1 Economic Outlook

1.1 Introduction

Pakistan's economy witnessed a modest improvement in FY12 – real GDP grew by 3.7 percent during the year, compared with 3.0 percent in FY11. Although the economy underperformed compared with the growth target of 4.2 percent, this outcome was expected given the energy shortages; security concerns; and floods in two consecutive years. Nevertheless, growth was more broad-based compared to FY11, as it was evenly distributed across agriculture, industry and the services sector.

The demand side was more insightful, as the growth in FY12 was primarily driven by private consumption. Strong worker remittances, a vibrant informal economy and higher fiscal spending, supported consumption growth during the year. On the other hand, investment remained sluggish – a continuing trend over the past several years.

Although the increase in fiscal spending contributed to commercial activity, it did so at the cost of pushing Pakistan's budget deficit to 8.5 percent of GDP.[1] This outcome is not surprising with the settlement of accumulated circular debt, losses stemming from public sector enterprise, higher interest payments, and floods in the last years, which boosted public works and transfer payments. However, the size of the fiscal deficit is not sustainable as it is contributing to inflation; squeezing out private investment; impacting the balance sheet of commercial banks; and could push the country into a debt trap.

Table 1.1: Macroeconomic Indicators

growth in percent

	FY11	FY12 Target	FY12
Real GDP	3.0	4.2	3.7
Agriculture	2.4	3.4	3.1
Industry	0.7	3.1	3.4
Services	4.4	5.0	4.0
Consumption	3.9	-	11.1
Investment	-4.7	-	-8.6
CPI inflation	13.7	12.0	11.0
as percent of GDP			
Current account balance	0.1	-	-2.0
Fiscal balance	-6.6	-4.0	-8.5*
Public debt	61.0	60.0	62.6

*See foot note 1.

Source: State Bank of Pakistan and Provincial Bureau of Statistics

On a positive note, food prices have remained relatively stable during FY12, which helped bring down overall inflation to 11.1 percent – better than the 12.0 percent projected earlier (**Table 1.1**). It was this easing that allowed the central bank to reduce the policy rate by 200 bps during the year; this was done to partially revive private sector borrowing, and encourage banks to improve their intermediation between private savers and borrowers.

Another positive was the external front, as remittances posted yet another year of strong growth, which not only helped narrow the current account deficit, but also contributed to economic activity. In overall terms, the external sector has been less worrying than anticipated at the beginning of the year; however, as financial inflows dried up, the burden of financing the current account deficit and external debt, has fallen on the country's FX reserves.

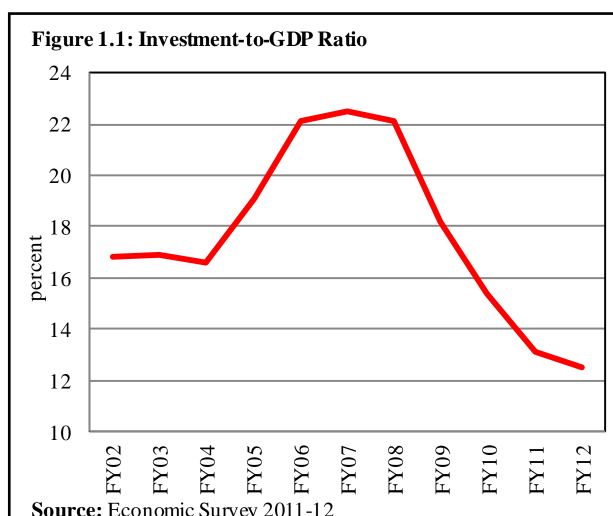
1.2 Assessment of the year FY12

Looking at the supply side, Pakistan's economic growth in FY12 was broad-based. While services continued to support the economy, commodity producing sectors (agriculture and industry) posted an

[1] Without the one-off payment of the circular debt, the fiscal deficit was 6.6 percent of GDP. However, this difference was *financed* by the government, so the overall gap was 8.5 percent.

