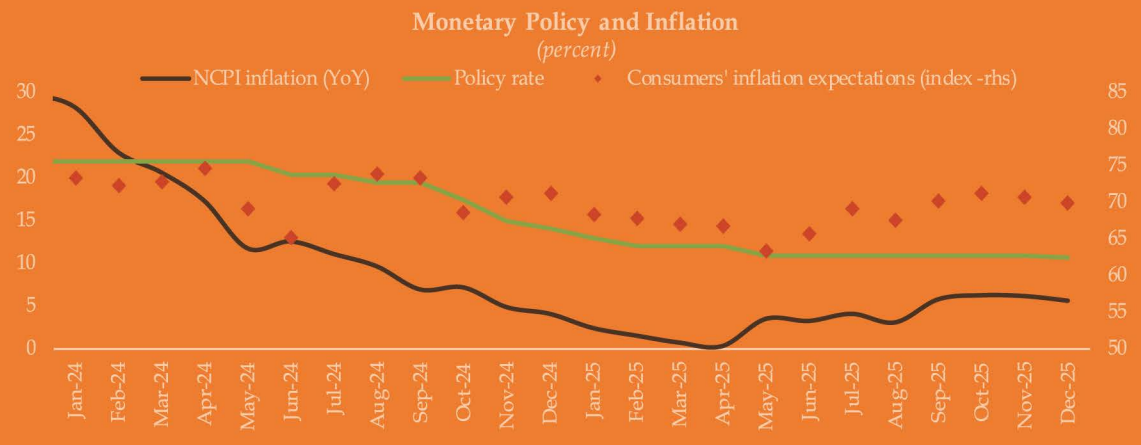
3

Monetary Policy and Inflation

Average NCPI inflation eased to 5.2 percent in H1-FY26 compared to 7.2 percent in the same period last year, while the year-on-year inflation stabilized within the target range of 5.0 – 7.0 percent. Continued prudent monetary and fiscal policy mix that kept domestic demand in check, softened global commodity prices, improved external account and favourable adjustments in electricity prices underpinned this improvement. Energy inflation fell to historically low levels, while core inflation also declined, though it remained persistent at elevated levels. Nevertheless, risks to inflation outlook from floods, uncertainty related to global trade environment and volatility in global commodity prices, and persistence in core inflation led the MPC to keep the policy rate unchanged during H1-FY26, except for December 2025. In tandem with the lower financing cost and a gradual momentum in economic activity, private sector credit also increased. This, together with higher government's budgetary borrowing from scheduled banks, uptick in commodity operations financing and credit to PSEs, drove increase in net domestic assets of the banking system. In addition, continued expansion in net foreign assets of the banking system, led to higher growth in money supply in H1-FY26.



3.1 Policy Review

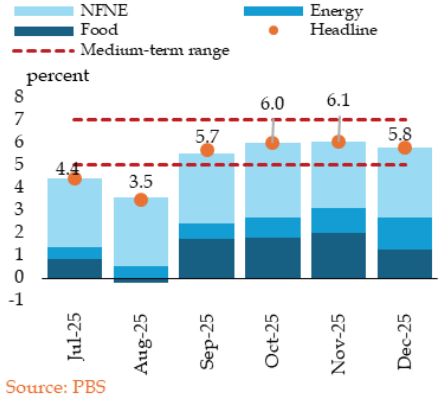
The Monetary Policy Committee (MPC) adopted a cautious stance amid lingering uncertainty surrounding the near-term inflation outlook and kept the policy rate unchanged in all its meetings during H1-FY26, except in December 2025, when the Committee reduced the rate by 50 basis points (bps). The average national CPI (NCPI) inflation eased to 5.2 percent in H1-FY26, close to the lower bound of the medium-term target range of 5.0 – 7.0 percent. On a year-on-year basis, inflation remained below the target band during the first two months of H1-FY26, before stabilising within the target range (**Figure 3.1a and 3.1b**). The moderation in inflation reflected the impact of prudent monetary stance, continued fiscal consolidation, stable exchange rate, and subdued global commodity prices.

Accounting for these trends, the MPC projected the average NCPI inflation to remain within the 5.0 – 7.0 percent range in FY26 in its July 2025 meeting, with some temporary deviations expected in a few months. However, this projection was susceptible to various risks. Specifically, uncertainties stemming from unanticipated energy price adjustments, inflationary impact of the flood-induced supply shock, volatile global commodity prices, evolving global trade dynamics, and wheat supply situation posed risks to inflation outlook during most part of H1-FY26.

Based on the gradual momentum in economic activity and expected recovery in agriculture, assuming limited flood-related disruptions, the MPC expected real GDP growth to be in the range of 3.25 - 4.25 percent in FY26, compared to a growth of 3.1 percent in FY25.[1] The expansion in economic activity was expected to drive a corresponding increase in imports. However, sluggish global demand and subdued outlook for export prices were likely to restrain exports, leading to a widening of trade deficit in FY26. Nevertheless, in view of a favourable outlook of workers' remittances, the MPC projected the current account deficit to

Inflation Composition - Urban

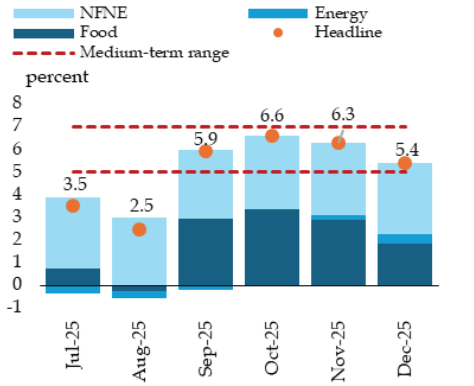
Figure 3.1a



Source: PBS

Inflation Composition - Rural

Figure 3.1b



[1] At the time of MPC meeting in July 2025, the provisional estimate for real GDP growth in FY25 was 2.7 percent.

remain in the range of 0 – 1.0 percent of GDP in FY26.

As anticipated, after remaining subdued in July and August, inflation increased to 5.8 percent in September 2025. In addition to the flood-related increase in prices of both perishable and non-perishable food commodities, this also reflected the impact of upward adjustment in energy prices and persistence in core inflation.

Moreover, high-frequency indicators, including automobile sales, fertilizer offtake, private sector credit, imports of intermediate goods and machinery, and the Purchasing Managers' Index,[2] pointed towards a robust expansion in economic activity in Q1-FY26. In line with these trends, LSM also saw a notable increase in Q1-FY26, against a contraction in the same period last year. In addition, Pakistan reached a staff-level agreement with the IMF on the Extended Fund Facility (EFF) and Resilience and Sustainability Facility (RSF) reviews, reflecting positively on the external account.

Based on these developments, the MPC, in its October 2025 meeting, noted further strengthening of growth outlook and assessed real GDP growth in FY26 to be in the upper half of the previously projected range of 3.25 – 4.25 percent. Moreover, accounting for the unfolding impact of a cumulative 1,100 bps reduction in the policy rate between June 2024 and May 2025, the uncertainties surrounding the inflation outlook, and the potential domestic supply pressures emanating from market frictions, the MPC decided to keep the policy rate unchanged in its meetings held in July, September and October 2025.

In its December 2025 meeting, the Committee reduced the policy rate by 50 basis points. The decision was supported by benign trends in inflation, as NCPI inflation had remained within the target range and food, energy, and core inflation were broadly in line with the earlier expectations. The MPC noted that the real policy rate remained adequately positive to stabilise inflation within the medium-term target range.

Looking ahead, the Committee expected inflation to rise above the target range towards the end of FY26 and in FY27.[3] Moreover, easing financial conditions and an overall improvement in business environment aided expansion in economic activity in H1-FY26. The MPC also underscored the need for initiating required structural reforms and continued coordination between monetary and fiscal policies to achieve a high economic growth trajectory on a sustained basis.

3.2 Monetary Aggregates

The broad money (M2) growth accelerated to 18.8 percent (YoY) at end-December 2025, compared to 10.2 percent in the corresponding period of last year (**Table 3.1**). Moreover, the composition of M2 growth somewhat changed as increase in net foreign assets (NFA) moderated, while expansion in net domestic assets (NDA) of

[2] The Purchasing Manager's Index increased to 56.81 in Q1-FY26 as compared to 50.25 in Q1-FY25.
[3] The ongoing Middle East war poses significant upside risks to inflation outlook.

Monetary Aggregates **Table 3.1**

stocks and changes in stock in billion Rupees; growth in percent

	Stocks end-period		Change in stock		Growth (YoY)	
	Dec-2024	Dec-2025	H1-FY25	H1-FY26	Dec-2024	Dec-2025
Broad money (M2)	35,614.4	42,302.2	-267.4	1,795.9	10.2	18.8
NFA	-470.6	854.2	667.3	389.4		
NDA	36,085.0	41,448.0	-934.7	1,406.5	7.7	14.9
Budgetary borrowing	27,508.6	33,731.4	-2,215.4	-347.0	13.1	22.6
SBP	3,639.2	2,355.6	-888.5	-1,480.6	4.1	-35.3
Scheduled banks	23,869.4	31,375.7	-1,326.8	1,133.6	14.6	31.4
Commodity operations	1,162.2	1,086.1	-216.1	19.5	-7.5	-6.6
Credit to private sector	10,845.7	10,941.0	1,978.9	992.3	22.8	0.9
Credit to PSEs	2,267.4	2,201.0	75.9	96.6	1.4	-2.9
Other items net	-7,704.0	-7,326.3	-2,101.6	763.2		
Currency in circulation	9,115.9	10,872.6	-37.2	238.1	7.9	19.3
Deposits	29,822.9	36,632.7	-358.8	2042.3	10.5	22.8
Reserve money	11,579.0	13,447.9	-33.9	477.3	9.1	16.1

Source: SBP

the banking system doubled in H1-FY26 compared to the same period last year.

Increased government borrowing from scheduled banks, in conjunction with a sustained increase in credit to non-government sector drove the expansion in NDA of the banking system in H1-FY26. Additionally, commodity operations financing and credit to Public Sector Enterprises (PSEs) also ticked up during H1-FY26.

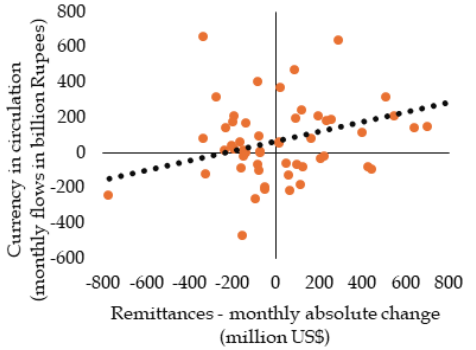
On the other hand, greater external inflows and valuation gains on gold holdings amid higher international prices supported an increase in SBP's net foreign assets. However, a contraction in scheduled bank's NFA contained the overall expansion in NFA of the banking system.

On the liability side, against a slight contraction during H1-FY25, currency in circulation (CiC) rose by Rs 238 billion during H1-FY26 (**Table 3.1**). The increase in CiC reflected the impact of at least three factors. First, in July 2025, the government raised withholding tax on cash withdrawals for non-filers from 0.6 percent to 0.8 percent, which may have discouraged transactions through formal banking channels.[4,5] Second, a sizeable increase in workers' remittances, especially during Q2-FY26, also added to CiC (**Figure 3.2**). Lastly, growing momentum of domestic economic activity bolstered

[4] Source: Finance act (2025). MoF.

[5] SBP (2017) found positive relationship between WHT and CiC. SBP (2017). Special section: Impact analysis of withholding tax on cash withdrawal and banking transactions. The State of Pakistan's Economy Annual Report 2016-17. SBP.

Remittances and Currency in Circulation **Figure 3.2**

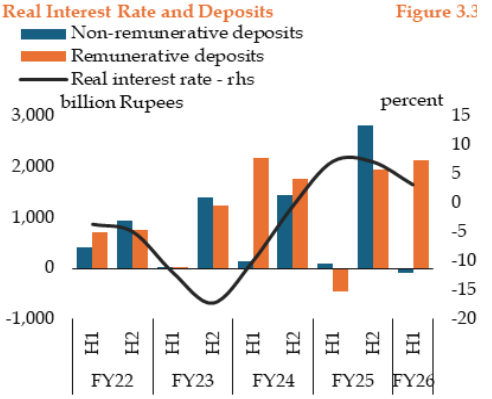


Note: Data covers the period Jul 2006 to Dec 2025.
Source: SBP

transaction demand for money and hence CiC.[6]

Meanwhile, bank deposits also increased by Rs 2,042 billion during H1-FY26, against a withdrawal of Rs 359 billion in the same period last year. The substantial increase in deposits during H1-FY26 could be attributed to a significant positive real interest rate (**Figure 3.3**). This is also evident from a slight drop in non-remunerative deposits, as depositors shifted funds out of zero-return current accounts to remunerative deposits and equity market. Moreover, part of the increase in deposits also appears to reflect the seasonal pattern. In contrast, during H1-FY25, banks had introduced service charges on deposits above certain amount to meet advances-to- deposit ratio (ADR)

Real Interest Rate and Deposits **Figure 3.3**



Source: SBP

requirement, which discouraged deposits mobilisation.

