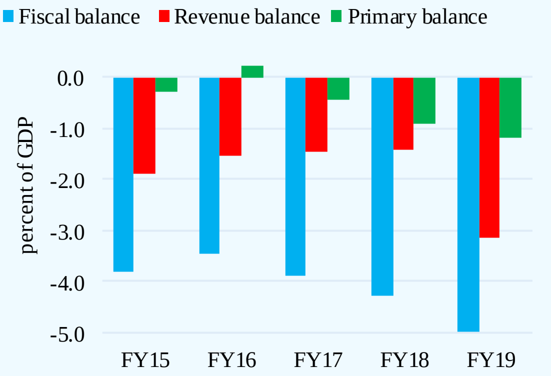
4 Fiscal Policy and Public Debt

4.1 Overview

The third quarter of FY19 recorded a major deterioration of fiscal indicators. Mainly due to a large expansion in current expenditures and stagnancy in revenue collections during Q3-FY19, another 2.3 percentage points were added to the cumulative fiscal deficit of the first half of FY19. Resultantly, the budget deficit widened to a historic high of 5.0 percent of GDP during Jul-Mar FY19 (**Figure 4.1**). Revenue and primary balances also deteriorated during the period under review.

Figure 4.1: Fiscal Balance Indicators (Jul-Mar)



Data source: Ministry of Finance and SBP calculations

Broad-based expansion in current expenditures with major contribution from higher than budgeted interest payments and security related expenditures did not bode well for the overall fiscal consolidation despite a major cut down in PSDP expenditures. The quarter-wise data shows that the increase in current expenditures gathered further pace and grew by an amount of Rs1,814.0 billion in Q3-FY19 as compared to the increase of Rs 1,530.2 billion during Q3-FY18. As a result, on a cumulative basis the current expenditure reached to Rs 4,798.4 billion in Jul-Mar FY19, which is 17.7 percent higher than that recorded in Jul-Mar FY18.

The moderation of economic activity (particularly in the industrial sector) and measures such as suspension of taxes on telephones, reduction in taxes on salary income, and lower sales tax on petroleum products adversely impacted the growth of tax revenue. Nonetheless, a double-digit growth was recorded in the collection of FED and customs duty (although still lower than the growth in FY18), mainly on the back of PKR depreciation and higher regulatory duties. A sharp fall in non-tax revenues (mainly due to the base-effect) and a slowdown in tax revenues, dragged down the ratio of revenues to GDP from 10.3 percent in Jul-Mar FY18 to 9.3 percent during Jul-Mar FY19 (**Table 4.1**), the lowest since FY14.[1]

Table 4.1: Summary of Fiscal Operations (Jul-Mar)
billion Rupees and percent

	Actual		Growth	
	FY18	**FY19**	**FY18**	**FY19**
A. Total revenue	3,582.4	3,583.7	13.9	0.0
Tax revenue	3,076.2	3162.1	14.2	2.8
Non-tax revenue	506.2	421.6	12.2	-16.7
B. Total expenditure*	5077.9	5482.5	16.0	8.0
Current	4,075.4	4798.4	13.0	17.7
Interest payments	*1,172.8*	*1459.2*	7.2	24.4
Defence	*623.8*	*774.7*	16.5	24.2
Development	993.3	655.9	23.6	-34.0
Net lending	9.2	28.3	-126.8	208.0
C. Statistical discrepancy	-14.6	23.7	-265.6	-262.3
Fiscal balance (A-B-C)	-1480.9	-1922.5		
Revenue balance	-493.0	-1214.6		
Primary balance	-308.1	-463.3		
Financing	1,480.9	1922.5		
External sources	524.3	524.5		
Domestic sources	956.6	1398.0		
Banks	813.5	787.7		
Non-bank	143.1	610.4		
Privatization	-	-		
percent of GDP				
Total Revenue	10.3	9.3		
Tax revenue	8.9	8.2		
Non tax revenue	1.5	1.1		
Total Expenditure	14.6	14.3		
Current	11.8	12.4		
Development	2.9	1.7		

* Excluding statistical discrepancy
Data source: Ministry of Finance and SBP calculations

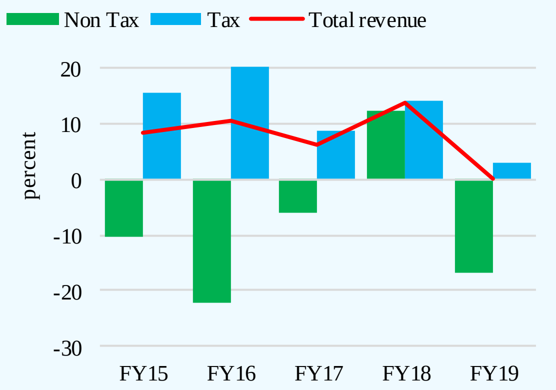
Additional financing needs, along with PKR depreciation, led to accelerated accumulation of public debt on both external and domestic fronts during Jul-Mar FY19. The surge in the former was largely an outcome of PKR depreciation as the financing component was almost at last year's level (**Table 4.2**). As fresh borrowing from external sources was not sufficient, the government had to rely on domestic sources, which led to accelerated accumulation of domestic debt during the review period. Meanwhile, the composition of domestic debt was tilted towards the borrowing from the central bank since commercial banks showed reluctance in lending to the government at the prevailing rates in anticipation of higher future interest rates. The current composition of domestic debt highlights the need of a better debt management strategy to avoid re-pricing and rollover risks of short-term debt. Further, a significant increase in borrowing from the central bank does not bode well for the economy as it carries the risk of generating inflationary pressures.

