

## The Banking Sector

*The banking sector maintained its soundness during CY25. Asset base of the sector expanded by 17.8 percent to reach Rs 63.2 trillion, mainly driven by investments. Advances declined over the year, mainly reflecting the higher-base effect of strong growth in Q4CY24 when ADR-linked tax policy incentivized the banks to sharply expand their advances and shed deposits. Nevertheless, in line with economic recovery and easing financial conditions, Q4CY25 recorded healthy increase of Rs 1.6 trillion in advance. Earnings indicators moderated mainly due to translation of lower policy rates to earning assets and increased corporate tax rate on banking companies during CY25. Asset quality indicators reflected muted risk to solvency on a net basis amid adequate provisioning coverage, easing financial conditions and improvement in repayment capacity of borrowers, especially of non-financial corporate firms. Gross NPLs recorded a notable, broad-based decline. Liquidity profile in terms of liquid assets vis-à-vis short-term liabilities remained comfortable – supported by the increased investments in government securities. Banks' exposure to currency and equity price risks remained contained, while market risk also remained muted due to rising share of floating rate instruments and falling weighted average duration of fixed income securities. Solvency indicators such as Capital Adequacy Ratio (CAR) strengthened further to 20.8 percent and remained well above the minimum regulatory requirements. Islamic Banking Institutions (IBIs) maintained their growth momentum, their market share in banking sector's asset base further improved to 22.9 percent. With sound financial position, IBIs contributed to the overall stability of banking sector.*



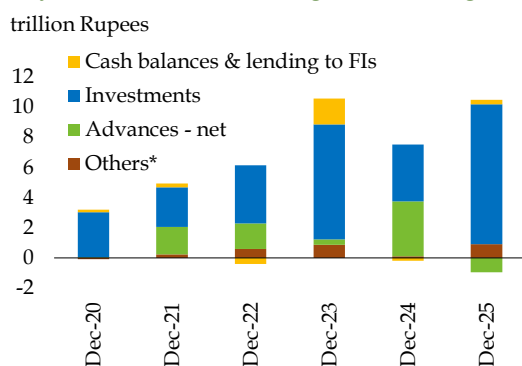


## 3 The Banking Sector

The banking sector maintained its steady performance and resilience during CY25, thus also anchoring overall financial stability in the economy as it plays a crucial role in monetary and payment systems and manages around 80 percent of the financial sector's asset base.

Asset base of the banking sector expanded by 17.8 percent in CY25, compared to 15.8 percent in last year (**Figure 3.1 and Table 3.1**). This expansion was mainly driven by investments (mostly government securities), while advances on the other hand contracted, reflecting higher-base effect of last year when ADR-linked tax policy encouraged the banks to substantially expand their loan book and slowdown deposit mobilization especially towards the end of CY24. However, filtering the ADR related impact shows that advances in fact grew during CY25, which is in line with easing financial conditions and improving economic activity. Similarly, deposit mobilization got significant traction during the year, i.e., deposits grew by 24.7 percent (9.1 percent in CY24), which bodes well for financial deepening.

**Yearly Flows in Assets of Banking Sector** **Figure 3.1**



\*Others include Fixed assets, Deferred Taxes and Other Assets

Source: State Bank of Pakistan

**Key Statistics and FSIs of Banking Sector**

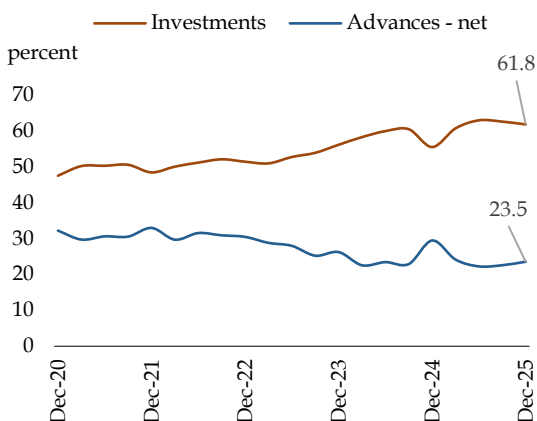
**Table 3.1**

Balance Sheet	CY23	CY24	CY25
<b>billion Rupees</b>			
Total Assets	46,364	53,693	63,231
Advances - Net	12,178	15,805	14,857
Investments - Net	26,019	29,791	39,066
Borrowings From Financial Institutions	11,673	15,006	15,849
Deposits	29,128	31,792	39,659
Total Liabilities	43,577	50,390	59,227
Net Assets	2,787	3,303	4,004
Profit/(Loss) Before Tax	1,287	1,368	1,565
Profit/(Loss) After Tax	642	644	716
<b>percent</b>			
Risk Weighted CAR	19.7	20.6	20.8
NPLs to Total Loans	7.6	6.3	6.1
Provision to NPLs	92.7	103.9	107.7
Net NPLs to Net Loans	0.6	-0.3	-0.5
Net NPLs to Capital	2.7	-1.2	-1.8
Return on Assets (Before Tax)	3.1	2.7	2.7
Return on Assets (After Tax)	1.6	1.3	1.2
Return on Equity (Before Tax)	54.4	45.8	43.3
Return on Equity (After Tax)	27.1	21.5	19.8
Liquid Assets/Total Assets	63.5	60.3	66.2
Liquid Assets/Total Deposits	101.1	101.9	105.6
Advances/Deposits	41.8	49.7	37.5

Note: Based on unaudited Quarterly Report of Condition (QRC) submitted by banks.

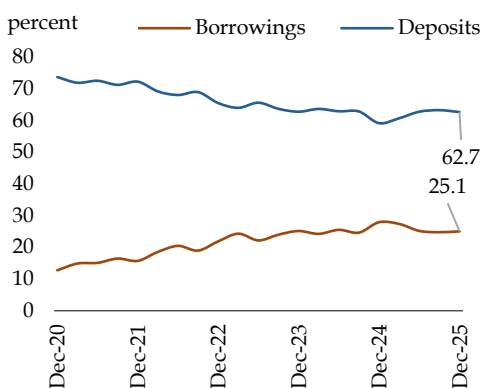
Source: State Bank of Pakistan

The balance sheet of the sector, however, continued to remain tilted towards investments (mostly government securities), which constitute around 62 percent of asset base in CY25 (55.5 percent in CY24), reflecting the government's heavy reliance on banking sector for budgetary support in the backdrop of limited capital market, constrained access to external sources and low saving rate in the economy, while private sector's credit demand remained moderate in the wake of improving economic conditions (**Figure 3.2**).

Share in Total Assets of Banking Sector **Figure 3.2**

Source: State Bank of Pakistan

As deposit mobilization rebounded during the year, mainly reflecting recovery from the sharp deceleration in CY24 amid the ADR-linked tax policy, the reliance of banking sector on borrowings to fund assets growth moderated during CY25 (**Figure 3.3**).

