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MPS REVIEW

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) has kept the policy rate unchanged at 11 percent in its meeting on July 30, 2025. This decision comes as inflation slowed to 3.2% year-on-year in June 2025, largely due to easing food prices and a slight decline in core inflation. However, the inflation outlook has deteriorated somewhat following a sharper-than-expected increase in energy prices, particularly gas tariffs. While inflation is projected to stabilize within the 5% to 7% target range, the MPC viewed today's stance as necessary for maintaining price stability amidst a recovery in economic activity driven by earlier rate cuts.

Key developments included SBP's foreign exchange reserves rising above $14 billion due to improved financial inflows and a current account surplus, and Pakistan's upgraded sovereign credit rating, which helped reduce Eurobond yields and CDS spreads. Meanwhile, inflation expectations edged up for consumers but declined for businesses, while FBR tax revenues reached Rs11.7 trillion, falling short of the revised FY25 target by Rs200 billion. Global oil price volatility, rising metal prices, and uncertainty from international trade tariffs also pose external risks. The MPC emphasized the importance of maintaining a positive real interest rate and sustaining a prudent monetary-fiscal policy mix, while reiterating the need for structural reforms to support long-term growth.

MPC Observations on Key Sectors

Real Sector

- High-frequency indicators point to a gradual economic recovery, with year-on-year growth in auto sales, fertilizer offtake, private sector credit, and imports of intermediate goods and machinery.
- LSM data turned positive in April and May after five months of contraction.
- Manufacturing sector outlook improving, supported by better demand and input conditions.
- Agriculture sector expected to recover, barring flood-related risks.
- Major crop outlook improved due to better water availability from recent rains.
- Commodity sector recovery expected to positively impact the services sector.
- Business sentiment improving on the back of easing financial conditions and macro stability.
- Real GDP growth projected at 3.25–4.25% in FY26, up from 2.7% in FY25.

External Sector

- Current account surplus reached $328 million in June and $2.1 billion (0.5% of GDP) in FY25.
- Strong remittances offset the widening trade deficit during FY25.
- SBP reserves rose above $14 billion, supported by materialized official inflows in June.
- Remittances growth to slow due to high base effect and incentive scheme rationalization.
- Trade deficit expected to widen amid rising import demand and weak export prices (especially rice).

- FY26 current account projected to be in the range of 0–1% of GDP.
- External inflows likely to improve, aided by higher private flows and recent credit rating upgrade.
- SBP FX reserves projected to reach $15.5 billion by end-December 2025.

Fiscal Sector

- Fiscal position improved in FY25, with both primary and overall balances beating targets.
- Strong growth in tax and non-tax revenues drove the fiscal improvement.
- FBR revenue grew by ~26%, though the revised target was slightly missed.
- FY26 targets a primary surplus of 2.4% of GDP, indicating continued fiscal tightening.
- Success depends on stronger revenue efforts and rationalized government spending.
- MPC emphasized sustaining fiscal consolidation to preserve recent macroeconomic gains.

Money and Credit

- Broad money (M2) growth rose to 14% YoY by July 11, driven by higher net foreign assets.
- Improved FX reserves contributed significantly to banking system liquidity.
- Private sector credit grew by 12.8% YoY, reflecting better economic activity and financial easing.
- Credit expansion was broad-based, covering working capital, investment, and consumer loans.
- Key borrowing sectors included textiles, telecom, and wholesale/retail trade.
- Currency-to-deposit ratio increased in July, after a decline in June.
- SBP increased liquidity injections to keep interbank rates aligned with the policy rate.
- Reserve money growth accelerated due to higher liquidity support operations.

Inflation

- Inflation eased to 3.2% YoY in June 2025, down from 3.5% in May.
- Food inflation moderated, and core inflation slightly reduced to 7.6%.
- Energy prices remained lower YoY, despite hikes in fuel and electricity tariffs.
- Energy inflation is expected to rise, due to gas tariff hikes and subsidy phase-outs.
- FY26 inflation forecast: 5–7%, with occasional spikes above the upper bound.
- Key risks include global commodity volatility, energy price shocks, and potential flooding.

