



# Economic Review



# 1 Economic Review

## 1.1 Overview<sup>1</sup>

Macroeconomic conditions improved during FY24, supported by stabilisation policies, successful engagement with the IMF, reduced uncertainty, and ease in global commodity prices. The real economic activity recovered led by agriculture, while inflation came down significantly particularly in the second half of the year. The current account deficit further narrowed and financial inflows improved, helping in build-up of FX reserves and reducing pressures on exchange rate. The fiscal consolidation continued with the primary balance posting a surplus for the first time in 17 years, which contributed to a considerable reduction in debt-to-GDP ratio (**Table 1.1**).

At the start of FY24, the economy was grappling with a host of macroeconomic challenges. Although on a declining path, inflation was still hovering around 30 percent. The aggressive adjustments in energy tariffs, which were started in FY23 and continued into FY24, somewhat slowed the pace of disinflation during the year. On the other hand, artificial wheat shortages added to price pressures in the domestic market, despite increase in its production in FY23. Although the Stand-By Arrangement (SBA) with the IMF in June 2023 had addressed near-term challenges, declining but elevated uncertainty and speculative activity maintained pressures in the FX market during initial months of FY24.

In view of the domestic macroeconomic challenges, the SBP and the government continued with the macroeconomic stabilization measures during FY24. A persistently elevated level of inflation and its expectations during the first half and increased uncertainty about the global commodity prices amid rising tension in the Red Sea region, led the SBP to continue with the tight monetary policy stance. However,

Selected Economic Indicators

Table 1.1

	FY22	FY23	FY24
<i>Growth rate* (percent)</i>			
Real GDP <sup>a</sup>	6.2	-0.2	2.5
Agriculture	4.2	2.2	6.4
Industry	7.0	-3.7	-1.1
o/w LSM	11.9	-9.8	1.1
Services	6.7	0.0	2.2
National CPI (period average) <sup>a</sup>	12.1	29.2	23.4
National CPI (yoy, June)	21.3	29.4	12.6
Private sector credit <sup>b</sup>	17.4	2.3	4.0
Money supply (M2) <sup>b</sup>	13.6	14.2	16.1
Exports <sup>b</sup>	26.7	-14.2	11.6
Imports <sup>b</sup>	31.8	-26.3	0.9
Tax revenue - FBR <sup>c</sup>	28.9	16.7	29.9
Exchange rate (end-period) (+app/dep%) <sup>b</sup>	-23.1	-28.4	2.7
Policy rate (end-period) <sup>b</sup>	13.75	22.0	20.5
<i>million US dollars</i>			
SBP's reserves (end-period) <sup>b</sup>	9,815	4,445	9,390
Workers' remittances <sup>b</sup>	31,279	27,333	30,251
Current account balance <sup>b</sup>	-17,481	-3,275	-665
<i>percent of GDP</i>			
Fiscal balance <sup>c</sup>	-7.9	-7.8	-6.8
Fiscal primary balance	-3.1	-1.0	0.9
Gross public debt	73.9	74.9	67.4
Current account balance	-4.7	-1.0	-0.2
Investment <sup>a</sup>	15.6	14.1	13.2

\* The numbers relating to real GDP for FY22, FY23 and FY24 are on constant basic prices of 2015-16 and represent final, revised, and provisional estimates respectively.

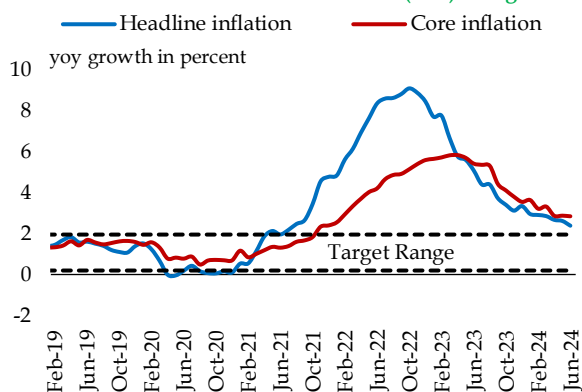
Sources: <sup>a</sup> Pakistan Bureau of Statistics; <sup>b</sup> State Bank of Pakistan; <sup>c</sup> Ministry of Finance

almost a consistent declining trend in headline and core inflation in H2-FY24 amid improving external account position, provided the SBP some room to cut the policy rate by 150 basis points (bps) to 20.5 percent in June 2024.<sup>2</sup> Furthermore, fiscal consolidation remained on

