IPS/INS/039/2026-39

Institute of Policy Studies
Islamabad

September 03, 2026

IPS INSIGHTS
Perspectives On the Issues Shaping Policy

## IPS Economic Review

# Pakistan's Economy in Fiscal Year 2025-26: Macroeconomic Stabilization and the Challenge of Sustainable Growth

Zafar ul Hasan Almas[1] and Dr. Asim Ehsan[2]

### Executive Summary:

Pakistan's economic performance in FY2025-26 reflects notable macroeconomic stabilisation, but the underlying recovery remains fragile. Real GDP growth reached 3.7%, supported by agriculture, industry and services, while inflation averaged 7%. Fiscal consolidation was particularly significant, with the fiscal deficit declining from 5.4% to 2.6% of GDP, although the adjustment was driven predominantly by expenditure reduction rather than revenue mobilisation. External-sector pressures, however, intensified. The current account moved into a USD 138 million deficit as imports increased and exports declined, while remittances reached a record USD 41.6 billion and helped support foreign-exchange reserves. FDI also fell substantially, highlighting continued weaknesses in investment attractiveness. The review, therefore, cautions that FY2027's key challenge is not simply achieving higher growth, but sustaining growth without renewed foreign-exchange stress. Durable recovery will require stronger exports, productive investment, revenue reforms and reduced dependence on external financing.

### Key Takeaways:

1. **Macroeconomic stability has improved but remains fragile**

Pakistan achieved notable stabilisation in FY2025-26, with GDP growth reaching 3.7%, inflation averaging 7%, and the fiscal deficit falling sharply to 2.6% of GDP. However, the recovery remains vulnerable to internal and external shocks, indicating that short-term stability has yet to translate into durable economic resilience.

2. **Fiscal consolidation has been significant but largely expenditure-driven**

The sharp reduction in the fiscal deficit represents a major achievement, but it was primarily achieved through expenditure compression rather than stronger revenue mobilisation. Continued reliance on expenditure cuts, particularly development spending, could constrain investment and undermine the foundations of future growth.

3. **Economic growth is recovering but productive capacity remains weak**

[1] Former Joint Chief Economist and Senior Research Associate, IPS
[2] Senior Research Officer, IPS

Growth was supported by agriculture, industry and services, while private investment also showed improvement. Nevertheless, the low investment-to-GDP ratio, continued weakness in large-scale manufacturing and modest **agricultural** performance indicate that the recovery has not yet generated sufficient expansion in the economy's productive capacity.

**4. The external sector remains the economy's critical vulnerability**

The current account moved back into deficit as imports increased and exports declined. Although record remittances and higher foreign-exchange reserves provided support, weak exports, declining FDI and continued dependence on external inflows leave Pakistan exposed to renewed balance-of-payments pressures.

**5. The central challenge is to transform stabilisation into export-led sustainable growth**

The FY2025-26 experience demonstrates that achieving higher GDP growth alone is insufficient. Pakistan needs to strengthen exports, attract productive investment, improve revenue mobilisation and reduce excessive reliance on consumption and remittances. The key challenge for FY2027 is, therefore, to sustain economic growth without recreating the foreign-exchange constraints that have repeatedly destabilised the economy.

## Overview:

The developments in the outgoing fiscal year 2025-26 were seemingly encouraging as twin deficits were manageable with unprecedented level of fiscal consolidation, nearly balanced current account with accretion of forex reserves that provided stability in the exchange rate. Economic growth was approaching 4 percent, and average inflation was below target. All three major sectors of the economy contributed to the revival of growth. This appears to be a very pleasant development on the economic front.

Nevertheless, the outlook for the year just begun seems murky with uncertainties on external and internal fronts. Pakistan's external account remains precarious, as usual. The 'improvement' is driven entirely by remittances, rather than by exports or FDI (both are stagnant or have declined). The former drives consumption while the latter two drive production. Also, half of our reserves are a result of rolled-over loans from friendly countries, which is a source of uncertainty. SBP kept buying from the open market, creating additional demand for it while also maintaining the rupee's value against the USD to keep the PKR apparently overvalued. The economy remained just one external shock away from the June 2022 level and, therefore, needs a substantial amount of forex inflows from various external sources.

