OICCI Economic Update

MARCH 2025

The First Port of Call for Foreign Investors

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Table of Contents

Despite recent stabilization efforts, Pakistan's economy has yet to gain momentum toward a robust growth trajectory. Although inflation has declined more sharply than anticipated, the recovery in economic growth remains slower than expected. This combination of subdued growth and easing inflation is particularly concerning for a growing population, as unemployment continues to rise to alarming levels.The government cannot rely on traditional fiscal tools, such as development spending, to boost growth, as it must maintain a primary fiscal surplus under the ongoing IMF program. Despite revising its downward in line with lower inflation and growth estimates, the government is still falling short of the stiff FBR target. While it may secure a waiver from the IMF on the indicative target, it must further cut development expenditure and raise revenues from other sources to avoid breaching the primary fiscal surplus requirement.

The key challenge is that whenever the government attempts to stimulate economic growth, balance of payments pressures begin to emerge. In recent weeks, signs of strain have emerged in the interbank market, where outflows are outpacing inflows. Banks are prioritizing imports payments, with some importers raising concerns about delays. The current account slipped into deficit in January after three consecutive months of surpluses, before returning to near balance in February. Combined with the pressure of debt principal repayments, SBP reserves have declined by almost a billion dollars in the last few weeks. Building reserves is crucial to creating buffers for financing growing imports.To strike a balance, the SBP wisely paused monetary easing after cutting 1,000 basis points over six consecutive reviews. From inflation and growth's perspective, there may still be room for further rate cuts. However, with falling reserves and growing pressure on the currency, a prudent approach is to take a breather. The SBP's primary focus, for now, should be on strengthening external buffers before shifting toward growth stimulation.Growth momentum is slowly picking up in certain sectors, as evident from high-powered money supply figures. However, rural economic struggles persist due to the absence of wheat and sugar support prices, along with a bleak outlook for wheat, cotton, and rice crops due to changing weather patterns. Water availability is likely to be lower this season due to dry winters, compounding farmers' difficulties.

Fiscal stimulus to spur growth is also lacking. The government is required to maintain a primary fiscal surplus, and the FBR faces constant pressure to meet stiff revenue targets. In the absence of a broader tax base, the burden remains disproportionately on the formal sector, hindering quality growth.

The global economic situation is becoming increasingly uncertain, casting doubts on planned foreign debt and capital inflows. The trade war initiated by the U.S administration. could have widespread implications. The U.S. is turning inward, imposing import tariffs and pushing for USD devaluation to bring manufacturing back. While the long-term impact of these measures remains to be seen, they carry the risk of triggering a U.S. recession with far-reaching global consequences.

A slowdown in the U.S. would negatively impact global exports, but Pakistan's exports may be less affected, as they are primarily low-value-added and largely insulated from tariff policies. Overall, this could benefit Pakistan's trade balance, which is heavily import-dependent. Falling commodity prices—particularly oil—could help offset the impact of growing import volumes. The government has seized this opportunity to impose higher levies on petroleum to compensate for the FBR's revenue shortfall.

Declining commodity prices provide both fiscal and monetary room for economic growth. Global interest rates may also fall, reducing the cost of external debt borrowing and opening avenues for market-based financing. The finance ministry is looking to secure market-based and commercial loans at better rates after the IMF review and a potential upward revision in sovereign debt ratings.

All these factors help keep the crisis at bay and buy time for the government to implement reforms. Pakistan needs Pakistan needs foreign investment focused on improving efficiency, which requires broad-based structural economic reforms. The upcoming budget framework is critical in shifting the tax burden away from the formal sector and toward untaxed areas. Any growth strategy must be built on macroeconomic sustainability, ensuring fiscal discipline through both taxation and expenditure reforms. The tailwinds are in our favor—now is the best time to reform, as the worst of high inflation and negative growth is behind us. It's time to strike while the iron is hot.

Inflation and interest rate outlook

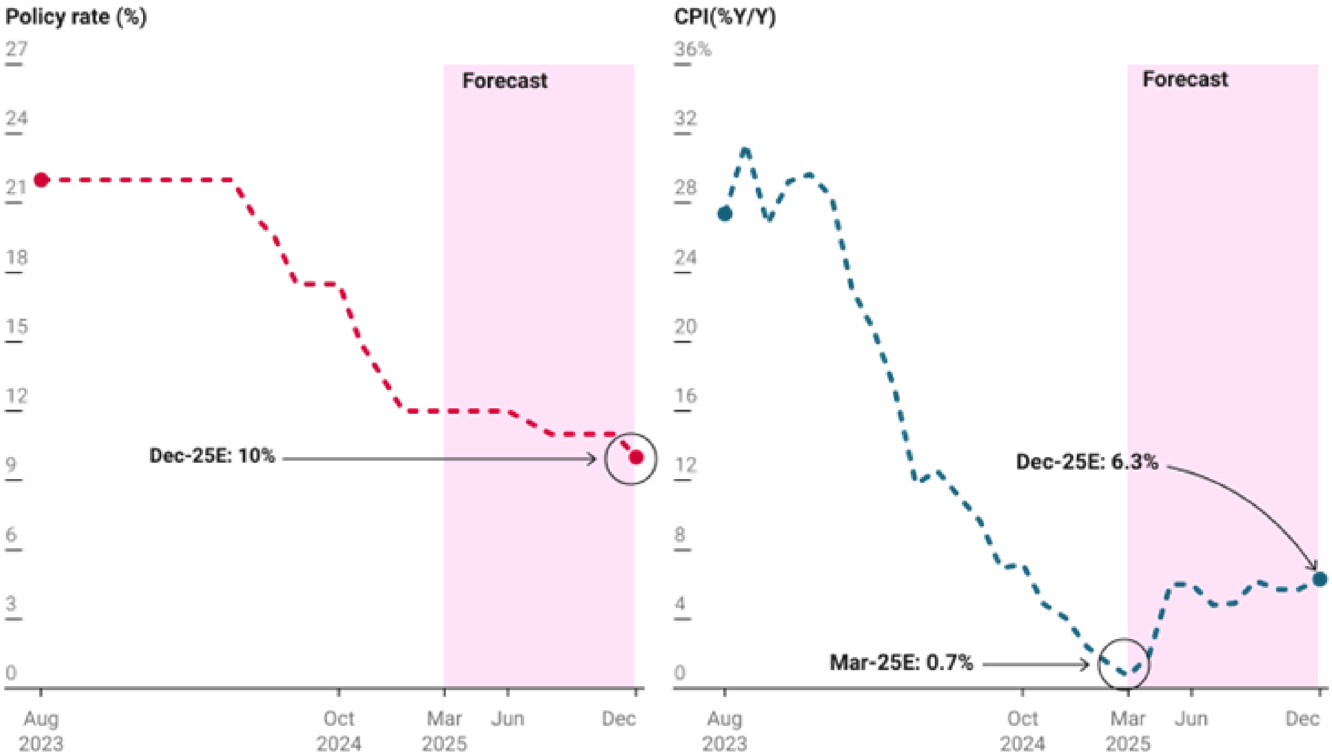
The headline inflation decline is steeper than expected, dropping to a nearly decade-low of 1.5 percent in February 2025 and likely falling below 1 percent in March. In the first eight months of FY25 (8MFY25), CPI stood at 6 percent compared to 28 percent during the same period last year. The downward inflation trajectory is driven by a combination of the high base effect and minimal monthly increases—month-on-month inflation averaged just 0.13 percent over the past 12 months, compared to 1.75 percent in the previous 12 months. Four of the last 12 months, including February, recorded negative month-on-month inflation.

