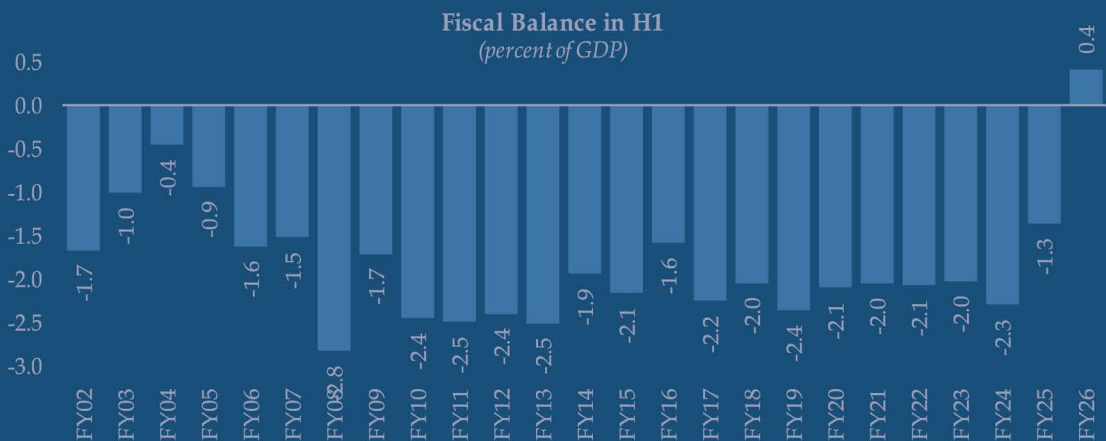




# 4

## Fiscal Policy and Public Debt

*Fiscal consolidation remained on track. Fiscal balance recorded a surplus during H1-FY26, first time in nearly three decades, while the primary surplus remained at last year's level. This improved fiscal performance largely owes to a notable decline in mark-up payments and substantial SBP profit, which more than compensated for a slight weakening in total revenue. The fiscal consolidation significantly slowed the growth in public debt, with moderation in both domestic and external debt accumulation. In addition to fiscal surplus, strengthening the overall public debt profile, higher remittances and the ongoing build-up of foreign exchange reserves strengthened the country's debt servicing capacity and solvency indicators. Nonetheless, liquidity indicators presented a mixed picture, due to an increase in short-term external debt in the period under review.*

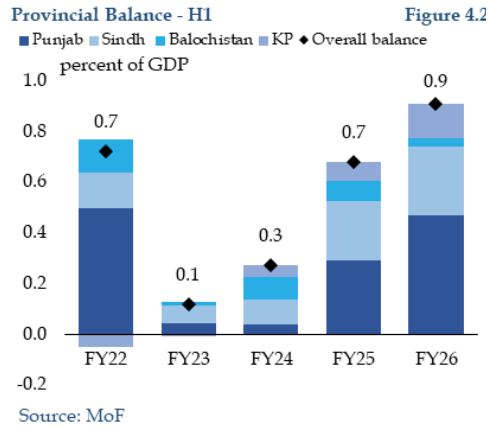




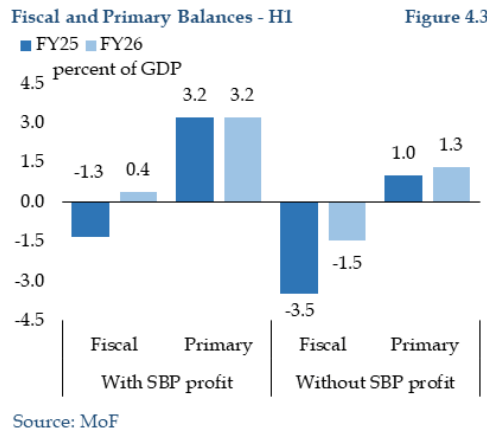
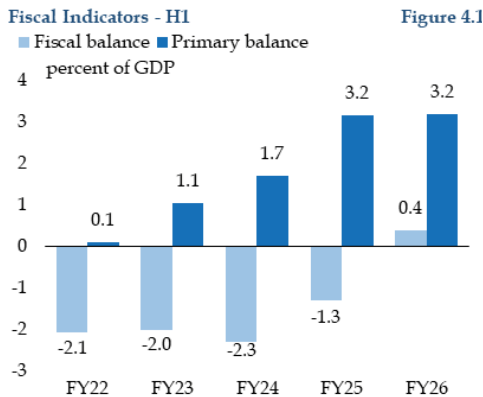
## 4.1 Fiscal Trends and Policy Review

Fiscal consolidation continued in H1-FY26, with a fiscal surplus, first time since H1-FY02<sup>1</sup> (Figure 4.1). This improvement was driven primarily by a sharp decrease in expenditure, led by substantial reduction in markup payments. This decline in expenditure more than offset the fall in total revenues, as percent of GDP. The primary balance, on the other hand, remained broadly unchanged from last year (Figure 4.1), as the gain in revenue was matched by an increase in non-interest expenditure.<sup>2</sup> Importantly, the contribution of provincial surplus in the overall balance increased compared to last year, further contributing to an improvement in the fiscal balance (Figure 4.2 and Table 4.1).

The slight deterioration in total revenue was due to a decline in both tax and non-tax revenue. Tax revenue underperformed relative to targets, despite the additional revenue mobilisation measures announced



in the FY26 budget and momentum in economic activity. Non-tax revenue also declined, mainly due to lower SBP profit, though still substantial, while higher PDL collections provided some support to revenues. Importantly, even if SBP profit is excluded, fiscal consolidation remained on track, as both fiscal and primary balances showed an improvement relative to last year (Figure 4.3).



<sup>1</sup> The first half-year surplus since FY02, when the MoF started publishing quarterly fiscal operations data.

<sup>2</sup> A large statistical discrepancy was one of the driving factors for the primary surplus in H1-FY26.

