

# MPS REVIEW

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**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 held on 15th September, 2025. This decision comes as inflation remained relatively moderate in July and August, with core inflation continuing to ease at a slower pace. Meanwhile, economic activity strengthened further, supported by large-scale manufacturing (LSM) and other high-frequency indicators. However, the outlook has been affected by the ongoing floods, which are expected to create a temporary but significant supply shock, particularly in the crop sector, leading to some upward pressure on headline inflation and the current account deficit in FY26. Growth is also projected to moderate compared to earlier assessments. The MPC viewed today's stance as appropriate to preserve price stability amidst evolving uncertainty.

Key developments included SBP's foreign exchange reserves remaining stable despite net debt repayments and a current account deficit, while inflation expectations for both consumers and businesses edged up in September. FBR tax collection during Jul-Aug 2025 fell slightly short of target, though it recorded strong year-on-year growth. On the external front, the announcement of revised U.S. import tariffs helped ease global trade uncertainty. The MPC noted that the economy is on a stronger footing compared to past major flood events, supported by low inflation, moderate domestic demand, a benign global commodity outlook, and improved fiscal and external buffers achieved over the past two years. The Committee emphasized the importance of maintaining a positive real interest rate, continuing a prudent monetary-fiscal policy mix, and pursuing structural reforms to strengthen resilience and sustain long-term growth, while ensuring inflation remains anchored within the 5% to 7% target range over the medium term.

## MPC Observations on Key Sectors

### Real Sector

- High-frequency indicators, including imports of machinery and intermediate goods, automobile and cement sales, private sector credit, and business confidence, signal continued economic momentum from H2-FY25 onwards.
- LSM posted 3% y/y growth in Q4-FY25, after contracting for three consecutive quarters.
- Recent floods have weakened the overall growth outlook for FY26.
- Losses to Kharif crops, based on current information and satellite imagery, along with flood-related supply chain disruptions, may dampen manufacturing and services activity in the near term.
- Prospects for Rabi crops have improved due to the likelihood of higher post-flood yields.
- Real GDP growth for FY26 is projected to remain near the lower bound of the earlier 3.25% to 4.25% range.

### External Sector

- The current account posted a deficit of \$254 million in July 2025, driven by higher imports amid rising economic activity and some moderation in remittances.
- Despite the deficit and weak financial inflows, SBP's FX reserves remained stable at around \$14.3 billion as of Sep-5.

- External sector outlook remains vulnerable to evolving domestic and global conditions.
- Flood-related crop losses are expected to widen the trade deficit, though improved market access to the US will partly offset this impact.
- Remittances have remained resilient and may strengthen further, as seen in past natural disaster episodes.
- Current account deficit for FY26 is projected to stay within the earlier forecasted range of 0% to 1% of GDP.
- With expected realization of planned official inflows, SBP's FX reserves are projected to reach around \$15.5 billion by Dec-2025.

### Fiscal Sector

- FBR's tax collection grew by 14.1% y/y in the first two months of FY26.
- A sizeable transfer of Rs2.4 trillion in budgeted profit from SBP and higher petroleum levy are expected to generate a significant primary surplus in Q1-FY26.
- Floods may raise current expenditures and slow revenue collection.
- Fiscal reforms need to be continued with priority on broadening the tax base and restructuring loss-making SOEs.
- Strengthening fiscal buffers will create room for social and development spending and enhance resilience against future economic shocks.

### Money and Credit

- Broad money (M2) growth slowed to 13.9% y/y as of August 29, with deposits remaining the main driver while currency in circulation declined seasonally.
- Net budgetary borrowing from the banking system fell sharply due to the transfer of SBP profit.
- Banks' credit to the non-government sector increased, with PSC growth accelerating to 14.1% y/y.
- Expansion in credit was broad-based, covering working capital, fixed investment, and consumer financing.
- Key borrowing sectors included textiles, telecommunications, and wholesale and retail trade.
- Demand for private sector credit is expected to remain firm, though some moderation may occur due to post-flood economic slowdown risks.