Total Assets Financed by Deposits and Borrowing of Banking Sector **Figure 3.3**

Source: State Bank of Pakistan

Total investment portfolio of banking sector predominantly comprises government securities (94.8 percent share), these securities rose by 32.9 percent or Rs 9.2 trillion in CY25, higher than Rs 3.3 trillion increase in CY24, reflecting government's reliance on banking sector for budgetary support. Though the overall fiscal deficit of the government remained lower in CY25 than last year, the government retired

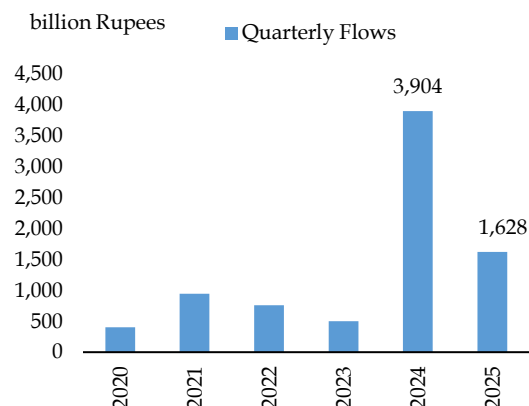
financing to non-bank sources resulting in relatively higher borrowing from the banking sector. Instrument wise, the major increase in government securities was in PIBs (mainly floating rate) followed by Sukuk and short tenor treasury bills. Auction data for CY25 show that banks tried to deploy funds in the long-term securities, especially in semi-annual floating PIBs. This behavior was consistent with the declining policy rate environment, wherein the government tried to take advantage of falling interest rates and banks aimed to lock in funds in long-term securities (for details see **Chapter 2: Financial Markets**).

*Advances declined showing the impact of high base effect from the ADR-linked tax policy in CY24 ...*

Advances fell by 6.0 percent in CY25 compared to a notable rise of 29.8 percent in CY24. However, the decline in CY25 needs to be carefully interpreted. That is, the significant increase in advances in CY24 was a one-off phenomenon amid the ADR-linked tax policy on banks' income from government securities, which induced banks to sharply extend advances and contain deposit mobilization to achieve ADR threshold. As the policy was withdrawn by the government from tax year 2025 onwards, the early quarters of 2025 witnessed net retirements of advances, which also resulted in overall decline in advances during CY25.

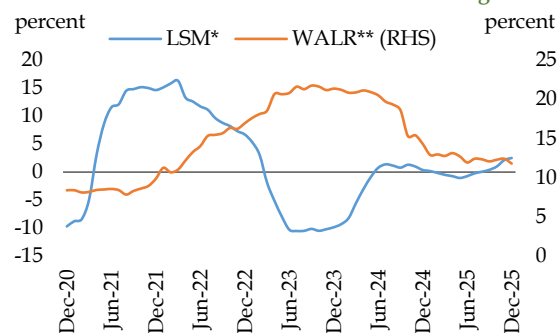
Within overall advances, domestic advances, which constitute around 93 percent of the total loan portfolio of banks, declined by 7.0 percent (or Rs 1.1 trillion) in CY25. The decline was mainly driven by domestic private sector, though a few sectors such as agribusinesses, chemicals & pharma, and automobiles increased their borrowing during CY25. However, with the easing financial conditions and improving economic activity, Q4CY25 recorded a healthy credit-offtake of Rs 862 billion in private advances, which was spread across various sectors such as agribusinesses, textile, chemicals & pharma, sugar and automobiles (**Figure 3.4 and Figure 3.5**).

Quarterly Flows of Advances in Q4CY Figure 3.4



Source: State Bank of Pakistan

LSM and WALR Figure 3.5



\* 12 MMA YoY change

\*\* rate on Gross disbursements (excluding interbank and zero-mark up)

Source: State Bank of Pakistan and Pakistan Bureau of Statistics

Inventories, working capital requirements, and fixed investment needs were the major factors for loan demand from businesses while the falling costs and better availability of funds also induced demand for loans.<sup>1</sup>

Another important aspect of credit offtake during CY25 was that while corporates made net retirements to banks, the advances of SMEs recorded a notable increase of Rs 248 billion, both in fixed investment as well as working

capital loans. On demand side, improving macroeconomic environment and business confidence, falling inflation, and easing financial conditions contributed to the rise in credit demand. On the supply side, various schemes of Government and initiatives of SBP to promote SME financing boosted credit to SMEs.<sup>2</sup> Just like SMEs, these initiatives also helped in improving advances flow to agriculture, which rose by Rs 96 billion in CY25 (Rs 76 billion increase in CY24).

Consumer financing that rebounded in CY24 after posting contraction in CY23, continued its rising momentum and recorded a notable increase of 22.3 percent (Rs 187 billion) to reach Rs 1,024 billion by end CY25.<sup>3</sup> This growth was driven by auto financing (Rs 66 billion), reflecting the upbeat demand for passenger cars in the backdrop of improving macro-financial conditions.<sup>4</sup> Similarly, personal loans rose significantly by Rs 56 billion (compared to Rs 7 billion in CY24); this relatively higher increase, however, also reflects graduation of an MFB to become first digital commercial bank of Pakistan.

The domestic **public sector advances** expanded moderately by 1.4 percent during the year under review and their share in total loans of the banking sector slightly rose to 22.9 percent at end CY25 (21.2 percent in last year), as the overall domestic private advances contracted during CY25. Disaggregated data shows that the increase in public sector mainly emanated from a few energy-related PSEs, which increased their borrowing for working capital needs while commodity finance contracted in CY25.

*Deposits mobilization revived from the ADR-related slowdown in CY24...*

<sup>1</sup> Source: Bank Lending Survey conducted by SBP for Q4CY25

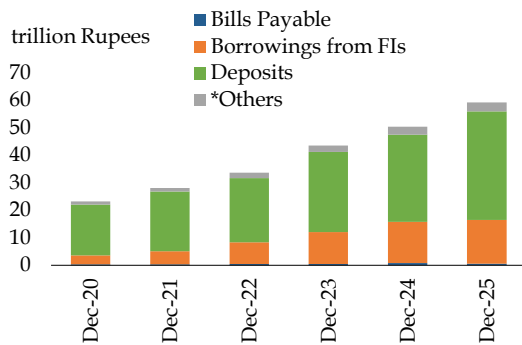
<sup>2</sup> It includes CM Punjab Asaan Karobar Card, Prime Minister's Youth Business and Agriculture Loan Scheme (PMYB&ALS) and Risk Coverage Scheme for SMEs. To highlight a few, the Revision in financing limits for SMEs, Enhancement in clean financing limit, and Incentive for export-based SMEs are among the major initiatives of SBP. For details see: SH&SFD Circular No. 05 of 2025

<sup>3</sup> These numbers reflect domestic portfolio of banks.

<sup>4</sup> Sales of passenger cars rose by 35.1 percent in CY25 to 131,611 units in CY25 from 97,419 units in CY24.

On funding side, deposit mobilization rebounded by Rs 7,868 billion or 24.7 percent in CY25 – substantially higher than Rs 2,664 billion increase in CY24. This notable growth, which is also well-above the last 10-year average of 13.3 percent, reflects recovery from the sharp slowdown in deposit mobilization amid ADR-linked tax policy in CY24.<sup>5</sup> Though the increase in deposits was broad-based across all the categories during CY25, the major increase in deposits mobilization was in current accounts followed by saving and fixed deposits (Figure 3.6 and Figure 3.7).

