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# Managing Oil Shocks: Pakistan's Fiscal Risks and Policy Choices



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## Executive Summary

The current oil price shock, emerged because of Israel-US-Iran war and its spread over the Gulf region, can have serious consequences on the fiscal consolidation efforts of the Government of Pakistan. The federal primary surplus, budgeted at Rs. 1,706 billion (1.3% of GDP), declines sharply across fiscal risk scenarios. Under a moderate shock (\$100/bbl), it falls to Rs 1,002 billion (0.7% of GDP), a reduction of Rs 704 billion (-0.6 percentage points). In a severe shock (\$120/bbl), it drops to Rs 821 billion (0.6% of GDP), Rs 885 billion (-0.7 pp). In an extreme scenario (\$144/bbl), it further declines to Rs 781 billion (0.6% of GDP), Rs 925 billion (-0.7 pp). At the same time, the fiscal deficit widens from Rs 6,501 billion (5.0% of GDP) to Rs 7,517 billion (5.8% of GDP), reflecting rising fiscal stress.

## 1. Introduction

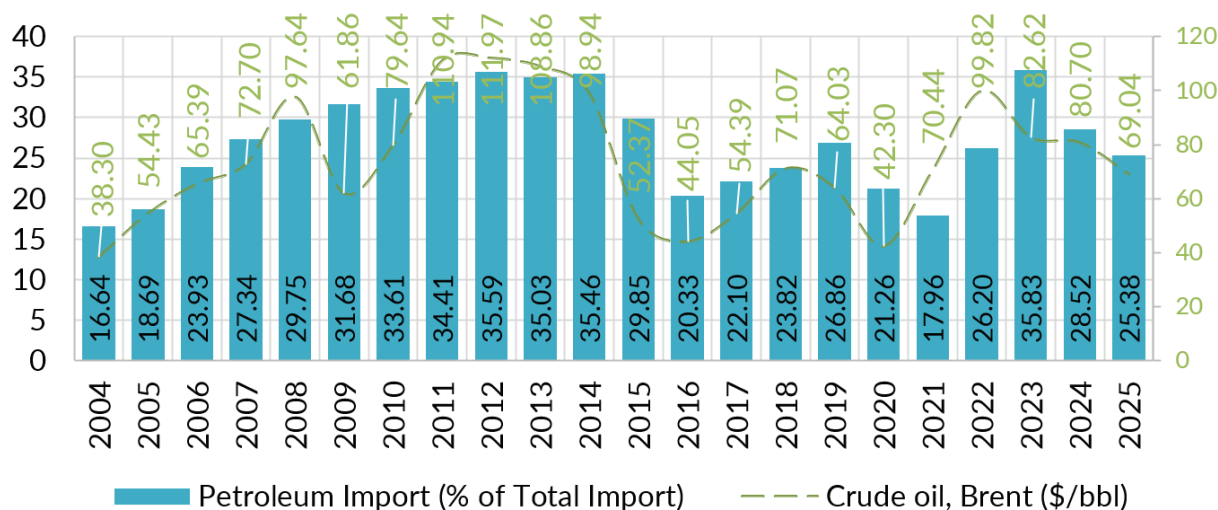
In the wake of the Israel-US-Iran war, the disruptions in the supply chain of petroleum products have shown serious consequences for Pakistan, which are not limited to the economy but also on the fiscal consolidation as well. Rising oil prices increase the import bill, intensify inflationary pressures, and place downward pressure on the exchange rate, thereby slowing economic activity. The existing closure of the Strait of Hormuz, if prolonged, can elevate industrial input costs and weaken overall business confidence. Furthermore, higher energy prices may also widen the trade deficit and strain external financing needs. It reduces fiscal space, while incre-

asing subsidy pressures and lowering the petroleum levy can undermine ongoing fiscal consolidation efforts. Accordingly, it can significantly increase the fiscal deficit and reduce the primary balance. Against this background, the primary balance provides the most useful fiscal lens for assessing whether Pakistan can absorb an external oil shock without undermining stabilization gains.

