

MPS REVIEW

ISSUE # 19 | OCTOBER 28, 2025

A Brief Assessment of SBP's Monetary Policy on Business and Economy

ICMA Research and Publications Department

Preamble

The State Bank of Pakistan's (SBP) Monetary Policy Committee (MPC), in its meeting on October 27, 2025, decided to maintain the policy rate at 11 percent, considering it appropriate to sustain price stability amid an improving macroeconomic outlook. Headline inflation rose to 5.6 percent in September, mainly on account of seasonal food price adjustments, while core inflation remained unchanged at 7.3 percent, suggesting limited demand-driven pressures. The MPC noted that the impact of recent floods on agriculture and supply chains was lower than expected, with economic activity continuing to gain momentum as reflected in strong high-frequency indicators.

The Committee cited several positive developments, including an upward revision of FY25 GDP growth to 3 percent, continued build-up of foreign exchange reserves despite Eurobond repayments, and the IMF staff-level agreement on EFF and RSF reviews. Inflation expectations for both consumers and businesses also eased, though risks persist from volatile global commodity prices and potential domestic food supply disruptions. The MPC emphasized that the real interest rate remains sufficiently positive to achieve the 5–7 percent inflation target, and stressed the importance of coordinated monetary-fiscal policy and structural reforms to consolidate stability and support sustainable growth.

MPC Observations on Key Sectors

Real Sector

- High-frequency indicators (HFIs) point to sustained growth momentum across key sectors.
- **Agriculture:** Major Kharif crop estimates exceeded expectations, supported by healthy vegetation cover observed in satellite imagery.
- Improved input conditions and a post-flood recovery are expected to boost Rabi crop yields.
- **Industry:** Large-Scale Manufacturing (LSM) grew by 4.4% during Jul–Aug FY26, compared to a slight contraction in the same period last year.
- Strong growth was recorded in automobile, cement, fertilizer, and POL product sales, reflecting rising industrial demand.
- Private sector credit uptake and improved business sentiment further strengthened the industrial outlook.
- Positive trends in commodity-producing sectors are expected to support a pickup in services sector activity.
- Overall, the real GDP growth outlook has improved and is now projected to remain in the upper half of the 3.25%–4.25% range for FY26.

External Sector

- Current account recorded a \$110 million surplus in September 2025, limiting the Q1-FY26 deficit to \$594 million, broadly in line with MPC expectations.
- Exports grew moderately, while imports increased faster, widening the trade deficit amid rising domestic demand.
- Workers' remittances remained resilient, supporting external stability alongside steady net financial inflows.
- SBP's foreign exchange reserves rose to \$14.5 billion as of October 17, 2025.
- Imports are expected to increase with stronger economic activity, though flood-related import needs are lower than earlier estimates.
- Remittance outlook has improved, expected to sustain external balance.
- The current account deficit is projected to stay within 0% to 1% of GDP in FY26.
- With planned official inflows, FX reserves are expected to reach \$15.5 billion by December 2025 and \$17.8 billion by June 2026.

Fiscal Sector

- Tax revenues grew by 12.5% YoY in Q1-FY26, reaching Rs 2.9 trillion, but fell Rs 198 billion short of target.
- Non-tax revenues strengthened due to higher SBP profit transfers and increased Petroleum Development Levy (PDL) collections.
- Both overall fiscal balance and primary balance are expected to show surpluses in Q1-FY26.
- Post-flood rehabilitation spending is anticipated to be financed within budgeted resources.
- The MPC emphasized maintaining fiscal discipline to meet balance targets and ensure long-term fiscal sustainability.

Money and Credit

- Broad money (M2) growth slowed to 12.3% (as of Oct 10, 2025), driven by a decline in banks' net domestic assets.
- The slowdown mainly reflected a sharp deceleration in credit to non-bank financial institutions.
- Net budgetary borrowing remained contained, indicating continued fiscal consolidation and creating space for private sector credit (PSC).
- PSC growth accelerated to 17%, supported by economic recovery and easier financial conditions.
- Expansion in PSC was broad-based, covering working capital, fixed investment, and consumer loans.
- Major borrowing sectors included textiles, telecommunications, chemicals, and wholesale/retail trade.
- On the liability side, currency in circulation increased, while deposit growth slowed, raising the currency-to-deposit ratio to 37.6%.
- Elevated currency circulation kept reserve money growth high.

