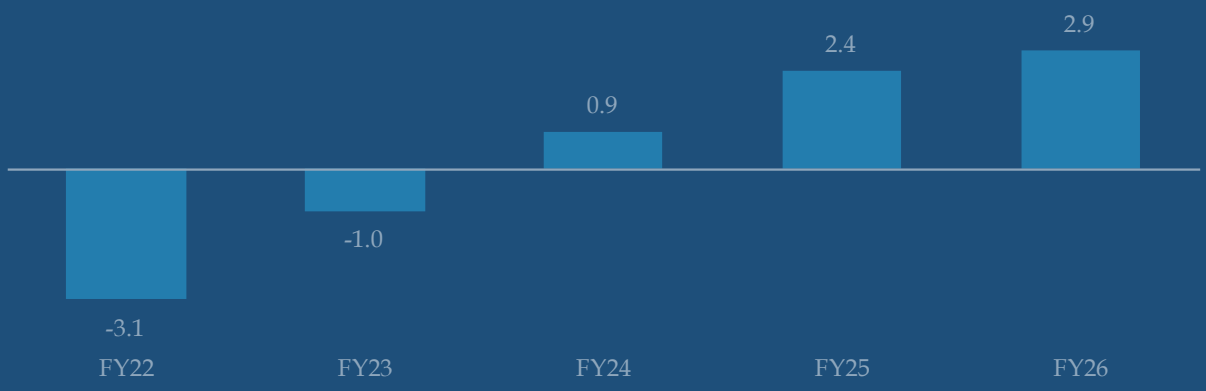


4

Fiscal Policy and Public Debt

Fiscal consolidation continued for the fourth consecutive year, with fiscal and primary balances improving further in FY26. The improvement primarily owes to a notable decline in debt servicing, which more than compensated for a slight decline in total revenue. Total expenditure declined substantially in FY26 due to significant drop in mark-up payments. Non-interest expenditure also declined, reflecting decrease in subsidies and provincial current expenditure. Continued fiscal consolidation slowed the pace of public debt accumulation, reducing the public debt to GDP ratio to 68.6 percent at the end of FY26 from 70.5 percent in the previous year. Furthermore, the increased issuance of medium- to long-term securities improved the public debt profile leading to reduction in refinancing and interest rate risks. In addition, the ongoing build-up in foreign exchange reserves and decline in interest payments improved the solvency indicators and repayment capacity of the government.

Primary Balance
(percent of GDP)



4 Fiscal Policy & Public Debt

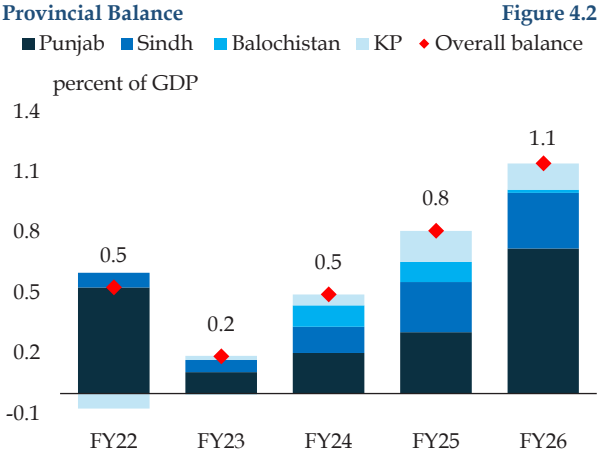
4.1 Fiscal Trends and Policy Review

Fiscal consolidation continued for the fourth consecutive year in FY26. Both fiscal and primary balances improved in terms of GDP compared to the previous year and outperformed their respective budget estimates for FY26 **(Figure 4.1a and 4.1b).** This improvement was driven by a sharp decline in total expenditure, led by substantial reduction in markup payments, which more than offset the decline in total revenue in terms of GDP.[1] Importantly, the provincial surplus continued to increase, providing support to the consolidated fiscal balance **(Figure 4.2)**.

The decline in total revenue (in terms of GDP) in FY26 was primarily due to lower non-tax revenue, while tax collections (in terms of GDP) slightly improved from last year's level. The decline in non-tax revenue was on account of lower, though still sizeable SBP profit, while Petroleum Development Levy (PDL) collection increased in terms of GDP.

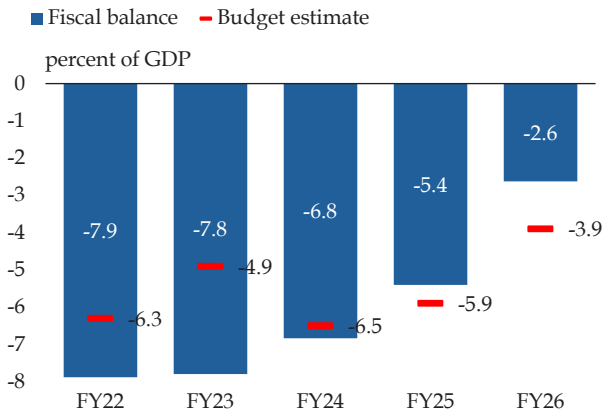
The marginal increase in tax-to-GDP ratio stemmed from incremental gains in provincial revenues, whereas growth in FBR taxes slowed amidst moderation in economic activity in Q4-FY26, reflecting the impact of Middle East conflict.[2] The deceleration in growth of FBR taxes was despite the additional revenue mobilisation measures announced in the FY26 budget and administrative efforts by the government. FBR missed its initial target (budget estimate) but achieved the revised (lower) target for FY26. Nonetheless, for the first time since FY01, the share of direct taxes in total FBR tax collection surpassed that of indirect taxes in FY26.

Provincial Balance **Figure 4.2**



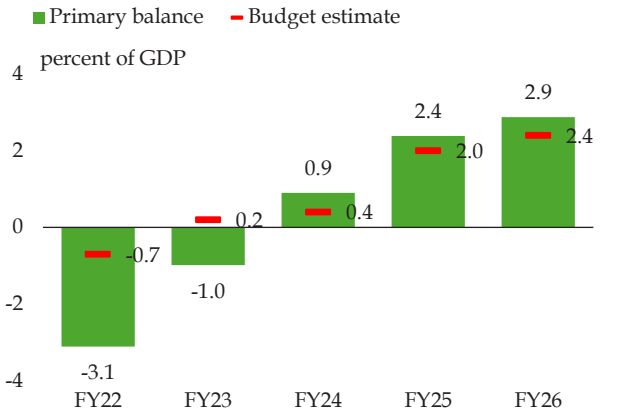
Source: MoF

Fiscal Balance **Figure 4.1a**



Source: MoF

Primary Balance **Figure 4.1b**



[1] A large statistical discrepancy also contributed to the higher primary surplus in FY26. However, the primary surplus remained higher in FY26 compared to the last year, adjusted for statistical discrepancy.

[2] The fourth quarter of the fiscal year usually records higher growth in FBR taxes i.e., the last 5-year's average is 22.5 percent. However, the growth in Q4-FY26 was just 12.6 percent, reflecting the impact of Middle East conflict on revenue mobilisation.

Consolidated Fiscal Operations **Table 4.1**

values in billion Rupees, growth in percent

	Values		Percent of GDP		Growth	
	FY25	FY26	FY25	FY26	FY25	FY26
1. Total revenue (a+b)	**17,997**	**19,774**	**15.8**	**15.6**	**35.6**	**9.9**
(a) Tax revenue	12,723	14,219	11.1	11.3	26.2	11.8
o/w FBR taxes	11,744	13,010	10.3	10.3	26.1	10.8
(b) Non-tax revenue	5,275	5,555	4.6	4.4	65.7	5.3
2. Total expenditure (a+b+c)	**24,166**	**23,087**	**21.2**	**18.3**	**18.0**	**-4.5**
(a) Current expenditure	21,529	20,686	18.9	16.4	15.9	-3.9
o/w Mark-up payments	8,887	6,948	7.8	5.5	8.9	-21.8
(b) Development expenditure & net lending	2,966	3,254	2.6	2.6	42.7	9.7
o/w PSDP	2,983	3,428	2.6	2.7	47.2	14.9
(c) Statistical discrepancy	-329	-853	-0.3	-0.7	89.6	159.4
3. Fiscal balance	**-6,168**	**-3,313**	**-5.4**	**-2.6**	**-14.4**	**-46.3**
4. Primary balance	**2,719**	**3,634**	**2.4**	**2.9**	**185.4**	**33.6**
5. Revenue balance	**-3,531**	**-912**	**-3.1**	**-0.7**	**-33.4**	**-74.2**
6. Provincial balance	**921**	**1,450**	**0.8**	**1.1**	**77.8**	**57.3**
7. Financing (a+b)	**6,168**	**3,313**	**5.4**	**2.6**	**-**	**-**
a) External (net)	619	1,178	0.5	0.9	-	-
b) Domestic (net)	5,549	2,136	4.9	1.7	-	-

Note: 1) Fiscal balance is total revenue minus total expenditure; primary balance is fiscal balance excluding mark-up payments; revenue balance is total revenue minus total current expenditure

Source: MoF

Total expenditure to GDP recorded a notable decline in FY26. This was led by a substantial reduction in current expenditure, primarily mark-up payments. Non-interest expenditure also edged down, mainly owing to decrease in subsidies and provincial expenditure.

The budget financing mix continued to remain tilted towards banking system during FY26, with net retirements to non-bank sources and minor contribution from privatisation proceeds. Financing from external resources also witnessed a notable increase.[3]

With sustained fiscal consolidation, lower interest payments and appreciation of PKR against US dollar, public debt to GDP ratio dropped by 1.9 percentage points to 68.6 percent at end-June 2026. This, together with the strategic shift towards financing through medium- to long-term instruments, improved the overall public debt profile. Particularly, the average time to maturity (ATM) lengthened and the interest rate risk declined.

The improving debt dynamics along with higher foreign exchange earnings, continued build-up in foreign exchange reserves and significant decline in interest payments enhanced the repayment capacity and solvency indicators. However, liquidity indicators showed deterioration due to reclassification of US$ 8.5 billion long-term external debt into short-term during FY26.

The recent fiscal consolidation was mainly achieved on the back of notable contribution from non-tax revenue and significant reduction in interest payments. Tax to GDP, however, remained close to its long-term average of around 10 percent.[4] While substantial non-tax revenue and reduction in interest payments have provided the necessary support for consolidation, sustaining fiscal consolidation would be challenging without increasing tax to GDP ratio by broadening tax net. Moreover, the high reliance

[3] This reflects the repayment of US$ 3.5 billion external liability (a non-budgetary support) and the inflow of US$ 3 billion for budgetary support, which became the part of public external debt.

[4] 10-year average tax to GDP ratio from FY17 to FY26.

on levies (PDL) raises energy costs and may impact competitiveness. Meanwhile, privatising or restructuring of loss-making state-owned enterprises and restoring public investment in vital infrastructure should also remain among the key priorities.

4.2 Revenue

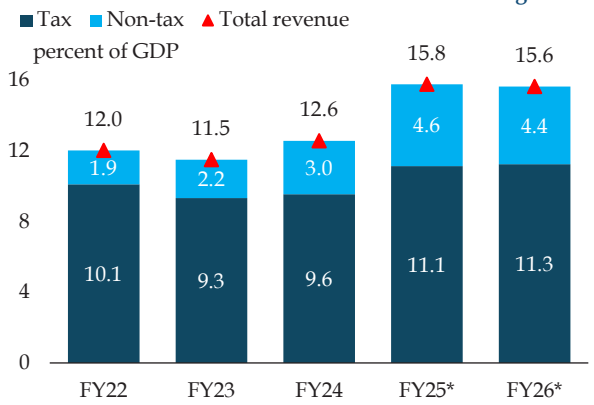
Total revenue declined by 0.1 percentage points (ppt) to 15.6 percent of GDP in FY26.[5] This was primarily due to a drop of 0.2 ppt in non-tax revenue, as tax revenue slightly improved to 11.3 percent of GDP **(Table 4.1 and Figure 4.3)**.

