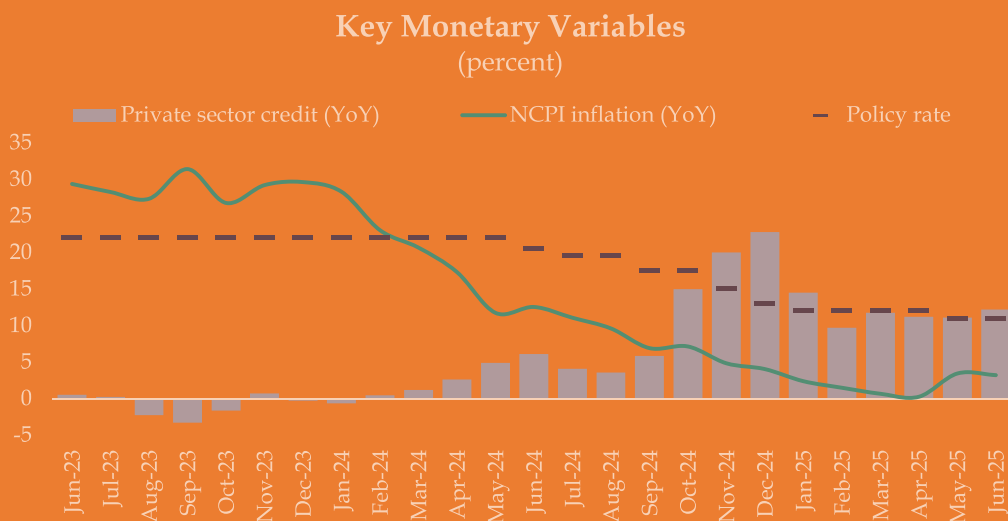




3

Monetary Policy and Inflation

The interaction of restrained domestic demand and improved supply conditions led to steep disinflation during FY25. Continued tight monetary policy stance, together with fiscal consolidation, kept the domestic demand in check, while adequate availability of food commodities, downward adjustments in administered energy tariffs, stable exchange rate, and softened global commodity prices eased pressures on food and energy prices. The average NCPI inflation fell to an eight-year low of 4.5 percent in FY25. Inflation saw an almost consistent decline from January 2024, with year-on-year inflation falling to a multi-year low of 0.3 percent in April 2025. The significant drop in inflation, together with an improvement in balance of payments position, allowed the Monetary Policy Committee to reduce the policy rate by 1,100 basis points between June 2024 and June 2025. The easing financial conditions spurred demand for private sector credit, which doubled compared to the previous year. Nevertheless, growth in net domestic assets of the banking system slowed, as reduced government reliance on bank borrowing and continued retirement of commodity operations financing and PSE debt more than offset the expansion in private credit. Therefore, despite a substantial increase in net foreign assets amid improvement in external account and build-up of SBP's FX reserves, broad money growth decelerated in FY25.



3 Monetary Policy and Inflation

3.1 Policy Review

Faster-than-anticipated pace of disinflation, improved inflation outlook and strengthened external account position allowed the Monetary Policy Committee (MPC) to aggressively reduce the policy rate by a cumulative 1,100 basis points (bps) during June 2024 – June 2025. The average national CPI (NCPI) inflation fell in FY25, to an eight-year low of 4.5 percent, below the medium-term target range of 5.0 – 7.0 percent. Monthly data shows an almost consistent fall in inflation from January 2024, with year-on-year (YoY) inflation bottoming out at 0.3 percent in April 2025. Moreover, the inflation for about half of the urban CPI items fell below 7 percent, the upper bound of the medium-term target range, as compared to 18 percent in FY24 (**Figure 3.1a and 3.1b**).

At the start of FY25, the MPC projected average NCPI inflation to fall in the range of 11.5 – 13.5 percent in FY25, compared to the average inflation of 23.4 percent in FY24. These projections took into account the unfolding impact of tight monetary policy stance, budgeted fiscal consolidation, reduced economic uncertainty amid approval of IMF's extended fund facility (EFF), stability in exchange rate, benign global commodity prices and lower-than-anticipated

impact of FY25 budget measures on inflation. However, potential fiscal slippages, unanticipated hike in administered energy prices, and the likelihood of new tax measures to address revenue shortfalls presented significant upside risks to these projections. On the downside, the major factors included favourable global food and fuel prices, along with the possibility of delays in domestic energy tariff adjustments.

The Committee projected real GDP growth in the range of 2.5 – 3.5 percent for FY25, expected to be driven by industrial and services sectors, supported by relatively lower interest rates and increased budgeted development spending. While the modest increase in economic activity was likely to lift import growth, a significant expansion in workers' remittances and exports was anticipated to keep the current account deficit (CAD) in the range of 0 to 1.0 percent of GDP.

As the year progressed, inflation saw a steep decline, falling from 12.6 percent (YoY) in June 2024 to below medium-term target range in November 2024. Several factors contributed to this sharp fall in inflation. First, in addition to the impact of tight monetary policy stance and continued fiscal consolidation, depressed farm incomes because of lower commodity prices in FY24 and subsequent fall in output of important

Frequency Distribution of Urban CPI Items

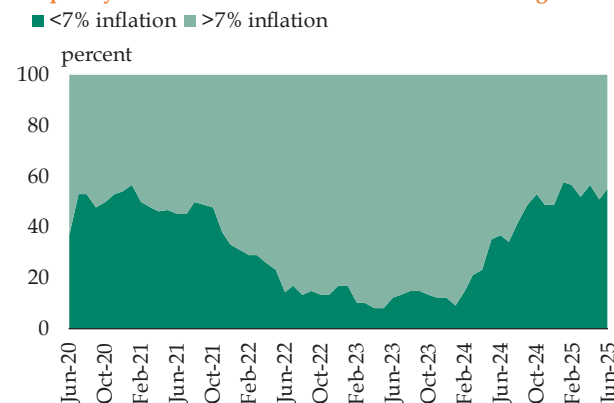
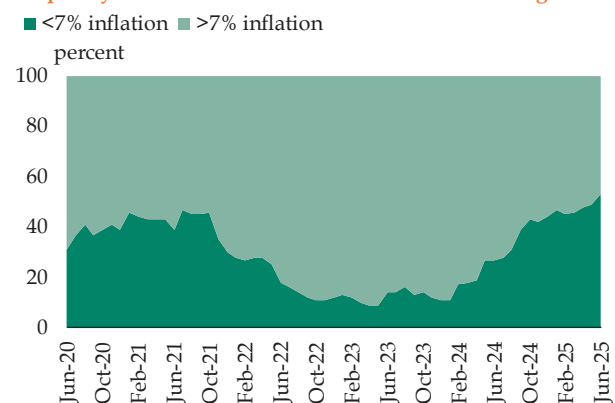


Figure 3.1a Frequency Distribution of Rural CPI Items



Sources: PBS and SBP staff calculations

crops in FY25 further restrained domestic demand. Second, the prices of non-perishable food items, especially of wheat and wheat products, declined sharply due to discontinuation of minimum support price (MSP) and procurement of the commodity by provincial governments. As farmers shifted away from major crops, discouraged by lower prices, the output of other crops including, perishable food crops, increased that reduced their prices as well. Third, delay in planned increase of energy prices postponed the pass-through effects on inflation. Lastly, global commodity prices continued to ease more than anticipated, adding to disinflationary trends.

Moreover, sluggish performance of agriculture sector slowed the real GDP growth in Q1-FY25, slightly lower compared to Q1-FY24. This was despite a moderate uptick in production of key LSM sub-sectors including textile, automobiles, food and petroleum products. In view of these developments, together with better-than-expected external sector performance, the MPC revised down inflation projection range for FY25 to 5.5 – 7.5 percent in January 2025. Additionally, based on strong growth in workers' remittances, current account balance (CAB) was expected to remain in the range of a surplus and a deficit of 0.5 percent of GDP.

Accounting for these favourable developments, the MPC reduced the policy rate in all six meetings between June 2024 and January 2025, with a cumulative reduction of 1,000 bps. In H2-FY25, however, the pace of decrease in core inflation slowed. This, along with uncertainty emanating from tariffs, geopolitical tensions, and the timing and size of adjustments in administered energy prices led the MPC to adopt a more cautious approach during March to June 2025, reducing the policy rate by only 100 bps in the meeting held in May 2025.

The MPC viewed that the monetary policy stance, with real interest rates remaining adequately positive, was appropriate to stabilize inflation in the medium-term range of 5.0 – 7.0 percent, after some near-term volatility. Moreover, the MPC

underscored the need for achieving budgeted fiscal consolidation through prioritizing fiscal policy and tax reforms to preserve macroeconomic stability and support economic growth.

On balance, the MPC's forward-looking approach anchored inflation expectations, while the reduction in the policy rate revived demand for private sector credit—supporting a gradual recovery in economic activity. However, the MPC noted that these gains remained subject to risks, including volatility in food prices, uncertainties in energy price adjustments, potential global supply chain disruptions, and volatile international commodity prices.

3.2 Monetary Aggregates

Broad money (M2) growth slowed to 13.7 percent in FY25, compared to 16.0 percent in the previous year (**Table 3.1**). The deceleration was primarily due to slower pace of expansion in Net Domestic Assets (NDA), while the contribution of Net Foreign Assets (NFA) of the banking system increased considerably relative to FY24. The NFA expanded by nearly three times its FY24 increase, supported by a marked current account surplus that contributed to the build-up of foreign exchange reserves. Additionally, the IMF's EFF program catalysed multilateral and bilateral inflows that further strengthened external buffers.

Besides slower growth, the composition of NDA also improved in FY25. Private sector credit offtake doubled compared to the previous year. On the other hand, budgetary borrowings from scheduled banks, while still sizable, declined from their FY24 peak due to continued fiscal consolidation and better availability of funding from external and non-bank financing sources. Moreover, net retirements by public sector enterprises (PSEs) and commodity operations financing also contributed to deceleration in NDA growth.

On the liabilities side, the slowdown in M2 growth is mainly explained by deposits amidst declining interest rate and advances-to-deposit

Monetary Aggregates

Table 3.1

flows in billion Rupees, growth in percent

	Flows		Growth*		Contribution to M2 Growth	
	FY24	FY25	FY24	FY25	FY24	FY25
Broad money (M2)	4,938.8	4,911.0	16.0	13.7	16.0	13.7
NFA	659.2	1,885.4	-	-	2.1	5.3
NDA	4,279.6	3,025.6	13.1	8.2	13.8	8.4
Net budgetary borrowing	7,479.9	4,358.4	33.6	14.7	24.2	12.1
SBP	-713.1	-691.5	-13.6	-15.3	-2.3	-1.9
Scheduled banks	8,192.9	5,049.9	48.2	20.0	26.5	14.1
Commodity operations	-107.6	-311.8	-7.2	-22.6	-0.3	-0.9
Credit to private sector	512.9	1,081.9	6.1	12.2	1.7	3.0
Credit to PSEs	-99.9	-87.1	-4.4	-4.0	-0.3	-0.2
Other items net	-3,439.2	-2,487.0	-	-	-11.1	-6.9
Currency in circulation	4.4	1,481.4	0.0	16.2	0.0	4.1
Deposits	4921.0	3,435.2	22.6	12.9	15.9	9.6
Reserve money	255.7	1357.8	2.3	11.7	0.8	3.8

*Growth in stocks as on end-June.

Source: SBP

ratio (ADR)-linked tax on banks, as currency-in-circulation (CiC) expanded sharply. Specifically, deposits declined in Q2-FY25 primarily due to banks' efforts to comply with the ADR threshold. To meet the threshold, certain banks imposed service charges on large deposits,¹ which discouraged deposit inflows during the quarter.

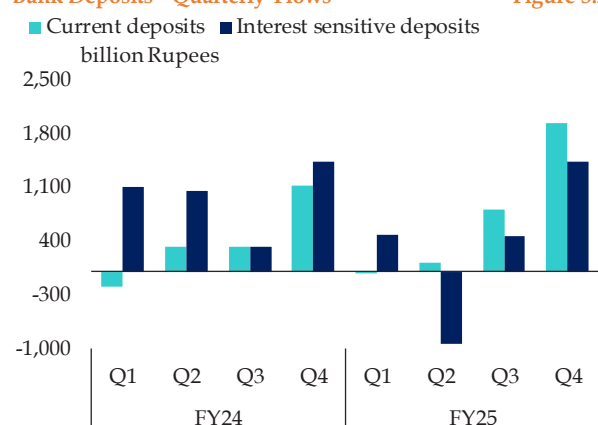
As a result, the deposits rose by Rs 3.4 trillion in FY25, lower compared to the expansion of Rs 4.9 trillion in FY24. While a sharp reduction in weighted average deposit rate (WADR), in nominal terms, discouraged interest-sensitive deposits, current deposits increased during FY25. Most of this increase was concentrated in Q4-

FY25, indicating end-of-the-year seasonal pattern; nearly three-fourths of this surge was reversed by the second week of July 2025 (Figure 3.2).

Category-wise bifurcation shows that deposits of private businesses and Non-bank Financial Institutions (NBFIs) decreased, as they redirected funds to alternate investment avenues in pursuit of higher returns, including increased participation in the Pakistan Stock Exchange (PSX) amid falling interest rates. Moreover, personal deposits also saw a slowdown during the year due to lower returns (Figure 3.3).