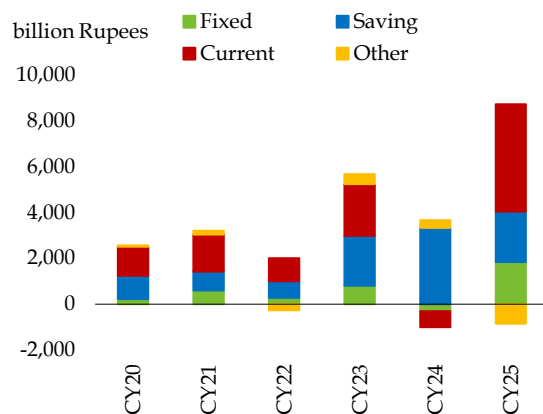
Funding Composition of Banking Sector Figure 3.6



\* Others include Sub-ordinated loans, Liabilities against Assets subject to Finance Lease, deferred tax liabilities and other liabilities

Source: State Bank of Pakistan

Composition of Deposit Mobilization Figure 3.7



Source: State Bank of Pakistan

<sup>5</sup> Average of YoY growth from CY15 to CY24

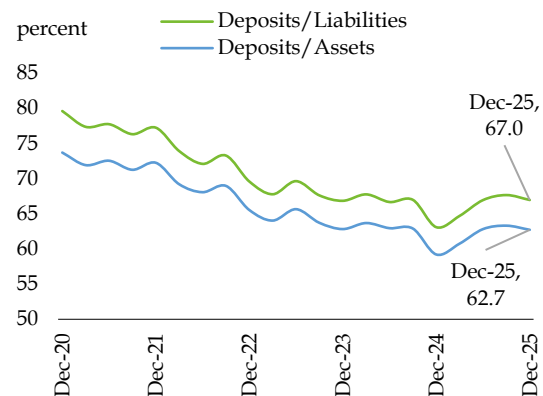
<sup>6</sup> For instance, increase in deposits of IBIs explains around 40 percent of deposit mobilization during CY25. Moreover, 56.5 percent of the increase in saving deposits of banking sector was contributed by IBIs during CY25.

<sup>7</sup> Amid these dynamics, the share of current deposits rose to 41.2 percent by end CY25 from 36.6 percent at end CY24, fixed deposits to 17.3 percent in CY25 from 15.8 percent in CY24 and that of savings deposits fell to 40.4 percent from 43.4 percent in CY24.

Data by deposit holders shows that the major impetus to deposit mobilization emanated from personal followed by NBFIs and private businesses categories. While the amendments in SBP policy on minimum saving rate, especially for IBIs, seem to be an important contributory factor in enhancing saving deposits; some of the customers may have preferred to place funds at fixed rate to lock returns amid the expectation of decline in policy rate.<sup>6</sup> Besides, the digitization initiatives of SBP such as Raast and banks' own strategy to enhance the share of non-remunerative deposits also contributed to deposit mobilization.<sup>7</sup>

With the healthy increase in deposit mobilization, the share of deposits in overall funding revived to 67.0 percent by December 2025 from 63.1 percent in December 2024 (Figure 3.8).

Deposits to Total Liabilities and Total Assets of Banking Sector Figure 3.8



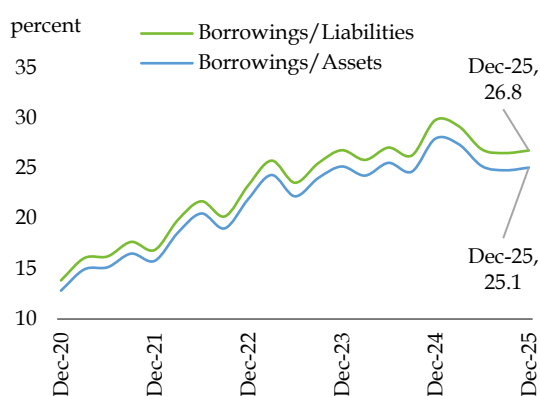
Source: State Bank of Pakistan

while reliance on borrowings subsided by end CY25...

Amid a healthy deposit mobilization during CY25, the reliance of banking sector on borrowing subsided by end CY25. Growth in borrowing decelerated to 5.6 percent in CY25

from 28.5 percent in the same period last year. Last year, banking sector sharply increased their borrowing amid the sharp decline in deposits in Q4CY24. However, the situation reversed in CY25, as the government abolished the ADR-related tax policy on banks from tax year 2025 onwards, and banks' deposit mobilization revived. The share of borrowing in funding base fell to 25.1 percent from 27.9 percent, which bodes well for the overall stability dynamics (Figure 3.9). However, at around 85 percent, the composition remained tilted towards borrowing from central bank in CY25 (82.3 percent in CY24).

**Borrowings to Total Liabilities and Total Assets of Banking Sector** Figure 3.9



Source: State Bank of Pakistan

*Earnings remained steady...*

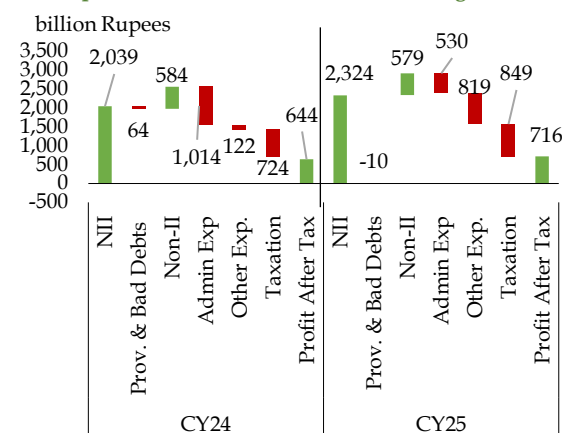
Earnings of the banking sector improved; after-tax profit of the banking sector rose by 11.2 percent to Rs 716 billion in CY25 from Rs 644 billion in CY24. With strong growth in earning assets and equity, the bottom-line indicators i.e. ROA and ROE, respectively, moderated to 1.2 percent (1.3 percent in CY24) and 19.8 percent (21.5 percent in CY24). ROA remained slightly above its long-term average of 1.19 percent,

however, ROE for CY25 was still well-above its long-term average of 15.4 percent.<sup>8</sup>

On a YoY basis, earnings rebounded by 11.2 percent in CY25 from 0.2 percent in CY24. The major push to earnings came from net interest income, where a larger decline in interest expenses compared to interest income boosted income. Further, there was a relatively lower fall in benchmark interest rate such as SBP policy rate (250 bps in CY25 compared to 900 bps decline in CY24), along with rising volume of earnings assets helped in higher interest income.<sup>9</sup>

However, non-interest income moderated by 0.7 percent in CY25, mainly due to lower trading gains on sale of government securities and quoted shares compared with last year (Figure 3.10).<sup>10</sup> Last year, not only were the gains on sales of securities higher due to large downward adjustment in secondary market yields but significant gains on securities were due to sale of treasury bills amid the buyback of MTBs by government in H2CY24.

