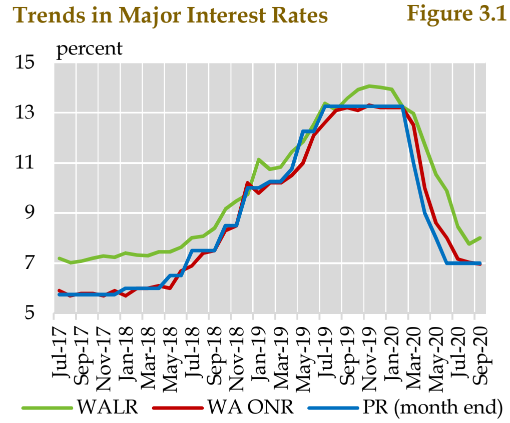
3 Monetary Policy and Inflation

With improving demand indicators and no change in the inflation forecast, SBP kept the policy rate unchanged at 7 percent during Q1-FY21. Continuation of the accommodative monetary stance was deemed appropriate to provide necessary support to the ongoing economic recovery while keeping inflation expectations well-anchored and maintaining financial stability. On the inflation front, food prices remained at an elevated level due to supply-side shocks, offsetting the impact of largely stable non-food prices and leading to a slight increase in the headline inflation for Q1-FY21 compared to Q4-FY20. These developments contributed to an uptick in secondary market yields. Meanwhile, credit to the private sector recorded higher net retirements of working capital loans, reflecting improvement in the liquidity situation of businesses on the back of higher sales tax refunds from the government, SBP's regulatory relief on debt servicing, muted inputs cost and availability of surplus carry-over stocks. In contrast, borrowing under fixed investment loans quadrupled, supported by the SBP's LTFF and TERF schemes. Furthermore, consumer financing posted substantial growth in response to a steep decline in lending rates during Q1-FY21.

3.1 Policy Review

The economy entered FY21 with some lingering damaging impacts of the Covid pandemic as growth slipped into negative territory in FY20. However, timely measures taken by the SBP and the government, including a host of refinance schemes and concessionary packages, to mitigate the impacts of the Covid shock, prevented the economy from plunging into a deeper recession.[1] In addition to this, frequent meetings of the Monetary Policy Committee (MPC) were held in the second half of FY20 to closely monitor the evolving situation and take necessary policy measures. With relatively benign inflationary projections compared to last year, the MPC decided to cut policy rate by a cumulative 625 bps during Mar-Jun FY20. [2]

Trends in Major Interest Rates **Figure 3.1**



Source: State Bank of Pakistan

During the first quarter of FY21, the accommodative environment continued: real interest rates remained slightly negative and the availability of concessionary refinance schemes lowered funding costs for businesses and for the households (**Figure 3.1**). Despite this, the downward trend in the growth of overall private sector credit persisted during Q1-FY21 mainly on account of significant retirements in working capital

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[1] For details, see SBP's Annual Report on The State of Pakistan's Economy FY20 and sbp.org.pk/COVID/index.html

[2] In the meeting held on 25th June 2020, a preponed meeting for July 2020, policy rate was reduced by 100 bps to 7 percent, reflecting improvement in the inflation outlook and downside risks to growth prospects.

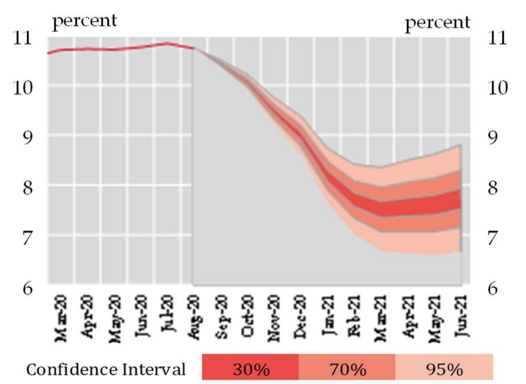
loans. The liquidity cushion available with the firms on the back of sales tax refunds by the government, debt relief measures (loan deferment and restructuring), availability of surplus carry-over stocks and muted input costs helped businesses in retiring their short-term loans.

Notwithstanding signs of recovery in the first quarter of FY21, overall demand side inflationary pressures remain contained due to negative output gap.[3] However, upward risks to inflation persist due to supply side factors. During Q1-FY21, core inflation stabilized but spikes in food prices were recorded in the months of July and September (on month-on-month basis) and, hence, in the overall average of the quarter. Headline inflation remained low (8.8 percent) as compared to the same period last year (10.1 percent), but was slightly higher than the level observed in the previous quarter (8.4 percent). Meanwhile, the inflation range projected for FY21 was kept unchanged at 7-9 percent as announced in May 2020, with broadly balanced risks. The upside risks included increase in food prices and potential tariff revisions whereas the downward risks included a protracted second wave of the pandemic (**Figure 3.2**).

The economic activity resumed with the removal of lockdown: large-scale manufacturing (LSM) displayed an expansion by the time of the monetary policy meeting in September 2020 after witnessing a deep contraction during Q4-FY20. High-frequency demand indicators including auto sales, cement dispatches, POL sales, and electricity consumption also indicated recovery (**Figure 1.1, Chapter 1**).

Therefore, in its meeting held in September 2020, the MPC decided to keep the policy rate unchanged at the level of 7 percent. This decision was taken in order to keep the monetary conditions accommodative given uncertainty over the growth trajectory and a slight upward revision to the inflation outlook.

Fan Chart-CPI Inflation (12mma) **Figure 3.2**



Source: SBP staff estimates

3.2 Monetary Aggregates

The growth of broad money accelerated to 1.2 percent during Q1-FY21 compared to a growth of 0.6 percent during the same period last year (**Table 3.1**). This expansion was the result of a sharp increase in the NFA of the banking system – similar to the trend observed in Q1-FY20 – reflecting an overall improvement in the country's balance of payments position. There was an increase in the NFA of both the scheduled banks as well as the SBP, the expansion in the former being higher compared to the latter.

[3] Negative output gap indicates that actual economic output is below the economy's full capacity; and the negative output gap was observed during the review period.

In case of the scheduled banks, the turnaround in the current account balance not only helped consolidate nostro balances, but was also instrumental in bringing down foreign liabilities. In case of the SBP, the increase in the NFA was primarily driven by a fall in the foreign liabilities alongside bilateral inflows from China. [4]

Monetary Aggregates (Q1)P **Table 3.1**
Table 3.1

billion Rupees; growth in percent

	Change in Stock		Growth	
	FY20	**FY21**	**FY20**	**FY21**
M2 (A+B)	105.2	260.5	0.6	1.2
A. NFA	259.6	307.3	17.2	59.5
B. NDA	-154.4	-46.8	-0.8	-0.2
Bud. borrowing*	156.0	285.2	1.3	2.1
SBP	-1,586.9	-281.9	-23.7	-4.3
Sch. banks	1,742.9	567.1	35.5	7.9
Com. operations	-15.6	-59.9	-2.1	-7.4
Pvt. sector credit	-16.9	-76.6	-0.3	-1.1
PSEs	-2.0	-11.9	-0.1	-0.8
Other items net	-275.2	-184.9	-24.9	-12.3
Reserve money	-207.4	-149.0	-3.2	-1.9

P: provisional

*These numbers are based on accrual basis. They do not tally with the amount of bank financing on cash-basis, as presented in **Table 4.1.**

Source: State Bank of Pakistan

On the other hand, the NDA of the banking system fell by Rs 46.8 billion during Q1-FY21 compared to a contraction of Rs 154.4 billion during the same period last year. This contraction was mainly on the back of the net retirements recorded in private sector credit, PSE credit, and government loans for commodity operations alongside a fall in the other items net. Cumulatively, these factors more than offset the impact of the increase in budgetary borrowings on the NDA of the banking system.

On the liability side, the entire growth in the money supply during Q1-FY21 emanated from an increase of Rs 289.3 billion in bank deposits, whereas the currency in circulation fell by Rs 40.4 billion resulting in overall improvement in currency to deposit ratio.[5] It is important to recall here that cash penetration in the economy spiked in the aftermath of the Covid outbreak that continued till Eid-ul-Azha. Effectively, the decline in the currency to deposit ratio during Q1-FY21 is mostly a reversal of the excessive cash penetration in the economy.

