MINUTES OF THE MEETING OF THE MONETARY POLICY COMMITTEE (MPC)
HELD AT KARACHI ON TUESDAY, DECEMBER 12, 2023

P R E S E N T

Mr. Jameel Ahmad	Chairperson & Governor SBP
Dr. Inayat Hussain	Deputy Governor (Banking & FMRM)
Mr. Saleem Ullah	Deputy Governor (F, I & I)
Mr. Muhammad Ali Malik	Executive Director (FMRM)
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. Hanid Mukhtar	External Member
Dr. S.M. Turab Hussain	External Member
Mr. Fayyaz-ur-Rehman	Corporate Secretary

Review of Current Economic Conditions and Outlook for FY24

1. The staff apprised the Committee of recent developments in the key macroeconomic indicators since the MPC meeting held on October 30, 2023. Assessments and analyses of evolving trends were also shared with the Committee, including key assumptions used in the baseline projections.

2. Discussing developments in the real sector, the staff stated that the latest high-frequency data on a year-on-year (y/y) basis reflected recovery, albeit at varying pace. The manufacturing sector recorded a moderate recovery in Q1-FY24. Cumulatively, the industry grew by 2.5 percent during Q1-FY24. Further, the agriculture sector posted a growth of 5.1 percent in Q1-FY24 on a y/y basis. The Committee was apprised that cotton arrivals slowed down in recent weeks and stood at 7.7 million bales as of November 2023. It was assessed that achieving the revised estimated target of 11.5 million bales by the Federal Committee on Agriculture (FCA) will be challenging. The services sector recorded a growth of 0.8 percent in Q1-FY24 on a y/y basis owing to decline in value addition in some sectors on account of high inflation. Cumulatively, the real GDP grew by 2.1 percent y/y in Q1-FY24, compared to 1.0 percent in the same period last year.

3. Discussing the outlook for FY24, the staff apprised the Committee that based on recent incoming data and estimates for LSM and agriculture, the near-term growth outlook remained positive amid low base-effect. This assessment was also supported by recent improvements in the survey results with respect to business and consumer sentiments, employment conditions and capacity utilization. The staff further apprised the Committee that the economic activity is expected to recover moderately in H2-FY24. At this stage, the upside and downside risks to the growth outlook – emanating from both evolving global and domestic economic developments, broadly remain in balance.

4. Discussing global developments, the staff stated that while inflation has reached within the target for many Emerging Market (EM) countries, it continues to stay above the average annual inflation target of 2.0 percent in most Advanced Economies (AEs), thus compelling central banks of these countries to maintain a contractionary monetary policy stance. Accordingly, indicators of global economic activity remained subdued while yields on sovereign bonds of AEs (like USA and UK) continued to be on the higher side. Combined with the higher Credit Default Swap (CDS) points for countries with vulnerable external sectors, commercial borrowing from international financial markets remained challenging. Further, while global oil price remained volatile, rising trend in metal prices could be an upside risk for Pakistan's imports.

5. Discussing the latest developments related to Pakistan's Balance of Payments (BoP), it was apprised that the Current Account Deficit (CAD) posted a significant improvement on a y/y basis. The CAD narrowed by 65.9 percent (y/y) to USD 1.1 billion during Jul-Oct FY24 as compared to USD 3.0 billion in the same period last year. This contraction in CAD was driven by an improvement in both the trade deficit and workers' remittances. The increase in remittances was driven by stable kerb premium and improvement in domestic economic environment as well as due to initiatives taken by the Government and SBP to encourage inflows through formal channels. The improvement in trade deficit was primarily driven by a sharp y/y contraction of 17.3 percent (PBS data) in imports during Jul-Nov FY24 owing to a downward trend in the international commodity prices. Additionally, exports witnessed a growth of 1.9 percent (PBS data) during Jul-Nov FY24 as compared to a decline of 3.4 percent in the same period last year. The improvement in exports was led by rice while High-Value Added (HVA) textile volumes supported this trend. The financial account inflows remained subdued after realization of substantial inflows from friendly countries in July 2023. It was noted that the release of second IMF Standby Arrangement (SBA) tranche would further facilitate inflows from multilateral and bilateral sources and would help to improve the FX reserves of SBP.

6. Presenting the outlook of various components of the Current Account Balance (CAB), it was apprised that import projections for FY24 were slightly revised upwards mainly on account of anticipated increase in international commodity prices, especially iron and steel prices. The outlook for exports remain largely unchanged from the October 2023 MPC meeting. The staff apprised that workers' remittances are expected to improve gradually due to policy and regulatory measures taken to facilitate inflows from formal channels. Moreover, the number of workers going abroad remain promising. Taking into account these developments, the CAD is projected to remain within the earlier projected range of 0.5-1.5 percent of GDP during FY24.

7. Discussing fiscal developments, the staff apprised the Committee that during Jul-Nov FY24, fiscal indicators improved as compared to the same period last year. Both tax and non-tax revenues showed significant improvement during Jul-Nov FY24. Federal Board of Revenue (FBR) recorded a 29.6 percent (y/y) increase in its revenues during Jul-Nov FY24 as compared to 15.9 (y/y) percent in the same period last year. The non-tax revenues remained robust due to higher Petroleum Development Levy (PDL) and sizable transfer of profit by SBP. The staff highlighted the importance of continuing the ongoing fiscal consolidation.

