

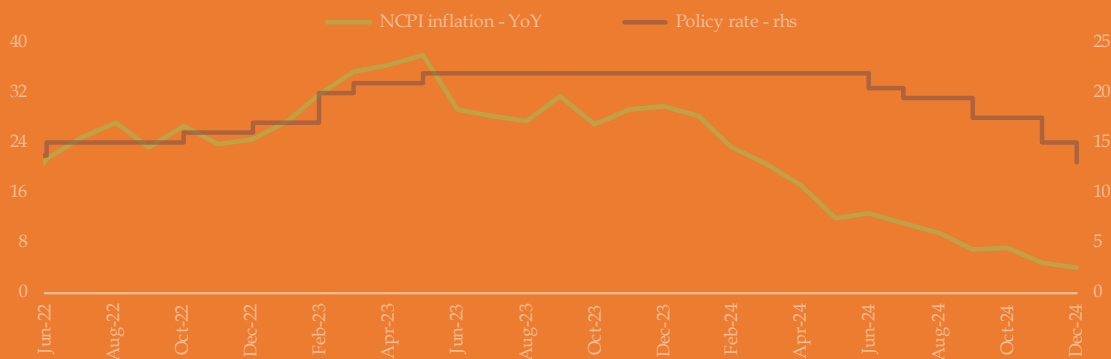


# 3

## Monetary Policy and Inflation

National CPI inflation maintained almost consistent declining trend witnessed since January 2024, falling to a multi-year low in February 2025. Tight monetary policy and continued fiscal consolidation played a key role in this sharp disinflation. In addition, adequate supply of key food commodities and benign global commodity prices and a stable exchange rate amid improvement in external account contributed to favorable inflation outcomes. The steep decline in inflation and improved external position allowed the MPC to reduce the policy rate by a cumulative 1000 bps till January 2025. The ease in financial conditions and banks' efforts to meet ADR threshold to avoid additional tax fueled a sharp expansion in credit to private sector. Nevertheless, large net retirements of government budgetary borrowings led to a contraction in broad money in H1-FY25.

Monetary Policy and Inflation  
(percent)





## 3.1 Policy Review

Steeper than anticipated fall in inflation and improved inflation outlook led the Monetary Policy Committee (MPC) to cut the policy rate in all of its meetings held between June 2024 and January 2025, with a cumulative reduction of 1000 basis points (bps). The National CPI (NCPI) inflation fell to a 6-year low in H1-FY25, from a multi-decade peak in H1-FY24. Monthly trend shows the decline became more pronounced from November 2024 onwards, with year-on-year (YoY) inflation falling below the SBP's medium-term target range of 5 – 7 percent. The combined impact of contained domestic demand, improved domestic supply of key food commodities, benign trend in global oil prices, a slight PKR appreciation, and a favorable base-effect mainly explain this steep disinflation (Figure 3.1).

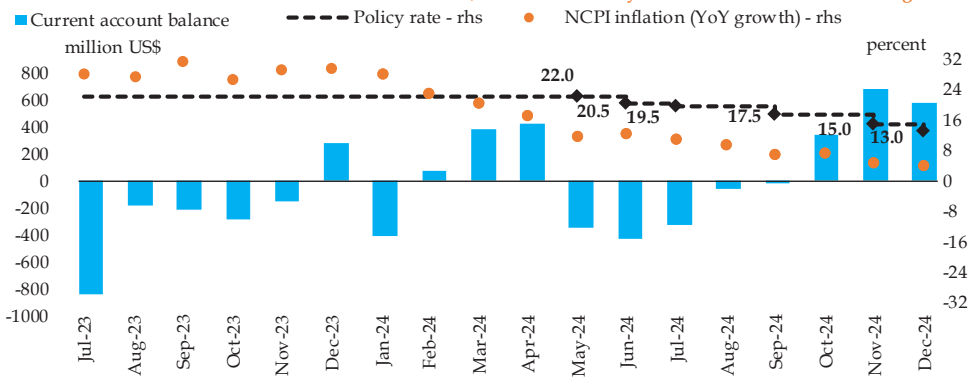
The strengthening external account position further supported the MPC's decisions. A surplus in the current account balance allowed SBP to make significant

FX purchases from the market; relatively conducive global financial conditions that helped increase investment flows; and disbursement of first tranche under the Extended Fund Facility (EFF) program of IMF supported the build-up of foreign exchange reserves, despite less-than-planned financial inflows.

Inflation outlook had notably improved when the MPC met for its first meeting in July 2024. The Committee noted that the impact of the FY25 budget measures on inflation projections was in line with the earlier expectations. Moreover, the external account continued to show positive trends, with increase in SBP reserves despite significant external debt repayments. Additionally, the country also secured a staff-level agreement with the IMF for a US\$ 7.0 billion EFF program.

Accounting for these positive trends, adequately tight monetary policy stance and continued fiscal consolidation, the MPC projected the average NCPI inflation to come down significantly from 23.4

Trends in NCPI Inflation and Current Account Balance, and the SBP Policy Rate Figure 3.1



Sources: SBP, PBS and WB

percent in FY24 to the range of 11.5 – 13.5 percent in FY25.<sup>1</sup> The committee observed that fiscal slippages and any discretionary changes in administered prices of energy posed significant risks to these projections.

Furthermore, the MPC projected continuation of moderate expansion in economic activity in FY25. While agriculture sector growth was expected to slow given high base effect from last year and input conditions for kharif crops, relatively lower interest rates and planned expansion in development spending were likely to support activity in industry and services sectors. Incorporating these developments, the MPC projected the real GDP growth in the range of 2.5 – 3.5 percent in FY25. The modest increase in demand was also likely to translate in a concomitant increase in imports during FY25. However, continued strong growth momentum in workers' remittances and rising exports were expected to keep current account deficit in the range of 0 – 1.0 percent of GDP in FY25.<sup>2</sup> Thus, the improvement in inflation outlook and a stable external account outlook led the MPC to cut the policy rate by 100 bps to 19.5 percent in July 2024.

Inflation continued an almost consistent declining trend when the MPC met in September, November and December 2024. The combined impact of contained demand, a sharp fall in food inflation, benign global oil prices, absence of expected hikes in gas tariffs and petroleum development levy (PDL), and a favorable base effect, contributed to steep

disinflation. However, the pace of decline in core inflation was relatively subdued, whereas inflation expectations of businesses and consumers remained volatile.

The Committee observed that calibrated rate cuts had key role in maintaining downward trajectory in inflation and managing external account pressures, while supporting gradual improvement in economic activity. Moreover, strong growth in workers' remittances and exports outweighed the increase in imports, leading to a surplus in current account balance during Jul-Oct 2024.

The reduction in borrowing cost and banks' efforts to meet advances-to-deposits ratio (ADR) threshold to avoid additional tax, fueled growth in private sector credit from October onwards. However, the broad money growth decelerated in November as the government made net retirement to banks. The continued fiscal consolidation amid transfer of a record-high SBP profit drove a surplus in the overall fiscal and primary balances during Q1-FY25, which reduced the government's financing requirements. Notwithstanding this improvement, tax revenue fell short of the target.

Taking stock of these developments, the MPC reduced the policy rate by a cumulative 650 bps in its meetings in September, November and December 2024 to 13 percent. The Committee noted that inflation outcomes were subject to substantial uncertainty arising from

<sup>1</sup> The MPC revised down inflation projection range to 5.5 – 7.5 percent in its meeting in January 2025.

<sup>2</sup> The MPC revised the projections in the range of -0.5 to 0.5 percent of GDP in its meeting in January 2025.

volatility in global commodity prices, unplanned adjustments in energy prices and any supplementary tax measures to meet the revenue shortfall. Given the risks inherent in these factors, the MPC anticipated the near-term inflation to remain volatile before eventually stabilizing within the target range.

The MPC assessed that the cumulative impact of the rate cuts since June 2024 would continue to unfold over the next few quarters, with the real policy rate remaining significantly positive to stabilize inflation within the 5 – 7 percent target range. However, the MPC noted the outcome to be conditioned on continued fiscal consolidation, timely realization of planned external inflows, and implementation of needed structural reforms.

### 3.2 Monetary Aggregates

The broad money (M2) contracted by 0.7 percent in H1-FY25, compared to an increase of 4.5 percent in the same period

last year (**Table 3.1**). The contraction in M2 was mainly due to decline in Net Domestic Assets (NDA) that outweighed expansion in Net Foreign Assets (NFA) of the banking system. A surplus in current account balance, which helped strengthen the SBP reserves, mainly explains the expansion in NFA.

A large net retirement of budgetary borrowing to the banking system, driven by the transfer of hefty SBP profit, alongside the repayment of commodity loans, mainly led to the contraction in NDA during H1-FY25. This was despite a significant expansion in credit to non-government sector during this period.

On the liability side, currency in circulation (CiC) edged down slightly by Rs 37 billion in H1-FY25, compared to a sizeable decline of Rs 697 billion during the same period in FY24. This decline was entirely concentrated in Q1-FY25, whereas Q2-FY25 saw a slight expansion in CiC. This can be attributed to banks' efforts to meet the ADR threshold by end December 2024.

