PAKISTAN INSTITUTE OF DEVELOPMENT ECONOMICS

September 2026 Monetary Policy Assessment

Market Expectations, Macroeconomic Conditions and Policy Assessment

PIDE MONETARY POLICY TRACKER: Pre-MPC scorecard risk dashboard and conditional forward guidance

EXECUTIVE ASSESSMENT

Pakistan enters the September Monetary Policy Committee meeting at a delicate policy juncture. Inflation has reaccelerated, but the evidence does not yet point to generalized demand overheating. The policy challenge is therefore not simply to react to a higher inflation print, but to distinguish between a first-round price shock and the emergence of persistent, broad-based inflation.

Headline inflation rose sharply to 11.15 percent in August, from 9.2 percent in July. More importantly for monetary policy, urban and rural NFNE core inflation reached 8.8 and 8.5 percent, while trimmed inflation stood close to 9 percent. The rise in underlying measures warrants vigilance and effectively rules out monetary easing. It does not, however, by itself establish the case for another rate increase.

Much of the immediate inflationary pressure continues to originate in food, energy and transport, with recent fuel and electricity adjustments adding further near-term pressure. Monetary policy cannot reverse these first-round relative-price shocks. Its critical task is to prevent them from propagating into core inflation, services prices, wages, inflation expectations and the exchange rate. The rise in trimmed inflation is therefore an important warning signal: the risk of propagation has increased and must be watched closely.

On the demand side, the evidence remains mixed rather than inflationary. Economic activity is recovering, but unevenly. Recent money and credit developments do not indicate a generalized overheating cycle, although positive annual private-sector credit growth warrants monitoring. At the same time, the previous monetary tightening continues to transmit through KIBOR, deposit and lending rates, strengthening the case for allowing the existing stance more time to work.

Financial-market pricing similarly calls for caution rather than an immediate policy response. Short-term Treasury yields remain close to the policy rate, while longer maturities carry a moderate premium. This is consistent with a hold while signaling medium-term inflation concern, rather than providing a compelling market case for an immediate hike.

The policy decision must ultimately be forward-looking. The relevant question is not whether the nominal policy rate remains marginally above today's headline inflation, but whether the forward-looking real policy rate remains sufficiently restrictive to return inflation toward its medium-term objective while preserving external stability and avoiding unnecessary damage to the recovery.

PIDE recommends maintaining the policy rate at 11.5 percent. The appropriate stance is a hawkish, conditional hold. Inflation is too elevated and uncertain to permit easing, but the evidence does not yet justify another increase. Further tightening should be triggered by clear evidence that the current price shock is becoming broader, persistent and embedded through accelerating core and trimmed inflation, worsening price diffusion, deteriorating inflation expectations, or sustained exchange-rate and reserve pressures. Easing should wait until disinflation is firmly re-established across both headline and underlying measures.

PIDE POLICY CALL

Maintain the policy rate at 11.5 percent with a tightening bias. The stance should remain restrictive and explicitly data dependent. Further tightening should follow sustained acceleration in core and trimmed inflation, broader price diffusion, worsening inflation expectations, or sustained exchange-rate and reserve pressure. Easing should wait until disinflation is firmly re-established across headline and underlying measures and the forward-looking real policy rate remains sufficiently positive.

PIDE DECISION FRAMEWORK: FIVE PILLARS OF THE POLICY CALL

The policy call comes from the combined reading of five pillars. No single data point carries the decision.

Table 1: Five Pillars of the September 2026 Monetary Policy Decision

Policy pillar	Current reading	Implication for 14 September
Inflation and persistence	Headline 11.15 percent; NFNE core 8.8 percent urban and 8.5 percent rural; trimmed measures close to 9 percent.	Hold with a tightening bias. Do not ease.
Inflation expectations and persistence indicators	The latest available SBP consumer and business surveys suggest some easing in inflation expectations relative to their preceding rounds. Because these surveys do not provide a directly comparable numerical 12-month inflation forecast, the signal should be treated as directional and assessed alongside core inflation, trimmed measures, price diffusion and exchange-rate developments.	Preserve credibility and watch for second-round effects.
Growth and output	Recovery is positive but uneven. Available indicators do not yet show generalized demand overheating, although positive annual private-sector credit growth and the recovery in activity warrant monitoring.	Avoid an immediate increase unless inflation broadens.
Financial conditions	Short T-bill yields remain near the policy rate. Longer tenors carry a moderate premium.	Hold while monitoring transmission and lending conditions.
External stability	Reserves and the rupee provide a buffer. Oil prices and financing needs limit the room for maneuver.	Supports a hold, but not a cut.