The central economic challenge for FY27 is, therefore, not simply whether Pakistan can grow by more than 4 percent. It is whether the country can sustain that growth without once again exhausting the foreign exchange required to finance it. Exports are not growing and are below their FY22 level. The prolonged import compression has also kept them under duress.

The developments during the outgoing fiscal year are narrated below;

## Economic Growth:

- ***Real GDP*** recorded the highest growth in the last 4 years at 3.7% in FY 2025-26, up from 3.2% last year, reflecting continued macroeconomic stabilization and recovery across key sectors of the economy in relatively lower inflation.

**Table-01: Sectoral Contribution to the GDP growth (% Points)**

| Sector | 2021-22 | 2022-23 | 2023-24 | 2024-25 | 2025-26 |
|---|---|---|---|---|---|
| **Agriculture** | **1.0** | **0.5** | **1.5** | **0.4** | **0.7** |
| **Industry** | **1.3** | **-0.7** | **-0.2** | **1.0** | **0.6** |
| **Manufacturing** | 1.3 | -0.7 | 0.4 | 0.2 | 0.8 |
| **Services** | **3.9** | **0.0** | **1.3** | **1.8** | **2.4** |
| **Real GDP (Fc)** | **6.2** | **-0.2** | **2.6** | **3.2** | **3.7** |

*Source: Pakistan Bureau of Statistics.*

- The agriculture sector, which was threatened by floods at the start of the fiscal year, grew by 2.9%. Although growth is primarily driven by livestock, with support from positive contributions from crops.
- The industrial sector registered a growth of 3.5%, reflecting improved performance in subsectors like manufacturing, construction, and mining & quarrying activities.
- The services sector expanded by 4.1%, primarily driven by wholesale & retail trade, government services, financial sector, etc.

## Investment and Savings:

- The investment-to-GDP ratio was recorded at 14.4%, fractionally down from last year. The national saving-to-GDP ratio stood at 14.1%, lower than 14.9% in the previous year, while domestic saving was recorded at 7% of GDP. Real growth in private investment across different sectors is given in the table below:

**Table 02: Real Growth in Private Investment**

| | 2020-21 | 2021-22 | 2022-23 | 2023-24 | 2024-25 | 2025-26 |
|---|---|---|---|---|---|---|
| **Private Investment Total** | 1.5 | 2.1 | -14.2 | 2.8 | 7.5 | 8.6 |
| Agriculture | 4.8 | 4.2 | -3.2 | 5.7 | 0.6 | 2.6 |
| Manufacturing (Large-Scale) | 0.3 | -5.9 | -23.0 | -7.2 | -0.5 | -4.0 |
| Manufacturing (Small-Scale) | -4.6 | 0.4 | -28.3 | -15.2 | 17.8 | 18.2 |
| Construction | -19.1 | 10.7 | -53.3 | 23.2 | 45.8 | 60.7 |
| Wholesale and Retail Trade | 2.4 | -17.8 | -35.5 | 6.4 | 39.3 | 56.1 |
| **Information Technology** | -45.1 | 27.3 | -66.9 | -3.4 | 12.4 | 101.5 |
| **Finance & Insurance** | 9.5 | -9.9 | -4.1 | 26.0 | 34.1 | 8.5 |
| **Mining** | -44.7 | 11.7 | 42.5 | 14.8 | -3.0 | 11.7 |
| **All Others** | 10.1 | 5.9 | -9.1 | 2.8 | 5.8 | 3.4 |

*Source: State Bank of Pakistan.*

## Agriculture:

- Agriculture continued its weak performance and 0.5 percentage points out of 0.7 percentage points (over 80%) of agriculture came from an increase in value addition by livestock, which complemented the paltry increase in crop output. Major crops like cotton and maize witnessed a decline owing to the adverse impact of floods. On the other hand, production of sugarcane and rice increased during the last year. Both crops benefitted from higher yields, but the cultivated area has increased in the case of sugarcane, while that of rice has decreased.
- The flood-related crop losses have not cost much, partly due to a coordinated flood response in the affected districts and the temporary nature of the flash floods.