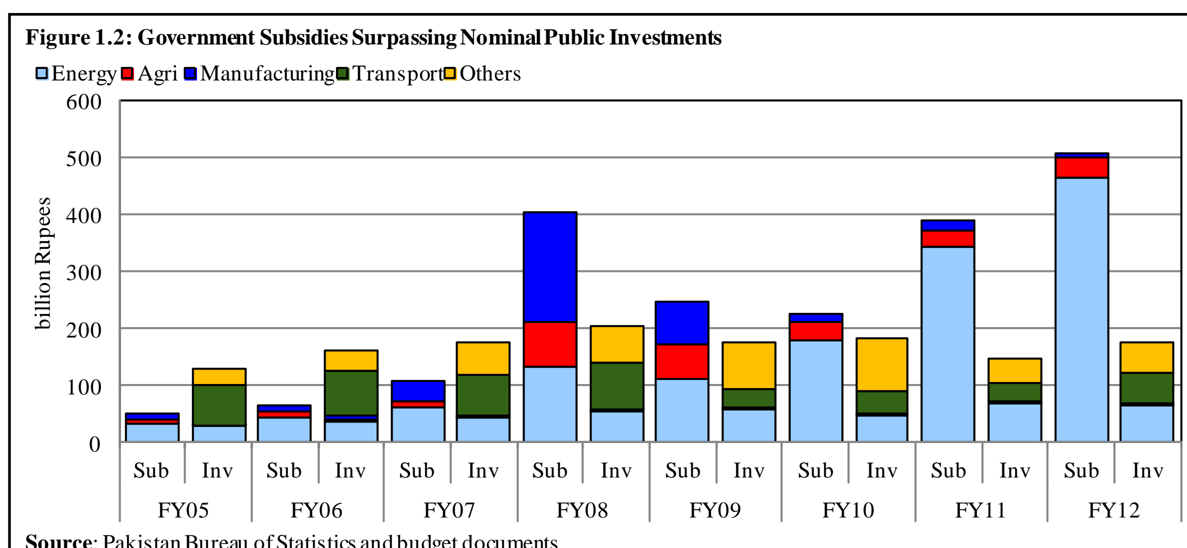
improvement over FY11. Growth in agriculture came from livestock and *kharif* crops, but minor crops witnessed a decline due to the floods in Q1-FY12.[2]

The positive spillovers from agriculture, coupled with strong remittances and income support schemes, boosted construction activities and household consumption – both of which helped the manufacturing sector. In terms of services, there was a sharp improvement in financial sector earnings, driven primarily by the volume of commercial bank financing of the fiscal deficit, and deceleration in fresh non-performing loans (NPLs).



On the demand side, real consumption grew by 11.1 percent during FY12. It is important to realize that over-dependence on consumption makes growth unsustainable, especially when the country's investment rate has been falling (**Figure 1.1**). During FY12, the investment-to-GDP ratio reached a low of 12.5 percent, due to security concerns; energy constraint; excess capacity with the manufacturing sector; the fiscal spillover on the balance sheet of commercial banks; and concerns about sector-specific policies. Public investment has also been overshadowed by subsidies (**Figure 1.2**).

Besides the low investment rate, the increase in the budget deficit has also emerged as a key challenge to the macroeconomic stability of the country. For FY12, the government had envisaged a significant fiscal consolidation, but the actual outcome was a sizeable expansion.



Subsidies turned out to be more than three times the target, but this included Rs 391 billion that was spent to consolidate the PSE debt, especially in the power sector.[3] Excluding subsidies, the fiscal

[2] In our view, the constant 7.5 percent growth in small-scale manufacturing (SSM) does not adequately capture the impact of the energy shortage on these manufacturing units, which generally cannot afford alternative sources of energy generation.
[3] In fact, the shift from hydel to thermal power; the change in fuel mix from low-priced gas to high priced furnace oil; high line-losses from old infrastructure; theft; inadequate collection from billed units; inefficient generation units; uncertain fuel

deficit narrows to 6.0 percent of GDP. This reflects higher-than-target expenditures including debt servicing, and the fact that fiscal devolution has not been as smooth as anticipated. Furthermore, provinces were expected to run budget surpluses, but they ended up contributing Rs 39.1 billion to the overall deficit. FY12 was also the sixth consecutive year when the government ran a revenue deficit, against the requirement of a revenue surplus stipulated under the Fiscal Responsibility and Debt Limitation (FRDL) Act of 2005.[4]

Transfer payments were another heavy item on the fiscal side. With income support programs like the Watan Card and Benazir Income Support Program (BISP), direct outreach was deemed necessary to alleviate the suffering from the floods in FY11, which were far worse than what was experienced in FY12. Another fiscal drain is the weak financial position of public sector enterprises (PSEs). Direct support to Pakistan Railways, Pakistan Steel Mills, PIA and others PSEs, amounted to Rs 33.8 billion in FY12 (see **Chapter 2**).[5]

