MINUTES OF THE MEETING OF THE MONETARY POLICY COMMITTEE (MPC)
<u>HELD AT KARACHI ON MONDAY, JANUARY 23, 2023 AT 10:00 AM</u>

<u>P R E S E N T</u>

Mr. Jameel Ahmad	Chairperson & Governor SBP
Dr. Inayat Hussain	Deputy Governor (Banking & FMRM)
Mr. Arshad Mehmood Bhatti	Executive Director (BPRG)
Mr. Fawad Anwar	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

7.1 The staff apprised the Committee of recent developments in key macroeconomic indicators since the last MPC meeting of November 25, 2022. In addition, assessments of evolving trends were also shared for the information of the Committee.

7.2 Giving an overview of the real sector, the staff apprised that the incoming data for high frequency economic indicators continue to reflect a broad-based slowdown in economic activity during the first half of FY23. Specifically, in December 2022, auto sales declined by 43.0 percent, Petroleum, Oil and Lubricants (POL) sales declined by 13.7 percent and domestic cement sales declined by 9.4 percent on a y/y basis. Further, the Committee was apprised that cumulatively, Large-Scale Manufacturing (LSM) contracted by 3.6 percent during July-November FY23 despite positive contributions by some export-oriented sectors.

7.3 Discussing developments in the agriculture sector, it was noted that as of January 1, 2023, cotton arrivals were 37.2 percent lower compared to last year. This decline was largely attributed to a decrease in the output of Sindh province due to the recent floods. Further, the wheat production target is likely to be achieved as progress on sowing broadly remains satisfactory. It was highlighted that the performance of the agriculture sector would affect the output of industry and the services sector. The Committee also noted that recently announced shutdowns and scaling back of operations by some companies, owing to supply chain disruptions and demand contraction, have further weakened the manufacturing outlook for this year.

7.4 Summarizing the outlook, the Committee was apprised that based on recent trends, including lower agriculture output, deterioration in LSM production, the ongoing monetary tightening and more than expected slowdown in major global economies, the downside risks to SBP's earlier outlook of real GDP growth for FY23 have increased.

7.5 Apprising the Committee about recent global developments, the staff stated that the world economy remains under stress due to fear of a global recession. However, multi-year high inflation in most countries is expected to come down due to moderation in international commodity prices. As a result, the pace and the magnitude of monetary tightening by central banks has started to weaken. The impact of these developments is already reflected in the slight easing of global financial conditions and a resumption of flows to emerging and developing economies. As a result, the depreciation pressure on the currencies of these countries has reduced since the last MPC meeting.

7.6 Discussing the latest developments related to Pakistan's Balance of Payments (BoP), the staff stated that the Current Account Deficit (CAD) declined significantly to USD 3.7 billion during Jul-Dec FY23 compared to USD 9.1 billion in the same period last year. This decline is primarily attributed to a sharp contraction in imports on account of policy tightening and regulatory measures. Led by a contraction in volumes of major items, except food, imports declined by 23.0 percent to USD 31.2 billion (as per PBS data) during Jul-Dec FY23 compared to USD 40.6 billion during same period of FY22. This decline in imports was more than the combined impact of the fall in both, exports and workers' remittances. Exports contracted by 5.7 percent to USD 14.3 billion during Jul-Dec FY23 from USD 15.1 billion in the corresponding period of the last year. Workers' remittances also continued to decline across the Middle Eastern and Western corridors owing to global economic conditions and ongoing domestic uncertainties.

7.7 Presenting the outlook of various components of the current account balance, it was noted that imports are expected to contract in coming months owing to the relatively weaker domestic economic prospects and some further decline in international commodity prices. The staff stated that exports are also projected to decline, reflecting a higher than earlier anticipated contraction in domestic LSM and declining global demand. Moreover, workers' remittances are expected to remain subdued given the weakening global economic prospects. However, the near term outlook for remittances appears positive, given the fact that both, *Eid-ul-Fitr* and *Eid-ul-Adha* fall in the second half of FY23 and there is a steady increase in the number of workers going abroad.

7.8 Discussing developments related to monetary aggregates, it was apprised that Broad Money (M2) growth decelerated to 10.3 percent on y/y basis (as of end December, 2022) from 14.8 percent in the same period last year. This was primarily because of a contraction in Net Foreign Assets (NFA) of the banking system, reflecting pressures on the external accounts. In contrast, Net Domestic Assets (NDA) of the banking system witnessed an expansion compared to the same period last year. This was largely due to an increase in net budgetary borrowings from the banking system and a December-end seasonal surge in Private Sector Credit. Disaggregated analysis shows that consumer loans recorded retirement, while growth in working capital and fixed investment loans moderated.

7.9 Discussing fiscal developments, the staff apprised the Committee that the fiscal deficit widened to 1.5 percent of GDP in Jul-Oct FY23 compared to 0.9 percent, while the primary surplus declined to 0.2 percent of GDP compared to 0.3 percent in the same period last year. This deterioration in fiscal accounts was largely due to a sharp year on year increase of 34.4 percent in current expenditures amid flood related spending and elevated interest rates. The growth in FBR taxes was recorded at 17.0 percent in H1-FY23, which is almost half of what it was in H1-FY22. Moreover, non-tax revenue declined by 52.7 percent during Jul-Oct FY23 due to; i) non-transference of SBP profit, which now takes place once a year upon finalisation of SBP accounts; and ii) lower Petroleum Development Levy (PDL) revenue due to fall in POL sales.

