Trip Notes



Pakistan & Sri Lanka

October 2026

Photo: Secretertat Halt Railway Station
Colombo, Sri Lanka

Aktia

Overview

We visited Pakistan and Sri Lanka in October 2026 to meet policymakers, economists and market participants to assess the macroeconomic outlooks of the respective countries. In total, we had over 20 meetings. The discussion largely focused on ongoing efforts to boost fiscal revenue streams, execute productivity enhancing business reform agendas, strengthen resilience to external vulnerabilities, and explore the path forward regarding financing self-sufficiency and cooperation with international financial institutions (IFIs) as well as other bilateral creditors.

Two major overarching themes, the Iran War and El Niño , were salient as global risk factors, to which both countries have varying degrees of sensitivities to. In the updated October WEO, the IMF sees the Iran War dragging on until next year, which was largely in the baselines or downside risk scenarios of economists and authorities of Pakistan and Sri Lanka. The degree and ways in which both shocks will impact economic prospects of both countries is naturally still highly uncertain, although authorities seemed to be mindful that further monetary tightening may be needed in the face of rising inflation and rising global yields, and fiscal support for households can go only so far as to provide a temporary bridging gap given tighter global liquidity.

On the flip side, both countries have, to varying degrees, engaged in measures to strengthen fiscal buffers and pre-emptively tighten monetary policy, providing a positive backdrop should a resolution to the Iran War be found. Consumers and businesses seem to be better prepared for this episode of El Niño, such as with accelerated pre-planting in Sri Lanka. The price mechanism on consumer goods and services seems to be functioning in calibrating aggregate demand and supply, although upside pressures to prices are present. Furthermore, the increased geopolitical fragmentation has placed a greater spotlight on the strategic importance of Pakistan and Sri Lanka, with the increased interest on cooperation from major global geoeconomic powers, providing both opportunities and challenges.

In summary, there was a mixed or cautiously optimistic tone on the medium-term prospects of both economies. Much depends on the continued execution of important (although ambitious) policy reform agendas. Focus will be on the next electoral cycles and future engagement with IFIs given the upcoming conclusions of IMF programmes.



Photo: Central Business District, Colombo, Sri Lanka

Pakistan

As the fifth most populous country in the world, with a population size of over 260 million growing at pace of 2.5% per year, the output potential of Pakistan is immense. The country has favourable demographics and vast natural resource deposits in the Western area of Balochistan and the North with Gilgit-Baltistan, Azad Kashmir, and Khyber Pakhtunkhwa. Pakistan's geoeconomically important location, with borders to China, India, Iran and Afghanistan has seen renewed interest by global powers, which presents its own unique opportunities and challenges. The recently signed Saudi-Pakistan-Turkey military pact is one example, as is the role of Pakistan as a mediator in the ongoing Iran-US war. Cooperation with China and historically tight links provide opportunities for FDI in critical mining, energy and strategic infrastructure. The Reko Diq gold and copper mining project is a joint venture with the large Canadian mining company Barrick, and a USD 10bn FX swap line with the US has been flirted with in public in addition to the existing Chinese RMB 30bn swap line. All these point towards geoeconomic interest which are unlikely to cede but rather deepen.

That being said, this intensified cooperation provide challenges related to possibly getting entangled in a potential expanded conflict in the Middle East and greater dependency on shifts in the balance of power. Regional turbulence such as with the politically sensitive Kashmir area are staple areas of friction but have historically always led to de-escalation with the efforts of international partners. The ongoing fighting between Afghanistan and Pakistan raise concerns on potential disruptions investments to the Reko Diq mining project and the supply chain. In addition, instability in the Balochistan region is likely to persist for the time being.