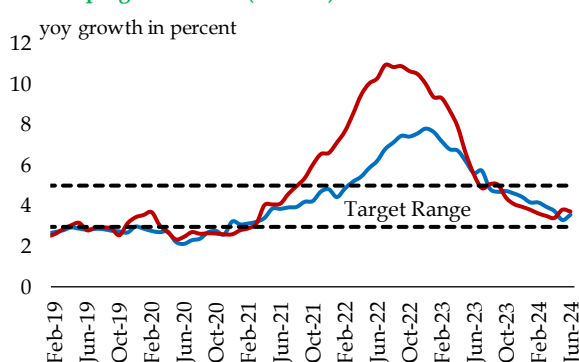
<sup>1</sup> The analysis and projections presented in this report were prepared on data outturns for FY24 and finalized in September 2024, using data and developments as of then.

<sup>2</sup> SBP reduced the policy rate further by 100 bps in July and 200 bps in September 2024 to 17.5 percent.

**Inflation Trends in Advanced Economies (AEs)\* Figure 1.1a**



**Inflation Trends in Emerging Market & Developing Economies (EMDEs)\* Figure 1.1b**



Note: Samples comprise 30 AEs in Figure 1.1a and 43 EMDEs in Figure 1.1b; \*median inflation  
Sources: Haver Analytics and World Bank

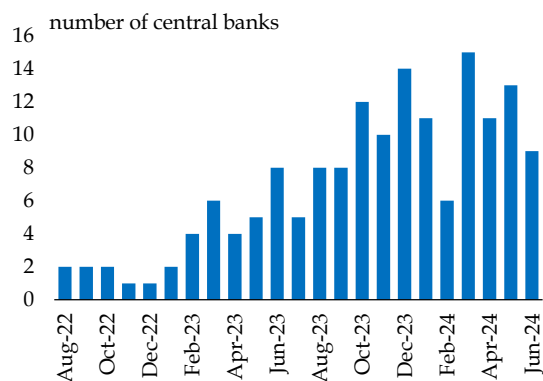
track, with primary surplus turning out to be higher than envisaged in the FY24 budget.

A relatively conducive global economic environment, somewhat eased the impact of domestic challenges during FY24. Particularly, the global commodity prices continued the downtrend witnessed since FY23, which was mainly led by decline in energy prices. A notable expansion in crude supplies from non-OPEC+ countries, cushioned the impact of output cuts by the OPEC members and the geopolitical tensions in the Middle East. Similarly, the prices of natural gas also softened as favourable weather and subdued industrial activity in Europe led to reduced demand. These developments had positive spillover on inflation

in both advanced economies (AEs) and emerging market and developing economies (EMDEs).

Inflation in AEs and EMDEs started returning to pre-pandemic levels in FY24 (**Figures 1.1a & 1.1b**). Core inflation also moderated in both AEs and EMDEs. However, relatively stubborn inflation in services slowed the pace of moderation in core inflation. In view of the sticky underlying inflationary pressures, the central banks in major AEs adopted a cautious approach and maintained the contractionary monetary policy stance during FY24. However, the central banks in many EMDEs transitioned to monetary easing during FY24 (**Figure 1.2**). These developments helped maintain global growth momentum.

