5 Fiscal Developments

5.1 Overview

As anticipated, key fiscal indicators improved in Q2-FY10 over the previous quarter bringing the cumulative fiscal deficit for H1-FY10 to 2.7 percent of annual estimated GDP (see **Table 5.1**). This figure is consistent with the SBP forecast of budget deficit for the year.

The improvement in revenue growth during Q2-FY10 is largely due to increased direct taxes collection. This was to be expected given that the traditional first quarter receipts had been pushed into the second quarter following the extension of the deadline for filing income tax returns. Moreover, tax collection was also helped by a revival in the economy and rise in rupee value of imports.

Table 5.1: Buildup of Fiscal Deficit

billion Rupees

	Jul-Sep		Oct-Dec	
	FY09	**FY10**	**FY09**	**FY10**
Total revenue	**385.0**	**427.3**	**449.5**	**482.7**
Tax revenue	278.7	298.8	328.2	360.4
Non-tax	106.3	128.5	121.3	122.3
Total expenditure	**522.8**	**650.9**	**561.1**	**662.2**
of which				
Current	456.1	521.0	463.1	537.6
Development & net lending	57.6	115.7	75.2	123.7
Budget deficit	**137.9**	**223.7**	**111.6**	**179.6**

Source: MoF

Note: Totals may not tally due to separate rounding off.

On the expenditure side, the government was able to contain the growth in total outlays during Q2-FY10. However, given the rigidities in current expenditure on account of the need to address the buildup of energy sector circular debt, security related expenditure etc, the government had little choice but to cut the development spending if pledges by FoDP are not realized and lags in reimbursement of Coalition Support Fund continues.

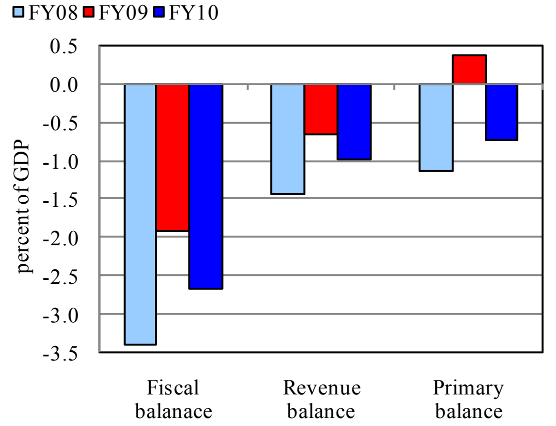
This weakness in expected external receipts is also reflected in the financing mix of budget deficit which is skewed towards domestic sources. Going forward, a fiscal pressure is expected to mount if proceeds from Coalition Support Fund and FoDP pledges are not realized.

Another concern on fiscal front is the increased volume of contingent liabilities issued by the government to the Public Sector Enterprises. In addition to the guarantees already issued to many PSEs, government is now issuing guarantees on TCP and PASSCO commodity financing loans. Such activities not only understate the volume of the public debt stock and pose a risk of increasing future liabilities but also potentially crowed out private investment.

5.2 Fiscal Performance Indicators

Although the fiscal performance during second quarter of FY10 was better than that in the first quarter, the overall fiscal position in H1-FY10 stands poor when compared with same period of the last year (see **Figure 5.1**). The large fiscal slippage in H1-FY10 resulted mainly from substantial increase in total expenditure, particularly power sector subsidies and security related expenses.

Figure 5.1: Fiscal Performance Indicators (Jul-Dec)



The deficit in the revenue balance,[1] as percent of annual estimated GDP has increased to 1.0 percent during H1-FY10 from 0.6 percent in H1-FY09. This reflects the inability of the government to finance capital expenditure from existing resources, as evident from recent cuts in the development expenditure. High revenue deficit during H1-FY10 is also against the target of a surplus FY08 onwards set under the Fiscal Responsibility and Debt Limitation Act (FRDL) 2005.

Primary balance[2] as percent of GDP turned into deficit of 0.7 percent in H1-FY10 from a surplus of 0.4 percent during H1-FY09. This reflects the viability of non-interest expenditure compared to total government's resource envelope, which could potentially lead to further increase in total debt stock.

[1] Revenue balance measures the saving capacity of the government and is calculated as the difference between total revenues and current expenditures.

[2] Primary balance helps assess the sustainability of the fiscal deficit. It highlights the *current* discretionary budgetary stance by excluding the impact of interest payments (that are caused by past policies).

5.3 Revenue

Total revenue in H1-FY10 stood at Rs 909.9 billion; with a YoY increase of 9.0 percent compared to 33.4 percent rise in H1-FY09 (see **Table5.2**). The deceleration in total revenue stemmed from lower growth both in tax revenue and non-tax revenue collection. A compositional analysis of the growth in total revenue shows that tax revenue contributed 6.3 percentage points with remaining being contributed by non-tax revenue collection.