ICMA Analysis

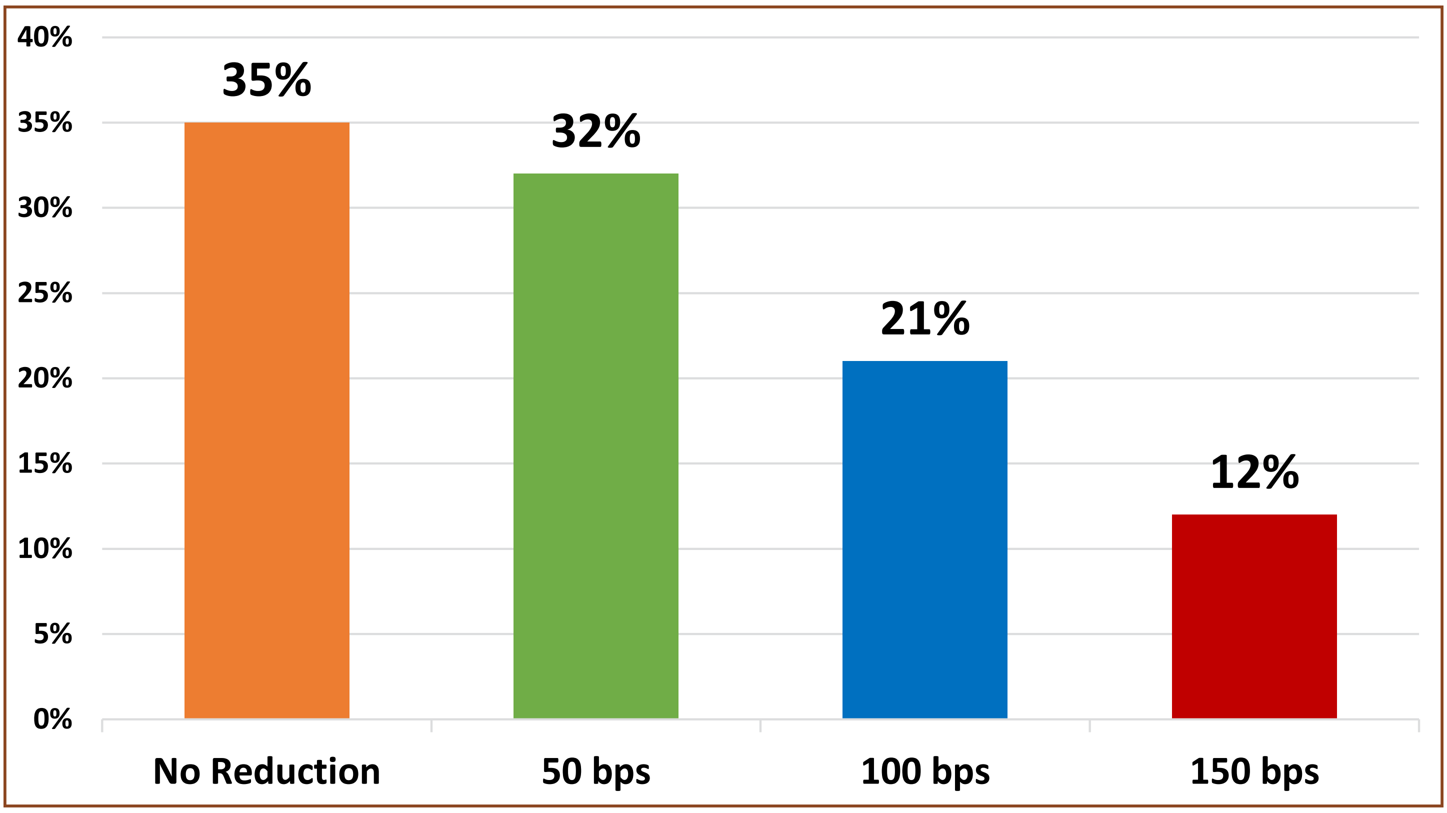
Poll Analysis

Figure 1 presents the results of an ICMA poll conducted prior to the Monetary Policy Committee (MPC) meeting held on 30th July, 2025. The objective was to capture the expectations of businesses and economic analysts regarding a potential change in the policy rate. The poll revealed that 35% anticipated no change, while 32% of respondents expected a moderate cut of 50 basis points. Only 33% foresaw a more substantial reduction of 100 basis points or more. These findings indicate a mixed preference for a cautious and gradual approach to monetary easing.

