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# Economic Review



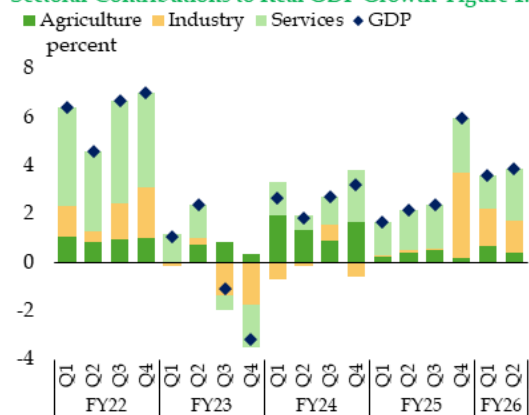
# 1 Economic Review

## 1.1 Overview

Macroeconomic stability strengthened further in H1-FY26, despite headwinds from global trade-related uncertainty and domestic floods. Since February 2026, however, the war in the Middle East has posed significant risks to macroeconomic outlook amid heightened uncertainty. The surge in international oil prices has prompted the government to implement austerity measures aimed at preserving macroeconomic stability. Going forward, the war-led supply chain disruptions may impact inflation trajectory, external trade and remittance flows, and economic activity in Pakistan.

In H1-FY26, economic outcomes had improved markedly. Real GDP growth gained momentum in H1-FY26, growing at twice the pace in the same period last year. This was led by a sharp increase in industrial output, followed by services and agriculture sectors (**Figure 1.1**). Average National CPI (NCPI) inflation eased further, falling close to the lower bound of the medium-term target range, while SBP's FX purchases and net financial inflows

**Sectoral Contributions to Real GDP Growth Figure 1.1**



Source: PBS

**Selected Economic Indicators**

**Table 1.1**

	FY25		FY26		
	H1	H2	Q1	Q2	H1
<i>Growth rate (percent)</i>					
Real GDP <sup>a</sup>	1.9	4.2	3.6	3.9	3.8
Agriculture sector	1.4	1.6	2.7	1.8	2.2
Services sector	2.6	3.5	2.4	3.7	3.1
Industrial sector	0.5	10.0	8.9	7.4	8.1
LSM	-1.8	0.3	3.9	5.7	4.8
National CPI <sup>a</sup>	7.2	1.9	4.3	6.0	5.2
Private sector credit, YoY <sup>b</sup>	22.8	11.9	13.9	0.9	0.9
Money supply, YoY <sup>b</sup>	10.2	12.9	12.0	18.8	18.8
Exports <sup>b</sup>	7.7	1.2	5.8	-13.9	-5.0
Imports <sup>b</sup>	9.8	12.6	8.7	16.3	12.4
Exchange rate – app (+)/dep (-) <sup>b</sup>	-0.1	-1.8	0.9	0.4	1.3
FBR tax revenue <sup>c</sup>	25.9	26.4	12.5	7.0	9.5
Policy rate (end period) <sup>b</sup>	13.0	11.0	11.0	10.5	10.5
<i>billion US\$</i>					
Remittances <sup>b</sup>	17.8	20.4	9.5	10.2	19.7
FDI in Pakistan <sup>b</sup>	2.5	1.8	0.9	0.9	1.8
FX loans (net) <sup>b</sup>	-0.4	2.7	0.4	0.3	0.7
Current account balance <sup>b</sup>	0.9	0.9	-0.7	-0.6	-1.4
SBP's liquid FX reserves <sup>b</sup>	11.7	14.5	14.2	16.1	16.1
<i>percent of GDP</i>					
Fiscal balance <sup>c</sup>	-1.3	-4.1	1.6	-1.2	0.4
Primary balance <sup>c</sup>	3.2	-0.8	2.7	0.5	3.2

Sources: <sup>a</sup>PBS; <sup>b</sup>SBP; <sup>c</sup>MoF

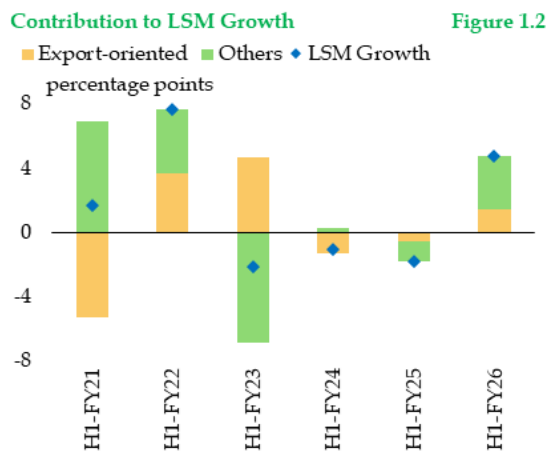
shored up external buffers, despite a decline in exports (**Table 1.1**).

