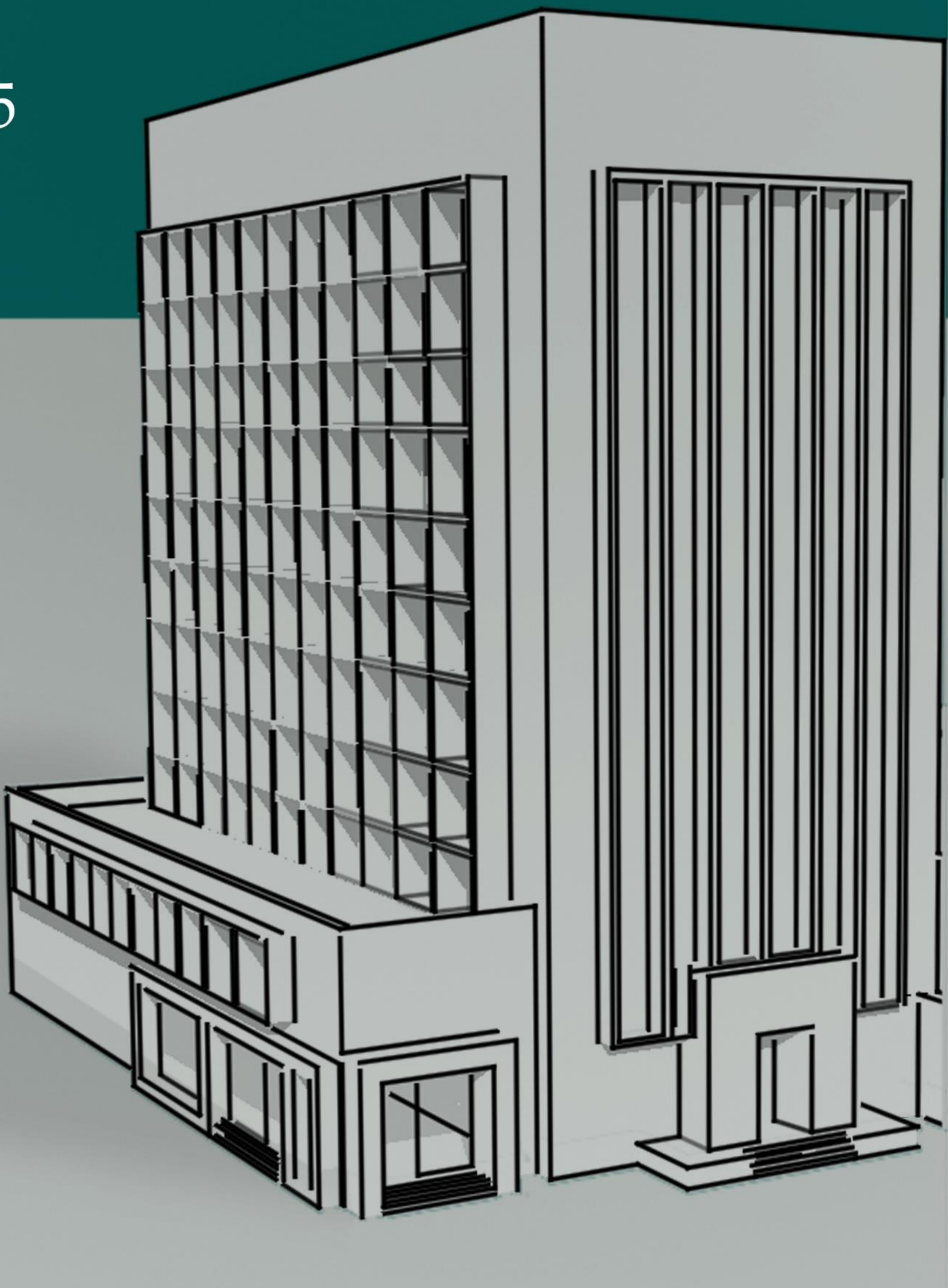
Monetary Policy Report

Staying the Course

August 2025



State Bank of Pakistan

Monetary Policy Report

August 2025

Monetary Policy Committee

Mr. Jameel Ahmad (Chairperson)	Governor, SBP
Mr. Saleem Ullah	Deputy Governor, SBP
Dr. Inayat Hussain	Executive Director, SBP
Mr. Muhammad Ali Malik	Executive Director, SBP
Mr. Fawad Anwar	Non-Executive Director, SBP Board
Mr. Muhammad Ali Latif	Non-Executive Director, SBP Board
Mr. Najaf Yawar Khan	Non-Executive Director, SBP Board
Dr. Hanid Mukhtar	External Member
Dr. Naved Hamid	External Member
Dr. S. M. Turab Hussain	External Member

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Preface

The conduct of monetary policy in Pakistan is governed under the State Bank of Pakistan Act, 1956, as amended up to 2022. The Act provides the Monetary Policy Committee of the State Bank of Pakistan (SBP) with the authority to independently formulate and implement monetary policy, aimed at fulfilling statutory objectives. The Act outlines the governance structure for the monetary policy decisions.

SBP's Objectives

Article 4B of the SBP Act states that:
(1) The primary objective of the Bank shall be to achieve and maintain domestic price stability.
(2) Without prejudice to the Bank's primary objective, the Bank shall contribute to the stability of the financial system of Pakistan.
(3) Subject to sub-sections (1) and (2), the Bank shall support the Government's general economic policies with a view to contributing to fostering the development and fuller utilization of Pakistan's productive resources.

Monetary Policy Formulation Process at SBP

The Monetary Policy Committee (MPC) is a statutory body formed and responsible for formulating the monetary policy under Sections 9D and 9E of the SBP Act. It consists of 10 members:

- The Governor SBP (Chairperson)
- Three senior executives of the Bank, nominated by the Governor
- Three members of the SBP Board, nominated by the Board
- Three external members appointed by the federal government, upon the recommendation of the SBP Board

The MPC meets eight times a year and assesses domestic and global economic and financial developments, reviews the outlook for major macroeconomic variables, and takes the appropriate monetary policy decision. The decisions are made by majority vote, with the Chairperson having a casting vote, and the outcome is communicated publicly via the Monetary Policy Statement to ensure transparency.

Monetary Policy Report

As part of efforts under the Bank's Strategic Plan 2023-28 to transition towards an inflation targeting regime, and to better anchor stakeholders' inflation expectations, SBP's Monetary Policy Reports (MPR) are to be published on a biannual basis, within two weeks of every January and July MPC meeting. The MPR provides a detailed and analytical review of the macroeconomic conditions and outlook, assessment of risks to the outlook, and recent considerations in the formulation of monetary policy.

The data and analysis in the Monetary Policy Report – August 2025 are as of July 29, 2025. The report and projections in it were reviewed by the MPC, and approved for publication by the Chairperson MPC on August 13, 2025.

Executive Summary and Recent Monetary Policy Considerations

The past few years have been extremely challenging for Pakistan's economy. A series of adverse global and domestic shocks had resulted in a period of high inflation, elevated twin deficits, low foreign exchange reserves, exchange rate pressures, and weak economic growth. However, due to calibrated policy response by the SBP, supplemented by sustained fiscal consolidation by the government, the economy has stabilized and is now on the path to recovery. As a result, Pakistan is in a better position today to manage external shocks and domestic risks than it was two years ago.

In line with the sharp deceleration in inflation, SBP's Monetary Policy Committee (MPC) reduced the policy rate by 1,100 bps to 11 percent during its meetings from June 2024 to May 2025. In its meetings in June and July 2025, the MPC decided to keep the policy rate unchanged at 11 percent. On balance and conditional upon the current policy rate, the Committee expects inflation readings to mostly remain in the range of 5 – 7 percent during FY26. At the same time, economic activity is projected to gain further traction, with the impact of the earlier reductions in the policy rate still unfolding (**Box 1**). As such, real GDP growth is assessed to range between 3.25 – 4.25 percent in FY26. In line with this outlook for economic growth, a further increase in import demand is projected, which is expected to lead to a moderate current account deficit of 0 – 1 percent of GDP in FY26. Nonetheless, with the planned official inflows and the expected pickup in foreign investment following the recent upgrade in the country's sovereign credit rating, SBP's FX reserves are projected to continue on their upward trajectory, reaching $15.5 billion by December 2025 and over $17 billion by June 2026.

The Committee acknowledged the recent improvement in macroeconomic dynamics, but also considered potential domestic and global risks to the macroeconomic outlook. These include volatile international commodity prices, global trade uncertainty, and unanticipated adjustments in domestic administered energy prices.

Based on these global and domestic developments and macroeconomic outlook, the MPC assessed the real policy rate to be adequately positive to stabilize inflation in the medium-term target range of 5 – 7 percent. At the same time, the MPC stressed on the importance of pursuing structural reforms to supplement monetary policy efforts and to achieve higher growth on a sustainable basis.

