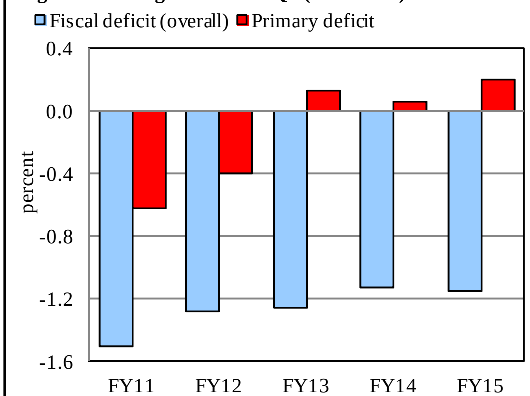
4 Fiscal Policy and Public Debt

4.1 Overview

The fiscal deficit increased slightly to 1.2 percent of GDP in Q1-FY15, from 1.1 percent in the same period last year. This increase came primarily from a rise in interest payments, reflecting a higher volume of PIBs in the government's resource mobilization during the last three quarters.[1] Otherwise, the primary balance has shown a surplus in Q1-FY15, which was even larger than that in Q1-FY14 (**Figure 4.1**).

Figure 4.1: Budget Deficits in Q1 (% of GDP)



Source: Ministry of Finance

The growth in non-interest expenditures was contained to 5.2 percent in the first quarter of FY15, compared with 28.4 percent in Q1-FY14. On the revenue side, the growth in total revenues declined to 1.2 percent, as some one-off factors that increased non-tax collection last year, were not available this year (**Table 4.1**).[2] Excluding these inflows, the growth in total revenues increases to 8.4 percent in Q1-FY15 (see **Section 4.2** for further detail).

Thus, in view of high interest payments to balance the maturity profile of the government's local currency debt, achieving the fiscal consolidation, as announced in the Budget FY15, may be challenging.[3] Furthermore, how the government decides to account for and settle the outstanding circular debt, may have

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[1] With the increase in the share of PIBs (having higher interest rates than T-bills) in government's debt, a rise in debt servicing cost was expected in FY15. The increase in interest payments of PIBs in Q1-FY15 was more than the decline in interest payments on T-bills during the quarter, when compared to the same period last year (**Figure 4.2**).

[2] The one-off non-tax receipts during the first quarter of FY14 include mark-up from PSEs and utilization of Universal Service Fund (USF).

[3] The FY15 budget estimated a reduction of the fiscal deficit from 5.5 percent of GDP in FY14, to 4.9 percent in FY15.

repercussions for the fiscal outcome. Finally, provincial surpluses do not seem in line with the targets set for the year, and has fallen significantly from Rs 121.6 billion in Q1-FY14, to only Rs 57.7 billion in Q1-FY15.[4]

Table 4.1: Summary of Fiscal Operations
billion rupees

	Budget	Actual		% Growth	
	FY15	Q1-FY14	Q1-FY15	Q1-FY14	Q1-FY15
A. Total revenue	4,218	829.7	839.7	19.9	1.2
Tax revenue	3,344	560.9	626.9	23.2	11.7
Non-tax revenue	874	268.8	212.9	13.4	-20.8
B. Total expenditure	5,640	1,038.50	1,170.20	17.1	12.7
Current[1]	4,420	868.4	1,050.10	6.9	20.9
Of which					
Interest payments	1,325	301.1	394.5	-3.7	31
Development	1,220	87.1	115.3	17.6	32.3
PSDP	1,175	79.5	93	16.4	16.9
Others		7.6	22.3	31.7	193.3
Net lending		83	4.8		
C. Statistical discrepancy		78.1	6.4		
Fiscal balance (A-B-C)	-1,422	-286.9	-336.8		
Financing	*1,422*	*286.9*	*336.8*		
External sources	508	-27.2	-13.5		
Domestic sources	914	314.1	350.3		
Banks	228	198	139.9		
SBP	0	352.8	-39		
Commercial banks	228	-154.8	178.9		
Non-bank	686	116.1	210.4		
% of GDP					
Overall fiscal balance	-4.9	-1.1	-1.2		
Revenue balance	-0.7	-0.2	-0.7		
Primary balance	-0.3	0.1	0.2		

[1]: Includes pensions, grants, subsidies, and general government expenses.
Source: Ministry of Finance

On the financing side, the government made external repayments of Rs 13.5 billion in Q1-FY15, against the target of net external *inflows* of Rs 507.6 billion

[4] The FY15 target for provincial fiscal surplus is Rs 289.0 billion, which is almost twice the surplus of Rs 149.5 billion realized in FY14.

for the full year.[5] Within domestic financing, non-bank borrowings increased sharply from Rs 116.1 billion in Q1-FY14, to Rs 210.4 billion in Q1-FY15, which was primarily due to increased holding of PIBs.[6] Encouragingly, the government retired Rs 39.0 billion to SBP (in net terms) during Q1-FY15, compared to the borrowing of Rs 352.8 billion in the same period last year.