**Monetary Aggregates - H1**

**Table 3.1**

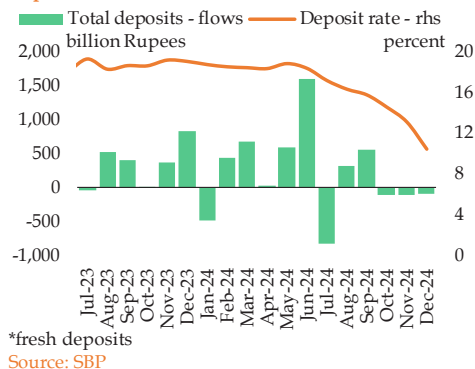
flows in billion Rupees, growth in percent

	Change in Stock		Cumulative Growth*		Contribution to M2 Growth	
	FY24	FY25	FY24	FY25	FY24	FY25
Broad money (M2)	1,388.2	-267.4	4.5	-0.7	4.5	-0.7
NFA	608.4	667.3	-	-	2.0	1.9
NDA	779.8	-934.7	2.4	-2.5	2.5	-2.6
Budgetary borrowing	2,084.0	-2,215.4	9.4	-7.5	6.7	-6.2
SBP	-1,744.2	-888.5	-33.3	-19.6	-5.6	-2.5
Scheduled banks	3,828.1	-1,326.8	22.5	-5.3	12.4	-3.7
Commodity operations	-229.2	-216.1	-15.4	-15.7	-0.7	-0.6
Credit to private sector	475.7	1,978.9	5.7	22.3	1.5	5.5
Credit to PSEs	-54.4	75.9	-2.4	3.5	-0.2	0.2
Other items net	-1,465.8	-2,101.6	-	-	-4.7	-5.9
Currency in circulation	-697.1	-37.2	-7.6	-0.4	-2.3	-0.1
Deposits	2,077.8	-226.0	9.6	-0.8	6.7	-0.6
Reserve money	-747.3	-33.9	-6.6	-0.3	-2.4	-0.1

\*Growth in stocks as on December relative to June.

Source: SBP

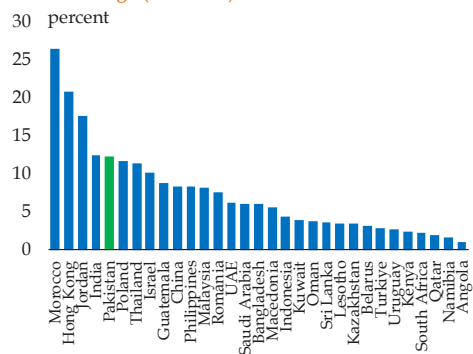
**Weighted Average Deposit Rate\* and Deposits** Figure 3.2



In this vein, some banks introduced service charges on deposits above a certain amount. Although withdrawn shortly after the imposition,<sup>3</sup> this may have discouraged deposits, leading to an expansion in CiC during Q2-FY25. In addition, declining interest rates, especially in Q2-FY25, and increased prospects of earning profit through investment in Pakistan Stock Exchange (PSX) also contributed to deposit withdrawals (Figure 3.2).

Notwithstanding the slight decline in H1-FY25, Pakistan remains among the countries with highest CiC in terms of GDP (Figure 3.3). Several underlying economic and structural factors contribute to higher CiC in Pakistan (Box 3.1). High level of CiC is one of the major constraints on credit as it reduces availability of loanable funds, which are critical for investment and economic growth.

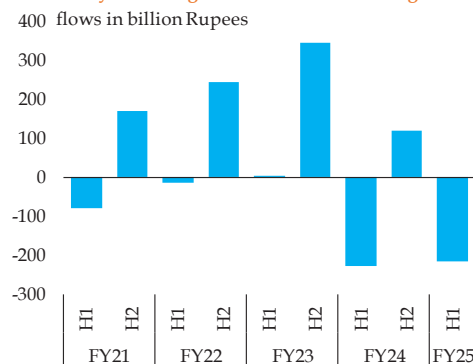
**CiC to GDP Ratio 5-Year Average (2019-2023)** Figure 3.3



### Commodity Financing

Financing for commodity operations saw a net retirement of Rs 216 billion during H1-FY25, slightly lower compared to Rs 229 billion during the same period last year. This was almost entirely driven by repayment of loans availed for wheat procurement (Figure 3.4). This mainly reflected the impact of reforms in

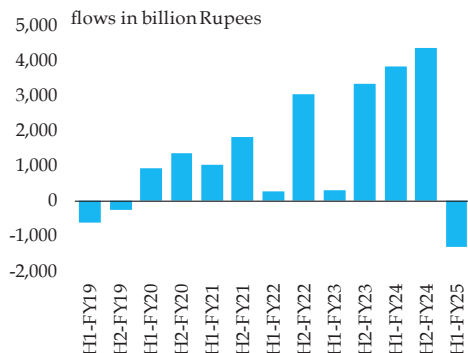
**Commodity Financing** Figure 3.4



<sup>3</sup> After the removal of Minimum Deposit Rate (MDR) requirement on financial institutions, public sector enterprises and public limited companies from November 26<sup>th</sup>, scheduled banks withdrew fees on large deposits. (BPRD circular No.5 of 2024, SBP).

**Government Borrowings from Scheduled Banks**

**Figure 3.5**



Source: SBP

## Government Borrowings

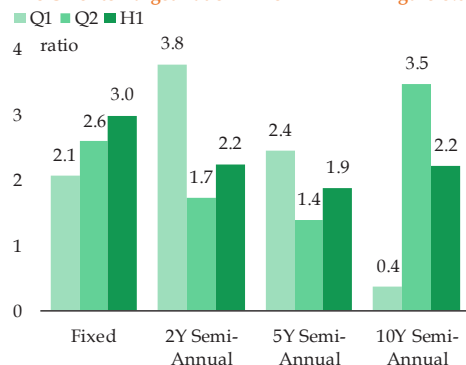
The government made a net retirement of Rs 1,327 billion to the scheduled banks in H1-FY25, for the first time since FY19 (**Figure 3.5**). In contrast to FY19 when the government borrowed from SBP to make repayments to scheduled banks, a lower fiscal deficit amidst the transfer of hefty SBP profit allowed the government to retire to scheduled banks in H1-FY25.

commodity operations to stem accumulation of commodity debt. These measures included rationalization of wheat procurement, gradual abolition of minimum support price (MSP),<sup>4</sup> timely payment of subsidies, and transitioning to targeted subsidies.<sup>5</sup>

In this backdrop, to benefit from the declining interest rate environment and to contain the rollover risk, the government kept higher auction targets for PFLs and fixed rate PIBs, and planned net-retirements in T-bills (**Table 3.2**). In line with the targets, the government met its financing requirements from PFLs – Semi-Annual, followed by fixed rate PIBs, and made retirements in T-bills. Furthermore, the government introduced 2-year bills in both fixed and floating PIBs to attract market interest.<sup>6</sup> Given the declining interest rate scenario, the market showed keen interest in these securities, which is visible from a high offer-to-target ratio of 3.3 for 2Y – Fixed, and 2.2 for 2Y – Semi-Annual in H1-FY25 (**Figure 3.6**).

**PIBs Offer to Target Ratio - FY25**

**Figure 3.6**



Source: SBP

The reduction in policy rate along with the government’s lower demand for financing led to a decline in T-bill cut-off rates during H1-FY25 (**Figure 3.7**). This further widened the negative spread between the cut-off rates on shorter-tenor securities and

<sup>4</sup> IMF (2024). Pakistan: 2024 Article IV Consultation and Request for an Extended Arrangement under the Extended Fund Facility-Press Release; Staff Report; and Statement by the Executive Director for Pakistan, International Monetary Fund, Washington, D.C.

<sup>5</sup> GOPb (2024). Punjab Debt Bulletin, Government of Punjab, Lahore.

<sup>6</sup> These bills had the feature of semi-annual coupon payments. In FY21, the government introduced 2-year PFLs with quarterly coupon payments.

## Auction Summary - H1-FY25

Table 3.2

billion Rupees

	Target	Maturity	Offers (competitive)	Acceptance	Acceptance (net of maturity)
<b>Treasury Bills</b>					
3-Month	1,695	1,405.1	5,740.3	2,135.8	730.7
6-Month	1,770	1,655.0	6,123.1	2,037.7	382.7
12-Month	3,420	7,106.4	9,509.6	3,678.2	-3,428.2
<b>Total</b>	<b>6,885</b>	<b>10,166.5</b>	<b>21,373.0</b>	<b>7,851.6</b>	<b>-2,314.8</b>
<b>Pakistan Investment Bonds</b>					
<i>Fixed rate</i>					
2Y	325	-	1,082.4	247.4	247.4
3Y	350	-	744.4	262.9	262.9
5Y	370	-	1,361.9	472.8	472.8
10Y	335	-	382.9	211.1	211.1
<b>Total</b>	<b>1,380</b>		<b>3,571.6</b>	<b>1,194.2</b>	<b>1,194.2</b>
<i>Floating rate</i>					
<i>Semi-Annual</i>					
2Y	600	-	1,345.3	25.3	25.3
5Y	2,050	-	3,851.5	1,326.5	1,326.5
10Y	2,250	-	4,642.0	3,022.8	3,022.8
<i>Quarterly</i>					
2Y	40	-	61.0	-	
3Y	40	802.1	626.9	25.4	-776.7
<b>Total</b>	<b>4,980</b>	<b>802.1</b>	<b>10,526.7</b>	<b>4,400.0</b>	<b>3,597.9</b>

Source: SBP

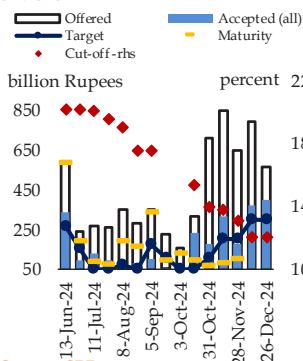
the policy rate. After the transfer of SBP profit in September 2024 that drove a surplus in the fiscal balance during Q1-FY25, the government rejected all bids in the T-bill auction held on 19<sup>th</sup> September 2024. Subsequently, the government also announced first debt buyback auction in October 2024. In addition, inflation fell to single-digit from August 2024 onwards, leading the market to price in further reduction in the policy rate. These expectations of declining inflation and expected cut in the policy rate lowered the secondary market yields especially for shorter-tenor securities, which declined throughout H1-FY25 (Figure 3.8).

In anticipation of a further cut in the policy rate, the government made net retirements

in 12-month T-bills and borrowed minimally in 3-month and 6-month T-bills. Moreover, the market showed contrasting behavior in bidding pattern during H1-FY25. In Q1-FY25, the market was more inclined to invest in 6-month and 12-month relative to 3-month T-bills. In Q2-FY25, however, offers for 3-month T-bills soared despite it being favorable for the market to invest in longer-tenor securities. This can be attributed to increased interest from non-bank participants.

