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Socio-Economic Effects of the Middle East Crisis on Household Welfare in Pakistan: Policy Responses



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Executive Summary

The broader vulnerability of Pakistan to external economic shocks has been highlighted by the Middle East crisis. Pakistan is heavily dependent on Gulf Cooperation Council (GCC) countries for fuel imports, with approximately 81 percent coming from this region. Regional disruptions can increase cost of fuel, transport, production and distribution and could place pressure on household purchasing power. This policy view therefore focuses on three important channels through which the crisis can affect households in Pakistan: imported cost-push inflation and the cost of living, pressure on health and education spending, and uncertainty around remittances, labour income and SME earnings.

The recent domestic price movements are in line with this transmission, but they may also be driven by other domestic factors. The HIES 2024-25 data show that lower-income households are devoting a significant proportion of their budgets to food, housing, and utilities with transport adding further pressure. This leaves them with limited capacity to absorb additional increases in essential costs. Recent remittance indicators do not yet indicate a sustained crisis-induced shock. Remittance inflows recorded positive year-on-year growth during May to July 2026 while the three-period moving average declined in June before increasing again in July. Unemployment estimates increase under longer-duration crisis scenarios, but these are scenario-based projections and do not represent actual outcomes.

Short term policy measures should thus aim at decreasing income losses through time bound and targeted income support, strengthening access to essential health and education services, supporting viable small and medium enterprises (SMEs) with documented cost pressures, and connecting the reintegration of returning workers to demands of the labour market. These interventions can help in reducing immediate pressures on household well being while protecting incomes, employment, and access to essential services. CPEC 2.0 can contribute towards medium term resilience with increased local supplier and SME linkages, skills training aligned with employer needs, more resilient supply chains, and reliable energy supply. Pakistan cannot remain unaffected by global external energy and geopolitical shocks. However, it can devise and adopt policy measures that can help in limiting their effects on household purchasing power and incomes, access to health and education, and employment.

1. Background & Introduction

Recent tensions in the Middle East have yet again highlighted Pakistan's economic vulnerability. IMF (2026) states that Pakistan is highly dependent on GCC countries for fuel imports, with 81 percent coming from that region. Disruptions in energy supply and price fluctuations in energy markets of that region may negatively impact cost of electricity generation and increase cost of transportation, production, and distribution at domestic level. These pressures can potentially be passed on to households in the form of increasing prices of essential commodities and services, job insecurity, and decreasing SME earnings. Wider regional instability can also lead to uncertainty around remittances inflows. These channels taken together show that Middle East crisis is no longer only a distant policy concern. It has economic and social implications which require broader domestic policy response.

This is particularly important as the crisis has emerged at a time when limited household financial resources and high poverty rate reduce the ability of families to cope with further income and price shocks. Pakistan's poverty rate stood at 28.9 percent, based on HIES 2024–25 data reported in the Pakistan Economic Survey 2025–26. Further increases in the prices of essential goods and services could weaken household purchasing power and increase the risk of more families falling into poverty. This could further deepen poverty and place additional pressure on household welfare. Therefore, it is important to understand and address the socio-economic consequences of the Middle East crisis in Pakistan. The main focus in this policy view is on:

- 01** What are the socio-economic channels through which the Middle East crisis can affect household welfare in Pakistan, and what are its potential short-term and long-term effects?
- 02** What policy responses can help mitigate the effects of the Middle East crisis on household welfare in Pakistan?
- 03** How can CPEC 2.0 support Pakistan's medium-term economic resilience to external shocks?

The analysis distinguishes between observed developments, emerging indicators, and scenario-based projections. Addressing these questions is essential for designing targeted and fiscally sustainable measures that protect household welfare and strengthen resilience to future external shocks.

2. Socio-Economic Channels and Household Welfare

This section discusses three socio-economic channels through which the Middle East crisis can affect the welfare of households in Pakistan.

2.1. Imported Cost-Push Inflation and The Cost Of Living

The most immediate channel through which the current Middle East crisis can affect household welfare in Pakistan is “imported cost-push inflation”. Naurin (2026) presented a stress scenario in which a three-month closure of the Strait could push oil prices between US\$120–150 per barrel and can potentially increase the monthly petroleum import bill of Pakistan to about US\$3.5–4.5 billion. This can raise CPI inflation from 7 percent to 17 percent. These figures are estimates from early stress scenario rather than realised outcomes. Since then, uncertainty surrounding oil flows through the Strait of Hormuz has been accompanied by volatility in international oil prices. Higher imported oil prices can lead to higher domestic fuel, transport, production and distribution costs. If firms pass part of these costs on to consumers, the prices of food and other essential goods could rise and reduce household purchasing power.