Financing the fiscal deficit in FY12 was also challenging, as net external financing (which was higher than FY11) did not even cover 8.0 percent of the total fiscal gap. With limited external finance and pending privatization receipts (Etisalaat), the government was able to realize a 12.3 percent increase in non-bank financing, which brought in Rs 529.4 billion.[6] Despite this increase in non-bank financing, the stream of on-going expenditures left the fiscal authorities with no other option but to rely on the banking system – first through commercial banks, then from SBP. The latter has breached the quarterly borrowing limits from the central bank during Q4-FY12.[7]

As a result, the country's domestic debt increased by Rs 1.6 trillion (YoY growth of 27.0 percent) during the year, and the public debt-to-GDP has reached 62.6 percent.[8] The shift of this debt towards the shorter-end has not only increased the debt servicing burden on the country, but has also intensified the roll-over and interest rate risks. These debt dynamics, together with persistence in primary and revenue deficits, indicate that Pakistan could move into a debt trap.

The current debt composition has also complicated monetary management, which was further compounded by the fact that the drawdown of FX reserves (during the year) continued to absorb domestic liquidity. With a price-insensitive dominant borrower, and SBP's aversion to deficit financing, the central bank had to inject short-term liquidity into the system (via OMOs) to smooth out market liquidity conditions.

Commercial banks were clearly not averse to lending to the government. As of June 2012, just the deficit financing by commercial banks (i.e., their holdings of government securities) accounted for 34.4 percent of their aggregate balance sheet, while total private sector lending was only 39 percent: in June 2008, the stock of government securities was only 16.4 percent, while lending to the private sector was 52.4 percent of their total assets. This significant shift in their balance sheet may provide

sources; and the inability to increase tariffs to cover generation costs, forced the fiscal authorities to earmark funds to subsidize these units – it also reduced capacity utilization in both private and public sector generating units.

[4] FRDL Act 2005 states that the government should generate revenue surplus from 2008 onwards.

[5] From company reports and public statements, it is clear that direct government funding is to pay salaries and pensions, and to ensure that minimal services are provided.

[6] However, even this number is deceptive. Rs 229 billion of this amount came from NBFIs (primarily mutual funds) that have shown limited primary mobilization: in effect, most of this "non-bank" financing came from commercial banks and was simply channeled via NBFIs. Net mobilization via National Saving Schemes (NSS), on the other hand, was only Rs 142 billion in FY12.

[7] According to the new Section 9C, in SBP Act 1956, the flow of federal government borrowing from SBP has been restricted by imposing a limit of zero quarterly borrowing on a net basis.

[8] The FRDL Act stipulates that public debt should be reduced to 60 percent of GDP by end-FY13, which means the government has till the end of this fiscal year to manage its public debt. SBP's public debt definition differs from the Ministry of Finance, as it includes military debt, short-term debt and external liabilities. According to the Ministry of Finance definition, the stock of public debt has reached Rs 12.7 billion at end-June 2012, which is 61.3 percent of GDP.

some comfort to banks (for the returns, and improvement in their risk-weighted assets), but also reveals their increasing risk aversion.

During FY12, net lending to private sector businesses was only Rs 18.3 billion, against Rs 692.3 billion that commercial banks lent (in net terms) to finance the budget deficit (and the circular debt settlement). Given the bank-dominated financial sector in Pakistan, SBP is concerned that banks are shifting away from their role as intermediaries between private savers and borrowers. This shift in lending strategy, is marginalizing the private sector.

Among other factors, SBP's decision to cut its policy rate by a cumulative 200 bps in H1-FY12 was partially motivated by the above concern. However, in the presence of a risk-free dominant borrower, average bank lending rates fell by only 112 bps, which suggests that banks remain apprehensive about (or uninterested in lending to) the private sector, and were willing to accept lower earnings on government securities.

Fixed investment loans have been falling for several years, and have now stagnated. What is more alarming is the sharp fall in working capital loans and trade finance during the year. We acknowledge that the fall in commodity prices (i.e., cotton and sugarcane), stricter regulation of loans under export finance scheme (EFS), and a fall in FX loans would reduce working capital needs. However, the low levels indicate that banks are more interested in lending to the public sector.

