Minutes of the Meeting of the Monetary Policy Committee of the Central Board
<u>held at Lahore on 27th March, 2010</u>

Meeting of the Monetary Policy Committee of the Central Board (MPC) was held at Lahore on 27th March, 2010 at 10:30 am. Mr. Yaseen Anwar, Deputy Governor chaired the meeting as the Governor was unable to attend the meeting.

<u>Present</u>:

1.	Mr. Yaseen Anwar	Chairman/Deputy Governor, SBP
2.	Mr. Tariq Sayeed Saigol	Member/Director of the Central Board
3.	Mirza Qamar Beg	Member/Director of the Central Board
4.	Dr. Hafiz Ahmed Pasha	Member/External Expert
5.	Mr. Riaz Riazuddin	Member/ Chief Economic Advisor, 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.

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

Leave of absence was granted to Dr. Ijaz Nabi, External Expert on his request as he was out of county.

Agenda Item No. 2: Confirmation of Minutes of last meeting held on 30st January, 2010.

Minutes of the last meeting of MPC held on 30th January, 2010 were placed before the Committee for confirmation alongwith the minutes of the same meeting for placement on SBP website, without the names of the members in deliberations and decision.

On the suggestion of one member, second sentence of last para on page 5 of the minutes of the last meeting held on 30th January, 2010 was amended as under:

> "One member said that the Monetary Policy stance of SBP also contributed towards curtailing the aggregated demand ……."

One member of MPC pointed out that his name is inadvertently appearing on page No. 3 para 1 in the minutes of MPC meeting for placement on SBP website, which may be deleted accordingly. On the suggestion of another member, it was also decided that designations of SBP economic team may also be removed from the minutes for placement on SBP website and also to mention the numbers of votes casted for and against the monetary policy decision even if the conclusion is made with consensus.

Discussing the frequency of meetings, it was decided that meetings of MPC would be held on monthly basis whereas the Monetary Policy Decision would be taken after every two months as per the existing practice.

The Committee confirmed the minutes of the last meeting of MPC and passed the following resolution.

RESOLVED

That the minutes of the meeting of the Monetary Policy Committee of the Central Board held on 30th January 2010 be and are hereby confirmed as amended above.

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

One member briefed the Committee on the status of compliance.

The Committee recorded its appreciation to the members of economic team of SBP for a good quality Monetary Policy Information Compendium. Discussing the plan for its publication, it was decided to start publishing the Monetary Policy Information Compendium without projections/outlook for few months, afterwards it may be reconsidered to publish projections/outlook, if deemed fit. Emphasizing on the importance of projections and outlook in the Monetary Policy Information Compendium, the member stated that it is based on information available with SBP and might be helpful for clear understating. One member desired that, in the next meeting, economic team may apprise the Committee on the methodology and frameworks being used for arriving at the economic forecasts.

Agenda Item No. 4: Monetary Policy Decision

One member of MPC briefed the Committee that although the CPI inflation (YoY) has declined to 13.0 percent in February 2010 but is still high and exhibits persistence. Explaining the reasons for this inflation behavior, after it slipped back from a low of 8.9 percent in October, 2009, the member stated that it is largely cost push i.e. due to increases in electricity tariffs, adjustments in the prices of domestic petroleum products and administered prices of commodities like wheat. He added that it is difficult to assess to which extent these factors would influence other prices in the economy and expectations of the public regarding inflation in the coming months. However, he apprised the Committee that SBP expects the average CPI inflation for FY10 to remain between 11.5 to 12 percent. Another member commented that the stance of government regarding procurement of wheat and its delivery price is extremely important as it would affect the overall commodity prices resulting in a change in the entire outlook on prices. He added that more budgetary implications can be expected if the benefit of lower international wheat price is to be trickled down to public. One member highlighted that the prices of dairy products are also expected to increase as the milk producing animal are getting scarce due to export of meat. He suggested to assess its likely impact on inflation for its presentation in the next meeting of the Committee.

Apprising the Committee on the growth in the Large Scale Manufacturing (LSM), a member stated that there was a growth of 8 percent in January 2010 despite crippling electricity shortages, challenging security conditions and high inflation, which is encouraging. He stated that LSM has been consistently showing growth at the average rate of 5 percent since October, 2009 after contraction for almost 20 months but remains fragile and the sustainability of this positive trend in LSM and overall economic growth would depend on improvements in the availability of electricity and security situation. On the comments of another member about the appropriateness of using monthly growth of LSM, the member agreed that more reflective proxy of developments in LSM sector is year to date growth which is at lower level of 2.4 percent. Responding to a query of a member it was stated that weight of LSM in entire GDP is around 12-13 percent.

