Prime Plus

A quarterly report published by PRIME that provides in-depth analysis of economic policies and macro-economic indicators with our views on the outlook.

April-June 2022

Policy Research Institute of Market Economy

One of the top 100 think tanks in Asia-Pacific according to the University of Pennsylvania's Think Tank Index

About PRIME: Policy Research Institute of Market Economy is a public policy research and advocacy organization striving for an open, free, and prosperous Pakistan. PRIME was established in Islamabad in 2013 and has played a leading role in advancing ideas and policies for open trade and economic efficiency in Pakistan through its research and public education. PRIME is included in Top 100 think tanks in Asia-Pacific according to the University of Pennsylvania's Think Tank Index.

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Overview of Report

Prime Plus is a quarterly report that aims at analyzing policies by the government or the regulators, and then discussing possible consequences or developments on the economy. The report would hence include federal level economic policies on a range of policies such as taxation, trade, and investment which influence business climate. Businesses can analyze and modify their planning scenarios in the light of government policies, reduce risk and improve their plans for investment and sales targets after reviewing this report.

What this Report is about?

In the first section of the report, the FY 2023 Budget is analyzed from the expenditure and revenue viewpoints. The budget is propagated as contractionary in nature but the expenditures have increased in reality. The government has made changes in the taxation system, introduced new taxes, and increased the rates of previously levied taxes. In the end, a commentary is provided to present facts on the effectiveness of the amendments in the taxation system.

In Section 2 we present Economic data on major macro indicators including Inflation, Current Account, Public Debt, Foreign Direct Investment, Government borrowing, and a general trend of how the economy is behaving, where we reach the conclusion that Pakistan's economy is currently facing insurmountable challenges and not performing at its potential level.

Section 3 summarizes the economic outlook of the country. Pakistan is experiencing severe inflationary pressures due to distortions emanating from the pandemic. The continuity of the war between Russia and Ukraine has significantly deteriorated the recovery from pandemic and posed a serious threat to the sustainability of the countries around the globe. The remarkable increase in the international commodity and petroleum prices and freight costs have pushed inflation to unexpected levels thereby plummeting the purchasing power of the masses. The economic activity, especially the output of the manufacturing sector, will experience a slowdown due to higher costs of inputs. However, proactive measures at the fiscal and monetary policy fronts may help to mitigate the slowdown. Furthermore, reforms are needed in the energy sector to ensure sustainability.

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FEDERAL BUDGET FY 2023

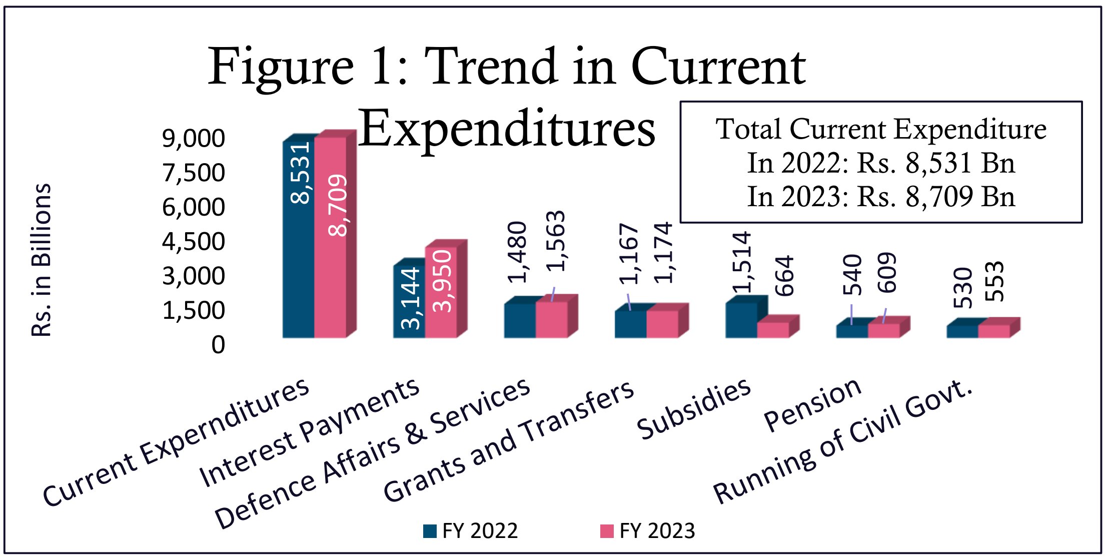
OVERVIEW OF THE BUDGET

Budget FY 2023 has been passed in a very challenging fiscal situation and it may dampen private sector led economic activity.

The priority of the government is to stabilize the economy and control inflation as countries around the world are experiencing unfettered commodity and petroleum prices. The stabilization of the economy is imperative for sustainable growth because country experienced higher than the anticipated fiscal and current account deficits in the last fiscal year. The relief package announced in February deteriorated the sustainability of the economy; contributed to a significant burden on the national exchequer, a rise in fiscal and current account deficits, and currency devaluation. Resultantly, the country struggled to revive the trust and resume the stalled International Monetary Fund (IMF) program while our foreign exchange reserves continue to plummet and instigate uncertainty in the markets. The economic crises is exacerbated by political instability in the country as incumbent coalition government struggles to find ground for much needed tough economic decisions and markets continue to speculate deterioration in economic outlook.

Federal budget FY 2023, though propounded as contractionary in nature, is actually not so constricting as the expenditures continue to rise, surpass the estimated revenues and post deficits.

The total federal government expenditures for FY 2023 increased by 4.9 percent cloaking at Rs. 9.57 trillion compared to Rs. 9.12 trillion in FY2022 where the budgeted amount was Rs. 8.48 trillion. Moreover, the current or non-development expenditures constitute 91 percent of the total budget. In current expenditures, debt servicing remains the biggest component, and comprises 45 percent of current expenditures (Figure 1). The share of Defense expenditure is around 18 percent, Grants and Transfers is 13.4 percent, Subsidies is 7.6 percent, Pension is 7 percent, and Running Civil Government is 6.3 percent.



The budget maintains a significant allocation of funds for subsidies without evaluating its output.

The expenditure in the form of subsidies usually surpass the budgeted amount and contributes to higher fiscal deficit. In FY 2022, the government has allocated Rs. 682 billion for subsidies but actual spending was 122 percent higher amounting to Rs. 1,514 billion. In FY 2023, the government has allocated Rs. 664 billion in terms of subsidies, which is higher than the entire budget for running a civil government. The power sector will receive a major proportion of subsidies amounting to Rs. 535 billion or 80 percent of total subsidies and allocation for the petroleum sector is Rs. 71 billion. The continuity of subsidies without any analysis of the outcome of subsidies poses a serious threat to the fiscal performance and the financial stability of the country.

Amidst rising burden on the lower income groups, the government has allocated Rs. 366 billion for the protection of unprivileged people under the Benazir Income Support Program.

The government has increased the allocation for social protection by Rs. 109 billion from Rs. 256 billion in FY2022 to Rs. 360 billion for FY2023. This is a good initiative on behalf of the government to help the deprived segments of society who are struggling to survive when inflation remains unabated. In June 2022, YoY inflation cloaked at 21.3 percent while MoM inflation stood at 6.3, which are highest in the decades. The food inflation in urban and rural areas were recorded at 24 percent and 27 percent. Therefore, targeted support for the needy people is appreciable.

The government has set an ambitious revenue target to finance the expenditures and budgeted collection of Rs. 7,470 billion as FBR revenues.

The government has set an ambitious target for FY 2023 on the back of remarkable performance in FY 2022 when the FBR collection surpassed the Rs. 6 trillion mark for the first time in the history of the country despite the hurdles prompted by pandemic enforced disruptions. The total revenue target is Rs. 9,579 billion of which FBR tax revenue is Rs. 7,470 billion while non-tax revenue is Rs. 1,935 billion. The share of provinces in divisible pool is around Rs. 4,373 billion; therefore, the federal government will be left with Rs. 5,032 billion to finance the expenditures. Resultantly, the government will have to borrow Rs. 4,450 billion from domestic and external sources.

