

## **MONETARY POLICY ADVISORY**

**NOTE** – June 2026

### **Policy Rate Decision: Refrain from Further Monetary Tightening**

*“Current inflation is cost-push, supply-side, and administratively induced, rather than demand-driven. Monetary tightening will not reduce it; it will only deepen real economic vulnerabilities without addressing the actual sources of inflation”*

#### **ADVISORY POSITION**

Maintain the policy rate at 11.5%. Current inflationary pressures are largely driven by administered pricing and supply-side cost transmission rather than demand-side overheating. Key contributors include higher petroleum levies on petrol and diesel, global oil price pass-through, and electricity and gas tariff adjustments. These price increases are not directly sensitive to interest-rate changes. Raising the policy rate in this context would increase borrowing costs, discourage investment, and weaken economic activity without addressing the underlying levy-driven and cost-push sources of inflation.

***Any further tightening risks triggering a policy-induced recession in response to a government-manufactured inflation signal.***

#### **POLICY RECOMMENDATIONS**

**Hold the Policy Rate at 11.5% - No Further Tightening**

The current 11.7% CPI is dominated by cost-push factors; none of which are interest-rate sensitive. Raising the policy rate will add to borrowing costs and suppress investment without reducing fuel prices, which are set by administrative fiat. Standard monetary theory does not support tightening in response to supply-side, administered-price inflation.

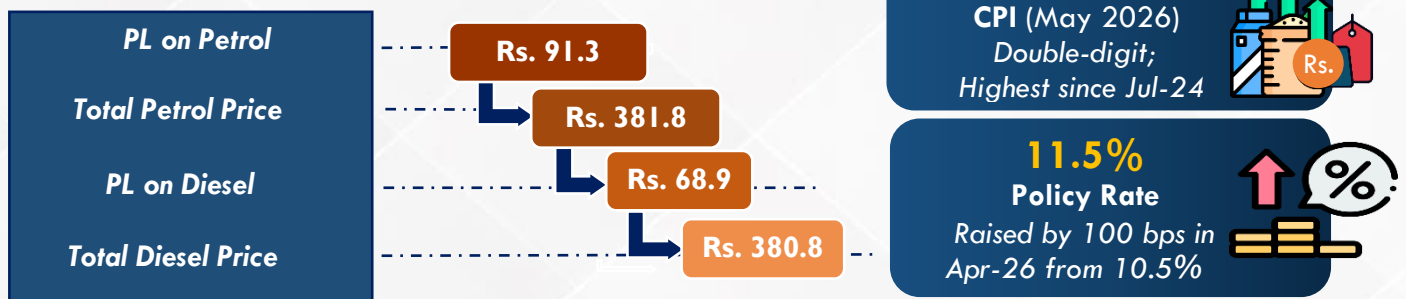
### Clarify That Fuel Levy-Driven Inflation Reflects a Supply-Side Price Shock

- The SBP should clearly distinguish between demand-pull inflation, which is policy-relevant, and the current cost-push episode, which is largely outside the interest-rate transmission channel. While the Petrol PL is easing from its Rs. 117.4 peak, the Diesel PL has risen from zero in April to Rs. 68.9 by May 30 and could approach Rs. 90+ by July 2026. The SBP should publicly acknowledge this diverging dynamic, model both trajectories, and communicate that neither validates monetary tightening.

### Publish a Decomposition of CPI Attributing Administered vs. Market-Driven Inflation

- Transparent communication requires that the SBP publish, as part of its quarterly Monetary Policy Statement, an explicit breakdown of inflation between administered/supply-side components and demand-driven components. This analytical discipline will improve policy credibility, provide political cover against pressure to tighten on administered price signals, and enable market participants to better distinguish noise from signal in headline CPI.