[1] Non-tax revenue also recorded a sharp fall of 16.7 percent during Jul-Mar FY19 in contrast to a rise of 12.2 percent during the same period last year. The surge in FY18 was largely due to increase in provincial non-tax revenue – transfer of hydel profits to provinces.

4.2 Revenue

A sharp decline in non-tax revenues and restrained growth in tax revenues kept the overall revenue collection almost at last year's level **(Figure 4.2)**. Despite different measures implemented by the tax authorities to increase the tax base, the tax collection remained almost stagnant. Considering the fact that the growth in tax revenues was lower than the growth of nominal GDP, it suggests the need for more rigorous tax efforts to provide the much needed uplift to revenue collection.[2]

Figure 4.2: Growth in Revenue Collection (Jul-Mar)



Data source: Ministry of Finance

Table 4.2: FBR Revenue Drivers (Jul-Mar)
billion Rupees

	Target FY19	Collection		Abs. Change	Growth in percent	
		FY18	**FY19**	**FY19**	**FY18**	**FY19**
Direct taxes	1,727.0	1,001.4	993.2	-8.2	12.2	-0.8
Indirect taxes	2,671.0	1,626.4	1,709.1	82.7	18.9	5.1
Customs duty	735.0	428.4	506.5	78.1	24.8	18.2
FED	266.0	144.3	162.9	18.6	13.5	12.9
Sales tax	1670.0	1,053.7	1,039.7	-14.0	17.4	-1.3
Total taxes	**4,398.0**	**2,627.8**	**2,702.3**	**74.5**	**16.2**	**2.8**

Data source: Federal Board of Revenue

<u>FBR taxes</u>

FBR tax collection grew only by 2.8 percent during Jul-Mar FY19 as compared to a double-digit growth of 16.2 percent during the same period last year **(Table 4.2)**. A decline in sales tax and direct taxes (particularly withholding taxes) along with a deceleration in customs duty and FED explained the overall slowdown of FBR tax collection.

FBR tax collection at the end of third quarter stood at 61.4 percent of the annual target, which leaves around 38.6 percent for the last quarter. In absolute terms, almost Rs 1,700 billion is to be collected in Q4; keeping in view the historical

[2] The tax to GDP ratio declined from 8.9 percent in FY18 to 8.2 percent in FY19.

trend, achieving the target seems challenging.[3]

Decline in direct taxes owing to some policy measures
Direct taxes having a share of 37.0 percent in overall FBR tax collection recorded a decline of 0.8 percent during Jul-Mar FY19 in contrast to a rise of 12.2 percent during the same period last year **(Table 4.3)**. Measures like the suspension of tax on mobile top-ups; reduction in come tax rates on salaries; reduction in the withholding tax rate on dividends; and spending under the PSDP explain the decline in direct taxes.

Within direct taxes, major hit emerged from withholding taxes (largest contributor in direct taxes), which recorded a contraction of 8.7 percent during Jul-Mar FY19 against a rise of 16.1 percent during the same period last year. One-half of the decline in total withholding taxes is in the category of telephone/mobiles. Collection from telephone was only Rs 5.3 billion during Jul-Mar FY19 compared to a collection of Rs 38.0 billion during the same period last year. This lower collection from telephone/mobile phones was not surprising amid suspension of taxes on mobile phone top-up by the Supreme Court.

Table 4.3: Drivers of Change in Direct Taxes
billion Rupees; growth in percent

	Jul-Mar		Changes in FY19	
	FY18	**FY19**	**Absolute**	**Percent**
A. Withholding taxes	**749.7**	**684.5**	**-65.2**	**-8.7**
of which				
Telephone/Mobiles	38.0	5.3	-32.7	-86.1
Salaries	95.2	53.5	-41.7	-43.8
Contracts	194.6	164.8	-29.8	-15.3
Imports	159.8	168.2	8.4	5.3
Bank interest & securities	34.5	44.0	9.5	27.5
B. Voluntary payments	**240.0**	**274.3**	**34.3**	**14.3**
C. Collection on demand	**68.4**	**74.3**	**5.9**	**8.6**
D. Miscellaneous	4.0	2.0	-2.0	-50.0
Gross income tax [A+B+C+D]	1062.1	1035.2	-26.9	-2.5
Net direct tax	**1001.4**	**993.2**	**-8.2**	**-0.8**

Data source: Federal Board of Revenue

Tax collection on salaries also remained much lower than last year. In absolute terms, tax on salaries declined by Rs 41.7 billion during the review period, mainly due to changes in income tax rates for all income slabs. Receipts from contracts were also lower compared to last year largely owing to a cut in the PSDP.[4] Voluntary payments increased by Rs 34.3 billion during Jul-Mar FY19.[5] It is