The political and military links in business activity continue to be apparent, making it more natural to view the economy from a political economy perspective rather than a market-based system. Efforts are being made by authorities to formalise greater parts of the economy and privatise significant parts of SOEs. The privatisation efforts, around 17 in the pipeline over the next 12-18 months seem notably ambitious given that the last privatisation was done in 2005 (arguably some minor privatisations have been carried out in the interim). Authorities have communicated the importance of these privatisation efforts and lessons learned from the past. This does not take away from the strong links the military has on various parts of the economy. For example, in Karachi, a large chunk of property development is carried out on land owned by the military establishment. Emaar is in the final stages of developing the "Crescent Bay" sea-front area, which places development of such luxury residential areas in stark contrast with much of the rest of the metropolitan area.

Islamabad was on the list of cities to visit during the investor trip, but the "long march" protests by the "third way" Pakistan Tehreek-e-Insaf party of jailed Imran Khan prevented that leg of the trip. The capital was effectively in lockdown, with shipping containers preventing access in-and-out of various parts of the city. The current government headed by Shehbaz Sharif has consolidated power but has arguably, despite protests by political opposition, created a greater sense of overall economic stability. The next elections are in 2029, providing some electoral calm in the interim.

The IMF expects Pakistan to grow at a pace of 3.6% this year and the next, with growth gradually picking up to 4.5% in the medium term. Aside from inflation which is projected to average 9.9% in 2027 compared to year beginning projections of 8.4%, growth, fiscal performance and current account dynamics were largely unchanged based on IMF's WEO projections. The State Bank proactively hiked its policy rate in April by 100bps to 11.5% to mitigate inflationary spillover effects building into inflation expectations stemming from fuel-import price pressures due to the Iran War. Both core- and headline inflation figures have been relatively well behaving compared to the State Bank's initial nowcasting projections, although some upwards pressures have been visible. El Nino also provides another upside risk to inflation, with slight pickup in prices paid on consumer staples, such as imported wheat. Inflation expectations remain well anchored based on survey data and the State Bank has expressed readiness to act with further tightening should conditions warrant it. Given the 5-7% inflation targeting band, it would not be surprising to see further tightening of 50-100bps by year end.

	2027F	2026F	2025	2024	2023	2012 - 2022
Real GDP (% annual percent change)	3.5%	3.6%	3.2%	2.6%	-0.2%	3.9%
Inflation (% annual percent change)	9.9%	7.1%	4.5%	23.4%	29.2%	7.5%
Overall Fiscal Balance (% of GDP)	-3.5%	-2.6%	-5.4%	-6.8%	-7.8%	-6.2%
Government Debt (% of GDP)	67.7%	69.8%	72.8%	70.3%	78.5%	67.1%
Current Account (% of GDP)	-1.0%	0.0%	0.5%	-0.6%	-1.0%	-2.4%
Import Cover	3.9*	3.9*	3.6	3.8	3.0	3.7

*Latest value that exists for Import Cover
Sources: Aktia, IMF and Macrobond

Pakistan

On the external side, Pakistan has been steadily accumulating reserves through FX policy and remittances. Pakistan's reserves sit at around USD 21bn. The State Bank has publicly communicated that reserve accumulation has been driven by purchases from the market rather than external debt accumulation. The current account is broadly balanced, while expectations are that there will be a slight widening deficit in 2027 amid higher import costs and geopolitical tensions. In terms of valuations, the PKR has seen some appreciation leading to mild overvaluation; pressures nonetheless are balanced and the parallel exchange market has not seen any meaningful widening since the beginning of the year (currently standing at around 4% above current spot levels). Persistently higher inflation prints and Ramadan-led import and consumption demand may nudge risks slightly to the upside.

Remittance increases have been driven by both the formalisation of transfer channels (Pakistan Remittance Initiative and digital platforms) and precautionary transfers stemming from the Iran war (support for families back home amid inflation pressures and rising import costs). The expected continued strength in remittances leading to Ramadan is seen to continue also further into 2027. Some risks to remittance flows come from regional issues such as with the recent targeted expulsion of Pakistani workers by the UAE in part due to Pakistan's neutral stance in the US-Iran War and Pakistan's deepened security cooperation with Saudia Arabia following the signing of the mutual defence pact.

