MINUTES OF THE MONETARY POLICY COMMITTEE (MPC)
HELD ON THURSDAY, JULY 7, 2022

PRESENT

Dr. Murtaza Syed	Chairperson & Acting Governor SBP
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. 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 May 23, 2022, along with an assessment of evolving trends.

2. Giving an overview of the real sector, the staff apprised that the momentum in high-frequency indicators suggests that demand has stabilised at elevated levels. On m/m basis, the sales of private vehicles, cement, and Petroleum, Oil & Lubricants (POL) increased in June 2022. However, on a cumulative basis, the sale of cement slightly declined in FY22 as compared to FY21. It was highlighted that going forward, sales of cement are expected to remain low due to moderation of activity in the construction industry. In aggregate, LSM grew by 10.7 percent during Jul-Apr FY22 as compared to 8.4 percent in the same period last year.

3. For the agriculture sector, it was noted that sales of fertilizers and tractors as well as agriculture credit disbursements increased during Jul-Apr FY22 as compared to the same period last year.

4. Summarizing the outlook, it was apprised that growth in the industrial sector is expected to decelerate on account of high energy prices, rising input costs and tightening of monetary and fiscal policies. However, the agriculture sector is expected to maintain its momentum in FY23, mainly on account of an expected increase in cotton production due to an increase in the area under cultivation in Punjab and improved availability of water after the recent spell of monsoon rains. The expected moderation in LSM and imports would have an impact on growth in the services sector, which is also likely to decelerate. Cumulatively, GDP growth is expected to fall in the range of 3.0 to 4.0 percent in FY23.

5. Discussing recent developments in monetary aggregates, it was apprised that broad money (M2) growth has decelerated amidst a sharp contraction in Net Foreign Assets (NFA) of SBP. On the other hand, Net Domestic Assets (NDA) of the banking system saw a substantial expansion due to a sharp rise in Private Sector Credit (PSC) and an increase in net budgetary borrowing from the banking system. On the liability side, a contraction in Currency in Circulation (CiC) contributed towards a deceleration in M2 growth, despite a steady accumulation in bank deposits. Reserve Money (RM) growth also decelerated, both on a y/y and cumulative basis, which is mainly attributed to the decline in SBP's NFA, which partially offset the impact of injections through Open Market Operations (OMOs) and SBP's claims on government and non-government sectors (via concessional credit schemes).

6. Further, the staff apprised that Private Sector Credit (PSC) witnessed broad based growth, increasing by 23.7 percent on a y/y basis to PKR 9.1 trillion in May 2022. All major components including working capital, fixed investments and consumer loans contributed to this PSC growth. It was highlighted that high input prices and strong activity in credit intensive sectors resulted in

increased working capital requirements. Cumulatively, PSC rose to PKR 1.40 trillion during 01Jul – 17Jun FY22 as compared to PKR 489.5 billion during the same period of FY21.

7. Apprising about credit growth, the staff noted that fixed investments and consumer loans increased during May 2022, owing to continued disbursements under the Temporary Economic Refinance Facility (TERF) and growing interest in the low-cost housing scheme (*Mera Pakistan Mera Ghar*).

8. Regarding credit growth projections, the staff informed that the pace of credit expansion is expected to decelerate in FY23, reflecting the impact of an anticipated slowdown in economic activity, the lagged effect of monetary tightening, an expected moderation in input prices and the culmination of TERF.

9. Discussing fiscal developments, it was apprised that the revised budget estimates suggest a fiscal deficit of 7.1 percent of GDP against the budget target of 5.1 percent of GDP in FY22. The primary deficit is likewise estimated at 2.4 percent of GDP, significantly higher than the target of 0.7 percent. The deterioration on the fiscal side is mainly attributed to an unprecedented increase in subsidies and grants, as well as a shortfall in non-tax revenues.

