

THE STATE OF PAKISTAN'S ECONOMY

2020-21

Third Quarterly Report of the Board of Directors



State Bank of Pakistan

SBP BOARD OF DIRECTORS

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LETTER OF TRANSMITTAL

State Bank of Pakistan
Karachi.
July 15, 2021

Dear Mr. Chairman,

In terms of Section 9A(2) of the State Bank of Pakistan Act, 1956, the Third Quarterly Report of the Board of Directors of the State Bank of Pakistan on the State of the Economy for the year 2020-2021 is hereby enclosed for submission to the Majlis-e-Shoora (Parliament).

With warm regards,

Yours sincerely,



(Dr. Reza Baqir)

Governor
Chairman Board of Directors

Muhammad Sadiq Sanjrani
Chairman
Senate
Islamabad

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(Dr. Reza Baqir)

Governor
Chairman Board of Directors

Asad Qaiser
Speaker
National Assembly
Islamabad

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| 3. Monetary Policy and Inflation | Sajawal Khan; Fatima Khaliq; Junaid Kamal; Umar Mashhood |
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Penetration by Addressing Information
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1 Overview

The recovery in Pakistan's economy gained further traction in the third quarter of FY21. The growing momentum over the three quarters of FY21 is reflected in the provisional estimates of GDP growth of 3.9 percent for the full year (**Table 1.1**). Compared to last year's contraction of 0.5 percent, the recovery this year was mainly achieved through a turnaround in large scale manufacturing (LSM) industry, and the services sector, particularly the expansion in the wholesale and retail trade segment. In the agriculture sector, growth in wheat, rice, maize and sugarcane — all expected to achieve record or near record high output this year — offset the decline in cotton production. The rebound in activity has also been reflected in the strength of a variety of demand indicators through the first three quarters of FY21, including sales of fast-moving consumer goods, automobiles, cement, and POL products. Moreover, other macroeconomic indicators remained stable during Jul-Mar FY21, as evident from the surplus in the current account and primary balance, and lower average headline inflation compared to last year.

One of the key factors behind the relatively contained impact of the pandemic and the on-going rebound in economic growth has been the deft response of policymakers. On the health side, the spread and fatality of the virus were controlled through a smart approach to testing, contact tracing and quarantine. As a result, cases which peaked at 30 per million in the beginning of the fiscal year were quickly brought down. In contrast to the wide-scale shutdown of industry and services during the first wave of Covid, the government opted for smart lockdowns during FY21, and continued to offer timely and targeted fiscal support, complemented by the SBP's flexible and aggressive

Selected Economic Indicators

Table 1.1

		FY19	FY20	FY21
<i>Growth rate* (percent)</i>				
Real GDP	Jul-Jun	2.1	-0.5	3.9
Agriculture	Jul-Jun	0.6	3.3	2.8
Industry	Jul-Jun	-1.6	-3.8	3.6
o/w LSM	Jul-Jun	-2.6	-10.1	9.3
Services	Jul-Jun	3.8	-0.6	4.4
CPI (period average) ^a	Jul-Mar	6.3	11.5	8.3
Private sector credit ^b	Jul-Mar	10.2	4.8	7.3
Money supply (M2) ^b	Jul-Mar	5.1	8.5	7.8
Exports ^b	Jul-Mar	-1.1	1.3	2.3
Imports ^b	Jul-Mar	-3.4	-13.2	9.4
Tax revenue -FBR ^c	Jul-Mar	2.8	13.2	10.9
Exchange rate (+app/dep%) ^b	Jul-Mar	-13.7	-4.0	10.0
Policy rate ^b	end-Mar	10.25	11.00	7.00
ONMMR ^b	end-Mar	10.0	10.7	7.8
<i>billion US dollars</i>				
SBP's reserves (end-period) ^b	Mar	10.5	10.8	13.5
Workers' remittances ^b	Jul-Mar	16.0	17.0	21.5
FDI in Pakistan ^b	Jul-Mar	0.9	2.2	1.4
Current account balance ^b	Jul-Mar	-10.3	-4.1	1.0
<i>percent of GDP</i>				
Fiscal balance ^d	Jul-Mar	-5.0	-4.1	-3.5
Current account balance	Jul-Mar	-4.8	-2.1	0.4
Investment	Jul-Jun	15.6	15.3	15.2

* The numbers relating to real GDP growth rate and its sub-components for FY19, FY20 and FY21 represent final, revised, and provisional estimates respectively.

Sources: ^a Pakistan Bureau of Statistics; ^b State Bank of Pakistan; ^{c,d} Ministry of Finance

initiatives to counter the pandemic. The successful containment of the spread of the pandemic, the various measures and incentives by the government and the SBP, as well as the optimism of households and businesses, converged to take the economy out of the Covid-induced recession. Higher than expected wheat production was also a contributing factor.

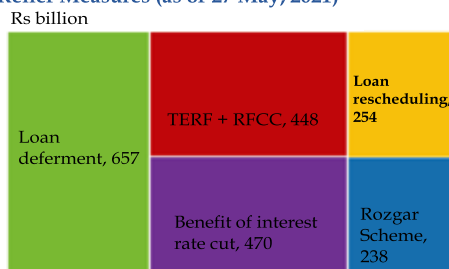
In addition to the successes in managing the health side of the pandemic, a number of policy measures are responsible for the rebound in economic activity. First, the monetary policy environment during FY21

was highly accommodative, in contrast to the necessary focus on stabilization before the Covid outbreak to deal with the severe balance of payments crisis. Having cut the policy rate from 13.25 percent to 7.0 percent between March to June 2020, the SBP's Monetary Policy Committee (MPC) maintained the status quo throughout FY21.

Second, fiscal support was targeted, cognizant of high public debt. Making use of the primary surplus achieved through the first nine months of FY21, the government was able to reorient expenditure toward the most vulnerable and priority areas, while still delivering a fiscal consolidation for the year as a whole. As a result, the pace of public debt accumulation decelerated considerably – its lowest increase in absolute terms since FY17. The fiscal consolidation has continued in FY21, despite the government not imposing any new taxes and offering support in the form of an energy package, which included major tariff relief for industry; faster tax refunds to exporters; and comprehensive social protection initiatives, such as the Ehsaas Emergency Cash program. Healthy revenue growth and restraint on spending have underpinned the continued fiscal consolidation, which has lifted market sentiment and supported the investment outlook.

Third, liquidity support was channeled through the SBP's wide-ranging measures to combat the Covid shock. The relief measures included low interest rates and regulatory relaxations for restructuring debt and deferring principal repayments, which eased the debt burden of firms and households. The central bank also rolled out refinance

Liquidity Impact of SBP's Major Relief Measures (as of 27 May, 2021)* **Figure 1.1**



* The overall size of SBP support is Rs 2,067 billion.
TERF: Temporary Economic Refinance Facility
RFCC: Refinance Facility for Combating Covid-19
Source: State Bank of Pakistan

facilities to support employment, investment, BMR, and setting up of health facilities (**Figure 1.1**). These quantitative interventions were focused on addressing specific challenges emanating from the pandemic, with specific credit allocation decisions left to the banks. This helped to deliver liquidity assistance where it was most needed. Furthermore, the export and construction sectors were facilitated through measures such as an expanded scope for the Export Financing Scheme (EFS), and SBP's mandatory targets to encourage banks to extend more housing and construction loans.¹

Fourth, the government's agriculture policies also played an enhanced supporting role. These mainly comprised subsidized inputs, such as fertilizer, pesticides, and weedicides, as well as increase in the minimum support price, such as for wheat and sugarcane crops. The resulting increase in production of most of the important crops supported the rural households.

¹ For more details on sector-specific policies, see Chapter 1 of the SBP's Second Quarterly Report on The State of Pakistan's Economy for FY21.

Further support to both urban and rural households came from a surge in workers' remittances, which rose by US\$ 4.5 billion to touch a record high of US\$ 21.5 billion during Jul-Mar FY21. The resulting increase in demand is reflected in a consistent growth in high frequency demand indicators over the three consecutive quarters of FY21 (Figure 1.2).

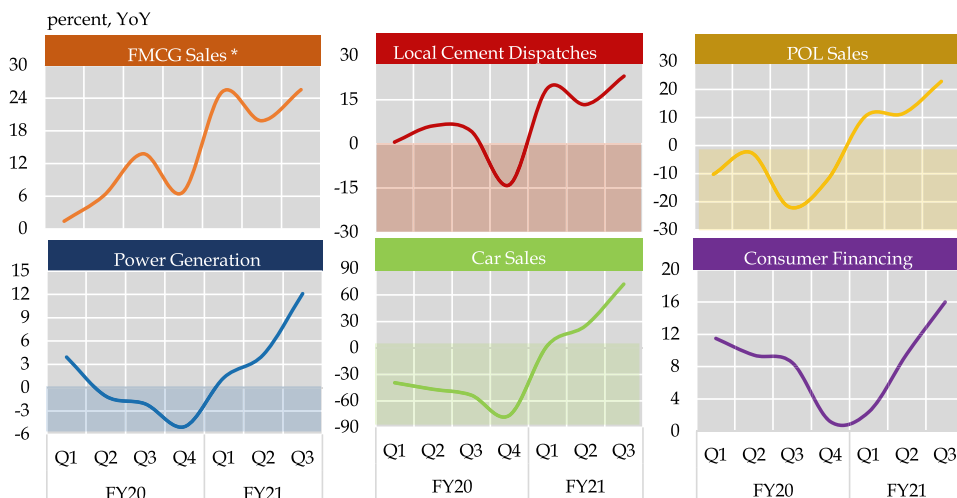
Workers' remittances were also instrumental in generating a cumulative current account surplus during Jul-Mar FY21. Further support to the external account came from deferred interest payments on external debt through the Debt Service Suspension Initiative (DSSI), curbs on international air travel, and lower global oil prices. Collectively, these factors offset a growing merchandise deficit stemming from: (a) substantial import of agriculture commodities at elevated prices; and (b) growing imports of raw material and capital goods to meet industrial demand, together

with sluggish growth in export receipts. On the financing side, inflows were available from commercial, bilateral and multilateral sources (including the IMF), as well as new inflows under Roshan Digital Accounts, which crossed US\$ 1 billion in April 2021. Overall, the SBP's liquid FX reserves rose by US\$ 1.4 billion, its net forward liabilities moderated by US\$ 1.5 billion, and the PKR strengthened by 10 percent against the US Dollar during Jul-Mar FY21.

Continuing their improving trend, fiscal accounts yielded a primary surplus of Rs 452 billion, while the fiscal deficit in terms of GDP was lower during Jul-Mar FY21 compared to last year. The improvement stemmed from a pronounced slowdown in spending and a decent increase in taxes. Rationalization of non-interest spending was instrumental, as there was a slowdown in non-priority current expenditure. On the other hand, growth in tax collection was supported by improvement in economic

Growth in Demand Indicators

Figure 1.2



* FMCG Sales are based on the financials of 25 listed companies.

Sources: SBP, APCMA, PAMA, OCAC, NEPRA & Corporate reports (various issues)

activity, FBR efforts to improve tax administration, as well as low base effects. However, development spending remained constrained and interest payments remained a significant burden, consuming 62.0 percent of tax revenues in the period.

Meanwhile, the pace of debt accumulation eased during Jul-Mar FY21. This could be traced to the lower fiscal deficit, revaluation gains stemming from PKR appreciation, and DSSI relief.

Average headline inflation during Jul-Mar FY21 remained lower than last year. On a quarterly basis as well, Q3-FY21 CPI inflation was lower in relation to the comparable period of last year. The third quarter outturn was largely on the back of deceleration in January 2021, in which inflation decelerated to 5.7 percent. This deceleration was led by food and poultry groups. Also, the outlook for inflation remained broadly unchanged, and the SBP's MPC maintained a status quo on the policy rate in its March 2021 meeting. However, during February and March 2021, rising prices of electricity, sugar, edible oil, cotton cloth and readymade garments contributed to increased momentum in inflation.

Credit to the private sector was nearly 50 percent higher during Jul-Mar FY21 compared to last year. During the third quarter, however, retirements of short-term loans led to a slowdown. In addition to seasonal retirements by rice-processing firms, the retirements were primarily attributed to better liquidity conditions of manufacturing businesses on account of improved export earnings (for high-value added textiles); greater profitability (for sectors such as fertilizer and refined petroleum); and higher sales tax refunds by

the government. The offtake for fixed investment loans was robust during Q3-FY21 though, driven by the SBP's concessionary refinance schemes such as the TERF. Moreover, consumer financing remained upbeat during Jul-Mar FY21. In addition to growth in auto and personal loans, there was an increase in house building loans, as banks responded to the SBP's mandatory targets for housing and construction finance.

Overall, while the economy made significant gains during FY21 compared to a year earlier, a few structural vulnerabilities still persisted. First, in the agriculture sector, the secular decline of the cotton crop continued, with acreage and yield falling short of the annual targets and previous year's performance. The below-par yields can mainly be attributed to issues in seed quality, adverse climate change impact, and pest attacks (whitefly and pink bollworm). Thus, reforms relating to research and development of improved varieties of cotton, which are resistant to pests and climate change, are needed. Such endeavors need to be backed up with timely availability of seeds and the support services of agriculture extension departments, so that growers can be motivated to dedicate more area to cotton cultivation, utilize quality inputs, and adopt climate-smart practices to increase cotton production in a sustainable manner.

Second, while the new flexible exchange rate regime should help to attenuate pressures, the impact of the recovery in economic activity on the external sector will need to be monitored carefully. Specifically, the monthly current account surpluses observed during Jul-Nov FY21 gave way to monthly deficits during Dec-Mar FY21. In particular, the merchandise trade deficit widened, as the growth in exports could not keep up with

import growth. While the import of raw materials and capital goods is inevitable to spur industrial output, the import of certain agricultural commodities (such as cotton, wheat and sugarcane) to bridge domestic supply gaps and/or stabilize prices needs to be contained by adopting better farming and crop management practices. In addition, the balance between consumption and investment items in the import basket will need to be monitored. Finally, merchandize exports still remain restricted to a handful of sectors and markets, underscoring the need for greater diversification.

Third, inflation out-turns seen in Q3-FY21 underscore the need for continued vigilance. The CPI inflation remained volatile during the third quarter, with a low reading in January 2021 followed by a rebound in February and March. Moreover, urban core inflation picked up during the quarter on the back of a rise in prices of clothing and footwear. Elevated cotton prices, triggered in part by lower domestic production, contributed to the inflation in clothing items. More broadly, despite being lower than last year, headline inflation remained at elevated levels during FY21, with supply side issues in the management of agriculture commodities triggering bouts of food inflation. This vulnerability needs to be addressed through better coordination among stakeholders, especially the federal and provincial food departments; provision of accurate data and monitoring of stocks and prices of food items; and timely decisions and import of items as required.

On the fiscal side, the space available for public investment, which is a vital lever for economic growth, continues to be constrained by debt servicing payments and a narrow revenue base. Another

vulnerability worth highlighting is circular debt, which underscores the long-standing structural issues in the power sector. Therefore, efforts to broaden the tax base by minimizing exemptions, documenting the informal economy, and simplification of tax rules and procedures need to be strengthened. In addition, the process of restructuring of the loss-making PSEs, and introduction of reforms in the energy sector need to be expedited to reduce burden on the scarce fiscal resources.

Finally, credit to the private sector has a skewed distribution, which could be improved through lending more extensively to a broader cross-section of creditworthy firms and individuals, including MSMEs. In general, the removal of information asymmetries tends to improve credit penetration in an economy. Information asymmetries can, in turn, be addressed by setting up private credit bureaus as part of a well-functioning credit reporting system. The government and the SBP have taken steps to improve credit reporting, including the introduction of the Credit Bureaus Act 2015 and the granting of licenses to two private credit bureaus. However, a number of legal, operational and policy level challenges continue to hold back private credit bureaus from realizing their potential. A special section in this SBP report highlights these challenges and makes policy recommendations to make private bureaus more effective in tackling information asymmetries, ultimately facilitating greater penetration of private sector credit.

Economic Outlook

Going forward, in FY22, the economic momentum that became evident during FY21 is expected to strengthen further. The

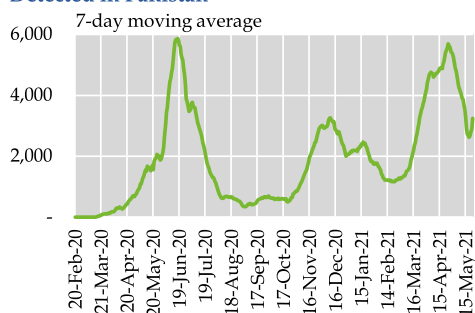
ongoing rollout of vaccines, coupled with the continuation of economic activities during the virus' second wave and most of the third wave, offers some optimism. On the agricultural side, the impetus is likely to come from a further improvement in output, with the government emphasizing the use of better seed varieties and modern technology. In particular, cotton production is expected to recover from the multi-year low recorded in FY21. The government's Kharif and Rabi packages, which typically include subsidies on fertilizers and other inputs, are also anticipated to support growth in the agriculture sector.

Further impetus to economic growth is likely to come from expected investments under TERF and the policy-driven boost in construction activities. While the former has seen a substantial increase in March 2021, the latter has received support from the government's Naya Pakistan Housing Scheme, coupled with the mark-up subsidy on house loans and the SBP's regulatory push for banks to increase the proportion of housing finance in their outstanding credit by end-December 2021. Furthermore, the government has indicated its intention to increase PSDP spending, which would also be a major contributing factor to the higher growth outcome. These favorable trends across agriculture and industry would also spill over to the services sector. However, a major downside risk to the overall growth outlook for FY22 is the ongoing third and potentially additional waves of Covid-19, which might necessitate the imposition of mobility restrictions and therefore disrupt the ongoing economic momentum (**Figure 1.3**).

Recent CPI outturns have indicated a consistent YoY increase in inflation in

Trend in Daily Covid-19 Cases Detected in Pakistan*

Figure 1.3



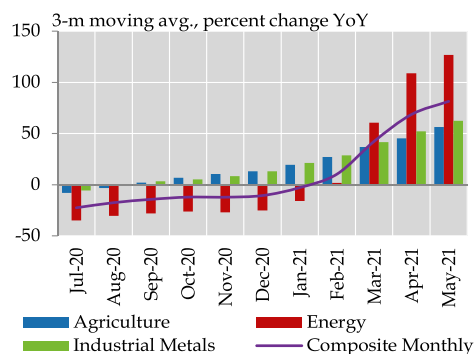
*As of May 23, 2021

Source: World Health Organization

February, March and April 2021, but it may be noted that these increases are primarily originating from the supply side, with the output gap still estimated to be negative. The current uptick is concentrated among food items and utility (electricity) prices, whereas wage pressures are judged to be stable at this point. Furthermore, better commodity management, including by building strategic reserves of staple food items, is likely to alleviate supply-side pressures from food items. As a result, second-round effects of the supply-driven shocks to inflation are currently muted and inflationary expectations continue to remain well-anchored.

However, there are multiple upside risks to the inflation expectations. First, the ongoing rising trend in international commodity prices is broad-based, with prices of oil, food and metals, all rising significantly (**Figure 1.4**). Second, upward adjustment in administered utility tariffs (electricity, gas, and fuel) could further feed into inflation as well as inflationary expectations. Third, wage pressures will need to be watched carefully, particularly in the context of any increases in the minimum wage and public

Trend in Global Commodity Prices Figure 1.4



sector pay. Fourth, the withdrawal of sales tax exemptions and other potential revenue-generating measures in the FY22 budget may also lead to an increase in inflation during the fiscal year.

In the fiscal sector, a decent growth in revenues has been noted so far in FY21, with collections until April 2021 being higher than the target. Furthermore, the growth in expenditures is lower than last year (FY20), mainly due to lower development spending and restraint on non-interest current spending. On this basis, the fiscal deficit for FY21 is expected to be 6.5-7.5 percent of GDP. However, an upside risk to this projection are higher payments on account of circular debt settlements. For FY22, while the budget is awaited, an improvement in the fiscal deficit is expected amid a continuation of the current growth trends in revenue collection into FY22, as well as the acceptance of the proposal to remove corporate tax exemptions. Lastly, the higher growth outcome in FY22 would further boost revenue collection, while PSDP spending is expected to increase.

In the external sector, while remaining bounded, the current account deficit is

expected to rise, mainly due to a further widening in the trade deficit on account of likely rise in import payments. The increase in imports reflects higher oil prices, which are now projected to add to the pressures coming from consistently growing import volumes of energy commodities. Second, the ongoing rising trend in global non-energy prices, including food and metals, would also contribute to the increase in import payments (Figure 1.4). And third, capital goods imports are projected to increase, in the wake of the significant borrowing under the TERF. While borrowing amounts under the scheme have been approved, the actual imports are expected to materialize over the next few months.

On the other hand, the growth in export receipts is mainly projected to come from the continued strong momentum in high value textile items (that is, apparel and home textiles), as well as a rebound in rice exports amid better crop expectations (which would allow exporters to offer more competitive prices). However, potential downside risks to the export growth include continually rising international prices of textile inputs (including cotton yarn), which might impact exporters' competitiveness; as well as the resumption in economic activity in key competitors (especially India and Bangladesh) amid vaccinations and a subsiding in Covid cases. Finally, workers' remittances are projected to remain buoyant, as the main factors (switch to formal channels, incentives for banks and MTOs, etc.) will still be in place. In addition to this, progress on the IMF program would help the continuation of foreign exchange inflows from external sources, while promoting further stability in the balance of payments.

2 Real Sector

Pakistan's economy posted a promising recovery during the year, with real GDP growth provisionally estimated to be 3.9 percent for FY21. This performance was achieved despite the ongoing Covid pandemic, which had played a part in restricting GDP growth to -0.5 percent last year. The rebound in FY21 growth mainly owed to a turnaround in the industry and services sectors. Within industry, the growth in food, automobile, textile, and construction-allied segments of large-scale manufacturing stood out. Moreover, while agriculture sector growth registered an overall slowdown compared to last year, wheat, rice and maize achieved historic production levels during FY21. Vibrancy in the commodity-producing sector spilled over to the services sector, most notably in the wholesale and retail trade subsector. Similarly, provincial surveys for Punjab and Sindh reported growth in industrial employment, which appeared to be broadly on the recovery path towards pre-Covid levels.

2.1 Economic Growth

Pakistan's economy posted GDP growth of 3.9 percent during FY21, which represented a recovery following the Covid-induced contraction a year earlier (**Table 2.1**). The growth was broad-based, with the agriculture, industry and services sectors expanding by 2.8 percent, 3.6 percent, and 4.4 percent respectively. The economic turnaround was enabled by the supportive policies of the government and central bank, which mitigated the health and economic fall-out of Covid on the economy.

The agriculture sector recorded growth of 2.8 percent during FY21, compared to 3.3 percent a year earlier. Almost all important crops performed better than last year. Specifically, during *Rabi* FY21, wheat production grew by 8.1 percent compared to a year earlier, as subsidies on inputs and an increase in the minimum support price contributed to the increase in cultivated area of wheat.¹ Moreover, after accounting for *Rabi* season cultivation, the maize crop grew by 7.4 percent over the full year, driven primarily by an improvement in its

yield. The latest estimates of crop production during the review period added on to the strong performance of rice and sugarcane during *Kharif* FY21. However, there was a notable decline in cotton, whose provisional estimates were revised further downward to around 7 million bales – i.e. a 22.8 percent decline in production compared to last year. This

GDP and its Components **Table 2.1**
growth in percent

	FY20 ^R	FY21 ^P
Agriculture	3.3	2.8
Industry	-3.8	3.6
Services	-0.6	4.4
GDP	-0.5	3.9

P: provisional R: revised

Source: Pakistan Bureau of Statistics

represents the lowest level of cotton production since FY85, attributed to a continuing fall in cultivated area and depressed yields due to exceptionally heavy monsoon rains and pest attacks.² Meanwhile, the livestock sector grew by 3.1 percent during FY21, compared to 2.1 percent a year earlier. This could mainly be traced to a recovery in the poultry sub-sector, which had been hit hard by the

¹ The *Rabi* FY21 season corresponds with the Oct-Mar FY21 period.

² For reference, cotton production in FY85 was 5.9 million bales. (Source: MNFSR)

strict lockdowns from March 2020 onwards during the first wave of Covid, but gradually recovered in FY21 as the government shifted to smart lockdowns.

The industrial sector grew by 3.6 percent during FY21, compared to a decline of 3.8 percent last year. Within industry, Large Scale Manufacturing (LSM) rebounded sharply in the review period, growing by 9.0 percent during Jul-Mar FY21 compared to a contraction of 5.1 percent in the comparable period last year. LSM growth was driven by food, cement, textile and automobile sectors. Within the food group, better harvest of the sugarcane crop led to expansion in sugar output. The construction-allied industries of cement and steel performed well on the back of targeted fiscal and monetary incentives. Vibrancy in automobile sector was due to entry of new players, pent up demand of last year, subsidy on tractors, stability in exchange rate, low interest rates, and improved rural incomes, which contributed to a revival in demand for automobiles and led to output growth in the sector.³ The textile sector also grew notably during the review period, amid a rebound in the cotton textile segment. By contrast, the electricity and gas sub-sector posted a sharp decline during FY21 compared to last year, mainly on account of a reduced allocation of subsidies to

DISCOs.⁴ It is worth highlighting that the quantum of electricity generation during Jul-Mar FY21 was, however, higher compared to Jul-Mar FY20.⁵

The positive performance of the commodity-producing sectors provided the impetus for a 4.4 percent growth in the services sector, compared to a 0.6 percent contraction last year. Specifically, there was a notable turnaround in *wholesale and retail trade* growth due to an increase in overall economic activity and imports, whereas *finance and insurance* and *general government services* also picked up the pace compared to a year earlier. Although, *transport, storage, and communication* activities recorded marginally negative growth, the magnitude of contraction was smaller than the one observed in FY20.

Meanwhile, employment within the industrial sectors of Sindh and Punjab continued to recover during Jul-Feb FY21.⁶ The impetus mainly came from industries related to food-processing and cigarette manufacturing, while automobile and cotton textile also contributed positively to employment growth; these developments were broadly in line with the LSM growth observed for these sectors. The February 2021 wave of SBP's Business Confidence Survey also showed an improvement in the

³ Rural incomes have improved during FY21, mainly on the back of higher agriculture income, foreign earnings, and record workers' remittances. Agriculture income constitutes about 26 percent of total monthly rural household income, while the share of foreign remittances in rural monthly household income is 5.8 percent (compared to 4.0 percent for urban households). (Source: Household Integrated Economic Survey (HIES) 2018-19)

⁴ Source: PBS Press Release for National Accounts Committee meeting held on 21st May, 2021, available at: www.pbs.gov.pk/sites/default/files//press_releases/2021/Press%20Release%20103rd%20NAC.pdf

⁵ Specifically, gross generation of electricity (excluding K-Electric's) rose from 88,173 GWh during Jul-Mar FY20 to 92,372 GWh during Jul-Mar FY21. (Source: NEPRA)

⁶ Source: Bureau of Statistics Punjab and Bureau of Statistics Sindh

Overview of Crop Performance - FY21^P**Table 2.2**

area in 000 hectares; production in 000 tons/bales for cotton; growth in percent

	Area				Production			
	FY20 Achieved	FY21 Target	FY21 Achieved	Growth over last year	FY20 Achieved	FY21 Target	FY21 Achieved	Growth over last year
Important Crops								
Wheat	8,804.7	9,214.0	9,177.6	4.2	25,247.6	27,000	27,283.4	8.1
Rice	3,033.9	2,953.0	3,335.1	9.9	7,413.7	8,000	8,419.3	13.6
Cotton	2,517.3	2,310.0	2,078.9	-17.4	9,148	10,900	7,063.90	-22.8
Maize	1,404.2	1,335.0	1,417.8	1.0	7,883	6,700	8464.9	7.4
Sugarcane	1,039.8	1,175.0	1,165.0	12.0	66,379.6	69,500	81,009.3	22.0
Minor Crops (Selected)**								
Gram	943.9	988.2	872.7	-7.5	497.6	540	251.2	-49.5
Moong	172.9	179.4	231.4	33.7	125.9	140	204.5	62.4
Potatoes	185.4	187.6	234.4	26.4	4552.7	4,700	4681.0	2.8
Onion	148.2	159.1	153.8	3.8	2,122.0	2,100	2099.8	-1.0
Tomatoes	57.8	49.9	59.0	2.1	594.2	500	670.5	12.8

P: Provisional

Source: MNFSR; PBS

current employment index for the industry and services sectors. However, future employment expectations, as captured by SBP's Consumer Confidence Survey, deteriorated in the March 2021 survey iteration, due to the beginning of the third Covid wave and subsequent restrictions to subdue it.

2.2 Agriculture

In overall terms, the crop sector performed better during FY21, with four out of five important crops achieving greater output compared to a year earlier (**Table 2.2**). In fact, provisional estimates suggest that maize, rice, and wheat reached historic high levels of production, while sugarcane also posted its second highest output on record.⁷ Specifically, provisional estimates available during Q3-FY21 indicated that wheat production grew by 8.1 percent compared to last year, on the back of an increase in area under cultivation and

improvement in yield. This outcome was also facilitated by policy support for the wheat crop.

Inputs

For the *Rabi* season, the government's policy support consisted of subsidies for fertilizer, fungicides and weedicides, and an increase in the support price of wheat. Specifically, DAP, phosphate, and potassic fertilizer received a subsidy of Rs 1,000 per 50 kg bag, while weedicides and fungicides received a per-acre subsidy of Rs 250 and Rs 150 respectively. Moreover, in November 2020, the Economic Coordination Committee (ECC) recommended an increase in the minimum support price (MSP) of wheat from Rs 1,400 per 40 kg bag in FY20 to Rs 1,650 per 40 kg bag for the current season; subsequently, in April 2021, the ECC recommended a further increase in the wheat MSP to Rs 1,800 per 40 kg bag.

⁷ Sugarcane touched its record peak production of 83.3 million tons in FY18.

DAP Offtake and Price during Oct-Mar

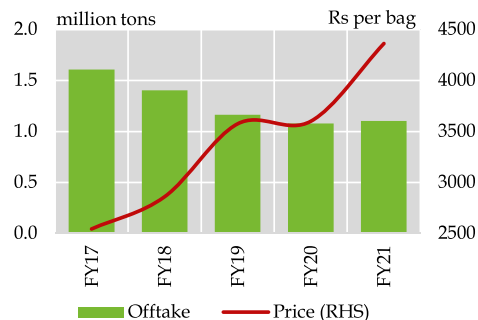


Figure 2.1a

Urea Offtake and Price during Oct-Mar

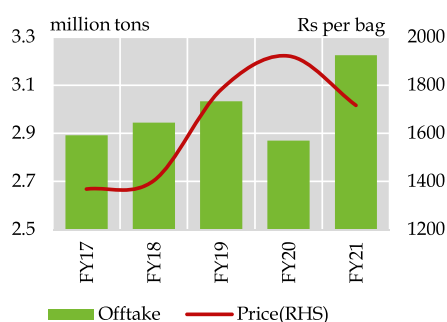


Figure 2.1b

Source: National Fertilizer Development Center

The subsidy on DAP contributed to a 2.3 percent increase in its offtake during Oct-Mar FY21 compared to a year earlier (Figure 2.1a). However, the impact of the subsidy was diluted by an increase in the price of DAP. Given that the majority of domestically available DAP is imported, its price tends to follow the trend in global price of the commodity, which rose by 49 percent, on average, between Oct-Mar FY21.⁸ The rapid increase in the global price of DAP somewhat restricted its offtake during the review period.

By contrast, urea prices had declined by 10.7 percent during Oct-Mar FY21 following a reduction in the Gas Infrastructure Development Cess (GIDC), which contributed to its higher offtake.⁹ Ultimately, even though urea did not receive subsidy, its offtake increased by 12.4 percent during Oct-Mar FY21 (Figure 2.1b).

Meanwhile, agriculture credit disbursements were 4.6 percent higher during Jul-Mar FY21 compared to a year earlier (Table 2.3). That said, the pace of disbursements picked-up during Q3-FY21, showing an increase of 13.1 percent. The farm sector witnessed growth in production loans associated with working capital needs in the third quarter. In addition, there was also a pick-up in long-term loans for development purposes.

In the non-farm sector, the increase in disbursements to the poultry sector stood out during Q3-FY21 compared to last year. Previously, supply-side losses incurred by producers during the strict Covid lockdowns appeared to be holding back credit off-take in H1-FY21. This pattern changed in the third quarter, with higher Q3-FY21 disbursements suggesting that there was recovery in the demand for poultry items during the review period.

⁸ Global DAP prices rose due to a combination of demand and supply factors. On one hand, demand was strong due to healthy farm incomes and government support schemes in major crop-growing regions. On the other hand, the disruption in fertilizer trade (mainly triggered by countervailing duties placed by the US on fertilizer imports from Morocco and Russia) weakened the supply side. (Source: The World Bank)

⁹ In January 2020, the ECC decided to waive Rs 400 off the GIDC to make cheaper fertilizer available to farmers. Urea prices subsequently moderated from February 2020 onwards.

Agriculture Credit Disbursements Table 2.3
billion Rupees

	Q3		Jul-Mar	
	FY20	FY21	FY20	FY21
Farm sector				
A. Production	151.5	162.8	430.9	452.4
B. Development	6.2	15.9	28.7	55.6
C. Total farm sector (A+B)	157.7	178.7	459.6	508.0
Non-farm sector				
Livestock/dairy	77.8	89.3	236.7	250.1
Poultry	50.7	56.0	177.9	158.0
Other	11.6	12.9	38.0	37.7
D. Total non-farm sector	140.1	158.2	452.6	445.8
Total agriculture credit (C+D)	297.8	336.9	912.2	953.8

Source: State Bank of Pakistan

This was consistent with fewer lockdowns restrictions in Jan-Feb 2021 pertaining to outdoor dining and gatherings, which eventually gave way to stricter SOPs later in March 2021.¹⁰

In terms of irrigation requirements, water availability was better during the *Rabi* FY21 season compared to last year, despite being short of the average system usage. Specifically, rim station inflows of 21.1 million acre feet (MAF) during Oct-Mar FY21 were around 10 percent short of the pre-*Rabi* forecast of 23.4 MAF.¹¹ After accounting for storage releases, system losses, and minor involuntary escape downstream of Kotri barrage, the total

canal withdrawals amounted to 31.2 MAF, i.e. nearly 15 percent short of the average system usage of 36.7 MAF.¹² An IRSA advisory committee expressed satisfaction with the overall canal withdrawals, since they deviated slightly from the 10 percent shortfall which had been anticipated prior to the *Rabi* season and were deemed to be manageable with the utilization of efficient water management practices.¹³

Wheat

Wheat production hit a historic high of 27.3 million tons during *Rabi* FY21, achieving 8.1 percent growth compared to last year (Table 2.4). This stemmed from a 4.2 percent increase in area under cultivation of wheat, while the yield also improved by 3.7 percent compared to last year. The increase in area was particularly noticeable in Punjab (i.e around 230 thousand hectares greater than last year), the province which accounts for nearly three-fourths of wheat production, on average. As mentioned earlier, policy support on inputs and the increase in minimum support price played a part in encouraging growers to dedicate more area to the wheat crop.

Nonetheless, despite production exceeding its annual target and hitting a record high, a concurrent increase in estimated annual

¹⁰ While the prices of poultry items had risen during Q2-FY21, this may not be a reliable indicator of a pickup in poultry demand in light of the Competition Commission of Pakistan's (CCP's) enquiry result made public in May 2021 that cartelization and price coordination among poultry feed mills to raise prices contributed to the increase in prices of chicken and eggs. (Source: CCP Press release dated 7 May, 2021)

¹¹ Rim station inflows comprise of inflows from Indus, Kabul, Jhelum, Chenab, and an Eastern Rivers component

¹² The average system usage is calculated on the basis of sub-clause 14b of the Water Apportionment Accord of 1991; relevant excerpt: 'The record of actual average system uses for the period 1977-82, would form the guide line (sic) for developing a future regulation pattern'.

¹³ Source: IRSA press release dated 1 October 2020.

Performance of Wheat Crop^p**Table 2.4**

area in 000 hectares; production in 000 metric tons; yield in kg/hectare

	Area			Production			Yield		
	FY20	FY21 Target	FY21	FY20	FY21 Target	FY21	FY20	FY21 Target	FY21
Punjab	6,515.3	6,555.78	6746	19,401.1	20,000	20,900	2,977.8	3,050.7	3,098.1
Sindh	1,134.2	1,214.03	1,202.6	3,846.1	4,000	3,995.5	3,391.0	3,294.8	3,322.4
KP	727.3	890.292	770.9	1,130.4	1700	1,235.7	1,554.2	1,909.5	1,602.9
Balochistan	427.9	566.549	458.2	607.2	1300	1,162.1	1,419.0	2,294.6	2,536.2
Pakistan	8,804.7	9,226.7	9,177.6	25,247.5	27,000	27,293.4	2,867.5	2,926.3	2,973.9
Growth YoY			4.2			8.1			3.7

p: provisional

Source: MNFSR

wheat consumption created a demand-supply gap. Specifically, after adjusting for 0.324 million metric tons (MMT) of leftover stocks, there was around 27.6 MMT of wheat available at the start of the food year (namely 1st May, 2020). Meanwhile, annual wheat consumption was estimated to be 29.5 MMT in 2021 (Table 2.5). Thus, the shortfall for the upcoming food year would have to be bridged through imported wheat.

Maize

Maize production posted 7.4 percent growth during FY21 compared to last year (Table 2.6). The increase was primarily achieved on the back of an increase in the maize yield in Punjab. The maize yield in Punjab has grown encouragingly over the past 17 years dating back to 2004-05, when the province's yield grew by 70.7 percent (Figure 2.2). The improvement in maize yield over time can partially be traced to the use of high-yielding imported hybrid seed varieties. For the FY21 season as well, imported seed accounted for around 85

**Annual Wheat Consumption
Estimates****Table 2.5**

in million metric ton

Province/Areas	2020	2021
Punjab	13.5	14.0
Sindh	5.8	6.0
KP	4.3	4.5
Balochistan	1.5	1.5
Gilgit Baltistan	0.2	0.2
AJK	0.3	0.3
Sub-total	25.4	26.4
Seed Requirement	1.2	1.2
Utility Stores Corporation	0.4	0.4
Poultry/Wastage	0.3	0.3
Pakistan Army	0.2	0.2
Strategic Reserves	0.0	1.0
Grand Total:	27.5	29.5

Source: MNFSR Working Paper for 16th Meeting of the Federal Committee on Agriculture (8th April, 2021)

percent of the available maize seed. This indicates a certain dependence on imported seed, and also implies a gap in the domestic capacity of local seed companies to meet the maize seed requirement.¹⁴

Previously, the development of hybrid maize seeds received support from mega initiatives like the Agricultural Innovation

¹⁴ It is worth mentioning that among the 55 varieties of hybrid maize seeds approved by the Variety Evaluation Committee (VEC) of the Pakistan Agriculture Research Council (PARC) in October 2020, only two of the varieties were developed by public sector institutes, namely Maize & Millets Research Institute (MMRI) Yousafwala and University of Faisalabad. (Source: PARC)

Performance of Maize Crop^p**Table 2.6**

area in 000 hectares (ha); production in 000 metric tons; yield in kg/ha; change in percent

	Area			Production			Yield		
	2019-20	2020-21	Change	2019-20	2020-21	Change	2019-20	2020-21	Change
Punjab	944.9	948.6	0.4	6,994.7	7,565.0	8.2	7,402.6	7,974.9	7.7
KP	452.5	460.7	1.8	881.6	891.0	1.1	1,948.3	1,934.0	-0.7
Balochistan	2.7	4.4	63.0	2.7	4.6	70.4	1,000.0	1,045.5	4.5
Sindh	3.9	4.2	7.7	4.0	4.2	5.0	1,025.6	1,000.0	-2.5
Pakistan	1,404.20	1,417.80	1.0	7,883.0	8,464.9	7.4	5,613.9	5,970.4	6.4

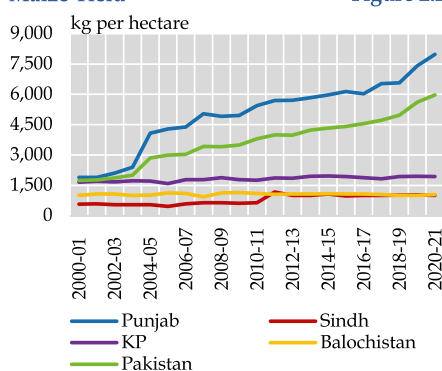
p: provisional

Source: MNFSR

Program (AIP), which remained active for around seven years till 2020. A joint endeavor of public and private sector stakeholders, the AIP supported the testing of over 3,000 maize products in Pakistan, culminating in the identification of 60 new maize hybrids and varieties.^{15,16} Such public-private collaboration allows high-yielding seed varieties to be developed, scaled, and deployed rapidly, and the

results have spoken for themselves in the case of improving maize yields.

In addition, the Punjab government has also facilitated maize growers in upgrading their technology and farming practices. This includes the promotion of drip irrigation (rather than flood irrigation) for maize cultivation, as part of the Punjab Irrigated Agriculture Productivity Improvement Project (PIPIP); the use of drip irrigation was reported to increase yields by as much as 20 percent compared to flood irrigation, while also generating significant savings in terms of water and fertilizer application.¹⁷ Another example was the promotion of the cob picker, as part of the 'Enhancing Technology-Based Agriculture and Marketing in Rural Punjab' project. The cob picker is a machine which enables more efficient harvesting of maize compared to traditional methods and also improves the yield prospects of the next season's crop yield.¹⁸

Maize Yield**Figure 2.2**

Source: MNFSR

¹⁵ The key AIP stakeholders included the PARC, the International Maize and Wheat Improvement Center (CIMMYT), and the U.S. Agency for International Development (USAID)

¹⁶ Source: News items titled 'International program ushers in a new era of maize farming in Pakistan', dated 30 June, 2020, extracted from CIMMYT, available at: www.cimmyt.org

¹⁷ Source: PIPIP feature story titled 'Transforming Traditional to Innovative Farming', released by the Government of the Punjab, Agriculture Department.

¹⁸ Source: CABI blog titled 'Pakistan's maize farmers get to grips with mechanized technology aimed at improving productivity', dated 23 Oct, 2020.

2.3 Industrial Sector

Provisional estimates point to industrial sector making a quick recovery during FY21 compared to FY20. Against contraction of 3.8 percent last year, the sector saw expansion of 3.6 percent in FY21 (**Table 2.7**).

The performance can primarily be attributed to two factors: (i) ease in lockdown conditions across the country, and (ii) conducive economic policies. Complete lockdowns had hurt the economy in Q4-FY20 and offset the gains made earlier in the year. The country was still in the grip of first wave of Covid when FY21 started. As more information became available about the virus and measures to mitigate it, the government resorted to smart lockdowns to combat Covid with lesser disruption to economic activity. The balancing act proved pivotal as industrial sector made a quick recovery even in subsequent second and third waves of Covid.

The smart lockdowns were complemented by targeted fiscal support and highly accommodative monetary policy. For the fiscal part, government announced special packages for various sectors of the economy. In particular, construction sector, due to its labor-intensive nature, was targeted with incentives for real estate developers. This led to expansion in construction and its allied industries. Aiding the government in its efforts to revive the economy, the SBP decreased its policy rate and announced various temporary schemes such as facilitation of

new investment under TERF, support for the health sector under RFCC, loan extension and restructuring, and SBP Rozgar scheme, amongst various other measures.¹⁹ Proactive steps by the government and the SBP to encourage more inflows through formal channels also helped attract record inflows of workers' remittances, which drove up demand.

Within the industrial sector, the manufacturing subsector was the primary contributor to growth in FY21. In particular, the LSM sector rebounded sharply and surpassed its average FY17-19 level (**Figure 2.3**). Meanwhile small-scale industries returned to their normal growth path after last year's disruptions.

On the other hand, two subsectors remained below-par during FY21. Energy sector suffered double-digit contraction, mainly due to lower allocation of subsidies by the government to DISCOs, low increase in output and higher proportional increase in intermediate consumption.²⁰ Another sector that saw its output shrink

Industrial Sector Growth **Table 2.7**
percent

	FY20 ^R	FY21 ^P
Industrial Sector	-3.8	3.6
Mining and Quarrying	-8.3	-6.5
Manufacturing	-7.4	8.7
Large Scale	-10.1	9.3
Small Scale	1.5	8.3
Slaughtering	4.1	3.9
EG&D and GD*	22.4	-23.0
Construction	5.5	8.3

R: revised, P: provisional

*Electricity gen. & distribution & gas distribution

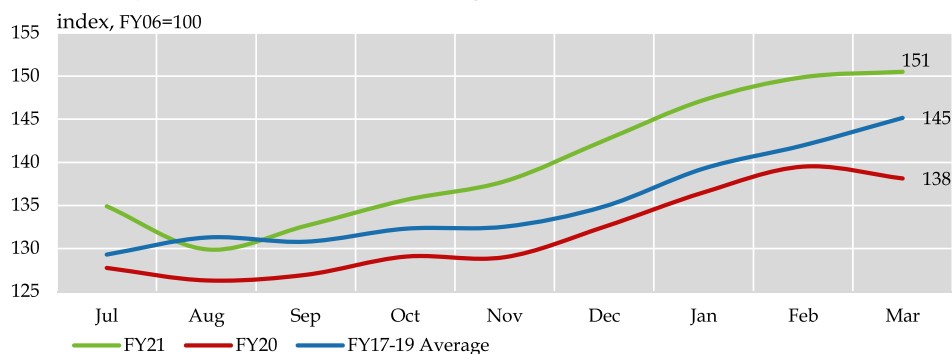
Source: Pakistan Bureau of Statistics

¹⁹ For more information on measures taken by the SBP to counter Covid, available at: www.sbp.org.pk/covid/index.html

²⁰ Source: PBS press release for National Accounts Committee meeting held on 21st May, 2021.

LSM - Monthly Quantum Index of Manufacturing

Figure 2.3



Source: Pakistan Bureau of Statistics

during FY21 was mining and quarrying. Assuming the trend witnessed in Q1-FY21 when output of crude oil and natural gas fell compared to last year, the loss in output of mining and quarrying sector during FY21 may be traced to decline in extraction of these commodities.

Large Scale Manufacturing (LSM)²¹

Output of the LSM sector grew by 9.0 percent during Jul-Mar FY21 in contrast to 5.1 percent contraction last year (Table 2.8). Base effect (as a result of strict lockdowns in Mar-Jun FY20) was one of the key reasons for variability of growth between the two periods. A conducive policy environment, comprising targeted fiscal support and highly accommodative monetary policy, also played a key role in the rebound. Fiscal measures such as tax relief and low-cost housing schemes stimulated demand for labor-intensive construction sector. Cement and steel industries benefited directly from these schemes. Monetary stimulus, especially in the form of low interest rates and

temporary relief measures, also facilitated recovery in the LSM sector. In addition, the market-based exchange rate continued to support external trade-oriented industries such as automobiles and textiles. The automobile sector benefited from stable exchange rate as well as from lower imports of used vehicles. Growth in textile was aided by strong foreign demand (see Chapter 5).

On quarterly basis, the production expanded by 11.5 percent during Q3-FY21 compared to 9.1 percent decline last year. The stark contrast of performances in the two periods (Q3-FY21 versus Q3-FY20) can be traced to the varying nature of the lockdowns amid Covid.

