

Impact of Exchange Rate Fluctuation and Political Instability on Economic Growth of Pakistan

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Abstract

This study examines how exchange rate volatility and political instability have influenced Pakistan's economic growth between 1980 and 2024, based on annual time-series data. The Gross Domestic Product (GDP) growth rate is the dependent variable, with the exchange rate and a political instability index serving as the primary explanatory variables. To investigate these relationships, the study utilizes Ordinary Least Squares (OLS) regression via EViews while ensuring that standard econometric diagnostics for model validity are applied.

Empirical findings indicate that exchange rate depreciation significantly hinders economic growth, suggesting that currency volatility negatively impacts investment, trade, and overall economic performance. Furthermore, political instability hinders growth, indicating that governance uncertainty, inconsistent policies, and weak institutions erode investor confidence and dampen economic activity. The analysis underscores the interconnectedness of macroeconomic and political stability, illustrating that Pakistan's sustainable economic growth depends on the prudent management of both financial markets and political institutions.

Keywords: Gross Domestic Product (GDP), Political Instability (PI), Exchange Rate (EXR).

1. INTRODUCTION

Economic growth is broadly considered one of the key indicators of a nation's economic well-being and progress. For developing nations such as Pakistan, sustained economic growth is vital to reduce poverty, create jobs, enhance living standards, and ensure macroeconomic stability. Nevertheless, Pakistan's economic growth has historically been unstable and inconsistent, hindered by a range of structural, political, and macroeconomic challenges. Exchange rate volatility and political instability are among the most critical factors influencing Pakistan's economic growth. These two factors

have consistently shaped economic performance, investment choices, inflation patterns, trade balances, and overall macroeconomic stability.

Since gaining independence in 1947, Pakistan has undergone alternating periods of economic advancement and stagnation. However, the period from 1980 to 2024 has been marked by significant volatility in both political transitions and exchange rate fluctuations. Throughout this period, Pakistan experienced a series of political regimes, ranging from military rule in the 1980s and again from 1999 to 2008, to democratic transitions in the late 1980s and 1990s, culminating in democratic governance from 2008 to the present. Such frequent changes frequently resulted in policy uncertainty, inconsistent economic reforms, and governance difficulties. Pakistan's political instability has been characterized by frequent leadership turnover, civil-military friction, widespread protests, corruption scandals, fragile institutional structures, and inconsistent policy shifts. This instability fosters uncertainty in economic planning, deters both domestic and foreign investment, and erodes overall economic confidence. Meanwhile, exchange rate volatility has remained a constant characteristic of Pakistan's macroeconomic landscape. Since 1980, the Pakistani Rupee has experienced substantial depreciation against major foreign currencies, especially the US dollar. While the exchange rate stayed relatively stable under a managed regime in the early 1980s, the following decades saw a gradual and then sharp depreciation. By the late 1990s, the rupee had already weakened significantly, with depreciation accelerating even more during the 2000s and 2010s. By 2024, the exchange rate had surpassed 280 Pakistani rupees per US dollar. This ongoing depreciation has had far-reaching consequences for inflation, the servicing of external debt, import expenses, and trade competitiveness. Fluctuations in exchange rates raise the prices of essential imported inputs like fuel, machinery, and raw materials, thereby increasing costs for Pakistan's production sector. As a result, depreciation frequently triggers cost-push inflation, which diminishes both real income and purchasing power.

The link between fluctuations in exchange rates and economic expansion is intricate. Under the Mundell-Fleming model, a flexible exchange rate regime allows currency depreciation to boost exports by making domestic products more affordable for foreign buyers. This could potentially boost aggregate demand and output. However, in developing economies such as Pakistan, where exports are low in value-added and imports rely heavily on essential goods and energy, currency depreciation tends to generate inflationary pressures instead of fostering export-led growth. Moreover, excessive exchange rate volatility creates uncertainty that deters long-term investment and trade agreements.

Political instability exacerbates the adverse impacts of exchange rate volatility. Investors view frequent government changes or unpredictable policy shifts as indicators of elevated risk. This results in capital flight, diminished foreign direct investment, and strain on foreign exchange reserves. Diminished reserves exacerbate the depreciation of the domestic currency, triggering a vicious cycle of devaluation and economic instability. Furthermore, political crises frequently postpone structural reforms, fiscal consolidation efforts, and institutional strengthening, which in turn jeopardizes long-term growth prospects.