Pakistan's public debt reached Rs 16.6 trillion as of end-September 2014, showing an increase of Rs 246.7 billion during Q1-FY15, which was almost a quarter of the rise recorded in Q1-FY14. More importantly, the government mobilized more through medium to long-term PIBs, which improved the maturity profile of the country's debt (see **Section 4.5** for detail).

4.2 Revenues

Total revenues posted an increase of only 1.2 percent, compared with 19.9 percent during the same period last year.[7] The slowdown was visible in both tax and non-tax revenues. While a decline in non-tax revenues was anticipated (as it benefitted from a number of one-off inflows during FY14), the growth of tax revenues was not in line with budget targets.[8] Tax collection showed a growth of 11.7 percent in Q1-FY15, against the full year target of 26.9 percent for FY15. More importantly, this growth was only half the growth in Q1-FY14. This was mainly due to the base effect in case of provincial, and other taxes.[9]

Tax revenues

FBR taxes, which constitute more than 85 percent of total (federal and provincial) tax collection, did not pick up as targeted. FBR had envisaged 24.0 percent growth in its tax collection during the year. However, tax collection showed a growth of 13.1 percent in Q1-FY15, on the higher base number, compared with 15.6 percent in Q1-FY14 (**Table 4.2**). This creates a tougher challenge for FBR, requiring a growth of 26.4 percent in the remaining three quarters to meet the full

[5] It must be noted that external financing showed some improvement in Q2-FY15, with the issuance of Sukuk worth US$ 1.0 billion, in the international market. The government is also planning to divest ABL, HBL and National Power Construction Corporation during the current fiscal year.
[6] With a rise in the spread between interest rates on PIBs and T-bills, both banks and non-bank financial institutions increased their PIBs holdings Q3-FY14 onwards.
[7] If the effect of one-off inflows in non-tax revenues is adjusted, growth in total revenues becomes 8.4 percent, instead of 1.2 percent.
[8] Budget target of non-tax revenues was Rs 874 billion for FY15, compared with actual receipts of Rs 1,002.4 billion last year.
[9] Other taxes also include GIDC and Gas Development Surcharge, which were earlier categorized as non-tax revenues by MoF.

year target.[10] Putting this in perspective, the required growth is nearly 10 percentage points *higher* than the average of the past five years for the same period.[11]

Table 4.2: FBR Tax Collection
billion rupees

	Budget FY15	Actual		% Growth	
		Q1-FY14	Q1-FY15	Q1-FY14	Q1-FY15
Direct	1,149	161.7	189.7	16.5	17.3
Indirect	1,661	313.6	348.1	15.2	11
Customs	284	52.4	64.5	0.2	23.1
Sales tax	1,206	235.8	258.2	19.5	9.5
Federal excise	171	25.4	25.4	12.9	0
Total taxes	**2,810**	**475.3**	**537.8**	**15.6**	**13.1**

Source: Federal Board of Revenue

Although FBR has taken a number of measures to increase tax collection (see **Box 4.1**), these focused more on deductions at source, and/or increasing the tax rates. It must be realized from the past, that such measures have had met limited success in increasing the tax-to-GDP ratio of the country. In our view, the taxation system in Pakistan needs improvement through enhanced documentation of the economy, simplification of tax procedures, and effective enforcement.

