THE STATE OF PAKISTAN'S ECONOMY

Third Quarterly Report
for the year 2018-19 of the
Board of Directors of State Bank of Pakistan

State Bank of Pakistan

SBP BOARD OF DIRECTORS

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Letter of Transmittal

July 15, 2019

Dear Mr. Chairman,

In terms of section 9A(2) of the State Bank of Pakistan Act, 1956, the Third Quarterly Report of the Board of Directors of the State Bank of Pakistan on the State of the Economy for the year 2018-19 is hereby enclosed for submission to the Majlis-e-Shoora (Parliament).

With warm regards,

Yours sincerely,

(**Dr.Reza Baqir**)
Governor
Chairman Board of Directors

Muhammad Sadiq Sanjrani
Chairman
Senate
Islamabad

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(**Dr. Reza Baqir**)
Governor
Chairman Board of Directors

Asad Qaiser
Speaker
National Assembly
Islamabad

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2. Real Sector	Waqas Ahmed; Javed Iqbal; Khurram Ashfaq Baluch; Saher Masood; Talha Nadeem
3. Inflation and Monetary Policy	Asma Khalid; Fatima Khaliq; Umer Khan Baloch; Amjad Ali; Umar Mashood
4. Fiscal Policy and Public Debt	Muhammad Mazhar Khan; Muhammad Idrees; Mansoor Saleem; Syed Zulqernain Hussain; Hira Ghaffar; Muhammad Ijlal Khan
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1 Overview

Towards the end of FY19, the challenges to the macro-economy have continued to persist. Specifically, during Jul-Mar FY19, fiscal deficit further deteriorated and while the current account gap relatively improved, its sustainability remained a concern. Meanwhile, CPI inflation averaging at 6.8 percent in the first 9 months of FY19 has already exceeded its 6.0 percent target for the current fiscal year. Furthermore, as per provisional national income accounts, GDP growth moderated to 3.3 percent in FY19. Thus far, these trends have yet again exposed Pakistan's structural deficiencies and its vulnerabilities to the buildup of external and internal deficits (**Table 1.1**).

Table 1.1: Selected Economic Indicators

		FY17[F]	FY18[R]	FY19[P]
Growth rate (percent)				
Real GDP	Jul-Jun	5.2	5.5	3.3
Agriculture	Jul-Jun	2.2	3.9	0.8
Industry	Jul-Jun	4.6	4.9	1.4
o/w LSM	Jul-Jun	5.6	5.1	-2.1
Services	Jul-Jun	6.5	6.2	4.7
CPI (period average)[a]	Jul-Mar	4.0	3.8	6.8
Private sector credit [b]	Jul-Mar	9.9	9.1	10.2
Money supply (M2)[b]	Jul-Mar	5.9	4.8	5.1
Exports [b]	Jul-Mar	-0.1	11.9	-1.3
Imports [b]	Jul-Mar	14.7	18.8	-3.7
Tax revenue –FBR [c]	Jul-Mar	7.5	16.2	2.8
Exchange rate (+app/-dep%)[b]	Jul-Mar	0.0	-9.2	-13.7
Policy Rate [b]	Mar	5.75	6.0	10.75**
ONMMR (end-period) [b*]	Mar	5.7	5.7	10.0
billion US dollars				
SBP's reserves (end-period) [b]	Mar	16.5	11.6	10.5
Worker remittances [b]	Jul-Mar	14.1	14.8	16.1
FDI in Pakistan [b]	Jul-Mar	2.0	2.6	1.3
Current account balance [b]	Jul-Mar	-8.0	-13.6	-10.3
percent of GDP[1]				
Fiscal balance[d]	Jul-Mar	-3.9	-4.3	-5.0
Current account balance	Jul-Mar	-2.6	-5.7	-4.7
Investment	Jul-Jun	16.2	16.7	15.4

P=Provisional; F= Final; R=Revised
* Overnight Money Market Rate
** Effective from April 01, 2019
[1] Provisional numbers for FY19
Data sources: [a] Pakistan Bureau of Statistics; [b] State Bank of Pakistan; [c] Federal Board of Revenue; and [d] Ministry of Finance

The moderation in GDP growth is partly a result of policy induced, demand-management measures, initiated since January 2018, to contain the buildup of inflationary pressures and rising twin deficits. These policy actions led to contraction in LSM, which was further entrenched by regulatory measures. At the same time, adverse developments such as water shortages and high input costs undermined the agriculture sector performance. In the meantime, less tangible factors such as uncertainty regarding decision on the IMF program for BoP support hampered business sentiments as reflected in the IBA-SBP Business Confidence Survey

result of April 2019. These developments also contributed to a slowdown in private sector credit during the third quarter of FY19.

The overall economic slowdown, along with specific import compression measures, led to a sizeable contraction in country's import bill. Exports managed to post a sizable growth in quantum terms; however, this recovery was not sufficient to offset the adverse price effect stemming from lower unit values. Nonetheless, improvement in trade deficit coupled with healthy growth in workers' remittances resulted in reduction in current account deficit from US$ 13.6 billion in Jul-Mar FY18 to US$ 10.3 billion in Jul-Mar FY19. However, slowdown in FDI inflows kept the external financing requirements at elevated levels. Thus, while the realized bilateral inflows from friendly countries did provide some support to foreign exchange reserves, its adequacy is still below the three-month of import coverage and the overall BoP position remained weak.

In the same vein, fiscal indicators have continued to deteriorate in the first nine months of FY19 despite a steep cut in development expenditures by 34.0 percent. At the same time, interest rate hikes and exchange rate depreciations accentuated the rigidities in the current expenditures. Making things worse, revenue mobilization remained weak due to stagnant tax revenues and steep fall in non-tax revenues. These trends are largely attributed to slowdown in economic activity and lack of tax effort both at provincial and federal level. As a result, the fiscal deficit increased to 5.0 percent of GDP; notably, the primary deficit has risen to 1.2 percent of GDP, which suggests that the debt servicing ability has deteriorated sharply and the country would be requiring more debt to service its current debt.

Despite several rounds of policy rate hike, a cumulative increase of 500 bps since January 2018, inflation has rather stubbornly kept an upward trajectory. Although demand-pull pressures have lessened in intensity towards the end of FY19, the Non-Food Non-Energy component continued to climb. This is because its major impetus came from cost-push factors, including the second round impact of exchange rate deprecation and increase in energy prices. Furthermore, food inflation that had remained benign over the past five years posted a sharp increase in Q3-FY19 due to supply-side bottlenecks.

In spite of being in stabilization phase led by demand management policies for the last sixteen months, three challenges still stand out in Pakistan's economy. First, external sector remains vulnerable. Second, fiscal consolidation remains elusive. Third, inflation continues to attain higher plateaus. This basically suggests that current stabilization agenda needs to be reinforced with deep rooted structural reforms.

The reforms in fiscal sector are particularly long awaited especially with respect to broadening the tax base, reduction in untargeted subsidies, withdrawal of discretionary tax exemptions and privatization/restructuring of loss making PSEs. These reforms are challenging to implement and thus demand serious realization and commitment. A cross cutting area is energy, where a massive overhaul is required across the entire value chain in terms of pricing, governance, management of circular debt and handling mechanism of IPPs (See **Special Section 1**).

As for the balance of payments, role of private sector would be equally important as of the government in terms of reducing the structural deficit. The government has to provide affordable infrastructure, competitive markets, skill development and business facilitation. The private sector, on the other hand, has to focus on adoption of innovation and technology to improve product and market diversification.

1.1 Executive Summary

Real Sector

The pace of economic growth slowed down considerably during FY19. This was mainly in response to the policy measures taken to curb the twin deficits. These measures affected the performance of the industrial sector and dampened manufacturing activities in the country. Meanwhile, water- and weather-related concerns, in tandem with the higher cost of major inputs, took a toll on crop production. The weak showing by the commodity-producing sectors also constrained the output of the services sector.

Industrial output moderated on the back of a cut in PSDP outlays, amid tightening in monetary policy, currency depreciation, and imposition of regulatory measures. Within industry, there were notable declines in LSM, construction, and mining and quarrying segments. Specifically, LSM posted a broad-based 2.9 percent decline during Jul-Mar FY19, compared to a 6.3 percent growth recorded during the same period last year; nearly all the leading sectors contracted during the review period (**Chapter 2**).

Meanwhile, the agriculture sector's subdued growth can be traced to a noticeable contraction in the crop sector, particularly important crops. Sugarcane and cotton crop outputs declined by 19.4 percent and 17.5 percent respectively. This recent stagnancy in agricultural output makes it pertinent to highlight the urgent need for boosting agriculture productivity in the medium term while population growth remains high. In this context, **Special Section 2** highlighted the state of food

security in Pakistan. However, the silver lining during FY19 was the livestock segment, which maintained its growth momentum from last year and ultimately pushed the agriculture sector's overall growth marginally into positive territory.

On the other hand, the services sector lost some of its growth momentum from last year, registering a growth of 4.7 percent during FY19 as compared to 6.2 percent in FY18. In particular, growth in wholesale and retail trade – a heavyweight segment with inherent linkages to the commodity-producing sectors – more than halved as compared to FY18. The slowdown in imports played a role in the lower growth of the retail trade segment.

In sum, the dominance of the services sector within the economy relative to industry and agriculture, continued to grow during FY19. If left unchecked, the evolving dynamics of domestic consumption relative to production can further exacerbate the gap between demand and supply, necessitating either higher imports or lower exportable surplus in the future. Clearly, neither of these outcomes is desirable from the external sector's stability perspective, and calls for the adoption of structural transformation at the earliest, to ensure a more balanced growth path of the economy.

Inflation and Monetary Policy

The headline CPI inflation rose steeply from 6.0 percent in H1-FY19 to 8.3 percent in the third quarter. Cost-push factors were mostly responsible: (i) managing the high level of twin deficits necessitated upward adjustments in administered prices (of mainly petrol, gas and electricity), which not only directly inflated CPI's energy component (and by extension, transport services), but also escalated manufacturing cost; (ii) the impact of a sharp increase in the rupee-dollar parity was felt across a number of items within the CPI basket; and (iii) supply-side constraints and higher transportation costs led to a surge in food prices (these prices had remained low and stable over the past 5 years). Furthermore, house rents posted a sharp YoY increase during Q3-FY19 due to base effect – quarterly revision in house rents was unusually modest in Q3-FY18.

As a result, inflationary pressures were broad-based – 72 percent of the items within the CPI basked recorded inflation of more than the 6 percent target rate, whereas 31.5 percent of the items recorded double-digit inflation. Importantly, the persistence of the large twin deficits weighed heavily on the near- to medium-term inflation outlook. Moreover, further adjustments in energy tariffs as well as continued pressures on the exchange rate also meant that cost pressures were not likely to dissipate. Therefore, the Monetary Policy Committee decided to continue with monetary tightening, and increased the policy rate by a cumulative

75 bps during the review period, taking the cumulative adjustment since the beginning of the recent tightening cycle to 500 bps by end of Q3-FY19.

On the monetary policy implementation front, voluminous budgetary transactions in the banking system complicated liquidity management during the third quarter. In particular, commercial banks continued to eye higher cut-offs in auctions of government securities, and were not willing to roll-over maturing debt at prevailing rates. As a result, the government had to borrow excessively from the SBP to finance the fiscal deficit and to repay commercial banks' debt. On aggregate, the government retired Rs 2.0 trillion to banks during Q3-FY19 – a record-high level for any quarter. To absorb the excess liquidity from the market and to keep overnight rates close to the policy rate, the SBP had to conduct 52 OMOs (mop-ups only) during the quarter.

The entrenched liquidity surpluses in the interbank market can also be explained by the weakening momentum of private sector credit in the wake of unfavorable macroeconomic conditions. After posting a sizable expansion in the preceding quarter, credit offtake suddenly and sharply slowed down to just Rs 41.1 billion in Q3-FY19, as compared to Rs 177.4 billion in the same period last year. The slowdown in the working capital component was more pronounced, as scheduled retirements by textile and fertilizer manufacturers largely offset fresh borrowings by sugar, dairy and beverages sectors. Among non-manufacturers, power generating firms also made net retirements during Q3-FY19, as their cash flows improved after the issuance of Rs 200 billion Sukuk by the government.

In overall terms, the subdued budgetary and private sector borrowings led to a containment in the growth of net domestic assets of the banking system during Q3-FY19. This more than offset the improvement in the net foreign assets and credit to PSEs during the quarter. As a result, the pace of monetary expansion (M2) slowed down to 1.4 percent during the quarter, as compared to the growth of 3.6 percent in H1-FY19 and 2.5 percent in Q3-FY18. While this slowdown conforms to the ongoing stabilization measures and may help rein in excess demand in the economy, the composition of M2 is worrisome.

Around 88 percent of the M2 growth during Q3-FY19 came from currency in circulation, as a substantial weakening was observed in deposit mobilization during the quarter. While the pace of deposits mobilization has remained underwhelming ever since the government had imposed withholding tax on non-filers for non-cash banking transactions, the trend in Q3-FY19 was quite concerning, as deposit growth fell to only 0.2 percent, from 1.8 percent in Q3-FY18. Furthermore, the currency to deposit ratio on average touched 39.6 percent

during the quarter. The rise in mark-up rates on NSS instruments, overall macroeconomic uncertainty, rising inflation, and expectations of further exchange rate depreciation, all extended the weak growth in bank deposits.

Fiscal Sector

The cumulative fiscal deficit during Jul-Mar FY19 stood at 5.0 percent of GDP, much higher than the deficit of 4.3 percent recorded in the same period last year. Most of the deterioration was recorded in the third quarter, when the deficit reached 2.3 percent of GDP; it is worth noting that the deficit during the H1-FY19 had amounted to 2.7 percent.

A steep fall in non-tax revenues and a slowdown in tax revenue led the overall revenue collection to stagnate at last year's level. The FBR's taxes grew by only 2.8 percent in Jul-Mar FY19, compared with double-digit growth of 16.2 percent recorded during the same period last year. Meanwhile, the non-tax revenues were lower mainly due to fall in SBP profits and delay in transfer of hydel profits to the provinces.

Within FBR taxes, sales and direct tax collection declined during Jul-Mar FY19 due to a cut in PSDP spending, as well as the impact of measures like suspension of tax on mobile phone top-ups and lowering of tax rates on salaries and POL products. Meanwhile, a double-digit growth in customs and excise duties supported overall revenue growth. The higher revenue from this segment was in response to the hiking of regulatory and excise duties on various products, including cigarettes, as well as the exchange rate deprecation during the period.

On the expenditure front, the cumulative growth stood at 8.0 percent during Jul-Mar FY19, against 16.0 percent last year. The slowdown in growth primarily came from cuts in PSDP spending, both at the federal and provincial levels, as current expenditures grew at a much higher rate (17.7 percent) than they had in the same period last year (13.0 percent). The increase in current expenditures stemmed from higher interest payments and security-related expenses during the period.

The resulting higher fiscal deficit was mainly financed through borrowing from the SBP, and non-bank and external sources. In particular, financing from non-bank sources was almost four times higher than last year, with the NSS being the primary source of increase. At the same time, external sources financed around 27 percent of the fiscal deficit, as the country received significant bilateral and commercial loans.

In addition to the higher fiscal deficit which increased financing needs, revaluation losses owing to the PKR's depreciation against the US dollar also contributed significantly to the rise in public debt. During Jul-Mar FY19, public debt rose by Rs 3.6 trillion and reached Rs 28.6 trillion by end-March 2019.

External Sector

The external account continued to improve as the year progressed, with the current account deficit in Q3-FY19 falling to a two-year low to US$ 2.0 billion. Contractions in import payments for both goods and services were the primary factors, and were supported by a decent growth in worker remittances. These factors cumulatively offset the higher primary income deficit and a decline in export receipts. As a result, the current account deficit for Jul-Mar FY19 declined 23.9 percent to US$ 10.3 billion.

As the year went on, the merchandize import payments further dropped with tapering demand for imported power generation and electrical machinery, following the conclusion of early harvest CPEC projects. Furthermore, purchases of aircraft and related parts from abroad that inflated last year's imports, normalized this year. Meanwhile, the overall slowdown in economic activity in the wake of macro adjustment policies and regulatory measures curbed the import demand for raw materials for construction and auto industries. Also, quantum-led drops in import payments for both POL products and crude oil in the third quarter pulled down energy imports for the first time since Q1-FY17. The lower energy purchases, along with declining non-energy imports, led overall import payments to decline 16.4 percent in Q3-FY19.

Both domestic and international factors were responsible for the subdued export performance. For exports of major textile products like knitwear and readymade garments, the slowdown in export growth was primarily due to a decline in their dollar-denominated unit prices, as their quantum exports rose significantly (**Chapter 5**). Besides, higher domestic demand for value addition and lower cotton yarn demand from China suppressed yarn exports to China. The phasing out of export subsidies on sugar and wheat from Q2 onwards made their exports unviable. Moreover, lower production of cotton and fertilizer not only crippled their export prospects, but instead necessitated hefty imports.

Meanwhile, workers' remittances have risen significantly in the year, with most of the increase coming from the US and the UK. The Pakistan Remittance Initiative (PRI) has intensified its efforts by launching advertisement campaigns in local and destination specific foreign media to encourage overseas Pakistanis to remit through legal channels. Besides this, strong real GDP growth, coupled with rising

wages in advanced economies, have boosted inflows from the US and the UK.

However, despite the higher remittances and the resultant reduction in the current account gap, the size of the deficit is still quite large. And this gap could not be filled by foreign investment. As a result, the country had to resort to bilateral and commercial sources for external financing; most of these inflows were realized in the third quarter. Yet, given the elevated CAD and the precarious FX reserves position, these inflows proved insufficient to completely calm down FX market sentiments. As a result, the PKR depreciated 13.7 percent against the US dollar during Jul-Mar FY19.

1.2 Economic Outlook

With stabilization policies in place and the economy moving along the reforms agenda, the country's macroeconomic indicators are expected to slowly revert to a stable trajectory. In this process, however, the real GDP growth is likely to remain contained.

In particular, adjustment on the fiscal side has yet to get underway. Related to this, the revenue measures announced in FY20 Federal Budget are likely to keep disposable incomes and domestic demand under check. Amid such conditions, the industrial growth is not expected to rebound notably next year. Having said that, some support to the GDP growth can possibly come from strong prospects in the agriculture sector, where there is a potential for higher output if the impact of constraints affecting area under cultivation and yields is managed effectively. Early investments in agriculture and SEZs under the CPEC and higher outlay of next year's PSDP can also have a positive impact on GDP growth in FY20.

As for the current account, the government is projecting the deficit to reduce further in FY20, on the back of an expected better export performance, containment of import payments and continued momentum in workers' remittances. However, downside risks persist in the wake of a slowdown in global economy, attributed to escalated trade war between US-China and uncertainty in Europe. Under these circumstances, increasing exports to the traditional markets may prove challenging. On the financing side, the initiation of the IMF Extended Fund Facility program would help assuage the overall external sector concerns.

Finally, despite monetary tightening, the government is projecting CPI inflation to be higher in FY20. This outlook is largely explained by supply-side factors, such as the upward adjustments in domestic energy prices and recent episodes of PKR depreciation along with their second-round impact, which are likely to increase the cost of production and doing business. Additional impact is likely to come from

various taxation measures taken in the FY20 Federal Budget and the risk arising from any volatility in the international oil prices.

2 Real Sector

2.1 Overview

The economy experienced a noticeable moderation as the real GDP growth decelerated to 3.3 percent in FY19, compared to 5.5 percent growth last year.[1] This slowdown had already been anticipated on account of policy measures taken to rein in the persistent twin deficits. While the resultant weakening in economic activities was broad-based, the industrial sector, particularly manufacturing activities, bore the brunt of these measures. At the same time, the agriculture sector remained beset with water shortages and increased cost of major inputs, which constrained the production of important crops. The services sector also faced the fallout from the weak performance of commodity-producing sectors, with its growth slowing down visibly compared to last year (**Table 2.1**).

Among the commodity-producing sectors, industrial output was well subdued, registering a growth of 1.4 percent in FY19 compared to 4.9 percent a year earlier. The decline in LSM, construction, and mining and quarrying stood out in particular. The underwhelming industrial performance was primarily attributed to cuts in PSDP spending. Moreover, it reflected the impact of factors such as monetary policy tightening, exchange rate adjustments, regulatory measures, and uncertainty among certain quarters of the business community regarding the future path of economic policies, which

Table 2.1: GDP and its Components

growth in percent; contribution in percentage points

	Growth			Contribution
	FY18^{R}	FY19^{P}	FY19^{T}	
Agriculture	**3.9**	**0.8**	**3.8**	**0.2**
of which				
Important crops	3.6	-6.6	3.0	-0.3
Livestock	3.6	4.0	3.8	0.4
Industry	**4.9**	**1.4**	**7.6**	**0.3**
of which				
Mining and quarrying	7.7	-2.0	3.6	-0.1
LSM	5.1	-2.1	8.1	-0.2
Electricity gen. & dist.	-9.1	40.5	7.5	0.6
Construction	8.2	-7.6	10	-0.2
Services	**6.2**	**4.7**	**6.5**	**2.8**
of which				
Wholesale & retail trade	6.6	3.1	7.8	0.6
Transport, stor. & com.	2.1	3.3	4.9	0.4
Finance & insurance	7.0	5.1	7.5	0.2
General gov. services	11.8	8.0	7.2	0.6
GDP	**5.5**	**3.3**	**6.2**	**3.3**

R: Revised; P: Provisional; T: Target (from Annual Plan 2018-19)
Data source: Pakistan Bureau of Statistics

[1] According to provisional figures released by PBS in May 2019.

set the tone for the broader economic slowdown.[2] In contrast, electricity and gas generation and distribution was an exception, and showed an encouraging increase compared to last year.

Table 2.2: Agriculture Sector Value-addition
share and growth in percent; contribution in percentage points

	Share	Growth			Contr. to growth
	FY19	FY18^{R}	FY19^{T}	FY19^{P}	FY19^{P}
Crop Sector	35.3	4.7	3.6	-4.4	-1.6
Imp. crops	21.9	3.6	3.0	-6.6	-1.5
Other crops	11.2	6.2	3.5	2.0	0.2
Cotton ginning	2.1	8.8	8.9	-12.7	-0.3
Livestock	60.5	3.6	3.8	4.0	2.3
Forestry	2.1	2.6	8.5	6.5	0.1
Fishing	2.1	1.6	1.8	0.8	0.0
Overall	**100**	**3.9**	**3.8**	**0.8**	**0.8**

R: Revised, T: Target, P: Provisional
Data source: Pakistan Bureau of Statistics

Agriculture also had a disappointing year overall, posting a growth of 0.8 percent during FY19, compared to 3.9 percent last year. Important crops could not deliver, as cotton and sugarcane experienced sizeable declines, while wheat production was also marginally lower compared to FY18. The low crop output was mainly a result of water shortages during important times and adverse weather conditions, while higher input prices (especially those of fertilizer) also had a dampening effect. Encouragingly, however, the livestock subsector was able to maintain its growth momentum in FY19.

The weak performance of the commodity-producing sectors spilled over into the services sector, as its growth moderated to 4.7 percent in FY19, compared to 6.2 percent last year. Given its strong linkages with the commodity-producing sector, it was hardly a surprise that growth in *wholesale and retail trade* nearly halved during the review period compared to FY18. The slowdown in *general government services* was also quite pronounced compared to last year, though the segment managed to surpass its FY19 growth target (**Table 2.1**).

2.2 Agriculture

The performance of the agriculture sector remained subdued during FY19, growing marginally by 0.8 percent; this was significantly lower than the 3.9 percent growth in FY18 and the target of 3.8 percent for the year (**Table 2.2**). It owed primarily to a considerable contraction in the crop sector, which declined by 4.4 percent compared to a growth of 4.7 percent in FY18. There was a marked decline in production of a number of major crops (**Table 2.3**). This was largely

[2] The uncertainty among the business community during the Jul-Mar FY19 period was partially linked to an anticipated IMF bailout, since the build-up to the eventual staff-level agreement in May 2019 featured protracted negotiations between the Pakistani authorities and the visiting IMF mission.

attributable to reduction in area under cultivation, mainly caused by sowing period water shortages, and hike in prices of basic inputs such as fertilizer, seeds and pesticides. Meanwhile, livestock, the dominant sub-sector within agriculture, managed to grow by 4.0 percent. Its contribution not only compensated for the loss in crop sector, but also helped the overall agriculture sector to post marginal growth.

Table 2.3: Production of Important Crops
million tons; cotton in million bales; growth in percent

	Production			Growth	
	FY18	FY19^{T}	FY19^{P}	FY18^{R}	FY19^{P}
Cotton	11.9	14.4	9.9	11.9	-17.5
Rice	7.5	7.0	7.2	8.8	-3.3
Sugarcane	83.3	70.0	67.2	10.4	-19.4
Wheat	25.1	25.6	25.2*	-6.0	0.5
Maize	5.9	6.0	6.3	-3.8	6.9

R: Revised, T: Target, P: Provisional. Targets are from the Annual Plan, except for wheat. These might vary from the FCA targets.
*Production numbers as given by NAC; however, the latest numbers by MNFSR, after accounting for rain damages, place production at 24.3 million tons.
Data source: Pakistan Bureau of Statistics

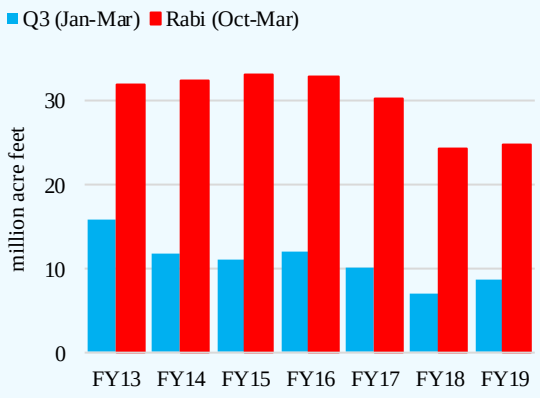
During *kharif* season in particular, there was a considerable decline in the area under cultivation, especially in Sindh where water shortages were more pronounced. The total area sown under *kharif* crops for FY19 declined by 7.2 percent over FY18. Moreover, water shortages and lower fertilizer off-take also had an adverse impact on crop yields. Thus, in overall terms, the contribution of *kharif* crops in the gross value addition (GVA) of the agriculture sector fell significantly below the FY18 level.

In *rabi* season, relatively improved water availability provided some relief. However, delayed sowing, lower fertilizer offtake and unfavorable weather conditions resulted in lower yields for wheat crop.

Inputs:

A review of the inputs situation shows that in 2018-19, both crop seasons *(kharif* and *rabi)* were characterized by stressed water flows. That said, the situation regarding water shortages faced in early *rabi* improved in Q3-FY19 as a result of adequate rainfall during the period. Consequently, irrigation water flows for *rabi* 2018-19 marginally improved by 2.3

Figure 2.1: Irrigation Water Flows



Data source: Indus River System Authority

percent compared to same period last year (**Figure 2.1**).

Table 2.4: Agriculture Credit Disbursement (July-March)
billion Rupees and growth in percent

	Q3		Percent Change		Jul-Mar		Percent Change	
	FY18	**FY19**	**FY18**	**FY19**	**FY18**	**FY19**	**FY18**	**FY19**
Farm sector								
A. Production[1]	112.4	137.3	32.2	22.2	298.7	368.3	36.0	23.3
All crops	60.6	58.6	8.0	-3.3	169.7	169.2	16.7	-0.3
Corporate Farming	30.6	41.4	130.1	35.3	70.4	117.3	109.5	66.6
B. Development[2]	5.7	6.3	54.1	10.5	16.8	23.8	36.6	41.7
Tractor	1.6	1.0	33.3	-37.5	4.2	3.2	40.0	-23.8
C. Total farm sector (A+B)	118.1	143.6	33.1	21.6	315.5	392.1	36.1	24.3
Non-farm sector (Working Capital and Fixed Investment)								
Livestock/dairy	60.7	67.7	52.1	11.5	177.4	210.6	43.5	18.7
Poultry	30.1	36.8	27.0	22.3	85.2	99.5	38.8	16.8
Other	25.3	29.7	33.9	17.4	88.0	102.9	56.9	16.9
D. Total non-farm sector	116.1	134.2	40.7	15.6	350.6	412.9	45.4	17.8
Total agriculture (C+D)	234.2	277.8	36.8	18.6	666.1	805.0	40.8	20.9

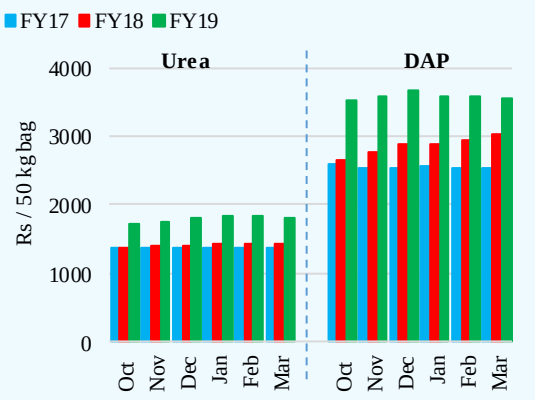
[1] Production loans are for purchase of inputs such as seeds, fertilizer, pesticides etc.
[2] Development loans are for tractors, tube wells and other agricultural machinery.
Data source: State Bank of Pakistan

However, the improvement was overshadowed by reduced fertilizer offtake, as well as relatively restrained growth in credit disbursements to crops sector, especially production loans, compared to last year. Total nutrient offtake continued to contract in Q3-FY19 as well; consequently, fertilizer offtake declined by 3.5 percent for *rabi* 2018-19 compared to *rabi* 2017-18. Product-wise breakdown shows that even though urea offtake expanded by 3.0 percent, it was offset by a significant contraction in DAP offtake of 17.0 percent. Decline in DAP offtake can be largely attributed to higher prices compared to last two *rabi* seasons, despite provision of various subsidies at the provincial and federal levels[3] (**Figure 2.2**). In keeping with the trends of weak crop sector performance and increased interest rates, loans to crop sector contracted marginally by 0.3 percent during Jul-Mar-FY19, while the disbursements for tractors declined by 23.8 percent on YoY basis.[4] Overall agriculture credit disbursements during the period, however, registered growth of 20.9 percent on top of healthy showing during the same period last year (**Table 2.4**).