Table 5.2: Summary of Consolidated Public Finance
billion Rupees

	Jul-Dec				YoY change (%)	
	FY07	**FY08**	**FY09**	**FY10**	**FY09**	**FY10**
Total revenue	614.8	625.6	834.5	909.9	33.4	9.0
Tax revenue[3]	451.5	458.0	606.8	659.2	32.5	8.6
Non-tax revenue	163.3	167.5	227.6	250.7	35.9	10.1
Total expenditure	783.8	981.9	1083.9	1313.2	10.4	21.1
Current	581.4	775.1	919.2	1058.6	18.6	15.2
Development and net lending	147.9	225.8	132.8	239.4	-41.2	80.3
Unidentified expenditure	54.4	-18.9	31.9	15.1	-268.9	-52.7
Fiscal balance	-169.0	-356.3	-249.5	-403.3	-30.0	61.9
As percent of GDP[4]						
Total revenue	7.1	6.0	6.4	6.1		
Tax revenue	5.2	4.4	4.6	4.4		
Non-tax revenue	1.9	1.6	1.7	1.7		
Total expenditure	9.0	9.4	8.3	8.7		
Current	6.7	7.4	7.0	7.0		
Development and net lending	1.7	2.2	1.0	1.6		
Unidentified expenditure	0.6	-0.2	0.2	0.1		
Fiscal balance	-1.9	-3.4	-1.9	-2.7		
Primary balance	-0.2	-1.4	0.4	-0.7		
Revenue balance	0.4	-1.1	-0.6	-1.0		

Source: Ministry of Finance

Tax revenue during the period under review experienced deceleration largely due to weak growth in FBR tax collection compared to the previous year. Specifically, growth in tax revenue during H1-FY10 decelerated to 8.6 percent from 32.5

[3] Surcharges on POL are added in tax revenues and subtracted from non-tax revenues from FY07 to FY09,to make figures comparable.
[4] Revised nominal GDP is used for FY07 to FY09.

percent in the corresponding period a year earlier (see **Table5.3**). As a percentage of the budgeted target, tax revenue reached only 43.5 percent during H1-FY10 compared to 51.0 percent a year earlier.

Table 5.3: Composition of Tax and Non-Tax Revenue
billion Rupees

	Jul-Sep		Oct-Dec		Jul-Dec		Difference (Jul-Dec)	
	FY09	FY10	FY09	FY10	FY09	FY10	FY09	FY10
Tax Revenue	**278.7**	**298.8**	**328.2**	**360.4**	**606.8**	**659.2**	**148.8**	**52.4**
Direct taxes	89.7	84.1	121.1	127.3	210.8	211.4	46.4	0.6
Taxes on property	1.8	1.7	0.7	1.2	2.5	2.8	0.5	0.3
Taxes on goods and services	136.6	146.1	136.0	155.1	272.6	301.2	65.4	28.6
Taxes on international trade	38.2	33.1	35.3	38.2	73.4	71.2	11.9	-2.2
Petroleum levy	1.8	24.1	27.0	27.8	28.8	51.9	21.5	23.0
Other taxes	10.5	9.9	8.1	10.8	18.7	20.7	3.0	2.0
Non-tax Revenue	**106.3**	**128.5**	**121.3**	**122.3**	**227.6**	**250.7**	**60.1**	**23.1**
Profit of PTA/PO	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest (PSE and others)	1.6	0.1	2.0	4.5	3.7	4.6	-11.2	1.0
Dividends	9.5	18.9	24.9	7.6	34.4	26.5	2.0	-7.8
SBP profits	28.0	70.0	43.9	65.0	71.9	135.0	24.6	63.1
Defence	29.2	1.9	1.0	1.3	30.2	3.2	27.9	-27.0
Development surcharges on gas	6.4	5.7	2.2	4.3	8.5	10.0	-3.6	1.5
Discount retained on crude oil	4.1	0.0	1.9	2.5	6.0	2.5	6.0	-3.5
Royalty on oil/gas	10.4	9.2	15.4	13.4	25.8	22.6	4.3	-3.2
Others	17.1	22.6	30.1	23.6	47.2	46.1	10.0	-1.0
Total revenue	**385.0**	**427.3**	**449.5**	**482.7**	**834.5**	**909.9**	**208.9**	**75.5**

Source: Ministry of Finance

Exceptional shortfall in direct tax collections and decline in the tax receipts from international trade during H1-FY10 largely translated into the deceleration in FBR taxes. The large deceleration in direct tax receipts is explained by decline in advance tax payments that highlight the fall in corporate earnings due to weak economic conditions. To increase the income tax collection, FBR allowed a 15 days relaxation in the last date of quarterly advance tax payment. The relaxation is valid till the third quarter of FY10. Also a greater number of tax payers failed to file the income tax statements till December 31, 2009; and the FBR had to announce an extension in the last date of filing income tax returns up to January 25, 2010. In the background of these measures taken by the FBR, an increase in direct tax collection is expected in the second half of FY10. Yet the entire shortfall may be hard to cover in the remaining months.