In terms of tax revenues, the government continues to rely more on indirect taxes compared to direct taxes. The share of direct taxes in total tax revenues is 40.6 percent while the share of indirect taxes is 59.4 percent. Out of the Rs. 3,039 billion direct taxes, Rs. 3,024 billion will be collected in the form of income tax, Rs. 0.5 billion as capital value tax, Rs. 6.9 billion as workers welfare fund and Rs. 7.4 billion as worker's profit participation fund. In budgeted indirect taxes revenues of Rs. 4,431 billion, Rs. 3,076 billion will be collected as sales tax, Rs. 953 billion as customs duties and Rs. 402 billion as federal excise duties.

The government envisages an 18 percent increase in income tax revenues and 23 percent increase in sales tax revenues compared to the last fiscal year. With an expected rise in inflation, there is a possibility of a slowdown in aggregate demand and a subsequent fall in expected sales tax revenues. The tax to GDP ratio proposed in FY 2023 is 9.2 percent, which is a manifestation of a dismal performance of our tax system. The government should strive for bringing more people into the tax net and restrict tax evasion through an overhaul of the country's taxation system.

Government's reliance on customs duties for revenue collection continues to distort the trade and manufacturing activities in the country.

The use of tariffs for revenue purposes affects the performance of local industries. For FY 2023, the government has anticipated a 17 percent growth in revenue collection from tariffs compared to an actual collection in the previous year. The government has rationalized 400 tariff lines related to the manufacturing sector, and extended exemptions on agricultural inputs and machinery. Although tariff rationalization is a good initiative, the country's tariff structure is still complex. Moreover, the government continues to protect domestic industries from international competition thereby eliminating incentives for them to improve, restricting the transfer of knowledge and technology, and enforcing consumers to buy low-quality domestic products at higher prices.

Privatization of loss-making state-owned enterprises is included in the budget with expected revenue of Rs. 96 billion.

Every year government includes the privatization of loss-making enterprises but remains unable to carry them out. Resultantly, the government had to provide funds to bleeding enterprises to keep them afloat. In FY 2022, the government budgeted Rs. 252 billion from privatization but could not privatized even a single entity. In FY 2023, the government has budgeted collection of Rs. 96 billion from privatization. The total loss of SOEs in 2019 was Rs. 143 billion. It is imperative to cut loose loss-making enterprises to ease the burden on the government and put public resources to efficient use.

Collection of Rs. 855 billion as petroleum development levy (PDL) seems difficult in the current environment of high petroleum prices.

The government intended to collect Rs. 610 billion PDL in the FY 2022 but was able to collect only Rs. 135 billion. Currently, a significant jump in the global demand for petroleum products from ease in pandemic enforced restrictions, resumption of economic activities globally and the start of the Russia-Ukraine War have resulted in a tremendous increase in the petroleum prices thereby making it impossible to collect intended revenues. For FY 2023, the government intends to collect a PDL of Rs. 855 billion from oil and PDL of Rs. 8 billion from gas, which will be impossible as it will contribute significantly to already unfettered inflation. The government has also amended the law pertaining to maximum limit of PDL on petroleum products and increased the limit from Rs.30/lit to Rs.50/lit. The government's target is based on the assumption that Russia-Ukraine war will end soon, global supply will increase and petroleum prices will fall.

Coalition government maintained the tradition of presenting deficit budget amounting 4.9 percent of GDP.

Traditionally, the governments are used to set ambitious targets and remained unable to stick to them at the end of the fiscal year. In FY 2022, the federal budget deficit was set to be Rs. 3,990 billion but it turns out to be Rs. 5,309 billion. The overall fiscal deficit was estimated to be 6.3 percent of GDP but it turned out to be 7.0 percent. Similarly, the government budgeted primary deficit of 0.7 percent of GDP but it turns outs to be 2.4 percent. For FY 2023, the government has budgeted overall budget deficit of Rs. 3,797 or 4.9 percent of GDP and primary surplus of Rs. 153 billion or 0.2 percent of GDP. Therefore, it is crucial for the government to achieve the budgeted targets in the short-run and break the tradition of deficits towards balanced budgets in the long-run by reducing expenditures and increasing revenues.

AMENDMENTS IN THE TAXATION SYSTEM

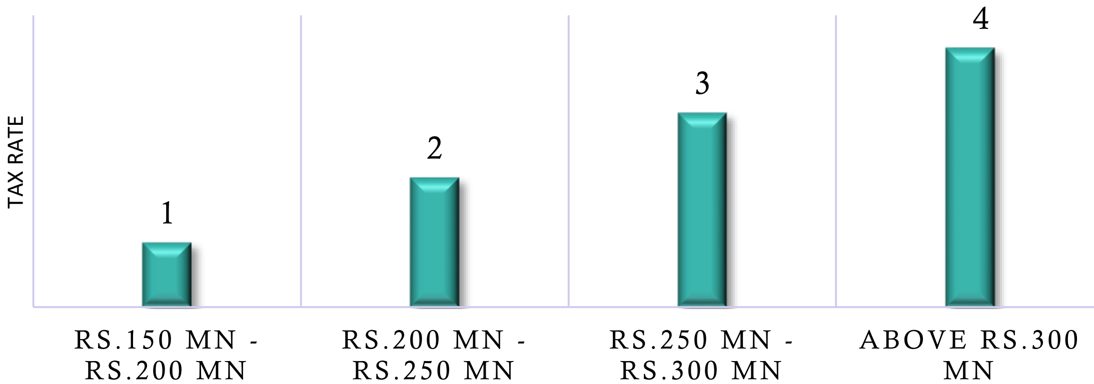
Finance Bill 2022 comprises significant amendments in the taxation system to achieve desired revenue targets and fulfill the conditions put forth by IMF for the revival of program.

The government has carried out changes in the taxation system with regard to income tax, sales tax and customs tax, which was the precondition to revive the IMF program. The passage of Finance Bill by the Parliament has resulted in achieving the staff level agreement.

i. **Super Tax on High Incomes for Poverty Alleviation**

The Finance Act has enacted the super tax on high earning persons from 15 sectors for the tax year 2022 and onwards. The super tax will be imposed over and above the income tax when income exceeds Rs. 150 million. The sectors are airlines, automobiles, beverages, cement, chemicals, cigarette and tobacco, fertilizer, iron and steel, LNG terminal, oil marketing, oil refining, petroleum and gas exploration and production, pharmaceuticals, sugar and textiles. Following slabs are created to calculate the super tax.
However, for tax year 2022, the taxpayers belonging to these 15 sectors will pay super tax of 10 percent in case their income exceeds Rs. 300 million. Moreover, the banking sector is subjected to tax rate of 10 percent for tax year 2023 if their income exceeds Rs. 300 million.

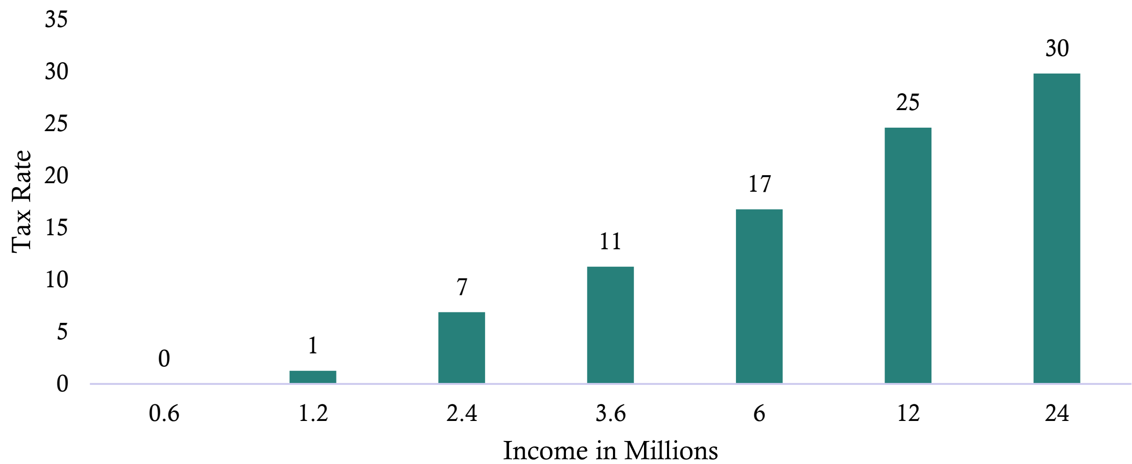
Figure 2: Super Tax Rates On Income



ii. Income Tax for salaried individuals

The Finance Act has revised the tax rates for the salaried individuals. The number of tax slabs have been reduced to 7. Following are the revised tax rates.

