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MPS REVIEW

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

ICMA Research and Publications Department

Preamble

15th September 2026: The State Bank of Pakistan (SBP), in its Monetary Policy Committee (MPC) meeting held on September 14, 2026, decided to maintain the policy rate at 11.5 percent. The decision reflects a cautious balance between the gradual recovery in economic activity and rising inflationary and external risks amid elevated food and energy prices, geopolitical tensions and global supply-chain disruptions. Against this backdrop, this review uses ICMA's Supply Shock Resilience Index (SSRI) to assess Pakistan's capacity to absorb external supply shocks and evaluate the appropriateness of the prevailing monetary policy stance.

Assessing Pakistan's Resilience to External Supply Shocks: An ICMA Supply Shock Resilience Index (SSRI)

External supply shocks pose a distinct challenge for monetary policy in Pakistan because their inflationary effects can emerge independently of domestic demand conditions. This challenge has become particularly relevant amid the ongoing Middle East conflict, which has increased uncertainty surrounding global energy prices, freight and insurance costs, and supply chains. Such pressures, together with exchange-rate and external financing conditions, can raise domestic production and import costs and transmit into consumer prices. While monetary tightening can contain second-round inflationary effects and anchor inflation expectations, it cannot directly eliminate the underlying supply constraint.

The appropriate monetary policy response therefore depends not only on the magnitude of the shock, but also on the economy's capacity to absorb it. This distinction is particularly important for Pakistan, where geopolitical disruptions can transmit through energy imports, trade and external financing channels. Stronger foreign-exchange reserves, greater import coverage through exports and remittances, lower dependence on critical imports and exchange-rate stability can reduce the likelihood of an external disturbance developing into persistent macroeconomic instability.

Against this backdrop, ICMA has developed the Supply Shock Resilience Index (SSRI) to assess Pakistan's capacity to withstand external supply-side disturbances and provide an additional analytical dimension for evaluating monetary policy under supply-driven inflationary pressures. The index is particularly relevant in the prevailing environment, where geopolitical shocks can simultaneously affect commodity prices, import costs and external-sector conditions.

The SSRI combines six indicators across two dimensions of shock resilience. Reserve Adequacy Ratio (RAR), Export Coverage Ratio (ECR) and Remittance Coverage Ratio (RCR) represent external shock-absorption capacity, whereas Oil Import Share (OIS), Food Import Share (FIS) and Exchange Rate Volatility Index (ERVI) capture sources of external vulnerability.

Since these indicators have different measurement units, each variable is transformed onto a common 0–1 scale through Min-Max normalization. Capacity indicators are normalized so that higher values indicate stronger resilience, while vulnerability indicators are reverse-normalized, ensuring that higher scores consistently represent greater resilience.

Disclaimer: For the complete analysis of the SSRI framework or for any queries regarding the analysis, please contact the Research & Publications Department at **rp@icmap.com.pk**

Supply Shock Resilience Index (SSRI)

$$SSRI = \frac{RAR + ECR + RCR + OIS + FIS + ERVI}{6}$$

Where

Reserve Adequacy Ratio ***(RAR)*** | Export Coverage Ratio ***(ECR)*** | Remittance Coverage Ratio ***(RCR)*** | Oil Import Share ***(OIS)*** | Food Import Share ***(FIS)*** | Exchange Rate Volatility Index ***(ERVI)***

Rule to Judge

SSRI	Interpretation
0.80–1.00	Very High Resilience
0.60–0.79	High Resilience
0.40–0.59	Moderate Resilience
0.20–0.39	Low Resilience
0.00–0.19	Very Low Resilience

Higher normalized values indicate stronger resilience. OIS, FIS and ERVI are reverse-normalized.

Note: A higher SSRI indicates greater capacity to absorb and withstand external supply shocks, while a lower SSRI indicates greater vulnerability. "High" resilience (0.60–0.79) suggests relatively strong shock-absorption capacity, whereas "Moderate" resilience (0.40–0.59) indicates some capacity to absorb shocks but with notable vulnerabilities.