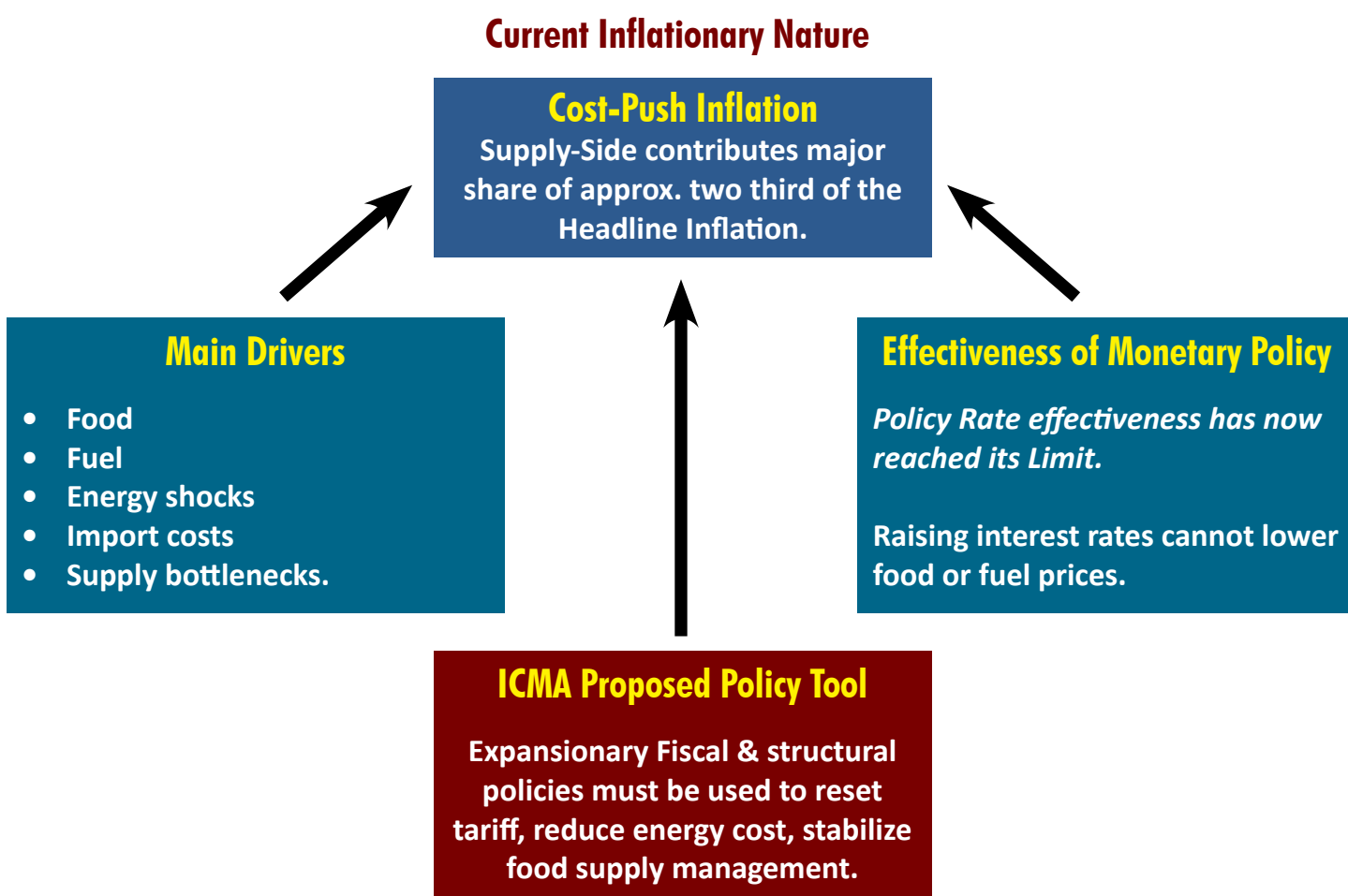
Inflation

- Headline inflation increased to 5.6% in September from 3.0% in August, driven by flood-related food price hikes, higher energy costs, and sticky core inflation.
- The food price surge was milder than earlier anticipated, as seen in SPI data showing slower price increases for wheat, sugar, and perishables.
- Energy prices edged higher, adding temporary cost-push pressure.
- The MPC viewed the real policy rate to be adequately positive to stabilize inflation within the target range of 5% to 7% over the medium term.
- Key upside risks include global commodity volatility, future energy price adjustments, and uncertainty in food supply, particularly wheat and perishables.

ICMA Analysis

The effectiveness of the SBP's monetary policy tool (the policy rate) has now reached its limit. Since around two-thirds of current inflation coming from supply-side factors such as food, energy, and housing, further monetary tightening would have diminishing returns and could slow economic recovery.

