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MONEY SUPPLY, FISCAL DEFICIT, AND INFLATION: EVIDENCE FOR PAKISTAN

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Abstract

There has been Investigation of relationship among money supply, budget deficit and inflation in this research study. Data for the period 1990-2017 has collected from the state bank of Pakistan and World Bank economic indicators on their website. In analysis, we have used unit root test, regression analysis and co-integration test for applying to the information gathered through secondary resources. In findings, we have key outcomes that money supply and inflation have different effects on the fiscal deficit. Our result has supported a positive relationship in between fiscal deficit and money supply. We had also explored the negative relationship between inflation and fiscal deficit. This mention that government has to implement such policies, which can control the inflation and money, supply both for reduction in fiscal deficit. Increase in inflation, decrease in money supply and later increase in fiscal deficit make bad impact to the Economy of Pakistan.

***Keywords*:** Money Supply, Inflation, Fiscal Deficit, Economy of Pakistan

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Introduction

Dealing with fiscal deficit, inflation and money supply has now become a global concern. There are different studies present, which identify the relationships among these variables either on individual basis or on collective basis. We can say that the coordinate relation is at the core of monetary economics amongst fiscal deficit, inflation and money supply. This is monetary phenomenon about money supply that when growth of money tends to be less than the growth rate of money, it is about to create inflation. In a period, when expenditure tends to be higher than the revenues then budget deficit arises and if we add borrowing and other liabilities to the budget deficit then we get fiscal deficit.

Interest rates have been yield to the fiscal deficits, which have hardened effects to the economic productivity and the growth. According to the Darrat & Suliman (1991), monetary authorities do monetization of parts of deficits, which then lower the inflation and money growth. It is present in the previous researches that high inflation rates had generated negatively due to tight monetary policy because of large deficit (Sargent & Wallace, 1984). This led to government officials; practitioners and economists for compose such mechanisms, which could utilize for the controlling and lowering the increase in budget deficit. Central Bank in most of developing countries is in direct control of the government where creation of money has done for overcoming the deficits of government.

Fiscal expansion has said to be a vital requirement for getting macroeconomic stability and growth of economy. According to the Aghevi (1975), Otani & Park(1976) and Aghevli & Khan (1976), in many developing countries , government borrowing from international resources and banking systems is linked with monetary expansion. According to Chaudhary & Abe (1999), budget deficit has considered as a source of high inflation, crowding out of the investment by private investors, current account deficit and low growth of economy. Government reply over debit financing is necessary in developing countries because they cannot able to mobilize the domestic resources and would not been able to broadening the narrow tax base (Tanzi, 1982). According to Gupta (1991), view of monetarist is that in log run higher inflation and increase in money supply could be occurred through monetization.

Low revenue resources and increasing expenditures have restricted the budget of Pakistan and there is high dependency on indirect taxes, public debt burden and less control of government over resources (Padda & Akram, 2009). In 1960, fiscal deficit of Pakistan was 2.1% of GDP, it was 5.3% in 1970 and it was amplified to 7.1% in 1980.In 1990, it was tied to lower the deficit and maintain it to the level of 4% of GDP but even then it stayed at 6.9% of GDP with a little success that it was lower than 1980s' deficit. During 2001-2010, the budget deficit is averaged 4%. From 2010-2013, it has been averaged 7.4% of GDP and then it gone down in 2014 as 5.5%. Targeted development

spending on lower side and non tax revenues on higher sides caused this enhancement (GoP Report, 2015).

As a percentage of GDP, Fiscal deficit continued to fall for 2015-2016.The fiscal deficit for 2015-2016 was 4.6% of GDP that was lower as compared to 5.3% in 2014-2015; it had achieved through control over current expenditure and growth in tax revenues (Fiscal Policy Statement, 2017).

Research Objective

In this paper, we empirically test the relationships amongst inflation, money supply and the fiscal deficit. The main purpose of this paper is to analyze empirically the factors that can influence the fiscal deficit of Pakistan for the period 1990-2016.

The Section 1 of the paper gives Introduction, followed by the Section 2 that is Literature Review. Methodology comes in the Section 3 later followed by the Section 4 that represents Data Analysis and Discussion. Heading Conclusion concludes the Section 5.

