Pakistan Economy

The Roadmap to Economic Growth

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- Pakistan plans to privatize 24 state-owned enterprises from 2024 to 2029 to alleviate fiscal burdens.
- All SOEs are to be integrated into a new legal framework by Jun'25

Trade dynamics and deficit

- CAS for FY25e: USD 940mn (+0.24% of GDP).
- Trade deficit for FY25 expected around USD 26.7bn, driven by a 12% YoY increase in imports and a 6% growth in exports.
- Remittances FY25e: +21% YoY to USD 36.6bn

Revitalizing Pakistan's economy with IMF support

- Pakistan has secured an EFF facility from the IMF, valued at USD 7bn.
- For FY25, the financing plan includes USD 16.4bn in rollovers

Stable PKR- The impact of strengthened reserves

- SBP is expected to end FY25 with reserves around USD 13.0bn.
- With strengthened reserves, supported by the IMF program and the removal of multiple currency practices; we expect USD/PKR will be around 285 by Jun'25 and 293.6 by Dec'25.

Time to pause on cuts?

- Inflation average of 6.5% expected in FY25.
- Combined efforts of stringent monetary and fiscal measures have led to a sustained reduction in inflationary pressures.
- Policy rate is expected to pause at 12%.

Emerging signs of modest growth

- GDPg in FY25 is projected at 2.8%.
- Growth expected at 5.1% in FY26.
- Agri- sector est. to grow at 0.6% in FY25.
- Industry is expected to grow by 1.8%.
- Services are projected to grow by 3.9%.

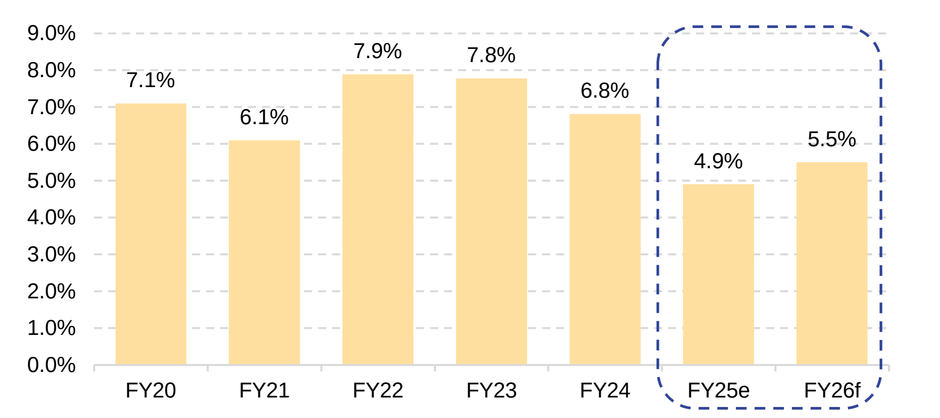
Aiming for fiscal consolidation

- Focus on fiscal consolidation
- If reforms are effectively implemented, the deficit could potentially decrease to 4.9% of GDP in FY25e.
- Gov't's fiscal plan includes revenue-enhancing and expenditure-controlling measures.

Pakistan is charting a bold course towards fiscal resilience in FY25, with the IMF spotlighting a leaner, more disciplined approach to economic management. Last year's historic primary surplus of PKR 953bn (0.9% of GDP) set the tone, and the government now targets a robust 2% surplus, reaffirming its commitment to fiscal stability. This quarter marks Pakistan's first budget surplus since 2QFY04, powered by an extraordinary PKR 2.5trn profit from the SBP and resulting in a record-high primary surplus of PKR 3trn. In line with IMF recommendations, Pakistan seems to be focused on curbing high expenditure on pensions, infrastructure, and subsidies to reduce debt and sustain deficit control. With a projected deficit of 5.9% (our expectation is 4.9%) of GDP this year, down from 6.8% in FY24, the country's fiscal roadmap reflects a clear commitment to reform.

Path to consolidation: The fiscal outlook for Pakistan in FY25e reflects an ambitious, yet achievable, path toward fiscal consolidation, building on the progress made in FY24. For FY25b, the government has laid out a fiscal adjustment plan aimed at reducing the overall fiscal deficit from 6.8% of GDP in FY24 to 5.9% (our expectation is 4.9%). This plan includes both revenue-enhancing and expenditure-controlling measures. The government projects gross revenue at 14.3% of GDP and total spending at 15.2% of GDP. While these targets are ambitious, there is potential for the deficit to be reduced even further, potentially down to 4.9% of GDP (we view), if reforms are successfully implemented. Key to achieving this will be the government's commitment to improving tax collection through direct and indirect taxes, including bringing the retail, export, and agricultural sectors fully into the tax net and curtailing markup expense.

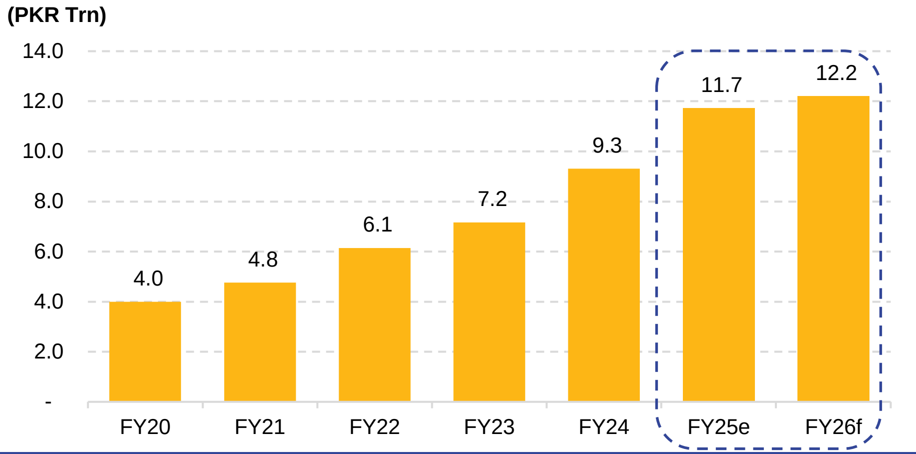
Figure: Fiscal Deficit (% of GDP)



Source (s): MoF, AHL Research

Revenue assumption remains aggressive: On the revenue front, the FBR target of PKR 12.9trn set for FY25 faces significant challenges as economic conditions and tax collection trends reveal potential shortfalls. With roughly 40% of FBR's revenue historically dependent on import taxes, the high tariffs and restrictions on non-essential imports, combined with PKR stability, mean customs duties and import sales tax collections may struggle to meet their targets. Although the FBR projects additional revenue from GDP and LSM growth, inflation, and recent tax measures, the first seven months already missed its target by ~ PKR 468bn. Achieving FY25's 40% YoY revenue growth increase will hinge on robust enforcement and favorable economic shifts. Moreover, the authorities aim to generate significant non-tax revenue, with the SBP alone contributing PKR 2.5trn in profits. This revenue boost, alongside targeted tax policy reforms, will be essential for meeting fiscal targets. As per the Budget FY25, personal and corporate income tax reforms are expected to yield PKR 357bn by incorporating exporters into the regular tax regime and simplifying individual tax brackets. Additionally, reforms in the sales tax system are projected to generate PKR 286bn by adjusting tax rates on various products. The expansion of Federal Excise Duty (FED) to cover property sales and other areas is forecasted to add PKR 413bn to the national coffers. Despite optimistic projections, we anticipate an overall shortfall in FBR collections for FY25, with total revenues likely to settle around PKR 11.7trn an estimated 9.6% below the ambitious PKR 12.97trn target.

Figure: FBR Tax Revenue

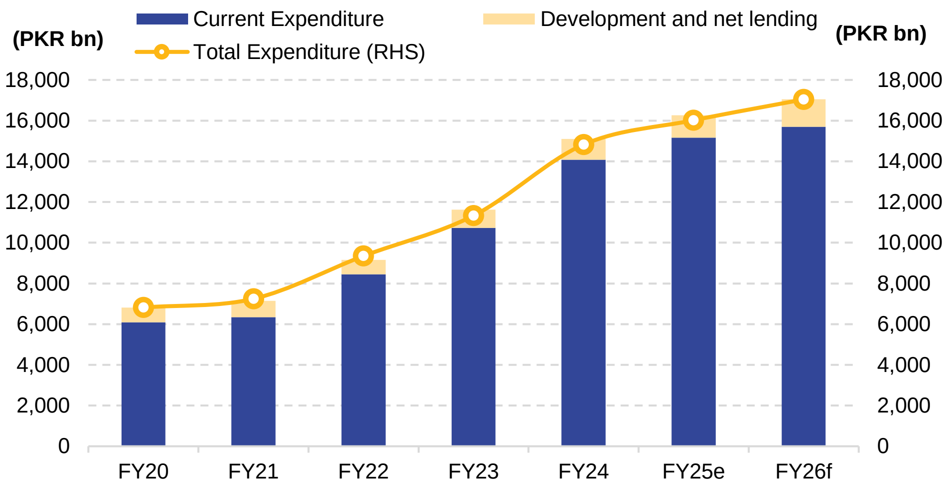


Source (s): MoF, FBR, AHL Research

Lower current expenditure to provide respite: While the revenue side of the fiscal equation is critical, managing expenditures remains a pressing challenge. Non-development expenditures continue to weigh heavily on the budget, largely due to soaring mark-up payments, which surged by 42% in FY24 and are projected to rise another 20% in FY25, reaching an anticipated PKR 9.8trn. However, substantial interest rate cuts could help ease debt-servicing costs. The government's recent T-bill buyback program, funded by SBP profits, also aims to reduce debt levels. We estimate that these measures could bring debt servicing down to approximately PKR 7.8trn 4.1% lower YoY than FY24's PKR 8.2trn and well below the budgeted PKR 9.8trn for FY25. Additionally, with a tighter grip on expenses, development spending may also fall short of the budgeted PKR 1.7trn, potentially landing closer to PKR 1trn by year-end.

