OICCI Economic Update

JAN 2025

Retrospection on 2024

The First Port of Call for Foreign Investors

Disclaimer

This report has been prepared for informational purposes only and is not intended to provide financial, investment, legal, or any other professional advice. While every effort has been made to ensure the accuracy and timeliness of the information in this report, no guarantees are made regarding its completeness or reliability. Any opinions or forecasts expressed reflect our judgment at the time of publication and are subject to change without notice.

The information provided may include forward-looking statements based on assumptions and expectations about future events or developments. Actual outcomes may differ materially from those expressed or implied in such statements. We do not assume any liability for any losses or damages arising from the use or reliance on the information contained in this report.

Readers are advised to seek independent professional advice before making any financial or business decisions based on the contents of this report. We are under no obligation to update or revise this report in light of new information, events, or circumstances following its publication.

By accessing this report, you agree to the terms of this disclaimer.

Copyright Statement

Table of Contents

The global economy showed signs of stabilization in 2024, following a period of massive global inflation over the previous two years. This inflation was driven by the simultaneous global commodity supercycle, the aftermath of COVID-19, and the Ukraine war. The monetary tightening across the world helped normalize the global macroeconomic landscape, with inflationary pressures easing and central banks responding with monetary easing. However, 2025 is likely to be a year focused on growth, which may take time to materialize due to evolving global economic and political conditions.

Pakistan's economic trends mirrored global patterns, with domestic volatility remaining elevated. A decline in global commodity prices helped ease inflationary pressures and allowed the State Bank of Pakistan (SBP) to lower the policy rate by 900 basis points in 2024. Inflation dropped to an average of 13 percent in 2024 compared to 22 percent in 2023. The fiscal position improved, achieving a primary surplus for the first time in two decades, but at the expense of higher taxation and reduced development spending. GDP growth remains subdued, with significant challenges in agriculture and industrial sectors.

The monetary policy has been complemented by a tight fiscal stance, with Pakistan achieving a primary surplus in FY24 for the first time in two decades, and a surplus likely in FY25. However, this has come at the cost of a higher tax burden on the formal sector and significant cuts in development spending—both of which have implications for economic growth.

GDP growth was a modest 0.92 percent in 1QFY25, following a contraction of 0.2 percent in FY24. Agriculture, which had rebounded in FY24 (growing by 6.25 percent), is facing challenges in FY25 due to poor cotton yields, lower rice export potential, and the absence of support prices for wheat and sugar. Falling farm incomes are affecting other sectors, as overall rural demand remains weak, limiting the impact of lower interest rates on economic demand. Nevertheless, the external sector remains positive, with a current account surplus allowing the SBP to build foreign reserves without exacerbating external debt levels.

With stabilization largely achieved, the focus now shifts to reviving economic growth and employment without triggering a balance of payments crisis. Real reforms in key areas—such as energy and taxation—will be critical.

In the energy sector, efforts so far have focused on reducing power generation costs through renegotiations with independent power producers (IPPs). However, this alone will not be sufficient to boost demand or improve capacity utilization, which remained at just one-third in the previous year. Addressing transmission and distribution losses is a complex challenge, and optimal utilization of energy resources, including the petroleum and gas sectors, will be necessary. It remains to be seen how the government will tackle these issues in 2025.

Fiscal reforms, particularly in taxation, are another crucial area. The broadening of the tax base remains a key puzzle, as FBR revenues are falling short of targets. The IMF may request additional taxation measures during the upcoming review in February. A critical milestone will be the FY26 budget, where the government must bring untaxed sectors into the formal tax net. The formal sector is already shrinking due to heavy taxation, and without rationalizing the tax system, attracting investment in the formal sector will remain a challenge.

Global recap of 2024

The global economy in 2024 experienced modest growth, with the IMF projecting a 3.2 percent expansion, consistent with previous forecasts. However, growth in advanced economies was uneven, with the U.S. leading at 2.7 percent, buoyed by robust consumer spending and easing inflation pressures. The Eurozone grew at a modest 0.8 percent, while Japan saw a minor contraction of 0.2 percent due to declining capital investments and sluggish exports.

Emerging markets displayed resilience, particularly in Asia, where growth was driven by surging demand for semiconductors and AI-related goods. Developing Asia maintained steady growth at 4.9 percent, although it faced headwinds from weaker demand in key economies like China, whose growth slowed to 4.8 percent due to its ongoing property market crisis.