Figure 3: Effective Tax Rate on Salaried Income



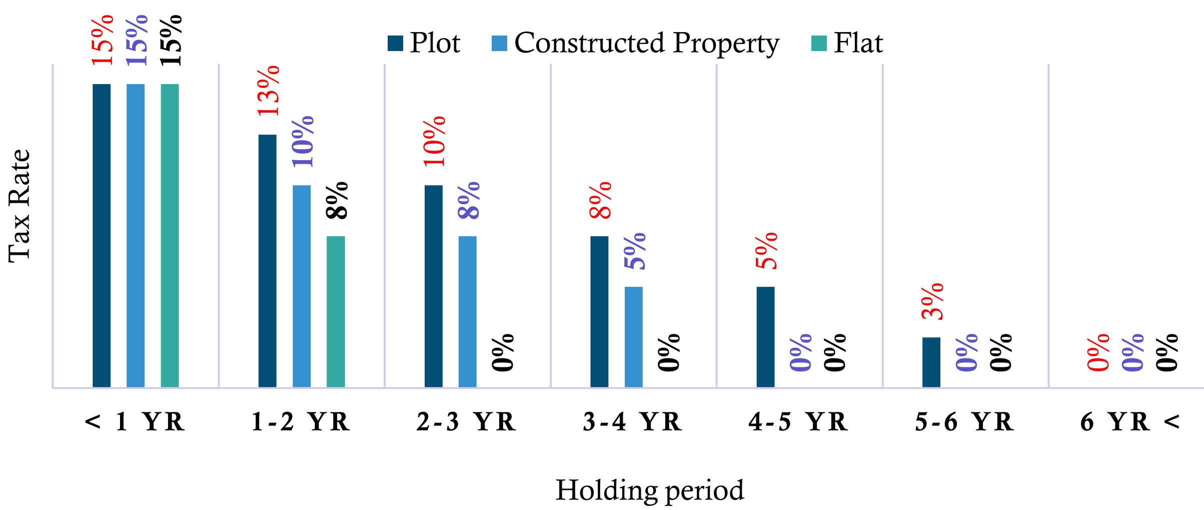
*Note: To find the effective tax rate, the total tax to be paid by an individual is calculated by adding the absolute amount and percentage of marginal income divided by the gross annual income.

The new tax rates have taken away the proposed tax relief to be provided to the individuals belonging to lower income individuals. On the other hand, the tax incidence has been increased considerably for the individuals belonging to higher income groups; whereas, the top marginal income tax is 35%.

iii. Capital Gains on Disposal of Immovable Properties

Previously, the gain on disposal of immovable property was taxed depending upon the holding period. Moreover, no tax is payable when the property is held for more than 4 years. The Finance Act has revamped the capital tax on the disposal of immovable property. The tax-free holding period has been increased from 4 years to 6 years and the applied rates are as follows.

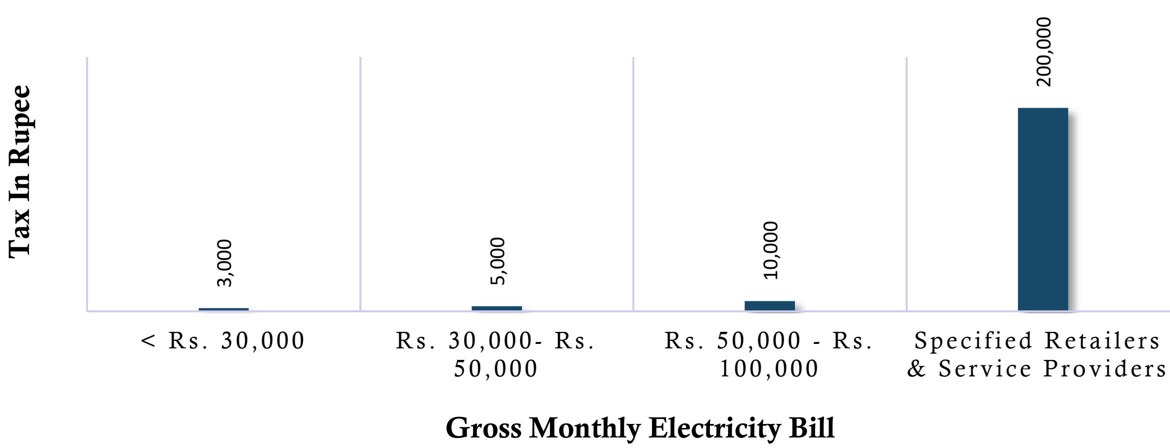
Figure 4: Tax Rate On Disposal Of Property



iv. **Sales Tax Regime for Retailers**

The government has enacted fixed tax for retailers, other than Tier 1, and specified service providers on the basis of gross amount billed for commercial electricity connections. The tax will be collected by power distribution companies through monthly bills in addition to the withholding tax. The tax rates are as follows

Figure 5: Fixed Sales Tax On Retailers



COMMENTARY ON THE AMENDMENTS

The government intended to raise revenues to meet the ambitious target set in the budget. The adoption of a progressive tax system by raising tax rates would not result in the broadening of the tax base. According to Arthur B. Laffer, a renowned supply-side economist and tax expert, taxes act like disincentives. The higher the tax rates, the lower will be the revenue collection and the higher will be the tax evasion. Pakistan's Taxation system continues to remain complex and difficult to administer. The government has levied Super tax along with income tax on the businesses. The imposition of a Super tax on the high-income earners, usually the entrepreneurs, will only discourage the expansion of businesses as high taxes leaves little room to carry out further investments. This will lead to stagnation of businesses. Raising the tax rate on incomes will only promote tax evasion and discourage business expansion.

A significant proportion of domestic investment is being carried out in the real estate sector in general and the purchase of plots in particular. The problem with such kind of investment is that it neither creates employment nor enhances the productive capacity. Rather, it only contributes to a hike in the prices of land. The increase in the holding period of property to make its disposal tax-free will make the investment in the real estate sector less profitable and people will shift towards entrepreneurial activities.

The government has promulgated fixed taxes for retailers and service providers to generate revenues. The underlying reason behind this initiative is the acknowledgment of the fact that government remains unable to bring retailers into the sales tax net. The imposition of fixed tax for specific businesses is actually discriminatory in nature and will create incentives for those retailers to keep themselves out of the sales tax net.

Therefore, the government should have opted for a flat and low-rate broad-based taxation system for broadening the tax base and reducing tax evasion. Such a system creates incentives for the businesses to enter into the tax net instead of bribing the system to avoid taxes.

SECTION 2: ECONOMIC ANALYSIS

ECONOMIC ANALYSIS

The countries around the globe continue to struggle to maintain their finances domestically and externally on the back of disruptions caused by pandemic, significant jump in aggregate demand after relaxation in restrictions, and supply chain bottlenecks. Moreover, the start of the Russia-Ukraine war further exacerbated the crisis resulting in an increase in food and petroleum prices. The underlying reason for such an increase in food prices is that Russia and Ukraine are the major wheat exporters in the world. Also, Russia is a supplier of oil and gas to the European Union and some Asian countries. With the onset of war, the western countries reduced their petroleum imports from Russia and increased their demand from the gulf. Therefore, the petroleum demand from the gulf increased and prices rose.