**Composition of Profit After Tax** Figure 3.10



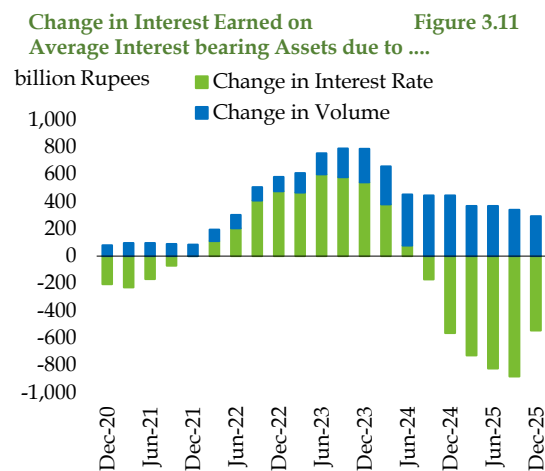
Source: State Bank of Pakistan

<sup>8</sup> Average of ROA and ROE from March 2010 to December 2025.

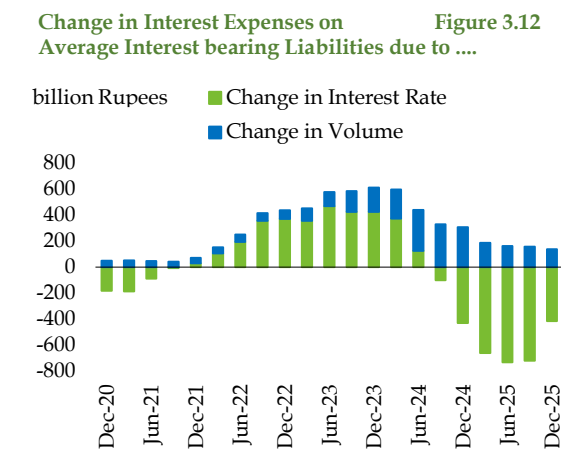
<sup>9</sup> The Weighted Average Lending rate (excluding zero-markup and excluding interbank) fell by 252 bps in CY25 compared to 707 bps in CY24, while Weighted Average Deposit rate (excluding zero-markup and excluding interbank) fell by 233 bps in CY25 compared 836 bps fall in CY24. Further, the 3-month KIBOR was around 11 bps above the SBP policy rate on average, suggesting that the market followed the benchmark rates and exhibited its normal behavior with respect to policy rate, suggesting that outstanding loans were repriced according to their repricing cycle and terms.

<sup>10</sup> Gains on sale of government securities amounted to Rs 77 billion in CY25, compared to gains of Rs 94 billion in CY24 and gains of Rs 6 billion in CY23.

A rate-volume analysis of YoY changes in interest earnings and interest expenses shows that the rate component was more pronounced and drew down both income and expenses on interest bearing assets and interest-bearing liabilities (Figure 3.11 and Figure 3.12).



Source: State Bank of Pakistan

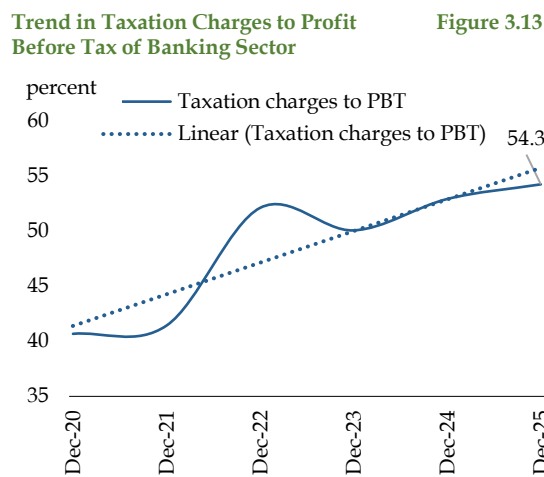


Source: State Bank of Pakistan

In line with rising share of investments in balance sheet of the banking sector, the proportion of interest/markup earnings from investments is on a consistent rise since March 2019 and has reached around 70 percent of total interest income, manifesting concentration in earnings from one major source i.e., government securities.

On the expense side, growth in operating expenses further decelerated to 18.7 percent in CY25 from 20.1 percent in CY24 and 32.5 percent in CY23, potentially reflecting the impact of falling inflation on administrative expenses, which helped keep operating expenses in check amid the rising branch network during CY25.<sup>11</sup> The provisioning expenses, which recorded an increase last year, declined as the gross NPLs fell during CY25. The absence of a one-off extraordinary expense booked by a major bank last year also supported earnings in CY25.

However, tax charges to profit before tax further rose to 54.3 percent in CY25 from 52.9 percent of pre-tax profit in CY24, and continued to drag profitability. The rising taxation in relation to profit before tax reflects the impact of increased income tax rates on banks introduced through The Income Tax (Amendment) Ordinance 2024, dated December 28, 2024 (Figure 3.13).



Source: State Bank of Pakistan

The extended DuPont analysis of after-tax ROE of the banking sector shows that the banking sector maintained its operating efficiency and interest margins improved; however, taxation dragged the ROE of the sector (Table 3.2).

<sup>11</sup> Branch network of banking sector grew by 1,138 to 18,846 branches by end December 2025. Data source: <https://www.sbp.org.pk/publications/Quarterly/Dec-2025.htm>

Extended Du Pont Breakup of Banking Sector's after-tax ROE Table 3.2

	CY22	CY23	CY24	CY25
Impact of tax i.e. PAT/PBT (a)	0.48	0.50	0.47	0.46
Operating efficiency i.e. PBT/NII (b)	0.60	0.68	0.67	0.67
Interest Margin i.e. NII/Interest Income (c')	0.34	0.30	0.27	0.39
Yield on Assets i.e. Interest Income/ Assets (d)	0.10	0.16	0.15	0.10
Leverage i.e. Assets/Equity (e)	16.65	17.31	16.75	16.03
ROE (f = a x b x c x d x e)	16.9%	27.1%	21.5%	19.8%

Source: State Bank of Pakistan

*A stable and objective taxation policy for banks is vital for financial stability and financial inclusion ....*

Objective and balanced tax policy is a key determinant of effective incentive structure in the economy. It has significant bearing on firms' business models and incentive to invest in resources for enhancing productivity. The banking sector in Pakistan operates under a higher corporate tax rate; moreover, an additional super tax at 10 percent applies on banks for posting higher absolute earnings.<sup>12</sup> Banks generally post higher absolute earnings, inter alia, due to prudential minimum capital requirement of Rs 10 billion that naturally warrants higher absolute earning to achieve desired return for shareholders and create cushions to absorb unexpected losses and support financial stability. Thus, higher effective tax rates can have implications for firms' ability and incentive to build financial cushions and make capital investments to improve efficiency.

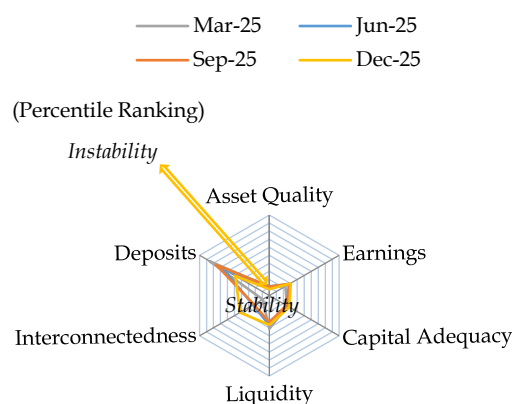
Similarly, ADR-linked tax policy that was applicable in CY22 and CY24 had unintended consequences for financial deepening and inclusion. Because in the backdrop of muted credit demand, slow economic growth and government's high fiscal needs vis-à-vis limited

availability of investable funds due to low saving rate in the economy, this tax policy created an incentive to slow down the deposit mobilization and rapidly increase loan portfolio for achieving the desired ADRs.