Chapter 1 – Macroeconomic Developments and Outlook

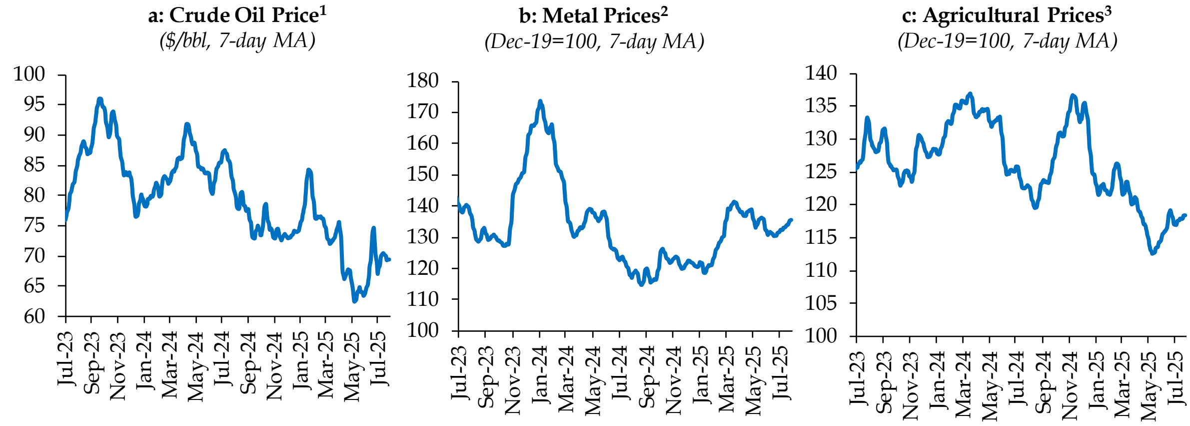
Global economic environment continues to remain challenging amidst elevated trade uncertainty

Global commodity prices remain volatile, driven by geopolitical developments and demand concerns, with implications for Pakistan's inflation and balance of payments outlook. International oil prices have fluctuated sharply, as they eased briefly after the Iran-Israel ceasefire and OPEC+ supply increases, but began to rise again, partly due to geopolitical concerns (**Figure 1**). At the same time, global metal prices – particularly iron and steel – have risen slightly, reflecting US tariffs, inventory restocking and improving construction demand across Asia. Meanwhile, agricultural commodity prices have also slightly increased, except for rice and cotton prices, which have declined. The sharp drop in international rice prices, triggered by increased supplies from regional exporters, has adversely impacted Pakistan's export prices, whereas the weakening in global cotton prices may reduce the cost of imported inputs for the domestic textile industry.

Inflation outturns across major economies have diverged, which have implications for the outlook of global interest rates and capital flows. Headline and core inflation have increased in many advanced economies, particularly in the US and UK, partly due to the rise in energy costs in June 2025. In emerging markets (EMs), inflation mostly remains within target, but EM central banks have highlighted potential inflationary concerns stemming from supply-side constraints and trade-related disruptions in their recent communications. These developments have tempered market expectations for further monetary easing, and this is reinforced by the cautious stance adopted by a majority of central banks in their recent monetary policy decisions (**Box 2**).

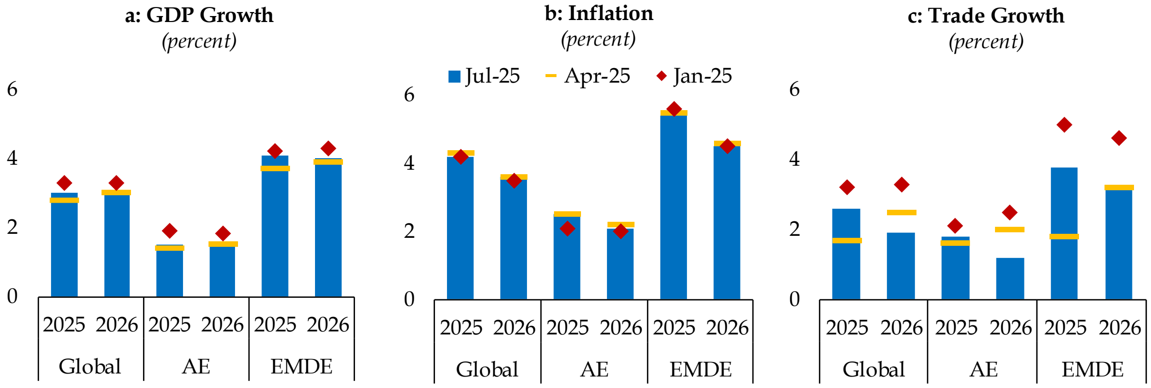
The global growth outlook has improved marginally, but trade-related uncertainty lingers on, posing mixed prospects for EMs, including Pakistan. The IMF's latest global growth forecasts for 2025 and 2026 have been revised slightly upward compared to the April assessment, partly due to the easing of

Figure 1: Crude Oil, Metal, and Agricultural Prices



1) Weighted avg. of Dubai Fateh & Saudi Light, based on Pakistan's import composition of Crude Oil and Petroleum Products; 2) Pakistan Trade Weighted Index of Metal Products includes Iron, Steel, Aluminum and Copper; 3) Pakistan's Trade Weighted Index of Agricultural Products consists of Wheat, Tea, Soybean Oil, Palm Oil, Sugar, Rice, Cotton
Source: Bloomberg & SBP staff calculations

Figure 2: IMF Global Economic Projections



Source: IMF WEO Update July 2025

some US tariffs and front-loaded trade activity earlier in the year (**Figure 2**). However, these latest forecasts are still below the levels projected in early 2025. While trade growth projections for 2025 have been revised up, the outlook for 2026 has been lowered due to higher than anticipated pre-tariff front-loading of trade activity in the second half of FY25. For Pakistan, this suggests continued challenges to export performance in the near to medium term.

Against the backdrop of recent global developments and potential risks, the assumptions used under the baseline outlook for macroeconomic variables are outlined in **Table 1**.

Table 1: Assumptions for FY26 Baseline Outlook

Global oil prices[1] ($/bbl.)	70.0
Global food inflation[2] (percent)	-6.2
Global growth[3] (percent)	2.9

Source: SBP Staff estimates based on data from Bloomberg, World Bank, and IMF

Inflation is projected to stabilize within the target range

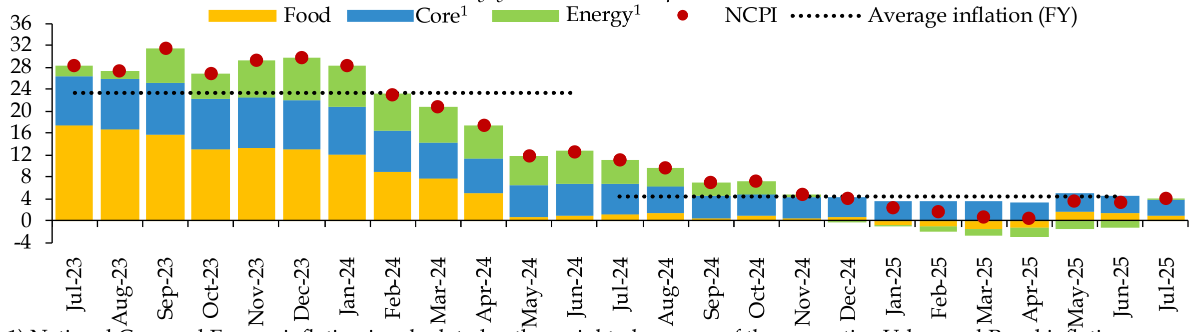
Average headline inflation declined sharply to 4.5 percent in FY25 (**Figure 3**), after averaging 23.4 percent and 29.2 percent in FY24 and FY23, respectively. In addition to lagged impact of tight monetary policy and fiscal consolidation, the decline in inflation was driven by favorable base effect in key food (especially wheat) and energy prices, benign international commodity prices, and relatively stable exchange rate. However, inflation is now reverting towards the target range of 5 – 7 percent. This is mostly based on the expected phasing out of favorable base effect in food and energy inflation. In particular, wheat prices are likely to stabilize around current levels, leading to a potential reversal in food inflation in FY26. Meanwhile, energy inflation is also expected to turn positive in FY26, given that the reduction in electricity tariffs that went into effect in Q4-FY25 is now no longer in place, and as gas tariffs have already been increased in July.

[1] Based on Pakistan's composition of energy imports, the oil price assumption is the weighted average of Dubai Fateh and Saudi Light prices. Moreover, the assumption incorporates movements in futures of Dubai Fateh, forecasts by international forecasters, and other relevant global oil market developments.

[2] Global food inflation is computed using the food price index, which is a monthly composite index published in the World Bank Commodity Price Data (The Pink Sheet - July 2025). This index is based on prices of key food grains, sugar, edible oils and meats (available online: https://www.worldbank.org/en/research/commodity-markets).