[3] Feed gas is being provided at cheap rate (Rs. 185 per MMBTU), whereas price of fuel gas is Rs. 780 per MMBTU. In this way subsidy of Rs. 714 per bag is given.
[4] Largely due to hike in tractor prices and rising interest rates, tractor sales declined by 27.8 percent in *rabi* 2018-19 compared to same period last year.

Despite contraction in farm activities, there was an increase in loans for production purposes, mainly due to a broad-based rise in input prices. Unlike the preceding *rabi* season, where price hike in diesel was the only major source of input cost increases, the situation worsened in FY19, given increase in prices of all inputs, namely tractors, fertilizer, insecticides and pesticides. Hence, farmers faced liquidity constraints due to both escalated input prices and lower crop returns (**Table 2.5**). Meanwhile, within the non-farm sector, growth was derived mainly from higher working capital requirements for livestock/dairy and poultry sub-sectors. This trend is in line with the 4.0 percent growth of the livestock sector during FY19.

Figure 2.2: Average Monthly Prices



Data source: National Fertilizer Development Centre (NFDC)

Wheat:

Data from Pakistan Economic Survey shows that the wheat production rose marginally by 0.5 percent to 25.2 million tons in FY19 **(Table 2.3)** as the government revised FY18 wheat output downwards by 0.4 million tons. However, according to the latest estimates by the Ministry of National Food Security and Research (MNFSR), wheat production for FY19 had been recorded at 24.3 million tons which instead shows a contraction of 3.2 percent compared to revised production of 25.1 million tons in FY18.

Table 2.5: Agricultural Input Prices for Rabi Crop (Oct-Mar)

YoY % Change in Wholesale Price Index

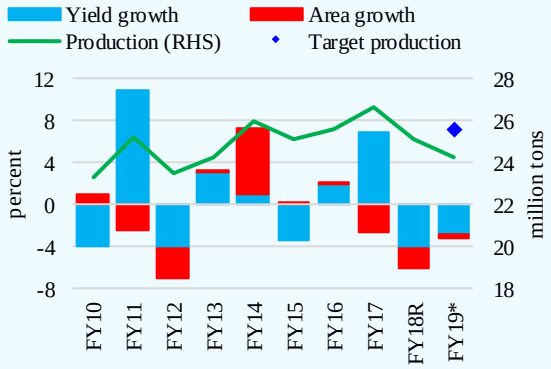
	2017-18	2018-19
Tractor	0.0	11.6
Fertilizer	2.7	17.8
Pesticide	0.8	2.4
Insecticide	-0.4	6.2
Cultivators	-7.1	0.0
Diesel	21.5	29.9
All Farm Inputs	***12.2***	***23.5***

Data source: Pakistan Bureau of Statistics

The discrepancy between the estimates provided by PBS and MNFSR may be attributed to the former one not accounting for production levels due to untimely rains and hailstorms at peak harvest time. The forthcoming Annual Report for FY19 could shed more light on the performance of the wheat crop as by then the datasets would have reconciled. The analysis below is based on the latest estimates provided by MNFSR.

This *rabi* season, the yield for wheat declined by 2.9 percent while the area under wheat contracted by 0.4 percent. This second consecutive seasonal decline in wheat production was mainly due to three developments: (1) delayed cane crushing led to decline in area under cultivation; (2) insufficient nutrient offtake, specifically for phosphate, resulted in lower yield; and (3) untimely and intermittent rains and hailstorm in the harvest period led to a portion of the crop being damaged, particularly in Southern Punjab (**Figure 2.3**).

Figure 2.3: Wheat Production and Growth Rates



Data source: Pakistan Bureau of Statistics. FY19* figure is post-rain estimate reported by MNFSR. Target by FCA.

Another reason for low yield is the usage of non-certified seeds in certain areas. Largely, losses in yield have been reported in districts such as Chakwal where desi varieties were planted, as opposed to new weather- and pest-resistant varieties. These varieties have inadequate resistance to weather changes. Lower adoption of certified seeds might have been caused partly by unchanged support price of Rs 1,300 per 40 kg for the season. Major losses were estimated in Punjab, specifically in southern region, where yields have declined by 4.0 percent compared to provisional numbers calculated before damage assessment. [5]

In a climate-changing scenario, adoption of certified and climate resistant seeds is crucial in mitigating losses from unpredictable and erratic seasonal patterns. Furthermore, resilience of small farmers through climate smart adoption and insurance practices is also needed. Recognizing this fact, the latest Punjab Crop Insurance Program aims to indemnify small landholders for yields losses, enhance productivity, and promote the adoption of climate smart practices such as new varieties of seeds. Under this program, *rabi* 2018-19 wheat yield losses will be compensated for farmers covered under the program (**Box 2.1).**

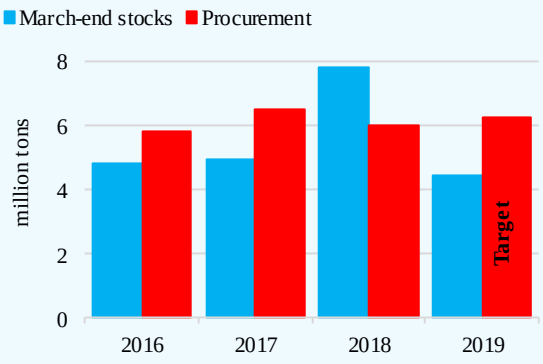
The position of wheat stocks held by provincial food authorities and PASSCO at end-March 2019 were 4.5 million tons, compared to 7.3 million tons in March

[5] Initial yield of Punjab according to FCA meeting in start of April was 2,951 kg per hectare while the latest loss adjusted yields are 2832 kg per hectare. Latest estimates were reported by MNFSR.

2018 (**Figure 2.4**). Despite lower than target wheat output, carryover stocks are still sufficient to cover the domestic consumptive requirements of 25.8 million tons.[6] Although depreciation of PKR did result in some export of wheat[7], it is hardly sufficient to reduce mounting pressures on provincial governments' wheat financing costs.

This year, the government had announced the target of 6.3 million tons for procurement, which was comparably higher than last year's target of 6.1 million tons and actual procurement of 5.9 million tons in FY18. That said, the actual procurement was still not confirmed by majority of provincial authorities as of end-March 2019. It bears mentioning that an absence of storage facilities at the farm level, and thus a reduced ability to save the crop from moisture damages, often results in sale of wheat at cheaper rates in case of non-procurement by the government.

Figure 2.4: Wheat Stocks and Procurement



Target: set as on May 15, 2019.
Data source: Ministry of National Food Security and Research

Box 2.1: Punjab Crop Insurance Program – Pilot Project Features and Lessons Learned

The Crop Insurance Program (CIP) was introduced as an essential component of the Government of Punjab's strategy to transform agriculture in the next five years in line with the goals of the World Bank's SMART[8] program to enhance productivity of crops, increase competitiveness, and improve resilience of smallholder farmers to climate change and natural disasters. Two rounds of pilot projects were launched, first in *kharif* 2018 for cotton and rice, and second in *rabi* 2018-19 for wheat. Due to lower than expected cotton crop yields, payout to cotton farmers in Sahiwal district was also made in the *kharif* 2018 season. The pilot projects have helped to identify several issues. While the improvements in input adoption and yield enhancement will take time to unfold, this Box highlights the key features of the program and the lessons learned.

Current situation

The existing federal level Crop Loan Insurance Scheme (CLIS), in place since 2008, is a catastrophe

[6] This is based on the 120 kg per person per annum requirement. Source: MNFSR

[7] Jul-Mar exports for FY19 were 0.56 million tons, compared to 0.31 million tons for same period in FY18.

[8] The crop insurance program was to be developed and rolled out under the World Bank financed US $300 Million project for "Strengthening Markets for Agriculture and Rural Transformation in Punjab" Program-for-Results (SMART Punjab PforR) from 2018 to 2022.

loss of yield program that is only triggered when the authorities declare calamity in a certain area and yield loss is above 50 percent. The scheme then pays out the lending institution the crop loan amount owed by farmers who default, hence it does not directly benefit the small land holder for yield loss.

Key goals and features of CIP

- Indemnify small land holders of Punjab with less than 5 acres for the loss in yield due to pest attacks and/or natural disasters
- Improve crop yields and production by linking crop insurance with credit lines; farmers will be incentivized to invest in high yielding seeds and fertilizer.
- Increase adoption of climate smart technology by subsidizing premiums and incentivizing uptake in the first 5 years. As highlighted in SBP's Second Quarterly Report for FY19, the risks of climate change for Pakistan are significant in terms of loss of yield.

Table 2.1.1: Uptake Details till March 2019

	Farmers	Area Insured (Acres)
Kharif 2018 (4 districts)	**16,750**	**42,779**
Cotton	12,357	31,874
Rice	4,393	10,905
Rabi 2018-19 (9 districts)	**41,375**	**97,773**
Wheat	41,375	97,773
Total	**58,125**	**140,552**

Data source: Program Implementation Unit- Crop Insurance Program Punjab

The program uses the Area-Yield-Index-Insurance (AYII) model for the crop insurance that compensates farmers for yield loss beyond the insured yield in a certain geographical area termed as Unit Area of insurance, (UAI) such as tehsil, or markaz. Hence, an individual farmer-level loss is based on an average area yield, rather than individual farm historical level.

Based on the historical yields, insured yields are set and compared with current yields; the loss of yield is paid by the insurance company. For example, in the district Chichawatni, the cotton historical yield was 726.3 kg per acre (which is essentially the AYII), and the coverage was 80 percent; thus, 581 kg per acre was the insured yield. Since the current yield was 485 kg per acre for the tehsil of Chichawatni, the loss ratio was 16.4 percent. In rupee terms, the insured amount for cotton was set at Rs 50,000 per acre. Hence the insurance company paid 16.4 percent, equivalent to Rs. 8,171 per acre to all farmers insured in the Chichawatni tehsil.

Pilot projects of *kharif* and *rabi* FY19

Starting from April 2018, up till March 2019, a total of 58,125 farmers with holdings over an area of 140,552 acres were insured. The crops covered were cotton, rice and wheat (**Table 2.1.1**). The initial pilot project was rolled out in 4 districts in *kharif* 2018 and expanded to 9 in *rabi* 2018-19.

- The target group comprised of the borrowers of Punjab Kissan E-Credit and federal CLIS, insured from plantation to time of harvest.
- The coverage was ground up (0-80 percent of expected yield) for E-credit borrowers and top-up (50-80 percent of expected yield) for CLIS borrowers. The initial bundling of the scheme with E-credit allows for the insurance companies to manage scale and risks, and save on marketing and other costs. The coverage was mandatory for all borrowers of E-credit and optional for CLIS.
- Sum insured is based on the CLIS crop indicative limits set by SBP which is the value of the crop. E-credit borrowers were insured for Rs.50,000 per acre for *kharif* and Rs.30,000 for wheat while CLIS were only insured Rs. 20,000 per acre. Premium subsidies were provided to farmers of E-credit at 100 percent for farmers with less than 5 acres of land, while above 5 acres farmers

were given a 50 percent subsidy. Majority of the farmers were E-credit borrowers with very limited CLIS borrowers. (**Table 2.1.2**).

Table 2.1.2: Premium Details

	Premium Amount (PKR/acre)			Subsidy (percent)	Premium Share by Farmers (PKR/acre)		
	Cotton	**Rice**	**Wheat**		**Cotton**	**Rice**	**Wheat**
E-Credit Borrowers							
0-5 acres	1,250	750	570	100	0	0	0
5.01-12.5 acres	1,250	750	444	50	625	375	222
CLIS Borrowers							
0-25 acres	600	200	444	50	300	100	222

Data source: Program Implementation Unit- Crop Insurance Program Punjab

Results and Cost of the program

For *kharif* 2018-19, decline in yield of cotton crop, triggered insurance in Sahiwal districts. The per farmer payout was Rs 8,171 per acre; with 1,986 famers paid out and an affected area of 5,193 acres, the total claim was Rs 32.9 million (**Table 2.1.3**). Claims for wheat 2018-19 crop are still to be calculated since the process of measurement of crop losses is still underway.

Table 2.1.3: Cotton Claim Payout for Sahiwal (Chichawatni)

No. of farmers	Area Effected	Insurance Index	Current Index	Yield Decline	Per farmer payout	Cost of production of cotton crop	Actual Calculated Claim
	Acres	**Kg/acre**	**Kg/acre**	**percent**	**PKR/acre**	**PKR/acre**	**Million PKR**
1,986	5,193	581	487	16.3	8,171	59,666	32.9

Data source: Program Implementation Unit- Crop Insurance Program Punjab

Lessons learned

- Development of the insurance market over time would be one of the key outcomes of this program.
- It was observed that the uptake was still lower than the initial target given the low level of farmer awareness and understanding of the purpose of the program.
- The uptake was larger for 0-5 acres where premium subsidy was 100 percent with very few farmers paying out the premium.
- The effect on yield and adoption of climate smart technology will unfold once the farmers realize the purpose of the insurance scheme and benefits it entails.
- The policy can support major crops without distorting the market through support prices.
- Farmers were paid out by insurance companies without much delay. This is expected to increase farmers' trust in the system and hence future rounds, with enhancement of awareness programs, are expected to improve yields through adoption of climate smart technology, high yielding seed varieties, and fertilizer uptake.
- Insurance for farmers is necessary to protect them against calamities and yield losses should be implemented in other provinces as well.

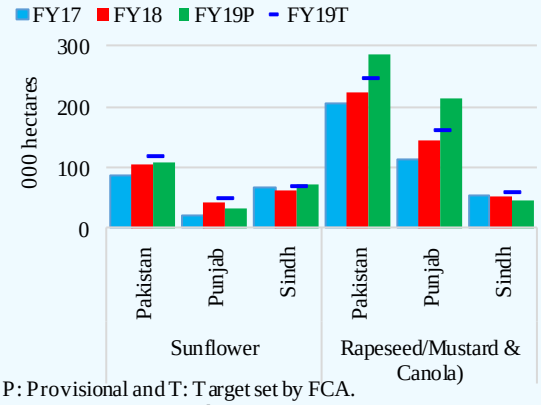
References:

Mirza Waseem. 2019. Pilot Project Report- *Kharif* 2018. Crop Insurance Program Punjab
Stutley, Charles; Kalavakonda, Vijayasekar; Jansen, Johannes Georges Pius. 2018. *A Feasibility Study: Assessing the Potential for Large-Scale Agricultural Crop and Livestock Insurance in Punjab Province, Pakistan.* Washington, D.C.: World Bank Group.

Minor crops:

For the oilseeds crops, growth of 20.5 percent in total area was estimated, which is expected to lead to higher production. Rapeseed/mustard and canola cultivation remained higher than target as per provisional estimates, while the sunflower crop could not achieve its target (**Figure 2.5**). Two observations are noteworthy. First, a shift in area from sunflower to canola and rapeseed/mustard in Punjab occurred despite a promise of subsidy on sunflower at the time of sowing.[9] This happened because the subsidy scheme for sunflower was characterized by operational delays and shortages of seeds. Second, area under sunflower in Sindh improved, while simultaneously area under canola and rapeseed/mustard declined. Lack of clarity regarding the scheme in Punjab resulted in transfer of seed sales by private seed companies at lower rates to farmers in Sindh, since the sowing season in the latter begins earlier than in Punjab.

Figure 2.5: Area under Oilseeds Cultivation



P: Provisional and T: Target set by FCA.
Data source: FCA Working Paper 2019-20.

2.3 Industry[10]

As the impact of macroeconomic stabilization measures intensified, the performance of the industrial sector slowed to 1.4 percent during FY19.[11] The impact of macroeconomic stabilization policies coupled with regulatory measures was most evident in construction and manufacturing activities.

On one hand, fiscal consolidation measures resulted in reduced public sector development spending, while CPEC related expenditure also witnessed marked deceleration during FY19. On the other hand, regulatory measures such as increase in regulatory duties, ban on non-filers to purchase new car and property[12], and shifting from furnace oil based electricity generation had a spillover impact on construction-allied activities, pharmaceuticals, automobiles, and POL production.

[9] The subsidy scheme only available in Punjab offers a buyback assurance of Rs 3,000 per 40 kg and a disbursement of Rs 4,000 on verification of planting of crop at time of harvesting.
[10] This section is based on actual data up to March 2019. Therefore, numbers reported in this section may not tally with those presented in Table 2.1, which are annual estimates.
[11] During the previous five years, the industrial sector had grown by 5 percent on average.
[12] The ban was ultimately reversed.

At the same time, tight monetary policy increased financial costs, and exchange rate depreciation also impaired activities of certain industrial segments. Bank credit to the private sector, especially working capital loans, surged substantially due to increase in inventories and prices of raw material, further escalating costs, while loans for fixed investment witnessed deceleration during FY19.

Table 2.6: YoY Growth in LSM (Jul-Mar)
growth in percent; contribution in percentage points

	Weight	YoY Growth		Contribution to Growth	
		FY18	FY19	FY18	FY19
LSM	70.3	6.3	-2.9	-	-
Textile	20.9	0.6	-0.3	0.2	-0.1
Cotton Yarn	13.0	0.1	0.0	0.0	0.0
Cotton Cloth	7.2	0.0	0.1	0.0	0.0
Jute Goods	0.3	33.4	-14.1	0.1	0.0
Food	12.4	-0.3	-4.7	-0.1	-1.0
Sugar	3.5	-11.7	-13.3	-1.2	-1.1
Cigarettes	2.1	84.9	7.2	0.9	0.1
Vegetable Ghee	1.1	7.4	0.8	0.1	0.0
Cooking Oil	2.2	2.9	0.5	0.1	0.0
Soft Drinks	0.9	-7.6	-4.2	-0.2	-0.1
POL	5.5	12.3	-6.0	0.7	-0.4
Steel	5.4	27.5	-11.0	1.0	-0.5
Non-Metallic Minerals	5.4	12.3	-5.0	1.3	-0.6
Cement	5.3	12.4	-5.4	1.3	-0.6
Automobile	4.6	18.9	-7.6	1.3	-0.6
Jeeps and Cars	2.8	22.1	-0.1	0.7	0.0
Fertilizer	4.4	-8.3	4.5	-0.5	0.2
Pharmaceutical	3.6	4.2	-8.4	0.4	-0.7
Paper	2.3	9.0	-3.9	0.3	-0.1
Electronics	2.0	106.6	23.7	1.8	0.8
Chemicals	1.7	0.5	-3.9	0.0	-0.1
Caustic Soda	0.4	21.1	-4.7	0.1	0.0
Leather Products	0.9	-8.2	1.0	-0.1	0.0

Data source: Pakistan Bureau of Statistics

Despite these adverse developments during the year, some sectors managed to register healthy performances; for instance, small scale and household manufacturing and the *electricity generation and distribution and gas distribution*. Growth in the latter sub-sector touched historical highs as relatively efficient CPEC-related (RLNG and coal-based) energy projects replaced inefficient furnace oil-based plants, coupled with an upward adjustment in energy prices.

LSM

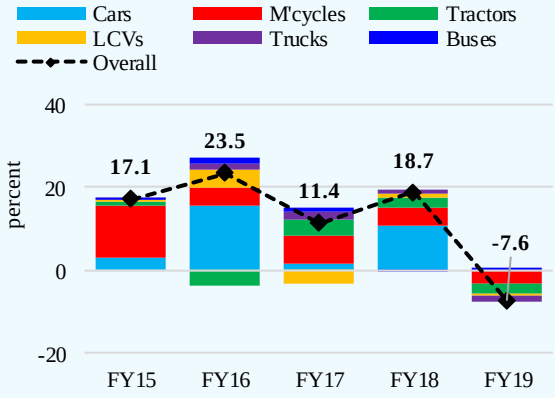
Large-scale manufacturing activities witnessed a broad based contraction (11 out of 15 major industries). Barring fertilizer sector, all the leading sectors posted decreases over the previous corresponding period **(Table 2.6)**.

Automobile

The downslide in automobile sector became more noticeable during Q3-FY19 compared to the previous two quarters. Resultantly, the sector contracted by 7.6 percent during Jul-Mar FY19 compared to an impressive growth of 18.9 percent during the same period last year (**Figure 2.6**).

Policy measures like regulatory restrictions prohibiting non-filers from purchase of vehicles,[13] and increase in interest rates dented the demand in the automobile segment to some extent.[14] Furthermore, significant depreciation of PKR increased the cost of production, resulting in escalated prices and dampening the demand further. The severity of dip in economic activities, especially agriculture incomes, was more evident in tractors and motorcycles (mainly rural demand) and commercial vehicles that showed double-digit contraction in growth (**Table 2.7)**.

Figure 2.6: Automobile Sector Growth (Jul-Mar)



Data source: Pakistan Bureau of Statistics

Table 2.7: Automobile Sector Production (Jul-Mar)

	Absolute values				Percent growth	
	FY16	**FY17**	**FY18**	**FY19**	**FY18**	**FY19**
All Cars	111,830	127,893	148,899	156,038	16	5
Cars <800 cc	27,893	29,966	36,438	30,649	22	(16)
Cars 800-1000 cc	19,139	26,180	38,377	45,627	47	19
Cars >1000cc	64,798	71,747	74,084	79,762	3	8
SUVs	621	812	9,841	5,745	1,112	(42)
LCVs	29,529	18,637	22,605	19,098	21	(16)
Trucks	3,940	5,489	6,907	5,027	26	(27)
Buses	746	893	555	649	(38)	17
Tractors	21,942	37,938	52,551	37,457	39	(29)
Motorbikes	982,174	1,211,454	1,425,453	1,342,185	18	(6)

Data Source: Pakistan Automotive Manufacturers Association

The car segment managed to grow by 5 percent during Jul-Mar FY19, benefiting largely from earlier bookings which partially diluted the impact of regulatory restrictions (especially on non-filers). The delivery times were 6-9 months for certain popular variants until June 2018, before the enforcement of regulatory measure requiring buyers to be active tax filers. The impact of earlier bookings

[13] The ban remained intact from July 2018 to March 2019.
[14] Bank lending for auto financing declined from Rs 13.9 billion in Q3-FY18 to Rs 5.9 billion during Q3-FY19.

lasted till December 2018. Subsequently, the production of cars contracted by 12 percent in Q3-FY19, compared to a growth of 4.6 percent in H1-FY19. Besides, the stringent imported used-car policy also helped in diverting consumers towards domestically produced cars, evident from reduced influx of imported used cars during FY19.

Construction Allied Industries

Construction sector witnessed a sharp contraction of 7.6 percent in FY19 from 8.2 percent growth during FY18. Other than the aforementioned macroeconomic factors, sector-specific issues like restriction on purchase of immovable property worth more than four million by non-filers and court proceedings against a leading property developer dampened demand in the property market.

Another major factor was the decline in margins of the real estate developers. With prices of imported raw materials rising, the cost of construction increased substantially. The increase in financing costs further escalated the cost of production. Also, restrictive regulatory measures created uncertainty in the real estate markets. However, the increase in costs was not commensurate with increase in prices of housing units. As margins weakened, more projects became unviable for developers due to the prevailing market dynamics.

Cement

Cement production recorded contraction of 5.4 percent during Jul-Mar FY19, compared to double-digit growth of 12.4 percent in the same period last year; this was the first decline in last eight years during Jul-Mar period. The decline may have been greater had it not been for cement exports, which partially offset the weakness in domestic demand.

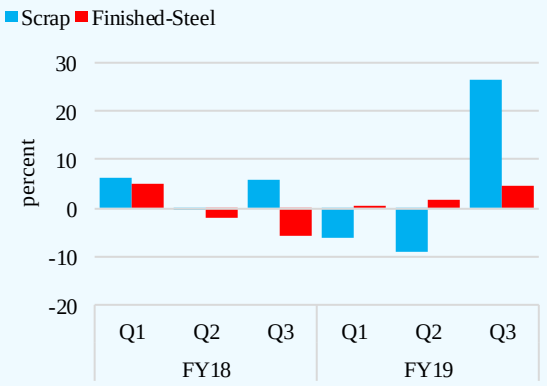
The cement sector has been going through a major expansionary phase in recent years, mirroring the increase in economic activity in the country. Public sector development spending, complemented by CPEC outlays on infrastructure, provided a boost to the cement industry. However, this type of support may not be as forthcoming during the ongoing phase of macroeconomic stabilization.

Steel

Steel industry witnessed a double-digit decline of 11.0 percent during Jul-Mar FY19 compared to remarkable increase of 27.5 percent during the same period last year. In addition to policy related impact, the exchange rate depreciation played a detrimental role in the sector's outcome as price of imported raw material (i.e. scrap and coal) soared. Upward adjustment in electricity prices further dented

domestic steel producers' margins. On the international market front, US-China trade tensions kept steel prices suppressed in the global market, which put the importers in the driving seat (**Figure 2.7**). Consequently, the earlier imposed anti-dumping duties on imports became ineffective, adding to the already challenging business environment for the domestic steel producers.

Figure 2.7: Growth in Quarterly Average Prices



Data source: Pakistan Bureau of Statistics

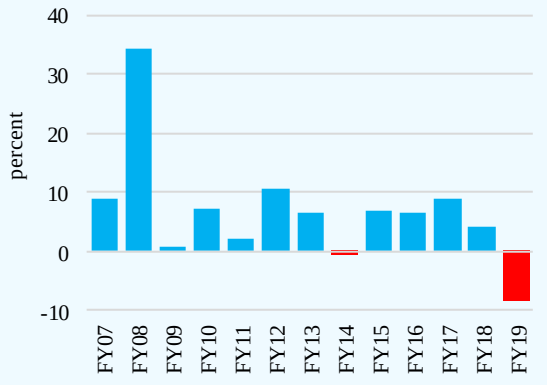
POL

The petroleum industry registered a decline of 6.0 percent during Jul-Mar FY19 against the growth of 12.3 percent in the previous period. The industry's output suffered from: (a) the policy move to shift away from furnace oil and towards RLNG for electricity generation, which hampered the demand for furnace oil (one of the major products of the local refineries); (b) increase in prices of petroleum products due to exchange rate depreciation; and (c) overall slowdown in economic activities, which also affected demand. Government's move to shift from expensive electricity generation to efficient and environment friendly electricity generation like RLNG, hydel, solar, wind based generation is a step in the right direction.

Pharmaceutical

The pharmaceutical industry witnessed its worst period in well over a decade as its production contracted by 8.4 percent during Jul-Mar FY19 against 4.2 percent growth in same period last year (**Figure 2.8**). One of the major explanations was the price adjustment mechanism in the country. During the course of the year, the pharmaceutical firms and regulatory authority, DRAP, were at odds about the

Figure 2.8: Pharmaceutical Sector Growth (Jul-Mar)



Data source: Pakistan Bureau of Statistics

price-setting mechanism. This situation led to an increased dependence on imported pharmaceutical products. Resultantly, imports of medicinal products rose by 9.7 and 7.3 percent in quantum and value terms respectively.

Another possible reason of this decline in pharmaceutical production was the shifting of some production units from Sindh to Punjab, which created temporary disruption.

Food

The food processing industry during Jul-Mar FY19 was pulled down by sub-par performance of the sugar sector, which accounts for more than one-fourth of the total food industry. Prospects of the sugar industry were uncertain from the start of the year since the raw material was scarce; sugarcane cultivation posted 17.9 percent decrease over last year. Lack of implementation of indicative sugarcane prices and water scarcity in certain parts of the country mainly resulted in lower sugarcane cultivation this year.

Table 2.8: Distortions in the Sugar Industry vis-à-vis Inefficient Pricing Mechanism

	million tons				Indicative Cane (Rs./40Kg)	Prices (Rs./Kg)		
	Cane harvested	Sugar Prod. (I)	Sugar Cons. (II)	Surplus (I -II)		Domestic Sugar (III)	Global Sugar (IV)	Differential (III-IV)
FY15	62.8	5.1	4.6	0.5	180	57	48	10
FY16	65.5	5.1	4.8	0.3	180	63	41	21
FY17	75.5	7.0	5.1	1.9	180	65	39	26
FY18	83.3	6.6	5.3	1.3	180	55	34	21
FY19	67.7	6.5[E]	5.3	1.2	180	57	33	24
Min.	62.8	5.1	4.6	0.3	180	55	33	10
Max.	81.1	7.0	5.3	1.9	180	65	48	26
Range	18.3	1.9	0.7	1.6	0	11	14	16

Data source: Pakistan Bureau of Statistics, USDA, Estimate (USDA)

For several years now, the government's intervention in the sugarcane market has been broadly ineffective. It could neither provide price security to growers at times of bumper crops, nor ensure smooth supply of sugarcane to the millers. The government has kept the price of commodity at the same level in the past few years, while the production has remained erratic and prices have not reflected the scarcity (or oversupply) of the product in the market (**Table 2.8)**.

This inefficient sugarcane pricing mechanism has repercussions for the external sector as well. High price of domestic sugar relative to global benchmarks means that the country can export surplus sugar only with export subsidy. With ample capacity to produce exportable surplus, the government needs to reconsider its

pricing mechanism such that it reflects the true cost of resource usage, incentivizes market agents to make decisions in the wake of prevailing market dynamics and enhances the possibility of exporting sugar without any subsidy.

Meanwhile, the cigarette sector's growth was recorded at 7.2 percent during Jul-Mar FY19. The government's prudent policy of three tier duty structure[15] and crackdown on illicit production continues to propel the sector towards formal market mechanism.