Figure: 1

ICMA Poll Analysis Prior to MPC Meeting of 30th July 2025

Expectation of Experts & Businesses about the Reduction in Policy Rate



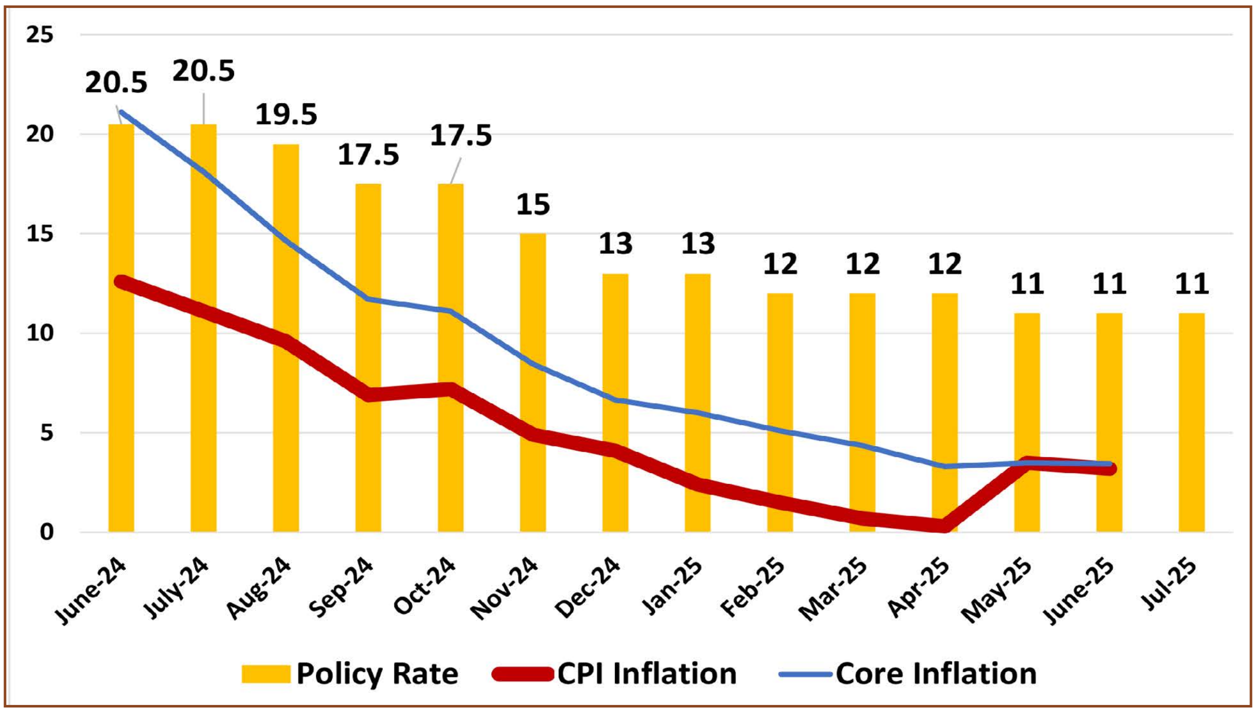
Source: ICMA Poll Analysis

Economic Analysis

The Figure: 2 shows a clear and sustained disinflationary trend in Pakistan's economy over the past year. Headline CPI inflation declined significantly from 12.6% in June 2024 to just 3.2% in June 2025, while core (non-food) inflation dropped even more steeply from 21.1% to 3.45% over the same period. Despite this steep fall in inflation, the policy rate has only gradually declined from 20.5% to 11%, maintaining a strong positive real interest rate. As of July 2025, the policy rate stands at 11%, while both headline and core inflation remain well below this level.