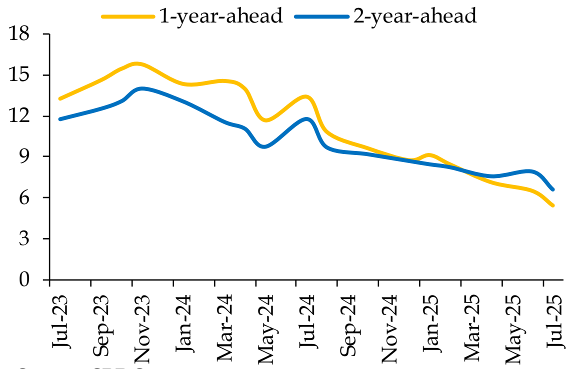
[3] Yearly global growth forecast (adjusted for FY terms) by the IMF's World Economic Outlook –April 2025 is taken as the assumption for global growth.

Figure 3: Composition of National CPI Inflation
(y/y contribution in percent)



1) National Core and Energy inflation is calculated as the weighted average of the respective Urban and Rural inflation indices, i.e. National Core inflation is 60 percent Urban Core and 40 percent Rural Core; likewise for Energy inflation
Source: PBS

Figure 4: Inflation Expectations of Professional Forecasters
(average growth in percent)

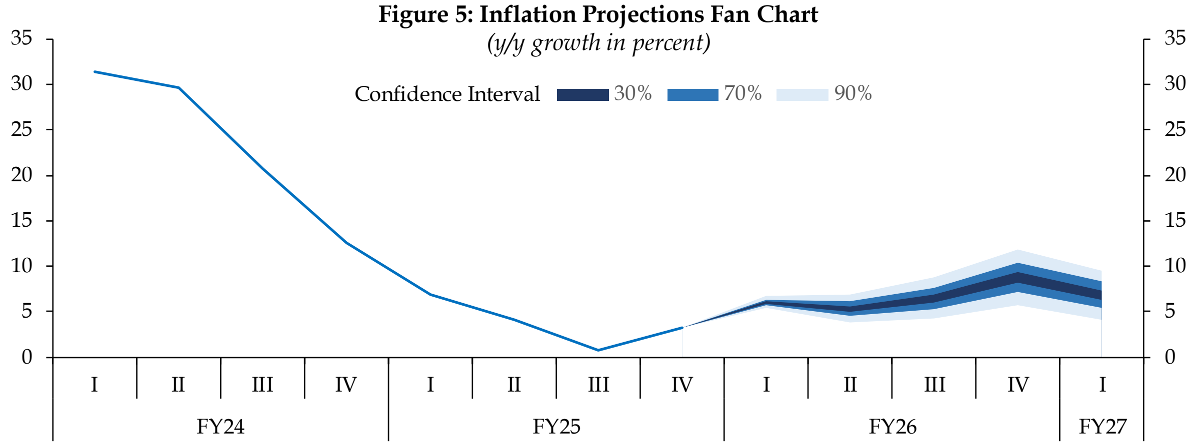


Source: SBP Survey

Meanwhile, inflation pressures from the demand side are expected to be relatively contained. Core inflation, after easing significantly during last year, is assessed to ease slightly further and remain mostly range-bound – in response to adequately positive level of real interest rates, along with continued fiscal consolidation, as envisaged in the FY26 budget. At the same time, the ease in underlying inflationary pressures is also evident in the steady improvement in inflation expectations of key stakeholders over the past few months. Inflation expectations of professional forecasters, after staying in double digits earlier on, have declined steadily from the start of FY25 and are now within the medium-term target range of 5 – 7 percent **(Figure 4)**. Inflation expectations of consumers and businesses have followed the same general declining trend over the past few months.

Going forward, based on these developments and outlook, inflation is expected to trend up from 3.2 percent y/y in June 2025 (**Figure 5**), yet most of the y/y outturns are projected to remain in the range

Figure 5: Inflation Projections Fan Chart
(y/y growth in percent)



Source: SBP Staff estimates

of 5 – 7 percent in FY26 (**Box 3**).[4] Nonetheless, the inflation outlook is susceptible to multiple risks, including volatile global oil prices and trade outlook, and unanticipated adjustments in administered energy prices.

Economic activity is improving gradually without creating excessive inflationary and external account pressures

Economic activity continues to pick up gradually, with real GDP growth rising to 3.9 percent in H2-FY25 from 1.4 percent in H1, bringing growth for the full-year to 2.7 percent, as per provisional data. The macroeconomic stabilization gains achieved through fiscal consolidation and monetary tightening– along with favorable supply-side dynamics – have collectively laid the foundation for this rise in economic growth. In this evolving landscape, aggregate demand has started to firm up, underpinned by rising business and consumer confidence, improving credit conditions amidst the sizable reduction in the policy rate, and benign inflationary pressures.

Latest high-frequency indicators (HFI) continue to reflect positive momentum and point towards ongoing pickup in economic activity **(Table 2)**. Auto sales have registered a growth of 44.2 percent y/y in June, supported by lower interest rates and improving consumer sentiments. At the same time,

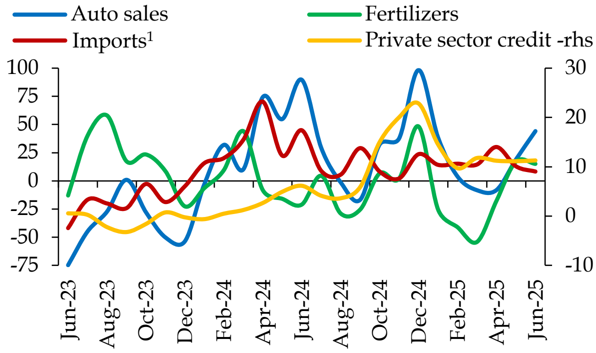
Table 2: Heat Map of Economic Activity Indicators
(deviations from monthly average during FY18-24, inflation adjusted)

1) Survey-based diffusion indices, deviation from 50 benchmark; 2) Large-scale manufacturing for Jun-2025 not published
Note: The high-frequency economic indicators heat map illustrates the deviation of each variable from its average benchmark level over the period 2018–2024. Green shade indicates that the variable's level is above average, red denotes below average, and yellow represents in line with the average. Based on seasonally adjusted data.
Source: SBP, PBS, NFDC, APCMA, PAMA, FBR, NEPRA, OCAC, PSX, SBP staff estimates

[4] Headline inflation rose to 4.1 percent y/y in July 2025, broadly in line with the assessment at the time of the July 30 MPC meeting.

sales of POL products, fertilizer and cement are on a generally rising trend, indicating increasing demand for key inputs (**Figure 6**).

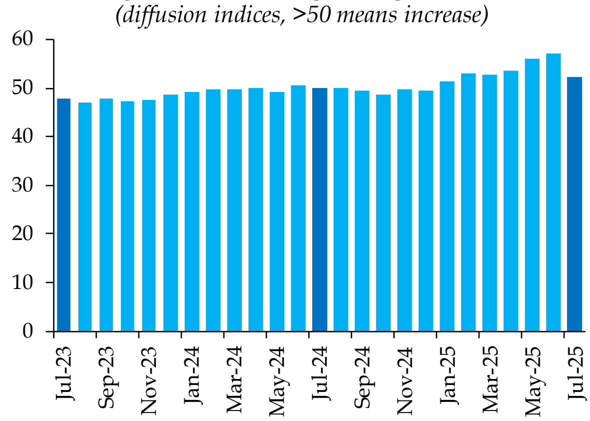
Figure 6: High Frequency Indicators
(y/y growth in percent)



1) includes imports of machinery & intermediate goods
Sources: PAMA, NFDC, PBS, and SBP

Indications from SBP-IBA business sentiment surveys[5] – corroborated by an increase in imports of machinery and intermediate goods – reinforce signs of a gradual revival in economic and investment activity. The Purchasing Managers Index has been on a rising trajectory since January 2025, indicating expanding manufacturing activity (**Figure 7**). Similarly, capacity utilization, as captured by the SBP-IBA surveys, has also shown steady improvement over the past three months, reflecting increased production activity. Together, these indicators reflect a recovery in business and employment sentiments, which, alongside a stable macroeconomic environment and easing financial conditions, support the growth outlook for FY26 (**Box 4**).

