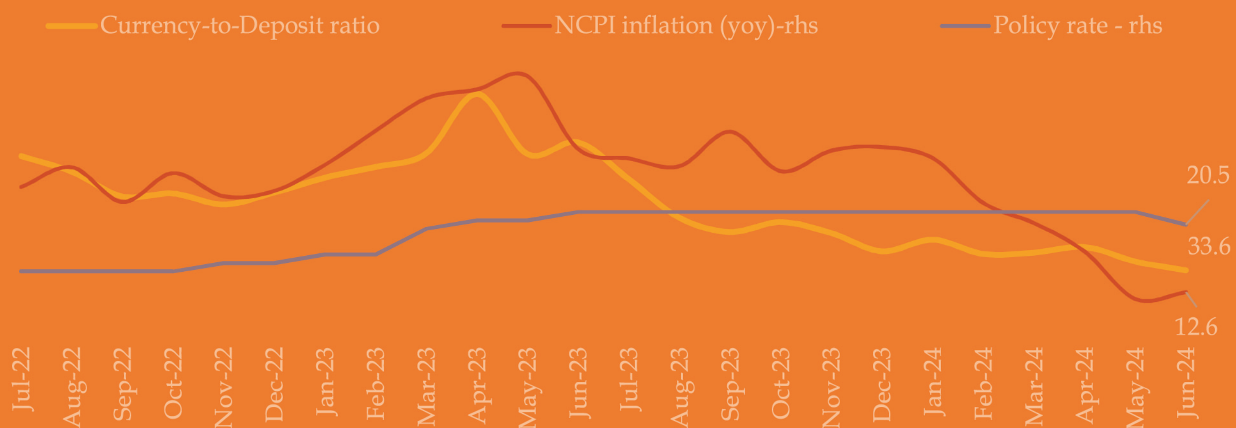
3

Monetary Policy and Inflation

The average NCPI inflation declined to 23.4 percent in FY24 from 29.2 percent in FY23. On year on year basis, the headline inflation came down sharply from 29.4 percent in June 2023 to 12.6 percent in June 2024. The combined effect of contractionary monetary and fiscal policies, the government's administrative measures to address artificial shortages of food commodities and improved agriculture output underpinned a sharp decline in inflation in H2-FY24. A significant increase in energy tariffs, especially gas charges, though impeded the pace of decline in inflation. Some of the above-mentioned measures also helped in further narrowing of current account deficit during FY24 and stability in foreign exchange market. A sustained decline in inflation during H2-FY24 and improved external position allowed the Monetary Policy Committee to reduce the policy rate by 150 basis points to 20.5 percent in June 2024. The build-up of SBP's FX reserves contributed to expansion in net foreign assets of the banking system. This, together with a sharp increase in the government's budgetary borrowing that inflated net domestic assets of the banking system, scaled up the broad money growth relative to the previous year. Moreover, amid a moderate recovery in economic activity and elevated input costs, the growth in private sector credit also inched up in FY24. Consistent with a tight monetary policy stance, growth in monetary aggregates remained lower than nominal GDP growth.

Key Monetary Variables
(percent)



3 Monetary Policy and Inflation

3.1 Policy Review

The average National CPI (NCPI) inflation eased to 23.4 percent in FY24, close to the lower bound of the SBP's revised inflation projection range of 23.0 – 25.0 percent.[1] While adjustments in administered food and energy prices kept the NCPI inflation elevated in H1-FY24, it declined sharply during H2-FY24 reflecting the lagged impact of monetary tightening, continued fiscal consolidation, improved supply of food commodities, ease in global commodity prices, and a high base from the previous year.

The Monetary Policy Committee (MPC) followed a cautious approach and kept the policy rate unchanged through most part of the year. However, an almost consistent downtrend in both NCPI and core inflation during H2-FY24, softening inflation expectations of consumers and businesses, and improved external account position allowed the MPC to put an end to its thirty-three months' long monetary tightening cycle – that began in September 2021 – in the last MPC meeting of FY24. Precisely, the MPC reduced the policy rate by 150 basis points (bps) to 20.5 percent in its June 2024 meeting. The MPC viewed that the stance was adequately tight to bring inflation down to the medium-term target of 5.0 – 7.0 percent during FY26.

The macroeconomic outlook had noticeably improved, when the MPC met in July 2023. The US$ 3.0 billion Stand-By Arrangement (SBA) with the IMF in June 2023 did not only mitigate near-term challenges to the external account, but also lowered the prevailing economic uncertainty. Moreover, the lagged impact of the accumulated monetary tightening since September 2021 coupled with the budgeted fiscal consolidation in FY24 was expected to keep domestic demand in check. In addition, a favourable outlook for global commodity prices reflected positively on inflation outlook. Further, the NCPI inflation had dropped significantly in June 2023 from its peak in May 2023. Accounting for these trends and developments, the MPC anticipated inflation to follow a declining trajectory during FY24, falling in the range of 20.0 – 22.0 percent. These projections were, however, subject to upside risks emanating from climate change, unfavourable global developments, and unanticipated hike in energy prices.

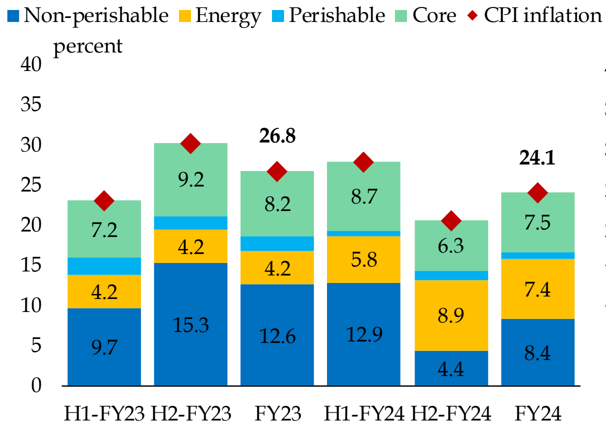
The MPC expected the real GDP growth to post an agriculture-led moderate recovery in the range of 2.0 – 3.0 percent in FY24. Although the removal of import prioritisation guidance from June 2023 was anticipated to ease supply bottlenecks faced by the industry, the continuation of tight monetary policy and fiscal consolidation was expected to keep GDP growth range bound. In view of an anticipated moderate expansion in economic activities led by agriculture, current account deficit (CAD) was projected to remain in the range of 0.5 to 1.5 percent of GDP during FY24.

In line with the MPC's expectations, the real GDP grew by 2.1 percent during Q1-FY24.[2] Reflecting the tepid improvement in economic activity, the current account balance slipped into a small deficit during Jul-Nov 2023, after witnessing a surplus in the last four months of FY23, whereas fiscal indicators improved during Q1-FY24. Meanwhile, an increase in crop production, government's administrative efforts to address artificial shortages of food commodities, and curb speculation in foreign exchange (FX) market contributed positively to inflation outlook. Notwithstanding these favourable trends, the NCPI inflation remained

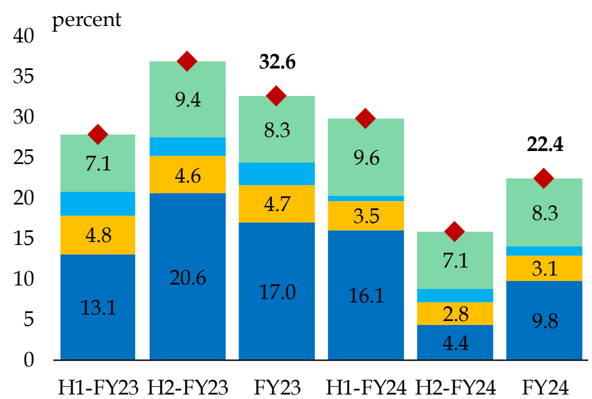
[1] The MPC's initial inflation forecast range in July 2023 was 20.0 - 22.0 percent.

[2] According to the revised estimates released in September 2024, the real GDP grew by 2.7 percent during Q1-FY24.

Contributors of Urban CPI Inflation **Figure 3.1a**



Contributors of Rural CPI Inflation **Figure 3.1b**



Sources: Pakistan Bureau of Statistics; SBP staff calculations

persistently higher in H1-FY24 than the same period of the previous year.

Large unanticipated hikes in energy prices (specifically gas charges) were mainly behind higher inflation outturns in H1-FY24. Aside from its direct impact, the increase in energy tariffs also seeped into underlying inflation through higher operational and transportation costs, and elevated inflation expectations of households and businesses.

The confluence of the second round effects of frequent adjustments in energy prices, along with the hike in tax rates, increase in wages, and PKR depreciation[3] kept the core inflation at elevated levels during H1-FY24, compared to the same period last year. Moreover, the volatility in global commodity prices and deteriorating geopolitical situation in the Middle East and shipping bottlenecks in the Red Sea region also posed upside risks to the inflation outlook. In view of these risks, and to keep inflation on the projected downward trajectory, the MPC maintained the policy rate unchanged at 22.0 percent in all its meetings held during H1-FY24.

Going into H2-FY24, the MPC noted that significant adjustments in energy prices had impeded the pace of expected decline in inflation and its expectations. To stem the accumulation of circular debt, the government introduced significant hikes in gas tariffs for all categories in November 2023 and February 2024. With these adjustments, the contribution of energy group in headline inflation in urban areas significantly increased in H2-FY24 **(Figures 3.1a and 3.1b)**.

These developments partly neutralized the impact of contractionary monetary and fiscal policies and favourable food supply conditions, having a strong bearing on near-term inflation outlook. Moreover, the geopolitical tensions continued to pose considerable risks in the form of disruption in trade flows, elevated freight charges and increase in global commodity prices. In light of these developments and potential risks, the MPC revised its inflation forecast range upward to 23.0 – 25.0 percent in its January 2024 meeting.

From January 2024 onward, inflation began its anticipated downward trend on year-on-year basis. Both food and core inflation started to ease. However, increase in administered energy prices continued to contribute to inflation directly and indirectly. Considering these

[3] On average, mark-to-market exchange rate depreciated by 12.4 percent during FY24.

developments, alongside the growing uncertainty surrounding global commodity prices and rising geo-political tension, the MPC kept the policy rate unchanged at 22.0 percent in the meetings convened in March and April 2024. In its policy deliberations, the committee also took into account the cautious monetary policy stance adopted by central banks in major advanced economies (AEs), and emerging market and developing economies (EMDEs).

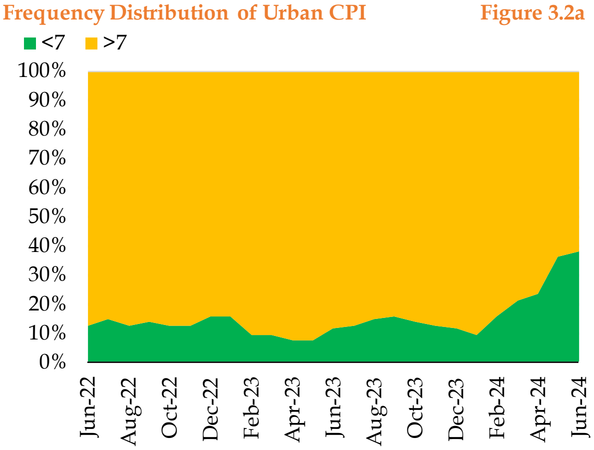
Around the time the MPC met in June 2024, the macroeconomic conditions were broadly in line with the MPC's earlier expectations. According to the provisional estimates, the real GDP showed a moderate increase of 2.5 percent in FY24, against a 0.2 percent contraction in FY23. Despite substantial debt repayments and weak official inflows, a steep reduction in CAD underpinned increase in FX reserves and strengthening of the PKR,[4] which also had positive implications for inflation outlook.

Moreover, year-on-year inflation in May 2024 more than halved to 11.8 percent from 28.3 percent in January 2024. Importantly, the YoY increase in the prices of nearly 25 percent of the CPI items was below the upper bound (7 percent) of the medium-term inflation target range in both the rural and urban baskets during H2-FY24 (**Figures 3.2a and 3.2b**). The impact of accumulated monetary tightening, fiscal consolidation, improvement in food supply, softening underlying inflation and a high base from last year, mainly explain this decline. Considering these developments, the MPC decided to reduce the policy rate by 150 basis points to 20.5 percent in June 2024.