*Key risks to financial stability subsided over the year*

The banking sector stability map (BSSM)<sup>13</sup> shows that risks to financial stability have subsided along various dimensions, including Asset Quality, Capital Adequacy and Interconnectedness as the year 2025 progressed (Figure 3.14). The most important improvement was along the dimension of deposits, which reflects the receding impact of the ADR-linked policy in CY24, as its withdrawal helped in reviving deposit mobilization. The dynamics of key risks are discussed in the next sections.

Banking Sector Stability Map Figure 3.14



Source: State Bank of Pakistan

### 3.1 Credit risk

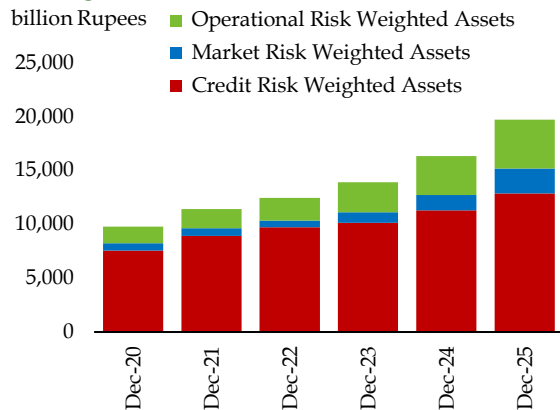
Credit risk is the major financial risk of the banking sector; it constitutes around 65 percent

<sup>12</sup> The tax rate for banking companies rose to 44 percent (for tax year 2025) from 39 percent as per The Income Tax (Amendment) Ordinance 2024 dated December 28, 2024. Tax rate for any other company (except a small company) is 29 percent. Source: Income Tax Ordinance 2001, FBR

<sup>13</sup> BSSM ranks the Financial Soundness Indicators of the current period vis-à-vis their historical level. It is based on percentile rankings (scaled from 1 to 10) of various indicators, and the summary score of these indicators in a particular dimension e.g. asset quality. A ranking close to 10 value on the summary statistic suggests increased risks but not necessarily immediate stability concern. This is because the summary statistic is based on percentile rankings of historical series and the actual indicators for the quarter may still be in comfortable position or above the minimum regulatory requirement. Methodology of BSSM is based on Dattels, P., McCaughrin, R., Miyajima, K., & Puig, J. (2010). "Can you map global financial stability?" *IMF Working Papers*, 1-42

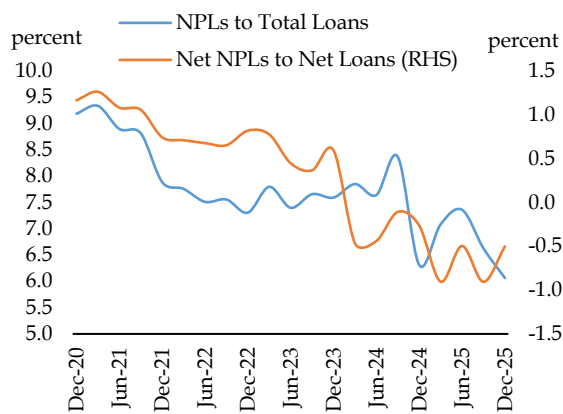
of the banking sector’s total risk weighted assets (**Figure 3.15**). Nevertheless, the asset quality indicators manifested no serious concerns. The non-performing loans (NPLs) to gross loans ratio fell to 6.1 percent in December 2025 from 6.3 percent in December 2024 (**Figure 3.16**). Banks are holding adequate provisioning against the existing stock of NPLs, and the total credit loss allowances and provisions exceed the NPLs i.e. provisioning to NPLs ratio improved to 107.7 percent by end December 2025 from 103.9 percent at end December 2024.

**Composition of Risk Weighted Assets of Banking Sector** Figure 3.15



Source: State Bank of Pakistan

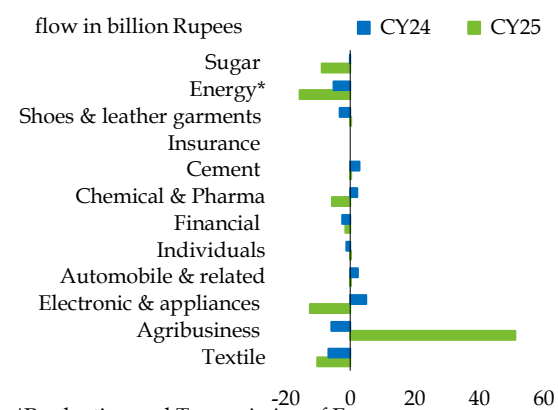
**Asset Quality Indicators of Banking Sector** Figure 3.16



Source: State Bank of Pakistan

Gross NPLs recorded a substantial fall of Rs 104 billion during CY25 as compared to an increase of around Rs 73 billion during CY24. The fall in gross NPLs in CY25 occurred in domestic as well as overseas operations of the banking sector. The reduction in NPLs was broad-based across all quarters of CY25, however, the decline in NPLs of a few overseas branches played an important role amid their recovery and settlement efforts. The domestic NPLs declined across various business sectors of the economy such as energy, textile, sugar, and auto, reflecting the improving economic conditions, falling inflation and revival in domestic demand (**Figure 3.17**).

**Sector wise Change in Gross NPLs** Figure 3.17



\*Production and Transmission of Energy

Source: State Bank of Pakistan

Sector-wise changes show that energy sector was leading the decline in the NPLs (Rs 16 billion), as the cashflow position in the sector improved amid the reduction of circular debt by the government.<sup>14</sup> The NPLs of textile sector fell by Rs 10 billion, as despite a volatile global economic environment and domestic challenges such as floods, the sector’s exports grew in dollar terms in CY25.<sup>15</sup> Various other sectors such as sugar, chemical & pharmaceuticals and automobiles also witnessed a decline in their NPLs during CY25.

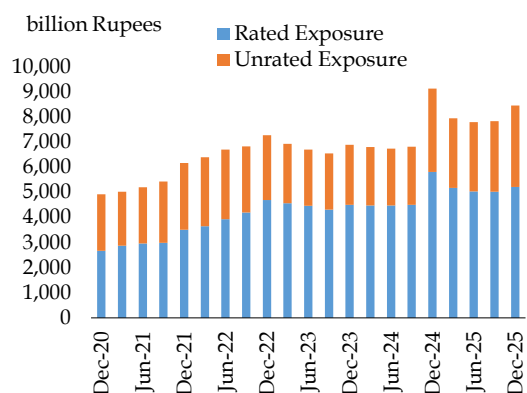
<sup>14</sup> For details see Press Release No 393 dated September 25, 2025, Finance Division, Government of Pakistan

<sup>15</sup> Textiles’ exports rose by 5.8 percent in CY25 to US\$ 17.7 billion in CY25, as compared to YoY increase of 5.9 percent in CY24. (Source: State Bank of Pakistan)

In line with the fall in NPLs, the Credit loss allowance and General provisions also fell by Rs 71 billion in CY25, compared to an increase of Rs 187 billion in CY24. The decline in Expected Credit Loss (ECL) allowance was across all three stages. The decline in Stage-3 ECL reflects mostly the fall in non-performing loans, Stage-1 and Stage-2, on the other hand, imply better economic outlook, as the ECL is heavily built on 'prospective approach' and incorporates business and economic considerations/data, which have shown improvement in CY25.<sup>16</sup>

It is worth mentioning that the major loan portfolio of the banks comprises of credit to large corporate borrowers. Around 62 percent of the corporate and commercial credit portfolio of banks comprise rated borrowers, which usually have an established business track record and well-developed corporate governance framework (Figure 3.18). Moreover, within rated exposure, around 52 percent carries credit risk weight of 20 percent, reflecting better credit worthiness of borrowers.