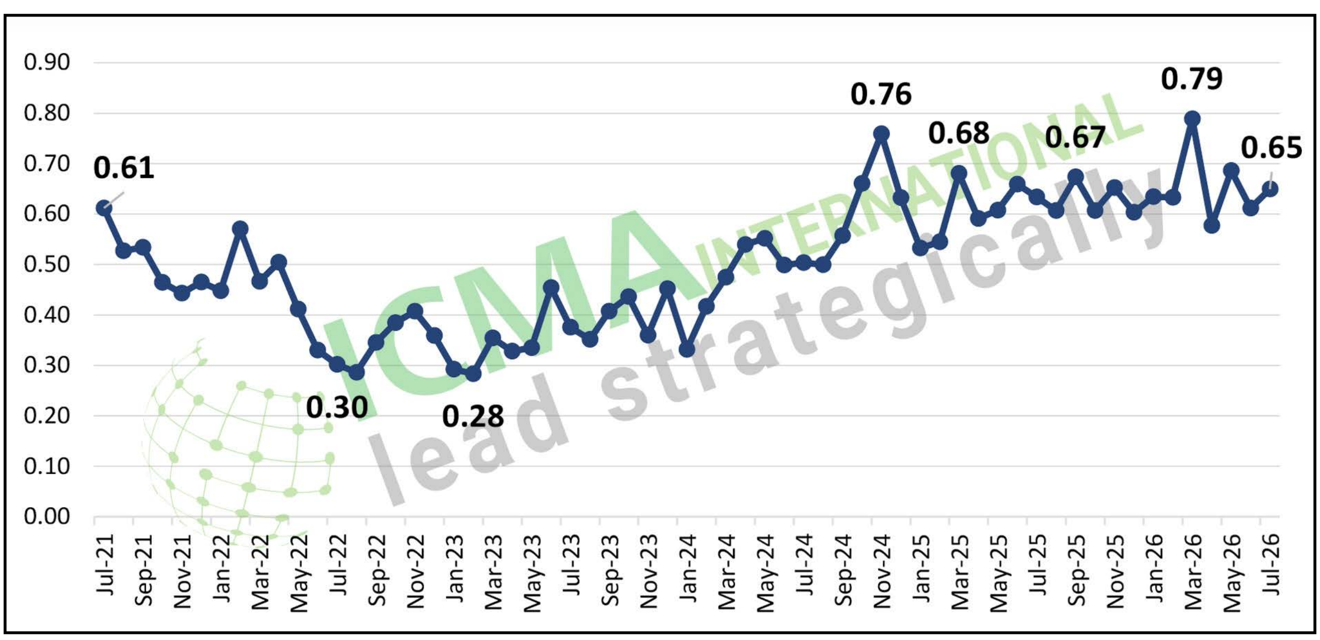
Disclaimer: The SSRI framework is informed by the Handbook on Constructing Composite Indicators (OECD, European Union and European Commission Joint Research Centre, 2008), the IMF's Assessing Reserve Adequacy in Low-Income Countries (2013), and UNCTAD's The State of Commodity Dependence reports, and remains subject to further methodological refinement.

Interpretation

- Pakistan's supply-shock resilience has improved, but the recovery remains uneven across the underlying buffers. The SSRI increased from the weak levels observed during 2022–23 to 0.65 in July 2026, placing Pakistan in the High Resilience range (Figure 1). However, the improvement is concentrated in selected components rather than being broad-based. This indicates that Pakistan currently has a stronger capacity to absorb external disturbances, although resilience could weaken if multiple external pressures emerge simultaneously.

- Exchange-rate stability currently provides the strongest protection against the domestic transmission of external shocks. ERVI reached 0.99 in July 2026, the highest component score in the SSRI (Table 1). Lower exchange-rate volatility reduces the likelihood that increases in global commodity prices are reinforced by currency depreciation. This weakens an important exchange-rate pass-through channel through which external shocks raise the rupee cost of imported fuel, food, intermediate inputs and ultimately domestic inflation.

Figure 1 : Pakistan's Supply Shock Resilience Index (SSRI), July 2021–July 2026



Source: Author's Calculation using the data from SBP

- Moderate reserve, export and remittance coverage indicates that Pakistan's external financing capacity remains less resilient than current exchange-rate conditions suggest. RAR, ECR and RCR recorded scores of 0.54, 0.43 and 0.50, respectively, in July 2026 (Table 1). These buffers are important for financing a higher import bill without placing excessive pressure on foreign-exchange reserves or the exchange rate. Weakness in recurring foreign-exchange earnings can therefore increase vulnerability to external shocks.

Table 1: Composition of Pakistan's Supply Shock Resilience Index for July 2026

Component	Jul-26	Resilience Assessment
Reserve Adequacy (RAR)	0.54	Moderate
Export Coverage (ECR)	0.43	Moderate
Remittance Coverage (RCR)	0.50	Moderate
Oil Import Share (OIS)	1.00	Very High
Food Import Exposure (FIS)	0.44	Moderate
Exchange Rate Stability (ERVI)	0.99	Very High
Overall SSRI	**0.65**	**High**

- The difference between oil and food-import resilience highlights that different supply shocks can have different inflationary effects. The normalized resilience score for Oil Import Share was very high at 1.00, while food-import resilience remained moderate at 0.44 in July 2026 (Table 1). This suggests that food-related external disruptions may pose a greater vulnerability than oil-related shocks at present. Since these pressures originate mainly from supply and cost channels, interest-rate tightening alone cannot remove their underlying causes.

