THE STATE OF PAKISTAN'S ECONOMY

Third Quarterly Report
for the year 2019-2020 of the
Board of Directors of State Bank of Pakistan

STATE BANK OF PAKISTAN

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Contents *Page No.*

1 Overview

As the economy moved into the third quarter of FY20, COVID-19 related lockdowns began to take their toll on an otherwise favorable macroeconomic trajectory following the necessary stabilization measures of recent times. Improvement in the inflation outlook was the exception as the real, fiscal, and external sectors deteriorated. Both production and retail activities came near to a standstill towards the end of the quarter and led to a significant contraction in economic activity **(Table 1.1)**. Such was the severity of the COVID-19 shock that after 68 years Pakistan's real GDP is provisionally estimated to record a negative growth of 0.4 percent for FY20.

Table 1.1: Selected Economic Indicators

		FY18[F]	FY19[R]	FY20[P]
Growth rate (percent)				
Real GDP	Jul-Jun	5.5	1.9	-0.4
Agriculture	Jul-Jun	4.0	0.6	2.7
Industry	Jul-Jun	4.6	-2.3	-2.6
o/w LSM	Jul-Jun	5.1	-2.6	-7.8
Services	Jul-Jun	6.3	3.8	-0.6
CPI (period average)[a]	Jul-Mar	4.6	6.3	11.5
Private sector credit [b]	Jul-Mar	9.1	10.2	4.8
Money supply (M2)[b]	Jul-Mar	4.8	5.1	8.5
Exports [b]	Jul-Mar	11.9	-1.1	1.1
Imports [b]	Jul-Mar	18.4	-3.4	-16.2
Tax revenue –FBR [c]	Jul-Mar	16.2	2.9	12.6
Exchange rate (+app/dep%)[b]	Jul-Mar	-9.2	-13.7	-4.0
Policy rate [b]	end-Mar	6.0	10.75	11.0
ONMMR [b]	end-Mar	5.7	10.0	10.7
billion US dollars				
SBP's reserves (end-period) [b]	Mar	11.6	10.5	10.8
Worker remittances [b]	Jul-Mar	14.8	16.0	17.0
FDI in Pakistan [b]	Jul-Mar	2.1	0.9	2.1
Current account balance [b]	Jul-Mar	-13.0	-10.3	-2.8
percent of GDP[I]				
Fiscal balance[d]	Jul-Mar	-4.3	-5.1	-4.0
Current account balance	Jul-Mar	-5.4	-4.8	-1.4
Investment	Jul-Jun	17.3	15.6	15.4

P=Provisional; F= Final.
Data sources: [a] Pakistan Bureau of Statistics; [b] State Bank of Pakistan; [c,d] Ministry of Finance

As expected in most other countries, this contraction in Pakistan's GDP is due to a decline in output of industrial and services sectors. Prior to the lockdowns, the industrial sector's performance continued to improve during the first two months of Q3-FY20 on account of gradual improvements in large scale manufacturing (LSM). While recovery in food and fertilizers helped, improved growth in exportable sub-sectors such as, textiles, leather and cement generated much of the momentum.

However, COVID-19 related disruptions during March FY20 adversely affected the nascent recovery in LSM as its growth declined by 22.0 percent on month-on-month basis. Nevertheless, the agriculture sector remained largely immune from the impact of COVID-19 and posted positive growth during FY20. Important crops managed to perform better despite missing their annual targets as unfavorable climate conditions and losses due to pest and locust attacks hurt yields. Faced with lockdowns and a lower level of output from the tradeable sectors, services sector growth deteriorated sharply towards the end of Q3-FY20 and turned negative for FY20.

Similarly, towards the end of Q3-FY20, the fiscal sector's performance also started to falter due to the large size of the shock to the economy. Specifically, notable gains in terms of primary budget surplus of the first half turned into a deficit during Q3-FY20. Growth in all categories of FBR taxes turned negative in March FY20 after recording encouraging gains earlier in the fiscal year. As the onset of lockdowns disrupted mobility and unemployment increased sharply, strong pressures to provide direct support to the most vulnerable segments of the society, especially in the informal sector, emerged.

Consolidation efforts during the earlier months of the fiscal year contributed positively towards creating the room that helped the government announce a meaningful relief package of PKR 1.24 trillion towards the end of Q3-FY20. Apart from direct handouts, it also includes sector specific outlays for agriculture, construction and exports. This package is being rolled out and would add to the deficit over the next few months.

On the external front, the current account deficit during Jul-Mar FY20 receded to only a quarter of last year's level. This was particularly led by a steep reduction in energy imports on account of lower international oil prices coupled with lower domestic demand, a decent growth in workers' remittances, and a significant reduction in the services deficit. The improvement in current account deficit along with multilateral financial inflows and some increase in foreign investments thus added to the SBP's FX reserves, which touched US$ 12.8 billion in February FY20 after 2 years.

However, as the COVID-19 led global panic resulted in foreign investors offloading their domestic debt holdings across emerging markets in March FY20, SBP reserves ticked down and the Pak rupee depreciated in the same month. Also, both export

receipts and workers' remittances were adversely impacted, resulting in current account deterioration in Q3-FY20 compared to Q2-FY20. In general, the impact of COVID-19 on Pakistan's asset prices and financial markets has been very much in line with that in other emerging markets.

Conversely, inflation outcomes have actually improved during Q3-FY20. Early on, last quarter's supply disruptions in the food sector were keeping headline inflation accentuated despite relatively steady core inflation, as measured by NFNE component of CPI, and contained inflation expectations. As a result, the Monetary Policy Committee (MPC) kept the policy rate unchanged during its January 2020 meeting. However, the situation changed rapidly towards the end of Q3-FY20 as COVID-19 started to spread globally and in Pakistan. This led to a further improvement in medium-term inflation prospects due to a notable slowdown in domestic demand, stabilizing food inflation and historic low international oil prices.

Supported by the favorable outlook for inflation, the MPC reversed its stance after 22 months and sharply reduced the policy rate by a cumulative 625 bps, starting with its regular meeting in mid-March FY20; followed by two first-ever emergency meetings before its next regular meeting in May FY20, and another emergency meeting in June FY20. SBP further supplemented these decisions by rolling out various refinancing schemes. These were designed to meet the short-term liquidity needs of households and firms, safeguard employment during the lockdown, and facilitate import of medical equipment for treatment of the disease, while creating an enabling environment for a robust pick-up of economic activity and exports in the post-COVID-19 environment.

While taking stock of developments so far during FY20, it is evident that the steadfast conduct of prudent policies early on resulted in favorable outcomes. The half-yearly surplus in the primary budget balance—the first since 2016—stemmed from notable fiscal consolidation measures; prudent and proactive conduct of monetary policy led to a softening in core inflation; and the policy shift to a market-determined exchange rate policy played a crucial role in reducing the current account deficit sharply and building a robust FX reserves buffer in the pre-COVID-19 environment. In turn, these improved macroeconomic fundamentals provided room for fiscal and monetary policy adjustments to contain adverse impacts when COVID-19 suddenly hit the economy from the second half of the fiscal year.

At the same time, the advent of this pandemic-related shock should not undermine the urgency of addressing long-standing structural impediments to higher and sustainable medium-term growth. In this regard, a Special Section in this report underscores the importance of Technical and Vocational Education and Training (TVET) with regard to growth and development. It emphasizes the need to raise productivity and skills so that the labor force can meaningfully contribute to Pakistan's goals for industrialization and export-driven growth.

Economic Outlook

As the economy moves towards the end of FY20, it continues to be faced with high uncertainty owing to the challenges posed by the COVID-19 pandemic on several economic fronts. The biggest concern is the fast growth in the extent of the disease. As the count of new infections is increasing every day, this shows that the distribution has not yet peaked. High levels of uncertainty are also reflected in recent SBP surveys. The Consumer Confidence Survey of May 2020 recorded a sharp deterioration in both consumer confidence and expected economic conditions following their improvement in March 2020. Similarly, the Business Confidence Survey of April 2020 registered its lowest historical level for overall business confidence. Importantly, Pakistan is not an outlier in this regard, as the global economic uncertainty index[1] also recorded its historic peak in April 2020, indicating a global manifestation of uncertainty at present.

However, going forward, there are some prospects for gradual improvement in economic activity as the government is easing the lockdown while allowing many sectors to resume activities. This may result in a supply side revival, though agriculture sector outlook is at risk from locust attacks, which can unfavorably impact the ongoing *kharif* season's output. Nonetheless, achieving the target of 2.1 percent growth in real GDP during FY21 will require a parallel improvement in underlying demand. This requires effective utilization of PSDP as per its allocation in the budget for FY21, while SBP schemes continue to support liquidity needs of both businesses and consumers. High demand for these schemes is indicating the stress faced by economic agents due to COVID-19; whereas, a growing number of approvals is increasing liquidity support that is going to be helpful in containing the pandemic

[1] www.policyuncertainity.com

related adverse fallout on supply and demand (**Table 1.2**).

Table 1.2: Progress under Various SBP Schemes to Counter COVID-19 by June 26, 2020*

1. Refinance Scheme for Wages to Prevent Layoffs	
Numbers of businesses financed	1,817
Number of employees covered	1,183,242
Amount of financing approved (billion Rs)	119.1
2. Loans Deferment and Restructuring	
Number of borrowers provided relief	1,045,173
Amount of principal deferred up to 1-year (billion Rs)	566.2
Amount of restructuring allowed (billion Rs)	112.8
3. Refinance Scheme for Hospitals to Combat COVID-19	
Number of hospitals	35
Amount of financing approved (billion Rs)	6.3
4. Refinance Scheme for Setting-up New Projects or Expansion/BMR	
Number of projects	16
Amount of financing approved (billion Rs)	9.7

*Visit www.sbp.org.pk/corona-update.html for more details and updates on number of applications and approvals under SBP schemes to counter COVID-19.
Data source: State Bank of Pakistan

On the fiscal front, consolidation achieved earlier in the year reversed as the COVID-19 shock started unfolding. Expenditures increased while revenues saw a sharp decline in their growth during Q4-FY20. Thus, fiscal deficit is estimated to touch 9.0 percent of GDP for FY20, against 4.0 percent recorded during Jul-Mar FY20. As we step into FY21, roll out of the much-needed socioeconomic support package may continue to keep government expenditures high in the coming months. However, the gross revenue target of PKR 6.57 trillion for FY21 is challenging as it entails significant growth over FY20 in a low economic activity environment. As current expenditures, such as interest payments and pensions, are expected to consume major share of the revenues, the government needs to have an efficient debt management policy while ensuring PSDP expenditures as per budget during FY21.

The inflation outlook is encouraging, although not without risks. Low domestic demand should continue to support a further softening trend in CPI headline inflation and stability in core inflation over the coming months. As a result, inflation is expected to fall in the range of 7.0-9.0 percent during FY21. However, recent increase in petrol prices have tilted risks on the higher side of this range. While low global demand may keep international oil prices subdued in the coming months, any agreement for a large cut in oil supply by OPEC members can be another upside risk for both inflation and its future expectations. Similarly, any new locust attacks of high intensity or COVID-19 related supply chain disruptions may hurt food security, resulting in higher inflation.

The outlook for the external sector is reasonably comforting, with the current account expected to remain bounded. While higher competition among competing exporters amid recovering global demand in the post-COVID-19 setting may restrict any quick recovery in exports, imports are expected to remain subdued due to low domestic demand and soft international oil prices in the coming months. While workers' remittances may remain low as current disruptions and declining oil prices have strained economies of GCC countries, some cushion in services imports may come from restrictions on international travel. However, multilateral inflows may grow further and make up for some weakness in global capital inflows as more funds have been pledged by various international institutions to help governments cope with their pandemic related relief efforts.

2 Real Sector

By the end of the first eight months of FY20, economic stabilization was largely achieved and signs of a recovery in economic activity had begun to emerge; however, this process was stalled by the spread of COVID-19 and the ensuing lockdowns all across the country. Manufacturing, transport and trade sectors faced unprecedented losses, as the government tightened containment measures to limit the spread. Agriculture remained somewhat insulated, as most of the important crops had already been harvested before disruptions began to surface. Based on the information available up till March 2020, and provisional assessment of the losses incurred in commodity producing and services sectors during the fourth quarter, real GDP is estimated to post a contraction of 0.4 percent during FY20.

2.1 GDP Growth

To put the real GDP growth estimate for FY20 in perspective, this will be the first time since FY52 – i.e. in 68 years – that Pakistan experiences negative GDP growth. The decline in the industrial sector is expected to deepen from last year due to a broad-based deterioration in Large Scale Manufacturing (LSM). Heavyweight sectors such as textile and food have lost momentum and also turned negative as COVID-19 related lockdowns and mobility restrictions towards the end of Q3-FY20 affected supply chains **(Table 2.1)**. This further added to the continued drag on LSM growth caused by the declining trend in production in automobile and petroleum sectors since the start of FY19.

Table 2.1: GDP and its Components
growth in percent

	FY19^{R}	FY20^{T}	FY20^{P}
Agriculture	**0.6**	**3.5**	**2.7**
Important crops	-7.7	4.6	2.9
Livestock	3.8	3.7	2.6
Industry	**-2.3**	**2.3**	**-2.6**
Mining and quarrying	-3.2	2.0	-8.8
LSM	-2.6	1.3	-7.8
Electricity gen. & dist.	14.5	1.5	17.7
Construction	-16.8	1.5	8.1
Services	**3.8**	**4.8**	**-0.6**
Wholesale and retail trade	1.1	3.9	-3.4
Transport, storage & com.	4.6	3.5	-7.1
Finance & insurance	5.0	6.5	0.8
General gov. services	5.2	5.7	3.9
GDP	**1.9**	**4.0**	**-0.4**
Memorandum item			
Investment-GDP ratio	15.6	15.8	15.4

Data source: Pakistan Bureau of Statistics, the Planning Commission of Pakistan

Limited mobility due to COVID-19 pandemic related lockdown also created a major drag for *transport, storage and communication* and *wholesale and retail trade*, the two most important segments within services, both of which are projected to contract from a year earlier. A notable slowdown is also expected in *finance and insurance*, which owed its large part to the pandemic's impact on business activities and slump in consumer and investor confidence.

Within agriculture, the rise in output of wheat (2.5 percent), rice (2.9 percent) and maize (6.0 percent) from a year earlier should set the tone for an overall turnaround in important crops. That said, declines are expected in cotton (6.9 percent) and sugarcane (0.4 percent) production. As for minor crops, higher production of pulses, oilseeds and vegetables should allow this segment to grow by 4.6 percent. Meanwhile, supply disruptions due to COVID-19 are also expected to lead to a slowdown in the livestock sector's performance.

2.2 Agriculture

While setting the target for agriculture growth in FY20, the government had pinned its hopes on an improved showing of important crops. While the important crops are not expected to achieve the FY20 target, they were nonetheless able to post a turnaround compared to last year.

During the *Kharif* season, pest attacks and untimely rains hurt cotton production, which clocked in at 9.2 million bales against the target of 12.7 million bales. Farmers also dedicated lesser area to sugarcane production, mainly due to delayed payments in earlier seasons; resultantly, sugarcane output of 66.9 million tons was around 1.8 million tons short of its annual target.

Subsequently, during *Rabi* season, wheat production was unable to deliver the bumper crop that seemed to be in sight based on greater area under cultivation, primarily due to heavy rains and unfavorable temperature at harvest time. Provisional estimates indicate wheat output of 24.9 million tons, short of its 27 million tons target for the year.

Inputs

Agriculture credit disbursements were higher by Rs 20 billion and Rs 107.2 billion both during Q3-FY20 as well as for Jul-Mar FY20, respectively **(Table 2.2)**. In the farm sector, corporate farming accounted for the uptick in production loans compared to crops. The rise in this trend shows that the tendency of cultivating and harvesting collectively is gaining momentum, which is further supported by increasing trend in credit for farm development as it includes expenditure on agriculture machinery. Meanwhile, loans availed for acquisition of tractors were relatively lower during the ongoing fiscal year compared to FY19, somewhat highlighting a usual slowdown after few years of high growth, especially in absence of subsidy. For the non-farm sector, the most encouraging development was the rising fixed investment in poultry. On the flip side though, credit disbursement to the livestock/dairy segment witnessed a slowdown.

Table 2.2: Agriculture Credit Disbursements
billion rupees

	Q3		Jul-Mar	
	FY19	**FY20**	**FY19**	**FY20**
Farm sector				
A. Production*	137.3	151.5	368.3	430.9
All crops	58.6	52.9	169.2	163.7
Corporate farming	41.4	51	117.3	134.7
Other	37.3	47.6	81.8	132.5
B. Development**	6.3	6.2	23.8	28.7
Tractor	1.0	0.6	3.2	2.1
Other	5.3	5.6	20.6	26.6
C. Total farm (A+B)	*143.6*	*157.7*	*392.1*	*459.6*
Non-farm sector				
D. Working capital	127	129.6	392.2	420.9
Livestock/dairy	62.5	75.1	195.1	223.9
Poultry	35.8	44.6	97.3	165
Other	28.7	9.9	99.8	32.0
E. Fixed investment	7.1	10.5	20.7	31.7
Livestock/dairy	5.2	2.7	15.5	12.8
Poultry	1.0	6.1	2.2	12.9
Other	0.9	1.7	3.0	6.0
F. Total non-farm (D+E)	*134.1*	*140.1*	*412.9*	*452.6*
Total agriculture (C+ F)	**277.7**	**297.8**	**804.9**	**912.2**

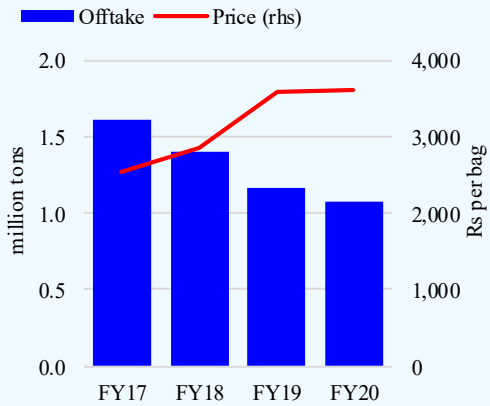
*Production loans are for purchase of inputs such as seeds.
**Development loans are for tractors, tube wells and machinery.
Data source: State Bank of Pakistan

In fertilizer, urea offtake during *Rabi* season (Oct-Mar FY20) remained at par with the levels observed in the previous few years (**Figure 2.1**). However, the outcome for DAP was less satisfactory. Even though DAP prices rose only marginally (and at a much lower pace compared to urea) during the period, its offtake was lower than the comparable period last year. The price differential between relatively expensive DAP and urea is a contributing factor; going forward, this may be offset to some degree by the higher subsidy for DAP announced in May 2020 as part of the government's

agriculture sector package.

Figure 2.1a: Urea during *Rabi* (Oct-Mar)

Figure 2.1b: DAP during *Rabi* (Oct-Mar)



Data source: National Fertilizer Development Center

Rabi FY20 Season; Wheat

The area under wheat cultivation (8.8 million hectares) was marginally higher during the review period compared to the *Rabi* season last year (8.7 million hectares). Keeping in view the better input situation compared to FY19 and favorable temperatures during early sowing, the initial outlook for the wheat crop was fairly upbeat.

However, heavy rainfall in the March-May period, accompanied with an unfavorably lower temperature close to harvest time and lower than optimal nutrient offtake, is expected to keep yield below envisaged target. Initial estimates suggested that there was only a 2.5 percent increase in wheat production compared to last year, with output amounting to 24.9 million tons during FY20.

While expected to miss its annual target, the wheat production may prove to be sufficient for domestic consumption. In the bigger picture, a greater downside risk to the wheat crop in particular, and food security in general, is posed by locust attacks – a threat which has been looming on the horizon for some time (**Box 2.1**).

Box 2.1: Threat Posed by Locust Attacks in Pakistan

Locusts, which resemble ordinary grasshoppers in appearance, are notorious for forming large swarms. Desert Locusts in particular form swarms that move rapidly across regions, laying waste to agricultural lands due to their voracious appetite. At their worst, Desert Locusts can trigger plagues with the potential to impact livelihoods for up to a tenth of the world's population.

Pakistan has tackled the menace of desert locusts before. In 2019, the Ministry of National Food Security and Research's (MNFSR's) Department of Plant Protection (DPP – the lead institution in charge of managing the Desert Locust threat in Pakistan) surveyed an area of 932,580 hectares, treated 300,595 hectares in three provinces, and sprayed 150,839 liters of pesticides during control operations.

Table 2.1.1: Area Treated as Part of Locust Control Operations, 2020

in hectares

	Jan	Feb*	Mar**	Apr	Jan-Apr
Ethiopia	22,550	50,350	51,633	99,948	224,481
Pakistan	**62,295**	**8,299**	**27,675**	**50,289**	**148,558**
Iran	2,041	2,617	39,676	98,658	142,992
Saudi Arabia	44,311	22,645	10,390	29,868	107,214
Kenya	20,000	15,278	38,378	14,637	88,293
India	61,178	11,420	--	1,970	74,568
Eritrea	15,068	12,153	5,640	--	32,861
Sudan	18,714	5,050	870	--	24,634
Yemen	15,465	1,475	3,190	--	20,130
Somalia	15,000	1,053	159	600	16,812
Top-10, Jan-Apr	276,622	130,340	177,611	295,970	880,543
Others	3,585	5,838	3,927	6,302	19,652
Total	**280,207**	**136,178**	**181,538**	**302,272**	**900,195**

* revised numbers for Ethiopia, Kenya for February 2020.

** revised numbers for Ethiopia and Kenya for March 2020.

Data source: FAO Desert Locust Bulletin

Despite these efforts, a more severe threat posed by the Desert Locusts emerged in H2-FY20 as new swarms originating in Africa continued to move east. Reports indicate that as many as 61 districts had already been impacted by locust swarms by end-May 2020, with Balochistan being the worst affected province. While the detailed assessment of quantum damage to crops is still forthcoming, the initial estimates indicated that over 115,000 hectares of crops (including wheat, oil seed, cotton, gram, fruits and vegetables) had been affected, according to the Pakistan Economic Survey 2019-20.

Should the control operations not be effective, the resultant losses could be severe, as evident from potential damage scenarios cited by the Food and Agriculture Organization (FAO):

- Scenario 1: 15 percent damage level, for wheat, gram and potato production only. Estimated losses to agriculture from locust invasion: Rs 205 billion

- Scenario 2: 25 percent damage level. Potential losses for (a) Rabi crops: Rs 353 billion; and (b) Kharif crops: Rs 464 billion

Mindful of the development, Pakistan declared a national emergency on locusts on 31st January 2020, calling upon the National Disaster Management Authority, Provincial Agriculture Departments, and the armed forces to join the DPP in mitigation efforts. A National Action Plan for Surveillance and Control of Desert Locust in Pakistan is duly being rolled out, consisting of three phases: *Phase 1: Jan-Jun 2020; Phase 2: Jul-Dec 2020; and Phase 3: Jan to Jun 2021.*

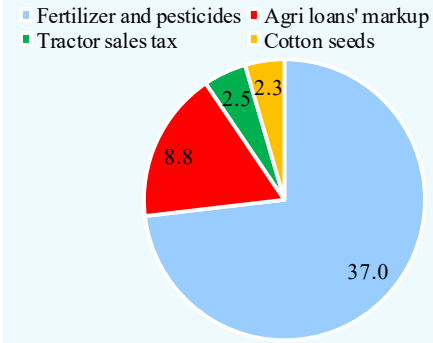
In the first phase, the country has already taken several measures to combat the threat, including treating a vast portion of area deemed to be vulnerable (**Table 2.1.1**). In addition, the Plant Protection Department is hiring a large batch of technical experts on emergency basis to help deal with the locust threat, while Micronair sprayers have also been procured to enhance control operations.

Sources: FAO, MNFSR, and National Geographic

Recent economic measures for agriculture

Realizing the importance of agriculture sector in (i) achieving national food security, (ii) job creation, and (iii) provision of raw material for upstream industries, the Economic Coordination Committee (ECC) of the Cabinet approved a Rs 50 billion package for the agriculture sector on 14th May, 2020, as part of the government's broader Rs 1.24 trillion outlay to soften the impact of COVID-19. This development is likely to boost the prospects of the *Kharif* 2020-21 season.

Figure 2.2: Allocations within the Agriculture Package (billion Rs)



Data source: Economic Coordination Committee meeting - May 13, 2020

As part of the package, farmers would receive a Rs 37 billion subsidy for purchase of fertilizers (**Figure 2.2**). DAP and other fertilizers would be subsidized by Rs 925 per

bag, while the urea and other nitrogen-based fertilizers were allocated a subsidy of Rs 243 per bag. This measure has the potential to boost fertilizer application in the *Kharif* season while also improving the offtake of the more expensive DAP component.

Moreover, a subsidy of Rs 2.5 billion on sales tax of locally manufactured light tractors was announced for a period of one year. While tractor sales had been subdued during Jul-Mar FY20, and agriculture credit disbursements for the acquisition of tractors were also on the lower side during Jul-Mar FY20 compared to last year, this subsidy has the potential to help revive demand. The ECC also earmarked Rs 8.8 billion for reduction in mark-up on agriculture loans, as well as a Rs 2.3 billion subsidy on cotton seeds. The measures may lead to better input availability, ultimately supporting the outlook for crop yields during *Kharif*.[1]

2.3 Industry

Necessary contractionary fiscal and monetary policies and adoption of market based exchange rate led to the curbing of excessive demand in the economy since FY19. But in doing so, growth of the industrial sector got affected negatively.

Nonetheless, some encouraging signs of industrial recovery started to emerge during FY20 following the stabilization phase. Q3-FY20, in particular, began on a relatively positive note for LSM. One of the reasons for this optimism was the performance of export oriented sectors, notably textile and leather, as they started to gain traction. These developments added on to the reversal in trends for cement and food during Q2-FY20 that turned positive during the second quarter after posting negative growth in Q1-FY20 (**Table 2.3**).

However, when the government imposed lockdown in the latter part of March 2020 onwards to control the spread of COVID-19, manufacturing activities were halted across Pakistan, hurting especially the urban-centric and labor-intensive industries. As a result, decline in overall LSM growth accentuated again after a brief period of curtailment due to further deterioration in domestic demand, supply chain disruptions, and fall in exports. It therefore reflected negatively on the LSM outcome of Q3-

[1] The impact of the agriculture package measures on *Kharif* would be discussed in SBP's FY20 Annual Report, once the data on area under cultivation and input situation is available.

FY20.

Table 2.3: LSM Growth
percent

	wt.	Q1		Q2		Q3		Jul-Mar	
		FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20
LSM	70.3	-0.5	-5.7	-2.9	0.0	-4.8	-9.7	-2.9	-5.4
Textile	20.9	-0.2	0.2	-0.3	0.5	-0.1	-8.4	-0.2	-2.6
Cotton yarn	13	0.0	0.2	0.0	0.0	0.0	-9.0	0.0	-3.0
Cotton cloth	7.2	0.1	0.1	0.2	0.3	0.0	-8.8	0.1	-2.8
Jute goods	0.3	-8.1	-14.8	-8.0	3.5	-24.8	37.6	-14.1	8.2
Food	12.4	1.9	-8.8	-7.6	15.4	-4.7	-7.8	-4.1	-2.3
Sugar*	3.5	-	-	-37.2	97.1	-8.9	-14.3	-13.3	-1.7
Cigarettes	2.1	4.4	-34.5	9.1	-24.3	8.0	-35.2	7.2	-31.5
Vegetable ghee	1.1	4.1	2.0	-0.7	8.3	1.8	6.4	1.7	5.5
Cooking oil	2.2	6.9	0.2	-3.8	13.9	3.9	14.0	2.2	9.4
Soft drinks	0.9	-6.7	-13.5	8.1	-9.5	-4.4	-11.4	-2.4	-11.8
POL	5.5	-5.4	-14.5	-4.4	-5.9	-8.1	-31.8	-6.0	-17.5
Steel	5.4	-2.9	-17.0	-12.4	-6.8	-18.0	2.0	-11.0	-8.0
Non-metallic minerals	5.4	0.1	-0.9	-2.3	6.3	-11.7	-0.4	-4.9	1.8
Cement	5.3	0.1	-1.4	-3.0	6.3	-12.4	-0.1	-5.4	1.7
Automobile	4.6	-1.2	-33.8	-6.4	-39.0	-14.6	-36.9	-7.6	-36.5
Jeeps and cars	2.8	4.7	-38.6	-0.2	-54.6	-4.5	-50.4	-0.1	-47.7
Fertilizer	4.4	-4.8	15.9	19.2	-5.1	0.2	7.9	4.5	5.8
Pharmaceutical	3.6	-4.8	-11.9	-14.6	-0.7	-5.1	-3.9	-8.4	-5.4
Paper	2.3	3.9	-1.3	-7.5	16.0	-3.3	-1.4	-2.5	4.2
Electronics	2	16.9	11.0	23.1	-6.1	14.3	-36.8	17.7	-13.5
Chemicals	1.7	-6.7	-8.9	0.3	-0.4	-4.8	2.6	-3.8	-2.3
Caustic soda	0.4	17.2	-21.4	-5.3	-7.4	-20.9	-4.5	-4.7	-11.5
Leather products	0.9	0.5	6.3	-4.1	16.0	8.2	-6.5	1.5	5.0

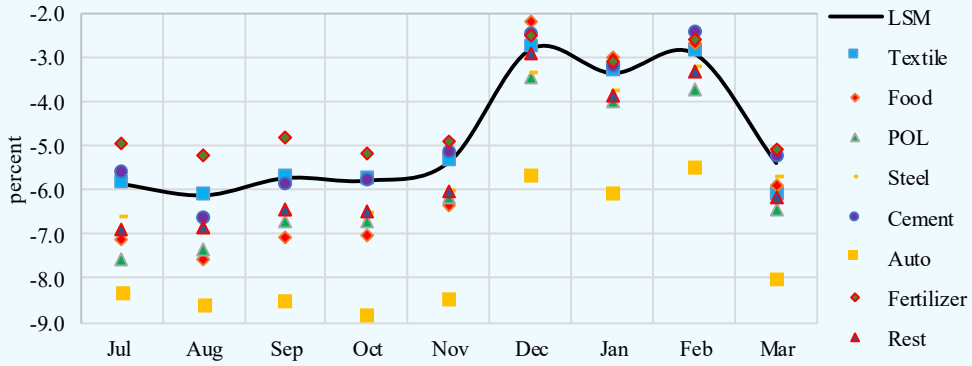
*Sugar production is seasonal. No production takes place in Q1 and hence no growth. Activity usually starts during Q2.
Data source: Pakistan Bureau of Statistics

LSM

The LSM sector had been showing some indications of nascent recovery up until February FY20 as negative growth rates were narrowing every month. However, manufacturing activities were adversely affected as a result of the lockdown. Even though these 10 days in Q3-FY20 represented only a fraction of time, the impact was

quite large. Data shows that the embryonic signs of recovery were reversed. Almost all the industries suffered contraction in March FY20. As a result, after showing some improvements in January and February 2020, LSM growth fell sharply in March to negative 5.4 percent on YoY basis. Also, on month-on-month (MoM) basis, growth turned negative in March FY20 after posting a positive growth in February FY20 (**Figure 2.3**).

Figure 2.3: Contribution of Major Industries in LSM Index Growth (YoY)



Points below the LSM line indicate negative contribution; distance from LSM line represents magnitude of contribution to LSM growth. For instance in March 2020, the automobile sector -represented by yellow squared dots in the figure- indicates negative contribution to LSM growth since it is below the black LSM line. The distance between the LSM line (-5.4 percent) and automobile yellow dot (-8.0 percent) indicates that auto sector contributed -2.6 percent in LSM growth.
Data source: Pakistan Bureau of Statistics

As market-driven exchange rate restored competiveness, export-oriented industries also played a part in improving LSM growth during Jul-Feb FY20. Textile sector, driven by higher export orders, registered positive growth of 0.4 percent during the period. This development syncs well with the trend in textile exports, which increased from 1.4 to 5.3 percent during the Jul-Feb FY20, mainly on account of the apparel segment.[2] As has been highlighted in previous reports, the disconnect between the two growth rates is

[2] Another factor that aided export growth and therein LSM was the earlier onset of COVID-19 and lockdowns in China. Cancellation of export orders from China by EU and US benefited countries such as Pakistan for the short-term. Activity in apparel manufacturing thus rose sharply as a result of export demand (see **Chapter 5**).