Bank Deposits - Quarterly Flows

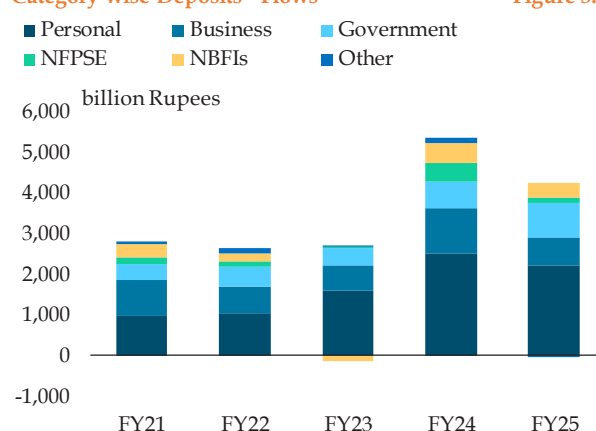
Figure 3.2



Source: SBP

Category-wise Deposits - Flows

Figure 3.3



Source: SBP

¹ These were later removed after SBP abolished the Minimum Deposit Rate (MDR) requirement for deposits of financial institutions, public sector enterprises and public limited companies. (BPRD Circular No.5 of 2024)

The CiC expanded by Rs 1.5 trillion in FY25, after remaining almost stagnant in FY24 (**Figure 3.4**). Specifically, H2-FY25 saw a notable spike in CiC, which is partly attributable to Ramadan and Eid festivals along with surge in remittances. Additionally, rising domestic uncertainty amid regional conflicts² might also have contributed to the increase in CiC (**Figure 3.5**).³

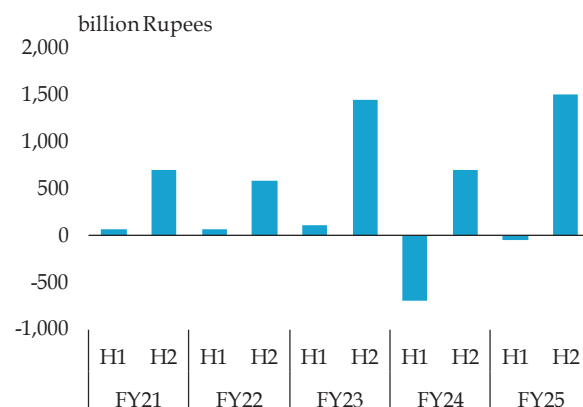
Credit to PSEs

Continuing the previous year's trend, credit to PSEs contracted by Rs 87 billion during FY25 (**Figure 3.6**). Pakistan State Oil (PSO) and power sector entities mainly led this decline, largely reflecting improved profitability amid lower financing costs. In addition to the lower cost of borrowing, PSO also benefitted from benign global commodity prices and greater operational efficiency, supported by expansion in marketing and distribution network.⁴

Similarly, National Power Parks Management Company Limited (NPPMCL) demonstrated

Currency in Circulation - Flows

Figure 3.4

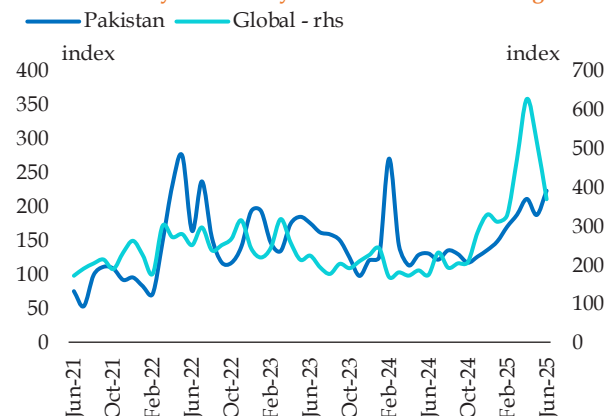


Source: SBP

strong operational performance, maintaining plant availability above 90 percent. This, coupled with reduced financial costs, led to higher profitability and reduced reliance on bank financing.⁵ On the other hand, National Transmission & Despatch Company's (NTDC) borrowing from banks declined due to increased support from government in the form of loans.⁶

Economic Policy Uncertainty

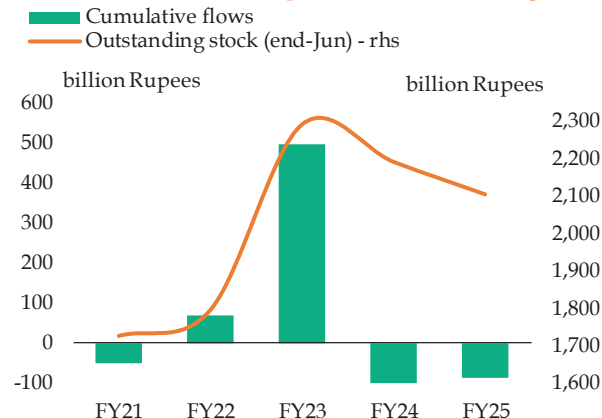
Figure 3.5



Sources: SBP and FED

Credit to Public Sector Enterprises

Figure 3.6



Source: SBP

² CiC increased by Rs 257.6 billion during the first week of May 2025, coinciding with a period of heightened geopolitical tensions.

³ Literature suggests that in periods of high uncertainty, consumers tend to hold money for safety reasons. Source: Muñoz, M. A., & Soons, O. (2023). Public money as a store of value, heterogeneous beliefs, and banks: Implications of CBDC, ECB Working Paper No. 2801. European Central Bank.

Rösl, G., & Seitz, F. (2023). Uncertainty, politics, and crises: The case for cash, IMFS Working Paper No. 186. Institute for Monetary and Financial Stability.

⁴ PSO's net profit increased to Rs 15 billion during Jul-Mar FY25. Source: PSO (2025). Report for the nine month ended March 31, 2025. Karachi.

⁵ NPPMCL's finance costs declined from Rs 13.5 billion to Rs 6.9 billion during first half FY25. Source: Ministry of Finance (2025)

⁶ MoF (2025). Bi-Annual Report on Federal State-Owned Enterprises (SOE), Ministry of Finance, Islamabad.

In contrast, bank borrowing by gas distribution companies increased during FY25. Sui Southern Gas Company (SSGC) raised financing for pipeline rehabilitation activities aimed at reducing transmission losses, in addition to meeting liquidity needs arising due to circular debt.⁷ Sui Northern Gas Pipelines Limited (SNGPL) also borrowed to manage liquidity requirements, amid significant outstanding receivables from the power and energy sector.⁸ Pak Arab Refinery Company (PARCO), on the other hand, relied on bank financing to cover maintenance and upgradation expense during its shutdown period, which adversely affected its profitability.⁹

Commodity Financing

The provincial governments made a net retirement under the commodity operations financing for the second consecutive year in FY25 (**Figure 3.7**). Most of these retirements were made by the Punjab Food Department, which repaid a substantial portion of the financing availed for wheat procurement.¹⁰ In an effort to reduce the stock of commodity debt and move towards a competitive agriculture commodity market, the provincial governments discontinued the MSP

policy for wheat and withdrew from procurement operations during the Rabi 2025.^{11,12} Moreover, the government also implemented various other measures including timely servicing of commodity debt to prevent further accumulation.¹³

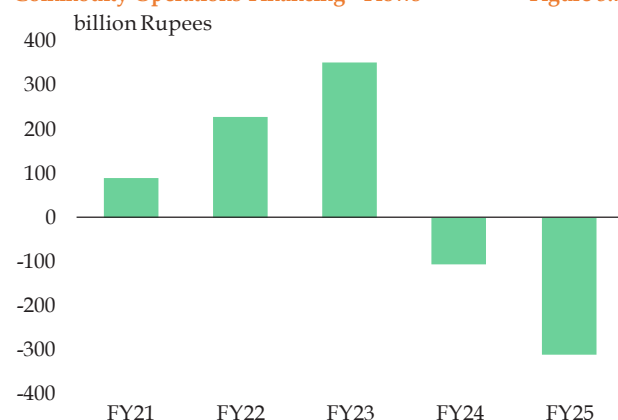
Budgetary Borrowing

A lower fiscal deficit and greater availability of financing from external and non-bank sources reduced government's borrowing requirements from the banking system in FY25. As a result, the net budgetary borrowing from scheduled banks remained Rs 5.0 trillion during FY25, down from a record Rs 8.2 trillion during FY24. In H1-FY25, supported by substantial profit transfers from SBP and the ongoing fiscal consolidation efforts, the government retired debt to scheduled banks on a net basis (**Figure 3.8**). However, the borrowing needs increased in H2-FY25 due to higher fiscal deficit relative to H1-FY25.

The government met most of its financing requirement through Pakistan Investment Bonds – Floating (PFLs) Semi-Annual coupon and Pakistan Investment Bonds (PIBs) – Fixed (**Table 3.2**). In

Commodity Operations Financing - Flows

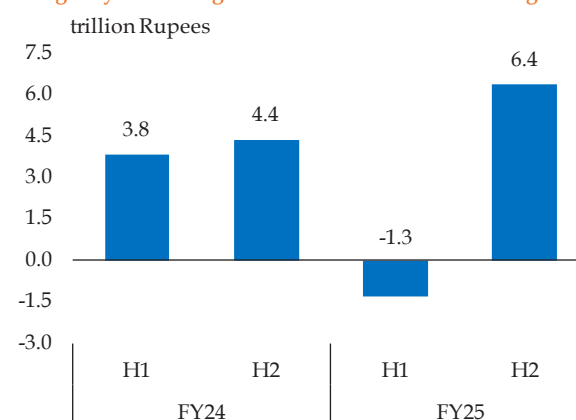
Figure 3.7



Source: SBP

Budgetary Borrowing from Scheduled Banks

Figure 3.8



Source: SBP

⁷ Ibid.

⁸ Ibid.

⁹ PARCO's net profit declined from Rs 35 billion to 2.7 billion during first half FY25. Source: MoF (2025)

¹⁰ GOPb (2025). Punjab Debt Bulletin, Government of Punjab, Lahore.

¹¹ Source: www.na.gov.pk/en/pressrelease.php?content=103, Accessed on August 4, 2025.

¹² IMF (2025). IMF Country Report No. 25/109, International Monetary Fund.

¹³ GOPb (2025). Punjab Debt Bulletin, Government of Punjab, Lahore.

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Auction Summary - FY25

Table 3.2

billion Rupees

	Target	Maturity	Offers (competitive)	Acceptance (net of maturity)
Treasury Bills				
Q1-FY25	1,835	1,343.9	9,049.5	1,165.7
Q2-FY25	5,050	8,822.5	12,323.5	-3,480.5
Q3-FY25	2,900	3,446.2	7,567.6	-1,014.9
Q4-FY25	5,550	5,023.9	16,734.1	692.8
Total	15,335	18,636.5	45,674.7	-2,636.9
Pakistan Investment Bonds				
<i>Fixed Rate</i>				
Q1-FY25	515	428.9	1,196.6	-94.4
Q2-FY25	850		2,375.0	947.2
Q3-FY25	1,050	70.3	2,954.7	842.6
Q4-FY25	950		2,960.0	1,283.4
Total	3,365	499.2	9,486.2	2,978.7
<i>Floating Rate</i>				
Q1-FY25	1,990	802.1	3,829.9	180.5
Q2-FY25	3,300		7,599.6	3,946.9
Q3-FY25	1,950		5,355.4	2,611.9
Q4-FY25	1,950	980.1	8,693.7	1,316.0
Total	9,190	1,782.3	25,478.5	8,055.3

Source: SBP

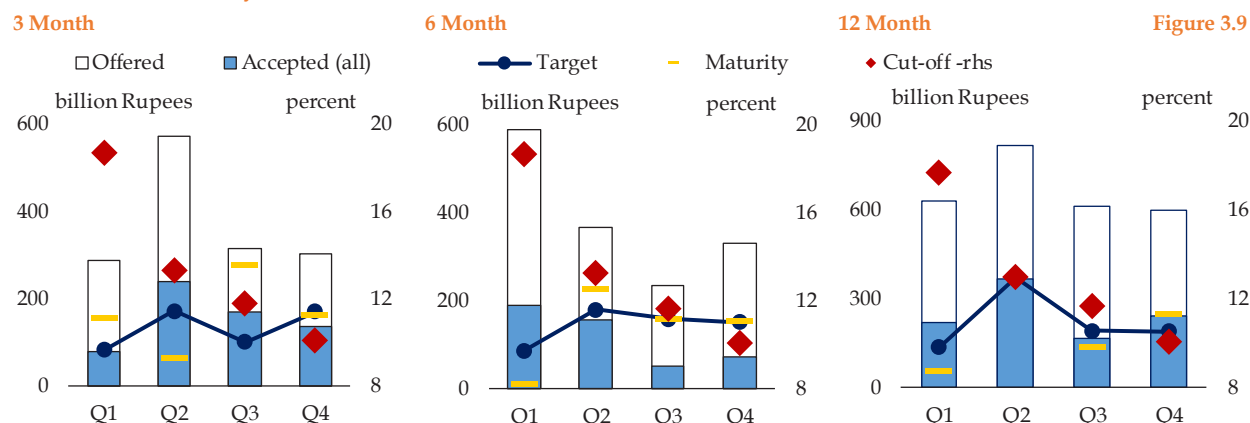
overall terms in FY25, the government kept T-bills auction targets below the maturities, and assigned higher targets for longer-tenor PIBs in order to contain the rollover risk, and to benefit from a lower borrowing cost.

In the backdrop of reduction in the policy rate in all MPC meetings between June 2024 and January 2025, the market's interest in shorter-tenor T-bills also waned gradually. This was reflected in falling offer-to-target ratio for T-bills during the first three quarters of FY25. Among these, 12-month T-bills received the highest bids, indicating the markets' preference to lock funds in longer-tenor securities (Figure 3.9).

