

5

Balance of Payments

Pakistan's balance of payments position continued to strengthen. SBP's foreign exchange reserves increased further and comfortably surpassed the end-June 2026 target of US$18 billion. Moreover, SBP's swap and forward liabilities also came down significantly. The improvement in FX buffers was despite the current account posted a marginal deficit, as imports increased while exports declined. Nonetheless, robust workers' remittances nearly financed the deficits in goods and services trade and primary income accounts. In financial account, besides multilateral and bilateral inflows, the government also raised funds through issuances of Euro and Panda bonds. The overall macroeconomic stability supported Pakistan's successful return to international capital markets. These favourable developments supported SBP in build-up of foreign exchange reserves through significant FX purchases. The strong external position was also reflected in a slight appreciation of USD-PKR exchange rate during FY26.

Foreign Exchange Buffers

(FX reserves in billion US$, Import cover in number of months)



5 Balance of Payments

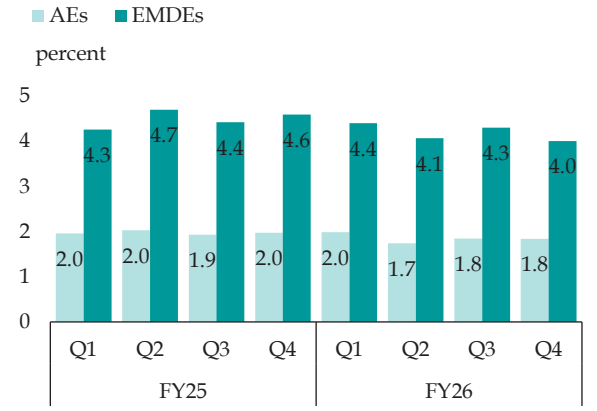
5.1 Global Economic Review

Global economic growth moderated in FY26 amid elevated economic policy uncertainty and the Middle East conflict **(Figure 5.1)**. The conflict caused supply chain disruptions, and raised energy prices, freight charges and insurance premiums. The resultant increase in production and transportation costs **(Figure 5.2)** translated into increased inflationary pressure, which forced central banks to remain cautious.

The economic impact of the conflict was uneven across advanced economies (AEs) and emerging and developing economies (EMDEs), depending on each economy's exposure to the conflict, geographic location, reliance on energy imports, and position in global technology value chain. The supply-chain disruptions led to cost-push inflation and dampened both consumer and business confidence, and moderated GDP growth. These effects were more pronounced in EMDEs,[1] while increase in technology-related capital spending supported growth in AEs.

Nonetheless, global trade volumes increased in FY26, as tariff-related uncertainties eased and

Real GDP Growth **Figure 5.1**

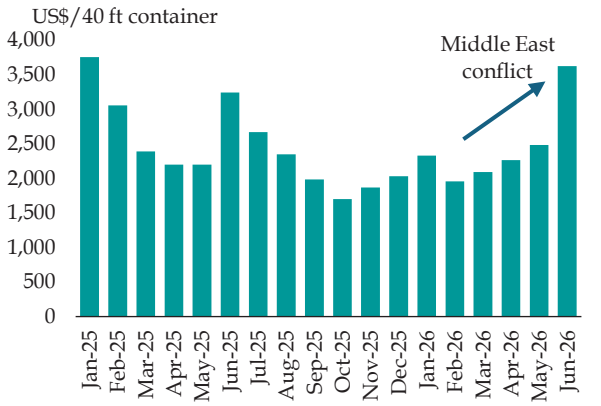


Source: IMF

economies gradually adapted to the changing trade policy landscape, supported in part by free trade agreements (FTAs) among major economies **(Figure 5.3)**.[2] Technology-intensive goods remained a key source of trade momentum.[3]

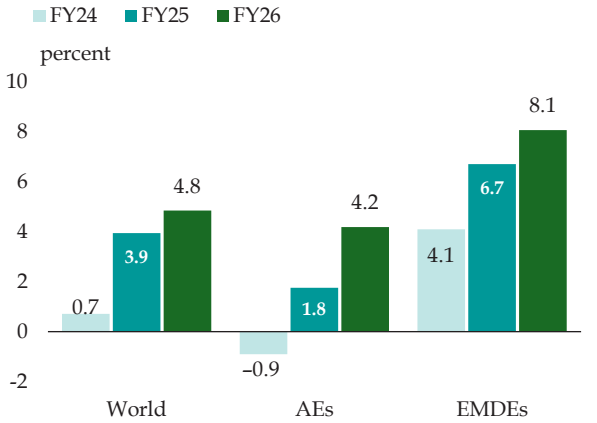
Energy prices, which had declined in H1-FY26, rose sharply as the conflict disrupted energy flows the most. Crude oil prices surged as the conflict intensified, with benchmark prices briefly rising above US$ 100 per barrel before moderating

Global Shipping Cost **Figure 5.2**



Source: Bloomberg

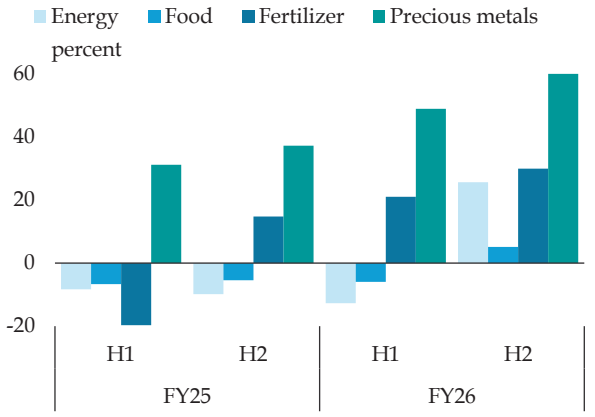
Global Trade Volumes **Figure 5.3**



Source: CPB World Trade Monitor

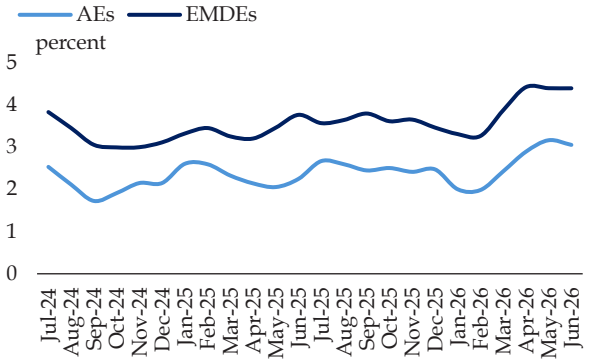
[1] IMF (2026). World Economic Outlook Update, July 2026, International Monetary Fund.
[2] New Zealand, UK, India, Switzerland, Norway, Iceland, and Liechtenstein entered in regional trade and partnership agreements.
[3] In Q1-CY26, global trade in semiconductors, batteries and electric vehicles increased by 25, 15 and 11 percent, respectively, while trade in ICT products rose by 14 percent; UNCTAD Global Trade Update (July/August 2026)

Global Commodity Prices **Figure 5.4**



Source: WB

Headline Inflation* **Figure 5.5**



* Median inflation of each group; the sample includes 30 AEs and 44 EMDEs.

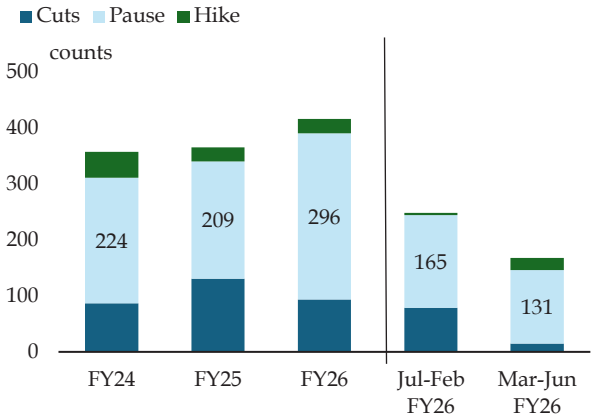
Source: Haver

towards the end of FY26. Natural gas prices also increased substantially following disruptions to Qatar LNG exports - roughly a fifth of the world's LNG supply.[4] The resulting increase in gas prices also put pressure on fertiliser prices, as Gulf economies are major producers and exporters of natural gas-based fertilisers, particularly urea and DAP.[5] Prices of precious metals, meanwhile, extended their earlier rally on the back of strong safe-haven demand **(Figure 5.4)**.

The energy shock posed a significant challenge to price stability across AEs and EMDEs owing to higher energy and input costs **(Figure 5.5)**. As a result, the pace of policy rate cuts slowed, with some central banks even raising the policy rates **(Figure 5.6)**.

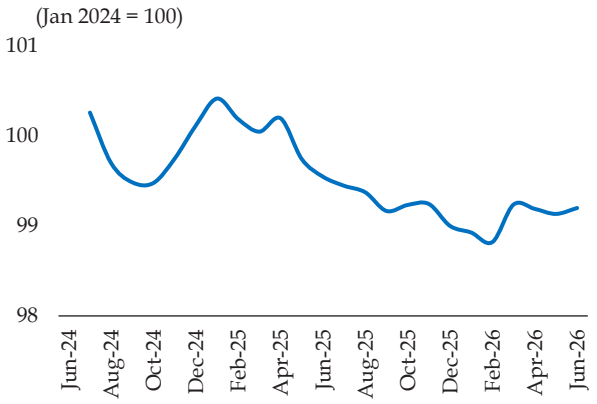
Consequently, the global financial conditions, which had been easing since January 2025, started to tighten from March 2026 onwards **(Figure 5.7)**. This, together with rise in inflation expectations, pushed up bond yields in major AEs. The financial conditions in EMDEs also tightened, leading to falling equity prices. While risk sentiment improved following the announcement of ceasefire in June 2026, they remained elevated relative to pre-conflict levels amid continued uncertainty. These developments are likely to

Changes in Central Banks' Policy Rates **Figure 5.6**



Sources: CB Websites; WIRP – Bloomberg

Global Financial Conditions Index **Figure 5.7**



Source: Bloomberg

[4] Qatar's exports accounted for approximately 18.7 percent of total global LNG trade in CY25, with the country exporting 81.5 million tons. Source: International Gas Union (IGU), World LNG Report 2026.

[5] Gulf region economies supplied 24.8 percent of global nitrogenous fertiliser exports and 11.4 percent of phosphatic fertiliser exports, Source: WTO Data Blog, July 2026.

affect the economic outcomes, as reflected in the latest projections by multilateral rating agencies.[6]

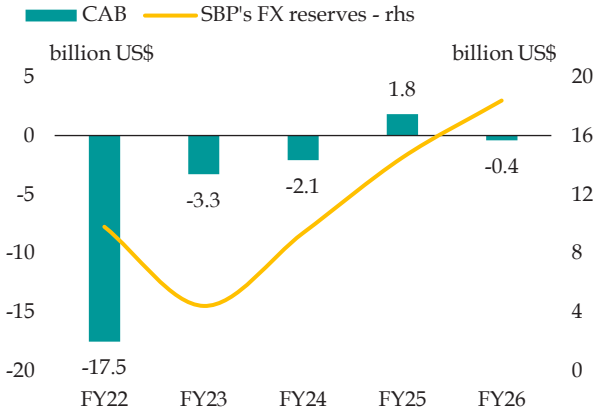
Expected slower global growth, increased inflationary pressures and tightened financial conditions specifically during Mar-Jun FY26 have implications for global economy, particularly for energy-importing economies like Pakistan. The emerging economies faced common pressures from higher import bills, elevated inflation, fiscal deficits, and higher borrowing costs.

5.2 Pakistan's Balance of Payments

Pakistan's external account remained resilient to energy price shock and trade disruptions stemming from the Middle East conflict. The overall balance of payments position strengthened further in FY26. This improvement reflected continued prudent macroeconomic policies, SBP's proactive FX purchases, and successful reviews under the IMF program. Moreover, workers' remittances remained strong, despite being vulnerable to the conflict as gulf region accounts for 54.2 percent of total remittance inflows. These, together with rising IT exports helped contain current account deficit (CAD) to 0.1 percent of GDP, close to the lower bound of its projected range of 0 – 1 percent of GDP.

It is worth highlighting that current account balance, excluding interest payments, remained in surplus. Moreover, the financial account also posted net inflows, supported by official multilateral and bilateral inflows, and investment in Naya Pakistan Certificates (NPCs), while other private inflows continued to remain subdued **(Table 5.1)**. The strengthened external position and improved macroeconomic conditions also helped Pakistan raise around US$ 1 billion through issuance of Eurobond and first ever

CAB and SBP's FX Reserves **Figure 5.8**



Source: SBP

issuance of Panda bond – as Pakistan re-entered global capital markets after four years.[7]

Supported by SBP's foreign exchange purchases and non-debt creating inflows, SBP reserves increased markedly from US$ 14.5 billion at end-FY25 to US$ 18.4 billion by end-FY26. In addition, SBP reduced its forward liabilities by US$ 1.6 billion to US$ 0.9 billion. Stronger external buffers considerably eased pressure on exchange rate.

5.3 Current Account Balance

The current account balance posted a marginal deficit of about US$ 391 million, as compared to a surplus of US$ 1.8 billion in FY25 **(Figure 5.8).** The deficit was mainly due to deterioration in trade in goods and services balance, while primary income deficit narrowed and surplus in secondary income account increased. The surplus in secondary income balance, primarily reflecting record workers' remittances, almost entirely financed the combined deficit in goods and services trade and primary income.

Trade in Goods[8]

Pakistan's merchandise trade deficit increased by US$ 7.2 billion to US$ 39.6 billion in FY26. This

[6] IMF (2026) World Economic Outlook Update, January and July 2026; and WB (2026). Global Economic Prospects, January and June 2026.

[7] Pakistan capitalised on its improved external position and credit ratings and entered Chinese bond market with first ever Panda bond to raise US$ 250 million. https://www.adb.org/news/adb-aiib-support-first-panda-bond-issuance-green-projects-pakistan

[8] This section is based on customs data reported by the Pakistan Bureau of Statistics (PBS). The PBS trade data would not tally with the payments record data, which is reported in Sections 5.2 and 5.4. For details on difference between these two data series, see Annexure on Data Explanatory Notes.

