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Pakistan Strategy 2026: From Stabilization to a Compelling Recovery

An Investment Thesis for the Pakistan Economy & Equity Market

Pakistan is navigating a pivotal phase of macroeconomic stabilization, creating a unique window of opportunity for investors.

After a period of significant volatility, the economic climate is showing clear signs of improvement. This outlook is underpinned by three core pillars that form the narrative of this report:

1. A Strengthening Macroeconomic Landscape

Hard data confirms a tangible recovery across key indicators, from GDP growth to external account stability.

2. A Credible Policy & Reform Framework

A new agreement with the IMF provides a powerful anchor for fiscal discipline, while decisive energy sector reforms are addressing long-standing structural issues.

3. Emerging Transformational Catalysts

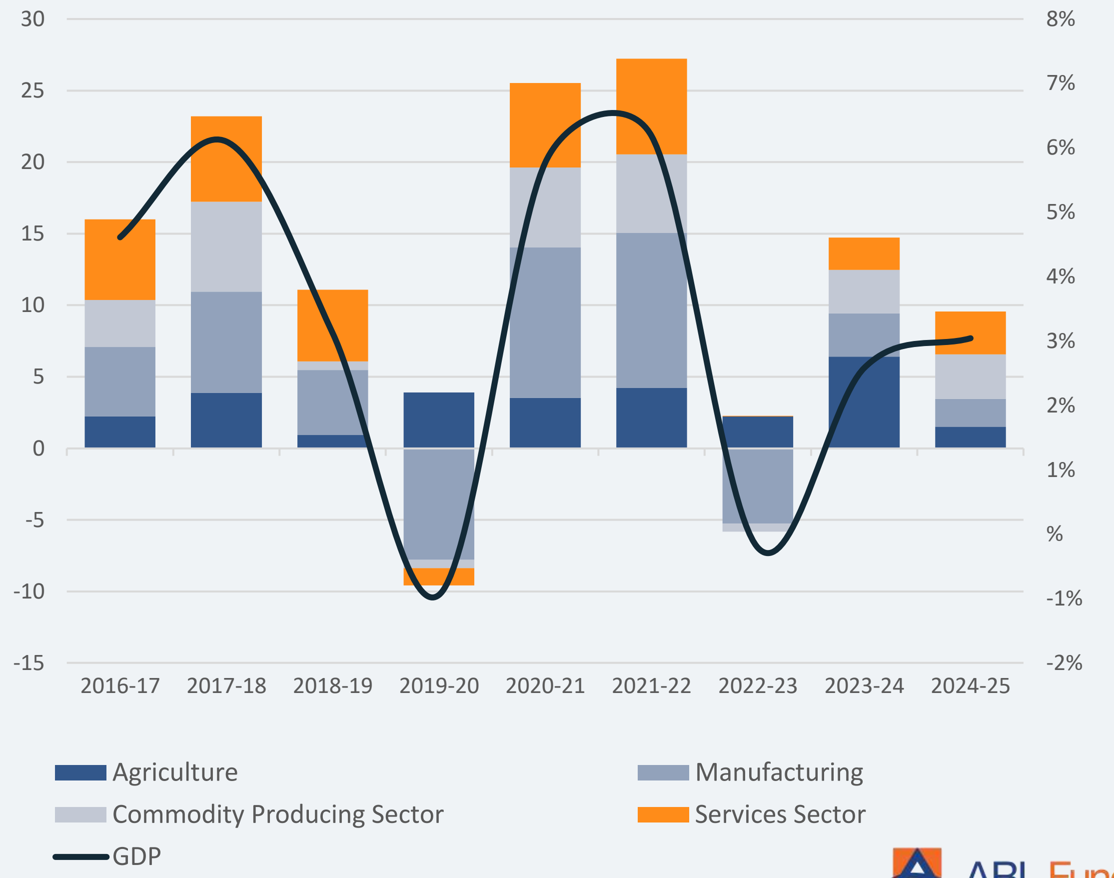
Strategic projects, led by the world-class Reko Diq mine, signal significant long-term growth potential and are renewing international investor confidence.

Economic growth is on a clear recovery path, driven by a strong rebound in the industrial sector.

- GDP growth recorded at 3.0% in FY25, with IMF forecasts showing acceleration to 3.2% in FY26 and 4.1% by FY27.
- The industrial sector is the primary driver, expanding by 5.3% in FY25, benefiting from lower interest rates and a stable currency.
- This robust performance offsets weakness in the agricultural sector, which saw critical wheat and cotton crop outputs decline by 10.8% and 30.7%, respectively.