Box 4.1: Taxation Measures in Budget FY15

In order to widen the tax net, a distinction was made between filers of income tax returns and the non-filers; and high withholding tax rates were suggested for the latter. Some of the specific measures are the following:

Direct taxes:

1. Capital gain tax (CGT): a CGT @ 12.5 percent for securities held up to 12 months, and 10 percent for securities held for a period between 12 to 24 months; whereas the securities held for more than 24 months shall be exempted from CGT.
2. Advance income tax: A number of transactions/businesses were brought under advance tax like: (i) 3 percent tax on first and business class airline tickets if the passenger is income tax filer and 6 percent in the case of non-filer; (ii) a 1 percent tax on the purchase of immovable property (with value more than Rs 2 million) for filer, and 2 percent for non-filer persons; (iii) an adjustable tax at a rate of 7.5 percent on electricity bills over Rs 100,000 per month for domestic electricity consumers; and (iv) an adjustable tax on interest income and dividends was imposed on persons who are non-filer with a rate of 5 percent .
3. Removal of tax loopholes: Tax on certain classes of income was being avoided because of loopholes. Taxation of bonus shares by companies and bonus units of mutual funds and modarbas was different than that of dividend. This anomaly has been corrected.

[10] Declining petroleum prices may pose another challenge to FBR in realizing the targets for sales tax and customs duties collection.
[11] In the past five years, the average YoY growth in tax collection was 17 percent for the period October to June.

4. Tax rates for services: the budget FY15 enhanced tax rate on services to 8 percent in corporate cases and 10 percent in other cases.
5. Reduction of tax rates: The budget FY15 also proposed reduction of tax rates for some cases, like: (i) for telecommunication services, FED was withdrawn from those provinces which have imposed GST on telecom services. In areas where FED shall continue to be collected, the rate was reduced from 19.5 percent to 18.5 percent. Furthermore, it was also decided to reduce the rate of withholding tax on telephone services from 15 percent to 14 percent; (ii) withholding tax on marriages and functions was reduced from 10 percent to 5 percent; (iii) in order to attract Foreign Direct Investment in manufacturing, construction and housing sectors, corporate tax rate was reduced to 20 percent in case of new investment; (iv) on the demand of business community, corporate tax was reduced by one percentage point to 33 percent; and (v) Income Support Levy, which was imposed during the last year budget was withdrawn.
6. In order to broaden the tax net, obtaining of NTN was made a compulsory condition for seeking commercial and industrial electricity and gas connections.

Sales Tax and FED:

1. At retail stage, the businesses were categorized into two tiers for the purpose of sale tax: the first tier comprises those retailers who operate as part of national and international chain stores; operate in air-conditioned shopping plazas; have machines for credit or debit cards; or have monthly electricity bills in excess of Rs 50,000; and all remaining retailers fall under the second tier. The first tier retailers would be required to pay sales tax in the normal regime and to keep electronic cash register. For the second types of retailers, a simple mechanism of payment of sales tax was introduced through their electricity bills with the rate of 5 percent for those having electricity bills less than Rs 20,000 in a month; and 7.5 percent for those having higher bills.
2. Increasing sales tax on steel sector from fixed rate of Rs 4 per unit of electricity to Rs7 per unit.
3. FED has been increased on locally produced cigarettes.

Customs Duty:

1. Maximum rate was reduced from 30 percent to 25 percent; and number of tax slabs reduced to six.
2. At present, 40 percent of imports are totally exempted for customs duty. For addressing the structural flaw in tariff and improving assessment and documentation, 0 percent slab in tariff was substituted by 1 percent. However, socially sensitive items like petroleum products, fertilizers, and all food items etc. were kept at 0 percent rate, through inclusion thereof in a new schedule to the Customs Act.
3. To promote agricultural sector and encouraging tunnel farming, the budget FY15 removed customs duty on import of plastic coverings and mulch film, anti-insect net and shade net.

Source: Budget Speech of Minister of Finance, FY15

Non-tax revenues
Non-tax revenues were abnormally high in Q1-FY14 due to one-off inflows (e.g., the universal service fund and the mark-up received from PSEs against the circular debt settlement **-Table 4.3**). In the absence of such inflows in Q1-FY15, non-tax revenues posted a decline. Some support came from the Coalition Support Fund during the quarter, which is basically reimbursement for logistic support provided by Pakistan to NATO troops in Afghanistan.[12]