Both global and domestic factors are contributing to the sharp decline in inflation. Domestically, demand destruction caused by skyrocketing inflation and negative economic growth has further pushed prices down. However, the decline in inflation is not broad-based. Most of the easing is concentrated in food and energy, while core inflation remains persistently high.

Food inflation fell by 4.1 percent year-on-year in February, with prices of perishable items plummeting by a staggering 20.3 percent. The housing and utility index declined by 0.6 percent, while transport inflation dipped by 1 percent. A stable PKR and lower global prices have helped drive food and energy inflation into negative territory. In contrast, the situation is starkly different for non-food, non-energy (NFNE) core inflation, which remains sticky at 8.6 percent in February, with an average of 10.3 percent in 8MFY25. The second-round effects of the extreme inflation spikes in FY23 and FY24 continue to play out in FY25, reflected in double-digit inflation across categories such as clothing and footwear, health, education, and miscellaneous goods and services.

Staying put

After successive cuts in policy rate, the SBP is adopting caution and has kept the policy rate at 12% despite expectations of another cut in the last policy review. Concerns over external pressures have risen anew. Over the next few months--at least until June- the policy rate may stay put at 12%.



Energy price inflation is likely to remain subdued given the pessimistic outlook for global oil prices, as recessionary fears in the U.S. grow due to the ongoing tariff adjustment. However, food prices may not follow the same trajectory—perishable food items are highly volatile and could rebound. Some reversal is also expected in key non-perishable items, such as wheat, which is currently down by two-thirds from its peak.

Inflation for FY25 is projected to be in the range of 5.0–5.5 percent, with the next 12-month average estimated at 6 percent. However, the Monetary Policy Committee opted to keep the policy rate unchanged at 12 percent, resulting in real interest rates of 5–6 percent based on forward-looking inflation.

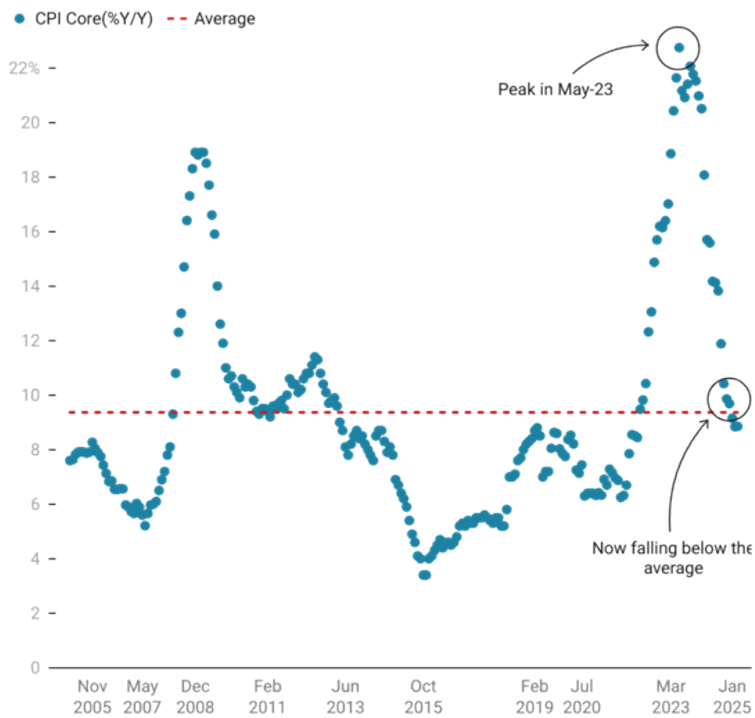
The SBP's primary reason for maintaining caution is to manage external account pressures, as imports have started rising and visible strain has emerged in the interbank market over the past few weeks. SBP reserves have declined by nearly $1 billion from their peak in the last two months, and the current account slipped into deficit in January and February after a few months of surplus.

The increase in import payments in January and February was primarily driven by cheap bank lending to importers before the end of 2024 to avoid the ADR tax. Those cheap loans are no longer available. However, the impact of a 1,000-basis point rate cut over eight months is expected to materialize in demand recovery, particularly in urban centers.

As a result, imports are expected to rise further. The key priority is to build forex reserves to create buffers for external debt repayments. According to the SBP governor, in the last quarter of FY25, the SBP will have to repay $3 billion in debt, with no plans for rollovers or refinancing. The expectation is that Pakistan will complete the IMF review and secure the next tranche. A potential improvement in Pakistan's sovereign debt rating could open new financing avenues at better rates. Once these developments materialize and SBP reserves surpass the June-end target of $13 billion, monetary policy easing can be considered. It is likely that the policy rate will remain at 12 percent until June, with a potential 1–2 percent rate cut in the first half of FY26.

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



Will the current account surplus continue?

Pakistan's current account surplus ended in January, with deficits of $399 million and $12 million in February, reducing the 8MFY25 surplus to $691 million from a $1.73 billion deficit last year. The shift was driven by rising imports, which surpassed $5 billion in January and February, fueled by cheap bank lending. Exports declined, worsening the trade deficit, while remittances remained strong but slightly lower than December levels. Additionally, financial accounts showed persistent negative balances, with net external assistance turning negative at $253 million compared to a $1.8 billion surplus in 8MFY24, leading to a lower overall balance of payments surplus of $1.2 billion.

Looking ahead, ADR-driven financing effects will diminish, but import volumes are expected to rise as demand recovers. Lower oil and commodity prices may help moderate the overall import bill, while export volumes should stabilize as forward bookings from late 2024 materialize. Strong remittance inflows during Ramadan and Eid could further narrow the current account deficit. However, sustaining external stability requires increasing financial and capital account inflows, which depend on the success of Pakistan's ongoing IMF review. The government is anticipating a sovereign debt rating upgrade, which could ease access to commercial financing. Still, attracting FDI remains a challenge, requiring structural reforms to reduce reliance on import restrictions for economic stability.

