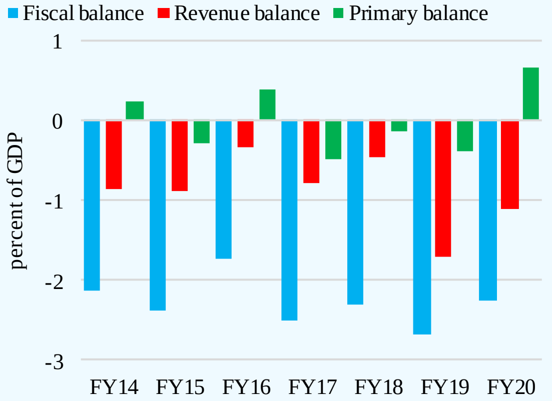
4 Fiscal Policy and Public Debt

4.1 Overview

The fiscal position significantly improved during H1-FY20. Fiscal deficit was recorded at 2.3 percent of GDP, against 2.7 percent last year (**Figure 4.1**). In particular, the primary surplus was almost three times the revised target set by the IMF program. This improvement is primarily attributed to a large increase in revenue collection that outpaced the expenditure growth. While the increase in revenues emanated from both tax and non-tax segments, the overall expenditures rose on the back of higher interest payments, grants, and development expenditures.

Figure 4.1: Fiscal Indicators during H1



Data source: Ministry of Finance

The strict fiscal controls employed during Q1-FY20 provided greater fiscal space to increase expenditures in Q2. Importantly, there was an uptick in expenditures on social and development fronts. During Q2-FY20, the growth in expenditures, however, more than offset the rise in revenues. Resultantly, the fiscal deficit clocked at 1.6 percent of GDP in Q2, compared to 0.7 percent in Q1-FY20 and 1.3 percent in Q2-FY19.

Revenue collection increased sharply in contrast to a decline recorded during H1-FY19 despite an overall slowdown in economic activity and a marked contraction in imports (**Table 4.1**). Policy measures, such as an increase in GST on petroleum products, re-enactment of taxes on telecom services, increased excise duty on cement and cigarettes, upward adjustment in power tariffs, upward revision in tax rate on salary slabs, end of preferential treatment sectors and zero-rating regime for five export-oriented sectors, contributed to this higher growth in revenues. Higher inflation may have contributed in higher revenue mobilization as well. *One-off factors* such as the GSM renewal fee and higher SBP profits were the main sources of non-tax revenues. However, the tax revenue target agreed under the IMF program could not be achieved during H1-FY20. Notably, the import compression measures adversely affected the revenue mobilization, since 40 percent of annual total tax collection is associated with imports.

Both current and development expenditures grew sharply during H1-FY20 as compared to last year **(Table 4.1)**. Higher growth of current spending was led by interest payments and grants, which were especially concentrated in Q2.[1] At the same time, the development expenditures also grew sharply at both the federal and provincial levels.

Table 4.1: Summary of Fiscal Operations in H1
billion rupees

	Actual			Growth		
	FY18	**FY19**	**FY20**	**FY18**	**FY19**	**FY20**
A. Total revenue	2,384.7	2,327.1	3,231.9	19.8	-2.4	38.9
Tax revenue	2,026.9	2,082.5	2,465.2	16.4	2.7	18.4
Non-tax revenue	357.8	244.6	766.7	43.4	-31.6	213.4
B. Total expenditure	3,181.0	3,357.0	4,226.6	14.0	5.5	25.9
Current	2,545.2	2,984.4	3,721.4	13.5	17.3	24.7
Interest payments	751.4	876.7	1,281.2	16.1	16.7	46.1
Development	574.8	361.1	464.9	15.6	-37.2	28.8
Net lending	2.0	8.3	8.3	-131.4	311.8	0.3
C. Statistical discrepancy	59.0	3.2	32.0			
Fiscal balance (A-B-C)	-796.3	-1,029.9	-994.7			
Revenue balance	-160.5	-657.3	-489.4			
Primary balance	-44.9	-153.2	286.5			
Financing	796.3	1,029.9	994.7			
External sources	384.1	218.0	513.6			
Domestic sources	412.2	811.9	481.1			
Banks	331.8	577.6	41.7			
Non-bank	80.4	234.4	439.4			
As percent of GDP						
Total Revenue	6.9	6.0	7.3			
Tax	5.9	5.4	5.6			
Non-tax	1.0	0.6	1.7			
Total expenditure	9.2	8.7	9.6			
Current	7.4	7.7	8.5			
Development	1.7	0.9	1.1			

Data source: Ministry of Finance

Lower financing needs, supported by an appreciation of PKR against the US dollar, contained the pace of public debt accumulation. The composition of

[1] The federal current spending was around 42.0 percent of the annual target during H1-FY20.

