1

Economic Review

1 Economic Review

1.1 Overview

Pakistan's macroeconomic conditions improved further in H1-FY25 (**Table 1.1**). The headline inflation maintained downward trajectory, falling to a multi-year low in March 2025. The current account posted a surplus, supporting build-up in FX reserves and stability in foreign exchange market. The fiscal deficit was contained to the lowest level in two decades, with primary balance posting a record surplus.

These outcomes were supported by calibrated monetary policy stance, continued fiscal consolidation, and a relatively benign global economic environment. In addition, the approval of IMF's Extended Fund Facility (EFF) also helped reduce economic uncertainty and improve overall business confidence alongside upgradation of Pakistan's credit rating by international agencies.

Selected Economic Indicators — **Table 1.1**

	FY24		FY25		
	H1	H2	Q1	Q2	H1
Growth rate (percent)					
Real GDP [a]	2.1	3.0	1.3	1.7	1.5
Agriculture sector	7.0	5.4	0.7	1.1	0.9
Services sector	1.9	2.9	2.2	2.6	2.4
Industrial sector	-3.3	0.2	-0.7	-0.2	-0.4
LSM	-0.7	2.8	-0.8	-2.9	-1.9
National CPI [a]	28.8	18.7	9.2	5.3	7.2
Private sector credit [b]	5.7	0.4	-1.4	24.0	22.3
Money supply (M2) [b]	4.5	11.0	-0.8	0.1	-0.7
Exports [b]	6.6	15.9	6.5	8.4	7.5
Imports [b]	-14.6	21.0	15.9	4.3	9.9
Exchange rate app (+)/dep(-) [b]	1.5	1.3	0.2	-0.3	-0.1
FBR tax revenue [c]	30.3	29.4	25.5	26.1	25.9
Policy rate* [b]	22.0	20.5	17.5	13.0	13.0
billion US$					
Remittances [b]	13.4	16.8	8.8	9.1	17.8
FDI in Pakistan [b]	1.1	1.2	0.8	0.5	1.3
FX loans (net) [b]	3.4	-0.1	-0.8	-0.2	-1.1
Current account balance [b]	-1.6	-0.5	-0.4	1.6	1.2
SBP's liquid FX reserves* [b]	8.2	9.4	10.7	11.7	11.7
percent of GDP					
Fiscal balance [c]	-2.3	-4.5	1.5	-2.8	-1.2
Primary balance [c]	1.7	-0.8	2.6	0.3	2.9

*end-period

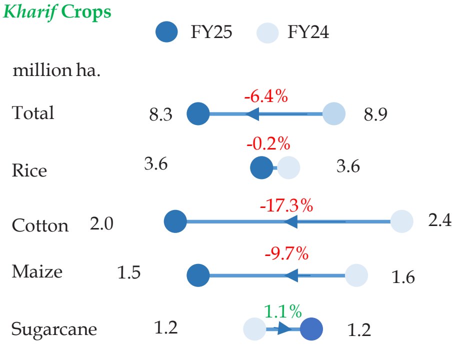
Sources: [a] PBS; [b] SBP; and [c] MoF

Nonetheless, the real GDP growth moderated on account of contraction in the main commodity producing sectors – important crops and large scale manufacturing (LSM). This was mainly owing to an uncertain agriculture policy environment, and the lingering impact of stabilization measures that kept the domestic demand in check.

In agriculture, there was a broad-based decline in the production of *Kharif* crops driven by decrease in both area under-cultivation and crop yields. Uncertainty surrounding the announcement of support prices and lower crop prices of last year led to a fall in area under cultivation (**Figure 1.1a**). Moreover, yields declined across all important crops as the favorable effect of post-flood soil enrichment, that boosted yields last year, subsided in the ongoing year (**Figure 1.1b**). The impact of these factors was compounded by erratic weather conditions amid climate change, and lower use of certified seeds and other inputs.