## KEY STATISTICS AT A GLANCE



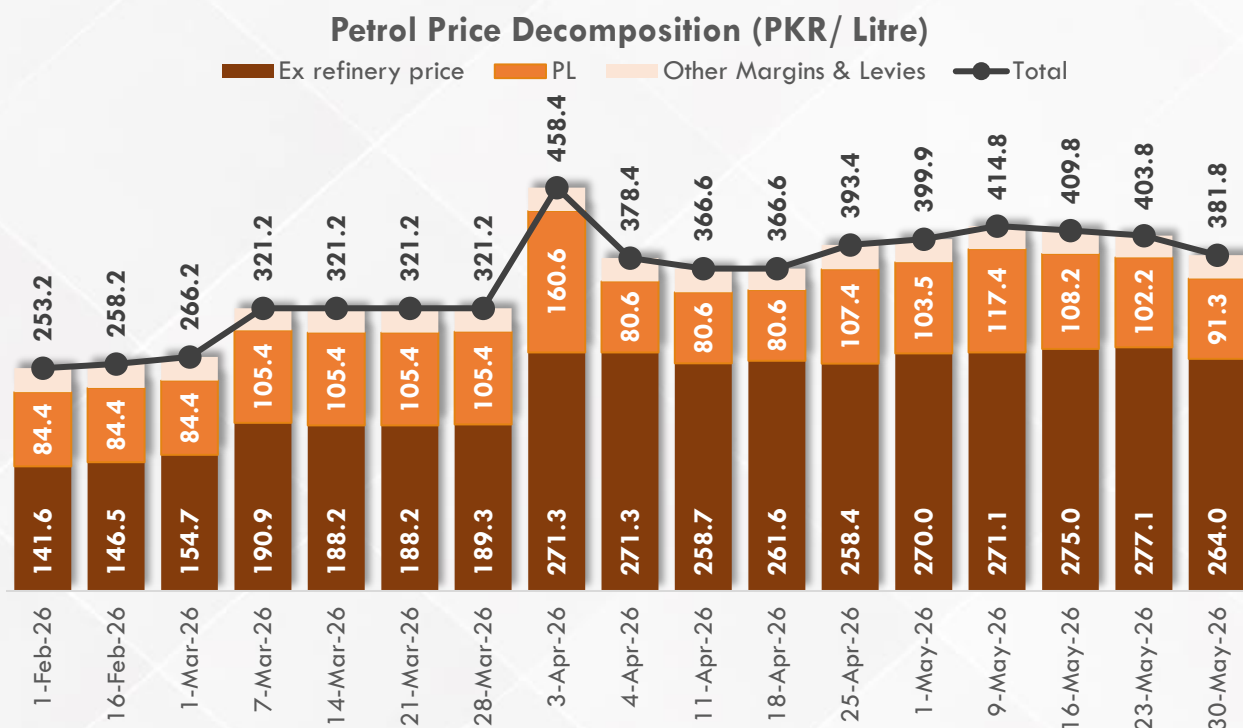
Source: SBP, PBS, OGRA

### A. The Petrol Levy: A Stabilisation Tool Repurposed as Revenue Instrument

Pakistan's PL was conceived as a fiscal shock absorber: reduced when global oil prices rise to cushion consumers, raised when prices fall to stabilise revenues. In practice, the mechanism operates in one direction only. Between 1 February and 9 May 2026, the PL was raised from Rs. 84.4 to Rs. 117.4 per litre, marking a 39.1% rise, even as ex-refinery prices remained broadly range-bound following a government-subsidised stability phase in March (Price Differential Claim applied on Mar-15, Mar-21 and Mar-28 to hold retail prices at Rs. 321.2 despite surging crude). The levy has since moderated to Rs 91.3 as of 30 May 2026, consistent with a phased IMF-programmed schedule of adjustments.

The trajectory is unambiguous: the levy increased by Rs. 84.4/litre from the February and reached to the highest peak of Rs. 160.6/litre on 03 Apr. Critically, these adjustments bore no relationship to global crude price movements. When Brent fell approximately 10% in early May, the levy was raised to 117.4. This decoupling from market fundamentals defines the PL as a discretionary fiscal instrument, not an oil price hedge.