A large decline in the rupee value of imports, particularly that of POL products, machinery and mechanical appliances, and electrical machinery, translated into a decrease in collection from taxes on international trade compared to last year.

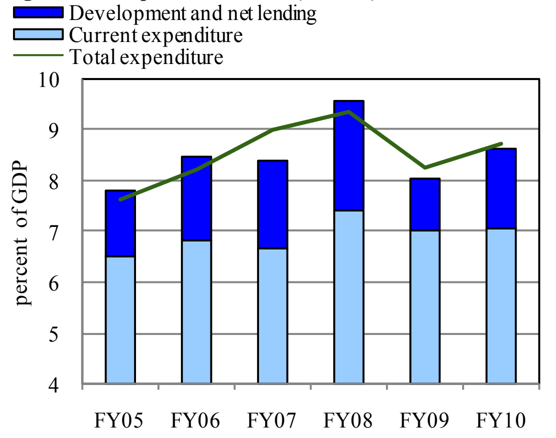
Although the tax collection from goods and services experienced a lower growth, it performed relatively better than other FBR tax heads during the period under review with an increase of Rs 28.6 billion in H1-FY10, up by 10.5 percent YoY compared to 31.6 percent YoY in H1-FY09. This growth is mainly attributed to: (a) increase in domestic sales tax collection under the heads of electrical energy, sugar, services, beverages and motor cars, (b) enhancement of rate of FED on cigarettes, advertisement, banking, insurance services and services provided by the stockbrokers during the budget FY10, and (c) increased tax collection from one percent special excise duty. A sharp increase in petroleum levy also helped raise revenue collection as it rose to Rs 51.9 billion during H1-FY10 compared with Rs 28.8 billion in H1-FY09 mainly due to increase in domestic consumption of high speed diesel (HSD), furnace oil and petrol in the period under review. It merits mentioning here that petroleum levy was imposed as fixed consumption tax from the start of the current fiscal year. Also, surcharges on POL have been replaced with petroleum levy and are now treated as part of tax revenue. Had petroleum levy not included in the tax revenue, net addition in tax revenue during H1-FY10 would stand at Rs 29.3 billion (5.1 percent YoY growth) instead of Rs 52.4 billion (8.6 percent YoY growth).

Non-tax revenue also decelerated by 10.1 percent during H1-FY10 compared to 35.9 percent growth during the corresponding period last year. The decline in revenue under the head of dividends and defense provided main reason for non-tax revenue to decelerate. The fall in dividends might be due to both lower earnings of public sector financial and non-financial institutions and a delay in dividend income receipts from these institutions. Decline in non-tax revenues under the head of defense largely reflect the holding back of reimbursements by the US for logistic support services provided by Pakistan to the coalition forces. The rise in transfer of SBP profits during H1-FY10, however, greatly helped the non-tax revenue to post a positive growth. Had the SBP contributed the same amount as it transferred to the government last year, the non-tax revenue would have declined by 17.6 percent YoY instead of increasing by 10.1 percent YoY.

5.4 Expenditure

Higher than expected security outlays and increase in the power sector subsidies[5] has produced significant acceleration in the growth of public expenditure during the first six months of FY10. Specifically, consolidated public sector expenditure rose to Rs 1313.2 billion during H1- FY10, up by 21.1 percent compared to 10.4 percent increase in the corresponding period last year. A further analysis shows that rise in total spending largely emanated from better growth in the development spending during H1-FY10. The strong growth in total spending has restored the increasing trend of total expenditure to GDP ratio, which saw a temporary reversal during FY09 (see **Figure 5.2**).

Figure 5.2: Expenditure Ratios (Jul-Dec)



Current expenditure increased to Rs 1058.6 billion during H1-FY10, reflecting a rise of 15.2 percent compared to 18.6 percent in the same period last year (see **Table 5.4**). This deceleration was mainly caused by decline in interest payments and expenditure under the '*economic affairs and services'* head. However, this decrease was largely compensated by high current spending owing to grants, subsidies and defense expenditure. The three heads combined constituted nearly 34.7 percent of total current expenditure during H1-FY10.

The break-up of current government expenditure data reveals that defense spending recorded 12.3 percent growth reaching Rs 166.0 billion during H1-FY10. This increase was mainly on account of continued military campaign in some northern areas of Pakistan. Similarly, spending under *other general public service* reached Rs 85.6 billion, up by 35.2 percent compared to 33.0 percent last year. The large outlay under this head was chiefly attributed to subsidy provided by government to power sector to offset the rising cost of the electricity tariff. Additionally, grants (other than provinces) increased by impressive 232.0 percent during H1-FY10, compared to a decline of 11.0 percent in the same period last

[5] These payments include partial settlements of tariff differential claims of the power sector build up in the previous years. It may be noted here that the government has increased the subsidy disbursement against the budgeted amount for FY10.

year. This increase was probably due to (a) non-receipts of the logistics support grants from the US; and (b) the grants extended to internally displaced persons (IDPs).