Figure: 2

Policy Rate needs to be cut by 50 to 100 bps, realigning with declining inflation trends in Pakistan



Source: Pakistan Bureau of Statistics, Analysis by ICMA

In this context, even though petrol prices have risen to Rs. 272.15 per liter and electricity charges remain moderate, the inflationary impact is largely cost-push and controlled through administered pricing. Demand-side inflation remains muted, as reflected in the low core inflation reading. Therefore, a cautious reduction in the policy rate by 50 to 100 basis points would not risk triggering an inflationary spiral. Instead, it would provide timely relief to the private sector and support the ongoing economic recovery, especially given the easing financial conditions and improving credit flows. Monetary easing of this scale remains consistent with the SBP's price stability mandate, given the subdued inflation outlook and elevated real interest rates.

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

Mr. M. Amayed Ashfaq Tola, President of Tola Associates, while speaking to the ICMA R&P Department, expressed his concerns over the recent monetary policy decision. He remarked that despite inflation remaining stable at or below 3.5% over the past three months, the SBP has chosen to maintain the policy rate for two consecutive MPC meetings. "The MPC's decision to keep the policy rate at such a high level, despite reasonable inflation readings, is imprudent," he said. He added that to achieve the targeted GDP growth of 4.2%, a further reduction in the interest rate by 3 to 4% is essential — and can be done while still maintaining a positive real interest rate. Looking ahead, Mr. Tola projected that inflation will likely remain within the 7.5% range for the remainder of FY2025–26. He pointed out that the current real interest rate stands at a steep 7.8%. He further emphasized that aligning the exchange rate closer to its actual value of Rs. 259.6 would enhance economic stability and improve Pakistan's overall macroeconomic outlook. "Under the present conditions, such an adjustment could even push inflation into negative territory — that is, deflation — creating additional room for monetary easing," he explained. This, he concluded, would not only accelerate GDP growth beyond current projections but also pave the way for a stronger and more sustainable economic recovery in FY2025–26.

Mr. Abdul Azeem, Head of Research at AL Habib Capital Markets (Pvt.) Ltd, noted that the SBP's decision to keep the policy rate unchanged reflects a cautious approach amid emerging inflation risks from higher energy prices. He said that while recent economic data indicates a steady recovery, the central bank aims to maintain positive real interest rates to anchor demand. He added that, going forward, monetary policy will remain data-driven, with close attention to inflation trends, external balances, and global volatility. He further stated that future adjustments are possible if price pressures escalate or external vulnerabilities intensify. This balanced stance, he concluded, signals the SBP's commitment to supporting economic growth without compromising macroeconomic stability.

Dr. Ikram ul Haq, a member of the Advisory Board and Visiting Senior Fellow at the Pakistan Institute of Development Economics (PIDE), during a conversation with ICMA R&P Department, stated that paradoxically, when inflation is in single digits and the government's outlook suggests stability, the policy rate remains in double digits and the MPC still prefers to keep it intact. He said this reflects underlying economic vulnerabilities on both internal and external fronts. He added that recent volatility in the forex market and pressure on the rupee highlight the delicate link between the discount rate and the rupee/dollar parity. He further noted that banks are once again refusing to open LCs, while the government is trying to convince exchange companies and banks to help ensure rupee stability. Internally, he observed, higher taxes—particularly on POL products—are driving up the prices of essential daily-use commodities. In these circumstances, he concluded, the MPC's decision to maintain the policy rate at 11 percent appears justified.

Ms. Sobia Saleem Mesiya, Financial Research Analyst at Daily Business Recorder, stated that she believes the MPC had enough cushion to cut the policy rate to single digits, given that inflation is expected to settle around 6 percent and liquidity is flowing into the system. She said the SBP is lending money to banks, but this liquidity is not reaching the private sector, as private investors are waiting for rates to drop further. She added that these investors are highly price elastic, and until rates decline, they will remain on the sidelines. She further warned that liquidity is not circulating effectively, and if this persists, it could trap the economy in yet another vicious cycle of inflation.