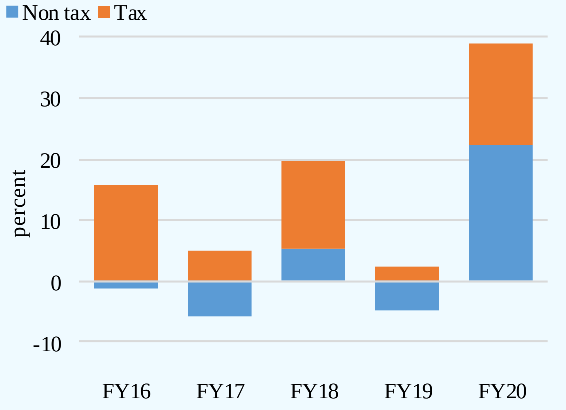
domestic debt also witnessed a transition, as the government strictly adhered to its commitment of zero borrowing from the central bank. Furthermore, as part of its debt management strategy, the government utilized its deposits (cash buffers) to meet its financing needs and retire existing debt stock. External debt increased in dollar terms on account of fresh borrowing from multilateral and commercial sources, receipt of IMF tranches, and a rise in foreign investment in government securities. These inflows more than offset the bulky repayments (including Sukuk of US$ 1.0 billion) during this period.

4.2 Revenues

Overall revenue collection increased during H1-FY20 compared to contraction observed during the same period last year **(Figure 4.2)**. The main increase came from a substantial rise in FBR taxes, supported by higher growth in non-tax revenues.

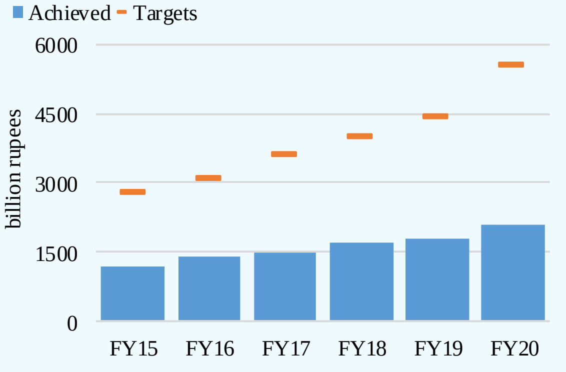
Total revenue collection posted a growth of 38.9 percent during H1-FY20 against a decline of 2.4 percent in the corresponding period last year. Despite the economic slowdown and a significant contraction in imports, tax revenue recorded a growth of 18.4 percent compared to the average growth of 12.4 percent during H1 of the last five years. Notwithstanding a notable growth in FBR taxes and improved tax collection efforts, FBR taxes could only achieve 37.7 percent of the budgeted target for FY20 **(Figure 4.3)**.[2]

Figure 4.2: Contribution in Revenue Growth in H1



Data source: Federal Board of Revenue

Figure 4.3: FBR Tax Revenue Collection during H1 in Comparison with Budgeted Target



Data source: Ministry of Finance

[2] On average, 42.0 percent of the budgeted annual target was achieved during first half of last 5 years.

FBR taxes

FBR tax collection grew by 16.7 percent during H1-FY20, compared with a meager growth of 4.3 percent in the corresponding period last year **(Table 4.2)**. The rise in FBR taxes was mainly supported by higher sales tax rates on various POL products, abolishment of zero-rating regime for export-oriented sectors, upward revision of tax rates on various salary slabs, re-enactment of WHT on telecom services, and higher FED rates. However, FBR would be required to put more collection efforts to further boost the revenues. In specific terms, FBR needs to collect Rs 3,143.9 billion in H2 to achieve the revised annual target of Rs 5,238.0 billion.

Table 4.2: FBR Tax Collection during H1
billion rupees; growth in percent

	Budget FY20*	Collection			Growth		
		FY18	FY19	FY20	FY18	FY19	FY20
Direct taxes	2,081.9	663.5	668.4	784.9	12.2	0.7	17.4
Indirect taxes	3,473.0	1,058.1	1,126.4	1,309.2	20.1	6.5	16.2
Customs duty	1,000.5	281.5	336.0	326.6	29.1	19.4	-2.8
Sales tax	2,107.7	686.5	688.0	857.5	18.9	0.2	24.6
FED	364.8	90.1	102.3	125.1	5.5	13.6	22.2
Total taxes	**5,555.0**	**1,721.6**	**1,794.8**	**2,094.1**	**16.9**	**4.3**	**16.7**

*Budget in Brief, Ministry of Finance
Data source: Federal Board of Revenue and Ministry of Finance

Importantly, the fiscal authorities have taken various steps during H1-FY20 to facilitate taxpayers in order to increase the tax base. These include: introduction of Fully Automated Sales Tax e-Refund system[3]; launch of FBR Tax Asaan mobile application; and a trade enablement program "Authorized Economic Operators" (AEO).[4] Moreover, FBR has introduced a Point of Sales (POS) system, which integrates the sales record with the FBR's centralized system of FBR.

Direct Taxes

Direct taxes, having a share of 37 percent in FBR taxes, recorded a growth of 17.4 percent in H1-FY20 against the growth of 0.7 percent in the same period last year.

[3] The refunds during H1-FY20 increased by 37.0 percent to Rs 75.5 billion against Rs 55.1 billion in H1-FY19.
[4] With AEO, the government will endorse the businesses with maximum compliance to the law, and shall be facilitated on priority basis.

This growth is explained by the upward revision in salary slabs, increase in tax rates on profit on debt, and the re-enactment of WHT on mobile phone top-ups.

