Monetary Policy Statement

January 26, 2026

1. The Monetary Policy Committee (MPC) decided to keep the policy rate unchanged at 10.5 percent in its meeting today. The Committee observed that headline inflation of 5.6 percent y/y in December 2025 was in line with its expectation. However, core inflation has steadied around a relatively higher level of 7.4 percent in recent months. Meanwhile, as reflected by the recent high frequency indicators (HFIs), including large-scale manufacturing (LSM), economic activity continues to gain momentum faster than anticipated, mainly led by domestic-oriented sectors. The Committee also noted that the trade deficit has widened in the wake of a substantial increase in imports, particularly import volumes, and a decline in exports. Nonetheless, based on the resilient workers' remittances and benign global commodity prices, the current account deficit remained relatively contained. In this backdrop, the MPC noted that the outlooks for inflation and the current account are broadly unchanged from its previous assessment, while the outlook for economic growth has improved significantly. Based on this, the Committee deemed it prudent to hold the policy rate unchanged at the current level to ensure price stability and support sustainable economic growth.

2. The Committee noted the following key developments since its last meeting. First, real GDP growth was provisionally reported at 3.7 percent y/y for Q1-FY26, mainly led by the industry and agriculture sectors. Second, both consumer and business confidence improved, whereas inflation expectations of these stakeholders eased. Third, SBP's FX reserves surpassed the end-December target, reaching $16.1 billion as of January 16, mainly led by SBP's ongoing interbank FX purchases. Fourth, FBR revenue growth decelerated to 7.3 percent in December, falling short of the target. Lastly, the IMF has slightly upgraded its global growth forecast for 2026, while also highlighting the risks from elevated global tariff uncertainty and volatile commodity prices amidst geopolitical developments.

3. In view of these developments, the MPC assessed the real policy rate to be adequately positive to stabilize inflation within the target range of 5 – 7 percent over the medium term. The MPC also emphasized the need for coordinated and prudent monetary and fiscal policy mix – as well as productivity-enhancing structural reforms – to increase exports and achieve high growth on a sustainable basis.

Real Sector

4. Real GDP grew by 3.7 percent y/y in Q1-FY26 as compared to 1.6 percent in the corresponding period last year, indicating a notable pickup in economic activity. Moreover, recent outturns of HFIs suggest that this momentum continued in the second quarter of the current fiscal year. Auto sales, domestic cement dispatches, POL sales (excluding furnace oil), fertilizer off-take, and imports of machinery and intermediate goods recorded notable growth, suggesting sustained domestic demand. Consistent with these trends, LSM posted a growth of 8.0 percent y/y and 10.4 percent y/y in October and November 2025 respectively, raising cumulative LSM growth to 6.0 percent during July-November FY26. Meanwhile, in the agriculture sector, latest information on sowing and satellite imagery points towards encouraging prospects for the wheat crop. These favorable developments in the commodity-producing sectors are expected to provide further impetus to the services sector. In this context, the growth outlook has substantially improved from the earlier assessment and real GDP growth is now projected in the range of 3.75 – 4.75 percent in FY26. This economic momentum is likely to strengthen further in FY27, supported by the still-unfolding impact of the earlier reduction in the policy rate and on-going macroeconomic stability.

External Sector

5. The external current account registered a deficit of $244 million in December 2025, leading to a cumulative deficit of $1.2 billion during H1-FY26. This was mainly led by a widening in the trade deficit due to a substantial growth in imports and a decline in exports. The weak export outturns were driven by a sharp drop in food exports, particularly of rice, while HVA textile exports remained resilient. Meanwhile, sustained growth in workers' remittances and ICT services exports helped in containing the current account deficit. This has helped the SBP to build FX reserves mainly through purchases. Going forward, continued uptick in workers' remittances and supportive global commodity prices are assessed to contain the current account deficit in the range of 0 to 1 percent of GDP in FY26. Based on this outlook and the realization of planned official inflows, SBP's FX reserves are expected to surpass $18.0 billion by June 2026 and rise further in FY27, approaching the benchmark of three months of import cover. This outlook is susceptible to some major risks, especially those emanating from global trade fragmentation and geopolitical uncertainty.

Fiscal Sector

6. FBR tax revenues grew by 9.5 percent in H1-FY26 as compared to 26 percent in the same period last year. This growth was lower than the target, resulting in a shortfall of Rs329 billion. This indicates that a significant acceleration in growth would be required in H2-FY26 to achieve the FBR revenue target. Nonetheless, estimates from the financing side suggest an improvement in the fiscal balance during H1-FY26, indicating relatively contained expenditures. In particular, interest payments remained significantly lower than the same period last year, which is likely to help achieve the full-year fiscal deficit target. However, achieving the annual primary surplus target seems challenging. In this backdrop, the MPC acknowledged the supportive role of fiscal consolidation in achieving recent macroeconomic stability. At the same time, the Committee emphasized that, for the economy to grow on a sustainable basis, recent fiscal discipline should be entrenched through durable progress on structural reforms, especially to broaden the tax base and to privatize loss-making SOEs.

Money and Credit

7. Since the last MPC meeting, broad money (M2) growth picked up to 16.3 percent by January 9, mainly driven by a pickup in private sector credit and government borrowing. Private sector credit expanded by Rs578 billion during FY26 (till January 9) amidst easing financial conditions. The major borrowers included key sectors, such as textiles, wholesale and retail trade, and chemicals. Consumer financing also continued to increase. Furthermore, SBP has decided to reduce the average Cash Reserve Requirement for banks from 6.0 percent to 5.0 percent that is expected to increase the private sector credit..

Inflation

8. Headline inflation (y/y) eased to 5.6 percent in December from 6.1 percent in November amidst a moderation in food prices, notwithstanding the sharp uptick in wheat and allied product prices. Meanwhile, energy inflation increased, mainly due to fading of favorable base effect in electricity tariffs. At the same time, the Committee noted that after declining steadily during FY25, core inflation has persisted at around 7.4 percent in the first half of FY26. However, inflation expectations of both consumers and businesses continue to ease. On balance, the Committee projects inflation to stabilize within the target range of 5 – 7 percent in FY26 and FY27, after temporarily exceeding the upper bound for a few months during this calendar year. This outlook is subject to risks emanating from volatility in global commodity and domestic wheat prices, unanticipated adjustments in administrative energy prices, and a sharper than assumed pickup in domestic demand.