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Pakistan’s Economic Stabilization: Progress and Persistent Challenges

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Over the past year, Pakistan has achieved notable macroeconomic progress, including a primary fiscal surplus of 3.0 percent of GDP (gross domestic product) for July-March, the first in 24 years, and inflation falling to a 60-year low of 0.3 percent in April 2025. Foreign exchange reserves increased by $16.64 billion, and the Pakistan Stock Exchange (PSX) index rose 50 percent in fiscal year 2025 (FY2025), signaling improved investor confidence. However, these positive indicators mask persistent structural challenges that threaten long-term growth and industrial development.

Foreign direct investment (FDI) totaled $1.785 billion in July-April but declined 2.8 percent year-on-year. Most FDI flows into low-impact sectors such as power and services, largely from a narrow group of countries, especially China. Little investment is directed toward manufacturing or high-tech industries, which are critical for transferring technology, boosting productivity, and diversifying exports. This FDI pattern fosters dependency on limited external partners and increases vulnerability to geopolitical risks.

Domestic investment remains weak despite a policy interest rate cut to 11 percent in May 2025 from 22 percent. Access to credit for small and medium-sized enterprises (SMEs) and startups remains limited due to high collateral demands and scarce risk capital, even as microfinance borrowers grew to 12.3 million. Gross fixed capital formation remains low compared to regional peers.

Large-scale manufacturing (LSM) contracted by 1.5 percent from July to March due to high input costs, structural bottlenecks, and shrinking output in key sectors such as food processing, chemicals, and steel. While automobiles and textiles showed growth, the mining sector declined 3.4 percent in FY2025, underscoring industrial weaknesses.

The IT sector's export receipts rose 23.7 percent to $2.8 billion, generating a trade surplus of $2.43 billion. Yet, this remains insufficient to transform the economy. Weak research and development and limited academia-industry collaboration hinder progress.

Pakistan's industrial sector remains trapped in low-value activities and primary exports, unlike regional competitors that have moved up the value chain through industrial policy and FDI. Regulatory unpredictability, cumbersome tax systems, and slow contract enforcement continue to deter investment.

Structural reforms are essential. These include improving financial markets, broadening SME credit access, modernizing tax and regulatory systems, and investing in human capital. The government's initiatives, energy reforms, tariff rationalization, SOE restructuring, and climate finance policies are positive but require consistent implementation.

Pakistan's recent stabilization is commendable but fragile. Without bold reforms addressing structural bottlenecks, current gains risk being short-lived. The choice is clear: maintain the status quo or seize this moment to unlock Pakistan's economic potential.