

Chapter13 | FISCAL, MONETARY AND CAPITAL MARKET DEVELOPMENT

There has been a significant improvement in fiscal indicators since 2013-14 as a result of the reforms initiated by the government for strengthening the public financial management, improving tax administration, reducing the untargeted subsidies and tax concessions/exemptions and addressing the financial losses of Public Sector Enterprises (PSEs). The improvement on fiscal front reflects the government's commitment to fiscal discipline and prudent public financial management as envisaged in Pakistan Vision 2025. The monetary policy remained synchronized with the fiscal policy for maintaining price stability, strengthening the financial sector and ensuring availability of cheaper credit to the productive sectors.

Review of fiscal developments 2016-17

During the last three years, fiscal deficit was reduced from 8.2 to 4.6 per cent of GDP through significant growth in tax revenue and expenditure rationalization. Similarly, overall tax-to-GDP ratio increased from 9.8 per cent in 2012-13 to 12.6 per cent in 2015-16. Federal budget 2016-17 aimed at further improvement in overall fiscal position with fiscal deficit-to-GDP ratio targeted at 3.8 per cent. Consolidated total revenue stood at Rs3,145.5 billion during July-March 2016-17, reflecting 6.2 per cent growth over the collection of Rs2,961.9 billion in the corresponding period of last year. Consolidated tax revenue was recorded at Rs2,694.3 billion, registering a growth of 8.6 per cent over the comparable period of last year whereas non-tax revenue witnessed a decline of 6.2 per cent and stood at Rs451.2 billion. The decline is primarily because of falling oil prices and 40-year lowest policy rate (5.75 per cent since May 2016). A summary of consolidated fiscal operations is given at Table-1 whereas their details are at Annexure-1.

Table-1
Consolidated fiscal operations (July-March 2016-17)

Item	Jul-March 2016-17	July-March 2015-16	% Change	As % of GDP	
				Jul-Mar 2016-17	Jul-Mar 2015-16
Total revenue	3,145.5	2,961.9	6.2	9.9	10.2
a. Tax revenue	2,694.3	2,481	8.6	8.5	8.5
b. Non-tax revenue	451.2	480.9	-6.2	1.4	1.7
Total expenditure	4,383.6	3,971.3	10.4	13.8	13.6
a. Current	3,605.1	3,407	5.8	11.3	11.7
b. Development	803.9	699.4	14.9	2.5	2.4
Fiscal deficit	1,238	1,009.4	22.6	3.9	3.5
GDP (current market prices)	31,862*	29,103			

*Provisional Source: Finance Division

The FBR's tax collection was recorded at Rs2,260.5 billion during the period under review as compared to Rs2,103.0 billion during the comparable period of last year, thereby registering a growth of 7.5 per cent. Collection of both direct and indirect taxes grew by 12.4 per cent and 4.5 per cent, respectively. The lower collection of indirect taxes was due to shortfall in the collection of sales tax. This fall is attributed to a slowdown in the growth of key manufacturing sectors, particularly petroleum sector which is the top revenue spinner.

Consolidated total expenditure during the period under review amounted to Rs4,383.6 billion, registering a growth of 10.4 per cent over the corresponding period of last year. Both current and development expenditures rose by 5.8 per cent and 14.9 per cent, respectively. Both federal PSDP and provincial ADP expenditures increased by 28.9 per cent and 13.6 per cent, respectively. Other development expenditure (non-PSDP) plummeted by 24.7 per cent. Net lending to PSEs recorded a retirement of Rs34.2 billion as compared to an expansion of Rs10.8 billion during the corresponding period of last year.

The fiscal performance remained off the track during 2016-17 as fiscal deficit has already surpassed its annual target of 3.8 per cent of GDP during the three quarters. This higher fiscal deficit is attributed to a low growth of total revenue as a result of a shortfall realised in tax collection and a decline in non-tax revenue. The analysis of financing-mix of consolidated fiscal deficit during the period under review reveals that the government relied more on domestic than external resources. Within domestic resources, greater reliance was on bank borrowing.

