Global and Domestic Developments

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Global economy grew steadily during CY25, resisting trade tensions and geopolitical disruptions. Global trade, supported by the rise in AI and tech-related demand, recovered during the year, with emerging markets and developing economies (EMDEs) outpacing the advanced economies (AEs). Inflation continued its downward trend, driven by decrease in commodity prices, especially oil and food prices. Financial conditions improved amid robust growth in equity markets. Equity markets in EMDEs outperformed others due to increased exports in tech sector and the weakening of US dollar. The global growth prospects, however, still face challenges, posed by trade and geopolitical tensions, and fears of lower-than-expected returns on AI-related investments. During CY25, domestic economic activity continued to gain traction amid improving macroeconomic conditions and enhanced policy credibility. CPI Inflation dropped further, while the current account deficit remained contained, and the primary balance recorded a surplus for third consecutive year. Foreign exchange reserves rose significantly, reinforcing external sector stability and strengthening market confidence. These gains were supported by improved supply chain conditions, prudent and well-coordinated monetary and fiscal policies, and relatively lower international commodity prices. Progress under the IMF's Extended Fund Facility program and its timely reviews and disbursements further bolstered investor sentiment. In addition, robust workers' remittance inflows, exchange rate stability and a reduction in the country risk premium collectively contributed to enhancing macroeconomic stability and strengthening overall economic resilience during the year. Going forward, ensuring policy consistency and reform continuity remains critical to achieving durable growth, maintaining price stability, and improving productivity, competitiveness and debt sustainability to ensure macro-financial stability and sustained economic growth in medium- to long-term.

1 Global and Domestic Developments

1.1 Global Economic Dynamics

Despite trade uncertainty, global economy remained resilient …

Global economy, growing by 3.4 percent, exhibited steady performance in CY25 (**Table 1.1**).[1] Despite unusual trade uncertainty, a number of factors supported economic momentum, including surging technology related investment, accommodative fiscal and monetary policies, broadly eased financial conditions, and adaptability of the private sector to US tariffs.

Advanced Economies (AEs) witnessed slight deceleration in their growth during CY25. The pace of economic activity in the US remained lower. However, strong AI-related investments, lower interest rates, and continued fiscal support aided the economy. Moreover, declining energy prices, ebbing interest rates, and targeted fiscal measures contributed towards growth in other AEs.

Emerging markets and Developing Economies (EMDEs) registered 4.4 percent growth. Economic prospects improved for China due to policy support, which helped contain the impact of slowdown in real estate sector.[2] Rising AI-related investment increased the global demand for semiconductors and related equipment. This results in higher exports of these items from Asian economies, contributing positively towards growth in EMDEs.

Gulf Cooperation Council (GCC) region—a major export destination and vital source of remittance for Pakistan—manifested noticeable revival in economic activity during CY25. The continued diversification in growth drivers of these countries primarily scaled up economic growth.

Global Economy: Real GDP Growth — **Table 1.1**

			percent
	2024	**2025**	**2026***
World	3.4	3.4	3.1
Advanced Economies	1.8	1.9	1.8
EMDEs	4.5	4.4	3.9
EMDEs - Asia	5.4	5.5	4.9
USA	2.8	2.1	2.3
Euro Area	0.9	1.4	1.1
GCC	2.2	4.4	2.0
UK	1.1	1.3	0.8
Japan	-0.2	1.2	0.7
China	5.0	5.0	4.4
Türkiye	3.3	3.6	3.4
India	7.1	7.6	6.5
Russia	4.9	1.0	1.1
Saudi Arabia	2.6	4.5	3.1
UAE	4.0	5.8	3.1
Pakistan**	2.6	3.1	3.6

*Projections

**Fiscal Year

Source: IMF WEO and REO

…along with increased global trade.

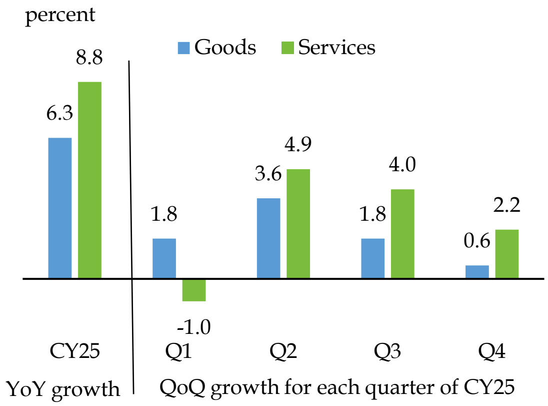
Global trade in CY25 exceeded $35 trillion, an increase of around $2.2 trillion from CY24.[3] Trade in services, particularly in information and business services, mainly drove this growth, followed by trade in goods. **(Figure 1.1)**. In volume terms, global trade has increased by 4.1% in CY25.

