MINUTES OF THE MONETARY POLICY COMMITTEE (MPC) MEETING
HELD ON MONDAY, OCTOBER 10, 2022

P R E S E N T

Mr. Jameel Ahmad	Chairperson
Dr. Murtaza Syed	Deputy Governor (Policy)
Dr. Inayat Hussain	Deputy Governor (Banking & FMRM)
Mr. Arshad Mehmood Bhatti	Executive Director (BPRG)
Mr. Nadeem Hussain	Director SBP Board
Mr. Fawad Anwar	Director SBP Board
Mr. Tariq Mahmood Pasha	Director SBP Board
Dr. Naved Hamid	External Member
Dr. Hanid Mukhtar	External Member
Dr. S. M. Turab Hussain	External Member
Mr. Mohammad Mansoor Ali	Corporate Secretary/Director OCS

Review of Current Economic Conditions and Outlook for FY23

1. The Committee was apprised of developments in key macroeconomic indicators since the last Monetary Policy decision on August 22, 2022, along with an assessment of evolving trends.

2. Giving an overview of the real sector, the staff apprised that the incoming data on high-frequency indicators suggests that sales are slowing sharply. During August 2022, auto sales declined by 37.8 percent, POL sales declined by 21.1 percent and domestic cement sales declined by 23.8 percent on a y/y basis. Further, it was noted that Large-scale Manufacturing (LSM) contracted by 16.6 percent (m/m) during July FY22, which is mainly attributed to high energy costs and the tightening of monetary and fiscal policies.

3. Discussing the developments in agriculture, it was noted that floods have severely affected major crops, including cotton. Cotton arrivals were 23.7 percent lower in October 2022 compared to the same period last year. The staff apprised that the standing flood water could lead to delays in sowing that may also negatively affect wheat production. It was further noted that the performance of the agriculture sector would also impact the output of the industry and services sectors.

4. Summarizing the outlook, the Committee was apprised that based on currently available information about the impact of floods, real GDP growth could fall close to 2 percent in FY23, compared to the pre-floods forecast of 3-4 percent. It was noted that the growth projection is subject to certain risks. Downside risks include; (i) more than anticipated deterioration in the external sector due to a sharper than anticipated global slowdown and geo-political uncertainties and (ii) larger than expected slowdown in the industry and services sectors due to spillovers from the agriculture sector. The main upside risks include fiscal expansion for rehabilitation of the flood-affected population and post-flood reconstruction.

5. Discussing recent developments in monetary aggregates, it was apprised that broad money (M2) growth moderated to 14.5 percent as of September 16, 2022, from 15.9 percent in the same period last year, on account of contraction in Net Foreign Assets (NFA) of the banking system, reflecting pressures on the external account. On the other hand, Net Domestic Assets (NDA) of the banking system witnessed a substantial expansion of 23.5 percent in FY23 due to a rise in Private Sector Credit (PSC) and an increase in net budgetary borrowings from the banking system. On the liability side, growth in Currency in Circulation (CiC) decelerated to 9.5 percent as of September 16, 2022 from 15.0 percent a year before, despite accumulation in bank deposits. Reserve Money (RM) growth also decelerated, which is mainly attributed to the decline in SBP's NFA.

6. Discussing fiscal developments, the staff apprised the Committee that provisional estimates for July 2022 show an improvement in the fiscal account. The fiscal deficit was lower, at 0.3 percent of GDP in July 2022, compared to 0.4 percent in the same period last year, while the primary balance witnessed a surplus of 0.2 percent in July 2022 compared to a deficit of 0.01 percent in the same period last year. FBR taxes grew by 17.1 percent in the first quarter of FY23, close to the average Q1 growth of 18.3 percent in the last five years (excluding FY21). Discussing the outlook, it was apprised that the fiscal stance in FY23 is expected to remain contractionary compared to FY22.

7. Discussing global developments, the staff apprised the Committee that the global economy remains under stress and the risk of recession has increased. This trend is also evident from falling Purchasing Manager Indices (PMI) for both, the manufacturing and the services sectors. At the same time, commodity prices are easing and the trend is expected to continue due to the anticipated slowdown in global demand. However, it was highlighted that despite the easing, global commodity prices are still about 50 percent higher than pre-Covid levels. Regarding the outlook, the Committee was apprised that global growth prospects are expected to remain subdued, while inflationary pressures are expected to dissipate gradually.

8. Presenting the latest Balance of Payments (BoP) trends and outlook, the staff stated that the Current Account Deficit (CAD) was USD 0.7 billion in August 2022 as compared to USD 1.2 billion in July 2022. Moreover, it was highlighted that, based on PBS data, the trade deficit declined by 19.2 percent (m/m) and 30.2 percent (y/y) during September 2022. Elaborating further on the various components of the current account, the staff stated that growth in exports is moderating, despite a slight increase in export volumes, as prices of High Value Added (HVA) textile have peaked and are now declining. Discussing trends in imports, the staff apprised that these have contracted by 11.9 percent on a m/m basis, from USD 6.1 billion to USD 5.3 billion in September 2022. It was noted that due to the contraction in imports, the trade deficit narrowed by 21.3 percent during Jul-Sep FY23. While apprising the Committee of the impact of floods on the current account, the staff stated that exports are anticipated to decrease amid a lower export surplus of rice and a decline in production of manufactures (reflecting the anticipated slowdown in LSM during FY23). Imports are expected to increase, mainly driven by imports related to agricultural goods (e.g. wheat and cotton). However, the recent decline in the international oil, commodity, and freight prices may largely offset the increase in imports due to floods.

