Chapter 1
Economic Review

1 Economic Review

1.1 Overview

Prudent monetary and fiscal policies, supported by the IMF's Extended Fund Facility program, helped the economy move progressively along the stabilization path during the first eight months of FY20. The economy also saw a notable, smooth transition to a market-based exchange rate system, which was pivotal to addressing the external imbalances and rebuilding the foreign exchange reserves buffer. This structural adjustment, along with the government's adherence to its commitment of zero SBP borrowing, improved overall monetary management and functioning of financial markets. A significant contraction in the twin deficits was visible from the start of the year. However, as the exchange rate was made more flexible and utility prices and taxes adjusted to rein in the fiscal deficit, inflationary pressures rose temporarily. Overall, the improving macroeconomic fundamentals helped restore consumer and business confidence, which set the stage for a recovery in the real sector.

However, just as early signs of this recovery were beginning to emerge, the global and domestic spread of the coronavirus (Covid-19), and ensuing containment measures, hit the economy hard. Manufacturing, retail, transport and trade-related activities were disrupted, causing a severe contraction in real GDP growth. At this critical point, better macroeconomic fundamentals and subdued inflation risks provided policy space to extend relief measures to businesses and households; without these measures, the economic and social fallout of the Covid crisis would have been much worse.

Macroeconomic trends and policies before and after the Covid spread

The country's external and fiscal sectors posted strong performances compared to last year, before the domestic spread of Covid-19 (**Table 1.1**). In particular, the current account had posted a significant improvement in the first 8 months of the year. This decline was attributed primarily to a sharp contraction in imports following demand compression and regulatory measures, alignment of the exchange rate with market fundamentals, and a steady shift in the energy basket from expensive fuels to hydel and coal. The economy also saw a record surge in foreign investment in the domestic debt market, as global fund managers expressed confidence in better macroeconomic and exchange rate policies while tapping on the interest rate differential and tax-related reforms. The improvement in the current account bolstered market sentiment and helped the SBP rebuild its foreign exchange reserves; support also came from reengagement with the IMF and other multilateral lenders. The elevated level of foreign exchange inflows allowed the SBP to unwind its short-term forward and swap contracts to the tune of US$ 5.2 billion during the period. This implied that the actual increase in the SBP's reserves position was US$ 10.7 billion during Jul-Feb 2020 – an average improvement of US$ 1.3 billion a month.

Similarly, on the fiscal front, the consolidation momentum gathered pace during the pre-Covid period, as reflected in the first primary surplus over the first nine months of the fiscal year since FY16. On the revenue side, the government reversed multiple tax concessions given last year, which led to an increase in the GST rate on petroleum products, resumption of collections on telecom, and an increase in the minimum threshold for income tax collection. In addition, the government eliminated the concessionary tax regime for voluminous items, such as textiles, sugar, edible oil, steel, and cigarettes, which led to higher collections compared to last year. Nonetheless, overall tax performance fell somewhat below the ambitious target, as import-related collections weakened significantly. Here, non-tax receipts, stemming primarily from higher SBP profits and GSM license renewal fees, supported

