Monetary Policy Statement

April 7, 2022

1. At its last meeting on 8th March 2022, the Monetary Policy Committee (MPC) noted in its statement the significant uncertainty around the outlook for international commodity prices and global financial conditions, which had been exacerbated by the Russia-Ukraine conflict. Given the unfolding situation, the MPC had highlighted that it "was prepared to meet earlier than the next scheduled MPC meeting in late April, if necessary, to take any needed timely and calibrated action to safeguard external and price stability."

2. Since the last MPC meeting, the outlook for inflation has deteriorated and risks to external stability have risen. Externally, futures markets suggest that global commodity prices, including oil, are likely to remain elevated for longer and the Federal Reserve is likely to increase interest rates more quickly than previously anticipated, likely leading to a sharper tightening of global financial conditions. On the domestic front, the inflation out-turn in March surprised on the upside, with core inflation in both urban and rural areas also rising significantly. While timely demand-moderating measures and strong exports and remittances saw the February current account deficit shrink to $0.5 billion, its lowest level this fiscal year, heightened domestic political uncertainty contributed to a 5 percent depreciation in the rupee and a sharp rise in domestic secondary market yields as well as Pakistan's Eurobond yields and CDS spreads since the last MPC meeting. In addition, there has been a decline in the SBP's foreign exchange reserves largely due to debt repayments and government payments pertaining to settlement of an arbitration award related to a mining project. Some of this decline in reserves is expected to be reversed as official creditors renew their loans.

3. As a result of these developments, average inflation forecasts have been revised upwards to slightly above 11 percent in FY22 before moderating in FY23. The current account deficit is still expected to be around 4 percent of GDP in FY22. While the non-oil current account balance has continued to improve, the overall current account remains dependent on global commodity prices.

4. The MPC noted that the above developments necessitated a strong and proactive policy response. Accordingly, the MPC decided at its emergency meeting today, to raise the policy rate by 250 basis points to 12.25 percent. This increases forward-looking real interest rates (defined as the policy rate less expected inflation) to mildly positive territory. The MPC was of the view that this action would help to safeguard external and price stability. The MPC also noted that SBP is in the process of taking further actions to reduce pressures on inflation and the current account, namely an increase in the interest rate on the export refinance scheme (EFS) and widening the set of import items subject to cash margin requirements. These items are mostly finished goods including luxury items and exclude raw materials. The announcement of these measures is expected soon and will complement the action taken by the MPC on interest rates today.

5. Importantly, the MPC highlighted that Pakistan's external financing needs in FY22 are fully met from identified sources. Looking ahead, the MPC noted that today's decisive actions, together with a reduction in domestic political uncertainty and prudent fiscal policies, should help ensure that Pakistan's robust economic recovery from Covid-19 remains sustainable.