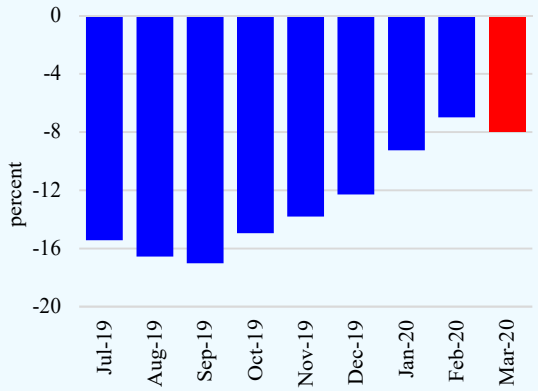
due to limited coverage of apparel sector in the LSM activity index.

As the retail sector shut-down was the major drag on domestic consumption, some downward pressure also came from lockdowns in major textile export destinations. As a result, textile sector's growth turned negative in March FY20.

Similar to textile, the revival in the leather industry also witnessed deceleration as manufacturing activities stopped at the onset of domestic lockdowns amid lowering global demand due to cascading implementation of lockdowns in many countries across the world. Gains from export competitiveness and some benefit from earlier lockdown in China, that resulted in more export orders, vanished in March FY20. As a result, production activities in leather sector contracted by 30.1 percent MoM in March FY20.

The cement industry was also recovering during Jul-Feb FY20. Cement dispatches rose by 10 percent during this period compared to no growth during FY19. Robust local sales in the north and export-led growth in the south put the cement industry on the path of recovery. However, the dispatches were down by 14.3 percent during March FY20. On the whole though, the sector was able to grow during Jul-Mar FY20 and would be expected to make some recovery given the recently announced incentive package to the construction industry. Similarly, the performance of steel industry that had managed to post marginal recovery, reversed in March FY20. (**Figure 2.4**).

Figure 2.4: Steel Industry Growth



Data source: Pakistan Bureau of Statistics

However, a few critical manufacturing industries were spared form the strict restrictions, such as food and pharmaceutical industries. Moreover, the fertilizer sector remained relatively insulated from the lockdown situation, predominantly due to the location of production units in rural areas and their high level of automation. Meanwhile, the

production cycle of the sugar industry for FY20 ended before the outbreak of COVID-19.

Production of fertilizer industry continued to expand. In Q3-FY20, larger urea producers clearly dominated whereas suspension of gas supplies to smaller units restricted their output noticeably (**Figure 2.5**). Additionally, lockdown measures had relatively lesser impact on the agricultural activity with little impact on demand for fertilizer. This was evident from the overall nutrients offtake for March and April 2020 that shows only mild variation compared to previous seasons.

Sugar production also remained largely immune to the lockdown due to its own dynamics. As envisaged in SBP's Second Quarterly Report for FY20, the sugar industry was not able to keep up with the earlier higher pace of production during Q3-FY20 on the basis of limited raw material (sugarcane) availability. As a result, production activity for FY20 mostly completed prior to the start of the COVID-19 related disruptions.

Figure 2.5a: Commulative Production-Urea, Large Firms

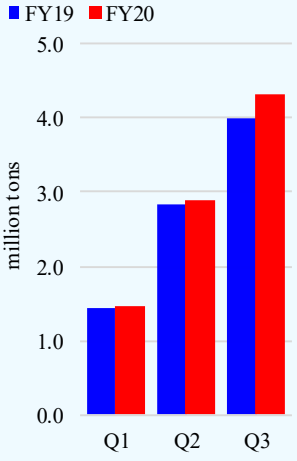


Figure 2.5b: Commulative Production-Urea, Small Firms

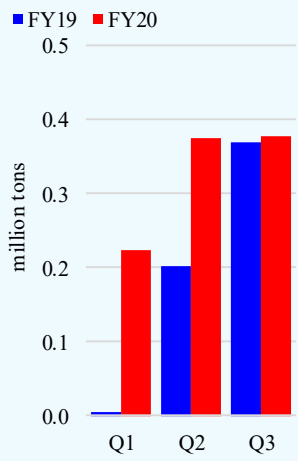
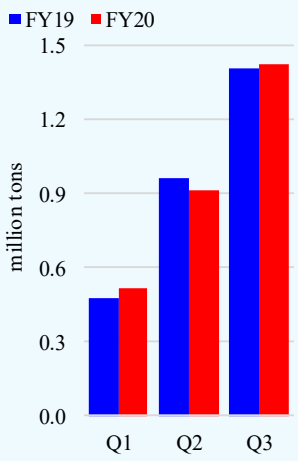


Figure 2.5c: Commulative Production-Other Fertilizer

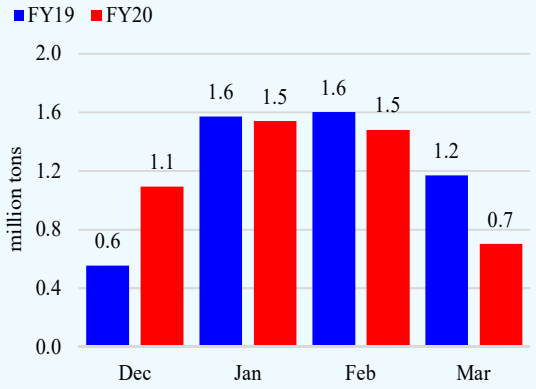


Data source: PBS

There was, however, one difference from last year; the period of bulk crushing shifted to Dec-Feb in FY20 from Jan-Mar in FY19. This shift in crushing pattern resulted in

significant growth in the initial part of the season due to the base effect (**Figure 2.6**).

Figure 2.6: Sugar Production Pattern



Data source: Pakistan Bureau of Statistics

Measures for the industrial sector

While realizing the need to arrest sharp decline in real economic growth during COVID-19, the government, and particularly SBP, announced several incentives to cushion its adverse impacts on current state of employment and to recover production in the post COVID-19 environment, once the lockdown period ends. The recovery phase would also depend on the global economic situation; particularly the extent and duration of the Great Lockdown. Impact evaluation of these measures would be covered in the next reports after data on uptake of these lending schemes and measures become available.

The government extended incentives to the construction sector to revive its growth. These included elevating construction to the status of an industry, revaluation of property prices, rationalization of capital gains tax, and numerous tax incentives such as exemption on sales tax and withholding tax[3], lower rates of taxes for builders and developers, reduction in project approval time, subsidy for housing/mortgage financing etc. These measures are expected to translate into real activities in the construction industry after the mobility restrictions are lifted.[4]

State Bank of Pakistan has also taken a number of measures to help industry tackle the COVID-19 challenge. With an improved inflation outlook, there has been a 625 basis points cumulative cut in the policy rate between March-June 2020. Moreover, a number of refinance schemes have been rolled out to facilitate BMR and expansion of

[3] Withholding tax remained intact on cement and iron & steel industry.
[4] With restrictions on mobility still in place since lockdown -through to May, 2020 at the earliest- the impact of these measures has so far remained limited. That said, the lifting of restrictions on labor movement and public transport along with the construction sector package would revive this sector.

projects, support employment and prevent layoff of workers, and strengthen the health sector to cope better with COVID-19 related challenges. Also, there is a relaxation of one-year in repayment of principal amount under various refinance schemes and credit limit to SMEs has been permanently increased to Rs 180 million, from Rs 125 million.[5]

2.4 Services

The services sector is expected to post a contraction during FY20, which is unprecedented in Pakistan's economic history. It is projected to occur due to the significant decline in *wholesale and retail trade* and *transport, storage and communication* segments (**Table 2.4**).

Table 2.4: Performance of the Services Sector
Percent

	Share in GDP-FY20	Growth	
		FY19[R]	FY20[P]
Wholesale & retail trade	18.2	1.1	-3.4
Transport, stor. & com.	12.3	4.6	-7.1
Finance & insurance	3.6	5.0	0.8
Housing services	7.0	4.0	4.0
General gov. services	8.6	5.2	3.9
Other private services	11.8	5.8	5.4
Services	**61.4**	**3.8**	**-0.6**

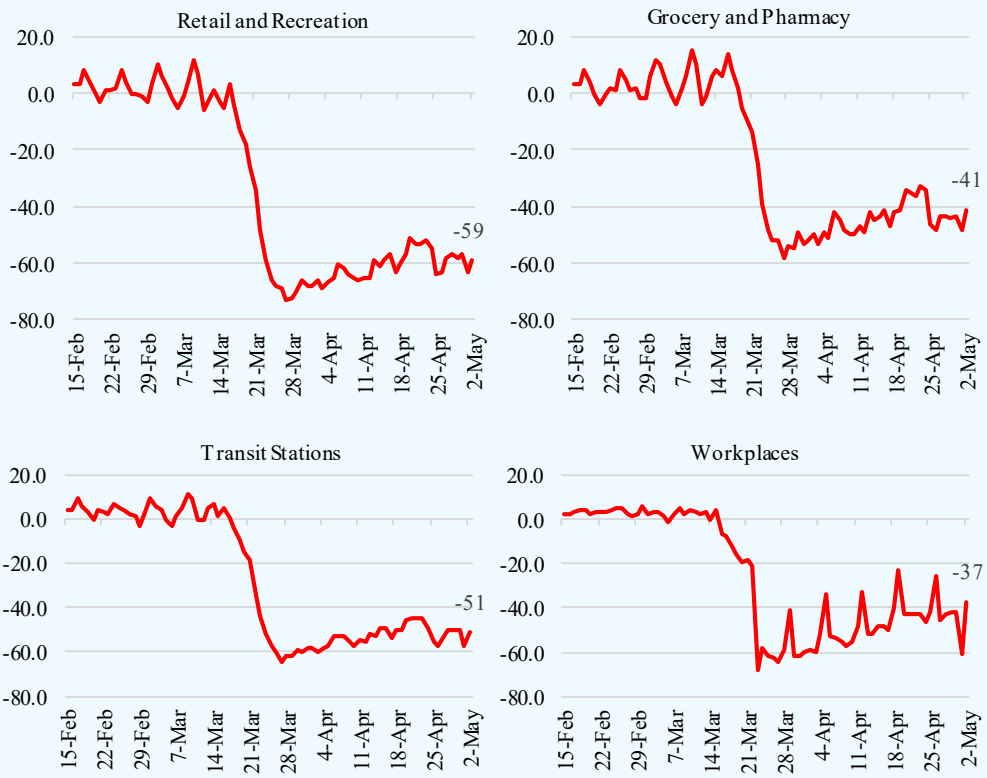
Data source: Pakistan Bureau of Statistics

Clearly, the imposition of a lockdown will have ramifications for the services sector during the remainder of the fiscal year. The closure of shopping malls, restaurants, and other commercial centers, together with social distancing arrangements and curbs on public gatherings, confined a great many people to their homes. The slowdown in imports and contraction in LSM also had a cascading impact on allied services. As a result, wholesale and retail trading activity nosedived immediately following the lockdown, and inched upward only gradually once restrictions were gradually eased (**Figure 2.7)**.

Similarly, complete suspension of flight operations, railways, and public transport for approximately 4-6 weeks, led to a sharp contraction in the transport sector. With non-fuel costs on the higher side, PIA, other domestic airlines and Pakistan Railways faced significant financial constraints. Thereafter, operations were gradually restored with the resumption of a limited number of domestic flights per day and thirty trains from 20th May, 2020. In addition to these disruptions, decline in sales of commercial vehicles also had a considerable bearing on the transportation sector.

[5] Please visit http://www.sbp.org.pk/corona.asp for more details

Figure 2.7: Mobility Changes
percent change, compared to baseline*



* The baseline is the median value, for the corresponding day of the week, during the 5 week period Jan 3–Feb 6, 2020.

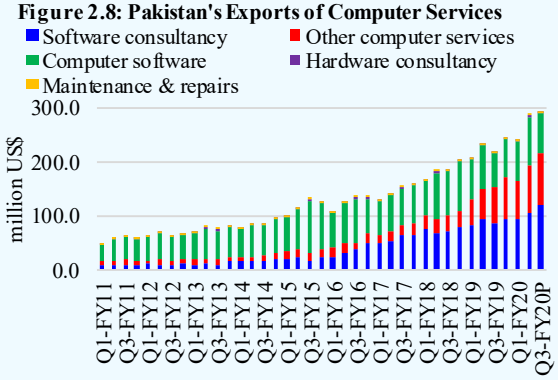
Data source: Google COVID-19 Community Mobility Report - May 2, 2020

That said, the telecom segment witnessed a rise in internet usage following the closure of educational institutes and adoption of work-from-home arrangements by a number of workplaces. Specifically, internet usage grew by 15 percent in just one week following the imposition of lockdown.[6] This was mainly attributed to increased use of e-learning and virtual meeting platforms.

[6] Source: Pakistan Telecommunication Authority press release dated 26th March, 2020.

In a similar vein, the disruption triggered by COVID-19 was relatively lower for *other private services*. In particular, ICT exports, covered under the *other private services* segment of GDP, were less hindered by lockdown. On this note, the official exports of computer services reached an all-time high of US$ 289 million on a quarterly basis during Q3-FY20 (**Figure 2.8**). The bulk of these exports was comprised of software consultancy services (41 percent) and computer software (25 percent); by their very nature, such services tend to be less affected by work-from-home arrangements, compared to traditional services that are not digitally enabled.

Figure 2.8: Pakistan's Exports of Computer Services



* as per BPM6 Extended Balance of Payments Services Classification (EBOPS 2010).
Data source: State Bank of Pakistan

Enhanced provision of government services also acted as a positive shock and provided some cushion to the economy. For instance, apart from direct cash disbursements and ration distribution, some of the provinces doubled the salaries of medical staff and made additional deployments of law enforcing agencies.

As far as *finance and insurance* was concerned, scheduled banks (which represent the lion's share within the segment) experienced contrasting fortunes during Jul-Mar FY20 and Q4-FY20. In the first period, during the predominantly high interest rate scenario, bank profitability was greater on average compared to last year; specifically, the after-tax profit of the banking system was Rs 134.3 billion during Jul-Mar FY20, compared to Rs 111.6 billion in Jul-Mar FY19.

However, these gains were largely diminished in Q4-FY20 amid the lockdowns and uncertainty generated by COVID-19. In an SBP survey rolled out in March 2020 to ascertain the financial institutions' perceptions of imminent risks, respondents foresaw some impact on profitability from a prolonged lockdown, although the bigger hit was

expected to come a bit later in their view, during H1-FY21.[7] The respondents had ranked electronics, textile, and 'travel, transport and tourism' as the sectors most likely to be affected by the pandemic, while they had expected trading to be less impacted. In hindsight, perhaps the limited information available at the time regarding the duration and scale of the lockdown had led the respondents to underestimate the vulnerability of the trading sector, and the resulting spillover on bank profitability.

As things panned out, the *finance and insurance* segment is estimated to post a mere 0.8 percent growth for the full year, which would be much lower compared to last year and below its FY20 annual target (**Table 2.4**). The outcome may have been worse had SBP not introduced a number of measures in its response to the pandemic with the aim of supporting the banking system. These included incentives designed to shift traditional cash-based transactions to digital channels and making cheque clearance easier and safer (**Table 2.5**).

Table 2.5: Selected SBP Measures to Facilitate Banking Services as Part of its Response to COVID-19*

Focus	*Circular/Press Release*	*Summary of Proposed Actions*
Better safety and health of employees; reduced customer contact with cash; continued availability of services.	BPRD Circular Letter No. 06 of 2020, dated March 16, 2020	Banks/DFIs were advised to: 1. Create awareness amongst staff and customers about COVID-19; 2. Implement the guidelines issued by WHO and the government; 3. Encourage customers to use Alternate Delivery Channels
Reducing the need to visit bank branches or ATMs, and promoting use of digital payment services	ERD Press Release dated March 18, 2020 PSD Circular No. 02 of 2020	1. SBP instructed banks to waive all charges on fund transfers through online banking channels. 2. Banks were advised to facilitate customers in using online banking while taking precautions to ensure safety/security 3. Financial industry was instructed to facilitate education fee and loan repayments via internet banking/mobile devices
Promoting the use of digital banking and alternate delivery channels; timely resolution of customer issues; taking contaminated notes out of circulation;	ERD Press Release dated 23-Mar-2020 BPRD Circular Letter 08, 2020 FD Circular No.01 of 2020	1. Continuous availability of ATMs would be ensured. 2. Detailed instructions for banks to clean, disinfect, seal and quarantine cash being collected from hospitals and clinics. 3. All critical functions and systems required to provide banking services would remain available. 4. Banks were allowed to maintain skeleton staff at premises and have work-from-home arrangements for other employees
Minimize the risk of COVID-19 spread due to biometric verifications and physical interactions	BPRD Circular Letter 10, 2020	Authorized Financial Institutions were advised to take measures related to, inter alia, biometric verification, monthly cash withdrawal and deposit limits, and daily transaction limit of branchless banking accounts

[7] For details, refer to SBP's Financial Stability Review 2019.

Regulations for Digital On-boarding of Merchants	BPRD Circular Letter No. 11 of 2020	Transaction limit for non-biometrically verified merchant accounts and maximum account balance of such merchant accounts was increased till Sep 30, 2020.
Facilitation regarding paper-based clearing operations help combat COVID-19	PSD Circular No. 04 of 2020	Banks/MFBs were allowed, inter alia, to provide: (1) Direct Cheque Deposit Facility; (2) Doorstep Cheque Collection Facility; (3) Drop box Cheque Collection Facility
Availability of SBP helpline and public warning against fraudsters calling for personal information citing COVID-19	ERD Press Release dated April 6, 2020	(1) If complainants do not get an appropriate response from banks, they may approach SBP helpline; (2) Bank employees /customers still having concerns may notify SBP by email; (3) The general public was again advised against fraudsters
To facilitate donations made to the governments' COVID-19 relief funds via payment cards	PSD Circular Letter No. 02 of 2020	All issuing and acquiring banks shall not charge any service fee (including Interchange Reimbursement Fee, Merchant Discount Rate, Merchant ID Fee), or any other fee that may be applicable on any transactions made to the Relief Fund
Uninterrupted supply of disinfected cash	FD Circular Letter 5 of 2020	Banks were allowed to use the quarantined cash which had completed quarantine period of 14 days.

* Please refer to circulars for full details.

Source: State Bank of Pakistan

3 Inflation and Monetary Policy

Anticipating potential disruptions due to COVID-19, SBP cut the policy rate by a cumulative 225 bps during Q3-FY20 and took a number of measures to support businesses and healthcare facilities. Also, inflation softened towards the end of the quarter, as its medium-term outlook improved further given a noticeable slowdown in domestic demand, stabilizing food inflation, and the pass-through of record-low global oil prices to domestic consumers. Meanwhile, panic-driven foreign selling in the domestic debt market and amortization of bilateral and multilateral loans increased government's reliance on commercial bank borrowing. Private sector too scaled up its borrowings from banks as containment measures affected firms' liquidity position.

3.1 Monetary Policy

While the supply-driven inflationary pressures of the second quarter intensified further in January 2020, the real challenge to the macro economy emerged towards the end of Q3-FY20. The domestic and global spread of COVID-19 began to unleash outsized disruptions to the economy, as containment measures brought production and retail activities to a near-halt. The ensuing uncertainties, layoffs and negligible work opportunities for daily wage earners led to a noticeable slowdown in domestic demand. Financial markets were not spared either, as heightened global risk aversion triggered outflow of foreign capital from the domestic debt market and also put significant selling pressure on the local bourses. Under these circumstances, the burden of government borrowings will fall disproportionately on the domestic banking system, as massive healthcare needs and social transfers begin to put additional burden on the fiscal bottom line.

These challenging economic and financial conditions warranted a preemptive and aggressive monetary policy strategy. In particular, it was important to lend some resilience to domestic demand in the face of the virus-led contraction. Furthermore, a careful management was needed to respond to possible cash flow pressures for businesses stemming from supply-chain disruptions, avoid growing defaults and financial system constraints. Accordingly, the SBP reduced the policy rate by a cumulative 225 basis points during the third quarter. In its prescheduled meeting on 17th March, the Monetary Policy Committee lowered the policy rate by 75 basis points, but due to fast changing economic conditions both domestically and globally, it met again in a week's time and cut the policy rate by

another 150 bps. [1]This off-schedule meeting and the decision highlighted – as was also spelled out clearly in the policy statement – that the MPC stands ready to take *whatever* measures it considers necessary in response to COVID-19 driven economic developments. Moreover, on the operations side, the MPC decided to make the interest rate corridor symmetric around the policy rate, in line with international best practices.

These decisions were supported by developments on the inflation front and a favorable medium-term price outlook. After plateauing in January 2020, overall inflation began to ease in the subsequent months, as perishables' prices responded positively to administrative supply-management measures. Even before the softening of food prices, the SBP had projected average headline inflation to fall in the target range of 5-7 percent over the medium term. These projections, premised on the transitory nature of supply shocks and contained inflation expectations, led the MPC to keep the policy rate unchanged in its January decision, despite consistently high inflation readings.

However, when the MPC met later in March 2020, it noted a qualitative improvement in the inflation forecast. Although the Committee noted temporary pressures on the exchange rate and escalated fiscal pressures in response to the COVID-19 shock, it gave more weight to the need to provide support to slowing economic activity. Furthermore, the overall inflation outlook appeared less of a concern in the context of a noticeable slowdown in domestic demand, softening food prices, and record-low global oil prices. Importantly also, the underlying trend in inflation appeared moderate as evident from relatively stable core inflation and a significant decline in inflation expectations. As a result of softening price pressures, the medium-term target range of 5-7 percent was now expected to be achieved somewhat earlier than previously forecast.

In addition to lowering the policy rate, the SBP also provided additional support to businesses by rolling out the Temporary Economic Refinancing Facility, which involved refinancing for bank lending for plant and machinery for new projects at a 7.0 percent fixed rate for 10 years. The SBP also announced a one-year extension in principal payments, doubled the period for rescheduling of loans from 90 to 180 days, and offered concessional financing to companies that do not lay off workers. All these measures are expected to alleviate cash flow pressures on local businesses as well as individual borrowers. The emergence of these pressures was already visible in the third quarter; the outstanding stock of non-

[1] This was followed by another 200 bps cut in mid-April 2020 and 100 bps each in May and June 2020, bringing the cumulative cut to date to 625 bps.

performing loans increased by 5.9 percent during the quarter taking the overall infection ratio to 9.1 percent at end March 2020, compared to 8.2 percent last year. Consequently, firms' reliance on banks to fulfill their liquidity needs remained on the higher side, especially exporters' who complained of cancellation of export orders post production and inventory build-up.

Table 3.1: Monetary Aggregates (provisional)
billion rupees

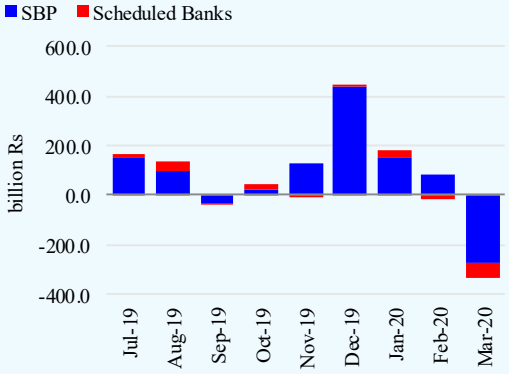
	Jul-Mar		Q3		Mar	
	FY19	**FY20**	**FY19**	**FY20**	**FY19**	**FY20**
M2 (a+b)	**812.9**	**1,520.0**	**235.6**	**602.7**	**327.6**	**639.4**
a. NFA	-613.7	797.1	67.4	-80.9	229.4	-329.9
b. NDA	1,426.6	722.9	168.2	683.6	98.2	969.3
Budgetary borrowings*	**828.8**	**966.5**	**178.2**	**779.8**	**-159.7**	**776.2**
SBP	3,444.9	-480.4	2,187.8	260.1	266.8	315.4
Scheduled banks	-2,616.1	1,446.9	-2,009.6	519.7	-426.5	460.7
Commodity operations	-166.1	-137.2	-80.7	-108.6	-25.6	-40.2
Private sector credit	**611.5**	**323.2**	**41.1**	**107.6**	**-4.4**	**73.2**
PSEs	310.2	3.5	165.1	5.8	194.3	12.3
Other items net	-160.4	-440.3	-135.1	-106.3	93.6	145.5

* These numbers are on accrual basis. They do not tally with the amount of bank financing on cash-basis, as presented in Table 4.1.
Data source: State Bank of Pakistan

3.2 Monetary Aggregates

The expansion in money supply (M2) more than doubled during Q3-FY20 over the same period last year (**Table 3.1**). On a cumulative basis, M2 expansion during Jul-Mar FY20 stood at Rs 1.5 trillion compared to Rs 812.9 billion last year. In contrast to the trend observed during the last two quarters, the expansion in Q3 mainly stemmed from a sharp increase in Net Domestic Assets (NDA), whereas Net Foreign Assets (NFA) posted a decline. Within NDA, the major increase came from the substantial growth in budgetary support from the banking system.

Figure 3.1: Monthly Change in Net Foreign Assets



Data source: State Bank of Pakistan

On the other hand, NFA fell by Rs 80.9 billion during Q3-

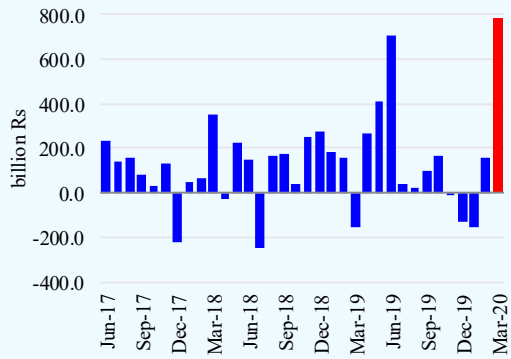
FY20 compared to an expansion of Rs 67.4 billion last year. However, monthly numbers show that NFA of the banking system continued to increase until February 2020, but posted a trend reversal in March (**Figure 3.1**).

This reversal primarily represented the drawdown in the SBP's foreign exchange reserves following the large outflow of foreign capital from the domestic debt market. Additional hit to the banking system's NFA came from the Pak Rupee's depreciation during the month, which increased the rupee value of the existing stock of foreign liabilities.

On the liability side, the cash penetration in the economy remained strong. The growth in currency was approximately twice the growth in deposits during the quarter. As a result, the currency-to-deposit ratio jumped from an already elevated level of 39.4 percent in December 2019 to 41.7 percent in March 2020.[2]

Budgetary Borrowings

Figure 3.2: Budgetary Borrowings from the Banking System



Data source: State Bank of Pakistan

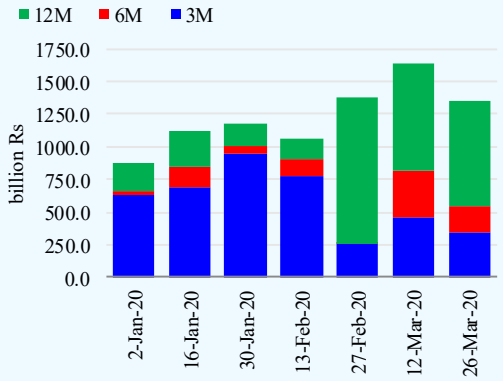
Despite a 23 percent lower fiscal deficit (in nominal terms) in Q3-FY20 compared to the same period last year, budgetary borrowings from the banking system rose sharply to Rs 779.8 billion in Q3-FY20 compared to only Rs 178.2 billion last year. These borrowings were largely concentrated in March, during which the government struggled with the COVID-led sharp slowdown in revenue mobilization as well as heavy financing burden (**Figure 3.2**). The latter stemmed from substantially large foreign selling pressure in the domestic debt market (equivalent to US$ 1.8 billion in March), as well as scheduled bilateral and multilateral repayments.[3]

The bulk of the budgetary requirements were financed by commercial banks,

[2] During March 1 to April 24, 2020, the currency-to-deposit ratio rose to an average of 42.8 percent. This was the highest increase in any eight-week period during the last 20 years.
[3] Of the total official loan amortization of US $1.4 billion in Q3-FY20, US$ 931 million was repaid in March 2020.

whereas the stock of borrowing from the SBP also increased by Rs 260.1 billion during Q3-FY20. This primarily reflected withdrawals from the government's cash buffers held with the SBP, as well as mark-up accruals. Importantly, the government adhered to its commitment of avoiding any fresh issuance of MRTBs from the central bank, in compliance with the SBP Act as well as the agreement with the IMF.

Figure 3.3: Bidding Pattern for T-bills



Data source: State Bank of Pakistan

As far as borrowings from commercial banks were concerned, these were mainly concentrated in T-bills, especially the 12-month paper in Q3. However, earlier in the quarter, the interbank market gave more weight to the rising inflation trend while bidding for government papers. Therefore, low expectations of a policy rate cut and an inverted yield curve resulted in the concentration of bids for 3-month T-bills (**Figure 3.3**). However, as sentiments shifted in favor of a rate cut in the March 2020 MPC meeting in response to February's soft inflation reading, fall in global oil prices, and weakening aggregate demand due to the intensifying COVID spread – the bidding pattern shifted in favor of 12-month paper.[4]

In overall terms, Rs 3,158.3 billion of T-bills were issued against the target of Rs 2,750.0 billion (**Table 3.2**). The short-term bond yields slid by 219 bps, 199 bps and 226 bps for 3-month, 6-month and 12-month T-bills respectively during the third quarter. Importantly, the cut-off rates remained broadly flat during the first five auctions of the quarter; it was

Table 3.2: T-bill Auction Summary during Q3-FY20

billion rupees

Tenor	Target	Maturity	Offered*	Accepted	
				Gross	*Net of Maturity*
3M	1,000.0	2,100.9	4,104.1	1,866.7	-234.2
6M	750.0	290.0	927.6	337.2	47.2
12M	1,000.0	0.0	3,566.9	954.3	954.3
Total	2,750.0	2,390.9	8,598.5	3,158.3	767.4

*competitive bids only

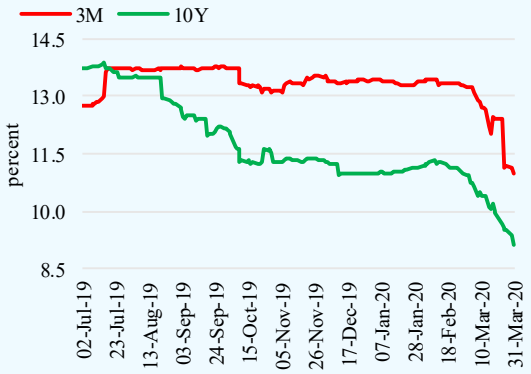
Data source: State Bank of Pakistan

[4] A number of central banks announced rate cuts in response to the coronavirus outbreak during February and early March, including Thailand, China, Indonesia, Australia, and the US, etc.

in the last two auctions when the rates fell sharply.

The demand pattern was similar in case of PIBs. In the last auction of the quarter, strong expectations of a rate cut resulted in a spike in demand for PIBs, and hence gave an opportunity to the government to recalibrate the yields downward. Interestingly, in an attempt to extend the maturity profile, the government also accepted the bid for a 20-year bond; it was back in January 2015 when this instrument was last issued. Meanwhile, the early signs of a flattening of the yield curve emerged in response to the 150 bps policy rate cut on March 24, when the short-term yields fell sharply compared to the long-term bond yields (**Figure 3.4**).

Figure 3.4: Secondary Market Yields

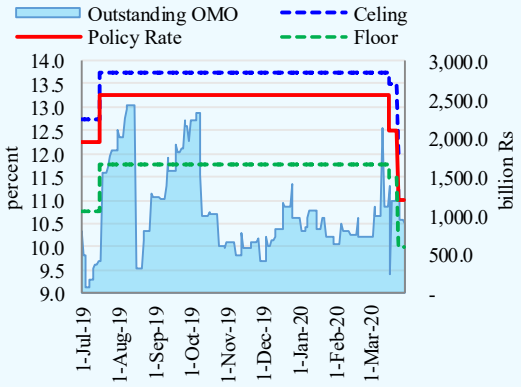


Data source: MUFAP

Interbank Liquidity

As in case of the primary market, the secondary market activity also witnessed some noteworthy developments during Q3-FY20. The quarter marked the end of the contractionary monetary policy stance that began in January 2018. At the same time, the MPC also announced aligning the interest rate corridor with international best practices by making it symmetrical around the policy rate (**Figure 3.5**).

