



External Communications Department

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SBP releases Half Year Report FY23 on the State of Pakistan's Economy

The State Bank of Pakistan (SBP) today released its Half Year Report for FY23 on the State of Pakistan's Economy. The analysis in the Report was prepared on data outturns for the July-December FY23. According to the Report, Pakistan's macroeconomic conditions deteriorated during H1-FY23 despite policy induced improvement in external current account and primary fiscal balance.

The report notes that adverse global economic conditions, uncertainty surrounding the completion of IMF program's 9th review, insufficient external financing and low level of FX reserves remained major concerns during H1-FY23 which were exacerbated by the fallout of flash floods and political instability. Specifically, both agriculture production and large scale manufacturing (LSM) contracted; whereas, headline inflation rose to multi-decade high level.

To address the challenges, SBP raised the policy rate by a further 225 bps in H1-FY23, on top of the 675 bps increase during FY22. Similarly, the government resorted to curtail federal expenditures on grants, subsidies and development. Furthermore, to contain pressures on external account the government and the SBP introduced various regulatory measures to restrict imports.

Despite visible contraction in domestic demand, the report adds that the inflation outturns remained stubbornly persistent since H2-FY22. High global commodity prices along with elevated inflation expectations and a range of domestic factors pushed the national consumer price index (NCPI) inflation to 25.0 percent during H1-FY23 as compared to 9.8 percent in the same period last year. Higher food prices, on account of flood induced supply shortages, mainly drove overall inflation followed by non-food & non energy (NFNE) and energy groups. In addition, PKR depreciation along with the increase in power tariffs and energy prices provided further impetus to inflationary pressures. The second round effect of these supply shocks to broader prices and wages along with rising inflation expectations pushed up core inflation.

Covering the fiscal sector, the report highlights the contraction in major non-interest current expenditure, particularly subsidies, grants, and development spending, which contributed to improvement in primary surplus during H1-FY23. However, fiscal deficit remained at last year's level, in terms of GDP, because of a sharp expansion in interest payments. On the revenues side, tax administration efforts, inflation and higher return on deposits led to an expansion in FBR taxes. However, a sharp contraction in imports and an overall dip in economic activity constrained tax collection below the target for the first half of FY23.

In the absence of sufficient external inflows, the government mainly relied on domestic bank and non-bank sources to meet its borrowing requirements, mostly through medium term floating rate instruments. Private sector credit (PSC) decelerated during H1-FY23 amid economic slowdown. Within PSC the growth in working capital loans weakened significantly, while fixed investment remained around the last year's level.

The external sector, in general, and external financing, in particular, remained under significant pressure during H1-FY23 due to uncertainty regarding the resumption of IMF program, along with tight global financial conditions. Also, supply chain disruptions resulting from Russia-Ukraine conflict and China's zero - Covid policy, hampered global demand, which also weighed on Pakistan's export performance. On the supply side, flood-related disruptions led to lower crop outturns, which not only dented the food exports but also deteriorated the commodity import outlook. Similarly, workers' remittances also declined during H1-FY23. In addition to the global economic slowdown, increase in



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the use of informal channels also affected remittances flows to the country. However, the decline in exports and remittances was more than offset by a much larger fall in imports during H1-FY23, leading to a notable decline in current account deficit (CAD).

Despite this improvement in CAD, the report notes that the dearth of financial inflows led to decline in FX reserves during H1-FY23. In addition to the delays in the disbursements of the IMF tranches and the political uncertainty in the country, higher net FX outflows on account of scheduled debt repayments and disinvestments added to external account pressures. The combined effect of these developments, in the backdrop of US dollar's appreciation against a basket of global currencies, led to PKR depreciation during H1-FY23.

At the end, the report features a Special Section on the opportunities and challenges in Pakistan's software-led IT exports and technology start-ups. While highlighting country's small share in global IT exports and negligible domestic software usage, the special section sheds light on the enabling policies that have facilitated growth in this space and some of the critical gaps that are to be addressed, if recent growth in this sector is to be sustained.

The detailed report is available at this link:

<https://www.sbp.org.pk/reports/half/arFY23/Half-index-eng-23.htm>