Textile

During FY19, cotton production declined by 17.5 percent, compared to last year. This prevented the textile sector from taking full advantage of the recent bouts of exchange rate depreciation, as exports barely grew from last year's level. Despite all concessions and incentive packages, the performance of the textile sector remained anemic.[16]

Higher production costs, especially the high cost of electricity, imported machinery and labor cost, amid depressed prices in the international market, have eaten into the margins of the industry. As profitability has waned over time, so has the investors' interest. Leading domestic textile firms continued to shift their attention to the domestic markets, where the margins have tended to be higher compared to exports. As a result, the exportable surplus has waned. Therefore, the economy kept on missing out on a significant chunk of foreign exchange earnings that the textile sector could potentially have generated.

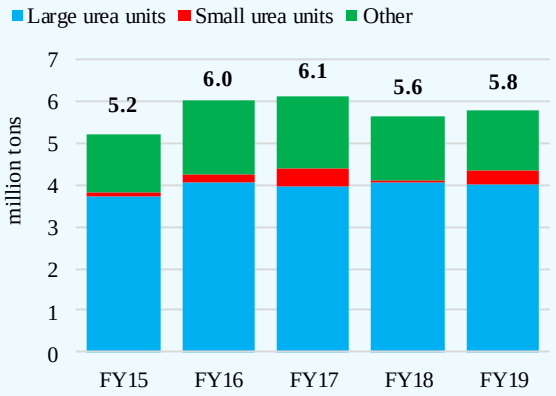
Fertilizers

The performance of fertilizer industry depends on availability of concessionary gas to fertilizer plants. In current fiscal year, some small urea plants managed to resume operations that helped the industry to post a growth of 4.5 percent during Jul-Mar FY19 whereas in preceding year production had shrunk by 8.3 percent. Government had earlier provided relief to the small urea producers by providing mix of domestic and imported RLNG at subsidized rates.[17] The government extended the subsidy up till October 2019 to ensure availability of urea at affordable rates.[18]

[15] Last year, duty structure on cigarettes was revised by FBR in which duty on lower tier cigarettes was reduced to merely Rs 800 per thousand cigarettes (Source: SRO 407(I)/2017)
[16] Prime Minister's Export Package and multiple incentives in form of taxes and interest rate relaxations relative to other industries.
[17] Ministry of Finance Press Release No. 9 (September 3, 2018)
[18] Ministry of Finance Press Release No. 88 (February 19, 2019)

Despite this relief offered by the government, the fertilizer industry was unable to recover to the production level of FY17. The industry managed to recover only 2.4 percent during Jul-Mar FY19 in terms of urea production, compared to 8.3 percent decline in same period last year. Some recovery in production owed largely to the resumption of activities at the smaller fertilizer units. Meanwhile, the production of larger firms, that contribute almost 90 percent of total urea output, declined by 1.3 percent; last year, these firms had witnessed growth of 2.1 percent **(Figure 2.9)**.[19]

Figure 2.9: Fertilizer Production by Type of Unit



Data source: National Fertilizer Development Centre

Prices of fertilizers rose sharply during Jul-Mar FY19 period on YoY basis; specifically, prices of urea increased by 27.0 percent and DAP 16.6 percent. This reflects the increase in cost of production plus price adjustment after exchange rate depreciation. Increase in prices of fertilizers provided reprieve for the manufacturers by keeping their margins intact. While imported DAP price is mainly reflective of international benchmarks, urea is still highly discounted compared to the international market.

Table 2.9: Performance of the Services Sector

growth and share in percent, contribution in percentage points

	Share in GDP FY19	Growth		Contribution to Services in FY19
		FY18[R]	FY19[P]	
Wholesale and retail trade	18.9	6.6	3.1	1.0
Trans, storage & comm.	12.9	2.2	3.3	0.7
Finance and insurance	3.5	7.0	5.1	0.3
Housing services	6.6	4.0	4.0	0.4
General government services	8.4	11.8	8.0	1.1
Other private services	11.0	8.1	7.0	1.2
Services	**61.2**	**6.2**	**4.7**	**4.7**

Data source: Pakistan Bureau of Statistics

2.4 Services

The services sector grew by 4.7 percent during FY19.[20] This represented a slowdown compared to last year, and was

[19] Reason being constrained domestic gas supply to large producers.

[20] The dominance of the services sector within the economy (relative to industry and agriculture) continued to grow; its share in GDP rose from 60.4 percent in FY18 to 61.2 percent during FY19. If left unchecked, the evolving dynamics of domestic consumption relative to production may further exacerbate the gap between demand and supply.

also much lower than the annual target of 6.5 percent (**Table 2.9**).

Growth in the *wholesale and retail trade* segment more than halved during FY19 compared to last year. On one hand, the lackluster performance of the commodity-producing sectors dragged the output of the subsector to some extent. On the other hand, despite a net contraction in LSM and crops, the increase in *wholesale and retail trade* still reflects higher price impact of imports, due to exchange rate depreciation, despite the decline in their growth in FY19.

Transport, storage and communication performed better during FY19 compared to a year earlier (**Table 2.10**). Growth in road transport, one of the heavyweight segments, nearly doubled compared to last year. Also noteworthy was the continuing improvement in the railways segment. According to official sources, Pakistan Railways generated higher earnings during Jul-Mar FY19 compared to a year earlier, having introduced 24 new trains as well as a trains tracking system which helped improve fuel efficiency.[21] On the other hand, growth in the air transport segment remained at 3.4 percent, similar to last year. The Q3-FY19 period appeared to offer some respite to PIA, as the national flag carrier claimed to have reached operational break-even during the period.[22] Elsewhere, in the telecom sector, cellular teledensity continued to rise, from 72.8 percent as of June 2018 to 75.9 percent by end-March 2019; similarly, broadband penetration increased from 28.3 percent as of June 2018 to 32.6 percent as of March 2019.[23] The Q3-FY19 period was an eventful one for PTCL, with profits for the three-month period nearly doubling

Table 2.10: Transport, Storage & Communication

	GVA		Growth	
	FY18^{R}	**FY19^{P}**	**FY18^{R}**	**FY19^{P}**
Railways	7,068	9,820	338.1	38.9
Water transport	62,998	60,676	20.5	-3.7
Air transport	101,671	105,108	3.4	3.4
Pipeline transport	1,970	1,941	4.1	-1.5
Communication	250,286	255,305	-4.1	2.0
Road transport	1,140,789	1,184,667	2.0	3.9
Storage	42,552	43,797	6.7	2.9
Total	**1,607,333**	**1,661,314**	**2.2**	**3.4**

Data source: Pakistan Bureau of Statistics

[21] For details, see the Associated Press of Pakistan news report titled 'Railways earns Rs 39 billion till March 2019', dated 5 May 2019.

[22] According to anecdotal evidence, contributing factors included an improvement in the seat occupancy per flight, the return of four planes previously grounded for repair and maintenance to the operational fleet, employee cutbacks, lower ticket reservation cost, better cargo load factor, and more flights on profit-making routes.

[23] Data sources: PTA Annual Report 2018 for June 2018 figures; PTA website for March 2019 figures. Broadband penetration is the ratio between the number of subscribers and total population, multiplied by 100 to represent broadband penetration per 100 inhabitants.

compared to a year earlier.[24]

Finance and insurance also witnessed a slowdown compared to last year (**Table 2.11)**. Lower growth in gross value addition by scheduled banks, which have the greatest share in the segment, set the tone for the moderation in the face of subdued growth of deposits while their investments declined. Meanwhile, performance of the equity market remained dismal. Since the portfolio of insurance companies and mutual funds is largely dominated by investments in equity market, that also adversely effected the segment's performance.

Table 2.11: Finance & Insurance
Percent

	Share in FY19	Growth	
		FY18	FY19
Central Banking	1.7	15.6	-12.5
Other Monetary Intermediation	87.0	8.8	6.2
Scheduled Banks	82.1	7.5	5.3
Non-scheduled Banks	4.9	46.1	24.6
Other Financial Services	1.1	-3.7	-8.2
Insurance, reinsurance and pension fund	5.0	26.3	12.8
Activities auxiliary to financial services	5.2	-21.7	-7.3
Finance and Insurance	**100.0**	**7.0**	**5.1**

Data source: Pakistan Bureau of Statistics

From a long-term perspective, it is worth highlighting that gaps in logistics performance may have prevented the services sector from realizing its full potential over the years. This especially applies to segments like *wholesale and retail trade* and *transport, storage and communication*, which have the largest weight within services. More broadly, better logistics can also enhance the output of commodity-producing sectors, and thus impact real GDP growth as a whole. Thus, being mindful of and addressing the gaps in logistics performance merits high priority (**Box 2.2**).

Box 2.2: Logistics Performance Index Identifies Room for Improvement

Efficient logistics lie at the heart of competitiveness, both at the firm and country level. They enable firms to connect with domestic and international markets, and affect a country's prospects of integration within global value chains. Logistics impact trade, job creation, and economic development (Hofman, 2017).

Given its importance, there is a need to track logistics performance and take corrective action as needed. To this end, the World Bank's Logistics Performance Index (LPI) serves as a benchmarking tool that scores and ranks logistics performance. The index can be further decomposed into 6 distinct components, namely:

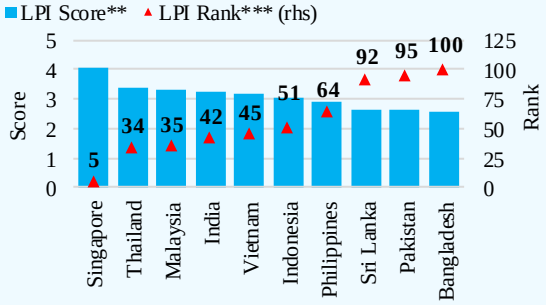
1. *International shipments*: The ease of arranging competitively priced international shipments
2. *Logistics competence*: The competence and quality of logistics services.

[24] PTCL's profit for the three months ended 31 March 2019 (after provision for income tax) was approximately Rs 2.0 billion, compared to Rs 1.0 billion during the comparable period a year earlier. Data source: PTCL 1st Quarter Report 2019 (Unaudited).

3. *Infrastructure*: The quality of trade- and transport-related infrastructure (example, ports, roads, railroads, information technology)
4. *Customs*: The efficiency of customs and border management clearance.
5. *Timeliness*: The frequency with which shipments reach consignees within the scheduled or expected delivery time.
6. *Tracking and tracing*: The ability to track and trace consignments

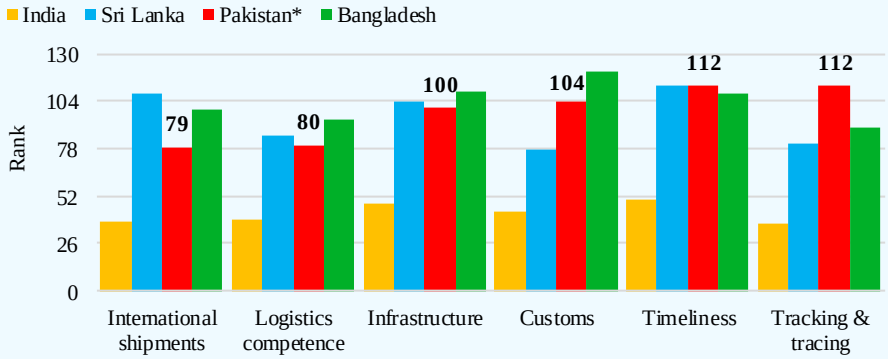
Furthermore, the Aggregated LPI 2012-2018 provides a composite, weighted score and ranking based on four surveys, which minimizes random variations across individual surveys and facilitates comparison across 167 countries.[25]

Figure 2.2.1: Aggregated LPI for Selected Countries*



* Amongst 167 countries in all, for the period 2012-2018
** Lower score indicates worse performance. Range: 1 to 5.
*** Higher ranking indicates worse performance. Ranks are labelled within the figure.
Data source: World Bank

Figure 2.2.2: Ranking Across Six Aggregated LPI Components for Selected South Asian Countries



* Only the bars representing Pakistan's ranking are labelled within the figure, for ease of reference

Data source: World Bank

Pakistan ranks 95th among 167 countries on the Aggregated LPI, trailing behind a number of its Asian counterparts (**Figure 2.2.1**). Moreover, decomposing the index into its six components reveals that the weaknesses are broad-based (**Figure 2.2.2**). In four out of six components, Pakistan's ranking ranges from 100th to 112th; in fact, the country ranks rock-bottom on the 'Tracking and tracing' component compared to selected South Asian countries.

Going forward, Pakistan's performance on the *infrastructure* component of the LPI may improve, particularly in the wake of CPEC-related development of roads, railways, and the Gwadar port. In addition, CPEC is also expected to give a boost to the prospects of the shipping industry, and

[25] The four LPI surveys in question were conducted in 2012, 2014, 2016 and 2018 respectively.

forward-thinking investors are reportedly keen to explore such opportunities.[26]

That said, a more concerted policy focus is required to tackle the shortcomings reflected in other LPI components. These can be viewed as a subset of the ease of doing business, and may thus be added to the agenda items that the country is looking to address in order to attract more FDI and boost exports.

References:

Hofman, B. (2017). Performance and Prospects of Global Logistics, Keynote speech at the CaiNiao Global Smart Logistics Conference.

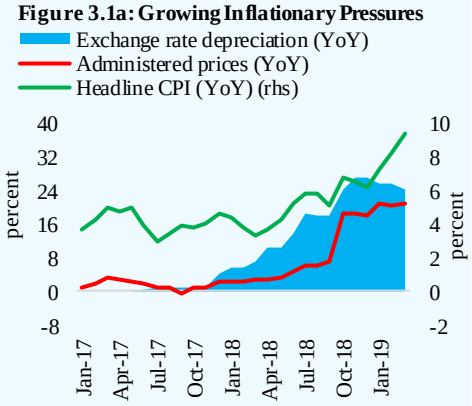
[26] For instance, a Singapore-based company has expressed interest in making a US$ 2 billion investment in Pakistan's shipping sector, according to newspaper reports published in Q3-FY19.

3 Inflation and Monetary Policy

3.1 Overview

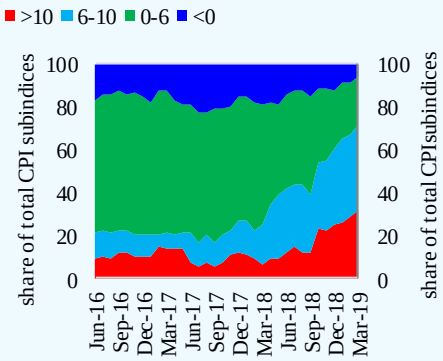
Inflationary pressures strengthened further in Q3-FY19 in terms of both magnitude as well as dispersion (**Figure 3.1**). The headline CPI inflation surged steeply to 8.3 percent during Q3-FY19, compared to 6.5 in the preceding quarter, and only 3.8 percent recorded in the same quarter last year. Attributed primarily to cost-push triggers, and given the fact that the economy was already in stabilization phase for over a year, these pressures warranted careful management.

Figure 3.1a: Growing Inflationary Pressures



Data source: State Bank of Pakistan and Pakistan Bureau of Statistics

Figure 3.1b: Frequency Distribution of Inflation in Various CPI Subindices



Data source: Pakistan Bureau of Statistics

Four factors explained the recent surge in inflation. First, the needed stabilization measures induced the government to make upward adjustment in administered prices (of petrol, gas and electricity); not only did this inflate the energy (and by extension, transport services) component of the headline CPI, but also escalated businesses' energy expenses. Second, the lagged impact of PKR depreciation continued to seep through the broader economy via rising input costs and capital outlay, and also fed inflation expectations in the economy. Third, food inflation, which had remained benign over the past 5 years, began to creep up due to supply-side constraints (mainly meat and tomatoes), costly transportation and the PKR-led price increases in imported items (such as pulses and tea). And finally, house rents posted a sharp YoY increase during Q3-FY19 due to base effect – quarterly revisions in house rents were unusually modest in Q3-FY18.

The important concern from the monetary policy perspective was the likely continuation in these trends. Specifically, the persistence of large twin deficits entailed risks to overall macroeconomic stability as well as inflation outlook over the near-to-medium term. In addition to this, cost-push pressures on inflation were not expected to subside for the rest of FY19: the elevated level of the current account deficit and weak FX reserves position meant that near-term pressures on the exchange rate (and their spillover to domestic inflation) were still strong. Similarly, on the fiscal front, revenue shortfalls and more-than-expected security-related expenses had left little room for the government to absorb commodity price variations; a breach of the targeted deficit was imminent already. In the context of these concerns, even the lower-bound of the SBP's near-term inflation forecast range stayed above the 6 percent target. Therefore, preserving macroeconomic stability required continuation of tight monetary conditions.

Taking stock of these developments, the monetary policy committee (MPC) increased the policy rate further by aggregate 75 basis points in the two meetings held during Q3-FY19. With these increases, the cumulative adjustment in the policy rate since the beginning of the on-going tightening cycle, reached 500 bps by the end of Q3-FY19. Importantly, while the tight monetary policy gained support from other stabilization and regulatory measures in its efforts of reining in excess demand in the economy, its implementation was complicated by voluminous budgetary transactions in the banking system. The overnight repo market remained volatile, necessitating frequent interventions by the central bank (**Table 3.1**).

Table 3.1: Liquidity Management Indicators

		No. of OMOs	Recourse to SBP facility			Avg. outstanding OMO (billion Rs)	Avg. deviation b/w ONR & PR (bps)*
			No. of Visits	Ceiling (billion Rs)	Floor (billion Rs)		
Jan	2018	7	1	0	12.4	1135.8	-5
	2019	29	5	49.9	162	-1148.2	-16
Feb	2018	8	2	12.4	0	1338.3	-2
	2019	18	4	109.4	4.7	-183.6	-1
Mar	2018	9	4	47	47.8	917.3	+3
	2019	11	5	57.3	16.2	-547.3	0

Data source: State Bank of Pakistan; * ONR-=Overnight rate, PR= policy rate

The most important development was the record-high net retirements of government borrowing to commercial banks, and its replacement with the SBP debt. Specifically, over Rs 6.0 trillion worth of government debt (all T-bills) was scheduled to mature during Q3-FY19, only 60 percent of which was rolled over by banks – they were not willing to invest in government papers due to persistent

expectations of rising interest rates. The month of January 2019 was particularly challenging, as the government retired Rs 2.4 trillion to commercial banks on net basis; public agencies retired another Rs 69.0 billion. To absorb excess liquidity from the market, SBP had to conduct 29 OMOs during the month (almost every day). Although these mop-ups were largely helpful in diluting their impact on the interbank liquidity, the overnight rates remained on average 16 bps below the policy rate during January 2019. The situation improved in subsequent months as overnight rates remained close to the policy rate – in fact, for most days in March 2019, these remained higher than the policy rate (**Section 3.2**). However, in these two months as well, SBP had to intervene on average every second day to ensure stability in the market.

The entrenched liquidity surpluses in the interbank liquidity can be explained by weakening momentum of private sector credit on account of unfavorable macroeconomic conditions. Specifically, Q3-FY19 observed a sudden and sharp slowdown in the off-take of private credit, especially after its sizable expansion in the preceding quarter. The working capital component tumbled the most, as scheduled retirements by textiles and fertilizer manufacturers largely offset borrowings of sugar, dairy and beverages sectors. It may be recalled here that producers had borrowed heavily in the preceding quarter in the wake of rising export demand for value-added products, as well as a steep rise in cotton/yarn prices; the magnitude of their retirements in Q3-FY19 was particularly large. Among non-manufacturing sectors, power generating firms deleveraged, as their cash flows improved after the issuance of energy-related Sukuks by the government. A YoY decline in power generation during the quarter further subdued their financing requirements.

It is important to note here that businesses have been navigating through challenging times from the start of this fiscal year, as sharp depreciation of the PKR, rising input costs, flagging domestic demand, PSDP cutbacks, regulatory tightening, and unintended inventory accumulation, were all taking toll on industrial volumes. Contractions were visible in LSM right from the start of FY19, but rising input costs and cash flow constraints kept the credit growth intact till the end of the second quarter. However, deepening growth constraints have now started weighing on businesses' credit appetite, especially in view of elevated level of interest rates. As for the fixed investment loans, while most firms are reluctant to take a long-term view of the economy due to prevailing uncertainties, few large corporates have stuck to their planned capex, especially in the power sector.

3.2 SBP's Liquidity Management

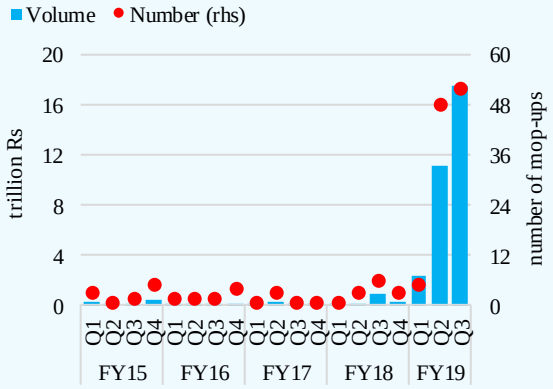
Three factors primarily explained volatile liquidity conditions in the interbank market during Q3-FY19:

(i) Persistent expectations of policy rate hikes by commercial banks that kept them away from investing in government papers. As a result, the government retired Rs 2.0 trillion to commercial banks during the quarter;

(ii) Although banks invested Rs. 496.1 billion in PIB auctions (fixed and floating combined) during the quarter, these were partly offloaded to insurance companies and money market funds, bringing the liquidity back into the banking system; and

(iii) A sharp slowdown in the offtake of private credit

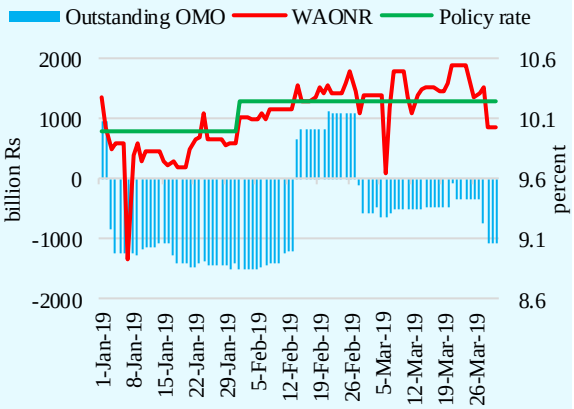
Figure 3.2: Volume and Number of Mop-ups



Data source: State Bank of Pakistan

Together, these developments more than offset the impact of a significant deceleration in commercial banks' deposits (non-government) during Q3-FY19. Consequently, the SBP continued to intervene regularly in the interbank market with an aim to maintain stability and ensure smooth implementation of monetary policy. Keeping in view the operational target, SBP conducted 52 open market operations to absorb surplus liquidity during the third quarter. The aggregate mop-up volumes in these operations were historic-highs **(Figure 3.2)**. As a result, outstanding mop-ups at end-March stood at Rs 1.1 trillion compared to net injection of Rs 1.5 trillion at end-FY18.

Figure 3.3: Key Liquidity Indicators



Data source: State Bank of Pakistan

Due to these heavy mop ups, liquidity conditions had relatively tightened from January 2019 through March 2019 (**Figure 3.3**). This is

evident from the fact that the weighted average overnight rate (WAONR) remained above the policy rate in only 3 days in January 2019, whereas the frequency rose to 11 days and 21 days in February 2019 and March 2019, respectively.

Table 3.2: Monetary Aggregates
billion Rupees

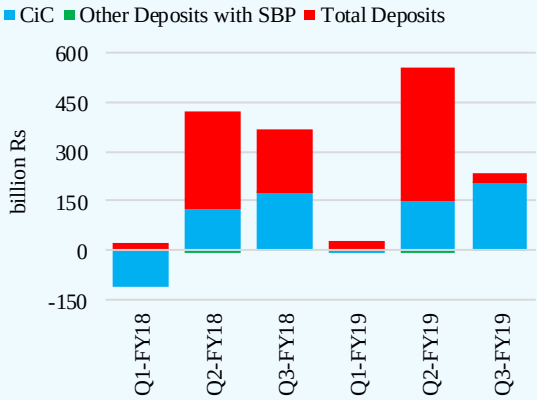
	FY18			FY19		
	H1	**Q3**	**Jul-Mar**	**H1**	**Q3**	**Jul-Mar**
Money supply (M2)	**336.4**	**366.0**	**702.4**	**577.3**	**235.6**	**812.9**
Net foreign assets	-174.4	-308.6	-483.1	-681.2	67.4	-613.7
Net domestic assets	510.8	674.7	1185.5	1,258.4	168.2	1,426.6
Net budgetary borrowing	313.2	457.4	770.6	650.6	178.2	828.8
SBP	-2.7	2,164.2	2,161.5	1257.1	2,187.8	3,444.9
Scheduled banks	315.9	-1,706.8	-1,390.9	-60;6.5	-2,009.6	-2,616.1
Credit to private sector	296.3	177.4	473.7	570.4	41.1	611.5
Credit to PSEs	66.0	107.6	173.6	145.1	165.1	310.2
Other items (net)	-152.5	-26.7	-179.3	-25.3	-135.1	-160.4
Currency in Circulation	15.6	171.6	187.3	143.3	206.4	349.7
Total Deposits	**320.8**	**194.0**	**514.8**	**433.8**	**29.0**	**462.8**

Data source: State Bank of Pakistan

3.3 Monetary Aggregates

After increasing sharply in the first half of the year, the pace of monetary expansion slowed down in Q3-FY19. This trend was attributed to a modest increase in overall budgetary borrowings from the banking system, as well as a subdued offtake in the credit to private sector. Therefore, a limited expansion was visible in net domestic assets (NDA) of the banking system (**Table 3.2**).

Figure 3.4: Money Supply - Liability Side



Data source: State Bank of Pakistan

Importantly, net foreign assets of the banking system posted an increase after falling consistently for the previous 4 quarters. This increase reflected the impact of official loans from bilateral resources, especially in March 2019, which allowed the government to partly retire its borrowings from the banking system.

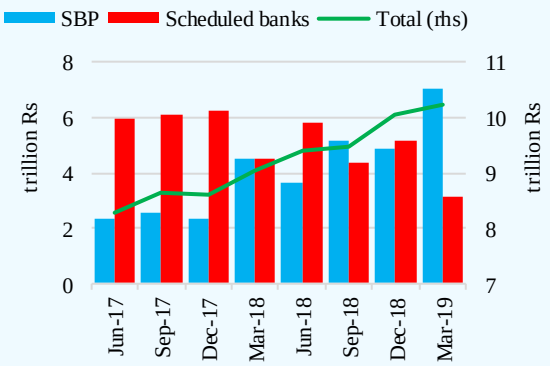
3.1. On the liability side, the contribution of currency in circulation remained glaringly dominant against deposits during Q3-FY19 (**Figure 3.4**). Around 88

percent of the monetary expansion during the quarter was comprised of currency in circulation, and as a result, the currency to deposit ratio touched a level of 39.6 percent. This trend can partly be traced to an increase in the rates of return on NSS instruments, which attracted Rs 229.9 billion worth of net investments during Q3-FY19. Effective January 1st 2019, the profit rates on savings certificates were increased by more than 200 bps. On a cumulative basis, the returns on these instruments since the beginning of monetary tightening cycle have increased by over 500 bps, which compares favorably with only 277 bps increase in case of bank deposits. Possibly, some interest-sensitive deposit holders have shifted their savings from banks to NSS instruments.

Another reason behind a slower deposit mobilization was the expectation of further depreciation of the exchange rate. Anecdotal evidence suggests that general public resorted to dollar holdings in order to preserve their purchasing powers (as reflected from widening kerb premium – **Chapter 5**). It may be recalled here that back in April 2018, non-filers were barred from depositing cash dollars in their foreign currency accounts; therefore, for majority of public, the available option was to hold them in cash.

Thus, in order to reduce the cash orientation and informality in the economy, there is a need to take corrective measures that may encourage the use of formal savings channels. It may be highlighted here that the government has recently removed withholding tax (WHT) on cash withdrawals for filers; however, as documented in SBP Annual Report of 2016-17, the impact of this WHT on deposits mobilization was (statistically) insignificant. The major impact on currency growth and currency-to-deposits ratio was coming from WHT on non-cash banking transactions, which is still in place for non-filers.

Figure 3.5: Budgetary Support from the Banking System (stocks)



Data source: State Bank of Pakistan

Government Budgetary Borrowings

Budgetary borrowings from the banking system slowed down during Q3-FY19 due to increased availability of non-bank and external funding. Within the banking system, the government continued to borrow heavily from SBP, and made significant retirements to scheduled banks

(**Figure 3.5**).[1] This trend was attributed to the persistence of rate hike expectations in the interbank market, which kept banks away from rolling over debt maturities. Similar to trend in previous few quarters, the incremental investments in T-bills during Q3-FY19 were concentrated in 3-month tenor, which took the share of these instruments in entire T-bill stock to 99.9 percent.