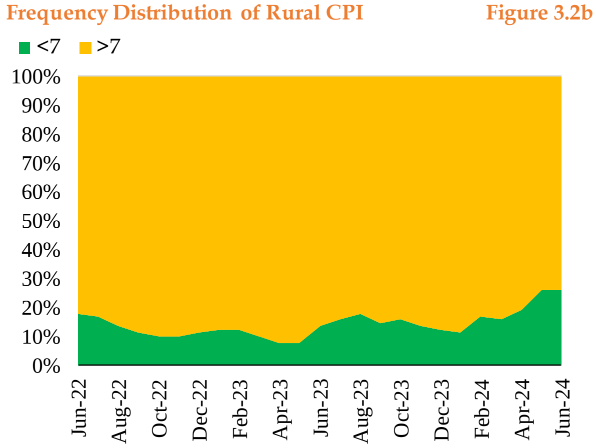
Furthermore, the MPC in its various meetings also highlighted the importance of tackling structural issues in the context of achieving and maintaining price stability. The Committee emphasized on continuation of stabilization measures, which included maintaining fiscal prudence, broadening tax base, reducing untargeted subsidies, and expediting reforms of loss-making Public Sector Enterprises (PSEs), for achieving macroeconomic stability and bringing inflation within the medium-term target range.

The monetary policy response in Pakistan during FY24 was in line with the developments in domestic economic conditions as well as the global economic trends.

Frequency Distribution of Urban CPI — Figure 3.2a



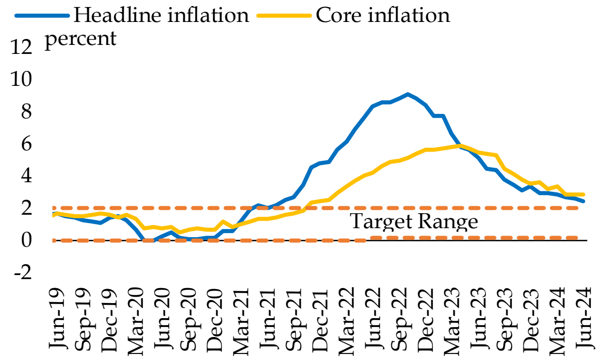
Frequency Distribution of Rural CPI — Figure 3.2b



Sources: Pakistan Bureau of Statistics; SBP staff calculations

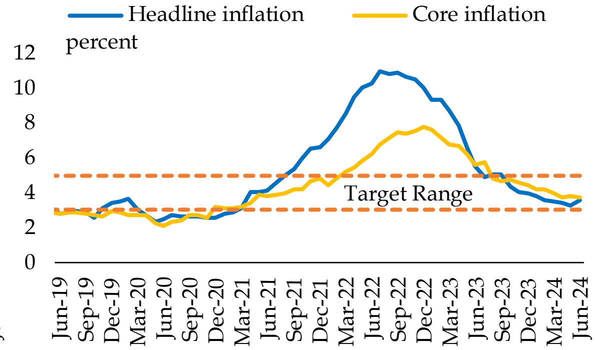
[4] The improvements in external account translated into a 2.3 percent appreciation in the PKR against the US dollar during Mar-Jun 2024 over the same period of the previous year.

Inflation* Trends in Advanced Economies (AEs) Figure 3.3



Note: The sample contains 30 advanced economies
*median inflation and target range
Source: Haver Analytics

Inflation* Trends in Emerging Market and Developing Economies (EMDEs) Figure 3.4



Note: The sample contains a group of 43 countries
*median inflation and target ranges.
Source: Haver Analytics

3.2 Global Inflation and Monetary Policy Responses

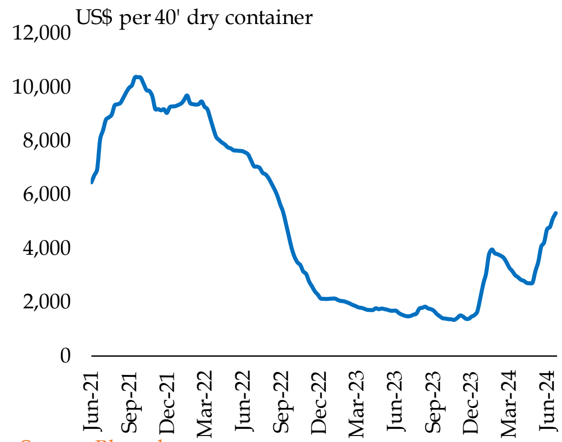
The headline inflation in many EMDEs and AEs[5] nearly returned to pre-pandemic levels in FY24 **(Figures 3.3 and 3.4)**. Albeit elevated compared to the AEs, inflation in EMDEs started returning to the target range. This decline reflects the impact of fading price shocks and subdued demand amid tight monetary policies.

With substantial increase in energy supply, the price pressures in energy group receded more quickly than anticipated. The resolution of pandemic-era supply chain disruptions led to improved delivery times, which also had a favorable impact on transportation costs. However, the attacks on commercial shipping in the Red Sea region spurred global transportation costs[6] in the latter half of the fiscal year (**Figure 3.5**).

Core inflation, albeit higher than the headline inflation, also moderated gradually in both the AEs and EMDEs. Most of this decline came from softening core goods inflation.[7] While services inflation also decreased, relatively stubborn demand and higher wages kept it at elevated levels (**Figure 3.6**).

Following a cautious approach, many central banks in the AEs and EMDEs maintained tight monetary stance in the first half of FY24. However, as underlying inflationary pressures began to unwind, the central banks, specifically in the EMDEs, started easing monetary policy stance. This policy shift became more evident in the second half of FY24 **(Figure 3.7).**

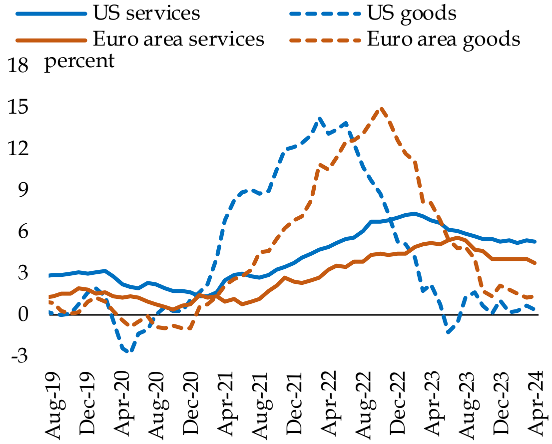
Global Shipping Cost Figure 3.5



Source: Bloomberg

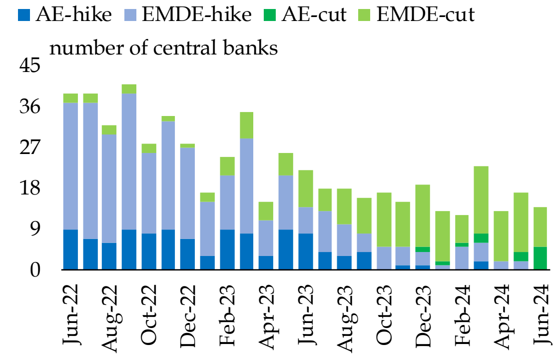
[5]AEs mainly include Canada, France, Germany, Italy, Japan, the United Kingdom and the United States; whereas EMDEs consists of a group of 83 countries.
[6] With Red Sea region shipping accounting for 12-15 percent of global trade and 20 percent of global container shipping, repercussions can be expected to become more severe if uncertainties continue. Source: World Economic Forum
[7] Goods inflation in the US was 0.54 percent in FY-24 (July-April) compared to 2.46 percent in the Euro Area. In contrast, services inflation was 5.53 percent in the US and 4.4 percent in the Euro Area during the same period.

Goods and Services Inflation Figure 3.6



Source: World Bank

Monetary Policy Decisions in Advanced and Emerging Market and Developing Economies Figure 3.7



Note: The sample contains 30 advanced and 43 emerging economies. *median inflation.

Source: Haver Analytics

3.3 Pakistan's Monetary Aggregates

The broad money (M2) growth ticked up to 16.1 percent in FY24 from 14.2 percent in the previous year (**Table 3.1**). Nonetheless, the tight monetary stance kept the M2 growth significantly lower than the nominal GDP growth, which boded well for inflation outlook. Further, the composition of M2 also improved as Net Foreign Assets (NFA) of the banking system expanded, reflecting the improvement in external account position during FY24. The Net Domestic Assets (NDA) of the banking system also increased, albeit at a slower pace compared to the previous year, driven by the government's increased reliance on budgetary borrowing from commercial banks (**Table 3.1**).

Although external financing inflows saw a notable increase during FY24, large retirements in non-bank borrowing increased government's reliance on commercial banks to finance the deficit. Furthermore, in line with a moderate recovery in economic activity and increase in input costs, private sector credit slightly improved during FY24. However, net

Monetary Aggregates Table 3.1

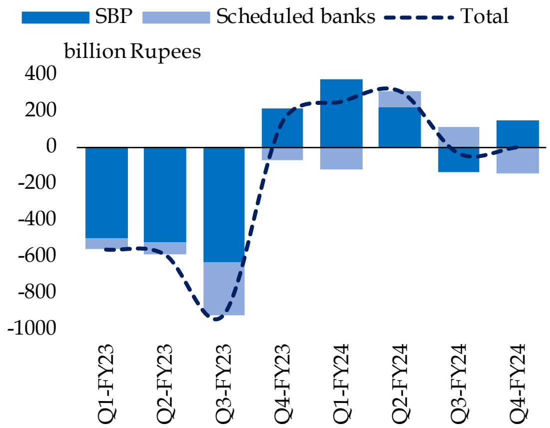
flows in billions; growth in percent; contribution in percentage points

	Change in Stock		Growth		Contribution to M2 Growth	
	FY23	FY24	FY23	FY24	FY23	FY24
NFA	-1,934.5	530.7	-	-	-7.0	1.7
NDA	5,855.1	4,531.0	20.6	13.2	21.2	14.4
Budgetary borrowing	3,747.9	7,478.0	20.3	33.6	13.6	23.7
SBP	108.7	-715.0	2.1	-13.6	0.4	-2.3
Scheduled banks	3,639.3	8,192.9	27.2	48.2	13.2	26.0
Commodity operations	352.3	-107.6	31.1	-7.2	1.3	-0.3
Credit to private sector	208.3	364.2	2.3	4.0	0.8	1.2
Credit to PSEs	293.7	18.5	21.5	1.1	1.1	0.1
Other items net	1,108.1	-3,155.3	-	-	-	-
Broad money (M2)	3,920.6	5,061.7	14.2	16.1	14.2	16.1
Total Deposits	2,327.6	5,002.1	11.7	22.5	8.4	15.9
Currency in circulation	1,576.3	4.4	20.82	0.0	5.7	0.0
Other deposits with SBP*	16.8	55.2	17.6	49.3	0.1	0.2
Reserve money	2,093.2	297.5	22.4	2.6	7.6	0.9

*Other deposits with SBP include deposits of NBFIs, DFIs and MFBs.

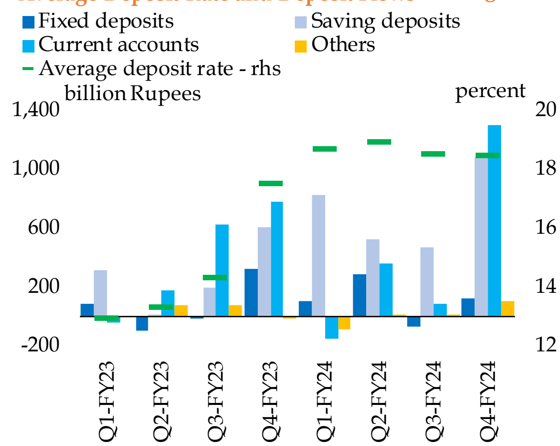
Source: State Bank of Pakistan

Quarterly Flows of NFA **Figure 3.8**



Source: State Bank of Pakistan

Average Deposit Rate and Deposit Flows **Figure 3.9**



Source: State Bank of Pakistan

retirements in commodity financing, a sizeable slowdown in loans to PSEs, and a large contraction in other items net (OIN) partly offset the impact of higher budgetary borrowings on NDA during the year.

The expansion in NFA of the banking system was led by the SBP, mirroring the build-up of external buffers **(Figure 3.8)**. Particularly, the SBA with the IMF in June 2023 was instrumental in unlocking financing from other bilateral and multilateral lenders, leading to a significant increase in inflows in FY24. In addition, narrowing of CAD provided the SBP an opportunity to build FX reserves.

On the liabilities side, the currency-in-circulation (CiC) remained almost unchanged, showing a meagre increase of Rs 4.4 billion in FY24 compared to a huge expansion of Rs 1.6 trillion in the previous year. Attractive rates of return on deposits and SBP's digitalization efforts

Commodity Financing **Table 3.2**

flows in billion Rupees

	FY23	FY24
Total	**352.3**	**-107.6**
Wheat	299.1	-177.2
Sugar	39.9	0.5
Cotton	0.2	-1.8
Seeds	1.7	0.7
Fertilizer	11.2	70.4

Source: State Bank of Pakistan

explain the trends in CiC. In addition, decrease in uncertainty and relatively lower inflation also partly contributed to the slowdown in CiC. Based on anecdotal evidence, crackdown on smuggling and hoarding of foreign currencies may also have discouraged CiC.

Meanwhile, growth in bank deposits accelerated to 22.5 percent in FY24 from 11.7 percent in FY23. This growth was led by saving deposits in line with the tight monetary policy stance **(Figure 3.9)**.