Pakistan's Balance of Payments **Table 5.1**

million US$

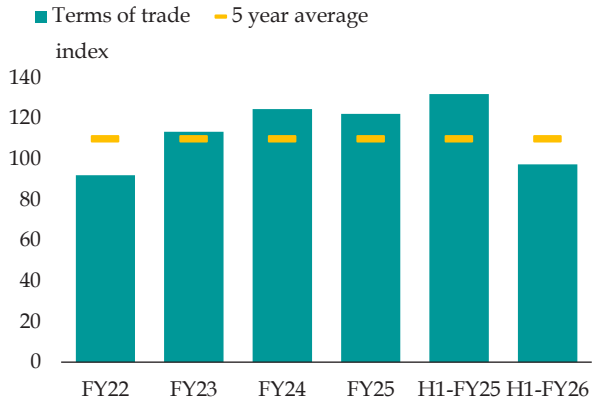
	FY24	FY25	FY26
Current account balance	**-2,072**	**1,838**	**-391**
Balance on trade in goods	**-22,177**	**-26,803**	**-33,691**
Exports (FOB)	30,980	32,343	30,836
Imports (FOB)	53,157	59,146	64,527
Balance on trade in services	**-3,110**	**-2,836**	**-1,891**
Exports of services	7,691	8,450	10,047
o/w ICT exports	3,223	3,814	4,600
Imports of services	10,801	11,286	11,938
Balance on primary income	**-8,986**	**-8,838**	**-8,497**
Profit & dividends	2,215	2,220	2,305
Balance on secondary income	**32,201**	**40,315**	**43,688**
o/w Workers' remittances	30,251	38,300	41,585
Capital account balance	**195**	**168**	**131**
Financial account balance*	**-5,370**	**-1,585**	**-2,029**
Direct investment (net)*^	-2,126	-2,462	-1,450
Portfolio investment (net)*	376	720	1,176
Other investment*	-3,610	159	-1,770
Build-up in FX assets abroad*	-381	82	388
FX loans & liabilities	3,229	-77	2,158
Central bank	999	0	-3,455
Banks	715	-1,536	1,061
General government	1,565	2,346	5,220
Disbursements	6,044	9,544	8,556
Amortisation	6,727	7643	6,823
Other liabilities (net)	2,248	445	3,487
Other sectors	-50	-887	-668
Disbursements	2,419	688	1,094
Amortisation	1,905	1,689	1,688
Net errors and omissions	**-631**	**153**	**65**
Overall balance	**-2,862**	**-3,744**	**-1,834**
SBP's liquid FX reserves (end-period)	**9,390**	**14,506**	**18,378**

*as per BPM6, negative sign means net FX inflow into Pakistan and vice versa; ^FDI (net) = net FDI inflows - net FDI outflows

Source: SBP

widening in trade deficit is attributed to deterioration in terms of trade, a sharp rise in merchandise imports amid a pick-up in domestic demand and national tariff rationalisation, and a decline in exports (**Figure 5.9**).

Pakistan's Terms of Trade (2017-18 = 100) **Figure 5.9**

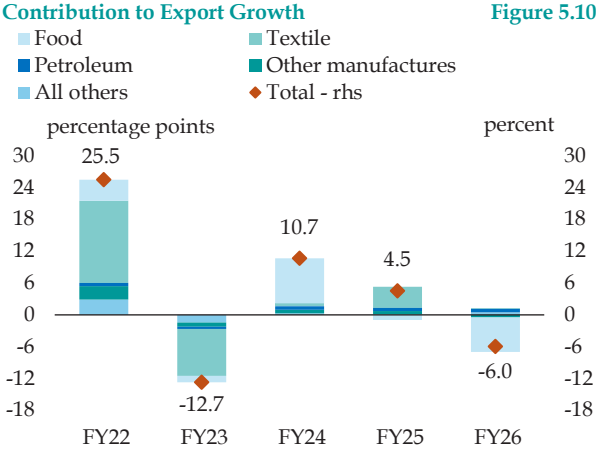


Source: PBS

Exports

Exports declined by 6.0 percent, primarily due to non-textile exports, particularly food and other manufactures, while textile exports recorded a marginal increase (**Figure 5.10).** Moreover, negative volume effect dominated across major commodities, particularly rice, that indicate lower demand for Pakistani exports **(Figure 5.11)**.

Contribution to Export Growth **Figure 5.10**



Source: PBS

Furthermore, US reciprocal tariffs and supply chain disruptions due to geopolitical tensions in the Middle East and closure of western borders also exerted pressure on export volumes. Domestic factors may also have weighed on exports by raising production costs. These include: i) elevated energy costs due to levy on gas supply to off grid captive power plants;[9] and ii) change in taxation from final to normal tax regime that affected operating margin and cash flows of exporters.[10,11]

The subdued performance of exports also highlights structural weaknesses, especially lack of product and market diversification, low research and development, energy and infrastructure bottlenecks, anti-export bias, quality controls and limited integration into global value chain. As a result, Pakistan's rank on ECI remains low, reflecting that the country's export basket comprises of less sophisticated products compared to regional peers **(Figure 5.12)**.

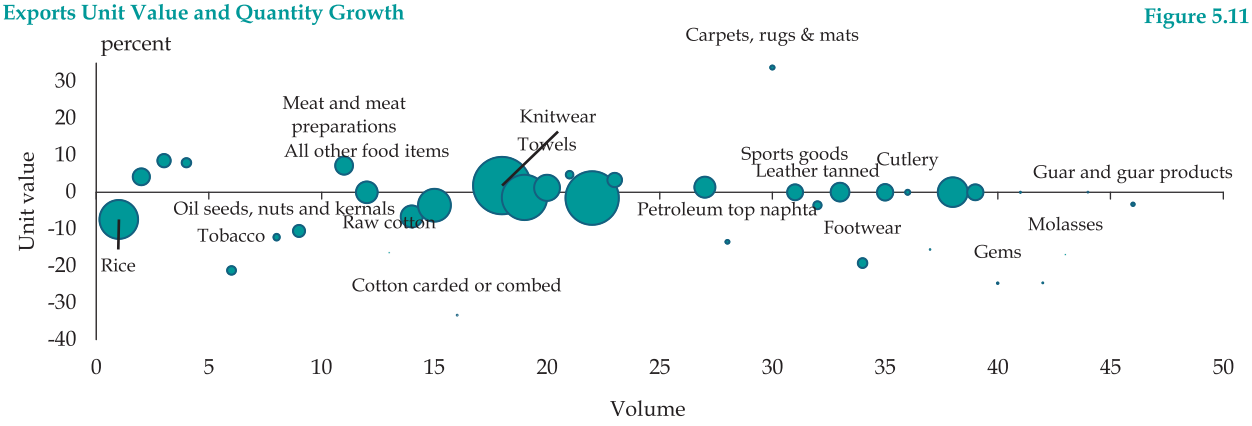
Food

Food exports declined for the second consecutive year, falling further to US$ 5.0 billion in FY26 from US$ 7.1 billion in FY25. About half of this decline was due to rice. Moreover, exports of oil seeds, nuts and vegetables also witnessed a significant decline (**Table 5.2**).

Rice exports fell sharply in FY26, due to intensified competition in global markets

Pakistan's rice exports fell to US$ 2.3 billion in FY26 from US$ 3.4 billion last year. This decline in rice exports is primarily attributed to record high global production of 546 MMT that created glut in

Exports Unit Value and Quantity Growth **Figure 5.11**



Note: size of bubble shows share of commodity in total exports

Sources: PBS; SBP staff calculations

[9] The levy on gas supplied to off-grid captive plants rose from Rs 1,243 to Rs 1,406 per MMBtu, a 15 percent increase, under the Off-Grid Captive Power Plants Levy Act 2025. Textile sector consumes 28 percent of industrial electricity consumption and 29 percent of industrial gas consumption. Due to unreliable grid supplied electricity, a considerable share of the electricity demand for textile manufacturing is met through captive generation in large textile mills. Source: World bank, Textile Sector: Energy Efficiency and Decarbonisation (EE&D) Opportunities (August 2025).

[10] Effective from July 2025, exporters have to pay a minimum advance tax irrespective of profitability. This change resulted into higher tax collection in FY26 despite declining exports, implying that the effective tax rate on exporters has increased.

[11] SBP's business confidence survey suggests that capacity utilisation of exporting sectors remained significantly lower during FY25 and FY26 compared to the historic average. Source: SBP staff calculation based on PBS.

Pakistan's Merchandise Exports **Table 5.2**

million US$

	Value		Change (FY26)		Volume Effect	Price Effect
	FY25	FY26	Absolute	Percent		
Exports	**32,130.0**	**30,130.1**	**1,910.3**	**-6.0**	-	-
Textile, *of which*	**17,887.0**	**17,932.3**	**45.3**	**0.3**	-	-
Apparel	9,139.0	9,253.9	115.0	1.3	23.8	91.2
Home textile	4,195.5	4,174.2	-21.3	-0.5	11.2	-32.5
Cotton yarn	680.7	765.1	84.4	12.4	138.5	-54.0
Non-textile, *of which*	**14,153.3**	**12,197.7**	**-1,955.6**	**-13.8**	-	-
Rice	3,353.0	2,291.7	-1,061.3	-31.7	-877.1	-184.2
Basmati	830.6	843.2	12.6	1.5	-13.8	26.4
Others	2,522.5	1,448.6	-1,073.9	-42.6	-759.5	-314.4
Meat	495.1	530.2	35.1	7.1	9.8	25.3
Vegetables	367.6	162.8	-204.8	-55.7	-216.9	12.1
Oil seeds	384.6	260.5	-124.0	-32.3	-92.5	-31.6
Petroleum products	463.6	718.2	254.6	54.9	212.7	41.9
Pharmaceutical	465.2	319.0	-146.2	-31.4	-119.9	-26.3
Footballs	229.8	256.7	26.9	11.7	32.2	-5.4
Cement	318.9	343.2	24.3	7.6	-13.0	37.3

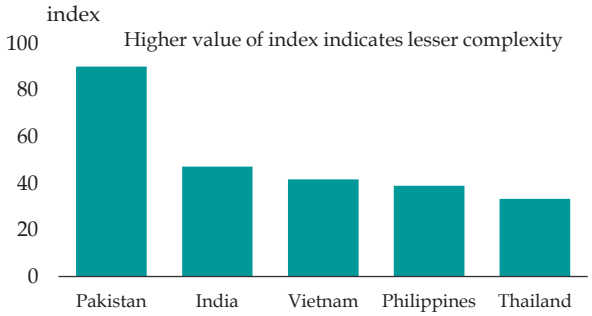
Source: PBS

the global market. Moreover, India, the biggest producer with global share of 28 percent, reentered the global market with increased supply to recapture its share in global rice exports, particularly non-basmati rice.[12] As a result, benchmark rice prices decreased by 19.7 percent in FY26 **(Figure 5.13).**

Basmati rice exports increased by 1.5 percent in FY26, mainly driven by price effect that more than offset the negative volume effect. The exports recovered towards the end of FY26, which coincided with the government's Drawback of Local Taxes and Levies (DLTL) scheme.[13]

Country-wise analysis of the market loss suggests that decline in rice exports was mostly concentrated in Indonesia and Philippines due to their policies of attaining domestic self-sufficiency.[14] Moreover, Pakistani non-basmati rice - low to medium grade broken rice - partly lost markets such as the UK, Saudi Arabia, Oman and some African countries to India and China **(Figure 5.14)**.

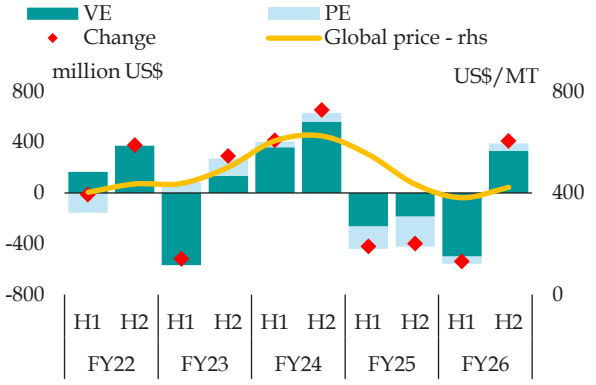
Economic Complexity Ranking of Exports Basket (Average 2020-2024) **Figure 5.12**



Note: the economic complexity of a country is calculated based on the diversity of exports a country produces and their ubiquity, or the number of the countries able to produce them.

Source: The Atlas of Economic Complexity

Change in Rice Exports **Figure 5.13**



Note: VE: volume effect; PE: price effect

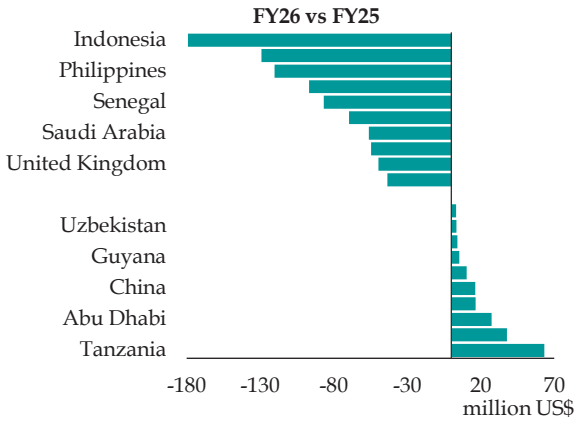
Sources: PBS; SBP staff calculations

[12] USDA and S&P global

[13] Under this scheme GoP provided a tax rebate of up to 9 percent for basmati and higher quality rice, and 3 percent for lower quality rice. GoP also removed the ceiling cap price of US$ 1,275 per ton FOB to support the exporters under the DLTL scheme.

[14] Indonesia and Philippines banned imports of rice to support the domestic produce.

Pakistan's Rice Exports: Markets Lost vs Gained **Figure 5.14**



Source: SBP

Exports of other major food commodities – oil seeds, vegetable, and nuts – also declined due to supply chain disruptions and production related losses. Among these, exports of oil seed decreased by 32 percent in FY26, driven by decline in export of sesame seed to China. This was because of re-entry of the major international players, Ethiopia and Sudan, as well as reduction in domestic production due to shifting of acreage towards major crops.[15]

The decline in exports of vegetables by 55.7 percent was mainly due to onions and potatoes owing to lower global prices. Onions and potatoes lost their major markets - Malaysia, Sri Lanka and GCC countries – due to excess supply of the cheaper Indian onions and trade disruptions. Moreover, the closure of Afghanistan border also affected exports to Afghanistan and Central Asian markets.[16]

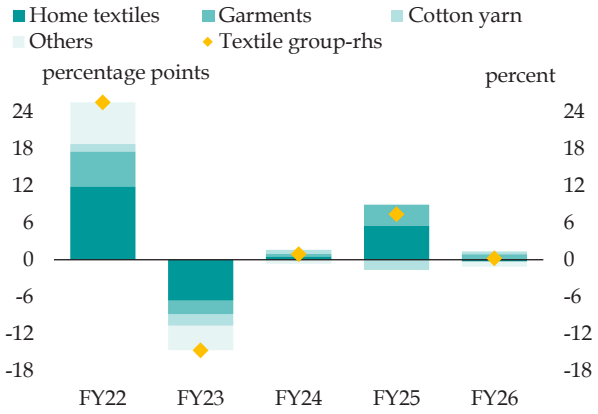
Textile

Textile exports grew marginally by 0.3 percent in FY26 as gains from apparel, particularly readymade garments, cotton yarn and other textile materials were partially offset by decline in exports of cotton cloth, knitwear and towels **(Figure 5.15).** Apparel exports increased by 1.3 percent in FY26, led by readymade garments. This largely reflected price effect, while volumes decreased due to removal of tariff differential benefit, elevated energy cost and change in tax regime. These factors compressed the exporters' margins and scope of competitive pricing. Home textile exports witnessed a marginal decline of 0.5 percent in FY26. Within the category, exports of towels declined owing to lower volumes, while bedwear exports remained flat, with volume and price effects offsetting each other. The weak performance of home textile exports is attributed to at least three factors: (i) demand softened from US; (ii) increase in production costs following the rise in energy prices stemming from the captive power gas levy; and (iii) higher insurance and freight costs.