## 2. Oil Price Shocks and Pakistan’s Macroeconomic Vulnerability

The oil price shock often leads to increased petroleum import costs, pressure on the external sector, rising inflation, slower growth, and increased fiscal vulnerability. Oil shocks have consistently been transmitted to Pakistan through imported inflation, external financing stress, subsidy pressure, and deterioration in fiscal buffers (See Appendix Table 1). The global oil price collapse from 2014 to 2016 provided temporary relief to the external sector when crude oil prices declined from USD 98.94 per barrel to USD 44.05. It led to a reduction in imports to USD 8.36 billion (20.33% of total imports) in 2016 (Figure 1). Following the U-shaped recovery of the global economy, the Russia-Ukraine war again put pressure on the external sector by increasing imports to USD 18.88 billion (35.83% of total imports). It again highlights Pakistan’s economic exposure to oil price shocks. Although oil prices were somewhat moderated in 2004 and 2025, the external sector remained highly sensitive to global energy market fluctuations.

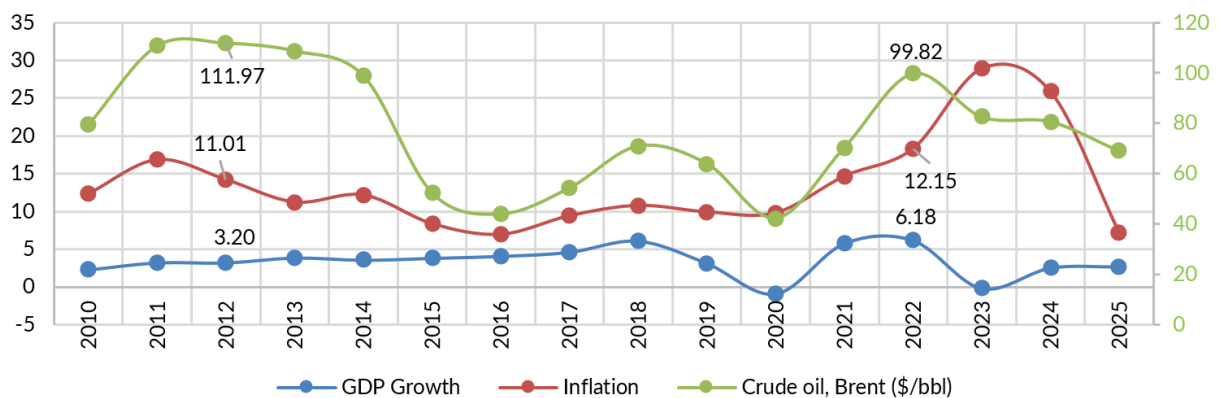
Figure 1: Petroleum Imports and Global Oil Prices: Pakistan’s External Vulnerability



Oil price movements in the international market underscore a strong relationship with inflation in Pakistan. For instance, during 2011-2012, when Brent prices exceeded \$110 per barrel, inflation remained in double digits (Figure 2). In contrast, the significant decline in global oil prices during 2015-2016, when Brent fell to around \$44-52 per barrel, coincided with a sharp moderation in inflation to below 5 percent. This reflects the economy’s structural dependence on imported energy and the strong pass-through from international prices to local fuel, transport, and production costs.

Oil-driven inflationary pressures are closely associated with weaker or more volatile growth outcomes. Periods of macroeconomic stress, particularly 2020 and 2023, combine elevated inflation with subdued or negative economic growth. As such, inflation surged to 29.18 percent in FY2023 while GDP growth turned negative at -0.21 percent (Figure 2), reflecting the combined impact of external shocks, energy price volatility, domestic macroeconomic imbalances, and tightening policy conditions. Managing external shocks, particularly oil price volatility, and maintaining sustained macroeconomic stability are critical prerequisites for sustained and equitable economic growth in Pakistan.