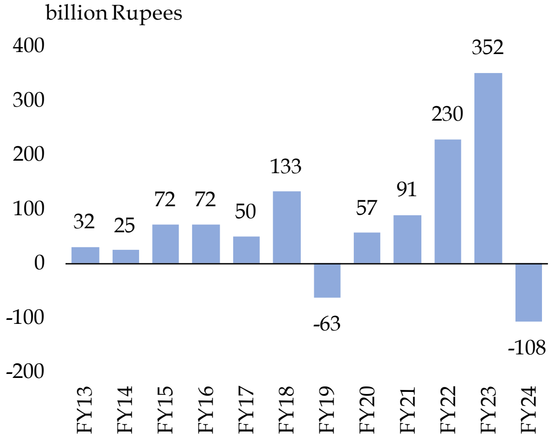
Commodity Financing

Financing for commodity operations posted a net retirement in FY24 as compared to a substantial offtake in the previous year (**Table 3.2**). This was the first time since FY19 that commodity financing saw a net retirement (**Figure 3.10**). This indicated improved cash position of wheat procuring agencies, higher borrowing cost and lower wheat procurement during FY24.

For the past four years, the provincial governments were not able to retire these loans due to non-payment of subsidies by the federal government. To address this issue, the government made a partial payment of overdue subsidies to provincial food departments, which

Commodity Financing Flows

Figure 3.10



Source State Bank of Pakistan

enabled them to retire a part of outstanding commodity debt during FY24.[8]

Government Borrowing

A higher fiscal deficit, in absolute terms, a notable decline in non-bank financing, and retirements to the SBP contributed to increased government borrowings from scheduled banks in FY24. The net budgetary borrowings from commercial banks increased by Rs 8.2 trillion during FY24, compared to an increase of Rs 3.6 trillion in FY23. The government met the bulk of its financing requirements through floating rate PIBs (PFLs) in FY24 (**Table 3.3**). To contain the rollover and interest rate risk, the government assigned higher auction targets to PFLs, followed by fixed-rate PIBs. Similarly, for T-bills, the government allocated higher targets for 6-month and 12-month papers, while the targets for 3-month bills were set below the maturities.

Although on a declining path, inflation was hovering close to the multi-decade peak at the start of the year. This, together with a sustained increase in government borrowing requirements from commercial banks, drove increase in cut-off rates during Q1-FY24. Also, the market appetite for 3-month T-bills and PFLs increased during this period. However, in line with its objective to reduce rollover risk, the government

Auction Summary - FY24 — **Table 3.3**

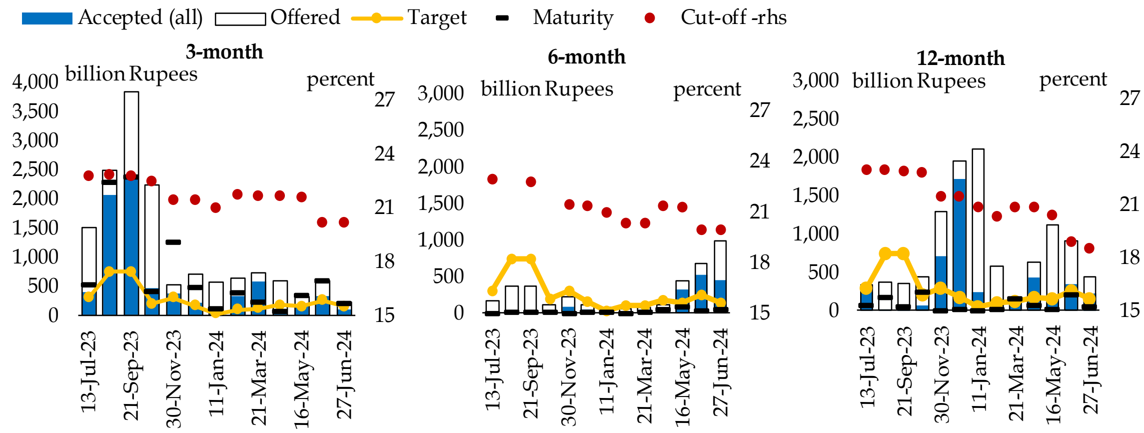
billion Rupees

	Target	Maturity	Offered (competitive)	Accepted (all)
Treasury Bills				
Q1-FY24	8,700.0	8,754.8	14,624.4	8,309.2
Q2-FY24	7,635.0	8,948.2	24,729.2	9,273.5
Q3-FY24	1,670.0	1,880.2	8,668.2	2,124.4
Q4-FY24	3,090.0	2,311.1	10,163.3	4,473.7
Total	**21,095.0**	**21,894.3**	**58,185.2**	**24,180.9**
Pakistan Investment Bonds				
Fixed Rate				
Q1-FY24	480.0	859.7	716.5	189.1
Q2-FY24	510.0	-	1,644.7	763.6
Q3-FY24	505.0	3.2	936.9	303.4
Q4-FY24	570.0	3.6	595.5	235.1
Total	**2,065.0**	**866.5**	**3,893.7**	**1,491.2**
Floating Rate				
Q1-FY24	1,360.0	475.4	3,407.9	2,168.4
Q2-FY24	2,280.0	1,515.6	6,556.7	2,999.7
Q3-FY24	1,280.0	-	2,400.6	901.6
Q4-FY24	1,860.0	-	4,374.6	1,628.7
Total	**6,780.0**	**1,991.0**	**16,739.9**	**7,698.4**

Source: State Bank of Pakistan

[8] Source: Punjab Debt Bulletin, September 30, 2023, Government of Punjab

Auction Summary of T-bills During FY24 **Figure 3.11**



Source: State Bank of Pakistan

mobilized most of the financing through PFLs during the first quarter.

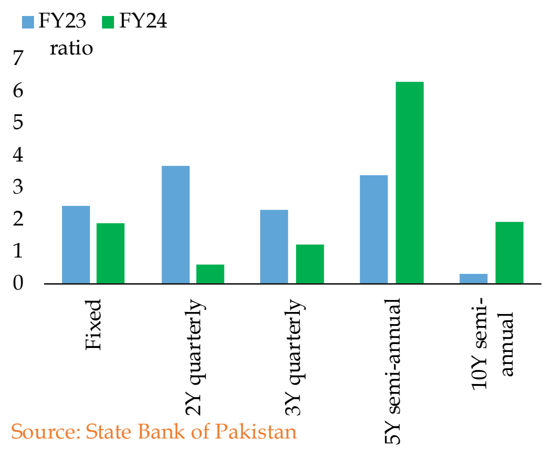
Anticipating inflation to start tapering off from the second half of FY24, the market began pricing in a cut in the policy rate, as evidenced by the decline in secondary market yields and auction cut-off rates from Q2-FY24 onwards, barring an uptick in the third quarter. Less than expected moderation in inflation due to a hike in gas prices and upward revision in SBP's inflation forecast range temporarily increased the cut-off rates in Q3-FY24.

Besides decrease in secondary market yields and cut off rates, offers for 3-month T-bills also declined in the latter half of FY24, reflecting the market's waning interest in short-term papers (**Figure 3.11**). The market stepped up offers for 6-month and 12-month T-bills in H2-FY24, specifically as the June 2024 MPC meeting drew closer, when the decision was in line with the market sentiments. In view of the market's keen interest, and soaring deficit financing requirements, the government accepted large amounts in 6-month T-bills, followed by 12-month bills on net of maturity basis during FY24, and retired 3-month T-bills.

Longer-tenor securities attracted market interest throughout the year. In particular, offers for semi-annual 5-year coupon increased manifold in the latter half of FY24. In overall terms, the offer-to-target ratio for semi-annual 5-year bonds increased to 6.3, more than twice that of T-bills during FY24 (**Figure 3.12**). Resultantly, the government met its financing needs mainly through these long-term securities. In the case of fixed-rate PIBs, the market offers were nearly double the target amount. However, in view of higher cost of borrowing, the government accepted only 38.9 percent of the offered amount.

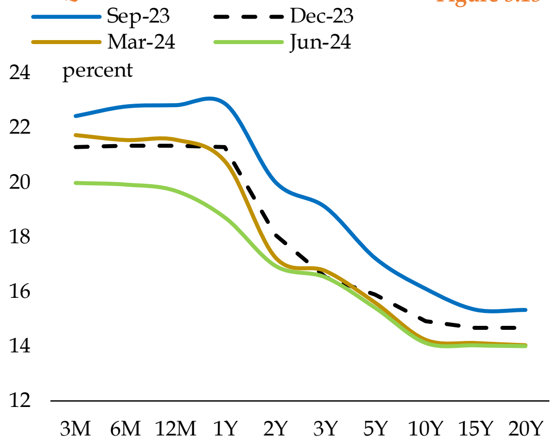
Against the backdrop of lower inflation expectations, the availability of external financing flows, and a stabilizing macroeconomic outlook, the secondary market yield curve shifted downwards. This depicted a decrease in the spread between secondary

Offer-to-Target Ratio - Fixed & Floating PIBs **Figure 3.12**



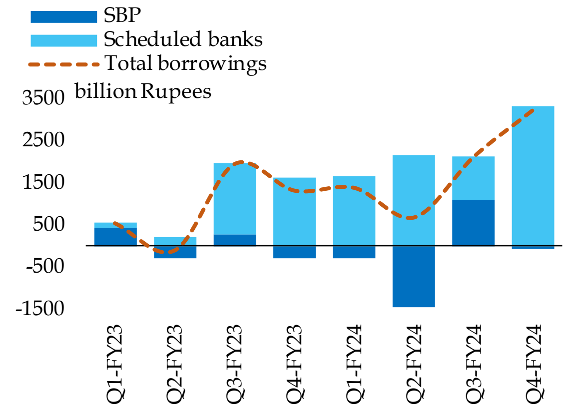
Source: State Bank of Pakistan

End-Quarter Yield Curve **Figure 3.13**



Source: Financial Markets Association Pakistan

Government Borrowings from the Banking System **Figure 3.14**



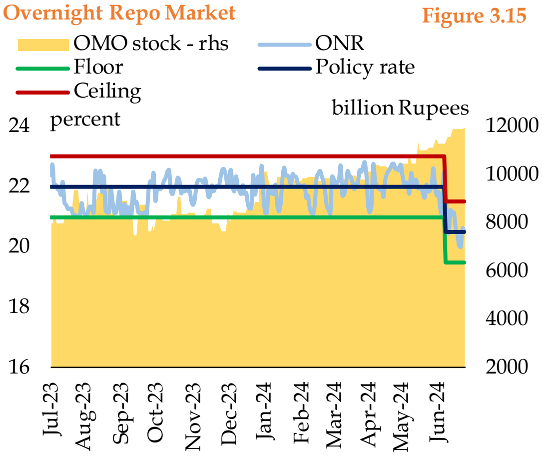
Source: State Bank of Pakistan

market yields and the policy rate. However, yields for short-term papers experienced a sharper decline than the yields for long-term securities (**Figure 3.13**).

Interbank Liquidity

Liquidity conditions in the interbank market remained strained during FY24. This was despite improved NFA of the SBP, strong growth in deposits and stagnation in CiC in FY24, net retirements in commodity financing, and sluggish growth in loans to PSEs compared to FY23. Despite these moderating factors, the government's increased budgetary borrowing requirements from commercial banks and a moderate increase in private sector credit maintained liquidity pressure in the interbank market **(Figure 3.14**). Given its objective to keep the overnight rate (ONR) aligned with the policy rate, the SBP had to inject a considerably higher amount in the interbank market via open market operations (OMOs). As a result, the average outstanding stock of OMOs rose by about 62 percent to Rs 9.4 trillion in FY24, from Rs 5.8 trillion in FY23 (**Figure 3.15).**

Overnight Repo Market **Figure 3.15**



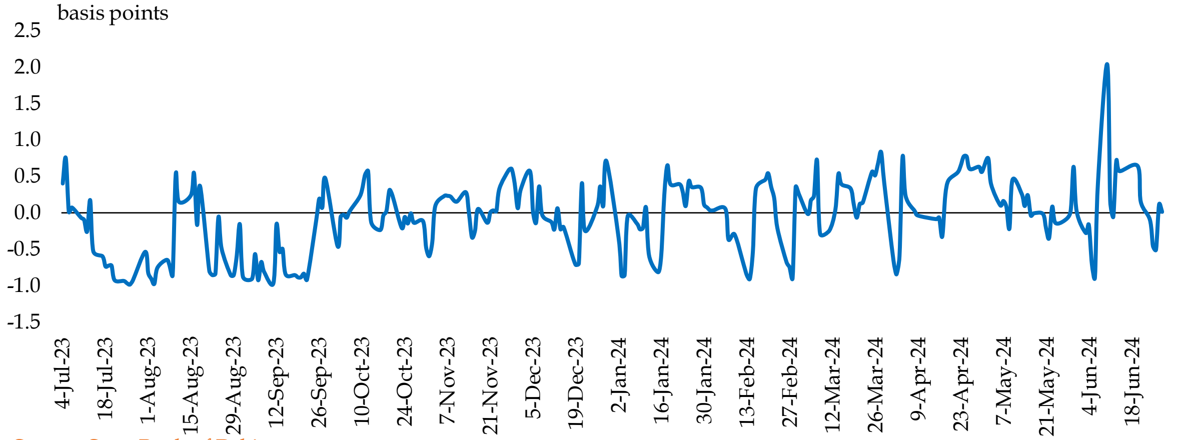
Source: State Bank of Pakistan

In Q1-FY24, the SBP employed longer-tenor OMOs. This, together with higher deposit flows, created ample liquidity in the system thus pushing the ONR below the policy rate (**Figure 3.16**). This resulted in greater utilization of the SBP's floor facility during Q1-FY24, as compared to the same period last year.[9]

However, in the remaining quarters of FY24, expectations of monetary easing drove market preferences towards shorter-tenor OMOs, as this offered the least opportunity cost in the case of future rate reductions. The SBP managed interbank liquidity through shorter-tenor OMOs, which served to move the ONR closer to the policy rate. In overall terms, the share of 7-

[9] The market used SBP repo facility 425 times in Q1-FY24, and parked Rs 24.3 trillion, compared to Rs 4.4 trillion in 102 instances in Q1-FY23.