Credit to PSEs

Credit to PSEs expanded by Rs 97 billion during H1-FY26, compared to an increase of Rs 76 billion in the same period last year (**Table 3.1**). The bulk of increase was concentrated in a few large enterprises, namely National Power Parks Management Company Limited (NPPMCL) and Pak-Arab Refinery Limited (PARCO), mainly to meet working capital requirements.

Circular debt-related receivables necessitated higher borrowing for NPPMCL,[7] while PARCO's borrowing requirements largely emanated from dividend payments in Q1-FY26, which created a liquidity gap.[8]

[6] Empirical literature identifies remittances as a major factor influencing currency in circulation in Pakistan, due to its positive impact on income and hence transaction demand for currency. Ejaz et al. (2019). The conundrum of rising demand for currency in Pakistan. SBP staff notes 1/20. SBP.
Khaskheli et al. (2013). The behavior and determinants of the currency deposit ratio in Pakistan. SBP research bulletin Vol 9. SBP.
Ghumro and Karim (2017). The role of remittances in the stability of money demand in Pakistan: A cointegration analysis. Economic Annals, Vol. 62, No. 213.
[7] NPPMCL (2025). Statement of Corporate Intent. National Power Parks Management Company Limited.
[8] PACRA (2025), Pak Arab Refinery Ltd. Credit Rating Report, The Pakistan Credit Rating Agency Limited.

Commodity Operations Financing

Commodity operations financing recorded a net increase of Rs 19.5 billion during H1-FY26, in contrast to a net retirement of Rs 216 billion in the same period last year (**Table 3.1**). The increase was primarily on account of borrowing by the Trading Corporation of Pakistan (TCP) for sugar imports to stabilise domestic prices. In addition, Pakistan Agricultural Storage and Services Corporation Limited (PASSCO) borrowed to fund carrying costs of existing commodity stocks in warehouses.

Budgetary Borrowings

Government's budgetary borrowings from the banking system saw a net retirement of Rs 347 billion in H1-FY26, substantially lower compared to Rs 2,215 billion in the same period last year (**Table 3.1**). While the government continued to retire the outstanding debt owed to SBP, it increased borrowing from scheduled banks in H1-FY26.

To benefit from the declining interest rates, and its strategy to lengthen the maturity profile, (**Table 3.2**) the government set auction targets below or close to maturities for Treasury Bills (T-bills) resulting in a net retirement in this category (**Figure 3.4**).[9] At the same time, the government allocated higher targets for PIBs. In line with its objective to reduce exposure to interest rate risk, the government mobilised bulk of

Auction Summary -H1-FY26 **Table 3.2**

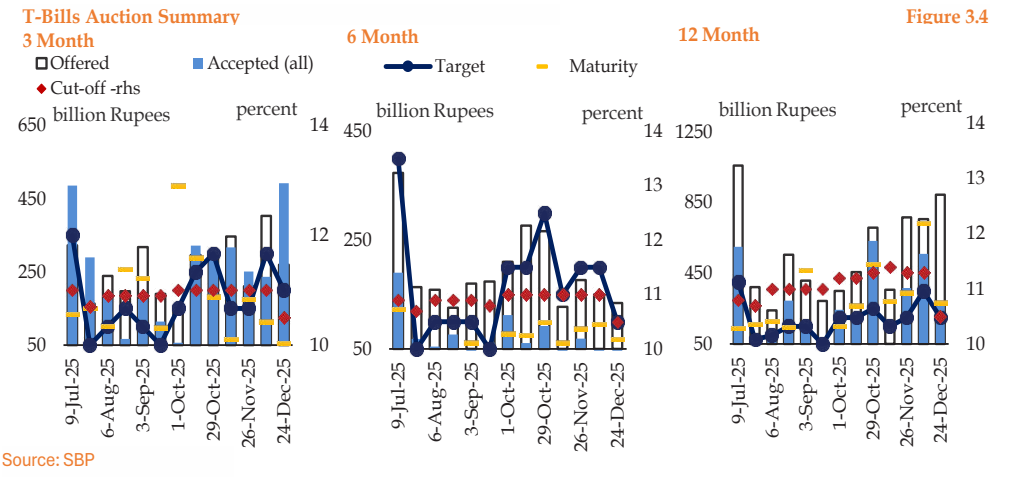
billion Rupees; ratio

	Target	Acceptance	Acceptance (net of maturity)	Offer-to-Target	Target-to-Maturity	Acceptance-to-Maturity
			Treasury Bills			
22-Day			-915.6			
1-Month	1,300.0	1,571.8	-22.1	6.7	0.8	1.0
3-Month	2,300.0	3,279.6	928.0	1.5	1.0	1.4
6-Month	2,150.0	913.5	48.5	1.2	2.5	1.1
12-Month	2,475.0	3,560.6	-117.6	2.9	0.7	1.0*
Total	**8,225.0**	**9,325.4**	**-78.8**	**2.7**	**0.9**	**1.0**
			Pakistan Investment Bonds			
Fixed Rate						
2Y	525	308.8	308.8	2.7	-	-
3Y	400	339.8	-245.1	3.6	0.7	0.6
5Y	475	627.0	-24.6	3.1	0.7	1.0
10Y	550	1,023.0	1,023.0	4.1	-	-
15Y	300	1,081.3	1,081.3	13.0	-	-
Total	**2,250**	**3,379.9**	**2,143.4**	**4.7**	**1.8**	**2.7**
Floating Rate						
Semi-Annual						
10Y	1,850	1,556.7	1,556.7	4.7	-	-
Total	**1,850**	**1,556.7**	**3,276.8**	**4.7**	**1.6**	**1.4**

* Rounded to one decimal place; the actual value is 0.96;

Source: SBP

T-Bills Auction Summary **Figure 3.4**



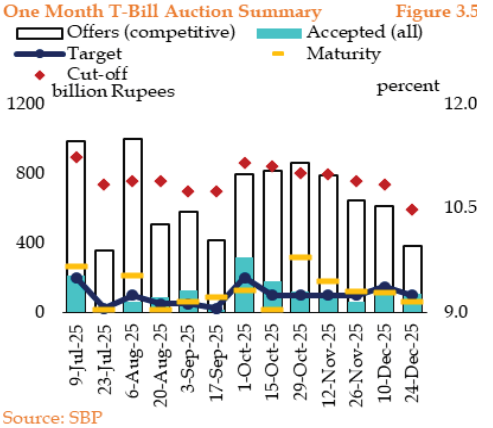
Source: SBP

financing from Pakistan Investment Bonds (PIBs) - Fixed, followed by PIBs – Floating (PFLs) Semi Annual Coupon.

Within T-bills, market appetite remained strong for the 12-month bill, indicating a preference for longer-tenor instruments driven by anticipation of further decrease in interest rates. In Q2-FY26, market increased offers for 12-month papers when increased government borrowing requirements pushed the cut-off rates higher **(Figure 3.4)**. On the other hand, offers for 1-month T-bill declined throughout Q2-FY26 as the market moved to extend its portfolio duration (**Figure 3.5**).

The PIB auctions also saw strong market participation despite shifting market expectations regarding the interest rates (**Figure 3.6**).[10] At the same time, the government deliberately restrained the issuance of PFLs by assigning targets for only 10Y bond, which nonetheless attracted offers that exceeded the target by more than four times. To further contain floating rate debt, the government conducted buyback auctions for both 5Y and 10Y semi-annual coupons in November, buying back a total of Rs 122.1 billion.

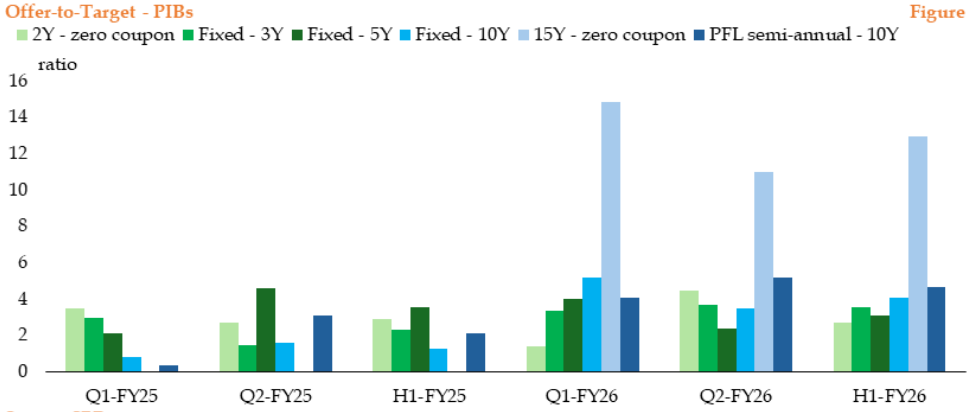
One Month T-Bill Auction Summary **Figure 3.5**



Source: SBP

[10] Market's expectations regarding the future path of interest rates varied in H1-FY26, largely influenced by inflation trends. Slightly higher inflation in September and October led to expectations of a possible policy rate hike, while ease in inflation in December 2025 supported expectations of a rate cut.

Offer-to-Target - PIBs Figure 3.6

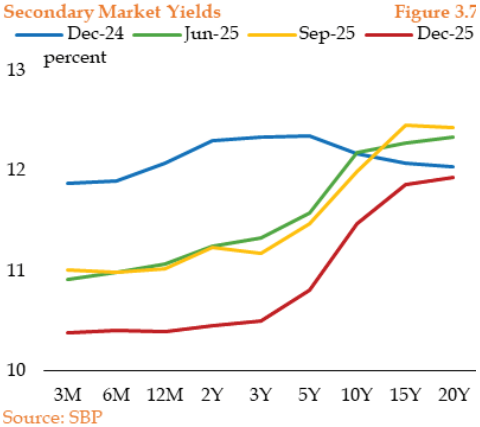


Source: SBP

The government increasingly relied on fixed-rate PIBs to raise financing to lock in lower borrowing costs, in a declining interest rate environment, and reduce repricing risks, as reflected from acceptances exceeding maturity by around three times. As a result, the share of PIBs-Fixed reached 83 percent of the overall mobilisation through auctions in H1-FY26. Likewise, the market's interest in longer-tenor instruments was significantly high, as the 15Y zero coupon was persistently oversubscribed.

Reflecting optimism about economic growth and expectations regarding inflation trajectory, the secondary market yield curve remained positively sloped during H1-FY26.[11] The yields for shorter-tenor securities continued to decline, which along with the policy rate cut, flattened the shorter-end of the yield curve in December 2025 (**Figure 3.7**).[12] This can be attributed to market's pronounced interest in longer-tenor securities (5Y, 10Y and 15Y), which kept the secondary market yields for these securities elevated while moderating the yields for shorter tenors.

Secondary Market Yields Figure 3.7



Source: SBP

[11] A positive yield spread between the 10Y and 3-month U.S. T-bill is a valuable indicator of economic activity and short-term interest rate expectations for two to six quarters ahead. Estrella & Mishkin (1996). The Yield Curve as a Predictor of U.S. Recession. Federal Reserve Bank of New York. Current Issues in Economics and Finance. Volume 2 Number 7.

[12] Empirical findings for Pakistan show that an increase in the yield spread is a strong predictor of output growth. Hussain, F. & Mahmood, A. (2017). Predicting Inflation and Output in Pakistan: The Role of Yield Spread, SBP Working Paper Series, No.93

Overall, the ongoing fiscal consolidation efforts have supported smooth pass-through of changes in the policy rate to short-term rates. During the monetary tightening phase that began in September 2021, elevated domestic financing needs, in conjunction with high inflation expectations pushed cut-off rates above the policy rate (**Figure 3.8**).

