

**MINUTES OF THE MONETARY POLICY COMMITTEE MEETING  
HELD ON MONDAY, MAY 23, 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. 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 April 7, 2022, along with an assessment of evolving trends.
2. Giving an overview of the real sector, the staff apprised the MPC that growth has been stronger than expected for the last two consecutive years. The provisional estimate of PBS for real GDP growth is almost 6.0 percent in FY22, which is higher than SBP's forecasted range of 4.0-5.0 percent. It was noted that this variation in growth was mainly due to wholesale and retail trade and educational services. The staff apprised the MPC that domestic demand continues to moderate since the last MPC meeting. However, POL sales reached a 46-month high, while cement and auto sales recorded a decline in April 2022.
3. Regarding aggregate supply, it was informed that conditions remained conducive for growth. Large-scale Manufacturing (LSM) posted 26.6 percent growth in March 2022, largely on the back of export-orientated textiles, consumer non-durables, automobiles and construction-allied sectors. Cumulatively, LSM grew by 10.4 percent in Jul-Mar FY22 as compared to a 4.3 percent increase in the same period last year.
4. In agriculture, there was an upward revision in the estimates of all major crops with rice and maize showing record production in FY22. However, the latest information suggests that wheat production is likely to decline as compared to last year. It was highlighted that in Pakistan, output levels and real GDP (in absolute terms) have converged to pre-pandemic levels much faster than seen in most other emerging markets.
5. Discussing the outlook, the Committee was apprised about emerging risks, notably water shortages, low rainfall and higher fertilizer prices for the next fiscal year. In particular, there is a drought like situation in South-Punjab and Sindh that is expected to impact the production of rice and cotton in the next financial year. This combined with recent policy actions and changes in baseline assumptions indicate that the economic growth for FY23 is expected to decelerate. The factors explaining the deceleration are high energy prices, rising input costs, monetary tightening and macro prudential regulations affecting the demand side.
6. Discussing recent developments in monetary aggregates, it was apprised that broad money (M2) growth has decelerated substantially, amid a sharp contraction in the Net Foreign Assets (NFA) of SBP, while Net Domestic Assets (NDA) of the banking system saw a substantial expansion due to an unprecedented uptick in the Private Sector Credit (PSC) and an increase in net budgetary borrowing from the banking system. On the liability side, a sharp decline in bank deposits (particularly demand deposits) kept overall M2 growth lower than in previous years. The Reserve Money (RM) growth also decelerated, both on y/y and cumulative basis, due to a decline in SBP's NFA, which partially offset the rising impact of Open Market Operations (OMOs)

injections and SBP's claims on government and non-government (via concessional credit schemes).

7. Further, the staff apprised that Private Sector Credit (PSC) surged by 22.3 percent on a y/y basis to PKR 8.9 trillion in April 2022 on the back of strong demand for working capital loans from manufacturing concerns and selected services sectors. Cumulatively, PSC rose to a historic high at PKR 1.30 trillion during 01Jul - 06May FY22, which is almost three-times that of PKR 420.7 billion during the same period of FY21.

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

9. Regarding credit growth projections, the staff informed that incorporating the latest developments and expected offtake in the remaining months of FY22, the credit growth projection range for the year has been revised further upwards. However, the pace of credit expansion in FY23, is projected to decelerate, 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.

10. Discussing fiscal developments, it was apprised that the fiscal deficit increased to 3.8 percent of GDP during Jul-Mar FY22 from 3.0 percent in the same period last year. Meanwhile, the primary balance turned into a deficit of PKR 447.2 billion (0.7 percent of GDP) in Jul-Mar FY22 against a surplus of PKR 451.8 billion (0.8 percent of GDP) in the same period last year. The deterioration during Q3-FY22 was due to an increase in current expenditures and a slowdown in non-tax revenues. During Jul-Mar FY22, subsidies and grants have more than doubled over the same period last year, reaching to almost one-third of FBR tax receipts. Despite the large amount of refunds paid to the pharmaceutical sector and reduction in sales tax on POL, fertilizers and pesticides, FBR revenue collection grew by 28.6 percent in Jul-Apr FY22, exceeding the target by PKR 239 billion. It was further apprised that while the fiscal deficit in FY22 is projected to be lower as compared to the last year, the primary deficit may be higher. For FY23, a preliminary assessment, assuming fiscal consolidation after the resumption of the IMF program, indicates that both the overall fiscal deficit and the primary deficit are expected to fall. However, these projections are dependent on; (i) the federal budget, (ii) international oil prices, (iii) changes in the policy rate, and (iv) the exchange rate.

11. Discussing global developments, the MPC was apprised that global economies remain under stress due to geopolitical uncertainty. It was noted that on account of the Russia-Ukraine war and extensive Covid-19 lock-downs in China, the Purchasing Managers' Index (PMI) for both manufacturing and services have been falling since January 2022. Furthermore, the staff apprised that volatility has increased in global financial markets, as indicated by the 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), the currencies of the EMEs are depreciating, which is further adding on to the inflationary pressures in these countries amid high global prices of major commodities.

12. In the case of Pakistan, imports are gradually contracting, while export growth is sustaining its momentum since the last MPC meeting. Exports rose to USD 2.9 billion in April 2022 and on an overall basis, exports reached USD 26.2 billion during Jul-Apr FY22, assisted by the strong performance of High Value Added (HVA) textiles. 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 kept imports at an elevated levels. As a result, the impact of rising exports was overshadowed by the 46.5 percent cumulative growth in imports during Jul-Apr FY22. In particular, the positive growth

(in terms of volume) of the components under the petroleum group, amid an unprecedented increase in international oil prices, is exacerbating import growth. Discussing workers' remittances, it was noted that inflows have maintained their momentum during FY22 and reached USD 3.1 billion in April 2022 (a historic monthly high). The increase is mainly attributed to the high number of workers going abroad and the increased use of formal digital channels.

