March 29, 2010

Pakistan's economy likely to sustain growth revival in FY10: State Bank Quarterly Report

Pakistan is likely to sustain revival of economic growth during the current fiscal year (2009-10) because of an above-target recovery in manufacturing, strong rebound by the construction sector, reasonable performance by the services sector and strong domestic consumer demand, according to the State Bank of Pakistan's Second Quarterly Report on the State of the Economy for FY10 which was released today.

State Bank's estimates for FY10 gross domestic product (GDP) growth remain unchanged from the previous quarter, with real GDP growth for the year projected to fall in the range of 2.5 percent to 3.5 percent. It pointed out that the resurgence in inflationary pressures due to revival in aggregate demand, exchange rate pass-through, etc. have, so far, not exceeded levels already embedded in the earlier SBP forecasts. The annual headline CPI inflation projection for FY10 also remains unchanged and it is estimated to be in the range of 11.0 percent to 12.0 percent, the Report said.

Encouragingly, due to a better than expected performance by the exports in recent months and robust performance of remittances earlier in the year, the current account deficit has narrowed more than projected earlier. Thus, even incorporating relatively less positive trend in months ahead, it seems likely that the full year FY10 deficit will be lower than earlier SBP forecasts. "Current projections suggest that the FY10 current account deficit is likely to fall in the range of 3.2 percent to 3.8 percent of GDP, which represents a 0.5 percent to 1.1 percent of GDP improvement from the earlier estimates," it added.

But SBP's Report pointed out that FY10 fiscal deficit is estimated to be higher on account of extraordinary defense related spending and weakness in revenue collection. In recent consultations with IMF, need for a cut in PSDP and relaxation in fiscal deficit target was also recognized, it said and added that the fiscal deficit is projected to lie in the range of 5.0 percent to 5.5 percent of GDP during FY10.

The State Bank's Report stressed that the country's overall economic outlook 'is mixed.' While inflation decelerated significantly during FY10 compared with the preceding year, inflationary pressures have decisively remerged in recent months, it said and added that although, the current account deficit witnessed improvement, sustaining it at low levels will be challenging given rising import requirements of the economy, and evident weakness in the pace of growth in remittances. "Prospects for real GDP growth are better relative to the preceding year. However, this level of growth is not adequate to generate required employment opportunities," it pointed out.

The Report stressed that there is a need for serious policy efforts to achieve sustained high growth. "This needs both macroeconomic stability (low inflation, prudent fiscal stance, low current account deficit, high investment and savings), and political stability, including improvement in law & order and security conditions," it said and added that implementation of structural reforms focused on elimination of subsidies, reduced role of government in price setting, formulation of effective regulations to ensure optimum market-based outcome, are needed to sustain growth and enhance resilience of the economy against exogenous shocks.

It reiterated that while tax reforms are most readily legislated during times of economic stress, this is also the period where the revenue impact of reforms is most limited. "In other words, revenue measures will gain most traction only when the economy recovers somewhat. This implies that, in the short run, there may be few options to contain the fiscal deficit," it said and added that aggressive fiscal reforms are key to achieving and retaining macroeconomic stability in the medium term. These need to focus on the entire range of options from increasing efficiency of public expenditures, reducing size of government, raising the tax-to-GDP ratio, etc, the Report stressed.

The Report said the growth prospects for the agriculture sector remain weak in contrast to the strong growth seen last year. Negative contribution by the two major crops of FY10 i.e. rice and sugarcane and expected decline in wheat harvest are mainly responsible for this gloomy outlook, it added. On the positive side, however, it said the relatively lower prices of fertilizer and higher farm incomes in FY09 encouraged farmers to use fertilizers aggressively. Fertilizer off-take also increased due to government support in terms of maintaining a higher support price for FY10 wheat crop despite a substantial decline in international prices of the grain, the Report added.

The pace of recovery in the LSM sub-sector increased in Q2-FY10 largely in response to rising domestic demand. Most of the recovery emanated from the consumer durable industries as demand for automobiles & allied industries increased sharply despite the quarter-on-quarter increase in prices, it added.

In terms of monetary aggregates, the Report pointed out that the growth in Broad Money (M2) accelerated to 5.7 percent during July-Feb. FY10 from 2.0 percent in the corresponding period of FY09. "This improvement resulted entirely from an expansion in net domestic assets (NDA) of the banking system on the back of rise in private sector credit and increased recourse of government to finance its deficit from the banking system," the Report said. On the other hand, trend improvement in the external account visible since December 2008, has started to reverse from October 2009 onwards. "Resultantly, NFA (Net Foreign Assets) of the banking system recorded a depletion of Rs 46.6 billion in July-Feb. FY10; though much lower compared to last year's contraction," the Report added.

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

****