- The current high SSRI suggests that Pakistan has some capacity to absorb external supply shocks. Therefore, a temporary supply shock may not require an immediate increase in interest rates and could instead be addressed through targeted supply-side measures. However, if the shock puts pressure on foreign exchange, inflation expectations and broader inflation, monetary policy action may become necessary.

ICMA Analysis: Pakistan's SSRI stands at 0.65 in July 2026, placing it in the High Resilience category. However, resilience remains uneven across the components. Exchange-rate stability and favorable oil-import share provide the strongest buffers, while reserve adequacy, export coverage, remittance coverage and food-import resilience remain moderate.

Trend: The SSRI has improved from the weak levels observed during 2022–23, indicating a gradual strengthening of Pakistan's capacity to absorb external supply shocks. However, the improvement remains concentrated in selected components rather than being broad-based.

Suggestion: SBP should continue building foreign-exchange reserves during periods of strong inflows, while the government should support export growth and formal remittance channels to strengthen recurring foreign-exchange earnings. For food and critical imports, authorities should improve strategic stocks, diversify import suppliers and establish contingency sourcing arrangements to reduce exposure to future external supply disruptions.

ICMA Policy Recommendations

Strengthen Foreign-Exchange Buffers

The analysis indicates that reserve resilience remains comparatively weaker than the recent improvement in exchange-rate stability. SBP should therefore continue building foreign-exchange reserves during favorable inflow periods to strengthen import-financing capacity and provide a stronger buffer against future external shocks.

Strengthen Export and Remittance-Based Foreign-Exchange Inflows

The analysis shows that external resilience is not yet supported by consistently strong export and remittance coverage. SBP and the government should therefore facilitate export-oriented industries and formal remittance channels to strengthen recurring foreign-exchange earnings and reduce reliance on reserves during periods of external pressure.

Strengthen Food and Energy Supply-Shock Management

The analysis highlights that Pakistan's resilience to import-related shocks remain uneven, particularly in relation to food-import exposure. The government should strengthen strategic stock management and timely procurement of essential commodities to limit the transmission of international food and energy disruptions into domestic prices.

Diversify Sources of Critical Imports

The SSRI findings demonstrate that import dependence remains an important channel through which global supply disturbances can affect domestic resilience. The government should diversify suppliers of essential food, fuel and industrial inputs and establish contingency sourcing arrangements to reduce exposure to geopolitical and global supply-chain disruptions.

Integrate Supply-Shock Resilience into Monetary Policy Monitoring

The variation across SSRI components shows that the headline index alone may not fully capture emerging external vulnerabilities. SBP should therefore monitor reserve adequacy, external earnings, import exposure and exchange-rate stability alongside inflation to identify changes in shock-absorption capacity when assessing the appropriate monetary policy response.

Industry and Experts' Insights

Mr. Asfandyar Farrukh Chairman, Chainstore Association of Pakistan, sharing his views with ICMA Research and Publications Department he termed the SBP's decision to retain the 11.5% policy rate appropriate, noting that further tightening would raise pressure on businesses, consumers and public debt servicing. He stressed that the unchanged rate is a pause rather than a growth signal, as prevailing inflation is largely cost-push and imported. With elevated financing costs continuing to constrain investment and demand, he called for gradual rate cuts complemented by fiscal, tax and energy reforms to restore business confidence and support sustainable growth.

Mr. Usman Shaukat, President, Rawalpindi Chamber of Commerce & Industry (RCCI), termed the decision prudent amid renewed international energy and commodity price pressures. He noted that maintaining the current rate supports inflation and macroeconomic stability, but the persistence of high financing costs continues to constrain private investment, industrial activity and SME credit demand. He added that, as external cost pressures moderate the inflation outlook improves but a gradual easing of monetary conditions could strengthen the transmission of credit to productive sectors, lower the cost of capital, stimulate investment and support export-oriented growth, while safeguarding the stability achieved so far.

Mr. Zulfiqar Alam, CEO of Pakistan Housing Finance Company Limited viewed the unchanged 11.5% policy rate as a cautious pause rather than a policy shift. He noted that while inflation, oil prices and geopolitical risks could warrant tighter policy, current pressures are largely supply-driven and imported, limiting the immediate impact of further rate hikes. With the existing rate remaining restrictive, the policy outlook will hinge on whether these pressures spill over into core inflation, wages, services and expectations, alongside oil prices, exchange-rate stability and fiscal conditions.

