PAKISTAN

The economy shrank as floods, uncertainty, and disrupted external support caused public investment to plunge and private investment and industry to contract. Inflation reached a 5-decade high as supply disruption and currency depreciation propelled increases in food and energy prices. If reforms are implemented, growth is forecast to restart gradually this fiscal year and improve slightly next year. Inflation is projected to moderate somewhat this year, and more next year, under stabilization policies. Improving women's financial inclusion is critical to strengthen growth.

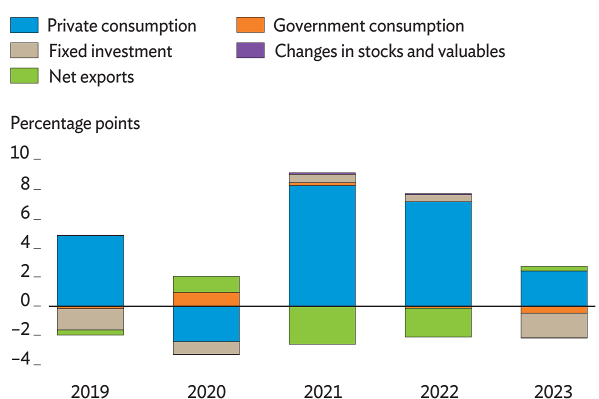
Economic Performance

The economy contracted as devastating floods, political unrest, and policy slippage curbed investment, consumption, and production. Real GDP declined by 0.2% in fiscal year 2023 (FY2023, ended 30 June 2023) following 6.2% expansion in FY2022. On the demand side, private consumption growth slipped to 2.4% from 7.1% in FY2022 (Figure 2.20.1), reflecting higher living costs and slower nominal income growth amid a weakening of employment. Limited fiscal resources led to a 31.6% drop in public investment, while private investment fell by 14.6%, in line with the pessimistic outlook. A steep decline in imports from ad hoc import controls allowed net exports to contribute positively to growth.

On the supply side, growth slowed or contracted in all main sectors. Growth in agriculture was halved to 2.3% from 4.3% in FY2022 as cotton and rice output declined (Figure 2.20.2). Less cotton production, scarcity of inputs due to import controls, and political instability and economic uncertainty led industry to contract by 3.8%, reversing expansion by 7.0% in FY2022. Large-scale manufacturing, accounting for nearly half of industry, shrank by 9.9%, while construction declined by 9.2%. With imports, crops, and industry all declining, services stagnated, with growth falling to 0.1% from 6.7% in FY2022.

Figure 2.20.1 Demand-Side Contributions to Growth

Private and public consumption and investment declined in 2023.



GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

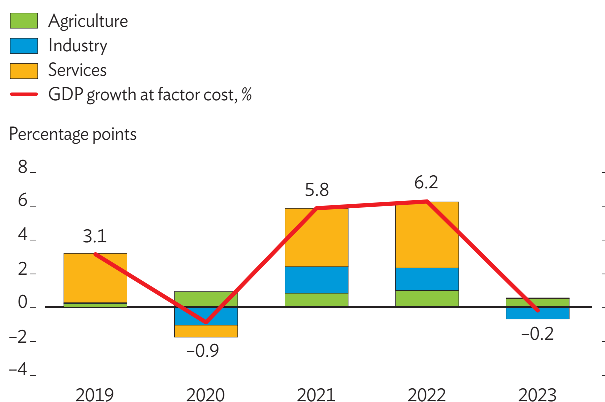
Source: Pakistan Bureau of Statistics. National Accounts Tables Base FY2016: Table 9.

Currency depreciation, increases to administered prices, and supply disruptions from floods and import controls caused inflation to soar. Average inflation jumped from 12.2% in FY2022 to a 5-decade high of 29.2%, as increases in food prices, representing more than half of the overall price index, rose from about 13% to nearly 40% (Figure 2.20.3). Core inflation increased to 16.2% in urban areas and 20.6% in rural areas.

