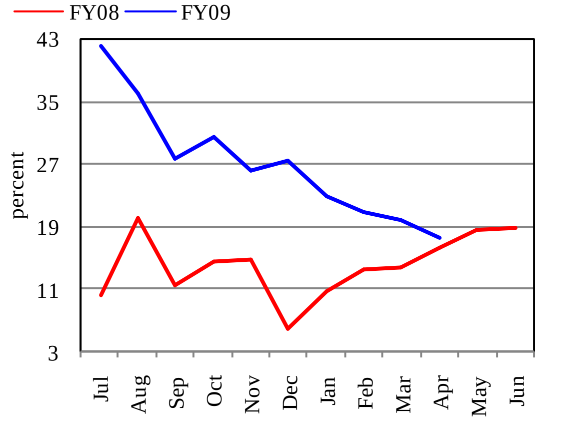
5 Fiscal Developments

5.1 Overview

Recent update on fiscal developments by Ministry of Finance[1] indicates that the budget deficit for Jul-Mar FY09, as a percentage of the estimated FY09 GDP, is likely to remain at 3.1 percent compared with 4.7 percent in the corresponding period of FY08. Though broadly consistent with the annual fiscal deficit target for FY09, the quality of this fiscal improvement can only be judged once consolidated fiscal accounts are released.

Even with limited information on fiscal operations during Jul-Mar FY09, a few observations warrant attention. First, in order to attain Rs 1.25 trillion tax collection (budget) target for FY09, FBR tax receipts will need to record a YoY growth of 24.1 percent by end-June 2009. Given the downtrend in growth of tax receipts (see **Figure 5.1**), achievement of tax revenue target for FY09 will be challenging. Second, government revenues during Jul-Mar FY09 are expected to have sustained the robust growth seen during H1-FY09 despite shortfall in FBR tax receipts. This is due to large inflows in non-tax revenues recorded in Q3-FY09. Specifically: (1) the government received Rs 63.3 billion in March 2009 under transfer of SBP surplus profit, making SBP profit transfer to the government a cumulative Rs 135.3 billion during Jul-Mar FY09; (2) the ongoing large differential in international and domestic oil prices provided further relief to the government; and (3) US$ 100 million were received on account of logistic support reimbursement during Q3-FY09.

Figure 5.1: YoY Growth in FBR Tax Collection (Cumulative)



[1] Review of Economic Situation (July-March 2008-09); released on MoF website (www.finance.gov.pk).

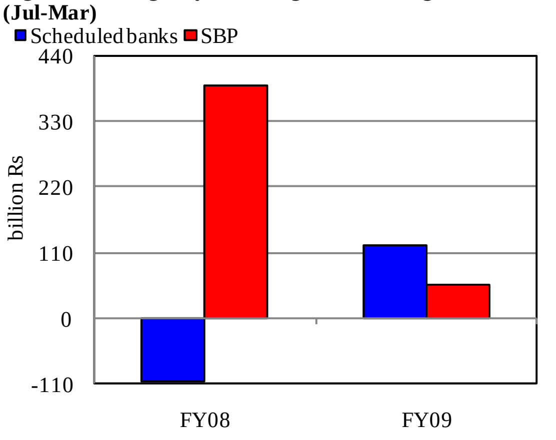
5.2 Domestic Budgetary Borrowings[2]

The aggregate government borrowing from domestic sources stood at Rs 353.0 billion during Jul-Mar FY09, which is significantly lower than the domestic budgetary requirements in the corresponding period of FY08. With apparent shortfall in external borrowing for budgetary support, the decline in budgetary borrowing from domestic sources in Jul-Mar FY09 reflects improvement in fiscal balance.

Financing from the Banking System

Net budgetary borrowing from the banking system was Rs 176.2 billion during Jul-Mar FY09 compared to Rs 283.1 billion in the same period last year. Moreover, the structure of budgetary financing from the banking system improved during Jul-Mar FY09 as reliance on borrowing from SBP was reduced substantially (see **Figure 5.2**).