LITERATURE REVIEW

An important discourse in economic literature is the correlation between budget deficit, money supply/ growth and inflation. Economists have applied various econometric strategies in various countries and different durations to analyze the relation between these three variables. Mostly studies analyzed correlation between monetary downfall and supply of money and their effect on inflation.

Exceptionally few endeavors have been made to analyze the effect of inflation influences monetary downfall and how monetary downfall influences inflation (Ndebbio 1998; Miller 1983 and Agheveli & Khan 1978).

Vieira (2000) inspected the effect of monetary downfall on the inflation in European nations. Cevdet et al., (2001) inspected the long-haul relationship of inflation rate, budget deficit, and genuine yield development. They conclude that changes in the monetary downfall does not have a long haul relationship with inflation while, borrowing from banks does have an impact on inflation in the long run.

Catao and Terrones (2003) have presented that there is positive correlation among monetary shortfalls and inflation for developing nations only. It was observed that decrease in monetary shortfall by 1% decreases the inflation by 1.5-6% in the long run depending on the inflation tax base.

Miller (1983) highlights that monetary downfall creates an inflationary pressure in every case. Fischer (1989) discovered that there was a strong relationship found between the monetary downfall and inflation for the countries facing higher inflation. Moreover, high rate of inflation increments budget deficit by declining seignorage income.

Ndungu (1995) found that for the Keynesian economy budget deficit influences the inflation by influencing the money supply. Hondroyiannis and Papapetrou (1997) determined how the budget defecit influences inflation both directly and indirectly in Greece. They determined that budget deficit increases inflation in an indirect manner. In any case, they too expressed that an increment in inflation comes about in an increment in budget deficit. Kivilcim (1998) has analyzed the long run relationship between budget shortfall and inflation in Turkish economy amid 1950-1987. He determined that an alterion in budget deficit cause to alter in inflation on the same heading. De Haan and Zelhorst (1990) also analyzed this relationship in developing countries and discovered that budget deficits of a country effects expansion, which causes inflation to increase.

In Pakistani context, results from the research examinations conducted for the purpose of examination of the roles of monetary shortfall as a prominent indicator of inflation are mixed. Bilquees (1988) found no correlation between the monetary shortfalls an inflation. Neyapti's (1998) found no statistically significant associations between the monetary shortfalls and inflation for many countries, which include Pakistan, from his analysis of the data set consisting of 44 less developed and developing countries. Whereas, Shabbir and Ahmed (1994) found a positive and significant relationship of monetary shortfalls and inflation in Pakistani context. Their study suggests a 6-7% increase in the pricing level because of 1% increase in the monetary shortfall. The findings of Chaudhary and Ahmad (1994) indicate that the financing of monetary shortfall through domestic sources like domestic banks would cause more inflation for the years to come. Results from severe inflation period of the 1970s indicate a positive relationship among monetary shortfalls and inflation. Researchers also discovered that the money supply is not affected by extrinsic factors, rather it is affected by the international reserves and monetary shortfalls of a country. Khan and Qasim (1996) indicate that "expansionary fiscal policy" has resulted in the repeated devaluation of Rupee, causing the pricing levels to increase drastically.

In the recent years, Agha and Khan (2006) have examined the long-haul relationship among monetary measures and inflation for the period of 1973-2003 in Pakistan. Their study using "Johansen cointegration analysis" stipulated that inflation in the long run is related to monetary variances as well as the sources of financing the monetary shortfalls. In essence, researchers conclude those government borrowings from banks for monetary shortfalls as well as the support of their budgets as the major source of inflation, thus monetary policy is a major indicator for explaining the pricing changes.