9. Discussing trends and developments in inflation, it was apprised that national CPI inflation eased to 23.2 percent (y/y) in September 2022 from 27.3 percent in August 2022. It was noted that on a m/m basis, national CPI inflation declined by 1.2 percent in September 2022. This is mainly attributable to the downward administrative revision in Fuel Costs Adjustment (FCA) in electricity charges, dragging down energy inflation. However, food and core inflation maintained a rising momentum. The rise in core inflation tends to have repercussions for inflation expectations and it would be important to keep a close watch on core inflation and direct measures of inflation expectations going forward.

10. In September 2022, the rise in food inflation was primarily attributed to an increase in the prices of both perishable and non-perishable food items on account of floods. On a y/y basis, core inflation in urban and rural areas rose to 14.4 percent and 17.5 percent, respectively.

11. Discussing the outlook, it was apprised that the average national CPI inflation for FY23 is projected to be slightly above the 18-20 percent range and inflation is expected to be stickier. This outlook remains subject to certain risks. Upside risks include an increase in wheat support prices, political uncertainty and de-anchoring of inflation expectations, while downside risks include more than anticipated global monetary tightening, additional administrative measures and a sharper fall in global commodity prices.

Financial Markets and Reserve Management

12. Apprising the Committee on monetary policy implementation, the staff stated that the O/N repo rate averaged 15.08 percent, against the target of 15 percent, since the last MPC meeting, while liquidity injections through OMOs witnessed a slight increase in recent days. However, net average daily outstanding level of OMOs increased to PKR 5.49 trillion during the current cycle of the monetary review period as compared to PKR 5.06 trillion during the previous monetary policy review period.

13. Further, it was noted that secondary market yields in benchmark tenors showed a mixed trend, as yields on short-term instruments decreased, while there was an uptick in the yields of long-term instruments. In primary auctions, the market offered higher than the target amounts in 3-month T-bills.

14. The staff apprised the Committee that despite the resumption of the IMF program, Pakistan Eurobond yields and CDS spreads remained elevated.

15. Further, it was informed that PKR has depreciated by 1.5 percent against USD since the last MPC meeting. This was mainly attributed to pressures on the country's external account and the strengthening of the USD against currencies of both developed and emerging economies.

Model-Based Assessment

16. The staff apprised the Committee of the key assumptions used in running the model. It was explained that the outlook for inflation for FY23 had been updated in light of the withdrawal of the FCA, moderation in global commodity prices and the expected lower growth in FY23 owing mainly to floods.

17. The staff apprised the Committee that inflation is expected to be on a declining path in the medium term due to: i) the fuller impact of previous monetary tightening, ii) strong planned fiscal consolidation , iii) moderation of international commodity prices owing to the resolution of supply-chain issues, and iv) an economic slowdown. However, relative to the projections presented to the Committee in Aug 2022, the initial FY24 path has been revised slightly upwards mainly due to the weakening of PKR, persistence of core inflation, and the smaller base effect due to FCA withdrawal in FY23. Nonetheless, inflation is expected to gravitate to its medium-term 5-7 percent target.

18. The Committee also discussed the medium-term conditional inflation forecast relative to its target, output gap; and the corresponding policy interest rate path suggested by the model to bring inflation within the medium-term range of 5 to 7 percent. In this context, the Committee also discussed the appropriateness of the current policy rate stance.

19. Then, the staff presented simulations of inflation and policy interest rate paths under alternative assumptions for global oil prices and PKR depreciation for FY23.

Result of SBP Surveys for Monetary Policy

20. The staff apprised the Committee that the confidence of both consumers and businesses has improved somewhat from their last waves, however, sentiments are still below the benchmark. The traditional measures of inflation expectations of businesses have significantly eased in the latest round of the survey while inflation expectations of consumers remain almost unchanged. However, the distribution of business inflation expectations has increasingly become skewed to the upside. The Purchasing Managers Index (PMI) has declined notably, whereas employment growth in the manufacturing sector has inched up in the latest wave.

21. The staff then apprised the MPC about the results of the 'Survey of Other Forecasters' from institutions other than SBP. It was noted that the vast majority of forecasters and experts expected a status quo in the SBP's policy rate in the current MPC meeting.

Monetary Policy Deliberations and Decision Vote

22. The MPC unanimously decided to keep the policy rate unchanged.

DECISIONS:

- The policy rate remained unchanged.
- The Monetary Policy Statement – October 2022 is approved.