Table 5.4: Composition of Current Expenditure

billion Rupees

	Jul-Dec			YoY change (%)	
	FY08	**FY09**	**FY10**	**FY09**	**FY10**
Current expenditure	**775.1**	**919.2**	**1058.6**	**18.6**	**15.2**
of which					
Interest payments	237.7	299.7	294.2	26.1	-1.9
Domestic	208.8	265.8	262.0	27.3	-1.4
Foreign	28.9	33.9	32.2	17.2	-5.1
Grants (other than provinces)	45.2	40.3	133.7	-11.0	232.0
Other General Public Service	47.6	63.3	85.6	33.0	35.2
Defence	131.8	147.8	166.0	12.1	12.3
Economic affairs	50.9	74.5	21.8	46.2	-70.7
Health	2.7	2.3	2.8	-13.8	21.6
Education affairs and services	10.5	7.7	13.7	-26.9	78.0
Provincial	210.1	236.5	284.8	12.6	20.4

Source: Ministry of Finance

Given the rigidities in the current expenditure, especially defense, interest payments and the security related expenses, the government had to slash the development spending during H1-FY10. Although development spending increased by 69.6 percent during H1-FY10, this seems to be lagged behind the original budgeted amount for FY10. For instance, the total development spending incurred by the government during H1-FY10 constituted only 28.0 percent of the total development spending target set for FY10. Moreover, data on development spending suggest that cut in the development expenditure was largely undertaken by the federal government and the development spending by the provincial governments remained largely on track. Additionally, spending under *other development expenditure* head saw a large boost during H1-FY10. This increase was mainly driven by; (a) spending on support programs for poor initiated by the government; and (b) spending related to relief and rehabilitation of the IDPs.

5.5 Financing

With shortfall on account of budgeted external financing during H1-FY10, the government had to rely on additional financing from domestic sources to finance the budget deficit. Of the total financing requirement, approximately one-fourth was met through external resources compared to only 14.8 percent in H1-FY09 (see **Table 5.5**). Despite this apparent improvement, the net external financing constitutes only 35.3 percent of the annual target for FY10. This shortfall came from delays in the realization of the Tokyo pledges. However, a part of commitments under Tokyo pledges was covered by bridge financing[6] provided by the IMF, adding approximately Rs 93.2 billion in total gross external inflows. Furthermore, Rs 83.7 billion outflows on account of repayment of external debt left the net external financing to only Rs 110.3 billion during H1-FY10.

Table 5.5: Sources of Financing

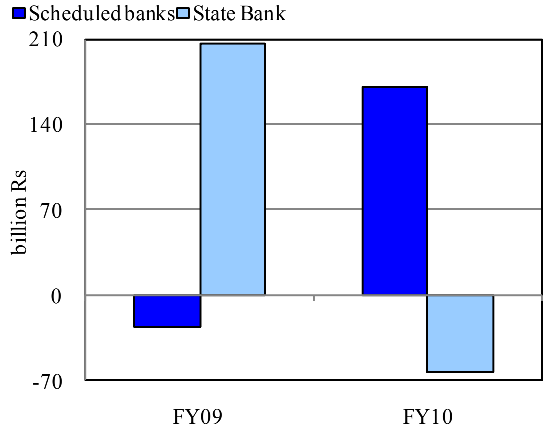
billion Rupees

	Jul-Dec			Growth (%)		Percent share[1]	
	FY08	FY09	FY10	FY09	FY10	FY09	FY10
Total financing of budget	356.3	249.5	403.3	-30.0	61.7	100.0	100.0
External resources (net)	68.0	37.0	110.3	-45.6	198.0	14.8	27.3
Internal resources (net)	288.3	212.5	293.0	-26.3	37.9	85.2	72.7
Banking system	228.6	181.0	107.2	-20.8	-40.8	(85.2)	(36.6)
Non-bank	58.0	30.2	185.8	-48.0	515.5	(14.2)	(63.4)
Privatization Proceeds	1.7	1.3		-21.8	-100.0	(0.6)	(0.0)

Source: Ministry of Finance

[1] Numbers in parenthesis represent share in internal source of financing.