Table 1: National CPI Inflation and Selected Groups - Month-on-Month (MoM), percent

Periods	National CPI	Food and Non-Alcoholic Beverages	Housing, Water, Elec., Gas and Other Fuels	Transport
Jan-26	0.4	0.1	1.1	-1.4
Feb-26	0.3	-0.9	1.9	-1.9
Mar-26	1.2	-0.3	1.5	11.8
Apr-26	2.5	1.8	2.4	15.5
May-26	0.5	0.1	-1.3	5.1
Jun-26	-0.3	1.0	-0.4	-7.2
Jul-26	1.2	4.2	-0.6	-5.2
Aug-26	1.2	1.7	0.6	3.4

Source: Inflation Monitor (August 2026), State Bank of Pakistan (2026b)

The inflation data for March and April 2026, shown in Table 1, are consistent with this transmission mechanism. However, these movements may also be influenced by other domestic economic factors. Therefore, these changes should not be attributed entirely to the Middle East crisis. Month-on-month transport inflation rose sharply in March and April, while housing, water, electricity, gas and other fuels inflation increased between March and April. National CPI inflation also increased alongside these movements. These increases were followed by lower transport inflation in May and negative transport inflation in June and July, before it turned positive in August. Housing, water, electricity, gas and other fuels inflation remained negative from May to July before turning positive in August. The increase in MoM national CPI inflation was followed by lower CPI inflation in May and negative inflation in June before rising to 1.2 percent in July and remaining at that level in August. Food inflation increased from March to April before decreasing in May. It increased again in June and further in July before decreasing in August.

In the short term, higher food, fuel, transport and utility costs can lower household purchasing power because nominal incomes may not adjust at the same rate as rising prices. Continued food price pressures may place additional strain on household food budgets. Households may respond by reducing food consumption and non-essential spending, or by switching to cheaper products. These changes are a matter of concern since food insecurity is a serious domestic challenge. Pakistan stands at 106th out of 123 countries within the 2025 Global Hunger Index. Based on nutrition data for 2023, Pakistan Economic Survey 2025–26 reports that 16.5 percent of Pakistan’s population was undernourished and 33.6 percent of children under the age of five were stunted. In the long term, persistent increases in food, fuel, transport and utility costs could further lower household purchasing power. Families may draw on their savings or borrow to cover basic expenses. This could increase debt burdens and limit future spending which will make households more vulnerable to future economic shocks.

2.2. Pressure on Health and Education Spending

The second channel through which the Middle East crisis can affect household welfare is the potential crowding out of health and education expenditures from household budgets. As inflationary pressures raise spending on food, fuel, transport and utilities, households may have less income available for medical consultations and medicines. Spending on tuition fees, books, and education-related transport may also come under pressure. Households with limited financial buffers may therefore reallocate spending towards immediate necessities at the expense of healthcare and education. Akram et al. (2025) find that inflation directly affects access to essential goods and services such as food, housing, and healthcare. This compels the households to make trade-offs that often lead to negative health outcomes.

Table 2: Percentage Distribution Of Monthly Consumption Expenditure Per Households By Selected Commodity Groups And Quintiles, 2024-25

Expenditure category/Quintiles ¹	Total	1st quintile ²	2nd quintile	3rd quintile	4th quintile	5th quintile
Food & non-alcoholic beverages	36.72	49.75	45.52	42.46	39.24	28.73
Housing, water, electricity, gas & other fuels	25.72	18.00	20.32	21.87	23.35	31.09
Health	3.34	3.54	3.54	3.54	3.46	3.12
Education	2.48	0.55	1.05	1.56	2.12	3.71
Transport	6.21	4.80	5.52	5.90	6.37	6.70

Source: Household Integrated Economic Survey (HIES) 2024-25

In Table 2, HIES 2024-25 provides a baseline for understanding how households allocate their budgets. For households in the first quintile (poorest households), food and non-alcoholic beverages account for 49.75 percent of consumption expenditure, followed by housing, utilities and other fuels at 18 percent, and transport at 4.8 percent. These households spend 0.55 percent on education and 3.54 percent on health. These expenditure patterns show that poorer households already spend a large share of their budgets on basic needs which may potentially leave them limited space to absorb further increases in food, energy and transport costs. The data do not imply that families have reduced health or education spending because of the crisis. Rather, these expenditure patterns provide a basis for understanding the risk of crowding out in health and education spending if cost pressures persist. Table 3 presents key health and education indicators to provide the broader context in which these household pressures occur.