Imports growing faster than exports

Import: In February, total imports for 8MFY25 reached $38.3 billion, reflecting an 11 percent year-on-year increase. Notably, machinery imports surged by 22 percent to $5.4 billion and textile imports rose by 60 percent to $3.7 billion, as the market cleared backlogs from previous restrictions and addressed the impact of poor domestic cotton output. Previous months trends had shown a steady upward movement in imports, with petroleum imports significantly rising—driven by cheap ADR financing and the entry of new companies in the Oil Marketing Companies (OMC) market—while textile imports benefited from favorable tax adjustments on raw material imports for re-export under the EFS, despite delays in tax refunds affecting domestic purchases.

Balance of Payment

In $Million | 8M

	8mFy23	8mFy24	8mFy25	Yoy
Current Account Balance	**-4,591**	**-1,730**	**691**	
Trade Balance	**-19,343**	**-14,053**	**-16,505**	**17%**
Goods Exports (fob)	18,643	20,357	21,820	7%
Goods Imports (fob)	37,986	34,410	38,325	11%
Services Balance	**-335**	**-1,736**	**-2,250**	**30%**
Services Exports	5,147	5,150	5,459	6%
Services Imports	5,482	6,886	7,709	12%
Primary Income Balance	**-3,534**	**-5,137**	**-5,822**	**13%**
Primary Income Credit	500	592	679	15%
Primary Income Debit	4,034	5,729	6,501	13%
Secondary Income Balance	**18,621**	**19,196**	**25,268**	**32%**
Secondary Income Credit	18,824	19,495	25,707	32%
Workers' Remittances	*18,308*	*18,084*	*23,969*	*33%*
Financial Account Balance	**-1,064**	**4,554**	**401**	**-91%**
Direct Investment	94	997	1,614	62%
Portfolio Investment	-1,015	113	-197	
Other Investments	-151	3,444	-1,016	
Net Errors and Omissions	*-288*	*-837*	*60*	
Overall Balance	**-5,607**	**2,124**	**1,244**	**-41%**

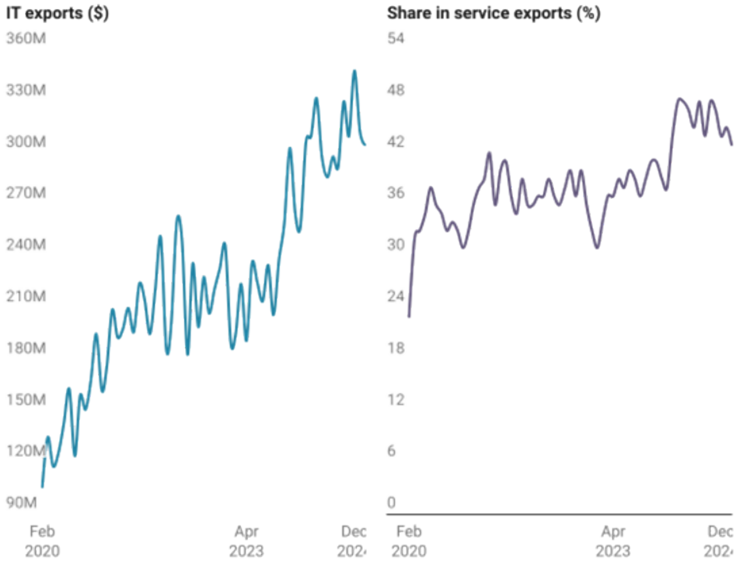
Looking ahead, overall import volumes are anticipated to continue rising in response to improved economic demand. The SBP has instituted measures to monitor non-essential imports, including maintaining financing restrictions of Rs3 million on automobiles for three years and enforcing strict controls on banks' forex transactions. Despite these controls and ongoing pressures from depressed commodity prices, monthly import volumes are expected to remain above the $5 billion threshold.

Exports: In 8MFY25, goods exports reached a record-high of $21.8 billion, marking a 7 percent increase. However, the sector presents mixed signals: food exports declined by 4 percent to $4.6 billion in the July-February period, with rice exports dropping 12 percent to $2.1 billion, while the partial reopening of the sugar sector resulted in exports of $396 million. Textile exports grew by 6 percent to $11.6 billion, as value-added segments performed well despite falling yarn and cloth exports—impacted by rising gas prices and reliance on imported raw materials to avoid lengthy domestic tax refund processes. Additionally, petroleum exports more than doubled to $642 million, driven primarily by furnace oil exports from Pakistan's longstanding refineries, even as global demand for lower-quality oil decreases due to environmental restrictions.

Looking ahead, export growth is expected to face challenges from structural issues such as inefficiencies in energy usage, unjust taxation, and increasing production costs amid PKR appreciation against most currencies except the USD. Although strong order books in textiles and stable performance in value-added sectors provide a foundation for continued activity, squeezing margins and potential capacity constraints remain concerns. Future improvements will depend on strategic policy reforms and enhancements in refinery capabilities to produce higher-value products, thereby offsetting import costs and strengthening overall competitiveness in the export market.

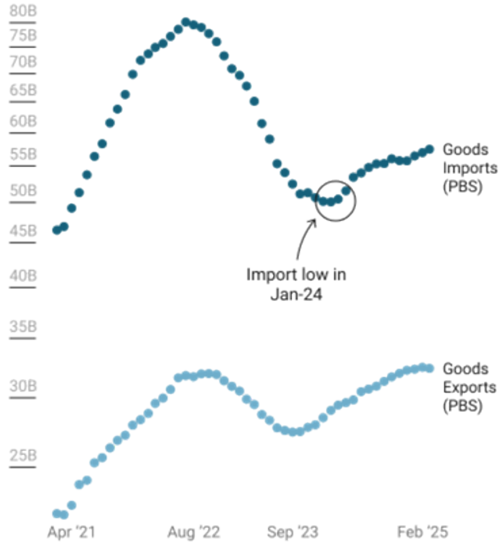
ICT exports

Confidence and expansion drive momentum in IT exports



Trade trials

After bottoming out in Jan-24, imports are coming up again. The graph shows 12M rolling average of dollar imports/exports over the past two years



All values are in US dollar terms

The sustained growth in **ICT exports** continues, rising by 26 percent to $2.5 billion in 8MFY25. This marks the 17th consecutive month of year-on-year growth in the sector. However, on a monthly basis, exports dipped by 3 percent to $305 million, though they remain 19 percent higher year-on-year.

Since FY20, ICT exports have already doubled, and the positive momentum persists. Confidence among IT companies is strengthening, leading to an expansion of their global footprint, particularly in the GCC region. Relaxed policies on external outflows and increased retention limits have further incentivized this expansion.