[1] International Monetary Fund. (2026, January). *World Economic Outlook Update: Global Economy: Steady amid Divergent Forces.*

[2] Fiscal expansion, front-loading of exports towards and European and Asian partners, and acceleration in domestic demand contributes towards positive outlook of Chinese economy.

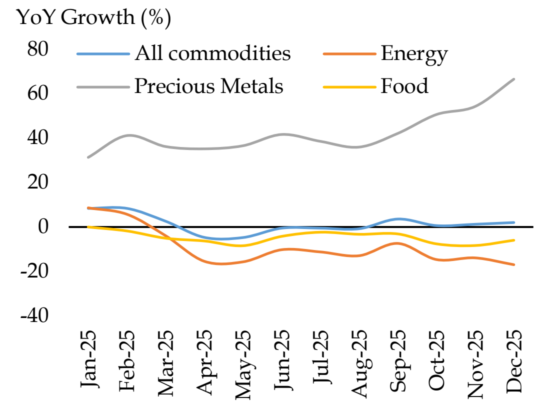
[3] UN Trade and Development (UNCTAD) Global Trade Update – December 2025

Growth in Trade of Goods and Services **Figure 1.1**



Source: UNCTAD

International Commodity Prices Index **Figure 1.2**



Source: International Monetary Fund

During H1-CY25, households and businesses frontloaded their consumption and investment in anticipation of higher tariffs. This temporarily boosted global activity in early 2025.[4] Moreover, bilateral trade agreement between US and various countries, especially the deal between US and China on rare earth minerals abated the trade tensions in H2CY25.

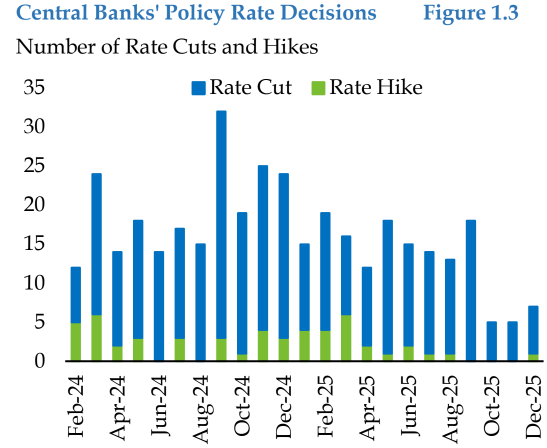
Global inflation continued to decline…

Global headline inflation fell to 4.1 percent from 5.8 percent in previous year. Decline in energy prices, softened consumer demand, and weak labor market conditions kept downward pressure on inflation. However, precious metals prices profoundly increased as investors hedged them amid rising geopolitical uncertainty **(Figure 1.2)**. Also, a few central banks increased their inventory of gold reserves. It is noteworthy that despite geopolitical stress, global oil prices declined on the back of increased supply and tepid global demand.

accompanied by a synchronized monetary easing…

Major central banks continued to ease monetary policy throughout the year, albeit with varying pace. Despite trade uncertainty and above-target inflation levels, AEs eased monetary policy in a calibrated manner amid concerns of economic slowdown and weak labor demand.[5] While emerging market central banks either cut or maintained key interest rates depending on the domestic inflation dynamics **(Figure 1.3)**.

