MINUTES OF THE MEETING OF THE MONETARY POLICY COMMITTEE (MPC) HELD AT KARACHI ON MONDAY, JUNE 12, 2023 AT 10:00 AM

PRESENT

Mr. Jameel Ahmad	Chairperson & Governor SBP
Dr. Inayat Hussain	Deputy Governor (Banking & FMRM)
Ms. Sima Kamil	Deputy Governor (FI & 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-Acting

Review of Current Economic Conditions and Outlook for FY23

1. The staff apprised the Committee of the recent developments in key macroeconomic indicators since the last MPC meeting of April 4, 2023. Moreover, assessments and analyses of evolving trends were also shared for the information of the Committee.

2. Discussing developments in the real sector, the staff stated that provisional National Accounts estimates show that real GDP grew by 0.3 percent in FY23, against the revised growth rate of 6.1 percent for FY22. The deceleration is consistent with trends in high-frequency indicators of economic activity. During FY23, the sales of Petroleum Oil and Lubricants (POL) declined by 26.3 percent, cement declined by 14.4 percent and automobiles declined by 48.6 percent on a y/y basis. Furthermore, the Committee was apprised that cumulatively, LSM contracted by 8.1 percent in Jul-Mar FY23. It was noted that this contraction was broad-based, with all major sectors including export-oriented sectors recording a decline in production. While apprising the Committee on developments in the agriculture sector, the staff stated that the agriculture sector is estimated to grow by 1.5 percent in FY23, supported by the bumper crops of wheat and sugarcane, along with robust growth in the livestock sector, which largely offset the flood-related damages to the cotton and rice crops.

3. Summarizing the outlook, the Committee was apprised that presently, the growth prospects are clouded by the prevailing economic uncertainty. The unfolding impact of the accumulated monetary tightening and other measures suggest that the economic recovery is expected to remain subdued in FY24. The agriculture sector is likely to be the primary driver of growth. It was noted that barring unfavourable weather conditions, the agriculture sector is expected to post an improved performance relative to FY23.

4. On the global front, it was noted that international financial conditions have eased, while global commodity prices have softened further. Concurrently, CPI inflation in many Advanced Economies (AEs) and Emerging Market Economies (EMEs) seems to have peaked and has started to moderate. However, core inflation is still at an elevated level and in order to anchor inflation expectations, most of the central banks of AEs and EMEs continue to increase the interest rates. Further, it was noted that the manufacturing activity remained subdued and services emerged as the main driver of global economic activity. Despite defaults by a few global banks in recent months, market liquidity conditions have improved since the last MPC meeting. It was also apprised that financial markets' volatility has decreased to pre-pandemic levels reflecting improvement in global economic prospects.

5. Discussing the latest developments related to Pakistan's Balance of Payments (BoP), it was noted that the current account posted a surplus of USD 750 million and USD 78 million in March and April 2023 respectively after almost twenty-seven months. Cumulatively, during Jul-Apr FY23, the Current Account Deficit (CAD) contracted by 77.0 percent to USD 3.2 billion compared to USD 13.7 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 demand compression policies. The imports declined by 29.2 percent to USD 51.2 billion (as per PBS data) during Jul-May FY23. At the same time, exports also contracted by 12.1 percent to USD 25.4 billion during Jul-May FY23 compared to USD 28.9 billion in the same period last year. It was noted that the volumes of High Value Added (HVA) products increased in the recent months owing to favourable impact of PKR depreciation. However, a decline in international prices has led to a contraction in the overall value of exports.

6. Further, it was noted that the workers' remittances rose sharply in March 2023 but then fell in April 2023 owing to the seasonal impact of Eid festival. It was further apprised that the monthly average remittances in FY23 so far stands at USD 2.3 billion as compared to the average inflows of USD 2.6 billion received in FY22. It was apprised that overseas Pakistanis surveyed in February 2023 identified the overall political and economic environment for investment in real estate, exchange rate movements, host country's inflation and income levels as the main considerations for sending remittances over the next six months.

7. Presenting the outlook of various components of the current account balance, it was apprised that imports are expected to shrink further in FY24 mainly on account of an expected moderation in commodity prices, weaker LSM growth prospects, the lagged impact of monetary tightening as well as exchange rate depreciation. It was noted that exports are expected to gain from the recent favourable exchange rate movements while a declining trend in international prices could have an opposite impact. Workers' remittances are expected to remain subdued due to political and economic uncertainties.

8. Discussing fiscal developments, the staff apprised the Committee that during Jul-Mar FY23, the fiscal deficit was still lower at 3.6 percent of GDP compared to 3.9 percent last year and the primary balance posted a surplus of 0.6 percent of GDP against a deficit of 0.7 percent in the same period last year. This improvement reflects a reduction in non-interest spending owing to lower subsidies and grants.