- FBR's FY25 revenue target of PKR 12.9trn overambitious.
- Interest rate cuts may help reduce debt-servicing costs to PKR 7.8trn (Budgeted: PKR 9.8trn).
- Develop. exp likely to fall short of the PKR 1.7trn budgeted number.

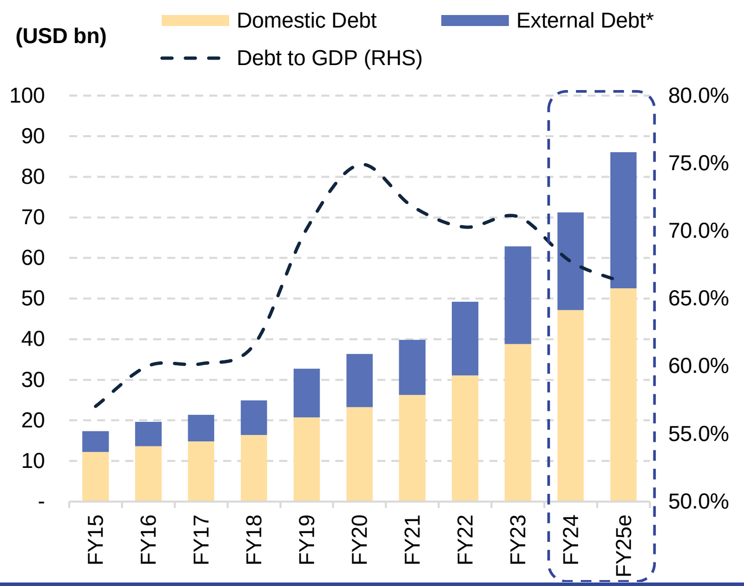
Figure: Breakdown of expenditure



Source (s): MoF, AHL Research

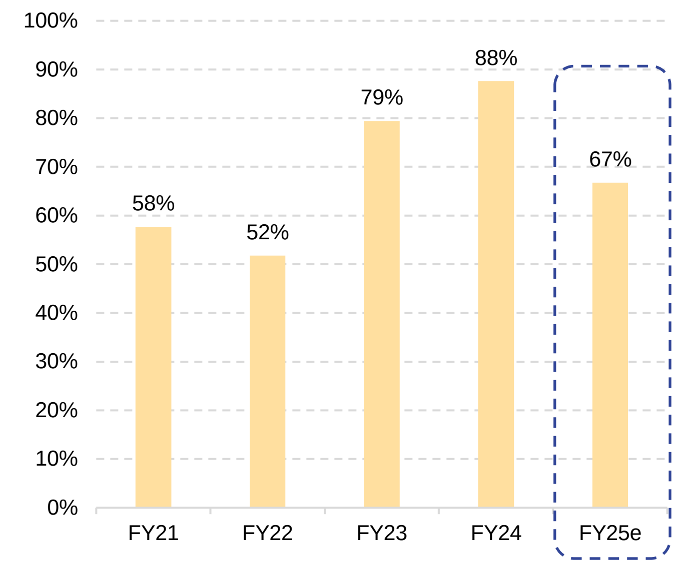
Looking beyond FY25, the government's broader fiscal strategy emphasizes the need for structural reforms to sustain fiscal health. This includes broadening the tax base, enhancing tax administration, combating evasion, and reducing corruption. Collaboration between federal and provincial governments is also crucial, with provinces expected to contribute to fiscal surpluses, targeting ~1% of GDP in FY25e. The EFF with the IMF aims for gradual fiscal consolidation, setting a long-term goal of achieving a primary surplus of 2% of GDP, supported by a 3% of GDP net revenue mobilization effort.

Figure: Total public debt (%)



Source (s): MOF, AHL Research, *including IMF

Figure: Markup expense as % of FBR revenue



Source (s): FBR, MOF, AHL Research

Exhibit: Pakistan Fiscal Operations

PKR bn	FY23	FY24	FY25e	FY26f
Gross Revenue Receipts	8,880	12,361	16,547	16,263
FBR Taxes	7,169	9,311	11,719	12,205
Non-Tax Revenue	1,711	3,050	4,828	4,057
Less: Provincial Share	**4,223**	**5,264**	**6,876**	**7,079**
Net Revenue Receipts	**4,656**	**7,098**	**9,671**	**9,184**
Total Expenditure	11,332	14,823	16,018	17,043
Current Expenditure	10,732	14,073	15,167	15,690
Mark-up Payments	5,696	8,160	7,825	7,981
Defence	1,586	1,859	2,122	2,228
Grants	1,070	1,395	1,777	1,866
Subsidies	1,080	1,067	1,363	1,431
Pension	666	808	1,115	1,171
Running of Civil Govt and Others	634	784	965	1,013
Federal PSDP	743	732	1,000	1,050
Federal Budget Balance	**(6,676)**	**(7,725)**	**(6,348)**	**(7,859)**
Provincial Surplus	155	518	655	650
Overall Budget Balance	**(6,521)**	**(7,207)**	**(5,693)**	**(7,209)**
Primary Balance	**(826)**	**953**	**2,132**	**772**

Source (s): MoF, AHL Research

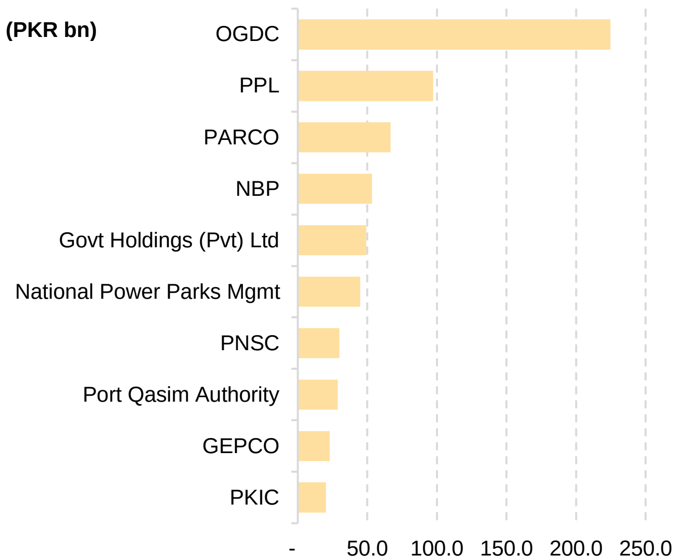
Structural reforms - Strategic necessities

Pakistan is on the verge of a transformative shift as it embarks on an ambitious privatization agenda aimed at alleviating the long-standing fiscal burden of inefficient and loss-making SOEs. With the decision by the Cabinet Committee on Privatization (CCOP) to approve the sale of 24 public sector entities, the government has made clear its intent to streamline its role in the economy over the next five years, covering 2024-2029. This initiative signifies a major policy shift, with even profitable SOEs potentially being considered for privatization, underscoring the administration's commitment to structural economic reforms.

- Pakistan plans to privatize 24 state-owned enterprises from 2024 to 2029 to alleviate fiscal burdens.
- All SoEs are to be integrated into a new legal framework by Jun'25.

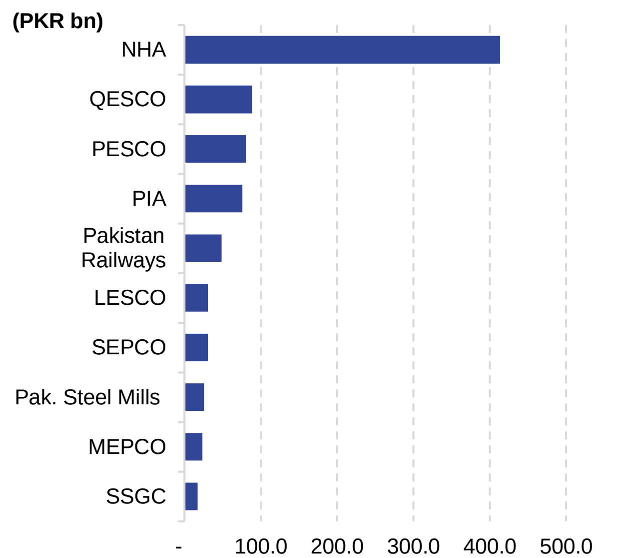
Economic revitalization via privatization: The need for privatization has never been more critical. Historically, SoEs have been a substantial drain on Pakistan's public finances, contributing to chronic budget deficits and stifling economic growth. In FY23 alone, 23 of these entities collectively posted a staggering loss of PKR 905bn, while the country's top 15 profit-making SoEs only managed to generate a profit of PKR 687bn. The inefficiencies within these enterprises have diverted much-needed resources away from essential sectors such as healthcare, education, and infrastructure, underscoring the necessity of privatizing these assets to improve fiscal stability.