**Interest Rate Cuts by Central Banks in EMDEs Figure 1.2**

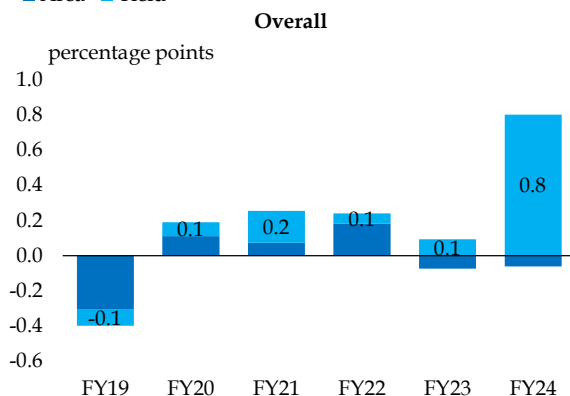


Note: Sample comprises 43 EMDEs  
Source: Haver Analytics

At the same time, domestic macroeconomic conditions also started to show early signs of recovery. The real GDP posted a moderate growth in FY24, compared to a contraction in the preceding year. The growth was led by agriculture sector, mainly on account of a rebound in the production of important crops; in particular, record wheat and rice harvests, and more than doubling of cotton production. Although area under cultivation of these crops expanded, improvement in crop yields predominantly contributed, accounting for about one-quarter of real GDP growth in FY24 (**Figure 1.3**). A range of supportive factors,

## Contribution of Important Crops in Real GDP Growth

■ Area ■ Yield

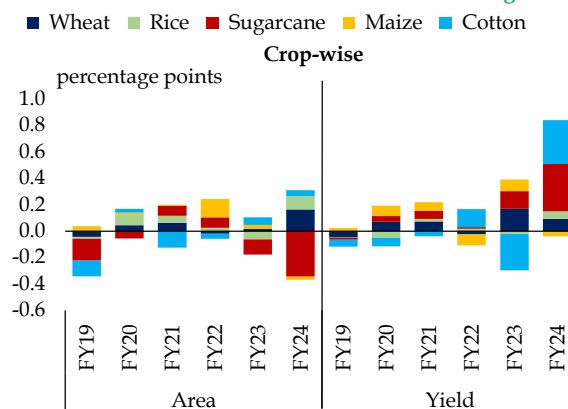


Sources: Ministry of National Food Security and Research; SBP staff calculations

including favourable weather conditions, better availability of inputs, and timely announcement of support price(s) explain the recovery in important crops in FY24.

The government had announced a significant increase in the Minimum Support Price (MSP) for wheat during FY23, which was maintained at that level in FY24. In addition, the government also announced support price for cotton in March 2023, right before the start of the sowing season. This encouraged farmers to increase area under cultivation of these crops during FY24. Similarly, better export prospects served as an incentive to enhance crop area under rice cultivation. In anticipation of higher profits, the farmers employed better crop management practices, such as greater use of certified seeds and fertilizer. Meanwhile, water availability remained satisfactory almost throughout FY24. Although somewhat erratic, the rainfall was close to the average of past ten years during most part of the year. Canal water withdrawals also increased compared to FY23. In addition, enhanced credit disbursement under *Kissan Package* further supported crop production during FY24. The confluence of these factors enhanced yields of wheat, rice and sugarcane to their historic levels, whereas cotton yield also recovery sharply from the decline in FY23 (Figure 1.3).

Figure 1.3



The strong performance of agriculture, however, did not translate into a concomitant recovery in industry during FY24. Within industry, Large Scale Manufacturing (LSM) saw a marginal increase of 1.1 percent in FY24, recovering from a sharp contraction of 9.8 percent in FY23. Although this moderate increase in LSM was relatively broad based, with ten (10) out of twenty-two (22) sub-sectors reporting expansion in output, compared to only four (4) in FY23; yet, most of those sectors could not reach the average production levels seen during FY21-22. Petroleum products, wearing apparel and pharmaceutical mainly contributed to the modest recovery in LSM.

Better export opportunities and improved liquidity position encouraged the refineries to increase production, despite declining domestic sales of petroleum products during the year. On the other hand, deregulation of drug prices, incentivised pharma industry to expand production to meet local demand. However, continued slack in two large sectors, automobiles and textile, prevented a sizeable recovery in LSM production. In particular, production of cotton yarn and cloth dipped to its lowest level since FY06, despite a substantial improvement in domestic cotton output during FY24.

