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ICMA MONETARY POLICY STATEMENT MPS REVIEW

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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 meeting on May 5, 2025, reduced the policy rate by 100 basis points to 11 percent, effective May 6. This decision was supported by a notable decline in inflation during March and April, driven by lower administered electricity prices and continued easing in food inflation. Core inflation also moderated, reflecting a favorable base effect amid subdued demand. While the inflation outlook has improved, the MPC noted rising global uncertainties, particularly around trade tariffs and geopolitical tensions, calling for a measured policy approach.

MPC noted that provisional real GDP growth reached 1.7% year-on-year in Q2-FY25, while Q1 growth was revised upward from 0.9% to 1.3%. In March, the current account recorded a surplus of $1.2 billion, supported by record remittances and SBP's foreign exchange purchases, which helped offset sizable debt repayments. Consumer and business confidence continued to improve; however, the widening shortfall in tax revenues remains a concern. Globally, tariff-related uncertainty led the IMF to significantly downgrade its growth outlook for 2025 and 2026, resulting in financial market volatility and a sharp decline in oil prices. The MPC assessed that the real policy rate remains sufficiently positive to keep inflation contained within the 5%–7% target range, while supporting the economy's path toward sustainable growth.

MPC Observations on Key Sectors

Real Sector

- Real GDP growth reached 1.7% in Q2-FY25, bringing H1-FY25 growth to 1.5%, in line with MPC expectations.
- High-frequency indicators reflect sustained economic momentum, with higher vehicle and petroleum sales, increased power generation, and improved stakeholders confidence.
- LSM remains below expectations due to contractions in low-weight and construction-allied segments, despite gains in garments, textiles, pharmaceuticals, and automobiles.
- Wheat output exceeded target but was lower than last year.
- FY25 GDP growth is projected at 2.5% to 3.5%, with potential acceleration in FY26, subject to global and climatic risks.

External Sector

- The current account surplus of $1.2 billion in March 2025, lifted cumulative surplus to $1.9 billion for Jul-Mar FY25, driven by record-high remittances and lower oil import bill.
- Trade deficit rose to $3.4 billion in April, per PBS data.
- High-value-added textile exports supported external sector performance.
- Net financial inflows remained weak due to large debt repayments and delayed official disbursements.
- SBP's foreign exchange reserves projected to rise to $14 billion by June 2025, with further buildup expected in FY26.
- External outlook faces risks from global economic and trade uncertainties.

Fiscal Sector

- FBR tax revenues grew 26.3% y/y in Jul-Apr FY25, but remained below target.
- Increased Petroleum Development Levy (PDL) rates expected to boost non-tax revenues.
- Expenditures remained contained in Jul-Mar FY25.
- Fiscal deficit likely to stay near target; however, achieving the primary surplus remains challenging.
- MPC emphasized fiscal reforms, especially expanding the tax base and SOE restructuring.
- Acknowledged recent provincial legislation to enhance agricultural income tax, urging effective implementation.

Money and Credit

- Broad money (M2) growth rose to 13.3% y/y by April 18, up from 11% in previous MPC meeting.
- NDA growth driven by private sector credit, which grew 12.6% y/y due to improving economic conditions.
- Credit expansion observed in textile, refinery, chemical, fertilizer, auto finance, and personal loans.
- Currency in circulation spiked due to Eid, with partial reversal afterward.
- Reserve money growth increased to 13.1% y/y by April 18.

Inflation Outlook

- Headline inflation dropped to 0.3% y/y in April, driven by falling food and energy prices.
- Major drivers: decline in wheat prices, lower global commodity prices, and reduced electricity tariffs.
- Consumer inflation expectations moderated; core inflation declined to 8.0% y/y in April from 9% previously.
- Inflation expected to rise modestly in coming months, stabilizing within 5% to 7% target range.
- Risks include food price volatility, energy price adjustments, global supply disruptions, and uncertain commodity trends.