The decline in the policy rate and the government's reduced borrowing needs amid a surplus in the fiscal balance in Q1-FY25 drove a steep decline in T-bill cut-off rates in H1-FY25. The improved fiscal position also allowed the government to conduct three buyback auctions in Q2-FY25 of 6-month and 12-month T-bills, which further pushed down the cut-off rates in subsequent T-bill auctions.

These developments scaled up market's appetite for longer-tenor securities. Within PFLs, the Semi-Annual coupon bonds were consistently oversubscribed – especially the 10-year, followed

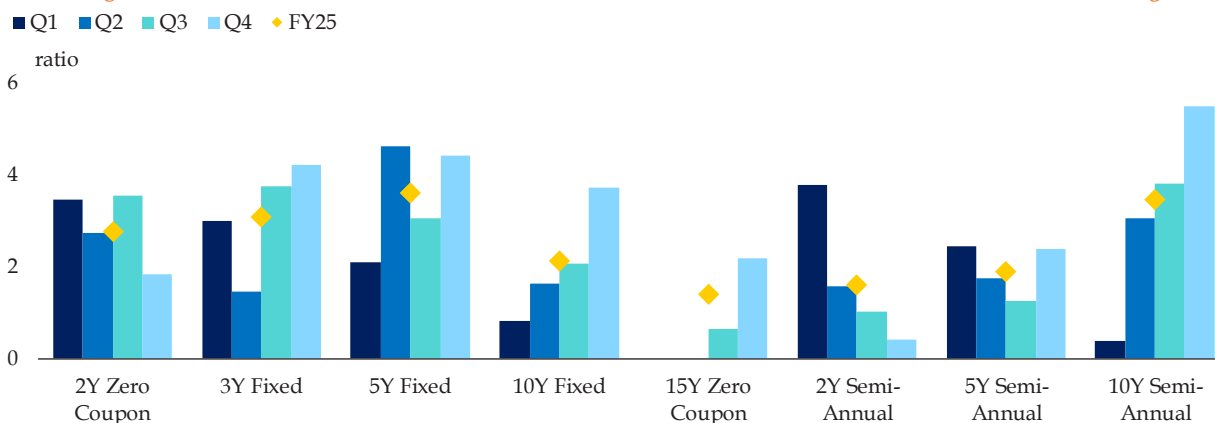
T-Bill Auction Summary - FY25



Source: SBP

Offer to Target - PIBs

Figure 3.10



Source: SBP

by 5-year PFLs (Figure 3.10).¹⁴ Bids for the 10-year Semi-Annual coupon surged towards the end of FY25, due to anticipation of a reduction in the policy rate in the June MPC meeting. On a net-of-maturity basis, 10-year PFLs accounted for the highest mobilization

The net acceptances from PIBs-Fixed more than quadrupled compared to FY24,¹⁵ in line with the government's strategy to contain interest rate risk.¹⁶ The 3-year and 5-year Fixed coupon PIBs received offers exceeding three times their targets with the highest interest seen in Q4-FY25, a parallel to the trends in floating-rate instruments. In line with this demand and its objective to extend the average maturity of public debt, the government introduced a zero-coupon 15-year PIB in H2-FY25.¹⁷

The secondary market yields on shorter-tenor securities also declined sharply, in line with developments in the primary market and a favourable macroeconomic outlook (Figure 3.11). This led to a positive spread between the yields on

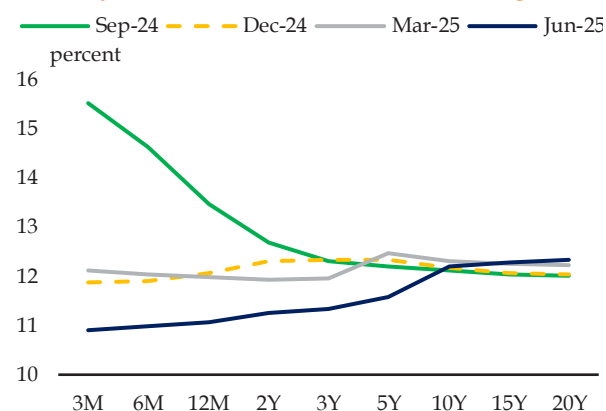
10-year security and 3-month T-bill from December 2024 onwards, likely indicating prospects of improved economic activity.^{18,19}

Interbank Liquidity

Despite lower government borrowing from banks, inter-bank liquidity remained under pressure in

Secondary Market Yield Curve

Figure 3.11



Source: MUFAP

¹⁴ Commensurate with this interest, the government introduced a 2-year zero coupon bond in the fixed category and a 2-year semiannual coupon in the floating category.

¹⁵ In FY24, net acceptances for PIBs-Fixed were Rs 624.7 billion. State Bank of Pakistan. (2024). The State of Pakistan's Economy, Annual Report FY24.

¹⁶ Ministry of Finance. (2025) Chapter 9: Public Debt. Economic Survey, Jul-March FY25.

¹⁷ Pak Investment Bonds, Auction Profile. sbp.org.pk/ecodata/Pakinvestbonds

¹⁸ A positive yield spread between the 10Y and 3 Month US T-bill was a valuable indicator of economic activity and short-term interest rate expectations for two to six quarters ahead. Estrella & Mishkin (1996). The Yield Curve as a Predictor of U.S. Recession. Federal Reserve Bank of New York. Current Issues in Economics and Finance. Volume 2 Number 7.

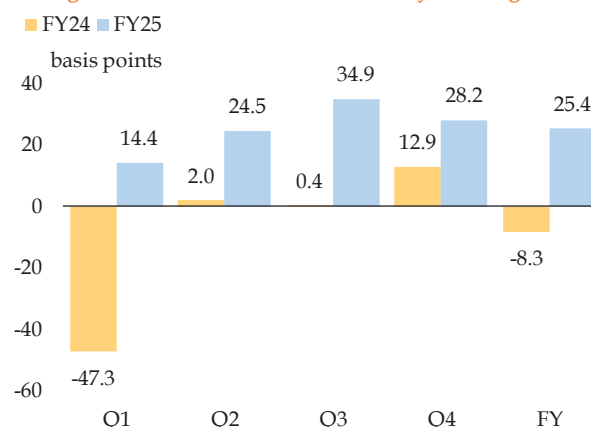
¹⁹ Empirical findings for Pakistan show that an increase in the yield spread is a strong predictor of output growth. Hussain, F. & Mahmood, A. (2017). Predicting Inflation and Output in Pakistan: The Role of Yield Spread, SBP Working Paper Series, No.93

FY25. This mainly reflected a significant expansion in private sector credit and increase in CiC. Although net retirements in commodity operations financing and PSEs debt somewhat cushioned liquidity situation, the persistent liquidity demand kept the Weighted Average Overnight Repo Rate (WAONR) on average 25.4 basis points above the policy rate during FY25 (Figure 3.12).

The sources of liquidity pressures, however, varied between the two halves. In H1-FY25, surge in private sector credit and an outflow of deposits, as banks' levied service charges on large deposits, increased liquidity needs. However, retirement in commodity operations financing, SBP's FX purchases, and a retirement of budgetary borrowing moderated these pressures. Nonetheless, the situation reversed in H2-FY25 as budgetary borrowings rose sharply, whereas CiC also saw a significant increase.

The heightened demand drained liquidity from the interbank market, causing larger positive deviations in WAONR from the policy rate and increased volatility in WAONR in H2-FY25 (Figure 3.13). Literature suggests that fluctuations in autonomous liquidity factors – particularly increase in currency demand – may induce volatility in overnight rates.²⁰ Moreover, banks'

Average Deviation of WAONR from Policy Rate Figure 3.12



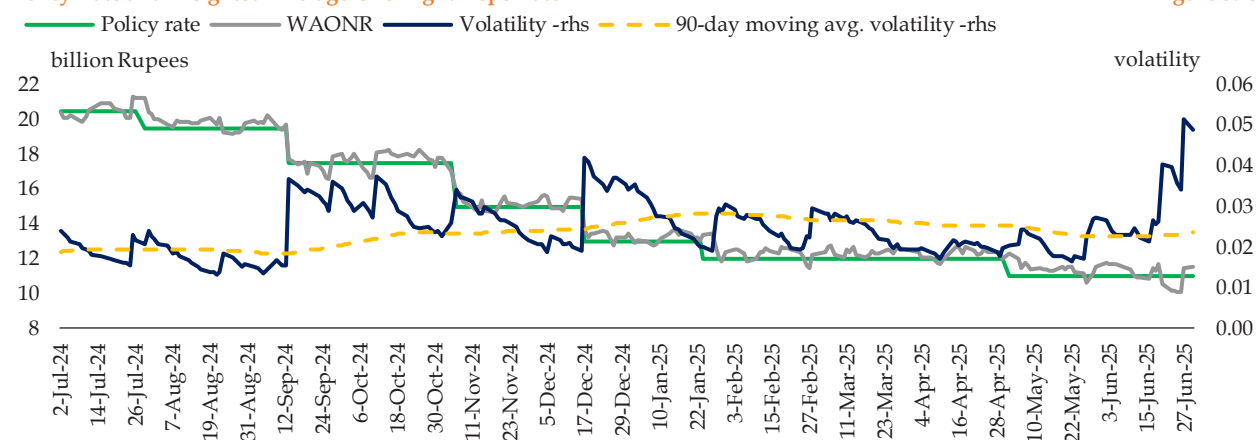
Source: SBP

large investment in long-term government securities may also have increased liquidity pressures, causing fluctuations in the overnight rate.²¹

In response to elevated liquidity demand, SBP scaled up liquidity injections through its Open Market Operations (OMOs), resulting in the outstanding stock of OMOs rising to Rs 11.3 trillion by end-June 2025 from Rs 9.4 trillion at end-June 2024 (Figure 3.14). The bulk of these injections were made through 7-day OMOs, followed by 28-day and 14-15-day operations. However, in Q4-FY25, SBP reduced the use of longer-tenor OMOs keeping in view market's

Policy Rate and Weighted Average Overnight Repo Rate

Figure 3.13



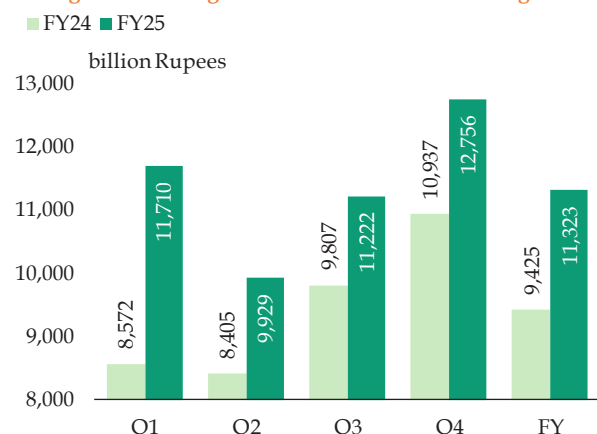
Source: SBP

²⁰ Disyatat, P. (2008). Monetary Policy Implementation: Misconceptions and their consequences. *BIS Working Papers* No 269.

²¹ Dack, J. (1998). Implementing Monetary Policy in Emerging Market Economies: An Overview of Issues. *BIS Policy Papers*.

Average Outstanding Stock of OMOs

Figure 3.14



Source: SBP

liquidity requirements amid expectations of further monetary easing.

Besides increase in OMO injections, banks' recourse to the ceiling facility also increased considerably in FY25, especially in Q4-FY25, mirroring the trends in budgetary borrowings and CiC.²² The number of days the facility was accessed also rose considerably compared to FY24, indicating persistent liquidity demand.

Similarly, the liquidity needs of the Islamic Banking Institutions (IBIs) also remained higher in FY25, as evidenced from an increase in the average volume per injection, which more than

doubled to Rs 234.6 billion from Rs 102.4 billion in FY24. Additionally, usage of the Islamic ceiling facility also increased, with both higher frequency and the amount borrowed.

3.3 Private Sector Credit

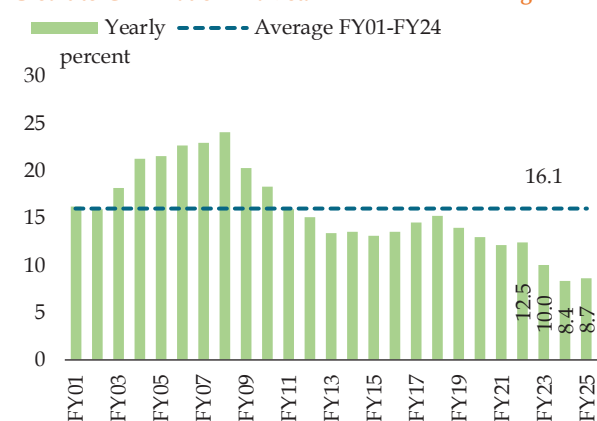
Private sector credit (PSC) saw a notable expansion during FY25, after remaining sluggish in the previous two years. Specifically, PSC grew by 12.2 percent in FY25, compared to the increase of 6.1 percent and 0.6 percent in FY24 and FY23, respectively. As a result, the credit-to-GDP ratio inched up slightly to 8.7 percent in FY25, though it remains significantly below the long-term average (Figure 3.15).

The growth in credit to private sector businesses (PSBs) was relatively broad-based, as the number of sectors availing credit for both working capital and fixed investment ticked up during FY25 (Figure 3.16). However, the credit uptake was largely concentrated in H1-FY25, as H2-FY25 saw retirement amid seasonal factors, a slowdown in exports and withdrawal of ADR-based tax²³ (Table 3.3 and Figure 3.17).