IMF Growth Projections (FY2025 - FY2027)	FY2025	FY2026	FY2027
Real GDP Growth (%)	3.0	3.2	4.1
Agriculture (%)	2.5	1.5	3.0
Industry (%)	5.0	4.5	5.5
Services (%)	3.2	3.5	4.0

Sectoral Contribution to GDP



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The Engine of Recovery: Monetary Easing is Unlocking Value

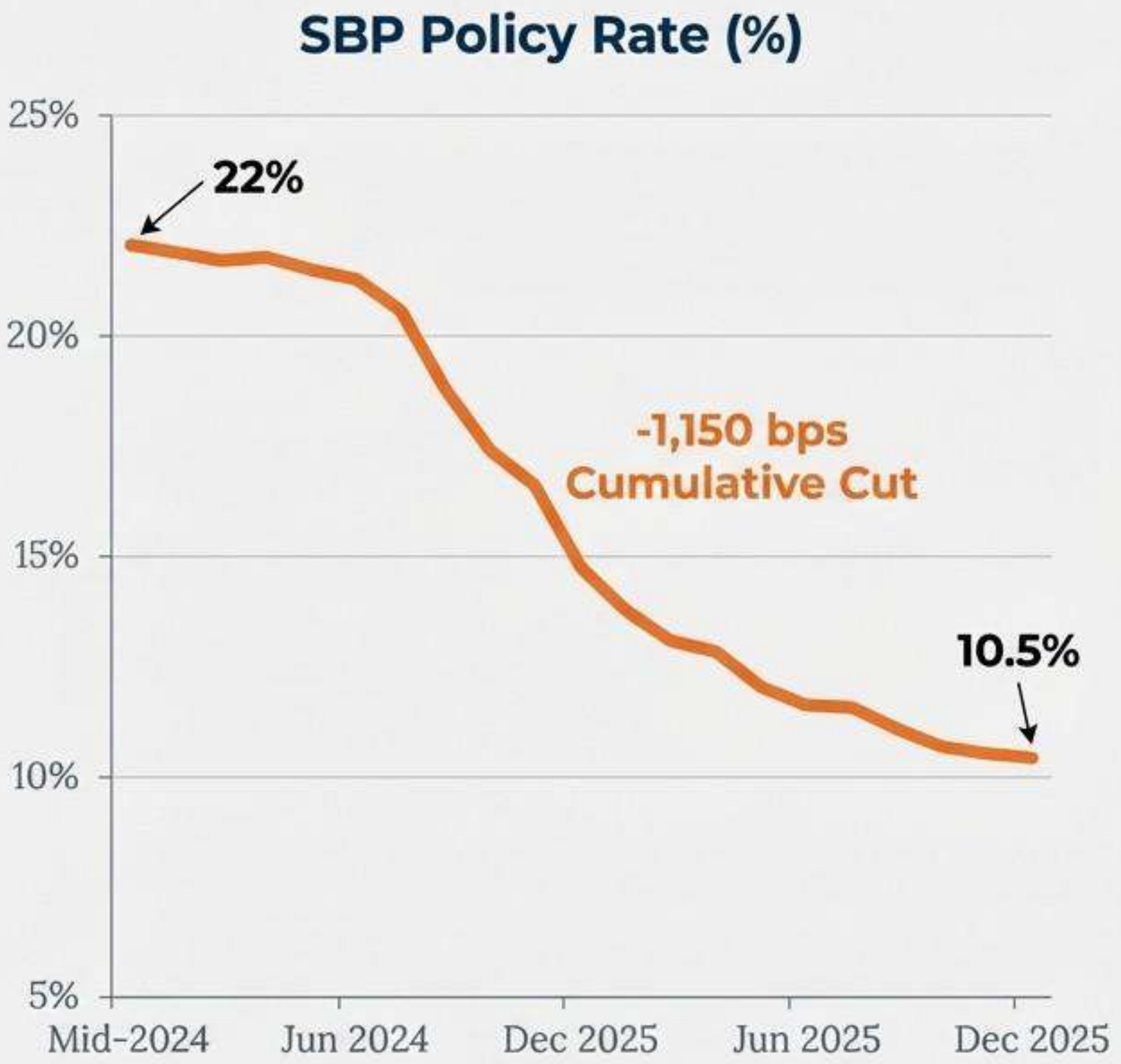
The State Bank of Pakistan (SBP) has shifted from aggressive tightening to a calibrated easing cycle, creating a powerful tailwind for the economy and equity markets.

The Pivot: After peaking at 22%, the policy rate was cut by a cumulative 1,150 basis points to 10.5% as of December 2025.

The Outlook: Further easing is expected in 2026 as inflation converges toward its 6-7% target, with the policy rate potentially declining toward 9.5%.

The Impact: Lower borrowing costs directly enhance corporate profitability and cash flows, especially for leveraged sectors (cement, steel, industrials).

The Re-rating: Declining risk premiums are driving a valuation expansion. The market P/E ratio, which averaged 5.2x during 2021-2024, is forecasted to expand towards 10x-11x as stability takes hold.



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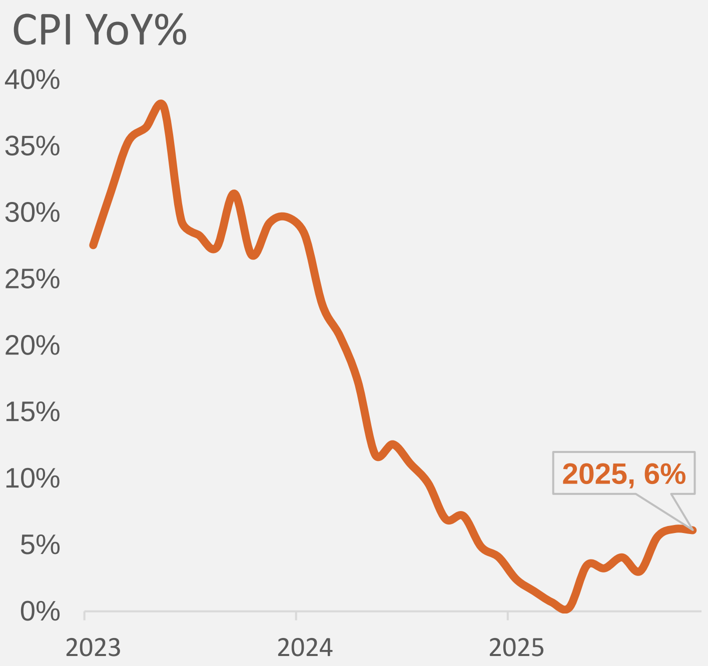
The Great Stabilization: Key Economic Indicators Have Turned the Corner

