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Pakistan's economy witnesses noticeable improvement in macroeconomic indicators in FY10: SBP Annual Report

Pakistan's economy witnessed a noticeable improvement in the macroeconomic indicators during 2009-2010 fiscal year (FY10) as the economy grew at a rate of 4.1 percent compared with only 1.2 percent in the preceding year, says State Bank's Annual Report on the State of the Economy for the year 2009-10 which was released today.

It said there was substantial decline in annual inflation and current account deficit. Foreign exchange reserves also rose to historic highs during the year, the Report added.

SBP Report said while these developments marked an improvement from the FY09, fundamental structural weaknesses in the economy remained unaddressed. For example, some key reforms failed to gather traction: (1) persistent disagreements led to the deferment of a proposed expansion of the tax net through the introduction of a broad based GST, (2) the proposed restructuring of public sector enterprises, to improve efficiency and lower the fiscal burden, did not take place; and, (3) after some initial work, there was little or no progress in either resolving the energy sector debt chain (the so-called "circular debt" problem) or substantially improving electricity supply, the Report said.

The Report pointed out that the principal structural problem, however, was the weak fiscal performance; the fiscal deficit bounced back to 6.3 percent of GDP in FY10, i.e., 1.1 percentage points higher than in the previous year. FY10 fiscal performance was characterized by continuing expansion in fiscal and quasi-fiscal operations, that crowded out and otherwise undermined private sector activities, supported the persistence of double-digit inflation, and increased the total public debt and liabilities substantially, from 68.7 percent of GDP in FY09 to 69.5 percent in FY10," the Report asserted.

Referring to recent unprecedented floods in the country, the Report pointed out that various FY11 macroeconomic targets have suffered a serious setback early into the year as large areas of the country were devastated by widespread rains and unprecedented floods. Large parts of the country's agricultural heartland were particularly hit hard by these floods, with significant damages to standing *kharif* crops (e.g., cotton, rice and, sugarcane) and livestock. The economy also suffered extensive damage to infrastructure (bridges, road networks, gas/power plants, and some industrial units such as rice mills, ginning factories, etc.), productivity losses from supply-disruptions, the large-scale displacement of people, etc., it added.

It said that even a cursory assessment of the broad contours of the losses indicates that their repercussions will continue to stress the economy for many years," It is therefore obvious that the economic priorities and targets for FY11, in particular, will see substantial revision, and all key macroeconomic indicators will likely record deterioration, the Report observed.

In this backdrop, the Report projected that GDP growth is likely to be between 2 percent to 3 percent in FY11, average annual inflation is expected to be 13.5 percent to 14.5 percent while the fiscal and current account deficits are likely to be between 5.0 percent to 6.0 percent of GDP, and between 3.0 percent to 4.0 percent of GDP. Furthermore, it projected that workers' remittances are likely to stay between $9.5 billion to $10.5 billion while exports and imports are likely to be between $20 billion to $21 billion and $34 billion to $35 billion, respectively.

SBP Report said that the impact of the floods has strengthened the inflationary expectations for FY11; the August 2010 CPI, included a 15.6 percent year-on-year rise in its food component. However, SBP assessments suggest that the direct impact of the flood-related supply shock is likely to be limited. For example, the impact of flood/rain damages and shortages of minor crops are not expected to persist beyond 2 to 3 months as supply line improves and as fresh crops (e.g., vegetables) enter the market. Similarly, for some other products, any rise in domestic prices would be capped by low international prices. It is important to note that prices of dairy products were already continuing on a secular rise, even prior to the floods, due to sustained strong domestic and external demand. Livestock losses in the flood would exacerbate this rising trend, but only to a small extent, the Report added.

The Report also acknowledged that the worsening in most of the Pakistan's macroeconomic variables has further complicated the monetary debate in FY11. "On the one hand, there is the argument that the central bank should respond to the rising inflationary pressures and excessive increase in the fiscal deficit, and on the other, the demand-shock stemming from the flood damages argues for a countervailing monetary easing to help revive the faltering economy," it added.

"In short, the negative shocks stemming from the floods have further exposed the existing structural weaknesses in the economy. Addressing these will require improvements in macroeconomic discipline as well as continued reforms to improve the resilience of the economy," the Report added.

The detailed Report is available at SBP website www.sbp.org.pk

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