Research Methodology

The Model:

Based on the available literature and with the support of previous researches, research equation will be:

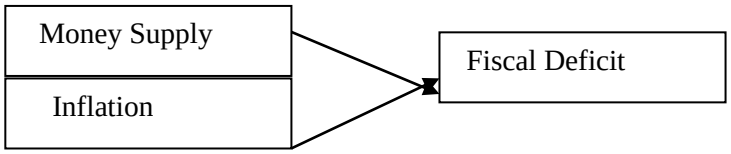
FiscalDeficit = C + β_0 M2 – β_1 Inflation

Where,

FiscalDeficit = Fiscal Deficit

M2 = Money Supply

Inflation = Inflation



Data & Sample:

In Pakistan's case, there are mixed results shown from the examination of the role of monetary downfall and inflation. Thus the data series from 1990-2016 may provide more reliable corroboration with respect to relationship of inflation, supply of money and monetary downfall.

The data was taken from "State Bank of Pakistan" and from the economic indices issued by "World Bank".

The data was analyzing for the assumptions of OLS (Multicollineraity, heteroscedasticity, Autocorrelation, Cointegration Test and Unit Root Test) as well.

Analysis and Results

Normal OLS Regression

Dependent Variable: FISCALDEFICIT, Least square method, 1990-2015, with 26 adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-8.926906	3.323917	-2.685658	0.0132
INFLATION	-0.003719	0.059083	-0.062940	0.9504
M2	0.064422	0.064262	1.002502	0.3265

R-squared	0.045434	Mean dependent var	-5.838462
Adjusted R-squared	-0.037572	S.D. dependent var	1.660380
S.E. of regression	1.691284	Akaike info criterion	3.997020
Sum squared resid	65.79019	Schwarz criterion	4.142185
Log likelihood	-48.96127	Hannan-Quinn criter.	4.038823

F-statistic	0.547354	Durbin-Watson stat	0.793770
Prob(F-statistic)	0.585829		

Interpretation:

FiscalDeficit = -8.9269 + (0.0644) M2 – (0.0037) Inflation

- The p-value for Inflation (0.9504) and M2 (0.3265) are greater than the common alpha level of 0.05, which indicates that they are not statistically significant. The t-stats are also not showing a significant impact.
- R square lies between 0 and 1, provided there is an intercept term in the model. The closer it is to 1, the better is the fit, and the closer it is to 0, the worse is the fit. In our case, R-Squared is 0.045.
- Here, if INFLATION increases by 1 unit the FISCALDEFICIT decreases by 0.0037 units ceteris paribus and if M2 increases by 1 rupee the FISCALDEFICIT increases by 0.064 units ceteris paribus.
- The "F value" and "Prob(F)" statistics test the overall significance of the regression model. Specifically, they test the null hypothesis that all of the regression coefficients are equal to zero. The F value is the ratio of the mean regression sum of squares divided by the mean error sum of squares. Its value will range from zero to an arbitrarily large number and in our case, it is 0.54. The value of Prob (F) is the probability that the null hypothesis for the full model is true (i.e., that all of the regression coefficients are zero). For example, if Prob(F) has a value of 0.01000 then there is 1 chance in 100 that all of the regression parameters are zero and here is our case, it is 0.58.

Variance Inflation Factor (VIF) for detection of Multicollinearity

Variance Inflation Factors
Date: 05/13/18 Time: 22:29
Sample: 1990 2016
Included observations: 26

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	11.04843	100.4247	NA
INFLATION	0.003491	4.328660	1.054879
M2	0.004130	89.44580	1.054879

Interpretation:

- The Variance Inflation Factor (VIF) is a measure of collinearity among predictor variables within a multiple regression. It is calculated by taking the atio of the variance of all a given model's betas divide by the variance of a single beta if it were fit alone.
- We have to check centered VIF values and start to check according to rule of thumb that value should be more than 3 then it should be considered that multicollinearity is present.
- In our case, multi-collinearity is not present.