The WHT contributed the most to direct taxes during H1-FY20 with salaries, bank interest and securities, and telephone together contributed 11.8 percentage points to the overall growth **(Table 4.3)**.[5] However, WHT from imports declined by 7.3 percent amid the declining trend in imports during H1-FY20.[6] Collection from contracts posted a growth of 5.9 percent in H1 FY20 compared to a 16.1 percent decline in the corresponding period last year. This rise was mainly because of an increase in PSDP releases.

Table 4.3: Major Revenue Spinners of Direct Taxes in H1

billion rupees; growth in percent

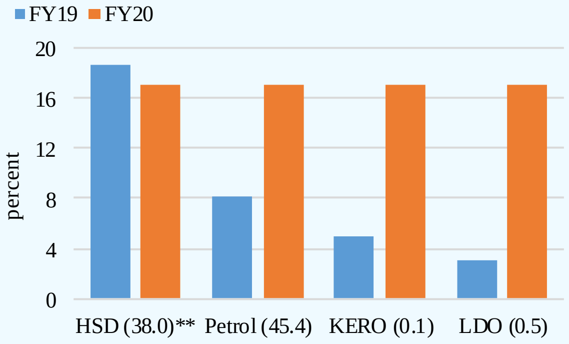
	FY19	FY20	Change FY19	Change FY20
Withholding taxes	**449.4**	**544.5**	**-42.1**	**95.1**
growth	*-8.6*	*21.2*		
Imports	114.2	105.8	9.4	-8.4
Salaries	32.8	57.5	-25.0	24.7
Dividends	25.4	30.4	-5.4	5.0
Bank interest & securities	25.9	56.7	3.6	30.8
Contracts	106.5	112.8	-20.5	6.3
Exports	15.5	19.9	2.1	4.4
Cash withdrawal	17.8	8.6	1.7	-9.2
Electricity bills	19.2	24.9	2.6	5.7
Telephone	3.7	27.0	-21.4	23.3
Collection on demand	**32.7**	**19.7**	**-7.4**	**-13.0**
growth	*-18.5*	*-39.8*		
Voluntary payment	**227.1**	**248.2**	**52.9**	**21.1**
growth	*30.4*	*9.3*		
Miscellaneous	-15.0	8.6	-17.9	23.6
Net direct taxes	668.4	784.9	4.9	116.5

Data source: Federal Board of Revenue

Indirect tax

Indirect taxes posted a growth of 16.2 percent during H1-FY20 against the subdued growth of 6.5 percent in the corresponding period last year **(Table 4.4)**. The rise in indirect taxes mainly derived from the higher sales tax and FED rates. Sales tax (mainly on POL products) alone contributed around 15.1 percentage points to the 16.2 percent growth in indirect taxes. Meanwhile, the increase in sales tax rates on petroleum was the

Figure 4.4: Sales Tax Rates on POL Products in H1*



*Effective rates are calculated on basis of weighted averages for H1. **Shares in parentheses.

Data source: Federal Board of Revenue and SBP calculations

[5] Higher interest rates and increased tax rates on profit increased the collection from bank interest and securities by Rs 30.8 billion.

[6] The imports declined by 17.0 percent in H1-FY20.

major driving factor in the upsurge in the collection during H1-FY20 **(Figure 4.4).**

The collection from electrical energy was the second major contributor to the sales tax growth, which is explained by the upward price adjustments in tariffs and the abolishment of zero-rating regime for export-oriented sectors.[7] Moreover, the upward revision in sales tax rates on sugar also contributed in higher revenue collection. With increase in tax rates and higher import cost (in rupee terms), the collection from iron and steel also grew by 17.8 percent. At the same time, collection from textile related items also recorded an upsurge during H1-FY20 on the back of the abolishment of zero-rating regime.

Growth in FED almost doubled in H1-FY20 when compared to the 5 year average of the same period. This growth is attributed to the upward revision in FED rates.[8] Cement, cigarettes & tobacco, and beverages together contributed more than half to its growth during the review period.

Table 4.4: Major Revenue Spinners of Sales Tax in H1
billion rupees; growth in percent

	Actual		Growth	
	FY19	**FY20**	**FY19**	**FY20**
Sales Tax	**688.0**	**857.5**	**0.2**	**24.6**
Of which				
POL	222.4	264.2	-14.4	18.8
Electrical energy (DISCOS)	28.6	52.6	-8.6	83.9
Iron and steel	39.9	47.0	23.5	17.8
Nuclear reactor & boiler	34.5	31.8	16.3	-7.8
Plastics	24.3	27.7	907.3	14.2
Semiconductor	25.9	27.5	5.9	6.3
Vehicles	35.3	23.2	7.5	-34.3
Textile related items	1.6	25.0	-	-
Sugar	9.7	16.5	4.6	69.6
Others	278.5	344.4	0.8	23.7
Indirect taxes	**1,126.4**	**1,309.2**	**6.5**	**16.2**

Data source: Federal Board of Revenue

Table 4.5: Major Revenue Spinners of Excise and Custom Duty in H1
billion rupees; growth in percent