8. Discussing developments in monetary aggregates, it was apprised that broad money (M2) growth decelerated to 13.7 percent y/y as of November 24, 2023, from 14.2 percent as of end-June 2023. This was primarily driven by a slowdown in Net Domestic Assets (NDA), while Net Foreign Assets (NFA) have increased since June 2023, backed by higher external inflows in July 2023. The deceleration in the NDA of the banking system was on account of decline in the Private Sector Credit (PSC) and more than seasonal decline in the Commodity Operation Financing (COF). After witnessing elevated levels in June 2023, Reserve Money declined till November 2023 owing to reduction in outstanding stock of net OMO injections and net budgetary borrowing by the government from SBP. Discussing the outlook for growth in monetary aggregates, the Committee was apprised that M2 is expected to grow within the range of 13-15 percent in FY24.

9. Discussing the trends and developments in inflation, the staff apprised the Committee that the headline inflation increased substantially in November 2023 due to higher-than-expected increase in the administered gas prices, especially with the incorporation of fixed charges. It was assessed that the increase in the administered gas prices contributed 3.2 percentage points in the 29.2 percent y/y inflation. Furthermore, the increase in perishable food items' prices also contributed somewhat to the elevated levels of inflation. The staff also stated that core inflation remained sticky at 21.5 percent during the month, easing somewhat from 21.8 percent in October 2023 and from its peak of 22.7 percent recorded in May 2023. It was also noted that contribution of wage growth to both core and headline inflation has started to reduce due to its relative y/y moderation in recent months.

10. Discussing the inflation outlook, the staff stated that, barring any further sizable increase in administered prices, the rise in inflation is expected to ease significantly in the second half of FY24. Developments which are expected to explain the downward trajectory of projected inflation include contained aggregate demand, easing supply side constraints on account of favourable agriculture output, ongoing fiscal consolidation, moderation in international oil prices, contained money supply and a favourable base effect. The staff also apprised the Committee that the baseline inflation projection is subject to upside risks associated with further adjustments in administered energy prices, increase in wheat support/issue price and some cost pressures due to axel-load management. The downside risks to inflation include: (i) easing of supply-side constraints due to improved agriculture sector outlook; (ii) softening international oil prices; and (iii) better external position due to the realization of projected external inflows.

Financial Market and Reserve Management

11. Apprising the Committee on the monetary policy implementation, the staff stated that the overnight repo rate averaged 21.79 percent since the last MPC meeting against the target of 22.0 percent.

12. SBP's liquidity support on average decreased to PKR 8.278 trillion during the review period (up to December 8, 2023) compared to PKR 8.536 trillion in the last monetary policy review period (up to October 30, 2023); reflecting an ease in market liquidity conditions. Secondary market yields also witnessed noticeable changes since the last MPC meeting. Initially, yields of securities up to 12-month maturities declined and dipped below the floor of Interest Rate Corridor (IRC) by mid-November 2023. However, short term yields (3 and 6 months) subsequently recovered to some extent, while yields of securities of 1 to 3 years' maturities remained lower.

13. In the primary auctions, the market participation was mostly in 1 to 5 year securities as the market recorded a visible shift towards longer periods. The Government was not only able to mobilize funding, but also reduce cut-off rates for all tenors. In the recent fixed-rate Pakistan Investment Bonds (PIB) primary auctions, yields of medium tenors (3 & 5 years) observed higher reduction as compared to longer tenors (10 years). In addition to fixed rate PIBs, participation in floating rate PIBs was also witnessed.

14. The staff informed the Committee that the Pakistan Eurobond yields and Credit Default Swap (CDS) spreads have come down; however, they were still at elevated levels.

15. In the FX market, PKR depreciated by 1 percent against the USD since the last MPC meeting. It was also apprised, that during the period under review, USD index also depreciated by 2.6 percent against other currencies.

Model-Based Assessment

16. The staff apprised the Committee on model-based assessments of inflation projection conditional on the policy rate path for FY24. In this regard, it was explained that higher than anticipated increase in the gas prices resulted in an upward revision in the inflation projection for FY24 compared to the last MPC meeting.

17. The Committee also discussed the medium-term conditional inflation projections relative to the 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 for FY24 and FY25, the staff presented inflation and policy rate paths under alternative assumptions of global oil prices and exchange rates.

Result of SBP Surveys for Monetary Policy

19. The staff apprised the Committee that in the recent wave of surveys conducted in November 2023, business confidence and consumer confidence have improved, along with a decline in inflation expectations of both consumers and businesses. However, it was noted that these surveys were conducted before increase in administered gas prices by the Government.

20. The Purchasing Managers' Index (PMI) remained unchanged in November 2023, while the perception about employment for the manufacturing sector showed a slight decrease.

Monetary Policy Deliberations and Decision Vote

21. The MPC unanimously decided to keep the policy rate unchanged.

DECISIONS:

- *The policy rate remains unchanged at 22 percent.*
- *The Monetary Policy Statement – December 2023 is approved.*