ERD/M&PRD/PR/01/2021-57 June 3, 2021

**SBP releases Second Quarterly Report on the State of Pakistan's Economy for FY21**

The State Bank of Pakistan released its Second Quarterly Report on *The State of Pakistan's Economy* for the fiscal year 2020-21 today.

The report highlights the strengthening of the economic recovery during the second quarter of the fiscal year. This was evident from the growing pace of industrial activity, promising output of major *Kharif* crops (with the exception of cotton), and a pick-up in the services sector during the review period.

The large-scale manufacturing (LSM) grew by 7.6 percent during H1-FY21, with its growth in the second quarter accelerating to 10.4 percent, the highest quarterly LSM growth since Q4-FY07. Construction-allied and food processing industries generated much of the momentum in industrial activity. The construction industry benefited from the favorable policy environment, which included the government's fiscal incentives under the construction support package, the Naya Pakistan Housing Scheme, as well as financial measures from the State Bank. Financing to the housing and construction sector in Pakistan has almost always remained quite negligible in the credit portfolios of banks when compared with other developed and developing countries. To support the vision of the Government of Pakistan, the State Bank has taken several measures since July 2020 to support the provision of financing for the housing and construction sector, including by giving incentives and targets to the banks.

Within agriculture, most of the major *Kharif* crops performed better than last year; this improvement was attributed mainly to increases in their areas under cultivation. The government's support package for *Rabi* crops, comprising subsidies on key inputs, and an increase in the support price for wheat, are likely to bolster the overall crop sector growth. However, cotton exerted a drag on the overall agricultural performance, as the revised production estimate of 7.7 million bales represented the lowest output since FY86. Nonetheless, due to better output of other crops, the overall agriculture sector is expected to register positive growth.

On the whole, the recovery was rooted in the timely and well-calibrate policy response of the SBP and the government to counter the Covid-19 shock. The SBP's policy response comprised liquidity support through continuation of low policy rate, loan deferments and restructuring, and refinancing schemes for payroll support, healthcare sector, and firms looking to undertake capital expenditures. At the same time, the government's support measures included direct cash support for the economically vulnerable segments, together with tax relief for the construction sector; expedited disbursement of outstanding refunds of exporters; concessionary energy prices; duty concessions on imported raw materials; and subsidies and higher minimum support prices to bolster agriculture. Importantly, these facilitative policies and the resultant rebound in economic activity did not contribute to a widening in macroeconomic imbalances, including the fiscal and current account deficits.

As the economic momentum picked up and the country successfully navigated the second wave of Covid without resorting to strict mobility restrictions, firms' demand for credit nearly doubled on YoY basis during H1-FY21. A significant part of this credit was extended through SBP's concessionary refinance schemes, especially the Export Finance Scheme (EFS), the Long-Term Financing Facility (LTFF), and the Temporary Economic Refinance Facility (TERF), as firms pursued capacity expansion and Balancing, Modernization and Replacement (BMR) activities. Specifically, the approved financing under the TERF scheme reached Rs 435.7 billion as of 31st March, 2021. House building loans also increased, after SBP set the mandatory target for banks to increase their housing and construction loans to 5 percent of their overall private sector credit portfolios by end-December 2021.

In the external sector, the current account posted a surplus of US$ 1.1 billion during H1-FY21, driven by record-high workers' remittances and reductions in the services and primary income deficits. Remittances rose from all the major corridors, with strong growth recorded from the advanced economies as well as from the GCC. Proactive policy measures by the government and SBP to encourage more inflows through formal channels, curtailed cross border travel in the face of Covid-19, altruistic transfers to Pakistan amid the pandemic, and orderly foreign exchange market conditions have contributed to the strength of remittances. With the current account in surplus and sufficient external financing available, the SBP's FX reserves increased by US$ 1.3 billion and its net forward liabilities also reduced by US$ 1.2 billion during H1-FY21. Moreover, the PKR appreciated by 5.1 percent against the US Dollar during the period. Meanwhile, the newly launched Roshan Digital Accounts (RDAs) were eagerly received by overseas Pakistanis, as inflows into these accounts crossed the US$ 1.0 billion mark in April 2021.

Meanwhile, overall national CPI inflation fell to 8.6 percent during H1-FY21, from 11.1 percent in the same period last year. This outcome largely reflected the weakening in core inflation across both urban and rural areas, which was enabled by the presence of spare capacity in the economy, a reduction in energy prices and a relatively stable exchange rate during the period.

On the fiscal side, tax collection was higher compared to last year, while non-interest expenditures declined, resulting in a primary surplus for H1-FY21. The fiscal deficit as percent of GDP remained at a similar level as last year.

Notwithstanding these positive developments, the report flags three areas that merit continuing vigilance by policymakers. First is the burden of debt servicing. Despite a relative improvement in revenue generation, the bulk of interest payments during H1-FY21 was financed via the issuance of new debt. Second, while national CPI inflation declined during H1-FY21 on YoY basis and stayed within the SBP's projection for the full year, the prices of food items remain vulnerable to supply-side pressures in recent months. Third, with the domestic economic activity recovering and global commodity prices rising, import pressures are resurfacing. Moreover, these pressures have been accentuated by the domestic supply-side challenges for major agricultural commodities – cotton, sugar and wheat – which necessitated their imports.

Finally, the report features a special section on the domestic LNG market, which discusses the challenges in the planning, purchasing, and supply of the imported commodity, and contextualizes these challenges within the current regulatory and operational framework. Going forward, the government's decision to allow greater involvement of the private sector in LNG import has the potential to address many of these issues, and ultimately enhance the share of the relatively cheaper fuel in the economy's energy mix.

The detailed report is available at this link:

https://www.sbp.org.pk/reports/quarterly/fy21/Second/qtr-index-eng.htm

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