Breusch-Pagan (BP) test for detection of Heteroscedasticity

Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	0.726613	Prob. F(2,23)	0.4943
Obs*R-squared	1.545148	Prob. Chi-Square(2)	0.4618
Scaled explained SS	0.945991	Prob. Chi-Square(2)	0.6231

Test Equation:
Dependent Variable: RESID^2
Method: Least Squares
Date: 05/13/18 Time: 17:31
Sample: 1990 2015
Included observations: 26

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.842674	6.414443	0.599066	0.5550
INFLATION	-0.133627	0.114017	-1.171991	0.2532
M2	0.000928	0.124011	0.007487	0.9941

R-squared	0.059429	Mean dependent var	2.530392
Adjusted R-squared	-0.022360	S.D. dependent var	3.227925
S.E. of regression	3.263814	Akaike info criterion	5.311837
Sum squared resid	245.0071	Schwarz criterion	5.457002
Log likelihood	-66.05388	Hannan-Quinn criter.	5.353639
F-statistic	0.726613	Durbin-Watson stat	1.386663
Prob(F-statistic)	0.494316		

Interpretation:

- Breusch–Pagan test has used to test for heteroskedasticity in a linear regression model. This is the basis of the Breusch–Pagan test. It is a chi-squared test: the test statistic is distributed nχ2 with k degrees of freedom.

The probability of Fstats is significant at the level of 1 % significance hence we may conclude that null hypothesis failed to be reject and here heteroscedasticity does not exist.

Durbin Watson Test for detection of Autocorrelation

Dependent Variable: DFISCALDEFICIT
Method: Least Squares
Date: 05/13/18 Time: 17:20
Sample (adjusted): 1991 2015
Included observations: 25 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DINFLATION	0.037571	0.040512	0.927399	0.3633
DM2	0.011589	0.103024	0.112492	0.9114

R-squared	0.032089	Mean dependent var	0.132000
Adjusted R-squared	-0.009994	S.D. dependent var	1.432283
S.E. of regression	1.439422	Akaike info criterion	3.642979
Sum squared resid	47.65452	Schwarz criterion	3.740489
Log likelihood	-43.53724	Hannan-Quinn criter.	3.670024
Durbin-Watson stat	2.399062		

Interpretation

- The DW value for this regression is 2.39, which fall into the category of uncertainty about the presence of negative autocorrelation.

Breusch-Godfrey Serial Correlation LM Test for detection of Autocorrelation

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	5.677015	Prob. F(2,21)	0.0107
Obs*R-squared	9.124204	Prob. Chi-Square(2)	0.0104

Test Equation:
Dependent Variable: RESID
Method: Least Squares
Date: 05/13/18 Time: 17:12
Sample: 1990 2015
Included observations: 26
Presample missing value lagged residuals set to zero.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.924936	2.991028	0.309237	0.7602
INFLATION	0.011108	0.050966	0.217955	0.8296

Interpretation

- The DW value for this regression is 1.90, which is near about 2 showing no autocorrelation.

Autocorrelation Function (ACF) and Correlogram

Date: 05/14/18 Time: 11:15
Sample: 1990 2016
Included observations: 26

Autocorrelation	Partial Correlation		AC	PAC	Q-Stat	Prob
. |**** |	. |**** |	1	0.598	0.598	10.403	0.001
. |*** |	. | . |	2	0.363	0.008	14.391	0.001
. |* . |	. *| . |	3	0.107	-0.176	14.752	0.002
. | . |	. | . |	4	0.041	0.067	14.808	0.005
. | . |	. | . |	5	-0.011	-0.015	14.813	0.011
. *| . |	.**| . |	6	-0.178	-0.275	15.961	0.014
.**| . |	. *| . |	7	-0.306	-0.154	19.551	0.007
***| . |	. *| . |	8	-0.418	-0.153	26.606	0.001
.**| . |	. |* . |	9	-0.298	0.091	30.420	0.000
. *| . |	. |* . |	10	-0.155	0.075	31.511	0.000
. *| . |	.**| . |	11	-0.194	-0.285	33.345	0.000
. *| . |	. *| . |	12	-0.199	-0.066	35.403	0.000

Interpretation

- Spikes are varying and no larger spikes have seen showing there is no autocorrelation.
- Null hypothesis for Q-Stat is HO that is data is non-stationary and based on p-value it has concluded that data found to be non-stationary.