Central Banks' Policy Rate Decisions **Figure 1.3**



Source: CB Rates.com

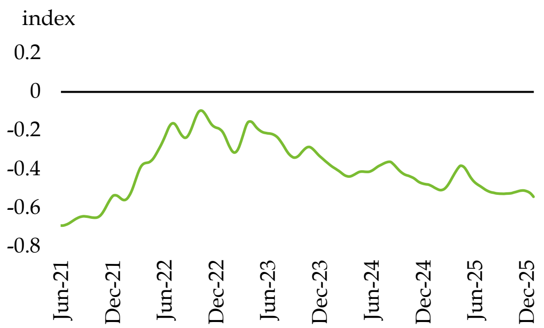
[4] World Economic Outlook, October 2025

[5] This year, the US Federal Reserve cut rates by a total of 75 basis points, the European Central Bank (ECB) 100 basis points, the Bank of England (BoE) 100 basis points, and the Reserve Bank of Australia 75 basis points, while the Bank of Japan (BoJ) raised its rates by 50 basis points.

contributing to accommodative financial conditions…

Financial conditions generally remained favorable during CY25 driven by lowering interest rates, weakening of US dollar against major currencies, and strong equity prices **(Figure 1.4)**. The tightening in financial conditions amid trade tariffs shocks in April-2025 proved short-lived, though. In emerging markets, external financing risks abated due to a weaker dollar, resulting in eased financial conditions.[6]

Financial Conditions Index **Figure 1.4**



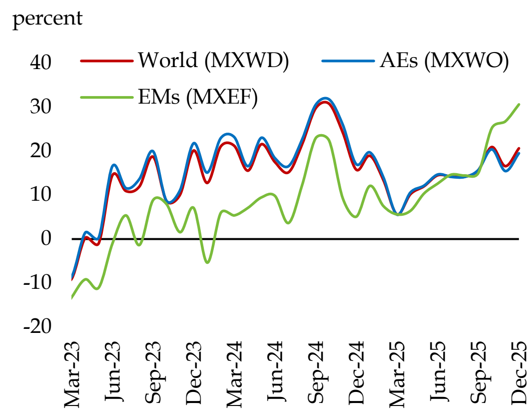
Note: Values below zero represent expansionary financial conditions, where credit is more accessible and market stress is lower than historical norms.
Source: St louis Fed

equity markets sentiment remained strong…

Global equity markets, with 21.6 percent growth in CY25, manifested strong investors' confidence. The performance was mainly contributed by EMDEs and USA equity markets. **(Figure 1.5)**.[7]

While Asian markets benefited from artificial intelligence boom as tech companies and chipmakers saw surges in demand, boost in European markets was backed by defense spending plans and improved economic prospects. Depreciation of US dollar against major currencies also provided a tailwind to international stocks.

MSCI Equity Price Indices (YoY change) **Figure 1.5**

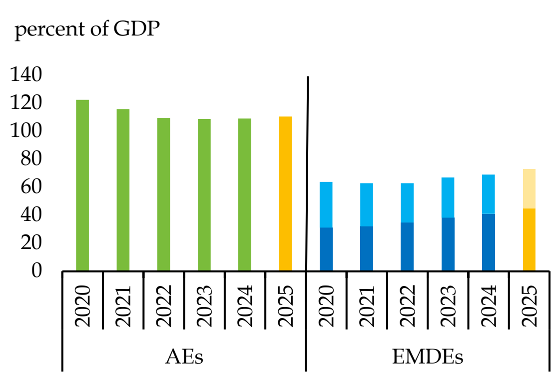


Source: Bloomberg

While debt levels remained stable in AEs, EMDEs debt increased in local currency.

The sovereign debt reached 110 percent of GDP for AEs by the end of CY25 (109 percent in CY24). However, in EMDEs case, the ratio rose to 73 percent from 70 percent in the previous year **(Figure 1.6)**. However, reliance on foreign currency borrowing reduced in some EMDEs, but progress has been uneven, and the currency

General Government Debt **Figure 1.6**



Note: Light colored columns represent the external debt of EMDEs as part of overall debt.
Source: International Monetary Fund

[6] Global Financial Stability Report, October 2025, Chapter 1, "Shifting Ground beneath the Calm: Stability Challenges amid Changes in Financial Markets"
[7] During CY25, S&P 500 posted total returns of approximately 17.9%, while the tech-heavy NASDAQ Composite jumped around 21.1%. In Asia, the Shanghai Composite Index gained approximately 18.4% during the year, while the Nikkei 225 returned about 26%, making it one of the top-performing major global equity markets of the year.

composition of government borrowing still varies considerably across economies.

1.2 Domestic Economic Developments

Macroeconomic stability gained traction in CY25…

Building upon the gradual recovery in CY24, the macroeconomic environment further improved in CY25. Economic activity paced-up, inflation fell further, current account deficit remained contained, Rupee stability largely remained intact, fiscal position improved, and SBP's FX reserves increased.