Figure 5.3: Financing from Banking Sector (Jul-Dec)



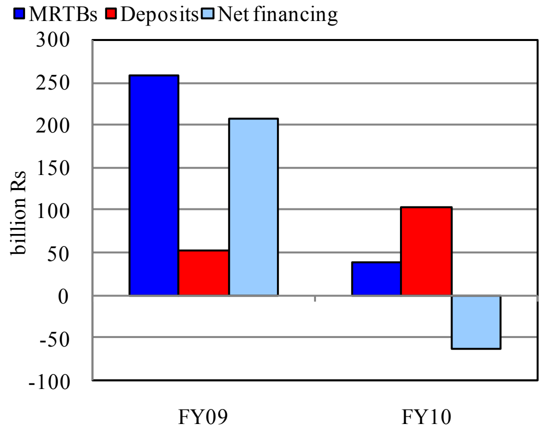
[6] Bridge financing is temporary financing and is used as a bridge to maintain liquidity while waiting for expected cash inflow.

Financing from the banking sector[7]

Budgetary financing availed from the banking sector declined by 40.8 percent YoY to Rs 107.2 billion in H1-FY10 (see **Figure5.3**). Scheduled banks remained the major source of deficit financing which provided Rs 171.0 billion, in contrast to a net retirement of Rs 25.6 billion during H1-FY09. This reflects the renewed interest of commercial banks in T-bill auctions in the falling interest rate scenario.

On the other hand, the government continued to retire its debt with the central bank to meet the limit imposed by the IMF under Stand-By Arrangement. Disaggregation of data shows that the government deposits with SBP (including other deposits) increased significantly by Rs 103.6 billion in H1-FY10 which has dropped the borrowings of Rs 39.8 billion through fresh MRTBs to a net retirement of Rs 63.9 billion during H1-FY10 (see **Figure 5.4**).

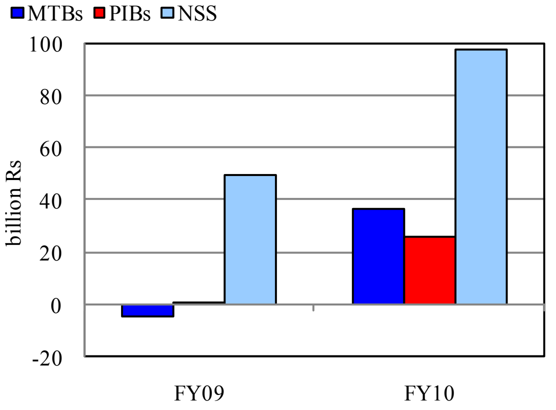
Figure 5.4: Financing from SBP (Jul-Dec)



Financing from the non-banks

Budgetary financing received from the non-banks increased to Rs 185.8 billion during H1-FY10 compared to only Rs 30.2 billion in the same period last year. NSS with Rs 98.8 billion was the largest contributor to the total non-bank financing (see **Figure 5.5**). Non-bank participation

Figure 5.5: Non-bank Investment in MTBs, PIBs and NSS (Jul-Dec)



[7] Budgetary financing from the banking system is worked out on cash basis and hence, these will differ from government borrowing numbers reported in the section on Money and Credit where data is measured on accrual basis.

in the budgetary financing through government securities also increased significantly during H1-FY10. This was possibly due to reduced availability of alternative investment opportunities to the non-bank financial institutions. In H1-FY10, financing received from PIBs increased to Rs 26.2 billion, while T-bills added Rs 36.8 billion in total non-bank financing against a net retirement in the same period last year.

Table 5.6: FBR Tax Collection (net) during (Jul-Dec)
billion Rupees

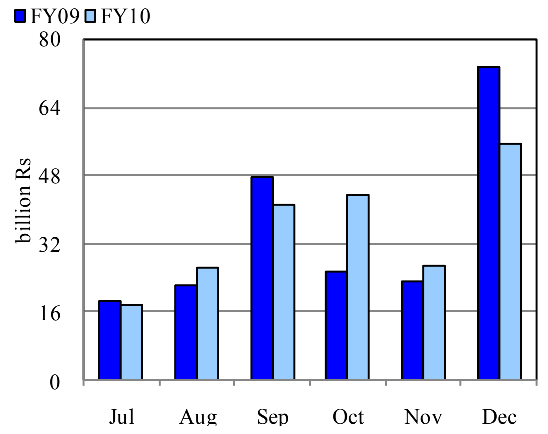
	Tax collection (net)		Absolute difference		Annual target		% of annual target achieved	
	FY09	**FY10**	**FY09**	**FY10**	**FY09**	**FY10**	**FY09**	**FY10**
Direct taxes	210.3	211.4	45.7	1.1	498.9	565.6	42.2	37.4
Indirect taxes	343.5	370.8	73.0	27.3	751.1	751.1	45.7	49.4
Sales tax	217.2	242.9	47.9	25.7	469.9	499.4	46.2	48.6
FED	53.6	56.7	14.0	3.1	112.0	152.8	47.8	37.1
Customs	72.8	71.2	11.1	-1.5	169.2	162.2	43.0	43.9
Total collection	**553.8**	**582.2**	**118.8**	**28.4**	**1,250.0**	**1,380.0**	**44.3**	**42.2**

Source: Federal Board of Revenue

5.6 FBR Tax Collection

The FBR tax collections rose by 5.1 percent during H1-FY10 compared to 27.3 percent increase in the same period last year (see **Table 5.6**). The growth was restricted largely due to decline in imports and shortfall in direct tax collection (see **Figure 5.6**).