Assessing the SBP's decision, ***Dr. Imran Batada, President and CEO, Pakistan Freelancers Association (PAFLA),*** said that retaining the 11.5% policy rate reflects a cautious response to renewed global volatility. He noted that improved external conditions, including a narrower current account deficit, stronger remittances and an upgraded sovereign credit rating, have reduced the need for an immediate policy response to short-term shocks. However, high borrowing costs continue to restrict SME expansion, export activity and investment in technology and freelance businesses. He added that easing inflationary pressures and further strengthening of the external position could create room for rate cuts to support investment, employment and productive economic activity.

Mr. Faisal Sharif, Director, South Asia Region GAC Group (Chinese State-Owned Automotive Giant) said the SBP's decision to retain the policy rate at 11.5% was broadly anticipated. He noted that escalating Middle East tensions and higher global fuel prices could raise Pakistan's import costs and place renewed pressure on domestic inflation. In his view, the unchanged rate represents a measured response to the emerging external shock while allowing the economy to sustain its recovery momentum and stability.

Mr. Atif Ikram Sheikh, President of the Federation of Pakistan Chambers of Commerce and Industry (FPCCI), voicing his views termed the decision of SBP to retain the policy rate at 11.5% highly contractionary for the business sector. He argued that elevated financing costs are suppressing private-sector credit, constraining industrial investment and reducing the competitiveness of export-oriented industries. With businesses also facing high energy and petroleum costs and rising geoeconomic uncertainty, he called for a shift towards a single-digit policy rate to reduce the cost of capital, restore credit flows and support industrial and export activity.

MPC Observations on Key Sectors

Real Sector

- Economic activity gradually recovered after slowing during Q4-FY26 due to conflict-related disruptions.
- High-frequency indicators, including POL sales, private-sector credit, textile exports, business sentiment, nighttime lights and gas-emission data, indicated improved economic activity during July.
- Increased acreage for rice and sugarcane, together with encouraging initial cotton arrivals, improved the agriculture-sector outlook.

- **Outlook:** ICMA expects the unchanged policy rate to preserve macroeconomic stability without materially interrupting the emerging recovery. However, elevated borrowing costs and external supply uncertainties may continue to constrain private investment and production growth.

External Sector

- Growth in imports of goods and services exceeded the increase in exports during July, although robust workers' remittances helped contain the current account deficit.
- Eurobond proceeds and continued foreign-exchange purchases increased SBP's reserves to US$21.4 billion.
- SBP expects remittances and ICT exports to help contain the FY27 current account deficit within 0–1 percent of GDP.
- Foreign-exchange reserves are projected to approach three months of import cover by June 2027.

- **Outlook:** ICMA expects the current monetary stance, stronger remittance inflows and continued reserve accumulation to support external stability. Nevertheless, moderate export and remittance coverage under the SSRI indicates that Pakistan remains vulnerable to a sustained rise in commodity prices or prolonged supply-chain disruptions.

Fiscal Sector

- Fiscal consolidation during FY26 exceeded budgetary targets, mainly because of contained current expenditure and lower interest payments.
- FBR tax collection remained aligned with its targets during July–August FY27, although collection growth slowed compared with the previous year.
- SBP transferred a profit of Rs1.9 trillion to the government, exceeding the budgeted amount of Rs1.4 trillion and improving the FY27 fiscal outlook.
- The MPC emphasized broadening the tax base and reducing public-sector enterprise losses.

- **Outlook:** ICMA believes that the unchanged policy rate will complement fiscal consolidation by limiting additional debt-servicing pressures. However, the improvement arising from higher SBP profit is largely non-recurring, making sustained tax reforms and expenditure discipline essential for durable fiscal stability.

Money and Credit

- Broad money growth moderated to 11.6 percent as of August 28, compared with 13.2 percent at the time of the previous MPC meeting.
- Private-sector credit increased by 13.4 percent, supported by lower net budgetary borrowing and the gradual recovery in economic activity.
- Credit growth was broad-based across working capital, fixed investment and consumer financing.

- **Outlook:** ICMA expects private-sector credit to strengthen alongside the recovery in economic activity. However, the 11.5 percent policy rate may continue to limit credit demand among smaller firms and interest-sensitive industries, particularly if inflationary uncertainty persists.

Inflation

- Headline inflation increased from 9.2 percent in July to 11.1 percent in August 2026.
- Food inflation rose due to higher prices of wheat, related products and perishable commodities.
- Higher energy and transportation costs pushed core inflation to 8.7 percent.
- Inflation expectations among consumers and businesses increased, while geopolitical and weather-related risks intensified.
- Inflation is expected to ease gradually towards the upper bound of the 5–7 percent target range by June 2027.

- **Outlook:** ICMA considers maintaining the policy rate at 11.5 percent appropriate for anchoring expectations and containing the second-round effects of food and energy inflation. However, because the current pressures largely originate from supply-side factors, monetary restraint should be complemented by targeted food, energy and supply-chain measures.

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