Textile

Output of the textile sector expanded by 5.9 percent during Jul-Mar FY21 compared to contraction of 2.6 percent last year. Cotton textile segment witnessed a rebound during Jul-Mar FY21. When compared to production numbers during the same

²¹ The analysis in this section is based on actual data up to March 2021. Therefore, the numbers reported in this section may not tally with those presented in Table 2.7, which are annual estimates.

LSM Growth

percent, YoY

Table 2.8

	wt.	Jul-Mar		Q1		Q2		Q3	
		FY20	FY21	FY20	FY21	FY20	FY21	FY20	FY21
LSM	70.3	-5.1	9.0	-5.5	4.5	0.1	10.4	-9.1	11.5
Textile	20.9	-2.6	5.9	0.2	2.2	0.5	2.9	-8.4	13.1
Cotton Yarn	13	-3.0	3.2	0.2	0.1	0.0	0.1	-9.0	9.9
Cotton Cloth	7.2	-2.8	3.0	0.1	-0.1	0.3	0.0	-8.8	9.7
Jute Goods	0.3	8.2	1.7	-14.8	10.7	3.5	-5.8	37.6	2.2
Food	12.4	-1.7	11.7	-9.0	13.4	16.7	25.0	-7.1	3.5
Sugar	3.5	-1.7	16.7	NA	NA	97.1	72.1	-14.3	0.4
Cigarettes	2.1	-31.5	17.8	-34.5	31.2	-24.3	0.9	-35.4	23.8
Vegetable Ghee	1.1	5.8	-3.4	2.0	-5.6	8.8	-0.9	6.8	-3.7
Cooking Oil	2.2	9.3	-0.1	0.0	3.2	13.9	-0.2	14.0	-2.9
Soft Drinks	0.9	-7.3	6.7	-14.1	7.6	-0.4	-9.4	-3.2	21.4
POL	5.5	-17.5	12.7	-14.5	2.4	-5.9	7.0	-32.0	33.8
Steel	5.4	-8.0	1.7	-17.0	-8.1	-6.8	6.0	2.0	7.2
Non-Metallic Minerals	5.4	1.9	24.3	-0.9	22.2	6.3	18.3	-0.2	33.2
Cement	5.3	1.8	25.1	-1.4	22.8	6.3	19.2	0.0	34.1
Automobile	4.6	-37.7	23.4	-34.6	-5.8	-40.1	31.1	-38.6	49.8
Jeeps and Cars	2.8	-47.7	24.7	-38.6	-21.1	-54.6	42.6	-50.4	67.4
Fertilizer	4.4	5.8	5.7	15.9	2.0	-5.1	13.3	7.9	1.9
Pharmaceutical	3.6	-5.3	12.6	-11.9	14.4	-0.7	12.0	-3.6	11.6
Paper	2.3	4.3	-0.6	-1.3	-2.2	16.0	-3.2	-1.2	3.7
Electronics	2	-15.6	-20.8	11.0	-20.4	-15.7	-21.4	-34.2	-20.6
Chemicals	1.7	11.3	11.7	4.9	10.5	14.7	10.7	14.6	13.8
Caustic Soda	0.4	45.5	7.9	35.0	2.5	60.5	5.1	42.2	17.1
Leather Products	0.9	6.5	-38.3	6.3	-44.5	16.0	-41.0	-2.1	-29.1

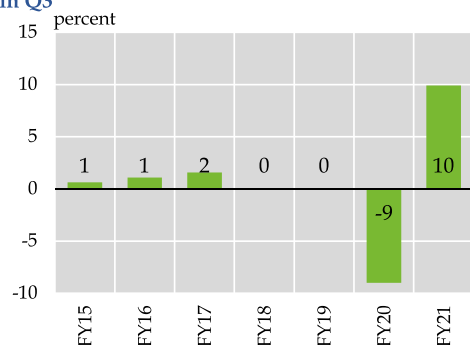
Source: Pakistan Bureau of Statistics

period last year, cotton yarn and cotton cloth registered growth of 3.2 and 3.0 percent in the Jul-Mar FY21. Almost all the gains in the cotton textiles were made during Q3-FY21, as yarn and cloth production rose by 9.9 and 9.7 percent, respectively, compared to last year (**Figure 2.4 a, b**).

That said, when comparing the production estimates with the lockdown-free Q3-FY19, the growth in Q3-FY21 at 3.7 percent is more subdued. The rebound in textile sector seems to be partly related to the base effect which in turn was caused by the Covid-induced lockdowns in FY20. The

cotton-textile sector effectively managed to recover the production losses.

Other factors that hampered growth of the cotton-textile sector during Jul-Mar FY21 could also be traced to shrinkage in area under cotton production and lower yields. As a result of domestic shortfall, the industrial units increased their reliance on imported raw material. Quantum of raw cotton imports jumped by 84.8 percent during Jul-Mar FY21 and with three months left to go in FY21, import of raw cotton is likely to increase further. One silver lining for the textile producers is that the unit values of imported raw material remained on almost the same level as last

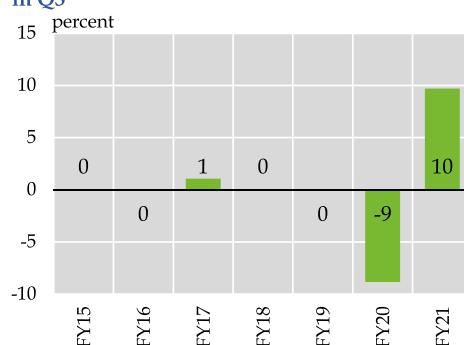
Growth in Cotton Yarn Production in Q3**Figure 2.4a**

Source: Pakistan Bureau of Statistics

year, which may have prevented the cost of production from escalating.

Food

The food sector witnessed output expansion of 11.7 percent during Jul-Mar FY21 compared to contraction of 1.7 percent in the previous period. Increase in sugar production was the primary contributor of this performance, while wheat-milling industry also contributed to the overall increase in output of the food-group. The increase in wheat-milling sector may be attributed to increase in the number of reporting firms in Punjab, as has been highlighted previously in the SBP's Second Quarterly Report on the State of Pakistan's Economy for FY21. Tobacco manufacturing also registered an upturn owing largely to the state's crackdown on illicit and counterfeit tobacco trade.²² Another important factor was the two-tier

Growth in Cotton Cloth Production in Q3**Figure 2.4b**

tax structure that was carried forward from last year, which helped prop-up production in the formal tobacco industry.

Sugar

Sugar production increased by 16.7 percent during Jul-Mar FY21 compared to 1.7 percent decline last year. One of the factors in this year's improved performance was early start of the crushing season. This is evident from looking at Q2-FY21 versus Q3-FY21 production numbers. Whereas in the former period, 72.1 percent growth was recorded over last year, the situation in latter period showed stagnancy as marginal growth of 0.4 percent was seen over last year (**Figure 2.5**).

POL

The petroleum sector rebounded sharply to register growth of 12.7 percent during Jul-

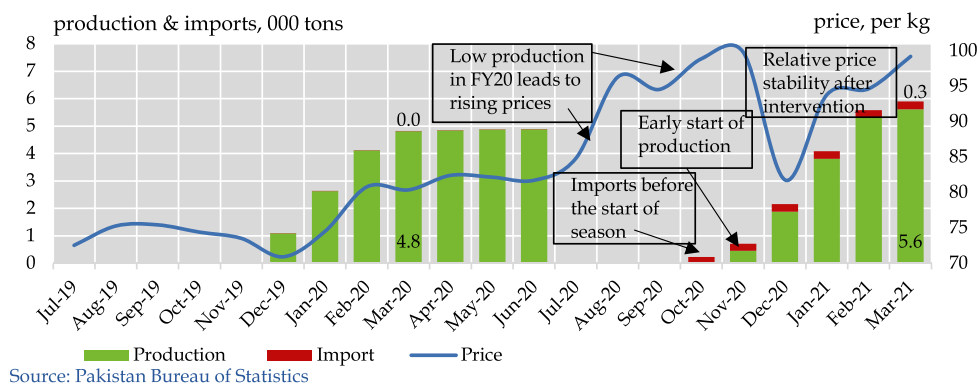
²² February, 2021 crackdown against counterfeit, non-duty paid and smuggled cigarette. (Source: www.fbr.gov.pk/pr/crackdown-against-counterfeit-non-duty-paid-a/152846)

March 5, 2021 - FBR continues crackdown against smuggled non-duty paid cigarettes. (Source: www.fbr.gov.pk/pr/fbr-continues-crackdown-against-smuggled-non-/152880)

March 30, 2021 - FBR continues crackdown against smuggled non-duty paid cigarettes. (Source: www.fbr.gov.pk/pr/fbr-continues-crackdown-against-smuggled-non-/152926)

Sugar Industry - Cumulative Production, Cumulative Imports and Price Trend

Figure 2.5



Mar FY21 compared to 17.5 percent contraction last year. Even compared to Jul-Feb period last year, when the Covid situation had not started to impact activities, the improvement is quite visible in FY21, i.e. 7.7 percent growth in Jul-Feb FY21 against contraction of 13.6 percent during Jul-Feb FY20.

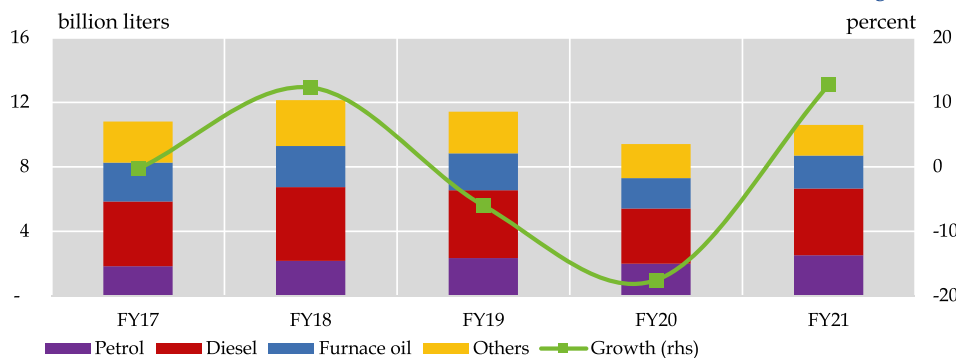
The Jul-Mar FY21 growth can largely be attributed to an increase in production of petrol, diesel, and furnace oil (Figure 2.6). Rebound in overall economic activity had a positive impact on transportation activities, which in turn led to increase in demand for

POL products. Surge in automobile sales, especially in the wake of low-interest rates, further facilitated transportation activities in the country.

In the past few years, regulatory changes had played an important part in keeping growth of POL sector in check - for instance, curbs on furnace oil for electricity generation. However, as the government relaxed its restrictions on power generation from furnace oil during Jul-Mar FY21 owing to surge in demand, the POL industry increased production of the commodity.

Product-wise Production and Overall Growth of POL Products

Figure 2.6



Source: Pakistan Bureau of Statistics

Automobile

The automobile sector improved from sharp contraction (37.7 percent) last year, to double digit growth (23.4 percent) during Jul-Mar FY21. The sector gathered the pace during the review period, which is evident from quarterly breakdown of growth rate (**Table 2.8**). The increase in economic activities had a positive effect almost across the board; cars (24.7), motorcycles (20.3), LCVs (30.2) and tractors (57.5) all witnessed double-digit growth (**Figure 2.7**). Multiple factors played a part in this performance. Low interest rates, relative stability in automobile prices, and introduction of new models facilitated growth in the automobile sector.

The impact of the low interest environment is evident from increase in consumer financing for purchase of vehicles to the tune of Rs 73.6 billion during Jul-Mar FY21 compared to Rs 3.2 billion last year. Almost 40 percent of these loans were disbursed in Q3-FY21 alone.

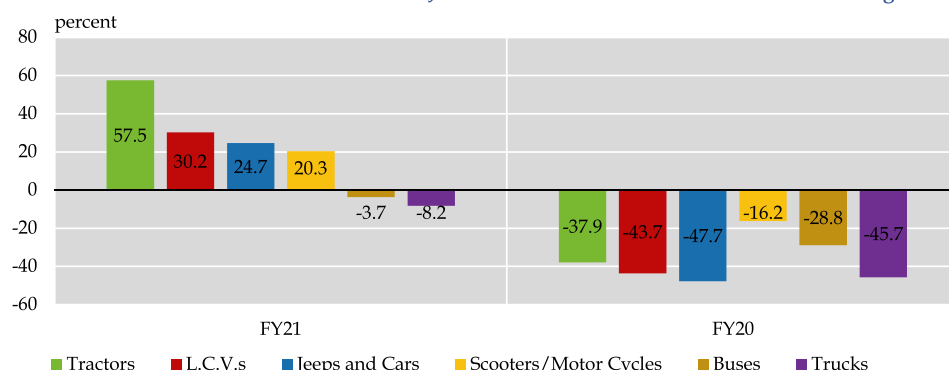
Stability in vehicle prices during the period also had a role in propping-up automobile production. For instance, car prices, which had jumped by 20.8 percent during FY20, rose by 3.4 percent during Jul-Mar FY21.²³ Stability in exchange rate played a part in keeping the pricing from escalating during the review period.

Under the Automotive Development Policy 2016-21, various new auto-assemblers had invested resources in the automotive industry. In order to attract consumers, the new entrants introduced vehicles with new features and also focused on SUVs, which previously had relatively little penetration in the country compared to sedans or hatchbacks. This strategy attracted high-end consumers and, with sales picking up, new entrants have started to gain some foothold in the domestic market.

Apart from the aforementioned factors, government incentive packages to revive the economy from negative shock of Covid also had a positive impact on the automobile sector. Demand for tractors

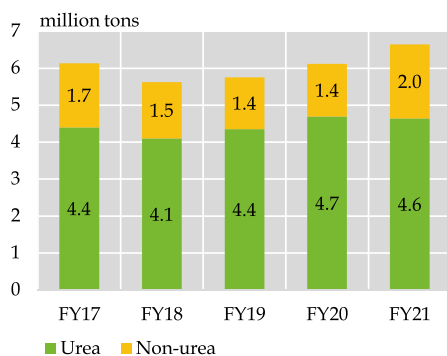
Automobile Sector - Product wise Growth in Jul-Mar

Figure 2.7



Source: Pakistan Bureau of Statistics

²³ Data source: Pakistan Bureau of Statistics

Fertilizer Production in Jul-Mar **Figure 2.8**

Source: National Fertilizer Development Center

received a boost from the pickup in construction sector activities, in addition to the sales-tax subsidy. Whereas, the 2-3 wheelers' growth can be attributed to pent-up demand due to strict lockdowns during the first domestic wave of Covid. Anecdotal evidence suggests that an increase in agriculture production leads to an increased demand for motorcycles. This, coupled with record workers' remittance inflows during Jul-Mar FY21, may have contributed to the recovery in this segment.

Moreover, the growth of the automobile sector may still be underreported as official production numbers for a few entrants are either not readily available or released with a long lag. The growth of the sector would have been even higher if the numbers of some new entrants – that have gained market share especially in the SUV category – were being reported in the industrial sector dataset.

Fertilizer

Fertilizer sector production rose by 5.7 percent during Jul-Mar FY21 compared to

5.8 percent growth in same period last year. The deceleration can be explained by drop in output of urea. On a positive note, this year's growth owed largely to expansion in output of non-urea products (Figure 2.8).

Urea output declined slightly by 1.2 percent during the Jul-Mar FY21 compared to 7.8 percent growth in the same period last year. Production activities at the large urea producing plants slowed down in Q3-FY21 as production contracted by 4.9 percent compared to 23.0 percent growth during same quarter last year. The decline in urea production was compensated to some extent by a rebound in the small-scale producers; however, it was not enough to avert the loss in production from the larger plants. Consequently, the overall urea production fell by 1.6 percent during Q3-FY21 compared to 7.8 percent growth in same quarter last year.

Non-urea fertilizer products saw growth of 40.8 percent in Jul-Mar FY21 compared to marginal growth of 1.4 percent last year. Production of fertilizers such as NP and CAN continued to expand during Q3-FY21. The output of NP and CAN underwent expansion of 68.3 percent and 64.0 percent during Jul-Mar FY21, respectively. One of the primary producers of these fertilizer products remained operational during the Jul-Mar FY21 period whereas last year it started its operations in January 2020, which explains the sharp increase in production of the commodities.

Construction Allied Industry

Facilitated by the government's construction package, the construction allied industrial sector continued to grow. Specifically, the industries of cement and

steel grew by 25.1 and 1.7 percent, respectively, during Jul-Mar FY21. The rebound in steel was particularly impressive, given that it had contracted by 8.0 percent in the same period last year. The robust performance of the construction sector was largely owed to the pickup in private sector activity. Moreover, even though the government decreased development expenditures by Rs 83.7 billion during Jul-Mar FY21 compared to last year, its construction package coupled with various other incentives for the industrial sector aided growth in the construction sector. Despite the dip in development spending, public expenditure on large infrastructure projects, such as dams and highways, continued to drive demand for construction allied industries.

The SBP also facilitated growth in the construction allied industry through several measures that especially targeted housing for low-income group.²⁴ These efforts drove the offtake of Rs 2.2 billion for construction financing in Q3-FY21. In addition, consumer financing for housing saw disbursements of Rs 13.8 billion during Jul-Mar FY21 compared to net retirements of Rs 5.6 billion last year. The impact of stimuli can be gauged from the rise in the prices of residential properties. According to Zameen.com – a website that tracks price trends in the real estate sector – prices, on average, have surged during Jul-Mar FY21 compared to last year. It was also the highest growth in the past 3 years (**Figure 2.9**).

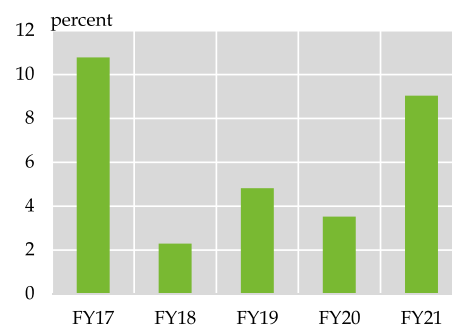
Cement

Domestic demand for cement remained robust in the wake of Prime Minister's construction package, Naya Pakistan Housing Scheme, and large infrastructure projects. Another factor that also aided output growth was the decrease in FED on cement for FY21. The duty was reduced from Rs 2 per kilogram to Rs 1.5 per kilogram, which resulted in decreasing the price of 50 kg cement bag by Rs 25.

Large cement producers anticipating further growth have indicated plans to expand further. In the last round of expansion, the capacity rose from around 45 million tons to 69 million tons per annum.²⁵ The proposed new investments are expected to stretch the capacity to slightly under 100 million tons per annum by around FY23, according to anecdotal evidence.²⁶

Growth in Prices of Residential Property in Jul-Mar

Figure 2.9



Source: Zameen.com

²⁴ For details on measures taken by the government and SBP, see the SBP's Second Quarterly Report for FY21.

²⁵ Source: All Pakistan Cement Manufacturers Association (APCMA)

²⁶ Report in Dawn newspaper titled 'Cement makers to expand production capacity by 40pc', dated 9th May, 2021.

The cement industry saw double-digit production growth in each of the past three quarters. Cement dispatches saw some changes over the course of the review period. Whereas, growth in Q1-FY21 was primarily driven by exports that changed in Q3-FY21 when domestic dispatches became the driving force. The share of domestic sales to total sales increased to 85.6 percent in Q3-FY21 compared to 79.8 percent in Q1-FY21.

Exports of cement increased by 10.8 percent in Jul-Mar FY21 compared to 25.6 percent growth last year. The clinker exports to China led to overall increase in cement exports during the review period. However, cement exports to Afghanistan decelerated largely due to Covid-related border closures.

Steel

The steel sector also benefited from the pickup in activities in the construction sector. The recovery in steel production, especially in the construction-oriented long steel segment, gained further traction. Production of billets expanded by 37.0 percent during Jul-Mar-FY21 compared to decline of 13.0 percent last year. Moreover, demand for long steel remained strong in the presence of incentives for the construction industry. However, the flat steel segment contracted by 22.5 percent during the Jul-Mar FY21, in addition to its 4.2 percent decline witnessed in the same period last year, as demand for steel from electronics and telecom sector dried up.

The price of iron bars has surged recently, which can largely be traced to increase in domestic demand. Despite decrease in unit values of imported scrap – a key input in

local steel processing industry – price pressures originating from demand side kept the prices elevated (**Figure 2.10**). The increased demand for steel is also evident from the import data, which reveals that the quantum of both scrap and finished steel products saw a sharp increase during Jul-Mar FY21 compared to last year.

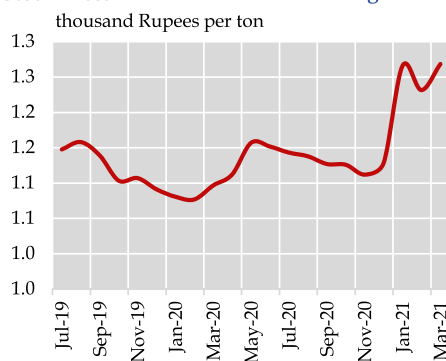
2.4 Services

The services sector also posted a rebound, growing by 4.4 percent during FY21 compared to contraction of 0.6 percent last year, according to provisional estimates. The performance of the sector is linked to the performance of the commodity producing sectors; since the latter recorded a positive performance during the fiscal year, the impact trickled down to the services sector as well (**Table 2.9**). The major impetus came from *wholesale and retail trade* and *finance and insurance* segments.

The *wholesale and retail trade* segment witnessed an impressive growth of 8.4 percent during FY21 – the highest growth since FY06. Along with base effect, the segment benefitted from (i) robust

Steel Prices

Figure 2.10



Source: Pakistan Bureau of Statistics

performance of LSM; (ii) rise in import quantum; and (iii) healthy agriculture production. The increase in activity in this segment was further evident from Google mobility data. The visits to 'grocery and pharmacy' and 'retail and recreation' segments were up by 41 percent and 14 percent by end-March 2021 from their baseline (pre-Covid) position (**Figure 2.11**).

The performance of *finance and insurance* subsector was also remarkable, as it recorded growth of 7.8 percent in FY21 compared to growth of 1.1 percent witnessed in FY20. This was mainly due to rise in deposits and loans of banking industry. Specifically, deposits and net advances grew by 16.4 percent and 2.2 percent, respectively in end-March 2021, compared to the same period last year. Moreover, profit after tax of commercial banks rose by 31.3 percent in Jul-Mar FY21, compared to the same period last year. The significant growth in bank's profitability can be attributed to higher net interest income. Furthermore, the profitability indicators of banking industry, such as return on assets (ROA) and return on equity (ROE), also improved during Jul-Mar FY21, compared to the same period last year.²⁷

In contrast, the *transport, storage and communication* subsector continued to observe contraction during FY21 on the back of slack performance in the transport sector. However, the magnitude of contraction was smaller than the one seen

Performance of the Services Sector Table 2.9
percent

	Share in GDP-FY21	Growth	
		FY20 ^R	FY21 ^P
Wholesale & retail trade	18.9	-3.9	8.4
Transport, storage & commerce	12.2	-3.8	-0.6
Finance & insurance	3.7	1.1	7.8
Housing services	7.0	4.0	4.0
General gov. services	8.2	1.0	2.2
Other private services	11.8	4.6	4.6
Services	61.6	-0.6	4.4

r: revised. p: provisional

Source: Pakistan Bureau of Statistics

in FY20. The second and third wave of Covid and subsequent limited inter and intra-city mobility had a negative bearing on transport sector.²⁸ Particularly, the Q3-FY21 period appeared to be challenging for PIA, as the national flag carrier booked gross losses of Rs 3.6 billion on account of Covid restrictions.²⁹

In the communication subsector, however, the demand for internet services continued to rise, as remote-working (**Figure 2.11**) and online-education arrangements remained in place due to Covid. This demand led to increase in cellular teledensity to 84.6 percent as of end-March 2021 from 80 percent as of March 2020; similarly, broadband users in the country increased from 82.7 million as of March 2020 to 98.0 million as of end-March 2021. However, Pakistan still lags behind regional economies in terms of an inclusive

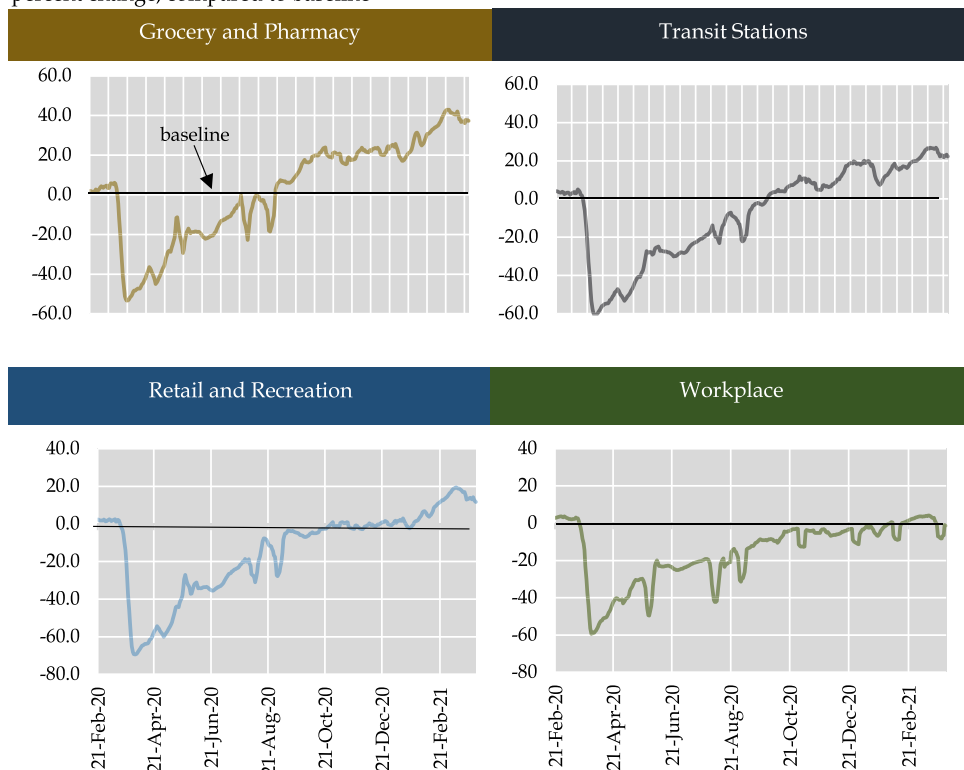
²⁷ As of end-March 2021, the ROA and ROE of banking industry were 1.5 percent and 21.0 percent compared to 1.4 percent and 18.9 percent same period last year, respectively.

²⁸ The inter-city transport was allowed to operate at 50 percent capacity, while Pakistan Railway service was operated at 70 percent of its capacity. (Source: NCOC, dated: March 22, 2021)

²⁹ Due to pandemic and strict border closure PIA's key routes (KSA, Gulf, Malaysia and UK) were largely affected. (Source: PIA first quarterly report 2021)

Google Mobility Changes in Pakistan (7-day moving average)
percent change, compared to baseline*

Figure 2.11



*The baseline (pre-Covid) is the median value for the 5- week period (Jan 3-Feb 6, 2020). the negative value represent activity is down while positive value represent activity is up from the baseline.

Source: Covid-19 Community Mobility Report

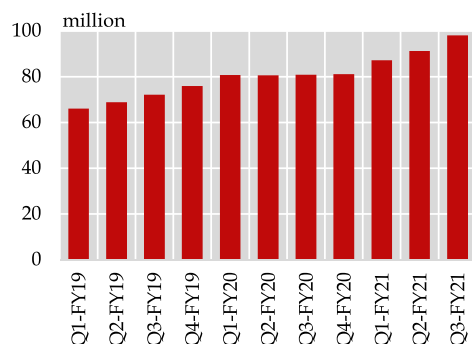
internet and mobile connectivity environment (**Box 2.1**).

The *other private services* subsector grew by 4.6 percent during FY21. Within *other private services*, the exports of information and communications technology (ICT) related services witnessed a growth of 43.6

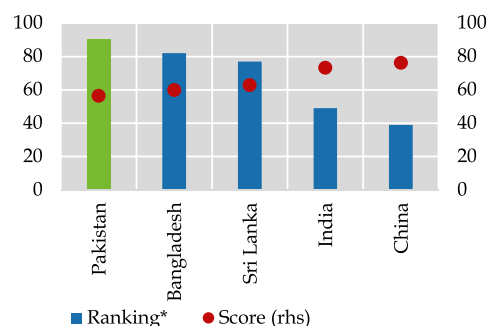
percent, YoY, and reached to US\$ 1.5 billion during Jul-Mar FY21. The country's IT services firms continue to make deeper inroads into the global market, utilizing the growth in demand amid the pandemic for a wide range of IT services (**Chapter 5**).

Box 2.1: The State of Internet Inclusiveness in Pakistan

After the onset of Covid and subsequent imposition of lockdowns, the usage of internet has become more essential than ever before. Like other countries, in Pakistan virtual meetings, online shopping and entertainment, digital financial services and events have taken center stage. The surge in demand for

3G and 4G Subscriber in Pakistan

Source: PTA

Figure 2.1.1**Inclusive Internet Index Ranking Figure 2.1.2**

*Ranking out of 120 countries. Importance in descending order

Source: The Economist Intelligence Unit Report, 2021

internet related services led to exponential increase in the 3G/4G and broadband subscriptions in the country (**Figure 2.1.1**). However, the cross-country analysis shows that Pakistan lags behind other regional economies in terms of internet inclusiveness (**Figure 2.1.2**).

The Economist Intelligence Unit's Inclusive Internet Index 2021 report ranked Pakistan 90th in overall terms (bottom quartile of the index) amongst the 120 countries surveyed (**Figure 2.1.3**). The index examines the performance of the country in four dimensions; namely, *availability*, *affordability*, *relevance* and *readiness*.

On the *availability* front – under which countries are compared against the inclusive indicators pertaining to level of internet usage, quality and scale of internet infrastructure and electricity necessary to support internet connectivity – Pakistan is ranked 97th in overall terms. This is mainly due to its dull performance in the internet usage and gender gap in internet access. As noted in the SBP's FY20 Annual Report, inadequate level of literacy and digital skills are prime factors behind the low smartphone and internet usage levels in the country.³⁰ Moreover, about a quarter of the population does not know how to use the internet, while around half does not consider it as a useful or interesting activity.³¹ In addition, there exists a disparity between number of male and female internet users in Pakistan. According to GSMA, cultural barriers appear to be hindering gender equality more broadly.³²

Under the *affordability* dimension – which examines the cost of access to internet relative to per capita income and the level of competition in the Internet marketplace – Pakistan was placed in the 67th position. This relatively better ranking is attributed to strong competition between the wireless internet providers. However, on the cost side, country scored low on the back of higher cost of smartphones and mobile phone pre-and-postpaid tariffs.

³⁰ Special Section: Covid-19 and the Need to Boost Digital Connectivity in Pakistan, State Bank of Pakistan Annual Report 2019-2020

³¹ Pakistan Social and Living Standards Measurement, Household Integrated Economic Survey (HIES) 2018-19 Report

³² According to GSMA "The Mobile Gender Gap Report 2020", in Pakistan, family disapproval is the main factor preventing 29 percent of sampled female non-users of mobile internet from getting online, compared to only 2 percent of men.

Index Score Comparison

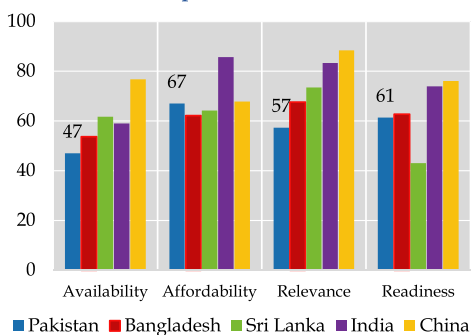


Figure 2.1.3

Source: The Economist Intelligence Unit Report, 2021

Proportion of Internet Users reported Literacy and Digital Skills as Barrier

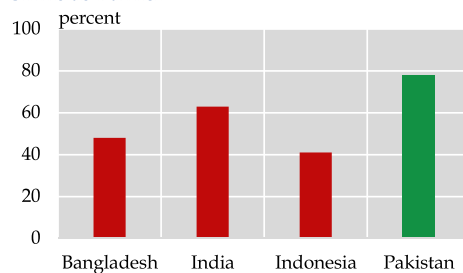


Figure 2.1.4

Source: GSMA Intelligence Consumers in Focus Survey 2019

On the *readiness* front – which examines the capacity to access the internet, including skills, cultural acceptance, and supporting policy – a low level of internet literacy left the country trailing behind its counterparts. Lack of literacy and digital skills appeared to be major perceived barrier to mobile internet adoption among mobile users aware of mobile internet (Figure 2.1.4).

Lastly, the *relevance* parameter measures the extent of local and relevant content available online to the public. It can be taken as an indicator of ease and usefulness of internet access in a country. The non-availability of public sector open data policy and e-government services in local language relegated Pakistan to 91st position out of 120 countries in the rankings.

In the next stage of its development, Pakistan's performance on the availability and readiness components is likely to improve. The continued focus of the government on National Financial Literacy Program (NFLP) and Digital Pakistan Policy 2018 will facilitate progress in these parameters. Meanwhile, Mobile Device Manufacturing Policy 2020 may aid affordability by reducing the cost of smartphones in the country via encouraging local production; it is expected to accelerate the transition from low-end smartphones (such as 2G) to more advanced equipment. While the policy focus is a welcome development, more efforts would be needed to integrate the rural society in the digital world. As such, infrastructure developments – particularly in those areas where operators have less incentive to invest – and subsidized access (offering Wi-Fi in public spaces) are required to improve the performance of Pakistan in terms of internet inclusiveness.

2.5 Labor Market

The employment growth for the large-scale manufacturing sector of Sindh and Punjab in Jul-Feb FY21 stood at 1.1 percent in comparison to 0.6 in the Jul-Feb FY20.³³ Despite the challenges on account of the

pandemic, measures like smart lockdowns and work from home along with targeted fiscal support and highly accommodative monetary policy helped maintain employment growth. The current employment trend from SBP's Business Confidence Survey (BCS) also improved in

³³ The growth is calculated excluding steel industry because of variation in its data due to government's decision to privatize Pakistan Steel Mills. For more information, see Chapter 2 of the SBP's Second Quarterly Report on The State of Pakistan's Economy.

the February 2021 wave with marginal deterioration in the future employment expectations. Further, the future unemployment index from SBP's Consumer Confidence Survey (CCS) also showed improvement in household confidence regarding employment between November 2020 and January 2021 surveys.

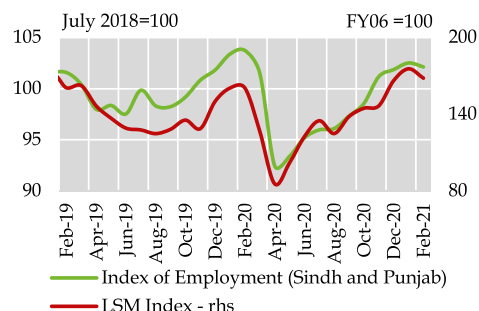
However, in the March 2021 survey of CCS, there was a 3.6 percent increase in future unemployment expectations compared with January 2021, which is in line with the third wave of Covid in the country. This indicates that employment situation has improved in Q3-FY21. However, future employment expectations suggest a slowdown in coming months, possibly due to concomitant Covid wave.

As for wages, there was 6.5 percent growth in the *construction sector wage-rate index* in Jul-Mar FY21. Meanwhile, increase in the earnings of the household servants and mechanics decelerated in the current quarter in comparison to the previous quarter. The growth in doctor clinic fees was at constant 16.0 percent in Q2-FY21 and in Q3-FY21, indicating increasing income for doctors.

Employment

Employment index for LSM sector of Sindh and Punjab continued to increase for Jul-Feb FY21 period (**Figure 2.12**). The growth was driven by 9.8 percent increase in employment for the sugar industry in Jul-Feb FY21. This is in line with increase in sugar production for the same period, which can be traced back to better harvest of the sugarcane crop. In addition, employment in cotton textile also grew by 0.9 percent in Jul-Feb FY21, in comparison to 4.2 percent contraction in the last fiscal

Combined Sindh and Punjab Industrial Employment and LSM **Figure 2.12**



Source: Bureau of Statistics, Punjab and Bureau of Statistics, Sindh

year.

At the provincial level, data indicates that employment growth in Punjab's LSM sector for Jul-Feb FY21 was 1.3 percent in contrast to negative 2.6 percent in the same period last year. The growth was largely driven by food, drinks and tobacco category, in Jul-Feb FY21 the growth for the category was 9.6 percent, whereas, in the last period it was negative 6.0 percent. Within the category, employment growth for sugar and wheat milling stands out. Employment in wheat milling recorded 17.8 percent growth in Jul-Feb FY21 in comparison to 2 percent growth in FY20. This was mainly because Bureau of Statistics Punjab increased the reported number of wheat milling units from 692 to 738 in July 2020.

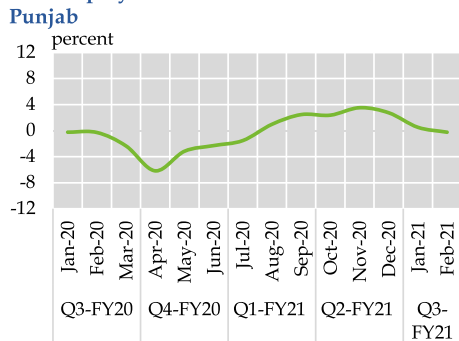
However, it is important to note that quarterly trend for the province shows deceleration in the employment growth for the current quarter. The growth for the first two months of Q3-FY21 was 0.1 percent in comparison to 2.9 percent in Q2-FY21. Moreover, looking at February 2021 data there is a contraction of 0.3 percent,

which also explains the fall in overall employment index as Punjab makes up 70 percent of the total employment index data. (Figure 2.13a).

The deceleration in growth for Punjab between Q2-FY21 and Q3-FY21 is explained by the timing of the sugar-crushing season. In FY21, the employment increased due to pick-up in crushing activities in the sugar industry started in November 2020; in contrast, the similar increase in FY20 started in December 2019 due to late crushing in the last fiscal year, hence causing an uptick in YoY growth in Q2-FY21 and the slower growth in Q3-FY21.

Another reason for decelerated growth in the employment sector of Punjab in the current quarter is slower employment growth in cigarette manufacturing (Table 2.10). In the first two months of Q3-FY21, employment in cigarette manufacturing grew only by 0.5 percent; however, in Q2-FY21 the growth was 3.2 percent.

YoY Employment Growth for Punjab Figure 2.13a



Source: Bureau of Statistics, Punjab

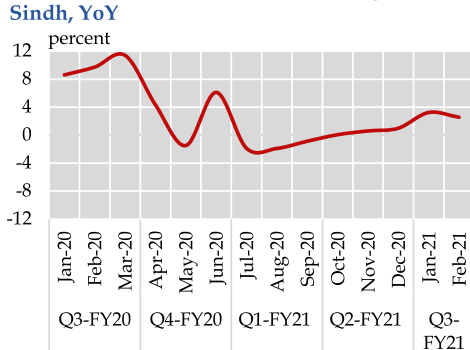
Sector-wise Employment Growth Table 2.10

	Jul-Feb		Jan-Feb	
	FY20	FY21	FY20	FY21
Punjab				
Vegetable Ghee	19.0	2.2	23.4	-2.0
Wheat Milling	2.0	17.8	4.6	19.0
Sugar	-13.6	16.1	0.1	-0.6
Cigarettes	18.6	4.1	16.7	0.5
Cotton Textiles	-3.9	1.9	-3.2	2.3
Cement	0.3	-3.8	-3.0	5.4
Sindh				
Sugar	-3.1	-8.3	3.4	4.5
Pharmaceutical	-35.4	6.3	-35.3	6.8
Fertilizer	-	1.6	-	0.6
Cement	-11.3	9.1	-14.3	9.4
Steel Products	-9.6	-98.5	-9.7	-97.5
Automobile	-	7.4	-	13.1

Source: Bureau of Statistics, Punjab and Bureau of Statistics, Sindh

The employment in large scale manufacturing sector of Sindh posted a growth of 2.9 percent in Q3-FY21 which is higher than the 0.5 percent growth in Q2-FY21 (Figure 2.13b).³⁴ It is mainly driven by 13.1 percent employment growth in automobile for the same period. Moreover, employment in cement, in line with its production in the province, posted a

Employment Growth for Sindh, YoY Figure 2.13b



Source: Bureau of Statistics, Sindh

³⁴ The growth is calculated excluding steel industry.

growth of 9.4 percent in the period.

The SBP's BCS showed improvement in the current employment index (past 6 months) for the industrial sector between December 2020 and February 2021 (**Figures 2.14a,b**). This indicates that employment numbers improved in December-January FY21; the same is evident from industrial employment numbers for the province of Sindh and Punjab. However, the expected employment index (next six months) slightly deteriorated between December 2020 and February 2021.

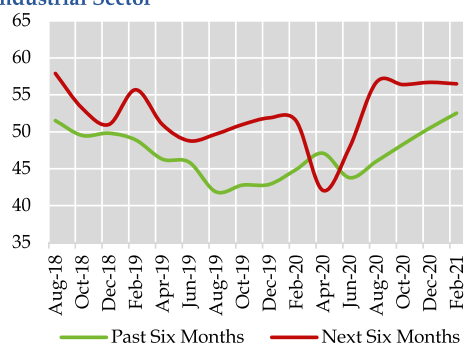
In addition, BCS shows that businesses in the services sector also reported an increase in the employment numbers in the February 2021 wave. This correlates with the waning effects of the second Covid

wave during the January-February period. The expected employment index remained the same for the services sector between December 2020 and February 2021 waves.

The trend depicted in BCS can also be noticed in the SBP's CCS.³⁵ As part of the Expected Economic Conditions index in CCS, participants are asked about their unemployment expectations over the next six months. Between the November 2020 and January 2021 wave, the future unemployment index fell, indicating increasing optimism in household expectations about employment (**Figure 2.15**). However, in March 2021, with advent of third Covid wave, the survey participants' confidence about future employment decreased.³⁶

BCS Employment Index for Industrial Sector

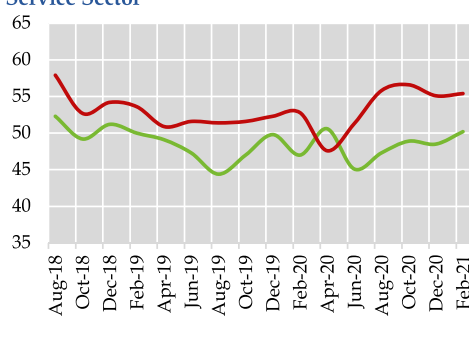
Figure 2.14a



Source: State Bank of Pakistan

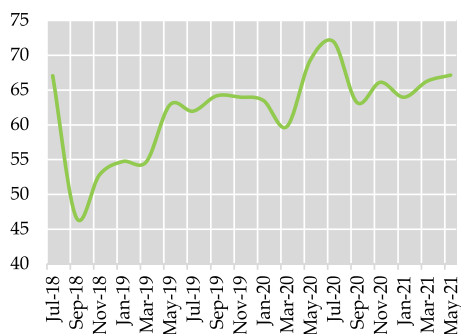
BCS Employment Index for Service Sector

Figure 2.14b



³⁵ The survey is conducted by State Bank of Pakistan and Institute of Business Administration (IBA), Karachi. It is a telephonic survey with approximately 1,670 households as participants.

³⁶ The results portrayed by the SBP's CCS are reinforced by a Consumer Confidence Survey published by Dun and Bradstreet Pakistan (D&B) and Gallup Pakistan. The findings of Gallup's survey show around 19 percent decrease in future net indicator of unemployment between Q2-FY21 and Q3-FY21. This indicates an increase in pessimism amongst the households regarding employment opportunities in the future. In Gallup's Q3-FY21 survey, more than 53 percent of approximately 1,600 participants were of the opinion that unemployment will increase in the coming months. This deterioration in confidence is due to the third wave of Covid and subsequent restrictions to control it.

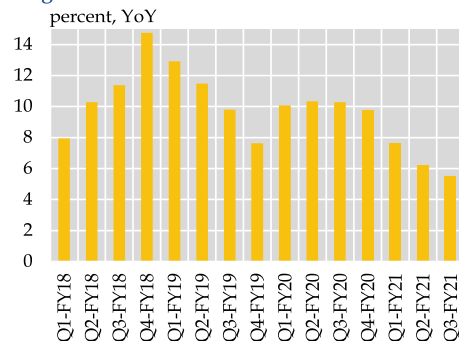
**Future Unemployment Index
(Next Six Months)- SBP CCS****Figure 2.15**

Source: State Bank of Pakistan

Wages

The wage-rate index for the construction sector taken from Consumer Price Index (CPI) dataset shows a growth of 6.5 percent for the Jul-Mar FY21 period, lower than the 10.2 percent observed in Jul-Mar FY20. In Q3-FY21 the growth stood at 5.5 percent, slightly lower than 6.2 percent in the last quarter (**Figure 2.16**). The wage rate in construction has constantly decelerated since the rise of Covid in March 2020, meaning the wages are increasing but the rate of increase is slowing down.

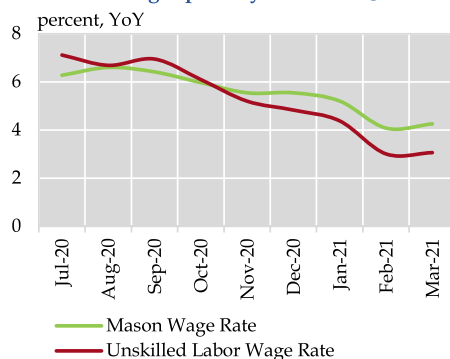
Upon exploring per-day wages for the professions closely related to the construction sector, namely unskilled labor and mason, the same trend could be observed (**Figure 2.17**). Initially, the lockdowns and resultant slowdown in the construction activity was responsible for the slowed growth in wages. However, as evident by the growth in construction-allied industries, the construction sector is picking up the pace in the country. In March 2021, growth in per-day wages of masons and unskilled labor hints towards acceleration and if the activities in the

**Growth in Construction Sector
Wages****Figure 2.16**

Source: Pakistan Bureau of Statistics

domestic construction sector continue to grow, the trend in wages for the construction sector may change in Q4-FY21.

Apart from wages for construction, CPI also includes indices for some occupations in the services sector. This data reveals that the earnings of household servants and mechanics portrayed slower growth in Q3-FY21 when compared to Q2-FY21 (**Figure 2.18**). The growth in household servants' salaries saw a major decrease between Q3-FY20 and Q4-FY20. This is the

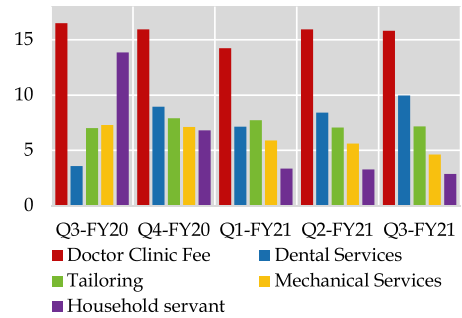
Growth in Wages per Day**Figure 2.17**

Source: Pakistan Bureau of Statistics

period when uncertainty due to Covid in the country increased. On the other hand, earnings of doctors (based on doctor clinic fee index reported in CPI) show the highest and consistent growth amongst the reported sectors. In Jul-Mar FY20, *doctor clinic fee* grew by 15.9 percent, followed by 15.3 percent growth in Jul-Mar FY21. This is due to the high demand for medical services because of the prevailing pandemic.