Monetary Policy Effectiveness Has Reached Its Limit

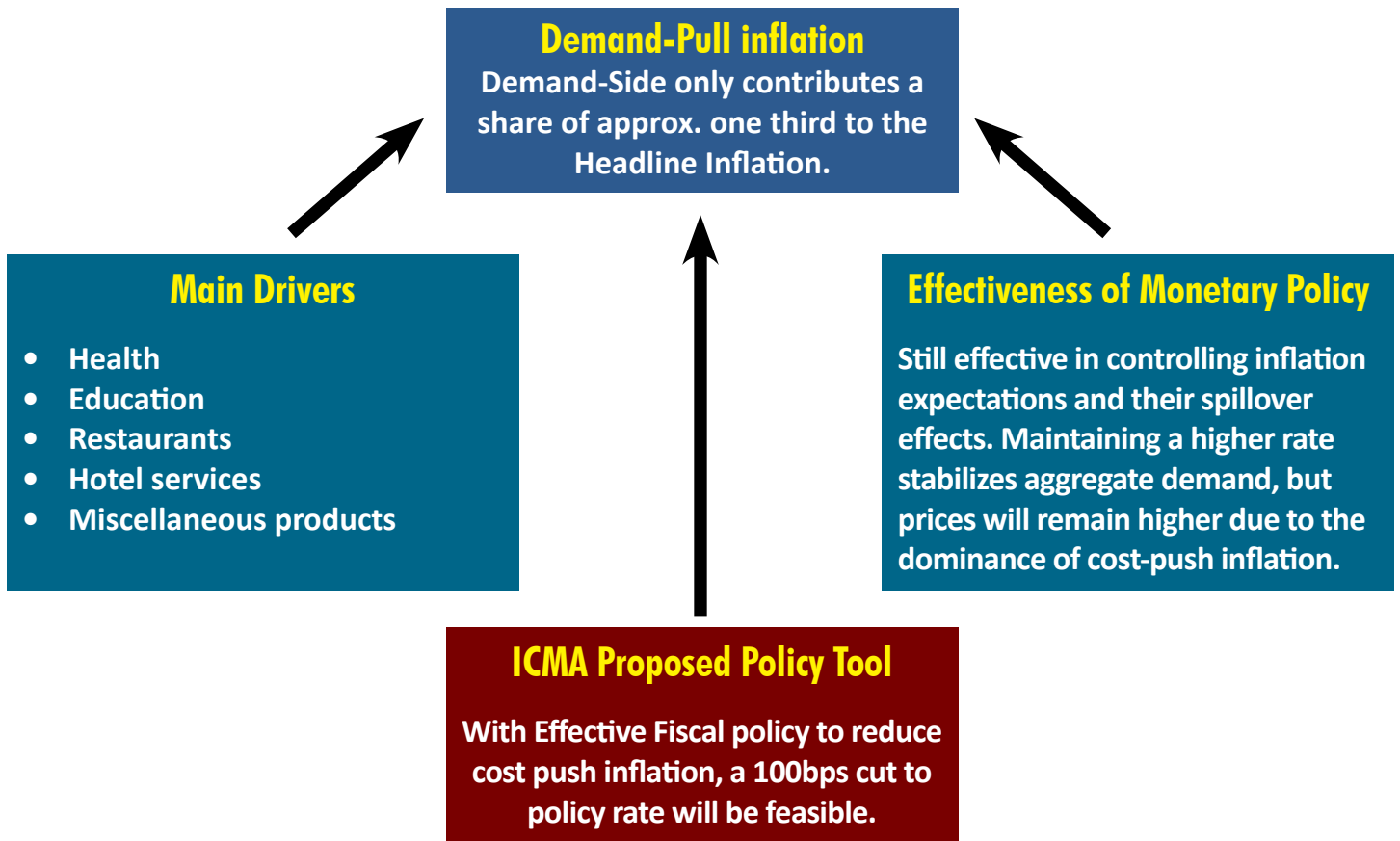


Data Source: State Bank of Pakistan, Analysis by ICMA.

The policy rate at 11% already provides a positive real interest rate, sufficient to anchor inflation expectations and prevent its spillover effect (second-round effects).

Therefore, the focus should now shift toward fiscal policy measures aimed at reducing cost-push pressures. Targeted interventions such as improving food supply chains, rationalizing energy tariffs, managing imports of key commodities, and exercising fiscal discipline can directly influence the sources of inflation.

Current Inflationary Nature



Data Source: State Bank of Pakistan, Analysis by ICMA.

