MINUTES OF THE MEETING OF THE MONETARY POLICY COMMITTEE (MPC) HELD AT KARACHI ON MONDAY, OCTOBER 30, 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 (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. 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 September 14, 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 reflected a moderate recovery in economic activity in the first quarter of this year. For example, during Jul-Sep FY24, on a Year on Year (y/y) basis, Petroleum, Oil and Lubricant (POL) sales (excluding Furnace Oil) showed a marginal decrease of 1.2 percent against a contraction of 40.5 percent in the same period last year, while domestic cement sales increased by 17.5 percent. Similarly, auto sales, though still reported a significant decline on a y/y basis in Jul-Sep FY24, show some improvement on month on month (m/m) basis. Discussing developments related to the agriculture sector, the Committee was apprised that during the ongoing Kharif season, cotton arrivals as of mid-October 2023 stood at 6 million bales and surpassed the arrivals when compared for the same period of the past four years. On industry, the staff highlighted that the two months' data on large-scale manufacturing output also showed an encouraging trend. This trend is supported by considerable improvement in capacity utilization reported by manufacturing firms in the latest surveys.

3. Discussing the outlook for FY24, the staff apprised the Committee that based on recent incoming data and first estimates for Kharif crops, the near-term growth outlook remained positive. This assessment was also corroborated by recent improvements in consumer and business sentiment surveys. Moreover, against the earlier concerns, it was noted that pest attack on cotton crop remained largely contained so far. The staff further apprised the Committee that compared to the last assessment, the economic activity was moving at a slightly higher pace than anticipated earlier. On part of risks, 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, it was noted that despite the recent increase in international oil prices, ongoing easing in non-oil global commodity prices resulted in relatively favourable terms of trade for Pakistan. The staff further stated that in Advanced Economies (AEs), despite ease in headline inflation, core inflation remained stagnated at elevated levels compelling their central banks to maintain a tighter monetary policy stance. While elevated interest rates in AEs are strengthening their currencies, the prevailing situation is becoming more challenging for vulnerable countries to manage their external financing needs. On the other hand, core inflation in some Emerging Markets and Developing Economies (EMDEs) has eased enough for their central

banks to cut policy rates. Regarding the global outlook, the latest IMF's World Economic Outlook indicated a downward trend in import demand for AEs.

5. Discussing the latest developments related to Pakistan's Balance of Payments (BoP), it was apprised that the Current Account Deficit (CAD) nearly balanced out in September 2023. On a cumulative basis during Q1-FY24, the CAD narrowed significantly to USD 0.95 billion as compared to USD 2.3 billion in the same period last year. This contraction in CAD was driven by an improvement in trade deficit primarily driven by a sharp y/y contraction of 25.1 percent (PBS data) in imports during Q1-FY24. This contraction was led both by the downward trend in international prices and subdued domestic demand amidst tight monetary policy and fiscal consolidation efforts. Exports, on the other hand, declined by 3.6 percent (PBS data) during Q1-FY24 largely due to export prices, while volumes of high-value-added textile exports remained elevated and rice exports have started gaining traction.

6. Presenting the outlook of various components of the current account balance, it was apprised that import projections for FY24 were slightly revised upwards mainly on account of higher than earlier anticipated international oil prices. The outlook for exports was relatively unchanged from the September 2023 MPC meeting, however, there are risks from contracting global trade volumes. The staff stated that workers' remittances are expected to increase, as policy and regulatory measures to facilitate inflows from formal channels have started to take effect, while the number of workers proceeding abroad remain encouraging. Encompassing all these developments, the CAD is projected to remain within the earlier projected range of 0.5-1.5 percent of GDP.

7. Discussing fiscal developments, the staff apprised the Committee that during Jul-Sep FY24, fiscal indicators improved as compared to the same period last year. Specifically, the fiscal deficit improved to 0.9 percent of GDP from 1.0 percent while the primary balance posted a surplus of 0.4 percent as compared to 0.2 percent last year. This improvement was due to better revenue collection of both tax and non-tax revenues and restrained government spending, supported by cuts in subsidies and grants.