In contrast, during the easing cycle, lower domestic borrowing requirements amid fiscal consolidation reduced pressure on cut-off rates, allowing them to align more closely with the policy rate.

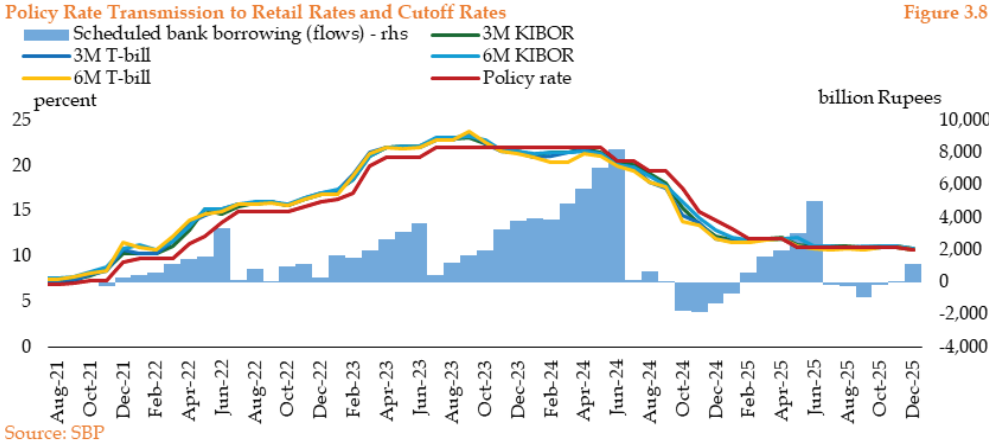
Interbank Liquidity

Higher government borrowing from the scheduled banks, continued expansion in private sector credit, and a rise in CiC kept interbank liquidity conditions under stress in H1-FY26, compared to the same period last year. Although SBP's net FX purchases and higher deposit mobilisation cushioned liquidity, these factors only partially offset the underlying pressures.

SBP met the additional liquidity requirements of the market through OMO injections on net basis. As a result, the average outstanding OMO stock rose to Rs 12.8 trillion in H1-FY26 from Rs 10.8 trillion in H1-FY25. The effective liquidity management contained volatility in Weighted Average Overnight Rate (WAONR), reducing its deviations from the policy (target) rate to an average 11.4 bps in H1-FY26 from 19.6 bps in H1-FY25 (**Figure 3.9 & 3.10**).[13]

In H1-FY26, the market also reduced its reliance on the SBP's corridor facilities, indicating that liquidity support through OMOs was sufficient in meeting the

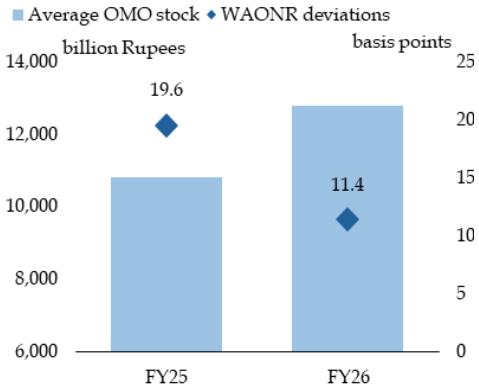
Policy Rate Transmission to Retail Rates and Cutoff Rates — Figure 3.8



Source: SBP

[13] The central bank's ability to align WAONR with the policy rate depends on liquidity forecasts, particularly the anticipation about autonomous factors affecting liquidity. If an inappropriate amount of liquidity is supplied through OMOs, this can result in higher interest rate volatility. Disyatat, P. (2008). Monetary Policy Implementation: Misconceptions and their consequences. *BIS Working Papers No 269*.

Interbank Liquidity Indicators - H1 Figure 3.9

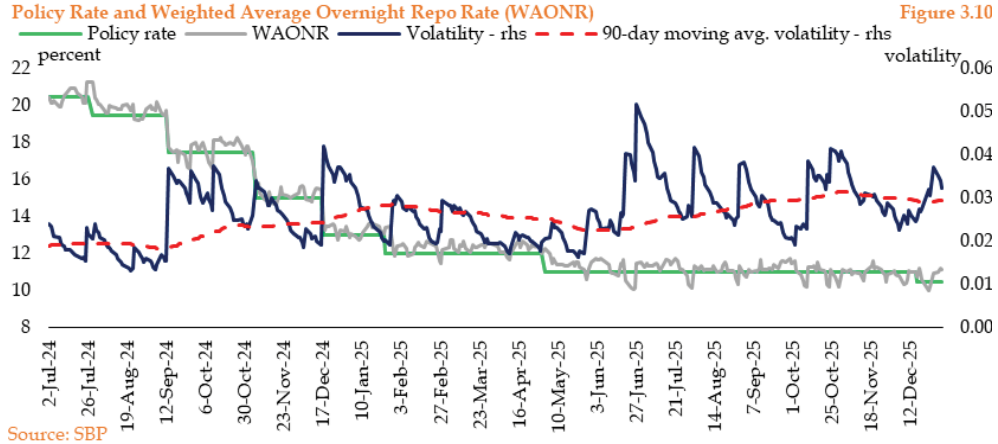


Source: SBP

market's requirements.[14] SBP predominantly injected liquidity through 7-day and 14-day OMO injections, in view of the market's anticipation of future rate cuts during H1-FY26.[15] In addition, SBP also strengthened risk management measures for its monetary policy lending operations, by introducing haircuts on government securities as collateral, effective from July 2025.[16,17]

In parallel with developments in the conventional interbank market, the liquidity needs of Islamic Banking Institutions (IBIs) also increased in H1-FY26 as evidenced by higher frequency and overall volume of injections, which nearly doubled in comparison to H1-FY25. As a result, the average outstanding stock of Shariah-compliant OMOs more than doubled to Rs 324.7 billion compared to Rs 147.3 billion.

Policy Rate and Weighted Average Overnight Repo Rate (WAONR) Figure 3.10



Source: SBP

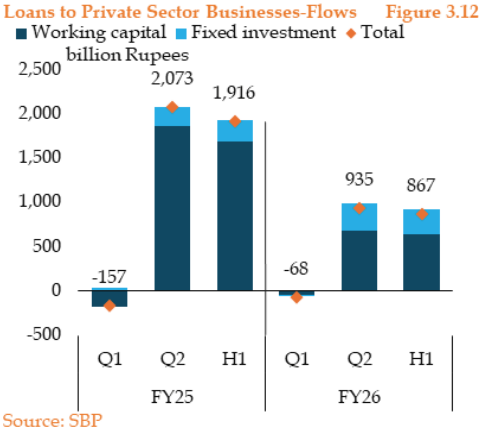
[14] Use of the SBP's interest rate corridor declined sharply relative to H1-FY25 in terms of both the frequency and volume, with lower placements at the floor facility and reduced recourse to the ceiling facility as well.
[15] In H1-FY25 liquidity was injected through the 7-day and 28-day tenor.
[16] Collateral haircuts refer to a reduction applied to the market value of securities pledged as collateral for loans, to act as a buffer against possible decline in market prices. Source: DMMD Circular No. 09 of 2024. SBP
[17] Globally, collateral haircuts are applied by many central banks to reduce credit risk in central bank monetary policy lending operations. The Federal Reserve, Bank of England and European Central Bank are some examples of central banks that apply collateral haircuts. Source: Collateral management in central bank balance policy operations. Garreth Rule (2012) *Centre for Central Banking Studies*

3.3 Private Sector Credit

Private sector credit (PSC) grew by 0.9 percent (YoY) as of end December 2025, compared to 22.8 percent (YoY) increase in the same period last year, and an average growth of 14.1 percent in the comparable period of last five years. The moderation in growth in H1-FY26 was anticipated due to high base in the previous year, when ADR-based tax led the banks to scale-up lending to the private sector.

In absolute terms, loans to private sector businesses (PSBs) expanded by Rs 867.2 billion in H1-FY26, compared to Rs 1,915.7 billion in H1-FY25. This increase was driven by both working capital and fixed investment loans. Moreover, the increase was mostly concentrated in Q2-FY26, specifically in December 2025, while Q1 saw seasonal retirement (**Figure 3.11**). Encouragingly, the expansion in fixed investment loans was slightly higher compared to the first half of last year (**Figure 3.12**).

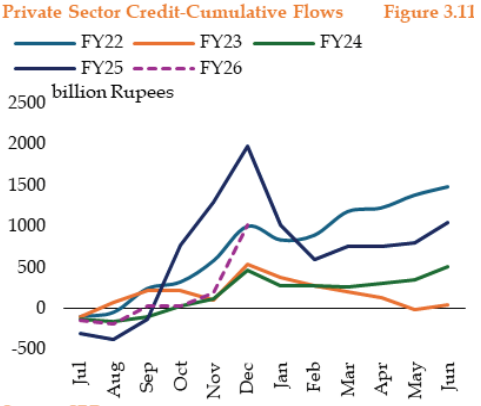
Loans to Private Sector Businesses-Flows Figure 3.12



Source: SBP

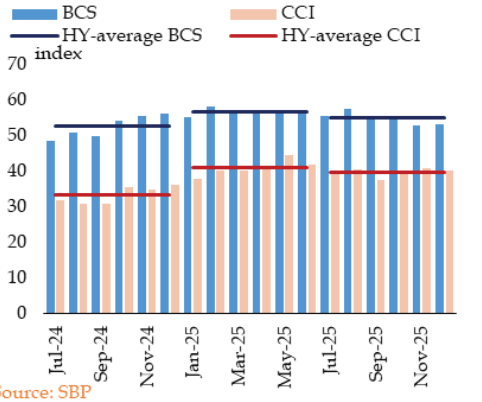
While the imposition of ADR-based tax along with elevated input costs mainly drove credit growth during H1-FY25, the expansion in credit to PSBs in H1-FY26 reflects a noticeable pickup in economic activity amid improved business and consumer confidence (**Figure 3.13** & **Table 3.3**). On supply side, increased bank deposits during H1-FY26 compared to last year enhanced the availability of loanable funds.[18] Additionally, the government

Private Sector Credit-Cumulative Flows Figure 3.11



Source: SBP

Business & Consumer Confidence Figure 3.13



Source: SBP

[18] On cumulative basis, total deposits of banks increased by 4.3 percent in H1-FY26 compared to 0.9 percent in the same period last year. Source: SBP

Underlying Indicators of Private Sector Credit **Table 3.3**

percent change

	H1-FY25	H1-FY26
Cost of production		
Global commodity prices	-4.1	-7.6
PKR/US$ ER (avg. +app./-dep.)	3.4	-1.1
Wholesale price index:	4.4	0.3
Diesel	-15.3	6.7
LNG	37.8	6.3
Coal	20	-3.7
Electricity	7.9	-15.4
Economic activity		
LSM	-1.8	4.8
PSDP	14.7	43.2

Source: SBP; PBS; WB

support measures for priority sectors, agriculture and SMEs, also contributed to continued expansion in credit to PSBs.

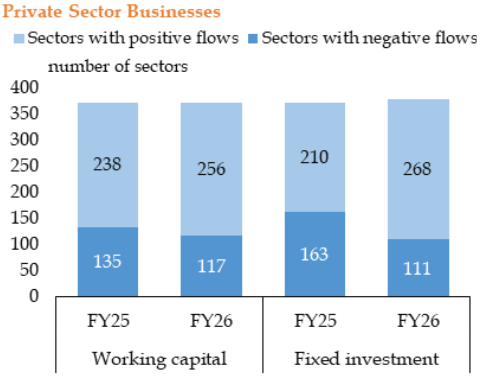
Meanwhile, lower output of important crops that dented farm incomes propped up short-term borrowing requirements of some agriculture-related sectors. However, despite various incentive schemes, share of agriculture credit in Pakistan remained stagnant at low levels. In this context, **Box 3.1** explores the pathways to enhance agriculture credit.

Pickup in economic activity drove the expansion in working capital loans in some sectors

The PSBs availed working capital loans amounting to Rs 643.6 billion in H1-FY26, compared to Rs 1,686.2 billion in the same period last year. While the overall amount was lower compared to last year, the number of sectors availing credit for working capital increased to 256 in H1-FY26 from 238 in H1-FY25 (**Figure 3.14**). The major sectors availing short-term financing included *textile & wearing apparel, rice processing, agriculture & fishing and motor vehicles* (**Figure 3.15**).