Mr. Aadil Nakhoda, a faculty member at IBA Karachi and Chair of the Economic Advisory Group (EAG), stated that the government appears to be following a 'wait and see' approach by maintaining the policy rate at 11 percent, considering the potential rebound in inflation, which is likely to hover around 5–7 percent. He said there is rising uncertainty in global commodity markets due to Trump's trade policies and ongoing war risks in the Middle East. He added that while foreign exchange reserves have increased to $14 billion, debt repayments and rollovers continue to fuel uncertainty. He further noted that the trade deficit is expected to widen, with the current account deficit projected to fall between 0–1 percent by the end of the calendar year. "I feel the main focus is on managing foreign exchange reserves," he explained, "as the government is taking a more restrained approach toward economic growth." He concluded that without strong export performance and foreign direct investment inflows, the management of reserves will remain dependent on low growth levels.

Prof. Dr. Shahida Wizarat, a renowned economist, while talking to ICMA, stated that for a long time, many of us — including the FPCCI, business community, and trade bodies — have been saying that the 11 percent policy rate is unjustifiably high. She said there is no rationale for maintaining such a high rate, yet it continues. She added that this is because many of Pakistan's key economic decisions are not made independently but are influenced by external powers, particularly the United States, and are shaped according to its strategic agenda. She further emphasized that this clearly shows there is no real intention to improve Pakistan's economic conditions. "It seems," she said, "that Pakistan has been caught in their grip, and they are unwilling to let go, keeping the country in a constant state of economic hardship."

Mr. Ashfaque Hasan Khan, a distinguished economist and former Economic Advisor at the Ministry of Finance, in his remarks to ICMA, said, "I am sick and tired of repeating the same comment every two months. Unless and until the IMF allows the SBP to reduce the policy rate, the SBP will continue to maintain a double-digit policy rate."

Dr. Manzoor Ahmad, member of the Prime Minister's Committee on Tariff and former Pakistan's Ambassador to the WTO, said that in his view, the Monetary Policy Committee's approach is overly cautious. He stated that with inflation expected to remain below 5% for 2025, there is little economic rationale for keeping interest rates at such elevated levels. He added that the economy has been stagnant for years, leading to rising unemployment and poverty. Under these circumstances, he stressed, the public deserves relief, and the private sector needs breathing space to invest and grow. He further remarked that even a reduction of just 100 basis points could have sent a strong, confidence-boosting signal. It would have lowered borrowing costs, stimulated demand, and unlocked economic potential. He noted that a modest recovery to 4% growth during this financial year—still below regional benchmarks—could have made a meaningful difference in terms of job creation and business activity. He concluded that in times of prolonged economic stress, playing it too safe can be just as damaging as taking risks, and that the moment calls for action, not hesitation.

Industry's Perspective

Mr. Aman Paracha, Vice President of the Federation of Pakistan Chambers of Commerce and Industry (FPCCI), speaking to ICMA, said that the business community had been hoping for a significant cut in the policy rate, with a longstanding demand to bring it down to 6 percent for the next six years. "We are extremely disappointed that the rate has been left unchanged," he said, "which has created confusion within the business community." He added that, on one hand, the government talks about promoting development, and on the other, it claims that inflation has dropped. "If the inflation rate has come down to 3.5 or 4 percent, and based on that the government calculates that the policy rate should not exceed 7 percent, then our demand for a reduction was entirely justified." He stressed that the business community had expected the rate to be brought down to single digits, but that expectation was not met. He further stated that this inaction makes it impossible for Pakistan to compete regionally or drive development effectively. "We are strongly demanding even a one-percentage-point reduction to help improve the money supply, support business activities, and reduce pressure on the dollar." He concluded by warning that unless inflation is reduced and a substantial rate cut is made to reflect current conditions, the business community will remain unable to grow, invest, or compete, as Pakistan continues to have the highest costs in the region.

Mr. Zia ul Arfeen, Senior Vice President, Karachi Chamber of Commerce & Industry, while speaking to ICMA, stated that in Pakistan's current economic environment—marked by inflation, currency instability, and rising input costs—the 11% benchmark interest rate poses serious challenges for the business sector. He said the high rate restricts access to affordable financing, reduces profit margins, and discourages investment, particularly for SMEs and export-oriented industries like textiles. He added that increased borrowing costs, coupled with fuel and electricity price hikes, have raised the overall cost of doing business, weakening Pakistan's competitiveness both domestically and internationally.