Net public debt as on March 31, 2017 stood at Rs18,925.4 billion, posting a growth of 9.1 per cent over the stock as on March 31, 2016 (Table-2). This accumulation in net public debt was mostly on account of domestic debt. Net public debt-to-GDP ratio dropped from 59.6 per cent to 59.4 per cent over the year. Gross public debt stood at 65.5 per cent of GDP as compared to its budget estimate of 61.4 per cent.

Table-2
Pakistan's public debt profile

Item	(Rs billion)		
	March 2017	March 2016	% Change
a. Domestic debt	14,746	13,398.1	10.1
b. External debt	6,127.9	5,769.8	6.2
Gross public debt (a+b) (FRDLA definition)	20,873.9	19,167.9	8.9
Net public debt*	18,925.4	17,346.2	9.1
As % of GDP			
Domestic debt	46.3	46	
External debt	19.2	19.8	
Gross public debt (FRDLA definition)	65.5	65.9	
Net public debt	59.4	59.6	
GDP (current market prices)	31,862**	29,103	

*Gross public debt minus government deposits with the banking system

**Provisional

Source: State Bank of Pakistan

Fiscal outlook 2017-18

The fiscal policy during 2017-18 will remain consistent with the prudent stance adopted by the government for achieving the growth objective as envisaged in the Vision. Efforts will be made to maintain fiscal deficit in manageable limits with the confines of Fiscal Responsibility and Debt Limitation Act (FRDLA) 2005. The fiscal policy will remain focused on enhancing revenue mobilization and containing non-priority/non-development expenditures. The FBR will continue broadening the tax base, reforming the tax administration, limiting the tax concessions/exemptions granted under SROs, rationalizing the tax rate structure, strengthening the automation of the taxation system, and strengthening the differential taxation system introduced for filers and non-filers to increase tax compliance. Efforts will also be made to address the issues of financial losses of PSEs and reduce public debt-to-GDP ratio to the FRDLA target of 60 per cent in 2017-18.

Review of monetary developments and inflation 2016-17

The State Bank of Pakistan followed an easy monetary policy stance and kept the policy rate unchanged at 5.75 per cent during 2016-17. The SBP has been following easy monetary policy stance on the basis of conducive and benign international commodity prices and improved macroeconomic conditions at domestic level since May 2016.

Money supply as measured by broad money (M2) expanded by Rs936.4 billion (7.3 per cent) during 1st July 2016 to 5th May 2017 as compared to its expansion of Rs716.9 billion (6.4 per cent) during the corresponding period of last year (Table-3). Net Foreign Assets (NFA) of the banking system contracted by Rs393.8 billion (-39.1 per cent) as compared to its expansion of Rs112.9 billion (13.9 per cent) during the corresponding period of last year. Net Domestic Assets (NDA) of the banking system increased by Rs1,330.2 billion (11.3 per cent) as compared to its expansion of Rs604.1 billion (5.8 per cent) last year.

Table-3
Monetary aggregates

(Rs billion)

Factors affecting broad money (M2) growth	Stocks at end of Jun-16	Monetary impact from 1 st July to	
		5-May-17	6-May-16
A. Net Foreign Assets of the banking system	1,007.6	-393.8	112.9
B. Net Domestic Assets of the banking system (1+2+3)	11,817.3	1,330.2	604.1
<i>Growth</i>		11.26%	5.77%
1. Net government sector borrowing (a+b+c)	7,819.5	847	513.3
a. Borrowing for budgetary support	7,194.8	928.8	573.8
i. From the SBP	1,442.2	947.3	-59.8
ii. From scheduled banks (net)	5,752.6	-18.5	633.6
b. Commodity operations	636.6	-84.3	-60
c. Others	-11.8	2.5	-0.5
2. Credit to non-government sector (a+b+c+d)	5,012.6	736.1	342.8
a. Credit to private sector	4,449.5	507.2	307.4
b. Credit to Public Sector Enterprises (PSEs)	568.1	225.1	34.9
c. PSEs Special Account-debt repayment with the SBP	-24.2	0	-0.2
d. Credit to Non-Banking Financial Institutions (NBFIs)	19.2	3.8	0.6
3. Other items (net)	-1,014.9	-252.9	-252
Broad money (M2) (A+B)	12,824.9	936.4	716.9
<i>Growth</i>		7.30%	6.35%

Source: State Bank of Pakistan

The government preferred to borrow from the SBP for budgetary support to the tune of Rs947.3 billion and retired loans of commercial banks worth Rs18.5 billion. Last year, the government adopted the opposite borrowing mix of retiring Rs59.8 billion to the SBP and borrowing Rs633.6 billion from commercial banks. Net retirement of Rs84.3 billion was registered under commodity operations (mainly in wheat and fertilizer) as compared to the last year's retirement of Rs60 billion in the comparable period.