Figure 2: GDP Growth, Inflation, and Brent Crude Oil Prices

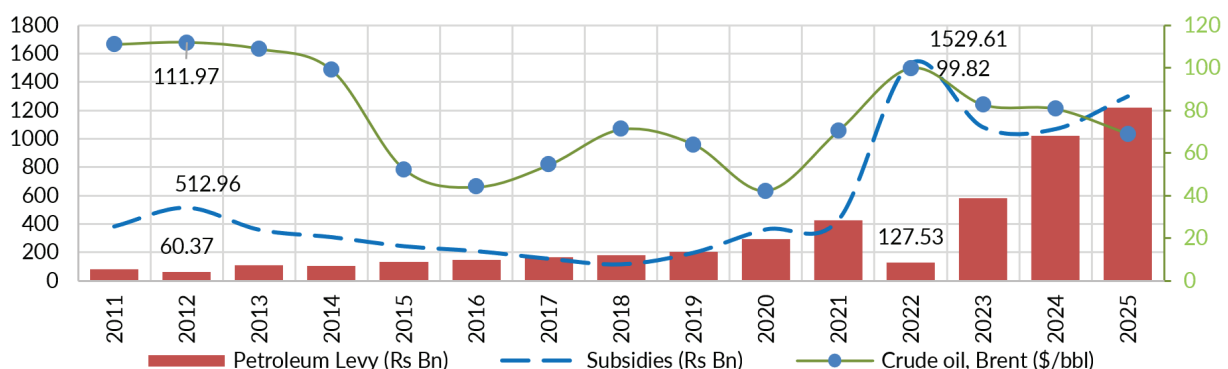


### 3. Oil Price Shocks and Fiscal Sustainability in Pakistan

Petroleum Levy and subsidy expenditures have remained key instruments during periods of price pressures, thereby undermining fiscal sustainability. Fiscal pressures were intensified around 2011-2014. In 2022, Brent crude oil price approached nearly \$100 per barrel, and subsidy expenditures surged to Rs 1,529.6 billion. At the same time, petroleum levy collections declined to about Rs 127.5 billion, indicating the government’s discretion to avoid pass-through. Furthermore, the increase in the petroleum levy to Rs 100 per liter in the Finance Act 2025-26 reflects the Federal Government’s policy of using it as the main source of revenue and to enhance fiscal consolidation.

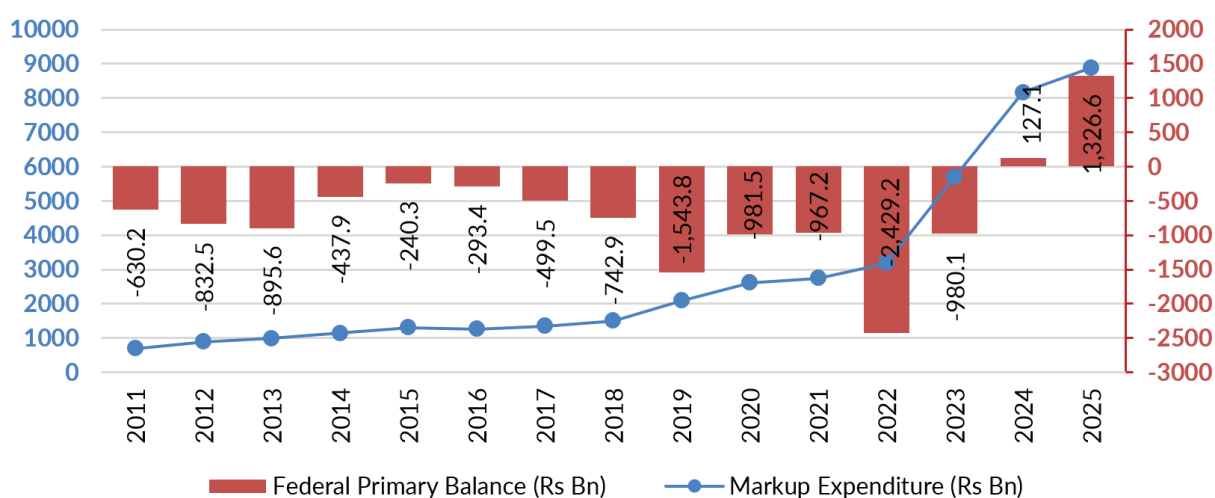
Figure 3: Global Oil Prices and Pakistan’s Fiscal Response