## The State of Pakistan's Economy, Half Year Report 2025-26

Consolidated Fiscal Indicators

Table 4.1

	billion Rupees				Percent of GDP			
	FY25	FY26			FY25	FY26		
	H1	Q1	Q2	H1	H1	Q1	Q2	H1
<b>Total revenue</b>	<b>9,764</b>	<b>6,200</b>	<b>4,484</b>	<b>10,684</b>	<b>8.6</b>	<b>4.8</b>	<b>3.5</b>	<b>8.2</b>
Tax revenues	6,067	3,153	3,576	6,729	5.3	2.4	2.8	5.2
FBR taxes	5,625	2,884	3,276	6,161	4.9	2.2	2.5	4.8
Non-tax revenue	3,696	3,046	908	3,954	3.2	2.4	0.7	3.1
SBP profit	2,500	2,428	-	2,428	2.2	1.9	0.0	1.9
PDL collection*	549	372	451	823	0.5	0.3	0.3	0.6
<b>Total expenditure</b>	<b>11,302</b>	<b>4,080</b>	<b>6,061</b>	<b>10,142</b>	<b>9.9</b>	<b>3.1</b>	<b>4.7</b>	<b>7.8</b>
Current expenditure	10,118	4,047	5,544	9,591	8.9	3.1	4.3	7.4
Mark-up payments	5,142	1,378	2,186	3,564	4.5	1.1	1.7	2.8
Subsidies	237	120	343	463	0.2	0.1	0.3	0.4
Grants	585	319	495	814	0.5	0.2	0.4	0.6
Development expenditure & net lending	744	295	669	964	0.7	0.2	0.5	0.7
PSDP	772	441	665	1,106	0.7	0.3	0.5	0.9
Federal	133	41	15	156	0.1	0.0	0.1	0.1
Provincial	639	400	550	950	0.6	0.3	0.4	0.7
Statistical discrepancy	440	-262	-151	-413	0.4	-0.2	-0.1	-0.3
<b>Fiscal balance</b>	<b>-1,538</b>	<b>2,119</b>	<b>-1,578</b>	<b>542</b>	<b>-1.3</b>	<b>1.6</b>	<b>-1.2</b>	<b>0.4</b>
<b>Primary balance</b>	<b>3,604</b>	<b>3,497</b>	<b>608</b>	<b>4,106</b>	<b>3.2</b>	<b>2.7</b>	<b>0.5</b>	<b>3.2</b>
<b>Revenue balance</b>	<b>-354</b>	<b>2,153</b>	<b>-1,060</b>	<b>1,092</b>	<b>-0.3</b>	<b>1.7</b>	<b>-0.8</b>	<b>0.8</b>
<b>Financing (net)</b>	<b>1,538</b>	<b>-2,119</b>	<b>1,578</b>	<b>-542</b>	<b>1.3</b>	<b>-1.6</b>	<b>1.2</b>	<b>-0.4</b>
External	-79	-39	73	34	-0.1	0.0	0.1	0.0
Domestic	1,617	-2,081	1,505	-576	1.4	-1.6	1.2	-0.4
<b>Memorandum items:</b>					-	-	-	-
Provincial balance	776	781	398	1,179	0.7	0.6	0.3	0.9
Non-interest expenditure <sup>^</sup>	5,720	2,964	4,027	6,991	5.0	2.3	3.1	5.4
GDP#	113,935	129,567	129,567	129,567	-	-	-	-

\* On petrol/diesel; ^total expenditure minus mark-up payments & statistical discrepancy; #budget estimate for FY26, and revised estimate for FY25

Source: MoF

The fall in total expenditure was due to a sharp decrease in interest payments, amid falling interest rates and reprofiling of debt. Lower mark-up payments created space for non-interest expenditure, such as Public Sector Development Program (PSDP), subsidies and grants. Higher non-interest expenditure was in part motivated by flood relief activities.<sup>3</sup> Moreover, the increase in subsidies reflects the government's efforts to contain the accumulation of power sector circular debt.

In the backdrop of continued fiscal consolidation, it is imperative to highlight the importance of such efforts for containing public debt accumulation and reducing debt servicing. This, in turn, has created fiscal space for social and development spending to support growth. While non-tax revenue has been instrumental in keeping the fiscal deficit at manageable levels during the last two years, sustaining it over the medium term requires a continued increase in tax

<sup>3</sup> Current expenditures in Q1 were driven by flood-related rescue and relief activities for provincial governments.

Source: MoF

**Tax Revenue - H1** **Table 4.2**  
amount in billion Rupees; growth in percent

	Amount		Growth		Percent of GDP	
	FY25	FY26	FY25	FY26	FY25	FY26
Direct	2,782	3,030	29.4	8.9	2.4	2.3
Indirect	2,843	3,131	22.5	10.1	2.5	2.4
Sales	1,898	2,087	25.3	10.0	1.7	1.6
Customs	599	643	10.7	7.4	0.5	0.5
FED	347	401	31	15.6	0.3	0.3

Source: FBR

revenue. Thus, reforms must start with broadening the tax base, along with efforts to enhance administration and governance.

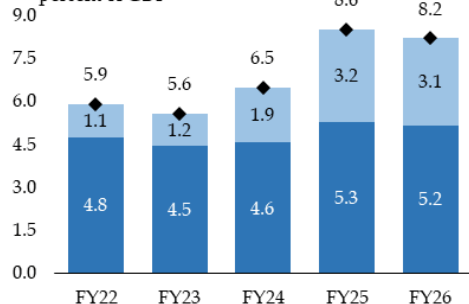
## 4.2 Revenue

After increasing for the past two consecutive years, total revenue collection declined in H1-FY26 to 8.2 percent of GDP from 8.6 percent last year. This was due to reduction in both tax and non-tax revenue (Figure 4.4).

### Tax Revenue

Total tax collection decreased by 0.1 percent of GDP in H1-FY26, primarily due to lower federal taxes, while provincial

**Breakdown of Total Revenue - H1** **Figure 4.4**  
percent of GDP



Note: Numbers might not add up due to rounding off  
Source: MoF

taxes slightly increased, helping to cushion the decline in total tax collection.

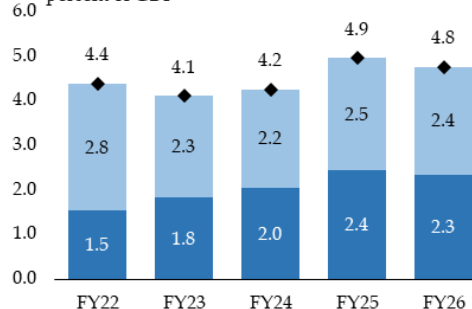
### Federal Taxes

Federal tax collection declined to 4.8 percent of GDP in H1-FY26, compared to 4.9 percent of GDP in the corresponding period of last year (Figure 4.5). This decline was broad-based, with all major taxes registering a deceleration in growth (Table 4.2). As a result, federal taxes fell short of the target set by the Federal Board of Revenue (FBR), despite robust growth in imports and improvement in economic activity (Figure 4.6).

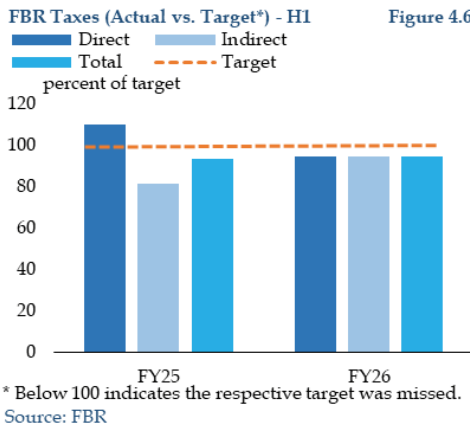
### Direct Taxes

Direct tax collection decline by 0.1 percentage point to 2.3 percent of GDP in H1-FY26. The decline was primarily due to reduction in withholding tax (WHT) collection, while collection on demand and voluntary payments remained almost unchanged in terms of GDP. This can be attributed to lower interest rates, a decline in exports, and negative quarterly tariff adjustments (QTA) and fuel charge

**Breakdown of Federal Tax Revenue - H1** **Figure 4.5**  
percent of GDP



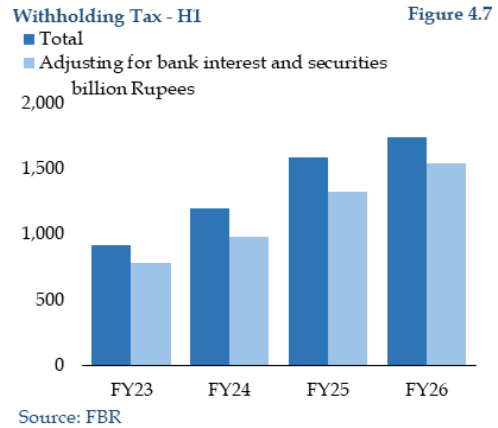
Note: Numbers might not add up due to rounding off  
Source: FBR



adjustments (FCA) on electricity bills that led to lower WHT collection.<sup>4,5,6</sup>

In addition to economic factors, several budgetary measures such as lower advance tax on purchase of immovable property, reintroduction of a tax rebate to teachers, and exemptions on cinema operations and on monetary rewards to sportspersons also contributed to a decline in WHT collection.