Effective policy coordination between SBP and the Finance Ministry is essential, with monetary policy maintaining stability, and fiscal policy addressing the underlying supply constraints to achieve sustainable disinflation and support growth.

ICMA Research and Publications (R&P) Department reached out to renowned economists and experts, as well as the businessmen and industrialists, to gather their insights on the recent decision of SBP to maintain the policy rate at 11 percent. Their views and perspectives are summarized below:

Experts' Insight

Dr. Ikram ul Haq, a member of the Advisory Board and Visiting Senior Fellow at the Pakistan Institute of Development Economics (PIDE), while talking to the ICMA Research and Publications Department, said that the State Bank of Pakistan (SBP) has maintained the interest rate at 11% for the fourth consecutive time. He stated that interest rates in Pakistan cannot be reduced at this stage, especially after the recent floods, as the livability of the economy is clearly at stake. He added that the flood situation has exposed the vulnerability of both fiscal and financial stability. Dr. Ikram expressed confidence that the SBP has taken all these factors into account, and the Monetary Policy Committee is well aware that, at this moment, there is no justification whatsoever to relax the rate. He further said that with inflation also rising, the decision appears fully justified.

Mr. Ashfaq Hasan Khan, a distinguished economist and former Economic Advisor at the Ministry of Finance, in his remarks to ICMA, said that unless and until the IMF allows a cut in the policy rate, the SBP or the Monetary Policy Committee cannot take any action. He added that the Governor SBP himself has stated this, which highlights the limited effectiveness of the Monetary Policy Committee.

Prof. Dr. Shahida Wizarat, a senior economist, stated that there is no economic justification for maintaining a high policy rate, suggesting that geopolitical factors rather than domestic fundamentals largely influence Pakistan's monetary decisions. She highlighted that external powers use economic levers to limit Pakistan's policy autonomy and growth potential.

Mr. M. Amayed Ashfaq Tola, President of Tola Associates, while talking to ICMA, said that in his humble view, there is a compelling case for SBP to reduce the prevailing policy rate. While headline inflation remained stable at 4.6% during July–September FY26, it increased slightly to 5.6% in September 2025, primarily due to flood-induced food inflation exceeding 6%. Despite these manageable price pressures, SBP has kept the policy rate unchanged for four consecutive MPC meetings, a stance increasingly inconsistent with current economic realities.

He added that the present high rate is the highest in the region and continues to suppress industrial activity, discourage investment, and slow economic recovery. Lowering the interest rate to below 9% would not only reduce production costs and stimulate industrial growth but also encourage new business ventures to enter the market. As the country faces a food shortage, a lower interest rate would incentivize businesses to expand operations and increase supply, ultimately easing inflationary pressures. Furthermore, he highlighted that a 1% reduction could save approximately PKR 540 billion in debt servicing, while a 4% cut could generate over PKR 2 trillion in fiscal space. With exports stagnating below USD 3 billion per month, he emphasized that a timely rate cut would help revive private investment, strengthen exports, and support SMEs struggling under high borrowing costs.

Mr. Abdul Azeem, Head of Research at AL Habib Capital Markets (Pvt.) Ltd, said that SBP's decision to maintain the policy rate at 11% is a prudent one, prioritizing long-term stability over short-term relief. While businesses understandably seek cheaper credit to boost growth, cutting rates prematurely risks reigniting inflation, which remains sensitive to food and energy shocks. He added that the current stance ensures inflation continues its downward trend towards the target range, protects the stability of the Pakistani Rupee, and safeguards the recent gains in foreign exchange reserves. This discipline is essential for achieving sustainable, non-inflationary growth in the medium term, which he noted will ultimately benefit the private sector more than a temporary rate cut.

Industry's Perspective

Mr. Usman Shaukat, President of the Rawalpindi Chamber of Commerce and Industry (RCCI), expressed strong disappointment over SBP's decision to maintain the policy rate at 11 percent for the fourth consecutive meeting. He said that he had expected a reduction to single digits to boost economic revival, and the decision has frustrated industrialists, traders, and investors. He warned that the high rate would prolong stagflation, discourage investment, and negatively affect employment. "The private sector is already under immense strain, and SBP's inaction is worsening the challenges for manufacturers and exporters," he stated. He urged SBP and the government to reconsider their stance and adopt a growth-oriented policy to stimulate economic activity, protect jobs, and ensure business sustainability. He also noted that even SBP acknowledged that the impact of recent floods on the broader economy was lower than previously expected. He reiterated that RCCI's call for pragmatic, business-friendly policies to foster investment, enhance industrial output, and support sustainable growth remains critical.