Figure: Top 10 profit making entities



Source (s): MoF, AHL Research

Figure: Top 10 loss making entities



Source (s): MoF, AHL Research

Beyond privatization- Comprehensive SOE reforms: Privatization is only one component of a broader structural reform agenda. As part of its commitments to the IMF, Pakistan is also pursuing comprehensive reforms in governance and legal frameworks governing SOEs. The recently adopted SOE Act, along with the establishment of a Central Monitoring Unit (CMU) in 2023, represents key milestones in this process. These reforms aim to modernize the management and oversight of SOEs, ensuring that only those with significant strategic, social, or security importance remain under state control. All others will either be privatized or restructured to improve efficiency and reduce their drain on public resources.

Further reforms are in the pipeline, with plans to bring all SOEs under the new legal framework by Jun'25 and to revise the Sovereign Wealth Fund Act by Dec'24. These legal adjustments will be complemented by efforts to improve the governance structures of key statutory SOEs and to implement the SOE triage plan, which will help classify enterprises based on their strategic importance and financial viability. Additionally, with support from the Asian Development Bank (ADB), privatization and restructuring plans are being refined to ensure a smooth transition for the selected enterprises.

Beyond SOE reform, the government is also focused on enhancing transparency and governance across the public sector. Anti-corruption initiatives are being strengthened, with a Governance and Corruption Diagnostic Assessment report set to be published by July 2025. Moreover, asset declarations of high-level public officials are expected to be publicly accessible by Feb'25, with appropriate safeguards for personal data. These measures are expected to reduce corruption, enhance public trust, and create a more transparent business environment. On the trade front, as per the latest IMF report, the authorities are working to further liberalize trade policies by reducing tariffs and simplifying import/export documentation. These reforms are part of the National Tariff Policy (2025-2029) and are aimed at boosting competitiveness, facilitating private sector growth, and promoting export-led economic development.

Exhibit: Pakistan - Structural Conditionality

Some of the key structural benchmarks	Rationale	Status
Fiscal		
Do not grant tax amnesties, and do not issue any new preferential tax treatment	Protect tax revenue	Continuous
Seek ex-ante parliamentary approval for any expenditures that are non-budgeted or that exceed the budgetary appropriation.	Improved parliamentary oversight of budget execution	Continuous
Approve a National Fiscal Pact devolving some spending functions to the provinces.	Address the mismatch of federal and provincial revenues and expenditures	Sep'24 end
Share with the IMF staff a report detailing actions to reduce the federal government's footprint.	Reduce the footprint of the state	Sep'24 end
Each province amends their Agriculture Income Tax legislation and regime so that taxation can commence from January 1, 2025.	Protect tax revenue	Oct'24 end
Fully implement compliance risk management measures in Large Taxpayer Units	Improve tax compliance	Dec'24 end
Introduce a 5 percent FED on fertilizer and pesticide.	Protect tax revenue	Jun'25 end
Monetary and Financials		
Average premium between the interbank and open market rate will be no more than 1.25 percent during any consecutive 5 business day period.	Maintain FX market functioning	Continuous
Parliamentary approval of amendments to the bank resolution and deposit insurance legislation	Strengthen crisis management toolkit	Oct'24 end
Place undercapitalized private banks under resolution unless (i) these banks are fully recapitalized by end-October 2024; or (ii) a legally binding agreement is in place by end-October 2024 towards a merger with other banks or with a new sponsor that would achieve full recapitalization by April 2025.	Enforce regulatory standards	Nov'24 end
Implement revised regulations on risk mitigating measures.	Improve safeguards in monetary policy operations	Sep'25 end
Energy Sector		
Complete all policy actions needed to prepare two DISCOs for privatization and concession transactions.	Improve DISCO management and efficiency	Jan'25 end
Eliminate captive power usage in the gas sector.	Push captive gas users on to the electricity grid and channel gas to the most efficient generators	Jan'25 end
Public notification by the government of the December 2024 semiannual gas tariff adjustment determination.	Maintain tariffs at cost recovery levels	Feb'25 end
State-Owned Enterprises and Investment Policy		
Amend the SWF Act and other legislation, in consultation with Fund staff and in line with MEFP	Improve SOE governance by bringing all SOEs into line with the SOE legal framework approved in 2023 and strengthen SWF governance and accountability.	Dec'24 end
Amend the laws for 10 additional statutory SOEs, in consultation with Fund staff and in line with MEFP.	Improve SOE governance by bringing all SOEs into line with the SOE legal framework approved in 2023	Jun'25 end
Prepare a plan based on the assessment conducted to fully phase out all current Special Economic Zone incentives by 2035.	Improve efficiency and provide a level playing field for investment	Jun'25 end

Source (s): IMF, AHL Research

Current account surplus expected after 14 years

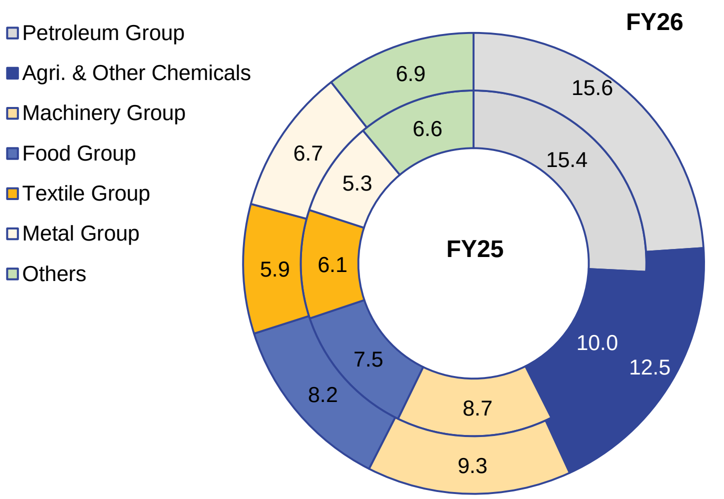
- CAS for FY25e: USD 940mn (+0.2% of GDP).
- Trade deficit for FY25 expected around USD 27bn, driven by a 12% YoY increase in imports and a 6% growth in exports.
- Remittances FY25e: +21% YoY to USD 36.5bn

Pakistan's external account in FY24 saw encouraging shifts, driven by stabilization efforts that curbed long-standing imbalances. FY24 witnessed a significant reduction in the current account deficit, which shrank to USD 1.7bn from USD 3.3bn in FY23. Looking ahead to FY25, we expect the current account surplus, projected at USD 940mn, which translates to +0.23% of GDP as during 1HFY25, country has already posted CAS of USD 1,210mn. This marks a continued commitment to economic stabilization, building on the modest performance of FY24, where the deficit was confined to a mere 0.45% of GDP.

Turning to trade dynamics, we project a trade deficit of USD 27bn for FY25e, reflecting an increase from the previous fiscal year. This reflects an increase from the previous fiscal year, driven by a robust 12% YoY rise in imports, while exports are expected to grow at a more conservative 6%. Despite the challenges posed by the global economic climate, the government's strategic initiatives aimed at enhancing export-oriented sectors, along with declining oil prices, offer a glimmer of hope for improving the trade balance.

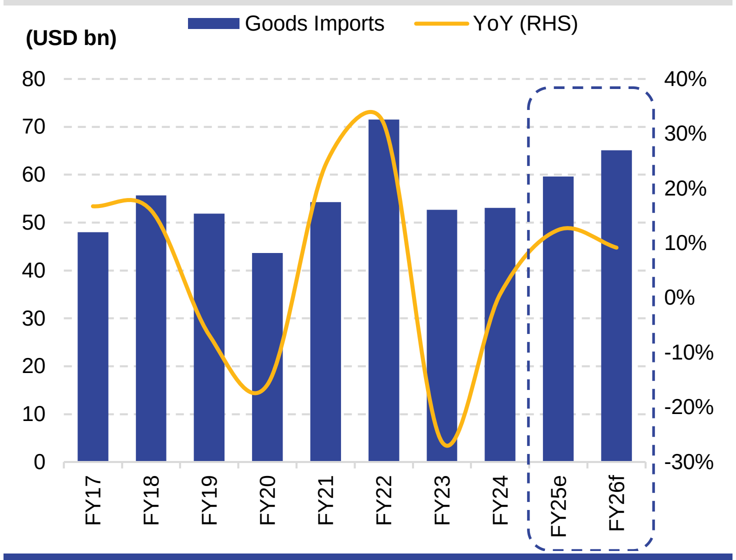
Vigilance remains concerning non-essential imports: In recent years, managing imports has become a critical focus for Pakistani authorities. Initially, strict restrictions were implemented to curb imports in response to economic pressures, but these measures have since been relaxed, leading to a more flexible import regime. While formal restrictions on imports have been lifted, vigilance remains concerning non-essential items. This cautious stance is influenced by the current reserve position of USD 11.4bn and the imperative to navigate upcoming debt repayments throughout FY25. The import sector is poised for significant growth in key areas, we believe. As per our estimates, petroleum products are projected to see a 1% YoY increase (with an assumption of 4% rise in volume), machinery is expected to grow by 18% YoY, and textiles are set to soar by an impressive 56% YoY, primarily driven by a surge in cotton imports.

