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GDP grows by 5 percent: SBP's Quarterly Report

The State Bank of Pakistan released its First Quarterly Report for FY14 on the State of Economy, today. The report says that since macroeconomic indicators were favorable at the start of the year, the increase in real GDP growth in FY14 was discernible. Estimates for growth exceeded expectations: GDP grew by 5.0 percent during Q1-FY14, compared to only 2.9 percent in Q1-FY13, and a target of 4.4 percent for the full year. Industry and services were the major drivers of growth, as agriculture performed below target.

As the industrial sector revived, import pressures reappeared, especially for capital goods and raw materials. The import of petroleum, machinery, and metal, was particularly strong, which increased the trade deficit by US$ 0.6 billion during Q1-FY14 over Q1-FY13. Additional stress on the current account came from delayed inflows of coalition support fund (CSF) in Q1-FY14 As a result, the current account posted a deficit of US$ 1.2 billion in Q1-FY14, against a surplus of US$ 0.4 billion in Q1-FY13. Although worker remittances posted an impressive 9.1 percent growth, this was not enough to cover the FX gap in other heads.

The report said that repayments on external debt continued to exceed fresh disbursements while foreign investments remained shy. This caused a strain on the country's FX reserves, which posted a decline of US$ 1.2 billion during the quarter. As a result, the PKR depreciated by 6.0 percent against the US Dollar during Q1-FY14, compared to only 0.3 percent in the first quarter of the previous year.

The report pointed out that headline CPI inflation increased to 8.1 percent in Q1-FY14, compared to only 5.6 percent in the preceding quarter. SBP increased its policy rate by 50 bps to 9.5 percent in the monetary policy decision announced in September 2013 to rein in the second-round effect of food inflation, curb inflation expectations and to counter market sentiments following the volatile PKR.

According to the report, government borrowing from the central bank was more pronounced, as commercial banks did not participate actively in T-bill auctions held during the quarter. As a result, the government could not meet the limit of zero quarterly borrowing from SBP, though its borrowings were well below the limit agreed with the IMF.

The fiscal deficit fell to 1.1 percent of GDP in Q1-FY14, from 1.2 percent in the corresponding quarter last year. This improvement occurred on both the revenue and expenditure sides. On the revenue side, it was the increase in tax rates and not the base which is responsible for higher collection during the quarter. Non-tax collections were also high due to certain one-off revenues. On the expenditure side, a major positive was the reduction in interest payments, following the interest rate cuts in FY13.

The report said that public debt posted a record increase of Rs 1.0 trillion during the quarter. This increase, however, does not represent the fiscal imbalances alone, which recorded only a modest increase. Instead, this increase can primarily be traced to large revaluation losses associated with the external debt stock due to adverse exchange rate movements during the period. According to the report, there is a corresponding need to rebalance the maturity profile of Pakistan's domestic debt. The growing prominence of 3-month instruments in the outstanding volume of T-bills requires attention because this exposes the financial system to *interest rate* and *roll-over* risks.

The report suggests that in order to maintain the current growth momentum, and to take the economy to a higher growth trajectory, the government should speed up structural reforms in the fiscal and energy sectors. By focusing on these sectors, the government has signaled that its priorities are correct. It urges the government to *sustainably* manage long-standing issues, which has kept growth below potential.

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