A number of factors explain the expansion in PSC during FY25. First, lower cost of borrowing and

Credit-to-GDP Ratio in Pakistan

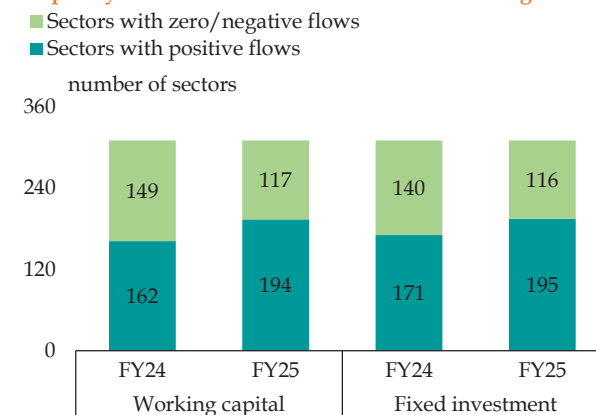
Figure 3.15



Source: SBP

Frequency Distribution of Loans to PSBs

Figure 3.16



Source: SBP

²² Utilization of the floor facility decreased in FY25 although it was still quite high.

²³ ADR-linked policy aimed to tax banks' income from government securities at progressively higher rates in case their ADR fell below 50 percent. (For details, see Chapter 3 in SBP's FSR (2024)).

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Loans to PSBs

flow in billion Rupees

Table 3.3

Major Sectors	Total Loans*						Working Capital [#]		Fixed Investment	
	FY24			FY25			FY24	FY25	FY24	FY25
	H1	H2	FY	H1	H2	FY25				
Total Loans to PSBs	442.6	16.0	458.6	1,915.7	-909.1	1,006.6	364.7	617.3	118.2	413.8
A. Agriculture, forestry & fishing	73.0	-16.5	56.5	59.9	34.0	93.9	-17.7	42.8	74.4	51.1
Of which: growing of wheat	18.4	5.3	23.7	28.6	16.9	45.4	13.2	36.6	10.5	8.8
B. Mining and quarrying	2.2	8.5	10.8	16.3	-16.9	-0.6	11.8	-4.9	-1.1	4.3
C. Manufacturing: <i>off which</i>	307.3	-9.3	298.0	1,401.0	-884.9	516.1	337.1	409.9	-33.8	109.5
Textile and wearing apparel	113.9	-90.7	23.2	611.1	-319.2	291.9	35.8	290.3	-11.6	4.5
Rice processing	82.9	-79.7	3.2	222.9	-222.9	-0.1	1.3	-8.6	3.6	8.8
Sugar	-49.4	180.4	131.0	-26.7	-16.4	-43.2	-22.1	8.2	-16.7	-27.5
Vegetable & animal oils	18.9	-18.6	0.2	17.6	-6.7	10.9	1.0	12.3	-0.5	-1.4
Cement & plaster	-18.0	-21.7	-39.8	107.1	-126.6	-19.5	-22.1	8.2	-16.7	-27.5
Fertilizers	-33.5	29.2	-4.4	45.8	2.5	48.4	6.0	28.1	-10.4	20.2
Refined petroleum	-5.1	-16.2	-21.2	42.7	-11.0	31.7	-21.0	5.1	-0.3	26.5
Motor vehicles	15.3	-16.2	-0.9	27.9	-19.4	8.6	2.4	11.5	-3.3	-3.0
Basic iron & steel	33.6	0.0	33.5	18.2	-2.7	15.5	39.6	1.1	-5.9	13.2
Paper and paper products	16.0	14.4	30.5	14.4	8.1	22.5	20.5	7.6	10.0	14.9
D. Electricity, gas, steam & air conditioning supply	-54.5	-2.9	-57.4	-24.8	-3.0	-27.8	-24.4	0.1	-32.8	-27.4
E. Water supply, sewerage, waste management	5.9	3.5	9.4	7.2	1.1	8.3	0.7	-1.9	8.7	10.2
F. Construction	10.0	-7.4	2.6	25.9	-8.4	17.5	8.1	11.7	-1.3	24.1
G. Wholesale and retail trade [^]	84.2	3.9	88.1	91.7	45.5	137.2	62.4	79.2	27.1	60.6
H. Transport & storage	7.2	-2.4	4.8	-14.8	20.7	5.9	1.6	-17.3	3.4	20.0
I. Accommodation & food service	3.0	-1.7	1.3	43.0	-0.8	42.2	0.5	-1.1	3.4	43.6
J. Information and communication	14.4	52.2	66.5	133.9	11.5	145.4	3.6	42.6	63.3	102.5
Others	-10.2	-11.9	-22.1	176.4	-107.8	68.5	-19.1	56.3	6.8	15.5

[^] including repair of motor vehicles and motorcycles; [#] includes trade finance

* 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.

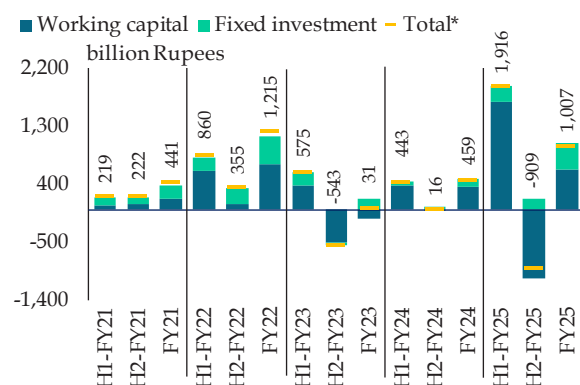
Source: SBP

stable macroeconomic conditions encouraged slight improvement in economic activity, leading to increased demand for both working capital and fixed investment loans (Figure 3.18). Second, elevated operational costs also lifted short-term financing requirements of some of the sectors, including textile and fertilizer. Specifically, heightened domestic prices of cotton, LNG, coal

and other inputs kept the cost of production higher for these sectors (Table 3.4). Third, a few sectors including agriculture, forestry and fishing availed short-term financing to overcome cash flow constraints. Lastly, banks' efforts to achieve the ADR threshold to avoid additional taxation in the first half, partly explain the overall expansion in PSC during the year.

Loans to PSBs - Flows

Figure 3.17

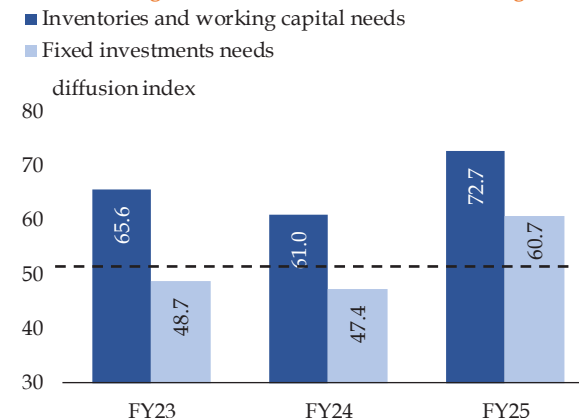


* Total includes construction finance

Source: SBP

Factors Driving the Loan Demand

Figure 3.18



Source: SBP

Cost Components
growth in percent

Table 3.4

	FY24	FY25
Financial Conditions		
Mark-up rate (6-m average KIBOR)	21.9	13.8
Global Commodity Prices Index	-13.4	-4.7
Raw materials	4.8	5.0
Agriculture	-0.8	4.9
Metal and minerals	-0.3	3.3
Energy	-18.1	-9.1
Wholesale price index components		
Textile and apparels input[#]	27.2	16.3
Metal product, machinery & equipment		
Engines and motors	42.2	18.7
Steel products	41.4	12.7
Fuels		
Natural gas liquefied	61.1	15.7
Coal	24.8	16.7
Agriculture machinery and agrochemicals		
Fertilizers	23.3	9.4
Pesticides	16.6	11.8
Insecticides	27.9	15.4

[#] excluding cotton yarn, nylon yarn and blended yarn whose prices are unchanged in WPI for about 4 years.

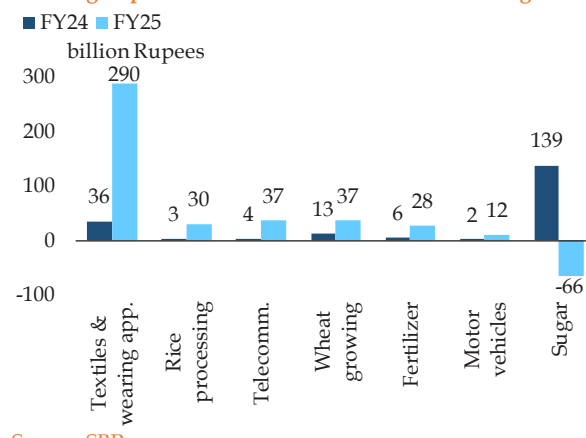
Sources: SBP, MoF, PBS, World Bank

The uptick in external demand partially reflected in the working capital needs of export-oriented sectors

The disaggregated data shows that manufacturing of textile and wearing apparel remained the major borrowers, which together accounted for 47 percent of the expansion in working capital loans in FY25. Rising domestic production and export volumes drove the sector's demand for short-term financing (**Figure 3.19**). Specifically, the production of cotton yarn and cloth recovered during FY25 after witnessing consistent decline in the preceding two years. Moreover, lower cotton production caused upward pressure on domestic cotton prices, besides driving increase in raw

Working Capital Loans - Flows

Figure 3.19



Source: SBP

cotton imports.^{24,25} These, along with elevated energy and other costs, raised the financing requirements for all sub-sectors within the textile and wearing apparel groups (**Figure 3.20**).²⁶

Similarly, the rise in demand for working capital loans by rice processing is also reflected by increase in export in H1-FY25. In line with the seasonal trend and 19.0 percent expansion in export volumes, the entire increase in credit offtake for rice processing was concentrated in H1-FY25.²⁷

Weak farm incomes scaled up short-term financing requirements of agriculture-related sectors

The governments' decision to discontinue wheat procurement and support prices, which led to notable decrease in prices and production of some important crops, suppressed farmers' incomes and profitability compared to the previous year (**Table 3.5**).²⁸ Weakened financial positions increased demand for working capital loans, particularly for wheat-growing in FY25.

²⁴ The raw cotton imports increased to 683,000 MT in FY25 compared to 205,000 MT last year. Source: PBS.

²⁵ Average seed cotton prices rose by 2.2 percent during FY25 as compared to a decline of 5.7 percent during FY24. Source: PCCC

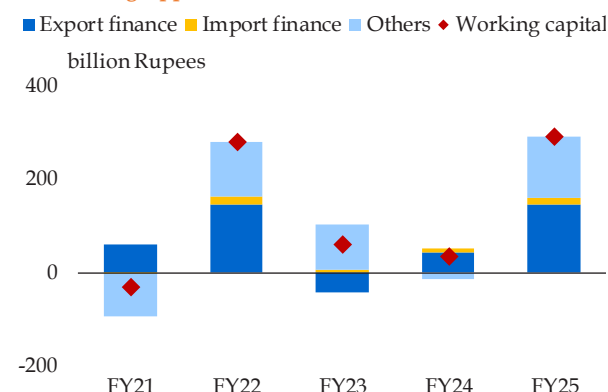
²⁶ The export of yarn other than cotton, ready-made garments and tents, canvas & tarpaulin increased in FY25 compared to last year. Source: PBS.

²⁷ Export finance under working capital for rice increased by Rs 12 billion in FY25, as against a decline of Rs 7 billion and Rs 5 billion in FY24 and FY23, respectively. Source: PBS

²⁸ The total loans for agriculture sector under Prime Minister's Youth Business & Agriculture Loan Scheme (PMYB&ALS) increased by Rs 18 billion in FY25, as compare to a rise of Rs 35 billion last year.

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Composition of Working Capital Flows - Textile and Wearing Apparel Figure 3.20



Source: SBP

Additionally, unfavourable economic conditions prevented farmers from increasing the use of crop nutrients, which in turn weighed on cash flow of fertilizer manufacturers.²⁹ This, together with soaring input costs led by elevated gas prices explain the increased credit demand of fertilizer sector during FY25.

Improvement in business sentiments, together with lower interest rates spurred demand for fixed investment loans

After a sluggish trend in the preceding two years, fixed investment loans to private sector businesses almost tripled in FY25, compared to previous year (Figure 3.21). This is in line with improving macroeconomic conditions and business sentiments. However, most of the loans for fixed investment were meant for enhancing production efficiency and upgrading of infrastructure, and only a few sectors borrowed for capacity expansion.