In addition, this contrasting trend in comparison to Q1-FY20 was due to: (i) a 31.1 percent YoY growth in workers' remittances (in dollar terms) during Q1-FY21 translated into higher growth in personal deposits; and (ii) the limited availability of NSS (as only limited CDNS outlets were allowed to open during the lockdowns and institutional investors were barred from investing in NSS w.e.f. July 01, 2020) and additional scrutiny measures taken by the government resulted in lower investment in NSS instruments and prize bonds compared to the average mobilization during the first quarters of FY15-FY19 (barring Q1-FY20).[6] This potentially channelized some funds into

[4] Since these inflows were recorded as the liability of the federal government, the NFA of the SBP posted an expansion.

[5] Despite this improvement, the average currency to deposit ratio during Q1-FY21 remained on the higher side compared to same period last year.

[6] It is important to recall here that on June 24, 2019 government had notified the withdrawal of Rs 40,000 denomination prize bond. Therefore, in Q1-FY20 higher NSS investment was recorded whereas prize bonds posted a decline as many bond holders converted their prize bonds into NSS (see the SBP's First Quarterly Report for FY20 on The State of Pakistan's Economy).

remunerative deposits that posted an increase of Rs 249.7 billion compared to Rs 114.3 billion same period last year. Meanwhile, the deposits of private sector business also increased by Rs 104.8 billion during Q1-FY21 compared to a drop of Rs 135.6 billion during same period last year. This was primarily on account of sound liquidity position of firms (see Section 3.3).

The weekly data shows that the currency to deposit ratio increased from 41.7 percent at the start of the quarter to 45.4 percent by the end of the first week of August 2020. This was particularly due to two reasons: (i) a seasonal decrease in deposits during the month of July (a reversal of temporary increase in deposits in June 2020 on account of window dressing by banks) and; (ii) cash withdrawals related to Eid-ul-Azha that was celebrated on Aug 1, 2020 in Pakistan. Subsequently, the trend reversal started in the middle of August and continued throughout the quarter, as the currency to deposit ratio eased down to 40.6 percent by the end of September 2020. Despite some improvement during the quarter, the currency to deposit ratio is at an elevated level compared to other emerging economies.[7]

Government Borrowings

With an overall higher deficit during Q1-FY21, financing from the banking system (on accrual basis) increased to Rs 285.2 billion compared to Rs 156.0 billion during Q1-FY20. It is important to recall here that during same period last year, the government made sizable retirements to the SBP while financing these outlays and additional borrowing requirements from the commercial banks. In contrast, in the absence of voluminous retirements to the SBP during Q1-FY21, borrowings from the scheduled banks remained significantly lower compared to last year. In addition, the government's adherence for zero borrowings from the central bank continued; the outstanding position of securities held by the SBP remained on a decreasing trend that began at the start of previous fiscal year. During Q1-FY21, the government retired Rs 285.0 billion worth of securities held by the SBP, while mobilizing Rs 567.1 billion from the scheduled banks.

Primary Auctions

Pre-Auction Targets

During Q1-FY21, the government set a gross pre-auction target of Rs 3,200.0 billion against the maturities of Rs 2,805.2 billion (of which more than 96 percent were T-bill maturities). However, given the government's inclination towards raising debt through long term papers, the pre-auction target for T-bills was set at Rs 903.8 billion lower than the maturities due during the quarter.

Instead, the government leveraged on the floating rate PIBs (PFL) that not only offer a longer maturity period but also provide a flexible return in line with the interest rate cycle. Around 55 percent of the target for new issuances (on net-of-maturity basis) was concentrated in the floating rate PIBs of various tenors (**Figure 3.3**).[8] To put this in

[7] For details, see Chapter 3 in the SBP's Annual Report for FY20 on The State of Pakistan's Economy.
[8] Floating rate PIBs (PFL) were initially introduced in May 2018 with a maturity of 10 years, subsequently in Jun 2020, 3-year and 5-year PFLs were also made available for the market.

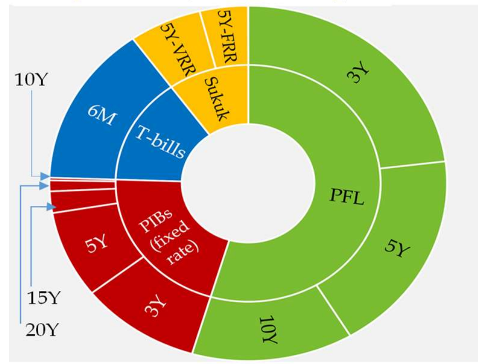
perspective, the pre-auction target for PFL during Q1-FY21 was set at Rs 830 billion versus a full year target for PFL of Rs 850 billion in FY20.

Auction summary and market behavior

In the backdrop of multiple rate cuts in the aftermath of the Covid shock, short term yields continued to decline initially. However, from mid-July onwards, as inflation expectations started to increase, the short-term yields began to inch up. This trend got further support from the decision of not holding the July 2020 MPC meeting (**Figure 3.4**). In contrast, the medium to long term yields had already started to rebound in May 2020. The long-end of the yield curve got further traction in July 2020 mainly on the back of the rising inflation expectations. This behavior may also reflect increased optimism of a rapid economic recovery as incidence of new daily Covid cases declined in the country.

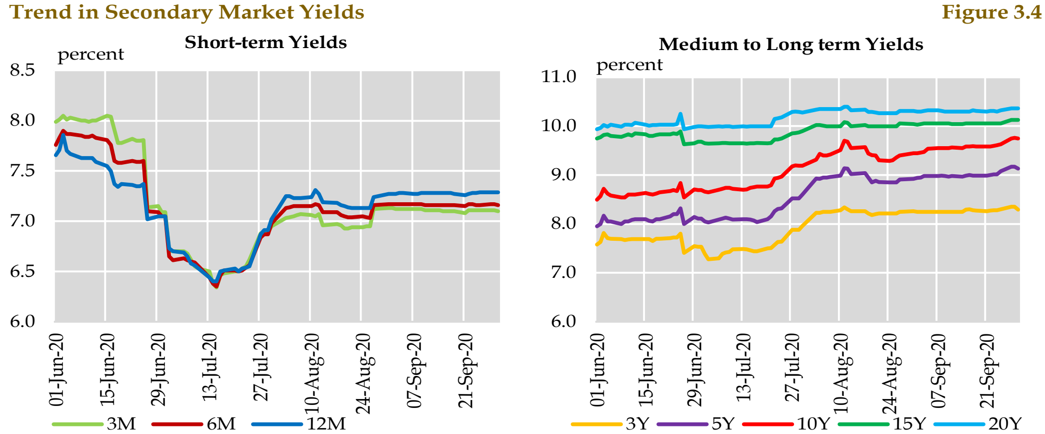
As a result, the market preferred investing in T-bills (particularly in 3M) and in medium-term floating rate PIBs (PFL). In case of T-bills, though the cumulative offers received during the quarter were nearly three times higher compared to the target, the government largely adhered to its auction plan. Therefore, T-bill issuance dropped to Rs 2,047.3 billion compared to Rs 6,482.7 billion during same period last year (**Table 3.2**). Likewise, in response to the introduction of 3Y and 5Y PFL and with increasing trend in the secondary market

Instrument-wise Auction Targets during Q1-FY21 (net of maturity) **Figure 3.3**



* the targets for 3M and 12M T-bills on net of maturity basis was Rs -162.8 bn and Rs -963.8 bn respectively.
PFL: PIBs (Floating Rate)
FRR: Fixed Rental Rate
VRR: Variable Rental Rate
Source: State Bank of Pakistan

Trend in Secondary Market Yields **Figure 3.4**



Source: Mutual Funds Association of Pakistan

Auction Summary **Table 3.2**

billion Rupees

	Target	Maturity	Offered*	Accepted
Treasury bills				
Q1-FY21	1,800.0	2,703.8	5,112.4	2,047.3
Q1-FY20	6,900.0	5,179.6	8,715.7	6,482.7
Pakistan Investment Bonds				
Fixed Rate				
Q1-FY21	420.0	101.4	448.9	249.2
Q1-FY20	325.0	275.9	2,521.2	963.5
Floating Rate				
Q1-FY21	830.0	0.0	1,970.4	870.6
Q1-FY20	300.0	0.0	334.2	219.4
GOP *Ijarah Sukuk*				
Fixed Rental Rate				
Q1-FY21	60.0	0.0	56.0	44.6
Variable Rental Rate				
Q1-FY21	90.0	0.0	215.4	117.4

