5 Fiscal Developments

5.1 Overview

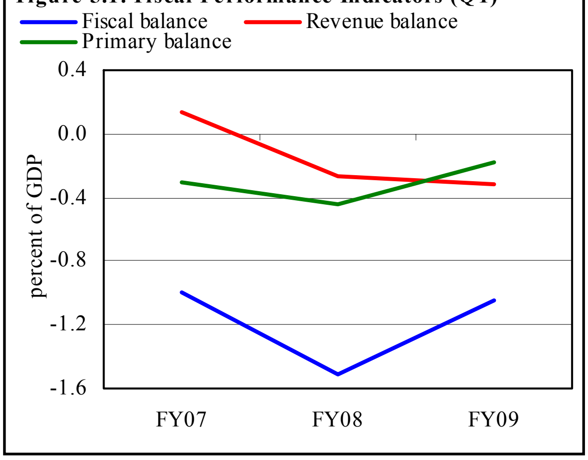
The large fiscal deficit in FY08, and the adverse economic consequences of its financing from SBP, placed fiscal consolidation at the top of government's macroeconomic stabilization agenda for FY09. The fiscal consolidation program of the government for FY09 consists of (1) substantial reduction in overall budget deficit, as a percent of GDP, through a mix of cut in expenditures (as a share of GDP) and a rise in tax revenues (as a share of GDP), and (2) a gradual elimination of government budgetary borrowings from SBP.

Not surprisingly, the Q1-FY09 fiscal performance improved consequent to the policy shift, with the overall fiscal deficit estimated to have dropped to 1 percent of annual GDP. This is consistent with the annual fiscal deficit target set under the IMF stabilization program. The fiscal improvement in Q1-FY09 has largely based on reduction of oil subsidies and a cut in development spending. This is understandable since (1) any meaningful effort to expand revenues (particularly by broadening the tax base) will only work in an extended time frame, and (2) given fiscal rigidities in current expenditures (especially interest payments) the gains will not be available in the short term. In the medium term, fiscal reforms will enable both discipline in non-development expenditures and a larger revenue base that will allow for necessary fiscal space to ensure appropriate level of public spending on social and infrastructure projects in the future. It is precisely in this context that the macroeconomic stabilization program being approved by IMF has specific conditionalities on fiscal performance.

5.2 Fiscal Performance Indicators

After sizeable slippage in FY08, overall fiscal balance showed quantitative recovery in first quarter of FY09 (see **Figure 5.1**). Primary deficit, as a share of GDP, declined to 0.2 percent in Q1-FY09 from 0.4 percent in the corresponding period last year indicating a deceleration

Figure 5.1: Fiscal Performance Indicators (Q1)



in growth of interest payments.

Table 5.1: Summary of Consolidated Public Finance During Jul-Sep
billion Rupees

	Jul-Sep				YoY change (%)	
	FY06	**FY07**	**FY08**	**FY09**	**FY08**	**FY09**
Total revenue	236.6	255.7	312.6	385.0	22.3	23.1
Tax revenue	158.4	191.6	215.6	276.8	12.5	28.4
Non-tax revenue	78.1	64.1	97.0	108.1	51.5	11.5
Total Expenditure	274.3	342.4	470.7	524.4	37.5	11.4
Current	219.8	244.2	340.0	427.8	39.2	25.8
Development and net lending	50.6	65.2	112.9	40.7	73.3	-64.0
Unidentified expenditure	3.9	33.0	17.8	55.9	-46.3	215.1
Budget deficit	-37.7	-86.7	-158.1	-139.5	82.3	-11.8
As percent of GDP						
Total revenue	3.1	2.9	3.0	2.9	--	--
Tax revenue	2.1	2.2	2.1	2.1	--	--
Non-tax revenue	1.0	0.7	0.9	0.8	--	--
Total Expenditure	3.6	3.9	4.5	3.9	--	--
Current	2.9	2.8	3.2	3.2	--	--
Development and net lending	0.7	0.7	1.1	0.3	--	--
Unidentified expenditure	0.1	0.4	0.2	0.4	--	--
Budget deficit	-0.5	-1.0	-1.5	-1.0	--	--

Source: Ministry of Finance

The reduction in fiscal deficit in Q1-FY09 was brought about mainly by a drastic cut in development expenditures. This is also confirmed by further deterioration of revenue balance for Q1-FY09 despite an impressive growth of 23.1 percent in total revenues during the quarter. This deterioration in the revenue balance could be understated. Q1-FY09 has seen a large increase in "unidentified" spending. Thus the deterioration would be even greater if a part Rs 55 billion in "unidentified expenditure" recorded for the quarter pertains to current spending.