A host of factors kept industrial activity subdued during FY24. These included an upward adjustment in energy prices; elevated inflation that dampened households' purchasing power; high borrowing cost; and, deceleration in development spending amid continued political uncertainty. The unwinding of government support in the form of energy subsidies to export-oriented industries, as well as weak external demand, also weighed on textile production during FY24. Moreover, the automobile industry was additionally affected by tightened macro-prudential regulations and increase in vehicle prices in the last two years.

The increase in agriculture production and a slight recovery in LSM, together with increase in import volumes, spilled over to *wholesale and retail trade* and *transport and storage services*. Meanwhile increased provincial spending, also boosted the value addition by *education services*. However, subdued demand and elevated operational cost constrained services sector growth during FY24.

The composition of real GDP from the expenditure side shows that private consumption remained the predominant contributor, whereas investment declined for the second consecutive year in FY24. The challenging political and business environment affected private sector's incentives to add capacities in manufacturing industries during the year. However, agriculture sector continued to attract private investment, which bodes well for addressing climate-related challenges, such as fast melting glaciers (see **Box 2.1**). However, increased policy attention, as well as investment, is needed for sustainability of the sector and reducing risks related to food security.

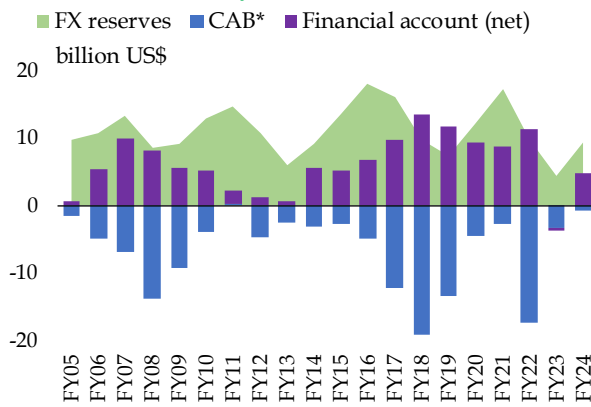
The increase in agriculture production also reflected positively on current account balance during FY24. A substantial increase in crop output, alongside subdued domestic demand and softening global commodity prices, helped keep imports contained close to the FY23 level. Specifically, the rebound in domestic cotton production reduced the import bill by US\$ 1.2

billion during FY24. In the same vein, higher production of food commodities led to a notable volume-driven recovery in exports. The upturn in rice production, which enabled exporters to capitalize on the opportunity created in the wake of the export ban by India, spurred rice exports by US\$ 1.3 billion to a record US\$ 3.9 billion in FY24. Besides, ICT exports contributed significantly in services exports (**Box 6.2**). The combined effect of these factors, along with a sizeable recovery in workers' remittances, underpinned a substantial reduction in CAD, which fell to a thirteen-year low of 0.2 percent of GDP in FY24.

A host of domestic and global factors drove a notable growth in workers' remittances, with inflows from all corridors reporting increase during FY24. In particular, declining headline inflation and strong labour markets in AEs, alongside better employment opportunities in the GCC countries, facilitated increase in remittances from these corridors. In addition, the governments' administrative measures and exchange company reforms introduced by the SBP calmed sentiments in FX market. This narrowed the spread between the interbank and open markets, which encouraged remittances through formal channels during FY24. The improvement in trade balance and robust growth in remittances overshadowed the widening of primary income deficit, amid surge in interest payments and repatriation of profits and dividends during FY24.

