Flash Note

Monday, July 31, 2023

Monetary Policy Statement

Central Bank Maintains Key Policy Rate at 22%, Expects Moderate Credit Growth and Inflation Moderation

In the latest Monetary Policy Announcement (link) the State Bank of Pakistan (SBP) kept the key rate unchanged at 22%.; in in-line with our expectation (link).

Key Points and Outlook:

Inflation:

- The average inflation rate for FY23 was 29.2 percent.
- The MPC projects average inflation in the range of 20 – 22 percent in FY24.
- Inflation is expected to fall gradually during the first half of FY24 before falling below 20 percent in the second half.
- The MPC particularly noted that year-on-year inflation is likely to continue decreasing over the next 12 months, which implies a significant level of positive real interest rate.
- In light of these developments, the MPC stressed maintaining an appropriately tight monetary policy stance with positive real interest rates on a forward-looking basis to keep inflation and its expectation on a downward path so as to achieve the medium-term inflation target of 5 – 7 percent by end-FY25.

Growth:

- The real GDP growth in FY23 was estimated to be 0.3 percent, which is significantly lower than the growth rate in the previous two years.
- The real GDP growth is projected in the range of 2.0 to 3.0 percent for FY24.
- Barring unforeseen events, the MPC expects economic activity to moderately recover in FY24, supported by a rebound in rice and cotton output.
- Improved business confidence and withdrawal of priority guidance on imports have improved the outlook for manufacturing, construction, and allied services.

External Sector:

- The cumulative current account deficit in FY23 substantially narrowed to 0.7 percent of GDP from 4.7 percent in FY22.
- The current account deficit is expected to remain contained in the range of 0.5 to 1.5 percent of GDP in FY24.
- This assessment takes into account the impact of evolving domestic and global economic conditions.

- The market-determined exchange rate will continue to serve as the first line of defense against external shocks and support reserve build-up.

Fiscal:

- The latest data indicates that both the fiscal and primary deficits may exceed their revised estimates for FY23.
- The MPC emphasized the importance of achieving the envisaged fiscal consolidation in FY24 in the context of achieving broader macroeconomic stability.

Money and Credit:

- Broad money (M2) growth increased to 14.4 percent in FY23 from 13.6 percent in FY22, mainly driven by increased public sector borrowing.
- Growth in private sector credit decelerated substantially in line with the slowdown in economic activity and tight monetary policy stance.
- Going forward, an improved financing mix after the unlocking of multilateral and bilateral external financing along with some uptick in economic activity would provide space for a moderate expansion in private sector credit this year.

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