

1

Economic Review

1 Economic Review

1.1 Overview

Pakistan's economy demonstrated resilience to domestic and global economic shocks, amid an increasingly uncertain geopolitical environment during FY26. The uncertainty about the US trade tariffs, monsoon floods at the start of the year, and outbreak of the Middle East conflict in late February 2026 created severe headwinds for the hard-earned macroeconomic stability. The coordinated macroeconomic policies helped to navigate the challenging domestic and global economic environment. This, together with economic reforms under the IMF program yielded improvements across key macroeconomic indicators in FY26. The real GDP growth maintained an uptrend; inflation remained contained; SBP's FX reserves, supported by significant SBP purchases, comfortably surpassed target; and fiscal deficit more than halved as a percent of GDP compared to last year (**Table 1.1**).

Although the Middle East conflict disrupted some of these favourable trends, the stronger fiscal and external buffers helped maintain overall macroeconomic stability (**Table 1.1**). SBP continued with a prudent monetary policy stance and maintained adequately positive real policy rate on forward looking basis to keep inflation within the medium-term target range. At the same time, the federal government continued its fiscal consolidation efforts for the fourth consecutive year.

Moreover, the government implemented a series of targeted austerity measures and passed on the surge in global oil prices to domestic fuel prices. These measures aided in containing the adverse impact of the external shock on both the fiscal and external accounts. The sustained improvement in key economic indicators prompted upgrade in Pakistan's sovereign credit ratings during FY26, which further supported favourable macroeconomic outcomes.

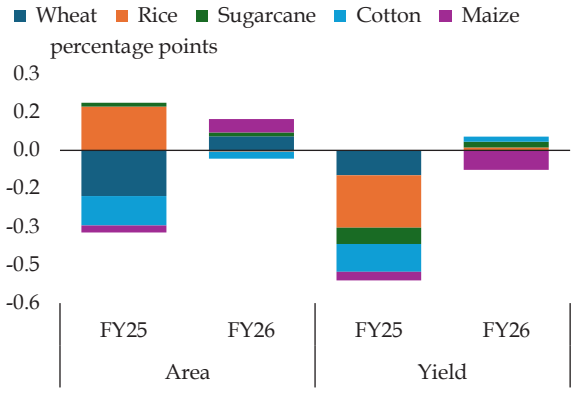
Selected Economic Indicators **Table 1.1**

	FY25	FY26	FY26	
			Jul-Feb	Mar-Jun
Growth rate (percent)*				
Real GDP [a,*]	3.1	3.7	4.2	2.0
Agriculture*	1.3	3.5	3.4	3.7
Industry*	5.5	3.3	6.4	-4.7
o/w LSM*	-0.7	5.0	6.5	0.4
Services*	3.1	3.8	3.9	3.6
National CPI (period average) [a]	4.5	7.1	5.5	10.2
Private sector credit [b^]	12.2	14.7	14.8	14.7
Money supply (M2) [b^]	12.9	14.7	17.5	14.7
Exports [b]	4.4	-4.7	-5.3	-3.3
Imports [b]	11.3	9.1	9.2	8.9
Tax revenue – FBR [c]	26.1	10.8	10.6	11.1
Exchange rate (end-period) (+app/dep%) [b]	-1.9	2.0	1.5	0.5
End period				
Exchange rate	283.8	278.2	279.5	278.2
Policy rate [b]	11.0	11.5	10.5	11.5
million US$				
SBP's reserves (end-period) [b]	14,506	18,378	16,299	18,378
Workers' remittances [b]	38,300	41,585	26,488	15,097
Current account balance [b]	1,838	-391	-800	409
percent of GDP				
Fiscal balance [c,*]	-5.4	-2.6	-0.7	-1.9
Primary balance*	2.4	2.9	3.2	-0.4
Gross public debt ^	70.5	68.6	-	68.6
Current account balance	0.4	-0.1	-0.2	0.1
Investment [a]	14.4	14.5	-	-

For real GDP, FY25 and FY26 estimates are revised and provisional, respectively. *sub-periods refer to Jul–Mar and Apr–Jun. ^sub-periods indicate end-period stock.
Sources: [a] PBS; [b] SBP; [c] MoF