Pakistan retained its share in its two largest markets for textile products, US and EU. Pakistan's share in US textile imports slightly improved, mainly due to a significantly higher decline in overall US imports of textiles **(Table 5.3).** While Pakistan's textile export volume to EU increased by 0.9 percent, the unit values declined by 8.2 percent, which was the sharper than the decline recorded for peer countries. In this context, the recent India-EU free trade agreement (FTA) could have significant implications for Pakistan's textiles exports to EU **(Box 5.1)**.

Cotton yarn exports increased by 12.4 percent to US$ 765 million in FY26. The growth was mainly

Contribution to Textile Exports **Figure 5.15**



Source: PBS

[15] Oilseed production in Pakistan decreased by around 6 percent to 2.75 million metric tons in FY26. Source: USDA (2026) Oilseeds and Products Annual, April 2026 and PBS.
[16] MNFSR (2026). Pakistan Food Group Trade Performance Review 2024-25 vs 2025-26.

Textile Imports by US and EU for the Period FY25 vs FY26 **Table 5.3**

US Imports

Country	Unit Value (US$/ square meter)			Volume (million square meter)		
	FY25	FY26	Percent change	FY25	FY26	Percent change
Bangladesh	2.8	2.8	-3.1	1,343	1,335	-0.6
Cambodia	2.8	2.6	-6.5	931	1,081	16.2
India	0.7	0.8	23.3	7,761	4,767	-38.6
Pakistan	1.2	1.1	-5.0	1,698	1,650	-2.8
Vietnam	2.5	2.3	-7.2	3,518	3,638	3.4
World	**1.0**	**1.0**	**1.6**	**54,685**	**44,882**	**-17.9**

EU Imports

Country	Unit Value (EUR/kg)			Volume ('000 tonnes)		
	FY25	FY26	Percent change	FY25	FY26	Percent change
Bangladesh	14.4	13.1	-9.3	1,308	1,274	-2.6
China	12.9	11.9	-7.9	2,492	2,653	6.5
India	9.6	8.5	-11.7	556	587	5.5
Cambodia	17.2	16.7	-3.0	238	243	2.
Pakistan	8.5	7.8	-8.2	661	667	0.9
Vietnam	17.1	17.7	3.1	256	255	-0.4
World	**12.5**	**11.8**	**-5.1**	**4,950**	**5,056**	**2.1**

Sources: Otexa; Eurostat

volume driven as shipments increased by 20.3 percent in the year. Cotton yarn exporters focused on external markets because of weaker demand from domestic apparel and home textile manufacturers, who shifted towards imported yarn.[17]

Other Manufactures

Exports of other manufactures recorded a decline of 3.7 percent in FY26, led by pharmaceuticals and plastic products. The decline in exports of pharmaceuticals was driven by both lower prices and volume. The decline in the latter is partly attributed to the closure of western border.[18] Among other exports, sports goods and cement showed improvement. Specifically, football exports increased by 11.7 percent to US$ 257 million in FY26, coinciding with the run-up to Football World Cup held in June 2026.

Cement exports also increased by 7.6 percent in FY26, mainly owing to significant rise in unit value as shipments declined. After the closure of western border since September 2025 and loss of biggest market, Afghanistan, Pakistani cement exporters focused on African and Gulf markets.

Petroleum Group and Coal

Petroleum exports witnessed a sharp increase, driven by petroleum products excluding naphtha, which increased by 54.8 percent and was supported by both volume and price effects. The government's decision to increase petroleum and climate support levies coupled with change in power generation mix and austerity measures implemented in Q4-FY26 reduced domestic demand. Moreover, higher refining output led to surplus, prompting refineries to higher export of petroleum products.[19, 20]

Imports

Imports maintained their upward trajectory in FY26 amid pick-up in economic activity and national tariff rationalisation. Nonetheless, import growth ticked to 8.1 percent from 7.7 percent witnessed in FY25. However, the import growth was broad-based, with all groups recording higher import values, except for textiles (**Table 5.4**).

The import growth in FY26 was mainly driven by non-energy groups, particularly intermediate goods, reflecting the pickup in domestic economic

[17] APTMA

[18] Afghan authorities announced a ban on pharmaceutical goods imports from Pakistan in November 2025 and stopped customs to process after February 9, 2026.

[19] Finance Act 2025 and Petroleum Products (Petroleum Levy) and Climate Support Levy Ordinance, 1961.

[20] In FY26 the refinery production of energy products increased by more than 11 percent to 11.7 MMT. Source: OCAC

Pakistan's Merchandise Imports **Table 5.4**

million US$

	Value		Change (FY26)		Volume Effect	Price Effect
	FY25	FY26	Absolute	Percent		
Imports	**64,507**	**69,728**	**5,221**	**8.1**	-	-
Food, *of which*	**8,195**	**9,151**	**955**	**11.7**	-	-
Palm oil	3,393	3,786	393	11.6	284	108
Sugar	4	175	171	-	-	-
All other food items	2,287	3,012	725	31.7	-	-
Energy, *of which*	**15,943**	**16,863**	**920**	**5.8**	-	-
POL	5,964	6,386	422	7.1	-29	449
Crude	5,446	7,166	1,720	31.6	696	1,024
LNG	3,476	2,221	-1,255	-36.1	-	-
LPG	1,055	1,089	34	3.2	-	-
Machinery, *of which*	**10,307**	**10,920**	**613**	**5.9**	-	-
Electrical	3,898	2,919	-979	-25.1	-	-
Textile	526	581	55	10.5	-	-
Power generating	689	797	108	15.7	-	-
Telecom	2,102	2,690	588	28.0	-	-
Textile, *of which*	**7,356**	**6,462**	**-894**	**-12.2**	-	-
Raw cotton	2,693	1,528	-1,165	-43.3	-615	-550
Other textile items	2,972	3,154	183	6.1	-	-
Agro chemical, *of which*	**9,644**	**10,324**	**680**	**7.1**	-	-
Plastic material	2,627	2,863	236	9.0	429	-193
Medicinal products	1,205	1,351	146	12.1	450	-304
Transport, *of which*	**2,443**	**4,084**	**1,640**	**67.1**	-	-
CBU	393	673	280	71.3	-	-
CKD/SKD	1,591	2,785	1,194	75.1	-	-
Metal, *of which*	**5,631**	**6,310**	680	12.1	-	-
Iron and steel	2,297	2,605	308	13.4	629	-321

Source: PBS

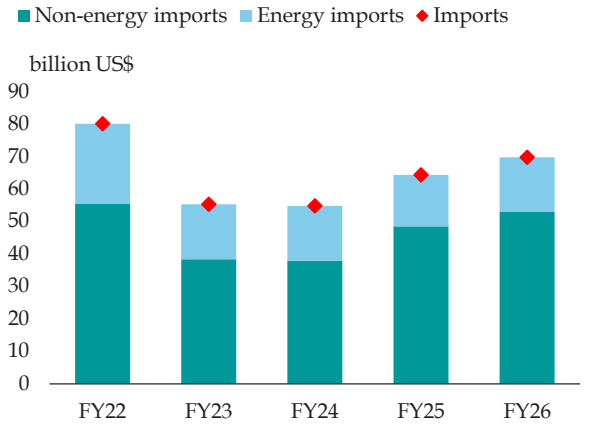
activity. Energy imports increased in Q4-FY26 driven by higher international energy prices, though the impact was partially offset by lower import volumes resulting from government's austerity measures. In contrast, the non-energy imports rose, with non-food non-energy imports increasing to US$ 44 billion (**Figure 5.16**).

The composition of non-energy imports also shifted notably, as import of transport group rose sharply, while import of textiles declined (**Figure 5.17**). Moreover, tariff rationalisation under the National Tariff Policy 2025-2030 also influenced the pattern of imports by changing the relative incentives across products and sectors in FY26.[21]

Food

Food imports increased by 11.7 percent to US$ 9.2 billion during FY26, primarily driven by palm oil and '*all other food items*'.[22] Palm oil import rose owing to both higher prices and volumes, while import of soybean oil declined mainly due to lower volumes.

Merchandise Imports **Figure 5.16**

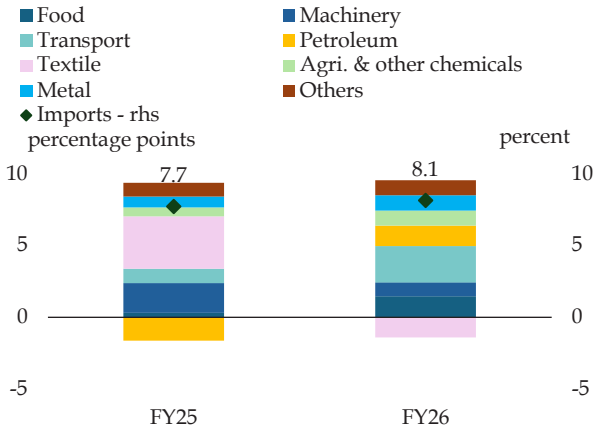


Source: PBS

[21] In Federal Budget 2025-26, the custom duty was reduced from 11.9 to 11.3 percent, additional custom duty from 3.7 percent to 1.8 percent and regulatory duty from 4.6 to 3.7 percent. For more details on national tariff rationalisation impact on different sectors, see Chapter 5 of H1-FY26 State of Economy Report, State Bank of Pakistan

[22] All other food items constitute around 33 percent of the total food imports. All other food items include different seeds, premium fruits, formula milk, inputs such as preservative and emulsifiers for processed food.

Contribution to Import Growth **Figure 5.17**



Source: PBS

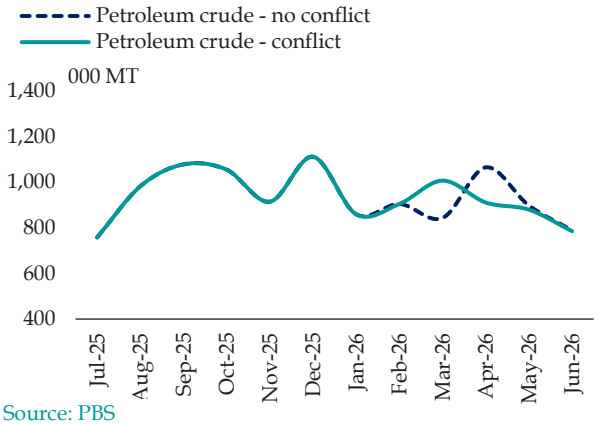
Global palm oil prices remained elevated as higher crude oil prices strengthened the demand for palm oil as a biodiesel feedstock. In addition, the rising prices of competing vegetable oils[23] and relatively tight global supply conditions reinforced the upward pressure on palm oil prices.[24] On the domestic front, import volumes expanded to meet growing demand from vanaspati ghee, cooking oil, bakery fats, feed and processed food industries.

Imports of '*all other food items*' increased, with higher import of oil seeds as National Biosafety Committee allowed import of genetically modified seeds. Moreover, lower domestic production also drove higher import of oilseeds.[25] Soyabean seeds dominated the oilseed imports as custom duty on soyabean seeds was reduced to 'zero' in FY26. The increase in seed imports also reflects rising demand from the edible oil crushing and livestock feed industries. Meanwhile, higher imports of premium edible oils and fruits (apples, grapes, dates and apricots) suggest increasing consumer demand for high value food products.

Energy

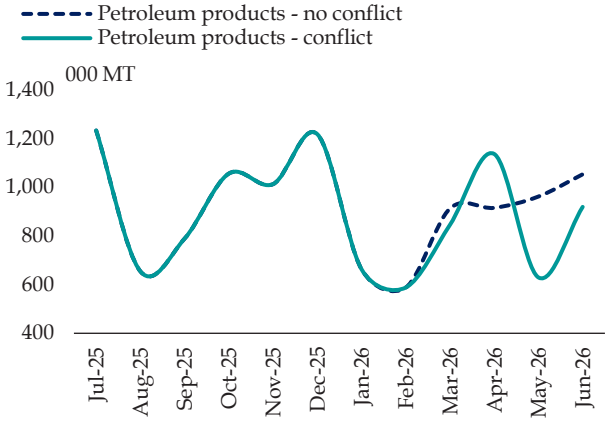
Energy imports increased across all categories, except LNG, primarily reflecting a spike in international prices.[26] While the impact of higher prices was partly offset by a decline in import volumes of petroleum products amid the ongoing conflict in the Middle East, crude oil import volumes remained relatively steady (**Figure 5.18a and b**). The counterfactual analysis[27] of prices and import volumes of crude and petroleum products shows that the Middle East conflict (Mar-June 2026) affected the energy import bill primarily

Impact of Conflict on Import Volume of Petroleum Crude **Figure 5.18a**



Source: PBS

Impact of Conflict on Import Volume of Petroleum Products **Figure 5.18b**



[23] Based on Jul-May HS-8 level PBS data, unit price of palm oil imported by Pakistan was around US$ 1.09/kg, soyabean oil (US$ 1.2/kg), sunflower oil (US$ 1.3/kg), vegetable oil (US$ 2.3/kg), margarin oil (US$ 2.5/kg), and virgin oil (US$ 3.6/kg)

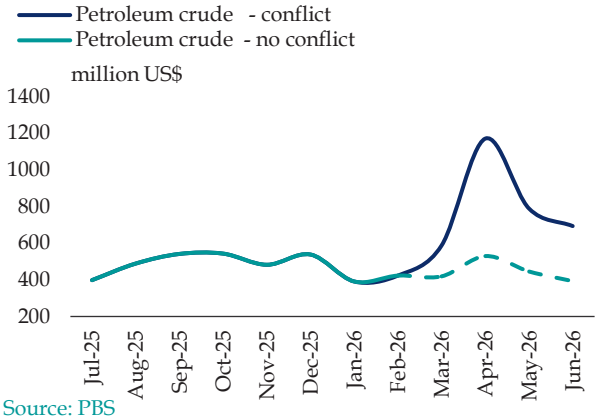
[24] Indonesia's finance ministry raised the country's crude palm oil export levy to 12.5 percent on March 1, 2026, from 10 percent. As a result, Indonesia's total export tax and levy on CPO rose to US$ 241.36/mt from US$ 165.85/mt. (Source: S&P Global) Moreover, Indonesia's B35-B40 biodiesel mandates are expected to consume more of its domestic supply, limiting export availability.

[25] Oilseeds and Products Update 2026, US Department of Agriculture, Foreign Agriculture Service.

[26] As per World Bank, average price of brent increased from US$ 74.6 in FY25 to US$ 79.4 in FY26.

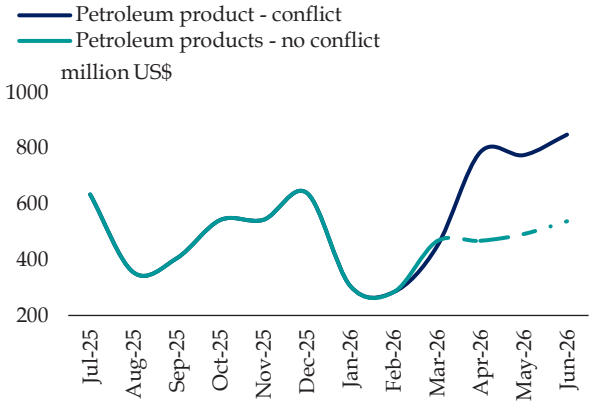
[27] For counter factual analysis, in Figure 5.18a&b, the reference volumes were assumed at the level of same month last year. While in Figure 5.19a&b, the unit value for Mar-Jun 2026 were replaced with average of Jul-2025 to Feb-2026.

