Monetary Policy Statement

September 15, 2025

1. The Monetary Policy Committee (MPC) decided to keep the policy rate unchanged at 11 percent in its meeting today. The Committee noted that inflation remained relatively moderate in both July and August, whereas core inflation continued to decline at a slower pace. Economic activity – as captured by high frequency economic indicators, including large-scale manufacturing (LSM) – gained further momentum. However, the near-term macroeconomic outlook has deteriorated slightly in the wake of the ongoing floods. This temporary yet significant flood-induced supply shock, particularly to the crop sector, may push up headline inflation and the current account deficit from earlier expectation in FY26. Meanwhile, economic growth is projected to moderate as compared to the previous assessment. In view of the evolving macroeconomic outlook and the flood-related uncertainty, the MPC deemed today's decision as appropriate to maintain price stability.

2. The MPC observed that the economy is on a significantly stronger footing to withstand the negative fallout of the ongoing floods as compared to previous major flood events. Given the low inflation environment, moderately growing domestic demand and relatively benign global commodity price outlook, the excessive inflationary and external account pressures witnessed after the previous floods, are projected to remain in check this time. Furthermore, the build-up in external and fiscal buffers over the past two years, which was achieved via a coordinated and prudent monetary and fiscal policy mix, will need to continue to make the economy more resilient to shocks and ensure higher growth on a sustainable basis.

3. The Committee noted the following key developments since its last meeting. First, SBP's FX reserves remained stable, despite net debt repayments and a current account deficit. Second, inflation expectations of both consumers and businesses inched up in September in the SBP-IBA sentiment surveys. Third, FBR tax collection fell slightly short of target during July-August 2025, though it grew significantly on y/y basis. Lastly, the announcement of revised import tariffs by the US has led to some reduction in global trade uncertainty.

4. In view of these developments and outlook, the MPC assessed that the real policy rate remains adequately positive to stabilize inflation within the medium-term target range of 5 – 7 percent, notwithstanding some expected short-term volatility in inflation outturns.

Real Sector

5. Incoming data of high-frequency indicators – such as machinery and intermediate goods imports, automobile and cement sales, private sector credit (PSC) and business confidence – continue to point toward strong underlying economic momentum from H2-FY25 onwards. Reflecting this momentum, LSM registered 3 percent y/y growth in Q4-FY25, after reporting contraction in the previous three quarters. However, the recent floods have moderated the overall growth outlook for FY26. Based on the currently available information, including satellite imagery, Kharif crops have incurred losses. These losses, together with flood-related supply chain disruptions, may also dampen activity in the manufacturing and services sectors in the near term. At the same time, the prospects for Rabi crops have somewhat improved in the wake of a likely increase in post-flood yields. Taking into account these developments, real GDP growth for FY26 is assessed to remain close to the lower end of the earlier projected range of 3.25 to 4.25 percent.

External Sector

6. The current account recorded a deficit of $254 million in July 2025, led by an increase in imports amidst a pickup in economic activity and some moderation in remittances. Despite this deficit and weak financial inflows, SBP's FX reserves remained stable around $14.3 billion as of September 5. Looking ahead, the external sector outlook remains susceptible to evolving domestic and global conditions. In particular, flood-related damage to crops is assessed to further widen the trade deficit, though this is likely to be partly offset by Pakistan's improved market access to the US. Moreover, remittances have remained resilient and may pick up further as experienced during previous episodes of natural disasters. On balance, the current account deficit is likely to remain in the earlier projected range of 0 to 1 percent of GDP in FY26. With the expected realization of planned official inflows, SBP's FX reserves are projected to reach around $15.5 billion by December 2025.

Fiscal Sector

7. In the first two months of FY26, FBR's tax collection recorded a 14.1 percent y/y growth. Furthermore, the transfer of sizeable budgeted profit of Rs2.4 trillion from SBP to the government and higher petroleum levy are expected to lead to a significant primary surplus in Q1-FY26. However, the MPC noted that the floods could increase current expenditures, besides leading to some potential slowdown in revenue collection. Going forward, the MPC reiterated the need to continue reforms, preferably through broadening the tax base and reforming loss-making SOEs, to create additional space for social and development spending, and to further build buffers to cushion the impact of future economic shocks.

Money and Credit

8. Since the last MPC meeting, the broad money (M2) growth decelerated to 13.9 percent y/y as of August 29, with some changes in its composition. Deposits remained the main driver of M2 growth, while currency in circulation saw a seasonal decline. Meanwhile, with the receipt of SBP profit, the net budgetary borrowing from the banking system declined sharply, while banks' credit to the non-government sector increased. PSC growth accelerated to 14.1 percent y/y, supported by easing financial conditions, improving economic activity and continued decline in budgetary borrowing. Notably, the expansion in credit was broad based, with increases recorded in working capital loans, fixed investment advances and consumer financing. The key borrowing sectors included textiles, telecommunications, and wholesale and retail trade. Going forward, the demand for private sector credit is likely to maintain its recent momentum, despite some risks arising from the anticipated post-flood slowdown in economic activity.

Inflation

9. Inflation rose to 4.1 percent y/y in July before falling to 3 percent in August. These outturns largely reflected volatility in food and energy prices, whereas core inflation remained on downward trajectory, albeit at a slower pace. The MPC noted that the recent floods have increased uncertainty related to the near-term inflation outlook, particularly for food inflation. Weekly SPI data has already recorded a substantial increase in prices of perishables and wheat and allied products. However, some of this impact of higher food prices on overall inflation is likely to be offset by recent favourable adjustments in electricity tariffs. On balance, the Committee assessed that inflation may cross the upper bound of the target range of 5 – 7 percent for most of the second half of FY26, before reverting to the target range in FY27. At the same time, the MPC observed that this outlook is susceptible to multiple risks, particularly those stemming from the evolving flood situation, volatile commodity prices, and unanticipated adjustments in energy prices.