The substantial reduction in CAD, together with the improvement in net financial inflows, helped build-up of SBP's FX reserves (**Figure 1.4a**), and induced stability in FX market during FY24. The successful completion of the SBA with the IMF was instrumental in catalysing official inflows from other multilateral and bilateral external creditors. In this vein, the country also had continued access to Saudi oil facility, and managed to mobilize deposits from friendly countries. Moreover, net FDI increased in FY24, reaching the average level of FY21-22, after a sharp decline in FY23. The inflows in NPCs also edged up during the year, primarily encouraged

Pakistan's Balance of Payments

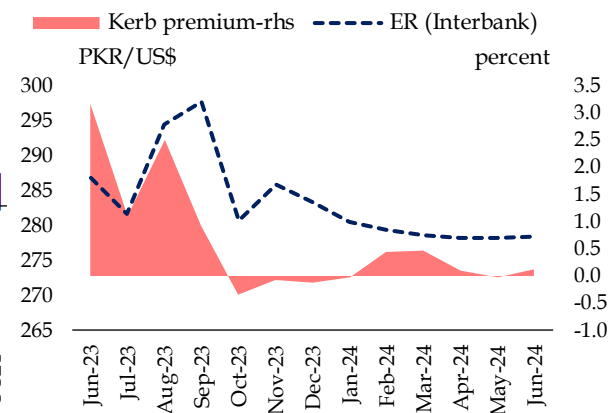


\*current account balance

Source: State Bank of Pakistan

Figure 1.4a Exchange Rate and Kerb Premium in FY24

Figure 1.4b



by increase in rate of return, after net outflows seen during FY23. These, along with the improved sentiments in the FX market, led to a 9.8 percent PKR appreciation during September 2023 to June 2024 (Figure 1.4b), with the kerb premium dropping to around one-fifth of the level seen in FY23.

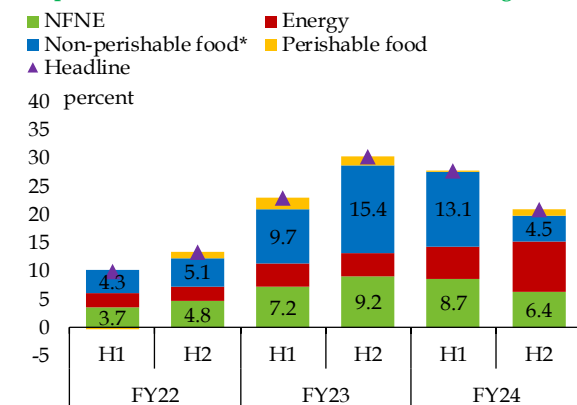
The combined effect of the improved supply of food commodities, appreciation of PKR, declining global commodity prices of food and continued contractionary monetary and fiscal policies led to a rapid decline in inflation in H2-FY24. The YoY inflation fell to a two-year low of 12.6 percent in June 2024, from a high of 38.0 percent in May 2023. Nevertheless, a significant increase in energy tariffs, especially the gas

charges, impeded the pace of decline in inflation during the year. Specifically, the contribution of energy group in urban inflation increased from around one-fifth in the first half to, nearly one-half in H2-FY24 (Figures 1.5a & 1.5b). The hike in administered energy prices and artificial shortages of key food commodities had kept inflationary pressures relatively high during the first half of FY24. However, the government's administrative efforts, wheat imports and increase in crop production eased supply situation of food commodities and considerably unwound food price pressures in the latter half of FY24.

In overall terms, the average National CPI (NCPI) inflation came down to 23.4 percent in