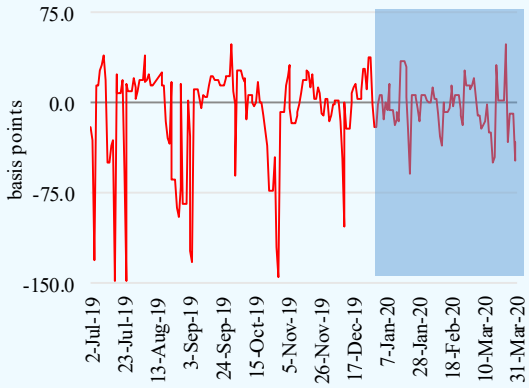
Figure 3.5: Interest Rate Corridor



Data source: State Bank of Pakistan

Encouragingly, the interbank market remained more stable during Q3-FY20 compared to the preceding two quarters of the ongoing fiscal year (**Figure 3.6**), though the monthly data shows that January and March were relatively more volatile than February.[5] In January, major liquidity pressures stemmed from a seasonal decline in deposits, which was partially offset by the SBP's foreign exchange purchases and retirements by the government and private sector. As a result, the average outstanding OMOs increased only slightly from Rs 845.8 billion in December 2019 to Rs 875.3 billion in January 2020. In February, the interbank market showed signs of stability, as the average outstanding OMOs fell to Rs 747.1 billion on the back of a recovery in deposit growth.

Figure 3.6: Deviation of O/N Rate from the Policy Rate



Data source: State Bank of Pakistan

In March 2020, the volatility in the interbank market increased again due to financing pressure faced by the government. Importantly, capital outflows from the domestic debt market during the month had a dual impact on bank liquidity: on the one hand, the outflows strained rupee liquidity as commercial banks scaled up their investments in government securities; on the other hand, the SBP's foreign exchange injections to stabilize the exchange rate put additional pressure on the rupee liquidity. To keep the overnight rates close to the policy rate, the SBP stepped up its OMO injections to Rs 1,057.7 billion.

3.3 Credit to Private Sector

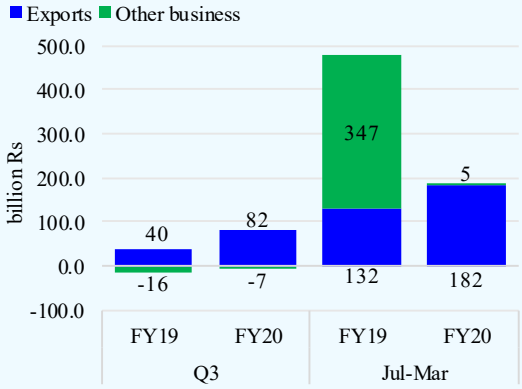
Loans to private businesses grew by Rs 187.3 billion during Jul-Mar FY20 – around one third of the Rs 554.7 billion increase recorded in the same period last year. However, the flow in Q3-FY20 was higher than the same period last year; as businesses aggressively took short-term loans to finance working capital needs. Importantly, a major part of the borrowing can be traced to industrial activity (e.g. textiles), which was consistent with the recovery in economy in the early part of

[5] The monthly average standard deviation of overnight rates in January, February and March amounted to 0.19 percent, 0.13 percent, and 0.21 percent respectively.

the quarter. But later on, the cash flows constraints also started to contribute towards the borrowing needs of businesses.

In particular, exporters complained of cancellation of export orders post production as advanced economies began to exercise containment measures. Therefore, almost the entire business sector borrowings during the quarter were concentrated in the export sector (**Figure 3.7**). In overall terms, the offtake of working capital loans by businesses stood at Rs 73.2 billion in March 2020, which was considerably large in comparison to Rs 55.5 billion in the preceding month, and net retirements of Rs 16.5 billion in March 2019.

Figure 3.7: Composition of Business Sector Loans

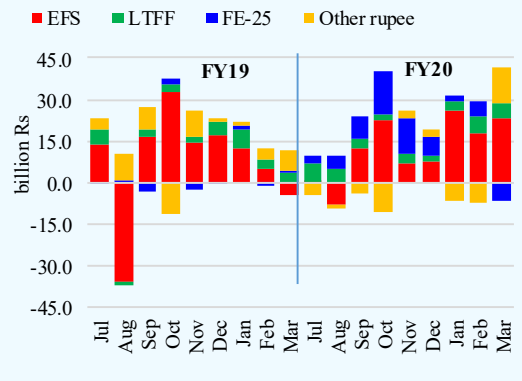


Data source: State Bank of Pakistan

Working capital loans to exporters increased further

Working capital loans posted net expansion of Rs 79.8 billion during Q3-FY20, much higher than the mere Rs 1.8 billion increase recorded during Q3-FY19. A noteworthy development within the working capital borrowings was a shift towards rupee-based borrowings by exporters during the quarter (**Figure 3.8**).

Figure 3.8: Composition of Export Loans (Monthly Flows)



Data source: State Bank of Pakistan

As noted in the Second Quarterly Report for FY20, exporters were more inclined towards foreign currency borrowings in the preceding quarter, especially those who were not eligible under SBP's refinancing scheme. Some supply-side constraints also contributed especially in case of those banks that had exhausted

most of the limit assigned for EFS. However, from January 2020 onwards, SBP enhanced the aggregate limit for the EFS by Rs 100 billion. Therefore, the overall borrowing under the EFS increased significantly during the quarter. Foreign currency borrowings, on the other hand, slowed down in January and February 2020 and posted net retirement during the month of March 2020 – the latter reflects the impact of pressures in the foreign exchange market.

Table 3.3: Loans to Private Sector Businesses Jul-Mar*

flow in billion rupees

	Total loans		Working capital**		Fixed investment	
	FY19	FY20	FY19	FY20	FY19	FY20
Private Sector Businesses	**554.7**	**187.3**	**471.5**	**192.5**	**83.1**	**-5.2**
Manufacturing	452.0	237.7	400.4	218.6	51.6	19.1
Textile	173.9	191.5	154.9	165.3	19.0	26.2
Readymade garments	5.7	26.8	5.6	22.8	0.1	4.0
Sugar	34.9	49.4	20.8	52.8	14.1	-3.4
Rice Processing	41.4	19.1	41.3	18.9	0.1	0.2
Motor vehicles	22.6	19.3	19.8	17	2.8	2.3
Cement, lime and plaster	33.4	20.6	12.6	26.5	20.8	-5.9
Basic iron and steel	10.6	0.5	11.8	-2.7	-1.2	3.3
Paper & paper products	1.1	-10.7	1.0	-7.7	0.1	-3.1
Refined petroleum	33.6	-10.6	39.3	-9.2	-5.7	-1.4
Vegetable and animal oil/fats	19.4	-15.5	22.6	-16.7	-3.2	1.2
Fertilizers	3.5	-18.3	9.9	-13.4	-6.4	-4.9
Power gen., transmission and dist.	59.7	48.0	10.4	43.6	49.4	4.4
Transportation and storage	3.5	12.2	6.3	19.1	-2.7	-6.9
Telecommunications	-8.1	8.2	5.6	-6.2	-13.8	14.4
Real estate activities	22.1	2.7	12.5	3.5	9.6	-0.8
Health	1.0	0.8	0.4	-0.8	0.6	1.6
Mining and quarrying	12.6	7.9	6.9	3.2	5.6	4.7
Agriculture	-9.7	-15.2	-0.5	-7.5	-9.2	-7.7
Construction	-11.8	-29.4	9.0	-19.8	-20.7	-9.6
Wholesale and retail trade	55.5	-45.4	44.3	-37.1	11.2	-8.3

* The sector-wise data for FY19 and FY20 may not be fully comparable, as the flows for Jul-Mar FY19 are based on ISIC 3.1 whereas the flows for Jul-Mar FY20 are based on ISIC 4.0 classification.

**includes trade financing

Data source: State Bank of Pakistan

The textile sector recorded higher borrowing in Jul-Mar FY20 compared to last year, and comprised around 75 percent of manufacturers' loan offtake (**Table 3.3**). Encouragingly, the sector's borrowing was mainly activity-driven, as quantum apparel exports reached a record high during Q3-FY20 and inflation in cotton

prices remained muted.[6] The sector benefited from the attractive rate of 3.0 percent on EFS, as more than half of the increase in working capital loans comprised of EFS loans during the quarter.

In the case of cement, some revival in construction activity was apparent as PSDP spending was higher during Q3-FY20 as compared to last year.[7] However, the financial position of most cement firms remained weak (evident from after-tax losses booked in the third quarter), as an overall economic slowdown did not allow them to pass on the impact of higher taxation and freight to end-consumers. As a result, the sector borrowed an additional Rs 13.7 billion during the quarter, taking the cumulative borrowing to Rs 20.6 billion in the Jul-Mar period. Similarly, the impact of COVID-19 related lockdowns seems to have amplified the already challenging environment for the petroleum refining sector. As the domestic demand for petroleum products plummeted in Q3-FY20 and OMCs were not picking products amid a lack of demand and to avoid inventory losses, refineries resorted to short-term bank borrowing to manage their cash crunch. Importantly, these businesses had retired loans in H1-FY20 to reduce their financing costs. However, as the fall in demand became severe during Q3-FY20, it led the sector to mobilize funds from banks once again. The sector borrowed Rs 5.1 billion in Q3-FY20, whereas it had retired Rs 14.3 billion in H1-FY20.

Among the non-manufacturing firms, the power sector's borrowing was noteworthy at Rs 43.6 billion during Jul-Mar FY20, compared to Rs 1.4 billion in the same period last year. Almost half of the increase in borrowing came in Q3-FY20, reflecting working capital requirements of coal-based power projects as well as other firms. Borrowings of coal-based power houses represented working capital needs as available data suggest that production from these plants significantly rose on YoY basis during Q3-FY20; quantum import of coal was higher in this period as well, which reflected the greater need for financing. In the case of other power producers, liquidity constraints apparently contributed to the short-term borrowing, as receivables soared during Q3-FY20 and the issuance of energy Sukuk II of Rs 200 billion got delayed.

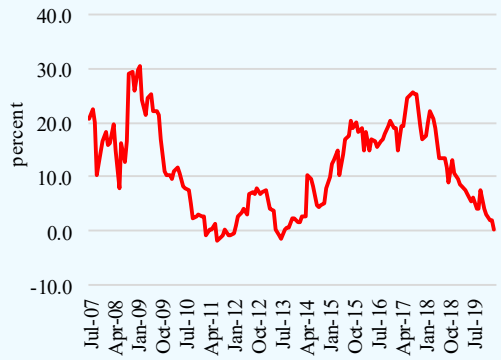
[6] Given that cotton prices recorded a modest inflation in domestic markets but declined in international markets on YoY basis, activity dominated the price effect for inputs. Domestic cotton prices rose only 3.4 percent and international prices were 9.7 percent lower on YoY basis during Q3-FY20.

[7] PSDP recorded 6.2 percent increase in Q3-FY20, compared to decline of 39.2 percent in the same period last year on YoY basis.

Fixed investment loans declined in the second consecutive quarter

Fixed investment loans declined for the second consecutive quarter; in fact, these loans recorded net retirement for the first time in any Jul-Mar period since FY07. It seems that the recent investment cycle in many sectors had peaked out during FY18, and now these businesses are retiring their long-term loans as per schedule (**Figure 3.9**).

Figure 3.9: YoY Change in Fixed Investment Loans to Private Sector



Data source: State Bank of Pakistan

Despite the above dynamics, a silver lining was the expansion in long-term loans taken out by manufacturing businesses; these loans increased by Rs 19.1 billion during Jul-Mar FY20, as sectors such as textile and power continued to invest on long-term plans. The development was also consistent with the import of textile and power machinery, which rose by 8.7 and 13.8 percent YoY, respectively, in rupee terms during Jul-Mar FY20. Textile's borrowing was actually higher than last year (**Table 3.3**).

In the case of textile, firms are taking a variety of capital expenditures, which include balancing and modernizing of existing plants and equipment, and expansions. The sector continued to capitalize on attractive borrowing rates on the SBP's long-term financing schemes, such as LTFF. The expansion in the sector's fixed investment loans were fully financed from the LTFF during Jul-Mar FY20. This suggests that the policy measure of extending the limit of LTTF by Rs 100 billion in January 2020 was quite helpful.

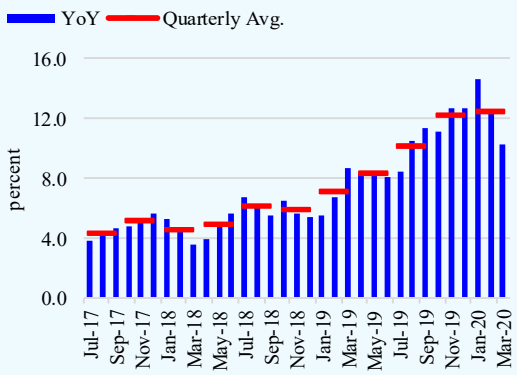
3.4 Inflation

After rising steeply for four consecutive quarters, the national CPI inflation was relatively stable during Q3-FY20. Rising slightly from 12.1 percent in the second quarter, the national CPI inflation clocked in at 12.4 percent during Q3-FY20 (**Figure 3.10**).

Notwithstanding the overall stability, the volatility in inflation across months rose considerably during the quarter. In January 2020, national CPI inflation touched

14.6 percent – the highest in any month since the availability of the index from July 2017. This level reflected a steep rise in food prices amid administrative weaknesses in the price control mechanism of essential items, such as wheat and sugar, as well as an increase in international prices of edible oil. Energy inflation also remained high due to fuel price adjustment in electricity prices during the month.

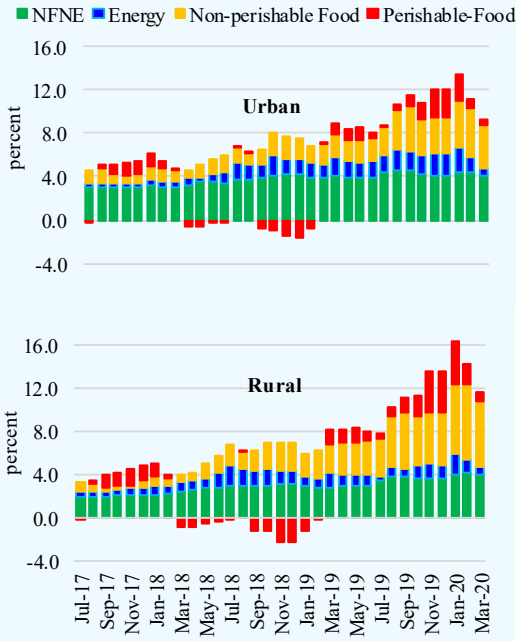
Figure 3.10: National CPI



Data source: Pakistan Bureau of Statistics

However, inflation softened in the subsequent months due to: (i) an effective crackdown on commodity hoarders, which led to improved supplies and an ease in non-perishables' prices; (ii) improved availability of important vegetables, which helped plug the demand-supply gap and softened prices; and (iii) the COVID-driven crash in the global crude oil market and the subsequent 6.2 percent drop in domestic fuel (petrol and diesel) index during March 2020. Energy inflation also softened from February onwards as an outcome of a delay in the fuel price adjustment (FPA) by the government. FPA was recorded zero for the months of February and March 2020, which resulted in a MoM decline in average cost of electricity for domestic consumers (**Figure 3.11**).

Figure 3.11: Composition of YoY CPI Inflation



Data source: Pakistan Bureau of Statistics

Finally, the underlying

inflationary pressures – as measured by the non-food-non-energy (NFNE) index – remained broadly stable during the quarter similar to the previous quarter. However, increase in a very few items (in January 2020) brought a small surge in the overall urban and rural NFNE in Q3-FY20.

Inflationary Pressure on Food Group Intensified in January

Contributed by both perishable and non-perishable items, food inflation surged during Q3-FY20. The impact of rural food prices was more pronounced with a 46.0 percent weight in the rural CPI basket compared to 36.8 percent weight in the urban CPI basket (**Figure 3.11**). However, it is important to note that after peaking out in January 2020, food inflation softened appreciably.

Non-perishable food items steered food inflation

In terms of contribution, the dominant push to non-perishable inflation came from

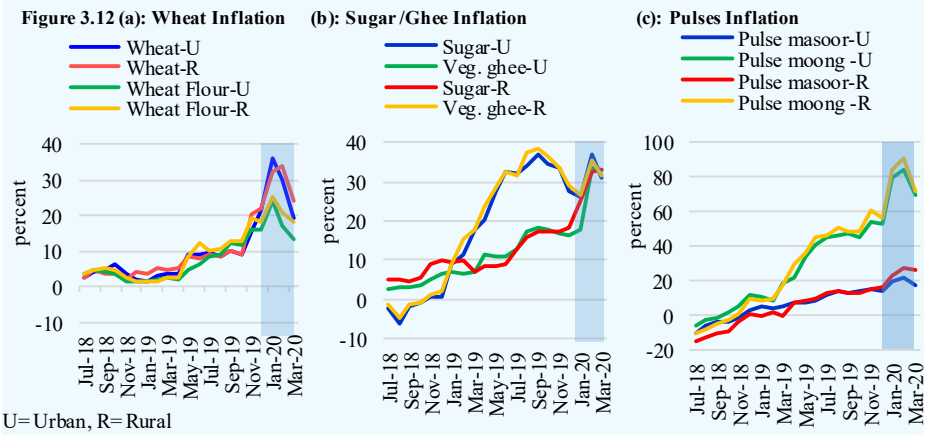
Table 3.4: Average CPI Inflation and Contribution

Items	Urban						Rural					
	Wt.*	Jul-Mar		Q3			Wt.*	Jul-Mar		Q3		
		FY19	FY20	FY19	FY20	Cont.*		FY19	FY20	FY19	FY20	Cont.*
CPI	100.0	6.7	11.1	7.4	11.3	11.3	100.0	5.7	12.2	6.3	14.0	14.0
Food & non-alcoh. bev.	30.4	2.9	15.7	5.7	17.3	5.0	40.9	2.7	17.2	5.0	20.5	8.1
Wheat	0.6	3.5	17.9	2.8	28.4	0.2	3.5	3.8	19.0	4.5	30.1	0.9
Wheat flour	3.0	2.8	14.3	1.9	18.3	0.5	3.4	3.1	16.5	1.8	21.3	0.6
Potato	0.4	-21.6	53.8	-19.4	92.4	0.3	0.7	-26.3	56.4	-23.2	113.1	0.6
Onions	0.6	-38.8	108.1	-27.3	104.9	0.4	0.9	-42.1	111.7	-31.5	109.3	0.6
Tomatoes	0.3	6.3	20.7	159.4	-30.9	-0.2	0.5	8.5	27.5	135.9	-19.1	-0.2
Fresh vegetables	1.5	-2.5	35.6	3.9	52.8	0.7	2.1	-3.7	39.4	-0.1	60.1	1.1
Sugar	1.1	2.9	32.5	12.6	31.3	0.3	2.0	4.0	33.1	14.2	31.0	0.5
Veg.ghee	1.0	5.0	20.5	6.9	28.0	0.3	2.4	7.3	21.1	8.9	30.2	0.7
Pulse moong	0.2	4.9	58.7	12.4	77.3	0.1	0.3	1.8	62.4	12.0	81.7	0.1
Clothing and ft.wear	8.0	5.4	9.1	6.2	9.5	0.8	9.5	7.7	9.8	7.0	11.1	1.1
Cotton cloth	2.2	5.5	12.9	6.4	12.7	0.3	2.8	10.5	12.4	10.3	14.7	0.5
Housing, Elec., Gas	27.0	8.3	8.2	9.2	7.2	2.0	18.5	8.1	5.3	7.3	6.8	1.3
Electricity charges	4.6	12.1	3.3	16.9	-1.9	-0.1	3.4	12.1	3.3	16.9	-1.9	-0.1
Gas charges	1.1	25.8	70.7	38.6	54.8	0.7	n.a	n.a	n.a	n.a	n.a	n.a
Health	2.3	6.1	11.4	5.9	11.8	0.3	3.5	6.5	12.2	6.9	12.4	0.5
Transport	6.1	16.6	17.2	11.5	17.1	1.1	5.6	14.8	15.0	9.7	15.1	0.9
Motor fuel	2.9	21.1	20.8	9.4	22.9	0.7	2.5	20.7	20.8	8.6	23.1	0.6
Communication	2.4	2.2	5.3	2.4	5.2	0.1	2.0	1.9	1.8	1.3	1.6	0.0
Restaurants and hotels	7.4	5.7	5.8	5.2	7.3	0.4	6.2	5.3	8.6	4.6	10.0	0.6

*wt. = weight and Cont.= Contribution for Q3
Data source: Pakistan Bureau of Statistics

wheat and wheat flour. Wheat inflation has been edging up consistently since April 2019, and prices of related items were following suit (**Table 3.4**). However, wheat prices rose by an exceptional 12.6 percent MoM in January 2020, which turned out to be the major contributor towards the acceleration in food inflation (**Figure 3.12a**). This crisis-like increase in prices from Q2-FY20 onwards stemmed from the following factors:

Despite low wheat production in the country compared to previous years and low carryover stocks with the procurement agencies, none of the procuring agencies met their procurement target for FY19.



U= Urban, R= Rural
Data source: PBS

Official export of wheat and wheat products (*maida, suji,* etc.) was not banned 11th September 2019 and 29th November 2019, respectively.[8] Although the magnitude of exports was too low to make an impact, this created speculative pressures in the market.

Amid low stocks with procurement agencies, poultry feed mills were allowed to purchase huge quantities of wheat from the private sector, further creating supply-demand disequilibrium in the market.

The situation in January 2020 deteriorated further due to transportation disruptions following a 15-day strike by goods' transporters against the hefty rise in penalties on traffic rule violations on highways and motorways. Moreover, these constraints

[8] S.R.O 1044(I)/2019 and S.R.O 1481(I)/2019, Ministry of Commerce and Textiles, Commerce Division.

were also reflected in the bullish price outlook in the wholesale and retail markets, which encouraged hoarding of the commodity. Therefore, when these disruptions subsided, wheat prices began to ease in the market.[9] Importantly also, the government's decision to allow the import of wheat from February onwards, led to a significant drop in wheat prices. In February and March 2020, wheat prices declined by 3.5 and 8.4 percent on MoM basis, respectively.

The story in the sugar sector was not different either. While the surge in sugar prices in the initial months of the year stemmed from the end of concessional sales tax regime for the commodity, a sharper increase (5.1 percent MoM) was observed in January 2020 during the goods' transporters strike. In contrast to wheat, however, sugar prices continued to increase even after the strike ended. This increase primarily reflected expected low production of the commodity and the absence of a reliable stock position, which had activated speculative elements in the sugar market. Prices increased further in the month of February (8.4 percent MoM and 36.9 percent YoY), pushing the government to announce a ban on exports and allow the import of the commodity. In March 2020, sugar prices stabilized and dropped by 0.5 percent on MoM basis.

Inflation in edible oil remained in double digits during Q3-FY20. This increase was attributed to a sharp rise in international edible oil prices. Specifically, palm oil prices rose by 15.1 percent in Jul-Mar FY20, and by 25.6 percent in Q3-FY20, whereas soybean oil prices rose by 4.6 percent in Jul-Mar FY20, and 2.0 percent in Q3-FY20. Furthermore, the imposition of FED also put upward pressure on domestic cooking oil and ghee prices during the year.

The pulses price index rose by 33.7 percent in Q3-FY20 compared to 5.3 percent last year. Since the data on domestic production is not available, an analysis of demand-supply gap is not possible for the commodity; only the import data is available, which shows around 68 percent YoY increase in quantity imported during the quarter, as well as around 15.7 percent increase in unit prices of imports.[10] The international market for pulses had remained under pressure throughout Q3-FY20 due to wildfires in Australia (among top-3 global exporters) that severely damaged the red lentils crop, and drought-like situations in Thailand and Burma. The impact of international prices was further intensified when Australian prices rose on account of increased demand from India – one of the world's largest consumers as well as producers of pulses – which escalated its

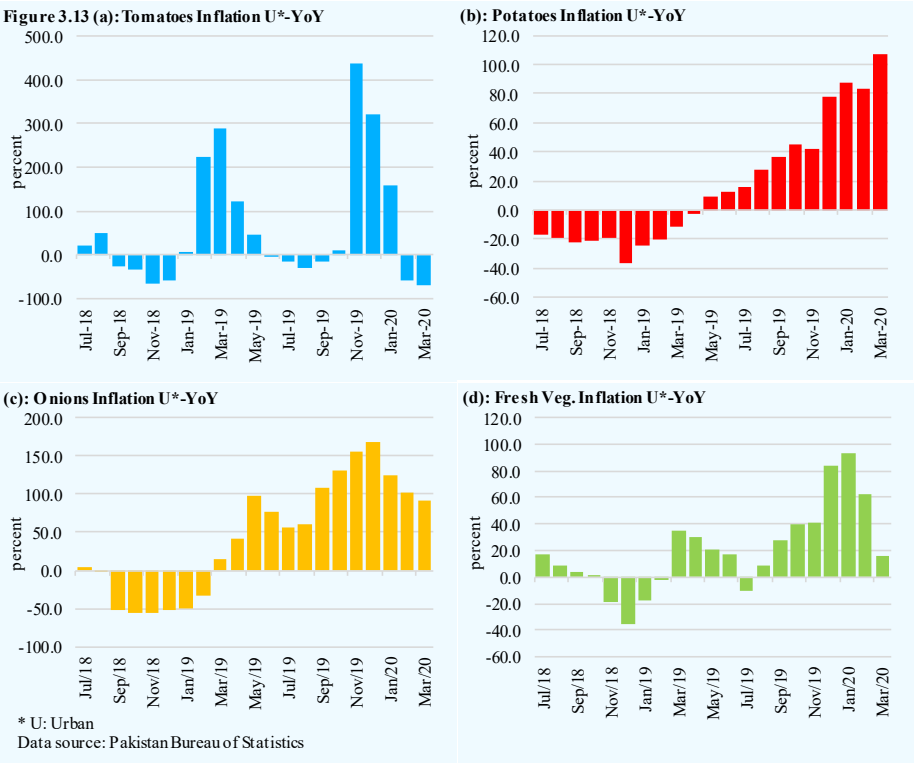
[9] In the third and fourth week of January 2020, wheat flour prices declined by 1.3 percent and 1.8 percent on a week-on-week basis, respectively

[10] Pakistan (which is among the top 10 importers of pulses in the world) imported around 356,400 MT pulses in Q3-FY20 compared to 212,000 MT in Q3-FY19.

purchases to build up its food security in response to COVID-related uncertainties.

Inflation in perishable items decelerated

Inflation in perishables, though higher compared to same period last year, declined in Q3 as compared to Q2-FY20. Deflation in tomatoes amid imports from Iran as well as arrival of the domestic harvest in the market eased the overall inflationary pressures on this group (**Figure 3.13)**.



However, inflation in potato prices in Q3 remained significantly higher compared to both same period last year and previous quarter of the current year. Similarly, onions also registered inflation of 104.9 percent during Q3-FY20 on YoY basis, as compared to deflation of 27.3 percent last year. This year, local growers were getting relatively good prices from international buyers as supplies of a few critical perishable items (onions and potatoes) remained disrupted in regional countries (India and Bangladesh); therefore, Pakistan exported more than it

usually does, creating a shortage in the local market despite a good harvest.[11]

In case of onions, the export ban announced by India (a major exporter in the region) was a major development in Q2-FY20. This created an opportunity for Pakistani traders to scale up onion supplies in the international market. This, together with the delayed crop arrival from Balochistan and restricted trade with India, caused a steep rise in domestic onion prices. The ECC, on the recommendation of the MNFSR, banned onion exports in March 2020 till 31st May to contain the pressure on domestic prices.

Core Inflation Rose Marginally

NFNE inflation, where stability was observed in Q2-FY20, posted an upward trend during Q3-FY20 in both urban and rural areas (**Figure 3.14**). House rent (with 19.26 weight) and marriage hall charges (with 1.75 weight) accelerated the NFNE inflation in urban areas in Q3-FY20, whereas house rent, clothing and miscellaneous goods and services caused rural inflation to surge during the quarter.

Other than these items, the overall NFNE index remained more or less unchanged during Q3-FY20, but recorded a moderate increase on a YoY basis. As documented in the First and Second Quarterly Reports for FY20, this increase was attributed to a rise in transport cost (on account of increase in motor fuel prices

Figure 3.14 (a): Composition of NFNE Inflation-Urban

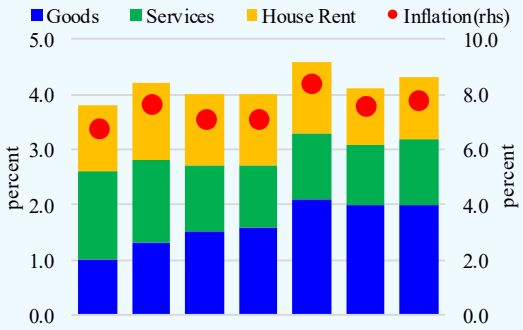
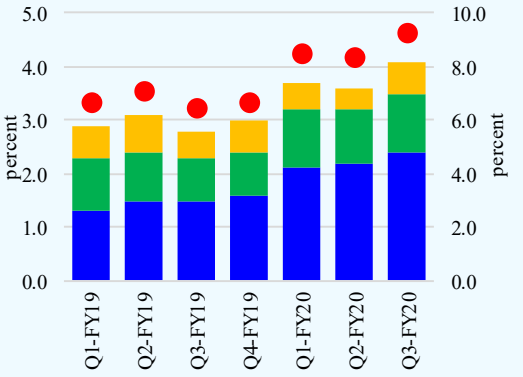


Figure 3.14(b): Composition of NFNE Inflation-Rural

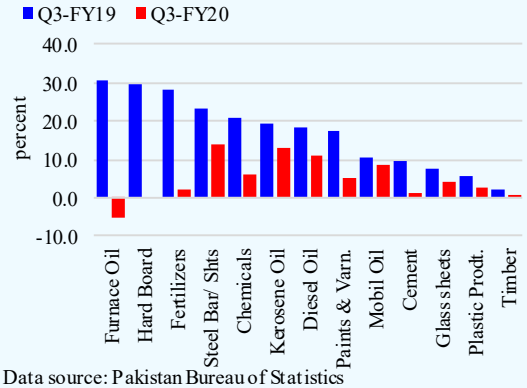


Data source: Pakistan Bureau of Statistics

[11] For a detailed analysis, see SBP Staff Note No 02/2020 "Price Stabilization Mechanism in Pakistan's Food Market: Exploring Issues and Potential Challenges".

and the axle load management), and revenue-enhancing measures taken in the budget 2019-20, including the elimination of zero-rating status of textiles and other export-oriented industries, increase of FED on cement, and the change in duty structure for the steel sector.

Figure 3.15: Declining Cost Push Pressures (Inflation in Key WPI Items)



Data source: Pakistan Bureau of Statistics

The overall moderation in prices of most items not only represented the impact of macroeconomic stabilization efforts, but also a considerable alleviation in cost push pressures in the economy. Notably, with the stability in global fuel prices along with the appreciation of the Pak rupee against the US dollar in H1-FY20, domestic prices of key raw materials stabilized in recent months. The wholesale price index (WPI), after plateauing in October 2018, recorded 22-month low inflation, on YoY basis, in March 2020. Disaggregated analysis suggests that the impact of declining raw material prices was visible on many items within the NFNE as well. The most evident impact could be observed in businesses' fuel costs. This was an outcome of a decline in global commodity prices, particularly fuel prices, on account of growth slowdown in major economies and government's decision to allow the pass-through of the falling oil prices to domestic consumers. However, a number of industries, including automobiles, construction and electronic appliances, experienced a slight increase in domestic prices of steel bars and sheets, cement and other important inputs (**Figure 3.15**).

Energy Inflation Registered Moderation

Stability in the administered prices of motor fuel, natural gas, electricity and CNG (indicative) remained instrumental in curtailing inflationary pressures in the energy group during Q3-FY20. However, the substantial ease in the overall energy inflation was observed on account of a decline in electricity inflation.

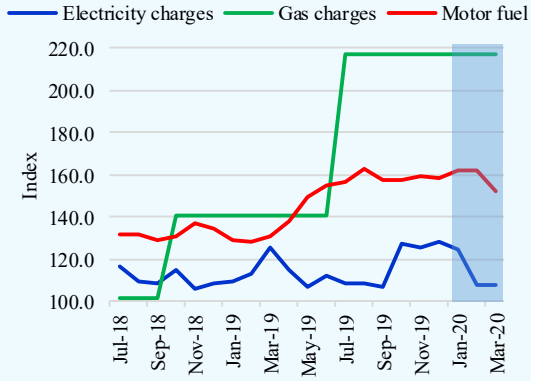
This decline primarily represented the postponement of fuel price adjustments (FPA) for November 2019 (and onwards), which was expected to be applicable in February 2020. However, Nepra deferred the decision following the

government's plan to freeze the electricity tariff for the next six months. This decision also considered the request of the Central Power Purchasing Authority (CPPA) to introduce changes in the FPA mechanism. Thus in the absence of the FPA component in February 2020 (and also in March), the average cost of electricity posted a MoM decline.