Figure 5.2: Budgetary Financing from Banking Sector (Jul-Mar)



In particular, SBP provided Rs 55.7 billion for budgetary financing during Jul-Mar FY09 compared to Rs 390.9 billion during the same period of FY08. Analysis of government borrowing from SBP during the period under review shows that while Rs 174.7 billion were provided through issuance of new T-bills, large buildup of government deposits with the SBP reduced net financing from SBP.

Financing from the Non Banks

Non bank borrowing (net) rose by Rs 176.8 billion in Jul-Mar FY09, compared to moderate increase of Rs 109.4 billion in the corresponding period of the previous year. With sharp decline in bank financing during Jul-Mar FY09, non banks' share in domestic sources of budgetary financing saw a large boost.

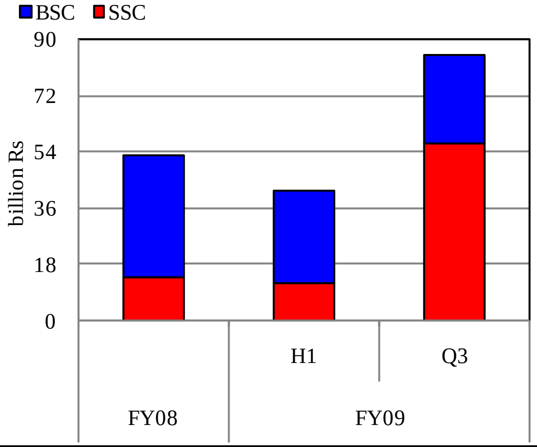
Disaggregation of nonbank financing shows that the government mobilized Rs 163.6 billion through NSS instruments during Jul-Mar FY09, which is

[2] Based on SBP calculation, the government borrowing numbers do consider the impact of government deposits with the banking system whereas the debt numbers do not. The government borrowing numbers reported here also exclude the impact of deposits and reserve fund under the non-bank financing.

substantially higher than Rs 67.4 billion borrowed during the corresponding period last year.

Interestingly, higher mobilization through NSS during Jul-Mar FY09 resulted from extraordinarily strong inflows in Q3-FY09. In particular, net investment in Behbood Saving Certificates (BSC) and Special Saving Certificates (SSC) increased by Rs 85.1 billion in Q3-FY09, which is even larger than the entire FY08 investment in these instruments (see **Figure 5.3**). While higher inflows in BSC during Q3-FY09 followed upward revision in its rate of return, the surprising rise in mobilization through SSC towards the end of March 2009 probably reflects institutional investment by one public sector organization on the expectation of immediate cut in the rate of return.

Figure 5.3: Net Flows through BSC & SSC



5.3 FBR Tax Collection

Indicators of tax performance suggest a likely shortfall in tax collection (budget) target for FY09. During Jul-Apr FY09, FBR tax receipts amounted to Rs 898.6 billion compared with Rs 763.6 billion in the same period last year, reflecting a YoY increase of 17.7 percent (see **Table 5.1**). Although the YoY growth in tax receipts during Jul-Apr FY09 is moderately higher than the 16.3 percent rise

Table 5.1: FBR Tax Collection (Jul-Apr)

billion Rupees

	Net collection			YoY change (%)		Percent of annual target		
	FY07	FY08	FY09	FY08	FY09	FY07	FY08	FY09
Direct taxes	25.9	284.6	332.5	12.5	16.9	95.5	70.3	66.6
Indirect taxes	403.6	479	566.1	18.7	18.2	70.8	77.3	75.4
Sales tax	245.8	293.7	358.9	19.5	22.2	71.5	78.3	76.4
FED	54.7	70.6	90.0	28.9	27.6	79.3	77.5	80.4
Customs	103.1	114.8	117.2	11.4	2.1	65.4	74.6	69.3
Total	**656.5**	**763.6**	**898.6**	**16.3**	**17.7**	**78.6**	**74.5**	**71.9**