Tax Revenue

The slight increase in tax to GDP ratio was contributed by marginal improvement in provincial taxes ratio, whereas federal taxes remained stagnant in terms of GDP. Federal tax collection remained flat at 10.3 percent of GDP in FY26 **(Figure 4.4).** This was primarily due to lower indirect taxes, as direct taxes increased in terms of GDP. In growth terms, there was a broad-based deceleration in FBR taxes **(Figure 4.5)**.

The deceleration was more pronounced in sales tax and customs duty collections, reflecting the impact of the Middle East conflict-related slowdown in domestic sales and imports towards the end of FY26. As a result, FBR missed the initial budget target by Rs 1,120 billion but surpassed its revised target of Rs 12,983 billion by Rs 27.8 billion **(Figure 4.6)**.

Breakdown of Total Revenue **Figure 4.3**



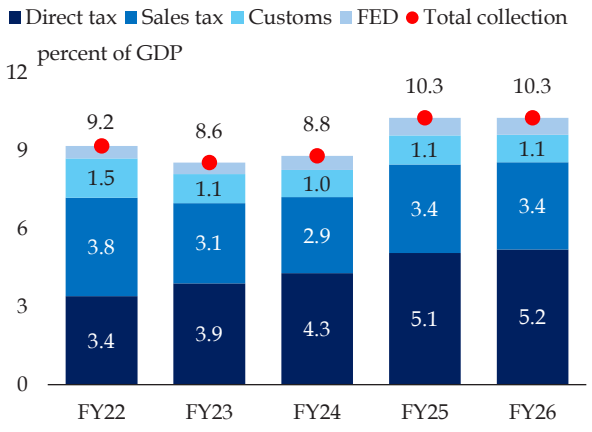
* The numbers might not add up due to rounding off

Source: MoF

Direct Taxes

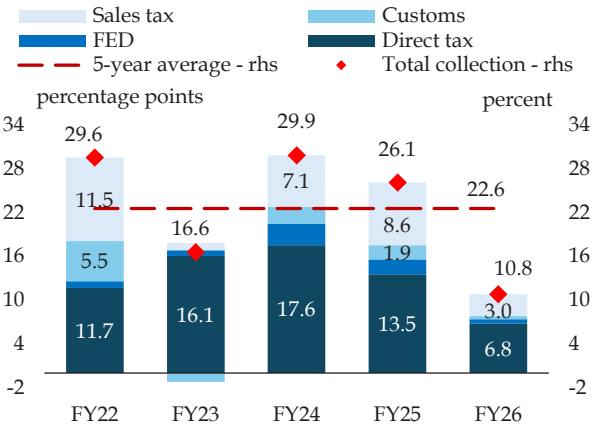
Direct tax collection inched up slightly in terms of GDP in FY26. As a result, the share of direct taxes in total FBR tax collection reached all-time high, and for the first time surpassed the share of indirect taxes **(Figure 4.7)**.[6] The increase in direct taxes was mainly on account of higher collection on demand, while voluntary payments remained at last year's level and withholding tax marginally declined in terms of GDP **(Figure 4.8)**. Collection on demand rose notably on the back of better tax

Breakdown of FBR Taxes **Figure 4.4**



Source: FBR

Contribution to Growth in FBR Taxes **Figure 4.5**

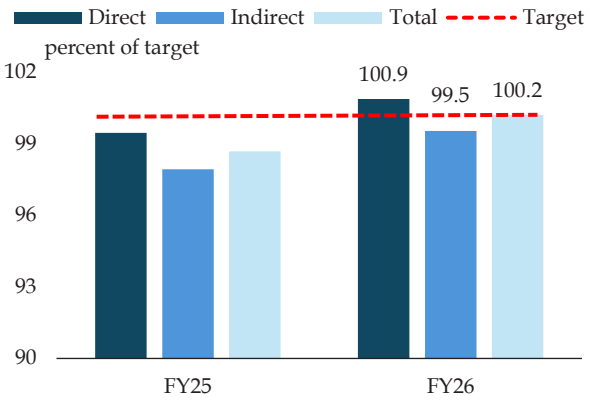


Source: FBR

[5] Exact change in the ratio may not equal the change in numbers of Table 4.1 due to rounding off at single decimal place

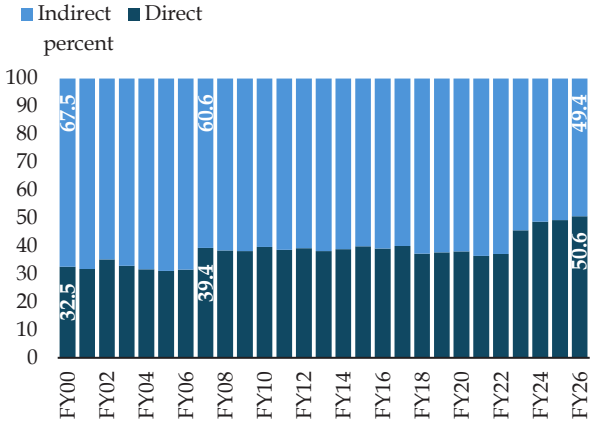
[6] Since publication of fiscal operations data in FY01.

FBR Taxes (Actual vs. Revised Target*) **Figure 4.6**



* Below 100 indicates the respective target was missed.
Source: FBR

Share of Direct and Indirect Taxes in FBR Taxes **Figure 4.7**

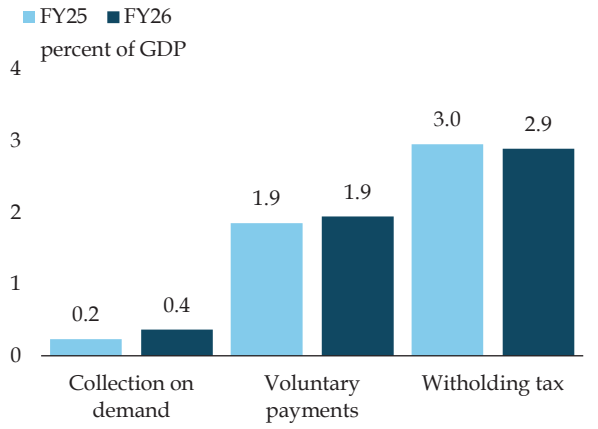


Source: FBR

enforcement and tax dispute resolution by the tax administration.[7]

The withholding tax (WHT) collection marginally declined in terms of GDP in FY26, despite higher rates on sale of immovable property, dividends from certain mutual funds and profit on debt. Moreover, the government also removed exemptions on digital transactions on e-commerce platforms and pensions,[8] adding them into the tax net. Within WHT, unlike the previous year when all major revenue spinners contributed positively, four major revenue spinners dragged collection in FY26.[9] Moreover, the contribution of most other revenue spinners was lower except for sales of property and imports (**Figure 4.9a and Figure 4.9b**). Higher growth in the former was on account of increase in WHT rates, while the latter reflects rise in import values.

Components of Direct Taxes **Figure 4.8**

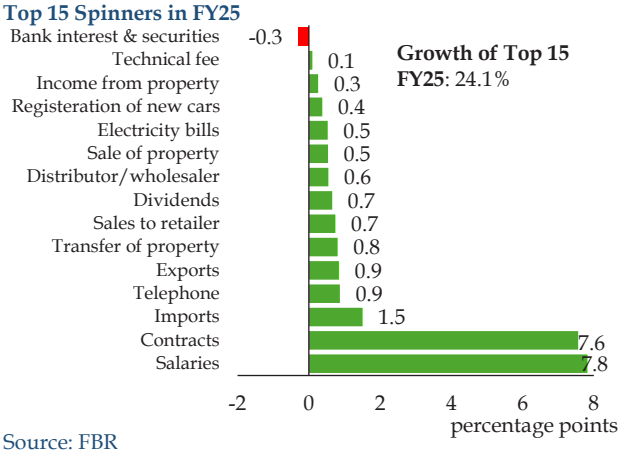


Source: FBR

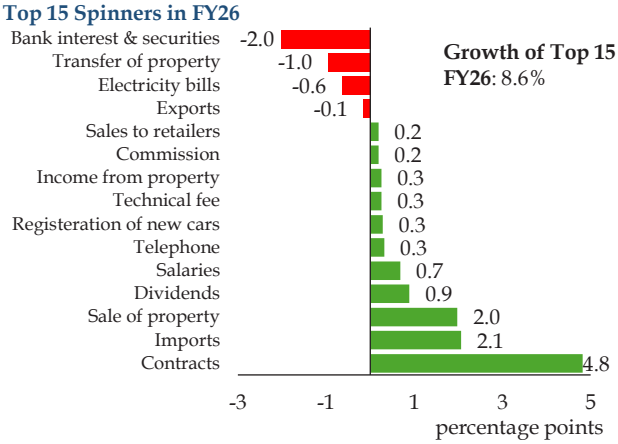
On the other hand, decline in collections under `*bank interest and securities*` was due to lower earnings from deposits amid fall in weighted average deposit rate (WADR) (rate effect), despite an improvement in deposit mobilisation (volume effect).[10] Moreover, WHT on purchase/transfer of immovable property fell due to reduction in tax rates across various slabs of property values. The decline in WHT collection from electricity bills, another major revenue spinner, can be traced to two factors: (i) negative average quarterly tariff adjustments (QTAs)[11]; and ii) a possible drag from solarisation that may have translated into lower electricity consumption from grid.[12] The lower WHT collections from exports can be attributed to

[7] Source: Pakistan-IMF Second Review under the Extended Fund Facility, December 2025.
[8] Pension above Rs 10 million per annum was subject to a final tax of 5 percent. Source: Finance Act 2025, FBR
[9] The top 15 WHT spinners accounted for 95.6 percent share in total WHT collections in FY26. Source: FBR
[10] The average WADR declined from 12.1 percent in FY25 to 8.3 percent in FY26, which more than offset the 14.0 percent growth in interest-earning deposits in the banks. As a result, earnings on deposits (proxied by the banking sector's interest expenses) declined by 22.0 percent in FY26. Source: Financial Soundness Indicators of Banking Sector, SBP
[11] On cumulative basis, the QTA for residential consumers was Rs -7.32/kwh in FY26, as compared to only Rs -1.51/kwh in FY25. Source: NEPRA
[12] Under section 235, WHT is applicable on bill amounting to Rs 25,000 or more per month on non-filer domestic consumers. Source: ITO 2001, FBR

Contribution to Growth in WHT by Top 15 Spinners in FY25 **Figure 4.9a**



Contribution to Growth in WHT by Top 15 Spinners in FY26 **Figure 4.9b**



Source: FBR

a decline in exports. Lastly, the government also provided relief in salary slabs up to Rs 3.2 million per annum in FY26 budget, which led to a notable deceleration in growth of WHT on salary income.

