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NBP Performance at a Glance

## Editor's Corner

Dear Readers,

A key focus area of the Federal Budget 2011-12 is to achieve sustainable GDP growth of 7 percent per annum to absorb the labour force growing by over 3 percent annually in the market. In Pakistan, there has been a gradual shift to a youthful age structure due to declines in birth and death rates. Presently 64 percent of the population lies within 15-65 years of age and it will continue to rise, increasing the working age population/labour force. Currently Pakistan has a labour force of 55 million people, and is the ninth largest country in the world with respect to the size of its labour force.

Without gainful employment, large numbers are denied access to basic facilities, like proper nutritious food, water, electricity, schooling for their children, a roof over their heads or in other words, have a decent living standard. If the economy enjoys high growth rates and is able to sustain this growth over a long period, can job opportunities for the young people entering the labour market be made possible.

In the last decade, GDP growth averaged 4 percent per annum, except for FY04 and FY05 when a higher growth (7.5 percent and 9.0 percent respectively) was registered. Last four years have been immensely difficult for the domestic economy (GDP growth averaged 2.9 percent, had fallen to a low of 1.7 percent in FY09), attributable to a number of factors like, acute energy shortages, the fallout of the war on terror and volatile security situation, high inflationary pressures, rise in international crude and food prices and a commensurate increase in domestic prices and then the floods caused severe damage to infrastructure in the affected areas, washed away entire villages, destroyed agricultural lands and thousand of acres of crops.

The economy suffered the consequences. Investment has fallen, poverty has increased, investor confidence has ebbed, capital flight has taken place and there has been a considerable loss of competitiveness in manufactured exports and the overall growth of the economy has slowed down. The need to address the problems, particularly security of life and property, energy, cost of borrowing, tax, tariff and policy distortions, of governance, effectiveness of resource use, incentives for innovation and high productivity, improving the quality of public and private efforts could lay the foundations for sustained long term growth.

Total investment to GDP ratio has fallen from 22.1 percent in FY07 to 13.4 percent in FY11. This is the lowest ever investment rate in four decades. The economy has failed to direct savings into productive investments with sustained payoffs. More importantly the private sector investment witnessed significant fall and recorded the lowest ratio since 1998-99. This implies 'a significant deterioration in the job creating ability of the economy', states the *Pakistan Economic Survey 2010-11*.

Cut down on development expenditures, impacts public sector investment which in turn has spill over effects for private sector investment. Accompanied by low savings rate it adversely affects the employment generating ability of the economy.

A new strategy has been initiated by the government to accelerate economic growth and sustain it. The strategy addresses the constraints to investment, productivity and competitiveness. A sustained implementation of the reform strategy would increase growth rate by about 3 percent per annum. The key focus areas of the *jobs and growth strategy* as highlighted in the Finance Minister's Budget Speech are: -

- productivity improvement
- governance reforms
- performance based and professional management
- public sector enterprises reforms
- develop markets to attract private investment
- liberalize building and zoning regulations to unleash the potential of several industries and youth to be engaged in all aspects of the economy

The jobs and growth strategy of the Federal Budget reflects the Pakistan Planning Commission's new growth framework. The Planning Commission has prepared a report '*Pakistan: Framework for Economic Growth; May 2011*'. The Report provides a strategy that seeks accelerated and sustained growth. It is a strategy which recognizes the resource constraints that the economy faces and therefore, focuses on productivity, innovation, issues of economic governance, strengthening of institutions such as the civil service, legal and judicial framework, the taxation system, human resources, improving the functioning of domestic markets, reform of the restrictive zoning laws, which have impeded the growth of domestic commerce and hampered the role of cities as generators of economic growth. Special programmes to be initiated for support of the youth.

This new strategy alongwith a more efficient role of the government where it performs regulatory functions, and provides the basic infrastructure would help transform Pakistan economy into a competitive, fast growing economy which will be able to create sufficient employment opportunities for all workseekers in a growing labour force.

Past policies have not been able to sustain high growth. Growing young population is adding to the labour force, and if economic growth cannot be accelerated to over 7 percent per annum, on a sustained basis, a large part of the labour force will not find employment, thus giving rise to numerous socioeconomic issues. Accelerating the economic growth rate and sustaining it at a high rate over a period of time, must therefore, be treated as a national priority.

Ayesha Mahmood

## Federal Budget 2011-12 – An Overview

### *Economic Review*

Difficult time for the economy

Times have been difficult for the Pakistan economy. The economy remains hampered by relentless power and gas shortages, inflationary pressures persist, energy subsidies continue to remain high, little effort has been made to widen the tax base and the tax GDP ratio continues to hover at around 9 percent, reliance on bank borrowings for financing the budget deficit continues to be a cause of concern, a continued difficult security situation, and breakdown of law & order is undermining investor confidence and encouraging capital flight. Severe floods that devastated the economy have contributed to the economic difficulties, deepening the economic crisis. The floods displaced millions of people, and caused severe damage to economic assets. Rise in international crude oil and commodity prices impacted domestic inflation. These are some of the major challenges facing the policy makers.

Growth declines

Owing to these factors, the overall GDP growth declined to 2.4 percent in FY11, compared to the target of 4.5 percent estimated initially. The growth in the agricultural sector is estimated at 1.2 percent, against a growth target of 3.8 percent. Major crops, which account for 31 percent of agricultural sector registered a negative growth for the second consecutive year; 4.0 percent against 2.4 percent a year earlier. The unprecedented floods had destroyed two major crops, rice and cotton. Minor crops grew by 4.8 percent as against declines in the previous two years. The livestock sector also slowed down.

The large scale manufacturing sector has suffered because of severe energy shortages and electricity tariff hike leading to cost escalation. It grew by 1 percent in FY11 against nearly 5 percent in FY10. The construction sector showed a 21 percent fall in its activity during the year and dragged the overall performance of the industrial sector to a negative 0.1 percent, against a 8.3 percent growth in FY10. The services sector performed well, as it grew by 4.1 percent in FY11 compared to 2.9 percent in FY10.

Investment declines

Domestic security challenges, the law & order situation and the acute energy shortages have had a knock-on effect on investment inflows and market confidence. With an inhospitable economic environment for growth and investment, total investment as percentage of GDP declined to 13.4 percent in FY11 against 22.5 percent in FY07. Domestic savings rate has fallen to 9.5 percent and national savings to 13.8 percent, against corresponding figures of 15.6 percent and 17.4 percent respectively in FY2009-10 .

Consistent with the declining trend of overall investment, inflow of foreign private investment is estimated to have declined to \$1.9 billion in FY11 against \$2.74 billion in FY10. There was a marked decline in inflows from western Europe and from the US. Inflows from developing countries increased, particularly from countries in Asia.

CPI higher

The inflation rate as measured by the changes in Consumer Price Index is estimated at 14 percent in FY11, as against 11.7 percent in FY10. Food inflation was higher at 18.0 percent and non-food at 10.5 percent, against 12.5 percent and 11.1 percent in FY10.

Trade deficit narrows

In the outgoing fiscal year (FY10) there was a narrowing of the trade deficit, while remittances showed an increase. The trade deficit is provisionally estimated to have declined to \$10.2 billion against \$11.5 billion in FY10, as exports grew by 29.4 percent to \$25.46 billion and imports showed an increase of 14.2 percent to \$35.64 billion. Meanwhile, home remittances grew by 25.8 percent to \$11.2 billion in FY11 against \$8.9 billion a year earlier.

Pakistan's public debt (domestic currency and foreign currency debt) stood at Rs10,020 billion by the third quarter of FY11. There has been a sharp rise in the local currency component of public debt, primarily because of slower disbursement from bilateral and multilateral donors and higher than budgeted fiscal deficit.

Box

## *Economy 2010-11 Highlights*

The outgoing fiscal year was a challenging year for Pakistan as it witnessed massive floods which caused damages estimated at \$10 billion to the economy, creating huge losses to standing crops and livestock sector, physical infrastructure and GDP. Oil prices shot to \$125 a barrel, inflationary pressures persisted, energy shortages played havoc with the economy, law and order situation worsened and the security challenges intensified.

The Economic Survey 2010-11 has been released. We give below highlights from the Report: -

### *Growth Trends*

- The floods affected the growth targets. Real GDP grew by 2.4 percent compared to 3.8 percent in the previous year.
- The agricultural sector showed a growth of 2.1 percent against a target of 3.8 percent for the year. Floods affected rice and cotton output. Major crops showed a decline of 4.0 percent, while minor crops grew by 4.8 percent.
- Law and order, power outages and rising cost of production affected the growth of the manufacturing sector. The sector showed an expansion of 3 percent, compared to 5.5 percent the previous year. Large scale manufacturing however, grew by 1 percent against 4.9 percent a year earlier.
- The services sector grew by 4.1 percent compared with 2.9 percent a year earlier.

### *Investment and Savings*

- Total investment declined to 13.4 percent of GDP compared to 15.4 percent in FY10. Cuts on development expenditure has resulted in a fall of public sector investment to GDP ratio from 5.6 percent in 2006-07 to 3.3 percent in 2010-11.
- Domestic savings have hovered at slightly over 9 percent of GDP for the last three years. In FY11 it was 9.5 percent against 18.1 percent in 2001-02.
- Inflow of foreign private investment declined to \$1760.5 million during July-May FY11, against \$2520.4 million during the corresponding period of FY10. Both its constituents foreign direct investment and portfolio investment fell. The former from \$1981.0 million to \$1392.3 million and the later from \$539.4 million to \$368.2 million in the corresponding period.

### *Inflation*

- Inflation as measured by changes in Consumer Price Index (CPI) grew by 13.9 percent, against 11.7 percent a year earlier. Food inflation rose by 18 percent over 12.5 percent in FY10, while non-food prices declined to 10.5 percent compared with 11.1 percent in the corresponding period.
- Core inflation (non-food-non-energy) decreased to 9.7 percent in FY11 compared with 11.0 percent in FY10.