The telecommunication sector continued to borrow for the ongoing expansion in wired and wireless

Wheat: Production and Wholesale Prices

Table 3.5

	Production (million tons)	WPI Prices (percent)
FY23	28.2	67.1
FY24	31.8	15.7
FY25	29.0	-35.3

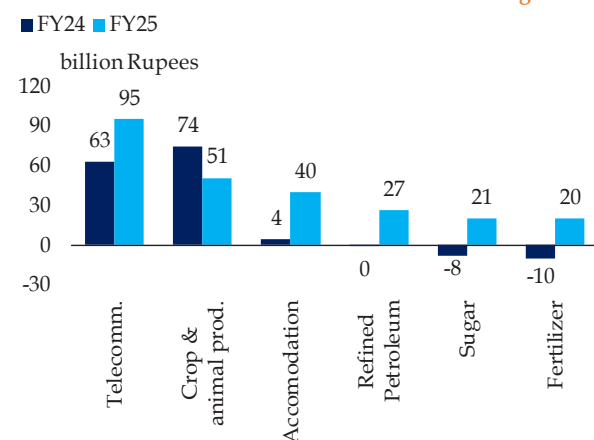
Source: PBS

communication infrastructure. Similarly, fertilizer sector availed long-term loans to finance merger and acquisition. Additionally, the sector is investing in gas pressure enhancement infrastructure to ensure adequate supply of gas required for urea manufacturing on a sustainable basis.³⁰ Moreover, some of the fertilizer companies reported opening of retail outlets across the country to increase outreach to the farmers.³¹ The refined petroleum sector obtained fixed investment loans to finance refinery's expansion aimed at improving efficiency and increasing capacity.³²

Beside these sectors, sugar industry also saw an uptick in fixed investment during FY25, marking a shift from the net retirements seen over the previous three years. This increase corresponds to

Fixed Investment Loans - Flows

Figure 3.21



Source: SBP

²⁹ First Quarterly Report 2025, Engro Fertilizers Limited, Karachi.

³⁰ Annual Report 2024, Engro Fertilizers Limited, Karachi.

³¹ Fatima fertilizer launched six retail outlets under the Sarsabz Agri Mart banner, with 24 more outlets planned for year 2025. Fauji Fertilizer Co. (FFC) took long-term loans for merger of Fauji Fertilizer bin Qasim Ltd. (FFBL) into FFC and announced the acquisition of Agritech Ltd. FFC also announced to increase the retail outlets across the Country 2024. Source: Annual and Quarterly Financial Statements of fertilizer companies.

³² Pakistan Refinery Limited (PRL) has initiated a Refinery Expansion and Upgradation Project (REUP) to enhance domestic refining capacity. The initiative will double the crude processing capacity to 100,000 barrels per day (bpd). Source: Financial reports and PRL's "Disclosure of Material" letter to PSX, May 2024.

development of ethanol distilleries, previously announced by several sugar producers.³³

Consumer Financing

In line with the reduction in weighted average lending rate (WALR), consumer financing expanded by Rs 111.5 billion in FY25, recording the first annual increase after two consecutive years of contraction under the tight monetary stance. The expansion in consumer financing was broad-based (**Table 3.6**). Nonetheless, auto loans, which are relatively more sensitive to the changes in interest rates, saw the largest increase (**Figure 3.22**). This is also corroborated by sharp increase in sale of passenger cars and light commercial vehicles (LCVs) in FY25.³⁴

Credit card loans maintained the rising trend. This is supported by rising tendency in use of credit cards. In first three quarters of FY25, the number of cards issued grew by 5.9 percent, the transaction volumes almost doubled, and the value of transactions rose by 23 percent compared with the same period of last year.³⁵

The increase in housebuilding finance, however, remained subdued. This reflects weak (private)

Consumer Financing
flows in billion Rupees

Table 3.6

	FY21	FY22	FY23	FY24	FY25
Consumer Financing	708	192	-40.4	-57.4	111.5
Credit cards	55.1	17.7	21	28.5	36.3
House building	103.6	97.1	11.6	-8.7	3.5
Personal loans	235	16.4	1.2	-14	24.4
Consumer durables	6.1	1.2	0	0.1	1.2
Auto loans	308.1	59.7	-74.1	-63.2	46.1

Source: SBP

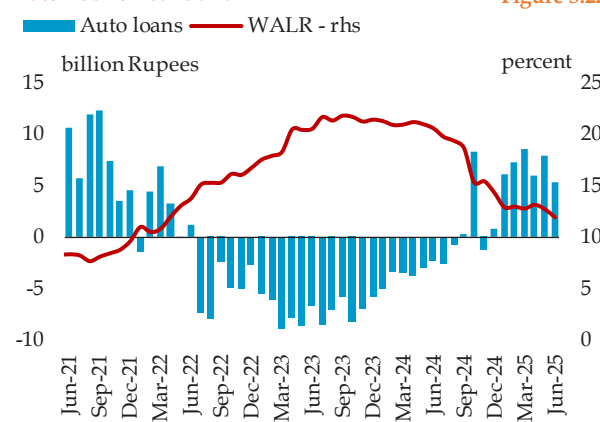
construction activity amid increase in construction material prices – particularly of cement and cement blocks, which rose by about 13 percent in FY25 following increase in Federal Excise Duty (FED) on cement from Rs 2 to Rs 4 per kg³⁶ – and higher taxation on property transactions.³⁷

Advances to priority sectors slightly increased in FY25

The share of SMEs and agriculture in total advances has increased in the past two years (**Figure 3.23**). This reflects the impact of several initiatives by the government and the SBP to promote credit to SMEs, agriculture and other underserved segments. These policies and schemes included SME Asaan Finance (SAAF) Scheme, Refinancing Facility for Modernization of SMEs and Risk Coverage Scheme for SMEs.

Automobile Loans and WALR

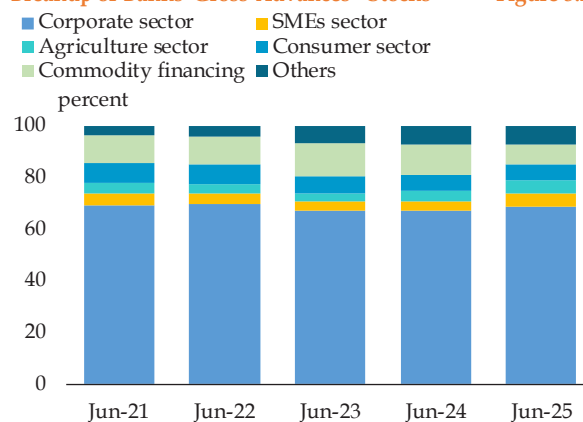
Figure 3.22



Source: SBP

Breakup of Banks' Gross Advances - Stocks

Figure 3.23



Source: SBP

³³ In Q3-FY24, Chashma Sugar Mills Limited and JDW Sugar Mills Limited disclosed plans to set up distilleries, anticipated to be completed in FY25. Source: Quarterly financial reports.

³⁴ Source: Pakistan Automotive Manufacturers Association (PAMA)

³⁵ SBP (2025). Payment Systems Quarterly Reviews, State Bank of Pakistan, Karachi.

³⁶ Source: FBR C. No. 1/8-ST13/2024, dated August 5, 2024

³⁷ Source: FBR finance act – explanation regarding important amendments made in the income tax ordinance 2001, published on July 29, 2024, Available at: <https://download1.fbr.gov.pk/Docs/20247291973384Circularno01of2024-25.pdf>

3.4 Inflation

The NCPI inflation dropped to an eight-year low of 4.5 percent in FY25, compared to 23.4 percent in the previous fiscal year (**Table 3.7 and Figure 3.24**). This steep disinflation reflected the interplay of favourable supply and demand dynamics during the year. Continued tight monetary policy stance, fiscal consolidation and lower farm incomes amid decline in prices and output of important crops kept the domestic demand subdued during FY25. On the supply side, greater availability of food commodities, a downward adjustment in administered energy tariffs, relative stability in exchange rate, and softened international commodity prices contributed to sharp decline in food and energy inflation, besides easing cost pressures.

In overall terms, easing prices of food group alone accounted for around half of the inflation decline during FY25, followed by one-third contribution of energy. The falling trend was not limited to food & energy prices, non-food-non-energy (NFNE) inflation – a measure of underlying inflationary pressures – also fell to nearly half of its FY24 level in both rural and urban baskets (**Figure 3.25a and 3.25b**). However, the pace of

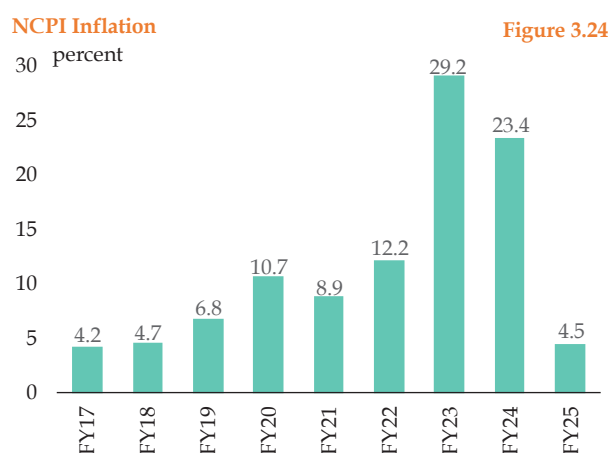


Figure 3.24

Source: PBS

decrease in core inflation slowed in H2-FY25, indicating rigid underlying inflationary pressures.

Improved supply conditions drove broad-based drop in food inflation

Food inflation, which had been the major contributor to both urban and rural CPI inflation in FY24, receded substantially during the course of FY25. A steep reduction in the prices of non-perishable food items, particularly of wheat and wheat flour, made the largest contribution to fall in food inflation in urban and rural baskets in FY25. This was the result of a bumper domestic

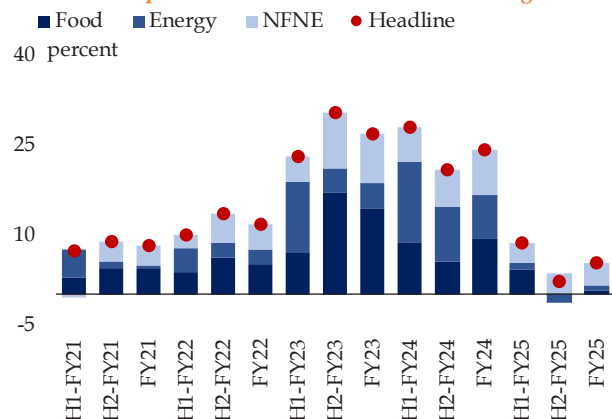
CPI Inflation and its Composition

Table 3.7

Items	Weight	Average Inflation						Contribution		
		H1-FY24	H2-FY24	FY24	H1-FY25	H2-FY25	FY25	H1-FY25	H2-FY25	FY25
NCPI	100	28.8	18.7	23.4	7.2	1.9	4.5	7.2	1.9	4.5
Urban										
CPI	100.0	28.0	20.7	24.1	8.7	2.1	5.3	8.7	2.1	5.3
Food	36.8	33.2	12.9	22.1	2.7	0.6	1.6	1.1	0.3	0.7
Perishable	4.4	7.5	25	16.2	21.6	-16.8	1.1	0.9	-0.8	0
Non-perishable	32.4	37	11.5	22.9	0.5	3	1.7	0.2	1.1	0.6
NFNE	53.7	18.4	13.9	16.1	9.5	7.5	8.5	8.7	4.1	3.2
Energy	9.5	47.9	76.1	62.6	24.8	-8.2	6.1	3.5	-1.4	1
Rural										
CPI	100.0	30.0	15.9	22.4	5.0	1.6	3.3	5.0	1.7	3.3
Food	45.9	33.7	11.6	21.6	0.4	-2.2	-0.9	0.2	-1.1	-0.5
Perishable	5.7	7.7	27.7	17.7	21.1	-21.1	-1.7	1.2	-1.3	-0.1
Non-perishable	40.3	37.8	9.6	22.1	-2.1	0.5	-0.8	-1	0.2	-0.4
NFNE	42.6	25.9	19.9	22.7	12.7	9.6	11.1	4.6	3.6	4.1
Energy	11.4	26.9	22.9	24.8	2.3	-6.2	-2.1	0.3	-0.8	-0.3

Source: PBS

Inflation Composition - Urban



Source: PBS

Figure 3.25a

Inflation Composition - Rural

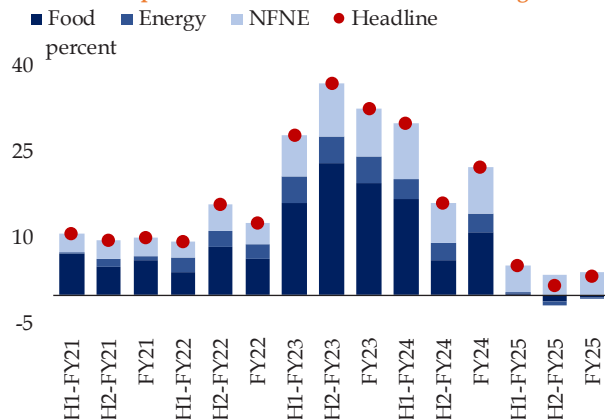


Figure 3.25b

wheat crop in FY24,³⁸ which together with substantial import of wheat before the harvest, improved domestic supply during FY25. In addition, the government's policy to move away from wheat procurement further weakened the prices of wheat and its products.

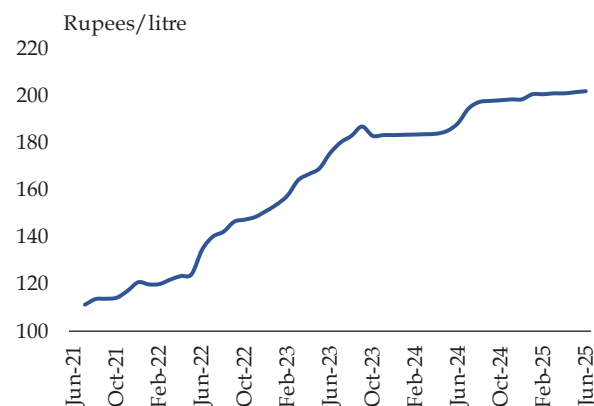
The increase in prices of other non-perishable food items – rice, cooking oil, readymade food, tea, condiments and spices, and fresh milk – also remained muted in FY25 compared to FY24. Among these, the pace of increase in price of fresh milk – having significant weight in CPI – saw a notable slowdown in FY25, compared to the past two years (Figure 3.26).³⁹ This reflected the impact of strict enforcement of administered prices by provincial authorities.^{40, 41} In addition, easing transportation and energy costs also limited the rise in the retail prices.