Figure: Breakdown of imports (USD bn)



Source (s): SBP, AHL Research

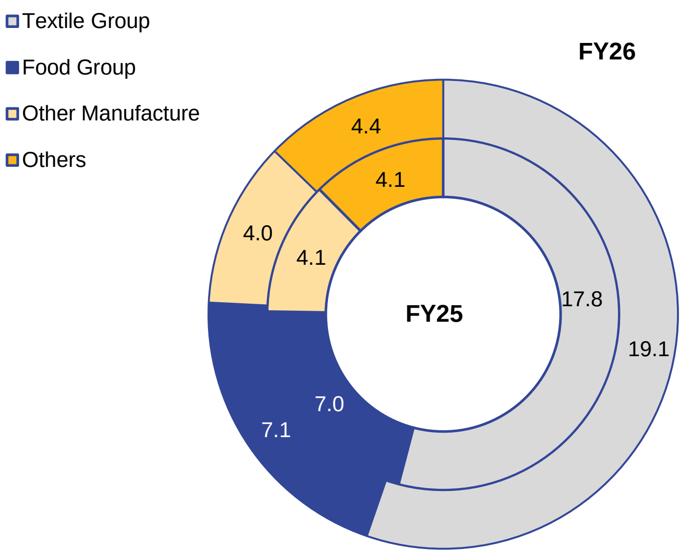
Figure: Historical trend of imports



Source (s): SBP, AHL Research

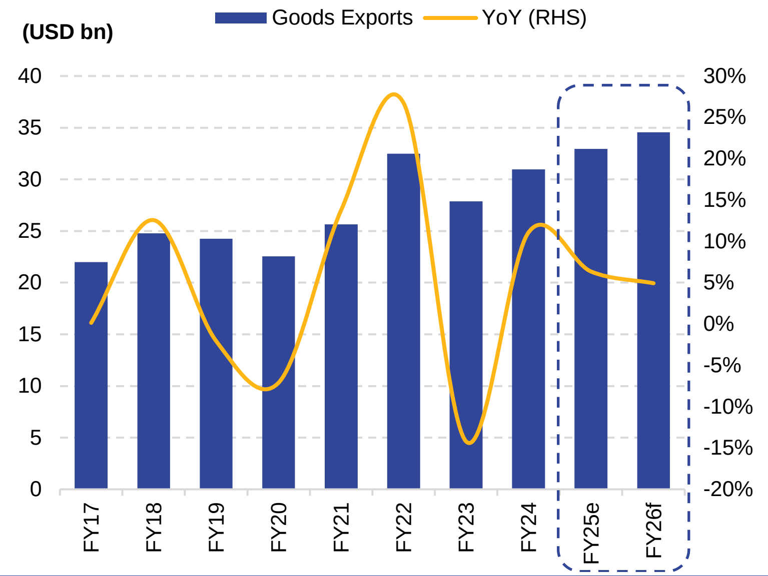
Seizing the export opportunities: On the export front, optimism surrounds an 9% boost in textile exports, partly fueled by a shift of orders from Bangladesh amid its internal challenges. However, agricultural exports may experience a decline of ~2%, attributed to reduced wheat production and intensified competition from India in the rice export market. Encouragingly, Pakistan's IT sector is experiencing remarkable growth. In the 1HFY25, total IT exports reached USD 1,864mn, marking a remarkable 28% YoY increase. This highlights the substantial potential for service exports to positively impact the trade balance. As the government navigates these evolving dynamics, focusing on enhancing service exports and diversifying the overall export landscape will be essential for fostering economic resilience and maintaining a balanced trade outlook.

Figure: Breakdown of exports (USD bn)



Source (s): AHL Research

Figure: Historical trends of exports



Source (s): SBP, AHL Research

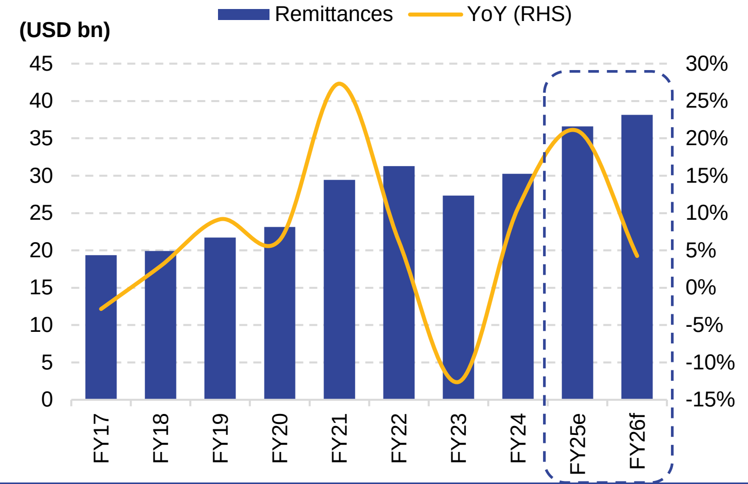
Remittances on a strong upward trajectory: Remittances, a crucial pillar of Pakistan's external account, have shown a commendable increase of 11% YoY in FY24, buoyed by improving macroeconomic conditions and the stability of the PKR. This influx of remittances is expected to contribute significantly to the external account, with estimates suggesting a total of USD 36.6bn in FY25e. Moreover, as the backlog of dividend payments has been addressed and interest rates have declined to 12%, we anticipate the primary deficit to normalize in FY25, which had surged by 56% YoY in FY24, further supporting the overall economic picture. Several key factors are contributing to the anticipated improvement in remittances for Pakistan. Firstly, the stability of the PKR against the US dollar is playing a crucial role. Additionally, the narrowing spread between interbank and open market exchange rates is making it more appealing for remittance senders to transfer funds through formal channels rather than informal ones. Finally, an increase in the number of Pakistani workers moving abroad is further bolstering remittance inflows.

Exhibit: Country wise remittances

USD mn	FY23	FY24	FY25e	FY26f
Saudi Arabia	6,533	7,424	9,263	9,726
UAE	4,656	5,535	7,741	8,095
Other GCC Country	3,198	3,180	3,727	3,913
UK	4,073	4,522	5,508	5,784
USA	3,168	3,531	3,560	3,738
EU Countries	3,134	3,531	4,026	4,228
Australia	593	644	742	780
Canada	552	505	574	603
Norway	111	107	109	115
Japan	75	52	58	61
Switzerland	44	46	48	51
Others Countries	1,196	1,174	1,248	1,071
Total	**27,333**	**30,251**	**36,605**	**38,163**

Source (s): SBP, AHL Research

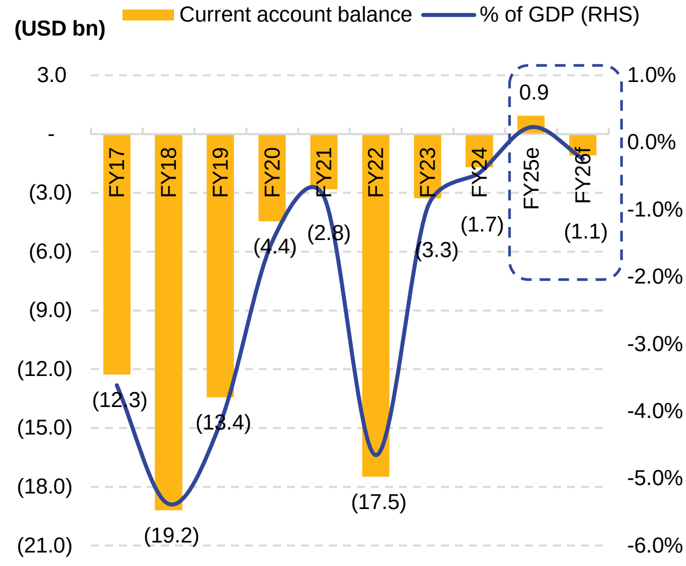
Figure: Historical trend of total remittances