### *Fiscal and Monetary Developments*

- During the fiscal year, the 7th NFC award was announced, and the distribution of funds has been made on the basis of multiple criteria — population, poverty and backwardness, revenue collection/generation and inverse population density.
- Tax policy measures were announced during the year to generate additional revenue of Rs53 billion during the last quarter of the year.
- Economic and financial reforms were undertaken during the year, which included an austerity plan, restructuring of public sector enterprises and power sector reforms.
- Pakistan's tax GDP ratio at 9.2 percent is the lowest in the region.
- Some initiatives have been announced to raise the tax-GDP ratio to 13-15 percent during the next five years.
- Fiscal deficit target of 4 percent was fixed for 2010-11. However, it is estimated to be higher at around 5.0-5.5 percent.
- Tax collection by the FBR was targeted at Rs1667 billion for FY11.
- Government borrowing from the banking system for budgetary support increased to Rs472.2 billion in FY11 (July-April) against Rs361.8 billion a year ago. Credit to private sector enterprises registered a sharp decline from Rs72.5 billion to Rs26.7 billion in the same period.
- Credit availed by private sector in FY11 (July-April) was Rs156.7 billion compared to Rs144.2 billion in the corresponding period a year earlier.
- The banking sector witnessed a sharp growth in non-performing loans. NPLs reached Rs548 billion during July-December 2011.

### *Balance of Payments*

- During July-May 2010-11, exports are provisionally estimated at \$22.78 billion, and imports at \$32.17 billion, resulting in a trade deficit of \$9.40 billion.
- Exports remained concentrated in few items like cotton manufactures, leather and rice, which accounted for 66.3 percent in total exports. The concentration of exports is changing but at a painfully slower rate states the Economic Survey. The share of other exports increased to 33.7 percent.
- The increase in import bill is primarily because of an increase in international oil and commodity prices.
- During July-April 2010-11, the current account deficit turned to surplus of \$748 million from a deficit of \$3.45 billion in the comparable period of the preceding year.

- Workers' remittances have risen to \$11.2 billion FY11, an increase of 25.8 percent over previous year's remittances of \$8.90 billion.
- Pakistan's foreign exchange reserves increased to \$17.1 billion by end April 2011.

### Energy

- Pakistan has been facing an unprecedented energy crisis for the past few years as the demand and supply gap widens. Its current energy demand far exceeds its indigenous supplies.
- There has been some change in the energy consumption mix during the last few years. While consumption of gas has increased, the share of oil has declined.
- Cement manufacturing plants have switched over to coal from furnace oil.
- Some positive initiatives have been taken to harness the huge coal reserves of Thar.
- Alternative sources of energy are being developed to meet the growing demand.

### Telecom Sector

- Total teledensity reached 65.2 percent by end December 2010.
- Cellular industry has a 94.6 percent share in total telecom teledensity, followed by fixed line 2.9 percent and wired line 2.5 percent.
- Total mobile subscribers at end December 2010 crossed the 102 million mark.
- During the last five years telecom sector invested \$11.6 billion in all segments of the sector. In FY10 the sector invested \$1.13 billion, which is \$508 million less than the previous year.
- The sector attracted \$6.3 billion of foreign direct investment in the last five years.
- In 2009-10, telecom sector contributed Rs109.1 billion to the national exchequer in the form of taxes, license fees and other duties.

### Public Debt

- Total public debt increased to Rs10,020 billion in the first nine months of FY11 against Rs8935 billion in FY10. The structure of public debt has changed over the years.
- Public debt to GDP ratio declined to 55.5 percent during July-March 2010-11, against 60.2 percent in FY10.
- Total external debt and liabilities stood at \$59.5 billion at end March 2011.
- Servicing of external debt and liabilities had risen to \$7.8 billion during July-March 2010-11.

- Total domestic debt has risen to Rs5462.2 billion in FY11, a 17.3 percent increase over Rs4658.3 billion in FY10. In relation to GDP the domestic debt stood at 30.2 percent.

### Capital Market

- Aggregate market capitalization stood at Rs314 billion by end March 2011.
- Total of 638 companies were listed at KSE end March 2011, with total listed capital of Rs920 billion.
- Investment in capital market during the period July-March FY10 by foreign investors showed an inflow of \$301.5 million.

### Targets 2011-12

- The Annual Plan aims at GDP growth of 4.2 percent, with agriculture growing by 3.4 percent, manufacturing 3.1 percent and services by 5.0 percent.
- Major crops are targeted to grow by 3 percent, minor crops 2 percent, livestock 4 percent, fishery 2 percent and forestry will register a decline of 1 percent.
- Industrial sector is expected to grow at 3.1 percent, with projected contributions of mining and quarrying 1 percent, manufacturing 3.7 percent, construction 2.5 percent, and electricity, gas and water supply 1 percent.
- Investment to GDP ratio is projected at 13.8 percent, whereas national savings is projected at 13.2 percent.
- Exports are projected to grow to \$25.8 billion, while imports are projected to increase to \$38.1 billion. Hence the trade account is projected to be in deficit by \$12.3 billion.
- The current account is targeted to be in deficit by \$1.4 billion.
- Gross reserves of SBP are likely to be around \$15.0 billion.
- Inflation as measured by CPI is expected to grow by 12 percent.
- Workers' remittances are targeted at \$12 billion.
- During 2011-12, the peak power sector demand is expected to increase to approximately 21,000MW.
- Power sector reforms and restructuring will continue.
- Total investment cost is around \$21 billion during 2011-15, which will add around 11,058MW of electricity.
- Crude oil production is expected to increase to 69,000 bpd.
- It is envisaged that CNG use for transport will be expanded to around 300 mmcf.
- A comprehensive energy policy document has been assigned top priority.
- Poverty related expenditures are expected to increase in FY11 to Rs1534 billion (7.2% of GDP) against an estimated Rs1326 billion (7.3% of GDP) in FY2010-11.



Rising domestic debt

Revenue collection remained weak throughout the year. Since external financing remained below expectations, the burden of financing the budget deficit fell on domestic sources (bank and non-bank). Outstanding domestic debt reached Rs5,463 billion (30.2% of estimated GDP for FY11) by end March 2011, which is Rs809 billion higher than at the end of FY10. Rising domestic debt is fueling concerns about government debt management.

Current expenditure higher, PSDP lower

The Federal Budget 2011-12 has a total budgetary outlay (expenditure) of Rs2.77 trillion, 14 percent higher from the original budget estimates of Rs2.42 trillion. Revised expenditure figures are placed at Rs2.56 trillion. In FY11, revised estimates for current expenditure show it to be higher by 15 percent at Rs2.3 billion over the budgeted figure, while development expenditure was slashed by 32.4 percent to Rs196 billion. Other development expenditure outside the PSDP was budgeted at Rs123.5 billion, but revised estimates place it at a much smaller figure of Rs45.5 billion. This was primarily because of zero expenditure under relief, rehabilitation reconstruction & security of IDPs against a budgeted figure of Rs45 billion. Under Benazir Income Support Programme, Rs35 billion was spent against budgeted Rs50 billion.

Current expenditures have overshot in recent years. In FY11, it exceeded the budgeted amount of Rs1997.9 billion by 15 percent. This was primarily because of higher interest payments, grants and transfers and subsidies which rose more than three times the budgeted figure. For FY12 current expenditure is budgeted at Rs2.3 trillion, 1 percent higher over revised estimates of FY11.

Servicing of debt higher

Servicing of foreign and domestic debt and foreign loan repayments consumed 52 percent of the allocation for general public service. Total debt servicing consumed 37 percent of the current expenditure outlay and for FY12 it is expected to be higher at 45 percent. Foreign loan repayment has been budgeted at Rs243.2 billion in FY12, as Pakistan starts with the repayment of IMF SBA loans.

The quantum of subsidies rose in FY11 to 2.2 percent of GDP as against 1.5 percent in the

budget estimates for the year. Total subsidies budgeted at Rs126.7 billion rose by over three times to end the year at Rs395.8 billion. WAPDA/PEPCO received Rs295.8 billion, against a budgeted amount of Rs84 billion, KESC was given Rs47.3 billion against Rs3.3 billion budgeted for FY11.

## Subsidies

	(Rs Bn)		
	Budget 2010-11	Revised 2010-11	Budget 2011-12
Subsidy to WAPDA/PEPCO	84	295.8	122.7
Inter-disco tariff differential	30	238.8	50.0
Subsidy to KESC	3.3	47.3	24.6
KESC to pick up tariff differential	2.0	46.0	24.0
Subsidy to Others	15.1	28.4	13.1
R&D Support to Textile Sector	0	7.5	0
TCP for import of urea fertilizer	0	4.0	0

Source: Budget in Brief 2011-12, Government of Pakistan

Subsidies to be reduced

For FY12 subsidy has been reduced to Rs166 billion (0.8% GDP). Power sector subsidies would be reduced to Rs147 billion from Rs343 billion in the outgoing fiscal year. The government has completely eliminated subsidies for manufacture and import of fertilizer and textile (R&D Support).

In FY11, the size of the Federal Public Sector Development Programme (PSDP) was slashed by Rs94 billion, reducing it to Rs196 billion, against the budgeted size of Rs290 billion. Allocation for the PSDP has been increased to Rs300 billion in FY12, 53 percent higher over last year's revised estimates. Including provincial development programme of Rs430 billion, the total outlay is Rs730 billion for FY12 versus Rs462 billion in FY11, a growth of 58 percent.

PSDP reflects new growth strategy

The Annual Plan 2011-12 states, the Federal PSDP has been developed in line with the new growth strategy, which focuses on innovation, institutional reforms, and entrepreneurship as opposed to the hardware (physical infrastructure) approach to growth.

In view of the resource constraints, PSDP focuses on completion of projects, development of infrastructure, especially overcoming energy shortages, development

of social sectors despite devolution of these sectors to the provinces. Water sector receives priority, where focus is on irrigation, drainage, flood control/reconstruction and enhancing capacity of storage. Major projects of this sector are: raising of Mangla Dam, Gomal and Satpara Dams, Kachi and Raineer and Pat Feeder Canals etc.

For water and power sector projects an allocation of Rs36 billion has been made, for planning and development Rs32 billion, for Pakistan Atomic Energy Commission Rs22 billion, Railways Rs15 billion, and Higher Education Commission Rs14 billion.