Figure 1: Petrol Retail Price Decomposition, Feb – May 2026



Source: OGRA, PRAC, AHL Research

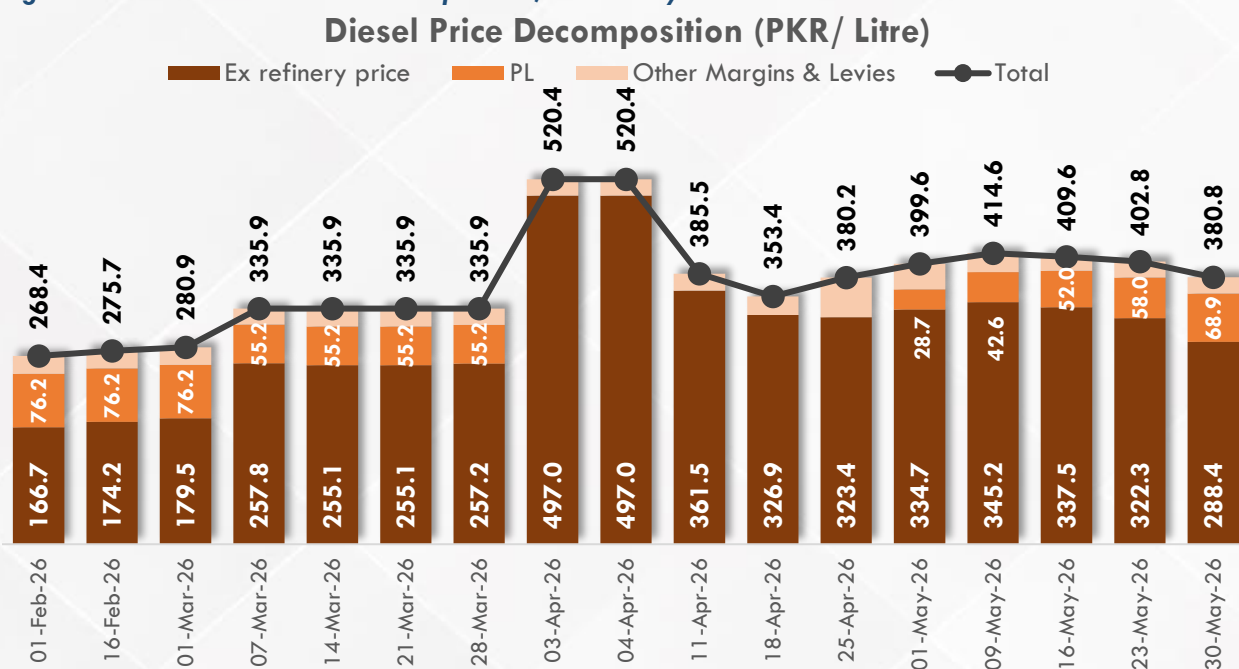
Note: Apr-3 anomaly (PL=160.61) was corrected to 80.61 on Apr-4. Ex-refinery prices are adjusted after deducting the Price Differential Claim subsidy applied in the March 15, March 21, and March 28 pricing cycles. Other Margins and Levies includes: Climate Support Levy (CSL), Inland Freight Equalization Margin (IFEM), OMC Margin, and Dealer Margin. Price

## A2. Diesel: The More Consequential Levy Shock

Diesel (High Speed Diesel / HSD) is the primary fuel for freight transport, agricultural machinery (tractors and tube-wells), public transport, railway operations and industrial captive power generation. Its inflationary transmission is broader and deeper than petrol: when diesel prices rise, food production costs increase, logistics costs pass through to every consumer good, and industrial operating margins compress. The diesel levy data reveals a pattern that, in several respects, is more alarming than the petrol trajectory.

**A three-act fiscal sequence.** In February 2026, diesel carried a levy of Rs. 76.2/litre, higher than petrol's Rs. 84.40 in absolute terms but proportionally moderate at 28.4% of the pump price. In March, the levy was reduced to Rs. 55.2 as global crude surged, requiring the PDC subsidy mechanism to hold the retail price at Rs 335.9. Then, in early April, as ex-refinery prices spiked to an extraordinary Rs. 496.97/litre, the highest in the dataset, the government waived the diesel levy entirely (PL = Rs 0). Even with zero levy, the diesel price reached Rs. 520.4 (Apr 4), and remained there for eight days. As global crude retreated, the government reintroduced the levy from May 1: Rs. 28.7, then Rs. 42.6, then Rs 52.0, then Rs. 58.0, then Rs. 68.9 by May 30, five consecutive increases in 29 days.