Nonetheless, the new budgetary measures helped to partially compensate for the decline in WHT due to above-mentioned factors. These measures included higher WHT rates on sellers of immovable property, cash withdrawals,<sup>7</sup> profit on



debt, securities disposal and dividends from mutual funds.

Moreover, the government also removed exemptions on digital transactions on e-commerce platforms and pensions,<sup>8</sup> adding them into the tax net. These, together with better enforcement and tax dispute resolution from the tax administration, supported direct tax collection (**Figure 4.7**).<sup>9</sup>

### Indirect Taxes

Indirect tax collection also recorded a slight decline of 0.1 percentage points in H1-FY26, primarily led by lower sales tax collection. While FED and customs collections remained broadly unchanged in

<sup>4</sup> Exports in rupee terms declined by 9.0 percent in H1-FY26 compared to growth of 11 percent last year. Source: PBS

<sup>5</sup> Lower interest rates (price effect) offset the impact of rebound in demand for interest-bearing accounts (volume effect) in H1-FY26, leading to lower collections under 'Bank interest and securities'. Source: Financial Soundness Indicators, SBP

<sup>6</sup> Growth in electricity generation, used as a proxy for electricity consumption, increased only slightly at an average of 1.3 percent in H1-FY26. This indicates that lower WHT collection came on the back of lower electricity charges (price effect). Source: NEPRA

<sup>7</sup> WHT on transactions such as cash withdrawals reflects higher reliance on withholding taxes, which may constrain the transition towards a broad-based tax system.

<sup>8</sup> Pension above Rs 10 million is now subject to a final tax of 5 percent. Source: Budget documents, MoF, and Several issues.

<sup>9</sup> Source: IMF-Pakistan Second Review Under Extended Fund Facility. December 2025

terms of GDP, sales tax collection weakened mainly due to lower receipts from electrical energy following the downward revision in electricity tariffs.

Despite this slight moderation, the momentum in indirect tax collection continued to be supported by policy-driven broadening of tax base. Key steps included further withdrawal of sales tax exemptions on the import and supply of solar panels, the local supply of imported iron and steel scrap, and FED exemption on the allotment and transfer of immovable property. Moreover, the scope of sales tax was expanded to several imported items.<sup>10</sup> These tax rationalisation measures are a step in the right direction, as they would help strengthen the country's tax revenue capacity.

### Provincial Taxes

Provincial tax revenue remained unchanged at 0.4 percent of GDP in H1-FY26; stagnating at this level for the past six years. Despite this stagnation in terms of GDP, provincial taxes continue to increase in absolute terms. This has been contributed by both direct and indirect taxes, led by property taxes and sales tax on services, respectively (Table 4.3).

### Non-tax Revenue

Non-tax revenues edged down to 3.1 percent of GDP in H1-FY26 compared to 3.2 percent last year. This decline was

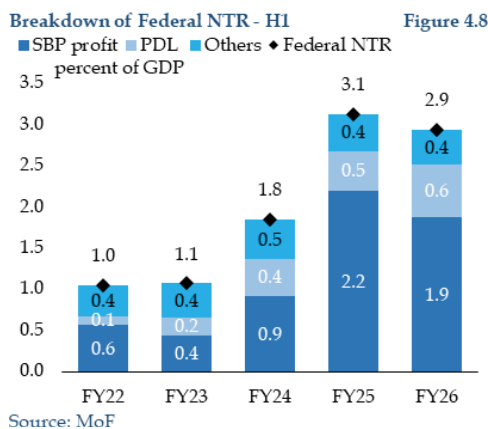
primarily due to slightly lower SBP profit amid falling interest rates. In contrast, PDL collection maintained an upward trend and reached 0.6 percent of GDP in H1-FY26, which partially offset the decline in SBP profit (Figure 4.8). This was supported by both higher PDL rates (price effect),<sup>11</sup> and POL sales (volume effect).<sup>12</sup>

### 4.3 Expenditure<sup>13</sup>

Total expenditure fell significantly compared to the same period last year (Figure 4.9). This drop was primarily due to a steep fall in mark-up payments, which created fiscal space for increased development spending and subsidies (Figure 4.10).

### Interest Expenditure

In the backdrop of the decline in the policy



<sup>10</sup> These include imported pet food, chocolates, coffee and cereal bars that are sold in retail packing.

<sup>11</sup> PDL on HSD was initially increased from Rs 74.5 to Rs 77.0 on 1<sup>st</sup> August 2025 and then subsequently reduced to Rs 75.4 on 16<sup>th</sup> Nov 2025 and has remained unchanged since then. PDL rate on petrol increased from Rs 78.0 to Rs 79.6 on October 2025. Source: PSO and OGRA.

<sup>12</sup> Albeit decelerated, sales of HSD and petrol increased by 3.5 percent and 2.5 percent, respectively.

<sup>13</sup> This section excludes statistical discrepancy, consistent with previous reports. Due to the large discrepancy reported for H1-FY26, the trends in non-interest spending may vary when included in total expenditure.

## The State of Pakistan's Economy, Half Year Report 2025-26

Provincial Fiscal Accounts - H1  
billion Rupees; growth in percent

Table 4.3

	Amount		Growth		Percent of GDP	
	FY25	FY26	FY25	FY26	FY25	FY26
<b>Total revenue</b>	<b>4,140</b>	<b>4,657</b>	<b>34.8</b>	<b>12.5</b>	<b>3.6</b>	<b>3.6</b>
NFC transfers	3,339	3,616	37.1	8.3	2.9	2.8
Own revenue	585	723	31.8	23.5	0.5	0.6
Taxes	443	569	21.2	28.4	0.4	0.4
GSTs*	261	329	13.6	25.9	0.2	0.3
Non-tax	143	155	80.4	8.4	0.1	0.1
Fed. Transfers	216	318	12.7	47.4	0.2	0.2
Loans (net)	125	168	8.1	35.2	0.1	0.1
Grants	91	149	19.7	64.0	0.1	0.1
<b>Total expenditure</b>	<b>3,365</b>	<b>3,478</b>	<b>21</b>	<b>3.4</b>	<b>3.0</b>	<b>2.7</b>
Current	2,524	2,869	21.7	13.7	2.2	2.2
Development	639	950	17.7	48.7	0.6	0.7
Statistical discrepancy	202	-342	-	-	0.2	-0.3
<b>Overall balance</b>	<b>775</b>	<b>1,179</b>	<b>167.9</b>	<b>52.1</b>	<b>0.7</b>	<b>0.9</b>

\*General sales tax on services

Source: MoF

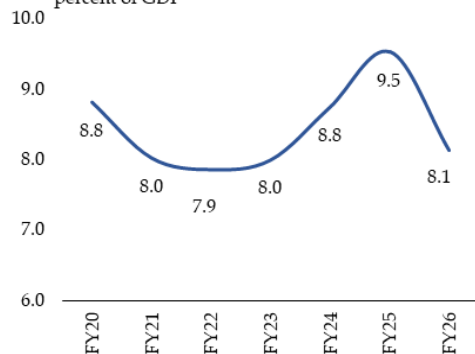
rate, mark-up payments witnessed a steep decline from 4.5 percent of GDP in H1-FY25 to 2.8 percent of GDP in H1-FY26 (Figure 4.11). The reduction in interest payments was mainly led by domestic mark-up payments, which dropped by 33.9 percent. Aside from falling interest rates, this also reflected the government efforts to lengthen the maturity profile of debt, especially by retiring T-bills that carry higher rates (Chapter 3).