10. For FY23, assuming fiscal consolidation after the resumption of the IMF program, the overall fiscal deficit and the primary deficit are expected to fall. However, these projections are subject to risks due to: *(i) political instability, (ii) international oil prices, (iii) changes in the policy rate, (iv) exchange rate movements, and (v) resurgence of the Covid-19 pandemic.*

11. Discussing global developments, the MPC was apprised that economies remained under stress globally due to geopolitical uncertainty, high inflation, China lockdowns, an increase in the policy rate by the US Fed, and the rising risk of a recession. Consequently, the global Purchasing Managers' Index (PMI) reached a twenty-month low and uncertainty prevailed in financial markets, as indicated by an increase in S&P's Volatility Index (VIX) and VSTOXX (implied volatilities on the underlying Euro STOXX 50 index). It was highlighted that due to geopolitical risks and the ongoing monetary tightening in Advanced Economies (AEs), currencies of EMEs are depreciating, which is further adding to inflationary pressures in these countries. Discussing international commodity prices, it was noted that except for crude oil, the prices of other commodities have generally declined since the last MPC meeting but are still much higher compared to pre-Covid levels.

12. It was apprised that the non-energy imports are gradually contracting, while export growth is sustaining its momentum since the last MPC meeting. Export receipts touched USD 2.9 billion in May 2022, and cumulatively reached a historic high of USD 28.9 billion during Jul-May FY22. This trend is attributed to the strong performance of High Value Added (HVA) textiles and rice exports. Furthermore, the increase in HVA exports is not only associated with favourable global prices but also rising volumes. It was highlighted that while high global commodity prices are supporting the momentum in exports, they also are keeping imports at elevated levels. As a result, the impact of rising exports was overshadowed by a 44.5 percent cumulative growth in imports during Jul-May FY22. The increase in imports is largely driven by energy imports and high global commodity prices. Discussing workers' remittances, it was noted that inflows have moderated in May 2022 to USD 2.3 billion due to the seasonal slowdown after Ramadan and Eid–ul-Fitr. However, it is anticipated that in June 2022, workers' remittances would rebound because of an increase in the number of workers going abroad and the increased use of formal digital channels.

13. The Current Account Deficit (CAD) has reached USD 15.2 billion during Jul-May FY22 as compared to USD 1.2 billion in the same period last year. It was noted that due to higher imports and relatively lower remittance inflows, the CAD reached USD 1.4 billion in May 2022.

14. Further, it was highlighted that the Financial Account remained under stress on account of weak official and private inflows. Foreign Direct Investment (FDI) from China almost halved during Jul-May FY22 as compared to the same period last year, as a result of which FDI inflows were almost unchanged at USD 1.6 billion during Jul-May FY22 as compared to USD 1.68 billion in the same period last year.

15. Apprising on the external sector outlook for FY23, it was noted that exports are expected to grow moderately due to: *(i) the recent capacity enhancement in the textile sector; (ii) favorable price of rice and availability of stock for exports; and (iii) a competitive exchange rate.* However, a slowdown in global growth and the expectation of a recession is a major downside risk to the export outlook for FY23. Despite administrative restrictions and contractionary measures by the Government and the SBP, a gradual decline in imports is expected during FY23, particularly owing to high commodity prices in the international markets. The outlook for remittances remains positive and is broadly unchanged since the last MPC meeting in May 2022. These developments suggest that the CAD would be lower in FY23 as compared to FY22. The projections also take into account recent efforts by the Government to curtail imports as well as the impact of increases in the policy rate and exchange rate depreciation.

16. Discussing trends and developments in inflation, it was apprised that national CPI inflation has risen to 21.3 percent on a y/y basis in June 2022 (the highest since August 2008), leading to an average National CPI inflation of 12.2 percent during FY22. It was noted that m/m national CPI increased by 6.3 percent in June 2022. It was explained that rise in inflation since the last MPC meeting was mainly due to an increase in food and energy prices. On a y/y basis (in June 2022), core inflation in urban and rural areas rose to 11.5 percent and 13.5 percent, respectively. On a m/m basis (in June 2022), core inflation was recorded at 2.0 percent and 2.3 percent, for urban and rural areas respectively. This reflects the second-round effects of persistently high energy and food prices.