*competitive bids only

Source: State Bank of Pakistan

yields, the market responded positively by making record high offers of Rs 1,970.4 billion during Q1-FY21 compared to Rs 334.2 billion in the same period last year. Interestingly, the market's offers remained concentrated in the 3Y and 5Y PFLs, which signifies the importance of timely issuance of these securities. A high market participation also helped the government to inch up the cut-off prices that in effect brought down the quoted margins of PFLs.[9]

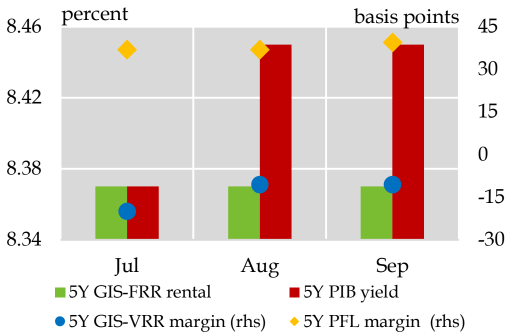
In contrast, despite a higher target set by the government for the fixed rate PIBs, the market's participation remained less than one-fifth of what was observed during Q1-FY20. The higher participation last year was on account of the interest rate cycle peaking out at 13.25 percent. As a result, the acceptance for fixed rate PIBs fell to only Rs 249.2 billion compared to a voluminous issuance of Rs 963.5 billion same period last year (**Table 3.2**). That said, with the policy rate at 7 percent a nearly Rs 250 billion mobilization in fixed rate PIBs is an encouraging development. This not only enabled the government to raise long term debt at relatively low interest rates but also helped diversify the portfolio of government securities.

As observed in case of conventional sovereign debt instruments, both the government and the market remained inclined towards variable rental Sukuk compared to fixed rental instrument. Given a decent market participation in the variable rental rate Sukuk, the government comfortably met the cumulative pre-auction target despite a shortfall in the acceptances of fixed rental rate Sukuk (**Table 3.2**).

For the auctions held during Q1-FY21, the comparison of the yields for Sukuks with PIBs highlights the underserved demand for Shariah compliant instruments in the market. In case of the fixed rate instruments the differential in yields grew from zero to around 8 basis points in the last two auctions in the quarter, whereas in case of variable rate instruments the implied margin for five-year Sukuk was nearly 52 basis points lower,

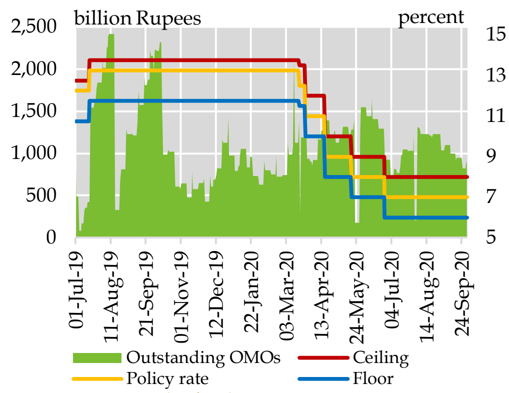
[9] The coupon of floating rate bonds has a flexible component (a benchmark interest rate) and a fixed component called quoted margin. In the fresh issuance of PFLs, the cut-off determines the quoted margin of that bond. In the subsequent reopening issuances, the cut-off is applicable on the price of the security. In case, a PFL is sold at a premium/discount, the implied margin becomes lower/higher than the quoted margin.

Shariah Compliant Instruments have Lower Yields* **Figure 3.5**



*the auction dates of comparable securities may differ.
Source: State Bank of Pakistan

Interest Rate Corridor **Figure 3.6**



Source: State Bank of Pakistan

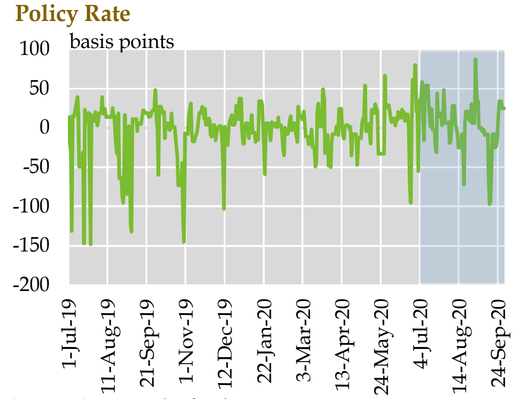
on average, compared to the five-year PFL (**Figure 3.5**).

Interbank Liquidity

An encouraging growth in the bank deposits together with higher retirements from the private sector, PSEs, and the government commodity procurement agencies helped in easing out liquidity requirements of commercial banks. Cumulatively, these inflows more than offset the liquidity requirement to meet government borrowings needs. Therefore, the average outstanding OMOs fell slightly to Rs 1,014.7 billion compared to Rs 1,192.4 billion in the preceding quarter and Rs 1,337.7 billion in the same period last year **(Figure 3.6).**

However, the interbank market remained relatively more volatile during Q1-FY21 **(Figure 3.7).** In the month of July 2020, the deviation of overnight rates from the policy rate remained highest at 17 basis points, on average, above the policy rate compared to a deviation of 3 and -4 basis points in August and September 2020 respectively. Rates remained on the higher side intially during

Deviation of O/N Rate from the Policy Rate **Figure 3.7**



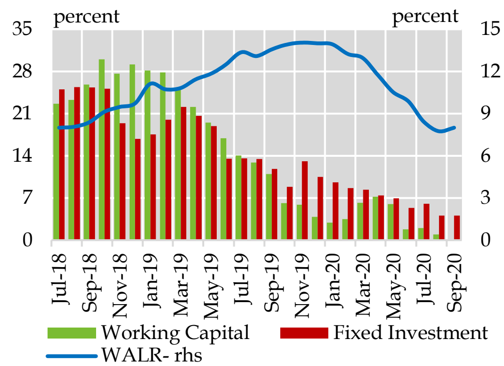
Source: State Bank of Pakistan

Q1-FY21 due to more than expected cashwithdrawls in July. From mid-August onwards, deposit mobilization picked up pace, which resuted in downward pressure on the overnight rates. This underlying uncertainty in the cash inflows and outflows of the banking system translated in to higher volatility in the overnight rates. Finally, on multiple instances the SBP either completely refrained from intervening in the market to let the market settle on its own or made interventions of lower volumes than was demanded by the market, which also led to heightened volatility in the overnight rates.

3.3 Credit to Private Sector

During Q1-FY21, a host of positive factors prevailed compared to the same period last year. First, the policy environment was accommodative, with the policy rate down by 625 bps to 7.0 percent, from 13.25 percent in Q1-FY20. Second, the SBP had introduced a number of refinancing schemes to counter the impact of Covid, such as Rozgar Scheme and Temporary Economic Refinance Facility (TERF) since March 2020. Third, the overall business confidence improved during the quarter.[10] Finally, the industrial activity (proxied by LSM) registered improvement during the period under review.

Growth in Loans to Private Businesses (YoY) **Figure 3.8**



Source: State Bank of Pakistan

Despite this favorable environment, the declining trend in the private credit, which had started from the third quarter of FY19, continued in Q1-FY21 (**Figure 3.8**). The downward trajectory in loans to businesses until the outbreak of Covid mainly represented subdued credit demand on the back of slowdown in manufacturing activity, coupled with higher interest rates. The demand for credit was further dampened with the start of business closures amid Covid-related lockdowns in the country. In fact, private businesses (mainly export-oriented sectors) made relatively higher short-term loan retirements in Q1-FY21, over the same period last year.

The weak private credit momentum in Q1-FY21 is likely due to three factors. First, firms' sound liquidity position on the back of increased sales (see **Figure 1.1** in Chapter 1), higher sales tax refunds by the government (see **Table 4.4** in Chapter 4), and SBP's relief package (deferment and restructuring).[11] Indeed, during Q1-FY21, private businesses benefitted not only from SBP's concessionary financing facilities, such as Export Finance Scheme (EFS) and Long-term Financing Facility (LTFF), but also borrowed under the schemes introduced by SBP to counter the impact of Covid, mainly Rozgar Scheme and TERF.[12] As shown in **Table 3.3**, the disbursements under these schemes have been quite substantial in Q1-FY21. Thus, while the disbursements under LTFF and TERF have played their part in the

[10] Keeping in view the ease in lockdowns amid falling Covid infections in the country the overall business confidence improved during the quarter, as reflected by a positive Business Confidence Index (BCI) in SBP's August 2020 survey after three consecutive observations of negative BCI.
[11] Sales-tax refunds of Rs 43.9 billion were released during Q1-FY21 compared to Rs.16.0 billion during Q1-FY20.
[12] Importantly, in August 2020, SBP had enhanced the limit of refinancing provided to the banks under EFS by Rs 100 billion, and allocated Rs 90 billion under LTFF in order to further facilitate the exporters [Source: SBP press release, ERD/M&PRD/PR/01/2020-89, dated August 19, 2020].

quadrupling of fixed investments loans in Q1-FY21 over the same period last year (**Table 3.4**), they might have also induced few firms to retire their previously taken bank loans against the conventional facilities.