These outcomes were supported by prudent monetary and fiscal policies, and ongoing structural reforms – like deregulation, tariff rationalisation, power sector reforms, etc. Specifically, SBP continued a cautious monetary policy stance, maintaining an adequately positive real interest rate. Fiscal consolidation also remained on track with the fiscal balance posting a surplus – first since FY02, led primarily by a sharp reduction in interest payments. Favourable commodity prices and IMF program also supported the overall macroeconomic conditions. The macroeconomic stability, in turn, facilitated growth momentum.

The growth in industry was led by a rebound in large-scale manufacturing (LSM) output. Meanwhile value addition by construction and electricity, gas and water supply also edged up, whereas mining and quarrying saw a contraction. Construction activity mainly benefitted from a surge in development spending, easing input costs, and government's concessional housing scheme. The increase in value addition by electricity, gas, and water reflects higher government subsidies amid relatively subdued demand for grid power.

The LSM output increased by 4.8 percent in H1-FY26, after showing contraction for the last three years. The recovery in LSM was mainly driven by automobiles, textiles & wearing apparel, and coke & petroleum products (Figure 1.2). The robust performance of automobiles reflected the combined impact of stronger domestic demand, amid a fall in borrowing costs, relatively stable prices, promotional discounts, and launch of new variants, especially in the SUV segment. Growth in textiles and wearing apparel mainly benefitted from higher exports amid relatively lower US tariffs. Cement and petroleum output increased in line with improved construction and transport activities in the country.

The growth in agriculture was primarily on the back of substantial increase in value addition by livestock, which more than offset the decline in output of crops. Within crops, the decline was largely due to cotton and maize which were most affected by floods. Meanwhile, production of sugarcane and rice increased over the



Source: PBS

last year. Sugarcane benefited from higher yield and increased area under cultivation in response to better returns compared to the competing crops. The increase in rice production was mainly on account of higher yield, as area under its cultivation decreased.

Moreover, the flood-related crop losses were somewhat contained relative to initial expectations, partly due to a coordinated flood response, with timely rescue and relief operations in affected districts. Reflecting the impact of better performance of commodity-producing sectors— industry and agriculture— the services sector growth edged up, mainly driven by wholesale & retail trade, transport & storage, and public admin & social security.

The momentum in economic activity translated into a volume-driven increase in imports in H1-FY26, amid relatively benign global commodity prices. Although lower energy and raw cotton prices helped contain the overall import bill, import volumes increased across almost all other

major categories. The composition of imports also saw signs of change during H1-FY26 owing to recent tariff rationalisation under the National Tariff Policy 2025-2030. The growth in imports was visibly stronger in groups where tariffs were reduced for a larger number of tariffs lines, such as machinery, metals and transport-related items.

Exports, on the other hand, declined despite an increase in global trade. The decline was led by significantly lower rice exports, while export of high value-added textiles remained relatively resilient. As a result of diverging trends in imports and exports, as well as deterioration in terms of trade (**Figure 1.3**), the trade deficit increased by nearly 36 percent in H1-FY26. The subdued export performance was largely attributable to a sharp decline in food exports – particularly rice. Lower global commodity prices, together with increased competition and closure of the western border, affected Pakistan’s exports. Barring the impact of volatile commodity prices, Pakistan’s exports performance has remained lacklustre as

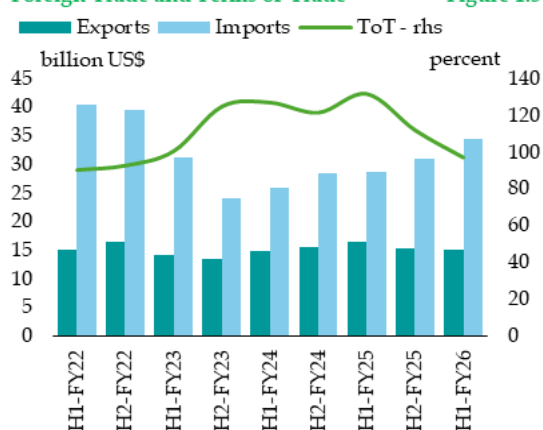
reflected by the falling export to GDP ratio over the last two decades. The downtrend in exports is due to a host of structural issues, including low productivity, policy inconsistencies, weak integration with the global value chains, and lack of products and market diversification. Together these make Pakistan’s exports vulnerable to price and demand shocks.