Similarly, improved domestic availability of rice amid large crop output and reduced export quantum kept the rice prices, on average, almost unchanged in FY25, compared to the previous year.⁴² The prices of cooking oil and tea also

remained stable, reflecting the lagged impact of declining international prices and a stable exchange rate. Meanwhile, lower food and energy prices were also transmitted to the ready-made food prices. Overall, these six categories – wheat and wheat flour, rice, tea, fresh milk, and readymade food, and condiments and spices – collectively accounted for nearly three-fourths of the decline in food inflation during FY25 (Figure 3.27).

Fresh Milk Prices - Urban

Figure 3.26



Source: PBS

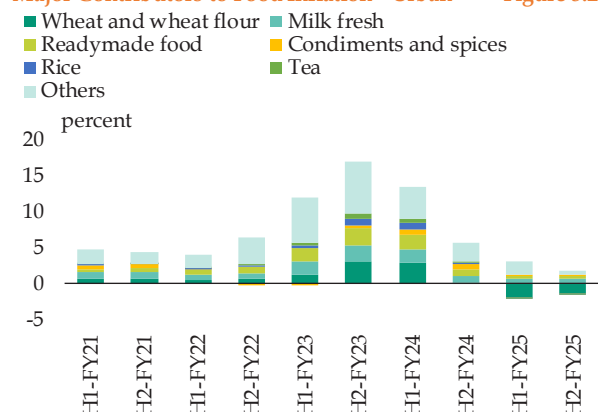
³⁸ Wheat production increased by 12.2 percent to 31.4 MMT in FY24. Source: PBS

³⁹ Fresh milk prices posted 10.3 percent increase in FY25, against 18.8 percent increase in FY24.

⁴⁰ Source: The Commissioner Office Karachi.

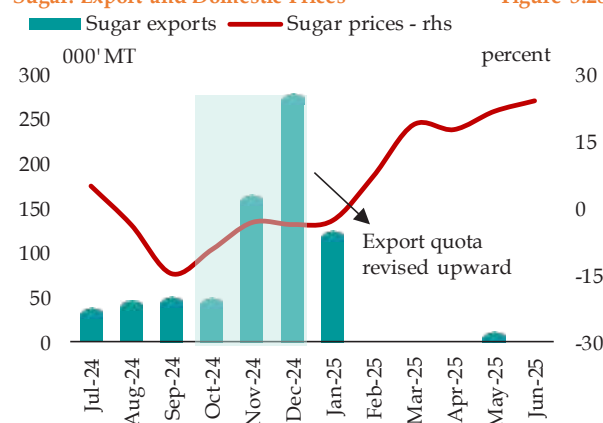
⁴¹ The Punjab Price Control of Essential Commodities Act, 2024, expanded the authority of Deputy Commissioners across the province to monitor and curb artificial price hikes and profiteering. The Act includes essential items such as tea, vegetable oil, ghee, and milk in the list of regulated commodities. Source: Punjab Price Control of Essential Commodities Act, 2024

⁴² Rice production stayed near 9.7 million tonnes in FY25, just below the record 9.8 million tonnes in FY24.

Major Contributors to Food Inflation - Urban **Figure 3.27**

Source: SBP

However, within non-perishables, sugar exhibited a distinct price path. Following a period of subdued prices in the first half of the year, sugar prices began rising sharply in the second half and contributed about one-half of the urban food inflation in H2-FY25 (**Figure 3.28**). This reversal came after a substantial increase in export quotas, which constrained domestic availability,⁴³ partially offsetting the overall benefit from declining prices of other non-perishable items in H2-FY25.

Sugar: Export and Domestic Prices **Figure 3.28**

Source: PBS

⁴³ From November 2024 onward, sugar exports surged – reaching 755 thousand metric tons in FY25, up from 33.1 thousand metric tons a year earlier. Moreover, sugar ending stocks declined sharply in FY25 compared to FY24, falling from 3.39 million tons to 1.95 million tons due to higher exports, and strong domestic demand during Ramadan. Source: USDA

⁴⁴ Tomato production declined by 30.3 percent in FY25. Source: PBS

⁴⁵ India's export ban during Dec 2023–Jun 2024 provided Pakistani suppliers the opportunity to grab the export market. Source: World Trade Scanner

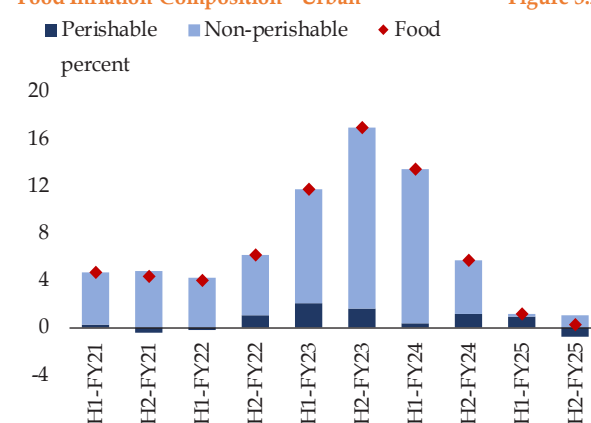
⁴⁶ Source: PBS

⁴⁷ The production of onion increase by 15 percent in FY25. Source: PBS

Perishable food prices presented a mixed picture. In H1-FY25, rise in prices of tomatoes and onions amid lower domestic supply,⁴⁴ partly neutralized the impact of falling prices of non-perishable items. The lower domestic supply of onions was due to increase in exports.⁴⁵ Export of onion more than doubled in Q4-FY24, squeezing domestic supply in H1-FY25.⁴⁶ However, the situation improved in H2-FY25,⁴⁷ as fresh supplies entered the market and prices of key perishables declined. This led to decline in food price index in the latter part of the year (**Figure 3.29**).

Energy inflation subsided following downward adjustment in power tariffs and fall in global oil prices

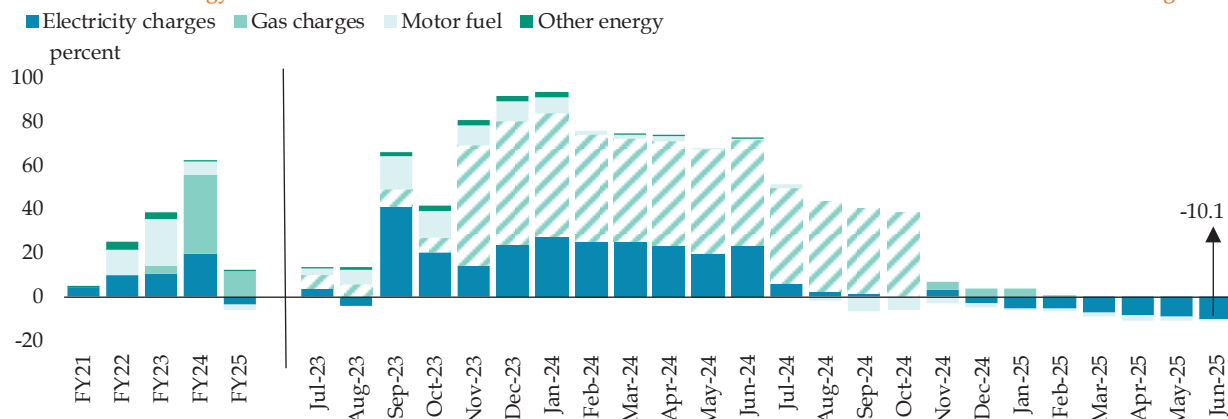
Energy inflation in urban areas fell sharply from 62.6 percent in FY24 to 6.1 percent in FY25 (**Figure 3.30**). Several factors contributed to this drop. These included dissipating base effect from earlier gas tariff adjustments – particularly the increase implemented in November 2023, downward adjustment in electricity charges, fall in global oil prices and the positive impact of government's reform measures in energy sector.

Food Inflation Composition - Urban **Figure 3.29**

Source: PBS

Contribution to Energy Inflation

Figure 3.30



Sources: PBS and SBP staff calculations

While the decline in energy inflation was broad-based, electricity contributed the most as Quarterly Tariff Adjustment (QTA) and Fuel Charge Adjustment (FCA), the mechanism through which electricity tariffs are periodically revised,⁴⁸ turned negative from December 2024 onwards. To shield domestic consumers from a large increase in tariffs, the government staggered the annual rebasing adjustment of Rs 5.72/kWh that originally had to take effect from July 1, 2024.⁴⁹

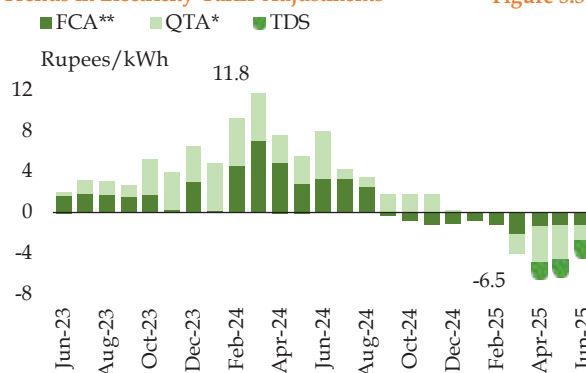
Instead, an initial increase of Rs 3.29/kWh was applied between July and September, while the remaining portion was incorporated from October 2024 onwards. In addition, the advance collection of quarterly adjustment charges for July and August 2024—carried out in June 2024—temporarily dampened effective tariffs during the first half of the year. These measures were supported by implementation of the Tariff Differential Subsidy (TDS) in Q4-FY25.

Consequently, adjustments in electricity tariff declined to negative Rs 6.5 per kWh by April 2025 (Figure 3.31).⁵⁰

Beyond these adjustments, policy actions further eased tariffs. The government renegotiated contracts with Independent Power Producers (IPPs), facilitating early termination of contracts of five power plants, which reduced capacity payments.⁵¹ At the same time, the government introduced a 5 percent levy on industrial captive power plants in March 2025 to encourage a shift back to grid usage, with an objective to improve

Trends in Electricity Tariff Adjustments

Figure 3.31



*Quarterly tariff adjustment for residential consumers

** Fuel charge adjustments

Sources: NEPRA and PBS

⁴⁸ QTA is revised every three months to account for variations in capacity payments, O&M costs, exchange rate fluctuations, and other allowed costs not captured in the base tariff. While FCA is a monthly mechanism that passes on the changes in actual cost of fuels (such as coal, gas, furnace oil, LNG) compared to the projected cost used at the time of tariff setting. Source: NEPRA

⁴⁹ Source: NEPRA notification dated July 11, 2024, and May 31, 2024, effective from June 01, 2024.

⁵⁰ Source: NEPRA notification dated April 10, 2025, effective from April 01, 2025.

⁵¹ Pakistan capacity payments crisis triggered power purchase agreement renegotiations with independent power producers. Five IPPs included Saba, Lalpur, Atlas, Rousch and Hub Power, with a combined 2,463 MW capacity. Source: IEEFA

utilization and reduce capacity payments to contain electricity tariffs (**Box 3.1**).⁵²

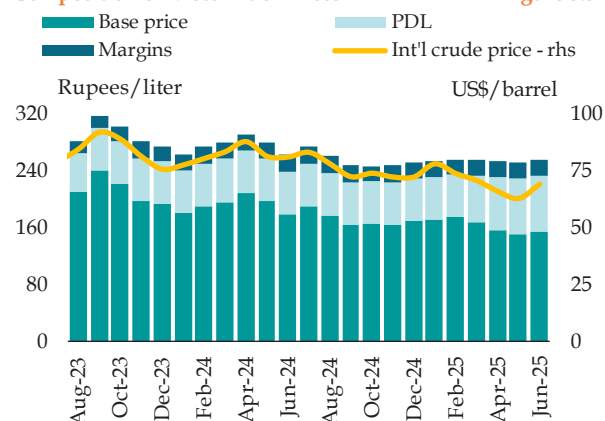
A combination of lower interest rates and improved operational performance provided further relief. Lower borrowing cost reduced the tariff impact of power sector liabilities financed through commercial loans, while improved collections and early outcomes of reforms in distribution companies helped reduce inefficiencies.⁵³

Together with the pricing measures, these gains laid the ground for sustained disinflation in electricity charges. Overall, electricity charges, alongside the fading impact of earlier gas price increases, accounted for nearly three-fourths of the decline in energy inflation.

Motor fuel prices also dropped during the year, in line with the retreat in global oil benchmarks. Although the Petroleum Development Levy (PDL) was raised from Rs 70 per litre in March 2025 to Rs 78 in April 2025, its inflationary effect was largely neutralized by the concurrent drop in international oil prices. Together, these developments ensured that energy inflation—remained subdued throughout the year (**Figure 3.32**).