Indirect Taxes

Indirect tax collection edged slightly lower in FY26 in terms of GDP, mainly due to a marginal decline in customs duty, sales tax and stagnation in FED collection, in terms of GDP **(Table 4.2)**. The slower growth in sales tax collections vis-à-vis nominal GDP growth can be attributed to lower receipt from electrical energy on the back of negative QTAs and reduced electricity consumption in Q4-FY26. On the other hand, FED collection remained almost flat due to lower revenue from cigarettes in FY26, as elevated cigarette prices may have shifted consumption to informal brands, leading to lower cigarette sales in formal sector.[13, 14]

The minor decline in customs duty in terms of GDP, despite an increase in imports, reflects the impact of tariff rationalisation under the National Tariff Policy (NTP) 2025-30.[15] Some of the key measures included reduction in customs duty on numerous tariff lines and elimination or generalisation of concessional rates.[16] These changes resulted in decline in collection from imports of iron and steel, boilers and machinery,[17] organic chemicals, paper, and plastics **(Table**

Breakdown of FBR Taxes **Table 4.2**

values in billion Rupees, growth in percent

	Values		Percent of GDP		Growth	
	FY25	FY26	FY25	FY26	FY25	FY26
Direct	**5,792**	**6,586**	**5.1**	**5.2**	**27.8**	**13.7**
Indirect	**5,953**	**6,425**	**5.2**	**5.1**	**24.5**	**7.9**
Sales	3,901	4,254	3.4	3.4	25.9	9.0
Customs	1,285	1,331	1.1	1.1	16.4	3.6
FED	767	840	0.7	0.7	32.8	9.6
Total	**11,744**	**13,011**	**10.3**	**10.3**	**26.1**	**10.8**

Note: Sales tax, Customs and FED (as percent of GDP) show decline at two decimal places; the rounded off figures should be read in conjunction with the text.
Source: FBR

[13] Source: Yearbook 2024-2025, FBR

[14] In Pakistan, duty-paid cigarette prices (real terms) tend to have a high positive correlation (80 percent) with size of informal market for cigarettes between 2013 and 2023. A 5.2 percent increase in duty-paid cigarette prices (real terms) increased the market share of informal cigarettes to 58.0 percent in 2023 from 23.0 percent in 2013. Source: Oxford Economics (2024). *An Economic Assessment of the Drivers of the Illicit Trade in Cigarettes*, November 2024, Available at: https://www.oxfordeconomics.com/resource/an-economic-assessment-of-the-drivers-of-the-illicit-trade-in-cigarettes/

[15] Imports, in PKR terms, rose by 8.7 percent in FY26 compared to 6.5 percent in FY25. Source: PBS

[16] Source: Customs Act 2026 and Pakistan Customs Tariff (FY25 and FY26), FBR, and National Tariff Policy (2025-30), Ministry of Commerce.

[17] Moreover, the growth in import of machinery group, in rupee terms, notably decelerated, led by sharp slowdown in growth of import of power generating machinery and other machinery, and a decline in import of electrical machinery and apparatus. Source: PBS

Spinners of Customs Duty **Table 4.3**

amount in billion Rupees, contribution in percentage points

	Amount		Contribution to Growth	
	FY25	FY26	FY25	FY26
Photosensitive devices	69	70	1.8	0.1
Boilers and machinery	68	60	2.2	-0.6
Animal/vegetables fat	50	57	0.7	0.6
Iron and steel	77	55	0.9	-1.7
Plastics and articles	48	43	0.7	-0.4
Coffee, tea and spices	30	29	0.0	-0.1
Paper and paperboard	27	25	0.2	-0.2
Oil seeds, grains and	18	16	0.0	-0.2
Tanning and dyeing	14	12	0.2	-0.1
Organic chemicals	15	7	1.0	-0.6
Others	868	957	9.4	6.9
Total	**1,285**	**1,331**	**16.4**	**3.6**

Source: FBR

4.3).[18] Moreover, a slight appreciation of exchange rate also offset the impact of higher import volumes on indirect taxes (**Chapter 5**). As a result, the growth in taxes collected at import stage decelerated to 13.2 percent in FY26 from 23.4 percent in FY25.

Despite this moderation, the base broadening measures provided some support to indirect taxes. These measures included the withdrawal of sales tax exemptions on import and supply of solar panels, and local supply of iron and steel scrap. Moreover, the scope of the sales tax was expanded to several imported items.[19] These tax rationalisation measures are a step in the right direction, as they would further help to reduce tax expenditure and strengthen the country's tax revenue **(Table 4.4**).

Breakdown of Tax Expenditure **Table 4.4**

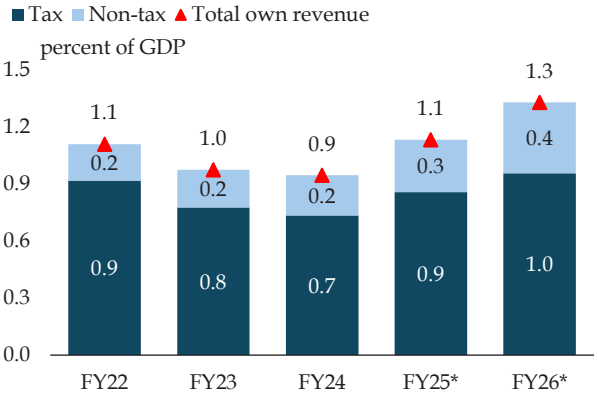
amount in billion Rupees

	Amount		Percent of GDP	
	FY24	FY25	FY24	FY25
Income tax	545	580	0.5	0.5
Sales tax	1,237	1,274	1.1	1.0
Customs duty	652	499	0.6	0.4
Total	**2,435**	**2,353**	**2.1**	**1.9**

Note: Percent of GDP numbers are based on revised GDP

Source: FBR

Breakdown of Provincial Own Revenue **Figure 4.10**



* The numbers might not add up due to rounding off

Source: MoF

In recent years, revenue growth was mainly driven by higher tax rates, an effect that now appears to have faded. This suggests that, instead of relying on raising rates to bring additional revenue, broadening tax base is imperative to lift the low tax to GDP ratio and reduce reliance on regressive indirect taxes.[20]

Provincial Taxes

Provincial taxes increased for the second consecutive year to 1.0 percent of GDP in FY26 **(Figure 4.10)**. The improvement mainly stemmed from base broadening efforts, including withdrawal of exemptions on services and subjecting them under the respective general sales tax on services (GSTS) regime.[21] These measures are essential for strengthening provincial own revenue collection and contributing to national resource mobilisation.

Non-Tax Revenue

After maintaining the momentum for three consecutive years, non-tax revenue (NTR) declined to 4.4 percent of GDP in FY26 **(Figure 4.11)**. This was mainly due to lower SBP profit, which though surpassed budget estimates but was lower than FY25.[22] However, the robust POL sales

[18] However, in PKR terms, import of iron and steel, iron and steel scrap, plastics, and other chemicals recorded higher growth in FY26, while growth in import of paper decelerated compared to last year. Source: PBS

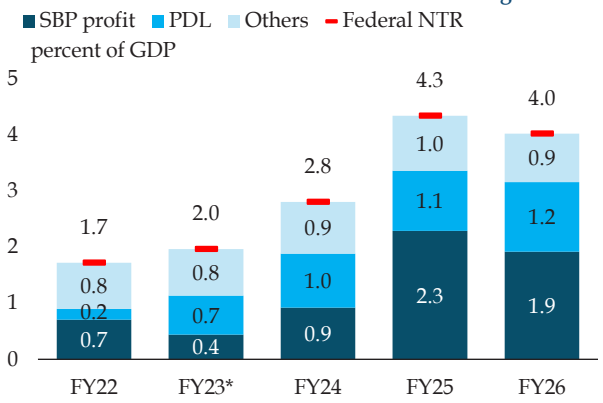
[19] These include imported pet food, chocolates, coffee and cereal bars that are sold in retail packing. Source: FBR

[20] For instance, Corporate Income Tax rate is 29 percent, which is higher than the optimal rate of 26 percent estimated for Pakistan. Source: Mehmood et al. (2022). Does Laffer Curve Exist in Tax Structure of Pakistan? A Threshold Regression Analysis. Journal of Economic Impact, Science Impact Publishers

[21] Source: Pakistan-IMF Second Review under the Extended Fund Facility, December 2025.

[22] The lower SBP profit can be attributed to decline in average interest rate in FY26.

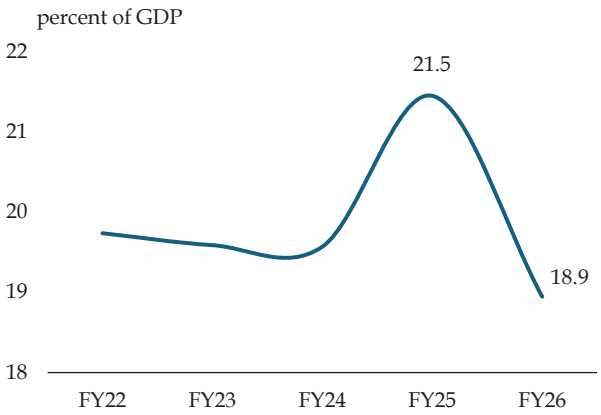
Breakdown of Federal NTR **Figure 4.11**



* The numbers might not add up due to rounding off

Source: MoF

Total Expenditure **Figure 4.12**



Source: MoF

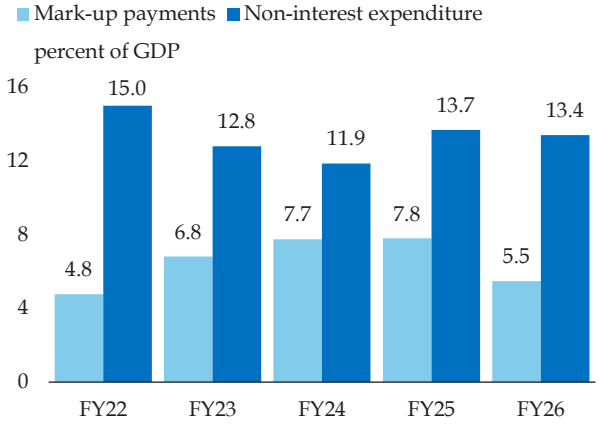
and higher average PDL rate on petrol supported increase in PDL collection in FY26.[23]

The government increased PDL rates on petrol and HSD to compensate for lower tax collection amid the Middle East conflict in Q4-FY26. However, the government charged relatively higher levy on petrol and lower on HSD to minimise its inflationary implications.

4.3 Expenditure[24]

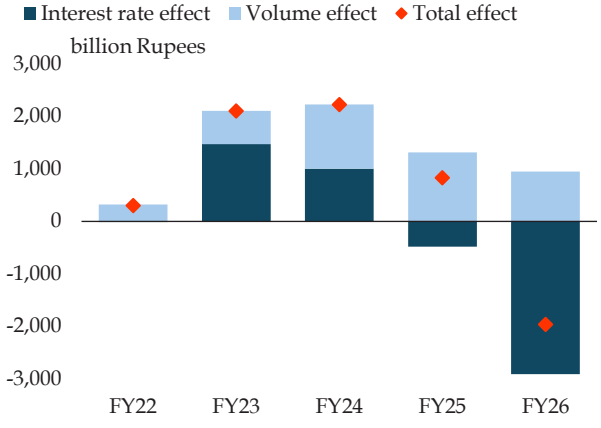
Total expenditure declined to 18.9 percent of GDP in FY26 from 21.5 percent the previous year (**Figure 4.12**). This decline was mainly due to significant reduction in mark-up payments and restrained non-interest expenditure **(Figure 4.13 and Table 4.5)**.