Credit to private sector registered an increase of Rs507.2 billion as compared to its last year's expansion of Rs307.4 billion. Credit to private sector is expanding that is expected keeping in view the recognition lag of easy monetary policy. On the supply side, the retirement of loans to scheduled banks by the government left ample resources for private sector credit. Bank credit went for both working capital and fixed investment purposes. Credit to PSEs expanded by Rs225.1 billion as compared to its expansion of Rs34.9 billion last year. Credit to Non-Banking Financial Institution (NBFIs) recorded an expansion of Rs3.8 billion as compared to its expansion of Rs0.6 billion last year.

Average CPI rose to 4.1 per cent in July-April 2016-17 from 2.8 per cent in the corresponding period of last year mainly due to low supplies of fresh vegetables and recovery in global prices of food commodities. However, it is well below the target of 6 per cent for 2016-17. A gradual build-up of domestic demand also exerted an upward pressure on prices which is also evident from the rise in average core inflation from 4.1 per cent to 5.1 per cent over the year. Average WPI moved from deflation of 1.3 per cent to inflation of 4 per cent whereas average SPI (for all income groups combined) fell from 1.8 per cent to 1.7 per cent over the year (Table-4).

Table-4
Average price indices (%)
(Base year: 2007-08)

Index	July-April	
	2016-17	2015-16
Consumer Price Index (CPI)	4.1	2.8
- Food	3.9	2.1
- Non-food	4.3	3.3
- Core (non-food non-energy)	5.1	4.1
Wholesale Price Index (WPI)	4	-1.3
Sensitive Price Indicator (SPI)*	1.7	1.8

*SPI for all income groups combined

Source: Pakistan Bureau of Statistics

In April 2017, CPI inflation increased by 4.8 per cent on year-on-year (YoY) basis as compared to 4.2 per cent in April 2016. Core inflation, on YoY basis, increased to 5.5 per cent in April 2017 from 4.4 per cent in April 2016.

Monetary and inflation outlook 2017-18

Monetary expansion during 2017-18 will be in line with the projected GDP growth and CPI inflation. During 2017-18, better energy supplies to manufacturing sector and higher aggregate demand would necessitate higher business / private sector loans which along with growing bank financing for CPEC-related activities and accelerated development works would lead to higher monetary expansion and inflation. Global commodity and oil prices are

expected to rise which are likely to put an upward pressure on inflation. Average CPI inflation is expected to be around 6 per cent during 2017-18.

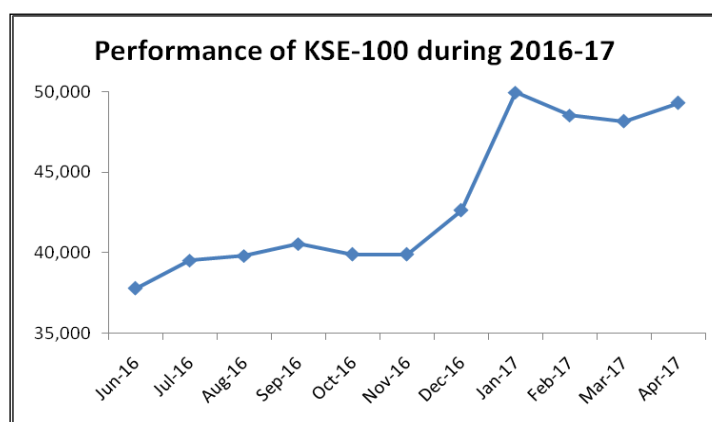
Review of capital market developments 2016-17