5.3 Revenues

First-quarter total revenues posted an impressive YoY growth for the second consecutive year. Specifically, total revenues rose to Rs 385.0 billion, registering YoY growth of 23.1 percent during Q1-FY09 as compared to 22.3 percent growth in Q1-FY08 (see **Table 5.1**). However, the contribution to growth in total revenues in Q1-FY09 saw a reversal from that of Q1-FY08. In particular, the strong rise in total revenues during Q1-FY09 is mainly due to substantial rise in tax revenues which offset the impact of a deceleration in the growth of non-tax revenues.

Tax revenues in Q1-FY09 stood at Rs 276.8 billion, with a YoY increase of 28.4 percent compared to 12.5 percent rise in Q1-FY08. The acceleration in tax revenues is largely on account of substantial receipts from indirect taxes, which surpassed the target for Q1-FY09. In particular, receipts from taxes on goods and services increased by Rs 38.6 billion in Q1-FY09, registering a growth of 39.4 percent YoY compared to 18.9 percent YoY in Q1-FY08. This large addition to tax revenues was caused by (1) raise in the rate of sales tax from 15 percent to 16 percent, (2) inflated tax base of POL products and natural gas due to realignment of market prices, (3) enhancement of rate of FED on cement, and banking, insurance and franchise services.

Also, taxes on international trade experienced robust growth during Q1-FY09 as a result of strong growth in the rupee value of imports, which in turn was triggered by higher international commodity prices and a steep depreciation of the rupee. In addition, duty rates on many non-essential items were raised up to 35 percent.

The growth in non-tax revenues witnessed a big deceleration in Q1-FY09, despite large inflows on account of logistic support reimbursements. The decline in interest income as well as transfer of SBP profits were the major factors behind the decline in growth of non-tax revenues during Q1-FY09. However, decline in growth of non-tax revenues during Q1-FY09 is not necessarily meaningful on a full year basis, as it may simply represent changes in timing of receipts. For example, SBP passed on Rs 28 billion to the government in Q1-FY09 compared to Rs 47.3 billion transferred in Q1-FY08. Given the unprecedented government borrowings from the central bank, receipts from transfer of annual SBP profits are expected to be strong, with corresponding impact on annual transfers to the government. Furthermore, petroleum surcharge for Q1-FY09 is not comparable to corresponding receipts in previous years as the latter also included the amount realized on account of discount retained on crude oil (see **Table 5.2**). Adjusting previous definition, to keep this figure comparable, it is seen that petroleum surcharge revenues show an increase of 43 percent YoY in Q1-FY09. The growth in these receipts could be stronger in the remaining months of FY09 if the benefit of decline in international oil prices is passed on to domestic consumers with lags.

5.4 Expenditures

Growth in consolidated public expenditure decelerated in Q1-FY09 as development spending experienced a 64.1 percent decline. Consequently, as a share of GDP, development expenditures dropped to 0.3 percent in Q1-FY09 (the lowest level of spending in preceding seven years) compared to 1.1 percent in Q1-FY08. Meanwhile current expenditures grew by 25.8 percent YoY in Q1-FY09 compared to 39.2 percent YoY in Q1-FY08. However, the apparent deceleration