Unit Root Test: Dicky Fuller Test for fiscal deficit

Null Hypothesis: FISCALDEFICIT has a unit root
Exogenous: Constant, Linear Trend
Lag Length: 0 (Automatic - based on SIC, maxlag=5)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-2.373959	0.3829
Test critical values:	1% level	-4.374307	
	5% level	-3.603202	
	10% level	-3.238054	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(FISCALDEFICIT)
Method: Least Squares
Date: 05/13/18 Time: 17:08
Sample (adjusted): 1991 2015
Included observations: 25 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FISCALDEFICIT(-1)	-0.390919	0.164669	-2.373959	0.0267
C	-2.248806	1.183442	-1.900225	0.0706
@TREND("1990")	0.006083	0.037474	0.162321	0.8725

R-squared	0.205352	Mean dependent var	0.132000
Adjusted R-squared	0.133111	S.D. dependent var	1.432283
S.E. of regression	1.333554	Akaike info criterion	3.525738
Sum squared resid	39.12403	Schwarz criterion	3.672003
Log likelihood	-41.07173	Hannan-Quinn criter.	3.566306
F-statistic	2.842602	Durbin-Watson stat	2.037474
Prob(F-statistic)	0.079786		

- This series is non-stationary as probability is more than 0.1, null hypothesis is accepted here

Remedy - Best- Augmented Dicky Fuller Test (First Difference)

- When we run the same test for first difference we got the results given below:

Null Hypothesis: D(FISCALDEFICIT) has a unit root
Exogenous: Constant, Linear Trend
Lag Length: 0 (Automatic - based on SIC, maxlag=5)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-5.647446	0.0006
Test critical values:	1% level	-4.394309	
	5% level	-3.612199	
	10% level	-3.243079	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(FISCALDEFICIT,2)
Method: Least Squares
Date: 05/14/18 Time: 10:29
Sample (adjusted): 1992 2015
Included observations: 24 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(FISCALDEFICIT(-1))	-1.210969	0.214428	-5.647446	0.0000
C	0.274054	0.672370	0.407595	0.6877
@TREND("1990")	-0.009657	0.044216	-0.218399	0.8292

R-squared	0.603295	Mean dependent var	0.012500
Adjusted R-squared	0.565514	S.D. dependent var	2.268367
S.E. of regression	1.495207	Akaike info criterion	3.758874
Sum squared resid	46.94850	Schwarz criterion	3.906131
Log likelihood	-42.10649	Hannan-Quinn criter.	3.797942
F-statistic	15.96806	Durbin-Watson stat	1.991860
Prob(F-statistic)	0.000061		

- After 1st Difference ADF test, the time series has become the stationary as we got the probability 0.0006.

Unit Root Test: Dicky Fuller Test for Inflation

Null Hypothesis: INFLATION has a unit root
Exogenous: None
Lag Length: 1 (Automatic - based on SIC, maxlag=5)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-1.237122	0.1922
Test critical values:	1% level	-2.664853	
	5% level	-1.955681	
	10% level	-1.608793	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(INFLATION)
Method: Least Squares
Date: 05/13/18 Time: 17:09
Sample (adjusted): 1992 2015
Included observations: 24 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INFLATION(-1)	-0.158512	0.128129	-1.237122	0.2291
D(INFLATION(-1))	-0.424675	0.188357	-2.254623	0.0344

R-squared	0.292810	Mean dependent var	-0.400000
Adjusted R-squared	0.260665	S.D. dependent var	8.240779
S.E. of regression	7.085800	Akaike info criterion	6.833718
Sum squared resid	1104.588	Schwarz criterion	6.931889
Log likelihood	-80.00461	Hannan-Quinn criter.	6.859763
Durbin-Watson stat	2.307636		

- This series is non-stationary as probability is more than 0.1, null hypothesis is accepted here

Remedy - Best- Augmented Dicky Fuller Test (First Difference)

- When we run the same test for first difference we got the results given below:

Null Hypothesis: D(INFLATION) has a unit root
Exogenous: None
Lag Length: 1 (Automatic - based on SIC, maxlag=5)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-6.060736	0.0000
Test critical values:	1% level	-2.669359	
	5% level	-1.956406	
	10% level	-1.608495	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(INFLATION,2)
Method: Least Squares
Date: 05/14/18 Time: 10:36
Sample (adjusted): 1993 2015
Included observations: 23 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(INFLATION(-1))	-2.117315	0.349350	-6.060736	0.0000
D(INFLATION(-1),2)	0.408642	0.201295	2.030061	0.0552

R-squared	0.790218	Mean dependent var	-0.095652
Adjusted R-squared	0.780228	S.D. dependent var	14.57643
S.E. of regression	6.833399	Akaike info criterion	6.764463
Sum squared resid	980.6023	Schwarz criterion	6.863201
Log likelihood	-75.79132	Hannan-Quinn criter.	6.789295
Durbin-Watson stat	1.936933		

After 1st Difference ADF test, the time series has become the stationary as we got the probability 0.0000.