GDP Growth is Recovering

Recovery driven by a strong rebound in the industrial sector (+5.3% in FY25) and benefits of lower interest rates.

Inflation Has Moderated Decisively



Benign outlook provides room for positive real rates and a predictable operating environment.

External Account Shows Material Improvement

Driven by a 27% YoY increase in workers' remittances, anchoring external stability.

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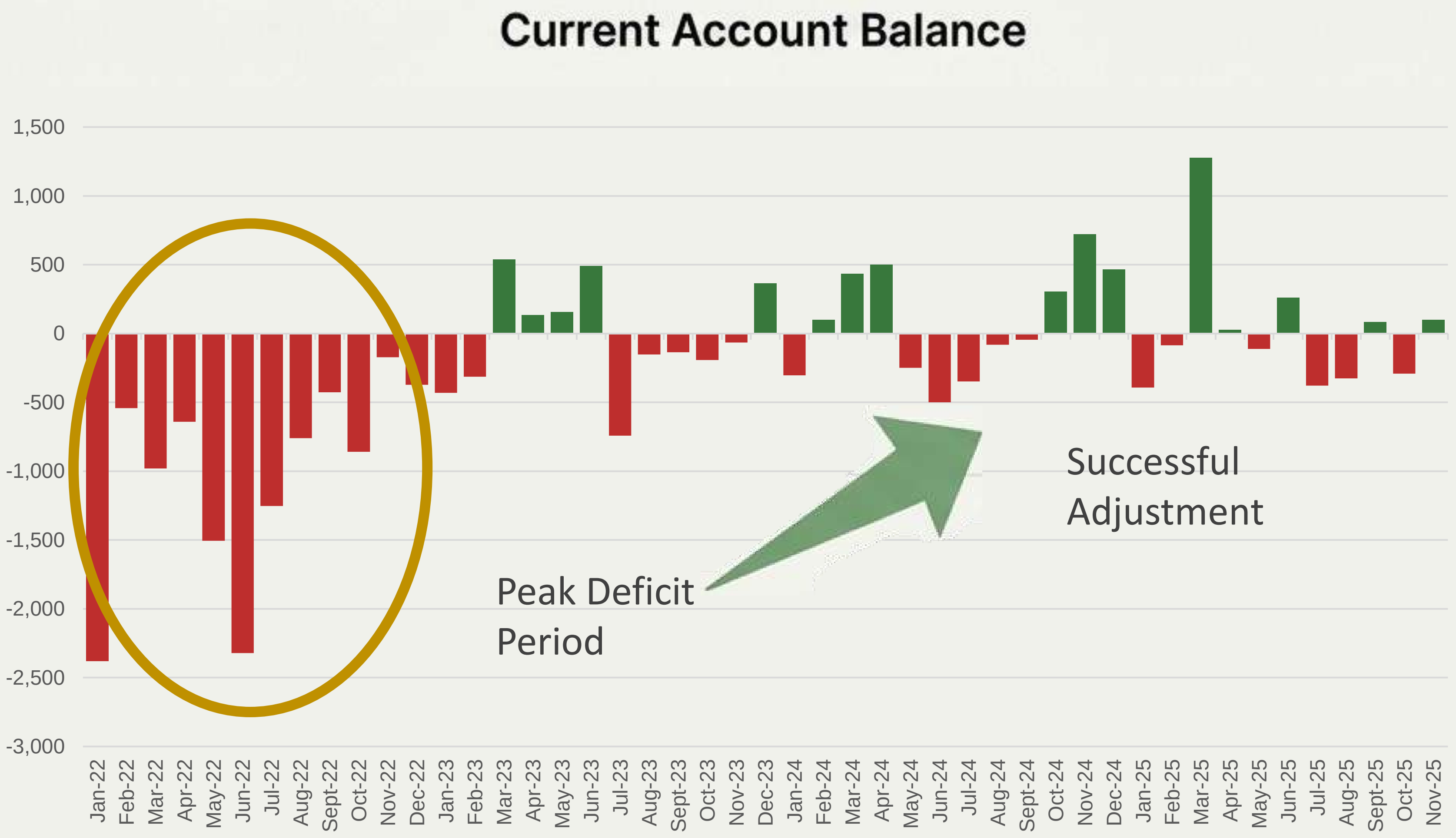
A Disciplined Contraction in the Current Account Deficit Underpins External Stability



Key Insight Box

The chart shows a dramatic swing from a significant deficit to a surplus or a much more manageable deficit.

This crucial adjustment halted the drain on foreign exchange reserves and was a key driver in stabilizing the currency.

Foreign exchange reserves have been rebuilt, supporting currency stability and ensuring external obligations are met.