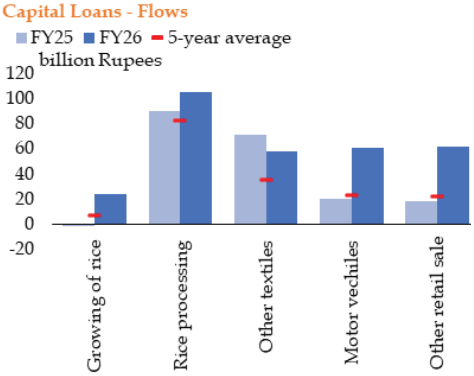
An uptick in economic activity, specifically strong recovery in LSM output, lifted short-term financing requirements of various sectors (**Table 3.4**).[19] The recovery in sales and softening input costs improved profit margins, which together with declining interest rates, suggests

Frequency Distribution of Loans to Private Sector Businesses **Figure 3.14**



Source: SBP

Major Sub-Sectors Availing Working Capital Loans - Flows **Figure: 3.15**



Source: SBP

[19] LSM grew by 4.8 percent during H1-FY26 compared to contraction of 1.8 percent in the same period last year. Output of 14 out of 22 LSM subsectors increased during H1-FY26. Source: PBS

Loans to Major Private Sector Businesses – H1 Table 3.4

flows in billion Rupees

	Total Loans*		Working Capital**		Fixed Investment		Average 2022-24		
	FY25	FY26	FY25	FY26	FY25	FY26	WC	FI	TL
Total	1915.7	867.2	1686.2	643.6	240.9	283.1	449.4	160.1	625.8
Manufacturing	1401	501.6	1305.1	396.9	100.1	113.4	383.6	108.8	493.7
Textile & wearing apparel	611.1	136.4	609.3	116.2	2.8	22.7	179.3	46.7	226.6
Basic pharma.	222.9	17	215.1	11.5	8	5.7	2.1	2.6	4.6
Cement & plaster	107.1	5.4	119.7	21.4	-12.3	-16	5.8	7.5	13.1
Rice processing	92.1	106.1	91	105.5	1.1	0.6	72.6	1.2	73.8
Fertilizers	45.8	37.6	26.5	5.5	19.4	32.1	2.5	6.2	8.7
Refined petroleum	42.7	26.9	20.7	17.1	22	9.8	19.8	4.7	24.5
Motor vehicles	27.9	68.9	20.7	61.6	7.2	7.3	11.9	2.5	14.4
Basic iron & steel	18.2	6.1	5	7.8	13.2	-0.5	30.4	2.5	32.9
Veg. & animal oils	17.6	-28.1	18.7	-26.4	-1.1	-1.7	12.4	0.8	13.1
Paper industry	14.4	5.7	10.1	1.2	4.3	4.5	12.5	8	20.6
Sugar	-26.7	-39.6	-46.9	-41.1	20.2	4.1	-48.7	-4.6	-53.3
Telecommunication	115.1	47.7	96.9	27.4	18.2	20.3	-4.3	26.6	22.3
Wholesale & retail trade	91.7	155.7	64.5	129.5	29.6	39	40.7	3.3	44.4
Agri.& fishing	59.9	123.1	28.5	69.5	31.5	53.9	20.5	21.4	42.4
Construction	25.9	9	18.1	8	9.3	24.4	4.9	-1.9	17.4
Mining & quarrying	16.3	-3.5	16.5	0.8	-0.2	-4.2	1.9	-1.1	0.9
Power gen. & dist.	-23.9	-85.4	-15.3	-33	-8	-52.2	-6.6	-1.3	-8
Transport. & storage	-14.8	27.6	-20.2	11.2	5.7	16.6	4.5	-0.5	4.2
Real estate activities	-0.4	1.4	-1.4	8.4	-0.7	5.5	0.1	-0.5	-0.1

* Total amount also includes construction finance. In terms of IH&SMEFD Circular Letter No. 28 of 2020, the data on credit/loans has been revised since June 2020 due to inter-sectoral adjustment in private sector business.

** Includes trade finance

Source: SBP

improvement in the repayment capacity of firms. The stronger financial position improved credit worthiness of companies, and hence their ability to borrow (**Table 3.5)**.

Particularly, higher production and exports explain Rs 116.2 billion increase in short-term borrowing of textile & wearing apparel in H1-FY26.[20] However, this was significantly lower compared to Rs 609.3 billion in H1-FY25, which may be partly attributed to lower input costs **(Table 3.4)**.

Motor *vehicles manufacturing* tripled the uptake of working capital loans in H1-FY26, compared to the first half of last year. This showed the impact of buoyant sales and production amid lower borrowing cost,[21] rationalisation of import tariffs and reduction of regulatory duty on

[20] Production of garments increased by 7.5 percent during H1-FY26 compared to a high growth of 9.5 percent recorded last year. Source: PBS

[21] During H1-FY26, production of automobiles increased by 67.2 percent compared to expansion of 49.7 percent in the same period last year. Source: PBS

Financial Indicators of Non-financial Corporates **Table 3.5**

percent growth; ratio

Sectors	Cost of Sale		Sales		Current Ratio		Operating	
	FY25	Sep-25	FY25	Sep-25	FY25	Sep-25	FY25	Sep-25
All Sectors	-2.6	-6.6	-2.5	-4.8	1.3	1.4	9.1	10.3
Textile sector	0.9	-2.8	0.1	-2.2	1.1	1.1	5.4	5.3
Made-up textile articles	13.1	-5.1	13.3	-3.8	1.2	1.1	7.0	4.7
Chemicals, chemical products and	6.1	11.3	9.1	11.1	1.3	1.2	16.8	17.2
Mineral products	1.5	9.7	2.6	7.7	1.9	2.0	14.9	9.9
Manufacturing	-3.3	0.6	-5.9	4.8	9.7	1.2	9.7	16.0
Motor vehicles, trailers & auto parts	22.5	31.1	24.9	32.8	1.4	1.5	11.1	11.4
Fuel and energy sector	-10.8	-30.5	-10.9	-28.2	1.4	1.7	13.7	15.5
Information and communication	4.5	10.0	2.9	17.0	0.9	0.9	11.0	14.9
Coke and refined petroleum	-8.0	-5.4	-9.0	-4.0	1.5	1.6	3.7	5.2
Paper, paperboard and products	-6.6	2.9	-8.8	0.5	1.6	1.4	4.5	5.4
Electrical machinery and apparatus	28.2	-4.7	21.0	2.2	1.4	1.5	8.2	8.0

Source: SBP

import of auto parts.[22,23] Similarly, construction-allied industries including *cement and steel* also availed higher working capital loans amid pick up in construction activity.[24,25]

Weakened farm incomes augmented short-term financing requirement of agriculture and related manufacturing sectors

While financial position of firms generally improved, lower output and exports of some kharif crops hampered cash flow of growers and crop-related manufacturing sectors during H1-FY26. Specifically, declining rice export in FY26 constrained liquidity of rice millers, driving increase in working capital loans. On the other hand, a decline in cotton production weighed on cash position of the farmers, leading to increased short-term financing requirements.[26] Support measures announced by the SBP and the government for small farmers and underserved areas, was another factor explaining increased borrowing in these sectors.

Improved profitability lowered working capital needs of some of the sectors

The significant decline in global crude oil prices trimmed input costs of petroleum refining sector. The improved financial position, as seen from strengthening profit margins, reduced short-term borrowing requirements of *refined petroleum* sector.

Conducive macroeconomic environment encouraged fixed investment

Fixed Investment loans maintained the

[22] Source: FBR S.R.O. 1151 (l)12025, S.R.O 1152(2025)
[23] See Chapter 2 for details.
[24] PSDP spending in H1-FY26 increased by 43.2 percent compared to 14.7 percent in the same period last year. Source: Finance Division
[25] Loans for house building expanded by Rs 13 billion compared to consecutive contraction of 3.0 billion observed in the last two years, indicating expansion in economic activity. Source: SBP
[26] Production of cotton declined by 1.2 percent in FY26, because of lower area under cultivation. Source: PBS & FCA working papers

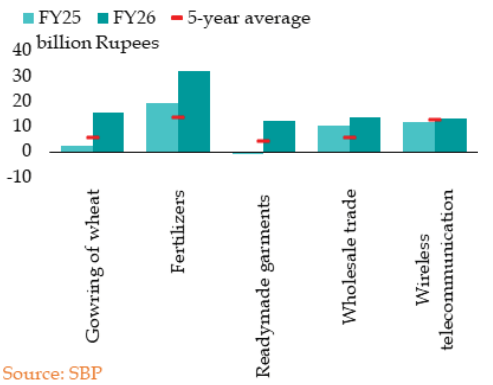
growth momentum with 15.4 percent (YoY) increase as of end-December 2025, up from 10.6 percent in the same period last year. Moreover, total number of sectors availing fixed investment loans also edged up in H1-FY26, compared to H1-FY25 (**Figure 3.14)**.

Lower interest rates, recovery in consumer demand, increased capacity utilisation of major industries, easing inflationary pressures, stable exchange rate, and improved business sentiments encouraged businesses to invest in capacity enhancement. In addition, the need to meet the global environmental standards has also raised investment in sustainable production processes in various exporting firms, especially in textile and clothing sectors, for the past few years. Pakistan's green financing landscape is evolving to encourage climate aligned investment for reducing the impact of climate change on its economy. In this regard, **Box 3.2** suggests some policy measures to promote green financing.

The sectors that availed long-term financing included *agriculture machinery & equipment*, *growing of wheat, wearing apparel, fertilizers & nitrogen* and *telecommunications* (**Figure 3.16**). The *wearing apparel* availed long-term financing for capacity enhancement and upgradation of production processes to achieve energy efficiency.[27] Likewise, the increase in fixed investment loans in *manufacturing of fertilizers & nitrogen compounds* was mainly driven by expansion in retail network by a large producer.[28] Moreover, an uptick in fixed investment loans in *telecommunications* sector, specifically the wireless telecommunications, can be attributed to upgradation of network infrastructure for improved service quality and 5G readiness.

The agriculture sector increased uptake of fixed investment loans led by wheat farmers. Specifically, to benefit from lower borrowing costs and anticipated increase in wheat prices under new policy, the farmers increased long-term borrowing for *growing wheat*. Anecdotal evidence suggests these loans were meant for agriculture machinery import used in land preparation for wheat crop.[29] Moreover *poultry* sector also increased long-term

Major Sub-Sectors Availing Fixed Investment Loans - Flows **Figure: 3.16**



Source: SBP

[27] A leading apparel exporter is investing in capacity expansion in the apparel segment to position itself as one of the leading apparel export players in the global market. The firm is also investing in improving energy efficiency of production process. Source: Interloop Limited Annual Financial Report for 2025.
[28] Source: Fauji Fertilizer company's quarterly financial statement, September 2025
[29] Land preparation for wheat is a capital-intensive activity and needs investment in agriculture machinery. Resultantly, import of agricultural machinery and implements increased to US$ 65.8 million (or grew by 21.6 percent) in H1-FY26, compared to US$ 54.1 million last year. Source: PBS

borrowing to switch to solar power and achieve cost efficiency.