Inflation moderated globally, declining from 6.7 percent in 2023 to 5.8 percent in 2024. Advanced economies achieved significant progress toward inflation targets, with global headline inflation expected to reach 4.3 percent in 2025. However, core inflation in services sectors remained sticky, requiring cautious monetary policy adjustments.

Geopolitical risks and financial instability weighed heavily on the outlook. China's property market fragility and potential protectionist policies in major economies posed downside risks. Additionally, shifts in U.S. fiscal policies and energy prices added uncertainty to global trade dynamics.

For Southeast Asia, robust domestic demand supported growth in nations such as Indonesia and the Philippines, while advanced economies in the region saw declining growth rates due to export slowdowns. Inflation in the region stabilized at around 2.1 percent, supported by falling energy prices and strong fiscal policies.

Pakistan's economic performance in 2024

The story of Pakistan mirrors global trends, though the volatility at home remains significantly higher.

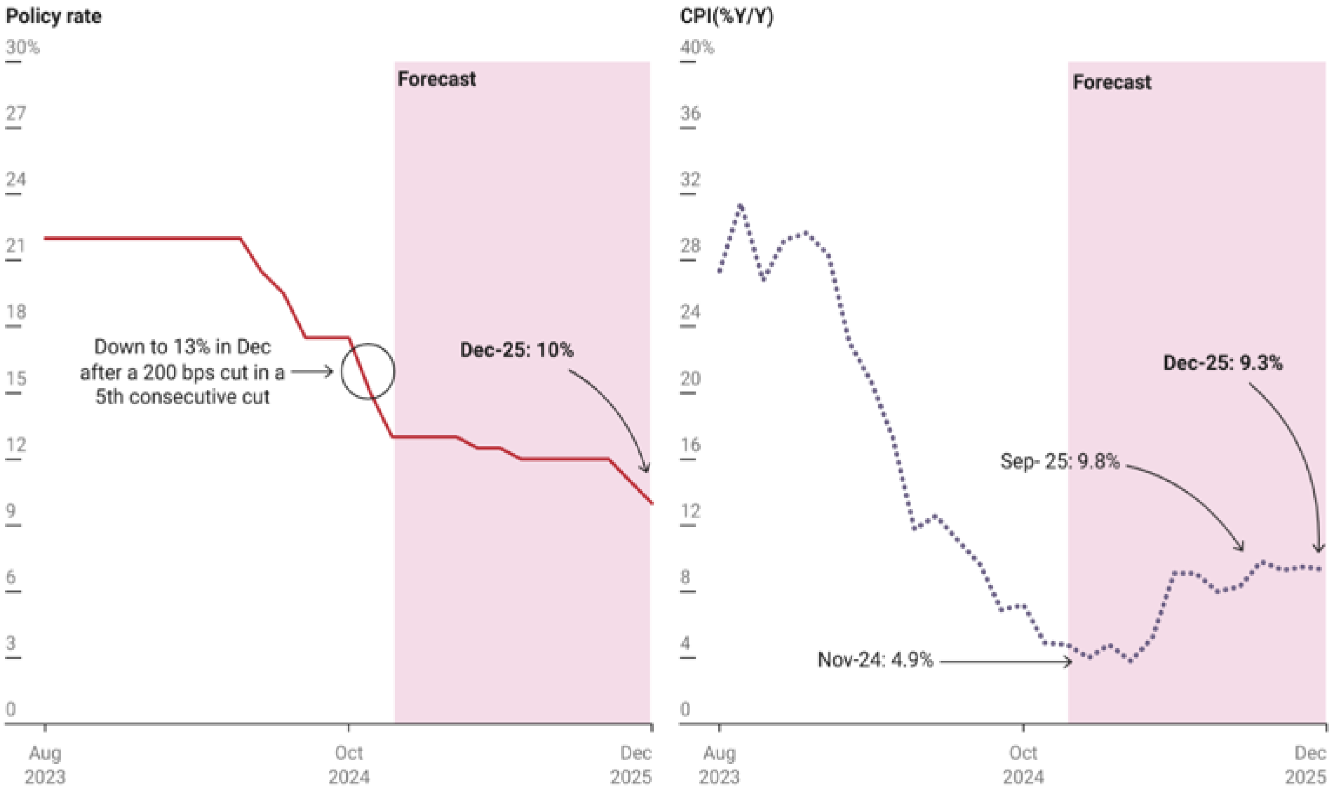
Inflation nosedives		Inflation nearly halved, dropping from an average of 22% in CY23 to 13% in CY24. This was driven by both tight monetary and fiscal policies under the IMF's guidance. The SBP began easing monetary policy in the second half of 2024, reducing rates by 41%, or 900 basis points, to 13%. 
Tight fiscal policy and low growth		Despite the easing of monetary policy, fiscal policy remained tight. Excessive taxation, reduced development spending, and the erosion of purchasing power from the previous years' inflation kept growth subdued. This resulted in a contraction of 0.2% in FY24, with a modest rebound of 0.92% in 1QFY25 on a low base.
Short-lived revival in agriculture		The agriculture sector, which showed a strong recovery in FY24 due to a low base from the previous year (impacted by floods), grew by an impressive 6.25%. However, the optimism was short-lived. FY25 started with disappointing results, as cotton production is expected to fall by a third, and the rice export boom from FY24—due to India's absence in the global market—is now waning. Furthermore, the government's policy shift of not setting a wheat support price is negatively affecting the farm economy in the short to medium term, although it could prove beneficial in the long run. The same challenges are observed in the sugar sector. The declining farm income has had a ripple effect, contributing to low growth in both the manufacturing and services sectors, as rural demand for goods and services declines.
Current Account Surplus was the highlight		One silver lining in this challenging environment was the current account surplus, which reached $646 million in 11MCY24. This surplus was largely driven by suppressed imports and a strong increase in home remittances, which rose by 31% to $31.6 billion in 11MCY24. This boost was due to better control over money laundering, increased migration, and the growth of freelance income.
Marginal improvement in debt profile		Pakistan's debt-to-GDP ratio peaked in FY20 during the COVID-19 crisis at 76.6%. Since then, it has declined, reaching 67.4% in FY24. However, concerns over default remained during FY22 and FY23 due to rising debt servicing costs. In FY23, debt servicing as a percentage of net federal revenues peaked at 125%, but this is expected to decrease to 85-90% in FY25 and 60-65% in FY26. Once this ratio drops below 60%, there will be greater fiscal space for the government to support growth in FY27 and FY28.