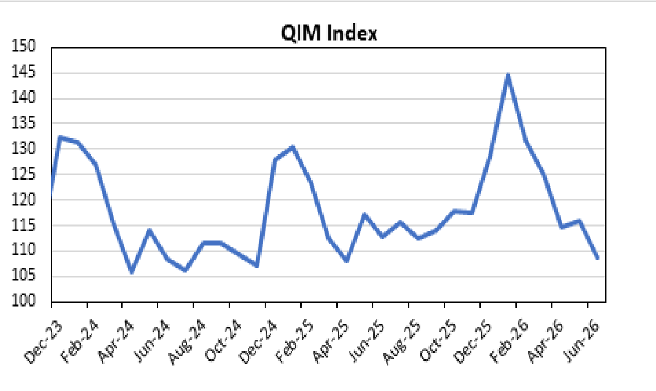
## Manufacturing:

- ***Large-Scale Manufacturing*** grew by 6.1% after showing three years of persistent contraction. Major contributions came from automobile, coke & petroleum products, cement and apparel.
- The growth in the automobiles is primarily driven by rising domestic demand, relative price stability owing to promotional discounts and launch of new variants especially by Chinese brands. The growth in textiles and wearing apparel has been persistent performer for the last few years and the new factor

of lower US tariffs also helped. Cement and petroleum were beneficiaries of the surge in economic activity.

- The bad news about LSM is that its index is continuously declining for the last 6 months which does not augur well for LSM growth in the coming year.

**Graph 01: QIM Index**




## Inflation:

- ***Inflation*** remained below the target of 7.5% and average CPI inflation stood at 7% compared to 4.5% last year. However, the year ended at 11.1% inflation. Food inflation took the major hit and stood at 4.7% while non-food inflation stood at 8.8%. Over the last three months, the contagion from the Iran-US standoff caused the inflation to rise above the double-digit level after almost 20 months.

- ***Food inflation*** remained subdued for the last two years and now it has bounced back. The main push for inflation came from the non-food side. Food and energy remained the primary drivers of inflationary pressure, and the situation in the Middle East continues to pose a significant challenge to the external sector.

**Table 03: CPI Inflation (%)**

| | July-June | | | | |
|---|---|---|---|---|---|
| | 2021-22 | 2022-23 | 2023-24 | 2024-25 | 2025-26 |
| **CPI National** | **12.2** | **29.2** | **23.4** | **4.5** | **7.0** |
| Food | 13.3 | 39.0 | 21.9 | 0.6 | 4.7 |
| Non-Food | 11.3 | 22.0 | 24.7 | 7.7 | 8.8 |
| Energy | 25.2 | 38.6 | 48.2 | 3.4 | 12.1 |
| Core | 8.4 | 17.9 | 17.9 | 9.2 | 7.7 |
| **CPI Urban** | **11.8** | **26.8** | **24.1** | **5.3** | **7.1** |
| Food | 13.4 | 37.6 | 22.1 | 1.6 | 4.2 |
| Non-Food | 10.8 | 20.1 | 25.5 | 7.9 | 9.0 |
| Energy | 25.4 | 38.4 | 62.6 | 6.1 | 13.4 |
| Core | 8.1 | 16.2 | 16.1 | 8.5 | 7.4 |
| **CPI Rural** | **12.6** | **32.6** | **22.5** | **3.3** | **6.9** |
| Food | 13.0 | 43.1 | 20.3 | -1.2 | 5.4 |
| Non-Food | 12.3 | 26.1 | 23.0 | 7.1 | 8.4 |
| Energy | 24.8 | 40.6 | 24.6 | -2.9 | 9.1 |
| Core | 9.0 | 21.7 | 22.4 | 10.7 | 8.2 |

*Source: Pakistan Bureau of Statistics*

## Fiscal Developments:

- An extraordinary fiscal adjustment took place during the year, which is unprecedented in the history of the country. Fiscal deficit nosedived from 5.4% of GDP last year to 2.6% in the outgoing year.

- The entire adjustment has come from the expenditure side and the contribution of revenue to this adjustment is negative. An earlier IMF study on fiscal adjustments in emerging markets found that: expenditure-cut-based consolidations raise the probability of approaching and achieving fiscal sustainability but are often insufficient to maintain it unless paired with revenue reforms.