Deviations of Overnight Rate from the Policy Rate **Figure 3.16**

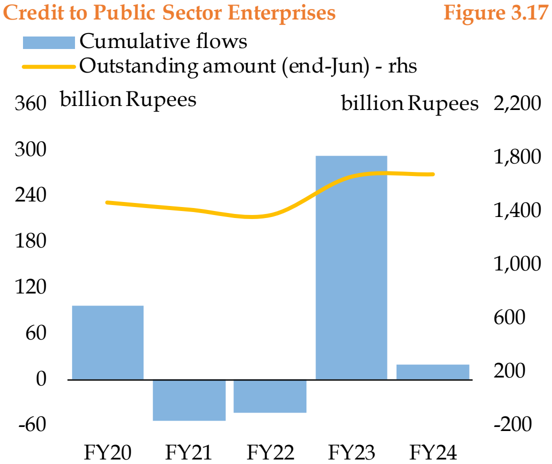


Source: State Bank of Pakistan

day OMOs rose to 59.8 percent in FY24, compared to 10.7 percent in FY23, while 28-day OMOs made up 34.9 percent of overall OMOs conducted in FY24.

In the last quarter, a sharp increase in the government borrowing from commercial banks, some recovery in private sector credit, increase in loans for commodity financing, and a spike in currency in circulation increased liquidity demand. Although total deposits also showed a notable growth, as reflected by the increasing spread between the ONR and the policy rate **(Figure 3.16)**, this was not sufficient to meet the

Credit to Public Sector Enterprises **Figure 3.17**



Source: State Bank of Pakistan

overall liquidity needs of the market. Hence, the SBP scaled up liquidity injections, causing the average outstanding stock of OMOs to rise to Rs 10.9 trillion in Q4-FY24, compared to Rs 9.8 trillion in Q3-FY24. Nonetheless, the impact of increase in stock of OMOs in FY24 was partially offset by the net retirement in government borrowing from the SBP and reduction in stock of SBP refinance schemes. Resultantly, the reserve money growth remained significantly lower in FY24.[10]

Liquidity requirements of Islamic Banking Institutions also increased in FY24. Overall, Rs 7.4 trillion was injected in FY24, as compared Rs 4.1 trillion in FY23. The average amount per injection increased to Rs 102.5 billion in FY24 as compared to Rs 58.6 billion in FY23.

Credit to Public Sector Enterprises

Credit uptake by the PSEs tapered off to only Rs 18.5 billion in FY24, after posting a steep increase of Rs 293.7 billion last year (**Figure 3.17**). Significant retirements by the Pakistan State Oil (PSO) and an oil refinery mainly explain this slowdown in the loans to PSEs.

PSO retired a part of its outstanding debt owed

[10] Higher SBP profit in FY24 also had a contractionary impact on reserve money through other items (net).

to banks during FY24. An expansion in its marketing and distribution network shored up the company's sales revenue, which contained its dependency on bank loans.[11,12] This was in contrast to FY23, when increase in outstanding receivables from the Sui Northern Gas Pipelines Ltd. (SNGPL), together with the company's net losses resulting from flood-related slack in sales had led to an overall rise in the company's borrowings.

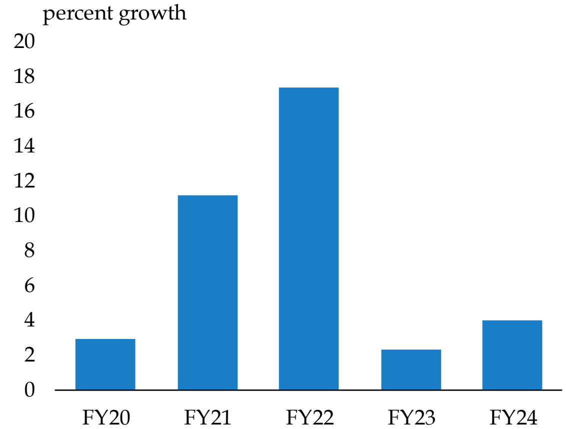
Similarly, export of furnace oil, and an uptick in capacity utilization, improved cash flow position of one of the large refineries, which reduced its reliance on bank borrowings.[13] The gas distribution companies SNGPL and Sui Southern Gas Co. Ltd. (SSGC), on the other hand, have seen a notable increase in bank loans since last year.[14] Large overdue receivables from the government on account of delayed payment of subsidies and tariff adjustment have undermined the cash flow position of these companies, leading to increased reliance on commercial borrowing to clear outstanding dues.

3.4 Private Sector Credit

Private sector credit (PSC) grew by 4.0 percent in FY24 as compared to 2.3 percent in FY23 (**Figure 3.18**). After remaining depressed during the first quarter, credit demand picked up from the second quarter onwards. A moderate expansion in economic activity, alongside persistent cost pressures in some industries, mainly explain the increase in PSC.

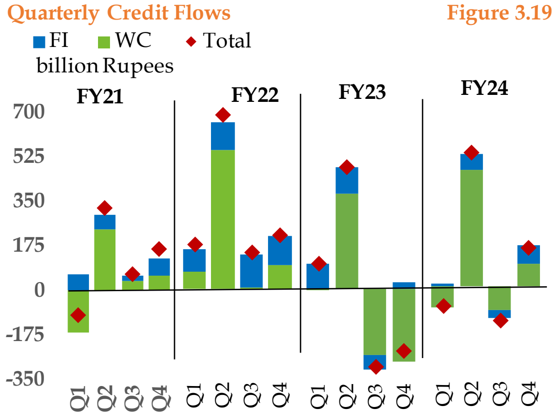
Nonetheless, tight monetary stance along with large financial needs from domestic sources continued to be the key factors behind subdued credit demand in FY24.[15] Furthermore, commercial banks exhibited a strong preference for risk-free investment in government securities, enticed by significant increase in government's borrowing requirements amid higher interest rates.[16] This was demonstrated

Private Sector Credit — Figure 3.18



Source: State Bank of Pakistan

Quarterly Credit Flows — Figure 3.19



Note: FI: Fixed Investment; WC: Working Capital
Source: State Bank of Pakistan

[11] Source: PSO's third quarterly financial report, March 2024
[12] According to PSO's third quarterly financial report 2024, it increased its outreach by establishing 37 new retail outlets, bringing the total number of locations nationwide to 3,555.
[13] The country exported 630,174 MT of furnace oil during FY24 as compared to 20, 600 MT in FY23.
[14] The loans to SNGPL and SSGC rose by Rs 29 billion and 18 billion respectively in FY24, after witnessing a Rs 76 billion and Rs 16 billion increase in FY23.
[15] Policy rate remained unchanged in FY24 till June 2024, when MPC reduced the policy rate by 150 bps.
[16] Government raised about twice the budgeted financing of Rs 3.5 trillion (on cash basis) from scheduled banks in FY24, registering a growth of 48.0 percent over FY23 borrowing.

Loans to Major Private Sector Businesses **Table 3.4**

flow in billion Rupees

	Total		Working Capital*		Fixed Investment		Construction Finance**	
	FY23	FY24	FY23	FY24	FY23	FY24	FY23	FY24
Private Sector Businesses	31.1	458.6	-145.0	363.6	173.8	119.3	2.3	-24.4
Manufacturing	89.4	298.0	-39.9	336.6	128.8	-33.4	0.6	-5.3
Textile	95.1	36.8	55.9	46.5	40.3	-10.5	-1.0	0.8
Cement, lime & plaster	36.5	-39.8	9.9	-22.1	27.0	-16.7	-0.1	-0.9
Refined petroleum	47.2	-21.2	45.4	-21.0	1.9	-0.3	0.0	0.0
Paper & paper products	3.9	30.5	-15.9	20.5	19.7	10.0	0.0	0.0
Basic iron and steel	-35.5	33.5	-37.6	39.6	2.3	-5.9	-1.0	0.0
Motor vehicles	-12.8	-0.9	-13.0	2.4	1.2	-3.3	-1.0	0.0
Basic pharma. products	17.3	4.5	15.7	1.3	1.9	3.6	-0.3	-0.3
Fertilizers	-8.4	-4.4	-6.1	6.0	-2.3	-10.4	0.0	0.0
Veg. & animal oils & fats	1.9	0.2	0.8	1.0	1.1	-0.5	0.0	-0.3
Rice Processing	3.3	3.2	4.7	2.9	-1.4	0.4	0.0	-0.1
Sugar	-12.3	131.0	-1.2	138.6	-11.4	-7.5	0.3	-0.1
Telecommunications	63.2	66.6	14.9	3.5	48.3	63.0	0.0	0.0
Construction	1.9	2.6	9.4	8.1	1.0	-1.3	-8.5	-4.2
Agri., forestry & fishing	17.9	56.5	-6.2	-17.8	24.2	74.5	-0.1	-0.2
Mining & quarrying	14.4	10.8	16.9	11.8	-2.5	-1.1	0.0	0.0
Real estate activities	-0.8	1.5	0.7	1.1	-2.3	3.5	-1.0	0.0
Transportation & storage	-8.4	4.8	-2.3	1.6	-6.1	3.5	-0.1	-0.3
Power gen, trans & dist.	-47.6	-56.0	-41.8	-22.6	-5.8	-33.2	0.0	-0.2
Wholesale & retail trade	-79.8	88.1	-81.4	62.1	-11.1	27.5	12.8	-1.4

* includes trade finance
** in terms of IH&SMEFD Circular Letter No. 28 of 2020, the data on credit/loans has been revised since June 2020 due to inter-sectoral adjustment in private sector business.
Source: State Bank of Pakistan

by the markedly higher bids compared to the auction targets and the maturities.[17]

Disaggregated data indicates that businesses scaled up working capital requirements from Q2 onwards, whereas loans for fixed investment remained sluggish throughout FY24 (**Figure 3.19**). Low capacity utilization in many industries, high interest rate environment, and persistent economic and political uncertainty dented firms' appetite for fixed investment loans (**Table 3.4**).

On the other hand, gradual phasing-out of SBP's concessionary financing schemes (EFS and LTFF) may also have led to some switching towards conventional financing for working capital.[18] As a result, the outstanding stock of loans under EFS and LTFF fell by 11.3 percent during FY24.

Surge in input costs underpinned increased credit demand in some industries

A significant growth in loans to private sector businesses largely emanated from the industries struggling with soaring overhead costs, along with the rise in input prices (**Table 3.5**). In particular, sugar industry accounted for around

[17] Banks offers to maturity ratio was more than double for T-bills, more than 4 times and 8 times of the maturity of both the fixed rate floating PIBs, respectively.
[18] As a condition of the IMF, the SBP will end its operational involvement in the two largest refinancing schemes (EFS and LTFF) after a five-year transition period started in July 2023.

Key Input Price Components **Table 3.5**

growth in percent

	FY23	FY24
Mark-to-market average exchange rate (PKR/US$)	-28.2	-12.4
Mark-up rate (1Y average KIBOR)	18.6	21.9
Wholesale price index	32.8	20.2
Furnace oil	14.3	22.9
LNG	7.7	61.1
Electrical energy	39.9	40.0
Steel products	23.3	41.4
Plastic products	15.7	33.2
Capacity utilization (%)	63.8	64.8

*exchange rate depreciated by around 15% in Q1-FY24 but appreciated from Q2-FY24 following the exchange companies' reforms and administrative actions taken by government

Sources: SBP, PBS, IMF

38.1 percent of the total increase in working capital loans during FY24. Despite a slight dip in sugarcane production in FY24 as compared to the previous year,[19] a significant increase in minimum support prices (MSP) of sugarcane augmented cost of production for the industry, enhancing its working capital needs.[20]

Likewise, wholesale trade sector also registered a large increase in credit offtake. The major beneficiaries were *food and beverages*, *electronics and communication equipment*, *solid, liquid and gaseous fuels*, *agriculture machinery and equipment*, and *fertilizers and agrochemicals.* The high credit demand of these sub-sectors was also driven by increase in input costs (**Table 3.6**).