Inflation and interest rate outlook

Headline inflation dropped to an almost seven-year low of 4.1 percent in December 2024, a sharp decline from 29.7 percent in the same month last year. The average inflation for 1HFY25 stood at 7.3 percent, compared to 28.8 percent during the same period last year. This significant drop is attributed to subdued domestic demand caused by last year's tightening, a high base effect, and a reversal in global commodity prices. Fiscal consolidation is also playing a role in curbing inflation. However, core inflation is not falling at the same rate as headline inflation. In December 2024, urban core inflation stood at 8.1 percent, while rural core inflation remained in double digits at 10.7 percent.

Hit pause

As inflation slid, the SBP has been generously cutting the policy rate, five times in succession since May-22. The MPC may slow its roll and evaluate the impact of the cuts so far before making any more aggressive moves



The downward trend in inflation is expected to continue, likely ranging between 4-7 percent until April 2025, before rising to 9-10 percent due to base effects. The average inflation for FY25 is estimated at 6.5-7.5 percent, with the calendar year 2025 (CY25) expected to see an average inflation of 7.5-8.5 percent.

After reducing rates by 900 bps in five reviews, it is anticipated that the pace of monetary easing will slow, and the SBP may pause after one or two more cuts, possibly settling rates between 11-12 percent. The aim is to assess the impact of the 900 basis points (41 percent) reduction in overall demand. By December 2025, rates are expected to range between 10-12 percent.

If the SBP continues to ease policy rates, bringing them into single digits, it may put unnecessary pressure on the currency. In such a scenario, the SBP may have to reverse course.

Core converge

Core CPI has come down from its high of 22.7% down to 9.15% in Dec-24, touching its 20-year average

Current account surplus is the hallmark

The current account posted a record surplus of $729 million in November, the highest surplus since March 2015. It marked the fourth consecutive month of surplus, with the 5MFY25 current account surplus standing at $944 million (the highest since 5MFY21), compared to a deficit of $1.676 billion in the same period last year. One of the reasons for the higher surplus in November was low oil import payments, as smuggling from Iran was higher. However, smuggling has significantly reduced, and higher volumes have been imported in recent weeks. This may result in increased payments in December and January, potentially reducing the current account surplus going forward.

Overall, the external account is in a stable position, with expectations of a current account surplus for the full year. Demand curtailment has helped keep import growth in check, while remittances continue to rise, driven by more workers going abroad, a surge in freelance earnings, and better control over money laundering. Export orders remain strong, particularly in textiles, as demand picks up in key importing countries, while competitors like Bangladesh face their own challenges.