Interest and Non-interest Expenditure **Figure 4.13**



Source: MoF

Change in Domestic Mark-up Payments **Figure 4.14**



Sources: SBP staff calculations based on MoF; SBP

Interest Expenditures

Markup payments fell by 2.3 ppt to 5.5 percent of GDP in FY26 (**Figure 4.13 and Figure 4.14**). The steep reduction in mark-up payments can be attributed to three factors: (i) decrease in average domestic interest rates following the decline in policy rate in FY25,[25] (ii) a deliberate transition towards fixed-rate instruments and zero-coupon long-term bonds, and (iii) early retirement of Rs

[23] HSD and petrol sales grew by 0.6 percent and 1.3 percent, respectively, in FY26. Average PDL rate on petrol increased from Rs 64.1 in FY25 to Rs 85.4 per litre to FY26, while average PDL rate on HSD fell from Rs 64.4 in FY25 to Rs 63.0 per litre in FY26. Source: OCAC; PSO & OGRA

[24] This section excludes statistical discrepancy, consistent with previous reports.

[25] Average policy rate fell to 11.0 percent in FY26 from 14.3 percent in FY25.

Breakup of Consolidated Expenditure **Table 4.5**

amount in billion Rupees, growth in percent

	Amount		Percent of GDP		Growth	
	FY25	FY26	FY25	FY26	FY25	FY26
Total expenditure	24,494	23,940	21.5	18.9	18.6	-2.3
1. Current expenditure (a+b)	21,529	20,686	18.9	16.4	15.9	-3.9
(a) Federal	15,696	14,449	13.7	11.4	12.4	-7.9
Mark-up payments	8,887	6,948	7.8	5.5	8.9	-21.8
Domestic	7,997	6,030	7.0	4.8	11.6	-24.6
Foreign	890	917	0.8	0.7	-10.6	3.0
Defense affairs and services	2,194	2,588	1.9	2.0	18.0	17.9
Pension	911	1,002	0.8	0.8	12.8	10.0
Running of civil government	892	1,034	0.8	0.8	13.7	15.9
Subsidies	1,298	1,014	1.1	0.8	21.6	-21.9
Grants to others	1,514	1,865	1.3	1.5	17.2	23.2
(b) Provincial	5,833	6,238	5.1	4.9	26.8	6.9
2. Development expenditure & net lending	2,966	3,254	2.6	2.6	42.7	9.7
(a) Total development expenditure	2,983	3,428	2.6	2.7	47.2	14.9
PSDP	2,983	3,428	2.6	2.7	47.2	14.9
Federal	786	727	0.7	0.6	23.7	-7.4
Provincial	2,198	2,701	1.9	2.1	57.9	22.9
(b) Net lending to PSEs	-18	-174	0.0	-0.1	-134.2	886.8
Memorandum items:						
Non-interest (total) expenditure	15,607	16,993	13.7	13.4	25.0	8.9
Nominal GDP*	114,177	126,360	-	-	8.2	10.7

* Revised GDP data is used from PBS.

Source: MoF

1.9 trillion debt to SBP.[26] The debt servicing during FY26 was around 15.3 percent lower compared to the budget estimates. This decrease in debt servicing played a key role in reducing the fiscal deficit.

Non-Interest Expenditure (NIE)

Non-interest expenditure fell from 13.7 percent to 13.4 percent of GDP in FY26 (**Figure 4.13**). The fall in NIE was led by decline in subsidies and reduced provincial expenditure.[27] However, the notable reduction in subsidies was offset by increases in grants and defense spending. Moreover, spending on pensions and running of civil administration remained almost unchanged in percent of GDP.

Development expenditure increased by 0.1 ppt to 2.7 percent of GDP in FY26. While federal PSDP declined and fell short of budgetary allocation, higher provincial spending more than offset the decline, with Punjab leading the increase, followed by Sindh, KPK and Balochistan. The priorities of provincial PSDP were community development, education, construction and transport, and agriculture, food, forestry and fishing. The federal government, on the other hand, cut PSDP to create room for providing energy relief to vulnerable segments amid the challenges posed by Middle East conflict in H2-FY26.

The decline in subsidies came from lower power sector subsidies, mainly to independent power producers (IPPs) (**Table 4.6**). In FY25, the government had paid an above average[28] subsidies to IPPs to reduce the circular debt. However, in FY26, the government arranged

[26] As a result of these factors, the government saved around Rs 1.97 trillion in domestic debt servicing in FY26 as compared to last year. Source: MoF

[27] From accounting perspective, reduction of provincial expenditure emanated from statistical discrepancy, if this discrepancy is set to zero, total expenditure would be at the last year's level.

[28] Average from FY22 to FY26.

Breakup of Subsidies and Grants **Table 4.6**

values in billion Rupees, share of budget and growth in percent

	Actual Values		Actual as percent of Budgeted		Growth
	FY25	FY26	FY25	FY26	FY26
Subsidies					
Total	**1,298**	**1,014**	**95.2**	**85.5**	**-21.9**
Power subsidies	**1,212**	**796**	**123.1**	**76.8**	**-34.3**
o/w: IPPs	753	254	350.1	267.8	-66.2
AJK (TDS)	80	87	73.8	117.0	8.5
Inter-disco TDS	288	379	104.3	152.0	31.5
Non-power subsidies	**86**	**218**	**22.8**	**145.5**	**152.4**
Others					
PM austerity fund	-	127	-	-	-
Grants to provinces	**119**	**149**	**105.2**	**99.5**	**25.5**
Grants to others	**1,514**	**1,865**	**91.0**	**104.9**	**23.2**
BISP	592	706	100.0	98.6	19.2
AJK and GB	173	225	100.0	102.1	29.9
Charges for remittances	65	120	100	-	84.9
Daanish education trust	-	55	-	-	-
Total grants	**1,633**	**2,014**	**91.9**	**104.5**	**23.3**

TDS: Tariff Differential Subsidy

Source: MoF; SBP staff calculations

financing of Rs 1.2 trillion from banking sector to settle outstanding dues related to circular debt.[29] As a result the government made significantly lower payments in subsidies to IPPs during FY26.

Non-power subsidies, on the other hand, recorded a notable increase on account of the PM's Austerity Fund, which aimed to provide targeted relief to vulnerable segments of the population in the face of Middle East conflict. Although this subsidy was not originally budgeted, the government neutralised its impact by taking additional measures and budgetary adjustments.

For this purpose, the government combined internal expenditure cuts, provincial burden-sharing, temporary austerity measures, and additional contribution from salaries of autonomous bodies' employees. Thus, the government was able to minimise the impact of relief measures on fiscal accounts in FY26, limiting subsidies to 0.8 percent of GDP.[30] This was unlike earlier shocks, such as from the Russia-Ukraine conflict, where subsidies ballooned from 0.8 percent in FY21 to 2.3 percent of GDP in FY22.

The containment of subsidies in FY26 not only reflects the moderation in IPP payments, but also a recalibration of compensation to new prosumers of distributed solar. The Prosumer Regulations 2026 introduced in February 2026, replaced one-to-one net-metering framework with a net-billing system that reduced the cross-subsidy burden on the power sector from new prosumer connections, contributing to the medium-term sustainability of power sector finances. The design, fiscal implications, and international precedents for this transition are discussed in **Box 4.3**.

A part of the fiscal space thus created was utilised for enhancing grants. The increase in grants was led by BISP,[31] followed by reimbursement of charges for remittances and Daanish education trust. The robust inflows of remittances in FY26, along with the inclusion of exchange companies in the reimbursement programme, contributed to higher reimbursement grants.[32] The objective of grants related to Daanish education trust was expansion of Daanish schools in other provinces.[33]

Provincial expenditure also declined to 6.8 percent in FY26 from 7.0 percent of GDP in FY25. The decline was due to current expenditure, while development expenditures increased from 1.9 to 2.1 percent of GDP in FY26 as provincial governments continued to increase their allocations for development programmes and projects (**Figure 4.15)**.

Provincial current expenditure fell to 5.0 percent of GDP in FY26 – a decline of 0.2 ppt of GDP. This

[29] The financing agreement includes the restructuring of Rs 660 billion in existing loans and Rs 565 billion in fresh financing to clear overdue payments to power producers. Importantly, this arrangement introduces no new burden on consumers, as repayments will be serviced through the already levied surcharge of Rs 3.23 per unit. Source: Press Information Department (PID), GoP

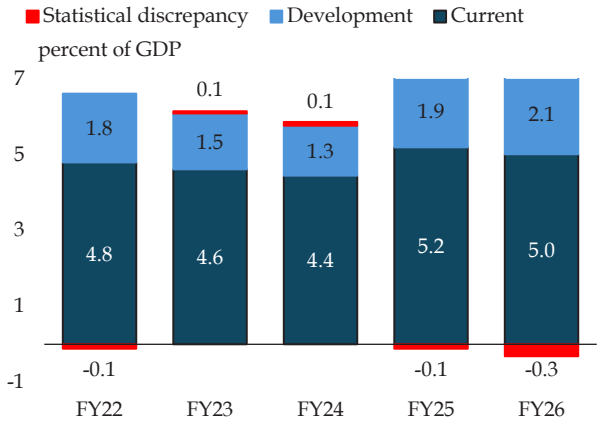
[30] Subsidies fell from 1.1 percent of GDP in FY25.

[31] An inflation adjustment was undertaken in the unconditional cash transfers (UCT) under Kafaalat programme in January 2026, along with planned expansions in Kafaalat and conditional cash transfer programmes - IMF (2026)

[32] Source: EPD Circular Letter No. 4 of 2025

[33] For example, 6 new Daanish schools were approved in Balochistan in FY26. Source: MoPD&SI

Provincial Disaggregated Expenditures **Figure 4.15**



Source: MoF

was due to reduced expenditure on General Public Services and Economic Affairs (in terms of GDP). Punjab, KPK and Balochistan spent less than the budgeted amount for General Public Services, while Punjab, Sindh and KPK underutilised their budget for economic affairs. This reduction in current expenditure was matched by an increase in development spending, with major spending on housing and community amenities. Sindh and Balochistan dedicated more spending towards social protection, with 47 and 15 percent of their actual development spending in this category.[34] Despite this increase in development spending, consolidated provincial utilisation was around 88 percent of the budgeted amount.

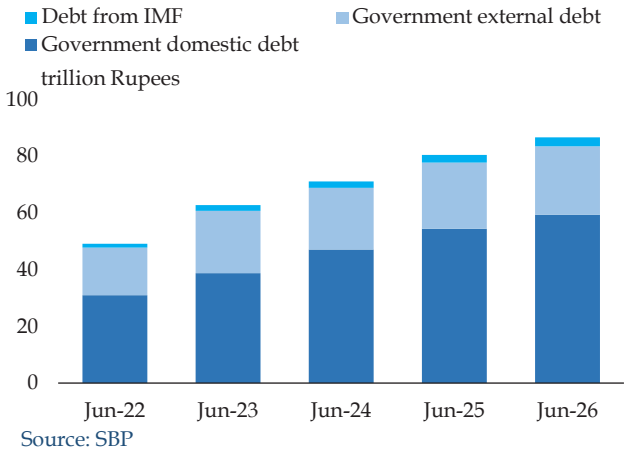
This underutilisation reflects efforts to support federal government efforts in providing energy relief to underserved segments, where provinces shared the burden of relief with the federal government.[35]

Nonetheless, provinces have steadily increased their PSDP expenditure since FY24, which along with contribution to the much-needed investment would also translate into increased job creation. SBP staff estimates show that development spending has relatively higher positive impact on employment (**Box 4.1**).