During 2016-17, the Securities & Exchange Commission of Pakistan (SECP) initiated a number of structural, legal and fiscal reforms to develop fair and competitive capital market. Reform measures aimed at improving governance of the capital market infrastructure institutions, strengthening risk management, enhancing transparency and increasing investor protection. Some of the key initiatives of the SECP during the first three quarters of 2016-17 include:

- The SECP facilitated timely completion of the divestment of Pakistan Stock Exchange (PSX) shareholding while ensuring absolute transparency, impartiality and efficiency.
- PSX has signed a share purchase agreement with the Chinese consortium comprising of the China Financial Futures Exchange, Shanghai Stock Exchange and Shenzhen Stock Exchange, along with two Pakistani financial institutions, i.e., Habib Bank Limited and Pak China Investment Company Limited;
- Under the Securities Act, 2015, new licensing and operational regulations were approved for the securities' exchange, Central Depository Company (CDC) and National Clearing Company of Pakistan (NCCPL);
- A new risk-based Know Your Client (KYC) and Customer Due Diligence (CDD) regime was introduced to facilitate small investors whereby documentation and due diligence requirements of customers in capital market were segregated based on their risk profile;
- The CDC has introduced mobile platform (M-Access) available for accessing and managing CDC account;
- The Code of Corporate Governance was amended to ensure verification of compliance with Access to Inside Information Regulations, 2016, through external auditors;
- The Companies (Buy-Back of Shares) Regulations, 2016 and the Credit Rating Companies Regulations, 2016, were notified to regulate the affairs of Credit Rating Companies (CRAs) fairly.

Performance of Pakistan Stock Exchange

The role of capital markets is vital for inclusive growth in terms of wealth distribution and making capital safer for investors. Pakistan's capital market is predominantly comprised of stock market. The Pakistan Stock Exchange market registered an upward growth consolidating at new heights as broad based surge led to MSCI upgrade. In a positive



development, the American stock index firm MSCI included the KSE-100 in its emerging

markets index, which represents 10 per cent of the world's market capitalisation. Average market capitalization of the PSX reached Rs10,016 billion in FY17 (upto May 17, 2017) as compared to Rs7,158 billion in FY16. Pakistan's benchmark equity index, the KSE-100, has beaten major Asian economies this year in stock market performance. In fact, it is the fifth best performing stock index globally. Bloomberg even referred to Pakistan as an "Asian Tiger" in a report.

Pakistan Stock Market has outperformed the leading stock markets of the world during the ongoing financial year. Table-5 presents percentage changes in the leading world stock market indices from end-June 2016 to end-April 2017.

Table-5
Regional comparisons

Index (month end)	30-Jun-16	28-April-17	% Change
KSE-100 Index	37,784	49,301	30.5
US S&P 500	2,099	2,384	13.6
UK FTSE 100	6,504	7,204	10.8
Tokyo NIKKEI 225	15,576	19,197	23.2
Hong Kong (Hang Seng)	20,794	24,615	18.4
China Shanghai Composite	2,930	3,155	7.7
Bombay Sensex	27,000	29,918	10.8

Source: Securities & Exchange Commission of Pakistan

Capital market outlook 2017-18

The SECP's future roadmap comprises of measures headed for capital market development and subsidiary legislation under the Securities Act and Futures Market Act. Following actions are envisioned for the growth and development of the corporate sector and capital market:

- Post-divestment of PSX shares, relevant regulations are being augmented to prescribe framework for self-listing and public offering of PSX shares, in accordance with requirements of demutualization law.
- Centralization of KYC process through the establishment of a central repository of all KYC information for entire capital market will be made. Efforts will be made for the establishment of an independent bond pricing agency to provide fair valuations of debt securities based on comprehensive data collection, validation, pricing, and dissemination to the stakeholders.
- Regulatory framework will be introduced to enable the CDC to offer services as a general/professional clearing member, to facilitate clearing and settlement of trades by trading-only brokers, to help achieve segregation of core brokerage functions. Various rules and regulations will be framed under the Futures Market Act, including regulations for futures brokers, futures exchange and clearinghouse etc. Efforts shall be made to bolster activity and introduce new products for derivatives and Islamic capital market.