Table 5.2: Composition of Tax and Non-tax Revenues (Jul-Sep)
billion Rupees

	Jul-Sep			YoY change (%)	
	FY07	**FY08**	**FY09**	**FY08**	**FY09**
Tax revenues	**191.6**	**215.6**	**276.8**	**12.5**	**28.4**
Direct taxes	70.2	79.2	89.7	12.8	13.3
Taxes on property	1.5	1.0	1.8	-31.2	73.1
Taxes on goods and services	82.4	98.0	136.6	18.9	39.4
Taxes on international trade	27.9	29.1	38.2	4.5	31.0
Other taxes	9.6	8.2	10.5	-14.0	28.2
Non-tax revenues	**64.1**	**97.0**	**108.1**	**51.5**	**11.5**
Profits from PTA/Post Office Dept	0.1	0.0	0.0	-70.0	120.0
Interest (PSE and others)	3.2	12.6	1.6	294.2	-87.1
Dividends	15.7	2.0	9.5	-87.2	372.2
SBP profits	15.0	47.3	28.0	215.3	-40.8
Defence	0.6	1.3	29.2	126.4	2070.2
Surcharges	13.6	8.8	8.2	-35.3	-6.6
Petroleum	7.6	4.2	1.8	-45.1	-55.6
Gas	6.0	4.6	6.4	-22.9	37.4
Discount retained on crude oil	--	--	4.1	--	--
Royalty on oil/gas	6.9	11.3	10.4	62.7	-7.8
Others	9.0	13.7	17.1	51.9	24.7
Total Revenue	**255.7**	**312.6**	**385.0**	**22.3**	**23.1**

Source: Ministry of Finance

in growth of current expenditures during Q1-FY09 could be deceptive. The correct position cannot be ascertained precisely due to the large unidentified expenditures. If these are correctly part of current spending, then the seeming lower growth reverses to 35.2 percent YoY increase (see **Table 5.3**). In any case, Q1-FY09 current expenditure growth is quite strong and needs to be brought down for sustained fiscal consolidation.

The continued strong rise in current expenditure during Q1-FY09 reflects (1) a surge in grants to non-government, (2) discharge of claims of oil refineries/OMCs, and (3) acceleration of defence expenditures probably on account of extended anti-terrorism operations of the armed forces.

Despite elimination of oil subsidies, unpaid claims from preceding months on account of oil price differential continued to exert considerable payment pressures on the current account of the budget, as reflected by the fact that spending under "economic affairs" almost doubled to Rs 50.6 billion in Q1-FY09. This amount

Table 5.3: Composition of Current Expenditures
billion Rupees

	Jul-Sep			YoY change (%)	
	FY07	FY08	FY09	FY08	FY09
Current expenditure	**244.2**	**340.0**	**427.8**	**39.2**	**25.8**
of which					
Interest payments	60.3	111.1	115.0	84.3	3.5
Domestic	49.1	98.5	101.0	100.7	2.5
Foreign	11.2	12.6	14.0	12.2	11.1
Grants (other than provinces)	9.7	7.7	15.8	-20.5	103.7
Defence	45.6	57.5	82.2	26.3	42.8
Economic affairs	7.9	25.6	50.6	222.7	97.7
Health	0.9	1.1	1.1	24.1	-0.2
Education affairs and services	3.7	5.0	5.3	34.8	6.3
Provincial	83.1	102.6	115.1	23.5	12.2
Memorandum item:					
Current expenditures (incl. unidentified expenses)	277.2	357.7	483.7	29.1	35.2

Source: Ministry of Finance

includes payment of Rs 40.8 billion to oil refineries/OMCs on account of outstanding price differential claims.

5.5 Financing

With net outflow on account of external financing in Q1-FY09, the government had to generate from domestic sources the full amount of budget deficit plus an additional Rs 27 million to cover net external outflows. In the absence of any receipts from privatization and a fall in non-bank resource mobilization, banking system met three-fourth of the Q1-FY09 financing requirement of the government (see **Table 5.4**).