The visible shift in macroeconomic environment was underpinned by coordinated macroeconomic policies, disciplined implementation of IMF program, favourable international commodity prices, and eased global financial conditions. Against this backdrop, sovereign credit ratings improved, and the country's risk premium declined.

The economic growth was primarily driven by the industrial sector, supported by a stronger expansion in large-scale manufacturing (LSM) reflecting a gradual recovery in domestic demand amid decline in inflation and reduction in interest rates. The agriculture and services sectors further complemented the growth momentum, benefiting from improved input availability[8] and increased activity across general government and financial services in line with improvements in economic conditions **(Table 1.2, Figure 1.7)**.

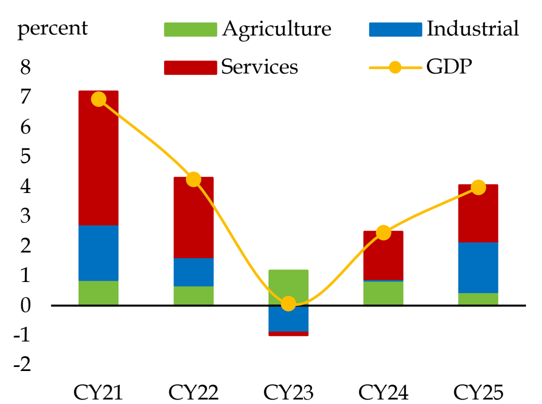
Key Economic Indicators of Pakistan* — Table 1.2

	2021	2022	2023	2024	2025
Real Sector			(percent)		
Real GDP Growth (FY)	5.8	6.2	-0.2	2.6	3.1
Real GDP Growth (CY)	7.0	4.2	0.1	2.4	4.0
Industrial Sector Growth	9.9	5.0	-5.0	0.4	9.2
Agricultural Sector Growth	3.8	3.0	5.0	3.5	1.9
Service Sector Growth	7.7	4.6	-0.1	2.7	3.3
LSM Growth (Average YoY)	17.5	6.7	-9.1	0.5	3.0
Inflation (Average)	9.5	19.9	30.8	12.6	3.5
External Sector			(billion US$)		
SBP Reserves (End-of-Period)	17.7	5.6	8.2	11.7	16.1
Current Account Balance	-12.3	-12.2	-1.0	0.5	-0.4
Exports (Goods & Services)	35.6	39.0	36.2	40.3	40.6
Imports (Goods & Services)	76.5	76.6	58.1	67.0	74.7
Remittances	31.1	29.9	26.4	34.7	40.2
PKR/USD Rate (End-of-Period)	176.5	226.4	281.9	278.6	280.1
Fiscal Sector			(percent)		
Fiscal Deficit (as % of GDP, FY)	-6.1	-7.9	-7.8	-6.8	-5.4
Revenue Growth (YoY)	17.5	16.9	34.3	37.2	16.9
Expenditure Growth (YoY)	11.3	31.1	30.3	16.9	8.5
Monetary Sector			(percent & trillion Rupees)		
Credit to Private Sector (YoY Growth)	19.6	13.4	-1.1	23.7	1.0
Government Budgetary Financing	3.6	5.6	7.2	6.3	4.1
Domestic Sources	1.7	5.7	7.0	6.7	3.4
External Sources	1.9	-0.1	0.2	-0.4	0.7

*All data are on Calendar Year unless stated otherwise.

Source: Ministry of Finance, Pakistan Bureau of Statistics and State Bank of Pakistan

GDP Growth & Sectoral Contributions — Figure 1.7



Source: Pakistan Bureau of Statistics

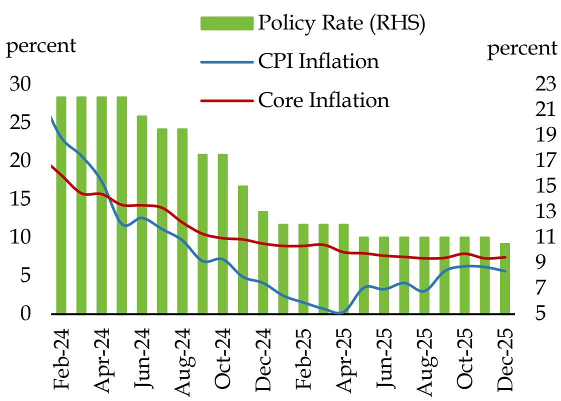
monetary policy stance further eased…

The early months of CY25 witnessed further slowdown in inflationary pressures due to moderate demand conditions, supportive