Table 3.3: Auction Profile of Government Securities (face value)
billion Rupees

	T-Bills			PIB -fixed rate			PIB -floating rate		
	Target	**Offered***	**Accepted**	**Target**	**Offered***	**Accepted**	**Target**	**Offered***	**Accepted**
In gross terms									
Q1-FY18	3,900.0	4,511.2	4,406.3	300.0	104.1	55.6	-	-	-
Q2-FY18	3,600.0	4,586.5	3,601.2	200.0	54.3	0.0	-	-	-
Q3-FY18	5,375.0	5,396.5	4,214.7	200.0	55.7	0	-	-	-
Q1-FY19	5,450.0	5,119.0	4,687.0	150.0	64.1	20.6	150.0	151.5	108.3
Q2-FY19	4,600.0	5,779.7	5,431.4	150.0	45.3	22.5	150.0	93.4	0.0
Q3-FY19	6,050.0	3,775.6	3,690.6	200.0	945.5	397.9	250.0	232.6	98.2
Net of maturity									
Q1-FY18	218.5	829.7	724.8	-296.6	-492.5	-541.0	-	-	-
Q2-FY18	-5.0	981.5	-3.8	200.0	54.3	0.0	-	-	-
Q3-FY18	315.8	337.3	-844.5	-326.8	-471.1	-526.8	-	-	-
Q1-FY19	-210.6	-541.6	-973.6	-311.1	-397.1	-440.6	150.0	151.5	108.3
Q2-FY19	198.5	1,378.2	1,030.0	150.0	45.3	22.5	150.0	93.4	0.0
Q3-FY19	30.5	-2,243.9	-2,328.9	200.0	945.5	397.9	250.0	232.6	98.2

* Offered amount excludes non-competitive bids
Data source: State Bank of Pakistan

An important development during the quarter was the market's renewed interest in long-term debt instruments (**Table 3.3**). This was potentially in the backdrop of a hike in the PIB cutoff rates in December 2018 auction. That in turn signaled the market regarding a shift in the government's strategy in favor of PIBs. During Q3-FY19, total offers for PIBs (both floating rate and fixed rate) soared to Rs 1.2 trillion against the target of Rs 450 billion. Of these, Rs 496.1 billion were accepted.

Credit to PSEs and Commodity Financing

Credit to PSEs registered a significant increase during Q3-FY19 compared to the corresponding period last year. Almost the entire borrowing represented the investment of Islamic banks in Sukuk worth Rs 200 billion, issued by the Ministry of Energy. This amount was mobilized by the Ministry via Power Holding Private Ltd. (PHPL) in order to address liquidity constraints in the energy sector.

[1] Until H1-FY19, the overall volume of budgetary support from the banking system was more than twice that of last year.

Reportedly, PHPL has made its due payments to the IPPs and OMCs, which brought some improvement in their cash flows.

As for the commodity operations, higher net retirements were entirely driven by the repayment of loans for wheat procurement during Q3-FY19 (**Table 3.4**). Wheat sales within the country as well as exports enabled the procurement agencies to make significant loan retirements during the period.[2]

Table 3.4: Commodity Financing
billion Rupees

	FY18			FY19		
	H1	**Q3**	**Jul-Mar**	**H1**	**Q3**	**Jul-Mar**
Wheat	-11.2	-44.3	-55.4	-91.8	-82.3	-174.1
Cotton	0.0	0.0	0.0	0.0	0.0	0.0
Rice	0.1	0.0	0.2	0.0	0.0	0.1
Sugar	-2.1	0.3	-1.8	2.1	0.6	2.7
Urea	-1.5	0.1	-1.4	4.2	0.9	5.1
Total	-14.6	-43.9	-58.4	-85.5	-80.7	-166.1

Data source: State Bank of Pakistan

3.4 Credit to Private Sector

The first 9-month position of private credit showed an encouraging picture, as the off-take rose to Rs 611.5 billion in Jul-Mar FY19, compared to Rs 473.7 billion recorded in the same period last year. However, focusing only on Q3-FY19, private credit moderated significantly as the offtake fell from Rs 177.4 billion in Q3-FY18 to only Rs 41.1 billion in Q3-FY19 (**Figure 3.6**). Textiles and fertilizer sectors, which had borrowed aggressively in H1-FY19, made heavy retirements during the quarter under review.

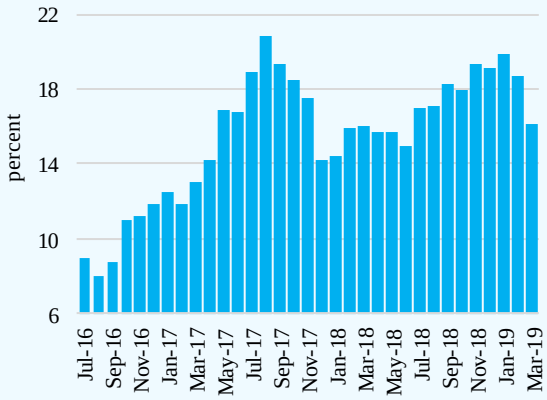
Net retirements in textile, fertilizer and edible oil muted working capital loans

Export-led activity in the textile sector coupled with rising input costs drove up working capital borrowing in H1-FY19, during which the sector borrowed Rs 187.4 billion. Because the sector received 25.2 percent higher export revenues in PKR terms during the quarter, it retired Rs 32.5 billion of short-term loans in Q3-FY19, compared to borrowing of Rs 4.0 billion in the same period last year. Furthermore, it might have been challenging for some firms to roll over their bank debt, due to higher interest cost.

[2] During H1-FY19, 461.3 thousand MT wheat was exported as compared to 0.2 thousand MT in the same period last year, whereas in Q3-FY19, 96.2 thousand MT was exported compared to 307.2 thousand MT in Q3-FY18. Moreover, procurement agencies offloaded almost double the quantity of wheat during Q3-FY19 compared to Q3-FY18.

In the case of fertilizer, the net retirements of short-term loans was mainly due to longer than usual maintenance shutdown of plants of few major manufacturers in Q3-FY19. Fertilizer offtake during the quarter also contracted due to its higher prices, lower area under cultivation of major crops and low rainfall in the sowing season, all of which resulted in decline in production during Q3-FY19. Similarly, edible oil firms made seasonal retirement of Rs 6.9 billion in Q3-FY19, majority of which were loans taken for import financing purpose.

Figure 3.6: Credit to Private Sector (YoY growth)



Data source: State Bank of Pakistan

Table 3.5: Loans to Private Sector Businesses during Q3 (flow)

billion Rupees

	Total Loans		Working Capital*		Fixed Investment	
	FY18	FY19	FY18	FY19	FY18	FY19
Private Sector Businesses	**159.8**	**47.9**	**85.5**	**1.8**	**74.2**	**46.1**
Manufacturing	104.4	66.1	83.8	50.6	20.6	15.5
Sugar	93.3	94.3	86.4	83.1	6.9	11.2
Basic chemicals	-7.6	20.1	-5.2	11.3	-2.4	8.8
Dairy	12.4	11.0	2.1	10.9	10.4	0.1
Soft drinks & beverages	4.1	9.2	1.3	7.0	2.8	2.2
Cement	20.4	6.2	2.6	5.1	17.7	1.1
Iron & Steel	7.5	3.4	5.3	4.0	2.3	-0.6
Refined Petroleum	5.6	0.6	7.4	2.7	-1.8	-2.1
Edible oil and ghee	-2.3	-6.5	-2.2	-6.9	-0.1	0.4
Fertilizer	-27.8	-13.5	-19.2	-12.3	-8.6	-1.3
Textiles	-8.6	-28.6	4.0	-32.5	-12.6	3.9
Prod., trans. & dist. of electricity	46.2	10.7	26.0	-21.0	20.2	31.7
Mining and Quarrying	3.1	6.8	-0.7	4.5	3.7	2.4
Real estate & related	10.9	1.2	1.2	0.2	9.7	1.0
Commerce and Trade	-6.1	2.7	-13.4	-7.3	7.3	9.9
Construction	11.5	-5.6	8.2	2.4	3.2	-8.0
Transport, stor. &communication	2.3	-9.2	-6.2	-6.0	8.5	-3.2
Agriculture	-5.9	-10.7	-4.0	-7.6	-1.8	-3.1
Ship breaking etc.	-3.8	-14.0	-3.6	-14.0	-0.2	-0.1

*includes trade financing

Data source: State Bank of Pakistan

Higher input cost raised financing requirement in sugar

Despite the fall in production of sugarcane on YoY basis, sugar sector borrowed at previous year's level during Q3-FY19.[3] However, unlike last year when most of the borrowing was activity-driven, the borrowings during Q3-FY19 period mainly reflected firms' liquidity constraints. It is important to recall here that a number of sugar manufacturing firms had defaulted on their bank loans in the preceding quarter, as prices remained depressed in the domestic market and the government was not able to make full payment of the export subsidy amount. An additional pressure in the third quarter was the increase in sugarcane prices by 16.6 percent YoY, compared to a decline of 4.2 percent last year. The liquidity constraints were also reflected in deposit withdrawals by the sector during Q3-FY19.

Besides sugar, other manufacturers also borrowed short term loans to finance their seasonal needs. These included dairy, soft drinks & beverages sectors, which borrowed a combined Rs 17.9 billion in Q3-FY19, compared to Rs 3.4 billion last year. However, their impact was diluted by the net retirements in textile, fertilizer and edible oil & ghee sectors. As a result, working capital loans in manufacturing grew only Rs 50.6 billion, compared to Rs 83.8 billion in the same period last year (**Table 3.5**).

Capex in power transmission helped push fixed investment loans

Unlike the first two quarters of FY19 when working capital dominated the increase in loans to private business, fixed investment loans constituted the major part of the increase in private credit. Sectors such as power generation, sugar and basic chemicals were the major beneficiaries. The major chunk of these loans was taken by power generation sector, as K-Electric (KE) is in the process of upgrading its power grids and the overall transmission network. It is pertinent to mention that the utility provider is investing heavily to strengthen power supply and improve operational efficiency.

Consumer financing remained depressed

Consumer financing rose Rs 43.0 billion in Jul-Mar FY19, compared to Rs 57.2 billion last year and consistently declined in all quarters. The major drag came from the segments such as auto and house financing. The decline in auto loans can be attributed to ban on non-filers from purchasing/registering cars, as well as rising markup cost. Moreover, house financing remained virtually stagnant in Q3-FY19, compared to Rs 2.7 billion increase in the same period last year (**Table 3.6**).

[3] The second estimate for the Kharif season reveals a contraction in the production of sugarcane by 15.9 percent compared to the corresponding period last year.

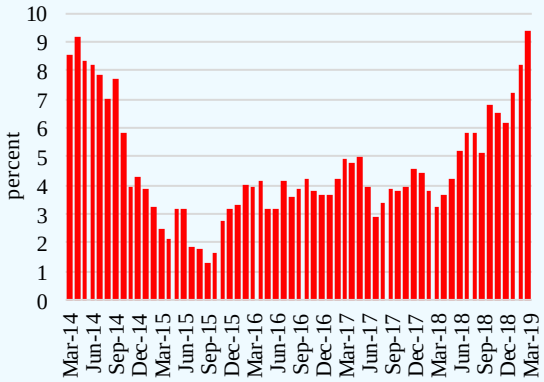
Table 3.6: Consumer Financing (flow)
billion Rupees

	Jul-Mar		Q1		Q2		Q3	
	FY18	FY19	FY18	FY19	FY18	FY19	FY18	FY19
Total	**57.2**	**43.0**	**18.4**	**15.3**	**17.1**	**14.5**	**21.7**	**13.2**
For Transport: Car	34.6	17.7	11.2	5.0	9.6	6.8	13.9	5.9
House building	15.1	8.3	6.3	5.4	6.1	2.9	2.7	0.0
Personal loans	1.8	9.8	0.8	3.5	-4.6	2.1	5.6	4.2
Credit cards	4.7	4.0	1.6	1.1	2.5	2.5	0.6	0.3
Consumer durables	1.0	3.2	-1.5	0.3	3.5	0.1	-1.1	2.8

Data source: State Bank of Pakistan

It may be noted that the SBP has introduced a policy for promoting low cost housing in March 2019 for lower income and special segments of the society, such as widows, children of martyrs, transgender people, and persons in areas severely affected by terrorism. The central bank has allowed certain regulatory relaxations to banks/DFIs. With 90:10 loan to value ratio, a housing unit/apartment having up to Rs 3 million value can be financed at a relatively low rate of 5 percent for up to 12.5 years. The loans are refinanced by SBP and banks have been exempted from the exposure limit of 10 percent on real estate to the extent of exposure taken on low cost housing.

Figure 3.7: Headline CPI Inflation (YoY)



Data source: Pakistan Bureau of Statistics

3.5 Inflation

CPI inflation (YoY) consistently rose on a quarterly basis and reached 8.3 percent on average during Q3-FY19 (**Figure 3.7**). As a result, the average headline CPI inflation recorded highest third-quarter inflation since FY12 at 8.3 percent, compared to 3.8 percent during Q3-FY18 (**Table 3.7**).

Table 3.7: Average CPI Inflation and Contribution during Q3
growth in percent, contribution in percentage points

	Weight	Growth		Contribution	
		FY18	FY19	FY18	FY19
Overall CPI	**100.0**	**3.8**	**8.3**	**3.8**	**8.3**
Food *of which*	**37.5**	**2.0**	**5.2**	**0.8**	**2.1**
Meat	2.4	8.4	13.6	0.3	0.4
Cigarette	1.4	-19.8	14.5	-0.5	0.3
Tomatoes	0.4	-14.9	136.5	0.0	0.3
Milk	6.7	4.0	4.1	0.3	0.3
Sugar	1.0	-16.6	14.0	-0.2	0.1
Energy *of which*	**9.0**	**3.3**	**20.9**	**0.3**	**1.7**
Gas	1.6	0.0	85.3	0.0	1.0
Electricity	4.4	0.0	8.5	0.0	0.4
Fuel	3.0	12.9	14.9	0.3	0.3
Non Food Non Energy *of which*	**53.5**	**5.4**	**8.6**	**2.7**	**4.5**
House rent	21.8	5.4	8.2	1.0	1.6
Transport services	2.7	1.3	15.1	0.0	0.4
Education	3.9	14.0	8.7	0.6	0.4
Personal equipment	0.8	9.1	12.4	0.1	0.2
Footwear	1.6	0.6	7.9	0.0	0.1
Drug medicine	1.3	2.0	7.9	0.0	0.1
Construction input item	0.6	4.9	12.0	0.0	0.1
Motor vehicle	0.7	5.7	12.8	0.0	0.1

Data source: Pakistan Bureau of Statistics

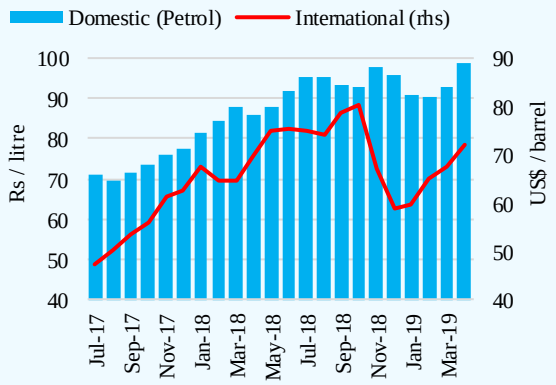
Major reasons for the rise in inflation included: (i) sustained pressures on twin deficits, which induced the government to adjust administered prices upwards and also impose regulatory duties on imported items; (ii) supply constraints of certain food items and imposition of FED on cigarettes; (iii) the second-round impact of rise in fuel prices and exchange rate depreciations; and (iv) a sharp YoY increase in house rents during Q3-FY19 due to base effect. As mentioned before, the inflationary pressures throughout FY19 have remained broad-based, as around 70 percent of the sub-indices showed more than 6 percent (target) inflation during Q3-FY19. Furthermore, around one-third of the sub-indices have grown by more than 10 percent.

Government price adjustments steered energy inflation

Administered prices, which primarily comprise of energy and important food items, posted a steep rise during Q3-FY19 (**Figure 3.8**). This increase was reflected in a high inflation in natural gas (85.3 percent), electricity (8.5 percent), and motor fuel (14.9 percent) during the third quarter. On aggregate, these contributed about 20 percent (1.7 percentage points) to the overall headline

inflation of 8.3 percent during the quarter. Last year, these CPI sub-indices had contributed only 7 percent to the headline inflation.

Figure 3.8: International and Domestic Fuel Prices



Data source: Pakistan Bureau of Statistics and Bloomberg

In particular, adjustments in domestic gas prices were necessary for the government to ease alleviate its current expenditures and also to bring down losses of gas distribution companies. It is important to recall here that the increase in natural gas tariffs was long due as gross underpricing of the commodity over the years has not just led to its overutilization but has also burdened the national exchequer significantly. While efficiency improvement at distribution level would help, it is important to reiterate that gas pricing needs to be much more competitive at the upstream level, in order to make bring online those gas fields that are presently commercially unviable.[4]

As for the motor fuel, it is important to mention here that after increasing consistently during FY18, domestic petrol prices have remained stable at an elevated level during Jul-Mar FY19.[5] This stability came on the back of a cut in sales tax on domestic motor fuel prices from July 2018 onwards, as well as a sharp decline in global crude prices in Q2-FY19. Although global crude prices surged again in Q3-FY19, their impact on domestic motor fuel prices did not materialize during the quarter.[6]

Food inflation began to surge

Food inflation during Q3-FY19 more than doubled to 5.2 percent, compared to 2.0 percent during Q3-FY18. While this increase was broad-based, the rise in prices of tomatoes, sugar and cigarettes was particularly steep. The surge in prices of

[4] This would also encourage fresh exploration, which could increase total gas reserves in the country and alleviate pressure on retail price of gas over the medium term.
[5] Petrol prices had been increasing throughout during FY18, surging from Rs 72.8 per liter to Rs 92 per liter at end June 2018. In the first 9 months of FY19, the average petrol price stayed at Rs 93.8 per liter.
[6] This impact was materialized with a lag in May 2019, when the government increased the petrol prices by Rs 9.5 per liter, and HSD prices by Rs 4.9 per liter.

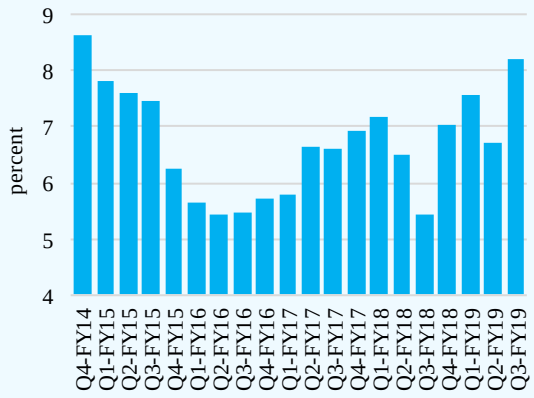
tomatoes was due to supply shortages emanating from lower domestic production, as well as tensions with India during the period that restricted its imports during Q3-FY19. In case of cigarettes, the imposition of federal excise duty from October 2018 onwards, resulted in a sharp rise in their prices.

The surge in sugar prices, which had stayed low and stable over the past couple of years, had been visible since the commencement of the current cane crushing season. By end-March 2019, sugar prices had soared to Rs 61.1 per kg in the domestic market from Rs 54/kg at the start of the year. It is also important to note here that sugar exports have already fallen this year in the absence of subsidies; compared to the export of 1 million ton of sugar in Jul-Mar FY18, only 123,000 tons was exported this year. However, the government is now mulling over banning the export of the commodity to keep domestic prices under check.

Prices of non-food-non-energy items remained high

House rent, second round impact of fuel prices, and multiple phases of exchange rate depreciation played a critical role in driving the NFNE inflation during Jul-Mar FY19. With the highest weight of 21.8 percent in the CPI, house rent contributes strongly to CPI inflation. During Q3-FY19, it added 1.6 percentage points to the headline CPI inflation against 1.0 percentage point contribution in Q3-FY18. Specifically, during Q3-FY19, house rent (YoY) inflation rose by 8.2 percent, which is the highest level since Q4-FY14; it may be highlighted here that upward adjustments in house rent during Q3-FY18 were quite low compared to the trend observed during the last three years (**Figure 3.9**). City-wise segregated data shows that 9 out of 40 cities showed a double-digit rise in rents, while 23 cities observed increase in rent by more than 6 percent, which is the target rate set for the overall CPI.

Figure 3.9: House Rent Index (YoY)



Data source: Pakistan Bureau of Statistics

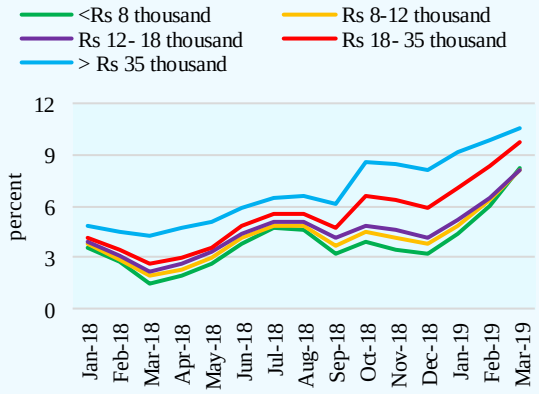
Triggered by rise in fuel prices, transport services posted an inflation of 15.1 percent during Q3-FY19. Moreover, private courier services also hiked up their prices during Q3-FY19 following an increase in their transportation cost.

Additionally, some of those items that rely on imported inputs recorded higher inflation during Q3-FY19; these included motor vehicles (12.8 percent), motor vehicle accessories (10.3 percent), medicines (7.9 percent), medical equipment (6.3 percent) and telephone sets (9.8 percent). Resultantly, NFNE recorded an increase of 8.6 percent during Q3-FY19, compared to 5.4 percent during the same period last year.

Income group-wise CPI Inflation

Though inflationary pressures have accelerated since the beginning of FY19, their incidence on low-income groups (with incomes less than Rs 12,000) remained quite benign till the end of the second quarter (**Figure 3.10**). During Q3-FY19, however, inflation incidence on these income groups grew stronger, as the inflation doubled from around 4.0 percent YoY in December 2018 to slightly more than 8.0 percent YoY by March 2019. Since consumption basket of low-income groups is mainly constituted of essential items, a broad-based rise in food prices have started to affect this group. Furthermore, the double-digit inflation in sensitive price index (which includes 53 essential items) during February and March 2019 also confirms that lower income groups have been more prone to rising inflationary pressures during Q3-FY19.

Figure 3.10: CPI Income Group-Wise Inflation

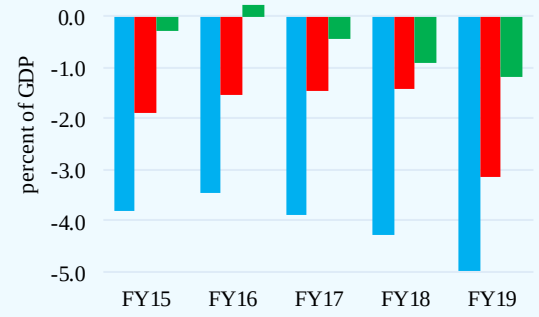


Data source: Pakistan Bureau of Statistics

4 Fiscal Policy and Public Debt

4.1 Overview

Figure 4.1: Fiscal Balance Indicators (Jul-Mar)



Data source: Ministry of Finance and SBP calculations

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

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

The moderation of economic activity (particularly in the industrial sector) and measures such as suspension of taxes on telephones, reduction in taxes on salary income, and lower sales tax on petroleum products adversely impacted the growth of tax revenue. Nonetheless, a double-digit growth was recorded in the collection of FED and customs duty (although still lower than the growth in FY18), mainly on the back of PKR depreciation and higher regulatory duties. A sharp fall in non-tax revenues (mainly due to the base-effect) and a slowdown in tax revenues,

dragged down the ratio of revenues to GDP from 10.3 percent in Jul-Mar FY18 to 9.3 percent during Jul-Mar FY19 (**Table 4.1**), the lowest since FY14.[1]

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

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

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

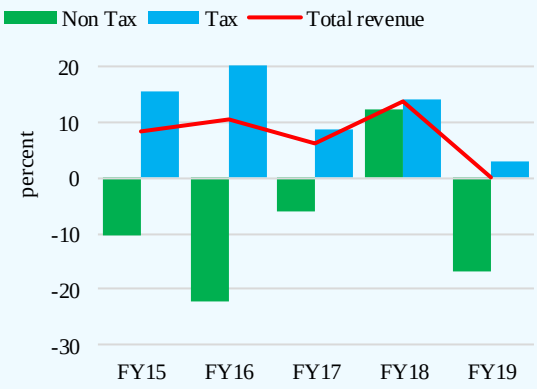
Additional financing needs, along with PKR depreciation, led to accelerated accumulation of public debt on both external and domestic fronts during Jul-Mar FY19. The surge in the former was largely an outcome of PKR depreciation as the financing component was almost at last year's level (**Table 4.2**).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

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

4.2 Revenue

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

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



Data source: Ministry of Finance

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

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

Data source: Federal Board of Revenue

FBR taxes

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

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

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

trend, achieving the target seems challenging.[3]

Decline in direct taxes owing to some policy measures

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

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

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

Data source: Federal Board of Revenue

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

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

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

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

Lower Collection of Indirect Taxes as Industrial Sector Faced Slowdown

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

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

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

Data source: Federal Board of Revenue

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

[6] The decline in voluntary payments during FY18 was primarily driven by reduction in corporate tax rate and lower bank profitability.
[7] Import quantum of petroleum products declined to 7.5 million MT during Jul-Mar FY19 compared to 11.1 million MT during Jul-Mar FY18.
[8] Import quantum of iron & steel declined to 2.3 million MT during Jul-Mar FY19 from 2.8 million MT during the same period last year.
[9] Cement sales recorded a decline of 0.5 percent during Jul-MarFY19 (Source: APCMA)

Custom and excise duty collections record double-digit growth

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

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

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

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

Non-tax revenues

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

4.3 Expenditure

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

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

Table 4.6: Analysis of Fiscal Spending
billion Rupees

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

* Excluding statistical discrepancy
Data source: Ministry of Finance

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

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

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

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

4.4 Provincial Fiscal Operations

Provincial revenue generation also recorded a significant moderation

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

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

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

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

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

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

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

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

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

A sharp decline in provincial development expenditure as well

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

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

Table 4.8: Pakistan's Public Debt Profile
billion Rupees

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

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

Data source: State Bank of Pakistan and Economic Affairs Division

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

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

4.5 Public Debt

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

Table 4.9: Absolute Change in Government Domestic Debt
billion Rupees

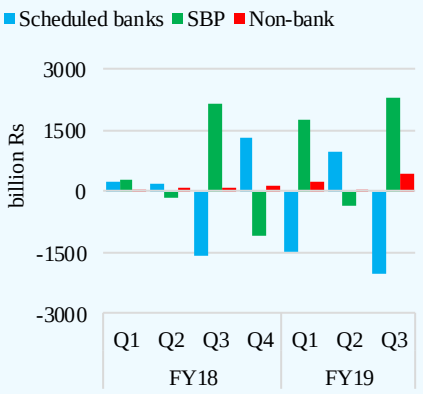
	Jul-Mar		FY19		
	FY18	FY19	Q1	Q2	Q3
Domestic debt	**1,224.8**	**1,754.3**	**503.6**	**615.9**	**634.9**
Permanent debt	-999.2	143.6	-290.2	12.8	421.0
of which					
PIBs	-1,067.7	183.0	-332.3	22.5	492.8
Prize bond	68.5	97.2	42.1	35.5	19.6
Floating debt	2,174.7	1,381.5	778.7	619.9	-17.1
of which					
MTBs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

Data source: State Bank of Pakistan

Domestic Debt

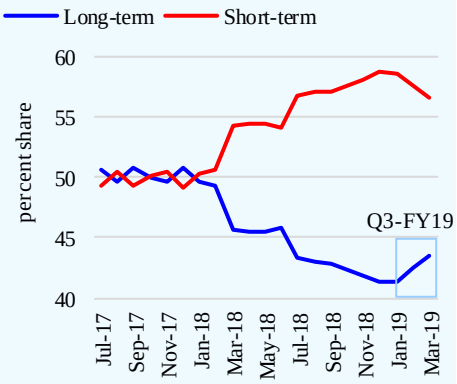
Domestic debt reached Rs 18.2 trillion at end-March 2019 - an addition of Rs 1.75 trillion during Jul-Mar FY19, compared to Rs 1.22 trillion during the previous corresponding period. As mentioned earlier, the composition of domestic debt reflects heavy reliance on central bank borrowing intended for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

Figure 4.3: Sources of Domestic Debt



Data source: State Bank of Pakistan

Figure 4.4: Maturity-wise Composition of Domestic Debt



Data source: State Bank of Pakistan

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

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

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

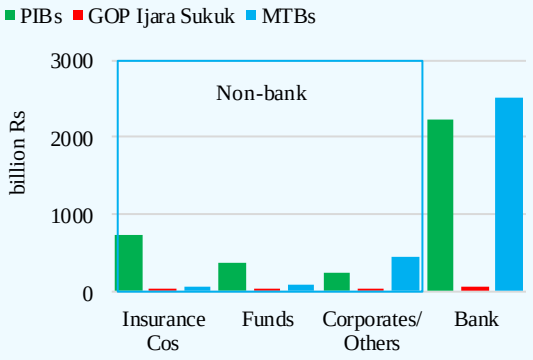
billion Rupees

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

*excludes short-term savings certificates

Data source: Central Directorate of National Savings

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



Data source: State Bank of Pakistan

NSS volume increased due to higher returns

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

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

recorded a decline during Jul-Mar FY19.