Nonetheless, workers’ remittances continue to comfortably finance the trade in goods and services deficit and a major part of the primary income deficit, helping to contain the current account deficit at moderate levels. A low kerb premium amid modest exchange rate appreciation, and favourable labour market conditions in the Gulf Cooperation Council (GCC) economies supported the surge in remittances. In addition, increased labour migration in recent years and measures taken by the government and SBP aimed at reducing transaction costs encouraged remittance inflows through formal channels.

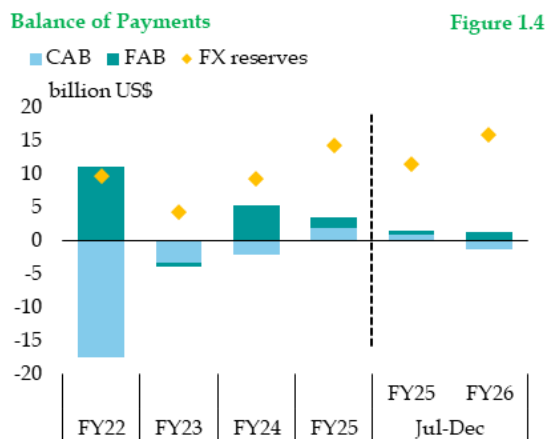
A contained current account deficit, together with moderate private inflows, allowed SBP to continue building FX reserves and supported stability in FX market (**Figure 1.4**). Moreover, official disbursements were higher compared to principal repayments in H1-FY26.

A prudent policy mix, resulting improved external account position and stability in exchange rate, softened international commodity prices and downward adjustments in administered electricity tariffs led to a moderation in inflation during H1-FY26. The NCPI inflation

Foreign Trade and Terms of Trade **Figure 1.3**



Source: PBS

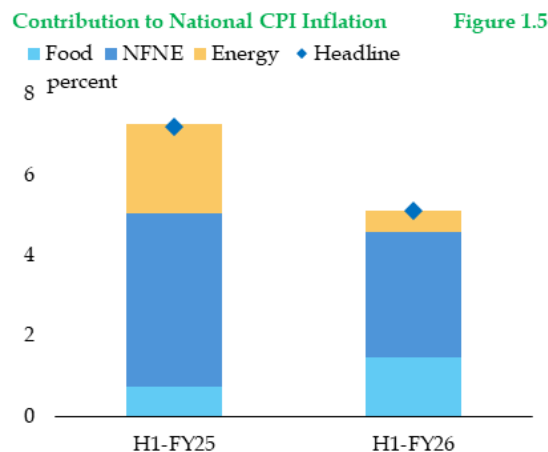


Source: SBP

averaged 5.2 percent in H1-FY26, about 2 percentage points lower compared to the average inflation in the same period last year (Figure 1.5).

In terms of composition, lower energy and core inflation mainly explain the overall moderation in inflation, while price pressures in food group increased during H1-FY26. The increase in food inflation mainly reflected the impact of lower production of key food crops, especially wheat, flood-related supply disruptions, and imperfections in commodity markets. In this context, the ongoing wheat policy reform (Box 3.3) is expected to improve market efficiency and price discovery over the medium term.

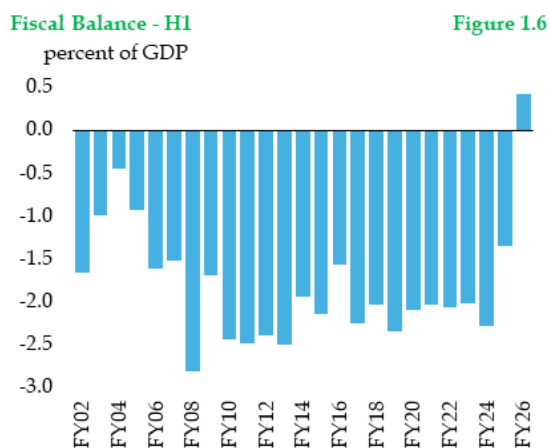
Energy inflation declined to a multi-year low in H1-FY26, mainly on account of favourable pass-through of lower global energy prices and power sector reforms. However, higher levies pertaining to PDL and climate change, partially offset the impact of lower global oil prices on domestic fuel prices.