Pakistan's reliance on International Monetary Fund-supported programs also shaped exchange rate dynamics throughout the study period. Stabilization programs frequently necessitate currency adjustments, fiscal tightening, and structural reforms. Although these measures are intended to restore macroeconomic stability, they could temporarily dampen growth and push inflation higher. When paired with political instability, these adjustments can fuel public discontent and additional unrest, establishing a feedback loop between economic strain and political turmoil.

Pakistan's economic resilience has also been tested by external shocks between 1980 and 2024. Economic activity was significantly disrupted by events such as the September 11 attacks and ensuing regional security challenges, the Global Financial Crisis, fluctuations in global oil prices, and the COVID-19 pandemic. These shocks compounded domestic political instability and exchange rate pressures, thereby heightening macroeconomic vulnerabilities. For instance, surging oil prices escalated import costs, thereby expanding the current account deficit and exerting downward pressure on the rupee. Political instability during these crises hindered the government's capacity to enact coherent and timely policy responses.

From 1980 to 2024, Pakistan's GDP growth has been inconsistent. Relatively high growth periods were frequently followed by sharp slowdowns. Economic growth was repeatedly hindered by inflationary pressures, balance of payment crises, surging public debt, and exchange rate misalignment. Although many studies have looked at exchange rate volatility or political instability on their own, fewer have examined their combined and interactive impacts on Pakistan's long-term economic growth using consistent annual data.

It is especially crucial to understand how exchange rate fluctuations and political instability jointly affect outcomes, given their interconnected nature. Political instability can lead to exchange rate depreciation by causing capital outflows and diminishing investor confidence. Conversely, a sharp decline in currency value can drive up inflation and economic distress, sparking public discontent and political instability. Consequently, the relationship is dynamic and may operate in both directions.

In light of Pakistan's pressing economic hurdles—such as soaring inflation, dwindling foreign reserves, escalating external debt, and governance issues—it is crucial to empirically investigate the impact of exchange rate volatility and political instability on economic growth. To craft effective strategies for currency stabilization, institutional strengthening, and sustainable growth, policymakers need insights grounded in evidence.

This study tries to address a gap in current research by looking at how exchange rate fluctuations and political uncertainty together affect Pakistan's economic growth. It uses yearly data from 1980 to 2024. The data comes from trusted sources like the State Bank of Pakistan, World Development Indicators, and World Governance Indicators. The goal is to gather solid evidence and suggest useful policies. In the end, this research helps us better understand the factors that influence economic growth in Pakistan and gives advice on how to achieve lasting economic stability and progress.

2. PROBLEM STATEMENT

Pakistan has faced ongoing economic problems for a long time. These problems include changing GDP growth, higher inflation, repeated balance of payments issues, and a constant need for help from foreign financial sources. One big reason for these problems is the constant changes and instability in the value of the currency. This has made imports more expensive, increased the country's debt to foreign countries, and pushed up inflation. At the same time, political issues like frequent changes in government, inconsistent policies, governance problems, and weak institutions have made things uncertain, which discourages both investment and long-term planning.

Even though there have been many discussions in economic studies, there isn't much detailed research that looks at how changes in the currency value and political instability together affect Pakistan's economic growth over the last 25 years.

Most studies look at either economic factors or political factors separately, without looking at how they work together. Because of this, there is a need to find out if these two factors have a big effect on the country's economic growth and how much they influence each other. This study aims to fill this gap and provide real evidence that can help government officials make better plans for economic stability.

3. RESEARCH QUESTIONS

- This study is guided by the following key questions:
- Has the persistent depreciation of the Pakistani Rupee had a measurable negative effect on GDP growth over the period 1980 to 2024?
- Does political instability slow economic growth by discouraging investment and disrupting policy continuity?
- Do exchange rate volatility and political instability amplify each other's negative effects on Pakistan's macroeconomic performance?
- What practical policy steps can reduce these twin pressures and put Pakistan on a more stable growth path?

4. RESEARCH OBJECTIVES

The study pursues the following objectives:

- To measure how exchange rate depreciation and volatility affect key macroeconomic outcomes in Pakistan, including inflation, investment, and the trade balance.
- To assess the role of political instability in shaping economic performance, with particular attention to how governance uncertainty weakens growth.
- To examine whether the interaction between exchange rate volatility and political instability creates a compounding negative effect on long-run GDP growth.
- To develop concrete, evidence-based policy recommendations for stabilizing the exchange rate, improving governance, and promoting sustainable economic development in Pakistan.