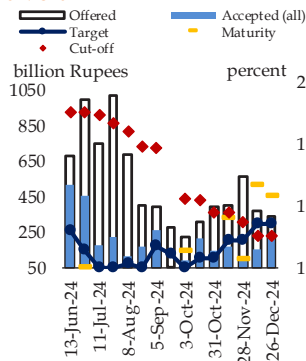
Longer-tenor securities attracted market interest throughout the year, which was particularly pronounced during Q2-FY25. This reflected market interest to lock funds in longer-tenor instruments in view of further rate cuts ahead. Offers were

**T-Bills Auction Summary**  
**3-Month**



Source: SBP

**6-Month**



**12-Month**

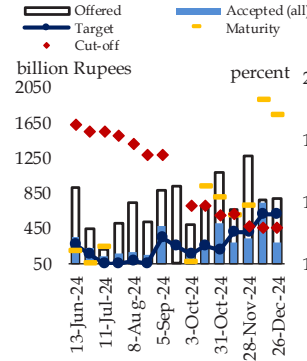


Figure 3.7

especially higher for Fixed and 10Y - Semi-Annual coupon bonds.

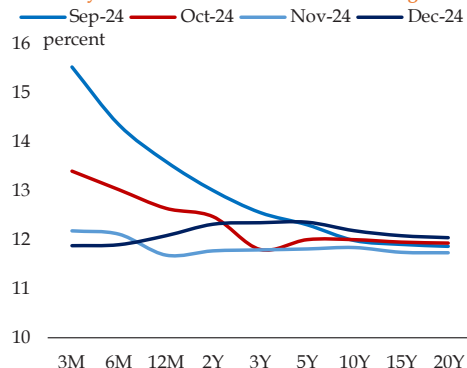
A significant drop in the policy rate, faster-than-anticipated disinflation, improvement in external sector, and lower uncertainty shifted the secondary market yield curve downwards (Figure 3.8). In December, the slope of the yield curve also turned slightly

positive. Specifically, the spread between the 20-year PIBs and 3-month T-bills turned positive by 16 bps in December from negative 46 bps in November. In light of economic literature on yield curves, this points to better macroeconomic outcomes in the near-term.<sup>7</sup>

### Interbank Liquidity

Liquidity pressures remained elevated in H1-FY25. This was despite a significant net retirement of government budgetary borrowing and commodity finance to scheduled banks. In addition, net FX purchases by SBP and a marginal decline in CiC further cushioned market liquidity. However, lower deposit mobilization, and surge in lending to the private sector strained interbank liquidity. Given these pressures, SBP injected a higher amount of liquidity in H1-FY25 in order to keep the Weighted Average Overnight Repo Rate

**Secondary Market Yields** Figure 3.8



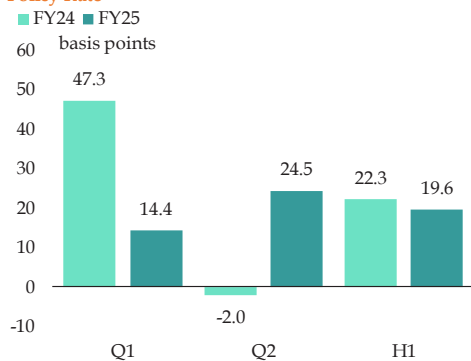
Source: SBP

<sup>7</sup> Empirical evidence shows that an increase in the yield spread is a strong predictor of output growth in Pakistan. Hussain, F. & Mahmood, A. (2017). Predicting Inflation and Output in Pakistan: The Role of Yield Spread, *SBP Working Paper Series*, No.93.

(WAONR) close to the policy (target) rate through 7-day and 28-day OMO injections.<sup>8</sup> Resultantly, the average outstanding OMO stock rose to Rs 11 trillion at end-December 2024 as compared to the Rs 9 trillion at end-December 2023.

Due to persisting liquidity demand, WAONR remained above the policy rate on average during H1-FY25 (Figure 3.9). Specifically, the WAONR saw a larger positive deviation and higher volatility during Q2-FY25 compared to Q1-FY25 and the second quarter of last year (Figure 3.10).<sup>9</sup> The use of SBP's ceiling facility also increased during this period.<sup>10</sup> This could be traced to increased liquidity pressures in Q2-FY25 stemming from a sizeable expansion in credit to non-government sector, significant deposit outflows and an uptick in CiC. While the debt buyback

Average Deviation of WAONR from Policy Rate Figure 3.9



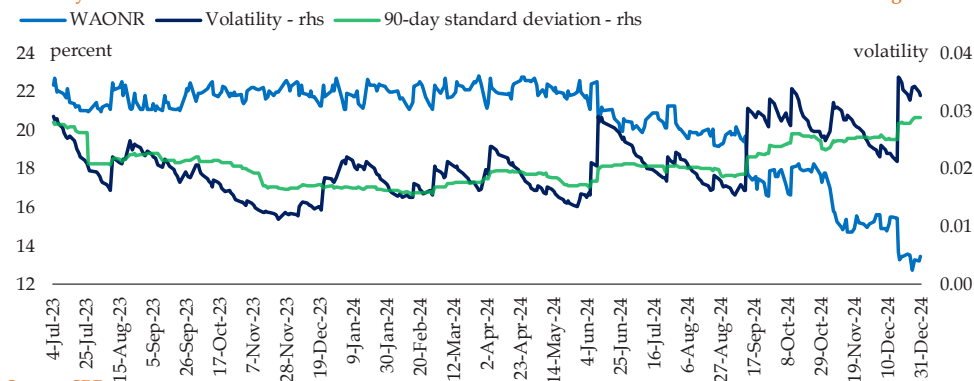
Source: SBP

auctions somewhat cushioned liquidity, in October (Figure 3.11), its impact was offset by rising liquidity pressures due to increased bank lending to private sector.

The liquidity requirements of the Islamic Banking Institutions (IBIs) also increased during H1-FY25 as the outstanding stock

Volatility in WAONR

Figure 3.10



Source: SBP

<sup>8</sup> The 7-day tenor made up 69 percent of the OMO injections whereas 28-day tenor made up 28.9 percent.

<sup>9</sup> Higher volatility in the WAONR corresponded with the MPC meetings as shifts in the policy rate spiked volatility on the same day.

<sup>10</sup> The use of ceiling facility stood at Rs 13,532 billion in H1-FY25, which is almost twice that of Rs 7,105 billion in H1-FY24.

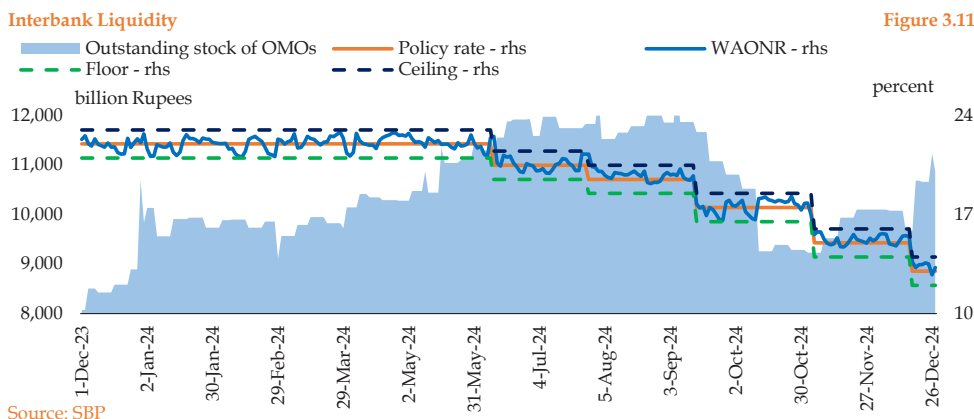


Figure 3.11

of OMOs rose to Rs 503 billion compared to Rs 235 billion in the same period last year. Similarly, SBP also met the liquidity needs of IBIs through OMO injections.

### Credit to PSEs

Credit to public sector enterprises (PSEs) increased by Rs 76 billion in H1-FY25 as compared to a net retirement of Rs 54 billion in the same period last year (Table 3.1). A sizeable borrowing by a large refinery mainly explains this increase, which outweighed significant retirements by PSO. The retirement by PSO reflected relatively better cash flow position of the company due to higher profits.<sup>11</sup> Increased borrowing by the refinery was meant to cover its maintenance and upgradation costs and to meet debt servicing obligations after temporary shutdown of operations for scheduled maintenance.

### 3.3 Private Sector Credit

Private sector credit (PSC) surged by 22.3 percent in H1-FY25, the highest growth for H1 since FY86 (Figure 3.12).<sup>12</sup> Almost entire increase was concentrated in Q2-FY25, specifically during October 2024, while Q1-FY25 saw seasonal net retirement. During Q2-FY25, the combined impact of easing financial conditions, some improvement in economic activity, and banks' efforts to avoid ADR-based tax,<sup>13</sup> led to an unprecedented expansion in PSC.

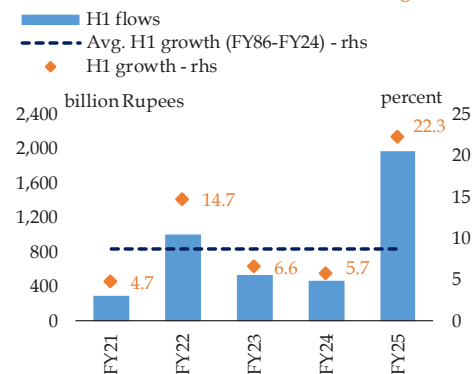
Following the reduction in the policy rate since June 2024, the weighted average lending rates (WALR) dropped sharply in H1-FY25 compared to the average rates observed in H1-FY24 (Table 3.3). The exchange rate also saw a slight appreciation during H1-FY25, which together with benign global commodity

<sup>11</sup> PSO (2025). Unconsolidated Financial Statements YTD Dec 2024, Pakistan State Oil Company Limited, Karachi.