Growth in Earnings for Occupations in Service Sector

Figure 2.18



Source: Pakistan Bureau of Statistics

3 Monetary Policy and Inflation

The SBP's Monetary Policy Committee decided to keep the policy rate unchanged at 7 percent during Q3-FY21. Further traction in the domestic economic recovery, uncertainty stemming from the third wave of Covid, along with anchored inflationary expectations mainly guided the policy decision. Economic activity indicators, including high frequency demand data, continued the recovery trend of FY21. Secondary market yields ticked up, amid relatively higher government borrowings from commercial banks. As for credit to the private sector, major private businesses retired their short-term loans during Q3-FY21, which moderated the overall private sector credit during the quarter. However, SBP's concessionary refinancing schemes, mainly TERF, drove up the offtake in fixed investment loans. On the inflation front, CPI inflation was volatile during Q3-FY21 on a YoY basis as both low and high readings were recorded during the quarter, partly due to the base effect. On an aggregate basis, nonetheless, CPI inflation weakened in Q3-FY21 on a YoY basis as well as over the preceding quarter. While core inflation remained broadly stable and energy inflation was higher, the decline in the headline number was mainly guided by deceleration in food inflation.

3.1 Policy Review

The recovery in the domestic economy continued to gain traction in the third quarter of FY21. The supportive policy measures taken by the government and the SBP after the outbreak of Covid played an important role in this trend. Economic activity data at large and the SBP's consumer and business sentiment surveys registered an improvement on the whole.¹ Large-Scale Manufacturing (LSM) registered growth of 9.0 percent during Jul-Mar FY21, compared to 5.1 percent contraction during the same period last year. Also, a wide range of high frequency demand indicators, including sales of cement, POL, and automobiles, displayed a recovery trend.²

Overall financial conditions remained accommodative despite a slight uptick in lending rates. Due to continued pick-up in overall economic activity as well as in exports, private sector credit also registered an increase during Jul-Mar FY21 compared to the same period last year. A sizable expansion in fixed investment loans and consumer financing was witnessed, primarily due to the low interest rate environment as well as the SBP's subsidized refinancing schemes, especially LTFF and TERF. However, overall loans to private businesses moderated during Q3-FY21 compared to the corresponding period of last year as the offtake fell from Rs 75.4 billion in Q3-FY20 to Rs 60.5 billion in Q3-FY21. This is primarily due to increased working capital loan retirements by a few manufacturing businesses that had borrowed significantly

¹ Consumer Confidence Survey posted improvement till January 2021 wave, whereas it declined in March 2021. By contrast, Business Confidence Index registered continued improvement.

² Cement dispatches registered 23.0 percent YoY growth in Q3-FY21 compared to 4.4 percent growth last year. Also, car and POL sales registered 72.4 and 22.9 percent increase in Q3-FY21 compared to 53.4 and 21.9 percent decline, respectively, in Q3-FY20.

during H1-FY21.³ On the other hand, fixed investment loans recorded an increase during Q3-FY21, compared to net retirements in the same period last year, as the textile sector benefitted from TERF – mainly to import textile machinery during the quarter.

On the inflation front, the YoY inflation readings were volatile during the quarter. By the time the Monetary Policy Committee (MPC) met in January 2021, inflation outturns were encouraging. Inflation pressure eased in January 2021, mainly on account of waning supply-side pressures from the food group, base effect,⁴ and stable core inflation amid existence of spare capacity in the economy. On a YoY basis, inflation fell to 5.7 percent in January 2021 (the lowest reading since January 2019) compared to 14.6 percent in the same period last year and 8.0 percent in December 2020. In the presence of excess capacity and well-anchored inflation expectations, second-round inflationary impacts of the expected rise in utility prices and any supply side shocks were unlikely to have a lasting inflationary impact. Therefore, average inflation was expected to be within the previously announced range of 7-9 percent in FY21. With the inflation outlook was relatively benign aside from the possibility of temporary supply-side shocks, the MPC felt that the existing accommodative stance of monetary policy remained appropriate to support the nascent recovery while keeping inflation expectations well-anchored and maintaining financial

stability. As a result, the MPC decided to keep the policy rate unchanged.

While noting these favorable growth and inflation developments, the MPC stressed that considerable uncertainty remained around the outlook. In particular, the trajectory of the Covid pandemic was difficult to predict, given still-elevated global cases, the emergence of new strains, and lingering uncertainties about the roll-out of vaccines worldwide, all of which could slow the recovery. In light of such Covid-related uncertainties, the MPC felt it appropriate to provide, for the first time ever, some forward guidance on monetary policy to facilitate policy predictability and decision-making by economic agents. In the absence of unforeseen developments, the MPC noted that it expected monetary policy settings to remain unchanged in the near term. Further, as the recovery became more durable and the economy returned to full capacity, it expected any adjustments in the policy rate to be measured and gradual to achieve mildly positive real interest rates.

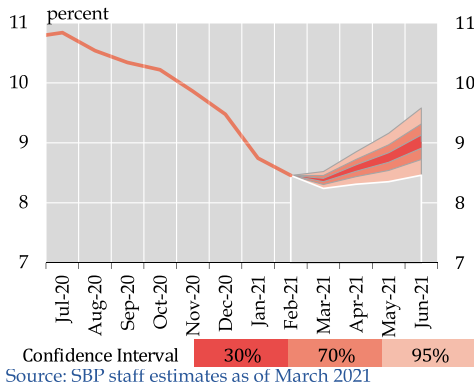
By the time the MPC met in March 2021, growth forecasts improved while inflation readings rose. On a YoY basis, headline inflation increased from 5.7 percent in January 2021 to 8.7 percent and 9.1 percent in February 2021 and March 2021 respectively. This rise was mainly attributed to increasing prices of electricity, sugar and wheat, whereas prices of perishable food items moderated during the period under review. Core

³ Rice, fertilizer and refined petroleum sectors, which had borrowed significantly in H1-FY20, made heavy retirements during the quarter under review.

⁴ On MoM basis, the inflation declined by only 0.2 percent in January 2021.

Fan Chart-CPI Inflation(12mma)

Figure 3.1

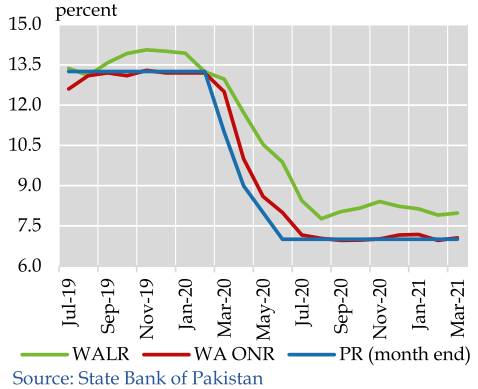


inflation continued to remain relatively stable, in line with the negative output gap in the economy.⁵ Given the rise in electricity tariffs that would continue to manifest in headline numbers in the coming months, inflation was expected to stay close to the upper end of the previously announced 7-9 percent range in FY21. However, uncertainty around the projection remained, with the summer's wage negotiations, any new tax measures in next year's budget, and higher international commodity prices associated with the global recovery posing upside risks (Figure 3.1).

In addition, the external sector position also strengthened, as the current account, on a cumulative basis, posted a surplus in the first seven months of FY21 on the back of record remittances and recovery in exports. Taking all these factors into consideration, the existing stance of

Trends in Major Interest Rates

Figure 3.2



monetary policy was deemed appropriate and the MPC, in its meeting held in March 2021, unanimously decided to keep the policy rate unchanged at 7 percent (Figure 3.2). Moreover, from the perspective of forward guidance, the MPC expressed the view that, in the absence of unforeseen developments, the monetary stance would remain broadly unchanged in the near-term and repeated the language from the January 2021 meeting related to future moves being measured and gradual.

3.2 Monetary Aggregates

The growth of money supply remained at an elevated level of 7.8 percent during Jul-Mar FY21.⁶ It is important to recall here that, during Jul-Mar FY20, the money supply posted a multi-year high expansion of 8.5 percent as the budgetary support from the banking system picked-up the pace in the aftermath of the Covid

⁵ For instance, in the auto sector, capacity utilization remained around 59.1 percent in cars, 43.5 percent in LCVs, 11.9 percent in buses, 11.7 percent in trucks and 76.8 percent in 2/3 wheelers, as per data taken from PAMA and Pakistan Economic Survey-FY20. In the cement sector, capacity utilization remained around 77.6 percent; whereas it was around 52.6 percent in the POL industry.

⁶ The average broad money growth stood at 5.5 percent during Jul-Mar in FY15-FY19.

Monetary Aggregates^P**Table 3.1**

billion Rupees

	Q3		Jul-Mar	
	FY20	FY21	FY20	FY21
M2 (A+B)	602.7	459.4	1,520.0	1,622.2
A. NFA	-80.9	104.6	797.1	683.3
B. NDA	683.6	354.9	722.9	938.8
Budgetary borrowing*	779.8	304.8	966.5	742.1
SBP	260.1	-664.8	-480.4	-1,250.7
Scheduled banks	519.7	969.7	1,446.9	1,992.8
Commodity operations	-108.6	-33.3	-137.2	-112.5
Private sector	107.6	156.0	323.2	499.6
PSEs	5.8	6.6	3.5	-22.8
Other items net	-106.3	-87.1	-440.3	-180.0
Reserve money	259.1	244.6	424.4	256.3
Currency in Circulation	392.6	334.6	722.6	399.1
Deposits	209.9	125.9	797.3	1,207.7

^P: Provisional

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

Source: State Bank of Pakistan

outbreak. On the asset-side, both Net Domestic Assets (NDA) and Net Foreign Assets (NFA) contributed towards the expansion of the broad money. Within the NDA, the main contributors to growth included continued government borrowings from the scheduled banks and a higher private credit off-take during Jul-Mar FY21 compared to the same period last year.⁷ Meanwhile, the improvement in NFA continued on the back of favorable external sector developments, including growth in workers' remittances and exports, and realization of official inflows. During Q3-FY21 the NFA expanded by Rs 104.6 billion compared to a contraction of

Rs 80.9 billion in the same period last year (**Table 3.1**).

On the liability side, the deposit mobilization decelerated to Rs 125.9 billion in Q3-FY21 compared to an increase of Rs 209.9 billion in Q3-FY20. This was mainly driven by an overall contraction in the remunerative deposits that, in turn, partly offset the growth in non-remunerative deposits.⁸ The contraction in remunerative deposits reflects the impact of a sharp reduction in the interest rates compared to last year. Likewise, the expansion in the Currency in Circulation (CiC) also remained slightly lower during Q3-FY21 compared to the same period last year.

⁷ Additionally, during Q3-FY21, both the government borrowings from the scheduled banks and private sector credit posted a higher expansion compared to the same period last year. However, as for the components of private sector credit, the loan to businesses moderated, whereas consumer finance recorded a sharp increase during Q3-FY21 compared to the same period last year.

⁸ During Q3-FY21, the remunerative deposits fell by Rs 75.9 billion compared to an expansion of Rs 290.2 billion in the same period last year. In contrast, the non-remunerative deposits increased by Rs 165.7 billion in Q3-FY21 compared to a decrease of Rs 80.2 billion in the corresponding period last year.

However, given a lower expansion in deposits compared to CiC growth, the currency to deposit ratio further inched up to an average level of 42.4 percent during Q3-FY21 compared to 42.0 percent in Q3-FY20. This highlights the underlying preference of the public to make cash transactions.

As for the monetary base, the reserve money growth slowed to 3.3 percent during Jul-Mar FY21 compared to 6.5 percent in the corresponding period last year. This was despite greater expansion in the NDA of the SBP owing to the increased monetary stimulus via SBP's refinance schemes in the aftermath of the Covid outbreak. During Jul-Mar FY21, the expansionary impact of SBP's refinance schemes on reserve money amounted to Rs 328.1 billion compared to Rs 133.7 billion in the same period last year. The major drag on the SBP's NDA came from the increase in the government's deposits with the central bank and net retirements of the government debt held by the SBP.⁹ This in turn more than offset the combined impact of SBP's subsidized lending schemes and Open Market Operations (OMOs).

Budgetary Borrowings:

The government borrowed Rs 304.8 billion from the banking system during Q3-FY21 compared to Rs 779.8 billion in the corresponding period last year. It is pertinent to note here that last year, the budgetary support from the banking system spiked in the third quarter in

response to the capital outflows and a slowdown in government's revenue collection due to the Covid fallout. Within the banking system, the government continued to borrow from the scheduled banks as it adhered to its commitment of zero borrowings from the SBP. Meanwhile, the government also shored up its deposits with the SBP during Q3-FY21.¹⁰

Auctions

During Q3-FY21 the government announced a cumulative pre-auction target of Rs 4,910.0 billion – nearly Rs 1 trillion higher compared to the upcoming maturities during the quarter (**Table 3.2**). Keeping in view the objective of enhancing the maturity profile of the outstanding debt, on net-of-maturity basis majority of the targets were allocated to the medium to long term instruments. However, it is important to note here that compared to the preceding two quarters of FY21, the target for floating-rate PIBs (PFL) remained on the lower side and zero targets were allocated to 5Y, 10Y quarterly coupon PFL and 3Y, 10Y semiannual coupon PFL from February 2021 onwards. Though PFLs have played an instrumental role to enhance the maturity profile of the government especially during low interest rate environment, zero-targets were assigned to less liquid floaters. This was done with a view to support the development of secondary market of PFLs,

⁹ The impact of budgetary support on the reserve money was Rs -1,250.7 billion during Jul-Mar FY21 and Rs -480.4 billion in the same period last year.

¹⁰ During Q3-FY21, government deposits held with the SBP increased by Rs 624.2 billion compared to Rs 82.9 billion in the same period last year.

Instrument-wise Auction Summary for Q3-FY21

Table 3.2

billion Rupees	Target	Maturity	Offered*	Accepted (all)
T-bills	4,025.0	3,908.6	6,783.3	4,825.6
3M	1,275.0	2,375.8	4,083.8	3,118.8
6M	1,375.0	669.3	2,374.4	1,693.5
12M	1,375.0	863.4	325.2	13.3
PIBs (fixed)	325.0	-	436.8	182.4
3Y	110.0	-	74.7	48.9
5Y	95.0	-	222.7	78.5
10Y	50.0	-	133.9	53.4
15Y	35.0	-	2.0	-
20Y	20.0	-	3.5	1.5
30Y	15.0	-	-	-
PIBs (floater)	510.0	-	206.8	112.2
2Y - Quarterly	90.0	-	78.7	79.1
3Y - Quarterly	150.0	-	65.1	33.1
5Y - Quarterly	30.0	-	-	-
10Y - Quarterly	30.0	-	21.0	-
3Y - SA	30.0	-	-	-
5Y - SA	150.0	-	42.0	-
10Y - SA	30.0	-	-	-
GIS - VRR	35.0	-	89.5	66.6
GIS - FRR	15.0	-	8.8	8.3
Total	4,910.0	3,908.6	7,525.2	5,195.0

*competitive bids only

Source: State Bank of Pakistan

by continuing with fewer but most liquid issuances in the market.

Participation in Longer Tenor Securities Improved

The market remained keen on investing in short-term papers, and with some adjustment in the term premium, the market's interest in 6M papers revived considerably (**Figure 3.3**). During Q3-FY21, the market placed competitive bids of Rs 2,374.4 billion for 6M papers compared to Rs 324.3 billion in Q2-FY21. Notwithstanding high offers, the cut-off rates for T-bills on-average remained 16 bps, 36 bps and 52 bps higher during Q3-FY21 compared to Q2-FY21 for the 3M, 6M and 12M T-bills respectively. This was

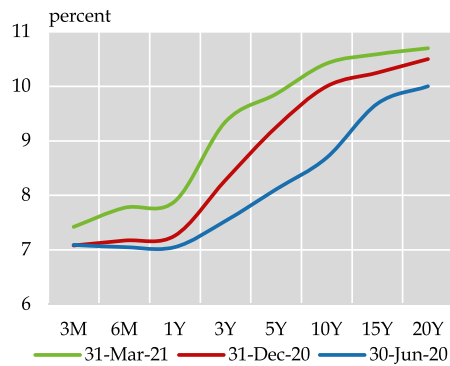
6M-3M Yield

Figure 3.3



Source: Financial Markets Association of Pakistan

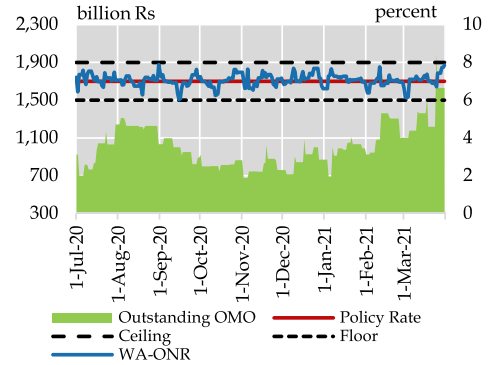
primarily on the back of relatively strong expectations of an interest rate hike in six to twelve months period.

Rising Secondary Market Yields **Figure 3.4**

Source: Financial Markets Association of Pakistan

Likewise, the offers for fixed rate PIBs also more than doubled compared to the preceding quarter. Though the participation was higher, the market demanded progressively higher yields. Consequently, medium to long term yields inched up, leading to an upward shift in the yield curve (**Figure 3.4**). The government made issuances amounting to Rs 182.4 billion of fixed coupon PIBs against a target of Rs 350.0 billion. In contrast, the market remained hesitant to invest in the floating rate PIBs as the offers fell to Rs 112.2 billion compared to Rs 1,970.4 billion and Rs 622.7 billion in Q1-FY21 and Q2-FY21 respectively.

As far as issuances of Shariah compliant instruments is concerned, only one auction took place during Q3-FY21. The government made issuances of Rs 66.6 billion of variable rental rate Sukuk and Rs 8.3 billion of fixed rental rate Sukuks against the target of Rs 35.0 billion and Rs 15.0 billion respectively. Importantly, since April 2020, the government was conducting auctions of Sukuk on a regular basis. This helped the government not only to diversify its outstanding debt, but

Key Interbank Liquidity Indicators **Figure 3.5**

Source: State Bank of Pakistan

also provided an avenue to raise financing at lower rates compared to conventional instruments.

Interbank Liquidity:

The interbank liquidity conditions tightened as the government borrowing from the scheduled banks continued to rise. Meanwhile, with sluggish deposit mobilization, commercial banks were able to fund only a fraction of high additional liquidity needs. Therefore, in order to ensure a smooth monetary policy transmission, the SBP stepped up its OMO injections to an average level of Rs 1,158.0 billion in Q3-FY21 compared to Rs 896.6 billion in the corresponding period last year and 822.8 billion in the preceding quarter (**Figure 3.5**). In addition, the absolute deviation of overnight rates from the policy rate on average remained at 23 bps compared to 14 bps last year, reflecting a higher volatility in the overnight lending rates.

3.3 Credit to private sector

The first 9-month position of private credit showed an encouraging picture, as the

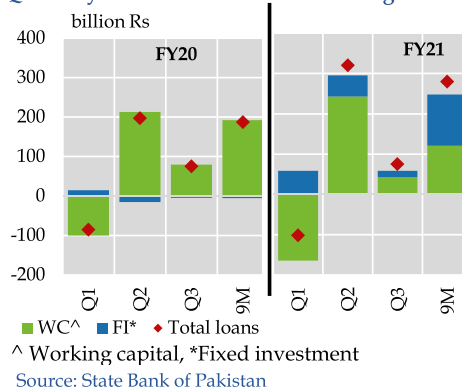
loan off-take rose to Rs 280.0 billion in Jul-Mar FY21, compared to Rs 187.3 billion recorded in the same period last year. However, focusing only on Q3-FY21, private credit moderated, as the offtake fell from Rs 75.4 billion in Q3-FY20 to only Rs 60.5 billion in Q3-FY21 (Figure 3.6).

Some of the major sectors such as rice, fertilizer and refined petroleum, which had borrowed significantly in H1-FY20, made heavy retirements during Q3-FY21 (Table 3.3). Besides seasonal retirements by rice processing firms, a major part of these retirements can be traced to better liquidity conditions of mainly manufacturing businesses. This was consistent with higher export earnings in textile (especially of high value-added textile exports) and increased profitability in fertilizer and refined petroleum sectors.^{11,12} In addition, higher sales tax refunds by the government provided further liquidity to the businesses for retiring their short-term loans.¹³

With a continued improvement in domestic demand, the overall business confidence also improved during the quarter. This, along with TERF, drove up the offtake in fixed investment loans to Rs

Quarterly Credit Flows

Figure 3.6



16.2 billion during Q3-FY21, compared to a net retirement of 4.4 billion last year.

Net retirements in rice and fertilizer muted working capital loans

Rice processing sector made higher seasonal loan retirement of Rs 20.4 billion in Q3-FY21, majority of which were loans taken for harvesting needs during the preceding quarter.¹⁴ The sector was able to retire its short-term loans on the back of higher export earnings.¹⁵

In case of fertilizer, the liquidity situation was relatively better this year, as the

¹¹ Around half of the short-term loan retirements in refined petroleum sector were made by two leading oil marketing companies that recorded net profit in Q3-FY21, compared to net loss in the same period last year.

¹² According to PBS data, exports of knitwear (33 percent), bedwear (19 percent) and towels (18 percent) posted a YoY increase in Rupee terms during Q3-FY21.

¹³ Sales-tax refunds of Rs 57.0 billion were released during Q3-FY21, compared to Rs 32.9 billion during the same period last year.

¹⁴ Third quarter is typically a period of seasonal retirements for rice processing sector. Importantly, during Q3-FY21, the sector's retirements remained on higher side compared to net retirement of Rs 7.2 billion, Rs 1.6 billion and Rs 7.7 billion during the corresponding periods in FY20, FY19 and FY18 respectively.

¹⁵ In Rupee terms, rice exports grew by 8.1 percent during Q3-FY21, compared to a decline of 6.0 percent in the same period last year.

Loans to Private Sector Businesses (Q3)**Table 3.3**

(Flow in billion Rupees)

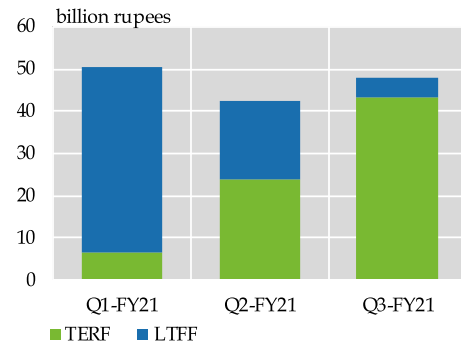
	Total Loans*		Working Capital**		Fixed Investment	
	FY20	FY21	FY20	FY21	FY20	FY21
Private Sector Businesses	75.4	60.5	79.8	42.2	-4.4	16.2
Manufacturing	115.0	80.1	111.1	55.4	3.9	23.0
Sugar	95.0	119.0	94.3	117.1	0.6	1.6
Vegetable & animal oils and fats	-5.2	22.0	-6.0	22.1	0.8	-0.1
Basic iron and steel	-9.9	12.2	-5.7	9.8	-4.1	2.3
Basic pharmaceutical products	-5.2	1.2	-5.0	2.5	-0.3	-1.2
Paper & paper products	-4.2	-1.3	-3.2	-1.1	-1.1	-0.2
Motor vehicles	-19.2	-0.8	-19.2	-4.2	0.1	3.4
Cement, lime and plaster	10.4	-10.9	13.7	-11.0	-3.4	0.1
Textile	79.1	2.5	69.2	-16.3	9.9	17.5
Refined petroleum	3.6	-16.7	5.1	-16.5	-1.5	-0.2
Fertilizers	-18.2	-23.1	-12.7	-17.2	-5.5	-5.9
Rice processing	-7.5	-20.5	-7.2	-20.4	-0.3	-0.1
Power gen., trans., and dist.	26.4	16.0	19.8	19.3	6.5	-3.0
Mining and quarrying	6.8	5.0	5.5	3.7	1.3	1.3
Construction	-3.2	-6.8	-0.6	1.0	-2.7	-3.2
Transportation and storage	-5.0	-0.4	-2.8	0.8	-2.2	-1.1
Real estate activities	-2.5	2.0	-1.7	0.6	-0.9	0.4
Agriculture, forestry and fishing	-20.0	-9.9	-12.7	-7.2	-7.3	-2.7
Telecommunications	-4.9	-5.4	-3.3	-7.6	-1.6	2.2
Wholesale and retail trade	-6.6	-16.3	-8.9	-17.5	2.3	1.3

*Total loans in Q3-FY21 include Rs 2.2 billion of construction financing, as the data on credit/loans has been revised since June 2020 due to inter-sectoral adjustment in private sector business (see IH&SMEFD Circular Letter No. 28 of 2020); ** working capital includes trade financing

Source: State Bank of Pakistan

sector's sales recovered in Q3-FY21, compared to the same period last year. In particular, urea offtake remained higher during the quarter. With this comfort, the sector retired Rs 17.2 billion in Q3-FY21, compared to a retirement of Rs 12.7 billion last year.

Refined petroleum retired short-term loans of Rs 16.5 billion during Q3- FY21, against an offtake of Rs 5.1 billion during Q3-FY20, when fall in domestic demand owing to the Covid-related lockdowns affected the liquidity positions of major Oil Marketing Companies (OMCs). This time around, with a revival in domestic demand for petroleum products, OMCs were able to retire their working capital

Gross disbursements under LTFF & TERF**Figure 3.7**

Source: State Bank of Pakistan

loans. This is consistent with increased profitability of major OMCs during Q3-

FY21, which actually posted losses in Q3-FY20.

Textile firms retired their working capital loans in Q3-FY21 on the back of better liquidity position, as high value-added exports of the sector posted a YoY increase in both quantum and Rupee terms during the quarter (**Chapter 5**). The loan retirements were despite rising input cost, as cotton prices (major input in textile) jumped by 25.1 percent during Q3-FY21, compared to an increase of 3.9 percent in Q3-FY20. Moreover, higher sales tax refunds during Q3-FY21 also supplemented the sector's liquidity position.

On the contrary, sugar sector borrowed working capital loans of Rs 117.1 billion during Q3-FY21, compared to an offtake of Rs 94.3 billion last year. The sector's borrowing need was mainly driven by relatively higher prices of sugarcane, as well as its increased production during the period under review.

Likewise, vegetable and animal oils and fats borrowed short-term loans of Rs 22.1 billion during Q3-FY21, compared to a net retirement of Rs 6.0 billion in the same period last year. This year's increase is primarily attributed to higher palm oil prices in the international market, which is mainly imported by the edible oil businesses in the country (**Section 3.4 – inflation**).

Textile sector dominated fixed investment loans

The borrowings under fixed investment loans were Rs 16.2 billion in Q3-FY21,

compared to a net retirement of Rs 4.4 billion last year. Businesses took advantage of SBP's concessionary refinancing schemes, particularly TERF. Businesses took maximum advantage of this facility, raising the disbursements to Rs 43.3 billion in Q3-FY21 from Rs 24.0 billion during the preceding quarter (**Figure 3.7**).

Among both the manufacturing and non-manufacturing segments, textile dominated the overall fixed investment loans, as the sector borrowed Rs 17.5 billion during Q3-FY21, compared to an offtake of Rs 9.9 billion during the same period last year. While benefitting from the SBP's subsidized refinancing schemes, textile businesses borrowed long-term loans mainly to import textile machinery. This is consistent with the YoY growth in the import of textile machinery during the period under review.¹⁶

Apart from textile sector, automobile sector borrowed fixed investment loans of Rs 3.4 billion during Q3-FY21, compared to a marginal increase of 0.1 billion last year. The sector benefitted from TERF mainly for capacity expansion and BMR purpose.

Consumer financing picked up the pace

Consumer financing posted an offtake of Rs 47.1 billion in Q3-FY21, against an increase of Rs 1.5 billion last year (**Table 3.4**). While the overall loans were on an upward trajectory since the first quarter of this fiscal year, it was the hefty increase in auto finance that dominated banks'

¹⁶ According to PBS, the import of textile machinery rose by 26.1 percent in Q3-FY21 compared to an increase of 4.9 percent in Q3-FY21.

Consumer Financing

(Flow in billion Rupees)

Table 3.4

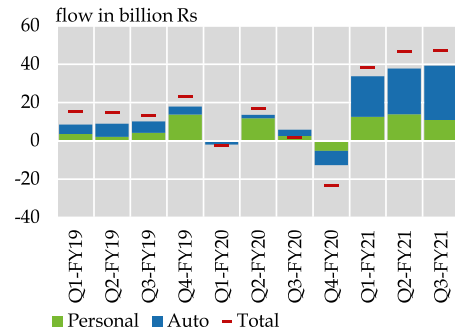
	Q3		Jul-Mar	
	FY20	FY21	FY20	FY21
Total	1.5	47.1	15.5	131.8
Auto	3.3	28.3	3.2	73.6
Personal loans	2.5	10.9	14.4	37.2
House building	-2.3	7.4	-5.6	13.8
Credit cards	-2.5	1.5	2.4	10.0
Consumer durables	0.5	-0.9	1.1	-2.7

Source: State Bank of Pakistan

consumer portfolio during Jul-Mar FY21 (Figure 3.8).

The growth in auto finance during Q3-FY21 is mainly attributed to (i) low interest rates; (ii) rising prices of passenger cars, which affected the consumers' capacity to buy on cash; and (iii) new entrants in the automobile market, which provided wider options to the consumers. This is consistent with an across the board increase in the sales of auto assemblers during the period under review. In particular, cars in the category of below 1000cc and jeeps were in higher demand.¹⁷

Likewise, personal loans also picked up the pace during Q3-FY21. Besides the low interest rate environment, this increase may be viewed as the impact of Covid and the overall inflationary pressures in the economy, which might have affected the real incomes of consumers, especially the low-income group.¹⁸

Consumer Financing (Quarterly flows)**Figure 3.8**

Source: State Bank of Pakistan

Apart from auto and personal loans, borrowings under housing finance also picked up the pace during the quarter under review. The increase is mainly driven by SBP's measures to promote housing and construction of buildings in the country. In particular, the SBP has assigned mandatory targets to banks in order to increase their housing and construction finance portfolios to at least 5 percent of their private sector credit by end-December 2021. So far (as of end-March 2021), the overall target has been achieved, as reflected by a persistent increase in the banks' housing and finance portfolio.¹⁹

3.4 Inflation

The inflationary pressures continued to ease in Jul-Mar FY21. In particular, national CPI inflation stood at 7.8 percent

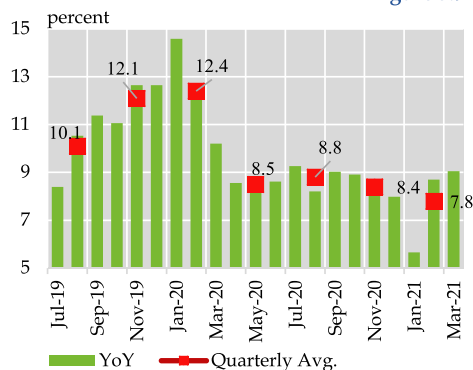
¹⁷ During Q3-FY21, the sales of below 1000cc cars more than doubled, and that of jeeps almost tripled, over the same period last year. (Source: Pakistan Automotive Manufacturers Association)

¹⁸ On average, the index of low-end urban wages fell from 9.5 in Q3-FY20 to 5.9 in Q3-FY21. (Source: PBS)

¹⁹ The outstanding stock of financing to the housing and construction sector increased from around Rs 149 billion in Q3-FY20 to Rs 202 billion in Q3-FY21. (Source: SBP press release, ERD/M&PRD/PR/01/2021-43, dated April 27, 2021)

National Consumer Price Index

Figure 3.9



Source: Pakistan Bureau of Statistics

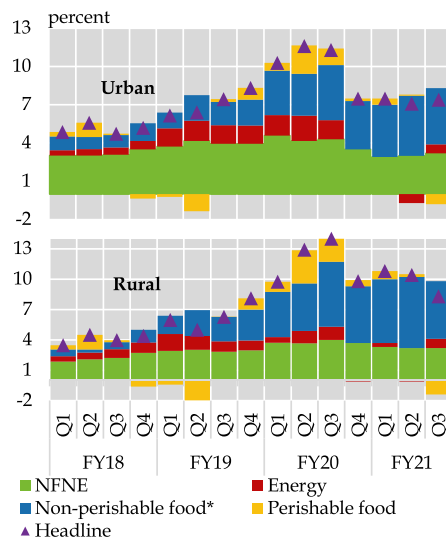
in Q3-FY21 compared to 12.4 percent in the same period last year and 8.4 percent in the preceding quarter. Notwithstanding the overall deceleration, CPI inflation remained volatile during the quarter as both low and high inflation outturns were registered (**Figure 3.9**). In fact, average inflation in Feb-Mar FY21 was 8.9 percent, higher than the preceding quarter.

In January 2021, national CPI inflation decelerated to 5.7 percent – the lowest in any month since January 1919. This level reflected a steep deceleration in the food group (**Figure 3.10**) and base effect. In particular, inflation in perishable food group declined amid improved availability of important vegetables such as tomatoes, potatoes and onions, which helped plug the demand-supply gap, resulting in softening in prices. In addition, inflation in poultry group also decelerated on account of the supply correction after witnessing a substantial rise in previous months on account of the demand-supply gap and rising feed prices.

However, inflation picked-up in the subsequent months. Particularly in March

2021, inflation increased due to: (i) hike in electricity prices on account of the base tariff, quarterly adjustments and fuel charge adjustments; (ii) rise in sugar and edible oil prices; (iii) higher inflation in cotton-cloth and ready-made garments groups on account of the surge in input prices as domestic and global cotton prices have been on rising trajectory since the start of FY21; (iv) rise in the prices of footwear by local producers after keeping prices of some variants unchanged during previous year; and (v) surge in poultry inflation amid disrupted supply on the back of work related uncertainty of restaurants and marriage halls on account of the third wave of Covid and further rise in input prices. Also, the Wholesale Price Index (WPI) posted a 13-month high inflation in March 2021, indicating emerging cost-push inflationary pressures.

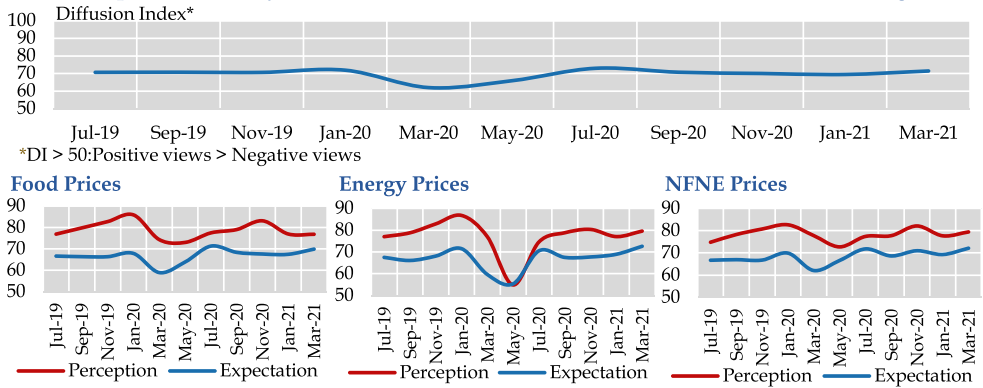
Composition of YoY CPI Inflation Figure 3.10



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

Inflation Expectation Survey

Figure 3.11



Finally, the underlying inflationary pressures – measured by the non-food-non-energy (NFNE) index – remained broadly stable during the quarter, similar to Q2-FY21. However, increase in a few items (in February and March 2021) brought a marginal uptick in urban NFNE in Q3-FY21.

Surveys suggested broadly anchored inflation expectations

The indicators of inflation expectations, gauged by the IBA-SBP Consumer Confidence Survey (CCS), presented a mixed picture during the quarter (Figure 3.11). The overall inflation expectations for the next six months subsided in January 2021 survey compared to previous iteration in November 2020 on account of the food and NFNE group. However, in March 2021, all the three categories (food, energy and NFNE) caused upward shift in the index, mainly reflecting surging electricity prices, after having experienced near stability in H1-FY21.

Inflationary pressure on food group subsided

Food inflation softened significantly after posting consecutive double-digit inflation for the past six quarters. Specifically, it decelerated to 9.7 percent and 9.1 percent for urban and rural segments respectively in Q3-FY21, compared to 15.8 percent and 19.6 percent during the same period last year. Inflation in both non-perishable items and perishable items decelerated; however, deflation in perishable food group mainly arrested the inflationary pressures in the overall food group (Figure 3.12).

Inflation in non-perishable items decelerated

In Q3-FY21, price of wheat continued its seventeen-month double-digit rising streak on a YoY basis ranging from 11.7 percent to 52.2 percent, albeit at a slightly slower pace.²⁰ Decelerating pace of inflation is attributed to narrowing supply-demand gap as around 3.6 MMT of wheat has been imported during Jul-Mar

²⁰ Leading the upward trend for a sixth month among major food items, the wheat price increased by around 26 percent year on year during Q3-FY21, both for urban and rural areas

Inflation Heat-map-Urban (YoY)*

Figure 3.12

	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21
Food & non-alcoholic Bev.	13.7	10.7	10.9	13.8	16.9	11.9	13.3	14.9	13.7	13.1	6.7	10.5	11.9
Wheat	19.3	16.8	11.7	22.1	28.5	44.3	42.1	52.2	36.6	24.2	19.2	23.8	35.2
Wheat flour	13.5	14.8	13.0	24.5	18.5	23.4	20.2	24.7	13.3	13.4	7.2	13.5	18.9
Chicken	4.2	-28.8	4.9	18.5	36.7	-38.3	-23.6	18.2	46.8	67.4	1.8	36.3	40.7
Cooking oil	26.7	22.2	20.7	20.2	17.3	11.4	11.1	11.4	10.1	10.6	13.7	15.4	15.2
Potatoes	107.5	92.3	96.9	72.0	63.0	62.4	67.2	53.1	56.1	38.3	-4.6	-4.6	-5.8
Onions	92.2	40.7	-21.2	-35.6	-19.6	-33.0	-30.8	-8.3	-6.6	-24.4	-30.4	-29.7	-49.2
Tomatoes	-71.1	-55.4	-39.5	-22.9	100.2	-0.7	51.9	66.9	-22.6	-11.2	-32.2	-29.5	-3.8
Sugar	30.9	27.8	20.1	14.7	17.0	28.0	25.4	33.0	35.8	15.3	25.9	17.2	23.5
Clothing & footwear	9.9	9.5	9.5	10.1	9.4	8.0	8.0	8.0	9.1	8.8	8.5	12.3	11.5
Cotton cloth	11.8	10.3	9.7	11.6	10.9	9.9	8.9	8.8	12.5	12.5	12.6	14.7	15.8
Footware	11.5	11.5	11.4	11.4	11.4	6.3	6.3	6.4	6.1	6.2	7.3	23.0	16.2
Housing, water, Elec.	5.1	5.1	6.5	5.6	3.6	5.4	5.5	2.3	2.2	2.8	2.9	10.0	8.2
Electricity charges	-13.9	-5.9	1.4	-3.5	-0.2	11.4	11.8	-7.8	-9.9	-6.0	-4.4	43.1	31.5
Transport	12.2	4.1	-6.5	-9.5	-4.8	-3.7	-1.6	-1.7	-4.5	-3.6	-2.8	-0.8	3.2
Motor fuel	16.3	0.4	-19.5	-28.0	-9.8	-10.3	-7.1	-7.1	-9.5	-8.8	-6.6	-5.3	1.0
Readymade food	8.2	7.7	7.4	8.0	7.0	8.8	8.7	9.4	9.7	10.6	10.8	9.5	10.1

Rural Inflation-YoY

Food & non-alcoholic Bev.	15.8	12.8	13.7	15.5	18.7	14.0	16.4	18.4	16.7	13.5	6.6	8.9	11.2
Wheat	24.3	21.9	13.9	20.7	30.4	41.1	45.1	51.1	37.9	28.1	24.4	23.1	32.5
Wheat flour	18.0	18.1	14.9	23.2	21.6	26.2	26.7	29.4	19.6	15.8	13.7	16.6	20.8
Chicken	-2.4	-28.5	4.9	13.7	35.7	-27.0	-19.4	15.6	41.0	63.2	2.3	27.3	50.1
Cooking oil	29.6	26.8	24.6	23.5	17.6	14.0	13.5	14.1	15.2	15.8	15.5	18.9	20.5
Potatoes	120.7	103.5	126.6	100.6	88.1	65.1	71.3	61.0	78.5	47.0	-7.9	-10.1	-6.3
Onions	100.9	38.9	-13.7	-36.3	-20.9	-38.7	-36.2	-2.6	-8.8	-27.6	-32.6	-30.2	-50.5
Tomatoes	-72.9	-56.3	-45.5	-27.1	129.3	11.9	57.1	104.0	-23.0	-12.9	-36.2	-34.3	-3.0
Sugar	31.4	24.5	19.3	14.0	16.6	25.5	25.3	33.4	42.5	12.8	23.5	15.1	22.7
Clothing & footwear	12.3	11.0	11.4	12.2	11.5	10.6	10.5	10.1	9.9	10.6	10.7	10.1	9.7
Cotton cloth	16.5	14.8	15.1	18.1	17.3	15.3	14.8	13.6	11.7	11.3	12.5	11.7	11.8
Footware	10.8	9.8	10.9	10.6	9.4	8.8	8.8	9.4	9.1	11.6	9.5	8.6	6.0
Housing, water, Elec.	4.6	5.2	6.0	4.9	5.5	7.2	7.4	3.7	3.6	4.9	4.5	12.2	10.1
Electricity charges	-13.9	-5.9	1.4	-3.5	-0.2	11.4	11.8	-7.8	-9.9	-6.0	-4.4	43.1	31.5
Transport	10.2	2.3	-9.0	-11.5	-3.8	-3.0	-1.4	-1.1	-3.5	-3.3	-2.2	-1.2	2.4
Motor fuel	15.7	-0.9	-21.5	-30.1	-10.0	-10.5	-7.2	-7.2	-9.9	-9.2	-6.8	-5.4	1.4
Readymade food	11.5	11.0	12.1	12.4	12.0	11.6	13.1	14.0	14.1	14.6	14.4	12.5	11.9

* lighter shades depict lower (and negative) inflation and darker shades indicate higher inflation on YoY basis.

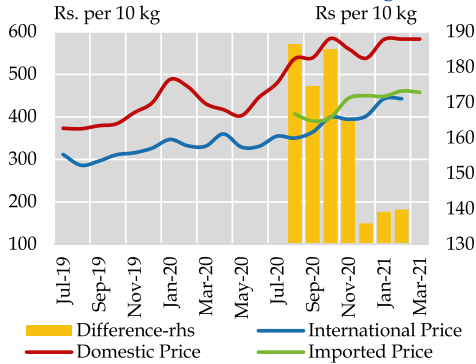
Source: Pakistan Bureau of Statistics

FY21. However, the pace of imports decelerated in Q3-FY21 on account of the rising international prices of wheat, particularly in January 2021, and sufficient domestic availability of the grain (Figure 3.13). Similarly, despite sugar being a major contributor to the overall food inflation, its inflation decelerated both on YoY and QoQ basis as the commodity's

price softened from November 2020 onwards, after the import of around 279,000 MT of sugar since July 2020.

Inflation in pulses registered a significant deceleration during Q3-FY21 despite reduced import quantum during the review period and around 15.6 percent YoY rise in imported unit values.

Wheat Prices



Source: World Bank, PBS

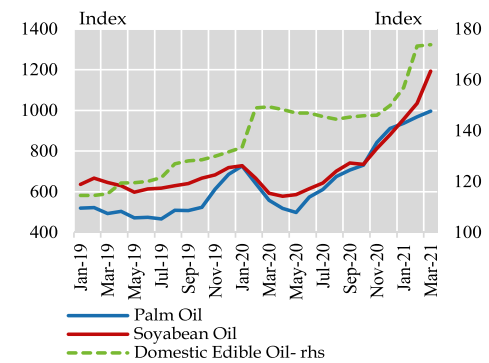
Improved domestic production (Mash and Mung bean) provided respite to inflationary pressures in this group.²¹

Some food items, on the other hand, posted rising inflation during the review period. For instance, condiments and spices remained one of the biggest contributors in food inflation during Q3-FY21 both in urban and rural areas. Disaggregated data reveals that red chilies powder dragged-up the overall index. Trade data shows that 162.5 thousand kg powder chilies were imported to fill in the supply demand gap during Jul-Mar FY21, compared to 0.4 thousand kg last year. As per Ministry of National Food Security & Research (MNFSR) recent estimates, both area and production reduced significantly for chilies crop in FY21 compared to last year.²²

²¹ Imports of pulses declined by 1.9 percent during Jul-Mar FY21 compared to same period last year mainly due to 22.9 percent less imports in Q3-FY21 amid improved local production of pulses. However, in H1-FY21, imports rose by 13.0 percent compared to last year.

²² Cultivated area of chilies declined by 24.8 percent, whereas total production was reduced by 26.7 percent.

Edible Oil

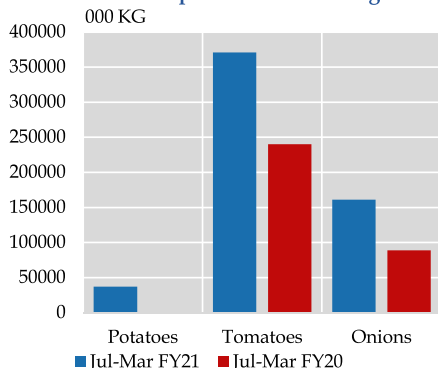


Source: IMF, PBS

The persistent increase in the edible oil price index, observed since the start of FY21, was further strengthened by higher global inflation in palm and soybean. Rise in edible oil inflation was mainly cost-led as bullish international prices of palm oil and soybean significantly increased import cost. International palm oil prices have been on upward trajectory since June 2020 on account of the tight inventory levels in major exporting countries (Figure 3.14). In view of the rising cost, Economic Co-ordination Committee (ECC) also approved increase in subsidized ghee price of Rs 25 per kg at Utility Stores Corporation (USC) by end-February 2021. Unlike the overall slowdown in inflation in food group, inflation in readymade food surged to double-digits both in urban and rural areas in Q3-FY21. Rise in cooking oil, wheat and poultry prices fed into cooked food prices, escalating the second-round

Prishable Items Import

Figure 3.15



Source: Pakistan Bureau of Statistics

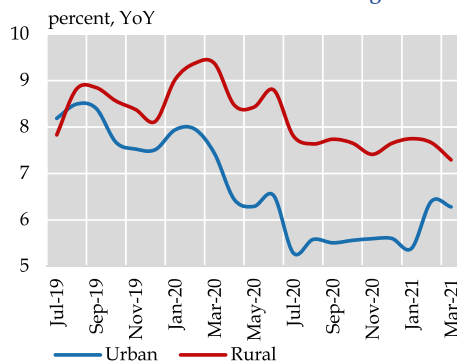
impact, which was stronger for readymade food segment within the inflation basket.