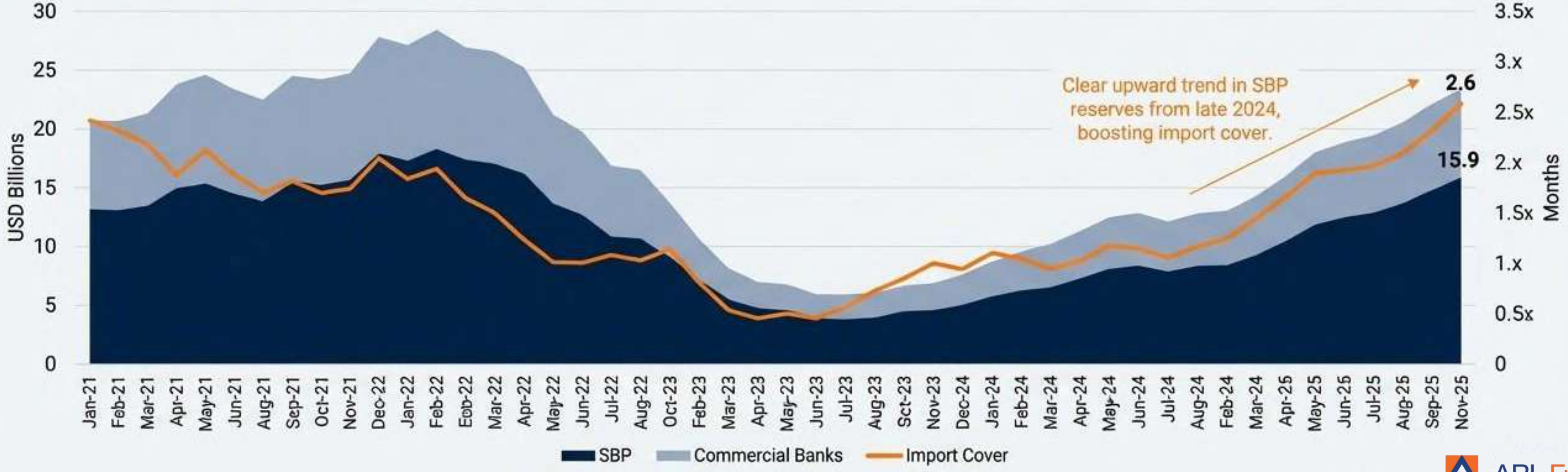
Key Reserve & Currency Data

- SBP foreign exchange reserves stand at approximately **USD 15.9 billion** (as of 19-Dec-2025).
- The Pakistani Rupee (PKR) remained broadly stable in CY25, with only a marginal **0.6%** depreciation against the USD.
- A gradual, manageable depreciation of **~3.0-3.5%** annually is projected for FY26-FY27.

Debt Servicing Profile (FY26)

- Total Requirement: **USD 25.8 billion**
- Management Plan: **USD 4.4B** repaid, **USD 5.3B** secured rollovers, and a further **USD 9.3B** expected to be rolled over, supported by bilateral partners (Saudi Arabia, UAE, China) and IMF disbursements.

FX Reserves & Import Cover (Jan-21 to Nov-25)



Part II: The Drivers

A Credible Policy & Reform Framework is Anchoring the Recovery.

The IMF program serves as the central anchor for policy discipline and investor confidence

The agreement with the IMF provides critical credibility to policy execution and ensures external financing continuity. Beyond funding, the program mandates a set of structural reforms aimed at embedding long-term fiscal sustainability and improving the investment climate.

Tax System & Governance

Simplification of the tax system and strengthening the FBR to broaden the tax base.

Public Financial Management

Implementing tighter controls on unplanned spending and development project overruns.

Trade Liberalization

Rationalizing tariffs to lower trade barriers and enhance export competitiveness.

Transparency & Governance

Strengthening anti-corruption and AML frameworks to align with international standards.

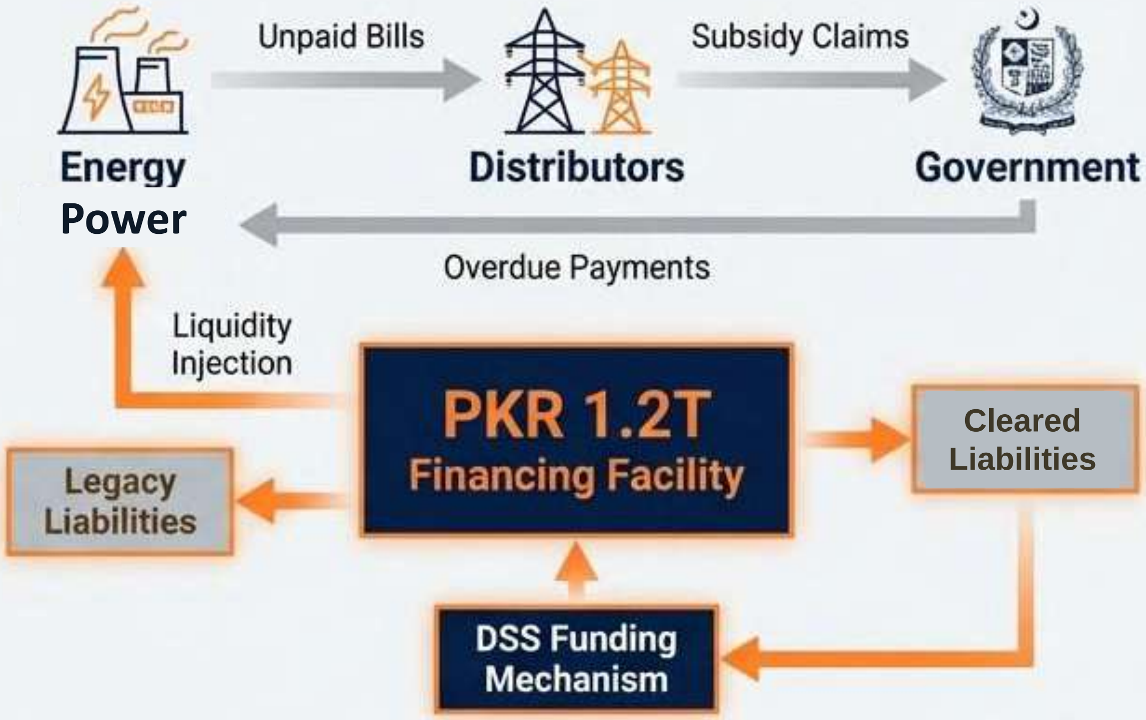
Decisive action is finally being taken to resolve the power sector's chronic circular debt.