17. In June 2022, the rise in food inflation was primarily attributed to an increase in the prices of perishable food items on account of higher than normal temperatures. At the same time, energy inflation jumped to above 45 percent on account of the pass-through of an increase in global oil prices and reversal of subsidies.

18. Discussing the outlook, it was apprised that average national CPI inflation for FY23 is projected in the range of 18-20 percent. This outlook is subject to certain risks. The upside risks include continuation of the Russian-Ukraine conflict and the upward adjustment of inflation expectations, while down side risks include an unexpected contraction in the global demand and possible new wave of the Covid-19 pandemic.

Financial Markets and Reserve Management

19. Apprising about monetary policy implementation, the staff stated that the overnight interbank repo-rate remained around 13.28 percent (on average) against the policy rate of 13.75 percent, reflecting surplus liquidity in the market. Liquidity injections through OMOs witnessed a slight increase since the last MPC meeting. During May 23, 2022 to Jul 5, 2022, the net average daily outstanding level of OMOs increased to PKR 3.89 trillion.

20. Further, it was noted that secondary market yields have increased since the last MPC meeting in May 2022. The increase was more pronounced in 3-month to 1-year tenors, but medium to long term yields also inched up. In primary auctions, the market offered higher than targeted amounts with growing interest in PIBs. Further, the prices of Pakistan's Eurobond have also declined significantly, which has made it difficult for the government to access international markets. It was noted that although the prices of sovereign bonds of peer countries have also declined, the decline is more pronounced and persistent in the case of Pakistan.

21. Further, it was informed that the PKR has depreciated by 3.4 percent against the USD since the last MPC meeting. This was mainly attributed to the global strengthening of the USD, higher international commodity prices, and lingering domestic uncertainty. Lastly, it was also highlighted that the volatility of PKR is consistently on the rise since April 2022, and is now more than that of the currencies of peer countries.

Model-Based Assessment

22. The staff apprised the Committee on key assumptions of the model. It was explained that the latest point forecast of inflation for FY23 has been revised upwards because of: *i) the significant change in initial conditions on the back of higher than expected adjustments in administered fuel, electricity and gas prices, ii) second-round impact of upward adjustment of energy prices iii) the reflection of inflation expectations in core inflation, and iv) the pass-through of recent weakening of PKR/USD parity and its projected path.* These factors have contributed to a rise in the medium-term inflation projection path.

23. The Committee also discussed the medium-term conditional inflation forecast relative to the target and the corresponding policy interest rate suggested by the model to bring inflation within the medium-term range of 5 to 7 percent. Based on current information, the model recommended a further sizeable increase in the policy rate and to maintain the policy rate at an elevated level for a longer period. This would help bring inflation down to 5 to 7 percent in eight quarters. The staff also presented scenarios based on alternative assumptions for global oil prices and the exchange rate.

Result of SBP Surveys for Monetary Policy

24. The staff apprised that the confidence of consumers and businesses has declined sharply in the latest round of the survey. The consumer confidence recorded its lowest level for the last ten years. Similarly, the short-term inflation expectations of consumers and businesses have increased sharply, reaching the highest levels for the last three-years. Putting these observations together, it appears that there is an expectation of a slowdown in economic activity.

25. The staff then apprised the MPC of the results of the 'Survey of Other Forecasters' from institutions other than the SBP. It was noted that real GDP growth of 4.0-4.9 percent is expected in FY23 with the highest probability. Similarly, average inflation is expected most likely to fall in the range of 17-17.9 percent in FY23. It was noted that most forecasters and experts expected an increase in the SBP's policy rate in the current MPC meeting.

Monetary Policy Deliberations and Decision Vote

26. The MPC decided to increase the policy rate by 125bps with a majority vote of 5 out of 6, with one member voted to increase the policy rate by 100bps.

DECISIONS:

- The policy rate is increased by 125bps.
- The Monetary Policy Statement – July 2022 is approved.