Muhammad Rehan Hanif, President of the Karachi Chamber of Commerce & Industry (KCCI), also expressed disappointment over SBP's decision to maintain the policy rate at 11 percent, calling it a missed opportunity to provide relief to the business community. He said that businesses had expected a reduction of at least 200 basis points to around 9 percent, but this was not met, and the government should have aligned its policy with regional competitors; even a reduction to 10 percent would have helped. He highlighted the imbalance in credit distribution, noting that government borrowings remain high while credit flow to the private sector is limited, and the current rate remains burdensome amid high-cost pressures. He recalled that the government had pledged to bring the rate down to single digits at the end of 2024, a commitment still unfulfilled.

He warned that the private sector, already struggling with soaring gas and electricity tariffs, cannot bear the additional strain of costly borrowing, and urgent steps are needed to reduce both the interest rate and utility costs. He concluded that KCCI's call for a substantial reduction in the cost of doing business is essential for Pakistan's economic recovery.

Mr. Kashif Anwar, former President of the Lahore Chamber of Commerce and Industry, while talking to ICMA Research Department, stated that SBP would have reduced the policy rate from 11% if any economic improvement had been observed, but the floods and rising food security concerns have driven higher prices and inflation. He explained that Pakistan's trade deficit is widening, and a \$10 billion discrepancy between FBR and PBS data could further worsen the fiscal deficit, alongside a Rs. 150 billion gap in tax collection. He added that staff-level discussions with the IMF considered revising the tax target, but if not agreed, a mini-budget may follow, and no serious steps have been taken to reduce electricity, oil, or other prices.

He further emphasized that while industry desires a lower rate, multinationals and foreign businesses are exiting due to declining sales and profits, which may soon require imports. Thus, he asserted that the policy rate cannot be reduced under current conditions and could even increase in upcoming MPC meetings given inflation, fiscal stress, and external imbalances.

Mr. Kamran Arshad, Chairman of All Pakistan Textile Mills Association (APTMA), in a message to ICMA's R&P Department, described the decision as "disappointing." He noted that the industry cannot compete with countries like Bangladesh, Vietnam, and India, where interest rates are less than half of Pakistan's, and that attracting fresh investment will remain a challenge under the current conditions.

ICMA Policy Recommendations

ICMA emphasizes that the effectiveness of monetary policy has reached its limit, as the current inflation trend is primarily supply-driven, originating from food, energy, and housing costs. In such conditions, setting policy rate high at 11 percent would have little impact on reducing inflation but would continue to suppress industrial activity, investment, and job creation. With the real interest rate already positive, monetary policy should now focus on stability and managing expectations, while fiscal and structural measures address the root causes of cost-push inflation.

ICMA therefore recommends the following actions:

Shift Policy Focus to Fiscal and Structural Reforms

The Government should take the lead in reducing cost-push pressures through targeted fiscal measures, including rationalizing energy tariffs, improving food supply management, and facilitating key imports to ease production costs. These interventions directly impact the supply-side factors that monetary policy cannot influence.

Establish Strong Monetary–Fiscal Coordination

ICMA reiterates the need for an effective Monetary-Fiscal Coordination Framework between the SBP and the Ministry of Finance to align objectives. This coordination will ensure that while SBP maintains price and financial stability, fiscal policy actively supports cost reduction, investment revival, and growth momentum.

Gradual Policy Rate Adjustment

Given the dominance of supply-side inflation and the existence of a positive real rate, ICMA suggests a moderate reduction of 100 basis points in the policy rate in the next review. This phased easing would support industrial recovery and credit flow to SMEs, without unanchoring inflation expectations.

Targeted Fiscal Relief for Productive Sectors

To complement monetary stability, fiscal authorities should prioritize sector-specific relief, including lower energy and tax burdens on manufacturing and export-oriented industries. Such measures will lower the cost of doing business and reinforce macroeconomic stability.

Enhance Supply Chain Resilience

ICMA urges the Government to strengthen food storage, logistics, and distribution networks to minimize future supply shocks. This will reduce inflation volatility and improve policy transmission effectiveness.

Research and Publications Team

Shahid Anwar, Senior Director

Hasan Rashid, Research Officer

Muhammad Wajahat Khan, Graphic Designer

For further information or queries regarding this Review, please email: rp@icmap.com.pk

Missed out any previous issues of ICMA MPS Review?

Don't worry. You can access it now!

ICMA has archived all back issues of the ICMA MPS Review on its website so that those who have missed out any issue can read it anytime.

The ICMA MPS Review archives are available on www.icmainternational.com/rportal_p28_ICMAMPSReview.aspx

