MINUTES OF THE MONETARY POLICY COMMITTEE (MPC) MEETING
<u>HELD ON NOVEMBER 19, 2021</u>

<u>P R E S E N T</u>

Dr. Reza Baqir	Chairman & Governor SBP
Dr. Murtaza Syed	Deputy Governor (Policy)
Dr. Inayat Hussain	Deputy Governor (Banking & FMRM)
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 in September 2021, along with an assessment of the evolving trends.

2. Giving an overview of the real sector, the staff apprised the Committee that high frequency demand and supply indicators suggest a continuation of the robust economic recovery since the last MPC meeting in September 2021. Automobiles and POL sales grew by 45.5 percent and 14.7 percent, respectively in September 2021. Also, while cement sales declined on y/y basis during the last two months due to a high base effect, growth on m/m basis in the same months reflects the momentum is continuing.

3. Discussing the supply side, it was noted that Pakistan Bureau of Statistics (PBS) has released Large-Scale Manufacturing (LSM) data for August and September 2021, which showed broad-based y/y growth of 12.7 percent and 1.2 percent respectively. It was noted that slower LSM growth in September 2021 is partly attributed to a high base effect and partly to normalisation of production levels in some LSM industries. Cumulatively, LSM grew by 5.2 percent in Q1-FY22 as compared to 4.5 percent in the same period last year. The staff highlighted that rising input prices and supply chain disruptions have somewhat affected the pace of industrial production. Accordingly, SBP has slightly revised down its projection of industrial sector growth.

4. Discussing the outlook for the agriculture sector, the staff apprised the Committee that the estimates by Federal Committee on Agriculture show that all the major Kharif crops except cotton have recorded the highest ever production levels in FY22. Moreover, cotton production is also expected to recover from 7.1 million bales in FY21to 9.4 million bales in FY22 primarily supported by a significant increase in yields. As a result, it is projected that during FY22, stronger growth in the agriculture sector would more than offset the expected slowdown in industry.

5. Based on these developments, the real GDP growth estimate for FY22 has been revised upwards, and is expected to remain close to the upper bound of the range of 4 to 5 percent. However, these projections are subject to certain risks. The risk factors include: i) waning of consumer and business confidence; ii) recent volatility in the financial markets and uncertainty regarding the IMF program; iii) the pass-through of increases in global commodity prices, especially energy, to domestic prices and iv) a Covid-19 resurgence.

6. Elaborating on developments in Pakistan's Balance of Payments (BoP), it was noted that during Jul-Oct FY22, exports grew by 32.2 percent while imports rose by 66.3 percent. Accordingly,

the goods trade deficit increased by 103.1 percent during Jul-Oct FY22 compared to the corresponding period of FY21. The widening of this trade deficit continued to put pressure on the Current Account Deficit (CAD), which reached USD 5.1 billion in Jul-Oct FY22. In particular, during October 2021, due to a moderate m/m decline in both exports (7.1) and remittances (5.7), the CAD widened to USD 1.66 billion from USD 1.13 billion recorded in September 2021. The Committee was apprised that growth in exports was primarily led by textiles, on the back of favourable international prices. Imports remained elevated due to persistently higher global commodity prices and faster than anticipated increase in the pace of domestic economic activity. Nevertheless, non-oil import volumes have started to rationalize.

7. Apprising the Committee on the external sector outlook for FY22, it was noted that the outlook for exports is positive, with major growth contribution expected from textiles. However, any downside shock to international prices and energy shortages in the coming months may have a negative impact on exports. It was also noted that the recent depreciation of the rupee would support the competitiveness of Pakistani exports going forward. Imports are also projected to increase relative to previous projections during FY22 due to a) elevated level of energy palm oil prices since the September 2021 and b) additional need of Covid-19 vaccine in the wake of government's extension of inoculation to children. With the recovery in the number of workers going abroad and higher use of formal channels for money transfers, the outlook for remittances remains broadly unchanged. The financial account is expected to show a higher surplus during FY22 as compared to FY21, subject to the timely disbursement of budgeted multilateral inflows (including from the IMF), planned issuance of Sukuks/Eurobonds and timely inflows from Saudi Arabia to support SBP's foreign exchange reserves.

8. Discussing monetary aggregates, it was apprised that Broad Money (M2) expanded by 1.4 percent during Aug 27 to Oct 31 FY22. On the asset side, the expansion in M2 was entirely due to Net Domestic Assets (NDA) on account of higher Government borrowings from commercial banks and a sharp pick-up in private sector credit. On the liability side, increased deposits, outweighed a decline in Currency in Circulation (CiC), and contributed towards the growth of M2. It was highlighted that although M2 growth has decelerated in y/y terms in recent months, it continues to remain above its long-term trend in both nominal and real terms.

