MINUTES OF THE MONETARY POLICY COMMITTEE (MPC) MEETING
HELD ON MONDAY, AUGUST 22, 2022

PRESENT

Dr. Murtaza Syed	Chairperson
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 about developments in key macroeconomic indicators since the last Monetary Policy decision on July 7, 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 a clear moderation in demand. The sales of items such as POL, auto, fertilizer and cement have substantially declined. During July 2022, auto sales declined by 51.8 percent, POL sales declined by 21.5 percent and domestic cement sales declined by 46.2 percent on a y/y basis. Further, it was noted that the Large-scale Manufacturing (LSM) grew by 11.7 percent (y/y) during FY22 compared to 11.2 percent in FY21, which is mainly attributed to export-oriented and consumer non-durables sectors.

3. On agriculture, it was noted that conducive input conditions including sale of fertilizers and tractors, agricultural credit disbursements, average temperatures, and especially rainfall, were encouraging during April - June in FY22, compared to the corresponding period of the previous year. However, recent ongoing floods and more than expected monsoon rains could adversely impact agricultural output. The staff then presented scenarios, based on past experiences, depicting the levels of agriculture output after taking into account assumptions of varying levels of floods and rainfall.

4. Summarizing the outlook, the Committee was apprised that real GDP growth is projected to remain unchanged since the last MPC meeting in the range of 3.0 to 4.0 percent. With this projection, real GDP growth is projected to converge to its long-term trend in FY22. It was noted that the growth projection is subject to certain risks which include; *(i) more than anticipated tightening of monetary and fiscal policies to curtail inflation* and *(ii) more than anticipated monsoon rains and floods.*

5. Discussing recent developments in monetary aggregates, it was apprised that broad money (M2) growth moderated to 13.5 percent in FY22 compared to 16.2 percent in FY21, on account of a sharp 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 20.2 percent in FY22 due to a rise in Private Sector Credit (PSC) and an increase in net budgetary borrowings from the banking system. It was noted that during FY22, on the liability side, a slight contraction in Currency in Circulation (CiC) contributed towards a deceleration in M2 growth, despite accumulation in bank deposits. During FY23, so far, M2 growth contracted on account of a contraction in both NDA and NFA. NDA of the banking system contracted due to seasonal retirements in PSC along with a reduction in net budgetary borrowings, while the NFA of the banking system continued to contract mainly on account of net foreign outflows.

Reserve Money (RM) growth also decelerated, which is mainly attributed to the decline in SBP's NFA.

6. Further, the staff apprised that PSC witnessed growth of 21.1 percent in FY22 compared to 11.2 percent in FY21. However, PSC witnessed a seasonal net retirement of Rs. 139.4 billion from July 1 to July 29 FY23 compared to a net retirement of Rs. 144.2 billion in the same period last year.

7. The staff informed that the pace of credit expansion is expected to decelerate in FY23. It was explained that this projection takes into account the anticipated slowdown in economic activity, the lagged effect of monetary tightening and an expected moderation in input prices.

8. Discussing fiscal developments, it was apprised that the fiscal deficit was 7.9 percent of GDP in FY22, as compared to 6.1 percent in FY21. The primary deficit was 3.1 percent of GDP in FY22, significantly higher than the target of 0.5 percent. The deterioration in fiscal accounts is mainly attributed to lower non-tax revenues and an increase in current expenditures. For FY23, the fiscal deficit is expected to fall on account of the continuation of ongoing fiscal consolidation. However, this projection is subject to risks emanating from: *(i) domestic/geopolitical political instability, (ii) exchange rate movements,* and *(iii) international oil prices.*

9. Discussing global developments, the staff apprised the Committee that the global economy continues to be stressed due to factors such as geopolitical uncertainty, high inflation, lockdowns in China, increase in interest rates by US and UK, and the rising risk of a global recession. It was highlighted that the Purchasing Managers Index (PMI) is declining in both advanced and emerging economies, while both Volatility Indices namely S&P's VIX (volatility index) and VSTOXX (implied volatilities on the underlying Euro STOXX 50 index) improved. The easing of volatility in the financial markets is attributed to expectations of a measured approach in further monetary tightening by major central banks in anticipation of a global recession. It was noted that the increase in interest rates by the Federal Reserve has resulted in pressure on currencies of Emerging Market Economies (EMEs). This impact is more pronounced in the case of Pakistan due to the country's low foreign exchange reserves. Lastly, it was also noted that despite a decline in international commodity prices, these are still well above their pre-pandemic levels.

