MINUTES OF THE MEETING OF THE MONETARY POLICY COMMITTEE (MPC) HELD AT KARACHI ON TUESDAY, APRIL 4, 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 (FI & I)
Mr. Arshad Mehmood Bhatti	Executive Director (BPRG)
Mr. Fawad Anwar	Director SBP Board
Mr. Muhammad Ali Latif	Director SBP Board
Mr. Najaf Yawar Khan	Director SBP Board
Dr. Naved Hamid	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 March 2, 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 on high-frequency economic indicators continued to reflect a pronounced and broad-based slowdown in economic activity during the current fiscal year. Specifically, in February 2023, auto sales declined by 63.5 percent while in March 2023, Petroleum, Oil and Lubricants (POL) sales declined by 39 percent and domestic cement sales contracted by 29 percent on a y/y basis. Further, the Committee was apprised that cumulatively, Large-Scale Manufacturing (LSM) contracted by 4.4 percent during July-January FY23 despite positive contributions by some export-oriented sectors. The activities in construction and its allied industries remained subdued during Jul-Mar FY23, mainly on account of high input costs. It was noted that electricity generation also declined, for the ninth consecutive month, in February 2023, reflecting a broad-based slowdown in economic activities.

3. Apprising the Committee on developments in the agriculture sector, the staff stated that as of March 1, 2023, cotton arrivals were recorded at 4.9 million bales; 34.5 percent lower on a y/y basis compared to the same period last year. This decline was largely attributed to the lingering impact of floods. Further, wheat production during FY23 is expected to remain lower than target, mainly on account of the rain spell in the upper parts of the country. It was highlighted that the subdued performance of the agriculture sector would negatively impact the output of the industry as well as the services sector growth. This is reflected by the recent shutdowns and scaling back of operations by some companies, owing to demand contraction as well as supply disruptions.

4. Summarizing the outlook, the Committee was apprised that these developments, combined with the lagged impact of the monetary tightening and recent fiscal consolidation measures, suggested growth in FY23 would be significantly lower than the earlier projection of around 2 percent presented in November 2022.

5. On the global front, it was noted that international financial conditions tightened further amid interest rate hikes and liquidity stresses faced by the banking system. These have led to capital outflows from Emerging Market Economies (EMEs), putting pressure on their currencies. However, global prices somewhat softened, while inflation seems to have peaked in most advanced and emerging countries. Despite all headwinds, global economic prospects continue to improve, mainly at the back of a recovery in emerging economies.

6. Discussing the latest developments related to Balance of Payments (BoP), the staff stated that the monthly Current Account Deficit (CAD) fell below USD 100 million in February FY23, which is the lowest in the last twenty-four months. Cumulatively, during Jul-Feb FY23, CAD contracted by 68.0 percent to USD 3.9 billion compared to USD 12.1 billion in the same period last year. This decline is primarily attributed to a sharp contraction in import volumes on account of monetary tightening and other measures. Imports, in particular, declined by 23.5 percent to USD 40.1 billion (as per PBS data) during Jul-Feb FY23 compared to USD 52.4 billion in the same period last year. At the same time, exports also contracted by 9.2 percent to USD 18.7 billion during Jul-Feb FY23 compared to USD 20.6 billion in the same period last year. It was noted that besides some moderation in High-Value Added (HVA) textile export volumes in recent months, a fall in international prices has contributed to a decline in exports. Further, it was noted that the recovery witnessed in workers' remittances on a m/m basis in February 2023 is expected to continue in coming months due to the seasonal Eid effect. However, on a cumulative basis, remittances remained lower in Jul-Feb FY23 compared to the same period last year. Regarding the decline in investment inflows during Jul-Feb FY23, the Committee was apprised that it was mainly on account of domestic uncertainty, weak growth prospects and tight global financial conditions.

7. Presenting the outlook of various components of the current account balance, it was apprised that imports are expected to shrink further in FY23 mainly on account of an expected moderation in commodity prices, weaker LSM growth prospects, the lagged impact of monetary tightening and exchange rate depreciation. It was noted that exports are expected to gain positively from the recent favourable exchange rate movements while declining trend in international prices could have an opposite impact. Workers' remittances are expected to improve marginally as the number of workers going abroad remains encouraging. However, uncertainty on both, domestic and global fronts may impact flows negatively.

8. Discussing fiscal developments, the staff apprised the Committee that the fiscal deficit was contained to 2.3 percent of GDP during Jul-Jan FY23 compared to 2.8 percent in the same period last year, while the primary balance recorded a surplus of 1.1 percent of GDP against a deficit of 0.3 percent last year. This improvement, notwithstanding a significant increase in interest payments, is mainly attributed to lower subsidies, grants and development expenditures. Further, it was apprised that the growth in tax revenues remained below target, amidst a slowdown in economic activity, a reduction in imports and an inadequate policy focus on expanding the tax base. On the revenue side, FBR taxes grew by 18.0 percent in Jul-Feb FY23, lower than the 31.3 percent growth in the same period last year. Further, with an increase in Petroleum Development Levy (PDL) on POL products, non-tax revenue increased by 33.6 percent in Jul-Jan FY23, against a 16.7 percent decline in the same period last year.

