Monetary Policy Statement

March 10, 2025

1. At its meeting today, the Monetary Policy Committee (MPC) decided to keep the policy rate unchanged at 12 percent. The Committee noted that inflation in February 2025 turned out lower than expectation, mainly due to a drop in food and energy prices. Notwithstanding this decline, the Committee assessed the risks posed by the inherent volatility in these prices to the current declining trend in inflation. At the same time, core inflation is proving to be more persistent at an elevated level and thus uptick in the food and energy prices may lead to increase in inflation. Meanwhile, economic activity continues to gain traction, as reflected in the latest high-frequency economic indicators. Moreover, the MPC viewed that some pressures on the external account have emerged due to rising imports amidst weak financial inflows. On balance, the MPC assessed the current real interest rate to be adequately positive on forward-looking basis to sustain the ongoing macroeconomic stability.

2. The Committee noted the following key developments since its last meeting. First, the current account turned into a deficit of $0.4 billion in January 2025 after remaining in surplus over the past few months. This, coupled with weak financial inflows and ongoing debt repayments, led to a decline in the SBP's FX reserves. Second, large-scale manufacturing output declined during H1-FY25, despite a substantial m/m increase of 19.1 percent in December 2024. Third, the shortfall in tax revenues from target widened further in January and February. Fourth, both consumer and business sentiments improved during the latest waves. And lastly, on the global front, uncertainty has increased significantly amidst the ongoing tariff escalations, which may have implications for global economic growth, trade and commodity prices. In response to these developments, central banks in advanced and emerging economies have recently slowed the pace of their monetary easing.

3. Based on these developments, the Committee noted that the impact of sizable earlier reduction in policy rate is now materializing. The MPC reiterated the importance of maintaining a cautious monetary policy stance to stabilize inflation within the target range of 5 – 7 percent. This, along with structural reforms, is essential to achieve sustainable economic growth.

Real Sector

4. High-frequency indicators – including sales of automobiles, POL products and cement, as well as import volumes, credit to private sector, and purchasing managers' index – show that economic activity is gaining further traction. Moreover, latest pulse surveys show improved consumer and business confidence. Nonetheless, the Committee noted that the momentum depicted by these indicators is yet to fully reflect in LSM data, which contracted by 1.9 percent in H1-FY25. The drag in LSM growth is mainly coming from a few low-weight sub-sectors, which have more than offset the positive momentum in key sub-sectors like textiles, pharmaceuticals, automobiles and POL. At the same time, in agriculture sector, latest information, including satellite imagery, indicates subsiding of downside risks to Rabi crops after the recent rainfalls. The MPC expects economic growth to recover in H2-FY25 on the back of easing financial conditions. On balance, the Committee maintains its earlier real GDP growth projection of 2.5 – 3.5 percent for FY25, and expects economic activity to gain further momentum going forward.

External Sector

5. Led by a broad-based acceleration in imports, the current account turned into a deficit in January 2025; shrinking the cumulative surplus to $0.7 billion during July-January FY25. While import volumes have been rising consistently in line with the pickup in economic activity, the uptick in some global commodity prices further pushed up import payments in January. However, robust workers' remittances, along with relatively moderate growth in exports, proved instrumental in financing the elevated imports. The MPC assessed that these developments are broadly in line with its expectation, and reaffirmed the FY25 current account balance projection of a surplus and a deficit of 0.5 percent of GDP. Nonetheless, net financial inflows remained weak, mainly due to a shortfall in planned official inflows. At the same time, the MPC noted that the majority of debt repayments for the year have already been made. With lower debt repayments and expected realization of planned official inflows in the remaining months of FY25, the SBP's FX reserves are likely to reach above $13 billion by June 2025. Going forward, the MPC emphasized the importance of strengthening external buffers in the presence of heightened global economic uncertainty.

Fiscal Sector

6. The fiscal accounts for H1-FY25 indicate an improvement in both the overall and primary balance relative to last year. This was on the back of a sizable rise in revenues, particularly non-tax revenues, as well as contained expenditures, mainly subsidies. The MPC noted that the shortfall in FBR tax revenue against its target widened further in January and February 2025. The Committee assessed that the fiscal cushion created through contained current expenditures and expected decline in interest payments may keep the overall fiscal balance close to the target for FY25. However, meeting the target for primary balance would be challenging. The MPC also emphasized the importance of the continued fiscal consolidation to support macroeconomic stability and reiterated the need for fiscal reforms targeted at widening the tax base.

Money and Credit

7. The broad money (M2) growth remained unchanged at around 11.4 percent y/y since the last MPC meeting. The Committee noted compositional shift in the NDA, as the government's borrowing from the banking system rebounded and private sector credit (PSC) showed greater than seasonal net retirement. The latter was anticipated given the aggressive lending by banks during Q2-FY25 to avoid ADR-related taxation. However, the MPC noticed that PSC growth, at 9.4 percent, is still significant, reflecting the impact of the ease in financial conditions and ongoing economic recovery. On the liability side, the growth of the currency in circulation increased, while deposit growth further decelerated since the last MPC.

Inflation

8. Led by conducive supply-side dynamics, headline inflation further declined to 1.5 percent y/y in February 2025 from 2.4 percent in the preceding month. The steep fall in prices of perishable food items reinforced the impact of sufficient stocks of major non-perishable items on overall food prices. Similarly, energy prices continued to benefit from the moderation in global oil prices, stable exchange rate and favorable base effect. However, core inflation is still at an elevated level and is proving stickier than anticipated. Inflation expectations of consumers and businesses are also showing a mixed picture. In view of these developments, the Committee assessed inflation to come down further before gradually inching up and stabilizing within the target range of 5 – 7 percent. This inflation outlook, however, is susceptible to risks emanating mainly from volatility in food prices, timing and magnitude of energy price adjustments, additional revenue measures, protectionist policies in major economies and uncertain outlook of global commodity prices.