MINUTES OF THE MONETARY POLICY COMMITTEE (MPC) MEETING
HELD ON FRIDAY, NOVEMBER 25, 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
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 staff apprised the Committee of developments in key macroeconomic indicators since the last Monetary Policy decision on October 10, 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 economic indicators continue to reflect a slowdown in economic activity. During October 2022, auto sales declined by 42.0 percent, POL sales declined by 19.3 percent and domestic cement sales declined by 15.5 percent, on a y/y basis. On a monthly basis, volumes slightly picked up in October 2022 as flood-related disruptions gradually eased. Further, it was noted that cumulatively, Large-Scale Manufacturing (LSM) contracted by 0.4 percent during Q1-FY23 despite positive contributions by export-oriented sectors. This slowdown is mainly attributed to high energy costs, recent floods and the lagged impact of tightening of domestic monetary and fiscal policies.

3. Discussing developments in the agriculture sector, it was noted that latest estimates by the Federal Committee on Agriculture show that floods have severely affected the cotton and rice crops for the current season. So far, cotton arrivals were 41 percent lower as of November 01, 2022, compared to the same period last year. It was highlighted that the lacklustre performance of the agriculture sector would also impact the output of industry and the services sector.

4. Summarizing the outlook, the Committee was apprised that based on current available information about the impact of floods, real GDP growth is expected to be around 2.0 percent in FY23. It was noted that the growth projection is subject to certain downside risks including; (i) more than anticipated deterioration in the external sector, particularly if global recession emerges in 2023; and (ii) larger than expected slowdown in industry and the services sectors.

5. Discussing recent developments in monetary aggregates, it was apprised that broad money (M2) growth moderated to 14.0 percent as of October 28, 2022, on account of a 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 expanded by 23.5 percent in FY23 due to an increase in net budgetary borrowings from the banking system. On the liability side, deceleration in Currency in Circulation contained M2 growth.

6. Discussing fiscal developments, the staff apprised the Committee that the fiscal deficit increased to 1.0 percent of GDP in Q1-FY23 as compared to 0.7 percent in Q1-FY22. Similarly, the primary surplus declined to 0.2 percent of GDP as compared to 0.3 percent in Q1-FY22. It was noted that the deterioration in fiscal balances is primarily attributed to a decline in non-tax revenue and higher interest payments. It was highlighted that total revenue declined to 2.6 percent of GDP in

Q1-FY23 from 2.7 percent of GDP in Q1-FY22, whereas overall expenditures increased to 3.6 percent of GDP in Q1-FY23 from 3.4 percent in Q1-FY22. Moreover, growth in FBR tax revenue remained significantly lower, at 16.6 percent, during the first four months of FY23 compared to the 37.8 percent growth in the same period last year.

7. Discussing global developments, the staff apprised the Committee that the global economy remains under stress due to; (i) rising fears of a global recession, (ii) high inflation, (iii) an increase in interest rates by Advanced Economies (AEs), and (iv) rising external liquidity constraints for Emerging/Developing Economies. This trend is also evident from falling Purchasing Manager Indices (PMI) for both the manufacturing and the services sectors. It was noted that commodity prices are easing and the trend is expected to continue due to an anticipated slowdown in global demand. However, it was highlighted that despite this easing, global commodity prices are still higher than pre-Covid levels. Moreover, an increase in interest rates by the Federal Reserve has resulted in capital outflows from Emerging Market Economies (EMEs) and the strengthening of USD against the currencies of EMEs. 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 2.8 billion during Jul-Oct FY23 compared to USD 5.3 billion in the same period last year. Imports declined by 15.9 percent (PBS data) during Jul-Oct FY23 compared to the same period of FY22. This is due to lower volumes that offset the impact of higher prices. Growth in exports, meanwhile, has also decelerated to 1.1 percent during Jul-Oct FY23 as compared to 24.9 percent during the same period in FY22. This trend reflects a global economic slowdown that is impacting both export volumes and prices. Workers' remittances recorded a broad-based decline from all corridors in October 2022. Elaborating on the outlook of various components of the current account, it was noted that imports are expected to remain contained in the coming months of FY23 due to the lagged impact of previous interest rate hikes, exchange rate depreciations, anticipation of a decline in global commodity prices and administrative/regulatory measures. The staff stated that amid slowing global economic conditions, exports are expected to fall below the level achieved in FY22 as prices and volumes of High Value Added (HVA) textiles are now declining after attaining a peak. Rice exports are also expected to decline amid flood related losses. Moreover, receipts of workers' remittances are expected to moderate amid domestic uncertainties and changing global economic prospects.