Composition of CPI Inflation - Urban

Figure 1.5a

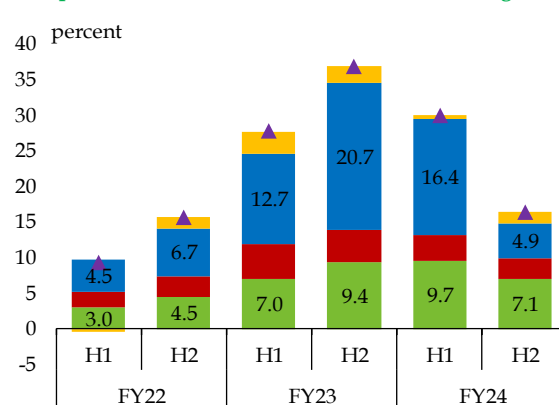


\*inclusive of alcohol beverages and readymade food

Sources: State Bank of Pakistan; SBP staff calculations

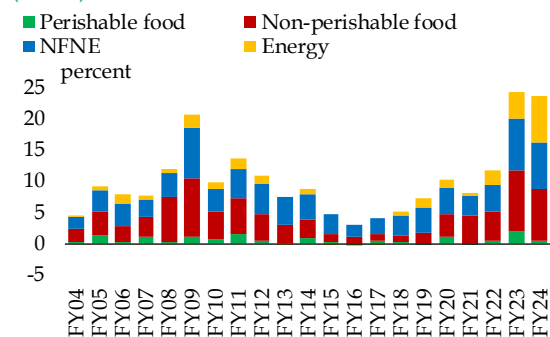
Composition of CPI Inflation - Rural

Figure 1.5b





Long-term Composition of CPI Inflation (Urban) Figure 1.6



Note: FY02-09 numbers are on base year FY00, FY09-17 numbers are on FY08, and FY17-23 numbers are on FY16  
\*urban indices are used from FY17 onwards

Sources: PBS and SBP staff calculations

FY24, from a high of 29.2 percent in FY23. The contribution of energy rose to a multi-decade high in FY24 due to large adjustments in administered energy prices (Figure 1.6). The escalating energy prices also seeped into underlying inflation through increased operational costs and elevated inflation expectations. This slowed the pace of decrease in core inflation relative to headline inflation during FY24.

The longstanding inefficiencies in energy sector have resulted in a substantial accumulation in power and gas circular debt (see Box 3.1). The government initiated adjustments in electricity prices in FY19 to align power tariffs with the cost recovery levels and reduce the stock of circular debt. Continuing these efforts, the government introduced a sizeable increase in gas charges during FY24. These price adjustments, though slowed the pace of disinflation, helped to curtail the fiscal burden through a decline in energy subsidies during the year.

The reduction in subsidies and development spending, together with a notable increase in revenue in terms of GDP, helped the government to achieve higher-than-envisaged fiscal consolidation during FY24. The primary balance posted a surplus of 0.9 percent in FY24, first time since FY07, against the budget target of 0.4 percent of GDP. The interest payments, on

the other hand, continued to surge, accounting for more than two-thirds of government tax revenue.

On the revenue side, while tax collection saw a notable expansion during FY24, the major impetus came from non-tax revenue. A surge in SBP profit was the major contributor to non-tax revenue during FY24. In addition, the government further increased petroleum development levy (PDL) rate during FY24, which spurred collection notwithstanding decline in POL sales. Within the tax collection, while direct taxes continued to grow sharply, indirect taxes also recovered during FY24. The tax measures, increase in tax rates and elimination of certain tax exemptions; a modest recovery in economic activity; declining but still elevated inflation; and high interest rates, all aided the expansion in tax collection during FY24. However, despite an accelerated growth in tax collection, the FBR taxes increased only marginally in terms of GDP. This underpins the need to widen the scope of tax policy efforts to achieve a sizeable and sustainable increase in tax collection.

The fiscal consolidation and substantial revaluation gains due to exchange rate appreciation led to a notable decline in public debt in terms of GDP during FY24. This was majorly contributed by a decline in external debt, primarily explained by revaluation gains stemming from the appreciation of US dollar against major international currencies, as well as the strengthening of PKR against US dollar. The domestic debt also declined in terms of GDP. However, lower-than-budgeted availability of external finance resulted in government's increased reliance on banks to meet its financing requirements. In view of the market's increased interest in long-term securities, the government met its financing needs mainly through long-term securities, which improved the maturity profile of domestic debt. Whilst the decline in debt-to-GDP ratio is an encouraging development, bringing it further down is imperative from the macroeconomic stability standpoint. This reinforces the need for



expediting fiscal reforms to help maintain primary surplus over the medium term. The increase in the government's budgetary borrowing inflated Net Domestic Assets (NDA) of the banking system. Moreover, amid a moderate recovery in economic activity and elevated input costs, the growth in private sector credit also inched up in FY24. Meanwhile, the improvement in external account contributed to expansion in the Net Foreign Assets (NFA) of the banking system, driving an uptick in broad money growth in FY24. However, consistent with the tight monetary policy stance, growth in monetary aggregates remained considerably lower than the nominal GDP growth. Also, deposits grew sharply amid attractive rates of return, whereas currency-in-circulation (CiC) remained almost unchanged at the previous year's level in FY24. As a result, the currency-to-deposit ratio has improved to 33.6 percent at end June 2024 from 41.1 percent at end June 2023.