### Revenue Receipts

Revised estimates for 2010-11 show that gross revenue receipts were smaller by 7.3 percent over the budgeted figure of Rs2.41 trillion. This is attributable to lower tax and non-tax revenue collection during the year. Budget documents for FY2011-12 show that revised tax revenue figures for FY11 were smaller against the target of Rs1.8 billion by 5.6 percent, while non-tax revenues were lower by 12 percent against the target of Rs632 billion.

Revenue falls short of targets

The targets set at the beginning of the fiscal year, were linked with the growth in the economy, on the assumption that growth in revenue collection would correspond with the growth in the economy. GDP was targeted to grow by 4.5 percent during the year and manufacturing by 4.7 percent. Tax base was assumed to increase accordingly. However, the economy faced the problems of energy shortages, circular debt in the power sector, loss making public entities and later the heavy losses inflicted by the floods. As all sectors of the economy suffered, shortfalls in sectoral targets were registered.

As resource mobilisation is linked with the performance of macroeconomic indicators, and when the later turned negative, revenue targets had to be revised down.

Tax-wise details show that in case of direct taxes, there was a decline in income tax

collections. All indirect taxes also showed falls and as such the total indirect taxes were short of the budgeted figure of Rs1.12 trillion by 6.1 percent.

### Revenue Receipts

	2010-11		2011-12
	Budget	Revised	Budget
<i>(Rs Bn)</i>			
<b>A. Tax Revenue*</b>	<b>1778.7</b>	<b>1679.4</b>	<b>2074.2</b>
<b>Direct Taxes</b>	<b>657.7</b>	<b>626.9</b>	<b>743.6</b>
Income	633.0	602.5	718.6
Workers' Welfare Fund	20.0	20.0	25.0
Capital Value Tax	4.7	4.4	0
<b>Indirect Taxes</b>	<b>1121.0</b>	<b>1052.5</b>	<b>1330.6</b>
Customs Duties	180.8	173.3	206.4
Sales Tax	674.9	654.6	836.7
Federal Excise	153.6	132.9	165.6
Petroleum Levy	110.0	90.0	120.0
Others	1.6	1.6	1.8
Airport Tax	0.07	0.07	0.07
<b>B. Non-Tax Revenue</b>	<b>632.3</b>	<b>556.5</b>	<b>658.0</b>
<b>Income from Property &amp; Enterprises</b>	<b>170.0</b>	<b>103.6</b>	<b>195.3</b>
Profits Pak Post Office	1.1	(0.14)	(2.2)
Profits Pak Telecom Authority	50.0	0	75.0
Interest (Provinces)	16.6	18.5	15.6
Interest (PSEs & Others)	38.0	41.8	42.5
Dividends	64.2	43.5	64.4
<b>Receipts from Civil Admn &amp; Other Functions</b>	<b>332.3</b>	<b>302.6</b>	<b>321.4</b>
General Admn	0.8	0.7	0.8
Surplus Profit of SBP	185.0	185.0	200.0
Defence	133.5	115.3	118.7
Law & Order	1.7	0.8	0.9
Community Services	0.8	0.5	0.5
Social Services	10.5	0.4	0.4
<b>Miscellaneous Receipts</b>	<b>130.0</b>	<b>150.3</b>	<b>141.3</b>
Economic Services	2.4	2.2	2.4
Gas Development Surcharge	30.0	31.7	24.9
Discount Retained on			
Local Crude Oil	12.0	25.2	25.1
Royalty on Oil	15.5	19.6	15.2
Royalty on Gas	32.0	35.1	32.8
Passport & Citizenship Fee	10.8	10.7	13.7
Others	27.3	25.7	27.1
<b>Total Revenue Receipt (A+B)</b>	<b>2411.0</b>	<b>2236.0</b>	<b>2732.1</b>
* Out of which FBR	1667.0	1587.7	1952.3

Source: Budget in Brief 2011-12



*Fiscal Measures – Highlights  
Some of the measures adopted in the Federal Budget 2011-12*

Income Tax	Customs Duty	Sales Tax/Federal Excise Duty
<ul style="list-style-type: none"> <li>▪ Minimum threshold for levy of tax for both salaried and non-salaried individuals enhanced from Rs300,000 to Rs350,000.</li> <li>▪ Individuals whose annual income is between Rs300,000 and Rs350,000 will be required to file return despite having zero percent tax.</li> <li>▪ The threshold for filing of wealth statement is proposed to be increased from Rs500,000 to Rs1 million.</li> <li>▪ The rate of tax on cash withdrawals from banks is proposed to be reduced to 0.2 percent from existing 0.3 percent.</li> <li>▪ A tax credit equal to 100 percent of tax payable is proposed for a company which establishes a new industrial undertaking with 100 percent equity financing and engaged in manufacturing in Pakistan or for investment under BMIR of the plant and machinery installed in an existing undertaking.</li> <li>▪ Commercial and industrial consumers of electricity having annual billing of more than Rs1 million are proposed to file income tax return.</li> <li>▪ Profits on debt arising from investment in Government securities shall be liable to tax withholding at 10 percent, which shall be final discharge of tax.</li> <li>▪ Rate of tax credit to companies for enlistment on stock exchange enhanced from 5 percent to 15 percent.</li> <li>▪ Rate of tax on dividend income received by bank from its asset management company is proposed to be enhanced from 10 percent to 20 percent.</li> <li>▪ Existing tax credits available to individuals for investment in shares and for life insurance premium is fixed at 15 percent of the taxable income, with maximum upper limit for investment Rs500,000.</li> <li>▪ The existing tax credit for companies' enlistment on stock exchange equal to 5 percent is proposed to be enhanced to 15 percent.</li> <li>▪ Tax credit on investment in shares and for premium paid to insurance company is rationalized. The monetary threshold of tax credit for investment in shares and life insurance enhanced to 15 percent of the person's taxable income for the year or Rs500,000, whichever is less.</li> </ul> <p><i>Capital Value Tax</i></p> <ul style="list-style-type: none"> <li>▪ CVT at 0.01 percent on Modaraba certificates, shares and instruments of redeemable capital traded at stock exchange withdrawn.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Regulatory duty removed on number of items. 397 items were listed on which regulatory duty was imposed at specified rates. Several items have been removed and now only 60 items are left on which the duty is levied.</li> <li>▪ Custom duty reduced to 5 percent on pharmaceutical raw materials.</li> <li>▪ Concessionary duty allowed on: - <ul style="list-style-type: none"> <li>▪ raw material for butyl acetate industry.</li> <li>▪ raw materials for glass industry.</li> </ul> </li> <li>▪ 15 components for CNG compressors manufacturing industry.</li> <li>▪ raw material of audio cassettes</li> <li>▪ machinery and equipment for oil exploration companies.</li> <li>▪ import of mechanism for car audio system.</li> <li>▪ Tariff rationalized on bars, rods and profiles of refined copper and copper alloy.</li> <li>▪ Repayment of duty incurred for supplies against international tenders.</li> <li>▪ Enhancement of the time period for serving of show cause notice from three years to five years for recovery of duty discovered by an audit.</li> <li>▪ Levy of transit fee on any goods or class of goods in transit across Pakistan to a foreign country.</li> <li>▪ Certain exemption from customs duty and sales tax to exploration and production companies on import of machinery, equipment, specialized vehicles/vessels etc.</li> </ul>	<p><i>Sales Tax</i></p> <ul style="list-style-type: none"> <li>▪ Rate of sales tax reduced from 17 percent to 16 percent.</li> <li>▪ Several exemptions withdrawn on certain goods.</li> <li>▪ Zero rating facility withdrawn on certain goods.</li> <li>▪ Increase in value addition tax levied on commercial importers from 2 to 3 percent.</li> <li>▪ Sales tax leviable on sugar at import and local supply stage has been withdrawn. Federal excise duty at 8 percent is to be levied under sales tax mode.</li> <li>▪ Input tax on acquisition of fixed assets may be claimed in the month of acquisition.</li> <li>▪ Specific provisions for enforcement of black listing companies.</li> <li>▪ Certain items like CNG buses, trailers and semi-trailers, road tractors for semi-trailers are chargeable to sales tax.</li> </ul> <p><i>Federal Excise</i></p> <ul style="list-style-type: none"> <li>▪ Scope of the definition of manufacture enhanced.</li> <li>▪ Special excise duty to be abolished.</li> <li>▪ Rate of excise duty leviable on aerated beverages reduced from 12 percent to 6 percent.</li> <li>▪ Excise duty on specified brands of cement reduced from Rs700 per MT to Rs500 per MT.</li> <li>▪ Excise duty rationalized on filter rods for cigarettes from Rs1 per filter rod to 20 percent advalorem.</li> <li>▪ Excise duty on unmanufactured tobacco raised from Rs5 per kg to Rs10 per kg.</li> <li>▪ Withdrawal of federal excise duty on a number of goods and services, like solvent oil, transformer oil, viscose staple fiber, airconditioners, deep freezers, waste oil, greases etc.</li> <li>▪ Federal excise duty on services provided by property developers or promoters abolished.</li> <li>▪ Uniformity proposed in the period of recovery of federal excise duty and sales tax.</li> </ul>

Source: Federal Budget Documents 2011-12

Taxes short of targets

Under direct taxes, income tax collected in FY11 shows a shortfall of Rs30.5 billion. Sales tax which is a major source of indirect taxes and is levied on manufacturers and retailers with an annual turnover of more than Rs5 million, as well as on the importers, wholesalers, distributors, dealers and specified services at a standard rate of 17 percent and few commodities are subjected to sales tax at 19 percent and 22 percent showed a Rs20 billion shortfall over the year's target of Rs674.9 billion. Sluggish growth of large scale manufacturing and with the telecom market having reached a saturation point, a lower collection is reflected.

Customs duty was lower against the target of Rs180.8 billion in FY11, primarily because of lower collection from POL products, edible oil, machinery and mechanical appliance, electrical machinery, iron and steel among few others. Federal excise duty collection at Rs132.9 billion was smaller by Rs20.7 billion against the target of Rs153.6 billion for the year (FY11). This was primarily because of lower collection from beverages, cement and cigarettes and tobacco.