7.10 It was noted that a surge in current expenditures and moderation in revenue growth squeezed the space for development spending, which consequently declined by 52.9 percent to 0.1 percent of GDP during Jul-Oct FY23 against 0.2 percent during the same period last year. The Committee noted that these developments point to the challenges in achieving the planned fiscal consolidation in FY23. It is further observed that this consolidation is necessary to make the fiscal stance consistent with the tight monetary policy stance, in the context of bringing down inflation.

7.11 Discussing trends and developments in inflation, it was apprised that the headline inflation slightly eased to 23.8 percent (y/y) in November 2022 and 24.5 percent (y/y) in December 2022 compared to 26.6 percent (y/y) in October 2022. A sharp rise in wheat flour prices and flood-related supply disruptions offset the seasonal decline in food prices. However, the downward revision in administered fuel prices and negative Fuel Cost Adjustment (FCA) in electricity charges contributed to lower energy inflation. The energy inflation in urban areas eased from 34.1 percent (y/y) in October 2022 to 24.5 and 15.4 percent (y/y) in November and December 2022, respectively. Whereas, the rural energy inflation remained elevated, despite moderating from 36.9 percent (y/y) in October 2022 to 30.7 and 26.2 percent (y/y) in November and December 2022, respectively. The elevated levels of energy inflation in rural areas are attributed to higher prices of coal and firewood.

7.12 Both food and core inflation maintained a rising momentum. The impact of moderating energy and services inflation was offset by rising food prices and core goods inflation. In rural areas, core inflation increased from 18.2 percent in October 2022 to 18.5 and 19.0 percent in November and December 2022, respectively. Whereas, urban core inflation after reaching 14.9 percent in October 2022, moderated to 14.6 and 14.7 percent in November and December 2022, respectively.

7.13 Discussing the outlook of inflation, it was apprised that based on recent developments, the projection of average national CPI inflation for FY23 is almost the same as presented in the last MPC meeting. However, there are upside risks to SBP's projection range of 21 to 23 percent. These include an increase in wheat and wheat flour prices, upward adjustments in PDL along with the imposition of GST on fuel and increase in gas prices. Nevertheless, a greater than anticipated slowdown in domestic and global economic activities may contribute to keep inflationary pressures in check.

Financial Markets and Reserve Management

7.14 Apprising the Committee on monetary policy implementation, the staff stated that the O/N repo rate averaged 15.7 percent, against the target of 16 percent, since the last MPC meeting. SBP's OMO liquidity injections witnessed a slight increase. The net average daily outstanding level of OMOs increased to PKR 5.62 trillion during the current cycle of the monetary review period compared to PKR 5.6 trillion during the previous monetary policy review period. Further, it was noted that secondary market yields in benchmark tenors showed an upward trend with an increase in policy rate. In primary auctions, the market offered higher than the target amount in 3-month T-bills auctions.

7.15 The staff apprised the Committee that although a gradual moderation is witnessed on Pakistan Eurobond yields and CDS spreads. However, levels remain elevated, well above the normal levels.

7.16 Further, it was informed that PKR has depreciated by 2.5 percent against USD since the last MPC meeting. This was mainly attributed to pressures on the country's external account.

Model-Based Assessment

7.17 The staff apprised the Committee about changes in key assumptions and explained that the medium-term outlook for inflation had been updated by incorporating the latest data readings of inflation, further slowdown in economic activities, and some softening of global commodity prices. Inflation in FY23 is expected to come down slightly compared to the earlier projection due to; i) some easing of headline inflation as reflected by December 2022 CPI data, ii) delayed exchange rate pass-through in FY23, iii) weaker than expected economic activity in FY23, and iv) a moderation in global oil prices.

7.18 Nonetheless, the inflation in the medium term is expected to ease due to; i) the fuller impact of previous monetary tightening, ii) planned fiscal consolidation, iii) moderation of international commodity prices owing to the resolution of supply-chain issues, and iv) the economic slowdown.

7.19 The Committee also discussed the medium-term conditional inflation forecasts relative to its target, output gap, 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.

7.20 In addition to discussing the downside risks to the baseline projections, the staff presented simulations of inflation and policy interest rate paths under alternative assumptions for global oil prices and PKR value for FY23 and FY24.

Result of SBP Surveys for Monetary Policy

7.21 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 means. The Purchasing Managers Index (PMI) and expected Employment Index for the manufacturing sector also declined in December 2022 compared to the last wave of October 2022. As compared to the latest wave, the traditional measures of inflation expectations of both consumers and businesses inched up in December 2022. These readings indicate signs of a ratcheting up of inflation expectations. The Committee also looked at deeper measures from inflation surveys, including the dispersion of expectations, as well as wages data.

7.22 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

7.23 It was recorded that the MPC has decided to increase the policy rate by 100 bps with a majority vote of 6 out of 7 members. One Member voted *to keep the policy rate unchanged*.

DECISIONS:

- *The policy rate is increased by 100 bps to 17 percent.*
- *The Monetary Policy Statement – January 2023 is approved.*