Notwithstanding the improvement in macroeconomic conditions during FY24, the perennial structural issues facing the economy continued to pose risks to macroeconomic stability. In view of the challenging business conditions, investment declined for the second consecutive year, falling to the lowest level in FY24. Consistently low and stagnant investment, constrained by low savings, has stifled country's potential to sustain higher growth – without pressures on external account – by limiting the pace of industrialization (see **Box 2.2**). Given low productivity and increasing vulnerability to climate change, agriculture sector, despite its considerable share in GDP, cannot consistently spearhead the economic growth.

In this context, the need for creating a conducive environment for investment can hardly be overemphasised. In particular, investment in physical as well as human capital is needed to support technology-based industries and encourage export diversification to generate stable and sustainable phase of high economic growth, and to absorb burgeoning labour force.

Moreover, a robust expansion in export earnings also requires a supporting business environment, removing administrative bottlenecks, enforcing intellectual property rights and enhancing R&D in export oriented industries (see **Box 6.1**).

Creating an enabling environment, however, requires sustainable stream of government resources. Although, the country saw a large increase in tax revenues during FY24, this mostly came from cyclical factors, such as higher interest rate and inflation. Efforts to boost tax revenue through efficient use of tax policy and administration, and broadening of tax base have remained wanting (see **Box 4.1 and 4.2**).

At the same time, there is a need to urgently address the long-standing agenda to rationalize government expenditures. This includes ending redundant and overlapping functions within the government; bringing efficiency-seeking reforms in government operations; and leaner organizational structures. In addition, there is a need to reduce poorly targeted energy and commodity subsidies, and roll out the necessary reforms in state-owned enterprises (SOEs). These do not only have a huge fiscal burden, but also undermine the country's growth potential by offering poor service delivery; discouraging competition; and inhibiting the role of market forces in efficient resource allocation. In this context, power sector, which is one of the largest contributors to loss-making SOEs, presents a basket case at the nexus of sectoral policy issues and SOEs' losses.

The untargeted energy (power and gas) subsidies, delayed tariff adjustments and slow pace of reforms, especially those related to privatisation and deregulation of prices, have exacerbated the impact of poor operational efficiency of the energy sector. In addition, excess power generation capacity that does not commensurate with the dilapidated state of transmission and distribution system, and huge capacity payments that drove a sharp increase in circular debt, have had implications on fiscal

performance, inflation dynamics and industrial production.

In view of these challenges the government has introduced significant price adjustments since FY23 to align tariffs with cost recovery levels. However, there is a need to widen the scope of these efforts for improvement in operational efficiency in the transmission and distribution segment. Furthermore, in view of the key contribution of capacity payments in power sector circular debt, there is a need to monitor capacity utilization of Independent Power Producers to ensure transparency.

Addressing such sector-specific policy and regulatory issues lies at the heart of SOE reforms that need to be resolved across both loss and profit making SOEs. These, however, need to be accompanied by proper implementation of recently introduced SOEs' legal and policy frameworks to strengthen their corporate governance, followed by adequate reforms of SOEs' business operations. In consideration of SOE's impact on Pakistan's economy, this report includes a special chapter on Reforming SOEs in Pakistan. The chapter sheds light on Pakistan's experiences with historical and ongoing SOE reforms in light of global best practices and outlines key ingredients for successful reforms including adequate management of SOEs' labour concerns and garnering of political consensus, failures to both of which have derailed the SOE reform efforts several times in the past.