Figure 5.6: Month -wise Collection of Direct Taxes



Out of the total growth of 5.1 percent, indirect tax collection accounted for 4.9 percentage points with the remaining being contributed by direct tax collection. The relatively better performance of indirect taxes is largely owed to the noticeable collection from the domestic source[8] which partially offset the effect of the decline in the rupee value of imports. Also the collection of indirect taxes up to the first

[8] The domestic source of the indirect taxes comprises collection of sales tax and federal excise duty from the domestic source.

half of the current fiscal year looks strong when viewed as a percent of the annual target.

To achieve the target FBR has to collect Rs 133 billion per month on the average in the remaining six months of the year.

5.7 Provincial Fiscal Operations

Notwithstanding a substantial rise in the total revenue, provincial public finances exhibited deterioration in the overall balance during H1-FY10. The overall balance of the provinces decreased by 39.4 percent during H1-FY10 compared to the same period last year.

Total revenue receipts of all provinces stood at Rs 385.5 billion, registering a growth of 18.1 percent during H1-FY10 against 14.4 percent last year (see **Table 5.7**). The sizeable increase in the growth of revenue receipts is mainly due to increase in transfer of grants by the federal government to the provinces. On the other hand, growth in federal tax assignment to the provinces observed a deceleration as expansion in divisible pool was restricted following slowdown in the growth of FBR taxes.

Table 5.7: Summary of Consolidated Provincial Finance (Jul-Dec)

billion Rupees

	Jul-Dec		
	FY08	**FY09**	**FY10**
Total revenue	**285.2**	**326.4**	**385.5**
Provincial share in federal revenue	187.4	250.6	284.8
Provincial taxes	18.2	22.0	23.7
Property taxes	2.0	2.5	2.8
Excise duties	1.3	1.5	1.6
Stamp duties	5.3	5.0	5.0
Motor Vehicle tax	3.9	3.5	4.4
Other	5.8	9.4	9.7
Provincial non-tax	34.2	24.7	21.4
Interest	9.8	0.1	0.1
Profits from hydro electricity	3.3	0.0	4.8
Irrigation	1.0	1.2	0.8
Others	20.2	23.5	15.6
Federal loans and transfers/grants	45.4	29.2	55.7
Loans (net)	3.7	1.8	5.8
Grants	16.3	19.2	35.5
Grant for dev. expenditure	25.4	8.2	14.3
Total expenditure	**322.4**	**294.4**	**366.1**
Current expenditure	218.3	245.0	293.2
Development Expenditure	104.2	49.4	72.9
Overall balance	**-37.2**	**32.1**	**19.4**

Source: Ministry of Finance

Total expenditure of the provinces rose strongly during H1-FY10, to reach Rs 366.1 billion from Rs 294.4 billion last year. The sharp rise in total expenditure was mainly brought about by acceleration in the growth of development expenditure during H1-FY10. The sudden increase in total expenditure resulted in a decline in overall balance of provinces to Rs 19.4 billion from Rs 32.1 billion in same period of FY09. Province wise details shows that while the other three provinces experienced surplus in their respective overall balance, Punjab recorded a deficit during H1-FY10 from surplus in the same period last year (see **Table 5.8**). The deficit in the overall balance of the Punjab government probably reflects spending on untargeted subsidy and aggressive commodity procurement operations. Despite significant increase in total expenditure of NWFP, the surplus in overall balance has deteriorated marginally during H1-FY10.This was mainly due to increase in the federal grants to NWFP for rehabilitation and relief of the IDPs during the period under discussion.