Source: PBS

Although core (NFNE) inflation decelerated compared to the last year, it remained sticky at elevated levels. Persistent pressures stemmed mainly from house rents, gold prices, education fees, and minimum wage adjustments. Moreover, an increase in gross margins of the corporate sector also contributed to core inflation as firms in some sectors increased product prices despite falling input costs.

Owing to the persistence in core inflation, together with uncertainty arising from changing global trade dynamics, volatile global commodity prices, unanticipated energy price adjustments, flood-related supply-shock, and concerns about wheat supply, SBP continued to pursue a cautious monetary policy stance. The Monetary Policy Committee (MPC) kept the policy rate unchanged in its meetings held during July-October 2025. In December 2025, SBP reduced the policy rate by 50 basis points (bps) due to relatively benign impact of floods as compared to the initial assessment, taking



Source: MoF

the cumulative reduction to 1,150 bps since June 2024.

Substantial reduction in interest payments and fiscal consolidation significantly reduced the country's debt servicing burden. This, alongside steady non-tax revenue, SBP profit and PDL collection, turned the fiscal balance into a surplus in H1-FY26 (**Figure 1.6**), while the primary surplus remained at last year's level. Lower mark-up payments helped increase development spending, subsidies and grants. This increase in social and development spending bodes well for sustaining economic growth momentum, as estimates show that development expenditure has a considerably higher fiscal multiplier than current expenditures (**Box 4.1**).

Sustained fiscal consolidation and a sharp decline in interest payments significantly slowed the pace of public debt accumulation. The gain from PKR appreciation against US dollar and lower accumulation of government deposits, also contributed to a slower pace of public debt

accumulation. Moreover, to benefit from the declining interest rates, the government raised funding mostly through fixed-rate long-term instruments and retired short-term debt. This lengthened the maturity profile of public debt. The steep decline in interest payments, increase in revenue collection, higher remittances, and continuous build-up in foreign exchange reserves also improved the debt repayment capacity of the country.

The surge in the government's budgetary borrowing requirements from scheduled banks, particularly in Q2-FY26, and an increase in credit to non-government sector led to a sizeable expansion in net domestic assets (NDA) of the banking system during H1-FY26. This, together with the increase in NFA, underpinned acceleration in broad money (M2) growth during H1-FY26.

On the liability side, currency in circulation (CiC) increased in H1-FY26 amid higher remittances, rise in transaction demand, and withholding tax on cash withdrawals for non-filers. This, along with higher government borrowing from scheduled banks and expansion in credit to private sector strained interbank liquidity conditions. The resulting shortfall was actively met by SBP through open market operations (OMOs). Better liquidity management reduced volatility in weighted average overnight repo rate and strengthened monetary policy transmission.

Private sector credit (PSC) grew by 0.9 percent (YoY) as of end December 2025, compared to a 22.8 percent increase in the

same period last year. In absolute terms, PSC expanded by Rs 992.3 billion in H1-FY26 compared to Rs 1,978.9 billion in last year. The moderation in PSC was largely due to high base last year, when banks had scaled-up lending to the private sector to avoid advances to deposit ratio (ADR) - based tax. Traction in economic activity, lower input costs and easing financing conditions contributed to an uptick in private sector credit demand during H1-FY26. On the supply side, increased bank deposits enhanced availability of loanable funds.

While Pakistan's overall economic conditions improved, country's transition to a sustainable high-growth path, besides maintaining overall macroeconomic stability, would require deep-rooted economic reforms to address the chronic structural weaknesses. These include low savings and investment, weak competitiveness, falling exports in terms of GDP, subdued foreign direct investment, and the persistently low tax-to-GDP ratio. In this context, the report highlights several underlying issues that continue to hinder the economy's long-term growth potential.

**Box 2.1**, based on Household Integrated Economic Survey (HIES) data, shows increased disparities in household income and consumption, pointing to uneven distribution of economic gains. At the same time, productivity challenges in agriculture remain significant. In this context, innovative approaches, such as urban agriculture, can help enhance food availability in rapidly expanding cities while also improving climate resilience

(**Box 2.2**). Similarly, improving access to agricultural credit can facilitate the adoption of climate-smart farming practices and modern technologies (**Box 3.1**).