5. SCOPE AND SIGNIFICANCE OF THE STUDY

This study looks at the time period from 1980 to 2024, which was a time of big changes in politics and currency values in Pakistan. During this time, there were several different political leaders, major economic changes, shifts in how the currency was managed, and various economic challenges both inside and outside the country. By studying this long-time frame, the research is able to understand long-term trends and important changes in Pakistan's economy. The study focuses on how changes in the exchange rate, political instability, and economic growth are connected, using yearly data over this period. The research uses data that has already been collected from reliable sources and does not gather new data directly.

The importance of this study is that it helps both scholars and those in government by showing how political and economic factors together influence economic growth in Pakistan.

The findings can help decision-makers, economists, and researchers create better plans to control currency fluctuations, improve government systems, and support long-term economic stability. The study is especially valuable because it brings together political instability and exchange rate issues in one analysis, which is not something that has been widely done before.

The long-time frame from 1980 to 2024 also makes the research more reliable by including different economic periods, political systems, and policy changes.

This wider view improves the ability to apply the results to different situations and offers stronger guidance for achieving lasting economic growth and stability in Pakistan.

6. LITERATURE REVIEW

Economic growth depends on both macroeconomic stability and the political environment. In countries that are still developing, such as Pakistan, changes in the value of currency and political uncertainty have become major factors affecting the long-term health of the economy. This section looks closely at the theories and research on these factors and how they affect each other.

6.1 Exchange Rate Fluctuations and Economic Growth

6.1.1 Theoretical Perspectives

The connection between how a country's currency value changes and its economic growth has been a big topic in international economics. The Mundell-Fleming model, created by Robert Mundell and Marcus Fleming, says that when a country's currency loses value, it can help boost overall spending. This happens because exports become cheaper and imports cost more. But this only works if exports and imports are sensitive to price changes. In places where exports aren't strong and imports are a big part of the economy, a weaker currency might instead cause rising prices.

The Purchasing Power Parity (PPP) theory, first introduced by Gustav Cassel, claims that exchange rates should eventually match the differences in price levels between countries.

But in many developing countries, exchange rates often don't line up with PPP, which can show problems like inefficient markets, trade imbalances, and weak institutions.

Another key idea is the Balassa-Samuelson Effect, developed by Béla Balassa and Paul Samuelson.

It suggests that countries that grow more efficiently in industries that sell abroad tend to see their currency strengthen in real terms. However, Pakistan's currency has been steadily losing value, which goes against this theory. This suggests that there are limits to productivity growth and underlying structural issues in the economy.

6.1.2 Empirical Evidence (Global Perspective)

Empirical studies from the time period between 1980 and 2024 show mixed results about how exchange rate volatility affects economic growth. Robert Barro, in 1996, said that having macroeconomic stability, like low exchange rate volatility, is key for long-term economic growth. High exchange rate volatility makes it hard for people to invest in the long term, increases uncertainty, and can make trade deals less efficient, which can hurt economic performance over time.

Stanley Fischer, in 1993, also pointed out that macroeconomic instability, including problems with exchange rates, can slow down economic growth in developing countries. His research suggests that unstable exchange rate systems during times of economic change can make investors less confident and reduce the amount of capital available for investment. These issues have been especially important for developing countries in the last four decades.

Dani Rodrik, in 2008, argued that having a competitive and stable exchange rate can help developing countries grow by focusing on exports.

His analysis shows that countries that kept their exchange rates stable and somewhat undervalued during the 1980s to 2010s saw more industrial growth and better export results.

However, too much depreciation or unpredictable changes in exchange rates can create uncertainty in financial markets.

This volatility increases the cost of managing risk, makes foreign investment less likely, and can reduce trade. Looking at the long period from 1980 to 2024, global evidence shows that while a moderate drop in the exchange rate may help exports, ongoing volatility typically hurts long-term growth, especially in developing countries with weak financial systems and high reliance on imports.

6.1.3 Empirical Evidence (Pakistan Context)

In Pakistan, the decline in the value of the currency from 1980 to 2024 has commonly been linked to rising inflation and ongoing difficulties in the balance of payments. Studies show that when the Pakistani rupee loses value, it becomes more expensive to import goods like energy, machinery, and raw materials needed for industry. These higher costs push up prices, leading to inflation, which lowers people's real income and reduces spending, eventually slowing down the economy.

Javed Ahmed and others (2020) used a statistical method called Vector Auto Regression to find that changes in the exchange rate have a significant effect on Pakistan's GDP growth.

Their research shows that exchange rate changes quickly lead to higher inflation and instability in the economy's external sector, which weakens overall economic performance. Similarly, Ahmed and Zafar (2021) found that even a small drop in the rupee's value, like 1%, causes inflation to rise, which in turn reduces people's ability to buy things and makes them less willing to invest, thus hurting economic growth.

