



DEBT SUSTAINABILITY ANALYSIS REPORT

FY2026 - FY2028

MFPU - Economic Adviser's Wing - Finance Division - Government of Pakistan



FOREWORD

The Debt Sustainability Analysis report presents a comprehensive assessment of debt sustainability over the medium term, FY2026 - FY2028. Pakistan's economy achieved stability in FY2025, marked by reduced inflation to 4.5 percent, a surplus in the primary balance and current account balance, and a stable exchange rate. While external uncertainties, tight monetary conditions, and climate-related risks pose challenges, the government remains actively addressing these through sound policies, structural reforms, and resilience-building measures to safeguard economic stability. Accordingly, this report aims to critically evaluate Pakistan's debt sustainability in the current economic environment and analyze the primary sources of risk. It covers both external and domestic debt, along with government guarantees, while incorporating anticipated macroeconomic and fiscal risks over the medium term.

A solid understanding of debt dynamics is vital for enhancing debt transparency, maintaining fiscal sustainability, and gaining insights into effective debt management strategies. This report also evaluates Pakistan's capacity to handle its debt amid ongoing economic pressures and provides recommendations for securing debt sustainability in the future.

I gratefully acknowledge the dedicated efforts of the officers at the MFPU, Economic Adviser's Wing, Finance Division, in preparing this document. Special commendation is due to Dr. Hasan M. Mohsin, Economic Adviser, Dr. Naseem Faraz, DG MFPU, Dr. S. M. Naeem Nawaz, Director (Fiscal), and Ms. Almazia Shahzad, Economic Analyst, for their diligent work in preparing this comprehensive report. My gratitude is also extended to the Debt Management Office, Finance Division, for providing the required data and valuable feedback during the preparation process. This report offers valuable insights for stakeholders, including policymakers and investors, highlighting the need for coordinated action to ensure economic and debt sustainability.

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Secretary Finance

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EXECUTIVE SUMMARY

Pakistan's public debt is projected to remain sustainable over the medium term, supported by macroeconomic stability and continued fiscal consolidation. However, a moderate risk arising from gross financing needs (GFN) could influence the debt trajectory. Steady inflows from multilateral and bilateral partners, along with stable domestic financing, cover the GFN, ensuring debt sustainability.

The Debt Sustainability Analysis demonstrates that the baseline public and publicly guaranteed debt-to-GDP ratio remains within the prudent threshold range of 50-70 percent of GDP for emerging economies like Pakistan. However, debt sustainability is susceptible to risks embedded in the macroeconomic and fiscal frameworks, as revealed by shock scenarios. Potential adverse shifts in the federal primary balance, exchange rate, interest rates, growth trajectory, or realization of contingent liabilities could drive the debt-to-GDP ratio and gross financing needs above benchmark levels after the system absorbs these shocks.

Pakistan's external debt constitutes 32.3 percent of the total public debt as of the end of June 2025 and is mainly sourced from concessional bilateral and multilateral creditors. The maturity structure is expected to be maintained above 6 years over the medium term. However, the share of short-term debt (24% of total external debt as of the end of June 2025) poses a risk of refinancing. Similarly, a large portion of floating external debt (41% of total external debt as of end June 2025) presents a moderate refinancing risk to GFN. Moreover, the external debt is within the IMF's benchmark and portrays moderate currency risk; however, it may risk debt sustainability if the current account deficit is higher than expected and foreign exchange reserves decline.

As of the end of June 2025, domestic debt accounted for 67.7 percent of total public debt, with a significant portion comprising long-term instruments. However, the composition of this debt remains skewed (80% held in floating-rate debt), exposing the domestic debt profile to elevated interest rate risk. Nevertheless, shocks to economic growth, climate change risks, external disturbances, shifts in the primary balance, and the materialization of contingent liabilities can significantly influence debt dynamics, thereby posing risks to debt sustainability over the medium.

The government remains committed to structural reforms, with a strong focus on export-led growth and the IT sector to support exchange rate stability and enhance debt sustainability. A comprehensive debt management strategy is being pursued by diversifying borrowing sources, extending maturities, smoothing repayment schedules, and improving transparency in debt issuance. Financing needs are being met through a mix of instruments, concessional borrowing, access to international capital markets, and non-resident investment in government securities. These efforts, coupled with sustainable growth, diversification, competitiveness, and technological innovation, strengthen the government's capacity to manage debt effectively.

1. INTRODUCTION

1.1. The Debt Sustainability Analysis (DSA) report presents the public debt dynamics, using the officially approved macroeconomic and fiscal targets for FY2026 and forecasts, as available in the Budget Strategy Paper, for the next two fiscal years. The analysis applies the International Monetary Fund's Market Access Countries DSA-MAC framework, which assesses the sustainability of public debt and gross financing needs in economies with market access. The objective is to provide a transparent assessment of debt risks, outline debt management strategies, and support policy design for medium-term debt sustainability.

1.2. Total public debt stands at 70.8 percent of GDP by the end of June 2025, which is expected to decline to 60.8 percent by FY2028. Moreover, guarantees are 3.8 percent of GDP by the end of June 2025, which would decline to 2.5 percent by FY2028. As such, the public and publicly guaranteed (PPG) debt is expected to remain sustainable over the medium term (FY2026-FY2028). The decrease in public debt would be mainly driven by prudent economic management and fiscal consolidation.

1.3. Nonetheless, in FY2025, prudent economic management and reform efforts helped reduce debt stress to some extent, in terms of saving for markup expenditures of Rs. 888 billion. The real GDP grew by 3.0 percent in FY2025, up from 2.6 percent in FY2024, while headline inflation sharply declined to 4.5 percent in FY2025 from 23.4 percent in FY2024, easing space for accommodative monetary policy. The policy rate has been reduced by 1100 basis points since June 2024, which has eased domestic debt interest payment pressure. Exchange rate pressures are also contained in response to policy measures addressing informal foreign exchange markets and cross-border flows, limiting external debt servicing risks. These improvements, together with fiscal discipline, supported upgrades in sovereign credit ratings and facilitated renewed access to international markets.

1.4. Effective fiscal management has contributed to lowering the federal fiscal deficit to 6.2 percent of GDP against the target of 6.8 percent. At the same time, the federal primary balance posted a surplus of 1.6 percent of GDP in FY2025. It is expected to remain at least 1.0 percent of GDP in the medium term, supported by continued revenue mobilization efforts, expenditure rationalization, and lower interest payments due to declining global and domestic interest rates. These fiscal developments will remain critical in reducing the debt burden and anchoring expectations of medium-term debt sustainability.