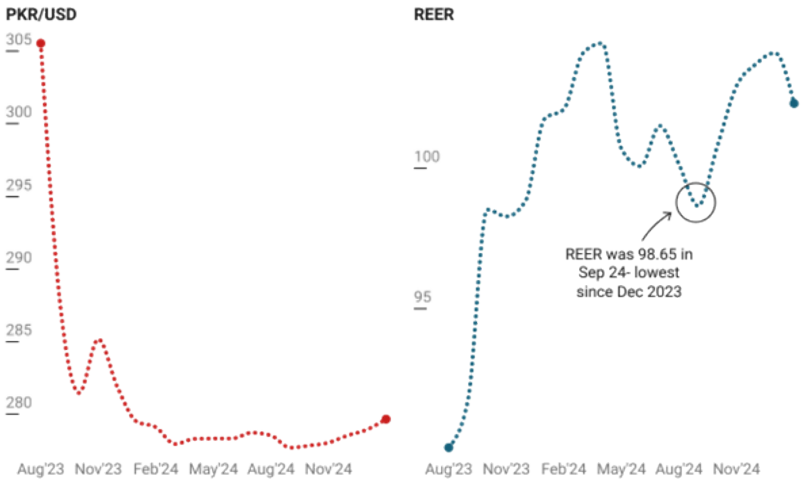
Currency is slowly depreciating

There have been pressures in the interbank market over the past few weeks, evident from delays in contract payments and some banks' reluctance to open L/Cs. In response, SBP has paused monetary easing and allowed a gradual depreciation of the currency. The PKR recently crossed the psychological barrier of 280 after more than a year, and this slow downward trend is expected to continue, with the currency likely closing the year around 287-290.

Overall, import growth is expected to remain contained, while strong remittance inflows should help keep the current account deficit in check. However, the absence of capital and financial account inflows is a concern. The balance of payments has been negative for three consecutive months, and SBP reserves have declined by $984 million from their mid-December peak, adding pressure on the currency.

Currency (dis)comfort

Gradual PKR depreciation continues amid interbank pressures, declining reserves, and delayed IMF inflows.



A slight relief came from negative month-on-month inflation in February, which led to a real effective exchange rate (REER) appreciation to 102.27 from 104.06, an increase of 1.72 percent. While inflation may not remain negative in March, the slow depreciation of the PKR is expected to prevent further significant REER appreciation.

The key challenge remains building SBP reserves. In 2024, SBP purchased over $9 billion from the interbank market, with official data showing $3.8 billion bought between June and October. However, with rising current account pressures, fewer surplus dollars are available, and whatever SBP acquires is largely used for debt servicing. The central bank urgently needs to bolster reserves but faces delays in the IMF review, with the next tranche unlikely before the FY26 budget is passed. As a result, reserve accumulation is expected to be slower than initially anticipated, likely reaching around $13 billion by June rather than the earlier target of $15 billion. Until then, the PKR will remain under pressure.

Fiscal austerity to continue

The government has no option but to continue with tight fiscal policies. FBR revenues are falling short of targets due to overly ambitious projections, lower-than-expected GDP growth, and declining inflation. GDP growth is expected to be significantly below the budgeted 3.6 percent, while inflation is likely to drop to 5-6 percent from the earlier forecast of 12 percent. Consequently, after consulting the IMF, the government has revised the nominal GDP estimate from Rs124 trillion to Rs116 trillion. To maintain the tax-to-GDP ratio at 10.6 percent, the FBR's revenue target has been lowered from Rs12.97 trillion to Rs12.35 trillion. However, given the even lower actual nominal GDP, FBR is likely to miss this revised target as well.

As of 8MFY25, FBR collected Rs7,346 billion, falling Rs601 billion short of the original Rs7,947 billion target. While overall tax collection has shown significant growth, it has come at the cost of strangling the formal, tax-compliant sector. The imposition of a super tax, higher indirect taxes on food and other essentials, and exorbitantly high salaried taxes have eroded purchasing power and dampened demand.

The rise of the informal economy: High tax rates are driving a greater share of economic activity into the informal sector. Increased indirect taxes on certain products have led to a decline in sales, ultimately reducing tax collection instead of boosting it. For instance, sales of formal dairy and juice products have dropped by 20-40 percent, limiting government revenue. Meanwhile, informal players are expanding, evading taxes while failing to meet food safety standards. Additionally, smuggling and under-invoicing have replaced domestically produced goods in supermarkets.

Higher tax rates often create stronger incentives for tax evasion—an issue made worse by weak enforcement. Several key sectors remain largely outside the tax net. Collections from retailers and traders under the Tajir Dost scheme have been negligible, real estate contributes virtually nothing, and provincial governments have yet to implement effective income taxation on agriculture.The government must shift its approach by rationalizing tax rates and broadening the base. The formal sector's ability to bear additional tax burdens is diminishing. Further rate hikes and new taxes are proving counterproductive, while an unfair system fuels the growth of the informal economy. This discourages investment from major corporations and deters foreign direct investment (FDI) from multinational companies.

The problem extends beyond investment—it is also driving capital flight. As tax rates have reached prohibitive levels, firms and wealthy individuals are increasingly moving their capital to jurisdictions with lower taxes and more stable policies. To curb this trend and encourage domestic capital formation, the government must either lower tax rates or balance them by improving service levels.

IMF's pressure on tax reforms: The IMF is pushing hard for tax broadening and is dissatisfied with the lack of progress. The ongoing review remains incomplete, with the IMF team leaving the country while discussions continue. The government is now drafting next year's budget, which must be approved by the IMF. The review is expected to conclude once the budget-making process is finalized, after which the case will likely be presented to the IMF Board for approval, leading to the release of the next tranche.

No mini-budget, but revenue measures continue: There will be no mini-budget in the last quarter, as the government remains committed to achieving the full-year primary fiscal surplus target of 2 percent of GDP. Instead, alternative revenue measures are being implemented. One such step is the recent increase in the petroleum levy by Rs10, bringing it to Rs70 per liter. This move was strategically timed to coincide with falling international oil prices, ensuring no change in consumer fuel prices. The levy increase is expected to generate an additional Rs15 billion per month, aiding fiscal consolidation.

The government plans to use this additional revenue to provide relief by reducing electricity tariffs. However, this would require further cuts to development spending.

