

Money, Prices & Fiscal Policy Section
Ministry of Planning, Development & Special Initiatives

**Review of
Monetary Developments (M2)**

July-May FY20-21

Introduction

M2 is the measure of money supply in an economy. It 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. Volume of money supply or liquidity in the banking system is generated by changes in Net Foreign Assets (NFA) and Net Domestic Assets (NDA). NFA shows whether a country is a creditor or debtor nation by measuring its external assets and liabilities. In other words, it depicts cumulative change in its current account balance. NDA of the banking system consists broadly of (i) government sector borrowings, (ii) credit to non-government sector, and (iii) other items.

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

Monetary Aggregates (Rs. Billion)			
Factors Affecting Broad Money (M2) Growth	Stocks at End Jun-2020^P	Monetary Impact since 1st July to	
		28- May - 21	29-May-20
A. Net Foreign Assets (NFA) of the Banking System	-516.153	1,016.218	654.038
B. Net Domestic Assets of the Banking System (1+2+3)	21,424.1	742.748	1,619.295
1. Net Government Sector Borrowing (a+b+c)	14,547.2	656.371	1,819.246
a. Borrowings for Budgetary Support	13,748.3	563.512	1,754.636
i. From SBP	6,538.8	-1,842.301	-301.388
ii. From Scheduled Banks	7,209.5	2,405.813	2,056.024
b. Commodity Operations	813.4	90.050	64.344
c. Others	-14.5	2.809	266
2. Credit to Non-Government Sector (a+b+c+d)	8,372.4	464.146	416.338
a. Credit to Private Sector	6,862.8	489.553	288.868
b. Credit to Public Sector Enterprises (PSEs)	1,490.5	-32.348	125,325
c. PSE Special Account-Debt Repayment with SBP	-24.2	0	0
d. Credit to Non-Banking Financial Institutions (NBFIs)	43.3	6.941	2.145
3. Other Items (Net)	-1,495.5	-377.769	-616.289
Broad Money (M2) (A+B)	20,908.0	1,758.966	2,273.333
<i>growth</i>		8.41%	12.77%
<i>Source: State Bank of Pakistan</i>			

Analysis of Factors Affecting Broad Money (M2)

the NFA improved on account of current account balance which remained in surplus at US\$ 153 million during July-May, FY21 as compared to deficit of US\$ -4.328 billion during last year of the corresponding period. There has been an increase in the NFA of both central and scheduled banks where volume for the former is higher i.e.850.949 billion as compared to Rs, 643.99 billion for the latter.

One of the important reasons for this improvement was a considerable increase in workers' remittances which reached \$26.737 billion during Jul-May FY21 that is significantly higher than the reference period during previous year (\$.20.658 billion). Furthermore, the remittances also offset the deficit in balance of trade in goods and services which is US \$ 24.13 billion during July-May, FY21. The remittances remained above \$ 2.0 billion for consecutive 12 months, where major inflow of remittances were from Saudi Arabia, UAE, USA and UK. This sustained increase in workers' remittances largely reflects increasing use of banking channel. The Initiatives taken by the SBP to increase and facilitate the remittances through official channels, especially after the COVID outbreak, are as under:

- In April, 2020 SBP announced the measures to encourage the banks and exchange companies to process the higher number of remittances which include doubling the rate of reimbursement for Telegraphic Transfer(TT). Further tiered based system to reimburse marketing transactions (where higher growth in remittances would lead to higher reimbursement of marketing charges) was introduced.
- The banks have been encouraged to use digital channels for sending and receiving remittances. Furthermore, from July 1, 2020, withholding tax was exempted on cash withdrawals, issuance of banking instruments, and on transfers from domestic bank accounts, to the extent of the amount of remittances received into the accounts in a year.
- The launch of 'M-Wallet Scheme' and 'Asaan Remittance Account' that is attributed to continuous efforts by Government and SBP to attract inflows through official channel, limited cross border travel amid second wave of COVID-19 and flexible exchange rate regime.

Highlights (During 01-07-2020 to May, 2021)

- Broad money expanded by 8.41% as compared to its expansion of 12.77% during the corresponding period of last year.
- Net Foreign Assets (NFA) of the banking system expanded by Rs. 1,016.218 billion during the period under review as compared to their expansion of Rs. 654.038billion during the corresponding period of last year.
- NDA expanded by Rs. 742.748 billion as compared to its expansion of Rs. 1,619.295 billion during the corresponding period of last year.
- Credit to private sector extended by Rs. 489.553 billion as compared to its expansion of Rs. 288.868 billion in last year.
- The borrowing for budgetary financing by the government from SBP contracted by Rs. 1,842.301 billion (debt retirement) as compared to its contraction by Rs. 301.388 billion during reference period last year. For budgetary support, Govt. borrowed from scheduled banks to Rs. 2,405.813 billion as compared to Rs. 2,056.024 billion borrowed last year in the same period.