Absence of tax culture

The Federal Government had taken additional tax measures in March 2011 to achieve the revenue collection target for 2010-11. Through these measures the government planned to generate an additional revenue of Rs90 billion (Rs53 billion by introducing new tax measures and Rs37 billion by plugging leakages). However, tax collection fell short of the year's target. Tax evasion and corruption is responsible for the absence of a responsive tax culture.

Non-tax receipts decline

Revised estimates of the non-tax receipts of the federal government for FY11 show a decline of 12 percent from a budgeted figure of Rs632.3 billion. Receipts from profit of Pakistan Post Office were budgeted at Rs1.1 billion for the year 2010-11. However, due to a decrease in the rate of Post Office commission, declining trend in letter mail and enhancement in salaries and pensions, a deficit of Rs140 million in the year was registered. For FY12, a deficit of Rs2.2 billion is budgeted for. Profit from Pakistan Telecommunication

Authority were budgeted at Rs50 billion. Revised estimates for the year show zero collections.

Dividends show a fall

Dividend collections from non-financial institutions were budgeted at Rs64 billion, while revised estimates place it at Rs43.5 billion, 32.3 percent short of the target. Dividends of Oil & Gas Development Corporation which is among the major contributors, declined from a budgeted figure of Rs29 billion to Rs14 billion in FY11 for Pak Arab Refinery a fall of 80 percent from Rs3 billion to Rs600 million was registered.

Miscellaneous receipts of the Federal government rose, primarily from gas development surcharge, royalty on oil and natural gas and as discount retained on local crude oil. The government forecasts reduced accruals from royalty and gas development surcharge budgeted at Rs72.9 billion in FY12 compared with Rs86.4 billion in FY11. A lower figure for FY12 reflects lower production flows from exploration companies. Petroleum levy (indirect tax) target is placed at Rs120 billion, 33 percent higher over Rs90 billion collected in FY11.

Revised estimates for 2010-11 show that external resources, budgeted at Rs386.6 billion registered a decline and inflows were smaller by 25 percent at Rs290 billion. A further break up of external inflows show a substantial decline under Tokyo pledges and commodity aid (non-food), while IMF assistance increased to Rs68.7 billion against a zero amount budgeted for the year.

## External Resources

	(Rs Bn)		
	Budget 2010-11	Revised 2010-11	Budget 2011-12
Project Aid	78.4	105.8	76.8
Commodity Aid (Non-food)	87.9	47.7	127.0
Tokyo Pledges	82.0	13.7	17.5
Kerry Lugar	51.9	11.0	34.2
Other Aid	86.5	111.6	88.0
IMF	0.0	68.7	0.0
Privatization	0.0	0.0	70.4
Total External Resources	386.6	289.8	413.9

Source: Explanatory Memorandum on Federal Receipts 2011-12, GoP

For FY12, Pakistan hopes to receive Rs414 billion through loans and grants. The increased amount of Rs124 billion in FY12 is being envisaged from significantly higher (Rs79 billion) programme loans, Rs44 billion aid from the Islamic Development Bank and privatisation proceeds of Rs70 billion. If there is any shortfall in the inflow of external resources (25 percent in FY11) from the budgeted amount, the government would fall back on domestic resources.

To finance its expenditure, the government resorted to bank borrowings, which showed a substantial jump of 171.5 percent, and stood at Rs452.2 billion in revised estimates for FY11, against a budgeted figure of Rs166.5 billion. For FY12, external resource inflows are budgeted at Rs413.9 and bank borrowings at Rs303.5 billion.

The strategy of the Federal Budget 2011-12:

- further reduction in the fiscal deficit.

- reduction of inflation to single digit.
- develop a broad, equitable and stable revenue mobilisation system.
- maintaining and further developing social safety nets.
- restructuring of loss making public sector enterprises.
- public sector development programme to focus on infrastructure development and human resource development.
- elimination of un-targeted subsidies.
- reduce debt to sustainable levels.

Over the Medium Term Budgetary Framework (2011-14) the government forecasts to achieve average real GDP growth of 4.7 percent (2013-14). Inflation is expected to come down to single digits i.e. 8 percent. Tax revenue is to climb to 10.8 percent of GDP, with fiscal deficit contracting to 3 percent of GDP and total public debt to GDP ratio falling to 45.9 percent.

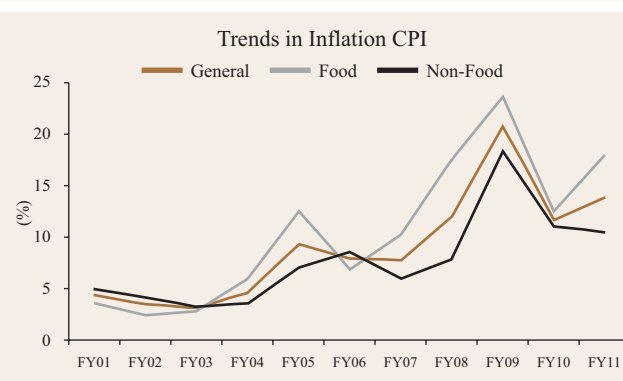
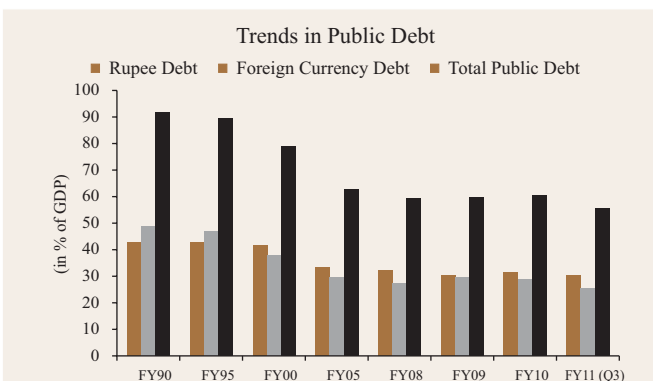
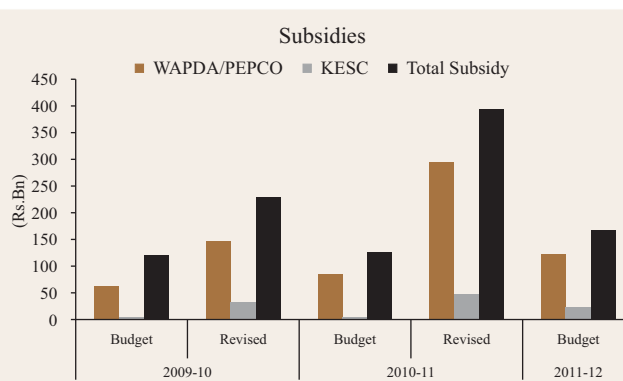
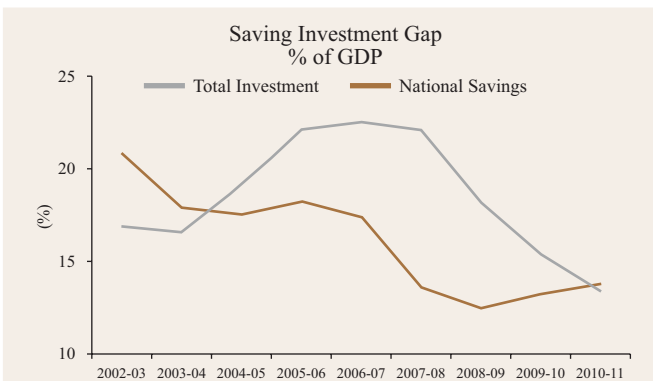
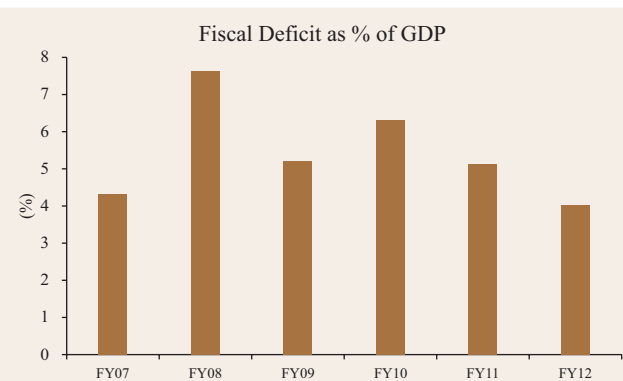
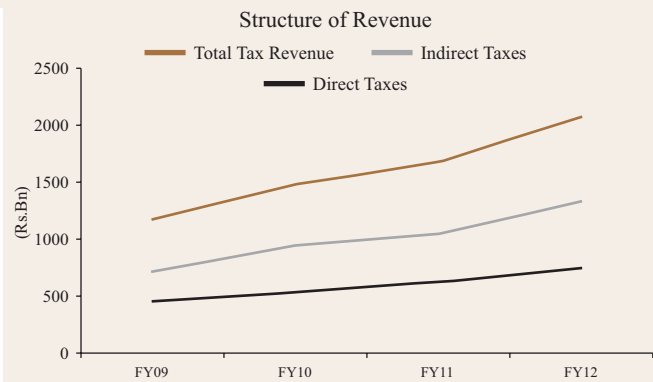
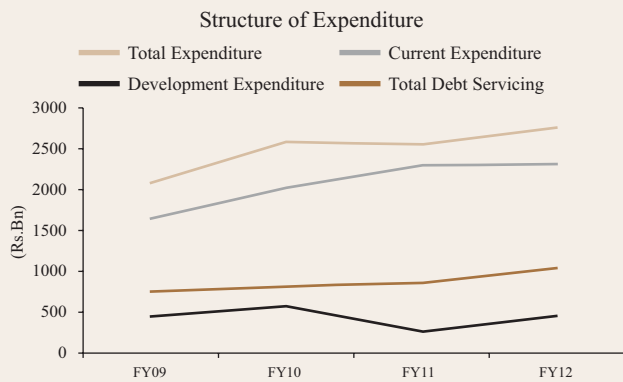
## Macroeconomic Indicators/Rolling Targets

Medium-Term Budgetary Statement	Original Budget 2010-11	Revised Estimates 2010-11	Budget 2011-12	Forecast	
				2012-13	2013-14
Real GDP Growth (%)	4.5	2.4	4.2	4.5	4.7
Inflation (%)	9.5	15.5	12.0	9.5	8.0
	(as percentage of GDP unless otherwise indicated)				
Total Revenue	14.9	13.0	13.6	13.4	13.2
Tax Revenue	10.9	9.8	10.3	10.5	10.8
FBR Revenue	9.7	8.8	9.3	9.6	9.9
Non-Tax Revenue	4.0	3.2	3.3	2.9	2.4
Total Expenditure	18.9	18.7	17.7	16.9	16.2
Current Expenditure	14.6	16.0	13.7	12.8	11.8
Development Expenditure	4.3	2.7	4.0	4.1	4.4
Fiscal Deficit	-4.0	-5.7	-4.0	-3.5	-3.0
Revenue Deficit/Surplus	0.3	-3.0	0.0	0.6	1.4
Total Public Debt	57.2	57.2	53.2	48.7	45.9
GDP at Market Prices (Rs Bn)	17250	18063	21041	24200	27464

To achieve these targets the government has adopted a strategy in the current Budget, as mentioned above.