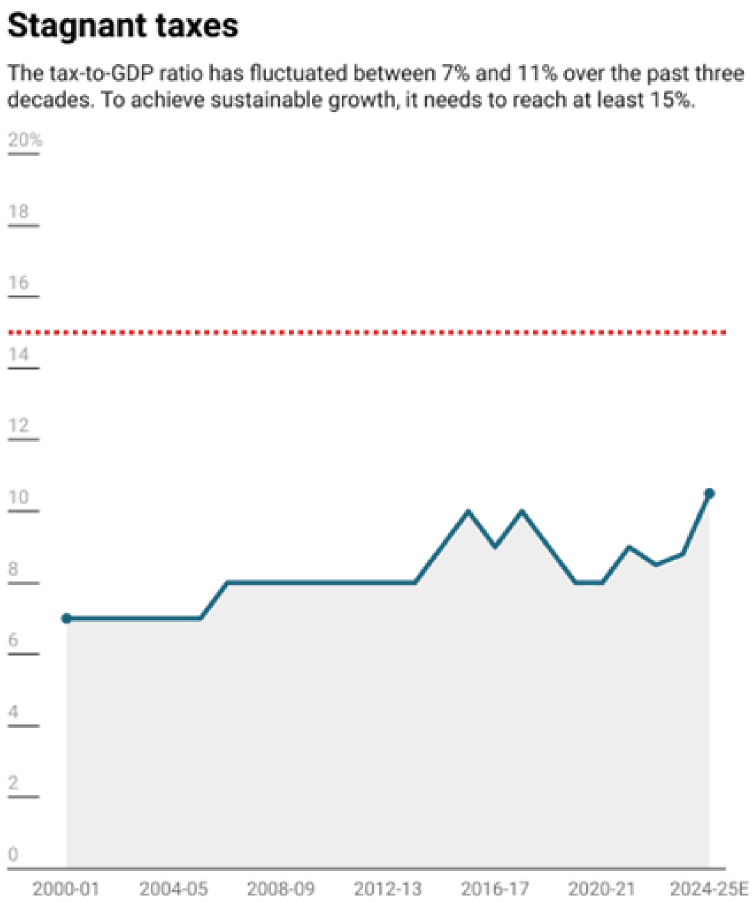
In 1HFY25, the government recorded a primary fiscal surplus of Rs3,604 billion (2.9 percent of GDP), compared to a surplus of Rs1,812 billion (1.7 percent of GDP) in the same period last year. The primary surplus comfortably exceeds the IMF target of Rs2,877 billion and is on track to achieve the full-year target of Rs2,435 billion.

However, this comes at the cost of imposing disproportionately high taxes on the formal sector. In 1HFY25, FBR revenues increased by 26 percent to Rs5,625 billion, equivalent to 4.9 percent of GDP based on the government's nominal GDP estimate. This marks the highest-ever tax revenue collection in the first half of the fiscal year as a percentage of GDP. Interestingly, nominal GDP is likely to be around Rs114-117 trillion, compared to the government's estimate of Rs124 trillion, due to plummeting inflation and lower real GDP growth.

Consolidated Fiscal Operations

in PKR billion I 1HFY25

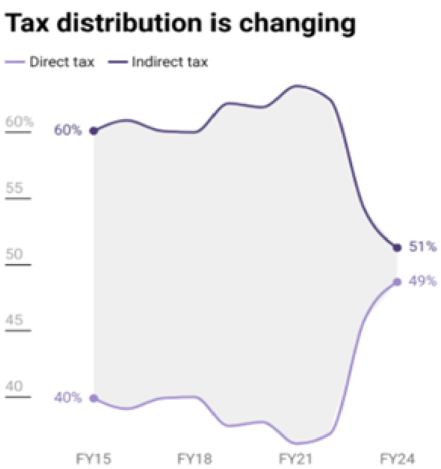
	1QFY25	2QFY25	1HFY25	1HFY24	YoY
Total Fiscal Revenue	**5,827**	**3,937**	**9,764**	**6,854**	**42%**
Total Tax Revenue	2,776	3,292	6,067	4,834	26%
Federal Tax Revenue	2,563	3,062	5,625	4,469	26%
Provincial Tax Revenue	213	230	443	365	21%
Total Non-Tax Revenue	**3,051**	**645**	**3,696**	**2,020**	**83%**
Federal Non-Tax Revenue	2,997	503	3,553	1,941	83%
Provincial Non-Tax Revenue	54	143	143	79	81%
Total Fiscal Expenditure	**3,931**	**7,370**	**11,302**	**9,262**	**22%**
Total Current Expenditure	**3,537**	**6,581**	**10,118**	**8,565**	**18%**
Total Development Expenditure and Net Lending	**277**	**467**	**744**	**661**	**13%**
Statistical Discrepancy	117	322	439	36	
Overall Budget Balance	**1,896**	**(3,434)**	**(1,538)**	**(2,408)**	**-36%**
Primary Balance	**3,202**	**303**	**3,604**	**1,812**	**99%**
Total Fiscal Financing	**(1,896)**	**(3,434)**	**(1,538)**	**2,408**	
External Fiscal Financing	(157)	(198)	(79)	608	
Domestic Fiscal Financing	(1,739)	(3,236)	1,617	1,799	-10%
GDP (Rs. in Billion)	*124,150*	*125,150*	*124,150*	*106,045*	
Budget Deficit (to GDP)	*-1.5%*	*-2.7%*	*-1.2%*	*-2.3%*	
Primary Balance (to GDP)	*2.6%*	*0.3%*	*2.9%*	*1.7%*	

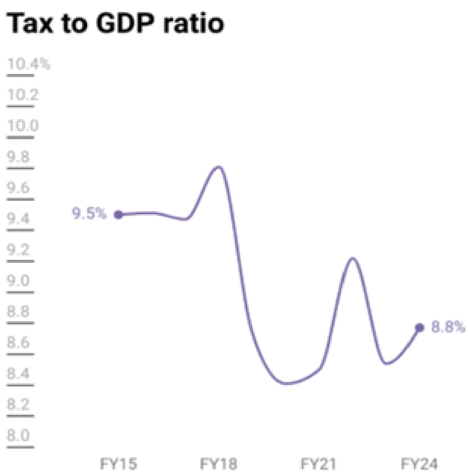


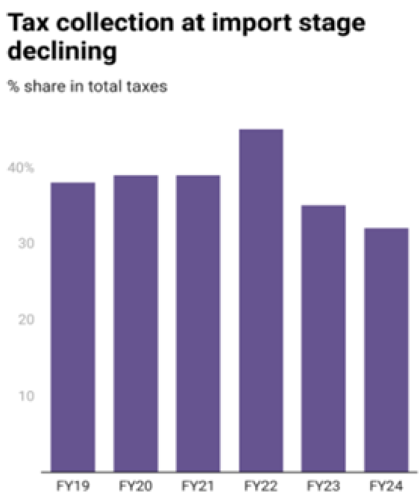
The expected FBR revenues for the full year are forecasted to reach Rs12.1-12.3 trillion, compared to the reportedly IMF's revised target of Rs12.35 trillion. Even at this lower collection, it is estimated to be 10.5 percent GDP, making possibly the highest-ever tax revenue in terms of GDP share. Within this, reliance is shifting toward direct taxes—49.5 percent of FBR taxes in 1HFY25 were direct, compared to 48 percent in the same period last year.

