

Pakistan's economic performance is notable despite challenges: SBP Third Quarterly Report

'The economic growth of 3.7 percent during FY12 is higher than the 3.0 percent realized in the previous year, but less than the target of 4.2 percent. Nevertheless, this performance is notable, given the considerable damage to the cotton crop due to floods in August 2011; ongoing energy shortages; the rise in international oil prices; and security concerns,' the State Bank said in its Third Quarterly Report for the fiscal year 2011-12 on the State of the Economy released today.

The Report said that this growth has also been more broad-based with a larger contribution from the commodity producing sectors compared to FY11. Moreover, as in the past, growth has been driven by domestic consumption (both private and public), which was partially offset by a decline in domestic investment and external demand, the Report said and added that the continuous decline in investment since the macro instability in 2008, is a source of growing concern as it will stifle the long term growth of the economy.

It observed that although Pakistan's economy has shown some recovery in terms of GDP growth, the key macro indicators still remain weak. Persistent inflation and pressure on the fiscal and current accounts, remain the key challenges for the economy, it added.

SBP Report said that while low investment and energy shortages have direct growth implications, the persistently high fiscal deficit remains a major risk to the macro-economy. Current information suggests a budget deficit of 4.3 percent of GDP for Jul-Mar FY12, and it appears that the budgetary gap for the full year will exceed the revised target of 4.7 percent, it said, adding that overall revenues are lower than expected.

Though the growth in current expenditure is lower compared to the previous year, the government has enhanced its development spending, it said and added: 'While such spending should improve the country's long-term growth prospects, this also creates financing pressures.' At the same time, despite efforts to reform public sector enterprises (PSEs), the operational efficiency of key PSEs has not improved, it said, adding that this continues to add to the country's fiscal burden.

The Report said that in terms of financing this gap, the government relied more on domestic sources as external financing dried up. The government borrowed Rs 847.5 billion in Jul-Mar FY12 from domestic sources, compared to Rs 700.1 billion in the corresponding period of FY11, it said and added that lately, this has been increasingly skewed towards borrowing from the central bank.

'Such borrowing is inflationary and a risk to macro-stability. Currently, two Acts – namely the Fiscal Responsibility and Debt Limitation (FRDL) Act (2005) and the newly amended SBP Act– provide guidelines on overall debt stocks and borrowing from the central bank, respectively,' the Report said.

The Report said that the large fiscal deficit has resulted in a sharp increase in Pakistan's debt. It said that Government domestic debt recorded an increase of Rs 1.2 trillion during Jul-Mar 2012 to reach

Rs 7.2 trillion. There is greater reliance on short term borrowing, which is creating liquidity management problems for the central bank, and *rollover* and *interest rate* risks for the government, it added.

It said that with the government's growing appetite for funding, banks have little incentive to finance the private sector. At the same time, demand for private sector credit is likely to be dampened this year, as loans to private businesses increased by only 1.8 percent in Jul-Mar FY12 – the lowest growth rate in the past 10 years, it said, adding that the slowdown is concentrated in working capital and trade financing. 'However, there are indications that fixed investment loans have bottomed out,' it added.

Developments in Q3-FY12 in external sector were less adverse than we had expected, the SBP Report said, adding that larger inflows of remittances and a lower trade deficit, explain this relative improvement. The current account deficit during Jul-Mar FY12 was US\$ 3.1 billion, compared to a deficit of US\$ 10.0 million in the corresponding period last year, it said, adding that more importantly, the expected inflows under Coalition Support Fund (CSF); the auction of 3G licenses; and arrears from PTCL privatization, did not materialize during the quarter.

While these challenges will continue to shape the outlook for the economy, it is important that GDP data should reflect the changing nature and composition of the country's economic activities, the Report said, and added that Pakistan Bureau of Statistics (PBS) is already in the process of rebasing the national income accounts. 'We expect that PBS would also consider releasing GDP estimates on a quarterly basis, which is now a norm in emerging markets. It will help get a more accurate and timely picture of the real economy, which will allow for more proactive policy corrections,' the Report added.
