Abstract: **Budget Deficit and Domestic Public Debt**

The recent budget shows extreme fiscal stress and it is the only budget in which nominal disposable income of middle income group has gone down. The major reason for this fiscal stress is the interest payment on public debt. The interest payment on public debt is closely related to the "Policy Rate" which is to be decided by Government herself. SBP, the institution which has mandate to decide policy rate, has increased policy rate from 5.75% to 13.25%, causing a direct and proportionate increase in the interest payments on public debt. The objective of SBP from the policy rate hike is to control inflation, but the consequent rise in interest payment causes hike in taxes which ultimately increase inflation contrary to the perception of monetary authorities. The cost of this policy rate is so high that it hurts allocation to most crucial sectors.
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This paper argues that fiscal stress can be reduced along with a reduction in inflation, if the policy rates are brought down to the level of peer economies like Bangladesh, Thailand and Vietnam.