	Actual		Growth	
	FY19	**FY20**	**FY19**	**FY20**
FED				
Cement	27.8	35.5	17.8	27.6
Cigarettes & tobacco	32.2	35.4	31.4	9.9
Total services	19.6	20.0	-2.0	2.1
Beverages	10.3	14.3	6.2	39.2
Others	12.4	19.8	0.8	60.0
Total	**102.3**	**125.1**	**13.5**	**22.3**
Custom Duty				
Pol	41.5	45.4	37.0	9.4
Vehicles	48.4	30.6	-1.0	-36.8
Photosensitive semiconductor	19.0	29.8	30.9	56.8
Iron and steel	25.0	22.7	26.2	-9.1
Nuclear reactor & boiler	20.5	16.5	22.0	-19.7
Edible Oil	15.4	15.4	-	0.0
Other	166.5	166.3	10.1	-0.1
Total	**336.0**	**326.6**	**13.3**	**-2.8**
Indirect Taxes	**1,126.4**	**1,309.2**	**6.5**	**16.2**

Data source: Federal Board of Revenue

[7] These sectors are now liable to pay sales tax on electricity consumption.
[8] The revised rate for beverages was increased to 13.0 percent from 11.5 percent. While FED on cigarettes and cement was increased by Rs 700 per 1000 sticks and Rs 0.5 per kg respectively.

Major drag came from the collection from customs duty (25 percent of indirect taxes), which declined by 2.8 percent in H1-FY20. Within this category, the slowdown mainly stemmed from a decline in collection from imported vehicles; it is worth noting that the import of vehicles has been constrained by regulatory measures (**Chapter 5**) as well as an increase in their cost following the currency adjustment (**Table 4.5**). [9]

Non-tax revenues

The overall non-tax revenues grew significantly by Rs 522.1 billion in H1-FY20, compared to a decline of Rs113.2 billion during the same period last year **(Table 4.6)**. The major rise in non-tax revenue emanated from higher SBP profits and GSM license renewal fee. The higher SBP profit resulted on account of the government's high debt stock, higher interest rates, and revaluation gains on reserves and profits. Further impetus to the non-tax revenue came from the hydroelectric profits from provinces.

Table 4.6: Non-tax Revenues during H1 (Consolidated)

billion rupees

	Actual		Abs. change	
	FY19	**FY20**	**FY19**	**FY20**
Mark-up (PSEs & others)	5.8	27.4	-8.1	21.6
Dividends	30.2	26.2	11.0	-4.0
SBP profits	63.2	426.5	-62.0	363.3
Defense	6.3	6.5	0.2	0.2
Profits from post office/PTA	15.9	112.1	7.3	96.2
Royalties on gas & oil	41.9	43.8	15.3	2.0
Passport & other fees	9.3	11.4	1.8	2.1
Discount retained on crude oil	6.5	7.2	2.4	0.7
Windfall levy against crude oil	4.5	3.3	3.7	-1.2
Petroleum levy on LPG	1.8	1.7	1.5	-0.1
Other	59.3	100.6	-86.5	41.3
Total	**244.6**	**766.7**	**-113.2**	**522.1**

Data source: Ministry of Finance

4.3 Expenditures

The trend of expenditure containment in Q1-FY20 was reversed in Q2-FY20 with a broad-based growth in current and development spending. The increase in current spending was more pronounced in the second quarter and mainly came from higher interest payments and grants for social spending (*Ehsaas* program). In addition, the development spending also grew with a higher pace during H1-FY20 **(Table 4.7)**.

[9] Dutiable imports (in rupee terms) declined by 7.2 percent during H1-FY20, whereas duty-free imports recorded a growth of 18.2 percent in H1-FY20.

Table 4.7: Fiscal Spending
billion rupees, growth in percent

			Abs. change		Growth	
	FY19	FY20	FY19	FY20	FY19	FY20
Current expenditures	**2,984.4**	**3,721.4**	**439.1**	**737.0**	**17.3**	**24.7**
Federal	1,936.2	2,593.0	280.2	656.8	16.9	33.9
of which						
Interest payments	876.7	1,281.2	125.3	404.5	16.7	46.1
Domestic	752.1	1,120.7	74.1	368.6	10.9	49.0
Foreign	124.6	160.5	51.1	35.9	69.6	28.8
Grants	129.0	239.6	-1.0	110.6	-0.8	85.7
Defense	479.6	529.5	86.2	49.9	21.9	10.4
Public order and safety	68.8	72.1	9.3	3.3	15.6	4.8
Others	382.1	470.6	60.5	88.5	18.8	23.2
Provincial	1,048.2	1128.4	159.0	80.2	17.9	7.6
Development expenditures	**361.1**	**464.9**	-213.7	**103.9**	**-37.2**	28.8
PSDP	328.2	456.8	-191.6	128.6	-36.9	39.2
Federal	160.5	237.5	-42.5	77.0	-20.9	48.0
Provincial	167.7	219.4	-149.0	51.6	-47.1	30.8
Others	32.9	8.1	-22.2	-24.7	-40.3	-75.3
Net lending	**8.3**	**8.3**	**6.3**	**0.0**	**311.8**	**0.3**
Total Expenditure*	**3,353.8**	**4,194.6**	**231.7**	**840.9**	**7.4**	**25.1**

