

REVIEW OF MONETARY DEVELOPMENT (M2) AUGUST FY21-22

Money, Prices & Fiscal Policy Section
MINISTRY OF PLANNING, DEVELOPMENT & SPECIAL INITIATIVE

INTRODUCTION

M2¹ plays an important role in forecasting issues like inflation which in turn affects the economy in general, in terms of consumer spending and business etc.

Provisional data on monetary aggregates is given in the table below:

Table1. MONETARY AGGREGATES

(Rs. billion)

Factors Affecting Broad Money (M2) Growth	Stocks at End Jun-2021 ^P	Monetary Impact since 1 st July to ²	
		September -21	September -20
A. Net Foreign Assets (NFA) of the Banking System	724.814	41.518	345.661
B. Net Domestic Assets of the Banking System (1+2+3)	23,559.281	-272.121	-501.467
1. Net Government Sector Borrowing (a+b+c)	16,338.778	-10.191	-106.746
a. Borrowings for Budgetary Support	15,447.123	-10.349	-54.813
i. From SBP	5,419.751	-226.918	-260.291
ii. From Scheduled Banks	10,027.372	216.569	205.477
b. Commodity Operations	903.999	2.358	-51.594
c. Others	-12.344	-2.200	-0.338
2. Credit to Non-Government Sector (a+b+c+d)	9,092.306	-71.768	-170.500
a. Credit to Private Sector	7,629.069	-74.344	-161.827
b. Credit to Public Sector Enterprises (PSEs)	1,436.745	1.662	-9.807
c. PSEs Special Account-Debt Repayment with SBP	-24.244	0	0
d. Credit to Non-Banking Financial Institutions (NBFIs)	50.736	0.915	1.134
3. Other Items (Net)	-1,871.804	-190.163	-224.222
Broad Money (M2) (A+B)	24,284.095	-230.603	-155.806
<i>Growth</i>		-0.95%	-0.75%

Source: State Bank of Pakistan

¹ M2 (broad money) is a category for measuring the amount of money circulating in an economy. It is defined as the most inclusive method of calculating a given country's money supply, and includes narrow money along with other assets that can be easily converted into cash to buy goods and services.

² The data for Broad Money (M2) represents the position as of September 10, 2021, whereas, the data for rest of the indicators is for the month of August, 2021.

ANALYSIS OF FACTORS AFFECTING BROAD MONEY (M2)

Net Foreign Assets

The Broad Money supply witnessed a contraction of 0.95% on account of reduced NDAs of the banking sector. There has been a decrease in both net government sector borrowing and credit to non-government sector along with other items. Their volumes decreased by Rs. 10.191 billion, Rs. 71.768 billion and Rs. 190.163 billion respectively.

The Current Account exhibited a deficit of \$ 2.3 billion for July-Aug FY2022 as against a surplus of \$838 million during the same period of the last year.

Furthermore, during this period, the growth of NFAs is mainly attributed to the inflow of remittances of around US\$ 5.4 billion, 10.4% higher than the amount of US\$ 4.9 billion received in July-Aug, FY2021. It is the 15th consecutive month that workers' remittances have sustained their unparalleled streak of above US\$ 2.0 billion. YoY, remittances have recorded decade high growth rate of 26.8% in the month of August, 2021 with US\$ 2.6 billion (US\$ 2.1 billion in August, 2020).

The proactive policy initiatives taken by the Government and SBP to enhance and facilitate inflow of remittances through formal channels, especially after the COVID outbreak have proved to be very supportive. Covid-19 driven reduction in cross-border travel, philanthropic transmissions to Pakistan amid the pandemic have been some other factors contributing towards the sustained improvement in the inflow of remittances since last year. The introduction of 'Roshan

Highlights (During 1st July to 10th September, 2021)

- Broad money contracted by 0.95% as compared to its contraction of 0.75% during the corresponding period of last year.
- Net Foreign Assets (NFA) of the banking system expanded to Rs. 41.518 billion during the period under review as compared to their expansion to Rs. 345.661 billion during the corresponding period of last year.
- NDA contracted by Rs. 272.121 billion as compared to its contraction by Rs. 501.467 billion during the corresponding period of last year.
- Credit to private sector contracted by Rs. 74.344 billion as compared to its contraction by Rs. 161.827 billion in corresponding period of the last year.
- The borrowing for budgetary financing by the government from SBP contracted by Rs. 226.918 billion (debt retirement) as compared to its contraction by Rs. 260.291 billion during reference period last year. For budgetary support, Govt. borrowed from scheduled banks expanded by Rs. 216.569 billion as compared to Rs. 205.477 billion borrowed last year in the same period.

Pakistan Digital Account' has facilitated financial inflow since September, 2020. Further, SBP has encouraged the banks and exchange companies to process the higher number of remittances which include doubling the rate of reimbursement for Telegraphic Transfer (TT). The use of digital channels for sending and receiving remittances and launch of 'M-Wallet Scheme' and 'Asaan Remittance Account' reflect continuous efforts by Government and SBP to attract remittances inflows.

