MINUTES OF THE MONETARY POLICY COMMITTEE (MPC) MEETING
HELD ON DECEMBER 14, 2021

P R E S E N T

Dr. Reza Baqir	Chairman & Governor SBP
Dr. Inayat Hussain	Deputy Governor (Banking & FMRM)
Dr. Murtaza Syed	Deputy Governor (Policy)
Mr. Arshad Mehmood Bhatti	Executive Director (BPRG)
Mr. Ali Jameel	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 FY22

1. The Committee was apprised about developments in key macroeconomic indicators since the last Monetary Policy decision on November 19, 2021, along with an assessment of the evolving trends.

2. Elaborating on developments in Pakistan's external sector, it was noted that during the month of November 2021, exports continued their momentum, rising 17.8 percent (m/m) to reach the highest monthly level of USD 2.9 billion (PBS data). However, this encouraging development was offset by a 24.5 percent (m/m) growth in imports, which also recorded a historic high of USD 7.9 billion (PBS data), resulting in an all-time high monthly trade deficit of USD 5.0 billion. It was highlighted that high global commodity prices have played a key role in keeping imports at an elevated level so far this fiscal year. Growth in exports during Jul-Nov FY22 has largely been driven by high value-added textiles, followed by food and other manufactured goods. Import growth, on the other hand, remained broad-based reflecting some impact of domestic demand on top of the unfavourable price effect, particularly coming from higher energy prices. Furthermore, the widening of the trade deficit in November 2021 is likely to exert additional pressure on the Current Account Deficit (CAD), which reached USD 5.1 billion in Jul-Oct FY22 as compared to a surplus of USD 1.3 billion in the same period last year.

3. Apprising the Committee on the external sector outlook for FY22, it was noted that exports are expected to maintain their momentum throughout the rest of the fiscal year with a major contribution coming from improving global demand, particularly for textiles. The recent depreciation of the rupee would also be helpful in supporting the competitiveness of Pakistani exports. At the same time, the recent decline in international oil prices and a number of monetary and regulatory measures already taken by the SBP would curtail import growth to help keep the CAD at around 4.0 percent of GDP during FY22, somewhat higher than projected at the beginning of the fiscal year. The outlook for remittances remains broadly unchanged since the last MPC meeting. However, some risks are emerging, particularly as a gradual slowdown in remittance growth has been observed for some peer countries. The financial account surplus is expected to cover the CAD fully and add to SBP's foreign exchange reserves. This expectation assumes the timely disbursement of budgeted multilateral inflows and planned issuance of Eurobonds.

4. Giving an overview of the real sector, the staff apprised the MPC that the growth momentum continues to remain strong although sales and production levels of some of manufacturing items are normalizing. It was noted that the impact of policy measures is already evident, especially on the automobile sector and consumer durables. Cement sales recorded double-digit growth in November 2021, after declining in September and October 2021, indicating that momentum in

construction is continuing. Based on these developments, and considering the impact of monetary tightening and global supply chain disruptions, LSM growth is projected to be slightly lower than anticipated earlier. This, combined with expected deceleration in the growth of import volumes, may affect the growth pace of wholesale and retail trade as well as transportation services. On an overall basis, SBP still expects real GDP growth to be close to the upper bound of the 4–5 percent range projected for FY22.

5. Discussing fiscal developments, it was apprised that the fiscal and revenue deficits improved, while the primary surplus was slightly lower in Q1FY22 over the same period last year. Further, it was highlighted that there was an increase in both development spending and non-interest current expenditures. The overall fiscal deficit declined to 0.8 percent of GDP in Q1FY22 as compared to 1 percent in Q1FY21, owing to a broad based recovery in FBR taxes. Discussing the latest developments, it was apprised that tax collection recorded a y/y growth of 36.5 percent in Jul-Nov FY22, surpassing the target by Rs. 298 billion. Going forward, the growth in tax collection is expected to maintain the current robust trends while revenue from PDL is also expected to pick up pace.