Historically, FBR tax collection was dominated by indirect taxes, with a significant portion coming from the import stage. In FY20, 43 percent of FBR taxes were collected at the import stage. However, the FBR stopped publishing granular data after that. The share of tax collection at the import stage has been declining with falling imports—GST at the import stage, along with customs duties, accounted for an average of 40 percent of total taxes during FY19-22, but this has dropped to 34 percent in FY23-24.

Another critical factor is the cost of debt servicing, which likely peaked in 1HFY25. Despite falling interest rates, debt servicing expenses increased by 22 percent to Rs5,142 billion in 1HFY25. Interest payments reached their highest point in 2QFY25, rising 35 percent year-on-year to Rs3,835 billion. However, most T-bills borrowed at peak rates have now matured, and floating bonds have been repriced. As a result, debt servicing costs are expected to decline significantly in 2HFY25 as the impact of a 1,000-basis point reduction in interest rates becomes evident.



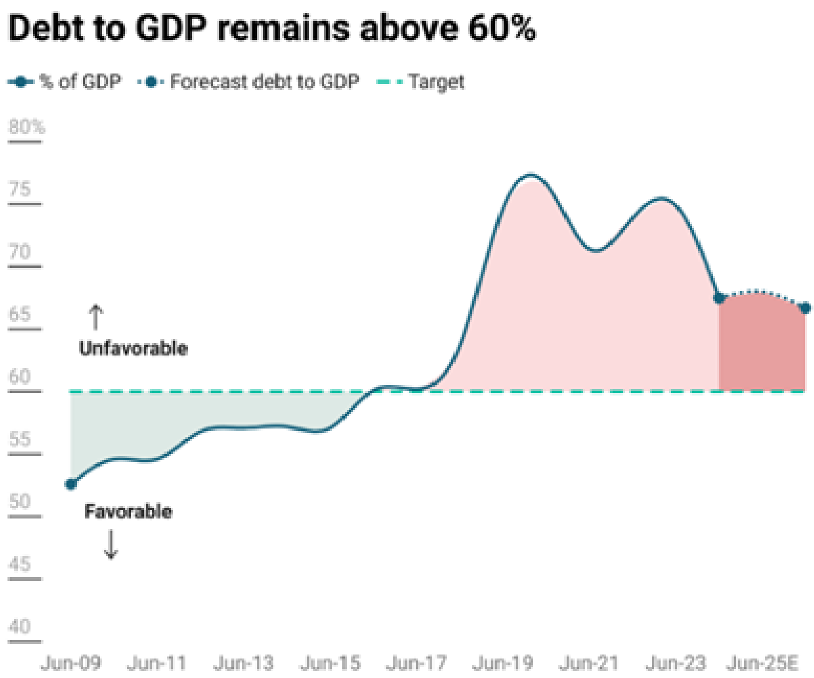


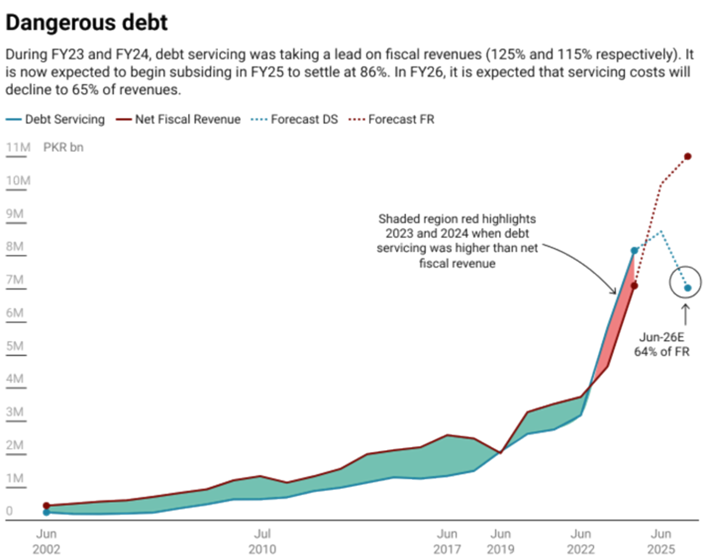


This may provide the government with some fiscal space to increase subsidies, which fell by 37 percent to Rs237 billion in 1HFY25. Additionally, the government may slightly accelerate the currently low pace of development spending, which stood at Rs165 billion. The key factor remains the primary surplus target. As long as the government stays on track to achieve this, there will likely be no new tax impositions, while there may be room to allocate more spending toward subsidies and development projects.

Pakistan debt profile is marginally improving

Pakistan's Central Government Debt stands at PKR 72.1 billion, comprising PKR 50.2 billion in domestic debt and PKR 21.9 billion in external debt. Pakistan's debt-to-GDP ratio peaked at 76.6 percent in FY20 during the COVID-19 period and has been declining since, reaching 67.4 percent in FY24. However, the risk of default remained a concern in FY22 and FY23 due to rising debt servicing costs. Debt servicing as a percentage of net federal revenues peaked at 125 percent in FY23 but is expected to decline to 85-90 percent in FY25 and further to 60-65 percent in FY26. Once this ratio falls below 60 percent, the government will have sufficient fiscal space to increase spending and provide marginal support for economic growth in FY27 and FY28.





Within debt servicing and other payments, external obligations are the most critical factor, as they directly impact foreign exchange reserves and the currency. The external payment obligation for FY25 stands at $26 billion. Apart from expected rollovers, approximately $5 billion in payments remain outstanding, while the rest have already been settled. Despite these significant repayments, the SBP's foreign exchange reserves increased by $2.7 billion in 1HFY25.

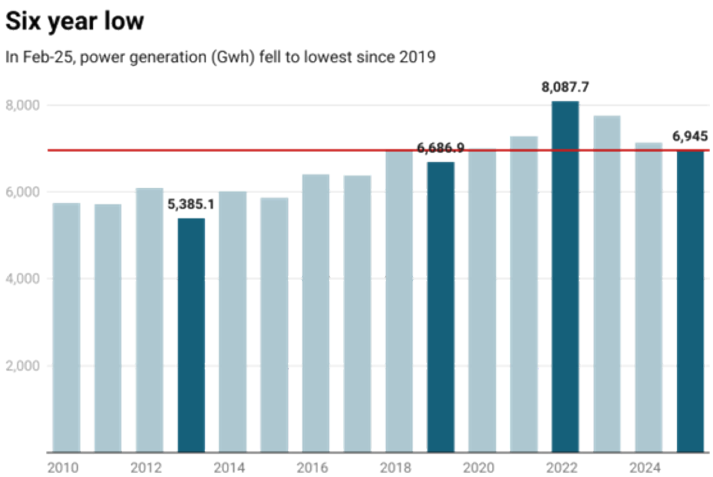
However, the challenge is far from over. As of November 2024, 12-month foreign liabilities stood at $29.3 billion. The key to managing this debt will be reducing the debt-to-GDP ratio below 60 percent. Achieving this will require maintaining primary fiscal surpluses.

