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Financial Services

FEDERAL BUDGET FY 2025-26

From Deficits to Discipline:
Pakistan's Budgetary Pivot

Detailed Review

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From Deficits to Discipline: Pakistan’s Budgetary Pivot

The Federal Budget for FY26 reflects a fiscally disciplined framework aimed at enhancing revenue mobilization and deepening structural reforms, particularly under the ongoing IMF program. The budget embeds lender-mandated benchmarks, reinforcing Pakistan’s commitment to macroeconomic stabilization. Building on improved economic fundamentals—such as easing inflation, monetary easing, and external account consolidation—the budget adopts a reform-oriented stance prioritizing tax base expansion, fiscal consolidation, and sectoral modernization.

A key highlight is the PKR 17.6tn budget outlay, reflecting a 7% y/y reduction, signaling economy-driven expenditure management. The fiscal framework projects GDP growth at 4.2%, with inflation expected to moderate to 7.5%. On the revenue side, the net tax and non-tax revenue target is set at PKR 5.15tn, supported by a tax collection target of PKR 14.13tn, reflecting a 19% y/y increase. To bridge the fiscal gap, the government plans to rely on bank borrowing of PKR 3.4tn, non-bank borrowing of PKR 2.9tn, and external and privatization receipts of PKR 193bn.

Expenditure allocations reflect fiscal prioritization, with interest payments consuming PKR 8.2tn—roughly 47% of total expenditure. Other major allocations include defense at PKR 2.5tn (20% of the budget), grants and transfers at PKR 1.93tn, civil government operations at PKR 1.36tn, pensions at PKR 1.95tn, development spending and lending at PKR 1.29tn, and subsidies totaling PKR 1.18tn. The resulting fiscal deficit is estimated at PKR 6.2tn (3.9% of GDP), while the government targets a primary surplus of 2.4% of GDP.

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The budget’s core agenda centers on expanding the tax net by enforcing compliance among non-filers, integrating pensioners into the tax regime, and applying taxation on digital income sources, while providing relief to the salaried class.

Macroeconomic indicators support a cautiously optimistic outlook, underpinned by stabilizing external accounts and improving investor confidence. Remittance inflows reached USD 31.2bn in FY25, with expectations to rise to USD 37–38bn by year-end. For the current year the country’s economic growth currently stands at 2.7%, while improved sovereign ratings—Fitch upgrading to B- and Moody’s signaling a positive outlook—underscore renewed credibility. As the FY26 budget outlines a strategic path to fiscal consolidation and sustainable growth we expect the economy to improve on the same pace for the upcoming year.

Budget at a Glance – FY26

Receipts	PKR bn	Expenditure	PKR bn
Tax Revenue	**14,131**	**CURRENT:**	**16,286**
Non-Tax Revenue	5,147	Interest Payments	8,207
(a) Gross Revenue Receipts	19,278	Pension	1,055
(b) Less Provincial Share	8,206	Defense Services	2,550
Net Revenue Receipts (a-b)	**11,072**	Grants and transfers	1,928
Non-Bank Borrowing (NSSs & Others)	2,874	Subsidies	1,186
Net External Receipts	106	Running of Civil Government	971
Bank Borrowing	3,435	Provision For Emergency and Others	389
Privatization Proceeds	87		
		DEVELOPMENT & NET LENDING:	**1,287**
		Federal PSDP	1,000
Total	6,501	Net Lending	287
Total Resources	**17,573**	**Total Expenditures**	**17,573**

Tax Revenue – FY26

PKR Mn	2024-25B	2024-25R	2025-26B
1. Direct Taxes			
Income Tax	5,454,062	5,749,392	6,811,243
Worker's Welfare Fund	16,637	21,727	25,740
Worker's Profit Participation Fund	25,639	40,369	47,825
Capital Value Tax	15,662	14,512	17,192
Total (Direct)	**5,512,000**	**5,826,000**	**6,902,000**
2. Indirect Taxes			
Customs Duties	1,591,000	1,316,000	1,588,000
Sales Tax	4,919,000	3,984,000	4,753,000
Federal Excise	948,000	774,000	888,000
Total (Indirect)	**7,458,000**	**6,074,000**	**7,229,000**
TOTAL TAX REVENUE	**12,970,000**	**11,900,000**	**14,131,000**

Economic Highlights – FY25

GDP Growth:

The projected GDP growth for FY25 stands at 2.68%, marking a modest recovery from FY24's growth of 2.51%. The initial budget target for FY25 was set at 3.6%.