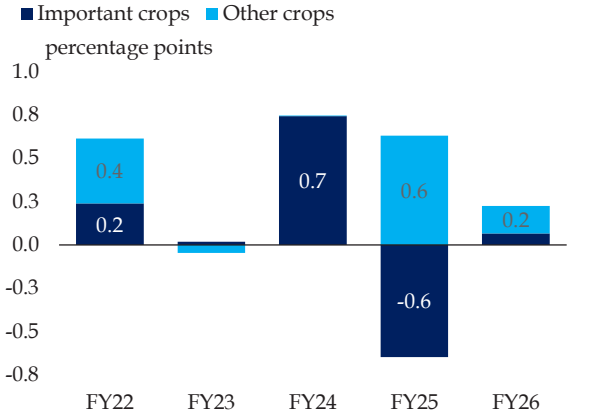
The combined impact of policy rate reduction in the previous year, lower input costs as reflected by deceleration in wholesale price index during Jul-Feb FY26, positive business sentiments and recovery in domestic demand supported expansion in economic activity in FY26. The real GDP growth edged up, with the major impetus coming from a rebound in large scale manufacturing (LSM) output having strong linkages with agriculture and services sectors. However, the momentum of economic activity

Contribution of Important Crops to GDP Growth **Figure 1.1**



Sources: MNFSR; SBP staff calculations

Contribution of Crops to GDP Growth **Figure 1.2**



Sources: MoF; SBP staff calculations

slowed in the last quarter due to increase in input costs, government austerity measures, and rising uncertainty in the aftermath of the Middle East conflict.

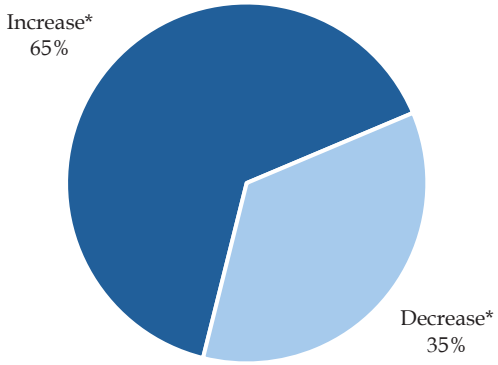
Agriculture growth improved on account of a slight recovery in important crops, though livestock continued to remain the dominant contributor to agriculture sector value addition. The recovery in important crops from last year's contraction was on account of increase in production of wheat, rice and sugarcane that outweighed the decline in the production of cotton and maize. Better flood management through timely rescue and relief measures, sufficient water availability and improved access to agriculture credit (**Box 2.4**) supported the recovery in output of important crops.

Yields of all important kharif crops, except for maize, recovered in FY26 (**Figure 1.1**). Post flood soil improvement supported yield gains in rice and sugarcane, while cotton benefitted from early sowing and improved availability of inputs. However, unfavourable weather conditions – high temperature at the time of sowing and winds during harvest – constrained a notable improvement in wheat yields. Meanwhile, other crops maintained the trend observed over the past few years, benefitting from increased area under cultivation (**Figure 1.2**).

The growth in industry slowed in FY26, dragged by contraction in electricity, gas and water supply, largely due to reduction in power subsidies. However, the LSM output recovered after a lacklustre performance in the preceding three years. Growth in LSM was driven by an uptick in domestic demand that led to increase in production of various sub-sectors, including automobile and allied sectors, food and beverages, petroleum products and cement.

However, performance of export-oriented sectors including textiles, wearing apparel, and pharmaceuticals remained subdued. Notwithstanding the recovery, output of around 35 percent of the LSM sub-sectors remained below the past five-year averages for FY21-25 (**Figure 1.3**). This indicates economic slack alongside the presence of persistent structural impediments, including declining investment and low productivity in manufacturing sector. Moreover,

Distribution of LSM Sectors - FY26 **Figure 1.3**



* Compared to FY21-25 average.
Source: SBP staff calculations

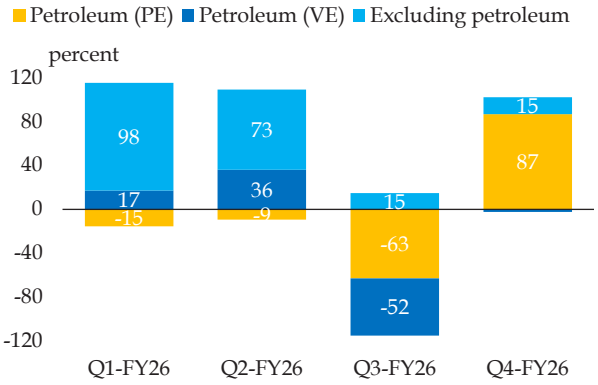
the real GDP measured from the expenditure side shows that consumption remained the primary driver, while investment-to-GDP ratio increased marginally. The investment, in terms of GDP, needs to be increased for the country to achieve and sustain higher growth, enhance exports and generate higher employment.