<sup>12</sup> Based on monthly monetary survey data of December 2024.

<sup>13</sup> The additional tax based on ADR of banks was introduced in Finance Bill, 2021, and was applicable for the tax year 2024. The additional tax was 10 percent above the normal income tax, if ADR remained between 40 to 50 percent and 16 percent if ADR remains below 40 percent. Later, towards the end of December 2024, federal government removed this additional tax based on ADR.

**Private Sector Credit** Figure 3.12



Source: SBP

prices, helped in lowering the cost of imported inputs.

The input costs also moderated, as reflected by a steep reduction in the wholesale price index (WPI) inflation to 4.4 percent in H1-FY25, from 25.4 percent in the same period last year. However, energy prices – electricity, LNG and coal - continued to remain elevated though lower compared to last year (Table 3.3). The relative ease in overall cost of production, together with some uptick in demand and continued momentum in exports, induced higher production in some of the major LSM groups during this period (Chapter 2), which also increased working capital requirements of the industry as a whole.

In addition to demand-driven increase, the ADR-based tax also contributed to the strong increase in PSC. Due to the seasonal retirement, the average ADR of the banking sector was below 40 percent at the end of Q1-FY25. Therefore, to avoid additional tax, banks looked for avenues to increase lending to private sector

**Cost of Production** Table 3.3

percent change YoY	H1-FY24	H1-FY25
PKR/US\$ ER (avg. +app. / -dep.)	-22.2	3.3
Weighted avg. lending rate*	21.5	17.1
Wholesale price index:		
LNG	44.1	37.8
Coal	39.5	20.0
Electricity	27.7	7.9

\* average for H1 (excluding zero mark-up and Inter-FIs)

Sources: SBP and PBS

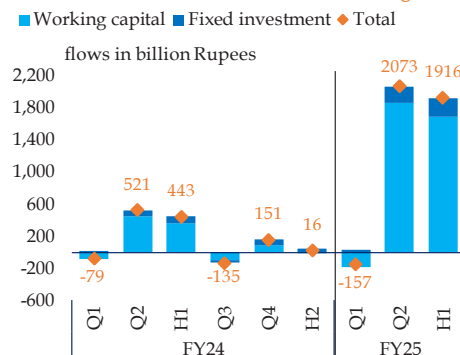
businesses and other segments from the start of October 2024.

Disaggregated analysis of loans to private sector businesses (PSBs) shows a substantial uptick in Q2-FY25. Though fixed investment loans also rose, the major thrust came from increase in working capital loans (Figure 3.13).

*The momentum in exports partially explains the surge in working capital loans to export-oriented sectors*

Increase in production and exports partially explains the expansion in credit requirements of some of the export-

**Loans to Private Sector Businesses** Figure 3.13



Source: SBP

Loans to Major Private Sector Businesses  
flow in billion Rupees

Table 3.4

	Total Loans*		Working Capital**		Fixed Investment		Total Loans*	
			H1				Q1	Q2
	FY24	FY25	FY24	FY25	FY24	FY25	FY25	
<b>Total</b>	442.6	1,915.7	369.3	1,686.2	76.0	240.9	-157.2	2,072.8
Manufacturing	307.2	1,401.0	279.7	1,305.1	29.5	100.1	-104.1	1,505.1
Textile	106.8	504.8	95.0	502.7	10.9	3.0	26.0	478.9
Basic pharma.	6.1	222.9	-0.9	215.1	7.2	8.0	1.2	221.6
Cement & plaster	-18.0	107.1	-16.3	119.7	-1.4	-12.3	-9.3	116.4
Rice processing	82.9	92.1	82.3	91.0	0.6	1.1	-18.9	111.0
Fertilizers	-33.5	45.8	-32.5	26.5	-1.0	19.4	-6.4	52.2
Refined petroleum	-5.1	42.7	-12.3	20.7	7.2	22.0	-10.9	53.6
Motor vehicles	15.3	27.9	14.9	20.7	0.3	7.2	1.0	26.9
Basic iron & steel	33.6	18.2	37.5	5.0	-3.8	13.2	3.1	15.1
Veg. & animal oils	18.9	17.6	19.1	18.7	0.1	-1.1	-21.2	38.8
Paper industry	16.0	14.4	10.4	10.1	5.6	4.3	5.4	9.0
Sugar	-49.4	-26.7	-41.2	-46.9	-8.2	20.2	-102.8	76.0
Telecommunication	11.0	115.1	-3.0	96.9	14.1	18.2	20.2	94.9
Wholesale & retail trade	84.2	91.7	73.5	64.5	11.0	29.6	-22.1	113.7
Agri. & fishing	73.0	59.9	28.4	28.5	44.7	31.5	-3.6	63.5
Construction	10.0	25.9	7.0	18.1	-3.7	9.3	12.6	13.3
Mining & quarrying	2.2	16.3	4.2	16.5	-2.0	-0.2	-8.6	24.9
Power gen. & dist.	-54.2	-23.9	-27.7	-15.3	-26.4	-8.0	-21.4	-2.4
Transport. & storage	7.2	-14.8	7.2	-20.2	0.1	5.7	-23.1	8.3
Real estate activities	-4.7	-0.4	-1.0	-1.4	-1.2	-0.7	-3.3	3.0

\* Total amount also includes construction finance. In terms of IH&SMEFD Circular Letter No. 28 of 2020, the data on credit/loans has been revised since June 2020 due to inter-sectoral adjustment in private sector business.

\*\* includes trade finance

Source: SBP

oriented sectors including *manufacturing of textile* and *rice processing* during H1-FY25. The credit off-take by sectors was not only higher compared to the same period last year, but also their past five years' average for H1 (Table 3.4).

*Manufacturing of textile* saw a significant rise of Rs 503 billion in working capital loans in H1-FY25, compared to Rs 95 billion in the same period last year. Weaving, finishing of textile, manufacture of made-up textile and wearing apparel

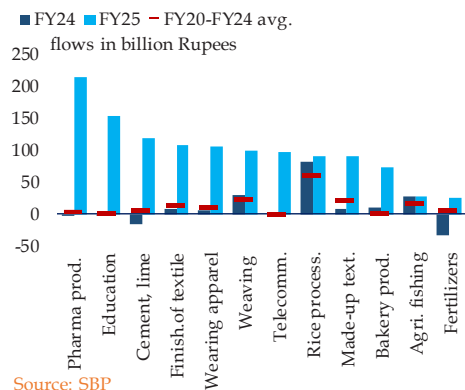
were the major textile sub-sectors that saw expansion in production and exports. Especially the export quantum of garments, bed-wear and synthetic textile showed recovery after a dip in last year (Chapter 5). Moreover, the elevated energy and labor cost also raised requirement for working capital loans.

Similarly, working capital requirements of *rice processing* increased as rice export maintained the last year's momentum in H1-FY25 as well.<sup>14</sup> Increased rice milling,

<sup>14</sup> Rice exports increased by 19.0 percent in H1-FY25 on top of growth of 48.4 percent in H1-FY24, which was driven by India's ban on certain rice categories. Source: PBS

The State of Pakistan's Economy, Half Year Report 2024-25

**Working Capital Loans to PSBs - H1** Figure 3.14



Source: SBP

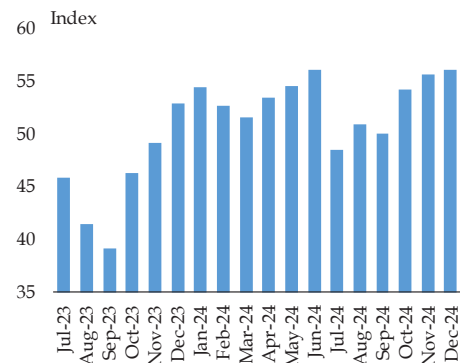
despite lower crop production, was on account of stocks available from the last year's bumper crop.

*Some sectors saw unusual spike in working capital loans*

Some of the sectors like *manufacturing of cement, lime and plaster; pharmaceutical production and fertilizers and nitrogen compounds* saw abnormally large increase in working capital loans, despite sluggish trends in production (**Figure 3.14**).

*Manufacturing of pharmaceutical products* availed the highest amount of credit, Rs 215 billion, in H1-FY25, compared to a retirement of Rs 1 billion in the same period last year.<sup>15</sup> The higher loan off-take was partially supported by increase in production activity, while major part of the unprecedented expansion seems to be ADR-related lending.<sup>16</sup> However, elevated

**Business Confidence Index** Figure 3.15



Source: SBP

energy prices, particularly of coal and RLNG, partially explain the increase in working capital loans to *cement, lime and plaster manufacturing*.

A one-off increase in *working capital loans* of Rs 154 billion was seen in *education sector*, which was about 9.0 percent of the total increase in working capital loans to private sector businesses during H1-FY25. Anecdotal evidence suggests that it was probably driven by ADR-related lending operations as the sector has never availed such a high amount of credit in past.<sup>17</sup>

*Loans for fixed investment increased amid reduced uncertainty and improved prospects of economic stability*

A sharp decline in inflation and reduction in the policy rate improved the overall business confidence (**Figure 3.15**). Moreover, slightly better macroeconomic

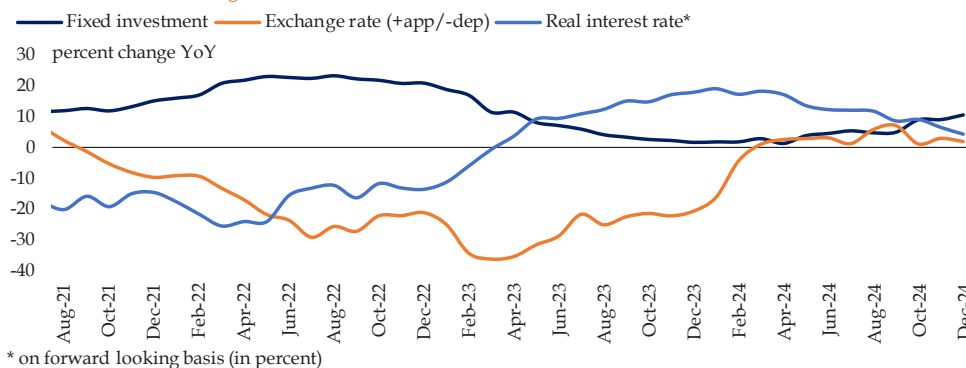
<sup>15</sup> The average working capital loan availed by the sector was just Rs 3.1 billion during H1 of last five years.

