPC held in January 2020) under the market-based exchange rate system to absorb the effect of the shock.

13. While sharing the latest developments in international bond markets, it was explained that Pakistan's risk premium (change in 5Y Credit Default SWAP Points) has increased after the Coronavirus outbreak but the increase is relatively moderate as compared to other emerging market economies. Responding to a query, it was explained that since the last MPC decision to keep the policy rate unchanged, the inverted yield curve has shifted further downwards, reflecting market expectations of lower interest rates. The expectations largely reflect the notable deceleration in CPI inflation data released in February FY20, improved external sector position and monetary easing by several central banks.

14. Further, discussing Pakistan's trade dependence, it was explained that in the case of both imports of capital and consumer goods, Pakistan relies heavily on China. As a result of Coronavirus outbreak, the supply disruption from China may hamper economic activity in Pakistan. On a query, it was explained that businesses in China have started to reopen and economic activity might gain some momentum if the epidemic comes under control. The staff then presented different scenarios that took into account the revisions of multiple intensities in global GDP, international oil prices and exchange rate. In all scenarios, the impact on current account for remaining part of FY20 is likely to be benign in the backdrop of decline in global oil prices and relatively subdued exports. Moreover, the staff informed that the remittances are expected to remain stable, however, the FDI is expected to decline slightly in FY20. As a result, the real GDP growth for FY20 is expected to be well below our earlier projection of around 3.5 percent. Nevertheless, the GDP growth for FY21 is expected to improve provided that the impact of Coronavirus remained confined to the first quarter of FY21. The Committee was of the view that the scenario analysis is very optimistic and globally things are not moving so smoothly. With 'lock-down' in Europe, USA, KSA and UAE, the exports would hamper badly and remittances might also decline.

15. The staff then discussed the implications of macroeconomic developments for inflation and interest rates. It was apprised that going forward, the decline in global oil prices would have a favourable impact on inflation. It was explained that global oil prices have declined substantially during last few weeks and are expected to remain low keeping in view the world economic outlook. Further, the Committee was informed that in response to the Coronavirus outbreak, sixteen central banks have reduced interest rates during Mar 01 – Mar 12, FY20. It was also highlighted that the advanced economies have reduced the interest rates substantially while the emerging economies have responded cautiously with relatively small cuts in the rates. Discussing the global fiscal responses to Coronavirus outbreak, it was elaborated that the appropriate fiscal impulse would be required in addition to monetary easing by the central banks to combat this crisis.

16. Further, the Committee was apprised about the non-interest rate initiatives taken by the SBP. Firstly, a Temporary Economic Refinance Facility (TERF) has been introduced to provide temporary support to the economy during this turbulent period associated with the global impacts of the Coronavirus outbreak through concessional refinance for setting up new industrial

units in the country. It was also highlighted that it would support the domestic manufacturing activities.

17. Secondly, the Committee was informed about the 'Refinance Facility for Combating COVID–19 (RFCC)'. Under this facility, SBP will provide time bound refinance facility support for hospitals & medical centres to purchase new imported and locally manufactured medical equipment to be used for combating COVID–19. It was explained that all the hospitals and medical centres duly registered with their respective federal/provincial health agencies/commissions and engaged in controlling & eradication of COVID–19 will be eligible under this facility. On a query, it was apprised that the SBP refinance rate on this facility would be zero to keep the end user rate at the minimum. After the detailed deliberation, the Committee agreed to move forward with these financing facilities.

18. Turning to inflation, it was stated that Y/Y National CPI inflation declined to 12.4 percent in February FY20 after rising sharply to 14.6 percent in January FY20. Likewise, Y/Y Urban CPI fell to 11.2 percent in February FY20 after rising to 13.4 percent in January FY20 and, Y/Y inflation in rural CPI declined to 14.2 percent in February FY20 from 16.3 percent in January FY20. The decline in inflation in February FY20 is attributed to moderation in prices of perishable and non-perishable food items owing to reasonable food supplies of perishables and administrative measures to control market irregularities. While discussing the core inflation, it was apprised that Y/Y core inflation in February FY20 recorded at 8.0 and 9.4 percent in urban and rural areas respectively. This uptick in core inflation is primarily due to higher inflation in Services in both urban and rural centres.