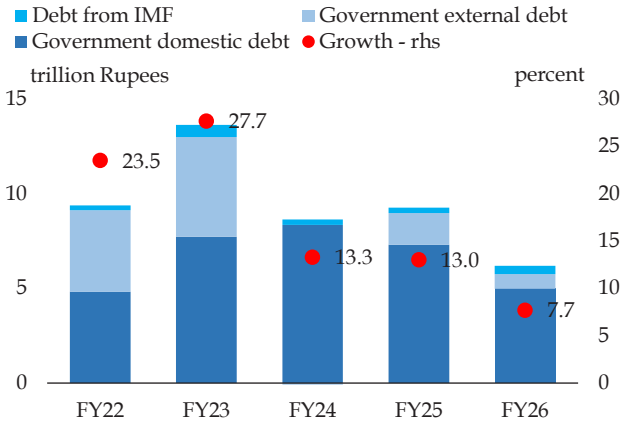
4.4 Public Debt

The pace of accumulation in public debt slowed significantly to 7.7 percent during FY26, from 13.0 percent in FY25, and last five years' average of 17.4 percent (**Figure 4.16a, Figure 4.16b and Table 4.7**).[36] The slowdown was broad-based across domestic and external debt. Following slowdown in public debt accumulation and improvement in macroeconomic conditions, debt to GDP ratio also declined to 68.6 percent by the end of FY26 from 70.5 percent at the end of previous fiscal year. The decomposition of change in public debt to GDP ratio depicts that the major contribution came from moderate inflation and a notable primary surplus, followed by better economic growth,

Gross Public Debt - Stock **Figure 4.16a**



Gross Public Debt - Flow **Figure 4.16b**



Source: SBP

[34] In contrast, Punjab and KPK spent 1 percent and 2 percent in this category, respectively.
[35] Provinces contributed around 48 percent to energy relief fund. Source: Finance Division, MoF
[36] Average of FY21-FY25.

Summary of Pakistan's Debt and Liabilities **Table 4.7**

stock and flow in billion Rupees, growth in percent

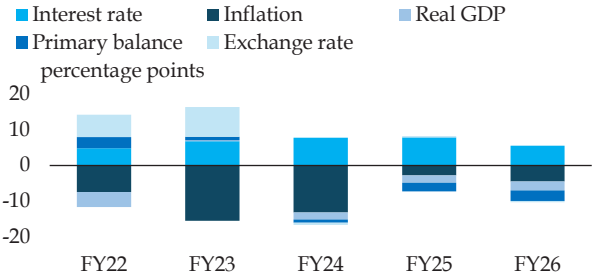
	Stock			Flow		Growth	
	Jun-24	Jun-25	Jun-26	FY25	FY26	FY25	FY26
Total debt & liabilities	**87,122**	**96,041**	**101,301**	**8,919**	**5,260**	**10.2**	**5.5**
Gross public debt (I+II+III)	**71,246**	**80,518**	**86,715**	**9,272**	**6,197**	**13.0**	**7.7**
I. Government domestic debt	47,160	54,472	59,441	7,311	4,970	15.5	9.1
II. Government external debt	21,754	23,417	24,201	1,663	784	7.6	3.3
III. Debt from IMF	2,332	2,630	3,073	298	443	12.8	16.8
IV. External liabilities	3,266	3,392	2,414	127	-978	3.9	-28.8
V. Private sector external debt	5,467	5,253	5,253	-214	1	-3.9	0.0
VI. PSEs external debt	2,068	2,200	2,184	132	-16	6.4	-0.7
VII. PSEs domestic debt	2,105	2,016	2,238	-89	223	-4.2	11.0
VIII. Commodity operations	1,378	1,067	1,009	-312	-58	-22.6	-5.4
IX. Intercompany external debt	1,592	1,595	1,487	3	-108	0.2	-6.8
	percent of GDP						
Gross public debt	67.5	70.5	68.6	-	-	-	-
Government domestic debt	44.7	47.7	47.0	-	-	-	-
Government external debt	22.8	22.8	21.6	-	-	-	-
Total external debt and liabilities	34.6	33.7	30.6	-	-	-	-

Source: SBP

reduction in effective interest rate and PKR appreciation against US dollar, respectively **(Figure 4.17)**.

Public debt profile also improved owing to higher issuance of medium- to long-term securities during FY26**.** As a result, refinancing and interest rate risks declined, supported by longer ATM and an increased share of fixed-rate securities. In addition, the investors' base was broadened through gradual increase in the share of Sukuk in government securities.[37]

Major Factors Contributing to Change in Gross Public Debt to GDP* **Figure 4.17**



*Based on methodology of Escolano, J. (2010). *A practical guide to public debt dynamics, fiscal sustainability, and cyclical adjustment of budgetary aggregates* (Vol. 2). Washington, DC: International Monetary Fund

Source: SBP staff calculations

Furthermore, the sizeable reduction in fiscal deficit, higher foreign exchange earnings and the significant build-up in SBP FX reserves have improved repayment capacity of the government and solvency indicators. Nonetheless, the liquidity indicators deteriorated mainly due to reclassification of external long-term bilateral and commercial loans to short-term during FY26.

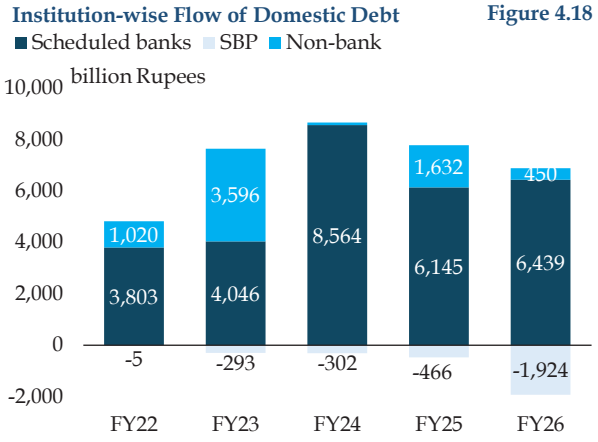
Domestic Debt

Growth in domestic debt decelerated to 9.1 percent during FY26, from 15.5 percent in FY25.[38] This deceleration can be attributed to notable decline in interest payments and consistent increase in primary surplus. Moreover, buyback of the government securities and early retirement of

[37] Share of non-bank (including provincial government) in domestic government securities increased to 21.7 percent by end FY26 from 21.1 percent in FY25. Since its inception in December 2023, total issuances (realised value) of Shariah-compliant government securities amounted around Rs 6 trillion till end FY26. Source: SBP and PSX

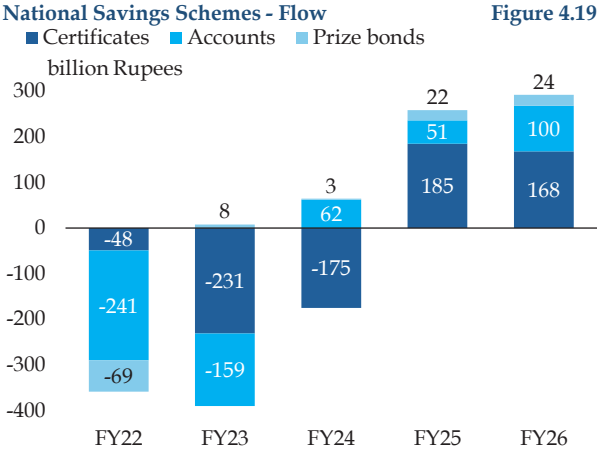
[38] The stock of domestic debt reached Rs 59.4 trillion, by end FY26.

Institution-wise Flow of Domestic Debt **Figure 4.18**



Source: SBP

National Savings Schemes - Flow **Figure 4.19**



Source: SBP

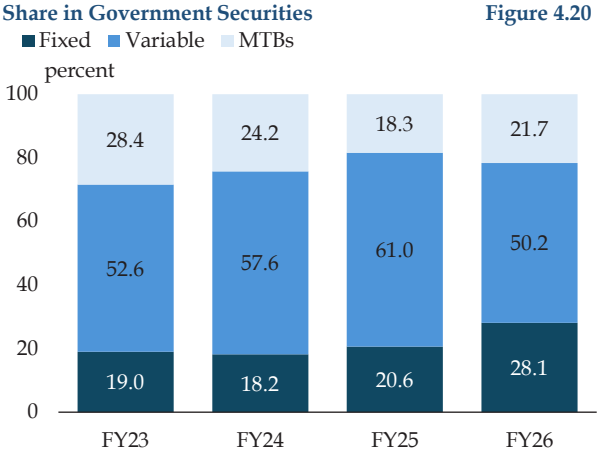
some of the SBP debt also contained growth in domestic debt during FY26.[39, 40]

Domestic debt was mainly raised from commercial banks as non-bank financing witnessed lower increase whereas the government continued to make net retirement to SBP during FY26 **(Figure 4.18)**. The relatively higher borrowing from the banks in FY26 reflects the reversal of ADR-linked tax on banks' income from government securities, in which, banks (to improve their ADR ratios) lent to NBFIs, which then invested in government securities. This was reflected in a significant increase in budgetary financing from non-bank sources in H1-FY25 and retirement in H2-FY25.

Nonetheless, within the non-bank sources, the government raised relatively higher financing from National Savings Schemes (NSS) including prize bonds **(Figure 4.19)**.[41] The investment in NSS during FY26 was mainly concentrated in Behbood Savings Certificates (BSC), Regular Income Certificates (RIC) and Pensioners Benefit Account (PBA).

An important aspect of the improvement in public debt was significant increase in the share of fixed rate securities and higher proportion of domestic borrowing through Sukuk **(Figure 4.20)**.[42] Within PIBs, the proportion of fixed rate PIBs increased to 40.4 percent by end of FY26 from 29.3 percent at end of FY25. This rising share of fixed rate instruments bodes well for containing interest rate risk and easing the problem of domestic original sin - a concept generally defined as country's inability to borrow in local currency at longer

Share in Government Securities **Figure 4.20**



Source: SBP

[39] Buyback amounted to Rs 996 billion in FY26 compared to Rs 1,299 billion in FY25. The government also retired Rs 1.9 trillion to SBP during FY26. Source: SBP

[40] The government used SBP profit to retire its debt to lower gross financing requirements. This strategy aligns with IMF programme, which mandates debt retirement in case of SBP profit exceeding 1.0 percent of GDP in any fiscal year. Source: Pakistan-IMF First Review under the Extended Fund Facility, May 2025.

[41] NSS registered net inflows of Rs 268.5 billion during FY26, higher than Rs 236.5 billion in the previous year. Source: SBP

[42] Around 35 percent of the increase in domestic debt and liabilities was contributed by Sukuk during FY26, higher than 20.4 percent in the same period last year.

maturities with a fixed interest rate (**Box 4.2 in the State of Pakistan's Economy, Annual Report FY2024-25**). Moreover, relatively lower interest rates on long term instruments during FY26 also helped the government to contain domestic debt servicing (**Figure 4.21**). Besides, the government expanded the available pool of government debt instruments, especially that of Shariah-compliant and diversified the sources of financing (**Box 4.2**).

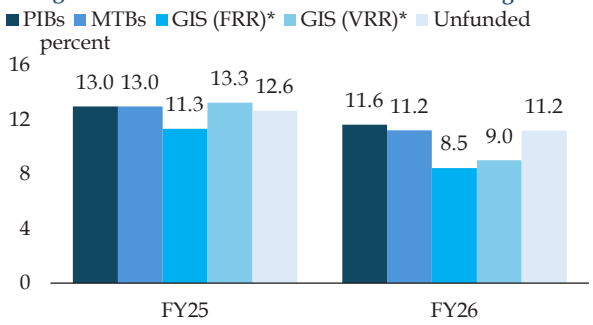
As the government raised financing via longer-tenor securities, the maturity profile of domestic debt further improved during FY26. The overall ATM of domestic debt improved to 3.9 years by end March 2026 from 3.8 years in June 2025 **(Figure 4.22)**.[43]

Nonetheless, after February 2026, investors' preferences shifted towards shorter-tenor instruments amid increased uncertainty associated with the Middle East conflict. As a result, the share of MTBs (in incremental domestic debt) rose from 17.0 percent in Jul-Feb FY26 to 65.4 percent in Mar-Jun FY26.

