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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), in its meeting on December 15, 2025, decided to reduce the policy rate by 50 basis points to 10.5 percent effective December 16, 2025. The decision aims to support sustainable economic growth while maintaining price stability. Headline inflation remained within the 5% to 7% percent target range during July–November FY26, though core inflation continues to show persistence due to ongoing sectoral cost pressures. The inflation outlook is broadly unchanged, supported by benign global commodity prices and anchored expectations, while economic activity continues to gain momentum, including stronger-than-expected large-scale manufacturing growth in Q1-FY26.

The Committee noted positive developments, including a modest rise in employment growth (Labor Force Survey 2024-25), accumulation of foreign exchange reserves above \$15.8 billion, improved consumer confidence and positive business confidence. Fiscal balances recorded Q1-FY26 surpluses, aided by SBP profit transfers. Despite a fluid global environment, the MPC emphasized that the real policy rate remains sufficiently positive to stabilize inflation over the medium term and reiterated the need for coordinated monetary-fiscal policies and structural reforms to sustain higher and durable economic growth.

ICMA Analysis

ICMA’s analysis of sector-wise CPI data for November 2025, shown in Table 1 (urban) and Table 2 (rural), indicates that price pressures are concentrated in education, health, food, transport, and housing. This underscores the limited effectiveness of policy rate adjustments in addressing current inflation dynamics, which are largely driven by sector-specific costs, as highlighted in ICMA’s Monetary Policy Statement Review, Issue #19 (October 2025). [\[Refer to: bit.ly/3MMnn0Z\]](https://bit.ly/3MMnn0Z)

Urban Areas: Sector-Wise Price Volatility in Pakistan

Table:1

Sectors/ Groups	Price Change % YoY Nov-25	Volatility Ranking
Education	8.2	1st
Health	7.0	2nd
Housing, Water, Elec., Gas and Other Fuels	6.4	3rd
Transport	6.2	4th
Clothing & Footwear	5.7	5th
Food & Non-Alcoholic Beverages	5.2	6th
Restaurants & Hotels (Non-Food Component)	5.1	7th
Alcoholic Beverages, Tobacco	4.9	8th
Restaurants & Hotels (Food Component)	4.3	9th
Furnishing & Household Equip. Maintenance	3.2	10th
Communication	0.5	11th
Recreation and Culture	-4.3	12th
Miscellaneous	17.6	13th
Urban CPI Inflation Rate	6.1	

Source: SBP, Analysis by ICMA.

In urban areas, education (8.2%), health (7.0%), housing & utilities (6.4%), transport (6.2%), and miscellaneous items (17.6%) recorded the highest increases, while in rural areas, education (11.2%), health (9.7%), restaurants & hotels (7.5%) and clothing & footwear (7.5%) were the most affected. These rises are largely driven by supply-side and cost-push factors, including higher operating costs for private schools and hospitals, energy and fuel price adjustments, transport fare increases, climate-related disruptions to food supply, and structural or administrative rigidities. **As such, monetary policy alone through changes in the policy rate, cannot directly alleviate these sectoral price pressures.**

Rural Areas: Sector-Wise Price Volatility in Pakistan

Table:2

Sectors/ Groups	Price Change % YoY Nov-25	Volatility Ranking
Education	11.2	1st
Health	9.7	2nd
Restaurants & Hotels (Non-Food Component)	7.5	3rd
Clothing & Footwear	7.5	4th
Restaurants & Hotels (Food Component)	6.5	5th
Transport	6.0	6th
Food & Non-Alcoholic Beverages	5.9	7th
Alcoholic Beverages, Tobacco	4.0	8th
Furnishing & Household Equip. Maintenance	3.9	9th
Housing, Water, Elec., Gas and Other Fuels	2.8	10th
Communication	0.9	11th
Recreation and Culture	-3.7	12th
Miscellaneous	18.6	13th
Rural CPI Inflation Rate	6.3	

Source: SBP, Analysis by ICMA.

These findings align with the SBP's assessment that inflation is increasingly non-demand driven. They underscore the need for targeted fiscal and structural interventions. Policy measures such as improving food supply chains, rationalizing energy tariffs, enhancing market competition, and providing sector-specific relief are essential to contain volatility in the most affected sectors.