### Non-interest Expenditure

The increase in non-interest expenditure was mainly due to higher subsidies and development spending (Figures 4.12 & 4.13). The growth in both subsidies and development expenditure was higher when compared to the average during the last 7 years (FY20 to FY26). In terms of GDP, subsidies and development expenditure each increased by 0.2 percentage points in H1-FY26.

Total Expenditure - H1  
percent of GDP

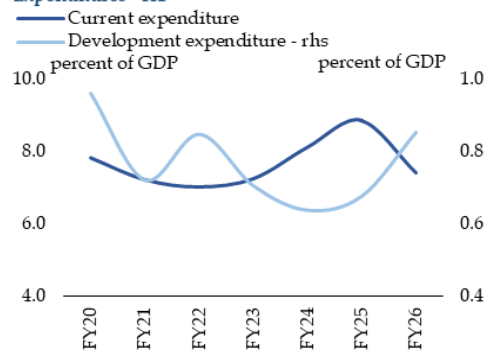
Figure 4.9



Source: MoF

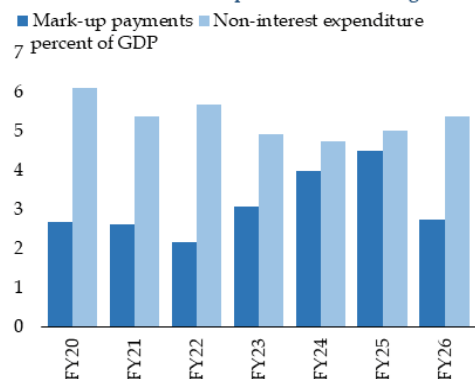
Current and Development  
Expenditures - H1

Figure 4.10



Source: MoF

**Interest & Non-Interest Expenditures - H1** Figure 4.11

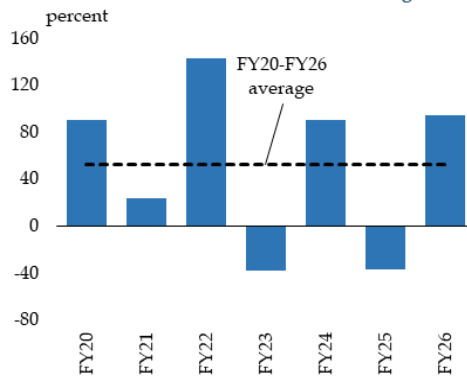


Source: MoF

The increase in development spending was led by a 48.7 percent rise in provincial expenditure (Figure 4.14), while federal development spending grew by 17 percent in H1-FY26. The utilisation of authorized PSDP budgets for H1-FY26 also rose to 59 percent, up from 39 percent last year.<sup>14</sup> The increase in subsidies was mostly on account of energy and power sectors, which accounted for 93 percent of total subsidies. These included subsidies for inter-disco tariff differentials, IPPs, Pakistan Energy Revolving Fund and electricity revenue shortfalls for AJK. A major part of power subsidies was meant to keep net circular debt accumulation at zero.<sup>15</sup> This signals the necessity of power sector reform, amid the push towards renewable energy (Box 6.5).

Following subsidies and PSDP, grants also rose sharply in H1-FY26. This largely reflected an increased allocation for the

**Growth in Subsidies - H1** Figure 4.12

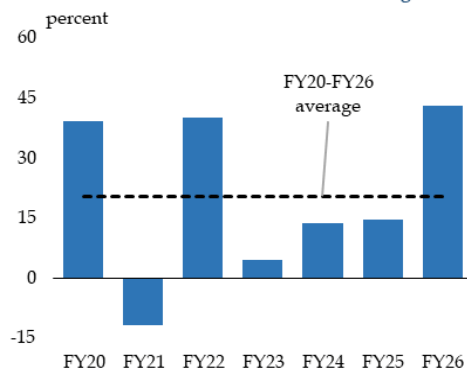


Source: MoF

Benazir Income Support Program (BISP), which was up by 41.5 percent compared to last year, with the commitment to increase the benefit size and coverage during FY26.<sup>16</sup>

This increased social and development spending bodes well for sustaining growth momentum, as estimates show that

**Growth in PSDP - H1** Figure 4.13



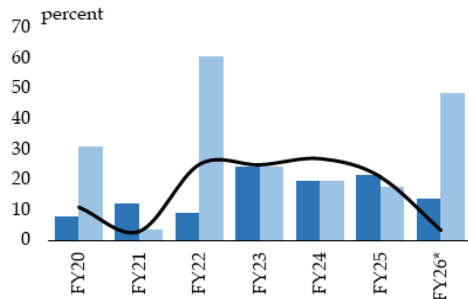
Source: MoF

<sup>14</sup> Source: MoPDSI (2025)

<sup>15</sup> Stock clearance subsidies of Rs 400 billion are expected to keep net circular debt accumulation at zero in FY26. Source: IMF (2025)

<sup>16</sup> Kafalaat unconditional cash transfers benefits will be increased from Rs 13,500 to Rs 14,500 and coverage will be expanded to at least 200,000 more families by the end of FY26. Source: IMF (2025)

**Growth in Provincial Expenditures - H1** Figure 4.14



\* Total expenditure is dampened by a statistical discrepancy of -0.3 percent of GDP.  
Source: MoF

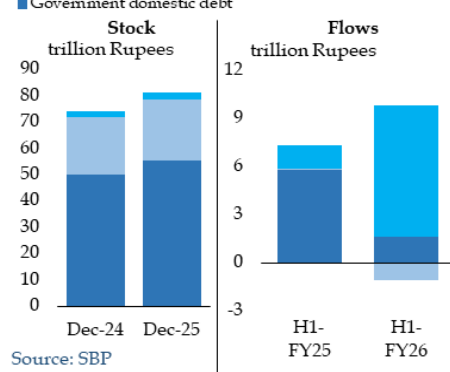
development expenditure has a considerably higher fiscal multiplier than current expenditures (Box 4.1).

