Monetary Policy Statement
November 24, 2017

The latest information reveals that economic activity is strong as corroborated by broad-based pick up in industrial output, gains in factors supporting production of major crops, and growth in private sector credit. This implies that the prospects of achieving 6.0 percent target of real GDP growth continue to be strong. Model-based projections for inflation and survey-based measures of inflation expectations show that in FY18 overall inflation is expected to remain well below the target of 6.0 percent. On the fiscal front, healthy growth in tax revenue collection by FBR during Q1-FY18, 22.0 percent compared to the modest 4.5 percent during Q1-FY17, is a welcome development. Near-term balance-of-payments challenges continue to persist. However, visible improvements in export growth, notable increase in foreign direct investments and expected other financial inflows will help contain these pressures.

A review of latest developments in the real sector show that during Q1-FY18 LSM growth has surpassed its earlier expectations as it has been recorded at 8.4 percent compared to 1.8 percent in the corresponding period of FY17. This is explained by improved security conditions and power supply, transformation of fixed investment into enhancements of productive capacity on the ground, low inflation and stable interest rates. Further support comes from the continuation of CPEC projects. Barring any extreme seasonal events, agriculture sector is expected to perform better for the second consecutive year. This is explained by increase in both cultivated area and fertilizer off-take during the Kharif season, on-going trend of investment in mechanization, higher uptick in agricultural credit and unchanged support price for wheat at the time of its sowing. Accordingly, demand for services is also expected to rise in FY18 given its inter-connectivity with the other two sectors. Taking all the evidence together, real GDP growth is expected to meet its target level of FY18.

Turning to inflation, CPI inflation averaged 3.5 percent during Jul-Oct FY18 - well below the annual inflation target. Higher international oil prices along with pass-through to domestic petroleum prices and the imposition of regulatory duty on non-essential import items are expected to increase inflation in the coming months. However, while taking into account these effects, inflation is still expected to fall inside the range of 4.5-5.5 percent projected at the start of FY18. Indeed, supply side dynamics, both for food and non-food items, are improving given the gains in agricultural yields and investment in manufacturing. The current growth momentum is being translated into upward pressure in the services component of the CPI basket. Consequently, NFNE measure of core inflation remains relatively high although stable around its current level of 5.3 percent (YoY) since November FY17.

An important development in the monetary sector is a visible change in the pattern of government borrowing for budgetary financing. Instead of relying heavily on Central Bank financing like last year, Government is securing funds both from SBP and scheduled banks. Alongside active liquidity management by the Central Bank kept the overnight repo rate close to the policy rate and is supporting the availability of credit. Indeed, the stock of credit to the private sector grew on YoY basis by Rs. 814.9 billion in October FY18 (a growth of 18.5 percent) as compared to Rs. 436.4 billion (11.0 percent growth) in the corresponding period last year. Looking into the break-up of this credit expansion, the already buoyant growth in fixed investment gained further traction at a slightly higher level relative to FY17, while both working capital loans and consumer financing showed encouraging trends. These developments are further supported by the improvement in capacity utilization of major sectors which indicates growing demand.

The current account deficit widened to US$ 5.0 billion during Jul-Oct FY18 as compared to US$ 2.3 billion during the corresponding period in FY17. Delving deeper, Pakistan's exports have seen an improvement during Jul-Oct FY18, growing at 11.3 percent as compared to the decline of 3.1 percent in the comparable period last year. Similarly, remittances recorded a modest increase of 2.3 percent during Jul-Oct FY18. Nonetheless, the impact of these positive developments on the overall current account was more than offset by growth in imports on account of rising domestic demand for consumption as well as investment and due to recent rise in international oil prices. However, the introduction of regulatory duties is expected to help curb some growth in imports during the coming months.

Finally, the financial account perspective shows that FDI inflows have risen, reaching US$ 940 million by the end of October FY18 as compared to US$ 539 million during the same period last year, indicating improving sentiments regarding the economy. Despite this positive development, SBP's foreign exchange reserves stand at US$ 13.5 billion on November 17, 2017 down from US$ 16.1 billion at end-June 2017. Going forward, progress on CPEC related projects and other official proceeds will be instrumental in managing the overall balance-of-payments deficit.

Following detailed deliberations, the Committee has decided to maintain the policy rate at 5.75 percent.