Monetary Policy Statement

January 27, 2025

1. At its meeting today, the Monetary Policy Committee (MPC) decided to cut the policy rate by 100 bps to 12 percent, effective from January 28, 2025. The Committee noted that inflation continued to trend downward in line with expectations, reaching 4.1 percent y/y in December. This trend is driven by moderate domestic demand conditions and supportive supply-side dynamics, amidst favorable base effect. Inflation is expected to come down further in January before inching up in the subsequent months. The Committee also noted that core inflation, while continuing to ease, is still at an elevated level. At the same time, high frequency indicators continued to show gradual improvement in economic activity. The MPC assessed that the impact of the significant reduction by 1,000 bps in the policy rate since June 2024 will continue to unfold and further support economic activity.

2. The Committee noted the following key developments since its last meeting. First, real GDP growth in Q1-FY25 turned out slightly lower than the MPC's earlier expectations. Second, the current account remained in surplus in December 2024, though the SBP's FX reserves declined amidst low financial inflows and high debt repayments. Third, despite a substantial increase in December, tax revenues remained below target in H1-FY25. Fourth, global oil prices have exhibited heightened volatility over the past few weeks. And lastly, the global economic policy environment has become more uncertain, prompting central banks to adopt a cautious approach.

3. Considering these developments and evolving risks, the Committee viewed that a cautious monetary policy stance is needed to ensure price stability, which is essential for sustainable economic growth. In this regard, the MPC assessed that the real policy rate needs to remain adequately positive on a forward-looking basis to stabilize inflation in the target range of 5 – 7 percent.

Real Sector

4. The latest high frequency indicators depicted continuing momentum in economic activity. This is reflected by a notable increase in automobile, POL and fertilizer sales, as well as in import volumes, electricity generation and credit disbursement to private sector. However, the provisional data of real GDP for Q1-FY25 showed a modest growth of 0.9 percent against 2.3 percent growth recorded in Q1-FY24. This slowdown was primarily explained by the expected sharp deceleration in agriculture sector growth to 1.2 percent in Q1-FY25, from 8.1 percent in the same period last year. And, the latest available information for wheat crop, including satellite images, are also pointing towards a relatively modest output. Meanwhile, the decline in industrial sector growth in Q1-FY25 moderated relative to last year. The MPC noted that the downtrend in LSM – which has been pulling down industrial growth – has been driven by a few low-weight items, such as furniture. In contrast, key industrial sectors – such as textile, food and beverages, and automobiles – have shown noticeable improvement. Moreover, the business confidence index has continued to show positive sentiments. Going forward, the MPC expects economic activity to gain further traction and real GDP growth to remain in the earlier projected range of 2.5 – 3.5 percent.

External Sector

5. Driven by strong workers' remittances and export earnings, the current account posted a surplus of $0.6 billion in December, bringing the cumulative surplus to $1.2 billion during H1-FY25. Led by HVA textile, exports maintained a strong momentum. At the same time, import growth also showed broad-based

acceleration on the back of higher volumes, pointing towards improvement in economic activity. While the import bill outpaced export earnings, remittances inflows more than offset the widening trade deficit. Based on these trends, particularly the robust workers' remittances, the outlook for the current account balance has improved considerably and is now expected to remain between a surplus and a deficit of 0.5 percent of GDP in FY25. Meanwhile, net financial inflows, though tepid during H1-FY25, are expected to improve going forward as a sizable part of official debt repayments has already been made. Consequently, the improved current account outlook, along with the expected realization of planned financial inflows, is likely to increase the SBP's FX reserves beyond $13 billion by June 2025.

Fiscal Sector

6. FBR revenues recorded a notable increase of around 26 percent during H1-FY25. However, the shortfall in tax collection from the target has widened. Accordingly, a steep acceleration in tax revenue growth would be required to achieve the annual target. Meanwhile, estimates from the financing side suggest an improvement in the fiscal balance during H1-FY25, indicating relatively contained expenditures. The Committee viewed that the anticipated lower interest payments than the budgeted amount is likely to contain the overall fiscal deficit around its target. However, achieving the target for the primary balance would be challenging.

Money and Credit

7. The broad money (M2) growth decelerated further to 11.3 percent y/y as on January 17, compared to 13.3 percent at the time of the last MPC meeting. The decline in M2 growth came primarily on account of a significant deceleration in the NDA growth. While the government's borrowing from the banking system remained relatively contained and shifted to non-bank sources, banks' credit to the private sector grew sharply. This was mainly on account of the ongoing economic recovery, ease in financial conditions, and aggressive efforts by banks to meet the advances to deposit ratio (ADR) thresholds. These factors also had an impact on bank deposits, which have declined noticeably since the last MPC meeting; whereas some increase in currency in circulation was also noted during this period.

Inflation

8. Headline inflation remained on its downward trajectory and eased to 4.1 percent y/y in December from 4.9 percent in November. The declining trend in inflation is mainly led by the downward adjustment in electricity tariffs; adequate supply of key food items leading to low level of food inflation; stability in exchange rate; and favorable base effect. Underlying inflationary pressures – as indicated by core inflation – also moderated amidst contained domestic demand, though these remain elevated. Moreover, inflation expectations also remained volatile. Based on these trends, the MPC reiterated its earlier assessment that the near-term inflation will remain volatile and is expected to increase close to the upper bound of the target range towards the end of FY25. On balance, the MPC expects headline inflation for FY25 to average between 5.5 – 7.5 percent. Going forward, inflation outlook is subject to risks emanating from volatile global commodity prices, protectionist policies in major economies, timing and magnitude of administered energy tariff adjustments, volatile perishable food prices, as well as any additional measures to meet the revenue target.