MACROECONOMIC SNAPSHOT

PRE-MPC DASHBOARD · MONETARY POLICY ASSESSMENT · 14 SEPTEMBER 2026

MACRO POLICY LAB – PIDE

POLICY SIGNAL

HAWKISH HOLD
policy rate 11.5%

MONEY MARKET PRICING

SIGNAL HOLD

11.39%	11.60%	11.90%	11.99%
1-month MTB	3-month MTB	6-month MTB	12-month MTB
Near policy rate	About +10 bps	About +40 bps	About +49 bps

Takeaway. The short end remains close to the policy rate. Longer tenors price caution, but do not make a strong case for an immediate increase.

INFLATION & MONETARY

SIGNAL HAWKISH HOLD

11.15%	8.8 / 8.5%	8.62%	11.5%
Headline CPI	Core NFNE	Weekly SPI	Policy rate
August 2026, YoY	Urban / rural	Week ended 10 Sep	Since 27 Apr 2026

Takeaway. Inflation leaves no room for easing. The MPC should watch whether food and fuel pressures spread into core prices and expectations.

DOMESTIC ECONOMY

SIGNAL HOLD

+4.98%	-3.5%	-Rs 370.13bn	-Rs2,514.39bn
LSM growth	LSM, June	Private credit	Broad money
FY2026	Year on year	End June to 28 Aug	End June to 28 Aug

Takeaway. The recovery remains uneven, and demand is not overheating. Higher rates would raise financing costs but do little against supply shocks.

EXTERNAL SECTOR

SIGNAL HOLD WITH CAUTION

-US$328m	US$3.66bn	US$23.72bn	Rs277.32/$
Current account July 2026	**Remittances** August 2026	**Total reserves** US$18.33bn-SBP reserves 4 September 2026	**Exchange rate** 11 September 2026

Sources: Pakistan Bureau of Statistics; State Bank of Pakistan; Finance Division. Information available up to 12 September 2026.

Maintain the policy rate at 11.5 percent. Keep a tightening bias and act only if inflation becomes broader and persistent, or external buffers weaken.

MONEY-MARKET PRICING IS CONSISTENT WITH A HOLD

Treasury-bill yields provide useful market evidence, but they should not dictate the MPC decision. The one-month yield remains below the policy rate, and the three-month yield is close. The premium rises across the six- and twelve-month tenors. These yields reflect banking-system liquidity, government borrowing requirements, auction supply and term premium. They should therefore not be interpreted as pure market expectations of the next MPC decision.

Table 2: Treasury Bill Yields and the Money-Market Signal

	Auction dates	8-Jul-26	22-Jul-26	2-Sept-26	Spread	Market Reading
		%	%	%	Bps	
MTBS	1-Month	11.40	11.35	11.39	-11	Low immediate pressure
	3-Month	11.40	11.52	11.60	+10	Broadly aligned with the policy rate
	6-Month	11.44	11.80	11.90	+40	Moderate medium-term caution
	12-Month	11.49	11.99	11.99	+49	Moderate longer-term caution

Source: State Bank of Pakistan; PIDE analysis.

> **Short-term yields support a hold. The premium at six- and twelve-months points to moderate inflation caution, not an immediate policy-rate increase.**

LENDING TRANSMISSION IS OPERATING BUT INCOMPLETE

Higher KIBOR, deposit rates and outstanding lending rates have followed the April policy-rate increase. The adjustment in rates on new lending has been smaller. Bank lending spreads have narrowed: the spread between new lending and fresh deposit rates declined from 3.91 percentage points in March to 3.66 percentage points in July, while the spread on outstanding loans and deposits fell from 3.49 to 3.16 percentage points. These comparisons indicate that transmission is operating, although the movements should not be read as pure causal effects because market conditions and changes in loan and deposit composition also matter. Since the April tightening is still transmitting through KIBOR, deposit and lending rates, another increase should require clearer evidence that underlying inflation or expectations are worsening, particularly if stronger credit demand also points to rising domestic demand.