8. Both tax and non-tax revenues showed a significant improvement during Jul-Sep FY24. Federal Board of Revenue (FBR) recorded a 24.9 percent increase in revenues, whereas non-tax revenues almost doubled as compared to the same period last year, due to higher Petroleum Development Levy (PDL) collection on the back of higher rates.

9. Discussing developments of monetary aggregates, it was apprised that broad money (M2) grew by 12.9 percent (y/y) as of September 30, 2023 against 14.2 percent in June 30, 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 a significant decline in Private Sector Credit (PSC) and Commodity Operation Financing (COF). The dip in PSC during Jul-Sep FY24 was largely due to net retirement in working capital loans, while consumer loans continued to decline.

10. Discussing the trends and developments in inflation, it was informed that as expected the headline inflation rose to 31.4 percent y/y in September 2023 from 27.4 percent y/y in August 2023. However, this rise in inflation was expected to reverse in October 2023 owing to base effect and certain developments, including the easing of prices of a few major commodities as well as a significant reduction in the domestic fuel prices. It was also apprised that the core inflation y/y also rose during September 2023, albeit at a modest pace. The staff also apprised the MPC about the improvement in inflation expectations of both consumers and businesses in the latest pulse surveys.

11. Discussing the inflation outlook, the staff stated that keeping in view the latest trends of high-frequency prices data and incorporating the approved gas tariffs adjustments with effect from November 1, 2023, inflation is projected to decline in October 2023 significantly and then maintain its downward trajectory, particularly in the second half of the fiscal year. It was noted that

improved agriculture outlook, tight monetary policy stance, expected fiscal consolidation, and favourable outlook for global commodity prices would be instrumental for the downward trajectory of inflation. The staff also apprised the Committee that the baseline inflation projection is subject to upside risk associated with increased volatility in international oil prices due to the conflict in the Middle East. The downside risks to inflation include: (i) easing of supply-side constraints due to continued moderation in imports and measures related to commodity markets; and (ii) better external position due to the realization of projected external inflows.

Financial Market and Reserve Management

12. Apprising the Committee on the monetary policy implementation, the staff stated that the Overnight repo rate averaged 21.54 percent since the last MPC meeting against the target of 22.0 percent.

13. The outstanding amount of SBP liquidity support on an average decreased to PKR 8.546 trillion during the current review period (from the last MPC meeting to October 27, 2023) compared to PKR 8.920 trillion in the last monetary policy review period. Another noticeable development since the last MPC meeting was change in market expectations; visible from a significant decline in the benchmark secondary market rates of 3, 6 and 12 months.

14. In the primary auctions, the market participation which remained concentrated in 3-month T-bills until the recent past, has recorded a marked shift towards 12-month T-bills (in the last MTB auction). The Government was able to mobilize funding and reduce cut-off rates for all tenors. In the recent fixed-rate PIBs (Pakistan Investment Bonds) primary auctions, issuance for medium to longer tenor PIBs (5 to 10-year) has also been observed. Moreover, participation in the floating rate PIBs also increased in the last auction (October 2023).

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

16. In the FX market, PKR has recorded significant appreciation for consecutive twenty-eight working days; strengthened from PKR 307.1 per USD to PKR 276.8 per USD, which was followed by gradual depreciation in the last few days.

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 upward adjustments in gas prices resulted in a slight upward revision in the inflation projection for FY24 compared to the last MPC meeting.

18. 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.

19. 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

20. The staff apprised the Committee that in the recent wave of surveys conducted in the first week of October 2023, business confidence and consumer confidence had improved, along with a

decline in inflation expectations of both consumers and businesses. The Purchasing Managers' Index (PMI) decreased slightly by one percentage point in October 2023, however, the perception about employment for the manufacturing sector witnessed some improvement.

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 – October 2023 is approved.*