Domestic Debt Servicing

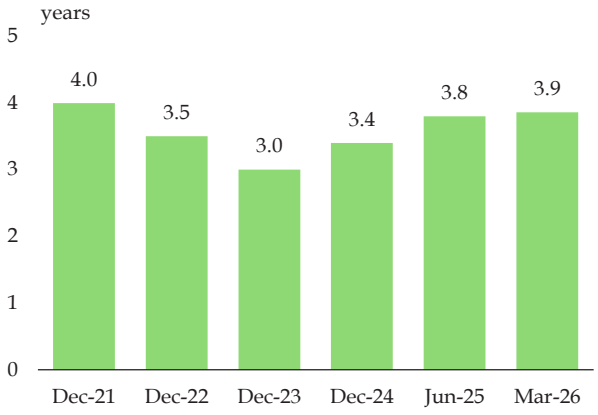
Amid the decline in domestic interest rates, servicing of domestic debt dropped to Rs 6.0 trillion during FY26 from Rs 8.1 trillion in the last year **(Figure 4.23)**. The reduction mainly came from a notable decrease in interest payments on floating debt, followed by permanent debt. Within the floating debt, significant reduction was registered in interest payments against 12-month T-bills. Likewise, owing to its high share in domestic debt, the reduction in interest payments against permanent debt was mainly associated with PIBs. The reduction in interest payments on unfunded debt majorly emanated from Defence Saving Certificates (DSCs).[44] Moreover, buybacks and early retirement of government securities also reduced the interest cost. As a result of decline in debt servicing cost, the domestic debt repayment capacity of the government substantially improved during FY26 **(Figure 4.24).**[45]

Average Yield on Government Securities **Figure 4.21**



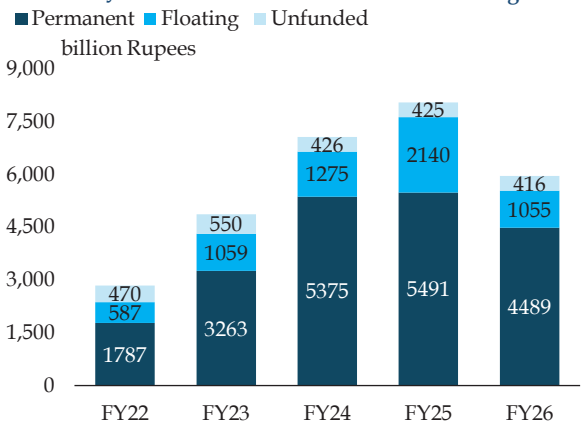
Note: PIB= Pakistan investment bond; MTB= Market treasury bill; GIS= Government Ijarah sukuk; FRR= Fixed rental rate; VRR= Variable rental rate
* Estimated from cutoff rates
Sources: SBP; PSX

Average Time to Maturity of Domestic Debt **Figure 4.22**



Source: MoF

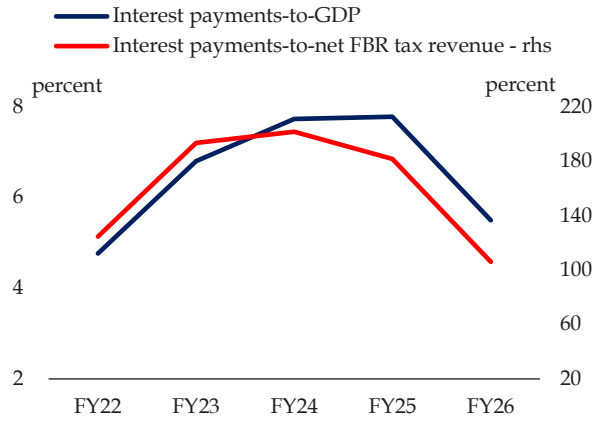
Interest Payments on Domestic Debt **Figure 4.23**



Source: SBP

[43] Economic Survey 2025-26.
[44] Interest payments on unfunded debt dropped to Rs 26.7 billion during FY26 from Rs 61.1 billion in the previous year. Source: SBP
[45] The repayment capacity is proxied by Domestic Interest Payments (DIP) to net FBR taxes and DIP to Gross Domestic Product.

Repayment Capacity of the Government **Figure 4.24**



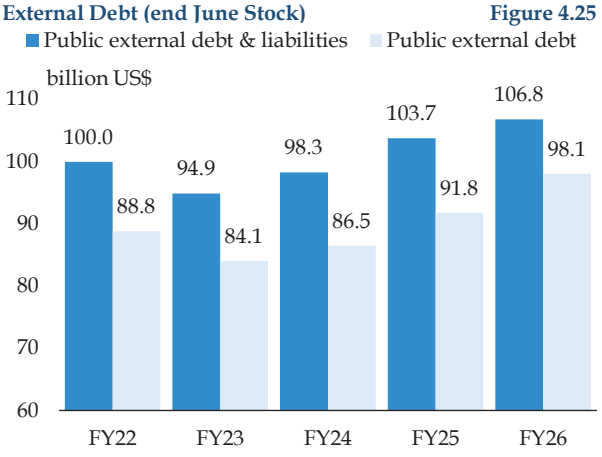
Sources: MoF; SBP

Public External Debt and Liabilities

Public external debt and liabilities (PEDL) rose by US$ 3.0 billion in FY26 to US$ 106.8 billion by end-June 2026, which was lower than US$ 5.5 billion increase last year. The repayment of external liabilities (central bank deposits) of US$ 3.5 billion contained the total increase in PEDL during FY26. However, Public External Debt (PED) rose by US$ 6.3 billion during FY26, compared to US$ 5.3 billion in the previous year **(Figure 4.25)**.[46]

The increase in PED was mainly on account of US$ 1.8 billion from IMF, followed by US$ 1.6 billion loans from multilateral creditors. Moreover, investment in Naya Pakistan

External Debt (end June Stock) **Figure 4.25**



Source: SBP

Certificates (NPCs) and local currency debt securities also recorded an uptick in FY26. On the other hand, principal repayment to NPC holders, multilateral creditors, commercial loans and Eurobonds substantially contained the pace of PED accumulation. Currency movement also turned favourable, as appreciation of US dollar against other currencies, reduced PED by US$ 369 million in FY26. Furthermore, short-term public external debt increased by US$ 9.1 billion during FY26. This largely reflected reclassification of US$ 8.5 billion long-term bilateral and commercial loans into short-term debt during FY26.[47]

External Disbursements

Amid improving macroeconomic conditions and progress under the IMF programme, external disbursements increased to US$ 16.2 billion during FY26, compared to US$ 12.1 billion in the previous year. Multilateral creditors remained the largest source of external disbursements, followed by investment in NPCs, time deposits from a friendly country, loans from commercial banks and bilateral sources. Within multilateral sources, Asian Development Bank (ADB), International Development Association (IDA) and Islamic Development Bank (IsDB) contributed around 86 percent of multilateral loans. Moreover, Saudi Arabia, China and Denmark provided the major chunk of bilateral loans for external financing during FY26.

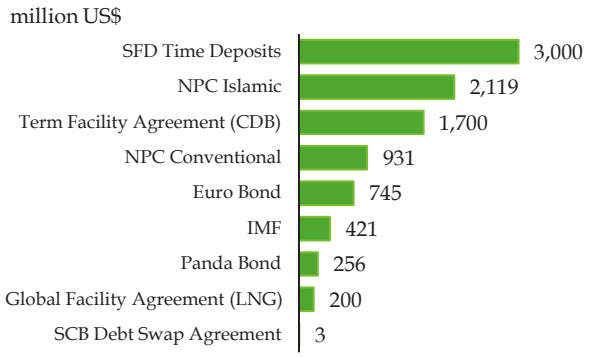
The rise in external disbursements reflects improved confidence of external creditors and investors after continued progress on reforms and better outlook of the economy as manifested in Pakistan's rating upgrades by international rating agencies (**Chapter 5**).

Breakdown of external disbursements by purpose depicts that around 80 percent of the loans were provided for non-project financing. Within the non-project financing, the predominant portion of US$ 9.4 billion (73.7 percent of total non-project disbursements) was meant to provide budgetary

[46] Owing to the repayment of US$ 3.5 billion external liabilities, the accumulation in PEDL remained lower than the rise in PED. Source: SBP

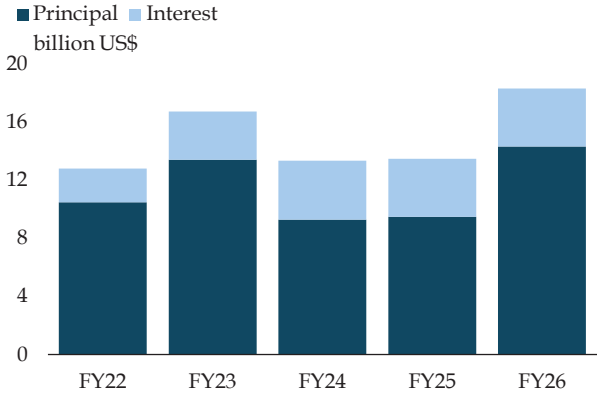
[47] Previously, some of the bilateral shorter-tenor (up to one year) time deposits placed for a fixed term were classified as long term.

Disbursements for Budgetary Support in FY26 **Figure 4.26**



Note: SFD= Saudi fund for development; CDB=China development bank; SCB= Standard chartered bank
Source: SBP

Debt Servicing of PEDL* **Figure 4.27**



* Public external debt & liabilities
Source: SBP

support **(Figure 4.26)**. Whereas the project-wise composition of external disbursements indicates that these loans are scattered across various projects led by flood-related reconstruction activities and power generation.

A relatively higher portion of funding was disbursed to the Sindh Flood Housing Reconstruction Project, which aims to reconstruct and restore 350,000 housing units damaged during the 2022 floods. In parallel, multilateral institutions provided support for both the Sindh Flood Emergency Rehabilitation and the Sindh Emergency Housing Reconstruction Projects.

These initiatives primarily focused on restoring infrastructure, recovering essential services, and rebuilding homes particularly for vulnerable and low-income households. Beyond immediate flood recovery, inflows were directed toward long-term development projects: the Dasu Hydropower Transmission Line to expand hydropower capacity, the Pakistan Multi-Mission Communication Satellite System to strengthen national communication networks, and the Second Power Transmission Enhancement Investment Programme to improve country's electricity grid (**Table 4.8**).

External Debt Servicing

External debt servicing (including principal and interest payments) was higher at US$ 18.3 billion during FY26 compared to US$ 13.5 billion in the previous year **(Figure 4.27)**. The increase in repayment against PED is mainly driven by principal repayments to multilateral creditors, NPC holders, Eurobond holders, and commercial creditors. In addition, repayment of foreign exchange liabilities (central bank deposits) of US$ 3.5 billion remained the major component of principle repayment during FY26.