Table 3: Changes in Market Lending and Deposit Rates Since March 2026

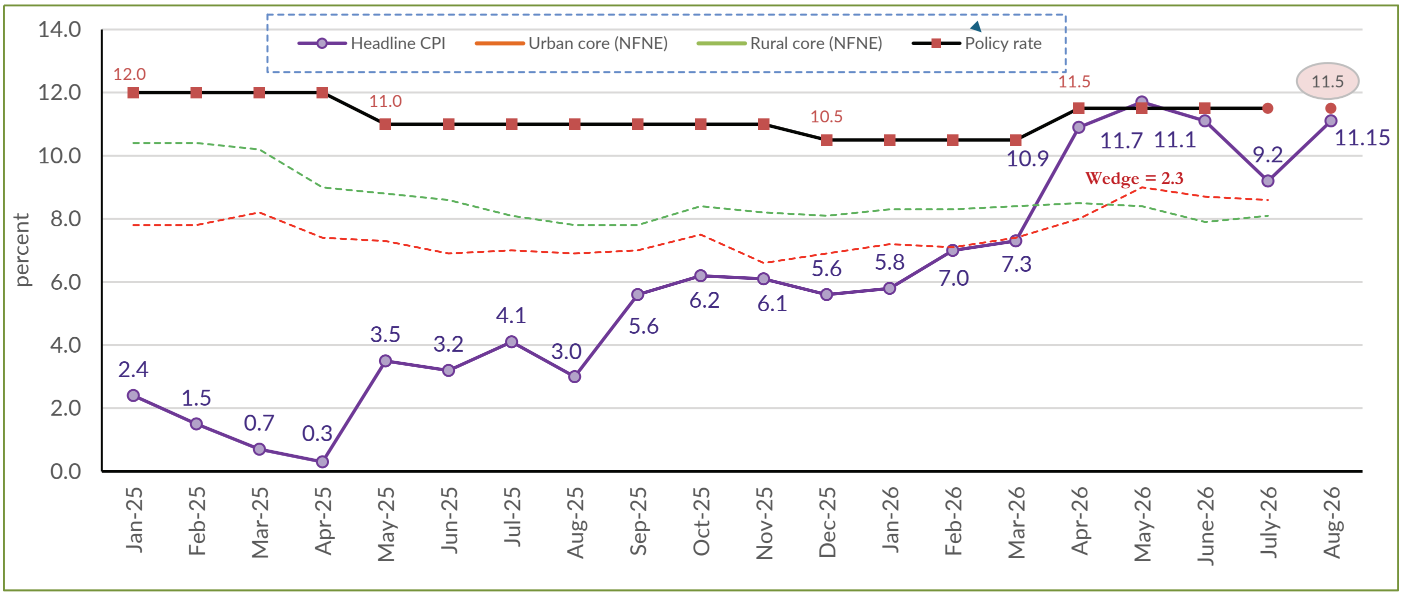
Indicator	March 2026 (%)	Latest observation (%)	Change (bps)
Policy rate	10.50	11.50	+100
3-month KIBOR offer	11.03	11.77	+74
6-month KIBOR offer	11.12	11.99	+87
Rate on new lending	11.92	12.34	+42
Rate on outstanding loans	11.54	12.24	+70
Rate on fresh deposits	8.01	8.68	+67
Rate on outstanding deposits	8.05	9.08	+103

Source: State Bank of Pakistan. KIBOR observations are for 11 September 2026; lending and deposit rates are for July 2026.

INFLATION RISKS REQUIRE CONTINUED VIGILANCE

August interrupted the easing seen in July. Headline inflation rose to 11.15 percent, while urban and rural NFNE core inflation reached 8.8 and 8.5 percent. Trimmed inflation also increased to 8.9 percent in urban areas and 9.1 percent in rural areas. The rise in trimmed measures matters because it shows that pressure is no longer confined entirely to a few administered prices. The restrictiveness of the monetary stance should be assessed against expected inflation over the policy horizon, rather than the latest headline inflation rate alone. SBP's July baseline projected inflation to stabilize near the upper bound of its 5-7 percent target range by June 2027. As an illustrative benchmark, comparing the 11.5 percent policy rate with the 7 percent upper bound gives a margin of 4.5 percentage points. This is not a precise forward-looking real policy rate, which depends on expected inflation over the policy horizon. Even so, it suggests that the current stance remains restrictive under the baseline. The cushion would narrow if food, fuel and administered-price shocks propagate into underlying inflation and expectations.