In industry, policy initiatives promoting new energy vehicles represent an important step toward reducing emissions and reliance on oil imports, improving energy efficiency, and modernising the transport sector (**Box 2.3**). Further, literature suggests that implementation of first-generation reforms (governance improvement, business deregulation and trade liberalisation) can potentially add about 4 to 8 percent to output over a period of 2 to 4 years. Similarly, second-generation reforms (credit access and labour market reforms) can add another 3 percent (**Box 2.4**). Expanding green financing can further help channel funds toward environmentally sustainable infrastructure and climate adaptation projects (**Box 3.2**).

Structural weaknesses are also evident in the export sectors. Pakistan's export base remains concentrated in a narrow set of products and markets, with limited technological upgradation. This is evident from only modest gains in textile exports despite favourable US tariffs, (**Box 5.1**), making the expansion of the textile value chain, particularly through circular and sustainable practices, crucial for maintaining market access (**Box 5.2**).

Thus, it has become imperative to move towards an export-oriented and investment-led growth model. Structural constraints, such as weak project

preparation, policy inconsistencies and governance gaps, financial sector weaknesses, and delayed project execution, keep investment, including FDI, concentrated in low-risk, market-seeking sectors like FMCGs, automobiles, power sector, etc. Addressing these issues can help attract investment into more productive and export-oriented activities, thereby supporting sustained and diversified economic growth. Building high-tech skills and digital capabilities, in particular, can further boost inflows from the IT and IT-enabled services sector (**Box 5.3**).

In addition to these structural issues, climate change has also started to emerge as the major challenge to Pakistan's economy. In this context, **Chapter 6** explores multiple dimensions of climate change and its impact on Pakistan's economy. Although Pakistan contributes only a small share to global greenhouse gas emissions, it ranks among the most climate-vulnerable countries in the world. Staff estimates show that recent climate events had significant impact on growth and inflation in Pakistan (**Box 6.1**). Further, the World Bank estimates suggest the impact on the country's GDP to intensify by 2050. At the same time, Pakistan's emissions intensity remains relatively high, reflecting structural inefficiencies and a carbon-intensive growth process, which poses challenges in the context of evolving global climate regulations and trade frameworks.

These vulnerabilities are compounded by

the country's low level of preparedness to address climate change through mitigation and adaptation measures. Climate action continues to be constrained by weak policy coordination, implementation gaps in policy and institutional framework, limited technical capacity, human capital deficits, and inadequate social readiness. Moreover, the substantial investment required for climate mitigation and adaptation also remains largely unmet due to low international climate-related inflows, and challenges to domestic public and private sector financing.

## 1.2 Economic Outlook<sup>1</sup>

The macroeconomic outcomes and developments in H1-FY26 had improved the overall outlook for FY26 (**Table 1.2**). However, the war in the Middle East poses significant risks to this outlook. Besides increases in energy prices, the supply chain disruptions, and increase in freight charges and insurance premium could significantly weigh on the country's macroeconomic outlook. The surge in international energy prices was immediately transmitted to domestic inflation despite government's decision to initially absorb the major chunk of the increase. However, its impact on overall economic activity is not expected to be significant in FY26.

The latest data on high-frequency indicators, including Purchasing Managers' Index (PMI) (**Figure 1.7**), suggest industrial output, particularly LSM and construction, has maintained the momentum observed in the first two

<sup>1</sup> The macroeconomic outlook in this section is based on data and developments as of April 30, 2026.

## The State of Pakistan's Economy, Half Year Report 2025-26

Macroeconomic Targets and SBP Projections for FY26

Table 1.2

	Target	SBP Projections
<i>Growth rate (percent)</i>		
Real GDP <sup>a</sup>	4.2	3.75 - 4.75
CPI (average) <sup>a</sup>	7.5	5.0 - 7.0
<i>billion US\$</i>		
Remittances <sup>a</sup>	39.4	41.0 - 42.0
Exports (fob) <sup>a</sup>	35.3	29.5 - 30.5
Imports (fob) <sup>a</sup>	65.2	63.5 - 64.5
<i>percent of GDP</i>		
Fiscal deficit <sup>b</sup>	3.9	3.5 - 4.5
Current a/c deficit <sup>a</sup>	0.5	0 - 1.0

