Modeling Lab

Innovation &
Technology Centre

LAHORE SCHOOL OF ECONOMICS

State of the Pakistan Economy, Growth, & Inflation in Pakistan

Financial Year 2025-2026 (Q1)

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State of the Pakistan Economy:
Estimates of annual GDP growth & inflation for FY 2025-26 based on (Quarter 1)

Executive Summary

GDP Growth

Pakistan's GDP growth has had a very slow recovery from flatlining three years ago. FY 2025-26 is expected to return to near trend growth. However, our estimates, based on observed macro variables for Quarter 1 (July to September) of FY 2025-26, show GDP growth over the whole financial year to be just 2.4% (Table 1).

Table 1: Estimates of Annual GDP Growth for FY 2025-2026 based on (Q1)

	FY 2023-2024 (est) ($ bn)	FY 2024-2025 (est) ($ bn)	FY 2025-2026 (est) ($ bn) (Lower Bound)	FY 2025-2026 (est) ($ bn) (Upper Bound)
GDP Supply plus Demand Shock Y (S+D)	346.37	382.18	420.78	423.01
C			302.90	304.73
I			65.33	65.33
G			54.95	54.95
NXn			-2.4	-2.0
GDP Growth Rate (%)	1.68%	2.44%	2.38%	2.92%

This estimate shows no increase from our last year's estimate for FY 2024-25 of 2.4%.

The single most important macro variable accounting for low GDP growth of 2.4%, persisting over FY2025-26, appears to be an unambiguous worsening of the Current Account. The last financial year, FY2024-25, was held to have stabilised this macro fundamental of the Current Account with a surplus of nearly $2 billion (Table 2).

Table 2: Current Account Balance FY 2024-2025 (Q1)

Million US$	FY 24-25 (R)	Jul 25-26	Aug 25-26	Sep 25-26 (P)	Jul-Sep (25-26) (P)
Exports-Goods	32,340	2,780	2,496	2,630	7,906
Exports-Services	8,408	724	677	797	2,198
Primary Income Credit	999	93	86	119	298
Total Exports	**41,747**	**3,597**	**3,259**	**3,546**	**10,402**
Imports-Goods	59,111	5,417	4,998	5,023	15,438
Imports-Services	11,053	995	1,139	995	3,129
Primary Income Debit	10,099	904	787	790	2,481
Total Imports	**80,263**	**7,316**	**6,924**	**6,808**	**21,048**
Exports-Imports	-38,516	-3,719	-3,665	-3,262	-10,646
Remittances	40,448	3,340	3,340	3,372	10,052
Current Account Balance	**1,932**	**-379**	**-325**	**110**	**-594**
Foreign Exchange Reserves	**12,727.8**	**14,303.9**	**14,319.5**	**14,400.4**	**14,400.4**

SBP October, 2025

Leading to an optimistic return to higher GDP growth for FY 2025-26. However, the first quarter shows the observed Current Account running back into a deficit of nearly $0.6 billion. Projection of this trend over the next three quarters gives an annual Current Account deficit mounting to $2.4 billion. Our model shows that this exogenous weakness in the Current Account brings down GDP growth considerably.

However, since only one quarter has passed, this estimate of GDP growth for FY 2025-26, of 2.4%, can be taken as a lower bound. If key macro aggregates, especially the Current Account, pick up over the course of the next three quarters, mitigating, even if not reversing the deficit, we estimate that GDP growth for FY 2025-26 can pick up to 2.9%.

This upper bound in our estimate of GDP growth for FY 2025-26, of 2.9%, is comparable to the GOP's own lower bound estimate of 3.3%, the IMF's estimate of 3.6%, and approximates the World Bank's estimate of 3.1%, and the ADB's estimate of 3% (Table 3).

Table 3: Comparator Growth Rate Projections FY 2025-2026

Government of Pakistan (SBP/PBS)	3.25% - 4.25%
International Monetary Fund (IMF)	3.60%
World Bank (WB)	3.10%
Asian Development Bank (ADB)	3.00%

Source: *SBP State of the Economy (Oct 2025), IMF WEO (FY, Oct2025(P)), World Bank Pak Development Update (April 2025), Asian Development Outlook (ADP)(Sep 2025)*

The overriding impact of the Current Account on aggregate GDP growth is further brought out by the model, which separates supply shocks from demand shocks. Supply shocks emanate from endogenous sectoral growth. The biggest supply shock over the past three years has been the contraction in Large Scale Manufacturing (Table 4).