Impact of Conflict on Import Value of Petroleum Crude **Figure 5.19a**



Source: PBS

Impact of Conflict on Import Value of Petroleum Products **Figure 5.19b**



through higher prices, while changes in import volumes were negligible (**Figure 5.19a and b)**.[28] Overall, in FY26, higher crude imports also reflected higher refinery throughput.[29]

In contrast, the imports of LNG declined in FY26, primarily due to lower demand for imported gas, particularly from the power sector. The continued reliance on lower-cost generation sources, including coal, RFO and rapidly expanding rooftop solar, reduced LNG use in power generation (**Figure 5.20**).

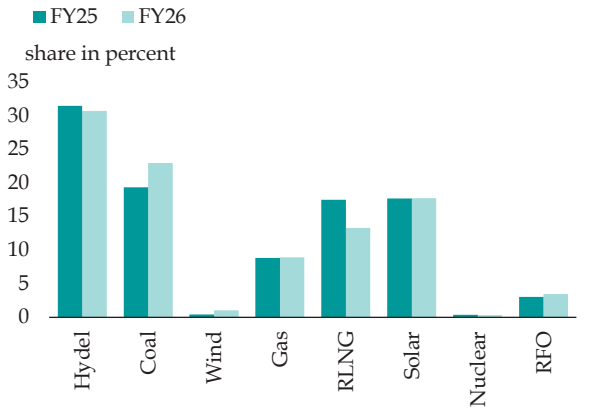
Lower industrial demand and deferral of surplus contracted LNG cargoes contributed to the decline in LNG imports, even though the average international RLNG price was lower during the year.[30] Moreover, the expansion of rooftop solar has begun to moderate Pakistan's dependence on imported fuels, with estimated annual savings of around US$ 4.5 – 5.5 billion in FY26 (**Table 5.5**). This may also have contributed to contain country's energy import bill during the last few years.

Declining global cotton prices trimmed the textile import bill

The decline in textile imports reflected the combined impact of lower prices and reduced import volumes. The price effect was mainly driven by lower international cotton prices, while the decline in volumes was partly attributable to a shift towards synthetic fiber and yarn as inputs, in line with increasing demand for man-made fiber (MMF) based garments.

In addition, the imposition of 18 percent sales tax on imported cotton may have encouraged greater reliance on domestically produced cotton, while the corresponding tax on domestically produced cotton has incentivised underreporting of ginned cotton.[31]

Energy Generation by Source **Figure 5.20**



Source: NEPRA

[28] As per SBP staff calculation, the price effect was dominant during the conflict period.
[29] As per OCAC data.
[30] The average RLNG price was US$9.13 per mmbtu in FY25 and US$8.38 per mmbtu in FY26. The disruption to LNG supplies from Qatar during the Middle East conflict, increased uncertainty in supply availability, which temporarily increased the spot prices for replacement cargoes.
[31] USDA (2025). Cotton and Products Update, United States Department of Agriculture.

Import Savings Due to Solarisation – FY26 **Table 5.5**

	Methodology/Calculation	FY26 Estimate
Installed solar capacity (FY2025) *	Pakistan Electricity Review Report	38GW
Installed solar capacity (March 2026) *	Pakistan Electricity Review Report	51GW
Average installed and operational capacity (FY26)^	(38 + 51)/2	44.5GW
Capacity Factor**	Assumed	17- 20 percent
Annual solar electricity generation	44.5* 8760 hours * (17-20)	66 - 78 TWh
Weighted average fuel cost of displaced generation****	RLNG (Rs 34/KWh), Coal (Rs 16/KWh) and RFO (Rs 58/KWh)	Rs 24.9/KWh
Estimated annual energy import savings	77.964 billion kWh × Rs 24.9/kWh	Rs 1,649.99 - 1,941.3 billion
Estimated Total Annual Energy Import Savings* **	Average exchange Rate, Rs 281	US$ 5.9 - 6.9 billion
Estimated Total Annual Import Savings Net of Imports of Solar Panels, Batteries, Inverters^	Solar panel (US$ 819 million) + Batteries (US$ 254 million) + Solar Inverters (US$ 344 million)	US$ 4.5 - 5.5 billion

Note: *values of estimated distributed solar deployment is taken from Pakistan electricity review report 2026
**average of last 5 years capacity factors taken from Pakistan electricity review report 2026. Solar capacity utilisation factor remains resource-driven, bounded solar irradiance, weather impact, reflecting daytime generation.
***it may be noted that reflecting ongoing solarisation drive, import of solar panels and solar-related components (inverters, batteries, etc.) recorded at around US$1.4 billion in FY26 which is reflected in machinery import bill.
**** weighted average of RLNG, Coal and RFO based on recent shares in the generation mix
^as per PBS HS 8 latest available data.
Sources: SBP staff estimates based on PBS HS 8 import data; Pakistan electricity review report; performance evaluation reports of operational power plants NEPRA; China's Solar PV Exports | Ember, Shedding light on Pakistan's distributed solar revolution

Modernisation and capacity expansion underpinned higher machinery imports

Import of machinery registered a broad-based increase across most segments, except for electrical machinery. Import of electrical machinery declined primarily due to falling solar panel prices; though Q4-FY26 witnessed some upward price adjustment, it was partially offset by the decline in the import volume of solar panels in FY26. This decline reflects a slowdown in the pace of capacity additions following the exceptionally strong growth in recent years and, to a certain extent, a response to the prosumer's regulation issued in February 2026. However, imports of lithium-ion batteries have risen rather sharply, reflecting second phase of solarisation where consumers are adding battery storage.

The increase in office machinery import reflects ongoing digitalisation, IT modernisation and capacity expansion, while the rise in agricultural machinery imports was on the back of provincial government's initiatives aimed at promoting farm mechanisation (**Chapter 2**).[32] Similarly, higher infrastructure requirements, driven by network fiberisation, rising international bandwidth capacity, and the forthcoming 5G spectrum rollout, supported growth in telecom equipment imports.[33]

Imports of transport group increased significantly

The increase in imports of transport group broadly mirrors trends in domestic production and sales of automobiles amid tariff rationalisation. The increase was mostly concentrated in CKD motor cars, which grew by around 96.8 percent to US$ 2.2 billion in FY26. Similarly, import of CBU cars increased by 32.0 percent to US$ 367 million. A relatively slower growth in import of CBU compared to CKD cars suggests that the increase in motor cars imports was driven by factors other than tariff, including a recovery in domestic demand and the introduction of new models with enhanced quality and advanced features.

FY26 also marked a notable transition in Pakistan's automotive, with investment and market activity increasingly shifting towards new energy vehicles (NEVs) alongside conventional

[32] Agriculture department of South Punjab. https://agriculturesouthpunjab.gop.pk/punjab-green-tractor-scheme-phase-3/; CM Punjab Hi-Tech Farm Mechanisation Financing program, https://cmhightech.punjab.gov.pk/
[33] Fibersation of network sites increased, while installed international bandwidth reached 17.2 Tbps, and total data usage climbed to 27,727 petabytes. Source: Pakistan Telecommunication Authority, Annual Report 2025.

Trade in Services **Table 5.6**

million US$

	Import (M)			Export (X)			Balance (X-M)		
	FY25	FY26	Change	FY25	FY26	Change	FY25	FY26	Change
a) Transport	**4,699.1**	**5,002.9**	**303.8**	**995.4**	**1,233.4**	**238.0**	**-3,703.7**	**-3,769.5**	**-65.8**
Sea freight	2,268.7	2,527.1	258.4	93.0	118.5	25.5	-2,175.7	-2,408.6	-232.9
Air passengers	1,410.0	1,529.6	119.6	404.8	398	-6.8	-1,005.2	-1,131.6	-126.4
Air freight	34.3	47.4	13.1	28.5	55.9	27.4	-5.8	8.5	14.3
b) Travel	**2,405.8**	**2,887.7**	**481.9**	**729.1**	**1,116.0**	**386.9**	**-1676.7**	**-1,771.8**	**-95.1**
Education expenses	623.3	627.4	4.1	18.9	23.2	4.3	-604.4	-604.2	0.2
Religious travel	598.6	867.5	268.9	5.4	5.3	-0.1	-593.2	-862.2	-269.0
Other (other personal)	1157.4	1,358.8	201.4	680.8	1,069.9	389.1	-476.7	-288.9	187.7
c) ICT Services	**492.9**	**683.1**	**190.2**	**3,819.7**	**4602.4**	**782.7**	**3,326.8**	**3,919.3**	**592.5**
Software consultancy	196.1	247.1	51	1,107.9	1,277.20	169.3	911.8	1,030.1	118.3
Other computer services	25.6	121.9	96.3	1,534.4	1,958.50	424.1	1,508.8	1,836.6	327.8
o/w freelance services	-	-	-	779.5	1,164.80	385.3	-	-	-
Export/Import of	146.1	241.8	95.7	593.9	655.8	61.9	447.8	414.0	-33.8
Telecommunications	116.4	56.6	-59.8	553.8	698	144.2	437.4	641.4	204.0
d) other business services	**1,323.9**	**1,245.20**	**-78.7**	**1,691.4**	**2,197.1**	**505.7**	**367.5**	**951.9**	**584.4**
o/w other freelance services	-	-	-	205.5	592.9	387.4	-	-	-
Total services	**11,290.2**	**11,930.20**	**640.0**	**8,446.8**	**10,055.8**	**1609.0**	**-2,843.3**	**-1,874.4**	**969.0**

Source: SBP

ICE models.[34] Moreover, importers also appear to have accelerated CBU shipments amid market expectation of higher sales tax and withdrawal of existing fiscal concessions (*reduced GST rates*) for EVs/PHEVs in the budget. This frontloading was pronounced in Q4-FY26.[35]

Imports of agriculture and other chemicals increase

The increase in imports of agricultural and other chemicals was led by plastic materials and medicinal products. Plastic materials imports rose, particularly of polyethylene and other polymers of ethylene. Both materials are used in domestic manufacturing particularly in packaging, construction and consumer goods, suggesting continued strength in downstream industrial activity. While import of pharma products, particularly Active Pharmaceutical Ingredients (APIs), increased in line with capacity expansion under API policy as well as abolition of customs duty on raw materials for life saving medicines and initiatives to localise national immunisation programs.

Trade in Services

The services trade deficit narrowed for the second consecutive year in FY26 **(Table 5.6)**. The improvement owes to relatively higher growth in exports of services compared to imports. The imports growth was primarily driven by increased payments for transport, travel, and other businesses services. While ICT services contributed more than one third of the services export during FY26.

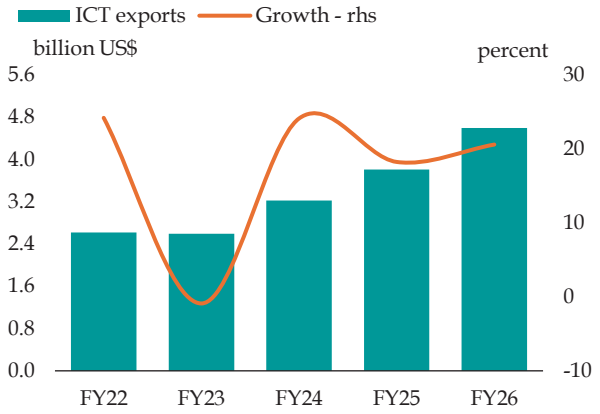
ICT exports maintained strong growth trajectory, rising by 20.5 percent to US$ 4.6 billion in FY26 **(Figure 5.21)**, and became the second largest export earner after knitwear. Freelancing was the dominant driver of growth in ICT exports. The strong growth of ICT exports is the outcome of various government and SBP initiatives to support ICT exporters and freelancers. For instance, SBP simplified documentation requirements to encourage use of formal channel for inward receipts and outward remittances.[36]

[34] The shift is evidenced by the entry of major Chinese NEV manufacturers. Moreover, under the NEV Policy 2025–30, the government proposed a PKR 100 billion subsidy package to accelerate EV adoption and expand EV charging infrastructure. Also see Box 2.3 on Pakistan's NEV Policy, SBP's The State of Pakistan's Economy Half Year Report 2025-26.

[35] Data and key insights have been taken from reports of equity market brokerage houses.

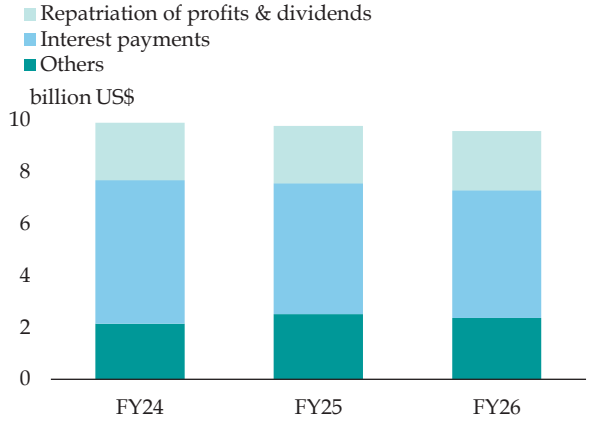
[36] The requirement for IT exporters to submit Form R for each transaction has been replaced with a one-time declaration at the time of opening the account. Source: SBP EPD Circular Letter No. 07 April 2026

Pakistan's ICT Exports **Figure 5.21**



Source: SBP

Primary Income Account - Major Payments **Figure 5.22**



Source: SBP

Moreover, SBP also raised the minimum reporting threshold[37] and set maximum one working day for inward receipts and outward remittances for process through Exporters' Special Foreign Currency Accounts (ESFCAs). In addition, freelancers and IT exporters were allowed to retain 50 percent of the export proceeds or US$ 5,000 per month, whichever is higher in ESFCAs, for import of equipment.[38] However, despite the strong growth in ICT exports, the limited upgrading of firms into larger-scale operations remains a structural challenge for the sector **(Box 5.2)**.

The increase in imports of transport services in FY26 is primarily attributable to higher sea freight payments resulting from increased imports of goods, as well as elevated risk insurance costs associated with the Middle East conflict.[39] Meanwhile, transport services' receipts also recorded an increase, reflecting increased port activity during the year.

Similarly, travel-related payments rose by 20 percent in FY26,[40] reflecting 10.8 percent increase in airfares due to higher global oil prices.[41] Moreover, increase in Hajj costs due to mandatory health insurance, which is included in visa cost, also added to travel payments.

Primary Income Account

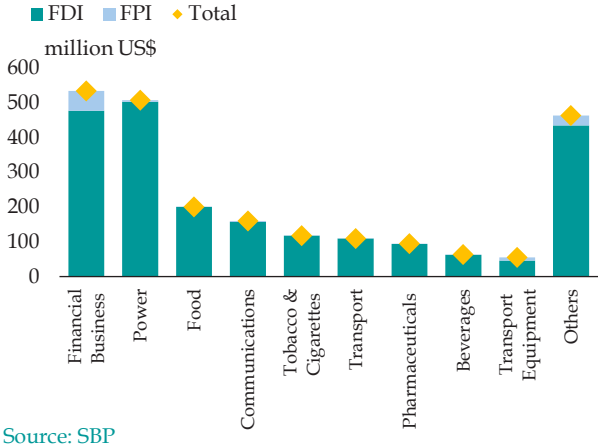
Primary income deficit narrowed by US$ 341 million in FY26 **(Figure 5.22).** This improvement was mainly on the back of lower interest payments. The decline, despite an increase of 6.6 percent in public debt stock excluding FX liabilities, is attributed to improved external debt profile and lower interest cost owing to easing global financial conditions in FY26 compared to FY25.

