



Prime Plus July 2024

A Quarterly Report on Pakistan's
Economy with Special Section on
Annual View of Fedral Budget

Policy Research Institute of Market Economy (PRIME)

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Prime Plus is a quarterly report published by PRIME that provides economic, institutional and policy analysis explaining developments, opportunities, and challenges of Pakistan’s economy.

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Overview

The **first section** of the report analyses the Finance Bill 2024. The Policy Analysis section provides a comprehensive summary of the national budget, highlighting key fiscal priorities and allocations for the fiscal year, with insights into government spending and revenue generation. According to the report, the budget is a missed opportunity to broaden the tax base and the focus remains on generating higher tax revenues by increasing rates on existing taxpayers. Additionally, with the increase in taxes, no special efforts have been made by the government to reduce its expenditures.

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 paints a macroeconomic outlook of the country. Pakistan like other countries around the globe has experienced moderate economic recovery. However, inflationary pressures continue to prevail. Petroleum prices remain elevated, contributing to a slowdown in economic activity. Pakistan's external financial obligations are expected to remain high; even with a slight improvement in reserves, it will be reliant on the IMF, and bilateral and multilateral assistance, which could keep the country vulnerable to external shocks. The economic activity, especially the output of the manufacturing sector, remains subdued due to a hike in energy prices, trade barriers and the high cost of borrowing. Therefore, proactive measures at the fiscal and monetary policy fronts are required along with the easing of trade restrictions to mitigate the slowdown of the economy. Furthermore, reforms are needed in the energy sector to ensure sustainable economic growth.

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Section 1: Policy Analysis

1. Budget Overview:

The federal budget - FY'25 - balancing on the taxpayer's shoulders has continued with the pro-cyclic policy approach. Following the previous federal budgets, some major critical constraints have remained unaddressed, including persistent fiscal and current account deficits, complex business rules and regulations, protectionist trade policies, a narrow tax base and an unsustainable energy sector, leading to stagnant economic growth for ages. To cater for these consistent economic challenges and instead of reducing its expenditures, the federal government has proposed a tax-driven budget, putting a major chunk of tax-burden, to counter the deficits, on salaried and low-income class, while blindly overlooking the agriculturists, retailers, real estate owners, service providers and speculators. The budget made under the constraints put by the IMF bail-out program has once again failed to address the long-term issues associated with the economy and is solely inclined towards achieving sustainability in the short run-through indirect taxation system and fueling its expenditures comprehensively based on taxes.

The budget for FY'25 has a total allocation of Rs.18.877 trillion, with an overall fiscal deficit of Rs.7.283 trillion which is 5.9% of the GDP. This depicts a sharp drop in the deficit from 7.4% of the GDP that is Rs.7.849 trillion as stated in FY24.

2. Federal Expenditures:

The federal expenditures for the FY 2024-25 can be seen showing a sharp increase of 24.5% with a total expense of Rs.18.877 trillion, as compared to last year's revised expenditures of Rs.15.160 trillion, which was only a 4.9% increase from the expenses of FY22 to FY23. The current non-development expenditures comprise 91% of the total expenditures of the economy, that is Rs.17.2 trillion out of 18.877 trillion. On the other hand, the development expenditures are only 9% of the total expenditures with a total value of Rs.1.674 trillion. The debt servicing or interest payments expenditures contribute the highest percentage in the non-development current expenditures with 56.82% which is Rs.9.775 trillion for FY25. The second highest share in the current expenditures of the federal government is of (goes to) the affairs and services related to defense, having a

percentage of 12.33%, while grants & transfers, subsidies, pensions, running civil government and provision for emergency & others exhibit 10.32%, 7.92%, 5.89%, 4.87% and 1.81% respectively.

2.1. Current/Non-development Expenditures:

As stated above, the current expenditures contribute the most to the federal budget FY25 expenditures. Out of these current expenditures, the major contribution is of the '*Interest or Mark-Up Payments*' having a share of 56.3% in the current expenditures and 51.17% in the overall federal expenditures. These interest expenses and high mark-up payments kept the total expenses of February 2024, raising the fiscal deficit to 3% of the GDP, compared to 2.8% of GDP in the budget presented in FY24¹. The second highest expense burdened on the federal government is '*Defense Affairs & Services*'. The expenses related to defense in the budget for FY24, are projected from a revised value of Rs.1.854 trillion to a budgeted value of Rs.2.122 trillion showing an increase of 14.4% and raising the current expenditures to Rs.14.2 trillion from Rs.17.2 trillion, ultimately raising the fiscal deficit. The rise in defense expenditures has contributed to a higher-than-budgeted budget deficit. However, in the budget for FY25, the percentage share of the defense affairs and services has remained almost consistent in the budget expenditures of FY24 (revised) and FY25 with contributions of 12.6% and 12.3%. The expenses of the federal government covered under the head of '*Grants & Transfers*' shows an increase of 21.4% from Rs.1.4 trillion in FY24 to Rs.1.7 trillion in FY25. A 27% increase in the grant allocated for the Benazir Income Support Programme (BISP) has been noted in FY25's budget.

A third major portion of the current fiscal government expenditures goes to the subsidies head. Following the trend set in the previous budgets, more amounts have been allocated to provide subsidies to various sectors as compared to running the whole civil government. Below is a detailed analysis of the distribution of the amount allocated to the subsidies.

¹ <https://www.brecorder.com/news/40301223>

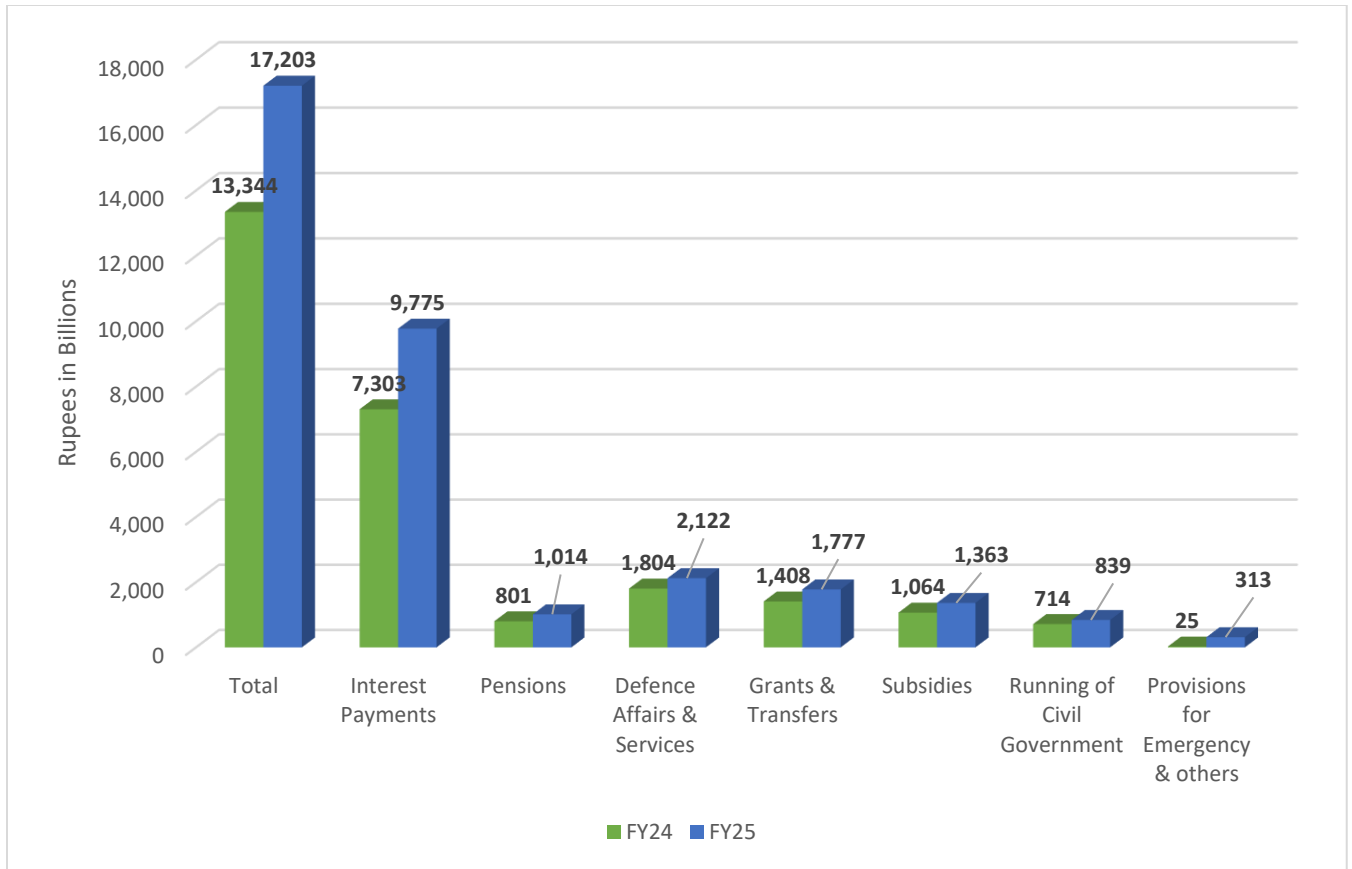


Figure 1: Current Expenditure Comparison

Below is a detailed analysis of the distribution of the amount allocated to the subsidies.

a. Subsidies:

i. Subsidies to Power Sector:

The fourth head is the ‘*Subsidies*’ provided by the federal government to various sectors. In FY24, the amount allocated by government to subsidies head was increased from Rs.1.06 trillion to Rs.1.07 trillion, creating more pressure on the fiscal deficit. The share of subsidies in the expenditures has been increased by 27% as compared to the last year’s budget. The federal government allocates subsidies in five major sub-heads including subsidy provided to power sector (WAPDA/PEPCO/KESC), Petroleum, Food, Industries and Production and Others. In the FY25, following the trend as seen in previous year, a significant amount of Rs.1.19 trillion, which is

almost 87.5% of the total amount allocated to the subsidies head, has been granted to power sector. However, in contrast to the previous allocations to the subsidies head, the government in FY25 has decided to earmark Rs.276 billion as compared to Rs.150 billion in FY24 (revised amount) to the subsidies provided to inter-DISCO and has constricted the subsidies for K-Electric Tariff Differential from the revised amount of Rs.228 billion in FY24 to Rs.174 billion in FY25. Considering the subsidies meant for the merged the districts of KP and FATA, Rs.65 billion has been designated in the FY25 by the government while the amount for this expense was revised from Rs.25 billion to Rs.39 billion in the FY24. A 66% increase in this specific subsidy has been granted by the government. An additional amount of Rs.86 billion has also been allocated for FATA Subsidy Arrears in the head of Power-Sector Subsidy Lump-Sum Provision, with a total allocation of Rs.509 billion. However, the government has also defined an additional subsidy of RS.86 billion this year with no specific details for the allocation. However, despite having all these allocations the government has given a major portion of the subsidies to the power sector, the authorities are facing serious issues in meeting the power demand of the country and causing a progressive increase in the power sector circular debt of the country, which has already surpassed Rs2.63 trillion in the first seven months of the FY24².

ii. Subsidies to the Petroleum Sector:

Furthermore, a sharp decline in the subsidies to the petroleum sector can be seen in FY25 from a value of Rs.50 billion (revised amount) in FY24 to Rs.18 billion, showing a firm pledge of the government to the IMF conditions of no fuel subsidy. A very small portion of the subsidies amounting to Rs.12 billion have also been provided to Pakistan Agricultural Storage & Services Corporation Ltd (PASSCO) for wheat reserve stock and cost differential for the sale of wheat. In addition to this, the government has decided to cut the burden of Industrial Subsidies by 91%, to increase the burden on consumers using over 400 units by 41% amounting to Rs.22 billion, that is from Rs.25 billion to Rs.3 billion only in FY24 and FY25 respectively. To balance this, the utility store corporation subsidies have been increased from Rs.35 billion to Rs.65 billion. The other subsidies include Mera Pakistan Mera Ghar Scheme, Wheat Subsidy to Gilgit Baltistan, Markup

² <https://www.dawn.com/news/1834574>

subsidy to Support Phasing out of SBPs Refinancing Facilities and several other heads with an amount of Rupees 21, 15, 13 and 10 billion respectively.

b. Pensions:

In the budget for FY25 government has allocated Rs.1.01 trillion for the pensions of civil and military servants. Military servants, acquiring the major portion of the pension funds are causing a huge burden on the civil government, although a separate head has also been dedicated for the defense affairs and services. A new head 'Pension Increase' has also been created this year to cater for the expenses of increased pensions, but the government needs to reconsider this approach, as there is already a defined head for the pensions. The government needs to work on pension scheme as there is a need of a dedicated pension fund strategy. Instead of making it an expense of the federal government, it should be made source of investment.