The expansion was also registered in NDA where government sector borrowings, credit to non-government sector and in other items observed an increase. For budgetary support, net government sector borrowings from the banking system stood at Rs.656.371 billion during July-May FY21. Government retired Rs. 1842.301 billion to SBP and borrowed Rs. 2405.813 billion from scheduled banks. Last year, during this period government net borrowing was Rs 1819.246 billion where Government retired Rs -301.338 billion to SBP and borrowed Rs. 2056.024 billion from commercial banks. Government has adopted the policy of returning to SBP. Under commodity operations, government borrowed 90.050 billion from the banking system as compared to the borrowing of Rs64.344 billion during the corresponding period of last year.

Credit to Private sector expanded by Rs. 489.553 billion during July-May FY21 compared to last year expansion of Rs. 288.868 billion. Stock of Loans to Private Sector Business during June 2020 and May 2021 and their variation are shown in the following table; Loans to Agriculture, forestry and fishing, Mining & quarrying, Transport and storage and Real estate activities declined during the reference period whereas for rest of the sectors loans increased during the reference period especially a substantial increase can be observed for manufacturing and Electricity, gas, steam and air conditioning supply.

CREDIT/LOANS CLASSIFIED BY BORROWERS

Rs. In Million

S.No	Description	June-20	May-21	Difference
	PRIVATE SECTOR (BUSINESS)	5,271,036	5,549,474	278,438
1	Agriculture, forestry and fishing	280,216	276,350	-3,866
2	Mining and quarrying	82,989	78,646	-4,343
3	Manufacturing	3,290,273	3,451,144	160,871
4	Electricity, gas, steam and air conditioning supply	491,843	563,923	72,080
5	Construction	129,561	132,136	2,575
6	Wholesale and retail trade; ...	429,343	442,121	12,778
7	Transportation and storage	119,607	112,195	-7,412
8	Information and communication	159,242	175,319	16,077
9	Real estate activities	29,439	24,811	-4,628

Credit to public sector Enterprises (PSEs) contracted by around Rs.32.348 billion during July-May, 2021 as compared to its contraction of Rs.125.325 billion for the same period

during last year. Credit provision to Non-Banking Financial Institutions (NBFIs) increased by Rs.6.914 billion as compared to last year's credit expansion of Rs.2.145 billion.

Conclusion

The growth in Broad money has been recorded by 8.41 % during July - May 2021. The growth owes to the expansion in Net Foreign Assets (NFA) of the banking system by Rs. 1016.218 billion during the period under review. The NDA also recorded an expansion of Rs.742.748 billion during the reference period (1619.295), however it did not expand much compared to the reference period last year due to slashed government borrowings as a result of which the credit to private sector expanded by Rs.489.53 billion compared to the reference period last year (Rs.288.868 billion).

The SBP has decided to maintain monetary policy stance at 7 percent in Monetary Policy Committee (MPC) Meeting held on 28th May, 2021. The current policy rate at 7 Percent has remained unchanged since June, 2020. However, with the resumption of economic dynamism, global growth outlook of around 5.6 percent and other growth oriented initiatives taken by the government, it is expected that a gradual change in monetary policy stance aligned with much needed economic expansion will be introduced.

As regards inflation, the Inflation as measured by CPI (national) during May, 2021 was registered at 10.9 percent (YoY) as compared to 11.1 % during previous month and 8.2 percent during the corresponding month of last year. The double digit reading of CPI is caused by the lagged effect of rise in electricity prices and food commodity prices.

The upward risk in inflation is presented in the wake of resumption in rising global commodity prices in May, 2021. The prices of energy commodities rose 7.1 percent while non-energy commodities jumped to 6.8 percent. Agriculture commodities rose to 5.7 percent, fertilizers 4.4 percent, metals and minerals 9.1 percent and precious metals 5.4 percent. According to the Semi-annual Commodity Markets Outlook of the World Bank, this trend is expected to sustain at current level throughout the year. Additional factors in contributing the upward risk in inflation at domestic front are negative output gap in the economy and other domestic supply side shock such as summer wage negotiations. The government is trying to maintain stability in prices. The massive relief in taxes in budget, 2021 is also expected to contribute to price stability through economic growth (possibly by reducing the negative output gap). However, the intensity of prospective 4th wave of the COVID-19 and corresponding policy measures may introduce the change in the inflation outlook.

The continued accommodative monetary policy stance of SBP may be supported given its role in recovery during forgoing period and uncertain situation arising out of prospective new wave of the pandemic.