Source: Budget in Brief 2011-12, Government of Pakistan

## Economy at a Glance



## Sectoral Implications of the Federal Budget 2011-12

### *Oil & Gas*

Measures

- Duty relief on import of E&P and other ancillary equipment.
- Revenue in the shape of petroleum levy targeted at Rs120 billion.

Impact – Neutral

There is no specific impact on the Oil & Marketing Companies but a general reduction in GST by 1 percent across the board would ease pump prices. The GST stands tall at 16 percent for the current fiscal year.

In the light of the above, a further non-budget revision is anticipated by the government for the regulated products to increase their margins for the OMCs, thus, the profitability of the sector is said to improve.

### *Electricity*

Measures

- Gross subsidy for WAPDA has been set at Rs123 billion for FY12.
- Inter-disco tariff differential subsidy has been substantially downgraded to Rs50 billion.
- Gross subsidy allocated to KESC arrives at Rs24.6 billion.

Impact – Neutral to Negative

Owing to consistent pressure from the IMF to resolve the circular debt issue on a serious note has eroded past leverage enjoyed by the Government of Pakistan and subsequently the power sector.

However, budgetary measures show tightening of screws on WAPDA and KESC with substantial empowerment of NEPRA. Subsidy to WAPDA has been reduced substantially in the current budget from Rs296 billion in the last fiscal year to Rs123 billion in FY12 depicting a downfall of 58 percent year-on-year.

Gross subsidy to KESC was cut down even more by 48 percent year-on-year arriving at Rs24.6 billion for the new fiscal year. Since

KESC is already marred by management difficulties marred by their dispute with CBA. Cut in subsidies would eventually lead to substantial rise in power tariffs which would further fuel unrest among the general public; hence not boding well for the current government on political grounds.

However, on a positive note, reduction in subsidies would force WAPDA and KESC to put their house in order. Moreover, since generation costs could now be completely reflected in the tariffs therefore profitability of government managed power companies could elevate.

### *Chemicals*

The salient features of the budget pertaining to the Fertilizer sector are:

Measures

- Decrease in GST to 16 percent from 17 percent.
- Again no subsidy for Pottasic and Phosphatic fertilizer.

Impact – Neutral

The budget remained silent on agri-tax and with no significant changes for farmer support in the budget speech we remain neutral on the overall sector. However, the key developments of 16 percent GST incase of 17 percent can be viewed favourable in terms of Urea and we believe price to decrease by Rs12 per 50kg bag. DAP prices would decline by Rs40 per bag, however, as prices are currently as high as Rs4000 we do not expect it to have a significant impact.

### *Cement*

The salient features of the budget with respect to the cement sector are:

Measures

- PSDP for FY12 has been set at Rs730 billion depicting a substantial rise of 10 percent year-on-year over last fiscal year with Federal component also elevating to Rs300 billion (rising by 53 percent year-on-year from Rs196 billion (revised estimate) in FY11).



- Furthermore, Rs20.5 billion was allocated for the construction of Diamer-Bhasha Dam.
- Federal excise duty was reduced from Rs700 per tonne to Rs500 per tonne, depicting a 40 percent decline and subsequently will be abolished over the next two years.
- Special excise duty has been completely abolished.
- Furthermore, General Sales Tax (GST) was slightly downgraded from 17 percent to 16 percent.

Impact –  
Positive

Similar to previous years an over ambitious amount has been set aside for the PSDP in FY12 arriving at Rs730 billion. Actual disbursement in FY11 was Rs462 billion in contrast with the huge Rs663 billion allocated. Hence, we expect actual disbursement in FY12 to also remain at similar levels. However, realistic allocation for the Diamer-Bhasha dam coupled with recurring pledges from US (under the Kerry-Lugar Bill) and the Asian Development Bank, we anticipate the construction work to commence in early FY12.

Substantial reduction of federal excise duty and GST coupled with complete removal of special excise duty and annulment of duty on white cement is welcome news for cement makers in the country; as this will help in improvement of margins particularly, for large loss making units for instance; MLCF. Furthermore, these budgetary measures could also lead to notable decline in cement prices which have constantly risen ever since December last year owing to cost push factors. Since higher cement prices have been discouraging domestic construction activity, therefore, some decline in cement prices would help local off-take in its recovery.

### *Commercial Banks*

Measures

- Tax rate on dividends from Asset Management Companies raised from 10 percent to 20 percent.
- Withholding Tax reduced from 0.3 percent to 0.2 percent on cash withdrawals.

Tax rate on dividends received from asset management companies (please note: not mutual funds) has been raised from 10 percent to 20 percent. Within our universe, every bank has stake in an asset management company (AMC) and this amendment will affect them. However, this effect will be limited as compared to other investments, in AMCs average only 0.13 percent for the banks we cover (ABL, BAFL, BAHL, FABL, HBL, MCB and UBL). All other income from dividends and capital gains will be taxed as before.

Impact –  
Neutral to  
Negative

Also, the withholding tax on cash withdrawals over and above Rs25,000 has been reduced from 0.3 percent to 0.2 percent, which does not affect banks' earnings.

Meanwhile, the targeted revenue receipts through PIBs issued to banks has been raised by 43 percent (2011-12 budget estimates: Rs41.6 billion, revised budget estimate 2010-11: Rs29.1 billion). Targets for raising revenues through other government securities have been increased too, though not by as much. For the coming year, therefore, we can expect the crowding out of private sector credit to continue.

Speculations regarding raising of taxes on government securities from 30 percent to 40 percent and raise in overall corporate tax rate from 35 percent to 50 percent did not materialize.

According to the finance minister, investments in government securities have been made more convenient by changing the status of the WHT (@10 percent) to a final tax. This, according to the minister, will encourage individuals and non-residents investment in government securities. We, however, feel that this will not increase investment in government securities on the individuals and non-residents part. If it were so, then banks would have suffered in the form of increased competition for deposits.

In the last budget a new limit was imposed for provisioning of NPLs (5 percent of

advances to SMEs), in addition to the limit of 1 percent for total advances. In this budget, additions have been made to let provisioning in excess of 5 percent be carried over to succeeding years (previously only the provisioning above 1 percent of total advances was allowed to be carried over). Again, this has no significance for banks' earnings.

*Fixed Line Telecommunication*

**Measures** Status quo maintained.

**Impact – Neutral** Though the budget has provided relief to many previously federal excise duty (FED) excisable goods, this relief has not been extended to excisable services. As a result, a 19.5 percent FED will continue to be levied on telecommunication services.

*Automobiles*

**Measures**

- Status quo has been maintained in terms of CKDs, CBUs, and used cars.
- Reduction in GST to 16 percent and removal of SED of 2.5 percent.
- 50 percent regulatory duty remains on imported vehicles of over 1800cc.

- Incentive for CNG compressors manufacturing industry through concession on its 15 components.
- Balloting of second phase of Benazir Tractor Scheme is likely to begin on 6th September, 2011. This will have a positive impact for the sector.
- Rs2 billion have been allocated in development expenditure under the Benazir Tractor Support Programme.

**Impact – Neutral to Positive** With no significant improvement in the existing status quo, auto industry does not stand to benefit from the FY2011-12 budget. The government has no particular policy targeting the auto sector. At present, car manufacturing is affected from numerous problems resulting in lower margins. With depressed margins, we do not believe car manufacturing would be lowering price except for Indus Motors.

Tractors manufacturers are likely to register higher sales due to increased crop prices. Benazir Tractor Scheme balloting is to commence on 6th September, we remain bullish on tractor manufacturing companies.

*(Contributed by Taurus Securities Ltd, a subsidiary of National Bank of Pakistan)*

## Provincial Budgets 2011-12 Highlights

### *Sindh*

- The provincial government estimates total expenditure for 2011-12 at Rs457.5 billion.
- Revenue receipts for the year are estimated at Rs458.4 billion, showing an estimated surplus of Rs882 million.
- The current revenue receipts are estimated at Rs391.9 billion. These include Rs251.8 billion of federal tax assignment, Rs54.9 billion as provincial receipts, Rs25 billion sales tax on services, Rs53.4 billion as straight transfers and Rs6.7 billion as grants.
- The revenue expenditure is estimated at Rs283.2 billion.
- The total development outlay for the province has been projected at Rs161 billion.
- Agriculture, livestock, irrigation, transport & communication, industries, education, health, Thar coal infrastructure development, housing, village and town rehabilitation programmes have been prioritised in terms of allocation.
- The province would collect sales tax on services from July, 2011.
- A new initiative in the shape of Sindh Land Development and Management Company has been taken. Under this housing schemes would be started. Around 10,000 plots would be distributed among the poor.
- Development of Thar coal and other energy projects to receive priority.
- Higher budgetary allocations for education and health.
- The provincial government has introduced the Minimum Funding Standard for Schools, tied to a grant of Rs1.79 billion. The programme aims to incentivise schools managed by districts to perform better with a grant to be allocated to their budget if they succeed.
- To eliminate extortion of bribes by policemen from the public, the government will assign every police station its own funds to spend on operating expenses. Under the current system, any funds needed for repair and maintenance, food expenses, stationery has to be bought by the officers themselves, which is later reimbursed. So instead of going through the trouble of paperwork, the policemen seek bribes to cover their operating expenses.
- 16 percent sales tax to be imposed on a wide range of services.
- The development package for Karachi is estimated to be Rs20 billion.
- A new city called Zulfikarabad will be established along the coastal belt of Thatta.
- 300 new schools will be built.