The government has also allocated Rs.313 billion in FY25 for the provisions of emergency and others, as compared to Rs.250 billion in FY24. An upsurge in the expense portion granted to Environmental Protection, Housing and Community Amenities and Social Protection has been seen in the current year's budget. Although in FY24, the portion dedicated to Housing and Community Amenities was constricted from Rs.22.9 billion to Rs.6.4 billion and now in the current budget for FY25, it has again been raised to Rs.27.9 billion.

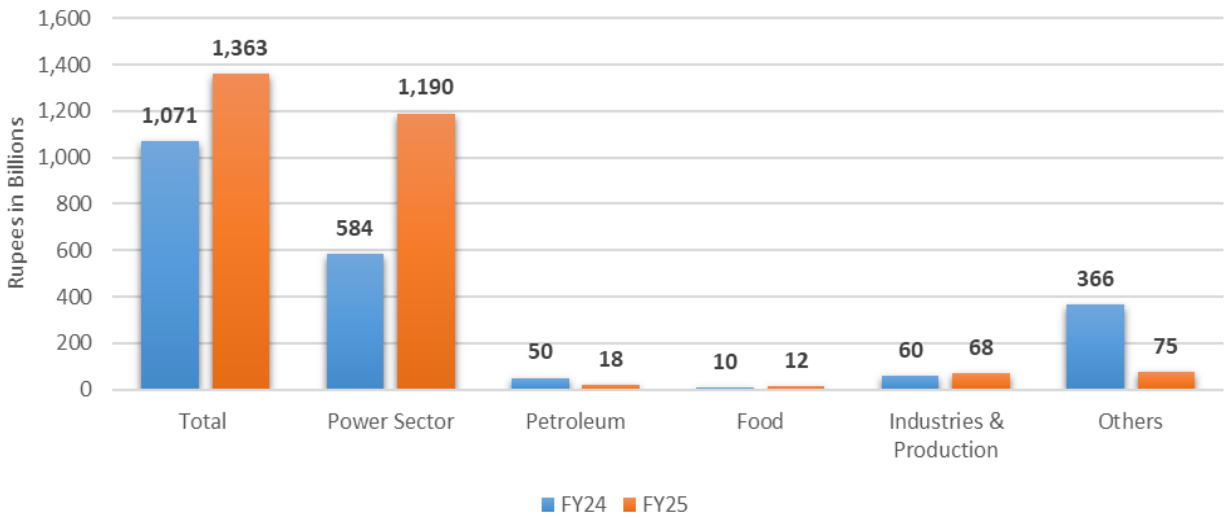


Figure 2: Comparison of Subsidies Allocation

2.2. Revenues:

i. Resources:

The government has set a revenue collection target of Rs.12.9 trillion in the FY25 budget, as collected by FBR, as compared to the revised amount of Rs.9.2 trillion in FY24, almost a 40% increase compared to the previous year. The increase in the federal tax revenue collection has been planned with a strategy of significant increase in both direct and indirect taxes. The direct taxes have been increased by 48% and indirect taxes by 34%. The indirect taxes can be seen, as contributing more, as compared to the direct taxes with an expected value of Rs.7.4 trillion as compared to the Rs.5.5 trillion. In order to increase tax revenue collection, three ways have been adopted by the government: withdrawal of tax exemptions, higher corporate taxes for exporters and an upsurge in the personal income tax.

Pakistan’s taxation structure favors regressive indirect taxes, with a share of 57% in total taxes. Contrary to this, 47% of tax revenue has been estimated and planned to be collected through direct taxation.

A significant amount of Direct tax revenues will be collected by the government through personal and corporate income tax, comprising 98% contribution in Direct taxes and 42% in overall taxation for the FY25. However, Rs.5.4 trillion has been estimated to be collected this year, through income tax under direct taxation, showing an increase of 50%. As for Indirect taxes, in FY25, Sales tax contributes 66% to the indirect tax collection and a significant proportion of 37% in overall taxes. According to the budgeted value, an increase of 36% in sales tax collection has been observed as compared to the previous year. Additionally, the government aims to collect more revenues from customs duties and Federal Excise Duty, with an increase of 15% and 58% respectively.

It is important to note here that the Sales tax and Income tax collectively contribute 79% of the total tax revenue collection, depicting a huge burden on the salaried and low-income class, having to pay multiple taxes including on their income and purchases as well.

If we break down the distribution of revenue collection, out of the gross revenue collection target of Rs.17.8 trillion, Rs.12.9 trillion has to be collected by FBR which is 72% of the total revenue target and the remaining 28% has been allocated to non-tax revenue targets. The share of provinces that is the divisible pool target for FY25 is Rs.7.4 trillion. After transferring the specified amount to the divisible pool target for the provinces, the federal government will be left with only Rs.10.3 trillion to meet its expenses. Ultimately, resulting in a federal deficit of Rs.8.5 trillion, that is 5.9% of GDP. The fiscal gap of expenditures will be covered through domestic and foreign borrowings.

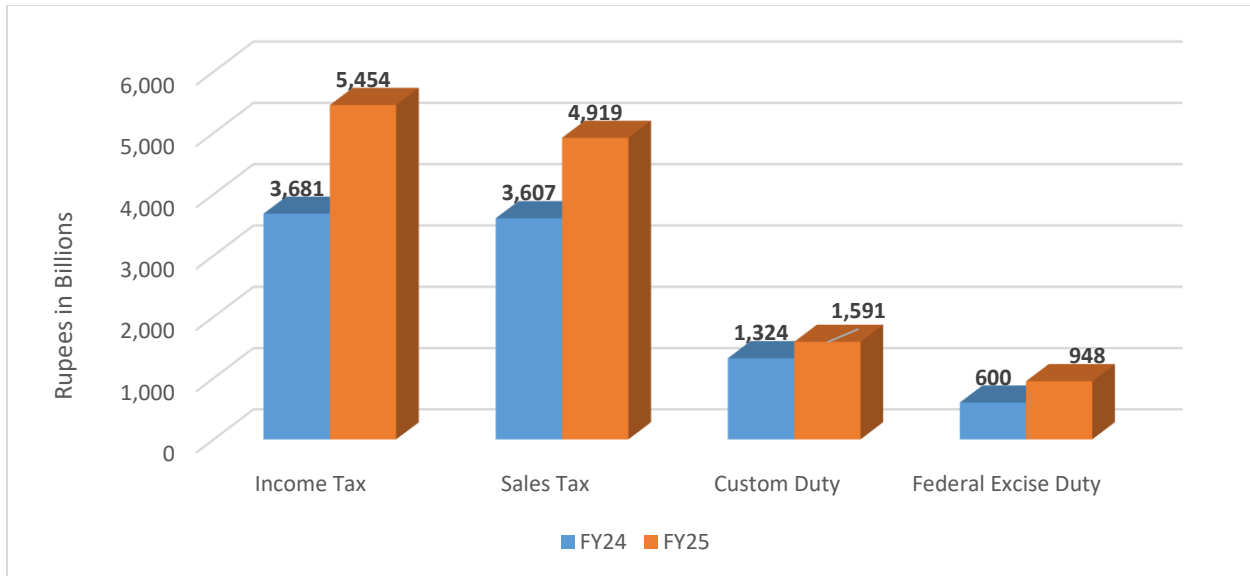


Figure 3: Comparison of Income Tax, Sales Tax, Custom Duty and Federal Excise Duty

ii. Privatization Proceeds:

In the budget for FY25, the government aims to collect Rs.30 billion from the privatization proceeds. A 100% increase in the revenue generated through the sale of loss-making entities can be seen, as compared to the FY24 where the proceeds to be collected were only Rs.15 billion. However, to achieve fiscal discipline and stabilize the economy, the government is still struggling to privatize its assets. Although, some progress has been made, but no success in privatizing any state-owned enterprise has been seen yet. In FY23 the loss-making SOEs reported an aggregate loss of Rs.905 billion, showing a 23% increase in loss as compared to the last year. The government needs to include intra-firm planning by streamlining procedures and strategic approaches, to reduce the losses and achieve successful privatization.

Additionally, some major increases have also been noticed in the collection of non-tax revenue receipts. A significant portion of this revenue comes from the SBP Profit. In FY25, the government aims to collect Rs.2.5 trillion. In FY24, the projected non-tax revenue collection from the SBP profits was Rs.1.1 trillion; however, the government was only able to collect Rs.972 billion.

iii. PDL on Petroleum

Another important source of this revenue is the Petroleum Development Levy (PDL). In FY24 the revenue collection from this head exceeded the projected target of Rs.869 billion and the government managed to collect Rs.960 billion, which is 10% more than the target. This year with the estimated goal of collecting Rs.1.2 trillion, the government has maximized the PDL limit from Rs.60 to Rs.70 per liter, which is a 16% increase.

The government needs to consider the aspect that, the increased percentage of indirect taxes, for revenue generation and meeting the deficit, can potentially lead to cost-push inflation, increased business costs and reduction in purchasing power, resulting in economic and social disparities.

iv. Change in Deficits:

In FY24 the overall fiscal deficit was initially projected to be Rs.6.9 trillion, which was then increased to Rs.7.8 trillion, a 13% increase from the projected target. The fiscal deficit in FY24 as related to the percentage of GDP increased to 7.4% from the projected 6.5%. Contrary to this, the FY25 estimates a deficit of Rs.7.2 trillion which is 5.9% of the GDP. To withstand this deficit, the government has a documented primary surplus of Rs.2.4 trillion, which is 2.0% of GDP as compared to only Rs.402 billion in FY24, which is 0.4% of GDP. However, there is a dire need to establish a robust and sustainable economic governance system to deal with this financial challenge, instead of just relying exclusively on external debt.