Like most other countries, there is no hard data to deconstruct private sector lending (the equilibrium) between the demand for loans, and what banks are actually willing to lend. As expected, there are opposing explanations for the sharp fall in private sector lending: banks complain about the lack of quality borrowers, and correctly highlight non-price impediments to invest (e.g., energy shortages; the law and order situation; forthcoming elections, etc.). Businessmen, on the other hand, always stress that banks are simply unwilling to lend and therefore charge high margins. In our view, commercial banks remain concerned about credit risks under the influence of a dominant borrower, and hence increase risk margins on the private sector. In effect, during a recession with a dominant borrower, banks become even more risk averse, which exacerbates the slump in private sector activity. The results change significantly when the dominant borrower is taken out of the picture.[9]

Finally, at the start of FY12, SBP's main concern was the external sector, as we did not expect the one-off current account surplus in FY11 to be repeated. With the expiry of the IMF Stand-by Agreement (SBA) in September 2011, the market was concerned about the accelerated IMF repayments that would begin in FY12. Our initial BoP projections were revised to show a larger external gap, after the trade deficit worsened in the first few months of the fiscal year, and remittances slipped below expectations. As a result, SBP projected the current account deficit at US$ 5.2 billion, and an overall BoP gap of US$ 3.4 billion.

The actual outcome for the year was better: a current account deficit of US$ 4.6 billion, and an overall gap of US$ 3.3 billion, which meant that Pakistan's FX reserves fell by US$ 4.0 billion, against an initial projection of US$ 4.4 billion. Nevertheless, this contributed to a 9.1 percent depreciation of the Rupee during the course of the year. The Rupee depreciated from November to late December 2011,

[9] To get a better handle, a framework was developed to understand this problem. By anchoring the framework to the concept of counter-cyclical bank margins (which simply refer to the fact that bank margins include a premium for credit risks, and these risks are lower during a boom, and are higher during a recession), we observe that in a near-recessionary environment with a dominant borrower (the government), an increase in the discount rate triggers an exaggerated increase in lending rates *offered* to non-prime borrowers. This sharply reduces private sector credit disbursements as the government becomes even more attractive. Furthermore, an increase in the benchmark rate only allows a partial pass-through in terms of the documented *average* lending rates, as non-prime borrowers are rationed out of the credit market. As banks only focus on prime borrowers, the increase in the *average* lending rate is smaller.

and sharply so in the last week of May 2012. The first event may have been triggered by the closure of NATO supply routes to Afghanistan, and sustained by rising oil prices; the second adjustment was a brief market panic in the backdrop of international developments.[10] In effect, the Rupee was impacted more by one-off events than the underlying economic fundamentals.

Looking at key tradeables, the fall in textile exports was primarily responsible for the negative growth in export receipts, and the realized trade deficit was slightly larger than projected. However, the price of oil ended up giving the country some comfort. Oil prices softened between July and October 2011, but edged up between November and March, and then fell sharply from April to June 2012; the latter period ensured that the actual BoP outcome was better than anticipated. Even the lumpy US$ 1.3 billion repayment to the IMF in H2-FY12, and a further US$ 1.3 billion owed to the other IFIs, did not unnerve the market (see Outlook for FY13).

The swing factor was worker remittances. Against a forecast of US$ 12.5 billion in FY12, Pakistan was able to realize US$ 13.2 billion. The 17.7 percent growth was realized despite continuing weaknesses in the global economy, as the number of Pakistani workers abroad increased by 6.4 percent during the year.[11] Putting this in perspective, the Rupee value of inward remittances surpassed the increase in domestic money supply during the year. As will be discussed in the outlook, SBP remains optimistic that remittances will continue to post strong growth in the remaining part of FY13.

In light of the above discussion, the solution to Pakistan's economic problems lies in initiating decisive reforms in the fiscal, PSEs and energy sector (see **Box 1.1**). These reforms are indispensible not only to manage scarce government resources that could otherwise be employed more productively, but also to create fiscal space to improve public services, infrastructure and revive investments.