Mian Zahid Hussain, Chairman of the National Business Group Pakistan and Chairman of the Policy Advisory Board FPCCI, in a statement to ICMA, conveyed that the SBP's decision to maintain the Monetary Policy Rate at 11% without any reduction has come as a disappointment to the business community. He said that a rate cut was widely expected, especially given the significant decline in inflation. "We were hoping for at least a 5% relief and anticipated that the interest rate would be brought down to around 6%," he said. He added that although the rate has come down from the previous 22%, keeping it at 11% remains too high—particularly in light of the serious challenges facing the trade and industrial sectors regarding the cost of doing business. He emphasized that this is a major reason why the nation continues to face intense economic pressure. "If we genuinely want to restart our economic engines, create jobs, revive industries, and boost exports, we must reduce the cost of doing business—and financing is a key factor in that," he stated. He concluded by saying that bringing interest rates down to 6–7% would not only stimulate the economy and improve exports, but also generate employment and help alleviate poverty.

Dr. Mirza Ishtiaq Baig, Vice Chairman of Baig Group and Adviser to President FPCCI on the African Region, in his comments to ICMA, stated that the State Bank of Pakistan (SBP), in its recent decision, has kept the benchmark policy rate unchanged at 11%. He said the business community had anticipated a reduction, especially in light of the visible decline in inflation. However, he added, the SBP's decision has led to disappointment and a sense of discouragement among industry leaders.

M. Ikram Rajput, Former Vice President FPCCI, Former President Hyderabad Chamber of Commerce and Industry, and Former Senior Vice President Korangi Association of Trade and Industry (KATI), in his comments to ICMA, stated that he is deeply disappointed by the SBP's decision to maintain the policy rate at 11%. He said that despite strong demand from the business community to bring the rate down to single digits, this decision will stifle economic growth and adversely impact businesses. He added that the high policy rate limits access to affordable credit, discourages investment, and reduces overall economic activity. He urged the State Bank to reconsider its stance and support economic revival by bringing the policy rate down to a single digit.

Mr. Kashif Anwar, former President of the Lahore Chamber of Commerce and Industry (LCCI), while speaking to ICMA, said that bringing down the interest rate from 22% to 11% is commendable, but the business community had expected it to fall into single digits this time. He noted that lower interest rates directly reduce the cost of doing business and manufacturing. With inflation now at 4–5%, as indicated by the Government and the Industrial Bank of Pakistan, he stressed that the interest rate should have been reduced further—by at least 1–2 percentage points. He added that simply lowering inflation won't boost manufacturing unless financing costs also come down. He emphasized the need to also address tax reforms, exchange rate stability, and political certainty to truly support industrial growth. If inflation continues to remain low, he concluded, the interest rate must be brought down in the next review.

ICMA Policy Recommendations

1. Phased Rate Cut with Forward Guidance

ICMA recommends SBP adopt a gradual rate cut path (50 to 100 bps per review) supported by forward guidance, as inflation has dropped to 3.2% while the real interest rate exceeds 7%. This tight stance is unwarranted given muted demand-side pressures. Clear signaling will boost investor confidence, support recovery, and align monetary easing with price stability.

2. Create Monetary-Fiscal Coordination Council (MFCC)

ICMA urges formation of a Monetary-Fiscal Coordination Council, jointly led by SBP and MoF, to avoid policy contradictions. With fiscal tightening (2.4% primary surplus target) and high interest rates acting simultaneously, growth risks being over-suppressed. Coordination ensures balanced macro policy, avoids overkill, and sustains recovery momentum.

3. Targeted Liquidity for Productive Sectors (TLTM)

ICMA recommends SBP implement a Targeted Liquidity Transmission Mechanism (TLTM) to channel credit to export-oriented and job-intensive sectors like textiles, SMEs, and IT. Despite liquidity injections, credit flow is weak due to transmission gaps. TLTM can include refinance schemes and credit guarantees, ensuring that easing actually reaches the real economy.

4. Launch Business Confidence Recovery Program (BCRP)

ICMA recommends a joint initiative of SBP and Government to restore business confidence through rate alignment with neighbouring countries (6% to 7%), lower cost of credit, and export incentives. High borrowing costs are discouraging investment. A BCRP would revive private sector activity, boost exports, and aid job creation in a low-inflation environment.