### *Punjab*

- The Punjab provincial government has presented a Rs655 billion budget for FY2011-12.
- The current expenditure is budgeted at Rs435.7 billion.
- The size of the Annual Development Programme is proposed at Rs220 billion. Focus is on completion of on-going schemes.
- In the outgoing fiscal year, the development budget was revised from Rs182 billion to Rs128 billion. The size had to be reduced as resources were needed to meet the challenges posed by floods. The funds were redirected to undertake massive relief, recovery and rehabilitation operations.
- Emphasis is laid on removal of inter-regional disparities.
- General revenue receipts are budgeted at Rs654.7 billion.
- In the budget, Rs88.5 billion are expected from provincial tax revenue, while Rs35.6 billion are expected from non-tax revenue.
- Punjab is to receive Rs530.8 billion from the federal divisible pool of taxes, Rs6.15 billion as straight transfers and Rs3.48 billion as federal grants.
- The provincial government envisages a 20 percent increase in the pay of government servants and 15-20 percent increase in the pensions.
- Conveyance allowance has been increased.
- The provincial government would launch a Yellow Cab Scheme.
- Interest free loans would be given to the educated unemployed for starting small businesses under the Punjab Rozgar Scheme.
- Pro-poor allocations have been raised in the budget. A large portion would be spent to provide subsidised wheat flour to the people, and the rest has been earmarked for subsidising essential food items during Ramazan.
- Some new tax measures imposed to broaden the tax net:
  - motor vehicle tax on engine power greater than 1000cc imposed.
  - taxes to be levied on club membership, fashion shows and musical concerts.
  - Property tax at Rs10-20 per square foot levied on farmhouses built on four kanals or more with minimum covered area of 5000 square feet.
  - 10 percent tax levied on elite clubs.
- Sales tax to be charged at 16 percent.
- Education and health sectors to receive higher allocations.

## *Khyber-Pakhtunkhwa*

- The provincial government has presented a Rs249 billion budget for fiscal 2011-12.
- It has earmarked Rs85.14 billion for Annual Development Programme. 61 percent of the funds are for on-going projects and the rest for new projects.
- The budget proposes no new levy, but an increase in the rates of taxes.
- Sales tax on services reduced from 17 percent to 16 percent.
- The provincial government announced self employment schemes for skilled people, stipend for outstanding students, and technical educational programmes.
- Salary and pension of government servants has been raised by 15 to 20 percent. Conveyance allowance has been extended to employees of grades 1 to 15 across the province.
- Revenue receipts are estimated at Rs232.78 billion.
- The provincial government is to receive Rs149.98 billion from the federal divisible pool under the NFC award. It will also receive Rs18.02 billion for offsetting the impact of the war on terror.
- The provincial government will also receive Rs13.806 billion as royalty on oil and gas through straight transfers.
- The budget envisages Rs7.35 billion as the province's own receipts through tax and non-tax measures.
- Current expenditure is budgeted at Rs149 billion.
- Of the expenditure, the police budget tops all sectors at Rs18.81 billion.
- Education and health jointly get Rs13.12 billion, irrigation Rs2.34 billion, technical education Rs1.23 billion, housing & communications Rs2.32 billion, and pension and insurance Rs16 billion.
- The province will spend Rs10.6 billion on debt servicing and Rs2.5 billion as subsidy on wheat.
- Sizeable amount would be spent on flood relief activities, as well as increasing the capacity of law enforcement agencies.
- Pro-poor schemes would be launched.
- Discretionary funds of MPAs enhanced.
- The province will receive Rs25 billion as instalment of net hydel profit arrears, in addition to the royalty of Rs6 billion from hydro power generation in the year.
- Stipends would be given to outstanding students of matriculation and intermediate.

## *Balochistan*

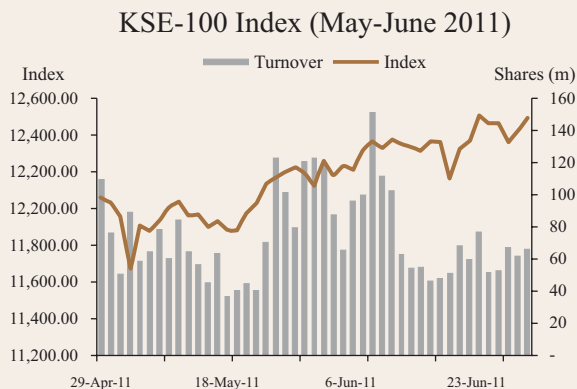
- The provincial government of Balochistan has presented a Rs164.45 billion budget for FY2011-12.
- Non-development expenditure has been budgeted at Rs133.2 billion, while the development programme has been allocated Rs31.24 billion.
- The development programme would be financed through provincial resources (Rs29.13 billion), foreign assistance (Rs2.22 billion) and Japanese grant (Rs0.016 million) for Pasni Fish Harbour.
- Nearly 30 percent of development allocation would be spent on development of communications infrastructure.
- 47 percent of the development funds would be spent on ongoing schemes and 53 percent on new schemes.
- The consolidated revenue and capital receipts are estimated at Rs157.84 billion, resulting in a deficit of Rs6.73 billion.
- The revenue receipts of Rs127 billion, consist of transfers of Rs93.25 billion from federal divisible pool, Rs13.4 billion as straight transfers, Rs3.54 billion on account of GST on services and Rs12 billion as well head price and gas development surcharge arrears. The provincial tax and non-tax receipts are estimated at Rs4.85 billion.
- The provincial government has announced a 15 percent increase in salary of government employees and 15-20 percent enhancement in pensions.
- Conveyance of provincial employees from Grade 1 to Grade 15 increased by 25 percent.
- More jobs to be created.
- Other initiatives focus on enhancing health and education facilities, construction of roads, development of mineral resources, establishment of new industrial estates for attracting investment.
- Education and health to receive higher allocations.
- Stipends of doctors increased.
- Rs8.5 billion has been allocated for investment in various sectors, including mining. It includes establishment of the Reko Diq copper and gold refinery and processing plant.
- The budget proposes introduction of new pay scales for employees from next year.
- Grant of five universities operating in the public sector has been raised.
- Educational boards to be established.

*(This was prepared from newspaper reports)*

## Market Analysis

### Market Review – May to June 2011

The market during the period showed a gradual rise on the back of eclectic volumes. Overall, the KSE-100 Index during May to June, 2011 gained 438 points or 3.6 percent to close at 12,496 on average daily turnover of 73.26m shares.



The market was mainly affected by the political events during the first week of the month. The KSE-100 Index began the week on a bearish note shedding 385 points during the first three days to close at 11,672 on May 4. The capture and killing of Osama Bin Laden during a US operation in Abbottabad along with the target killing of a political leader in Karachi caused nervousness among most local and foreign investors leading to some panic selling. In addition, there was fear that the U.S. Congress would cut off economic aid to the country.

Political events affect the market

The release of the April 2011 inflation data showed that inflation was slowly creeping up again. Fortunately, the market rebounded on May 5 on the back of good news that Moody's maintained Pakistan's sovereign credit rating and stated that Pakistan did not face an immediate risk of a withdrawal of foreign aid despite accusations that it sheltered Bin Laden. There was renewed buying activity in oil stocks such as OGDC, PPL and PSO as there were reports in the market that OGDC's production over the next 2-3 years will be higher than originally anticipated and that

Renewed buying activity

PSO received PKR 89.1bn from Hubco and Kapco and thus, was able to pay off some money owed to refineries and the FBR which led to the unfreezing of its bank accounts. The KSE-100 Index shed 177 points during the week to close at 11,879 on May 6.

The market was mainly upbeat but dull in terms of turnover during the second week. The KSE-100 Index started the week on a bullish note as it gained 156 points in the first 3 trading days to close at 12,036 on May 11. Despite the continuing concerns over the Abbottabad incident, the market was positive due to various news reports on the weekend regarding recommended budgetary measures such as a lower corporate tax rate for listed companies and to not introduce further tax measures on existing taxpayers. In addition, the World Bank team decided to visit Pakistan.

Some positive developments

There was renewed investor interest in ENGRO as it is expected to launch an IPO for Engro Foods, which recently acquired a Halal food company in the USA. There was a slight rebound in international crude oil prices during mid-week and news that production from Maramzai field was about to restart soon (approximately 2,000 bpd crude oil and 40 mmcf/d gas) that led to buying interest in oil stocks such as OGDC, POL, PPL and PSO. Fertilizer stocks had a good week based on news reports that urea prices may hike by another Rs105 per bag as a result of government's agreement to divert 40 mmcf/d gas from Independent Power Producers (IPPs) to fertiliser plants.

In addition, there were positive developments on the macroeconomic front with remittances during FY11 reaching US\$11bn and the trade deficit during the ten months to April 2011 shrinking by 33 percent YoY to US\$ 870m. The KSE-100 Index dipped on May 12 over concerns regarding the uncertainty of the outcome of the meetings during the week with the IMF and some profit taking activity and was subdued on May 13 due to the bomb blast in front of paramilitary training centre in



Charsadda. The KSE-100 posted a marginal gain of 87 points during the week to close at 11,967 on May 13.

The activity was dull with thinning volumes during the third week, as activity was focused on lower tier stocks. The KSE-100 Index dipped by 65 points on May 16 to close at 11,902. The main reason for the decline was the fear among investors regarding the souring US-Pakistan relations and imposition of new taxes. There were warnings from members of the US Congress to cut-off aid and restrict trade with Pakistan if terrorism and militancy were not curbed. In addition, it was reported that the FBR has only accepted less than half of the budget proposals forwarded by the SECP. The Index staged a slight recovery on May 17 to end the day at 11,930 on the back of US Senator John Kerry's statement that there was no immediate threat to aid to Pakistan. The KSE-100 Index dipped again on May 18 to 11,884 because of realization among investors that the next IMF tranche remained uncertain.

