MINUTES OF THE MONETARY POLICY COMMITTEE (MPC) MEETING
HELD ON NOVEMBER 23, 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
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	Corporate Secretary/Director OCS

Review of Current Economic Conditions and Outlook for FY21

1. The Committee was apprised about developments in key macroeconomic indicators since the last Monetary Policy decision in September 2020, along with an assessment of the evolving trends.

2. Giving an overview of the real sector, the staff apprised that the domestic recovery continued to gain traction since the last MPC meeting. It was highlighted that the average sales of POL and automobiles have surpassed their pre-COVID levels of FY20, and that cement sales have reached an all-time high. Providing further details on the auto sector, it was explained that the categories of personal cars, Light Commercial Vehicles (LCVs) and tractors were the major contributors to the increase in sales. This recovery was helped by a number of factors, including lower cost of borrowing, provision of subsidy on tractors, and increase in remittances and delayed demand post-lockdowns.

3. The Committee was informed that the sales of Fast Moving Consumer Goods (FMCGs) rebounded in Q1-FY21, after a steady decline in the past two years. While providing an update on the sales volume of October FY21, the Committee was informed that POL sales reached a two-year high. It was noted that manufacturing activity registered a broad-based recovery, with nine out of fifteen sub-sectors showing Y/Y increase during Jul-Sep FY21, including textiles, food and beverages, petroleum products, paper and board, pharmaceuticals, chemicals, cement, fertilizer, and rubber products. As a consequence, Large Scale Manufacturing (LSM) recorded an expansion of 4.8 percent (Y/Y) in Q1-FY21 as compared to a decline of 5.5 percent in the same quarter last year. It was highlighted that these improvements are mainly attributed to the stimulus provided by the Government, reduction in the policy rate and the SBP's timely measures to mitigate the impact of the COVID-19 pandemic on businesses and households. Turning to the agriculture sector, it was apprised that the latest information shows that all *Kharif* crops except cotton are expected to surpass their production targets for FY21.

4. However, despite positive developments during the year so far, the real GDP growth projection was kept unchanged at slightly above 2 percent for FY21 within the range of 1.5-2.5 percent, in recognition of risks to the economic outlook. The downside risks include the second wave of COVID-19, the supply-side shocks from uncertain weather conditions, and political uncertainty. The upside risks include the development and distribution of an effective vaccine and its possible availability by early next year, better than expected out-turn of *Rabi* crops and greater spillover of improved agriculture performance to industry and the services sector.

5. Discussing global economic conditions, the staff highlighted that the global economic recovery during Q3-CY20 seems to have lost some momentum since then, which is mainly attributed to the uncertainty caused by the second wave of COVID-19. It was apprised that the Bloomberg global manufacturing Purchasing Manager Index (PMI), which is globally recognized as an indicator of the industrial sector performance remained steady in October 2020, after witnessing an improvement throughout Q3-CY20. For the Euro Area, the trend has actually reversed owing to the new lockdowns. Similarly, the Chicago Board Options Exchange (COBE) Volatility Index (VIX), which is based on future pricing trends in the important stock markets, also showed an increase in uncertainty from September 2020 onwards. This was largely attributed to the US elections and the second wave of COVID-19. The Committee was informed that the VIX also suggested that the global uncertainty would continue to remain high in the short-run. Further, it was highlighted that global commodity prices are recovering but as per the Bloomberg Composite Monthly Index, they are still below December 2018 levels. The staff also highlighted that although volatility in equity markets has increased across emerging and advanced economies, global equity markets in general have recorded a rise during the last two months.

6. While apprising the Committee about the country's Balance of Payments (BoP), it was highlighted that the Current Account Balance (CAB) continued to improve, and recorded a quarterly surplus in Q1-FY21 for the first time since Q3-FY15. Incorporating the latest data for October 2020, the current account surplus during the first four months of FY21 reached USD 1.16 billion as compared to a deficit of USD 1.42 billion during the same period last year. Besides a modest improvement in the balance of trade in goods and services, this improvement was primarily driven by a significant increase in workers' remittances, which recorded a Y/Y increase of 26.5 percent in Jul-Oct FY21. It was also informed that exports have recovered to their pre-COVID monthly level of around USD 2 billion in September and October 2020. Further, the staff highlighted that an increase in the unit price of export items, particularly High Value Added (HVA) textiles, led to some improvement in export. Meanwhile, low global oil prices kept imports in check despite recovering domestic demand. The Committee was informed that inflows in workers' remittances remained above USD 2 billion for the fifth consecutive month (Jun-Oct 2020). It was also noted that there is a visible deceleration in the number of registered overseas workers returning in the last two months. Keeping in view the positive developments in workers' remittances, the World Bank has also improved remittances' outlook from negative 23.0 percent to positive 9.0 percent for CY20. It was noted that a sizable improvement in the CAB helped strengthen external buffers, and contributed to an appreciation of the PKR. SBP's foreign exchange reserves also increased to USD 12.9 billion as of November 13, 2020, which can finance around 3 months of the country's import of goods and services, an important metric of foreign exchange reserve adequacy.