19. Further, the staff apprised the Committee that keeping in view recent developments, the average CPI inflation for FY20 is expected to remain in range of 11.0 to 12.0 percent. It was also highlighted that in FY21 National CPI inflation is likely to fall further. However, it was explained that the FY21 forecast might be revised depending on the taxation measures, utility tariffs, international crude oil prices and other adjustments that would be announced in the federal budget -FY21.

Result of Surveys on Monetary Policy

20. The staff apprised the Committee that the last wave of the Consumer Confidence Survey (CCS) was conducted during the first week of March 2020 after the reduction in domestic oil prices. However, it was highlighted that the completion of the survey was followed by some important developments related to coronavirus. It was informed that the latest wave of CCS showed a significant decline in the consumer inflation expectations across all indices i.e. food, energy and non-food non-energy. While discussing the results of the quantitative measure of inflation expectations, it was informed that the decline in expected inflation is more pronounced in the latest wave compared to previous wave of January 2020.

21. Further, the staff apprised the Committee about the Bloomberg market survey regarding SBP's policy rate decision expectation. It was highlighted that 55 percent respondents were expecting a 50bps cut in the policy rate while 30 percent respondents were expecting a 100bps cut. On a query, it was informed that these results are in line with the results of SBP 'Survey of Other Forecasters' conducted earlier in the month.

Model-Based Assessment

22. Keeping in view the Coronavirus outbreak, the research staff apprised the MPC that additional assumptions have been incorporated in the model pertaining to emergency interest rate cut by

FOMC and the average exchange rate path to accommodate the recent exchange rate movements. The other main assumptions of the latest FPAS output includes: i) international oil prices around US$60 and US$ 58 per barrel for FY20 and FY21, respectively, and (ii) likely upward adjustments in electricity and gas tariffs.

23. Discussing the baseline assumptions, the staff presented the comparison of actual realization of February 2020 inflation data and the now-casting assumption about the end-quarter inflation used in the MPC meeting held in January 2020. The staff discussed the implications of deviations between numbers for the inflation projections path and the future policy interest rate path. It was added that since there is a higher than expected realization of inflation numbers, this has not only impacted the projected figures of inflation for this year but also changed the trajectory for future inflation moderately. As a result, the model suggested a slight upward revision in policy rate by Q3-FY20.

24. It was elaborated that while there are some moderate upward adjustments in the inflation projections for FY20 and FY21, nonetheless, the revised projections for FY20 remain within the inflation projection of 11-12 percent for FY20 and inching toward 5-7 percent over the medium term. Hence, the inflation path over the medium term remains broadly similar to the previous MPC meeting. The model proposed some adjustment in the policy rate to reflect consistency with the modified uncovered interest rate parity condition and a moderate increase in the projected headline inflation for FY21.

25. At the end, the staff presented various projections based on alternative scenarios for: (i) nominal exchange rate, (ii) international oil prices, (iii) growth assessment due to the coronavirus shock, and (iv) the calibrated interest rate scenario to hit the mid-point of the inflation target sooner rather than later. The Committee then deliberated on all the scenarios and their possible implications for the policy rate.

Monetary Policy Deliberations and Decision Vote

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

27. The MPC decided to reduce the policy rate by 75.0bps with a majority vote of 6 out of 10 members, 2 members voted for less than 75.0bps reduction, while 2 members voted for reducing the policy rate by more than 75.0bps.

28. The Committee then scripted the Monetary Policy Statement.

29. The Committee decided as follows:

DECISION:

- *The policy interest rate is decreased by 75.0bps to 12.50 percent.*
- *The Monetary Policy Statement – March 17, 2020 is approved.*