<sup>16</sup> The manufacturing of pharmaceutical products witnessed a net retirement of Rs 127 billion and Rs 96 billion in Jan-25 and Feb-25, respectively to result a cumulative net retirement of Rs 7 billion during Jul-Feb, FY25.

<sup>17</sup> The working capital loans to education sector saw a net retirement of Rs 103 billion and Rs 50 billion in Jan-25 and Feb-25, respectively. This resulted in a net decrease of Rs 0.2 billion in working capital loans during Jul-Feb, FY25 billion for the sector.

**Real Interest Rate, Exchange Rate and Fixed Investment Loans**

**Figure 3.16**



\* on forward looking basis (in percent)  
Sources: SBP and PBS

conditions and improved medium-term growth prospects, encouraged businesses to borrow for fixed investment (Figure 3.16).

Specifically, *manufacture of refined petroleum products, sugar, fertilizers and nitrogen compounds, and telecommunications, wholesale and retail trade*, saw large increases in loans for fixed investment in H1-FY25. Some of these sectors even reported unprecedented increases in H1-FY25 (Figure 3.17).

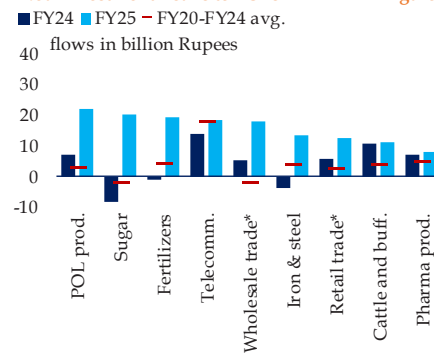
The *manufacturing of refined petroleum products* availed fixed investment loans to support ongoing expansion project by one of the refineries aiming to produce EURO-V compliant fuels, and increase its refining capacity.<sup>18</sup> Other refineries also announced upgradation and expansion projects in annual reports for 2024 in light of ‘Pakistan

Oil Refining Policy for Upgrading Brownfield Refineries 2023 (as amended in February 2024)’.<sup>19</sup>

Fixed investment loans to *Sugar industry* witnessed an increase in H1-FY25, after showing a net-retirement during the last 3

**Fixed Investment Loans to PSBs - H1**

**Figure 3.17**



\*excluding motor vehicles and motorcycles  
Source: SBP

<sup>18</sup> Refinery Expansion and Upgradation Project (REUP) by Pakistan Refinery Limited (PRL) is aiming to increase the crude processing capacity from 50,000 bpd to 100,000 bpd. The FEED (Front End Engineering Design) study has been in process and the company has already spent US\$50 million on the FEED study. Source: PRL financial reports and “Disclosure of Material” letter to PSX, May 2024.

<sup>19</sup> The main objective of the Policy is to modernize refineries to produce more environmentally friendly Euro-V fuels and reduce Furnace Oil production. Source: Ministry of Energy (Petroleum Division), Government of Pakistan.

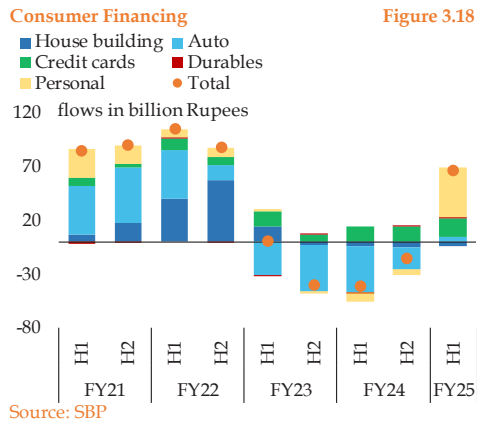
years. These loans were in continuation of the announcement made by some of the sugar manufacturers last year to install ethanol distilleries.<sup>20</sup>

Pharmaceutical sector availed long-term loans to finance expansion in product lines and asset acquisition agreement between a local firm and a multinational firm.<sup>21</sup> Similarly, telecommunication sector obtained fixed investment loans for continued expansion in wired and wireless communication sectors, and manufacturing of mobile phones.

### Consumer Financing

Consumer financing recovered in H1-FY25, after showing net retirement for the last two consecutive years. On cumulative basis, consumer financing recorded an increase of Rs 66 billion in H1-FY25 as compared to a net retirement of Rs 42 billion in H1-FY24 (Figure 3.18). A jump in personal loans primarily drove this expansion, which mainly reflects banks' efforts to meet ADR requirements. Moreover, amid the decline in borrowing costs, auto loans ticked up slightly, after showing net retirement in last two years.

Despite a decline in borrowing cost, housebuilding loans remained subdued. Elevated prices of construction materials and increase in tax on property transactions, have dampened demand in this segment. On the other hand, credit



cards maintained their upward momentum, continuing the growth trend observed over the past few years.

### 3.4 Inflation

The disinflationary trends, observed since January 2024, steepened during H1-FY25 with NCPI inflation falling to a multi-year low. The disinflation was broad-based, with dominant contribution from non-perishable food items (Table 3.5, Figure 3.19a and 3.19b). The interaction of improved supply conditions with weak domestic demand underpinned this steep disinflation. In addition, delay in energy price adjustments, benign global commodity prices and a favorable base effect, further reinforced the falling trend in inflation.

Improved availability of key food items mainly explains the sharp decline in non-

<sup>20</sup> Chashma Sugar Mills Limited and JDW Sugar Mills Limited announced to set-up these distilleries in Q3-FY24, which are expected to complete in Q3-FY25. Source: Various quarterly financial reports

<sup>21</sup> Lucky Core Industries (LCI) acquired long-term loans to successfully completed acquisition of manufacturing facility, selected pharmaceutical products, and associated trademarks under the Asset Purchase Agreements with Pfizer Pakistan Limited and other Pfizer groups. Source: Quarterly financial report for September 2024.

**Average CPI Inflation**

**Table 3.5**

Percent

Items	Wt.*	Average Inflation during			Contribution		
		H1-FY24	H2-FY24	H1-FY25	H1-FY24	H2-FY24	H1-FY25
<b>NCPI</b>	<b>100</b>	<b>28.8</b>	<b>18.7</b>	<b>7.2</b>	<b>28.8</b>	<b>18.7</b>	<b>7.2</b>
<b>Urban CPI</b>	<b>100</b>	<b>28.0</b>	<b>20.7</b>	<b>8.7</b>	<b>28.0</b>	<b>20.7</b>	<b>8.7</b>
<b>Food</b>	<b>36.8</b>	<b>33.2</b>	<b>12.9</b>	<b>2.7</b>	<b>13.5</b>	<b>5.5</b>	<b>1.1</b>
Perishable	4.4	7.5	25.0	21.6	0.4	1.1	0.9
Non-perishable	32.4	37.0	11.5	0.5	13.1	4.4	0.2
<b>NFNE (Core inflation)</b>	<b>53.7</b>	<b>18.4</b>	<b>13.9</b>	<b>9.5</b>	<b>8.7</b>	<b>6.3</b>	<b>3.5</b>
<b>Energy</b>	<b>9.5</b>	<b>47.9</b>	<b>76.1</b>	<b>24.8</b>	<b>5.8</b>	<b>8.9</b>	<b>4.1</b>
<b>Rural CPI</b>	<b>100</b>	<b>30.0</b>	<b>16.5</b>	<b>5.0</b>	<b>30.0</b>	<b>16.5</b>	<b>5.0</b>
<b>Food</b>	<b>45.9</b>	<b>33.7</b>	<b>12.9</b>	<b>0.4</b>	<b>16.8</b>	<b>6.7</b>	<b>0.2</b>
Perishable	5.7	7.7	29.9	21.1	0.5	1.7	1.2
Non-perishable	40.3	37.8	10.7	-2.1	16.3	4.9	-1.0
<b>NFNE (Core inflation)</b>	<b>42.6</b>	<b>25.9</b>	<b>19.3</b>	<b>12.7</b>	<b>3.5</b>	<b>6.9</b>	<b>4.6</b>
<b>Energy</b>	<b>11.4</b>	<b>27.2</b>	<b>23.3</b>	<b>2.0</b>	<b>9.6</b>	<b>2.9</b>	<b>0.3</b>

\*wt. = weight

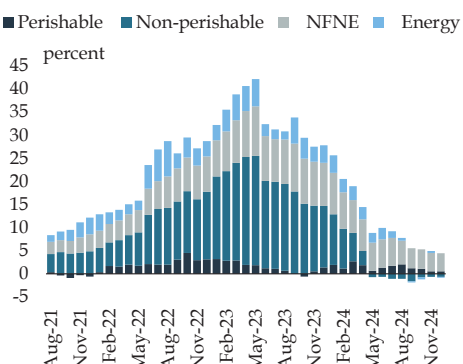
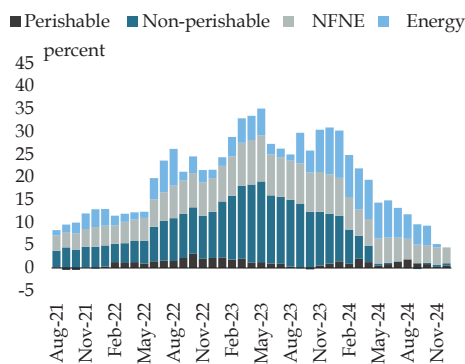
Source: PBS

perishable food inflation. Specifically, falling prices of wheat & its products alone accounted for around one-quarter of the decline in urban and one-third in rural inflation. Further, tight monetary policy stance and continued fiscal consolidation kept domestic demand in check. Despite a

modest recovery in some of the demand indicators, spare production capacity in the economy helped ease inflationary pressures.<sup>22</sup> Also, the fading second-round effects of past shocks to food and energy prices contributed to a notable slowdown in core inflation.