1.5. Debt dynamics have also been analyzed under six alternative scenarios to capture potential risks. Scenario 1 considers deviations in the federal primary balance due to revenue shortfall or expenditure overrun. Scenario 2 evaluates lower than the targeted economic growth. Scenarios 3 and 4 assess the effects of higher-than-baseline interest rates and exchange rate depreciation, respectively. Scenario 5 models a combined macro-fiscal shock, while Scenario 6 incorporates the probable materialization of contingent liabilities (though less likely), which could weaken the primary balance and raise debt levels.

1.6. The government is committed to maintaining debt sustainability, focusing on

continued fiscal discipline, low and stable inflation, sustained growth, and a market-aligned exchange rate. Effective implementation of revenue and expenditure measures, combined with strengthened debt management practices, will be essential to anchoring confidence and gradually reducing the debt burden.

2. DEBT COVERAGE

2.1. The DSA covers the PPG debt that includes both external and domestic debt obligations and guarantees. In this analysis, total public debt (external & domestic debt obligations) refers to the government debt, which is defined in ‘Fiscal Responsibility and Debt Limitation (FRDL) Act 2005’ as the debt owed by the Government (including Federal Government and Provincial Governments), serviced out of the consolidated fund and debts owed to the International Monetary Fund. Whereas ‘guaranteed debt’ refers to a loan or other financial obligation that is backed by a guarantee from the federal government. Considering the PPG debt, this report assesses the debt dynamics for FY2026-FY2028.

BOX 1: DEBT COVERAGE

PPG includes the following components:

- Stock of total PPG debt
- Short-term debt
- Long-term debt, including guarantees
- Debt denominated in domestic currency, including guarantees
- Debt denominated in foreign currency, including guarantees

3. STYLIZED FACTS ABOUT PUBLIC DEBT

3.1. As of end-June 2025, Pakistan’s public debt was recorded at Rs. 80.52 trillion (70.8% of GDP), reflecting an increase from Rs. 71.24 trillion in June 2024 (67.7% of GDP). Domestic debt constituted the major share and showed a relatively higher rise, whereas external debt remained broadly stable in USD terms. This shift reflects the government’s policy to rely more on domestic sources, thereby reducing exposure to exchange rate volatility and external refinancing risks. Publicly guaranteed debt stood at Rs. 4.27 trillion, up from Rs. 3.38 trillion a year earlier. This increase in publicly guaranteed debt is mainly due to the incorporation of guarantees from Commodities Operations into the total guarantees issued limit, demonstrating prudence in the management of contingent liabilities. It is important to note that historically, the government has never been required to honour any publicly issued guarantees, reflecting prudent appraisal and management of such commitments.

3.2. Overall, public and publicly guaranteed debt reached Rs. 84.79 trillion (74.5% of GDP), compared to Rs. 74.62 trillion (70.9% of GDP) in June 2024. The government remains focused on a sustainable debt path by managing risks, diversifying financing sources, and aligning borrowing with fiscal and external sector stability. Having successfully achieved macroeconomic stability, the government is now steering the

economy onto a sustainable path, where growth momentum and stable market conditions will reinforce debt sustainability over the medium term.

Table 1: Public and Publicly Guaranteed Debt as of End June - (Rs Trillion)

	June 2024	June 2025	Difference
Public Debt	71.24	80.52	9.28
Domestic	47.15	54.47	7.32
External	24.09	26.05	1.96
External (USD billion)	86.52	91.79	5.27
Publicly Guaranteed Debt	3.38	4.27	0.89
Domestic	1.46	2.21	0.75
External	1.92	2.06	0.14
Public and Publicly Guaranteed (PPG)Debt	74.62	84.79	10.17
Domestic	48.61	56.68	8.07
External	26.01	28.11	2.1
Public Debt (% of GDP)	67.72	70.79	
PPG Debt (% of GDP)	70.93	74.54	

Source: Debt Management Office, Finance Division

3.3. The domestic debt is highly sensitive to changes in interest rates, while the external debt is to exchange rate fluctuations.

Table 2: Debt Structure (End-June 2025)

Category	Type of Debt		Term to Maturity	
	Fixed Rate (%)	Floating Rate (%)	Medium to Long Term (%)	Short Term (%)
Domestic				
Public Debt	20	80	82	18
Guaranteed Debt	4	96	59	41
External				
Public Debt	59	41	76	24
Guaranteed Debt	95	5	100	0

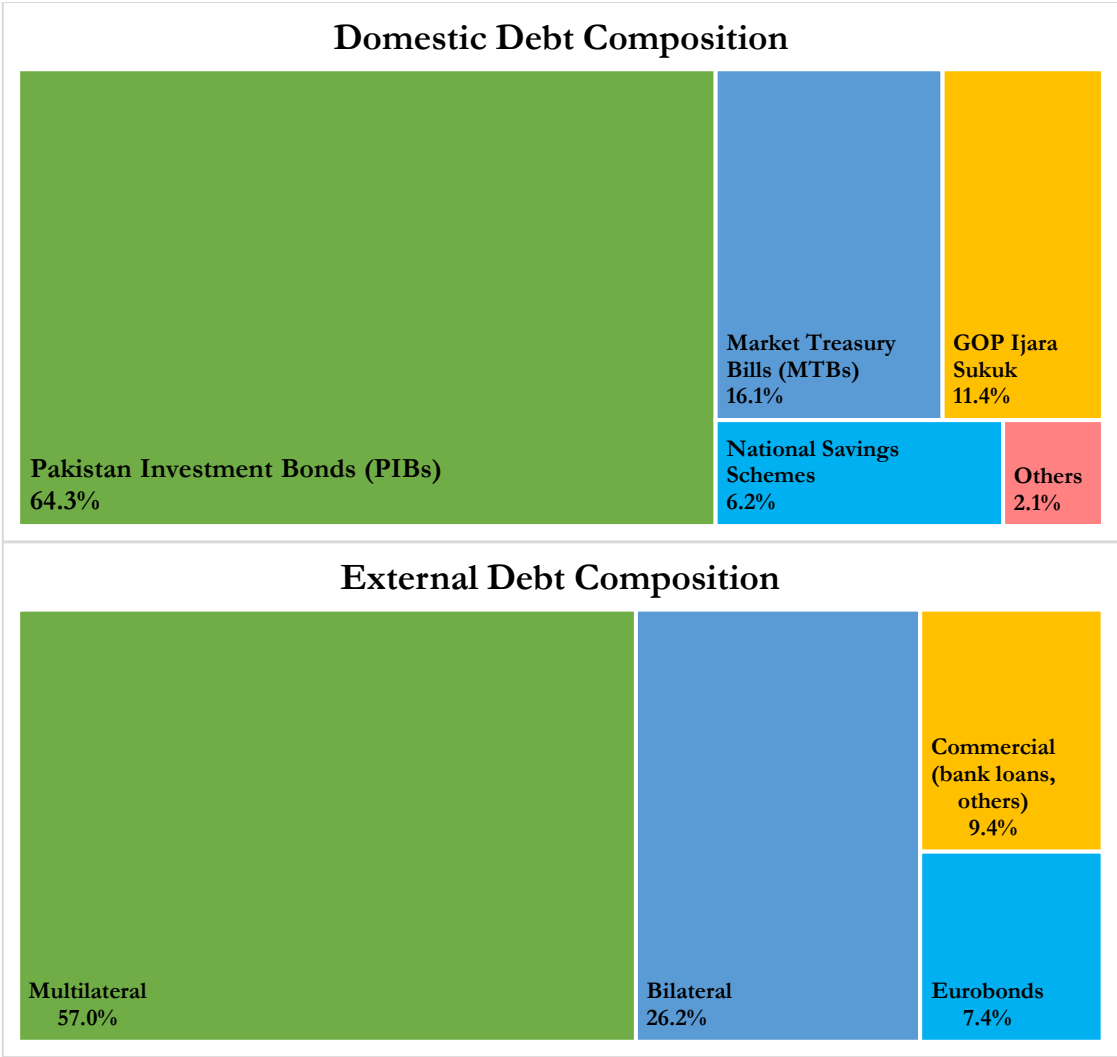
Source: Debt Management Office, Finance Division