9. Discussing developments related to monetary aggregates, it was apprised that Broad Money (M2) growth accelerated in recent months, primarily due to a substantial expansion in Net Domestic Assets (NDA) of the banking system on account of increased government budgetary borrowings. In contrast, the Net Foreign Assets (NFA) of the banking system continued to contract on account of foreign debt payments along with declining foreign inflows. The staff further apprised that growth in Private Sector Credit (PSC) witnessed a broad-based deceleration. PSC recorded a growth of 7.2 percent (PKR 667.1 billion) in Jul-Feb FY23 compared to 11.8 percent (PKR 903.6 billion), mainly attributed to the high cost of borrowing, regulatory measures and a slowdown in economic activity.

10. Discussing trends and developments in inflation, it was apprised that headline inflation surged to 35.4 percent (y/y) in March 2023 from 31.5 percent (y/y) in February 2023, pushing up average inflation during Jul-Mar FY23 to 27.3 percent, against 10.8 percent in the same period last year. It was noted that the surge in inflation was mainly attributed to (i) upward revision in administered energy prices, (ii) taxation measures implemented through the Finance (Supplementary) Bill, 2023, (iii) pass-through of exchange rate depreciation, (iv) seasonal Ramadan effect, and (v) second-round effects, particularly of adjustments in energy prices. The

staff apprised the Committee that inflation is expected to rise further in the next few months as the impact of the aforementioned factors is fully realised.

11. It was apprised that core inflation has risen to 18.6 percent in urban and 23.1 percent in the rural basket in March compared to 17.1 percent and 21.5 percent in February 2023, respectively. It was noted that second round impact of adjustments in administered energy prices, persistently high inflation expectations and exchange rate depreciation is mainly contributing to core inflation, while the demand-side pressures have started to subside due to the slowdown in economic activities.

12. Discussing the outlook of inflation, the staff stated that keeping in view the latest trends, the inflation projection for FY23 remains unchanged since the last MPC meeting. The staff also apprised the Committee that the projection of average national CPI inflation for FY23 is expected to remain between 27-29 percent. The inflation projection for FY24 has been revised downwards mainly because of further monetary tightening in March and an expected softening of international oil prices for FY24. The staff also apprised the committee that the baseline inflation projection is subject to upside risks such as: (i) lower-than-expected wheat crop; (ii) recurrence of heavy rains and floods; and (ii) unfavourable external developments.

Financial Markets and Reserve Management

13. Apprising the Committee on monetary policy implementation, the staff stated that the O/N repo rate averaged as per the target of 20.0 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 6.775 trillion during the monetary policy review period compared to PKR 6.474 trillion in the last MPC review period. It was noted that after the 300bps increase in the policy rate during the last MPC meeting, rates in the primary and secondary markets increased only by around 200bps, as the market had earlier already adjusted in anticipation of an increase in the policy rate.

14. In primary auctions, the market participation was broadly confined to 3-month T-bills. However, some shift was witnessed from floating to fixed rate PIBs.

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

16. Further, it was apprised that PKR has remained broadly stable as no significant movement was witnessed in PKR-US Dollar parity since the last MPC Meeting. Lastly, it was noted that PKR depreciation in recent months is mainly attributed to ongoing political and economic uncertainty, whereas, other emerging market currencies remain stable against the USD.

Model-Based Assessment

17. The staff apprised the Committee about the model-based assessments for inflation projections conditioned on policy rate path for FY23 and FY24. In this regard, it was explained that the inflation projection for FY24 is revised downwards on account of a slowdown in economic activity after the recent monetary tightening.

18. 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.

19. 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 exchange rate for FY23 and FY24. The staff also presented an inflation trajectory incorporating no change in the policy rate.

Result of SBP Surveys for Monetary Policy

20. The staff apprised the Committee that in the recent wave of the survey (March 2023), consumer confidence improved slightly while business confidence deteriorated marginally compared to the last wave (February 2023). Moreover, households' inflation expectations declined slightly, while businesses' inflation expectations witnessed an uptick. The Purchasing Managers Index (PMI) for the manufacturing sector also declined in March 2023 compared to the last wave of February 2023.

21. The Committee was apprised that Business Employment Expectations deteriorated sharply and it was noted that automobiles and textiles are the worst-hit sectors owing to the economic slowdown.

22. 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

23. The MPC decided to increase the policy rate by 100bps with a majority vote of seven out of nine while two members voted to *keep the policy rate unchanged*.

DECISIONS:

- *The policy rate is increased by 100bps to 21 percent.*
- *The Monetary Policy Statement – April 2023 is approved.*