3. Amendments in the Taxation System

With the main aim of dealing with the country's historical fiscal deficit, and economic challenges and boosting revenues, the government of Pakistan, in its FY25, came up with new taxes and several amendments in the taxation system. Some of the significant changes proposed in the Budget for FY25 are listed below:

a. Changes in Income Tax:

With a significant increase in the income tax rates, a huge burden has been thrown on the shoulders of salaried and non-salaried individuals and AOPs. The Personal Income Tax for non-salaried individuals and AOPs have been increased from 35% to 45%. For salaried individuals, the maximum tax rate remains at 35%. However, the incremental rates have been increased across

different income slabs. For example, salaries up to Rs. 600,000 are exempted from tax. Individuals earning between Rs. 600,001 to Rs. 1,200,000 will now have to pay 5% of the amount exceeding Rs. 600,000, an increase of 100% from 2.5% exceeding 600,000 from the previous year. Those earning Rs. 1,200,001 to Rs. 2,200,000 will now have to pay Rs. 30,000 + 15% of the amount exceeding Rs. 1,200,000, as compared to Rs. 15,000 + 12.5% of the amount exceeding 1200,000 of FY24 and so on.

For the FY25, the government has changed the limits of the tax slabs. All the tax slabs except the first one has been revised. The upper limit of the slab Rs.1200,000 to Rs.2400,000 has been reduced to Rs. 2,200,000. Similarly, the third slab has been revised from Rs.2400,000 - Rs.3600,000 to Rs. 2,200,000 - 3,200,000 and so on. Additionally, Super Tax has been retained. However, high-income non-salaried individuals and AOPs face an effective rate of up to 45% with additional 4% Super Tax.

The percentage increase in the respective tax slabs for FY25 can be seen in the graph below. Also, tax rates for FY25 have been compared with FY24 in the graphs below for salaried and non-salaried individuals.

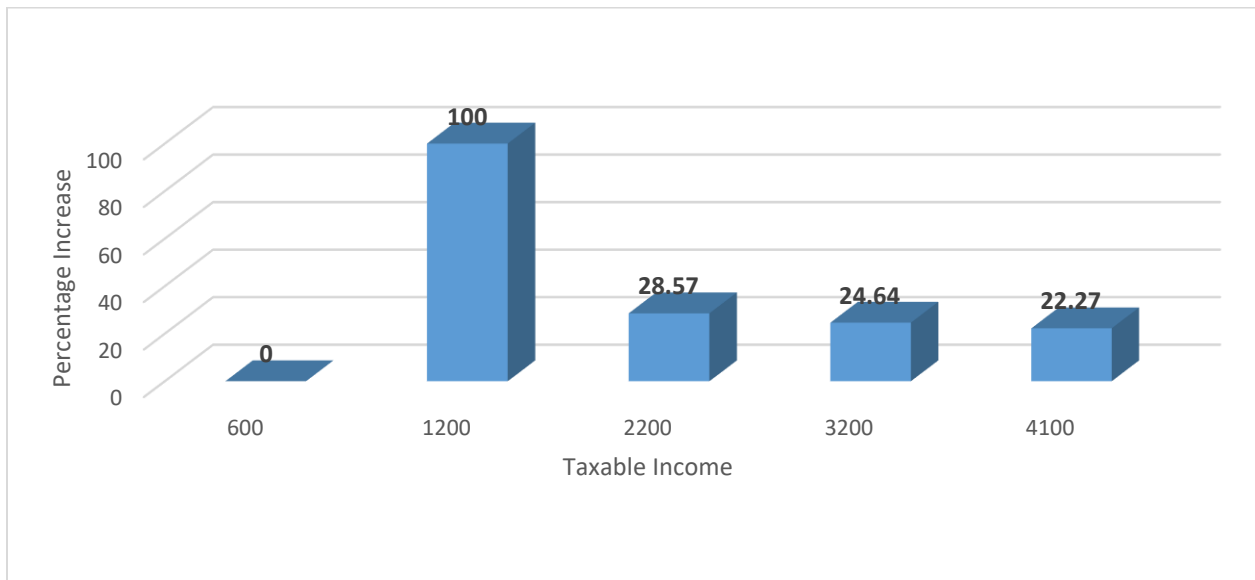


Figure 4: Percentage Increase in Tax Slabs of Salaried Class

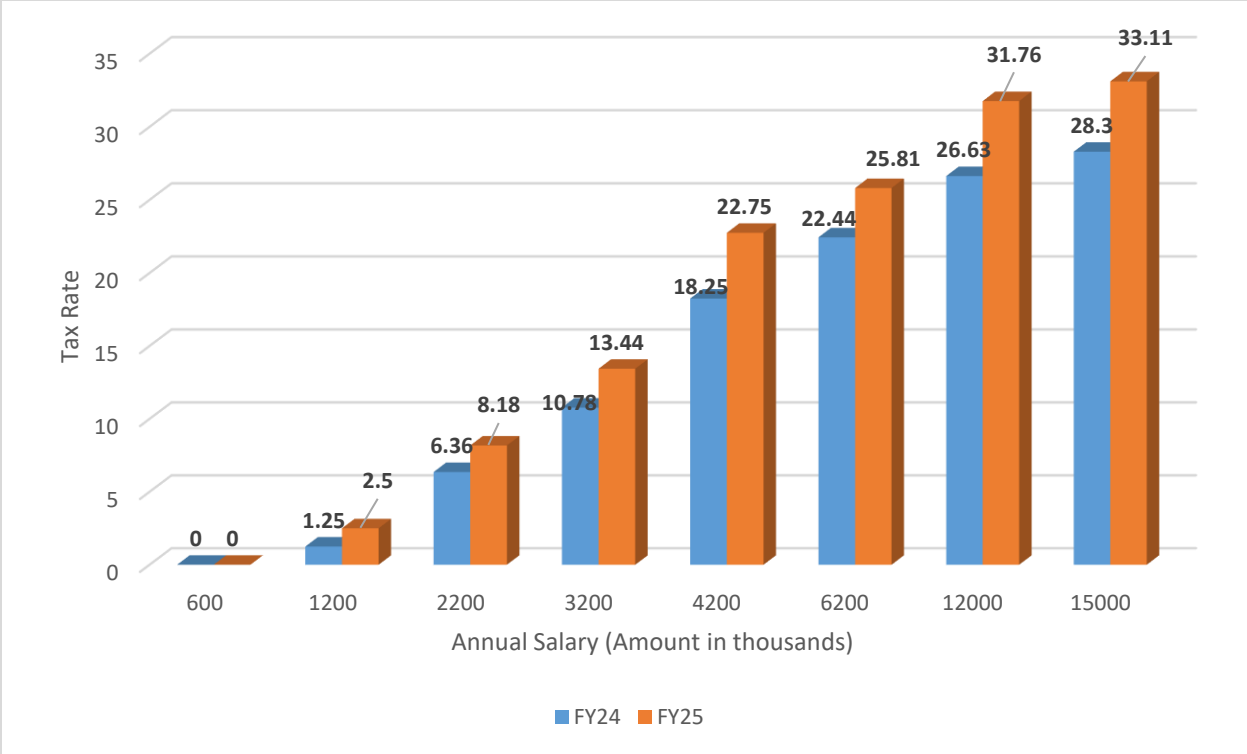


Figure 5: Tax Rates on Salaried Class

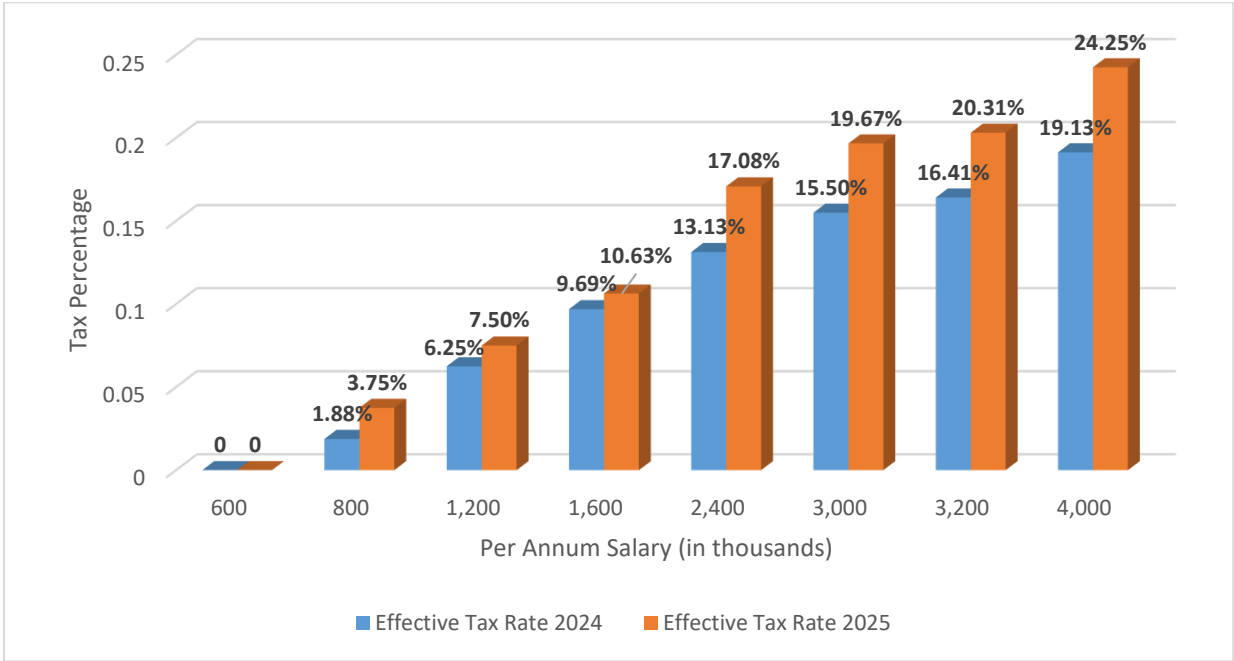


Figure 6: Tax Rates on Non-Salaried Class

b. Changes in Sales Tax:

In the budget for FY25, the overall Sales Tax revenue has been increased by 36%. However, the government has planned to withdraw exemptions from various sectors including Edible Vegetables and Fruits from Afghanistan, Medical and Diagnostic Kits/Equipment, Supplies to Charitable Hospitals, Imports by Non-profit Institutions and Stationary Items.

i. Tax on Hybrid Vehicles:

Initially, the government decided to exclude hybrid vehicles from the reduced tax regime but later on, the federal government decided to continue with the reduced tax rates for hybrid vehicles until June 30, 2026. Vehicles with engine capacities up to 1800cc and between 1801-2500cc will be taxed at 8.5% and 12.75%, respectively.³

ii. Extension of Sales Tax Benefits to FATA and PATA:

The federal government has decided to extend the sales tax benefits for the Federally Administered Tribal Areas (FATA) and the Provincially Administered Tribal Areas (PATA), until June 30, 2025⁴.

iii. Corporate Tax on Exporters:

The standard corporate income tax rate in Pakistan is 29 per cent. However, a super tax applies to high-earning individuals at varying rates based on income levels, ranging from 1 per cent to 10 per cent.⁵

c. Federal Excise Duty:

Following the FBR forecasts, that excise revenue measures will generate an additional Rs70 billion in taxes, the government has imposed FED on acetate, nicotine pouches and e-liquids.

- It has also proposed imposing an FED of Rs.15 per kg on sugar supplied to manufacturers.

