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Government making headway towards improving its finances: SBP First Quarterly Report

Recent fiscal figures show that the government has been making some headway towards improving its finances. The budget deficit for the first quarter of FY12 was 1.2 percent of GDP, compared with 1.5 percent during the same quarter last year, says State Bank's First Quarterly Report on the State of the Economy released today.

It said that this reduction in the budget deficit was caused primarily by 29.7 percent growth in FBR revenues, on the back of increased tax collection efforts and higher revenues from imports. Non-tax revenues also recorded impressive growth of 50.4 percent, it added.

However, on the basis of seasonal trend in FBR revenues, the amount collected up to end-Dec 2011, falls short of the amount needed to meet the annual target of Rs 1,952.3 billion, it said, adding that meeting end-year revenue targets would also depend upon the realization of CSF and sale of 3G licences (around Rs 150.0 billion), in absence of which, it would be difficult for the government to contain the fiscal deficit within its annual target.

The Report said that the federal government has budgeted a surplus of Rs 125.0 billion on part of provinces, however, due to 52.8 percent increase in their expenditures, provinces managed only Rs 11.6 billion surplus up to Q1-FY12, which was 85.7 percent lower than the corresponding period last year. 'Any short fall in the contribution by the provinces would make achievement of the fiscal deficit target more challenging', the Report cautioned.

According to the Report the lack of external funding has put the burden of financing the deficit disproportionately on the banking system, which has led to crowding out of private sector and is acting as a disincentive for banks to perform their role of financial intermediation.

Government borrowing from the banking system up to end-Nov 2011 was Rs 736.8 billion, against Rs 336.1 billion in the corresponding period last year. This amount includes Rs 391.0 billion borrowed from banks to retire PSE debt, which has now been transferred on to the government's books, it said, adding that unfortunately, PSEs continue to hemorrhage as a credible restructuring plan has not been put into action. As a result circular debt issue is likely to persist, the Report said.

The Report said the government's efforts to keep its borrowing from SBP in check during the initial months of FY12, helped in keeping demand-driven inflationary pressures at bay, which was supplemented by the easing of food prices. As a result, YoY CPI inflation declined to single digit (9.7 percent) in December, 2011 after remaining in double digits for the last two years. While the increase in energy prices, recent weakening of Pak Rupee and the base effect may increase inflation in the coming months, the end-year average inflation is likely to fall close to 12.0 percent as projected earlier, the Report added.

While SBP has shown its willingness to relax its policy to support the private sector as it did in July and October, 2011, it cannot add to the stress on the economy arising from weaknesses in other sectors. The most recent policy decision to keep the policy rate unchanged was influenced among others, by the weakness in external accounts during Q1-FY12, the Report observed.

It said that Pakistan was fortunate in FY11 that its current account ended up in a surplus and, despite the drying up of FDI and other foreign investments; there was a net increase in its FX reserves. 'Given the rigidities in the trade account and the vulnerability of the financial account, sustaining this performance in FY12 was always going to be difficult. Nevertheless, the pace at which the current account deteriorated during the first quarter of FY12 took many by surprise. Specifically, the current account deficit for Sep 2011 alone was over US$ 1.0 billion,' the Report added.

The Report said that in the past, Pakistan has sustained larger current account deficits without losing its foreign reserves due to healthy inflows in the financial account. Unfortunately, owing to both domestic weaknesses and the international financial upheaval, financial flows have almost dried up, adding to the country's economic vulnerability, it said, adding that while some financial inflows are expected, a part of the current account deficit is likely to be financed through reserves as was the case during July-October FY12. This has important implications for monetary management and price stability, the Report observed.

The Report noted that the government is, however, optimistic that the 3G telecom licence fee will be realized. In addition, due to recent developments, there is still optimism that parts of the CSF, bilateral assistance from the US, and the privatization proceeds of PTCL will be received. Furthermore, currency swap arrangements, which were recently formalized with the central banks of Turkey and China, will also facilitate bilateral trade and investment, easing the stress on the country's reserves.

Nevertheless, SBP remains vigilant that pressure on the Rupee is not translated into market speculation, which could become self-fulfilling, the Report said and added that striking a balance in managing a flexible exchange rate driven by economic fundamentals *and* by market speculation (within the context of sharp currency movements in the global economy) is challenging. 'SBP will continue to monitor the forex market closely to remove any excessive volatility in the Rupee,' the Report added.

The Report said the policy makers were hopeful that the country would put up a better economic performance in FY12 after last year, which was a difficult one for the economy, not only due to the devastating floods that hit the country early in the fiscal year, but also due to the lack of external financing and energy shortages.

The Report observed that realizing the 4.2 percent growth target for FY12 GDP looks difficult due to a host of factors that include, among others, gas shortages, high oil prices and decline in global prices of agricultural commodities. (The complete text of the Report both in English and Urdu languages is available on SBP website: www.sbp.org.pk)

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