**Major Contributors to Inflation - Urban** Figure 3.19a

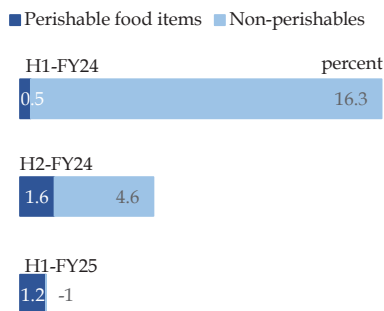
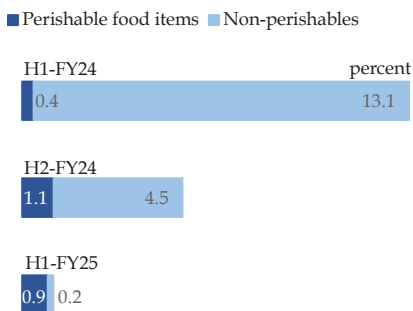
**Major Contributors to Inflation - Rural** Figure 3.19b



Source: PBS

<sup>22</sup> During H1-FY25, production in around half of the 123 LSM industries remained lower than the average levels observed during FY21-22, when the real GDP growth posted around 6 percent increase, indicating spare capacity in the economy.

Urban Food Inflation - Major Contributors Figure 3.20a Rural Food Inflation - Major Contributors Figure 3.20b



Source: PBS

The significant impact of supply conditions on inflation dynamics highlights the need to introduce productivity-enhancing measures as one of the important policy interventions to achieve long-term price stability. Specifically, targeted productivity-enhancing measures in agriculture sector — such as optimizing input use, adopting efficient irrigation techniques, and logistics improvements can prevent supply disruptions and stabilize food inflation. Similarly, investment in human and physical capital can drive productivity gains, thereby contributing to stable inflation overtime (Chapter 6).<sup>23</sup>

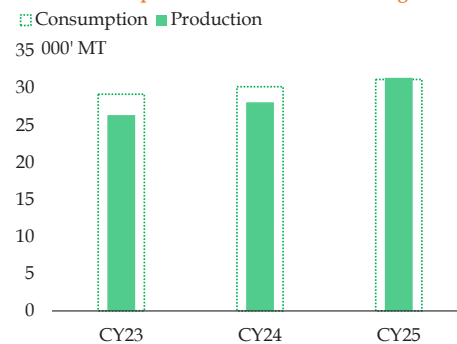
*Ample supply of key items lowered food inflation*

Sufficient availability of key food items, and discontinuation of government intervention in the market for agricultural commodities mainly contributed to the

steep decline in food inflation during H1-FY25 (Figure 3.20a & 3.20b).

Specifically, prices of wheat and wheat products fell by 25 percent across urban and rural areas in H1-FY25. The bumper wheat crop in FY24, which was sufficient to meet domestic demand, along with large import volumes mainly underpinned the

Wheat Consumption and Production Figure 3.21



Note: The data shown corresponds to the crop year

Source: USDA

<sup>23</sup> Kim, S. Lim, H. & Park, D. (2012). Does Productivity Growth Lower Inflation in Korea? *Journal of Applied Economics*. Vol.45, No. 16. The study investigates the relationship between productivity growth and inflation using quarterly data from 1985 to 2002. They find that productivity growth unidirectional influences inflation, with a 1 percent increase in labor and Total Factor Productivity (TFP) reducing CPI inflation by 0.07-0.08 percent and 0.37-0.44 percent, respectively.

decline in prices of wheat and wheat products during H1-FY25 (Figure 3.21). In addition, the government’s decision to discontinue the minimum support price (MSP) and withdrawal from procurement operations further pushed prices downward. In fact, the prices of wheat flour dropped close to the level seen in H1-FY23. Prices of other major non-perishable food items, such as rice, sugar and cooking oil, also fell compared to H1-FY24. This collective reduction more than offset the increase in prices of perishable food items.

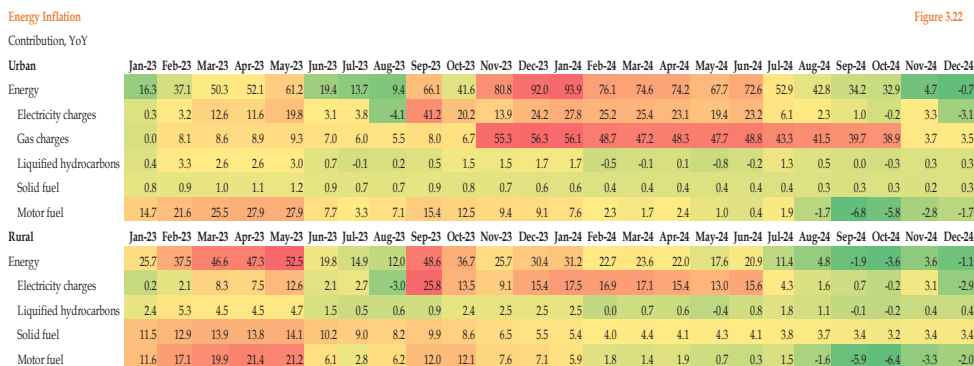
*Perishable food inflation saw a notable increase during H1-FY25*

The prices of onions, tomatoes, and fresh vegetables rose sharply during H1-FY25. Specifically, onion prices increased by 40 percent in urban and 51 percent in rural CPI in H1-FY25, accounting for approximately 25 percent of urban and 33 percent of the rural perishable food inflation. The rise in onion prices was

primarily due to constrained domestic supply. India, the world’s second-largest onion exporter, imposed an export ban from December 2023 till June 2024, which resulted in a global supply shortage. This development led domestic traders to capitalize on the opportunity and export their produce at higher prices. As a result, onion exports more than doubled in the last quarter of FY24,<sup>24</sup> squeezing domestic supply in the first quarter of FY25. However, the price pressures eased with the arrival of Sindh’s crop in Q2.

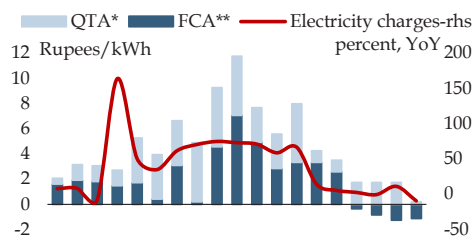
*Energy inflation moderated as global oil prices eased and the exchange rate remained broadly stable*

Urban energy inflation fell sharply from 47.9 percent in H1-FY24 to 24.8 percent in H1-FY25, reflecting the fading effects of the November 2023 gas tariff hike, which continued to exert upward pressure during the first four months of H1-FY25 (Figure 3.22). As a result, energy’s contribution to



<sup>24</sup> Source: Pakistan Bureau of Statistics

**Trends in Electricity Charges and Tariff Adjustments** **Figure 3.23**



\*Quarterly tariff adjustment for residential consumers  
\*\* Fuel charge adjustments

Sources: NEPRA and PBS

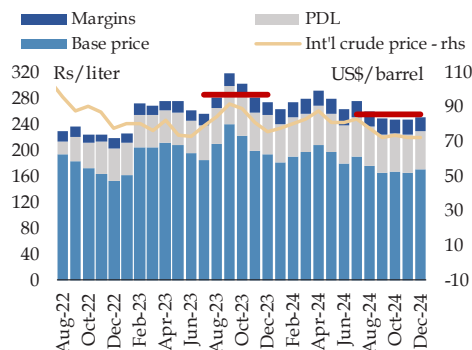
urban headline inflation receded significantly towards the end of H1-FY25.

The government's approach to electricity tariff adjustments in H1-FY25 further

moderated the energy inflation. Although an annual adjustment<sup>25</sup> of Rs 5.72/kWh was scheduled to take effect on July 1, 2024, its implementation was staggered to give relief to consumers. An initial increase of Rs 3.29/kWh was applied between July and September 2024, with the remaining increment phased-in from October onward. Additionally, the collection of quarterly adjustment charges for July and August was advanced to June, providing temporary respite in electricity tariffs during H1-FY25 (Figure 3.23).<sup>26</sup>

Favorable fuel charge adjustments,<sup>27</sup> which declined during Sep-Dec 2024 compared to the same period last year, also contributed to lower electricity prices. Meanwhile, softening global oil prices and stable PDL rates alleviated fuel price pressures (Figure 3.24).

**Composition of Motor Fuel Prices** **Figure 3.24**



Source: OGRA

*Underlying inflationary pressures considerably eased in H1-FY25*

Underlying inflationary pressures receded during H1-FY25, with Non Food Non Energy (core) inflation coming down to almost half of the level seen in H1-FY24 (Figure 3.25). Urban core inflation continued the almost consistent declining trend since December 2023, reaching a 34-month low of 8.1 percent in December 2024.<sup>28</sup>

<sup>25</sup> Annual rebasing adjusts electricity tariffs based on Power Purchase Price (PPP), distribution and supply margins, and prior period adjustments. For FY25, the PPP increased by Rs 4.86/kWh compared to FY24, as per the NEPRA notification dated July 11, 2024.

<sup>26</sup> Source: NEPRA notification dated July 11, 2024, and May 31, 2024, effective from June 01, 2024.