## 1.2 Economic Outlook

The latest data on high-frequency indicators points to further improvement in macroeconomic conditions in FY25. This, combined with the approval of the Extended Fund Facility (EFF) program by the IMF Board in September 2024, is expected to boost investor confidence and further upgrade Pakistan's credit rating.<sup>3</sup> These developments could make way for external inflows from multilateral

Macroeconomic Targets and Projections for FY25 Table 1.2

	Target	SBP Projections
<i>Growth rate (percent)</i>		
Real GDP <sup>a</sup>	3.6	2.5-3.5
CPI (average) <sup>a</sup>	12.0	11.5-13.5
<i>billion US\$</i>		
Remittances <sup>a</sup>	30.3	32.0-33.0
Exports (fob) <sup>a</sup>	32.3	30.5-31.5
Imports (fob) <sup>a</sup>	57.3	56.5-57.5
<i>percent of GDP</i>		
Fiscal deficit <sup>b</sup>	5.9	5.5-6.5
Current account deficit	0.9	0.0-1.0

Sources: <sup>a</sup>Annual Plan 2024-25, <sup>b</sup>Federal Budget 2024-25

creditors, as well as from private investors. Moreover, global commodity prices are maintaining a downtrend while global growth is expected to remain steady, as per the IMF's latest World Economic Outlook. These developments have improved Pakistan's near-term macroeconomic outlook (**Table 1.2**). However, inherent volatility in global energy prices may pose some risks to this outlook.

Amid receding inflationary pressures, the SBP has already started to lower the policy rate, after maintaining the tight monetary policy stance for the longest period in recent past. Lower borrowing costs, combined with improving external position and fall in global commodity prices, are expected to support expansion in industry and services sectors during FY25. Meanwhile, the FY25 budget envisages a notable increase in development spending that may further boost economic activity. The high-frequency demand indicators also continue to show signs of bottoming out, whereas LSM saw almost consistent improvement since December 2023. However, the latest information about *kharif* crops suggest that agriculture sector may not sustain its growth momentum into FY25. According to the preliminary estimates as of 1<sup>st</sup> September 2024, cotton arrivals reported a 59.7 percent decline compared to the same period last year. In view of these developments, the real GDP growth is expected in the range of 2.5 – 3.5 percent in FY25.

<sup>3</sup> Moody's upgraded Pakistan's local and foreign currency ratings from Caa3 to Caa2 in August 2024.

Despite reduction in the policy rate, the real interest rates remain significantly positive. The tight monetary policy stance and continued fiscal consolidation, as envisaged in FY25 budget, are expected to keep inflation significantly contained during FY25. Moreover, the headline inflation has maintained a general downtrend since June 2023, falling to 6.9 percent in September 2024, whereas core inflation has also declined considerably in recent months. In view of the recent outturns, the average inflation in FY25 may even fall below the earlier projected range of 11.5 – 13.5 percent. However, volatility in international oil prices, fiscal slippages and unplanned subsidies pose significant risks to this projection.

The SBP projects fiscal deficit in the range of 5.5 – 6.5 percent in FY25, compared to 6.8 percent of GDP in FY24. This improvement is expected to come from a sharp increase in both tax and non-tax revenues. While direct taxes are expected to continue the uptrend witnessed since the last year, the continuing momentum in economic activity, which is anticipated to be led by industry and services sectors in FY25, and an uptick in imports are likely to further boost indirect taxes.

On the other hand, expenditures are also expected to continue to grow. The FY25 budget envisages notable increase in expenses for social protection. In addition, the government has announced increase in salaries and pensions of government employees in view of the heightened inflation. Similarly, to give a boost to economic growth, the budget envisages substantial increase in development spending during FY25.

In line with the moderate expansion in industry and services sectors, imports are likely to increase in FY25. Moreover, while there are upside risks to global commodity prices due to rising geo-political tensions, commodity prices continue to be low. On the other hand, both the exports and workers' remittances are holding the trends observed in FY24. Incorporating these trends and expected future developments, the SBP expects the CAD to remain contained in the range of 0 – 1.0 percent of GDP in FY25. On the other hand, the approval of US\$ 7 billion EFF program and the realization of external inflows from multilateral and bilateral creditors are expected to further strengthen the external buffers.