Core Issue:

Circular debt has historically distorted balance sheets and curtailed reinvestment across the energy supply chain.

The Structural Resolution:

- A ~PKR 1.2 trillion syndicated financing facility was signed in September 2025.
- **Mechanism**
  The facility allows for the settlement of legacy liabilities and overdue payables.
- **Funding**
  It is serviced through the existing PKR 3.23/unit Debt Servicing Surcharge (DSS), which now has no cap, reducing refinancing risk.



Key Takeaway

While transmission and distribution inefficiencies remain a challenge, this measure marks a significant shift from temporary relief to a structural resolution, materially reducing liquidity stress in the sector.

Reform momentum is extending to the gas sector, reviving upstream investment and attracting foreign interest.

Gas Sector Challenge:

- Circular debt estimated at PKR 2.6 trillion, concentrated on upstream balance sheets.

Policy Response:

- Successive gas tariff revisions have slowed debt accumulation and improved cash collections.
- A comprehensive circular debt management framework is being developed (utilizing SOE dividends, petroleum levy, etc.).

Tangible Results:

- **Renewed Foreign Interest:**
  - Highlighted by Turkish Petroleum's entry into offshore blocks.
- **Increased Domestic Activity:**
  - Leading E&P companies expanded exploration, delivering reserve replacement ratios above 100% in FY25.

Part III: The Catalyst

Unlocking Long-Term Transformational Growth.

Reko Diq: A Transformational Catalyst for Long-Term Growth

The Reko Diq project is a cornerstone of Pakistan's long-term economic transformation, set to materially strengthen the balance of payments, catalyze a broader industrial ecosystem, and signal a new level of investor confidence.

Partnership: Barrick Gold (50%), Federal SOEs (25%), Balochistan Govt (25%).

Timeline: Production targeted to begin by 2028, with a 50+ year mine life.

Scale: One of the world's largest undeveloped copper-gold deposits.

Projected Output: ~200,000 tons of copper & 250,000 ounces of gold annually.