6. Discussing trends and developments in inflation, it was apprised that national CPI inflation has risen to 11.5 percent on a y/y basis in November 2021 from 9.2 percent in October 2021. It was also noted that m/m national CPI inflation has accelerated to 3 percent in November 2021, the highest monthly inflation since August 2008. It was further apprised that inflation in November was broad-based. The major push to inflation, nevertheless, came from an upsurge in energy prices. In addition, core inflation rose by 0.9 and 1.5 percentage points in urban and rural areas, respectively in November from their October outturns. This reflects robust domestic demand and the second-round effects of higher energy and other international commodity prices.

7. On the other hand, an improved shelf-life of some perishable items due to winter decreased their prices in November 2021. It was apprised that the underlying inflation trend, measured by the 18 month moving average of National CPI inflation, reversed in November after moderating in the previous month. More specifically, trend inflation, which had moderated from 9.9 percent in January 2021 to 8.8 percent in October 2021, increased to 9 percent in November 2021. The staff further explained that cyclical inflation, the difference between actual and trend inflation, is mainly being driven by an upsurge in electricity charges and the prices of motor fuel, liquefied hydrocarbons, edible oil and ghee. The staff further explained that the surge in global commodity prices has also led to higher-than-anticipated inflation in many other emerging and developed economies. In addition, the Committee noted that increasing prices of durable goods have been a key factor behind the rise in core inflation.

8. Discussing the outlook, the MPC was apprised that the forecast range for average NCPI inflation for FY22 has been revised upward to 9-11 percent. The revision incorporates the latest inflation outcomes, trends in global commodity prices, adjustments in administered prices, and expected changes in some tax exemptions.

Financial Markets and Reserve Management

9. Apprising the Committee on monetary policy implementation, the staff stated that the overnight interbank repo-rate remained around 9.2 percent on average since the last MPC meeting, against the target policy rate of 8.75 percent. SBP liquidity injections through Open Market Operations (OMOs) decreased since the last MPC meeting; reflecting the impact of lower government borrowing from commercial banks.

10. Further, it was apprised that the secondary market yields have increased significantly since the last MPC meeting in November 2021. It was highlighted that secondary market yields and

benchmark rates have increased in the range of 84 to 213 bps during the review period. In anticipation of further increase in the policy rate, the offered amounts were at higher yields, though the participation remained higher than the Federal Government targets.

11. Further, it was informed that PKR depreciated by 1.4 percent against the USD since the last MPC meeting. This was mainly attributed to growing economic activity and higher international commodity prices. Lastly, it was also highlighted that the PKR volatility has increased in the last month, though broadly in line with that in other major currencies.

Model-Based Assessment

12. The staff apprised the Committee on key assumptions of the model. It was explained that the point forecast of inflation for FY22 in the baseline scenario has been revised upward because of; *i) higher than expected headline and core inflation in November, ii) pass-through of PKR depreciation and, iii) the uptick in inflation expectations.* These factors contributed to an inching up of the medium-term inflation projection path, in response to which the model suggested the need for further tightening of monetary policy.

13. The Committee also discussed the medium-term conditional inflation forecast relative to the target and the corresponding normalization of policy interest rate suggested by the model to bring inflation within the medium-term range. The staff also presented scenario analysis based on alternative assumptions for growth and global oil prices for FY22.

Result of SBP Surveys for Monetary Policy

14. Discussing the results of the external polls for the monetary policy rate conducted by different entities, it was apprised that the majority expects a 100 bps increase in the policy rate. Further, the polls conducted by SBP itself also showed that the vast majority of treasury officers and other forecasters also expects an increase in the policy rate in the current MPC meeting.

Monetary Policy Deliberations and Decision Vote

15. The Committee unanimously decided to increase the policy rate by 100 bps.

16. The Committee then scripted the Monetary Policy Statement.

DECISIONS:

- *The policy rate is increased by 100 bps to 9.75 percent.*
- *The Monetary Policy Statement – December 14, 2021 is approved.*