



MONETARY POLICY COMMITTEE STATE BANK OF PAKISTAN

Monetary Policy Statement

March 2, 2023

1. At its meeting held on 2nd March 2023, the Monetary Policy Committee (MPC) decided to increase the policy rate by 300 basis points to 20 percent. During the last meeting in January, the Committee had highlighted near-term risks to the inflation outlook from external and fiscal adjustments. Most of these risks have materialized and are partially reflected in the inflation outturns for February. The national CPI inflation has surged to 31.5 percent y/y, while core inflation rose to 17.1 percent in urban and 21.5 percent in rural basket in February 2023.
2. In today's meeting, the MPC noted that the recent fiscal adjustments and exchange rate depreciation have led to a significant deterioration in the near term inflation outlook and a further upward drift in inflation expectations, as reflected in the latest wave of surveys. The Committee expects inflation to rise further in the next few months as the impact of these adjustments unfolds before it begins to fall, albeit at a gradual pace. The average inflation this year is now expected in the range of 27 - 29 percent against the November 2022 projection of 21 – 23 percent. In this context, the MPC emphasized that anchoring inflation expectations is critical and warrants a strong policy response.
3. On the external side, the MPC noted that despite a substantial reduction in the current account deficit (CAD), vulnerabilities continue to persist. In January 2023, the CAD fell to \$242 million, the lowest level since March 2021. Cumulatively, the CAD – at \$3.8 billion in Jul-Jan FY23 – is down 67 percent compared to the same period last year. Notwithstanding this improvement, scheduled debt repayments and a decline in financial inflows amid rising global interest rates and domestic uncertainties, continue to exert pressure on FX reserves and the exchange rate. The MPC noted that FX reserves remain low and concerted efforts are needed to improve the external position. In this regard, conclusion of the ongoing 9th review under the IMF's EFF will help address near-term external sector challenges. Furthermore, the MPC stressed on the urgent need for energy conservation measures to alleviate pressure on the external account and meet the import requirements of other sectors.
4. Recent fiscal measures – including an increase in GST and excise duties, reduction in subsidies, adjustments in energy prices, and the austerity drive – are expected to help contain the otherwise widening fiscal and primary deficits. As highlighted in earlier statements, the envisaged fiscal consolidation is critical for economic stability and will complement the ongoing monetary tightening in bringing down inflation over the medium-term. The Committee emphasized that any significant fiscal slippages will undermine monetary policy effectiveness in the context of achieving the price stability objective.
5. The MPC also assessed the impact of further monetary tightening on financial stability and the near-term growth outlook. The Committee views that the risks to financial stability remain contained, given that financial institutions are broadly well capitalized. On growth, however, there exists a trade-off. The MPC, nonetheless, reiterated its earlier view that the short-term costs of bringing down inflation are lower than the long-term costs of allowing it to become entrenched. Barring unexpected future shocks, the MPC noted that today's decision has pushed the real interest rate in positive territory on a forward-looking basis. This will help anchor inflation expectations and steer inflation to the medium-term target of 5 – 7 percent by end-FY25.
6. The Committee also decided to hold its next meeting on April 4, 2023.