3.4. Domestic debt is primarily raised through Government Securities. It includes Market Treasury Bills (T-Bills), Pakistan Investment Bonds (PIBs), and Government Ijara Sukuks. Domestic debt also comprises unfunded debt, which is raised through National Savings Schemes (NSS). Additionally, there are other components of domestic debt, such as Naya Pakistan Certificates, foreign currency-denominated domestic debt, Special Drawing Rights (SDR) on-lending loans, and others (see Figures 1 & 2).

3.5. External debt is obtained from multilaterals (including IMF), bilateral partners, and commercial sources (bank loans, capital market issuances and others). As of end-June 2025, debt from multilateral and bilateral sources (excluding short-term bilateral

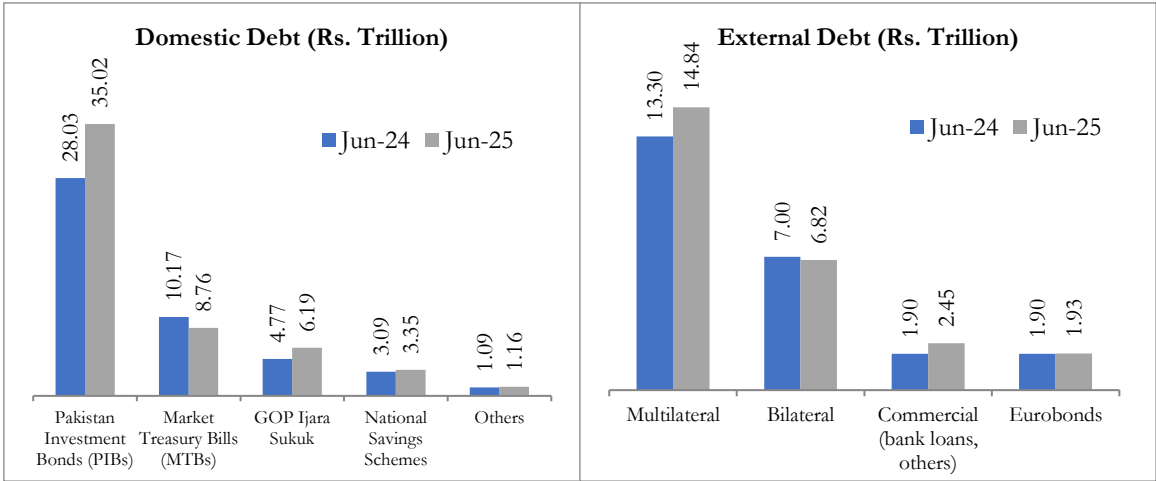
deposits) cumulatively constituted USD 67.3 billion of the external debt portfolio, which is concessional (Figures 1 & 2).

Figure 1: Composition of Debt Stock - End June FY2025



Source: Debt Management Office, Finance Division

Figure 2: Value of Debt Stock - End June FY2025



Source: Debt Management Office, Finance Division

3.6. As of the end of June 2025, the PPG debt-to-GDP ratio stood at 74.5 percent, depicting a year-on-year increase of 3.6 percentage points from 70.9 percent at the end of June 2024 (Table 6). The depreciation of the PKR against major currencies, coupled with easing inflation and a persistently high policy rate (as compared to inflation), has raised the real interest rate, thereby increasing the debt-to-GDP ratio. In contrast, the slight increase in real GDP growth and the rise in the primary surplus have helped reduce PPG debt as a percentage of GDP. Overall, the domestic PPG debt-to-GDP ratio rose to 49.8 percent in FY2025 from 46.2 percent in FY2024, while the external PPG debt-to-GDP ratio remained broadly unchanged during the same period.

4. BASELINE ASSUMPTIONS

The main baseline macroeconomic and fiscal assumptions for the DSA FY2025 are outlined as follows:

4.1. Global GDP growth is projected to moderate slightly from 3.3 percent in 2024 to 3.2 percent in 2025 and 3.1 percent in 2026, with inflationary pressures continuing to ease globally, due to lower food and energy prices. Pakistan's economic outlook remains favourable, with continued improvement in the economic and fiscal position. Real GDP growth is projected to increase from 4.2 percent in FY2026 to 5.7 percent in FY2028 (Table 3), driven by investment and export-led growth strategies targeting high-potential sectors, such as agriculture, information technology, renewable energy, mining, and pharmaceuticals. Targeted interventions to advance digital infrastructure, enhance productivity and competitiveness, engage the private sector and governance reforms will sustain economic momentum. Over the medium term, inflation is projected to decline from 7.5 to 6.5 percent. Rising exports, foreign investment, and remittances, along with lower global energy prices, are likely to bolster foreign exchange reserves and ease external account pressures. The exchange rate is projected to remain broadly stable, with only moderate depreciation over the medium term.