In Pakistan, the last quarter of FY2022 was more challenging due to political instability emanating from the change in the government. The new coalition government took some time to fully grasp the intensity of existential challenges that required immediate attention. The deterioration in macroeconomic indicators on the external front and pause in the IMF program gave rise to speculations of the country moving towards default like Sri Lanka. However, the reversal of the power and petroleum subsidies given by the previous government, which was also a precondition for the revival of the IMF program, and the transfer of costs to the consumers eased the subsidy pressure on the national exchequer and provided stability to the dwindling foreign exchange reserves. Moreover, the data reported by the National Accounts Committee regarding the GDP growth rate of 5.9 percent in FY 2022 promoted stability and anchored the market expectations.

i- Inflation

On the domestic front, inflation posed the biggest challenge to the government and endangered the survival of the lower-income groups. The rise in prices and drop in purchasing power made it difficult for the masses to maintain their standard of living. In the 4th quarter of FY 2022, the average YoY CPI inflation stood at 16 percent, average YoY SPI inflation stood at 16.6 percent and average YoY WPI inflation stood at 32.2 percent. In FY 2022, the average CPI inflation remained at 12.1 percent, CPI Urban at 11.82 percent and CPI Rural at 12.65 percent. The reason behind unabated price hikes is a significant supply-demand gap, currency devaluation, and a global rise in the prices of food and petroleum products.

ii- Fiscal Sector

The government experienced an increase in expenditures in FY 2022 compared to the budgeted amount; the actual expenditures stood at Rs. 9.12 trillion and the budgeted amount was Rs. 8.48 trillion. The increase came on the back of a significant jump in the subsidies as a result of petroleum and power subsidies given by the previous government in February 2022. The allocated amount of subsidies was Rs. 616 billion and the actual was Rs. 1,449 billion. On the other hand, the government, for the first time in history, crossed the Rs. 6 trillion revenue mark, which helped to curtail the fiscal imbalance. The revenue collection in the last quarter was Rs. 1.733 trillion as compared to Rs. 1,448 trillion in the 3rd quarter of FY 2022. The overall fiscal deficit increased from the budgeted 6.3 percent to 7.1 percent of GDP.

The government borrowed Rs. 1.34 trillion in the first two months of the last quarter of FY 2022 (April and May) as compared to a borrowing of Rs. 871 billion in the 3rd quarter of FY 2022. In April and May, the government borrowed Rs. 592 billion from the State Bank of Pakistan (SBP) and the SBPs total credit to the government stood at Rs. 5.9 trillion till May 2022. The government also borrowed money amounting to Rs. 754 billion from the banks by selling securities and the total banks' investment in the government sector cloaked at Rs. 12.9 trillion till the end of May 2022.

The higher government's borrowing to finance the public expenditures resulted in the accumulation of debt. The public debt (central government debt) accumulated in the first two months of the last quarter of FY 2022 (April and May) was Rs. 1.6 trillion as compared to Rs. 1.4 trillion accumulated in the 3rd quarter. The total public debt stood at Rs. 44.6 trillion where domestic debt is Rs. 29 trillion and external debt is Rs. 15.6 trillion.

iii- Foreign Investment

The foreign investment in Pakistan improved in the last quarter of FY 2022 despite the global uncertainty prompted by the Russia-Ukraine war and the reemergence of infections caused by the pandemic and political instability at home. In April and May, the net FDI to Pakistan stood at $312 million as compared to $170 million in the 3rd quarter of FY 2022. The inflow of FDI was $194.4 million and $167.3 million in April and May while the outflow was $23.8 million and $26.1 million. The 11 months net FDI cloaked at $ 1.53 billion while the inflow of FDI was $ 2.34 billion, which surpassed the usual $2 billion annual FDI trend. Despite the external and internal challenges, FDI inflows to Pakistan remained robust in the FY 2022 due to better management of the pandemic and lesser disruptions compared to other countries.

iv- Credit to Private Sector

The total private sector borrowing increased by Rs. 176 billion in April and May as compared to an increase of Rs. 143 billion in the 3rd quarter of FY 2022. The total private sector financing stood at Rs. 7 trillion till May 2022. The long-term fixed financing (LTFF) increased by Rs. 19 billion in April and May as compared to an increase of Rs. 75 billion in the 3rd quarter of FY 2022. The total LTFF stood at Rs. 613 billion till May 2022. The short-term financing (working capital) increased by Rs. 4 billion in April and May as compared to a contraction of Rs. 52 billion in the 3rd quarter of FY 2022. The total short-term financing stood at Rs. 281 billion till May 2022. The export financing increased by Rs. 27 billion in April and May as compared to an increase Rs. 27 billion in the 3rd quarter of FY 2022. The hike in the policy rate by 250 basis points in April and 150 basis points in May significantly raised the cost of borrowing and resultantly slowed down the borrowing of the private sector.

v- Manufacturing Sector

The performance of large-scale manufacturing (LSM) declined in the last quarter of FY 2022. LSM declined by 13.3 percent in April and 1.3 percent in May as compared to the growth of 18 percent in the 3rd quarter of FY 2022. The decline comes on the back of the emergence of the energy crisis in the country where several hours of power and gas outages were observed in a day. Furthermore, the significant rise in the prices of inputs and hike in the policy rates contributed to a slowdown in manufacturing activities. However, the manufacturing sector showed a robust performance of 11.7 percent in the 11 months of FY 2022. The best performing sectors were wearing apparel, textile pharmaceutical, chemicals, automobiles and furniture.

vi- External Sector

The exports of Pakistan increased by $ 200 million in the 4th quarter to $ 8.4 billion as compared to $ 8.2 billion in the 3rd quarter. The total merchandise exports of the country cloaked at $31.7 billion in FY 2022. The imports showed an increase of $ 2.8 billion in the 4th quarter to $21.1 billion as compared to $ 18.3 billion in the 4th quarter. The total imports of the country cloaked at $ 80 billion in FY 2022. However, the growth in imports outpaced the growth in exports and the total trade deficit stood at $ 48.2 billion in FY 2022, one of the highest in history.

The remittances remained robust and showed an increase of \$1.1 billion to \$ 8.2 billion in the 4th quarter as compared to \$ 7.1 billion in the 3rd quarter. The total inflow of remittance was \$ 31.1 billion in FY 2022. The growth in the remittance helped the government in the management of the balance of payment crisis.

The performance of the country on the external front remained weak as indicators deteriorated and endangered the sustainability of the country. The government was able to slow down the speed of deterioration in the balance of payment crisis in the last quarter of FY 2022 with the current account deficit of \$2 billion in April and May as compared to the \$\$4.1 billion in the 3rd quarter. However, the current account deficit in 11 months of FY 2022 stood at \$15.2 billion.

The increase in the aggregate demand for dollars emanating from higher import payments, debt servicing, and increase in traveling resulted in significant pressure on the foreign exchange reserves of the country. This pressure resulted in a fall of \$1.8 billion in the 4th quarter to \$ 10.2 billion as compared to a \$5.6 billion drop in the 3rd quarter. In the last quarter, the government of Pakistan also received \$2.3 billion from China as safe deposits but at the same time, external payments brought the level to the same position.