Box 1.1: Reforms Required to Lift Pakistan's Economic Growth

In assessing Pakistan's economic performance, there are three key points:

Energy sector reforms

The growing losses of energy-related PSEs have been draining scarce fiscal resources in recent years. Specifically, the federal government has provided over Rs 1.0 trillion to the power sector during the last 4 years (FY09-12), an amount more than the cost of Diamer Bhasha Dam. Despite these efforts, the country faced a record shortfall of both electricity and natural gas in FY12, and the circular debt stood at Rs 382.5 billion as of 27th July 2012. With this backdrop, the following points would capture our assessment:

1. ***Short run fix***: capacity utilization in the power sector must be increased. At this stage, the goal should not be to invest in new capacity *per se*, but to work with the infrastructure Pakistan currently has, and ensure that cash-flows are not hampered and government guarantees are honored. More to the point, subsidies must be accurately budgeted, and public and quasi-public entities must be compelled to pay their bills on time.
2. Leakages in terms of theft and inefficiencies at the generation and transmission stage, must be seriously addressed. In this regard, the example of a privatized KESC is insightful: this utility has shed surplus staff (despite stiff union opposition); has cut power supply on account of unpaid bills (even for high profile government agencies); has invested in more efficient generation units; and has formulated a commercially-driven load-shedding schedule. As a result, the situation is quite different in Karachi compared to the rest of the country.
3. DISCOs must take necessary actions to increase collections, which are far below the desired level.
4. It is important to formulate a comprehensive medium-to-long-term strategy to develop hydel and coal-based generation units. This plan must be shared with the general public, so they have a handle on how the current supply problem is to be resolved in the next several years.

[10] May 2012 witnessed currency volatility in the region and beyond. During this month, while the Pak Rupee lost 2.2 percent of its value, the Indian Rupee depreciated by 5.1 percent; the Sri Lankan Rupee lost 1.5 percent; and the Bangladesh Takka depreciated by 0.3 percent. The British Sterling also lost 3.3 percent of its value during the month.

[11] Source: Bureau of Emigration & Overseas Employment, Islamabad.

5. The regulatory authorities that set tariff rates for power and gas, need to rethink their pricing for end users. Grossly underpriced household and industrial gas leads to wastage, and carries a high opportunity cost (see **Chapter 3**). Although the government's recently approved Petroleum Policy has increased well-head prices and standardized this across the country (which should bring more foreign investment for oil and gas exploration), more pressing concerns about security and contract enforcement need to be addressed first.

Cognizant of the above issues, the government has prepared a restructuring plan to resolve structural weakness in the energy sector. In addition to financial support as mentioned earlier, the following steps are worth noting:

1. Dissolution of PEPCO has been finalized. The administrative and financial intervention of PEPCO in the power sector has ceased.
2. Formation of new Board of Directors of CPPA, QESCO, SEPCO and the GENCO holding company (GHC). The CEOs for GHC, HESCO and PESCO have been appointed, while CEOs for 3 other DISCOs (LESCO, MEPCO and SEPCO) have been replaced.
3. The NEPRA Act has been amended to facilitate passing of Fuel Price Adjustment (FPA) on to the consumers. However, there have been delays by NEPRA in determination of FPA that contributed to liquidity crunch in the sector.
4. A new Electricity Act has been approved by the cabinet to strengthen the legal framework for curbing theft and other administrative losses.

In addition to these reforms, the government may work with the IFIs to formulate a sustainable, irreversible and credible energy policy for the country.

PSE reforms

Although energy has dominated public attention, one must realize the underlying problem in the energy sector is effectively the inability of PSEs to operate commercially. Other PSEs like Pakistan Railways; PIA and the Pakistan Steel Mills, also need to embark on difficult reforms to nudge them back to commercial viability. Comprehensive reform strategies have already been formulated; it just requires the will to take the first difficult steps to reduce staff and rationalize operations. In simple terms, these PSEs need to implement business plans that meet strict standards of commercial viability. In this regard, the government has taken some measures to change senior level management in PIA and Pakistan Steel Mills.[12]

Fiscal reforms

It is important to put things into perspective. Since FY07, Pakistan has been running a *revenue* deficit and also a *primary* deficit[13] – the only upside, is these imbalances slightly narrowed in FY12 compared to FY11. A *revenue* deficit implies the government is borrowing to meet current expenditures, which means the government is effectively borrowing without *creating* repayment capacity (assuming all development spending is used productively and creates repayment capacity).

The repercussions of this fiscal overstretch on the energy sector and the impact on the banking sector, are recurring themes in this report. The solution remains the same as put forward by the IFIs for many years. However, with Pakistan's investment rate already at record lows, the fiscal problem will have to be addressed while taking concurrent steps to revive private investment. As is the case in Europe, a customized reform program will have to be designed to achieve both fiscal austerity and private sector growth.