However, there are risks to export growth. Recently, concerns raised by international stakeholders regarding domestic developments have created a risk for the continuation of GSP+ status. If this status is revoked, textile exports to the EU could decline by 30-40 percent. Additionally, there is the potential risk of new trade policies or import duties affecting

Pakistan's exports to key markets such as the US.

The standout performer remains ICT exports, which continue to show impressive growth.

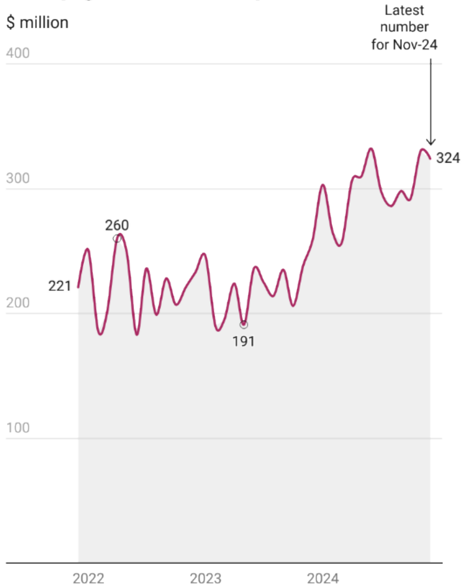
Balance of Payment

In $Million | 5M	5mFy23	5mFy24	5mFy25	Yoy
Current Account Balance	**-3,474**	**-1,676**	**944**	
Trade Balance	**-13,603**	**-8,838**	**-9,689**	**10%**
Goods Exports (fob)	11,914	12,364	13,283	7%
Goods Imports (fob)	25,517	21,202	22,972	8%
Services Balance	**-301**	**-1,260**	**-1,148**	**-9%**
Services Exports	3,090	3,043	3,276	8%
Services Imports	3,391	4,303	4,424	3%
Primary Income Balance	**-1,985**	**-3,228**	**-3,722**	**15%**
Primary Income Credit	319	315	480	52%
Primary Income Debit	2,304	3,543	4,202	19%
Secondary Income Balance	**12,415**	**11,650**	**15,503**	**33%**
Secondary Income Credit	12,530	11,837	15,766	33%
Workers' Remittances	*12,318*	*11,054*	*14,768*	*34%*
Financial Account Balance	**1,405**	**3,598**	**1,282**	**-64%**
Direct Investment	611	821	1,102	34%
Portfolio Investment	-31	38	161	4.2x
Other Investments	819	2,739	19	-99%
Net Errors and Omissions	*18*	*-490*	*-510*	*4%*
Overall Balance	**-1,992**	**1,527**	**1,784**	**17%**

Imports for 5MFY25 reached $23.0 billion, up 8 percent from last year. However, the good news is that the growth in exports and remittances is outpacing the rise in imports. Over the past few months, demand has gradually picked up, reflected in the 12-month rolling import data, which has increased from its lowest point of $50.1 billion in January 2024 to $55.1 billion.

Exports, particularly in textiles, are performing well, with orders rising as business shifts from Bangladesh to Pakistan. However, rising energy costs, income tax impositions, and delays in refunds are making exporters less competitive. Additionally, concerns are mounting over the potential for the US administration to impose new duties on imports, including from Pakistan.