Major Macroeconomic Indicators **Table 1.1**

	FY18	FY19			FY20			
		Jul-Feb	Mar-Jun	Full-year Actual	Jul-Feb	Mar-Jun	Full-year Actual	Full-year Target
percent growth								
Real GDP	5.5			1.9			-0.4	4.0
Agriculture	4.0			0.6			2.7	3.5
Industry	4.6			-2.3			-2.6	2.3
o/w LSM	5.1	-1.6	-3.7	-2.6	-2.9	-24.0	-7.8	1.3
Services	6.3			3.8			-0.6	4.8
Private sector credit	14.9	10.3	1.2	11.6	3.8	-0.8	2.9	
National consumer price index	4.7	6.0	8.3	6.8	11.7	8.9	10.7	5-7
Exports	13.7	1.7	-6.1	-1.1	3.6	-26.7	-6.8	6.2
Imports	14.9	-6.3	-16.4	-9.9	-13.9	-28.2	-18.6	0.8
Exchange rate (+app/-dep%)	-13.7	-12.5	-13.3	-24.1	3.8	-8.2	-4.8	
percent of GDP								
Current a/c balance	-6.1	-3.4	-1.4	-4.8	-1.0	-0.1	-1.1	-3.0
Primary balance*	-2.2	-1.2	-2.4	-3.6	0.5	-2.3	-1.8	-0.9
Fiscal balance*	-6.5	-5.1	-4.0	-9.1	-4.0	-4.1	-8.1	-7.5
Gross public debt*	72.1	74.2	86.1	86.1	84.4	87.2	87.2	NA
billion Rupees								
Total revenue*	5,228.0	3,583.7	1,317.0	4,900.7	4,689.9	1,582.3	6,272.2	7,458.0
Total expenditure*	7,488.4	5,506.2	2,839.4	8,345.6	6,376.1	3,272.4	9,648.5	10,740.0
billion US$								
Change in SBP FX reserves	-6.4	-1.7	-0.8	-2.5	5.5	-0.6	4.9	
Workers' remittances	19.9	14.3	7.4	21.7	15.1	8.0	23.1	24.0
Foreign portfolio investment	2.2	-0.4	-1.0	-1.4	2.1	-2.7	-0.5	2.3
FDI in Pakistan	2.8	0.8	0.6	1.4	1.9	0.7	2.6	4.3
Change in net forward position (incl. swaps)	-2.8	-0.8	-0.3	-1.1	5.2	-2.9	2.3	

*The data in Jul-Feb and Mar-Jun column is for Jul-Mar and Apr-Jun respectively.

Source: PBS, SBP, MOF

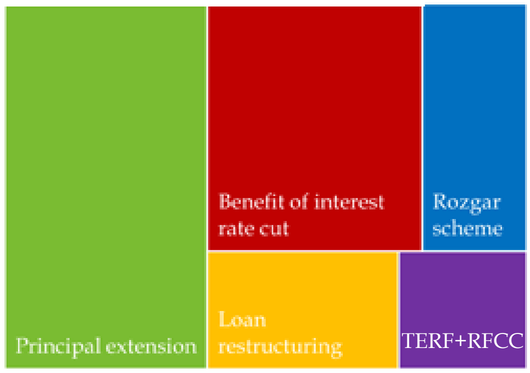
revenue mobilization. Progress on expenditure control on the development side was also evident, although high debt servicing cost and a steady increase in social transfers (grants) doubled the growth in overall expenditures. Nonetheless, the authorities refrained from issuing supplementary grants during the year.

Trends in inflation also pointed toward subsiding demand-side pressures. Although inflation in the non-food-non-energy segment of CPI remained at an elevated level – as the economy absorbed the impact of the exchange rate depreciation of the previous year, taxation measures announced in the FY20 budget and higher fuel and transportation costs – its trend stabilized as the year progressed. Nonetheless, supply-side pressures remained strong in the food market, as temporary disruptions triggered speculative sentiments and contributed to price build-up. While these developments weakened consumer confidence, they were not entrenched enough to affect the SBP's full-year inflation projections and influence monetary policy decisions. Thus, after increasing the policy rate by 100 bps in July 2019, the SBP kept the policy rate unchanged. As expected, after plateauing in January 2020, food inflation also began to recede, as seasonal (and import) supplies resumed and the government initiated a countrywide crackdown on hoarding practices.

Thus, at the time the Covid-19 infections began to increase, the country had already made noticeable gains on the macroeconomic stability front. This made it possible to extend aggressive policy support to businesses and households to help them cope with the necessary mobility restrictions and ensuing supply-chain disruptions. Those in special need of immediate policy support included manufacturing firms – as factory closures tightened cash cycles and raised the risk of surging unemployment – and a number of services concerns, especially in the hospitality industry, such as event management, catering, restaurants, food deliveries, salons/barber shops, and travel and ticketing. Wherever possible, the adoption of digital channels (such as teleworking and e-commerce) supported business continuity, but given the weak digital landscape, most businesses struggled (**Special Section**). Although the agriculture sector remained largely immune to the Covid shock (since major crops for the year had already been harvested), repayment risks began to emerge in the farm segment of micro loans. Consequently, the scale and breadth of the needed efforts meant that the relief measures would entail large fiscal and quasi-fiscal costs, requiring adjustments in the consolidation agenda. Accordingly, the government expanded the volume and outreach of its ongoing social uplift programs, enabling over 12 million households to receive emergency cash transfers (Rs 12,000 per family) for meeting essential needs.