Rising input and operational costs amplified credit appetite for energy-intensive sectors

Iron and steel sector has been struggling since the beginning of the year. Depreciation of local currency in Q1-FY24, and rise in global prices of iron fueled cost of production, raising working capital requirements during H1-FY24.[21]

Wholesale Price Index **Table 3.6**

growth in percent

	FY23	FY24
Food Group		
Meat of animals	17.5	22.1
Dairy products	33.0	37.9
Sugar refined	5.1	47.0
Sugar confectionary	8.9	13.9
Spices	-23.6	67.9
Beverages	33.2	41.7
Electronics and Machinery		
Engines and motors	3.8	42.2
Fridge, washing, sewing machines, fans, iron	21.5	32.0
Radio and television	28.7	36.7
Fuels		
Natural gas liquefied	7.7	61.1
Furnace oil	14.3	22.9
Agriculture Machinery and Agrochemicals		
Cultivators	45.4	56.7
Pesticides	8.4	16.6
Insecticides	5.9	27.9

*bank floating average exchange rates

Sources: SBP, MoF, PBS, PAMA, World Bank

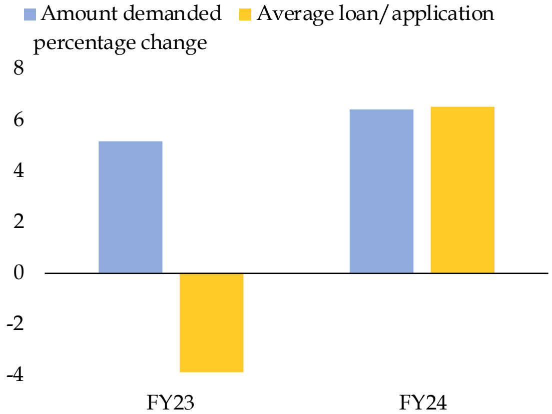
A significant rise in gas and electricity tariffs that amplified operational expenses of the industry during H2-FY24, further increased working capital demand for the sector.

A modest recovery in economic activity and strong agriculture production provided some boost to credit growth

In addition to rising input cost for few industries, increase in agricultural production and an uptick in LSM output[22] increased the demand for private sector credit. For instance, increased production levels led various industries such as leather, chemical and rubber and plastic to increase borrowing from the banking sector. Similarly, strong agriculture production (wheat, cotton and rice) in FY24 also

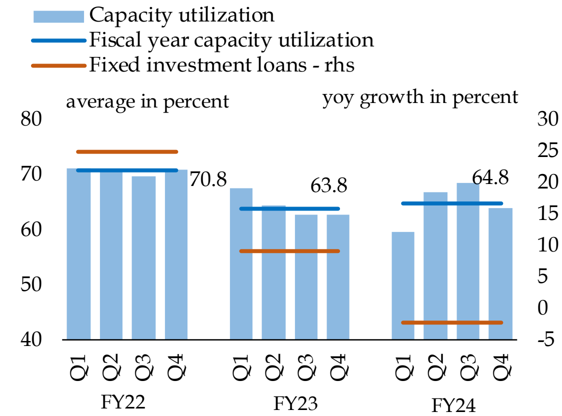
[19] Sugarcane production registered 0.4 percent decline in FY24 as compared to 0.8 percent decline last year.
[20] For Punjab and KPK, the price was raised to Rs 400/maund in FY24 as compared to Rs 300/maund last year whereas for Sindh, it was raised to Rs 425/maund from Rs 302/maund last year (Source: Economic Survey 2023-24).
[21] As per the World Bank pink sheet data, global iron prices rose by 8.5 percent during FY24 as compared to a decline of 20.8 percent last year. The electricity and gas in WPI increased by 40.0 percent (39.9 percent in FY23) and 61.1 percent (7.7 percent in FY23), respectively in FY24.
[22] LSM increased by 1.1 percent in FY24 as compared to contraction of 9.8 percent in FY23.

Private Sector Businesses' Demand for Working Capital Loans **Figure 3.20**



Source: State Bank of Pakistan

Capacity Utilization and Fixed Investment Loans - Manufacturing **Figure 3.21**



Source: State Bank of Pakistan

raised credit requirements of grain milling and allied industries.

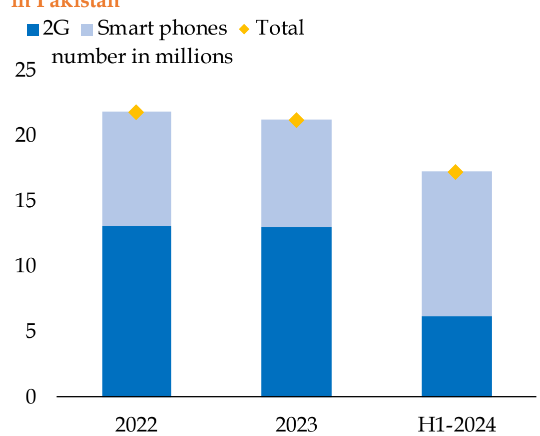
The number of industries witnessing increase in working capital uptake in FY24, almost doubled as compared to FY23. Moreover, the total amount demanded for working capital and the loan demand per application also increased during FY24 **(Figure 3.20)**.

Tight macroeconomic policies and economic and political uncertainty impacted fixed investment loans

The fixed investment loans decelerated for the second consecutive year, registering a growth of 4.6 percent in FY24 compared to 7.1 percent last year. The combined effect of contractionary policy environment, political and economic uncertainty, and a sluggish increase in capacity utilization in manufacturing sector, were the major factors behind the slowdown in fixed investment loans during FY24. Specifically, one-third of the total capacity of manufacturing sector still remained unutilized in FY24, which dented firms' incentives to add further capacity **(Figure 3.21).**

However, *agriculture and forestry* and *telecommunication* sector continued to avail fixed investment loans in FY24. Telecommunication was the only sector witnessing an increase in fixed investment for the fifth consecutive year. The sector saw expansion in both wired and wireless communication, including infrastructure as well as in manufacturing of mobile phones. The subscriber base grew to 194.6 million, achieving a tele-density of 80.7 percent, while, the mobile manufacturing already reached about 85 percent of CY2023 production in H1-CY2024 (**Figure 3.22**).[23]

Mobile Phone Manufacturing/ Assembling in Pakistan **Figure 3.22**



Source: Pakistan Telecommunication Authority

[23] The broadband subscriptions increased to 135.4 million, corresponding to a penetration rate of 56.1 percent. The ICT services exports increased by 24.1 in FY24, compared to a contraction of 0.8 percent in FY23. Source: Economic Survey 2023-24; State Bank of Pakistan.

Consumer Financing **Table 3.7**

flows in billion Rupees

	FY22	FY23	FY24
Total Consumer Financing	**192.2**	**-40.4**	**-57.4**
Credit cards	17.7	21.0	28.5
House building	97.1	11.6	-8.7
Personal loans	16.4	1.2	-14.0
Consumers durable	1.2	0.0	0.1
Auto loans	59.7	-74.1	-63.2

Source: State Bank of Pakistan

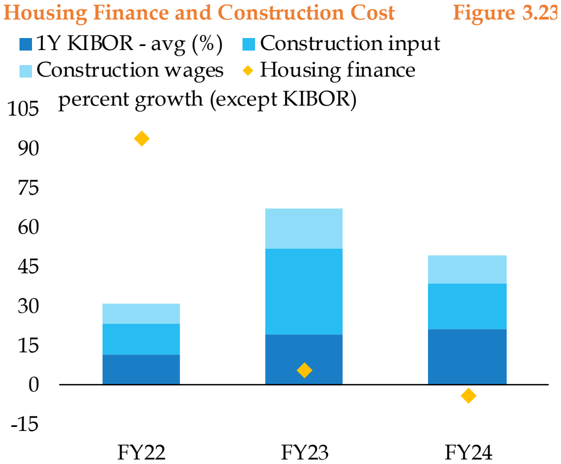
Consumer financing remained on a downtrend for the second consecutive year

Consumer loans continued the declining trend and witnessed net retirement of Rs 57.4 billion in FY24, compared to Rs 40.4 billion in FY23 (**Table 3.7**). Amid the tight monetary stance, interest rates remained at their highest levels almost throughout FY24. Moreover, elevated inflation continued to constrain demand for consumer durables.

While all segments of consumer finance, barring credit cards, saw retirement, the major drag came from auto loans. Alongside the elevated borrowing cost, tightened prudential regulations, and a notable increase in car prices in the last two years, made it difficult for many customers to avail the auto-finance due to higher monthly installments.[24] This is also evident from a marked, 20.2 percent, decline in the sales of cars, jeeps and vans during FY24, reflecting lackluster consumer demand.
Since the end of the government's concessional housing finance scheme, house-building loans have also been on a downward trajectory. In addition to the higher mark-up rates, elevated construction cost also discouraged credit uptake **(Figure 3.23)**. The only category in consumer finance witnessing expansion for the last two years is credit card loans, which rose 30.4 percent in FY24. The growing adoption of digital technologies by both consumers and merchants, given the ease and convenience of transactions, has significantly boosted credit card usage. This is evident from the rise in both credit card based transactions volume as well as their value **(Figure 3.24).**

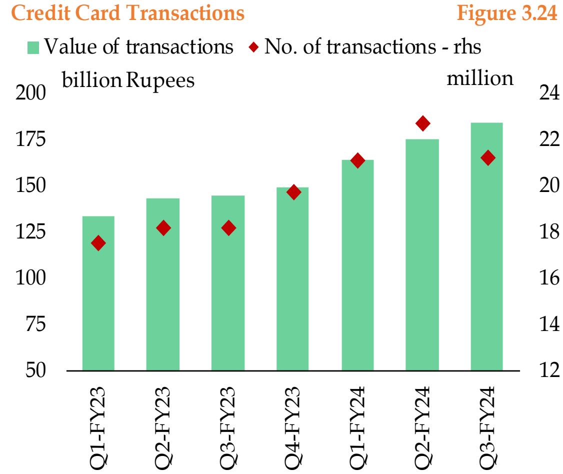
The number of point of sale (POS) machines has also risen during the Jul-Mar FY24 period compared to the same period last year.[25] Lesser preference of consumers to carry cash, rise in price levels and the discounts and offers on

Housing Finance and Construction Cost **Figure 3.23**



Sources: Pakistan Bureau of Statistics and State Bank of Pakistan

Credit Card Transactions **Figure 3.24**



Source: State Bank of Pakistan

[24] Despite some reduction announced by several companies for particular models in FY24, the car prices have increased by more than 50 percent compared to FY22 levels. SBP had introduced several amendments to the Prudential Regulations (PRs) for consumer financing (September 2021, May 2022) aiming to moderate the auto loans by limiting the per customer exposure; increasing the down-payment requirement and reducing the maximum tenure of auto financing.
[25] Number of POS machines increased to 120,641 at the end of Q3-FY24, compared to 112,302 POS machines at the end of Q3-FY23 as per SBP's "Payment System Review" for Q3-FY24.

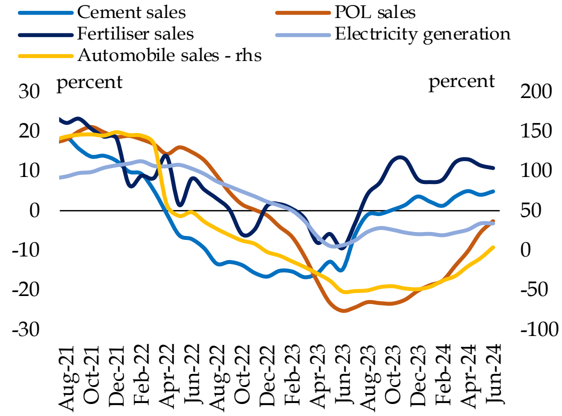
credit card based transactions are also contributing to the overall rise in credit card loans.

3.5 Inflation

The average NCPI inflation came down to 23.4 percent in FY24, from the recent high of 29.2 percent in FY23 **(Table 3.8)**. The core inflation remained almost at the previous year's level, whereas energy inflation spiked to a multi-decade peak in FY24 amid the continued price adjustments in the energy sector. The monthly data shows that disinflationary trends gained traction during H2-FY24, with the YoY inflation falling to a two-year low of 12.6 percent in June 2024, from a high of 38.0 percent in May 2023.