The decomposition of changes in interest payments shows that lower interest rates drove the decline which was partly offset by the larger debt stock. This contrasts with previous years when rising interest rates were the main driver of interest payments **(Box 5.3)**.

Repatriation of profits/dividends, which is another major component of primary income account, increased by US$ 0.1 billion to US$ 2.3 billion in FY26. The repatriation of profits/dividends was mainly led by financial businesses (US$ 534 million), and power sector (US$ 508 million), respectively **(Figure 5.23)**.[42]

[37] The minimum threshold was raised to US$ 25,000 from US$ 10,000
[38] EPD Circular Letter No. 06
[39] https://www.spglobal.com/energy/en/news-research/latest-news/shipping/072226-middle-east-shipping-insurance-costs-rise-on-hormuz-risks-marsh
[40] Religious, education and personal tourism related travel payments primarily constitute the overall travel payments.
[41] Global airfare increased to US$ 461 on June 2026 compared to US$ 416 in Jun2025. Source: OAG
[42] Government cleared payments to Chinese IPPs in August 2025, as part of circular debt reduction plan.

Sector wise Repatriation of Profit - FY26 **Figure 5.23**



Source: SBP

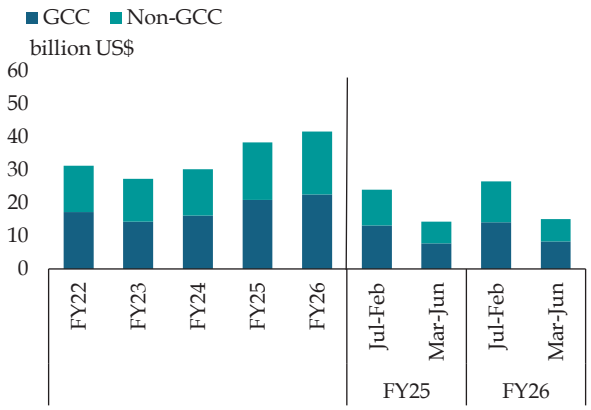
Secondary Income Account

Secondary income account showed a record surplus, mainly contributed by workers' remittances. Workers' remittances grew by 8.6 percent to US$ 41.6 billion in FY26. Several factors contributed to this strong performance, including increased labor emigration, and government and SBP's initiatives aimed at encouraging the use of formal remittance channels. Geographically, the Gulf region continued to be the main source of workers' remittances, with Saudi Arabia and the UAE accounting for around 45 percent of total remittance inflows **(Figure 5.24)**.

The UAE emerged as the largest contributor to the increase in FY26, adding nearly US$ 978 million compared to the previous year. Other significant contributors included Saudi Arabia, EU and the United Kingdom. Moreover, economic activity in UAE remained strong before the conflict, which was supported by non-oil sectors.[43] In case of Saudi Arabia, Pakistan and KSA have formalised a long-term labour mobility strategy aligned with Saudi Arabia's Vision 2030 non-oil diversification agenda,[44] which reinforced structural, non-oil-linked demand for Pakistani labour force. Since Pakistani workers in both economies are concentrated outside the oil sector,[45] with a large share of un-skilled labour **(Figure 5.25),** the slowdown in oil sector had a relatively limited direct impact on their employment and earnings.

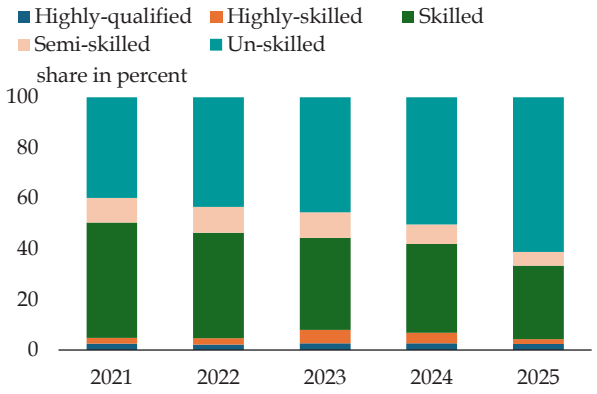
Importantly, remittance growth remained robust even after discontinuation of cost-related incentives.[46] SBP continued to strengthen the

Workers' Remittance Inflows **Figure 5.24**



Source: SBP

Skill Composition of Registered Workers Going Abroad **Figure 5.25**



Source: BE&OE

[43] UAE non-oil GDP grew 4.8 percent YoY in Q1-2026, raising its share of national output to 79.4 percent from 78.0 percent in 2025. Source: The National, "UAE economy grows 3 percent in first quarter" (Aug. 4, 2026).

[44] Under the Human Resource Deployment Plan (2025–2039), Pakistan targets deployments of 1 million worker to Saudi Arabia by 2030 across construction, hospitality, healthcare, IT, logistics, aviation and infrastructure sectors, aligned with Saudi Vision 2030.

[45] Pakistani workers in Saudi Arabia are concentrated in construction, skilled trades (electricians, HVAC technicians, plumbers, welders), transport/logistics and domestic services. In UAE, Pakistani workers are primarily in construction, retail, hospitality and transportation. Source; DITRC, "Top 7 Countries that Employ Pakistani Workers".

[46] Under the Incentive Scheme for Marketing of Home Remittances, financial institutions received a per-dollar cash incentive of Rs 1, Rs 2 and Rs 3 for incremental remittance growth of up to 5 percent, between 5 and 10 percent, and above 10 percent, respectively.

capacity of exchange companies to mobilise and manage remittance inflows. In this regard, SBP amended the regulatory framework for Exchange Companies in April 2026 to give them greater flexibility in managing foreign exchange positions linked to remittance inflows.[47] This measure complements the formal-channel framework by reducing operational constraints faced by exchange companies in mobilising remittances.

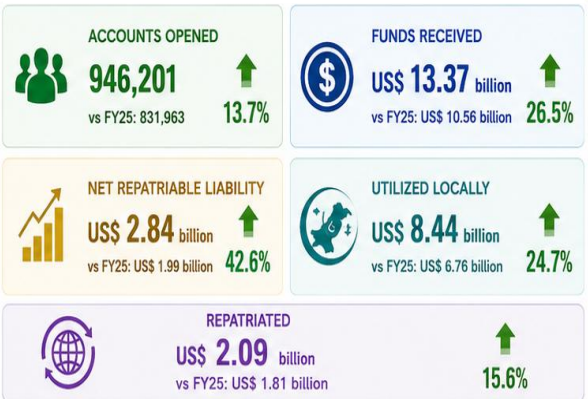
While these measures have strengthened the formalisation and resilience of remittance flows, an important policy question is whether remittances can be leveraged beyond household consumption to support savings, investment, and productive activity; **Box 5.4** attempts to shed light on the question. This is also worth highlighting that remittances help finance external imbalances and support domestic consumption, they cannot permanently compensate for weak export performance and low investment.

5.4 Financial Account

With current account almost in balance, the net financial inflows of US$ 2.0 billion in FY26, compared to US$ 1.6 billion in FY25, helped in reserve build-up and support the overall external position. The slight moderation in net financial inflows was primarily due to relatively lower foreign private investment, while net official disbursements increased mainly due to lower amortisation in FY26.[48]

Multilateral development partners remained the largest source of external financing.[49] Bilateral disbursements also amounted to US$ 1.4 billion. Meanwhile, KSA provided US$ 3 billion-time deposits in April 2026,[50] which facilitated Pakistan to repay US$ 3.45 billion to UAE in April 2026.

Roshan Digital Accounts **Figure 5.26**



Source: SBP

Moreover, Roshan Digital Accounts (RDAs) maintained a strong momentum, with cumulative inflows, and account openings, and steady increase in net repatriable liabilities (**Figure 5.26**). The net repatriable liabilities rose to US$ 2.8 billion, with Naya Pakistan Certificates (NPCs), particularly Islamic NPCs, attracting US$ 1.9 billion. To further attract non-resident investment, SBP expanded the scheme to non-resident foreign entities and added major Gulf currencies (Saudi Riyal and UAE Dirham), alongside highly competitive profit rates.[51]

FDI declined amid elevated global uncertainty

Net FDI declined to US$ 1.5 billion in FY26 from US$ 2.5 billion in FY25, reflecting weaker inflows across major sectors, particularly power and grid transmission. Gross FDI in Pakistan also decreased by 22.7 percent to US$ 3.3 billion, while gross FDI outflows increased by around 15.8 percent to US$ 1.5 billion (**Figure 5.27**).

The scheme was discontinued with effect from July 1, 2025, per SBP EPD Circular Letter No. 06 of 2025, which withdrew the scheme established under EPD Circular Letter No. 15 of 2023.

[47] SBP, EPD Circular Letter No. 08 of 2026 (Apr. 10, 2026), allowing Exchange Companies to enter for sale transactions with Authorized Dealers against receipt of home remittances for up to five working days, by amending Para 7, Chapter 7 of the Regulatory Framework for Exchange Companies.

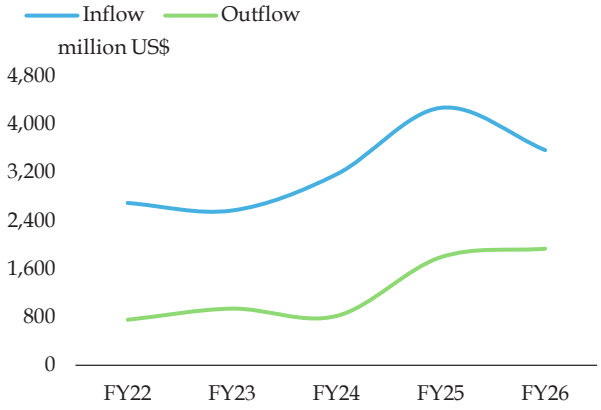
[48] This does not include repayment of Eurobond, which is reflected in FPI in financial account.

[49] International Islamic Trade Finance Corporation (ITFC) arranged the largest syndicated financing for Pakistan over the last 3 years. The proceeds are used for energy imports.

[50] This was in addition to the US$ 5 billion-time deposits provided to Pakistan in FY25.

[51] Finance Division vide Gazette notifications No. S.R.O. 482(I)/2026 dated March 16, 2026, and Gazette notifications No. S.R.O. 483(I)/2026 dated March 16, 2026. Finance Division vide Gazette Notification No. S.R.O.870(I)/2026, dated May 15, 2026.

Foreign Direct Investment **Figure 5.27**



Source: SBP

Direct investment abroad by Pakistanis rose from US$ 15 million in FY25 to US$ 342 million in FY26, indicating that some firms are finding overseas markets more attractive for deploying incremental capital. The phenomenon extends beyond cyclical movements, highlighting concerns over corporate taxes, policy predictability, regulatory certainty, energy costs, infrastructure and institutional capacity.[52] Moreover, the global FDI landscape is shifting from cost-driven investment towards strategic considerations, including supply-chain resilience, technology and industrial policy. For Pakistan, this raises the bar for attracting FDI. A large market and low-cost labour are no longer sufficient without reliable infrastructure, skill, policy predictability and stronger integration into regional and global value chains.[53]

FDI remains uneven across key sectors

Financial business and power sector remained the principal recipients of FDI in FY26. The *financial business* was the only major sector to record a relatively higher net inflow, US$ 806 million in FY26 compared to US$ 702 million last year. The increase was supported by continued foreign participation in banking and other financial services, including Islamic banks, digital banks and fintech providers.[54]

The FDI in fintech and digital banking broadly reflects the global trend, which is reinforced by SBP's initiatives on developing digital infrastructure and technology ecosystems in the financial sector. At the same time, there is a considerable scope for Pakistan to attract FDI in cloud-based banking platforms, and AI-driven financial services.

Power sector FDI slows, primarily due to lower investment in hydel projects

The net FDI inflows in power sector declined from US$ 1,178 million in FY25 to US$ 958 million in FY26, despite higher net inflows in the thermal and coal-based[55] power projects. The decline was primarily driven by the fall in investment in hydropower projects from US$ 736 million in FY25 to US$ 422 million in FY26. The inflows in FY26 were largely sourced from China, accounting for nearly three-quarters of total FDI in hydel power, followed by Republic of Korea.

The decline in FDI in hydel projects reflects not only weaker project-level investment but also a broader transition in the power sector policy from capacity expansion towards consolidation. The investment pipeline also reflects this shift. As of June 2026, the Azad Pattan and Kohala hydro projects remained on hold, despite having received Letter of Support.[56] The PPIB portfolio also places the Mahl project on hold, with pending approval of IGCEP 2025-2035.[57] Together, these developments suggest that the key constraint is

[52] The State of Pakistan's Economy, Half Yearly Report FY26

[53] As per UNCTAD World Investment Report 2026 report, global FDI flows rose by 6 per cent, to US$ 1.6 trillion. Inflows increased by 11 percent in developed economies and by 2 percent in developing economies. The FDI shift is concentrating investment in strategic sectors while leaving many developing countries behind.

[54] Notable developments included the expansion of UAE-based Mashreq Bank's digital banking operations and the establishment of Kuwait-backed Raqami Islamic Digital Bank. UAE has also increased its investment in Mobilink bank. Source: SECP

[55] This trend is consistent with China's continued dominance in global coal-based projects as over 70 percent of the upcoming global coal-based projects are being commissioned by China. Source: Index box website

[56] PPIB website: https://www.ppib.gov.pk/cpec.html

[57] IGCEP (2025–35) is Pakistan's 10-year least-cost power-generation plan, and it affects hydropower projects by determining whether and when proposed projects are included in the least-cost generation pipeline based on projected demand, costs and system requirements. Source: https://nepra.org.pk/Admission Notices/2025/08 Aug/IGCEP_2025-35_R2.pdf

not the availability of identified hydropower resources, but the ability to establish a sufficiently predictable, financially viable and policy-consistent framework for converting projects in the pipeline into investible opportunities.

Grid and transmission investment lags despite rising needs

Chinese companies accounted for nearly all FDI in the grid and transmission segment. The FDI composition within the power sector has remained skewed towards generation, with FDI inflows into electric machinery (*including grid and transmission upgradation*),[58] has consistently remained lower despite its critical role in ensuring the reliability and efficient utilisation of generation capacity. The gap became more pronounced in FY26, as FDI in electric machinery further slowed. This limited FDI is particularly notable as the rapid expansion of distributed solar in Pakistan, is altering demand patterns and power flows. This is increasing the need for grid modernisation, flexibility and enhanced transmission infrastructure.

Upstream investment slows amid structural issues

Meanwhile, FDI in oil and gas exploration decreased to US$ 111 million compared to inflows of US$ 250 million last year, reflecting the sector's persistent commercial and operational challenges, including the capital-intensive nature of exploration, declining production from mature fields and security risks in frontier areas.[59] Nevertheless, the resumption of offshore and online licensing in the last quarter of FY26 signals renewed efforts to revive upstream investment.