Table 5.4: Sources of Financing
billion Rupees

	Jul-Sep				Percent share	
	FY06	FY07	FY08	FY09	FY08	FY09
Total financing of budget	**37.7**	**86.7**	**158.1**	**139.5**	**100.0**	**100.0**
External resources (net)	5.0	27.8	36.8	-0.0	23.3	0.0
Internal resources	32.7	58.9	121.3	139.5	76.7	100.0
Banking system	14.9	34.5	69.9	104.6	44.2	75.0
Non-bank	14.3	10.0	51.4	34.9	32.5	25.0
Privatization proceeds	3.5	14.4	--	--	--	--

Source: Ministry of Finance

5.6 FBR Tax Collection

The Federal Board of Revenue (FBR) surpassed its revenue target of Rs 413.2 billion for Jul-Nov FY09, despite a shortfall of Rs 12.3 billion in direct tax collections. This was made possible by above-target collection for all three components of indirect taxes (see **Table 5.5**). As a result, indirect taxes reached Rs 290.8 billion during Jul-Nov FY09; up by 28.3 percent YoY compared to a 13.4 percent YoY rise in the corresponding period last year.

Table 5.5: FBR Tax Collection

billion Rupees

	FY09 Target		Net Tax receipts (Jul-Nov)		FY09 receipts as % of		YoY change (%)	
	Annual	Jul-Nov	FY08	FY09	Annual target	Jul-Nov Target	FY08	FY09
Direct taxes	499.0	144.5	113.4	132.2	26.5	91.5	17.6	16.6
Indirect taxes	751.0	268.7	226.7	290.8	38.7	108.2	13.4	28.3
Sales tax	470.0	173.8	144.0	185.1	39.4	106.5	14.6	28.5
FED	112.0	41.2	31.7	44.2	39.4	107.2	27.0	39.2
Customs	169.0	53.7	50.9	61.6	36.4	114.6	3.6	20.9
Total taxes	**1250.0**	**413.2**	**340.1**	**423.0**	**33.8**	**102.4**	**14.8**	**24.4**

Source: FBR, Islamabad

Though welcome, the strong growth in indirect taxes should not be taken as an indication of higher tax buoyancy since a significant part of this increase was contributed by a rise in international commodity prices and steep depreciation of the Pakistani rupee. With recent declines in POL product prices and presence of considerable scope of further downward adjustment, the tax base, and, consequently, the tax receipts, could decelerate in remaining months of FY09. Furthermore, the deceleration in direct tax collection could intensify with possible declines in withholding tax receipts from contracts as a result of large cuts in development expenditures.

5.6.1 Direct Tax Collection

Growth in direct taxes decelerated marginally from 17.6 percent YoY during Jul-Nov FY08 to 16.6 percent YoY in comparable period during FY09. However, category-wise data on direct taxes, available for Jul-Sep FY09, reveal a substantial deceleration in advance tax payments in Q1-FY09. Specifically, advance taxes registered a growth of 13.2 percent YoY in Q1-FY09 compared to 21.6 percent increase in the corresponding period last year. Since advance tax is paid on the basis of self-assessed expected income within the PAYE regime, the deceleration in advance taxes could indicate weakening profitability of the corporate sector.

Collection on account of demand creation jumped to Rs 8.9 billion in Q1-FY09 reflecting a growth of 118 percent (see **Table 5.6**). The large increase in collection on demand and the fact that almost this entire rise was generated by current demand clearly indicates increased focus of FBR on audit and assessment of tax returns.

Table 5.6: Direct Tax Collection during Q1
billion Rupees

	Jul-Sep		Growth %	% Share in total (net)	
	FY08	FY09		FY08	FY09
Gross income tax	76.7	92.5	20.5	99.2	104.8
Collection on demand	4.1	8.9	118.0	5.3	10.1
Voluntary payments	30.3	31.8	5.0	39.1	36.0
Withholding taxes	42.3	51.7	22.3	54.7	58.6
Others	0.1	0.0	-60.2	0.1	0.0
Other direct taxes	4.6	1.6	-65.6	5.9	1.8
Gross direct taxes	81.3	94.1	15.7	105.1	106.6
Refunds	3.9	5.8	48.1	5.1	6.6
Net direct taxes	77.4	88.2	14.0	100.0	100.0