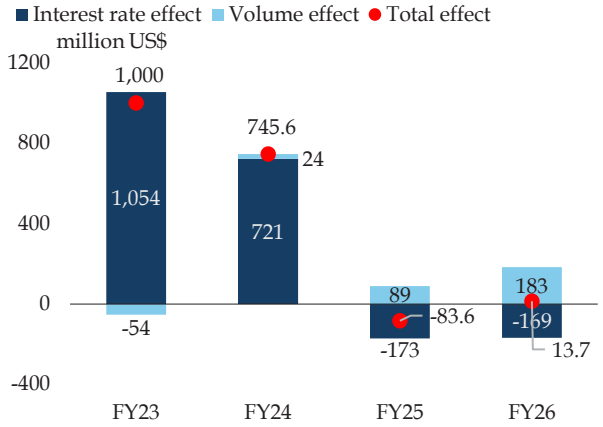
Interest payments, including expense against liabilities, amounted to US$ 3.9 billion, up by US$ 13.7 million compared to FY25. Major payments

Purpose of External Disbursements **Table 4.8**
million US$

Purpose	Type	Grants	Loans	Total
Non-project	Budgetary support	3	9,371	9,374
	IsDB (short term)		1,019	1,019
	Programme	44	1,285	1,329
	SFD oil facility		1,000	1,000
	Sub total	**47**	**12,676**	**12,723**
Project	Sindh housing reconstruction			268
	Dasu hydro transmission line			130
	Pakistan-MM1 satellite			98
	Sindh emergency house reconstruction			96
	Flood assistance			71
	Jamshoro power generation			63
	SEC power transmission enhancement			60
	CAREC corridor			57
	Sub total*	**102**	**3,333**	**3,435**
	Grand Total	**150**	**16,008**	**16,158**

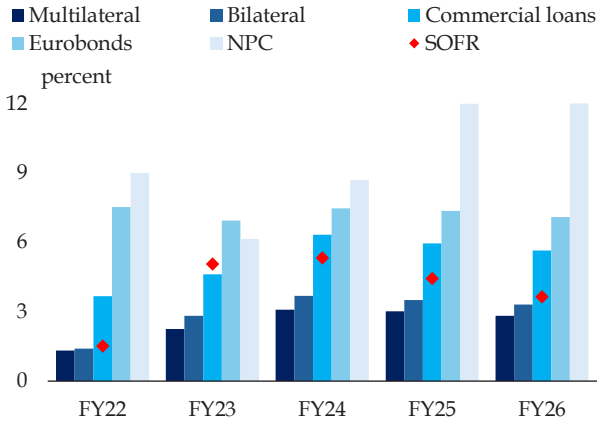
* Includes all projects
Source: EAD

Change in Debt Servicing of PEDL **Figure 4.28**



Source: MoF

Effective Interest Rates on Public External Debt **Figure 4.29**



Source: SBP

were made to multilateral creditors, bilateral sources, Eurobonds and commercial loans. Additionally, interest payments to IMF and on central bank deposits also added to the overall interest expense on public external debt and liabilities.

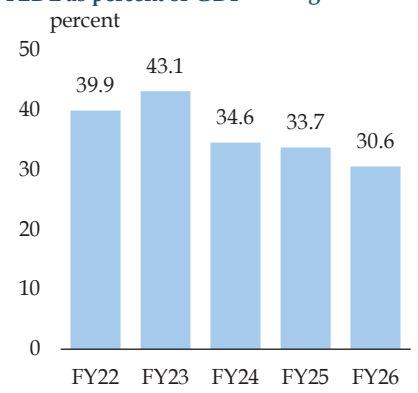
The increase in interest payments can be attributed to the volume effect **(Figure 4.28)**. The effective interest rates across most of the external debt categories, barring NPCs, declined during FY26. This reflected the downward trend in global interest rates, as indicated by Secured Overnight Financing Rate (SOFR) **(Figure 4.29)**.

External Debt Sustainability

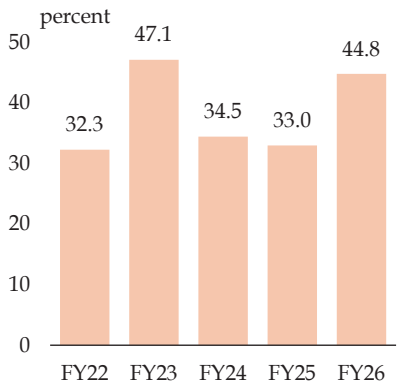
External debt sustainability indicators posted a mixed picture during FY26. The solvency indicator, measured by Total External Debt and Liabilities (TEDL) to Gross Domestic Product (GDP) ratio, continued its declining trend, indicating improvement in external debt sustainability. In contrast, the other two indicators, i.e., External Debt Servicing (EDS) to Foreign Exchange Earnings (FEE) and EDS to Exports Earnings (EE), reflect deterioration in repayment capacity. The latter could be attributed to higher external debt servicing, mainly principal repayment of US$ 3.5 billion foreign exchange liabilities, during FY26 **(Figure 4.30a, 4.30b and 4.30c).**

Moreover, liquidity indicators based on Short-term Public External (STPED) to Public External Debt & Liabilities (PEDL) and STPED to SBP FX reserves, also suggest deterioration in external

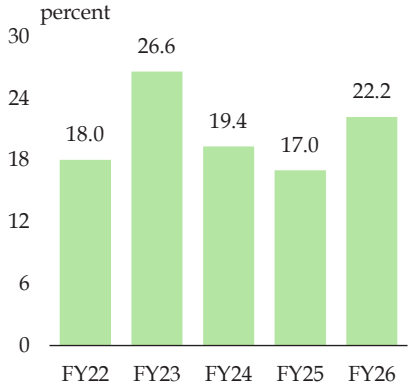
TEDL as percent of GDP **Figure 4.30a**



EDS as percent of EE **Figure 4.30b**



EDS as percent of FEE **Figure 4.30c**



Note: TEDL= Total external debt & liabilities; EDS= External debt servicing; EE= Export earnings; FEE= Foreign exchange earnings

Source: SBP

debt sustainability (**Table 4.9**).[48] The deterioration mainly emanated from the reclassification of US$ 8.5 billion long-term loans into short-term debt during the period under review and needs careful interpretation in the backdrop of a significant build-up in SBP FX reserves and improved economic conditions.

Liquidity Indicators **Table 4.9**

	FY22	FY23	FY24	FY25	FY26
STPED/PEDL	1.3	0.2	0.8	0.7	9.2
STPED/total reserves (liquid)	8.7	1.7	5.4	3.8	42.3
STPED/SBP reserves	13.7	3.6	8.1	5.1	53.5

Source: SBP

Box 4.1: Composition of Government Spending and Employment Generation in Pakistan

Employment remains a persistent economic challenge in Pakistan. While private sector plays a key role in generating employment opportunities across the world, the role of government is also important in developing countries like Pakistan. The literature shows that government spending can generate employment, however, its magnitude depends on composition of public spending, and the sectors that ultimately benefit from the spending. This is usually referred to as multiplier impact on growth that may translate into higher employment.

The literature shows that government spending can generate employment through several interconnected channels. First, public investment creates direct or first-round employment by increasing demand for labour through government-funded projects, such as development in physical infrastructure, with the impact on employment depending on the size, sectoral composition and labour intensity of spending (IMF, 2020, Antonopoulos et al., 2010). Second, spending generates indirect or second-round employment, as contractors and sub-contractors place orders for inputs and intermediate goods and their manufacturers hire additional workers. These jobs can further increase household consumption, generating spillover demand and additional employment across the economy (Wilson, 2012). For example, in case of Pakistan, the Ministry of Planning estimated that development spending led to 289,153 direct and 424,052 indirect employment opportunities during FY26.

To assess the impact of government spending on employment, we estimated spending multipliers and employment elasticities with respect to real GDP (Jha, 2009; PIDE, 2019; SBP, 2026). The results suggest that government spending has become increasingly less effective in generating employment over time, with fewer jobs generated for every one percent increase in spending. Consistent with the existing literature, development spending was found to be relatively more effective in generating jobs than current spending in Pakistan (**Table 4.1.1**). During 2000-25, results depict that a one percent increase in current and development expenditures may increase employment by 0.03 percent and 0.05 percent, respectively.

The Impact of 1 percent Increase in Government Spending on Employment **Table 4.1.1**

Scenario	1972-78	1978-87	1990-00	2000-10	2011-18	2000-18	2000-25
Elasticity and multiplier values							
a) Current spending multiplier	0.24	0.24	0.24	0.24	0.24	0.24	0.24
b) Development spending multiplier	0.42	0.42	0.42	0.42	0.42	0.42	0.42
c) Employment elasticity of growth	0.64	0.36	0.41	0.23	0.25	0.20	0.11
Impact on employment (percent)							
d) Current expenditure (a)*(c)	0.15	0.09	0.10	0.06	0.06	0.05	0.03
e) Development expenditure (b)*(c)	0.27	0.15	0.17	0.10	0.11	0.08	0.05

Source: SBP staff calculations

Conversely, to push employment by 1 percent, current and development expenditure should be increased by 17.0 percent and 12.0 percent, respectively. This suggests that development expenditure would likely be relatively more effective from an employment perspective. The results are consistent with the literature. For example, Antonopoulos et al. (2010) estimates that a US$ 50 billion investment in social care would generate around 1.2 million jobs, compared with 556,000 jobs from an equivalent investment in infrastructure construction, showcasing that the composition of spending is an important determinant of employment creation.

[48] Adjusting for reclassified short-term debt back into long term debt, the liquidity indicators reflect slight deterioration.

The results imply that the fiscal consolidation should be characterised with reduction in current expenditure rather than development expenditure for sustained employment generation in Pakistan.

**The contribution of Muhammad Musab Imran and Ali Ahmed Shah is acknowledged in writing this box.*

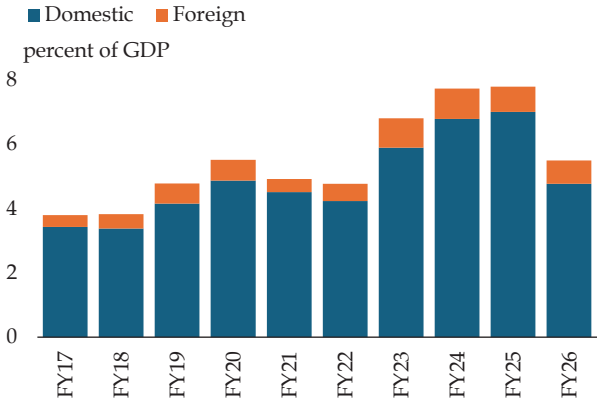
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Box 4.2: Expanding the Pool of Public Debt Instruments and Diversifying the Sources of Financing

Pakistan has navigated a challenging macroeconomic environment characterized by high inflation and a tight monetary policy stance in recent years. This has led to rising public debt servicing (**Figure 4.2.1**). Moreover, the share of variable rate bonds in government domestic securities rose to 61.0 percent by end of FY25, which raised sensitivity of government securities to changes in interest rates. The government heavily financed its budget deficit through the banking system—ranging from 74.0 percent to 99.9 percent of budgetary needs during the last two years i.e., FY24 to FY25. This concentration not only increased banks' balance sheet exposure to government but also squeezed space for expansion in private sector credit.

Trend in Debt Servicing Expenditure of Pakistan **Figure 4.2.1**



Source: MoF

To address these challenges, the government introduced specialised instruments designed to manage cash flow and diversify the funding sources. These are discussed below:

1. **Long-term Zero-Coupon Bonds:** The issuance of 2-year, 15-year zero-coupon Pakistan Investment Bonds (PIBs) and 10-year zero-coupon fixed-rate Sukuk allowed the government to defer interest and profit payments until the maturity. Since its introduction on May 29, 2025, the government has issued fixed rate-zero coupon Sukuk of around Rs 176 billion (realised value), while it raised Rs 678 billion and Rs 801 billion (realised amount) from fixed rate-zero coupon PIBs (2 and 10-year combined) in FY25 and FY26, respectively. These bonds offer an attractive avenue to long-term institutional investors, such as insurance companies and pension funds.

