MINUTES OF THE MEETING OF THE MONETARY POLICY COMMITTEE (MPC) HELD AT KARACHI ON THURSDAY, SEPTEMBER 14, 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)
Mr. Saleem Ullah	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. 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 July 31, 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 high-frequency data showed a slight uptick in the economic activity at a varying pace, however, volumes are still lower compared to the recent past. During Jul-Aug FY24 on Year on Year (y/y) basis, Petroleum sales grew by 8.2 percent (excluding Furnace Oil) and Cement sales rose significantly by 44.8 percent. On the other hand, auto sales witnessed a 45 percent y/y decline in the first month of FY24. Discussing developments related to the agriculture sector, the Committee was apprised that during the ongoing Kharif season, cotton arrivals by August almost doubled compared to the arrivals in the same period last year and are already at three-fifth of last year's level. Furthermore, amid better input conditions, and subsided floods related concerns, the recent satellite images are also depicting favourable outlook for other Kharif crops in this fiscal year.

3. Discussing the outlook for FY24, the staff apprised the Committee that, despite some pick-up in economic activity, the near-term growth outlook remains uncertain. Moreover, it was noted that recent pest attack on cotton crop could potentially impact the output from Punjab. The staff apprised the Committee that in spite of some compositional changes to growth outlook, as projected earlier, the economic recovery is expected to be moderate this year. However, at this stage, the outlook is surrounded by both upside and downside risks sourcing from unfolding global and domestic developments.

4. Discussing global developments, it was noted that global commodity prices have reversed their declining momentum due to recent spike in international oil prices, resulting in weaker terms of trade for Pakistan. In Advanced Economies (AE), despite ease in headline inflation, core inflation remains stagnated at an elevated level leading to continued monetary tightening by their central banks. This monetary tightening is putting downward pressures on Emerging Market Economies' (EME) currencies including PKR.

5. Discussing the latest developments related to Pakistan's Balance of Payments (BoP), it was apprised that the current account recorded a deficit of USD 809 million in July 2023, reversing the trend of the preceding four months. The Current Account Deficit (CAD) in July emanated from a broad-based increase in imports due to lifting up of import prioritization guidelines by SBP. In comparison to last year, it was stated that imports contracted by 25.8 percent to USD 8.2 billion (PBS data) during Jul-Aug FY24, compared to USD 11.0 billion in the same period of FY23. Whereas

during Jul-Aug FY24, the exports declined by 6.4 percent to USD 4.4 billion from USD 4.7 billion in the same period last year. Further, it was noted that the workers' remittances during Jul-Aug FY24 remained lower than earlier projections.

6. Presenting the outlook of various components of the current account balance, it was apprised that during FY24, imports are projected to remain constrained due to favourable trend in non-oil commodity prices, moderate domestic demand due to the lagged impact of monetary tightening and improved cotton production. It was noted that the exports are expected to increase on the back of favourable rice output and the resultant surplus. Furthermore, workers' remittances are expected to recover going forward due to the narrowing of the difference between the interbank and open market exchange rate after recent administrative measures and structural reforms to formalize the FX sector.

7. Discussing fiscal developments, the staff apprised the Committee that the fiscal deficit was recorded at 7.7 percent of GDP during FY23 compared to the revised budget estimate of 7.0 percent. The primary deficit was recorded at 0.8 percent of GDP compared to a revised budget estimate of 0.5 percent. The increase in fiscal deficit is mainly attributed to a noticeable increase in debt servicing cost and a shortfall in provincial surplus.

8. During Jul-Aug FY24, FBR's revenue recorded a 27.2 percent increase compared to the same period last year, mainly attributed to fiscal measures and some recovery in the economic activity. Further, petroleum development levy collection is estimated to increase amidst better sales and higher rates.

9. Discussing developments of the monetary aggregates, it was apprised that broad money (M2) grew by 13.6 percent (y/y) as of Sep 01, 2023 against 14.2 percent at end-June 2023. This was primarily driven by a slowdown in Net Domestic Assets (NDA), while Net Foreign Assets (NFA) improved, backed by higher external inflows. The deceleration in the NDA of the banking system was on account of broad-based net retirements in the Private Sector Credit (PSC) along with improved external financing of the fiscal deficit. He added that PSC recorded a decline of PKR 172 billion in July FY24 against PKR 140 billion in the same month last year, largely due to net retirement in working capital loans. In addition, consumer loans recorded a decline for the eighth consecutive month in July 2023, primarily, owing to decline in auto financing.