It is important to note here that electricity prices have been inching up since FY19 in an attempt to rein in the growing circular debt by withdrawing the provision of subsidized power supply and passing on the impact of increased capacity payments, T&D losses, low recoveries and net hydel profits to end-consumers. A similar adjustment is also needed in the natural gas sector; but the government has delayed this decision to manage cost-push inflationary pressures in the economy.

In the case of motor fuels and gas charges, a higher inflation during Q3-FY20 represents 1.9 percent increase in motor fuel prices in the month of January 2020 on MoM basis. In addition, YoY increase also reflects previous petroleum price hikes (in July, September and November 2019) during the year. However, as mentioned earlier, motor fuel index dropped by 6.2 percent in March 2020 on MoM basis following the slump in global crude oil prices (**Figure 3.16**).

Figure 3.16: Energy Indices-Urban



Data source: Pakistan Bureau of Statistics

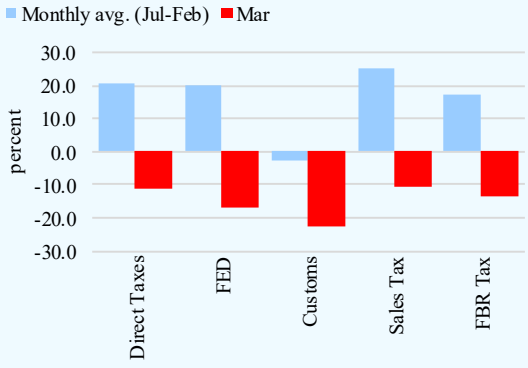
4 Fiscal Policy and Public Debt

The overall fiscal position during Jul-Mar FY20 showed considerable improvement over the corresponding period of last year. Fiscal deficit declined to 4.0 percent from 5.1 percent; while revenue deficit contracted, primary balance recorded a surplus. The improvement is primarily attributed to a strong growth in non-tax revenues and higher tax rates, along with curbs on expenditures in Q1. Within expenditures, current spending recorded a marginal deceleration while spending on social fronts notably increased in Q2 and Q3. However, the arrival of COVID-19 pandemic towards the end of Q3 has challenged an otherwise encouraging trend in Pakistan's fiscal accounts. While remaining largely within the contours of IMF agreed fiscal targets, primary surplus seen in the first two quarters transformed into a deficit in Q3; fiscal and revenue deficits also deteriorated. In March 2020, all categories of FBR taxes recorded a negative growth and PSDP releases shrank. In effect, the pressures on public finances are quite significant both because of the contraction in economic activity and additional spending requirements especially on health and cash transfers. As for the financing of the budget deficit is concerned, the burden fell on both domestic and external sources. Resultantly, public debt increased during the period under review; however, pace of debt accumulation was slower as compared to last year due to lower financing needs.

4.1 Revenues

Before COVID-19 pandemic, the growth in tax revenues was on track during Jul-Feb FY20 with expectations of meeting the revised FBR tax revenue target. However, as the COVID-19 pandemic worsened in the world and started to interrupt the normal functioning of the economy by mid-March 2020 in Pakistan, FBR tax collection deteriorated sharply on account of the large shock to activity, thus disrupting the pace of revenue

Figure 4.1: Growth (YoY) in FBR Taxes (FY20)



Data source: Federal Board of Revenue

growth by the end of Q3 **(Figure 4.1)**.[1] The impact was more pronounced as bulk of tax collection is concentrated at quarter and year ends. Yet, the cumulative growth in revenues during Jul-Mar FY20, both in tax and non-tax revenue remained in double digit.

Table 4.1: FBR Tax Collection during Jul-Mar
billion rupees, growth in percent

	Budget FY20*	Collection			Growth		
		FY18	FY19	FY20	FY18	FY19	FY20
Direct taxes	2,081.9	1,001.4	993.2	1,142.3	12.2	-0.8	15.0
Indirect taxes	3,473.0	1,626.4	1,709.1	1,918.2	18.9	5.1	12.2
Customs duty	1,000.5	428.4	506.5	481.5	24.8	18.2	-4.9
Sales tax	2,107.7	1,053.7	1,039.7	1,250.2	17.4	-1.3	20.2
FED	364.8	144.3	162.9	186.5	13.5	12.9	14.4
Total taxes	**5,555.0**	**2,627.8**	**2,702.4**	**3,060.5**	**16.2**	**2.8**	**13.3**

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

FBR Taxes

Overall FBR tax collection reached Rs 3,060.5 billion during Jul-Mar FY20, a growth of 13.3 percent compared to 2.8 percent growth in the same period last year **(Table 4.1)**. It is important to note that the steps taken in Q1-FY20 remains the main drivers in FBR revenue growth. Accordingly, main impetus came from higher sales tax rates on various POL products, abolishment of zero-rating regime for export-oriented sectors, upward revision of income tax rates on various salary slabs, re-enactment of WHT on telecom services, and higher FED rates. Relatively higher inflation during Jul-Mar FY20 may also have contributed to revenue growth. Moreover, import-related taxes, constituting more than 40 percent FBR taxes, continued to remain under stress due to the declining trend in imports.[2]

Direct Taxes

Direct taxes that constitute one-third of the overall FBR taxes, rose by 15.0 percent in Jul-Mar FY20 in contrast to a decline of 0.8 percent in the corresponding period last year. Breakup of direct taxes shows that collection from withholding taxes (WHT) had the largest contribution. Within this

[1]The growth in FBR taxes declined sharply by 13.2 percent (YoY) in March 2020.
[2] The FBR tax collection target for FY20 has been revised further down from Rs. 4803.0 billion to Rs 3,908.0 billion to incorporate COVID-19 impact.

category, taxes on salaries, bank interest and securities, and telephone together contributed 13.0 percentage points to the overall growth in direct taxes **(Table 4.2)**.

Tax measures such as upward revision in tax rates on various salary slabs, increase in tax rates on profit on debt, and the re-enactment of WHT on mobile phone top-ups helped in higher collection in these categories. With the abolishment of advance tax on banking transaction for filers in Finance Supplementary (Second Amendment) Bill, 2019, the collection from cash withdrawal declined by 52.5 percent during Jul-Mar FY20 as compared to a rise of 7.8 percent in the review period. The import compression suppressed the WHT on imports that declined by 7.9 percent in Jul-Mar FY20 compared to growth of 5.3 percent.[3]

Collection from contracts grew by 5.5 percent during Jul-Mar FY20 in contrast to a decline of 15.3 percent in the corresponding period last year. This is largely due to higher PSDP releases during the period under review.

Table 4.2: Major Revenue Drivers of Direct Taxes - Jul-Mar
billion rupees; growth in percent

	FY18	FY19	FY20	Growth	
				FY19	FY20
Withholding taxes	**749.7**	**684.5**	**827.2**	**-8.7**	**20.8**
Imports	159.8	168.2	155.0	5.3	-7.9
Salaries	95.2	53.5	89.7	-43.8	67.6
Dividends	38.7	33.6	38.5	-13.2	14.4
Bank interest & securities	34.5	43.7	100.8	26.8	130.4
Contracts	194.6	164.9	173.9	-15.3	5.5
Exports	20.2	24.2	29.7	19.8	22.5
Cash withdrawal	24.8	26.8	12.7	7.8	-52.5
Electricity bills	23.3	26.7	35.8	14.9	33.8
Telephone	38.0	5.3	41.3	-86.1	680.8
Collection on demand	**68.4**	**74.4**	**41.5**	**8.8**	**-44.3**
Voluntary payments	**240.0**	**308.6**	**324.7**	**28.6**	**5.2**
Miscellaneous	4.0	-14.8	2.5	-470.7	-116.7
Gross income tax	1,062.1	1,052.7	1,195.9	-0.9	13.6
Net direct tax	**1,001.4**	**993.2**	**1142.3**	**-0.8**	**15.0**

Data source: Federal Board of Revenue

Table 4.3: Major Revenue Spinners of Sales Tax during Jul-Mar
billion rupees; growth in percent

	FY19	FY20	Growth
Sales tax	**1,039.7**	**1,250.2**	**20.2**
POL	193.9	209.0	7.8
Electrical energy (DISCOS)	37.6	73.9	96.6
Textile sector	5.9	54.1	812.3
Sugar	16.9	26.8	58.9
Iron and steel	14.5	13.0	-10.2
Plastics	4.4	4.6	4.7
Photosensitive semiconductor devices	4.9	4.0	-19.5
Indirect taxes	**1,709.1**	**1,918.2**	**12.2**

Data source: Federal Board of Revenue

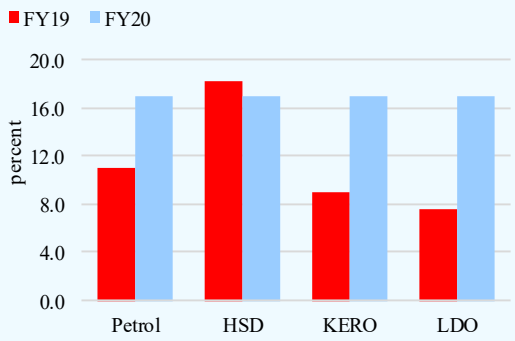
[3] Overall imports in value terms declined by 14.4 percent during Jul-Mar compared to a decline of 8.1 percent in same period last year.

Indirect Taxes

Indirect taxes grew by 12.2 percent during Jul-Mar FY20 against a subdued growth of 5.1 percent in the corresponding period last year **(Table 4.3)**.[4] The rise in collection of indirect taxes is primarily due to upward revision of sales tax rate and federal excise duty.

Within indirect taxes, sales tax grew by 20.2 percent during Jul-Mar FY20 in contrast to a decline of 1.3 percent during the review period of last year. This rise in sales tax was mainly derived from the collection on POL and Electrical energy (DISCOS) **(Figure 4.2)**. Having the second largest share in sales tax, the collection from electrical energy surged to Rs 73.9 billion in Jul-Mar FY20 against Rs 37.6 billion in the same period last year. This rise is explained by the upward price adjustments in power tariffs.[5] Lastly, taxes from textile sector recorded an exponential increase on account of the abolishment of zero-rating regime for export-oriented sector. Collection from textile sector increased by Rs 48.2 billion to Rs 54.1 billion during Jul-Mar FY20 against Rs 5.9billion in the same period of last year. Meanwhile, an upward revision in sales tax rates on sugar also contributed to higher revenue collection.[6]

Figure 4.2: Sales Tax Rates on POL in Jul-Mar*



*Effective tax rates are calculated on the basis of weighted average formula
Data source: Federal Board of Revenue and SBP calculations

[4] However, the growth would have been even higher if we take out the sharp decline of 14.6 percent in March 2020.
[5] Now variable charges are collected, i.e. on peak (Rs 20.7 per unit) and off peak (Rs 14.4 per unit) instead of previously consumption slabs-based tariff.
Source: https://nepra.org.pk/tariff/Tariff/KESC/2019/SRO%20575%20I%202019%2022-05-2019.PDF
[6] Sales tax collection from sugar increased to Rs 26.8 billion in Jul-Mar FY20 against Rs 16.9 billion during Jul-Mar FY19.

Collection from FED grew by 14.4 percent in Jul-Mar FY20 compared with 12.9 percent growth in Jul-Mar FY19.[7] The rise in FED collection was explained by an upward revision in FED rates.[8] Cement and beverages together contributed almost 9 percentage points to the overall growth in FED during the review period.

Table 4.4: Major Revenue Spinners of Excise and Custom Duties in Jul-Mar
billion rupees; growth in percent

	FY19	FY20	Growth
Custom Duty	**506.5**	**481.5**	**-4.9**
Mineral fuel, oil, and products.	59.2	68.1	15.0
Vehicles	66.1	43.6	-34.0
Iron and steel	35.5	35.1	-1.0
Other	345.7	334.6	-3.2
FED	**162.9**	**186.5**	**14.4**
Cement	42.6	53.3	25.0
Cigarettes & Tobacco	58.2	58.2	0.0
Concentrate/ aerated Water/beverage	13.7	18.6	35.1
Indirect tax	**1709.1**	**1918.2**	**12.2**

Data source: Federal Board of Revenue

Having a share of around 25 percent in indirect taxes, collection from custom duty declined by 4.9 percent in Jul-Mar FY20, compared to 18.2 percent growth in the corresponding period of last year **(Table 4.4)**.[9] With the exception of POL and photosensitive semiconductor devices, the collection from other major heads of custom duty declined during Jul-Mar FY20, mainly in collection from vehicles.

Non-tax Revenues

Non-tax revenues rose significantly by Rs 673.9 billion during Jul-Mar FY20, compared to a decline of Rs 84.6 billion in the corresponding period last year **(Table 4.5)**. The rise is largely attributed to higher SBP profits and revenues received through GSM license renewal fee. The renewal fee of GSM license was realized in Q1 and Q2 of FY20. SBP profits

Table 4.5: Non-tax Revenues during Jul-Mar (consolidated)
billion rupees

			Abs. change	
	FY19	FY20	FY19	FY20
SBP profits	138.2	635.5	-5.0	497.3
Profits (post office/PTA)	16.2	113.2	7.3	97.0
Mark-up (PSEs & others)	14.4	70.0	-7.3	55.7
Royalties on gas & oil	61.8	65.6	19.4	3.8
Dividends	32.2	26.6	-1.4	-5.6
Passport & other fees	16.3	16.3	4.4	0.0
Defense	10.7	10.8	1.4	0.1
Discount retained (crude oil)	10.4	10.5	3.9	0.1
Others	121.4	147.0	-107.4	25.6
Total	**421.6**	**1,095.6**	**-84.6**	**673.9**

Data source: Ministry of Finance

[7] The growth in FED collection during Jul-Mar FY20 is higher than the 5-year average of the same period.
[8]The FED rate for beverages was increased to 13.0 percent from 11.5 percent. While FED on cigarettes and cement was increased by Rs 700 per 1000 sticks and Rs 0.5 per kg, respectively.
[9]Overall, the import related collection constitutes more than 40 percent share in the overall FBR taxes.

increased by Rs 497.3 billion compared to a decline of Rs 5.0 billion during the same period of last year. This sharp increase in profits is largely attributed to higher interest rates, and revaluation gains.

Table 4.6: Analysis of Fiscal Spending
billion rupees; growth in percent

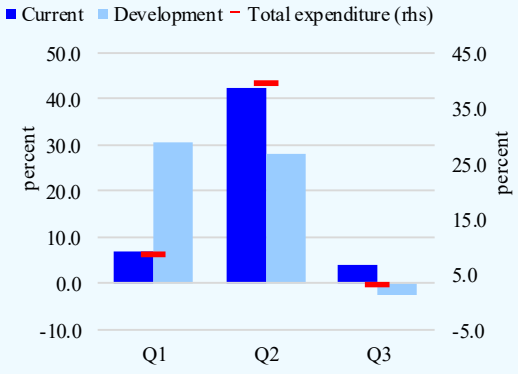
	Jul-Mar		Abs. change		Growth	
	FY19	**FY20**	**FY19**	**FY20**	**FY19**	**FY20**
Current expenditures	**4,798.4**	**5,611.6**	**722.9**	**813.2**	**17.7**	**16.9**
Federal	3,180.9	3,887.7	527.6	706.8	19.9	22.2
of which						
Interest payments	1,459.2	1879.7	286.3	420.5	24.4	28.8
Domestic	1,276.8	1645.6	205.4	368.9	19.2	28.9
Foreign	182.4	234.1	81.0	51.6	79.8	28.3
Grants	227.1	363.1	-6.5	136.0	-2.8	59.9
Defense	774.7	802.4	150.9	27.7	24.2	3.6
Public order and safety	106.1	111.2	12.2	5.1	12.9	4.8
Others	840.9	1,094.3	311.8	253.5	58.9	30.1
Provincial	1,617.4	1723.9	195.3	106.4	13.7	6.6
Development expenditures	**655.9**	**751.7**	**-337.4**	**95.9**	**-34.0**	**14.6**
PSDP	578.5	722.5	-352.9	144.0	-37.9	24.9
Federal	302.4	340.5	-51.1	38.0	-14.5	12.6
Provincial	276.0	382.0	-301.8	106.0	-52.2	38.4
Others	77.4	29.2	15.5	-48.2	25.0	-62.2
Net lending	**28.3**	**29.7**	19.1	**1.4**	**208.0**	**4.9**
Total expenditure*	**5,482.5**	**6,393.0**	**404.6**	**910.5**	**8.0**	**16.6**

* Excluding Statistical discrepancy
Data Source: Ministry of Finance

4.2 Expenditures

Total expenditures grew by 16.6 percent during Jul-Mar FY20 as compared to 8.0 percent during the same period last year. A broad-based increase in current and development expenditure at both federal and provincial fronts, contributed to this growth **(Table 4.6)**.

Figure 4.3: YoY Growth of Fiscal Spending during FY20



Data source: Ministry of Finance

However, the quarter-wise analysis reveals that the total expenditure actually decelerated in Q3-FY20 after a sharp growth reported in the second quarter. Moreover, the development expenditure declined along with the slowdown in current expenditure in Q3-FY20 **(Figure 4.3)**.

Major contribution in current spending came from the interest payments (mainly on the back of domestic debt) and the government's concern to support social spending (*Ehsaas* Program). Towards the end of Q3-FY20, the COVID-19 pandemic necessitated the need for fiscal stimulus package and accordingly the government announced one **(Table 4.7)**.

Table 4.7: Government's Stimulus Package amid COVID-19
(billion rupees)

Emergency measures	**190**
Emergency funds	100
Tax relief on food and health items	15
Incentive for workers/ medical equipment	50
National Disaster Management Authority (NDMA)	25
Support to business and economy	**480**
Relief to SMEs and Agriculture	100
Relief to Exporters	100
Payment to farmers (wheat)	280
Relief to citizens	**570**
Relief to poor and *Panahgahs*	150
Funding to Utility stores	50
Power and gas subsidy/payment deferrals	100
Support to daily wage workers	200
Relief to petrol/diesel	70
Total funding	**1,240**

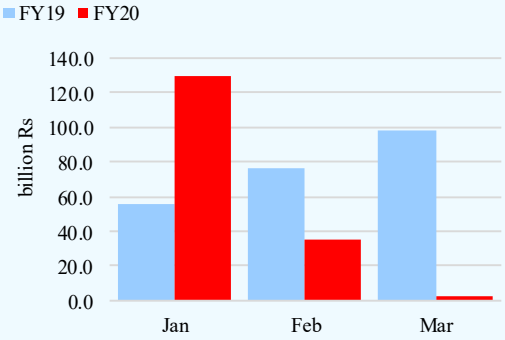
Data source: Ministry of Finance

The dynamics of interest payments and grants for social spending were noteworthy in Q3-FY20. On one side, the interest payments grew by only 2.7 percent in Q3-FY20 as compared to 38.2 percent during Q3-FY19. On the other side, the grants with a continued increasing trend for the last two quarters, further grew significantly by 25.9 percent in Q3-FY20 against a decline of 5.4 percent in the corresponding period of last year.

Despite a relatively higher growth in development expenditures during Jul-Mar FY20 than the corresponding period of last year, Q3-FY20 witnessed a YoY decline, which can be explained by a decline in federal PSDP spending during the quarter. In contrast, provincial PSDP grew sharply by 50.2 percent in Q3-FY20.

The preferences for PSDP remained towards infrastructure (National Highway Authority), water resources division, security enhancement, programs for special areas (AJK and Gilgit Baltistan), and merged areas 10-year development program[10]. About 60 percent of the budgeted target was spent on PSDP during Jul-Mar FY20 which was below the cumulative 80 percent target of the three quarters of FY20.[11] This is evident from a decline of federal PSDP in Q3-FY20, which slowed down the pace of development expenditures during Jul-Mar FY20. Although already on a decline, PSDP releases fell sharply in March 2020 that may also be on account of disruptions caused by COVID-19 pandemic **(Figure 4.4)**.

Figure 4.4: Federal PSDP Releases in Q3



Data source: Ministry of Planning, Development, and Reform

Table 4.8: Provincial Fiscal Operations during Jul-Mar
billion rupees and percent growth

	Total		Growth	
	FY19	**FY20**	**FY19**	**FY20**
A. Total revenue	2,198.3	2,467.4	1.5	12.2
Provincial share in federal revenue	1,779.1	1,931.6	7.9	8.6
Provincial revenue (I+II)	353.0	400.8	-13.2	13.5
I. Taxes	287.7	321.2	2.8	11.6
II. Non-tax revenue	65.3	79.6	-48.4	21.9
Fed loans and transfers	66.1	134.9	-40.3	104.0
B. Total expenditure	1,906.0	2,123.8	-5.2	11.4
Current**	1,630.0	1,741.8	13.8	6.9
Development	276.0	382.0	-52.2	38.4
Gap (A-B)	292.3	343.1	87.5	17.4
Financing* (overall balance)	**-291.6**	**-394.1**	**52.6**	**35.2**

*Negative sign in financing means surplus. ** Current expenditure data may not match with those given in Table 4.6 as numbers reported here includes the markup payments to federal government.
Data source: Ministry of Finance

[10] This program is for the FATA which was merged with KP under the 25th amendment of the constitution.
[11] Revised Release Strategy for Funds Allocated for the Public Sector Development Program (PSDP) 2019-20

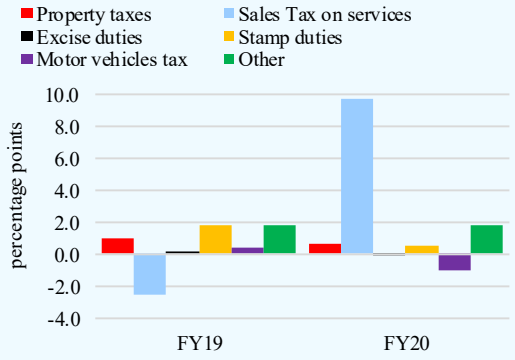
4.3 Provincial Fiscal Operations

Provinces remained committed to the fiscal consolidation and posted a surplus of Rs 394.1 billion during Jul-Mar FY20 which covers around 93 percent of the target envisaged in the budget **(Table 4.8)**. Specifically, Punjab contributed Rs 122.6 billion followed by Rs 106.3 billion, Rs 90.0 billion and Rs 75.2 billion from Balochistan, Sindh and KP respectively.

Total provincial revenue grew by 12.2 percent during Jul-Mar FY20 as compared to 1.5 percent in the corresponding period last year. About 83.8 percent of this came from provincial share (as per NFC award) and *federal loans and transfers*. The remaining 16.2 percent constituted the provincial own revenue collection, which grew by 13.5 percent during Jul-Mar FY20 as compared to a decline of 13.2 percent recorded in last year.

Both tax and non-tax sources contributed to provincial own revenue collection. Provincial tax collection grew sharply during Jul-Mar FY20 compared to last year **(Table 4.8)**. Moreover, the dynamics in provincial tax sources were noteworthy. General sales tax on services (GSTS) continued to be a major revenue spinner that rose by 19.7 percent during Jul-Mar FY20 against a decline in the same period last year.[12]

Figure 4.5: Major Contributors to Provincial Tax Collection during Jul-Mar



Data source: Ministry of Finance and SBP calculations

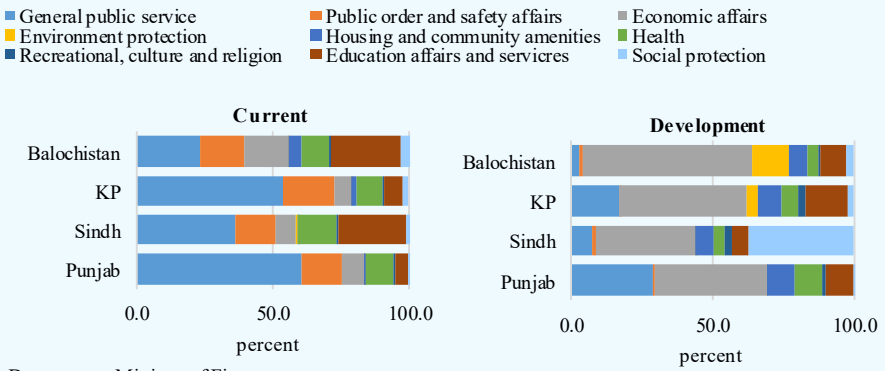
In contrast, motor vehicle tax and excise duties declined during Jul-Mar FY20 against a growth witnessed in last corresponding period **(Figure 4.5)**. This stemmed from a lower growth in the production of cars and motorcycles amid the effects of demand management policies and that was further aggravated due to COVID-19 in the country. Since GSTS and stamp duties are the prominent spinners of the provincial taxes, their growth augmented the provincial own revenue collection during Jul-Mar FY20. Provincial non-tax revenue also surged

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

mainly on the back of profits from hydroelectricity - KP (Rs 15.6 billion) and Punjab (Rs 6.5 billion) contributed the most.

The total provincial expenditures grew by 11.4 percent during Jul-Mar FY20 against a decline of 5.2 percent in the same period last year. However, provincial current expenditure decelerated during the review period compared to last year. The province-wise breakup shows that Punjab recorded Rs 848.9 billion, Sindh recorded Rs 486.9 billion, KP recorded Rs 254.2 billion, and Balochistan recorded Rs 151.7 billion under current expenditures during the review period. A sharp growth was seen in provincial development spending which has been highest during Jul-Mar since FY16.

Figure 4.6: Provincial Expenditures during Jul-Mar FY20



Data source: Ministry of Finance

The disaggregated analysis shows that the provincial current spending priorities continued to remain towards general public services[13] followed by public order and health. A major portion of development spending was allocated to economic affairs, primarily construction and transport, agriculture and food related spending. **Figure 4.6** elucidates the provincial preferences in the current and development expenditure during Jul-Mar FY20.

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

4.4 Public Debt

Overall lower financing needs helped in containing the pace of public debt accumulation during Jul-Mar FY20 **(Table 4.9)**.[14] Gross public debt increased by Rs 2.5 trillion during the period under review compared to a rise of Rs 3.7 trillion in the corresponding period last year (**Table 4.10**). Two-third of the rise in public debt originated from domestic sources, while the rise in government external debt (in Rupee terms) remained much lower compared to same period last year.

Table 4.9: Sources of Change in Public Debt (Jul-Mar)
trillion rupees

	FY19	FY20
Total change in public debt	**3.7**	**2.5**
Key sources		
1. Deficit financing	1.9	1.7
2. Change in govt. deposits	0.3	0.6
3. Impact of exchange rate movements*	1.3	0.2
4. Others	0.2	-

* Impact of exchange rate movements include the movement of international currencies against the US$ and the movement of PKR against the US$.
Data sources: Ministry of Finance and State Bank of Pakistan

In absolute terms, government external debt (in Rupee terms) increased by Rs 0.6 trillion during Jul-Mar FY20 compared to a rise of Rs 1.8 trillion in the corresponding period last year.[15] Unlike last year when most of the increase in government external debt was due to depreciation of PKR against the US dollar, a

Table 4.10: Pakistan's Public Debt Profile
billion rupees

	Stock		Flow				
			Jul-Mar		FY20		
	Jun-19	Mar-20	FY19	FY20	Q1	Q2	Q3
Gross public debt (1 to 3)	**32,707.9**	**35,207.0**	**3,654.6**	**2,499.2**	**1,532.8**	**-529.0**	**1,495.4**
1. Govt. domestic debt	20,731.8	22,477.7	1,754.3	1,745.9	1,918.1	-973.5	801.3
2. Govt. external debt	11,055.1	11,658.1	1,829.9	602.9	-457.1	395.0	665.1
3. Debt from the IMF	921.0	1,071.3	70.4	150.3	71.7	49.5	29.0
Total debt of government*	29,520.7	31,452.4	3,344.2	1,931.7	-220.6	669.2	1,483.1
Govt. deposits	3,187.2	3,754.6	310.4	567.5	1,753.4	-1,198.2	12.2

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

[14] Compared to a fiscal deficit of Rs 1.9 trillion during Jul-Mar FY19, the country recorded a fiscal deficit of Rs 1.7 trillion in Jul-Mar FY20. PKR (last day average exchange rate) depreciated by 2.0 percent against the US$ during Jul-Mar FY20 compared to a depreciation of 13.6 percent during the same period last year.
[15] This does not include debt from the IMF.

relatively stable PKR contained revaluation losses during Jul-Mar FY20.[16] It is important to note that movement in the international currencies (in which debt is contracted) and PKR vis-à-vis US$ can change the dollar and PKR value of external debt respectively (for details – see Box 4.1 Second Quarterly Report FY18).[17]

Table 4.11: Absolute Change in Government Domestic Debt
billion rupees

	FY19	FY20	FY20		
	Jul-Mar		Q1	Q2	Q3
Government domestic debt	**1,754.3**	**1,745.9**	**1,918.1**	**-973.5**	**801.3**
Permanent debt	143.6	1,164.3	754.1	327.9	82.3
of which					
PIBs	182.9	1,321.3	906.4	333.4	81.5
Prize bond	97.2	-157.0	-152.3	-5.5	0.8
Floating debt	1,381.5	270.8	1,028.2	-1,429.6	672.2
of which					
MTBs	-2,265.1	555.8	1,028.2	-1,144.6	672.2
MRTBs	3,646.6	-285.0	0.0	-285.0	0.0
Unfunded debt	228.3	310.6	136.0	128.3	46.3
Memorandum Items:					
Internal financing	1,398.0	1,003.8	119.5	361.6	522.7
Govt. deposits	310.4	567.5	1,753.4	-1,198.0	12.2

Data source: State Bank of Pakistan

Domestic Debt

As financing needs of the government remained relatively lower in Jul-Mar FY20, the pace of domestic debt accumulation decelerated during the period. It grew by 8.4 percent during Jul-Mar FY20 compared to a growth of 10.7 percent in the same period last year. Furthermore, the maturity profile of domestic debt improved as almost two-third of the increase in domestic debt during the period was contributed by permanent debt (long-term).[18] This is opposite to last year, in which the government mainly relied on floating debt (short-term) to meet its financing needs (**Table 4.11**).

Quarterly break-up of government domestic debt illustrates that major increase occurred in the first quarter. Apart from deficit financing, the government created cash buffers by further accumulating its deposits with the banking system in Q1, subsequently the government used these cash buffers in the second quarter for debt repayments and deficit financing. However, the pace of domestic debt accumulation accelerated again in Q3 mainly due to higher deficit financing – net

[16]In dollar terms, government external debt stood at US$ 70.0 billion (excluding IMF debt) as of end March 2020, registering a growth of 3.3 percent over June 2019. In Rupee terms, however, the external debt increased by 5.5 percent during the same period. The difference in growth primarily reflects the impact of PKR depreciation during Jul-Mar FY20. The difference in growth was much higher during Jul-Mar FY19 - in dollar terms, government external debt increased by 6.7 percent while in Rupee terms, external debt increased by 23.5 percent.

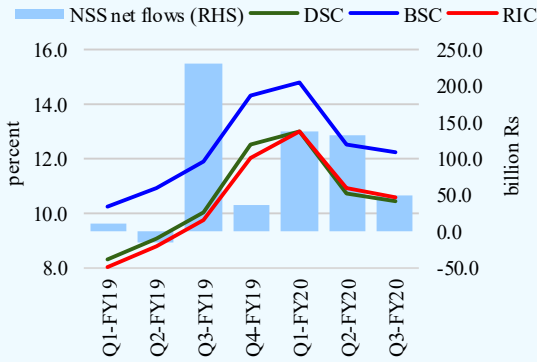
[17]http://www.sbp.org.pk/reports/quarterly/fy18/Second/Chap-4.pdf

[18] On 29th June 2019, government converted the stock of more than Rs7 trillion MRTBs held by SBP into PIBs.

internal financing increased by Rs 522.7 billion in Q3 compared to an increase of Rs 119.5 and Rs 361.6 billion in Q1 and Q2 respectively **(Table 4.11)**.

Importantly, the government continued to adhere to its commitment of zero fresh borrowing from the central bank for financing needs during the period under review and relied on non-banks and commercial banks for fund mobilization during Jul-Mar FY20. Both were largely interested in long-term government securities in the first two quarters of FY20 (**Table 4.12**). This is evident by the offered to target ratio, which increased from 1.3 in Q1-FY20 to 3.1 in Q3-FY20 (competitive bids). The offered to target ratio for PIBs (both fixed and floating) decreased from 3.9 in Q1-FY20 to 2.6 in Q3-FY20 (**for details, see Chapter 3**).