Source (s): SBP, AHL Research

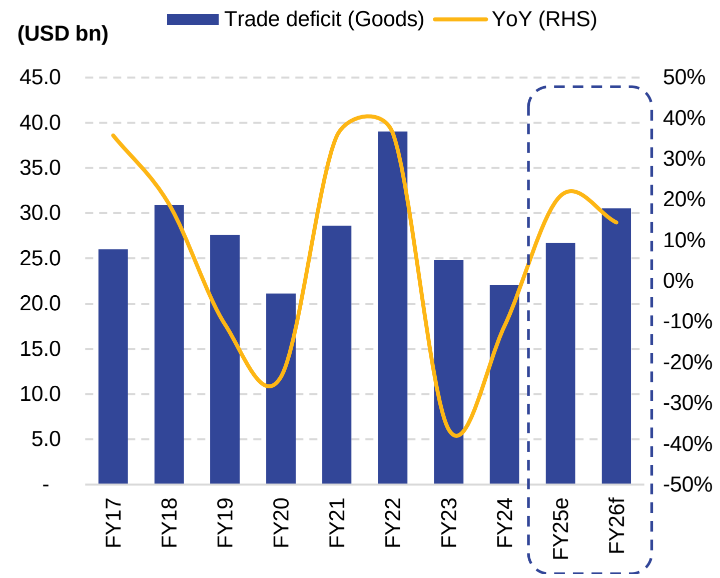
Foreign investment surges with improving confidence: Talking about foreign investment, Pakistan is taking proactive steps to attract and retain capital through the SIFC. This initiative is designed to create a more investor-friendly climate, with a particular focus on engaging key regional players such as Gulf countries, Turkey, and China. Particularly, the UAE recently committed to investing USD 10bn across major sectors, while Saudi Arabia is expediting an initial USD 5bn investment, primarily targeting the minerals sector, including the Reko Diq. These commitments highlight a growing interest in Pakistan's economic potential, but the actual execution of these investments will be critical in determining their impact on foreign investment flows. In addition, net foreign direct investment reached USD 1,329mn in 1HFY25, up by 20% YoY. The substantial increase in FDI is driven by Chinese investment, which accounts for 40% with a contribution of USD 536mn, followed by Hong Kong with a share of USD 134mn. The major sector for FDI is Power, attracting USD 488mn, followed by Financial Business and E&P’s, with net FDI of USD 353mn and USD 167mn, respectively.

Figure: Historical trend of current account balance



Source (s): SBP, AHL Research

Figure: Historical trend of trade deficit



Source (s): SBP, AHL Research

Exhibit: Current Account Balance

USD mn	FY23	FY24	FY25e	FY26f
Current Account Balance	**(3,275)**	**(1,695)**	**940**	**(1,085)**
% of GDP	***-1.0%***	***-0.5%***	***0.2%***	***-0.2%***
Exports of Goods	27,876	30,967	32,933	34,556
Imports of Goods	52,695	53,056	59,644	65,113
Balance on Trade in Goods	(24,819)	(22,089)	(26,711)	(30,556)
Exports of Services	7,596	7,870	8,596	9,199
Imports of Services	8,638	10,692	11,011	11,878
Balance on Trade in Services	(1,042)	(2,822)	(2,415)	(2,680)
Balance on Trade in Goods and Services	(25,861)	(24,911)	(29,126)	(33,236)
Balance on Primary Income	(5,765)	(8,996)	(8,413)	(7,812)
Balance on Secondary Income	28,351	32,212	38,479	39,963
Workers' Remittances	27,333	30,251	36,605	38,163

Source (s): SBP, AHL Research

Revitalizing Pakistan’s economy with IMF support

Pakistan successfully signed a crucial agreement with the IMF for a 37-month Extended Fund Facility valued at ~USD 7bn. This arrangement followed the completion of a USD 3bn Stand-By Arrangement (SBA) and arises from a challenging economic environment where securing such financing was not merely an option but a vital necessity. The program is fully financed, featuring firm commitments for the first 12 months, with promising prospects thereafter.

- Pakistan has secured an EFF facility from the IMF, valued at USD 7bn.
- For FY25, the financing plan includes USD 16.4bn in rollovers.

Bridging funding gap: For FY25, Pakistan's total external debt obligations are estimated at USD 26.1bn, comprising USD 22.1bn in principal repayments and USD 4bn in interest. This includes, USD 12.3bn of roll over, and USD 3.7bn through commercial loans. Of the remaining USD 10.1bn due, USD 6.4bn has already been repaid, leaving USD 3.7bn scheduled for repayment over the remaining months of FY25. This outstanding amount will be financed through a mix of commercial and multilateral loans. Additionally, authorities have received firm commitments from essential bilateral partners to maintain their existing exposures throughout the program, ensuring continued rollover of existing short-term liabilities, which will help meet financing needs during the remaining program period. Together with commitments from multilateral institutions, these arrangements provide necessary financing assurances.

Exhibit: History of Lending Commitments

Date of Arrangement	Expiration Date	Amount Agreed SDR mn	Amount Drawn SDR mn
Standby Arrangement			
Dec-58	Sep-59	25	0
Mar-65	Mar-66	38	38
Oct-68	Oct-69	75	75
May-72	May-73	100	84
Aug-73	Aug-74	75	75
Nov-74	Nov-75	75	75
Mar-77	Mar-78	80	80
Dec-88	Nov-90	273	194
Sep-93	Feb-94	265	88
Dec-95	Sep-97	563	295
Nov-00	Sep-24	465	465
Nov-24	Sep-24	7,236	4,936
Jul-24	Apr-24	2,250	2,250
Extended Fund Facility			
Nov-80	1-Dec	1,268	349
Dec-81	Nov-83	919	730
Oct-97	Oct-00	455	114
Sep-13	Sep-16	4,393	4,393
Jul-19	Jun-23	4,988	2,144
Sep-24	Oct-24	5,320	760
Feb-94	Dec-95	379	123
Oct-97	Oct-00	682	265
Feb-94	Dec-95	607	172
Dec-24		1,034	861
Structural Adjustment Facility Commitment			
Dec-88	Dec-91	382	382
Total		**31,947**	**18,948**

Source (s): IMF, AHL Research

Stable PKR- The impact of strengthened reserves

In a remarkable turnaround, the SBP's foreign exchange reserves have surged past the USD 11.2bn mark, marking a significant milestone amid ongoing economic challenges. The SBP's proactive measures during the consolidation phase played a crucial role in managing dollar outflows. By tightening import restrictions and overseeing the repatriation of profits from foreign investments, the central bank effectively stabilized the currency. In FY24, ~USD 12bn of these repayments were made, with an equivalent amount rolled over. As Pakistan sails through FY25, the outlook appears cautiously optimistic. External debt repayments are projected to total USD 26.1bn, with expectations of rolling over USD 16.4bn, leaving a manageable net repayment of USD 3.7bn.

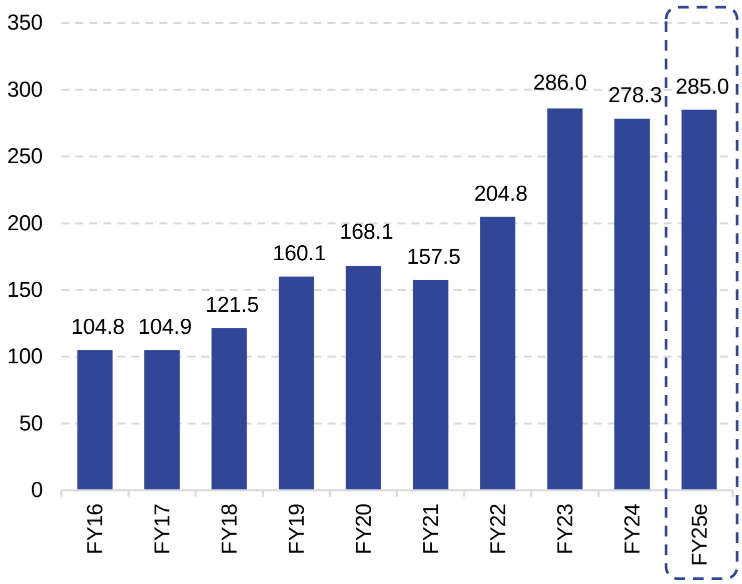
- SBP is expected to end FY25 with reserves around USD 13bn.
- For FY25e, external debt repayments are projected at USD 26.1bn, with expectations to roll over USD 16.4bn, resulting in a net repayment of USD 3.7bn.

Following the IMF disbursement, the country is well-positioned to attract inflows from multilateral and bilateral lenders. Initiatives to boost Foreign Direct Investment, enhance export performance, and eventually re-enter international capital markets are expected to bolster the external account further. With these strategic initiatives, the SBP is projected to close FY25 with reserves estimated at USD 13bn. The strengthening of reserves has played a vital role in stabilizing the PKR. A key catalyst for this recovery was the nine-month SBA with the IMF, which provided essential policy support and reinstated effective operations in the foreign exchange market. Additionally, the government's removal of multiple currency practices and lifting of restrictions on import advance payments have further contributed to stabilizing the PKR. The recovery of the PKR has been particularly noteworthy, rebounding from declines of 23% and 28% in FY22 and FY23, respectively, to a 4% appreciation against the USD in FY24. This impressive turnaround is a direct result of the increased foreign exchange reserves, which have instilled confidence in the currency market and attracted investor interest. Moreover, the successful execution of the IMF EFF program has not only enhanced foreign exchange reserves but is likely to unlock additional. The IMF program underscores the importance of maintaining a market-determined exchange rate as a fundamental strategy to rectify external imbalances and support the gradual buildup of reserves.

