Monetary Policy Statement

June 16, 2025

1. At its meeting today, the Monetary Policy Committee (MPC) decided to keep the policy rate unchanged at 11 percent. The Committee noted that the increase in inflation in May to 3.5 percent y/y was in line with its expectation, whereas core inflation declined marginally. Meanwhile, inflation expectations of both households and businesses moderated. Going forward, inflation is expected to trend up and stabilize in the target range during FY26. The MPC also assessed that economic growth is picking up gradually and is projected to gain further traction next year, supported by the still-unfolding impact of earlier policy rate cuts. At the same time, the Committee noted some potential risks to the external sector amidst the sustained widening in the trade deficit and weak financial inflows. Moreover, some of the proposed FY26 budgetary measures may further widen the trade deficit by increasing imports. In this regard, the Committee deemed today's decision appropriate to sustain the macroeconomic and price stability.

2. The Committee noted the following key developments since its last meeting. First, the real GDP growth for FY25 is provisionally reported at 2.7 percent, and the government is targeting higher growth of 4.2 percent for next year. Second, despite a substantial widening in the trade deficit, the current account remained broadly balanced in April. Meanwhile, the completion of the first EFF review led to the disbursement of around $1 billion, which increased the SBP's FX reserves to $11.7 billion as of June 6. Third, the revised budget estimates indicate the primary balance surplus at 2.2 percent of GDP in FY25, up from 0.9 percent last year. For next year, the government is targeting a higher primary surplus of 2.4 percent of GDP. Lastly, global oil prices have rebounded sharply, reflecting the evolving geopolitical situation in the Middle East and some ease in US-China trade tensions.

3. Taking stock of these developments and potential risks, the Committee assessed that the real interest rate remains adequately positive to stabilize inflation within the target range of 5 – 7 percent. Furthermore, the Committee emphasized the timely realization of planned foreign inflows, achievement of the targeted fiscal consolidation and the implementation of structural reforms as essential to maintain macroeconomic stability and achieve sustainable economic growth.

Real Sector

4. According to provisional PBS estimates, the economy gained momentum during the second half of FY25, with real GDP growth accelerating to 3.9 percent from 1.4 percent in H1-FY25. This outturn was broadly in line with the MPC's earlier expectations, though with compositional differences. The agriculture sector underperformed relative to FY24 due to a sizable decline in the production of major crops. In contrast, the industry and services sectors contributed to the uptick in real GDP growth, particularly in H2-FY25. Looking ahead, the MPC anticipates the industry and services sectors to continue to drive economic growth in FY26. This assessment is supported by the sustained momentum in high-frequency indicators – including credit to private sector, imports of machinery and intermediate goods, and business sentiments – and easing financial conditions. However, agriculture prospects appear subdued, as indicated by initial information of Kharif crops amidst unfavorable weather conditions. On balance, the Committee expects real GDP growth to increase further during FY26.

External Sector

5. The current account was almost balanced in April 2025, taking the cumulative surplus to $1.9 billion during July-April FY25. Imports continued to grow in line with improving economic activity; while export growth decelerated, partly due to the challenging global trade environment. However, workers' remittances continued to remain strong and more than offset the impact of the widening trade deficit on the current account. Based on these trends, the current account is expected to remain in surplus in FY25. Nonetheless, the uncertain global trade environment, coupled with expected continued strong import demand, is projected to turn the current account into a moderate deficit in FY26. Meanwhile, the MPC noted that despite net financial inflows remaining weak so far, the SBP's FX reserves are expected to increase to around $14 billion by end-June 2025. Going forward, external outlook is susceptible to multiple risks, which mainly stem from heightened geopolitical tensions, volatility in international oil prices, possible adverse impact of proposed budgetary measures, and potential shortfalls in planned financial inflows.

Fiscal Sector

6. The revised budget estimates indicate that both the overall fiscal and primary balances improved further during FY25. This improvement came on the back of an increase in revenues and relatively contained expenditures, especially PSDP. Meanwhile, amidst a shortfall in budgeted external financing, the government's reliance on domestic financing sources rose significantly. For FY26, the government is targeting further fiscal consolidation and has set the primary surplus target at 2.4 percent of GDP. The MPC emphasized on achieving the envisaged fiscal consolidation by pursuing effective and timely implementation of reforms, especially broadening the tax base and privatizing or reforming PSEs.

Money and Credit

7. As of May 30, broad money (M2) growth moderated to 12.6 percent from 13.3 percent at the time of the last MPC meeting. This is due to a deceleration in NDA of the banking system, as the growth in net budgetary borrowing declined. Meanwhile, private sector credit growth remained strong at around 11 percent in the wake of easing financial conditions and improving business sentiments. Textiles, telecommunications and wholesale & retail sectors were the major borrowers, whereas consumer finance also grew at a robust pace. At the same time, the Committee noted a significant uptick in reserve money growth. This is mainly explained by the Eid-related seasonal rise in currency in circulation, which required SBP to increase its liquidity injections to ensure that the interbank overnight repo rate remained close to the policy rate.

Inflation

8. As anticipated, headline inflation increased to 3.5 percent y/y in May from 0.3 percent in April. This reversal largely reflected the phasing out of the favorable base effect from food prices, along with persistence in core inflation. In contrast, energy prices continued to remain lower than last year, mainly reflecting the impact of moderation in global oil prices. Further, the MPC's initial assessment indicates the recent budgetary measures to have a limited impact on the inflation outlook. Nonetheless, some near-term volatility in inflation is expected, before it gradually inches up and stabilizes within the 5 – 7 percent target range. This outlook, however, remains subject to multiple risks emanating from potential supply-chain disruptions from regional geopolitical conflicts, volatility in oil and other commodity prices, and the timing and magnitude of domestic energy price adjustments.