Source: FBR, Islamabad

Withholding tax receipts consolidated its share in net direct taxes from 54.7 percent in Q1-FY08 to 58.6 percent in Q1-FY09. In absolute terms Rs 51.7 billion were generated through withholding tax in Q1-FY09 against Rs 42.3 billion in the corresponding period of last year showing a robust growth of 22.3 percent (see **Table 5.7**). Major heads contributing to withholding tax receipts were contracts (Rs 17.2 (up 23.3 percent), imports (Rs 8.0 billion, up 23.5 percent), and salaries (Rs 5.4 billion, up 26.2 percent). Furthermore, the relative contribution of various components to total withholding taxes in Q1-FY09 has remained largely unchanged from that of Q1-FY08. With larger increases in withholding taxes as well as collection on demand, the share of voluntary payments in total direct taxes (net) during Q1-FY09 declined by 3.1 percentage points.

Table 5.7: Withholding Tax Collection during Q1
billion Rupees

	Jul-Sep			Growth %	
	FY07	FY08	FY09	FY08	FY09
Imports	6.8	6.4	8.0	-5.8	23.5
Salaries	3.2	4.3	5.4	34.4	26.2
Dividends	0.7	1.1	1.6	57.6	45.9
Securities	3.1	3.3	3.2	5.3	-1.4
Contracts	9.9	13.9	17.2	40.9	23.3
Exports	2.5	2.3	3.6	-7.1	54.6
Cash withdrawal from banks	1.0	1.3	2.2	33.3	71.0
Electricity bills	1.2	1.3	1.6	8.7	25.9
Telephone	2.8	4.4	4.9	57.9	12.8
Others	3.0	4.1	4.1	33.1	0.9
Withholding tax (gross)	**34.1**	**42.3**	**51.7**	**23.9**	**22.3**

Source: Federal Board of Revenue

5.6.2 Indirect Tax Collection

Indirect tax receipts surpassed the revenue target set for Jul-Nov FY09 with a wide margin of Rs 22.2 billion, offsetting the revenue shortfall in direct taxes for the period. In absolute terms, indirect taxes increased to Rs 290.8 billion during Jul-Nov FY09 against Rs 226.7 billion in the corresponding period last year, showing a growth of 28.3 percent. Relatively strong growth of indirect taxes along with the deceleration in direct taxes led to decline in share of direct taxes in total taxes.

The domestic component of indirect taxes recorded the strongest growth during first five months of FY09. Specifically, sales tax on domestically produced goods and services during Jul-Nov FY09 rose by 53.7 percent (see **Table 5.8**) while FED (domestic) increased by 43.6 percent during the same period. The exceptional growth in domestic share of indirect taxes during Jul-Nov FY09 is explained, in large part, by strong inflationary pressures in the economy, particularly the energy sector. Top ten contributors to sales tax (domestic) during first five months of FY09 reveal that the big increase is largely fed by collections from POL products (Rs 46.7 billion, up 267.4 percent), natural gas (Rs 6.1 billion, up 20.3 percent), and electrical energy (Rs 2.5 billion, up by 188.8 percent).

Table 5.8: Gross Sales Tax (Domestic): Top 10 Contributors

billion Rupees

	Jul-Nov		Growth %	Share in total	
	FY08	FY09		FY08	FY09
POL products	12.7	46.7	267.4	20.8	49.7
Telecommunications	18.2	19.1	4.8	29.8	20.3
Natural gas	5.1	6.1	20.3	8.3	6.5
Sugar	4.2	3.9	-7.4	6.8	4.1
Cigarettes	2.9	3.3	12.8	4.7	3.5
Electrical energy	0.9	2.5	188.8	1.4	2.6
Services	2.5	2.4	-2.1	4.1	2.6
Aerated waters/beverages	1.9	1.8	-5.5	3.2	1.9
Cement	1.4	1.3	-4.1	2.3	1.4
Tea	1.1	1.0	-5.2	1.8	1.1
Others	10.3	5.8	-43.4	16.9	6.2
Grand total	61.1	93.9	53.7	100.0	100.0

Source: FBR, Islamabad

Customs duty added Rs 61.6 billion to the national exchequer during Jul-Nov FY09, up by a healthy 20.9 percent compared to a mere 3.6 percent in the corresponding period last year.