Figure 1: Headline Inflation Core Inflation and the SBP Policy Rate



Source: Pakistan Bureau of Statistics, Monthly Review on Price Indices, August 2026; State Bank of Pakistan.

Table 4: Headline Core and Trimmed Inflation Measures August 2026

Measure	August 2026 YoY (%)	August 2026 MoM (%)	Assessment
Headline CPI	11.15	1.19	Sharp rebound
Urban NFNE	8.8	0.5	Persistent
Rural NFNE	8.5	0.6	Rising
Urban trimmed	8.9	0.4	Breadth increased
Rural trimmed	9.1	1.1	Most concerning breadth signal

SHORT-TERM PRICE PRESSURES AND SPI BREADTH

The Sensitive Price Indicator increased by 0.23 percent week-on-week during the week ended 10 September 2026, while year-on-year SPI inflation reached 8.62 percent. The combined SPI stood at 364.26, compared with 363.42 in the preceding week. Of the 51 monitored items, prices of 14 increased, 10 decreased and 27 remained unchanged. The petroleum-price revision effective 12 September is not captured in the SPI for the week ended 10 September and represents an additional near-term inflation risk.

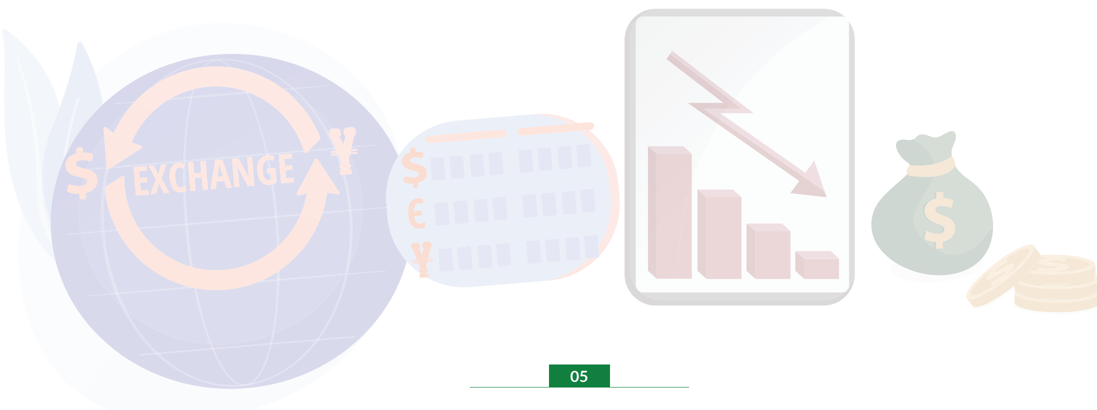
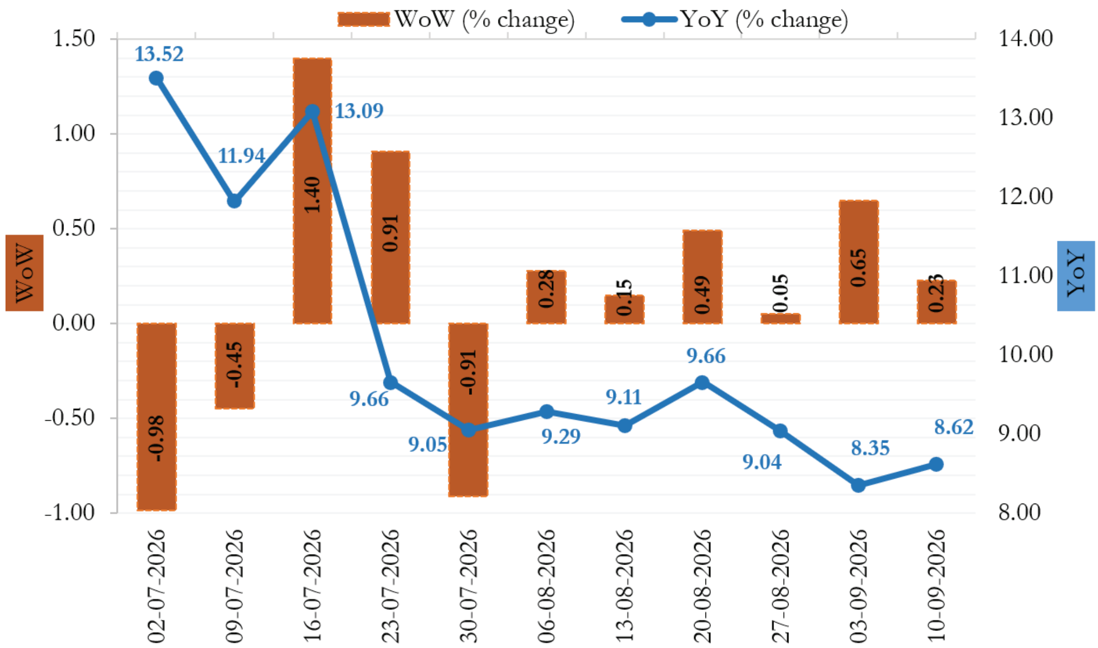