Figure 2: Diesel Retail Prices Decomposition, Feb – May 2026



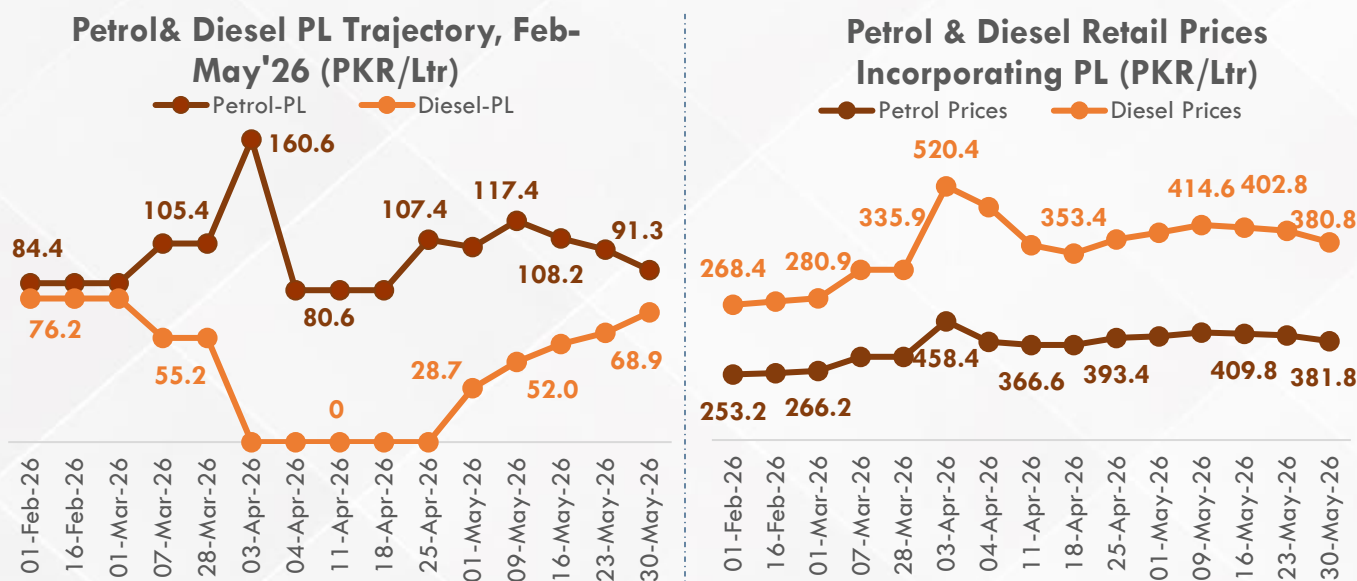
Source: OGRA, PRAC, AHL Research

Note: In April, there was PL-free period (Apr 4–25), when diesel ex-refinery spiked to Rs 497.0/L forcing a full levy waiver. The levy has since been reintroduced at an accelerating pace, reaching Rs 68.9/L by May 30.

**Pace and trajectory.** The diesel PL increased by Rs. 40.2/litre in just 29 days (May 1 to May 30). This implies an average increase of nearly Rs. 10/litre per week. If this pace is maintained, the diesel levy will approach Rs. 109–110/litre by end of June 2026, well above the February baseline of Rs. 76.2 and approaching petrol-parity. This is not a gradual normalization; it is a compressed revenue recovery following the April waiver, implemented against a backdrop of declining ex-refinery prices that create fiscal headroom.

