MINUTES OF THE MONETARY POLICY COMMITTEE (MPC) MEETING
HELD ON JANUARY 24, 2022

P R E S E N T

Dr. Reza Baqir	Chairman & Governor SBP
Dr. Inayat Hussain	Deputy Governor (Banking & FMRM)
Dr. Murtaza Syed	Deputy Governor (Policy)
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
Mr. Haroon ur Rehman	Secretary to the Committee

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 December 14, 2021, along with an assessment of evolving trends.

2. Giving an overview of the real sector, the staff apprised the MPC that key demand and supply side indicators have shown moderation since the last MPC meeting. Production and sales in most sectors have stabilized at elevated levels. It was informed that there was a slight uptick of 0.3 percent in Large-scale Manufacturing (LSM) in November 2021 after a decline in October 2021. The slowdown in LSM was mainly due to higher input prices and supply chain disruptions. Further, the high base effect also played its part because sugarcane crushing in FY21 was started in November 2021, while in FY22 crushing has been delayed and its impact would be reflected in December 2021 data.

3. In agriculture, input conditions broadly remain supportive for sowing of Rabi crops. However, fertiliser shortages and unexpected weather conditions pose downside risks. Cotton arrivals as of January 1, 2022 were 7.3 million bales, lower than earlier expectations. Further, discussing the recent revision in the National Income Account (NIA) by Pakistan Bureau of Statistics (PBS), the staff apprised the MPC that revision of provisional estimates of GDP is a regular activity. It was noted that the revised GDP estimates for FY21 show that the economy grew by 5.4 percent as compared to an earlier estimate of 3.9 percent, released in May 2021. Further, the change of base (from FY2005-06 to FY2015-16) by the PBS, along with an enhanced coverage of industries, have increased the level of real GDP and pushed growth to 5.6 percent for FY21. Further, elaborating on the impact of rebasing of the NIA by PBS, it was apprised that staff's preliminary assessment suggests that the higher base effect of growth in FY21 might mechanically push down growth in FY22. Together with the moderation in activity indicators noted above, real GDP growth in FY22 is now expected to come in around the middle of the previously announced 4–5 percent range. Further, it is not likely to have any material impact on the output gap and overall inflation projections.

4. Elaborating on developments in Pakistan's external sector, it was noted that exports are sustaining their momentum, recording an increase of almost 25 percent during H1-FY22 to reach a record-high of USD 15.1 billion (PBS data). Growth in exports during H1-FY22 has largely been driven by high value-added textiles, followed by food and other manufactured goods. However, this encouraging development was more than offset by an almost 66 percent (y/y) growth in imports in H1-FY22, which was recorded at USD 40.6 billion (PBS data), resulting in a trade deficit of USD 25.5 billion during H1-FY22. It was highlighted that high international prices, particularly those of oil, along with higher domestic demand and need for Covid-19 vaccines amid the government's

vaccination drive are the major factors keeping imports at an elevated level so far this fiscal year. With regard to workers' remittances, the MPC was informed that inflows have remained robust and were recorded at USD 2.5 billion in December 2021, and have risen by 11.3 percent (y/y) during H1-FY22 to an all-time high of $15.8 billion. Another positive development was the record increase in the number of registered workers going abroad in December 2021. This number is now close to monthly levels observed during the pre-Covid period. Nevertheless, due to the import bill, the current account deficit (CAD) widened to USD 9.1 billion during H1-FY22 as compared to the surplus of USD 1.2 billion during the same period last year.

5. Apprising the Committee on the external sector outlook for FY22, it was noted that exports and workers' remittances are expected to maintain their momentum through the rest of the fiscal year. However, downside risks stem from the heightened incidence of Covid-19 cases due to its newer variant "Omicron" that could result in disruptions to economic activity abroad. With regards to import, it was highlighted that a number of monetary and regulatory measures already taken by the SBP are expected to curtail domestic demand and moderate import growth going forward. The expected impact of these measures would be helpful in keeping the CAD at around 4 percent of GDP. However, if high international oil prices continue to persist and the full impact of the demand moderating measures takes longer than expected to manifest, both the import bill and the CAD could be higher. The financial account surplus is expected to cover the CAD fully and would add to SBP's foreign exchange reserves subject to timely disbursement of budgeted multilateral inflows and planned issuance of Eurobonds.

6. Discussing recent developments in monetary aggregates, it was apprised that Broad Money (M2) expanded at slightly faster pace at 5.5 percent during November 19 to December 31 FY22. On the asset side, the expansion in M2 was entirely due to Net Domestic Assets (NDA) on account of a sharp pick-up in private sector credit and higher government borrowing from commercial banks. On the liability side, the seasonal surge in bank deposits during December 2021 was the primary contributor to M2 growth.

7. Further, the staff apprised that the Private Sector Credit (PSC) saw a significant expansion in December 2021. This was led by increased working capital requirements owing to higher input prices. At the same time, fixed investment loans saw a steady expansion due to continued disbursements under SBP's Temporary Economic Relief Program (TERF), while housing and construction finance picked up pace in December as banks sought to achieve the targets given by the SBP. It was noted that Rs. 137 billion has been disbursed under TERF in FY22 and another Rs. 167 billion is expected to be disbursed in H2-FY22. However, growth in auto loans remained flat during last few months, reflecting the tightening of prudential regulations and high borrowing cost. It was further apprised that credit expansion in H1-FY22 was mainly led by scheduled banks (own sources) compared to last year when it was being driven by SBP's refinance schemes. Based on these developments, the PSC growth projection range is revised upwards.