At the same time, the SBP arranged multiple emergency meetings of the Monetary Policy Committee (MPC) to take frequent stock of the fast evolving situation and decide accordingly. The MPC cut the policy rate by 625 bps in a roughly 3-month time period, which not only favorably repriced most of the existing loans by the private sector, but also made borrowing viable for firms that would otherwise have been priced out due to high interest rates and weakened profitability. Importantly, the SBP also rolled out multiple unprecedented schemes, including the deferment of principal repayments; subsidized financing for firms to pay salaries to their employees; relaxations in operational criteria for export-related refinance schemes; and concessionary refinance facilities for investment projects and hospitals. Businesses have shown a keen interest in these financing schemes and actively used them to plug their cash flow gaps. Put together, the estimated liquidity impact of the SBP's relief measures was equivalent to 4.0 percent of GDP (**Figure 1.1**).

Composition of the Estimated Liquidity Impact of SBP's Major Relief Measures (as on Oct 16, 2020)* **Figure 1.1**



* The overall size of the rectangle is equivalent to 4.0 percent of GDP.
TERF: Temporary Economic Refinance Facility
RFCC: Refinance Facility for Combating Covid-19
Source: State Bank of Pakistan

The size and scope of these novel measures were instrumental in ensuring business continuity and job security. Encouragingly also, data-intensive verification process for social transfers, banks' strict compliance with prudential norms, better financial management and the strictly targeted nature of relief provision avoided the build-up of excessive cost. Thus, it turned out that although the Covid crisis led to temporary output losses, weakened consumer and businesses' confidence, and pushed the government to recalibrate the economic reform process, it did not have a strong bearing on the economy's risk profile. Specifically, the improvement in underlying macroeconomic fundamentals remained intact despite the Covid-related strain.

On the fiscal side, plummeting economic activity significantly dented tax revenue growth in Mar-Jun 2020, and a steep surge was observed in non-interest current spending, as the government had to respond to the country's social safety and healthcare needs (including ensuring supplies of testing kits, ventilators, stipends to health personnel, data management, contact tracing, etc). As a result, the primary surplus accumulated in the first three quarters turned into a deficit, causing a slippage in the target set in the FY20 budget as well as committed under the EFF program. But it is imperative to note that despite these challenging and unprecedented conditions, the full-year primary deficit during the year was only half the level seen last year.

Importantly, even after accounting for the Covid-related borrowing strain, the increase in the public debt-to-GDP ratio was contained to 1.1 percent of GDP during the year, as the government used its cash buffers held with the SBP. These buffers were particularly helpful in financing unanticipated expenditures during the Covid period: over 53 percent of the increase in budgetary borrowings from the banking system during the Mar-Jun period comprised withdrawals from deposits with the SBP. Also, as the exchange rate was relatively more stable in FY20 compared to last year, the revaluation losses were contained; recall here that these losses alone were responsible for nearly 40 percent of the increase in the country's debt stock in FY19. From a debt management standpoint, the composition of public debt in FY20 remained favorable, as most of the increase came from longer tenor borrowings, which helped contain the rollover risk for the government. Having said that, while the damage from Covid-19 was limited on the overall debt profile, the Covid shock disrupted the targeted reduction in the level of public debt burden. At end-FY20, public debt stood at 87.2 percent of GDP, which was in excess of 80.5 percent envisaged for FY20 under the EFF program, and much higher than the 60 percent limit stipulated under the Fiscal Responsibility and Debt Limitation Act.

Similarly, on the external front, two concerns emerged during the Covid period. First, export growth tapered, as limited retail sales in advanced economies led to a fall in orders. Second, as uncertainties emerged with respect to the impact on the global economy, foreign fund managers pulled capital out from emerging market economies. In Pakistan also, the trend of portfolio inflows in the domestic debt market reverted during the Mar-Jun period, partially reversing the build-up in the country's foreign exchange reserves. However, these developments did not affect the external balance significantly, and the reserves still ended the year higher than in FY19.

