MINUTES OF THE MEETING OF THE MONETARY POLICY COMMITTEE (MPC) HELD AT KARACHI ON MONDAY, JULY 31, 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)
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
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 June 26, 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 till June 2023 continued to show broad slowdown in the economic activity. In June FY23, the sales volumes of Petroleum Oil and Lubricants (POL) declined by 31.6 percent, cement by 30 percent and automobiles by 74.9 percent on year-on-year basis. Furthermore, the Committee was apprised that Large-Scale Manufacturing (LSM) output contracted for the eleventh consecutive month in May 2023. Cumulatively, LSM contracted by 10.3 percent during Jul-May FY23. It was noted that this contraction was broad-based, with all major sectors recording decline in production. Staff also highlighted that decline in some indicators in recent months is more than expectations and there is a possibility that provisional GDP estimates for FY23 could possibly be revised down.

3. Discussing the outlook for FY24, the staff apprised the Committee that agriculture sector is expected to perform better this year, to be mainly supported by increase in rice and cotton output on account of higher area cultivation. This will have positive slipover impact for other key sectors of the economy. However, the staff stated that the unfolding impact of accumulated monetary tightening and expected fiscal consolidation would keep the economic recovery moderate this year with baseline real GDP growth projected in the range of 2.0 to 3.0 percent.

4. Discussing global developments, it was noted that global financial conditions continued to remain tight. The Committee was apprised that headline inflation has moderated, while core inflation remains elevated in many Advanced Economies (AEs). In view of persistent underlying inflationary pressures, many central banks of AEs and Emerging Market Economies (EMEs) continue to increase the interest rates in order to anchor inflation expectations. It was apprised that since the last Committee meeting held in June 2023, the global commodity prices have increased slightly. Discussing the outlook for global growth, it was apprised that amid monetary tightening, AEs are expected to grow only moderately while Emerging Markets and Developing Economies (EMDEs) in Asia are expected to lead the global growth during 2024.

5. Discussing the latest developments related to Pakistan's Balance of Payments (BoP), it was apprised that the current account balance recorded a surplus for the fourth consecutive month in June FY23. In FY23, the Current Account Deficit (CAD) contracted by 85.4 percent to USD 2.6 billion compared to USD 17.5 billion in FY22. The 'CAD as percent of GDP' in FY23 substantially narrowed

to 0.7 percent of GDP from 4.7 percent in FY22. This improvement is primarily attributed to contraction in import volumes on account of monetary tightening and other demand compression measures. As a result, imports declined by 27.3 percent to USD 52.0 billion in FY23. At the same time, exports also contracted by 14.1 percent to USD 27.9 billion during FY23 compared to USD 32.5 billion in FY22.

6. Further, it was noted that the workers' remittances have remained subdued in June FY23. It was further apprised that the monthly average remittances in FY23 stand at USD 2.2 billion as compared to the average inflows of USD 2.6 billion received in FY22. The MPC was briefed that domestic political and economic uncertainty, exchange rate movement, and elevated global inflation and high interest rates are some of the major reasons for moderation in the workers' remittances.

7. Presenting the outlook of various components of the current account balance, it was apprised that during FY24, imports are projected to remain slightly lower than their level in FY24, however, any increase in international oil and commodity prices is going to have an upside impact. It was noted that the exports are also expected to increase, although marginally owing to favourable exchange rate and better rice stocks as compared to the flood related losses last year. Workers' remittances are expected to remain subdued, whereas, early normalization of uncertainties would have a positive impact.

8. Discussing fiscal developments, the staff apprised the Committee that the revised estimates show fiscal deficit at 7 percent of GDP during FY23 compared to 7.9 percent in FY22. The primary deficit is estimated at 0.5 percent of GDP compared to 3.1 percent in the same period last year. However, estimate from the financing side indicates that fiscal deficit may exceed the revised budget estimates.

9. Further, it was apprised that tax revenues remained below target, amidst a slowdown in economic activity and reduction in imports. FBR collected Rs7.2 trillion during FY23 against the revised target of Rs7.6 trillion. On the expenditure side, interest payments and subsidies are estimated to exceed the budget targets.