Table 4.11: Public External Debt & Liabilities

billion US dollars

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

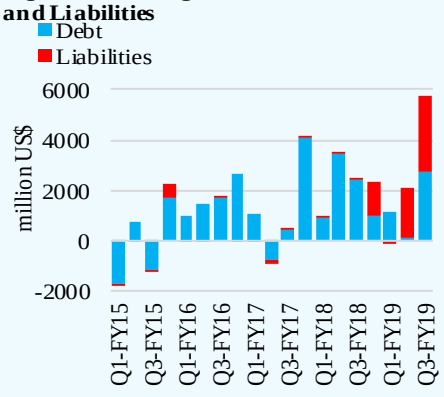
Data source: State Bank of Pakistan and Economic Affairs Division

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

External Public Debt and Liabilities

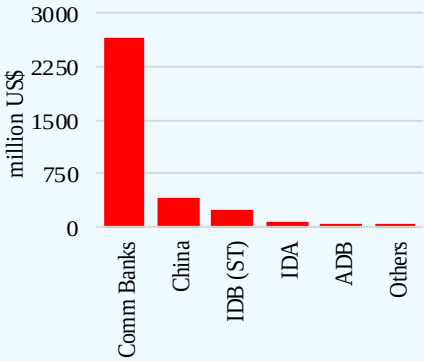
External public debt and liabilities (EDL) went up by US$ 8.9 billion during Jul-Mar FY19 to reach US$ 84.2 billion as of end March 2019 (**Table 4.11**). Particularly, the third quarter witnessed a net increase of US$ 5.8 billion, the

Figure 4.6: Change in External Public Debt and Liabilities



Data source: State Bank of Pakistan and Economic Affairs Division

Figure 4.7: Gross External Loan Disbursement during Q3



Data source: Economic Affairs Division

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

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

Borrowing pattern remained skewed towards commercial loans

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

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

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

Data source: State Bank of Pakistan

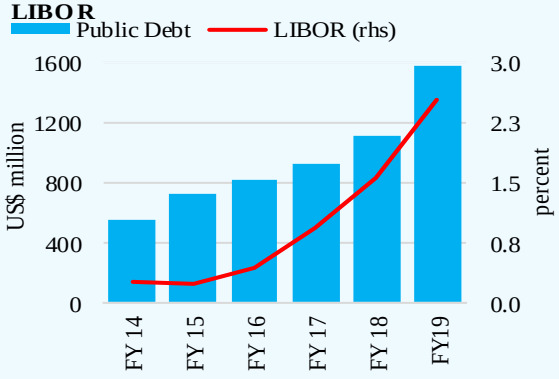
[17] Euro depreciated by 3.6 percent against US$, while SDR and Chinese yuan both depreciated against US$ by 1.3 percent during Jul-Mar FY19.

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

External debt servicing increased

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

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



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

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

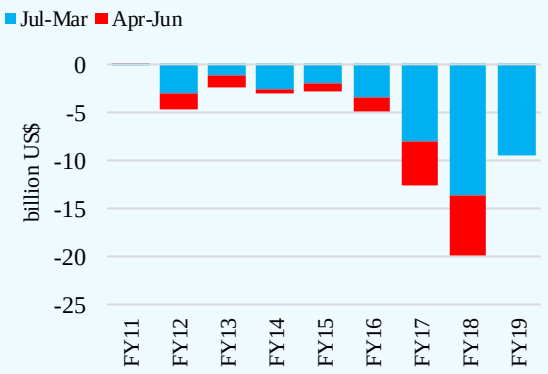
From the debt sustainability perspective, the country's repayment capacity weakened as debt servicing to foreign exchange earnings increased to 14.0 percent during Jul-Mar FY19 from 9.7 percent in the same period last year. Similarly, debt-bearing capacity measured in terms of public external debt to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

5 External Sector

5.1 Overview

The improvement in Pakistan's current account balance gained further momentum in Q3-FY19 as a significant decline in imports more than offset the stagnancy in exports and resulted in the shrinking of the merchandize trade deficit. Further support came from a substantial recovery in the services balance and healthy growth in workers' remittances. However, despite the contraction, the current account deficit (CAD) still remains at a higher level from the external account's stability perspective. The average CAD between FY11-15 was US$ 2.6 billion only, while this number is

Figure 5.1: Yearly Trend in Current Account Deficit



Data source: State Bank of Pakistan

Table 5.1: Pakistan's Balance of Payments

million US$

	Q3			Jul-Mar		
	FY18	**FY19**	***change***	**FY18**	**FY19**	***change***
Current account balance	-4,560.0	-2,022.0	2,538.0	-13,589.0	-10,345.0	3,244.0
Trade balance	-7,886.0	-5,820.0	2,066.0	-23,095.0	-21,813.0	1,282.0
Exports	6,463.0	6,170.0	-293.0	18,254.0	18,020.0	-234.0
Imports	14,349.0	11,990.0	-2,359.0	41,349.0	39,833.0	-1,516.0
Services balance	-1,299.0	-693.0	606.0	-4,320.0	-2,776.0	1,544.0
Primary income balance	-1,103.0	-1,237.0	-134.0	-3,683.0	-3,872.0	-189.0
Secondary income balance	5,728.0	5,728.0	0.0	17,509.0	18,116.0	607.0
Remittances	4,939.0	5,065.0	126.0	14,803.0	16,095.0	1,292.0
Financial account balance	-2,060.0	-5,486.0	-3,426.0	-9,395.0	-11,720.0	-2,325.0
FDI inflows (net)	709.0	478.0	-231.0	2,622.0	1,274.0	-1,348.0
Portfolio investment (net)	14.0	21.0	7.0	2,332.0	-398.0	-2,730.0
Eurobond/Sukuk	0.0	0.0	-	2,500.0	0.0	-2,500.0
FX liabilities (net)	1,456.0	5,539.0	4,083.0	4,673.0	11,234.0	6,561.0
SBP reserves (end-period)	11,602.0	10,492.0	-1,110.0	11,602.0	10,492.0	-1,110.0

Data source: State Bank of Pakistan

US$ 10.3 billion in Jul-Mar FY19 (**Figure 5.1**).[1]

The macroeconomic stabilization measures undertaken earlier resulted in a slowdown in economic activity in the country. The sizable decline in machinery imports following the conclusion of early phase of CPEC, lower quantum energy imports (excluding LNG) amid lower power generation in Q2 and Q3, and a temporary softening in global oil prices, all contributed significantly to improvement in the CAD by lowering of import payments.

Specifically, import payments dropped quite sharply in Q3-FY19 (**Table 5.1**). In percentage terms, it was the largest drop in almost 10 years, and was more than sufficient to offset a marginal contraction in exports in the quarter. Specifically, declines in both energy and non-energy import payments contributed to the sharper decline in overall imports in the third quarter. Energy imports had peaked in Q1, and then actually declined in Q3 for the first time in over two years. A sizable reduction in crude oil import payments, a moderation in LNG imports in the wake of lower power generation, and a temporary dip in global oil prices contributed to this decline in energy imports (**Section 5.5**). Meanwhile, the drop in the non-energy import payments, specifically machinery and transport, became more pronounced as the year progressed.

At the same time, workers' remittances registered a significant increase, particularly from the US and UK, on the back of improved macroeconomic conditions and wage rises in these countries. Moreover, increased efforts by the Pakistan Remittance Initiative (PRI) also helped attract higher remittances from the Pakistani diaspora.

Nonetheless, despite the improvement in the CAD, its management remains challenging, especially when exports and foreign investments did not show corresponding increases. In Jul-Mar FY19, foreign investments were unable to pick up, partially due to the looming uncertainty regarding the exchange rate adjustment and the finalization of the IMF program, which may have dented the investors' confidence. Besides, the lowering of Pakistan's credit rating by Fitch in December 2018, due to the country's external financing risk and deteriorating fiscal position, further exacerbated the situation.

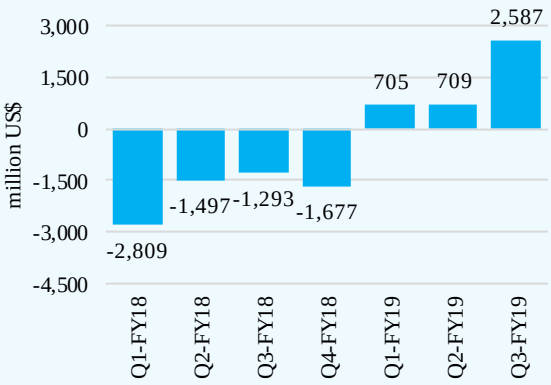
In particular, foreign direct investment declined both in Q3 and Jul-Mar FY19.

[1] FY11-15 was relatively more stable period for Pakistan's external sector after the global financial crisis. In terms of GDP, current account was 1.1 percent between FY11-15 and 4.7 percent during Jul-Mar FY19.

The drop was more pronounced in power and telecommunications; the former, being the flagship of the CPEC, was the key recipient of FDI in recent years. Similarly, private portfolio investment also witnessed a higher net outflow in Jul-Mar FY19.

While foreign investment was insufficient to bridge the current account gap, the external financing from bilateral (China, Saudi Arabia and the UAE) and commercial sources not only plugged the current account gap, but also provided some support to Pakistan's FX reserves in the third quarter. Resultantly, SBP's FX reserves jumped by US$ 3.3 billion in Q3-FY19. As a result, the Pak rupee remained relatively stable not only in the interbank market, but also in the open market during Q3.

Figure 5.2: YoY Change in Quarterly CAB



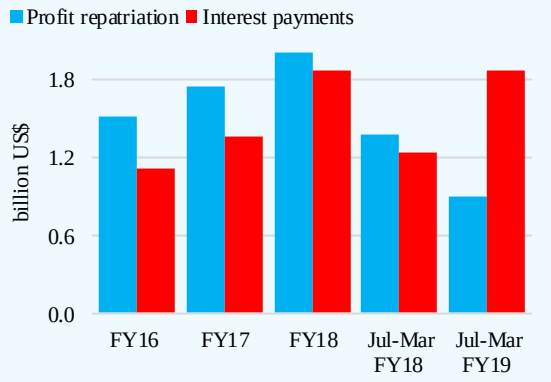
Data source: State Bank of Pakistan

5.2 Current Account

The current account deficit narrowed substantially to US$ 10.3 billion in Jul-Mar FY19, declining by US$ 3.2 billion from the same period last year. Importantly, the third quarter witnessed a pronounced improvement; the deficit fell to US$ 2.0 billion from US$ 4.6 billion, resulting in an improvement of US$ 2.6 billion in Q3-FY19, as both merchandize and services import payments declined (**Figure 5.2**).

The pressure on the primary income account continued to persist due to interest payments. The primary income deficit increased to US$ 3.9 billion in Jul-Mar FY19 from US$ 3.7 billion in the same period last year (**Figure 5.3**).

Figure 5.3: Profit Repatriation and Interest Payments



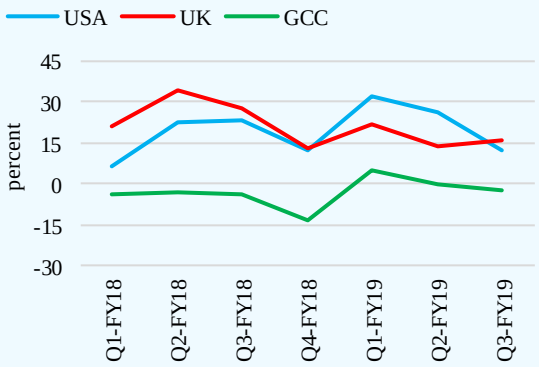
Data source: State Bank of Pakistan

While the repatriation of profit declined to US$ 0.9 billion from US$ 1.4 billion last year, it was more than offset by an increase in interest payments that climbed to US$ 2.3 billion in Jul-Mar FY19 from US$ 1.8 billion realized in the same period of FY18. This increase was driven by payments on short-term commercial borrowings. As the commercial borrowings are largely benchmarked with LIBOR, increase in the global interest rates contributed to the higher interest payments by Pakistan.

5.2.2 Workers' Remittances

Increased inflows in the workers' remittances further supported the CAB, which maintained its rising trajectory. Despite a slowdown in Q3 from key corridors, the momentum gathered in the previous two quarters propelled cumulative remittances to a record US$ 16.1 billion in Jul-March FY19 (**Figure 5.4**). Inflows were up 8.7 percent YoY in the period, almost double the growth rate of last year. Meanwhile, the growth in Q3-FY19 remained subdued at 2.6 percent on YoY basis.

Figure 5.4: Growth in Remittances from Key Corridors



Data source: State Bank of Pakistan

Pakistan Remittance Initiative (PRI) has intensified its efforts by launching campaigns in local and destination specific foreign media to encourage overseas Pakistanis to remit through legal means. Moreover, PRI facilitated local exchange companies to increase their tie-ups with the international money transfer operators. This may be supporting the higher remittances inflows in the ongoing fiscal year.

Table 5.2: Workers' Remittances to Pakistan

million US$

	Q3			Jul-Mar		
	FY18	FY19	Abs. Change	FY18	FY19	Abs. Change
Total	**4,939**	**5,066**	**127**	**14,803**	**16,096**	**1,293**
GCC	2,825	2,732	-92	8,616	8,704	88
S. Arabia	1,160	1,180	20	3,691	3,748	57
UAE	1,113	1,066	-47	3,277	3,415	137
Others	552	487	-65	1,648	1,542	-106
Non-GCC	2147	2333	187	6,187	7,392	1,205
US	697	784	87	2,037	2,517	480
UK	714	828	114	2,117	2,476	358
Malaysia	319	351	32	820	1,139	318
EU	164	125	-39	481	438	-43
Others	252	245	-7	732	823	91

Data source: State Bank of Pakistan

The country specific data suggests that the major impetus came from the non-GCC corridor, specifically the US, the UK and Malaysia (**Table 5.2**), as inflows from these countries increased by 23.5 percent, 17.0 percent and 39.0 percent respectively.

In fact, remittances from the US crossed the US$ 2.5 billion mark for the first time. The sharp increase from the US was primarily driven by higher economic activity. Tax reforms enacted by the US authorities have stimulated investment activities in the economy and resulted in low unemployment and increase in wages.[2] The unemployment rate in the US fell to 3.8 percent in March 2019, the lowest in the last 49 years.

Meanwhile, uncertainty in the UK over Brexit is fueling labor demand, as the firms are cautious on committing for long-term investment in case Britain crashes out of the European Union without any deal.[3] This situation is powering the labor wages in the UK, and leading to higher remittance outflow from the country.[4]

On the other hand, remittances from the GCC witnessed a marginal recovery of 1.0 percent in Jul-Mar FY19, after declining 3.2 percent in the same period last year. Nevertheless, the GCC remains the largest source of remittances for Pakistan. The moderate recovery in inflows from the GCC could be attributed to increased government spending in the Kingdom of Saudi Arabia (KSA). The Saudi government announced 7.0 percent increase in the state spending in 2019.[5]

5.3 Financial Account

Foreign investments in Pakistan failed to show improved picture in Jul-Mar FY19. While inflows in FDI remained substantially lower than the last year, the portfolio investment actually witnessed an accelerated outflow. Uncertainty regarding the exchange rate adjustment and finalization of IMF program, country's vulnerable external and fiscal position, and downgrading of Pakistan's credit rating by Fitch in December 2018 may have dented the investors' confidence.

[2] Source: Bloomberg available at, https://www.bloomberg.com/news/articles/2019-02-28/u-s-gdp-grows-above-forecast-2-6-as-business-spending-picks-up
[3] Source: Bloomberg available at, https://www.bloomberg.com/news/articles/2019-04-16/u-k-labor-market-remains-robust-as-employment-surges
[4] During March 2019, the UK's wage growth rate was 3.3 percent (source: Office for National Statistics, UK).
[5] Source: Reuters, available at https://www.reuters.com/article/us-saudi-arabia-budget-instant-view/saudi-2019-state-budget-boosts-spending-idUSKBN1OH1SG

Despite the unfavorable condition, Pakistan managed to finance its current account gap by the substantial external financing from friendly countries and commercial banks. Most of this financing was realized in the third quarter, which supported the country's depleting FX reserves.

Foreign direct investment

The net foreign direct investment in the country dropped 32.6 percent in Q3-FY19 over the same period last year. Cumulatively, net FDI plunged by 51.4 percent to US$ 1.3 billion in the first nine months of this fiscal year, from US$ 2.6 billion realized in the same period of FY18 (**Table 5.3**).

Table 5.3: Sector-wise Net FDI in Pakistan
million US$

	Q3		Jul-Mar	
	FY18	**FY19**	**FY18**	**FY19**
Construction	176	97.6	527.3	385.4
Oil & gas explorations	122.2	95.9	295.4	253.2
Financial business	85	45.4	361.2	247.6
Electrical machinery	2.9	1.9	13.8	126.6
Chemicals	-3.4	33.1	27.6	113.9
Beverages	-2.4	23.1	-7.2	86.3
Transport (automobiles)	10.1	29.9	11.6	84.3
Food	69	-20	82.9	-16.2
Telecommunications	3.2	-20.1	-12.1	-157.4
Power	108.1	35.7	929.1	-293.7
Others	138.9	155.5	392.1	443.8
Total	**709.6**	**478**	**2,621.7**	**1,273.8**
o/w: CPEC	69.7	27.5	829.1	-307.1
Non-CPEC	639.9	450.5	1,792.6	1,580.8

Data source: State Bank of Pakistan

The power sector, which remained the single largest recipient of the CPEC-related FDI over the last few years witnessed an outflow of US$ 293.7 million during Jul-Mar FY19. This was due to the repayment of an intercompany loan of around US$ 530.0 million by a power entity to its parent company in October 2018.

With regards to non-CPEC FDI, an outflow from telecommunications dragged down the overall investment during Jul-Mar FY19, as telecom firms operating in Pakistan made principal loan repayments to their parent companies abroad.

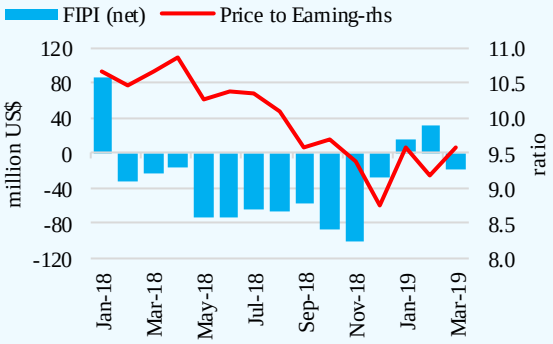
On a positive note, some other sectors, including chemicals, beverages and automobiles, were on the investors' radar during the period under review. A few automakers have now started investing in Pakistan, following the incentives announced under the Automotive Development Policy 2016-21.

Foreign portfolio investment

During Jul-Mar FY19, overall portfolio investment witnessed an outflow of US$ 398.0 million against an inflow of US$ 2.3 billion in last year, when the government had raised US$ 2.5 billion from Eurobond and Sukuk.

Pakistan's macroeconomic situation in FY19, specifically external, made it challenging for the government to raise capital from the global financial market. Instead, the government had launched US dollar denominated Pakistan Banao Certificates (PBCs) in January 31, 2019, to attract the overseas Pakistani investors.[6] However, initial response from investors was not very encouraging; in Q3-FY19, the PBCs attracted US$ 9.3 million only. Uncertainty regarding the country's external account and probably weak marketing strategy could have had been the factors behind the lukewarm response.

Figure 5.5: Foreign Portfolio Flows to Pakistani Equities and P/E ratio

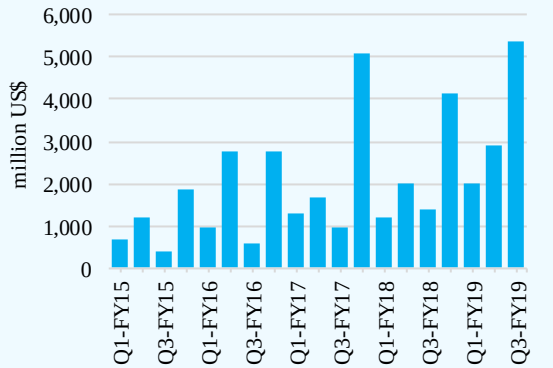


Data source: National Clearing Company of Pakistan Limited and Bloomberg

In the absence of these official inflows, the outflow of US$ 408.0 million in private equity investment in Jul-Mar FY19 set the tone of the overall portfolio investment. In Jul-Mar FY18, outflows in private equity were relatively lower at US$ 118.6 million.

In contrast, the foreign selling pressure eased in Q3-FY19, as private portfolio investment recorded an inflow of US$ 10.3 million. Pakistani equities, after declining by almost 5,000 points between Jul-Dec FY19, became attractive for investors as the price-to-earnings ratio was bottoming out by the end of 2018 (**Figure 5.5**).

Figure 5.6: Net Incurrence of Liabilities



Data source: State Bank of Pakistan

<u>Other investment</u>

During Jul-Mar FY19, the net inflow of FX liabilities more than doubled to US$ 11.2

[6] PBCs provide opportunity to overseas Pakistanis to safely invest their savings at higher profits. PBCs are offered for 3 years and 5 years maturity having profit rates, payable semiannually, of 6.25 percent and 6.75 percent, respectively. Moreover, minimum investment amount is US$ 5,000 or higher in the integral multiple of US$ 1,000 with no maximum limit.

billion compared to US$ 4.7 billion recorded last year (**Figure 5.6**). The major inflows came from commercial and bilateral sources, namely China (US$ 6.3 billion), Saudi Arabia (US$ 3 billion) and the UAE (US$ 2 billion). Most of these inflows were realized in Q3-FY19.

In net terms, the government loans increased substantially by US$ 1.4 billion during Jul-Mar FY19. Most of the activity was observed in the long-term loans, where the government had realized US$ 4.9 billion, against retirement of US$ 2.5 billion. While in the short-term, retirements exceeded disbursements, as the government retired US$ 1.4 billion, against an inflow of US$ 819 million last year.

Table 5.4: Pak Rupee vis-à-vis Major Currencies
percent change*

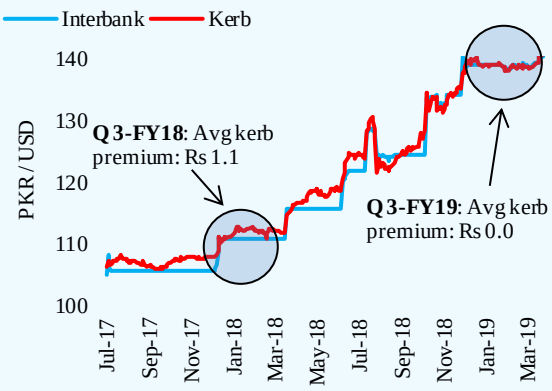
	FY18				FY19		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
US dollar	-0.5	-4.5	-4.4	-4.9	-2.2	-10.5	-1.4
Euro	-3.8	-6.0	-7.1	0.6	-1.8	-9.2	0.5
Japanese yen	0.0	-4.5	-9.9	-0.9	0.2	-13.2	-0.8
British pound	-3.4	-5.4	-8.2	1.5	-1.4	-8.3	-3.5

*Mark-to-market exchange rate;
Data source: State Bank of Pakistan

5.4 Exchange rate

The mounting pressure on the Pak rupee-US dollar exchange rate over the past few quarters seemed to have eased in Q3-FY19, owing to the external hefty FX inflows received during the quarter (**Table 5.4**). As a result, SBP's FX reserves jumped by US$ 3.3 billion in Q3-FY19.

Figure 5.7: Rupee-Dollar Parity



Data source: State Bank of Pakistan

Resultantly, the local currency remained relatively stable not only in the interbank market, but also in the open market during Q3-FY19 (**Figure 5.7**). The latter was partially due to the SBP's efforts to strengthen the AML/CFT regime for exchange companies in order to control market speculation and discourage US dollar hoarding.[7]

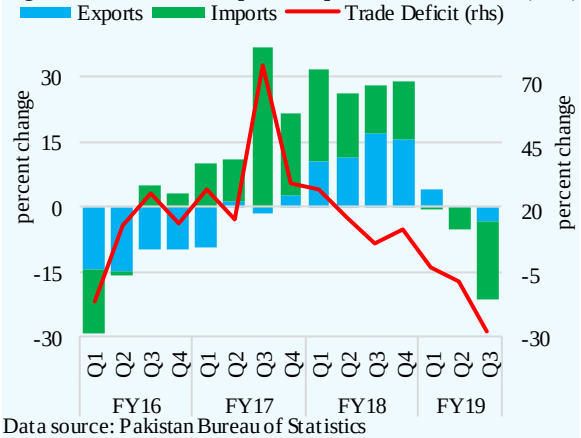
[7] The SBP, via FE Circular No. 15, dated 12 December 2018, standardized the monitoring mechanism for exchange companies by mandating the installation of CCTV cameras at company outlets.

In real terms, the PKR slightly appreciated by 2.1 percent during Q3-FY19, against a huge depreciation of 6.3 percent witnessed during the same period last year. The appreciation was mainly driven by a higher relative price index (RPI), as the local currency's NEER slightly depreciated during Q3-FY19. Most of the other emerging market currencies, including Chinese yuan, Thai baht, Indonesian rupiah, Malaysian ringgit and the Indian rupee, also appreciated in Q3-FY19, helped by the temporary easing in the US-China trade dispute and a pause in interest rate hikes by the Fed.

5.5 Trade Account[8]

The trade deficit declined by 13.1 percent to US$ 23.6 billion in Jul-Mar FY19; in comparison, the deficit had risen by 16.9 percent in the same period last year. The entire improvement in the deficit came from the import side, as exports stagnated at last year's levels.

Figure 5.8: Growth in Exports, Imports & Trade Deficit (YoY)



Data source: Pakistan Bureau of Statistics

Most of the deficit reduction during Jul-Mar FY19 was recorded in Q3, when imports dropped quite sharply in response to a deepening decline in purchases of foreign power generation machinery, aircraft and railway locomotives; technical and administrative hiccups in LNG imports (and power generation); and a temporary softening in global oil prices.[9]

Further support came from regulatory and macro stabilization measures taken earlier, which impacted industrial performance and reduced demand for imported raw materials (such as iron and steel), and also curtailed consumers' demand for cars (thereby lowering imports of CBUs). In percentage terms, the 18.1 percent decline in the overall imports in Q3-FY19 was the largest drop in a quarter in

[8] This section is based on customs data reported by the PBS. The information in this section may not tally with the SBP data reported in **Section 5.1**. To understand the difference between these two data series, please see Annexure on data explanatory notes.

[9] Arab light crude oil prices were, on average, 2.1 percent lower in Q3-FY19 than in Q3-FY18. Quantum crude oil imports declined by a much higher 26.4 percent YoY in Q3-FY19, as compared to drops of 11.2 percent and 8.2 percent recorded in Q1 and Q2 respectively.

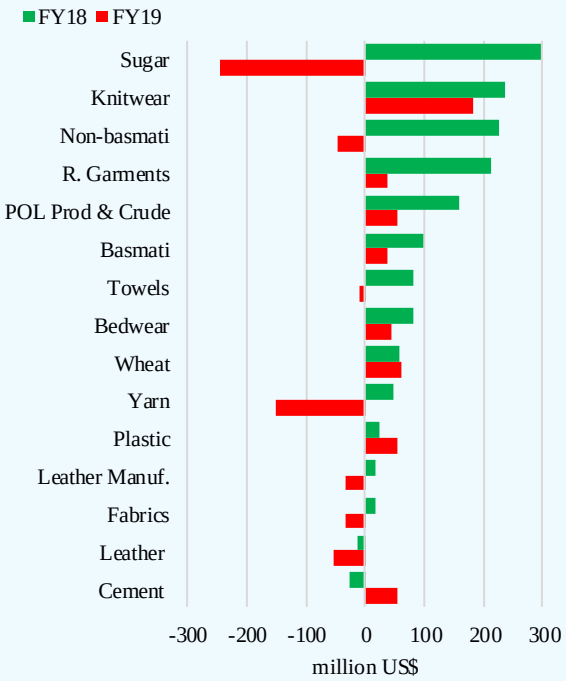
almost 10 years. It was more than sufficient to offset a 3.3 percent contraction in exports in the quarter, and led the trade deficit to drop by a sizable 27.6 percent (**Figure 5.8**).

On the other hand, the overall export values stagnated during Jul-Mar FY19 and actually declined in Q3 on YoY basis. This lackluster performance can be attributed to: (i) a drop in dollar-based unit prices of readymade garments and knitwear, which offset healthy increases in their quantum exports; (ii) lower quantum yarn exports amid stagnant domestic production and strong domestic demand; and (iii) the phasing out of export subsidies on sugar and wheat, which led to lower quantum exports of both commodities from Q2 onwards.

Exports

Pakistan's exports were recorded at US$ 17.1 billion during Jul-Mar FY19, unchanged from the same period last year (when they had grown by 13.0 percent). The broad-based slowdown in growth originated from quantum-led drops in sugar and non-basmati rice exports, tepid overall textile exports amid generally falling unit prices, and sluggishness in exports of other items, such as leather and sports goods (**Figure 5.9**).

Figure 5.9: Absolute YoY Change in Export Values (Jul-Mar)



Data source: Pakistan Bureau of Statistics

Textile exports

Pakistan's textile exports amounted to US$ 10.0 billion during Jul-Mar FY19, unchanged from the same period last year.

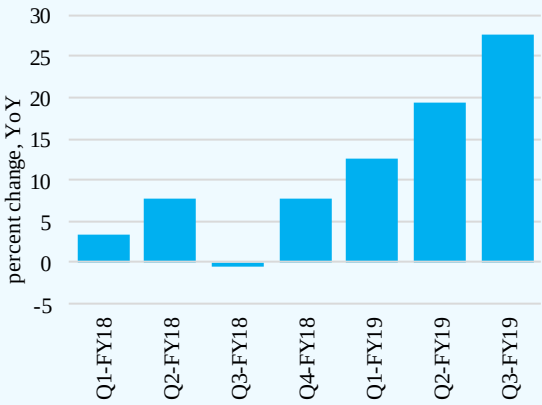
The stagnation in overall textile exports stemmed from a slowdown in export growth (in value terms) of readymade garments and knitwear items, and YoY declines in cotton fabric and yarn exports. Except for yarn, export values of all these major products suffered from a drop in unit prices, as quantum exports grew appreciably. The drop in

dollar-based unit prices was mainly owed to exchange rate adjustments, as exports rose significantly in PKR terms.[10]

(i) Apparel exports

In case of apparel, quantum exports have been rising consistently at a higher pace (**Figure 5.10**). Especially in Q3-FY19, both the US and the EU contributed to the uptick in quantum exports. Interestingly, in the EU, despite a slowdown in the bloc's import demand for clothing, Pakistani exporters managed to ship 4.3 percent more clothing items in Jul-Feb FY19 than they did last year.

