**Minutes of the Meeting of the Monetary Policy Committee of the Central Board held at Karachi on 29th July, 2010**

Meeting of the Monetary Policy Committee of the Central Board (MPC) was held at Karachi on 29th July, 2010 at 3:00 pm.

**Present**:

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| 1. | Mr. Yaseen Anwar | Chairman/Acting Governor, SBP |
| 2. | Mirza Qamar Beg | Member/Director of the Central Board |
| 3. | Dr. Hafiz A. Pasha | Member/External Expert |
| 4. | Dr. Ijaz Nabi | Member/External Expert |
| 5. | Mr. Riaz Riazuddin | Member/ Chief Economic Advisor, Monetary Policy & Research, SBP |
| 6. | 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 Mr. Asad Qureshi, Member MPC/Executive Director-Financial Markets & Reserve Management, SBP.

**Agenda Item No. 2: Confirmation of Minutes of last meeting held on 24th May, 2010.**

Minutes of the last meeting of MPC held on 24th May, 2010 were placed before the Committee for confirmation along with the version without the names of the members to be placed on SBP website. A member suggested some editorial changes in a few sentences to enhance the clarity of the narration, which were approved by the Committee.

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 24th May, 2010 along with its web-version be and are hereby confirmed with the editorial changes referred above.

**Agenda Item No. 3: Monetary Policy Statement – July, 2010.**

Presenting the synopsis of the under consideration monetary policy statement, one of the members briefed the Committee on the ongoing weaknesses on fiscal side, persistence of high inflationary trend and decrease in investments. He mentioned the narrower current account balance of 2 percent as the only positive development despite steady acceleration in imports in the second half of the year. Expressing his concerns, he said that current developments indicate continuation of high inflationary trends in FY11 to the tune of 11 to 12 percent similar to the trend of FY10 where average inflation remained 11.7 percent, exceeding the target by 2.7 percentage points. He pointed out that this inflation forecast excludes some expected supply shocks, impacts of likely implementation of VAT and effects of increased government sector wages. He stated that the government borrowings from the Central Bank are exceeding the target along with substantial deficit financing from commercial bank and non-bank resources which may push the fiscal deficit for FY10 above 6 percent, against the revised target of 5.1 percent. On the revenue side, he mentioned that, as per preliminary data, tax to GDP ratio has come down to 9 percent, lowest since 1968. Highlighting the scale of public sector borrowing, he mentioned that apart from financing for budget deficit, debt stock of commodity operations has crossed Rs.400 billion and outstanding against public sector enterprises is around Rs.375 billion with 30 percent increase over the previous year. In view of the aforesaid situation, he suggested further tightening of the monetary policy in an effort to reduce aggregate demand and inflationary trends.

Referring to the previously observed positive association of NDA/NFA ratio with CPI, the same member informed that this ratio is increasing since January, 2010 that also hints of high inflation in the coming year. Elaborating the positive development in current account deficit (CAD), he enumerated the major contributors as exports with growth of 2.7 percent, negative imports growth of 2.3 percent, worker's remittances of USD 8.9 billion and realization of coalition support fund (CSF) of USD 1.4 billion. Going forward, he said that for FY11, CAD is projected to be close to 3.7 percent of GDP assuming 7 and 12 percent growth rate of exports and imports respectively with estimates of worker's remittances and CSF at FY10's level.

In response to a query, one member explained that primarily the imports growth of about 20 percent in last two quarters, has pushed the projection of imports growth of FY11 to 12 percent. However, another member was of the view that the imports growth may remain less than 12 percent as the imports of power generating machinery, telecom equipment are on decline and no major price hike in international commodity market is in sight. On a query of one member, another member clarified that the expected inflows regarding Euro Bonds have been incorporated in CAD projection. Discussing the factors causing stickiness in inflation, a member mentioned that continued high level of inflation is also due to high inflationary expectation that have been strengthened by the recent increase in the salaries of the government employees.

Members of MPC discussed the rationale of increasing policy interest rate to which government borrowings trend remains usually impervious, whereas it negatively impacts economic growth. As an alternate approach, a member discussed the possibility of having stronger linkage between deficit financing and exchange rate, also to promote export led economic growth, as similar approaches have been successfully adopted by several East Asian countries. Mentioning the imports based component in inflation and arguable link between exports growth and exchange rate, another member supported the argument to the extent of removing any misalignment of exchange rate. However, he stressed on the need for giving stronger signal to fiscal authorities to contain consumption based increases in demand. One member also supported the signaling aspect of the interest rate change that could also support the fiscal managers to build case for taking corrective measures. A member stated that more weight should be assigned to the behavior of macroeconomic aggregates and less to the behavior of its sub-component while deciding about macroeconomic policy and from this perspective; emerging macroeconomic imbalances clearly suggest the need to increase the policy rate.

On a query of a member regarding recent data depicting overvaluation of rupees, another member highlighted the role of market dynamics and stated that the exchange rate is expected to become more reflective of the economic realities as market is now self managing the foreign exchange even for the oil related imports. On the interest rates aspect of market, he added that even with status quo in policy interest rate, the increasing public sector borrowing may push the interest rates upward. He also mentioned that the real interest rates are already at the verge of becoming negative. On another query, one member explained SBP's endeavors to promote economic awareness, particularly the mechanics of the monetary management, are yielding positive results. These efforts include recently conducted workshop for journalists, country-wide lecture series for various chambers of commerce & industries and other institutions.

Discussing the sizeable government borrowing from non-bank sources, i.e. national savings schemes offered by the government, it was expressed that financial market is not offering ample choices for the public. A member explained that the trends in non-bank borrowing by government may continue in FY11 to the tune of 2 percent of GDP as of FY10. Pointing to the debt servicing aspect of the government borrowing, a member stated that we may be heading towards debt trap and no serious work is apparently being done to avoid it. In the context of delays in implementation of VAT, the continuation of IMF program was also discussed. Pondering upon the likely scenarios, another member highlighted the undesirable tradeoffs involved in case reliance for external financing arrangements is to be shifted from multilateral to unilateral sources.

The Committee discussed the market reaction in case the policy interest rate is increased. On a query of the member regarding expectations of no change in the interest rate, it was pointed out that the rejection of recent PIB bids, marked 40-50 basis points above KIBOR, may be a reason for market's anticipation of no change in the interest rate.

Members were invited to vote for increasing interest rate either by 25 basis points or increasing the rate by 50 basis points. All the members of MPC voted to increase the policy interest rate by 50 basis points. Therefore, consensus decision on recommendation of MPC to increase the policy interest rate by 50 basis points to 13.00 percent was reached with 6/0 votes for further consideration and final decision by the Central Board. The Committee appreciated the draft Monetary Policy Statement and recommended the same for the consideration of the Central Board with some suggestions for further improvement.

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

Chairman
(Mr. Yaseen Anwar)
21-08-2010