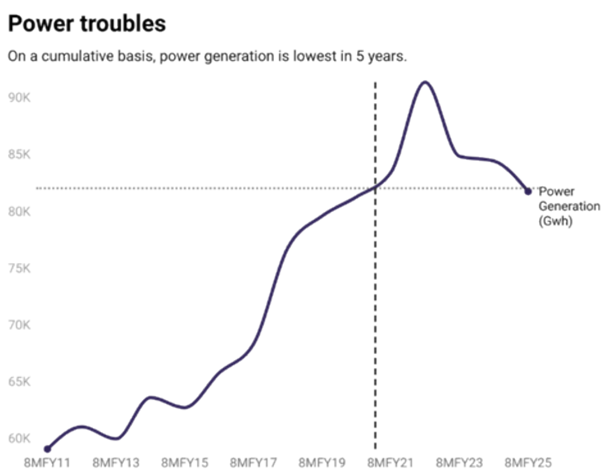
Energy challenge - dwindling power consumption

There is no respite in the decline of power consumption, despite government measures to boost demand. In February 2025, power consumption stood at 6,945 GWh, the lowest in six years. The government's winter package failed to stimulate consumption, as power generation fell 2.6 percent year-on-year (YoY) and remained 6 percent below the reference generation. While industrial activity is showing some improvement, rapid solarization continues to limit grid electricity demand.

On the positive side, falling global energy prices and an improved fuel mix have helped lower consumer electricity tariffs. X-DISCOs have recorded eight consecutive months of negative Fuel Cost Adjustments (FCA)—a stark contrast to the previous two years, where rising FCAs and Quarterly Tariff Adjustments (QTA) worsened the impact of increasing base tariffs. However, February's generation shortfall relative to the reference price could negatively affect the upcoming QTA.

Declining grid demand amid rising solarization: In 8MFY25, total power consumption fell to 81,738 GWh, down 3.2 percent YoY, marking a five-year low and remaining 7 percent below the reference generation. The fuel mix continues to improve, with nearly zero generation from diesel and furnace oil, and reduced reliance on expensive RLNG.





The government is pushing to increase grid electricity consumption to improve utilization. Grid capacity usage has been below 25 percent in the past three months, and even in the peak summer month of July, it remained under 50 percent. A 2.75x increase in electricity tariffs from Rs18/kWh in 2018 to Rs49/kWh in 2024, coupled with the rapid adoption of solar energy, has significantly reduced demand.

To address this, the government revised net metering rates, as total installed capacity surged from 321MW in 2021 to 4,241MW by December 2024, with capacity doubling in the last six months alone. While existing net metering consumers remain unaffected, new policy changes include a buyback rate reduction from Rs27/unit to Rs10/unit, aligning with the grid's marginal production cost. This transition from net to gross metering is expected to slow net metering adoption, but solarization will continue at a rapid pace—particularly among industries that are installing solar setups without net metering to reduce daytime electricity costs.

Gas price hike driving industrial shift away from captive power: Under IMF pressure, the government has sharply raised gas tariffs for captive power plants to Rs3,500/MMBtu, with an additional Rs791/MMBtu levy. Even the most efficient combined cycle plants now find grid electricity more cost-effective than gas, yet most industrial consumers remain reluctant to switch due to grid reliability concerns. Instead, industries are doubling their solar capacity with battery backups and exploring alternative fuels such as biomass, bagasse, coal, and furnace oil.

The only way to incentivize industrial consumers to switch to the grid is by making grid electricity reliable and affordable. While the government claims it can cut power costs by 25-30 percent, achieving this target remains highly ambitious. Any delay in addressing this issue risks industries locking in long-term capital investments in alternate energy sources, further reducing grid demand.