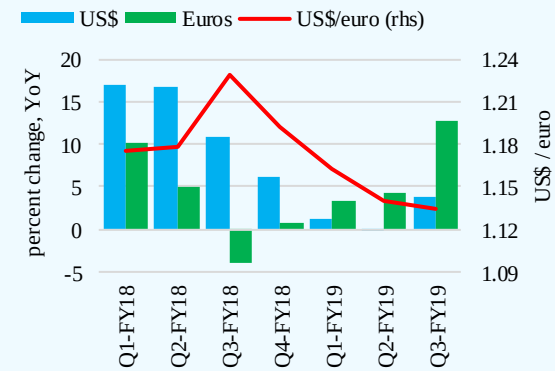
Figure 5.10: Growth in Pakistan's Quantum Apparel Exports



Data source: Pakistan Bureau of Statistics

Meanwhile, export values had also risen 4.7 percent YoY in euro terms. However, in dollar terms, the uptick dwindled to just 0.4 percent YoY (**Figure 5.11**), as the dollar appreciated against both the euro and the PKR during most of FY19. This is in contrast to last year, when the dollar was weakening against the euro, and Pakistan's apparel exports to the EU had risen more strongly in dollar terms (17.2 percent) than in euro terms (6.4 percent).

Figure 5.11: Growth in the EU's Apparel Imports from Pakistan & US$/EUR Exchange Rate



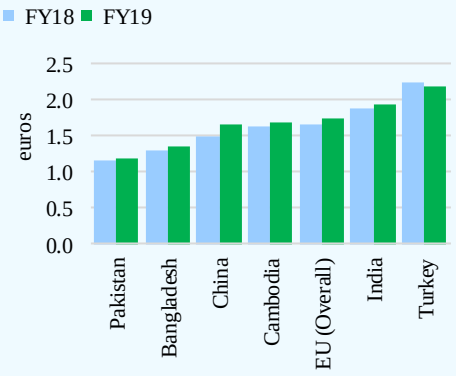
Data sources: Eurostat & Bloomberg

With regards to quantum apparel exports to the EU, Pakistan, Bangladesh,

[10] In PKR terms, overall textile exports have grown 23.1 percent YoY during Jul-Mar FY19, as compared to a 0.1 percent growth recorded in US dollar terms. PKR export values for knitwear and readymade garments have grown even more strongly, by 34.4 percent and 25.7 percent respectively during the period. The substantial increase in PKR export values has allowed textile firms to comfortably retire their borrowings to banks (**Chapter 3**).

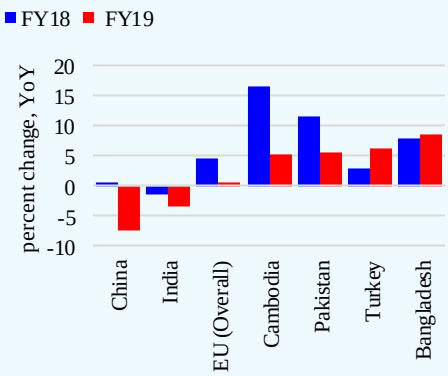
Cambodia and Turkey, all witnessed decent growths this year. Duty-free access to the bloc, along with heavy currency depreciations against the euro (in case of Pakistan and Turkey) kept the unit prices (in euros) of apparel exports of these countries in check, and contributed to higher shipments. This was despite a slowdown in demand from the bloc (**Figure 5.12 a,b**).[11] The brunt of this slowdown was faced by India and China, which could not effectively compete in the bloc. Instead, these two countries deepened their presence in the US market.

Figure 5.12 a: Unit Value of the EU's Clothing Imports (Jul-Mar)



Data source: Eurostat

Figure 5.12 b: Growth in EU's Quantum Apparel Imports from Major Suppliers (Jul-Mar)



Data source: Eurostat

The US' quantum apparel imports have risen quite significantly as compared to last year amid higher real GDP growth, falling unemployment and rising retail sales.[12] Exports of almost all major clothing suppliers to the US rose in quantum terms, including Pakistan's.

However, Pakistan could not benefit to the extent that China, Bangladesh and Vietnam did during the year. In China's case, most of the growth in its exports was realized in Q2-FY19, as the US importers rushed their purchases before Chinese textile and clothing products also came in the crosshairs of the ongoing

[11] That said, most of the growth in Bangladesh's exports came during the first (7.9 percent) and second quarters of FY19 (11.3 percent), before the minimum wage hike kicked in early 2019, raising production costs. As a result, quantum clothing exports grew by a lower 4.7 percent during Jan-Feb 2019 (source: Eurostat).

[12] Real GDP growth in the US averaged 3.1 percent in Jul-Mar FY19, up from 2.5 percent in Jul-Mar FY18. At the same time, the unemployment rate fell to 3.8 percent by March 2019, from 4.0 percent in June 2018 (source: Haver Analytics). Retail clothing sales in the US grew at a higher rate of 3.0 percent YoY during Jul-Mar FY19, as compared to 2.0 percent growth recorded last year (source: US Census Bureau).

US-China trade war.[13] At the same time, US importers also shifted some of their demand to other countries, such as Vietnam and Bangladesh, which saw an upsurge in their clothing shipments to the country.

(ii) Cotton yarn

Pakistan's cotton yarn exports declined 15.4 percent to US$ 835.7 million in Jul-Mar FY19. The decline was almost entirely driven by a 15.9 percent drop in shipments, as unit prices rose marginally. Both domestic and foreign factors played a role in the lower quantum exports during the period. On the domestic front, yarn production was basically unchanged from last year, at 2.3 million MT. However, demand for yarn by spinners has been rising in response to higher demand by local garment manufacturers (including exporters). The stagnant production amid higher demand boosted domestic yarn prices by an average of 21.0 percent YoY during Jul-Mar FY19.[14] As a result, it made more business sense for domestic spinners to cater to the local demand instead of going for exports.[15]

Internationally, exports became unviable amid a challenging situation in the primary market, China. According to Chinese customs data, cotton and yarn imports by China had dropped by a sizable 17.2 percent in CY18, as the country imposed additional retaliatory tariffs on its top yarn supplier, the United States (in July 2018). To make up for the resultant shortfall, China started unloading the sizable stockpile of cotton it had built up over the years to its ginning industry.[16] At the same time, China diverted some of its import demand for higher count yarn to Brazil, Australia and India, which managed to increase their market shares, according to the USDA. However, due to a product mismatch, Pakistani exporters could not benefit from this shift in Chinese demand, as Pakistan's ginning industry mostly produces low-count yarn, which is not widely used in apparel-making.

Food exports

Overall food exports declined 2.4 percent to US$ 3.3 billion during Jul-Mar FY19,

[13] The continued uncertainty created by the US-China stand-off on trade has interfered with US importers' timing decisions and led to frontloading of purchases from China during Q2-FY19. As of end-June 2019, both the US and China had raised tariff rates on imports that they had already targeted in CY-18.

[14] Data source: Emerging Textiles.

[15] While the PKR's depreciation also raised Pakistan's yarn export prices in PKR terms (by an average of 28.1 percent during Jul-Mar FY19), industry players said they preferred to sell to local buyers at good prices as they wanted to avoid undertaking the procedural requirements entailed in exporting the material.

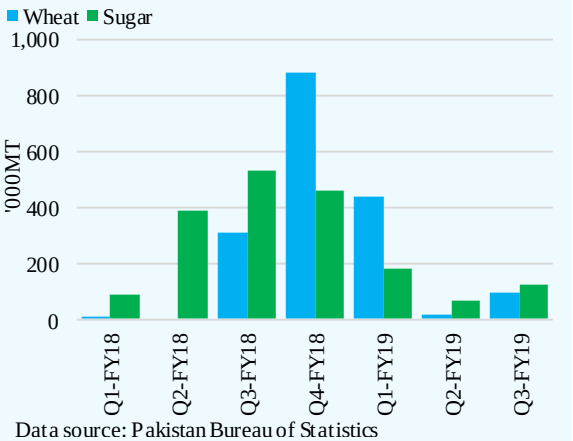
[16] Between August 2018 and July 2019, the USDA is estimating the ending stock of cotton in China to decline by 13.0 percent (from 8.3 million tons to 7.2 million tons).

compared to a sizable 28.0 percent increase recorded last year.

(i) Sugar and wheat

The major drag on food exports was sugar, whose exports dropped by a hefty 68.2 percent to US$ 115.1 million this year. In the wake of a 12.4 percent drop in average international sugar prices during Jul-Mar FY19, exporting sugar became unfeasible for Pakistani exporters in the absence of subsidies. Once the subsidies and the export quota (of 2.0 million MT announced in H1-FY18) had expired by Q1-FY19, the quantum sugar exports tapered (**Figure 5.13**).

Figure 5.13: Trends in Quantum Wheat and Sugar Exports



Data source: Pakistan Bureau of Statistics

Then in December 2018, the Economic Coordination Committee (ECC) allowed the export of 1.1 million MT of sugar; however, it left the decision regarding the scale and disbursement of any export subsidy to the provincial governments Subsequently, by end-January 2019, the Punjab government announced a sliding-scale subsidy of Rs 5.35/kg for sugar mills in the province, up to an expenditure cap of Rs 3 billion and a quantum cap of 0.572 million MT.[17] Mainly as a result of this measure, some sugar exports were recorded in Q3-FY19. However, these were quite low as compared to Q3-FY18, when a much higher federal subsidy was in place.[18]

Similarly, in case of wheat, while the overall exports more than doubled to US$ 121.9 million during Jul-Mar FY19, most of the exports were realized in the first quarter, when subsidies were in place (**Figure 5.13**). Their culmination led to a tapering in wheat exports in Q2-FY19. In Q3, quantum exports picked up slightly,

[17] Via Punjab Finance Department's notification No. FD (W&M)2-3/2018 dated January 31, 2019. Also see EPD Circular Letter No. 04 of 2019 dated February 22, 2019, on the same subject.

[18] A total of 377,678 MT of sugar was exported during Q3-FY19, down 62.6 percent from Q3-FY18. Last year, the federal government had announced an export subsidy of up to US$ 97 per MT, which worked out at around Rs 10.65 per kg (at FY18's average exchange rate of 109.84). Against this, only the Punjab government has announced an export subsidy in FY19, and that too of a lower amount of Rs 5.35 per kg.

in response to the ECC's November 2018 decision to allow exports of 0.5 million MT, with the quota split between PASSCO and the Sindh and Punjab governments. The federal and provincial governments were responsible for subsidizing exports by PASSCO and private exporters, respectively.

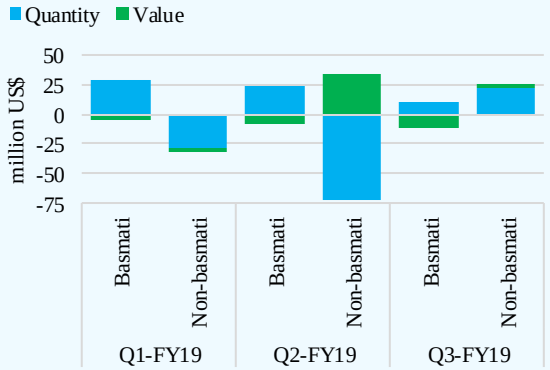
From Pakistan's perspective, the global environment appears favorable, as international wheat prices have risen in response to lower production in major exporters (the EU, Russia and China), and record demand from the Philippines.[19,20]

(ii) Rice exports

Overall rice exports stayed almost flat at US$ 1.5 billion during Jul-Mar FY19, with a 4.2 percent decline in non-basmati exports overshadowing a 10.0 percent increase in basmati exports during the period. In fact, non-basmati rice has been driving the overall trend in rice exports throughout the year, as steep declines in its quantums during the first and second quarters had more than offset healthy performance by basmati during the period.

However, the trends reversed in Q3-FY19, with an uptick in quantum non-basmati exports countering the drag from a price-led decline in basmati rice exports (**Figure 5.14**). Non-basmati rice exports to Afghanistan and China have risen significantly in Q3.[21] In case of Afghanistan, according to the industry sources, repeated border closures during Jul-Dec FY19 had curtailed exports, and the reopening of

Figure 5.14: Contribution of Quantum & Price Effects to Abs. YoY Change in Rice Exports



Data source: Pakistan Bureau of Statistics

[19] International wheat prices were, on average, up 16.4 percent during Jul-Mar FY19 as compared to the same period last year (source: World Bank).

[20] The Philippines is projected to import a record 7.0 million MT wheat in the 2018-19 year, up from around 6.0 million MT imported last year, in response to continually rising consumption and a typhoon that impacted domestic production (source: Grain: World Markets and Trade Report, USDA April 2019). However, Pakistani exporters have yet to tap this demand, and have mostly focused on Afghanistan and Indonesia so far this year.

[21] Pakistan's quantum non-basmati rice exports to Afghanistan rose 22.9 percent YoY during Q3-FY19, while those to China increased by a sizable 113.5 percent.

the crossing in January 2019 led to the resumption of normal trade activities.

Cement exports

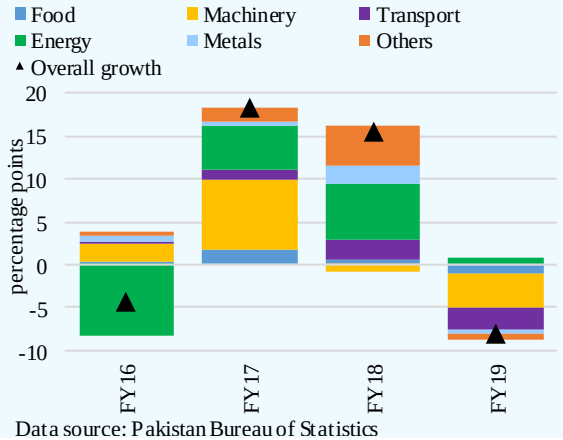
Cement exports grew 32.8 percent YoY to US$ 221.3 million in the period. A hefty 55.5 percent increase in quantum exports offset the drag from lower unit prices. Facing continuously rising surplus capacity and declining local sales amid the slowdown in domestic economic activity, cement manufacturers have diverted their attention to mostly African markets.[22] That said, the lower unit prices reflect the shift in the exporting product mix: Pakistani manufacturers are exporting more of the low-value clinker (used as a raw material) than finished cement.

Imports

The overall imports declined by 8.1 percent to US$ 40.7 billion in Jul-Mar FY19, after rising by 15.4 percent in the same period last year. The entire decline came from the non-energy group, which contracted by 11.5 percent; this offset the marginal 3.8 percent uptick in energy imports during Jul-Mar FY19.

With regards to energy imports, most of the increase was realized in Q1, with imports actually dropping by 16.9 percent YoY in Q3 – the first such decline since Q1-FY17. The curtailment in quantum imports of both LNG and crude oil led to declines in their import values, and contributed to the decline in overall energy imports in the quarter. Further relief came from the temporary dip in global oil prices, which were on average down 2.9 percent during Q3-FY19 as compared to Q3-FY18. With negative contribution from energy, overall imports dropped more steeply in Q3 than in previous quarters of FY19 (**Figure 5.15**).

Figure 5.15: Contribution to Growth in Imports (Jul-Mar)

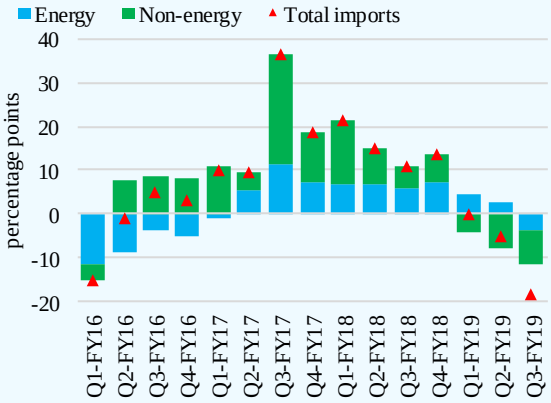


Data source: Pakistan Bureau of Statistics

[22] According to the All Pakistan Cement Manufacturers Association, domestic surplus capacity increased from 7.55 million tons in FY18 to 8.27 million tons by March 2019. Local cement dispatches declined 6 percent during Jul-Mar FY19, after rising 15.9 percent in Jul-Mar FY18.

At the same time, the drop in machinery imports, led by power generation (following the conclusion of early phase of CPEC), became more pronounced as the year progressed, and contributed sizably to the YoY drop in overall imports in Jul-Mar FY19 (**Figure 5.16**).[23] Major support also came from the normalization of imports of aircraft and related parts, which had inflated transport imports last year.

Figure 5.16: Contribution to YoY Change in Imports



Data source: Pakistan Bureau of Statistics

Some support also came from the macro adjustment policies undertaken since December 2017, including exchange rate adjustments, cuts in development spending, policy rate hikes and regulatory measures, which have subdued the performance of multiple sectors (particularly construction and auto industries), and lowered their demand for imported raw materials. As a result, imports of items like iron and steel (scrap, old ships for ship breaking, and finished products), transport fuel for heavy commercial vehicles (diesel), and cars (CBUs), all dropped in the year.

Energy imports

During Jul-Mar FY19, energy imports rose by 3.8 percent YoY to US$ 10.6 billion, as compared to the 31.8 percent increase recorded in the same period last year. The entire increase in import values came from higher international oil prices, as quantum imports of both crude oil and POL products declined significantly during the period.[24]

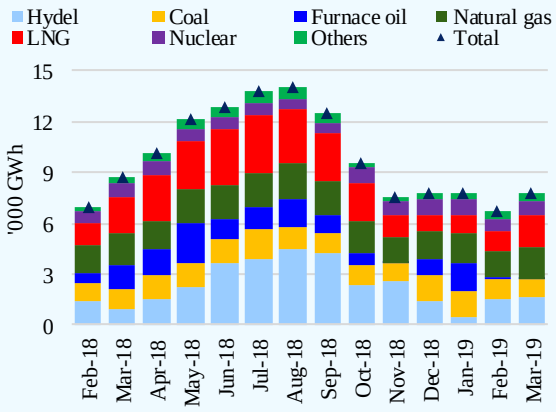
The growth in energy imports had peaked out in Q1-FY19, and actually dropped by double digits in Q3-FY19. The main factor was related to administrative and technical issues that lowered quantum LNG imports in the period.[25] As per energy

[23] Machinery imports declined by a hefty 24.7 percent YoY in Q3-FY19, as compared to drops of 17.9 percent and 19.3 percent recorded in Q1 and Q2 respectively.
[24] Arab Light crude oil prices were, on average, 19.3 percent higher in Jul-Mar FY19 as compared to the same period last year.
[25] The growth rate of quantum LNG imports fell from 44.3 percent YoY in Q1-FY19 to 19.1 percent in Q2. These imports then declined by 6.3 percent in Q3-FY19 – the first such drop since the

industry sources, the government had curtailed LNG purchases during the winter months (especially during December 2018 and January 2019). Given that LNG is now a major fuel source for power generation in the country, the government compensated for the lower LNG supplies to the power sector during these months by shifting some of the generation to furnace oil (FO) and coal (**Figure 5.17**).

This had a two-fold effect: on one hand, the country saved forex by importing lower LNG; on the other, the excessive FO stocks built up with oil refineries (which was now constraining their throughput and therefore impacting production of essential transport fuels) was utilized. That said, power generation from FO could only *partially* compensate for the decline in generation from LNG.

Figure 5.17: Source-wise Power Generation



Data source: National Electric Power Regulatory Authority

On the technical side, two LNG power plants could not operate at full capacity during Q2 and Q3, owing to low LNG supply and their inability to immediately shift to FO.[26] As a result, total power generation dropped 6.5 percent during Q3-FY19.[27] Since LNG was the top contributor to rising imports, a slowdown in its purchases contributed significantly to the curtailment in overall as well as energy imports from Q2-FY19 onwards.[28]

Meanwhile, coal imports followed a trend largely similar to that of LNG, at least until December 2018.[29] Its import values had surged in Q1-FY19, led by hefty

country started importing LNG in FY16. A 27.3 percent decline in average spot LNG prices during Q3-FY19 also contributed to its lower import values in the period.

[26] The summary of Nepra's meeting to decide on fuel price adjustment for March 2019 mentioned that "certain efficient power plants remained on forced outages during March 2019". Such underutilization of capacities is also referenced in summaries of meetings in other months as well.

[27] Moreover, anecdotal evidence suggest that the lower LNG imports also led to lower gas supplies to household consumers during the winter months.

[28] In value terms, LNG imports grew 136.3 percent YoY in Q1-FY19, with the growth then slowing down to 60.8 percent in Q2. Finally, imports declined 5.3 percent YoY in Q3.

[29] Coal is classified under the "All other items" category in the import data of both PBS and SBP.

rises in both import quantities and unit prices, and then began to moderate in Q2.[30] The slowdown in quantum imports also reflected lower demand from cement manufacturers, which were facing lower capacity utilization and slumping overall dispatches. However, quantum coal imports surged again during Q3-FY19, as it partially compensated for lower LNG supply to the power sector during the period.

On the POL product side, import values declined 15.3 percent YoY in Jul-Mar FY19 to US$ 4.6 billion, after rising 12.6 percent in Jul-Mar FY18. The ban on FO imports (imposed in January 2019) brought their imports to zero in Q3 (**Table 5.5**). Even though local FO production also declined, existing stocks with refineries and fresh production were sufficient to cater to already lower demand for FO from power producers.

Table 5.5: Growth in Quantum Import of Energy Products
percent change, YoY

	Q3		Jul-Mar	
	FY18	**FY19**	**FY18**	**FY19**
HSD	-2.8	-15.4	8.8	-29.9
Furnace oil	-82.5	-100.0	-36.0	-91.1
Petrol	2.3	7.8	4.2	2.1
Total Products	-31.0	-12.3	-11.2	-36.5
Crude oil	31.7	-27.3	24.1	-13.9

Data source: Oil Companies Advisory Council

Among other products, high speed diesel (HSD) imports dropped amid lower demand from the transport sector; overall sales declined 18.9 percent in Jul-Mar FY19, after rising 10.2 percent in Jul-Mar FY18. This is understandable, given the overall slowdown in construction activity (including the building of new power plants), which has curtailed the movement of heavy commercial vehicles (which primarily run on diesel). In contrast, petrol imports rose 2.1 percent YoY during Jul-Mar FY19, with most of the increase coming in Q3. This corresponding with a decline in its local production in the quarter.[31]

The lower petrol production was in response to a rebuilding of FO stocks with refineries from Q2-FY19 onwards, amid declining power generation from the fuel. As per industry sources, refineries curtailed their throughput to avoid producing even more FO, which they were already unable to sell to power producers. This, in turn, led to a drop in refineries' demand for crude oil as well. As a result of these issues, quantum crude oil imports declined by double digits; nonetheless higher oil prices (during H1-FY19) completely offset its impact and led to a 15.2

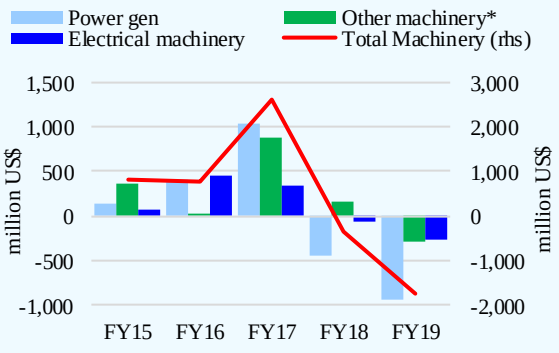
[30] The growth in quantum coal imports peaked in Q1 at 70.8 percent YoY, before reaching 13.5 percent in Q2 and 14.3 percent in Q3-FY19. International coal prices were, on average, 22.0 percent higher in Q1-FY19 on YoY basis; these grew by a much contained 3.5 percent in Q2, and declined 6.7 percent in Q3 (source: Bloomberg).
[31] Petrol production declined 1.7 percent in Q3-FY19, after rising 13.1 percent in Jul-Dec FY19.

percent growth in import values, which reached US$ 3.4 billion in Jul-Mar FY19.

Non-energy imports

During Jul-Mar FY19, non-energy imports declined 11.5 percent YoY to US$ 30.1 billion, after rising 11.2 percent in the same period last year. Power generation machinery was the single largest drag on imports, with its import values declining by almost US$ 1.0 billion during Jul-Mar FY19 (**Figure 5.18**), and accounting for a quarter of the YoY decline in non-energy imports during the period. The conclusion of the initial phase of CPEC power projects largely explains this trend. Other items related to CPEC power projects, captured under electrical and 'other machinery' categories, have been following a similar trend, and also contributed significantly to the decline in non-energy imports.

Figure 5.18: Absolute Change in Machinery Imports (Jul-Mar)



Data source: Pakistan Bureau of Statistics
*mostly comprises parts and components related to power generation and electrical machinery

The transport group emerged as the second-largest drag, with its imports declining 35.8 percent YoY to US$ 2.1 billion during the nine-month period. As indicated in **Table 5.6**, a large chunk of the decline came from aircraft- and railway-related parts, whose imports had spiked last year and have normalized this year. Car imports (both CBU and CKD) declined 13.8 percent during Jul-Mar FY19, after growing by 23.5 percent last year. Lower CBU imports accounted for a large proportion of this slowdown, and reflected tightening of regulations regarding used car imports.[32] Furthermore, multiple price hikes by auto manufacturers in the wake of the PKR depreciation, lower auto financing amid rising interest rates (**Chapter 3**), and the ban on non-filers from purchasing new vehicles, also

[32] In January 2019, the Ministry of Commerce, via SRO No. 52(I)/2019, reintroduced a restriction on used car imports under the gift and personal baggage schemes, where the importer has to pay applicable duties and taxes on the import in foreign exchange and provide documentary evidence that this foreign exchange was received from abroad. A similar restriction was in place during October 2017 to February 2018 as well.

impacted domestic new car sales.[33,34] Faced with rising inventory, auto manufacturers had to curtail production; this, in turn, lowered their CKD imports.[35]

Among other products, palm oil imports contracted by 10.2 percent YoY to US$ 1.4 billion, with the entire decline coming from lower unit prices, as import quantums had risen 9.5 percent. International prices of the commodity were, on average, down 18.7 percent in Jul-Mar FY19 over the same period last year, encouraging edible oil mills to build up their inventories. That said, international prices have bounced back from the trough hit in December 2018, and may exert upward pressure on imports going forward. Domestic palm oil consumption is expected to increase five percent and reach a record 5.0 million MT next year (as per USDA estimates).

Table 5.6: Composition of Transport Imports (Jul-Mar)
million US$

	FY18	FY19	Abs. change
Aircrafts, ships and boats	**757.5**	**222.0**	**-535.5**
Tankers*	281.6	0	-281.6
Aircraft (complete)*	52.3	5.2	-47.1
Aircraft (parts)*	47.8	48.7	0.9
Ships for shipbreaking*	350.5	135.5	-215.0
Cars	**951.3**	**820.4**	**-130.9**
CBU	358.6	209.0	-149.6
CKD	592.6	611.4	18.7
Buses & trucks	**464.9**	**370.0**	**-94.9**
CBU	195.4	108.5	-86.9
CKD	269.5	261.5	-8.0
Other transport equipment	**332.4**	**50.4**	**-282.0**
Railway locomotives*	337.2	53.7	-283.5
Transport group	**3,245.0**	**2,083.2**	**-1,161.8**

*For Jul-Feb
Data source: Pakistan Bureau of Statistics

In the case of iron and steel, cumulative imports (of both scrap and finished products) declined by 8.0 percent to US$ 2.8 billion, with most of the decline coming from lower imports of finished products. Lower quantum led the way for both these categories, reflecting the slowdown in demand from construction and automobile sectors.[36]

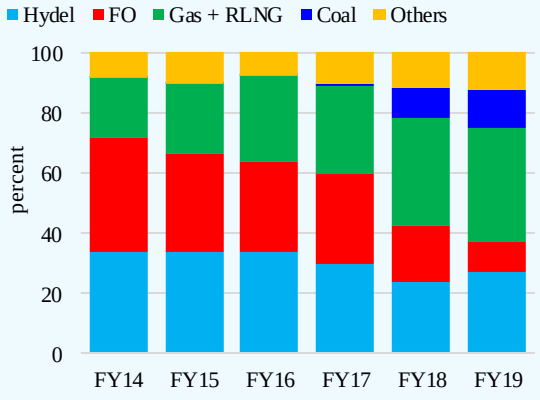
[33] New car sales by PAMA members stagnated in Jul-Mar FY19, dropping 0.7 percent YoY, after growing 15.6 percent in Jul-Mar FY18. In response, car production rose by just 2.4 percent YoY in the period, against the rise of 15.9 percent recorded last year.
[34] However, by end-March 2019, non-filers were again allowed to purchase new locally manufactured vehicles, via the Finance Supplementary (Second Amendment) Bill 2019.
[35] CKD car imports declined 6.6 percent in Q3-FY19; this was the first such decline since Q2-FY16.
[36] Domestic steel production declined 12.3 percent YoY during Jul-Mar FY19, after rising 27.9percent last year. However, production of steel sheets (commonly used by the auto industry) rose 3.1 percent; but this increase was more than offset by a 24.7 percent decline in billet (steel bar) production.

Special Section 1: Why are Power Tariffs in Pakistan Consistently High?

S1.1 Introduction

The power generation sector in Pakistan has undergone significant changes during the last 5 years. The overall electricity generation capacity increased by over 40 percent from June 2013, with a visible shift in fuel composition towards cheaper sources (**Figure S1.1**). The objective behind this transformation was to avoid power outages in the country and to make energy affordable. While a significant containment has occurred in load management over the past 5 years, the affordability issues persist. Instead of declining, power tariffs determined by Nepra remain stubbornly high, preventing the government from alleviating subsidy expenses meaningfully.

Figure S1.1: Fuel-wise Comparison of Power Generation



Data source: National Electric Power Regulatory Authority

This section will look into detail the process of power tariff determination in the country and the reason why tariffs have not softened despite an apparent decline in fuel cost. The analysis suggests that capacity payments constitute the bulk of power tariffs in Pakistan, and a sharp increase in these payments in recent years has completely offset gains from declining fuel cost. It appears that until a significant amount of investment is done on transmission and distribution, the increase in generation capacities would keep electricity tariffs at escalated levels. Furthermore, if the government wants to do away with subsidies, it must carry out reforms in the entire power sector value-chain in order to ensure affordable electricity to households, exporters and other consumers.

