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Pakistan's economy continues to show resilience to domestic & international shocks: SBP Report

Pakistan's economy continues to show resilience to domestic and international shocks. Although these shocks have taken their toll, the economy is expected to turn in a reasonable growth performance during the current fiscal year (2007-08), albeit substantially lower than target. This observation was made in the Second Quarterly Report for FY08 of the State Bank on the State of Pakistan's Economy which was released today.

The Report said the State Bank estimates suggest that FY08 real Gross Domestic Product growth would be in the range of 6.0-6.5 percent. "This below target growth nonetheless remains strong," it asserted. It said an unanticipated strength in international commodity prices is mainly responsible for cost push driven inflationary pressures in the economy and added these pressures further intensified due to strong aggregate demand amidst a continuing fiscal stimulus. "As a result, it is likely that FY08 inflation would be in the range of 8.0-9.0 percent, significantly above the target of 6.5 percent for the year," it added.

The Report noted that the growing macroeconomic imbalances, particularly the widening fiscal and current account deficits continued to create complications and add to inflationary pressures. On the other hand, Pakistan has so far largely been untouched by the continuing turmoil in the international credit markets. It said the rise in the fiscal deficit during first half (July-December) of FY08 has more troubling implications than the increase in the previous year. The modest increase in the fiscal deficit during the preceding two years had been relatively less troubling, as (1) revenue growth had remained strong, and (2) rise in spending essentially reflected the impact of post-earthquake relief and reconstruction (excluding this, the fiscal deficit remained below 4.0 percent of GDP); these substantive expenditures would fall sharply in a few years, it added.

Reducing the fiscal deficit in the remaining part of the fiscal year will thus be challenging, but is nonetheless essential, the Report said and added that support to aggregate demand due to fiscal deficit contributed directly to a rise in monetary aggregates, raising inflationary pressures, complicating monetary management, and stoking the growth of the current account deficit.

The Report said the combination of rising fiscal deficit and weak external receipts has pushed the government borrowings from SBP to a record Rs 359.3 billion during July-1st March FY08, compared to only Rs 25.6 billion in the corresponding period of last fiscal year. "This has been instrumental in sustaining the growth in broad money (M2) for the period at 17.6 percent YoY, significantly offsetting the central bank's efforts to tighten monetary policy," the Report added.

The Report said the information available by mid-February 2008 suggests that agriculture sector is likely to record reasonable growth during the fiscal year. Prospects

of achieving the targeted 4.8 percent growth for the year, however, remain dim, largely due to disappointing performance of cotton and rice crops.

The Report pointed out that large scale manufacturing (LSM) has been encountering headwinds since the start of FY08. Domestic as well as external factors are responsible for the relatively slower growth in this sector compared to the stellar performance of preceding years. These factors include: the continued strong increases in the international commodity prices, domestic energy woes and dampened demand (particularly for textile exports). Economic losses in the aftermath of December 27, 2007 have further weakened the chances of meeting the annual target. Overall, the slowdown in LSM during H1-FY08 was broad based and was seen in 11 out of 15 industrial groups.

Most of the indicators for the services sector suggest robust growth in this sector during the first half of FY08. Wholesale and retail trade seems likely to perform well given a significant increase in imports (which accounts for more than half of the value addition in this sub-sector). “This sub-sector is also likely to benefit from expansion in the network of domestic and foreign chain store,” the Report added. (The detailed Report can be accessed at www.sbp.org.pk).
