Minutes of the Meeting of the Monetary Policy Committee of the Central Board
held at Karachi on 24th May, 2010

Meeting of the Monetary Policy Committee of the Central Board (MPC) was held at Karachi on 24th May, 2010 at 9:30 am.

Present:

1.	Syed Salim Raza	Chairman/Governor, SBP
2.	Mr. Yaseen Anwar	Member /Deputy Governor, SBP
3.	Mirza Qamar Beg	Member/Director of the Central Board
4.	Dr. Ijaz Nabi	Member/External Expert
5.	Mr. Riaz Riazuddin	Member/ Chief Economic Advisor, Monetary Policy & Research, SBP
6.	Mr. Asad Qureshi	Member/Executive Director Financial Markets & Reserve Management, SBP
7.	Dr. Hamza Ali Malik	Member/Director Monetary Policy, SBP

Mr. Aftab Mustafa Khan Corporate Secretary, SBP also attended the meeting as Secretary. Mr. Mansoor Ali - Director Economic Analysis Department, Mr. Muhammad Ali Malik- Director Domestic Markets & Monetary Management Department and Dr. M. Ali Choudhary- Director Research Department were also present on special invitation.

Agenda Item No. 1: Leave of absence to members.

Leave of absence was granted to Dr. Hafiz A. Pasha, External Expert.

Agenda Item No. 2: Confirmation of Minutes of last meeting held on 27th March, 2010.

Minutes of the last meeting of MPC held on 30th April, 2010 were placed before the Committee for confirmation. The Committee confirmed these minutes and passed the following resolution.

RESOLVED: That the minutes of the meeting of the Monetary Policy Committee of the Central Board held on 30th April, 2010 be and are hereby confirmed.

Agenda Item No. 3: Compliance Report on the decisions of the previous meeting of the Monetary Policy Committee

The Committee reviewed and recorded the status of compliance of the decisions of previous MPC meeting.

Agenda Item No. 4: Monetary Policy Decision Statement – 24th May, 2010.

A member circulated the draft Monetary Policy Decision (MPD) statement. He summarized the three main arguments that were discussed in the last MPC meeting in support of keeping interest rate unchanged in the current scenario. The first argument was the positive inflation outlook at that time which has not remained as favorable as before and points towards increase in policy interest rate as all inflation metrics are showing upward trends, even the nonfood-non-energy core inflation. Secondly, the argument of support for nascent recovery in manufacturing may now be open to interpretation due to better than expected GDP growth of 4.1 percent against the target of 3.1 percent as per provisional GDP estimates for 2009-10. Thirdly, the liquidity conditions have now improved and interest rates are stable even without liquidity injections which allow flexibility of decision making.

Discussing rationale for supporting interest rate increase, the member referred to current slippage in fiscal targets and expected fiscal deficit target next year as a perpetual concern and highlighted the need to be mindful of its impacts on aggregate demand as the tilt of government borrowing is from domestic sources. He pointed towards the linkage observed between inflation and Net Domestic Assets and Net Foreign Assets ratio (NDA/NFA ratio) that has improved significantly from around 14 in November 2008 to 8.5 at present. Going forward, however, this ratio may deteriorate in next year due to expected government borrowing from domestic sources and anticipation of relatively low build up of NFA which may perpetuate unwanted double digit inflation. He also pointed towards the risk of overvaluation of rupee in case of prolonged high inflation as compared to the trading partners.

One member referred to the last meeting of MPC where he voted for increase in interest rate by 50 basis points due to its implications for exchange rate and increasing trends in WPI and CPI numbers. He stated that under the current circumstances interest rate increase of 100 basis points will be more meaningful as 50 basis points increase now may not be sufficient to have required impact on inflationary trends.

Agreeing with the need to raise interest rate, a member recalled the experiences of 2007-08, when despite the Bank's signaling, the government kept on borrowing substantial amounts and at that time the Bank waited for fiscal authorities to take corrective measures which eventually led to crisis situation. Referring to the fiscal dominance, he said that prime concern for a central bank should be to maintain price stability which eventually set the stage for growth. Another member opined that MPD statement should be taken more than a signaling tool for the fiscal authorities as it has implications for other economic agents as well. He added that although the growth has picked up and the stabilization program has resulted in improvement in current account at present, its continued financing arrangements remain uncertain. He stated that major concern remain the fiscal slippages which results in increasing the aggregate demand and that too mostly for imported goods as evident from next year's projection of the current account deficit of four percent. Accordingly there is a strong case for increase in policy rate.

A member said that the signaling aspect of interest rate increase in the context of its cost impact to the government is uncertain as it has remained impervious. However, the cost increase due to increase in policy rate may adversely affect private sector growth.

Another member explained the importance of conveying to fiscal authorities the need to orient government expenditure towards investment rather than consumption. The current pattern of expenditure, if unchecked, may ultimately lead to substantial correction in the exchange rate. Referring to the un-sustainability of current level of exchange rate in the absence of workers' remittances and official flows, he opined that exports are adversely affected also due to misalignment of the exchange rate, especially when there is a possibility that our major trading competitors, like China, may be maintaining undervalued currencies to favour their exports.

Acknowledging the central bank's mandate to use interest rate adjustments to attempt to bring balance in monetary and fiscal policy, a member pointed to the cost push aspect of inflation that may not be receptive to interest rate adjustments and highlighted the need for continued positive signaling to private sector for growth. He also referred to the soft world demand of oil products and expectation of inflows that could, nevertheless, support price stability. Supporting these arguments another member said that as fresh surge in world commodity prices is not insight and recovery in the real sector has not rooted sufficiently to create meaningful impacts like increase in tax revenues etc., therefore, maintaining interest rate may be a more viable option.

One member emphasized the need to take immediate corrective measures otherwise inflation may remain in double digit in the next year. He stated that if status-quo is maintained for too long, it may also be seen as the Bank's validation of the fiscal slippages. A member stated that the recent inflation surge may be because of elimination of some subsidies by the government and as more such measures are likely to be taken, supply side rather than demand side factors may keep the inflation high and that could limit the effectiveness of interest rate interventions.

Members were invited to vote for keeping interest rate unchanged at 12.50 percent or increasing it by 50 basis points. Four members of MPC voted to keep the policy interest rate unchanged whereas other three members voted to increase the policy interest rate by 50 basis points. Therefore, the decision on recommendation of MPC to keep the policy interest rate unchanged at 12.50 percent was reached with 4/3 votes for further consideration and final decision by the Central Board. The Committee reviewed the draft Monetary Policy Decision statement and suggested certain improvements.

The meeting ended with a vote of thanks to the Chair.

Chairman
(Syed Salim Raza)
02-06-2010