[8] Fertilizer offtake remained stable with low Urea prices and improved water availability, particularly in second half of CY25. Credit to agriculture and services sector also increased significantly.

supply-side dynamics, and the lagged impact of earlier policy-rate cuts along with favourable base effect. Nonetheless, inflation re-surfaced since May2025, reflecting decaying favourable base effect from food prices and persistent behaviour of core inflation **(Figure 1.8)**. In this context, SBP adopted a cautious approach by delivering three cuts in policy rate of 250 basis points cumulatively bringing policy rate down to 10.5 percent in CY25.[9] As a consequence of prudent monetary and fiscal policies as well as benign international commodity prices inflation fell in the target range of 5-7 percent.

Interest Rates and Inflation **Figure 1.8**

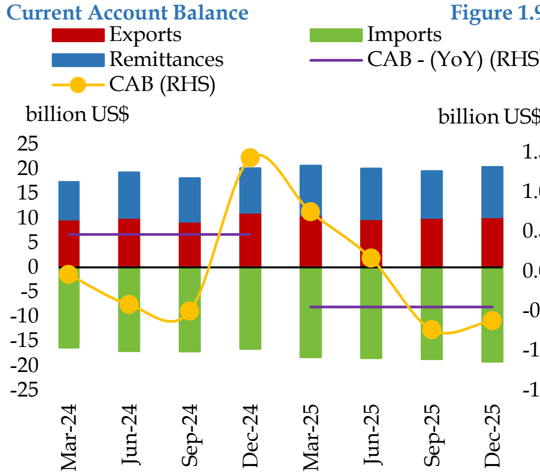


Source: State Bank of Pakistan and Pakistan Bureau of Statistics

External account posed improvement due to increasing remittances and softening of global commodity prices, …

On external front, the exports grew by 0.8 percent in CY25 compared to 11.3 percent in previous year primarily due to decline in food group. The decline was particularly driven by exports of rice and sesame seeds due to re-entry of India in the rice market and restoration of sesame seeds' supply lines from Ethiopia and Sudan. Low global commodity prices, rise in trade uncertainties amid hikes in trade tariffs, and rising geopolitical tensions also contributed to the subdued growth. On the contrary, imports grew by 11.5 percent, predominantly due to higher volumes, consistent with improving economic activity **(Figure 1.9).** As a result, the trade deficit widened to US$ 34.0 billion. Nevertheless, strong growth of 15.9 percent in workers' remittances more than compensated for trade deficit, keeping current account deficit just to US$ 0.4 billion in CY25.

Current Account Balance **Figure 1.9**



Source: State Bank of Pakistan

A mix of favourable domestic and global factors propelled workers' remittances during CY25. On the domestic front, robust growth in first half of CY25, is explained by the impact of incentives and subsidies introduced in CY24 that encouraged inflows through formal channels and remained effective till end of June-2025. Nevertheless, despite discontinuation of a few incentives and reduction in subsidy, remittances remained steady in second half of CY25, mainly due to stable exchange rate and reduced kerb premium. Moreover, labour demand remained strong in the host countries, especially in the Gulf region due to upbeat growth dynamics.

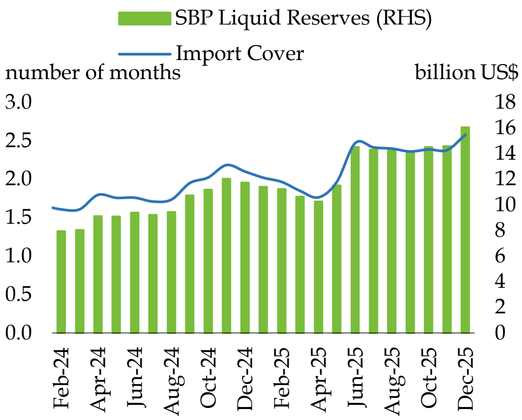
…and supported build SBP's FX reserves

The subdued current account deficit in CY25 reinforced Rupee stability and enabled SBP to undertake strategic purchases from the inter-bank market, leading to rebuilding of external

[9] The year under review recorded three policy rate cuts: i) by 100 bps on 27 January 2025, ii) 100 bps on 5 May 2025, and iii) 50 bps on 15 December 2025.

buffers. Moreover, timely materialization of planned official financing inflows, including disbursements under the IMF's Extended Fund Facility and the Resilience and Sustainability Facility, alleviated external financing pressures and reduced macroeconomic uncertainty. In this backdrop import cover increased to approximately 2.6 months **(Figure 1.10)**.