Details of custom duty for Jul-Sep FY09 show that POL products were the major source of custom receipts, contributing Rs 7.6 billion in Q1-FY09 as compared to Rs 2.2 billion in Q1-FY08. Custom receipts on vehicle imports declined by 8.0 percent but these still form the second largest component of custom duties, adding Rs 5.7 billion in Q1-FY09 compared to Rs 6.2 billion in Q1-FY08. Other major sources of custom receipts during Q1-FY09 comprise of electrical machinery (Rs 4.1 billion), edible oil (Rs 3.5 billion), and iron and steel (Rs 3.4 billion).

Table 5.9: Summary of Consolidated Provincial Finance During Jul-Sep
billion Rupees

	Jul-Sep				YoY change (%)	
	FY06	**FY07**	**FY08**	**FY09**	**FY08**	**FY09**
Total revenue	**76.7**	**98.7**	**119.4**	**160.3**	**20.9**	**34.3**
Provincial share in federal revenue	55.2	78.5	90.9	124.4	15.7	36.9
Provincial taxes	8.9	9.8	9.5	12.6	-3.5	32.8
Property taxes	2.0	1.5	1.0	1.8	-31.2	73.1
Excise duties	0.5	0.5	0.6	0.6	25.0	-2.7
Stamp duties	2.3	2.4	2.7	2.6	14.8	-4.6
Motor vehicle tax	2.0	2.0	2.3	2.1	18.7	-9.2
Other	2.1	3.5	2.8	5.5	-20.5	98.2
Provincial non-tax	5.7	4.9	18.4	8.4	275.0	-54.0
Interest	0.0	0.0	9.5	0.0	52667	-99.9
Irrigation	0.5	0.5	0.5	0.4	13.3	-13.3
Others	5.2	4.4	8.3	8.0	88.6	-4.3
Federal loans and transfers/grants	6.8	5.4	0.7	14.8	-87.9	2159.1
Loans (net)	-0.7	-1.5	-7.3	1.5	384.7	-121.0
Grants	7.5	6.9	8.0	13.3	15.1	66.6
Total Expenditure	**90.4**	**111.7**	**167.8**	**140.1**	**50.2**	**-16.5**
Current expenditure	72.6	88.2	107.1	119.4	21.5	11.5
Interest payments to federal govt	5.7	5.1	4.4	4.2	-12.3	-4.2
Other current expenditure	67.0	83.1	102.6	115.1	23.5	12.2
Development expenditure	17.8	23.5	60.7	20.8	158.0	-65.8
Overall balance	**-13.8**	**-13.0**	**-48.4**	**20.1**	**272.9**	**-141.6**

Source: Ministry of Finance

5.7 Provincial Fiscal Operations

Provincial public finance exhibited a noticeable improvement during Q1-FY09 as total expenditures witnessed a sizeable decline accompanied by a large increase in revenue receipts (see **Table 5.9**). Consequently, overall balance in Q1-FY09 turned into Rs 20.1 billion surplus compared to a deficit of Rs 48.4 billion in Q1-FY08. However, the reversal from a sizeable deficit to a moderate surplus in overall balance carries certain costs as this was achieved with large decline in development expenditures across all the four provinces (see **Table 5.10**).

Table 5.10: Provincial Finance during Jul-Sep
billion Rs

	Punjab		Sindh		NWFP		Balochistan	
	FY08	FY09	FY08	FY09	FY08	FY09	FY08	FY09
Total revenue	**63.2**	**70.9**	**29.8**	**46.7**	**17.5**	**23.9**	**9.0**	**18.8**
Provincial share in Federal revenue	44.5	59.8	28.0	37.4	10.8	15.5	7.7	11.7
Provincial taxes	5.2	5.7	3.4	6.2	0.6	0.6	0.2	0.2
Provincial non-tax	12.9	3.7	1.6	0.8	3.5	3.5	0.3	0.4
Federal loans and transfers/grants	0.6	1.8	-3.3	2.2	2.6	4.3	0.7	6.5
Total Expenditure	**96.6**	**68.1**	**41.1**	**46.6**	**19.5**	**17.0**	**10.5**	**8.4**
Current expenditure	51.6	56.8	34.7	41.3	12.4	14.5	8.4	6.9
Development Expenditure	45.0	11.3	6.5	5.4	7.1	2.5	2.1	1.5
Overall balance	**-33.4**	**2.8**	**-11.4**	**0.0**	**-2.1**	**6.9**	**-1.6**	**10.4**