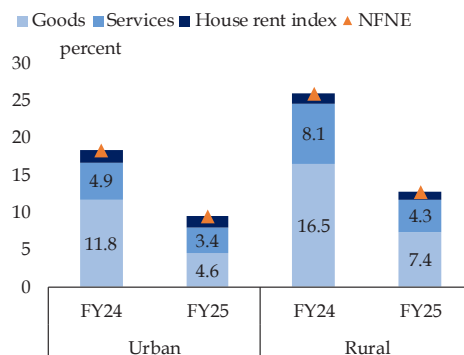
<sup>27</sup> Fuel charge adjustments reflect changes in the fuel cost component of the Power Purchase Price (PPP). These adjustments are made on a monthly basis to account for fluctuations in fuel prices.

<sup>28</sup> Rural core inflation also continued the almost consistent declining trend since October 2023, reaching a 33-month low of 10.7 percent in December 2024.

Item-wise analysis of the core basket indicates the deceleration was broad-based. Around three-fifth of the items in the urban basket recorded single-digit increase in prices in H1-FY25, compared to only 11 percent in H1-FY24. Similarly, around 44 percent of the items in rural basket saw single-digit increase in prices in H1-FY25, compared to only 13 percent in H1-FY24 (Figure 3.26a and 3.26b).

Decline in core goods' prices mainly explains the decrease in core inflation, whereas services inflation somewhat softened, though it remained elevated.<sup>29</sup> Weak domestic demand, stable exchange rate, decline production costs as indicated by WPI inflation, fading second-round effects of past shocks to food and energy prices, and ease in inflation expectations explain the significant moderation in core inflation.

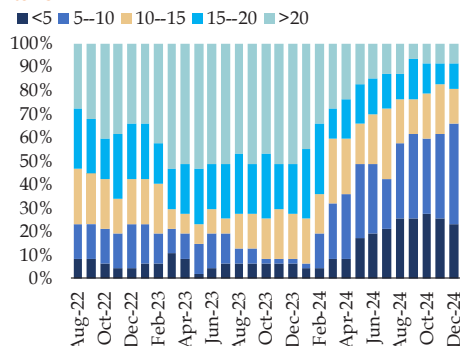
**NFNE Inflation** Figure 3.25



Source: PBS

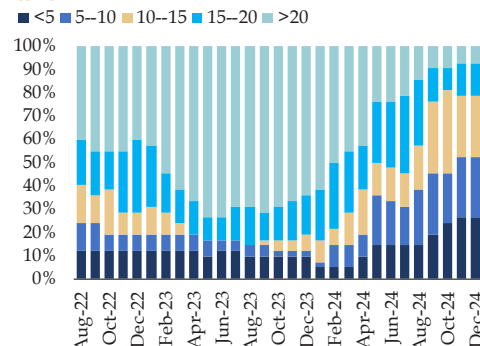
Continued tight monetary policy stance and fiscal consolidation were instrumental in keeping domestic demand subdued.<sup>30</sup> While there were signs of recovery in demand during H1-FY25, spare capacity in large industries reflects that demand-

**Frequency Distribution of Urban NFNE Items** Figure 3.26a



Sources: PBS and SBP staff calculations

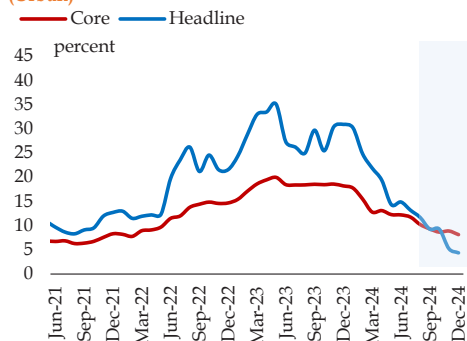
**Frequency Distribution of Rural NFNE Items** Figure 3.26b



<sup>29</sup> The higher services inflation is due to slower adjustments in wages and contracts, that take longer to reflect fluctuations in raw material and energy costs, causing services inflation to trail both goods inflation and headline inflation during high inflation periods. Source: Bañbura, M. Boleica, E. & Hernández, C.M. (2023). What drives core inflation? The role of supply shocks. *ECB Working Paper Series*, No. 2875.

<sup>30</sup> The impact of tight monetary policy stance typically begins to influence inflation in 6 to 10 months, with the full transmission materializing over 18 to 24 months. Source: Hussain, F., Hussain, F. & Hyder, K. (2022). Monetary Policy Effectiveness in Pakistan: An In-depth Analysis of Four Transmission Channels, *SBP Working Paper Series*, No. 109.

**Trends in Headline and Core Inflation (Urban)** Figure 3.27

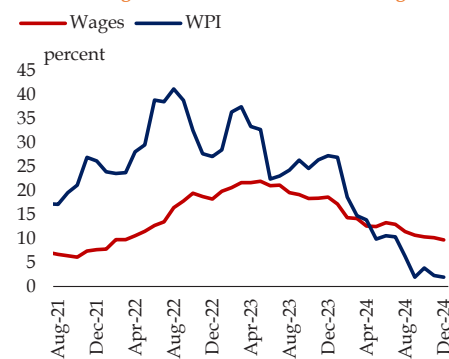


Source: PBS

driven pressures remained contained.<sup>31</sup> Furthermore, moderation in global commodity prices amid ease in supply chain bottlenecks and exchange rate stability reduced imported inflation.

In addition to these demand and supply dynamics, dissipating second-round effects of past shocks to food and energy prices that had spilled over to broader prices and wages during FY24, further escalated the disinflationary process during H1-FY25. This can be evidenced by the convergence of the headline to core inflation in the last few months of FY24 (**Figure 3.27**), which

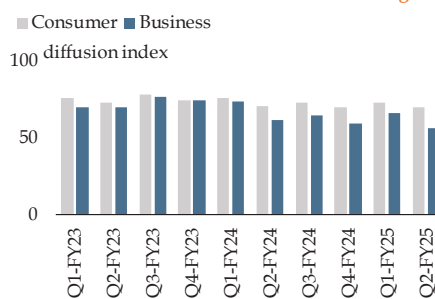
**Trends in Wages and WPI** Figure 3.28



Source: PBS

indicates the fading impact of the shocks to food and energy prices.<sup>32,33</sup> Hence, as the

**Inflation Expectations** Figure 3.29



Note: Diffusion index ranges from 0 to 100, with 50 indicating neutrality; above 50 signals higher inflation expectations, below 50, lower.

Source: SBP

<sup>31</sup> Fisher, P.G., Mahadeva, L. & Whitley, J. D. (2014). The output gap and inflation: Experience at the Bank of England, *BIS Conference Papers*, Vol.4. Examining the UK economy, Fisher et al. (2014) find that the output gap plays a significant role in forecasting inflation. The impact of policy changes on inflation in a given period depends not only on the current period's output gap but also on past and future output gap levels. Moreover, a negative demand shock, which gives rise to a negative output gap leads to disinflationary trends, which may sustain on account of excess productive capacity in the economy.

<sup>32</sup> Cecchetti, S. G. & Moessler, R. (2008). Commodity prices and inflation dynamics, *BIS Quarterly Review*, 12/2008. While investigating the presence of second round effects of shocks to food and energy prices on headline inflation in cross section of emerging economies, they found that core inflation did not revert to headline inflation which suggested absence of second round effects on wages and expectations. They argued that when headline inflation returns to the core, it indicates transitory nature of commodity price shocks, reducing concerns about second-round effects.

<sup>33</sup> Borio, C., Lombardi, M., Yetman, J., & Zakrajšek, E. (2023). The two-regime view of inflation, *BIS Papers*, No. 133. Examining inflation regimes, Borio et al. (2023) show that a decline in long-term inflation expectations strengthens the reversion of headline inflation to core, mitigating the persistence of second-round effects.

effect of temporary shocks to food and energy prices waned, the growth in wages and input costs also weakened during H1-FY25 (Figure 3.28).<sup>34,35</sup> Similarly, lower

inflation expectations of consumers and businesses, especially during Q2-FY25, also indicate the fading impact of the transitory shocks (Figure 3.29).

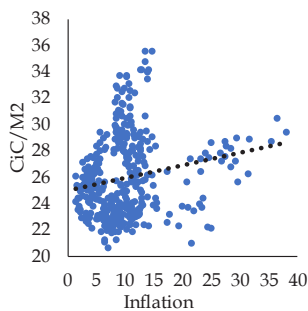
**Box 3.1: Recommendations to Contain Currency in Circulation in Pakistan\***

Literature identifies several factors responsible for increase in CiC in Pakistan, including changes in financial landscape, macroeconomic conditions, tax policies and frequent episodes of economic and policy uncertainty. Khaskheli et al. (2013) and Ejaz et al. (2020) found that CiC increased during the episodes of high inflation, as higher prices necessitate increased cash withdrawals to meet transaction demand (Figure 3.1.1a).<sup>iii</sup> Moreover, during periods of heightened economic and political instability, people tend to hold more cash as a precautionary measure (Figure 3.1.1b). Contrary to general economic theory that defines a negative relationship between interest rates and CiC, high interest rates seem to have played little role in mitigating currency demand in Pakistan (Figure 3.1.1c). Predominant use of cash based transactions in the informal economy may explain this trend.<sup>iii</sup> Low documentation requirements and lack of regulatory oversight encourage the use of cash as preferred mode of transactions in the informal economy.

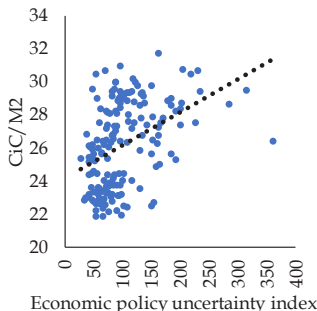
The past trends suggest that currency in circulation declined during 1990s with improvements in financial inclusion amid banking sector reforms (Figure 3.1.2), which enhanced access to formal financial services. This trend was further reinforced by financial innovations such as credit/debit cards, and online banking. However, the imposition of a withholding tax (WHT) on non-filers' banking transactions in 2015<sup>iv</sup> incentivized cash transactions fueling large increase in the CiC-to-M2 ratio.