Figure 4.7: Profit Rates and Net Inflows in NSS Instruments



Data source: Central Directorate of National Savings

Table 4.12: Institution and Instrument-wise Details of Domestic Debt - Absolute Changes

billion rupees

	Q1-FY20	Q2-FY20	Q3-FY20
Through Scheduled Banks			
Long-term securities	751.6	232.9	29.2
Short-term (T-bills)	880.1	-984.1	544.2
Through Non-Banks			
Long-term securities	157.7	100.5	52.3
Short-term (T-bills)	148.1	-160.5	128.0
NSS (net of prize bonds)	-16.3	122.8	47.1
Through State Bank of Pakistan	0.0	-285.0	0.0

Data source: State Bank of Pakistan

The net flows in National Savings Schemes (NSS) recorded marginal improvement in Jul-Mar FY20 compared to the same period last year. However, quarterly analysis indicates that net flows decelerated in Q3-FY20. This was expected due to downward revision in the profit rates on most of the saving schemes (**Figure 4.7**).

Public External Debt

The pace of accumulation of Pakistan's public external debt & liabilities decelerated during Jul-Mar FY20 – an increase of US$ 2.4 billion compared to a sharp rise of US$ 8.9 billion in the same period last year (**Table 4.13**). One-half of the increase stemmed from foreign investment in local government securities while the remaining expansion in government external debt was sourced through disbursements from multilateral donors and IMF.

Table 4.13: Public External Debt & Liabilities
billion US dollars

	Stocks		Flows				
			Jul-Mar		FY20		
	Jun-19	Mar-20	FY19	FY20	Q1	Q2	Q3
Public external debt & liabilities (1+2+3)	83.9	86.4	8.9	2.4	0.6	3.1	-1.3
Public external debt (1+2)	73.4	76.5	3.9	3.0	0.7	3.6	-1.2
1.Government debt	67.8	70.1	4.3	2.3	0.0	3.2	-0.9
of which							
Paris club	11.2	10.8	-0.4	-0.5	-0.2	-0.2	-0.1
Multilateral	27.8	28.9	-0.7	1.1	0.3	1.3	-0.5
Other bilateral	12.7	13.4	3.8	0.7	0.1	0.4	0.1
Euro/*Sukuk* bonds	6.3	5.3	0.0	-1.0	0.0	-1	0
Commercial loans	8.5	9.0	2.1	0.5	-0.5	1.3	-0.3
Local currency securities	0.0	1.3	0.0	1.3	0.3	1.2	-0.2
2.IMF	5.6	6.4	-0.3	0.8	0.7	0.4	-0.3
3.Foreign exchange liabilities	10.5	9.9	4.9	-0.6	-0.1	-0.4	-0.1

Data source: State Bank of Pakistan

Revaluation gains contributed positively in controlling public external debt

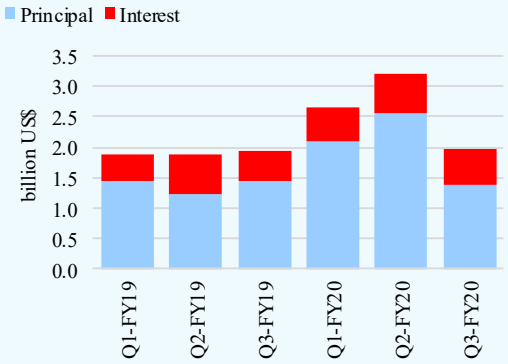
Revaluation gains of US$ 0.7 billion during Jul-Mar FY20 helped in containing the increase in public external debt. Around 94 percent of the revaluation gains is attributed to depreciation of SDR, Euro, Japanese Yen and Chinese Yuan against the US dollar. Quarter-wise breakup reveals that most of the revaluation gains were attained in the first and third quarters.

Debt servicing decelerated in Q3

The servicing of public external debt increased by US$ 2.1 billion during Jul-Mar FY20. Within principal component, *Sukuk* (US$ 1.0 billion in Q2), bilateral and commercial loan repayments recorded a significant increase. Interest payments also increased to US$ 1.8 billion in Jul-Mar FY20, slightly higher than US$ 1.6 billion during the same period last year. This was mainly driven by higher

payments on bilateral and commercial loans. Quarterly analysis indicates that after a sharp rise in the first two quarters, public debt servicing decelerated in Q3-FY20 **(Figure 4.8)**. It is important to note that during Q1 and Q2, one-off scheduled payments against central bank liabilities in Q1 and *Sukuk* in Q2 kept debt servicing on higher side.

Figure 4.8: Servicing of Public External Debt



Data source: State Bank of Pakistan

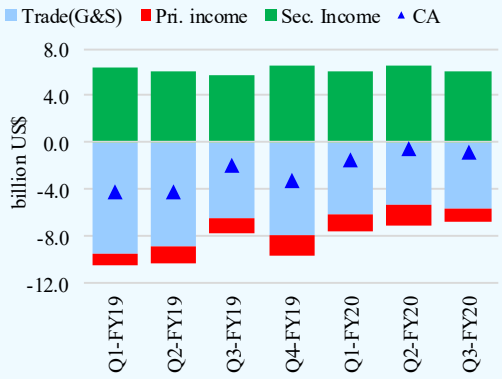
5 External Sector

Improvement in Pakistan's external account continued in Jul-Mar FY20, mainly on the back of contraction in imports. While demand for non-energy imports was already subdued, energy imports declined substantially due to COVID-19 related weakness in global oil prices and lower domestic demand in Q3. Export values were also suppressed due to weak terms of trade, despite the country exporting a significantly higher quantum in the period. Nonetheless, the lower trade deficit, together with a decent growth in workers' remittances (specifically from the US and the GCC), and a significant reduction in the services deficit, lowered the Jul-Mar FY20 current account deficit to a quarter of last year's level. Thus, this reduction in current account deficit, along with realization of significant multilateral financial inflows and some improvement in investments helped strengthen SBP's FX reserves to a 24-month high of US$ 12.8 billion by end-February 2020. However, in March 2020, COVID-19 related uncertainty crept into global financial markets and, as in other emerging markets, foreign investors started offloading their holding of local debt securities. As a result, Pak Rupee depreciated by 7.5 percent in this month and large repayments of official external debt led to a fall in SBP's FX reserves by US$ 1.9 billion. Both of these falls were lower than in many other emerging markets, reflecting Pakistan's improved fundamentals and prudent policy response to COVID-19.

5.1 Current Account

During Jul-Mar FY20, the current account deficit was recorded at US$ 2.8 billion, falling by US$ 7.5 billion from the same period last year (**Table 5.1**). This outcome was largely due to a drop in import payments, as exports receipts stagnated at last year's level, and a decent increase was noted in remittances. However, increased outflow from the primary income exerted some pressure on the current account, amid both higher profit repatriation and interest payments (**Figure 5.1**).

Figure 5.1: Breakdown of Current Account Balance



Data source: State Bank of Pakistan

Table 5.1: Pakistan's Balance of Payments
billion US dollars

	Q3			Jul-Mar		
	FY19	**FY20[P]**	**Abs change**	**FY19**	**FY20[P]**	**Abs change**
Current account balance	-2.0	-0.7	1.2	-10.3	-2.8	7.5
Trade balance	-5.6	-4.9	0.7	-21.3	-14.7	6.6
Exports	6.2	5.9	-0.3	18.1	18.3	0.2
Imports	11.8	10.8	-1.0	39.3	32.9	-6.4
Energy	*2.8*	*2.4*	*-0.4*	*10.8*	*7.7*	*-3.1*
Non-Energy	*9.1*	*8.4*	*-0.6*	*28.5*	*25.2*	*-3.3*
Services balance	-0.9	-0.8	0.1	-3.5	-2.4	1.0
Primary income balance	-1.2	-1.1	0.1	-3.7	-4.3	-0.5
Interest payments	*0.6*	*0.8*	*0.2*	*1.7*	*2.3*	*0.6*
Profit Repatriation	*0.3*	*0.2*	*-0.1*	*1.0*	*1.0*	*0.0*
Secondary income balance	5.7	6.1	0.4	18.2	18.6	0.4
Workers' remittances	*5.0*	*5.6*	*0.6*	*16.0*	*17.0*	*1.0*
Capital account balance	**0.0**	**0.0**	**0.0**	**0.2**	**0.2**	**0.1**
Financial account balance	**-5.4**	**-0.3**	**5.0**	**-11.4**	**-5.9**	**5.4**
Direct investment in Pakistan	0.4	0.8	0.4	0.9	2.1	1.2
Portfolio investment in Pakistan	0.0	-0.2	-0.3	-0.4	0.2	0.6
Other investment	-5.0	0.2	5.2	-10.7	-3.5	7.2
Net incurrence of liabilities	5.3	-0.2	-5.6	10.6	3.6	-7.0
General government	2.2	-0.5	-2.7	4.0	3.7	-0.3
Private sector (excl. banks)	0.0	0.1	0.1	1.1	0.5	-0.5
Banks	0.1	0.1	0.1	0.6	-0.2	-0.7
SBP's liquid reserves (end-period)				**10.5**	**10.8**	**0.4**
Total liquid reserves (end-period)				**17.4**	**17.1**	**-0.3**
PKR app(+) /dep(-) against US$ (in %)	-1.4	-7.1	-	-13.7	-4.0	-

[P] Provisional
Data source: State Bank of Pakistan

Workers' remittances

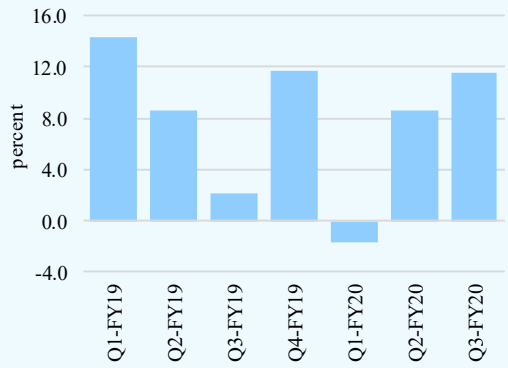
Workers' remittances rose by 6.0 percent YoY to US$ 17.0 billion in Jul-March FY20. This growth was marginally lower than the 8.3 percent growth recorded in the same period of last year.

The rise in workers' remittances this year was broad-based. Particularly, inflows from the USA and the GCC countries exceeded US$ 400 million from last year. Among the GCC countries, inflows from the UAE and Saudi Arabia continued to rise due to a surge in emigration of low-skilled labor in the recent past to mostly

work on infrastructure projects.[1] In case of the USA, the remmitances growth reflects tight labor market and rising wages in the country.[2]

Specifically, in the third quarter, the remittances grew by an impressive 11.6 percent (**Figure 5.2**).[3] This growth was in sharp contrast to only 2.0 percent increase seen in the same period of last year **(Table 5.2)**. Particularly, remittances went up by 9.3 percent in the month of March 2020, as the prevailing uncertainty regarding the COVID-19 pandemic may have brought forward some of the inflows. It is worth highlighting that the impact of COVID-19 is yet to be reflected in remittance inflows, as a number of host countries are facing lockdowns and the layoff of immigrant workers may get worse with spike in confirmed cases by end-March 2020.

Figure 5.2: YoY Growth in Workers' Remittances



Data source: State Bank of Pakistan

Table 5.2: Workers' Remittances to Pakistan
(million US dollars)

	Q3		Jul-Mar		
	FY19	**FY20**	**FY19**	**FY20**	**Change**
Total	**5,043.0**	**5,627.0**	**16,030.9**	**16,991.6**	**960.7**
GCC	2,730.2	3,047.8	8,701.9	9,104.4	402.5
S. Arabia	1,179.8	1,307.7	3,747.3	3,925.7	178.4
UAE	1,063.8	1,202.9	3,412.2	3,552.2	140.0
Other GCC	486.6	537.3	1,542.4	1,626.5	84.1
USA	756.0	1,021.5	2,446.4	2,880.4	434.0
UK	829.2	801.1	2,476.2	2,554.1	77.9
EU	124.9	135.4	437.7	474.7	37.0
Others	602.87	621.1	1,968.7	1,978.0	9.3

Data source: State Bank of Pakistan

However, with the unfolding of the COVID-19 pandemic since then, the slowdown in global economic activity amid slumping market sentiments has contributed to a sizable drop in global oil prices, leading to a double dent to the economies of oil exporting countries, especially the

[1]According to the Bureau of Emigration and Overseas Employment, nearly 70 percent of the workers registered for employment fell under the category of labourer and drivers during 2019. Moreover, around 87 percent of the overall number of workers who emigrated abroad for work, went to the UAE and KSA during 2019.
[2] Unemployment rate in the US lowered to 3.8 percent in Q3, leading to higher wage earnings.
[3] Growth in Q3 propelled cumulative growth to 6 percent in Jul-Mar from 3.4 percent in Jul-Dec.

GCC. As a result, layoffs in the Gulf economies may have implications for Pakistan's future remittance inflows, as the GCC is one of the largest remittance corridors for Pakistan.

5.2 Financial Account

While the improvement in the current account reduced the country's external financing need, the situation in the financial account in Q3-FY20 became unsteady. Foreign exchange inflows via FDI rebounded as the work on CPEC-related projects gained traction. On the other hand, foreign portfolio investors, while investing in the local currency government securities till mid-Q3, started liquidating these holdings by the end of the quarter in the wake of uncertainty created by the COVID-19 pandemic for the global economy. This reversal in portfolio investment created some outflow pressure on the financial account. In overall terms, in Jul-Mar FY20, the financial account received US$ 5.9 billion inflows; almost half of the US$ 11.4 billion recorded in the same period of last year; however, these inflows in financial account were more than sufficient to finance the current account deficit.

Foreign direct investment

The growth in foreign direct investment in H1-FY20, carried its momentum into Q3-FY20 as well, as the country received US$ 791 million in the quarter compared to US$ 404 million in the same period last year. As a result, net FDI inflows in Jul-Mar FY20 increased to US$ 2.1 billion, up from 0.9 billion in this period of FY19 (**Table 5.3**).

Table 5.3: Sector-wise Net Foreign Direct Investment
million US dollars

	Q3		Jul-Mar	
	FY19	**FY20**	**FY19**	**FY20**
Power	31.7	495	-353.1	757.4
Financial business	45.4	48.4	247.6	210.5
Exploration & prod.	110.5	76.7	267.8	218.3
Electrical machinery	1.9	25.5	126.6	143.4
Transport equipment (Automobiles)	29.9	7.3	84.3	51.8
Telecommunications	-20.1	45.1	-157.4	464.8
Others	224.5	92.7	689.3	302.2
Total	**404.0**	**791.0**	**905.1**	**2,148.0**
of which				
China	100.0	476.0	22.4	872
Non-China	304.0	315.0	882.7	1,276

Data source: State Bank of Pakistan

FDI inflows from China witnessed a rebound, specifically in Q3, as the country continued to invest in CPEC projects even though its own economy was reeling under the COVID-19 pandemic. Sector-wise disaggregation suggests that the dynamics of FDI inflows has changed as the year progressed. The power sector was the key driver behind Q3-FY20 inflows, as the sector alone attracted

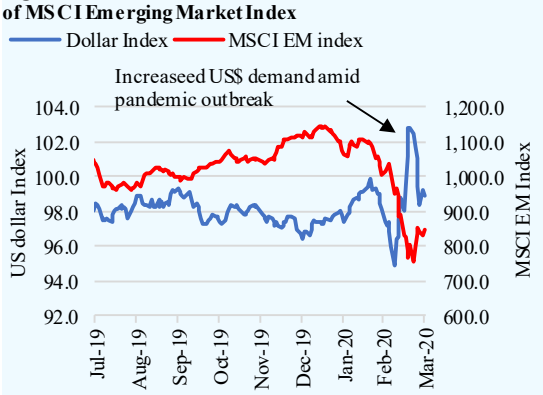
more than half of the total FDI in Q3. A significant part of these inflows was received by firms working on CPEC-related power projects. Moreover, a Chinese company operating in Pakistan received an intercompany loan of US$ 190 million in Q3 for working capital needs from its parent company. In contrast, until H1-FY20, the telecommunication sector was the leading recipient of FDI, with inflows of US$ 478 million. A one-off inflow from multinational cellular companies for renewal of their operating licenses in Pakistan was the main driver of these telecommunication-related inflows.

Meanwhile, investment activities in the oil and gas exploration sector remained subdued in Q3-FY20 as falling oil prices led major oil companies to halt their capital investment plans. Exploration and drilling have become infeasible due to lower demand amid sagging oil price environment.[4]

Foreign portfolio investment

With the unfolding of the global COVID-19 pandemic, EMs witnessed an outflow of portfolio investment, as investors fled towards safe-haven assets, such as the US Dollar (**Figure 5.3**). As a result, since January 21 2020, the emerging markets have witnessed portfolio outflows to the tune of almost US$ 97 billion – US$ 72 billion in equity and US$ 25 billion in debt – within 75 days, surpassing the outflows during the global financial crisis of 2008.[5] During the GFC, portfolio investors had pulled out almost US$ 25 billion from EMs in 90 days, starting from September 8, 2008.

Figure 5.3: Historical Value of Dollar Index and Performance of MSCI Emerging Market Index



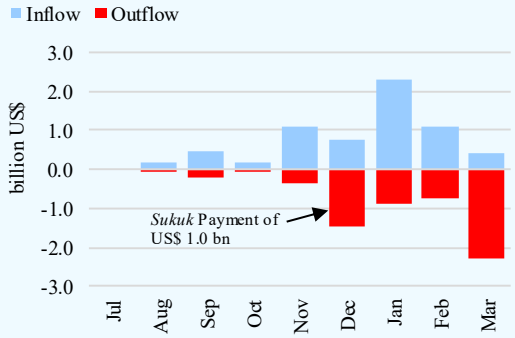
Data source: Bloomberg and MSCI

[4] Source: Bloomberg (https://www.bloomberg.com/news/articles/2020-03-20/oil-crash-wipes-out-31-billion-from-industry-s-investment-plans).

[5] January 21 is used as the starting point, as lockdowns began in China around that time (source: Institute of International Finance).

In the backdrop of this global investment scenario, the foreign portfolio investment in Pakistan in Q3-FY20 also came under strain. The foreign investment that started pouring in from Q1 in the domestic debt market (T-bills and PIBs) continued to gather pace till January 2020 **(Figure 5.4)**. In January, inflows into these securities surged to US$ 2.3 billion. However, with the unfolding of COVID-19 into a pandemic by March 2020, these portfolio inflows witnessed a trend reversal, with outflows to the tune of US$ 2.2 billion, in line with the global trend. On aggregate, Q3-FY20 witnessed a net outflow of US$ 153 million.

Figure 5.4: Portfolio Investment in T-bills and PIBs during Jul-Mar FY20

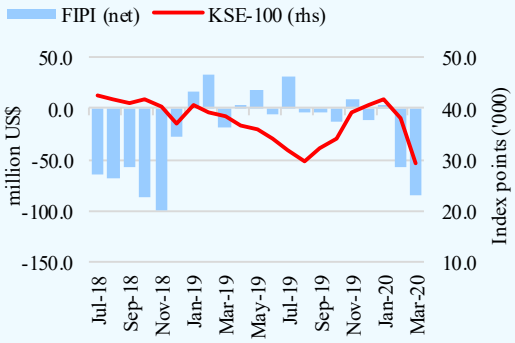


Data source: State Bank of Pakistan

Similarly, Pakistan's equity market came under severe pressure, as both local and foreign investors resorted to panic selling. Foreign portfolio investors pulled out US$ 138.2 million in Q3-FY20 from the equity market. Comparatively, in Q3-FY19, there was a net inflow of US$ 30.7 million. During Q3-FY20, the KSE-100 index declined by 28.2 percent and plummeted to 29,000 points on the last day of March 2020 (**Figure 5.5**).

Despite this Q3 outflow, the overall portfolio investment in Jul-Mar FY20 witnessed a net inflow of US$ 227.5 million, against an outflow of US$ 410 million in the corresponding period of last year.

Figure 5.5: Foreign Investment in Pakistan's Equities and PSX Performance



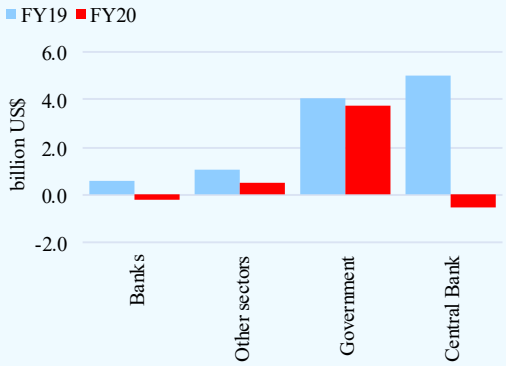
Data source: NCCPL and Pakistan Stock Exchange

Net incurrence of liabilities

A sharp decline in the CAD, along with some rebound in financial investment, alleviated the government's external financing needs. As a result, the net inflow of foreign exchange liabilities into the country declined by a significant 66.0 percent to US$ 3.6 billion in Jul-Mar FY20, compared to US$ 10.6 billion recorded in the same period last year (**Figure 5.6**).[6]

The declining trend was prominent in both official and non-official inflows (**Figure 5.6**). The net government loans during Jul-Mar FY20 declined by 6.0 percent to US$ 3.8 billion.[7] Specifically, in the third quarter, the government did not resort to commercial borrowings and received US$ 876 million in financing.[8] On the contrary, it had retired foreign obligations worth US$ 1.4 billion in this quarter.

Figure 5.6: Net Incurrence of FX Liabilities (Jul-Mar)



Data source: State Bank of Pakistan

5.3 Exchange Rate and Reserves

Pakistan's total liquid foreign exchange reserves increased by US$ 2.6 billion during Jul-Mar to US$ 17.1 billion by March 2020. The breakup of this increase shows that the SBP's reserves increased by US$ 3.6 billion, whereas commercial banks' reserves depleted by US$ 944 million.

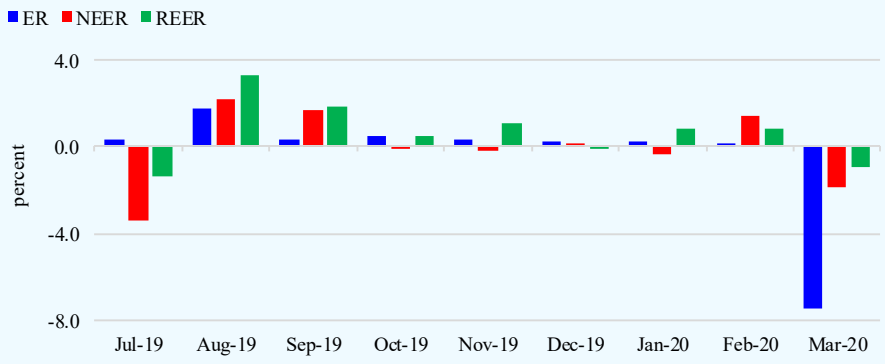
The improvement in the CAD and the realization of significant multilateral financial inflows and some improvement in investments helped build up the country's foreign exchange reserves till February 2020. However, this trend reversed in March 2020, when the SBP's liquid reserves dropped by around US$ 1.9 billion. This was partly due to higher debt servicing to multilateral and commercial lenders and interbank support amid pressure from capital outflows

[6] Last year, the country had received commercial and bilateral inflows from China (US$ 6.3 billion), Saudi Arabia (US$ 3.0 billion) and the UAE (US$ 2.0 billion) for BoP support.
[7] In H1-FY20, gross disbursements and amortization were US$ 7.1 billion and US$ 2.8 billion, respectively.
[8] During H1-FY20, the government had borrowed US$ 1.8 billion from commercial banks.

during the COVID-19 pandemic.[9]

The situation was quite similar for the exchange rate. The Pak Rupee kept appreciating against the US dollar, albeit marginally, from July 2019 till February 2020. However, foreign exchange outflows in March 2020, largely due to a reversal in FPI, led the Pak Rupee to depreciate by 7.5 percent in the month vis-à-vis the US Dollar (**Figure 5.7**).

Figure 5.7: Exchange Rate Appreciation(+)/ Depreciation (-)



Data source: State Bank of Pakistan

In the meantime, the NEER depreciated only by 2.0 percent in March 2020, as the currencies of other major trading partners also depreciated against the US dollar. However, the higher RPI, due to higher domestic inflation, reduced the REER depreciation to only one percent during the month. In overall terms, the NEER in March 2020 was almost at the June 2019 level, while the REER appreciated by 5.8 percent in Jul-Mar FY20.

5.4 Trade Account[10]

The trade deficit dropped by 26.4 percent to a four-year low of US$ 17.4 billion in Jul-Mar FY20. The reduction in imports played a major role in lowering this deficit, as exports recorded a marginal growth. Lower international prices of most commodities during this period exerted downward pressure on the unit values of many export and import items. However, the impact was more pronounced on

[9] The debt servicing to multilateral and commercial lenders went up by 31 percent YoY to reach US$ 3.3 billion in Jul-Mar FY20.

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

imported products (**Figure 5.8**).

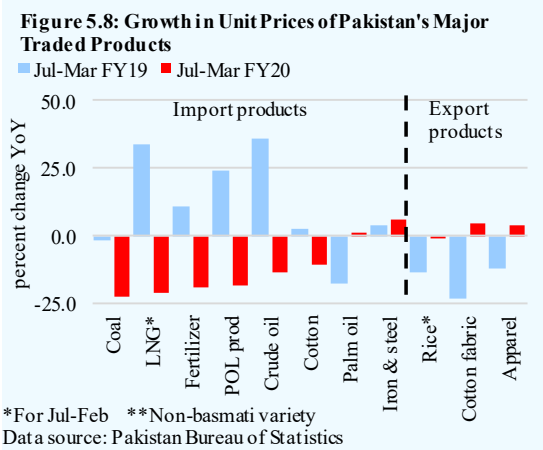


Figure 5.8: Growth in Unit Prices of Pakistan's Major Traded Products

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

Meanwhile, economic activity seemed to pick up in some sectors as the year progressed, leading to an apparent bottoming out of the declining trend in imports. Sectors with greater external linkages, such as power (FDI-dependent) and textiles (export-oriented), stood out in this regard. With a rebound in FDI into CPEC-related power projects, a notable rise in electrical machinery imports was recorded. Also, the fall in domestic cotton production (**Chapter 2**) necessitated hefty imports, given the strong demand from the textile industry, whose export prospects appeared bright till late-March 2020 (before the outbreak of COVID-19 outside China led to the Great Lockdown).

These upward pressures on some imports were countered by a slump in import demand of domestic-oriented industries, such as transport and construction-allied firms, which were among the hardest hit by the macroeconomic stabilization measures, and led to hefty declines in steel and car imports.

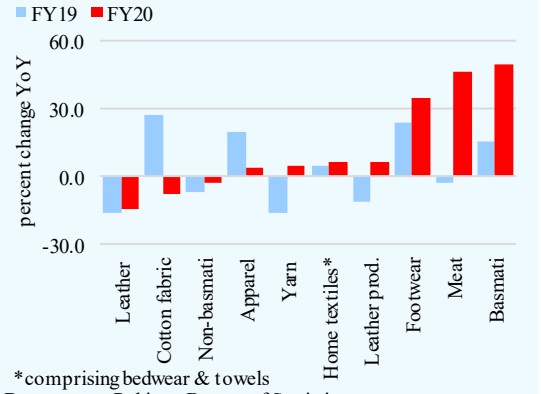
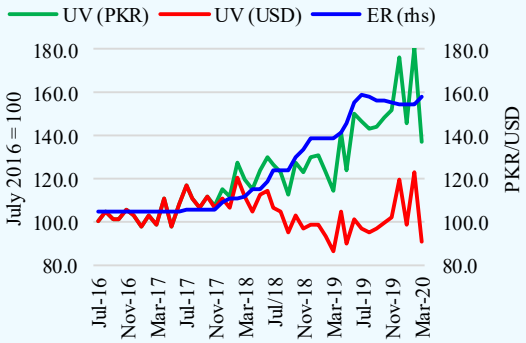


Figure 5.9: Growth in Quantum Exports during Jul-Mar

*comprising bedwear & towels
Data source: Pakistan Bureau of Statistics

Meanwhile, on the export front, the country exported higher quantities of multiple traditional and non-traditional items (**Figure 5.9**). This was enabled by a two-pronged policy effort. First, the exchange rate realignment with market fundamentals and the provision of electricity to exporting industries at concessionary rates allowed Pakistani exporters to compete by, generally, selling their products at lower unit prices **(Figure 5.10)**.[11] While this compromised Pakistan's export earnings to an extent, the country was still among the few EMs whose exports rose during Jul-Mar FY20 **(Figure 5.11)**. And second, the timely release of sales tax refunds and availability of concessionary Export Finance Scheme (EFS) in a high interest rate environment helped ease exporters' liquidity constraints.[12]

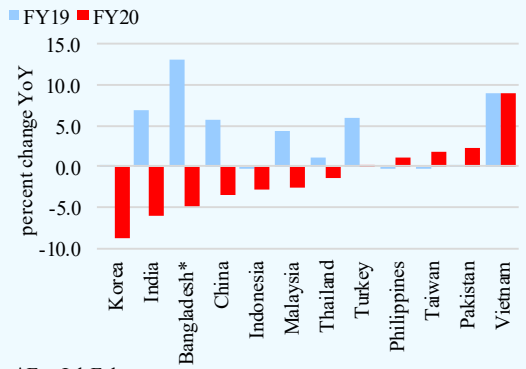
Figure 5.10: Unit Value Index of Pakistan's Apparel Exports and Exchange Rate



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

With regards to the impact of COVID-19 on the trade account during Q3, it may be recalled that among Pakistan's trading partners, manufacturing activity had halted only in China (February onwards); lockdowns had yet to firmly take hold in most of Europe and the US till mid-March. In Pakistan also, trade activities continued smoothly till March 23, when lockdowns began.

Figure 5.11: Export Growth in Major EMs during Jul-Mar



*For Jul-Feb.
Data source: Haver Analytics

In line with the development,

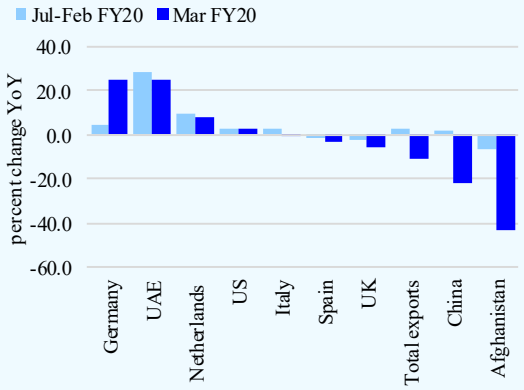
[11] The government had announced and continued a flat 7.5 cents/kWh power tariff for exporting industries in January 2019 via S.R.O. 01(I)/2019 to S.R.O. 12(I)/2019 (source: Ministry of Energy).
[12] Disbursements under EFS rose to Rs 109.2 billion in Jul-Mar FY20, from Rs 70.7 billion last year (**Chapter 3**). Sales tax refunds worth Rs 56 billion were sanctioned via FASTER in Jul-Mar FY20 (source: https://www.fbr.gov.pk/pr/rs-56-billion-refund-claims-sanctioned-by-fbr/152303).

SBP data shows that receipts from China and Afghanistan slumped dramatically in March 2020 on YoY basis, relative to their performance during Jul-Feb (**Figure 5.12**). In case of Afghanistan, the government had announced sealing of borders from March 16 to prevent the spread of COVID-19, adversely affecting trade with the country.[13] Meanwhile, for imports, payment data suggests that purchases from China had declined the most in March, with the drop concentrated in machinery items (cranes, air compressors) steel, and chemicals.[14]

Exports

Exports grew 2.2 percent YoY to US$ 17.4 billion in Jul-Mar FY20; the growth was much higher than last year. While the unit prices continued to exert downward pressure on export values, volumetric exports of a wide range of products rose substantially enough to offset this drag, and led to higher export earnings (**Table 5.4**).

Figure 5.12: Growth in Exports to Top Destinations



Data source: State Bank of Pakistan

The country's textile exports rose 4.2 percent YoY to US$ 10.4 billion in Jul-Mar FY20, after recording negligible growth last year. Quantum-led increases in apparel and bed wear exports were mainly responsible for the improved performance this year, and offset slight declines in exports of low value-added products.[15]

Apparel exports (comprising knitwear and readymade garments) grew 8.8 percent to US$ 4.5 billion in the period, with quantums and unit prices both rising and contributing to higher export values. Pakistani exporters – along with those from Cambodia, Bangladesh, Turkey and Vietnam –benefitted from China's gradual retreat from the EU and the US (after imposition of additional tariffs on its apparel products in September 2019), as indicated in **Tables 5.5** and **5.6**.