10. It was apprised that due to historic high energy imports of USD 3.0 billion, Pakistan's CAD reached USD 2.3 billion in June 2022. In July 2022, however, energy imports contracted sharply along with a gradual contraction in non-energy imports. Export receipts were recorded at USD 3.1 billion in June 2022 indicating a continuing high growth momentum throughout FY22. This increase is mainly attributed to the strong performance of High Value Added (HVA) textiles and other manufactured exports. Discussing workers' remittances, it was highlighted that after a seasonal moderation in May 2022, workers' remittances recovered in June 2022 to reach USD 2.8 billion. All together, after remaining around or below USD 1.0 billion for four months, the Current Account Deficit (CAD) reached USD 2.3 billion during June 2022. However, the non-oil current account balance recorded a surplus of USD 0.6 billion, reflecting the impact of monetary tightening and various administrative measures by the SBP and the Government. The financial account recorded a net inflow of USD 2.8 billion in June 2022, mainly due to the rollover of Chinese loans of USD 2.3 billion.

11. Presenting the outlook for FY23, it was apprised that exports are expected to fall modestly due to a projected decline in global growth. Also, owing to a downward revision in the outlook of global commodity prices, the contraction in imports is expected to be faster. Moreover, due to high inflation and slowing economic activity in some host countries, workers' remittances are expected to grow marginally.

12. Discussing trends and developments in inflation, it was apprised that as expected, national CPI inflation has risen to 24.9 percent on a y/y basis in July 2022 (the highest level in the last fourteen years). It was noted that m/m national CPI increased by 4.3 percent in July 2022. It was

apprised that the increase in inflation was broad based and all three categories (energy, food and core inflation) contributed to the high inflation. On a y/y basis, core inflation in urban and rural areas rose to 12 percent and 14.6 percent, respectively. On a m/m basis, core inflation was recorded at 1.2 percent and 1.6 percent for urban and rural areas, respectively. This reflects the second-round effects of higher transportation and other input costs.

13. In July 2022, the rise in food inflation was primarily attributed to an increase in the prices of both perishable and non-perishable food items. Further, a reversal of subsidies, together with gradual imposition of Petroleum Development Levy (PDL) and General Sales Tax (GST) also pushed energy inflation to a record high.

14. Discussing the outlook, it was apprised that the average national CPI inflation for FY23 is projected to fall in the range of 18-20 percent. This outlook remains subject to certain risks. The upside risks include exchange rate depreciation, political uncertainty and the ongoing floods, while down side risks include a fall in global commodity prices, appreciation of PKR, and another Covid-19 wave.

Financial Markets and Reserve Management

15. Apprising the Committee on monetary policy implementation, the staff stated that the O/N repo rate averaged 14.76 percent, against the target of 15 percent, since the last MPC meeting, while liquidity injections through OMOs witnessed a significant increase. The net average daily outstanding level of OMOs increased to PKR 5.06 trillion during the current cycle of monetary review period as compared to PKR 4.02 trillion during the previous monetary policy review period.

16. Further, it was noted that secondary market yields of 3-month to 12-month tenors have increased since the last MPC meeting in July 2022. However, medium to long-term yields have declined slightly. In primary auctions, the market offered higher than the target amounts, with increasing interest in PIBs.

17. The staff apprised the Committee that Pakistan Eurobond yield and CDS spreads have declined in recent days and the situation is expected to improve further after the resumption of the IMF program.

18. Further, it was informed that the PKR has appreciated by 3.0 percent against the USD since the last MPC meeting. This was mainly attributed to foreign exchange inflows, a narrower trade deficit and improved market sentiment owing to expectations of a resumption of the IMF program. Lastly, it was also highlighted that the volatility of PKR is higher than compared to the currencies of other Emerging Market Economies (EMEs) since the last MPC meeting.

Model-Based Assessment

19. 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 due to *the weakening of PKR, the expected upward adjustments in electricity charges and recent flooding across various parts of Pakistan, which is likely to put pressure on the price of perishable food items going forward.*

20. The Committee also discussed the medium-term conditional inflation forecast and the corresponding policy interest rate path suggested by the model to bring inflation within the medium-term target range of 5 to 7 percent. In this context, the Committee also discussed the appropriateness of the current policy rate stance. Going forward, the factors explaining a likely moderation in the inflation rate include; *i) favourable base effect for FY24 due to higher-than-anticipated inflation in FY23, ii) fuller impact of previous monetary tightening, iii) strong fiscal consolidation as planned under the IMF program, iv) moderation of international commodity prices owing to the resolution of supply-chain issues,* and *v) economic slowdown.*

21. Then, the staff presented scenarios based on alternative assumptions for global oil prices and PKR depreciation for FY23.

Result of SBP Surveys for Monetary Policy

22. The staff apprised the Committee that the confidence of businesses has improved and inflation expectations of businesses have significantly eased in the latest round of the survey. The Purchasing Managers Index (PMI) has declined notably, whereas employment growth in the manufacturing sector has inched up in the latest wave.

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

Monetary Policy Deliberations and Decision Vote

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

DECISIONS:

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