Net Domestic Assets

A contraction was registered in NDAs where government sector borrowings, credit to non-government sector and other items observed a decline. For budgetary support, net government sector borrowings from the banking system declined by Rs. 10.349 billion during July- September FY22. Government retired Rs. -226.918 billion to SBP and borrowed Rs. 216.569 billion from scheduled banks. Last year, during this period government net borrowing for budgetary support was decreased by Rs. 54.813 billion whereas Rs. 260.291 billion were retired to SBP and Rs. 205.477 billion were borrowed from commercial banks. Under commodity operations, government borrowing increased by Rs. 2.358 billion from the banking system as compared to a decline of Rs. 51.594 billion during the corresponding period of last year.

Credit to private sector contracted by Rs. 74.344 billion during July-Sep FY22 compared to last year contraction of Rs. 161.827 billion. It is noteworthy that an increase in government borrowing from the scheduled bank seems to be correlated with reduction in credit to private sector.

The net effect of government borrowing on employment and economic development depends upon its influence on real investment, i.e., the purchase of new capital goods. Therefore, it is important that government is investing the borrowed funds in right direction and use. If government borrows more from the commercial banks, lesser amount is available for the private investors, thus private investment is crowded out.³

³ "Crowding out" is an economic theory that argues that rising public sector spending either decreases or eliminates private sector spending.

An outlook of Stock of Loans to Private Sector Business during July 2020 and July 2021 and their variation are shown in the following table:

Table 2. CREDIT/LOANS CLASSIFIED BY BORROWERS

Rs. million				
S.No	Description	August-20	August-21	Difference
	PRIVATE SECTOR (BUSINESS)	5,146,838	5,627,396	480,558
1.	Agriculture, Forestry & Fishing	279,650	284,951	5,301
2.	Mining & Quarrying	73,272	63,992	-9,280
3.	Manufacturing	3,150,908	3,489,871	338,963
4.	Electricity, Gas, Steam & Air Conditioning Supply	498,674	547,894	49,220
5.	Construction	126,909	144,287	17,378
6.	Wholesale and Retail Trade; ...	445,469	457,435	11,966
7.	Transportation & Storage	118,344	118,351	7
8.	Information & Communication	157,271	192,257	34,986
9.	Real Estate Activities	31,603	30,009	-1,594

Loans to Mining & Quarrying and Real Estate Activities declined during the reference period whereas for rest of the sectors loans increased, especially a significant increase can be observed for Manufacturing, Electricity, Gas, Steam & Air Conditioning Supply and Information & Communication.

Credit to public sector Enterprises (PSEs) expanded by around Rs.1.662 billion during July-Sep, FY2021-22 as compared to its contraction of Rs.9.807 billion for the same period during the last year. An increase in credit provision to Non-Banking Financial Institutions (NBFIs) has been observed. It increased by Rs.0.915 billion as compared to corresponding period's credit expansion of Rs.1.134 billion.

CONCLUSION

A contraction of 0.95 % in Broad Money has been recorded during July - September FY22. This contraction owes to the decline in Net Domestic Assets (NDA) of the banking system by Rs. 272.121 billion during the period under review. The decline in NDAs is due to the government's debt retirement amounting to Rs. 226.918 billion to

SBP. The NFAs recorded an expansion of Rs.41.518 billion during the reference period, compared to the expansion of Rs. 345.661 during the reference period last year.

SBP has announced to raise the policy rate by 25 basis points to 7.25% in the backdrop of the pace of economic recovery exceeding expectations, higher international commodity prices, rising imports and current account deficit. As the situation shows that latest Covid19 wave has remained contained in Pakistan due to overall adroit management of the pandemic by the government and persistent progress in vaccination, therefore, the economic recovery seems less vulnerable to pandemic-related uncertainty. The latest MPC deems fit to ensure an appropriate policy mix to protect the longevity of growth, keep inflation expectations intact and decelerate the growth in current account deficit.

The CPI inflation General, increased by 8.4% on year-on-year basis in August 2021 as compared to an increase of 8.4% in previous month and 8.2% in August 2020. The rising trend in international commodity prices also exerted upward pressure on domestic prices. The key risks for upward trend in inflation include the resurgence of pandemic, higher than expected global prices, domestic energy tariffs and fiscal slippages.

SBP has raised the policy rate for the first time in more than 2 years, from July 2019. Like many other central banks, SBP lowered the policy rate in response to the covid19 pandemic. Now, as the economic recovery has started picking up, SBP has increased the policy rate to control inflation, support rupee and to curtail inflating current account deficit. The MPC noted that “abnormal volatility” of rupee despite increased reserves is mainly because the burden of adjusting to the rising current account deficit has fallen on the exchange rate and use of other adjustment tools including interest rate was appropriate.