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SBP releases Annual Report on The State of Pakistan's Economy

The State Bank of Pakistan released today its Annual Report on *the State of Pakistan's Economy* reviewing the fiscal year 2020-21. The analysis and projections presented in the Report were estimated on data outturns for FY21, and finalized in July 2021, using data available as of then.[1] According to the report, Pakistan' economy rebounded during FY21, with real GDP growth rising to 3.9 percent. Importantly, this expansion in economic activity was accompanied by a 10-year low current account balance that contributed to a significant build-up in foreign exchange reserves. The fiscal deficit also edged down despite Covid-related spending, leading to an improvement in the public debt-to-GDP ratio, unlike the experience of most countries across the world. Headline CPI inflation also eased during the year mainly due to relatively stable prices of non-food and non-energy items. However, overall price levels, especially of food items, remained high owing to supply-side challenges.

The report notes that the economic turnaround was facilitated by exceptional management of the Covid health pandemic, as well as a prompt and targeted monetary and fiscal response to counter its impact on economic growth and livelihoods. The SBP's liquidity support amounted to around 5 percent of GDP by the end of FY21, featuring a combination of policy rate cuts as well as several targeted and time-bound measures, such as the Temporary Economic Refinance Facility (TERF) for promotion of new investment, Rozgar payroll financing scheme to prevent layoffs, the Refinance Facility to Combat Covid to provide concessional financing to construct hospitals and facilities to combat COVID, and temporary loan deferments and restructurings to provide temporary liquidity relief to small and big businesses as well as individual borrowers. Other policy initiatives to bolster economic activity included: (i) promoting digitization in the economy; (ii) temporarily relaxing concessionary credit and realization and settlement of export proceeds and trade loans; (iii) incentivizing housing and construction finance and promoting provision of mortgages for low income households; and (iv) providing forward guidance for the near-term monetary policy stance to facilitate economic decision-making amid Covid-related uncertainty.

Similarly, the government provided targeted fiscal support of around 2 percent of GDP through an economic stimulus package, which covered over 15 million families through emergency cash transfers. In addition, the government introduced various incentives to prop up activity in agriculture, manufacturing and export sectors during FY21.

The report highlights that a broad-based recovery in real GDP growth was recorded. Led by the favorable supply and demand dynamics as well as a low base effect from the Covid-led contraction in FY20, large-scale manufacturing posted a 14.9 percent increase in FY21. Though the growth in agriculture was slightly lower than in FY20, the production of wheat, rice and maize rose to historic levels. The cumulative increase in the production of these crops offset the decline in cotton production. The improvement in the commodity-producing sectors and a surge in imports led to a sharp recovery in wholesale and trade services in FY21.

[1] This line has been added on 27th November 2021 to bring clarity on the subject. A clarification to this effect has also been issued vide press release number ERD/M&PRD/PR/01/2021-134 dated 27th November 2021.

The recovery in economic activity was also enabled by a significant expansion in credit offtake by the private sector. The SBP's concessionary refinance schemes, such as TERF and the Long-Term Financing Facility, played a major role in driving fixed investment loans during the year.

The report also notes that the economic rebound was achieved without a worsening of macroeconomic imbalances, as the overall policy mix was still prudent. The current account deficit reduced substantially amid record high workers' remittances and export receipts, and contributed to the US$ 5.2 billion increase in the SBP's FX reserves during the year. The country also retained access to sizable external financing, with inflows received from the IMF and other multilateral and bilateral creditors; the issuance of Eurobonds after a long hiatus; and deposits and investments from non-resident Pakistanis via the Roshan Digital Accounts.

The report points out that the recovery in exports was driven by the continued adherence to the market-based exchange rate system; provision of subsidized inputs; lower duties on imported raw materials; and the fast-tracking of GST refunds. Also, the impact of some deflected orders from competitors as Pakistan emerged faster from the Covid shock helped boost textile exports. The higher exports partially offset a significant rise in import payments, which surged amidst the upswing in economic activity; supply-side challenges in wheat, sugar and cotton; and elevated international commodity prices. These pressures became more prominent towards the end of the year, leading to a 3.0 percent depreciation of the PKR against the US Dollar during the fourth quarter; during Jul-Mar, the PKR had appreciated 10.0 percent, mainly due to the accumulated current account surpluses.

Meanwhile, the fiscal deficit reduced to 7.1 percent of GDP, from 8.1 percent in FY20. Restrained non-interest current expenditures allowed for undertaking spending on social safety nets, the economic stimulus package and provision of targeted support to various sectors of the economy. Development spending also recovered slightly after consistently declining over the past three years. However, the government had to make payment of power sector subsidies to partially clear circular debt. On the revenue side, the FBR's tax collection improved sharply, in the wake of the economic rebound, surge in imports, and efforts to streamline tax administration. With the containment of the twin deficits and PKR appreciation, the public debt-to-GDP ratio declined to 83.5 percent in FY21.

Furthermore, average headline CPI inflation fell to 8.9 percent in FY21 – within the SBP's forecast range of 7-9 percent. The resurgence in domestic demand did not translate into inflationary pressures amidst the presence of some spare capacity in the economy. However, inflation remained volatile during the year, because of the impact of the increase in fuel prices and power tariffs. Moreover, the food group emerged as the largest contributor to inflation during FY21, primarily because of supply-side challenges in non-perishable items.

The report maintains that addressing deep-rooted structural impediments is crucial for sustaining and improving the current growth momentum. These impediments include consistent decline in the yield of important crops (especially cotton); insufficient export coverage of imports, low and declining productivity of labor, stagnant tax-to-GDP ratio; anemic investment-to-GDP ratio; and the rising fiscal burden of the power sector. In this context, tapping the potential of Special Economic Zones (SEZ) can play an important role. The SEZs are already gaining prominence in Pakistan, given the focus of the second phase of the CPEC on enhancing business-to-business cooperation. A Special Chapter in this report provides an overview of the SEZ landscape in the country and policy recommendations to ensure that the SEZs achieve their desired objective of stimulating investments in the country.

The full report is available at the SBP's website: https://www.sbp.org.pk/reports/annual/arFY21/Anul-index-eng-21.htm

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