The recovery in economic activity drove a volume-led expansion in imports during FY26, reinforced by tariff rationalisation under the National Tariff Policy 2025–2030. Non-energy imports explained this growth, led primarily by the transport sector, while food imports rose due to persistent reliance on edible oil imports and to meet domestic sugar shortages during the year. Furthermore, a surge in energy prices, following the Middle East conflict, inflated the energy import bill in Q4-FY26 (**Figure 1.4**).

Exports, on the other hand, were constrained by subdued global demand amid uncertainty about the US trade tariffs, closure of country's Western borders, falling commodity prices, and supply chain disruptions following the Middle East conflict. The major drag came from food group and other manufactures including cement and pharmaceuticals. In food group, India's re-entry in global rice trade that intensified competition amid substantial increase in global rice stocks weighed negatively on Pakistan's rice export volumes and unit values. Meanwhile, textile exports posted a marginal increase, driven primarily by a favourable price-effect in wearing apparel. Similarly, export of petroleum products, specifically furnace oil, increased on account of surplus amid enhanced domestic refining and reduced domestic demand from power sector.

Against widening of merchandise trade deficit, the services trade deficit narrowed considerably. This mainly reflected the momentum in export of information and communication technology (ICT) services. ICT emerged as Pakistan's second-largest export sector after knitwear in FY26, driven by various supportive measures by the government and SBP. However, the sector remains constrained by a low firm size, primarily because of lack of skilled labour force with required technical and

Composition of Change in Imports **Figure 1.4**



Note: PE = price-effect; VE = volume-effect
Sources: PBS; SBP staff estimates

managerial capabilities (**Box 5.2**). This challenge points to the urgent need for reforming education, with broadening policy focus beyond basic enrolment metrics.

Furthermore, primary income deficit edged down due to lower interest payments (**Box 5.3**). This improvement was on account of relatively lower global interest rates. Moreover, workers' remittances posted strong growth underpinned by targeted policy measures by the government and the SBP to promote receipts via formal channels, low kerb premium, and increase in labour emigration. Aside from supporting external account and reserve build-up, remittances may also contribute to capital formation through financial deepening, especially by increasing households' access to saving and investment products (**Box 5.4**). The robust workers' remittances nearly financed the combined deficit in primary income and the trade in goods and services balances. Consequently, the current account recorded a marginal deficit equivalent to 0.1 percent of GDP in FY26.

Furthermore, ample inflows from official multilateral and bilateral creditors, successful Eurobond and Panda bond issuances, and steady inflows in Roshan Digital Accounts supported FX buffers during FY26. This, alongside significant FX purchases by SBP shored up SBP's foreign exchange reserves to US$ 18.4 billion by the end of FY26, up from US$ 14.5 billion at the end of FY25, which continued supporting exchange rate

stability. Besides, SBP reduced its forward liabilities by US$ 1.6 billion during FY26. This together with reserve build-up via purchases points to improved quality of FX buffers.

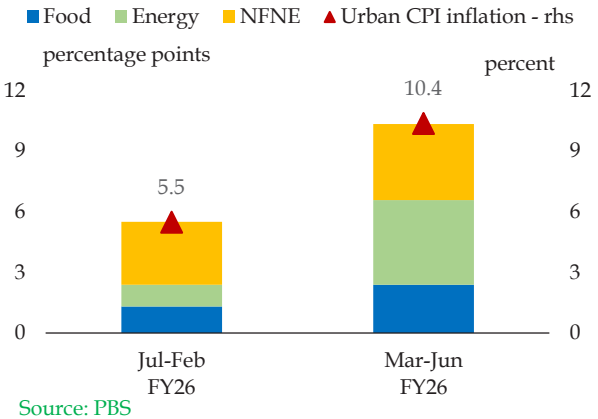
The prudent monetary and fiscal policies helped contain the average national CPI (NCPI) inflation at 7.1 percent, close to the upper bound of the medium-term target range of 5.0 – 7.0 percent during FY26, despite global oil price shock and domestic food supply frictions. However, the direct and indirect effects of the energy price shock pushed the year-on-year inflation above the upper bound of the target range from March 2026 onward. The average inflation nearly doubled from 5.5 percent during Jul-Feb FY26 to 10.4 percent in the urban regions in Mar-Jun FY26. Similarly, contribution of energy to urban inflation rose from one-fifth in Jul–Feb FY26 to two-fifth in Mar–Jun FY26 (**Figure 1.5**). Moreover, the general increase in price pressures following the Middle East conflict also impacted consumer and business inflation expectations, which had previously improved during Jul–Feb FY26.