This chapter was written by Khadija Ali, Farzana Noshab, and Maleeha Rizwan of the Pakistan Resident Mission, ADB, Islamabad.

Figure 2.20.2 Supply-Side Contributions to Growth

In 2023, growth slowed significantly in agriculture and services while industry contracted.



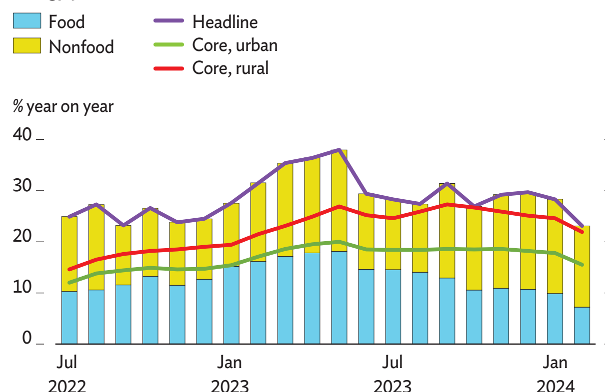
GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: Pakistan Bureau of Statistics. National Accounts Tables Base FY2016: Table 6 and 7a.

Figure 2.20.3 Monthly Inflation

Inflation jumped to a 5-decade high in 2023 due to high food and energy price increases.



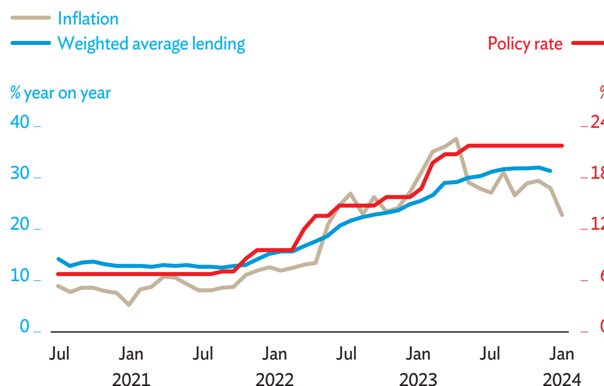
Source: Pakistan Bureau of Statistics. Monthly Review on Price Indices: February 2024.

Monetary policy was tightened to curb inflationary expectations and contain external imbalances. The State Bank of Pakistan, the central bank, raised its policy rate by a cumulative 700 basis points to 22.0% (Figure 2.20.4) and linked interest rates for subsidized credit schemes to the policy rate to strengthen monetary policy transmission. Credit to the private sector declined by 0.8% in FY2023, reversing a rise of 21.1% in FY2022.

The budget deficit showed little change as the government missed major fiscal targets. The fiscal deficit declined slightly from 7.9% of GDP in FY2022 to 7.7%, still exceeding both the budget target of 4.9% and the revised target of 6.9% for the supplementary budget passed in February 2023, which included provisions for flood relief and rehabilitation. The primary balance recorded a deficit of 1.0% of GDP, improving on a 3.1% deficit in FY2022 but well short of the targeted 0.2% surplus. Fiscal targets were missed in FY2023 because the economic slowdown and import controls limited revenue to about 11.4% of GDP. Although nontax revenue rose from 1.9% of GDP to 2.1% as the petroleum levy was raised to its statutory limit, a weak economy caused tax revenue to fall from 10.1% of GDP in FY2022 to 9.2%, despite measures implemented in February 2023 raising direct tax revenue by 0.4% of GDP. Despite cuts in noninterest expenditure, mounting interest payments from higher interest rates, a growing stock of public debt, and significant currency depreciation undermined fiscal consolidation efforts and limited the drop in total expenditure to 0.9 percentage points, from 20.0% of GDP in FY2022 to 19.1%.

Figure 2.20.4 Interest Rates and Inflation

The central bank raised its policy rate sharply as inflation accelerated.