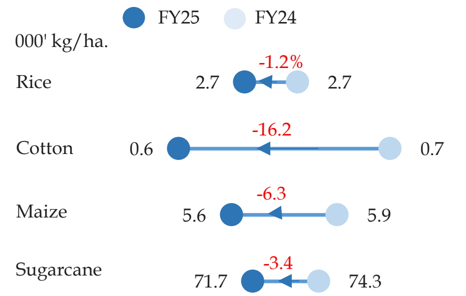
The industry recorded a contraction, albeit lower than last year amid improving macroeconomic conditions — a trend that is also reflected in rising import volumes (**Figure 1.2**). The contraction in H1-FY25 was led by a notable decline in construction and mining & quarrying activities. The latter was largely due to fall in the production of crude oil and gas

Area Under Cultivation of Important *Kharif* Crops **Figure 1.1a**



Sources: PBS and FCA Working Paper

Yield of Important *Kharif* Crops **Figure 1.1b**

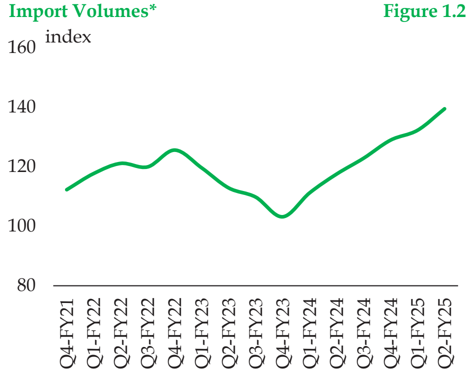


amid weak exploration activity, while restrained development spending and higher construction material prices affected the former. The LSM also declined by 1.9 percent during Jul-Feb FY25, mainly due to a sharp fall in the production of furniture (a low-weight sub-sector), which offset the impact of recovery in some major sectors — textiles, automobile, pharmaceuticals and POL.

The slight up-tick in services sector growth was largely supported by general government, information & communication; and other private services (**Figure 1.3**). This, along with lower contraction in industry, was also reflected in a marginal increase in employment and employment sentiments. Moreover, real wages started to recover recently from persistent decline in last few years.

While economic growth remained somewhat tepid, the headline inflation maintained downward trajectory, falling below the lower bound of the medium term target range of 5 – 7 percent from November 2024 onwards, reaching a multi-

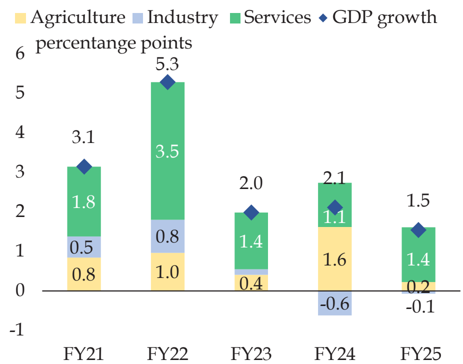
Import Volumes* **Figure 1.2**



*four quarters moving average

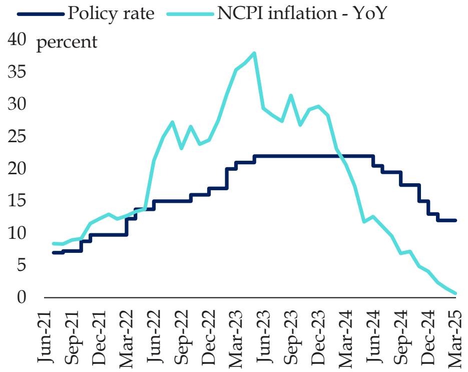
Source: PBS

Contribution to GDP Growth in H1 **Figure 1.3**



Source: PBS

Monetary Policy and Inflation **Figure 1.4**

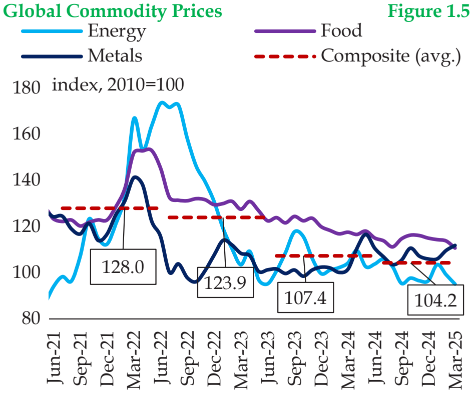


Sources: SBP and PBS

decade low of 0.7 percent in March 2025. A combination of improved supply of key food items, downward adjustments in energy prices, spare production capacity in the economy owing to still sluggish domestic demand, and benign global commodity prices underpinned this steep disinflation. The core inflation, though still elevated, has gradually fallen to single digit since October 2024.