Perishable food items registered deflation

The perishable-food index registered a 16.8 percent decline compared to 32.8 percent increase during same period last year. For instance, improved supplies of tomatoes kept the prices stable during the review period. Smooth local production of tomatoes²³ along with sufficient imports caused prices to remain stable, unlike the previous year where prices registered unprecedented hike amid delayed harvests, import barriers and structural weaknesses in the overall price control mechanism.²⁴

NFNE Growth

Figure 3.16



Source: Pakistan Bureau of Statistics

Similarly, onion and potato prices remained stable in Q3-FY21. Sufficient local production along with imports have flushed the market with vegetables during the review period, causing deflation on a YoY basis (Figure 3.15).²⁵

NFNE inflation remained broadly stable

After staying within the range of 5.3 percent to 5.6 percent YoY throughout July 2020 to January 2021, core inflation for urban areas jumped by 100 basis points in February 2021 to 6.4 percent from 5.4 percent in January 2021 (Figure 3.16). In rural areas, on the other hand, NFNE inflation decelerated to 7.3 percent in March 2021 after staying within the range of 7.4 percent to 7.8 percent YoY throughout July 2020 to February 2021.²⁶

²³ Local production of tomatoes registered an increase of 12.8 percent in FY21.

²⁴ For details of last year's developments, see Chapter 3 of the SBP's Second Quarterly Report for FY20 on The State of Pakistan's Economy

²⁵ Local production of potato registered an increase of 2.8 percent during FY21.

²⁶ Rural NFNE has outpaced urban NFNE almost since the publication of separate indices. However, the gap significantly widened after January 2020. Analysis for the stated period suggests that house rent, construction inputs and wage rates, water supply, household furniture and miscellaneous goods and services registered significantly higher inflation in rural areas compared to urban areas. One of the

Broadly speaking, core inflation remained stable and has actually declined in rural areas in March 2021. Stability in the overall NFNE inflation (both urban and rural segments) can be attributed to: (i) existence of spare capacity in the economy; (ii) stable exchange rate environment; and (iii) muted fuel prices on a YoY basis. However, a few items caused NFNE to rise in urban basket.

Within urban NFNE, services index continued to decelerate in Q3-FY21; however, goods index registered rise in inflation owing to increase in clothing and footwear group during the review period. The price of cotton, an important industrial input for textiles, witnessed unabated spike during Q3-FY21 as its lower local production continued to widen the demand-supply gap. Due to increase in the prices of cotton yarn, the cotton cloth, readymade garments and hosiery items witnessed strong inflationary pressures. Also, footwear posted significant rise in inflation as two of the major producers increased prices of shoes and slippers for all three categories of gents, ladies and children after keeping prices unchanged for some variants last year.

In case of rural NFNE, both services and goods indices decelerated in Q3-FY21; however, the impact of the latter was more prominent. Prices for some components that fell sharply because of government

relief and weak demand early in the pandemic have continued to hold down inflation. Examples include education fee, furniture prices, and hotel accommodation charges as well as transport charges. In addition to this, the group of construction inputs (cement, bricks, bajri and sand) registered deceleration mainly on account of the declining price of bricks. In personal items, deceleration is attributed to declining prices of gold in response to global trends on account of the weaker demand for the metal and low cost of imports.

In the perspective of stable inflation, post lockdown analysis, March 2020 onwards, suggests that prices of around 30 percent NFNE items remained almost unchanged (0 - 0.05 difference) at least for 6 of the last 12 months (**Figure 3.17**).²⁷ The unchanged indices reflect weak demand for those items, declining metal and fuel prices in international market as well as tax relief provided in budget FY20, such as motor vehicle tax etc.

Energy inflation resurged

Energy inflation remained muted in HI-FY21, both for the urban and rural segments. However, in Q3-FY21, the trends reversed as inflation bounced back after registering deflation for last two consecutive quarters. Disaggregated analysis reveals that the major increase in the energy index is attributed to upward

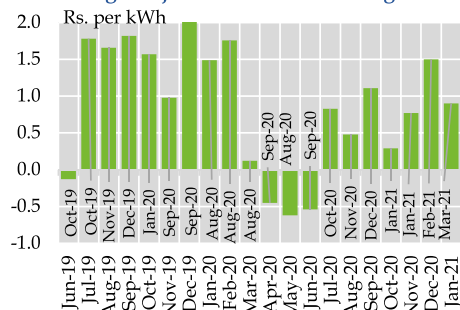
factors behind the difference in urban and rural core inflation is different consumption baskets (rural NFNE basket contains around 137 items whereas urban basket contains 236 items. In terms of mutually common items, only 124 number of items are common between urban-NFNE and rural-NFNE segments as around 13 items in rural basket are not part of urban NFNE basket) along with difference in weights.

²⁷ Index of some items typically register less changes during the year like motor vehicle tax, postal services and newspapers etc. However, index of other items such as personal effects, electrical appliances and transport services changes frequently during the year.

Unchanged NFNE Items
no. of months

Motor vehicle tax, 12	Accommodation services, 10	Postal services, 9	Communication apparatus, 9
Newspaper, 12	Electrical Appliances, 9	Footwear, 7	Woolen garment, 6
Communication services, 11	Education, 8	Transport services, 6	Marriage hall, 6
	Text books, 6	Personal effects, 6	

Source: Pakistan Bureau of Statistics

Figure 3.17**Fuel Charge Adjustment****Figure 3.18**

Note: x-axis indicate months for which fuel charge adjustment was charged

Source: NEPRA

revision in electricity tariffs. Whereas, motor fuel and liquefied hydrocarbons indices continued to post deflation and gas index remained unchanged.

In case of electricity, a significant YoY inflation hike was observed during Q3-FY21 as authorities stepped-up their efforts to implement some critical policy measure to contain the accumulation of circular debt in the energy sector. These measures include: (i) increase in base tariff of Distribution Companies (Discos) as notified by National Electric Power Regulatory Authority (NEPRA) for all consumers (including life-line consumers consuming up to 50 units per month²⁸ and (ii) notification of the Q2-FY20 and Q3-

FY20 quarterly tariff adjustments (QTAs) in December 2020 and Q4-FY20 QTA in February 2021. Moreover, monthly fuel charge adjustments also contributed to rise in inflation (**Figure 3.18**)

Domestic fuel prices, on the other hand, rose during the quarter under review in response to increase in global fuel prices.²⁹ However, the previous fall in fuel prices on account of the Covid-related sluggish global demand outlook continued to weigh on CPI inflation in Q3-FY21 on a YoY basis. Thus, the revised electricity tariffs, to address power sector issues, contributed to the rise in the overall energy inflation in Q3-FY21.

²⁸ The base tariff was raised by Rs 1.95/kWh.

²⁹ The recent rise in global oil prices reflects improved global growth prospects (with the arrival of vaccines) which could boost demand for oil-intensive activities. In addition to global recovery, cut in oil production by some OPEC countries also put pressure on prices.

4 Fiscal Policy and Public Debt

Fiscal indicators witnessed improvement during Jul-Mar FY21. The primary surplus for the period stood higher than the overall target for FY21 in absolute terms and at a 17 year-high in terms of GDP, while the fiscal deficit was also lower compared to last year. This improvement emanated both from rationalization of non-interest spending as well as a notable increase in tax collection. The containment of non-priority outlays also provided room to expand the social safety nets. However, the continued pressures of interest payments constrained the space for other expenditure, including development spending. The reduced deficit financing requirements led to a concomitant slowdown in the pace of public debt accumulation. In addition, PKR appreciation also contributed to a reduction in the external debt burden in Rupee terms. The overall increase in the debt stock emerged from domestic sources, with a larger share of long-term instruments.

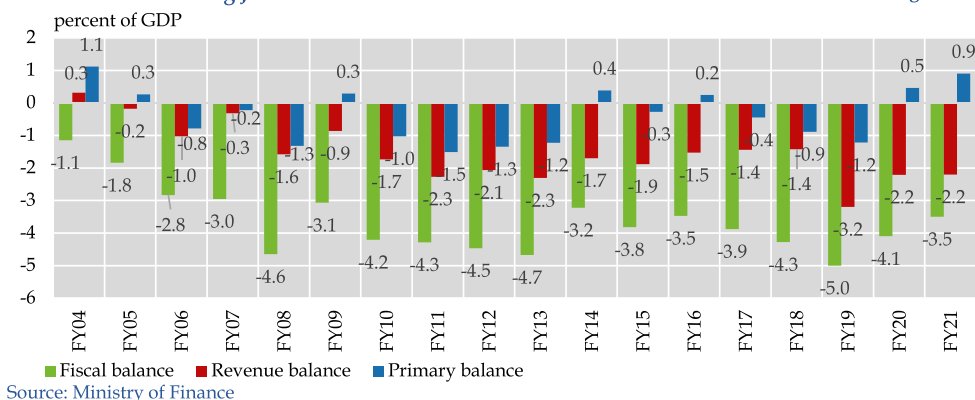
4.1 Fiscal Trends and Policy Review

The fiscal deficit for Jul-Mar FY21 declined to 3.5 percent of GDP compared to 4.1 percent in the same period last year (**Figure 4.1**). The government maintained a prudent policy stance by strengthening tax administration efforts and economizing non-priority current spending. Provinces also delivered on the commitment of fiscal consolidation and the provincial surplus of 0.9 percent of GDP during Jul-Mar FY21 exceeded the annual target of 0.5 percent.¹

The fiscal deficit stood at 1.1 percent of GDP in Q3-FY21, compared to 1.7 percent in the same period last year. This improvement was helped by a sharp 24.6 percent increase in FBR taxes, which outpaced a nominal 0.3 percent growth in expenditures witnessed in this quarter. The broad-based increase in FBR taxes during Q3-FY21 was helped by the continued expansion in economic activity, FBR's efforts to improve tax administration, the impact of price increase in some categories, as well as a low base from last year associated with the onset of the Covid pandemic.

Fiscal Indicators during Jul-Mar

Figure 4.1



¹ Provincial surplus during Jul-Mar FY21 stayed at almost last year's level (0.9 percent of GDP during Jul-Mar FY20)

Consolidated Fiscal Indicators

Table 4.1

billion Rupees, growth in percent

	Jul-Mar FY20	Jul-Mar FY21	YoY growth		Q3	
			Jul-Mar FY20	Jul-Mar FY21	FY20	FY21
1. Total Revenue (a+b)	4,689.9	4,992.6	30.9	6.5	1457.9	1641.4
(a) Tax Revenue	3,365.5	3,765.0	12.5	11.9	1057.7	1309.1
Federal	3,044.3	3,394.9	12.6	11.5	950.9	1184.8
Provincial	321.2	370.1	11.6	15.2	106.8	124.3
(b) Non-Tax	1,324.4	1,227.6	123.9	-7.3	400.3	332.3
Federal	1,244.8	1,145.4	136.6	-8.0	380.6	297.4
Provincial	79.6	82.2	21.9	3.2	19.7	34.9
2. Total Expenditure (a+b+c)	6,376.1	6,644.6	15.8	4.2	2149.4	2155.5
(a) Current Expenditure	5,611.6	6,085.4	16.9	8.4	1890.2	2056.1
Of which : Mark-up Payments	1,879.7	2,103.9	28.8	11.9	598.5	628.7
Defence	802.4	784.0	3.6	-2.3	272.9	297.4
Non-markup expenditure	4,496.4	4,540.7	11.1	1.0	1550.9	1526.8
(b) Development Expenditure & net lending	781.4	722.9	14.2	-7.5	308.1	265.1
(c) Statistical Discrepancy	-16.9	-163.8	--	--	-48.9	-165.7
3. Overall Budget Balance	-1,686.2	-1,652.0	-12.3	-2.0	-691.5	-514.1
percent of GDP	-4.1	-3.5			-1.7	-1.1
4. Primary Balance	193.5	451.8	-141.8	133.5	-93.0	114.6
percent of GDP	0.5	0.9			-0.2	0.2
5. Revenue balance	-921.7	-1092.9	-24.1	18.6	-432.2	-414.7
percent of GDP	-2.2	-2.2			-1.0	-0.9
6. Financing (a+b)	1,686.2	1,652.0	-12.3	-2.0	691.5	514.1
(a) External (Net)	682.4	562.2	30.1	-17.6	168.8	107.7
(b) Domestic (Net)	1,003.8	1,089.9	-28.2	8.6	522.7	406.4
Non-Bank	402.0	292.1	-34.1	-27.3	-37.4	159.9
Bank	601.8	797.8	-23.6	32.6	560.1	246.5

Source: Ministry of Finance

The restraint on non-interest current spending during Jul-Mar FY21, including running of the civil government and defense, provided fiscal space to the government for continued spending on social safety nets. The expenditure on running of the civil government was contained by limiting non-priority spending through restricting supplementary grants and implementing austerity measures.

The primary balance (the difference between revenues and non-interest

expenditures) recorded Rs 452 billion surplus during Jul-Mar FY21 amounting to 0.9 percent of GDP, which not only exceeded the annual target of -0.5 percent but was also the highest in the comparable period since FY04 (**Table 4.1**). This shows that overall revenues were sufficient to absorb non-interest expenditures, and also partly covered debt servicing payments.²

Aside from the improvements in fiscal and primary balances, the revenue balance, which reflects the difference between total revenue and current expenditures,

² The primary balance continued to be in surplus in Q3-FY21 and stood at 0.2 percent of GDP (against a deficit of 0.2 percent in Q3-FY20).

remained at a similar level during Jul-Mar FY21 as compared to the corresponding period last year, which indicates continued strain on fiscal space for undertaking development expenditures (**Figure 4.1**).³ While the non-interest current spending was contained, a large increase in the interest payment was mainly responsible for the worsening of this ratio. Specifically, the interest payments posted 11.9 percent increase in Jul-Mar FY21, compared to 28.8 percent increase in the same period last year. Despite this relative slowdown, debt servicing claims over FBR taxes rose to 62.0 percent in Jul-Mar FY21 from 61.4 percent in the same period last year.

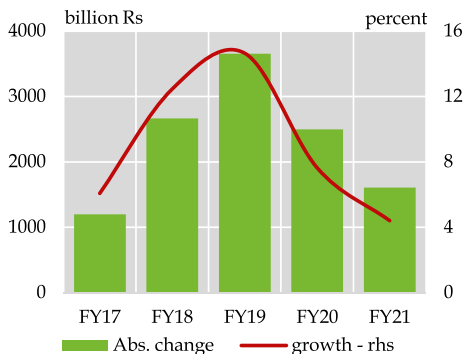
During Jul-Mar FY21, development expenditures posted an 11.1 percent decline, against 14.6 percent increase in the same period last year. In addition to the budget constraint, the Covid-related execution delays and implementation of Public Financial Management (PFM) Rules 2019, which allocated greater responsibility of undertaking development projects to

relevant ministries, also partially contributed to the decline in development spending. It may take some time for PFM reforms to yield desired results, with gradual adaptation of the relevant departments to the new rules of conduct. The process may also entail hiring of new staff with specialized skills to undertake various development expenditures.

The financing mix of the fiscal deficit remained tilted towards domestic commercial banks, whereas the inflows from non-bank and external resources posted a slowdown in this period (**Table 4.1**). In line with the containment in the fiscal and current account deficits, as well as revaluation gains emerging from the appreciation of PKR, the pace of public debt accumulation also slowed down during Jul-Mar FY21 (**Figure 4.2**). The entire increase in the public debt stock was contributed by domestic debt, while external debt saw a small decline during this period (in PKR terms). With the continued focus on debt management reforms, around 81.6 percent of the increase in domestic debt came from long-term instruments during Jul-Mar FY21 in line with Medium-Term Debt Strategy.

The consistent strain on fiscal resources posed by debt servicing payments has constrained public investment and is not favorable for the country's economic growth prospects. In this regard, the continuation of ongoing reforms aiming at broadening the tax base, careful management of spending, structural reforms in Public Sector Enterprises (PSEs), reforms in energy sector and better

Public debt accumulation (Jul-Mar) Figure 4.2



Source: State Bank of Pakistan

³ The revenue balance slightly improved to -0.9 percent of GDP in Q3-FY21, compared to -1.0 percent in last corresponding period.

FBR Tax Collection

billion Rupees, growth in percent

Table 4.2

					Growth			Growth Cont.	
	Jul-Mar		Q3		Jul-Mar		Q3	Jul-Mar	Q3
	FY20	FY21	FY20	FY21	FY20	FY21	FY21	FY21	FY21
Direct taxes	1,142	1,246	362	415	14.5	9.1	14.8	3.4	5.2
Indirect taxes	1,917	2,149	589	770	12.3	12.1	30.7	7.6	19.9
Customs duty	481	541	146	203	-5.2	12.5	39.2	2.0	6.7
Sales tax	1,250	1,416	384	498	19.3	13.3	29.8	5.4	12.5
Import	675	791	229	301	15.3	17.1	31.6	3.8	8.0
Domestic	575	625	155	197	24.4	8.7	27.1	1.6	4.5
FED	186	192	60	69	22.7	3.2	15.6	0.2	0.9
Total taxes	3,060	3,395	951	1,185	13.2	10.9	24.6	10.9	24.6

Source: Federal Board of Revenue

targeting of subsidies are expected to introduce sustained improvement in the fiscal account in the medium term.

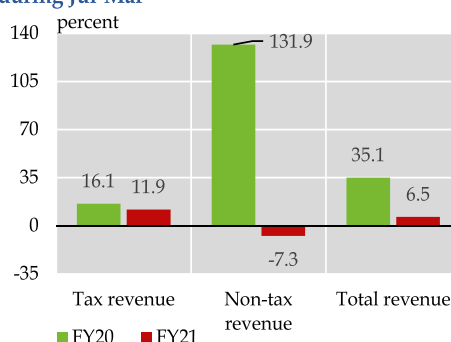
4.2 Revenues

The total revenues went up by 6.5 percent during Jul-Mar FY21, compared to 35.1 percent increase in the same period last year. This growth is entirely explained by 11.9 percent increase in tax revenues, while non-tax revenues showed 7.3 percent decline in this period (**Figure 4.3**).

FBR Collections

The improvement in economic activities, higher imports, FBR tax administrative efforts, a low base from last year, and inflationary impact in some categories led to a decent 10.9 percent increase in tax receipts during Jul-Mar FY21, compared to

13.1 percent increase in same period last year (**Table 4.2**).^{4,5} Importantly, this increase was witnessed despite higher payment of tax refunds and the absence of any major increase in tax rates during this period.^{6,7}

Growth in Overall Revenues during Jul-Mar**Figure 4.3**

Source: Ministry of Finance

⁴ Sugar prices posted 23.9 percent YoY increase during Jul-Mar FY21, over same period last year, while electricity prices were revised upward by 7.7 percent in this period.

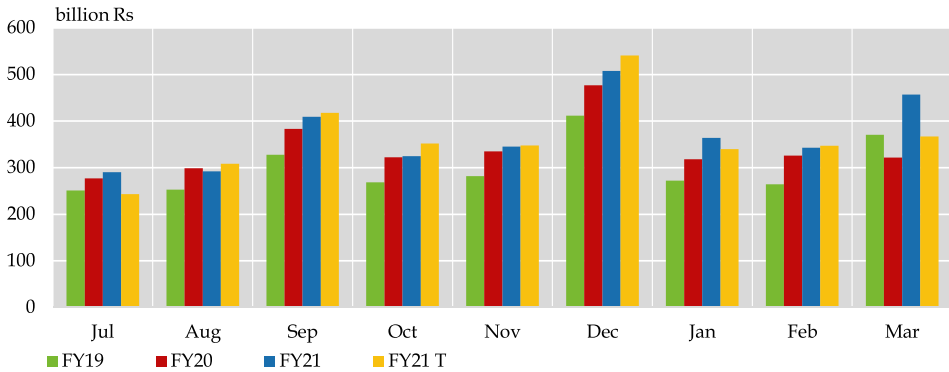
⁵ This number may not tally with number provided in Figure 4.3, as Figure 4.3 represents tax revenue reported by MoF.

⁶ With the exception of beverages, for which FED rates were increased in FY21.

⁷ FBR issued higher refunds of Rs 235.5 billion in Jul-Mar FY21 compared to Rs 130.9 billion last year. This was because of the introduction of an IT module named Fully Automated Sales Tax e-Refund (FASTER) that was introduced in FY20. The system was further improved at the start of FY21 by addressing some technical glitches.

Monthly FBR Tax Collection

Figure 4.4



Source: Federal Board of Revenue

The quarterly analysis shows that FBR taxes posted a significant YoY growth of 26.4 percent in Q3-FY21 compared to 6.5 percent last year. This rise reflects the impact of low base of last year, amid Covid-led lockdowns in the month of March 2020. Specifically, the FBR tax collection posted 5.1 percent YoY increase during Jul-Feb FY21. However, the 41.9 percent YoY surge seen in March FY21, pushed the overall growth to 10.9 percent for the overall Jul-Mar FY21.

The annual target for FBR tax collection was revised down to Rs 4.7 trillion from Rs 4.9 trillion in March 2021, amid the third wave of Covid.⁸ The FBR taxes surpassed the revised target by around Rs 100 billion in Jul-Mar FY21 (Figure 4.4).

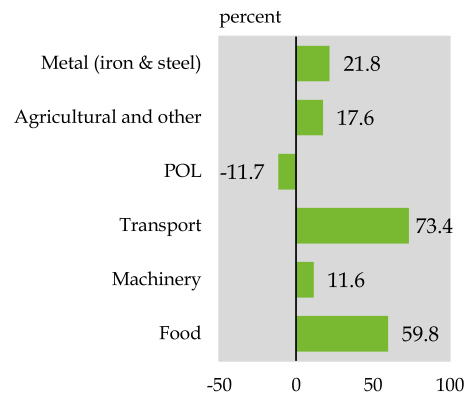
Indirect Taxes Recorded a Broad Based Increase during Jul-Mar FY21

Around half of the entire increase in tax collection was contributed by import related taxes, namely GST on imports and

custom duties during Jul-Mar FY21. This increase was seen despite tariff rationalization measures and decline in global oil prices, and mainly reflects the impact of revival in economic activity, which led to higher imports of various capital and consumer goods and raw materials (Figure 4.5). Specifically, receipts from iron and steel, vehicles, food items

Growth in Import Value during Jul-Mar FY21 (sector-wise)

Figure 4.5



Source: State Bank of Pakistan

⁸ IMF country report (2021), "Second, Third, Fourth, and Fifth Reviews Under the Extended Arrangement Under the Extended Fund Facility and Request for Rephasing of Access-Press Release; Staff Report; Staff Supplement, and Statement by the Executive Director for Pakistan".

Import Related Taxes in Jul-Mar Table 4.3

billion Rupees; growth in percent

	FY20	FY21	Growth	Growth Cont.
Sales tax	675.4	791.2	17.1	
POL	192.2	175.3	-8.8	-2.5
Iron and steel	63.4	85.6	35	3.3
Vehicles	33.1	53.3	61.2	3
Edible oil	39.2	52.3	33.6	1.9
Plastic	42.8	51.4	20.1	1.3
Machinery	47.2	54.4	15.3	1.1
Semiconductor devices	39.4	40.6	3.1	0.2
Custom Duty	481.5	541	12.4	
Vehicles	43.6	70.7	62.1	5.6
POL	68.1	63.1	-7.4	-1
Iron and steel	35.1	42.4	20.7	1.8
Machinery	24.7	30.1	22.1	1.1
Edible oil	23.3	25	7.4	0.4
Semiconductor devices	44.7	46.2	3.4	0.3

Source: Federal Board of Revenue

and machinery witnessed a sharp YoY increase during Jul-Mar FY21, whereas collection from POL declined amid softening import prices (**Table 4.3**).⁹

GST collection from domestic sales also witnessed a decent expansion. Receipts from electrical energy had the most prominent share in the overall increase, which was led by both upward revision of electricity tariffs and increase in sales (**Table 4.4**).¹⁰ Similarly, collection from sugar also surged amid sharp increase in domestic prices, whereas the revival in vehicle and POL sales during Jul-Mar FY21 also contributed positively to the overall collection. Moreover, intensified crackdown against the illegally imported

Sales Tax (domestic) during Jul-Mar Table 4.4

billion Rupees, growth in percent

	FY20	FY21	Growth	Growth Cont.
Electrical energy	78.6	105.7	34.5	4.3
POL	211.8	228.2	7.8	2.6
Sugar	26.8	43.8	63.2	2.7
Cement	16.0	26.5	65.7	1.7
Cotton yarn	24.5	34.1	39.1	1.5
Motor cars	3.0	12.1	305.2	1.4
Beverages	14.3	23.1	61.9	1.4
Cigarettes	13.9	18.2	30.8	0.7
Iron and steel	6.2	7.8	26.0	0.3
Textile	9.0	9.8	9.5	0.1
Others	230.8	271.5	17.6	6.4
Gross	634.8	780.8	23.0	-
Net	578.8	624.6	7.9	-

Source: Federal Board of Revenue

cigarettes made these brands more expensive in the local market. Resultantly, the consumption of local substitutes of these products increased, which led to higher collections from cigarettes at domestic stage.¹¹

Collections from FED ticked up slightly during the period under review, with major share from cigarettes and beverages. As discussed earlier, collections from cigarettes increased due to the switching of demand to local brands amid anti-smuggling drive by FBR.

WHT and Collection on Demand (CoD) Helped Increase the Direct Taxes

Direct taxes posted a growth of 9.1 percent during Jul-Mar FY21, compared to 15.0 percent increase in the same period last

⁹ The price of crude oil per barrel declined by 17.6 percent during Jul-Mar FY21 compared to last year.

¹⁰ Electricity generation posted 4.8 percent increase during Jul-Mar FY21, compared to 1.0 percent in the same period last year.

¹¹ This can be seen from 17.8 percent increase in cigarettes production during Jul-Mar FY21, compared to 31.5 percent decline in the same period last year.

Direct Taxes during Jul-Mar

billion Rupees, growth in percent

Table 4.5

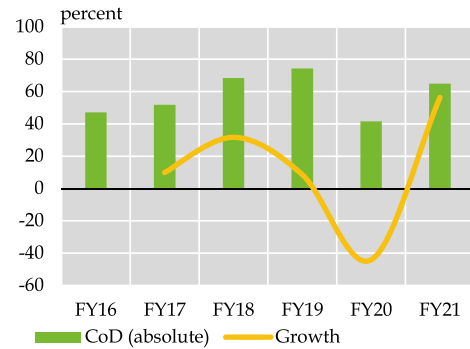
	FY20	FY21	Growth	Growth Cont.
Collection on demand	41.5	64.9	56.6	2.1
Voluntary payments	324.7	356.3	9.7	2.8
Withholding taxes	827.2	876.5	6.0	4.3
Imports	155.0	157.3	1.5	0.2
Salaries	89.7	105.1	17.2	1.4
Dividends	38.5	41.0	6.5	0.2
Bank interest and securities	100.8	105.7	4.9	0.4
Contracts	173.9	180.3	3.7	0.6
Export	29.7	30.3	2.1	0.1
Cash withdrawals	12.6	11.5	-8.6	-0.1
Electricity bills	35.8	36.4	1.8	0.1
Telephone	41.3	46.9	13.6	0.5
Other WHT	150.0	161.9	7.9	1.0
Net Direct Taxes	1,142.3	1,246.4	9.1	9.1

Source: Federal Board of Revenue

year. The growth during the review period was contributed by all the three sub-heads in this category namely, WHT, Voluntary payments and CoD (**Table 4.5**).

The increase in WHT was mainly driven by the sub-heads of contracts, bank interest and securities and telecom services. The boost in construction activity, uptick in saving deposits,¹² increasing usage of telecom services (due to virtual meetings and online educational activities, etc., amid Covid) helped the WHT grow during Jul-Mar FY21.

Meanwhile, the CoD showed a strong growth during the period when compared with last year. In fact, the growth in CoD was the highest in past five years (**Figure 4.6**). This improvement can be traced to administrative efforts of FBR, which

Collection on Demand during Jul-Mar of Last Five Years**Figure 4.6**

Source: Federal Board of Revenue

included: targeted audits of big revenue-yielding corporates and multi-nationals, and issuance of higher demand notices to the potential taxpayers.¹³ Also, FBR has established two dedicated offices in Multan and Islamabad to facilitate large taxpayers to improve tax facilitation system. Furthermore, the FBR has also launched *Maloomat Tax-Ray*, under which it collects the information of individuals' assets and withholding deductions from third-party sources (such as banks) and shares the same with the individuals. The use of third-party data sources helps the FBR to better determine the tax liability of high net-worth individuals (and issue demand notices).¹⁴

Federal Non-tax Revenue Declined on Account of Lower SBP and PTA Profits

Non-tax revenues declined in Jul-Mar FY21 compared to last year due to lower SBP and PTA profits (**Table 4.6**). In fact, the contraction in these two heads alone led to

¹² Saving deposits increased by around 14 percent in Jul-Mar FY21.

¹³ Source: Monthly Economic Update & Outlook April 2021 available at: www.finance.gov.pk/economic/economic_update_april_2021.pdf

¹⁴ www.fbr.gov.pk/pr/pakistan-banks-association-and-fbr-agrees-to/152491 (dated: September 24, 2020)

Federal Non-Tax Revenue during Jul-Mar Table 4.6

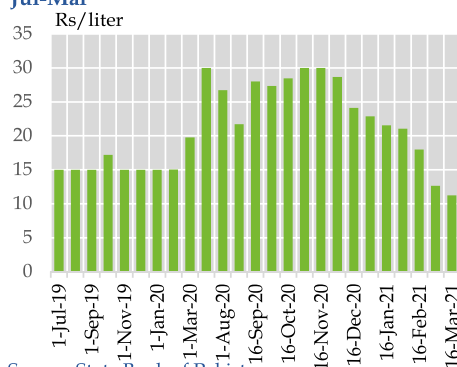
billion Rupees, percent

	FY20	FY21	Growth	
			FY20	FY21
Mark-up	70.0	53.2	387.3	-24.0
Dividends	26.6	19.6	-17.4	-26.3
PTA profits	113.2	20.0	599.4	-82.3
SBP Profits	635.5	497.5	359.8	-21.7
Passport Fee	16.3	10.2	0.0	-37.2
Royalties on Oil Gas	65.6	53.3	6.2	-18.7
Petroleum Levy	198.3	369.2	40.3	86.2
GIDC	6.2	15.4	-64.7	147.4
NGDS	7.9	17.2	64.7	117.8
Others	60.2	55.6	27.5	-7.7
Total	1,262.7	1,165.6	134.4	-7.7

Source: Ministry of Finance

Rs 231.2 billion reduction in total non-tax revenues in the period under review. However, this impact was partially offset by Rs 170.9 billion increase in collections from Petroleum Development Levy (PDL) in Jul-Mar FY21.

The transfer of SBP profits to the government marked a sharp 21.7 percent YoY reduction during Jul-Mar FY21. This mainly reflects the impact of lower interest rates, and a decline in the government debt stock with the SBP.¹⁵ In the case of PTA, the decline in profits reflects the impact of one-off payment of GSM license renewal fee last year. It may be recalled that last year the telecom companies had paid 50 percent of their license renewal fee, while the remaining amount had to be paid in tranches over the next five years. PTA transferred Rs 20 billion to the government

PDL Rates on Petrol during Jul-Mar**Figure 4.7**

Source: State Bank of Pakistan

during Jul-Mar FY21 in this head, compared to Rs 113 billion last year.

PDL levy, on the other hand, showed a robust growth in Jul-Mar FY21 compared to last year. The government raised PDL rates on gasoline and diesel during Jul-Feb FY21 compared to last year, which reached a historic high of Rs 30/liter during the months of July and November 2020 (Figure 4.7). On the other hand, led by the economic recovery, the consumption of these POL products also witnessed 14.3 percent YoY increase during the period under review.¹⁶ The combination of higher rates and consumption led to 86.2 percent YoY increase in collection from PDL during the entire Jul-Mar FY21, compared to the same period last year. However, in Q3-FY21 the government reduced the PDL rates amid rising international oil prices, which slowed down the pace of collection from the levy compared with the previous quarters of this year.

¹⁵ The government retired Rs 0.3 trillion to the SBP during Jul-Mar FY21.

¹⁶ Source: OCAC

4.3 Federal Expenditures¹⁷

Federal expenditures grew by 4.9 percent during Jul-Mar FY21, compared to 21.0 percent increase in Jul-Mar FY20. Major contribution came primarily from growth in domestic markup payments and grants and subsidies which covered Covid related expenditures and social spending under Ehsaas program. However, non-interest expenditures (including running of civil government, pension, defence, and federal development expenditures) declined by 0.4 percent as compared to 15.8 percent increase in the same period last year. Specifically, the expenditures for the running of the civil government showed consistent YoY declines in the last two quarters, after witnessing an increase in Q1-FY21.

Federal Current Expenditures

Within current spending, major increase was observed in markup payments, which grew by 11.9 percent during Jul-Mar FY21 as compared to 28.8 percent in the same period last year. This deceleration mainly came from a decline in foreign markup payments during the period.

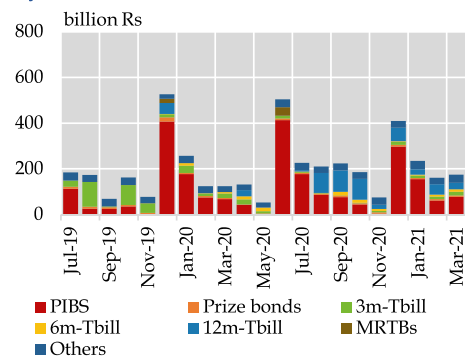
Interest payments on domestic & external debt

The interest payments on domestic debt posted 17.5 percent increase during Jul-Mar FY21. According to quarterly details, the YoY growth in interest payments slowed down to 8.4 percent in the past two quarters, after showing a large 29.8 percent increase in Q1-FY21. The surge seen in Q1-

FY21 was mainly contributed by the coupon payments on PIBs, which inflated the overall interest payments during Jul-Mar FY21 (**Figure 4.8**).

Instrument-wise Interest Payments

Figure 4.8



Source: State Bank of Pakistan

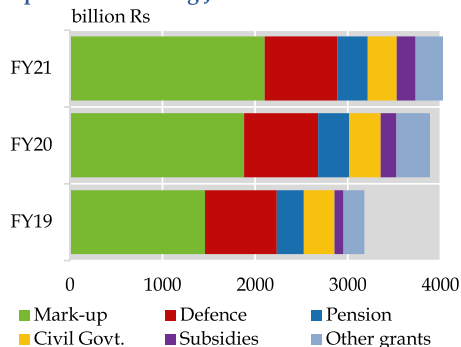
On the other hand, interest payments on external debt declined by 27.4 percent during Jul-Mar FY21, compared to the same period last year. This decline was primarily due to the debt relief provided under DSSI. In addition, a 10.0 percent appreciation of PKR against the US\$ during the period and a drop in foreign interest rates (Libor), which favorably repriced the floating debt contracts, also contributed to this decline.¹⁸

Curtailment in Non-Interest Current Expenditures

The slowdown in non-interest current spending was mainly led by contraction in the outlays for running of civil government, defense and pensions (**Figure 4.9**). The expenditure for running of the civil government was contained by limiting

¹⁷ The discussion in this section is based on federal expenditures excluding statistical discrepancy

¹⁸ See Chapter 5 for detail.

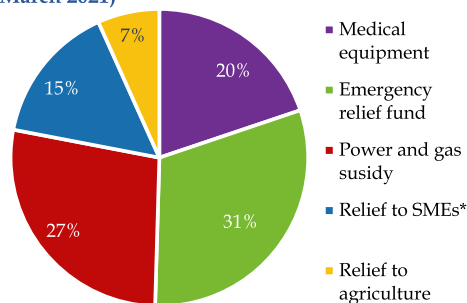
Composition of Federal Current Expenditures during Jul-Mar **Figure 4.9**

Source: Ministry of Finance

non-priority spending, restricting supplementary grants and implementing austerity measures.¹⁹ These included restraints on protocols (traveling-related, etc.), better accounting practices under PFM Act (2019), ban on vehicle purchases (such as cars and vans, etc.), suspension of new vacancies, and rationalization of other operational expenditures.²⁰

Economic Stimulus Package continued

The government announced Rs 1.2 trillion Economic Stimulus Package in FY20 to provide relief and mitigate the impact of Covid. Out of this amount, 56.5 percent was spent last year, and a further 12.0 percent was utilized during Jul-Mar FY21. Around half of these disbursements during Jul-Mar FY21 catered to Covid management requirements i.e., medical equipment and lockdown administration in the virus hotspots and emergency relief (such as purchase of vaccines, hospital services, awareness campaigns, etc.). The

Covid-related Spending under Fiscal Stimulus Package (Up to March 2021) **Figure 4.10**

Source: Ministry of Finance

remaining amount was spent for providing incentives to revive growth in various sectors of the economy (**Figure 4.10**).

Social Protection Programs remained robust

The government launched Ehsaas Emergency Cash (EEC) transfer program in April 2020, to save the vulnerable families from the recessionary impact of Covid. Under this program, immediate one-time cash assistance amounting to Rs 12,000 per household was provided to eligible families identified with the help of the provinces and communication campaigns. By end-June 2020, the authorities had reached 12.5 million families and disbursed Rs 133 billion from the fiscal stimulus package. This support continued until end-September 2020, by including 2.3 million additional households. From Q2-FY21, this support was reverted to the regular Benazir Income Support Program

¹⁹ Ministry of Finance (2021). Mid-year Budget Review Report, 2021. Islamabad: Budget Wing, Ministry of Finance.

²⁰ Circular No. 7(1) Exp. IV/2016-430, dated August 6, 2020, Expenditure Wing, Finance Division.

(BISP) beneficiaries.²¹ According to details, the BISP disbursements witnessed Rs 8.6 billion YoY increase during Jul-Mar FY21. However, the entire increase (Rs 38.3 billion) came in H1-FY21, while the Q3-FY21 disbursements stood at Rs 4.5 billion, against Rs 34.2 billion in the same period last year.

Furthermore, government is gearing its efforts to broaden the scope of social welfare spending. In this regard, some of the major efforts include: (i) increase in the coverage and stipend to support children's education under various programs, announced during Jul-Mar FY21;²² and (ii) opening shelter homes (*Panagahs*) across different parts of the country in Q3-FY21.²³

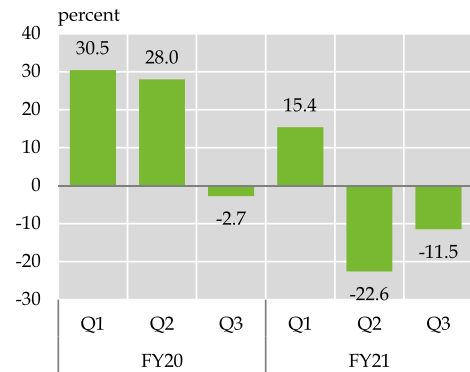
Federal Development Expenditures

The federal government development expenditures saw a 17.7 percent contraction during Jul-Mar FY21 as compared to 9.3 percent increase seen in the same period last year. In fact, after witnessing increase during Q1-FY21, the development expenditure edged down in the past two quarters (**Figure 4.11**).

As per the PFM guidelines of 2019, a strategy for the fund allocation was introduced in order to streamline disbursements under PSDP spending.

YoY Growth in Federal PSDP

Figure 4.11



Source: Ministry of Finance

Accordingly, about 80.0 percent of the budgeted PSDP target ought to be spent up to March of every year.²⁴ However, only 54.3 percent of the budgeted PSDP has been spent up to March 2021.

This sluggishness is partly attributable to the government's efforts to contain fiscal deficit. This can also be seen from the reduction in FY21 budgetary allocation of federal PSDP to Rs 650 billion, from Rs 700 billion a year earlier. However, according to official sources, a number of other factors also explain this reduction:

(i) The PFM rules of 2019 require involvement of relevant ministries to execute the identified projects. However, the relevant government departments may take some time to adapt to these changes as

²¹ IMF country report (2021), "Second, Third, Fourth, and Fifth Reviews Under the Extended Arrangement Under the Extended Fund Facility and Request for Rephasing of Access-Press Release; Staff Report; Staff Supplement, and Statement by the Executive Director for Pakistan".

²² Under the Conditional Cash Transfers (CCT) program, the stipend for boys and girls was doubled to Rs 1500 and RS 2000, respectively from August 2020, and the coverage was expanded to all 154 districts of the country. Furthermore, Ehsaas steering committee approved expansion of Waseela-e-Taleem Digital for secondary education stipends.

²³ Source: Monthly Economic Update & Outlook, April 2021. Finance Division, Government of Pakistan.

²⁴ Revised Release Strategy for Funds Allocated for the Public Sector Development Programme (PSDP) 2019-20, Budget Wing, Finance Division

Provincial Fiscal Operations**Table 4.7**

billion Rupees; growth in percent

	Jul-Mar				Growth			
	FY20	FY21	Q3-FY20	Q3-FY21	Jul-Mar FY20	Jul-Mar FY21	Q3-FY20	Q3-FY21
A. Total revenue	2,467.36	2,584.29	783.95	925.99	12.2	4.7	7.92	18.12
a. Provincial share in fed. revenue	1,931.61	1,985.76	605.79	705.70	8.57	2.80	4.47	16.49
b. Fed. loans and transfers	134.91	146.26	51.66	61.09	N-A	8.41	386.02	18.25
c. Provincial own revenue	400.84	452.27	126.50	159.20	13.55	12.83	-6.97	25.85
Taxes	321.22	370.12	106.81	124.27	11.65	15.22	6.88	16.34
Non-taxes	79.62	82.15	19.69	34.93	21.92	3.18	-45.38	77.43
B. Total expenditure (a+b+c)	2,073.25	2,171.58	738.28	768.41	8.74	4.74	4.26	4.08
Expenditures (a+b)	2,123.82	2,338.35	764.08	829.70	11.43	10.10	12.08	8.59
a. Current	1,741.80	1,948.39	601.42	667.39	6.86	11.86	4.88	10.97
b. Development	382.02	389.96	162.66	162.31	38.41	2.08	50.21	-0.21
c. Statistical discrepancy	-50.57	-166.77	-25.81	-61.29	N-A	229.81	-197.83	137.50
Overall balance (A-B)	394.11	412.71	45.67	157.59	35.15	4.72	148.67	245.02
Financing	-394.11	-412.71	-45.67	-157.59	35.15	4.72	148.67	245.03

*Negative sign in financing means surplus.

Source: Ministry of Finance

the process may entail hiring of new staff with specialized skills to undertake various development expenditures. In this regard, Pakistan's experience is not different from other developing countries that experienced both technical and non-technical issues while implementing PFM rules (Haque et al., 2012).²⁵ As explained in the literature, the pace of PFM reforms in various countries should be matched with the level of technical capabilities of the relevant departments, while policy efforts should also aim at capacity building of staff (Welham et al., 2013).²⁶

(ii) A part of the overall decline in PSDP spending can also be attributed to Covid-related execution delays, emerging from the implementation of smart

lockdowns in various parts of the country as required from time to time.

However, some fast moving projects such as 10 Billion Tree Tsunami, Karachi Transformation Plan, projects related to National Commission for Human Development, housing, interior division, and IT related projects were given more funds by re-appropriation from slow moving projects.

4.4 Provincial Fiscal Operations

Provinces remained committed to fiscal consolidation and posted a combined surplus of Rs 412.7 billion during Jul-Mar FY21 against Rs 394.1 billion in the same period last year (**Table 4.7**). In terms of

²⁵ Haque, T., Knight, D., and Jayasuriya, D. (2012). Capacity Constraints and Public Financial Management in Small Pacific Island Countries: Capacity Constraints and PFM. Asia & the Pacific Policy Studies.

²⁶ Welham, B., Krause, P., and Hedger, E. (2013). Linking PFM Dimensions to Development Priorities. Working Paper 380, Results of ODI research presented in preliminary form for discussion and critical comment.

GDP, the provincial fiscal surplus stood at 0.9 percent in Jul-Mar FY21 as compared to 0.9 percent in Jul-Mar FY20 (last 5-year average is 0.7 percent) and budget target of 0.5 percent of GDP.

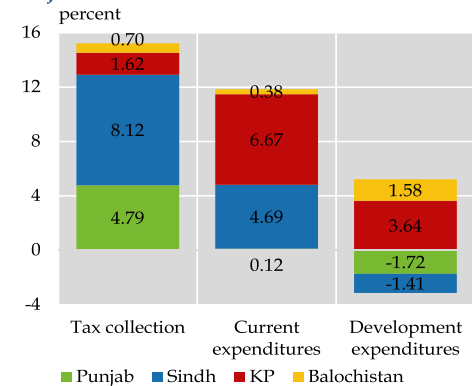
This improvement was contributed by both an increase in revenues and a slowdown in spending. In the wake of Covid situation, there was a shift of preference towards current expenditures, whose growth almost doubled during Jul-Mar FY21 as compared to same period last year. On the other hand, development expenditures posted a nominal growth of 2.1 percent during this period, against 38.4 percent increase in the same period last year.

During Q3-FY21, provincial surplus stood at 0.3 percent of GDP against a nominal 0.1 percent in the same period last year. This improvement was contributed by a large 18.1 percent YoY increase in revenues, while expenditure growth remained muted in this quarter. The expansion in revenues was broad based including all sub-heads, namely federal transfers under the NFC, provincial own tax and non-tax resources, and federal loans and grants. While on the expenditure side, the overall growth stemmed from an increase in current expenditures, whereas development expenditures showed a slight YoY decline in Q3-FY21.

Provincial tax revenues grew strongly

Provincial revenues posted a 4.7 percent increase during Jul-Mar FY21, compared to 12.2 percent increase in the same period

Province-wise Growth Contribution Figure 4.12 in Tax Collection and Expenditures for Jul-Mar FY21

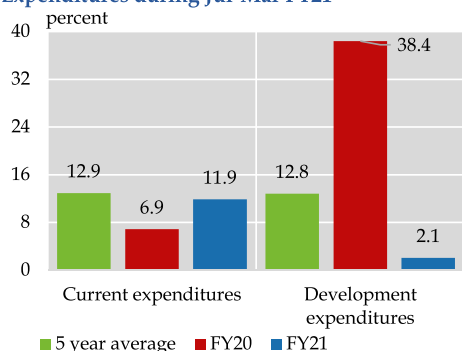


Source: Ministry of Finance

last year. This slowdown emanated from reduction in the pace of NFC transfers to provinces, deceleration in federal loans and transfers as well as non-tax revenue (due to lower profits from hydroelectricity) during Jul-Mar FY21.²⁷ However, provincial tax revenues showed a sharp 15.2 percent YoY increase during Jul-Mar FY21, which was mainly helped by increased GST collection on services.

In terms of province-wise performance, tax collection by Sindh had the highest contribution in growth, followed by Punjab (Figure 4.12). In the case of Sindh, this growth mainly stemmed from two factors: (i) a rise in import activity which led to an uptick in collections from ports and shipping services; and (ii) resumption of GST collection on telecommunication services. In the case of Punjab, most of the YoY increase in tax collection was seen in Q2-FY21, which was mainly on account of

²⁷ The NFC transfers to provinces, posted an average 25.7 percent YoY increase in the past two quarters, after showing a 29.4 percent YoY decline during Q1-FY21.

Growth in Current and Development Expenditures during Jul-Mar FY21 Figure 4.13

Source: Ministry of Finance

cross-input tax adjustment between FBR and the Punjab Revenue Authority.²⁸

Provinces prioritized current spending

Provincial spending maintained the growth momentum seen last year, as expenditures grew by 10.1 percent during Jul-Mar FY21 compared to 11.4 percent increase in the same period last year. However, unlike last year, most of the increase came from current expenditures, whereas development spending witnessed only a marginal increase (**Figure 4.13**). Specifically, current spending in KP witnessed a sharp 45.7 percent increase during Jul-Mar FY21, compared to a nominal 0.8 percent expansion in the same period last year (**Figure 4.13**). According to the provincial authorities, a large sum from the last year's allocated budget for operational expenditures under the head of

General Government Services remained unspent because of prevailing lockdown. This amount was included in the FY21 Budget and was used during Jul-Mar FY21.