On the fiscal side, the revenue base is narrow, and efforts to broaden the tax base are essential for medium-term CAPEX spending and macro-fiscal stability. The informal sector of the economy is large, and the estimated true size of the economy is double that of official figures. Tax revenue increases have mostly occurred in already formalised sectors, and the tax rate for example for profitable banks stands at a large 53%. Bureaucracy related to small- and medium sized businesses place notable frictions, as do regulatory obstacles making it hard for international business to operate in Pakistan. The government has placed efforts into streamlining regulatory institutions with overlapping mandates or jurisdictions, however work still remains in this area. Furthermore, difficult reforms related to agriculture, retail and manufacturing sectors have let to bare fruit in expanding the tax base.

Regarding IFIs and other international creditors, Pakistan reached a Staff-Level Agreement on the 7th of October with the IMF on the fourth review of the EFF and third review of the RSF. This is expected to unlock some USD 1.2bn in funding, with programme specific targets on fiscal consolidation, revenue mobilisation, energy sector viability and structural adjustments related to SOEs and financial governance.

The IMF programme is scheduled to end in September next year. While official communications have been on the view that another IMF programme is not needed, other private sector actors and observers are largely of the view that another IMF programme will be negotiated. Pakistan made a return to the international markets last month through USD 3bn dual-tranche Eurobonds (USD 1.75bn in 5.5Y at 7.5% and USD 1.25bn in 10Y with 7.9%). Other funding sources come from China (USD 261m panda bond in May 2026 with partial ADB and AIIB guarantees with talks for follow up issuance of USD 1bn, possible Samurai Bonds and Islamic Sukuk issuance.

Our View: Both our Frontier Local Currency and Hard Currency strategy hold small (<1%) positions in Pakistan. We remain cautiously constructive, supported by improving external buffers and continued IMF engagement. However, the Pakistani rupee's valuation, renewed inflation risks and persistent fiscal and structural vulnerabilities warrant for keeping exposure modest. We think that implementation of the ambitious reform agenda remains a key challenge.

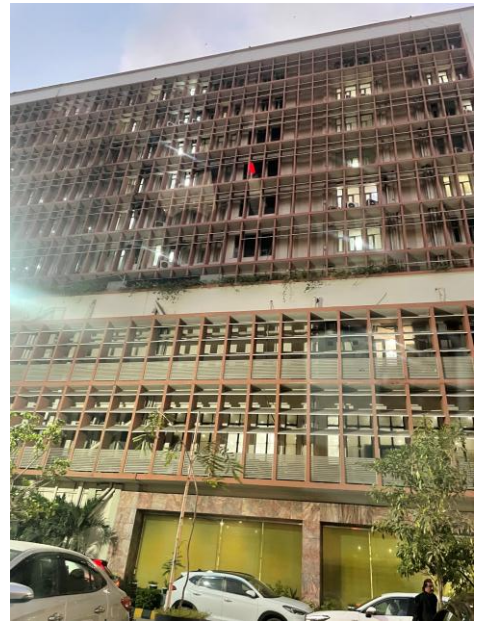


Photo: State Bank, Karachi, Pakistan

Sri Lanka

Sri Lanka's economy has seen a marked recovery since the 2022 balance-of-payments and sovereign debt crisis that was a function of compounding external shocks and domestic policy blunders. Since then, authorities, in engagement with the IMF, have demonstrated a determined effort to recalibrate the economy onto a more sustainable path. The recovery has brought debt-to-GDP back to pre-crisis levels, inflation towards the central bank's target range and supported a gradual accumulation of fiscal and reserve buffers. Although the debt burden and external liability picture has improved, work remains to consolidate these gains. Fitch's September credit rating upgrade was an important milestone, but it has not yet brought a decisive increase in capital inflows; investors appear to be waiting for further rating confirmation and greater policy certainty amid a more uncertain external macroeconomic environment. FDI inflows, while having increased to USD 1bn in 2024 and 2025, have picked up, but remain below levels that economists consider necessary to support durable growth and debt sustainability.