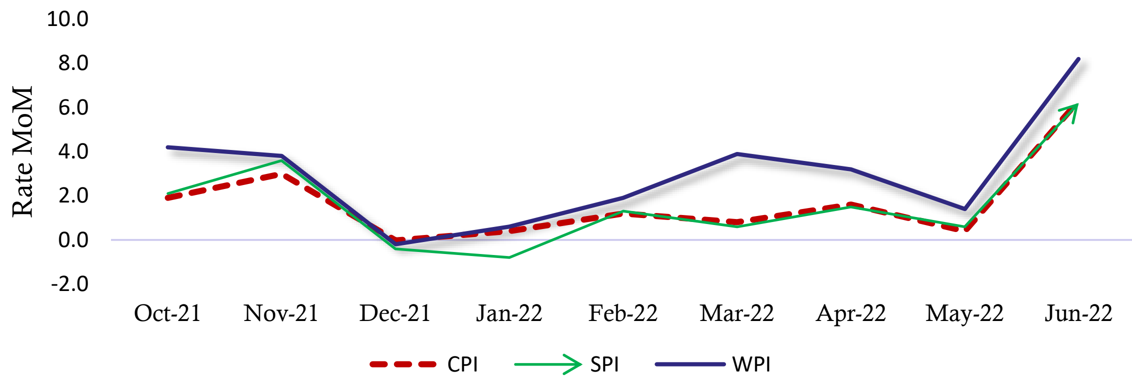
The decline in forex to low levels, which are not sufficient to finance imports for two months, and rising external financial obligations contributed to the depreciation of the local currency. The fall in the exchange rate in the 4th quarter was 14 percent to Rs. 204.9 as compared to the fall of 1.4 percent to 180.1 in the 3rd quarter.

vii- Business Environment

The business environment deteriorated significantly in the 4th quarter of FY 2022 due to a colossal rise in the trade deficit, a drop in the foreign exchange reserves, and a depreciation of the rupee. Furthermore, the inability of the government to resume the IMF program further increased the uncertainty. Resultantly, Moody's, one of the world's top three credit rating agencies, downgraded Pakistan's outlook from stable to negative. The downgrade came due to the amplification of external vulnerabilities due to a rise in inflation, a fall in forex, and intensified political instability. The performance of the stock market is also a spectacle of decline in a business environment. The KSE-100 Index dropped by 3,855 points from 45,152 to 41,297 in the 4th quarter as compared to the gain of 42 points in the 3rd quarter. Therefore, the market capitalization dropped by Rs. 559 billion from Rs. 7.4 trillion at the end of March to Rs. 6.9 trillion at the end of June.