³ pwc, Amendments Enacted by Finance Act, 2024 Vis-À-Vis Those Proposed in Finance Bill, 2024

⁴ <https://mettisglobal.news/fata-pata-tax-exemptions-extended-for-another-year/>

⁵ <https://www.ibanet.org/document?id=Taxes-country-report-Pakistan>

- The FED rate on cement has been increased from Rs2 to Rs3 per kg, which is a 50% increase.
- Similarly, a 5% FED has been imposed on commercial properties and the first sale of residential properties.
- Additionally, the price threshold for locally manufactured cigarettes increased from Rs 9,000 to Rs 12,500.
 - *High-Priced Cigarettes:* For locally produced cigarettes with an on-pack printed retail price exceeding Rs12,500 per 1,000 cigarettes, the rate of duty will be Rs16,500 per 1,000 cigarettes. This is an increase from the previous threshold of Rs9,000 per 1,000 cigarettes.
 - *Low-Priced Cigarettes:* For locally produced cigarettes with an on-pack printed retail price not exceeding Rs12,500 per 1,000 cigarettes, the rate of duty will be Rs5,050 per 1,000 cigarettes. Previously, this applied to cigarettes priced up to Rs9,000 per 1,000 cigarettes⁶.

d. Custom Duty:

An additional customs duty has been imposed by the government on 1600 tariff lines, to collect Rs.40 billion from the customs collection.

- Concessions offered on import of hybrid cars have been withdrawn.
- Duty on import of raw materials and semi-finished products has been imposed to protect local industries.
- The customs duty exemption has also been withdrawn on the import of fresh and dry fruits.
- Similarly, there has been a reduction in the concession on customs duties on the import of electric vehicles having a value above \$50,000.
- Moreover, the government has offered a host of incentives for those manufacturing solar panels and allied equipment.

e. Capital Gains on Properties & Securities:

- For properties acquired on or after July 1, 2024, the rates are 15% for filers and 15-45% for non-filers.

⁶ https://www.pwc.com.pk/en/tax-memorandum/AFFs_Tax_Memorandum_on_Federal_FinanceBill_2024.pdf

- For securities acquired on or after July 1, 2024, the tax rate will be flat 15% for filers, and non-filers will be taxed at normal rates with a minimum of 15% and a maximum of 45%.

4. Commentary on the Amendments

The budget for FY25 exhibits a significant challenge of generating higher revenues. The rising expenses of the government include increased salaries, debt servicing, pensions, bonuses, defence services and military expenses. However, the focus of the current budget remains on generating higher tax revenues by increasing the rates on the existing taxpayers. Moreover, the current budget has unleashed some serious financial strains caused by rising inflation, that would be resulting in decreased purchasing power and reduced take-home pay. The increased amount of tax on the salaried class contributes more than their fair share of taxes, as they pay 200% more taxes than exporters and retailers⁷, with an burden of Rs.375 billion. However, as mentioned above, the government has failed to broaden the tax base, and only Rs.4-5 billion have been collected from the 3.6 million retailers per annum.

The withdrawal of various exemptions and increased amount of Sales Tax on various products has caused a deep strain on the pockets of the common man. As already discussed, the increased taxes have resultantly decreased the general public's purchasing power, causing more inflation and increased poverty. People cannot afford the necessities required for daily use, as a huge tax of 18% has been imposed on milk and some other basic items.

Similarly, on the matter of reduced tax on hybrid vehicles, Arif Habib Limited (AHL) commented that removing customs duty exemption on completely built-up hybrid vehicles is expected to raise demand for locally produced hybrid vehicles. However, the Chairman of the All-Pakistan Motor Dealers Association, HM Shahzad said that the government is openly giving protection to a few assemblers who have rolled out costly hybrid vehicles in the name of higher localization. However, due to the removal of custom duty exemptions, tax has been increased on the import of hybrid vehicles. This step has been taken by the federal government to support the domestic auto industry. However, the local consumer, after the implication of this decision will be left with limited options, as there are no exemptions available and the only available option for a consumer is to buy the

⁷ <https://www.dawn.com/news/1843118>

product, which is locally produced, eliminating competition from the market. In short, the only entity being benefitted in this scenario are local assemblers, while the consumers are in a worst-off situation, as they have to opt the products with limited and low-quality features and high prices.

Additionally, the government's goal of increasing revenue through increased corporate tax rates on exporters will result in increased costs of business, which will ultimately affect their profit margins. This will make the exporters, not bring their income from exports into the country and shift their businesses elsewhere. Contrary to this, a 5% reduction in custom duties on raw material imports will improve the gross margins of the pharmaceutical industry by lowering the cost of importing pharmaceutical raw materials.

Additionally, concessions offered by the federal government on solar panels, have been designed to foster local production and meet the domestic demand, thereby contributing to sustainability and growth of sector. With the exemption of customs duties on imports of machinery by manufacturing units of solar panels and concessions offered by the government to local assemblers of solar panels, competition has been created in the market.

The increased rates of FED on sugar, cement and cigarettes smack of a significant policy move by the government for revenue generation. However, it will result in increased production costs as well as an upsurge in the sugar price, making it difficult for the public to purchase sugar as it is part of our staple foods.

An increase in the FED applied to cement will lead to a higher price of cement and a higher cost of construction. The higher cost will ultimately lead to increased price and hence, Pakistan being an exporter of cement, will not be able to compete internationally in the global market. Thus, making Pakistani cement, less competitive internationally, will lead to an expected fall in cement exports.

The FED imposed on commercial properties is causing segregation in the economy, as civil and military bureaucrats have been exempted from this duty and the whole burden has been thrown on the shoulders of common man

Section 2: Macroeconomic Analysis

Pakistan witnessed moderate economic recovery in FY 2024 due to political stability after elections and exchange rate stability after the government's intervention in the forex market. In contrast, the surge in terrorism, especially attacks on law enforcement agencies, has greatly affected the business environment in the country. According to the provisional estimates provided by the Pakistan Bureau of Statistics, economic growth hovered around 2.38 percent in Pakistan against the initial target of 3.5 percent. The agriculture sector's output recovered beyond expectations due to a favorable climate and recovery from the floods in 2022 and recorded a growth of 6.3 percent against the target of 3.5 percent. For FY 2025, the government has set an ambitious growth target of 3.5 percent while Asian Development Bank forecasts it to be around 2.8 percent and World Bank predicts it to be around 2.5 percent.

Inflation remains a challenge for the country as prices due to significant rise in utility and petroleum prices remain elevated despite monetary tightening. Against the target of 21 percent for FY 2024, inflation surpassed 23 percent. It is imperative to highlight that the inflation statistics provided by the government are based on the prices of food, including fruits and vegetables, announced by the government, and prevailing in government administered markets or utility stores. However, actual prices are slightly higher, indicating a possibility of underreporting of inflation estimates. According to Asian Development Outlook, the inflation forecast for FY 2025 is 15 percent compared to the government's target of 12 percent.

The incumbent government has initiated a reform drive aimed at the privatization of loss-making state-owned enterprises and the rightsizing of the government. On the privatization front, progress has been made as the privatization of the Pakistan International Airline is on the track, but no transaction has yet been concluded, though the government envisages the privatization process of PIA to be completed by the end of August 2024. Besides PIA, all other entities considered for privatization are in their initial stages and various policy prescriptions are under consideration.

The claims made by the government about structural reforms lack clarity and direction as illustrated by the closure of Pak PWD under the rightsizing exercise. The Cabinet approved the closure of the department with an impression to curtail government expenditures. However, 2 new

departments are being considered to be established to replace Pak PWD, negating the objective of rightsizing.

Energy sector reforms also appear to be a distant reality as the government is unable to devise a sustainable policy. The energy sector circular debt continues to mount, and power sector debt soars to Rs. 2.6 trillion while the gas sector debt surpassed Rs. 2 trillion. Moreover, in the last couple of months, various proposals regarding provincialization or privatization of loss-making distribution companies have been floated by the government but no policy prescription has been approved at the moment. Furthermore, news related to the changes in net-metering policy has been reported by various media outlets including revision of buy-back rates or gross metering policies or imposition of taxes on individuals having installed solar systems. However, no clear policy has been announced by the government, indicating a lack of consensus on the way forward.

Unaddressed supply-side bottlenecks continue to keep prices elevated

Inflation has shown a declining trend in recent months but remains elevated compared to the budgeted level. The average CPI inflation stood at 23.4 percent in FY 2024 as compared to the budgeted level of 21 percent. The average year-on-year inflation in the last quarter of FY 2024 (April- June) stood at 13.9 percent as compared to 34.6 percent last year. The average SPI inflation in the last quarter of FY 2024 clocked at 17.8 percent and WPI inflation clocked at 11.5 percent.

The year-on-year CPI inflation in April, May, and June was 17.3 percent, 11.8 percent, and 12.6 percent respectively. The month-on-month inflation in April, May, and June stood at -0.4 percent, -3.2 percent, and 0.5 percent respectively.

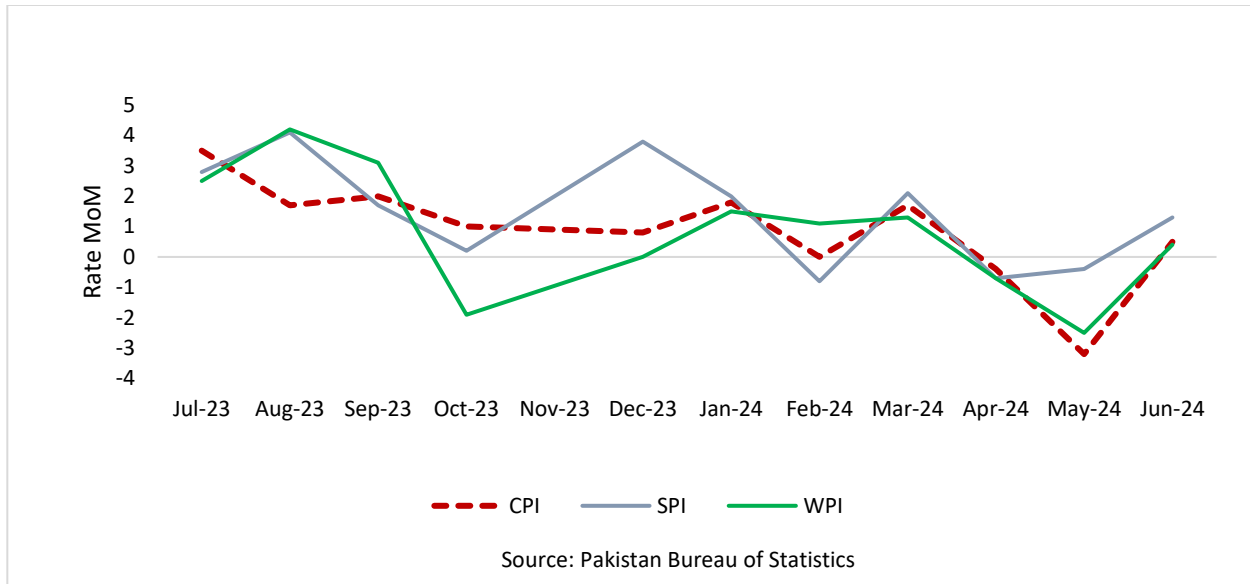


Figure 7: Inflation

In FY 2024, a major increase has been observed in the Housing, Water, Electricity, Gas & Fuels segment, that is, more than 35 percent. In Urban areas, this segment witnessed an increase of 42 percent while in rural areas, perishable items witnessed an increase of 20 percent, contributing significantly towards the lowering of the purchasing power of the masses.

There are multiple reasons behind the inflation. The increase in General Sales tax from 17 percent to 18 percent, hike in petroleum and electricity prices, and growth in money supply as compared to the output have contributed significantly.