2. **Fixed Rate Ijarah Sukuk Issued at Discount:** These instruments offer a shariah-compliant alternative to treasury bills and are available up to 1-year tenors. From its first issuance in December 2023 till March 2026, these Sukuk were issued on Ijarah structure. However, from April 2026 onwards, these Sukuk are available on Hybrid Structure (Ijarah and Commodity Murabaha). The government mobilised Rs 826 billion (realised value) in FY26, compared to Rs 455 billion in FY25, which reflects the increasing acceptability of this instrument among market participants.[49]

[49] Detailed transaction structure is available at: https://www.psx.com.pk/psx/themes/psx/uploads/1-Year-Fixed-Rate-Discounted-GIS-Transaction-Structure-18-03-26.pdf and https://www.psx.com.pk/psx/themes/psx/uploads/3--6-Month-Short-term-GHS-Transaction-Structure-17-07-26.pdf

3. **Government Hybrid Sukuk:** The government launched the Government Hybrid Sukuk (GHS) on April 17, 2026. The GHS combines Murabaha (cost-plus-profit) and Ijarah (lease-based) structures. The GHS allows the government to leverage limited physical assets while accessing large-size funding and offers a sustainable financing instrument to manage debt. This instrument is also helpful for promotion of Shariah-compliant finance.

4. **Green Sukuk:** Combining shariah-compliant mechanism with environment, sustainability and governance (ESG) principles, the government issued its first Green Sukuk amounting to around Rs 32 billion on May 19, 2025, which received an overwhelming response from investors. Resources from these instruments aim at building resilience of the economy against climate and transition towards a green economy. Besides climate considerations, it is expected to help in promoting the Islamic capital market by targeting climate sensitive investors.

5. **Broadening the Investors' base via digital platforms:** A key pillar of the diversification strategy is the transition of "sophisticated investors" away from traditional bank deposits toward direct government securities. SBP launched a Web Portal named 'InvestPak', to digitise the process of investment in government securities for individuals and corporate customers, maintaining PKR accounts with banks.[50] On July 06, 2026, SBP formally launched the **"InvestPak"** a dedicated web portal and mobile application ecosystem to allow retail and corporate investors to invest directly in government securities.[51] To encourage this shift, effective August 1, 2026, SBP restricted the applicability of minimum deposit rate on saving deposits of individuals with balances under PKR 10 million.[52]

6. **Encouraging micro savings**: In late FY26, the government in collaboration with SBP and microfinance banks allowed digital wallet holders to invest in government securities. Customers having a digital wallet such as JazzCash can invest a minimum of Rs 5,000 in treasury bills. This effort represents an important step in broadening the investors' base of government securities and allowing retail investment in government securities.

7. **Re-entry into international capital markets:** Building on improved credit ratings in FY26 and August 2026, Pakistan successfully ended a four-year hiatus from international capital markets by issuing Eurobonds and first ever Panda Bonds and Eurobonds.[53] This is expected to diversify foreign currency borrowing and reinforce foreign exchange buffers against external shocks (**Chapter 5**).

8. **Global Medium-Term Note (GMTN) programme**: Pakistan launched an enhanced Global Medium-Term Note (GMTN) programme in May 2026 and in July 2026. The programme aims to broaden Pakistan's global investor base, optimise sovereign borrowing costs, and reinforce its long-term presence in international debt markets. In this regard, Pakistan has selected international bank consortium to lead a three-year tenure programme. The GMTN program would enable frequent international debt issuances over a multi-year horizon. The programme covers issuance of conventional Eurobonds, Islamic financing instruments, and PKR-denominated USD-settled bonds.

Implications: While the introduction of new debt instruments and diversification of financing sources are steps in the right direction, greater acceptability of these instruments would depend on financial literacy among public. Investing in government securities is different from traditional saving accounts. To make informed decisions, it is important for investors to understand various aspects of investing in government securities. Specifically small savers who are accustomed to plain vanilla and liquid saving products like a bank saving account, need to know that investing in government securities would lock the funds till their maturity. Further, adoption may vary across different demographic segments, geographically spread investor base within the country. The availability of Shariah-compliant products will be helpful in needs of faith-sensitive customers, particularly through the aggressive expansion of Shariah-compliant instruments like Government Ijarah Sukuk alongside conventional Treasury Bills.

[50] DMMD circular No. 08 of 2025
[51] Source: SBP formally launches InvestPak portal for investment in government securities, SBP press release dated July 06, 2026
[52] BPRD circular letter No 15 of 2026
[53] Pakistan issued Eurobonds amounting to US$ 750 million in April 2026 and Panda bonds of US$ 250 million in May 2026. Further, the government raised US$ 3 billion of dual tranche Eurobond on September 02, 2026.

Nonetheless, these initiatives are expected to reduce sovereign's reliance on commercial banks, thereby encouraging bank lending to private sector and improving price discovery in the secondary market. These developments are expected to reduce rollover risk for the issuer (the government) and reduce its cost of debt by increasing participation of retail investors. A coordinated operational alignment between the central bank, primary dealers, and mobile operators can permanently shift domestic household savings away from informal channels directly into national finance.

**The contribution of Amjad Ali is acknowledged in writing this box.*

Box 4.3: Pakistan's Prosumer Regulations 2026 – Global Precedent, Cross-Subsidy Reform, and Power Sector Implications

Pakistan's solar expansion over the past five years ranks among the fastest in the developing world,[54] driven by rising grid electricity tariffs and decline in solar panel prices, along with a favourable regulatory regime such as the Net Metering Regulations 2015. Under this regime, households with rooftop solar could offset electricity imports with exports to the national grid, with net exports effectively valued at the retail tariff. This policy (net metering) is desirable in situations when the distributed solar is at early stage of adoption.

However, as distributed solar capacity scaled to nearly 7,319 MW of registered net-metered capacity by March 2026,[55] it increased challenges for the power sector: it reduced grid purchases, while much of the tariff, including capacity payments, remained fixed. These fixed costs, transmission and distribution charges and capacity payments to power plants, were increasing burden on non-solar consumers and contributing to the cross-subsidy embedded in electricity tariffs. In response, the government introduced the Prosumer Regulations 2026, notified in February 2026,[56] replacing the one-to-one net-metering framework with a net-billing system under which new solar connections are compensated for exported electricity at a lower reference price. This box examines the policy reform in a global context, provides an indicative range of cross-subsidy reduction under different adoption-rate scenarios, and the parallel structural reforms without which the full benefit of the transition cannot be realised.

A mainstream global policy response. The transition from net-metering to net-billing is in line with the regulatory frameworks adopted by matured distributed solar markets worldwide. According to REN21 data, 116 policy instruments supporting distributed solar were active across 93 countries in 2024, with 11 countries already operating net billing frameworks and 6 having recently completed the transition from net metering: Jamaica, Latvia, Lithuania, Portugal, South Africa, and Spain. California's Net Energy Metering 3.0 (NEM 3.0), implemented in April 2023, is a particular case in point due to stark similarities with Pakistan's experience. Both markets experienced rapid solar penetration driven by rising electricity tariffs and falling panel prices; both reached a scale at which one-to-one net-metering cross-subsidy became financially unsustainable;[57] and both chose the same policy instrument of reducing export compensation from retail rate to avoided cost while grandfathering existing consumers.[58] This implied that the one-to-one regime was meant to be reoriented in a financially sustainable manner considering the scale of adoption.

Cross subsidy relief dimensions. The Prosumer Regulations 2026 reduced the export compensation, i.e. the differential between the old retail rate and the new reference price, applied to future exported generation volumes.

[54] According to BloombergNEF's Climatescope 2025, Pakistan is ranked one of the Asia Pacific's fastest-growing solar markets after adding around 13 GW of solar capacity in 2024, which accounts for roughly 11 percent of all new installations in emerging markets.
[55] Pakistan Economic Survey, 2025-26 (Chapter 14) available at https://www.finance.gov.pk/survey/chapter_26/14_Energy.pdf
[56] These were subsequently amended in April 2026 to provide transitional protection for existing net-metering agreements.
[57] California's Public Advocates Office estimated the annual cross-subsidy burden at US$ 8.5 billion by end-2022, up from US$ 3.4 billion in 2021. Pakistan reached a comparable threshold earlier than anticipated as NEPRA estimated an impact of Rs 101 billion in FY24 alone on just 4,500-5,000 MW of registered net-metered capacity.
[58] California's Public Utilities Commission (CPUC) replaced the retail-rate crediting mechanism with an Avoided Cost Calculator compensating exports at approximately US$ 0.08/kWh (down from around US$ 0.30/kWh under the old regime, and around 27 percent of the retail rate), while retaining full retail-rate billing for imported electricity, and grandfathering all existing contracts for 20 years. Pakistan's Prosumer Regulations 2026 mirror this architecture precisely with new consumers to receive a reference price resembling avoided cost (approximately 20 percent of the retail tariff at prevailing rates), while existing 2015 net-metering contracts are grandfathered until expiry, and imported electricity continues to be billed at full retail rates.

The scale of this reduction is scenario-dependent: across plausible ranges of new prosumer connections (4,000–8,000 MW per year)[59] and accounting for uncertainty in reference price evolution and self-consumption ratios, the yearly cross-subsidy reduction falls within a range of approximately 7.0 – 14.0 percent of total power sector subsidy in FY26 (**Table 4.3.1**).[60] It implies that the financial benefit of the reform could be reflected in lower tariffs for non-solar consumers, a reduction in the tariff differential subsidy, or slower accumulation of circular debt, rather than generating a direct revenue gain for the government.

Estimated Cross-Subsidy Savings **Table 4.3.1**

	Expected Yearly Impact
Assumed new capacity *(MW)*	4,000 - 8,000
Annual generation *(GWh)*	5,956 - 11,912
Exported units *(GWh, 30 percent)*	1,787 - 3,574
Annual savings = Difference b/w per unit cost under old (net-metering) and new (net-billing) rates *(billion Rupees)*	**71 - 143**
Saving as percent of Budgeted Power Subsidies (FY26 = *Rs 1,036 billion)*	7.0 – 14.0
Saving as percent of GDP *(FY26 GDP = Rs 126.4 trillion)*	0.06 - 0.11

Note: Numbers have been rounded off.
Source: SBP staff calculations

Required parallel structural reforms. The Prosumer Regulations 2026 addresses the cross-subsidy embedded in export compensation for new connections. However, the deeper structural vulnerabilities of Pakistan's power sector remain unaddressed. The design of regulations promotes consumers' self-consumption with minimal export to grid to maximise their financial return. The recent trend in battery imports reflects consumers are already working on viability of their solar investments. As a result, grid consumption may likely decline, requiring the tariffs to increase to meet fixed capacity payment obligations. This implies that tariff/subsidy relief produced by the reform may be offset depending upon the proportion of solar generation consumed on-site versus exported to the grid.

Sustainable distributed solar policy therefore requires a parallel structural reform agenda. This could involve renegotiating IPP contracts on performance-based frameworks and improving DISCOs' operational efficiency – without which the long-term financial viability of any prosumer compensation mechanism remains contingent on continued fiscal support.

** The contribution of Ravi Kumar is acknowledged in writing this box.*

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[59] The range is constructed around the net-metering uptake in FY26, with the lower bound (conservative) assumes (4,000 MW new connections per year), and upper bound (optimistic) assumes (8,000 MW/year), reflecting the possible policy effects in the wake of prosumer regulations 2026.

[60] Solar capacity factor is assumed at 17 percent, based on 4–5 peak Sun hours per day and consistent with NEPRA technical standards and AEDB solar resource data. The export ratio (share of generation exported to the grid versus self-consumed on-site) is assumed at 30 percent, based on NEPRA prosumer metering data.