Figure 2: Weekly SPI Price Breadth for the Week Ended 10 September 2026



Source: Pakistan Bureau of Statistics, Weekly SPI report through 10 September 2026

Weekly outcome	Official reading
Items increasing	14 of 51
Items decreasing	10 of 51
Items unchanged	27 of 51
Largest weekly increase	Petrol (6.18%), Diesel (5.49%), LPG (4.32%)
Largest weekly decreases	Bananas (7.73%), Tomatoes (5.24%), Chicken (4.22%), Onions (3.72%)

OIL PRICES AND SECOND ROUND INFLATION RISK

According to the official petroleum-price notification effective 12 September 2026, the price of petrol increased to Rs375.82 per litre, while high-speed diesel increased to Rs403.32 per litre. These increases reinforce the near-term inflation risk through freight charges, public transport fares, farm operations and household budgets. Their full direct and indirect effects will appear in the CPI with a lag. The higher diesel price may be particularly consequential because diesel costs pass through widely into production and distribution. Monetary policy cannot reverse this first-round supply shock. The policy concern is whether repeated fuel-price increases begin to influence wage demands, services prices and inflation expectations. A rate increase would become more defensible if this second-round transmission became broad and persistent.

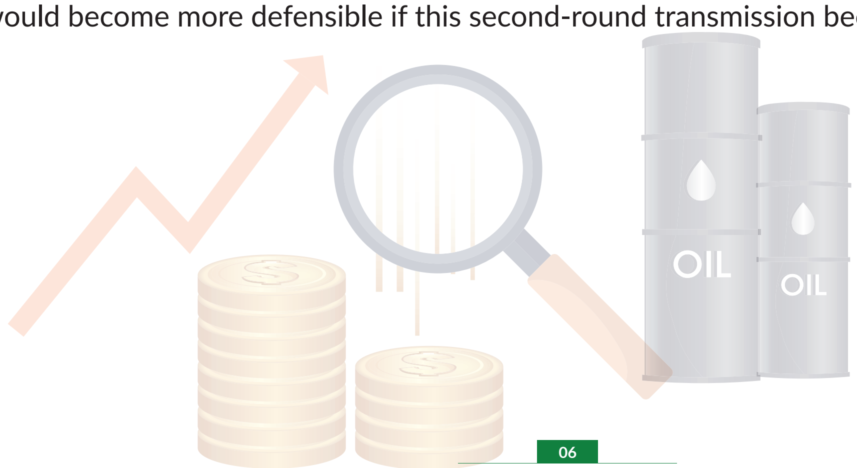
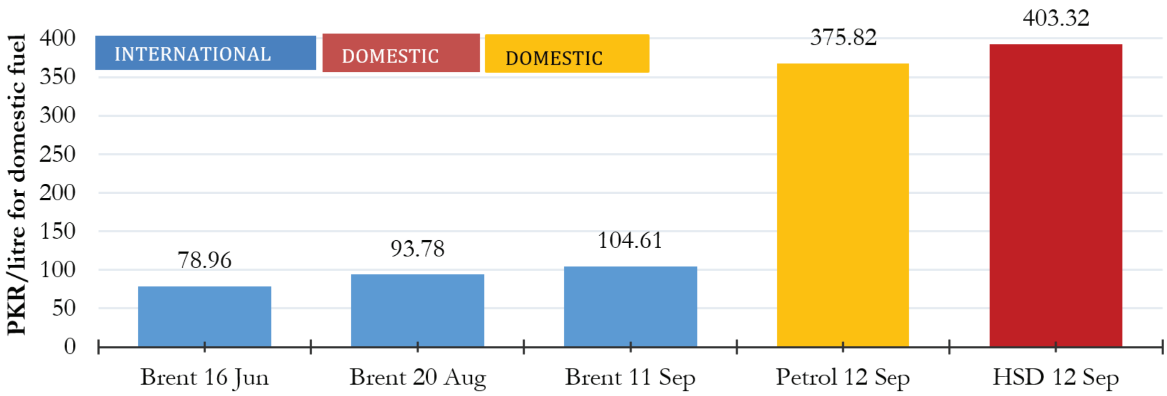