Table 4.3: Non-tax Revenues
billion rupees

	Budget FY15	Actual		Absolute change	
	(full-year)	Q1-FY14	Q1-FY15	Q1-FY14	Q1-FY15
Mark-up (PSEs & others)[1]	26	56.8	0.9	55.9	-56
Dividend	82	3.7	10.9	-11.3	7.1
SBP profits	270	80	67.5	30	-12.5
Defence (incl. CSF)	140	2	77.3	-105.3	75.4
Royalties on gas & oil	81	19.2	20	4.3	0.8
Passport & other fees	20	4	2.7	0.8	-1.3
Discount retained on crude oil	20	3.9	2.3	0.7	-1.6
Windfall levy against crude oil	17	3.8	5.3	-0.7	1.6
Foreign grants	35	10.1	8	10.1	-2.1
Other federal [2]	125	74.6	5.5	69.6	-69
Of which USF	--	67.6	--		
Provincial	58	10.7	12.4	-13.7	1.7
Total nontax revenue	**874**	**268.8**	**212.9**	**40.5**	**-55.9**
Memorandum [3]					
One-off inflows		124.3	75.4		
Nontax revenue (excl. one-offs)		144.5	137.5	21.9	-7

[1]: Markup for Q1-FY14 includes Rs 56 billion as a recovery of payables from PSEs (NTDC, Atomic Energy Commission and Wapda) to the federal government. This inflow was a part of the non-cash component of the circular debt settlement, which took place in July 2013.
[2]: Budget FY15 includes Rs 56 billion from the auction of the remaining licenses for 3G/4G spectrum.
[3]: We have excluded inflows on account of mark-up on PSEs and USF from Q1-FY14; and CSF inflows from Q1-FY15, to make the numbers comparable.
Source: Ministry of Finance

4.3 Expenditure
Federal expenditure remained under pressure due to a sharp increase in interest payments in Q1-FY15, as said earlier. While total non-interest expenditures increased by only 5.2 percent YoY basis; interest expenses grew by 31.0 percent in Q1-FY15 (**Table 4.4**).

[12] The government received US$ 371.4 million under CSF on August 27, 2014, and US$ 363.8 million on September 30, 2014.

Nearly 70 percent of the increase in total expenditures came from domestic interest payments alone. This increase was expected, as the maturity profile of domestic debt has been shifting towards costlier long-term government bonds, for the last three quarters. As a consequence, interest payments on account of PIBs increased sharply in July 2014, when the 6-monthly coupon payments fell due. In fact, the increase in servicing PIBs more than offset the decline in interest payments on T-bills during Q1-FY15 (**Figure 4.2**).

Defence is the second largest expenditure of the federal government and increased by 12.4 percent in Q1-FY15. This was broadly in line with the Federal Budget for the current year that envisaged 11.2 percent growth under this head.[13]

Table 4.4: Analysis of (Consolidated) Fiscal Spending – Q1
billion rupees

			% growth	
	FY14	**FY15**	**FY14**	**FY15**
Total expenditure	**1,038.5**	**1,170.2**	**17.1**	**12.7**
Current	868.4	1,050.1	6.9	20.9
Federal	639.5	772.1	4.9	20.7
Interest payments	301.1	394.5	-3.7	31
Domestic	286.3	375.9	-4.4	31.3
External	14.9	18.6	11.1	24.8
Pension	36.4	39.7	6.3	8.8
Grants	41.8	52.8	7.2	26.3
Defence	146.5	164.6	24.7	12.4
Public orders & safety	18.3	21.3	19.4	16.3
Health & education	14	12.7	19.7	-9.6
Others	81.4	86.7	2.8	6.5
Provincial	228.8	278	12.9	21.5
Development	87.1	115.3	17.6	32.3
PSDP	79.5	93	16.4	16.9
Federal	44.9	39.6	48.2	-11.9
Provincial	34.6	53.4	-9	54.4
Other dev. expenditure	7.6	22.3	31.7	193.3
Net lending	83	4.8	--	-94.2
Memorandum				
Non-interest expenditures:				
Total - consolidated	737.4	775.7	28.4	5.2
Total – federal	486.9	468.6	36.6	-3.8
Current - federal	350.6	385	12.9	9.8

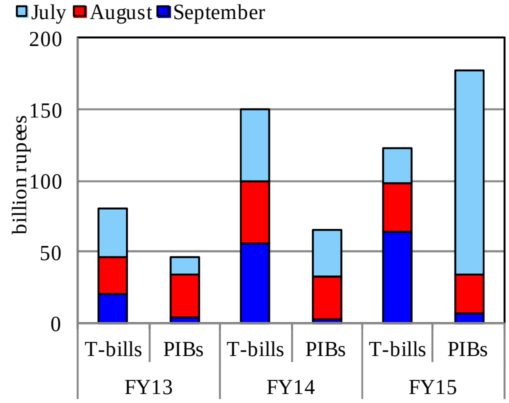
Source: Ministry of Finance

Federal government's expenditure on health and education, on the other hand, declined from Rs 14.0 billion in Q1-FY14 to Rs. 12.7 billion in Q1-FY15. Most of the health and education related activities have been transferred to provincial governments, except for some services that are still in the federal domain, like higher education, national vocational & technical training, and a number of big hospitals.