13. The Current Account Deficit (CAD) has moderated in the last three months. However, the financial account balance remained under stress on account of weak official and private inflows. Since, the last Monetary Policy cycle, the financial account has recorded a large net outflow of USD 3.8 billion during Mar-Apr FY22. Further, Foreign Direct Investment (FDI) from China declined by almost 50 percent during Jul-Apr FY22 as compared to the same period last year.

14. Apprising the Committee on the external sector outlook for FY22, it was noted that exports are expected to maintain their momentum with major contribution coming from improving global demand, particularly for textiles. At the same time, due to the increase in global commodity prices, especially international oil prices, imports are also expected to remain at an elevated level. On an overall basis, the CAD is expected to remain at around 4.0 percent of GDP during FY22. However, in FY23, CAD is expected to narrow on account of the recent efforts by the Government to curtail imports, supported by an increase in the policy rate and exchange rate depreciation. The outlook for remittances remains broadly unchanged since the last MPC meeting.

15. Discussing trends and developments in inflation, it was apprised that national CPI inflation has risen to 13.4 percent on a y/y basis in April 2022, leading to an average national CPI inflation at 11.04 percent during Jul-Apr FY22 as compared to 8.62 percent in the corresponding period last year. It was noted that m/m national CPI increased by 1.6 percent in April 2022. It was explained that the rise in inflation in the last two months was mainly due to an increase in food and core inflation. Average core inflation across urban and rural areas also rose to 9.8 percent on y/y basis in April 2022. This reflects the second-round effects of persistently higher energy and food prices.

16. The rise in food inflation in April 2022 was primarily attributed to the Ramzan factor and shortened shelf-life of some perishable items due to an early start of summer. Fuel and electricity prices remained stable during April 2022, as a result of the previous government's subsidy package but on a y/y basis, energy inflation is still at an elevated level of 15.0 percent.

17. Discussing the outlook, the MPC was apprised that the average NCPI inflation for FY22 is now expected to breach the upper bound of the SBP's forecast range of 9-11 percent. In FY23, inflation is expected to remain elevated on account of rationalized fuel and electricity subsidies along with normalization of the Petroleum Development Levy (PDL) and GST on fuel.

### **Financial Markets and Reserve Management**

18. Apprising the Committee on monetary policy implementation, the staff stated that the overnight interbank repo-rate remained around 12.47 percent (on average) against the target policy rate of 12.25 percent. Liquidity injections through OMOs increased significantly since the last MPC meeting. During April 7, 2022 to May 19, 2022, the net average daily outstanding level of OMOs increased to PKR 3.3 trillion.

19. Further, it was noted that secondary market yields have increased significantly since the last MPC meeting in April 2022. The increase was more evident in 3-month to 1-year tenors in line with the higher cut-off rates in primary auctions. In auctions, the offered amounts remained higher than the Federal Government targets, albeit largely in PIBs. Further, the prices of Pakistan's Eurobond have also declined. This decline started in early March 2022 in the wake of the challenging economic environment for emerging economies, domestic political uncertainty and mounting pressure on the country's external accounts. It was noted that although the prices

of sovereign bonds of peer countries have also declined, but the decline is more pronounced and persistent in the case of Pakistan.

20. Further, it was informed that the Rupee has depreciated by 6.0 percent against the USD since the last MPC meeting. This was mainly attributed to the global surge in the dollar, higher international commodity prices, and lingering domestic policy uncertainty. Lastly, it was also highlighted that the volatility of PKR has increased in the last month, and is now broadly in line with the volatility in other major currencies.

### **Model-Based Assessment**

21. The staff apprised the Committee on key assumptions of the model. It was explained that the latest point forecast of inflation for FY22 and FY23 has been revised upwards because of; *i) higher than expected headline and core inflation readings in April, ii) pass-through of recent weakening of PKR/USD parity and its projected path, and iii) assumed complete removal of subsidies and gradual restoration of PDL and GST on administered petroleum prices effective from July 1, 2022.* These factors have been contributing to a significant rise in the medium-term inflation projection path.

22. 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 5-7 percent. Based on current information, the model recommended a large increase in the policy rate and to maintain the policy rate at an elevated level for a longer period than previously projected. This would help bring inflation down 5-7 percent in eight quarters from now. The staff also presented scenario analysis based on alternative assumptions for global oil prices and impact of resolution of ongoing political uncertainty on PKR/USD parity for FY23.

### **Result of SBP Surveys for Monetary Policy**

23. The staff apprised the Committee that the Consumer Confidence Survey was conducted in the second week of May 2022 and Business Confidence Survey in the second half of April 2022. It was highlighted that the confidence of both consumers and businesses has slightly improved in the latest round of the survey. Similarly, short-term inflation expectations of consumers and businesses have marginally declined.

24. The staff then apprised about 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 FY22 with the highest probability. Similarly, average inflation is expected to most likely to fall in the range of 11.0-11.9 percent in FY22. 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**

25. The Monetary Policy Committee unanimously decided to increase the policy rate by 150bps.

#### **DECISIONS:**

- The policy rate is increased by 150bps.
- The Monetary Policy Statement – May 23, 2022 is approved.