Agriculture Sector:

The agriculture sector registered a modest growth of 0.56% in FY25, hindered by a notable decline in key crop production by ~12.24%.

Industrial Sector:

Following a downturn in FY24, the industrial sector rebounded with a growth rate of 4.77% in FY25. This recovery was largely propelled by a 28.88% surge in electricity, gas, and water supply, alongside a 6.61% expansion in construction activity, despite ongoing contractions in mining and Large-Scale Manufacturing (LSM).

Services Sector:

Contributing the largest share to GDP at 58.4%, the services sector demonstrated resilient performance with a robust growth of 2.91% in FY25.

Economic Highlights – FY25

Per Capita Income (USD):

Per capita income rose by USD 144 in FY25, reaching USD 1,824, supported by increased economic activity and favorable exchange rate movements.

Inflation:

Inflation fell to 0.3% in April 2025- six decade low. Average Consumer Price Index (CPI) inflation for July-April FY25 improved significantly, recording an average single-digit rate of 4.73%, compared to a high of 26.0% in FY24.

Savings (as % of GDP):

The savings-to-GDP ratio increase to 14.1% in FY25 from 12.6% in FY24, reflecting better domestic resource mobilization.

Public Debt:

As of April 2025, the federal government’s total debt stock reached an unprecedented PKR 76tn, up by PKR 7.1tn since June 2024 (PKR 68.914tn).

- Domestic debt PKR 51.518tn
- External debt PKR 24.49tn

Economic Highlights – FY25

Current Account:

Pakistan recorded a current account surplus of USD 1.9bn in FY25, a marked improvement from the USD 1.3bn deficit recorded in the same period of FY24.

Fiscal Deficit:

The fiscal deficit for July-March FY25 was contained at PKR 2.97tn (2.6% of GDP), showing an improvement over the previous year's deficit of 3.7%. The government also achieved a fiscal surplus in the first quarter (July–September) for the first time in 24 years, which amounted to PKR 1.89tn, or 1.7% of GDP.

Forex Reserves:

Foreign exchange reserves increased to USD 16.64bn (SBP: USD 11.50bn, Commercial Banks: USD 5.14bn) as of May 27, 2025, up from USD 14.31bn in the same period last year.

Economic Targets – FY26

Fiscal and Economic Benchmarks	Targets
GDP Growth	4.2%
Expenditure	PKR 17.57tn
Inflation	7.5%
Fiscal Deficit as % of GDP	3.9%
Tax Target	PKR 14.13tn (19% up y/y)
Primary Deficit as % of GDP	2.4%
Defence Budget	PKR 2.55tn (21% up y/y)
PSDP	PKR1tn

PSDP Allocation	Amount
Education	PKR 63bn
Science and IT	PKR 53bn
Water	PKR 140bn
Transport	PKR 328bn
Energy	PKR 104bn
Health	PKR 22bn
Agriculture	PKR 4.2bn