Food inflation was primarily driven by sharp increase in prices of wheat and its products. Several factors explain wheat price surge in FY26. These include reduced production in the preceding year amid transitional impact of market deregulation, flood-related stock losses and shortages due to market uncertainty regarding wheat supply. However, softening prices of perishables partly offset the impact of price increases in non-perishables. The core inflation, though moderated further across urban and rural baskets particularly in H1-FY26, it remained elevated, signalling persistence of underlying price pressures (**Box 3.7**).

The monetary policy committee (MPC) maintained status quo in six out of eight monetary policy meetings in FY26. This measured approach was based on careful assessment of key macroeconomic trends and inflation outlook. In December 2025, the improved inflation outlook provided room for 50 basis points (bps) reduction in the policy rate to 10.5 percent to support economic activity. However, the committee proactively raised the policy rate by 100 bps to 11.5 percent in April 2026 to limit the potential second round effects from the energy price shock following the Middle East conflict (**Box 3.1 & 3.2**).

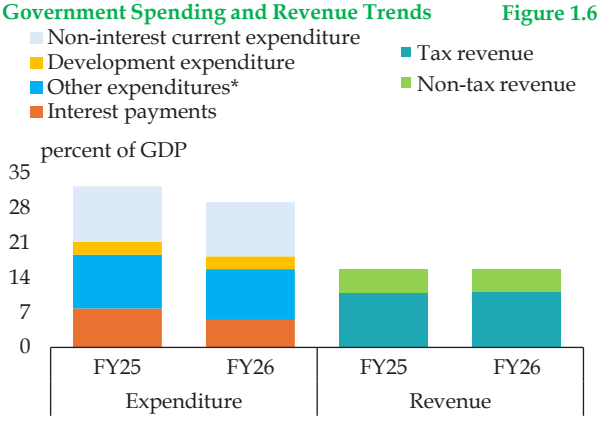
The government's continued fiscal consolidation efforts and a substantial drop in interest payments contributed to a considerable improvement in fiscal outcomes in FY26, even as total revenue declined slightly in terms of GDP (**Figure 1.6**). Fiscal deficit more than halved, whereas both fiscal and primary balances outperformed the budget estimates by wide margins. A sizeable provincial surplus also contributed to these gains. The reduction in interest payments reflected the combined impact of lower interest rates and better cash flow management by the government.

Inflation Contribution: Pre-conflict versus Post-conflict - Urban **Figure 1.5**



Source: PBS

Government Spending and Revenue Trends **Figure 1.6**



* This includes statistical discrepancy

Source: MoF

In addition, a major reduction in power subsidies, resulting from energy sector reforms (**Box 4.3**) and circular debt restructuring further contained spending. The government partly used the fiscal space created from lower subsidies and interest payments for increasing grants for Benazir Income Support Program (BISP) and spending on education. Meanwhile, provinces made notable increase in development spending focusing mainly on housing and community amenities.

On the revenue side, as a percent of GDP, while the tax revenues increased marginally, non-tax revenue declined. The modest increase in tax revenues stemmed from incremental gains in provincial taxes ratio, whereas FBR taxes remained stagnant in terms of GDP. Within FBR taxes, a slowdown in indirect taxes primarily dragged the overall tax collection, whereas direct taxes increased as a percent of GDP. The decline in non-tax revenue was on account of relatively subdued SBP profit due to lower interest rates. Nonetheless, the overall SBP profit transfers were still substantial and exceeded the budget target in FY26.

