



STAGNATION TO SUSTAINABILITY? CHARTING PATHWAYS FOR A TRANSFORMING ECONOMY

Pakistan's current economic landscape is defined by urgent realities that need to be addressed immediately. While growth has returned, it remains fragile, poverty is rising, and debt servicing increasingly crowds out development. Rapid population expansion, escalating climate vulnerabilities, and severe air pollution impose heavy economic costs. Furthermore, child labour threatens future productivity, energy reforms remain incomplete, and export competitiveness requires vital structural interventions, underscoring that economic stability alone is insufficient without inclusive growth.

These contemporary challenges compound historical constraints. Since independence, political instability, weak institutions, and low productivity have persistently hindered sustainable progress, added to which recent external geopolitical shocks exacerbate this fragility. Ultimately, these intersecting domestic and global pressures weaken macroeconomic stability, severely complicating Pakistan's pathway toward sustainable development. Considering these challenges, IBA's upcoming State of the Economy Report will chart the pathways to transform the economy from one of stagnation toward a more sustainable future.

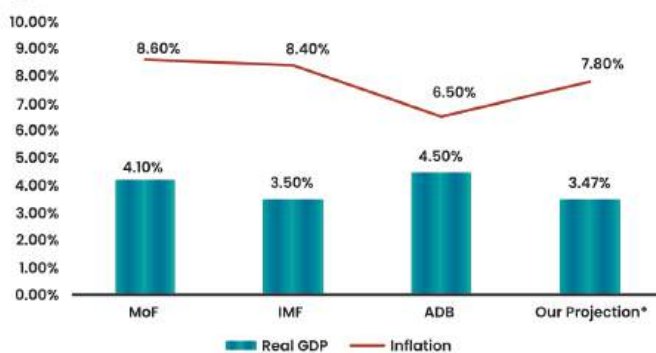
STATE OF ECONOMY 2025-26

- During the current fiscal year 2025-2026, Pakistan's economy reported a provisional growth rate of 3.70%, with the total size of the economy surpassing \$450 billion. Based on population estimates from the 2023 Census, per capita income has increased to Rs 533,629, or \$1,901.
- During FY26 provisionally, agriculture grew at a rate of 2.89%, industry grew by 3.51%, with large-scale manufacturing emerging as the top performer, the country's largest economic sector, services, grew by 4.09%.

FUTURE LANDSCAPE OF THE ECONOMY

- For the past three years, Pakistan's economy has been in a state of stagnation. Although this period was marked with significant challenges in terms of our economic activities, the recent numbers suggest that stability has returned. However, international oil prices have increased due to the supply shock caused by the conflict in West Asia. According to the IMF's most recent assessment, Pakistan's economy will face more difficulties because of the conflict.
- Our baseline estimates for real GDP growth in FY27 would be 3.47 percent, while average inflation stays high at 7.8 percent. This forecast is based on the situation remaining peaceful and the ceasefire remaining in place for the upcoming year. It is assumed further that energy supplies would take a full year to reach pre-war levels.

Figure 1: Real GDP Growth & Inflation- Forecast



Source: IMF Report 2026, ADB Report, Finance Ministry
*Based on Author's estimates- Dynamic VAR Forecast

IMF PROGRAMS AND FISCAL PRIORITIES

- IBA's study finds that macroeconomic performance tends to deteriorate during IMF-supported periods. Average real GDP growth declined to 4.09% during IMF years, compared to 5.53% in non-IMF periods, while industrial growth fell from 6.68% to 4.41%. At the same time, inflation increased to 8.33%, unemployment rose to 5.5%, and interest rates averaged 10.94% during IMF engagements, indicating weaker economic conditions under stabilization programs.
- The fiscal analysis reveals a major shift in expenditure priorities under IMF programs. Development expenditure declined from 6.07% of GDP in non-IMF years to 4.42% during IMF periods, while current expenditures, particularly debt servicing, rose sharply. Debt servicing accounted for nearly 45% of total expenditure in 2024, whereas PSDP spending fell to nearly 5% of total expenditure, demonstrating how fiscal adjustment increasingly crowds out long-term development investment.