Petroleum Levy (PL): Maximum Rs. 8 per liter on HSD and Rs. 10 on Petrol, up to FY2018, then increased to Rs 30 for both products, increased to Rs 70 in Finance Act 2024-25, and to Rs 100 in Finance Act 2025-26



The federal primary balance (difference between net federal revenues and non-markup expenditures) is a critical indicator of debt sustainability. For instance, the federal primary deficit from 2011 to 2023 led to the debt-to-GDP ratio exceeding the 70 percent benchmark of debt sustainability. Given that Pakistan is under the IMF's Extended Fund Facility programme, room for discretionary reduction in the petroleum levy is constrained by federal revenue targets and the fiscal commitments embedded in the current macroeconomic framework. However, it seems plausible under an alternative arrangement to cross-subsidize the prices of petroleum products by a decrease in expenditures.

Figure 4: Fiscal Sustainability: Interest Burden and Primary Balance



The Prime Minister of Pakistan has announced several measures to contain expenditures. However, in the volatile war situation and rising price pressures on petroleum products, the question remains: for how long and to what extent can the government absorb the decline in petroleum levy, particularly when it cannot afford to derail the IMF programme. For this, Pakistan achieve to achieve a Federal Primary surplus of Rs 1,706 billion (Rs 3,170 billion overall) during the current fiscal year. The fiscal implications of an oil shock extend beyond petroleum pricing decisions alone. They also operate through lower revenue collection, possible energy-sector support requirements, exchange-rate pressures, and contingent liabilities in the broader energy chain. These channels must be assessed jointly in any realistic fiscal-risk exercise.

#### 4. Fiscal Risk Analysis: FY2026

This section provides an analysis of fiscal risk, assuming possible macro-fiscal implications of alternative oil price shock scenarios, using actual fiscal and macroeconomic data for the current fiscal year. Scenario 1: Oil Price at \$100 per Barrel (Moderate Shock)

Starting from an already prevailing FBR revenue shortfall during the first half of the current fiscal year, the fiscal position weakens relative to budget projections. The federal fiscal deficit rises from the budgeted Rs 6,501 billion (5.0 percent of GDP) to Rs 7,333 billion (5.7 percent of GDP). At the same time, the federal primary surplus is expected to decline significantly from Rs 1,706 billion (1.3 percent of GDP) to Rs 1,002 billion (0.7 percent of GDP). This decline reflects

rising expenditure pressures, partially managed through austerity measures, contingency spending, and lower development expenditures, despite some revenue support from higher nominal GDP.

Figure 5: Federal Fiscal Deficit Under Alternative Oil Shock Scenarios (PKR-Billion)