ICMA Analysis

POLL Analysis

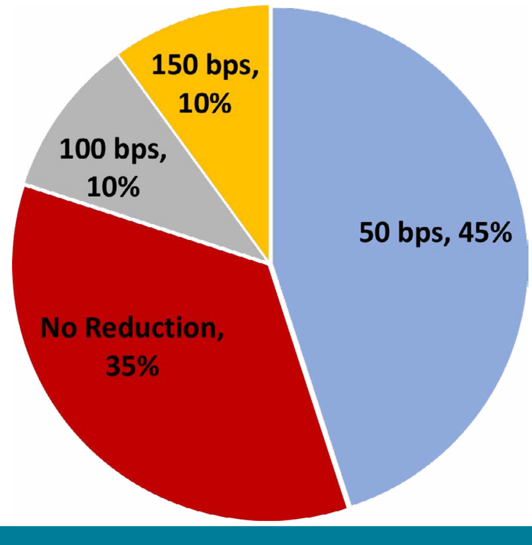
Figure 1 presents the results of an ICMA poll conducted prior to the Monetary Policy Committee (MPC) meeting held on May 5, 2025. The objective was to capture the expectations of businesses and economic analysts regarding a potential change in the policy rate. The poll revealed that 45% of respondents expected a moderate cut of 50 basis points, while 35% anticipated no change. Only 10% foresaw a more substantial reduction of 100 basis points or more. These findings indicate a clear preference for a cautious and gradual approach to monetary easing.