Over the long period from 1980 to 2024, the continuous fall in the value of the Pakistani rupee shows deeper issues like trade imbalances, heavy reliance on imported energy, dependence on foreign loans, and repeated efforts to stabilize the economy.

These factors have led to unstable exchange rates and uncertainty in the economy. As a result, most research on Pakistan's economy supports the idea that changes in the exchange rate and long-term depreciation have had a negative impact on economic performance and the potential for future growth during this time.

6.2 Political Instability and Economic Growth

6.2.1 Theoretical Foundations

Political instability refers to the likelihood of government collapse, policy inconsistency, regime change, or political violence. According to institutional economics, strong institutions promote economic growth by ensuring property rights, policy credibility, and contract enforcement.

Alberto Alesina et al. (1996) argued that frequent government turnover reduces growth because it creates policy uncertainty. Investors delay decisions when future policies are unpredictable.

Similarly, Douglass North emphasized that institutional stability is essential for economic development. Weak governance structures increase transaction costs and discourage productive investment.

6.2.2 Empirical Evidence (Global Studies)

Cross-country studies consistently find a negative relationship between political instability and economic growth. Countries experiencing coups, revolutions, or frequent elections often show lower investment rates and slower GDP growth.

Political uncertainty increases risk premiums, leading to capital flight and reduced foreign investment. In emerging markets, instability often triggers currency depreciation and stock market volatility.

6.2.3 Political Instability in Pakistan

Pakistan's political history from 1980 to 2024 includes military interventions, democratic transitions, coalition governments, political protests, corruption scandals, and governance challenges. During the 1980s, Pakistan experienced military governance, followed by democratic governments in the late 1980s and 1990s. Later, military rule re-emerged from 1999 to 2008, followed by democratic transitions and coalition governments thereafter. These frequent political changes led to inconsistent economic policies, delays in structural reforms, and uncertainty in macroeconomic management.

Recent studies also support the negative impact of political instability on economic performance. Hussain and Shear (2024) found that GDP growth declined during periods of political unrest and governance uncertainty in Pakistan. Their findings indicate that political disturbances reduce investor confidence and slow economic activity. Similarly, Dogar and Khalid (2024) highlighted that institutional quality mediates the relationship between instability and economic growth, suggesting that stronger governance can reduce the negative impact of political shocks.

Political crises in Pakistan over the 1980–2024 period have often resulted in capital outflows, pressure on foreign exchange reserves, and exchange rate depreciation. Such

instability discourages both domestic and foreign investment, disrupts economic planning, and weakens policy implementation. As a result, empirical literature for Pakistan suggests that political instability significantly undermines economic growth by reducing investor confidence, increasing uncertainty, and limiting the effectiveness of macroeconomic policies.

6.3 Combined Impact of Exchange Rate Volatility and Political Instability

Empirical and theoretical research consistently highlights a dynamic and mutually reinforcing relationship between exchange rate volatility and political instability, with significant implications for macroeconomic performance and long-term growth. Over the period 1980–2024, Pakistan has experienced repeated episodes of political turbulence—frequent changes in government, military interventions, and mass protests—which have often coincided with heightened macroeconomic instability, particularly in foreign exchange markets.

Political instability affects economic expectations and investor confidence. Episodes such as the late 1980s political realignments, the 1990s oscillation between civilian governments, the 2007–2008 emergency and post-election uncertainty, and the 2018–2024 political volatility surrounding elections and IMF programs have been accompanied by accelerated exchange rate depreciation and increased volatility. These macroeconomic disruptions have material consequences:

- **Capital Flight and Sharp Exchange Rate Depreciation:** Political crises discourage foreign investment and encourage capital outflows, exerting sustained pressure on the Pakistani rupee. This pattern is visible across multiple decades—for example, during the political crises in the 1990s and early 2000s—which coincided with depreciating exchange rates and reserve depletion.
- **Inflationary Pressures and Reduced Purchasing Power:** Exchange rate depreciation transmits directly into higher import prices, feeding into inflation. Weak policy coordination and delayed responses during politically unstable periods further exacerbate inflation, eroding consumer purchasing power and amplifying socioeconomic discontent.
- **Undermined Export Gains:** Although a depreciated exchange rate can theoretically enhance export competitiveness, sustained political instability weakens institutional capacity and export-oriented policy frameworks. This limits the ability of producers to capitalize on exchange rate-driven price advantages in international markets.
- **Feedback Loop between Economic and Political Instability:** As economic conditions weaken—through rising inflation, currency instability, and declining investment sentiment—public dissatisfaction tends to escalate, leading to further political instability. This positive feedback loop prolongs uncertainty and depresses growth prospects.