Source: Ministry of Finance

Federal tax assignments to provinces during Q1-FY09 rose by 36.9 percent against 15.7 percent in the corresponding period last year. The high growth in provincial share in federal revenues during Q1-FY09 was caused by larger divisible pool following strong growth in indirect taxes. Provincial non-tax receipts declined by Rs 10 billion in Q1-FY09, however, the fall in non-tax revenues was more than offset by Rs 14.1 billion rise in federal government loans and grants to the provinces.

5.8 Domestic Debt

Despite a decline in fiscal deficit in Q1-FY09, growth in domestic debt accelerated reflecting non-availability of financing through external sources. During Jul-Oct FY09, domestic debt increased by 6.3 percent (or Rs 205.1 billion); significantly higher than the 4.6 percent growth in the same period of the preceding year (see **Table 5.11**). Although the government raised substantial amount from long term instruments, short term debt continued to have the major share, ending up at 87.4 percent in total domestic debt in Jul-Oct

Table 5.11 : Key Developments of Domestic Debt
billion Rupees

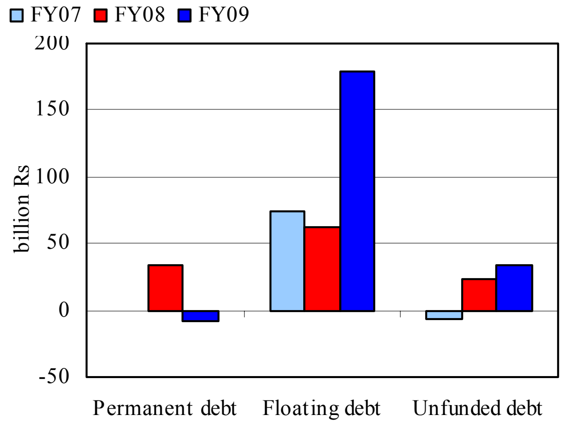
	Jul-Oct	
	FY08	FY09
Growth in domestic debt (percent; since June)	4.6	6.3
Contribution of LT debt	57.8	25.8
Contribution of ST debt	61.6	179.3
Addition to stock of domestic debt	119.4	205.1
Domestic debt stock outstanding (end-Oct)	2,720.0	3,471.2

FY09. The strong growth in short term debt is mainly due to heavy government borrowings from the central bank.

Components of Domestic Debt

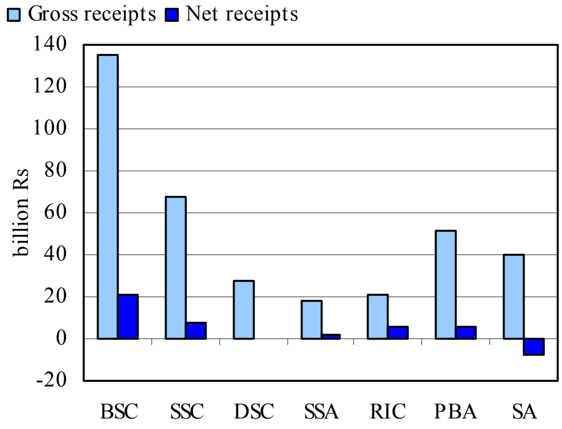
The sharp rise in domestic debt during Jul-Oct FY09 was mainly contributed by a large increase in floating debt (see **Figure 5.2**). On the other hand, the stock of permanent debt declined by 8.4 percent reflecting poor gross mobilization of funds through PIBs. In fact, gross receipts in PIBs during Jul-Oct FY09 were nearly one-fourth of the maturing stock of PIBs in the same period. The poor response by investors in PIB auction probably indicates their expectations of upward movement of the long term interest rates under tight monetary policy stance.