- In the case of Pakistan, revenues actually went down by 0.2 percentage points and expenditures went down by 3 percentage points. In this way, the fiscal deficit went down by 2.8 percentage points. This kind of adjustment has not been observed in any developing country.

- In the current year (FY 2027) again the main focus of the adjustment is on the expenditure side, and especially the development expenditure. This will be counterproductive for growth.

**Table 04: Consolidated Fiscal Operations**

| Item | July-June | | % Change | As % of GDP | |
|---|---|---|---|---|---|
| | 2024-25 | 2025-26 | | 2024-25 | 2025-26 |
| **Total Revenues** | **17,997** | **19,774** | **9.9** | **15.8** | **15.6** |
| Tax Revenue | 12,723 | 14,219 | 11.8 | 11.2 | 11.2 |
| Non-Tax Revenue | 5,275 | 5,555 | 5.3 | 4.6 | 4.4 |
| **Total Expenditure** | **24,166** | **23,087** | **-4.5** | **21.2** | **18.2** |
| Current expenditure | 21,529 | 20,686 | -3.9 | 18.9 | 16.3 |
| Dev. Expenditure | 2,966 | 3,254 | 9.7 | 2.6 | 2.6 |
| Net Lending & Statistical Discr. | -346 | -968 | -179.5 | -0.3 | -0.8 |
| **Federal Fiscal Balance** | **7,089** | **4,763** | **-32.8** | **6.2** | **3.8** |
| Provincial Surplus | 921 | 1,450 | 57.3 | 0.8 | 1.1 |
| **Overall Fiscal Balance** | **6,168** | **3,313** | **-46.3** | **5.4** | **2.6** |
| **Primary Balance** | **2,719** | **3,634** | **33.6** | **2.4** | **2.9** |

*Source: Finance Division*

## Public Debt:

- ***Total public debt*** stood at Rs 86.7 trillion by the end of June 2026–with domestic debt standing at Rs 59.4 trillion and external debt at Rs 24.2 trillion (including all liabilities, including IMF obligations and deposits, etc., the figure is Rs 38.6 billion). Total debt and liabilities have touched Rs.100 trillion.

## External Sector:

- The ***current account*** posted a deficit of USD 138 million, compared to a surplus of USD 1.8 billion last year.

- The merchandize trade deficit surged to USD 33.6 billion against USD 26.8 billion in the previous year, driven by a 9% increase in imports as domestic economic activity picked up, but the 4.6% contraction in exports also played a role in the widening of the trade imbalance.

| Table 05: Causative Factors of CAD (USD Million) | | |
|---|---|---|
| | Jul-June | |
| | 2025-26 | % Cont. |
| **CAD Deterioration** | **-1,977** | **100** |
| **Negative Contributions** | **-7,459** | |
| **Trade Balance Deterioration** | **-6,820** | **-345** |
| o/w Increase in Imports (Goods) | -5,320 | -269 |
| o/w Decrease in Exports (Goods) | -1,500 | -76 |
| Increase in Imports (Services) | -639 | -32 |
| **Positive Contributions** | **5,482** | |
| Income Account Improve | 400 | 20 |
| Increase in Exports (Services) | 1,584 | 80 |
| **Current Transfers Improv.** | **3,498** | **177** |
| o/w Increase in Remittances | 3,285 | 166 |

Source: SBP

- The merchandize ***trade deficit*** surged to USD 33.6 billion against USD 26.8 billion in the previous year, driven by a 9% increase in imports as domestic economic activity picked up, but the 4.6% contraction in exports also played a role in the widening of the trade imbalance.

- The ***services trade account deficit***, on the other hand, narrowed by almost USD 1 billion from USD 1.8 billion in the previous year, primarily driven by higher export growth (26.7%) on the back of a 19.8 percent increase in IT exports. Services imports also increased by 5.7%.

- ***Remittances*** reached an all-time high at USD 41.6 billion and showed sustained growth of 8.6%.