A second source of weak credit momentum could be the availability of surplus carry-over stocks, which led to a weak demand for working capital loans.[13,14] Subdued economic activity in the preceding two quarters gives credence to this assumption.

Finally, input prices remained muted, mainly driven by oil, glass sheets, steel bars and sheets and chemicals. This might have dragged down the working capital demand as well.

Consumer financing, nonetheless, did benefit from relatively accommodative policy environment in Q1-FY21. Under car financing and personal loans, a significant increase was registered in Q1-FY21 over the same period last year, when it had recorded net retirements (**Table 3.5**).

Working capital loans recorded net retirements

Working capital loans posted a net retirement of Rs 163.4 billion in Q1-FY21, compared to Rs 100.0 billion decrease recorded in Q1-FY20. Within manufacturing sector, more than sixty percent of the

SBP's Major Concessionary Financing Schemes **Table 3.3**

flow in billion Rupees

	Approved Amount	Q1-FY20	Q1-FY21
EFS	-	4.7	14.7
LTFF	-	14.8	36.8
of which TERF	86.3**	-	4.5
SBP Rozgar Scheme	216.9*	-	99.9

*as on 25th Sep, 2020; **as on 24th Sep, 2020

Source: State Bank of Pakistan

retirement was driven by sugar and textile. The sugar industry retired Rs 82.7 billion in Q1-FY21, compared to a relatively lower retirement of Rs 36.9 billion during the same period last year. This is mainly attributed to higher offtake in Q3-FY20 on account of increased sugar prices, which led to a persistent increase in loan retirements in the subsequent quarters.[15]

Meanwhile, the textile sector retired Rs 42.7 billion in Q1-FY21, compared to a marginal retirement of Rs 2.0 billion during the same period last year. Textile businesses benefitted from SBP's concessional EFS, thus increasing the overall borrowing under the scheme to Rs 14.7 billion in Q1-FY21 from Rs 4.7 billion in Q1- FY20. In addition, with higher export proceeds in rupee terms, the businesses managed to retire their short-term loans during the period under review. Therefore, a strengthening in the repayment capacity of textile industry was not surprising. While the gross non-performing loans of overall private businesses increased,

[13] Analysis of the financial statements of major textile firms reveals that Covid-related lockdowns led to build-up of inventories till Q4-FY20, which reduced their short-term borrowing requirements in Q1-FY2.
[14] Banks received 24.7 percent lower applications of working capital loans in Q1-FY21, over the same period last year.
[15] Sugar sector posted a net retirement of working capital loans amounting Rs 40.0 billion and Rs 82.7 billion in Q4-FY20 and Q1-FY21, respectively.

Loans to Private Sector Businesses (Q1) **Table 3.4**

flow in billion Rupees

	Total Loans		Working Capital*		Fixed Investment	
	FY20	FY21	FY20	FY21	FY20	FY21
Private Sector Businesses	-85.4	-100.9	-100	-163.4	14.6	62.5
Manufacturing	-50.7	-157.4	-46.5	-196	-4.3	38.5
Fertilizers	-19.2	9.3	-16.5	12.8	-2.7	-3.5
Basic pharmaceutical products	2.2	17.4	1.7	3.6	0.5	13.8
Basic iron and steel	15.8	2.8	11.9	2.5	3.9	0.3
Basic chemicals	3.5	-15.4	2.8	-6	0.8	-9.4
Refined petroleum	-4.1	-6.6	-2.9	-6.7	-1.1	0
Electrical equipment	-6.2	-9.7	-3.1	-9.3	-3.1	-0.4
Cement, lime and plaster	-1.8	-10.3	1.4	-11.5	-3.2	1.2
Rice Processing	-21.6	-15.2	-21.7	-15.7	0.1	0.6
Motor vehicles	30.7	-16.5	29.4	-16.8	1.3	0.3
Textile	6.6	-28.7	-2	-42.6	8.6	13.9
Sugar	-42.7	-82.3	-36.9	-82.7	-5.9	0.4
Power gen., trans., and dist.	9.6	9.1	3.8	-9.3	5.8	18.4
Construction	-17.1	6.6	-19	2.5	1.9	4.1
Wholesale and retail trade	-43.8	17.8	-34.7	15.6	-9	2.2
Mining and quarrying	-5	-3.3	-5.8	-3.4	0.9	0.1
Transportation and storage	4.6	1.8	5.4	3.1	-0.8	-1.3
Real estate activities	5.3	-3.1	-0.2	-1.3	5.6	-1.8
Agriculture, forestry and fishing	-0.8	3.7	0.6	6.1	-1.3	-2.4
Telecommunications	24.4	1.7	-0.4	5.1	24.8	-3.4

*includes trade financing

Source: State Bank of Pakistan

the non-performing loans (NPLs) in the textile sector declined during the quarter.[16] Further, despite an increase of 3.8 percent YoY in cotton prices during Q1-FY21, the textile sector's demand for working capital loans remained weak mainly due to the availability of surplus carry-over stocks, besides the sector's sound liquidity position.[17]

In addition to textile, some activity was also recorded in cement and automobiles during Q1-FY21. Higher exports and increased local dispatches allowed cement industry to retire its working capital loans. In case of automobiles, local assemblers were able to retire their short-term loans with the help of higher sale proceeds during the period under review.

Meanwhile, fertilizer industry borrowed short-term loans amounting to Rs 12.8 billion in Q1-FY21, compared to a net retirement of Rs 16.5 billion during the same period last year. This was mainly on the back of higher

[16] The overall infection ratio increased marginally from 8.8 percent at end-September 2019 to 9.9 percent in September 2020. However, the infection ratio of textile sector declined from 16.7 percent in September 2019 to 14.3 percent in September 2020.

[17] See footnote 13.

fertilizer imports during the quarter.[18] In view of the government's recently announced agriculture package, the domestic demand for fertilizer picked up in Q1-FY21 **(see Chapter 2 for details**). Among non-manufacturing businesses, wholesale and retail trade borrowed Rs 15.6 billion in Q1-FY21, compared to a net retirement of Rs 34.7 billion during the same period last year. The borrowing was prominent in wholesale of fuels, as the major Oil Marketing Companies (OMCs) in the country borrowed short-term loans mainly to meet the rising fuel demand amid revival of economic activities in the country following the ease in lockdown restrictions.[19]

Borrowing for fixed investment purposes increased

Fixed investment loans increased by Rs 62.5 billion in Q1-FY21, compared to an offtake of Rs 14.6 billion during the same period last year. This increase was mainly driven by textile and pharmaceutical segments in the manufacturing sector, and electric power segment in the non-manufacturing sector Pharmaceutical sector borrowed long-term loans of Rs 13.8 billion in Q1-FY21, compared to an increase of only Rs 0.5 billion in the same period last year. This mainly represents the acquisition of a chemical manufacturing business by a renowned pharmaceutical firm in the country. Resultantly, the exposure of the former was transferred to the books of latter, as reflected by retirement in basic chemicals in August 2020 and an increase in pharmaceutical in the same month.

Consumer Financing (Q1) **Table 3.5**
flow in billion Rupees

	FY20	FY21
Total consumer financing	**-2.7**	**39.6**
For Transport: Car	-2	21.3
Personal loans	0.2	16
Credit cards	1.8	6.1
House building	-2.2	-1.2
Consumers durable	-0.5	-2.6

Source: State Bank of Pakistan

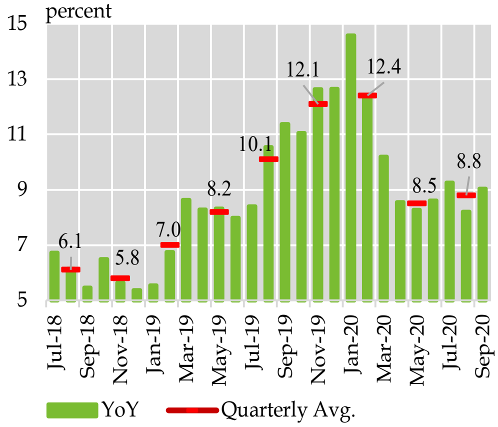
The textile sector took long-term loans of Rs 13.9 billion in Q1-FY21, compared to Rs 8.6 billion during the same period last year. The sector benefitted from SBP's LTFF for export-oriented projects, as loans under the facility constituted around 96 percent of the textile sector's overall fixed investment borrowing during Q1-FY21. Among non-manufacturing entities, electric power firms borrowed fixed investment loans of Rs 18.4 billion in Q1-FY21, primarily to import power generating machinery, compared to a borrowing of Rs 5.8 billion during the same period last year.