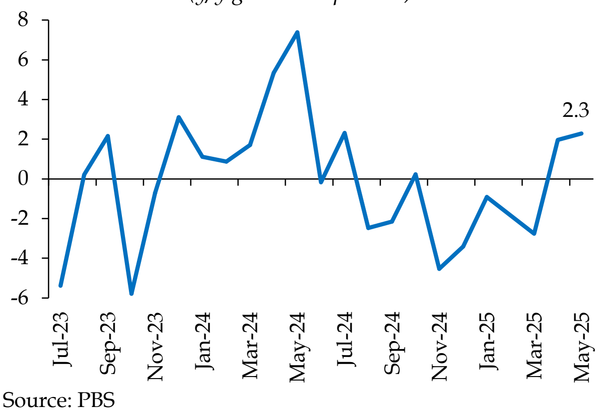
Figure 7: Purchasing Managers Index
(diffusion indices, >50 means increase)



Source: SBP-IBA Survey

The rising trend in HFIs is now being captured in large-scale manufacturing (LSM) data, which bodes well for the industrial sector's growth outlook in FY26. LSM rose 2.0 percent y/y and 2.3 percent y/y in April and May respectively, after recording contraction over the past five consecutive months (**Figure 8**). This momentum is expected to continue in FY26, led by textile, consumer durables, and construction-allied industries. Lower policy rate, along with budgetary support measures – including broad-based reduction in import duties – are assessed to lower input costs and boost overall manufacturing activity.

Figure 8: Large-scale Manufacturing
(y/y growth in percent)



Source: PBS

Easing financial conditions are playing an important role in the ongoing pickup in industrial activity. The growth in private sector credit (PSC) remained robust during FY25 and has continued so far in FY26, reaching around 12.8 percent as of July 11, 2025[6] - reflecting improved

[5] The nationwide sentiment surveys are conducted by the SBP in collaboration with the Institute of Business Administration (IBA) Karachi. The survey reports are available at https://www.sbp.org.pk/research/intro.asp
[6] Private sector credit growth stayed close to this level (12.8 percent) as per the latest available data (as of July 25, 2025).

Figure 9a: Private Sector Credit
(y/y growth in percent)

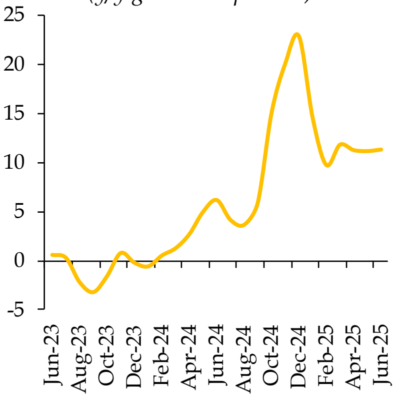


Figure 9b: Business Loans
(flows in billion Rupees)

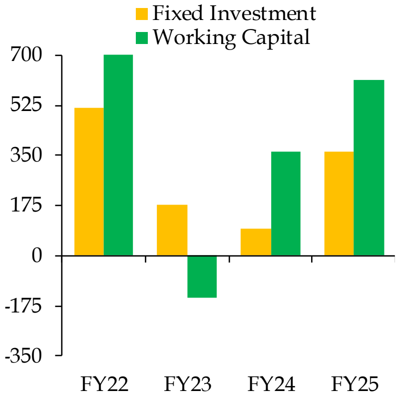
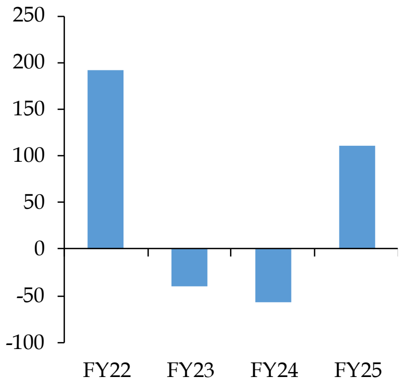


Figure 9c: Consumer Finance
(flows in billion Rupees)



Source: SBP

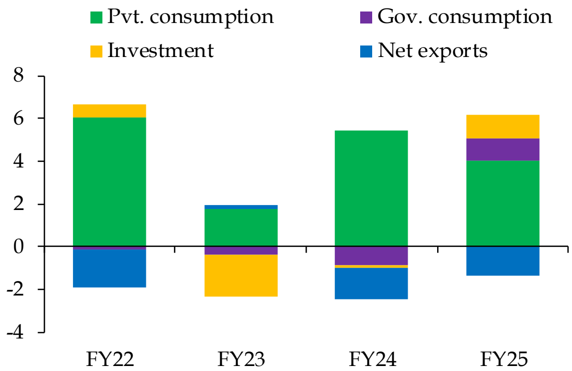
economic activity and business sentiments. Moreover, there has been a broad-based uptick in PSC, with increase recorded in working capital, fixed investment and consumer loans (**Figure 9**).[7] The key borrowers included textiles, telecommunications, and wholesale and retail trade firms.

In the agriculture sector, growth is projected to improve in FY26 from 0.6 percent in FY25, but is expected to remain lower than the government's target of 4.5 percent. The growth is likely to be primarily driven by livestock, which accounts for nearly 60 percent of the agriculture sector. Livestock is assessed to grow in line with recent trend, providing some impetus to overall agricultural performance. Within the crop sector, production of major crops is likely to recover in FY26, facilitated by the recent rainfalls that have improved water availability. Major reservoirs are nearing last year's levels, while precipitation and soil moisture have improved across key croplands (**Box 5**). This is important for the outlook of the two major water-intensive crops – sugarcane and rice. However, initial information indicates area under cotton cultivation to be lower so far this year as compared to last year, especially in Sindh.

The improved outlook of commodity-producing sectors will have a knock-on impact on the services sector, which is projected to grow close to the government's target of 4 percent. Growth in the services sector is expected to be led by wholesale and retail trade, and transportation activities, both of which are closely associated with the performance of the commodity-producing sectors and import volumes. Based on these trends and outlook, real GDP growth is projected to remain between 3.25 percent and 4.25 percent in FY26.

From the demand side, economic growth in FY26 is assessed to continue to be driven by private consumption, which may grow faster and more than offset the projected deepening drag from net exports **(Figure 10)**. Meanwhile, the output gap is

Figure 10: Demand-side Growth Drivers
(contribution to y/y growth in percent)



Source: PBS

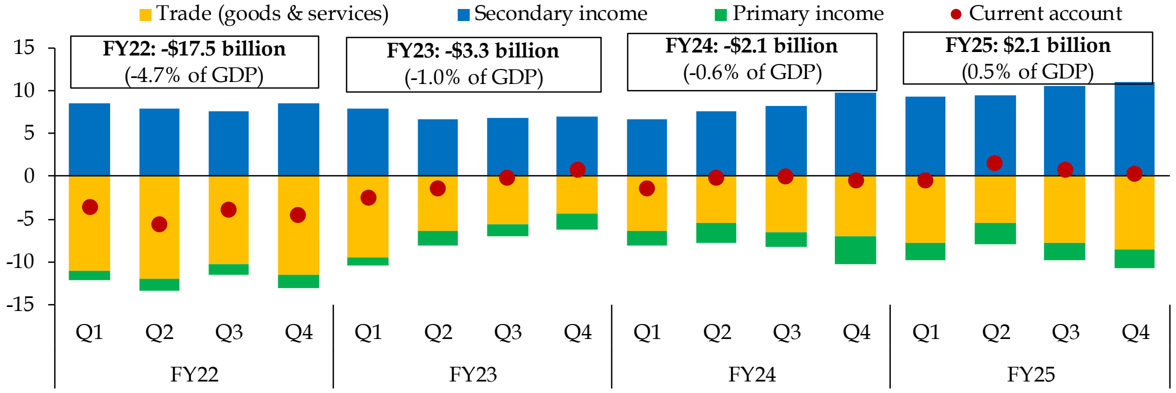
[7] The temporary and unusual rise in lending activity during H1-FY25 – associated with regulatory requirements related to the advances to deposits ratio – had largely subsided by early 2025.

expected to remain slightly negative in FY26, which is expected to keep inflationary and external account pressures in check.

The external account is expected to support further build-up in FX buffers, despite a challenging global environment

The current account improved substantially during FY25, posting a cumulative surplus of $2.1 billion in the year **(Figure 11)**. Workers' remittances played a crucial role in offsetting a widening trade gap and turning the current account into a surplus. On the financing side, a significant share of planned official inflows arrived in late June, propelling SBP's FX reserves past $14 billion.