9. Further, the staff apprised that the Private Sector Credit (PSC) saw a substantial expansion since the last MPC meeting in September 2021. It was noted that the uptick in PSC is an indicator of a higher than expected recovery in economic activity. Further, expectations of a rise in the policy rate has encouraged borrowers to bring forward their borrowings. It was highlighted that the expansion in the PSC is also being supported by SBP schemes. Moreover, robust activity in the textile, energy, fertilizer and construction sectors along with rising input prices have enhanced working capital requirements. It was also highlighted that growth in fixed investment and consumer loans continued the momentum witnessed in FY21. Growth in fixed investment loans was led by textile and energy sector, while consumer loans have accelerated on the back of auto finance and housing loans.

10. The latest data from October 2021 shows that PSC has increased by Rs. 273 billion during July to October FY22 as compared to a retirement of Rs. 46 billion in the same period last year. It was noted that for the first time housing finance has also picked up sharply after banks were given targets by SBP. Sharing the outlook, the staff highlighted that the PSC growth estimates for FY22 remain unchanged since the last MPC meeting in September 2021.

11. The staff then highlighted recent developments with respect to inflation. On y/y basis, National CPI inflation accelerated in September and October 2021 to 9 and 9.2 percent, respectively. On m/m basis, National CPI inflation averaged at 2 percent in September and October 2021- the highest levels since February 2021. It was noted that the increase in inflation in the last two months was mainly due to rising energy costs and an uptick in core inflation. It was also highlighted that in the domestic market, there are signs of increased demand-pull inflation.

Discussing the uptick in core inflation, the Committee noted that increasing prices of durable goods were the main contributing factor.

12. Moreover, the staff apprised the Committee that global supply chain disruptions, increased transportation/freight charges and increasing global commodity prices are fueling imported inflation. As a result, the contribution of import-based inflation in the CPI has been increasing. Further, it was highlighted that the pass-through of higher global prices of energy and food commodities, together with the impact of exchange rate depreciations, may continue to affect inflation out-turns going forward.

13. Discussing the outlook, it was informed that the latest assessment shows that upside risks to the average inflation projection for FY22 of 7-9 percent have increased. Lastly, the staff presented inflation projections based on alternative scenarios, including higher growth and stronger global oil prices.

Financial Markets and Reserve Management

14. Apprising the Committee on monetary policy implementation, the staff stated that the overnight interbank repo-rate averaged 7.45 percent since the last MPC meeting, against the target policy rate of 7.25 percent. Liquidity injections through Open Market Operations (OMOs) decreased slightly since the last MPC meeting. However, the recent increase in Cash Reserve Requirement (CRR) required higher short-term injections, pushing the net average daily outstanding level of OMOs to Rs 2.2 trillion.

15. Further, it was informed that secondary market yields began to rise ahead of the last MPC meeting in September 2021 and that this trend continued in the Oct and Nov 2021 period. As a result, secondary market yields and benchmark rates have increased in the range of 115 to 160bps since the last MPC meeting. In anticipation of an increase in the policy rate and rejection of bids in some of the auctions, participation in the auctions of Market Treasury Bills (MTBs) and Pakistan Investment Bonds (PIBs) has remained low. However, the offered amounts remained higher than the Federal Government targets, albeit largely at higher yields.

16. Further, the MPC was informed that the PKR depreciated by 3.1 percent against the USD since the last MPC meeting. This was mainly attributed to pressure on the country's external accounts, which in itself is primarily driven by growing economic activity, higher international commodity prices, and uncertainty linked to developments in Afghanistan. Lastly, it was also highlighted that the PKR volatility has increased in the last month, although it remained broadly in line with that of other major currencies.

Model-Based Assessment

17. 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 primarily because of the pass-through of higher international oil prices to domestic administered energy prices as well as the PKR depreciation. Further, it was noted that domestic demand has also started to put some pressures on prices as reflected in the uptick in core inflation. These factors have been contributing to an inching up of the medium-term inflation projection path. As a result, the model suggests an upward revision in the policy rate path when compared with the same presented in the last MPC meeting.

18. 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 analyses based on higher growth and stronger global oil prices for FY22.

Result of SBP Surveys for Monetary Policy

19. The staff apprised the Committee that the Consumer Confidence Survey was conducted in the first half of November 2021 and Business Confidence Survey in the second half of October 2021. It was highlighted that the confidence of both consumers as well as businesses have declined in the latest wave of the survey.

20. It was also noted that the inflation expectations by consumers as well as businesses have increased during the latest waves of the respective surveys. The businesses inflation expectations appear to be also driven by their views about PKR exchange rate fluctuations.

21. The staff then apprised about the results of the “Survey of Other Forecasters” from institutions other than the SBP. It was explained that the real GDP growth of 4-4.9 percent is expected in FY22 by most respondents. Similarly, average inflation is thought to be most likely in the range of 9-9.9 percent in FY22 by the respondents. Lastly, it was highlighted that most of the forecasters and experts expected an increase in the SBP’s policy rate in the current MPC meeting.

Monetary Policy Deliberations and Decision Vote

22. The Committee decided to increase the policy rate by 150bps with a majority vote of 8 out of 9 members, with one member voting to increase the policy rate by 175bps. The Committee then scripted the Monetary Policy Statement.

DECISIONS:

- The policy rate is increased by 150bps to 8.75 percent.
- The Monetary Policy Statement – November 19, 2021 is approved.