The reduction in interest rates also constrained withholding tax collection from interest earning on bank deposits. Additionally, negative quarterly adjustments in electricity prices and import tariff rationalisation measures adversely affected energy-related taxes and custom duties. Aside from these factors, the slowdown in economic activity due to the Middle East conflict weighed on tax collection during Q4-FY26. Nonetheless, the stagnation in tax-to-GDP ratio poses risks to the sustainability of fiscal consolidation, going forward.

The fiscal consolidation and improved macroeconomic fundamentals translated into a reduction in public debt-to-GDP ratio in FY26. In terms of composition, both domestic and external debt contributed to the slowdown. Moreover, the government improved the domestic debt profile by raising funds through fixed-rate, medium- to long-term instruments. Further, to broaden the investor base, the government also introduced various specialised instruments in FY26 (**Box 4.2**).

The decline in interest payments, improved maturity profile, higher foreign exchange earnings, and continued build-up of FX reserves also strengthened country's debt repayment capacity in FY26.

However, due to limited availability of non-bank financing and retirement of SBP debt, the government continued to rely primarily on scheduled banks to finance the fiscal deficit. The uptick in budgetary borrowing from scheduled banks, along with increase in credit to private sector (PSC) and loans to public sector enterprises (PSEs) drove expansion in Net Domestic Assets (NDA) of the banking system in FY26. This, together with continued expansion in Net Foreign Assets (NFA) of the banking system, aided by the build-up of foreign exchange reserves, led to an increase in broad money growth during FY26.

The growth in PSC was contributed by both working capital and fixed investment loans supported by expanding economic activity, easing financing conditions, rising input costs linked to the Middle East conflict, and strong deposit growth. On the liabilities side, strong deposit mobilisation mainly explains the uptick in M2 growth, while currency-in-circulation (CiC) slowed compared to the previous year.

While Pakistan's macroeconomic conditions have improved over the last three years, sustaining these gains requires implementing deep-rooted structural reforms. The policy efforts are also needed to put country on a sustainable high-growth path to absorb the expanding working-age population. In this context, **Chapter 6** of the report explores key structural challenges to job creation in Pakistan. In the macroeconomic context, weak and volatile GDP growth, and slow pace of structural transformation amid signs of premature deindustrialisation have been the key impediments to job creation in the country over the past few decades (**Box 6.1**). The impact of these factors is compounded by labour market challenges including low female labour force participation, high youth unemployment and sizeable informal employment amid relatively low decent work opportunities (**Box 6.3**) and

education-skill mismatch (**Box 6.4**). In addition, emerging trends – such as Industry 4.0, the green transition, and geoeconomic fragmentation—are adding to the challenges of job creation by widening technological gaps, increasing reskilling needs, constraining investment, and intensifying global competition.

The country's inability to address structural weaknesses has consistently constrained its capacity to generate high economic growth on a sustainable basis over the last two decades (**Figure 1.7**), which has also weighed negatively on employment prospects. This weakness stems from a range of various interlinked structural issues including persistently narrow tax base, weak export earnings, low saving and investment levels, and low productivity of human and physical capital. Specifically, Pakistan's tax-to-GDP ratio has remained stagnant, only slightly exceeding double digits in the past two decades (**Figure 1.8**).

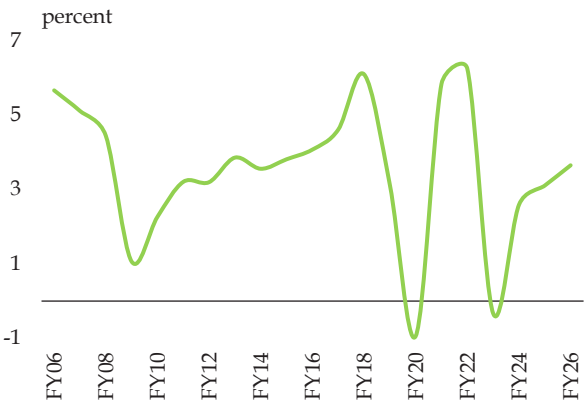
This has particularly hampered country's economic growth through two compounding factors. First, to mitigate revenue shortfalls, the government frequently implements discretionary revenue measures and ad hoc tax rate increases. This unpredictable policy environment undermines investor confidence, negatively impacting their production and investment decisions (**Box 2.5 & 3.3**). Second, insufficient tax collection compresses the fiscal space required for expanding public investment on infrastructure, education and health.