The Marxist-Leninist JVP led coalition government has positively surprised many market observers with its commitment to market reform and fiscal sustainability. The administration has maintained much of the reform discipline associated with the IMF programme despite its earlier anti-IMF rhetoric prior to being elected into government. New Central Bank and public debt management laws, together with the new financial management framework, have strengthened fiscal and monetary institutions. The current government remains relatively popular and consolidated its political position. The downside risks relate to implementation: technical implementation concerns remain, legislative and institutional decisions can be slow, and the government's policy signals have not always been consistent.

While the World Bank upgraded Sri Lanka's status to an upper-middle-income economy in July, around 60% of the population lives under the poverty line (classified for upper-middle-income economies as living off under $8.30 a day). Post-crisis emigration has slowed down, but nonetheless continued despite the recovery, leaving a demographic gap among working-age people and reduced birth rates.

On the external side, the current account is expected to be slightly negative this year, with a deficit below USD 300m based on Central Bank of Sri Lanka estimates. Fitch sees the possibility of a surplus next year if oil retreats to below USD 100. The exchange-rate outlook is relatively balanced: the Central Bank and IMF assessments consider the currency broadly consistent with fundamentals, while other estimates by local market analysts expect USDLKR to depreciate by around 3-4% by year-end, followed by stabilisation. At the same time, emigration has coincided with stronger remittance inflows. Remittances are expected to reach roughly USD 9bn in 2026, compared with a pre-crisis norm near USD 6bn. The more recent pickup has reflected the formalisation of remittance flows, also in part due to re-routing through digital platforms. The consensus is that remittance growth will stabilise rather than continue accelerating at the current pace.

The Port of Colombo has benefited from rerouted shipping and its important position on East-West trade routes, including transshipment to other regional economies, providing an offset but not eliminating broader external vulnerabilities. Further growth in logistics will depend in part on investment and port facility liberalisation. Tourism receipts are also expected to continue rising, supported by regional visitors and European travellers seeking alternatives to the Middle East, while tourism from China and Southeast Asia has not yet picked up. A global tourism promotion campaign is planned for 2027.

The external outlook remains vulnerable to imported fuel costs and regional disruption. A prolonged Strait of Hormuz disruption or re-escalation in the Iran conflict could pose significant downward pressure on the current account through depressed tourism and increased costs related to tourism-sector imports and elevated energy prices. El Niño is another key risk, although local business representatives and forecasters consider the country better prepared compared to the El Niño shock in 2016-17: planting has begun on an accelerated schedule and no material hit to this year's agriculture performance is expected. Drought and crop-flooding risks may be more relevant in 2027.

	2027F	2026F	2025	2024	2023	2012 - 2022
Real GDP (% annual percent change)	4.0%	4.0%	5.0%	5.0%	-2.0%	2.6%
Inflation (% annual percent change)	5.3%	5.3%	-0.5%	1.2%	17.4%	8.6%
Overall Fiscal Balance (% of GDP)	-4.2%	-4.2%	-2.3%	-5.4%	-8.3%	-7.4%
Government Debt (% of GDP)	95.2%	95.2%	96.8%	100.2%	109.9%	82.9%
Current Account (% of GDP)	-0.5%	-0.5%	1.6%	1.2%	1.7%	-2.7%
Import Cover	3.5*	3.5*	3.5	3.6	3.0	4.2