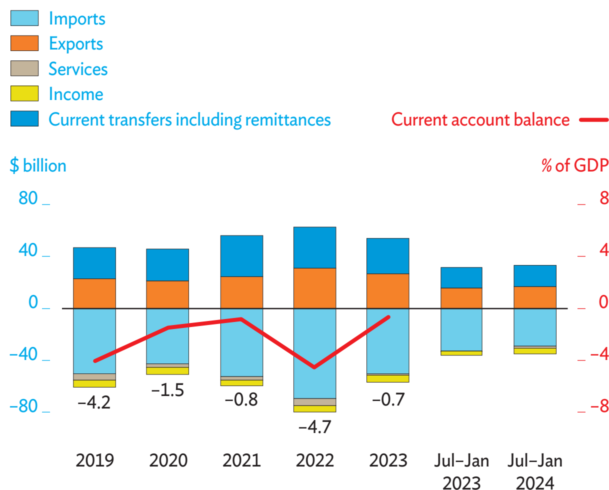


Sources: State Bank of Pakistan. Economic Data; Pakistan Bureau of Statistics. Monthly Review on Price Indices: February 2024.

Stringent import controls aimed at preventing the depletion of foreign exchange reserves slashed the current account deficit. The deficit fell by 87%, from 4.7% of GDP in FY2022 to 0.7% (Figure 2.20.5), despite declines in exports and workers' remittances. Imports of goods and services fell by 29.0% in FY2023 to $60 billion, as the central bank imposed restrictions on foreign exchange to curb rapid depletion of foreign reserves. Administrative restrictions on imports resulted in a scarcity of raw materials and intermediate inputs that, coupled with flood-related crop damage,

Figure 2.20.5 Current Account Components

The current account deficit shrank in 2023 following the imposition of strict import controls.



GDP = gross domestic product.

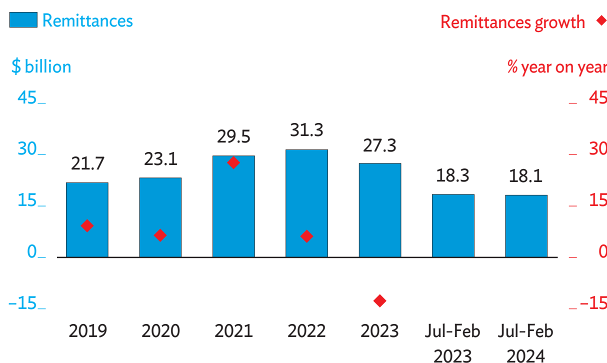
Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. Economic Data: External Sector. Summary Balance of Payments as per BPM6 - January 2024.

reduced exports. Efforts to manage the exchange rate led to the emergence of a parallel foreign exchange market with a substantial premium over the official exchange rate, prompting some inward remittances and proceeds from service exports to shift to the parallel market. Increased pressure on the currency from tightened foreign currency liquidity in the interbank market led to downgrades by credit rating agencies. Recorded workers' remittances fell by $4.0 billion to $27.3 billion in FY2023 (Figure 2.20.6).

Figure 2.20.6 Remittances

Remittances declined in 2023 as a parallel foreign exchange market emerged.



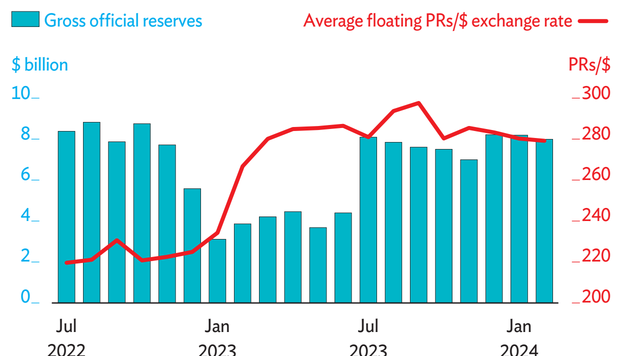
Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. Economic Data: External Sector. Worker's Remittances.