Improved reserves to support parity: Looking ahead, forecasts indicate that by Jun'25 and Dec'25, the USD/PKR exchange rates are likely to hover around 285 and 293.6, respectively. Rebuilding reserves is crucial to ensuring that gross reserves cover at least three months of imports, supported by disbursements from multilateral and bilateral loans, along with foreign exchange purchases. Should outflow pressures resurface, the SBP remains committed to allowing flexible exchange rate adjustments while refraining from intervening against a trend depreciation. The foreign exchange market has shown significant improvement, with the interbank-open market spread remaining negligible, enabling the SBP to make substantial foreign exchange purchases, effectively doubling its reserves.

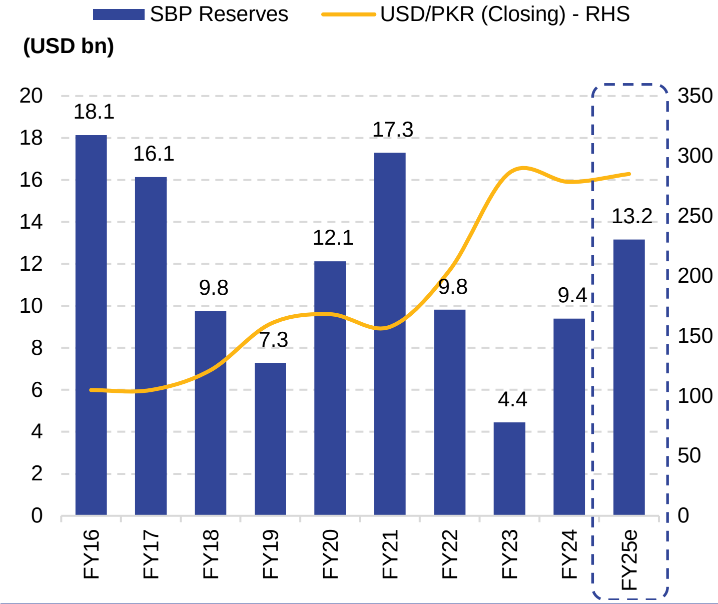
- Strengthened reserves have stabilized the PKR, supported by the IMF program and the removal of multiple currency practices.
- We expect USD/PKR will be around 285 by Jun'25 and 293.6 by Dec'25.

Figure: Historical trend of USD/PKR (Closing)



Source (s): SBP, AHL Research

Figure: Historical trend of SBP reserves and PKR parity



Source (s): SBP, AHL Research

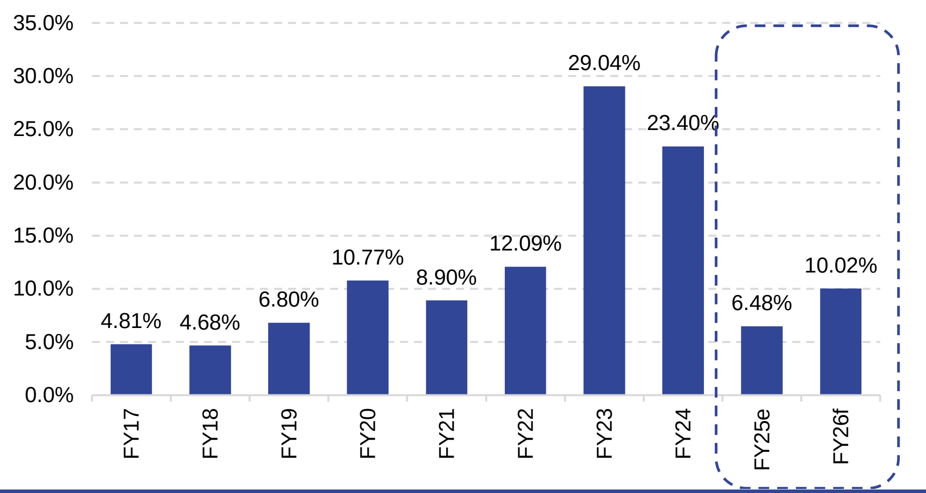
Interest rates bottom-out

Pakistan's economy has witnessed a remarkable turnaround following a challenging period marked by peak inflation rates of 38% in May'23. By Dec'24, inflation has significantly eased to 4.1%, reflecting the effectiveness of stringent monetary and fiscal policies alongside stabilizing energy and food prices. The initial success in controlling inflation was largely influenced by base effects, as energy prices that had previously surged due to geopolitical tensions could not sustain their trajectory, resulting in a YoY moderation. Additionally, the sharp increases in food prices, initially exacerbated by shortages, have begun to stabilize. The combined impact of these factors, bolstered by tight monetary and fiscal policies, has led to a sustained decrease in inflationary pressures.

- Current estimates suggest inflation may decline further to an average of 6.48% in FY25.
- Combined efforts of stringent monetary and fiscal measures have led to a sustained reduction in inflationary pressures.

Base effect verses real measures: The initial success in curbing inflation was relatively straightforward, primarily attributable to base effects. The rapid escalation of energy prices, driven by geopolitical tensions, could not sustain its steep upward trajectory, leading to a moderation in year-over-year increases. Moreover, the sharp rise in food prices, initially exacerbated by shortages, has begun to stabilize. These developments, coupled with disciplined monetary and fiscal measures, have played a pivotal role in fostering a sustained reduction in inflationary pressures. The impact of higher interest rates is increasingly evident, as they systematically alleviate inflationary pressures on the headline CPI. The momentum of rising prices is diminishing, signaling that monetary tightening is gradually bringing inflation under control. The SBP in its latest MPS stated that they do not anticipate any upside risk for food inflation and energy prices. Headline inflation has fallen sharply compared to core inflation. Current forecasts suggest that inflation may further decline, averaging around 6.5% in FY25, representing a reduction from FY24's average of 23.4%.

Figure: Average National Consumer Price Index



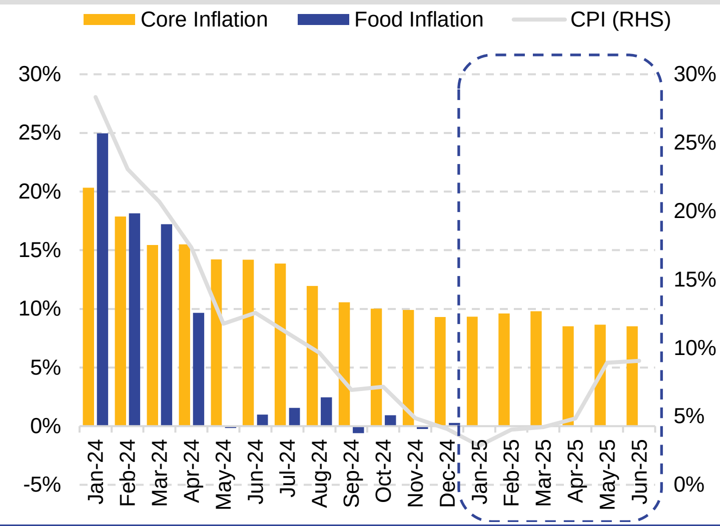
Source (s): PBS, AHL Research

- Policy rates has likely bottomed out at 12%.
- Pakistan's real interest rate stands at ~ 790bps, with historical averages between 1.5% and 2.0%.

Following a prolonged period of stagflation characterized by low growth and high inflation, the economy is now poised to transition towards moderate growth and disinflation. Achieving sustainable growth is contingent upon enhancing both domestic and foreign investment and improving productivity. While discussions often prioritize foreign investment, it is essential to recognize the critical role of domestic investment. To foster domestic investment, lower interest rates are necessary, contingent upon a continued decline in inflation. Thus, maintaining prudent macroeconomic policies is essential for reducing both inflation and interest rates. Nevertheless, several risks remain that could impede progress. A significant depreciation of the PKR against the USD could reignite inflationary pressures. Additionally, major upward revisions in gas and electricity tariffs may contribute to inflation. Furthermore, a widening demand-supply gap for food commodities exacerbated by rising demand and adverse weather conditions affecting crop yields could lead to persistent food inflation.