Within this framework, coordinated fiscal and administrative measures should be implemented alongside ongoing monetary policy reviews. Addressing underlying supply-side constraints is critical to achieving sustainable disinflation and supporting broad-based economic 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 cut the policy rate by 50 basis points to 10.5 percent. Their views and perspectives are summarized below:

Experts' Insight

Dr. Ashfaque Hasan Khan, Former Economic Advisor, Director General Debt Office, and Special Secretary Finance, Ministry of Finance, and currently the Director General, NUST Institute of Policy Studies, in a written statement sent to ICMA R&P Department, mentioned that after keeping the interest rate at 11%, much higher than the inflation rate, for seven long months, the SBP reduced its policy rate by only a token 50 bps, a move that significantly damaged Pakistan's budget. He added that the real interest rate remains at 4.4%, still much higher than that of our regional competitors. He further stated that keeping the real interest rate above the projected real GDP growth is a flawed policy and represents a condition of debt unsustainability, a fundamental principle of economics. Yet, he noted, our Central Bank has maintained such a high real interest rate for an extended period.

He noted that, as a result, Pakistan's budget has been severely strained, with interest payments ballooning and consuming a large share of resources, leaving very little for people and infrastructure. He added that to meet other federal budgetary responsibilities under these conditions, the government had to borrow from within and outside Pakistan, leading to a significant accumulation of debt. In his view, the monetary policy stance of the SBP has contributed substantially to the country's rising debt burden.

He further argued that keeping the real interest rate at 4.4% makes little sense. He explained that the SBP has maintained such high rates with the stated objective of controlling inflation. However, Dr. Hasan Khan emphasized, inflation in Pakistan is largely a supply-side phenomenon, compounded by government-led increases in utility prices, which are ultimately passed on to consumers. He questioned whether the interest rate is the appropriate instrument to control inflation when it originates from the supply side.

He also pointed out that Pakistan's inflation rate has remained in single digits for the past six to seven months, yet the SBP continued to maintain the interest rate in double digits for an extended period. He asked whether they did not realise that by keeping the interest rate so high for so long, they have damaged Pakistan's budget and contributed significantly to pushing the country deeper into debt.

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, remarked that while the SBP's reduction of the policy rate by 50 basis points to 10.5 percent may make appealing headlines, its actual impact on economic growth and business revival is likely to be minimal. In his view, the decision is not fully justified, particularly given the potential risks of rising inflation in the coming months. He added that it would have been more prudent to maintain the rate at 11%, as the marginal 50 basis points cut offers little practical benefit in the current economic context.

Dr. Manzoor Ahmad, member of the Prime Minister's Committee on Tariff and former Pakistan Ambassador to the WTO, was of the view that the 50-basis point cut is a welcome but long-overdue move. With inflation remaining subdued for months, the policy rate had been kept excessively tight for nearly eight months, unnecessarily constraining economic activity. While there were concerns that the September floods in Punjab might push up food prices due to crop damage, those fears proved unfounded and inflation stayed firmly under control. He added that the central bank should now stay the course and continue easing into 2026, provided inflation remains around current levels. The recent positive IMF review appears to have given the Monetary Policy Committee the confidence to act, shifting the stance from undue caution to much-needed support for businesses and investment.

Mr. Aadil Nakhoda, a faculty member at IBA Karachi and Chair of the Economic Advisory Group (EAG), in a message to ICMA R&P Department, said that the reduction in the discount rate suggests that the SBP is being cautious but optimistic. He explained that the completion of the IMF's review and the inflows from the package provide a significant boost and cushion to reduce interest rates. This also indicates the direction that the SBP is likely to follow, given the need to revive the economy and boost output. Mr. Nakhoda added that the SBP also believes inflation rates will fall within the targeted zone. A sharper increase may have signaled optimism but could have diverted the SBP from achieving its target inflation levels, given that commodity prices are still showing volatility. Although many say the cut itself comes as a surprise, the fact is that it follows immediately after the IMF Board's approval, suggesting a timely move to initiate a downward trend in the discount rate.