A substantial increase in administered food and energy prices added to inflationary pressures during H1-FY24, compared to the same period last year. In addition, PKR depreciation that pared the gains from easing global commodity prices, and increase in tax rates, levies and wages announced in the FY24 budget also contributed to higher inflation during this period. These developments partly neutralized the impact of policy-induced slack in domestic demand (**Figure 3.25**) and improved supply of food commodities **(Figure 3.26)**

Trends in High Frequency Indicators (12-MMA) **Figure 3.25**



Sources: APCMA, OCAC, NFDC, PAMA, & NEPRA

The increase in gas prices alone contributed around one-fifth of urban headline inflation during FY24, compared to its negligible 0.4 percent contribution in FY23. Longstanding inefficiencies in the energy sector have resulted in piling up of a huge stock of circular debt in

Average CPI Inflation and Contribution **Table 3.8**

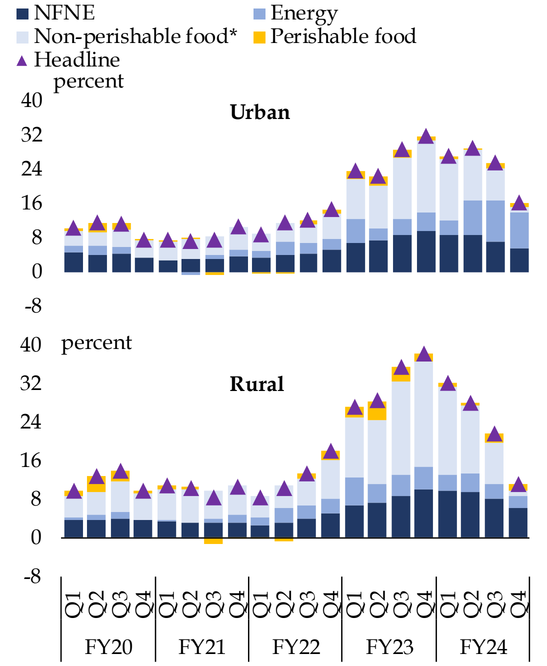
percent

Items	Average Inflation							Contribution		
	Wt.*	H1-FY23	H2-FY23	FY23	H1-FY24	H2-FY24	FY24	H1-FY24	H2-FY24	FY24
NCPI	**100**	**25.0**	**33.0**	**29.2**	**28.8**	**18.7**	**23.4**	**28.8**	**18.7**	**23.4**
Urban										
CPI	**100.0**	**23.1**	**30.4**	**26.8**	**28.0**	**20.7**	**24.1**	**28.0**	**20.7**	**24.1**
Food	**36.8**	**30.7**	**44.0**	**37.6**	**33.2**	**12.9**	**22.1**	**13.5**	**5.5**	**9.2**
Perishable	4.4	48.3	36.0	41.9	7.5	25.0	16.2	0.4	1.1	0.8
Non-perishable	32.4	28.5	45.0	37.1	37.0	11.5	22.9	13.1	4.4	8.4
NFNE	**53.7**	14.1	18.2	16.2	18.4	13.9	16.1	8.7	6.3	7.5
Energy	**9.5**	25.1	38.0	38.4	47.9	76.1	62.6	5.8	8.9	7.4
Rural										
CPI	**100.0**	27.9	37.0	32.6	30.0	16.5	22.4	30.0	16.5	22.4
Food	**45.9**	33.6	48.0	41.1	33.7	12.9	21.6	16.8	6.7	11.3
Perishable	5.7	52.0	41.3	46.4	7.7	29.9	17.7	0.5	1.7	1.1
Non-perishable	40.3	31.3	48.9	40.4	37.8	10.7	22.1	16.3	4.9	10.2
NFNE	**42.6**	17.4	23.5	20.6	25.9	19.3	22.7	3.5	6.9	8.1
Energy	**11.4**	41.0	37.4	39.1	27.2	23.3	24.9	9.6	2.9	3.1

*wt. = weight, Cont.= Contribution

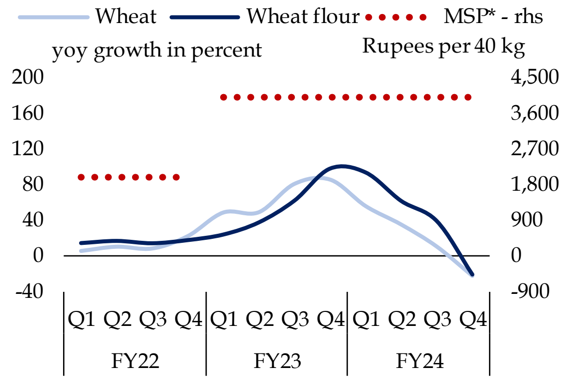
Source: Pakistan Bureau of Statistics

Composition of CPI Inflation **Figure 3.26**



*inclusive of alcohol beverages and readymade food
Sources: Pakistan Bureau of Statistics; SBP staff calculations

Trends in Wheat Prices **Figure 3.27**



*minimum support price of Sindh was Rs 4,000 per 40 kg in FY23 & FY24
Source: Pakistan Bureau of Statistics

power and gas sectors.[26] To stem the pace of accumulation in circular debt, the government has initiated aggressive price adjustments in the energy sector since FY19.[27,28] In the same vein, the government introduced sizeable and broad-based increase in gas charges during FY24, which amplified energy inflation during the year **(Box 3.1)**. Moreover, the steep increase in gas prices pushed the urban inflation above rural inflation in FY24.[29]

The impact of escalating energy inflation seeped into prices of core goods and services as well as higher inflation expectations of consumers and businesses. However, subdued domestic demand and strengthening of the PKR amid improved external account position, moderated the pace of core inflation during H2-FY24.

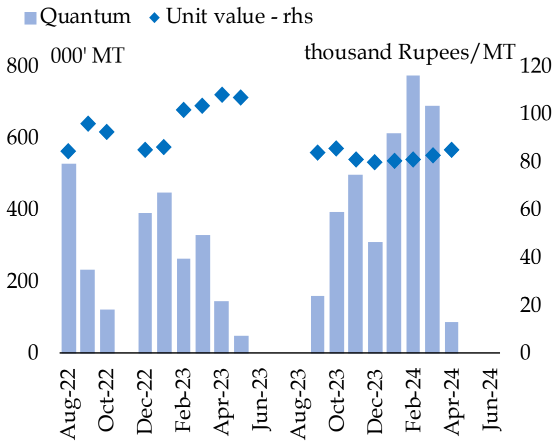
Improved supply situation eased price trends in major food commodities

Food inflation in urban areas decreased to 22.1 percent in FY24, from 37.0 percent in FY23. Increase in crop output, administrative measures and declining global commodity prices mainly explain receding prices of major food items, particularly of wheat, during FY24. After rising significantly in the first half, wheat prices declined sharply in the latter half of FY24 **(Figure 3.27)**. The government introduced a large increase in MSP of wheat in FY23 to incentivize its production that fuelled increase in market prices of wheat and wheat products during H1-FY24.

Besides, artificial shortages further escalated price increases in the first half. To address these issues, the government initiated administrative actions in Q1-FY24.[30] Meanwhile, the

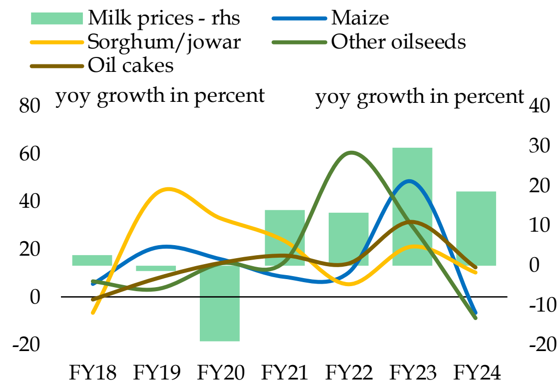
[26] IMF (2024). Second and Final Review under Stand-By Arrangement, published in May 2024
[27] IMF (2019). Staff Report under Request for an Extended Arrangement under the Extended Fund Facility, published in July 2019
[28] However, the tariff adjustments were delayed during the pandemic. Source: IMF (2021). Staff Report under Second, Third, Fourth, and Fifth reviews under the Extended Arrangement under the Extended Fund Facility and Request for Re-phasing of Access, published in April 2021
[29] The CPI basket of the rural areas does not include gas in energy group due to non-availability of piped gas in many parts of rural areas.
[30] Source: Press Release: Second session of the 5th APEX committee of SIFC on September 9, 2023

Wheat Imports **Figure 3.28**



Source: Pakistan Bureau of Statistics

Trends in Prices of Feed Inputs* and Milk Fresh **Figure 3.29**



*wholesale prices of feed inputs

Source: Pakistan Bureau of Statistics

government also allowed the private sector to import wheat, which shored up supply and reversed the price trend in the domestic market **(Figure 3.28)**.[31] In addition, record production of wheat also added to the downtrend in domestic wheat prices especially during Q4-FY24. [32]

Lower input prices allayed price pressures in milk

After witnessing a strong uptrend during FY23, milk prices stabilized albeit at elevated levels during FY24. This may be attributed to a significant reduction in feed prices, including oilseeds and maize during FY24 compared to the preceding year. A significant supply shock in the form of floods had fuelled large increase in milk prices during FY23, on account of shortages of feed inputs and loss of large number of animals.[33] However, during FY24 some important animal feed products including oilseeds witnessed sizeable increase in production, leading to lower prices.[34,35] Furthermore, an overall slowdown in maize (corn) demand from the poultry industry dragged its prices down in FY24,[36] despite a reduction in its production during the year **(Figure 3.29)**. In addition, stringent administrative measures to enforce price controls also contributed to stability in milk prices during FY24. The provincial governments ensured adherence to the announced administered prices of milk that reduced the pace of increase in milk prices in FY24.[37]

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[31] Wheat import volume rose by 29.6 percent in FY24 to 3.5 MMT compared to 2.7 MMT in FY23.

[32] Wheat production grew by 12.2 percent to 31.4 MMT in FY24 as compared to a growth of 7.4 percent with a production of 28.2 MMT in FY23. Source: Pakistan Bureau of Statistics

[33] For details, see Chapter 3 of SBP's Half Year Report FY23 on The State of the Pakistan's Economy

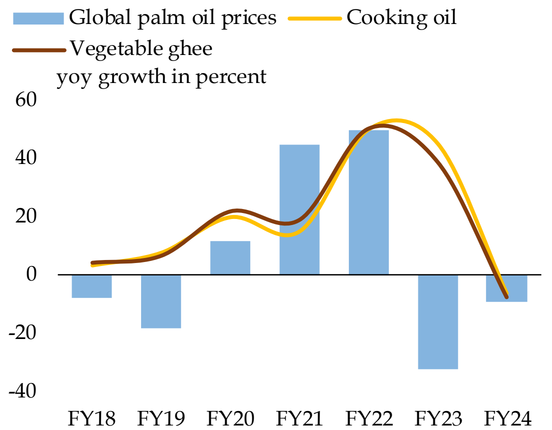
[34] Oilseed crops include cottonseed, sorghum, and mustard, which are used in the composition of dairy feed. Sources: Pakistan Economic Survey and Pak Dairy Info, available at (Pak Dairy Info - concentrates in dairy animal nutrition)

[35] The production of oilseeds significantly increased by 21.5 percent in FY24 reaching 3.2 million tonnes as compared to 2.7 million tonnes in FY23. Source: Pakistan Bureau of Statistics

[36] The demand for maize as poultry feed decreased drastically in FY24 amid the dismal performance of the poultry sector due to rising input costs and the ban on genetically engineered (GE) soybean imports. Traditionally, poultry feed constitutes about 65 percent of corn consumption, while wet milling and dairy feed account for about 15 and 10 percent, respectively. Source: USDA (2024). Report on Grain and Feed Annual, published in April 2024

[37] Under Sindh Essential Commodities Price Control and Prevention of Profiteering and Hoarding Act 2005 (Amended in 2008 and 2023), the Commissioner Office Karachi set the retail milk prices at Rs 200 per liter.
Source: Notification No. CK/AC(HQ)/865/2023, published on October 3rd, 2023.
Likewise, the Deputy Commissioner Office (Lahore) also announced milk prices at Rs 160 per liter. Source: Notification No. DO(IPWM)/LHR/34, published on March 8th, 2024

Trends in Global and Domestic Oil Prices **Figure 3.30**



Sources: Pakistan Bureau of Statistics and World Bank

Lower global palm oil prices induced declines in edible oil prices

The drop in prices of vegetable ghee and cooking oil collectively accounted for more than one-quarter of the decline in food inflation during FY24. Mirroring the falling trend in international palm oil prices amid stable exchange rate, domestic prices of edible oil decreased substantially during FY24, compared to an uptrend in the previous year **(Figure 3.30)**.