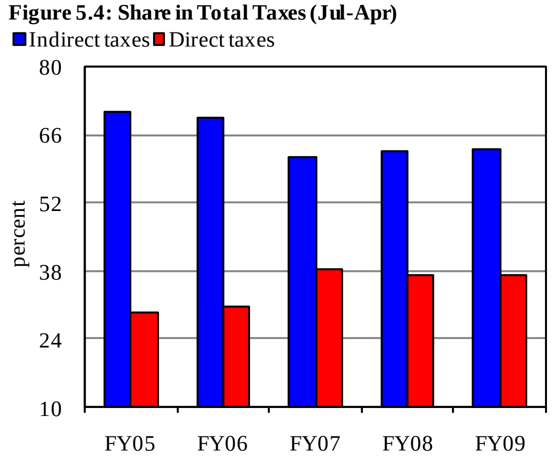
Source: Federal Board of Revenue

experienced in the corresponding period of FY08, monthly trend projects a deceleration in FBR tax collections for the entire fiscal year 2008-09 (see **Figure 5.1**). Even if FBR is able to arrest the downtrend in the growth of tax collection during the remaining months of FY09, the current pace of increase in tax receipts falls short of the 24.1 percent YoY growth required to attain Rs 1250 billion annual budget target for FY09.

As a percent of annual target, total tax collection stood at 71.9 percent by end April 2009. Importantly, 74.5 percent and 78.6 percent of the annual budget targets were achieved in the same period of FY08 and FY07 respectively. It merits mentioning here that the FBR tax collections fell short by Rs 17.8 billion in FY08. To still achieve FY09 target of Rs 1250 billion would require FBR to amass almost 28 percent of the target amount in the remaining two months; indicating that the revenue target for FY09 will be hard to achieve keeping in view the prevailing economic conditions in the country.

Direct tax collection increased by 16.9 percent YoY to reach Rs 332.5 billion during Jul-Apr FY09 against the FY09 annual budget target of Rs 499.0 billion. On the other hand, indirect taxes registered a growth of 18.2 percent during Jul-Apr FY09 compared to 18.7 percent in the same period last year. As a result, the rise in the share of indirect taxes in total tax receipts continued for the second consecutive year (see **Figure 5.4**).

Figure 5.4: Share in Total Taxes (Jul-Apr)



5.4 Domestic Debt

The stock of domestic debt rose by Rs 484.4 billion during Jul-Mar FY09 compared to Rs 433.0 billion in the corresponding period last year (see **Table 5.2**). The increase in absolute flows of domestic debt in Jul-Mar FY09 is despite a fall in government

Table 5.2 : Key Developments of Domestic Debt
billion Rupees

	Jul-Mar	
	FY08	**FY09**
Growth in domestic debt (percent)	16.7	14.8
Absolute	433.0	484.4
Of which		
Long term	111.5	198.3
Short term	321.6	286.1
Domestic debt stock (end-Mar)	3,033.7	3,750.5

budgetary borrowing from domestic sources during this period. The apparent disconnect is explained by strong buildup of government deposits due to large inflows from domestic as well as external sources.

Composition of Domestic Debt

With a net addition of Rs 44.0 billion, the outstanding stock of permanent debt went up by 7.2 percent in Jul-Mar FY09. The breakup analysis reveals that this rise stemmed largely from receipts from Ijara Sukuk bond (see **Table 5.3**). The government fetched Rs 27.8 billion through three successful auction of Ijara Sukuk Bond during Jul-Mar FY09. Although the government received Rs 25.9 billion through three PIB auctions during Jul-Mar FY09, huge repayments to the commercial banks on the matured stock of PIBs reduced net receipts to only Rs 9.7 billion.