Consumer Financing

Consumer financing posted a significant increase of Rs 39.6 billion in Q1-FY21, compared to a decline of Rs 2.7 billion in Q1-FY20 (**Table 3.5**). The offtake was mainly driven by two segments: auto and personal loans, as consumers benefitted from lower bank lending rates in Q1-FY21 **(Figure 3.1)**.[20] Further, the increase in auto finance is also

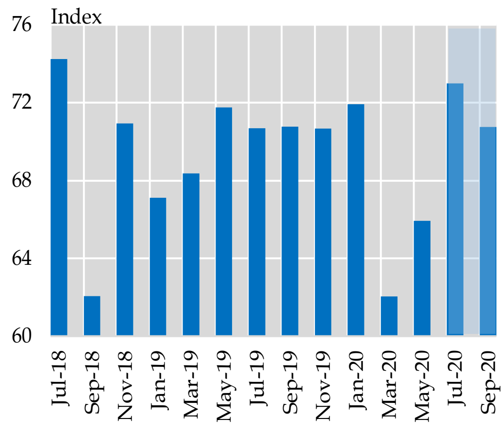
[18] The import of fertilizer during Q1-FY21 increased by 23.8 percent compared to a decline of 50.7 percent in same period last year.
[19] During Q1-FY20, POL sales grew by 10.5 percent over the same period last year.
[20] The Weighted Average Lending Rate (WALR) dropped from 13.4 percent in Q1-FY20 to 8.1 percent in Q1-FY21.

National Consumer Price Index **Figure 3.9**



Source: Pakistan Bureau of Statistics

Inflation Expectation Survey **Figure 3.10**



Source: State Bank of Pakistan

explained by higher demand of passenger cars, particularly in 1,300cc and above category. For instance, a renowned auto assembler introduced a new variant of passenger car in 1,300cc and above category which was well received by the market.[21]

3.4 Inflation

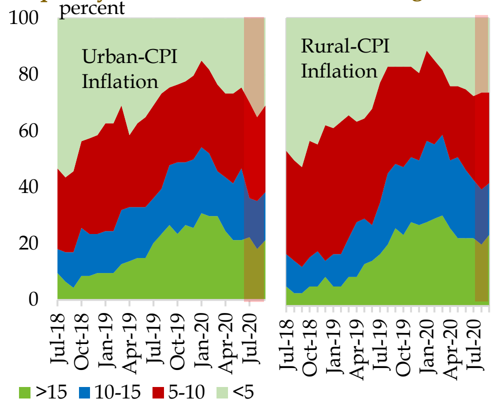
The pace of inflation stabilized around single digits during the first quarter of FY21. Macroeconomic stabilization efforts initiated earlier in FY19, administrative measures (including crackdown on speculative elements), resumption of seasonal supplies of perishables and the Covid-related steep fall in the global crude prices largely helped to rein in inflationary pressures in the economy by the end of FY20. In addition, the tax relief measures in Budget 2020-21 in response to Covid also provided relief in terms of stable prices of various goods.

Accordingly, the average national headline CPI inflation clocked in at 8.8 percent during Q1-FY21 compared to double digit growth of 10.1 percent in the same period last year, and at almost the same level observed in the previous quarter (**Figure 3.9**). Nonetheless, inflation expectations (gauged by the IBA-SBP Consumer Confidence Survey (CCS)), crept up by the start of the year, mainly reflecting surging food prices, after having experienced a steep downward movement in Q4-FY20 amid Covid-related sluggish demand (**Figure 3.10**).

In terms of dispersion, for the quarter under review, the inflation increase was concentrated in half of the sub-indices (48 out of 94- with around 51 percent share in CPI in urban indices and 48 out of 89- with around 54 percent share in CPI in rural indices) compared to the broad-based rise last year during the same period. Meanwhile, in terms of both distribution and magnitude, the trends reversed during Q1-FY21 compared to last year. The number of items

[21] According to PAMA, sales of 1300cc and above passenger cars jumped from 9,953 units in Q1-FY20 to 16,736 units in Q1-FY21.

Frequency Distribution **Figure 3.11**



Source: Pakistan Bureau of Statistics

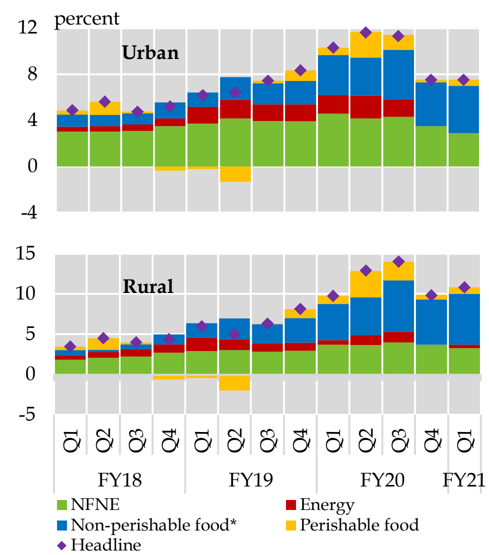
posting double-digit inflation during the first nine months of the FY20 started to shift toward the less than 5 percent bracket. This depicted subsiding inflationary pressures on account of waning underlying demand as well as subdued cost-push pressures in the economy (**Figure 3.11**).

The category-wise breakdown suggests that food inflation remained the major contributor to headline inflation in both urban and rural areas, whereas underlying inflationary pressures (reflected in NFNE) were largely stable (**Figure 3.12**).

Food continued to remain the main source of inflation

After subsiding by the end of FY20, food inflation rose again significantly during Q1-FY21, contributing more than half (around 62 percent) to overall inflation (**Table 3.6**). Both perishable and non-perishable food items registered increasing price trends, with the latter trend being stronger. Details suggest that domestic agriculture production and commodity management issues mainly led to higher prices. Harvesting disruptions amid lockdown and locust attacks dented the local production of various food items. Moreover, rising trends in prices of global agricultural products also escalated pressures on domestic food prices (**Box 3.1**).

Composition of YoY CPI Inflation **Figure: 3.12**



*inclusive of alcohol beverages and readymade food
Source: Pakistan Bureau of Statistics

Non-perishables

Among non-perishable food items, the major thrust came from staple group: wheat and wheat flour. Prices continued a steep upward trajectory in Q1-FY21 as well, as was observed during FY20.[22]

For the 2020 wheat crop, the procurement target was set at 8.25 million metric tons (MMT), keeping in view: (1) the estimated crop size of 25.25 MMT against a target of 27.03 MMT; (2) carryover stocks of 0.602

[22] See the SBP's Third Quarterly Report for FY20 on The State of Pakistan's Economy for details.