Sharp growth in IT exports

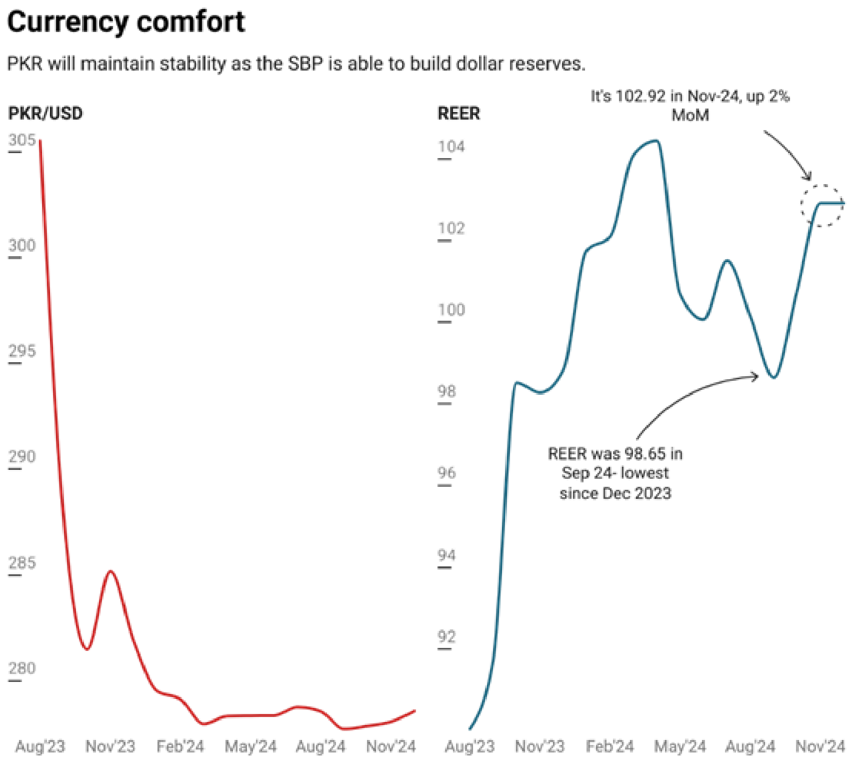


ICT exports surged by 25 percent in November, reaching $324 million, with 5MFY25 proceeds rising by 33 percent to $1.53 billion. This marks the fourteenth consecutive month of growth in ICT exports. Since FY20, exports have already doubled, and the positive momentum continues. Companies are expanding globally, with a particular focus on the GCC region. Relaxed policies on external outflows and increased retention limits have provided incentives for further expansion.

Current account surplus to be challenging in CY25: Growth in remittances is expected to be limited in CY25, while imports are likely to surge. The impact of significant monetary easing will be visible on economic demand in the second half of 2025, potentially leading to a slip in the current account and putting pressure on the currency. As a result, inflation may rise slightly, which aligns with the forecast for similarly struggling economies.

Currency stability will continue

Currency stability continues, as the current account surplus is helping the SBP buy dollars from the interbank market to build reserves. SBP has published the buying data with a lag, and so far, it has bought $1.864 million from the interbank market over three months, from June to August 2024. This, along with stricter controls on money laundering, will help keep demand in the grey market in check. With falling inflation, the inflation differential between Pakistan and its trading partners is expected to decrease. This will help maintain the Real Effective Exchange Rate (REER) close to 100, despite declining interest rates and a stable nominal currency.



However, the recent REER reading has crossed the 100 mark, and textile exporters have raised concerns about squeezed margins due to the absence of currency depreciation domestically, while currencies in competitive markets (such as India and Bangladesh) have slightly depreciated. Additionally, after Trump's win, the USD index future is strengthening, which is putting pressure on other currencies to depreciate.

Fiscal discipline is the key

The key is continuation of fiscal tightening without further eroding the potential of growth. FY24 posted a primary fiscal surplus for the first time in two decades and the IMF framework is not allowing to run a primary deficit at all during the programme. That is going to be a challenge. This has been evident in the dairy and juices indusry and tobacco industries, where informal sector mushroomed after the imposition of higher FED in the last two years.

In the formal sector, high tax rates are discouraging fresh investment, leading to capital outflows. There is a growing risk of businesses relocating to the UAE to benefit from more favorable tax policies, as Pakistan's high income tax rates are hindering capital formation. Additionally, higher GST is constraining exports by SMEs and emerging sectors, as firms face challenges in obtaining refunds, and domestic inefficiencies cannot be passed on to international markets.

