Minutes of the Meeting of the Monetary Policy Committee
of the Central Board held at Lahore on 29th November, 2010

Meeting of the Monetary Policy Committee of the Central Board (MPC) was held at Lahore on 29th November, 2010 at 9:30 am.

Present:

1.	Mr. Shahid H. Kardar	Chairman/Governor, SBP
2.	Mr. Yaseen Anwar	Member/Deputy Governor (Banking), SBP
3.	Mr. Asad Umar	Member/Director of the Central Board
4.	Dr. Hafiz A. Pasha	Member/External Expert
5.	Dr. Ijaz Nabi	Member/External Expert
6.	Mr. Riaz Riazuddin	Member/Chief Economic Advisor, Monetary Policy & Research, SBP (CEA-MP&R)
7.	Mr. Asad Qureshi	Member/Executive Director-Financial Markets & Reserve Management, SBP (ED-FMRM)
8.	Dr. Hamza Ali Malik	Member/Director Monetary Policy Department, SBP (Director-MPD)

Mr. Aftab Mustafa Khan Corporate Secretary, SBP attended the meeting as Secretary whereas Dr. Muhammad Ali Choudhary - Director Research Department was also present through special invitation.

Agenda Item No. 1: Leave of absence to members

Leave of absence had been granted to Mirza Qamar Beg, Member/Director Central Board on his request.

Agenda Item No. 2: Confirmation of Minutes of last meeting held on 25th October, 2010

The Committee confirmed the minutes of the last meeting of the MPC held on 25th October, 2010 and passed the following resolution.

RESOLVED: That the minutes of the meeting of the Monetary Policy Committee of the Central Board held on 25th October, 2010 be and are hereby confirmed.

Agenda Item No. 3: Monetary Policy Decision - November, 2010

Presenting the latest macroeconomic projections, a member highlighted the salient assumptions to initiate the debate. On the projected -2.2 percent growth rate for agriculture, another member shared his observation of the surge in economic activities in the rural areas as agricultural produce like cotton and rice were fetching increased prices which could be indicative of potentially higher agricultural growth next year. One member explained that these effects only reflected the price impact and in terms of real growth and its quantum the projection of even -2.2 seemed optimistic as the flood had affected around 10 percent area under cultivation. Agreeing with his views, another member added that prospects of improved livestock growth might help boost some growth in agriculture. He also clarified that increased economic activities had not been observed country-wide, especially in lower Sindh. A member also expressed his opinion that the manufacturing sector might also not attain the projected growth of 4.0 percent in view of the uncertainty about the size of the sugarcane crop.

In the case of the external sector, a member was of the view that growth in exports was largely owing to the higher price of cotton which had contributed to the decision to revise downward the projected current account deficit for FY 11 to USD 5.1 billion or 2.6 percent of GDP. However, there might be a decline in net foreign assets in flow terms and more external inflows would be required to maintain the ratio of net domestic assets to net foreign assets. On a query from one member on the upward revision of the export forecast to 8 percent, the member explained that 85 percent of textile related items had shown a rising trend in quantity whereas the price effect had contributed to an overall increase in export proceeds. Referring to expected donor inflows, the he said that under current assumptions expected net flows for budget financing were close to USD 1.2 billion for FY11, including inflows to finance flood related expenditures. In addition, reimbursement of close to USD 1.2 billion in the form of Coalition Support Fund was expected as well, which would help government's non-tax revenues and external current account. He added that other major inflows were USD 640 million and USD 266 million expected under licensing fee for 3G bandwidth (part of current account) and privatization proceeds (part of financial account) respectively, apart from the USD 3.2 billion expected under the ongoing IMF program (part of SBP's reserves). A member commented that the privatization proceeds were more likely to be realized than inflows from the 3G licensing fee. Sharing the market perspective in case of delays in the receipt of inflows from the IMF, another member responded that the market was not likely to exhibit a noticeable negative reaction provided the economic reforms program remained broadly on track.