At the same time, the bank financing of large budget deficit crowds out the private sector. This subsequently erodes the country's long-term growth potential by inhibiting productivity gains due to slow technological adoption. The absence of rapid innovation and product and market diversification, a narrow industrial base and persistent reliance on imported raw materials have also constrained the country's export earnings.

Over the years, the combined impact of credit constraints, low productivity levels, economic policy uncertainty and distorted incentive structure has discouraged private investment in Pakistan, especially in LSM (**Box 2.1**). Private sector can serve as a catalyst for sustained high growth and an engine for employment generation due to its better allocative efficiency of resources. However, unlocking its potential requires supportive policy measures and a favourable economic environment.

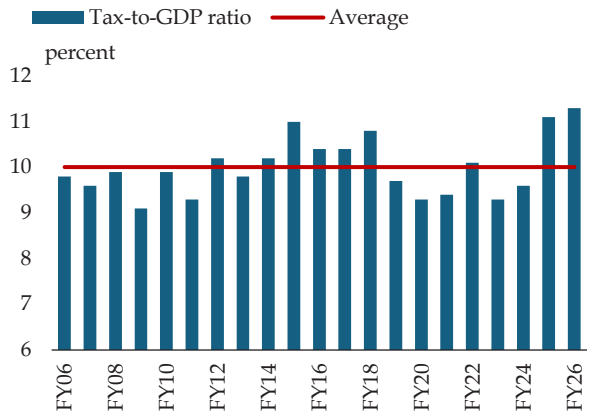
This entails ensuring consistency in economic policies by adopting credible fiscal framework, predictable energy policy, strong legal and regulatory frameworks, better access to finance and provision of necessary infrastructure. Adopting a resilient fiscal consolidation framework requires comprehensive reforms across revenue and expenditure management. While the government has already initiated measures to expand tax collection, there is a need to broaden the scope of these efforts to achieve a

Real GDP Growth **Figure 1.7**



Source: MoF

Tax-to-GDP Ratio **Figure 1.8**



Source: MoF

sustainable increase in revenues. Key priorities include improving tax administration efficiency and expanding the tax net to under-taxed sectors, such as agriculture, real estate, and retail.

On the expenditure side, improving public financial management and government's spending efficiency will further aid in achieving sustainable fiscal balance. Similarly, governance reforms in both energy and non-energy sector State-Owned Enterprises (SOEs) and expeditious privatisation are also critical. Restructuring these entities will mitigate financial losses, reduce the burden on public resources, and help build essential fiscal buffers for productivity-enhancing investment. The resulting increase in public investment will not only crowd-in private sector but also support job creation. The empirical analysis confirms that development expenditures have relatively greater impact on job creation than current expenditures in Pakistan (**Box 4.1**).

Some recent policy interventions and structural reforms, such as import tariff rationalisation, have improved the domestic business sentiments. At the same time, strengthening the overall business environment also requires comprehensive institutional reforms to judicial and financial frameworks. This includes enhancing judicial efficiency by lowering the time and cost for litigation and enhancing alternate dispute resolution mechanisms to build investor confidence. Addressing these impediments will also enhance foreign direct investment (FDI) as well as unlock the country's export potential by driving competitiveness and product diversification.

Moreover, rising frequency of climate shocks and extreme weather events have affected agriculture productivity, besides creating volatility in farmers' income in the past few years. In pursuit of stable economic returns, growers are increasingly adopting short-cycle alternative crops. Although this transition reflects a degree of crop diversification, it presents risks to domestic food security, industrial output, and external sector stability. This underscores the importance of prioritising development of climate-change resistant seed varieties and balancing renewable energy generation with environmental sustainability (**Box 2.3**).

Addressing these structural challenges will unlock public, private, and foreign investment, driving productivity by enhancing human and physical capital. This will foster long-term economic stability, support job creation, and reduce country's vulnerability to global supply chain disruptions.