The government has focused solely on administrative controls such as enforcement of price controls to restrict prices, however, remains unsuccessful. This problem could only be addressed through resolving issues related to the supply side and monetary expansion.

Unsustainable government expenditures continue to accumulate debt

The government's current expenditures increased by 35 percent from Rs. 10.5 trillion in FY 2023 to Rs. 14.2 trillion in FY 2024. The development expenditures increased by 5.9 percent from Rs. 787 billion in FY 2023 to Rs. 834 billion in FY 2024. Moreover, the total government expenditures increased by 4.6 percent compared to the initial budget estimates. On the revenue side, the government collected Rs. 9.2 trillion against the target of Rs. 9.4 trillion in FY 2024. While, the

revenues increased by 28.2 percent from Rs. 7.2 trillion in FY 2023 to Rs. 9.2 trillion in FY 2024. As a result, the fiscal deficit as a percentage of GDP increased from the budgeted level of 6.5 percent to 7.4 percent.

In the 4th quarter of FY 2024, the FBR collected Rs. 2.61 trillion compared to the collection of Rs. 1.84 trillion last year and Rs. 2.24 trillion in the 3rd quarter of FY2024. The higher collection of revenues could be attributed to an increase in sales tax and the easing of import restrictions.

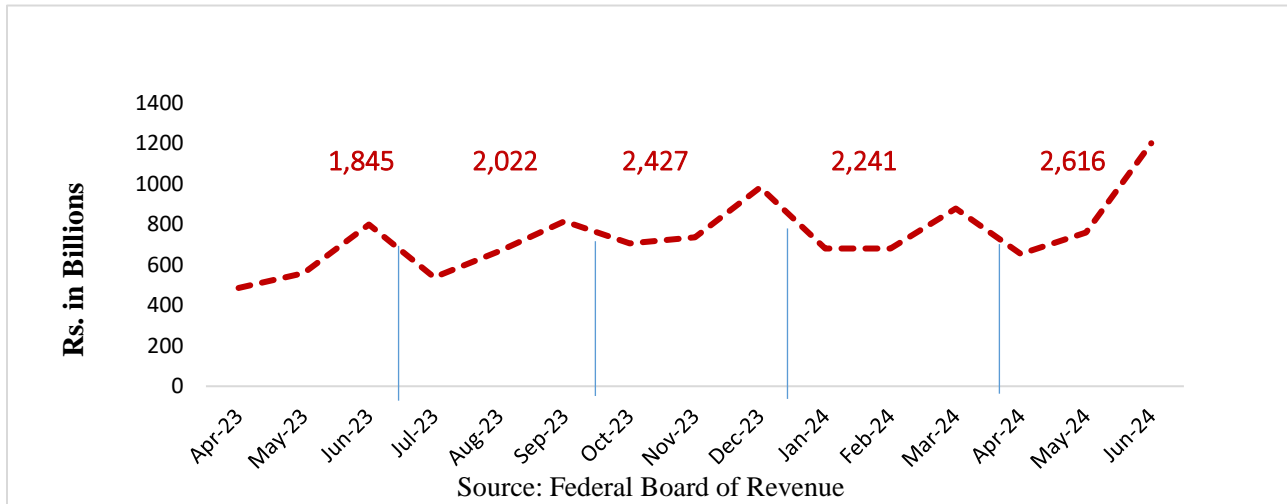


Figure 8: Revenue Collection

The higher government expenditures compared to the revenue collection prompted the government to borrow from domestic and external sources. In the first two months of the 4th quarter of FY 2024 (April and May), the government borrowed Rs. 2 trillion to finance the expenditures as compared to Rs. 1.28 trillion last year. The outstanding government borrowing stood at Rs. 30.2 trillion at the end of May 2024. The outstanding borrowed amount from the State Bank of Pakistan declined by Rs. 431 billion in the first two months of the 4th quarter of FY 2024 and stood at Rs. 4.1 trillion. The banks' credit to the government in the form of investment in government securities increased by Rs. 2.44 trillion in the first two months of the 4th quarter of FY 2024 and stood at Rs. 26.1 trillion. The government borrowing from the commercial banks in

the 11 months of FY 2024 (July-May) stood at Rs. 7.59 trillion as compared to Rs. 3.46 trillion last year.

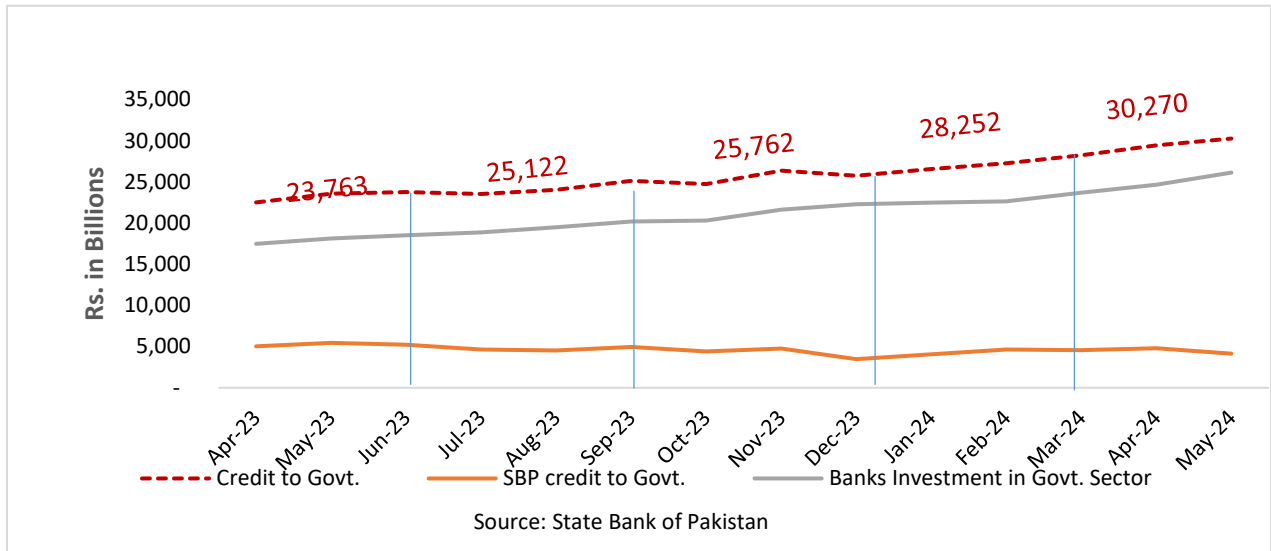


Figure 9: Government Domestic Borrowing - Outstanding Period End Position

The government borrowing from domestic and external sources to finance the fiscal deficit and external payments resulted in the accumulation of debt. The central government's public debt increased by Rs. 2.4 trillion in the first two months (Apr-May) of the 4th quarter of FY 2024 as compared to Rs. 1.9 trillion last year. The central government's total debt stood at Rs. 67.8 trillion out of which domestic debt is Rs. 46.2 trillion and external debt is Rs. 21.6 trillion at the End of May 2024.

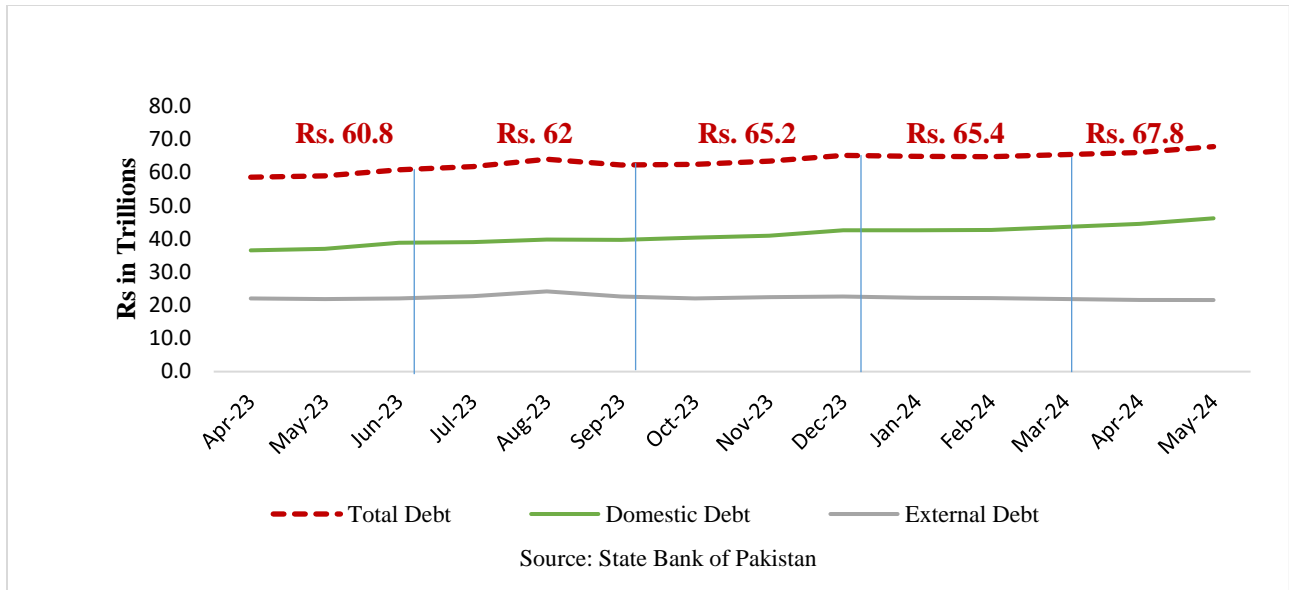


Figure 10 : Public Debt of Pakistan – Outstanding Period End Position

Pakistan remains an unattractive destination for foreign investors

The foreign investment in Pakistan improved in FY 2024 as compared to last year. The net foreign private investment in the first 11 months of FY 2024 stood at \$1.72 billion as compared to \$1.5 billion last year. The inflow of investment in the 11 months was \$2.7 billion and the outflow was \$983 million. The inflow of foreign private direct investment in April and May was \$414 million and \$339 million, while the outflow was \$55 million and \$68 million.

Despite a bit of improvement in foreign investment, Pakistan remains unable to attract sizeable foreign investment in the country keeping in view the market size and opportunities. Due to protection, excessive regulations, security issues, and an unstable political environment, Pakistan remains a least favorable country for investment.