Activity  
dull

In addition, the MSCI review led to lowering the weightage of Pakistani stocks in the MSCI Frontier Market Index. Despite positive news on the macroeconomic front about the 10MFY11 current account surplus of \$748m, the market sentiments remained bearish. The T-bill auction held on May 18 resulted in a slight increase in cut-off yields across all tenors which led to further apprehension that there was a slight possibility that the SBP could raise the discount rate in the upcoming Monetary Policy Statement on May 21. There was positive movement in the share price of BAFL on the back of news that it was planning to open 20 new branches by August 2011. On May 19, the KSE-100 Index was lackluster as it shed 5 points to close at 11,878, as most investors decided to sit on the sidelines ahead of the Monetary Policy Statement.

ENGRO witnessed selling pressure as it reported that SNGP cut the gas supply to its new unit in contravention of the Sindh High Court decision and thus will take the matter back to the court. OMC stocks such as PSO

experienced a rise in share price due to news reports that the margins on regulated products such as HSD and Motor Spirit might rise. The falling cotton prices had a negative impact on the share price of LOTPTA. The KSE-100 ended the week on a slight positive note due to speculation regarding the Capital Gains Tax on shares in terms of either the central collection of CGT or possible removal coupled with a hike in CVT. The KSE-100 Index gained only 6 points to end the week at 11,973 on May 20.

The fourth week of May saw the market become bullish with improvement in turnover from the previous week on the back of news flow on the possibility of relaxation in CGT and other budgetary measures. It was reported that the Pakistan Business Council and prominent members of the KSE met with the Federal Finance Minister to discuss budget proposals and it was also reported that the GoP would further consider these proposals. In addition, the SBP kept the policy rate unchanged at 14 percent for the next 2 months on the back of improved external account position and stable prices and the visit of US Secretary of State to Islamabad was seen as a positive development, indicating restoration of some normalcy to Pak-US relations. The last 2 sessions of the month saw slight profit taking with activity concentrated in lower tier stocks. The KSE-100 Index surged by 149 points over the final 7 trading days to end the month at 12,123 on May 31.

Market  
bullish

The market continued to rally in the immediate run-up to the budget as well as the post-budget scenario. The KSE-100 Index gained 254 points from June 1 to 10 to close at 12,377.

KSE Index  
gains

Despite no mention of GCT exemption for individual investors announced in the federal budget on June 3, the reaction remained positive due to the absence of new tax measures or increasing existing income tax rates. In addition, the budget was positive for cement stocks as the FED was decreased by PKR 200 per tone and eventually will be phased out over the next 2 years. This led to a buying spree in cement stocks. Outside of

the budget, the announcement by the government to partially deregulate the retail prices of petroleum products led to renewed interest in OMC sector and the news of discovery at Ikhlas Block (942 bpd of oil and 11mmcf of natural gas) helped boost the share price of POL.

Third week dull

The third week of June was dull and lackluster as there were no positive drivers leading to thinner volumes compared to the previous week. The KSE-100 Index shed 16 points to end the week at 12,361 on June 17. There was profit taking in bell-weather stocks due to fears of double dip recession in the U.S. and Eurozone. The KSE experienced a spill-over effect from the slump in global equity markets. The continued energy shortage has led to 4 IPPs which includes Nishat Power and Nishat Chunian Power to invoke sovereign guarantees to collect outstanding dues from WAPDA, a shutdown of Hubco's Narowal plant and lower gas allocation to fertilizer sector, especially impacting ENGRO's new plant. There was positive news report that the GoP is contemplating increasing the dealer and OMC margin by 50 paisas on regulated oil products.

Market rises slightly

The fourth week of June saw the market rise slightly due to buying activity in selective Index stocks. The KSE-100 Index gained 102 points to end the week at 12,464 on June 24. The Index began on a negative note on the back of gas supply concerns for ENGRO's new plant and news report of lethargic LSM growth during 10mFY11 at 1.7 percent. Fortunately, the market recovered during mid-week because of buying interest in oil and consumer stocks. There were news reports about POL's operated field Domail-II entering the testing phase suggesting another oil and gas discovery might be expected.

In addition, FFC witnessed buying interest on the back of expectations of rising urea prices by ENGRO. NESTLE share price during the week gained 24 percent, albeit an inactively traded stock; it has a significant weight on the KSE-100 Index and hence, contributed to the rise in the Index. The week ended on sour note with profit taking as the next review

Mixed market activity

under the SBA with IMF will not occur until the end of July when the final macroeconomic data for FY11 will be available for review against the targets.

The final week of June saw the market become mixed and range bound. Activity was concentrated in fertilizer, banking and oil sectors. The KSE-100 Index gained 31 points in the last week to end the month at 12,496. The market sentiments were slightly negative, which led to a decline in the KSE-100 Index during the first two days of the week. The market began to recover at mid-week due to buying activity in consumer stocks such as NESTLE, selective oil, fertilizer and banking stocks.

There was buying activity in fertilizer stocks such as FATIMA and ENGRO on the back of a government proposal to increase the feedstock gas price by 100 percent from July 1, 2011, but these plants would continue to receive feedstock at a subsidized rate for 10 years. The market suffered a foreign fund outflow of US\$38.17m during the last 4 sessions of June. The floatation of OGDC exchangeable bonds by the GoP was postponed due to the Greece financial crisis, as the timing was not right and fears that international investors would not be receptive to this offering.

The market direction in the immediate term will be influenced by the following factors:

- IMF negotiations expected in late July will determine if the next tranche under SBA is disbursed ;
- Direction of foreign flows regarding emerging markets ;
- Political developments on both the domestic and geopolitical fronts ;
- Inflation and interest rate trends and
- Quarterly results season.

Looking Ahead

*(Contributed by Taurus Securities Ltd, a subsidiary of National Bank of Pakistan)*

## Book/Report Reviews

*The Economy of Pakistan*  
*Revised and Updated*  
*Khawaja Amjad Saeed*  
*Oxford University Press*

The book has been divided into three parts; (i) Pakistan's economic framework, (ii) economic planning and policies, and (iii) the economic manifesto for the country. While the first chapter shows how Pakistan fares in the world economy, the following chapter discusses the leading theories for economic development. The major economic areas, agriculture, manufacturing, financial, balance of payments, resource mobilisation, both domestic and foreign, infrastructural services like education and health, transport, communication and energy resources have been allocated a chapter each.

The chapter on balance of payments not only talks about some of the theoretical aspects of the issue, but also discusses the main causes of disequilibrium in Pakistan's balance of payments, and gives policy options to the problem. The chapter on Financial Sector shows how this sector evolved in Pakistan. There is a brief description of the financial institutions operating in the country. Money and capital markets have been discussed here. This is followed by a chapter on infrastructural services.

The second part of the book deals with Pakistan's planning experience. The objectives and strategy of the various plans have been mentioned here. This section of the book has chapters devoted to agriculture sector policies, industrial sector policies, commercial, monetary and fiscal policies, labour policies. There is an entire chapter on manpower planning. Mention is made of the development strategies pursued during the last six decades and differences are observed in the strategies.

In the second five year plan due consideration was given to the employment issue, however, according to the author it was lacking, as it failed to assess the sector-wise employment potential. The approach was more integrated but lacking in comprehensiveness. To generate

employment in the country, a strategy was announced during the 1990s. After the establishment of the manpower division at the federal level, plans are being formulated and specific manpower and employment oriented data is being collected.

The second but last chapter in the book suggests an economic strategy for Pakistan to move out from the vicious circle of poverty.

*Tyranny of Language in Education*  
*The Problem and its Solution*  
*Zubeida Mustafa*  
*Ushha Publishing International, 2011*

The author talks about the issue of language in education. What should be the approach adopted towards the medium of instruction in our schools. She feels Pakistan has failed to educate its children because our policy makers have defied common sense when drawing up education policies. Hence the result has been abject failure in achieving the goals that have been set in the education sector.

In the first chapter the author talks about the problem and says, "it is intriguing why language has not been given the importance it deserves in Pakistan's education planning. The language to be used in the education system was determined more by accident or default rather than by careful design."

The choice of language in Pakistan's education system has proved to be a complex issue. Language teaching and the medium of instruction have never been determined by factors related to education, such as competence of teachers, availability of books and the mother tongue of the students. The next two chapters in the book touch on the language policy in education in Pakistan.

Over the years ambiguity has surrounded the language policy in education. The author states, "it is time our educationists did some serious and rational thinking on the language issue if they want their education policy to make an impact. If the class barriers have to be smashed, the government will have to come

forward and take a clear stand on language teaching, especially the medium of instruction.”

There is a chapter on bilingualism, followed by examples from foreign countries and its options in Pakistan, followed by experiences of some bilingual people. The author has visited schools where children of the common man study to get a better understanding of the challenges they face.

What needs to be done is the subject of chapter 8. The government has to take a clear stand on the language policy not only in state matters but also in education. The author recommends that “the child must be taught in the language of the environment upto Grade 5, while the other languages and English should be taught as a subject. After Grade 6 there should be a choice in the medium. It should be Urdu or the language of the environment. English should be taught as a second language from Grade 4 onwards upto Matric.”

It is further stated English can be taught as a second language in school without making it the medium of instruction. Therefore, no institution upto the Matric level should be allowed the option of using English as the medium of instruction, which should only be introduced in higher education, that is, in colleges and universities. The crux of the debate on language in this book is that it is stratifying Pakistani society and leading to inequity in education.

*The Culture of Power and  
Governance of Pakistan 1947 – 2008*  
Ilhan Niaz  
Oxford University Press 2011

The book explains the decline in the ability of the Pakistani state to govern effectively and in accordance with its own formal constitutional parameters between the 1950s and the 1990s.