- On the financing side, ***Financial Account*** recorded a net inflow of USD 1.3 billion, which is 23.8% lower than a net inflow of USD 1.7 billion last year. Both debt-creating and non-debt-creating inflows witnessed a contraction.

- On the ***non-debt-creating-inflows, FDI*** shrank by a massive 47.8% and reached its second-lowest inflow (USD 1.3 billion) in a decade with the lowest being in FY2023, at USD 670 million. Pakistan has to pay back the Eurobond due to maturity which contributed to a net outflow of portfolio investment by USD 1.1 billion.

- ***Official loan disbursement*** was also 10% lower but, despite of 11% lower amortization payments, net inflows remained low.

- ***Foreign exchange reserves*** rose by USD 3.8 billion mainly because of net inflow of USD 1.8 billion from the IMF and some private inflows and stood at USD 19.7 billion by the end of June 2026.

- SBP had to launch open market purchases of around USD 9 billion that helped increase reserves to USD 18 billion and compensate lower FDI and exports. These purchases have kept the rupee's value low due to mopping up of dollars.

- The ***exchange rate*** remained broadly stable and averaged at Rs 281.1/USD for FY2026 which represents a slight depreciation of 0.4% from FY2025. This prolonged stability in exchange rate is contributing to growing confidence in the external sector.

**Imports:**

- Surge in imports has become a serious issue especially when looking into its composition. Table-3 suggests that 37%

of the increase in imports is attributable to consumer durables and another 18% from food imports. Raw material imports have contributed 21% of additional imports.

- Global POL price has provided much needed relief as POL imports have decreased in dollar terms in the first half but, owing to the uncertain situation in the Gulf, this surged by 5% and its share in the increase in imports rose to 18%.

**Table 06: Increase in Imports during FY2026**

| | July-June | | Increase in Imports | % Contr. in Increase | |
|---|---|---|---|---|---|
| | 2024-25 | 2025-26 | % Change | | |
| Total Imports | 64,507 | 69,761 | 8.1 | 5,254 | 100.0 |
| Food Group | 8,195 | 9,151 | 12.0 | 955 | 18.2 |
| Pulses | 1,016 | 832 | -18 | (184) | (3.5) |
| Palm Oil | 3,394 | 3,786 | 12 | 392 | 7.5 |
| Machinery Group | 8,814 | 9,031 | 2.5 | 217 | 4.1 |
| Elect. Machinery & Appl. | 3,898 | 2,919 | -25.1 | (980) | (18.6) |
| Power Generating Mach. | 689 | 797 | 15.8 | 109 | 2.1 |
| Textile Machinery | 526 | 581 | 10.5 | 55 | 1.0 |
| Consumer Durables | 3,842 | 5,774 | 50.3 | 1,932 | 36.8 |
| Mobiles Phone | 1,493 | 1,889 | 26.6 | 396 | 7.5 |
| Road Motor Vehicles | 2,349 | 3,885 | 65.4 | 1,536 | 29.2 |
| Textile Group | 7,356 | 6,462 | -12.2 | (894) | (17.0) |
| Raw Cotton(M.MT) | 2,694 | 1,528 | -43.3 | (1,165) | (22.2) |
| Raw Materials | 7,962 | 8,790 | 10.4 | 1,131 | 21.5 |
| Plastic Material | 2,627 | 2,863 | 9 | 236 | 4.5 |
| Iron & Steel Scrap | 1,833 | 1,971 | 8 | 447 | 8.5 |
| Iron & Steel | 2,297 | 2,605 | 13 | 302 | 5.8 |
| Medicinal Products | 1,205 | 1,351 | 12 | 146 | 2.8 |
| Petroleum Products | 15,944 | 16,863 | 5.8 | 19 | 17.5 |
| Petroleum Products (M.MT) | 5,966 | 6,386 | 7.0 | 420 | 8.0 |

| | | | | | |
|---|---|---|---|---|---|
| Petroleum Crude (M.Barrels) | 5,446 | 7,166 | 31.6 | 1,720 | 32.7 |
| LNG | 3,476 | 2,221 | -36.1 | (1,255) | (23.9) |
| Others | 12,393 | 13,691 | 10.5 | 995 | 18.9 |

*Source: PBS*

- Exports plunged by 5.9% and non-textile exports crashed by 13.8%. Pakistan's main export, rice, decreased by 31.7%. Although this was a price shock at the global level, even volume fell by 26%. The foreign exchange loss from the fall in rice exports was USD 1.1 billion.