Table 3: Medium-Term Macroeconomic Framework

Macroeconomic Indicator	Final	Revised	Baseline	Projected		
	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
Real GDP Growth- at Basic Prices (%)	-0.2	2.6	3.0	4.2	5.1	5.7
Inflation (Average) (%)	29.2	23.4	4.5	7.5	6.8	6.5
Nominal GDP at Market Prices (Rs bn)	83,650	105,190	113,748	129,567	144,913	162,513
Nominal GDP Growth (%)	25.5	25.7	8.1	13.9	11.8	12.1
Current Account Balance (USD mn)	-3,275	-2,072	2,113	-2,116	-2,420	-4,410
as % of GDP	-1.0	-0.6	0.5	-0.5	-0.5	-0.8
Exports (Goods) - (USD mn)	27,876	30,980	32,302	35,282	38,634	42,690
Imports (Goods) - (USD mn)	52,695	53,157	59,088	65,211	71,207	79,712
Exports (Services) - (USD mn)	7,596	7,691	8,383	9,550	11,081	12,244
Imports (Services) - (USD mn)	8,638	10,801	11,005	14,015	16,041	17,324
Workers Remittances - (USD mn)	27,333	30,251	38,300	39,437	41,974	44,824

Source: Annual Plan 2025-26, Government of Pakistan and Economic Adviser's Wing

4.2. FBR tax revenues recorded a growth of 26.3 percent in FY2025, reaching Rs. 11,744 billion (10.3% of GDP). For non-tax revenues, the main drivers include State Bank of

Pakistan (SBP) profit transfers (Rs. 2,619.61 billion, 2.3% of GDP) and Petroleum Levy (PL) collections (Rs. 1,220.2 billion, 1.1% of GDP), which jointly stand at 76% of total non-tax revenues of Rs. 5,056.4 billion. These outcomes reflect the impact of consistent and disciplined policy implementation throughout the fiscal year.

4.3. In FY2025, markup payments remained notably below budgeted levels, with actual expenditures at Rs. 8,887.4 billion compared to the budgeted Rs. 9,775.0 billion. This indicates the effect of lowering interest rates, disciplined and cautious debt management, including liability management operations. Subsidy expenditures stood at Rs. 1,297.9 billion, lower than the budgeted Rs. 1,363.4 billion, primarily due to better targeting and containment of untargeted subsidies in the power sector. Power tariff adjustments and improved efficiency in subsidy allocation contributed to managing the fiscal burden.

4.4. Pension spending was recorded at Rs. 910.9 billion, remaining below the budgeted allocation of Rs. 1,014.0 billion. This underspending partially includes the initial impact of pension reforms, which aim to contain the unsustainable growth of pension liabilities.

4.5 The federal fiscal deficit was contained at Rs. 7,089 billion, equivalent to 6.2% of GDP, significantly lower than the budgeted deficit of Rs. 8,500 billion (6.8% of the GDP Target). This improved outturn reflects a combination of better-than-expected expenditures, particularly in markup payments, subsidies, and pensions, as well as strong growth in tax revenues.

4.6. The consolidated primary surplus for FY2025 stands at Rs. 2,719.4 billion, which includes a provincial surplus of Rs. 921.5 billion. This performance has helped reduce the consolidated fiscal deficit to 5.4% of GDP (Rs. 6,168.015 billion), remaining well below the targeted 5.9%. The lower deficit signals improved fiscal discipline and underscores the government's efforts to adhere to its fiscal consolidation path under the medium-term macro-fiscal framework.

Table 4: Medium-Term Fiscal Framework (Rs. Billion)

	Actual	Baseline/ Actual	Budgeted	Projected	
	FY2024	FY2025	FY2026	FY2027	FY2028
FBR Revenue	9,311	11,744	14,131	16,078	17,974
Non-Tax Revenue	3,050	5,056	5,147	4,729	5,118
Gross Federal Revenue	12,361	16,801	19,278	20,807	23,092
Transfer to Provinces	5,264	6,854	8,206	9,112	10,204
Net Federal Revenue	7,098	9,947	11,072	11,695	12,888
Total Federal Expenditure	14,823	17,036	17,573	18,171	19,176
Federal Fiscal Balance	-7,725	-7,089	-6,501	-6,476	-6,288
As % of GDP	-7.3	-6.2	-5.0	-4.5	-3.9
Federal Primary Balance	435	1,798	1,706	1,407	1,615
As % of GDP	0.4	1.6	1.3	1.0	1.0

Source: Fiscal Operations, Budget Wing and MFPU, Economic Adviser's Wing, Finance Division

4.7. On the back of a favourable macroeconomic outlook and prudent fiscal management, the federal primary balance is projected to remain in surplus during FY2026-2028. This improvement will be supported by lower interest payments owing to declining global interest rates and an accommodative monetary policy stance. Higher tax

revenue collections, stemming from efforts to broaden the tax base through reforms, intensified compliance enforcement, digital transformation of tax administration, and enhanced documentation of economic activity. Together with expenditure rationalization through targeted subsidies, pension reforms, and right-sizing, these measures are expected to gradually reduce the fiscal deficit. Collectively, these steps reflect the government's commitment to maintaining debt sustainability through a balanced fiscal approach that supports growth.

5. DEBT SUSTAINABILITY ANALYSIS

5.1. Debt sustainability analysis covers medium-term (FY2026-FY2028), whereas FY2025 is treated as a base year. The one-time structural shocks are assumed to carry an impact over the medium term in FY2026. The scenarios¹, covered in the analysis, are described as follows:

Table 5: Description of Scenarios

Sr. No.	Shock Scenario	Shock Description
1	Federal Primary Balance Shock	i. Minimum shock equivalent to 50 percent of planned adjustment (50 percent implemented) in the baseline, or the baseline minus half of the 10-year historical standard deviation, whichever is larger. ii. Federal primary balance is set to historical averages, i.e. -1.4 percent of GDP
2	Real GDP Growth Shock	Real GDP growth is reduced by 1 standard deviation for 2 consecutive years; the revenue-to-GDP ratio remains the same as in the baseline; the level of non-interest expenditures is the same as in the baseline.
3	Interest Rate Shock	Interest rate increases by the difference between the average real interest rate level over the projection and the maximum real historical level or by 200bp, whichever is larger. It leads to a nominal interest rate shock of 300bp.
4	Exchange Rate Shock	Estimate of overvaluation or the maximum historical movement of the exchange rate, whichever is higher; pass-through to inflation with an elasticity of 0.25 for emerging markets. Consequently, a 15 percent exchange rate depreciation has been assumed, which transmits its direct and indirect impact on debt stock and flows.
5	Combined Macro-Fiscal Shock	Shock size and duration are based on all underlying shocks explained above. This scenario provides a pragmatic combined macro-fiscal shock effect on debt sustainability.
6	Financial Sector Contingent Liability Shock	Under this scenario, a one-time increase (FY2026 only) in non-interest expenditures equivalent to 10 percent of banking sector assets leads to a real GDP growth shock (see above): growth is reduced by 1 standard deviation for 2 consecutive years; revenue-to-GDP ratio remains the same as in the baseline; deterioration in primary balance lead to higher interest rate; decline in growth leads to lower inflation.