S1.2 How are the power tariffs determined?

Before we dig deeper into the issue, it is important to understand how the power tariffs are determined. In accordance with the Nepra Tariff Standard & Procedure Rules, 1998, the authority determines the tariff for all the generation, transmission and distribution companies. Details are summarized in **Table S1.1.**

At the generation level, the tariff is determined based on power purchase agreements (PPA) between power producers (IPPs and public Gencos) and a

single buyer: Central Power Purchasing Agency (CPPA). The PPA allows calculating the revenue requirements for an individual power producer based on (i) a capacity charge, which includes costs pertaining to the design and construction of power units, the guaranteed return on equity, and debt financing charges, among others; and (ii) an energy charge, that covers variable costs, primarily fuel (which is based on a benchmark for fuel price by Nepra), and operation and maintenance (O&M) costs.[1]

Table S1.1: Tariff Components at Various Stages of Power Supply-chain

Generation	Transmission	Distribution (retail tariff)
A. Capacity transfer charge Land purchase; design, procurement & construction; taxes & duties; fees and infrastructure; insurance; admin & utilities; financing fee; debt servicing charges; return on equity	**A. Use of system charge**	**A. Power purchase price** **Capacity transfer charge** **Energy charge** **Variable O&M** **Use of system charge**
B. Energy charge Price of fuel; thermal efficiency including of ageing and cleaning; output; heat rate; caloric value; and partial loading		**B. Distribution margin** O&M cost; salaries, wages and other benefits; depreciation; other operating expenses; return on rate base; other income
C. Variable operation and maintenance (O&M) component		**C. Transmission and distribution losses (allowed)** **D. Prior year adjustments** **End-consumer tariff (A+B+C+D)**

Data source: National Electric Power Regulatory Authority (Nepra)

Importantly, the capacity charge is indexed periodically with multiple parameters including exchange rate, domestic interest rates, foreign interest rates, etc. Furthermore, power producers are allowed to impose this capacity charge irrespective of the amount of electricity (produced and) sold by them.[2] In contrast, their variable cost depends on the estimated amount of electricity produced and sold, reference fuel mix (e.g., furnace oil, RLNG, coal) and their prices. Fuel costs above or below the Nepra benchmark are passed onto consumers as fuel price adjustment (FPA); these appear on end-consumers' electricity bills separately based on units consumed in the previous month.[3]

[1] Here, it is important to mention that capacity payments serves as a means to ensure electricity adequacy at all the times. This concept implies that there should always be "enough supply available to match demand but it does not reduce the need for reserves in order to meet real-time demand". Capacity payments are extensively used to encourage investment in power sector in a number of countries including UK, Chile, Argentina, Brazil, South Korea and Indonesia. However, mechanisms to determine these capacity payments differ across countries. Source: Report on Market Design for Capacity Markets in India, published by GIZ.

[2] The mechanism of capacity payments has been laid out in power purchase agreements with IPPs.

[3] These can be driven by variation in the *actual* fuel mix versus Nepra's *reference* mix (e.g., gas shortages that force power plants to substitute gas with more costly high speed diesel); and/or

At the transmission level, the tariff includes the Use of System Charge (UoSC) payable to NTDC. This charge takes into account the revenue requirement of NTDC, which includes permissible expenses on administration, mark-up payments, corporate taxes, and repair and maintenance, as well as on the return on equity. Prior period adjustments are also allowed for any of these components. The UoSC in terms of kWh is then calculated by dividing the revenue requirement by the sum of maximum demand index of all distribution companies and bulk power consumers connected to the NTDC transmission network.

Finally, the retail tariff is determined at the distribution stage. Here, the estimated power purchase price (in terms of kw/hour) is calculated for each Disco, which includes capacity and energy charge paid to power producers as well as UoSC paid to the NTDC. On top of this, Nepra allows Discos to earn a permissible distribution margin, which is meant to cover a part of their costs pertaining to operation and maintenance, salaries, and depreciation as well as return on rate base. Nepra also allows Discos to take some of the distribution losses incurred by these entities to their tariff build-up. Prior year adjustments are also taken into consideration while determining the end-user tariff.

The above discussion leads to following important insights about power tariffs:
(i) If a power producer does not sell even a single unit into the national grid, it will still be paid for the capacity charge (fuel charge will be zero in this case) that will eventually be included in the retail tariff;
(ii) Depreciation of the Pak rupee and/or increase in domestic or foreign interest rate increase the capacity charge and the retail tariff;
(iii) If a new generation plant is installed, the overall revenue requirement for the capacity charge will increase. If this new plant operates at 100 percent capacity and is able to sell every single unit it produces, the capacity charge in terms of Rs/kWh will remain unchanged. However, if it does not operate at full capacity, the capacity charge in terms of Rs/kWh will increase, and so will the end-user tariff.
(iv) If the thermal power composition shifts in favor of expensive fuels, say due to shortage of cheaper fuels, the energy charge in terms of Rs/kWh will increase.
(v) If the merit order list is not followed and inefficient plants are allowed to dispatch ahead of the efficient ones, the energy charge will increase.
(vi) If Nepra allows Discos to include more transmission and distribution (T&D) losses as part of their tariff build-up, the end-user tariff will increase.
(vii) Additional staff hiring, if allowed by Nepra, at any stage of the power sector

changes in fuel prices in the global market. Either of these can automatically increase (or decrease) the generation costs, and is passed on to consumers through FPAs.

value chain, increases the retail tariff.

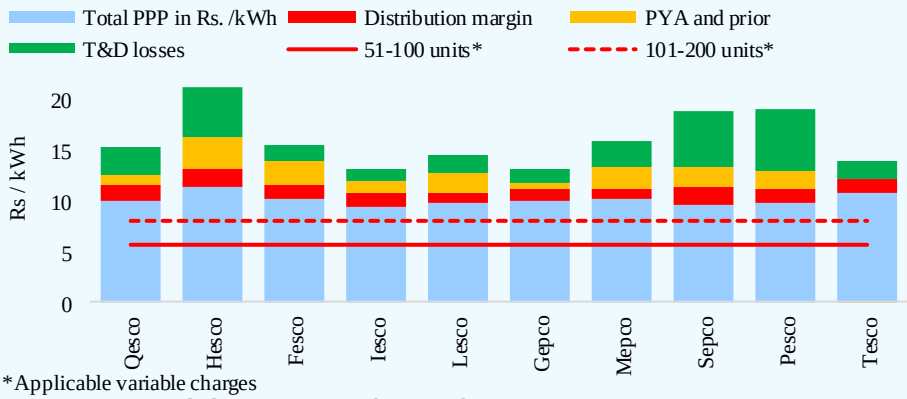
(viii) The overall cost of electricity generation from renewables (hydel, wind and solar) comprises primarily of the capacity charge, as the fuel charge is negligible (if any).

However, it must be noted that while the end-user tariff determined by Nepra changes with the developments mentioned above, the actual tariff is notified by the government to unify tariff across all Discos. This incorporates the element of subsidy to shield consumers from rising generation and/or distribution costs.

S1.3 The existing build-up of power tariffs

As shown in **Figure S1.2**, power purchase price constitutes on average 65 percent of the end-user tariff determined by Nepra. In case of some of the efficient Discos, such as Gepco and Iesco, the share of power purchase price in the end-user tariff determined by Nepra, is as high as 76 and 71 percent, respectively. It is also important to note that the tariff notified by the government to subsidize households consuming up to 200 units, is even lower than the price at which Discos procure electricity from the CPPA. This implies that while subsidizing power to end-consumers, the government pays not only for the inefficiencies at Discos level (especially those operating in Hyderabad, Sukkur and Peshawar regions), but also for the inefficiencies and excess capacities in the generation sector.

Figure S1.2: Composition of End-user Tariffs (Notified in January 2019)

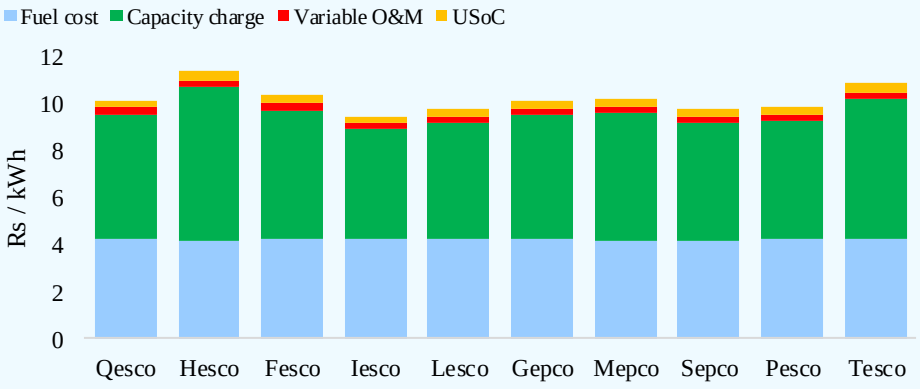


*Applicable variable charges
Data source: National Electric Power Regulatory Authority

The latter can be explained by the fact that the strongest contribution to power purchase price comes from the capacity charge (**Figure S1.3**). In absolute terms, capacity payments are estimated to be around Rs 664 billion for FY19,

representing an increase of around 60 percent over the preceding year. This rise partially stemmed from an increase of approximately 729 MW capacity added into the system during the year; modest growth in power supply; the increase in net hydel profits (NHP) to provincial governments; and the associated arrears. As discussed in the following section, rising capacity payments recently have been the major contributing factor to the consistently high end-user tariffs (determined by Nepra). As things stand, these are likely to increase even further going ahead.

Figure S1.3: Break-up of Power Purchase Price (as per tariffs notified in January 2019)



Data source: National Electric Power Regulatory Authority

S1.4 Rising capacity payments offset the impact of declining fuel cost

If we compare the tariffs between 2013 and 2018, it becomes clear that while the fuel charges have certainly softened due to lower oil prices and a shift in domestic fuel composition, capacity charges have actually increased. For nearly all the Discos, the increase in capacity charges have completely offset the fall in fuel charges (**Figure S1.4**). Reasons for this trend are discussed below:

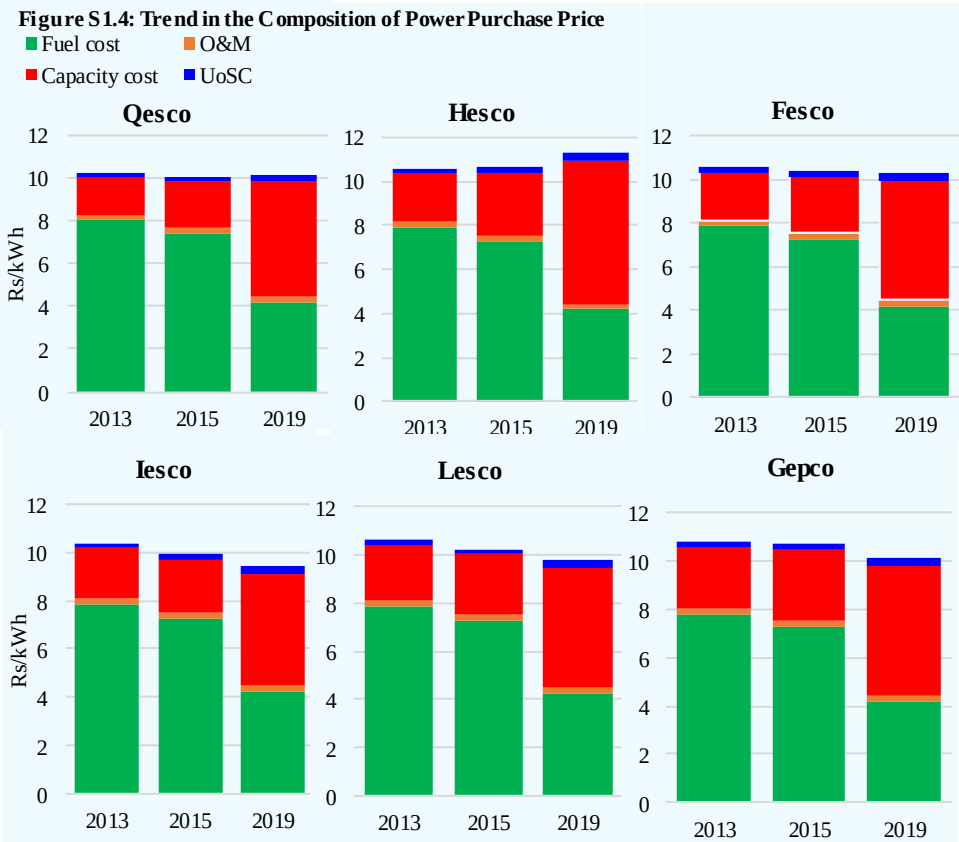
(1) Dispatch remained weaker than capacity additions

Since June 2014, the country's power generation capacity has increased by 45.7 percent (7.8 percent CAGR) to reach 34,282 MW at end March 2019.[4] This reflects the massive investment from the government in the power sector, as well as the completion of CPEC-related energy projects. Although power sold by generation companies also increased during this period, this has not been sufficient to keep the capacity cost unchanged. Here, Nepra's estimates are useful to put things in perspective: According to the regulatory authority, the energy sold was required to be increased by at least 30 percent between FY18 and FY19 in

[4]Source: Pakistan Economic Survey 2018-19.

order to keep the capacity cost component at the FY17 level, and by at least 57 percent to keep the capacity cost component at the FY16 level.[5] In actual, the energy sold grew by only 12 percent during the year; therefore, the capacity cost per kWh continued to increase. Multiple factors explain a subdued growth in power dispatch including:

Figure S1.4: Trend in the Composition of Power Purchase Price



Data source: 2019 data: SRO No. 01(I)/2019 to SRO No. 12(I)/2019, dated January 01, 2019, Ministry of Water and Power; 2015 data: SRO No. 566 (I)/2015 to SRO No. 575(1)/2015 dated June 10, 2015, Ministry of Water and Power; 2013 data: SRO No. 911(I)/2013 to SRO No. 918(I)/2013, dated October 11, 2013, Ministry of Water and Power

Constraints in transmission and distribution system

It is important to note here that the transmission and distribution capacity in the country falls significantly short of the installed generation capacity. At the

[5] Nepra's State of Industry Report, 2017

transmission level, the available system can transfer only 25,339 MW (end- FY18) at 220 KV level (this level represents the interconnection voltage level between NTDC and the Discos – step down transformers) (**Table S1.2**). Therefore, NTDC has to execute planned outages to avoid overloading of its transformers. At the distribution level, situation is not different either: around 37 percent of the total power transformers and 29 percent of the 11kV feeders in the Discos are overloaded.

Feeders often need to be switched off to avoid power tripping and damages to transformers, and Discos are, hence, not able to ensure smooth power supply. Thus, if the state of transmission and distribution does not change significantly and if one goes by Nepra's estimates, it is not possible to increase the power supply by 9 or 10 percent per annum in the coming years.[6]

Table S1.2: Transmission and Distribution Infrastructure

	No. of transformers	Percent overloaded
Transmission Level:		
550/220 kV	33	39.0
220/132 kV	143	55.0
Distribution Level:		
Power transformers	1,828	36.8
11 kV feeders	8,454	29.0
Distribution transformers	681,805	12.5

Data source: State of Industry Report 2017, National Electric Power Regulatory Authority

Mismatch between electricity generation and demand

The overall pace of economic activity is likely to grow modestly during FY20, especially in the industrial sector (only 2.3 percent). Resultantly, the GDP growth for the year has been targeted to be around 4.0 percent. The subdued growth environment, along with upward pressures on power tariffs, will make it challenging to generate power demand sufficient to compensate for the expected rise in capacity payments. This implies that if more generation capacity is added to the system – the planned increase as per NTDC is 65 percent between FY19 and FY25 –[7] it will lead to further increases in capacity payments and the overall power tariffs in the country.

(2) A sharp rise in net hydel profits

Net hydel profits (NHP), which the federal government is legally bound to pay to provinces against the bulk hydropower generation, have posted a sharp rise in recent years.[8] Up till 2015, this amount was capped at Rs 6.0 billion per annum,

[6] Source: State of Industry Report 2017, Nepra

[7] Source: State of Industry Report 2017, Nepra

[8] Article 161(2) of the Constitution of Pakistan, 1973 states, "The net profits earned by the Federal Government or any undertaking established or administered by the Federal Government for the bulk

and that too only for the Khyber Pakhtunkhwa (KP) province. However, following the successful negotiations between the federal and KP governments and their concurrence by the Council of Common Interest (CCI), Nepra allowed the uncapping of these profits from FY16 onwards.

Table S1.3: Hydel Levies Tariff Determined by Nepra for FY18, FY19 and FY20

		FY18					FY19**	FY20
Rs/kWh	Province	NHP Arrears	Current Year's NHP	Irsa	12-month arrears*	Total NHP Payments	NHP Arrears	NHP Arrears
		(a)	(b)	(c)	(d)	(a+b+c+d)		
Mangla	AJK	-	0.15	0.005	-	0.155	-	-
Gomalzam	FATA	-	-	0.005	-	0.005	-	-
Tarbela	KP	0.419	1.155	0.005	0.2595	1.838	0.4186	-
Warsak	KP	0.419	1.155	0.005	0.2595	1.838	0.4186	-
Chitral	KP	0.419	1.155	0.005	0.2595	1.838	0.4186	-
K. Garhi	KP	0.419	1.155	0.005	0.2595	1.838	0.4186	-
Dargai	KP	0.419	1.155	0.005	0.2595	1.838	0.4186	-
Jabban	KP	0.419	1.155	0.005	0.2595	1.838	0.4186	-
Khan Khwar	KP	0.419	1.155	0.005	0.2595	1.838	0.4186	-
Allai Khwar	KP	0.419	1.155	0.005	0.2595	1.838	0.4186	-
Dubair Khwar	KP	0.419	1.155	0.005	0.2595	1.838	0.4186	-
Tarbela 4	KP	-	1.155	0.005	-	1.160	-	-
Golen Gol	KP	-	1.155	0.005	-	1.160	-	-
Ghazi Bharotha	Punjab	-	1.155	0.005	3.9429	5.103	0.9456	0.9456
Chashma	Punjab	-	1.155	0.005	3.9429	5.103	0.9456	0.9456
Jinnah	Punjab	-	1.155	0.005	3.9429	5.103	0.9456	0.9456
Rasull	Punjab	-	1.155	0.005	3.9429	5.103	0.9456	0.9456
Shadiwal	Punjab	-	1.155	0.005	3.9429	5.103	0.9456	0.9456
Nandipur	Punjab	-	1.155	0.005	3.9429	5.103	0.9456	0.9456
Chichoki	Punjab	-	1.155	0.005	3.9429	5.103	0.9456	0.9456
Renala	Punjab	-	1.155	0.005	3.9429	5.103	0.9456	0.9456

* Since the notification was issued on December 14, 2017, half of the year FY18 was passed. This column refers to those arrears that account for months of FY18 prior the issuance of this notification.
**Total NHP for the year FY19 will be calculated as Rs 1.155/kw/hr + 5 percent indexation + NHP arrears to be collected in FY19. Moreover, if additional capacities come online, their NHP will be included as well.
Data source: National Electric Power Regulatory Authority (Nepra)

Specifically, Wapda was allowed to charge from CPPA the net hydel profit of Rs 18.7 billion for FY16 against the purchase of hydro-electric power – this amount

generation of power at a hydro-electric station shall be paid to the province in which the hydro-electric station is situated."

was to be included in the capacity charge.[9] In 2016, the CCI approved NHP payment of Rs 83 billion to the government of Punjab for Ghazi-Barotha Hydropower Project on the grounds similar to those in case of the KP government.

In 2017, Nepra issued a detailed ruling on the subject and determined the hydel levies (including NHP, Irsa charges and water use charge) for all the provinces for the year FY18. For KP and Punjab, the regulator also allowed 5 percent indexation every year for the computation of NHP. Moreover, it also determined the values of NHP arrears for the years FY19 and FY20 (**Table S1.3**).

However, there are certain caveats to this decision which need to be addressed jointly by Wapda and CCI:

(i) First, the Constitution stipulates transfer of NHP incurred by the federal government to provinces. However, the current arrangement applies a pre-determined fixed rate of NHP uniformly to all hydel power stations, instead of transferring actual profits earned by them. Since actual profitability differs across various hydel generation plants, applying a notional fixed NHP rate (currently @ Rs1.155 / kWh) does not seem justified, as this would potentially turn even the loss-making units into profitable ones.
(ii) Second, even before the imposition of NHP, consumers were paying hydel profits (retail price minus the cost of generation). However, instead of transferring these profits to relevant provincial governments, the federal government had been using these for subsidizing the overall electricity in the country (by compensating for expensive power generating units).
(iii) Third, it is important to note that hydel generation plants are given a must-run status in the country, because they incur no fuel cost and thus produce the cheapest electricity. However, if NHP is continuously passed on to the end-users, and is indexed every year at 5 percent, a few hydel plants will eventually become more expensive compared to some of the non-hydel plants.

The existing distortions in hydel tariffs need to be addressed. The NHP payments will likely increase going forward not just because of indexation, but also on account of planned additions in hydel capacity.

(3) Quarterly indexation of capacity payments against macroeconomic variables

As mentioned earlier, the government has put in place an indexation mechanism

[9] However, in the absence of a clear interpretation of the term "net hydel profit", Nepra termed this an "interim arrangement" and emphasized on the need for increased consultation with CCI for the distribution formula.

for the capacity charge against changes in exchange rate, interest rates, fuel prices, US and domestic inflation, O&M costs, and other factors. Nepra is authorized to decide in the matter of indexation/adjustment of capacity purchase price and O&M on a quarterly basis.

With a sharp depreciation of the Pak rupee from FY18 onwards, and an increase in the interest rates, capacity payments of all the power producers have increased during the last couple of years. It is important to mention here that the returns guaranteed to IPPs via power purchase agreements, and their dollar-based indexation, is allowed on both foreign as well as domestic investments. Therefore, the government and the regulator are finding it legally challenging to make any adjustments in the granted incentives.

S1.5 Going forward

With pressures building on the country's balance of payments as well as fiscal resources, it has become imperative for the government to cut down its expenditures and reduce (among others) the significant level of power subsidies. However, chronic governance issues in state-owned Discos and rising capacity payments mean that with the reduction in power subsidies, it will be challenging for the government to achieve the objective of providing cheap electricity to domestic users.

Table S1.4: Fuel related Expected Additions in Power Generation Capacity (Megawatt)

	Additions every year					
	2019-20	**2020-21**	**2021-22**	**2022-23**	**2023-24**	**2024-25**
Oil	0	0	0	0	0	0
Coal	823	3,300	2,610	1,320	0	0
Gas/RLNG	420	0	0	0	0	0
Wind	0	1,224	0	0	0	0
Solar	600	0	0	0	0	0
Bagasse	144	0	0	0	0	0
Hydro	201	177	824	3,080	4,325	2,203
Nuclear	0	1,100	1,100	0	0	1,100
Year-wise addition	**2,188**	**5,801**	**4,534**	**4,400**	**4,325**	**3,303**
Capacity post additions	**39,822**	**45,623**	**50,157**	**54,557**	**58,882**	**62,185**

Data source: State of Industry Report 2017, National Electric Power Regulatory Authority

Here, the investment in transmission and distribution infrastructure that is currently underway would be crucial going forward in terms of reducing T&D losses. However, the capacity payments are likely to grow over the next 5-6 years, as a number of ongoing power projects (mostly coal and renewables) come online and, in the absence of a commensurate growth in demand amidst a challenging macroeconomic environment, augment the capacity surplus situation in the

country (**Table S1.4**). As mentioned above, the resultant costs would eventually be borne by the end-users.

In this regard, the practice of keeping government-notified tariffs below even the levels of procurement costs for most of the Discos, is proving as a major disincentive for such institutions to carry out the necessary investments at an adequate scale. Hence, there is an urgent need for the government to review this practice to ensure that the power sector is able to channel forward the coming additions in generation to the industrial, domestic and other end-users.

Similarly, it is pertinent to note that the power purchase agreements – which allow for guaranteed returns along with the indexation of capacity payments – of some IPPs are going to expire in a 4-5 year period. It is vital now that for the renewal of these agreements as well as for selection of new projects, the government takes a long-term holistic view of the economy.

Finally yet importantly, the government must realize that if the capacity payment structure remains unchanged, the desired effects of providing affordable energy to the public by increasing the share of cheaper power sources in the generation mix are unlikely to materialize. Here it is important to mention that the issue of transfer of net hydel profits to provinces should be addressed in a more technical manner. To this end, Nepra has repeatedly advised Wapda to take the matter to CCI, so that CCI may issue policy guidelines to Nepra for NHP determination, in compliance with the provisions of the Constitution and Nepra Act, 1997. As things stand, the rate of Rs 1.1 per kWh, indexed at 5 percent per annum, is only an interim arrangement between Federal and KP governments, which may not be used as a final settlement of the NHP computation.

All these challenges warrant a policy overhaul and rationalization strategy to be implemented at the earliest. The entire sector needs to become more efficient and financially sustainable in order to ensure smooth and affordable electricity to end-users.

Special Section 2: The State of Food Security in Pakistan

Food security deals with the state of having reliable access to sufficient quantity of affordable, nutritious food. Essentially a pressing social concern, the lack of food security has strong economic implications. First, ensuring food security within the country may entail large fiscal costs as governments incentivize farm sector to ensure food self-sufficiency, and also resort to social safety net programs (including direct transfers) to keep purchasing powers of poor population intact. In case the food self-sufficiency is not achieved, the country has to bear balance of payments cost to ensure food availability.

And second, the state of food security has strong linkages with the state of human capital in the country. According to the Food and Agriculture Organization (FAO) of the UN, high rate of malnutrition can cost an economy around 3-4 percent of GDP. In case of Pakistan, estimates suggest that malnutrition and its outcomes cost the economy 3 percent of GDP (US$ 7.6 billion) every year.[1] In particular, high child mortality rates, prevalence of zinc and iodine deficiencies, stunting, and anemia, lead to deficits in physical and mental development that weakens labor productivity and loss of future labor force in the country.

This section will focus on the state of food security in Pakistan and highlights challenges the country is likely to face going forward. The analysis suggests that despite the fact that Pakistan produces vast quantities of major staple and non-staple food crops, the state of food security in the country is unsatisfactory. Moreover, a high population growth and unfavorable water and climatic conditions in the country mean that concerns regarding food security may increase manifolds over the next two to three decades. More importantly, the overall fiscal and BoP cost will also escalate just to maintain the current level of food security in the country.

S2.1 The Concept of Food Security

According to the UN's Food and Agriculture Organization (FAO), the concept of food security is flexible, but is widely believed to "exist when all people, at all times, have physical, social and economic access to sufficient, safe and nutritious food which meets their dietary needs and food preferences for an active and healthy life." Major dimensions include:

(i) *Food availability*: The availability of sufficient quantities and appropriate quality of food, supplied through domestic production or imports (or aid).

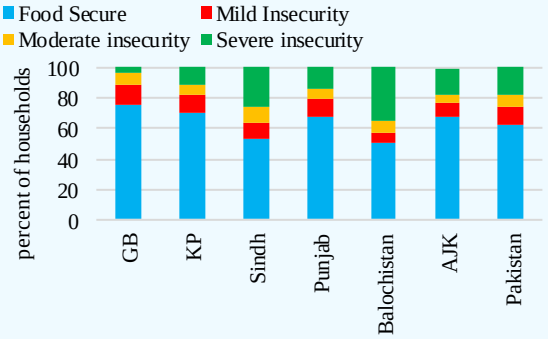
[1] Report on "The Economic Consequences of Undernutrition in Pakistan: An Assessment of Losses" (2017), launched by the Pakistan Scaling Up Nutrition (SUN) Secretariat at the Ministry of Planning, Development and Reform, in collaboration with UN's World Food Program.

(ii) *Food access*: Access/entitlement by individuals to adequate resources for acquiring appropriate foods for a nutritious diet.

(iii) *Stability*: Population, household or individual should not risk losing access to food as a consequence of sudden shocks (e.g., climatic crisis) or cyclical events (e.g., seasonal food shortages). In short, the stability concept can refer to both the availability and access dimensions.

(iv) *Utilization*: Utilization of food through adequate diet, clean water, sanitation and health care to reach a state of nutritional well-being where all physiological needs are met (this reflects importance of non-food inputs in food security).

Figure S2.1: Household Food Insecurity in Pakistan by Province/Region



Data source: National Nutritional Survey 2018; Ministry of Health and UNESCO

S2.2 The Current State of Food Security in Pakistan

Pakistan is presently self-sufficient in major staples – ranked at 8th in producing wheat, 10th in rice, 5th in sugarcane, and 4th in milk production. Despite that, only 63.1 percent of the country's households are "food secure", according to the Ministry of Health and Unicef's National Nutritional Survey 2018. The survey incorporates the Food Insecurity Experience Scale developed by the Food and Agriculture Organization (FAO) of the United Nations. The scale trifurcates insecurity along the following dimensions: mild (worrying about the ability to obtain food); moderate (compromising variety/quantity of food and often skipping meals); and severe (experiencing hunger on a chronic basis). Alarmingly, of the 36.9 percent of the households in Pakistan labelled as "food insecure", 18.3 percent face "severe" food insecurity.[2] Across the provinces, KP and Gilgit-Baltistan are relatively more food secure than Sindh and Balochistan **(Figure S2.1)**.