Figure 3: International Crude Oil and Domestic Fuel Prices

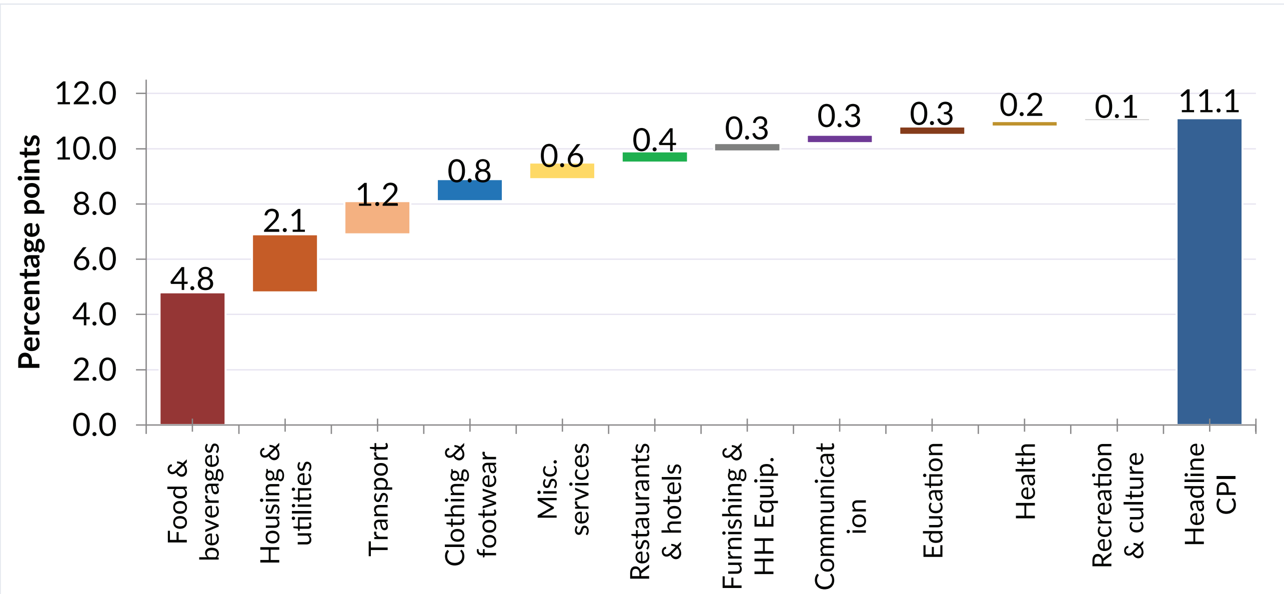


Source: Petroleum Division notifications; International Energy Agency September 2026.

INFLATION CONCENTRATION AND SIGNS OF BROADENING

Food, housing and energy, and transport contributed about 73 percent of August headline inflation. This concentration explains why a further rate increase would have only a limited effect on the initial shock. It does not justify complacency. Core inflation remains elevated, and the increase in trimmed inflation indicates that pressure is reaching a wider set of prices. The crucial question for the MPC is whether this broadening continues after the immediate food, fuel and electricity adjustments pass through. Persistent increases in services prices, wages or inflation expectations would materially change the policy balance.

Figure 4: Contributions of Major CPI Groups to Year on Year Headline Inflation August 2026



Source: Pakistan Bureau of Statistics, Monthly Review on Price Indices, August 2026; MPL calculations.