[13] By mid-September 2014, Finance Ministry released Rs 33 billion for the Operation Zarb-e-Azb, which also includes the requirement of funds for Internally Displaced Persons (IDPs).

Development expenditures increased sharply on the back of higher PSDP spending by provinces, and other expenditure (including the Benazir Income Support Program) by the federal government.

Figure 4.2: Interest Payment on T-bills and PIBs



Source: State Bank of Pakistan

4.4 Provincial fiscal operations

As mentioned above, provinces are required to show a combined surplus of Rs 289.0 billion during FY15, which is almost double the surplus in FY14. However, the actual surplus posted by the provinces in Q1-FY15 is Rs 57.7 billion, i.e., less than half the surplus in Q1-FY14. This decline was driven by current expenditures, which showed considerably higher growth during the quarter, compared to the corresponding period of last year (**Table 4.5**). In addition, all provinces also increased their PSDP spending. On the revenue side, transfers from the divisible pool were lower compared to last year, whereas provincial government efforts only posted a marginal increase in tax collection.

In Punjab, while the damages from the floods of September 2014 partly explain higher current spending during the quarter,[14] development expenditures also doubled due to infrastructure and social sector development. Infrastructure developments projects mainly include construction of road, energy and urban development, whereas health and education account for the bulk of total social sector development spending.

In Sindh, spending on Thar coal has the largest share in total development outlays. In addition to this, health related spending, and the expense on special initiatives like the construction of drinking water hubs, pushed the increase in development expenditures.

[14] According to Punjab government, Rs 15.1 billion is estimated as initial damage cost by recent floods. [Source: Post Flood Restoration & Rehabilitation of Public Infrastructure; http://www.pndpunjab.gov.pk/downloads].

The KPK government launched a pro-poor initiative to provide subsidies on basic food items, which explains very high growth in its current expenditures.

Table 4.5: Provincial Fiscal Operations
billion rupees

	All	Punjab	Sindh	KPK	Balochistan
Q1-FY15					
Total revenue	392.7	183.5	104.9	63.6	40.7
Share in federal revenue	311.3	145.3	79.2	52.3	34.5
Taxes	44.7	23.9	17.5	3.0	0.3
Non-taxes	12.4	5.4	1.7	4.7	0.6
Federal loans and transfers	24.3	8.9	6.5	3.6	5.3
Total expenditure	335.0	150.9	95.0	59.9	29.1
Current	281.5	120.3	81.9	52.7	26.8
Development	53.4	30.6	13.2	7.3	2.3
Overall balance	57.7	32.6	9.8	3.6	11.6
Q1-FY14					
Total revenue	388.4	164.6	113.8	62.7	47.3
Share in federal revenue	322.7	136.4	93.0	51.5	41.8
Taxes	42.1	22.5	17.0	2.3	0.3
Non-taxes	10.7	5.5	0.9	3.2	1.2
Federal loans and transfers	12.9	0.1	3.0	5.8	4.0
Total expenditure	266.8	117.3	80.7	44.9	23.9
Current	232.2	102.1	69.3	38.3	22.5
Development	34.6	15.1	11.5	6.6	1.4
Overall balance	121.6	47.3	33.1	17.8	23.4

Source: Ministry of Finance

4.5 Public debt[15]

With an addition of Rs 246.7 billion during Q1-FY15, Pakistan's public debt reached Rs 16.6 trillion as of end-September 2014 (**Table 4.6**). Encouragingly, the addition to public debt was almost quarter of the increase seen in Q1-FY14. Furthermore, this increase was primarily driven by government borrowing from domestic sources. Finally, the maturity profile of Pakistan's debt improved compared to Q1-FY14, as the government was able to mobilize more through medium to long-term PIBs.

