ICMA
PRE-MONETARY POLICY OUTLOOK
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PRE-MP OUTLOOK

Analyzing the Drivers of Pakistan's Monetary Policy

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ICMA Pre-Monetary Policy Outlook: Assessing the Global and Domestic Drivers of Pakistan's Monetary Policy

Preamble

The upcoming Monetary Policy Committee (MPC) meeting comes at a time when Pakistan is balancing easing domestic inflation against an increasingly uncertain global environment. While the policy rate has been maintained at 11.5 percent after a significant easing cycle, renewed geopolitical tensions, volatile international oil prices and evolving global financial conditions continue to pose risks to inflation and external-sector stability. As an energy-importing economy, Pakistan remains particularly vulnerable to oil price movements, which affect domestic fuel prices, transportation costs, production expenses and inflation expectations. These developments reinforce the need for monetary policy to assess not only domestic macroeconomic indicators but also the evolving global environment.

Global Monetary Conditions and Domestic Economic Challenges: Pakistan's Monetary Policy Outlook

Monetary policy decisions in emerging economies are influenced not only by domestic inflation and economic activity but also by external financial conditions. Changes in the US Federal Reserve's policy stance influence global financing costs, capital flows, exchange-rate expectations, imported inflation and foreign-exchange liquidity. For economies exposed to external financing and dollar-denominated obligations, these spillover channels can narrow the space available for independent monetary policy decisions.

Empirical evidence for Pakistan also suggests that the State Bank of Pakistan's interest-rate-setting behavior has historically responded not only to domestic inflation and the output gap, but also to movements in the federal funds rate. However, this relationship should not be interpreted as evidence that SBP mechanically follows the US Federal Reserve. Rather, global monetary conditions form part of the broader external environment within which SBP balances inflation, exchange-rate stability, external financing needs and domestic economic activity .

Recent BIS research similarly shows that emerging-market central banks facing higher foreign-currency exposure and relatively shallow foreign-exchange markets are more likely to move their policy rates in the same direction as US monetary-policy shocks. This co-movement may help contain excessive exchange-rate fluctuations and external financial pressures, although the intensity of the response differs according to each country's vulnerabilities and domestic conditions .

Pakistan's monetary policy cannot be viewed in isolation from global monetary developments. The United States remains a key anchor of the international financial system, while the US dollar serves as the dominant currency for global trade, external borrowing and international reserves.

Pakistan's external financing obligations, international trade settlements, import payments and a significant share of cross-border financial transactions are denominated in, or closely linked to, the US dollar. Consequently, changes in the Federal Reserve's policy stance influence Pakistan through exchange-rate movements, external financing costs, capital flows and imported inflation, making an assessment of Fed–SBP policy dynamics both relevant and necessary .

Ahead of the upcoming Monetary Policy Committee (MPC) meeting, ICMA examines the historical policy stance alignment between the US Federal Reserve and the State Bank of Pakistan from April 2023 to June 2026 to assess the extent to which global monetary conditions have influenced Pakistan's monetary policy decisions. The analysis focuses on the direction of monthly policy actions rather than the magnitude of interest-rate changes. Each monthly observation is classified as a Hike, Hold or Cut by comparing the prevailing policy rate with that of the preceding month. For concise presentation, the monthly policy stances are grouped by quarter, with the table reporting quarter-end policy rates and the number of months during which the Federal Reserve and SBP adopted the same policy direction. The findings provide useful context for assessing the external monetary environment ahead of the forthcoming MPC decision.

Table 1: Quarterly Summary of Monthly Fed–SBP Policy Stance Alignment, Q2 2023–Q2 2026