Furthermore, the latest available estimates of FAO suggested that the country lags behind the progress of lower-middle income countries in all four dimensions of

[2] The remaining 11.1 percent and 7.6 percent of the households face mild and moderate food insecurity, respectively.

food security (**Table S2.1**). With per capita income of US$ 1,497, Pakistan is still struggling with issues such as under-nourishment, micronutrient (iron, calcium, vitamin-A etc.) deficiencies, [3] and a deficit of safe drinkable water. Per capita consumption of food products that possess high-nutritional value like beef, chicken, fish, milk, vegetables and fruits is almost 6-10 times lower than that of developed countries.

Table S2.1: Indicators of Food Security

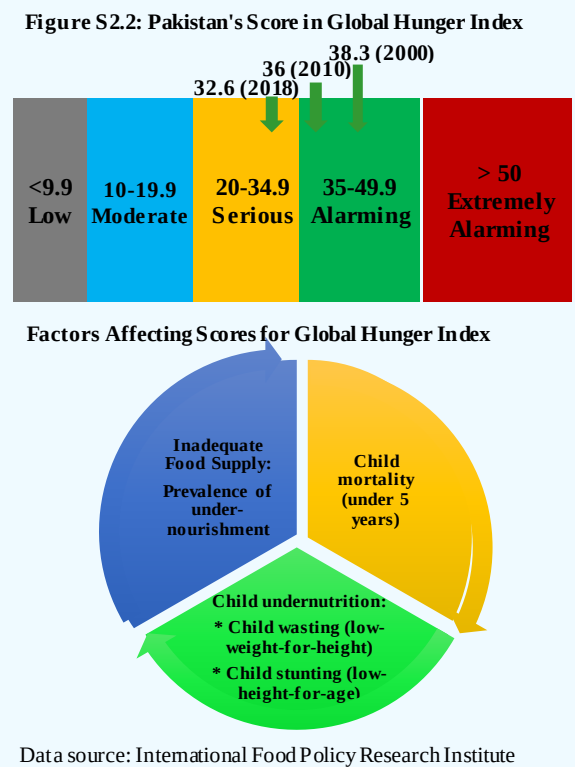
Group	Variables	Unit	Year	World	Lower-middle income	Pakistan
Availability	Avg. dietary energy supply adequacy	percent	2015-17	120	113	108
	Average value of food production	$ per capita	2014-16	313	210	196
	Average protein supply	gr/caput/day	2011-13	80	55	74
	Average fat supply	gr/caput/day	2011-13	79	64	64
Access	GDP per capita (PPP)	const. 2011$	2016	15080.4	6298.5	4857.2
	Prevalence of undernourishment	percent	2015-17	10.8	13.9	20.5
	Share of food expenditure of poor	percent	2015-16			48.52
	% of population undernourished	percent	2017	10.6	13.7	20.1
Stability	Cereal import dependency ratio	percent	2011-13	0.9	-1.5	-17.3
	% arable land equipped for irrigation	percent	2013-15	23.3	32.8	66.3
	Food imports / total exports	percent	2011-13	5	9	16
	Political stability and absence of violence/terrorism	Index	2016			-2.47
	Per capita food prod. variability	Const.2004-06	2016	2200	3600	2500
	Per capita food supply variability	kcal/caput/day	2013	6	18	21
Utilization	People using at least basic drinking water services	percent	2015	88.5		88.5
	People using safely managed drinking water services	percent	2015	71.2		35.6
	People using at least basic sanitation	percent	2015	68.0		58.3
	Children under 5 years of age affected by wasting	percent	2012			10.5
	Children under 5 years of age who are stunted	percent	2012	24.9		45.0
	Prevalence of anemia among women (15-49 years)	percent	2016	32.8		52.1

Data source: Food and Agriculture Organization of United Nations: http://www.fao.org/economic/ess/ess-fs/ess-fadata/en/

More worryingly, almost half of the children under 5 years are stunted (low-height-for-age) and one in ten has been suffering from wasting (low-weight-for-height) in the country. Incorporating these factors, Pakistan was ranked 106th among 119 countries surveyed for the Global Hunger Index, and has been characterized as facing a "serious" level of hunger **(Figure S2.2)**. In fact, Pakistan is among those seven countries that cumulatively account for two-thirds of the

[3] Source: National Food Security Policy, Government of Pakistan, June 2017

world's under-nourished population (along with Bangladesh, China, Congo, Ethiopia, India and Indonesia).[4]



Data source: International Food Policy Research Institute

While country rankings are important to view things in relative terms, it is also crucial to understand the economic implications of a large malnourished population. The SUN Secretariat at the Ministry of Planning, Development and Reform in collaboration with the UN's World Food Program, launched its report containing assessment of malnutrition in Pakistan and estimates of its cost to the economy. According to this report, under-5 malnutrition costs around US$ 7.5 billion every year, which is equivalent to 3 percent of GDP. This cost is comprised of the following components: (i) US$ 2.24 billion is estimated as the loss of future labor force resulting from under-5 mortality; (ii) US$ 1 billion is the estimated healthcare expense, which the families incur to address diarrhea and respiratory infection among children; (iii) US$ 3.7 billion is the estimated cost of low labor productivity emanating from stunting, anemia or iodine deficiencies in childhood; and (iv) US$ 657 million is the estimated cost of prevalence of chronic weakness and fatigue among 10 million working adults with anemia experience.

S2.3 Reasons behind the current state of food security

In overall terms, the dismal state of food insecurity in Pakistan can be traced primarily to the limited economic access of the poorest and most vulnerable to disruptions in the food chain. A part of this can be explained by the prevalence of poverty in the country: almost a quarter of Pakistan's total population lives below the poverty line (set at Rs 3,030.3 per adult equivalent per month). This means

[4] Food and Agriculture Organization of the United Nations

that around 50 million people in the country are unable to access basic needs given their incomes. Most of these people dwell in rural areas of the country where the poverty rate is 30.7 percent. According to a World Bank's report, the incidence of under-5 malnutrition rates (which includes stunting and wasting) in Pakistan is "considerably higher among poorer quintiles" of the expenditure distribution.[5]

Another factor that contributes to food insecurity in the country is the import-dependence for certain items, which is partly responsible for significant variations in their prices. In particular, limited (if any) attention has been paid to the local production of minor crops and livestock produce, such as pulses, fruits, vegetables, nuts and oilseeds, which not only contribute around 50 percent of dietary energy, but also significantly contribute to the nutritional food security.[6] Furthermore, prices of meat and dairy products have increased steadily. In contrast, a large physical and financial infrastructure of government-run commodity operations works in the country to implement the support/ indicative prices for major food crops (especially wheat) to ensure their availability. Although these operations entail a large fiscal cost, these have proved helpful in maintaining commodity stocks and stabilizing the prices of these commodities over the years.

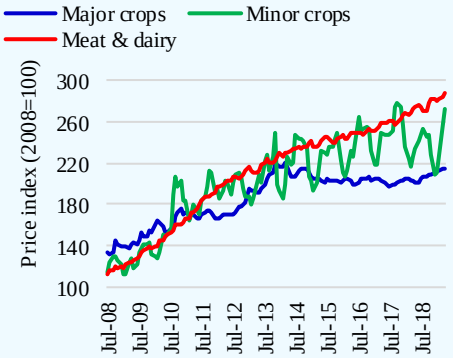
This approach had two major fallouts. First, with population growing at a rapid pace amidst changing consumption behaviors, food imports rose consistently over the years, which reinforced the already stressed balance of payments. Second, domestic prices of these food items have been governed by global trends. As shown in **Figure S2.3**, while prices of major food crops (wheat, rice and sugar) have remained fairly stable within and across years, prices of minor crops have exhibited strong seasonal variations during the past few years.

This, coupled with the fact that the bottom 60 percent of households in the country spend a substantial part of their incomes (45 percent on average) on food, has compromised their nutritional security.[7] Furthermore, it is important to note that even if prices are relatively low and stable, poorest families still lack the purchasing power to buy food. Thus, like other developing countries, Pakistan also has to resort to in-kind and cash transfers to stabilize and increase the real

[5] Mansuri, Ghazala; Sami, Mohammad Farhanullah; Ali, Muhammad; Doan, Hang Thi Thu; Javed, Bilal; Pandey, Priyanka. 2018. "When Water Becomes a Hazard: A Diagnostic Report on The State of Water Supply, Sanitation and Poverty in Pakistan and Its Impact on Child Stunting". WASH Poverty Diagnostic Series. Washington, D.C.: World Bank Group.
[6] Source: Draft National Food Security Policy, MNFSR, Government of Pakistan
[7] Source: Household Income and Expenditure Survey 2015-16

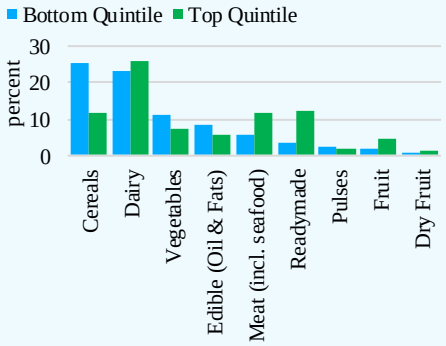
incomes of the poor. Unfortunately, the effectiveness of these transfers has often been questioned due to governance issues and poor service delivery. [8]

Figure S2.3: Trend in Price Indices of Major Food Items



Data source: Pakistan Bureau of Statistics

Figure S2.4: Distribution of Food Spending on Major Items - A Comparison b/w Bottom and Top Income Quintiles



Data source: Household Integrated Economic Survey (2015-16)

Furthermore, the level penetration of these social programs also varies across the regions/provinces. For instance, only 0.3 percent of the population in Balochistan and 1.8 percent of the people in Punjab benefit from social protection programs of some kind.[9] This ratio, however, is relatively higher for the people in Sindh (12.7 percent), Gilgit-Baltistan (10.3 percent), and KP (5.1 percent). The combined effect of these developments is that there exists a huge disparity in dietary composition across households of various income groups **(Figure S2.4)**.

S2.3 Pakistan may not even sustain staple self-sufficiency in coming years

Food self-sufficiency per se does not guarantee food security. A country is considered food secure if food is not only available, but is also accessible, nutritious, and stable, regardless of its origin. Despite this, countries still make efforts to achieve food self-sufficiency (by increasing production and imports, and

[8] For instance, the government has set up utility stores all across the country to provide necessary food items (wheat flour, edible oil/ghee, sugar, pulses, etc.) to the poorest households at subsidized rates. However, anecdotal evidence points toward issues of poor service delivery in these stores, some of which are often out-of-stock on crucial items, and customers also complain of substandard quality of the items available for sale.

[9] The survey distinguishes between three types of social protection programs: nutrition-sensitive (protecting against all forms of malnourishment, explicitly incorporating nutrition objectives and targeting the nutritionally vulnerable); risk responsive (reducing disaster risk vulnerability); and shock responsive (strengthening livelihoods against the impact of a range of shocks and ensuring that the households develop more resilience). Source: National Nutritional Survey 2018; Government of Pakistan and Unicef.

constraining exports) in order to buffer themselves from volatility in global food markets. In effect, self-sufficiency helps countries improve on at least the availability and stability dimensions of food security.

Pakistan, too, provides support to its farm sector at various levels, in order to encourage sufficient production levels of major food crops (particularly wheat and sugarcane). As mentioned before, although the country relies heavily on imports for certain food items such as edible oil, tea and pulses, it is able to provide for major staples on its own. Following analysis will show that if population increases at the existing pace over the next couple of decades, it will become extremely challenging for Pakistan to sustain even the food self-sufficiency.

Land extension is not an option anymore

Pakistan experienced more than 65 percent land extension during 1947-80, when the most fertile available land was brought into cultivation. Beyond this period, cropping area did not exhibit any significant expansion. Furthermore, the available agriculture land has been facing degradation caused by water and wind erosion, depletion of soil fertility, deforestation, unsustainable livestock grazing and water logging practices. According to latest estimates, water logging and salinity affects 11 and 5 million hectares, respectively, in the country. Moreover, the area affected by water erosion has increased by 27.3 percent in the period 1998-2007, whereas, degradation related to wind erosion increased by 17.4 percent during the same period.[10] According to the Economic Survey 2013-14, the cost associated with loss of soil fertility alone is estimated to the extent of Rs 70 billion per year in Pakistan. Furthermore, rapid urbanization also works as an important factor in limiting the odds of land extension for agriculture purposes.

In the presence of current cropping practices, water shortages and expected climatic changes, it will be challenging to improve yields substantially

In the absence of land extension, focus on yield improvements is the sole alternative to sustaining the agriculture growth in the country. Table S2.2 compares the yield required to meet the domestic need of different agriculture products (with current cropping practices), with respect to population growing at different rates of 1.8, 2.1 and 2.4 percent (keeping the per capita consumption unchanged). In case of sugarcane and wheat, even the combination of maximum level of crop area and yield that the country has ever achieved, would not result in production rising to a level sufficient to meet the growing domestic demand beyond 2020.

[10] Source: Pakistan National Biodiversity Strategy and Action Plan for achieving Aichi Biodiversity Targets and Sustainable Development Goals

Table S2.2: Yield Required to Meet Domestic Demand With Different Projected Estimates of Population Growth

thousand MT per Hectare

Yield	Population growth (%)	Max. Yield achieved	Required Yield 2020	2030	2040
	1.8		2.7	3.3	3.9
	2.1	2.973	2.8	3.4	4.2
Wheat	2.4		2.8	3.5	4.5
	1.8		48.9	58.4	69.9
	2.1	61.972	49.3	60.7	74.8
Sugarcane	2.4		49.8	63.1	80.0

Data source: Economic Survey of Pakistan

Here it is important to acknowledge that non-traditional cropping techniques such as Hydroponics (growing plants without soil), Aeroponics (growing plants with no soil and very little water), and Aero Farms (vertical farming), all may bring a drastic improvement in crop yields in Pakistan. However, not only would this require large financial capital (infrastructure and R&D), but also a significant amount of time to introduce these techniques on a mass scale and bring desirable results. In the absence of these techniques, prospects of sizable yield improvements are limited keeping in view the deteriorating water conditions and rising temperatures in the country.

Currently, water productivity of most of the crops in Pakistan is lower than the desirable range. For instance, sugarcane and wheat use around four times the global average of irrigation water, while rice consumes more than six times the world's average. Going forward, growing water shortages are expected to drag down yield of different crops on considerable scale. The latest estimates of 'Aqueduct Projected Water Stress Country Rankings' suggest that Pakistan will fall to the rank of 18th most water-stressed country in 2020, compared to the current ranking of 31.

S2.4 A focus on population control and timely implementation of policies would be vital to ensure food security in the country

It appears that the state of food security in Pakistan may deteriorate further over the next couple of decades. The major concern is that the fiscal cost of ensuring food security – in the form of food subsidies, cash transfers through BISP, nutrition interventions program, school feeding/Tawana Pakistan – would escalate steadily if the population continues to grow at a rapid pace.

It is important to note that due to low and stable global and domestic food prices, the government spending of Rs 95.7 billion during the previous 5 years (FY14 – FY18) on food-related subsidies was quite modest compared to Rs 142.5 billion spending in the preceding 5 years. However, with food prices now rising and import-dependence growing, fiscal costs may increase substantially if the government adheres to its food security objectives.

Similarly, the demand-supply gap in the domestic market is likely to emerge in major food crops going forward, even if population growth subsides. This implies that the country will likely face a steady increase in its import bill of food and non-food farm products. Food imports currently stand at US$ 6.2 billion (FY18), constituting 10.2 percent of the country's total import bill. More importantly, these imports have more than doubled in the span of only 12 years – food bill was only US$ 2.7 billion in FY07 – representing the impact of growing domestic demand, limited availability of locally-produced food items, and rising global prices.

Taking stock of these concerns, the Ministry of National Food Security and Research of Pakistan announced and published a Draft National Food Security Policy in 2018. This has been considered as a major development in terms of solving an issue of significant importance. The policymakers have realized that food security is an issue that warrants immediate attention, and have highlighted main challenges that need to be resolved, such as an inadequate focus on nutrition; supply-side constraints pertaining to agricultural inputs; slow rate of technological diffusion; trade restrictions; degradation of land; alarming water scarcity levels; and the impending impact of climate change. The draft also stressed on the poor state of public sector investment in Pakistan's agricultural R&D compared to other countries and limitations of concerned authorities to achieve goal of modern agriculture.

Resultantly, the policy lays out twenty different qualitative and quantitative goals, stretching from 4 percent per annum growth in agriculture sector and eradication of poverty, to the achievement of the zero hunger SDG and implementation of provincial agricultural policies.[11] Other objectives pertain to the enhancement of legislation for food safety and the associated trade regime.

As much as it is necessary to appreciate the announcement of the draft food security policy as a timely and ambitious silver lining, it is equally, if not more, important to urge that the agenda included therein is implemented in its full spirit. It is understandable that this would not be an easy task for the authorities, especially in terms of acquiring funding amidst the current atmosphere of limited fiscal space and persistent balance of payments constraints. However, gauging the stock of existing situation and communicating clear objectives is a good start, and

[11] SDGs refers to Sustainable Development Goals came into effect in January 2016; these include 17 different goals aimed to end poverty, protect the planet and ensure that all people enjoy peace and prosperity.

the government now needs to build on that. Furthermore, the policy does not factor in the case of population growth and its impact on the food security over the long term. This is important, considering that the country's population is estimated to double over the next 25 years at the present annual growth rate of 2.4 percent. With that, the urgency of addressing food security concerns would also commensurately escalate.

Annexure: Data Explanatory Notes

1) **GDP:** SBP uses the GDP target for the ongoing year, as given in the Annual Plan by the Planning Commission, for calculating the ratios of different variables with GDP, e.g., fiscal deficit, public debt, current account balance, trade balance, etc. SBP does not use its own projections of GDP to calculate these ratios in order to ensure consistency, as these projections may vary across different quarters of the year, with changing economic conditions. Moreover, different analysts may have their own projections; if everyone uses a unique projected GDP as the denominator, the debate on economic issues would become very confusing. Hence, the use of a common number helps in meaningful debate on economic issues, and the number given by the Planning Commission better serves this purpose.

2) **Inflation:** There are three numbers that are usually used for measuring inflation: (i) period average inflation; (ii) YoY or *yearly* inflation; and (iii) MoM or *monthly* inflation. Period average inflation refers to the percent change of the *average* CPI from July to a given month of the year over the corresponding period last year. YoY inflation is percent change in the CPI of a given month over the same month last year; and monthly inflation is percent change of CPI of a given month over the previous month. The formulae for these definitions of inflation are given below:

Period average inflation (π_{Ht}) = $$\left(\frac{\sum_{i=0}^{t-1} I_{t-i}}{\sum_{i=0}^{t-1} I_{t-12-i}} - 1 \right) \times 100$$

YoY inflation (π_{YoYt}) = $$\left(\frac{I_t}{I_{t-12}} - 1 \right) \times 100$$

Monthly inflation (π_{MoMt}) = $$\left(\frac{I_t}{I_{t-1}} - 1 \right) \times 100$$

Where I_t is consumer price index in t^{th} month of a year.

3) **Change in debt stock vs. financing of fiscal deficit:** The change in the stock of public debt does not correspond with the fiscal financing data provided by the Ministry of Finance. This is because of multiple factors, including: (i) The stock of debt takes into account the gross value of government borrowing,

whereas borrowing is adjusted for government deposits with the banking system, when calculating the financing data; (ii) changes in the stock of debt also occur due to changes in the exchange rate, which affects the rupee value of external debt, and (iii) the movement of various other cross-country exchange rates also affect the US Dollar rate and, hence, the rupee value of external debt.

4) Government borrowing: Government borrowing from the banking system has different forms and every form has its own features and implications, as discussed here:

(a) Government borrowing for budgetary support:

Borrowing from State Bank: The federal government may borrow directly from SBP either through the "Ways and Means Advance" channel or through the purchase (by SBP) of Market Related Treasury Bills (MRTBs). The Ways and Means Advance is extended for the government borrowings up to Rs 100 million in a year at an interest rate of 4 percent per annum; higher amounts are realized through the purchase of 6-month MTBs by SBP at the weighted average yield determined in the most recent fortnightly auction of treasury bills.

Provincial governments and the Government of Azad Jammu & Kashmir may also borrow directly from SBP by raising their debtor balances (overdrafts) within limits defined for them. The interest rate charged on the borrowings is the three month average yield of 6-month MTBs. If the overdraft limits are breached, the provinces are penalized by charging an incremental rate of 4 percent per annum.

Borrowing from scheduled banks: This is mainly through the fortnightly auction of 3, 6 and 12-month Market Treasury Bills (MTBs). The Government of Pakistan also borrows by auctions of 3, 5, 10, 15, 20 and 30 year Pakistan Investment Bonds (PIBs). However, provincial governments are not allowed to borrow from scheduled banks.

(b) Commodity finance:

Both federal and provincial governments borrow from scheduled banks to finance their purchases of commodities e.g., wheat, sugar, etc. The proceeds from the sale of these commodities are subsequently used to retire commodity borrowing.

5) **Differences in different data sources:** SBP data for a number of variables, such as government borrowing, public debt, debt servicing, foreign trade, etc., often does not match with the information provided by MoF and PBS. This is because of differences in data definitions, coverage, etc. Some of the typical cases are given below:

   (a) Financing of budget deficit (numbers reported by MoF vs. SBP): There is often a discrepancy in the financing numbers provided by MoF in its quarterly tables of fiscal operations and those reported by SBP in its monetary survey. This is because MoF reports government bank borrowing on a cash basis, while SBP's monetary survey is compiled on an accrual basis, i.e., by taking into account accrued interest payments on T-bills.

   (b) Foreign trade (SBP vs. PBS): The trade figures reported by SBP in the *balance of payments* do not match with the information provided by the Pakistan Bureau of Statistics. This is because the trade statistics compiled by SBP are based on exchange record data, which depends on the actual receipt and payment of foreign exchange, whereas the PBS records data on the physical movement of goods (customs record). Furthermore, SBP reports both exports and imports as free on board (fob), while PBS records exports as free on board (fob) and imports include the cost of freight and insurance (cif).

   In addition, the variation in import data also arises due to differences in data coverage; e.g., SBP import data does not include non-repatriable investments (NRI) by non-resident Pakistanis;[1] imports under foreign assistance; land-borne imports with Afghanistan, etc. In export data, these differences emerge as PBS statistics do not take into account short shipments and cancellations, while SBP data does not take into account land-borne exports to Afghanistan, export samples given to prospective buyers by exporters, exports by EPZs, etc.

[1] The non-repatriable investment (NRI) consists of small investments made by expatriate Pakistanis transporting machinery into the country that has been bought and paid for abroad and the purchases made from the *duty-free shops.*

Acronyms

3m	Three month
AC&MFD	Agricultural Credit and Microfinance Department
AJK	Azad Jammu and Kashmir
AML	Anti-Money Laundering
APCMA	All Pakistan Cement Manufacturers Association
Avg	Average
AWD	Alternate Wet and Drying
AYII	Area-Yield-Index-Insurance
BISP	Benazir Income Support Program
bln	billion
BMR	Balancing, Modernization and Replacement
BoP	Balance of Payments
BPO	Business Process Outsourcing
Bps	Basis Points
BSC	Behbood Saving Certificates
CAD	Current Account Deficit
CAGR	Compound Annual Growth Rate
CBU	Completely Built Up
cc	cubic centimeters
CCI	Council of Common Interests
CiC	Currency in circulation
CCTV	Closed-Circuit Television
CDNS	Central Directorate of National Savings
CFT	Combating the Financing of Terrorism
CKD	Completely Knocked Down
CLIS	Crop Loan Insurance Scheme
CNG	Compressed Natural Gas
CIP	Crop Insurance Program
CPEC	China Pakistan Economic Corridor
CPI	Consumer Price Index
CPPA	Central Power Purchasing Agency
CSF	Coalition Support Fund

DAP	Diammonium Phosphate
DFIs	Development Financial Institutions
DISCO	Distribution Companies
DRAP	Drug Regulatory Authority of Pakistan
DSC	Defence Savings Certificate
EDL	External Debt and Liabilities
EM	Emerging Markets
EU	European Union
FATA	Federally Administered Tribal Areas
FAO	Food and Agriculture Organization
FBR	Federal Board of Revenue
FCA	Federal Committee on Agriculture
FDA	United States Food and Drug Administration
FDI	Foreign Direct Investment
FED	Federal Excise Duty
FEE	Foreign Exchange Earnings
FESCO	Faisalabad Electric Supply Company
FIPI	Foreign Investors Portfolio Investment
FMD	Foot and Mouth Disease
FO	Furnace Oil
FPA	Fuel Price Adjustments
FX	Foreign Exchange
FY	Fiscal Year (July to June)
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
Genco	Power Generation Companies
Gepco	Gujranwala Electric Power Company
GFCF	Gross Fixed Capital Formation
GHPL	Government Holdings (Private) Limited
GIZ	Gesellschaft für Internationale Zusammenarbeit
GoP	Government of Pakistan
GSTS	General Sales Tax on Services
GVA	Gross Value Addition
H1	First Half (July-December)

H2	Second Half (January-June)
HCI	Human Capital Index
HDI	Human Development Index
Hesco	Hyderabad Electric Supply Company
HRW	Hard Red Winter (wheat)
HSD	High Speed Diesel
ICT	Information and Communications Technology
Iesco	Islamabad Electric Supply Company
ILO	International Labor Organization
IMF	International Monetary Fund
IMPACT	International Model for Policy Analysis of Agriculture Commodities and Trade (FAO)
IPPs	Independent Power Producers
IRSA	Indus River System Authority
IT	Information Technology
JPY	Japanese Yen
KEL	K-Electric Limited
KIBOR	Karachi Interbank Offer Rate
KP	Khyber Pakhtunkhwa
KSA	Kingdom of Saudi Arabia
LC	Letter of Credit
LCV	Light Commercial Vehicle
Lesco	Lahore Electric Supply Company
LIBOR	London Interbank Offer Rate
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
LPI	Logistics Performance Index
LSM	Large Scale Manufacturing
LT	Long Term
LTFF	Long Term Financing Facility
M^3	Cubic meters
MAF	Million Acre-Feet
Mepco	Multan Electric Power Company
mln	million
mmbtu	One Million British Thermal Units

MNFSR	Ministry of National Food Security and Research
MoF	Ministry of Finance
MPC	Monetary Policy Committee
MSCI	Morgan Stanley Capital International
MT	Metric Ton
MTBs	Market Treasury Bills
MRTBs	Market Related Treasury Bills
MTO	Money Transfer Operators
MW	Megawatt
M2	Money Supply
MYT	Multi Year Tariff
NAC	National Accounts Committee
NCCPL	National Clearing Company of Pakistan Limited
NDA	Net Domestic Assets
NDFC	National Development Finance Corporation
NEER	Nominal Effective Exchange Rate
NEPRA	National Electric Power Regulatory Authority
NFNE	Non-food-non-energy
NHA	National Highways Authority
NHP	Net Hydel Profits
NIC	National Incubation Center
NPL	Non-Performing Loan
NSS	National Saving Scheme
NTDC	National Transmission and Dispatch Company
O/N	Overnight
OCAC	Oil Companies Advisory Committee
OGRA	Oil and Gas Regulatory Authority
OGDCL	Oil and Gas Development Company
OMCs	Oil Marketing Companies
OMOs	Open Market Operations
O&M	Operation and Maintenance
OTEXA	Office of Textiles and Apparel
PAMA	Pakistan Automotive Manufacturers Association
Parco	Pak Arab Refinery Ltd

PASSCO	Pakistan Agricultural Storage and Services Corporation Limited
PAYE	Pay As You Earn
PBC	Pakistan Banao Certificates
PBS	Pakistan Bureau of Statistics
PEPCO	Pakistan Electric Power Company
Pesco	Peshawar Electric Supply Company
PHPL	Power Holding Private Limited
PIA	Pakistan International Airlines
PIBs	Pakistan Investment Banks
PKR	Pakistani Rupee
POL	Petroleum, Oil and Lubricants
PPA	Power Purchase Agreements
PPL	Pakistan Petroleum Limited
PPP	Power Purchase Price
PR	Pakistan Railways
PR	Policy Rate
PRI	Pakistan Remittance Initiative
PSDP	Public Sector Development Program
PSEs	Public Sector Enterprises
PSM	Pakistan Steel Mills
PSO	Pakistan State Oil
PTA	Pakistan Telecommunication Authority
PTCL	Pakistan Telecommunication Company Limited
PYA	Prior Year Adjustment
Q1	First Quarter (Jul-Sep)
Q2	Second Quarter (Oct-Dec)
Q3	Third Quarter (Jan-Mar)
Q4	Fourth quarter (Apr-Jun)
Qesco	Quetta Electric Supply Company
REER	Real Effective Exchange Rate
Rhs	Right Hand Side
RIC	Regular Income Certificate
RLNG	Re-Gasified Liquefied Natural Gas
RM	Malaysian Ringgit

Rs	Pakistan Rupees
SA	Savings Account
SBP	State Bank of Pakistan
SDR	Special Drawing Rights
Sepco	Sukkur Electric Supply Company
SMART	Strengthening Markets for Agriculture and Rural Transformation
SNGPL	Sui Northern Gas Pipelines Limited
SOEs	State Owned Enterprises
SRO	Statutory Regulatory Order
SSA	Special Saving Account
SSC	Special Saving Certificate
SSGC	Sui Southern Gas Company Limited
ST	Short Term
SUV	Sports Utility Vehicle
SYT	Single Year Tariff
T-bill	Treasury Bill
Tesco	Tribal Electric Supply Company
T&D	Transmission and Distribution
UAE	United Arab Emirates
UAI	Unit Area of insurance
UBL	United Bank Limited
UK	United Kingdom
UoSC	Use of System Charge
US$	US Dollar
USA/US	United States of America
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
WALR	Weighted Average Lending Rate
WAPDA	Water and Power Development Authority
WAONR	Weighted Average Overnight Rate
WHT	Withholding Tax
WPI	Wholesale Price Index
YoY	Year-on-Year