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Real GDP growth likely to be around annual target of 3.3%: SBP First Quarterly Report

The real gross domestic product (GDP) growth in the current 2009-10 fiscal year (FY10) is likely to be around the annual target of 3.3 percent, higher than the 2.0 percent growth seen in FY09, according to the State Bank of Pakistan's First Quarterly Report on the State of the Economy for FY10 which was released today.

"The major impetus for this growth is expected to come from the services sector," the Report said and added that the prospects of returning to macroeconomic stability have improved in the initial months of FY10 as most of the key indicators continue positive trends that began in the closing months of the last fiscal year.

According to projections embodied in the Report, real GDP growth in FY10 is likely to be between 2.5% and 3.5%, average Consumer Price Index inflation may remain between 10% and 12%, total amount of workers' remittances likely to receive during FY10 may hover between $7.8billion and $8.8 billion, total exports and imports may remain between $18.5 billion and $19.0 billion, $30.5 billion and $31 billion, respectively while fiscal and current account deficits are likely to be between 4.7% and 5.2% and 3.7% and 4.7% of GDP, respectively.

It said that data on agriculture and the industrial sector, is in line with the expectations of a modest recovery in economic growth during FY10. While the performance of major crops during FY10 *kharif* (April-October 2009) cropping season was below expectations, growth in large-scale manufacturing has recovered substantially after recording a 20.6 percent year-on-year decline in March 2009. Similarly, a sharp reduction in inflation, contained government borrowings from SBP, substantial contraction in external imbalances, the stability in the rupee-US$ parity, and easing monetary stance, are all likely to support economic stability, it said and added that the drop in overall volume of trade, poor tax growth, risk of lower than expected aid receipts and, in particular, a rise in the fiscal deficit, highlight the fragility of the improvement and pose continuing risk to the recovery.

The Report said that within the commodity producing sector, an improvement in industrial output is expected to be partially offset by weaker agriculture. Similarly, the current account deficit is likely to improve further in FY10 relative to the previous year, though some expected revival in import demand from manufacturing and rising commodity prices may possibly contain the improvement going forward, it added.

It pointed out that while average CPI inflation during FY10 is projected to decelerate significantly from FY09 levels, it is likely to remain higher than the annual target of 9.0 percent for the year. "The adjustment in administered prices of key fuels amid rising international oil prices and cut in electricity subsidies, are important factors behind the expected strengthening of inflationary pressures," the Report added.

The Report asserted that a major challenge in the economy is to improve the tax-to-GDP ratio. "The 0.6 percent Y-o-Y increase in tax collection during Jul-Nov FY10 is a source of concern; if this continues, Pakistan's tax-to-GDP ratio will decline from an already low 9.8 percent seen in FY09," it said and added that in view of the needs of the structural second generation reforms in the economy, it is necessary to strengthen the capability of Federal Board of Revenue, increase documentation, reduce exemptions, equal treatment of incomes from different sources, and accelerate the levy of a comprehensive Value Added Tax.

It said that another challenge in public finance is the increasing level of contingent liabilities of the government. In particular, the energy sector circular debt issue has not been resolved yet, and the government's borrowings for commodity operations have not seen the expected seasonal retirement in Q2-FY10, the Report pointed out.

"It must be stressed that excessive government involvement in commodity trade/finance, and the interference in market price setting, can be counter-productive and should be avoided," the Report opined and said that cases of market failure are best handled through effective reforms and strengthening institutions like the Competition Commission of Pakistan.

The Report said that SBP continued to gradually ease monetary policy in FY10, reducing the policy rate by 150 bps in two rounds while on cumulative basis, it means a total reduction of 250 bps in the policy discount rate since the beginning of current easing cycle in April 2009. These policy measures were supported by substantial moderation in demand pressures. For instance, a very sharp drop in headline inflation, i.e., from 24.7 percent in November 2008 to 10.5 percent in November 2009; persistent Y-o-Y fall in import growth, particularly the negative growth in import volumes during Jul-Nov FY10, and the low growth in private sector credit expansion, it said.

The Report pointed that the scale and speed of the decline in inflation suggest that the tight monetary policy and sharply constrained monetization of the fiscal deficit have eased excess demand pressures that had plagued the economy in the previous three years. "This disinflationary impact received further support from lower imported inflation and improved domestic production of key staples," it added.

The detailed Report is available on State Bank's website www.sbp.org.pk

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