These qualitative mechanisms are supported by recent empirical findings:

- **Khan et al. (2023)** document a strong inverse relationship between FDI inflows and political instability in Pakistan, which intensifies during periods of rupee depreciation. This suggests that when the exchange rate becomes unstable,

politically induced investor risk aversion magnifies the adverse effects on foreign investment.

- **Malik and Rehman (2021)** find that inflation rises during political transitions, highlighting that political change—especially if abrupt or contested—coincides with exchange rate pressures and weakened monetary policy enforcement.
- **Naeem (2020)** argues that even when exchange rate depreciation could theoretically make Pakistani exports more competitive, political instability prevents full realization of export gains. Institutional weakness, policy unpredictability, and disruptions to trade logistics dampen the potential benefits of a weaker currency.

Taken together, the literature and historical patterns from 1980 to 2024 indicate that exchange rate volatility and political instability in Pakistan are not isolated phenomena but interlinked forces that create a reinforcing cycle of uncertainty. This cycle distorts investment decisions, weakens external balances, fuels inflation, and undermines long-term economic growth. Policies aimed at stabilizing both the political environment and exchange markets—through transparent institutions, credible macroeconomic frameworks, and investor-friendly reforms—are therefore crucial for sustaining economic development.

7. CONCEPTUAL FRAMEWORK

This conceptual framework illustrates the relationship between independent and dependent variables. Exchange rate fluctuation and political instability are independent variables, while economic growth rate is the dependent variable. Both exchange rate fluctuation and political instability directly influence economic growth in Pakistan. Exchange rate fluctuations affect growth through inflation, trade balance, and investment channels, whereas political instability influences economic performance through policy uncertainty, reduced investor confidence, and delayed reforms.

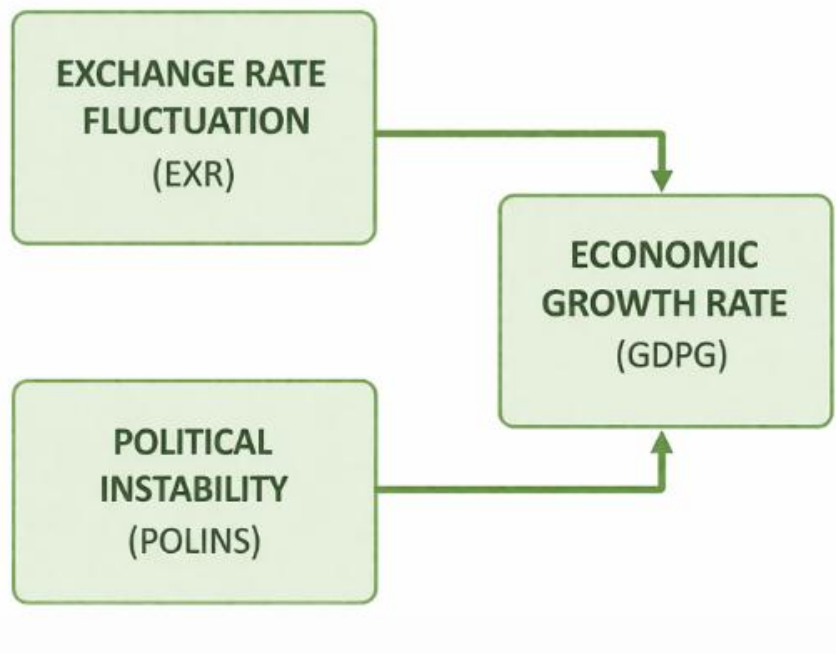


Figure 1. Conceptual Framework of the Study

8. RESEARCH HYPOTHESIS

H₀: Exchange Rate Fluctuation and Political Instability have no significant Impact on Pakistan's economic growth.

H₁: Exchange Rate Fluctuation and Political Instability both have significant impact on Pakistan's economic growth.