The study highlights the social consequences of prolonged stabilization policies. Poverty increased to 28.9% in 2025 during continued IMF-supported adjustment periods, while inequality rose substantially, with the Gini coefficient increasing from 28.4 in 2019 to 32.7 in 2025, suggesting that fiscal tightening, indirect taxation, and reduced development spending disproportionately affected lower- & middle-income groups.

THE NATIONAL TARIFF POLICY 2025-30

- The findings in terms of the correlation between selected variables suggest that the East Asian economies have achieved rapid growth through export-led strategies and tariff liberalization, while Pakistan's reliance on high import tariffs for domestic protection has hindered its global competitiveness and economic output.
- Pakistan's National Tariff Policy (NTP) 2025-30 marks a strategic pivot to rationalize import tariffs, aiming to lower domestic production costs and foster a competitive business environment and pursue sustainable economic growth by aligning the tariff policy with successful counterparts like Vietnam.
- The NTP will drastically reduce the difference in import tariffs between Pakistan and Vietnam across highly import-dependent industries, including transportation vehicles, iron and steel, and machinery, thereby lowering the broader costs of doing business.

MESSAGE

Some information from this year's Pakistan Economic Survey FY26 (PES26) stands out, showing particularly disturbing trends. Pakistan's poverty rate now stands at 28.9% of the population. These figures in the PES26 are for 2024-25, which show an increase in the number and proportion of those living in poverty rising from 21.9% in 2018-19, a mere six years ago. In terms of numbers, if we assume that the poverty rate has remained the same as it was in 2024-25, more than 72 million people currently live in poverty in Pakistan today. It is worth adding that given current birth rates, Pakistan is destined to have 390 million people in 2050 and be the third most populous country in the world.



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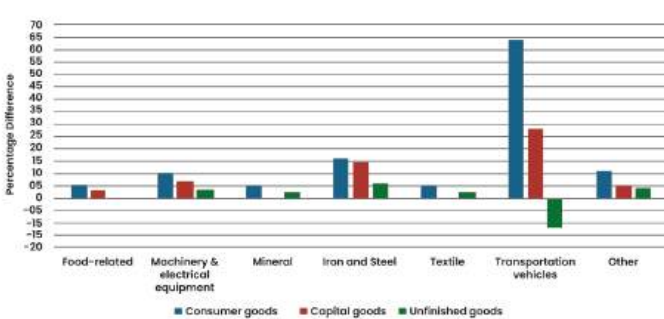
Pakistan was ranked the world's "most polluted country", clearly as ignominious a distinction as being the worst in the world amongst 148 countries reporting data according to the Global Gender Gap Report 2025. The PES26 shows that unemployment as reported by the Government of Pakistan is the highest in twenty-one years, with 5.9 million unemployed. Moreover, the highest unemployment is amongst Pakistan's youth, those aged 15-29. One should add that even for those who are fortunate enough to have a job, the real wages of workers have fallen by almost 20% in the last three years. Finally, the PES26 reveals that government education spending has halved in the last two years and is a mere 0.8% of GDP, the lowest in this region and substantially below the 4-6% recommended by UN agencies.

One can clearly triangulate just these sets of very elementary and basic data - population growth, poverty, unemployment, women's social and economic status, education - and can underscore how precarious Pakistan's current predicament and future prospects look like. Without substantial social, economic and human development, Pakistan will continue to fall further in global Human Development Index rankings, falling from 161st in 2020-21 to 168th in 2025.

These very basic facts and figures speak volumes. They disclose what those in power prioritise and what they constantly ignore and shy away from. Pakistan's political economy is built on opportunistic alliances and immediate gratification and on extracting rents. Investment as a percentage of GDP is the lowest since 1972-73! Pakistan's basic economic and social indicators have been in decline for decades, both compared to other countries in the region and even to its own historical trends. A dismal situation continues to worsen, yet those who have power focus primarily on self-interest and their own benefits. It is not difficult to see where Pakistan is heading.