### Inflation

- Inflation rose to 4.1% y/y in July before easing to 3% in August, mainly due to volatility in food and energy prices.
- Core inflation continued to decline, though at a slower pace.
- Floods have raised uncertainty for near-term inflation, especially food prices.
- Weekly SPI data shows notable increases in perishables and wheat and allied products.
- Part of the food price impact may be offset by recent favorable electricity tariff adjustments.
- Inflation is projected to exceed the 5% to 7% target range for much of H2-FY26, before returning to target in FY27.
- Outlook remains vulnerable to risks from the evolving flood situation, volatile global commodities, and unexpected energy price adjustments.

## ICMA Analysis

The State Bank has kept the policy rate at 11%, which provides stability but may not fully address the problems caused by recent floods. While the steady rate helps control demand-driven inflation and manage expectations, the main challenge now is supply disruptions, especially in agriculture and food production. At this stage, keeping rates high could restrict investment and recovery financing when the economy actually needs more liquidity.

Figure: 1

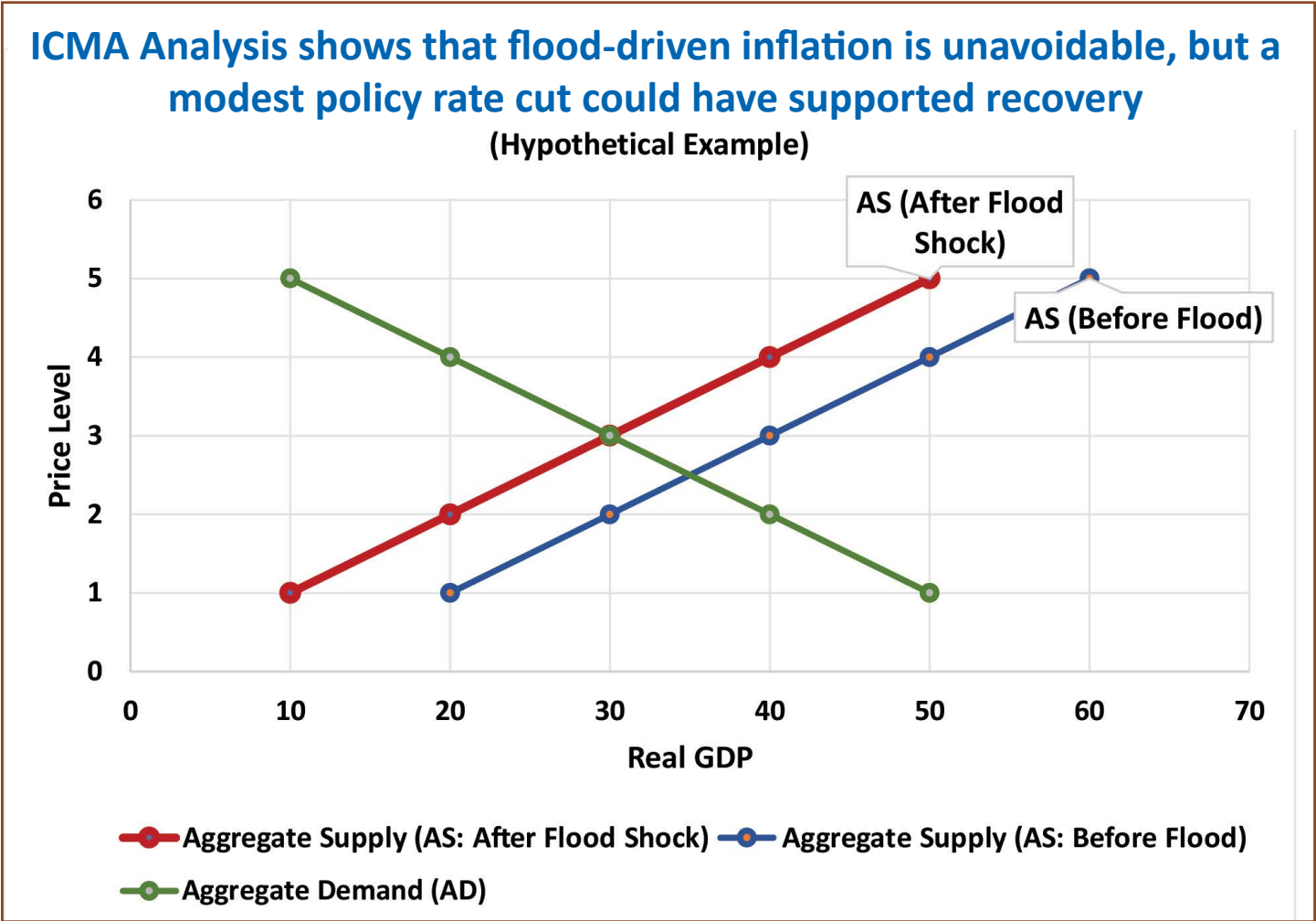


Figure 1 (hypothetical illustration) shows how supply shocks create cost-push inflation. Although the current rate can help manage demand pressures, the floods are expected to reduce supply in the short run, pushing prices higher. To stop these pressures from lasting, timely supply-side measures are needed. The State Bank can support recovery by slightly lowering the policy rate to encourage investment in agriculture and the food sector, helping ease supply problems and prevent future shortages.

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. Miftah Ismail, former Federal Finance Minister**, informed ICMA that this was an opportunity for SBP to reduce the interest rate by one percent. However, keeping the policy rate unchanged means that economic growth will remain constrained. As a result, new job opportunities will continue to be scarce, and unemployment and disillusionment are likely to rise. At the same time, he noted, high interest rates help suppress demand and keep inflation in check. He added that these difficult decisions are a consequence of past policy errors. Due to excessive foreign borrowing in the past and its deployment in the foreign exchange market to artificially support the rupee, we now have to borrow again to manage the fallout.

This, he said, demonstrates the adverse effects of fundamental policy mistakes, and we must be careful not to repeat them. He expressed concern that we appear to be heading down the same path again, pointing out the persistent large gap between interbank and open market rates, which, if maintained, will be a policy mistake with consequences in the future.