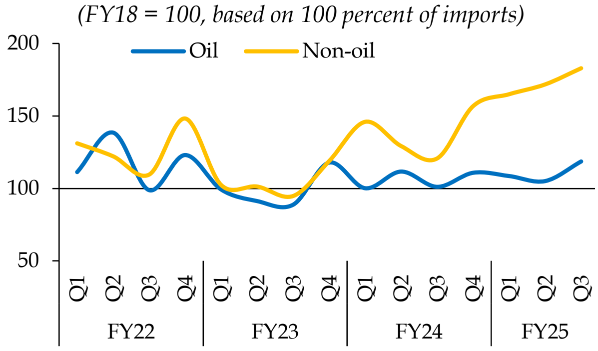
Figure 11: Current Account Balance
(billion US$)



Source: SBP

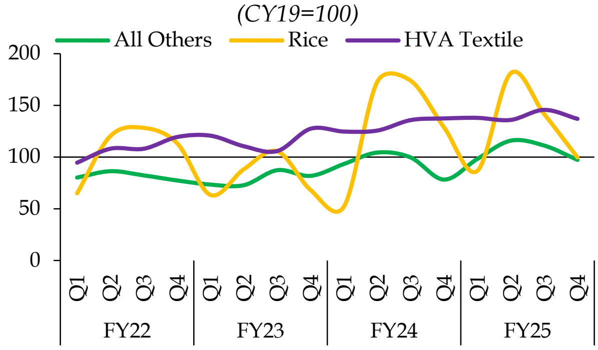
With rapidly evolving global developments and heightened global trade uncertainty, the trade deficit is expected to widen further and result in a current account deficit of 0 to 1 percent of GDP in FY26. A gradual firming of domestic activity amidst easing financial conditions, along with a broad-based reduction in import tariffs under the FY26 budget, is expected to stimulate import demand (**Figure 12**). At the same time, the export outlook is clouded by subdued global prices of Pakistan's key exports (rice and cotton), and relatively weaker prospects for major high value added (HVA) textile items amidst intensifying US tariff-related uncertainty and relatively moderate global growth prospects (**Figure 13**).

Figure 12: Oil and Non-oil Import Volume
(FY18 = 100, based on 100 percent of imports)



Note: Imports are categorized into two groups: oil (covering the energy group) and non-oil (covering all other import categories).
Sources: PBS and SBP staff calculation

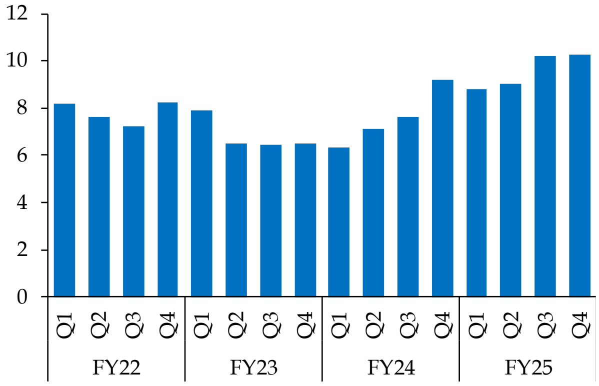
Figure 13: Export Volume Index
(CY19=100)



Note: Indexed at CY19=100, based on 84 percent volume data from Monthly Advance Releases of Foreign Trade Statistics by the Pakistan Bureau of Statistics
Sources: PBS and SBP staff calculation

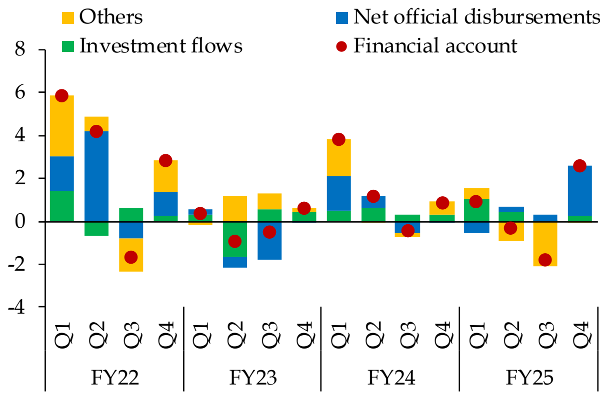
Workers' remittances, while elevated, are expected to grow at a slower pace in FY26, after surging 26.6 percent y/y to a record-high $38.3 billion in FY25 (**Figure 14**). In addition to high base effect, this is due to reduction in incentives for attracting inflows via formal channels and potential weak growth prospects in key corridors (especially the US and EU). Nonetheless, renewed labor migration to Kuwait after the lifting on a 19-year ban on labor immigration from Pakistan, may provide a new potential avenue for inflows.

Figure 14: Workers' Remittances
(billion US$)



Source: SBP

Figure 15: Financial Account Inflows
(billion US$)



Source: SBP

The financial account is expected to remain in surplus in FY26, similar to FY25 (**Figure 15**). Foreign investment inflows are projected to improve in the wake of the recent upgrade in the country's sovereign credit rating and the resultant decline in CDS spreads. Moreover, timely realization of official financial flows, coupled with continued SBP's interbank FX purchases,[8] would support the buildup of SBP reserves, which are projected to rise further to $15.5 billion by end-December 2025 and reach around $17 billion by end-June 2026.[9]

Fiscal consolidation is supplementing monetary policy in bringing inflation down and maintaining macroeconomic stability

Pakistan's fiscal position improved notably in FY25 and further consolidation is targeted in FY26, though challenges remain. Revised estimates for FY25 show the fiscal deficit contained at 5.6 percent of GDP, lower than the earlier budgeted 5.9 percent, while the primary surplus reached 2.2 percent of GDP, slightly above the 2.0 percent target.[10] Building on this momentum, the FY26 budget aims to further narrow the overall deficit to 3.9 percent of GDP and raise the primary surplus to 2.4 percent (**Figure 16**). Similar to FY25, substantial profit transfer by SBP will augment the targeted improvement in the fiscal indicators in FY26 as well. This reflects the government's stronger adherence to fiscal discipline, which bodes well for long-term debt sustainability and macroeconomic

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[8] SBP's FX market purchases amounted to $6.7 billion during July-April FY25.

[9] SBP's forward liabilities reduced by almost $819 million during July-May FY25. The release of data for June 2025 (after the July 30 MPC meeting) shows a further reduction of $131 million in these liabilities, bringing the cumulative reduction to around $950 million during FY25.

[10] As per the fiscal operations data released after the July 30 MPC meeting, the overall fiscal deficit for FY25 amounted to 5.4 percent of GDP, whereas the primary balance posted a surplus of 2.4 percent of GDP.

stability. Achieving the fiscal targets, however, will require effective implementation of revenue measures, strict control on expenditures, and continued fiscal-monetary coordination.

Figure 16a: Fiscal Balance
(as percent of GDP)

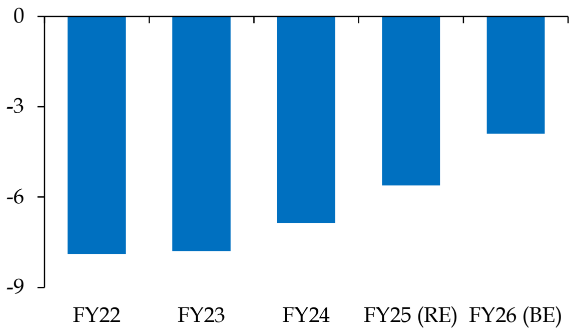
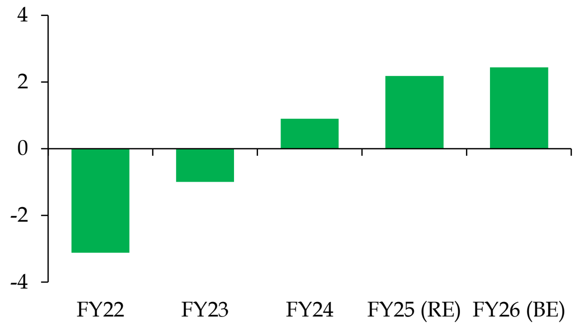


Figure 16b: Primary Balance
(as percent of GDP)



Note: BE = Budget estimate; RE = Revised estimate
Source: MoF

Achieving fiscal consolidation in FY26 will be challenging but essential for preserving macroeconomic stability and higher sustainable economic growth. Sustaining the fiscal consolidation efforts going forward will hinge on broad-based structural reforms to expand the tax base, improve public financial management, and enhance spending efficiency.

Chapter 2 – Risks to the Macroeconomic Outlook

The projections in this report are subject to various risks that stem from two main sources: (i) divergence in realized outcomes from the assumptions underlying the baseline macroeconomic forecasts; and (ii) the assessment regarding the materialization of various developments, including their magnitude, which have implications for the key macroeconomic projections.

On the external front, a key risk stems from heightened global economic uncertainty, particularly triggered by recent trade-related tariff developments. As reflected in the recent IMF projections, these tariff measures have raised concerns over a renewed slowdown in global trade, which could dampen external demand and weigh on global growth prospects over the short-to-medium term. These measures will also carry implications for global commodity prices. The net impact of these unfolding developments remains uncertain as the application of new tariffs may also lead to possible supply-chain reorientations. At the same time, potential volatility in global commodity prices, particularly of energy and food products, poses risks to the outlook for the external account and domestic inflation.