Figure5.2: Domestic Debt Outstanding (Jul-Oct)



Another important development within the permanent debt is the issuance of the Ijara Sukuk bond by the Government of Pakistan. Again, the government only succeeded in fetching Rs 6.5 billion against a target of Rs 10.0 billion through first auction of Ijara Sukuk bonds in mid-September 2008.

Figure 5.3: Gross & Net Receipts of NSS (Jul-Oct)



Unfunded debt witnessed a moderate growth of 3.3 percent in Jul-Oct FY09 compared to 2.5 percent in the corresponding period last year. However, the hefty rise in floating debt during Jul-Oct FY09 resulted in fall in the share of unfunded debt by three percentage points to

16.5 percent.

Despite significant gross receipts in major NSS instruments (see **Figure 5.3**), the aggregate outstanding stock of these instruments showed subdued growth reflecting sizeable repayments. Given that the government has increased interest rate twice on NSS instruments, the large inflows probably indicate (1) reinvestment of maturing amount to NSS instruments (2) switching within NSS instruments towards BSC and PBA because of their relatively attractive rates of return.

Table 5.12 Gross Receipts and Payments of T-bills (Jul-Oct)

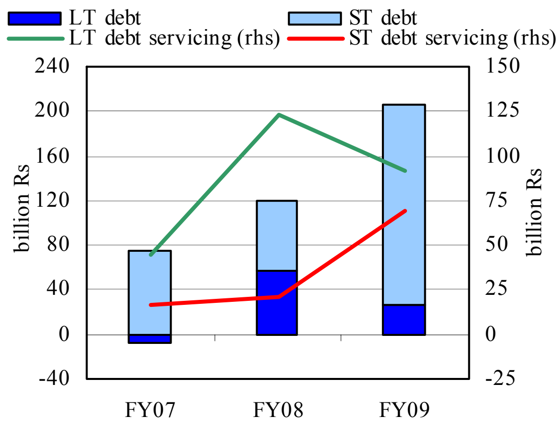
billion Rupees

	FY08		FY09	
	Gross Receipts	**Repayments**	**Gross Sales**	**Repayments**
MTBs	223.9	115.7	405.3	499.6
MRTBs*	229.7	276.3	750.5	482.9
Total	453.6	392.0	1,155.8	982.5

* MRTBs are used for replenishment and MTBs are issued in auction

The floating debt, comprising of zero coupon T-bills, increased by 10.9 percent in Jul-Oct FY09 as compared to a moderate increase of 5.6 percent in the corresponding period last year. Within floating debt, the stock of treasury bills with SBP ended up at Rs 1373.9 billion at end-October 2008 with net addition of Rs 321.3 billion during Jul-Oct FY09 (see **Table 5.12**). On the other hand the stock of T-bills with commercial banks reported a fall of Rs 94.3 billion, clearly reflecting the dependence of the government on central bank financing. It is hoped that the substantial increase in the policy rate in recent months would help the government to attract more liquidity from the commercial banks and to off load the existing stock of MRTBs to the market.

Figure 5.4: Domestic Debt Servicing (Jul-Oct)



Interest payments on domestic debt reached at Rs 160.9 billion in Jul-Oct FY09, registering a growth of 37.3 percent (see **Figure 5.4**). Despite a fall in the share in domestic debt servicing, the long term interest payments continue to have the largest share. In absolute terms, Rs 91.6 billion accounted for permanent and unfunded interest payments during Jul-Oct FY09. The cost incurred against maturing DSCs still constitutes a major share in the long-term debt servicing.

The share of interest payments on short term debt in total domestic debt servicing has increased significantly from 14.4 percent in Jul-Oct FY08 to 43.1 percent in Jul-Oct FY09. This seems to be consistent with the rising stock of the floating debt amid rising rate of financing from the central bank. However the substantial increase in the rate of return on the NSS instrument would increase the debt servicing cost of the government on unfunded debt in future.