Monetary Policy Statement

December 16, 2024

1. At its meeting today, the Monetary Policy Committee (MPC) decided to cut the policy rate by 200 bps to 13 percent, effective from December 17, 2024. Headline inflation declined to 4.9 percent y/y in November 2024, in line with the MPC's expectations. This deceleration was mainly driven by continued decline in food inflation as well as the phasing out of the impact of the hike in gas tariffs in November 2023. However, the Committee noted that core inflation, at 9.7 percent, is proving to be sticky, whereas inflation expectations of consumers and businesses remain volatile. To this effect, the Committee reiterated its previous assessment that inflation may remain volatile in the near term before stabilizing in the target range. At the same time, the growth prospects have somewhat improved, as reflected by the recent uptick in high-frequency indicators of economic activity. Overall, the Committee assessed that its approach of measured policy rate cuts is keeping inflationary and external account pressures in check, while supporting economic growth on a sustainable basis.

2. The Committee noted the following key developments since its last meeting that may have implications for the macroeconomic outlook. First, the current account remained in surplus for the third consecutive month in October 2024, which, amidst weak financial inflows and substantial official debt repayments, helped increase the SBP's FX reserves to around $12 billion. Second, global commodity prices remained generally favourable, with positive spillovers on domestic inflation and the import bill. Third, credit to the private sector recorded a noticeable increase, broadly reflecting the impact of ease in financial conditions and banks' efforts to meet the advances-to-deposit ratio (ADR) thresholds. Lastly, the shortfall in tax revenues from the target has widened.

3. Based on these developments, the Committee assessed that the impact of the cumulative reduction in the policy rate from June 2024 is beginning to unfold and will continue to materialize over the next few quarters. In this context and taking into account today's decision, the Committee noted that the real policy rate remains appropriately positive to stabilize inflation within the target range of 5 – 7 percent.

Real Sector

4. The incoming data indicates improved prospects for economic growth. In the agriculture sector, downside risks to the overall crop outlook have somewhat subsided. This is based on better than expected cotton arrivals since the last MPC meeting and encouraging initial information, including satellite images, pertaining to sowing area of the wheat crop. Also, activity in the industrial sector is gaining further traction. Key large-scale manufacturing sectors – such as textile, food, automobiles, POL and tobacco – were already depicting strong growth till Q1-FY25. Moreover, the latest high-frequency indictors – such as domestic sales of cement, auto, fertilizer and POL products – suggest that this momentum in industrial activity is continuing. The knock-on impact of these improved prospects for the commodity-producing sectors and reduced inflationary pressures would support the services sector as well. Going forward, improving business confidence and easing financial conditions are expected to support economic growth. Considering these developments, the MPC expects the real GDP growth in FY25 to remain in the upper half of the projected range of 2.5 – 3.5 percent.

External Sector

5. The current account continued to improve and posted a surplus of $0.2 billion during July-October FY25, driven by robust workers' remittances and strong export performance. Exports grew by 8.7 percent,

mainly driven by HVA textile, rice and POL exports. At the same time, favorable global commodity prices helped contain the import bill despite a sizeable increase in import volumes. Supported by narrowing gap between interbank and open market exchange rates and enabling policies, workers' remittances remain strong. The surplus in the current account, along with the improved foreign investment inflows, helped build up SBP's FX reserves, despite weak official inflows. Going forward, sustained uptrend in workers' remittances and exports, along with favorable international commodity prices, are expected to keep the current account deficit near the lower bound of the projected 0 – 1 percent of GDP range in FY25. This will enable the SBP's FX reserves to exceed $13.0 billion by June 2025.

Fiscal Sector

6. The revised data for fiscal operations showed improvement in both the overall and primary balances during Q1-FY25. FBR revenues grew by 23 percent y/y during July-November FY25. This is, however, substantially lower than the required growth to achieve the annual tax collection target. On the expenditure side, the declining yields will lead to a sizeable saving in interest payments on domestic debt compared to the budget estimates. These lower interest payments will help the government to contain the fiscal deficit; however, achieving the targeted primary surplus would be challenging. In this regard, considerable efforts and additional measures would be required to meet the annual revenue target. This highlights the importance of fiscal reforms to broaden the tax base to achieve the targeted fiscal consolidation.

Money and Credit

7. The broad money (M2) growth decelerated to 13.9 percent y/y at end-November from 15.2 percent at the time of the last MPC meeting. This deceleration primarily stemmed from NDA of the banking system due to a decline in government borrowing, while the contribution of NFA in overall M2 growth increased. Banks' lending to the private sector and non-bank financial institutions accelerated amidst easing financial conditions and their efforts to comply with minimum ADR thresholds by end-December 2024. Credit to private sector businesses increased substantially, with consumer financing also recording a noticeable rise in October 2024. On the liability side, deposits remained the mainstay in M2 growth, though the currency-to-deposit ratio increased slightly.

Inflation

8. Headline inflation eased further to 4.9 percent y/y in November from 7.2 percent in the previous month. This sharp decline was mainly driven by a favourable base effect from gas prices, along with the continued moderation in food inflation and benign global commodity prices. The Committee noted that these factors are likely to continue in the near term and may bring headline inflation even lower in the coming months. Accordingly, the Committee assessed FY25 inflation to average substantially below its earlier forecast range of 11.5 – 13.5 percent. Meanwhile, it was observed that core inflation declined marginally in November, while consumers' inflation expectations inched up further. At the same time, the inflation outlook is susceptible to multiple risks, including additional measures to meet the revenue shortfall, resurgence in food inflation and an increase in global commodity prices. Notwithstanding these risks and the expected phase out of the favourable base effect, the Committee, on balance, viewed that the monetary policy stance remains appropriate to stabilize inflation in its target range.