SBP Reserves and Import Cover **Figure 1.10**



Source: State Bank of Pakistan

Encouragingly, the spread between the open market and interbank exchange rates remained confined due to continued enforcement of targeted administrative and regulatory measures to curb speculative demand for foreign exchange and improved market discipline. These developments, together with improved confidence in macroeconomic management, helped maintain exchange rate stability with only a marginal depreciation of 0.6 percent against the US dollar during CY25.

Fiscal imbalance continued to shrink…

With 35.5 percent reduction, fiscal deficit further narrowed to Rs 4.1 trillion in CY25 from Rs 6.3 trillion in CY24. Notably, primary balance remained in surplus for the third consecutive calendar year. Notwithstanding these measures, FBR collections fell short of Rs. 493.6 billion against the intended calendar year target, primarily due to lower inflation, decelerating imports affecting sales tax and customs duties, and persistent structural weaknesses in tax compliance and enforcement.

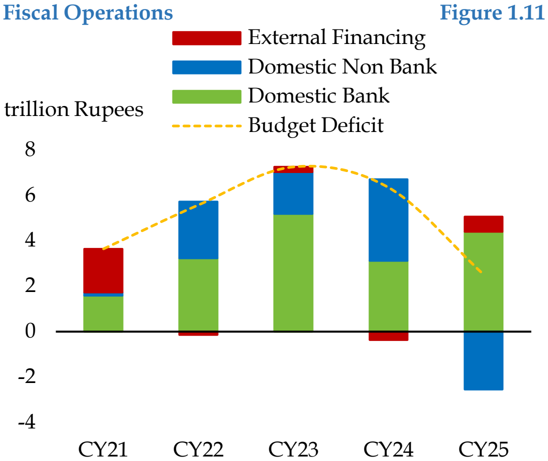
The first half of CY25 witnessed a broad-based expansion in revenue, primarily driven by federal tax and non-tax revenue mobilization amid increased tax rates on salaried class, higher withholding tax rates and withdrawal of zero-ratings and sales tax exemptions on several items.[10] The expenditure also grew significantly due to higher development spending, defense spending, subsidies, grants and expenditure on running of the civil government. These developments translated into a budget deficit of Rs 4.6 trillion.

During second half of CY25, revenue growth remained subdued amid lower withholding tax collection and slightly lower SBP profit compared to last year, driven by declining average interest rates. In contrast, PDL collections maintained an increasing momentum. However, fiscal expenditure growth observed substantial moderation, primarily driven by reduced domestic mark-up payments amid lower interest rates. Resultantly, fiscal surplus of Rs 0.5 trillion was recorded in H2CY25.

On financing side, the government availed 82.1 percent of the total required financing from domestic sources. Within domestic financing, almost all of the deficit requirements were financed through banking sector, while non-bank recorded net retirements **(Figure 1.11)** (**for details see Chapter 3 on Banking sector**).

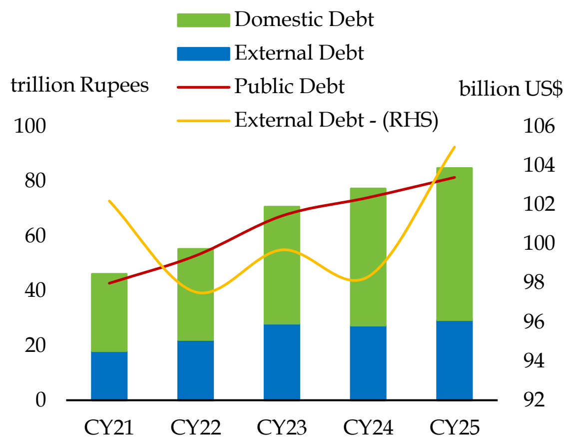
[10] The changes in tax policy were announced as part of 2024-2025 federal budget that became effective on July 01, 2024.