The most striking data point in the dataset is the convergence of petrol and diesel retail prices: Rs. 381.8 and Rs. 380.8 per litre, respectively, on May 30, a differential of just Rs. 1.00. Historically, diesel has traded at a meaningful discount to support agriculture and commercial transport. Although the Petroleum Levy (PL) on diesel was removed in April 2026 to provide relief to these sectors, no corresponding relief was extended to petrol. Consequently, the broader objective of using the levy mechanism to cushion consumers from international oil price shocks was only partially achieved, contributing to the unprecedented near-parity between petrol and diesel prices.

Figure 3: Petrol & Diesel Trajectory and Retail Price Hikes, Feb – May'26



Source: OGRA, PRAC, AHL Research

## B. INFLATION ATTRIBUTION: THE COMBINED FUEL LEVY EFFECT

Incorporating both petrol and diesel levy data materially strengthens the supply-side inflation argument. The table below disaggregates May 2026 CPI by driver type, explicitly identifying both the petrol and diesel PL channels.

Table 1: Monetary Policy Impact on CPI Components

GROUP	Group Weight %	CPI (%) May-26	Contribution (pp)	Monetary Policy Impact
<b>General</b>	<b>100.0</b>	<b>11.7</b>	<b>11.7</b>	
<b>Food &amp; Non-alcoholic Beverages</b>	<b>34.6</b>	<b>7.9</b>	<b>2.8</b>	No Impact, Logistic cost bear by Customers
<b>Alcoholic Beverages &amp; Tobacco</b>	<b>1.0</b>	<b>2.3</b>	<b>0</b>	No Impact, Logistic cost bear by Customers
<b>Clothing &amp; Footwear</b>	<b>8.6</b>	<b>8.8</b>	<b>0.8</b>	Partial Impact
<b>Housing, Water, Electricity, Gas &amp; Fuels</b>	<b>23.6</b>	<b>16.8</b>	<b>3.5</b>	No Impact, Administered Tariff
<b>Furnishing &amp; Household Equipment Maintenance</b>	<b>4.1</b>	<b>5.1</b>	<b>0.2</b>	Partial Impact
<b>Health</b>	<b>2.8</b>	<b>7.5</b>	<b>0.2</b>	Limited Impact
<b>Transport</b>	<b>5.9</b>	<b>36.8</b>	<b>2.5</b>	No Impact, Levy set prices
<b>Communication</b>	<b>2.2</b>	<b>1.0</b>	<b>0</b>	Partial Impact
<b>Recreation &amp; Culture</b>	<b>1.6</b>	<b>-0.2</b>	<b>0</b>	Partial Impact
<b>Education</b>	<b>3.8</b>	<b>8.4</b>	<b>0.3</b>	No Impact
<b>Restaurants &amp; Hotels</b>	<b>6.9</b>	<b>5.7</b>	<b>0.4</b>	Partial Impact

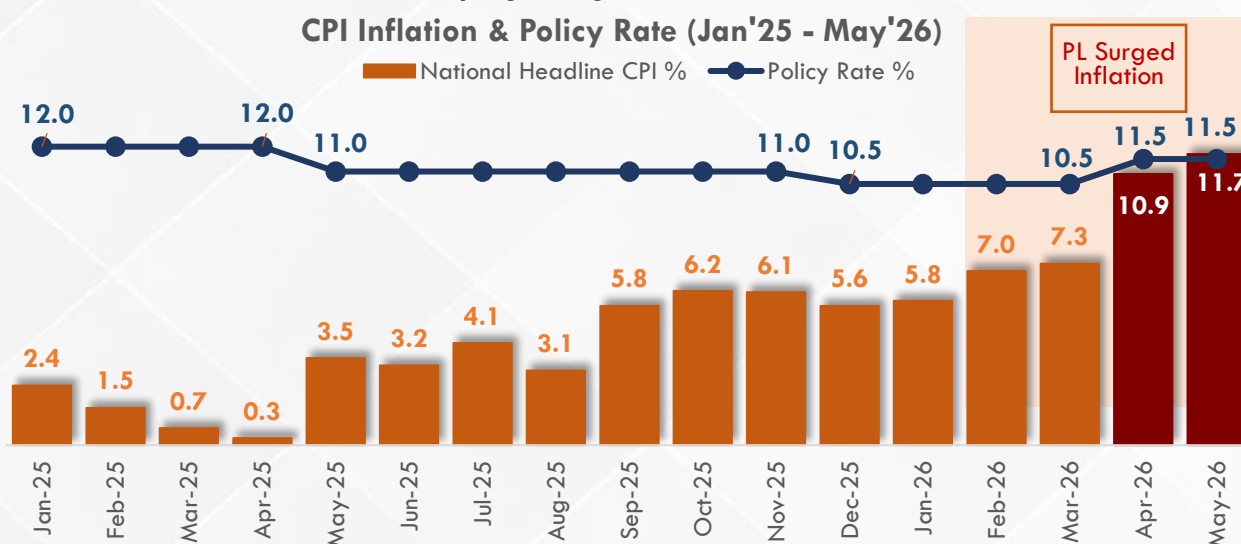
Miscellaneous	4.9	15.0	0.9	Partial Impact
---------------	-----	------	-----	----------------