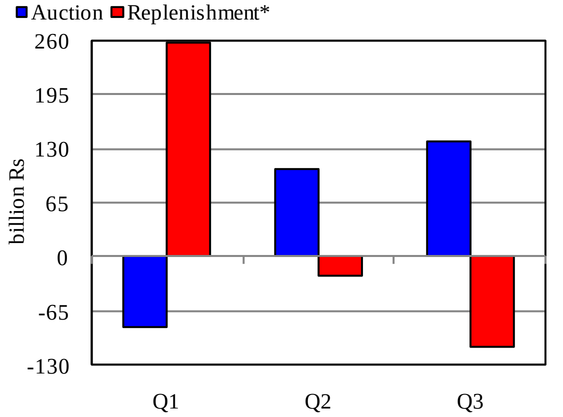
Table 5.3: Gross & Net Receipts of Major Permanent Debt Instruments (Jul-Mar)
billion Rupees

	FY08		FY09	
	Gross	Net	Gross	Net
PIB	68.8	57.5	25.9	9.7
Ijara sukuk	-	-	27.8	27.8
Prize bonds	78.5	8.7	75.8	7.0
Others	0.0	-11.9	0.0	-0.5
Total	147.4	54.3	129.5	44.0

Floating debt recorded a growth of 17.5 percent during Jul-Mar FY09 compared to 29.0 percent in the corresponding period last year. Deceleration in the growth of floating debt reflects the government's reduced reliance on the central bank for budgetary financing.

A notable development in floating debt is the shift in the ownership profile of the T-bills. The outstanding stock of T-bills (auction) increased by 29.6 percent in Jul-Mar FY09, as commercial banks' interest in government paper revitalized (see **Figure 5.5**). This preference for T-bills developed as increase in credit quality risks coupled with reduced demand for bank credit from the private sector produced a large decline in credit extended to the private sector. On the other hand, the stock of T-bills for replenishment went up by 11.5

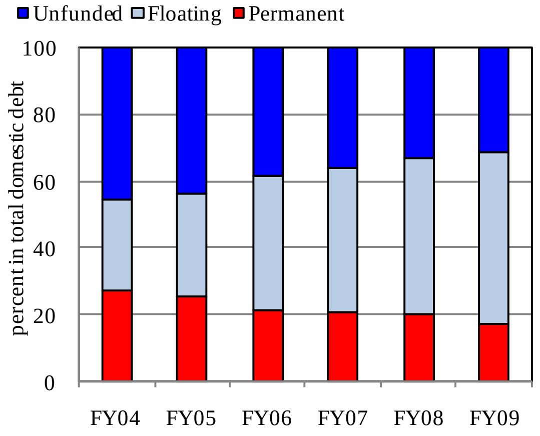
Figure 5.5: Net Flows through T-bills in FY09



*Inclusive of outright sale of MTBs to commercial banks percent in Jul-Mar FY09, compared to a rise of 87.1 percent in the same period of FY08.

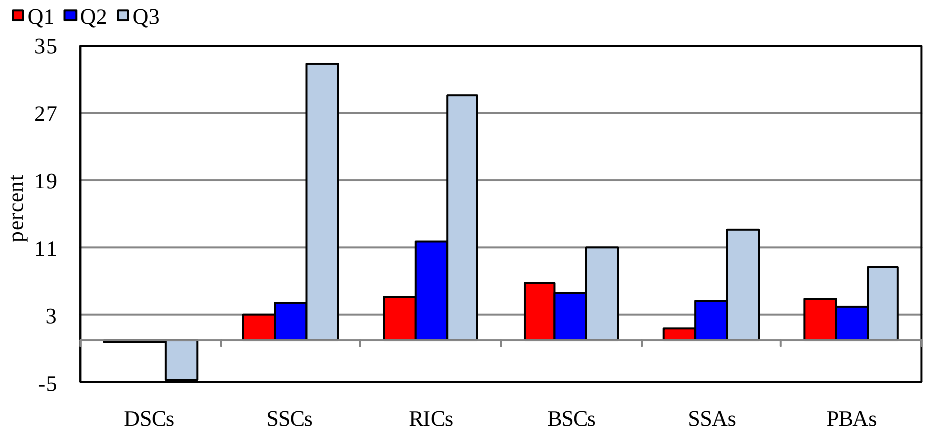
Even with a 11.5 percentage point decline in its growth, floating debt still represents the largest component in the stock of domestic debt as on March 31st 2009. Irregular and sparse issuance at the longer tenor has resulted in a persistent decline in the share of permanent debt, in total domestic debt, since FY04. Notably, the share of permanent debt declined to 17.4 percent as on end March 2009 compared to 20.0 percent a year earlier. Similarly, the share of unfunded debt in total domestic debt decreased by 1.6 percentage points, despite a sizeable growth of 15.1 percent during Jul-Mar FY09. Consequently, the share of floating debt in total domestic debt increased by 4.2 percentage points during Jul-Mar FY09 (see **Figure 5.6**).