* Excluding statistical discrepancy
Data Source: Ministry of Finance

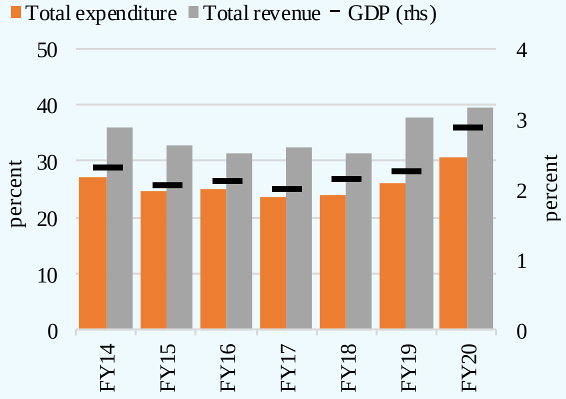
There was a notable increase in the grants during the period.[10] This shows the government's preference towards social spending, which is also evident from the launch of the *Ehsaas program* in March 2019. Interest payments also increased mainly on domestic debt during H1-FY20. The re-profiling of domestic debt besides higher interest rates largely contributed to higher interest payments.[11] As shown in **(Figure 4.5)**, interest payments relative to expenditures, size of the economy and revenues has grown substantially during the period under review. [12]

During H1-FY20, the development expenditures grew sharply across both federal and provincial levels **(Table 4.7)**. Specifically, PSDP releases recorded an

[10]Previously, the budget allocation of *development expenditure outside PSDP* was reported under the development spending. Now, under the revised public financial management, ***grants*** are reported under federal current spending. Also, the budgeted target for the grants was comparatively higher i.e. Rs 734.7 billion as compared to Rs 449.9 billion.
[11] In June 2019, the government converted the stock of short-term MRTBs held by the SBP into long-term PIBs of various maturities. Around 70 percent of the MRTBs were converted into 10-year PIBs with floating rates.
[12] Interest payments have an average share of about 43.5 percent in last 10 years in federal current spending during H1.

increase of 60.3 percent (39.4 percent of target) in contrast to a decline posted in the same period last year. However, they remained lower than the 50 percent expenditure envisaged in PFM procedures.[13] Further disaggregation of PSDP releases showed the same development preferences, such as the federal ministries, infrastructure (especially National Highway Authority), and some specialized development programs for special areas.

Figure 4.5: Interest Payments during H1 (as percent of)



Data source: Ministry of Finance

4.4 Provincial Fiscal Operations

Provinces adhered to the fiscal consolidation efforts by posting a surplus of Rs 348.4 billion during H1-FY20, which is around 82 percent of the full year budgeted target. Punjab and Balochistan contributed the most to this surplus **(Table 4.8)**.

Table 4.8: Provincial Fiscal Operations during H1

billion rupees and growth in percent

	Total		Growth	
	FY19	**FY20**	**FY19**	**FY20**
A. Total revenue (I+II+III)	1,471.8	1,683.4	4.9	14.4
I. Provincial share in federal revenue	1,199.3	1,325.8	9.6	10.5
II. Provincial Revenue	217.0	274.3	-9.9	26.4
Taxes	187.8	214.4	6.4	14.2
Non-tax revenue	29.3	59.9	-54.6	104.8
III. Fed loans and transfers	55.5	83.2	-18.6	50.0
B. Total expenditure (I+II)	1,224.3	1,359.7	0.9	11.1
I. Current**	1,056.6	1,140.4	17.9	7.9
II. Development	167.7	219.4	-47.1	30.8
Gap (A-B)	247.5	323.7	30.4	30.8
Financing* (overall balance)	**-273.2**	**-348.4**	**34.0**	**27.5**

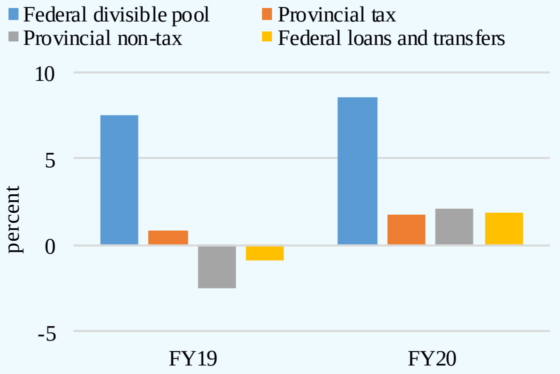
*Negative sign in financing means surplus. ** Current expenditure data may not match with those given in Table 4.7, as numbers reported here includes the markup payments to federal government.
Data source: Ministry of Finance and SBP calculations

[13] Revised Release Strategy for Funds Allocated for the Public Sector Development Programme (PSDP) 2019-20

Total provincial revenues grew by 14.4 percent during H1-FY20, as compared to 4.9 percent in last year. A big chunk of provincial revenue came from federal side in the form of provincial share (as per the NFC award) and federal loans and transfers. However, the provincial non-tax revenue rebounded from a decline and grew sharply during H1-FY20 **(Figure 4.6)**.