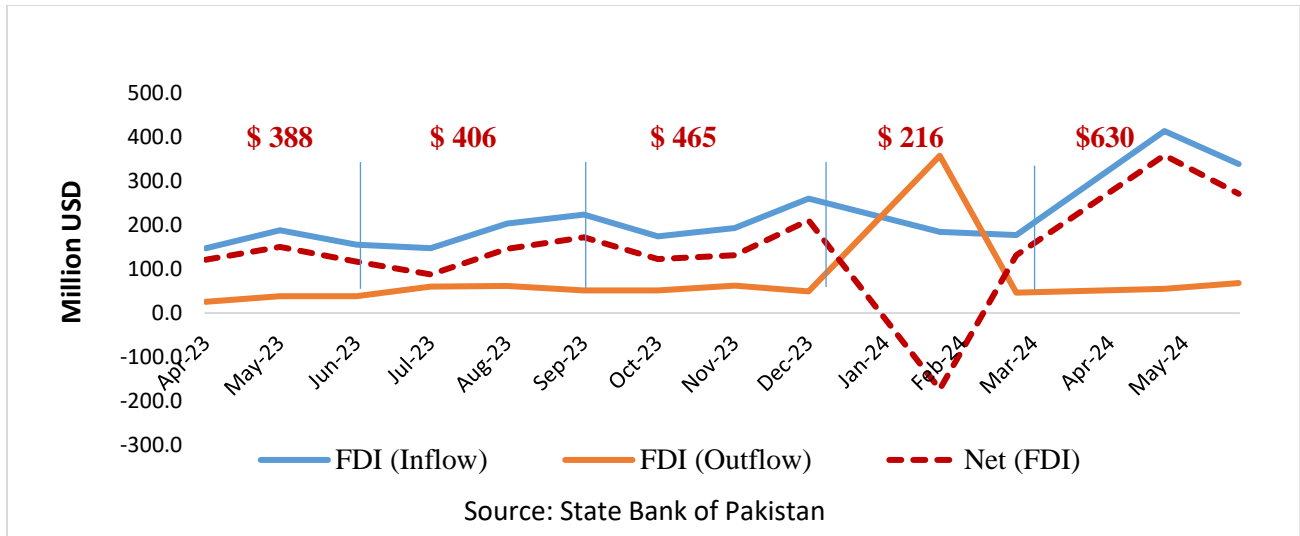


Figure 11: Foreign Investment in Pakistan – Quarter End Position

Private sector borrowing witnesses a declining trend amid the high cost of borrowing

Private sector borrowing exhibited a declining trend in the first two months of the 4th quarter of FY 2024. The total private sector borrowing fell by Rs. 12 billion as compared to a fall of Rs. 281 billion last year. The total private sector borrowing stood at Rs. 7.47 trillion at the end of May 2024. The long-term fixed financing (LTFF) declined by Rs. 16 billion in the first two months of the 4th quarter of FY 2024 as compared to a fall of Rs. 21 billion last year. The LTFF stood at Rs. 546 billion at the end of May 2024.

The short-term financing (working capital) declined by Rs. 16 billion in the first two months of the 4th quarter of FY 2024 as compared to a fall of Rs. 7 billion last year and total short-term financing declined to Rs. 292 billion at the end of May 2024. The private sector borrowing under the export financing scheme declined by Rs. 3 billion as compared to an increase of Rs. 7 billion last year and total export financing stood at Rs. 633 billion. The decline in private-sector borrowing can be attributed to the high cost of borrowing, inflation, frequent increases in petroleum and electricity prices, and the reluctance of investors due to the uncertain economic environment of the country.

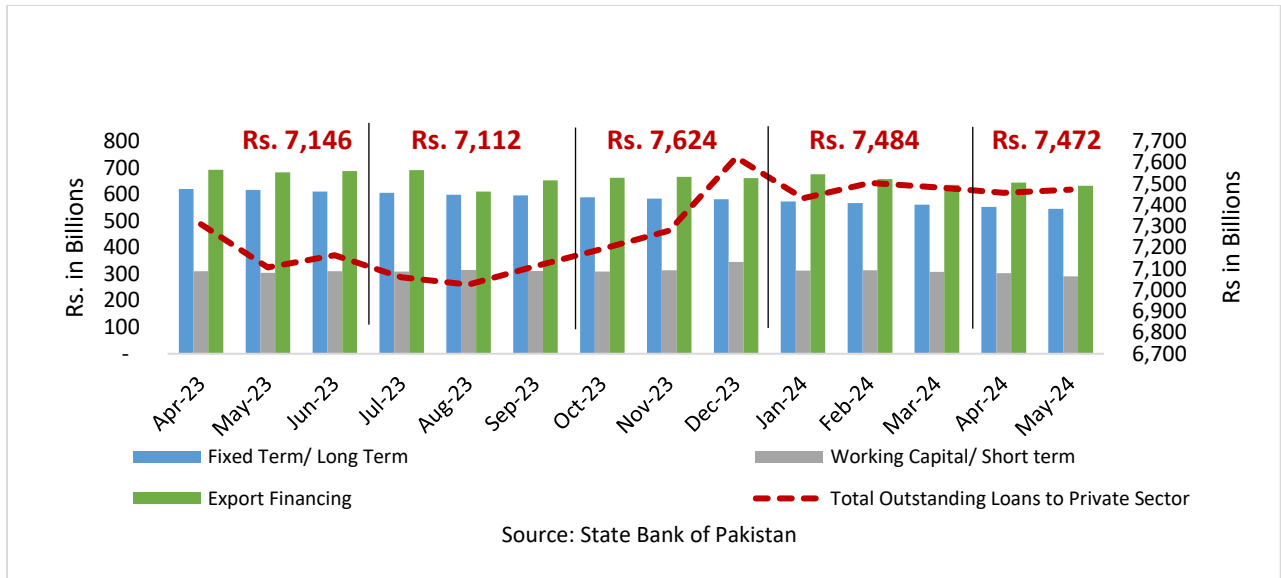


Figure 12 :Private Sector Borrowings from Banks - Outstanding Period End Position

Manufacturing sector output remains subdued amid higher utility and input prices

The large-scale manufacturing sector (LSM) has shown some recovery after a long declining trend due to high inflation and operational costs. The LSMI output increased by 5.76 percent in April 2024 when compared with April 2023 and declined by 8.14 percent when compared with March 2024. During the 10 months of FY 2024 (July- April), the output of LSMI increased by 0.45 percent.

In April 2024, the textile, coke, and petroleum products sectors posted positive growth, while the food, chemicals, wearing apparel, and chemical sectors experienced negative growth.

The excessively high tax burden due to the increase in GST and income tax rates has diminished the working capital of the industry. Moreover, a significant increase in the petroleum and utility prices has increased the input costs and prices, which reduced the aggregate demand.

The excessive cost of borrowing due to high policy rates has contributed to the inability of the industry to maintain or expand the scale or scope of operations.

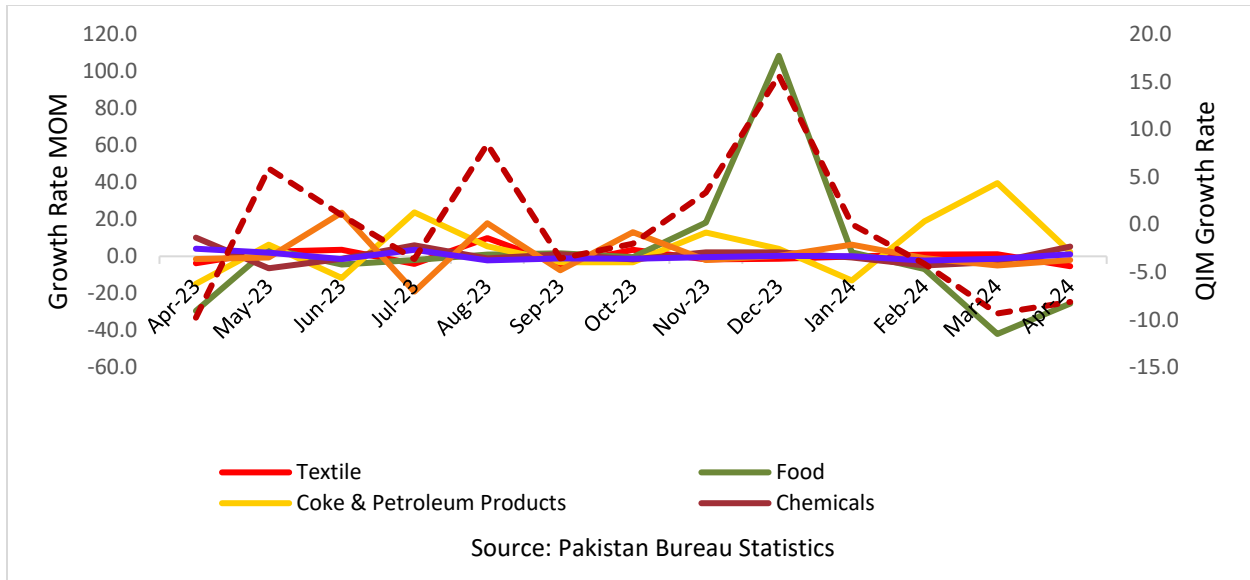


Figure 13: Large Scale Manufacturing Sector Performance

Monetary expansion higher than real growth leads to inflation

Monetary policy plays a crucial role in providing stability to the economy. The policy rate was changed to 20.5 percent in June after remaining unchanged at 22 percent for several months. The change in policy rate was made following a decline in inflation. However, the monetary expansion as manifested by growth in M2 remained prominent as compared to the real growth i.e. GDP. The growth in M2 in the 4th quarter of FY 24 stood at 8.3 percent as compared to GDP growth of 2.9 percent. In the 4th quarter of FY 2023, the growth in M2 was 9.4 percent while GDP growth was -3.7 percent. The monetary expansion caused by excessive borrowing of the government has resulted in the inability to restrict inflationary pressures.

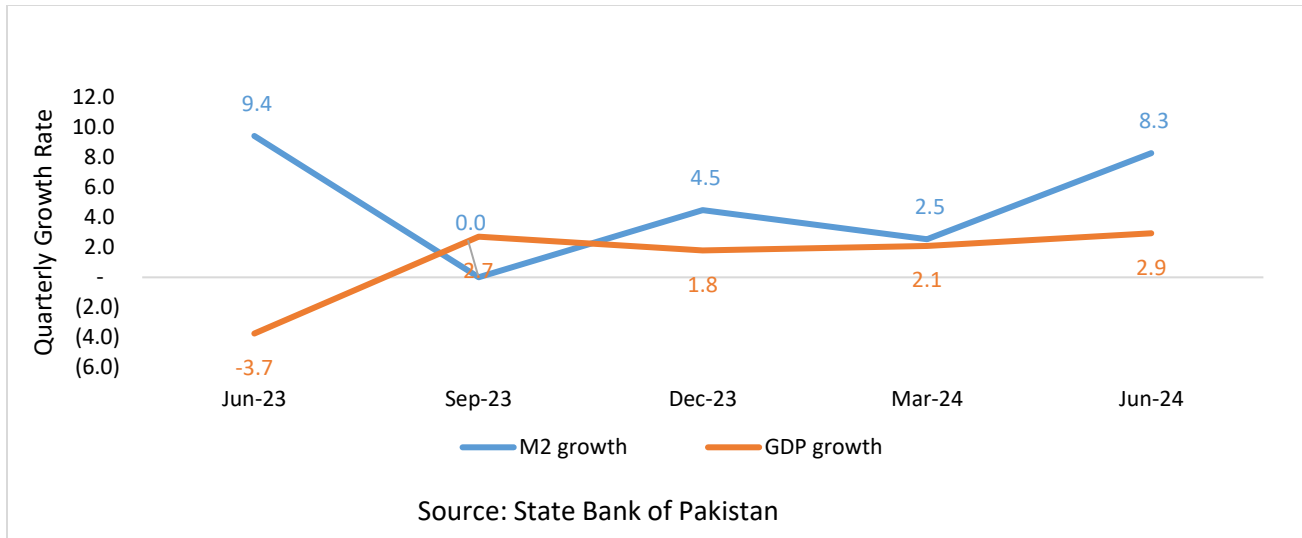


Figure 14: Money Supply and GDP Growth

External financial pressures continue to mount despite improvement in current account balance obtained through restrictions and administrative controls

The exports of Pakistan increased by 15 percent in the 4th quarter of FY 2024 compared to last year, increasing from \$6.7 billion to \$7.72 billion. The exports in April, May, and June were \$2.35 billion, \$2.84 billion, and \$2.52 billion respectively. The total exports increased by 10.29 percent from \$27.7 billion in FY 2023 to \$30.6 billion in FY 2024. The increase in exports can be attributed to the easing of restrictions on imports, availability of raw materials, and stability in the exchange rate.