Global supply-chain shifts weigh on export-oriented FDI sectors

FDI inflows into export-oriented industries also weakened, particularly textile, other chemicals, food processing and pharma, reflecting both domestic competitiveness constraints and a less favourable global investment environment for supply-chain intensive manufacturing. The global greenfield investment announcement in supply-chain intensive sectors, - textiles, processed food, electronics and automotive - declined sharply amid tariff uncertainty, geopolitical tensions, and multinational efforts to de-risk supply chains.[60] This global shift is particularly relevant for Pakistan, where export-oriented FDI remains concentrated in relatively low-value manufacturing and has yet to establish a strong position in higher-value global value chains.

FPI outflows were dominated by debt-repayments and profit-taking

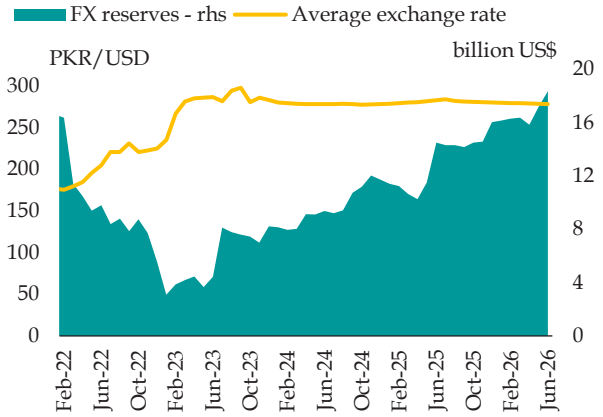
Net FPI recorded an outflow of US$ 1.2 billion during FY26, compared to an outflow of US$ 0.7 billion in FY25.[61] This largely reflected repayment of maturing Eurobonds. At the same time, Pakistan regained access to international capital markets after a four-year gap and raised US$ 750 million through a three-year-Eurobond in April 2026. Moreover, Pakistan raised US$ 250 million through first Panda bond[62] in May 2026, with the latter being oversubscribed by five times. The successful issuances were supported by improved sovereign credit worthiness, following rating upgrades by Moody's and S&P during FY26, alongside continued macroeconomic stability and progress under the IMF programme.[63]

5.5 Exchange Rate and FX Reserves

SBP's liquid foreign exchange reserves increased by US$ 3.9 billion during FY26 to US$ 18.4 billion by end June 2026 (**Figure 5.28).** SBP also reduced its forward/swap liabilities by US$ 1.6 billion

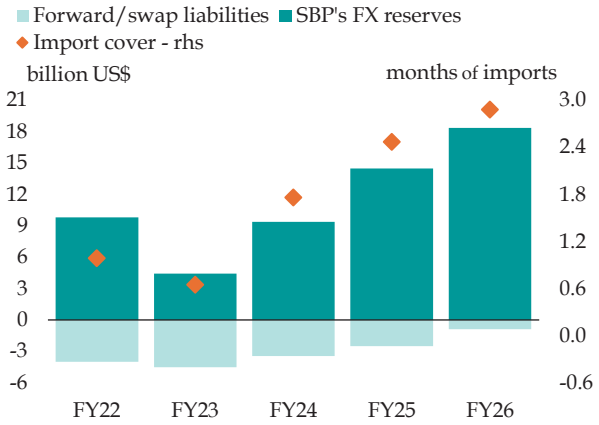
[58] All the investment in this segment was dominated by a single project named Pak Matiari–Lahore Transmission Company. PMLTC functions as an Independent Transmission Company (ITC) under a long-term concession, earning regulated transmission charges approved by Pakistan's power regulator. It addresses the transmission bottleneck by transporting electricity from power plants in southern Pakistan to major demand centers in Punjab.
[59] Source: https://petroleum.gov.pk/NewsDetail/NzFlYWI0YjYtODAxNi00MTVkLTk5ZDQtNzY4YjdiMDVhNzJh
[60] UNCTAD Global Investment Report.
[61] This reflects repayment of US$ 500 million Eurobond repayment in September 2025 and US$ 1.3 billion Eurobond in April 2026.
[62] Issued in the Chinese capital market at an interest rate of 2.5 percent, with a three-year maturity
[63] S&P Global upgrade to B- from CCC+ in July 2025, Moody's upgraded Pakistan from Caa2 to Caa1 in August 2025.

FX Reserves and Exchange Rate **Figure 5.28**



Source: SBP

Forward/Swap Liabilities and Import Cover **Figure 5.29**



Source: SBP

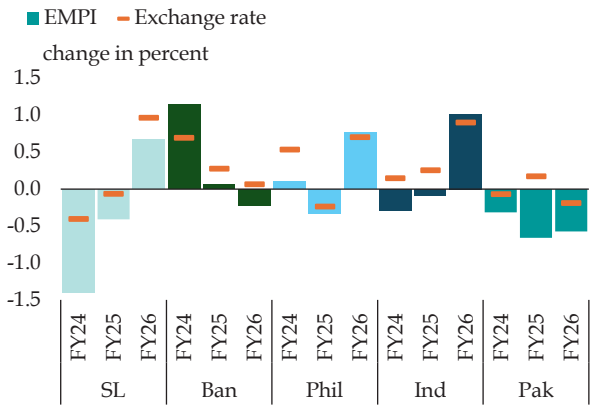
(Figure 5.29). As a result, reserve adequacy – as measured by import coverage of FX reserves – rose to 2.9 months of imports, the highest in the last five years and the 3-month benchmark**.** This build-up in external buffers reflects not only a significant increase in the quantum of reserves, but also a qualitative improvement.

The key factor contributing to the build-up of FX buffers contained current account deficit, in fact a surplus current account balance excluding interest payments. This together with private financial inflows helped SBP to make net purchases of US$ 8.1 billion during FY26. In addition, net official inflows and disbursements from the IMF under EFF and RSF also contributed to reserve build-up.

These, together with improved external debt profile, i.e. shift from short-term to the longer tenor deposits, eased exchange market pressures, as indicated by lower exchange market pressure index (EMPI).[64] The EMPI indicates net appreciation pressures for last three years compared to peer economies **(Figure 5.30),** which explains relative stability in forex market.

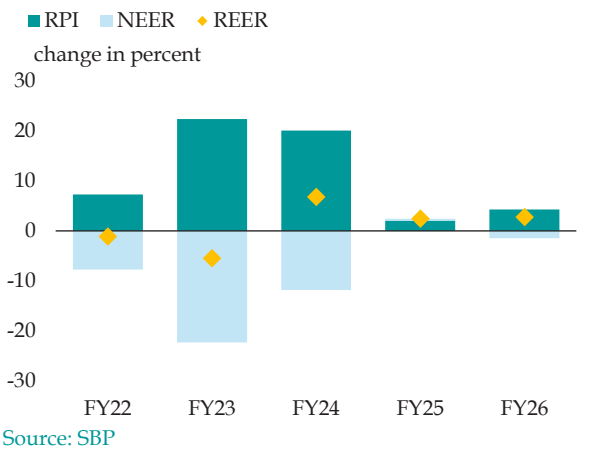
The nominal effective exchange rate (NEER) depreciated by 1.5 percent against competitors'

Exchange Market Pressure Index **Figure 5.30**



Sources: IMF; SBP staff calculations

REER, NEER and RPI **Figure 5.31**



Source: SBP

[64] The Exchange Market Pressure Index (EMPI) measures underlying pressures in the foreign exchange market by combining exchange rate movements with changes in official foreign exchange reserves. Higher values indicate greater pressure on the domestic currency, while lower values indicate weaker market pressures. Sources: Khan 2010 and SBP staff calculations.

and trading partners' currencies. However, a relatively sharp increase in relative prices index (RPI) of 4.3 percent due to higher domestic inflation vis-à-vis competitors and trade partners, more than offset the nominal depreciation (**Figure 5.31**). As a result, the real effective exchange rate was appreciated by 2.8 percent on average in FY26.

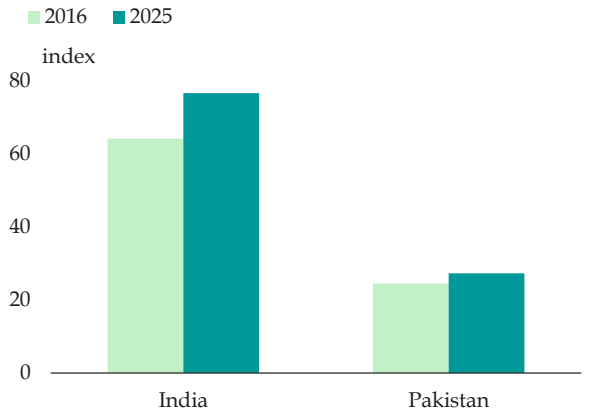
Box 5.1: India-EU Free Trade Agreement: Implication for Pakistan and the Way Forward

Pakistan has benefitted from EU GSP+ preference since 2014, under which more than 85 percent of Pakistani exports, including textile and clothing, enter the EU duty-and-quota free. The EU is Pakistan's second largest trading partner.[65] In 2025, Pakistan's exports to the EU amounted to US$ 10.1 billion, with around 72 percent comprising textile-based products. On the other hand, India's exports to EU stood at US$ 75.9 billion dominated by non-textile/non-agricultural exports. In this context, the conclusion of negotiations of the India-EU Free Trade Agreement (FTA) in January 2026, marks a significant shift in the competitive landscape facing other South Asian exporters. The agreement will provide India with substantially improved and more predictable access to the EU market.[66] Importantly for Pakistan, most EU tariffs on Indian textiles and apparels are scheduled to be removed. Although the India-EU FTA does not alter Pakistan's existing preferential access to the EU, it would reduce Pakistan's historical tariff in the EU advantage to Pakistan. This is particularly significant because India and Pakistan compete in several similar labor-intensive export categories in EU market.

From preferential advantage to competitive neutrality

For over a decade, Pakistan's GSP+ status provided a tariff advantage over India in several products in the EU market, which allowed Pakistani exporters to compete despite relatively high domestic costs, weak infrastructure and limited product diversification. With the implementation of the India-EU FTA, this tariff cushion will progressively narrow (**Table 5.1.1**). Analysis shows that Pakistan's trade complementarity index (TCI) with EU is significantly below India's and has remained stagnant over the last decade. This is because of Pakistan's exports are concentrated in textiles, whereas India's export basket is more diversified (**Figure 5.1.1**).[67]

Trade Complementarity Index **Figure 5.1.1**



Source: SBP staff calculations based on data of ITC trademap

Quadrant Analysis based on Export Portfolio Diversification Matrix (EPD)

The lower TCI of Pakistan's export basket points to a broader structural challenge, but it does not shed light on the products that offer scope for expansion; the existing strengths are becoming vulnerable; or loss of opportunities in growing EU markets. To identify these product level differences, we use EPD matrix (**Figure 5.1.2**). It assesses where Pakistan is gaining or losing ground in the EU market, by comparing the growth of Pakistan's exports across product categories vis-à-vis growth in EU demand in those product categories. This distinction is particularly important, because strong Pakistani export growth does not necessarily indicate a promising market. Pakistan may be expanding in products for which overall EU demand is stagnant and vice versa. The analysis first separates products into four quadrants[68]: rising stars, falling stars, losing opportunities, and retreat. Then, Pakistan's market share is used to assess the economic significance of each category.

[65] Accounted for around 14 percent of Pakistan's total trade in 2025.

[66] The EU will eliminate or reduce tariffs on over 90 percent of tariff lines, corresponding to 91 percent of the trade value, while India will liberalize 86 percent of tariff lines, covering 93 percent of the trade value.

[67] The TCI measures the degree to which a country's export profile matches the import profile of its trading partner. A score closer to 100 suggests a perfect match (high potential for trade), while a score closer to 0 suggests no complementarity.

[68] **Rising Star:** EU CAGR ≥6 percent and Pakistan CAGR ≥0 percent; **Lost Opportunity:** EU CAGR ≥6 percent and Pakistan CAGR <0 percent; **Falling Star:** EU CAGR <6 percent and Pakistan CAGR ≥0 percent; **Retreat:** EU CAGR <6 percent and Pakistan CAGR <0 percent. The 6 percent is used as a cutoff/benchmark used in this analysis. Pakistan 0 percent CAGR is the natural threshold separating export growth from decline, while market share is treated as a separate indicator of the economic important of each product.

India–EU FTA and Pakistan's Competitive Position in the EU Market **Table 5.1.1**

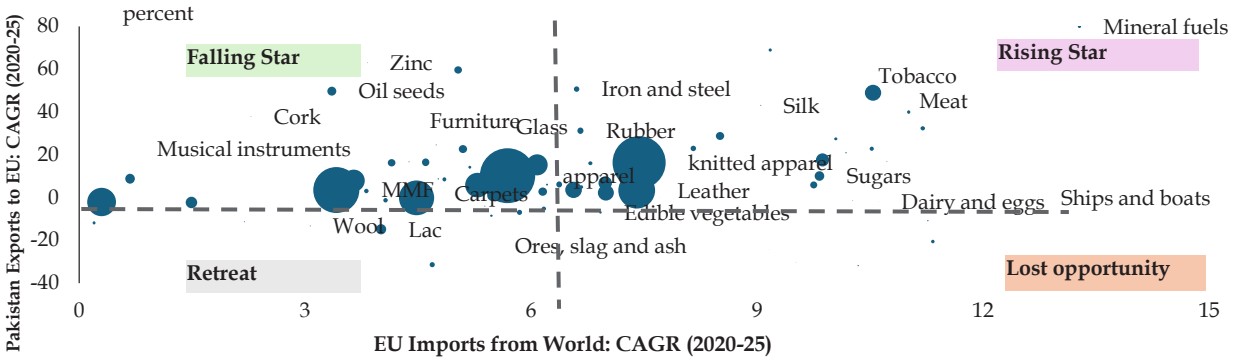
Dimension	Pakistan under GSP+	India under EU-India FTA	Implication for Pakistan
Tariff Access	Preferential/duty-free access on large share of eligible exports	Tariffs eliminated or reduced across almost the entire trade basket	Historical tariff advantage will narrow
Home Textile & Apparel	Under GSP+, 66 percent of tariff lines are covered for this segment. Moreover, Pakistan's exports are fragmented and cotton heavy. Pakistan's textile export unit value in FY26 was 7.8 Euro/kg.	Tariffs removed on India's home textile and apparel imports in EU on 100 percent of tariff lines. India's exports are vertically integrated and have higher MMF capability. India's textile export unit value in FY26 was 8.5 Euro/kg.	Pakistan loses its historical 10–12 percent price cushion. Direct competition in Pakistan's main export commodity will intensify
Rules of Origin and Supply Chain Competitiveness	To move into high value MMF, Pakistan often needs to import yarn or fabric. Under GSP+ "Double Transformation"[69] rules, Pakistan does not qualify for duty-free access.	Indian manufacturers can import technical textiles or luxury yarns, turn them into finished products, and send them back to the EU at 0 percent duty.	Pakistan may lose in high value MMF segment as India can easily move into high value MMF textile segment, due to supply chain flexibility.
Coverage	More than 85 percent of exports	More than 90 percent of exports covered	Pakistan has relatively lower market access
Policy Certainty	Preference remains subject to GSP+ eligibility and monitoring. Will be reviewed in December- 2027 for renewal[70]	Binding bilateral FTA framework	Greater certainty for Indian exporters
Services & digital trade	Limited preferential framework	Dedicated services and digital trade provisions.	Pakistan may not gain from service exports compared to India

Source: SBP staff assessment based on Euro commission website

Rising stars: Pakistan has a relatively broad set of products in this quadrant, including knitted apparel, leather, toys and sports goods, footwear, beverages and pharma products.