9. Discussing trends and developments in inflation, it was apprised that national CPI inflation accelerated to 26.6 percent (y/y) in October 2022 from 23.3 percent in September 2022. The normalization of Fuel Costs Adjustment (FCA) in electricity charges is primarily responsible for the acceleration of inflation. The energy inflation increased to 34.1 and 36.9 percent (y/y) in October 2022 in urban and rural areas, respectively. It was noted that on a m/m basis, national CPI inflation increased by 4.7 percent in October 2022 against a reduction of 1.2 percent in September 2022. Both food and core inflation maintained a rising momentum. It was highlighted that energy costs and their second round impacts are driving the recent increase in core inflation. In addition, the potential entrenchment of inflation expectations have repercussions for core inflation and it would be important to keep a close watch on core inflation going forward.

10. In October 2022, the rise in food inflation was primarily attributed to an increase in both the prices of perishable and non-perishable food items on account of floods. On a y/y basis, in October 2022, core inflation in urban and rural areas rose to 14.9 percent and 18.2 percent, respectively.

11. Discussing the outlook, it was apprised that based on normalization of FCA, higher food prices and rising core inflation, average national CPI inflation for FY23 is projected to be in the 21-23 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 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 15.21 percent, against the target of 15 percent, since the last MPC meeting, while liquidity injections through OMOs witnessed a slight increase. However, net average daily outstanding level of OMOs increased to PKR 5.59 trillion during the current cycle of the monetary review period as compared to PKR 5.49 trillion during the previous monetary policy review period. Further, it was noted that secondary market yields in benchmark tenors showed a slight upward trend. In primary auctions, the market offered higher than the target amount in 3-month T-bills.

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

14. Further, it was informed that PKR has depreciated by 2.7 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

15. The staff apprised the Committee of key assumptions used in running the model. It was explained that the medium-term outlook for inflation had been updated in light of the normalization of FCA and its pass-through, uptick in core inflation, and disruptions in supply chains mainly owing to floods. The staff apprised the Committee that inflation is expected to remain elevated for a while due to the aforementioned factors before declining 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) the economic slowdown.

16. 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 range of 5 to 7 percent in the medium-term. In this context, the Committee also discussed the appropriateness of the current policy stance.

17. The staff then presented simulations of inflation and policy interest rate paths under alternative assumptions for global oil prices and PKR value for FY23.

Result of SBP Surveys for Monetary Policy

18. The staff apprised the Committee that the confidence of both consumers and businesses has improved somewhat from their last waves; but, sentiments are still below the benchmark. The staff also apprised the Committee that the Purchasing Managers Index (PMI) and expected Employment Index for the manufacturing sector remained unchanged in the latest wave. The traditional measures of inflation expectations of both consumers and businesses, though, have eased in the latest round of the survey, nonetheless, these readings are still below the benchmark and indicate some sign of ratcheting up of inflation expectations. The committee also looked at deeper measures from inflation surveys, including the dispersion of expectations, as well as wages data.

19. The staff then apprised the MPC about the results of the 'Survey of Other Forecasters' from institutions other than SBP and their medium term inflation projections. It was noted that a majority of forecasters and experts expected a status quo in the SBP's policy rate in the current MPC meeting while medium term expectations had inched up.

Monetary Policy Deliberations and Decision Vote

20. The MPC has decided to increase the policy rate by 100bps with a majority vote of 7 out of 9 members. One Member voted to increase the policy rate by 50bps while another voted to keep the policy rate unchanged.

DECISIONS:

- The policy rate is increased by 100 bps.
- The Monetary Policy Statement – November, 2022 is approved.