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State Bank releases 3rd Quarterly Report

Economy showed revival after many years of low growth: SBP

The State Bank of Pakistan released its Third Quarterly Report for FY14 on the State of Economy, today. According to the report, Pakistan's economy appears to have turned a corner during the third quarter. Revival of economic activity is a key development in FY14, with real GDP growth of 4.1 percent, which is the highest in the past five years.

The report says that after many years of low growth, sentiments about the economy seem to have improved. Manifestations can be seen in the rebound in real GDP growth; the rise in private sector credit; a contained fiscal deficit; the subdued inflation outlook; the sharp increase in FX reserves; and the appreciation and subsequent stability in the exchange rate.

The report mentioned that improvements in the economy were the result of the government's resolve to address the energy shortage, a growing perception of business friendly policies, and external inflows that have recently been realized. More specifically, auction of 3G/4G licenses; a larger than projected inflow via Eurobonds; program loans from the IFIs; and SBP's efforts to support the FX reserves, have sharply improved the outlook of the country's external sector, and to some extent, its fiscal position.

However, the Report emphasized that "these signs of improvements should not discount the challenges faced by the economy; and efforts for much needed structural reforms should continue. These positives developments provide a strong platform to move towards sustained economic growth in the medium term."

According to the Report, the recent influx of external resources not only stabilized the exchange rate, but also sharply increased SBP's FX reserves. "As of 30th May 2014, SBP's reserves were US$ 8.7 billion, compared to only US$ 3.5 billion as of end-December 2013. While the PKR's appreciation improved business sentiments and its subsequent stability has eased inflationary expectation, the sharp increase in the country's FX reserves provides some comfort for domestic and foreign investment.''

The report says that average inflation during Jul-Mar FY14 was 8.6 percent. Going forward, the stability of PKR, stable international oil prices, and softer global commodity prices should further contain inflationary expectations.

On the basis of data released by the Ministry of Finance, the SBP Report says that fiscal deficit during the first nine months of FY14 was only 3.2 percent of GDP, which is significantly lower than the average deficit in the last five years. The Report, however, points out that despite efforts for fiscal consolidation on the expenditure side, tax mobilization still remains lackluster, as FBR is still operating on a narrow tax base. While the FBR should take concrete steps to plug tax leakages and increase documentation of all financial transactions, provincial governments (having constitutional right to tax services and agricultural income) also need to implement provincial taxes more effectively.

On the financing side, the Government mainly relied on domestic sources during Jul-Mar FY14. However, external financing has increased subsequently with the issuance of Eurobonds, fresh loans from

IFIs, and bilateral assistance. Although the resumption of external inflows is important for a resource constrained economy, this will add to Pakistan's external indebtedness. The SBP Report highlights that total public debt (external plus domestic) has already crossed the limit of 60 percent of GDP, as set by the Fiscal Responsibility and Debt Limitation Act (2005) for FY13 onward. Hence, any addition to the external debt should at least be matched with an equivalent reduction in the domestic debt outstanding.

Pressure in balance of payments also eased as bulky re-payments to IMF subsided after November 2013, and the country experienced influx of external grants, loans and foreign investment (like Eurobonds). While acknowledging this improvement, the Report emphasized the need to address structural problems that continue to plague Pakistan's economy. The policymakers should formulate an Industrial Policy that prioritizes production efficiency and job creation. Such an initiative should focus on: efforts to promote competitiveness, instead of a culture that creates and rewards inefficiencies; restructure loss-making PSEs (especially Gencos and Discos in the power sector; and PIA and Railways in transportation sector) to make them more dynamic and profitable; and create a skilled labor force that meets the current (and potential) needs of the manufacturing sector.

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