#### 4.4 Public Debt

Sustained fiscal consolidation and a sharp decline in interest payments significantly slowed the pace of public debt accumulation to 1.1 percent during H1-FY26 from 3.9 percent in the corresponding period of the previous year (Figure 4.15). The gain from PKR appreciation against US dollar and lower accumulation in government deposits, together with retirement of SBP loans, also contributed to slower pace of public debt accumulation (Figure 4.16).<sup>17</sup>

Both domestic and external debt contributed to curtail the pace of public debt accumulation. While increase in domestic debt was contained substantially,

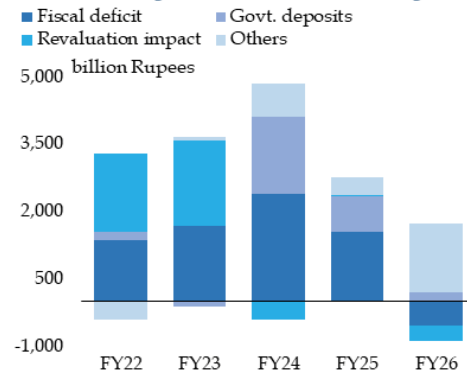
**Public Debt - Stock and Flows** Figure 4.15



Source: SBP

external debt saw net retirement during H1-FY26. The latter also reflects the impact of PKR appreciation against US dollar and appreciation of US dollar against other currencies, and government's lower reliance on external financing.<sup>18,19</sup> Moreover, the government continued to rely on financing through medium to long-term instruments, while limiting

**Sources of Change in Public Debt - H1** Figure 4.16



Source: SBP

<sup>17</sup> Public debt declined by Rs 342.0 billion on account of PKR appreciation against US dollar in H1-FY26.

<sup>18</sup> In terms of PKR, appreciation of US dollar against other currencies also lowered public debt by Rs 18.5 billion during H1-FY26.

<sup>19</sup> As per the Annual Borrowing Plan FY26, deficit financing planned through external sources declined to 1.6 percent of total financing for FY26 significantly lower than 7.8 percent for FY25.

## Government Domestic Debt

Table 4.4

Stocks and flows in billion Rupees; share and growth in percent

	Stocks		Flows		Share		Growth	
	Dec-24	Dec-25	H1-FY25	H1-FY26	H1-FY25	H1-FY26	FY25	FY26
<b>Government Domestic Debt</b>	<b>49,883.3</b>	<b>55,362.9</b>	<b>2,723.1</b>	<b>891.6</b>	<b>100.0</b>	<b>100.0</b>	<b>5.8</b>	<b>1.6</b>
<b>I. Permanent Debt, of which</b>	<b>3,7863.9</b>	<b>43,015.6</b>	<b>4,207.7</b>	<b>766.5</b>	<b>75.9</b>	<b>77.7</b>	<b>12.5</b>	<b>1.8</b>
GOP Ijara Sukuk	5,709.3	6,552.3	943.1	365.3	11.4	11.8	19.8	5.9
PIBs	31,216.2	34,929.8	3,190.4	-85.1	62.6	63.1	11.4	-0.2
Prize Bonds	394.3	422.7	9.2	15.2	0.8	0.8	2.4	3.7
<b>II. Floating Debt, of which</b>	<b>8,696.0</b>	<b>8,744.1</b>	<b>-1,551.6</b>	<b>-14.8</b>	<b>17.4</b>	<b>15.8</b>	<b>-15.1</b>	<b>-0.2</b>
Market Treasury Bills	8,602.0	8,610.6	-1,565.3	-27.9	17.2	15.6	-15.4	-0.3
<b>III. Unfunded Debt, of which</b>	<b>2,868.7</b>	<b>3,156.6</b>	<b>69.9</b>	<b>135.6</b>	<b>5.8</b>	<b>5.7</b>	<b>2.5</b>	<b>4.5</b>
NSS (Net of Prize Bonds)	2,785.8	3,083.5	78.0	141.1	5.6	5.6	2.9	4.8
<b>IV. Foreign Currency</b>	<b>373.8</b>	<b>384.5</b>	<b>0.3</b>	<b>4.1</b>	<b>0.7</b>	<b>0.7</b>	<b>0.1</b>	<b>1.1</b>
<b>V. Naya Pakistan Certificates</b>	<b>81.0</b>	<b>62.1</b>	<b>-3.1</b>	<b>0.1</b>	<b>0.2</b>	<b>0.1</b>	<b>-3.7</b>	<b>0.2</b>

Source: SBP

mobilisation through T-bills. At the same time, with inflation stabilising in the medium-term target range, the share of government borrowing via fixed rate instruments saw a notable increase during H1-FY26. As a result, the overall public debt profile improved in terms of average time to maturity, roll-over risk, interest cost and currency risk.<sup>20</sup>

Moreover, steep decline in interest payments, increase in revenue collection, higher remittances, and continuous build-up in foreign exchange reserves improved debt repayment capacity and solvency indicators. Nonetheless, a mixed picture emerged in liquidity indicators due to increase in short-term external debt in H1-FY26.

### Domestic Debt

Domestic debt increased by Rs 891.6 billion during H1-FY26, substantially lower

compared to an expansion of Rs 2,723.1 billion in the same period of the last year (Table 4.4). The slowdown in domestic debt accumulation largely owed to fiscal surplus resulting from healthy SBP profit and noteworthy reduction in interest payments. In addition, lower accumulation in government deposits held with the banking system as compared with same period last year, along with Rs 1.6 trillion retirement of SBP loans also contributed to decreasing the pace of domestic debt accumulation during H1-FY26.

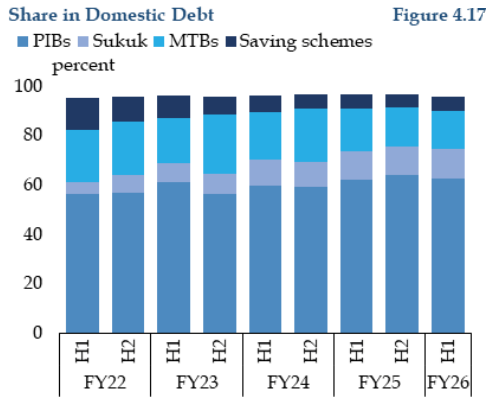
In order to contain roll-over and interest rate risks, the government continued to borrow through long-term fixed-rate securities, while at the same time curtailing mobilisation via T-bills (Figure 4.17).<sup>21</sup> As a result, the share of fixed rate instruments increased to 33.5 percent at the end of H1-FY26, from 27.0 percent at the end of FY25 (Figure 4.18).<sup>22</sup> This helped in improving

<sup>20</sup> Exchange rate stability majorly contributed in reducing currency risk.

<sup>21</sup> The share of long-term securities, mainly Sukuk, increased to 77.7 percent at the end of H1-FY26 from 75.9 percent at the end of the corresponding period last year.

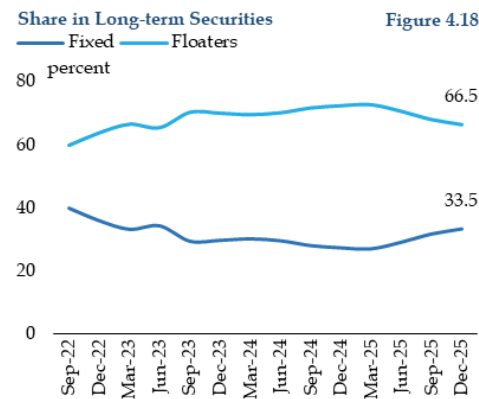
<sup>22</sup> It is pertinent to mention that during high inflation episode, investors tend to invest in short-term or floating-rate instruments to minimise losses due to the expectation of imminent increase in interest rates.

