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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 April 27, 2026 meeting, raised the policy rate by 100 basis points to 11.50 percent, citing rising inflationary pressures and heightened global uncertainty amid the prolonged Middle East conflict. Inflation rose to 7.3 percent in March (core 7.8 percent), while higher energy prices, supply chain disruptions, and weakening expectations reinforced the need for a tighter stance to anchor inflation and contain second-round effects. On the domestic side, economic activity improved with H1-FY26 GDP growth at 3.8 percent, alongside a current account surplus during July–March FY26 and SBP reserves at $15.8 billion, supported by Eurobond issuance and an IMF staff-level agreement.

ICMA's latest analysis, using the Sectoral Credit Transmission Gap (SCTG) framework, reveals a more nuanced picture of credit dynamics across sectors. While overall credit transmission appears to be functioning, the distribution of credit remains uneven, raising important questions about allocative efficiency and its alignment with growth objectives that warrant closer examination.

Against this backdrop of rising inflation, external uncertainty, and evolving credit dynamics, the MPC emphasized continued fiscal discipline, external buffer strengthening, and structural reforms to ensure macroeconomic stability and sustainable growth.

## Credit is flowing, yet not driving growth: ICMA identifies structural misallocation in Pakistan's economy

Effective monetary policy transmission is essential for macroeconomic stability and growth, but a key structural challenge is the misallocation of credit away from high-productivity sectors toward lower-productivity uses, alongside persistent under-financing of productive sectors. Global evidence, including IMF and Bank for International Settlements (BIS) research, shows that such inefficiencies reduce allocative efficiency, weaken productivity growth, lower GDP growth, and can increase financial instability by preventing capital from flowing to its most productive uses. Together, this literature highlights that credit allocation efficiency; not just total credit expansion, is a critical determinant of long-term economic performance, productivity, and sustainable growth.

## Toward Efficient Sectoral Credit Allocation: A Targeted Credit Rebalancing Framework

In this study, ICMA introduces the Sectoral Credit Transmission Gap (SCTG) framework, an expanded extension of the earlier Manufacturing Credit Transmission Gap (MCTG) model presented in the **ICMA Monetary Policy Statement Review on 10 March 2026.** The SCTG measures the divergence between sectoral credit growth and sectoral output growth to assess whether credit allocation aligns with real economic activity across agriculture, manufacturing, and services in Pakistan. The framework is consistent with international approaches such as the Bank for International Settlements (BIS) credit gap methodology and IMF financial stability analysis, widely used under Basel III as indicators of credit imbalances and macroprudential risk.

## Sectoral Credit Transmission Gap (SCTG) Model

The Sectoral Credit Transmission Gap represents the difference between the growth of bank credit to a sector and the output growth of that sector.

**SCTG = % Credit Growth of a Sector – % Output Growth of a Sector**

## Three Shades Rule to Judge the SCTG Ratio:

- (Yellow) **Positive SCTG > 0:** Credit growth exceeds output growth
  *Potential over-financing or inefficiency risk*
- (Red) **Negative SCTG (<0):** Output growth exceeds credit growth
  *Credit constraint or under-financing*
- (Green) **SCTG ≈ 0:** Balanced Financial Intervention

## ICMA Analysis: Credit constrained in manufacturing, expanding in agriculture, stable in services

| Sectors | SCTG Model | 2024-25 | | | | 2025-26 | | |
|---|---|---|---|---|---|---|---|---|
| | | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| **Agriculture** | Credit Growth % | -0.30 | 5.08 | 0.11 | 2.41 | 3.07 | 4.77 | -1.34 |
| | Output Growth % | 1.12 | 1.72 | 2.36 | 0.93 | 2.72 | 1.76 | N/A |
| | **Credit Transmission Gap %** | -1.41 | 3.36 | -2.25 | 1.49 | 0.36 | 3.01 | N/A |
| **Manufacturing** | Credit Growth% | -0.70 | 9.66 | -4.32 | -0.58 | -0.66 | 3.83 | 0.06 |
| | Output Growth % | 1.79 | 0.49 | 0.95 | 4.75 | 5.66 | 6.78 | N/A |
| | **Credit Transmission Gap %** | -2.48 | 9.17 | -5.27 | -5.33 | -6.31 | -2.94 | N/A |
| **Services** | Credit Growth % | -0.13 | 6.73 | -2.66 | 2.52 | 1.24 | 3.49 | 0.73 |
| | Output Growth % | 2.39 | 2.80 | 3.09 | 3.83 | 2.44 | 3.69 | N/A |
| | **Credit Transmission Gap %** | -2.52 | 3.93 | -5.75 | -1.31 | -1.20 | -0.21 | N/A |

***Data Sources:*** *Analysis and SCTG Model generated by ICMA based on SBP Data.* | ***Note:*** *"N/A" represents data is not officially available.*

## Interpretation

- Agriculture Sector shows fluctuations with a recent move toward positive SCTG, meaning credit is growing faster than output. However, this should be viewed carefully because agricultural production naturally responds with a time lag due to crop cycles and structural factors. The current gap likely reflects early-stage credit expansion, where output benefits will appear later. This calls for monitoring how effectively credit is being used, rather than immediately treating it as inefficiency.