Substantial hike in gas prices pushed energy inflation to multi-decade peak

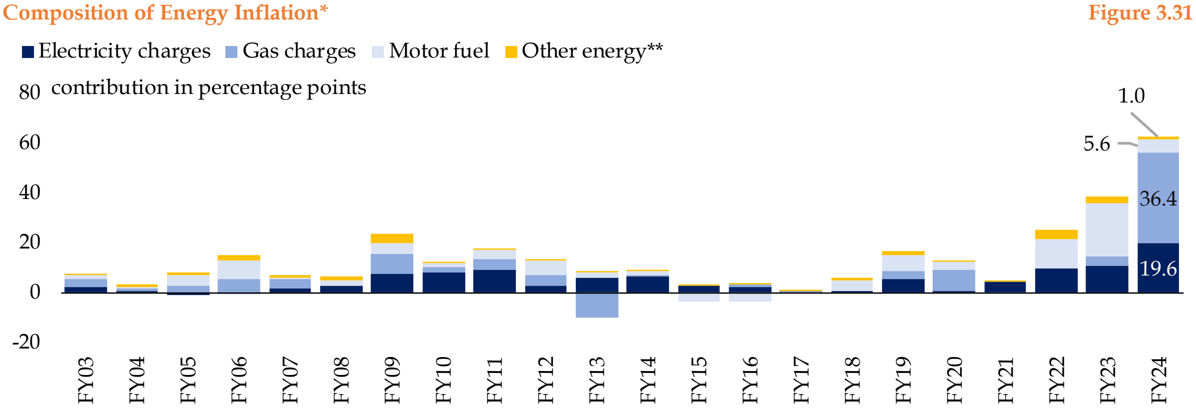
Energy inflation nearly doubled to 62.6 percent in urban areas in FY24 from 38.4 percent in the preceding year. The power and gas price adjustments, especially a significant increase in gas charges, pushed the energy inflation to a multi-decade high level in FY24 **(Figure 3.31)**.

In a bid to shield domestic consumers from the impact of rising global oil and LNG prices, the government had kept the prices of natural gas unchanged since FY20. However, persistent fiscal constraints did not allow the government to pay overdue subsidies to gas distribution companies, which severely affected cash position of these entities leading to accumulation of inter-corporate circular debt in the gas sector.

To stem the flow of circular debt, the government initiated gas price adjustments from January 2023, with a view to align gas charges with cost recovery levels. Continuing these measures, the government significantly scaled up both variable and fixed gas charges for protected and non-protected domestic consumers in November 2023 and February 2024 **(Table 3.9)**. Gas charges for the non-domestic sector, including commercial and captive users, and CNG stations, almost doubled from previous rates, further contributing to inflation in urban areas.

Conversely, in rural areas energy inflation exhibited an opposite trend, falling to 24.9 percent in FY24 from 39.1 percent in FY23. This

Composition of Energy Inflation* **Figure 3.31**



Note: Inflation indices are based on following base years: FY02-09 on base year of FY00, FY09-17 on FY08, and FY17-23 on FY16; *inflation indices for urban areas are used from FY17 onwards; **includes firewood, kerosene oil, bulbs, match box

Sources: Pakistan Bureau of Statistics; SBP staff calculations

Gas Charges Increased Manifold during FY24 — **Table 3.9**

Rupees per MMBTU

	Jan-23	Nov-23	Feb-24
Variable charges			
Protected category			
Up to 0.25 hm^3	121	121	200
Up to 0.5 hm^3	150	150	250
Up to 0.6 hm^3	200	200	300
Up to 0.9 hm^3	250	250	350
Non-protected category			
Up to 0.25 hm^3	200	300	500
Up to 0.6 hm^3	300	600	850
Up to 1 hm^3	400	1,000	1,250
Up to1.5 hm^3	600	1,200	1,450
Up to 2 hm^3	800	1,600	1,900
Up to 3 hm^3	1,100	3,000	3,300
Up to 4 hm^3	2,000	3,500	3,800
Above 4 hm^3	3100	4000	4200
Fixed charges			
Protected category	10	400	400
Non-protected category	460	1,000 (<= 1.5 hm^3) 2,000 (>1.5 hm^3)	1,000 (<= 1.5 hm^3) 2,000 (>1.5 hm^3)

Source: Oil & Gas Regulatory Authority

Fuel Charges Adjustment - FY24 — **Figure 3.32**

May-23	1.9	Jul -23
Jun-23	1.81	Aug -23
Jul-23	1.46	Sep-23
Aug-23	1.71	Oct-23
Sep-23	0.4	Nov-23
Oct-23	3.08	Dec-23
Nov-23	4.13	Jan-23
Dec-23	4.57	Feb-23
Jan-24	7.05	Feb-23
Feb-24	4.92	April-24
Mar-24	2.84	May-24
Apr-24	3.33	Jun-24
May-24	3.32	Jul-24

Note: LHS indicates months for which FCA was charged; indicative months on RHS are months in which FCA was actually billed. FCA is collected with a two-month lag

Source: National Electric Power Regulatory Authority

Quarterly Adjustments in Electricity Tariffs for Residential Consumers — **Table 3.10**

Rupees per KWh

Quarter	Unit	Billing period
Q1-FY23	1.49 to 3.21	Feb- Mar 2023
Q2-FY23	0.5	Apr-Jun 2023
Q3-FY23	1.25	Jul-Sep 2023
Q4-FY23	3.28	Oct 2023-Jan 2024
Q1-FY24	1.15	Jan-Mar 2024
Q2-FY24	2.75	Apr-Jun 2024
Q3-FY24	1.9	Jun-24

Source: National Electric Power Regulatory Authority

is because gas is not part of the rural basket, and hence gas price increases did not translate into higher energy inflation. However, electricity prices along with solid fuel contributed dominantly to inflation due to higher prices of firewood and coal across rural segments.

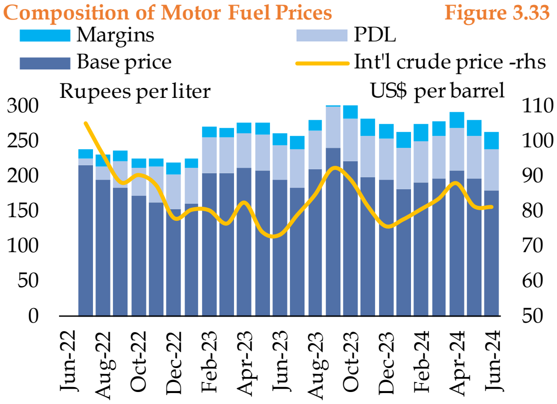
Hikes in electricity tariffs also continued to contribute to inflation during the year, accounting for around one-third of the increase in urban energy inflation during FY24. Effective July 01, 2023, the government introduced an annual adjustment to variable electricity charges across all consumer slabs. Similarly, regular quarterly power tariff adjustments were also implemented throughout the year **(Table 3.10)**. Additionally, fuel charge adjustments (FCAs), typically collected due to variation in actual and reference fuel cost for a particular month, also contributed to the cost of electricity **(Figure 3.32)**.

This was despite a declining trend in global oil prices during the year. The weaker local currency, especially during the first half, exacerbated the fuel cost, leading to higher electricity prices even as global oil prices fell.

Furthermore, the petrol prices, on cumulative basis, increased in FY24 relative to last year on account of higher Petroleum Development Levy (PDL). The government increased the PDL from Rs 50 per litre in July 2023 to Rs 60 per litre from September 2023 **(Figure 3.33)**.[38]

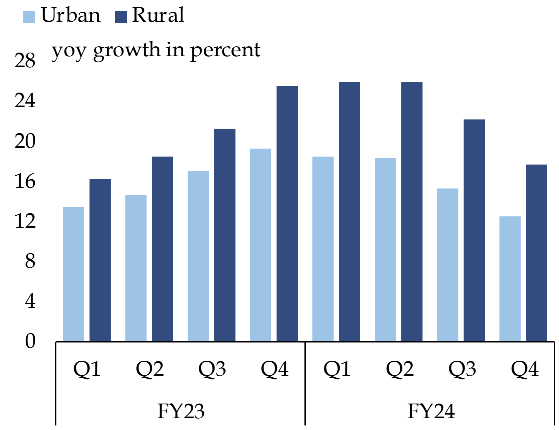
[38] Similarly, PDL on Diesel was raised from Rs 50 per litre to Rs 55 per litre in October 2023, and Rs 60 per litre in November 2023. Source: OGRA

Composition of Motor Fuel Prices **Figure 3.33**



Note: The effect of subsidies and sales tax remained zero during the review period
Source: Oil & Gas Regulatory Authority

Trends in Core Inflation **Figure 3.34**



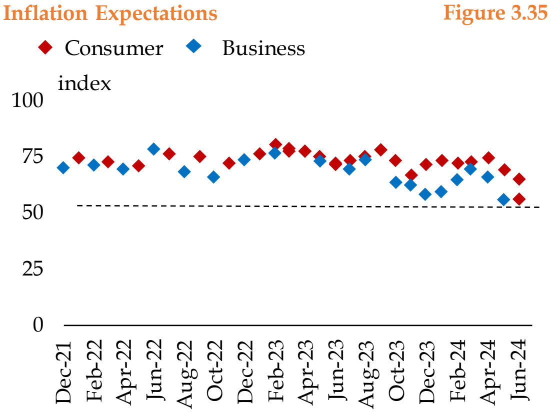
Source: Pakistan Bureau of Statistics

The underlying inflationary pressures started to ease from the start of H2-FY24

Average core inflation in urban areas during FY24 remained almost at the last year's level.[39] This indicated the combined impact of hike in tax rates, levies and wages introduced in the FY24 budget, the lagged impact of PKR depreciation up till September 2023, and second round effects of adjustments in administered prices of food and energy.[40] However, after plateauing at an elevated level, core inflation showed a gradual decline almost throughout H2-FY24 (**Figure 3.34**).

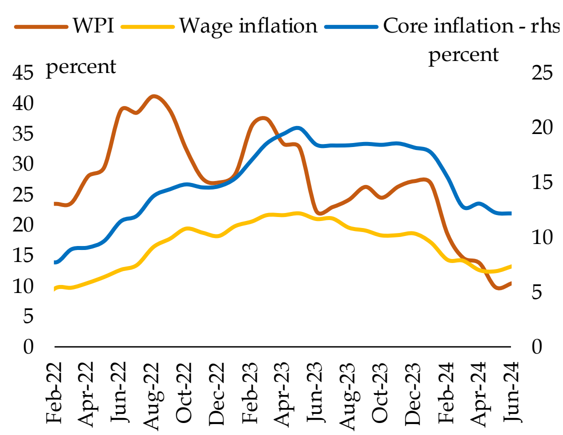
Soaring energy and food prices kept inflation expectations of households elevated in the first half. However, as food inflation began to fall sharply in H2-FY24, consumer expectations also somewhat eased during the second half, which partly effected a slowdown in wage growth during this period (**Figures 3.35 and 3.36**). In addition, strengthening PKR alongside the policy induced slack in domestic demand that relieved price pressures on input costs also played a role in taming core inflation during the second half of FY24**.** More **s**pecifically, inflation

Inflation Expectations **Figure 3.35**



Note: The values exceeding 50 indicates that high inflation views are more than low inflation views.
Source: State Bank of Pakistan

Inputs Costs, Wages, and Core Inflation **Figure 3.36**



Source: Pakistan Bureau of Statistics

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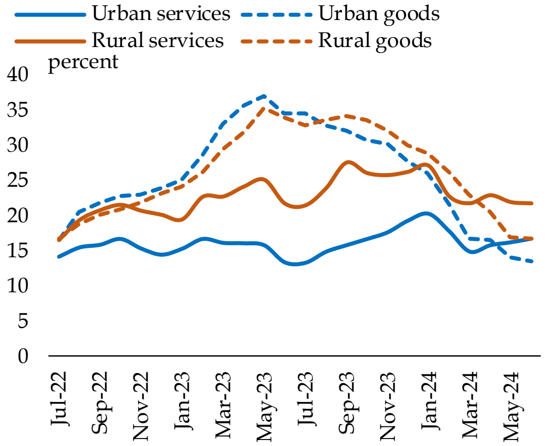
[39] Core inflation in FY24 was 16.1 as compared to 16.2 in FY23.
[40] Wages include charges/wages for tailoring, household servants, cleaning and laundering, construction workers, garbage collection, dental services, doctor fees, mechanical services, and personal grooming services.

Trend in Goods and Services Inflation Figure 3.37



Source: Pakistan Bureau of Statistics

in core goods fell more swiftly than in services (**Figure 3.37**).