INFLATION OUTLOOK AND POLICY HORIZON

Available indicators do not yet show generalized demand overheating. Large-scale manufacturing grew by 4.98 percent during FY2026 but fell by 3.5 percent year-on-year in June. Similarly, seasonal private-sector credit retirement has occurred alongside positive annual growth in the outstanding credit stock. FY2026 fiscal consolidation improved the starting position, with the fiscal deficit narrowing to 2.6 percent of GDP and the primary surplus reaching 2.9 percent. However, the September policy decision must also consider the prospective FY2027 fiscal impulse. The FY2027 targets envisage an overall deficit of 3.6 percent of GDP and a primary surplus of 2.0 percent. Their monetary implications will depend on actual tax collection, development-spending execution, government borrowing and energy-pricing measures.

Table 5: Inflation Outlook Scenarios and Monetary Policy Implications

Scenario	6–12-month outlook	12–18-month outlook	Policy implication
Baseline	Near-term inflation remains elevated but gradually eases as food and energy shocks fade.	Inflation moves closer to the target range if expectations, the exchange rate and fiscal conditions remain stable.	Maintain 11.5 percent and allow existing tightening to work.
Upside risk	Repeated fuel, electricity, food or exchange-rate shocks spread into core and trimmed inflation.	Inflation becomes broader and more persistent, with expectations becoming less anchored.	Tighten if propagation is sustained and supported by multiple indicators.
Downside risk	Food and energy pressures reverse, price diffusion narrows and core inflation moderates.	Disinflation becomes established across headline and underlying measures.	Consider gradual easing while preserving a positive forward-looking real rate.

GROWTH IS RECOVERING BUT REMAINS UNEVEN

Large-scale manufacturing expanded by 4.98 percent during FY2026, but output fell by 3.5 percent year-on-year in June. The recovery therefore has real momentum, yet it is not uniform. Money and credit data tell the same story. There is little evidence that strong domestic demand is driving the present inflation shock. The FY2026 fiscal consolidation provides a stronger starting position. Its support for monetary policy during FY2027 will, however, depend on actual revenue collection, development-spending execution, government borrowing and energy-pricing decisions.

Figure 5: Domestic Activity, Money and Credit Indicators

Money & Credit Indicators: Policy Reading

INDICATOR	LATEST OBSERVATION	POLICY READING
LSM FY2026	+4.98%	▲ Recovery improved
LSM June 2026	-3.5% YoY -6.1% MoM	▼ Recent momentum weakened
Broad money	Rs43,945.707 billion as of 28 August 2026; down Rs2,514.387 billion since end-June	◆ No excess liquidity signal
Private-sector credit	–Rs370.13 billion from 1 July to 28 August 2026; outstanding stock approximately Rs11.04 trillion, up about 13.4% YoY	◆ Seasonal retirement; annual credit growth remains positive

● Improving ● Weakening ● Neutral – liquidity ● Neutral – credit

Growth (LSM FY2026) has improved on the year, but the latest monthly reading has softened. Available money and credit indicators do not yet show generalized overheating, although positive annual private-sector credit growth warrants monitoring.

EXTERNAL SECTOR PROVIDES POLICY SPACE, BUT RISKS REMAIN

The current-account deficit stood at US$ 328 million in July, while remittances reached US$ 3.66 billion in August 2026. External buffers remain useful but have weakened since early July. SBP reserves declined from US$18.471 billion on 3 July to US$ 23.72 billion on 4 September. This reduces the need for an immediate defensive rate increase, but it also limits the room for monetary easing. NEPRA also approved a fuel-cost adjustment of Rs 2.0581 per kWh for July consumption and a quarterly tariff adjustment of Rs 0.5194 per kWh, both subject to the notified billing treatment. These adjustments may add to near-term inflation. The government also announced a US$ 3 billion dual-tranche Eurobond transaction on 3 September. It improves near-term market access, but the resulting debt will add to future servicing obligations.