[3] The average collection of Q4 is Rs 964.8 billion and the maximum is Rs 1,214.2 billion during the last five years.
[4] As compared to Rs 931.4 billion in FY18, the size of PSDP was only Rs 562.3 billion in FY19.
[5] VP comprises of payments with returns and advance tax payments on the basis of self-assessed expected income within the PAYE (pay as you earn) regime.

important to mention that during FY18, voluntary payments remained much lower than its average.[6] Collection on demand increased by Rs 5.9 billion compared to an increase of Rs 8.8 billion during the same period last year. This marginal deceleration is apparently an outcome of extension in the deadline for e-filing of tax returns in FY19. In practice, the deadline is usually within the second quarter of the fiscal year; however, in FY19, the deadline was extended beyond Q3-FY19.

Lower Collection of Indirect Taxes as Industrial Sector Faced Slowdown

As compared to a growth of 18.9 percent during Jul-Mar FY18, the indirect taxes grew only by 5.1 percent during Jul-Mar FY19. Disaggregated analysis of indirect taxes show a contraction of 1.3 percent in sales tax during Jul-Mar FY19 in contrast to a growth of 17.4 percent during the same period last year. Both categories of sales tax, i.e. domestic and import, recorded a negative growth. Lower industrial growth, moderation in overall economic activity and subdued import demand contributed to this decline.

Table 4.4: Drivers of Change in Excise and Custom Duty (Jul-Mar)

billion Rupees and percent

	FY18	FY19	Abs. Change	Growth
Custom Duty				
Vehicles	70.3	66.1	-4.2	-6.0
Mineral Fuel, oil and their products	46.9	59.2	12.3	26.2
Iron and Steel	30.3	35.5	5.2	17.2
Total	**428.4**	**506.5**	**78.1**	**18.2**
FED				
Cigarettes & Tobacco	41.9	58.2	16.3	38.9
Cement	38.5	42.6	4.2	10.9
Total services	32.4	30.7	-1.7	-5.2
Beverages & Concentrates	13.6	13.8	0.2	1.5
Total	**144.3**	**162.9**	**18.7**	**12.9**

Data source: Federal Board of Revenue

Within sales tax, major fall was in the category of petroleum products. Lower tax rates on various petroleum products and lower import quantum during Jul-Mar FY19 were the primary reasons of the decline in tax collection.[7] Similarly, sales tax collection on iron & steel products declined amid contained domestic demand & lower import quantum during the period under analysis.[8] Sales tax collection from cement also recorded a fall because of lower sales volume.[9]

[6] The decline in voluntary payments during FY18 was primarily driven by reduction in corporate tax rate and lower bank profitability.

[7] Import quantum of petroleum products declined to 7.5 million MT during Jul-Mar FY19 compared to 11.1 million MT during Jul-Mar FY18.

[8] Import quantum of iron & steel declined to 2.3 million MT during Jul-Mar FY19 from 2.8 million MT during the same period last year.

[9] Cement sales recorded a decline of 0.5 percent during Jul-MarFY19 (Source: APCMA)

Custom and excise duty collections record double-digit growth

The depreciation of PKR, imposition of regulatory duty, and an increase in excise duties led to a double-digit growth in custom and excise collection during Jul-Mar FY19. FED and customs duty recorded a YoY growth of 12.9 and 18.2 percent respectively during Jul-Mar FY19. As highlighted in the second quarterly report for FY19, though there was a slowdown in the quantum of imports, the PKR depreciation mainly helped maintain the overall growth in value terms. With the exception of vehicles, custom collection on other major categories i.e. iron & steel, and electrical machinery & equipment increased significantly during the period under review (**Table 4.4**). The FED collection increased by Rs 18.7 billion, out of which Rs 16.3 billion was collected from cigarettes, largely due to upward revision of FED on locally produced cigarettes.[10]

Table 4.5: Non-tax Revenues (Jul-Mar)
billion Rupees and growth in percent

	FY18	FY19	Growth
Mark-up	21.7	14.4	-33.8
Dividend	33.6	32.2	-4.2
Profits from post office/PTA	8.8	16.2	83.9
SBP profits	143.2	138.2	-3.5
Defence	9.3	10.7	15.5
Passport & other fees	11.9	16.3	37.1
Discount retained on crude oil	6.5	10.4	60.2
Royalties on Oil/Gas	42.4	61.8	45.7
Petroleum levy on LPG	2.3	6.1	163.5
Others*	225.4	112.5	-50.1
Total	**506.2**	**421.6**	**-16.7**

*Includes provincial non-tax revenue
Data source: Ministry of Finance

Non-tax revenues

The overall collection of non-tax revenues remained subdued during Jul-Mar FY19 compared to last year despite higher collection in most of the categories (**Table 4.5**). A major hit to non-tax revenues largely emanated from the fall in SBP profits and a delay in the transfer of hydel profits to provinces. The surge in defence, passport & other fees, royalties on oil & gas, and windfall levy on crude oil was not sufficient to offset this decline.