Quarter	Fed Quarter-End Rate (%)	Fed Monthly Stance Pattern	SBP Quarter-End Rate (%)	SBP Monthly Stance Pattern	Monthly Stance Matches
Q2 2023	5.08	Hike–Hike–Hike	22.00	Hike–Hold–Hike	2 of 3
Q3 2023	5.33	Hike–Hike–Hold	22.00	Hold–Hold–Hold	1 of 3
Q4 2023	5.33	Hold–Hold–Hold	22.00	Hold–Hold–Hold	3 of 3
Q1 2024	5.33	Hold–Hold–Hold	22.00	Hold–Hold–Hold	3 of 3
Q2 2024	5.33	Hold–Hold–Hold	20.50	Hold–Hold–Cut	2 of 3
Q3 2024	5.13	Hold–Hold–Cut	17.50	Cut–Hold–Cut	2 of 3
Q4 2024	4.48	Cut–Cut–Cut	13.00	Hold–Cut–Cut	2 of 3
Q1 2025	4.33	Cut–Hold–Hold	12.00	Cut–Hold–Hold	3 of 3
Q2 2025	4.33	Hold–Hold–Hold	11.00	Hold–Cut–Hold	2 of 3
Q3 2025	4.22	Hold–Hold–Cut	11.00	Hold–Hold–Hold	2 of 3
Q4 2025	3.72	Cut–Cut–Cut	10.50	Hold–Hold–Cut	1 of 3
Q1 2026	3.64	Cut–Hold–Hold	10.50	Hold–Hold–Hold	2 of 3
Q2 2026	3.63	Hold–Cut–Hold	11.50	Hike–Hold–Hold	1 of 3

Note: Monthly policy stances are determined by comparing each month's policy rate with the preceding month. The table groups the three-monthly policy stances within each quarter and reports the number of months in which the Federal Reserve and SBP adopted the same policy direction. Quarter-end rates represent the rates prevailing in March, June, September and December, respectively.

Interpretation

- ICMA's analysis shows that the Federal Reserve and SBP adopted the same monthly policy stance in 26 out of 39 observations between April 2023 and June 2026, representing an overall policy stance alignment of approximately 67 percent. This indicates broad co-movement between the two monetary policy cycles, although the relationship was neither continuous nor one-to-one.

- Of the 26 matching observations, 19 were Hold–Hold, five were simultaneous cuts and two were simultaneous hikes, indicating that policy persistence contributed more to overall alignment than active policy changes. Co-movement was also evident during selected tightening and easing episodes when global and domestic macroeconomic conditions broadly warranted a similar policy response.

- Despite the overall policy alignment, episodes of divergence demonstrate that SBP continued to calibrate its policy decisions in response to Pakistan's domestic inflation outlook, external-sector conditions and broader macroeconomic risks, rather than mechanically mirroring the Federal Reserve's policy stance.

- Importantly, the observed policy alignment should not be interpreted as evidence that SBP lacks monetary policy independence. Rather, it reflects the practical realities of an emerging economy that remains exposed to external financing needs, exchange-rate pressures and the predominance of the US dollar in Pakistan's external trade and financial obligations.

The findings suggest that Pakistan's monetary policy operates within the broader global monetary cycle while retaining sufficient flexibility to respond to domestic macroeconomic conditions. Although changes in the Federal Reserve's policy stance influence global financial conditions, exchange-rate expectations and external financing costs, SBP continues to calibrate its policy decisions in line with Pakistan's inflation outlook, external-sector position and growth prospects. As the upcoming Monetary Policy Committee meeting approaches, both global monetary developments and domestic macroeconomic conditions will remain central to future policy decisions.

ICMA Policy Recommendations

1. Strengthen Monitoring of Global Monetary Conditions

The State Bank of Pakistan should continue to systematically assess developments in the Federal Reserve's policy stance alongside global financial conditions, commodity prices and capital flow trends. Regular monitoring of these external factors can help improve the timeliness and effectiveness of monetary policy decisions.

2. Preserve a Balanced and Data-Driven Policy Framework

While global monetary developments influence Pakistan's policy environment, monetary policy decisions should continue to be guided primarily by domestic inflation, economic activity, financial stability and external-sector conditions. Maintaining this balanced approach will help preserve monetary policy credibility while responding appropriately to evolving economic conditions.

3. Enhance External Sector Resilience

Strengthening foreign exchange reserves, promoting export competitiveness and reducing vulnerabilities associated with external financing will expand Pakistan's monetary policy flexibility and improve its ability to withstand global monetary and financial shocks.

4. Strengthen Coordination Between Monetary and Fiscal Policies

Given the interaction between global monetary conditions and domestic macroeconomic management, closer coordination between monetary and fiscal authorities can support macroeconomic stability, reduce policy trade-offs and improve the effectiveness of policy responses during periods of external uncertainty.

5. Enhance Transparency on External Policy Considerations

Where global developments materially influence policy decisions, the State Bank of Pakistan may further strengthen policy communication by clearly explaining how international monetary conditions, alongside domestic economic indicators, have been considered in the policy assessment. Greater transparency can help improve market understanding, anchor expectations and reinforce confidence in the monetary policy framework.