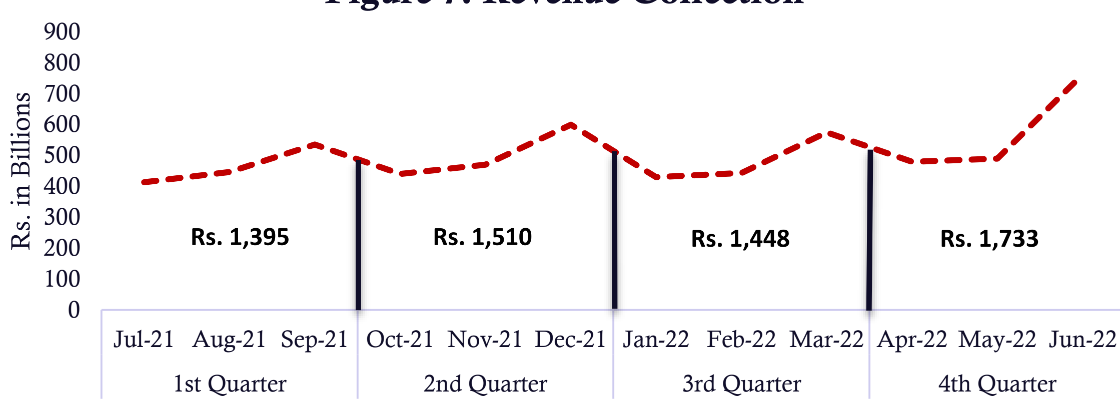
MACROECONOMIC INDICATORS

Figure 6: Inflation



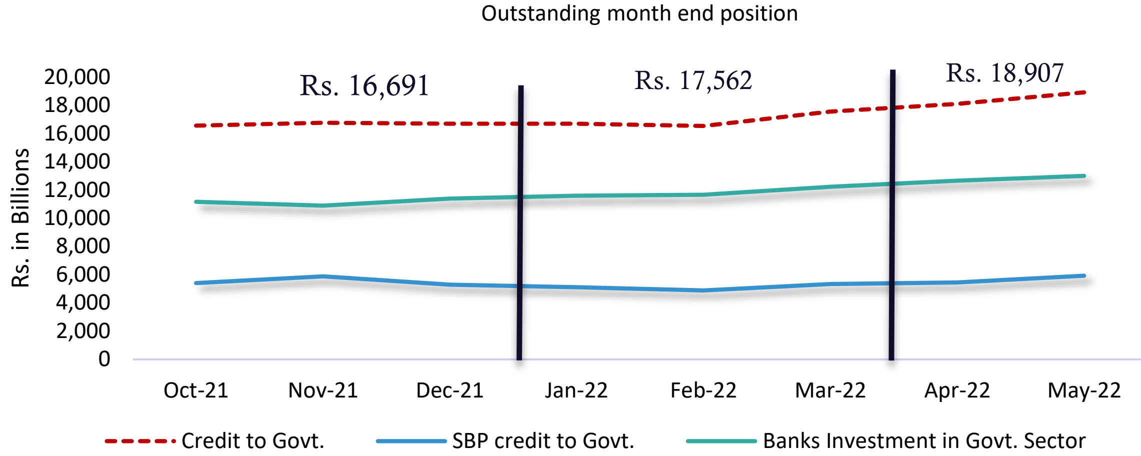
Source: Pakistan Bureau of Statistics

Figure 7: Revenue Collection



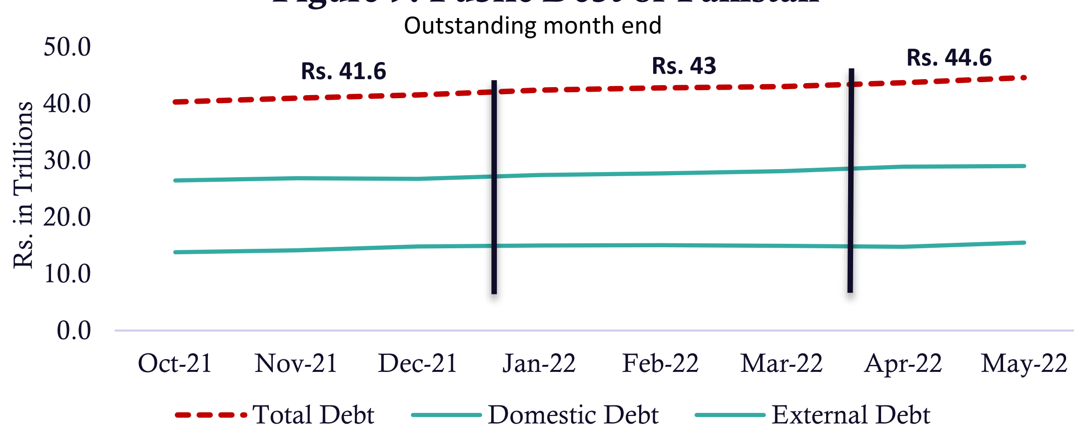
Source: Federal Board of Revenue

Figure 8: Government Domestic Borrowing



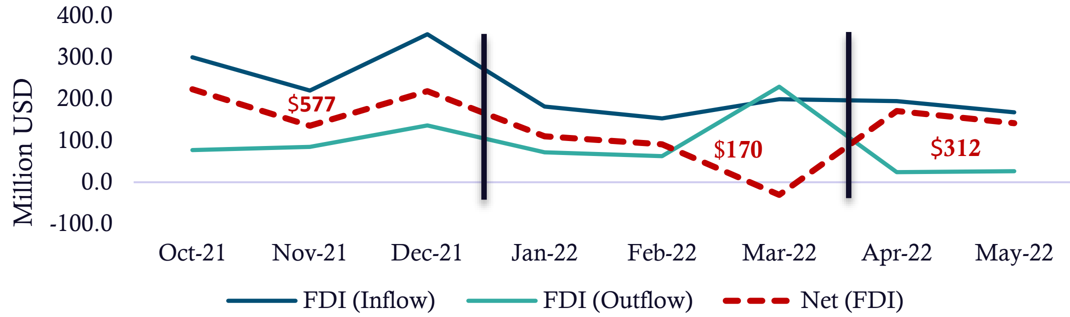
Source: State Bank of Pakistan

Figure 9: Public Debt of Pakistan



Source: State Bank of Pakistan

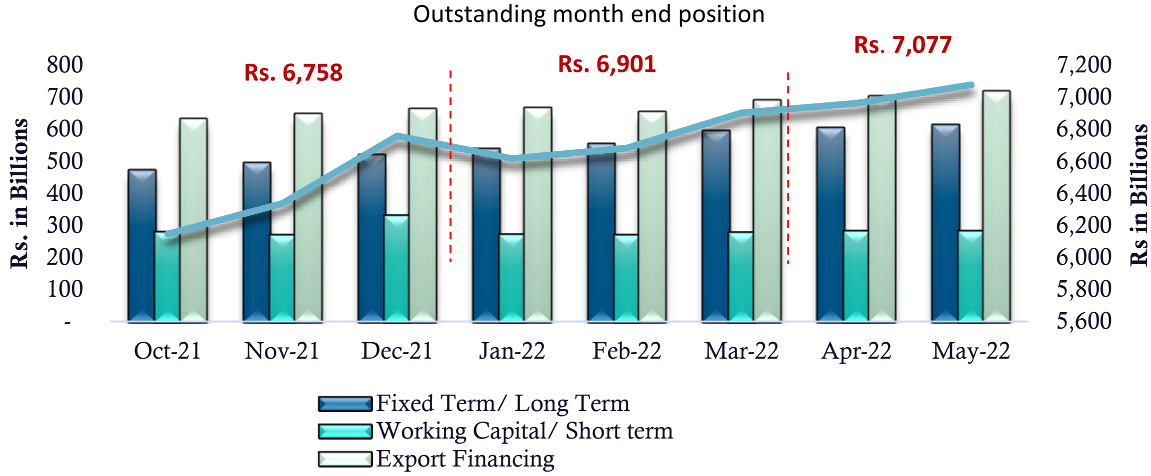
Figure 10: Foreign Investment in Pakistan



Source: State Bank of Pakistan

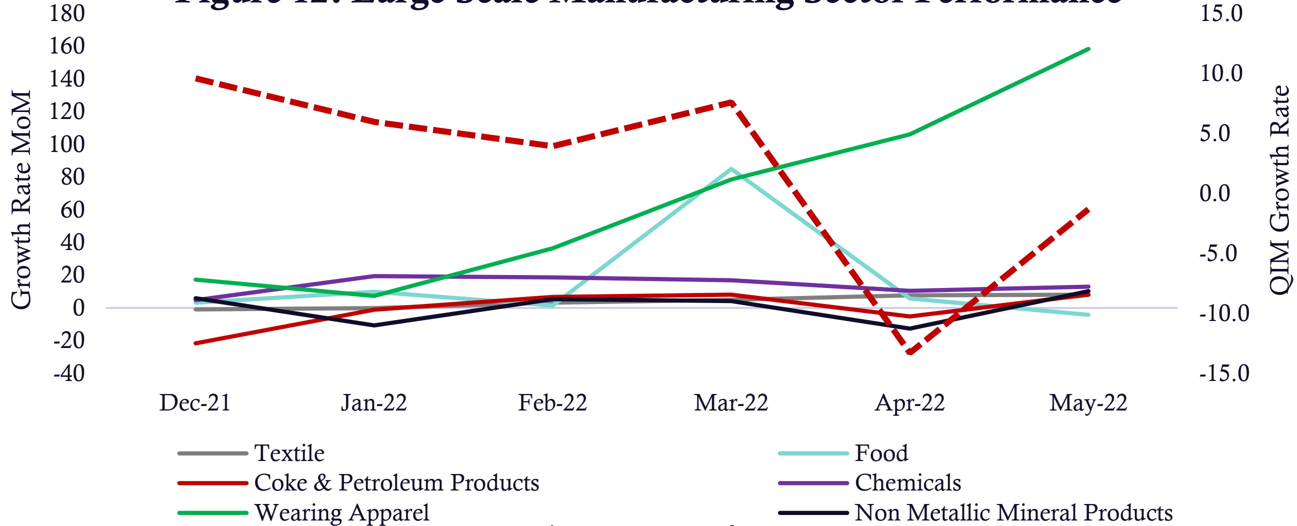
Figure 11: Private Sector Borrowing from Banks