Consolidated Fiscal Operations

In PKR billion | 1QFY25

	1QFY24	2QFY24	3QFY24	4QFY24	1QFY25	Yoy	QoY
Total Fiscal Revenue	**2,686**	**4,168**	**2,926**	**3,489**	**5,827**	**117%**	**67%**
Total Tax Revenue	**2,217**	**2,617**	**2,428**	**2,823**	**2,776**	**25%**	**-2%**
Federal Tax Revenue	2,042	2,428	2,242	2,599	2,563	26%	-1%
Provincial Tax Revenue	175	190	186	223	213	21%	-5%
Total Non-Tax Revenue	**469**	**1,551**	**498**	**666**	**3,051**	**551%**	**358%**
Federal Non-Tax Revenue	435	1,506	419	602	2,997	589%	398%
Provincial Non-Tax Revenue	34	45	80	64	54	59%	-16%
Total Fiscal Expenditure	**3,666**	**5,596**	**4,421**	**6,793**	**3,931**	**7%**	**-42%**
Total Current Expenditure	**3,173**	**5,392**	**3,769**	**6,238**	**3,537**	**11%**	**-43%**
Debt Servicing	1,380	2,840	1,298	2,642	1,306	-5%	-51%
Defence Expenditure	343	415	465	636	410	20%	-36%
Other Current Expenditure	**1,450**	**2,137**	**2,006**	**2,959**	**1,821**	**26%**	**-38%**
Total Development Expenditure and Net Lending	**282**	**379**	**482**	**936**	**277**	**-2%**	**-70%**
Statistical Discrepancy	211	-175	171	-380	117		
Overall Fiscal Balance	**-980**	**-1,428**	**-1,495**	**-3,304**	**1,896**		
Primary Balance	**400**	**1,413**	**-197**	**-662**	**3,202**	**701%**	
Total Fiscal Financing	**980**	**1,428**	**1,495**	**3,304**	**-1,896**		
External Fiscal Financing	442	166	-115	-173	-157		
Domestic Fiscal Financing	538	1,262	1,609	3,478	-1,739		
GDP	105,741	105,741	105,741	105,741	124,150		
Budget deficit (to GDP)	-0.9%	-1.4%	-1.4%	-3.1%	1.5%		
Primary balance (to GDP)	0.4%	1.3%	-0.2%	-0.6%	2.6%		

FY25 budget: Consolidation will continue

The government is eager to shift towards a high-growth path after achieving balance of payment stability. However, fiscal space remains limited under the IMF framework. There has already been a significant slippage in FBR tax revenues in the first half of FY25. The collection for FY25 is likely to be Rs12.1 trillion, falling short of the target of Rs12.9 trillion. The key question is whether the IMF will trigger revenue contingencies or demand new taxes during the first review, expected to begin in February 2025.

While the IMF has shown leniency to the current government, this could, this could change with the takeover by the new US administration, which may push the IMF to enforce stricter conditions.

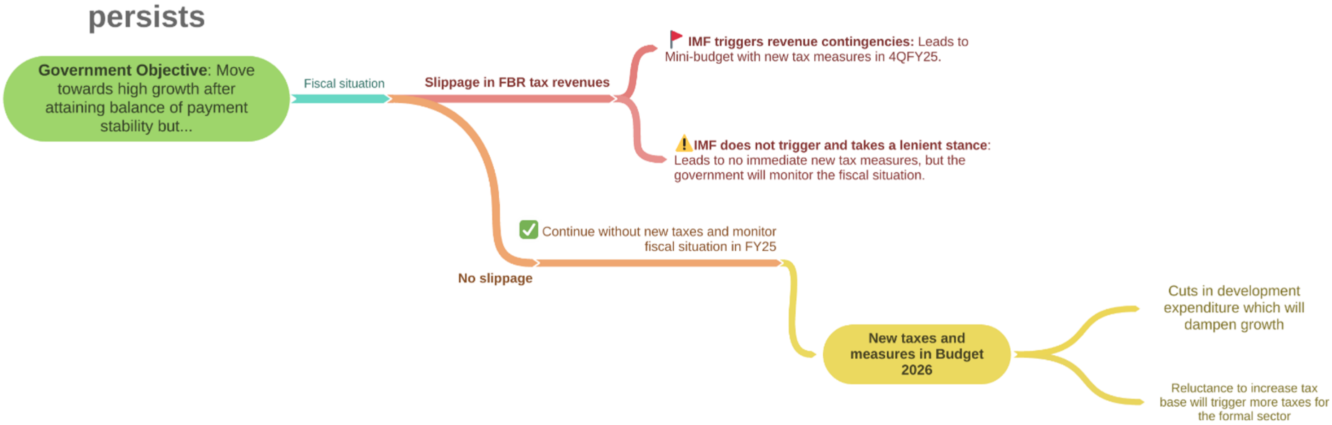
As a result, new revenue measures (mini-budget) cannot be ruled out in 4QFY25. If the government manages to avoid them, new tax measures are likely to be introduced in the next budget. Additionally, the government will need to cut expenditures, meaning the development budget is expected to be lower in FY26, which could dampen growth revival prospects.

The formal sector cannot bear more taxes without losing market share. This is already happening in some sectors, and others may follow suit. The incentive for tax avoidance undermines government efforts to reduce informality by limiting economic transactions by tax dodgers.