- Textile sector managed to grow marginally in the fiscal year 2025-26. However, the value-added sector felt the impact of the global price decrease and, except for readymade garments, other value-added sectors could not perform well. Raw material imports for textiles, such as raw cotton, plunged significantly which hint at weak export performance of the sector in the ongoing year, as well. Petroleum exports increased by 36%.

**Table 07: Group-wise Increase in Exports**

| | | | | $ Million |
|---|---|---|---|---|
| | Particulars | **July-June** | | **Change** |
| | | **2024-25** | **2025-26** | **(%)** |
| **A. Food Group** | | **7,117** | **5,018** | **-29.5** |
| | Rice | 3,353 | 2,292 | -31.7 |
| | Meat and Meat Prep. | 495 | 530 | 7.1 |
| **B. Textile Group** | | **17,887** | **17,933** | **0.3** |
| | Cotton Yarn | 681 | 765 | 12.4 |
| | Cotton Cloth | 1,809 | 1,672 | -7.5 |
| | Knitwear | 5,010 | 4,966 | -0.9 |
| | Bed Wear | 3,113 | 3,113 | 0.0 |
| | Readymade Garments | 4,129 | 4,288 | 3.9 |
| | Synthetic | 400 | 353 | -11.5 |
| **C. Petroleum Group** | | **573** | **779** | **35.8** |
| **D. Other Manufacturer** | | **4,228** | **4,074** | **-3.6** |
| | Chemicals & Pharma. Pro. | 1,574 | 1,375 | -12.6 |
| | Engineering Goods | 409 | 432 | 5.6 |
| | Cement | 330 | 343 | 4.0 |
| | Leather Products | 711 | 706 | -0.7 |
| **E. All Other Items** | | **2,236** | **2,335** | **4.5** |
| | **Total** | **32,040** | **30,139** | **-5.9** |
| | **Excluding Textile** | **14,153** | **12,206** | **-13.8** |
| | Share of Textile | 55.8 | 59.5 | |
| | Share of Non-Textile | 44.2 | 40.5 | |

### Foreign Direct Investment:

- Net ***foreign direct investment (FDI)*** has decreased by 32% during fiscal year 2025-26 from USD 2,477 million last year to USD 1,672 million this year. Around 96% of this FDI came from China (USD 862 million), Hong Kong (USD 339 million), Switzerland (USD 205 million) and UAE (USD 236 million). Two sectors power sector and financial business attracted USD 958 million and USD 805 million whereas telecommunication along witnessed outflow of USD 500 million. Important to note that within FDI in power sector USD 463 million went to coal sector at a time when entire world is moving out of it and hardly any country is offering foreign investment in this sector.
- Total foreign investment, comprising FDI, portfolio investment, and foreign public investment, declined by 74 percent, or USD 1.295 billion, during FY26. Total foreign investment stood at USD 451 million in the last fiscal year, compared to USD 1.746 billion in FY25.

### Conclusion:

FY2025-26 represents an important phase of macroeconomic stabilisation for Pakistan. The reduction in the fiscal deficit, moderation of inflation, recovery in GDP growth and accumulation of foreign-exchange reserves provide evidence of improved short-term stability. However, the review demonstrates that stabilisation has not yet translated into a sufficiently strong and self-sustaining economic recovery.

The principal concern is the quality and sustainability of growth. Weak exports, declining FDI, low investment, rising consumption-oriented imports and continued reliance on remittances and external financing leave the economy vulnerable to external shocks. Fiscal consolidation has also relied heavily on expenditure compression rather than structural revenue reform, potentially constraining development and future productive capacity.

The policy priority for FY2027 should, therefore, be moving beyond preserving macroeconomic stability and towards building the productive foundations of sustainable growth. Export diversification, investment mobilisation, revenue reform, productivity enhancement and a healthier balance between consumption and production will be essential to avoid repeating the cycle of stabilisation followed by renewed external-sector stress.