Foreign reserves declined to critically low levels as suspension of the ongoing International Monetary Fund (IMF) Extended Fund Facility (EFF) slowed official inflows. Despite the cut in the current account deficit, Pakistan's external financing requirements remained high because of large debt repayments. Securing adequate inflows to cover financing needs became a major challenge, as bilateral and multilateral inflows slowed with the suspension of the IMF EFF, requiring debt repayments to be financed largely by drawing down official reserves. Pakistan's access to world financial markets was further constrained by tight global financial conditions and rapid deterioration in its external position. Thus, gross foreign exchange reserves declined by more than half, from $9.8 billion at the end of FY2022 to $4.4 billion a year later. Reserves were restored in July 2023 with the start of a new short-term IMF Stand-By Arrangement (SBA) (Figure 2.20.7).

Figure 2.20.7 Gross Official Reserves and Exchange Rate

International reserves were restored with a short-term International Monetary Fund program in July 2023.



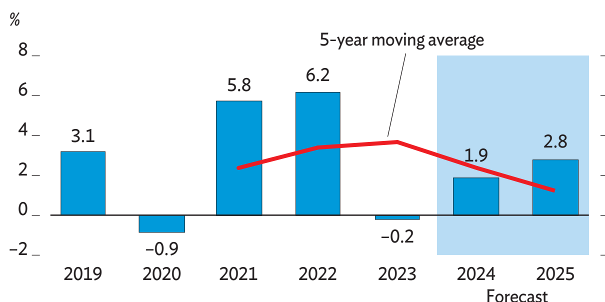
Source: State Bank of Pakistan. Economic Data.

Economic Prospects

Growth is projected to remain subdued in FY2024 and pick up in FY2025, provided economic reforms take effect. Real GDP is projected to grow by 1.9% in FY2024 (Figure 2.20.8), driven by a rebound in private sector investment linked to progress on reform measures and transition to a new and more stable government. An expansion in private consumption and a rise in workers' remittances from a move toward a market-determined exchange rate should buttress growth. However, low confidence,

Figure 2.20.8 Gross Domestic Product Growth

Growth is forecast to restart gradually in 2024 and improve slightly in 2025.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Pakistan Bureau of Statistics. National Accounts Tables Base FY2016: Table 5; Asian Development Bank estimates.

a surge in living costs, and the implementation of tighter macroeconomic policies under the IMF SBA will restrain domestic demand. In FY2025, growth is projected to reach 2.8% (Table 2.20.1), driven by higher confidence, reduced macroeconomic imbalances, adequate progress on structural reforms, greater political stability, and improved external conditions.

Table 2.20.1 Selected Economic Indicators, %

Growth will revive this year and accelerate next year, with inflation declining.

	2022	2023	2024	2025
GDP growth	6.2	−0.2	1.9	2.8
Inflation	12.2	29.2	25.0	15.0

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

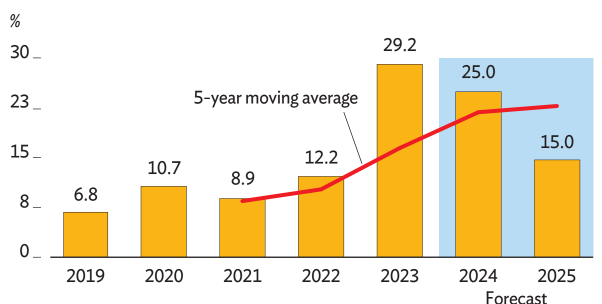
Sources: Pakistan Bureau of Statistics, National Accounts Tables (Base FY2016), Table 6; Pakistan Bureau of Statistics, Price Statistics, Monthly Price Indices (Base FY2016); Asian Development Bank estimates.

On the supply side, growth will be led by post-flood recovery in agriculture. Output will rise from a low base on improved weather conditions and a government package of subsidized credit and farm inputs that will support expanded area under cultivation and improved yields. Higher farm output will help expand manufacturing, which will also benefit from the increased availability of critical imported inputs. Large-scale manufacturing expanded in 3 of the first 6 months of FY2024. Higher crop output and some improvement in global growth are expected to support recovery in industrial output in the latter half of the year. Construction will remain weak due to elevated construction costs, higher tax rates on property transfers implemented in the FY2024 budget, and rationalization of public investment to consolidate the fiscal position. Growth in services is projected to strengthen in FY2024 as recovery in agriculture and industry benefit services.