On the domestic front, recent heavy rainfalls and flooding in some parts of the country pose near-term risks to the inflation outlook, primarily through an increase in prices of perishable food items. Beyond these immediate risks, the economic outlook remains susceptible to a shortfall in budgeted external inflows, whereas global financial conditions continue to remain tight. In addition, risks related to the unanticipated timing and magnitude of adjustments in administered energy prices have implications for the outlook of both inflation and overall economic activity. Moreover, the implementation of additional administrative measures in case of slippages in fiscal revenue targets would introduce uncertainty, weaken business sentiments, and adversely affect the broader macroeconomic outlook.

To navigate these evolving risks and challenges, it is essential that the ongoing prudent monetary and fiscal policy stance be sustained to ensure ongoing overall macroeconomic stability. Moreover, to put the economy on a trajectory of higher, sustainable and inclusive growth, there is a need to undertake wide-ranging structural reforms. Reforms are particularly needed to increase productivity; promote exports; expand the tax base; address financial losses and inefficiencies in the public sector; ease tariff and infrastructure constraints in the energy sector; and deepen the financial system, to name a few major considerations.[11] Some progress is already being made by the government and other relevant stakeholders, including the SBP, to introduce reforms in these areas.

[11] For more details on the structural constraints that are impeding productivity growth in Pakistan, please see Chapter 6 in SBP's Half Yearly Report on the State of Pakistan's Economy for 2024-25, titled "Pakistan's Low Competitiveness: A Case for Investing in Productivity".

Box 1: Transmission of SBP's Monetary Policy: Tracking the Initial Trends and Effects

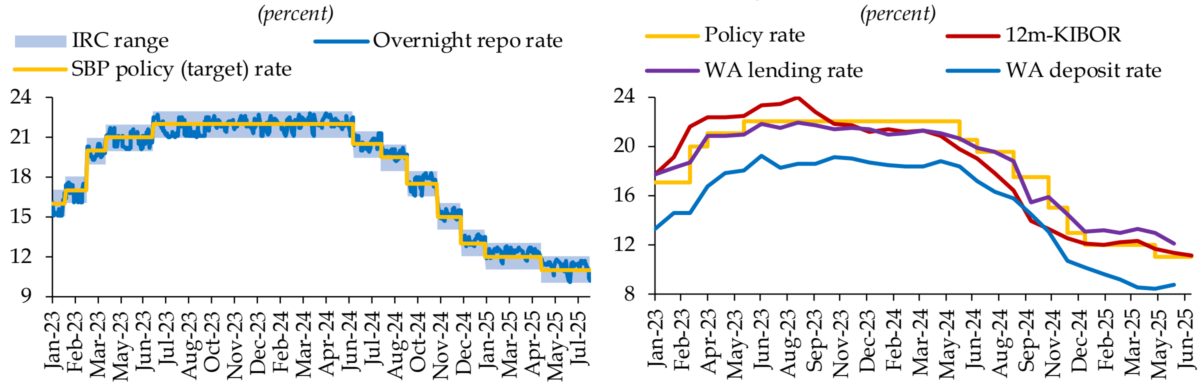
Monetary policy works through various channels to influence aggregate demand and inflation. However, its impact materializes with a significant lag, as households and businesses require time to adjust their spending and investment decisions. Due to this lag, monetary policy is inherently forward-looking, relying on expected trends in inflation and economic activity to make decisions proactively to anchor inflation expectations. This transmission lag varies across countries, depending on the economic structures, financial systems, and institutional frameworks. In case of Pakistan, the full impact of policy rate changes on inflation and economic output typically materializes in 18-24 months.

SBP has reduced the policy rate from 22 percent in June 2024 to 11 percent in May 2025, which is underpinned by a significant decline in headline inflation. Recent market data indicates that monetary policy transmission is actively unfolding. Short-term market interest rates have adjusted broadly in line with the policy rate (**Figure 1.1**). The broad-based decline in both market and retail interest rates has contributed to the easing in overall financial conditions, stimulating private sector credit and strengthening business sentiment. In FY25, loans to private businesses grew significantly higher than the previous year, with notable increase in manufacturing credit, mainly supported by lower borrowing costs and improved demand. The services sector followed a similar trend, while personal loans registered a robust growth, indicating a revival in household consumption and consumer confidence.

Figure 1.1: SBP's Policy Rate Transmission to Key Interest Rates

a: SBP's Interest Rate Corridor (IRC) *(percent)*

b: Key Market and Retail Interest Rates *(percent)*



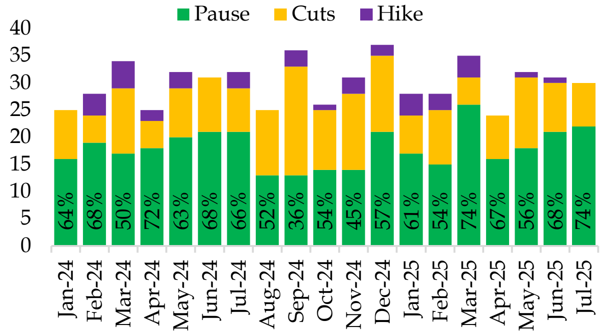
Sources: SBP and FMA

It is important to note that the full impact of recent cuts in policy rate is expected to unfold in coming quarters and is likely to contribute to a gradual recovery in investment and consumption demand. At the same time, as the MPC has noted in its recent statements, the still-positive real interest rates on a forward-looking basis suggest that monetary conditions remain appropriate to ensure that inflation expectations remain well anchored to guide inflation towards the medium-term target.

Box 2: Monetary Easing on Hold – Why Central Banks are Hitting Brakes on Rate Cuts

After the post-Covid-19 synchronized monetary tightening, central banks around the world started normalizing their interest rates in 2024 as inflation eased from its peak. In recent months, however, a rising number of central banks are taking a pause in their interest rate easing cycle as policymakers are deliberately seeking greater clarity on how major global headwinds will evolve before committing to further easing **(Figure 2.1)**. New risks have emerged, which are expected to pull inflation away from targets. Furthermore, central banks are also evaluating the lagged impact of prior monetary easing. This box item discusses some of the major factors that are explaining the central banks recent policy rate decisions.

Figure 2.1: Central Bank Rates



This graph is based on a sample of 54 central banks (AEs: 15, EMDES: 39), accounting for 53 percent of global GDP. Labels show pauses as percent of total meetings. Aggregate bar size reflects total number of meetings by sample CBs in each month
Source: CB Websites

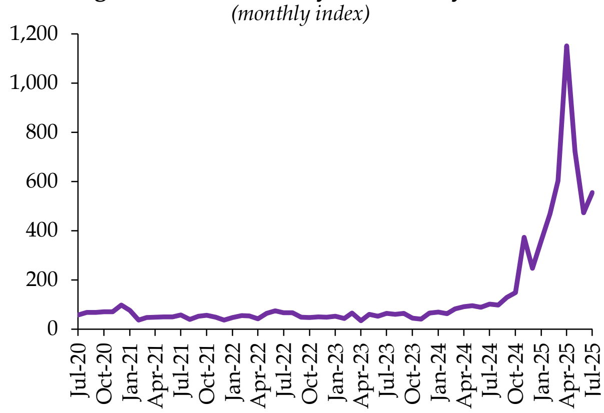
i. Slowing disinflation and sticky core inflation:

Although inflation quickly decelerated during 2023 and 2024, the progress of disinflation has stalled recently owing to some risks. Specifically, as of June 2025, headline inflation is yet to converge to the target in most of the AEs, and in nearly half of the EMDEs. Moreover, core inflation has remained stickier**.** These developments have kept the policymakers wary of premature cuts as any misstep could unwind the prior gains in curbing the inflationary pressures.

ii. Global trade policy uncertainty:

Global trade tensions escalated significantly since the beginning of 2025 **(Figure 2.2)**. Several central banks have flagged the potential upside risk to inflation if these trade tensions lead to global supply chain disruptions. Given that trade policy uncertainty is likely to persist in the near term, many central banks are awaiting more clarity on how these frictions will affect the inflation going forward, before they proceed with further policy easing.

Figure 2.2: Trade Policy Uncertainty Index
(monthly index)



Source: Caldara et al. (2020)

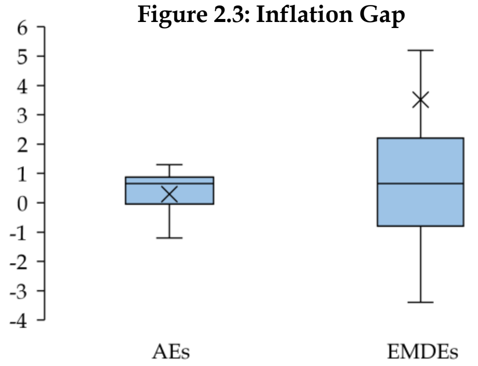
iii. Geopolitical tensions and volatile commodity prices:

Geopolitical tensions tend to induce volatility in commodity prices, particularly in energy prices. Several such episodes have occurred over the past 12 months. The most pronounced was in June 2025, when the risk of closure of the Strait of Hormuz caused crude oil prices to rise sharply. The unpredictable nature of these shocks—along with prior experience of supply chain disruptions during the Russia-Ukraine conflict—is reinforcing the hawkish stance of central banks.

iv. Uptick in inflation outlook and elevated inflation expectations:

The slowing pace of disinflation and heightened global uncertainties have kept the inflation forecasts of most of the AEs and EMDEs above their respective targets **(Figure 2.3)**. In some cases – specifically in AEs – the inflation forecasts have increased as well in recent months. This development, along with the inching up of inflation expectations – as gauged by sentiments surveys and financial markets prices – is an important factor that has made central banks hesitant in further reducing their policy rates.