Outstanding month end position



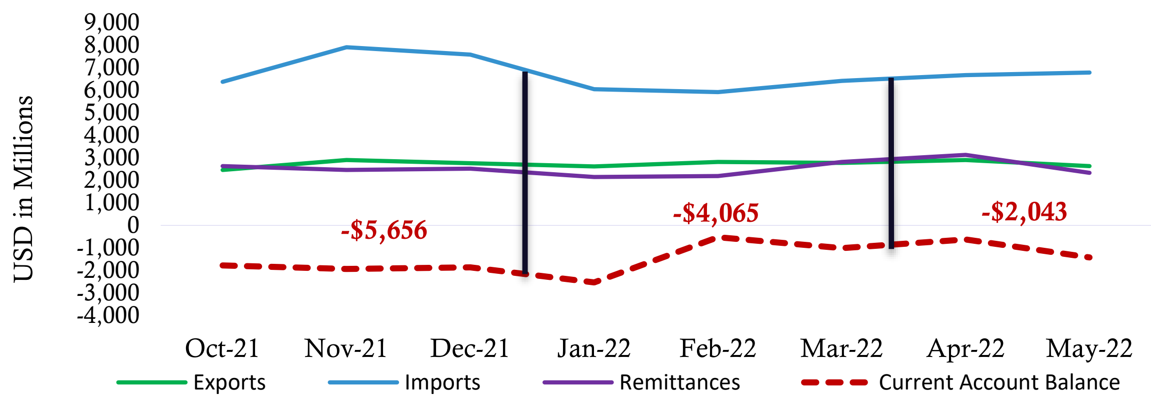
Source: State Bank of Pakistan

Figure 12: Large Scale Manufacturing Sector Performance



Source: Pakistan Bureau of Statistics

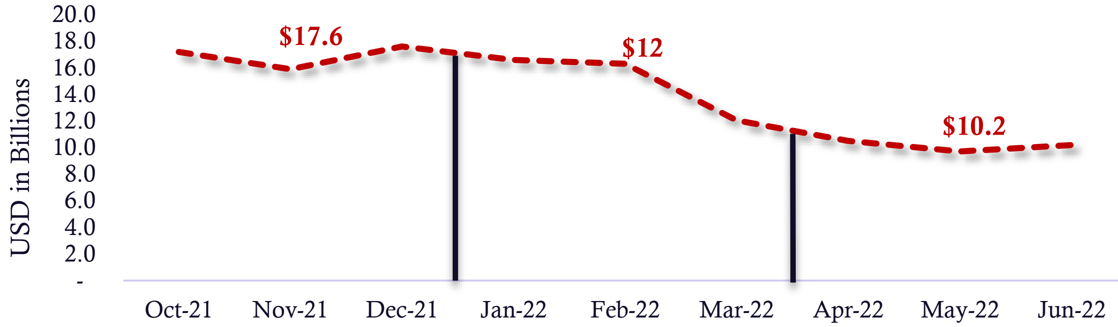
Figure 13: Current Account Balance



Source: Pakistan Bureau of Statistics

Figure 14: Foreign Exchange Reserves of Government

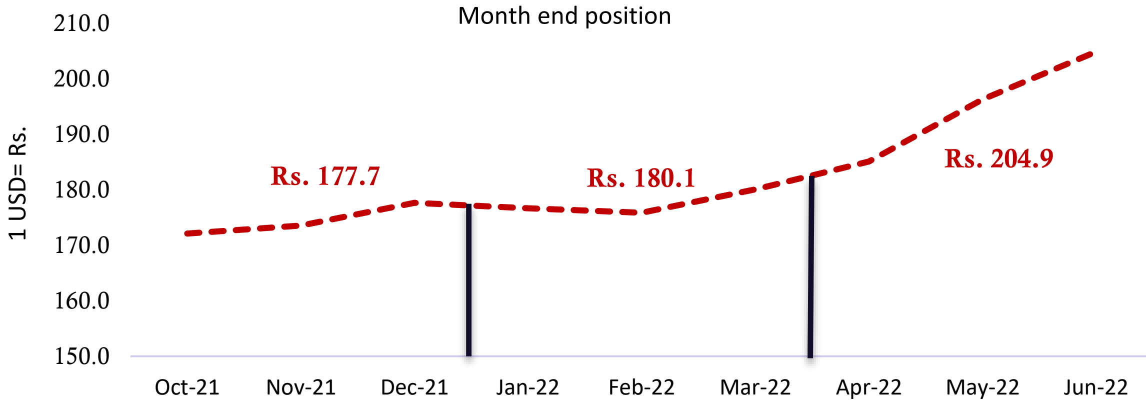
Month end position



Source: State Bank of Pakistan

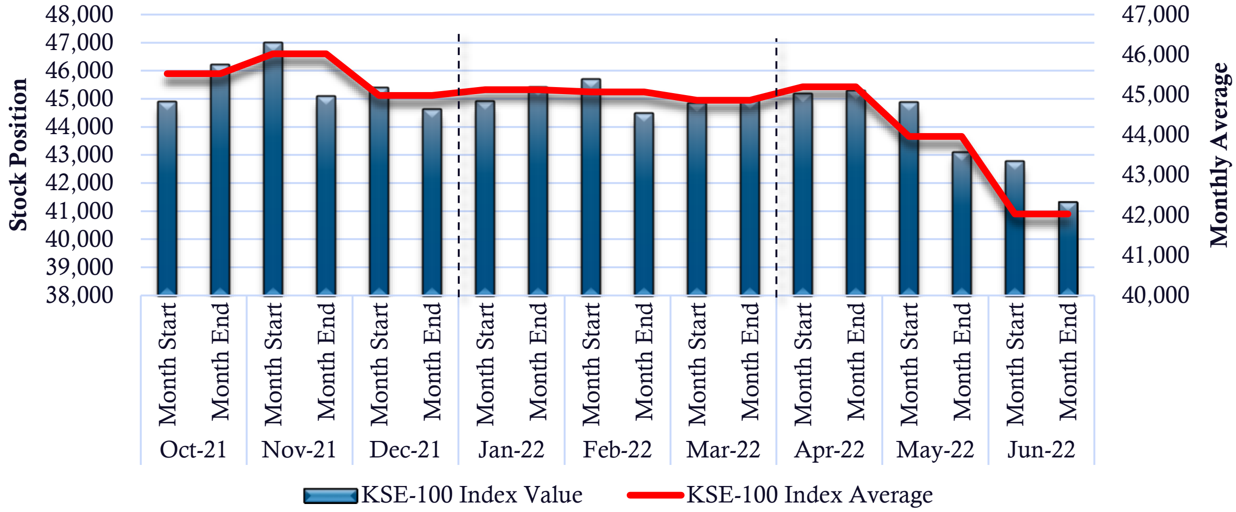
Figure 15: Exchange Rate Trend

Month end position



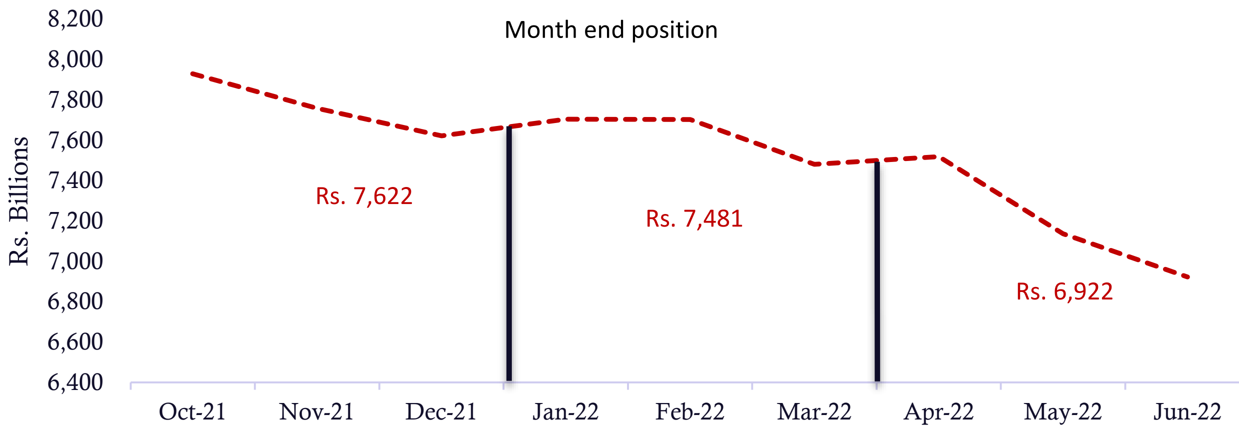
Source: State Bank of Pakistan

Figure 16: Stock Market Performance



Source: State Bank of Pakistan

Figure 17: Market Capitalization in Stock Market



Source: Business News, Dawn

SECTION 3: MACROECONOMIC OUTLOOK

MACROECONOMIC OUTLOOK

The recurrence of COVID 19 infections and intermittent restrictions in the countries worsen the global economic outlook, present barriers to resumption of international trade and hinder business activities. Resultantly, the global supply-demand gap remains unabated. The continuity of the Russia-Ukraine war has contributed to food and energy insecurity throughout the world, which is likely to persist in the coming months.

The political stability and continuity of policies are cardinal for economic prosperity. The current political instability in the country is hurting the economy more than the external shocks. Therefore, it is imperative for the political leadership in the country to create a stable business environment in the country and lay out long-term policies for the investors to plan potential investments.

The developing world, and Pakistan in particular, faces insurmountable challenges in the form of inflation. The masses face a fall in their purchasing powers and struggle to maintain their standards of living. The SBP has projected the inflation to be 18 percent to 20 percent in FY 2023. This calls for a proactive approach from the government on fiscal and monetary policy. Across the board tax cuts and tightening of money supply is a good start in combating double digit inflation.

The shift in the petroleum demand from Russia to the gulf resulted in the inability of the government to timely procure oil and gas to meet domestic needs. Pakistan currently faces an energy crisis because conventional suppliers are reluctant to supply RLNG to the country. Therefore, the crisis is expected to prevail in the short to medium term until the global supply matches the demand.

The higher cost of inputs and supply chain hindrances will contribute to a slowdown in the manufacturing activities as experienced in the last quarter of FY 2022. In addition, the hike in the policy rate will stem the business from expansion as the cost of borrowing is too high.

The rise in borrowing and subsequent increase in the external financial obligations of the country will continue to build pressure on the foreign exchange reserves and currency devaluation. Therefore, it is important for the government to look for a sustainable solution like attracting foreign investment in the country instead of depending on loans and safe deposits.

The SBP has increased the policy rate but the aggregate demand remains unabated and inflation persists. This indicates the limitation of using the interest rate as a tool to curb inflation. Therefore, the government needs to reduce its expenditures and decrease borrowing by selling securities as it not only crowds out the private sector but also increases the money supply in the country, which results in inflation. In our view, the most effective counter-inflation strategy would be simultaneous reduction in government expenditures and money supply and a reduction in the tax rate which will prop up country's productive capacity.