Table 5.8: Provincial Finance during Jul-Dec

billion Rs

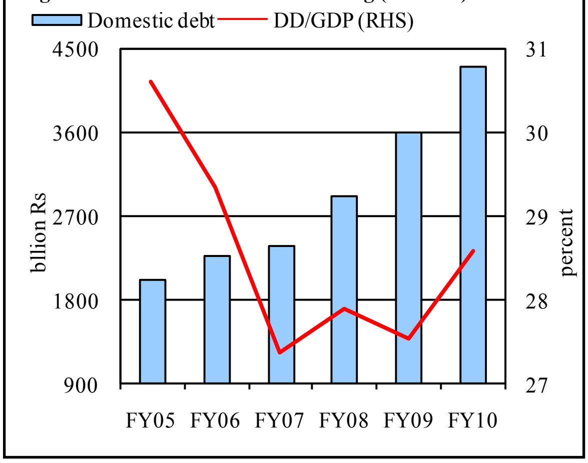
	Punjab		Sindh		NWFP		Balochistan	
	FY09	FY10	FY09	FY10	FY09	FY10	FY09	FY10
Total revenue	**159.8**	**162.5**	**89.9**	**107.9**	**43.3**	**75.2**	**32.8**	**39.8**
Provincial share in Federal revenue	124.0	143.0	76.7	86.6	31.4	34.7	18.5	20.5
Provincial taxes	10.2	12.1	10.4	10.0	1.1	1.2	0.3	0.4
Provincial non-tax	19.7	7.4	1.8	3.3	2.3	10.0	1.0	0.6
Federal loans and transfers/grants	6.0	0.0	1.0	8.1	8.6	29.3	13.9	18.3
Total expenditure	**148.2**	**188.0**	**94.0**	**103.2**	**29.1**	**62.1**	**22.3**	**25.3**
Current expenditure	120.2	141.7	83.1	90.6	23.5	50.4	18.2	23.0
Development Expenditure	28.0	46.3	11.0	12.6	5.6	11.7	4.1	2.3
Overall balance	**11.5**	**-25.5**	**-4.1**	**4.7**	**14.2**	**13.0**	**10.5**	**14.5**

Source: Ministry of Finance

5.8 Domestic Debt

Country's outstanding stock of domestic debt amounted to Rs 4.3 trillion at end-January 2010, up by 11.4 percent YoY compared to 10.4 percent in the same period last year, and an average growth of 6.4 percent during FY04-09 period. A sharp rise in domestic debt and a relative slowdown in nominal GDP

Figure 5.7: Domestic Debt Outstanding (end-Jan)



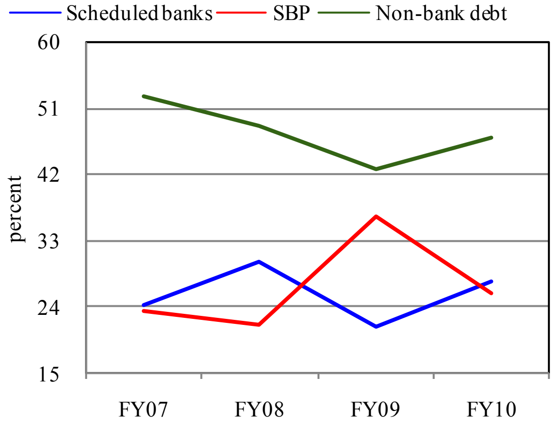
growth, resulted in rise in the domestic debt to GDP ratio to 28.5 percent by end-Jan FY10, which showed some recovery during FY09 (see **Figure 5.7**).

The rise in domestic debt is mainly attributed to net external financing due to (a) lower than expected disbursements of the pledged foreign financing (b) increase in the external debt repayments on maturing stocks of the foreign currency bonds.

Composition of Domestic Debt

A slightly higher than the projected fiscal deficit and the virtual halt with the budgeted external financing during H1-FY10 put pressure on the domestic source of financing to finance the budget deficit. Consequently, the structure of domestic debt changed significantly with increasing share of scheduled banks and non-bank debt in total domestic debt. Financing through non-bank sources, mainly comprising NSS remained almost in tandem with its budgetary estimates for FY10. With the cap on the borrowing from central bank agreed with IMF under SBA, the proportion of domestic debt held by scheduled banks increased significantly during the period under discussion. Even so, with the rise in the borrowings from scheduled banks during H1-FY10, the debt held by non-bank still constitutes a major share in the total domestic debt as on end-January 2010 (see **Figure 5.8**).

Figure 5.8: Share in Total Domestic Debt (end -Jan)



The outstanding stock of permanent debt went up by 10.2 percent during Jul-Jan FY10 compared to a rise of 0.1 percent a year earlier. Despite this acceleration, the share of the permanent debt in total domestic debt as on end January 2010 only recorded a marginal increase compared to the same period of last year.

Within the permanent debt, a major development was the introduction of first ever tradable National Saving Bond (NSB) in January 2010**.** The government was able to attract Rs 3.7 billion through NSB during January 2010. On the other hand, PIB retained its dominant share in outstanding stock of permanent debt by adding Rs 32.7 billion during Jul-Jan FY10 against a net retirement of Rs 12.5 billion in the same period last year (see **Table 5.9**). Additionally, mobilization through prize bonds also saw significant improvements during Jul-Jan FY10.

Floating debt rose by 13.7 percent during Jul-Jan FY10, compared to 16.3 percent in the corresponding period last year. The deceleration in the rise of floating debt is largely stemmed from heavy retirement of the government debt held by the central bank. In contrast, commercial banks' holding of T-bills increased by 32.4 percent in Jul-Jan FY10 compared to 12.2 percent increase during Jul-Jan FY09. Despite this increase during Jul-Jan FY10, government may have difficulty in mobilizing funds through commercial banks in the coming months, as the monthly flows through T-bills observed declining trend. Gradual fall in the net mobilization through T-bills was mainly due: (a) increase in demand for credit from private sector during Q2-FY10; and (b) slowdown in accumulation of Non-performing Loans (NPLs).