Figure 2.3: Inflation Gap



Note: Gap between inflation forecast (available at Bloomberg) of each country with its respective target. Sample includes 13 AEs (including ECB) and 27 EMDEs.
Sources: Bloomberg, CB Websites, Staff calculations

v. Interest rate differential:

With the US Federal Reserve keeping its monetary easing at hold, many EMs that rely on financial inflows to bridge their external financing needs are also refraining from easing their interest rates. This reluctance stems from concerns about widening interest rate differentials, which could trigger capital outflows and thereby exert pressure on their exchange rates, and in turn worsen their inflation outlooks.

References

1. Caldara, D., Iacoviello, M., Molligo, P., Prestipino, A., and Raffo, A., 2020. "The Economic Effects of Trade Policy Uncertainty," Journal of Monetary Economics, 109, pp.38-59

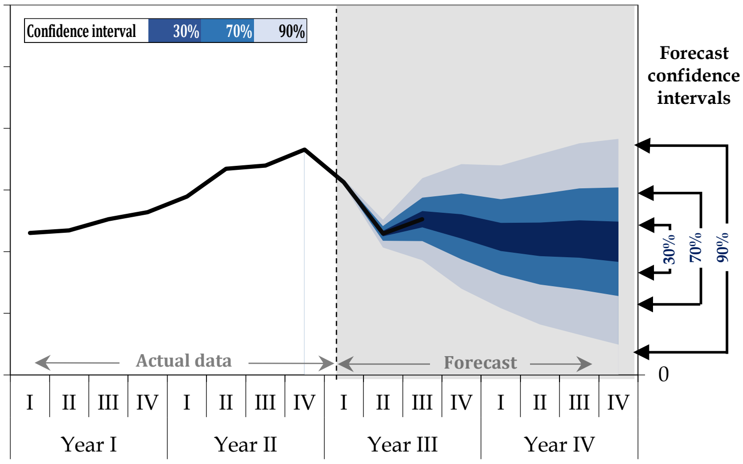
Box 3: Interpreting Fan Charts – A Guide

Fan chart is a common communication tool to visually present uncertainty associated with baseline forecasts. It helps policymakers to factor in forecast uncertainty in their decisions, and it is also an important tool to anchor public expectations to the outlook.

Interpretation: The fan chart usually consists of three parts: a) the line that shows the past data; b) shaded area capturing forecast uncertainty around the baseline; and c) bands of different colors or shades showing the likelihood of the forecast being within a certain threshold level. Typically, the width of the fan chart increases as the forecast extends further into the future, depicting increasing uncertainty (**Figure 3.1**).

1. The darkest blue shade reflects the 30 percent confidence interval, 30 percent probability that the forecast value will fall within this range.
2. The dark blue shade shows the 70 percent confidence interval, 70 percent likelihood that forecasted value is to fall within this band.
3. The light blue band depicts the 90 percent confidence interval, 90 percent chance that forecasted value is to fall within this band.
4. The remaining 10 percent captures the probability of the tail-end events (outliers) and not shown in the fan charts. These events are less likely but may have large and long lasting impact on forecasts.

Figure 3.1: Illustration of a Fan Chart
(values in percent, y/y)



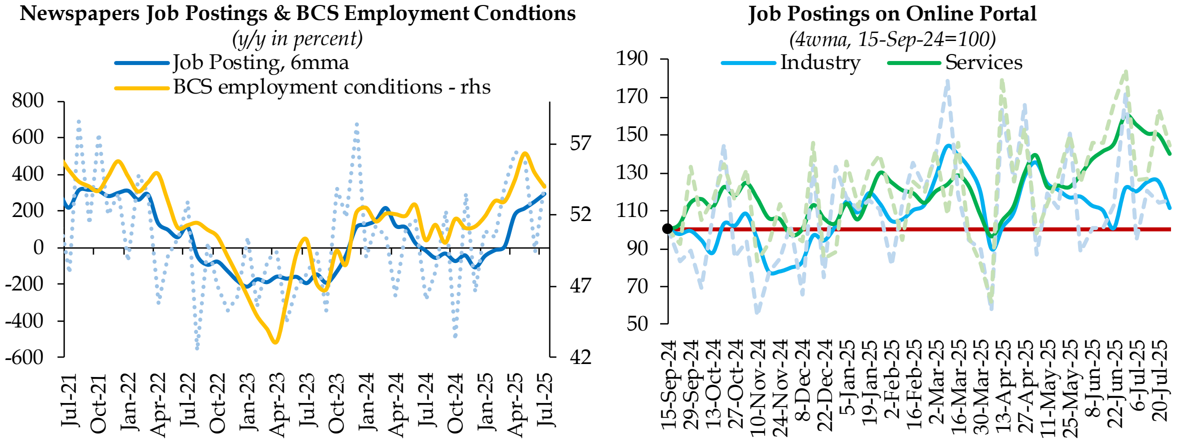
Importantly, fan charts are based on the information available at the time of making projections and are subject to change with the arrival of new information. Central banks regularly update their fan charts and publish revised charts in their reports.

Box 4: Detecting Labor Market Trends Using Alternative Data Sources

Central banks in both advanced and emerging economies monitor labor market conditions, which is important for monetary policymaking. Labor market dynamics serve as key indicators of aggregate demand pressures, wage trends, and overall economic momentum. However, a major constraint, particularly in emerging markets like Pakistan, is the considerable lag and low (annual in Pakistan's case) frequency of official labor force statistics, which are often published at irregular intervals. This significantly affect policymakers' ability to respond swiftly to evolving economic conditions. To address this gap, SBP has expanded its big data analytics efforts by developing high-frequency proxies for labor market activity using alternative data sources such as online job postings, newspaper advertisements, and labor-related news. Grounded in emerging literature and advanced data science techniques, these proxies offer more timely and granular insights into labor demand patterns, thereby strengthening the analytical base for forward-looking macroeconomic assessments.

As part of this initiative, SBP has constructed two main labor market indicators: a newspaper-based labor demand index derived from classified ads in leading national newspapers, and an online job postings indicator sourced from online employment portals (**Figure 4.1**). These indicators enable real-time monitoring of employment trends across sectors and regions, providing a richer and more dynamic understanding of the labor market. Recent data points to a gradual recovery in labor demand: newspaper-based job advertisements rose by 16.6 percent in H2-FY25 after a slowdown in H1, consistent with improved employment sentiments reported in SBP-IBA Business Confidence Survey. Similarly, online job postings showed an upward trend, particularly in the services sector, reinforcing signals of improving labor market conditions. Broadly, all these trends corroborate well to reflect the gradually increasing momentum in economic activity from H2-FY25.

