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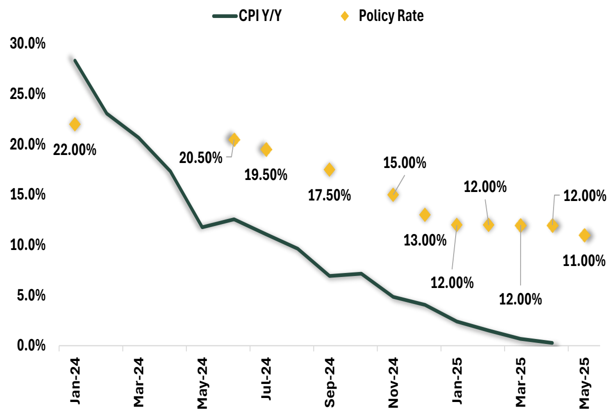
Financial Services

Economy

Monday, May 5, 2025

Rate Cut Alert: SBP Cuts Rates as Inflation Drops to Record Low

CPI vs Interest Rate



Source: SBP, PBS, HMFS Research

The State Bank of Pakistan (SBP), in a surprise move during its Monetary Policy Committee (MPC) meeting held on May 5, 2025, announced a 100 basis points cut in the policy rate - bringing it down to 11%, effective from May 6, 2025.

The SBP has reduced the policy rate, citing improved macroeconomic conditions and a sustained disinflationary trend, with inflation hitting a record low of 0.3% in April 2025, driven by lower food, fuel, and electricity prices. While the real interest rate has risen to over 11%, providing room for easing, this decline in inflation largely reflects weak demand rather than a robust economic recovery. External accounts remain relatively strong, with a current account surplus of USD 1.2bn in March bolstered by a 33% Y/Y increase in remittances. Yet, the sustainability of these improvements remains uncertain considering ongoing geopolitical tensions and global economic headwinds. Despite these external gains, SBP's decision to ease monetary policy aims to counter the persistent weakness in domestic industrial activity and stimulate economic growth by lowering borrowing costs to support investment and consumption. While SBP has justified the rate cut, the broader economic outlook remains fragile, with structural challenges and external risks clouding the path to recovery.

Sectorial Impact:

The recent policy rate cut is likely to weigh on the Commercial Banking sector by compressing interest income, which may challenge overall profitability. In contrast, the impact on Fertilizer and Oil & Gas sectors is expected to vary based on their individual liquidity positions, leading to a more mixed performance outlook. Sectors with high debt exposure—such as Cement, Engineering, Automobile and Textiles—stand to benefit from reduced borrowing costs, which could enhance margins and support future growth.

Outlook:

In the upcoming (MPC) meeting, the State Bank of Pakistan (SBP) is not expected to pursue an aggressive rate cut, as inflation is likely to edge higher amid potential new tax measures in the FY26 budget and persistent geopolitical tensions. Despite continued improvement in external account indicators and fiscal consolidation efforts, the overall macroeconomic environment remains fragile, limiting the scope for significant monetary easing. That said, if improving trends persist, there may be slight room for a measured rate reduction. However, any policy move will remain closely tied to inflation dynamics, external funding inflows, and progress on IMF program conditions. SBP is expected to maintain a cautious and data-driven approach, aligning monetary policy with the broader economic recovery and structural reform agenda. .

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HMFS RATING GUIDE	
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