- Manufacturing Sector shows consistently large negative SCTG, indicating that output is growing but credit support remains insufficient. This highlights a structural shortage of financing in the most productive and investment-driven sector. The lack of adequate credit is likely restricting industrial expansion and limiting overall economic growth.

- The Services Sector is close to balance, with SCTG values near zero. This suggests that credit and output are broadly aligned, indicating relatively efficient credit allocation with limited distortion at present.

***Overall, the results show that Pakistan's monetary system is working, but credit is not distributed efficiently across sectors. The main issue is not the total amount of credit, but where it is going and how effectively it supports output.***

***Manufacturing remains clearly under-financed despite strong output growth, while the recent increase in agricultural credit may reflect timing lags in output realization rather than immediate inefficiency; however, close and continuous monitoring is essential to ensure efficient resource allocation and credit productivity. The services sector is relatively stable. This situation suggests that policy should focus on better targeting of credit across sectors, rather than relying only on overall monetary tightening or easing.***

# ICMA Policy Recommendations

### 1. Introduce a Sectoral Credit Allocation System at SBP

Develop a real-time monitoring system integrating credit flows (SBP banking data) with sectoral output (PBS) to track SCTG monthly. This would allow early detection of misallocation and support evidence-based monetary and macroprudential decisions.

### 2. Expand Targeted Refinance Facilities for Manufacturing SMEs

Scale up concessional refinancing and credit lines for manufacturing SMEs, especially export-oriented and value-added industries. This should include lower policy-linked lending rates and simplified collateral requirements.

### 3. Shift Agricultural Credit Toward Productivity-Linked Financing

Reform agricultural lending by linking credit access to productivity indicators such as yield improvement, mechanization, and climate-smart practices instead of volume-based disbursement.

### 4. Strengthen Credit Guarantee Schemes for Manufacturing Expansion

Expand Government-backed credit guarantee programs to reduce lending risk in manufacturing and SMEs, encouraging banks to shift portfolios toward productive sectors.

**The Research and Publications (R&P) Department of ICMA solicited perspectives from distinguished experts, business leaders, and industrialists regarding the State Bank of Pakistan's (SBP) recent decision to increase the policy rate by 100 basis points to 11.5%, thereby sustaining a tighter monetary policy stance amid the protracted conflict in the Middle East. A summary of their views is presented below.**

# Experts' Insight

**Dr. Ashfaque Hasan Khan, Former Economic Advisor, Director General Debt Office and Special Secretary Finance, and currently Director General, NUST Institute of Policy Studies,** told ICMA R&P Department that it was not the right policy decision by SBP. He said that if prices in Pakistan are rising, it is not because of excessive demand but due to the rise in oil prices and disruption in the supply chain, over which there is no control. He questioned whether raising the interest rate can reduce the price of oil or restore the supply chain, and maintained that the shock is coming from the supply side, for which the interest rate is not an ideal policy instrument. He further explained that high interest rates will have a serious impact on the budget as interest payments will increase, which will widen the fiscal deficit, leading to more borrowing to bridge the revenue-expenditure gap and further accumulation of public debt. Secondly, he noted that high interest rates will increase the cost of production, which will be passed on to consumers, thereby adding to inflationary pressure. The bottom line, he said, is that since Pakistan had committed to the IMF in the last review, the increase in the interest rate had to be made; however, this has nothing to do with Pakistan's current economic fundamentals. Overall, he concluded that it was a bad decision, and at best the status quo should have been maintained.

**Prof. Dr. Shahida Wizarat, a renowned economist,** during a conversation with ICMA R&P Department, stated that the SBP's decision to raise the policy rate by 100 bps is linked to intensifying regional instability and rising global energy costs, particularly in petroleum and gas. She explained that higher fuel and utility prices have pushed up transportation and production expenses, resulting in widespread cost-push inflation as input costs continue to escalate across the economy. Prof. Wizarat noted that inflation management in Pakistan has traditionally relied on a demand-side approach since the 1990s.