7. Discussing the outlook, the staff apprised that projections for exports and imports remained broadly unchanged since the last MPC meeting. Contingent on a rebound in global economic growth, exports are projected to grow in the range of 4.0-6.0 percent. Similarly, keeping in view an expected uptick in the domestic economic activity, growth in imports is expected to remain in the range of 1.0-3.0 percent during FY21. Further, the staff apprised that the outlook for remittances has improved significantly since the last MPC meeting, notwithstanding risks to sustainability of current flows from low number of workers going abroad and economic activity in the host countries. On an overall basis, the Current Account Deficit (CAD) is now projected to remain below 2 percent of GDP in the range of 0.5-1.5 percent.

8. Presenting developments on the fiscal side, it was apprised that a fiscal deficit of 1.1 percent of GDP was recorded in Q1-FY21 as compared 0.7 percent in the same period last year. However, the primary balance posted a surplus of 0.6 percent of GDP in Q1-FY21, which is close to the surplus of 0.7 percent in the same period last year. The increase in the fiscal deficit is attributed to a decline in non-tax revenues, and an increase in current expenditures on account of higher interest payments. On the revenue side, FBR tax collection grew by 4.5 percent (Y/Y) in July-Oct FY21, primarily due to higher sales tax collection, and reached close to targeted levels. There was also a considerable increase in revenues from the Petroleum Development Levy (PDL). Further, it was

highlighted that the Public Sector Development Program (PSDP) releases recorded an increase of 12.8 percent (Y/Y) during Jul-Oct FY21.

9. Presenting projections for FY21, it was explained that the fiscal deficit is projected to remain in the range of 6.5-7.5 percent of GDP, which is also in line with the budget estimate of 7.0 percent of GDP. However, this projection is subject to several risks. The second wave of COVID-19 may deteriorate the fiscal deficit. However, better than expected growth in revenues from PDL and Gas Infrastructure Development Cess (GIDC) may lead to an improvement in the fiscal balance.

10. Discussing monetary aggregates, it was apprised that Broad Money (M2) expanded by 0.69 percent during Jul-Oct FY21, compared to an expansion of 0.87 percent in the same period last year. The expansion in M2 was entirely contributed by an improvement in Net Foreign Assets (NFA), which offset the contraction in Net Domestic Assets (NDA) of the banking system. The contraction in NDA is mainly attributed to higher retirements in Private Sector Credit (PSC), and lower net budgetary borrowing from the banking system. It was highlighted that the expansion in NFA reflects improvement in the country's external accounts. On the liability side, the Currency in Circulation (CiC) recorded a small increase of Rs. 152 million only during Jul-Oct FY21, in contrast to an expansion of Rs. 335.6 billion in the corresponding period last year. The decline is mainly explained by the lower precautionary demand for cash and increased use of digital modes of payment.

11. Discussing Private Sector Credit (PSC) in detail, it was apprised that this witnessed a net retirement of Rs. 45.6 billion in Jul-Oct FY21 compared to an expansion of Rs. 11.9 billion seen in the same period last year. It was highlighted that this retirement was mainly due to working capital loans, while the demand for fixed investment and consumer finance has picked up momentum. Fixed investment recorded an increase of Rs. 89 billion in Jul-Oct FY21 as compared to only Rs. 35 billion in the same period last year. Similarly, personal loans saw disbursements of Rs. 73 billion in Jul-Oct FY21 as compared to Rs. 10 billion in the same period last year. This trend was mainly attributed to SBP refinancing schemes and the decline in the policy rate.

12. Going forward, the staff apprised that both demand and supply-side factors are favorable for credit expansion. The demand-side factors include recovery in Large Scale Manufacturing (LSM) output, declining cost of borrowing and a pickup in credit demand as suggested by the recent surge in the number of loan applications in the last four months (Jun-Sep). Supply-side factors also indicate some improvement as fresh Non-Performing Loans (NPLs) moderated to Rs. 50 billion in Q1-FY21 as compared to Rs. 66 billion in Q4-FY20, on account of lifting of the lockdown restrictions. Similarly, deposits recorded an increase Rs. 145.7 billion in Jul-Oct FY21 as compared to an outflow of Rs. 181.2 billion in the same quarter last year. The increase in deposits, despite low interest rates, is attributed to substantial inflows of remittances and liquidity support by the SBP and the Government measures to facilitate businesses. Taking into account these factors, PSC is estimated to grow in the range of 7.0-9.0 percent in FY21.

13. The staff then apprised the Committee about recent developments with respect to inflation. It was highlighted that recent inflation out-turns have been slightly higher than expected. On a M/M basis, national CPI increased by 1.7 percent in October 2020 on top of the 1.5 percent rise seen in September 2020. The inflation in recent months was mainly driven by sharp increases in prices of selected food items (wheat, eggs, chicken, onions and tomatoes) due to supply-side issues. However, core inflation was lower and recorded a 0.6 percent on M/M basis for both urban and rural areas, in October 2020, reflecting tepid underlying demand pressures in the economy.