Lost opportunities: The most concerning category, where EU demand is expanding but Pakistan's exports are declining. This quadrant includes cereals, hides and skin, soaps, edible vegetables. The challenges facing these export

Export Portfolio Diversification Matrix **Figure 5.1.2**



Note: size of the bubble shows Pakistan's market share of each commodity/product in EU. percent
Rising Star: EU CAGR ≥6% and Pakistan CAGR ≥0%; **Lost Opportunity:** EU CAGR ≥6% and Pakistan CAGR <0%; **Falling Star:** EU CAGR <6% and Pakistan CAGR ≥0%; **Retreat:** EU CAGR <6% and Pakistan CAGR <0%.

Source: SBP staff calculations based on ICT Trademap data

[69] Double transformation requires that both the yarn and fabric used in a textile product are produced within the eligible countries for the product to qualify for preferential tariff treatment.

[70] It is important to note that the EU has revised its Generalised Scheme of Preferences Plus (GSP+) framework, ending the automatic extension of trade preferences starting in January 2027. Therefore, Pakistan will have to formally apply for an extension and submit an action plan covering 32 UN conventions.

segments need to be explored regarding their productive capacity, standards and certification, input availability, competitiveness and market access constraints.

Falling stars: This quadrant includes other made-up textile articles like knitted fabrics and fur skins etc. These products demonstrate the Pakistani firms can remain competitive even when market conditions are less favorable but continued growth may be constrained by weak EU demand. An appropriate strategy to address this would be product upgrading, productivity improvements, and quality differentiation.

Retreat: This quadrant represents products where both the EU demand and Pakistan exports are declining. Cotton is the most important example, as its EU demand declined by 1.9 percent and Pakistan's exports declined by 1.8 percent, yet cotton requires particular attention because Pakistan still holds a 12.4 percent market share in EU. This illustrates why this quadrant should not be interpreted in isolation. A retreat product with a larger market share can be more economically important than a rising star with a 0.01 percent share. For such products, the objective should be defending viable market share while moving towards higher-value or faster-growing downstream products.

Conclusion and Way Forward

Pakistan should not view India-EU FTA as a loss of preferential access but as a structural shift in relative competitiveness, requiring greater reliance on productivity, supply-chain depth and product sophistication rather than tariff preferences alone. Pakistan will continue to benefit from the GSP+ preferences, but the reduction of tariff on India's products, once the India-EU FTA comes into force, will increase competitive pressure in the sectors where Pakistan's exports are concentrated such as textile, leather, cutlery, etc. The product level evidence reinforces this concern. Pakistan may remain well-positioned in several *Rising Star* products including knitted apparel, meat, leather, footwear, and several nontraditional exports but it is simultaneously losing ground in *lost opportunity* products despite expanding EU demand. The risk from the India-EU FTA is not that Pakistan suddenly loses EU market access, but that India becomes a much stronger competitor.

Therefore, Pakistan's response should move beyond seeking to preserve preferential margins and focus on building competitiveness before tariff convergence makes the competitive gap harder to close. First, establishing *Rising Star* products should be upgraded through greater product diversification and encourage investment in MMF capabilities, technological adoption and stronger links between textile inputs and downstream manufacturing. Second, the *lost opportunity* products identified in the matrix should become a targeted policy agenda with warranted diagnostics of standard certification, logistics, productive capacity, and market access, constraints rather than generic export incentives. Finally, Pakistan should use its existing EU GSP preference status while it still provides an advantage to diversify beyond traditional cotton-based exports and build presence in higher-value manufacturing, pharma, engineering goods, and other emerging segments (PBC, 2026). The India-EU FTA consequently presents Pakistan with a warning, but also a policy window.

** The contribution of Ana Khattak is acknowledged in writing this box.*

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i. EU commission website: https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/pakistan_en
ii. European Commission website; MEMO: EU-India Free Trade Agreement: Chapter-by-Chapter Summary
iii. PBC (2026). The India-EU FTA: Implications for Pakistan, Pakistan Business Council.

Box 5.2: Beyond Export Entry: Scaling Pakistan's ICT Exporting Firms

Pakistan's ICT exports have more than doubled in the last five years. With a CAGR of 16.9 percent, ICT exports have risen from US$ 2.1 billion in FY21 to US$ 4.6 billion in FY26. Yet, export growth has not been accompanied by comparable shift of firms into higher export-receipt brackets. The distribution of ICT exporting firm-size in FY26 shows a pronounced long-tail: 68 percent of computer software firms, 77 percent of software consultancy firms, 89 percent of other computer services firms and 99 percent of NTN-reporting freelancers earn less than US$ 0.1 million on an annual basis (**Table 5.2.1)**. This concentration of firms at the lower end of the export-receipt distribution is particularly important given evidence in the literature that firm size and prior export experience appear to be key

Distribution of Firms by Size of Annual Export Receipts – FY26 **Table 5.2.1**

million US$, percent of total firms in the category

Exports proceeds	Exports of Computer Software (HS code: 9184)		Software Consultancy Services (HS code: 9182)		Other Computer Services (HS code: 9185)		Freelance of computer and information services (HS code: 9186)	
	No. of Firms* (percent of total)	Amount (percent of total)	No. of Firms* (percent of total)	Amount (percent of total)	No. of Firms* (percent of total)	Amount (percent of total)	No. of Firms* (percent of total)	Amount (percent of total)
<0.1	776 (68)	18 (3)	4332 (77)	95 (10)	6688 (89)	96 (22)	2658 (99)	13 (54)
0.1-0.5	224 (20)	52 (9)	996 (18)	228 (25)	722 (10)	153 (34)	13 (0)	2 (10)
0.5-1.0	68 (6)	49 (8)	171 (3)	117 (13)	85 (1)	60 (13)	1 (0)	1 (3)
1.0-5.0	56 (5)	122 (21)	121 (2)	225 (25)	55 (1)	102 (23)	4 (0)	8 (33)
5.0-10.0	8 (1)	58 (10)	16 (0)	114 (13)	2 (0)	14 (3)	0 (0)	0 (0)
10.0-50.0	8 (1)	155 (27)	5 (0)	83 (9)	1 (0)	19 (4)	0 (0)	0 (0)
>50	1 (0)	118 (21)	1 (0)	53 (6)	0 (0)	0 (0)	0 (0)	0 (0)
Total	**1141**	**572**	**5642**	**914**	**7553**	**443**	**2676**	**24**
Non-NTN Reporting Firms	**NA**	**80**	**NA**	**363**	**NA**	**351**	**NA**	**1141**

* NTN Reporting Firms

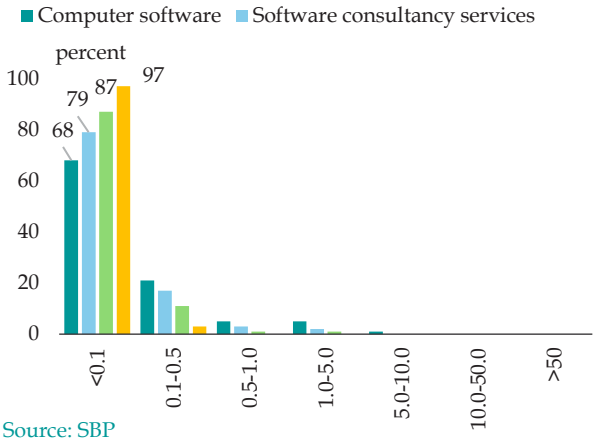
Note: Firms are aggregated by NTN within each service before assigning the firm to an export-receipt size band. Percentages may not sum to exactly 100 due to rounding.

Source: SBP

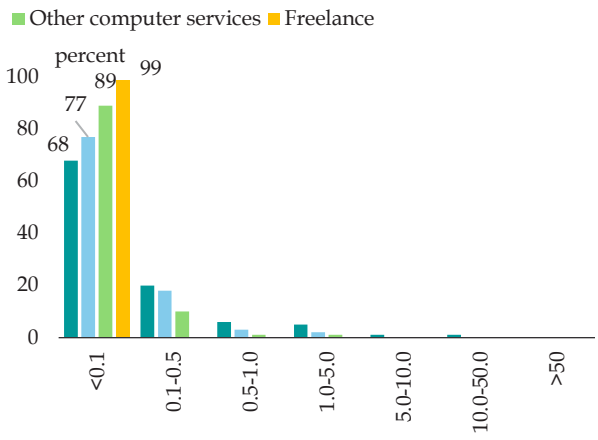
factors in dealing with at-the-border and behind-the-border trade barriers for service sector. In case of Pakistan, this is a structural issue which has persisted over the years (**Figure 5.2.1a and b**).

The problem of 'long-tail' continues to persist despite a number of policy initiatives taken by the SBP and the government to facilitate ICT exporting firms. These initiatives include SBP has raised the foreign currency retention limit for IT exporters from 35 to 50 percent and liberalised the use of retained funds for payments abroad;[71] it has also facilitated IT firms' overseas investment.[72] Moreover, since April 2026, banks are required to establish mechanisms for resolving inward receipts and outward remittance issues faced by IT firms and freelancers.[73] The tax regime also provides a preferential 0.25 percent concessionary tax rate for registered ICT exporters,[74] while also allowing them a simplified tax filing system to claim tax exemption.[75] But these incentives do not by themselves create the capabilities required to win larger contracts, develop propriety products, specialise in high-value services or organise individual

ICT Firm Size Distribution - FY21 **Figure 5.2.1a**



ICT Firm Size Distribution - FY26 **Figure 5.2.1b**



Source: SBP

[71] EPD Circular Letter No. 17: https://www.sbp.org.pk/circulars/epd-circular-letter-no-17-of-2023

[72] This directly addressed the need for overseas presence and market expansion. Source: FE Circular No. 01 https://www.sbp.org.pk/circulars/fe-circular-no-01-of-2024

[73] EPD Circular Letter No. 06 dates April 2026, https://www.sbp.org.pk/circulars/epd-circular-letter-no-06-of-2026

[74] Registered with Pakistan Software Export Board. The tax incentive is provided till 2029.

[75] FBR website: https://fbr.gov.pk/fbr-clarifies-news-item-captioned-it-industry-abandoned-in-the-budget-202223/173490

talent into scalable firms. The fact that aggregate exports can grow exponentially whereas the firm's size remains concentrated, which indicates that export growth and firm upgrading are not the same process.

AI is likely to reinforce the importance of firm upgrading. Services most exposed to AI-driven automation rely heavily on routine, repeatable and easily codified tasks.[76] This is particularly relevant for Pakistan, where many ICT exporters remain concentrated in small-scale, low-value and labor-intensive activities. Recent evidence shows that the median value of freelance transactions fell by 41 percent between FY21 and FY25, even as aggregate freelance exports more than doubled, indicating a proliferation of relatively small-value transactions. While this trend cannot be attributed to AI alone, it highlights the vulnerability of transaction-based, low-value digital services to technological and competitive pressures. Similarly, firms relying on effort-based services may therefore face greater pressure as AI reduces the cost of performing routine digital tasks.

The central constraint is increasingly the "middle": moving from a small exporter to a global supplier

The policy challenge therefore is about helping existing exporters to cross specific capability thresholds. Firm-wise data suggests that the greatest opportunity lies not necessarily in creating more firms, but in moving existing firms through the middle of the distribution.

Category-wise policy suggestions: different scaling problems

Software Consultancy Services (9182): Scaling beyond small project teams requires capabilities in project management, business analysis, cybersecurity, data management, quality assurance and international sales. Pakistan Software Development Export Strategy (PSDE) 2023-2027 identifies these gaps among smaller and second-tier firms. A targeted '*Enterprise Readiness Passport*'[77] could address this gap, whereby specific requirements could be tailored to support eligible firms across relevant IT service categories. The program could co-finance internationally recognised certifications, cybersecurity, data-compliance readiness etc. with support linked with verified milestones, which would help firms to scale.

Computer software (9184): Computer software services include web development services, data entry and processing, web scraping, mobile app development etc. The challenge is to move from selling development capacity to owning reusable technology – propriety products, IP and recurring revenue. PSDE Strategy 2023-2027 identifies weak product and IP-led development and limited access of smaller software firms to government IT projects as constraints.[78] Digitalisation of government services or e-government initiatives can therefore create domestic 'reference markets' for SMEs by expanding domestic demand. In particular, procurement rules can be structured to allow small firms to compete for smaller, modular contracts and to favour reusable, scalable solutions rather than bespoke one-off development products, enabling firms to build reference customers, validate products, and subsequently export them. For instance, Singapore uses government procurement and digitalisation initiatives to help local ICT firms develop solutions for public-sector agencies and subsequently promotes successful firms through government-to-government partnerships. Sri Lanka's ICT Agency similarly supports domestic ICT capability by encouraging joint ventures between foreign and local firms and awarding such partnerships additional points in public procurement evaluations, (UNCTAD, 2013).

Other Computer Services[79] (9185): The more fundamental challenge this category faces is moving from generic outsourcing towards specialised, knowledge-intensive and vertical services. Most of Pakistan's offshore services firms remain concentrated in low value-added services in Information Technology Outsourcing and Business Process Outsourcing, with limited participation in vertical and Knowledge Process Outsourcing. [iv] Therefore, a *vertical ICT export program*[80] could concentrate support on areas such as fintech, Cybersecurity, health tech, logistics, and

[76] ILO's Global Index of Occupational Exposure.
[77] Enterprise Readiness Passport refers to a standardised certificate/benchmark that an ICT firm's financial, governance, business and export credentials to demonstrate its readiness for international market.
[78] Pakistan Software Development Export Strategy 2023-2027 states that in cases where government projects are open to the private sector, preconditions for bids involve a certain size and experience that only a few large private IT firms can meet, therefore the procurement conditions are biased against small IT firms.
[79] This category consists of a broad mix of unspecified hardware, software and software-related services.
[80] Refers to a targeted program that focuses resources, finance, and market access to specific high-potential ICT subsectors, to help firms scale and enter international market.

industrial technology, combining specialised skills, certifications, anchor clients and overseas buyer linkages. For instance, Malaysia's Digital Acceleration Grant targets firms in priority verticals, while the X-Port Grant supports export-ready technology firms in global commercialisation.

Freelance Computer and Information Services (9186): Freelancing has the lowest entry barrier. Individual transactions rarely provide the organisational infrastructure needed for larger enterprise contracts. The policy response could be to create '*export pods*,[81] which would be small, formally registered teams of proven freelancers, that are matched to larger contracts and support for the specific functions they cannot provide individually such as legal contracting, quality assurance, cybersecurity compliance etc. Support should be conditioned against milestones such as incorporation, first team contract, enterprise certification etc.