Consumer Financing

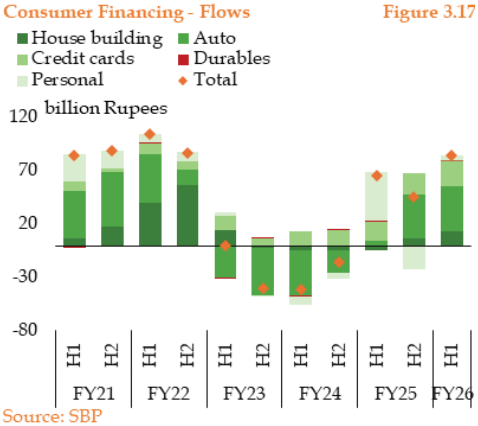
Amid declining borrowing cost, consumer financing expanded by Rs 84.4 billion in H1-FY26, compared to Rs 66.0 billion in H1-FY25. Auto loans accounted for about half of the overall expansion in consumer financing in H1-FY26 (**Figure 3.17**). The increase was led by passenger cars, especially higher engine-capacity models.[30]

House-building finance, which started to recover in H2-FY25, increased further in H1-FY26, with net disbursement of Rs 13.3 billion, against a net retirement of Rs 3.9 billion in H1-FY25. In addition to lower lending rates, decline in construction input prices also supported higher credit uptake for housebuilding.[31] Meanwhile, credit card financing maintained the uptrend. In H1-FY26, the number of cards issued rose by 45 percent year-on-year, while transaction volumes and values rose by 29 percent and 51 percent, respectively, pointing to sustained growth in card-based spending.[32]

Advances to SMEs increased

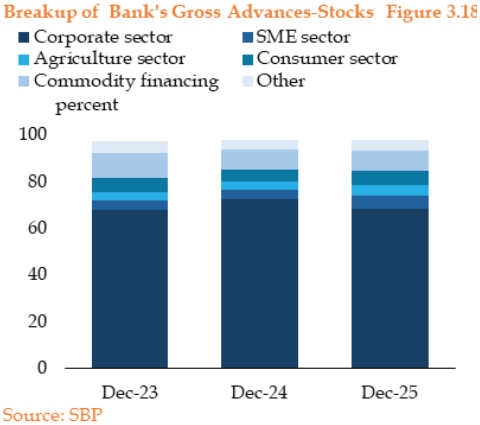
Advances to SMEs grew by 33.2 percent (YoY) in December 2025 compared to the growth of 39.1 percent (YoY) in December 2024. As a result, the share of SMEs in total advances increased to 5.7 percent by end-December 2025 compared to 4.0 percent in the same period last year (**Figure 3.18**). This expansion was broad-based as both working capital and fixed investment loans increased.[33] The expansion in SME financing can be linked to government's support measures aimed at improving access to finance, including government's Risk Coverage Scheme for Small Farmers

Consumer Financing - Flows Figure 3.17



Source: SBP

Breakup of Bank's Gross Advances-Stocks Figure 3.18



Source: SBP

[30] See Chapter 2 for details.
[31] After witnessing an average 26.6 percent increase in FY23-24, the increase in prices of construction inputs eased to 3.3 and 1.2 percent in H1-FY25 and H1-FY26, respectively.
[32] Source: Payment Systems Quarterly Review, SBP.
[33] In December 2025, working capital loans increased to Rs 438 billion compared to Rs 332.8 billion in the same period last year. While fixed investment loans expanded to Rs 408.7 billion compared to Rs 277.8 in last year. Source: SBP

CPI Inflation **Table 3.6**

inflation in percent; contribution in percentage points

Items	Weight	Average Inflation			Contribution		
		H1-FY25	H2-FY25	H1-FY26	H1-FY25	H2-FY25	H1-FY26
NCPI	**100**	**7.2**	**1.9**	**5.2**	**7.2**	**1.9**	**5.2**
Urban CPI	**100**	**8.7**	**2.1**	**5.2**	**8.7**	**2.1**	**5.2**
Food	**36.8**	**2.7**	**0.6**	**3.1**	**1.1**	**0.3**	**1.2**
Perishable	4.4	21.6	-16.8	-8.7	0.9	-0.8	-0.4
Non-perishable	32.4	0.5	3.0	4.8	0.2	1.1	1.7
NFNE (Core inflation)	**53.7**	9.5	7.5	7.0	4.1	3.2	3.1
Energy	**9.5**	24.8	-8.2	5.6	3.5	-1.4	0.9
Rural CPI	**100**	5.0	1.7	5.0	5.0	1.7	5.0
Food	**45.9**	0.4	-2.2	3.9	0.2	-1.1	1.9
Perishable	5.7	21.1	-20.4	-8.8	1.2	-1.3	-0.6
Non-perishable	40.3	-2.1	0.6	5.9	-1.0	0.2	2.5
NFNE (Core inflation)	**42.6**	12.7	9.6	8.1	4.6	3.6	3.1
Energy	**11.4**	2.3	-6.2	-0.1	0.3	-0.8	0

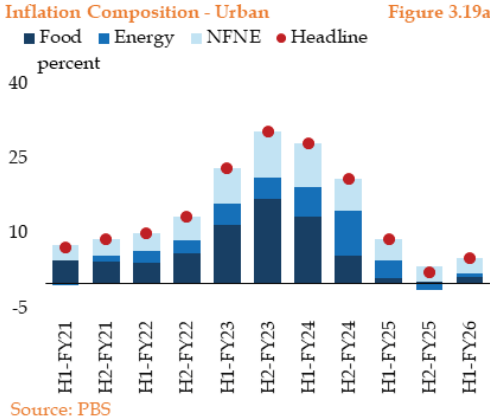
Source: PBS

and Prime Minister's Youth Business and Agriculture Loans.[34]

3.4 Inflation

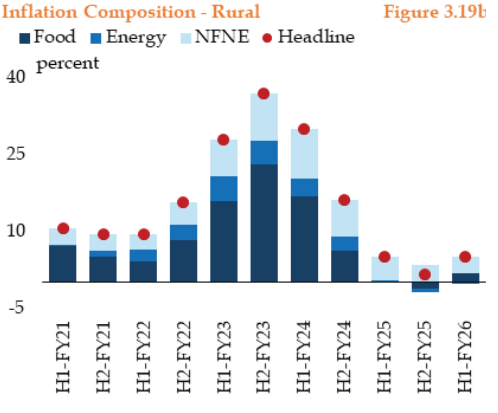
Average NCPI inflation eased to 5.2 percent in H1-FY26 compared to 7.2 percent in the same period last year (**Table 3.6**). The moderation largely stemmed from lower energy and core (NFNE) inflation, amid continued prudent monetary and fiscal policy mix, relative stability in the exchange rate, downward adjustments in administered electricity tariffs and softened international commodity prices (**Table 3.6 and Figure 3.19a and 3.19b).** However, the moderation

Inflation Composition - Urban **Figure 3.19a**



Source: PBS

Inflation Composition - Rural **Figure 3.19b**



[34] Prime Minister's Youth business & agriculture loans scheme provided employment opportunities to youth by extending concessional financing for starting new businesses, improving existing businesses and loans for agricultural purposes.

in energy and core inflation was partly offset by rise in food inflation.

The uptick in food inflation was largely due to supply shortages of non-perishable food items and imperfections in commodity markets, especially wheat and sugar. However, steep decline in the prices of perishable items contained overall food inflation. Moreover, albeit lower than same period last year, core inflation remained sticky at somewhat elevated levels in H1-FY26.

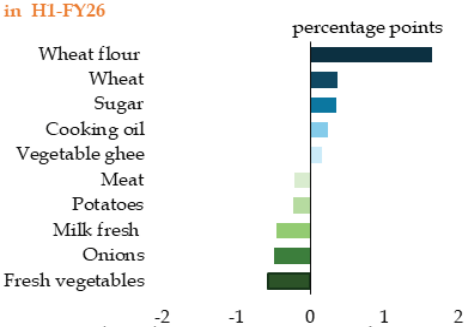
In overall terms, urban inflation eased compared to H1-FY25, supported by moderation in NFNE and energy components. Similarly, softening core and energy inflation helped rural inflation remain unchanged at 5.0 percent in H1-FY26, despite increase in food inflation.

Unfavourable market conditions explain price pressures in food group

Food inflation explained nearly one-fourth of urban inflation and around two-fifths of rural inflation during the first half of FY26. Price increases were most pronounced in wheat and wheat-related products, sugar, rice, and edible oils. The major underlying factor was reduced supply, due to flood-induced production losses, domestic supply-chain constraints, an increase in global price of palm oils and artificial shortages of some commodities (**Figure 3.20a and 3.20b**).

Wheat prices emerged as the major contributor to food inflation. Amid transition to deregulated price regime, wheat production fell by around 11 percent in Rabi 2024-25 season, as farmers reduced area under cultivation for the crop.[35] Impact of the shift in policy regime was compounded by flood-related losses, alongside artificial shortages.[36] The resulting shortfall pushed up prices of wheat and wheat-related products considerably above the last year's level (**Figure 3.21**). In this context, **Box 3.3**

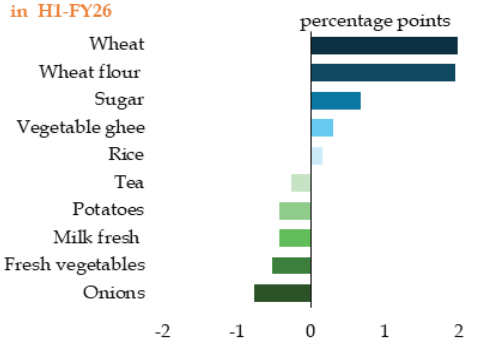
Top Contributors to Urban Food Inflation in H1-FY26 **Figure 3.20a**



Note: Bars show change in item-wise contribution to food inflation relative to H1-FY25

Source: PBS

Top Contributors to Rural Food Inflation in H1-FY26 **Figure 3.20b**



[35] Flood-related damage to wheat stocks amounted to 201 thousand MT. Source: MNFSR Working Paper (October 2025)

[36] Source: Price Controls & Commodities Management Department (PCCMD), Punjab

examines the implications of wheat policy reform under a market-based framework on inflation.

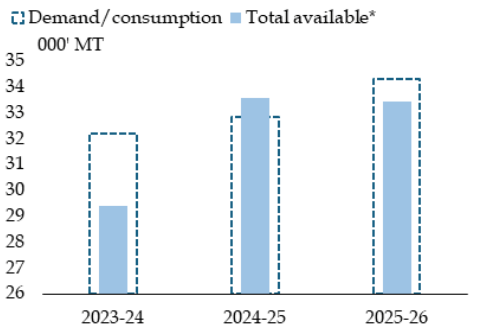
Similarly, rice prices also increased notably after floods. Moreover, a slight decline in sugarcane production in FY25, together with expansion in sugar export quotas that trimmed domestic availability of sugar, dove domestic prices up (**Figure 3.22**).[37] To contain the surge in sugar prices, the government allowed its import and temporarily removed import duties and taxes –including customs duty, sales tax, and income tax – to ease domestic shortages.[38] These administrative measures helped stabilise prices with some lag.

Furthermore, increase in international palm oil prices contributed to higher domestic cooking oil prices.[39] These pressures were compounded by market imperfections, which exacerbated food price inflation during H1-FY26. In response, provincial authorities strictly enforced administered prices for essential commodities, including cooking oil, milk, meat, and other perishable food items.[40] Meanwhile, the Competition Commission of Pakistan issued notices to a number of sugar mills against anti-competitive market practices.[41]

However, sharp decline in prices of mostly perishable food items helped partially offset the rise in prices of non-perishable items. Perishable food prices declined by around 9 percent in both urban and rural regions.

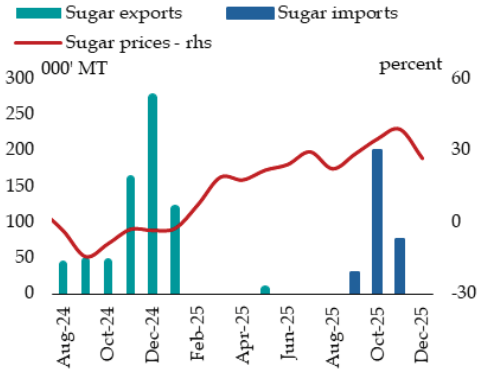
Specifically, a sizeable increase in production of potatoes and onions together

Wheat Demand and Availability **Figure 3.21**



Note: The data shown corresponds to the crop year
*production and carry forward stocks
Source: MNFSR

Sugar Trade and Domestic Prices **Figure 3.22**



Source: PBS

[37] Source: USDA (2025). Sugar Semi-annual, December 2025, Report No. PK2025-0012
[38] Source: MNFSR press release, dated: July 9, 2025.
[39] The international palm oil prices increased during April–September, the most relevant period for domestic prices in H1-FY26 given typical shipping and transmission lags. Source: WB and PBS.
[40] Price monitoring and enforcement visits in Karachi increased by 21 percent in Q2-FY26 compared to Q2-FY25. These inspections were aimed at enforcing administered prices of essential commodities, including cooking oil, milk, meat, and other perishable food items. Source: The Commissioner Office Karachi
[41] Source: Competition Commission of Pakistan press release, dated: November 28, 2025.

with closure of Afghanistan border, improved domestic availability, contributing to lower prices. Alongside perishables, tea prices also eased during H1-FY26, in line with lower international prices that were gradually reflected in domestic prices.[42]