1.2 Economic Outlook

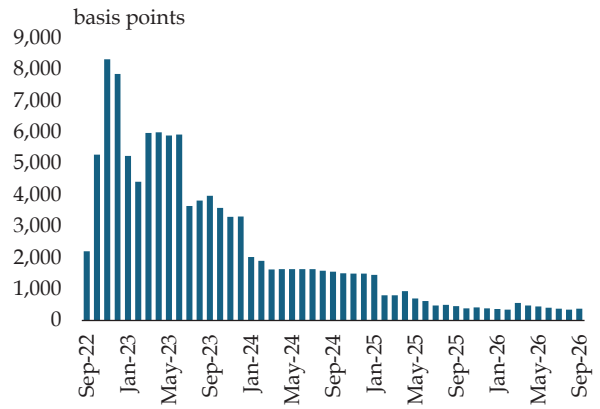
Pakistan entered FY27 on a relatively stronger macroeconomic footing, despite Middle East conflict-related supply disruptions and resultant spike in input costs. So far, the economy has proved to be more resilient than at the time of Russia-Ukraine conflict in FY22, positioning the country to better absorb global supply shocks. Further, the country's continued engagement with the IMF, alongside strengthened fiscal and external buffers, has lowered its risk premium (**Figure 1.9a**). This is also reflected in recent upgrading of country's sovereign credit ratings by major credit rating agencies (**Figure 1.9b**).[1]

In this backdrop, the economic momentum is expected to continue in FY27, aided by the lagged impact of earlier monetary easing, recovery in domestic demand, and recent fiscal support measures to expand industrial activities. This improvement is reflected by a recovery in high-frequency indicators, including automobile sales, cement dispatches, electricity generation, and consumer financing (**Figure 1.10**).

The government has introduced various tax incentives in FY27 budget to stimulate economic

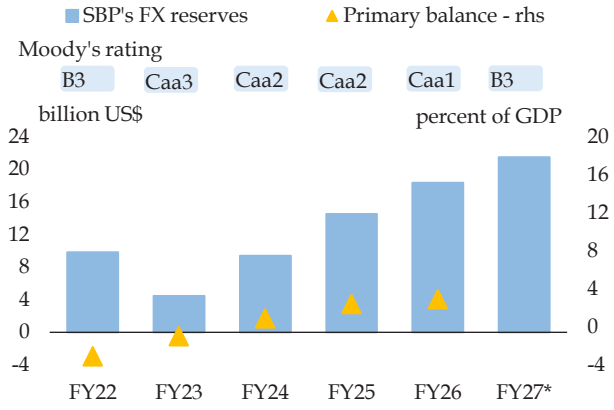
[1] Moody's upgraded Pakistan's sovereign rating from Caa1 to B3 on 24 August 2026. Earlier, S&P Global raised the rating from B− to B on 22 July 2026, while Fitch upgraded it from CCC+ to B− on 15 April 2025. Each agency maintains a stable outlook. Sources: Moody's, S&P Global Ratings and Fitch Ratings.

Sovereign CDS Spread **Figure 1.9a**



Sources: Bloomberg; Moody's; MoF; SBP

Selected Economic Indicators **Figure 1.9b**



* till end-September 2026

activity. These include reduction in super tax, import tariffs, tax on sale and purchase of property, and export proceeds. Further, the government also rationalised tax for the salaried class. These measures are expected to support expansion in economic activity in FY27.

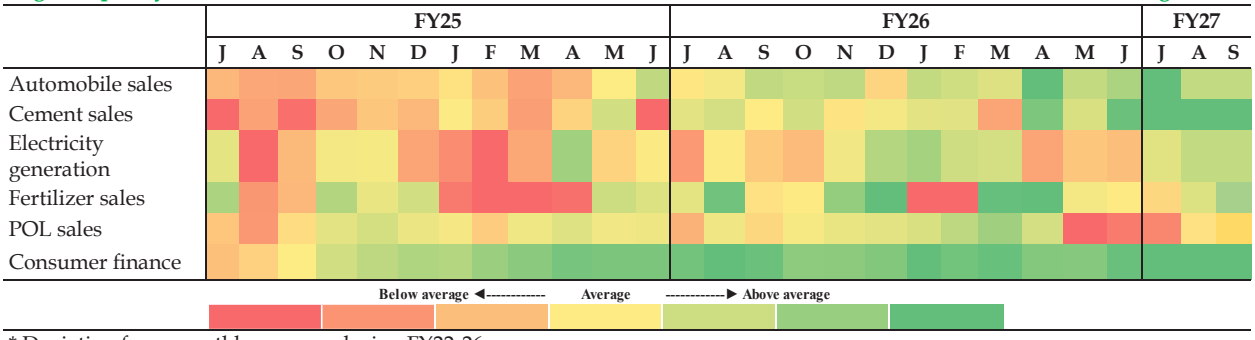
Although, the worsening El-Nino conditions (extreme weather events) pose risks to agriculture sector outlook, latest information indicates increase in output of key kharif crops including sugarcane, rice and maize, compared to last year. The improvement in commodity producing sectors is expected to have knock-on effect on services. Accounting for these trends, SBP projects real GDP growth in the range of 3.5 – 4.5 percent in FY27 (**Table 1.2**).