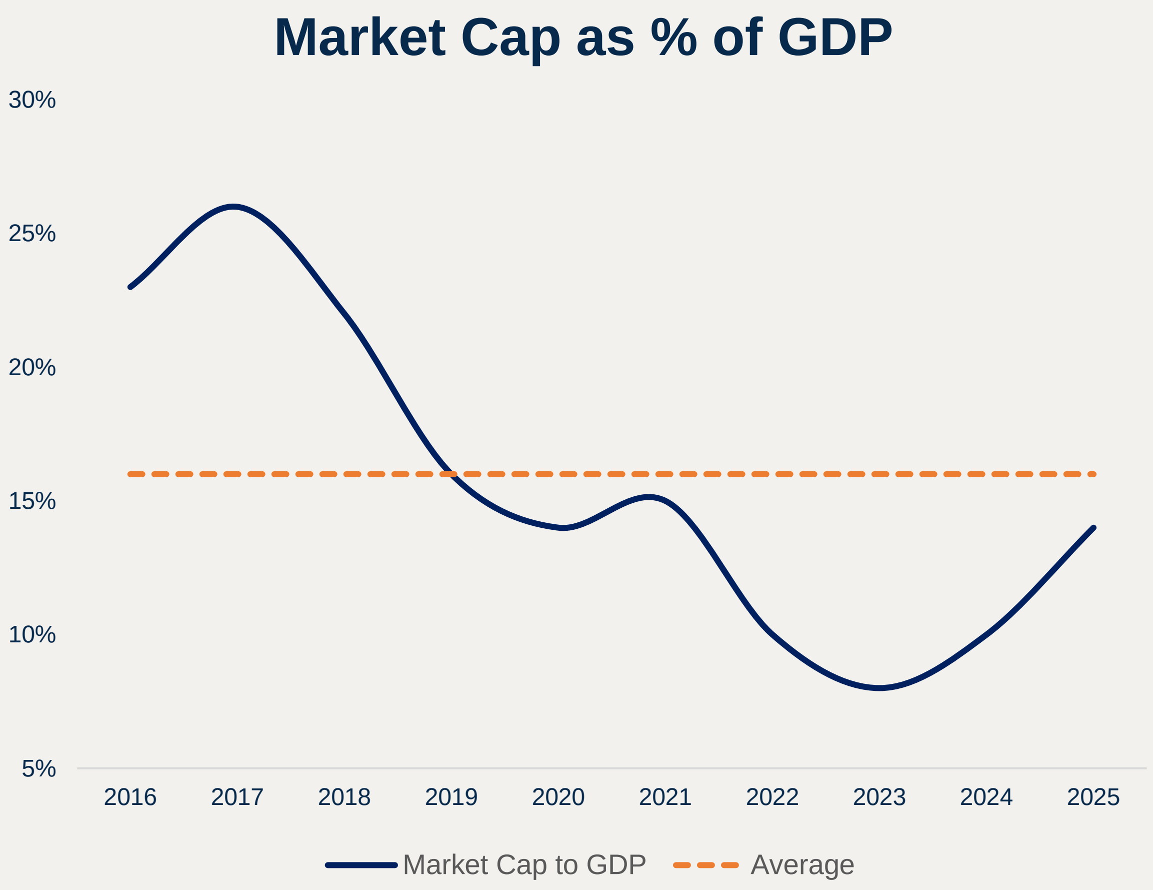
Strategic Significance

- **Macro Impact:** Will generate sustained export inflows, support currency stability, and reduce reliance on external borrowing.
- **FDI Signal:** As Pakistan’s largest FDI to date,it isreinforced by strong interest from international partners (e.g., Saudi Arabia) and a USD 3.5B IFC-led financing package.
- **Ecosystem Catalyst:** Expected to drive demand for mining services, logistics, and infrastructure.

Improving Liquidity and a Stable Political Outlook Support a Sustained Inflow of Capital

Robust domestic liquidity has become a structural feature of the market, while an improving political and geopolitical landscape is lowering the risk premium and brightening prospects for foreign investment.

Valuations Remain Below Historical Averages, Signaling Room for Growth



Domestic Liquidity

Mutual fund equity AUM grew 47% in 2025.

Vibrant M&A activity (PIA privatization, PTC-Telenor merger) is injecting fresh dynamism.

Foreign Investment Prospects

Sovereign rating upgrades, Vietnam's EM-status (raising Pakistan's weight in frontier indices), and currency stability are setting the stage for a revival.

The UAE's $1B investment in Fauji Foundation is a key signal of renewed Gulf investor enthusiasm.

Political & Geopolitical Stability

Institutional continuity, reinvigorated ties with China, US, and Saudi Arabia, and de-escalation on regional borders are lowering the country's overall risk premium.

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Pakistan presents a compelling investment case at a macroeconomic inflection point

Stabilization Achieved

- GDP Growth Accelerating to 4.1%
- Inflation Contained Below 7%
- Historic Current Account Surplus
- FX Reserves Rebuilt

Reforms Delivering Credibility

- IMF Program as Policy Anchor
- Structural Fix for Power Sector Debt
- Gas Sector Reforms Reviving Investment

Growth Catalysts Emerging

- Reko Diq as a Transformational Project
- Renewed Foreign Direct Investment
- Monetary Easing to Fuel Corporate Growth

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Pakistan Equities: The Great Re-rating and the Path Forward

2026 Market Outlook

2025: A Historic Market Re-Rating Set the Stage for Further Gains

+51.05% KSE-100 Index return in CY2025, reaching an all-time high of 173,896 points.

Primary Drivers of the Rally

- **Macro Anchors**
  Successful IMF reviews and sovereign rating upgrades from Fitch, S&P, and Moody's.
- **The 'Great Asset Rotation'**
  Aggressive monetary easing (policy rate down 1,150 bps) drove a profound shift from fixed income to equities.
- **Domestic Strength**
  Local institutions countered foreign outflows of ~$362M, with mutual funds leading with net inflows of $287M.
- **Corporate Resilience**
  KSE-100 corporate earnings expected to expand by 10.3%

Broad-Based Performance (Returns %)

Sector	CY21	CY22	CY23	CY24	CYTD*
KSE-100	1.92%	-9.36%	54.50%	84.35%	**51.05%**
Commercial Banks	10.31%	-18.21%	89.48%	97.49%	**101.67%**
Cements	-9.89%	-33.38%	72.01%	63.78%	**93.77%**
E&P	-13.32%	-5.76%	37.48%	106.61%	**10.21%**

Returns are calculated as on December 29,2025 (CYTD)

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Broad-Based Rally Driven by Resilient Corporate Earnings

Corporate earnings across the KSE-100 expanded by approximately **10.3%**.