Figure 6: Monthly Workers Remittances and Three Month Moving Average

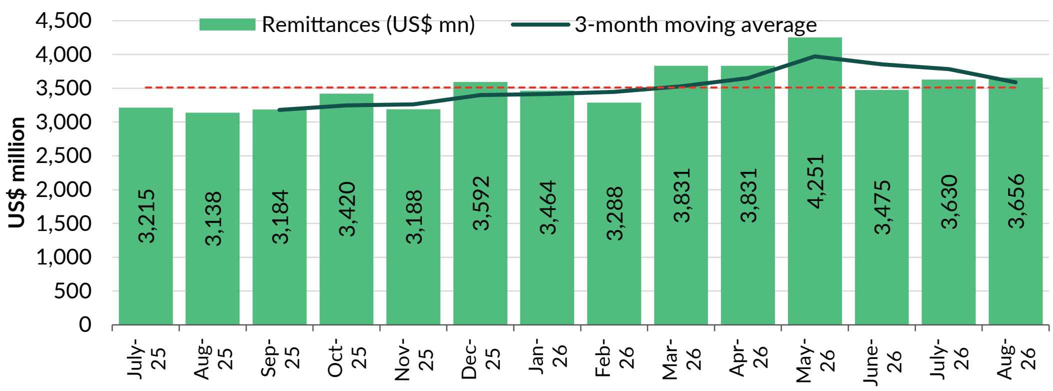


Table 6: Selected External Sector Indicators

Indicator	Latest observation	Assessment
Current account	-US$328m in July	Manageable with caution
Workers remittances	US$3.63bn in July; US$3.66bn in August	Supportive
SBP reserves	US$18.47bn on 3 July, 2026 US$18.33 bn on 4 September, 2026	Supports hold
Total reserves	US$23.99bn on 3 July, 2026 US$23.72bn on 4 September 2026	Useful but reduced buffer
PKR per US dollar	Rs277.32/US$ on 11 September 2026	Orderly

POLICY RISK MATRIX

Table 7: Monetary Policy Risk Matrix

RISK	LIKELIHOOD	LIKELY EFFECT	POLICY IMPLICATION
Persistent oil shock	HIGH	Higher transport costs, import bill, and expectations risk	Hold with tightening bias; increase if second-round effects broaden.
Persistent core inflation	MEDIUM-HIGH	Slower disinflation and weaker expectations anchoring	Delay easing; tighten if persistence strengthens.
Food supply disruption	HIGH	Higher CPI and a heavier burden on lower-income households	Use supply and administrative action; tighten only if effects broaden.
Exchange-rate pressure	MEDIUM	Imported inflation and reserve loss	Hold or tighten according to persistence and pass-through.
Weak industrial recovery	MEDIUM	Lower investment, output and employment	Argues against unnecessary tightening.
Faster disinflation with stable buffers	LOW-MEDIUM	Improved real incomes and more policy space	Consider gradual easing later.

POLICY ASSESSMENT

The case against an immediate increase

The largest inflation pressures still come from food, energy and transport. Recent credit flows remain subdued, although the outstanding stock of private-sector credit continues to show positive annual growth. The recovery also remains uneven. Higher rates would raise financing costs quickly but would not reverse the first-round supply shock. An increase should require decisive evidence that the shock is spreading into underlying inflation, expectations or external pressure.

The case against a rate cut

Headline, core and trimmed inflation all worsened in August. Oil and domestic fuel prices remain elevated, while electricity adjustments may add to near-term pressure. Longer Treasury-bill yields carry a moderate premium. Moreover, the high inflation readings in the first two months of FY2027 have increased the risk that average inflation will exceed the government's budget assumption. Easing would therefore be difficult to defend.

Overall policy judgment

The balance still favours holding the rate at 11.5 percent. The stance should be described as a hawkish hold. This is a conditional decision rather than a passive one. The MPC should be prepared to tighten if core inflation, price breadth and external pressure worsen together.

FORWARD GUIDANCE CONDITIONS FOR HOLD CUT OR HIKE

Table 8: Conditional Forward Guidance for Hold Cut or Increase

Policy stance	Indicative conditions
HOLD baseline	Inflation remains above target; core stays elevated but does not accelerate sharply; the rupee and reserves remain broadly stable; and demand does not overheat.
CUT gradual easing	Sustained moderation in headline, core and trimmed inflation; stable oil prices; secure external financing; an orderly exchange rate; and a positive forward-looking real rate.
HIKE risk response	Sustained acceleration in core or trimmed inflation; persistent broadening of price increases over several weeks; worsening inflation expectations; stronger fuel and electricity pass-through; or sustained exchange-rate and reserve pressure.

PIDE Policy Call

PIDE Policy Call: Maintain the policy rate at 11.5 percent on 14 September 2026. Keep a tightening bias. A measured increase should remain available if core or trimmed inflation accelerates, price increases broaden persistently over several weeks, fuel and electricity adjustments generate visible second-round effects, or sustained exchange-rate and reserve pressures emerge. Easing should wait until disinflation is visible in both headline and underlying measures.

DATA SOURCES

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