[13] Source: Press Information Department, March 13, 2020 (pid.gov.pk/site/press_detail/13321).
[14] Of the US$ 793.0 million drop in total import payments in March 2020, US$ 228.7 million decline was recorded from China.
[15] Quantum apparel exports had risen 4.4 percent YoY in Jul-Mar FY20, whereas bed wear shipments had increased 8.1 percent during the period.

Furthermore, in light of the COVID-19 outbreak in China, anecdotal evidence suggests that some orders that had been cancelled from China by European and American buyers in February and March, were diverted towards Pakistan, leading to decent growth in Pakistan's exports to these economies in Q3.[16] While clothing imports of the EU and US dropped significantly in Q3 as buyers desperately looked for suppliers outside China, Pakistani exporters managed to outperform major competitors in both markets during this period (**Tables 5.5 and 5.6)**.[17]

Table 5.4: Pakistan's Major Exports during Jul-Mar FY20
million US dollars

	FY19	FY20	Abs. change	Quant. Effect	Price Effect
Food group	**3,348.1**	**3,394.7**	**46.5**	**-**	**-**
Rice	1,487.9	1,594.0	106.1	79.5	26.6
Basmati	428.8	569.2	140.4	214.5	-74.1
Non-basmati	1,059.1	1,024.8	-34.3	-23.7	-10.6
Wheat	122.0	11.4	-110.6	-111.5	0.9
Sugar	115.1	70.7	-44.5	-59.8	15.3
Fruits & veg.	537	637.3	100.3	3.0	97.3
Meat & prep	156.4	233.0	76.5	72.3	4.2
Textile group	**9,989.8**	**10,413.0**	**423.2**	**-**	**-**
Raw cotton	15.7	17.0	1.3	5.0	-3.7
Cotton yarn	835.7	819.8	-15.9	43.4	-59.3
Fabric	1,595.9	1,547.4	-47.8	-115.3	66.8
Apparel	4,110.6	4,470.6	360.2	180.0	180.0
Bedwear	1,719.4	1,761.5	42.1	138.5	-96.4
Towels	588.1	591.6	3.5	12.4	-8.1
POL group	**361.8**	**238.9**	**-122.8**	**-69.5**	**-53.3**
Other manuf.	**2,492.1**	**2,426.5**	**-65.7**	**-**	**-**
Sport goods	222.9	222.6	-0.3	-	-
Leather tanned	187.9	151.4	-36.6	-26.8	-9.7
Leather goods	358.8	401.1	42.3	23.8	18.5
Footwear	90.1	104.4	14.3	31.7	-17.4
Medical items	279.9	303	23.2	-	-
Chemicals	439.2	348.7	-90.5	-	-
Cement	221.3	210.1	-11.2	16.3	-27.5
Total Exports	**17,071.1**	**17,446.9**	**375.7**	**-**	**-**

Data source: Pakistan Bureau of Statistics

In contrast, exports of the low value-added segment remained weak, with their cumulative exports dropping 2.6 percent to US$ 2.4 billion in Jul- Mar FY20; quantum exports of yarn had risen but those of fabric had declined.[18] Disaggregated data shows that China and Bangladesh – generally the largest buyers of Pakistan's low value added-textile products – purchased more cotton yarn from Pakistan, instead of the finished product (fabric).

[16] Manufacturing activity in China's two key apparel-producing areas (Guangdong and Zhejiang) were halted from January 24 until mid-February, as a result of the New Lunar Year holidays, which were ultimately extended amid the COVID-19 lockdown.
[17] The drop in the US' and EU's imports in Q3 mainly resulted from sizable drops in March. The EU's apparel imports were down 4.6 percent YoY in Jan-Feb FY20, and then fell by a sizable 15.2 percent in March 2020. Similarly, the US' apparel imports were down 11.4 percent YoY in Jan-Feb FY20, before declining by 12.9 percent in March 2020.
[18] Quantum yarn exports had risen 5.2 percent YoY in Jul-Mar FY20, whereas fabric shipments dropped 7.2 percent during the period.

Non-textile exports

The non-textile exports dropped by a marginal 0.7 percent to US$ 7.0 billion in Jul-Mar FY20. It is worth noting that these exports had performed decently during the first two quarters of FY20, with traditional and non-traditional items contributing to the increase.19 In Q3, however, these exports dropped 5.1 percent, mainly due to a heavy, quantum-led drop in non-basmati exports, which offset slight increases in exports of other products, and also dragged down the export growth recorded in the first two quarters.

Table 5.5: Growth in EU's Quantum Apparel Imports

	Jul-Mar		Jan-Mar	
	FY19	FY20	FY19	FY20
Pakistan	5.6	8.9	9.0	7.7
Turkey	6.0	1.9	5.6	-3.8
India	-3.7	-3.8	-3.1	-6.9
Bangladesh	9.6	-2.8	7.2	-2.3
China	1.8	-7.9	-10.2	-14.6
Cambodia	6.1	-12.6	-0.3	-17.8
World	5.2	-3.1	0.0	-6.8

Data source: Eurostat

Table 5.6: Growth in the US' Quantum Apparel Imports

	Jul-Mar		**Jan-Mar**	
	FY19	**FY20**	**FY19**	**FY20**
Pakistan	4.8	10.3	7.6	13.8
Bangladesh	7.7	1.8	15.9	6.7
China	4.4	-16.5	0.8	-32.4
Vietnam	7.2	3.2	12.8	2.6
India	5.8	-1.5	10.4	-0.8
Indonesia	0.5	-9.6	5.4	-10.4
Cambodia	2.4	9.7	-3.8	14.4
World	4.7	-6.7	4.5	-11.8

Data source: US Office of Textiles and Apparel

Rice exports

Overall rice exports rose 7.1 percent YoY in Jul-Mar FY20; however, the entire growth was recorded in the first half, as exports dropped 16.3 percent in the third quarter. Throughout the year, the trend in quantum exports played a dominant role in determining export values, as international prices of Pakistani (as well as Indian and Vietnamese) rice varieties generally remained soft.[20]

In terms of varieties, while both basmati and non-basmati exports grew strongly in H1-FY20, the latter recorded a sharp drop in the third quarter, pulling down overall rice exports. Data for Jan-Feb FY20 indicates that the drop in non-basmati exports is mostly traced to Philippines and China. The drop in exports to Philippines came about as it imposed restrictions on rice imports in December

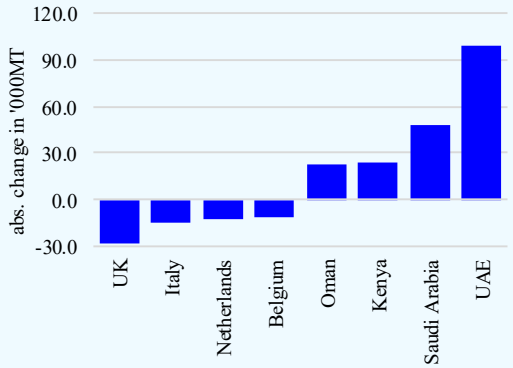
[19] Non-textile exports had risen 1.9 percent and 1.8 percent in Q1 and Q2-FY20 respectively, before dropping 5.1 percent in Q3.

[20] Export prices of Pakistan's non-basmati rice were, on average, 1.8 percent lower in Jul-Mar FY20 on YoY basis. Export prices of comparable Indian and Vietnamese varieties were also down 0.9 percent and 8.8 percent respectively during the period (source: FAO Rice Price Monitor).

2019, amid a significant buildup in domestic stocks.[21] Meanwhile, the drop in shipments to China might reflect the impact of lockdowns in the neighboring country from February onwards.[22]

In contrast, basmati rice performed remarkably well, with exports rising 33.7 percent in the nine-month period. Higher quantums played a dominant role; in fact, quantum exports in Jul-Mar FY20 reached an eight-year high. However, a shift is underway in the market destinations for Pakistani basmati: while European countries used to dominate, Middle Eastern markets like the UAE and Saudi Arabia have accounted for the bulk of increase in Pakistan's basmati exports this year (**Figure 5.13**). Exporters claim that a sizable chunk of exports to these countries are transshipped by traders to other countries in the region, especially Iran, Yemen, and Iraq, where regular banking transactions attract higher scrutiny.

Figure 5.13: Change in Pakistan's Quantum Basmati Exports in Jul-Feb FY20



Data source: Pakistan Bureau of Statistics

With regards to the EU countries, there is reason to believe that they are importing higher quantities of brown rice from Pakistan instead of white basmati rice, owing to differences in import duties on the two varieties.[23]Brown rice, while similar in quality to basmati, is classified by the PBS as non-basmati.

Other exports

Among other food products, fruit and vegetable exports grew 18.7 percent in Jul-Mar FY20 to a record high of US$ 637.4 million. Due to higher production, aggressive marketing and improved packaging, mango and orange exports recorded decent increases, with exporters making inroads into new Central Asian

[21] Finishing rice stocks in Philippines by end 2019-20 are projected to be 62.6 percent higher than those at end of 2017-18 (source: USDA Grain: World Markets and Trade Report, April 2020).
[22] Pakistan's quantum non-basmati rice exports to China dropped by a sizable 70.9 percent YoY in Jan-Feb FY20.
[23] This partly explains the increase in EU's share in Pakistan's brown rice exports to 67.6 percent in Jul-Feb FY20 from 48.5 percent, while white basmati's share fell from 28.3 percent to 9.4 percent.

markets, while retaining their presence in the Middle East and Europe.[24]

Cement exports dropped 5.0 percent to US$ 210 million in Jul-Mar FY20. Disaggregated data shows that volumetric exports of finished (Portland) cement and clinker (intermediary product) both increased in the Jul-Jan period, whereas unit prices for both had dropped. Faced with slowing local dispatches and trade disruptions with India (a major destination in the past), the cement manufacturers have revived traditional markets, such as Afghanistan and Sri Lanka, and diversified towards some African countries, such as Madagascar and Mozambique. These markets accounted for the bulk of increase recorded in quantum Portland cement exports. Meanwhile, Bangladesh accounted for almost the entire rise in Pakistan's clinker exports, with indications that Pakistani firms are eating into Vietnam's share in the Bangladesh market owing to Vietnam's focusing more on the Chinese market.[25]

Lastly, footwear exports grew 15.9 percent to US$ 104.4 million in Jul-Mar FY20, led by a healthy 41 percent volumetric increase. Exporters managed to ship higher quantities to the US and Middle Eastern and European countries (Saudi Arabia, Kuwait, Oman, Germany, and the UK). While leather footwear still dominates the export profile, it is worth noting that since FY18, non-leather (synthetic) footwear have been rising at a faster rate. This trend is indicative of change in buyers' preference in some countries towards more stylish and cheaper textile-based sneakers, and faux (synthetic) leather-based footwear. [26]

Imports

The country's imports dropped 14.5 percent to a four-year low of US$ 34.8 billion in Jul-Mar FY20. The continuation of stabilization policies up till mid-March 2020 – along with the ongoing transformation in the energy mix and its effects on the downstream activities – had led to tepid import demand for both non-energy and energy products (**Table 5.7**). Global oil prices were also quite favorable and played an important role in reducing the energy import values.[27]

[24] For instance, quantum mango exports to Central Asian Republics like Kazakhstan, Uzbekistan and Tajikistan, rose 132.5 percent in Jul-Feb FY20.
[25]New market demand emerged for Vietnamese clinker in China as the latter turned to shut down some of its own cement factories in view of rising environmental pollution.
[26] For instance, the share of non-leather footwear in the UAE's overall footwear imports (in quantum terms) rose from around 32 percent in 2015 to 46 percent in 2019, while that of leather footwear declined from 69 percent to 54 percent (data source: International Trade Centre).
[27] Arab Light crude oil prices were, on average, down 12.6 percent YoY during Jul-Mar FY20.

However, by Q2, some upward pressure on non-energy imports was evident, indicating the possibility that the drop in imports was bottoming out (**Figure 5.14**). The import of power generation and electrical machinery had risen strongly, corresponding with a rebound in foreign investment in the power sector (on both the generation and transmission fronts), and these trends continued into Jan-Feb FY20 as well.

Additional pressure came from cotton in Q3, whose import demand had risen sharply following a fall in domestic production and decent export prospects for the textile industry. The government also facilitated cotton imports by withdrawing import duties in January 2020.[28] Lastly, global palm oil prices had surged in recent months in response to lower production in the top two producers (Indonesia and Malaysia), which pushed up the commodity's import values despite a decline in their volumetric imports.

Table 5.7: Pakistan's Major Imports during Jul-Mar
(million US dollars)

Items	FY19	FY20	Abs. change	Quant. impact	Price impact
Energy group	**10,614.0**	**8,900.6**	**-1,713.4**	-	-
POL prods.	4,623.0	3,964.7	-658.3	256.9	-915.3
Crude oil	3,379.0	2,452.6	-926.4	-542.9	-383.5
LNG*	2,404.6	2,237.3	-167.4	429.0	-558.4
Agri and chem	**6,577.8**	**5,576.9**	**-1,001.0**	-	-
Fertilizer	716.0	482.3	-233.8	-117.4	-116.3
Other chem.	3,271.3	2,739.0	-532.3	-	-
Transport group	**2,083.2**	**1,197.6**	**-885.6**	-	-
Cars	820.4	408.2	-412.2	-	-
CBUs	320.5	64.8	-144.3	-	-
CKDs	611.4	343.4	-268.0	-	-
Truck & buses	370.0	216.5	-153.5	-	-
Aircraft & ships	222.0	240.7	18.8	-	-
Metals group	**3,756.3**	**3,074.7**	**-681.6**	-	-
Steel scrap	1,108.9	1,188.2	79.3	-180.8	260.0
Iron & steel	1,657.1	1,159.3	-497.8	-427.3	-70.5
Food group	**4,261.3**	**3,963.3**	**-298.1**	-	-
Tea	445.8	376.2	-69.6	-38.8	-30.8
Palm oil	1,386.1	1,380.2	-5.8	-24.8	19.0
Pulses	393.4	428.8	35.4	65.2	-29.8
Oth. food items	1,633.4	1,461.8	-171.6	-	-
Textile group	**2,237.1**	**1,915.8**	**-321.3**	-	-
Raw cotton	412.4	556.2	143.8	208.6	-64.8
Syn. yarn	485.3	429.9	-55.4	-20.5	-34.9
Oth. textile items	782.8	453.6	-329.2	-	-
Machinery group	**6,716.0**	**6,632.2**	**-83.8**	-	-
Power gen	955.7	920.0	-35.6	-	-
Electrical	1,321.2	1,748.8	427.6	-	-
Cell phones	557.2	980.0	422.8	-	-
Other machinery	2,408.0	1,746.5	-661.5	-	-
All other items	**4,433.8**	**3,538.0**	**-895.8**	-	-
o/w Coal*	1,052.1	914.2	-137.9	125.8	-263.7
Total imports	**40,679.5**	**34,799.1**	**-5,880.4**	-	-

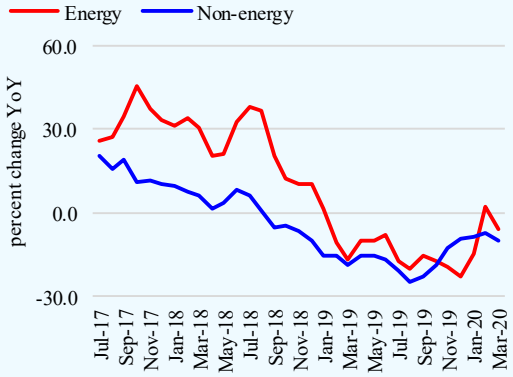
Data source: Pakistan Bureau of Statistics*For Jul-Feb

[28] Via S.R.O. 37(I)/2020, dated January 21, 2020.

Energy imports

Energy imports declined 16.1 percent YoY to US$ 8.9 billion in Jul-Mar FY20; the fall was steeper than the drop recorded in the same period last year. For two major categories – POL products and LNG – lower international prices played a dominant role in curbing the import values, as quantum imports for both had risen in the nine-month period.

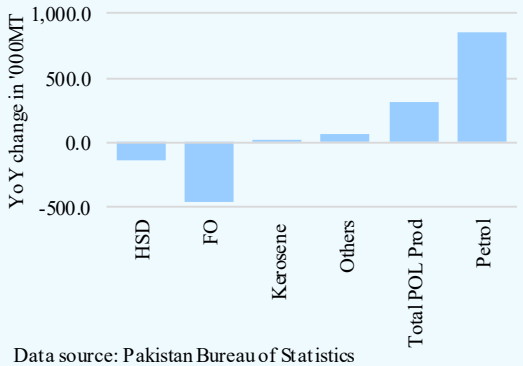
Figure 5.14: Growth in Imports (3m rolling average)



Data source Pakistan Bureau of Statistics

In case of POL products, the higher volumetric imports were driven mostly by petrol, as imports of other major fuel items, such as high speed diesel (HSD), furnace oil and kerosene, all declined during the period (**Figure 5.15**).[29] Petrol imports had been rising since Q2, when occasional closure of CNG stations had forced motorists to switch to petrol; with refineries curtailing production, the demand-supply gap had to be filled via imports. This switch to petrol appeared to be temporary, as petrol sales in Q3 (Jan-Feb) dropped on YoY basis (**Table 5.8**), likely in response to resumption of regular operations of CNG stations. Yet, despite the lower demand, OMCs accelerated their gasoline purchases from abroad in Q3 to build inventories in order to benefit from declining international prices.[30]

Figure 5.15: Change in Quantum POL Products' Imports during Jul-Feb FY20



Data source: Pakistan Bureau of Statistics

Among other POL products, quantum furnace oil and HSD imports dropped

[29] This graph will be updated as detailed PBS data for March becomes available. During March 2020, petrol import payments (SBP data) had risen by 80.8 percent YoY.
[30] Average global gasoline prices were down 14.8 percent YoY in Q3-FY20 (source: Bloomberg).

significantly, as demand for both fuels stayed depressed. With the policy shift away from FO-based power generation, the fuel's demand has fallen significantly. For HSD, the slowdown in construction and imports has lowered the plying of heavy vehicles; this, in turn, has reduced the segment's demand for fuel. That said, the decline in imports of these fuels was completely offset by the rise in petrol imports, especially in the third quarter. As a result, overall POL product import values rose 13.7 percent YoY in Q3-FY20 – the first such increase since Q4-FY18.

Table 5.8: Change in POL Product Sales during Jul-Mar FY20 (MT)

Items	Q1	Q2	Q3	Jul-Mar
Petrol	35.5	132.0	-185.5	-18.0
High speed diesel	-286.9	-97.5	-493.6	-877.9
Furnace oil	-216.3	-116.6	-278.5	-611.3
Jet fuel	-42.4	-29.2	-66.8	-138.4
Kerosene	1.1	-3.9	-1.8	-4.6
Others	-11.0	-5.1	-10.2	-26.2
Total product sales	**-519.8**	**-120.4**	**-1,036.3**	**-1,675.5**

Data source: Oil Companies Advisory Council

Meanwhile, refineries' demand for crude oil stayed subdued, as they curtailed their throughput to avoid adding to the FO stockpiles. As a result, quantum crude oil imports fell 16.1 percent during Jul-Mar FY20. International oil prices were also favorable, declining 12.6 percent on average in Jul-Mar. Also, as OMCs accelerated POL product imports in Q3, crude oil imports fell more drastically in the quarter: quantum crude oil imports in Q3 fell to their lowest level in five years.

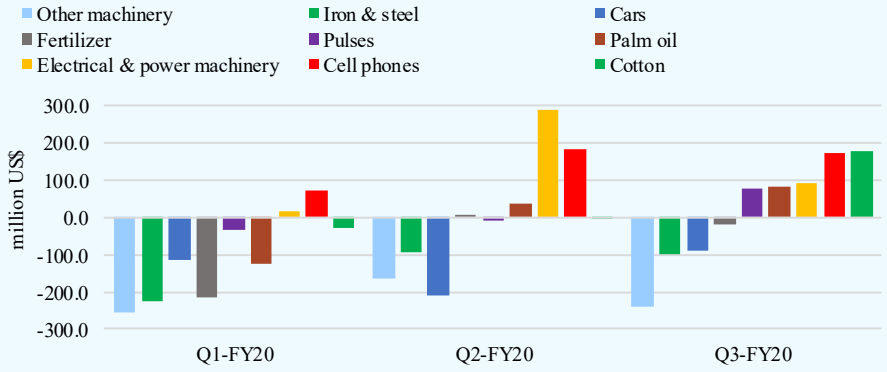
Regarding LNG and coal,[31] the country imported higher quantities than last year, but lower unit prices curtailed their import values.[32]Greater usage of both fuels in power generation (in place of FO) mainly necessitated higher imports.

Non-energy imports

The country's non-energy imports dropped 13.9 percent to US$ 25.9 billion in Jul-Mar FY20. The drop was concentrated in products more susceptible to the demand-compression policy measures, such as construction-allied materials and transport. In contrast, imports of the FDI-dependent power and the export-oriented textile industries rose strongly, in line with improved activity in these sectors (**Figure 5.16**).

[31] Coal imports are classified under "all other items" by both the PBS and the SBP.
[32] Quantum LNG and coal imports had risen 19.6 percent and 12.0 percent respectively during Jul-Feb FY20.

Figure 5.16: Absolute YoY Change in Major Non-Energy Imports



Data source: Pakistan Bureau of Statistics

Machinery imports were the first to rebound as the year progressed, and the country recorded hefty purchases of electrical equipment, such as heavy-duty transformers, capacitors and circuit breakers, from abroad. These imports corresponded with sizable FDI inflows into a firm working on the Lahore-Matiari transmission line project. Upward pressure also came from cell phones, whose imports rose by a significant 75.9 percent in Jul-Mar FY20. The rise mainly stems from the diversion of imports via grey channels to official channels following the introduction of the Device Identification Registration and Blocking System (DIRBS) system by the PTA in H2-FY19.[33]

However, the rise in electrical and cell phone imports was more than offset by a 27.5 percent drop in 'other machinery' imports in the period. Disaggregated Jul-Feb data for this category shows that the decline was concentrated in items mainly related to the construction industry – such as agglomeration machinery to mould cement and sand, cement crushing & grinding machinery, rolling mills for cold steel sheets, and conveyer belts. As a result, overall machinery imports fell 1.2 percent in Jul-Mar FY20.

With subdued construction activity and slumping automobile production (**Chapter 2**), the country's import demand for steel also stayed low. Cumulative quantum imports of steel scrap and finished products fell 20.1 percent during Jul-Mar, and were mainly responsible for the 15.1 percent drop in import values.

Meanwhile, upward pressure on imports came from some non-energy

[33] For details, see Chapter 5 of SBP's Second Quarterly Report of FY20.

commodities, like cotton, palm oil and pulses. For cotton, import values rose 34.9 percent during Jul-Mar, with the entire increase coming in the third quarter and due to higher volumetric imports.[34] In fact, quantum imports of cotton in Q3-FY20 surged to the highest level in any quarter since Q3-FY08. On the other hand, palm oil imports during Jul-Mar were virtually flat at last year's levels. However, unlike last year, average international prices had been rising since Q2, amid production shortfalls in Malaysia and Indonesia, and more than offset a slight decline in quantum imports.

[34] International cotton prices were, on average, down 0.6 percent YoY in Q3-FY20 and 15.5 percent in Jul-Mar FY20 (source: World Bank).

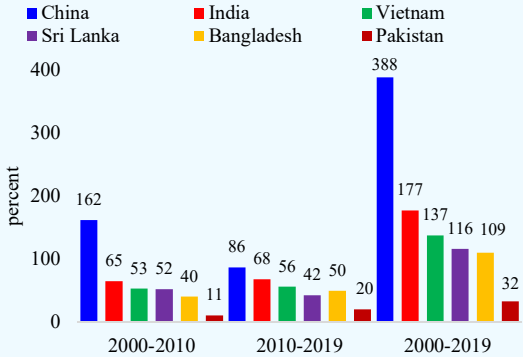
Special Section: Technical and Vocational Education and Training (TVET) in Pakistan: Issues and Challenges for Productivity Enhancement[1]

Labor productivity levels in Pakistan lag behind regional countries and the poor state of human capital is considered a major binding constraint towards achieving the country's export-driven growth and industrialization objectives. While a low level of basic education compromises the training acquisition abilities of workers, the contribution of the private sector has also remained underwhelming in scaling up the quality of the vocational curriculum. Furthermore, not only do a minority of incoming and existing employees get proper vocational and technical training, but even those that do often end up acquiring skills that are not relevant to current and emerging work scenarios. While a skill gap exists in various manufacturing industries, it cannot be filled by the existing TVET ecosystem in Pakistan, which is characterized by lack of skilled trainers, weak infrastructure, technological obsolescence and, more importantly, inadequate coordination between the formal TVET sector and industry players.

S1.1 Introduction

Pakistan's economy is at a crossroads. A significant uptick in investment activities and an increase in the level of export-orientation is required to lead the country towards a sustainable growth direction. Likewise, the focus on liberalizing trade policy, diversifying exports base, reducing overdependence on locally available resources, and digitizing production processes needs to increase substantially. However, the crucial ingredient for all this to work is to have a domestic market structure that is not only competitive, but also conducive for businesses to embrace productivity and innovation.

Figure S1.1: Change in Labor Productivity 2000-2019*



*output per person (constant 2010 US$)
Data source: ILO modelled estimates

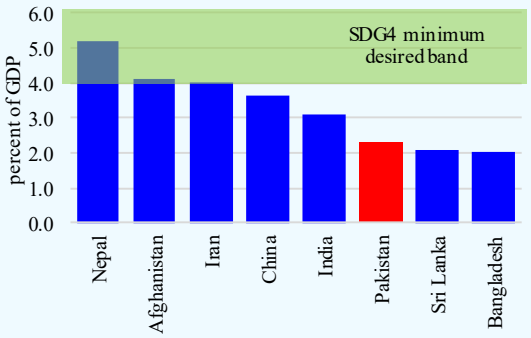
When it comes to productivity, the poor state of human capital development is cited as one of the major binding constraints for Pakistan. With education and training on the lower side, the existing and incoming labor

[1] Authors are thankful to Waqas Ahmed (Lead Economist, SBP), Mazhar Khan (Senior Economist, SBP) and Muhammad Omer (Economist, SBP) for their valuable feedback.

force does not have the desired level of capacity to effectively participate in economic activities. This is also evident from labor productivity levels in Pakistan lagging behind regional countries (**Figure S1.1**).[2]

Here, it is important to highlight that the inadequate human capital development is not the binding constraint in itself. Instead, it is symptomatic of the deep-rooted challenges that are more structural in nature. To start, Pakistan currently stands far from achieving the goal of universal primary and secondary education – in the context that the lack of basic education compromises the ability of labor force to effectively acquire the needed vocational and technical skills.[3]. Though steady progress has been noticed over the past decades, educational indicators of Pakistan in general remain weak. Importantly, around one-fourth of primary school age children are out-of-school, with overall literacy rate hovering around 60 percent (age 10+) (**Table S1.1**). Here, much of the responsibility falls on the government, as public spending on education has consistently remained on the lower side; the current level also falls significantly short of the prescribed level laid out in the SDG's Education 2030 Framework for Action (**Figure S1.2**).

Figure S1.2: Government Expenditure on Education



Figures are for FY19 or latest
Data source: World Bank; Government of China; Ministry of Finance India; Ministry of Finance Pakistan; UNESCO

The role of the corporate sector has not been much supportive either. Importantly, the underwhelming extent to which the business community has got itself engaged in the formal TVET sector limits the scope, coverage and effectiveness of technical and vocational education in the country. As business surveys illustrate, most firms do not appear particularly keen on skill-building amongst their

[2] For details, refer to Special Section 1 titled, "The Importance of Human Capital in the Context of CPEC" in SBP's Second Quarterly Report for FY19 on the State of Pakistan's Economy.
[3] For example, see (i) Desjardins, R., Milana, M., & Rubenson, K. (2006) "Unequal chances to participate in adult learning: International perspectives". UNESCO; and (ii) Grotlüschen, A., et al. (2016), "Adults with Low Proficiency in Literacy or Numeracy", *OECD Education Working Papers*, No. 131, OECD Publishing, Paris

employees and appear mostly content with the existing human resource. Probably this represents their own disinclination towards adopting modern production processes (particularly in manufacturing firms) and innovation activities, and overall weak business dynamism (particularly in the sense of diversifying product base). Add to this the existing undersupply of formal vocational/training institutes and negligible involvement of the private sector in the setting of vocational curriculum, and Pakistan is left with an ecosystem that is ill-equipped to produce the workforce compatible with the country's growth and industrialization objectives. Importantly also, the domestic TVET system has not been able to contribute significantly to improving the competitiveness of the country's manpower exports either. This is worrying, considering that workers' remittances continue to remain an important source of foreign exchange earnings for the country.

Table S1.1: Why is Education Attainment Low in Pakistan?

Criteria	Selected Indicators	Reasons
Access to Education	23 percent of primary school age children are out of school 33 percent of the enrolled students drop out before finishing primary school	Family poverty Insecurity Natural disasters Shortage of nearby schools
Quality of education	Amongst Grade 8 students, only 31 percent are proficient/advanced in Urdu reading and 2 percent are proficient/advanced in Urdu writing In Mathematics, only 23 percent are proficient or advanced at Grade 8 level.	Acute shortage of well-trained and motivated teachers Unavailability of quality learning materials Poor school environment curricula/assessment systems promote rote learning Teacher absenteeism
Inequity in Opportunities	Persistent gender gap in all aspects of education Early childhood education (ECE) higher for boys than for girls Adult female literacy is shockingly low (18 percent) in Balochistan, with significant gender gaps in all four provinces	Large inequities exist by district, rural/ urban location, socioeconomic background, religious, linguistic and caste affiliation, disability and nomadic or refugee status Degree of inequity in education is not always fully understood due to lack of comprehensive data
Weak governance and budgetary constraints	Education spending (2.6 percent of GDP) is below the average of 3.0 percent across South Asia and far below the lower end of the range of 4 - 6 percent recommended in the Incheon Declaration District education planners lack the required expertise and need training Community participation in school matters not widespread.	Higher incidence of non-discretionary spending given the country's huge bill on defense spending, interest payments and energy needs Lack of proper training of staff

Data source: UNICEF (2017) Sustainable Development Goal 4 Gap Analysis: Pakistan

While acknowledging this external dimension that warrants additional examination, this special section is focused on issues arising in the domestic market due to a suboptimal TVET ecosystem. In particular, this section intends to:

(i) underscore the importance of Technical and Vocational Education and Training (TVET) education with regards to human capital development, export competitiveness and economic growth; (ii) describe the current TVET ecosystem of Pakistan; (iii) highlight the skills gap situation in the labor market of Pakistan, particularly focusing on the manufacturing sector; (iv) analyze both supply and demand side dynamics to capture the structural impediments affecting skill building of the workforce; and (v) provide suggestions to correct the trends.

SS1.2 Vocational and Technical Education was a Crucial Element of Export-led Development Strategies of Asian Economies

The state of TVET in Pakistan is particularly concerning when compared with the trends witnessed worldwide. Businesses and public sector institutions in both advanced and emerging economies have focused heavily on actively training their labor forces. Concepts such as adult education (AE) and lifelong learning (LLL) are gaining traction amongst researchers and policymakers, particularly since its inclusion as an objective in the UN Sustainable Development Goals (SDGs) agenda (**Box S1.1**).

This is because in some cases, such as those of the Asian Tiger economies, LLL activities contributed crucially to their export-led and successful economic development trajectory.[4] Here, the integration between academic and vocational institutions in Taiwan, which aimed at ensuring the supply of skills at a desired level alongside basic education at each developmental stage and across industries; the "picking winners" approach of South Korea of investing in skill-building of workers under the Heavy Chemical and Industrialization Plan in 1970s; and the continued learning initiative of Singapore in the 1980s to reskill labor force, increase focus on math and IT education, and ensure that citizens completed their education, all are cited as successful forays into AE and LLL. Importantly, such "schemes for lifelong learning constituted an integral part of the conscious attempt to enhance and diversify the industrial base of the economy and to ensure that the move during the 1980s in the direction of higher-value-added forms of production was not held back by inadequacies in work-force skills" (Green et al, 1999).[5]

[4] Organization for Economic Co-operation and Development. (2001). Economics and Finance of Lifelong Learning. OECD Publishing.
[5] Green, F., Ashton, D., James, D., & Sung, J. (1999). The Role of The State in Skill Formation: Evidence from the Republic of Korea, Singapore, and Taiwan. *Oxford Review of Economic Policy*, 15(1), 82-96.