4.3 Expenditure

Led by interest payments and defence expenses, a marked increase in current expenditure was registered in Jul-Mar FY19. However, it was partially offset by a substantial reduction in the development spending. Resultantly, the overall fiscal spending growth was contained to 8.0 percent in Jul-Mar FY19 as compared to a 16.0 percent increase in the corresponding period of last year. As percent of GDP, the overall expenditure was recorded at 12.6 percent in Jul-Mar FY19, which is lower than 14.8 percent in Jul-Mar FY18 **(Table 4.6)**.

[10] Effective from 18th September 2018, the government revised FED on different cigarette brands.

Table 4.6: Analysis of Fiscal Spending
billion Rupees

	Jul-Mar		Abs. change	Growth in percent	
	FY18	FY19		FY18	FY19
Current expenditures	**4,075.4**	**4,798.4**	**723.0**	**13.0**	**17.7**
Federal *of which*	2,653.3	3,180.9	527.6	8.8	19.9
Interest payments	1,172.8	1,459.2	286.4	7.2	24.4
(i) Domestic Debt Servicing	1,071.4	1,276.8	205.4	6.1	19.2
(ii) Foreign Debt Servicing	101.4	182.4	81.0	19.9	79.9
Defense	623.8	774.7	150.9	16.4	24.2
Public order and safety	94.0	106.1	12.1	14.8	12.9
Others	762.7	131.2	-631.5	4.9	-82.8
Provincial	1,422.1	1,617.4	195.3	22.0	13.7
Development expenditures	**993.3**	**655.9**	**-337.4**	**23.6**	**-34.0**
PSDP	931.4	578.5	-352.9	24.7	-37.9
Federal	353.6	302.4	-51.2	9.1	-14.5
Provincial	577.8	276.0	-301.8	36.7	-52.2
Others (including BISP)	61.9	77.4	15.5	8.2	25.0
Net lending	**9.2**	**28.3**	**19.1**	**-126.9**	**207.6**
Total Expenditure*	**5,077.9**	**5,482.5**	**404.5**	**16.0**	**8.0**

* Excluding statistical discrepancy
Data source: Ministry of Finance

The increase in interest payments was due to a higher debt stock, an increase in interest rates, and continued exchange rate depreciation. Quarter-wise data shows that the interest expenditures recorded a substantial increase of Rs 582.5 billion Q3-FY19 as compared to increase of Rs 421.4 billion in Q3-FY18.[11] Resultantly, the interest payments as percent of GDP reached to its 17-year high level of 3.8 percent in Jul-Mar FY19. Owing to heightened security-related needs in the country, the defense expenditures also recorded a sharp increase. During Jul-Mar FY19, the expenditures on defence increased by 24.2 percent and reached to Rs 774.7 billion.[12]

[11] During Jul-Mar FY19, the government domestic debt increased by Rs 1,754.3 billion as compared to Rs 1,224.8 billion in same period of last year. During Q3-FY19, the government borrowed Rs 634.9 billion, which is highest as compared to last two quarters.
[12] As percent of GDP, the defence expenditures stood at 2.0 percent in Jul-Mar FY19 as compared to 1.8 percent in Jul-Mar FY18.

The other components of current expenditures also remained at elevated levels during Jul-Mar FY19.[13] For instance, current expenditure excluding interest payments was 8.8 percent of GDP in Jul-Mar FY19, the highest since FY02 (the data point from where information on quarterly fiscal accounts is available). Similarly, current expenditures excluding both interest payments as well as defence expenditures reached to 6.8 percent of GDP in Jul-Mar FY19, which was also the highest since FY02.

Amid elevated current expenditures, the burden of fiscal consolidation fell on the development expenditures as reflected in the sharp decline of PSDP releases compared to last year. The disaggregated data of PSDP shows that the reduction mainly emanated from a cut in funds pertaining to corporations (NHA, NTDC/PEPCO), special areas, and other specialized programs. The PSDP funds for federal ministries, on the other hand, recorded an increase from Rs138.9 billion in Jul-Mar FY18 to Rs173.9 billion in Jul-Mar FY19.

4.4 Provincial Fiscal Operations

Provincial revenue generation also recorded a significant moderation

The provinces also recorded a marked slowdown in revenue growth that grew by only 1.5 percent in Jul-Mar FY19 against 24.8 percent growth in the same period of last year. Due to a slowdown in FBR's revenue collection, the 'provinces share in federal revenue' recorded a moderation and increased by 7.9 percent in Jul-Mar FY19 as compared to 16.0 percent in Jul-Mar FY18. The provinces' own revenue collection also remained lower than last year, which added to the slowdown in overall revenue growth at the provincial level. **(Table 4.7)**

The disaggregated data of provincial revenue sources shows a substantial reduction in non-tax revenues, which observed a decline of 48.4 percent during Jul-Mar FY19 as compared to a growth of 113.5 percent in Jul-Mar FY18. The decline in non-tax revenues was mainly due to lower profits transfer from hydroelectricity from the federal government.