9. DATA COLLECTION AND SOURCES

This study is based on secondary data collected from reliable and internationally recognized sources for the period 1980 to 2024. The use of secondary data ensures consistency, comparability, and credibility of the empirical analysis. The data for each variable have been obtained as follows:

- **State Bank of Pakistan (SBP):** Exchange rate data have been collected from official publications and statistical bulletins of the State Bank of Pakistan. The annual average exchange rate of Pakistani Rupee against the US Dollar is used to measure exchange rate fluctuations. SBP is considered the most authentic national source for financial and monetary statistics.
- **World Development Indicators (WDI):** Data for economic growth rate, measured by annual GDP growth percentage, have been obtained from the World Development Indicators database published by the World Bank. This source provides standardized and internationally comparable macroeconomic data for Pakistan.
- **World Governance Indicators (WGI):** Political instability data have been sourced from the World Governance Indicators compiled by the World Bank. Specifically, the Political Stability and Absence of Violence index is used as a

proxy for political instability. This index captures perceptions of government stability, political violence, and policy uncertainty.

10. VARIABLES

Dependent Variable: Economic Growth (GDP growth rate)

Independent Variables: Exchange Rate Fluctuation (e.g., PKR/USD Exchange Rate), Political Instability (e.g., Political Instability Index).

11. MODEL SPECIFICATION

Model specification is a crucial step in empirical research as it defines the mathematical relationship between the dependent and independent variables. This study examines the impact of exchange rate fluctuations and political instability on Pakistan's economic growth using time-series data from 1999 to 2024.

The dependent variable of the study is Economic Growth, measured by the annual GDP growth rate. The independent variables include Exchange Rate Fluctuation (measured by PKR/USD exchange rate) and Political Instability (measured by Political Stability Index from World Governance Indicators).

To estimate the relationship among variables, the Ordinary Least Squares (OLS) regression technique is used.

11.1 Functional Form of the Model

The functional relationship of the model can be expressed as:

$$\text{GDPG} = (\text{EXR}, \text{POLINS})$$

Where:

- **GDPG** = GDP Growth Rate
- **EXR** = Exchange Rate (PKR/USD)
- **POLINS** = Political Instability Index

11.2 Econometric Model

The econometric model of the study is specified as:

$$\text{GDPG}_t = \beta_0 + \beta_1 \text{EXR}_t + \beta_2 \text{POLINS}_t + \varepsilon_t$$

Where:

- **GDPG_t** = Economic growth rate at time *t*
- **β₀** = Intercept (constant term)
- **β₁** = Coefficient of exchange rate
- **β₂** = Coefficient of political instability
- **ε_t** = Error term
- **t** = Time period (1999–2024)

12. RESULTS AND FINDINGS

12.1 Regression Analysis

Regression results show that exchange rate has a negative coefficient, indicating that depreciation of the currency reduces GDP growth. This result is consistent with economic theory, which states that depreciation increases import costs and inflation. Political instability also shows a negative coefficient, suggesting that unstable political conditions discourage investment and reduce economic activity. However, the

statistical significance of political instability may be weaker compared to exchange rate. The R-squared value indicates that exchange rate and political instability jointly explain a moderate portion of variation in GDP growth during 1980–2024.

Dependent Variable: GDPG Method: Least Squares Date: 04/01/26 Time: 23:15 Sample: 1980 2024 Included observations: 45					
Variable		Coefficient	Std. Error	t-Statistic	Prob.
EXR		-0.014070	0.004567	-3.080670	0.0036
POLINS		0.904083	0.359770	2.512947	0.0159
C		6.730642	0.617118	10.90658	0.0000
R-squared		0.303369	Mean dependent var	4.512000	
Adjusted R-squared		0.270196	S.D. dependent var	2.372592	
S.E. of regression		2.026872	Akaike info criterion	4.315205	
Sum squared resid		172.5448	Schwarz criterion	4.435649	
Log likelihood		-94.09211	Hannan-Quinn criter.	4.360105	
F-statistic		9.145067	Durbin-Watson stat	1.876681	
Prob(F-statistic)		0.000505			

Figure 2. OLS Regression Output (EViews)

12.2 Descriptive Analysis

Descriptive statistics provide information about the mean, minimum, maximum, and standard deviation of the variables used in the study. The mean value of GDP growth indicates the average economic growth of Pakistan during 1980–2024. The exchange rate shows a rising trend over time, reflecting depreciation of the Pakistani rupee. Political instability values indicate fluctuations in governance conditions over the study period. The standard deviation values suggest that exchange rate experienced higher volatility compared to GDP growth, indicating macroeconomic instability.