Sector Performance (CYTD % Return)

Sectors	CY21	CY22	CY23	CY24	CYTD*
KSE-100	1.92%	-9.36%	54.50%	84.35%	51.05%
Commercial Banks	10.31%	-18.21%	89.48%	97.49%	101.67%
Cements	-9.89%	-33.38%	72.01%	63.78%	93.77%
E&P	-13.32%	-5.76%	37.48%	106.61%	10.21%
Autos Assembler	-1.48%	-10.08%	83.55%	71.29%	15.95%
Fertilizer	9.05%	8.85%	45.45%	148.99%	66.70%
Pharma	-10.10%	-32.22%	5.76%	166.71%	7.55%
OMC	-16.25%	-3.00%	44.77%	116.59%	6.21%
Chemical	17.50%	-4.62%	32.43%	34.56%	59.26%
Power	9.73%	19.45%	119.59%	30.53%	61.98%
Food	-7.99%	-18.21%	60.99%	17.50%	18.44%
Textile	-5.22%	-20.84%	46.23%	15.60%	28.66%
Refinery	-22.75%	-27.11%	92.31%	71.67%	-2.68%
Technology	50.40%	1.97%	-8.47%	50.39%	22.33%

**Returns are calculated as on December 29,2025 (CYTD)*

Sector Highlights

Banks
Led the index with steady Net Interest Margins.

Cement
Staged a robust comeback with **12%** domestic demand growth in H2.

Technology
Outpaced all sectors in percentage terms, propelled by an **18%** rise in IT exports and the PTC-Telenor merger.

E&P
Thrived on enhanced cash flows from circular debt resolutions, with recovery ratios for OGDC & PPL exceeding **100%**.

The Foundations of the 2025 Turnaround

IMF Program Success

Adeptly navigated the first and second reviews of the US$7 billion Extended Fund Facility, unlocking vital disbursements.

Sovereign Rating Upgrades

Fitch and S&P Global to **'B-'**. Moody's to **'Caa1'** with a stable outlook.

Inflation Tamed

Headline inflation plummeted to an average of **4.6%** in FY25, down from 23.4% the prior year.

Currency Stability

The Pakistani Rupee (PKR) showed remarkable stability, depreciating just **0.59%** against the US Dollar.

Four Key Catalysts Will Propel the Market in 2026

1. Sustained Monetary Easing

The policy rate is expected to settle around **9.5%**, supporting a continued P/E multiple expansion towards a target of **10x-11x**.

2. Improving Liquidity & Valuations

Strong domestic flows continue, with potential for foreign investor return, highlighted by the UAE's **$1B** investment in Fauji Foundation. Market Cap to GDP (**~15%**) remains below its long-term average, suggesting **room to grow**.

3. Enduring Political & Geopolitical Stability

Lower geopolitical risk premium due to institutional alignment (new Chief of Defence Forces role) and invigorated ties with China, the US, and Saudi Arabia.

4. Softening Global Oil Prices

A major tailwind. Brent crude is projected to average a subdued **$55-60/bbl**, controlling domestic inflation and limiting the Current Account Deficit to a manageable **0.3%-0.6%** of GDP.

The Playbook: The Resilient Core (Banking & Fertilizers)

Banking – A Core Allocation for Growth and Yield

Thesis: Sustained profitability (earnings +13.6% TTM), attractive dividend yield (~6.8%), and positioned to benefit from improving credit offtake as the economy recovers.

Key Data: Healthy deposit growth of 11.2% (TTM), with leaders like UBL (+31.6%) and Meezan (+23.5%). Capital ratios remain comfortably above regulatory minimums.

Outlook: Sector earnings and dividends projected to grow ~9.6% in CY26.

Fertilizers – Defensive Strength and Diversification

Thesis: Stable and defensive play supported by resilient demand, secure gas availability, and strong cash generation.

Key Data: Policy-backed gas supply has ensured high capacity utilization (~103% in CY24). Farmer affordability is normalizing with government support.

Outlook: Strong free cash flow enables diversification into strategic projects, including mining and UAE-backed investments into Fauji Foundation-linked ventures.

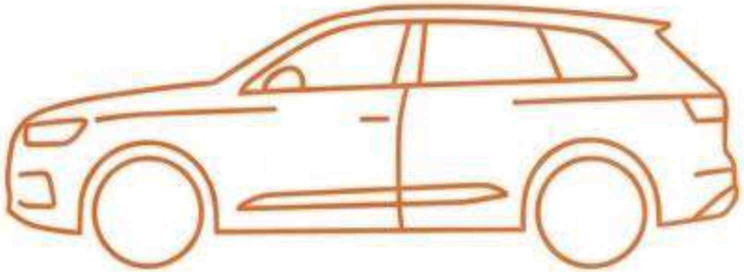
The Playbook: The Cyclical Recovery (Construction & Automobiles)

Construction (Cement & Steel) – At a Cyclical Inflection Point

- **Thesis:** Domestic demand is set to recover, driven by monetary easing and a revival in private construction.
- **Key Data:** Domestic cement dispatches increased **15% YoY** during 5MFY26. FY26 domestic demand is forecast to grow **8-10%.** Margins are resilient due to stable coal prices (**<$100/ton**).
- **Valuation:** Compelling valuation at **~USD 50 EV/ton** vs. replacement cost of USD 70-80/ton, providing meaningful upside.

Automobiles – Benefitting Directly from Lower Financing Costs

- **Thesis:** A clear recovery is underway as improving consumer confidence and lower interest rates boost affordability and sales.
- **Key Data:** Passenger car sales increased **38% YoY** in FY25. Auto financing rebounded **~34% YoY** by Oct'25.
- **Outlook:** Further monetary easing will act as a key catalyst. The market is also undergoing a structural shift towards SUVs and EVs, with new players entering.