Within tax revenues, the General Sales Tax on Services (GSTS), that constitutes around 50 percent share in provincial tax collection, recorded an increase of Rs 142.3 billion in Jul-Mar FY19 as compared to Rs 149.4 billion in the same period of last year. This relatively lower revenue in the current period can be attributed to

[13] Other major components include superannuation allowances & pension, grants (other than provinces), other general public service, public order and safety affairs, economic affairs.

a slowdown in the growth of services sector in the GDP during FY19.[14] The other major components, such as stamp duties and motor vehicle tax, also recorded some moderation in Jul-Mar FY19. For instance, the collection from stamp duties, which constitute around 15 percent share in provincial tax revenues, grew by 11.7 percent in Jul-Mar FY19 as compared to 62.7 percent growth in Jul-Mar FY18. The provinces-wise break-up of tax revenues shows a relatively higher growth of 6.5 percent in Sindh, while tax collections in other provinces remained broadly close to their last year levels.

Table 4.7: Provincial Fiscal Operations (Jul-Mar)
billion Rupees

	Punjab	Sindh	KP	Baluchistan	Total	Growth
FY19						
A. Total Revenue	**1,046.4**	**598.1**	**355.6**	**198.2**	**2,198.3**	**1.5**
Provincial share in federal revenue	866.6	441.9	290.4	180.3	1,779.1	7.9
Provincial own revenue (I+II)	167.5	133.6	41.1	10.8	353.0	-13.2
I. Taxes	141.1	126.7	13.4	6.5	287.7	2.8
II. Non-tax revenue	26.4	6.9	27.7	4.3	65.3	-48.4
Fed loans and transfers	12.3	22.6	24.1	7.1	66.1	-40.3
B. Total expenditure	**889.1**	**545.7**	**316.8**	**154.5**	**1,906.0**	**-5.2**
Current	769.8	466.4	252.3	141.6	1,630.0	13.8
Development	119.3	79.3	64.5	12.9	276.0	-52.2
Gap (A-B)	157.3	52.4	38.8	43.7	292.3	87.4
Financing* (overall balance)	**-172.5**	**-57.4**	**-16.7**	**-45.0**	**-291.6**	**52.6**
FY18						
A. Total Revenue	**1,036.0**	**584.9**	**361.3**	**184.1**	**2,166.3**	**24.8**
Provincial share in federal revenue	801.7	418.1	269.3	159.9	1,649.0	16.0
Provincial own revenue (I+II)	190.5	131.5	69.9	14.8	406.6	40.3
I. Taxes	141.2	119.3	13.0	6.5	280.0	21.5
II. Non-tax revenue	49.3	12.2	57.0	8.3	126.6	113.6
Fed loans and transfers	43.9	35.3	22.1	9.4	110.7	357.3
B. Total expenditure	**1,018.8**	**529.1**	**321.4**	**141.2**	**2,010.5**	**25.8**
Current	659.5	413.9	237.7	121.6	1,432.7	21.8
Development	359.3	115.2	83.7	19.6	577.8	36.7
Gap (A-B)	17.3	55.8	39.9	42.9	155.9	13.3
Financing* (overall balance)	**-62.8**	**-50.0**	**-24.5**	**-53.8**	**-191.0**	**-16.1**

Negative sign in financing means surplus.
Data source: Ministry of Finance and SBP calculations

[14] According to provisional estimates, the services sector has recorded a growth of 4.7 percent in FY19 from 6.2 percent in FY18.

A sharp decline in provincial development expenditure as well

Following the trend of federal fiscal accounts, a sharp reduction in development expenditures was also recorded at provincial level during Jul-Mar FY19. Specifically, a reduction of 52.2 percent in Jul-Mar FY19 was recorded as compared to a growth of 36.7 percent in the same period of last year. Although remaining robust, the provinces witnessed a slight slowdown in the growth of current expenditures that grew by 13.8 percent in the current period as compared to 21.8 percent in Jul-Mar FY18. Therefore, overall expenditures at the provincial level decreased by 5.2 percent in Jul-Mar FY19 against an increase of 25.8 percent in Jul-Mar FY18.

In terms of growth in current expenditures, Punjab and Balochistan recorded the highest growth of 16.8 percent each, followed by 12.6 percent in Sindh and 6.0 percent in KPK. While all provinces recorded a decline in development expenditures, it was more pronounced in Punjab (-66.9 percent), followed by Balochistan (-33.7 percent), Sindh (-31.4 percent) and KPK (-23.5 percent). During Jul-Mar FY19, the share of development expenditure in total expenditures was the highest in KPK (20.2 percent), followed by Sindh (14.5 percent), Punjab (13.4 percent) and Balochistan (8.4 percent).[15]

Table 4.8: Pakistan's Public Debt Profile
billion Rupees

	End period stocks		Flows				
			Jul-Mar		FY19		
	Jun-18	Mar-19	FY18	FY19	Q1	Q2	Q3
Gross public debt	24,952.9	28,607.5	2,667.7	3,654.6	830.6	1,672.4	1,151.6
Government domestic debt	16,416.3	18,170.6	1,224.8	1,754.3	503.6	615.9	634.9
Government external debt	7,795.8	9,625.7	1,350.9	1,829.9	327.1	978.2	524.6
Debt from the IMF	740.8	811.2	91.9	70.4	-0.1	78.3	-7.8
Total debt of the government*	23,024.0	26,368.1	2,424.3	3,344.1	668.0	1,546.2	1,129.9

*Gross public debt minus government deposits with the banking system.