Average CPI Inflation and Contribution (Q1) **Table 3.6**

percent

Items	Urban				Rural			
	Wt.*	FY20	FY21	Cont.**	Wt.*	FY20	FY21	Cont.**
CPI	100.0	10.3	7.5	7.5	100.0	9.7	10.8	10.8
Food & non-alcoholic beverages	30.4	12.2	14.0	4.1	40.9	12.3	16.3	6.6
Wheat	0.6	9.5	38.3	0.2	3.5	9.2	38.9	1.2
Wheat flour	3.0	10.0	20.7	0.5	3.4	11.3	24.9	0.8
Potato	0.4	26.2	64.3	0.4	0.7	24.1	74.1	0.7
Tomatoes	0.3	-20.8	45.3	0.1	0.5	-21.1	60.1	0.3
Sugar	1.1	34.2	23.5	0.2	2.0	35.7	22.6	0.4
Condiments and spices	1.3	20.4	39.8	0.6	1.5	12.8	55.3	0.8
Clothing and footwear	8.0	8.5	8.4	0.7	9.5	8.4	10.9	1.1
Housing, electricity and gas	27.0	8.3	4.9	1.3	18.5	2.8	6.7	1.2
House rents	19.3	6.5	4.3	0.8	8.6	5.5	4.9	0.4
Electricity charges	4.6	-3.2	7.7	0.3	3.4	-3.2	7.7	0.2
Furnishing and household	4.1	12.4	6.3	0.2	4.1	10.0	10.0	0.4
Health	2.3	11.0	6.6	0.2	3.5	11.8	9.2	0.3
Transport	6.1	18.4	-3.4	-0.2	5.6	16.6	-2.8	-0.2
Motor fuel	2.9	21.5	-9.1	-0.3	2.5	21.0	-9.3	-0.3
Communication	2.4	5.6	0.4	0.0	2.0	2.0	0.2	0.0
Education	4.9	7.0	1.0	0.1	2.1	5.2	1.0	0.0
Restaurants and hotels	7.4	5.2	7.7	0.6	6.2	7.6	8.3	0.5
Miscellaneous goods and services	4.8	12.1	11.2	0.5	5.0	12.9	14.5	0.7

*wt. = weight; **Cont.= Contribution for Q1

Source: Pakistan Bureau of Statistics

MMT; and (3) estimated demand of 27.47 million tons for the year. However, this target could not be achieved, despite higher production compared to last year (24.34 MMT). Shortfall of 1.619 MMT was expected given the consumption requirement for FY21.

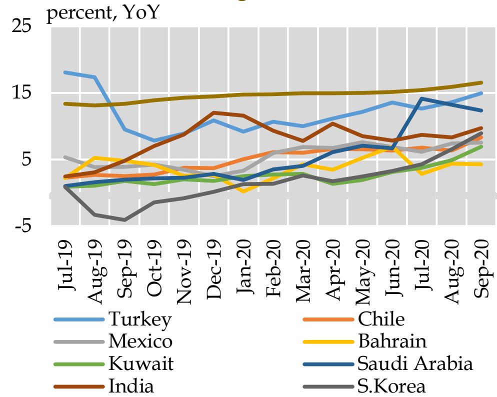
Box 3.1: Rising Global Food Prices

Initial readings of inflation data from advanced and emerging economies provided sufficient evidence of rising food inflation since the start of the pandemic (**Figure 3.1.1**). However, no solid indication of inflation in broader indices, barring food group, has been registered. Particularly, headline inflation dropped mainly on account of low energy prices, whereas core inflation also declined or stabilized due to weaker demand.

Food prices started to rise with the beginning of the Covid containment phase. South Asia, Sub-Saharan Africa, and Latin America have been among the most affected regions. The following supply-chain factors are considered to be the major contributors to rising food inflation during pandemic: [23]

- Lockdown and restricted mobility measures affected the supply and demand of certain products.
- Panic buying and hoarding escalated food prices of non-perishable items.
- Supply disruptions in agriculture products due to labor shortages resulting from a decline in the number of migrant workers: Palm oil harvesting and processing operations have been increasingly affected by labor force reduction, especially in Malaysia, where several plantations are suffering from acute shortages of migrant laborers triggered by policies to curtail the spread of Covid.[24] Similarly, the value chain for fruits, the most perishable items which require labor-intensive handling and rapid (often airborne) transport, was also affected.[25]
- Reliance on imported goods especially in case of emerging and developing economies, given the currency depreciation episodes.
- Hoarding practices in international trade as countries fail to coordinate their emergency policies. [26]

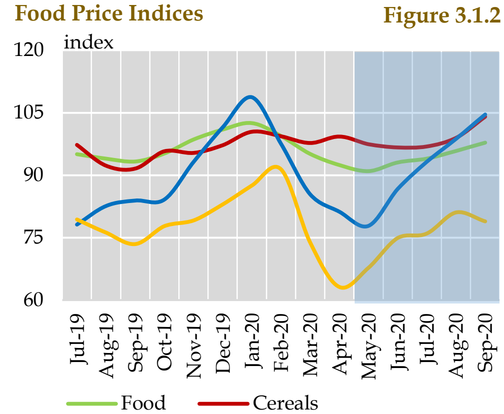
CPI: Food and Beverages **Figure 3.1.1**



Source: Haver Analytics

Here, it is important to note that major grain prices were almost stable during this period (March and April 2020); in fact, they rather declined on account of sufficient production and stocks available with the major grain producing countries. However, prices started posting rise since May 2020 and surged nearly 8 percent by end-September 2020. This reversed the stable trend witnessed earlier in the year (**Figure 3.1.2**). Recent gain in agricultural commodity prices are mainly driven by a) greater demand for grain-based food by major consumers such as China and b) supply shortfalls in some agri-products on account of unfavorable weather.

Food Price Indices **Figure 3.1.2**



Source: FAO

From the global demand perspective, China has stepped up its purchases for edible oil and grains

[23] Ebrahimy, E.., Igan, D. and S.M. Peria (2020). *The Impact of COVID-19 on Inflation: Potential Drivers and Dynamics*. Special Notes Series on COVID-19. Washington DC: International Monetary Fund.

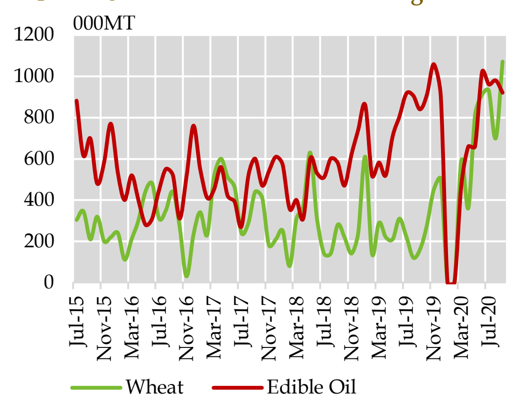
[21] FAO price indices for oilseeds, vegetable oils and oil meals, October 2020

[25] FAO (2020, June 06). *COVID-19 causes havoc to supply chains for fresh fruits and vegetables*. New York: Food and Agriculture Organization of the United States. fao.org/support-to-investment/news/detail/en/c/1278468/

[26] According to the World Trade Organization, as of the end of April, around 80 countries and customs territories had introduced export restrictions as a result of the pandemic on both food and nonfood items.

significantly to secure domestic food requirement (**Figure 3.1.3**). Similarly, India is reported to have increased its imports for edible oil.[27] As per industrial experts, second round of stockpiling has started by the consumers in fear of another Covid wave. Moreover, towards the end of September 2020, Malaysia's top producing state considered imposing a new set of temporary restrictions (state-wide movement control) on palm oil producers, in an effort to contain fresh outbreaks of Covid. Limiting plantations' workforce numbers and mills' operating hours is expected to affect the production significantly during peak harvest season. Similarly, Russia's agriculture ministry is planning to limit the amount of grain (wheat, barley and maize) that can be exported from February 2021, over constrained production prospects and high world demand.

Imports by China **Figure 3.1.3**



Source: Haver Analytics

While the supply-chain disruptions were already shaping up food inflation expectations, weather related reduced production prospects further escalated the food inflation. For instance, prices of edible oil gained most in the quarter due to supply shortfalls. Palm oil also registered gain amid the problems that suppliers are having in securing enough labor to proceed with the palm harvest, as mentioned earlier. Wheat prices, in particular, posted significant rise in prices reflecting strong global demand, unfavorable growing conditions in Argentina and Australia and continued dry weather adversely affecting winter wheat conditions in some parts of Europe, northern America and the Black Sea region. Meanwhile, international soybean quotations maintained their upward momentum due to unfavorable weather conditions in key growing regions of the US.

In view of the Covid-driven supply disruptions and grain production outlook, food insecurity persists. Stockpiling behavior, increasing protectionism, limited food exports and unfavorable production prospects are likely to keep the global food inflation at elevated level for some time.[28]

In view of the constrained stock position with the public sector and missed production target, Economic Coordination Committee (ECC) allowed wheat imports by end June 2020. Particularly, the Trading Corporation of Pakistan (TCP) was allowed to place an order for the import of 200,000 tons of wheat in the public sector following the import of 500,000 tons of wheat by the private sector in the country.[29] Also, ECC approved the request of the Ministry of Commerce to reduce the margin of commission of TCP on the import of wheat and sugar to 0.75 percent from the existing 2.0 percent in order to reduce the import cost.