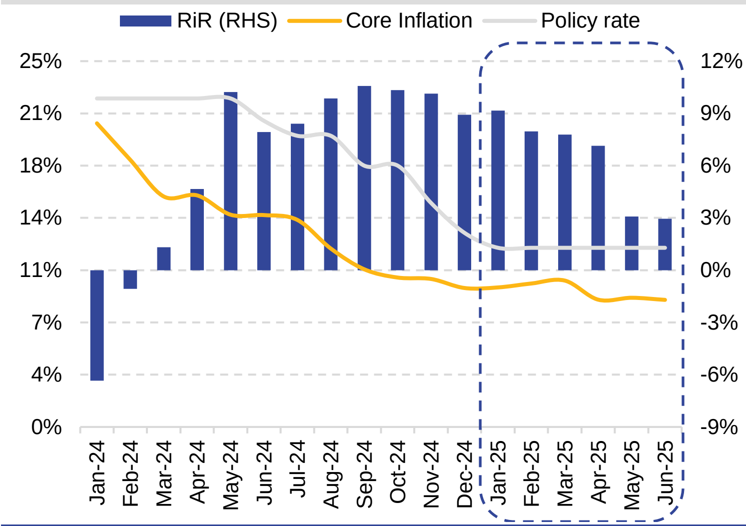
To support economic growth, the SBP implemented its first rate cut in Jun’24, reducing the policy rate by 150bps, followed by a 100bps cut in Jul’24, 200bps in Sep’24, 250bps reduction in Nov’24, 200bps reduction in Dec’24, and a 100bps reduction in Jan’25 bringing the rate down to 12.0%. However, with inflation projections indicating that the base effect will conclude by the end of 3QFY25, we expect the SBP to adopt a more cautious approach moving forward and maintain the rate at 12%, especially as inflation is expected to rise in 4QFY25. Pakistan's real interest rate remains exceptionally high, reaching ~7.9% on a spot basis. Even on a forward 12-month basis, real interest rates hover around 694bps. Historically, Pakistan's average real interest rate has ranged between 1.5% and 2%, indicating substantial room for rate cuts to bring the real interest rate closer to historical norms.

Figure: Trend of National CPI and Core



Source (s): PBS, AHL Research

Figure: Real Interest Rates in Pakistan



Source (s): PBS, SBP, AHL Research

In its statement after the signing of the Staff-Level Agreement for the Extended Fund Facility program, the IMF emphasized that monetary policy should focus on disinflation to safeguard real incomes, especially for vulnerable groups. The policy rate, which is expected to stay at 12%, is in line with the IMF's recommendations we believe, as inflation is projected to rise again by the end of this fiscal year.

Emerging signs of modest growth

Pakistan is on a positive recovery path, with FY24 showing a GDP growth rate of 2.52%. For FY25e, we expect growth to remain around 2.75%. However, we anticipate a stronger rebound in FY26f, with growth potentially reaching 5.07%. The modest growth in FY25e could have been higher had the agriculture sector not faced setbacks, primarily due to the low cultivation of important cash crops. While this figure remains below the long-term average of 3.50%, the potential for progress hinges on the government's ability to maintain a balanced and effective economic policy.

- FY25e GDPg is projected at 2.75%.
- Growth expected to remain 5.1% in FY26.
- Future progress depends on effective government economic policies.

Agriculture growth to remain subdued: The robust 17.02% increase in major crops during FY24 has been a defining factor in Pakistan's economic growth narrative. However, as we look ahead to FY25e, the outlook appears less favorable, with a projected slight decrease in output of 9.42%. In light of this, farmers are reassessing their sowing strategies for staple wheat, particularly after the Punjab government’s failure to procure grain last season an issue of significant concern, given that Punjab contributes 70% of the nation’s wheat production. Additionally, challenges such as water scarcity and rising temperatures have already begun to adversely affect cotton sowing and yields. The situation is further complicated by India’s re-entry into the global rice export market, which poses a risk to Pakistan's multibillion-dollar rice exports.

Industries and Services to support growth: As the agriculture sector is projected to moderate growth in FY25e, two vital sectors industry and services are expected to propel economic growth, with anticipated growth rates of 1.80% and 4.67%, respectively. In the 5MFY25, large-scale manufacturing (LSM) has experienced a YoY decline of 1.25%, primarily driven by low demand and high cost of doing business. Moreover, this marks the first time in six months that cumulative LSM growth has turned negative, suggesting a slow and uneven recovery trajectory. This downturn occurs against the backdrop of a historically low base. However, there is cautious optimism on the horizon, as a reduction in interest rates and currency stabilization are projected to facilitate a rebound in LSM, which has encountered numerous obstacles in recent years. With positive trends emerging in food, textiles, and automobiles, these sectors are likely to be key contributors to the economy, alongside the export-oriented industries for FY25. Expectations are particularly high for growth in textiles and apparel, especially as orders shift from Bangladesh following internal issues there. The automobile sector is also poised for recovery, aided by the reversal of the interest rate cycle already in progress. Meanwhile, the food sector has remained robust with minimal fluctuations, and the performance of the sugar crop will be crucial in shaping sectoral growth in the on-going quarter of FY25.

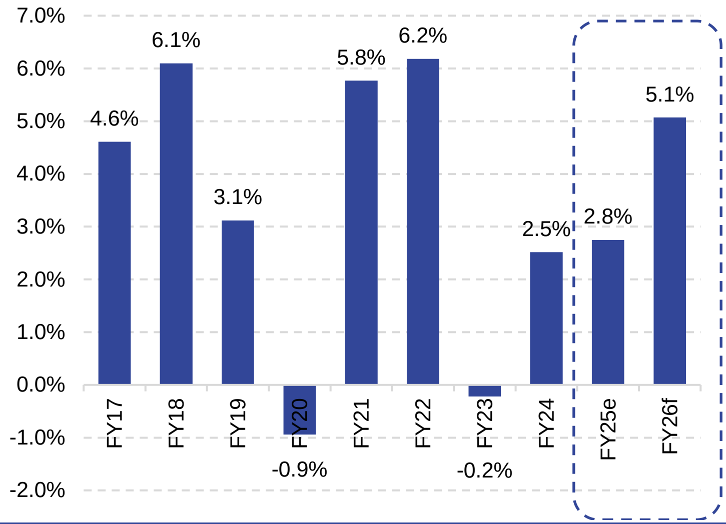
We anticipate that the growth momentum in the services sector will persist into FY25, bolstered by developments in commodity-producing sectors and increased goods imports. Specifically, LSM is expected to contribute positively to this growth. Merchandise imports are projected to rise to USD 59.6bn in FY25e, up from USD 53.1bn last year, reflecting an expansion in economic activities that will positively impact wholesale and retail trade as well as the transport sectors during the review period. In addition to these trends, the services sector particularly wholesale and retail trade, along with finance and insurance is poised to maintain its upward trajectory, supported by favorable policies from the SBP. A standout area is Pakistan’s rapidly expanding IT industry, which has demonstrated remarkable growth in export earnings for FY24.

- Agri- sector growth est. at +0.59% in FY25.
- Industry is expected to grow by 1.80%.
- Services are projected to grow by 3.93%.
- LSM and wholesale & retail trade -key contributors to economic growth.

Key risks: However, the path to sustained growth is not without its challenges. Geopolitical uncertainties, global inflationary pressures, and a potential rise in oil prices could drive up inflation, increasing costs for consumers and businesses alike. These factors will play a crucial role in shaping the country's overall economic performance in the coming fiscal year. Overcoming these challenges will be essential for maintaining growth momentum. Monetary easing, coupled with efforts to lower business costs such as cutting energy prices could create a more supportive environment for economic growth. Attracting foreign investment and boosting export potential will be key in strengthening the economy. Additionally, addressing the effects of climate-related risks, especially in the agricultural sector, will be crucial to keeping the recovery on course.

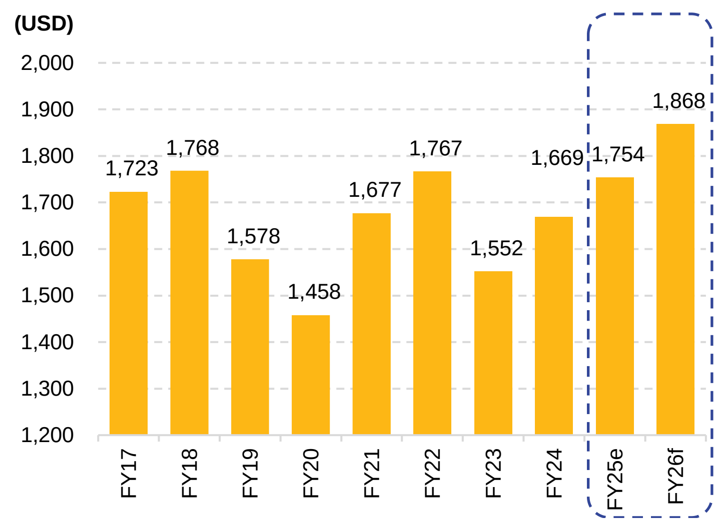
Various organizations have forecasted Pakistan's GDP growth with differing outlooks for the ongoing fiscal year FY24-25. BMI, a Fitch Solutions company, projects growth at 3.2%, while the Asian Development Bank (ADB), in its Asian Development Outlook, anticipates GDP growth of 2.4% for 2024 and 2.8% for 2025. The International Monetary Fund (IMF) offers a more optimistic estimate of 3.5% for FY2024-25. Additionally, the State Bank of Pakistan (SBP), in its recent State of the Economy report, expects GDP growth to fall within the range of 2.5% to 3.5%, supported by lower borrowing costs and a gradual recovery in the large-scale manufacturing and services sectors.