Table 4: Sectoral Growth Rates

	FY 2023-2024	FY 2024-2025	FY 2025-2026
Agriculture	1.50%	0.60%	3.00% *
Industry	0.07%	-1.90%	0.50% **
LSM	0.07%	-1.90%	0.50% **
Services	0.33%	1.43%	3.00% ***

Source: **Planning & Development (Sep 2025), **SBP (Oct 2025) ***PBS (NAC Meeting) (Oct 2025)*

However, over the first quarter of FY 2025-26, growth in this sector is observed to have just turned positive at 0.5%.

Similarly, agriculture has also been growing below trend over the past two years. This has been a policy own goal, with the GOP's removal of long-established crop support prices, as we have highlighted in our previous State of the Economy reports. While this policy has been disinflationary, it has been at the expense of growth in food and export staples. Possible reconsideration of support prices and providentially low flood damages lead to a pickup in agricultural growth to trend growth of 2.5%-3.0% over FY2025-26.

However, the supply shock improvement in sectoral growth over FY2025-26 is being overridden by the greater impact of the demand shock, in the reversal in the Current Account from a surplus in the previous year, FY2024-25, to a deficit in this year. While exports and the bailout of remittances have been on trend, a surge in imports has racked up a deficit of $0.6 billion observed in the first quarter of 2025-26.

So, the Achilles heel of the economy remains, as ever, its exogenous weakness.

This warrants further focus on the complex relationship between the exogenous economy and aggregate GDP growth.

Inflation

We estimate FY 2025-2026 inflation at 7.1% (Table 5).

Table 5: Price Model Estimated for FY 2020, FY 2021, FY 2022, FY 2023 FY 2024 FY 2025 & FY 2026

Time Period	Persistently Large Output Gap (% of GDP)	Budget Deficit (obs) (% of GDP)	Impact of Depreciation on Inflation (est) (%)	Impact of ΔCommodity Prices on Inflation (est) (%)	Model Estimated Inflation (%)	GOP Inflation (%)	IMF Inflation (%)
FY 2020-2021	-1.80	5.20	-0.78	9.07	13.49	8.20	8.90
FY 2021-2022	0.00	7.00	3.59	7.70	15.88	11.00	12.15
FY 2022-2023	0.00	5.00	26.26	2.04	33.30	38.0	29.18
FY 2023-2024	0.00	7.5	6.04	5.39	18.9	23.41	23.40
FY 2024-2025	-1.60	6.0	0.00	3.97	8.37	5.50-7.50	5.10
FY 2025-2026	**-1.60**	**6.0**	**-0.54**	**3.24**	**7.09**	**5.00-7.00**	**6.00**

Our estimate compares to the GOP's upper-range estimate of 5% to 7.0%. The IMF has a lower estimate of inflation of 6.0%.

Our model shows that the most significant contributor to double-digit inflation, which peaked at 38% three years ago, has been the depreciation of the exchange rate. Table 5 shows that after substantive depreciation from FY 2021-2022 to FY 2023-2024, the exchange rate has stabilized over FY 2024-2025 and the current FY 2025-26. This slide has been halted much to the credit of GOP policy, of finally realizing the need to stop the disastrous depreciation, and effectuating it through monetary policy and careful open market operations by the State Bank.

The impact of energy prices is the second major contributor to inflation, after the perennial fiscal deficit. Energy pricing, with a 0.52% pass-through coefficient into the general price level, contributed nearly 4.0 % to inflation last FY 2024-2025, as Table 5 shows.

Tables 6 through 9 show that energy prices still contribute approximately 3.2% to inflation in FY 2025-2026.