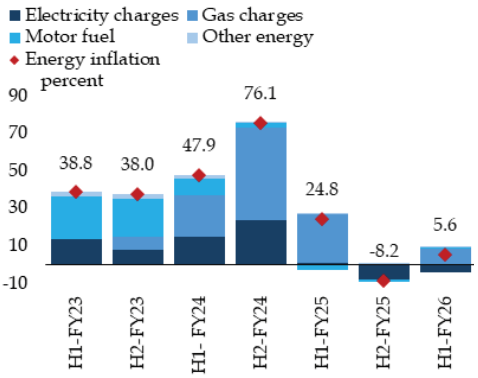
Lower global oil prices, together with downward adjustment in electricity prices, led to a sharp deceleration in energy inflation

Energy inflation dropped to multi-year low in H1-FY26, despite a substantial increase in gas prices (**Figure 3.23**).[43] In addition to pass-through of the decline in global crude oil prices to domestic electricity and, to some extent, motor fuel prices, this also reflected the impact of ongoing reforms in the energy sector.[44]

The government increased domestic gas prices from July 2025 to ensure full cost recovery, rationalize subsidies, and address the accumulating circular debt. Although per-unit tariffs for households were left unchanged, the substantial rise in fixed monthly charges led to around 23 percent increase in gas prices.[45] However, the inflationary impact of higher gas prices was somewhat offset by reduction in electricity tariffs. Negative quarterly tariff adjustments (QTA) and fuel charge adjustments (FCA) reduced consumer electricity charges during H1-FY26 (**Figure 3.24**).[46]

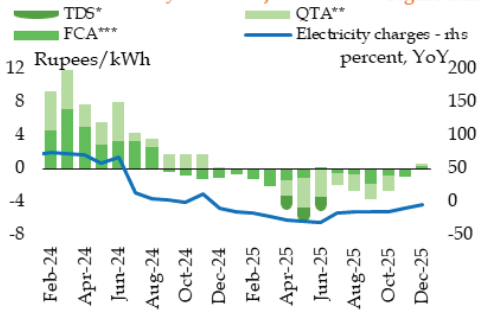
The decline in QTA represented the impact of several policy initiatives in energy sector. Specifically, the introduction of 'Off

Contribution to Energy Inflation - Urban Figure 3.23



Sources: PBS; SBP; Staff calculations

Trends in Electricity Tariff Adjustments Figure 3.24



* Tariff differential subsidy
** Quarterly tariff adjustment for residential consumers
*** Fuel charge adjustments

Sources: NEPRA; PBS

[42] Domestic tea prices reflected developments during April–September, when Mombasa tea prices (in Kenya) declined by around 6 percent. Source: WB and PBS

[43] Urban energy inflation is at its lowest half-year level since FY21 and rural energy inflation the lowest since FY18. Rural energy inflation data starts from FY18, which is the earliest available series. Source: PBS

[44] Including measures that strengthened cost recovery and reduced borrowing requirements, thereby lowering financing costs in the energy sector. Source: IMF Country Report No. 25/332, International Monetary Fund.

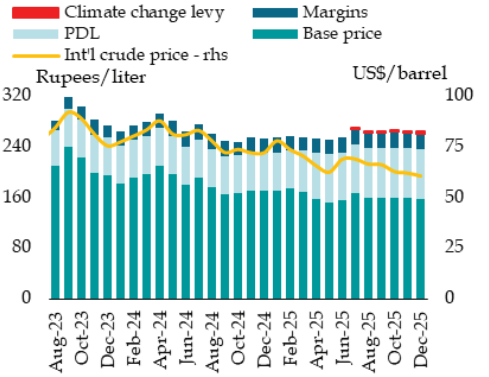
[45] Source: OGRA notification dated June 09, 2025.

[46] QTA is revised every three months to account for variations in capacity payments, O&M costs, exchange rate fluctuations, and other allowed costs not captured in the base tariff. While FCA is a monthly mechanism that passes on the changes in actual cost of fuels (such as coal, gas, furnace oil, LNG) compared to the projected cost used at the time of tariff setting. Source: NEPRA

the Grid (captive power plants) Levy Act, 2025'[47] in May 2025, facilitated transition of industrial units from captive power generation to national grid,[48] leading to increased grid demand and reduction in capacity payments. This, along with the reduction in energy sector circular debt stock, which lowered interest payments on energy sector payables, partly explains the negative adjustment in electricity charges during H1-FY26.[49] Moreover, the government also deferred the annual tariff rebasing scheduled from July 2025 to January 2026, thereby limiting upward pressure on power tariffs.[50]

On the other hand, despite lower international oil prices, domestic motor fuel prices increased. This was mainly due to increase in Petroleum Development Levy (PDL) on motor fuel. Additionally, the government also introduced a Climate Change Levy of Rs 2.50 per litre from July 2025. These together more than offset the benefit from softened global oil price benchmarks (**Figure 3.25**).

Composition of Motor Fuel Prices Figure 3.25

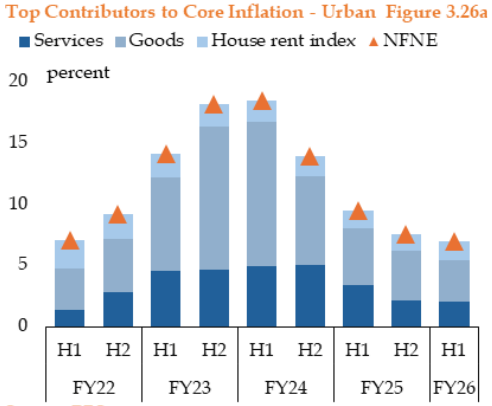


Sources: OGRA; WB

Contained demand and lower input costs eased core inflation

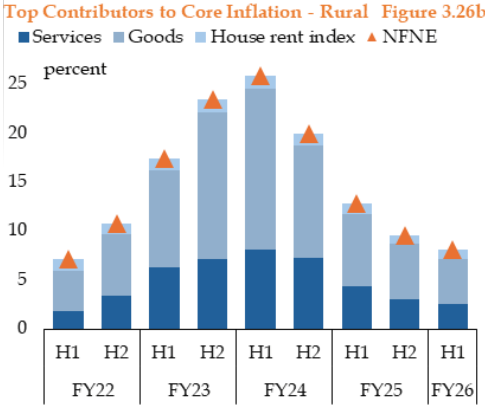
Reflecting the impact of prudent monetary and fiscal policies that contained domestic demand, and benign global commodity prices, core inflation registered a broad-

Top Contributors to Core Inflation - Urban Figure 3.26a



Source: PBS

Top Contributors to Core Inflation - Rural Figure 3.26b



[47] Source: Off the Grid (Captive Power Plants) Levy Act, 2025
[48] IMF (2025). IMF Country Report No. 25/332, International Monetary Fund.
[49] Source: IMF (2025). IMF Country Report No. 25/332, International Monetary Fund.
[50] Source: NEPRA notification dated January 07, 2026.

based deceleration during H1-FY26 **(Figure 3.26a and 3.26b**). Notably, the share of items with inflation below the upper bound of SBP's target range increased in both the urban and rural baskets (**Figure 3.27a and 3.27b**).

The pass-through of softening global commodity prices and a slight appreciation of exchange rate to domestic prices alleviated cost pressures across a range of items. Item-wise price trends indicate that disinflation mainly came from easing prices of cotton cloth, textbooks, recreation and culture, footwear, and marriage hall charges (**Table 3.7**).

Particularly, a drop in domestic raw cotton prices emanating from lower import unit prices contained price increase in cotton cloth. Likewise, lower global paper prices helped reduce textbook prices during H1-FY26.[51] Moreover, a reduction in GST on imported laptops amid lower valuations assessment by the FBR, and lower tax on cable TV charges in Sindh, reduced prices of recreation and culture.[52,53] In addition, the pace of increase in footwear prices and marriage hall charges moderated due to base effects.[54]

Top Contributors to Low Core Inflation **Table 3.7**

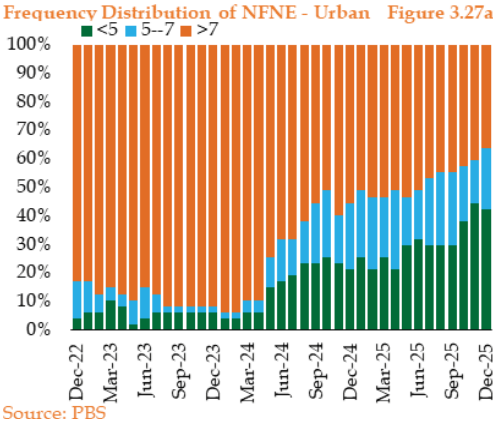
percentage points

	H1-FY25	H2-FY25	H1-FY26
Cotton cloth	10.0	7.5	5.4
Recreation and culture	2.6	1.7	-2.0
Textbooks	1.4	0.4	-2.6
Footwear	6.5	7.8	3.5
Marriage hall charges	5.4	2.8	3.0

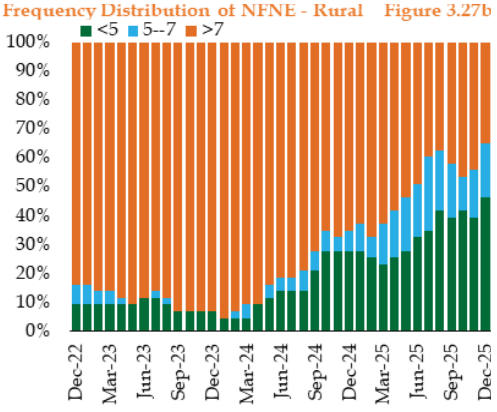
Source: PBS

Notwithstanding the improvement relative to H1-FY25, core inflation in H1-FY26 persisted around the level seen in the second half of FY25. The persistence reflected the impact of increase in international gold prices, house rents and fees of educational institutions (**Table**

Frequency Distribution of NFNE - Urban **Figure 3.27a**



Frequency Distribution of NFNE - Rural **Figure 3.27b**



Source: PBS

[51] PPPL (2025). Quarterly Financial Statements, Pakistan Paper Products Ltd.
[52] Source: Valuation Ruling No. 2000/2025, Directorate General of Customs Valuations.
[53] Sindh Finance Act (2025).
[54] Footwear prices rose in H1-FY25 due to higher gas charges increasing input costs, while marriage hall charges climbed with stricter withholding tax enforcement; the elevated base makes current growth lower vs H1-FY25.

Top Contributors to Core Inflation **Table 3.8**

percentage points

	H1-FY25	H2-FY25	H1-FY26
Personal effects (Gold)	6.2	11.1	16.8
House rent	15.7	18.5	22.5
Education	7.7	9.4	11.7
Products for personal use	5.4	6.8	8.7
Readymade garments	2.0	3.0	2.8

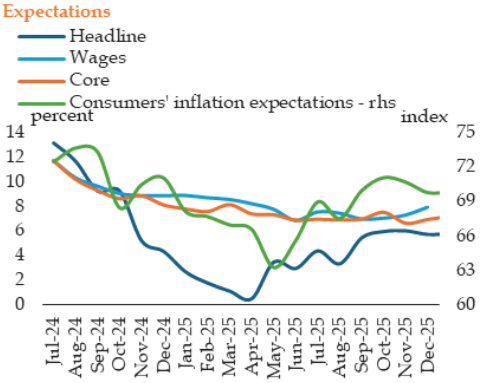
Source: PBS

3.8).[55] In violation of regulatory limits, private educational institutes, specifically medical colleges, introduced sizeable increase in education fees.[56] On the other hand, the house rents increased in line with improving economic activity that raised housing demand in major urban centers.[57] Persistently high house rents largely reflect structural imbalances in the housing market.[58]

In addition, the stickiness of core inflation also suggests the impact of structural challenges including backward-looking inflation expectations and market imperfections. As shown in **Figure 3.28,** barring a brief decline in H2-FY25, the consistently elevated inflation expectations of households induced rigidity in core inflation.[59]

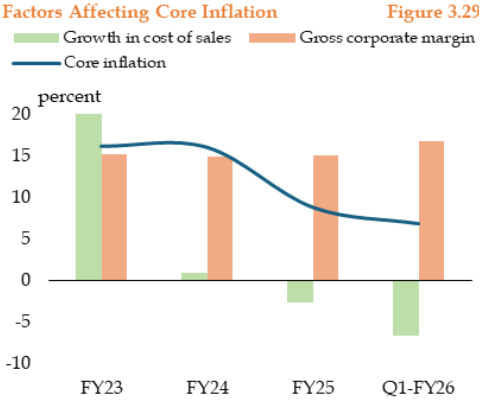
Moreover, increase in corporate gross margins also influenced core inflation trends, as firms in some sectors increased prices, despite easing input costs in Q1-

NCPI, Core Inflation, and Inflation Expectations **Figure 3.28**



Sources: PBS; SBP

Factors Affecting Core Inflation **Figure 3.29**



Source: SBP

[55] Gold carries the major weight in personal effects. While other items in personal effects include silver, wall clock, artificial jewellery, suitcase ragzine, trunk, and ladies' purse.