- The Company Regulation Offices (CROs) Regulations will be amended to ensure smooth functioning of CROs to reflect present practices/procedures and to meet future requirements will be drafted.
- Framework for registration of consultants/intermediaries providing corporate filing services will be introduced. Facilitation to the public and company representatives will be provided on Saturdays. E-Services will be revamped to make them cost-effective, efficient and user friendly.
- The Modaraba regulatory framework will be amended to implement the original Modaraba concept, resolve the funding issues and introduce the concept of unlisted Modarabas for the growth of the sector. The new Modaraba Act is in the pipeline.
- One hundred per cent off-site review of all NBFCs will be carried out. Performance data of all mutual funds and pension funds will be compiled on a quarterly basis for uploading on the SECP's website. Thematic inspection of mutual fund industry regarding equity trading of funds will be conducted. A performance-based fee model for asset management companies' guidelines for stress testing for income and money market funds will be developed.
- Insurance Bill, 2016 will be finalized. Draft Insurance Rules, 2016 (Merging of Insurance Rules, 2002 and SEC (Insurance) Rules, 2002) will be notified. The Insurance Accounting Regulations, 2016 and the Reinsurance Broker Regulations, 2016, will be prepared. The Regulatory Requirement for Reporting of Family Window Takaful Operations by Life Insurers will be introduced. The Credit & Suretyship (Conduct of Business) Rules, 2016, will be notified.

Annex-1

Consolidated fiscal operations

(Rs billion)

Item	July-March 2016-17	July-March 2015-16	% Change	As % of GDP	
				Jul-Mar 2016-17	Jul-Mar 2015-16
Total revenue	3,145.5	2,961.9	6.2	9.9	10.2
A) Tax revenue	2,694.3	2,481	8.6	8.5	8.5
a) Federal	2,463.8	2,294.3	7.4	7.7	7.9
i) FBR taxes	2,260.5	2,103	7.5	7.1	7.2
- Direct taxes	892.3	794	12.4	2.8	2.7
- Indirect taxes	1,368.2	1,309	4.5	4.3	4.5
Customs duties	343.4	300	14.5	1.1	1
Sales tax	897.7	894	0.4	2.8	3.1
Federal excise duty	127.2	115	10.6	0.4	0.4
ii) Other taxes	203.3	191.3	6.3	0.6	0.7
b) Provincial	230.5	186.7	23.5	0.7	0.6
B) Non-tax revenue	451.2	480.9	-6.2	1.4	1.7
a) Federal	391.9	436.2	-10.2	1.2	1.5
b) Provincial	59.3	44.7	32.6	0.2	0.2
Total expenditure	4,383.6	3,971.3	10.4	13.8	13.6
A) Current expenditure	3,605.1	3,407	5.8	11.3	11.7
a) Federal	2,439.3	2,368.9	3	7.7	8.1
- Markup payments	1,094.5	1,079.4	1.4	3.4	3.7
- Defence	535.7	482.9	10.9	1.7	1.7
b) Provincial	1,165.8	1,038	12.3	3.7	3.6
B) Development exp. & net lending	769.6	710.2	8.4	2.4	2.4
a) Development expenditure	803.9	699.4	14.9	2.5	2.4
i) PSDP	746.6	623.4	19.8	2.3	2.1
- Federal*	324	251.3	28.9	1	0.9
- Provincial	422.7	372.1	13.6	1.3	1.3
ii) Other development expenditure	57.2	76	-24.7	0.2	0.3
b) Net lending	-34.2	10.8	-417	-0.1	0.04
Statistical discrepancy	8.8	-145.8	-	-	-
Fiscal deficit	1,238	1,009.4	22.6	3.9	3.5
Financing	1,238	1,009.4	22.6	3.9	3.5
a) External	220.2	222.9	-1.2	0.7	0.8
b) Domestic	1,017.9	786.5	29.4	3.2	2.7
- Bank borrowing	694.7	538	29.1	2.2	1.8
- Non-bank borrowing	323.2	248.4	30.1	1	0.9
Primary balance	-143.6	70	-	-0.5	0.2
Revenue balance	-459.6	-445.1	-	-1.4	-1.5
GDP (current market prices)	31,862**	29,103			

*Net excluding development grants to provinces (Rs3.212 billion in Jul-Mar FY17; Rs5.638 billion in Jul-Mar FY16)

**Provisional

Source: Finance Division