MINUTES OF THE MEETING OF THE MONETARY POLICY COMMITTEE (MPC) HELD AT KARACHI ON THURSDAY, MARCH 2, 2023 AT 10:00 AM

P R E S E N T

Mr. Jameel Ahmad	Chairperson & Governor SBP
Dr. Inayat Hussain	Deputy Governor (Banking & FMRM)
Ms. Sima Kamil	Deputy Governor (I, I, IF)
Mr. Arshad Mehmood Bhatti	Executive Director (BPRG)
Mr. Fawad Anwar	Director SBP Board
Mr. Najaf Yawar Khan	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

Review of Current Economic Conditions and Outlook for FY23

1. The staff apprised the Committee of recent developments in key macroeconomic indicators since the last MPC meeting of January 23, 2023. Moreover, assessments and analyses of evolving trends were also shared for the information of the Committee.

2. Presenting an overview of the real sector, the staff stated that recent data for high frequency economic indicators continued to reflect a pronounced and broad-based slowdown in economic activity during the first seven months of current fiscal year. Specifically, in January 2023, auto sales declined by 44.1 percent and Petroleum, Oil and Lubricants (POL) sales declined by 24.0 percent. The domestic cement sales, however, showed a slight recovery of 5.3 percent on a y/y basis. Further, the Committee was apprised that cumulatively, Large-Scale Manufacturing (LSM) contracted by 3.7 percent during July-December FY23 despite positive contributions by some export-oriented sectors. The Committee was apprised that employment related sentiments deteriorated sharply during the last six months. It was noted that automobiles and textiles are the worst hit sectors owing to economic slowdown.

3. Apprising the Committee on the developments in the agriculture sector, the staff shared that, as of February 1, 2023, cotton arrivals were recorded at 4.8 million bales; 35.8 percent lower compared to the same period last year (*SPLY*). This decline was largely due to the impact of floods. It was highlighted that the lacklustre performance of the agriculture sector would negatively impact the output of industry as well as the services sector. This was evident in the recent shutdowns and scaling back of operations by some companies, owing to both supply chain disruptions and demand contraction.

4. Summarizing the outlook, the Committee was apprised that based on recent trends, including lower than anticipated agriculture output, accelerated deterioration in LSM production, moderation in the services sector and recent fiscal adjustments, the downside risks to SBP's earlier outlook of real GDP growth for FY23 have significantly increased.

5. Apprising the Committee about evolving trends in international markets and other global developments, the staff stated that the fears of a global recession are now relatively milder as compared to the last MPC meeting (January 23, 2023) since economic prospects in both the advanced and emerging economies have slightly improved. Further, multi-year high inflation in most countries appears to have peaked, while international commodity prices have plateaued around their current levels. The recent policy rate hike by the US-Fed has reversed the weakening trend of the US dollar, hence, investment inflows in emerging markets have receded.

6 Discussing the latest developments related to Pakistan's Balance of Payments (BoP), the staff stated that the Current Account Deficit (CAD) narrowed significantly to USD 3.8 billion during Jul-Jan FY23 compared to USD 11.6 billion (*SPLY).* This decline is primarily attributed to a sharp contraction in imports on account of monetary tightening and other measures. Imports, in particular, declined by 22.5 percent to USD 36.1 billion (as per PBS data) during Jul-Jan FY23 compared to USD 46.6 billion (*SPLY)*. At the same time, exports also contracted by 7.0 percent to USD 16.5 billion during Jul-Jan FY23 compared to USD 17.7 billion (*SPLY).* It was noted that beside moderation in volumes of High-Value Added (HVA) textile exports, the decline in international prices has resulted in low export values.

7. Presenting the outlook of various components of the current account balance, it was apprised that imports are expected to shrink further in the coming months due to the weaker domestic economic prospects, recent fiscal measures and exchange rate depreciation. Workers' remittances are expected to remain subdued due to the global economic outturn and the elevated kerb premium also poses a downside risk. However, the near-term outlook for remittances appears positive, given the fact that both *Eid-ul-Fitr* and *Eid-ul-Adha* are falling in the second half of FY23 and there is a steady increase in the number of workers going abroad.

8. Discussing fiscal developments, the staff apprised the Committee that the fiscal deficit stood at 2.0 percent of GDP in H1-FY23, unchanged compared to *SPLY*, while the primary surplus improved to 1.1 percent of GDP compared to 0.1 percent (*SPLY)*. This improvement in the fiscal accounts was largely due to decline in overall expenditures to 7.6 percent of GDP in H1-FY23 from 8.0 percent in H1-FY22. On the revenue side, FBR taxes grew by 18.0 percent in Jul-Jan FY23, lower than 31.8 percent growth in *SPLY*. Further, due to an increase in Petroleum Development Levy (PDL) on POL products, the non-tax revenue increased by 26.4 percent in H1-FY23, against a 14.6 percent decline in *SPLY*.

9. It was noted that an increase in current expenditures, due to a sharp increase in interest payments, and a moderation in revenue growth squeezed the space for development spending. As a result, the growth in development expenditures decelerated to 11.4 percent in H1-FY23 from 24.8 percent (SPLY). Discussing the outlook, it was noted that the new taxation measures and cut in subsidies might help in containing fiscal deficit.