Mr. Abdul Azeem, Head of Research at AL Habib Capital Markets (Pvt.) Ltd, noted that the State Bank of Pakistan's decision to cut the policy rate by 50 basis points reflects a calculated pivot toward stimulating growth amid signs of stabilizing macroeconomic conditions. He explained that this move was made possible by headline inflation remaining firmly within the central bank's target band of 5–7%, supported by converging price trends across food, energy, and core inflation segments. At the same time, the economy is demonstrating renewed momentum, with large-scale manufacturing expanding by 4.1% in 1QFY26 and agricultural prospects looking upbeat. Bolstered by rising foreign exchange reserves and well-anchored inflation expectations, the SBP has seized the opportunity to lower borrowing costs, a strategic step aimed at accelerating credit uptake, supporting businesses, and fostering sustainable economic expansion without compromising price stability.

Industry's Perspective

Mr. Usman Shaukat, President of the Rawalpindi Chamber of Commerce and Industry (RCCI), described the reduction in the policy rate as a constructive step but noted that the business community had expected a deeper cut to 9 percent or lower. He explained that the previous rate of 11 percent had largely been maintained due to SBP's concerns over high inflation following the floods, which did not materialize. He expressed optimism that the upcoming meeting could see a more substantial reduction of 200 basis points or more, providing stronger support to the business sector.

Mr. Junaid Naqi, former Chairman of the Korangi Association of Trade and Industry (KATI), termed the Monetary Policy Committee's decision to cut the policy rate by 50 basis points to 10.5 percent as deeply disappointing. He noted that the business community had been calling for a reduction to single-digit levels, and the prevailing mood within industry is one of frustration due to high energy costs, particularly electricity and gas, alongside a heavy taxation burden. Recalling when the policy rate stood at 21 percent, Mr. Naqi pointed out that for over one and a half years, industry has demanded a more growth-supportive range of 6 to 7 percent. He argued that the slow pace of monetary decisions and the justifications offered, largely anchored in inflation metrics, are misaligned with current economic conditions. He also criticized what he described as an artificially constructed narrative under the guise of IMF conditionalities and emphasized that the federal government must take concrete steps to support industry, particularly SMEs, and accelerate export-led growth.

Mr. Kashif Anwar, former President of the Lahore Chamber of Commerce and Industry (LCCI), termed the reduction in the policy rate as a surprising yet welcome move by the government. He noted that most economists had expected the rate to remain at 11 percent or even rise, given inflationary risks highlighted by the IMF and other international agencies. He said the decision provides immediate relief to businesses burdened with high taxation and soaring energy costs. He added that a continued downward trend toward single-digit rates, as demanded by the business community, would help industries manage heavy machinery, raw material expenses, and debt obligations more effectively, easing inflationary pressures, supporting smoother industrial activity, and benefiting consumers and the broader economy.

Muhammad Rehan Hanif, President of the Karachi Chamber of Commerce & Industry (KCCI), expressed disappointment over the SBP's 50-basis point policy rate cut, stating that such a token adjustment falls short of what is needed to revive Pakistan's fragile economy and restore business confidence. He noted that borrowing costs remain among the highest in the region, while industries face multiple pressures including high energy tariffs, fuel prices, excessive taxation, logistics costs, and regulatory compliance. He emphasized that without affordable credit, businesses defer expansion, reduce employment, and limit production, undermining industrial growth, exports, and government revenues. Highlighting that regional economies maintain single-digit rates to support competitiveness, he called for a bold and decisive cut in interest rates to unlock growth, protect jobs, and strengthen Pakistan's business sector.

ICMA Policy Recommendations

ICMA emphasizes that monetary policy has reached its effectiveness limit, as the current inflation trend is largely supply-driven, driven by cost pressures in education, health, food, transport, and housing. In this context, the recent 50 bps reduction of the policy rate to 10.5 percent is unlikely to significantly lower inflation, though it may provide limited support to economic activity.

Experts and industry representatives also note that high real interest rates have strained public finances, and marginal rate cuts offer minimal growth stimulus. Therefore, monetary policy should focus on maintaining stability and anchoring expectations, while targeted fiscal, structural, and administrative measures are essential to address the root causes of supply-side inflation.

1) Develop an Economic Rapid Response Unit

An Economic Rapid Response Unit should be established to manage economic shocks effectively. This unit would coordinate rapid-response measures to address floods, droughts, or other disruptions, preventing abrupt price spikes. It would also facilitate continuous collaboration with industry and business associations to quickly identify and resolve bottlenecks in production, transport, and imports, ensuring smoother supply chains and enhanced price stability.