Surplus RLNG & the looming gas crisis: The decline in captive power gas consumption is creating a new challenge. With captive users shifting away from gas, Sui companies are struggling to manage excess gas in the system. Pakistan already has a surplus of RLNG, with about 1.5 LNG cargoes per month going unused. The additional reduction in captive demand will leave another three cargoes redundant, nearly 50 percent of Pakistan's LNG imports from Qatar
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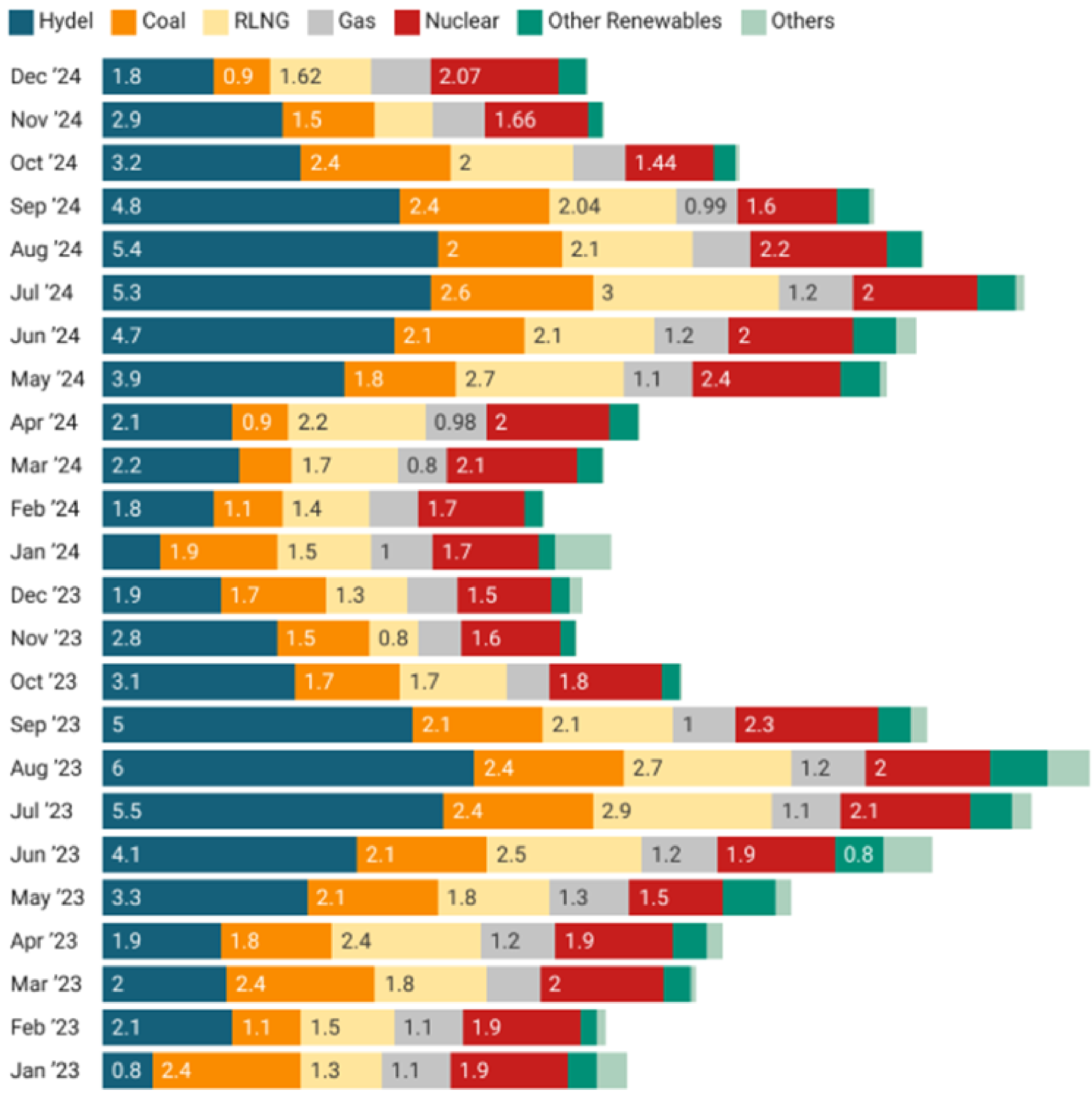
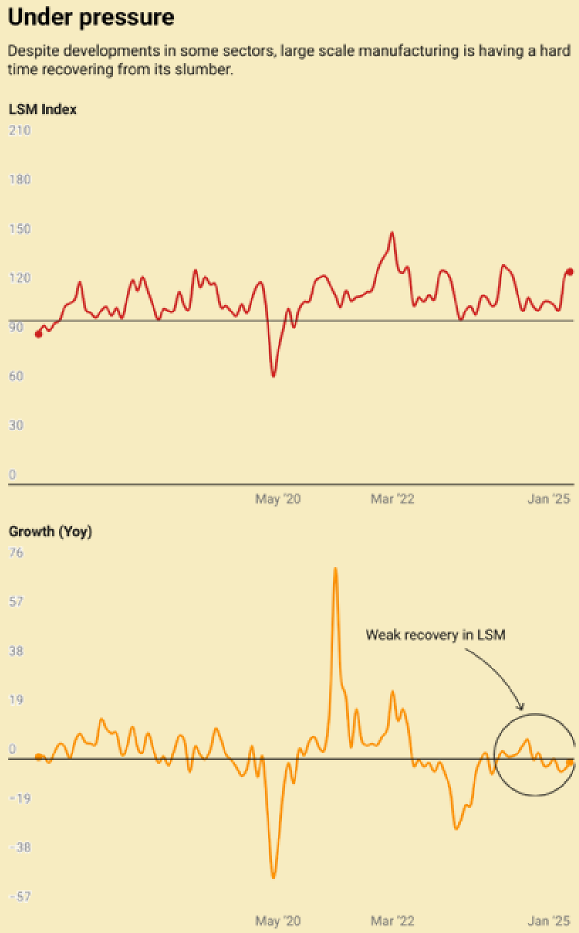
To address this, domestic gas production has been curtailed to accommodate imported RLNG. However, as captive plants shift away, the situation is set to worsen. Meanwhile, the best-paying RLNG consumers—captive power plants—are exiting, leaving a revenue gap for Sui companies. Some RLNG may be diverted to commercial use, but this requires significant infrastructure investment to separate commercial gas supply from domestic consumption.
Higher domestic gas tariffs seem inevitable, but this risks driving households toward alternative fuels, exacerbating the gas circular debt, even as the government struggles to manage the power sector's circular debt crisis.

Electricity generation by sources



Economic growth is missing



Despite a 1,000-basis points reduction in interest rates, nosediving inflation, and a stable currency, economic growth remains sluggish, even from a low base. GDP grew by just 0.92 percent in 1QFY25, with expectations of a modest improvement in the remainder of the fiscal year. However, full-year growth is likely to fall short of the government's 3.6 percent target and the SBP's 2.5-3.5 percent estimate, settling around 2-2.5 percent for FY25. This would mark FY23-25 as the weakest growth period in 70 years.

Large-Scale Manufacturing is struggling to recover: The industrial sector is finding it difficult to recover from a low base. LSM output declined by 1.2 percent YoY in January and fell 1.8 percent in 7MFY25.

The value-added export segment is performing relatively better. Wearing apparel (a key value-added export) grew by 15.1 percent in January, with 7MFY25 growth at 10.4 percent. However, low value-added exports remain sluggish, with textiles growing by only 2.1 percent in 7MFY25.

The automobile industry has shown a 45.7 percent increase in July-Jan, with February's volumes remaining healthy (except for tractors). In February, car sales rose by 24 percent YoY to 12,084 units, with stronger growth in high-end vehicles. In 8MFY25, car sales surged 50 percent to 89,764 units, with SUVs and LCVs leading the growth. However, tractor sales declined by 30 percent, reflecting the ongoing farm sector distress.

Industries burdened by higher taxation are struggling. Beverage production fell 0.2 percent, while tobacco production plunged 40.5 percent, primarily due to excessive taxation and weaker purchasing power. Additionally, informal and tax-evading production is reportedly increasing, limiting government revenue collection.

Despite some improvements in selected segments, the overall manufacturing sector remains under pressure due to: low development spending, bank-imposed import restrictions, and high real interest rates. As a result, manufacturing is expected to grow by only 1.4 percent in FY25, after two consecutive years of contraction, but will still fall short of the peak levels seen in FY22.

Agriculture: weak outlook amid declining crop yields. The agriculture sector posted 1.15 percent growth in 1QFY25, mainly supported by livestock, which grew 4.89 percent. However, crop production contracted by 5.93 percent, with important crops declining by 11.2 percent. The outlook remains weak, as cotton output is disappointing and wheat sowing has declined by 8 percent, from 9.63 million hectares to 9 million hectares. With slight yield declines, wheat production could drop by 10-15 percent. Additionally, water availability is expected to be suboptimal due to lower rainfall and snow levels this winter, further dampening agricultural prospects.

Services sector: Urban-led growth to provide some support. The services sector grew 1.4 percent in 1QFY25 and is expected to recover to 2.3percent for the full year. Urban-driven sectors are likely to perform better, but weak agriculture and manufacturing growth will weigh on overall services output.