Source: Pakistan Bureau of Statistics, PBS

### C. THE RE-EMERGENCE OF DOUBLE-DIGIT CPI: A LEVY-DRIVEN SURGE

Pakistan's CPI had moderated to 0.3% year-on-year in April 2025, marking its lowest level in decades, enabling a 150-basis-point easing cycle through December 2025 (12% → 10.5%). Inflation then accelerated steadily: 5.8% in January 2026, 7.0% in February, 7.3% in March, tracking closely with the PL increases of March 1 (to Rs. 105.4). The decisive break came in April and May 2026, when CPI jumped to 10.9% and 11.7% respectively, coinciding with the PL reaching Rs. 117.4 on May 9.

Figure 4: Cost Push Inflation and Monetary Tightening



Source: Pakistan Bureau of Statistics, (PBS) & Sate Bank of Pakistan (SBP).

Note: The CPI re-escalation from March 2026 tracks the PL increase schedule precisely. The SBP's policy rate hike from 10.5% to 11.5% (in April 2026) represents monetary tightening in response to an administered, supply-side price shock.

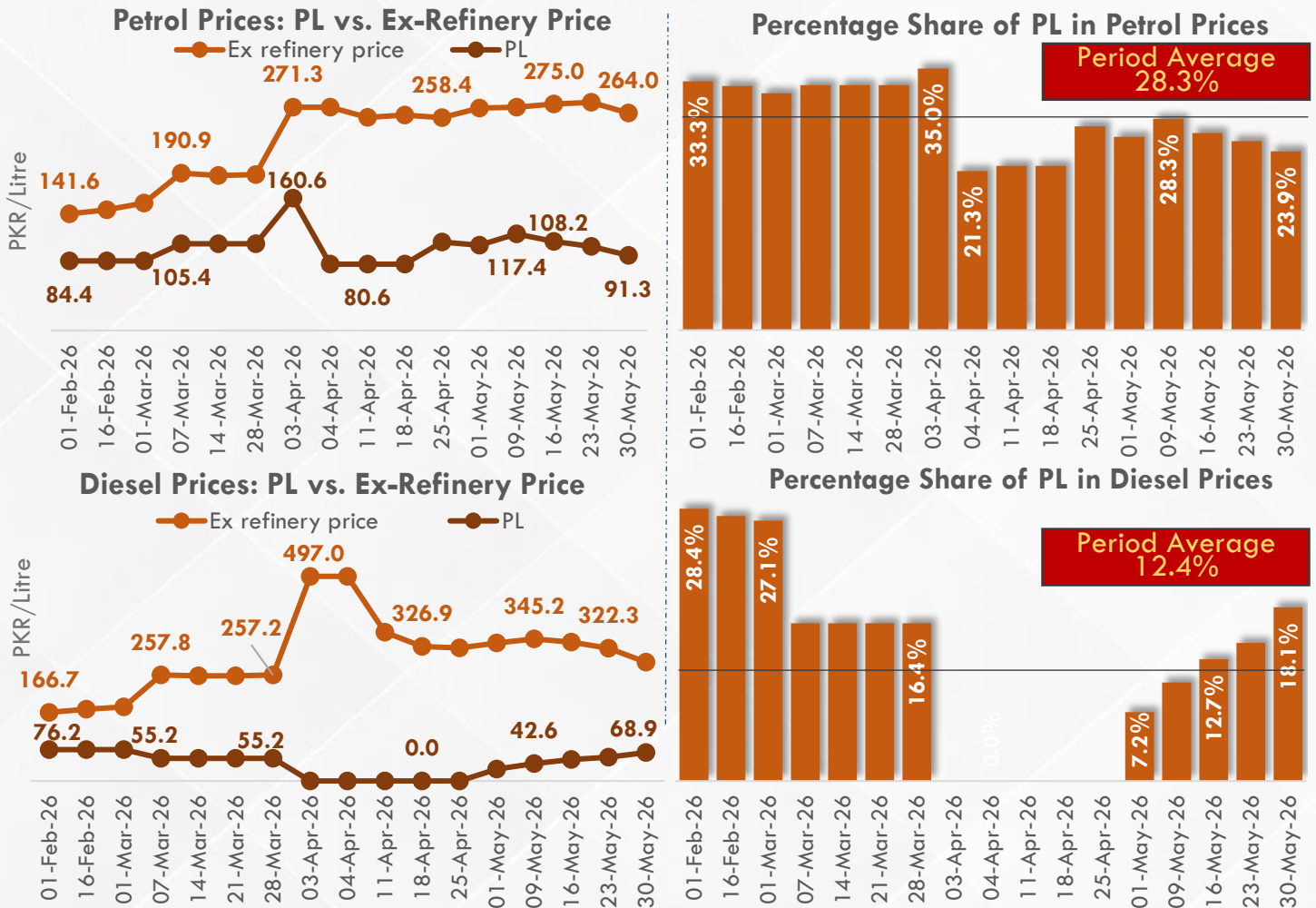
Transport CPI reached 36.8% YoY in May 2026, the single largest contributor to the inflation surge at 2.5 pp. Housing, water, electricity, gas and fuels reached 16.8% YoY, contributing 3.5 pp. Together, these two energy-linked categories account for 6.0 pp of the 11.7% headline, more than half. The miscellaneous category at 15.0% reflects secondary-round fuel cost embedding in consumer services. The SBP's April policy rate hike occurred precisely as this levy-driven surge was materializing.

### D. THE FISCAL-MONETARY CONTRADICTION: CROSS-PURPOSE POLICY

The most damaging dimension of the current situation is the cross-purpose dynamic between fiscal and monetary policy. The federal government, through the PL, directly injects cost-push inflation. The SBP, observing headline CPI, has responded by raising the policy rate, increasing borrowing costs for the private sector, suppressing credit growth, and discouraging fixed investment. The fiscal instrument creates the inflation; the monetary

instrument then tries to suppress it, at real economic cost to firms and households that have no control over either lever.


**Figure 5: The Petroleum Levy Divergence: When Falling Crude Results in Rising Prices** Source: OGRA,



PRAC, AHL Research

**This is not a monetary problem.** Cost-push inflation generated through administered prices is unresponsive to higher interest rates. The conventional monetary transmission mechanism works by compressing aggregate demand; however, this channel is weak when inflation originates from a per-litre levy imposed on fuel prices. In such a setting, policy-rate increases do not address the source of inflation. Instead, they raise debt-servicing costs for firms already facing elevated energy and input costs, further compressing margins and delaying the recovery in private investment.

The design of the Petroleum Levy also creates an asymmetric and potentially perverse transmission mechanism. When international oil prices decline, the resulting fiscal space allows the government to raise the levy without fully breaching politically sensitive pump-price thresholds. As a result, falling crude prices may not translate into disinflationary relief for consumers; instead, they can be absorbed through higher taxation and become inflationary through administered pricing. The State Bank of Pakistan's inflation assessment



must therefore explicitly account for this asymmetric fuel-price transmission, rather than treating fuel prices as a purely exogenous input.