Table 3: Health and Education Indicators of Pakistan

Indicator	Value
Public health expenditure	0.8% of GDP, FY2025
Infant mortality rate	47 per 1,000 births, 2024-25 PSLM
Education expenditure (Federal and Provincial government)	Rs 962.0 billion, or 0.8% of GDP, FY2025
Literacy rate (population aged 10 and above) Total	63% - Total
	74% - Urban
	55% - Rural

Source: Chapters 10 and 11, Pakistan Economic Survey 2025-26.

Table 3 shows that public health expenditure was 0.8 percent of GDP. This level of expenditure is particularly low given Pakistan's continuing health challenges which include infant mortality and child stunting. The literacy rate is 63 percent with a clear rural and urban difference. Rural literacy is 55 percent compared with 74 percent in urban areas. Pakistan also falls behind some of its regional peers in educational attainment. According to the Human Development Report 2025, mean years of schooling is 10.8 years in Sri Lanka and 6.8 years in Bangladesh while it is 4.3 years in Pakistan. These figures indicate the presence of weaknesses in health and education even before the current crisis and could worsen if cost pressures continue.

In the short term, rising prices of food, utilities, fuel, and transport may require households to redirect a large share of their spending towards basic commodities. This may result in crowding out of healthcare and education related expenditures. If nominal income fails to keep pace with the rising costs, households may delay buying medicines and doctor visits. They may also reduce spending on school fees, books and transport

1.HIES consumption quintiles are defined by per capita monthly consumption expenditure: 1st, up to Rs. 6,711; 2nd, Rs. 6,712-8,885; 3rd, Rs. 8,886-11,718; 4th, Rs. 11,719-16,839; and 5th, Rs. 16,840 and above.

2.The poorest households fall into the first quintile.

which could increase the risk of irregular attendance. In the long term, sustained reductions in healthcare use and disruptions to schooling could weaken health and educational outcomes, lower labour productivity and future earnings, and increase the risk of persistent poverty.

2.3. Remittance Uncertainty, Labour Income, and SME Earnings

The third channel through which the Middle East crisis can affect household welfare is remittance uncertainty and pressure on labour income and SME earnings. Regional instability can weaken earnings prospects for Pakistani workers in Gulf countries which could reduce transfers to remittance-dependent households. Domestically, higher fuel, freight, imported-input and financing costs can reduce SME profit margins. Firms may respond by cutting production, working hours, wages and employment which could lower the earnings of workers and self-employed households.

2.3.1. Gulf Labour-Market and Remittance Channel

Table 4: Workers' Remittances, May–July 2025 and 2026 (Million USD)

Month	2025 Remittances (US\$ Mn)	2026 Remittances (US\$ Mn)	YoY Change (%)
May	3685.59	4252.16	15.37
June	3406.39	3474.56	2.00
July	3214.51	3630.48	12.94

Source: Monthly data from Country-wise Workers' Remittances, State Bank of Pakistan, (2026a)

Table 4 shows the pattern in remittance inflows and year-on-year percentage changes across the two years. In 2025, remittance inflows declined from May through July. In 2026, inflows fell between May and June but increased again in July. At this stage, this trend does not indicate a sustained decline in remittance inflows. Remittance inflows recorded positive year-on-year growth in all three months of 2026.

Table 5: Country-wise Workers' Remittances (Three Period Moving Average)

Month	Total Cash Flow (USD Billions)	Saudi Arabia (USD Millions)	UAE ³ (USD Millions)	Other GCC Countries ⁴ (USD Millions)
May-26	3.87	928.48	856.98	362.69
Jun-26	3.75	898.8	844.4	347.36
Jul-26	3.79	922.91	845.37	349.83

Source: Monthly data from Country-wise Workers' Remittances, State Bank of Pakistan, (2026a)

Table 5 presents the three-period moving average of workers' remittances. The moving average of total remittances declined from May to June 2026, before increasing in July. Saudi Arabia, UAE, and other GCC countries followed a similar pattern. Overall, the moving average trend does not indicate a sustained decrease in remittance inflows.