Figure 4.1: Trend in the Job Postings Data



Sources: SBP, PBS, Various Newspapers, and Staff Calculations

Box 5: Analyzing Economic Activity Using Novel Satellite Data

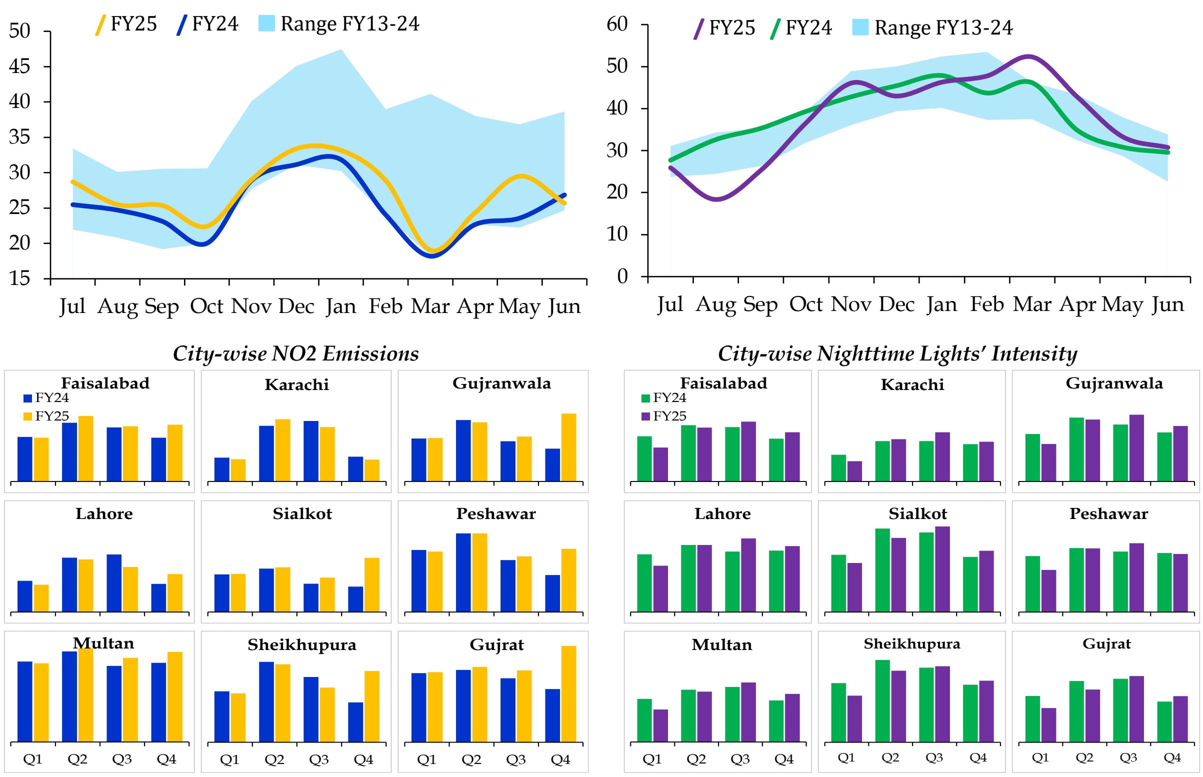
Traditional economic data are often delayed and infrequent, limiting timely analysis for policymakers. To address this, satellite-based indicators have emerged as real-time, high-frequency tools offering objective insights into economic trends through remote sensing (Henderson et al., 2012).[1] Capturing dimensions such as cropping patterns, urban growth, and industrial emissions, these indicators allow earlier detection of economic shifts than conventional methods. Building on Choudhary et al. (2025), SBP is advancing this approach under its big data initiative by integrating satellite-based metrics into its regular economic assessment framework.[2] SBP specifically focuses on three key proxies. These are the nitrogen dioxide (NO2) emissions, which reflect industrial activity and mobility; nighttime light (NTL) intensity, which gauges urban economic vibrancy; and the Normalized Difference Vegetation Index (NDVI), which is used to monitor vegetation health and seasonal agricultural performance.

Reflecting the underlying pickup in economic activity, particularly during the second half of FY25, both NO2 emissions and NTL levels recorded notable increases. As exhibited in **Figures 5.1a & 5.1b**, though indicated some moderation in June, average NO2 emissions rose by 9.1 percent in H2-FY25 compared to 7.2 percent in H1. The improvement was more pronounced in key industrial hubs, such as Faisalabad, Karachi and Lahore, suggesting a rebound in manufacturing and transport activity. Similarly, nighttime light intensity rebounded sharply across all major urban centers, reaching 8.7 in H2-FY25, after showed a decline in the first half. This uptick in NTL is indicative of increased

Figure 5.1: Pakistan - NO2 Emissions and Nighttime Light Intensity

a: NO2 Emissions *(average micrograms per cubic meter)*

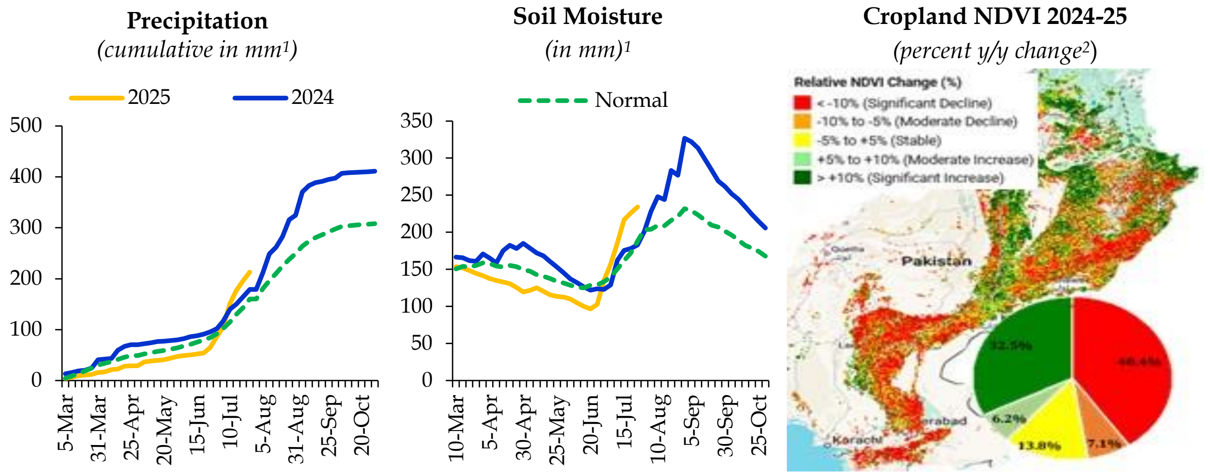
b: Nighttime Lights' Intensity *(average lumens per square meter)*



Source: NASA/NOAA, SBP Staff calculations commercial and residential energy usage, consistent with relatively improved consumer and business sentiments in the recent quarters.[3]

With regards to agriculture, recent satellite data suggests that the vegetation position for cotton crop remained relatively weaker amidst lower area under its cultivation this year. As of mid-July 2025, NDVI levels in both Sindh and Punjab declined by 5.7 percent and 2.4 percent, respectively, on y/y basis. At the same time, some of the earlier risks to the upcoming Kharif crops have subsided. In particular, supported by recent rainfall in the upper parts of the country, water availability has relatively improved with storage in major reservoirs now approaching levels seen last year. Reflecting this, soil moisture conditions have also improved in recent weeks across all major croplands (**Figure 5.2**). Thus, crop outlook for other water-resilient major Kharif crops has somewhat improved. Overall, based on satellite imagery for June and July, NDVI in approximately 60 percent of the country's cropland is currently near or above FY25 levels.

Figure 5.2: Pakistan - Weather and Vegetation Conditions



1) Normal levels for precipitation, temperature and soil moisture denote average for 2001-23; 2) Cropland NDVI change for June 23rd to July 23rd
Source: NASA, USDA, Google, SBP Staff calculations

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2. Choudhary, M.A., Dal Barco, I., Haqqani, I.A., Lenzi, F. and Limodio, N., 2025. Subnational income, growth, and the COVID-19 pandemic. The World Bank Economic Review, 39(2), pp.362-376.

3. According to the SBP-IBA sentiment surveys, both consumer confidence and business confidence improved in H2-FY25 compared to H1.

List of Abbreviations

A

AEs	Advanced Economies
APCMA	All Pakistan Cement Manufacturers Association

B

bbl	barrel
BE	Budget Estimate

C

CDS	Credit Default Swap
CY	calendar year

E

EMDEs	Emerging Market & Developing Economies
EMs	Emerging Markets
EU	European Union

F

FBR	Federal Board of Revenue
FI	Fixed Investment
FX	Foreign Exchange
FY	Fiscal Year

G

GDP	Gross Domestic Product

H

H1	First Half
HFI	High-frequency Indicators
HVA	high value added

I

IBA	Institute of Business Administration
IMF	International Monetary Fund

K

KIBOR	Karachi Interbank Offered Rate

L

LSM	large-scale manufacturing

M

M2	Broad money
MA	Moving Average
MoF	Ministry of Finance
MPC	Monetary Policy Committee
MPR	Monetary Policy Report

N

NASA	National Aeronautics and Space Administration
NCPI	National Consumer Price Index
NDVI	Normalized Difference Vegetation Index
NEPRA	National Electric Power Regulatory Authority

	NFDC	National Fertilizer Development Centre
	NO2	Nitrogen Dioxide
	NOAA	National Oceanic and Atmospheric Administration
	NTL	Nighttime Light
O		
	OCAC	Oil Companies Advisory Council
	OPEC+	Organization of the Petroleum Exporting Countries Plus
P		
	PAMA	Pakistan Automotive Manufacturers Association
	PBS	Pakistan Bureau of Statistics
	PMI	Purchasing Managers Index
	POL	Petroleum, Oil, and Lubricants
	PSC	private sector credit
	PSX	Pakistan Stock Exchange
Q		
	Q1	First Quarter
	Q2	Second Quarter
	Q3	Third Quarter
	Q4	Fourth Quarter
R		
	RE	Revised Estimate
S		
	SBP	State Bank of Pakistan
U		
	UK	United Kingdom
	US	United States
	US$	United States Dollar
	USDA	United States Department of Agriculture
Y		
	y/y	year-on-year