As inflationary pressures receded, the SBP successively reduced the policy rate by

Global Commodity Prices **Figure 1.5**



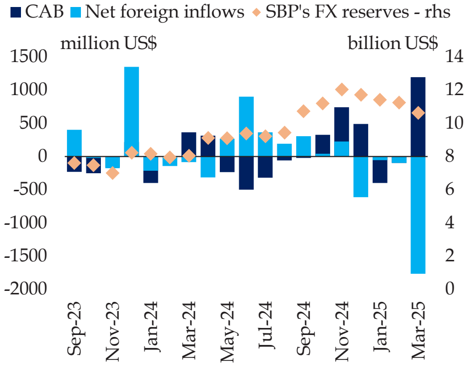
Source: WB

1000 basis points between June 2024 and February 2025 (**Figure 1.4**). This trend was in line with easing monetary policy in the advanced as well as emerging economies, as inflation approached close to the target ranges. The global inflation outturns were supported by the lagged impact of tighter monetary policies and softening commodity prices due to improved supply of energy and food items following ease in geo-political tensions (**Figure 1.5**). However, global demand remained resilient, led by strong activity in the advanced economies.

These favorable global trends, along with the measures to promote IT exports and encourage remittances through official channels, supported improvement in Pakistan's balance of payments position. The resulting steady momentum in exports and robust workers' remittances not only outweighed the volume-driven increase in imports, but also helped to comfortably finance higher repatriation of profits and dividends. These developments collectively resulted in a surplus in the current account balance and stability in exchange rate, enabling the SBP to build external buffers through FX purchases. While other official loan inflows fell short of commitments, disbursement of the first tranche under the IMF's EFF also contributed to the build-up in SBP's FX reserves (**Figure 1.6**).

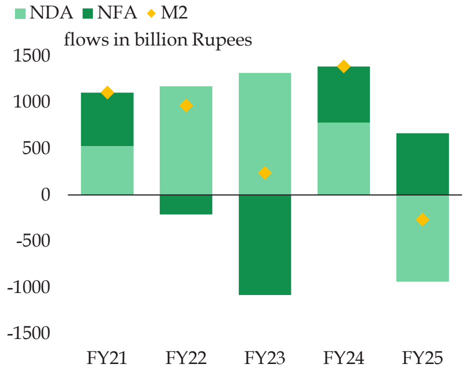
On a positive note, private inflows, particularly FDI, somewhat recovered particularly in power, financial business, and oil & gas sectors. Foreign portfolio investment experienced net outflows, mainly from equity and debt markets,

Balance of Payments and Forex Reserves **Figure 1.6**



Source: SBP

Monetary Aggregates in H1 **Figure 1.7**



Source: SBP

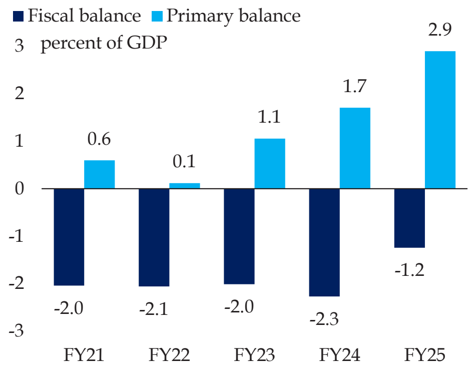
while Naya Pakistan Certificates attracted inflows incentivized by relatively higher returns.