The imports of the country increased by 28 percent in the 4th quarter of FY 2024 compared to last year, increasing from \$11.5 billion to \$14.7 billion. The imports in April, May, and June were \$4.86 billion, \$4.94 billion, and \$4.91 billion respectively. The total imports declined by 2 percent from \$55.7 billion in FY 2023 to \$54.6 billion in FY 2024.

The trade deficit increased by 46 percent from \$4.8 billion to \$ 7.01 billion in the 4th quarter of FY 2024 compared to last year. The total trade deficit declined by 14 percent from \$28 billion in FY 2023 to \$24 billion in FY 2024.

Remittances play an important role in balancing the inflow and outflow of foreign exchange and help fulfill the country’s external obligations. The inflow of remittances increased by 42 percent

in the 4th quarter of FY 2024 compared to the last year. The inflow of remittances in the 4th quarter of FY 2024 was \$9.2 billion and in the 4th quarter of FY 2023 was \$6.4 billion. In FY 2024, Pakistan received remittances of \$30.2 billion compared to \$26.9 billion in FY 2023.

The current account balance posted a surplus of \$229 million in April-May FY24, compared to a surplus of \$289 million in the last year. The current account balance in the 11 months of FY 2024 stood at a deficit of \$464 million as compared to a deficit of \$3.76 billion in FY 2023. The improvement in the current account balance can be attributed to fall in imports and a rise in exports, remittances, and foreign investment.

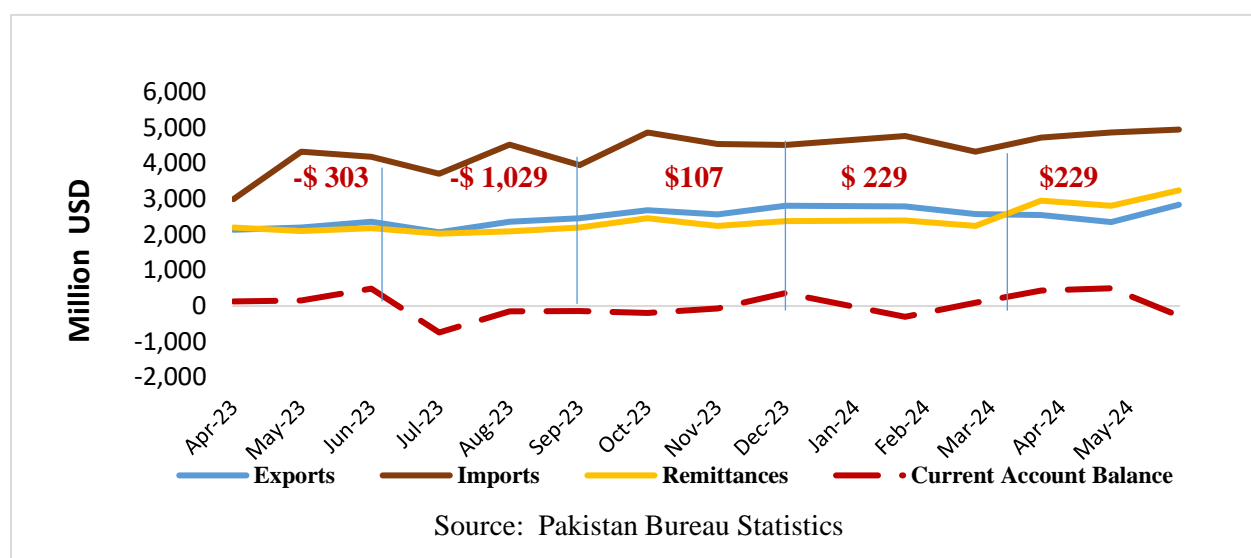


Figure 15 : Current Account Balance

The exchange rate appreciated in the 4th quarter of FY 2024 by 0.1 percent, from Rs. 279 at the end of March 2024 to Rs. 278.7 in June 2024 and appreciated by 2.9 percent compared to June 2023. The appreciation in the value of the rupee resulted from the completion of the IMF-SBA, a crackdown on the smuggling of foreign exchange last year, policy revision of currency exchange companies, and improvement in the political environment of the country.

The foreign exchange reserves of the government increased by 16.7 percent in the 4th quarter of FY 2024 from \$8.04 billion at the end of March 2024 to \$9.38 billion at the end of June 2024. In contrast, the reserves increased by 6.1 percent in the 4th quarter of FY 2023. The building up of

reserves can be attributed to the successful completion of IMF-SBA, rollovers of debt, stability in the exchange rate, and improvement in the inflow of foreign exchange.

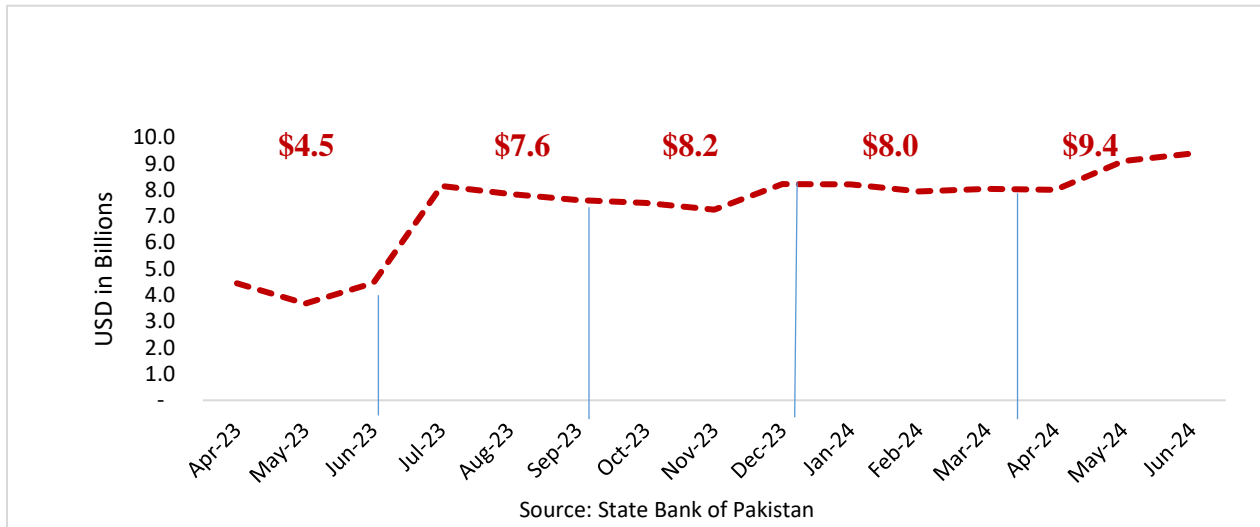


Figure 16 : Foreign Exchange Reserves of Government - Outstanding Period End Position

Business confidence increases due to improvements in the external balance and political stability

The performance of the stock market can be used as a proxy to represent investor confidence and the business environment, although its share is minute in the economy. The KSE-100 Index stock position at the start of the 4th quarter of FY 2024 was 67,756 and it increased to 78,444 at the end of June 2024, a growth of 15.7 percent as compared to a growth of 3.6 percent in the 4th quarter of FY 2023. The market capitalization increased by 9.81 percent in the 4th quarter of FY 2024 from Rs. 9.4 trillion at the end of March 2024 to Rs. 10.3 trillion at the end of June 2024 as compared to an increase of 4.5 percent last year. The improvement in KSE-100 is attributed to factors such as the improvement in the current account balance, successful completion of the IMF program, stability in the exchange rate, and political stability.