Sources: <sup>a</sup> Annual Plan 2025-26; <sup>b</sup> Federal Budget 2025-26

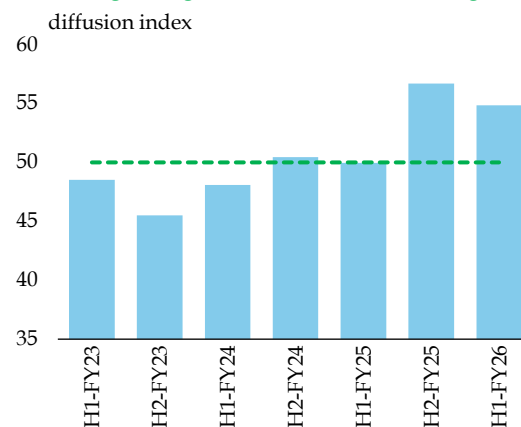
quarters till February 2026. However, the war is expected to weigh on output towards the end of FY26.

The latest information on wheat points to better harvest compared to last year, albeit slightly lower than the target for FY26. This, together with less than anticipated impact of floods on major kharif crops like sugarcane and rice, is expected to help agriculture to perform relatively better in FY26. The performance of agriculture and industry will have positive spillovers on the services sector. Therefore, real GDP growth is now expected to remain close to the lower bound of the projected range of 3.75 to 4.75 percent.

Increase in production of food crops and limited export opportunities due to regional conflicts are expected to moderate food inflation, which may partly offset by increase in transportation costs in H2-FY26. Energy inflation is set to increase after the government passed on the surge in international oil prices following the outbreak of the war. Oil price shocks also pose significant upside risks to core inflation via increased cost pressures,

Purchasing Managers' Index

Figure 1.7



Source: SBP

second-round effects and inflation expectations. These developments suggest that the national CPI inflation (YoY) is likely to remain above the upper bound of the medium-term target range of 5 to 7 percent in the remaining months of FY26 and in FY27.

The spike in energy prices and increased insurance and freight charges are also expected to inflate Pakistan's import bill and freight service payments. However, the government's decision to pass on the impact of an increase in oil prices to domestic energy prices alongside the implementation of energy conservation measures is likely to help contain domestic demand and thus reduce energy import volumes. In addition, decline in LNG imports may further reduce energy imports.

On the other hand, exports are expected to remain weak due to the possibility of slower global economic growth; multi-year low rice prices; closure of Pakistan's western border; and realignment of global trade flows due to ongoing tariff

adjustments. Workers' remittances may also be impacted in Q4-FY26, considering that remittances from the GCC countries contributed around 55 percent of total remittances between FY21-FY25. However, on a full-year basis, remittances are expected to remain strong in FY26, which would partially offset the widening in the trade deficit. Consequently, the current account deficit in FY26 is projected to remain close to the lower bound of the of the range of 0 to 1.0 percent of GDP.

The war and surge in energy prices have implications for tax and non-tax revenue, and government's discretionary spending. In particular, the adjustment in domestic fuel prices vis-à-vis a surge in global oil prices is likely to increase energy subsidies. Moreover, the PDL collection may also be impacted due to reduced POL sales (volume effect) following the increase in POL prices and implementation of energy conservation measures. However, the government's decision to reduce the development budget could somewhat cushion the impact. On balance, SBP envisages the fiscal deficit within the range of 3.5 to 4.5 percent of GDP. While the near-term outlook remains broadly stable,

lingering impacts of war on supply chain resumption and global economic activity could pose significant challenges to macroeconomic stability over the medium-term. First, slower economic activity, amid an uncertain situation in the Gulf economies, may impact remittance inflows, which has been instrumental in financing trade deficit and supporting stability in the foreign exchange market. Second, supply chain disruptions, especially the import of critical raw materials and machinery could affect industrial production as well as exports. Similarly, fertilizer shortages may impact crop yields.

Third, the slowdown in economic activity is likely to have implications for revenue generation. On the other hand, the need for discretionary expenditure may also necessitate additional revenue measures, which may have inflationary consequences. Lastly, these developments and outcomes may also stoke inflation expectations, which have remained well anchored so far. However, SBP will continue to take appropriate actions to preserve macroeconomic stability, particularly to keep inflation in check and maintain external buffers to support economic activity.