**Prof. Dr. Shahida Wizarat, a renowned economist**, during a conversation with ICMA R&P Department, stated that the SBP policy rate decision reflects a misunderstanding of Pakistan's inflationary dynamics. She explained that inflation in Pakistan is not driven by demand, but occurs when the currency is devalued, which raises the cost of imports and pushes up prices across the economy. Raising lending rates in response does not address the underlying problem; instead, it worsens economic challenges. She added that Pakistan is experiencing cost-push inflation due to currency depreciation and import dependence, while the overall economy remains stagnant. Recent climate-related disasters, including heavy rains and floods, have destroyed key crops such as rice and wheat, creating supply-side shortages that further drive-up prices. Yet, policy responses continue to focus on interest rate hikes, which do not tackle the root causes and only add to the difficulties faced by businesses and consumers.

Prof. Dr. Wizarat also noted that Pakistan's economic decisions have at times been influenced by external actors, including the USA, whose policies can indirectly shape the country's economic environment. However, she emphasized that domestic policy responses must be guided primarily by Pakistan's own economic realities and needs. According to Prof. Dr. Wizarat, the economy is not overheating, and the observed price increases are largely due to higher import costs and disrupted supply chains rather than excessive domestic demand. She stressed that understanding these factors is essential to design effective policies that stabilize prices without harming economic growth.

**Dr. Manzoor Ahmad, member of the Prime Minister's Committee on Tariff and former Pakistan Ambassador to the WTO**, was of the view that there was ample room to cut the policy rate by 50–100 basis points. He added that poverty and unemployment remain unacceptably high, and one cannot take comfort simply because the stock market is performing well. He emphasized that it has been a long time since the economy has experienced meaningful growth, and what people need most today are jobs. Without a reduction in the policy rate, he warned, economic stagnation will persist.

**Dr. Ikram ul Haq, a member of the Advisory Board and Visiting Senior Fellow at the Pakistan Institute of Development Economics (PIDE)**, conveyed a different perspective while talking to ICMA. He said that the SBP decision to keep the policy rate unchanged is fully justified in the wake of disastrous floods that have damaged standing crops and caused other losses. He added that the supply chain of essential commodities has also been disrupted. In view of massive economic losses and the daunting challenges of rescue and recovery, inflation is inevitably being pushed upward, coupled with increased borrowing from banks by the government. Dr. Haq explained that these extraordinary challenges are the reason for not reducing the policy rate, even marginally.