10. Discussing the trends and developments in inflation, it was informed that the headline inflation continues to decline to 27.4 percent y/y in August 2023 for the third consecutive month from its peak of 38 percent recorded in May 2023. However, the decline in inflation was lower than anticipated earlier, largely due to a surge in international oil prices and its impact on domestic energy prices and PKR depreciation witnessed during Jul-Aug FY24. It was also apprised that core inflation has risen to 25.9 percent in the rural basket in August 2023 compared to 24.6 percent in July 2023 while remaining flat at 18.4 percent in the urban basket. It was noted that the impact of energy prices, elevated inflation expectations of households and businesses, and higher contribution of services sector amid second round impact of energy prices adjustments largely explain the uptick in core inflation.

11. Discussing the inflation outlook, the staff stated that keeping in view the latest trends of high-frequency prices data, inflation is likely to increase in September 2023 on account of base effect and adjustment in administered fuel prices. However, inflation would subsequently decline in October 2023 and resume its downward trajectory in the remaining part of FY24. It was noted that improved agriculture outlook, tight monetary policy stance, expected fiscal consolidation, favourable outlook for global commodity prices, and positive base effect would be instrumental for downward trajectory of inflation. The staff also apprised the Committee that the baseline inflation projection is subject to upside risks such as: (i) upward adjustments in domestic administered gas tariff; (ii) surge in domestic sugar price; and (iii) un-favourable external developments i.e., an upward adjustment in the international oil prices. The downside risks to inflation include: (i) easing of supply-side constraints due to continued moderation in imports and administrative measures related to commodity markets; and (ii) lower than assumed international oil prices.

Financial Market and Reserve Management

12. Apprising the Committee on the monetary policy implementation, the staff stated that the Overnight repo rate averaged 21.36 percent since the last MPC meeting against the target of 22.0 percent.

13. The outstanding amount of SBP liquidity support was PKR 8.964 trillion on September 12, 2023 compared to PKR 8.426 trillion on July 27, 2023. It was noted that since the last MPC meeting, the benchmark secondary market rates have increased in expectation of an increase in the policy rate.

14. In the primary auctions, the market participation has remained concentrated in 3-month T-bills with marginal interest in 12-month and 6-month T-bills. In the recent fixed-rate (Pakistan Investment Bonds) primary auctions, issuance has largely been concentrated in PIBs of 3-years tenor. It was noted that the participation in the floating rate PIBs has decreased.

15. The staff informed the Committee that the Pakistan Eurobond yields and Credit Default Swap (CDS) spreads have shown a downward trend after SBA agreement with IMF, though they are still above normal levels.

16. Further, it was apprised that PKR remained under pressure for most of the period since the last MPC meeting. The FX market remained volatile for majority of this period on account of political and economic uncertainty.

Model-Based Assessment

17. 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 an increase in the global oil prices and ensuing upward adjustments in administered energy prices have resulted in an upward revision in inflation projection for FY24 compared to the last MPC meeting.

18. The staff apprised the Committee that the slowdown in aggregate demand reflected by a decrease in economic activity, indicated by a negative output gap, would drag the inflation down in H2-FY24.

19. 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.

20. While discussing the risks to the baseline projections for FY24, the staff presented inflation and policy rate paths under alternative assumptions of global oil prices and exchange rate.

Result of SBP Surveys for Monetary Policy

21. The staff apprised the Committee that in the recent wave of surveys conducted in the first week of September 2023, business confidence and consumer confidence has deteriorated, while inflation expectation of consumers and businesses has further inched up.

22. The Purchasing Managers Index (PMI) and perception about employment for the manufacturing sector have not witnessed any significant changes. As compared to July 2023, PMI dipped slightly by one percentage point in August 2023, however, PMI recovered by the same amount in September 2023.

Monetary Policy Deliberations and Decision Vote

23. The MPC decided to keep the policy rate unchanged with a majority vote of eight out of nine while one Member voted to increase the policy rate by 100bps.

DECISIONS:

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