Table 6: GCC Share in Pakistan's Total Workers' Remittances, FY2025–26

Source	Share in Total Remittances, FY2025-26
Saudi Arabia	23.53%
UAE	21.18%
Other GCC Countries	9.46%
Total	54.16%

Note: Total calculated from unrounded shares. Source State Bank of Pakistan, (2026a) - Share in Total Remittances, FY2025–26 estimated by Author

3.Dubai, Abu Dhabi, Sharjah, Ajman, Fujairah, Ras-al-Khaimah and Umm Al-Qawain

4.Bahrain, Kuwait, Qatar and Oman

Table 6 shows the share of GCC countries in Pakistan's total workers' remittances for FY2025–26. GCC countries accounted for 54.16 percent of total remittance inflows. Saudi Arabia contributed 23.53 percent, UAE 21.18 percent and other GCC countries 9.46 percent. This shows the continued importance of Gulf labour markets for Pakistan's remittance inflows and for remittance-dependent households.

In the short term, the recent remittance movements do not yet indicate a sustained crisis-induced shock. In the long term, Pakistan's high dependence on remittance inflows from Gulf countries means that prolonged disturbances in these labour markets could place greater pressure on remittance-dependent households. Therefore, any developments in these labour markets should continue to be monitored.

2.3.2. Domestic Production, SME and Employment Channel

Table 7: Labour-Market Indicators

Indicators	Value (%)
Overall Unemployment Rate - (19 th ICLS ⁵)	7.1
Formal Sector Employment- (21 st ICLS ⁶)	19.2
Informal Sector Employment- (21 st ICLS)	80.8

Source: Pakistan Labour Force Survey 2024 -25, Pakistan Bureau of Statistics

The crisis may also affect household welfare through domestic employment and SME earnings. Table 7 shows labour market conditions in Pakistan before the current crisis. The unemployment rate stood at 7.1 percent, while informal employment accounted for 80.8 percent of total employment. Given this high degree of informality, higher operating costs and weaker labour demand may prompt SMEs to reduce working hours, wages and employment. This could translate rapidly into lower household earnings, particularly for informal and daily-wage workers.

Khan et al. (2026) presented scenario-based projections of the headline unemployment rate for Pakistan, suggesting that the potential unemployment consequences of the crisis in the Gulf region may go beyond the return of the overseas workers. They identified that a combination of increasing energy costs, remittances driven demand contraction, freight disruptions, and tightening of credit could lead to shift reductions, force layoffs, and closures across various sectors. Under an early resolution scenario, they estimated that the headline unemployment rate (June 2026) may be 7.2–7.7 percent. Under the moderate (Q3 2026) and prolonged scenarios (Q1 2027), the rate is projected to range between 7.6–8.5 percent and 8.1–9.4 percent respectively. If the current scenario lasts more than 12 months, the unemployment rate in Pakistan is projected to range between 8.6–10.4 percent. These estimates are scenario-based projections and do not represent realised unemployment outcomes. In the short term, higher fuel, freight and input costs may prompt SMEs to reduce shifts, overtime and daily-wage work. In the long term, if these cost pressures persist, they may lead to layoffs and business closures. As a result, affected households may face lower earnings, reduce consumption, utilise their savings or borrow to meet essential expenses.

Across the channels discussed above, the policy response should therefore protect household purchasing power and income, maintain access to healthcare and education, sustain viable SMEs, and support the reintegration of any returning migrant workers. Existing national programmes should be utilised for the provision of immediate support. Over the medium term, CPEC 2.0 can complement these immediate interventions by supporting participation of local suppliers and SMEs, skill development aligned with employer demand, stronger supply chain resilience, and improved energy reliability.

5.The International Conference of Labour Statisticians (ICLS) has served as the global standard-setting forum for labour statistics since 1923. The 19th ICLS (2013) adopted revised standards redefining "work" and "employment."