- Despite the NTP's reductions, problematic cascading tariffs will persist, with consumer goods facing higher import duties than unfinished goods. This structure protects domestic output markets and inadvertently compels firms to produce for the domestic market instead of increasing participation in the export markets.
- To truly capitalize on the NTP, Pakistan must implement complementary structural reforms. Improving competitive energy pricing, bringing in land reforms, enhancing logistical infrastructure, and the broader regulatory environment is essential to transform the economy from stagnation to one that is characterized by sustainable economic growth.

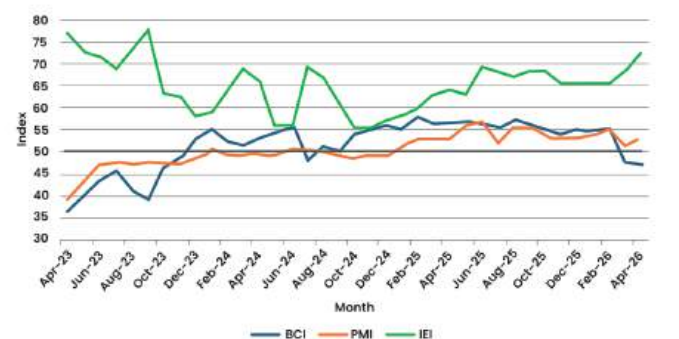
Figure 2: Difference in weighted average tariff rate applied on imports into Pakistan and Vietnam by Major HS Sections and Product Categories at start of NTP. Source: World Bank's World Integrated Trade Solution and NTP 2025-30



INSIGHTS FROM THE IBA-SBP BUSINESS CONFIDENCE SURVEY

- BCI (Business Confidence Index), which is the average of CBCI (Current Business Confidence Index) and EBCI (Expected Business Confidence Index), was negative for most of 2023. It became positive by the end of 2023 and remained there from then until the start of the US-Iran conflict in March 2026. EBCI has almost always performed more positively than CBCI.
- Other than BCI, the current employment index and the PMI (Purchasing Manager Index) have both been negative for most of 2023. They plunged to their lowest level in mid 2023 and recovered close to positive levels in early 2024. They continued to remain positive in 2025, suggesting improvement in business confidence. The business community felt less confident about their hiring and their purchases, suggesting poor business prospects in the economy for most of 2023. However, there were some signs of recovery around the general election period in 2024. The conditions improved towards the end of 2024 and continued into 2025, till the start of the US-Iran conflict.
- CEI (Current Employment Index) and EEI (Expected Employment Index) have maintained sustained positive momentum since late 2024, moving in tandem with broader business confidence and indicating an overall recovery in economic activity. Meanwhile, IEI (Inflation Expectations Index) initially moved inversely to these growth metrics but has recently surged while other indicators decreased, signaling the business community's anticipation that rising costs and geopolitical conflicts will drive up future prices.
- LSMI (large scale manufacturing index) and the trading activities from Pakistan performed relatively poorly in 2023, showed signs of improvement towards the end of 2023 and as the general elections in 2024 approached. However, the levels remained steady throughout much of 2024 with improvements in their levels towards the end of it. Later, the LSMI index once again remained stable most of 2025, with an upward trend towards the end of it. Imports of goods and services increased in 2025 over the level in 2024, however exports have been relatively stable with little volatility in 2025. This suggests that BCI does well in explaining the economic trend in Pakistan as it correlates well with the trend in LSMI index and exports, particularly in explaining the economic conditions as Pakistan recovers from one of its most daunting economic challenges in recent history.
- Considering the BCI at the industry-level, the average BCI prior to the conflict in FY26 was above 54 in FY26 in the five selected industries prior to the start of the US-Iran conflict, indicating a positive level of confidence across them. However, the confidence plunged after the start of the conflict, suggesting that the business confidence is highly sensitive to geopolitical volatility in the region.