The challenge of broadening the tax base remains unsolved. Efforts to bring retailers and traders into the tax net have not yielded significant results. One of the IMF's conditions is to treat agricultural income like any other income and fully tax it. Provinces are in the process of passing legislation, but the revenue generated is likely to be only a fraction of the potential.

The problem is that the ruling political parties are reluctant to tax their shrinking voter base and instead aim to stimulate growth to win over disgruntled voters. However, this goal conflicts with the macroeconomic framework agreed upon with the IMF. The next budget will likely attempt to strike a balance.

The fiscal problem persists



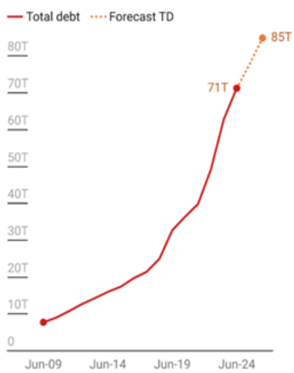
Pakistan debt profile is marginally improving

Pakistan's debt-to-GDP ratio peaked in FY20 (during the COVID-19 period) at 76.6 percent and has since been declining, reaching 67.4 percent in FY24. However, the threat of default remained a concern in FY22 and FY23 due to growing debt servicing costs. Debt servicing as a percentage of net federal revenues peaked at 125 percent in FY23 but is expected to decrease to 85-90 percent in FY25 and 60-65 percent in FY26. Once this ratio falls below 60 percent, there will be enough room for the government to increase spending and marginally support growth in FY27 and FY28.

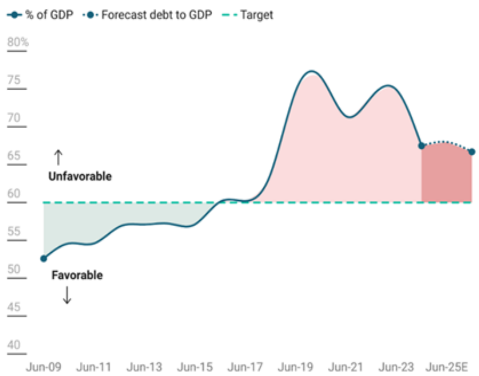
Within debt servicing and other payments, external payments are the most critical element, as they have a direct impact on foreign exchange reserves and the currency. The external payment obligation for FY25 is $26 billion. Apart from expected rollovers, approximately $5 billion in payments are still pending, with the rest already met. Despite these heavy repayments, SBP's forex reserves increased by $2.7 billion in 1HFY25.

However, the challenge is far from over. As of November 2024, 12-month foreign liabilities stood at $29.3 billion. The key to managing this debt will be reducing the debt-to-GDP ratio below 60 percent, and to achieve that, running primary fiscal surpluses will be essential.

Rising debt

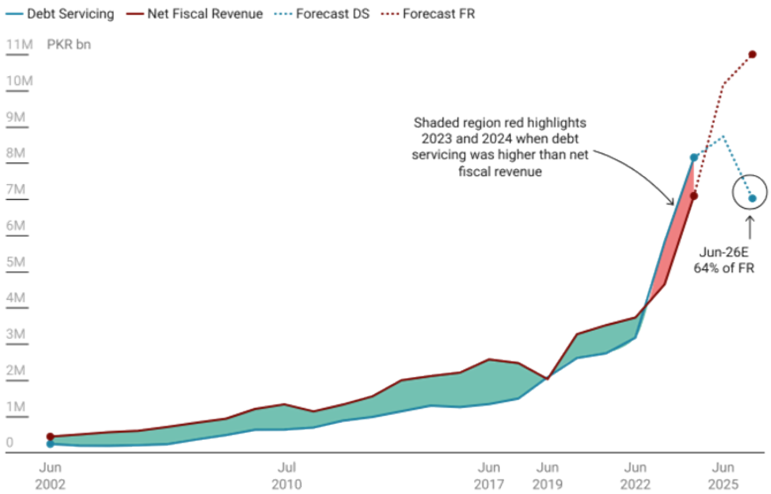


Debt to GDP remains above 60%



Dangerous debt

During FY23 and FY24, debt servicing was taking a lead on fiscal revenues (125% and 115% respectively). It is now expected to begin subsiding in FY25 to settle at 86%. In FY26, it is expected that servicing costs will decline to 65% of revenues.