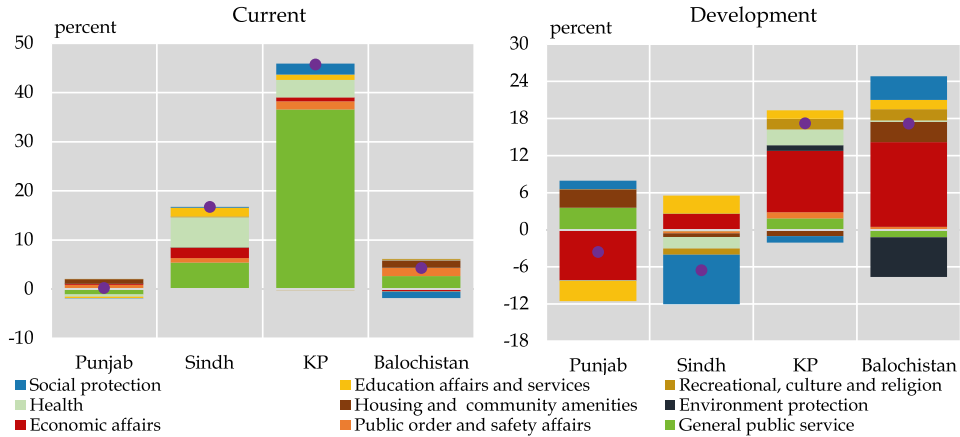
Current spending in Sindh posted 16.8 percent increase during Jul-Mar FY21, against 4.4 percent increase in the same period last year. This growth mainly stemmed from Covid-related spending by the health department as well as an increase in salaries and pensions of government employees. For Punjab, current expenditures remained almost at the same level during Jul-Mar FY21 as last year.

As for development expenditures, the marginal increase observed during Jul-Mar FY21 was contributed by increased spending in the sub-head of *Economic Affairs* by KP and Balochistan (**Figure 4.14**). This category mainly includes spending on projects related to construction and transport, agriculture, food, irrigation, forestry and fishing, etc. Development spending by Punjab fell by 3.6 percent during Jul-Mar FY21 against 53.7 percent increase in the same period last year. This decline was led by lower spending on construction, transport and education sector. Similarly, Sindh also recorded a decline of 6.5 percent during Jul-Mar FY21, compared to 4.4 percent increase in the same period last year.

²⁸ Cross input tax adjustment refers to adjustments of input tax across provincial and federal tax jurisdictions. When tax on goods used as input (i.e. input tax) for a particular services is collected by the FBR, and taxpayers only pay GST on that service to provincial revenue authorities, the tax for goods used as input for these services becomes a receivable from FBR for provincial revenue authorities. The same is true for vice versa, where services are used as input for goods, and the tax on such services becomes payable to FBR by the provincial revenue authorities.

Province-wise Growth Contribution in Current and Development Expenditures

Figure 4.14



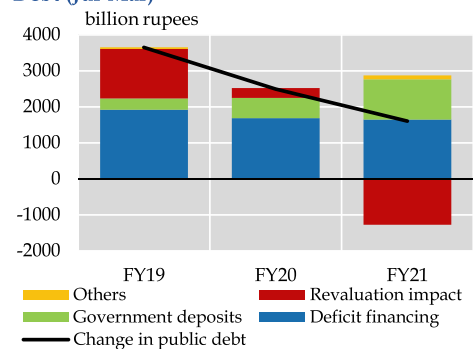
4.5 Public Debt

With the addition of Rs 1.6 trillion during Jul-Mar FY21, Pakistan's public debt reached Rs 38.0 trillion on end-March 2021 (Table 4.8). The growth in accumulation of debt slowed down to 4.4 percent during Jul-Mar FY21, compared to 7.6 percent in the same period last year. This slowdown is attributed to: (i) reduction in fiscal deficit, which was partially contributed by the debt relief under DSSI; and (ii) higher revaluation gains on existing debt stock due to appreciation of PKR (Figure 4.15).

While government external debt (including debt from IMF) posted a Rs 0.7 trillion decline in PKR terms in this period,²⁹ the entire increase in public debt during Jul-Mar FY21 emanated from domestic debt,

Source of Change in Public Debt (Jul-Mar)

Figure 4.15



which increased by Rs 2.3 trillion during the period under review. This increase came from both a slight increase in the deficit financing requirements from domestic sources as well as the increase in

²⁹ The entire decline in government external debt was due to PKR appreciation, excluding the impact of 10.0 appreciation of PKR against the US dollar, government external debt (including debt from IMF) actually increased by almost Rs 0.6 trillion.

Public Debt Composition - Jul-Mar (Rs Billion)

Table 4.8

	Stock		Absolute change				
	Jun-20	Mar-21	Jul-Mar FY20	Jul-Mar FY21	Q1	Q2	Q3
I. Government Domestic Debt	23,282.5	25,552.2	1,745.9	2,269.7	420.0	611.6	1,238.1
II. Government External Debt	11,824.5	11,288.6	603.0	-535.9	162.2	-28.9	-669.2
III. Debt from IMF	1,291.5	1,164.9	150.3	-126.5	-30.8	-67.2	-28.6
Gross Public Debt (sum I to III)	36,398.6	38,005.8	2,499.2	1,607.2	551.4	515.6	540.3

Source: State Bank of Pakistan

government deposits during Jul-Mar FY21.³⁰

Quarterly analysis of public debt composition shows that the rise in public debt was almost equally distributed across the three quarters (Table 4.8). While the external debt (in Rupee terms) recorded a YoY decline during Q3-FY21, domestic debt witnessed a sharp Rs 1.2 trillion expansion in Q3-FY21. This was led by an increase in the deficit financing requirements from domestic sources and increase in government deposits with the banking system.

While there is a slowdown in the pace of public debt accumulation, significant additions in the country's public debt during the past few years have pushed up the markup expense to substantially high levels (Figure 4.16a), whereas the interest payments to FBR tax ratio has also seen a large increase for the past few years (Figure 4.16b).³¹ To address these concerns, the government has introduced various reforms in public debt management in the past few years, which aim at improving the

composition and risk exposure of public debt. In this regard, some of the important highlights of the debt management operations included:

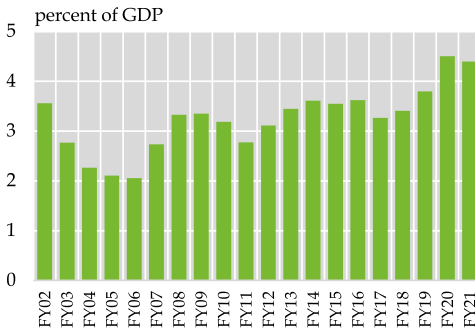
(i) continued focus on lengthening of maturity profile of domestic debt; (ii) diversification of the debt instruments and investor base by introducing new instruments; (iii) imposing a ban on institutional investments in National Saving Schemes to ensure institutional investment in long-term debt market; (iv) zero fresh borrowing from the SBP for deficit financing; (v) withdrawal of Rs 25,000 denomination prize bond to improve the documentation of the economy; (v) re-profiling of the existing stock of the SBP debt from short-term (6 months) to medium to long-term (1 to 10 years) with the target to retire it completely over a period of ten years; and (vi) diversification of external borrowing sources by mobilizing US\$ 2.5 billion through a multi-tranche transaction of dollar-denominated Eurobonds in the international capital market.

³⁰ The overall deficit financing requirements declined to Rs 1.65 trillion during Jul-Mar FY21, from Rs 1.69 trillion in the same period last year. However, while the financing from external sources posted 17.6 percent YoY decline in Jul-Mar FY21, the domestic financing increased by 8.6 percent YoY in this period.

³¹ In this regard, it should be noted that the increase in the public debt level in the past few years was partly contributed by higher mark-up cost.

Interest Payments during Jul-Mar

Figure 4.16a



Source: Ministry of Finance

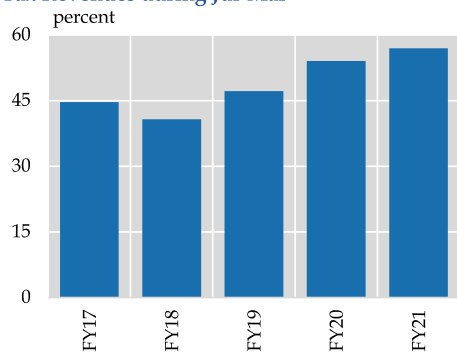
Composition of Domestic Debt

Government domestic debt increased by Rs 2.3 trillion during Jul-Mar FY21, reaching Rs 25.6 trillion on end-March 2021. On cumulative basis during Jul-Mar FY21, almost 80 percent of the increment in domestic debt was sourced through long-term instruments (Table 4.9).

From institutional perspective, the government adhered to its commitment of zero fresh borrowing from the SBP. In fact, the government retired Rs 0.3 trillion to the SBP during the period under review. Fund mobilization through National Saving Schemes (NSS) recorded net outflows, with the government's decision to impose ban on institutional investment in these schemes. Prize bonds also recorded net outflows during the period under review, as the government discontinued the sale of Rs 25,000 denomination bond in December 2020.³²

Interest payments as percent of Tax Revenues during Jul-Mar

Figure 4.16b



Absolute change in Domestic Debt during Jul-Mar

Table 4.9

billion Rupees

	FY20	FY21
I. Permanent Debt (1+2+3)	1,164.3	1,852.4
of which		
GOP Ijara Sukuk	-	438.1
Pakistan Investment Bonds (PIBs)	1,321.3	1,488.5
Prize Bonds	(157.0)	(74.2)
II. Floating Debt	270.8	421.7
of which		
Market Treasury Bills	555.8	421.3
III. Unfunded Debt	310.6	(22.0)
of which		
Saving Schemes (Net of Prize Bonds)	317.9	(11.4)
IV. Foreign Currency Loans	0.2	(0.6)
V. Naya Pakistan Certificates	-	18.2
Domestic Debt (I+II+III+IV+V)	1,745.9	2,269.7

Source: State Bank of Pakistan

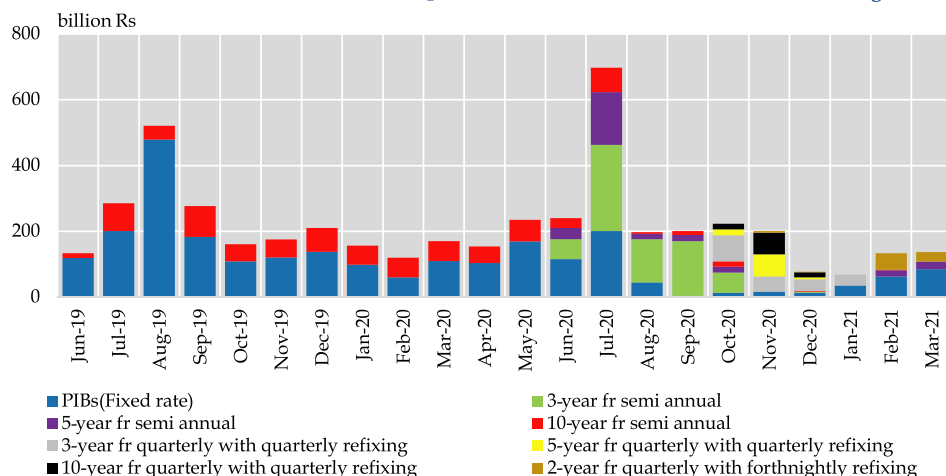
Lengthening maturity profile of domestic debt

The share of permanent debt in government domestic debt increased to

³² The holders were provided three options in this regard: (i) convert to premium prize bond; (ii) replace with Special Savings Certificates (SSC)/Defence Savings Certificate (DSC); and (iii) encash at face value. However, most of the holders opted for the encashment of these bonds, as the rise in sales of the premium prize bonds and the SSC/DSC was marginal.

Auction of Pakistan Investment Bonds (Accepted Amount)

Figure 4.17



*fr= floating rate

Source: State Bank of Pakistan

62.1 percent by end-March FY21, from 60.2 percent as of end-June 2020.³³ To improve the maturity profile of domestic debt and to diversify the investor and instrument base, a number of new instruments were introduced during Jul-Mar FY21, including: (i) availability of Shariah Compliant Sukuks of longer tenors (5-years) with fixed and variable returns; and (ii) introduction of new long-term instruments (including 3- and 5-year floating rate PIBs). In addition, the government also imposed a ban on institutional investments in NSS with effect from July 1, 2020, to enhance institutional participation in competitive primary and secondary markets of long-term debt. Due to these above-mentioned steps, the government was able to diversify the investor base and mobilize funds across long-term instruments (Figure 4.17). From the demand side also, market participants

seemed keen to invest in these instruments due to the embedded coupon re-fixing feature.

The introduction of the 5-year Ijara Sukuk (both fixed and variable-rate rental options), helped the government to mobilize Rs 0.4 trillion during the period under review. This instrument not only helped diversify the domestic debt portfolio, but also improved the maturity profile and provided an investment avenue to Islamic banks.

Shift towards floating debt in the third quarter

Short-term securities contributed around 77.3 percent to the increase in domestic debt during Q3-FY21. This can be

³³ The share of permanent debt in domestic debt on end December was 64.1 percent. A shift towards short-term debt (MTBs and MRTBs categorized as floating debt) during Q3-FY21 lowered the share of permanent debt slightly on end March 2021 to 62.1 percent.

Auction Summary of Market Treasury Bills

Table 4.10

billion Rupees

	Target	Target Net of Maturity	Maturity	Offered(all)	Accepted (all)
Q1-FY20	6,800	1,620.4	5,179.6	8,290.2	6,124.2
Q2-FY20	3,300	-1,137.2	4,437.2	8,210.7	3,340.2
Q3-FY20	2,750	359.1	2,390.9	8,299.6	2,978.1
Q4-FY20	2,200	221	1979	6,139.6	1,806.7
Q1-FY21	1,800	-903.8	2,703.8	5,143.1	1,981.4
Q2-FY21	2,750	-743.9	3,493.9	4,909.9	3,188.0
Q3-FY21	4,025	116.4	3,908.6	6,887.2	4,711.8

Source: State Bank of Pakistan

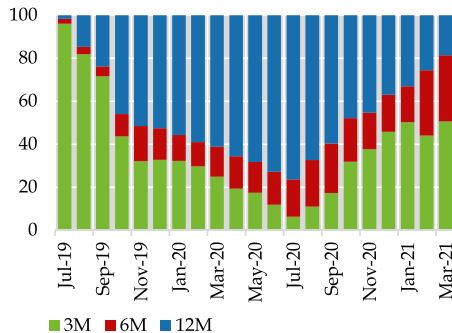
explained by lower targets set for floating-rate PIBs (PFL). In addition, in response to higher yield demanded by the market on PIBs, the government increased the net of maturity targets of MTBs (Table 4.10) during Q3-FY21.

From demand side, the market started to invest in short-term papers (3M-Tbills) from Q2-FY21 as the market expected

bottoming out of interest rate. However with the rise in term premium, the market's interest shifted towards 6M-Tbills in the third quarter (Figure 4.18).³⁴ The average term premium between 6M and 3M T-bills increased to 23 bps in Q3-FY21 compared to 8bps in Q2-FY21. During Q3-FY21, the market placed bids of Rs 2.3 trillion for 6M-Tbills compared to Rs 0.4 trillion in the preceding quarter.³⁵

Share in outstanding stock of MTBs

Figure 4.18



Source: State Bank of Pakistan

Inclusion of Naya Pakistan Certificates in Domestic Debt

Naya Pakistan Certificates held by residents were included in the category of domestic debt. Naya Pakistan Certificates (NPCs) are USD, PKR, Euro and GBP-denominated sovereign instruments issued by the Government of Pakistan. NPCs offer attractive risk-adjusted returns over different maturities. They are available in both conventional and Shariah compliant versions and are administered by the SBP.³⁶

³⁴ The cut-off rates for 6M T-bills on average remained 36 bps higher during Q3-FY21 compared to Q2-FY21.

³⁵ See Chapter 3 for detail.

³⁶ Naya Pakistan Certificate (NPC) is a fixed income security offered digitally by Government of Pakistan under NPC Rules 2020 framed under Public Debt Act, 1944. It is a sovereign security denominated in US Dollars, and Pak Rupees issued with full faith and credit of the Government of Pakistan. The NPCs are available in five maturities, namely, 3-month, 6-month, 12-month, 3-year and 5-year. Non-resident Pakistanis having National Identity Card for Overseas Pakistanis (NICOP) or Pakistan Origin Card (POC)

Absolute Change in Government External Debt during Jul-Mar

Table 4.11

billion US\$

	FY20	FY21	Q1-FY21	Q2-FY21	Q3-FY21
A. Public external debt (1+2)	3,049.2	3,611.7	1,912.6	2,499.5	-800.4
1. Government external debt	2,259.9	3,657.8	1,988.0	2,625.3	-955.5
i) Long term(>1 year)	835.0	4,366.5	2,358.1	2,881.4	-872.9
Paris club	-449.2	-486.2	278.4	343.9	-1,108.5
Multilateral	1,072.4	1,823.3	1,487.3	779.9	-443.9
Other bilateral	646.2	1,294.7	984.0	190.5	120.2
Euro/Sukuk global bonds	-1,000.0	0.0	0.0	0.0	0.0
Commercial loans/credits	498.6	1,092.2	-425.5	1,366.3	151.4
Local Currency Securities	41.0	251.9	23.3	73.0	155.6
Naya Pakistan Certificates	0.0	382.1	0.5	128.0	253.5
Others	26.0	8.6	10.0	-0.2	-1.2
ii) Short term (<1 year)	1,424.9	-708.7	-370.0	-256.1	-82.6
Multilateral*	279.8	-363.4	-303.7	64.9	-124.6
Local Currency Securities	1,345.4	-203.8	-39.9	-206.0	42.1
Commercial loans/credits	-200.3	-141.5	-26.5	-115.0	0.0
2. From the IMF	789.3	-46.2	-75.4	-125.8	155.1
i) Federal government	1,424.9	581.5	65.6	67.3	448.5
ii) Central bank	-635.5	-627.7	-141.1	-193.1	-293.5
B. Foreign exchange liabilities	-617.1	-1,212.8	-859.3	228.9	-582.3

Source: State Bank of Pakistan

The government mobilized funds worth Rs 18.2 billion through NPCs during Jul-Mar FY21.³⁷

Public External Debt & Liabilities

Pakistan's public external debt reached US\$ 81.6 billion by end-March 2021, with 4.6 percent increase over its end-June 2020 position.³⁸ Improvement in the current account balance amid strong remittances and debt relief provided under the DSSI kept the external financing needs relatively lower in FY21 (**Box 4.1**). Revaluation losses

of almost US\$ 1.1 billion due to depreciation of US dollar against other international currencies inflated the external debt in dollar terms. One half of the revaluation losses were due to appreciation of Special Drawing Rights (SDR) against the US dollar. Excluding the revaluation impact, the increase in external debt would have been much lower.

Quarterly breakup shows that the stock of public external debt declined by US\$ 0.8 billion during Q3-FY21 after recording an

and resident Pakistanis having declared assets abroad, are eligible to invest in NPCs through Foreign Currency Value Account (FCVA) and Non Resident Pakistanis Rupee Value Account (NRVA) account being marketed by agent banks as Roshan Digital Accounts (RDAs). Opening a Roshan Digital Account with one of the 11 agent banks is a pre-requisite for investment in NPCs. NPCs held by residents are part of domestic debt while NPCPS held by non-residents are part of external debt.

³⁷ Source: State Bank of Pakistan, available at: www.sbp.org.pk/ecodata/D-Debt-Liabilities.pdf

³⁸ Foreign exchange liabilities of the country reached US\$ 8.7 billion by end-March 2021, a decline of 12.3 percent over its end June 2020 position.

increase during the first two quarters.³⁹ The stock of both long-term and short-term loans declined during the quarter mainly due to repayments to multilateral donors. This decline neutralized the impact of the increase emanating from inflows received against NPCs and foreign investment in government securities during Q3-FY21 (Table 4.11).

Maturity profile of external debt improved

Composition of external debt shows that the entire increase in external debt stock during Jul-Mar FY21 was sourced through long-term debt (Table 4.11). In addition, the country repaid its short-term debt worth US\$ 0.7 billion during the period under review, which improved the maturity profile.

Foreign investment in long-term government securities also saw an uptick, which bodes well in terms of diversifying the investor base. Fund mobilization through NPCs held by non-residents stood at US\$ 0.4 billion during the period under review. Most of the inflows under NPCs came in Q3-FY21.⁴⁰

Overall, gross disbursements were recorded at US\$ 7.4 billion during Jul-Mar

Donor-wise Disbursements during Jul-Mar **Table 4.12**

billion US\$

	FY20	FY21
1. Commercial Sources	1.8	3.1
2. Multilateral & Bilateral Sources	4.8	3.3
<i>of which</i>		
ADB	2.2	1.2
World Bank	0.3	0.9
IDB	0.8	0.5
Other multi & bilateral	1.5	0.7
3. Others	0.1	1.0
Total disbursements (1+2+3)*	6.7	7.4

*Excluding inflows from IMF, Pakistan Banao Certificates, Naya Pakistan Certificates and non-resident investment in government securities

Source: Economic Affairs Division

FY21, compared to US\$ 6.7 billion during the same period last year.^{41,42} A large part of these disbursements (42 percent) was in the form of commercial borrowings to repay maturing foreign commercial loans. Meanwhile, budgetary support and project assistance for the ongoing development projects constituted 18 percent and 20 percent share in the overall loan inflows. Multilateral and bilateral sources disbursed around US\$ 3.3 billion during the period under review with major contribution coming from the ADB and the World Bank (Table 4.12). Another important development was Pakistan's re-entry in the international capital market after a gap of more than three years.⁴³

³⁹ Foreign exchange liabilities declined by US\$ 0.6 billion during Q3-FY21.

⁴⁰ www.sbp.org.pk/NPC-/page-npc.html

⁴¹ Ministry of Economic Affairs available at:

www.ead.gov.pk/SiteImage/Publication/BulletinMarch2020-21with%20Annexure1.pdf

⁴² This amount excludes inflows from IMF, Pakistan Banao Certificates, Naya Pakistan Certificates and Non-resident investment in government securities.

⁴³ Actual proceeds from the issuance arrived during early April 2021, and were therefore not reflected in the external debt data in Q3-FY21.

Pakistan's External Debt Servicing -Principal**Table 4.13**

million US\$

	Jul-Mar FY20	Jul-Mar FY21	Q1-FY21	Q2-FY21	Q3-FY21
1. Public debt (a+b)	4,839.9	4,402.4	1,423.5	1,381.1	1,597.9
a. Government debt	4,302.3	3,624.2	1,170.2	1,078.5	1,375.5
Paris Club	371.3	4.7	0	4.7	0
Multilateral	1,148.8	1,216.2	442.7	319.1	454.4
Other Bilateral	386.5	85.7	70	4.7	11.1
Euro/Sukuk global bonds	1,000.0	0.0	0	0	0
Commercial loans /credits	1,395.0	2,317.5	657.5	750.0	910.0
b. To the IMF	537.6	778.0	253.3	302.6	222.4
2. Foreign exchange liabilities	500.0	3,000.0	1,000.0	1,000.0	1,000.0
<i>Memorandum Items</i>					
Short-term government debt	696.6	744.9	272.3	154.5	318.1

Source: State Bank of Pakistan

Repayment of sovereign debt

The country repaid its sovereign debt worth US\$ 5.1 billion during the period under review (Table 4.13).⁴⁴ While external debt servicing to multilateral sources remained almost at last year's level, repayments to bilateral sources

recorded a slowdown during Jul-Mar FY21 mainly due to the debt relief provided under the DSSI. Furthermore, a net reduction of US\$ 3.0 billion was recorded in stock of foreign exchange liabilities. The country repaid US\$ 1.0 billion in each quarter.

Box 4.1: Debt Service Suspension Initiative - Implications for Pakistan's Fiscal Sector and Debt Sustainability Indicators

The World Bank and the IMF urged G20 countries to establish the Debt Service Suspension Initiative (DSSI) in April 2020 with the objective of helping developing countries to manage the adverse impact of Covid pandemic. In all, 73 countries are eligible for a temporary suspension of debt-service payments owed to their official bilateral creditors. The suspension period, originally set to end on December 31, 2020, has been extended through December 2021.⁴⁵ Under this initiative, the debt repayments are postponed for the short-term, instead of the actual cancellation of debt obligations. The repayment period for the restructured principal and interest amounts is 4-6 years.

Pakistan was also eligible for a deferment of both interest and principal repayments on bilateral official debt on repayments falling due between May 2020 and December 2020.⁴⁶ In absolute terms, the DSSI has provided a temporary relief of around US\$ 3.7 billion to Pakistan, of which one-third of the relief is

⁴⁴ Including government short-term debt.

⁴⁵ Source: [worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative](https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative)

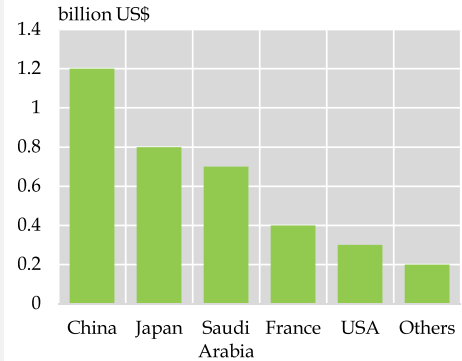
⁴⁶ According to the October 2020-dated joint IMF-WBG staff note, titled "Implementation and Extension of the Debt Service Suspension Initiative", the bilateral official creditors had committed to "suspend payments on all principal and interest coming due between May 1 and December 31, 2020." The scope of the initiative was later extended to cover debt payments for eligible countries till June 2021. (Source: [worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative](https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative))

sourced from China (Figure 4.1.1). The relief amount under first two phases (May-December 2020) and (January-June 2021) was around US\$ 2.7 billion;⁴⁷ under the third phase (July-December 2021), it is expected to be around US\$ 1.0 billion. As percent of GDP, potential savings of 0.9 percent are provided under the DSSI.

Importantly, the DSSI has positive implications for the country's fiscal accounts as well as external debt sustainability indicators. First, with the deferment in markup payments on external debt, fiscal deficit is likely to be reduced by around 0.09 percent of GDP during H1-FY21 and a further 0.08 percent in FY22.⁴⁸

This entails reduction in the government's gross financing needs and hence public debt burden by the same amount. Second, the pressure on FX reserves has also subsided due to this temporary relief. This can be seen from improvement in the external debt servicing to exports ratio to 34 percent (Table 4.1.1). In the absence of this relief, external debt servicing would have claimed 49 percent share of the country's export earnings. In the same manner, the ratio of external debt servicing to FX earnings has improved during H1-FY21 due to the relief provided under the DSSI.

Creditor-wise relief under DSSI **Figure 4.1.1**



Source: World Bank - IDS

Impact of DSSI on debt sustainability indicators

Table 4.1.1

	Unit	H1-FY19	H2-FY19	H1-FY20	H2-FY20	H1-FY21*
Interest payments on government external debt	billion US\$	1.0	1.1	1.1	0.9	0.7
**External debt servicing/FX earnings	Ratio (percent)	13.3	20.6	18.6	22.4	12.7
**External debt servicing/exports	Ratio (percent)	31.1	46.5	42.3	57.7	33.7

* First phase of DSSI **Including principal repayments

However, the repayment of the deferred payments will fall due after 2024. It is imperative to pace up structural reforms aiming at diversification of the country's export base and strengthening of non-debt related capital inflows to ensure stable stream of FX inflows for servicing external debt payments in the medium term. In this regard, the inflows from Roshan Digital Account (RDA) bode well for external debt sustainability.

⁴⁷ Economic Affairs Division (EAD) press release titled 'Government of Pakistan signs Memorandum of Understanding with Paris Club countries for 2nd round of Debt Suspension Initiative', available on the EAD website.

⁴⁸ Under the DSSI, Pakistan's markup payments on external debt have been deferred. These markup payments were estimated to be around Rs 29 billion during H1-FY21. If the country had paid this amount during FY21, country's overall expenditures and consequently fiscal deficit would have increased by 0.09 percent of GDP. However due to this relief, the deficit is estimated to be reduced by 0.09 percent of GDP.

5 External Sector

Pakistan's external account position continued to improve during Jul-Mar FY21. The cumulative current account remained in surplus, notwithstanding a modest deficit in Q3. The surge in remittances was sustained and contributed significantly to the improvement in the current account, with further support coming from deferred interest payments on external debt, the curtailment in international air travel, and lower international oil prices. These factors were sufficient to offset a widening in the merchandise trade deficit. Import payments rose as the revival in industrial activities and positive business sentiments increased the industrial demand for imported raw materials and capital goods. In addition, temporary supply-side bottlenecks in key agricultural commodities also necessitated sizable one-off imports of these consumer-oriented items, at elevated international prices. While multiple exporting sectors experienced healthy production activity, overall export receipts were marginally higher than last year's levels based on data reported to the SBP. On the financing side, sufficient inflows were available to allow for debt retirements without impacting reserve buffers. After a Covid-induced pause, the IMF program also resumed in late March, with the successful completion of the 2nd-5th combined reviews. In line with these developments, the SBP's liquid FX reserves rose by US\$ 1.4 billion during Jul-Mar FY21 to a three-year high of US\$ 13.5 billion, the central bank's net forward liabilities reduced by US\$ 1.5 billion, and the PKR appreciated by 10 percent against the US Dollar during the period.

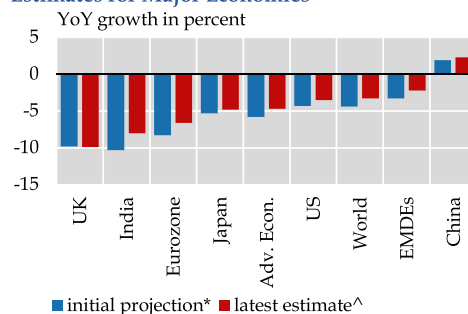
5.1 External Sector Developments

With a year having passed since the outbreak of Covid, the global economy appears poised for a relatively rapid – albeit uneven – rebound from the lows touched in Apr-Jun 2020. The real GDP contraction for the major advanced and developing economies in 2020 was less severe than expected, partly due to somewhat resilient, but still constrained, consumer spending (**Figure 5.1**). Meanwhile, the pace of Covid vaccination has also picked up since the start of 2021, especially in advanced economies. Financial markets have largely remained upbeat and conducive for this recovery process. Capital flows to EMs have remained strong as investors continue to look for higher yielding assets, though more recently, expectations of an eventual policy normalization in the advanced economies have begun to take hold amid the emergence of inflationary concerns.

The impact of these global developments, especially the accommodative policy

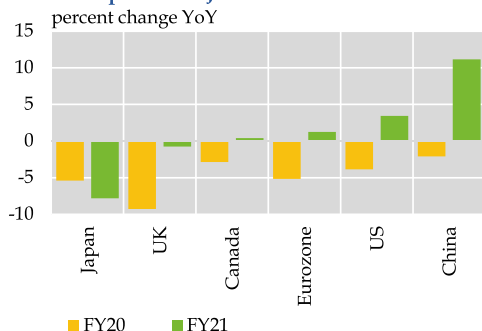
response to Covid, is playing out across both the trade and capital flow channels for EMs, including Pakistan. For instance, imports by the world's largest importers, including the US, China and Eurozone members, are higher than last year, and have helped prop up the export performance of EMs (**Figure 5.2**). Among the exporting EMs, countries that are more integrated in the global electronics supply chain, such as China, Taiwan and Vietnam, have recorded more

Updates to 2020 Real GDP Estimates for Major Economies **Figure 5.1**



*Apr-2020, ^May-2021

Source: IMF WEO (Oct 2020 & Apr 2021)

Trend in Import Growth Across Major Global Importers in Jul-Mar Figure 5.2

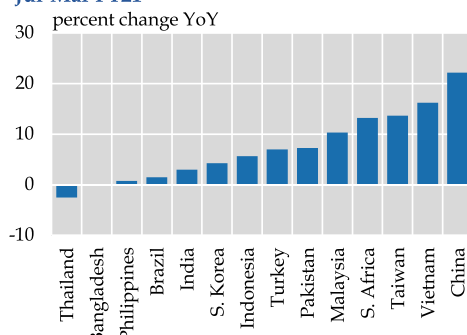
Sources: OECD/Haver Analytics

noticeable export gains (Figure 5.3), given the sizable increase in global demand for electronic gadgets and equipment after the Covid outbreak. The trade interlinkages within EMs have also played a major role in pushing up their exports and contributed to higher current account receipts.

In Pakistan's case, while exports have also grown, the significant improvement in the current account has primarily come from workers' remittances, which reached a record high of US\$ 21.5 billion during Jul-Mar FY21 (Table 5.1). Inflows from all the major corridors have maintained their rising trajectory, with multiple pull and push factors, including the incentives announced by the government and the SBP to channelize more flows via formal channels, playing key roles. Meanwhile, the ongoing air travel restrictions due to Covid continued to have a positive impact on the country's balance of payments as, in addition to helping divert remittances to formal channels, they were also the dominant reason for the nearly halving of the services trade deficit during the nine-month period.

Growth in EM's Exports in Jul-Mar FY21

Figure 5.3

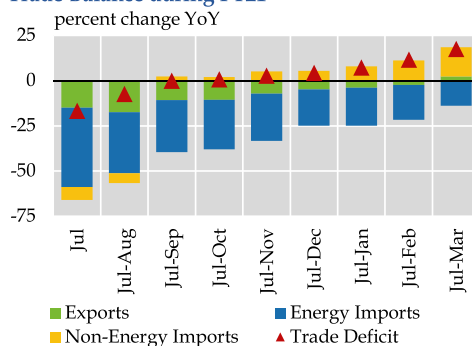


Sources: Haver Analytics & Pakistan Bureau of Statistics

On the other hand, Pakistan's merchandise trade deficit widened during Jul-Mar FY21. Monthly trade figures show that the trade gap had started to widen from September 2020 onwards, amid a strong and sustained pick-up in non-energy import payments soon after the lifting of lockdowns in early FY21 (Figure 5.4). Payments were also pushed up by the higher non-energy commodity prices and the country's need to address the domestic supply gaps across multiple key agricultural commodities by pursuing imports. On the export side, while certain sectors, notably high valued added (HVA) textiles, have seen strong growth in volumes,

Cumulative Growth in Goods Trade Balance during FY21

Figure 5.4



Source: State Bank of Pakistan

Pakistan's Balance of Payments

Table 5.1

million US\$

	Q3			Jul-Mar		
	FY20	FY21	Abs. Change	FY20	FY21	Abs. Change
Current account balance	-700	-274	426	-4,147	973	5,120
Merchandise trade balance	-4,949	-7,256	-2,307	-15,855	-18,642	-2,787
Exports	5873	6,883	1,010	18,281	18,698	417
Imports	10,822	14,139	3,317	34,136	37,340	3,204
o/w Energy imports	2,379	2,388	9	7,744	6,671	-1,074
Non-energy imports	8443	11,751	3,308	26,392	30,669	4,277
Services balance	-791	-419	372	-2,861	-1,361	1,498
Primary income balance	-1,072	-921	151	-4,135	-3,594	541
o/w interest payments	830	581	-249	2,557	1,871	-686
Workers' remittances	5,637	7,265	1,628	17,008	21,468	4,460
Financial account balance	-209	-1,057	-848	-7,354	-1,366	-5,988
Direct investment inflow	778	516	-262	2151	1396	-755
Portfolio investment inflow	-243	168	411	227	-267	-494
Build-up in fin. assets abroad	95	-277	-372	282	1,296	1,014
FX loans inflow (net)	-244	115	359	5,092	1,615	-3,477
o/w General government	-304	702	1006	4,055	3,744	-311
SBP	0	-534	-534	-498	-1465	-967
Banks	133	69	-63	-158	-551	-393
SBP's liquid reserves (end-period)*	10,845	13,493	78*	10,845	13,493	1,361*
SBP's forward liabilities (end-period)*	-3,860	-4,285	325*	-3,860	-4,285	1,164*
PKR app(+)/dep(-) in percent*	-7.1	4.6	-	-4.0	10.0	-

*Change in reserves, forward liabilities and mark-to-market PKR exchange rate during the period. Positive sign with change in the SBP's forward liabilities indicates a reduction (improvement) in the liabilities. Note: Negative sign with financial account balance means net FX inflow into Pakistan and vice versa. Negative sign for change in financial account balance means lower net FX inflow into Pakistan on YoY basis.

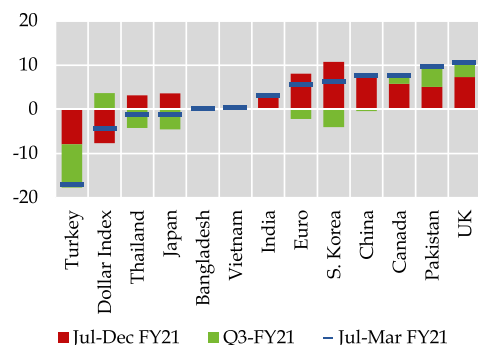
Source: State Bank of Pakistan

overall export receipts have registered a moderate growth during Jul-Mar FY21, as per data reported to the SBP.¹ A strong growth in export volumes (mostly of some major textile items) could not translate into higher export earnings, partially reflecting the impact of temporary Covid-related relaxations allowed to exporters to hold back receipts abroad for a longer period.

On the external financing side, overall financial inflows were lower on net basis during Jul-Mar FY21, reflecting: (i) weak foreign investment; (ii) lower undertaking of

new official debt; and (iii) higher official debt and liability retirements. The availability of higher current account receipts allowed the space to lower fresh (gross) official borrowings, without impacting the official reserves position. In terms of availability, official inflows were received from commercial, bilateral and multilateral sources; however, the share of commercial borrowings in the official borrowing mix increased during the period (Section 5.3). The resumption of the IMF program in Q3 also unlocked US\$ 500 million in direct financing.

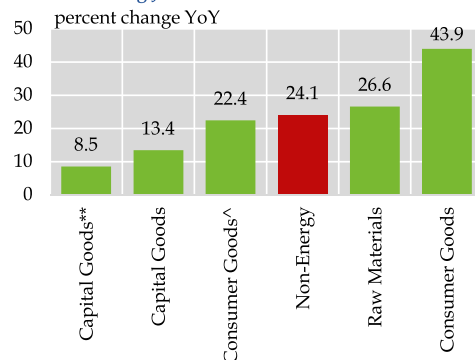
¹ According to export receipts data reported by banks to the SBP, overall export receipts rose by 2.3 percent YoY during Jul-Mar FY21. According to data reported by Customs authorities to the PBS, exports have risen by 7.1 percent in the same period (see Section 5.5: Trade Account). For details, see definitional differences provided in the Data Annexures enclosed with this report.

Nominal Exchange Rates against US Dollar **Figure 5.5**

Sources: Bloomberg, Haver Analytics

Amid these dynamics, the SBP's FX reserves rose by a cumulative US\$ 1.4 billion during Jul-Mar FY21, and the PKR appreciated 10 percent against the US Dollar during the period. The PKR's appreciation continued throughout the year, including in Q3, when the Dollar had begun to strengthen against other EM currencies (**Figure 5.5**). The PKR's relative strength in Q3 generally reflected some indigenous factors, including the successful conclusion of the IMF program reviews and the sustained growth in remittance inflows (**Section 5.4**).

While the overall external account remains stable, some emerging patterns will need to be monitored. First, the recent import profile suggests that shortfall in the domestic availability of agricultural commodities (**Figure 5.6**) – including food (wheat and sugar, but also vegetables) as well as non-food items (cotton) – are eating into the

Breakdown of Import Growth in Pakistan during Jul-Mar FY21* **Figure 5.6**

*As per PBS classifications. Excluding energy imports (HS-27) from all categories. **w/o cell phones; ^w/o wheat and sugar

Sources: Pakistan Bureau of Statistics

valuable FX earnings currently available, especially from workers' remittances.² While the imports of wheat and sugar, at least, may arguably be temporary amid expectations of better output in the coming months (**Chapter 2**), the ongoing surge in international commodity prices necessitates proactive supply management and planning to ward off import payment pressures (**Chapter 1**).

Second, while the country's gross external financing requirements are currently lower due to an overall current account surplus, the reliance on commercial and bilateral inflows to make retirements to these same sources, as observed this year, may require some active liability management. In the presence of currently modest FDI inflows, it is necessary to continue the engagement with multilateral partners and global capital investors and pursue needed reforms.

² As per the PBS' classification and data, the top contributors to the rise in consumer goods imports during Jul-Mar FY21 were wheat, sugar, dried peas, black tea, and garlic. Medicinal vaccines are also classified by the PBS under consumer goods (under HS Code 300220 at the HS-6 level), and their import values rose 31.7 percent YoY to US\$ 223.7 million during Jul-Mar FY21.

In this regard, the ongoing diversification of the country's FX earnings, especially after the introduction of Roshan Digital Accounts (RDAs) for overseas Pakistanis in September 2020, holds promise. The ongoing expansion in the scope of the RDAs, to provide further avenues to non-resident Pakistanis to pursue investments and support their families, would play a major role in channeling additional foreign exchange inflows into the country.

5.2 Current Account

The current account turned into a surplus of US\$ 973 million during Jul-Mar FY21, from a deficit of US\$ 4.1 billion in the same period last year. The surplus was accumulated over the first five months of the year, whereas modest deficits were recorded in the subsequent four months. The cumulative surplus over the period mainly originated from a sustained increase in workers' remittances, along with contractions in both the primary income and services deficits, in the wake of a drop in interest payments on external debt and lower international air travel, respectively. The net FX receipts from these sources were sufficient to offset a 17.6 percent widening in the merchandise trade deficit during the nine-month period.

Surge in workers' remittances continues

Workers' remittances to Pakistan grew by a substantial 26.2 percent and reached a historic high of US\$ 21.5 billion during Jul-Mar FY21. Inflows have been rising consistently since the start of the year, and the increase has been recorded from all major as well as relatively minor corridors (Table

Corridor-wise Remittances to Pakistan during Jul-Mar **Table 5.2**
million US\$

	FY20	FY21	Change
US	1,246.5	1,901.8	655.3
UK	1,793.2	2,900.5	1,107.3
GCC	11,259.1	12,716.6	1,457.4
KSA	4,775.7	5,731.8	956.1
UAE	4,219.1	4,526.3	307.2
Other GCC	2,264.3	2,458.5	194.1
Belgium	47.2	176.9	129.7
France	180.0	303.3	123.3
Italy	275.4	428.9	153.5
Australia	229.8	440.2	210.4
Canada	208.6	394.4	185.8
Others	1,769.0	2,205.2	436.2
Total	17,008.7	21,467.8	4,459.1

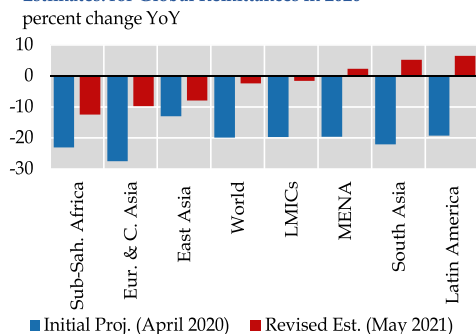
Source: State Bank of Pakistan

5.2). Moreover, inflows from virtually all the major corridors (except the US) are also at their all-time record levels.

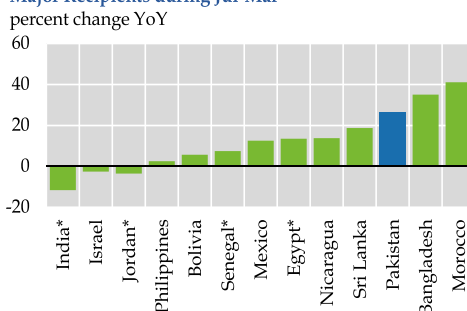
With over a year already passed since the Covid outbreak, remittances to Pakistan – along with those to some other major recipients – have been remarkably resilient, whereas those to some other countries have predictably dropped. Based on World Bank data released in May 2021, a clear diverging trend is visible in remittance flows to different regions: South Asia and Latin America have seen inflows surge in 2020, whereas Europe, Central Asia and sub-Saharan Africa have recorded declines (Figure 5.7a). These diverging growth trends across different regions, against the initial expectation of an across-the-board decline, resulted in a modest 1.6 percent YoY drop in global remittances in 2020, according to latest World Bank estimates.³

The higher remittances to South Asia were mainly driven towards Pakistan, Bangladesh and Sri Lanka, whereas inflows to India have

³ Source: World Bank (2021). *COVID-19 Crisis through a Migration Lens*. Migration and Development Brief 34. Washington, DC: World Bank.

Initial Projection & Revised Growth Estimates, for Global Remittances in 2020**Figure 5.7a**

Source: World Bank (April 2020 & May 2021)

Post-Outbreak Remittance Growth in Major Recipients during Jul-Mar**Figure 5.7b**

*During Jul-Dec (latest available data)

Sources: Haver Analytics, State Bank of Pakistan

been under pressure (**Figure 5.7b**). Similarly, the higher inflows to Latin America mainly went to Mexico and Brazil, whereas remittances to other countries in the region remained relatively weaker. On the other hand, the fall in remittances to Europe and Central Asia mostly originated from Russia, where the dual crises of Covid and the oil price decline severely impacted economic activities and dented migrants' ability to remit funds.

There are multiple factors at play that have driven this seemingly disparate trend in remittances to these regions. Some of these factors are clearly common across the major recipient economies, irrespective of the region. A common pull factor has been the pandemic itself. The lockdowns and the resultant loss of employment and business, along with an increase in expenditures on healthcare and other emergencies in the recipient economies, have increased families' reliance on support from relatives living abroad – factors that have also been

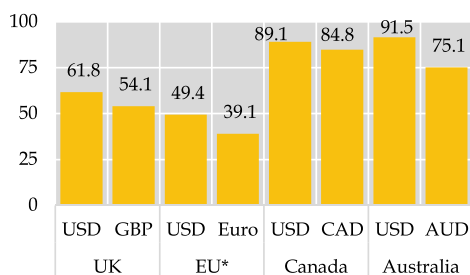
recognized by the World Bank in its latest Migration and Development Brief (May 2021).

Other pull factors are more relevant to a select group of countries. For instance, in South Asia, both Pakistan and Bangladesh have increased the incentives for migrants as well as remittance payment processors, including banks and money transfer operators (MTOs). These incentives have encouraged the banks and MTOs to increase their outreach efforts to migrants, especially via digital avenues, whereas they have also facilitated migrants to shift to formal channels for funds transfer.⁴ In Bangladesh's case, another pull factor was the heavy floods of July 2020, which further encouraged its migrants to remit higher amounts to support the recovery process.

In terms of push factors, a common one seems to be the sizable policy support in the advanced economies, especially the US and

⁴ For more details on these incentives announced after the Covid outbreak, see Chapter 5 in the SBP's State of Pakistan's Economy Report for Q1-FY21.

Remittance Growth to Pakistan in USD & Remitting Currency Terms in Jul-Mar FY21 **Figure 5.8**



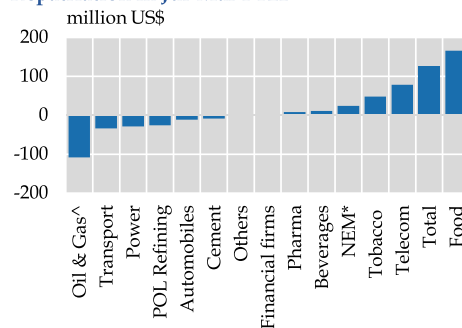
*9 top Eurozone corridors

Sources : SBP, Haver Analytics & SBP calculations

the UK, which are major destinations for international migrants. This support, including via direct cash transfers, unemployment benefits, rent and utility payment deferrals, etc, has been an important source of extra income and savings for migrants, and allowed them to remit these funds back home. It is also important to note that this policy support in the advanced economies has not only helped first generation (i.e. foreign born) workers, but also the extended family networks that have been settled abroad for longer periods.