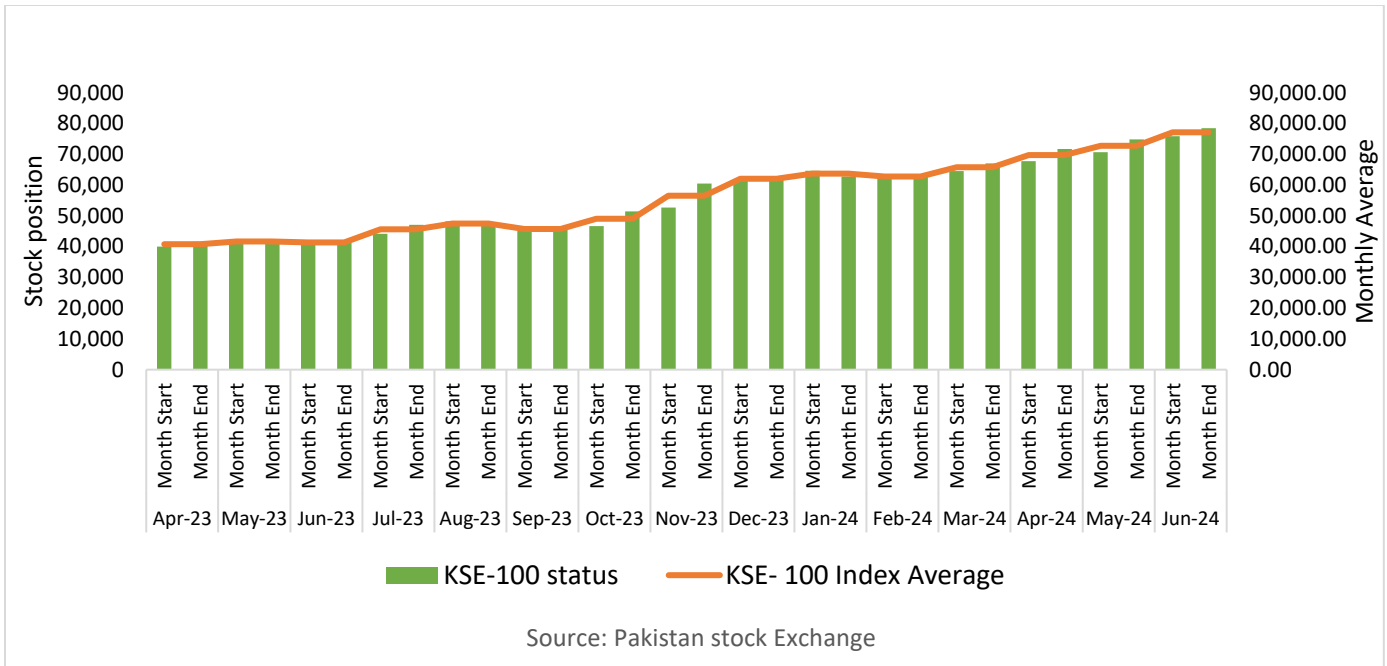


Figure 17: Stock Market Performance

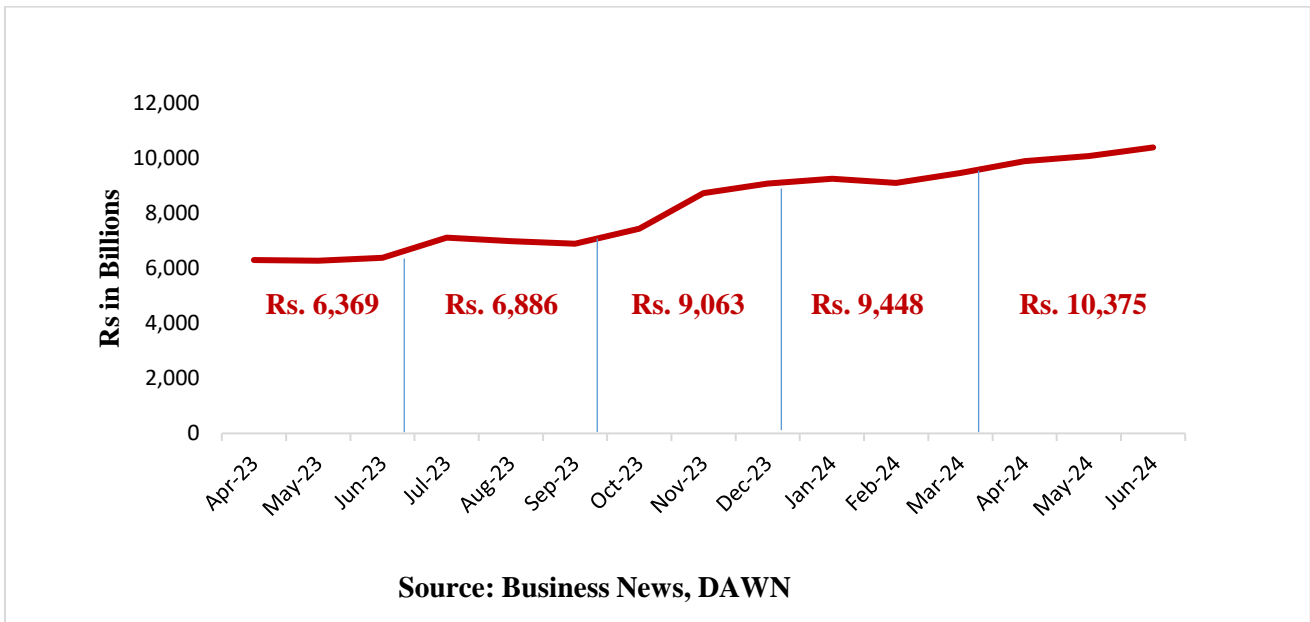


Figure 18 : Market Capitalization in Stock Market

Section 3: Macroeconomic Outlook

The government achieved staff-level agreement with the IMF for the 24th Program- Extended Fund Facility of \$7 billion. The prerequisites of the Program have been met in the budget such as raising sales tax, expanding the scope of sales tax, withdrawal of exemptions, an increase of Rs. 10 in petroleum development levy and increase in income tax. However, without cutting expenditures and improving the allocation of funds, fiscal sustainability cannot be achieved. Unfortunately, no significant reform is expected in the short to medium term.

The country's taxation system has become predatory to businesses and the masses. The increasing tax rates and the number of taxes has diminished the purchasing power of citizens and the working capital of the industry. According to the Laffer Curve, raising taxes increases revenues up to a certain point after which revenues start to fall due to evasion and avoidance. Pakistan's taxation system is encouraging defiance and incentivizing the citizens to stay out of the tax base. Unless the government moves towards a low rate and broad-based tax system, the fiscal challenges will exacerbate and become unsustainable.

The inflationary pressures are expected to mount in the coming months due to an increase in utility tariffs, scope of sales tax, and withdrawal of exemptions particularly on food items. Moreover, frequent hikes in base tariffs and fuel price adjustments have made utility unaffordable for the masses, squeezed the aggregate demand, and increased the burden of capacity payments on the narrow consumer base. Resultantly, more upward revisions are expected in the coming months until the government devises a plan to control losses and leakages from the system.

External financial obligations have remained elevated and are expected to hover around \$25 billion including debt servicing and financing imports. The external borrowing of \$20 billion from the IMF, multilateral, and bilateral as envisaged from the budget document might become difficult if the country's rating remains downgraded. The restriction on imports has proved futile in managing the balance of payments and resulted in a fall in exports. Therefore, a liberal trade policy is required. The imposition of tax on exports might result in a fall in exports proceeds and create an additional burden on the exchange rate.

Privatization of the loss-making entities is a prominent feature of the incumbent government's agenda, however, lack of clarity on the way forward and excessive government regulations may prove to be a bottleneck in concluding transactions. The absence of the realization of distortions created by the higher presence of the government in businesses and the insistence of the government to retain some entities as essential and in the national interest may result in its inability to reduce fiscal burden.

Energy sector reforms remain a daunting challenge for the government. The circular debt is continuously rising, and the government has not devised a plan to minimize losses. The utilities have become unaffordable for the masses while the only prescription the government has is to raise tariffs. A hefty amount has been earmarked in the budget for the energy sector to keep it afloat, which is a cause of serious concern keeping in view the fiscal constraints. The domestic industry has experienced a steep fall in profits due to soaring input costs and is gradually becoming uncompetitive globally. The government needs to address the issue of cross-subsidy by moving away from charging high tariffs from the industrial consumers and facilitating protected residential consumers of electricity.

The country's monetary policy appears to be incongruous with the fiscal policy as inflation targeting is carried out solely through the policy rate. In a country, where major financing is availed by the government and private businesses are crowded out, the efficacy of policy rates becomes questionable. The monetary expansion through government borrowing has contributed greatly to inflation, abnormal profits for the banks, and accumulation of debt for the government, whose burden is ultimately borne by the masses

Annexures

Table 1: Current Account Indicators of Pakistan

Month	Exports	Imports	Remittances	Current Account Balance
	Million USD			
Apr-23	2,137	2,997	2,198	78
May-23	2,200	4,328	2,103	255
Jun-23	2,366	4,180	2,184	-2387
July-23	2,068	3,705	2,029	-775
Aug-23	2,366	4,528	2,093	-160
Sep-23	2,465	3,954	2,206	-985
Oct-23	2,690	4,864	2,463	-184
Nov-23	2,573	4,539	2,250	-15
Dec-23	2,812	4,514	2,381	397
Jan -24	2,792	4,771	2,398	-303
Feb-24	2,583	4,326	2,250	128
Mar-24	2,555	4,726	2,953	229
Apr-24	2,352	4,865	2,813	499
May-24	2,840	4,948	3,243	-270
Jun-24	2,529	4,919	3,158	

Table 2: Foreign Direct Investment in Pakistan

Month	Net	Inflow	Outflow
	Million USD		
Mar-23	163.4	210.7	47.3
Apr-23	121.6	147.3	25.6
May-23	149.6	178.0	28.4
Jun-23	114.3	141.4	27.1
July-23	87.7	147.7	60.0
Aug-23	146.1	197.6	51.5
Sep-23	172.6	223.8	51.2
Oct-23	122.5	174.2	51.7
Nov-23	131.4	193.5	62.2
Dec-23	211.1	260.6	49.5
Jan-24	-173.2	184.7	357.9
Feb-24	131.2	177.3	46.1
Mar-24	258.0	330.1	72.1
Apr-24	358.8	414.0	55.2
May-24	270.9	339.1	68.2

Table 3: Inflation

Month	CPI	SPI	WPI
Apr-23	2.4	2.7	0.1
May-23	1.6	1.3	1.0
Jun-23	-0.3	0.2	-0.3
Jul-23	3.5	2.8	2.5
Aug-23	1.7	4.1	4.2
Sep-23	2.0	1.7	3.1
Oct-23	1.0	0.2	-1.9
Nov-23	2.7	3.3	1.4
Dec-23	0.8	3.8	0.0
Jan-24	1.8	2.0	1.5
Feb-24	0.0	-0.8	1.1
Mar-24	1.7	2.1	1.3
Apr-24	-0.4	-0.7	-0.7
May-24	-3.2	-0.4	-2.5
Jun-24	0.5	1.3	0.4

Table 4: Public Debt of Pakistan

Month	Public Debt	Domestic Debt	External Debt
	Rs. in Trillions		
Apr-23	58.6	36.5	22.0
May-23	59.0	37.1	21.9
Jun-23	60.8	38.8	22.0
July-23	61.7	39.0	22.7
Aug-23	64.0	39.8	24.2
Sep-23	62.3	39.7	22.6
Oct-23	62.5	40.4	22.1
Nov-23	63.4	41.0	22.4
Dec-23	65.2	42.5	22.6
Jan-24	64.8	42.6	22.2
Feb-24	64.8	42.7	22.1
Mar-24	65.4	43.4	21.9
Apr-24	66.1	44.5	21.6
May-24	67.8	46.2	21.6

Table 5: Domestic Borrowing of Government

Month	Total Credit	SBP Credit to Government	Banks Credit to Government
	Rs. in Trillions		
Apr-23	22,516	5,033	17,483
May-23	23,582	5,454	18,127
Jun-23	23,763	5,222	18,541
Jul-23	23,531	4,663	18,868
Aug-23	24,031	4,533	19,498
Sep-23	25,122	4,944	20,178
Oct-23	24,723	4,427	20,297
Nov-23	26,391	4,764	21,628
Dec-23	25,762	3,481	22,281
Jan-24	26,570	4,068	22,501
Feb-24	27,275	4,646	22,629
Mar-24	28,252	4,566	23,686
Apr-24	29,442	4,796	24,646
May-24	30,270	4,135	26,135

Table 6: Private Sector Borrowing (Rs. in Billions)

Month	Total loans to Private Sector	Fixed-Term/ Long Term	Working Capital/ Short term	Export Financing
Mar-23	7,387	638	311	676
Apr-23	7,311	621	311	693
May-23	7,106	617	304	683
Jun-23	7,164	611	311	688
Jul-23	7,060	606	310	691
Aug	7,026	598	315	611
Sep-23	7,112	597	313	653
Oct-23	7,195	590	310	662
Nov-23	7,280	585	315	666
Dec-23	7,624	582	346	662
Jan-24	7,431	573	313	676
Feb-24	7,504	567	315	658
Mar-24	7,484	562	308	636
Apr-24	7,458	553	304	644
May-24	7,472	546	292	633

Table 7: Exchange Rate and SBP Reserves

Month	Policy Rate	Exchange Rate	SBP Reserves (USD Billions)
Apr-23	21.00	285.4	4.5
May-23	21.00	286.0	3.7
Jun-23	22.00	287.0	4.5
Jul-23	22.00	281.7	8.2
Aug-23	22.00	290.8	7.8
Sep-23	22.00	297.9	7.7
Oct-23	22.00	280.8	7.5
Nov-23	22.00	286.0	7.0
Dec-23	22.00	283.6	8.2
Jan-24	22.00	280.7	8.2
Feb-24	22.00	279.6	8.0
Mar-24	22.00	279.0	8.0
Apr-24	22.00	278.4	9.1
May-24	22.00	278.5	9.1
Jun-24	20.50	278.7	8.9

Table 8: Performance of Stock Market

Month	KSE-100 Index Status		Monthly Average	Market Capitalization (Rs. in Billions)
	Month Start	Month End		
Apr-23	40,000	41,580	40,791	6,289
May-23	41,927	41,340	41,634	6,265
Jun-23	41,330	41,452	41,391	6,369
Jul-23	44,207	47,077	45,642	7,099
Aug-23	48,230	46,770	47,500	6,972
Sep-23	45,312	46,232	45,773	6,886
Oct-23	46,627	51,482	49,054	7,423
Nov-23	52,656	60,502	56,579	8,718
Dec-23	61,691	62,451	62,071	9,063
Jan-24	64,661	62,773	63,717	9,243
Feb-24	62,393	63,219	62,806	9,089
Mar-24	64,578	65,005	65,791	9,448
Apr-24	67,756	71,695	69,725	9,872
May-24	70,657	74,878	72,769	10,067
Jun-24	75,878	78,444	77,161	10,375