ICMA
PRE-MONETARY POLICY OUTLOOK
PRE-MP OUTLOOK
Analyzing the Drivers of Pakistan's Monetary Policy
ICMA Research and Publications Department

Assessing Pakistan's External Economic Stress through the ICMA External Economic Stress Index (EESI)

Preamble

22 October 2026: Pakistan faces renewed inflationary pressure and an uncertain global outlook ahead of the Monetary Policy Committee (MPC) meeting on 26 October 2026. In September, the State Bank of Pakistan (SBP) kept the policy rate at 11.5 percent, while headline inflation rose to double digits in August. Although monetary policy mainly responds to domestic inflation, economic activity and financial stability, changes in global commodity prices, supply chains and financial markets also affect Pakistan's economy.

Global developments affect Pakistan through more than imported inflation. Changes in global economic activity can influence exports, remittances and foreign investment. Higher oil and food prices increase import bills and production costs. Financial-market volatility can affect investment flows and investor confidence, while supply-chain disruptions can raise transport costs and limit access to imported industrial inputs. Together, these pressures can affect foreign-exchange availability, exchange-rate stability and domestic prices.

Against this backdrop, ICMA presents an updated **External Economic Stress Index (EESI)**, adapted from the IMF's external stress index framework[1]. The index tracks five international indicators: global economic activity, oil prices, food prices, financial-market volatility and supply-chain pressures. Each indicator is weighted according to Pakistan's exposure to that risk. The EESI brings these factors together to help assess external risks ahead of the next monetary policy decision.

ICMA's External Economic Stress Index (EESI)

EESI measures Pakistan's external economic stress by combining global shock indicators with Pakistan's structural exposure weights.

$$\mathbf{EESI_t} = \boldsymbol{\omega_1}(\mathbf{IGREA_t}) + \boldsymbol{\omega_2}(\mathbf{Oil_t}) + \boldsymbol{\omega_3}(\mathbf{Food_t}) + \boldsymbol{\omega_4}(\boldsymbol{VIX_t}) + \boldsymbol{\omega_5}(\boldsymbol{GSCPI_t})$$

- **IGREA** represents global real economic activity,
- **Oil** is the monthly crude oil price variation (YoY Changes),
- **Food** is the FAO Food Price Index variation (YoY Changes),
- **VIX** represents global financial volatility (YoY Changes),
- **GSCPI** captures global supply-chain pressures.

The negative sign on IGREA reflects the inverse relationship between global economic activity and external stress, while higher values of the remaining indicators signal greater stress. The weights are based on Pakistan's exports, remittances and FDI (IGREA); petroleum imports (Oil); food imports (Food); portfolio equity and investment-fund liabilities (VIX); and non-food, non-petroleum imports (GSCPI), each relative to nominal GDP.

Interpreting the EESI: Positive values indicate that external conditions are adding to Pakistan's economic stress, while negative values indicate easing external pressures; higher values signal greater stress.

[1]For more details, please look at the IMF report (link given). https://www.imf.org/-/media/files/publications/cr/2024/english/1mkdea2024001.pdf

The analysis starts in January 2023, when Pakistan faced severe external liquidity pressures and SBP reserves covered less than one month of imports. This period marks the start of the current external adjustment phase and avoids the unusual base effects of 2021–22. The US Treasury yield is excluded from ICMA's version of the index. Nearly 75 percent of Pakistan's external public debt is concessional and long-term, which may limit the direct effect of changes in global yields. Including this indicator would also give it a very large weight in the index.

Trend Line of Economic External Stress Index (Jan-2023 To Aug-2026)