Table 4.6: Debt Burden
billion rupees

	Stock		Absolute change				
	Jun-14	Sep-14	Q1-FY14	Q2-FY14	Q3-FY14	Q4-FY14	Q1-FY15
Public debt	**16,321.0**	**16,567.8**	**1,052.7**	**-23.1**	**277.9**	**438.9**	**246.7**
Public domestic debt	10,907.0	11,096.4	634.0	72.7	592.3	87.1	189.4
Public external debt	5,414.0	5,471.3	418.7	-95.8	-314.5	351.8	57.3
Govt external debt	4,791.3	4,839.8	361.1	-34.3	-264.4	417.9	48.4
Debt from the IMF	298.4	300.1	6.5	-61.9	-22.7	-58.2	1.7
External liabilities	324.2	331.5	51.1	0.4	-27.3	-7.9	7.2

Source: State Bank of Pakistan

Despite an increase in the fiscal deficit during Q1-FY15, the net addition to domestic debt stock was lower than budgetary borrowings from domestic sources.[16] This apparent disconnect is explained by the huge withdrawals of government deposits kept with the central bank (**Table 4.7**).

Domestic Debt

Following the net addition of Rs 189.4 billion, the outstanding stock of domestic debt reached Rs 11.1 trillion by end-September 2014. This increase was

[15] Public debt-to-GDP ratio is based on SBP data, which is slightly different from numbers reported by the Ministry of Finance. The disparity in debt numbers is due to differences in coverage of public debt reported by the two sources. Public debt reported by SBP is composed of: (i) government domestic debt; (ii) government external debt; (iii) IMF loans; and (iv) external liabilities. While both MoF and SBP follow the same definition of domestic public debt, the coverage of external debt compiled by MoF differs from that of SBP. Specifically, MoF does not include short-term debt, military debt and external liabilities in its compilation of external public debt (see Data Explanatory Notes at the end of the Report).

[16] Although the change in debt should be equal to the size of budget deficit during a given period, this is not the case in practice, because: (i) exchange rate movement exerts a significant impact of the PKR value of external debt, without having strong implications for financing of the deficit; and (ii) changes in government deposits directly impact government borrowing from the domestic sources, without affecting the domestic debt.

concentrated in long term instruments, mainly 3-year PIBs. Anticipating a decline in interest rates, banks were actively participating in PIBs auctions throughout Q1-FY15, enabling the government to retire its debt to the central bank. As a result, the government was able to meet the limit of zero quarterly borrowings from SBP for Q1-FY15.

Table 4.7: Absolute Change in Government Domestic Debt
billion rupees

	Q1-FY14	Q1-FY15
1. Government domestic debt	**634.0**	**189.4**
Permanent debt	**-3.0**	**248.0**
of which		
PIBs	-21.2	234.0
Floating debt	611.1	-112.9
of which		
MTBs	-138.6	37.2
MRTBs	749.7	-216.7
Unfunded debt	25.6	54.1
Foreign currency loans	0.3	0.2
2.Change in govt. deposits with SBP	345.5	-161.5
Domestic financing of fiscal deficit	314.1	350.9

Source: State Bank of Pakistan

In terms of ownership, though a considerable portion of PIBs has been shifted to non-bank financial institutions through secondary market trading, around two-third of outstanding PIBs are still held by commercial banks (**Table 4.8**). This is not the mandate of the primary dealers, who are required to offload PIBs to non-banks, instead of carrying them on their balance sheets. However, in terms of quantum, the holding of non-bank has doubled in the last year, which is indeed a welcome development.

Table 4.8: Bank & Non-banks holding of PIBs - End September Stock
billion rupees

	FY13		FY14		FY15	
	Volume	**Share**	**Volume**	**Share**	**Volume**	**Share**
Scheduled Banks	562.9	52.4	681.6	52.4	2,290.3	66.2
Non-Banks/ Corporates	512.1	47.6	620.2	47.6	1,167.3	33.8
of which						
Insurance companies	240.6	22.4	280.7	21.6	448.2	13.0
Funds	182.0	16.9	152.9	11.7	382.5	11.1
Corporates/Other	89.5	8.3	186.5	14.3	336.6	9.7
Total	**1,075**	**100.0**	**1,301.8**	**100.0**	**3,457.6**	**100.0**

Source: State Bank of Pakistan

On the other hand, short-term debt (mainly T-bills) declined by Rs 112.9 billion during Q1-FY15. More specifically, banks offered Rs 619.6 billion in T-bill auctions during the quarter, against a target of Rs 700 billion, and maturities of Rs 630.1 billion (**Table 4.9**). The expectations of a fall in interest rates, and the record high term premium between T-bills and PIBs, largely explain why banks were not interested in T-bills.[17] In this environment, the government rightly decided to finance a portion of the budget deficit by drawing down its deposits with the central bank.