Date: 03/31/26 Time: 01:03 Sample: 1980 2024			
	EXR	GDPG	POLINS
Mean	74.23889	4.512000	-1.298667
Median	57.80000	4.440000	-1.520000
Maximum	286.5800	10.22000	0.000000
Minimum	9.900000	-1.270000	-2.810000
Std. Dev.	67.55013	2.372592	0.857530
Skewness	1.603678	-0.120845	0.358911
Kurtosis	5.265262	3.075390	1.828799
Jarque-Bera	28.90977	0.120183	3.538090
Probability	0.000001	0.941678	0.170496
Sum	3340.750	203.0400	-58.44000
Sum Sq. Dev.	200772.9	247.6845	32.35572
Observations	45	45	45

Figure 3. Descriptive Statistics of Variables

12.3 Correlation Coefficient

The correlation matrix shows the relationship among variables. The correlation between exchange rate and GDP growth is negative, indicating that depreciation of the exchange rate is associated with lower economic growth. Similarly, political instability is negatively correlated with GDP growth, implying that unstable political conditions reduce economic performance. The correlation between exchange rate and political instability is positive, suggesting that political uncertainty may contribute to exchange rate volatility.

	EXR	GDPG	POLINS
EXR	1.000000	-0.445676	-0.137986
GDPG	-0.445676	1.000000	0.382040
POLINS	-0.137986	0.382040	1.000000

Figure 4. Correlation Matrix

12.4 Scatter and Line & Symbol Diagrams

Scatter Diagram of Exchange Rate with GDP

The scatter diagram indicates a negative relationship between exchange rate and GDP growth. As exchange rate increases (currency depreciation), GDP growth tends to decline.

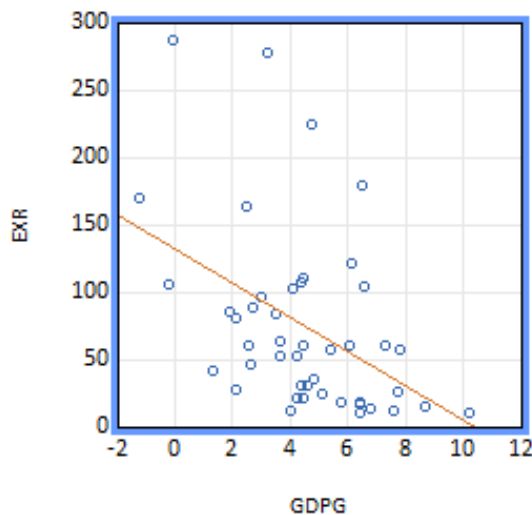


Figure 5. Scatter Diagram — Exchange Rate vs GDP

Scatter Diagram of Political Instability with GDP

The scatter plot shows that higher political instability is associated with lower economic growth.

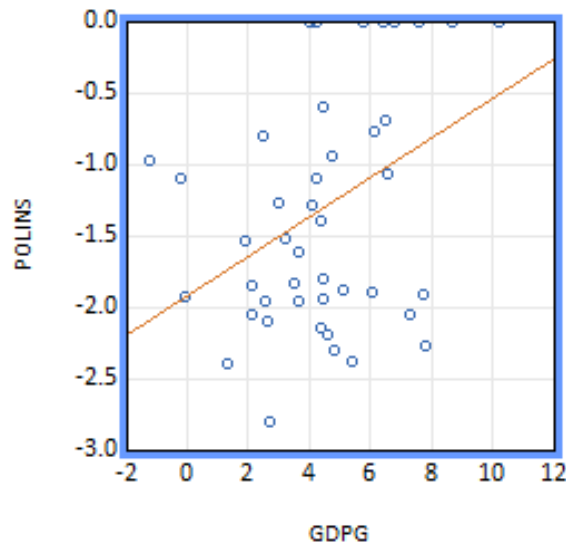


Figure 6. Scatter Diagram — Political Instability vs GDP

Scatter Diagram of Combined Variables

The combined scatter diagram suggests that both exchange rate depreciation and political instability jointly influence economic growth negatively.

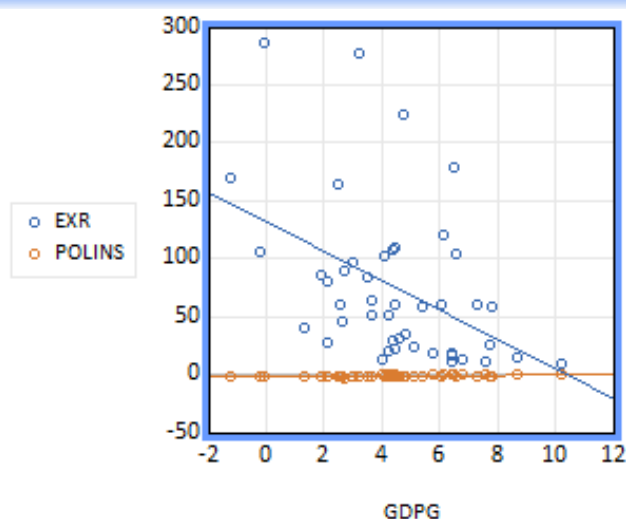


Figure 7. Scatter Diagram — Combined Variables
Line Diagram of Combined Variables