Encouragingly, provincial own revenue collection grew sharply by 26.4 percent during H1-FY20 as compared to a decline of 9.9 percent last year. The increase was broad-based as both the tax and non-tax sources contributed. General sales tax on services (GSTS) continued to be the major spinner of provincial tax collection;[14] all provinces recorded a significant increase, leading to a growth of 19.9 percent during H1-FY20 as compared to a decline of 1.8 percent recorded last year. However, a decline was observed in the collections of excise duty and motor vehicle taxes due to lower growth in the production of cars and motorcycles during the period under review.

Figure 4.6 Composition of Provincial Revenue duirng H1 (Contribution in growth)



Data source: Ministry of Finance and SBP calculations

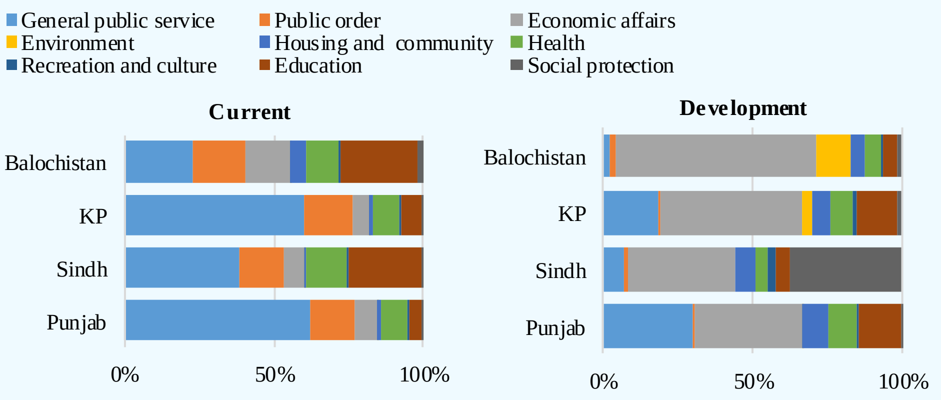
Non-tax revenue also surged mainly on the back of *profits from hydroelectricity*. KP (Rs. 13 billion) and Punjab (Rs. 6 billion) contributed the most in the collection under this head.

The total provincial expenditure rose by 11.1 percent during H1-FY20 as compared to 0.9 percent last year. This stemmed from a sharp growth in development spending; however, the current spending decelerated during H1-FY20.

[14] As per the *Human Rights Case No. 18877 of 2018*, there was a ban on collection of sales tax on mobile top-ups that was applicable to all the provinces. Since telecom services make as significant share of taxable services, the collection was lower in H1-FY19. However, the GSTS for provinces increased in H1-FY20 with the revoke of the ban.

The disaggregated analysis shows that the provincial current spending preferences continued to remain towards general public services followed by public order and health. [15] A major portion of development spending was allocated to economic affairs, primarily construction and transport, agriculture and food related spending. **Figure 4.7** summarizes the provincial priorities in the current and development expenditure during H1-FY20.

Figure 4.7: Composition of Provincial Expenditures during H1-FY20



Data source: Ministry of Finance

4.5 Public debt

The pace of public debt accumulation decelerated in H1-FY20 with an increase of Rs 1.0 trillion compared to a rise of Rs 2.5 trillion during the corresponding period last year (**Table 4.9**). This slowdown in growth of public debt was due to lower financing needs and appreciation of PKR against the US dollar. Bifurcation of public debt indicates that the Rupee value of external debt declined due to revaluation gains on the existing debt stock during H1-FY20. Although the domestic debt increased during the period under review, the rise was lower than the same period last year. Furthermore, the structure of domestic debt also changed in H1-FY20, as the government remained committed to zero fresh borrowing from the central bank and mainly relied on non-banks and commercial banks for fund mobilization.

Quarterly analysis reveals that the public debt decreased by Rs 0.5 trillion in Q2-FY20 compared to a rise of Rs 1.5 trillion in Q1-FY20. The government used its deposits with the banking system (cash buffers) to make net retirements of public

[15] General public services include executive, legislative, financial, and fiscal affairs, transfers to districts, administration of general services to public etc.

debt in Q2-FY20 (**Table 4.9**). External debt, on the other hand, increased during the second quarter as foreign investment in government securities along with fresh borrowing from multilateral and commercial sources increased. These inflows led to smoother repayment of Sukuk and other bilateral and multilateral loans.