**Rated and Unrated Corporate Exposure of Banking Sector** Figure 3.18



Source: State Bank of Pakistan

These high rated borrowers have the option to access the capital market for their financing needs; however, they prefer bank borrowing due to several reasons including more flexible credit lines with banks and limited outreach of domestic capital market in the country.

SBP recognizes the importance of a developed capital market for financial stability and sustainable economic growth. That is why SBP is not only coordinating with Securities and Exchange Commission of Pakistan (SECP) for the development of the market, but has also tailored its regulations to promote, strengthen corporate governance standards in firms and incentivizes firms with large credit needs to access capital market.

*Stress test results show that banking sector in general has adequate resilience to credit risks factors..*

The results of latest single factor sensitivity analysis (stress tests) show that the banking sector in general has adequate resilience to extreme but plausible shocks to different credit risk factors, reflecting both contained risk exposures as well as adequate capital cushions that banks have for unforeseen losses (Table 3.3).

Stress Testing (Sensitivity Analysis) of Banking Sector (Credit Shocks) Table 3.3

Description of shock	Number of Banks with CAR*			
	< 0%	0% - 8%	8% - 11.50%	> 11.50%
<b>Pre-Shock Position</b>	0	0	0	29
<b>Post-Shock Position</b>	< 0%	0% - 8%	8% - 11.50%	> 11.50%
10% of performing loans become non-performing, 50% of substandard loans downgrade to doubtful, 50% of doubtful to loss.	-	-	4	25
Default of top 3 private sector borrowers/Groups (fund based) exposures, including outstanding or limit which ever is higher and investments in borrowers' TFCs, equity etc., as defined under Revised PRs, net of deductions.	-	1	1	27
Default of top 3 private sector borrowers/Groups (fund based and Non-Fund based) exposures, including outstanding or limit which ever is higher and investments in borrowers' TFCs, equity etc., as defined under Revised PRs, net of deductions.	-	1	2	26
All NPLs under substandard downgrade to doubtful and all doubtful downgrade to loss.	-	-	-	29
Increase in provisions against NPLs equivalent to 25% of Net NPLs.	-	-	1	28
Increase in NPLs to Loans Ratio (NPLR) equivalent to the historical maximum quarterly increase in NPLs to Loans Ratio of the individual banks.	-	2	1	26
Increase in NPLs of all banks equivalent to the historical maximum quarterly rise	-	-	1	28
Increase in NPLs to Loans Ratio of Textile Sector of the banks equivalent to the historical maximum quarterly increase in these banks.	-	-	1	28
Increase in NPLs to Loans Ratio of Consumer Sector of the banks equivalent to the historical maximum quarterly increase in these banks.	-	-	-	29
Increase in NPLs to Loans Ratio of Agriculture & SME Sector of the banks equivalent to the historical maximum quarterly increase in these banks.	-	-	2	27

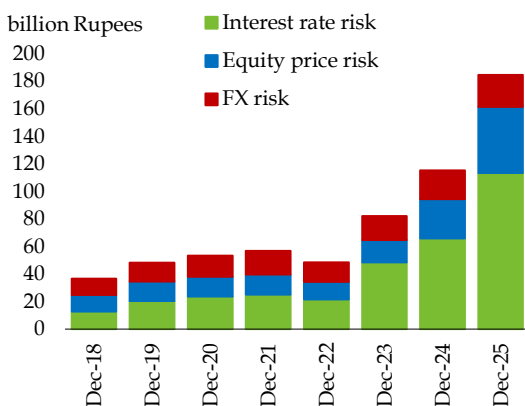
\* Excluding Digital banks and PPCBL  
Source: State Bank of Pakistan

<sup>16</sup> International Financial Reporting Standard (IFRS) 9 requires provisioning against financial instruments (loans and investments) on Expected Credit Loss (ECL) approach, instead of Incurred Credit Loss approach that was being followed under IAS-39.

## 3.2 Market Risk

Market risk accounts for a relatively small share of the capital requirements of the banking sector, which in general has sufficient cushions to absorb any significant price shocks (**Figure 3.15**). Over the last few years, a substantial increase in banks' holding of government securities has increased their exposure to interest-rate risk that dominates the overall market risk profile (**Figure 3.19**), while significant fluctuation in the financial-asset prices has highlighted the significance of market risk. Nevertheless, the banking sector has quite effectively weathered these fluctuations due to adequate capital cushions and effective management of their repricing profile by reducing the duration of government securities. Banks' exposures to FX and equity price risk remain contained, inter alia, due to prudent regulatory limits on holding of equity stocks and open FX positions.

Capital Charge for Market Risk **Figure 3.19**



Source: State Bank of Pakistan

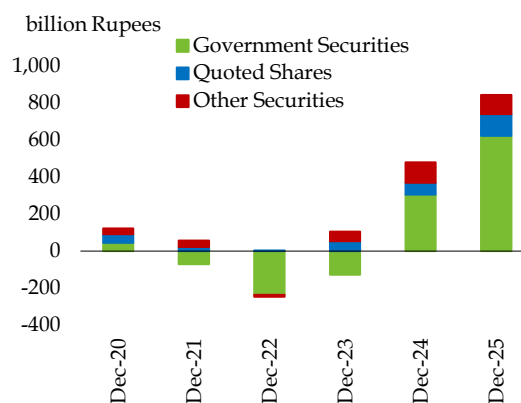
### Revaluation surplus strengthened by end of CY25

A large part of banks' holding of government securities are subject to marked-to-market requirements, indicating that substantial part of interest rate risk is accounted for in the capital

requirements and risk management process of banks.<sup>17</sup>

During CY25, SBP reduced the policy rate by a cumulative 250 bps (900 bps reduction in CY24), which resulted in revaluation surpluses on fixed-income securities that mainly comprise government securities. Similarly, as the equity market continued its upbeat momentum in CY25, the revaluation surplus on quoted shares also rose (**Figure 3.20**).

Revaluation Surplus/Deficit on Securities **Figure 3.20**



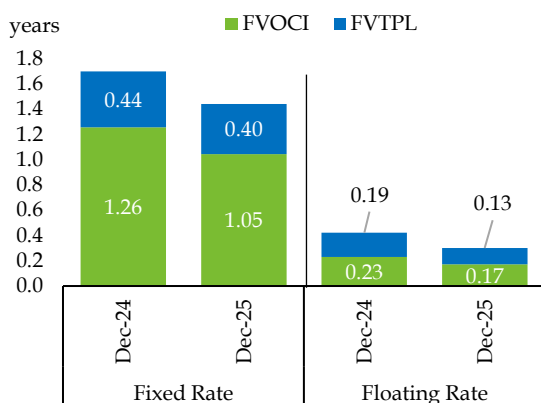
Source: State Bank of Pakistan

### Share of floating-rate government securities further increased...

The banking sector continued to increase the combined share of floating rate portfolio in their government securities. The rising share of floating-rate securities reduces the effective duration of fixed-income securities and their sensitivity to changes in interest rates, reflecting a conservative approach in asset-liability management. Not only did the weighted average duration of floating rate portfolio fell further when compared to last year, the weighted average duration of fixed rate government bonds also fell during CY25 (**Figure 3.21**).