10. Discussing developments related to monetary aggregates, it was apprised that Broad Money (M2) growth recorded a sharp deceleration, primarily due to a contraction in Net Foreign Assets (NFA) of the banking system. In contrast, Net Domestic Assets (NDA) of the banking system continued to expand on account of increased government budgetary borrowing. On the other hand, growth in Private Sector Credit (PSC) has decelerated owing to subdued demand for working capital and consumer loans, which may be attributed to the high cost of borrowing, deteriorating income levels and tightening of prudential regulations by SBP.

11. Discussing trends and developments in inflation, it was apprised that headline inflation surged to 31.5 percent (y/y) in February 2023 from 27.6 percent (y/y) in January 2023 and 24.5 percent (y/y) in December 2022. Consequently, National CPI inflation averaged to 26.2 percent during July-February FY23 compared to 10.5 percent *(SPLY)*. It was apprised that the increase in inflation has been broad-based with contributions coming from all major groups – core, food and energy. Increase in food inflation remains the major contributor to inflation as prices of essential food items spiked in February 2023. The pace of core inflation also accelerated due to the materialization of second round effects of administered energy prices and elevated inflation expectations as manifested in the latest consumer and business sentiment surveys. Energy group inflation, which was subdued previously, also started to contribute in headline inflation due to adjustments in POL prices and the partial impact of upward adjustments in gas prices announced in February 2023 as well as exchange rate depreciations.

12. Discussing the outlook of inflation, it was noted that fiscal adjustments, increase in energy prices, and exchange rate depreciation have led to a significant deterioration in the near term inflation outlook. The staff apprised the Committee that inflation is expected to rise further in the next few months as the full impact of the aforementioned adjustments unfolds. The staff also apprised the Committee that the projection of average national CPI inflation for FY23 has been revised upward to 27-29 percent compared to the earlier projection of 21-23 percent during the last MPC review period. However, this baseline projection is subject to upside risks such as (i) lower-than-expected wheat crop; and (ii) increase in global crude oil prices following the expected increased demand emanating from the opening up of Chinese economy.

Financial Markets and Reserve Management

13. Apprising the Committee on monetary policy implementation, the staff stated that the O/N repo rate averaged 16.88 percent, against the target of 17 percent, since the last MPC meeting. SBP's OMO liquidity injections increased and the net average daily outstanding level of SBP liquidity support was PKR 6.47 trillion during the monetary policy review period compared to PKR 5.66 trillion in the last review period. Further, the rates in primary and secondary market increased more than the increase in the policy rate in the last MPC meeting. In primary auctions, the market participation was broadly confined to 3-month T-bills and floating rate PIBs during the review period.

14. The staff apprised the Committee that Pakistan Eurobond yields and Credit Default Swap (CDS) spreads remain elevated well above normal levels.

15. Further, it was informed that PKR has depreciated by 13.5 percent against USD since the last MPC meeting. This was mainly attributed to pressures on the country's external account, while higher volatility was witnessed during this period as compared to the start of FY23 owing to both domestic and international developments.

Model-Based Assessment

16 The staff apprised the Committee about the key assumptions of the baseline inflation projections for FY23 and FY24 conditioned upon the policy rate path. The staff explained that the medium-term outlook for inflation has been updated by incorporating the latest inflation outturns, exchange rate depreciation, increase in energy prices and impact of various fiscal measures. Inflation in FY23 is expected to remain elevated as compared to the earlier projection due to; (i) the pass-through of assumed weaker PKR; (ii) the second round impact of fiscal measures; (iii) persistence of core inflation; and (iv) the impact of a ratcheting up of inflation expectations.

17 The Committee also discussed the medium-term conditional inflation forecasts relative to its target 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 discussed the appropriateness of the current policy stance.

18 While discussing the risks to the baseline projections, the staff presented simulations of inflation and policy rate paths under alternative assumptions for global oil prices and PKR value for FY23 and FY24. Staff also presented inflation trajectory with no change in policy rate.

Result of SBP Surveys for Monetary Policy

19. The staff apprised the Committee that the confidence of both consumers and businesses declined from their last waves as well as the respective 1-year averages. The Purchasing Managers

Index (PMI) for the manufacturing sector also declined in February 2023 compared to the last wave of December 2022. It was apprised that there is a marginal improvement in the expected Employment Index for the manufacturing sector. Moreover, the traditional measures of inflation expectations of both consumers and businesses inched up in February 2023 compared to the last wave. These readings indicate a further upward drift in inflation expectations. The Committee also looked at deeper measures from inflation surveys, including the dispersion of expectations, as well as wages data.

20. 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 an increase in the policy rate in the current MPC meeting.

Monetary Policy Deliberations and Decision Vote

21. The MPC decided to increase the policy rate by 300 bps with a majority vote of seven out of nine members. One Member voted to increase the policy rate by 200 bps while another Member voted for a 400 bps increase.

DECISIONS:

- *The policy rate is increased by 300 bps to 20 percent.*
- *The Monetary Policy Statement – March 2023 is approved.*