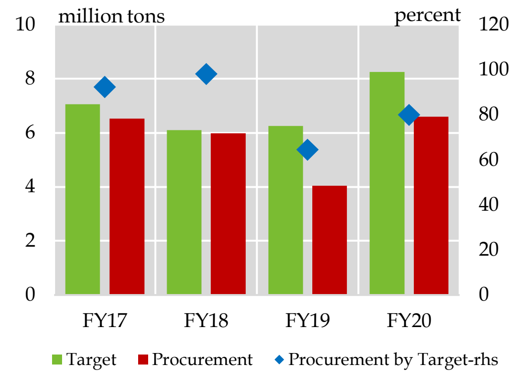
Despite these measures, wheat inflation rose significantly during the period under review.

[27] 11.5 percent rise on YoY basis in Q1-FY21 in terms of USD compared to similar period last year, whereas 46.8 percent rise was observed compared to Q4-FY20.
[28] World Bank (2020). *Food Security and Covid-19*. Webpage Brief. Washington, DC: World Bank.
[29] By end Q1-FY21, around 432 thousand MT of wheat import has been made with only around 39 thousand MT in August 2020 and around 392 thousand MT in September 2020.

One issue may be related to government's commodity operations. For the second consecutive year, procurement agencies are missing the procurement targets by large margins (**Figure 3.13**). One probable factor behind this could be the rising spread between the support price and the wholesale price of wheat. In fact, in six wheat producing districts in Punjab (including the top-two wheat producers, Bahawalpur and Rahim Yar Khan), the wholesale price of wheat was above the government support price (GSP) during these procurement months (mid-April to July) (**Figure 3.14**). Second, release of timely stocks by the procurement agencies also plays an important part in determining the price pressure. Despite the Public sector's procurement above the level of last year, price pressures could not be controlled, indicating supply-demand gaps managed by the procurement agencies. Third, the import process seemed to be slow in making a significant impact on the market prices: ECC allowed import by end- June 2020 whereas first shipment arrived in August 2020. Moreover, a considerably high level of international wheat price, though lower than domestic prices, seems to have demotivated the private sector in aggressive participation in imports.[30] Fourth, speculative activities in the market also seemed to have played a dominant role in price hike as government was consistently warning hoarders for strict action against those found involved.

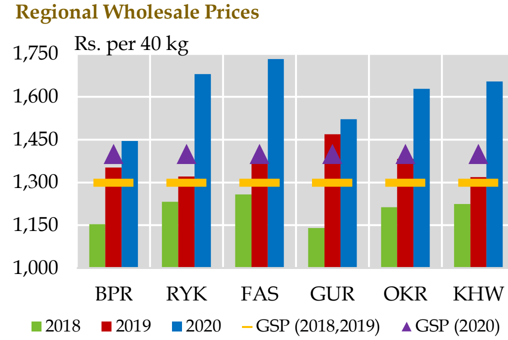
In addition to wheat, sugar prices continued to rise in Q1-FY21. The double-digit inflation in sugar can partially be attributed to slightly low production of sugarcane in FY20,[31] absence of a reliable stock position and speculative activities in the market. During Q1-FY21, the ECC also considered a proposal to allow import of refined sugar up to 300,000 metric tons by the TCP to maintain buffer stocks in addition to the ban imposed on sugar exports by the mid of FY20. Despite import of around 30 thousand MT sugar in

Public Sector Wheat Procurement **Figure 3.13**



Source: Provincial Food Departments

Government Support Price & Regional Wholesale Prices **Figure 3.14**



*procurement season generally starts in Punjab around mid-April and ends in July.

Source: Agriculture Marketing Information Service

[30] Wheat prices rose by 19.4 percent in Q1-FY21 compared to 23.3 percent decline last year same period as per IMF commodity prices.

[31] In FY20, 66.37 million tons of sugarcane was produced compared to 67.17 million tons in FY19.

Q1-FY21 compared to 7.6 thousand MT imported in FY20 and better sugarcane production prospects for FY21, prices continued on their upward trajectory.[32] Speculative activities and price fixing behavior seems to have put upward pressure on the commodity price, with the Competition Commission of Pakistan (CCP) noting that Pakistan Sugar Mills Association (PSMA) has maintained cartels among its members to keep the commodity's prices high.[33]

In addition to wheat and sugar, prices of cigarettes, edible oil and ghee, and pulses also remained under pressure during Q1-FY21. In case of cigarettes, the significant revision in FED announced in the Budget 2020-21 pushed up its price. Particularly, FED on imported cigarettes, cheroots, cigarillos, cigars and other tobacco substitutes has been enhanced from 65 percent to 100 percent in line with WHO (World Health Organization) standards.

In case of edible oil and ghee products, edible oil refineries were struggling with rising international prices of palm oil and soybean registered during Q1-FY21. [34] In terms of unit prices of imports, 0.7 percent and 21.8 percent rise has been observed in Q1-FY21 for soybean and palm oil respectively (**Box 3.2**). Heavy rainfall brought on by La Nina disrupted output in palm-producing countries,[35] whereas, soybean prices have surged to their highest levels driven by heavy buying from Chinese importers.

In case of pulses also, inflationary pressures were mostly imported. The international market for pulses experienced various supply and demand pressures among the major exporters and importers (as pointed out in detail in the SBP's Third Quarterly Report for FY20). As a result, Pakistan saw approximately 11 percent increase in unit values of imported pulses in Q1-FY21 as compared to same period last year.

Perishables

Issues related to managing inflation in perishable food items (limited domestic production, timely import hurdles etc.) persisted in Q1-FY21.[36] The index of perishables rose but with significant variation among its components. The substantial surge in the prices of potatoes and tomatoes pushed the headline numbers of perishable items towards a high level despite relative stability in fruit prices and significant deflation in onion prices compared to same period last year.

The pandemic-induced lockdown has interrupted food supply chains across major agricultural products (**Box 3.2**). For instance, tomato farmers faced substantial disruption

32 Estimated sugarcane production for FY21 increased to 75.64 million tons

33 Hussain, S., Laiq, N. and M. Quddus (2020). *Enquiry Report in the Matter of Alleged Anti-Competitive Activities in the Sugar Industry*. Islamabad: Competition Commission of Pakistan.

34 International palm oil prices rose by 34.5 percent in Q1-FY21, and prices of soybean increased by 10.5 percent during Q1-FY21.

35 Commodity Markets Outlook, October 2020, World Bank

36 For details, see the SBP's The State of Pakistan's Economy report for Q2-FY20 and Khalid, A. and Sabahat (2020). *Price Stabilization Mechanism in Pakistan's Food Market: Exploring Issues and Potential Challenges*. SBP Staff Note 2/20. Karachi: State Bank of Pakistan.

Box 3.2: Covid Impacts on Domestic Production

The Asian Development Bank (ADB) conducted a survey of farmers in Sindh and Punjab to gauge the impact of Covid on their production and marketing activities. More than 400 farmers were contacted in this regard both in Punjab and Sindh using computer-assisted telephone interviewing. The survey of farmers revealed that Covid crisis had a significant impact on the production and marketing of agricultural products, including wheat, vegetables and fruits.

Impacts on Farm Households in Punjab*

- More than 27.0 percent of respondents reported facing disruptions related to Covid while purchasing or receiving farm inputs for the next cycle of sowing. Respondents indicated disruptions in the supply of the following farm inputs: seed (81.2 percent); fertilizer (23.9 percent); pesticides (19.7 percent); and diesel fuel (17.1 percent).
- The lockdown took place just as the wheat harvesting season and sowing of summer (kharif) crops began. Disruptions such as higher rental charges, labor shortage, and farmers' limited access to markets were also reported (FAO 2020).

Impacts on Farm Households in Sindh**

- Most respondents (78.9 percent) reported facing Covid-related disturbances while purchasing farm inputs for the next cycle of sowing. The shares of respondents noting disruptions to the purchase and/or delivery of farm inputs caused by Covid are as follows: seed (97.2 percent), fertilizer (43.6 percent), pesticides (36.1 percent), diesel fuel (22.1 percent), and machinery (14.3 percent).
- Tomato farmers faced substantial disruption, with 61 percent of respondents unable to complete their harvest at the usual time. The challenges most often cited were the farmers' inability to travel to markets and cities and the unavailability of traders to purchase the crops.
- Around one-third of the farmers (32.5 percent), felt their harvest of vegetables and fruits had been delayed compared with the past years; of these, 41.5 percent cited the unavailability of labor as the primary reason for the delay.