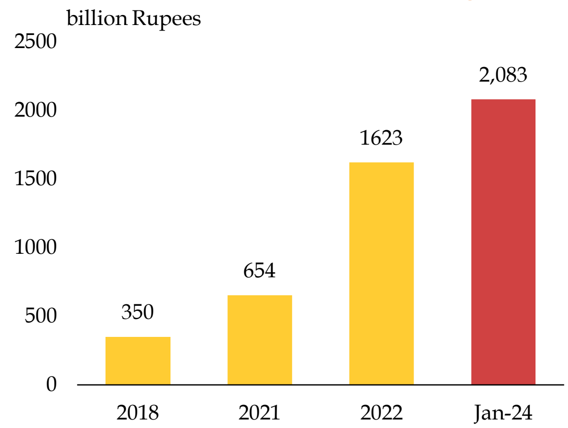
The elevated inflation in services is explained by slower adjustment of wages and contracts, which do not immediately reflect changes in raw material and energy costs. This lag results in services inflation trailing goods inflation as well as the headline inflation during periods of high inflation.[41] Furthermore, higher taxes on services, including additional tax on marriage halls and caterers introduced via the Finance (Supplementary) Act in November 2023 also raised prices of these services.[42] In addition, increased fuel levies contributed to higher transport service charges, including elevated fares. However, the house rent index, the largest component of core inflation, remained stable in urban areas, but experienced a rise in rural areas.

Core inflation in the rural basket increased slightly, rising from 20.6 percent last year to 22.7 percent in FY24. Despite declining headline inflation in rural areas, core inflation remained persistent, although it weakened as the year progressed. The rural basket saw a slight increase in the contribution from services, with marriage hall charges being the main contributor to this rise.

Box 3.1: Factors Underpinning Increase in Gas Prices

A significant hike in gas prices was the major driver of inflation in FY24. These price adjustments were part of the pricing policies pursued by the government since FY19 to stem the pace of increase in energy sector circular debt. The circular debt in the gas sector reached Rs 2.1 trillion in early 2024, around 2.0 percent of GDP **(Figure 3.1.1)**. There are three major interrelated issues underpinning the increase in gas prices. First, political considerations in determination of gas tariffs and extension of gas distribution network which have led to freezing gas tariffs below cost recovery levels. The cheaper availability of the fuel has stoked its demand, which also amplified the government's fiscal burden. However, scarcity of fiscal resources constrained timely payment of subsidies by successive governments, leading to accumulation of circular debt. Second, in the face of diminishing domestic gas reserves, the government has resorted to import costlier LNG since 2015, which has further exacerbated the debt stock. Third, the inability of gas distribution companies to contain transmission and distribution losses has further worsened the gas sector circular debt.

Circular Debt of Gas Sector in Pakistan Figure 3.1.1



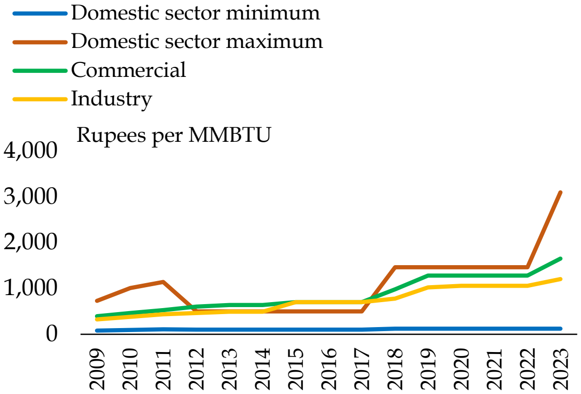
Sources: IMF and Finance Division

Cross-subsidization distorts price signals to domestic consumers. On account of political considerations, successive governments have extended protection to domestic gas consumers, at the expense of industries. A subsidized price for

[41] Bańbura, M., Bobeica, E., & Martínez Hernández, C. (2023). What drives core inflation? The role of supply shocks. ECB Working Paper Series, 2875

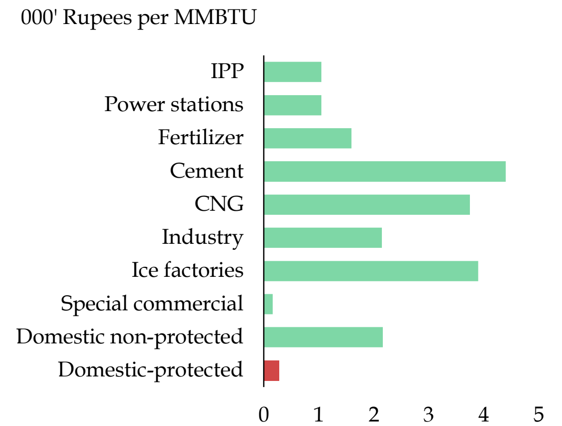
[42] Advance tax of 10 percent has been announced in supplementary finance bill in addition to 15 percent sales tax on marriage halls/lawns/clubs/caterers.

Gas Tariff Adjustments in Pakistan **Figure 3.1.2a**



Source: Pakistan Energy Year Book and Pakistan Economic Survey (various issues)

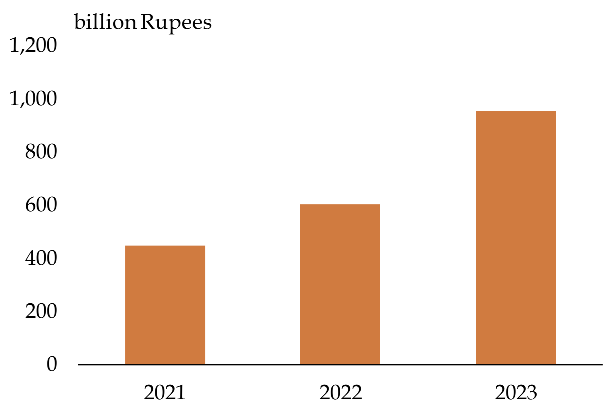
Sector-wise Gas Tariffs **Figure 3.1.2b**



Source: Oil & Gas Regulatory Authority

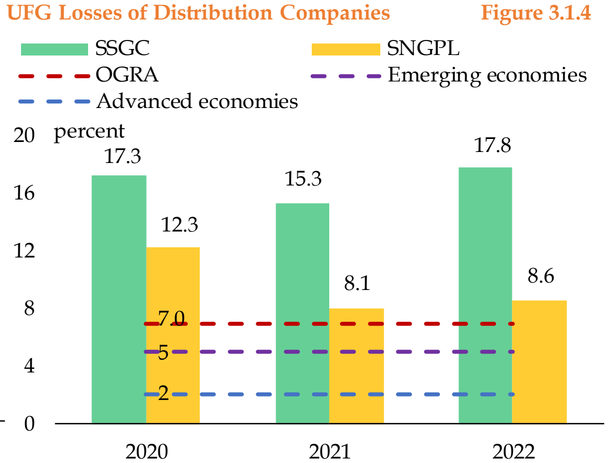
the domestic sector distorts price signals by protecting households at the cost of other sectors **(Figure 3.1.2a and 3.1.2b)**. This encouraged consumption amid diminishing gas reserves. The Oil and Gas Regulatory Authority (OGRA) determines the tariff schedule by incorporating full cost recovery of the distribution companies including SNGPL and SSGC pertaining to sales of gas, transmission and distribution (T&D) costs, and unaccounted for gas (UFG) cost. However, the government intervenes in the price adjustment process by providing subsidies to shield the domestic sector. In addition, the government also absorbs the LNG delivery cost[43] thereby keeping the gas tariff unchanged for a prolonged period. The initial cost differential is borne by the distribution companies which is reimbursed by the government in the form of a subsidy. However, delays in the timely disbursement of the subsidy, erodes the liquidity position of these companies and gives rise to accumulation of intercorporate debt. SNGPL – one of the major gas distribution companies – has reported a substantial increase in pending receivables from the government on account of delayed gas tariff adjustments since past few years **(Figure 3.1.3)**.

SNGPL Receivables on Account of Delayed Tariff Adjustment **Figure 3.1.3**



Source: SNGPL Annual Reports (various issues)

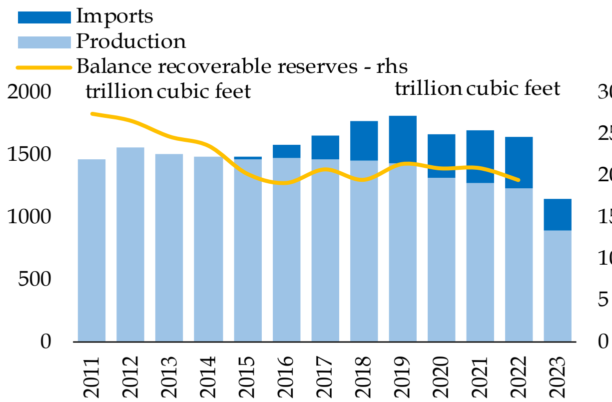
UFG Losses of Distribution Companies **Figure 3.1.4**



Sources: SSGC & SNGPL Annual Reports; KPMG

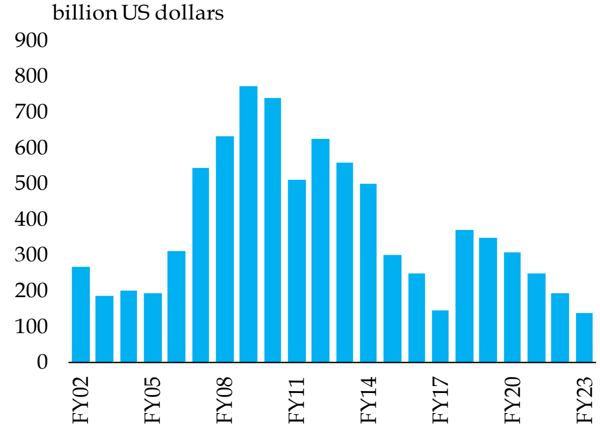
[43] The substantial variance between the LNG basket price and the natural gas price is the amount paid by the government in the form of a subsidy when imported LNG is provided to domestic consumers at the price of natural gas. The government has initiated the process of passing on the entire delivered cost of LNG to the consumers. However, the pace of this shift needs to be expedited (Saad et al. 2023).

Availability of Gas Resources Figure 3.1.5



Sources: Ministry of Energy and Pakistan Energy Yearbook (various issues)

Foreign Direct Investment in Pakistan Figure 3.1.6



Source: Pakistan Bureau of Statistics

Operational inefficiencies of the gas sector lead to large unaccounted-for-Gas (UFG) losses. UFG is the difference between metered gas volume injected into the T&D network and the metered gas delivered to the end consumers. OGRA has set the UFG allowance as 6.98 percent **(Figure 3.1.4)**. The amount that exceeds the UFG allowance is treated as a disallowance and negatively impacting gas prices.[44] A number of factors contribute to high UFG losses including aged infrastructure, law and order issues, and theft of gas. Old infrastructure together with poor maintenance of distribution pipelines and utility networks lead to gas leakages from the system. Old gas meters also hinder efforts to accurately estimate UFG losses and identify domestic gas theft. The magnitude of UFG is higher in areas where law and order situation obstructs the operations of gas companies.[45] Gas theft is also higher in such areas as the practice of installing illegal connections is more common. This further impacts the company's ability to repay their dues and circular debt is generated. As an example, SSGC has been running losses from 2016-2022 due to high UFG disallowances that eroded the company's revenues. On account of these operational bottlenecks, gas distribution companies report higher UFG losses than their counterparts in developing and advanced economies **(Figure 3.1.4)**. The mounting inter-corporate circular debt has hampered the ability of the companies to fix issues in the gas distribution and transmission network, which has further augmented the gas sector circular debt.

Depletion of natural gas reserves has led to growing reliance on costlier LNG imports. The country's gas reserves have been declining, which has increased RLNG imports over the past few years **(Figure 3.1.5)**. Government's involvement in price fixation is one of the primary reasons behind the lower gas reserves, which has discouraged foreign direct investment in the oil and gas exploration sectors (**Figure 3.1.6**). In addition, mounting burden of inter corporate circular debt has also dented the pace of the gas exploration activities by the domestic sector. Thus, since 2015, the government has been importing costly LNG to meet demand, which has increased the country's vulnerability to adverse movements in the global commodity prices.

Conclusion: The settlement of the huge stock of circular debt requires bringing gas tariffs to cost-recovery levels, aligning domestic gas charges with imported LNG prices and phasing out politically motivated preferential treatments. These pricing policies will go a long way in correcting price signals, which is required to rationalize gas demand in the country. This will, however, entail regular adjustments in energy prices, which will escalate energy inflation. Furthermore, there is also a need to focus on introducing improvements in gas transmission and distribution network to lower UFG losses. Similarly, extension of gas exploration activities by encouraging domestic and foreign investment also has a potential to reduce requirements on expensive LNG imports, which may ease price pressures in the gas sector.

[44] OGRA determines prices by equating revenue requirements of the companies with costs of selling gas. OGRA computes the average prescribed gas price by taking the ratio of total revenue requirement (TRR) to the sales volume of gas for each company. The TRR includes the revenue of gas sales at the current prices and the demand-supply shortfall. While the gas sales volume covers the cost of gas sold, T&D losses, UFG allowance/disallowance, return on assets, and depreciation. [OGRA (2022)].
[45] SSGC cited 53 percent UFG losses in Baluchistan.