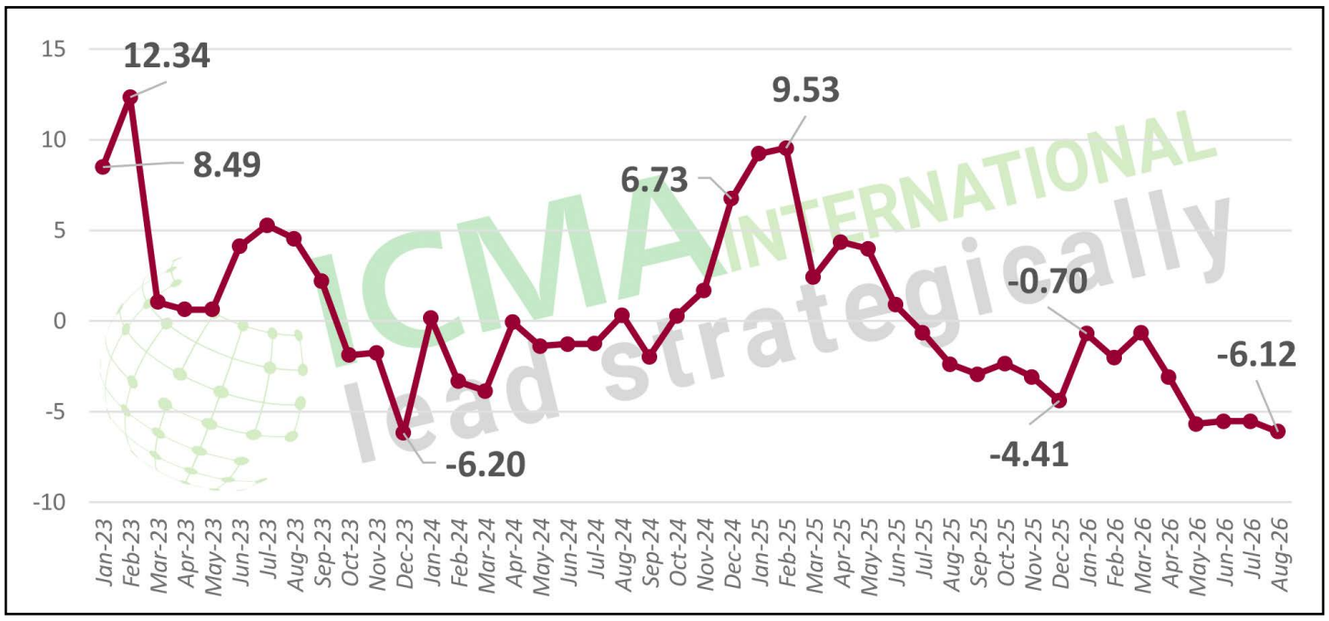


Table 1: Decomposition of Pakistan's External Economic Stress, August 2026

Indicator	Original value	Weight	Weighted contribution
IGREA	50.64	0.14	-7.09
Oil (YoY %)	26.54	0.03	+0.80
Food (YoY %)	2.52	0.02	+0.05
VIX (YoY %)	-3.30	0.02	-0.07
GSCPI	1.20	0.10	+0.12
EESI (Total)			-6.12

Interpretation

- External stress was high in early 2023 and early 2025. The EESI reached 12.34 in February 2023 and rose again to 9.53 in February 2025. These increases reflected Pakistan's exposure to changing commodity prices, tighter financial conditions and uncertainty in global markets. Stress later eased, although the index continued to fluctuate with changes in global conditions.

- After the US-Iran conflict escalated in February 2026, the global economic activity indicator increased from 28.54 in December 2025 to 50.64 in August 2026. Pakistan's external receipts provide some supporting context. Monthly workers' remittances rose from approximately US$3.6 billion to US$3.656 billion, while net foreign direct investment (FDI) changed from an outflow of US$134.7 million to an inflow of US$315.9 million. These figures show continued support from remittances and an improvement in net FDI alongside the stronger global activity reading. However, they do not prove that the conflict caused these changes.

- Pakistan's external receipts showed mixed developments. Remittances remained broadly stable, while FDI moved from a net outflow to a net inflow. Remittances continue to provide foreign exchange, and sustained FDI could support investment and production over time. However, monthly FDI can change sharply. Neither indicator directly measures global economic activity, so both should be treated as supporting evidence about Pakistan's external position rather than direct explanations for the rise in IGREA.

- The EESI fell to -6.12 in August 2026, mainly because global economic activity contributed -7.09 index points. This offset the upward contributions from oil prices (+0.80), food prices (+0.05) and global supply-chain pressures (+0.12), while the VIX contribution was -0.07. The negative reading reflects how the index is calculated; it does not mean that all external risks have eased. Remittances continued and net FDI improved, but higher oil prices and supply-chain pressures still pose risks to imported inflation and foreign-exchange availability ahead of the MPC decision.

The latest EESI shows that overall external stress can decline even when some risks remain high. The index fell to -6.12 in August 2026, mainly because global economic activity made a strong negative contribution. Remittances remained steady and net FDI turned positive, supporting foreign-exchange inflows. However, higher oil prices and supply-chain pressures remain risks. Continued remittances and sustained investment could help Pakistan achieve the IMF's projected 3.5 percent GDP growth for FY2026–27, but higher energy costs and geopolitical uncertainty could make this harder. A negative EESI reading therefore means lower net stress within the index, not that external risks have disappeared.

ICMA Policy Recommendations

1. **Introduce an External Financing Stress Test Before Future Rate Decisions**
   Although US Treasury yields are excluded from the EESI because most of Pakistan's external public debt is concessional, global borrowing costs still matter for maturing commercial loans, Eurobond refinancing and new market borrowing. SBP, in coordination with the Ministry of Finance, should assess how increases of 50 and 100 basis points in global benchmark yields would affect refinancing needs, foreign-exchange liquidity and the cost of new external borrowing. The assessment should focus on the commercial and variable-rate portion of external debt. This would allow the financing risk to be assessed separately alongside the EESI before MPC decisions.

2. **Differentiate Supply-Driven Inflation from Persistent Domestic Price Pressures**
   The EESI shows that overall external stress declined in 2026, even as international oil prices rose sharply and global supply-chain pressures reached their highest level since mid-2022. Since the negative contribution of global economic activity offsets some of these pressures in the EESI, SBP should assess them separately from the overall index. Commodity prices and supply-chain pressures should be monitored alongside core inflation, producer prices and inflation expectations to determine whether higher import costs are spreading through the economy. A temporary external price shock should not automatically lead to tighter monetary policy, but if it continues to affect underlying inflation, a policy response may be needed.

3. **Strengthen Foreign-Exchange Liquidity Planning for Higher Petroleum Import Costs**
   The EESI shows that oil-price pressures returned in 2026, even as overall external stress declined. Petroleum accounts for about one-fifth of Pakistan's goods imports. SBP and the Ministry of Finance should regularly assess upcoming external debt repayments, essential import payments, particularly for petroleum, and expected foreign-exchange inflows. If expected inflows are not enough to meet near-term payments, the authorities should arrange refinancing and secure financing facilities in advance. This would help manage short-term gaps in foreign-exchange availability without disruptive import restrictions or excessive intervention in the exchange rate.

4. **Introduce Scenario-Based External Risk Assessment into MPC Communication**
   The EESI shows that its current low reading depends heavily on strong global economic activity. If global demand weakens, external stress could rise quickly, even if oil prices and supply-chain pressures remain unchanged. SBP should include three external scenarios in its monetary policy assessments: the baseline outlook, a further rise in oil prices and supply-chain disruptions, and a slowdown in global economic activity. Each scenario should assess the possible effects on imported inflation, external financing needs and exchange-rate risks. The EESI should support these assessments rather than automatically determine the policy rate.