Revenue Measures – FY26

- 'Digital Transactions Proceeds Levy' has been introduced along with necessary changes in Income Tax Ordinance, 2001 to cover domestic vendors supplying digitally ordered goods and digitally delivered services.
- Withholding tax rate increase for specified services from 4% to 6% with the exception of IT and IT enabled Services has been proposed.
- Capital gains and dividend taxes remain unchanged, but tax on debt mutual funds rose to 25% (from 15%), while equity mutual funds stay at 15%.
- Pension income received by an individual below the age of 70 years and over and above of PKR 10mn has been charged to tax at the flat rate of 5%. There will be 0% tax rate on pension income not exceeding PKR 10mn.
- Withholding tax rate on cash withdrawal on non-filers proposed to be increased from 0.6% to 0.8% for transactions over PKR 50,000.
- The budget proposes removing the sales tax exemption for FATA/PATA industries, introducing a 10% GST, which will rise by 200bps annually over the next three years.
- Imposition of carbon levy of PKR 2.5/liter on petrol, diesel and furnace oil for FY26, and to be increased to PKR 5.0/liter in FY27.
- Proposal to levy sales tax of 18% on solar panel imports in FY26 budget, which were exempted earlier.
- Introduction of National Tariff Policy, with gradual reduction in ACDs, RDs and CDs.
- ACDs gradually reduced to 0% in 4 years, RDs to be reduced to 0% in 5 years, CDs to be reduced to 0% in 5 years, maximum custom duty set at 15%.

Revenue Measures – Tax Revision on Salaried Class

Sr. No.	Taxable Income Slabs	Existing Incremental Rates	Proposed Incremental Rates
1	**Up to PKR 600,000**	0%	0%
2	**PKR 600,001 to 1,200,000**	5% of the amount exceeding PKR 600,000	1% of the amount exceeding PKR 600,000
3	**PKR 1,200,001 to 2,200,000**	PKR 30,000 + 15% of the amount exceeding PKR 1,200,000	PKR 6,000 + 11% of the amount exceeding PKR 1,200,000
4	**PKR 2,200,001 to 3,200,000**	PKR 180,000 + 25% of the amount exceeding PKR 2,200,000	PKR 116,000 + 23% of the amount exceeding PKR 2,200,000
5	**PKR 3,200,001 to 4,100,000**	PKR 430,000 + 30% of the amount exceeding PKR 3,200,000	PKR 346,000 + 30% of the amount exceeding PKR 3,200,000
6	**Exceeding PKR 4,100,000**	PKR 700,000 + 35% of the amount exceeding PKR 4,100,000	PKR 616,000 + 35% of the amount exceeding PKR 4,100,000

Relief Measures – FY26

- Removal of FED of 7% and reduction in Advance Tax by 150bps on immovable property has been proposed.
- Proportionate tax credit to on profit on debt on loan obtained for construction or acquisition of a house of 250 sq. yd. and a flat having 2000 sq ft. or less area has been proposed.
- BISP allocation increased to PKR 716bn for FY26, an increase of 21% y/y.
- GST of 10% on Buns and Rusks is to be removed.
- Income tax exemption along with withholding tax exemption for erstwhile FATA/PATA areas propose for extension for one year i.e. up to FY 2026.
- 25% rebate against tax payable by full time teachers and researchers to be restored retrospectively i.e. from FY 2023 to FY 2025.

Sector Wise Snapshot

Fertilizer & Agriculture

No change in Federal Excise Duty (FED) on Fertilizer and pesticide inputs (Fertilizer: Neutral)

Cement & Steel

Abolition of Federal Excise Duty (FED) (Cement & Steel: Positive)

Removal of 7% FED and 150bps reduction in Advance Tax on immovable property is expected to stimulate private sector construction activity, further enhancing demand visibility for cement and steel players.

Budget target for PDSP allocated at PKR 1tn (Cement & Steel: Positive)

PSDP allocation of PKR 1tn is set to drive public infrastructure spending, providing a strong demand tailwind for the construction value chain—positive for steel & cement.

Sector Wise Snapshot

Automobile Sector

Restriction on Vehicle Purchase for Ineligible Persons (Section 114C) – Ban on booking, purchase, and registration of vehicles for non-filers (OEMs: Neutral to Negative)

The restriction narrows the eligible customer base for mid-to-high-end vehicles and is enforceable by both OEMs and registration authorities. It primarily impacts non-filers and cash buyers, potentially affecting demand in the 1000cc+ segment. Exemptions for motorcycles, rickshaws, tractors, and pick-ups up to 800cc preserve entry-level demand.