5.2. Under the baseline scenario, the PPG debt-to-GDP ratio² is estimated at 63.3 percent in FY2028, a decline from 74.5 percent in FY2025. Fiscal consolidation and growth-interest rate differential lead to its declining path. Based on the underlying macro-fiscal assumptions in the baseline scenario, the PPG debt-to-GDP ratio stays within the prudent benchmark range, as depicted in Table 6. The GFN to GDP ratio is declining from 26.1 percent in FY2025 to 15.6 percent in FY2028, highlighting the government's

¹ The scenarios, given in Table 7, are based on realistic assumptions, given the history. The analysis on the realism of assumptions is provided in Appendix Figure 6.

² Henceforth, the debt-to-GDP ratio and PPG debt-to-GDP ratio is used alternatively.

commitment to prudent macroeconomic and fiscal management. However, it will remain a little higher than the 15 percent benchmark.

Table 6: Contributions in PPG Debt Reduction (% of GDP)-Baseline Scenario

(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators^{1/}

	Actual			Projections		
	2023	2024	2025	2026	2027	2028
Nominal gross public debt	79.4	71.0	74.5	69.6	65.9	63.3
Of which: guarantees	4.2	3.2	3.8	3.1	2.8	2.5
Public gross financing needs	25.1	26.1	26.1	19.2	16.6	15.6
Real GDP growth (in percent)	-0.4	3.0	3.7	5.5	5.2	5.3
Inflation (GDP deflator, in percent)	26.0	22.0	4.3	8.0	6.3	6.5
Nominal GDP growth (in percent)	25.5	25.7	8.1	13.9	11.8	12.1
Effective interest rate (in percent) ^{4/}	11.6	13.1	12.5	8.0	7.9	8.7

As of July 14, 2025

Sovereign Spreads

EMBIG (bp) 3/555

5Y CDS (bp)583

Ratings

Moody'sForeignCaa1LocalCaa1

S&PsB-B-

FitchB-B-

Contribution to Changes in Public Debt

	Actual			Projections				
	2023	2024	2025	2026	2027	2028	cumulative	
Change in gross public sector debt	1.0	-8.4	3.6	-4.9	-3.7	-2.6	-11.3	debt-stabilizing
Identified debt-creating flows	2.2	-9.1	1.8	-5.3	-3.5	-3.1	-11.9	primary
Primary deficit	1.1	-0.5	-1.4	-1.4	-1.0	-1.1	-3.5	balance ^{9/}
Primary (noninterest) revenue and grants	5.6	6.8	8.7	8.6	8.1	8.0	24.7	-2.0
Primary (noninterest) expenditure	6.7	6.3	7.3	7.2	7.1	6.9	21.3	
Automatic debt dynamics ^{5/}	1.0	-8.7	3.2	-3.9	-2.5	-2.0	-8.4	
Interest rate/growth differential ^{6/}	-8.7	-8.0	2.8	-3.9	-2.5	-2.0	-8.4	
Of which: real interest rate	-9.0	-6.0	5.3	-0.3	0.8	1.1	1.6	
Of which: real GDP growth	0.3	-1.9	-2.4	-3.6	-3.3	-3.1	-10.0	
Exchange rate depreciation ^{7/}	9.7	-0.7	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., privatization receipts)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., other debt flows) (	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{8/}	-1.1	0.7	2.1	0.4	-0.2	0.5	2.7	

Debt-Creating Flows

(in percent of GDP)

Primary deficit

Real GDP growth

Real interest rate

Exchange rate depreciation

Other debt-creating flows

Residual

Change in gross public sector debt

2020

2021

2022

2023

2024

2025

2026

2027

2028

Projection →

4

2

0

-2

-4

-6

-8

-10

-12

-14

-16

cumulative

1/ Public sector is defined as general government and includes public guarantees, defined as .

2/ Based on available data.

3/ EMBIG (bp).

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[r - \pi(1+g) - g + ae(1+r)] / (1+g+\pi+g\pi)$ times previous period debt ratio, with r = effective nominal interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

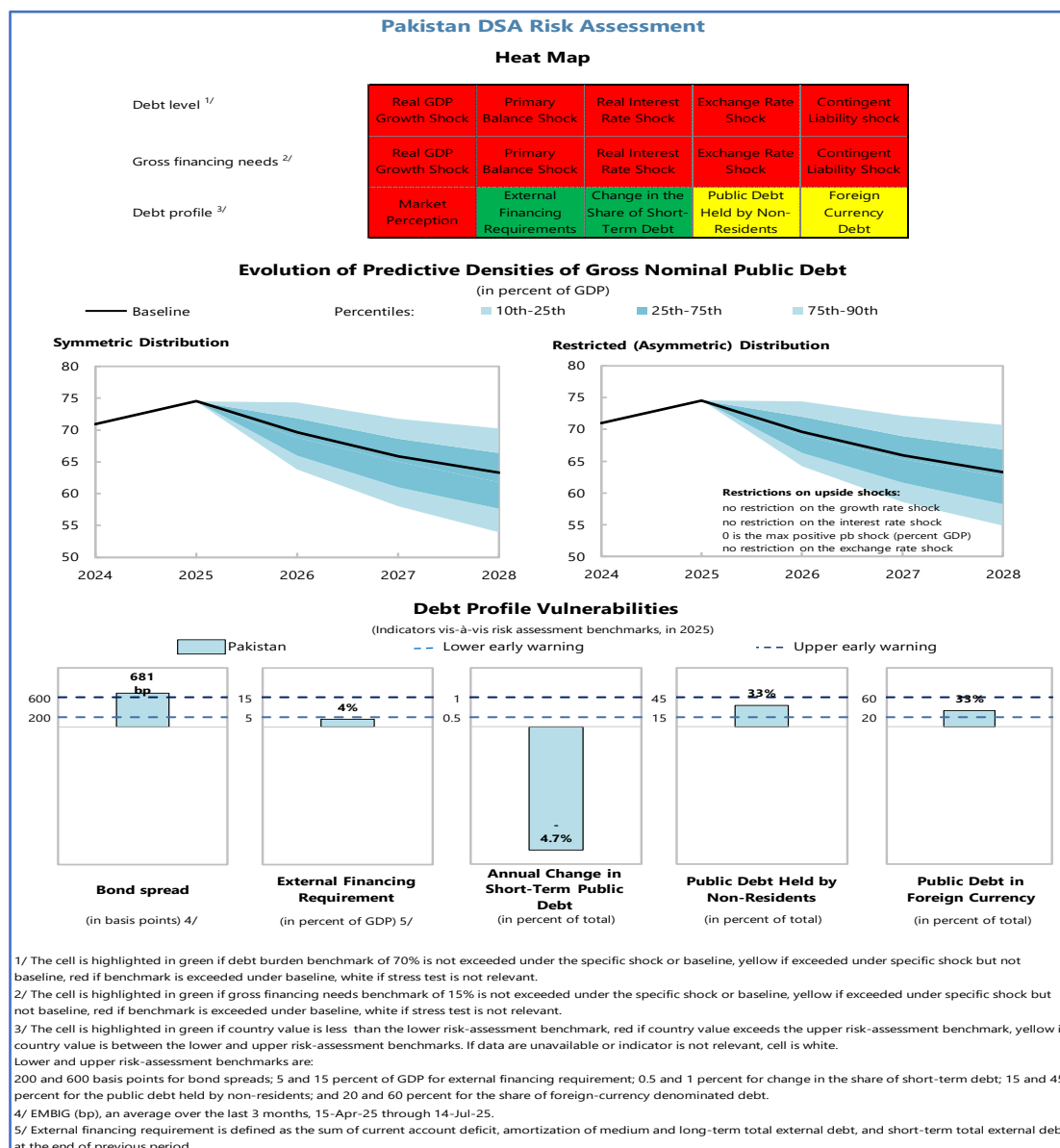
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Source: Calculations by MFPU staff, Economic Adviser's Wing, Finance Division