Among other factors, cross-currency movements against the US Dollar have also played an important role in driving up remittances in USD terms. In this regard, the substantial 61.8 percent growth in remittances to Pakistan from the UK during Jul-Mar FY21 stands out, given that the British Pound (GBP) has appreciated by over 10 percent against the USD during the

YoY Change in Profit & Dividend Repatriation in Jul-Mar FY21 **Figure 5.9**



^oil & gas exploration.*non-electrical machinery

Sources: State Bank of Pakistan

period. An appreciation in the remitter's currency (the GBP, for remittances sent from the UK) will translate into a higher amount of remittances when converted into USD, even if the migrant would send the same amount in their currency. Similar appreciation trends in currencies of other major sending countries, including the Eurozone members, Canada and Australia, have also pushed up the volume of remittances from these corridors in USD terms. After adjusting for currency movements, the growth rates in remittances from some major advanced economies would have moderated slightly, though they would still be at fairly elevated levels (**Figure 5.8**).⁵ For the 12 countries in the graph, the exchange rate impact (i.e. an appreciation of their currencies against the USD) has led to an additional 14.9 percent (US\$ 318.4 million) cumulative increase in inflows from these corridors in USD terms to Pakistan.

⁵ The growth in remitting currency terms in Figure 5.8 is calculated by converting the monthly remittances received in US Dollar terms from these economies into the remitting currency (to GBP for inflows from the UK, for instance) at the average monthly exchange rate (GBP/USD), then aggregating the monthly data for the Jul-Mar periods of both FY20 and FY21, and lastly calculating the YoY growth.

Primary income deficit curtailed by lower interest payments

The primary income deficit contracted 13.1 percent to US\$ 3.6 billion during Jul-Mar FY21. The improvement stemmed almost entirely from a sizable 26.8 percent reduction in interest payments on external debt, which fell to US\$ 1.9 billion during the period. The reduction mainly reflected the temporary relaxations availed by Pakistan from the G-20's Debt Service Suspension Initiative (DSSI), under which a wide range of mainly multilateral creditors has deferred principal and interest payments on external debt (Chapter 4). Initially, debt and interest payments falling due until December 2020 were deferred under the DSSI; the initiative has been extended multiple times since then, and now covers payments that are falling due until end-December 2021.⁶ Furthermore, the sizable reduction in global interest rate benchmarks after the Covid outbreak has helped curtail the repayments on floating rate debt.⁷ For instance, the six-month LIBOR rate had fallen from 0.37 percent at end-June 2020 to 0.21 percent by end-March 2021.⁸

Meanwhile, profit and dividend repatriations by foreign investors (both direct and portfolio) rose 12.5 percent to US\$ 1.1 billion during Jul-Mar FY21. The repatriations were most visible across sectors where foreign investors' footprint is higher, and where profitability has also surged over the past year, such as FMCGs, telecom and tobacco

(Figure 5.9). However, lower repatriations from the energy sector, including both the upstream (exploration) and downstream (refining and retail sales) segments, mainly due to the lower global oil prices, helped contain the increase in overall repatriations during the period.

Lower international travel helped shrink services deficit

The services trade deficit shrank 52.4 percent to US\$ 1.4 billion during Jul-Mar FY21. Nearly all the improvement came from the import side, as payments fell by a sharp 20.4 percent during the period; export receipts, on the other hand, were stagnant at around last year's levels.

As detailed in the SBP's State of the Economy Report for Q2-FY21, the fall in services import payments is mainly driven by imports under two categories, which are both linked with international air travel and have been deeply impacted by the Covid pandemic (Table 5.3). The sizable reduction in payments for air transport services imports, which basically represent the purchase of air tickets of foreign airlines by Pakistani residents, is the primary factor behind the improvement in the overall services account. Closely related is the import of air travel services, which includes hard FX cash purchases by Pakistani residents for international travel purposes.

⁶ Source: World Bank Brief, dated May 28, 2021, available at:

www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative

⁷ Major sources of floating rate external debt outstanding for Pakistan include multilaterals (including the Paris Club), commercial banks, development banks, and bilateral partners. (Source: Pakistan Economic Survey 2019-20). Most of these loans are either entirely based on floating rate, or have a fixed component and a floating component. In contrast, the Eurobonds and Sukuk are contracted at fixed rates.

⁸ Source: ICE Benchmark Administration.

**Breakdown of Services Balance
during Jul-Mar***
million US\$

Table 5.3

	FY20	FY21	Change [^]
Transport	-1,894	-1,575	319
Air passengers	-447	83	530
Freight	-1,399	-1,516	-117
Travel	-699	-221	478
ICT Services	762	1,111	349
Exports	1,053	1,512	459
Imports	291	401	110
Others	-1,030	-678	351
Services Balance (net)	-2,861	-1,363	1,497

*Negative balance means deficit and a positive sign means surplus. [^]Positive sign shows YoY improvement & vice versa

Source: State Bank of Pakistan

In contrast, freight import payments underwent a trend reversal and rose 8.4 percent during the nine-month period, with the entire increase coming due to a surge of 37.9 percent YoY in Q3.

On the services export front, the information and communications technology (ICT) sector recorded a healthy 43.6 percent growth in receipts, which reached US\$ 1.5 billion during Jul-Mar FY21. The country's IT services firms continue to make deeper inroads into the global market, utilizing the explosive growth in demand amid the pandemic for a wide range of IT services. However, the encouraging ICT exports were almost completely offset by a weakening in receipts from other services sectors, including the local shipping and airlines industries.

5.3 Financial Account

The net financial flows into the country dropped to US\$ 1.4 billion during Jul-Mar FY21 – a fraction of the US\$ 7.4 billion inflows received in the same period last year. This sizable reduction was in response to a few major developments. First, the net FX payment pressures in the economy were relatively muted, as the overall current account remained in surplus during the nine-month period. On one hand, this surplus reduced the country's external financing requirements, and allowed the government to lower its gross borrowings without compromising the official reserves position. On the other hand, the surplus was reflected in a build-up in foreign assets abroad of Pakistani banks and other entities, which lowered the net financial flows recorded in the balance of payments data.⁹

The second major development was the higher debt and liability repayments by the government and the central bank, which lowered the inflow of loans on net basis. Third, foreign investment inflows were lower than last year, as foreign direct investment (FDI) dropped on YoY basis, while a net outflow was recorded from foreign portfolio investment (FPI). And last, the resumption of the IMF program from Q3-FY21 onwards unlocked around US\$ 500 million in direct EFF financing during the quarter, and also facilitated the country's foray into the global capital markets by end-March 2021.¹⁰

⁹ The current account surplus partially contributed to a US\$ 1.3 billion build-up in foreign assets held abroad by Pakistani banks and other entities during Jul-Mar FY21, which is treated as an FX outflow from Pakistan in the balance of payments data.

¹⁰ While Pakistan had issued Eurobonds on March 31, 2021, the actual proceeds from the issuance arrived during early April 2021, and were therefore not reflected in the end-March reserves position.

**Sector-wise Net FDI during
Jul-Mar**
million US\$

Table 5.4

	FY20	FY21	Change
Food	20.4	14.2	-6.3
Textiles	31.3	13.3	-18.0
Chemicals	-1.2	16.6	17.8
Oil & gas exploration	218.3	158.3	-59.9
Oil refineries	3.5	-38.1	-41.7
Information tech.	25.6	50.2	24.6
Electrical machinery	143.4	104.9	-38.4
Automobiles	55.5	19.7	-35.8
Power	742.4	737.8	-4.6
Telecom	464.8	-62.6	-527.4
Financial firms	210.5	192.1	-18.4
Others	235.8	188.6	-47.2
Total	2,150.3	1,395.0	-755.2

Source: State Bank of Pakistan

Foreign direct investment

Net FDI to Pakistan dropped 35.1 percent to US\$ 1.4 billion during Jul-Mar FY21; investment fell throughout the three quarters on YoY basis. Similar to last year, the power sector continued to dominate the FDI inflows, accounting for 52.9 percent of the total direct investment that arrived in the country during the period. Nearly half (46.7 percent) of this investment arrived from China, which remained the single-largest source of FDI for Pakistan.

Global direct investment has been constrained ever since the outbreak of Covid, with flows declining quite sharply in 2020 to levels that were even lower than the troughs witnessed during the last global financial crisis of 2008-09.¹¹ Advanced economies experienced the sharpest declines, though FDI flows to developing economies were also

weaker than the previous year. China and India, however, were major exceptions to this trend, as FDI to both these economies rose; firms in the high-tech and ICT industries witnessed higher inflows amid mergers and acquisitions (M&A), whereas Chinese pharmaceutical firms also received fresh FDI inflows from abroad.

Nonetheless, the overall weak global trends were also partially responsible for the tepid FDI flows to Pakistan so far in FY21. At the same time, some indigenous factors were also at play. First, there was a lack of triggers that could have stimulated fresh investment into sectors that have been receiving higher FDI over the past few years, such as telecom and power. In case of telecom sector, cellular service firms had borrowed from their foreign parent companies last year to deposit their license renewal fees with the government. These firms did not need to make large licensing payments this year, and did not need receive any significant fresh investment from abroad for other business or operating activities (**Table 5.4**). In fact, some of the firms repaid their intracompany loans this year, which slightly increased the gross FDI outflows from telecom sector this year.

In case of the power sector also, FDI was nearly unchanged at last year's level of US\$ 0.7 billion. Some CPEC-related power generation and distribution projects, which had received significant FDI last year, received relatively lower investments this year as the projects neared completion, whereas FDI outflows were also recorded from some power projects.

¹¹ Global FDI inflows were projected to have dropped 42 percent in 2020 to an estimated US\$ 859 billion. For comparison, worldwide FDI in 2008 had amounted to US\$ 1.5 trillion (down 21.2 percent YoY) and to US\$ 1.2 trillion in 2009 (down 17 percent), before recovering. (Source: World Investment Trends Monitor Report, January 2021, United Nations Conference for Trade and Development)

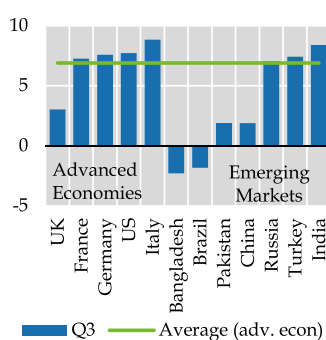
Furthermore, some industry-specific developments, such as the volatile oil prices and corporate consolidation at the global level, triggered some portfolio rebalancing by investors. In Pakistan's case, this led to a marked slowdown in fresh investments into the oil and gas exploration sector; at the same time, FDI outflows were recorded from the downstream (refining and retail) oil sector.

In this context, it is important for the country to attract foreign investment in the more vibrant sectors of the economy. From the policy and regulatory perspective, the focus has been on providing a facilitative environment. In this regard, some recent measures include the ease in FX regulations for services firms (especially ICT firms), whereas sector-specific policies for the cell phone manufacturing and electric vehicle industries have the potential to attract investors with potentially long-term investment horizons. Meanwhile, any progress on the second phase of CPEC, with its focus on setting up special economic zones and attracting foreign firms to relocate their production to Pakistan, could also drive FDI flows to the country.

Foreign portfolio investment

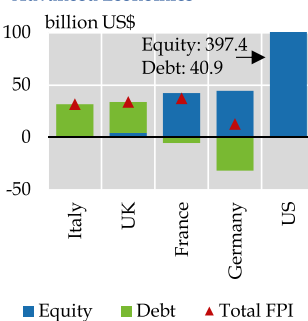
At the global level, investors' risk appetite is still at an elevated level in the wake of the unprecedented Covid-related liquidity injections and stable and low policy rates across both advanced and developing economies. This dynamic has fueled investments into a wide range of relatively riskier assets, across different asset classes, such as equities and higher yielding debt (by corporates as well as sovereigns). However, a few interesting patterns are visible. First, there appears to be geographical dispersion of foreign investment into different asset classes. Specifically, from the end of Q2 and throughout Q3-FY21, equity market returns have been relatively much higher across the major advanced economies, especially the US, and these higher returns have helped equity markets in these economies to attract stronger capital flows (Figures 5.10 & 5.11). Meanwhile, equity market performances of some major EMs, though decent in absolute terms, have been relatively muted as compared to the returns in advanced economies, leading to relatively weaker FPI inflows to EM equities (Figure 5.12). Instead, EMs have seen foreign capital flows enter

Equity Returns in Adv. & EMEs in Q3-FY21 **Figure 5.10**



Source: Haver Analytics

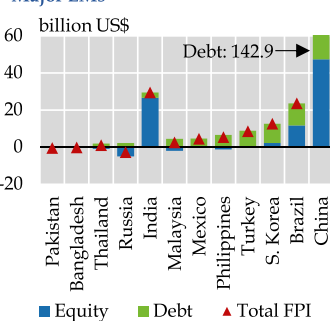
Net FPI Inflows to Advanced Economies* **Figure 5.11**



*Jul-Dec FY21 (latest data)

Sources: IMF/Haver Analytics

Net FPI Inflows to Major EMs* **Figure 5.12**



*Jul-Dec FY21 (latest available data)

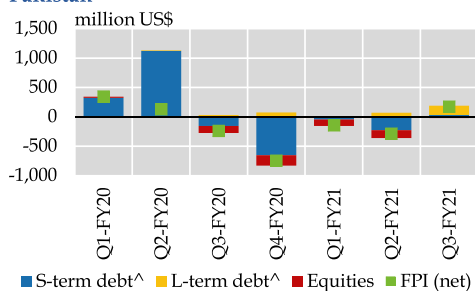
Sources: IMF/Haver Analytics

their local currency debt securities, as global investors continue to hunt for higher yielding fixed income securities.

To some extent, these global trends were also visible across the portfolio investment flows to Pakistan during Jul-Mar FY21. While overall FPI saw a net outflow of US\$ 267 million during the nine-month period, the outflows were concentrated within equities, the entire outflows were recorded in the first half of the year, and there was a trend reversal in these investment flows during Q3 (Figure 5.13). FPI into long-term local currency debt securities (Pakistan Investment Bonds, specifically) started rising from Q2 onwards and increased further in Q3. The entry of foreign investors into longer tenured bonds likely reflected the favorable sentiments in the wake of the resumption of the IMF program. At the same time, the country's interest rate differential with other advanced and emerging economies also held steady, allowing investors to lock in the higher rates for a longer period (Chapter 3).

The higher FPI into local debt securities helped partially offset continued outflows from equity securities during the period. Data from the National Clearing Company of Pakistan Limited (NCCPL) indicates that selling by foreign investors was noted across nearly all sectors, and the heaviest selling was observed across sectors where foreign ownership is also higher, namely banking, oil & gas, and cement.¹² The textile sector was an exception to this broad-based selling trend, as foreign investors were net buyers of listed textile equities over the nine-month

Breakdown of FPI Inflows into Debt & Equity Securities in Pakistan* Figure 5.13



*excluding Eurobond/Sukuk. ^short-term/long-term

Sources: State Bank of Pakistan

period, though the buying was of a relatively modest amount (US\$ 3.2 million).

Net incurrence of liabilities

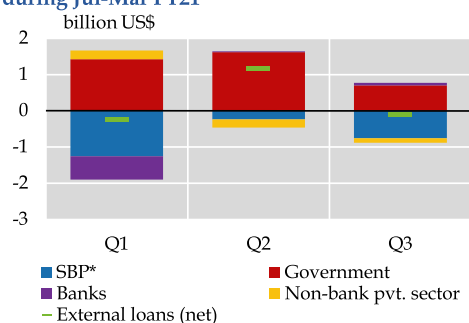
The net inflow of external loans amounted to US\$ 1.6 billion during Jul-Mar FY21, which was over three times lower than the US\$ 5.1 billion received in the comparable period of last year. Quarterly data breakdown shows that over 91 percent of the net flows were realized in the second quarter, whereas heavy repayments in the first and third quarters curtailed the net debt flows in these quarters (Figure 5.14).

The fresh borrowings were dominated by commercial loans, and inflows from bilateral and multilateral sources; the financing from most multilateral sources was mostly for Covid-related budgetary support. Within multilaterals, the Asian Development Bank (ADB) dominated, with gross inflows amounting to US\$ 1.2 billion from the lender during Jul-Mar FY21 (Table 5.5). The ADB

¹² During Jul-Mar FY21, foreign investors were net sellers of US\$ 295.1 million worth of Pakistani equities. The highest selling was noted across stocks in banking (US\$ 98.3 million), followed by oil and gas exploration & production (US\$ 45.8 million) and cement sectors (US\$ 40.5 million). (Source: National Clearing Company of Pakistan)

Net Inflow of External Loans during Jul-Mar FY21

Figure 5.14



*including below-the-line IMF repayments

Sources: State Bank of Pakistan & SBP calculations

financing was concentrated in Covid-related support, and for projects to improve the country's trade competitiveness and to further develop the domestic capital market. Other major inflows included US\$ 750 million jointly from the World Bank and the Asian Infrastructure Investment Bank (AIIB) under the Resilient Institutions for Sustainable Economy (RISE) program for budgetary support and fiscal reforms after the Covid outbreak. Commercial borrowings were higher on gross basis this year and were the single-largest source of official flows in gross terms; however, higher repayments of commercial loans led to a slowdown in the net build-up in these loans during the period under review.

Meanwhile, the resumption of the IMF program in March 2021 unlocked around US\$ 500 million in a combined tranche (for the second through fifth reviews) of the EFF program.¹³ However, the country has also been repaying previous IMF loans, which lowered the stock of IMF debt on the SBP's books. On net basis, the country made a

Major Sources of Official External Loans during Jul-Mar*

Table 5.5

	FY20	FY21	Change
Commercial	1,799.2	3,119.7	1,320.5
ADB	2,221.6	1,247.3	-974.3
World Bank	323.3	905.3	582.0
IDB	780.6	462.2	-318.4
AIIB	6.5	252.1	245.6
Other multilateral	82.6	65.7	-16.9
Bilateral inflows	1,516.1	1,360.9	-155.2
Overall official loans	6,729.9	7,413.3	683.4

*in gross terms. Excluding US\$ 500 EFF tranche (FY21) & central bank liabilities

Source: Economic Advisor's Wing, Ministry of Finance

retirement of US\$ 280 million to the Fund during Jul-Mar FY21.

5.4 Exchange Rate and Reserves

The country's overall foreign exchange reserves rose by US\$ 1.7 billion over the nine-month period and reached US\$ 20.6 billion by end-March 2021. A large share of this increase came from the SBP's FX reserves, whereas banks' reserves rose by a relatively smaller magnitude. Over the same period, the SBP retired its net forwards liabilities by US\$ 1.5 billion.

Most of the improvement in the official reserves position was noted in the second quarter (Table 5.6). With the current account in surplus, the availability of net financial flows was also higher in Q2 amid borrowings from commercial and bilateral sources. Official loan repayments were also relatively lower in Q2 as compared to the other quarters and contributed to the reserves build-up during the period. That said, the net build-up in official reserves slowed down in Q3, in the wake of higher loan repayments

¹³ The current EFF allows the program financing to be used for budgetary support as well, and is being recorded under the general government's external borrowing in the balance of payments data.

by both the central bank and the government.

Meanwhile, commercial banks' reserves rose by US\$ 356 million during Jul-Mar FY21 and reached US\$ 7.1 billion by end-March. However, the data breakdown shows that there was a lot of variation within the period. Specifically, banks reserves (i.e. foreign currency account deposits, net of trade financing) and trade nostro balances, had cumulatively risen substantially in the first quarter, reflecting the accumulation of net current account earnings abroad.¹⁴ However, over the next two quarters, the banks' reserves stabilized around the US\$ 7.1-7.2 billion mark, as they increased their trade financing activities and as import payment pressures started to emerge. These developments were also reflected in a drawdown in the banks' nostro balances in Q3.¹⁵

Meanwhile, similar to a few other EM currencies (**Section 5.1**), the PKR has continued to strengthen against the US Dollar throughout this year, with the appreciation amounting to 10 percent during Jul-Mar FY21. The appreciation in Q3 (4.6 percent) was higher than in the other quarters (1.4 percent in Q1 and 3.7 percent in Q2). The PKR's strengthening in the third quarter reflected overall positive sentiments, in the wake of the successful conclusion of

**Change in Liquid FX Reserves
& SBP's Forward Liabilities (net)
during Jul-Mar FY21**
million US\$

Table 5.6

	Q1	Q2	Q3	Jul-Mar	Stock [^]
SBP's reserves	22	1,262	78	1,361	13,493
Banks' reserves	477	-135	14	356	7,110
Overall reserves	499	1,127	92	1,717	20,604
SBP's net forward liability.*	0	-1,164	-325	-1,489	-4,285

[^]Stocks as of end-March 2021. Negative sign with stock of forward liability indicates a net short position.

*Negative sign for change in forward liability indicates net retirement of liabilities (i.e. improvement)

Sources: State Bank of Pakistan

the EFF program review, the country's impending return to the international capital markets, expectations of a stable current account balance amid the continued surge in remittances, effective management of Covid's second wave without resorting to stringent mobility restrictions, and the encouraging industrial performance.

In Real Effective Exchange Rate (REER) terms, a mixed trend was noted across the EMs during Jul-Mar FY21, with Pakistan among those countries whose REER appreciated during the period (**Figure 5.15**).¹⁶ In Pakistan's case, almost the entire increase in REER came from an increase in domestic prices relative to those of the country's other major trading partners, as captured by the

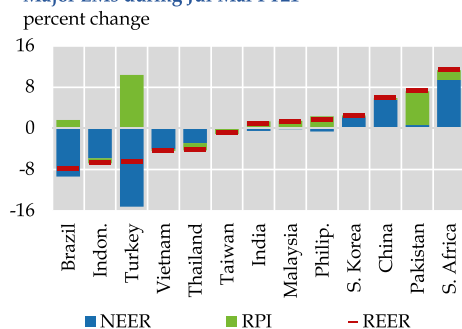
¹⁴ Banks' liquid foreign exchange reserves are defined as the balance in their foreign currency accounts (FE-25 deposits), after netting out the FX loans they have extended to importers and exporters for trade financing. These reserves had risen US\$ 477 million during Q1-FY21. Meanwhile, banks' nostro balances – which are not included in the calculation of their liquid reserves position – had increased by a further US\$ 408 million during the quarter.

¹⁵ Banks' trade nostro balances had peaked at US\$ 566 million by end-October 2020, and have been declining steadily since then, reaching US\$ 26 million by end-March 2021.

¹⁶ The appreciation (depreciation) of REER is often confused with the concept of currency overvaluation (undervaluation). These are two separate concepts; for details, see the SBP's explainer video on the REER, available at: www.youtube.com/watch?v=RX0Oa7oevLg

Breakdown of Change in REERs of Major EMs during Jul-Mar FY21

Figure 5.15



Sources: JP Morgan/Haver Analytics

Relative Price Index (RPI). Similar price pressures had also played a dominant role in REER appreciation of some other EMs, including China and South Africa. Pakistan's Nominal Effective Exchange Rate (NEER), on the other hand, remained stable during the Jul-Mar FY21 period.

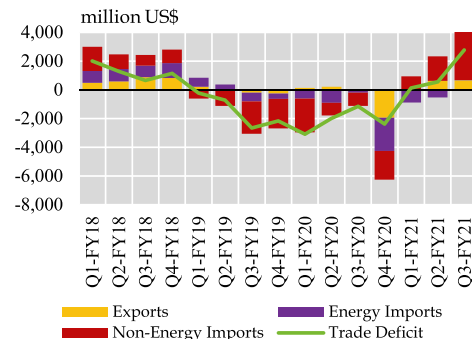
5.5 Trade Account¹⁷

After declining over the last two consecutive years, the trade deficit rose by 19.9 percent YoY to US\$ 20.8 billion during Jul-Mar FY21, on the back of a sharp increase in non-energy imports (Figure 5.16). Food, transport, textile and machinery groups largely contributed to the increased imports. Energy imports, on the other hand, remained subdued, due to higher base effect.

Meanwhile, exports also rose, but less sharply as compared to the increase in imports. Value-added textiles contributed the most to the expansion in exports during Jul-Mar FY21. Among non-textile exports,

Breakdown of YoY Change in Trade Deficit

Figure 5.16



Source: Pakistan Bureau of Statistics

the increase in rice exports remained moderate, as higher non-basmati rice exports partly arrested the decline in basmati rice exports.

Exports

Based on Customs data, exports increased 7.1 percent to US\$ 18.7 billion in Jul-Mar FY21, reaching the highest level since FY14. Growth in exports was led by the textile group (Table 5.7). Within textiles, value-added items contributed the most to the growth. These items included apparel, home textiles (bedwear and towels), and other textile made-ups (personal protective equipment, etc.). Among non-textile items, higher non-basmati rice exports partially offset the impact of lower basmati rice exports; whereas, chemicals, pharmaceuticals, and medical instruments also contributed positively to the overall export growth. Lastly, exports of petroleum crude and POL products declined significantly.

¹⁷ This section is based on Customs data reported by the PBS. The information in this section does not correspond 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.

The SBP and government's policies to support the revival of economic activity in the wake of the pandemic have facilitated growth in the leading export sectors. They included, among others: sharp decline in policy rate, which lowered the cost of financing; subsidies on gas and power supply to industries; faster sales tax refunds; enhancement in the limits of refinancing under the Export Finance Scheme (EFS) and the Long-Term Finance Facility (LTFF) by Rs 100 billion and Rs 90 billion respectively¹⁸; and the launch of the Temporary Economic Refinance Facility (TERF).¹⁹ As explained in the next section, these conditions complemented the favorable conditions under which Pakistan received some deflected orders from other countries for its major products (apparel and home textiles).

Textile exports reached highest nine-month level

Responsible for around three-fourth of the overall growth in exports, textile exports grew 9.1 percent to US\$ 11.4 billion in Jul-Mar FY21. Both volumes and unit values played pivotal roles in achieving this level. Exports of apparel and home textiles registered a cumulative increase of 14.2 percent and reached US\$ 7.8 billion in the period. Due to the peculiar circumstances created by the pandemic and the government's facilitative policies, there was limited impact of Covid on Pakistan's industrial activity, as indicated by the LSM index. This led to an opportunity for the country's value-added textile exporters to boost their output and exports.

Pakistan's Major Exports during Jul-Mar

Table 5.7

million US\$

Groups/Items	FY20	FY21	Abs. Change
Textile group	10,413	11,355	942
Non-textile group	7,030	7,332	301
Textile	10,413	11,355	942
LVA* textiles	2,384	2,141	-243
Apparel	4,471	5,049	579
Home textiles	2,354	2,744	390
Other textile made-ups	492	566	73
Food	3,395	3,331	-63
Rice (a+b)	1,594	1,560	-34
a) Basmati	570	408	-162
b) Non-basmati	1,024	1,152	128
Fish & prep.	317	304	-14
Fruits & vegetables	637	624	-13
Meat & preparations	233	247	14
Petroleum	239	116	-123
Petroleum crude	153	63	-90
Petroleum products	40	21	-19
Other Manufactures	2,426	2,566	140
Raw leather	151	113	-38
Leather manufactures.	401	428	27
Medical instruments	303	324	21
Chemicals & pharma	734	844	110
Cement & products	210	210	0
Total Exports	17,443	18,687	1,244

* low value-added (cotton fiber, yarn, cloth)

Source: Pakistan Bureau of Statistics

Growth in apparel exports, which stood at US\$ 5.0 billion, was mainly due to an

¹⁸ After the Covid outbreak, the SBP implemented various measures to facilitate exporters. They included a reduction in the performance requirement from twice to one-and-a-half times and extension in time period to meet performance requirements by 6 months, etc. For more details, visit: www.sbp.org.pk/corona-others.asp

¹⁹ For details on some of these schemes, see Chapter 3: Monetary Policy and Inflation.

impressive quantum effect. After posting negative year-on-year growth rate in the first quarter, the quantum of apparel exports, driven by knitwear, picked up significantly in the second and third quarters.

Higher apparel exports could be traced to the US and the UK, whose quantum of apparel imports from Pakistan increased by 21.1 percent and 15.4 percent, respectively, in Jul-Mar FY21 (**Tables 5.8 and 5.9**). It is pertinent to note here that apparel imports of these markets had decreased not only from some of Pakistan's major competitors, like India, Indonesia, Bangladesh, but also in overall terms.²⁰ This substantiates the anecdotal evidence that Pakistan's apparel exporters were the beneficiaries of orders deflected from some competitor countries whose export industries were more heavily and more persistently impacted by Covid. Higher shipments to the US and UK markets, it should be noted, more than offset the slight decline to the EU-27 market (**Figure 5.17**).

Pakistan's apparel exports increased as demand recovered, on MoM basis, in the major destination markets.²¹ In case of the US, the retail sales data shows that soon after experiencing significant decline in clothing sales in the first half of 2020, markets in the country normalized afterwards (**Figure 5.18**). In case of the UK, the retail sales index for

US' Apparel Imports from Major Countries during FY21 **Table 5.8**

	Unit Value (US\$/m ²)	Percentage Change in Quantum Imports		
	Jul-Mar	H1	Q3	Jul-Mar
China	1.7	-11.5	34.8	-1.5
Pakistan	2.2	17.1	28.7	21.1
Cambodia	2.4	15.3	11.6	14.1
Bangladesh	2.7	7.5	1.0	4.9
India	3.2	-3.3	-3.9	-3.5
Vietnam	3.2	5.1	9.3	6.6
Indonesia	3.7	-11.7	-14.5	-12.8
Turkey	6.7	-1.1	14.6	3.9
World	2.7	-5.8	11.6	-0.6

Source: OTEXA (US Department of Commerce)

UK's Apparel Imports from Major Countries during FY21 **Table 5.9**

	Unit Value (GBP/kg)	Percentage Change in Quantum Imports		
	Jul-Mar	H1	Q3	Jul-Mar
Pakistan	9.1	10.9	24.4	15.4
Bangladesh	11.4	-18.3	-24.3	-20.4
India	15.9	-23.4	-17.3	-21.4
Cambodia	17.7	-28.6	-19.4	-26.3
Turkey	18.6	19.5	8.0	16.3
Vietnam	20.6	-33.6	-27.3	-31.9
China	23.1	7.3	6.1	7.1
World	19.5	-11.7	-16.0	-12.9

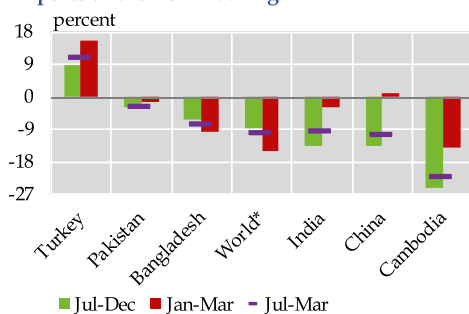
Source: UK Trade Info

'textile, clothing and footwear stores' showed marked improvements in the months of Aug-Nov 2020.²² Subsequently, the index showed a decline from December onward during the second wave of Covid. Nevertheless, the

²⁰ In the neighboring India, Covid has caused some permanent garment factory closures, resulting in loss of hundreds and thousands of jobs. For example, in one of the garment manufacturing hubs, Bengaluru, 50-62 percent of the workforce was forced to resign due to low revenues and losses. (Source: GATWU and ALF (2021). *Forced Resignations, Stealthy Closures*, India. Garment and Textile Workers Union and the Alternative Law Forum)

²¹ Nishat (Chunian) Limited's Jan-Mar 2021 report noted that: "As glut of demand for value added textile business has come forth with retail sector opening up worldwide post Covid-19 lockdown, companies are already operating at full capacity to grasp this opportunity as exports for this period are already quite impressive".

²² While it was still quite below last year's comparable levels, the average monthly index improved 53.1 percent during Aug-Nov as compared to four months prior. (Source: Office of National Statistics, UK).

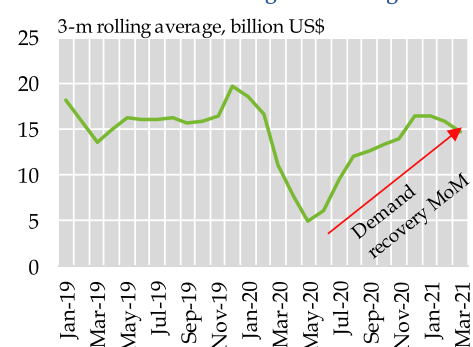
Growth in Quantum Apparel Imports of the EU-27 during FY21

*March data not available yet

Source: Eurostat

UK's shipments still rose from Pakistan, despite falling by one-fourth in overall terms, further adding credence to the deflected orders argument.

Moreover, prompted by the pandemic, the change in consumers' behavior in some parts of the world, including the US, has possibly led to cost-cutting among some consumers.²³ With Pakistan offering cheaper apparel imports vis-à-vis its competitors, some western buyers likely pivoted to the country amidst the pandemic (Tables 5.8 and 5.9).^{24,25} Although China's per unit cost was the lowest to the US, it ended up sending lesser shipments to the country in Jul-Mar FY21 over the same period last year.²⁶ This could be explained by the US-China trade tensions,

Retail Sales at US' Clothing Stores

Source: US Census Bureau

which nudged American buyers away from China and towards other sources, including Pakistan.

Favorable demand-side dynamics were also accompanied by some supply-side factors, which enhanced exporters' competitiveness. The government and SBP's facilitative measures played a crucial role in improving liquidity position—hence higher capacity utilization—of high-end textile exporters, who were able to process and deliver more orders during Jul-Mar FY21 than the year before. While some of these measures have already been mentioned, they included, among others: extensions in the validity of erstwhile zero-rating certificates to provide

²³ "Some 20 percent of US consumers expect the crisis to affect their personal or household finances for more than a year, and 27 percent say they will trade down to more inexpensive items to save money." (Source: McKinsey and Co., and Business of Fashion (2020): The State of Fashion 2021)

²⁴ "According to an analysis by Just Style of full-year US import data for 2020, Pakistan was the second cheapest supplier of apparel to the US, with its per-unit cost for clothing sitting at \$2.22." (Source: www.just-style.com/analysis/us-apparel-imports-continued-to-gain-ground-in-january_id140909.aspx)

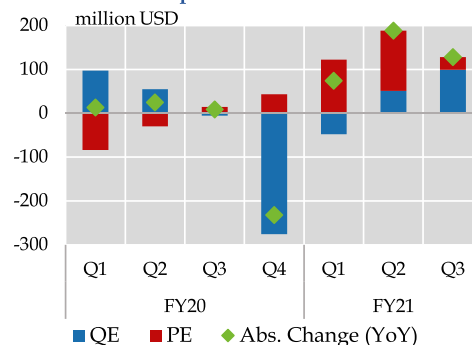
²⁵ In case of the UK, Pakistan offered cheapest imports among major competitors in Jul-Mar FY21. (Source: UK Trade Info)

²⁶ It may be noted that the US experienced massive growth in quantum imports from China in Q3-FY21 mainly due to the low base effect from the same period last year, when these imports had declined 32 percent, as Covid-related lockdowns had gone in effect in China. (Source: OTEXA)

power and gas subsidies to top-five export sectors until November 2020; gas and power subsidies under the industrial support package from November onwards; and the reduction in the policy rate from 13.25 percent to 7.0 percent in a short span of time from mid-March to June 2020, which helped lower the financing cost for industrialists.²⁷ Moreover, the government upgraded FASTER to FASTER Plus to further expedite sales tax refunds for exporters.²⁸ Overall, sales tax refunds were up significantly during the period under review, further bolstering the liquidity positions of exporters, especially the textile firms.²⁹ Customs duty on import of cotton yarn was also removed in December 2020.³⁰

Besides apparel in value-added category, home textile (bedwear and towel) exports increased 16.6 percent to US\$ 2.7 billion in Jul-Mar FY21. Overall, it was the positive price effect that lifted these exports (**Figure 5.19**). This price effect reflected among other things, the knock-on impact of higher cotton prices in both the domestic and international markets.³¹ That being said, the country also exported higher shipments as the year progressed; its share in the EU-27's quantum imports increased from around 48 percent in Jul-Mar FY20 to 51 percent in Jul-Mar FY21

Breakdown of Absolute Change in Home Textiles Exports **Figure 5.19**



Source: Pakistan Bureau of Statistics

(**Table 5.10**).³² This shows that in the home textiles segment, Pakistan, which has an established market share in the EU market, was able to increase its export volumes even

Share in EU-27's Quantum Home Textiles Imports **Table 5.10**
percent

	Jan-Mar		Jul-Mar	
	FY20	FY21	FY20	FY21
Pakistan	67.5	72.3	47.6	50.5
China	26.6	27.6	23.2	22.6
Turkey	21.5	22.0	16.7	16.8
India	14.4	14.2	10.2	9.9
Bangladesh	7.5	8.5	5.6	6.1

Source: Eurostat

²⁷ For more details, see Chapter 5: External Sector of SBP's State of the Economy Report for Q2-FY21.

²⁸ FASTER stands for Fully Automated Sales Tax e-Refund, and it was introduced by the FBR in Jul-2019. Owing to some technical and other glitches in its system, it was upgraded to FASTER Plus in October 2020 (Source: FBR Press Release, www.fbr.gov.pk/pr/fbr-upgrades-faster-to-faster-plus-system-for/152507)

²⁹ Sales tax refunds increased to Rs 155 billion in Jul-Mar FY21, which were 158 percent higher than last year's comparable refunds of Rs 60 billion. (Source: FBR)

³⁰ Source: FBR SRO 1352(I)/2020

³¹ At Karachi Cotton Association, quoted price of Pakistan cotton rose 8.8 percent year-on-year to US 74 cents/lb. in Jul-Mar FY21, from US 68 cents/lb in the same period last year. Except for India, there was double-digit growth in cotton prices for Brazil, China, and the US. (Source: Emerging Textiles)

³² Source: Eurostat

at slightly higher unit prices.³³ Moreover, as in the case of apparel, the unit value offered by Pakistan was lower than its major competitors (except for China), despite showing an increase.³⁴

In low value-added textiles, exports of cotton yarn and fabrics registered a cumulative 9.6 percent decline and reached US\$ 2.1 billion in Jul-Mar FY21. Amidst a shortage of cotton raw materials in the local market, these intermediary goods were diverted towards domestic production of finished textile products, which, as discussed earlier on, witnessed higher global demand in the period under review. This resulted in low exportable surplus of these goods, and hence lower exports.

Moreover, led mainly by higher demand for personal protective equipment (PPE) and other sanitary products during the pandemic, Pakistan's exports of 'other textile made-ups' grew 14.9 percent to US\$ 566 million in Jul-Mar FY21 – the highest ever level in this category.

Rice exports stayed muted

Rice exports declined by 2.1 percent to US\$ 1.6 billion in Jul-Mar FY21. The entire

decline was caused by quantum-led lower basmati rice exports, which fell 28.4 percent to US\$ 408 million. Unit value-led higher non-basmati rice exports did shore up falling rice exports in value terms, but fell short of making up for sharp decline in basmati rice exports.

One major factor for the decline is that Pakistan is facing stiff competition from India in the traditional markets. With abundant exportable surplus available, India has been offering the most competitive prices vis-à-vis all of its major competitors.³⁵ Pakistan basmati rice exporters were edged out by their Indian counterparts in the Middle East. Specifically, with India offering lower unit values, its overall basmati rice exports to the Middle East (Yemen, Iraq, Saudi Arabia, Oman, Yemen, Bahrain and UAE) increased nearly 11 percent to 1.5 million tons in Jul-Feb FY21, while Pakistan's decreased by around 51 percent to 0.17 million tons in Jul-Mar FY21.³⁶

Same was the case with the non-basmati rice exports. Not only did India offer lower unit values on average, Pakistan's unit values were also higher than last year (**Figure 5.20**). As a result, Pakistan's shipments to major, price-sensitive markets in Africa – Kenya,

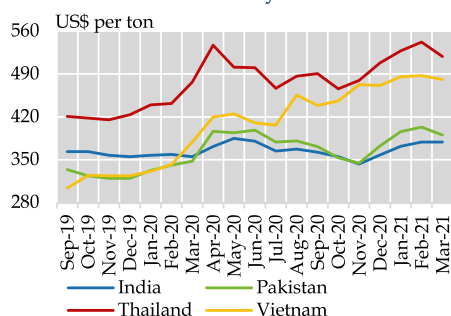
³³ In USD/100 kg terms, average unit value of EU's home textiles imports from Pakistan rose by 1.7 percent YoY in Jul-Mar FY21, as opposed to declining by 4.7 percent in the comparable period of last year. It should be noted that EU's overall unit value also showed similar trends in these two periods. (Source: Eurostat)

³⁴ Evaluated in USD/100 kg terms, average unit values during Jul-Mar FY21 were: Pakistan 607, Bangladesh 684, India 697, Turkey 886, and China 574. (Source: Eurostat)

³⁵ USDA 2020/2021: *Grain World Trade Report*. Various issues. Washington, DC: United States Department of Agriculture.

³⁶ Average unit value of India's basmati rice dropped from US\$ 983 per ton to US\$ 858 during Jul-Feb periods of FY20 and FY21. Meanwhile, Pakistan's unit values rose from US\$ 878 per ton to US\$ 956 per ton in Jul-Mar periods of FY20 and FY21. (Source: Ministry of Commerce and Industry, India, and Pakistan Bureau of Statistics)

International Price Comparison of Non-Basmati Rice Variety* **Figure 5.20**



* 25% broken

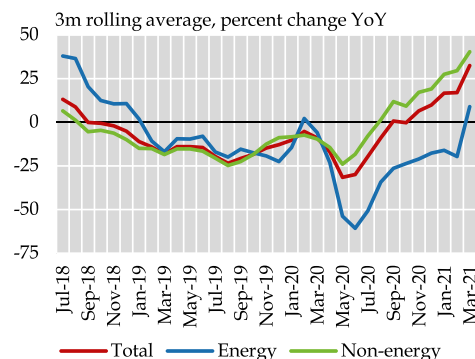
Source: Food and Agriculture Organization

Tanzania, Mozambique, Somalia in East Africa, and Togo, Senegal in West Africa – stayed muted.³⁷

Imports

Pakistan's imports rose in three consecutive quarters for the first time in the last 10 quarters, indicating that the declining trend in the imports that had appeared since Q1-FY18 has bottomed out (**Figure 5.21**). As the economic recovery gained traction, imports increased by 13.5 percent during Jul-Mar FY21, after declining by 14.5 percent in the same period of last year. Moreover, after moderate rises in the first two quarters, imports increased by 29.7 percent in Q3-FY21; the highest since Q3-FY17, when these had risen by 36.6 percent.

Growth in Pakistan's Imports **Figure 5.21**



Source: Pakistan Bureau of Statistics

On the contrary, aggregate energy imports during Jul-Mar FY21 remained below last year. However, rising international energy prices brought a sharp increase in the Q3 energy imports, specifically in March 2021.

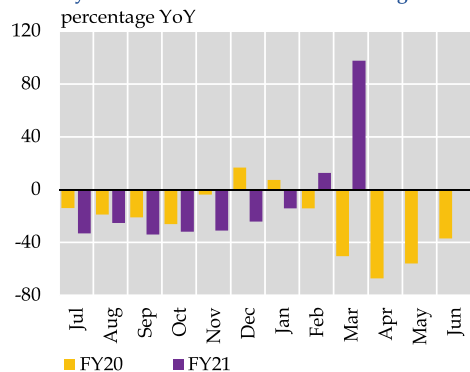
On the other hand, the Covid shock warranted the introduction of accommodative policies to stimulate economic activity.³⁸ Reviving economic activity, however, led to a broad-based increase in non-energy imports during Jul-Mar FY21 to a record 23.4 percent. Meanwhile, the import of consumer goods, on the back of higher food and medicine imports, increased by 25.9 percent during Jul-Mar FY21.

Besides, the lower than targeted wheat output last year and the government's efforts to stabilize wheat and wheat flour prices,

³⁷ Pakistan's quantum non-basmati exports to these countries decreased by 55 percent YoY to 0.38 million tons in Jul-Mar FY21. Meanwhile, India's rice exports to East Africa and West Africa rose 183 percent to around 5 million tons in Jul-Feb FY21 from a year before. (Source: Pakistan Bureau of Statistics; and Ministry of Commerce and Industry, India)

³⁸ LSM grew by 7.5 percent in Jul-Feb FY21, after declining by 2.8 percent in this period of FY20. Another indicator of the rise in economic activity was the sale of petroleum products, specifically high-speed diesel, which increased by 16.1 percent during Jul-Mar FY21; diesel sales had declined by 13.8 percent in this period of FY20.

Monthly Growth in Brent Prices



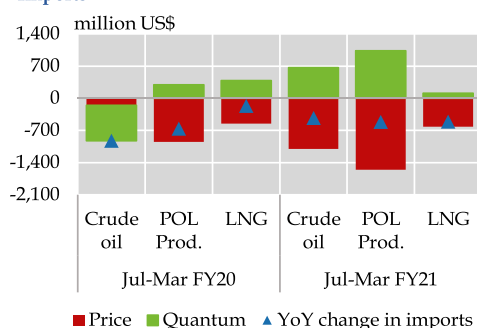
Source: World Bank

contributed to significant wheat imports. This, coupled with rising international palm oil prices, pushed up food imports to US\$ 6.1 billion, with a YoY growth of 54.5 percent; the highest addition in 9 months since 2011.³⁹

Energy imports continued to show declining trend despite recent surge in global energy prices

Global oil prices, which had started to taper since the third quarter of FY20, rebounded strongly in Q3-FY21, specifically in March 2021, which saw a 98 percent YoY increase in Brent prices (Figure 5.22). Despite this sharp jump in international oil prices in Q3, the unit value of Pakistan's energy imports during Jul-Mar FY21 remained lower compared to last year due to lower energy prices that prevailed in the first half of the fiscal year (Figure 5.23). As a result, energy imports decreased by 15.1 percent in Jul-Mar FY21, after falling 16.1 percent in the same period of last year.

Contribution of Unit Price & Quantum Effects to YoY Change in Energy Imports



Source: Pakistan Bureau of Statistics

While import values have decreased, quantum energy imports increased by 24.7 percent in this period, suggesting that the economic activity is gaining momentum (Figure 5.23).⁴⁰ Moreover, sale of diesel increased by 18.2 percent while that of the furnace oil increased by 35.3 percent YoY basis (Table 5.11). Overall increase in the economic activity on the back of a significant increase in large-scale manufacturing (LSM) reinvigorated the fuel demand from the transport and power sectors.

Change in POL Product Sales during Jul-Mar FY21

Table 5.11

metric ton

	Q1	Q2	Q3	Jul-Mar
Petrol	151	127	252	530
HSD	155	273	411	840
Furnace oil	259	186	210	656
All products sales	478	528	844	1,850

Source: Oil Companies Advisory Council

³⁹ Food imports had risen by 60.6 percent during Jul-Mar FY11, due to the devastating floods in Pakistan, as well as a sharp increase in international commodity prices.

⁴⁰ Quantum imports of crude oil increased by 16.6 percent while that of the POL products increased by 30.3 percent during Jul-Mar FY21.