9. Further, it was apprised that the growth in tax revenues remained below target, amidst a slowdown in economic activity and a reduction in imports. On the revenue side, FBR taxes grew by 16.1 percent in Jul-May FY23, lower than 28.5 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 25.5 percent in Jul-Mar FY23, against a 14.3 percent decline in the same period last year.

10. 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 3.7 percent (PKR 341.9 billion) in Jul-Apr FY23 compared to 17.3 percent (PKR 1319.4 billion), mainly attributed to the high cost of borrowing, regulatory measures and a slowdown in economic activity.

11. Discussing trends and developments in inflation, it was apprised that headline inflation surged to 38 percent (y/y) in May 2023 from 35.4 percent (y/y) in March and 36.4 percent in April, pushing up average inflation during Jul-May FY23 to 29.2 percent, against 11.3 percent in the same

period last year. It was noted that the surge in inflation was mainly attributed to (i) an upward revision in the 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. It was also noted that while inflation, on m/m basis, has decelerated in May compared to the preceding two months, nonetheless, it still remains high reflecting the impact of a renewed supply shock associated with wheat flour prices amid inter and intra provincial restrictions on movement of wheat.

12. It was also apprised that core inflation has risen to 20 percent in urban and 26.9 percent in the rural basket in May 2023 compared to 19.5 percent and 24.9 percent in April 2023, respectively. It was noted that second round impact of adjustments in administered energy prices, elevated high inflation expectations and pass-through of exchange rate depreciation have been mainly contributing to core inflation, while the demand-side pressures have started to subside due to the slowdown in economic activities.

13. Discussing the outlook of inflation, the staff stated that keeping in view the latest trends of high frequency prices data, the average inflation in FY23 is expected to remain around 29 percent. The staff apprised the Committee that inflation has peaked, and barring any unforeseen shocks, is expected to start falling from June onwards due to weak domestic demand amid tight monetary policy stance, waning second round effects, high base effect, moderation in businesses and consumers' inflation expectations and easing of global commodity prices. The staff also apprised the Committee that the baseline inflation projection is subject to upside risks such as: (i) adjustments in energy prices; (ii) recurrence of heavy rains and floods; and (ii) unfavourable external developments.

Financial Markets and Reserve Management

14. Apprising the Committee on monetary policy implementation, the staff stated that the O/N repo rate averaged 20.72 percent since the last MPC meeting against the target of 21.0 percent. SBP's OMO liquidity injections increased and the net average daily outstanding level of SBP liquidity support was PKR 8.1 trillion during the monetary policy review period compared to PKR 6.8 trillion in the last MPC review period. It was noted that despite a 100bps increase in the policy rate during the last MPC meeting, benchmark rates witnessed marginal movement owing to earlier market adjustment in anticipation of an increase in the policy rate.

15. In primary auctions, the market participation remained concentrated in 3-month T-bills. In recent fixed rate (Pakistan Investment Bonds) primary auctions, there has been no issuance beyond 3-years. It was noted that the participation in floating rate PIBs has also came down.

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

17. Further, it was apprised that PKR has slightly appreciated by 0.1 percent against the US Dollar 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 broadly stable against the USD.

Model-Based Assessment

18. The staff apprised the Committee about the model-based assessments for inflation projections conditioned on policy rate path for June FY23 and FY24. In this regard, it was explained

that measures announced in recent Federal Government Budget for FY23-24 have resulted in a slight revision in the inflation projection for FY24.

19. The staff appraised the Committee that the slowing aggregate demand reflected by plummeting economic activity and negative output gap would drag inflation down, going forward. In addition, the drag from aggregate demand may offset the inflation induced by inflation persistence and elevated inflation expectations.

20. 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.

21. 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.

Result of SBP Surveys for Monetary Policy

22. The staff apprised the Committee that in the recent wave of the survey (May 2023), both consumer and business confidence improved slightly compared to the last wave (April 2023). Moreover, households' and businesses' inflation expectations have eased further. The Purchasing Managers Index (PMI) for the manufacturing sector also declined in May 2023 compared to the last wave of April 2023.

23. The Committee was apprised that Business Employment Expectations have also shown some improvement.

24. 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 no change in the policy rate in the current MPC meeting.

Monetary Policy Deliberations and Decision Vote

25. The MPC decided to keep the policy rate unchanged with a majority vote of 8 out of ten while one Member voted to decrease the policy rate by 100bps and one Member voted to increase the policy rate by 25bps.

DECISIONS:

- *The policy rate remains unchanged at 21 percent.*
- *The Monetary Policy Statement – June 2023 is approved.*