5.3. The Heat Map depicts that the debt dynamics continue to be shaped by external and domestic factors (Figure 3). The analysis shows significant improvement in the debt

dynamics over the medium term. However, a rigorous approach is important to deal with any possible shocks (Figure 3). The heatmap illustrates the risk, as the PPG debt-to-GDP ratio exceeds the thresholds in the baseline (74.5 percent in FY2025). It also highlights the significance of ensuring a stable macroeconomic and fiscal outlook in the medium term, especially GDP growth, primary balance, real interest rate and contingent liabilities, for debt sustainability to happen.

Figure 3: Pakistan Debt Sustainability Risk Assessment



Source: Calculations by MFPU staff, Economic Adviser's Wing, Finance Division

5.4. The DSA-MAC sets benchmarks for two key metrics: the PPG debt as a percentage of GDP and gross financing needs as a percentage of GDP. For emerging markets, these benchmarks are set at 70 percent for the public debt-to-GDP ratio and 15 percent for the gross financing needs-to-GDP ratio, though it approaches an acceptable limit in FY2028. The GFN-to-GDP ratio remains high in the baseline, indicating a risk to debt sustainability. The debt dynamics of Pakistan are complicated owing to risks of deviation in the federal primary balance, exchange rate depreciation, slower economic

growth, and the emergence of contingent liabilities. These are the key drivers of the increasing debt ratio and gross financing needs. However, external and domestic debt risk is weighed down by the planned improvement in quasi-fiscal operations, external financing, and better market access during the period of assessment.

5.5. Federal Primary Balance Shock: In the baseline fiscal projections, the primary balance remains more than 1 percent of GDP over the medium-term due to fiscal consolidation measures and stable economic growth. However, due to limited fiscal space, a sudden shift in the primary balance cannot be ignored. The analysis shows that a 50 percent cut in the planned primary balance would increase the PPG debt-to-GDP ratio to 65.1 percent in FY2028 from 63.3 percent in the baseline (Table 7). As such, it would remain sustainable over the medium term³. The same applies to the GFN to GDP ratio, increasing from 15.6 percent of GDP in the baseline to 16.7 percent in FY2028 (Table 7). Conversely, assuming a shock in the primary balance that results in a primary deficit near the historical average (i.e., a primary deficit of 1.4 percent of GDP), the PPG debt-to-GDP ratio would slightly surpass the benchmark, reaching 70.1 percent in FY2028, risking debt sustainability. This sensitivity illustrates how even modest fiscal slippages can erode the sustainability margin, reinforcing the importance of consistent consolidation efforts and proactive fiscal management.

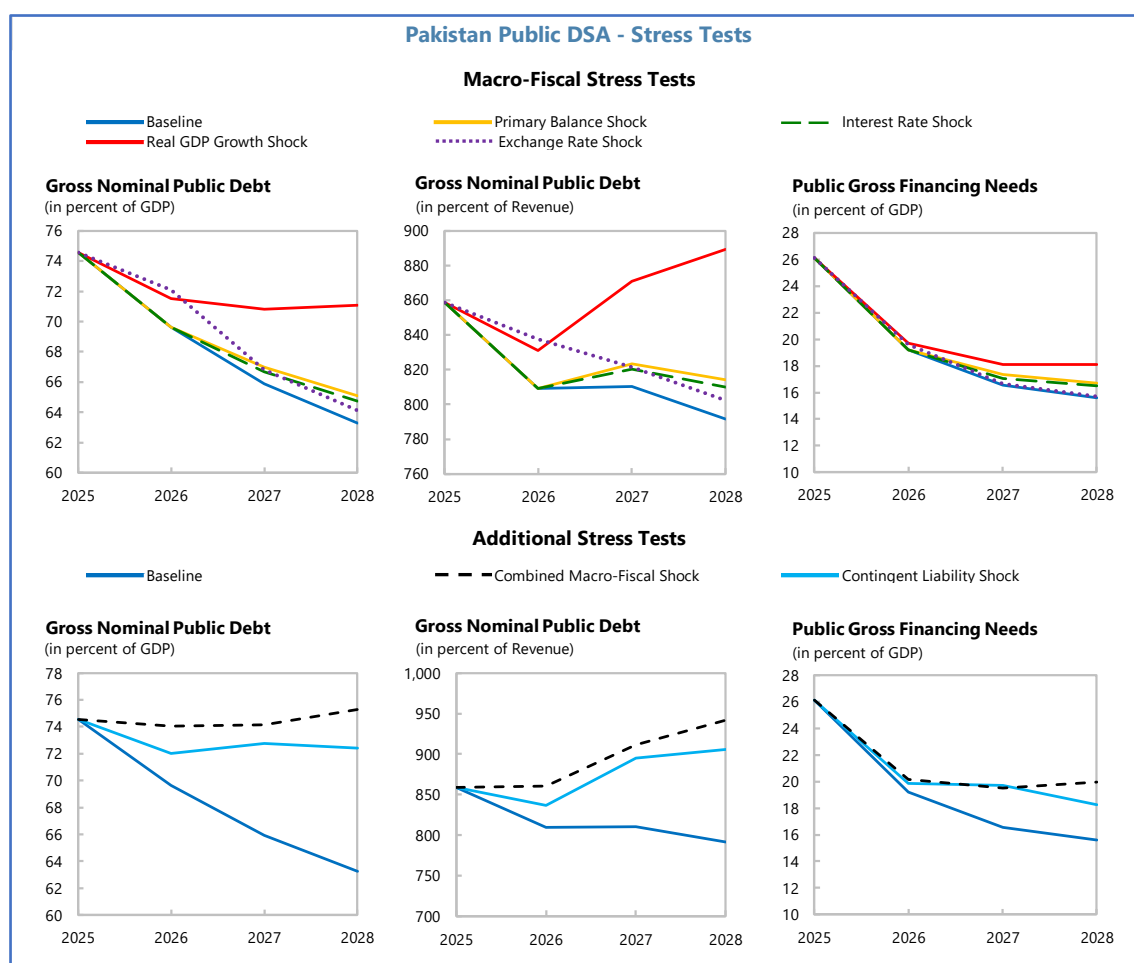
5.6. Real GDP Growth Shock: Any adverse event that leads to a decline in economic growth significantly increases the PPG debt-to-GDP ratio. The stress-test analysis identifies those adverse events which slow down economic growth and raise debt stress. In response to a 1 standard deviation shock to economic growth for two consecutive years starting from FY2026, the PPG debt-to-GDP ratio will surpass the benchmark to reach 71.1 percent in FY2028 (Table 7). As such, lower growth in GDP, through its implications on revenue and subsequently on the fiscal deficit, put pressure on higher debt accumulation. This highlights the centrality of growth in preserving debt sustainability, as weaker output not only raises debt ratios mechanically but also undermines fiscal consolidation efforts. Consequently, the GDP growth shock adversely affects debt dynamics and jeopardizes debt sustainability over the medium term.