6.The most recent 21st ICLS (2023) addresses emerging topics such as platform work, green jobs, and digital labour to ensure that global labour statistics remain relevant in a changing world.

3. Policy Recommendations

3.1. Short-Term Crisis Response and Household Protection

The short-term policy response should aim to protect household purchasing power and income, improve access to health and education services, and support viable SMEs under cost pressures. It should also support the reintegration of returning workers through retraining linked to available jobs and better job matching services. This can be achieved through time bound and targeted interventions provided using existing institutions. The policy matrix below summarises the policy actions, responsible institutions, trigger and duration, and funding/budgetary considerations.

Table 8: Short-Term Policy Response Matrix

Shock / Channel	Policy Actions	Responsible Institutions	Trigger & Duration	Funding / Budgetary Considerations
Cost of living	Provide CNIC-verified, time-bound income support; avoid broad commodity subsidies.	Ministry of Poverty Alleviation and Social Safety	Sustained rise in essential living costs; temporary	Targeted allocation through existing social protection mechanisms.
Health access	Maintain CNIC/B-Form-linked cashless essential treatment through the Prime Minister's National Health Programme with direct payment to empanelled hospitals.	Ministry of National Health Services / Provincial Health Departments	Rising healthcare affordability pressure; temporary	Through existing health programmes and allocations
Education retention	Provide targeted support through Out-of-School Children (OOSC) and School Meal programmes, linked to verified enrolment and attendance	Ministry of Federal Education and Professional Training / Provincial Education Departments	Rising dropout or irregular-attendance risk; time-bound	Through existing programmes
SME cost pressures	Provide working-capital finance for viable SMEs with documented cost increases, subject to bank assessment	State Bank of Pakistan (SBP) / Commercial Banks / Small and Medium Enterprises Development Authority (SMEDA)	Sustained fuel, freight or input-cost pressure; temporary	Through existing credit-support scheme
Returning workers	Provide demand-linked retraining and job matching against verified vacancies	National Vocational and Technical Training Commission (NAVTTTC) / Ministry of Overseas Pakistanis and Human Resource Development	Verified return/displacement; time-bound	Through existing skills programmes

Source: The table is Author's Own Creation

3.2. CPEC 2.0 and Medium-Term Economic Resilience

CPEC 2.0 could serve as a medium-term resilience mechanism rather than a short term solution for providing immediate relief to households. This could involve building stronger linkages between local suppliers and SMEs, skills development in line with employer demand, and improved energy reliability through grid upgrades, better storage and renewable energy. The policy matrix below summarises the policy actions, responsible institutions, implementation period, and funding/budgetary considerations.

Table 9: Medium-Term Policy Response Matrix

Resilience Area	Policy Actions	Responsible Institutions	Implementation Period	Funding / Budgetary Considerations
Energy resilience	Grid and transmission upgrades under URAAN Pakistan; CPEC Phase II cooperation in renewables and storage	Ministry of Planning, Development and Special Initiatives (MoPD&SI) / Power Division	On approval and implementation of relevant energy projects; medium-term	Within approved energy and infrastructure programmes
Local production, SMEs and skills	Expand local supplier participation, strengthen supply-chain linkages, ensure timely SME payments and provide employer-linked technical training under CPEC projects.	MoPD&SI / CPEC Secretariat / NAVTTC / Implementing Agencies	During CPEC project procurement and implementation; throughout the project cycle	Existing project, procurement and skills budgets

Source: The Table is Author's Own Creation

4. Conclusion

The Middle East crisis has increased risks to household welfare through higher cost of living, pressures on health and education expenditures, remittances uncertainty, and risks to SME and labour earnings. In short term, these pressures can be addressed by policy measures that focus on providing time bound and targeted support using existing programmes. These interventions should prioritise safeguarding purchasing power of households and their access to healthcare and education, supporting viable SMEs, and reintegration of returning workers.

Policy measures in short term can alleviate the immediate burden but they cannot address the root causes of vulnerability. Over the medium term, Pakistan needs to build up its production capacity, diversify its energy supply, create better links between skills training and employment, and strengthen competitiveness of SMEs and supply chains. CPEC 2.0 can contribute towards this through linkages between local suppliers and SMEs, skills development linked to employer demand, competitive supply chains and improved energy reliability. Therefore, the broader policy task is to improve the ability of households, workers and firms to cope with future external shocks.

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