1.3 Global Economic Conditions and Implications for Pakistan

Throughout FY12, European policymakers struggled to manage conflicting goals: how to show tangible fiscal austerity to calm an increasingly skeptical global financial market; and how to mollify public sector employees who could lose their benefits (or livelihood) and vote accordingly. This uncomfortable trade-off is made worse by the fact that members of the Euro can broadly be placed into two categories: those that are fiscally responsible, and those that are not. Fortunately, the market has already shown where each country stands: Greece; Spain; Portugal; Ireland; Italy and Cyprus need help; Germany; Finland and Austria do not.

For a union, which is political as much as it is economic, such differences will determine the level of pain that individual countries would have to endure, if they are to win the market's trust. Not

[12] It is expected that with the current bailout package to PSM, it may attain capacity utilization of 55 percent from its current 20 percent. Likewise, the new management in PIA has prepared its draft Business Plan, which is in the process of being fine tuned.

[13] A primary deficit implies that revenues (tax and non-tax) cannot even cover non-interest expenses; this basically means the government must borrow to meet its debt servicing obligations.

surprisingly, the champions of austerity are those that will have to experience less pain, and those who want growth would like to defer the pain. Deferring fiscal reforms (and pushing for growth) raises the issue of the credibility of future austerity plans, which is not easy given the track record of the problem countries in the Euro.

A further complication is that some members of the Euro will have to bailout the others, which means one set of tax-payers will have to pay for the other. And it is not just about lending enough to keep problem countries current on their debt payments – these countries already have high debt-to-GDP ratios, which is an important metric the market uses in pricing sovereign bonds (**Table 7.4**). Hence, a credible solution would entail grants from the disciplined to the less disciplined, which will not be easy. By most accounts this issue will drag on, and the uncertainty it creates is likely to keep the Eurozone in a recession for the next several years.

Developments in the US, on the other hand, have been somewhat better. However, even in the US, the lead-up to the fiscal cliff in January 2013, created a good deal of uncertainty about what would happen.[14] The non-partisan Congressional Budget Office (CBO) had predicted the cliff could bring about a 2.9 percent contraction in US GDP, which would push US unemployment back above 9 percent. The total impact would be a fiscal contraction of US 560 billion, or 3.5 percent of GDP.

The resolution of the fiscal cliff in early 2013, has been a temporary compromise. Taxes on the very rich have automatically increased, but spending cuts have been postponed for two months. A more credible solution will require a Congressional decision regarding the debt ceiling, which is likely to be politically divisive.

What we do know, is the modest US growth in the past few years has been jobless. We also know that with bleak employment opportunities, households will continue to deleverage (i.e., pay off their debts), which implies that a consumer-led recovery is highly unlikely. This is a growing concern, as two-thirds of the US economy is driven by consumer spending. In response to this, the Fed has announced the third round of quantitative easing (QE3), which is an open-ended bond-purchasing program that seeks not just to revive economic growth, but more importantly, to create jobs. Analysts are not convinced that such injection of liquidity would necessarily create jobs, especially with the government's focus to revive the housing market.

Making matters worse, the Asia Giants are beginning to slow. Since China and India have been powering world economic growth over the past decade, this slowdown can be traced to falling export demand from the US and EU. In effect, these export-driven countries cannot avoid the contagion from the OECD.

Although a major concern for both China and India are weakening exports, domestic demand in India is beginning to taper off. In particular, declining corporate investment, low public investments and rising input costs, is troubling Indian policymakers. Furthermore, the heavy burden of government subsidies is creating fiscal pressures, which are difficult to contain politically. On the other hand, China is also beginning to slow, with concerns that easing demand for Chinese exports could increase unemployment and puncture the real estate boom.

As the near-term recovery in the global economy appears unlikely, the prospects for Pakistan's external sector are mixed. Although the global recession would hurt Pakistan's exports, the possible upside could come from international commodity prices – the most obvious being oil. It is clear that geo-political uncertainty about Syria and Iran is keeping oil prices high, but such levels are also

[14] The cliff refers to specific tax laws that will expire in December 2012, which will eliminate Bush-era tax cuts and halt certain unemployment benefits and tax holidays.

dragging down the global economy. In our view, this uncertainty will dissipate after the US elections, which means the remaining half of FY13 should see oil prices falling.