14. On a Y/Y basis, headline inflation remained close to 9.0 percent during the last two (Sep-Oct) months. Core inflation has been relatively moderate and stable in both urban (around 5.5 percent) and rural (around 7.7 percent) areas, again reflecting subdued demand pressures in the economy. It was also highlighted that the Sensitivity Price Index (SPI) releases for the recent weeks

of November 2020 suggest a weakening in the momentum of food prices, as the Government has taken various measures to address the supply-side issues.

15. The staff apprised that the overall assessment of macroeconomic factors suggests low farm and non-farm input costs and soft demand would keep inflation in check in coming months. In the last few weeks, food inflation has also been tapering down and it is expected that the situation would improve further with food imports.

16. In FY21, National CPI inflation is expected to fall within the previously announced range of 7.0-9.0 percent. It was informed that this projection is subject to several risks. The upside-risks include pass-through of higher wheat prices to wheat flour (as currently wheat flour prices are lower than wheat prices). The downside-risk include a second wave of the pandemic, which could dampen the nascent demand recovery.

17. Concluding the presentation on inflation, the staff presented inflation projections based on alternative scenarios for the exchange rate and GDP growth from the expected path in the baseline. The Committee then deliberated on alternative scenarios and their possible implications for the policy rate.

Financial Markets and Reserve Management

18. Apprising the Committee on monetary policy implementation, the staff stated that the overnight interbank repo rate remained around 7.05 percent, on average, against the policy target rate of 7.0 percent. It was explained that in order to ensure an effective implementation of the monetary policy stance, SBP had to consistently inject liquidity in the market. The average daily outstanding net injection since the last MPC meeting stood at Rs. 804 billion.

19. It was explained that the yield curve is relatively flat up to 1 year, but steepens sharply thereafter. This, along with increased market participation in short-term T-bills and floating rate PIBs, suggested that the market may be expecting no further cuts in the policy rate.

20. Further, the Committee was appraised that liquidity in the foreign exchange market was improving and accordingly the exchange rate appreciated significantly. The improvement in liquidity conditions in the foreign exchange market was primarily due to high remittances and an overall improvement in the Balance of Payments.

Model-Based Assessment

21. The staff highlighted that based on the latest developments, the FPAS model suggests continuing with the current stance of monetary policy in order to support the nascent economic recovery. It was further elaborated that although the point forecast for inflation in FY21 has been revised upwards in the latest baseline scenario, it was still within the forecasted range of 7.0-9.0 percent communicated earlier. It was informed that the recent uptick in inflation is mainly attributed to higher than expected out-turn of food inflation. It was also highlighted that the shorter end of the proposed policy interest rate path is in line with the prevailing secondary market expectations of interest rates over a one-year horizon.

22. The Committee also discussed the medium term inflation forecast relative to the target and the corresponding interest rate path suggested by the model.

23. At the end, the staff presented projections based on alternative scenarios such as higher international oil prices, as well as high and low GDP growth for FY21 taking into account the current

COVID-19 situation and its potential impacts. The Committee then deliberated on all scenarios and their possible implications for the monetary policy stance.

Result of SBP Surveys for Monetary Policy

24. The staff apprised the Committee that the last wave of the Consumer Confidence Survey (CCS) was conducted in November 2020. The results suggested that consumer confidence had deteriorated somewhat, after showing an improvement in September 2020. It was highlighted that by contrast, business confidence continued to get stronger and touched a two-year high level during the latest wave of the survey which was conducted in October 2020. Similarly, the Purchasing Manager Index (PMI) also improved and rose above the par level for the first time after 16 months.

25. It was also reported that inflation expectations of both consumers and businesses declined slightly, suggesting these remained well-anchored. Further, presenting the results of the Bank Lending Survey (BLS), it was informed that senior loan officers of banks are expecting a sharp increase in credit demand going forward.

26. Lastly, sharing the results of 'Survey of Other Forecasters', it was explained that the market analysts expect real GDP in FY21 to grow at 1.0-3.0 percent and their average inflation projection for FY21 is 8.0-9.0 percent as per the latest wave conducted in November 2020. It was also highlighted that most of the forecasters and experts foresee no change in SBP's policy rate.

Monetary Policy Deliberations and Decision Vote

27. Following a detailed discussion, the Committee decided to keep the policy rate unchanged. Given the broadly unchanged outlook for growth and inflation, the Committee viewed the existing stance of monetary policy as appropriate to support the nascent recovery while keeping inflation expectations well-anchored and maintaining financial stability. Eight members voted to keep the policy rate unchanged, while one member voted to increase the policy rate by 25bps.

28. The Committee then scripted the Monetary Policy Statement.

DECISION:

- *The policy rate is kept unchanged at 7.0 percent.*
- *The Monetary Policy Statement – November 23, 2020 is approved.*