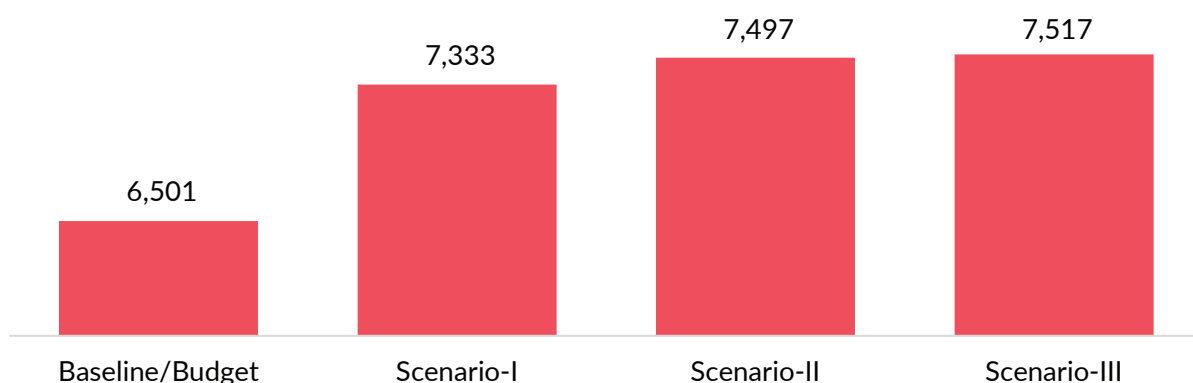
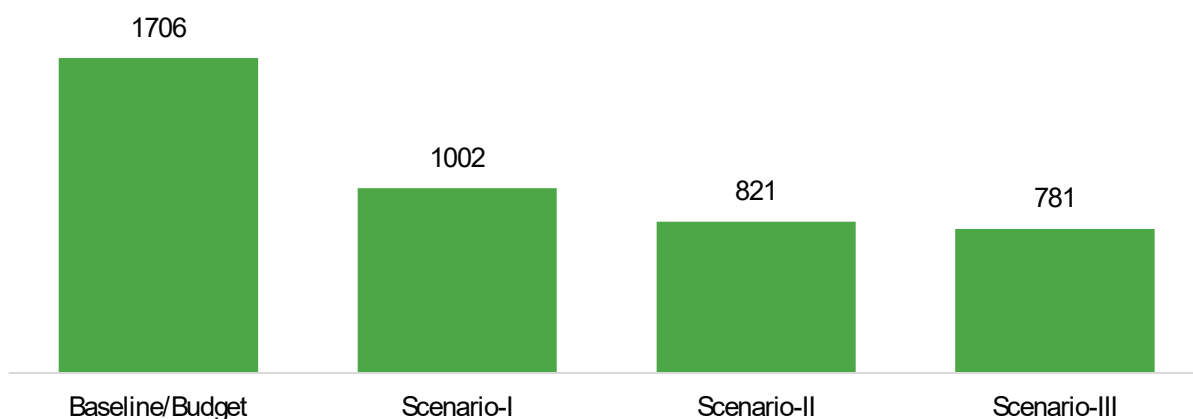


Figure 6: Federal Primary Balance Under Alternative Oil Shock Scenarios (PKR-Billion)



### Scenario 2: Oil Price at \$120 per Barrel (Severe Shock)

If average oil prices remain around \$120 per barrel for up to the end of April 2026, due to continued disruption in the Strait of Hormuz, fiscal pressures will intensify. The federal fiscal deficit may widen to Rs 7,497 billion (5.8 percent of GDP), while the federal primary surplus is expected to decline further to Rs 821 billion (0.6 percent of GDP). As such, higher energy import costs increase external-sector pressures and contribute to inflation, whereas slower real economic activity constrains revenue growth.

### Scenario 3: Oil Price at \$144 per Barrel (Extreme Shock)

In the extreme scenario, where oil prices remain elevated up to the end of May 2026, fiscal vulnerabilities become more visible. The federal fiscal deficit may increase to Rs 7,517 billion (5.8 percent of GDP), while the federal primary surplus declines to Rs 781 billion (0.6 percent of GDP). Although higher inflation raises nominal revenues, the adverse effects of a significantly larger energy import bill and broader macroeconomic pressures dominate, leading to further erosion of fiscal buffers.

## 5. The Way Forward

The scenario based analysis confirms that even a moderate oil shock would significantly reduce the primary surplus, given the already FBR revenue shortfall in the first half of the ongoing fiscal year. Following measures may help to reduce fiscal stress:

- Fully shield domestic prices at all costs but manage the shock in a way that preserves the federal primary surplus for sustained IMF-consistent fiscal adjustment.
- The primary balance should remain the central fiscal indicator for managing external oil shocks. This requires pre-defined response options under moderate, severe, and extreme oil-price scenarios rather than ad hoc decisions after the shock materializes.
- Strengthen tax administration, improve compliance in domestic and import-linked taxes, reduce leakages, and accelerate digital monitoring of high-yield sectors. Greater enforcement on undertaxed segments, better documentation, and stronger audit-based compliance should therefore accompany the fiscal contingency plan.
- If oil prices remain elevated, the government should create fiscal room by curbing non-essential current expenditure, improving procurement discipline, and delaying low-priority spending commitments, while protecting social protection and high-impact development spending.
- Prioritize growth-enhancing public spending in infrastructure, productivity, and export-supporting sectors so that fiscal adjustment does not come at the expense of long-term revenue generation and resilience.