Figure:1

Percentage of Participants Who Expected a Policy Rate Cut or No Reduction

ICMA Poll Analysis Prior to MPC Meeting of 5th May 2025

Expectation of Businesses and Experts about the Reduction in Policy Rate



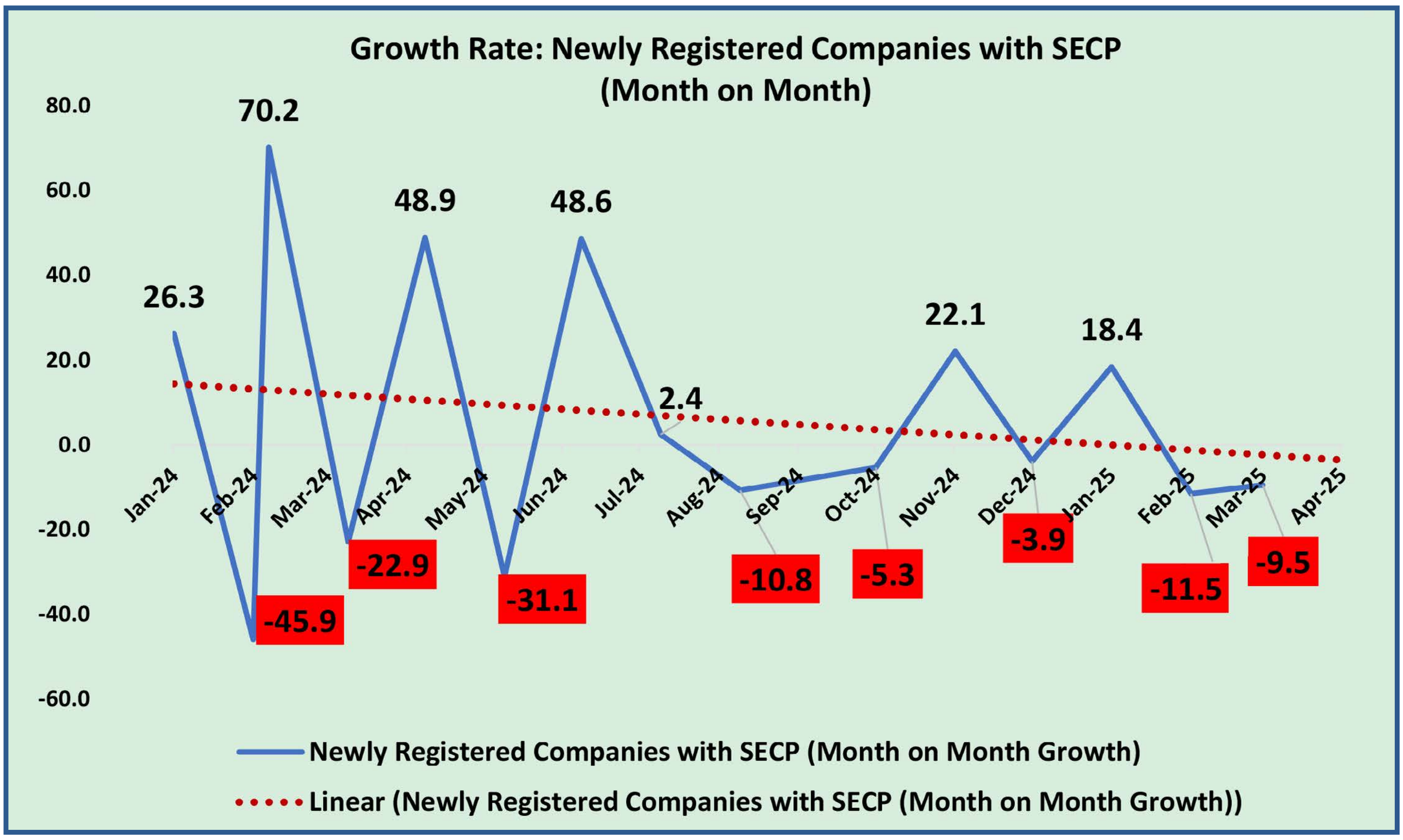
Source: ICMA Poll Analysis

However, contrary to market expectations, the State Bank of Pakistan (SBP) announced a 100 basis points cut, bringing the policy rate down to 11%. Although this decisive step is intended to boost economic activity, it contrasted with the prevailing market sentiment, which largely expected a smaller adjustment or no change. This divergence between SBP's policy stance and business expectations has introduced greater uncertainty into the market, undermining investor confidence and delaying investment decisions. The resulting disconnect is also reflected in the continued decline in new company registrations with the SECP, as highlighted in ICMA Pakistan's following economic analysis.

Interest Rate Cuts Fail to Boost New Business Registrations: ICMA Analysis

ICMA analyzed the growth trend of newly registered companies with the Securities and Exchange Commission of Pakistan (SECP) from January 2024 to March 2025. As shown in Figure 2, the number of new company registrations exhibited a mostly declining and unstable pattern, despite a substantial reduction in the State Bank of Pakistan's (SBP) policy rate from 22% to 12% over the same period.

Figure:2



Source: SECP, analysis by ICMA

In early 2024, company registrations fluctuated sharply, rising by 70% in March 2024 after falling by 46% in February 2024, reflecting heightened business uncertainty. Although the SBP began reducing the policy rate from mid-2024 to support economic activity, new business registrations failed to show consistent growth. A temporary surge in July was followed by several consecutive months of decline from August 2024 to March 2025, even when interest rates were at historic lows.

This trend suggests that monetary easing alone has not been sufficient to drive new investment or business formation. Broader structural challenges continue to constrain entrepreneurship, including political instability, delays in key economic reforms, high energy tariffs, and increased taxation in the FY25 budget. Additionally, elevated import costs for raw materials and limited access to credit; particularly for small and medium enterprises (SMEs) remain significant barriers.

Without addressing these underlying issues, lower interest rates will have a limited effect in promoting sustainable business growth and entrepreneurial activity in Pakistan.

ICMA Research and Publications (R&P) Department reached out to renowned economists and experts, as well as the businessmen and industrialists, to gather their insights on the recent decision of SBP to reduce the policy rate by 100 bps to 11 percent. Their views and perspectives are summarized below:

Experts' Insight

Dr. Ashfaque Hasan Khan, a distinguished economist and former Economic Advisor at the Ministry of Finance while speaking to ICMA, appreciated the Monetary Policy Committee's decision to cut the policy rate by 100 basis points. However, he remarked that, given the current inflation rate—hovering around 1.0%—there was sufficient room for a more aggressive rate cut. He said he had expected a reduction of at least 200 basis points. With the policy rate at 11.0% and inflation at just 1.0%, he highlighted that the real interest rate currently stands at 10.0%. He further stated that with a projected real GDP growth of only 2.5% and such a high real interest rate, achieving debt sustainability would be highly unlikely. He emphasized that this concern must be well understood by members of the Monetary Policy Committee, including the Governor of the State Bank of Pakistan. He added that overlooking the issue of debt sustainability was surprising and concerning. He concluded by saying that the decision to cut the policy rate by only 100 basis points did not appear to be based on sound economic theory or principles, but rather seemed influenced by external pressures.