5.7. Interest Rate Shock: Real interest rate risks are moderate. The large share of floating-rate debt within domestic debt (around 80 percent at the end of June 2025) makes domestic debt vulnerable to a nominal interest rate shock. Particularly, this shock increases the risk of increasing interest payments in the near term, leading to a debt burden. Furthermore, with low foreign exchange reserves and scarce market financing, the nominal interest rate adversely impacts the debt-to-GDP ratio. This indicates that Pakistan's debt profile is highly sensitive to interest rate movements, underscoring the importance of pursuing an optimal policy mix to contain risks. However, in this scenario, the negative differential between the real interest rate and real GDP growth helps in moderating nominal interest rate impacts on the debt-to-GDP ratio and GFN (Table 7). The debt-to-GDP ratio is expected to reach 64.7 percent in FY2028 compared to 63.3 percent in the same period in the baseline scenario (Table 7).

³ Alternative primary fiscal balance scenario analysis can be seen in Figure 5.

5.8. Exchange Rate Shock: The high share of external debt poses risks to debt sustainability through exchange rate depreciation. Although Pakistan's capacity to service its external debt obligations remains adequate, it is subject to risks emanating from inadequate export receipts and a rise in imports, which widen the current account deficit and exert pressure on the exchange rate. Stress analysis indicates that exchange rate depreciation has the potential to widen the financing gap, thereby increasing the debt-to-GDP ratio to 64.1 percent in FY2028 compared to 63.3 percent in the baseline, as shown in Table 7. This highlights the structural vulnerability of debt dynamics to external sector imbalances, where even moderate exchange rate shocks can quickly translate into higher debt ratios.

Figure 4: Pakistan Debt Sustainability -Stress Test



Source: Calculations by MFPU staff, Economic Adviser's Wing, Finance Division

5.9. Combined Macro-Fiscal Shock: The PPG debt-to-GDP ratio in a combined macro-fiscal shock scenario will surpass the 70 percent threshold, thereby risking debt sustainability. In this scenario, the debt-to-GDP ratio increases from 69.6 percent in FY2026 to 75.3 percent in FY2028 (Table 7 & Figure 4). Factors such as lower-than-expected economic growth, a deterioration in the federal primary balance, an increase in interest rates, and exchange rate depreciation could significantly raise public debt and GFN (both as ratios of GDP) over the medium term. It highlights the need for a prudent and coordinated policy mix, such as tightening non-priority expenditures, enhancing domestic

revenue mobilization, and extending debt maturities, to manage debt effectively in the event of simultaneous macro-fiscal shocks.

5.10. Contingent Liability Shock: The public debt is vulnerable to an increase in contingent liabilities, as the PPG debt-to-GDP ratio remains above the benchmark, which largely risks debt sustainability. The PPG debt-to-GDP ratio in this scenario elevates to 72.4 percent in FY2028. A reduction in primary balance due to an increase in non-interest expenditure has a detrimental impact on the public debt. GFN also increases by 2.6 percentage points of GDP over the medium term (Table 7 & Figure 4). This underscores how hidden fiscal risks, when realized, can significantly amplify debt vulnerabilities and complicate the medium-term fiscal outlook.

6. CONCLUSION

6.1 This report examines the possible dimensions of debt that may challenge its sustainability and underscores the need for an optimal policy mix to safeguard macroeconomic stability and fiscal resilience in the medium term. This report comprehensively analyzed the public and publicly guaranteed debt dynamics, showing that Pakistan's debt is projected to remain sustainable under the baseline scenario, supported by macroeconomic stability and fiscal consolidation. A moderate risk arises from gross financing needs, which are expected to be adequately met through steady inflows from multilateral and bilateral partners, alongside stable domestic financing. While the debt-to-GDP ratio remains within the prudent 50-70 percent threshold typical for emerging economies, sensitivity analysis highlights vulnerabilities.

6.2 These vulnerabilities are most evident under shocks to the federal primary balance, slower economic growth, exchange rate depreciation, higher interest rates, and the realization of contingent liabilities. Recognizing these risks, the government emphasizes the need for continued fiscal discipline and structural reforms and remains committed to keeping public debt on a sustainable trajectory.

6.3 Considering the critical role of federal primary surplus to keep the debt-to-GDP ratio on a sustainable path, the government is prioritizing increasing the tax-to-GDP ratio through revenue mobilization, improving tax administration, enhancing tax compliance, and broadening the tax base. Moreover, the government is focusing on adopting a performance-based budgeting process to improve expenditure management. This approach links budget allocations to specific performance outcomes and objectives, ensuring that funds are used efficiently and effectively to achieve desired results, thereby improving the fiscal space.