Data source: State Bank of Pakistan and Economic Affairs Division

Consequently, owing to a sharp reduction in development spending and some moderation in the growth of current expenditures, the provinces recorded a combined surplus of Rs 291.6 billion in Jul-Mar FY19, which stands higher as compared to Rs 191.0 billion recorded in Jul-Mar FY18. While all provinces recorded a surplus, Punjab and Sindh contributed most with Rs 172.5 billion and Rs 57.4 billion, respectively.

[15] During Jul-Mar FY18, Punjab had highest share of 35.3 percent followed by Sindh (21.8 percent), KPK (26.0 percent), and Balochistan (13.9 percent).

4.5 Public Debt

As the government struggled to generate sufficient financing from multilateral sources amid ongoing negotiations with the IMF, the government was forced to borrow from the domestic sources. Within domestic debt, borrowing from the central bank increased as commercial banks showed reluctance in lending to the government amid the ongoing phase of monetary tightening. On the face of it, the external debt increased by Rs. 1,800 billion (**Table 4.8**). However, this acceleration was largely due to PKR depreciation as the financing component was at the last year's level.

Table 4.9: Absolute Change in Government Domestic Debt

billion Rupees

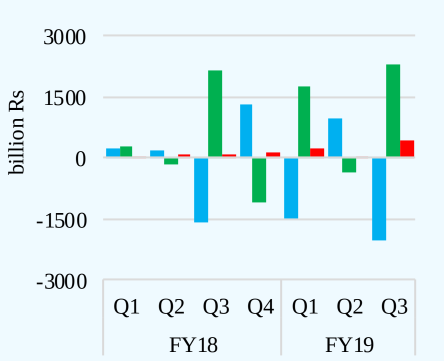
	Jul-Mar		FY19		
	FY18	**FY19**	**Q1**	**Q2**	**Q3**
Domestic debt	**1,224.8**	**1,754.3**	**503.6**	**615.9**	**634.9**
Permanent debt	-999.2	143.6	-290.2	12.8	421.0
of which					
PIBs	-1,067.7	183.0	-332.3	22.5	492.8
Prize bond	68.5	97.2	42.1	35.5	19.6
Floating debt	2,174.7	1,381.5	778.7	619.9	-17.1
of which					
MTBs	-57.0	-2,265.1	-970.7	993.5	-2,287.9
MRTBs	2,231.7	3,646.6	1,749.5	-373.7	2,270.8
Unfunded debt	49.0	228.4	14.8	-17.4	230.9
o/w					
NSS	48.7	225.3	10.5	-15.1	229.9
FC loans	0.4	0.8	0.1	0.6	0.1

Data source: State Bank of Pakistan

Domestic Debt

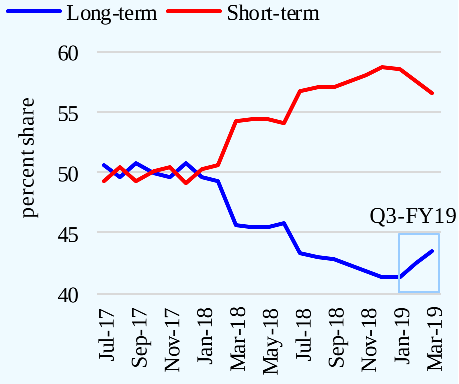
Domestic debt reached Rs 18.2 trillion at end-March 2019 - an addition of Rs 1.75 trillion during Jul-Mar FY19, compared to Rs 1.22 trillion during the previous corresponding period. As mentioned earlier, the composition of domestic debt reflects heavy reliance on central bank borrowing intended for retirements to commercial banks **(Table 4.9 and Figure 4.3)**.

Figure 4.3: Sources of Domestic Debt



Data source: State Bank of Pakistan

Figure 4.4: Maturity-wise Composition of Domestic Debt



Data source: State Bank of Pakistan

Maturity-wise composition of domestic debt shows that up till the first half of FY19, the banks mainly invested in 3-month papers, which was an outcome of expectations of further increase in the policy rates. Resultantly, Market Treasury Bills (MTBs) of maturity more than 3-months remained unattractive.

However, some interest in Pakistan Investment Bonds (PIBs) was also seen during Q3-FY19; out of Rs 1,215.1 billion offered, more than one-third of the bids were accepted which amounted to Rs 496.1 billion. Hence, the overall volume for PIBs for Jul-Mar FY19 was notably higher than the corresponding period last year. This was a positive development as it marginally improved the maturity profile of domestic debt particularly in the third quarter (**Figure 4.4**).