Figure: Historical trend of GDP growth



Source (s): MoF, AHL Research

Figure: Historical trend of Per Capita GDP (in USD)



Source (s): MoF, AHL Research

Figure: Industrial sector breakdown

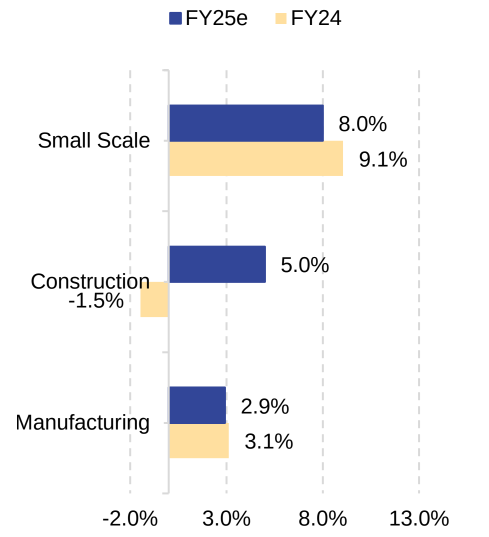


Figure: Agriculture sector breakdown

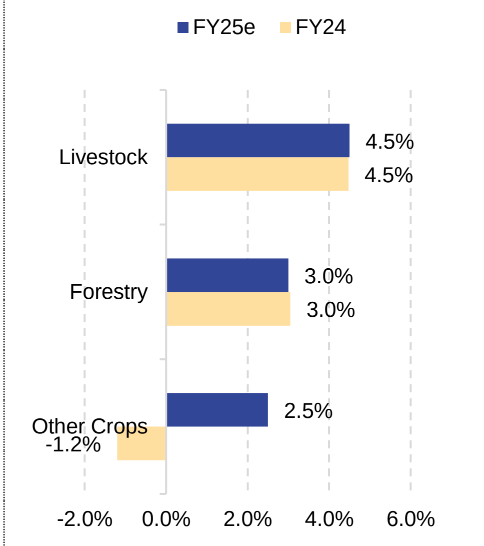
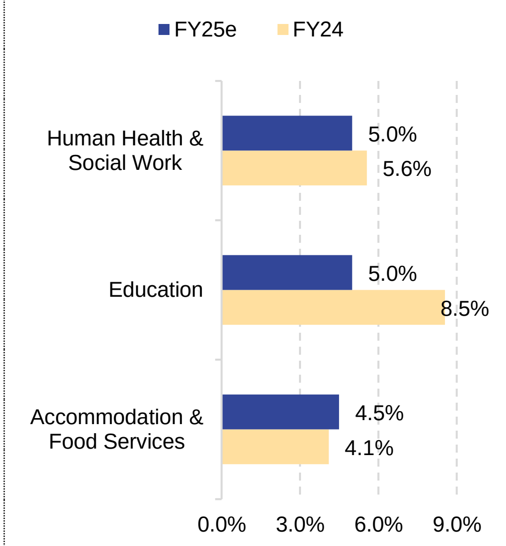


Figure: Service sector breakdown



Source (s): PBS, AHL Research

Exhibit: Gross Domestic Product of Pakistan

Items	FY23	FY24	FY25e	FY26f
Commodity Producing Sector	**-0.5%**	**3.0%**	**1.1%**	**4.2%**
Agriculture Sector	**2.2%**	**6.4%**	**0.6%**	**4.4%**
1. Crops	-1.2%	10.3%	-6.4%	4.3%
2. Livestock	3.7%	4.5%	4.5%	4.5%
3. Forestry	16.6%	3.0%	3.0%	3.0%
4. Fishing	0.6%	0.8%	0.9%	1.0%
Industrial Sector	**-3.7%**	**-1.1%**	**1.8%**	**4.0%**
1. Mining & Quarrying	-3.2%	3.5%	3.5%	3.5%
2. Manufacturing	-5.3%	3.1%	2.9%	4.4%
3. Electricity Generation & Distribution & Gas Distribution	9.9%	-23.1%	-10.0%	3.0%
4. Construction	-9.2%	-1.5%	5.0%	3.0%
Service Sector	**0.0%**	**2.2%**	**3.9%**	**5.7%**
1. Wholesale & Retail trade	-4.0%	3.4%	4.7%	10.9%
2. Transportation & Storage	3.8%	1.9%	3.0%	3.0%
3. Accommodation and Food Services Activities	4.1%	4.1%	4.5%	4.5%
4. Information and Communication	-0.7%	0.3%	3.0%	3.0%
5. Financial and Insurance Activities	-10.0%	-10.7%	2.0%	2.0%
6. Real Estate Activities (OD)	3.7%	3.7%	4.5%	3.0%
7. Public Administration and Social Security	-7.0%	-7.3%	3.0%	3.0%
8. Education	5.1%	8.5%	5.0%	5.0%
9. Human Health and Social Work Activities	8.8%	5.6%	5.0%	2.5%
10. Other Private Services	4.2%	3.6%	3.5%	3.5%
GDP Growth	**-0.2%**	**2.5%**	**2.8%**	**5.1%**

Source (s): MoF, AHL Research

Exhibit: Key Economic Indicators

		FY21	FY22	FY23	FY24	FY25e	FY26f
Real							
GDP Growth		5.8%	6.2%	-0.2%	2.5%	2.8%	5.1%
Nominal GDP	$ bn	348.9	375.6	338.5	373.8	412.1	449.3
CPI and Policy Rate							
CPI (YoY average)		8.9%	12.2%	29.0%	23.4%	6.5%	10.0%
Policy Rate (Period end)		7.0%	13.8%	22.0%	20.5%	12.0%	12.0%
External Sector							
Exports (Goods)	$ bn	25.6	32.5	27.9	31.0	32.9	34.6
Imports (Goods)	$ bn	54.3	71.5	52.7	53.1	59.6	65.1
Trade Deficit (Goods)	$ bn	28.6	39.1	24.8	22.1	26.7	30.6
Remittances	$ bn	29.5	31.3	27.3	30.3	36.7	38.2
FX Reserves (Period end)	$ bn	24.4	15.5	9.2	14.0	4.6	4.6
SBP FX Reserves (Period End)	$ bn	17.3	9.8	4.4	9.4	13.2	13.7
Bank FX Reserves (Period End)	$ bn	7.1	5.6	4.7	4.6	4.6	4.6
Exchange Rate (Period end)	USD/PKR	157.5	204.8	286.0	278.3	285.0	302.1
PKR Appreciation / (Depreciation) (%)		6.7	(23.1)	(28.4)	2.7	(2.3)	(5.7)
Debt							
Domestic	PKR bn	26,265	31,085	38,810	47,160	50,576	54,902
External	$ bn	86.5	88.8	84.1	86.5	88.4	92.4
Fiscal Sector							
Total Revenue	PKR bn	6,270	7,328	8,880	12,361	16,547	16,263
FBR Taxes	PKR bn	4,764	6,143	7,169	9,311	11,719	12,205
Nontax Revenue	PKR bn	1,505	1,185	1,711	3,050	4,828	4,057
Total Expenditure	PKR bn	7,245	9,350	11,332	14,823	16,018	17,043
Current Expenditure	PKR bn	6,349	8,452	10,732	14,073	15,167	15,690
Budget Deficit	PKR bn	3,403	5,260	6,521	7,207	5,693	7,209
% of GDP							
Current Account Balance		-0.8%	-4.7%	-1.0%	-0.5%	0.2%	-0.2%
Trade Deficit		8.2%	10.4%	7.3%	5.9%	6.5%	6.8%
Fiscal Deficit		6.1%	7.9%	7.8%	6.8%	4.9%	5.4%
External Debt		24.8%	23.6%	24.8%	23.1%	21.5%	20.6%
Domestic Debt		47.0%	46.6%	46.2%	44.6%	43.8%	41.3%

Source (s): MoF, PBS, SBP, AHL Research

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Equity Research Ratings

Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as Dec 2025 for Target Price. In addition, return excludes all type of taxes. For more details, kindly refer the following table;

Rating	Description
BUY	Upside of subject security(ies) is more than +15% from last closing of market price(s)
HOLD	Upside of subject security(ies) is between 0% and +15% from last closing of market price(s)
SELL	Upside of subject security(ies) is less than 0% from last closing of market price(s)

Equity Valuation Methodology

AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- **Discounted Cash Flow (DCF)**
- **Dividend Discount Model (DDM)**
- **Sum of the Parts (SoTP)**
- **Justified Price to Book (JPTB)**
- **Reserved Base Valuation (RBV)**

Risks

The following risks may potentially impact our valuations of subject security (ies);

- **Market risk**
- **Interest Rate Risk**
- **Exchange Rate (Currency) Risk**