She argued that this policy direction has constrained economic growth and has been reinforced through IMF-aligned frameworks, despite earlier warnings about its limitations. She maintained that alternative policy tools are available to address supply-driven inflation more effectively, but expressed concern that current monetary policy decisions appear insufficiently aligned with broader economic fundamentals. In her assessment, the prevailing inflationary and policy shifts are largely shaped by geostrategic developments rather than purely domestic economic conditions in Pakistan.

**Dr. Manzoor Ahmad, member of the Prime Minister's Committee on Tariff and former Pakistan Ambassador to the WTO** shared that the SBP should have followed other countries in adopting a wait-and-see approach. He said that if a rate hike was necessary, a modest 50 basis point increase would have sufficed, helping balance inflation concerns with the need to avoid prolonging economic stagnation and support growth.

**Dr. Ikram ul Haq, Advisory Board member and Visiting Senior Fellow at the Pakistan Institute of Development Economics (PIDE)** noted that the 100-point increase in the discount rate is in line with expectations, given rising inflation and heightened uncertainty in the wake of the unwarranted and unlawful war imposed on Iran by the United States and Israel. He emphasized that geopolitical conflicts in energy-producing regions are not distant events—they directly shape domestic economic realities, influence policy choices, and test institutional resilience. In this backdrop, he added, the SBP committee's decision is grounded in objective reality.

**Mr. Aadil Nakhoda, a faculty member at IBA Karachi and Chair of the Economic Advisory Group (EAG)** said that it is important to weigh macroeconomic stability against the immediate vulnerabilities of the industrial base, which is already struggling with high electricity tariffs, fuel prices, transport premiums, and the risk of energy shortages. He noted that the sector has yet to recover from the three-year balance of payments crisis, and that the rate hike could lead to an adverse investment shock. He expressed the view that fiscal policy needs to be strengthened to address these challenges, as monetary policy has a longer-term impact, particularly as the ceasefire continues to hold. He suggested that targeted subsidies should be used to absorb rising costs, as higher interest rates can adversely impact production and worsen economic conditions if investor and business confidence declines. However, he acknowledged that fiscal space is also severely constrained. He further observed that the SBP relies heavily on tools to anchor inflation expectations, rather than on the government's plan to reduce demand while providing subsidies to poorer segments of society. He added that while the monetary cost of raising interest rates can be high, the SBP may be aiming to stabilize the impact of price shocks without market distortions and trade flow disruptions, which could worsen if the oil price shock leads to currency depreciation.

## Industry's Perspective

**Mr. Atif Ikram Sheikh, President of the Federation of Pakistan Chambers of Commerce & Industry (FPCCI),** in a message to ICMA R&P Department, expressed profound concern and unequivocally rejected SBP Monetary Policy Committee decision to increase the key policy rate by 1 percent. He termed the move ill-timed and unfortunate, stating that the economy was entering a take-off stage after stabilization. He noted that FPCCI had already cautioned that continued monetary tightening would severely impact the struggling industrial and export sectors. He emphasized that Pakistan no longer needs contractionary monetary and fiscal policies, as a high-interest rate environment contradicts the goals of economic revival, export growth, and job creation, while rendering Pakistani products uncompetitive in regional and global markets.

He strongly condemned the decision, calling it a setback for the business community, and said industries cannot survive or expand under such a high cost of borrowing, especially while competing with regional economies that operate at much lower interest rates. He added that instead of controlling inflation, largely driven by administrative energy pricing and supply chain inefficiencies, the policy will further increase the cost of doing business, restrict private sector credit, and intensify deindustrialization pressures. He further stated that the government cannot rely on squeezing trade and industry while expecting economic growth. He demanded that SBP reconsider the monetary policy direction and adopt a comprehensive, growth-oriented macroeconomic framework focused on broadening the tax base and reducing energy and borrowing costs for export-oriented and manufacturing sectors.

**Mr. Usman Shaukat, President of Rawalpindi Chamber of Commerce and Industry (RCCI),** expressed strong reservations over SBP's decision to raise the policy rate by 100 basis points. He termed the move unfavorable for business and industrial growth, particularly at a time when the economy is already facing global uncertainties. He stated that given the ongoing geopolitical tensions, especially the Iran–US/Israel conflict, the business community had expected SBP to maintain the policy rate. He noted that with diplomatic efforts and a ceasefire raising hopes for stability, the rate hike appears untimely. "The private sector is under immense strain, and SBP's decision is further worsening the challenges faced by manufacturers and exporters," he said. He emphasized that high interest rates increase the cost of doing business, discourage investment, and weaken export competitiveness, ultimately slowing economic activity. He urged SBP to review the policy stance, reiterating his demand to bring the policy rate down to single digits once the regional situation stabilizes.