Moving on to the balance of payments side, a member stated that overall balance of payments turned into a surplus during February 2010 largely as a result of decline in trade deficit and receipt of logistic support fund. The external account deficit has come down to USD 2.6 billion during July-February, FY10 compared to USD 8 billion in the corresponding period of the last year, which has resulted in accumulating foreign exchange reserves, USD 11 billion as on 22nd March, 2010. He added that accumulation of foreign exchange reserves has facilitated stability in the foreign exchange market. Regarding future outlook, he emphasized on the close monitoring of other developments in the external sector, such as Foreign Direct Investment and workers' remittances, especially in the circumstances when prospects of foreign official flows are uncertain as FDI has almost halved from USD 2.1 billion to USD 1.3 billion. Highlighting the relative stagnation in the growth of export and steady uptick in import bill, a member endorsed the need to be watchful on external side despite comfortable situation for the time being. Referring to the relative increase in the export quantity of yarn, the member mentioned the need to analyze fall in its low per unit exported price in view of rising international yarn and cotton prices.

On the weak fiscal position, a member stated that achieving the target of 4.9 percent budget deficit may not be possible in view of the significant increase in expenditures and shortfalls in revenues. Developments leading to further deterioration of the fiscal side include low revenue collections, losses of public sector enterprises, stuck-up liquidity due to build-up of commodity stocks, increased expenditure on security and, going forward, expected subsidies in the energy area. He added that over and above these factors, there are issues of circular debt and uncertainty of receipt from donor countries. He mentioned that government borrowing from the SBP has been substantial in Q3-FY10 and exceeds the quarterly ceiling agreed with IMF by nearly Rs.130 billion as of 24th March, 2010 and this trend has also started impacting the price structure of interest rates for the private sector, adding to the crowding out of private sector. He also pointed towards the tying up of market resources in government guaranteed debt where financing rates are now exceeding KIBOR and quoted the example of lending for commodity operations where financing is offered in the range of KIBOR plus 2.5 to 2.75 percent. One member added that it is important to unclog the balance sheets of corporate from circular debt as the increased spread reflects anticipated ongoing rollover cost, which is distorting the overall pricing curve of the economy.

Highlighting the importance of fiscal policy, one member said that the effectiveness of monetary policy depends on the extent of fiscal deficit and, therefore, there is a need to give appropriate signal to the fiscal authorities and this may also highlight our economic problems to the international community, especially the donor countries. On the ongoing talks with IMF, the member commented that SBP may also be involved actively in the process, being one of the signatories of the letter of intent signed with IMF.

Expressing his views on the options for change in monetary stance, one member said that interest cost may become notably high in one to three years in view of pattern of higher debt creation by the fiscal and public sector with low revenue collections. As a result, the most likely reduction may come in the public sector development program adversely affecting the investment activity in the economy in which contribution of private sector is already receding. He said that these factors may lead to stagnation in the production capacity and demand resulting in stickiness of inflation at around 12 percent that may not reflect the actual low economic activity. Under the circumstances, more suitable options are to either create a provision for development expenditure on the fiscal side, which may be difficult to attain, or to support private sector investments as far as possible.

Responding to the arguments of two members of MPC to give the right signal to the market as well as to the fiscal authorities by increasing the policy interest rate, another member pointed out the arguments discussed in the previous MPC meeting where, in spite of fiscal and liquidly concerns, it was agreed to hold the policy rate to support signs of nascent recovery in the private sector output. He added that while it is important to give the right signal to the fiscal authorities, the Central Bank also needs to support growth and as such, a hike in the rate would stifle the current, albeit nascent, recovery in LSM sector and at the same time give a misleading signal to curtail private sector credit. Notwithstanding, he suggested rewording of MPD text to place heightened concerns on the fiscal trends that if unabated going forward, would likely exacerbate inflation.

One member was of the view that the present inflation forecast still provides room to delay change in policy stance which may be availed, as far as possible, to support the nascent recovery in the private sector. Supporting these views, another member argued from a systemic liquidity perspective that even if some of the expected external financing inflows materialize, there may be no immediate market liquidity issues in near-term. Hence, it would be prudent to defer change in policy stance to give room to fragile growth and re-assess situation in May, 2010.

The Chairman then invited members to vote for one of the following options:

Recommend to the Central Board to keep the policy interest rate unchanged at 12.50 percent

or

Recommend to the Central Board to increase the policy interest rate by 50 basis points to 13.00 percent

Five members of MPC voted in favour of the recommendation to keep the policy interest rate unchanged whereas the other two members voted for the recommendation to increase the policy interest rate by 50 basis points. Therefore, the decision on recommendation of the Committee to keep the policy interest rate at 12.50 percent was reached with 5/2 votes for further consideration and final decision by the Central Board.

The Committee reviewed the draft Monetary Policy Decision statement. The analysis and description of the statement was discussed and some improvements were advised to make the statement in line with the rationale of the decision and to signal it more appropriately. The Committee also finalized the draft of Monetary Policy Decision (27th March, 2010) for the consideration of the Central Board.

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

Chairman
(Yaseen Anwar)
21-04-2010