In this discussion, one must realize that in the past decade, global demand for oil has come primarily from Asia (i.e., China and India): if these economies were to slow, global demand for oil will be impacted. Add to this the strength of the US Dollar as investors adjust their currency holdings to the on-going Euro crisis, and realize that oil is priced in Dollars. So with easing global demand for oil and a strong Dollar, oil prices are likely to edge lower. As discussed in **Chapter 8**, easing oil prices could have a decisive impact on Pakistan's current account deficit, while rising food prices (wheat and rice) would help at the margin. In net terms, Pakistan's external sector is relatively insulated from developments in the global economy, with a possible upside on commodity prices.

1.4 Outlook for FY13

The target GDP growth of 4.3 percent for FY13 appears optimistic; we think Pakistan will grow at about the same rate as it did last year (**Table 1.2**). We are confident that milder flooding this year and the underlying factors that allowed for 3.7 percent growth in FY12 will largely remain in play.

The structural problems in the energy sector, PSEs and the fiscal side, may not be tackled in the near-term. However, since the government paid-off the accumulated subsidies in FY12, we do not expect the same level of fiscal pressure this year. While the government hopes to achieve a fiscal deficit target of 4.7 percent of GDP, we think a range of 6 – 7 percent is more realistic.

A key concern for the central bank is the on-going decline in domestic investment. Although the investment environment in Pakistan is likely to remain challenging, we believe the recent 250 bps cut in the benchmark interest rate, could revive private investment and provide some relief to commercial enterprises. This decision was supported by an improved inflation outlook, and also seeks to signal that banks may re-examine the rapid accumulation of government securities on their balance sheets (directly or indirectly). In our view, with interest rates at current levels, commercial banks may be incentivized to book high-return private assets, rather than just place money with the government. Although SBP does not tell banks what to do, commercial banks should be cautious about how their balance sheets are evolving, and look to diversify their asset portfolio with a long-term view.

In addition to the inclination of banks, the effectiveness of this interest rate signal will depend on the quantum of government borrowing, its borrowing mix and liquidity conditions in the market. Since the size of the fiscal deficit last year was mainly due to one-off factors, we are hoping things will be better this year. We are also optimistic that with the opening of NATO supply routes, Coalition Support Fund (CSF) will be realized in a timely manner.[15] SBP remains hopeful that inflows from privatization (Etisalaat) and the 3G licenses will also be realized in FY13.

Table 1.2: Major Macroeconomic Targets and Projections

	FY12^P	FY13 Targets	FY13 SBP Projections
	percent growth		
Real GDP	3.7	4.3	3.0 – 4.0
CPI	11.0	9.5	8.0 – 9.0
M2	14.1		14.0 – 15.0
	billion US Dollars		
Remittances	13.2	14.1	14.0 – 15.0
Exports (fob)	24.6	25.8	25.0 – 25.5
Imports (fob)	40.0	42.9	41.0 – 42.0
	percent of GDP		
Fiscal deficit	6.6	4.7	6.0 – 7.0
Current account deficit	2.0	1.9	0.5 – 1.5

Note: Targets of fiscal and current account deficits to GDP ratios are based on the nominal GDP in the budget projections. P: provisional

The central bank shares the market's view that the Rupee-Dollar parity is a key indicator. Given the nature of this market, the Rupee parity is perhaps the most important market signal that policymakers have. In making our interest rate decisions, SBP looks closely at the likely

[15] Pakistan has already received US$ 1.8 billion under CSF as of December 2012.

impact on the FX market. One must note that the FX market's reaction to the discount rate cuts in August and October 2012 was quite muted. However, in late November 2012, some pressure appeared, even though the current account posted a surplus in the first four months of FY13. In our view, this pressure can be traced to net outflows to the IFIs (around US$ 1.5 billion during Jul-Nov FY13). Although these payments do not impact the FX market directly, the drawdown of SBP's forex reserves has impacted market sentiments.

In terms of tradeables, our export projections assume that cotton prices have bottomed-out, while Pakistan's low value-added textiles may be insulated from the demand contraction in the OECD. We do not expect any spike in imports given the sluggishness in domestic investment, and our view on global commodity prices. We also remain optimistic that inward remittances will continue to post strong growth.

On a final note, we would stress the *urgent* need to embark on structural reforms in the energy sector, PSEs and public finances. This, together with a more balanced deficit financing mix in FY13, would ease a great deal of pressure from domestic sources of financing – especially the commercial banks.