Composition of Motor Fuel Prices

Figure 3.32



Sources: OGRA and WB

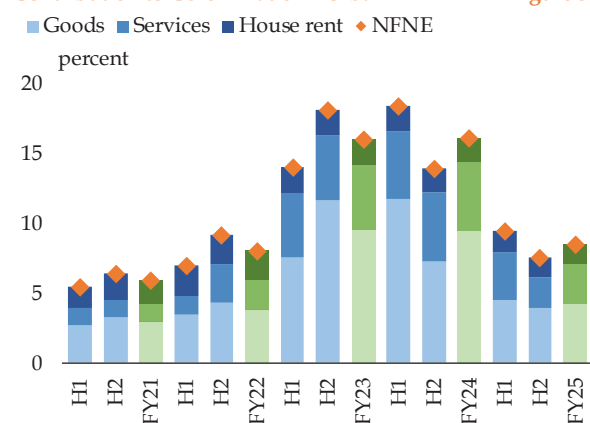
Core inflation in FY25 almost halved compared to FY24

Reflecting the fading second-round effects of shocks to food and energy prices, contained domestic demand and stable exchange rate, core inflation in both urban and rural baskets nearly halved in FY25, compared to the preceding year. However, the pace of disinflation moderated in the second half of FY25, reflecting persistence in underlying inflationary pressures (**Figure 3.33a and 3.33b**).

The breakdown of core inflation into its components shows large contributions from

Contribution to Core Inflation - Urban

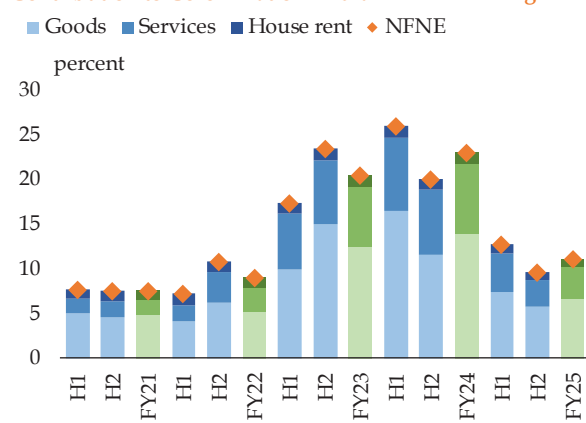
Figure 3.33a



Source: PBS

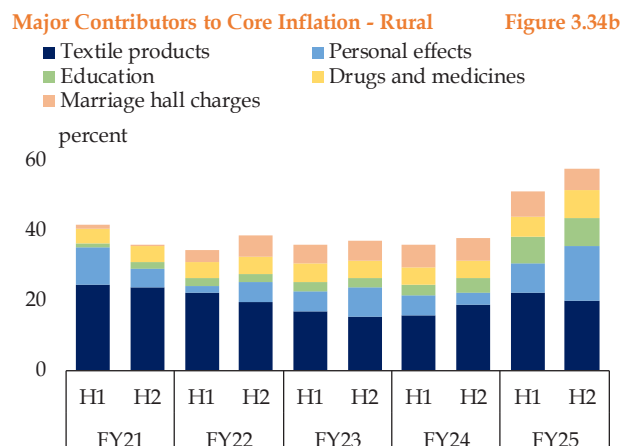
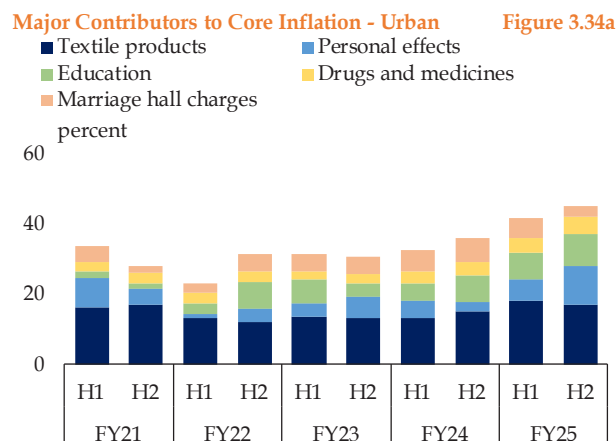
Contribution to Core Inflation - Rural

Figure 3.33b



⁵² Source: OGRA Notification No. 10-3(8)/2023, published on January 26, 2025

⁵³ Since T&D losses and non-recoveries are typically passed on to consumers through tariff adjustments, higher collections help narrow these inefficiencies, and limit upward pressure on electricity prices.



Source: PBS

clothing, drugs & medicines, personal effects, education and marriage hall charges in slowing the pace of decline in core inflation across urban and rural baskets (**Figure 3.34a and 3.34b**). This reflects the combined impact of elevated operational costs, escalating prices of raw materials, and the governments' regulatory and tax measures. Specifically, the lingering impact of the hike in gas charges introduced in November 2023 and a 15 percent increase in minimum wages pushed up the operational costs pushed up the prices across core goods and services.⁵⁴

Additionally, the pass-through of rising raw material costs exacerbated price pressures in some of the core goods. For instance, a notable increase in domestic cotton prices, following a large drop in cotton production in FY25 led to higher prices of cloths, whereas surging prices of gold drove the prices of personal effects items during FY25.^{55,56} Moreover, the impact of deregulation of non-essential drugs' prices announced in February

2024 partly explains increase in drugs & medicines price in FY25.⁵⁷

Increase in core services inflation had sizeable contributions from education and marriage hall charges. Apart from the rising operational costs, imposition of sales tax on education services in Sindh, was also responsible for uptick in education fees in FY25.⁵⁸ Moreover, strict enforcement of withholding tax (WHT) on marriage halls contributed to price increases in this services sub-sector.⁵⁹

Alongside the short-term dynamics, the persistence in core inflation also encompassed the impact of structural factors, including frequent supply shocks, weak supply-chains and market imperfections (**Box 3.2**). Moreover, weak coordination between monetary and fiscal policies in past has also restrained the effectiveness of monetary policy in addressing price rigidities in the past two decades.

⁵⁴ Sources: No. SO (L&P) MW/2024, Labour & HR Department, Govt. of the Punjab.

No. SO (L-II)/13-3/2016-I, Labour & HR Department, Govt. of Sindh.

No. SOL/LD/8-4/2024/MWB/3364-84, Labour Department, Govt. of KPK.

⁵⁵ Gold constitutes about 50 percent share in personal effects items.

⁵⁶ Gold prices surged by around 31 percent in FY25 as compared to FY24. Source: PBS

⁵⁷ Prices of non-essential medicines were deregulated through S.R.O 228(I)/2024 issued by the Ministry of National Health Services, implemented in April 2024.

⁵⁸ Government of Sindh imposed 3 percent sales tax on educational institutions through Finance Act 2024.

⁵⁹ WHT on marriage halls was imposed through The Finance (Supplementary) Act 2023.

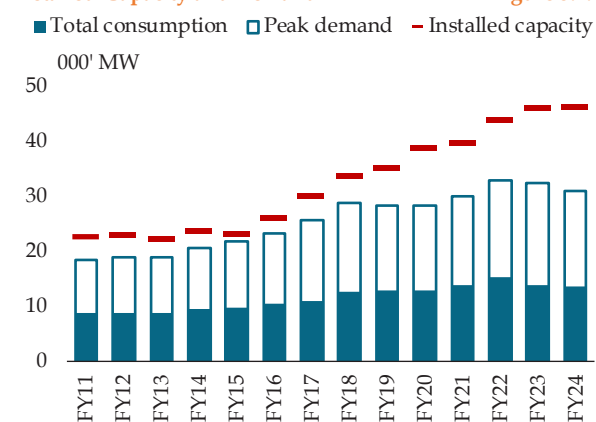
Box 3.1: Policy Measures to Increase Grid Demand and Lower Electricity Prices

Pakistan's power sector has long struggled with a mismatch of available capacity and actual demand, compounded by transmission and distribution (T&D) inefficiencies. To address this issue, the government undertook a large-scale expansion of generation capacity (**Figure 3.1.1**), backed by long-term power purchase agreements (PPAs) with Independent Power Producers (IPPs) on terms that often included take-or-pay clauses and dollar indexation. At the same time, other long-standing inefficiencies have further inflated costs. A major contributor to these inefficiencies is Pakistan's aggregate technical and commercial (AT&C) losses, currently at 18 percent – high compared to regional peers (**Figure 3.1.2**).ⁱⁱ These losses reduce the effective supply reaching consumers and increase the burden on grid users.

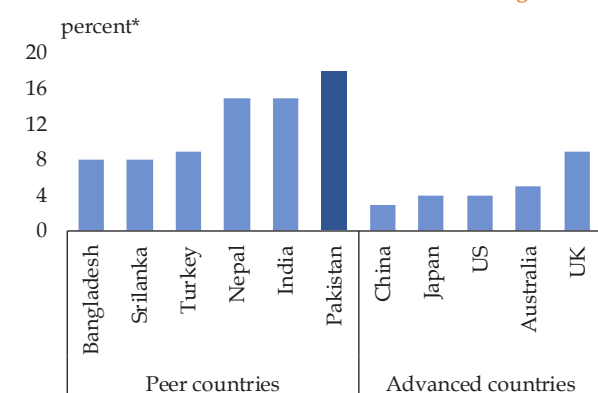
Electricity tariffs are set to recover the total cost of supply – including generation costs, capacity payments, operations and maintenance, and T&D expenses – from paying customers. This means that those who remain connected to the grid carry the combined burden of idle capacity and system losses. This creates a spiral: higher losses push tariffs up, prompting more users to leave the grid, which further erodes the paying customer base and amplifies the problem. The impact of these losses thus swells electricity tariffs and deepens the sector's long-term inefficiencies.

This entrenched imbalance has created a high-cost, low-demand system, where capacity payments dominate the cost structure and declining grid usage undermines financial viability. This necessitates a closer look at utilization trends, tariff design, and country experiences with regard to increasing grid demand.

Excess supply and system constraints: The power generation capacity in Pakistan has outpaced demand growth since past many years. At the end of FY24, the installed electricity generation capacity stood at 45,888 MW (including KE and excluding solar capacity), while the peak demand recorded during the year was only 30,150 MW and the average utilization rate remained around 44 percent.ⁱ In this backdrop, electricity prices reflect the structural weight of fixed capacity charges. In FY24, capacity-related charges contributed approximately Rs 17.01 (38 percent) per unit in the overall per unit cost of electricity of Rs 45.06 (**Figure 3.1.3**). However, with demand projected to grow by 3–5 percent, the capacity cost component is expected to decline slightly to Rs 16.67 per unit in FY26.

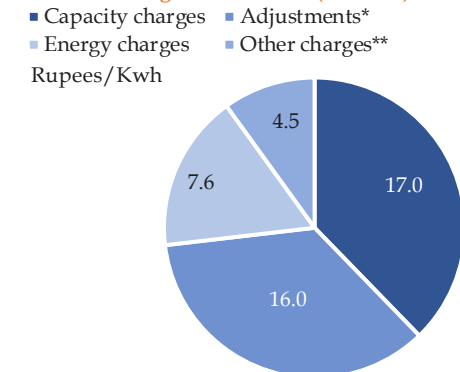
Installed Capacity and Demand**Figure 3.1.1**

Source: NEPRA

Transmission and Distribution Losses**Figure 3.1.2**

*As a percent of total electricity generation

Sources: WB and NEPRA

National Average Tariff - FY24 (Per Unit)**Figure 3.1.3**

*Prior year recoveries and taxes/surcharges

**Transmission, market, and DISCO service cost

Source: NEPRA

Assessing capacity payments: According to NEPRA, eligibility for capacity payments requires compliance with Annual Dependable Capacity (ADC) tests, which confirm a plant's ability to reliably generate electricity under standard conditions. Under PPAs, capacity payments compensate power producers for maintaining available capacity, as determined by the ADC test required once a year under the contract. As a result, even if power plants remain idle due to low demand, they continue receiving payments for their availability. However, only 15 power plants were tested for dependable capacity in FY24.ⁱ Irregular testing may lead to over-invoicing, particularly for plants whose reliable output has declined over time. Rationalizing this process would improve the alignment between payments and actual capacity.

Electricity slabs and solar adoption discourage demand:

Between FY21 and FY24, total electricity consumption remained stagnant. As capacity payments grew, the flaws in the existing tariff structure became more apparent. Originally designed to discourage excessive usage during years of power shortfalls, the slab-based tariff structure is incompatible with current conditions with surplus capacity. Currently, each additional slab consumed pushes households into a higher tariff bracket, raising the effective marginal rate and discouraging further usage. This limits grid demand and undermines the ability to recover fixed costs through higher volumes (**Table 3.1.1**).

Concurrently, solar adoption has gained traction—spurred by declining installation costs, and higher grid electricity prices. As more consumers generate power off-grid, the volume of on-grid sales shrinks—yet fixed capacity charges remain, pushing per-unit tariffs even higher for remaining users.

Electricity Tariff Slabs

Table 3.1.1

	Usage Slab (Units)	Rate (Rs/kWh)	Percentage increase
Protected	Up to 50 (Lifeline)	3.95	
	51 - 100 (Lifeline)	7.74	95.9
	1 - 100	11.69	51.0
	100 - 200	14.16	21.1
Unprotected	1 - 100	23.59	
	101 - 200	30.07	27.5
	201 - 300	34.26	13.9
	301 - 400	39.15	14.3
	401 - 500	41.36	5.6
	501 - 600	42.78	3.4
	601 - 700	43.92	2.7
	Above 700	48.84	11.2

Source: NEPRA

Government efforts to address demand decline: The higher electricity prices have placed domestic and industrial users at a clear disadvantage, with electricity consumption in FY24 remaining around FY21 level. To address the issue of lower demand, the government has tried making alternative fuels less economical—by increasing levies on natural gas for captive power. In Q4-FY25, the government announced a tariff differential subsidy of Rs 1.71 per unit to generate higher demand for grid electricity. However, these measures are not enough and more collaborated long-term efforts are needed to make grid electricity more attractive.