<sup>17</sup> Around 97 percent of securities are classified as Fair Value through Other Comprehensive Income (FVOCI) and Fair Value through Profit and Loss (FVTPL) categories. These categories are subject to marked-to-market requirements as per applicable IFRS-9

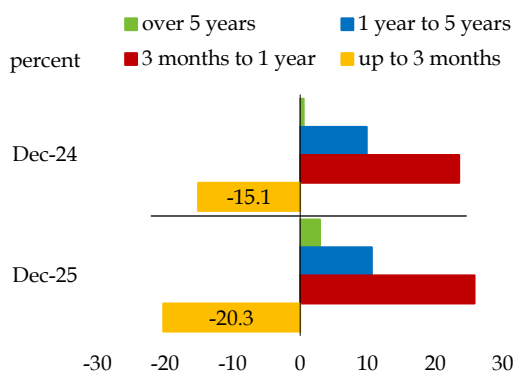
**Figure 3.21**  
Weighted Average Duration of Government Securities



Source: State Bank of Pakistan

Similarly, banking sector also maintained quite contained repricing gaps between rate-sensitive assets (RSA) and liabilities (RSL), especially for 3-months and above maturity buckets (Figure 3.22).

**Figure 3.22**  
Gap of Rate Sensitive Assets and Liabilities as Percent of Total Assets



Source: State Bank of Pakistan

*Banks show strong resilience to changes in market rates ...*

The banking sector maintains adequate resilience to severe shocks in market prices i.e. yield curve, equity prices and exchange rates. The results of the latest single factor sensitivity stress testing show that the banks in general remain compliant with the minimum CAR requirement even in the face of severe adverse movements in prices (see Table 3.4).

Stress Testing (Sensitivity Analysis) of Banking Sector (Market Shocks) Table 3.4

Description of shock	Number of Banks with CAR*			
	< 0%	0% - 8%	8% - 11.50%	> 11.5%
<b>Pre-Shock Position</b>	1	0	0	28
<b>Post-Shock Position</b>	< 0%	0% - 8%	8% - 11.50%	> 11.50%
Parallel upward shift in the yield curve - increase in interest rates by 300 basis points along all the maturities.	-	-	2	27
Upward shift coupled with steepening of the yield curve by increasing the interest rates along 3m, 6m, 1y, 3y, 5y and 10y maturities equivalent to the historical maximum quarterly increase.	-	-	2	27
Downward Shift plus flattening of the yield curve by decreasing the interest rates along 3m, 6m, 1y, 3y, 5y and 10y maturities equivalent to the historical maximum quarterly increase.	-	-	-	29
Impact of Increase in interest rate by 100bps on investment portfolio only	-	-	1	28
Depreciation of Pak Rupee exchange rate by 30%.	-	-	-	29
Depreciation of Pak Rupee exchange rate by 25.29% equivalent to the quarterly high depreciation of rupee against dollar.	-	-	-	29
Appreciation of Pak Rupee exchange rate by 7.06% equivalent to the quarterly high level of appreciation of rupee against dollar.	-	-	-	29
Fall in general equity prices equivalent to maximum decline in the index.	-	1	1	27
Fall in general equity prices by 50%.	1	-	1	27

\* Excluding digital banks and PPCBL

Source: State Bank of Pakistan

### 3.3 Liquidity Risk

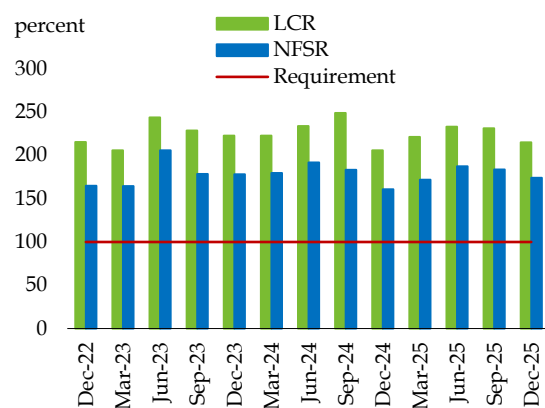
*Balance sheet-based indicators suggest a comfortable liquidity profile during CY25...*

The banking sector maintained a comfortable liquidity profile during CY25, which is reflected in liquidity-related financial soundness indicators (FSIs) of the sector. Liquid assets fully covered total deposits and short-term liabilities during CY25 (i.e., relevant FSIs were above 100 percent). The satisfactory liquidity profile reflects significant investments in liquid (government) securities by banks. The treasury instruments have a reasonably developed and active secondary market, which helps banks in managing daily liquidity needs.

The Basel-III standard liquidity ratios i.e., Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) of the banking sector complied with the prescribed minimum benchmarks of 100 percent for all quarters of CY25. Both LCR and NSFR remained

comfortably above the 100 percent regulatory requirement, suggesting a satisfactory liquidity profile (**Figure 3.23**).

Liquidity Indicators of Banking Sector **Figure 3.23**



Source: State Bank of Pakistan

*Liquidity conditions in the interbank market remained mixed albeit the growth in deposits revived during CY25...*

The liquidity conditions remained relatively tight, the average OMOs injections spiked mid-CY25. The market continued to rely on shorter tenors of OMOs in an easing monetary policy cycle, a behavior adopted in late December 2023 amid the expectation of sharp fall in SBP policy rate. The tenor-weighted average size of OMOs injection rose to Rs 2,307 billion in CY25 (Rs 1,717 billion in CY24). Nonetheless, due to SBP's active monetary policy operations, the money market functioned smoothly without any significant disruption or deviations from the policy rate (for details see the section on Money Market in **Chapter 2**).

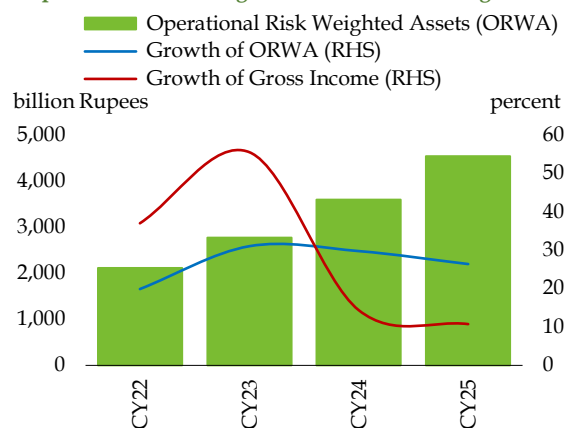
The stress testing (sensitivity analysis) results of hypothetical liquidity shocks also suggest that most of the banks can survive withdrawal of up to 10 percent of customer deposits beyond five

days. However, in a more severe hypothetical shock of withdrawal of up to 50 percent wholesale deposits and unsecured borrowings, a few non-systemic banks (with low market share) may face liquidity constraints beyond three days.<sup>18</sup>

### 3.4 Operational Risk

Operational risk is the second major driver of banks' risk weighted assets, contributing 23.0 percent of the TRWAs. The growth of Operational Risk Weighted Assets (ORWAs) decelerated (**Figure 3.24**), reflecting a slower growth in gross income which is key determinant of operational risk.<sup>19</sup>

Operational Risk Weighted Assets **Figure 3.24**



Source: State Bank of Pakistan

Amid the policy support of SBP and changing market demand, the use of digital finance and innovation in delivery of services have significantly increased. These developments not only promoted financial inclusion and enhanced efficiency and convenience in financial services but also increased the cyber security risks. Miscreants are using a variety of social engineering and fraudulent methods to obtain important financial information from customers.