Presenting the year-end fiscal estimates, a member said that the government was expecting tax revenue of Rs.1,655 billion and targeting a fiscal deficit of 4.7 percent for FY11. He apprised the Committee that annual tax revenues were projected to be Rs 1,425 billion based on tax collections of the first quarter of the year and Rs.1,630 billion based on last year's tax to GDP ratio. He added that the implementation of the tax reforms was expected to raise an additional Rs.60 billion which had now been revised to Rs.30 billion due to the delays in the passage of the RGST legislation whereas the government was also expected to save Rs. 50 to 60 billion through administrative measures. He said that PSDP had already been reduced to Rs.530 billion with federal and provincial components of Rs.150 billion and Rs.230 billion respectively, apart from Rs.150 billion for cash transfers to assist flood affected households. Discussing the budgetary financing requirement the he said that current estimates suggested that there would be extra pressures on domestic funding sources, implying even more crowding out of the private sector. On the prospects of implementation of the tax reforms, one member observed that the only achievement with respect to the tax regime were structural in nature resulting in the reduction in dependence on international trade for revenues, a view endorsed by the other members of the Committee. Another member also suggested the need to consider the leakages in the tax collection system when estimating incremental tax revenue from new tax measures.

The Committee reviewed the inflation estimates that suggested an average CPI inflation of 15.5 percent for FY11 with year-on-year inflation in June 2011 at 16.5 percent. The Committee observed that though inflation, especially food inflation, had marginally decreased, the overall inflationary outlook was not promising. To influence borrowing behavior, the major cause of high inflation, the Committee endorsed the steps taken by the Bank to enforce the overdraft limits of the provinces.

The draft monetary policy statement was circulated and various amendments were suggested in the text by the members in line with the deliberations of the Committee.

The Committee discussed the options for change in the policy interest rate of the Bank. A member commented that if inflation was estimated to be 15.5 percent then the policy interest rate cannot be substantially negative. One of the members urged maintenance of consistency in the recommendations of the Committee and to also avoid uneven changes in the interest rate. Another member favored a significant enhancement amid persistent government borrowings as a moderate increase might raise questions about the credibility of the central bank under the prevailing macroeconomic situation and related projections.

Expressing his point of view on the upward revision of the policy rate, a member said that increases in the interest rate had failed to impact the borrowing behavior of the government and a sharp increase may be needed. However, he suggested that the policy rate hike be held for now to assess the impact of the tax reform initiatives of the government, to avoid any premature squeezing of private sector demand for credit. One member was also of the view that while government had taken difficult initial steps to reform the tax regime that might eventually address the issue of inflationary pressures, a sharp increase in the interest rate at this point in time might unnecessarily stifle any potential growth prospects. On his argument that a sharp increase of a hundred basis points would adversely affect market sentiment with respect to the economy and the banking sector going forward, which would also impact the interbank credit lines and potentially lead to complications for smaller banks who were more dependent on such facilities to fund their portfolios, most of the members agreed that a moderate increase in the policy rate would be more appropriate. Supporting only a moderate increase of 50 basis points, a member suggested that the MPC always had the option to consider a further hike well before the scheduled two month review, if required.

The members were then invited to vote for increasing the policy interest rate by 50 basis points, 100 basis points or for no change. Six members of the MPC voted to increase the policy interest rate by 50 basis points. One member voted to raise the interest rate by 100 basis points. Another member voted for no-change in the interest rate; however, he suggested the need to reconsider the change in the policy rate in two weeks and if there was nothing positive to report by way of government behavior then we may decide to raise the policy rate by 100 basis points. Therefore, the decision of the MPC to recommend to the Central Board for its consideration to increase the policy interest rate by 50 basis points to 14.00 percent was reached with 6/1/1 votes.

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

Sd/-
Chairman
(Shahid H. Kardar)