The improvement in external account drove an expansion in the net foreign assets of the SBP. However, a substantial contraction in net domestic assets, mainly because of large net retirement in budgetary borrowings, led to a contraction in broad money (M2) in H1-FY25 (**Figure 1.7**). This was despite a sizeable increase in credit to non-government sector on account of easing financial conditions and a slight uptick in economic activity, as well as banks' efforts to avoid advances-to-deposit related tax.

Government made substantial retirements to the scheduled banks in line with continued fiscal consolidation. The improved fiscal position, largely driven by hefty SBP profits and reduction in non-interest expenditures as percent of GDP, also enabled the government to conduct buyback auctions of T-bills to improve maturity profile and reduce the roll-over risk (**Box 4.3**). On the revenue side, although FBR tax collection improved, it still fell short of the target for H1-FY25 amid falling interest rates and inflation, and stable exchange rate. Accordingly, the government contained its non-interest spending (in percent of GDP), especially development expenditures and subsidies, to achieve the envisaged fiscal consolidation in H1-FY25 (**Figure 1.8**).

These trends highlight the need for structural reforms to broaden the tax base that would not only support investment and development needs of the economy, but would also help reduce burden on existing taxpayers such as salaried individuals, corporates and other documented sectors. Further the focus should also be on rationalizing excessive reliance on indirect taxes, which are regressive in nature. In the absence of reforms, the burden of fiscal consolidation will continue to fall on development spending, compromising the growth potential of the economy, which is beset with a host of structural challenges.

Fiscal Indicators in H1 **Figure 1.8**



Source: MoF

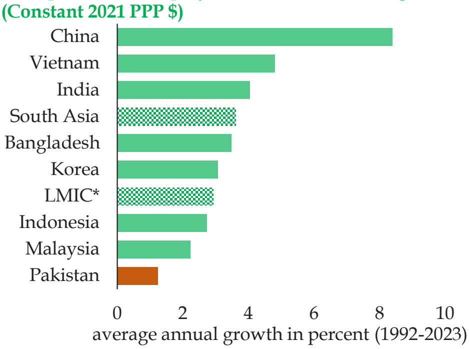
One of the prominent challenges long undermining the sustainability of growth is low and falling productivity that has adversely affected the country's economic competitiveness. This is particularly evidenced from Pakistan's lowest GDP per worker among the peer countries (**Figure 1.9**). The country's weak productivity growth has contributed to frequent balance of payments crises with the economy stuck in recurring boom-bust cycles. This necessitates thinking beyond tax amnesties, tax incentives, subsidies, and foreign debt funded growth spurts, and instead focus on addressing the macroeconomic and structural constraints to productivity growth.

In recognition of its importance, **Chapter 6** of this Report takes a detailed review of the trends in aggregate and sectoral productivity in Pakistan, along with the state of various macroeconomic and structural drivers of productivity growth in the country. The review finds that Pakistan's performance across most drivers of productivity—investments, financial inclusion, trade integration, fiscal management, education and health, research & development, institutions, innovation, and infrastructure—has been notably weak compared to peer countries or has worsened over the last few decades.

Other chapters of the Report also discuss challenges constraining productivity in Pakistan's economy. In Chapter 2, **Box 2.1** sheds light on the prospects of exploring vertical farming both to address climate change concerns as well as to help improve agriculture productivity. The chapter also explores the implications of brain drain for Pakistan's economy **(Box 2.2)**.

Similarly, in Chapter 3, **Box 3.1** discusses trends in currency in circulation in Pakistan and various measures required to enhance financial inclusion, increase documentation of the economy, and reduce the size of informal economy. These steps, in turn, can help increase access to credit and thus promote productivity growth. In Chapter 4, **Box 4.1** takes a look at government's efforts to rationalize expenditures through pension reforms to create fiscal space for productivity-

GDP per Person Employed (Constant 2021 PPP $) **Figure 1.9**



*Lower Middle Income Countries
Source: WB

enhancing spending. Lastly, Chapter 5 talks about the need to diversify the country's exports and to that end, it explores the potential of aquaculture exports in **Box 5.1**. The chapter also sheds light on specific challenges to attracting FDI in Pakistan (**Box 5.2**).