To streamline efforts towards financial inclusion, SBP has introduced two financial inclusion strategies (NFIS) - 2015-18 and 2019-23. These strategies were aimed at increasing outreach of financial infrastructure to unbanked population through improvement in regulatory framework, introducing

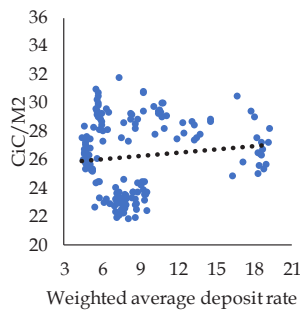
**Inflation and CiC/M2** Figure 3.1.1a **EPU Index and CiC/M2** Figure 3.1.1b **WADR and CiC/M2** Figure 3.1.1c



Note: Data points range from Jun-90 till Aug-24  
Source: SBP



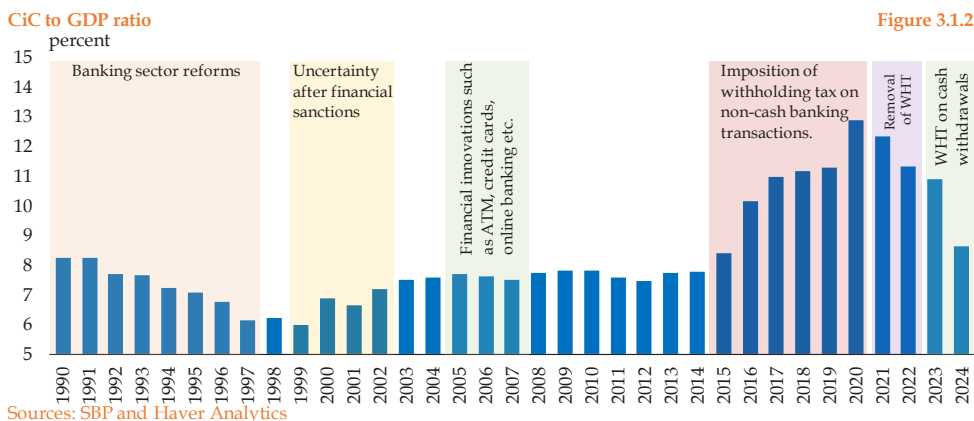
Note: Data points range from Aug-10 till Aug-24



Note: Data points range from Jan-11 till Aug-24

<sup>34</sup> Wages in H1-FY25 increased by 10.9 percent as compared to 19.2 percent in H1-FY24.

<sup>35</sup> Wages include charges/wages for tailoring, household servants, cleaning and laundering, construction workers, garbage collection, dental services, doctor fees, mechanical services, and personal grooming services.



digitization of financial services, and increasing public-private partnership. As a result of these efforts, percentage of adult population having a bank account increased to 64 percent in 2023 from 13 percent in 2014. Further to capitalize on the achievements in the two strategies, the SBP launched its third NFIS - 2024-2028, recently.

Increasing access to financial services is the key to reduce the use of cash in the economy. In view of literature and international experiences, several recommendations are proposed to further reduce the use of cash in the economy.

*Enhancing financial and digital literacy:* Pakistan's low financial literacy rate, indicates potential for greater financial inclusion by stepping-up efforts to enhance financial literacy. For instance, Sri Lanka, with financial literacy rate of 59 percent compared to Pakistan's 26 percent has achieved much higher financial inclusion as (Table 3.1.1).<sup>vi</sup> This highlights the transformative impact of financial education on financial inclusion. Moreover, in view of low literacy levels in the country, removing barriers, such as extensive documentation requirements for opening bank accounts may increase outreach of formal financial services.<sup>vii</sup> Similarly, revamping the role of credit bureaus to assess credit worthiness of small borrowers and substituting collateral requirements with social collateral and personal guarantees can significantly enhance financial inclusion.

*Enhancing the quality of customer services:* Anjum et al. (2017) identified various factors that banks should focus to expand their quality of services.<sup>viii</sup> Key factors include staff behavior, which can greatly influence customer satisfaction through positive interactions. Additionally, comfortable and well-organized seating arrangements, clear and helpful guidance, efficient processes and reduced wait times enhance the overall customer experience. Improvement in quality of financial services and increased client satisfaction can further reduce barriers to financial inclusion.

*Expanding Shariah-compliant banking to cater to religious preferences:* According to the Global Findex Database, 7 percent of Pakistanis cite religious reasons for not having a bank account. Expanding shariah-compliant banking solutions also hold potential to enhance financial inclusion by integrating individuals voluntarily excluded from the formal financial system due to religious beliefs.

**Financial Inclusion Indicators**

**Table 3.1.1**

	Year	Pakistan	Sri Lanka	India	Bangladesh
Percentage of population with formal bank account	2021	64% <sup>a</sup>	89%	78%	53%
Financial literacy rate	2014	26%	59% <sup>b</sup>	24%	19%
Commercial bank branches per 100,000 adults	2023	10.8	17.3	14.5	8.8
ATMs per 1,000 adults	2023	12.0	-	24.9	13.6
Mobile money agent outlets: active per 100,000 adults	2023	181.8	-	-	601.9

<sup>a</sup> 2023, <sup>b</sup> 2022

Sources: SBP, WB Findex, IMF Financial Access Survey, and GFLEC

*Removing tax on cash withdrawals:* The imposition of a withholding tax (WHT) on non-filers' banking transactions in 2015 led to a large increase in the CiC-to-M2 ratio. SBP (2017) found that WHT led to 3.7 percentage point increase in growth of CiC during Jul 2015-Apr 2017.<sup>ix</sup> CiC saw a significant decline after the removal of WHT. Hence, there is a need to refine tax policy to avoid unintended consequences of measures that lead to increase in cash circulation in the economy.

*Increasing documentation of the economy:* Pakistan has an unusually large informal economy. Since transactions in informal sector are often conducted outside the banking system, cash remains the preferred medium due to its convenience and privacy. There is a need to direct policy efforts to encourage documentation of the economy, which may reduce use of cash based transactions.

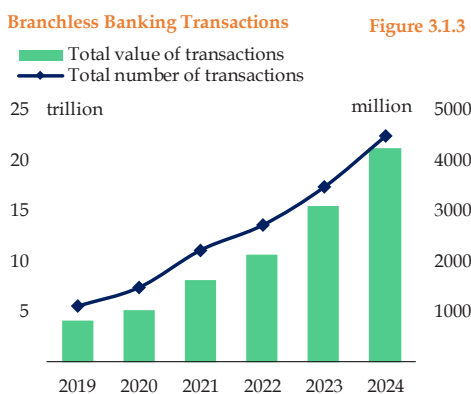
*Closing the gender gap with women-focused financial programs and tools:* Only 47 percent of women in Pakistan have formal accounts, compared to 81 percent of men.<sup>x</sup> Addressing gender disparity in financial inclusion holds a unique opportunity. Women can be empowered through enhancing their mobility, access to technology and targeted financial programs.

*Digitalization can play key role to move towards cashless economy.* Over the years, significant steps have been taken to expand digital financial services. Mobile phone penetration has enabled innovations like branchless banking, which began in 2008 and has since grown rapidly (Figure 3.1.3). Initiatives like the Asaan Mobile Account (AMA) in 2015 and Roshan Digital Account (RDA) in 2020 facilitate easier access to banking services, even for those with basic mobile phones.<sup>xi</sup> The introduction of RAAST in 2021, a cost-free and interoperable instant payment system, has further driven the adoption of digital financial services, enhancing efficiency and inclusivity. Nonetheless, obstacles such as limited internet access, technological barriers, and cybersecurity concerns continue to hinder progress. The introduction of digital currencies and mobile wallets have significant potential to increase financial inclusion. Regulatory oversight and robust security measures can also aid leveraging digital solutions to reduce reliance on cash-based transactions.

\* The contribution of Muhammad Zuhaib is acknowledged in writing this box.

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<sup>i</sup> Khaskheli, G.H. Ahmed, A. & Hyder, K. (2013). The Behavior and Determinants of the Currency Deposit Ratio in Pakistan, *SBP Research Bulletin*, Vol.9, No.1.



Source: SBP

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<sup>ii</sup> Ejaz, M. Iqbal, J. Nafees, M. & Pasha, F. (2020). The Conundrum of Rising Demand for Currency in Pakistan, *SBP Staff Notes 01/20*.

<sup>iii</sup> According to World Economics (2023), the size of the informal economy is 35.7 percent, Available at: [www.worldeconomics.com](http://www.worldeconomics.com)

<sup>iv</sup> The government imposed a withholding tax on non-filers of income tax returns through the Finance Act 2015 at a rate of 0.6 percent on all non-cash banking transactions. It was later removed through the Finance Act 2021. Moreover, a WHT tax on cash withdrawals was introduced through the Finance Act 2005 and was also removed through the Finance Act 2021. However, it was reintroduced through the Finance Act 2023.

<sup>v</sup> CBSL (2021). Financial Literacy Survey Sri Lanka, Central Bank of Sri Lanka, Colombo.

<sup>vi</sup> Klapper, L. Lusardi, A. & Oudheusden, P.V. (2014). Financial Literacy Around the World, *Global Financial Literacy Excellence Center*, California.

<sup>vii</sup> WB (2009). Bringing Finance to Pakistan's Poor, The World Bank, Washington, D.C. USA.

<sup>viii</sup> Anjum, M. Xiuhun, B. Abbas, J. & Shuguang, Z. (2017) Analyzing predictors of customer satisfaction and assessment of retail banking problems in Pakistan, *Cogent business & management*. Vol.4, No.1.

<sup>ix</sup> SBP (2017). State of Pakistan's Economy, Annual Report FY17, State Bank of Pakistan, Karachi

<sup>x</sup> SBP (2024). National Financial Inclusion Strategy 2024-28, State Bank of Pakistan, Karachi

<sup>xi</sup> SBP (2022). Financial Stability Review, Annual Report FY22, State Bank of Pakistan, Karachi