Inflation will remain elevated at about 25.0% in FY2024, driven by higher energy prices, but is expected to ease in FY2025 (Figure 2.20.9). While improvement in food supplies and moderation of inflation expectations will likely ease inflationary pressures, further increases in energy prices envisaged under the IMF SBA are projected to keep inflation high. Headline consumer inflation increased to 28.0% in the first 8 months of FY2024, mainly from hikes in administered energy prices. Although improved supplies have tempered food inflation, it remains high, driven largely by rising prices for energy and inputs to agriculture. Core inflation also remains elevated, reflecting domestic recovery and the pass-through of upward adjustments in energy prices.

Figure 2.20.9 Inflation Outlook

Inflation is projected to decline this year and next.



Note: Years are fiscal years ending on 30 June of that year.

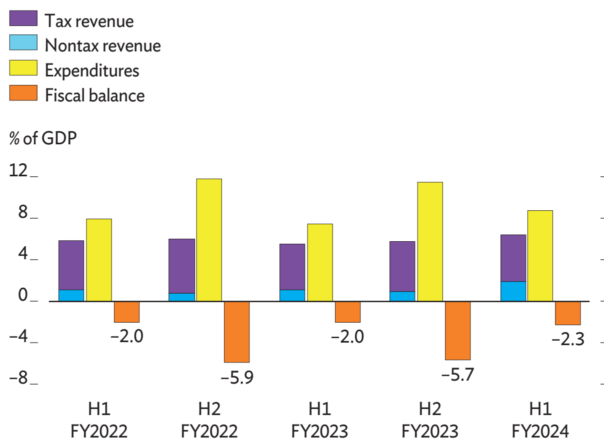
Sources: Pakistan Bureau of Statistics, Price Statistics: Monthly Review on Price Indices - February 2024; Asian Development Bank estimates.

Headline inflation is expected to decrease to 15.0% in FY2025 as progress on macroeconomic stabilization restores confidence. The central bank has maintained a tightened monetary policy, keeping the policy interest rate at 22.0% in response to persistent inflationary pressures and external imbalances. The central bank has committed to keeping an appropriately tight policy to lower inflation to its medium-term target range of 5%–7%.

The government projects significant fiscal consolidation in the medium term, supported by increased revenues and rationalized spending. The goal is to achieve a primary surplus of 0.4% of GDP and an overall deficit of 7.5% of GDP in FY2024, with both declining gradually in subsequent years. Considerable progress toward the goal occurred during the first half of the fiscal year, with a primary surplus of 1.7% of GDP and an overall deficit of 2.3% (Figure 2.20.10). Total revenue increased to 6.5% of GDP in the first half of FY2024 from 5.6% in the same period in FY2023, mainly from higher petroleum levy receipts and increased profit transfers from the central bank. Tax collection increased by 29.5%, as reforms in the personal income tax, higher taxes on property transfers, and the reintroduction of taxes on cash withdrawals from banks and the issuance of bonus shares raised direct tax collections. Revenue mobilization is expected to strengthen in the medium term, reflecting planned reforms to broaden the tax base. A rise in interest payments equal to 1.0% of GDP from higher interest rates boosted expenditure to 8.8% of GDP in the first half of FY2024 from 7.6% a year earlier. Fiscal consolidation will also benefit from plans to rationalize current expenditure.

Figure 2.20.10 Fiscal Indicators

Total revenue increased in H1 FY2024 due to higher tax and nontax revenue collections.



GDP = gross domestic product, H = half.

Note: Years are fiscal years ending on 30 June of that year.

Source: Ministry of Finance. Pakistan Summary of Consolidated Federal and Provincial Fiscal Operations 2022–23 and 2023–24.