Fiscal Operations **Figure 1.11**



Source: Ministry of Finance

Pakistan Debt Profile **Figure 1.12**



Source: State Bank of Pakistan

Debt dynamics reflected domestic borrowing and exchange rate effects…

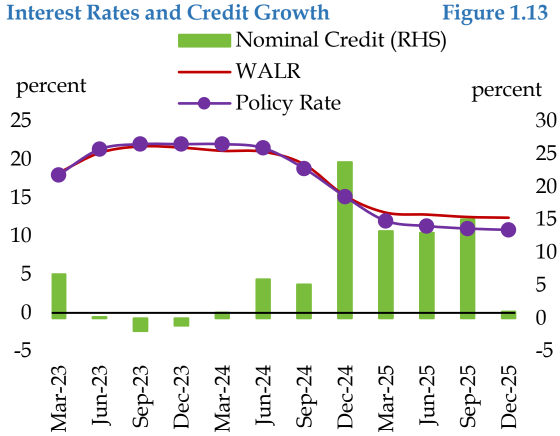
Public debt-to-GDP ratio increased to 70.7 percent in June 2025 from 67.7 percent in June 2024. This rise was largely attributable to an expansion in domestic debt. Encouragingly though, several proactive debt management initiatives contributed towards strengthening of the public debt profile. These included a strategic shift toward longer-term instruments to reduce refinancing and rollover risks, re-profiling of existing debt to extend maturities, and diversification of financing sources to secure relatively lower funding cost. These measures supported improvements in the maturity structure and risk composition of public debt.[11]

External public debt, increased by 6.7 percent to US$ 105.0 billion in CY25.[12] The rise primarily reflected higher gross disbursements during the year, partly offset by repayments, along with valuation effects arising from appreciation of major international currencies against the US dollar **(Figure 1.12)**.

Private sector credit growth increased…

With the onset of monetary easing and consequent gradual reduction in borrowing costs, growth in private sector credit (PSC) accelerated during CY25. However, on year-end basis, PSC recorded a contraction in December 2025, primarily due to base effects emanating from banks' sharp portfolio adjustments in December 2024 to cope with ADR-linked tax policy. Otherwise, the average YoY growth for four quarters was 10.6 percent, showing elevated business confidence and stable macroeconomic conditions **(Figure 1.13)**.

Interest Rates and Credit Growth **Figure 1.13**



WALR = Weighted Average Lending Rate
Source: State Bank of Pakistan

[11] The State of Pakistan's Economy, Annual Report, 2024-25.
[12] Includes Government debt from IMF and Foreign exchange liabilities.

Credit expansion was particularly pronounced in consumer finance, wholesale and retail trade, information technology, agriculture, and transportation and storage, reflecting strengthening domestic demand and investment activity. However, growth in the manufacturing and energy sectors remained subdued during CY25.

Government's exposure to the banking sector further increased...

The government's reliance on the banking sector (in terms of banking sector' exposure to government) further increased to 64.6 percent in CY25 from 59.1 percent in CY24. This continued reliance reflected a less developed capital market and lack of alternative sources for financing of fiscal deficit.

Amid improving economic conditions, the banking sector continued to exhibit steady performance throughout the year. Financial soundness indicators pertaining to solvency, earnings, and liquidity improved, supported by decent profitability, adequate capital buffers, and strong liquidity positions. Asset quality indicators suggested that credit risk remained contained, with manageable levels of non-performing loans and adequate provisioning coverage (**for details Chapter 3: The Banking Sector**).

Going forward

Global growth is expected to remain resilient in the near term, with headline inflation continuing to decline. However, risks remain tilted to the downside due to potential trade tensions, geopolitical conflicts, and the possibility of financial market corrections if expectations around AI-driven productivity weaken. High fiscal deficits and rising public debt could also tighten global financial conditions. Conversely, stronger AI-related investment and easing trade tensions may support growth. Domestically, economic activity in 2026 is likely to strengthen, supported by lower inflation, improved confidence, and stable external balances. However, continued fiscal consolidation, structural reforms, and consistent policy implementation will remain essential to sustain macroeconomic stability, enhance competitiveness, and ensure durable long-term growth.