1.2 Economic Outlook

The macroeconomic outcomes and developments have significantly improved the overall outlook for FY25 compared to the beginning of the year (**Table 1.2**). While growth slowed in H1-FY25 compared to the same period last year, the latest data on high-frequency indicators suggest that momentum in economic activity is gaining traction. Specifically, purchasing managers' index, which is a leading indicator of manufacturing activity, rose to 53.0 in February 2025, the highest since August 2022. Similarly, sales of automobiles, cement, and POL products have picked up in recent months, and exports of high value added textiles is maintaining a rising trend. The ease in financial conditions and lower global energy prices are other favorable factors expected to gradually support industrial and services sectors. The agriculture sector, however, continues to show subdued growth with the latest estimates indicating lower wheat production.

In view of these developments, the real GDP growth projection remains unchanged in the range of 2.5 – 3.5 percent for FY25. Risks to growth projection are, nonetheless, tilted on the downside. While lower international oil prices can provide an upside, additional fiscal consolidation and less than expected wheat harvest may weigh down on growth.

Macroeconomic Targets and SBP Projections for FY25 **Table 1.2**

	Target	SBP Projections
Growth rate (percent)		
Real GDP [a]	3.6	2.5 – 3.5
CPI (average)*	5.0 – 7.0	5.5 - 7.5
billion US$		
Remittances [a]	30.3	37.0 – 38.0
Exports (fob) [a]	32.3	31.5 – 32.5
Imports (fob) [a]	57.3	58.0 – 59.0
percent of GDP		
Fiscal deficit [b]	5.9	5.5 – 6.5
Current a/c balance [a]	-0.9	-0.5 – 0.5

*Medium term target

Sources: [a] Annual Plan 2024-25, [b] Federal Budget 2024-25,

Considering the improvement in fiscal accounts in H1-FY25 was majorly enabled by hefty SBP profit transfer and contained subsidy disbursements, the projection for fiscal deficit remains unchanged in the range of 5.5 - 6.5 percent for FY25. Moreover, any further shortfall in tax revenue remains a major upside risk.

The fiscal consolidation, tight monetary policy stance, ample stock of key food staples, and benign trends in global commodity prices are expected to keep overall inflationary pressures subdued for the remainder of FY25. Reflecting the steep disinflationary trend and recent movements in food and energy prices in domestic as well as in international markets, the projection of average inflation for FY25 has been considerably revised downward to 5.5 – 7.5 percent, from the earlier projection of 11.5 – 13.5 percent.

These projections incorporate the expected increase in inflation in the last few months of FY25 due to fading high base effect.

While inflation is expected to stabilize around the lower bound of the revised projection range in FY25, there are several risks to medium-term outlook. These include global trade disruptions and related commodity price volatility in light of the reciprocal tariffs, the timing and magnitude of adjustments in administered energy prices, new revenue measures, and pressures on local currency due to movements in international currencies and weak financial inflows.

With higher than earlier projected growth in workers' remittances, lower commodity prices, and continuing momentum in exports, the current account balance for FY25 is projected in the range of -0.5 to 0.5 percent of GDP. This is expected to provide cushion against lower financial inflows and help strengthen external buffers. However, given that import volumes are rising in line with activity in some large industries, any shock to global commodity prices could pose an upside risk.

The macroeconomic outlook is contingent on how the global economic and political environment shapes up. In this context, there are three prominent risks. First, the recent shift towards more protectionist trade policies has already begun to take effect. These tariffs are impacting geo-political contenders and key trading partners. Rising tariffs could disrupt trade and economic activity, having implications for EMDEs' exports and remittances, and international commodity prices. Second, the possible spillovers of ongoing geo-political conflicts to global economy, in general and commodity prices, in particular. Third is concerning the resurgence of inflation globally due to tariffs and potential supply-chain constraints, and their implications for global financial conditions, which may adversely impact emerging economies.