Food, transport, textile and machinery contributed largely to the robust non-energy import growth

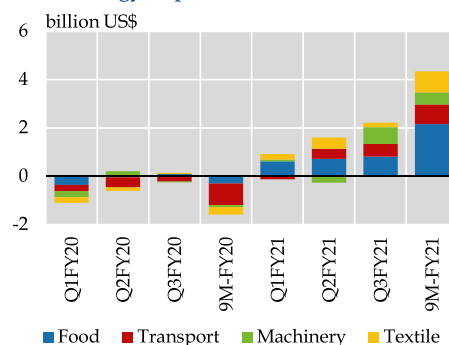
Non-energy imports gained further momentum and increased by 38.6 percent YoY in Q3-FY21 after rising consecutively in the first and second quarters.⁴¹ On aggregate, non-energy imports rose to US\$ 12.3 billion almost equaling the record import witnessed in Q4-FY18. Although this revival was broad-based, food, transport, textile and machinery contributed more than 70 percent to the Jul-Mar FY21 increase (Figure 5.24).

Food

In Jul-Mar FY21, food imports increased by 54.5 percent to US\$ 6.1 billion; the highest in 9 months since 2011 when floods had pushed up the food imports by 60.6 percent. Decline in wheat output in FY20 and some disruption in wheat supply chain created upward pressure on wheat and flour prices. Moreover, at the start of the current season, sugar stocks fell to their lowest level since FY13. To address the situation, the government decided to allow both wheat and sugar imports. As a result, Pakistan imported US\$ 983 million of wheat and US\$ 127.5 million of sugar in Jul-Mar FY21 (Table 5.12). Despite an estimated good wheat crop in FY21, the government continued to encourage wheat imports to build strategic reserves. However, expectation of good wheat crop tapered import demand, and imports declined by 42.4 percent QoQ in Q3-FY21.

Major Contributors to Increase in Non-Energy Imports

Figure 5.24



Source: Pakistan Bureau of Statistics

The import of palm oil increased by 34.8 percent in Jul-Mar FY21 to US\$ 1.9 billion, while imports had declined 0.4 percent in the same period last year. Higher imports this year are driven largely by greater unit values, as the global palm oil prices increased by 57 percent during Jul-Mar FY21.

Labor shortages and unexpected rainfall hindered the crude palm oil production in Malaysia; whereas the Indonesian government's inclination to substitute imported diesel with domestically produced palm oil-based biodiesel, also drove up the commodity's international prices. On the contrary, palm oil demand from Pakistan, India and China increased significantly. Both India and China were increasing imports to replenish their depleting stocks. Pakistan, on the other hand, was facing a shortage of oilseed due to lower cotton output and therefore imported higher quantity to support the domestic demand.⁴²

⁴¹ In Q1 and Q2 of FY21, non-energy imports rose by 11.6 percent and 18.9 percent respectively.

⁴² Source: United States Department of Agriculture.

Pakistan's Major Imports during Jul-Mar

Table 5.12

million US\$

Groups/Items	FY20	FY21	Absolute change	Quant. impact	Price impact
Energy group	8,901	7,554	-412	1,706	-2,118
POL prods.	3,965	3,448	-517	1,036	-1,553
Crude oil	2,453	2,023	-429	670	-1,099
LNG	2,237	1,732	-506	109	-615
Agri and chem	5,577	6,342	765	-	-
Fertilizer	482	440	-42	-70	28
Other chem.	2,739	3,166	427	-	-
Transport group	1,197	2,010	814	-	-
Cars	408	895	487	-	-
CBUs	65	163	99	-	-
CKDs	343	731	388	-	-
Truck & buses	217	329	112	-	-
Aircraft & ships	240	373	138	-	-
Metals group	3,075	3,621	547	-	-
Steel scrap	1,188	1,419	231	299	-69
Iron & steel	1,159	1,428	269	337	-69
Food group	3,963	6,121	2,158	-	-
Wheat	0	983	983	-	-
Sugar	2	127	125	110	15.3
Palm oil	1,380	1,861	481	95	386
Textile group	1,916	2,787	871	-	-
Raw cotton	556	1,032	476	407	69
Syn. yarn	430	500	70	245	-175
Machinery group	6,634	7,133	499	-	-
Power gen	921	1,356	435	-	-
Electrical	1,749	1,102	-467	-	-
Cell phones	980	1,536	556	-	-
Other machinery	1,746	1,872	125	-	-
All other items	2,893	3,000	105	-	-
Total imports	34,791	39,489	4,699	-	-

Source: Pakistan Bureau of Statistics

Transport

After food, transport was the second largest contributor to the increase in overall imports, with its imports rising 68.0 percent YoY during Jul-Mar FY21 compared to the 42.6 percent YoY decline in this period of FY20. Specifically, car imports witnessed a rapid growth, rising by 119.2 percent YoY to

US\$ 895 million in Jul-Mar FY21 and 191.4 percent YoY in Q3-FY21 alone (Table 5.12).⁴³

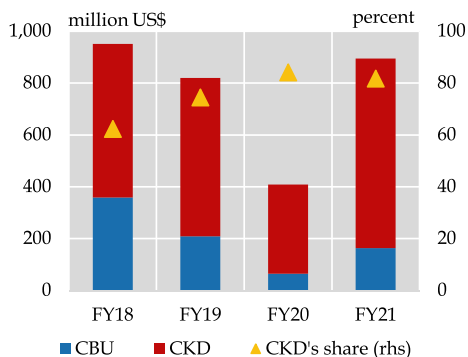
Accommodative policies adopted to support the economy in wake of the Covid supported the growth in the transport sector.

Noticeably, value of car imports in Jul-Mar FY21 is higher than the imports in the same period of FY19, when stabilization policies were rolled out. However, the import mix

⁴³ In Jul-Mar FY20, car imports had declined by 50.2 percent.

Composition of Car Imports

Figure 5.25



Source: Pakistan Bureau of Statistics

has further increased in favor of CKD (Figure 5.25). Incentivized by the Automotive Development Policy (2016-2021), a number of new entrants have successfully introduced new variants to cater to the demand of the high-income groups, which has also led to the rise in CKD car imports.

Nevertheless, demand for CBU cars, especially of cars with smaller engine capacities, has started rising in FY21 after bottoming out in FY20. Limited options are available to purchase under 1,000cc domestically produced cars. Demand for smaller capacity cars from middle and low-income groups remains untapped and therefore requires some policy focus, as lack of options in this category are pushing the demand for imported CBU cars.

Apart from cars, imports of trucks and buses and heavy vehicle import increased by 70.0 percent in Q3, while in Jul-Mar FY21 imports rose by 51.7 percent on YoY basis. Relatively higher export shipments and the resurgence

in overall economic activity led to increased import of the heavy vehicles.

Corresponding with the rise in transport imports, imports of rubber tyres and tubes also surged by 264.5 percent YoY in Jul-Mar FY21, against a 31.1 percent decline in the same period last year. The crackdown on smuggling by the FBR also contributed to this substantial rise in rubber tyre and tubes imports in FY21.

Textile

Pakistan imported cotton worth US\$ 1,032.1 million, with a YoY increase of 85.6 percent during Jul-Mar FY21; the highest in this period since FY08 when the country imported US\$ 1,063 million of cotton.⁴⁴ Pakistan's cotton output has continued to slide since FY15, as the area under cultivation is shrinking. To keep its textile sector running, the country resorted to importing cotton. Moreover, to facilitate the textile exporting sector, the government relaxed some of the custom duties on imports of this commodity.⁴⁵

Notably, import of worn clothing increased by 49.6 percent in Jul-Mar FY21 to a record US\$205 million, after rising by only 6.0 percent in the same period of last year. This suggests that a section of the society is switching to used clothes as their purchasing power of new clothes has declined.

Machinery

In Jul-Mar FY21, machinery imports increased by 7.5 percent, while they had declined by 1.2 percent in the same period

⁴⁴ In FY08, cotton production had declined by 9.3 percent YoY.

⁴⁵ For more details, see the SBP's State of Pakistan's Economy Report for Q1-FY21.

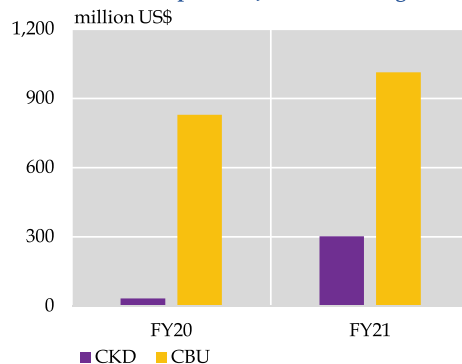
last year. Power generating machinery and telecom largely drove the overall machinery imports. Ongoing work on the power projects, such as Suki Kinyari and Karot hydropower station under CPEC, has increased the demand of the power generating machinery.

The import of mobile phones, on the other hand, increased by 56.7 percent to US\$ 1,536 million in Jul-Mar FY21. Protracted presence of Covid in the country sustained the strong demand for mobile gadgets, as educational institutions and some offices continued to rely on online activities.

Importantly, this year, CKD mobile set imports increased significantly by more than 800 percent; rising from US\$ 33 million in Jul-Mar FY20 to US\$ 303 million in Jul-Mar FY21 (**Figure 5.26**). A number of startups have started assembly of mobile sets in Pakistan, influenced by the Mobile Device Manufacturing Policy (MDMP) 2020.⁴⁶

Import of electrical machinery and apparatus, on the other hand, declined by 37 percent YoY during Jul-Mar FY21.

Mobile Phone Imports in Jul-Mar **Figure 5.26**



Source: Pakistan Bureau of Statistics

Improvement in power generation in the country by 4.8 percent YoY may have depressed the demand of these products in this period.

Higher activity in the transport sector and revitalization in the construction sector, as evident by the increase in housing finance, including loans sanctioned under Naya Pakistan Housing Scheme, increased the demand of both steel scrap and finished steel products. Quantum increases in both of these commodities largely drove their import growth during Jul-Mar FY21 (**Table 5.12**).

⁴⁶ The important features of MDMP 2020 include: i) removal of regulatory duty on imports of CKD/SKD units; ii) removal of fixed income tax on CKD/SKD manufactured mobile devices, up to \$350; iii) 3 per cent research and development allowance to be given to local manufacturers for exports of mobile devices; and iv) locally assembled or manufactured phones would be exempted from the 4 percent withholding tax on domestic sales.

Special Section: Private Credit Bureaus in Pakistan – Enhancing Credit Penetration by Addressing Information Asymmetries¹

Information asymmetries in credit markets prevent efficient allocation of finance and restrict overall credit penetration in an economy. This is particularly disadvantageous for low-income individuals and micro, small and medium enterprises who lack adequate collateral and sufficient credit history. In Pakistan, too, inadequate attention to such impediments in the past has been among the major factors that led to low credit penetration, even as evidence from both advanced and emerging economies reveals a noticeable increase in credit offtake due to effective functioning of private credit bureaus. In recognition of these problems, the government and the SBP have taken steps to facilitate the development of credit reporting system. These include the introduction of the Credit Bureaus Act 2015 along with its necessary regulations, and the issuance of official licenses to two private credit bureaus. However, the country's credit reporting system continues to face multiple legal, operational and policy level challenges that are preventing credit bureaus from adequately addressing the challenge of information asymmetries. This section sheds light on the specific problems and potential solutions, drawing on the experience of other developing economies that faced similar challenges in nascent stages of credit reporting systems, as well as innovative trends in the fintech space.

S1.1 Introduction

Formal credit to the private sector in Pakistan has declined both in absolute and relative terms over the past few decades, and is currently one of the lowest among emerging market and developing economies (EMDEs) (**Figure S1.1**). This is despite multiple reforms aimed at deregulation and liberalization of the financial sector since the 1990s, in a bid to reverse the impact of nationalization of banks in the 1970s.

Various factors have contributed to low level of formal credit in Pakistan, as highlighted in the SBP's FY20 Annual Report on the State of

Pakistan's Economy.² The reforms aimed to increase access to finance by implementing measures to improve governance, supervision, and risk management of the financial institutions. However, while banking profitability improved as a result of these reforms, the presence of market failures in the form of information asymmetries made commercial banks generally averse to lending to underserved segments such as housing, agriculture, and small and medium enterprises (SMEs).

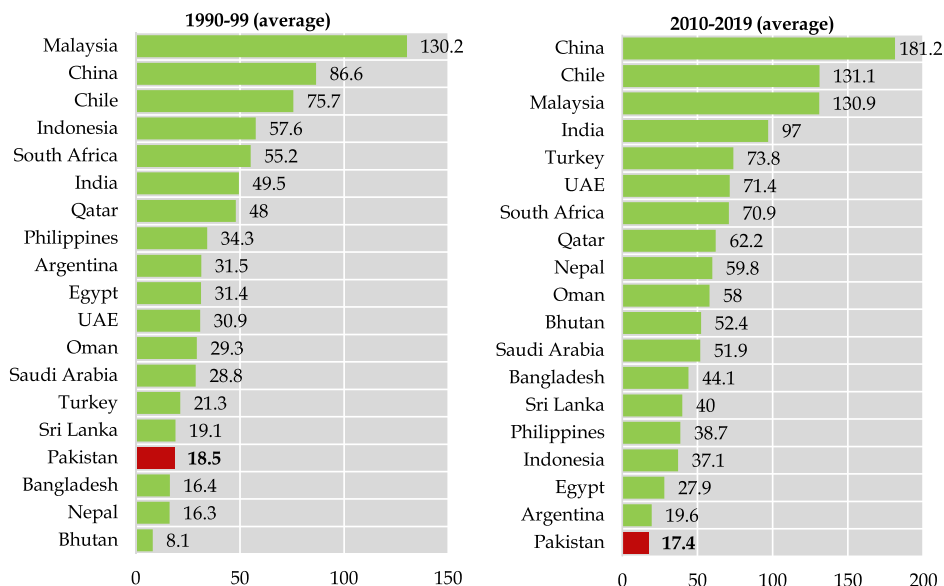
This behavior was further fueled by the presence of a dominant borrower in the form of the government sector, whose debt

¹ This section benefited from conversations with local and international players in the credit reporting services industry, including the licensed credit bureaus operating in Pakistan; commercial banks; various microfinance banks and institutions; Ministry of Energy (Power Division); utility companies; and Pakistan Telecommunication Authority.

² For an extensive discussion on the factors constraining credit penetration in Pakistan, see Chapter 7, titled "Understanding Low Private Credit Penetration in Pakistan- Contextualizing Recent Policy Reforms" in the SBP's FY20 Annual Report on the State of Pakistan's Economy.

Relative Standing in Private Sector Credit to GDP Ratio (percent) among selected EMDEs

Figure S1.1



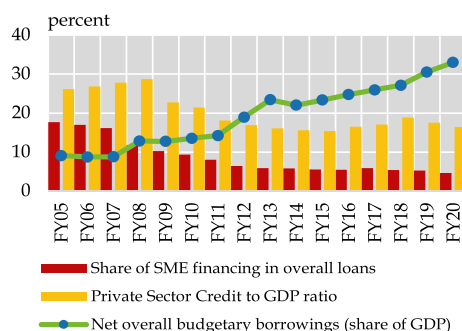
Source: World Bank

requirements increased significantly (Figure S1.2).³ Meanwhile, challenges such as high informality in the economy, faith-based considerations, and low financial and digital literacy continued to keep the demand of formal credit low in the country.

While tackling all these issues is of paramount importance, the scope of this special section is confined to the challenges of information asymmetries prevailing in Pakistan's credit markets,⁴ both on the adverse selection and moral hazard fronts, and how these may be addressed to help expand access to credit in the country.

Net Budgetary Borrowings and Private Sector Credit in Pakistan

Figure S1.2



Source: SBP

³ Lack of suitable product development by specialized institutions, and particularly the eventual phase-out of Development Finance Institutions (DFIs), also contributed to this outcome.

⁴ The term "credit market" is being used in this special section to describe private sector credit obtained from banks and non-bank financial institutions.

Within this context, the special section will first briefly shed light on the role of credit bureaus, how they function and the type of services they provide (Section S1.2). Section S1.3 will then provide evidence of how the presence of a developed credit bureau market has benefited various economies in comparison to those where credit bureaus do not exist or are not adequately developed. Section S1.4 will evaluate and contextualize the development of such institutions in Pakistan, and Section S1.5 will highlight the key legal and operational challenges to the development of the credit bureau market in the country. Section S1.6 will offer policy recommendations in light of global best practices to make private bureaus more effective in Pakistan going forward, followed by concluding remarks in Section S1.7.

S1.2 Evolution and Functions of Credit Bureaus

In comparison to the high level of credit penetration in developed countries, access to formal lending remains elusive for a large share of the population in developing countries. In these economies, formal lending

institutions place greater emphasis on serving the well-off and already well-served segments of the society, and shy away from lending to low-income individuals and SMEs.

Even when such segments are extended loans, financial institutions charge higher rates to price in their risk, which negatively impacts demand for formal borrowing. This, in turn, hampers credit offtake, and ultimately proves detrimental to economic growth and development.

From the supply side, banks/non-bank financial institutions find it difficult to serve the marginalized segments of society given borrowers' inability to meet the collateral requirement and provide a sufficient set of information that may help lenders get a better sense of repayment capacity of borrowers.⁵ In the agriculture sector too, given limited past banking history and cumbersome procedures with regards to loan appraisals, banks have a limited incentive to increase their lending portfolio.⁶ Recently in the case of Pakistan, the State Bank of Pakistan carried out a financing project in

⁵ Banks need collateral to guarantee the amount of credit. In most developing countries, however, there exists a mismatch between the composition of assets held by firms and the ones accepted as collateral by the financial institutions. According to the World Bank Enterprise Surveys, 78 percent of assets owned by firms in such countries consist of machinery and accounts receivables, while the share of fixed assets such as land and buildings is just 22 percent. In stark contrast, however, the composition of collateral from firms accepted by banks reveals that fixed assets have a share of 73 percent, and the share of machinery and accounts receivable is only 27 percent. (Source: Safavian, M., Fleisig, H., and S. Jevgenijs (2006)) *Unlocking Dead Capital: How Reforming Collateral Laws Improves Access to Finance*. Public Policy for the Private Sector Viewpoint Note No. 307. Washington, DC: World Bank.

⁶ For instance, a 2014 trader-agent intermediation lending (TRAIL) case study conducted by the SBP found that it took on average about 52 working days in total for a single agriculture-based lending transaction to be completed (after taking into account factors such as interactions with treasury and revenue departments, inadequate availability of public transport, and law and order situation, etc.). Reference: Baluch K. A., and M.A. Choudhary (2014). *Agent Intermediated Lending: The Matiari Case Study*. Occasional Research Papers. Karachi: State Bank of Pakistan.

which collateral-based lending to farmers was replaced with trader-agent-intermediated-lending (TRAIL) – with a third-party guarantor in the form of a sugar mill, facilitating bank-lending to small and medium size farmers against the supply of sugarcane. The project revealed the potential benefits of value-chain financing in overcoming adverse selection and moral hazard problems.⁷

These information asymmetries lead to the problem of adverse selection when lenders find it difficult to differentiate among good and bad borrowers. For example, Choudhary and Jain (2020) find that after the public credit registry of Pakistan stopped releasing group-level information of firms (all firms that shared at least one mutual director), banks that had more private information (“informed banks”) about other firms in a borrower’s group lent more to that firm than other, less-informed banks. This was the case even for banks having pre-existing relationships with that firm, suggesting that past relationships do not compensate for the information imperfection. The study also revealed that small enterprises were particularly affected by this information asymmetry.⁸

The other side of this phenomenon is that of moral hazard. From the demand side, this may arise if borrowers, for example, rely on weak penalty for non-payment and take on higher risks after obtaining the loan, or default despite having the financial means to repay. From the supply side, if a borrower has a good credit history with one commercial bank, then in the absence of information symmetry, other commercial banks would not be able to offer her attractive rates based on her good history. As a result, the borrower’s existing bank may keep on charging higher rates despite her good record, in turn exploiting the information asymmetry to extract “information rents”.⁹

The solution to asymmetric information lies in monitoring and evaluation of borrowers’ past behavior with a reasonable assumption that future behavior can be predicted on past behavior. However, conducting this exercise for individuals, MSMEs (micro, small and medium enterprises), and big businesses across an economy entails significant resources, which every lender may not have or may not find it feasible to make such investments, especially in case of small and micro loans.

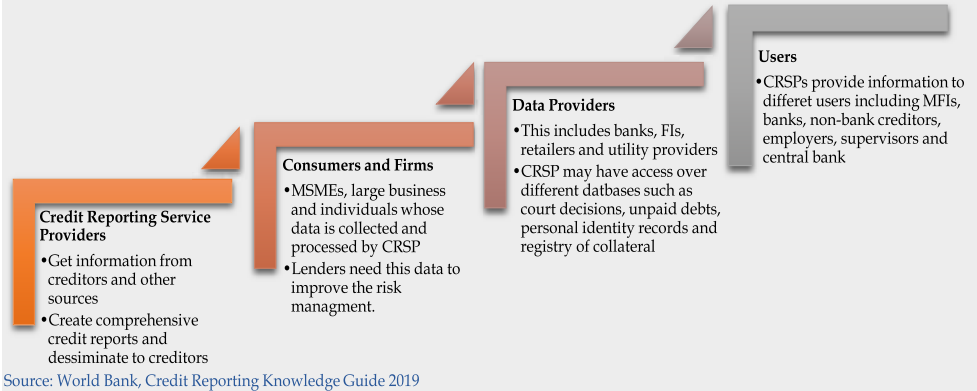
⁷ In pre-contract context, the sugar mill was found to be significantly more willing to lend to farmers than the bank. While the bank focused more on observable characteristics indicative of greater farm wealth (e.g., higher crop sales, large farm sizes, ownership of expensive machinery, etc.), the mill gauged creditworthiness based on factors suggesting deeper relationship between the farmer and the mill (e.g., geographical proximity, and proportion of crop sold to that mill). In terms of post-contract, the project revealed that farmers were less likely to delay their repayment on loans guaranteed by that mill than on direct bank loan since the mill was able to leverage its role in the value-chain in an efficient manner. Reference: M.A. Choudhary., and A. Jain (2020). Why Do Banks Not Lend: An Experiment Testing Contractual Frictions. *Working Paper Presentation*. Lahore: IGC Pakistan Programme

⁸ Choudhary, M. A and A.K. Jain (2020). “How Public Information Affects Asymmetrically Informed Lenders: Evidence From a Credit Registry Reform,” *Journal of Development Economics*, 143: 102407

⁹ Jappelli, T., and M. Pagano (2005). *The Role and Effects of Credit Information Sharing*. CSEF Working Paper No. 136. Fisciano: Center of Studies in Economics and Finance.

Functions Performed by Key Stakeholders in Credit Reporting System

Figure S1.3



Overall, therefore, the challenges associated with information asymmetries call for a credit reporting system where information aggregators, such as public credit registries and private sector credit bureaus gather and maintain industry-wide set of financial and non-financial credit information. A well-covered credit reporting system helps improve the efficiency of the credit market by lowering the intermediation cost, increasing the outreach of financial products to a higher number of individuals and MSME borrowers, and enhancing the confidence of lenders.

Key stakeholders

The credit reporting system comprises of the following key players: 1) *credit reporting service providers* (CRSPs) who gather information about borrowers' credit history and share it with data users; 2) *data subjects*, which are firms and individual borrowers; *data providers* and *users*, which include banks/non-bank financial institutions (NBFIs), utility companies, retailers etc.

The CRSPs are of two main types: credit registries and credit bureaus. Credit registries in most countries are governed by the public sector with their role mainly confined to assist the government/central banks in supervising the financial sector to ensure financial soundness. However, in some countries, such as China, credit registries perform the function of credit bureaus as well.

Credit bureaus are privately operated businesses that gather credit related financial and non-financial data from various data providers and cater to the information requirements of lenders or users (Figure S1.3). Typically, they also provide various value-added services, whereas credit registries only offer plain vanilla products.

The credit registries and bureaus perform similar functions, i.e., gather borrowers' information and disseminate it to relevant stakeholders. However, the difference is in their primary objectives. Credit registries back the mandate of monitoring banking-wide risk; their coverage is limited to loans above a minimum threshold level and

usually excludes small loans.¹⁰ These registries collect information from supervised institutions including banks/NBFIs, but do not pursue other non-financial institutions such as utility companies, retailers, and telecommunication companies.

Credit bureaus, on the other hand, are specialized in collecting information from financial institutes (banks and NBFIs, MFIs, and other formal lending institutes) and non-financial sources (retail outlets, utility and telecom companies, court decisions and property records etc.).

After gathering data from diverse sources, credit bureaus apply sophisticated data-mining techniques to develop credit scores. They also offer other value-added set of information such as trade experiences, corporate family trees and ownership structure, business registrations, contacts and principals etc. These bureaus may sell their services to banks, NBFIs, MFIs, utility companies, and even to businesses. In other words, credit bureaus are in the business of data where they gather different types of credit related information to make value-

added products that offer insights to lenders about their existing and potential borrowers. **(Box S1.1)** summarizes the main types of data maintained by credit bureaus and a few examples of services offered by them.

S1.3 Importance of Credit Bureaus

Empirical literature documents a noticeable impact of credit bureaus in reducing information asymmetries in both advanced economies and EMDEs. For example, analyzing the trends in private credit in 129 countries, Djankov et al. (2007) found that credit registries and bureaus were associated with higher credit uptake in both poor and rich countries. Taking the analysis further, they showed that credit bureaus that offer a broader range of data and value-added services were associated with “significantly more private credit” than in economies where such services were not available.¹¹

Similarly, studying the effect of information sharing on bank lending in 40 countries, Japelli and Pogano (2002) found that bank lending to GDP ratio was 20

Box S1.1: Types of Data Maintained by Credit Bureaus, and their Value-added Services

Credit bureaus serve as an “institutional solution to the problems of information asymmetries and moral hazard in credit markets” (OECD, 2010) to ensure diversified and prudent lending practices in the financial sector. To achieve this objective, credit bureaus rely primarily on information shared with them by financial institutions. The list of variables usually includes detailed identification and demographic data, as well as information regarding the amount of loans availed and/or outstanding, credit card histories, and instances of defaults (if any). In addition, bureaus across the world have also started compiling transactional, payments and savings data, as well as third party information from utility companies and social media, etc., which proves particularly useful in case of individuals and enterprises

¹⁰ The threshold varies in different countries; for example, in France it is 25,000 Euros; in Germany, 1 million Euros; and in Italy, 30,000 Euros (Source: World Bank, 2019).

¹¹ Djankov, S., McLiesh, C., and A. Shleifer (2007). “Private Credit in 129 Countries”. *Journal of Financial Economics*, 84(2), 299-329.

with limited or no formal credit history. Furthermore, credit bureaus collect data on micro loans from microfinance banks and non-bank microfinance institutions. This also means that the breadth of data on small loans is greater with private credit bureaus as compared to public credit registries, as the latter tend to focus on higher-value loans from a systemic risk perspective.

Overall, the data reporting of credit bureaus can be classified into following key dimensions:

- **Classification of borrowers:** Credit bureaus collect and report data on both firms and individuals
- **Negative and positive data:** Earlier, credit bureaus used to only collect and report information about borrowers' missed payments, defaults, and notices of write-offs or delinquencies, or what is termed as the "negative data". Over time, however, the reporting became more exhaustive in nature and included information on variables such as the type of financing facility availed, date of application, contract conditions regarding installments, financing limit available to the borrower, monthly repayment histories, contact details and addresses, interest rate applied, tax filer status and ID, business registration ID, balance sheet indicators, income statement variables, business group or conglomerate, etc. (Miller, 2003). All these additions in data collection are collectively termed as "positive data" reporting, comprehensive credit reporting, or full-file reporting, and it is particularly useful when financial institutions are looking for additional potential borrowers.
- **Third party or alternate data:** Increasingly, some credit bureaus also collect information about utility services payments, retailer transactions and/or supply chain financing in recent years. These transactional datasets help gauge the creditworthiness of individuals and firms based on their "reputational collateral" (OECD, 2010), especially if they lack permissible physical collateral.
- **Reporting on small sized loans:** In some countries, bureaus collect and report information on loans valued less than 1 percent of per capita national income. Data collection on small loans means that credit bureau coverage in terms of share of adult population is higher (World Bank, 2020).

With the help of digitized databases used for compiling and analyzing all these various types of datasets, credit bureaus are able to offer value-added services to their member financial institutions to assist them in assessing creditworthiness of existing and potential borrowers. These services include, but are not limited to:

- (i) **Credit Scoring** – Statistical analysis to develop a scoring spectrum from which to rank different borrowers in terms of their credit worthiness. While commercial banks also perform in-house risk assessment and creditworthiness analysis, those exercises are only based on that specific bank's own portfolio and therefore do not include information on individuals and firms that are borrowing simultaneously or exclusively from other financial institutions.
- (ii) **Portfolio Expansion Diagnostics** – The whole portfolio of member financial institutions is compared to the overall market database to identify pockets of potential new borrowers and rank those in terms of creditworthiness.
- (iii) **Regional and Demographics-Based Portfolio Scrubbing** – Data scrubbing is used to analyze a certain geographic or demographic segment of member's overall borrower portfolio to flag loans that are vulnerable to default (based on historical trends and model benchmarks), or to identify borrowers with a healthy positive data to help in decisions such as credit limit increases, cross-lending or lower markups.

- (iv) **New Borrowing Alerts** – The alert system notifies members if a previously marked borrower has gone into default with another financial institution or is an increased risk of doing so. Such alerts are usually provided on a daily basis, sometimes even real-time.
- (v) **Recovery Agency Services** – If a member institution is facing difficulty in recovering a loaned amount, then credit bureaus, with the help of their database of contact information on borrowers from different financial institutions over the years, can help locate the defaulter and potentially recover the stuck amount.

References:

Miller, M. (2003). *Credit Reporting Systems and the International Economy*. Cambridge: MIT Press.

OECD (2010). *The Economic Consequences of Consumer Credit Information Sharing: Efficiency, Inclusion and Privacy*. Background Paper#2 Joint WPISP-WPIE Roundtable on The Economics of Personal Data and Privacy: 30 Years after the OECD Privacy Guidelines. Paris: Organization for Economic Co-operation and Development.

World Bank (2020). *Doing Business 2020*. Washington DC: World Bank.

percentage points higher in the presence of credit registries and bureaus, and with banks having access to borrowers' data across the financial system, the prevalence of non-performing loans was 1 percentage point lower.¹²

The presence of credit bureaus was also found to be associated with higher availability and lower cost of credit to firms (Brown et al., 2009).¹³ In particular, mechanisms of information sharing and credit scoring help expand credit availability for small businesses, especially for riskier firms that tend to pay higher rates to avail credit (Berger et al., 2005),¹⁴ and also reduce the funding gap between small and large enterprises (Galindo and Micco, 2010).¹⁵

Cross-country data lends support to these findings. There exists a positive correlation between credit bureau coverage and the credit to GDP ratio in EMDEs (**Figure S1.4a**). Furthermore, disaggregated analysis reveals that bureau coverage as well as credit uptake is greater in those EMDEs where depth of credit information, as measured using World Bank Doing Business indicators, is higher.

In particular, the credit to GDP ratio was higher by 21 percentage points in EMDEs where credit bureaus register positive as well as negative information on loans, compared to EMDEs where positive data is not maintained (**Figure S1.4b**). As of 2020, around 90 percent of all credit bureaus collect and record positive information

¹² Jappelli, T., and M. Pagano (2002). "Information Sharing, Lending and Defaults: Cross-country Evidence." *Journal of Banking & Finance*, 26(10), 2017-2045.

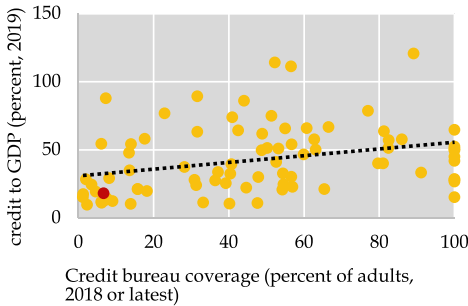
¹³ Brown, M., Jappelli, T., and M. Pagano (2009). "Information Sharing and Credit: Firm-level Evidence from Transition Countries." *Journal of Financial intermediation*, 18(2), 151-172.

¹⁴ Berger, A. N., Frame, W. S., and N.H. Miller (2005). "Credit Scoring and the Availability, Price, and Risk of Small Business Credit." *Journal of Money, Credit and Banking*, 191-222.

¹⁵ Galindo, A., and A. Micco (2010). *Information Sharing and Access to Finance of SMEs: Cross Country Evidence from Survey Data*. AF Working Paper No. 2010/06. Caracas: Development Bank of Latin America.

Relationship Between Credit Bureau Coverage and Private Credit Offtake in EMDEs

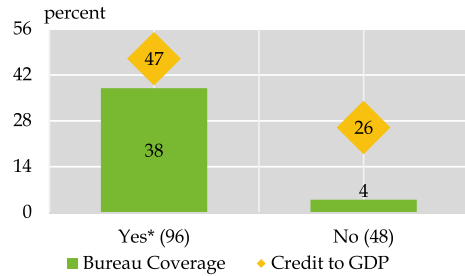
Figure S1.4a



Source: World Bank

EMDE Credit Bureaus Distributing Positive Information* on Loans

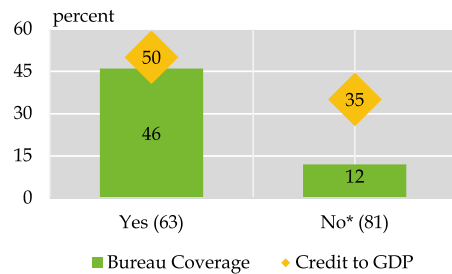
Figure S1.4b



*Positive reporting means having a comprehensive record of the financial sector lending portfolio that goes beyond simple default & delinquencies information; also termed as full-file/comprehensive credit reporting.

EMDE Credit Bureaus Distributing Information from Utility Providers and Retailers

Figure S1.4c

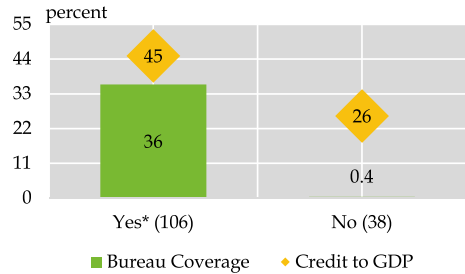


Note: Bracket values indicate number of EMDEs in each category; * denotes category including Pakistan.

Source: World Bank

EMDE Credit Bureaus Distributing Data on Loans Below One Percent of Income per Capita

Figure S1.4d



(World Bank, 2020).¹⁶ Positive data reporting has been found to lead to an 88 percent rise in approval rates and a 43 percent decrease in default rates in the US based on a simulation exercise (Barron & Staten, 2003),¹⁷ and a similar study showed that positive data collection led to a 22 percent and 45

percent decline in default rates in Argentina and Brazil, respectively (Powell et al, 2004).¹⁸

Likewise, credit to GDP ratio is 15 percentage points higher in EMDEs where bureaus use alternate information from utility providers and/or retailers about borrowers compared

¹⁶ World Bank (2020). *Doing Business 2020*. Washington DC: World Bank.

¹⁷ Barron, J. M., and M. Staten (2003). *The Value of Comprehensive Credit Reports: Lessons from the US Experience*. Credit Reporting Systems and the International Economy, 8, 273-310.

¹⁸ Powell, A., Mylenko, N., Miller, M., and G. Majnoni (2004). *Improving Credit Information, Bank Regulation, and Supervision: On the Role and Design of Public Credit Registries*. Policy Research Working Paper No. 3443. Washington, DC: World Bank.

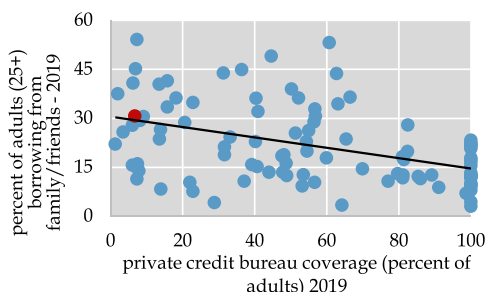
to EMDEs where such data is not used (**Figure S1.4c**). Credit to GDP is also found to be 19 percentage points higher in EMDEs where credit bureaus maintain information on loans below 1 percent of income per capita, compared to EMDEs where such data is not maintained and used for various information needs (**Figure S1.4d**).

Similarly, credit bureau coverage ratio is found to be negatively associated with the incidence of adults in an economy borrowing money from their family or friends, and from an informal savings club (**Figure S1.5a and**

b). There also exists a positive correlation between bureau coverage and proportion of adults borrowing from a financial institution in any economy (**Figure S1.5c**). This indicates that credit bureaus, by gathering and disseminating information, help reduce informal lending and increase effectiveness of the intermediary role of the formal banking channel in terms of reallocation of capital. In particular, higher coverage of bureaus is also negatively correlated with the proportion of financially constrained MSMEs (**Figure S1.5d**).

Correlation Between Credit Bureau Coverage and Incidence of Borrowing from Family/Friends

Figure S1.5a

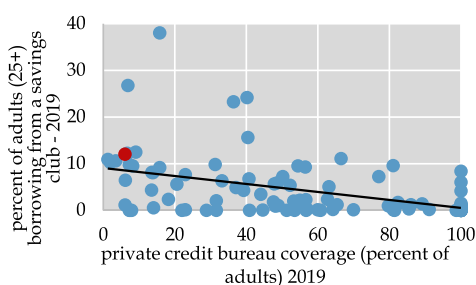


Note: Red dot denotes Pakistan

Source: Global Findex Database

Correlation Between Credit Bureau Coverage and Incidence of Borrowing From a Savings Club

Figure S1.5b

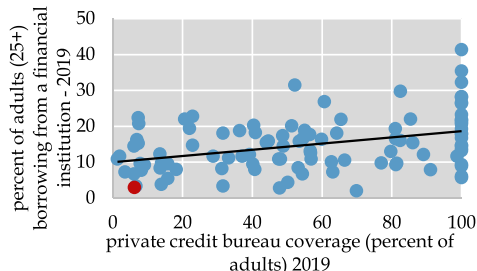


Note: Red dot denotes Pakistan

Source: Doing Business indicators; Global Findex Database

Correlation Between Credit Bureau Coverage and Incidence of Borrowing from a Financial Institution

Figure S1.5c

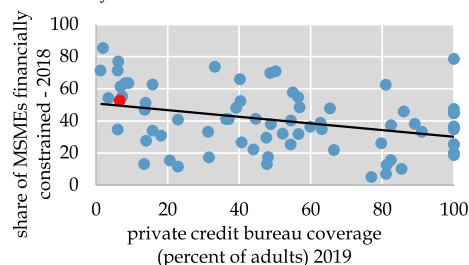


Note: Red dot denotes Pakistan

Source: Doing Business indicators; Global Findex Database

Correlation Between Credit Bureau Coverage and the Proportion of Financially Constrained MSMEs

Figure S1.5d



Note: Red dot denotes Pakistan

Source: Doing Business Indicators; International Finance Corporation MSME Finance Gap Database 2018

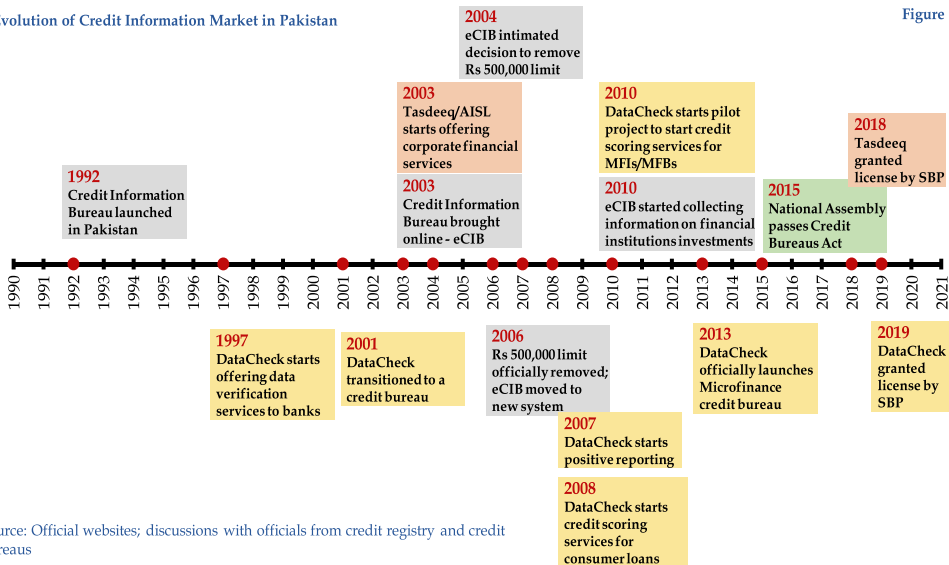
S1.4 The Structure of the Credit Information Market in Pakistan

In Pakistan, the State Bank of Pakistan established the Credit Information Bureau (CIB) in 1992 (see **Figure S1.6** for timeline of key events), with the objective of utilizing the information for prudent lending and better risk management, in turn improving overall financial stability in the country. Operating under the provisions of Section 25(A) of the Banking Companies Ordinance 1962, the credit registry served as a database of credit history of all consumers of the formal financial sector on loans amounting to Rs 500,000 or greater.¹⁹

The registry's services were brought online in April-2003 in collaboration with the Pakistan Banks Association (PBA), the data submission and retrieval guidelines were revised accordingly, and the registry came to be known as electronic CIB (eCIB).²⁰ In December-2004, the eCIB communicated to the financial institutions the intention to remove the Rs 500,000 reporting limit,²¹ and in this regard the shift to a new reporting system was made in April-2006.²² In November-2010, the eCIB also started collecting information on financial institutions' selected investment portfolio in order to increase the overall coverage. Another major decision taken by the eCIB in 2006 was to stop publishing certain group-

Evolution of Credit Information Market in Pakistan

Figure S1.6



Source: Official websites; discussions with officials from credit registry and credit bureaus

¹⁹ www.sbp.org.pk/ecib/about.htm

²⁰ www.sbp.org.pk/ecib/cir/CIB%20ON-LINE.pdf

²¹ www.sbp.org.pk/ecib/cir/CIB%20Data%20Reporting%20Limit.pdf

²² www.sbp.org.pk/ecib/cir/e-CIB%20data%20reporting%20limit.pdf

level firm information (group containing all firms having at least one mutual director), particularly the terms detailing the group's outstanding loans.²³ Overall, the eCIB system has been refurbished five times in the last thirty years to keep up with the technological changes and to incorporate international best practices.

Meanwhile, in late 90s, a few private sector credit bureaus also began operations in Pakistan in the absence of a formal licensing regime. These included DataCheck, ICIL and Credit Chex. Recognizing the need for regulation, the National Assembly passed the Credit Bureaus Act in 2015 "to provide for the incorporation and functioning of credit bureaus" (see **Annexure-I** for key definitions covered in the Credit Bureaus Act 2015, and **Annexure-II** for other important features of the Act).²⁴

Following the passing of the Act, the SBP was authorized to grant licenses to and supervise the affairs of the credit bureaus in the private sector. Accordingly, Tasdeeq was granted a license in November-2018,²⁵ followed by DataCheck in January-2019;²⁶ these are the only two licensed bureaus in the country at present.

The services currently provided by these two credit bureaus include credit reports, portfolio scrubbing, daily alerts, microfinance credit report, recovery agency, and benchmark comparisons (**Figure S1.7**).

Both the bureaus have been working on credit scoring services as well, with the usage currently confined to consumer and microfinance banks. eCIB, meanwhile, being a supervisory authority, only issues creditworthiness report and does not offer any other value-added services to the members.

At present, eCIB has data on 14.9 million individuals and around 150,000 firms on an overall basis. This equals around 12 percent of adult population. Private bureaus, on the other hand, collectively have information on 8.6 million individuals, or 6.7 percent of the overall adult population in the country (**Figure S1.8**).

S1.5 Challenges faced by Private Credit Bureaus in Pakistan

While credit bureau coverage in Pakistan has grown between 2013 and 2019, the coverage is still only marginally better than the minimum threshold of 5 percent as defined by the World Bank. This is, in part, because five years after the passing of Credit Bureaus Act 2015, credit bureaus, information furnishers and users of credit bureaus' services, i.e., lenders, have been facing various regulatory, legal and administrative problems that are common at the initial stage of development of a credit bureau market.²⁷ An early recognition of, and solution to these challenges will help the industry realize the potential benefits of an efficient credit bureau

²³ This development, as stated earlier, exacerbated the information asymmetry issues and hampered financial institutions' ability to conduct due diligence on the firm and groups.

²⁴ www.na.gov.pk/uploads/documents/1438856508_332.pdf

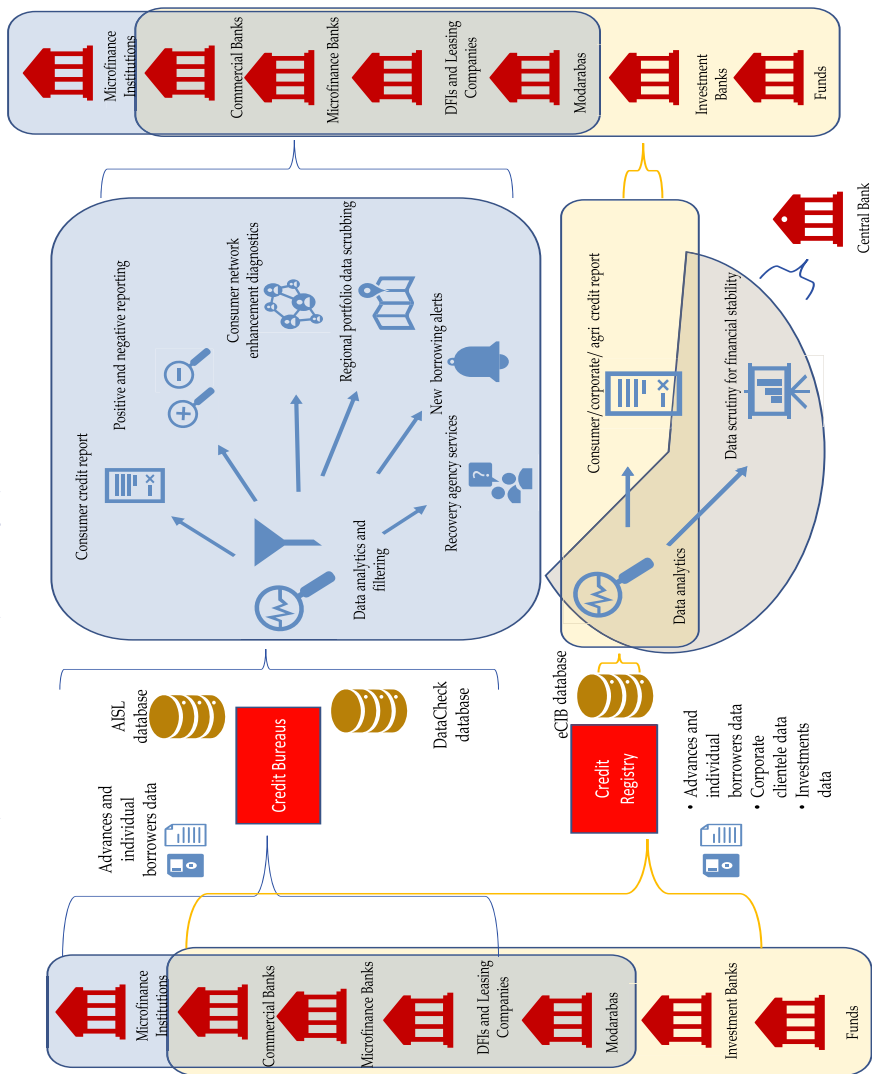
²⁵ www.sbp.org.pk/notifications/BCCPD/2018/ntf1.htm

²⁶ www.sbp.org.pk/notifications/BCCPD/2019/ntf1.htm

²⁷ World Bank (2019). Credit reporting Knowledge Guide. Washington, DC: World Bank.