The objective of the study is to explain why the Pakistani state thus far has failed to exercise power and act in its own enlightened self interest. Over the years the various reforms that have taken place have misunderstood Pakistan’s problems. The author is of the

opinion that the reformers have either failed to understand Pakistan’s underlying structural imperatives or having understood failed to translate their ideas into practice.

As a result the state has slowly but steadily become ineffective while the society has become increasingly ungovernable. The study covers the period 1947–2008, and ends with the resignation of Pervez Musharraf in August 2008.

The book has been divided into seven chapters. The first gives a historical background to the study, while the second chapter examines the first few years of Pakistan’s independence and identifies some of the critical fissures that opened up. Chapter three is essentially about the civil service and higher bureaucracy in Pakistan, chapter four about the military and its role in providing leadership to the state apparatus, while chapter five is about the justice system in Pakistan with particular emphasis on the higher judiciary and the police. Chapter six is about the financial administration of Pakistan and the final chapter addresses the role of corruption in Pakistan.

The book draws to a conclusion that over the last sixty years, Pakistan failed to build upon the positive aspects of the British imperial democracy. It has actually done worse through the subversion and destruction, both conscious and unintentional, of the structure, ethos and discipline of the state apparatus.

There is arbitrariness, delay, personalisation and negation of rules and procedures by the servants of the state, which is reflected in growing ineffectiveness. As the state functionaries divert their attention away from the performance of their duties under law it becomes harder for the state machinery to do anything properly. Incompetence creeps in which brings the rulers as well as the state into disrepute. The writer states, “on the one hand Pakistan has many honest but inexperienced bureaucrats while on the other it has a greater number of dishonest ones who invest their time not in performing their statutory functions but in pleasing the boss. The moral relationship within the apparatus, and between the servants of the state, citizens and the leadership, have, consequently, all but collapsed.”

## Pakistan Economy – Key Economic Indicators

	Unit	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2000-11 <sup>P</sup>
<b>Output and Prices</b>								
GNP Size (MP)	Rs.bn	6634	7773	8831	10452	13070	15403	18847
GDP Size (FC)	Rs.bn	6123	7158	8235	9921	12110	14066	17107
Income Per Capita	\$	724	823	904	1015	990	1073	1254
<b>Real Growth</b>								
	(%)							
GNP		8.7	5.6	6.7	3.7	2.2	5.1	2.3
GDP		9.0	5.8	6.8	3.7	1.7	3.8	2.4
Agriculture		6.5	6.3	4.1	1.0	4.0	0.6	1.2
Manufacturing		15.5	8.7	8.3	4.8	-3.6	5.5	3.0
Services Sector		8.5	6.5	7.0	6.0	1.7	2.9	4.1
<b>Prices</b>								
	(%)							
Consumer Price Inflation		9.3	7.9	7.8	12.0	20.8	11.7	13.9
Wholesale Price Inflation		6.8	10.1	6.9	16.4	18.2	12.6	23.4
Food Inflation CPI		12.5	6.9	10.3	17.6	23.7	12.5	18.0
Non Food Inflation CPI		7.1	8.6	6.0	7.9	18.4	11.1	10.5
Core Inflation <sup>†</sup>		7.2	7.5	5.9	8.4	17.6	11.0	9.7
GDP Deflator		7.0	10.5	7.7	16.2	20.0	11.9	18.8*
Gold Tezabi (Karachi)	Rs./10 grams	8216	10317	12619	16695	22195	29587	39017*
Petrol Super	Rs/Ltr	40.74	55.12	56.00	57.83	67.68	67.56	73.16*
Kerosene Oil	Rs/Ltr	29.11	36.19	39.09	43.44	66.79	72.65	82.12*
Wheat Flour (Avg. Quality)	Rs/Kg	13.28	13.06	13.64	18.07	25.64	28.77	29.73*
<b>Savings and Investment</b>								
	% GDP							
National Savings		17.5	18.2	17.4	13.6	12.5	13.1	13.8
Domestic Savings		15.4	16.3	15.6	11.5	9.8	9.3	9.5
Fixed Investment		17.5	20.5	20.9	20.5	16.6	13.8	11.8
Public		4.3	4.8	5.6	5.4	4.3	3.6	3.3
Private		13.1	15.7	15.4	15.0	12.3	10.2	8.5
<b>Public Finance</b>								
Revenue Receipts (Fed Govt)	% GDP	13.8	14.2	14.9	14.6	14.5	14.0	14.3
Tax Revenue	% GDP	8.9	9.4	9.7	9.8	9.1	8.9	9.2
Total Expenditure	% GDP	17.2	18.5	19.1	22.2	19.9	20.3	18.0
Fiscal Deficit	% GDP	3.3	4.3	4.3	7.6	5.3	6.3	4.0
FBR Tax Collection (Fed Govt)	Rs.bn	588.4	713.4	847.2	1007.2	1161.1	1327.0	1667.0
Direct Taxes	% share	30.1	31.5	39.4	39.6	38.2	39.9	39.4
Indirect Taxes	% share	68.9	68.5	60.6	60.4	61.8	60.2	60.5
Internal Debt Outstanding	Rs.bn	2178	2337	2610	3275	3860	4654	5431
Funded Debt	% Internal Debt	59.8	62.3	64.0	68.8	67.1	68.7	64.2
Un-Funded Debt	% Internal Debt	40.1	37.7	36.0	31.2	32.9	31.3	35.8
<b>Monetary Sector</b>								
Growth of Monetary Assets M2	%	19.3	15.2	19.3	15.3	9.6	12.5	9.4
Currency in Circulation	Rs.bn	665.9	740.4	840.2	982.3	1152.2	1295.4	1510.0

P Provisional

<sup>†</sup> non-food non-energy

\* July-March



	Unit	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11 <sup>P</sup>
Credit to Private Sector	Rs.bn	1712	2114	2480	2890	2907	3020	3250
Credit to Public Sector	Rs.bn	752	834	927	1508	2034	2441	2641
Borrowings for Budgetary Support	Rs.bn	647	708	810	1365	1681	2011	2329
Resident Foreign Currency Deposits	Rs.bn	180	196	207	263	280	345	368
Demand Deposits / Money Ratio	%	32.1	31.9	65.0	65.5	62.4	62.2	60.5
<b>Capital Market (KSE)</b>								
Listed Capital	Rs.bn	439	496	631	706	782	910	920 <sup>†</sup>
Market Capitalisation	Rs.bn	2068	2801	4019	3778	2143	2732	3148 <sup>†</sup>
Listed Companies at KSE	Nos	659	658	658	652	651	652	638 <sup>†</sup>
<b>Banking Sector</b>								
Scheduled Banks Deposits <sup>a</sup>	Rs.bn	2428	2817	3373	3812	4138	4693*	4984*
Scheduled Banks Advances <sup>b</sup>	Rs.bn	1694	2071	2376	2816	3080	3174*	3306*
Non-Performing Loans All Banks	Rs.bn	177	173	214	314	432	460	548 <sup>†</sup>
Lending and Deposit Rates	weighted average							
Deposits	% pa	1.37	1.96	2.60	4.13	4.44	5.91*	5.97
Advances	% pa	8.81	10.61	11.55	12.49	14.25	13.52*	13.55
<b>Open Market Operation</b>								
SBP 3-Day Repo <sup>1</sup>	% pa	9.00	9.00	9.50	12.00	14.00	12.50	14.0 <sup>†</sup>
Treasury Bills Yield - 6 Months	% pa	7.96	8.49	8.90	11.47	14.01	12.59	13.67
KIBOR - 6 Months	% pa	8.46	9.36	9.75	13.95	12.65	12.25	13.73
Pakistan Investment Bonds - 5 yrs	weighted average	7.50	9.65	10.0	10.80	14.33	12.56	14.28 <sup>†</sup>
Interbank Call Rates (Overnight)	%	6.10	8.80	8.90	9.90	11.35	11.0	13.50
SBP Export Finance Rate	%	6.50	7.50	6.50	6.50	6.50	8.00	10.0
<b>External Sector</b>								
Exports	\$ bn	14.48	16.55	17.28	20.43	19.12	19.67	22.78 <sup>†</sup>
Imports	\$ bn	19.00	25.00	26.98	35.40	31.75	31.21	31.21
Balance of Trade	\$ bn	-4.52	-8.45	-9.71	-14.97	-12.63	-11.54	-8.43
Current Account Balance	\$ bn	-1.75	-5.65	-7.40	-14.30	-9.26	-3.95	748mn
Workers' Remittances	\$ mn	4168	4600	5494	6451	7811	8906	10096 <sup>†</sup>
Foreign Private Investment	\$ mn	1677	3872	6960	5454	3209	2739	11760 <sup>†</sup>
Direct	\$ mn	1525	3521	5140	5410	3720	2151	1392 <sup>†</sup>
Portfolio	\$ mn	153	351	1820	44.3	-510	588	368
<b>Debts</b>								
External Debt and Liabilities	\$ bn	35.8	37.6	40.5	46.2	52.3	55.9	59.5 <sup>†</sup>
Domestic Debt Outstanding	Rs.bn	2158	2337	2610	3275	3860	4658	5462 <sup>†</sup>
Internal Debt as % of GDP	%	33.5	30.7	30.1	32.0	30.3	31.4	30.2
National Saving Schemes**	Rs.bn	940	936	1004	1094	1361	1668	1755
Total Reserves	\$ mn	13338	14354	18890	13436	13971	17921	20000 <sup>†</sup>
Gold	\$ mn	917	1268	1344	1926	1935	2575	2979 <sup>†</sup>
Liquid Fx Reserves	\$ mn	12421	13086	17546	11510	12036	15346	17021 <sup>†</sup>
Exchange Rate (Average for year)	Rs/US\$	59.3576	59.8566	60.6342	62.5465	78.4983	83.8017	85.5994

<sup>†</sup> July-March <sup>a</sup> excludes deposits of schedule banks <sup>b</sup> excludes advances to schedule banks

\* December 2010 \*\* Outstanding

<sup>1</sup> SBP 3 day repo rate was renamed as SBP reverse repo rate wef August 17, 2009

Source: Pakistan Economic Survey 2010-11