[56] Source: https://www.na.gov.pk/en/pressrelease.php?content=103, Dated 20th Oct 2025.

[57] Housing prices in H1-FY26 show a rising trend compared to H1-FY25, indicating increasing demand. Source: www.zameen.com

[58] Ali (2021) highlights that Pakistan faces a sizable national housing backlog, which is further compounded by a recurring annual shortfall that continues to add to the deficit each year. Ali, Y. (2021) Analysing macroeconomic factors that affect housing price in Pakistan. PIDE.

[59] SBP (2025) and Choudhary et al. (2016) suggest that backward looking inflation expectations of economic agents induce persistence in core inflation in Pakistan. SBP (2025). The State of Pakistan's Economy Annual Report 2024-25. SBP.

Choudhary, M. A., Faheem, A., Hanif, M. N., Naeem, S., and Pasha, F. (2016). Price setting & price stickiness: A developing economy perspective. Journal of Macroeconomics, Vol. 48. No. 1

FY26, which indicated their pricing power (**Figure 3.29**).[60] Lastly, an upward revision in minimum wages[61] contributed to price pressures in both core goods and services.

Box 3.1: Reform Measures to Improve Agriculture Finance

Agriculture sector in Pakistan contributes around one-fifth of GDP and employs around 33 percent of labour force.[62,63] However, the sector's use of formal finance stood around 5 percent of total private sector credit in FY25, which is low compared to peer countries (**Figure 3.1.1**). Literature shows that credit positively impacts agricultural productivity in Pakistan [Ishfaq and Khalid (2025), Khan (2019), Chaiya et al. (2023)]. Therefore, enhancing agriculture credit can help in sustaining food supply in the face of growing population in the country.[64]

Considering the significance of agriculture credit, the government and SBP have introduced various supporting measures and policies from time to time.[65] Despite these efforts, the share of agriculture credit in total credit continues to remain significantly lower vis-à-vis share of agriculture in GDP. In this regard, this Box suggests following pathways for reforms in view of literature and country experiences.

Enhancing credit guarantee coverage to reduce risk

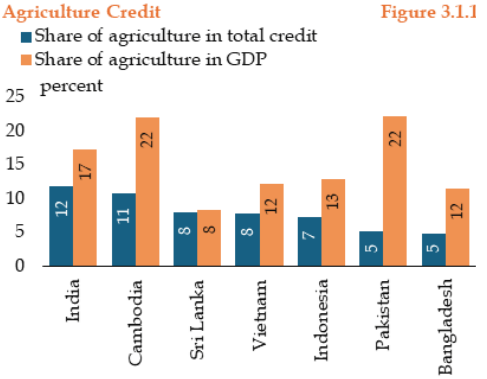
Agriculture is vulnerable to shocks such as weather events, pests, and price volatility, which weaken farmers' repayment capacity and increase default risk (**Figure 3.1.2**).[66] This vulnerability discourages banks from expanding exposure to the sector. To address this issue, Pakistan provides Risk Coverage Scheme for Small Farmers and Underserved Areas, which covers only 10 percent of loan amount.[67] Against this, Cambodia's Credit Guarantee Corporation provides guarantees up to 80 percent.[68] Moreover, the coverage is for crops only and excludes livestock. This is also one of the reasons for relatively lower credit uptake for livestock. The cross-country comparison suggests that increase in coverage of the scheme may be helpful in further improving banks' incentives to lend to agriculture sector.

Lowering farmers' reliance on land collateral through peer support and monitoring

Agriculture loans in Pakistan face strict collateral and documentation requirements due to the sector's high-risk profile. However, fragmented land holdings and poor documentation limit farmers' ability to use land as collateral. Many farmers also avoid pledging their primary asset for fear of losing land in case

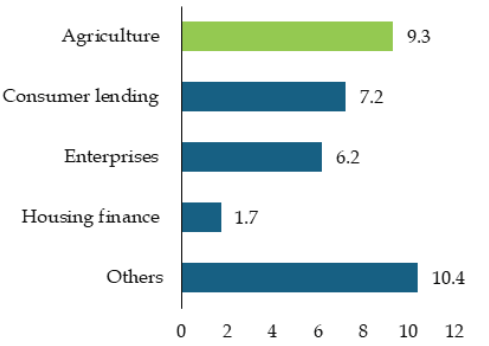
[60] In H1-FY26, 44 of the 47 core goods and services items recorded price increases.
[61] Sources: No. SO (L&P) MW/2025, Labour & HR Department, Govt. of the Punjab. Dated 8th Sep 2025.
No. SOL/LD/8-4/2025/MWB, Labour Department, Govt. of KPK. Dated 10th Sep 2025.
No. SO (L-II)/13-3/2016-I, Labour & HR Department, Govt. of Sindh. Dated 28th Jul 2025.
[62] PBS (2025). Pakistan Labour Force Survey 2024-25, Pakistan Bureau of Statistics, Islamabad.
[63] The sector also employs 61 percent of total female labour force.
[64] Abdullah et al. (2015). Agricultural Credit in Pakistan: Past Trends and Future Prospects, Journal of Applied Environmental and Biological Sciences, Vol. 5, No. 12.
[65] Some of the key initiatives include crop loan insurance scheme introduced in 2008, credit guarantee for small and marginalized farmers introduced in 2016 and targeted relief measures introduced in 2022 for calamity affected farmers. In 2025, SBP introduced Zarkhez-e service, a fully digital, collateral-free loan scheme. In the private sector, Habib Bank Limited has set up a subsidiary HBL Zarai Services Limited in 2024 to support farmers with storage, equipment, seeds, fertilizer, and farming advice.
[66] AgriSense (2023). The state of Pakistan's agriculture & case for product innovation.
[67] Source: ACFID Circular No. 02 of 2025, SBP
[68] Source: https://www.cgcc.com.kh/en/, Accessed on February 24, 2026.

Agriculture Credit **Figure 3.1.1**



Note: Data represent the five-year average (2019–2023)
Source: FAO

Infection Ratio* **Figure 3.1.2**



* FY21-FY25 average.
Source: SBP

of default, which pushes them toward informal lenders to meet liquidity needs.[69] To ease these constraints, Pakistan can draw lessons from India's group-based lending model introduced in 1992, which connects local community groups with banks. This mechanism eliminates collateral requirements and relies on peer support and monitoring.[70] Similarly, Bangladesh's Grameen Bank model organizes borrowers into small groups and centres with weekly meetings, where peer discipline, and field-level monitoring by loan officers ensure repayment and sustain collateral-free credit.[71]

Utilizing alternative data to build credit histories

In rural markets, transactions are often undocumented, making it difficult for banks to assess repayment capacity through conventional methods. Many farmers lack bank accounts or face limited access to formal services, and the absence of credit histories increases lending risk.[66] Considering this, since 2024, SBP has allowed banks to use satellite based data as an alternative to Khasra Girdawari.[72] Moreover, digitisation of land records is also in process in provinces: Punjab has digitalised around 90 percent of its land records,[73] and KPK achieved about 50 percent coverage 2025.[74] Banks can leverage digitised land records for quicker ownership verification.

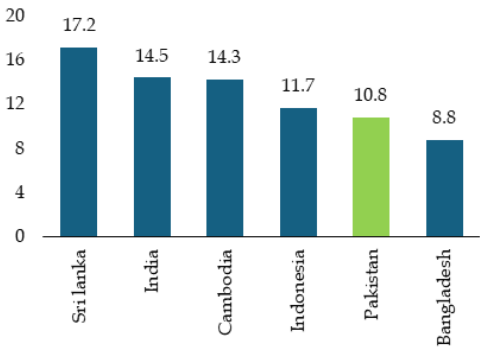
To further reduce information gaps, banks need to strengthen credit assessment by leveraging alternative data such as input purchases, produce sales, and digital payment trails. To this end, collaboration with platforms like Agri Mall[75] to track payments for input purchases, creating verifiable transaction trails may support credit appraisal. At the same time, regular field monitoring and supervision can improve oversight and build confidence in lending decisions.

[69] PIDE (2022). The role of arthis in agriculture marketing: an exploiter or facilitator of farmers? Source: PIDE.
[70] Gulati et al. (2019). Agricultural credit system in India: Evolution, effectiveness and innovations.
[71] Rahman (2011). The Synthesis of Grameen Bank Microfinance Approaches in Bangladesh. International Journal of Economics and Finance
[72] Khasra Girdawari refers to the periodic record of crop inspection and cultivation status maintained by the local revenue officials (Patwari).
[73] Source: Punjab Land Records Authority (PLRA)
[74] Source: Revenue and Estate Department, Government of Khyber Pakhtunkhwa
[75] Agri Mall is a one-stop outlet network, which acts as a comprehensive platform for farmers to access high-quality seeds, fertilizers, pesticides, and modern machinery rentals under the Green Pakistan Initiative.

Reducing procedural delays in formal borrowing, through a standardised seasonal financing product
Informal sources are often preferred because they provide quick access to credit. In contrast, borrowing through formal channels can involve delays due to documentation requirements and procedural checks. When credit is not available during the sowing window, farmers may reduce input use, delay cultivation, or resort to informal sources.[66] To tackle this issue, the CM Punjab Livestock Scheme and the CM Punjab Kissan Card introduced in 2024, provide zero-markup seasonal financing to farmers. Introducing such programs in rest of the country can have a broader impact in terms of farmers' enhanced access to affordable credit.

Bank Branch Coverage*

Figure 3.1.3



* Number of bank branches per 100,000 adults in 2023.
Source: WB

Improving access to finance through adopting correspondent framework
Limited bank branch penetration and long distances to financial institutions remain major barriers to agricultural credit in Pakistan (**Figure 3.1.3**). To address similar challenges, Reserve Bank of India introduced Business Correspondent Framework in 2006 enabling banks to deliver services via local agents. These agents can support customer acquisition and loan processing. They can also conduct basic transactions such as small-value credit disbursement and recovery, deposit collection, and remittances.[70] Adopting a similar framework in Pakistan would reduce access barriers, expand outreach, and strengthen farmers' connection to formal credit channels. In addition, Pakistan can leverage Zarai Taraqiati Bank Limited (ZTBL), the specialized institution for agricultural finance, which has significant rural penetration with 58 percent of villages reporting access to its credit services.[76] By enforcing stronger customer due diligence in loan provision and improving loan recovery mechanisms, ZTBL can play a more effective role in expanding agricultural finance.

Training bank staff to assess farmers' needs more effectively
Agricultural financing requires trained staff to assess creditworthiness and financing needs of farmers. Bank staff often lack this expertise, which leads to more risk averse behaviour of banks. To bridge this gap, bank staff should be trained in agriculture sciences and rural finance to better understand agriculture cycles like crop production seasons, livestock management, and seasonality of cash flows. This specialized knowledge will enable banks to introduce financing products tailored to farmer's needs and better risk assessment.

**The contribution of Muhammad Zuhaib is acknowledged in writing this box*

Box 3.2: Combating Climate Change through Green Financing

Pakistan's green financing ecosystem has been gradually evolving in recent years.[77] SBP and the government have introduced various measures to integrate climate risks mitigation into the financial

[76] PBS (2020). Pakistan Mouza Census 2020, PBS, Islamabad.
[77] Green finance is any structured financial activity created to ensure a better environmental outcome. It includes an array of loans, debt mechanisms and investments that are used to encourage the development of green projects or minimize the impact on the climate of more regular projects. Source: World Economic Forum

system in the past few years.[78] However, the scale of green financing in Pakistan remains constrained due to various factors such as lack of awareness about sustainable investment opportunities, high upfront costs of green projects, and narrow range of green products. In this context, this Box discusses several measures to encourage climate-aligned investment in Pakistan.