<sup>18</sup> The results of stress testing (sensitivity analysis) are available at: <https://www.sbp.org.pk/ecodata/fsi/qc/2025/QC-%20Dec-25.pdf>

<sup>19</sup> Gross income forms the basis of calculating the ORWA under Basic Indicators approach (BIA) of Basel-III standards and is used by most of the banks in Pakistan. Capital charge for operational risk under the BIA is a fixed percentage of the average annual gross income of a bank over past three years.

Besides, the increased exposure to technology and digital platforms makes financial institutions vulnerable to multiple types of cyberattacks, such as phishing, ransomware, and data breaches. The result of 17<sup>th</sup> wave of **SBP's Systemic Risk Survey** shows that the market participants have also identified cybersecurity risk among the top ten prevailing risks to financial stability (see **Box 1 on SBP's Systemic Risk Survey**).

SBP remains vigilant to cybersecurity concerns and has been taking several measures to strengthen cyber resilience of banks. Besides establishing a dedicated cybersecurity risk supervision function last year, technological innovation is already a strategic theme under SBP's Vision 2023-28, which has brought renowned emphasis on the promotion of innovation and use of technologies as well as to cybersecurity and privacy of data. The proactive supervision of cybersecurity related issues of the regulated entities will help in containing the intensity of cybersecurity related incidents and cyber threats. Customer awareness campaigns are also helping in mitigating the cybersecurity risk by educating users on phishing, strong passwords, and Two-factor authentication (2FA), directly reducing financial fraud and enhancing digital resilience. These initiatives, supported by SBP, banks and FIA Cybercrime Wing, promote safer online behavior in banking and e-commerce, creating a more informed and cautious user base.

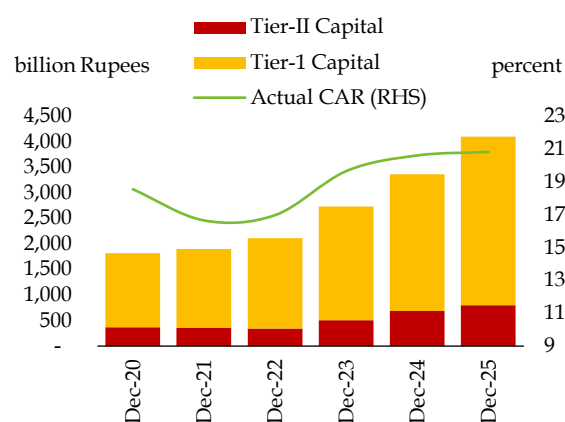
Acknowledging the importance of practical drills for effectively managing the crises, SBP and Pakistan Bank Association (PBA) conducted a dedicated industry-wide cyber security simulation exercise in January 2026. The drill followed dual-track approach, covering both technical and management aspects of cyber threats. This initiative is expected to substantially help the industry in identifying the gaps and improving the cybersecurity profile (see **Box 3.2 for details**).

### 3.5 Solvency

*Solvency indicators remained above the minimum regulatory requirement during CY25*

Headline solvency indicators of the banking sector such as CAR further improved to 20.8 percent by end CY25, when compared to 20.6 percent by end December 2024. The uptick in CAR emanated from higher growth in regulatory capital that outpaced growth in total risks weighted assets. While Tier-I Capital increased due to steady earnings, the Tier-II capital rose on the back of revaluation gains on securities (**Figure 3.25**).

Solvency Indicators of Banking Sector Figure 3.25

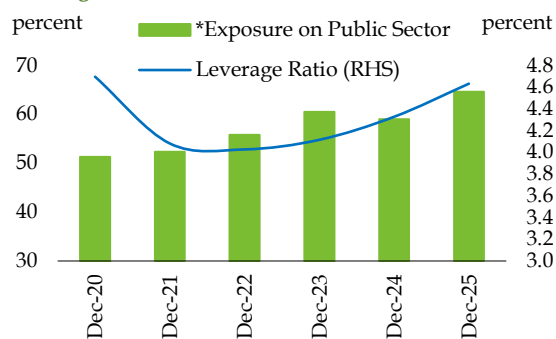


Source: State Bank of Pakistan

A major part of banks' exposure is in government securities, which are treated as per Basel framework to reckon the adequacy of capital for credit and market risks. These securities require no capital charge (involving zero risk weight) for credit risk and relatively low capital charge in respect of market risk. However, to prevent the build of excessive leverage even in non-risky assets and address any model issues in calculating the relative riskiness of assets, a non-risk based regulatory requirement i.e., Leverage Ratio, is also applicable on banks in Pakistan as a backstop tool. Banks are required to maintain minimum leverage ratio of 3.0 percent as per Basel standards.

The leverage ratio of Pakistan's banking sector has come down in the last few years due to increase in assets base and exposure, particularly the investment in government securities. After falling to 3.7 percent in March 2023, the ratio continued to improve and reached 4.6 percent in December 2025 (Figure 3.26). Importantly, the ratio is higher than both the minimum requirement of 3.0 percent and its long-term average of 4.4 percent.

**Banks' Exposure to Public Sector and Leverage Ratio** Figure 3.26



\* Exposure to Public Sector = Investment in Government Securities + Public Sector Advances

Source: State Bank of Pakistan

While the government continued its fiscal consolidation initiatives, a sustained reduction in government borrowings from banking sector is essential for a more optimal balance sheet structure of the sector and increasing the share of private sector in the overall financial intermediation.

The creditworthiness and soundness of individual banks have a profound bearing on the overall stability of the financial system. The ratings assigned by independent credit rating agencies to banks also suggest that these institutions in general have satisfactory creditworthiness, indicating that they have adequate ability to honor their financial obligations and keep flow of credit to the economy. A comparison of banks' credit ratings over the last three years shows that the number

of banks and their market share with better credit ratings have further improved.<sup>20</sup>

Banking sector shows adequate resilience to key financial risks in terms of both contained risks exposures and capital buffers. Besides the results of stress tests (sensitivity analysis), this resilience is also validated in the detailed scenario analysis (macro stress tests), which assesses impact of emerging economic environment and severe macroeconomic shocks (hypothetical) that could emerge in next three years (for further details on the scenario analysis, see chapter 4).

<sup>20</sup> For details see Governor's Annual Report 2024-2025 available at: <https://www.sbp.org.pk/reports/annual/Gov-AR/pdf/2025/Gov-AR.pdf>