6.5 A stable exchange rate, aligned with market fundamentals, is essential for sustaining public debt. In FY2025, rigorous policy measures helped narrow the current account deficit through higher exports and remittances, strengthened foreign exchange reserves, and improved regulation of the foreign exchange market, all of which supported the domestic currency to remain stable. The government remains committed to structural reforms, with a strong focus on export-led growth and the IT sector, which are expected to reinforce exchange rate stability going forward.

6.6 The government has adopted a multi-faceted debt management strategy to improve sustainability by diversifying borrowing sources and balancing costs and risks. Key actions include extending the maturity of domestic debt, smoothing repayment schedules, and improving transparency in debt issuance. The government is focusing on meeting financing needs and reducing borrowing costs by introducing various financial instruments, availing concessional borrowing from diversified sources, tapping international capital markets, and encouraging non-resident investment in government securities.

6.7 Going forward, sustainable economic growth is critical for strengthening the government's capacity to manage debt. The government is therefore implementing structural reforms to achieve sustainable export-led growth by boosting productivity across all sectors, economic diversification, enhancing competitiveness, and fostering innovation and technological development.

APPENDIX

Table 7: Summary Table- Comparison of Shock Scenarios

Shock Scenarios	2025	2026	2027	2028
Baseline				
Nominal PPG Debt (in percent of GDP)	74.5	69.6	65.9	63.3
Gross Financing Need (in percent of GDP)	26.1	19.2	16.6	15.6
Historical Primary Balance (Federal)				
Nominal PPG Debt (in percent of GDP)	74.5	69.6	69.6	70.1
Gross Financing Need (in percent of GDP)	26.1	19.2	19.3	19.2
Deviation from Baseline		0.0	3.4	6.5
Primary Balance Shock (Federal)				
Nominal PPG Debt (in percent of GDP)	74.5	69.6	67.0	65.1
Gross Financing Need (in percent of GDP)	26.1	19.2	17.3	16.7
Deviation from Baseline (percentage point of GDP)		0.0	0.8	1.5
Real GDP Growth Shock				
Nominal PPG Debt (in percent of GDP)	74.5	71.5	70.8	71.1
Gross Financing Need (in percent of GDP)	26.1	19.7	18.1	18.1
Deviation from Baseline (percentage point of GDP)		1.9	4.6	7.5
Interest Rate Shock				
Nominal PPG Debt (in percent of GDP)	74.5	69.6	66.7	64.7
Gross Financing Need (in percent of GDP)	26.1	19.2	17.1	16.5
Deviation from Baseline (percentage point of GDP)		0.0	0.5	1.2
Exchange Rate Shock				
Nominal PPG Debt (in percent of GDP)	74.5	72.1	66.8	64.1
Gross Financing Need (in percent of GDP)	26.1	19.6	16.6	15.7
Deviation from Baseline (percentage point of GDP)		2.5	0.6	0.6
Combined Macro-Fiscal Shock				
Nominal PPG Debt (in percent of GDP)	74.5	74.0	74.1	75.3
Gross Financing Need (in percent of GDP)	26.1	20.2	19.5	20.0
Deviation from Baseline (percentage point of GDP)		4.4	7.9	11.8
Contingent Liability Shock				
Nominal PPG Debt (in percent of GDP)	74.5	72.0	72.8	72.4
Gross Financing Need (in percent of GDP)	26.1	19.9	19.7	18.2
Deviation from Baseline (percentage point of GDP)		2.4	6.6	8.9

Source: Projections based on MFPU staff, Economic Adviser's Wing, Finance Division

Figure 5: Composition of Public Debt and Alternative Scenarios

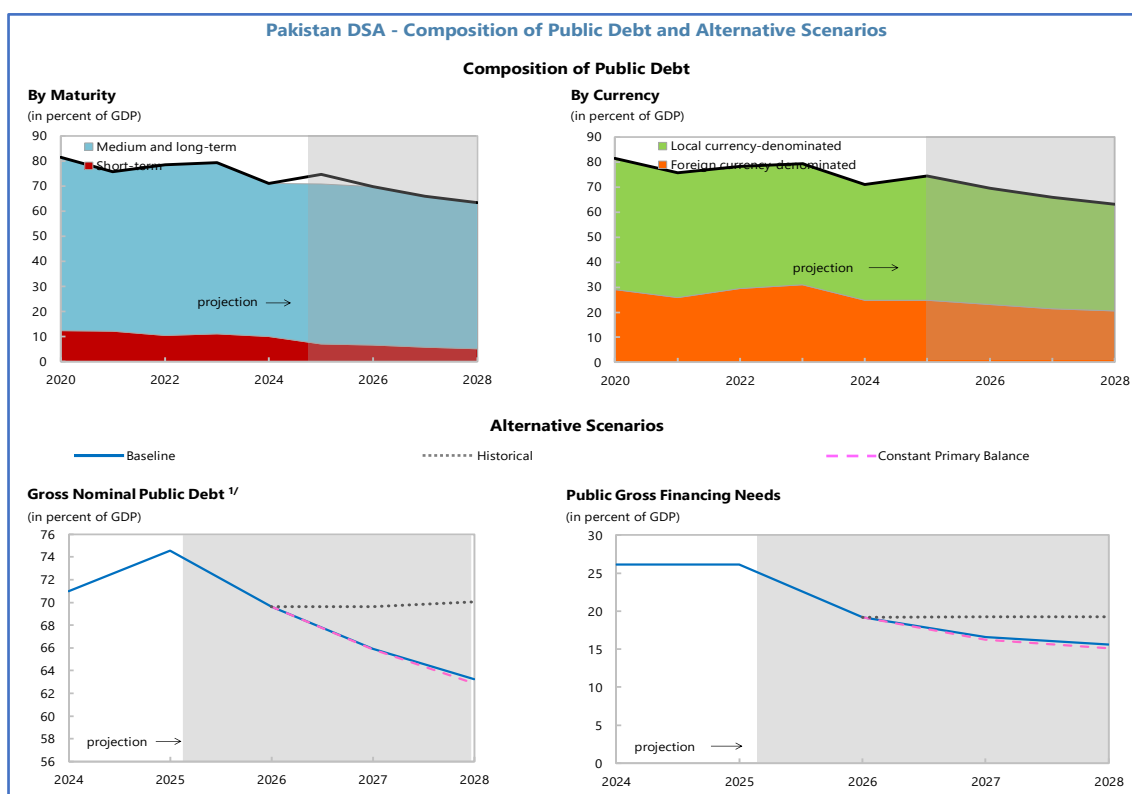


Figure 6: Realism Baseline Assumptions