The relaxation of import restrictions, coupled with economic recovery, is expected to widen the current account deficit. The current account deficit fell to $1.1 billion in the first 7 months of FY2024 from $3.8 billion in the same period in FY2023, as the merchandise trade deficit narrowed by 30.8% (Figure 2.20.11). Merchandise imports declined by 11.1% from weak demand growth, lower global food and fuel prices, and higher domestic production of cotton and wheat. Merchandise exports rose by 9.3%. However, imports are expected to expand during the year as domestic demand strengthens and stabilization of the currency market makes it easier for firms to import inputs. Thus, the current account deficit is projected to widen to 1.5% of GDP in FY2024. A transition toward a market-determined exchange rate is expected to encourage remittance inflows through official channels, thus enhancing the economy's resilience under future external shocks. However, Pakistan will continue to face challenges from substantial new external financing requirements and the rollover of old debt, exacerbated by tight global financial conditions.

Figure 2.20.11 Trade Balance

The merchandise trade deficit shrank in 2024 as exports increased while imports declined.

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. Economic Data: External Sector. Summary Balance of Payments as per BPM6 - January 2024.

The outlook is uncertain, with high risks on the downside. Political uncertainty that affects macroeconomic policy making will remain a key risk to the sustainability of stabilization and reform efforts. On the external front, potential supply chain disruptions from escalation of the conflict in the Middle East would weigh on the economy. With Pakistan's large external financing requirements and weak external buffers, disbursement from multilateral and bilateral partners remains crucial. However, these inflows could be hampered by lapses in policy implementation. Further IMF support for a medium-term reform agenda would considerably improve market sentiment and catalyze affordable external financing from other sources.

Policy Challenge—Closing a Financial Inclusion Gender Gap

Pakistan has one of the lowest financial inclusion rates for women in the world. While Pakistan's overall financial inclusion has improved, the gender gap in account ownership more than doubled over the past decade, reaching 32% in 2021. The World Data Lab estimates that, without immediate action, this gap will widen to over 42% by 2030. In a World Bank survey encompassing 135 economies, Pakistan ranked fourth lowest overall, and third lowest in Asia, on female financial inclusion. More than three out of every five Pakistani women remain unbanked.

Pakistani women face multiple barriers when accessing finance. On the demand side, low female labor force participation means that most women lack a steady income stream and are largely dependent on male family members for their financial needs. Social and religious traditions influence gender roles, with women viewed as homemakers rather than breadwinners. The absence of formal income and proper documentation makes it difficult for women to open and maintain standard bank accounts, as banks consider them high risk. Moreover, low literacy levels and insufficient financial education undermine women's ability to utilize formal banking channels and render them more susceptible to fraud. Rural women are further marginalized, as their access to banks is even more limited due to long distances and commute times.

On the supply side, expanding women's financial inclusion requires strong will and a prioritized push for legal and regulatory change. New rules must support gender-inclusive finance while easing persistent liquidity constraints in the sector. The central bank's Banking on Equality Policy is a monumental step in advancing women's financial inclusion. The Securities and Exchange Commission of Pakistan has also initiated significant steps toward refining the regulatory framework for nonbank finance companies, including microfinance institutions that traditionally target women in Pakistan.

Regulators should continue to play a critical role in providing an enabling regulatory environment. They should continue to influence action by financial service providers to promote gender-inclusive finance and incentivize the country's financial institutions to integrate a gender focus into the national financial services industry and widen access to digital financial services, including mobile banking, digital wallets, and banks on wheels. Financial institutions can also promote greater gender diversity at their access points and mandate more robust gender-disaggregated data collection and target setting. Commercial banks and fintech enterprises should continue to dedicate time and resources to better understand the needs of women customers and the strategic value of women's market, organize gender-sensitivity training for their staff, and design women-centric products and services.

Gender-inclusive opportunities for smaller enterprises and microfinance should be expanded further. This can involve credit guarantee schemes, export financing facilities, business development and financial literacy training, tax incentives to banks, and digitalized business registration processes. In addition, the sector would benefit from the continued growth of a gender bonds market to channel much-needed finance to women-owned businesses.