## Appendix

Appendix Table 1: Major Global Oil Price Shocks and Transmission to Pakistan's Economy

Oil Shock	Year	Global Oil Price Shock	Transmission to Pakistan's Economy
<b>First Oil Crisis</b>	1973-1974	Oil prices rose from \$3 to \$12 per barrel following the Arab oil embargo	Sharp rise in oil import bill, inflation surge, widening trade deficit
<b>Second Oil Crisis</b>	1979-1980	Oil prices increased from \$15 to about \$39 per barrel after the Iranian Revolution	Higher inflation and industrial costs, pressure on the balance of payments
<b>Gulf War Oil Shock</b>	1990-1991	Oil prices rose from \$17 to about \$36 per barrel due to the Gulf War	External account deterioration and exchange rate pressure

<b>Global Oil Price Boom</b>	2007-2008	Oil prices peaked at about \$147 per barrel	Fiscal stress due to fuel subsidies, a rise in circular debt, and currency depreciation
<b>Arab Spring Oil Price Spike</b>	2011-2014	Oil prices remained above \$100 per barrel	higher circular debt, fiscal stress, subsidy pressures, and external account deterioration
<b>Global Energy Shock</b>	2022	Oil prices increased from about \$70 to above \$120 per barrel after the Russia-Ukraine war	Surge in energy import bill, current account deficit, inflation spike
<b>Middle East Conflict Risk</b>	2026 (ongoing)	Oil prices increased due to geopolitical risk premiums in global energy markets	Potential fiscal pressures, inflation risks, and external sector vulnerability

Appendix Table 2: Description of Alternative Scenarios

Scenario	Scenario 1: Moderate Oil Shock	Scenario 2: Severe Oil Shock	Scenario 3: Extreme Oil Shock
<b>Oil Price Assumption (\$/bbl)</b>	100	120	144
<b>Trigger / Duration Assumption</b>	Oil prices remain elevated around current average levels due to geopolitical tensions and are assumed to be settled by end-March	Disruption in shipping through the Strait of Hormuz through April	Disruption with the Strait of Hormuz remaining constrained through May
<b>Macroeconomic Transmission</b>	Raise inflation moderately; the petroleum import bill increases; some pressure on the exchange rate; and lower economic growth	Significant increase in petroleum import bill, stronger exchange rate pressure, higher inflation, lower economic growth	Increase in import bill, strong exchange rate depreciation pressures, and a spike in inflation with slower real GDP growth
<b>Fiscal Implications</b>	Nominal GDP increases due to higher inflation, supporting FBR tax collection, but higher energy costs raise fiscal risks	Partial revenue gains from higher nominal activity offset by higher subsidy risks and fiscal pressures in the energy sector	Fiscal pressures intensify due to rising energy costs, potential subsidy requirements, and higher circular debt risks

Appendix Table A3: Fiscal Impact of Oil Price Shock Scenarios

Indicator	Scenario	Level	$\Delta$ (Rs bn / pp)	$\Delta$ (%)
<b>Primary Surplus (Rs bn)</b>	Baseline	1,706		—
	Moderate (\$100)	1,002	-704	-41.3
	Severe (\$120)	821	-885	-51.9
	Extreme (\$144)	781	-925	-54.2
<b>Primary Surplus (% GDP)</b>	Baseline	1.3		—
	Moderate (\$100)	0.7	-0.6 pp	-46.2
	Severe (\$120)	0.6	-0.7 pp	-53.8
	Extreme (\$144)	0.6	-0.7 pp	-53.8
<b>Fiscal Deficit (Rs bn)</b>	Baseline	6,501		—
	Moderate (\$100)	7,333	+832	+12.8
	Severe (\$120)	7,497	+996	+15.3
	Extreme (\$144)	7,517	+1,016	+15.6
<b>Fiscal Deficit (% GDP)</b>	Baseline	5.0		—
	Moderate (\$100)	5.7	+0.7 pp	+14.0
	Severe (\$120)	5.8	+0.8 pp	+16.0
	Extreme (\$144)	5.8	+0.8 pp	+16.0

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