Energy reforms started – a long way to go

Gains from power generation cost reduction

Energy especially, power sector reforms are imperative to revitalize the industrial sector. The government is cognizant of the fact and is in attempt to bring the costs down. The negotiations with the IPPs are to meet the objective. The savings from terminating a couple of Independent Power Producers (IPPs) are estimated at approximately Rs. 0.3 per unit, while transitioning to a hybrid take-and-pay model with a few IPPs established under earlier policies could yield additional savings of around Rs. 1.2 per unit.

Higher saving is to be achieved from debt reprofiling of newer – mainly 2015 IPPs, and revisiting tariff structure of government's own IPPs and renewable – solar and wind projects. Collectively these can save Rs7/unit. Then government can save Rs5/unit by cutting taxes (for households mainly, as businesses adjust taxes). Overall savings aim to reach Rs12/unit which is highly unlikely to achieve.

Fixing distribution and transmission is imperative

The real juice is to extract from reforming the distribution and transmission sector where losses are much higher than the permissible limits and that keeps on adding to the circular debt. In FY23, DISCOs inefficiencies added Rs160 billion to the circular debt, as per the latest data, and the losses remained higher in FY24. Then in FY22, under-recoveries of DISCOs added Rs230 billion in the power sector circular debt.

Once the losses are reduced and costs to be lowered on generation side, the electricity demand to grow which is imperative for the capacity utilization which was at 33 percent in FY24.

T&D losses exceed target in both FY23 and FY24

DISCO	Target Losses (%)	Actual Losses (%)	Implication (PKR BN)	Target Losses (%)	Actual Losses (%)	Implication (PKR BN)
	FY23			FY24		
Overall Avg	12%	16%	160	12%	18%	276
GEPCO	9%	9%	-2	9%	12%	9
FESCO	9%	9%	-1	9%	10%	5
TESCO	9%	9%	-0	9%	9%	-0
IESCO	8%	8%	0	7%	9%	6
MEPCO	13%	14%	8	12%	15%	23
HESCO	19%	27%	15	18%	28%	23
SEPCO	17%	34%	20	17%	35%	29
QESCO	14%	27%	21	14%	30%	37
LESCO	8%	11%	22	10%	16%	48
PESCO	20%	37%	77	30%	38%	97

Recovery vs under-collection

low high

DISCO	Recovery (%)	Billing under-collection (PKR mn)	Recovery (%)	Billing under-collection (PKR mn)	Recovery (%)	Billing under-collection (PKR mn)
	FY22		FY23		FY24	
Overall Avg	91%	229,917	93%	211,795	92%	314,507
GEPCO	98%	4,579	98%	6,842	96%	17,760
IESCO	96%	12,693	105%	-19,181	97%	15,487
TESCO	66%	14,658	85%	7,146	106%	-2,608
FESCO	95%	18,930	100%	-1,877	98%	14,827
PESCO	92%	19,172	92%	26,180	92%	31,037
LESCO	97%	19,419	94%	45,183	96%	39,464
SEPCO	64%	22,895	67%	27,210	65%	38,189
HESCO	74%	23,362	74%	29,133	76%	36,779
MEPCO	92%	31,739	98%	8,853	97%	19,249
QESCO	35%	62,470	37%	82,305	32%	104,322

Uraan: Think beyond numbers

Creating a five-year economic plan is a valuable exercise. However, its success depends on backing it with sound policies and ensuring buy-in from all relevant authorities. Uraan is a good starting point, but the targets must be realistic and supported by a robust policy framework. The country is currently in an IMF program, where the primary goal is to solidify stability and implement structural reforms, with growth being the eventual outcome.

In the energy sector, deregulation and the privatization of distribution companies (DISCOs) are key steps. Reducing generation costs and optimizing energy allocation will pave the way for investment in energy-intensive industries, especially those focused on exports.

For the agriculture sector, OICCI is aligned with the government to move away from the support price mechanism. The focus should shift to identifying new crops and expanding the cultivation of existing, more efficient crops to unlock full potential. Value chains should be developed to support these areas. The government's role is to facilitate the growth of crops and livestock sectors where the private sector can drive investment.

The services sector has shown potential, particularly in ICT and other export-oriented services. Ensuring better and more reliable internet and connectivity infrastructure is crucial for attracting both local and foreign investment in this sector.

Boosting overall political and economic confidence is essential. Fiscal consolidation must be achieved, alongside the rationalization and harmonization of taxes and the right sizing of government. The exchange rate should be market-driven, and interest rates should focus on achieving low and stable inflation. This approach will help attract capital back into the country, reverse capital flight, and stimulate fresh investment.