New Energy Vehicles Adoption Levy Act, 2025 – Levy imposed on all ICE vehicles at manufacturing/import stage (EVs: Positive | ICE OEMs: Negative)

A new levy of 1% on engines ≤1300cc, 2% on 1301–1800cc, and 3% on engines above 1800cc will be applied to all ICE (Internal Combustion Engine) vehicles. NEVs, export-dedicated, and diplomatic vehicles are exempt, creating a pricing gap in favor of electric and hybrid vehicles. The measure supports OEMs with EV capabilities and advances the government's clean mobility agenda.

Sector Wise Snapshot

Withdrawal of Concessional GST on Small and Hybrid Vehicles – Sales tax raised to standard 18% for ≤850cc and hybrid cars (Entry-Level & Hybrid OEMs: Negative)

The removal of Entry No. 72 from the 8th Schedule ends the 12.5% concessional GST for locally assembled ≤850cc cars, now taxed at 18%. Additionally, GST on hybrid vehicles has been increased from 8.5% to 18%, removing a key price incentive and impacting affordability. These changes could soften demand in both entry-level and hybrid segments, especially among cost-sensitive buyers.

National Tariff Policy 2025–30 – Gradual elimination of ACDs, RDs, and reduction in CDs; max CD capped at 15% (Auto Vendors: Negative | OEMs: Mixed)

The policy aims to simplify import tariffs by removing ACDs in 4 years, RDs in 5 years, and reducing CDs on industrial inputs. Cheaper imported parts could pressure local auto part vendors on pricing and competitiveness. OEMs may benefit from lower CKD input costs but face rising competition from imported CBUs and components.

Sector Wise Snapshot

Energy Sector

Petroleum Levy Hike, increasing it to PKR 100+/Litre from the current PKR 78 (OMCs: Neutral to Negative)

This measure is likely to negatively impact refineries and OMCs, as higher prices may suppress demand, ultimately weighing on revenues.

Carbon levy to be added on the petroleum prices starting from PKR 2.5/litre (OMCs: Neutral to Negative) (EV: Positive)

Cost-push inflation, pressure on margins for transporters, this would indirectly affect consumer prices. Transport and Auto sectors would be negatively affected by this measure.

Reduction in Tax of Imported Machinery (E&P: Positive) (OMC: Positive)

The tax on machinery, plant, and specialized vehicles for petroleum companies has been reduced from 15% to 10%. This measure is expected to lower capital costs and facilitate improved exploration and production activities within the sector.

Sector Wise Snapshot

Commercial Banks

Encouragement of Digital Transactions (Banks: Positive)

The government's proposal to discourage cash usage is likely to support deposit mobilization within the banking system, a positive development for the sector.

Tax on Interest Income (Banks: Negative)

The proposed increase in tax on interest income could negatively impact banks, given their substantial investment portfolios in government securities.

Higher Withholding Tax on Cash Withdrawals by Non-Filer (Banks: Neutral to Positive)

The proposed upward revision in withholding tax on cash withdrawals for non-filers—from 0.6% to 0.8% on amounts exceeding PKR 50,000—may create an additional revenue stream for banks through fee collection.

Super Tax Slab Adjustments (Banks: Neutral)

The proposed downward adjustment in super tax slabs is unlikely to benefit the banking sector, as banks generally fall within the highest income bracket and thus remain unaffected by these changes.

Proposed Changes In Super Tax

Sr. No	Taxable Income	Previous Rate of Tax	New Rate of Tax
1	Where income does not exceed PKR 150mn	0% of the income	0% of the income
2	Where income exceeds PKR150mn but does not exceed PKR 200mn	1% of the income	1% of the income
3	Where income exceeds PKR 200mn but does not exceed PKR 250mn	2% of the income	1.5% of the income
4	Where income exceeds PKR 250mn but does not exceed PKR 300mn	3% of the income	2.5% of the income
5	Where income exceeds PKR 300mn but does not exceed PKR 350mn	4% of the income	3.5% of the income
6	Where income exceeds PKR 350mn but does not exceed PKR 400mn	6% of the income	5.5% of the income
7	Where income exceeds PKR 400mn but does not exceed PKR 500mn	8% of the income	7.5% of the income
8	Where income exceeds PKR 500mn	10% of the income	10% of the income

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