The Playbook: Strategic Growth Engines (E&P & Technology)

Exploration & Production (E&P) – Entering a More Constructive Phase

Thesis: Improving liquidity from progress on circular debt containment, pricing reforms, and strategic diversification into mining.

Key Data: Payout ratios have improved meaningfully from ~22% to 39%, reflecting stronger cash flow confidence. Collection rates have shown visible improvement.

Outlook: Strategic diversification into mining via Reko Diq and other mineral projects offers significant long-term growth and earnings diversification.

Technology & Communication – Pakistan's Global Growth Pillar

Thesis: A powerful dual-engine model of robust IT exports and a transforming domestic market.

Key Data: IT exports rose 18% YoY to $3.8B in FY25 and are expected to grow ~20% in FY26.

Outlook: Sector is being reshaped by major consolidation (PTC-Telenor merger). Companies like Systems Limited exemplify global capability with a projected 25% 5-year revenue CAGR.

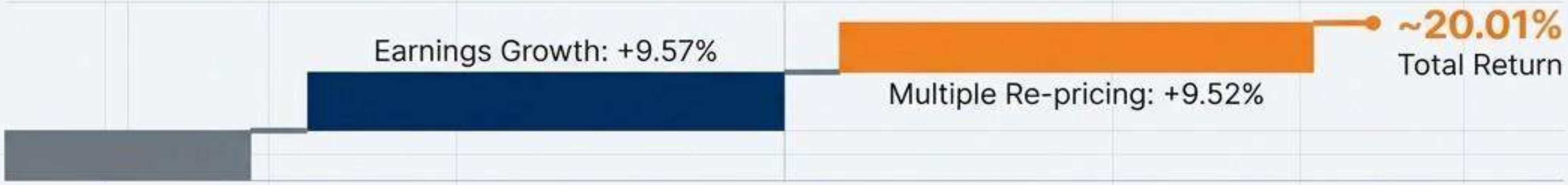
2026 Outlook: A KSE-100 Target of 209,000

CY26 KSE-100 Target: 209,000

Implied Upside: ~20.01%

from current levels

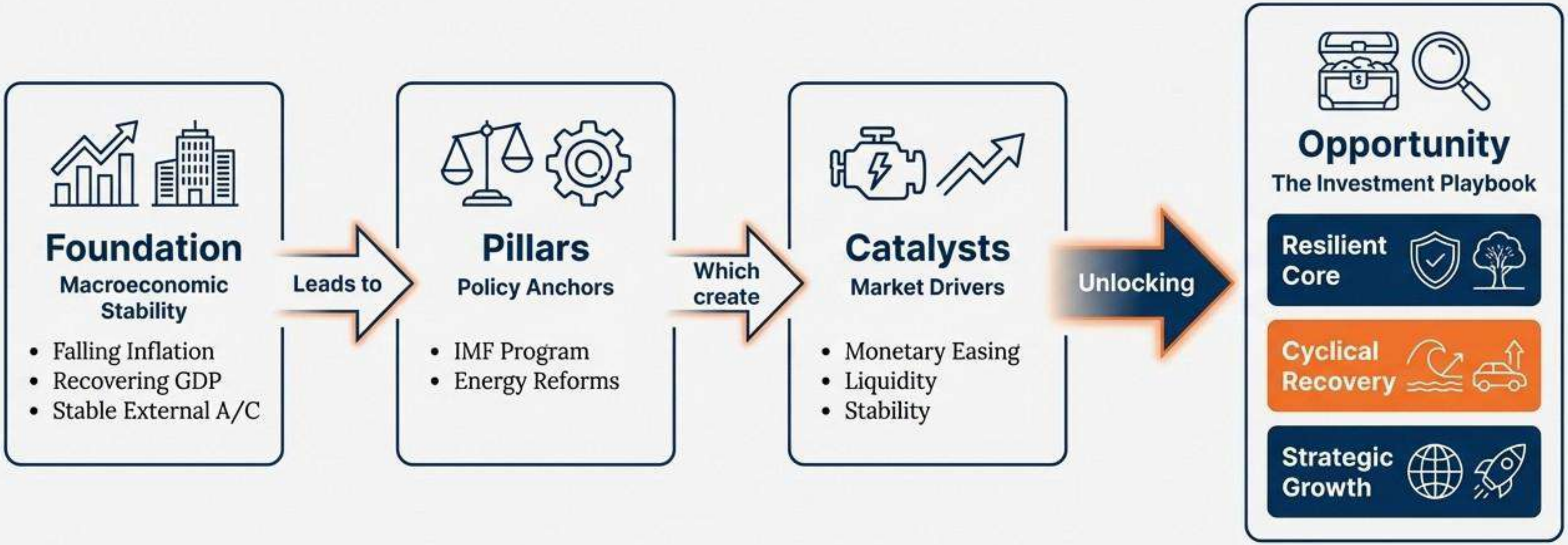
Components of the Target Return



The confluence of macroeconomic stabilization, supportive policy, and resilient corporate fundamentals provides a clear and compelling path for Pakistan's equity market to continue its re-rating journey in 2026.

The Verdict: A Rare Confluence of Catalysts Unlocking Value

Pakistan's journey from stabilization to a durable recovery is creating a compelling and time-sensitive investment window. The convergence of macro stability, credible policy discipline, and powerful market drivers is set to unlock significant value across the equity landscape.



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