Figure 51.7

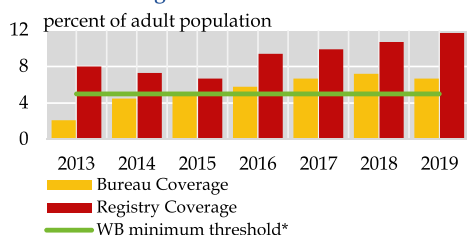
The Process of Data Collection, Analysis and Dissemination by Credit Registry and Bureaus in Pakistan



Source: Official websites

Trend in Credit Registry and Bureau Coverage in Pakistan

Figure S1.8



*If the credit bureau or registry is not operational or covers less than 5% of the adult population, the total score on the depth of credit information index of the Doing Business Score is 0 for that country.

Source: Doing Business indicators, World Bank

market. This section sheds light on the major bottlenecks.

(i) Limited membership of credit bureau

The Credit Bureaus Act 2015 makes it mandatory for every credit institution to become a member of “at least” one private sector credit bureau in the country. In spirit, this was meant to be a floor and not a ceiling of membership. In comparison to 32 commercial banks, 26 are members of AISL and 25 are members of DataCheck (**Figure S1.9**). Between the 32 banks reporting data to the credit bureaus, 20 are members of both whereas 11 banks are members of only one of the two credit bureaus. This means that both the bureaus do not have full coverage of credit institutions, as a result of which the problem of information asymmetry continues to persist in the country’s credit market.

It is pertinent to note here that becoming a member of two or more credit bureaus requires nominal cost, as is evident from the fact that nearly all of the microfinance banks—financial institutions that have fewer resources – already are members of both the bureaus. Bureaus do not charge fees from members who provide data, whereas the data itself is shared by means of computer applications that are both relatively cheap and easy to maintain.²⁸

(ii) Limited coverage of bureaus by borrower type

Currently, the scope of the credit information coverage by both credit bureaus has been confined to individual loans, be it consumer loans, or loans taken by sole proprietorships. Loans taken by corporations and SMEs are yet not covered by the bureaus. This is reflected in the World Bank’s Getting Credit Indicator, which shows zero number of firms covered under private credit bureaus in Pakistan.²⁹

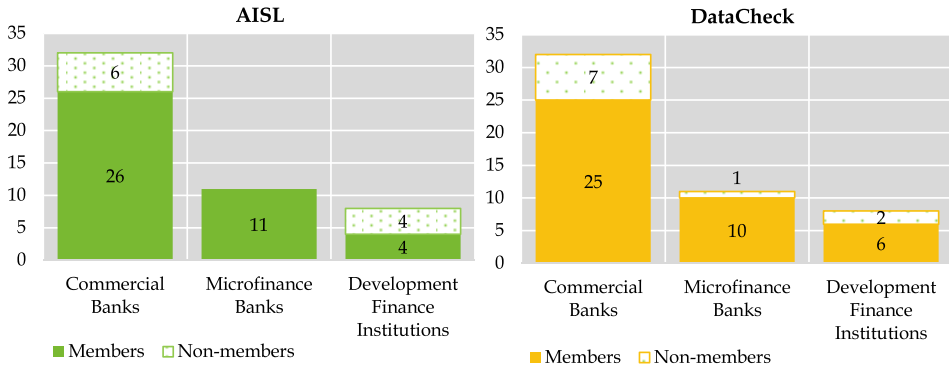
There are two reasons behind this limited coverage, as per the feedback of various stakeholders. The first reason is path dependency. Before the Credit Bureaus Act 2015, the operations of credit bureaus began and grew on the back of consumer loans. Consumer loans were considered much riskier compared to corporate and SME loans due to multitude of borrowers, and banks wanted to reduce their risks by reducing information asymmetries vis-à-vis individual

²⁸ Data sharing is carried out by means of APIs, or Application Programming Interfaces, which are software intermediaries that allow for interactions and data transfers between either same or different software over multiple hardware.

²⁹ World Bank (2020). *Doing Business 2020: Economy Profile of Pakistan*. Washington, DC: World Bank.

Number of Member Institutions of Private Credit Bureaus in Pakistan*

Figure: S1.9



*Data as of 24th June, 2021

Source: Banking Conduct & Consumer Protection Department, SBP

borrowers. In contrast, corporate loans were considered relatively clean portfolio whereas SME lending was mainly relationship based, and banks therefore relied more on relationships and eCIB report than on vanilla products of credit bureaus for these two segments.

From the credit bureaus' perspective, the practice of relying only on consumer loans can also be traced back to 2010, when pilot projects for microfinance loans were launched by DataCheck in collaboration with the SBP.³⁰ It had focused on building a microfinance exclusive consumer information bureau at Lahore; the success of the pilot program led to the national roll-out of Microfinance-exclusive CIB in 2012. After getting their licenses under the Credit Bureaus Act 2015, both bureaus continued to tap the consumer/individual credit information segment as it offered an easy

and familiar take off point for their respective businesses.

Secondly, the limited segment coverage could be attributed to prevailing role of public credit registry i.e., eCIB. The eCIB has the legal mandate to collect credit information from banks, DFIs and microfinance banks for regulatory and supervisory purposes.³¹ However, the eCIB also processes raw information to produce credit information reports, which lenders are legally obligated to use before giving out loans. This implicitly substitutes and even eclipses the role of credit bureaus as credit information providers.

For instance, the credit information report (CIR) generally suffices the basic requirement of banks/DFIs who are legally bound to get eCIB report (of the borrower and its group's) while undertaking any

³⁰ www.sbp.org.pk/about/speech/Governors/Mr.Yaseen.Anwar/2012/20-Jun-2012-2.pdf

³¹ www.sbp.org.pk/ecib/cir/CIB%20Data%20Reporting%20Limit.pdf

exposure (including renewal, enhancement and restructuring) to corporate/commercial loans.³² For SMEs and consumer financing, banks/DFIs can get the report on their prospective borrowers from eCIB or any credit information bureau licensed and regulated by the SBP.³³ MFBs, on the other hand, are required to obtain credit report from eCIB or any credit information bureau, but if the credit facility exceeds Rs 30,000, MFBs are obliged to obtain CIR from eCIB.³⁴

(iii) Lack of key demo-geographic indicators

As discussed in earlier sections, globally credit bureaus are in the business of data and offering actionable intelligence based on that data to lenders. In this light, the fact that banks and other credit institutions, being primary providers of data and members of credit bureaus, are not collecting and/or reporting certain types of demographic and geographic data puts constraints on the growth and development of credit bureau market in Pakistan.

Information on number of dependents a borrower has, age profile of the borrowers, literacy, and education level are either not reported by the commercial banks to the bureaus, or are not being collected at all. Similarly, in the case of agricultural loans, only the name and amount of loans are being reported, and bureaus have no

disaggregation of sector-wise (crop, livestock, or dairy) and crop-wise lending.

It is important to note that such demo-geographic information has different uses in different regions. For example, while education may be a better indicator of creditworthiness in urban areas, it does not hold as much importance in rural localities where crop harvesting patterns could reveal better insights. Likewise, not having quality demo-geographic data also means that bureaus have difficulty figuring out loans taken out from different microfinance banks/institutions by members of the same family, each showing the same shop or business as their own to different lenders. Anecdotal evidence points towards a high incidence of such cases, especially when it comes to consumer and micro and small business lending.

(iv) Legal challenges in collection of alternate data

Although formal financial information is an essential part of credit information reporting and helps lenders to avoid high-risk borrowers, it does not help the lender to predict the riskiness of a potential borrower who have never resorted to FIs for his/her credit needs and consequently not maintained credit history with them.

Globally, these shortcomings are mitigated by the use of alternate data sets such as

³² Prudential Regulations for Corporate/ Commercial Banking (Revised till January 2015), State Bank of Pakistan

³³ Prudential Regulations for Small & Medium Enterprises Financing, (Updated till April 05, 2021), State Bank of Pakistan and Prudential Regulations for Consumer Financing, (Updated on August 03, 2016), State Bank of Pakistan

³⁴ Prudential Regulations for Microfinance Banks, (Updated on June 10, 2014), State Bank of Pakistan

telephone bills, utility payments, transactional overheads, rental information, and trade transactions etc. This kind of transactional data becomes a proxy of income and expenditure and is especially important to bring those individuals and businesses into the formal credit market who have no collateral and little to no credit history to show for. In other words, alternate data is critical for growth in financial inclusion in the bottom of the pyramid segment of economy.

In Pakistan, the coverage of alternate data is currently non-existent because the data is not available, even though notifications to the effect have been passed in at least two cases. Under the Credit Bureau Act 2015, the government issued a notification in April-2020 whereby it directed all electricity and gas distribution or transmission companies to be member of credit bureau and advised them to furnish information in accordance with requirement and specification of the Act. However, except for K-Electric, to date no other electricity and gas distribution company is providing the data to credit bureaus.³⁵

Even if reported, the utility data set is prone to factual inaccuracies, and therefore unreliable.³⁶ This is because many consumers of these utilities are not officially registered users of those utilities. For instance, billing meters are in the name of the owner of property rather than the tenant. Or it is often in the name of the parent or grandparent of the current user, and

sometimes even the previous owner of the property. In case of buying the property, the Nepra's Consumer Service Manual (CSM) obligates the new owner to apply to Disco for a change of name accompanied with written consent and/or no objection certificate from previous owners – a stipulation rarely followed. In the case of tenants, there is no such obligation.

Meanwhile, telecom data, which can be a boon for nano-lending as well as microfinance lending, is also not available to credit bureaus yet, despite a 2019 government notification that instructed mobile operators in the country to become members of credit bureaus and furnish telecom users' billing information.

The legal interpretation of what constitutes telecom data is contested, as telecom companies maintain that they are restricted to share consumers' billing data under PTA's Telecommunication Consumer Protection Regulations, 2009. They also maintain that even if (under a relaxed interpretation of the aforementioned law) they could share consumers' billing data, they can only share data of post-paid customers since no credit is being furnished to pre-paid telecom users. This presents a challenge to lenders who might have appetite for giving nano or micro loans based on transactional information, where telecom spending is an important proxy to assess creditworthiness of lower-income households.

³⁵ K-Electric (KE) has only started reporting data for commercial/industrial consumers because of availability of CNIC/NTN in KE's system; it has been unable to share residential data on account of reasons discussed above. (Source: Power Division, and K-Electric)

³⁶ Source: Power Division

Similarly, according to the April-2016 notification by the Ministry of Finance, court judgements relating to debtors shall be included into the public records as credit information for the purpose of Credit Bureaus Act 2015. However, data pertaining to court judgements are not yet available in a format that are easily accessible to credit bureaus for the purpose of credit information reports and credit scores.

(v) Other operational bottlenecks

Since their inception, the credit bureau industry in Pakistan has seen a host of operational issues, which present a challenge to smooth management of the business, and adds to credit risks of lenders. These operational issues – such as delays in information sharing by credit institutions, and limited historical data, based on which bureaus develop credit scores – are found to be common at initial stage of development of credit bureaus market in several developing economies.³⁷

For instance, current regulations in Pakistan require credit institutions to upload monthly update of their borrowers' information by the 10th of each month i.e., the monthly update for June must be updated by July 10. This means if a debtor defaults or goes past due on his payments on 1st of July, it may take 40 days for the system to reflect this information in database of credit bureaus, and consequently on CIR, which reduces the efficacy of credit reports.

Likewise, anecdotal evidence suggests that there have been instances where borrowers have applied for consumer loans

simultaneously in several banks. But since bureaus have limited information of new loan application on daily basis, the lenders are unable to adequately assess the borrowers' future repayment capacity. As a result, borrowers have been able to get loans from several banks simultaneously, beyond their repayment capacity, leading to credit risks that can be avoided by timely data sharing.

Similarly, while commercial banks and other lenders, being members of eCIB and credit bureaus, share their credit information with the former on time, there are often delays in reporting to the latter. This hurts the efficacy of bureaus, as it creates information asymmetry. Furthermore, unlike the eCIB, credit bureaus cannot penalize their members for delaying the sharing of data.

While the retention period for negative information in CIR by private credit bureaus varies from 3 years to 15 years (**Table S1.1**), that for the e-CIB varies from 2 years to 10 years. The latter is in line with the World Bank's Doing Business indicators. However, domestic credit institutions are generally risk averse and demand credit history to be retained in e-CIB's system for longer time period as well.

S1.6 The Way Forward

To address the aforementioned challenges, implementing the following set of recommendations could help Pakistan towards achieving the potential returns on its credit reporting system.

³⁷ World Bank (2019). Credit Reporting Knowledge Guide. Washington, DC: World Bank.

Rules Governing Maximum Retention Period of Information in CIR of Credit Bureaus

Table S1.1

		Retention period	
		Individual borrower	Corporate borrowers
Bankruptcy cases	from the date of decision of the court	5 years	10 years
Default	from the date of repayment or adjustment of default amount	3 years	4 years
Write off or waiver after settlement/recovery	from the date of settlement or recovery	5 years	5 years
Rescheduling and restructuring	from the date of rescheduling and restructuring	3 years	5 years
Write off or waiver -unsettled		15 years	15 years

Source: SRO 73(KE)/2016, Ministry of Finance

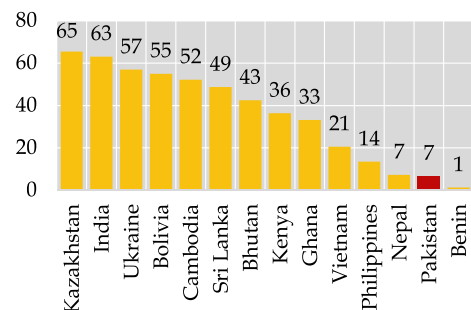
Align regulatory framework and create enabling environment

As discussed in previous section, presently both credit bureaus only have partial coverage of the overall financial sector loan portfolio since several banks are yet not members of both credit bureaus (**Figure S1.10**). This requires nudging the remaining commercial banks to become members of all credit bureaus; credit institutions could then choose the bureau(s) of their liking to purchase various value-added services. This would mean that there would be no competition between the bureaus on data accumulation, instead leading to greater competition on value-added services that hold the potential of minimizing information asymmetries in the credit market.

The prevailing regulations that necessitate obtaining mandatory credit report from eCIB and/or credit bureaus for different credit

Coverage of Adult Population in Private Credit Bureaus in Group of Lower Middle Income Economies

Figure S1.10



Source: World Bank

segments discourages credit bureaus to commence operations in commercial/SME credit markets. The government therefore needs to notify a sunset clause for eCIB, leaving the market space for private sector credit bureaus to compete on a full spectrum of loan segments and credit information services.³⁸

³⁸ In this regard, it is pertinent to note that during deliberations on the Credit Bureaus Act in March-2015, the National Assembly Standing Committee on Finance, Revenue, Economic Affairs, Statistics and Privatization mulled over the option of inserting a sunset clause under which the eCIB was to "cease to furnish credit reports to credit institutions on expiry of twelve months from the date of commencement of this Act". However, this provision was not included in the final version of the Act. (Source: Report of the National Assembly Standing Committee on Finance, Revenue, Economic Affairs, Statistics and

Concerted efforts are needed to streamline various aspects of reporting formats, reporting time, data retention, and operational bottlenecks, as did India in nascent stages of its credit bureau market. India's original set of regulations under Credit Information Companies (Regulation) Act 2005 did not offer standardized formats for reporting corporate, consumer and MFI data.³⁹ To resolve these issues, the RBI formed a committee and, based on its instructions, adopted measures to streamline various aspects of the credit reporting framework, including but not limited to standardized data formats for different credit segments, and the rationalization of the data submission to credit bureaus.⁴⁰ These factors contributed towards an increase in the credit information coverage on commercial lending in India from 1 million firms in 2010 to more than 23 million firms in 2019.⁴¹

Similarly, daily update of credit information vis-à-vis new loan inquiries and approvals can be introduced to reduce the time-lag currently factored in the reporting system.

This would also help bureaus in issuing on-time alerts to their members.

Legal and national level policy reforms to increase availability and use of alternate data

The inclusion of alternate dataset would help unbanked individuals/SMEs to build credit history and increase their access to finance. In addition, it would also offer much needed granularity on SMEs payment behavior that FIs may use to design products and services well-suited to SMEs financial needs. These allied benefits have encouraged CRSPs in many countries to include information on alternative datasets and embraced a positive change in financial inclusion. For example, Guyana had experienced significant increase in financial inclusion (from 2.4 percent in 2015 to 16.4 percent in 2016) after adopting a regulatory provision that obligated utility providers to share data to credit bureaus.⁴² Similarly, in Kenya, the number of borrowers increased significantly after mobile lenders were obligated to provide data to credit bureaus.⁴³

In India, the World Bank has conducted various interaction programs and

Privatization on Credit Bureaus Bill, 2014, available at: www.na.gov.pk/uploads/documents/1455174664_465.pdf

³⁹ Source: Credit Information Companies (Regulation) Act, 2005, India Code

⁴⁰ Another important measure was to require all credit institutions, including NBFIs and cooperative banks, to be a member of all CRSPs and submit data to them including historical information set. (Source: RBI (2015), Membership of Credit Information Companies (CICs), Notification: RBI/2014-15/458 DNBR(PD).CC.No 019/03.10.01/2014-15 and Notification: DBR.No.CID.BC.59/20.16.056/2014-15, available at: www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9555&Mode=0)

⁴¹ Doing Business 2010 India, IFC, available at: www.ihk-krefeld.de/de/media/pdf/international/doing-business/indien-doing-business-in-india-2010.pdf

⁴² Source: World Bank Group (2018), Improving Access to Finance for-SMEs.

⁴³ World Bank (2019). *Disruptive Technologies in the Credit Information Sharing Industry: Developments and Implications*. FinTech Note No. 3. Washington, DC: World Bank

stakeholder meetings under the Commercial Credit Reporting India Project to identify ways to enhance the efficiency of the country's credit reporting market. Responding to a 2015-16 survey under the project, India's financial institutions identified gaps in credit information needed for MSME financing, and highlighted the need for various alternate data for increasing access to finance to MSMEs.⁴⁴ These included utility bills data, telecom usage statistics, income tax and VAT returns, and insurance claims, etc. Based on the findings of the study, a pilot project has been launched to include information collected from various MSME associations and e-commerce companies in the credit bureau database, and to provide support in gathering alternate data from utility companies and telecom operators.

In Pakistan, the availability of alternate datasets requires enabling legal environment and regulatory provisions. For example, to increase the usefulness of utility data, the Power Division needs to make amendments in NEPRA's CSM to ensure that electricity users are correctly identified across its consumer segments, and the data for the same is duly recorded and shared with credit bureaus. In this vein, the CSM also needs to obligate tenants to update their name and whereabouts in case of relocation to a new residence.

Similarly, a host of legal and policy changes are required to ensure that telecom billing data is available to credit bureaus, and that sole proprietorships and Association of Persons across the country are assigned

unique identification. Moreover, various other important alternate datasets, such as those pertaining to residential/commercial rental properties and court judgments, first need to be properly recorded and then shared with the credit bureau industry.

For instance, Sindh government has rolled out a Tenancy Registration System,⁴⁵ where it records tenant's photo, signature and rental agreement, but does not record whether or not monthly rental payments were made, and made within due date. A step forward in this direction should include recording of monthly rental payments, which in turn is linked to Sindh's land automation database and its planned e-stamping database. Such a rich database will help increase access to credit and financial inclusion vis-à-vis credit bureaus; it will also help reduce tenancy litigations whilst assisting federal and provincial tax authorities to expand their tax net. Similar steps should be taken by other provinces.

To this end, there needs to be a national consensus on data and policy reform aimed at addressing data needs of the country, including for credit bureaus and financial inclusion, whilst ensuring data validity, accuracy, linkages and preservation across various data touchpoints.

Include credit reporting system in focus areas of National Financial Inclusion Strategy

Pakistan's National Financial Inclusion Strategy 2015-2020 (NFIS) highlighted that two of the major factors hindering the uptake of MSME financing in the country were: (i)

⁴⁴ World Bank (2019). *Credit Reporting Knowledge Guide*. Washington, DC: World Bank.

⁴⁵ www.tr.sindhpolice.gov.pk/admin/login

lack of adequate regulations to set up legislations for credit bureaus and transactions registry; and (ii) dearth of alternate funding and limited knowledge or lack of use of alternate financing, such as value-chain and cash-flow based financing methodologies.

Both these concerns have been addressed to a large extent with the passing of the Credit Bureaus Act 2015, and the establishment of a Secured Transactions Registry within SECP under NFIS 2023,⁴⁶ wherein specific headline targets have been adopted for priority sectors like SME finance, agriculture finance, low-cost housing and Islamic banking. In this regard, further impetus can be provided by incorporating an action plan for credit reporting system by setting up a Working Group on credit information market to improve the coverage, data quality and usage of credit bureaus in the country. Here, it is pertinent to note that at the time of drafting the NFIS 2015-20, the legislative process of Credit Bureaus Act 2015 was under progress; hence, no associated actions were made part of the NFIS action plan.

Lastly, a Financial Innovation Challenge Fund should be launched by the government to encourage: (a) the use of credit scoring models currently being piloted by credit bureaus; and (b) the creation and testing of new credit scoring models, especially those based on alternate data or otherwise aimed at the segment of individuals and businesses that have no collateral and little or no credit history.

Globally, credit scores are fundamental pillars of the entire credit ecosystem. This is

not only because credit scores reduce the administration expense of banks, MFBs/MFIs and other lenders, but also because of their disciplinary effect where borrowers of good credit score reap benefits whilst those with bad history are penalized. In Pakistan, however, anecdotal evidence suggests that borrowers' good credit history with one or two lenders only benefits within existing banking relationship but not across banks and MFBs/MFIs. This is where credit scores can benefit.

Meanwhile, it is important to note that access to credit in general and credit bureau coverage in particular cannot increase without a significant rise in financial literacy and an awareness about the potential advantages that bureaus bring to the table. To this end, the National Financial Literacy Program (NFLP) needs to incorporate policies that specifically focus on consumers and banks so that they are able to understand the benefits of the existence of private credit bureaus and of having a positive information database. Major focus areas may include generating greater awareness and understanding about a credit bureau's operations; effective use of its services; and requesting, analyzing and improving ones' credit history as maintained by the bureaus.

For instance, individuals and MSMEs need to be made aware that even a dishonored cheque can negatively affect credit scoring of existing and potential borrowers. Likewise, a delayed rental payment will hurt credit score, whenever rental payment data starts getting recorded. At the same time, training programs may be carried out for financial sector officers involved in reporting and

⁴⁶ www.finance.gov.pk/NFIS.pdf

maintaining data related to credit bureaus to increase their skills, improve their understanding of over-indebtedness and smart borrowing principles, and how and when to graduate borrowers and to cross-sell products based on credit reports and other value-added services.

Digital solutions can prove to be a crucial enabler in this regard going forward

Over the past decade, there has been a substantial increase in the adoption of digital financial services across the world. Proliferation of mobile-wallets, fintech service providers, and e-money institutions has transformed core banking as well as the associated segments of payment systems and information intermediaries. Digitization of such services has also resulted in enhanced accumulation and availability of financial sector data.

With regards to credit information agencies, the potential of utilizing digital avenues is tremendous. Already, credit bureaus around the world are utilizing advancements in computing abilities to record, integrate, store, manage, process, and transfer large information datasets from multiple sources. Similarly, electronic payment systems and digitization of tax records is providing bureaus with new sets of information on which to base their scoring and other value-added services. These datasets include electronic funds transfer data, card-based transaction histories, and other person-to-person (P2P), business-to-consumer (B2C) and business-to-business (B2B) interactions

enabled by e-commerce and digitization of supply chains. Furthermore, the implementation of biometric verification measures is resulting in capturing fraudulent practices swiftly.

Lastly, techniques related to artificial intelligence and machine learning are helping bureaus analyze trends using Big Data. For instance, Equifax has worked with an American tech-based startup Cignify to construct a "Prediction Inclusion Score" in Chile for individuals who either have limited or no formal credit history. Individuals who opt in for the service will have their telecommunications usage patterns analyzed and a credit worthiness score assigned to them, which could be shared with financial institutions to offer them loans.⁴⁷ Recent research has shown that even "simple digital footprints", i.e., information that users may leave online by accessing different websites – complement the information content of credit bureaus, and if utilized for credit analysis purposes, increase access to finance and reduce default rates "substantially" (Berg et al., 2020).⁴⁸

When it comes to Pakistan, there has been a similar rise in e-commerce and mobile-payment services. The overall e-commerce transactions sourced from digital payments amounted to Rs 73.7 billion during FY20, rising appreciably from Rs 20.7 billion in FY17. Similarly, the number of active mobile wallet accounts in the country reached 26.7 million at end-June 2020. Meanwhile, the government has made digitization a priority focus area, introducing the Digital Pakistan

⁴⁷ World Bank (2019). *Credit Reporting Knowledge Guide*. Washington, DC: World Bank.

⁴⁸ Berg, T., Burg, V., Gombović, A., and M. Puri. (2020). "On the Rise of Fintechs: Credit Scoring Using Digital Footprints." *The Review of Financial Studies*, 33(7), 2845-2897.

Policy in 2018 and later the e-Commerce Policy in 2019. The five focus areas of the policies are access and connectivity, digital infrastructure, e-governance, digital skilling and training, and innovation and entrepreneurship.

The launch of Micro-Payment Gateway and *Raast* Instant Payment System by the SBP to digitize banking transactions and make transfers real-time further hold the potential to significantly enhance the adoption of mobile and internet banking going forward. *Raast* will allow smooth sector-wide interoperability, making digital payments accessible to users of all the financial institutions. Furthermore, by removing transaction costs, providing smoother customer experiences (with APIs allowing funds transfer only based on one variable such as mobile phone numbers), and increased focus on privacy and security, *Raast* would help remove barriers to adoption of digital financial services from the demand-side as well.

Recently, there has been a trend in some countries to adopt an “open banking” framework, wherein real-time data-sharing happens between all regulated financial institutions via standardized APIs. This is a shift from the “classical banking” model, where information is scattered across various financial services providers unless compiled by specialized institutions such as credit bureaus and registries. As open banking is an emerging concept, different forms of data sharing have emerged. In most cases, however, customers authorize cross-sharing

of information from multiple financial accounts across the entire banking ecosystem.

With regards to credit bureaus, this would mean easier collection of borrowing and defaults data, opportunity to analyze banking transactions, including payments indicative of alternate data, such as utility services payments and tax deductions (if performed via the banking channel). From the perspective of customers, this can significantly tackle the issue of “information rents” issue raised earlier, leading to lower mark-ups and less stringent borrowing conditions.⁴⁹

Credit bureaus should aim to utilize this digital stream of data to enhance their coverage and analyze the creditworthiness of the consumers and businesses, even those who may not yet have a credit history. Recently, fintech players in the country, such as Finja, Telenor Microfinance Bank, Mobilink Microfinance Bank, and FINCA Microfinance Bank are already working on issuing nano-loans based on alternate datasets such as telecom spending and digital payment histories. Meanwhile, start-ups such as Creditbook and DigiKhata aim to digitize personal and small business payments and keep a log of credit transactions (receivables and payables) in their respective online databases. Such information, if available with credit bureaus, can be instrumental in determining the creditworthiness of individuals and enterprises, especially those who lack

⁴⁹ For more information, see Delloite (2017). *How to Flourish in an Uncertain Future: Open Banking*. London: Delloite; and Plaitakis, A. and S. Staschen (2020). *Open Banking: How to Design for Financial Inclusion*. Working Paper October 2020. Washington, DC: Consultive Group to Assist the Poor.

adequate collateral or previous banking history.

Globally, the experience of M-Shwari sheds light on the potential of lending based on alternate information. M-Shwari facility was launched by the Commercial Bank of Africa in 2012 in order to provide deposit-taking and loan-extending facilities using the M-Pesa mobile-wallet platform in Kenya. Those users of M-Shwari who have been active for 6 months become eligible to take a loan. To determine how much customers may borrow, the service considers the average deposit amount kept in the wallet over the past six months, the volume and value of transactions performed through the service, and trends in usage of telecom services such as internet bundles, voice data and M-Pesa. The service then lends an amount derived from these metrics by crediting the funds directly into the M-Shwari account, with the repayment period of 30 days. M-Shwari reports borrowing data to the country's credit bureaus and it has helped increase the coverage of credit bureaus and make credit records for individuals who were mostly borrowing from the informal sector before using M-Shwari.⁵⁰

S1.7 Concluding Remarks

The introduction of Credit Bureaus Act 2015 and the issuance of licenses to two private credit bureaus are foundational steps towards minimizing information asymmetries in the credit information market of Pakistan. However, the operational

framework needs to be improved in the light of international best practices, to make the credit reporting system more effective. Streamlining data submission formats and timelines appear as quick wins in this regard. However, enhancing the pool of data to include demo-geographic variables and alternate credit data may prove to be more time- and cost-intensive. This is because of three major reasons. First, our discussions with the stakeholders revealed that most of the financial institutions are not even collecting the key demographic information at their end, using which credit bureaus develop their scoring and portfolio scrubbing services all over the world. Therefore, increasing awareness about the importance of collecting, disseminating, pooling and analyzing more information needs to be prioritized for long term credit information needs of the credit markets.

Second, there are either significant issues when it comes to quality of data currently available with utility companies (for example, gas and electricity bills), or where data is available (such as telcos), there is lack of agreement on the sharing of such data with credit bureaus. Here, the coordination of key stakeholders, especially respective regulators and government divisions/departments, to ensure that such information is available with the credit bureaus can pave way for smooth collection and sharing of data. Sharing of data would be a win-win situation, as utility service providers would also be able to use the

⁵⁰ According to the Bill and Melinda Gates Financial Inclusion Insights Program M-Shwari Survey of 2015, most of the users of M-Shwari were new formal financial sector borrowers, as 52 percent of the users reported not borrowing at all from any other institutions in the past three months, and 33 percent reporting borrowing from family and friends.

analysis provided by credit bureaus to improve recoveries and lower defaults.

Third, high informality means that even when all such data is available with credit bureaus, it may still not reveal correct indebtedness levels of consumers and MSMEs in particular. This is because there is a high incidence of informal borrowing by these segments in Pakistan.

A long-term solution to this end may involve gradually bringing informal lenders, such as grocery retailers and consumer appliances superstores, in the formal sector with the help of fintech. For example, Oraan is a Pakistani startup that enables individuals to group save and group lend through rotating savings and credit associations (ROSCAs), (known as 'committees') via its mobile application. This is an important development, as ROSCAs are a significant part of household savings in Pakistan.⁵¹

Going forward, credit bureaus may collaborate with alternate credit scoring providers that harness information from varied sources such as social media, telecommunications authorities, mobile phone usage statistics such as messaging content, mobility and browser data, etc. Examples of such alternate scoring companies include the earlier mentioned Cignify, Saudi Arabia's Lenddo, the multi-country operational data-crunching company Tiexo, and India-based CreditVidya.⁵²

With continuous rise in teledensity, internet subscriptions and data usage in the country, similar companies are going to tap into Pakistani credit market as well. However, it is important to mention here that it is the government's responsibility to create an enabling legal and policy environment for collection and sharing of alternate data whilst ensuring data privacy and security.

⁵¹ Source: Pakistan Financial Inclusion Insights Tracker survey 2017, Bill and Melinda Gates Foundation and Karandaaz

⁵² World Bank (2019). *Disruptive Technologies in the Credit Information Sharing Industry: Developments and Implications*. FinTech Note No. 3. Washington, DC: World Bank.

Annexure-I: Some Important Definitions Covered in Credit Bureaus Act 2015

Credit information: is any information with respect to a debtor relating to (i) the amounts, nature of loans or advances, finance and other credit facilities granted by a credit institution and repayment thereof by the debtor and the nature of security taken by a credit institution for credit facilities granted; (ii) the guarantee or any other non-fund based facility furnished by a credit institution for the benefit thereof; (iii) the amounts and nature of commercial transactions, facilities and services entered into or availed of credit from non-financial companies and bodies and other lenders and authorities including but not limited to retailers, insurance companies, utility providers and landlords as notified by the Federal Government; (iv) any and all factors included in the financial history bearing on the credit worthiness, credit standing and credit capacity thereof; (v) any other related public record and information as prescribed by rules; or (vi) personal information as prescribed by rules.

Credit information furnisher: any credit institution, person or entity which provides credit information to a credit bureau including non-financial companies and bodies and other lenders and authorities.

Credit information report: any written or electronic communication issued by a credit bureau containing credit information relating to any debtor for the purposes of this Act.

Credit institution: includes (i) a banking company; (ii) microfinance banks; (iii) a financial institution, which means (a) any company, whether incorporated within or outside Pakistan, which transacts business of banking or any associated or ancillary business in Pakistan through its branches within or outside Pakistan and includes a government savings bank but excludes the State Bank of Pakistan; (b) a modaraba, leasing company, investment bank, financing company, unit trust or mutual fund of any kind and credit or investment institution, corporation or company; and (c) any company authorized by law to carry on any similar business; (iv) non-banking financial company; and (v) any company, corporation or institution or class of companies or institutions as the Federal Government may from time to time, by notification in the official Gazette, specify for the purpose.

Credit scoring: a system whereby points are awarded to debtors enabling users to assess the credit worthiness and capacity of debtors to repay loans and advances and to discharge any and all other obligations with regard to credit facility availed of or to be availed of by the debtors.

Debtor: a person to whom finance as defined in the Financial Institutions (Recovery of Finances) Ordinance, 2001(XLVI of 2001) has been provided, including those who have been credit recipients and who are potential recipients of credit as notified by the Federal Government.

Default: includes omission or failure to perform a legal or contractual obligation involving credit.

Source: Ministry of Finance

Annexure-II

Important Features of Credit Bureaus Act 2015

Establishment of Credit Bureau (CB)	
Licensing Authority	State Bank of Pakistan
Eligibility for license	An entity shall be eligible to apply for credit bureau license, if it meets certain conditions, including: 1) it is incorporated as public limited company; 2) none of its promoters, sponsors, and key ownership, and management personnel have been associated in illegal banking activities, or convicted of any offence involving fraud etc., or have an overdue loan/ default history; or have defaulted on government taxes/ dues; 3) its promoters have knowledge of credit bureau business; and 4) its promoters and directors don't have conflict of interest
Minimum paid up capital	Rs 225 million*
Requirement to provide credit information	
Direction to provide credit information	Credit information furnishers are required to provide information to CBs
Membership status	Every credit institution shall be a member of at least one credit bureau. The Act doesn't discuss the membership requirement of other credit information furnishers
Audit	Every CB is required to prepare annual financial accounts, duly audited by authorized auditors and submitted to the SBP.
Empowering SBP	The SBP is authorized to 1) give directions to CBs; 2) formulate, modify or cancel policies, rules, guidelines and procedures; 3) call information from CBs 4) may remove directors or other managerial persons of CBs; 5) may appoint auditors to conduct special audit of CBs
Functions of CBs	1) Collect, process, collate, store and maintain credit information and provide this information to designated users and other CBs; 2) undertake credit scores and may sell such scores to users; 3) undertake other permissible businesses; and 4) No CB shall engage in any other activity.
Protection of consumers	
Permissible purpose	• The CB may furnish the credit information report to 1) credit institution; 2) the concerned debtor; 3) SECP; 4) competent court; 5) any other purpose prescribed by regulations. • The CBs cannot maintain its database outside Pakistan and in case of closure of operation, shall sell this information set to any other CB or surrender it to the SBP.
Content of credit information report	The credit should only report the information as prescribed in the law and shall not contain any other information
Prohibition of collection of credit information	CBs cannot collect the information that violates any law and includes unreasonable extent of personal affairs of concerned individual.
Deletion of information	CBs cannot include overdue/default information w.r.t any obligation involving credit after certain years of settlement of default/overdue as prescribed in the law
Disclosure of source of information	Upon request of debtor, CBs must inform debtor the source of credit information
Accuracy and security of information	CBs must ensure the accuracy, completeness, recency, and appropriateness of credit information and also arrange required systems and procedures and maintained strict security safeguards against loss, unauthorized use and disclosure.

False or misleading credit infor.	The dissemination of false or misleading information by CBs or credit information furnisher is prohibited and the failure to meet this condition may lead to penalty of not exceeding Rs 5 million.
Unauthorized access to credit information	The disclosure/dissemination of credit information is allowed when authorized under this act or any other law in force, the violation of this condition will be treated as an offence and shall be punishable.
Obtaining access to credit information by false pretences	Obtain credit information under or by false pretences is punishable offence
Obligations as to fidelity, confidentiality and secrecy	The credit information shall regard as secret and confidential and the disclosure may only allow in connection with discharge of duties or function under this Act.
Exchange of credit information	The CBs can exchange the credit information among themselves or with other companies as approved by the SBP
Protection of action taken in good faith	legal proceedings, suit, claims or demand shall lie against government, SBP, CBs, credit information furnishers and their management/employees for any loss or damage caused by anything which is done in good faith in pursuance of this Act
Requirement on users	In case of adverse action by user of credit information, the user shall provide the concerned debtor the copy of credit information report and the contact details of credit bureau
Legal recognition of electronic forms	The record/ document/information etc. made under this Act shall be deemed valid if made in electronic form
Dispute resolution	In event of dispute, the debtor shall notify in writing to concerned CB of alleged error, which then CB will take up with credit information furnisher
Offences and penalties	
Penalties	Any violation or obstruction of this Act shall be punishable
Adjudication of fine or penalty	The fine if imposed shall be adjudged by the SBP
Application of fine or penalty	The Court imposing any fine or penalty shall be applied in or towards payment of cost of proceedings, or credited to Public Account of the Federal Government
Adjudication of punishment by imprisonment	The imprisonment shall be adjudged by the Court
Appeal	The appeal against decision of court can be filed in High Court
Appeals and legal proceedings	
Complaint to SBP	Any person aggrieved by any action of CBs, credit information furnisher, debtor or any other person may make a complaint to the SBP to resolve the dispute
Appeal to High Court	Any person aggrieved by decision of the SBP may make an appeal to the High Court
General	
Removal of difficulties	The federal government may undertake necessary action for the removal of any difficulty arising in giving effect to any of the provision of this Act
Power of the Federal Government to make rules	The federal government after consultation with the SBP may make rules for the purpose of giving effect to the provision of this Act
Power to make regulations	The SBP may make regulations that are consistent with the rules.

* Revised following a 2017 Sindh High Court Ruling

Source: Ministry of Finance; www.sbp.org.pk/warnings/pdf/2018/Minimum-PaidUp-Capital-CB.pdf

Annexure: Data Explanatory Notes

- 1) **GDP:** In case of an ongoing year, for which actual GDP data is yet not available, SBP uses the GDP target given in the Annual Plan by the Planning Commission in order to calculate 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 (national, urban, or rural) 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:

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

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

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

Where I_t is consumer price index in t^{th} month of a year. The CPI can be national, urban or rural.

For detailed information on the methodology, please see:
www.pbs.gov.pk/content/methodology-2

- 3) **Change in debt stock vs. financing of fiscal deficit:** The change in the stock of gross 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 financing is calculated by adjusting the government borrowing with its deposits held with the banking system; (ii)

changes in the stock of debt also occur due to movements in exchange rates, both PKR and other currencies against US Dollar, which affect 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). Ways and Means Advance allows government to borrow up to Rs 100 million at a time 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 (AJK) 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. However, the Federal Government has taken over from the State Bank of Pakistan (SBP) the business of direct credit to provincial governments on 29th June 2020. In this regard, the federal government has executed tripartite agreements with four provincial governments and SBP (as executer) for extension of Ways and Means loans on account of Federal Government Central Account No.I (non-food) on 29th June 2020.

Borrowing from scheduled banks: This is mainly through (i) fortnightly auction of 3, 6 and 12-month Market Treasury Bills (MTBs); (ii) monthly auction of 3, 5, 10, 15, 20 and 30 year fixed rate Pakistan Investment Bonds (PIBs); (iii) fortnightly auctions of 3, 5, 10 year floating rate PIBs; (iv) Sukuk and (v) Bai Muajjal of Sukuk (on deferred payment basis). 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, foreign trade, etc – often do 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 have been 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 banking 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).

List of Acronyms

A

ADB	Asian Development Bank
AEO	Authorized Economic Operators
AIIB	Asian Infrastructure Investment Bank
AIP	Agricultural Innovation Program
AML	Anti-Money Laundering
APCMA	All Pakistan Cement Manufacturers Association
API	Application Programming Interface

B

B2B	Business to Business
B2C	Business to Consumer
bbl	Barrel
BBO	Branchless Banking Operators
BCS	Business Confidence Survey
BISP	Benazir Income Support Program

C

CAN	Calcium Ammonium Nitrate
CBU	Completely Built-Up
CCP	Competition Commission of Pakistan
CCS	Consumer Confidence Survey
CCT	Conditional Cash Transfers
CFT	Combating the Financing of Terrorism
CIC	Credit Information Corporation
CIMMYT	International Maize and Wheat Improvement Center
CIR	Credit Information Report
CKDs	Completely Knocked Down
CNIC	Computerized National Identity Card
CPEC	China-Pakistan Economic Corridor
CPI	Consumer Price Index
CRILC	Central Repository of Information on Large Credits
CRSP	Credit Reporting Service Provider
CSM	Consumer Service Manual

D

DAP	Diammonium Phosphate
DC	District of Columbia
DFI	Development Financial Institution
DISCO	Distribution Company
DISCO	Distribution Companies
DSC	Defence Saving Certificate
DSSI	Debt Servicing Suspension Initiative

E

EAD	Economic Affairs Division
ECC	Economic Co-ordination Committee
ECC	Economic Coordination Committee
eCIB	Electronic Credit Information Bureau
EEC	Ehsaas Emergency Cash
EFF	Extended Fund Facility
EFS	Export Finance Scheme
EM	Emerging Market
EMDEs	Emerging Markets and Developing Economies
EU-27	European Union-27

F

FASTER	Fully Automated Sales Tax e-Refund
FASTER (Plus)	Fully Automated Sales Tax e-Refund (Plus)
FBR	Federal Board of Revenue
FCVA	Foreign Currency Value Account
FDI	Foreign Direct Investment
FED	Federal Excise Duty
FI	Financial Institution
FPI	Foreign Portfolio Investment
FX	Foreign Exchange
FY	Fiscal Year

G

G-20	Group of Twenty
GBP	Great Britain Pound
GCC	Gulf Cooperation Council

GDP	Gross Domestic Product
GIDC	Gas Infrastructure Development Cess
GIS-FRR	Government Ijarah Sukuk - Fixed Rental Rate
GIS-VRR	Government Ijarah Sukuk - Variable Rental Rate
GOP	Government of Pakistan
GSM	Global System for Mobile communication
GST	General Sales Tax

H

H1	First Half
H2	Second Half
HIES	Household Integrated Economic Survey
HS	Harmonized System
HSD	High Speed Diesel

I

IBA	Institute of Business Administration
ICE	Intercontinental Exchange
ICT	Information and Communications Technology
ID	Identification Document
IDB	Islamic Development Bank
IMF	International Monetary Fund
IRSA	Indus River System Authority
IT	Information Technology

K

KE	K-Electric
KP	Khyber Pakhtunkhwa
KSA	Kingdom of Saudi Arabia

L

LCR	Light Commercial Vehicle
LIBOR	London Interbank Offer Rate
LNG	Liquefied Natural Gas
LSM	Large-Scale Manufacturing
LTFF	Long-term Financing Facility

M

MAF	Million Acre Feet
MDMP	Mobile Device Manufacturing Policy
MFB	Microfinance Bank
MFI	Microfinance Institution
MMRI	Maize and Millets Research Institute
MMT	Million Metric Ton
MNFSR	Ministry of National Food Security & Research
MoM	Month on Month
MPC	Monetary Policy Committee
MSMEs	Micro, Small and Medium Enterprises
MSP	Minimum Support Price
MT	Metric Tons

N

NBFI	Non-bank Financial Institution
NCCPL	National Clearing Company of Pakistan
NCOC	National Command Operation Center
NDA	Net Domestic Assets
NEER	Nominal Effective Exchange Rate
NEPRA	National Electric Power Regulatory Authority
NFA	Net Foreign Assets
NFC	National Finance Commission
NFIS	National Financial Inclusion Strategy
NFLP	National Financial Literacy Program
NFNE	Non-food Non-energy
NGDS	National Gas Development Surcharge
NICOP	National Identity Card for Overseas Pakistanis
NP	Nitro Phosphate
NPC	Naya Pakistan Certificates
NRVA	Non Resident Pakistanis Rupee Value Account
NSS	National Saving Certificates

O

OCAC	Oil Companies Advisory Council
ODI	Overseas Development Institute
OECD	Organization for Economic Co-operation and Development
OMO	Open Market Operation
OPEC	Organization of the Petroleum Exporting Countries
OTEXA	Office of Textiles and Apparel

P

P2P	Person to Person
PAMA	Pakistan Auto Manufacturers Association
PARC	Pakistan Agriculture Research Council
PBA	Pakistan Banks Association
PBS	Pakistan Bureau of Statistics
PDL	Petroleum Development Levy
PFL	Floating Rate PIBs
PFM	Public Financial Management
PIB	Pakistan Investment Bond
PIBs	Pakistan Investment Bonds
PIPIP	Punjab Irrigated Agriculture Productivity Improvement Project
PKR	Pakistani Rupee
POC	Pakistan Origin Card
POL	Petroleum, Oil, and Lubricants
PPE	Personal Protective Equipment
PPP	Public Private Partnership
PR	Policy Rate
PSDP	Public Sector Development Program
PSE	Public Sector Enterprise
PSM	Pakistan Steel Mill
PTA	Pakistan Telecommunication Authority

Q

Q1	First Quarter
Q2	Second Quarter
Q3	Third Quarter
Q4	Fourth Quarter
QoQ	Quarter on Quarter
QTA	Quarterly Tariff Adjustment

R

RBI	Reserve Bank of India
RDA	Roshan Digital Accounts
REER	Real Effective Exchange Rate
RFCC	Refinance Facility to Combat Covid-19
RISE	Resilient Institutions for Sustainable Economy
ROA	Return on Assets
ROE	Return on Equity
ROSCA	Rotating Savings and Credit Association
RPI	Relative Price Index

S

SBP	State Bank of Pakistan
SDR	Special Drawing Rights
SECP	Securities & Exchange Commission of Pakistan
SME	Small and Medium Enterprises
SOP	Standard Operating Procedure
SRO	Statutory Regulatory Order
SSC	Special Saving Certificate
SUV	Sport Utility Vehicles

T

TERF	Temporary Economic Refinance Facility
TRAIL	Trader-Agent Intermediated Lending

U

UAE	United Arab Emirates
UK	United Kingdom
US	United States
US\$/USD	US Dollar
USC	Utility Store Corporation
USDA	United States Department of Agriculture

V

VAT	Value-added Tax
VEC	Variety Evaluation Committee

W

WALR	Weighted Average Lending Rate
WAONR	Weighted Average Overnight Rate
WBG	World Bank Group
WfH	Work-from-Home
WHT	Withholding Tax

Y

YoY	Year-on-Year
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