International experiences for stimulating grid demand: International experience shows that sustainable demand growth requires structural reforms in tariff design and targeted incentives that encourage households and industries to remain connected to the grid.

Nepal's experience with demand inertia and tariff restructuring. Nepal transitioned from severe shortages to surplus generation and faced a similar inertia in electricity demand. Households moved to LPG, diesel, and backup generators and were slow to return to grid electricity. To address this, Nepal restructured its tariffs to encourage consumption: slab rates were flattened; time-of-use pricing was introduced for applications like EV charging; and, lifeline consumers (1–20 kWh/month) received free electricity.ⁱⁱⁱ These measures increased electricity sales and utilization without amplifying subsidies, and led to a broader shift towards electrification of cooking and heating.

Indonesia's drive to electrification of end-uses to absorb surplus capacity. In Indonesia, the government addressed the issue of potential oversupply of electricity by electrifying end-users that had traditionally relied on other fuels. A flagship initiative—the “induction stove program”—aimed to convert households from LPG cooking gas to electric cooking (including induction cooktops and rice cookers). This strategy sought both to reduce the fiscal burden of LPG subsidies and to absorb surplus electricity generation.^{iv}

Ghana's tariff reforms to address excess capacity and tariff burden. Ghana provides another example where rapid capacity expansion created excess generation and significant capacity payment obligations. To mitigate underutilization and assuage the tariff burden, the Public Utilities Regulatory Commission in 2018 enacted a major tariff cut – reducing average electricity prices by 17 percent for households and 30 percent for businesses – while making the tariff structure less steeply progressive, thereby incentivizing higher consumption.^v

Policy suggestions for Pakistan: First, the current punitive slab structures should be rationalized. A more gradual tariff progression would mitigate abrupt cost increases, making additional electricity use less prohibitive. Introducing a mid-block band for households moving beyond lifeline slabs could facilitate a gradual shift towards electric cooking, which is especially relevant under recurring gas shortages. Second, Time-of-Use (ToU) pricing should be mainstreamed with off-peak discounts, encouraging industries and households to shift flexible demand – such as ironing, refrigeration, and washing – into non-peak hours. This would help keep the grid busier throughout the day without requiring new generation capacity. Third, for industries, demand packages that guarantee lower rates during nights and weekends can make it viable to return from captive generation to grid electricity.

While these reforms can stimulate demand, their effectiveness depends on parallel improvements in distribution, billing, and collection. Capacity payments are contractually fixed, so higher demand can distribute costs more evenly – it does not eliminate them. Moreover, with new plants of about 7,500 MW expected to enter the system by 2030, the need to expand demand is urgent. Without demand-enhancing reforms, idle capacity and high fixed charges will continue to elevate tariffs, undermining competitiveness and discouraging grid reliance. At the core, Pakistan cannot achieve sustained economic growth without ensuring the availability of ample and affordable energy. Hence, enhancing demand must go hand in hand with policies that guarantee cheap and reliable power, which is fundamental to industrial competitiveness and overall development. However, increasing demand will only be effective if transmission and distribution inefficiencies are also addressed.

**The contribution of Syed Hamza Ali is acknowledged in writing this box.*

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Box 3.2: Persistence in Core Inflation in Pakistan

Inflation persistence refers to a situation when inflation takes longer to revert to its long-term trend in response to a shock. According to the ECB (2006), the return of inflation to its long-run trend is inversely related to its degree of persistence. A high degree of persistence usually requires larger monetary policy adjustments to bring down inflation to the desired range, which leads to higher output losses. In view of SBP's primary objective to maintain domestic price stability, it is instructive to assess inflation persistence and understand the possible contributory factors.

In this backdrop, this Box first estimates inflation persistence at disaggregate level and then explores the underlying factors. The estimates based on sum of autoregressive coefficients (SARC) for the period FY01-FY25 are shown in **Table 3.2.1**.⁶⁰ The estimates suggest that core inflation in Pakistan is more persistent than food and energy inflation. Moreover, the persistence in core inflation increases in periods of high inflation. The literature identifies a number of factors responsible for inducing inflation persistence. These include backward looking inflation perceptions;

⁶⁰ A value of the persistence coefficient below 0.7 indicates that the impact of about half of the initial shock to inflation fades in approximately three quarters ECB (2006). This benchmark is based on the sum of autoregressive coefficients in univariate time-series, the frequently use method in literature to measure inflation persistence.

indexation of wages; imperfect markets; weak coordination between fiscal and monetary policies; and persistent supply shocks. These factors are discussed below.

Backward looking inflation perceptions. IMF (2023) shows that inflation expectations of economic agents in emerging economies are usually backward looking, and do not take into account the impact of monetary policy actions on future inflation. Pakistan is not an exception. As shown by Choudhary et al. (2016), the backward looking price-setting behaviour of firms partially explains inflation persistence in Pakistan. According to their findings, about 71 percent of the firms were either relying solely (25 percent) or using some backward information alongside inflation forecast for price adjustments (46 percent) (Table 3.2.2). Although the latest survey reports drop in percentage of firms considering just the past information for price setting [Inayat, A., Naeem, S. (2025)], backward looking price-setting behaviour still remains significant factor in price adjustments.

IMF (2023) suggests that strengthening monetary policy framework with the aim of increasing central bank's autonomy and adopting clearer communication strategy is likely to increase credibility of central bank. This, in turn, helps in effectively anchoring inflation expectations of households and firms with central bank's medium-term projections and the inflation target range. As the economic agents' confidence in central bank inflation forecast solidifies, they start factoring in central bank forecasts in their economic decisions, rather than relying on past inflation. In this context, it is crucial to have a monetary policy framework with a clearly defined nominal anchor to better anchor inflation expectations and enhance policy credibility.

Structure of market and degree of competitiveness: Market structure plays a crucial role in the pricing strategy of the firms. According to a large strand of literature, firms in a highly competitive environment adjust prices more frequently according to market conditions, whereas market imperfections significantly contribute to inflation persistence [(ECB, 2006), Hosny (2014), Fabiani et al. (2006)].

In the case of Pakistan, firm-level price-setting surveys indicate presence of less competitive markets. In the latest survey in 2025, the proportion of firms that report using mark-up-over-cost pricing has increased substantially, whereas a lower percentage of firms now structure their prices on competitors' behaviour, suggesting existence of market power (Table 3.2.3). This highlights the importance of reforms to enhance degree of competition in the economy, including facilitating market entry, simplification of tax procedures, and rationalization of corporate tax rates. Additionally, the Competition Commission of Pakistan (CCP) needs to be empowered to ensure effective enforcement of its decisions.

Supply chain disruptions and supply-side shocks: Shocks whether stemming from domestic or global commodity prices, particularly oil, are also an important source of inflation persistence in Pakistan. Moreover, disruptions in food supply caused by floods, droughts and other climate-related events often lead to sharp price swings. These shocks seep into core inflation through second-round effects and have a pronounced impact over time. Khan and Hanif (2012) find that the impact of supply shocks on inflation is not only substantial but also long lasting, reinforcing the role of supply-side factors in driving persistent inflation.

Inflation Persistence in Pakistan - SARC Approach

Table 3.2.1

	Overall Sample FY01-FY25	High Inflation Periods ¹	Low Inflation Periods ²
Variable	SARC	SARC	SARC
CPI	0.63*	0.49*	0.00
Food	0.45*	0.17*	-0.26
Energy	0.47*	0.27*	0.00
Core	0.71*	0.83*	0.46*

* Significant at 5 percent

¹ and ² When CPI inflation remained above/below average of FY01-FY25 (single-digit inflation years)

Source: SBP staff estimates

Information Used for Price Adjustment Decisions
share of firms, percent

Table 3.2.2

	2009	2019
Historical data	25	22
Forecast	29	15
An average of past and future	46	63

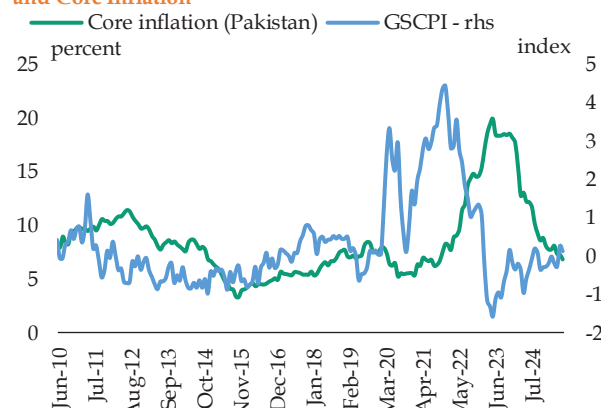
Sources: Choudhary et al. (2016), Naeem and Inayat (2025).

Price Setting Rule

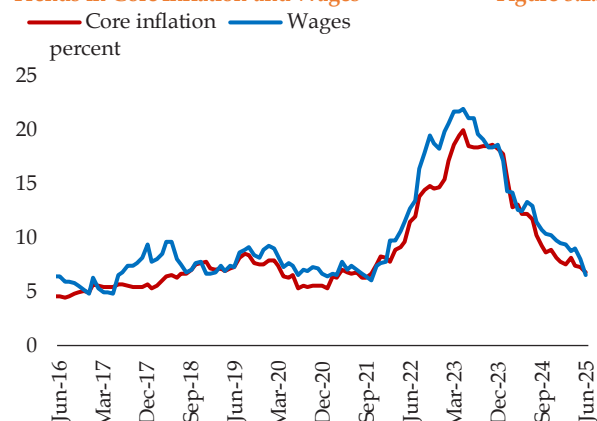
Table 3.2.3

	2011	2019
percent share of firms		
Mark-up on cost	47	61
Competitor's price	37	33

Sources: Choudhary et al. (2016), Naeem and Inayat (2025)

Global Supply Chain Pressure Index (GSCPI) and Core Inflation **Figure 3.2.1**

Sources: SBP and the Fed

Trends in Core Inflation and Wages **Figure 3.2.2**

Source: PBS

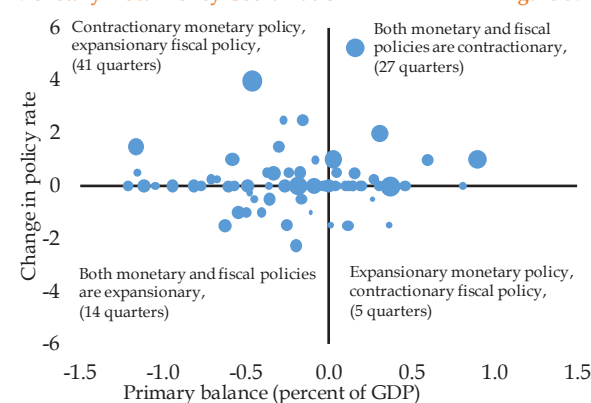
Supply chain disruptions also lead to higher core inflation. Unlike supply shocks that influence core inflation indirectly, supply chain disruptions affect the production and delivery of manufactured goods, raising core inflation directly. Events such as political instability, natural disasters and terrorism frequently interrupt supply chain operations in Pakistan, contributing to sustained inflationary pressures. Moreover, global supply chain disruptions caused by geopolitical events also have a persistent and significant impact on inflation. **Figure 3.2.1** shows that global supply chain pressures impact inflation in Pakistan with a lag, highlighting the lasting influence of global supply conditions.

Mitigating these challenges entails reducing dependence on oil imports through improved energy efficiency, enhancing water governance, expanding storage infrastructure, and fostering climate-resilient agriculture.

Indexation of wages: The indexation based on past inflation plays a significant role in inflation persistence. If the workers or firms expect inflation to remain elevated by looking at the inflation in previous periods, the actual inflation outturn would be significantly influenced by past inflation. This is despite the fact that the forecast suggests inflation to fall. In other words, backward-looking wage indexation tends to amplify the persistence of inflation shocks. The rise in wages not only adds inflationary pressures through a rise in cost of production but also by boosting the aggregate demand.

According to Choudhary et al. (2016), in Pakistan, approximately 47 percent of firms in the informal sector and 30 percent in the formal sector report indexing wages to inflation, with most relying on historical inflation data. Furthermore, there is strong evidence that minimum wage adjustments are closely linked to inflation, shaping workers' expectations and prompting demands for higher wages. These implicit indexation mechanisms have become an important driver of inflation persistence in the country (**Figure 3.2.2**). Adopting innovative strategies for labour compensation, for instance partially linking income adjustments to the central bank's inflation target or a medium-term forecast may help address this issue.

Weak coordination between fiscal and monetary policies raises concern about credibility of monetary policy actions and adversely affects inflation expectations. Looking at Pakistan's experience, the policy environment is characterized with low coordination between fiscal and monetary policies. An analysis of data from FY03 to FY25 reveals that SBP adopted a contractionary monetary policy stance in 68 out of 87 quarters. However, the contractionary monetary policy stance was accompanied

Monetary-Fiscal Policy Coordination **Figure 3.2.3**

Note: bubble size indicates average inflation for each quarter.

Sources: SBP, PBS and MoF

by a contractionary fiscal policy in only 27 instances, when primary balance reported a surplus (**Figure 3.2.3**). This disconnect undermined the central bank's ability to manage inflation expectations, contributing to inflation persistence. Hence, stronger coordination between fiscal and monetary policies is a necessary condition to mitigate inflation persistence. A strong monetary framework is also necessary to absorb and respond effectively to the challenges posed by expansionary fiscal actions.

**The contribution of Syed Qamar Hussain and Muhammad Zuhaib is acknowledged in writing this box.*

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