Table 4.9: Pakistan's Public Debt Profile
billion rupees

	End period stocks		Flows			
			FY20		H1	
	Jun-19	Dec-19	Q1	Q2	FY19	FY20
Gross public debt	32,707.9	33,711.6	1,532.8	-528.9	2,503.0	1,003.8
Government domestic debt	20,731.8	21,676.4	1,918.1	-973.5	1,119.5	944.6
Government external debt	11,055.1	10,993.0	-457.1	395.0	1,305.3	-62.1
Debt from the IMF	921.0	1,042.3	71.7	49.5	78.2	121.3
Total debt of the government*	29,520.7	29,969.3	-220.6	669.2	2,214.3	448.6
Govt. deposits with the banking system	3,187.2	3,742.4	1,753.4	-1,198.2	288.8	555.2

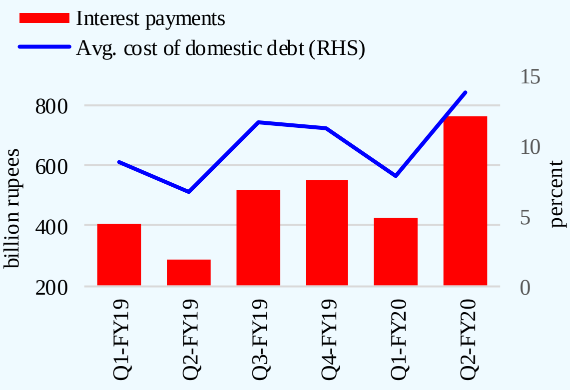
*Gross public debt minus government deposits with the banking system.
Data source: State Bank of Pakistan and Economic Affairs Division

In terms of the composition of public debt, the share of domestic and external debt has not changed much compared to end of FY19. However, tenor-wise analysis indicates that the share of long-term debt has increased. This bodes well from the debt management point of view, as the average term to maturity improved and roll-over risks associated with short-term debt decreased.

Domestic debt

Domestic debt increased by Rs 0.9 trillion in H1-FY20, lower than the accumulation of Rs 1.1 trillion witnessed in the same period last year. The government adhered to its commitment of zero borrowing from the central bank throughout H1-FY20. However, the average cost of domestic debt, measured by the actual interest paid as percent of average level of debt, also increased sharply in Q2-FY20 (**Figure 4.8**).

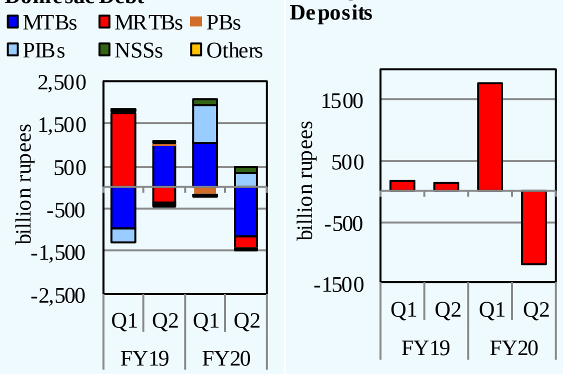
Figure 4.8: Annualized Average Cost of Domestic Debt*



*actual interest paid, as percent of 2 year average level of debt
Data source: State Bank of Pakistan

Dynamics of domestic debt changed considerably in Q2-FY20. Unlike Q1-FY20, when the government mobilized substantial funding through T-bills and PIBs, Q2-FY20 witnessed a visible contraction in the stock of domestic debt. Main contribution to this contraction came from the net retirements of short-term loans (both to commercial banks and the central bank), while fund mobilization through PIBs also remained lower in Q2-FY20. It must be recalled that the government had created substantial cash buffers (accumulated deposits with the banking system) during the first quarter of FY20. However, in Q2-FY20, the government largely utilized its deposits with the banking system for repayments. As evident in **Figure 4.9**, the government's deposits declined significantly during Q2-FY20 by almost two-third of the deposits it accumulated in Q1-FY20.

Figure 4.9: Change in Domestic Debt



Data sources: State Bank of Pakistan & Central Directorate of National Savings

Table 4.10: Net Receipts under NSS Instruments in H1
billion rupees

	Net Receipts		Avg. Profit Rates	
	FY19	**FY20**	**FY19**	**FY20**
DSCs	-1.0	89.6	9.1	11.8
SSCs	-1.8	-10.4	7.9	12.0
RICs	17.4	69.9	8.8	11.9
BSCs	42.1	63.7	11.0	13.6
SSAs	-79.3	32.3	7.9	12.0
PBAs	14.9	19.9	11.0	13.6
SFWAs	0.0	4.2	11.0	13.6
Prize bond	77.6	-157.8	NA	NA
Others	3.1	0.7	NA	NA
NSS	**73.0**	**112.1**	**NA**	**NA**

Data sources: Central Directorate of National Savings & State Bank of Pakistan

Fund mobilization through NSS accelerated

The government also accumulated debt through National Savings Schemes (NSS), as returns offered on most of the instruments remained relatively higher than the corresponding period of last year **(Table 4.10)**. In addition, there was also a possible switchover from the discontinued 40,000 denomination prize bonds towards other NSS instruments. An instrument-wise breakup shows that Regular Income Certificate (RIC) and Behbood Saving Certificate (BSC) were the major contributors.

Public external debt & liabilities

The pace of increase in public external debt & liabilities in US dollar terms accelerated in H1-FY20, an increase of US$ 3.7 billion compared to an increase of US$ 3.1 billion during the same period last year (**Table 4.11**). Although financing needs were lower in HI-FY20, the commencement of the IMF program and the improvement in credit outlook of the country helped mobilize funds through some multilateral and commercial loans. In addition, one third of the change in external debt was attributed to foreign investment in government securities. These inflows helped in smoothing the repayments of the maturing debt during this period.