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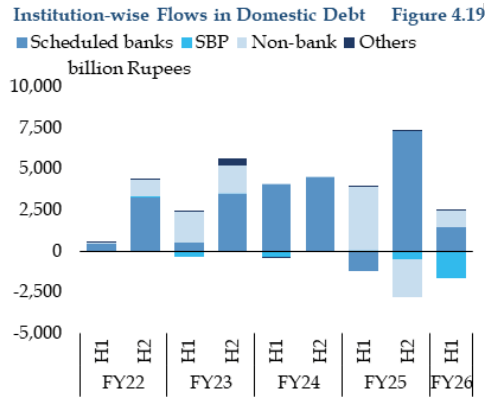


the domestic debt profile, besides reducing interest cost.

The data on institution-wise holdings shows that the government primarily borrowed from scheduled banks during H1-FY26, which was substantially higher compared to the corresponding period of last year, while it retired SBP debt. In contrast, mobilisation of funds from non-



<sup>23</sup> In the previous year, the banks increased lending to private sector and reduced investment in government securities to avoid ADR-based tax.



bank sources witnessed a pronounced decline. As a result, the share of scheduled banks' investment in government securities rose to 66.5 percent at the end of H1-FY26, from 56.1 percent in H1-FY25 (Figure 4.19). This can be attributed to the removal of tax on banks linked to their advance-to-deposits ratio (ADR).<sup>23</sup>

Furthermore, continuing the last year's trend, National Savings Schemes (NSS) witnessed net inflows during H1-FY26. Particularly, the net inflows in savings certificates and accounts stood at Rs 90.4 and Rs 48.2 billion respectively, compared to Rs 64.5 and 15.4 billion in the same period of the previous year. Behbood Savings Certificates (BSC), Regular Income Certificates (RIC) and Pensioners' Benefit Account (PBA) mainly contributed to net inflows. This largely reflected renewed investors' interest and relatively higher average profit rates on NSS instruments

compared to the return on government securities and bank deposits.<sup>24</sup>

### Domestic Debt Servicing

Interest payments on domestic debt declined to Rs 3.1 trillion during H1-FY26 from Rs 4.9 trillion in the same period last year. The reduction majorly came from lower interest payments against PIBs and T- bills.<sup>25</sup> In addition, interest payments on unfunded debt, mainly driven by Defence Saving Certificates (DSC), also recorded a downtick during the current review period (Figure 4.20).

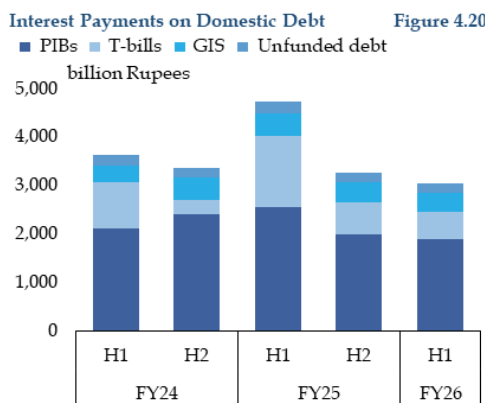
Easing domestic debt servicing is mainly attributed to a significant decrease in interest rates, followed by government's reliance on long-term instruments (Figure 4.21), as per Medium-Term Debt Management Strategy (MTDS) for FY26-28. Consequently, the domestic debt

repayment capacity, measured by ratio of domestic interest payments (DIP) to FBR taxes, significantly improved during H1-FY26 (Figure 4.22).

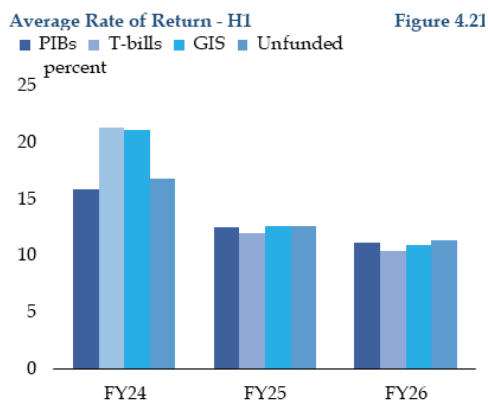
### Public External Debt and Liabilities

The stock of public external debt and liabilities (PEDL) stood at US\$ 104.9 billion at the end-December 2025, up from US\$ 103.7 billion at end-December 2024. The increase mainly stemmed from Public External Debt (PED), which rose by US\$ 1.1 billion during H1-FY26 (Table 4.5).

The accumulation in PED was largely due to disbursements under the IMF's EFF, followed by other bilateral and multilateral sources. In addition, investment in Naya Pakistan Certificates (NPC) and short-term commercial loans also witnessed an uptick during H1-FY26.<sup>26</sup> In contrast, repayments of Eurobonds, long-term commercial loans,



Source: SBP



Sources: SBP; CDNS

<sup>24</sup> The average rate of return on NSS instruments remained 11.43 percent during H1-FY26, which is relatively higher than the average interest rate on T-bills, PIBs and Sukuk.

<sup>25</sup> Domestic interest payments declined by 35.4 percent during H1-FY26, mainly contributed by 61.1 and 26.0 percent reduction in interest payments against T-bills and PIBs, respectively.

<sup>26</sup> The increase in short-term multilateral loans reflects disbursements under the oil facility of the Islamic Development Bank, while inflows in NPCs were supported by favourable interest rates amid a decline in the US Fed policy rate.

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## Public External Debt

Table 4.5

Stocks and flows in million US\$; growth in percent

	Stocks			Flows		Growth	
	Dec-24	Jun-25	Dec-25	H1-FY25	H1-FY26	H1-FY25	H1-FY26
<b>Public external debt (1+2)</b>	<b>86,621.4</b>	<b>91,794.6</b>	<b>92,873.1</b>	<b>96.3</b>	<b>1,078.5</b>	<b>0.1</b>	<b>1.2</b>
<b>1. Government external debt</b>	<b>78,128.6</b>	<b>82,526.6</b>	<b>82,715.8</b>	<b>-18.8</b>	<b>189.1</b>	<b>0.0</b>	<b>0.2</b>
<b>i) Long-term (&gt;1 year)</b>	<b>77,016.3</b>	<b>81,787.5</b>	<b>81,627.6</b>	<b>-371.3</b>	<b>-159.9</b>	<b>-0.5</b>	<b>-0.2</b>
Paris club	5,745.8	6,004.6	5,604.0	-728.6	-400.6	-11.3	-6.7
Multilateral	39,663.7	42,480.1	42,721.3	415.7	241.2	1.1	0.6
Other bilateral	17,908.9	18,038.9	18,704.5	-643.5	665.7	-3.5	3.7
Euro/Sukuk global bonds	6,800.0	6,800.0	6,300.0	0.0	-500.0	0.0	-7.4
Commercial loans/credits	5,774.7	7,156.3	6,834.0	284.4	-322.3	5.2	-4.5
Naya Pakistan Certificates	1,054.8	1,225.1	1,350.1	270.9	125.0	34.6	10.2
<b>ii) Short-term (&lt;1 year)</b>	<b>1,112.2</b>	<b>739.2</b>	<b>1,088.2</b>	<b>352.5</b>	<b>349.0</b>	<b>46.4</b>	<b>47.2</b>
Multilateral	389.6	552.3	796.5	139.6	244.2	55.8	44.2
<b>2. From IMF</b>	<b>8,492.8</b>	<b>9,268.0</b>	<b>10,157.3</b>	<b>115.1</b>	<b>889.3</b>	<b>1.4</b>	<b>9.6</b>
<b>3. Foreign exchange liabilities</b>	<b>11,709.5</b>	<b>11,955.3</b>	<b>12,079.7</b>	<b>-21.6</b>	<b>124.3</b>	<b>-0.2</b>	<b>1.0</b>
Central bank deposits	3,700.0	3,700.0	3,700.0	0.0	0.0	0.0	0.0
Other liabilities (SWAP)	4,181.0	4,221.5	4,357.8	11.4	136.3	0.3	3.2
Allocation of SDRs	3,827.9	4,033.0	4,019.7	-32.9	-13.2	-0.9	-0.3

Source: SBP

and Paris club loans contained accumulation in PED.