Table 6: Calculation of Impact of Depreciation on Inflation (est) (%)

X_{rt0}	XR in t0	284.0
X_{rt1}	XR in t1	281.0
	Depreciation of XR (nominal PKR)	-3.00
ΔXr	Change in XR (%)	-1.1
β_m **	Share of fuel/energy imports in GDP	0.52
X_{rm}	Impact of depreciation on Inflation	-0.54

Table 7: Calculation of Impact of ΔCommodity Prices on Inflation (est) (%)

β_{mp}	Share of intermediate imported products in value added	51.50%
mp*	Change in the value of commodity prices	6.29
MP	Impact of commodity prices on Inflation	3.24

Table 8: Derivation of Increase in Commodity Prices (unweighted percentage change)
June 2024 to September 2025

	ΔSupplier Price	ΔTaxation	ΔConsumer Price
Petrol	-8.61%	30.03%	0.03%
Kerosene	7.52%	16.00%	7.79%
HSD	-8.78%	17.17%	0.15%
Electricity	13.73%	16.68%	15.61%
Coal	3.54%	0.00%	3.54%
Natural Gas	103%	183.27%	134%
Furnace Oil	-34.84%	0.00%	-34.84%

Note: The price increase for each category is given for the period between t0 and t1, with t0 = June 2024 and t1 = Sep 2025, except for Natural gas, where t0 = Jan 2023 and t1 = Feb 2025.

Table 9: Pakistan's Energy Mix (weights)

Petrol	8.37%
Kerosene	1%
HSD	11%
Electricity	17%
Coal	19%
Natural Gas	33%
Furnace Oil	10.85%
Total Energy Consumption	100.00%

Table 10 also notes that this increase in energy prices is contributed to much more by the GOP's increase in taxes, by 60%, than by suppliers' prices by 40%.

Table 10: Energy Equations FY 2025-2026
(weighted %age change in Consumer Price)

Energy Source: Supplier price+ Taxation – Subsidies= Consumer price

	ΔSupplier Price	ΔTaxation	ΔConsumer Price
Petrol	-0.56%	0.56%	0.00%
Kerosene	0.07%	0.01%	0.08%
HSD	-0.61%	0.62%	0.02%
Electricity	0.85%	1.81%	2.65%
Coal	0.67%	0.00%	0.67%
Natural Gas	20.71%	23.61%	44.32%
Furnace Oil	-3.78%	0.00%	-3.78%
Weighted Average	2.48%	3.80%	6.28%

Share of Tax Change in Increase in Total Consumer Prices (%)	60.53%
Share of Supplier Price Change in Increase in Total Consumer Prices (%)	39.47%

Policy for the Achilles heel of the Current Account

Therefore, as observed, Pakistan's GDP growth is extremely susceptible to being brought down by the Current Account. Export-led growth has always been held out as the solution. But now, even the prospect of this growth path is threatened by a global trade environment fractured by a tariff war. The primary question then is, what growth path does Pakistan take now? Given an uncertain global trade environment, potential losses to Pakistan's exports in the US market are estimated by Chaudhry & Andaman (2025)[1] at about $0.6 bn. They further show our exports to be extremely inelastic to the successive rounds of depreciations, especially the staple of textiles, (Chaudhry & Andaman, 2025)[2].

1 Chaudhry, A., & Andaman, G. (2025). Assessing the impact of trade restrictions on Pakistan's exports: US tariff policies and the EU's carbon border adjustment mechanism (Working Paper). Lahore School of Economics.

2 Chaudhry, A. A., & Andaman, G. (2025). Factors that impact Pakistan's exports: An empirical analysis. Innovation and Technology Center, Lahore School of Economics.

One solution offered by the Lahore School's Modeling Lab's trade model for Pakistan shows GDP growth to be constrained primarily by investment, which in turn is constrained mainly by the import of investment goods. This finding argues for a policy to liberalize the import of investment goods, to raise investment and GDP growth. But the Current Account has to be balanced, for sustainability, by cutting imports, which can be achieved by cutting non-wage consumption goods.

The Modeling Lab at the Lahore School will continue its analytic focus on this macro dilemma, of stabilising the Current Account, to enable, in turn, macro policy for higher GDP growth. The Annual Conference on the Management of the Pakistan Economy, in April 2026, will then afford an opportunity to examine the persistent, abiding nature of this macro dilemma, of stabilisation and GDP growth.