2) Agriculture and Food Supply Management

To mitigate food-related inflation, the government should enhance crop productivity and storage through targeted incentives and investment in cold storage, strengthen supply chains for perishable goods to reduce climate-related disruptions, and establish buffer stocks and market monitoring to prevent seasonal price surges, as highlighted in ICMA's rural CPI analysis.

3) Rationalizing Energy and Utility Prices

To address supply-side inflation in the energy sector, electricity, gas, and fuel tariffs should be adjusted gradually and predictably to avoid sudden cost shocks that directly contribute to inflation. At the same time, targeted support in the form of conditional subsidies for farmers and SMEs can help mitigate the impact of unavoidable price increases, ensuring business continuity and reducing the burden on consumers.

4) Timely Completion of Development Projects

To address transport-related cost pressures, pending infrastructure and logistics projects should be prioritized and completed promptly. Timely completion of freight corridors, public transport initiatives, and intercity logistics networks will help reduce input costs for goods and services, alleviating high transport inflation in both urban and rural areas. Additionally, implementing mechanisms to stabilize fuel prices can prevent sudden cost pass-through to consumers and businesses, further supporting overall price stability.

5) Enhance Market Competition and Regulation

To contain inflation in essential goods and services, competition should be strengthened by addressing monopolistic practices in sectors such as food, healthcare, and education, promoting efficiency and preventing price manipulation. Additionally, establishing transparent pricing mechanisms and enhancing regulatory oversight can improve price discovery and curb excessive cost escalation, ensuring fair prices for consumers.

MPC Observations on Key Sectors

Real Sector

- **High-Frequency Indicators** show continued robust momentum across key sectors.
- **Agriculture:** Wheat and other major crops expected to surpass targets, supported by favorable inputs and government incentives.
- **Industry:** LSM grew 4.1% YoY in Q1-FY26, led by automobiles, cement, fertilizer, and machinery; export challenges pose some risks.
- **Services:** Positive trends in agriculture and industry likely to boost services activity.
- **GDP Outlook:** Real GDP growth for FY26 expected in the upper half of 3.25–4.25% range.

External Sector

- **Current Account:** Deficit of \$0.7 billion (July-Oct FY26), aligned with MPC expectations.
- **Trade:** Imports up with economic activity; exports pressured by rice and food decline; remittances remained resilient.
- **FX Reserves:** Surpassed \$15.5 billion, supported by SBP purchases; projected to reach \$17.8 billion by June 2026.
- **Outlook:** Deficit expected to stay 0% to 1% of GDP; lower oil prices may ease import growth, while trade headwinds may constrain exports.

Fiscal Sector

- **Q1-FY26 Balances:** Overall & primary surpluses supported by SBP profit transfers.
- **Revenue:** FBR collections slowed to 10.2% YoY, requiring acceleration to meet budget targets.
- **Expenditure & Interest:** Spending lower than last year; interest payments below budget aid deficit containment.
- **Policy Outlook:** Primary surplus challenging; structural reforms (tax base broadening, SOE privatization) needed to strengthen fiscal buffers and enable public investment.

Money and Credit

- **Broad Money (M2):** Grew 14.9% YoY (Nov 28), driven by higher net budgetary borrowing.
- **Private Sector Credit (PSC):** Expanded by Rs 187 billion (Jul–Nov FY26), led by textile, wholesale & retail, and chemicals; consumer financing, especially auto loans, remained strong, down 0.3% YoY, reflecting a high base from ADR-driven Q2-FY25 credit expansion.
- **Currency & Deposits:** Currency in circulation stable; deposit growth caused a moderate decline in currency-to-deposit ratio.

Inflation

- **Headline Inflation:** Remained within the medium-term target range over the past three months.
- **Components:** Food, energy, and core inflation are converging, broadly as anticipated.
- **Policy Impact:** Prudent monetary policy and fiscal discipline are helping stabilize inflation despite supply-side frictions and sticky core inflation.
- **Expectations & Risks:** Inflation expectations remain anchored; however, upside risks exist from volatile global commodity prices, energy adjustments, fiscal slippages, and price uncertainty in wheat and perishable foods.
- **Outlook:** Inflation may rise above the target rate by the end of FY26 due to low base effects, before reverting to target in FY27.

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