Unit Root Test: Dicky Fuller Test for Money Supply

Null Hypothesis: LNM2 has a unit root
Exogenous: Constant, Linear Trend
Lag Length: 1 (Automatic - based on SIC, maxlag=5)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-2.999829	0.1526
Test critical values:	1% level	-4.394309	
	5% level	-3.612199	
	10% level	-3.243079	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(LNM2)
Method: Least Squares
Date: 05/14/18 Time: 10:37
Sample (adjusted): 1992 2015
Included observations: 24 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LNM2(-1)	-0.502582	0.167537	-2.999829	0.0071
D(LNM2(-1))	0.444120	0.197060	2.253732	0.0356
C	1.878022	0.625861	3.000700	0.0071
@TREND("1990")	0.005722	0.002409	2.375072	0.0277

R-squared	0.341231	Mean dependent var	0.012109
Adjusted R-squared	0.242416	S.D. dependent var	0.065052
S.E. of regression	0.056621	Akaike info criterion	-2.753854
Sum squared resid	0.064119	Schwarz criterion	-2.557512
Log likelihood	37.04625	Hannan-Quinn criter.	-2.701764
F-statistic	3.453222	Durbin-Watson stat	2.014822
Prob(F-statistic)	0.035996		

- This series is non-stationary as probability is more than 0.1, null hypothesis is accepted here

Remedy - Best- Augmented Dicky Fuller Test (Second Difference)

- When we run the same test for second difference we got the results given below:

Null Hypothesis: D(LNM2,2) has a unit root
Exogenous: Constant, Linear Trend
Lag Length: 0 (Automatic - based on SIC, maxlag=5)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-5.647267	0.0007
Test critical values:	1% level	-4.416345	
	5% level	-3.622033	
	10% level	-3.248592	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(LNM2,3)
Method: Least Squares
Date: 05/14/18 Time: 10:38
Sample (adjusted): 1993 2015
Included observations: 23 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LNM2(-1),2)	-1.231651	0.218097	-5.647267	0.0000
C	-0.022618	0.041835	-0.540642	0.5947
@TREND("1990")	0.001578	0.002699	0.584434	0.5655

R-squared	0.614665	Mean dependent var	0.002519
Adjusted R-squared	0.576132	S.D. dependent var	0.131421
S.E. of regression	0.085562	Akaike info criterion	-1.958043
Sum squared resid	0.146417	Schwarz criterion	-1.809935
Log likelihood	25.51749	Hannan-Quinn criter.	-1.920794
F-statistic	15.95145	Durbin-Watson stat	2.148030
Prob(F-statistic)	0.000072		

- After 2nd Difference ADF test, the time series has become the stationary as we got the probability 0.0007.

Conclusion and Policy Implications

When inflation rises in the country then money growth of a country decreases, showing an inverse relationship. The main concern of the paper is that if there is inflation and money growth in an economy then how does it affect the fiscal deficit in an economy, and the responsibility falls on the central bank and other financial institutions if they are not independent and do not make an attempt to curtail the budget deficits. Our result shows negative relationship between "inflation" and the "fiscal deficit" and increase in the inflation by 1 unit decreases the fiscal deficit by 0.004 units. Our results also show a positive relationship between the supply of money and the fiscal deficit. When applying the monetary policies to foster the economy, governments of Pakistan should be careful at money supply because it can contribute to fiscal deficit. Therefore, governments have to choose between their borrowing requirements, it suggests monetary, and macroeconomics insinuations must be contemplated and to achieve this goal, close coordination between the fiscal authorities is needed.

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