ANNEXURE

Table 1: Super Tax on Income		
Sr. No	**Income**	**Tax Rate**
1	Exceeding Rs. 150 million to Rs. 200 million	1%
2	Exceeding Rs. 200 million to Rs. 250 million	2%
3	Exceeding Rs. 250 million to Rs. 300 million	3%
4	Above Rs. 300 million	4%

Table 2: Income Tax Rate for Salaried People	
Income	**Tax Rate**
Up to Rs. 0.6 million	0%
Rs. 0.6 – 1.2 million	2.5% of amount exceeding Rs. 0.6 million
Rs. 1.2 – 2.4 million	Rs. 15,000 + 12.5% of amount exceeding Rs. 1.2 million
Rs. 2.4 – 3.6 million	Rs. 165,000 + 20% of amount exceeding Rs. 2.4 million
Rs. 3.6 – 6 million	Rs. 405,000 + 25% of amount exceeding Rs. 3.6 million
Rs. 6 – 12 million	Rs. 1,005,000 + 32.5% of amount exceeding Rs. 6 million
Amount exceeding Rs. 12 million	Rs. 2,955,000 + 35% of amount exceeding Rs. 12 million

Table 3: Income Tax Rate for Non-Salaried People	
Income	**Tax Rate**
Up to Rs. 0.6 million	0%
Rs. 0.6 – 0.8 million	5% of amount exceeding Rs. 0.6 million
Rs. 0.8 – 1.2 million	Rs. 10,000 + 12.5% of amount exceeding Rs. 0.8
Rs. 1.2 – 2.4 million	Rs. 60,000 + 17.5% of amount exceeding Rs. 1.2 million
Rs. 2.4 – 3 million	Rs. 270,000 + 22.5% of amount exceeding Rs. 2.4 million
Rs. 3 – 4 million	Rs. 405,000 + 27.5% of amount exceeding Rs. 3 million
Rs. 4 – 6 million	Rs. 680,000 + 32.5% of amount exceeding Rs. 4 million
Amount exceeding Rs. 6 million	Rs. 1,330,000 + 35% of amount exceeding Rs. 6 million

Table 4: Tax Rate on Disposal of Property			
Holding Period	**Rate of Tax**		
	Plot	**Constructed Property**	**Flat**
Where the holding period does not exceed 1 year	15%	15%	15%
Where the holding period exceeds 1 year but does not exceed 2 years	12.5%	10%	7.5%
Where the holding period exceeds 2 years but does not exceed 3 years	10%	7.5%	0
Where the holding period exceeds 3 years but does not exceed 4 years	7.5%	5%	0
Where the holding period exceeds 4 years but does not exceed 5 years	5%	0	0
Where the holding period exceeds 5 years but does not exceed 6 years	2.5%	0	0
Where the holding period exceeds 6 years	0	0	0

Table 5: Sales Tax on Retailers	
Gross Monthly bill	**Tax (Rupees)**
Where the amount does not exceed Rs. 30,000	3,000
Where the amount exceeds Rs. 30,000 but does not exceed Rs. 50,000	5,000
Where the amount exceeds Rs. 50,000 but does not exceed Rs. 100,000	10,000
Specified retailers and service providers through Income Tax General	200,000

Table 6: Current Account Indicators of Pakistan				
Month	**Exports**	**Imports**	**Remittances**	**Current Account Balance**
	Million USD			
Oct-21	2,464	6,369	2,629	-1,779
Nov-21	2,901	7,899	2,460	-1,929
Dec-21	2,764	7,580	2,520	-1,857
Jan-22	2,614	6,036	2,144	-2,531
Feb-22	2,820	5,907	2,190	-519
Mar-22	2,740	6,186	2,810	-1,015
Apr-22	2,897	6,661	3,125	-618
May-22	2,626	6,777	2,333	-1,425
Jun-22	2,887	7,722	2,761	-

Table 7: Foreign Direct Investment in Pakistan			
Month	**Net**	**Inflow**	**Outflow**
	Million USD		
Oct-21	223.0	299.6	76.6
Nov-21	135.7	220.1	84.4
Dec-21	218.7	355.1	136.5
Jan-22	110.0	181.6	71.6
Feb-22	90.8	153.2	62.4
Mar-22	-30.4	199.0	229.4
Apr-22	170.6	194.4	23.8
May-22	141.2	167.3	26.1

Table 8: Inflation			
Month	**CPI**	**SPI**	**WPI**
Oct-21	1.9	2.1	4.2
Nov-21	3	3.6	3.8
Dec-21	-0.02	-0.4	-0.2
Jan-22	0.4	-0.8	0.6
Feb-22	1.2	1.3	1.9
Mar-22	0.8	0.6	3.9
Apr-22	1.6	1.5	3.2
May-22	0.4	0.6	1.4
Jun-22	6.3	6.2	8.2

Table 9: Public Debt of Pakistan			
Month	Public Debt	Domestic Debt	External Debt
	Rs. in Trillions		
Oct-21	40.3	26.5	13.8
Nov-21	41.0	26.8	14.1
Dec-21	41.6	26.7	14.8
Jan-22	42.4	27.4	15.0
Feb-22	42.8	27.7	15.1
Mar-22	43.0	28.1	14.9
Apr-22	43.7	28.9	14.8
May-22	44.6	29.0	15.5

Table 10: Domestic Borrowing of Government			
Month	Total Credit	SBP Credit to Government	Banks Credit to Government
	Rs. in Trillions		
Oct-21	16.5	5.3	11.1
Nov-21	16.7	5.8	10.8
Dec-21	16.6	5.2	11.3
Jan-22	16.7	5.1	11.5
Feb-22	16.5	4.8	11.6
Mar-22	17.5	5.3	12.2
Apr-22	18.1	5.4	12.6
May-22	18.9	5.9	12.9

Table 11: Private Sector Borrowing (Rs. in Billions)				
Month	**Total Loans to Private Sector**	**Fixed Term/ Long Term**	**Working Capital/ Short term**	**Export Financing**
Oct-21	6,145	470	278	632
Nov-21	6,336	493	269	647
Dec-21	6,758	519	329	662
Jan-22	6,615	536	272	664
Feb-22	6,682	552	268	653
Mar-22	6,901	594	277	689
Apr-22	6,961	603	283	700
May-22	7,077	613	281	716

Table 12: Exchange Rate and SBP Reserves		
Month	**Exchange Rate**	**SBP Reserves (USD Billions)**
Oct-21	172.1	17.2
Nov-21	173.6	15.9
Dec-21	177.7	17.6
Jan-22	176.7	16.6
Feb-22	175.9	16.3
Mar-22	180.1	12.0
Apr-22	185.1	10.5
May-22	196.3	9.7
Jun-22	204.9	10.2

Table 13: Large Scale Manufacturing Sector Growth						
Month	**QIM**	**Textile**	**Wearing Apparel**	**Food**	**Chemicals**	**Coke & Petroleum Products**
Dec-21	9.6	-0.9	17.3	3.3	4.8	-21.6
Jan-22	6.0	0.0	7.4	9.9	19.6	-1.0
Feb-22	4.0	3.2	36.6	1.5	18.8	6.8
Mar-22	7.6	5.1	78.6	8.5	17.0	8.1
Apr-22	-13.3	7.7	106.2	5.8	10.5	-5.1
May-22	-1.30	8.2	158.5	-4.1	13.1	8.1

Table 14: Performance of Stock Market				
Month	**KSE-100 Index Status**		**Monthly Average**	**Market Capitalization (Rs. in Billions)**
	Month Start	**Month End**		
Oct-2021	44,872	46,185	45,528	7,931
Nov-2021	46,975	45,072	46,024	7,759
Dec-2021	45,369	44,596	44,983	7,622
Jan-2022	44,887	45,375	45,131	7,705
Feb-2022	45,675	44,461	45,068	7,703
Mar-2022	44,804	44929	44,866	7,481
Apr-22	45,152	45,249	45,200	7,519
May-22	44,841	43,078	43,960	7,136
Jun-22	42,756	41,297	42,026	6,922