Figure 3: Recent trend in selected indicators suggesting the level of confidence in the economy



Source: IBA-SBP Business Confidence Survey

DISTRIBUTED SOLAR GROWTH

- Weak planning, poor coordination, and insufficient regulatory oversight are exacerbating system inefficiencies, increasing electricity prices, and undermining the overall performance of the power sector.
- Electricity prices are significantly inflated by taxes, levies, surcharges, and inefficient cost structures, placing a heavy burden on consumers while weakening industrial competitiveness and slowing economic activity.
- Higher prices of electricity are accelerating the shift toward rooftop solar and other self-generation options, as consumers seek more affordable and reliable alternatives to grid supply.
- By June 2025, Pakistan had 6,680 MW of on-grid solar capacity, of which 5,900 MW (88%) came from rooftop systems, underscoring the rapid rise of distributed generation over utility-scale solar (780 MW).
- Declining grid consumption is leaving installed 'Take or Pay' generation capacity underutilized, increasing per-unit costs, straining cost recovery, and heightening the risk of a utility "death spiral."
- Rooftop solar presents both operational challenges and strategic opportunities; with effective policy, better planning, targeted investments, and grid modernization, it can be transformed into a net benefit for both consumers and the overall power system.

RISING POVERTY

- Sharp reversal in poverty trends: National poverty has risen significantly to 28.9%, with nearly 15 million additional people falling below the poverty line, reversing earlier gains and revealing heightened vulnerability to economic shocks.

Inflation as the primary driver of poverty: Rising prices, especially for energy and essential goods, have emerged as the main channel through which macroeconomic instability and external shocks translate into increased poverty.

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- Worsening inequality and poverty intensity: Poverty is deepening alongside rising incidence, with pronounced rural-urban disparities and a growing share of households falling into extreme and ultra-poor categories.
- Critical role of social protection (BISP): The Benazir Income Support Programme remains central to mitigating poverty, but requires higher transfers, expanded coverage, and inflation-indexed adjustments to remain effective in a high-inflation environment.
- Enhanced BISP support: The chapter recommends increasing the monthly stipend to Rs. 6,000 and allocating approximately Rs. 950 billion for FY2026-27 to ensure adequate support, maintain purchasing power amid inflation, and expand coverage to newly

AIR POLLUTION

- Pakistan's major cities rank among the most polluted in the world, with PM 2.5 concentrations far exceeding WHO safe limits.
- The health burden is severe and inequitable. Pakistan recorded 194.6 air pollution-attributed deaths per 100,000 people, compared to 7.4 in Finland, 7.9 in Norway, and 8.1 in Sweden. The heaviest toll falls on newborns, the elderly, and low-income households with the least means to protect themselves.
- The economic damage runs deep. Air pollution costs Pakistan an estimated 6.5 percent of GDP annually, treatment of pollution-related illness alone amounts to nearly \$1.5 billion per year, and crop losses from ground-level ozone are estimated at 0.76 percent of GDP (losses that compound silently in an economy already under strain).
- Transport is a central driver of the crisis. Total transport sector emissions reach 49.19 Mt, dominated by two-wheelers and passenger cars, and the average Pakistani vehicle produces 25 times more carbon and nearly 4 times more NOx per kilometer than one meeting US standards.
- Behavioral evidence from Karachi shows that awareness campaigns alone will not drive modal shift.
- Pakistan has built a substantial body of environmental legislation over nearly three decades, yet enforcement has consistently lagged behind ambition. Without a decisive shift from policy formulation to actual implementation, the crisis will deepen regardless of how many frameworks are added to the list.