Table 4.10: Net Receipts under NSS Instruments* (Jul-Mar)

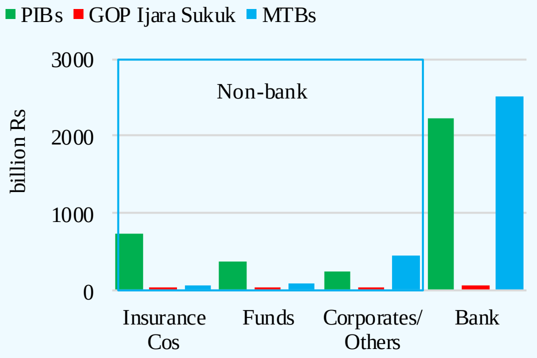
billion Rupees

	FY18	FY19	Abs. Change
Defence Saving Certificates (DSC)	8.3	44.6	36.3
Special Saving Certificates (SSC)	-38.5	33.1	71.6
Regular Income Certificates (RIC)	1.9	102.9	100.9
Behbood Saving Certificates (BSC)	32.1	89.5	57.5
Special Saving Accounts (SSA)	27.5	-75.4	-102.9
Saving Accounts (SA)	2.2	-1.1	-3.3
Others	15.3	31.7	16.5
Total	**48.7**	**225.3**	**176.6**

*excludes short-term savings certificates

Data source: Central Directorate of National Savings

Figure 4.5: Institution-wise Composition of Debt during Jul-Mar FY19



Data source: State Bank of Pakistan

NSS volume increased due to higher returns

In addition, the unfunded debt presented some positive picture as net receipts of National Saving Schemes (NSS) surged to Rs 225.3 billion, compared to only Rs 48.7 billion recorded in the previous corresponding period **(Table 4.10)**. The major rise was observed only in Q3 where the main contribution was from Regular Income Certificates (RICs), followed by Behbood Saving Certificates (BSCs) and Defense Saving Certificates (DSCs). This is due to higher rates offered on these instruments (refer to **Chapter 3**).[16] However, saving and special saving accounts

[16] Central Directorate of National Savings (CDNS) has increased profit rates on the savings' instruments under NSS w.e.f. January 2019. For more details, visit: savings.gov.pk/revised-rates-notification/

recorded a decline during Jul-Mar FY19.

Table 4.11: Public External Debt & Liabilities
billion US dollars

	Stock		Flows				
	End-period		Jul-Mar		FY19		
	Jun-18	Mar-19	FY18	FY19	Q1	Q2	Q3
External public debt & liabilities (i+ii+iii)	75.4	84.2	6.9	8.9	1.0	2.1	5.8
External Public debt (i+ii)	70.2	74.2	6.7	3.9	1.0	0.1	2.7
i. Government debt	64.1	68.4	6.5	4.3	1.2	0.2	2.8
Of which;							
Paris club	11.6	11.3	0.4	-0.4	-0.1	-0.1	-0.1
Multilateral	28.1	27.4	0.8	-0.7	-0.5	0.1	-0.3
Other bilateral	8.7	12.5	1.4	3.8	2.2	0.5	1.1
Euro/Sukuk bonds	7.3	7.3	2.5	0.0	0.0	0.0	0.0
Commercial loans	6.8	8.9	0.7	2.1	0.0	0.0	2.1
Short term	1.6	1.1	0.8	-0.5	-0.3	-0.3	0.1
ii. IMF	6.1	5.8	0.2	-0.3	-0.1	-0.1	-0.1
iii. Foreign exchange liabilities	5.1	10.1	0.2	4.9	-0.1	2.0	3.1

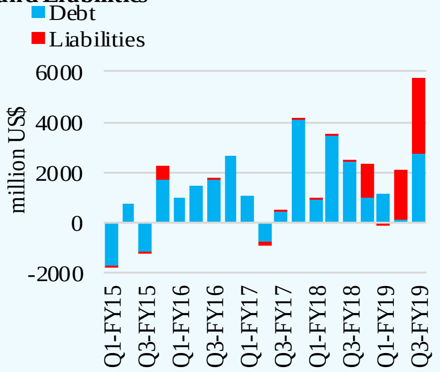
Data source: State Bank of Pakistan and Economic Affairs Division

The non-bank debt showed an uptick constituting mainly from PIBs held by the insurance companies. Meanwhile, MTBs in the non-banking sector gathered some volume that was primarily from corporates **(Figure 4.5)**.

<u>External Public Debt and Liabilities</u>

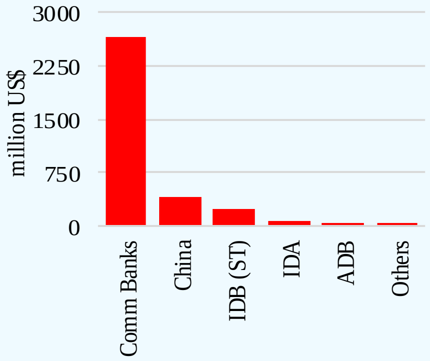
External public debt and liabilities (EDL) went up by US$ 8.9 billion during Jul-Mar FY19 to reach US$ 84.2 billion as of end March 2019 (**Table 4.11**). Particularly, the third quarter witnessed a net increase of US$ 5.8 billion, the

Figure 4.6: Change in External Public Debt and Liabilities



Data source: State Bank of Pakistan and Economic Affairs Division

Figure 4.7: Gross External Loan Disbursement during Q3



Data source: Economic Affairs Division

highest ever quarterly increase in EDL observed during the last five years, driven by changes in both debt and liabilities (**Figure 4.6**).