**Mr. M. Amayed Ashfaq Tola, President of Tola Associates**, while speaking to ICMA, stressed that there are compelling grounds for the SBP to reduce the policy rate. He pointed out that inflation held steady at 3.5% in July and August of FY26 and has now dropped further to 3.0%. Yet, the SBP has kept the policy rate unchanged for three consecutive Monetary Policy Committee (MPC) meetings — a stance he termed increasingly questionable and out of touch with ground realities.

He was of the view that to achieve the targeted GDP growth of 4.2%, a cut of 2–3 percentage points in the policy rate is essential while still ensuring a positive real interest rate. Highlighting current challenges, he noted that Large-Scale Manufacturing (LSM) is showing negative growth and exports remain stuck below \$3 billion per month. An interest rate reduction, he emphasized, is critical to revive the struggling economy by spurring private investment, boosting industrial growth, reducing the government's debt burden, and providing relief to SMEs facing high borrowing costs.

**Mr. Aadil Nakhoda, a faculty member at IBA Karachi and Chair of the Economic Advisory Group (EAG)**, said that the SBP's decision was very much in line with expectations. He observed that the central bank has adopted a softer approach towards lowering interest rates and, with floods ravaging the country, it is unlikely to shift its stance.



According to him, SBP would prefer to hold rates steady at a time when inflation may rise due to shortages caused by flood-related disruptions. He cautioned, however, that the key question is what impact this will have as growth remains elusive and fiscal challenges continue to mount — challenges that may be further aggravated by the massive costs of rebuilding and rehabilitation in flood-hit areas.

**Mr. Abdul Azeem, Head of Research at AL Habib Capital Markets (Pvt.) Ltd**, noted that SBP's decision to keep the policy rate unchanged at 11% appears justified given the inflationary risks arising from recent flood damages. He said that a rate cut at this stage could have undermined price stability and fueled food-driven inflation, especially when the near-term outlook remains uncertain. He added that the real interest rate is still adequately positive, anchoring expectations and reinforcing SBP's stance. In the current scenario, SBP is rightly being cautious to protect not only inflation but also external and fiscal buffers. A gradual reduction in rates, he suggested, may be considered later once the flood impacts subside and inflation stabilizes.

## Industry's Perspective

**Mr. Usman Shaukat, President of the Rawalpindi Chamber of Commerce and Industry (RCCI)**, expressed disappointment over the SBP's decision to maintain the current interest rate and said that despite easing inflationary pressures and other favorable economic indicators, not reducing the policy rate will likely hamper economic growth. He emphasized that RCCI has consistently advocated for a single-digit policy rate over the past three cycles, as it would provide much-needed relief to businesses and stimulate economic activity. He urged the State Bank to reconsider its stance and bring down the policy rate to single digits in order to support Pakistan's growth and development.

**Mr. Muhammad Jawed Bilwani, President of Karachi Chamber of Commerce and Industry (KCCI)**, in a message to ICMA, voiced strong disappointment over the State Bank of Pakistan's decision to keep the policy rate unchanged at 11 percent, calling it inconsistent with current economic indicators and detrimental to growth. He noted that with inflation down to around 3–4 percent, businesses had expected a cut to close the wide gap between borrowing costs and actual inflation. Instead, SBP's decision places an undue financial burden on industries already struggling with high input costs and energy tariffs. Bilwani stressed that keeping such a high rate undermines Pakistan's competitiveness, particularly against regional economies with lower benchmarks, while discouraging investment, hurting exports, and constraining SMEs. He urged that reducing the policy rate to single digits would lower the cost of doing business, restore investor confidence, and drive industrial revival and job creation.