Monitoring green investment trends. An important challenge in assessing green financing needs is the lack of comprehensive data on private sector investment in green projects. This gap partly stems from the absence of a uniform classification framework. The launch of the Pakistan Green Taxonomy (PGT) in 2025 is a significant milestone, offering clarity on what constitutes a green project, enabling investors to identify compliant assets while reducing the risks of greenwashing.[79] To encourage green financing, Pakistan needs to monitor adoption trends in various sectors, which will aid in identifying policy gaps and refine the framework based on emerging needs. Various advanced and emerging economies compile and publish sector-based green investment trends. For example, US Clean Investment Monitor (CIM)[i] is a quarterly dataset used to track investment in clean energy, clean vehicles production, electrification and other carbon technologies. Similarly, China's Global Green Tech Investment Dashboard[ii] is a comprehensive dataset that tracks investment in Electric Vehicle (EV) value chain, providing insights into country's commitment to sustainable development.

Capacity building in the private sector. Limited understanding of green financing tools remains a major barrier for both banks and businesses, especially small and medium enterprises (SMEs). Financial institutions need to invest in training programs to strengthen internal expertise on climate risks, sustainable lending practices, and the long-term benefits of green investments.[iii, iv] SMEs, meanwhile, require targeted awareness campaigns and capacity building initiatives to encourage the adoption of sustainable production methods. Enhanced technical knowledge will help businesses better identify, structure, and implement green projects, improving their access to finance.

Expanding availability of green financial products. Pakistan currently offers a narrow set of green financing instruments such as green loans, bonds, and insurance products. To broaden access, financial institutions should be encouraged to design innovative solutions tailored to local market needs. A notable example is the first rupee denominated green bond issued by Parwaaz Financial Services Limited (PFSL) in 2025, listed on the Pakistan Stock Exchange to fund renewable energy, clean energy, and clean transportation initiatives.[i] The regulators can promote wider market participation by offering incentives such as reduced registration fees.

Introducing credit guarantee schemes on green projects. Borrowers in underserved sector like SMEs and agriculture often struggle to finance climate-smart investments due to perceived risks and limited collateral. To address this issue, the government should establish credit guarantee schemes and provide concessional funding for priority green sectors. These schemes can significantly improve credit access to these sectors pursuing climate mitigation and adaptation projects.[i, vii, 80]

Establishing ***specialized institution for green financing***. Drawing from international experiences including Australia, India, and the UK,[iii] Pakistan may consider establishing specialized green financing institutions. Such institutions can offer dedicated financial products, provide guarantees for high-risk

[78] See Chapter 6 for details.
[79] Greenwashing is the practice of presenting companies or products as more environment friendly.
[80] Some country examples are the Ghana's Incentive Based Risk Sharing System for Agricultural Lending (GIRSAL), a guarantee scheme to support small farmers and large corporations on agro-value chain and renewable projects and, the Jordan's Loan Guarantee Corporation (JLGC) that offer credit guarantee to industries in renewable energy, energy efficiency, SMEs and microfinance, and offer preferred coverage to women-based SMEs.

projects, issue green bonds and green asset backed securities, and help develop a robust market for green financial trading. They can also serve as key intermediaries for channelling funds from domestic and international investors into climate aligned projects.[iv]

Incentivising ***green investments***. To attract investment in green technologies, the government should introduce incentivise import of equipment used in climate friendly projects. Similarly, foreign investors with the potential to provide technical expertise to local firms should be offered targeted incentives.[v]

Establishing ***environment endowment fund***. Provincial governments can help secure long-term financing for environmental initiatives by creating environmental endowment funds. These funds would pool capital to support green projects and reduce reliance on external grants. In this regard, Punjab Environment Endowment Fund is an example. The fund was established with an allocation of Rs 15 billion to promote environmentally conscious startups and businesses. Other provinces may adopt similar mechanisms to ensure sustainable climate financing.[iii]

Pakistan has introduced significant steps toward greening its financial system. Strengthening regulatory frameworks, increasing market capacity, expanding financial products, and incentivizing both businesses and the public, will further support the country's transition toward a resilient, low carbon economy.

**The contribution of Abdul Basit Alias Shahzad is acknowledged in writing this box*

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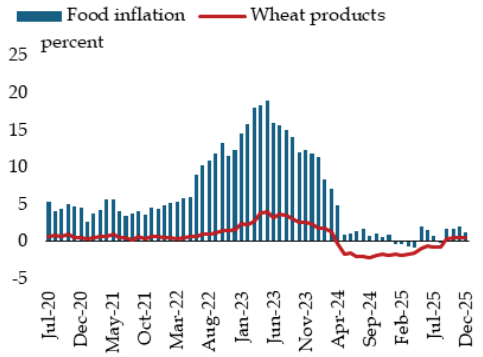
ii) Source: China Global Tech Investment Dashboard available at:
https://cbm.rhg.com/dashboard/china-global-clean-tech-investment-dashboard
iii) SDPI (2022). Policy brief, Green Financing to Support Energy Transition: Options and Challenges for Pakistan
iv) GFI (2025). Green Finance Institute, Transactions to Transitions, October 2025
v) Source: Finance Division, Pakistan's first PKR-denominated Green Bond launched to accelerate climate finance, press release No. 253, 21 March 2025
vi) WB (2021). Guidelines-for-Greening-Public-Credit-Guarantee-Schemes-Consultative-Document-For-public-comment.pdf
vii) AFI (2022). Alliance For Financial Inclusion, Special Report, Green Credit Guarantee Schemes for MSMEs, 2022
viii) CPI (2025). Climate Policy Institute, The State of Green Banks 2025
ix) UNDP (2023). policy brief, Greening the Financial System of Pakistan, 2023
x) WB (2020). Catalyzing Investment for Green Growth, 2020
xi) Source: Department of Environmental Protection & Climate Change, Government of Punjab available at: https://epd.punjab.gov.pk/adps

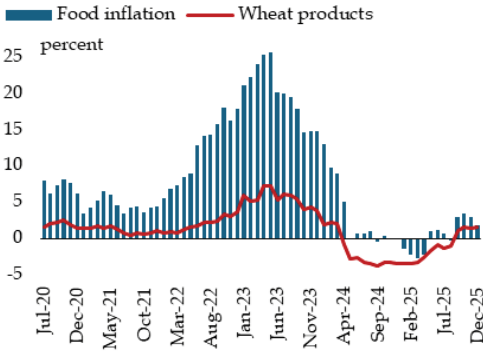
Box 3.3: Implications of Wheat Policy Reform for Inflation

Inflation outcomes in Pakistan are sensitive to wheat price developments. Given a large weight in CPI basket, wheat price movements have often dominated food inflation (**Figure 3.3.1 and 3.3.2**). Wheat price trend is also a major determinant of crop profitability and hence farmers' decision about cultivation of crop. Price movements due to policy measures as well as production shocks and climatic variations therefore transmit across the economy. This box discusses the shift in Pakistan's wheat procurement and minimum support price regime announced in FY25, its implications and some key considerations for effective policy implementation.

Contribution of Wheat in Food Inflation - Urban Figure 3.3.1a



Contribution of Wheat in Food Inflation - Rural Figure 3.3.1b



Source: PBS

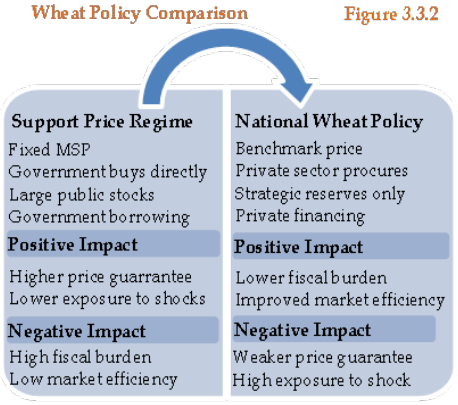
Pre-reform wheat procurement system

Under the earlier framework, the government used to announce an annual Minimum Support Price (MSP) and conducted large-scale wheat procurement through provincial food departments and PASSCO. By acting as a dominant buyer at a pre-announced price, the state effectively set a price floor and shaped market conditions through public stockpiling and release. Over time, this system imposed substantial inefficiencies and fiscal costs. Procurement operations were largely financed through commercial borrowing. Public stockholding was further undermined by storage losses, and quality deterioration, while procurement and release decisions were often influenced by administrative rigidities and political considerations rather than market conditions.[i]

Transition to market-oriented reserve system

The current wheat policy framework reflects a two-stage transition over the last two years. In FY25, the government did not announce MSP and refrained from routine procurement to deregulate the market and reduce fiscal costs. Wheat procurement was left to private traders and flour mills - a period during which price volatility intensified.[81] Under the FY26 policy, the government re-entered the market only to build strategic reserves, rather than open-ended procurement (**Figure 3.3.2**). An indicative benchmark price aligned with international import parity has been introduced in place of a traditional MSP and set at Rs 3,500 per 40 kg for FY26. The benchmark serves as a reference for reserve procurement during the harvest period and does not operate as a legal price floor.[ii]

Wheat Policy Comparison Figure 3.3.2



Source: MNFSR

[81] After a record wheat harvest of 31.4 million metric tons in 2023-24, the crop output fell to 28.9 million metric tons in 2024-25. The drop followed the government's decision not to announce MSP and to stay out of procurement, which weakened farm-gate prices and increased uncertainty for growers. In 2024–25, wheat and wheat flour prices declined by around 33 percent in both urban and rural markets; the associated income losses reduced the financial attractiveness of wheat cultivation and led to a decline in cultivated area, weighing on output.

Execution is delegated to licensed private aggregators, with the government currently undertaking the bidding process. Once selected, aggregators will procure wheat from farmers, arrange financing independently, store wheat in approved facilities under joint custody, meet quality and reporting requirements, and release stocks strictly in accordance with government schedules. Strategic reserve targets include 1.5 million metric tons at the federal level and population-based provincial allocations, including 2.5 million metric tons for Punjab.[iii] The total reserve envelope of around 6.2 million metric tons corresponds to approximately two to three months of national consumption, while routine procurement is expected to be carried out by private market participants from the next crop season.

Implications and risks

Under the new framework, price stabilisation is pursued through strategic reserve operations rather than fixed prices, with implications extending beyond inflation to supply incentives, market behavior, and external exposure. The success of the policy, however, rests on effective management of inflationary risks.

Short-term risks arise primarily from delays in implementation of the new procurement mechanism during the harvest window. The wheat calendar suggest procurement in April–May, and any lag in finalising aggregator selection, financing arrangements, or operational readiness could limit timely buying. [iii] The 2024-25 experience bet illustrates the risk. In the absence of public procurement, harvest-time prices fell to around Rs 2,200 per 40 kg, compressing farm incomes, followed by an increase to nearly Rs 4,000 per 40 kg in September 2025 as supplies tightened. If procurement at scale is not executed on time under the FY26 framework, depressed farmgate prices would again discourage production and reduce marketed surplus, with subsequent upward pressure on consumer prices towards the end of marketing cycle. These short-term risks may be amplified if procurement becomes concentrated among a limited number of large aggregators[82], potentially weakening competition at the farmgate and increasing vulnerability of small growers to intermediary margins.[83] The policy therefore hinges on timely execution to preserve price continuity between harvest and lean months.

Over the medium term, wheat prices are expected to fluctuate within a band defined by import and export prices, improving price discovery and reducing policy-induced discontinuities. However, a closer alignment with international prices increases exposure to exchange rate movements and global price shocks, placing increased importance on credible reserve management and timely releases to anchor inflation expectations.

Thus, effective governance and execution capacity is central to the success of the new framework. The state's role has shifted from direct procurement to contract management and market oversight, requiring skills in auditing, monitoring, and enforcement. Digital traceability of procurement, payments, and stocks, supported by independent verification, is central to preserving credibility and limiting scope for collusion or discretionary intervention.

**The contribution of Syed Hamza Ali is acknowledged in writing this box*

[82] Firm-level allocations are capped between 12,500 MT (minimum) and 500,000 MT (maximum). Source: Prequalification document for licensing of private companies for the procurement, storage, and handling of wheat to maintain national wheat strategic reserves (2025), MNFSR.

[83] Private firms are required to demonstrate availability of covered warehouses or silos (owned or leased) with a minimum storage capacity of 10,000 MT, suitable for food-grade bulk wheat storage. Source: Prequalification document for licensing of private companies for the procurement, storage, and handling of wheat to maintain national wheat strategic reserves (2025), MNFSR.

References:
i) Institute of Strategic Studies Islamabad 2025
ii) Prequalification document for licensing of private companies for the procurement, storage, and handling of wheat to maintain national wheat strategic reserves (2025). Source: MNFSR
iii) Directorate General of Food, Punjab