Table 4.9: T-bills Auction Profile (competitive bids only)
billion rupees

	Target	Offer	Acceptance	Maturity
Jul-14	225.0	254.6	253.6	190.1
Aug-14	225.0	163.4	163.1	180.4
Sep-14	250.0	201.6	200.6	259.6
Oct-14	550.0	351.7	349.3	482.7
Nov-14	520.0	504.5	498.8	399.0

Source: State Bank of Pakistan

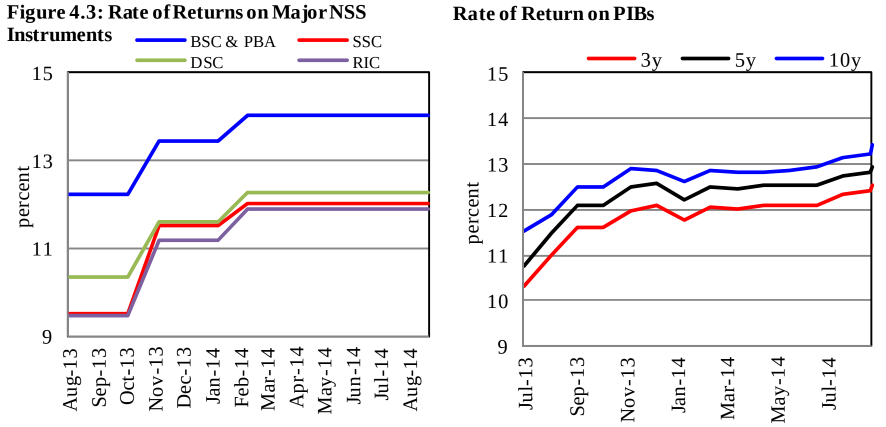
As for financing through National Saving Schemes (NSS), net mobilization more than doubled in Q1-FY15 compared to same period last year (**Table 4.10**), mainly due to attractive return on underlying instruments (**Figure 4.3**).[18]

Table 4.10: Receipts under NSS Instruments during Q1
billion rupees

	FY14		FY15	
	Gross	Net	Gross	Net
DSCs	9.1	1.7	10.5	3.2
SSCs	23.5	3.7	56.6	17.1
RICs	18.3	5.0	37.2	14.6
BSCs	28.5	11.0	35.8	15.2
Others	73.1	4.2	70.9	2.1
Total	**152.5**	**25.6**	**211.0**	**52.2**

Source: Central Directorate of National Savings (CDNS)

Figure 4.3: Rate of Returns on Major NSS Instruments



Source: SBP and CDNS

An instrument-wise breakup shows Special Saving Certificates (SSC) as the most popular scheme, recording a net inflow of 17.1 billion during the quarter.

[17] See SBP's Annual Report for FY14.
[18] The tenor of DSC, BSC and PBA is ten year, while that of SSC is three year. Traditionally, NSS rates are linked with PIBs of same tenor.

Furthermore, in case of SSC and Defence Saving Certificates (DSC), the absence of any direct penalty on early encashment, may have encouraged some investors to re-invest their original certificates, so that mobilization in net terms did not increase much, though gross investment showed a significant increase.[19]

Public external debt & liabilities

Pakistan's public external debt & liabilities, posted a decline of US$ 1.5 billion during Q1-FY15 (**Table 4.11**). This happened despite an increase in loan disbursements, and a fall in debt repayments during the quarter. In fact, this reduction in external debt was the outcome of a hefty US$ 1.8 billion revaluation gain from the appreciating US Dollar against other hard currencies during Q1-FY15.

Table 4.11: Pakistan's Public External Debt & Liabilities

million dollars

	Jun-14	Sep-14	Change
Public external debt & liabilities	**54,793**	**53,301**	**-1,492**
Government debt	48,491	47,148	-1,343
IMF	3,020	2,923	-97
External liabilities	3,281	3,229	-52

Source: State Bank of Pakistan

Disbursements

External loan disbursements saw an increase of 16.4 percent in Q1-FY15, over the same period last year, mainly from China and ADB. Gross inflows from almost all other creditors declined in Q1-FY15 (**Figure 4.4**):