References: *ADB (2020a). *COVID-19 Impact on Farm Households in Punjab, Pakistan: Analysis of Data from a Cross-Sectional Survey*. ABD Briefs No. 149. Mandaluyong: Asian Development Bank. **ADB (2020b). *COVID-19 Impact of COVID-19 and Locust Swarms on Farm Households in Sindh, Pakistan: Analysis of Data from a Cross-Sectional Survey*. ABD Briefs No. 149. Mandaluyong: Asian Development Bank

in completing timely harvest. In addition to that, severe locust invasions and heavy rains also damaged Sindh's tomato crop.[37] It is pertinent to note here that price pressures persisted despite significant imports from Iran and Afghanistan.[38]

Potatoes index also registered 64.3 percent and 74.1 percent rise in urban and rural areas, respectively, during Q1-FY21. This is despite significant imports from Iran, Afghanistan and Bhutan.[39] Exports also almost halved compared to the same period last year.

Core inflation tapered down

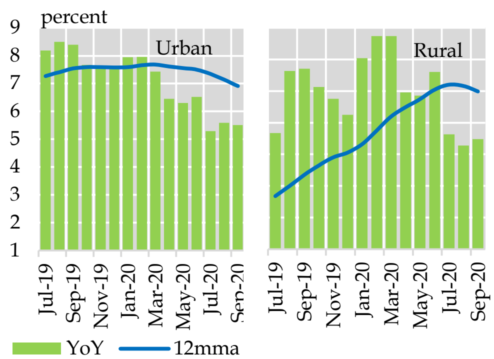
The underlying inflationary pressures eased during Q1-FY21 for urban areas, whereas rural inflation depicted stabilizing trend after

[37] 73.7 percent of respondents reported having seen locust swarms in their area as per a survey conducted in June 2020 under Asian Development Bank (ADB) technical assistance. Source: ADB (2020b).

[38] Import of tomatoes rose by around 38 percent in Q1-FY21 compared to last year same period

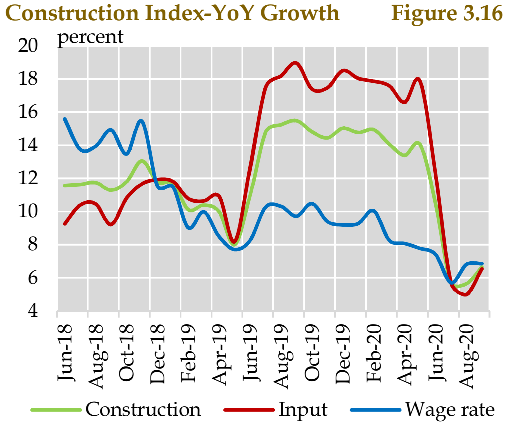
[39] Pakistan imported 14,377 thousand kg in Q1-FY21 compared to 19.5 thousand kg last year same period.

Non-food Non-energy Index-YoY Growth **Figure 3.15**



Source: Pakistan Bureau of Statistics

Construction Index-YoY Growth **Figure 3.16**



Source: Pakistan Bureau of Statistics

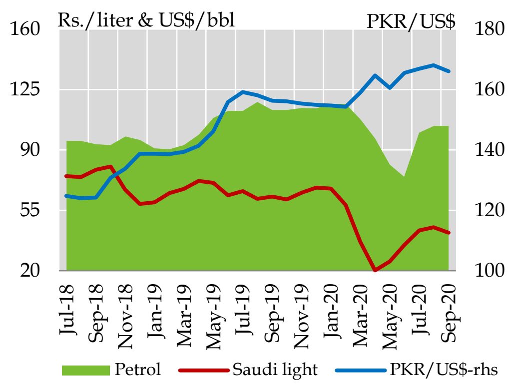
posting consistent rise since July 2019 as gauged by the 12-month-moving- average of non-food-non-energy (NFNE) index (**Figure 3.15**). The overall moderation in prices represented the impact of macroeconomic stabilization measures taken earlier in FY20, along with a considerable alleviation in cost-push pressures in the economy. For instance, muted fuel prices and tax relief measures announced for construction industry and tariff concessions for a number of industrial raw materials in Budget 2020-21 largely curbed the cost-push pressures.

Within urban NFNE, both the goods and services indices decelerated during Q1-FY21, however, the impact of latter was more pronounced. The subdued growth in goods category in urban areas can be attributed to motor vehicles, construction inputs, education and recreation and culture. In case of rural NFNE, services index declined over comparable period last year as well as Q4-FY20, whereas goods index rose slightly on YoY basis, but decelerated compared to Q4-FY20. It is important to mention here that significant slowdown in almost half of the services group mainly altered the rising trajectory of rural NFNE observable for the last four consecutive quarters.

Disaggregated analysis reveals that downward pressure on construction related prices has been observed, especially in cement, *bajri* and iron bars. The FED on Portland cement, aluminous cement, slag cement, super sulphate cement and similar hydraulic cements has been reduced in Budget 2020-21 from Rs 2/kg to Rs 1.75/kg in the wake of Covid. As shown in **Figure 3.16,** the CPI construction index – which includes items related to cement, iron, bricks, paints, sand, painter, mason, unskilled labor, plumber and electrician – has been dropping since the start of the year, and clocked in at 6.0 percent in Q1-FY21 compared to 15.2 percent in the same period last year.

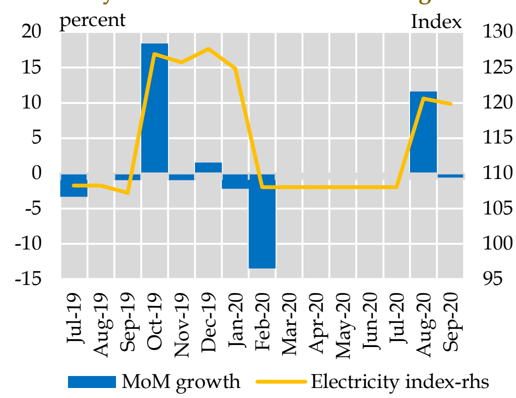
In services category, both for urban and rural areas, component-wise analysis suggests that house rent, motor vehicle tax, construction wages and education played a significant role in driving down the overall services inflation. In education sector, the decline in inflation came from private school fees. This can be attributed to: (a) the Supreme Court's

Domestic and Global Oil Prices **Figure 3.17**



Source: PBS and Bloomberg

Electricity Inflation **Figure 3.18**



Source: Pakistan Bureau of Statistics

decision taken earlier in Q1-FY20 to restore school fees to the 2017 level, on which it fixed the maximum increase in fees at 5 percent a year; (b) concession in tuition fees as provided in the Sindh Covid Emergency Relief Ordinance, 2020, as well as The Punjab Private Educational Institutions Ordinance, 2020; and (c) withdrawal of collection of advance tax on tuition fee by some educational institutions. In addition, postal services and motor vehicle taxes posted no change in inflation during Q1-FY21 on account of no new taxes imposed by the government in order to provide Covid-related relief to the masses.

Decelerating trend in energy inflation persisted

The urban-energy inflation continued to decelerate in Q1-FY21 whereas it rose marginally in case of rural areas. In case of motor fuel, the average inflation declined by 9.1 percent compared to 21.5 percent rise in same period last year. This substantial softening is attributed to the overall Covid-related global decline in the fuel prices since January 2020 and allied weak demand (**Figure 3.17**). On MoM basis, domestic fuel prices rose during Q1-FY21 in response to recent marginal recovery in global oil prices; however, on YoY basis, the domestic oil prices are still at a relatively lower level.

Electricity index, on the other hand, posted robust growth after witnessing deflation for almost two consecutive quarters. This decline in the previous quarters was on account of the postponement of fuel price adjustments (FPA) to freeze the electricity tariff for November 2019 (and onwards). However, by the start of FY21, NEPRA approved the tariff on account of variations in fuel charges for the months of November 2019 till June 2020, for power distributing companies (DISCOs), in an attempt to rein in the growing circular debt. These adjustments were realized in August 2020 and September 2020.[40] Thus, the revised tariffs to address power sector issues contributed to the rise in electricity inflation in Q1-FY21 (**Figure 3.18**).

[40] As per details, fuel cost adjustment (FCA) pertaining to January, February, March, and May 2020 have been charged in August 2020, while FCA for the months of November 2019, December 2019, April 2020 and June 2020, have been charged in September 2020.