Box S1.1: The Importance of Lifelong Learning (LLL)

Nowadays, governments, businesses and international organizations are working actively to increase the focus on lifelong learning (LLL) of the labor force. Lifelong learning may be defined as, "all general education, vocational education and training, non-formal education and informal learning undertaken throughout life, resulting in an improvement in knowledge, skills and competences within a personal, civic, social and/or employment-related perspective. It includes the provision of counselling and guidance services".[6]

The 1996 United Nations Delors Report is known as one of the most important landmarks in the pursuit of making education and skill-building of the workforce key priorities in terms of economic development and growth. According to the report, LLL should comprise of the following characteristics:

Learning to know: getting to know the needs of tomorrow and being able to prepare accordingly

Learning to do: acquiring not only occupational skills, but also, more broadly, the competence to deal with many situations and to work in teams

Learning to live together: carrying out joint projects, managing conflicts, establishing and minting long-distance work relationships, perceiving things as win-win, etc. This is particularly important with respect to the growing importance of Global Value Chains.

Learning to be: developing people's personality and ensuring that no aspect of a person's potential goes disregarded. This includes focus on memory, reasoning, aesthetics, physical capacities, communication skills, etc.

While initial training provides core working skills and general knowledge that helps workers transition from education to work, LLL keeps those job-related and interpersonal skills and abilities relevant as the nature of work, technology and skill requirements evolve over time. The importance of LLL is further strengthened by its inclusion as a central feature of the 2030 agenda for sustainable development goals (SDGs). SDG Goal 4 states that member states are to ensure "inclusive and equitable quality education and promote lifelong learning opportunities for all.

This is considered important for four major reasons. First, good quality education serves as a foundation for job placement and future training. Second, proper provision of training helps closely match skills supply to the needs of enterprises and labor markets. Third, it enables workers and enterprises to adjust to improvements in technology and work operations. Fourth, it readies firms and workers for the skill needs of the future. Resultantly, LLL enables people to seize employment opportunities, raises enterprises' productivity levels, and boosts future innovation and development potential of the economies.

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Hager, P. (2011). 'Concepts and Definitions of Lifelong learning', in London, M. (ed.) Oxford Handbook on Lifelong Learning, Oxford University Press, Oxford.

[6] European Commission (2011). The Lifelong Learning Programme 2007-2013 Glossary.

ILO (2019). Lifelong Learning: Concepts, Issues and Actions, International Labour Office, Geneva.
UNESCO (1996). Learning: The Treasure Within, the Report of the Delors Committee, UNESCO Publishing, Paris.
UN (2015). Transforming Our World: The 2030 Agenda for Sustainable Development, United Nations, New York

It is not surprising to see that this was the time during which firms from the Asian Tiger economies, alongside Japan, leapfrogged their US counterparts and began to dominate the emerging industries such as that of consumer electronics. For example, American companies served around 96 percent of the U.S. radio-set and TV market in 1955. By 1965, the share declined to 30 percent, and around 1975, it had fallen to almost zero. By the 1990s, all the domestic TV manufacturers had been replaced by foreign companies, most notably Motorola's television brand by Matsushita (Japan), and LG Electronics (South Korea) (Greenspan and Wooldridge, 2019).[7] Failure to change the management practices of the firms (Hayes and Abernathy, 1980),[8] and ineffectiveness of the public sector investments in training the workforce "compared to the magnitude of the skill deficiencies that policymakers are trying to address" (LaLonde, 1995) [9] are considered the reasons for the demise of popularity of US based firms.

S1.3 Investments in TVET Lead to Increased Productivity and Economic Growth: Theoretical and Empirical Foundations

Human capital plays a vital role in the pursuit of sustainable economic growth. Alongside education, skill-building of workforce is also vital for economic development. From an individualistic viewpoint, skilled workers (existing or incoming) are not only more employable, and so have more opportunities, but are also more adaptable to evolving working conditions. From the perspecive of businesses, presence of a skilled labor force enables them to gain a competitve edge over other firms in terms of better research and innovation, easier adoption of latest technologies, improved management practices, and diversification of the product base.

From a macroeocnomic standpoint, this results in an improvement in the total factor productivity (TFP) of the country. Besides increasing the labor

[7] Greenspan, A., & Wooldridge, A. (2019). Capitalism in America: A History. Penguin Books.
[8] Hayes, R. H., & Abernathy, W. J. (1980). Managing Our Way to Economic Decline. *Harvard Business Review*;(United States), 58(4).
[9] LaLonde, R. J. (1995). The Promise of Public Sector-Sponsored Training Programs. *Journal of Economic Perspectives*, 9(2), 149-168.

productivity, skill-building also helps make the interplay of capital and labor inputs more efficient and effective. Emperical literature points towards solid evidence indicating that workforce training helps increase the labor productivity (**Table S1.2)**. This improvement in productivity, in certain cases, then leads to firms becoming more competitive and export-oriented. This associatoin has been attributed to improved R&D activities, conscious invetsment decisions to improve tehnical efficiency, better quality of products, and improved innovation decisions.

Human capital investments are also important because recent literature demonstartes that research productivity (in case of firms, described as the impact of R&D expenditures on sales revenue, market capitalisation, and revenue labor productivity) declines over time and that a higher volume of research actitvity is required just to maintain the growth in economic activity at an existing level (Bloom et al. 2020). This means that businesses/economies have to continuously focus on skill-building and research/innovation practices to establish/maintain their competitive edge.[10]

Table S1.2: Literature Review on the relationship between Human Capital, TVET, Productivity and Exports Growth	
Human Capital Development is crucial for economic growth and development	
Becker, G. S., Murphy, K. M., & Tamura, R. (1990). Human Capital, Fertility, and Economic Growth. *Journal of Political Economy*, 98(5, Part 2), S12-S37.	Societies where there exists a scarcity of human capital, family size is bigger and investment on each member lower. Thus, economic growth and development is influenced by factors such as investments in human capital, choices over family size, and the interplay between human and physical capital, etc
Manuelli, Rodolfo E., and Ananth Seshadri. 2014. "Human Capital and the Wealth of Nations." *American Economic Review*, 104 (9): 2736-62.	Differences in ouputs between different countries can, to a considereble extent, be explained by a variation in the quality of human capital. This is because people in poor countries do not only get fewer years of education, but they also aquire less capital per year of schooling compared to people in richer countries
Gennaioli, N., La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (2013). Human Capital and Regional Development. *The Quarterly Journal of Economics*, 128(1), 105-164.	Analyzing a database of 1,569 subnationl regions from 110 countries, Gennaioli et al (2013) find that human capital (represented by regional education levels) is a major determinant of the differences in regional development (GDP per capita) both among countries and within regions in a single economy.
Alongside education, TVET is important to increase total factor productivity…	
Sala, H., & Silva, J. I. (2013). Labor productivity and Vocational Training: Evidence from Europe. *Journal of Productivity Analysis*, 40(1), 31-41.	While analyzing a multi-country multi-sectoral firm level database from Europe, they find that an extra hour of training per employee increases productivity growth by around 0.5 percentage points
Dearden, L., Reed, H., & Van Reenen, J. (2006). The Impact of Training on Productivity and Wages: Evidence from British panel data. O*xford*	Studying a panel of British industries between 1983 and 1996, the authors find that raising the share of trained

[10] Bloom, Nicholas, Charles I. Jones, John Van Reenen, and Michael Webb. 2020. "Are Ideas Getting Harder to Find?" *American Economic Review*, 110 (4): 1104-44.

Bulletin of Economics and Statistics, 68(4), 397-421.	workers by one percentage point was associated with an increase in per worker value addition of about 0.6 percent
Konings, J., & Vanormelingen, S. (2015). The impact of training on productivity and wages: firm-level evidence. *Review of Economics and Statistics*, 97(2), 485-497.	Examining a panel of Belgian manufacturing and non-manufacturing firms from the period 1996-2006, authors find that productivity premium for a trained worker relative to an untrained worker is 23 percent
… which makes firms more innovative, research focused and quality-conscious…	
Griliches, Z. (2007). R&D and productivity: The Econometric Evidence. *University of Chicago Press*.	Analyzing data on over a hundred US firms, and then on a similarly constructed French data, authors come to the finding that there is a strong relationship between firm productivity and the level of its past R&D investments
Foster, L., Haltiwanger, J., & Syverson, C. (2008). Reallocation, Firm Turnover, and Efficiency: Selection on Productivity or Profitability? *American Economic Review*, 98(1), 394-425	Studying the data of 11 firms listed in the census of manufacturers (CM) during the years 1977 and 1997, the authors conclude that exiting businesses have lower prices and lower productivity (either revenue based or physical quantity based) than incumbents or entrants.
… as well as export-oriented	
Cassiman, B., Golovko, E., & Martínez-Ros, E. (2010). Innovation, Exports and Productivity. *International Journal of Industrial Organization*, 28(4), 372-376.	Higher productivity leads to improved innovation decisions. Product innovation then induces small non exporting firms to enter the export market. Data on 1,487 Spanish firms using the national survey.
Yang, C. H., & Chen, Y. H. (2012). R&D, Productivity, and Exports: Plant-level Evidence from Indonesia. *Economic Modelling*, 29(2), 208-216.	The relationship between R&D/exports and productvity is found from both sides, indicating self-selection of firms for exports as well as learning-by-exporting
Falk, M., & de Lemos, F. F. (2019). Complementarity of R&D and Productivity in SME Export Behavior. *Journal of Business Research*, 96, 157-168.	The relationship between R&D activity and export performance is stronger in cases of higher productivity levels

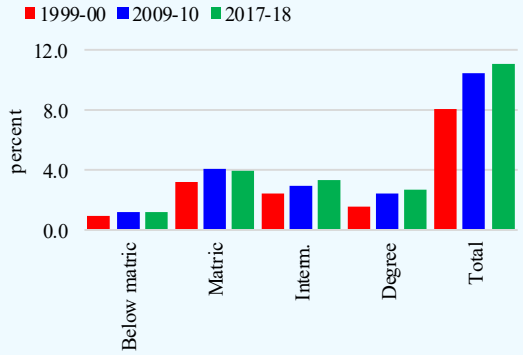
S1.4 In Pakistan, Growth Diagnostics Reveal that the Focus on Human Capital Remains One of the Weakest Links

In Pakistan, the poor state of human capital proved to be a major hurdle towards achieveing high growth and development. For example, Abbas and Peck (2008) demonstrate that human capital develoment accounted for just under one-fifth of the increase in Pakistan's GDP per capita during the period 1961-2003. In fact, the contribution turned negative during the period 1991-2000. During this period. "Rapid labor force growth was not matched by expansion of secondary education, so that the proportion of the educated workforce declined. As the opportunities for benefiting from world technology increased, Pakistan's ability to reap the advantages deteriorated".[11]

[11] Abbas, Q., & Foreman-Peck, J. S. (2008). Human Capital and Economic Growth: Pakistan 1960-2003. *Lahore Journal of Economics*, 13(1), 1-27.

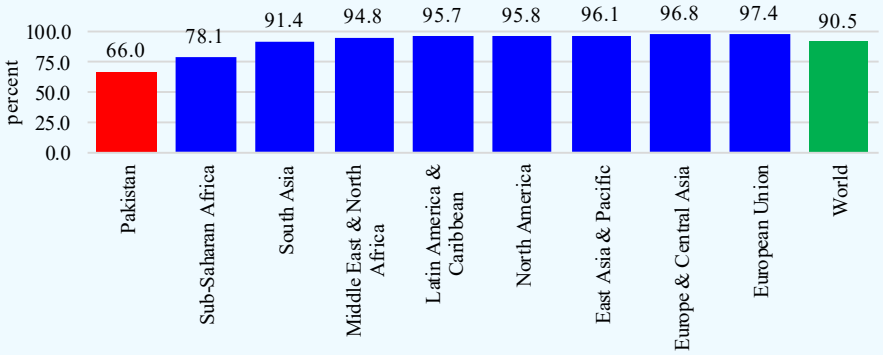
The situation has improved only marginally since: the share of population aged 15 and above enrolled in any stage of education stands at just 11.1 percent as of 2017-18 (**Figure S1.3**). If we compare internationally, the adjusted net enrollment rate of primary school children in Pakistan, calculated by dividing the number of children in the official primary school age who are enrolled in primary or secondary education by the population of the same age group and multiplying by 100, is the lowest when compared to all regional averages (**Figure S1.4**).

Figure S1.3: Percentage Distribution on Enrolled Population (15 years and above) by Level of Education Attainment



Data source: Pakistan Employment Trends (various issues), PBS

Figure S1.4: Adjusted Net Enrollment Rate (percent of primary school age children)



Note: Regioal averages are from 2017, while information pertaining to Pakistan is from 2018-19
Data source: Pakistan Social And Living Standards Measurement Survey 2018-19; World Bank

This has impacted the overall performance of businesses in the country severely. Let us take the case of the textiles sector. Studying the firms situated in the knitwear cluster in Lahore, Rehman (2012) found that the presence of highly educated entrepreneurs and a skilled workforce was associated with higher productivty, more innovations, bigger firm size and better marketing strategies

that helped attract and book more product orders.[12] Furthermore, Khan (2005) makes the case that alongside better investment policies and stronger institutions, a much higher human capital quality is what led the East Asian miracle economies to perform much better, concluding that "Pakistan could have achieved higher growth rates, had it invested more in its human capital".[13]

This dimension has strong historical foundations. Since inception, with severe resource constraints and a high share of agriculture sector workers, "Pakistan's post-Independence economic development strategy gave virtually no attention to labor, except as an industrial input to be drawn from rural areas at subsistence wages".[14] Resultantly, public policies were oriented towards "creating the circumstances which lead the *share of profits* in the national income to increase".[15] This agenda continued during the 1960s, with the government regarding the wealth maximizing element of economic growth a "functional justification for inequality of income", i.e. initial concentration of capital was deemed necessary to reap equitable socio-economic welfare later. Interesting to note is the fact that while Pakistan was experiencing healthy growth rate in the 1960s, the unemployment levels rose and real wages in the industrial sector actually declined by a third.[16] This was the time when the high concentration of wealth in the country became a widely debated issue.

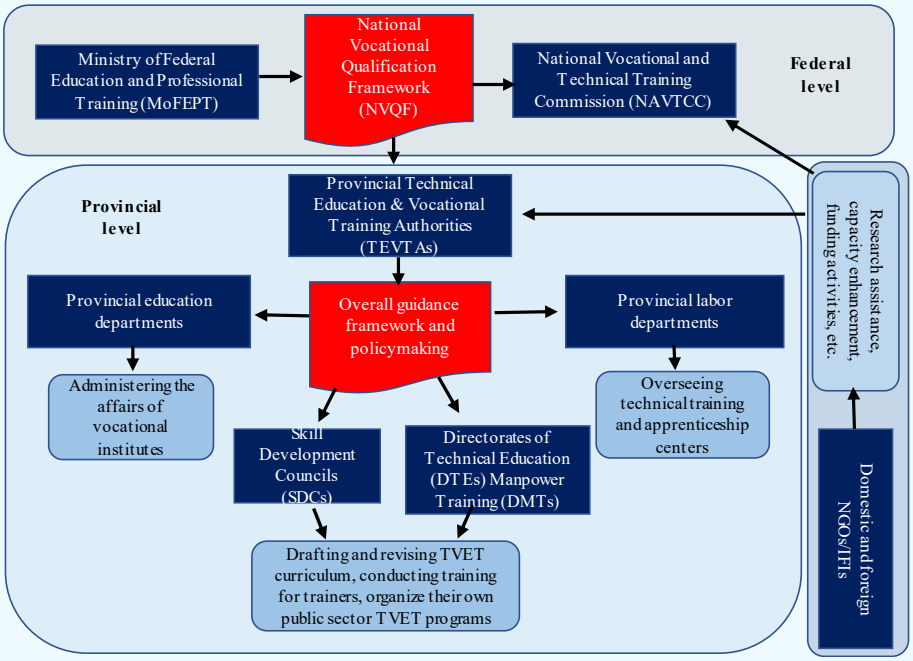
However, over the period of time, the government started focusing extensively on workforce welfare, social security, and productivity enhancement. In particular, virtually all the national and later provincial labor policies have included clauses on ensuring employees' learning and development. This is primarily why the technical and vocational training in Pakistan has come to revolve around a broad-based and multi-layered ecosystem.

[12] Rehman, F. (2012). Human Capital and Multifaceted Innovation: Evidence from the Lahore Knitwear Cluster in Pakistan. *Lahore Journal of Economics*, 17(2), 63-86.
[13] Khan, M. S., Amjad, R., & Din, M. U. (2005). Human Capital and Economic Growth in Pakistan. *The Pakistan Development Review*, 455-478.
[14] Candland, C. (1995). Trade Unionism and Industrial Restructuring in India and Pakistan. Bulletin of Concerned Asian Scholars, 27(4), 63-78.
[15] Rahman, H. (1962). Growth Models and Pakistan: A Discussion of Planning Problems. Allies Book Corp..
[16] Haq, Mahbub ul - Articles and Speeches (1971 - 1977), 1651847, World Bank Group Archives, Washington, D.C., United States.

S1.5 The State of Workforce Training in Pakistan

Pakistan has a complex TVET regulatory and operational ecosystem (**Figure S1.5**). The National Vocational and Technical Training Commission (NAVTCC) is the main regulatory body for technical and vocational education at the federal level. With TVET a provincial matter, each province also has a Technical Education & Vocational Training Authority (TEVTA) to promote and provide such trainings for the existing and incoming workforce. The TVET institutions have to operate under the roadmap developed by the provincial TEVTAs. The affairs of *vocational* institutes are administered by the provincial education departments, while provincial labor departments oversee the *technical* training and apprenticeship centers.

Figure S1.5: TVET Ecosystem in Pakistan



Source: Comparative Analysis of TVET Sector in Pakistan (2017), National Vocational & Technical Training Commission

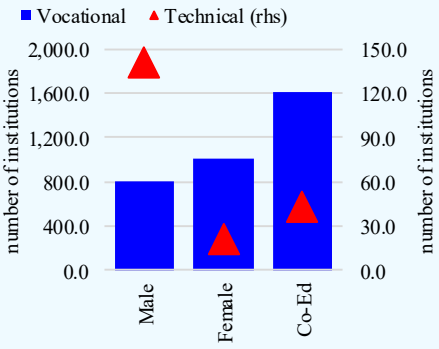
Furthermore, the autonomous Skill Development Councils and the provincial Directorates of Technical Education and Manpower Training are tasked with drafting and revising TVET curriculum and conducting training for trainers. In between, different domestic and international donor agencies help the government carry out research and capacity enhancement activities pertaining to the sector.

In what follows, the analysis presented is based on the 2018 skills gap surveys conducted by NAVTCC and provincial TEVTAs, the National Skills for All Strategy introduced by the MoFEPT, and the annual labor force surveys conducted by the Pakistan Bureau of Statistics (PBS).

The supply side leaves a lot to be desired

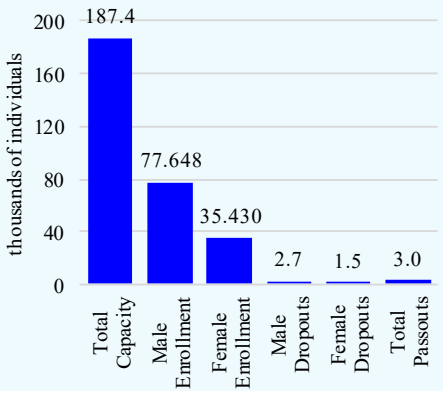
The existing vocational and technical training ecosystem of Pakistan is not adequate to meet the needs of the present and incoming labor force. This is because of various issues. There are 3,740 institutions in the country, including both from the public and private sectors, having a combined enrollment capacity of 187,393 (**Figure S1.6**). However, Pakistan had 3.8 million people from its workforce as unemployed as of 2018, with 1.8 million being added into the unemployed pool every year.[17]

Figure S1.6a : Number of TVET Institutions in Pakistan



Data source: Skilling Pakistan, NAVTCC

Figure S1.6b: Enrollment Statistics of TVET Institutions in Pakistan



Furthermore, a majority of the TVET institutions is situated in major urban centers, which makes acquiring skills for the people in far-flung areas difficult. This proves particularly challenging for the female labor force, as they often cite distance to workplace/training institute as one of the principal barriers to employment. Transport facilities are usually provided to address this issue, and 22 percent of the institutions in Punjab offer this service. However, this is followed by just 3 percent in Sindh and 1.4 percent of institutions in FATA and GB providing such facilities.[18]

[17] National "Skills for All" Strategy: A Roadmap for Skill Development in Pakistan (2018). Ministry of Federal Education & Professional Training, Pakistan.
[18] Comparative Analysis of TVET Sector in Pakistan (2017). National Vocational & Technical Training Commission, Pakistan.

It is also important to note that in the manufacturing sector, TVET graduates are also getting harder to find. If we look at the data for the top 30 most demanded occupations by the manufacturing sector firms in Punjab and Sindh (provinces having the largest share in total employment), the TVET supply against such occupations is substantially low. In Punjab, the total supply for such occupations meets just 10.6 percent of the total demand; while in Sindh, it is only 20.7 percent (**Table S1.3**).[19]

Table S1.3: Demand and Supply Gaps (2018) in Top 30 Demanded Manufacturing Sector Occupations in Punjab and Sindh

Punjab			Sindh		
Occupation	**Demand**	**Supply**	**Occupation**	**Demand**	**Supply**
Stitcher	19,382	240	Machine Operator	8,890	671
Machine Operator	18,956	11	Plant operator	5,975	0
Welder	14,021	4,864	Boiler Operator	3,205	0
Electrician	9,481	4,219	DAE Mechanical	2,765	4,761
Fitter	8,360	111	Steel Fixer	2,195	0
Cutter	8,215	0	Printing machine operator	2,150	0
Machinist	6,773	1,073	General Fitter	1,890	274
Lab Technician	6,519	46	Welding	1,870	926
Polisher	6,310	0	Lather Machine operator	1,505	0
Garments Designer	4,556	0	Stitching machine operator	1,260	233
Designer	4,335	0	Dying & Bleaching	1,120	0
Mixer Machine Operator	4,309	0	DAE Chemical	910	422
Packing Machine Operator	3,371	0	Tiles Fixer	875	0
DAE Mechanical	3,208	4,555	Dying Maker	840	0
Wood work	2,729	99	Mill Technician	805	0
Steel Fabricator	2,605	0	CNC Operator	792	0
Leather Garment Stitching	2,515	202	Garments making	658	906
Plant Operator	2,412	0	DAE Apparel Merchandizing	630	77
Press Machine Operator	2,221	0	Forman	595	0
Mechanical	1,861	0	LMO machine operator	595	0
Design & Patternmaker	1,807	0	Fitter (Press)	556	0
Fabricator	1,709	0	Weaving Operator	490	0
Surgical Instrument Fitter	1,485	0	Spray painter	455	0
Pattern Making	1,437	0	Wood Working	450	456
Finishing and Polishing	1,264	0	Injection molder	420	0
Loader Machine Operator	1,260	0	Pattern making	385	0
Mechanical Technician	1,180	49	DAE Garments Technology	356	298
Production Manager	1,148	0	Textile Designing	350	0
Die Fitter	1,144	0	Injection Blow	275	0
Leather Cutter	985	0	Mix machine operator	250	0
Total	**145,558**	**15,469**	**Total**	**43,512**	**9,024**

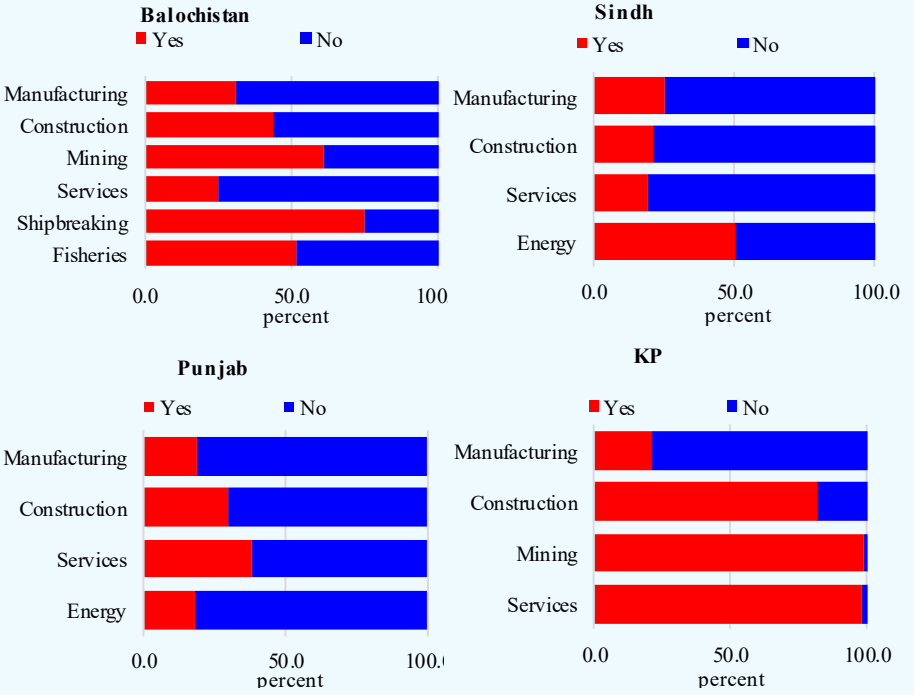
Data source: National Vocational & Technical Training Commission (NAVTTC), various skill gap surveys

[19] One thing to keep in mind is that it is not necessary for TVET students graduating with manufacturing sector training to actually pursue a career in manufacturing sector. Same is the case with non-manufacturing training programs.

Despite the apparent skill gap, businesses seem content with the quality of the workforce employed – the demand for TVET

Business executives pertaining to industrial and services sectors in Pakistan surprisingly appear mostly satisfied with the quality of skills of their employed workforce. Here, the share of satisfied executives in the manufacturing sectors is one of the highest across sectors and provinces (**Figure S1.7**).

Figure S1.7: Percent of Firms Stating They Face Skills Deficiency



Data source: NAVTCC Provincial Skill Gap Surveys (2017/18)

It is imperative here to first establish the context within which this survey finding is to be analyzed. In Pakistan, level of competition in the market is low, businesses are predominantly domestic market-oriented, incentive for research and innovation is minimal, informality in the market is high, and production processes and management practices are not up-to-date (**Box S1.2**). This means that firms do not face pressure or feel adequately incentivized to focus on productivity enhancement, of which training of the workforce is a crucial component. This needs correction, because without a commensurate demand for skill development

from the employers, there will be limited incentive for prospective as well as present workers to improve their knowledge base and skill levels.

Box S1.2: Why Businesses in Pakistan Focus on Surviving rather than Thriving? Do Market Failures Exist in TVET?

Inadequate provision of training to the labor force can be described as a market failure in an economy. Therefore, like all market failures, it needs to be properly diagnosed before relevant policy actions can be taken to help address it.[20]

Poaching and matching externalities in the labor market: First comes the imperfection in the labor market. Suppose if all employers desire a particular skill in the workers, and there exists perfect competition in the market, then those skills become fully transferable and employees can fully appropriate the returns on the training. On the other hand, if there are certain types of training that can only be employed by a certain employer, then those skills become non-transferable and this time employers fully appropriate the returns. In real life, however, trainings fall in between these two extremes and hence there is suboptimal investment by both parties. Firms underinvest because workers can be "poached" by competitors (poaching externalities). Workers underinvest because they do not receive remuneration commensurate to increased productivity levels (matching externalities

Credit constraints in the capital markets: Access to finance can also play a deterministic role in training provision of the workers. In particular, there is evidence that training decisions of low-income workers are negatively affected by lack of financing.[21] One option is to borrow, and it could be feasible if the rate of return is higher than the cost of borrowing. Financial institutions, however, usually have negligible information about the effect of training on the wages and creditworthiness of the individual seeking funding. Resultantly, they decide against lending. There can also be the case that financial markets are not developed enough to offer such financing avenues.

Coordination failures: It is well established that more skilled workers help improve the quality of R&D activities of firms and help make them more productive (for details, refer to Section S1.3 above). However, workers may not invest in those high-skill trainings because the firms might not demand them. This would be a case in an economy with poor competitiveness characteristics, where many firms do not focus on innovations and productivity enhancements and instead manipulate with their marker power to earn excessive profits and engage in rent-seeking activities. In such a situation, there would simply be not enough jobs for high-skilled workers.

[20] Almeida, R.; Behrman, J.; Robalino, D. (2012). The Right Skills for the Job? Rethinking Training Policies for Workers. Human Development Perspectives. Washington, DC: World Bank

[21] Greenhalgh, Christine, and George Mavrotas. 1994. "The Role of Career Aspirations and Financial Constraints in Individual Access to Vocational Training." *Oxford Economic Papers* 46(4): 579–604.

Decision-making failures: Workers and businesses may not have complete information regarding the type of skills that might be required to keep performing well in the near future. This can result in making wrong investment decisions: they might spend money and time on acquiring skills that might not be needed going forward due to technological advancements, for instance. Even in the case where such information is properly accessible, issues can arise when workers do not have knowledge about the quality of training institutes and end up choosing one that fails to enhance their abilities to the desired extent.

Such market failures are prevalent in Pakistan economy. Following points highlight this further.

Weak competition environment: The competition environment in the country has historically not been favorable for productivity enhancement and growth. With high degree of market concentration, direct and indirect government involvement in key economic sectors, and legal and policy uncertainty that hampers investment decisions and influx of multinational enterprises, the focus on quality enhancement, research and innovation and productivity enhancement has been below-par. Low competition in the domestic market, coupled with entrenched anti-export bias, means that firms do not see any incentive to become more efficient and productive.[22]

Management constraints, particularly in small firms: Management practices is an often over-looked determinant of firm productivity and revenue growth. Management practices are strongly associated with differences in performance across firms and countries.[23] In Pakistan, management practices have been found to be a major determinant of inequality in productivity and performance. As came out from Management and Organization Surveys in more than 2,000 establishments in Punjab, management practices are less structured in small (and medium sized) firms compared to large firms, especially with respect to decentralization of decision-making, data-driven performance monitoring, target- and incentive-setting, and usage of data for decision-making.[24] This means that production processes and work methods are not revised to a desirable extent, and firms go out-of-touch with the emerging trends and best practices. This adversely affects their competitiveness.

Financing constraints: The overall bank credit to GDP in Pakistan is one of the lowest among emerging market economies, with large corporates constituting the largest clientele

[22] For more information, refer to Special Section 1 titled, "The State of Competition in Pakistan" in SBP's Second Quarterly Report for FY20 on the State of Pakistan's Economy

[23] For example, see Black, S. E., & Lynch, L. M. (2001). How to Compete: The Impact of Workplace Practices and Information Technology on Productivity. *Review of Economics and Statistics*, 83(3), 434-445 and Bloom, N., & Van Reenen, J. (2007). Measuring and Explaining Management Practices Across Firms and Countries. *The Quarterly Journal of Economics*, 122(4), 1351-1408.

[24] Source: Lemos, R., Choudhary, A., Van Reenen, J., Bloom, N., (2016) Management in Pakistan: First Evidence from Punjab, IGC

of bank lending.[25] Small and medium enterprises (SMEs) have a share of only 5.4 percent in banks' lending portfolio (at end December 2019). Overdependence on own savings or informal channels of funding means that small firms disproportionately face financing constraints as well as considerable difficulties to expand their operations. As a result, innovation, productivity enhancement and diversification take a back seat in terms of organizational goals.

High degree of informality: In Pakistan, higher incidence of informality in the product and labor market further discourages innovation. This is because adherence to intellectual property rights is negligible and replication of ideas and products is common practice. Regulation and monitoring in terms of consumer protection laws is also considerably weak, which means that there is negligible pressure on firms to follow quality standards protocols. Furthermore, with employment not contractual and the share of temporary workers high, investment on training and labor productivity enhancement is not attractive for the employers as they fear that their workers might leave or get poached by competitors.[26]

Within this context, it is hence not surprising to find a low incidence of employers providing either on-the-job or off-the-job training to their employees. According to the 2017-18 labor force survey conducted by the Pakistan Bureau of Statistics, the percent of employees working in the manufacturing sector that had received any type of on-the-job training stood at 12.4 percent, of which around half had acquired any training more than 8 years ago. Similar was the case with those having off-the-job training experience.