10. Discussing developments in the monetary aggregates, it was apprised that growth in Broad Money (M2) slightly increased during FY23, primarily due to a substantial expansion in Net Domestic Assets (NDA) of the banking system on account of increased government budgetary borrowings, commodity operations financing and Public Sector Entities (PSEs) borrowings. In contrast, the Net Foreign Assets (NFA) of the banking system continued to contract on account of higher foreign exchange outflows. The staff further apprised that the growth in Private Sector Credit (PSC) witnessed a broad-based deceleration. The PSC recorded a growth of 3.8 percent during FY23 compared to 21.1 percent in FY22 largely driven by net retirement in working capital and consumer loans.

11. Discussing trends and developments in inflation, it was apprised that headline inflation declined to 29.4 percent year on year in June 2023 after peaking at 38 percent in May 2023. As a result, average inflation for FY23 stood at 29.2 percent against 12.2 percent in previous year. It was noted that surge in inflation was mainly attributed to: (i) direct and indirect effects of upward revisions in the administered energy prices, (ii) series of domestic and external supply shocks, (iii) pass-through of exchange rate depreciation, and (iv) elevated inflation expectations.

12. It was informed that core inflation moderated to 18.5 percent in the urban and 25.2 percent in the rural basket in June 2023, compared to 20 percent and 26.9 percent in May 2023, respectively. It was noted that policy-driven slowdown in domestic demand and high base effect, led to a deceleration in core inflation.

13. Discussing the inflation outlook, the staff stated that keeping in view the latest trends of high frequency prices data, the y/y inflation is expected to remain generally on a downward trajectory despite the adjustment in electricity tariff. Continuing subdued domestic demand, tight monetary policy stance, expected fiscal consolidation, favourable outlook for global commodity prices, and positive base effect will be instrumental for downward trajectory of inflation. Lastly, staff also apprised the Committee that the baseline inflation projection is subject to upside risks such as: (i) adjustments in gas prices; (ii) recurrence of heavy rains / floods; and (ii) unfavourable external developments. Taking into account these risks, the average inflation for FY24 is expected to be in the range of 20 – 22 percent.

Financial Markets and Reserve Management

14. Apprising the Committee on the monetary policy implementation, the staff stated that the Overnight repo rate averaged 21.59 percent since the last MPC meeting against the target of 22.0 percent. The outstanding level of SBP liquidity support was PKR 8.35 trillion on June 27, 2023 compared to PKR 8.56 trillion on June 26, 2023 and 7.99 trillion on June 10, 2023. It was noted that following an unanticipated 100bps increase in the policy rate in the last MPC meeting, the benchmark secondary market rates witnessed an increase of same quantum.

15. In primary auctions, the market participation remained concentrated in 3-month T-bills with some interest in 12-month T-bills. In the recent fixed rate (Pakistan Investment Bonds) primary auctions, there has been no issuance beyond 3-years tenor. It was noted that the participation in the floating rate PIBs has increased.

16. The staff apprised the Committee that Pakistan Eurobond yields and Credit Default Swap (CDS) spreads have shown some respite, though they are still above normal levels.

17. Further, it was apprised that PKR to USD rate did not record any noticeable movement since the last MPC meeting on point to point basis. However, FX market remained volatile as a noticeable appreciation of PKR was followed by a gradual depreciation of PKR.

Model-Based Assessment

18. The staff apprised the Committee on model-based assessments of inflation projection and policy rate path for FY24. In this regard, it was explained that the increase in the electricity charges has resulted in upward revision in inflation projection for FY24 compared to last meeting.

19. The staff appraised the Committee that the slowdown in the aggregate demand reflected by decrease in the economic activity and negative output gap would drag the inflation down in H2-FY24.

20. The Committee also discussed the medium-term conditional inflation projections relative to 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 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

22. The staff apprised the Committee that in the recent wave of surveys (July 2023), business confidence has improved compared to the last wave (June 2023), while consumer confidence has moderated slightly. Moreover, businesses' inflation expectations have eased further, whereas the inflation expectations of the households inched up.

23. The Purchasing Managers Index (PMI) and perception about employment for the manufacturing sector has improved in July 2023 compared to the last wave in June 2023.

Monetary Policy Deliberations and Decision Vote

24. The MPC decided to keep the policy rate unchanged with a majority vote of seven out of nine while two Members voted to increase the policy rate by 100bps.

DECISIONS:

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