Table 5.9: Profile of Permanent Debt (Jul-Jan)
billion Rupees

	FY09		FY10	
	Net receipts	**Debt (end Jan)**	**Net receipts**	**Debt (end Jan)**
PIBs	-12.5	399.1	32.7	473.7
Ijara Sukuk	12.5	12.5	14.4	42.2
Prize bonds	0.7	183.5	19.2	216.7
NSB	--	--	3.7	3.7
Others	-0.1	13.9	-1.0	10.8
Total	0.6	609.0	69.0	747.1

Source: SBP

Unfunded debt showed an increase of 8.7 percent in Jul-Jan FY10 to reach Rs 110.0 billion from Rs 72.9 billion last year. The outstanding stock against major NSS instruments recorded positive growth except for DSCs which recorded a net retirements of Rs 32.4 billion during Jul-Jan FY10 (see **Table 5.10)**.

Table 5.10: Gross & Net Receipts of Major NSS Debt Instruments (Jul-Jan)
billion Rupees

	FY09		FY10	
	Gross	**Net**	**Gross**	**Net**
DSCs	45.2	-3.6	28.4	-32.2
SSCs	128.1	20.1	79.4	44.5
RICs	44.6	13.4	38.0	27.1
BSCs	257.4	38.4	55.6	35.1
SSAs	36.9	5.0	39.0	27.0
others	174.9	-0.3	105.6	8.6
Total	**687.0**	**72.9**	**346.1**	**110.0**

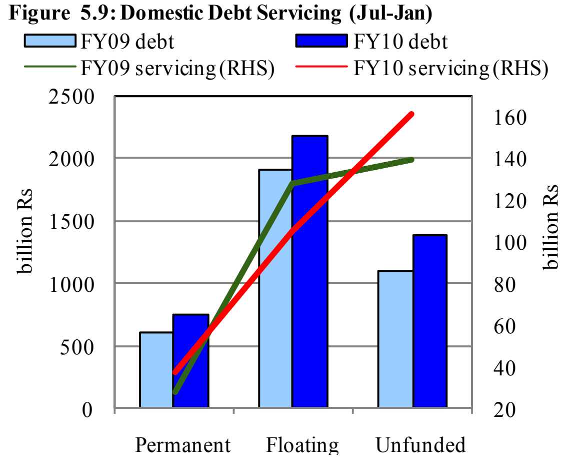
Source: Central Directorate of National Savings (CDNS)

Gross mobilization through NSS stood at Rs 346.1 billion during Jul-Jan FY10, almost half compared with the mobilization in Jul-Jan FY09. In fact, huge rise in the gross flows through NSS during Jul-Jan FY09 was based on the investor's efforts to lock in their funds at higher profit rates before any downward revision in the profit rates in the second half of the last fiscal year. Also the massive encashment to jump toward the higher profit rates further boosted the gross receipts and lowered the net receipts during Jul-Jan FY09.

Interest Payments on Domestic Debt

In Jul-Jan FY10 period, interest payments on domestic debt increased by 2.7 percent compared with a rise of 15.7 percent in the same period last year. The relative deceleration in the growth of interest payments on domestic debt is attributable to decline in the interest payments on the floating debt.

Figure 5.9: Domestic Debt Servicing (Jul-Jan)



The breakup of domestic debt servicing data reveals that interest payments on the permanent debt increased significantly during Jul-Jan FY10 compared to same period last year. This increase was largely due to interest payments on 10- year PIBs, in line with its increasing share in the total outstanding stock of PIBs. On the other hand, interest payment on floating debt fell down by 18.2 percent to reach Rs 104.7 billion during Jul-Jan FY10 (see **Figure 5.9**). Interest payment on the outstanding stock of MRTBS remained almost consistent with Jul-Jan FY09 level. However, fall in the interest payments on T-bills (auction) brought down the overall interest payment on floating debt compared to H1-FY09. This was mainly on account of increased participation of commercial banks in 12-months and lesser maturities of T-bills during Jul-Jan FY10, as the banks were reluctant to participate in the 12 months T-bills during the Jul-Jan FY09.

Debt servicing cost being incurred against matured stock of DSCs stood at Rs 97.7 billion during Jul-Jan FY10, which constitutes almost 60.4 percent of the total debt servicing cost on the unfunded debt. However it is pertinent to note here that the outflow in the form of interest payments on DSC is declining overtime. Also the debt servicing cost of Behbood Saving Certificates (BSC) and Special Saving Certificates (SSC) increased significantly in the period under discussion, as the major amount raised against these certificates was issued at significantly higher interest rates during FY09.