POPULATION GROWTH

- Pakistan's demographic and human capital challenges are well documented and are also structurally connected. High population growth dilutes per-capita public investment, weak investment sustains high fertility, and high fertility perpetuates the fiscal pressure that limits investment in the first place. This is not a vicious cycle that resolves itself but requires deliberate policy to interrupt.
- The evidence points in one direction. Fertility falls with female education. Human capital outcomes improve with spending. Per-capita investment improves when population growth slows. Provincial disparities narrow when fiscal allocations reflect demographic realities. None of these relationships is speculative as they are visible in Pakistan's own data and in the transitions achieved by comparable economies in the region.
- Population policy is economic policy. Treating demographic change as a background social concern will keep reproducing this cycle. Integrating population planning into budgeting, expanding family planning access, investing seriously in girls' education, and building a coherent life-cycle approach to human capital are not separate agendas. They are the same agenda. The longer they are treated as peripheral, the more costly the course correction becomes.

DRIVERS OF FLOOD RISK AND SOCIOECONOMIC IMPACTS

- The Indus Basin, located in the northern region of Pakistan, is a key source for livelihood and water supply for downstream regions across the country.
- Rising climate changes in the northern region has increased flood vulnerability due to higher meltdown of glaciers and snow across Pakistan.
- Increase of winter and monsoon precipitation, and winter temperature anomalies in Gilgit-Baltistan (GB) districts raise the likelihood of flood occurrence nationwide.
- In contrast, higher winter storage or snowfall can reduce total flood damage, a greater number of affected people, and increased fatalities due to floods nationwide.



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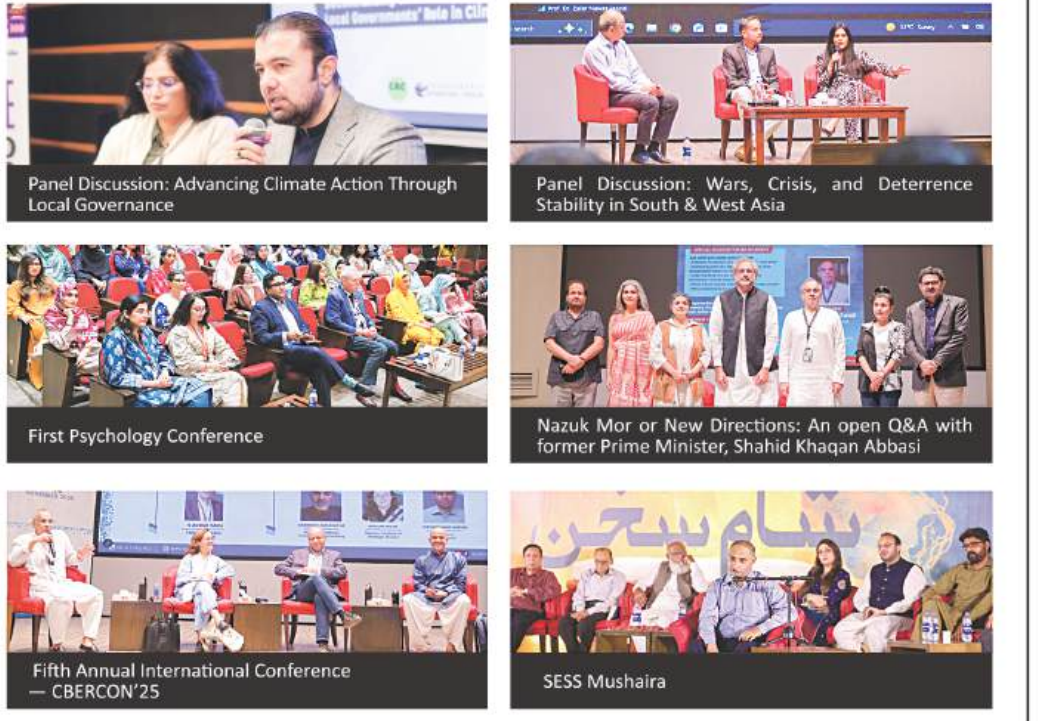
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