Dr. Ikram ul Haq, a member of the Advisory Board and Visiting Senior Fellow at the Pakistan Institute of Development Economics (PIDE), stated that with core inflation at its lowest, a one-percent reduction in the discount rate may seem modest. However, considering the prevailing volatility following baseless allegations from India and continued war-mongering, the decision appears justified.

Mr. M. Amayed Ashfaq Tola, President of Tola Associates, while speaking to ICMA Research Department, stated that the 100-bps cut in the policy rate, though a step in the right direction, is insufficient to meaningfully boost business confidence or stimulate investment. He pointed out that with April 2025 inflation at just 0.3%, the resulting real interest rate exceeds 10%, which is excessively high by any standard. He emphasized that businesses—particularly in the manufacturing sector—are under significant stress. The LSM sector contracted by 1.9% during July–February FY25, and GDP growth in the first half of FY25 remained below 2%. In such a weak economic environment, he said, access to affordable credit is crucial for meeting working capital and investment needs. He further added that maintaining such a high real interest rate discourages private sector borrowing and increases the government's debt servicing burden. According to him, a more aggressive rate cut of around 500 basis points could have substantially reduced borrowing costs, revitalized private investment, supported job creation, and helped ease fiscal pressure through lower domestic debt payments.

Mr. Aadil Nakhoda, a faculty member at IBA Karachi, stated that recent trends in several key indicators, including the inflation rate suggest there is room for a rate cut. He noted that economic activity has increased, imports are rising, and the current account has turned positive due to record-high remittances. These developments, he said, provide the government with a cushion to reduce the discount rate and capitalize on the current momentum. He added that the 100-bps rate cut reflects a cautious approach by the SBP, which remains concerned about the potential rebound in inflation. He pointed out that external challenges persist, including uncertainties related to Trump's tariff policies and the threat of conflict on the eastern border.

Mr. Muhammad Sabir, Principal Economist at the Social Policy and Development Centre (SPDC), stated that SBP took a cautious step in the right direction by cutting the policy rate by 100bps. He noted that while this move marginally lower borrowing costs, slightly reduces debt servicing, and may encourage investment over passive savings, a more aggressive cut into single digits would have signaled greater confidence. He added that such a bold move could have provided a stronger stimulus to the real economy and created additional fiscal space by significantly reducing debt servicing costs.

Mr. Abdul Azeem, Head of Research at AL Habib Capital Markets (Pvt.) Ltd, noted that the 100bps cut to 11% is a welcome move that signals SBP's intent to revive economic growth—especially following the sharp cumulative reduction from the peak of 22%. However, he pointed out that there is still room for further easing, as LSM growth remains weak and private sector activity has yet to show meaningful recovery. He emphasized that despite this aggressive monetary easing, domestic demand continues to lag, primarily due to persistently high inflation and heavy taxation on the salaried middle class, who are the primary drivers of consumption. He added that unless real incomes rise in proportion to inflation, monetary easing alone may not be sufficient to stimulate demand. Furthermore, he stressed that SBP must maintain a careful balance between supporting growth and preserving external account stability. While lower interest rates can spur production, they may also fuel import demand. If this is not offset by stronger exports or remittances, it could place pressure on the current account and foreign exchange reserves, potentially reversing recent gains in the external sector.

Industry's Perspective

Muhammad Jawed Bilwani, President of the Karachi Chamber of Commerce & Industry (KCCI), in a message to ICMA, expressed concern over SBP's 1% policy rate cut, describing it as inadequate in the context of record-low inflation. He stated that reducing the rate to 11% does not meet the expectations of the business community, which has consistently advocated for a single-digit rate to stimulate economic growth. With inflation dropping to just 0.3% in April 2025, he argued that there is considerable room for a more significant reduction. He further noted that Pakistan's interest rate remains among the highest in the region despite having the lowest inflation, which hampers investment and job creation. "SMEs and exporters are struggling under high borrowing costs," he said, urging a more growth-oriented monetary policy. KCCI reiterated its call for a single-digit interest rate to support industry, enhance competitiveness, and attract investment.