The expansion in economic activity, tariff rationalisation measures, and higher global energy and non-energy prices are expected to drive a corresponding increase in imports during FY27. On the other hand, exports are expected to recover moderately, supported by policy incentives and a slight rise in global demand. Moreover, remittances are expected to continue the momentum. Incorporating these trends, SBP projects current account deficit to remain in the range of 0 – 1.0 percent of GDP in FY27.

Furthermore, the upward revision of the sovereign credit rating facilitated mobilisation of US$ 3 billion through Eurobond issuance in September 2026. This, combined with SBP's FX purchases and projected official inflows, is expected to support further reserve build-up toward four-month import cover.

The direct and indirect impact of the global energy price shock is anticipated to exert upward

High Frequency Indicators* **Figure 1.10**



* Deviation from monthly average during FY22-26

Sources: APCMA; OCAC; NFDC; PAMA; NEPRA

Macroeconomic Targets and Projections for FY27 **Table 1.2**

	Target	SBP Projections
Growth rate (percent)		
Real GDP [a]	4.0	3.5 – 4.5
National CPI inflation (average) [b]	5.0 – 7.0	5.5 – 7.5 [e]
billion US$		
Remittances [a]	42.4	44.5 – 45.5
Exports (fob) [a]	32.9	32.0 – 33.0
Imports (fob) [a]	70.0	70.5 – 71.5
SBP FX reserves [c]	23.0*	25.0
percent of GDP		
Fiscal deficit [d]	3.6	3.0 - 4.0
Current account deficit [a]	0.7	0 – 1.0

* End-December 2026

Sources: [a] Annual Plan 2026-27; [b] Annual Plan 2020-21; [c] SBP; [d] MoF; [e] July's projections, based on oil price of US$ 80/bbl., as per practice, projection range will be revised in January 2027 to account for higher oil prices and other key developments.

pressure on inflation. To manage heightened global commodity price volatility, the government has revised the petroleum pricing mechanism, moving from fortnightly reviews to weekly reviews in March 2026, and subsequently introducing daily price adjustments from July 2026 onward (**Box 3.5**). This may help in a smooth pass-through of changes in international oil prices in a more predictable manner, rather than abrupt and, sometimes, large adjustments.

Moreover, to mitigate food supply constraints, the government has allowed wheat import. While the rising input costs may induce some rigidity in core inflation, continuation of prudent monetary policy stance is expected to keep inflation expectations anchored. In view of these developments, the SBP expects inflation to remain above the medium-term target range in FY27.

Government's fiscal consolidation measures and power sector reforms are expected to keep government expenditures at moderate levels in FY27 as well. On the revenue side, efforts to improve tax enforcement and broadening the tax net are expected to support tax collection in FY27. Considering these trends, SBP projects fiscal deficit to range between 3.0 – 4.0 percent of GDP in FY27.

This macroeconomic outlook, however, is susceptible to risks, particularly emanating from the ongoing Middle East conflict, new trade blocks and climate change. A protracted conflict—and the resulting upward pressure on energy prices—may weigh on domestic economic activity via supply chain disruptions and rising input costs. Furthermore, the economic conditions within the GCC region could impact remittance inflows. Similarly, the regional tensions risk dampening global economic growth prospects, thereby suppressing external demand for exports. Moreover, the recent India-EU FTA may have implications for Pakistan's exports (**Box 5.1**). Higher energy costs may also stoke domestic inflationary pressures due to its both direct and indirect impact on prices.

The impact of these risks could be amplified by the domestic economic vulnerabilities. Particularly, weak investment trends in productive, export-oriented sectors may have implications for sustaining economic growth momentum, enhancing exports and creating employment opportunities. Moreover, El Nino related weather anomalies may impact agriculture output, exert pressures on food prices and increase imports. The mitigation of these risks requires implementation of early preparedness measures (**Box 2.2**). In this volatile macroeconomic environment, SBP remains committed to its objective to preserve price stability, safeguard financial system and support sustainable economic growth through prudent, data-driven policy interventions.