**Mr. Junaid Naqi, Chairman of the Korangi Association of Trade and Industry (KATI)**, in a video message to ICMA, said that the SBP's decision to keep the policy rate at 11% for a third consecutive meeting is deeply disappointing. He added that, compared with regional peers, Pakistan's policy rate remains high despite consumer inflation moderating at roughly 2–3%. Key macroeconomic indicators suggest a need for monetary easing, while entrepreneurs face acute capital constraints that hinder business formation and expansion. He emphasized that lowering financing costs is essential to improve the ease of doing business. Moreover, the state is burdened by heavy debt-servicing obligations that could be partly eased through a more accommodative monetary stance. Mr. Naqi said that the policy adopted by the State Bank lacks a clear, defensible rationale and has left the industrial and business community in distress. He therefore appealed to the competent authorities to adopt a more considered, evidence-based approach before issuing such policy announcements.

**Mr. Kamran Arshad, Chairman of All Pakistan Textile Mills Association (APTMA)** in a message to ICMA's R&P Department, said he is deeply concerned about the MPC's decision to keep the policy rate at 11%. With inflation at just 3% in August 2025, this creates a real interest rate of 8%, one of the highest in the world, which he said is hurting investment, weighing down business sentiment, and slowing industrial recovery. He pointed out that Pakistan's textile sector, the country's largest export industry and a major source of jobs, is already struggling with high energy costs, heavy taxation, weak export demand, and underused capacity, while new investment is held back by policy uncertainty and expensive borrowing. Mr. Arshad urged the MPC to rethink its monetary policy, lower the rate to 9% to match inflation and regional standards, and set a clear plan to bring it down further to 6% by year-end to support economic growth and boost business confidence.

**Mr. Kashif Anwar, former President of the Lahore Chamber of Commerce and Industry,** said that if inflation is considered the key factor guiding monetary policy, then normally a decline in inflation should lead to a cut in interest rates. However, the recent floods have severely disrupted the agricultural sector, damaging key crops such as rice, wheat, and vegetables, and pushing prices sharply upward — with wheat alone rising to around Rs. 1,000. In this context, he noted, SBP’s decision to maintain the policy rate at 11 percent appears justified given the ongoing inflationary pressures. At the same time, he cautioned that businesses are now burdened with higher borrowing costs, which increase input expenses and reduce competitiveness. He added that the floods have also hurt rice exports, potentially worsening the trade deficit, while the rupee is expected to come under further pressure as inflation continues to rise in the coming months.

## ICMA Policy Recommendations

ICMA analysis reveals that the State Bank’s decision to keep the policy rate unchanged at 11% provides short-term stability, but Pakistan’s inflation is largely supply-driven, triggered by currency depreciation, import dependence, and flood-related crop losses. In such a situation, keeping the rate unchanged does little to control inflation but makes credit more costly for businesses and households. This limits investment, delays recovery, and risks higher unemployment. Since cost-push inflation from flood-related supply shocks is unavoidable in the short run, ICMA believes a modest cut in the policy rate could have eased financing pressures and supported recovery without undermining stability.

At the same time, ICMA stresses the importance of announcing a predictable roadmap for gradual rate reductions once flood impacts ease and inflation stabilizes. Such a signal would strengthen investor confidence, align interest rates with actual inflation (3% to 4%) and regional benchmarks, and support long-term economic stability and industrial revival. Lower borrowing costs are especially critical for SMEs and industries to expand production, improve competitiveness, and generate employment.

ICMA also recommends expanding concessional credit and refinance schemes for agriculture, SMEs, and flood-affected sectors. Targeted financing would help restore food supply chains, reduce cost-push pressures, and channel recovery support to the most vulnerable groups.

Moreover, ICMA thinks monetary policy must be guided by a clear and transparent rationale to reduce uncertainty and restore business confidence. A well-communicated approach will enable the private sector to plan and invest with greater clarity.

Finally, ICMA proposes stronger coordination between monetary and fiscal authorities. Fiscal policy should prioritize emergency relief, subsidized farm inputs, and facilitation of essential imports, while SBP ensures liquidity and external buffer management. Alongside this, structural reforms to build climate resilience, crop insurance, and disaster financing frameworks are essential to mitigate future shocks and lay the foundation for sustainable growth.

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