Mr. Usman Shaukat, President of the Rawalpindi Chamber of Commerce and Industry (RCCI), in a conversation with ICMA, said that the 100bps cut in the policy rate was lower than anticipated, as the business community had been expecting a minimum cut of 200bps. While this reduction will somewhat lower the cost of leverage, he noted that the rate remains excessively high and continues to adversely impact the cost of doing business. He emphasized that the rate should be brought down to single digits immediately, as the government has long promised. He urged the SBP to adopt a more aggressive approach in reducing rates in the upcoming policy meetings.

Mr. Asif Inam, Vice President of the Federation of Pakistan Chambers of Commerce and Industry (FPCCI) Welcomed the policy rate reduction, terming it a positive step. He expressed optimism that the rate may soon enter single digits, noting that a steeper cut under the prevailing low inflation environment would have been more impactful. He added that the reduction would create fiscal space and potentially support further economic improvement.

Mr. Kashif Anwar, former President of the Lahore Chamber of Commerce and Industry (LCCI), acknowledged the significant reduction in the policy rate from 22% to 11%, calling it a commendable step. However, he emphasized that lowering interest rates alone is insufficient to stimulate industrial growth. He stressed the need for a more comprehensive approach, which includes reducing the overall cost of doing business, particularly electricity prices, and addressing regulatory challenges. Mr. Anwar also highlighted growing concerns within the business community regarding FBR and other regulatory bodies. He noted that recent policy changes have increased complexity and hindered the ease of doing business. He urged that reforms be grounded in practical realities to avoid eroding business confidence and deterring investment. He cautioned against repetitive taxation on the same tax incidents, advocating for a more balanced policy framework that also considers exchange rate stability. Without restoring investor confidence, especially among domestic investors, he warned that meaningful progress toward industrialization would remain elusive.

Mr. Abdul Waheed Khan, Director General, Pakistan Automobile Manufacturers Association (PAMA), while talking to ICMA said that the reduced cost of borrowing will certainly help grow the private sector by increasing output, alongside boosting domestic demand, despite the inflationary pressures. He cautioned, however, that a higher money supply could put pressure on the local currency, potentially affecting the exchange rate. He also highlighted the positive impact on the auto sector, noting that cheaper financing will benefit the industry.

ICMA Policy Recommendations

Following the State Bank of Pakistan's (SBP) recent 100 basis points cut in the policy rate to 11%, the lowest since March 2022. ICMA Pakistan recommends a balanced approach to maintain economic momentum and address key challenges.

Combine Monetary Easing with Structural Reforms

Lower interest rates alone are not enough to boost business activity. ICMA urges the government to support this policy by reducing industrial electricity prices, simplifying tax rules, and improving the business environment to encourage investment and growth.

Improve Fiscal Management and Widen the Tax Net

Although FBR revenues rose by 26.3% during Jul–Apr FY25, they still fell short of targets. ICMA recommends increasing tax collection by expanding the tax base, ensuring better compliance, and cutting unnecessary spending. Reforms in state-owned enterprises are also important to ease the fiscal burden.

Diversify Exports to Reduce the Trade Deficit

April's trade deficit shows that Pakistan's external position remains weak. ICMA suggests giving more support to export sectors like IT, agriculture, and pharmaceuticals to reduce reliance on imports and make the economy more stable in the long run.

Boost Investor Confidence and Make Regulations Business-Friendly

Business confidence is improving but still faces issues due to unclear regulations and complex taxes. ICMA recommends creating a stable, transparent regulatory system and involving businesses in policy-making to build trust and attract investment.

Keep Inflation Under Control and Maintain Exchange Rate Stability

Although inflation dropped to 0.3% in April, global risks still exist. ICMA advises the SBP to keep a careful watch on inflation and allow the exchange rate to adjust as needed, to help manage external shocks and avoid sharp currency movements.

Improve Access to Finance for SMEs and Key Sectors

Despite lower interest rates, many SMEs still struggle to get loans. ICMA recommends that banks be encouraged to lend more to SMEs in sectors like agriculture, IT, and manufacturing. Credit guarantee schemes, support for fintech, and better digital lending rules can help more small businesses access financing.

Muhammad Yasin, FCMA
Vice President ICMA and
Chairman, Research and Publications Committee

Research and Publications Team

Shahid Anwar, Director
Hasan Rashid, Research Officer
Muhammad Wajahat Khan, Graphic Designer

For further information or queries regarding this Review, please email: rp@icmap.com.pk