8. Discussing fiscal developments, it was apprised that higher tax revenue and restrained expenditure growth led to an improvement in the fiscal deficit to 1.1 percent of GDP in Jul-Oct FY22 as compared to 1.7 percent of GDP in the comparable period last year. It was noted that FBR's collection rose to Rs. 2,920 billion during H1-FY22, a 32.5 percent increase over the corresponding period last year. With the increase in Petroleum Development Levy (PDL) rates by Rs. 4 per litre from November 2021, non-tax revenues are expected to recover further in the remaining months of FY22. It was noted that Public Sector Development Program (PSDP) expenditures were Rs. 209.5 billion in Jul-Nov FY22, 64 percent higher than the corresponding period of last year. Further, it was apprised that with the Finance (Supplementary) Act, 2022, the fiscal deficit was expected to be about 0.5 percent of GDP lower than the earlier projection. This greater than planned fiscal consolidation is expected to help moderate domestic demand and inflation, especially in FY23.

9. Discussing trends and developments in inflation, it was apprised that national CPI inflation has risen to 12.3 percent on a y/y basis in December 2021 from 11.5 percent in November 2021. It

was also noted that on m/m basis, national CPI inflation slowed down significantly in December 2021, declining by 0.02 percent compared to 3.0 percent recorded in November 2021. A sharp seasonal decline in prices of perishable food items and poultry helped to keep food inflation low. The major push to inflation came from an upsurge in energy prices. Energy inflation is maintaining an upward trajectory, rising to 41.3 and 34.0 percent (y/y) in urban and rural areas, respectively, in December 2021. In addition, core inflation rose to 8.3 and 8.9 percent (y/y) in urban and rural areas, respectively, in December 2021. This reflects robust domestic demand and the second-round effects of higher energy and other international commodity prices.

10. The staff further explained that cyclical inflation, the difference between actual and trend inflation, is being driven by an upsurge in electricity charges and the prices of motor fuel, liquefied hydrocarbons, edible oil and ghee. The staff further explained that the surge in energy prices, transportation cost and supply shortages have also led to higher-than-anticipated inflation in many other emerging and developed economies. In addition, the Committee noted that roughly one-fourth of inflation at the national level is being contributed by import-based items.

11. Discussing the outlook, the MPC was apprised that the forecast range for average NCPI inflation for FY22 remained unchanged between 9-11 percent, with the outcome expected to be close to the upper end of the range. The projection incorporates the latest inflation outcomes, trends in global commodity prices, adjustments in administered prices, and the expected impact of the Omicron variant of Covid-19.

Financial Markets and Reserve Management

12. Apprising the Committee on monetary policy implementation, the staff stated that the overnight interbank repo-rate remained around 10.07 percent on average, against the target policy rate of 9.75 percent. The liquidity injections through Open Market Operations (OMOs) increased slightly since the last MPC meeting. The net average daily outstanding level of OMOs stood at approximately Rs. 1.8 trillion during December 14, 2021 to January 11, 2022. Following MPC approval, SBP has introduced a Shariah Compliant Standing Ceiling Facility and Open Market Operations (injections) for Islamic Banking Institutions (IBIs). The total amount availed under the standing facility was Rs. 631 billion since its inception. It was noted that the utilization of the facilities is expected to increase in near future.

13. Further, it was noted that secondary market yields have generally fallen across the curve since the last MPC meeting in December 14, 2021. It was highlighted that secondary market yields of longer tenors (above 1-year) and benchmark rates have witnessed an especially significant reduction, in the range of 19 to 51 bps since the last MPC meeting. Primary market auction cut-offs also depicted a similar pattern.

14. Further, it was informed that, on an overall basis, the Pakistani rupee (PKR) appreciated by around 1.0 percent against the USD since the last MPC meeting.

Model-Based Assessment

15. The staff apprised the Committee about key assumptions used in the model-based assessment of inflation. It was explained that the point forecast of average inflation for FY22 in the baseline scenario has been revised slightly upward because of higher than expected inflation in December 2021. However, the inflation projection for FY23 has been revised downward on account of recent fiscal tightening and additional planned fiscal consolidation in FY22 as a result of the Finance (Supplementary) Act. Moreover, expected softening of international commodity prices, favourable base effects, and lagged impacts from monetary tightening are also expected to help lower the medium term inflation outlook.

16. The Committee also discussed the path of the policy rate suggested by the model to bring inflation within the medium-term range of 5-7 percent. The staff also presented scenario analysis based on alternative assumptions for growth and global oil prices for FY22.

Result of SBP Surveys for Monetary Policy

17. The staff apprised the Committee that the Consumer Confidence Survey was conducted in the first half of January 2021 and Business Confidence Survey in the second half of December 2021. It was highlighted that the confidence of consumers remained broadly stable while business confidence improved slightly in the latest wave of the survey.

18. It was also noted that inflation expectations of consumers remained unchanged while that of businesses declined considerably during the latest waves of the respective surveys. The easing of uncertainty associated with the resumption of IMF program, expected improvement in supply chain issues, recent exchange rate movements, and recent and planned fiscal consolidation are some of the likely factors behind improved business inflation expectations.

19. The staff then apprised about the results of the "Survey of Other Forecasters" from institutions other than the SBP. It was highlighted that most of the forecasters and experts expected no change in the SBP's policy rate in the current MPC meeting.

Monetary Policy Deliberations and Decision Vote

20. The Committee unanimously decided to keep the policy rate unchanged.

21. The Committee then scripted the Monetary Policy Statement.

DECISIONS:

- *The policy rate is kept unchanged.*
- *The Monetary Policy Statement – January 24, 2022 is approved.*