The skilled labour is becoming a constraint on firm scaling

The concentration of ICT exporters at the bottom of the size distribution is also closely linked with the composition of skills available to and affordable for small firms. Pakistan's ICT firms report difficulty recruiting not only technical workers but also candidates with the social and managerial capabilities required for client-facing work, such as communicating with international clients, managing projects and teams, and coordinating complex service delivery. These capabilities are particularly important for securing and executing larger, more sophisticated contracts; the shortage of such skills constrains the firm's ability to scale beyond small-scale engagements.

A survey conducted by SBP also points to high-salary expectations and workers' preferences for larger established firms (SBP,2023). This creates a particular disadvantage for small exporters. The same firm that needs senior engineers, solution architects, project managers, and international sales specialists, to win and deliver large contracts is also the firm least able to compete with large domestic and international employers for these workers. Consequently, the skills constraint can become self-reinforcing; limited specialised technical and managerial talent restricts the size and complexity of contracts a firm can undertake, while its small scale limits its ability to offer the compensation, career progression and specialised teams needed to attract senior talent.

This helps explain why supplying more entry level programmers in the job market alone may not translate into firm scaling in size. Scaling an ICT exporter requires a relatively small but critical layer of specialised workers who can convert technical labor into a commercial scalable service: architecting solutions, managing large projects, assuring cybersecurity and quality, developing client relationships and selling in international markets. World Bank evidence on Pakistan's online labour market similarly shows strong demand for ICT skills alongside demand for sales and other complementary capabilities. The policy implication is therefore not simply to increase the number of ICT trained workers but to make scarce senior and complementary skills accessible to firms to the point where they are attempting to scale. The subsidised training for smaller exporters will help to share costly specialist talent, such as enterprise architect, cybersecurity leads, and international sales managers, until they reach sufficient scale to employ them permanently.

To mitigate AI's impact on low value-added ICT exports, targeted transitions into AI-complementary skills should be supported through training. Data annotators could move into model evaluation and AI operations, web developers into cloud and platform engineering, and content writers into AI-assisted content strategy and editorial oversight. Programs should align with firms' export upgrading needs and verified skills and employment outcomes, rather than providing generic AI training. This would shift workers towards technical, managerial and domain-specific capabilities supporting larger, complex international contracts.

** The contribution of Ana Khattak is acknowledged in writing this box.*

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i. Rouzet, D., S. Benz and F. Spinelli (2017), Trading firms and trading costs in services: Firm-level analysis, OECD Trade Policy Papers, No. 210, OECD Publishing, Paris.

[81] Exports Proof of Delivery (POD) in this box refers to a small, formally registered team of proven freelancers that pool complementary skills and receive shared support in areas such as legal contracting, quality assurance, cyber security etc. to collectively bid and deliver large international contracts.

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vii. PBC & CDPR (2026). Expanding Pakistan's IT Footprint Strategic Directions for International Market Access.

Box 5.3: Decomposing Pakistan's Interest Payments on Public External Debt: Implications for Balance of Payments

Pakistan's interest payments during FY25 and FY26 cumulatively, have been lower than FY24 despite increases in debt stock **(Table 5.3.1).** The public external debt stock increased by around 8.7 percent between June 2024 to June 2026 to US$ 106.8 billion while interest payment decreased by US$ 70 million (1.7 percent) to US$ 4.0 billion. This improvement was driven by lower average interest rates, partly offset by some increase in the external debt stock. This box aims to quantify the drivers of interest obligations on public external debt over the past five years and quantify the contribution of interest rates and debt stock in lowering the interest payments.

Decomposition of Interest Payments on External Debt **Table 5.3.1**

million US$

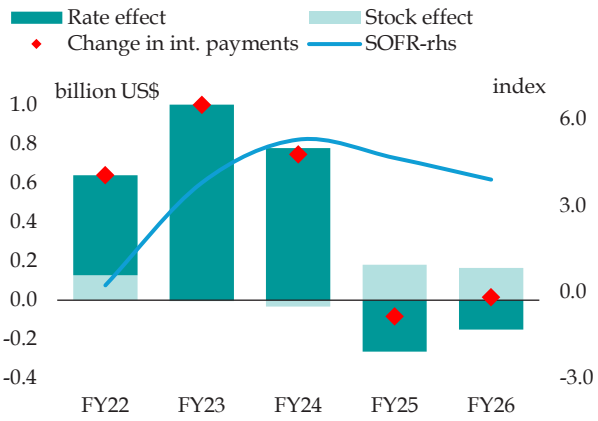
	FY22	FY23	FY24	FY25	FY26
Public external debt, end-June stock	99,972	94,881	98,256	103,750	106,757
Public external debt, average stock	97,596	97,427	96,569	101,003	105,253
Interest payments	2,318.1	3,318.1	4,063.7	3,980.1	3,993.8
Implied interest rate (percent)					
Total public external debt	2.38	3.41	4.21	3.94	3.79
Multilateral	1.36	2.23	3.02	2.94	2.86
Change in interest payments	639.9	999.9	745.6	-83.6	13.7
Rate effect	512.7	1,004.8	778.3	-264.3	-150.7
Stock effect	127.2	-4.9	-32.7	180.7	164.4

Source: SBP staff calculations

Since the interest payments are influenced by both interest rate and debt stock, the changes can be decomposed into parts attributable to the rate and stock. Average implied interest rate decreased to 3.79 percent in FY26 from 4.21 percent in FY24. The 42-bps decrease in average interest rates contributed around US$ 415 million decline in interest payment, which was offset by US$ 345 million rise due to US$ 8.7 billion increase in debt stock over the period (**Figure 5.3.1).**[82]

Recently, Pakistan has shifted towards long-term multilateral and IMF financing sources resulting into lower debt servicing costs. The implied interest rate on public external debt decreased to 3.8 percent in FY26 from 4.2 percent in FY24. This partly reflects easing in global interest rates, as much of lending is repriced with reference to global benchmark rates. The shift towards longer term multilateral and IMF financing, however, has helped contain the impact, as the rate effect could have been higher in its absence. The financing is consistent with government of Pakistan's medium term debt management

Interest Payments on External Debt **Figure 5.3.1**



Source: SBP staff calculations

[82] Average implied interest rate is estimated using ratio of interest payments to average of opening and closing debt stocks.

strategy (FY23 - FY26) which focused on meeting financing needs at lowest possible costs keeping in view the tradeoff between cost and risks.

Implications for Balance of Payments

Even with the expansion of nominal external debt, the lower average interest rate effectively compresses primary income outflows, contributing to narrowing of current account deficit. However, if the global financial conditions are tightened, the combination of larger debt base and rebounding interest rates could trigger a bigger balance of payments shock. For current account the effect accumulates since interest rate is recurring cost of past debt.

** The contribution of Muhammad Nafees is acknowledged in writing this box.*

Box 5.4: Transforming Remittances into Financial and Development Capital

Pakistan received US$ 41.6 billion in workers' remittances in FY26, placing it among the world's five largest remittance-receiving economies. Remittance inflows are equal to around 10 of the GDP, amounting to nearly 1.4 times of exports. As a result, remittances have become the country's most stable source of FX earnings (**Figure 5.4.1a and b**). The resilience of workers' remittance has been particularly evident during periods of stress on external account. For instance, remittance inflows increased significantly during the COVID-19 pandemic, natural disasters including floods, and the recent US-Iran war. This resilience is consistent with literature, which suggests that remittance flows tend to be counter-cyclical and positively correlated with potential GDP in recipient countries Bettin, G., et al. (2013).

Remittances' contribution to long term growth

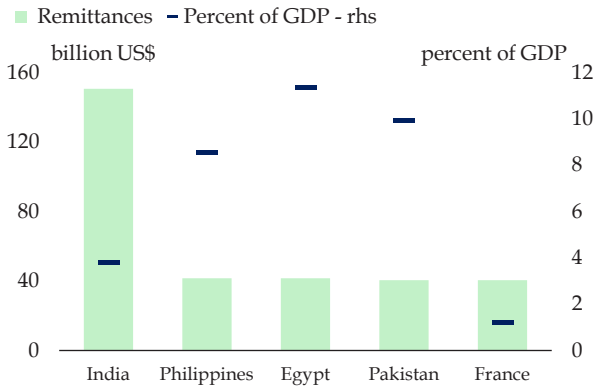
Remittance has a potentially important role, but their contribution to long-term growth depends on the financial environment through which they are intermediated (Frankel, 2011). While remittances support household consumption and welfare, their developmental impact is greater when they are transformed into productive capital. A review of literature points to financial deepening as one potential factor that can help transform remittances into productive finance. A deeper financial system can weaken the remittance-consumption relationship by providing households with greater access to savings instruments, credit, and investment opportunities.

In Pakistan, empirical results support this financial intermediation channel. For quantitative analysis, we use an ARDL model[83] with the interaction between workers' remittances and the IMF Financial Development Index (data period 1980-2025). The estimated long-term specification is:

$$INV_t = \alpha + \beta_1 REM_t + \beta_2 FINDEX_t + \beta_3 (REM_t \times FINDEX_t) + \beta_4 REER_{\{t-1\}} + \beta_5 growth_{t-1} + \varepsilon_t$$

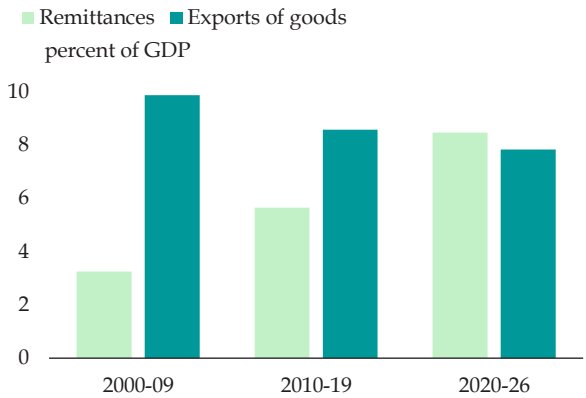
where (INV) and (REM) denote private investment and workers' remittances as shares of GDP.

Top 5 Workers' Remittance Receiving Countries in 2025 — Figure 5.4.1a



Source: WB

Pakistan's Goods Exports and Workers' Remittances — Figure 5.4.1b



Source: Haver

[83] The ARDL bounds testing framework accommodates a mixture of I(0) and I(1) variables and estimates both short run dynamics and long run relationships. The interaction specification follows Giuliano and Ruiz Arranz (2009), who examine how financial development conditions the growth and investment effects of remittances.

We find a strong long-run relationship and a positive, highly significant interaction coefficient of 8.073 ($p<0.001$), indicating that financial development strengthens the effect of remittances on private investment. Importantly, the marginal effect of remittances on investment varies systematically with the level of financial development. At the minimum level of FINDEX, the marginal effect is -1.43, implying that remittances are associated with lower investment, whereas at the maximum observed level, the effect rises to 0.63. The marginal effect crosses zero at a FINDEX of approximately 0.285. This threshold effect suggests the developmental impact of remittances is not uniform: where financial systems are relatively shallow, remittances may be absorbed primarily outside productive investment.

These findings shift the central policy question from simply asking whether remittances are consumed or invested to asking under what financial conditions remittances can be transformed into productive capital.[84] For Pakistan, financial deepening could be a potential bridge between remittance flows and investment.

Policy implications for financial deepening

Our results suggest that the policy challenge is to strengthen financial mechanisms. Policies should particularly focus on expanding the range, accessibility, and quality of financial services, rather than on subsidies aimed at increasing the volume of remittances. Several policy instruments could support this transition, including remittance-linked SME and agricultural lending, housing finance based on documented remittance histories, diaspora investment funds for export-oriented[85], especially the ICT sector, matching funds for migrant funded enterprises and digital savings and investment products.

Several case studies demonstrate how such channels can be developed. Moldovo's PARE 1+1 programme is particularly relevant because it was explicitly designed to address the same policy challenge identified in our analysis: converting remittances into productive investment. Under PARE 1+1 programme, migrants or their immediate family members invested from verified remittance resources in an approved business project, received a matching grant from the government, alongside entrepreneurial training, business-plan-preparation, project screening, and post-intervention monitoring. This programme created an explicit pipeline from remittances to enterprise formation and expansion. Within 10 years, the programme trained more than 2,600 participants and approved more than 1,800 investment projects. The programme was subsequently expanded through PARE 1+2 programme under which successful initial beneficiaries could access additional support for business expansion. This fiscal case of such a model, however, depends on whether the matching grant generates additional investment that would not have otherwise occurred; for Pakistan, this argues for a targeted and performance-based scheme rather than a broad subsidy to remittance recipients.

From financial deepening to mobilising remittance flows at scale

If financial development strengthens the investment response to remittances, then the question is whether relatively stable flow of remittances can be used to mobilise long-term financing for productive investment in a country. This provides a natural bridge from financial deepening to future-flow securitisation, a mechanism through which predictable future remittance receivables are used to raise financing upfront. International experience demonstrates the feasibility of this approach.[86] World Bank (2018) suggests that the use of future remittances as a collateral (*securitisation*) can lower borrowing costs and lengthen debt maturity of a country.

For Pakistan, the relevance of this mechanism lies in the scale and persistence of remittance inflows. Importantly, this is no longer only a prospective financing concept: the SBP has established a regulatory framework enabling Authorized Dealers to undertake foreign-exchange-future-flow transactions for long-term financing from outside

[84] The three stages of remittances suggest that the third stage of remittance life cycle is that of developmental capital. This arises when remittance-related liquidity is transformed into productive investment. Under this channel, the deposits transform into credit, to investment to productivity gains.

[85] India has leveraged diaspora bonds to channel funds into its development since 1991.

[86] No recent data are available on the size of future flow securitisation of remittances, but as of 2008, over US$ 20 billion had been raised by developing country banks using this approach, notably in Mexico, Brazil, and Turkey. Mexico pioneered major future-remittance securitisation in the 1990s, while Banco de Brasil raised US$ 250 million in 2002 by securitising future remittance receivables from Brazilian workers in Japan.

Pakistan.[87] This, therefore, represents a second, complementary channel of financial intermediation. The first operates at the household and firm level, where deeper financial systems can help transform remittances into savings, credit and private investment. The second operates at the financial-system level, where predictable flow of remittances can potentially be leveraged to mobilise larger pools of capital for investment. Recent developments in Pakistan, including transaction undertaken by a financial institution under the SBP framework suggests that this channel is moving from a theoretical possibility towards a practical instrument for mobilising external financing and deepening the country's financial system.[88] As market capacity, institutional expertise and investor confidence develop, Pakistan has considerable potential to scale future-flow-financing beyond initial transactions, broaden the range of eligible foreign-exchange receivables, attract long-term international capital, and ultimately use its stable external payment flows to support substantially greater levels of productive investment and financial deepening.

** The contribution of Ana Khattak and Muhammad Nafees is acknowledged in writing this box.*

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[87] SBP EPD CL 05 2024 https://www.sbp.org.pk/circulars/epd-circular-letter-no-05-of-2024

[88] Bank Alfalah signed a landmark agreement with the International Finance Corporation (IFC) on August 20, 2026, to launch Pakistan's first Diversified Payment Rights (DPR) program, aiming to mobilize up to $100 million in long-term FCY financing.