Figure 5.6: Composition of Domestic Debt (end-Mar)



Quarterly growth in major NSS instruments reveal significant improvement in all but DSC since Q2-FY09 (see **Figure 5.7)**. Although gross sale of BSC was substantially higher in Jul-Mar FY09, huge repayments pushed back net

Figure 5.7: Quaterly Growth in Major NSS Instruments



investment from this instrument to a lower level. Net inflows through SSC remained unusually high in Q3-FY09 with net addition of Rs 39.6 billion in March 2009 alone. This exceptional increase probably reflects institutional investment by one public sector organization on the expectation of immediate cut in the rate of return.

Banks' increased willingness to finance government budgetary requirements coupled with the recent fall in interest rates on long term government paper has made possible for the federal government to cutback the profit rates on major NSS instruments by 70-140 basis points with effect from 1st April 2009 (see **Figure 5.8**).[3]

Figure 5.8: Rate of Return on Major NSS Instruments

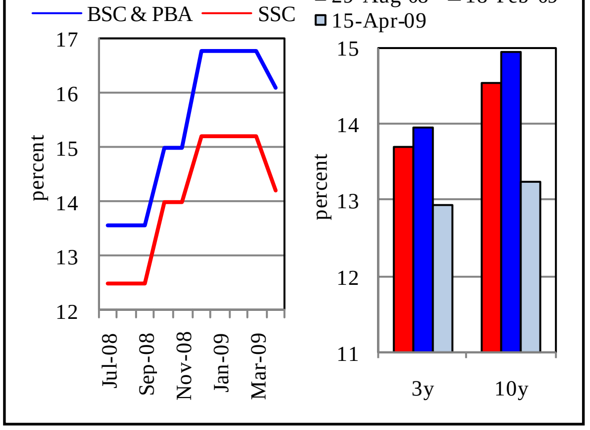
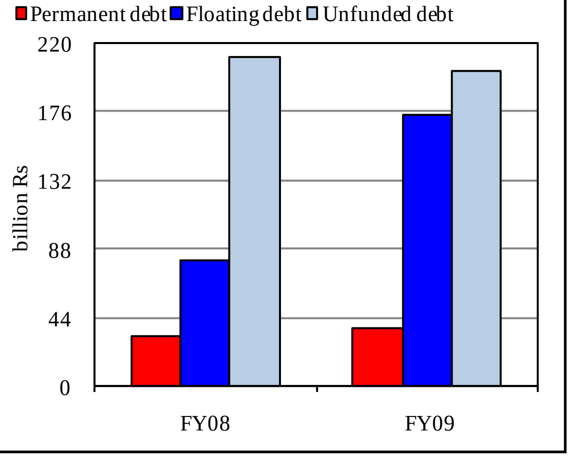


Figure 5.9: Domestic Debt Servicing (Jul-Mar)



Domestic Debt Servicing

During Jul-Mar FY09, debt servicing cost of the domestic debt increased by 27.2 percent YoY to reach Rs 412.2 billion. A break up of domestic debt servicing data shows that the servicing cost of the permanent debt has moved in tandem with its outstanding balance. The cost of unfunded debt still constitutes the single largest component in total domestic debt servicing (see **Figure 5.9**), even though its share has declined to 49 percent in Jul-Mar FY09 from 65.2 percent in the same period of FY08.

In contrast, the share of floating debt servicing in total domestic debt servicing jumped to 42.1 percent in Jul-Mar FY09 from 24.8 percent in the

[3] The tenor of BSC and PBA is ten year, while that of SSC is three year.

same period last year. This seems to be consistent with the rise in the stock of floating debt since FY08 coupled with the hikes in interest rates.