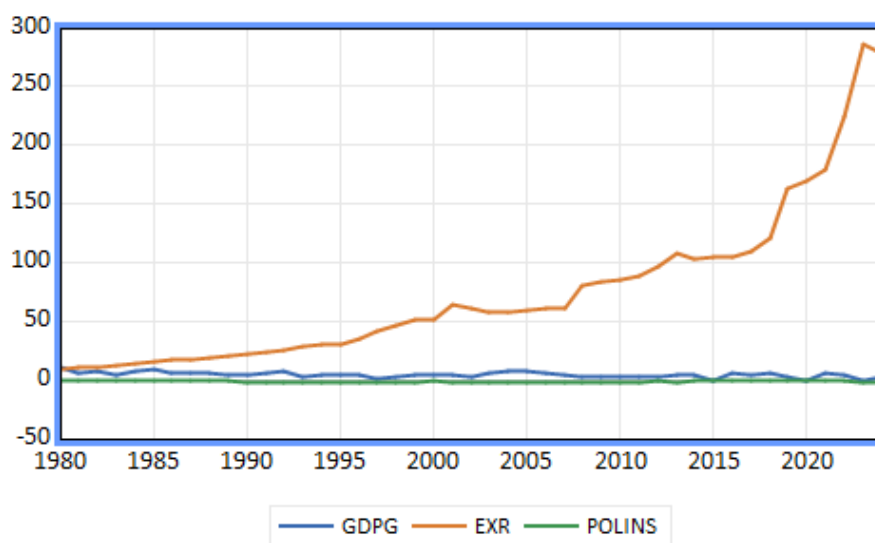


Figure 8. Line Diagram — Combined Variables (1980–2024)

13. CONCLUSION

This study examined the impact of exchange rate fluctuations and political instability on Pakistan's economic growth using annual data from 1980 to 2024. The results indicate that exchange rate depreciation negatively affects economic growth by increasing inflation and import costs. Political instability also exerts a negative influence by discouraging investment and creating policy uncertainty. The regression analysis confirms that both variables jointly influence GDP growth. Overall,

macroeconomic stability and political stability are essential for sustainable economic growth in Pakistan.

14. IMPLICATION OF THE STUDY

The findings carry a number of practical implications:

- Exchange rate management cannot be an afterthought. Persistent depreciation has real and measurable costs for growth, and policies that stabilize the currency without sacrificing competitiveness would help create a more predictable environment for investment.
- Political stability is not just a governance goal; it is an economic one. The data show clearly that political uncertainty discourages investment and disrupts growth. Institutional reforms that improve the credibility and continuity of government policy regardless of which party is in power are among the most valuable investments Pakistan could make.
- International institutions working in Pakistan, including the IMF and World Bank, should account for the political economy context when designing stabilization programs. Conditions that are technically sound but politically unsustainable tend to produce neither stability nor growth.
- The study also highlights the value of coordinated reform tackling currency instability and governance weakness together, rather than treating them as separate problems

15. LIMITATION OF THE STUDY

This study has several limitations that are worth acknowledging:

- The model includes only three variables GDP growth, the exchange rate, and political instability. Many other factors influence growth, including inflation, interest rates, foreign direct investment, and government spending. Their exclusion means the model captures only part of the picture.
- Annual data was used throughout, which is appropriate for long-run trends but may miss important short-term dynamics particularly around crisis episodes that unfold over months rather than years.
- The political instability index from the World Governance Indicators has limited coverage for the earlier part of the study period, which may introduce some inconsistency in the data across time.
- The OLS methodology assumes a linear relationship between variables. In reality, the relationship between exchange rate volatility, political instability, and growth is likely non-linear and potentially subject to threshold effects.

16. POLICY RECOMMENDATION

Based on the findings, the following policy recommendations are proposed:

- Government should maintain stable exchange rate policies to reduce volatility.
- Political stability should be strengthened through institutional reforms.
- Policies should encourage foreign direct investment to support growth.
- Fiscal discipline and export promotion strategies should be adopted.
- Long-term economic planning should be prioritized to reduce uncertainty.

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