*Latest value that exists for Import Cover
Sources: Aktia, IMF and Macrobond

Sri Lanka

Fiscal performance has been strong, with economists estimating a primary surplus of around 7% during the first half of 2026, alongside improving revenue. The government reports that the digitalisation of tax registration and improved confidence in the new tax system have increased net revenue by about LKR 20bn (USD ~60m) per month. Fitch estimates that the Treasury has built a domestic cash buffer of roughly LKR 1tn (USD ~3bn), giving it room to absorb shocks as private-sector credit expands and the government rolls over existing debt obligations. The authorities are also seeking to improve spending practices by phasing out untargeted subsidies in favour of targeted support and by not extending the temporary diesel subsidy into 2027. These gains remain somewhat vulnerable to political factors and election-cycle spending pressures, with the next election expected in 2028, as well as delays in capital spending and reforms.

Energy sector sustainability remains a key structural constraint. Costs are among the highest in South Asia, raising expenditures for households and businesses, and constraining the expansion in energy-intensive sectors such as IT services. Cost-reflective pricing, the successful restructuring and unbundling of the Ceylon Electricity Board (CEB), and faster renewable-energy investment are widely identified as policy priorities for the government. A USD 40m World Bank payment-guarantee facility exists as a backstop designed to de-risk payment obligations from the CEB but remains unused. Coal-quality problems also increased reliance on more expensive diesel generation in April and May, adding to inflationary pressures, but the issue has since been resolved. Solar and hydro account for a large proportion of energy supply, but further investments in transmission require greater policy predictability and improved coordination and implementation.

The relationship with the IMF after the current four-year EFF concludes in Q1 2027 is a looming area of uncertainty. A new funded programme would require establishing a balance-of-payments financing gap, which Sri Lanka has effectively resolved under the current programme; alternative modalities of collaborations are in the form of a precautionary arrangement, technical support and/or another non-funded framework. Views are divided: many large corporates favour a new programme, the government is still undecided, and the opposition considers a fully funded programme less likely while favouring continued IMF engagement as a policy anchor. Fitch sees a precautionary arrangement as plausible, while the World Bank has warned that the decision is being left too late. A sustained oil shock combined with severe El Niño effects would increase the likelihood of renewed balance-of-payments and fiscal pressure, increasing the justification for a funded programme. The broader challenge is to preserve fiscal discipline and reform momentum while moving beyond crisis stabilisation towards higher investment and productivity.

Our View: In our Frontier Local Currency strategy, we have a small position in Sri Lanka. Decisive policy action by the government, strong fiscal performance and improving external fundamentals and improving external buffers have supported post-crisis recovery. However, external vulnerabilities and transition beyond the current IMF programme remain important tests of policy credibility and reform momentum, arguing for keeping position size modest. Our Hard Currency strategy does not currently have a position in Sri Lanka.

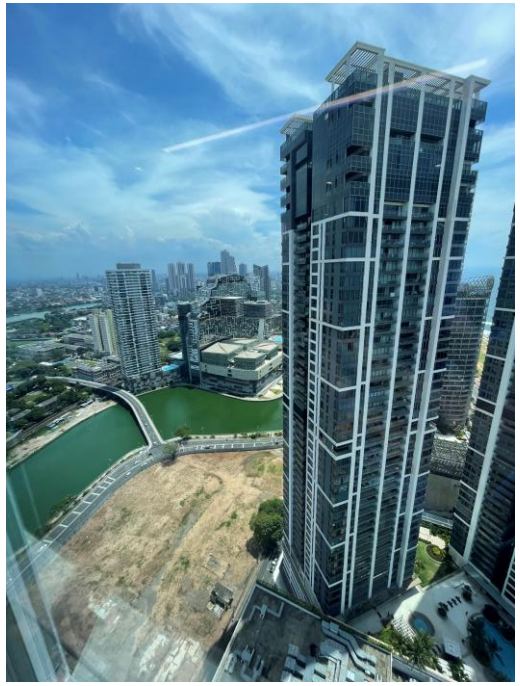


Photo: Galle Face, World Bank, Colombo, Sri Lanka

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