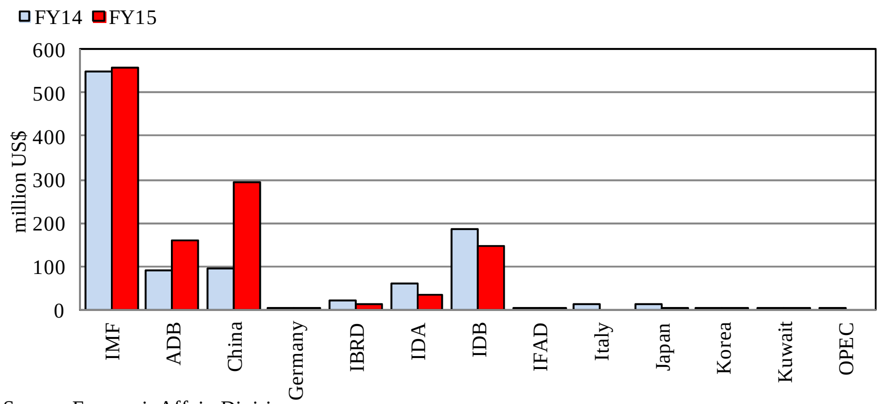
(i) China disbursed a tranche of US$ 242.8 million in Q1-FY15, for setting up nuclear power plants (K2 & K3) in Karachi;

(ii) Inflows from ADB included US$ 50 million under the *Social Protection Development Project*, which seeks to enhance the coverage of the Benzair Income Support Program. ADB has so far committed a total of US$ 430 million for this purpose.[20] ADB also disbursed US$ 43.3 million for *Flood Emergency Reconstruction Project* (signed in April 2011) to restore infrastructure after the 2010 flooding;

(iii) Pakistan also received US$ 556 million from the IMF in July 2014, after the completion of 3rd Review in June 2014. Importantly, net inflows from

[19] For example, the increase in NSS rates in January 2014 encouraged investors to re-price their certificates whenever their subsequent coupon payment falls due.
[20] http://adb.org/projects/details?proj_id=45233-001&page=overview

Figure 4.4: External Loan Disbursements - Q1



Source: Economic Affairs Division

IMF stood at US$ 36 million in Q1-FY15, compared to negative US$ 308 million in Q1-FY14.

In overall terms, GoP expects substantial inflows from external creditors during FY15, which include: US$ 1.1 billion from ADB; US$ 1.5 billion from China and US$ 1.6 billion from IDA.[21] Furthermore, the government successfully raised US$ 1 billion from the issuance of a 5-year Sukuk in the international market, in November 2014. Like the Eurobonds issued in April 2014, this bond was also oversubscribed (against an initial offering of US$ 500 million, the market offered US$ 2.3 billion). Encouragingly, the government was able to get a lower rate compared to the Eurobond (6.75 percent for this 5-year paper, compared to 7.25 percent rate on the same tenor Eurobond issued in April 2014).

Debt servicing

Servicing of public external debt fell by US$ 448.5 million in Q1-FY15, compared to the same period last year (**Table 4.12**). This also eased servicing pressure on Pakistan's foreign exchange earnings (FEE) – the ratio of external debt servicing (EDS)-to-FEE, fell from 14.3 percent in Q1-FY14 to 9.7 percent in Q1-FY15.

The largest decline was seen in repayments to the IMF. As discussed in SBP's *Annual Report FY14*, external debt servicing is likely to ease in FY15, as the

[21] Source: Economic Affairs Division

country has already made bulk repayments to IMF during FY14. Specifically, debt servicing to the Fund is projected at US$ 1.3 billion in FY15, compared to US$ 3.2 billion in FY14.

Table 4.12: Public External Debt Servicing - Q1

million dollars

	FY14	FY15	Change FY15 over FY14
Public debt (a+b+c)	**1,620.1**	**1,171.6**	**-448.5**
Principal	1,451.8	958.7	-493.1
Interest	168.3	212.9	44.6
a. Government debt	743.4	619.7	-123.7
Principal	596.8	438.9	-157.9
Interest	146.6	180.8	34.2
b. IMF	873.4	533.1	-340.4
Principal	854.9	519.8	-335.1
Interest	18.5	13.3	-5.2
c. Foreign exchange liabilities	3.3	18.9	15.6
Principal	0.0	0.0	0.0
Interest	3.3	18.9	15.6
Memorandum item: Debt servicing/Foreign exchange earnings	14.3	9.7	

Source: State Bank of Pakistan