Table 4.11: Public external debt & liabilities
billion US$

	Stock		Flow			
	Jun-19	Dec-19	H1-FY19	H1-FY20	Q1-FY20	Q2-FY20
A. Government debt	67.8	71.0	1.4	3.2	0.0	3.2
Of which						
Paris club	11.2	10.9	-0.3	-0.3	-0.2	-0.2
Multilateral	27.8	29.4	-0.4	1.6	0.3	1.3
Euro/Sukuk	6.3	5.3	0.0	-1.0	0.0	-1.0
Bilateral	12.7	13.2	2.7	0.5	0.1	0.4
Commercial loans (LT)	8.5	9.3	0.0	0.8	-0.5	1.3
Local currency securities (ST)	0.0	1.6	0.0	1.6	0.4	1.2
B. Debt from IMF	5.6	6.7	-0.2	1.1	0.7	0.4
C. Foreign exchange. liabilities	10.5	9.9	1.9	-0.6	-0.1	-0.4
Public external debt & liabilities (A+B+C)	83.9	87.7	3.1	3.7	0.6	3.1

Data source: State Bank of Pakistan and Economic Affairs Division

Revaluations gains helped in containing the pace of debt accumulation

The impact of fresh external borrowing was also partly offset by revaluation gains of approximately US$ 0.2 billion during H1-FY20. Out of this, the major contribution came from depreciation of the SDR, Japanese Yen, Euro and Chinese yuan against the US Dollar. It must be recalled that all of the revaluation gains (US$ 0.7 billion) arose during Q1-FY20. The US dollar depreciated significantly during Q2-FY20, leading to revaluation losses of US$ 0.5 billion.

Debt servicing remained high

Debt servicing of public external debt (both principal and interest payments) increased to US$ 5.9 billion in H1-FY20 as compared to US$ 3.8 billion in the same period last year. Within principal component, Sukuk (US$ 1.0 billion), bilateral and commercial loan repayments recorded a significant increase. Interest payments also recorded an increase of US$ 1.2 billion in H1-FY20, slightly higher than US$ 1.0 billion in H1-FY19. This was mainly driven by higher payments on bilateral and commercial loans **(Table 4.12)**.

Table 4.12: Public External Debt Servicing in H1

million US$

	FY19	FY20	Change
Principal (P)			
Public debt(a+b)	2,676.8	4,656.5	1,979.7
a. Government debt	2,551.3	3,826.0	1,274.6
Paris club	315.6	340.3	24.8
Multilateral	663.5	726.7	63.2
Other bilateral	162.3	196.7	34.4
Commercial loans (LT)	200.0	1,130.0	930.0
Euro/Sukuk bonds	0.0	1000.0	1000.0
Short term	1,210.0	431.5	-778.4.
b. IMF	125.5	330.6	205.1
Interest (I)			
Public debt (a+b)	1,089.9	1,203.3	113.4
a. Government debt	946.2	999.8	53.6
Paris club	116.0	110.8	-5.2
Multilateral	217.2	229.6	12.4
Other bilateral	121.0	182.1	61.1
Euro/Sukuk bonds	251.8	215.1	-36.7
Commercial loans (LT)	198.1	235.1	37.0
Multilateral (ST)	31.0	16.8	-14.1
b. IMF	71.2	84.9	13.7
Total (P+I)	3,766.7	5859.8	2093.1

Data source: State Bank of Pakistan

External debt sustainability indicators present a mixed picture

From sustainability perspective, relevant indicators (solvency and liquidity) present a mixed picture at the end of H1-FY20 (**Table 4.13**). Some of the solvency indicators such as the ratio of external debt and liabilities as percent of GDP have improved considerably compared to the end of FY19.

Similarly, contained current account deficit and substantial inflows have improved the ratio of reserves to debt & liabilities. However, liquidity indicators deteriorated, as the share of short-term external debt ticked up during the period under review. Foreign investment worth US$ 1.6 billion in domestic government securities (mainly T-bills) during H1-FY20 increased the share of short-term external debt in total external debt from 1.5 to 3.2 percent.

Table 4.13: Indicators of External Debt Sustainability

Percent

	Jun-15	Jun-16	Jun-17	Jun-18	Jun-19	Dec-19
Solvency indicators						
Total external debt and liabilities/GDP	24.2	26.6	27.4	33.5	45	39.5
Public external debt/GDP	18.9	20.8	20.5	24.7	31.1	27.1
Total reserves/total external debt & liabilities	28.7	31.2	25.7	17.2	13.6	16.3
SBP reserves/total external debt & liabilities	20.8	24.5	19.3	10.3	6.8	10.3
External debt servicing/FX earnings	10.2	10.4	15.7	13.8	21	24.8
External debt servicing/export earnings	18	19.4	29.6	24.9	39.1	56.4
Liquidity indicators						
Short-term external public debt/PEDL	1.9	2.8	1.3	2.1	1.5	3.2
Short-term external public debt/total reserves	5.4	7.3	4.1	9.9	8.7	15.5
Short-term external public debt/SBP reserves	7.5	9.3	5.5	16.3	16.3	23.9

Data source: State Bank of Pakistan Calculation