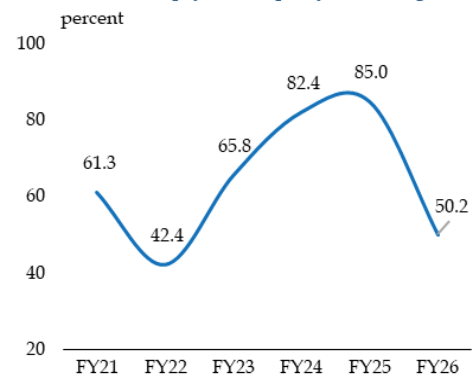
Furthermore, the appreciation of US dollar against other currencies resulting in a US\$ 66 million decline, marginally constrained PED growth. The stock of short-term public external debt increased to US\$ 1,088 million during H1-FY26. Most of this debt was mobilised from multilateral sources. Despite this increase in short-term borrowing, its share in overall public external debt continues to remain small (Figure 4.23).

### External Disbursements

Total external disbursements amounted to US\$ 4.3 billion in H1-FY26, higher than US\$ 3.6 billion during the corresponding period of FY25. Increase in external financing, points to improvement in the country's risk perception, amidst the

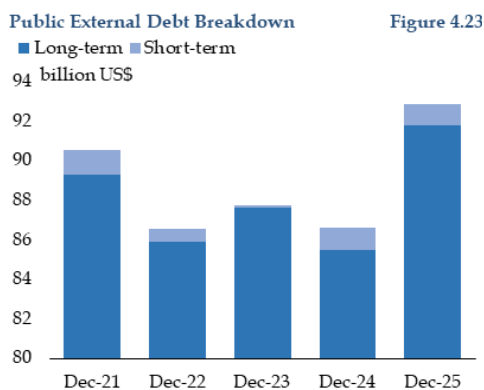
ongoing IMF program.<sup>27</sup> Major inflows came from bilateral sources, followed by multilateral creditors and loans under NPC. Among the multilateral inflows, World Bank (WB), the Asian Development Bank (ADB) and the Islamic Development

Domestic Debt Repayment Capacity - HI Figure 4.22



Sources: MoF; SBP

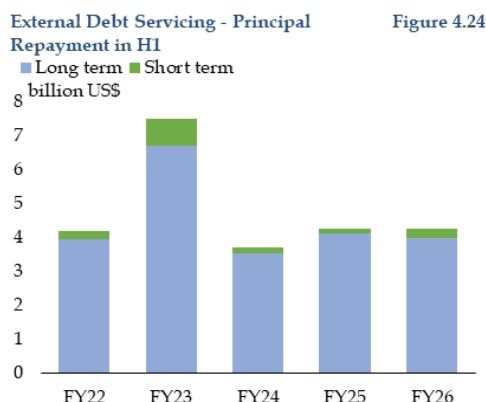
Pakistan's sovereign credit rating improved during the period under review, as reported by Moody's in August 2025.



Source: SBP

Bank (IsDB) contributed the most (Table 4.6).

Regarding bilateral disbursements, the major inflows were realised from Saudi Arabia and China, followed by Denmark. Like H1-FY25, more than 50 percent of the external disbursements were meant for budgetary support, while the share of project financing was 38.3 percent. In



Source: SBP

absolute terms, non-project aid in H1-FY26 stood at US\$ 2.7 billion, including US\$ 1.6 billion budgetary support and US\$ 600 million oil facility. Further breakdown of external disbursements highlights that project aid was mainly concentrated in the power sector and flood-related reconstruction activities, while non-project aid was primarily directed towards the petroleum sector (Table 4.7).

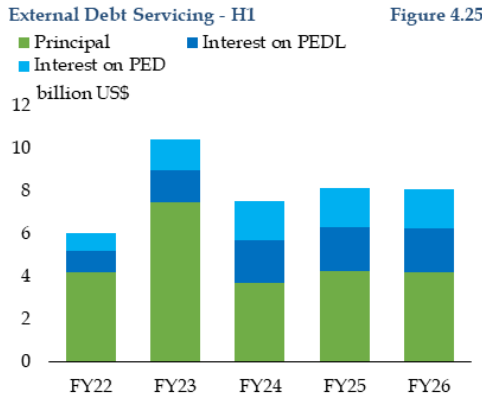
#### External Disbursements

Table 4.6

million US\$

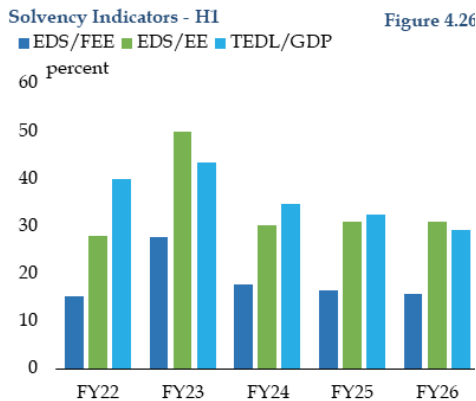
Sources	Grants		Loans		Total	
	H1-FY25	H1-FY26	H1-FY25	H1-FY26	H1-FY25	H1-FY26
Multilateral	28.6	29.0	1,835.9	1,938.3	1,864.5	1,967.3
ADB	3.9	2.7	905.1	546.6	909.0	549.2
AIIB	-	-	51.0	57.2	51.0	57.2
IBRD	14.7	15.4	125.5	206.3	140.3	221.7
IDA	2.8	8.2	349.1	572.6	351.9	580.8
IsDB (Short-term)	-	-	239.6	483.8	239.6	483.8
Bilateral	71.2	33.6	1,668.2	2,297.0	1,739.4	2,330.6
China (Guaranteed)	-	-	-	255.6	-	255.6
China	2.4	10.6	96.8	61.7	99.2	72.3
Denmark	-	-	-	71.2	-	71.2
France	0.0	0.5	100.5	15.1	100.5	15.6
Japan	9.9	11.9	0.0	-	9.9	11.9
Korea	4.6	-	6.2	9.5	10.8	9.5
Saudi Arabia	-	3.3	8.7	5.4	8.7	8.7
Saudi Fund for	-	-	-	600.0	-	600.0
USA	39.4	0.4	-	-	39.4	0.4
Foreign banks	-	1.9	500.0	54.4	500.0	56.3
Naya Pakistan Certificate	-	-	927.6	1202.1	927.6	1,202.1
<b>Total</b>	<b>99.8</b>	<b>62.5</b>	<b>3,504.1</b>	<b>4,235.4</b>	<b>3,603.8</b>	<b>4,297.9</b>

Source: EAD



### External Debt Servicing

External debt servicing (including principal and interest) marginally decreased to US\$ 6.2 billion compared to US\$ 6.3 billion in the same period last year (Figure 4.24). Major repayments were made to Eurobond investors, IMF, and bilateral and multilateral sources. In terms of composition, a major part of the external debt servicing consisted of long-term principal repayments to multilaterals, IMF, and NPC holders. Likewise, interest payments were mostly to multilaterals, IMF and bilateral sources (Figure 4.25).