This means that not only are a majority of incoming and existing employees not getting proper vocational and technical trainings, but those that have received some training have skills that are often not relevant anymore to the current and emerging work scenarios. This trend is visible in all the non-agricultural sectors of employment (**Table S1.4**).

This leaves businesses detached from the TVET sector, thereby reducing the effectiveness of training programs

With businesses not deeming training of the workforce as a priority objective, their involvement and interaction with the TVET sector has remained

[25] According to the 2017 Global Findex database, the share of adults in Pakistan who accessed formal banking channels to borrow for business inception, conduct or expansion was zero percent for young adults and only 2 percent for older adults.

[26] Afraz, N., Hussain, T., Khan, U., (2013). Barriers to the Growth of Small Firms in Pakistan: A Qualitative Assessment of Selected Light Engineering Industries Lahore Journal of Economics, *The Lahore School of Economics*, Vol.19 (Special Edition), pages 135-176, September, 2014.

Table S1.4: Training Status (percent) of the Labor Force in Pakistan

	With on the job training						With off the job training						Total
Years ago →	during the last year	2-3 years	4-5 years	6-7 years	8 or more years	Total	during the last year	2-3 years ago	4-5 years ago	6-7 years ago	8 or more years ago	Total	
Share of total manufacturing employees	0.8	1.7	2.3	1.4	6.3	**12.4**	0.5	1.9	1.8	1.4	10.0	**15.6**	**28.0**
Share of trained manufacturing employees	2.9	5.9	8.2	4.9	22.4	**44.3**	1.9	6.6	6.5	5.1	35.5	**55.7**	**100.0**
Share of non-manufacturing employees	0.3	0.6	0.6	0.4	2.4	**4.3**	0.4	1.8	1.8	1.8	9.9	**15.6**	**20.0**
Share of trained non-manufacturing employees	1.6	3.0	2.8	2.2	12.0	**21.7**	1.9	9.1	8.8	9.1	49.3	**78.3**	**100.0**

Data source: Pakistan Bureau of Statistics; authors' calculations based on LFS 2017-18

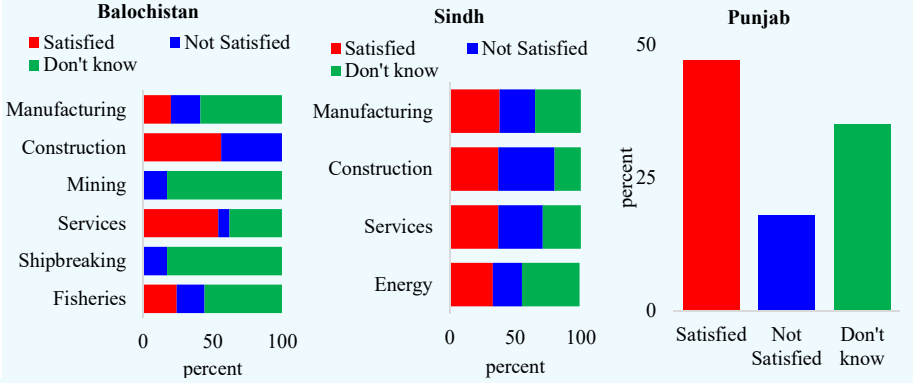
unsatisfactory. As the 2019 National Skills for All Strategy roadmap of the government puts it, "In Pakistan, technical and vocational training primarily takes place in time-bound, theory-based, teacher-led classroom environments, in virtual isolation from industry".[27]

This has three major implications. First, the curriculum of the institutions is not aligned with the requirements of the industrial work, which results in existing workers not observing a noticeable improvement in productivity after graduating. Second, the skill-imparting programs are skewed towards theoretical teaching compared to practical learning, which particularly affects the incoming labor force and leaves them ill-equipped in terms of hands-on experience and unattractive in the eyes of potential employers. Third, and perhaps more important, there is the potential of a vicious cycle whereby businesses, disappointed with the results of such training programs, get further alienated from the institutions. With consistent aloofness of the industry, the curriculum remains outdated and/or incompatible with the emerging requirements, and the graduates continue to suffer in terms of productivity gains and job placement.

[27] Reference: navttc.org/wp-content/uploads/2019/03/National-Skills-for-All-Strategy-2018-1.pdf

It is not surprising, hence, to find a sizable share of senior executives not satisfied with the design and impact of off-the-job technical and vocational training programs. Equally alarming is the notable share of executives responding with a "Don't know". This can be either because employees of these firms did not have any recent experience with TVET institutions, or because the executives of those businesses simply have no link or contact with such training providers. Both the answers are worrying on their own merits (**Figure S1.8**).

Figure S1.8: Satisfaction Level of Firms with Regards to TVET-Trained Workforce



Data source: NAVTCC Provincial Skill Gap Surveys (2017/18); KP data not available in provincial report

Industrial sector also does not focus on the multi-skilling of workforce

Multi- or cross-skilling of the labor force has been identified as one of the reasons for the industrial sector success of countries such as Japan and Germany in the 20th century, and the rise of China in the 21st century. In a multi-skilled labor force, workers tend to possess a range of skills which allow them to participate in more than one work process. While the federal government spearheads the multi-skilling framework in some economies, in others, employers lead the initiative. In Japan, for example, the employers take advantage of plant-level *oyakata* craftsmen and apprenticeship providers to help impart the desired skills to employees via on-the-job training programs.[28] A crucial component of Japan's industrialization strategy since the 1980s has been to make occupations broadly defined and job rotations frequent, so as to instill the motivation for pursuing multiple skills in employees.[29]

[28] Thelen, K. (2004). How Institutions Evolve: The Political Economy of Skills in Germany, Britain, the United States, and Japan. Cambridge University Press.
[29] Gregg, C., Jansen, M., & Uexkull, E. V. (2012). Skills for Trade and Economic Diversification: A Practical Guide. Geneva: International Labor Organization.

Another dimension that merits a discussion here is the role of labor unions in the TVET domain. Union involvement in training programs can help encourage a "productivity coalition" among management, unions and the workforce. Labor unions are also "often well placed to help run training programs in a way that appears fair and wins the trust of the workforce".[30] Germany, for example, is cited as a success story in this regard. Labor unions in Germany are involved in a tripartite vocational education ecosystem with the government and employers and actively establish occupational groupings, revise training curriculums, and set recruitment targets based on future skill needs at a firm and even plant level basis. Turkey has a similar system, whereby unions and employer groups mutually oversee the quality and delivery of apprenticeship programs, while the Vocational Training Councils serve as a platform where all the TVET stakeholders can get together and provide policy recommendations to the government.[31]

Figure S1.9a: Labor Unions in Pakistan - Strength and Memberships

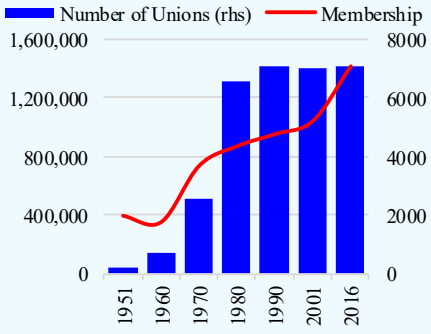
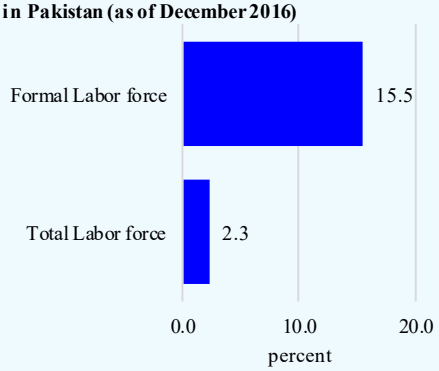


Figure S1.9b: Percentage of Unionized Workforce in Pakistan (as of December 2016)



Data source: ILO (2018)

In Pakistan, however, the same is not the case. The number of unions in Pakistan has continued to noticeably rise in terms of both strength and membership (**Figure S1.9**). However, the proportion of union membership in the non-agriculture workforce has remained low at 6 percent throughout the period and has declined to 5.5 percent during the recent past, and their focus on employee learning and development has been negligible. Both legal restrictions and the anti-union bias

[30] Katz, H. C., Kuruvilla, S., Turner, L., Katz, Harry C. (1993). Trade Unions and Collective Bargaining. Policy, Research Working Papers; no. WPS 1099. Education and Employment. Washington, DC: World Bank.

[31] Towards a Model Apprenticeship Framework: A Comparative Analysis of National Apprenticeship Programs. (2013). New Delhi: International Labor Organization, International Bank for Reconstruction and Development/ the World Bank.

among employers are the reasons behind this trend. Although emphasis on trade unions and training was part of virtually all the labor policies drafted by the government since the start, those policies were never actively implemented in full spirit by the federal and later provincial governments.[32] In Pakistan, thus, neither the labor unions are so involved in skill-building and occupation defining activities nor is rotation and "multi-skilling" of employees a prevalence in the industrial workplaces.

In this environment, employees see limited incentive to improve skills on their own

As previous sub-sections have established, employers are not actively focusing on providing either in-house or off-the-job training to their employees. An alternative could be for workers to pursue such training on their own. However, attraction for undertaking such an endeavor is hampered by the fact that there are negligible gains in terms of wages between formally trained and untrained workers.

We analyze the wage differentials between trained and untrained workers employed in elementary occupations, working as plant and machinery operators and/or involved in crafts related trade activities in the manufacturing sector of Pakistan. Using the information available in the Labor Force Survey 2017-18, we find that in many industries/occupations, there is little to no difference in wages when we consider either on-the-job training or off-the-job training (**Figure S1.10**). There are some industries where we find a positive wage gap, such as in mechanical assembling, cement, tobacco and fabric processing, but in many industries wage incentive (if any) does not appear to be large.

Consider the case of the readymade garments industry of Pakistan. According to a 2015 Punjab Skills Development Fund (PSDF) sector study regarding the effectiveness of TVET, 56 percent of the training service providers (TSPs) reported that there was a gap between the skillset being taught to the students and that required by the garment sector. The business experts in their response to the survey highlighted this issue in a more pronounced manner, with 86 percent of them saying there existed a skill-gap. Two of the most important reasons cited were lack of skilled teachers in the TVET institutions and poor coordination between the TSPs and industry players. While TSPs suggested increasing industrial sector's input as a vital condition for improving the efficacy of training

[32] Khalil, Z. K. (2018). A Profile of Trade Unionism and Industrial Relations in Pakistan. International Labor Organization.

Figure S1.10a: Wage Advantage for Manufacturing Workers with on the Job Training

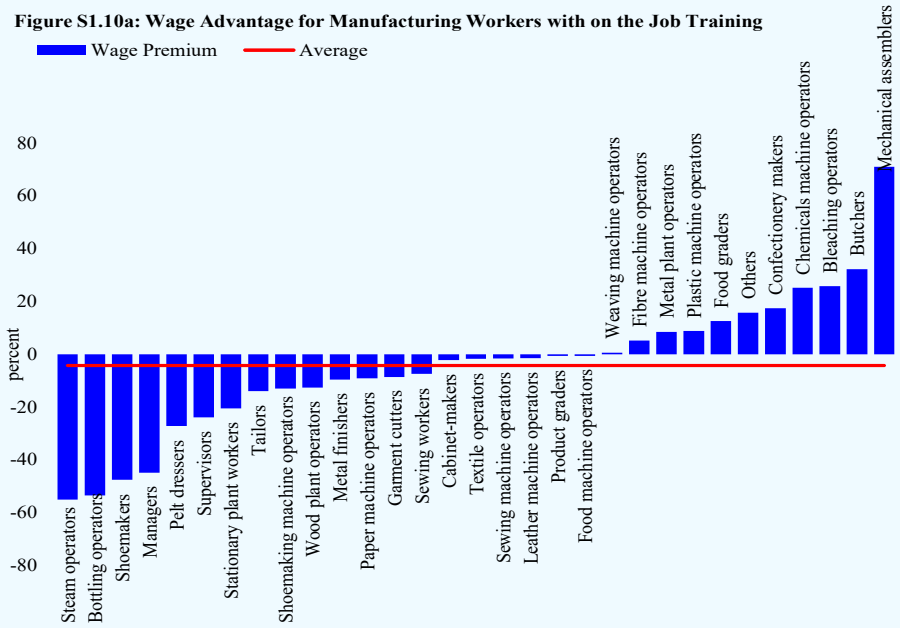
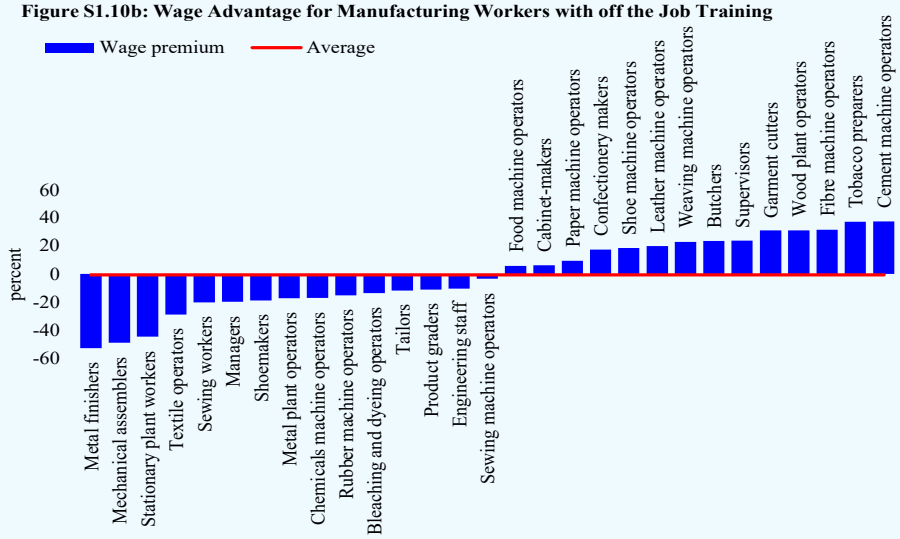


Figure S1.10b: Wage Advantage for Manufacturing Workers with off the Job Training



Note: each dot represents an industrial classification pertaining to crafts related trade works, plant and machinery operations and elementray positions of the manufacturing sector.
Data source: PBS Labor Force Survey 2017-18; author's calculations

programs, business experts highlighted the lack of demand driven curriculum, technological obsolescence and poor infrastructure of TSPs as the major impediments (**Figure S1.11**).

Figure S1.11a: TVET-Industry Divide in the Garments Manufacturing Sector

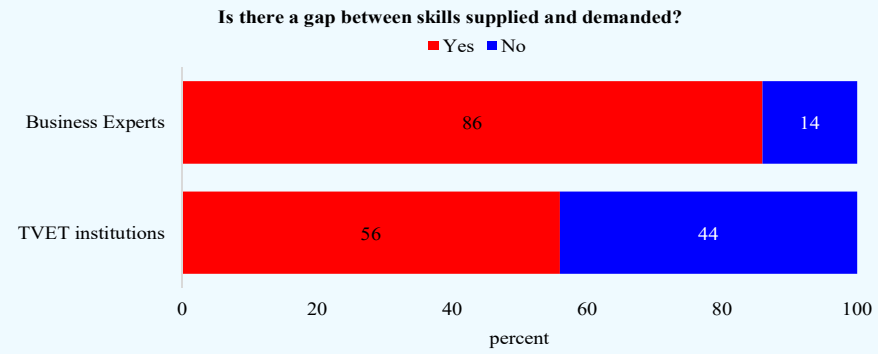


Figure S1.11b: Top Proposals (percent) cited by TVET Institutions to Address Skill Gap in Graduates

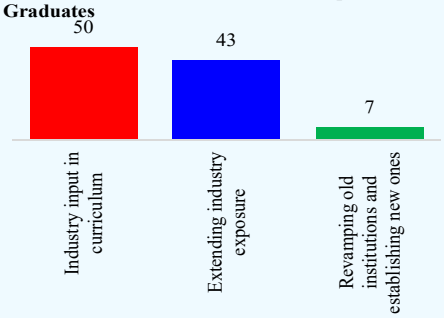
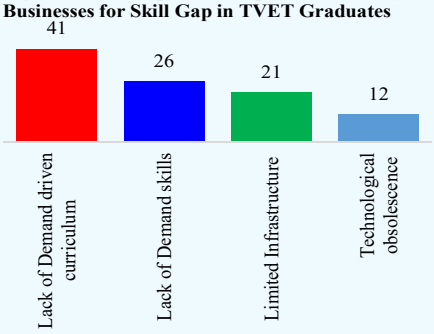


Figure S1.11c: Top Reasons (percent) cited by Businesses for Skill Gap in TVET Graduates

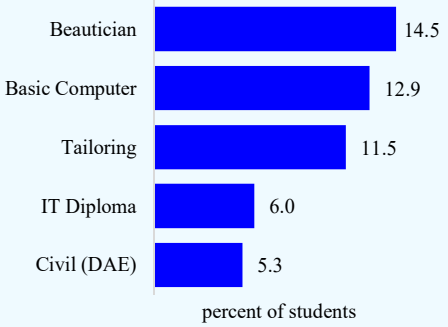


Data source: Sector Skills Study – Garments Sector (2015), Punjab Skills Development Fund

And their interest is instead shifting towards self-employment opportunities

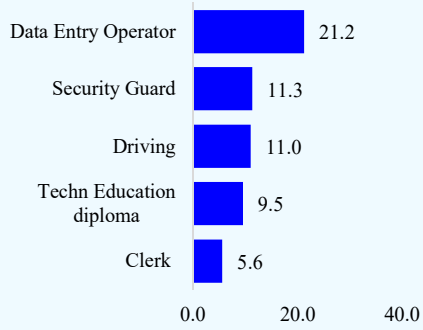
Courses that may generate self-employment opportunities are the most popular among TVET-enrolled individuals. These include beautician courses, basic computer learning and tailoring, etc. This contrasts with the courses most demanded by the employers, such as data entry operations, driving, and clerical works (**Figure S1.12**). This demonstrates both the increasing importance of services sector in the country and the much lower than required job growth levels in the country.

Figure S1.12a: Top 5 Courses Taken at TVET Institutions in Pakistan



Data source: SkillingPakistan.org

Figure S1.12: Top 5 Courses Demanded by Employers in Pakistan



According to a 2018 World Bank South Asia Focus report, 1.4 million additional jobs would be required every year in Pakistan for it to maintain the existing employment rate from 2015 to 2025. Worryingly, the report finds that the actual level of employment rate in Pakistan is around 13 percent lower than what may be expected given the level of income per capita. This is because of both the very low levels of female labor force participation (the gap is closed to 30 percentage points) and the very high share of public sector jobs (around 35 percent) in regular wage jobs, indicative of the fact that the private sector is simply not producing the levels of jobs that are required.

S1.6 Policy Implications and the Way Forward

Keeping in view the dynamics of the TVET sector mentioned above, reforms are needed along the following lines:

Industrial cooperation should be enhanced

First, the business community should exercise greater control over the curriculum building and training delivery channels of the TVET programs through closer collaboration. This is because training in isolation from the trends and demands of the industrial sector cannot achieve the desired results of efficiency and effectiveness.

As we have discovered, problems exist at both the supply and demand ends in this regard. A solution could be to establish a common platform (such as a coordination committee or a joint task force) between the TVET institutions and

businesses whereby specific skills requirements are highlighted by the industries and then the curriculum is developed by the institutions with constant feedback and participation from the business executives.

Meanwhile, there is also a need for firms to develop and/or upgrade their on-the-job training programs. This would be important in two major ways. First, as any particular firm would be training its own workers, it would know the exact requirements for the curriculum and would be able to structure the contents and duration of the program accordingly. Second, from the employees' perspective, it may also increase their job satisfaction and self-actualization levels, which would implicitly make them more committed to the tasks at hand. Palpable gains from both these developments would enable firms to recognize the benefits of training and thus help break the cycle of labor force going under-utilized.

Businesses and training institutions should be forward-looking and prepare for emerging trends

A particularly worrying trend is that many firms are satisfied with the level of skills their employees have and some are not even sure if those skills are adequate enough. In this regard, businesses need to adopt a forward-looking approach to identify skill gaps that may help the firms not only compete in the international market but also adopt the latest production and operational processes. Without properly trained employees, these would be difficult.

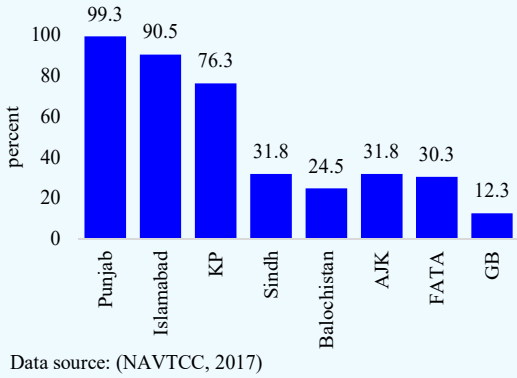
According to a 2017 McKinsey report, around 15 percent of jobs (400 million workers) might end up getting potentially displaced all over the world because of digitization of the economy. Moreover, the spending on digitization would continue to increase, which is likely to result in the creation of up to 50 million new technology jobs by 2030. All this means that the focus on acquiring and improving worker's skills would become more and more important.

A possible way of increasing the skill building of employees could be to include employees' training and development as a part of companies' corporate social responsibly (CSR) programs. Employer involvement in workers' learning and development also increases the latter's satisfaction and motivation levels and makes them less inclined to search for other jobs. According to the LinkedIn's 2019 Workplace Learning Report, 94 percent of employees surveyed stated they would stay at a company longer if it invested in their learning and development. Furthermore, employees who spent more than five hours per week learning were more likely to know where they wanted to go in their careers (74 percent of the

responders), to find their work purposeful (48 percent), and to feel less stressed (47 percent).[33]

Including training as a CSR objective could help address another potential bottleneck: workers being hesitant of asking employers to assist in training provision. According to the edX 2019 Reskilling Trends survey, while around a third of workers feel that employers should be responsible for making sure that the workers are prepared for the jobs of the future with the right skills, nearly half of them do not feel comfortable asking their employer to pay for the learning costs.[34]

Figure S1.13: Share of TVET Institutions having Internet Connection Facility



Data source: (NAVTCC, 2017)

Businesses also need to focus on emerging technologies, such as those pertaining to the Fourth Industrial Revolution (4IR). The government has indicated in many official planning and policy documents that adoption of 4IR would be a strategic priority. However, without a workforce properly equipped to handle such technology this cannot be achieved. Here, it is pertinent to note that apart from Punjab and KP, the share of TVET institutions having internet access is very low (**Figure S1.13**). This not only hinders the skill building of existing and potential workforce but also limits the reach of such training programs due to the lack of infrastructure for online/distance learning facilities, etc.

Public sector should increase efforts towards national skill building

Without direct public sector focus on skill building, the TVET sector cannot function effectively. For example, many businesses, especially those belonging to the SME sector, cannot afford to provide formal training to their workforce. Here, measures such as subsidies or tax breaks from the government can prove helpful. Similarly, the authorities must invest in the TVET institutions to equip them with the latest machineries and systems and to train the teaching staff accordingly.

[33] Source: 2019 Workplace Learning Report. (2019). LinkedIn.
[34] Source: https://blog.edx.org/edx-announces-results-new-survey-reskilling-trends/?track=blog

This would aid in preparing the incoming batches with the latest and in-demand skills. On the workers' end, the authorities can widen the scope of financial aid and scholarships to ensure affordability of such programs for the lower and lower-middle income portion of the population.

Encouragingly, some positive developments are taking place in this regard. For instance, the National Skills for All Strategy prepared by the Ministry of Federal Education & Professional Training provides a roadmap to: (i) broaden the scope of targeted skills development programs, (ii) increase the participation and input from the private sector in curriculum design and training delivery, (iii) enhancing female labor force participation; and (iv) implementing apprenticeship laws around the country. In this context, the government launched the *Hunarmand Jawan* program and the Digi-Skills initiative, via which it aims to equip the youth with the skills required to effectively take part in the existing and emerging job requirements in the country. Salient features of *Hunarmand Jawan* include: (i) training 50,000 of the youth labor force belonging to less developed areas of country; (ii) creating 100 smart tech labs across Pakistan for distant learning programs in technical & vocational education; and (iii) establishment of 50 Business Incubation Centers to promote self-employment and entrepreneurship in skilled youth.

Another encouraging development is that the National Vocational and Technical Training Commission (NAVTCC) of Pakistan has launched officially defined skill-set categorizations to help improve the placement and skill matching in the domestic labor market. Under the revised National Vocational Qualifications Framework (NVQF), an assessment criterion has been developed to classify workers according to skill-sets and to facilitate their gradual promotion to higher levels. Similarly, NAVTCC is also in the process of setting up institutional accreditation process for TVET institutions. The training service providers would be assessed based on indicators such as affiliation/accreditation with relevant bodies; adequacy of training facilities; teaching staff quality; type of trades being offered; employability of graduates; alignment with NVQF; and health and safety requirements, etc. The objective is to foster a sense of healthy competition amongst the training institutes to bring overall improvement in the sector.

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:

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

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

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

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

ADB	Asian Development Bank
AE	Adult Education
AEO	Authorized Economic Operators
AJK	Azad Jammu and Kashmir
AML	Anti-Money Laundering
APCMA	All Pakistan Cement Manufacturers Association
ATM	Automatic Teller Machine
BISP	Benazir Income Support Program
BMR	Balancing, Modernization and Replacement
BOI	Board of Investment
BoP	Balance of Payments
bps	Basis points
BSC	Behbood Savings Certificate
CA	Current Account
CAA	Civil Aviation Authority
CAD	Current Account Deficit
CBRT	Central Bank of the Republic of Turkey
CBU	Completely Built Up
CCI	Consumer Confidence Index
CCP	Competition Commission of Pakistan
CFT	Combating the Financing of Terrorism
CKD	Completely Knocked Down
CNG	Compressed Natural Gas
CNIC	Computerized National Identity Card
COVID-19	Coronavirus disease 2019
CPEC	China–Pakistan Economic Corridor
CPI	Consumer Price Index
CPPA	Central Power Purchasing Authority
CRC	Cold Rolled Coil
CSR	Corporate Social Responsibility
CY	Calendar Year
DAE	Diploma of Associate Engineer
DAP	Diammonium Phosphate
DIRBS	Device Identification Registration and Blocking System

DISCOS	Distribution Companies
DPP	Department of Plant Protection
DSC	Defense Saving Certificate
DMT	Directorate of Manpower Training
DTE	Directorate of Technical Education
ECB	European Central Bank
ECC	Economic Coordination Committee
ECE	Early Childhood Education
EFF	Extended Fund Facility
EFS	Export Finance Scheme
EM	Emerging Market
EU	European Union
FAO	Food and Agriculture Organization
FAPMMEC	Food and Agricultural Product Markets Monitoring and Evaluation Committee
FASTER	Fully Automated Sales Tax e-Refund
FATA	Federally Administered Tribal Areas
FATF	Financial Action Task Force
FBR	Federal Board of Revenue
FC	Financial Cost
FCA	Federal Committee on Agriculture
FDI	Foreign Direct Investment
FE-25	Foreign Exchange-25
FED	Federal Excise Duty
FO	Furnace Oil
FPA	Fuel Price Adjustment
FPI	Foreign Portfolio Investment
FRDLA	Fiscal Responsibility and Debt Limitation Act
FTA	Free Trade Agreement
FWO	Frontier Works Organization
FX	Foreign Exchange
FY	Fiscal Year
GB	Gilgit-Baltistan
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product

GFC	Global Financial Crisis
GIDC	Gas Infrastructure Development Cess
GSM	Global System for Mobile
GSP	Government Support Price
GSP	Generalized System of Preferences
GST	General Sales Tax
GSTS	General Sales Tax on Services
H1	First Half
H2	Second Half
HSD	High Speed Diesel
IBA	Institute of Business Administration
ICT	Information and Communications Technology
IT	Information Technology
IFEM	Inland Freight Equalization Margin
IFFCF	International Fast Food Chains Franchisees
IFI	International Financial Institution
IGC	International Growth Centre
ILO	International Labour Organization
IMF	International Monetary Fund
ISIC	International Standard Industrial Classification
KERO	Kerosene Oil
KG	Kilogram
KHI	Karachi
KM	Kilo Meter
KP	Khyber Pakhtunkhwa
KSA	Kingdom of Saudi Arabia
LDO	Light Diesel Oil
LLL	Life-long Leaning
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
LSM	Large Scale Manufacturing
LT	Long-term
LTFF	Long-term Financing Facility
MCA	Monopoly Control Authority

MIEWS	Market Intelligence and Early Warning System
MNFSR	Ministry of National Food Security and Research
MoC	Ministry of Commerce
MoF	Ministry of Finance
MPC	Monetary Policy Committee
MoFEPT	Ministry of Federal Education and Professional Training
MPD	Monetary Policy Department
MRTBs	Market related Treasury Bill
MRTPO	Monopolies and Restrictive Trade Practices (Control and Prevention) Ordinance
MSCI	Morgan Stanley Capital International
MT	Metric Ton
MUFAP	Mutual Funds Association of Pakistan
NAVTCC	National Vocational and Technical Training Commission
NDA	Net Domestic Asset
NDMA	National Disaster Management Authority
NEER	Nominal Effective Exchange Rate
NEPRA	National Electric Power Regulatory Authority
NFA	Net Foreign Asset
NFC	National Finance Commission
NFDC	National Fertilizer Development Center
NFNE	Non-food-non-energy
NHA	National Highway Authority
NITB	National Information Technology Board
NLC	National Logistics Cell
NPPO	National Plant Protection Organization
NSER	National Socio-Economic Registry
NSS	National Savings Scheme
NTC	National Tariff Commission
NTDC	National Transmission and Dispatch Company
NTP	National Tariff Policy
NVQF	National Vocational Qualifications Framework
OCAC	Oil Companies Advisory Council
OECD	Organization for Economic Co-operation and Development
OG	Operation Green
OGRA	Oil and Gas Regulatory Authority

OMCs	Oil Marketing Companies
OMO	Open Market Operation
OUP	Oxford University Press
PAMA	Pakistan Automotive Manufacturers Association
PB	Prize bond
PBA	Pensioners' Benefit Account
PBO	Provisional Booking Order
PBS	Pakistan Bureau of Statistics
PCRCL	Pakistan Corporate Restructuring Company Limited
PEDL	Public External Debt Liability
PFM	Public Finance Management
PFMA	Pakistan Flour Mills Association
PIA	Pakistan International Airlines
PIB	Pakistan Investment Bond
PKR/Rs	Pakistan Rupee
POL	Petroleum, Oil and Lubricants
POS	Point of Sales
PPA	Pakistan Poultry Association
PPRO	Plant Protection Release Order
PRA	Pest Risk Analysis
PSDP	Public Sector Development Program
PSE	Public Sector Enterprise
PTA	Pakistan Telecommunication Authority
Q1	First Quarter
Q2	Second Quarter
Q3	Third Quarter
Q4	Fourth Quarter
REER	Real Effective Exchange Rate
RIC	Regular Income Certificate
RMG	Readymade Garment
ROA	Return on Assets
RPI	Relative Price Index
SAR	Saudi Arabian Riyal
SBP	State Bank of Pakistan
SDC	Skill Development Council

SDG	Sustainable Development Goal
SDR	Special Drawing Rights
SFWA	Shuhadas Family Welfare Account
SIM	Subscriber Identity Module
SMEs	Small and Medium-sized Enterprises
SNGPL	Sui Northern Gas Pipeline Limited
SPS	The Agreement on the Application of Sanitary and Phytosanitary Measures
SRO	Statutory Regulatory Order
SSA	Special Savings Account
SSC	Special Savings Certificate
SSGC	Sui Southern Gas Pipeline Limited
ST	Short-term
SUPARCO	Space and Upper Atmosphere Research Commission
SUV	Sports Utility Vehicle
T-bills	Treasury bills
T&D	Transmission and Distribution
TCP	Trading Corporation of Pakistan
TEVTA	Technical Education & Vocational Training Authority
TFP	Total Factor Productivity
TOP	Tomato, Onion and Potato
TVET	Technical and Vocational Education and Training
UAE	United Arab Emirates
UK	United Kingdom
US	United States
US$	United States Dollar
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNICEF	United Nations International Children's Emergency Fund
UN	United Nations
USA/US	United States of America
USDA	United States Department of Agriculture
USFIA	US Fashion Industry Association
WHT	Withholding tax
WTO	World Trade Organization
YoY	Year on Year