ERD/M&PRD/PR/01/2020-03 January 6, 2020

SBP releases First Quarterly Report on the State of Economy

The State Bank of Pakistan today released its First Quarterly Report on the State of Pakistan's Economy for FY20. According to the report, Pakistan's economy moved progressively along the adjustment path during the first quarter of FY20. The macroeconomic stabilization process picked up momentum with the initiation of the IMF's Extended Fund Facility program: the SBP continued to keep the monetary policy consistent with the medium-term inflation target; whereas, consolidation efforts were visible on the fiscal front. Furthermore, a market-based exchange rate system was implemented, to which the interbank foreign exchange market adjusted relatively well. Notably, the government avoided deficit monetization, including rollover of SBP debt and actively pursued documentation efforts.

According to the report, the payoff from ongoing stabilization efforts has become visible in the form of declining twin deficits. The current account deficit in Q1-FY20 fell to less than half of last year's level, primarily on the back of significant import compression. Owing to low unit prices, exports growth remained low. However, in volumetric terms exports witnessed noticeable growth. On the fiscal front, the overall deficit remained lower as compared to the same period last year, and the primary balance recorded a surplus for the first time in 7 quarters. This improvement was made possible through both revenue enhancing and expenditure control measures. Importantly, development expenditures witnessed a sharp growth of 30.5 percent during the quarter.

In case of GDP, the report noted that the revised estimates for the kharif season suggest that the production of important crops is likely to fall short of target for FY20. The large-scale manufacturing sector witnessed a decline of 5.9 percent in Q1-FY20 on YoY basis. This contraction was broad-based, as construction-allied industries, petroleum and automobile industries continued on downward path. In contrast, previous corrections in the exchange rate helped the export-oriented industries, as reflected in the relatively better performance of textiles and leather. On balance, however, achieving the real GDP growth target of 4 percent appears unlikely.

The report further highlighted that the average headline CPI inflation reached 11.5 percent in Q1-FY20, extending the steep upward trend persistent since the beginning of FY19. Not only this level was double the inflation observed in the same quarter last year, it was also the highest level of quarterly inflation since Q4-FY12. This outcome was attributed to the lagged pass-through of the exchange rate depreciation towards the end of FY19; rationalization of energy tariffs; and revenue-led fiscal measures taken in the budget 2019-20, which included the imposition of federal excise duty on a number of consumer items, and the ending of the zero-rating regime for export-oriented sectors and of the reduced GST regime on sugar.

On the external front, the balance of payments continued to improve during Q1-FY20. Beside significant improvement in trade deficit, and with the receipt of the first EFF tranche from the IMF and increase in foreign portfolio investment, the current account gap was plugged by the available financial flows. These inflows also helped the SBP to increase its foreign exchange reserves by US$ 656.2 million and reduce its net forward liabilities by US$ 1.3 billion during the quarter.

Going forward, the report emphasizes, it is vital that the government continues to address the underlying structural vulnerabilities and put the economy on a balanced and sustainable growth trajectory. Furthermore, there is a need to build on gains on the ease of doing business front. Side by side, it is equally important for firms to leverage on the facilitative policies, particularly the export-promotion incentives, and gain a foothold in the global value chains (GVCs). As mentioned in a separate special section in the report, increased participation in the GVCs would not only align the country's product mix with trends in global demand, but also put the exports on a sustainable growth path.

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