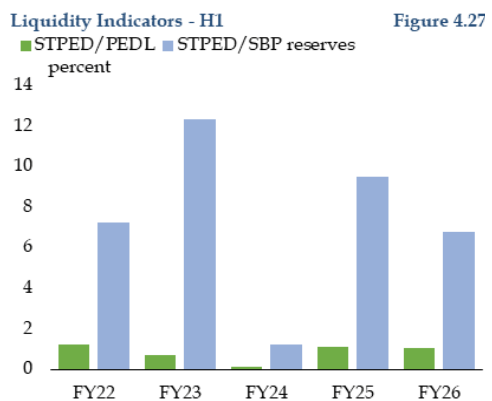
**Major Disbursement Sources** Table 4.7  
million US\$

Sources	Type of Aid	Name of Loan/Grants	Amount
China	Loan	Chashma Nuclear Power Plant-5 (C-5)	255.6
ADB	Loan	Sindh Emergency House Reconstruction Project	73.2
IDA	Loan	Sindh Flood House Reconstruction	160.6
IDB	Loan	ITFC Short-term financing for Importing oil & LNG	483.8
IMF	Loan	-	209.5
Saudi Arabia	Loan	Import of petroleum and crude oil	600

Source: EAD

### External Debt Sustainability

In H1-FY26, external debt sustainability improved, supported by higher remittance inflows, and a buildup in SBP's foreign exchange reserves. Improved solvency indicators based on External Debt Servicing (EDS) to Foreign Exchange Earning (FEE) and EDS to Exports Earning (EE) reflect country's enhanced capacity to repay its external obligations. Likewise, Total External Debt and Liabilities (TEDL)



to Gross Domestic Product (GDP) in H1-FY26 fell to its lowest level in the past five years, underscoring the improvement in external debt sustainability (Figure 4.26). Unlike solvency indicators, liquidity indicators posted a mixed picture in H1-FY26. While short-term public external

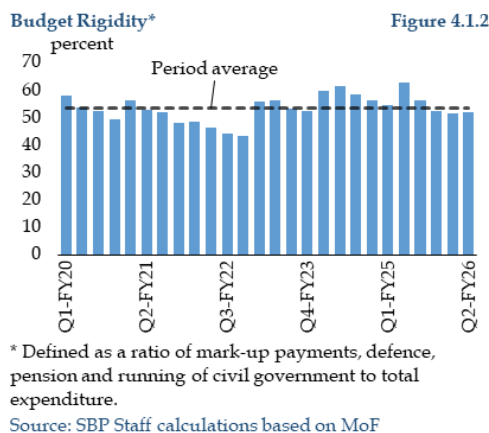
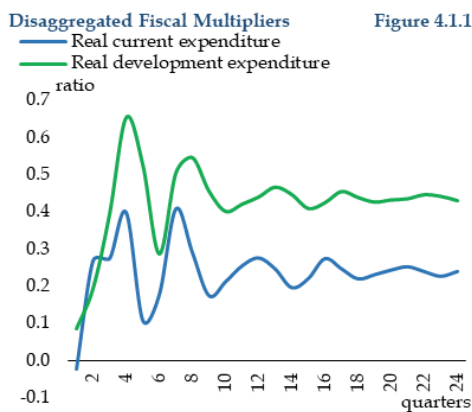
debt (STPED) to public external debt and liabilities (PEDL) slightly deteriorated, STPED to SBP reserves improved significantly due to increase in SBP reserves (Figure 4.27).

#### Box 4.1: Efficiency of Fiscal Spending in Pakistan

Research shows that a decrease of pre-committed spending in current expenditure and an increase in discretionary development spending raises allocative efficiency of expenditure in an economy. Estimates show that the impact of increased allocative efficiency is quite significant for Emerging Market and Developing Economies (EMDEs).

Switching 1 percent of GDP from government consumption to infrastructure investment is estimated to increase output by 3.5 percent over the long-term.<sup>28</sup> Similarly, expenditure redirected towards education yields a 6 percent increase in output in the long run (IMF, 2025a). In this context, recent changes in Pakistan's expenditure mix, with reduced interest expenses and increased development spending, if sustained, bodes well for economic growth in the coming years.

In the case of Pakistan, SBP staff estimates show that the growth dividends of development expenditure outstrip that of current expenditure by an average of 0.19 over a period of 24-quarters and a maximum of 0.42 (in the 5<sup>th</sup> quarter) for their respective fiscal multipliers (Figure 4.1.1).<sup>29</sup> A reallocation of current into development expenditure also signals a decrease in budget rigidities and a greater ability of the government to channelise discretionary spending (Figure 4.1.2). Higher rigidity is associated with



<sup>28</sup> The study analyses the long-term gain in infrastructure and human capital investment from 2026 to 2050.

<sup>29</sup> Fiscal multipliers represent the growth dividend of expenditure, a multiplier of 1 means that spending generates a proportional increase in real GDP. Values above 1 indicate a more than proportionate increase, and vice versa. Staff estimates utilise the impulse responses of a Vector Autoregression (VAR) model to find the impact of an expenditure shock on real GDP.

inefficient levels of public expenditure (Olaberria & Herrera, 2020), indicating lower levels of allocative efficiency. In this context, the current trend of expenditure is promising, and continued consolidation bodes well for reducing budget rigidities and increasing the allocative efficiency of spending for greater growth.

However, in the long-term, increasing allocative efficiency alone is not enough. It must be accompanied by enhanced technical efficiency of spending i.e. maximising output for a given level of resources. This may boost fiscal multipliers, lead to improved development outcomes and better service delivery. A primary source for ameliorating technical efficiency is institution building, which is found to have a positive relationship with technical efficiency (Herrera et al., 2025). In this regard, reforms to enhance transparency and improve governance are key. Examples of such reforms are requirements for budget publications and frameworks, contract disclosures and independent audits and oversight.

Decentralisation of spending and spending reviews through local governments are also associated with improved expenditure efficiency, with notable increases in savings and program effectiveness (IMF, 2025a). Furthermore, leveraging digitisation and government technology (GovTech) for public finance management can further boost transparency, if complemented with an enabling environment, e.g. digitally literate workforce, data-driven platforms, etc. (Amaglobeli et al., 2023).

Recent examples of such reforms in Pakistan include a project selection methodology scorecard to improve public investment quality, and digitisation of public procurement for federal and provincial agencies (IMF, 2025b). These steps can serve to increase efficiency by improving the selection of high impact projects, along with increasing transparency and reducing corruption. Deepening measures in this direction are key to enhancing Pakistan's spending efficiency.

Spending efficiency is essential not only to boost output gains but also to determine if such gains will even occur. Research shows that output responds minimally in countries with low investment efficiency (IMF, 2025a). Therefore, fiscal consolidation is a key starting point to increasing allocative efficiency, however, to increase growth dividends and fiscal multipliers in Pakistan, expenditure must be technically efficient with an emphasis on service delivery, transparency and cost effectiveness.

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*\*The contribution of Ali Ahmed Shah is acknowledged in writing this box.*