Although the higher amortization and revaluation gains contributed positively in reducing public debt (in $ terms), significantly higher disbursement resulted in around 12 percent growth in the external debt. In absolute terms, the combined impact of both revaluation changes and amortization was around US$ 800 million during the period under review. Particularly, the revaluation gains were on account of depreciation of major borrowing currencies against US dollar. Having around 34.3 percent share in public and publically guaranteed debt, the debt dominated in three currencies (SDR, Euro and Chinese Yuan) explains around 92 percent of the revaluation changes observed during Jul-Mar FY19.[17]

Borrowing pattern remained skewed towards commercial loans

The external loan disbursement increased mainly on account of US$ 2.6 billion from foreign commercial banks (**Figure 4.7**). Moreover, external liabilities increased by US$ 3 billion in the form of deposit held with the central bank from Saudi Arabia and UAE during Q3-FY19. The inflows from commercial banks were for budgetary support, while UAE and Saudi Arabia made disbursement for BOP support. Within government debt, the project aid was only one-third of the total disbursement that came from China for the infrastructure development in the country. On contrary, there was a net retirement to

Table 4.12: Servicing of Public External Debt (Jul-Mar)
million US dollars

	FY18	FY19	Change
Principal (Long-term)			
i. Government debt	2,045.0	2,511.9	466.9
of which			
Paris club	321.4	338.9	17.5
Multilateral	1,069.6	1,123.3	53.7
Other bilateral	170.1	304.7	134.6
Commercial loans	463.9	745.0	281.1
ii IMF	43.6	250.5	206.9
iii. External liabilities	0	0.0	0.0
I. Total (i+ii+iii)	2,088.5	2,762.4	673.9
Interest			
i. Government debt	997.6	1,361.3	363.7
of which			
Paris club	128.2	121.7	-6.5
Multilateral	273	333.0	60.0
Other bilateral	190.6	297.0	106.4
Euro/Sukuk bonds	171.9	284.2	112.3
Commercial loans	155.2	275.5	120.3
ii. IMF	94.6	108.2	13.6
iii External liabilities	16.3	112.4	96.1
II. Total (i+ii+iii)	1,108.50	1,581.9	473.4
Grand Total (I+II)	**3,197.0**	**4,344.3**	**1,147.3**

Data source: State Bank of Pakistan

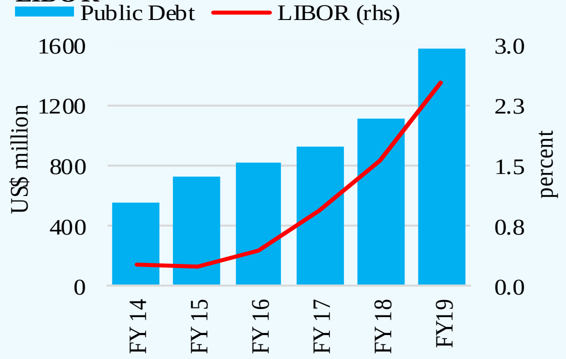
[17] Euro depreciated by 3.6 percent against US$, while SDR and Chinese yuan both depreciated against US$ by 1.3 percent during Jul-Mar FY19.

multilateral donors during the period. However, these loans are likely to revive with the inception of the IMF program that bodes well in terms of servicing cost, as these loans are relatively long-term and concessional in nature.

External debt servicing increased

External debt servicing was up by US$ 1.1 billion, reaching US$ 4.3 billion during Jul-Mar FY19 (**Table 4.12**). The increase was due to both higher amortization and interest payments during the period. Within government debt, around half of the repayments were made to multilateral donors. Moreover, the repayment to commercial lenders and IMF's EFF loan grew significantly during the period under review.

Figure 4.8: Interest Payment viz a viz 3-Month LIBOR



Data source: State Bank of Pakistan and www.macrotrends.net

The interest payments increased by US$ 473.4 million to reach US$ 1.6 billion during Jul-Mar FY19. In line with the recent external borrowing trends, the interest payments grew significantly during the past few years. Particularly, the interest payment to commercial lenders and bilateral donors went up during the period. Along with higher external debt stock, increase in the benchmark rate (i.e. LIBOR) was also responsible for higher interest payments during the recent years (**Figure 4.8**).

From the debt sustainability perspective, the country's repayment capacity weakened as debt servicing to foreign exchange earnings increased to 14.0 percent during Jul-Mar FY19 from 9.7 percent in the same period last year. Similarly, debt-bearing capacity measured in terms of public external debt to FX reserves ratio also deteriorated to 4.8 in March 2019 from 4.1 in the same period last year.