**Muhammad Rehan Hanif, President of the Karachi Chamber of Commerce & Industry (KCCI),** in a message to ICMA Research and Publications Department, expressed serious concern over SBP's decision to raise the policy rate by 100 basis points. He said inflation in Pakistan was relatively contained before the recent escalation in the US-Iran conflict, and while it has edged up since, the increase does not justify monetary tightening. He noted that even earlier, with lower inflation, the policy rate of 10.5 percent was considered excessive and had been consistently opposed by the business community, which has repeatedly called for a reduction to single digits in line with regional peers. He stated that SBP could have maintained the status quo, terming the move imprudent as it will increase borrowing costs, raise the cost of doing business, and discourage investment and expansion. He added that regional economies facing similar shocks are maintaining lower single-digit interest rates, placing Pakistan at a competitive disadvantage. He urged SBP to adopt a more balanced, growth-oriented monetary stance aligned with business needs and economic stability.

**Mr. Kashif Anwar, former President of the Lahore Chamber of Commerce and Industry (LCCI),** is of the view that SBP decision to raise the policy rate was largely expected and could have gone up to 2 percent, driven mainly by rising regional tensions around the Strait of Hormuz and broader geopolitical uncertainty. He said inflation is being driven by rising energy prices, including petrol, electricity and gas, which are increasing overall production and living costs, and added that despite earlier signs of easing inflation, pressures remain strong and the rate hike will further raise the cost of doing business. He noted that had the decision not been taken now, it would likely have followed in the next MPC meeting, and called for a balanced approach through fuel price adjustments in line with actual costs. Referring to external factors, he pointed to IMF related pressures following recent staff level discussions, including tax base expansion, reduced export incentives, improved tax compliance, subsidy rationalization and privatization of state-owned enterprises, alongside concerns over revenue shortfalls and policy adjustments in exports and real estate. In conclusion, he said the hike was expected and warned that interest rates may continue to rise unless regional stability improves.

# MPC Observations on Key Sectors

## Real Sector

- Real GDP grew by 3.9% in Q2-FY26, with H1-FY26 growth at 3.8%, indicating broad-based recovery.
- LSM rose by 5.9% during July–February FY26, reflecting strong industrial performance.
- High-frequency indicators remained strong till February but moderated in March.
- Agriculture outlook weakened slightly due to lower wheat output (FCA estimates).
- External risks, including the Middle East conflict, may weigh on Q4 activity.
- GDP outlook: FY26 growth likely near the lower bound, with further moderation expected in FY27 amid geopolitical risks.

## External Sector

- Current account recorded a cumulative surplus during July–March FY26, supported by surpluses in February and March.
- Remittances remained the key driver of external stability.
- FY26 current account is expected near the lower end of the projected range amid weak terms-of-trade.
- External inflows via bilateral financing and Eurobonds cushioned debt repayments and supported SBP reserves.
- SBP reserves are projected to exceed $18 billion by June 2026.
- Outlook: FX buffers need further strengthening amid persistent global uncertainty.

## Fiscal Sector

- FBR tax collection fell short of target in March, widening the cumulative shortfall to Rs. 611 billion during July–March FY26.
- Despite revenue shortfall, financing data suggests the fiscal deficit remained contained up to March.
- The Middle East conflict has increased fiscal pressures, particularly through higher global oil prices.
- Targeted subsidies were provided to protect vulnerable groups from the pass-through of higher energy costs.
- Achieving the full-year primary surplus may require additional expenditure rationalization.
- Outlook: Sustained fiscal reforms; particularly tax base broadening and reduction in SOE losses, remain critical for strengthening fiscal sustainability and resilience.

## Money and Credit

- Broad money growth slowed to 14.5% (from 16.0%), driven by lower government borrowing from banks.
- Private sector credit grew ~13%, supported by improving activity and earlier policy rate cuts.
- Credit flows expanded in working capital, fixed investment, and consumer finance during July–March FY26.
- Lending remained concentrated in textiles, wholesale & retail trade, and chemicals, with rising consumer finance signaling demand recovery.
- Currency in circulation and deposit growth both moderated since the last MPC meeting.

## Inflation

- Headline inflation rose to 7.3% in March, with core inflation at 7.8%.
- Energy price shock has pushed fuel costs higher, with partial pass-through to transport fares, while food inflation remained contained.
- Inflation is expected to rise to double digits in the near term before easing gradually.
- Outlook: Inflation likely to stay above the 5% to 7% target range for most of FY27.
- Risks include conflict duration, global energy pass-through, and fiscal slippages.

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