First, the market-based exchange rate worked as a valuable shock absorber, as payment imbalances were appropriately reflected in movements in the Pak rupee-US dollar parity. The Pak rupee strengthened by around 4 percent in the pre-Covid period (between Jul-Feb FY20) – in line with the improvement in the current account and financial inflows, which supported the country's reserves position and market sentiment. This trend reversed from March onwards with the global sell-off causing a depreciation of 8.2 percent in the Pak rupee during the Mar-Jun period. It is important to highlight here that this weakening in the exchange rate took place in an orderly manner and was largely in line with pressures faced by other emerging markets. Second, contraction in manufacturing and the over 50 percent drop in global oil prices led to a broad-based decline in imports, which significantly eased outward payments. Third, the growth in workers' remittances remained intact, as the orderly exchange rate conditions, effective marketing campaigns under the PRI and increased incentives under TT charges reimbursement scheme provided valuable support. Fourth, inflows under the IMF's Rapid Financing Facility also proved helpful. As a result, the decline in the SBP's reserves was contained to US$ 625.9 million between March and June; on a full-year basis, reserves recorded an improvement of US$ 4.9 billion in FY20. With SBP's forward liabilities declining by US$ 2.3 billion, the increase in the net reserves buffer over the fiscal year was US$ 7.1 billion.

Developments on the inflation front also remained largely favorable, as the Covid-related steep fall in global crude prices, coupled with easing food prices and the government's decision to postpone further upward adjustments in power tariffs, led to a sharp fall in both headline and core inflation. While a significant amount of liquidity was injected into the system following the monetary and fiscal relief measures, domestic demand remained weak, helping contain inflation. This was because limited work opportunities, layoffs and subdued sales growth had put many firms and households under severe financial constraints. All the available high frequency indicators (such as petroleum sales, cement dispatches and automobile sales,) pointed at weak retail activity. As a result, after remaining at an elevated level of 8.0 percent on average during Jul-Feb FY20, core inflation (urban) declined from March onwards to reach 6.5 percent YoY at end-June.

Resuming the Pre-Covid Trajectory: Policy Considerations

Thus, with the pre-Covid improvement in macroeconomic fundamentals remaining intact and the strong policy response helping to cushion the shock, the economy seems poised to pick up from where it was before the Covid shock. Encouragingly, this process has already started taking hold following the flattening out of the Covid curve in the country and the resumption of economic activity. However, three risk factors bear watching. First, challenges emanating from Covid-19 have cut across the entire operational value chain of businesses: their supply lines were disrupted; inventories cut short; savings dried up; and capital expenditures put on hold. The pace of the recovery would hinge on when they recoup the financial damage, and how soon and fast domestic demand picks up. Second, though export volumes have rebounded during the past couple of years, relatively modest growth (of 2.7 percent) was observed in export earnings during Jul-Feb 2020. Now, with a less vibrant outlook of advanced economies, a meaningful recovery in export receipts could be challenging. Third, the country's tax base remains narrow, heavily reliant on a few sectors, and excessively vulnerable to business cycle fluctuations. This implies that any pressure on the expenditure side could put a significant strain on the already high debt burden of the country.

Therefore, it has become crucial to build on the progress made on the reform front so far, and address the economy's structural bottlenecks to boost competitiveness, improve the business environment and ultimately raise the economy's growth potential over the medium term. Here, it is important to emphasize that a number of reforms were introduced in the earlier part of FY20 to address deep-seated problems, especially in the areas of taxes, documentation, power, access to finance, and financial scrutiny. However, progress on some of these reforms was temporarily interrupted by the more pressing economic and social concerns emanating from the Covid-related lockdowns, which required immediate policy attention. This progress needs to be put back on track, and further reforms initiated, to take the economy on a sustainable growth path. In this context, the following points are important:

First, a more sustainable solution to correct the country's fiscal vulnerabilities is needed, which requires more than just increasing tax rates. Documentation, reducing informality, and harmonizing the tax regime, are all needed to broaden the tax base and reduce reliance on non-tax revenues. Though exemptions and concessions in some sectors were phased out in the FY20 budget, they still prevail in other sectors (such as those included in 5th, 6th and 8th Schedules of Sales Tax Act) and contribute to below-potential revenue collections. Simplification and harmonization of the tax base and rates for agricultural income tax and sales tax on services, are also unfinished reform agendas. To make notable progress here, strong coordination is needed between the federal and the provincial governments. Tax enforcement also needs to be strengthened by tightening risk-based auditing and strengthening data cross-checks through CNIC, third-party data and/or point of sales. At the same time, concerted efforts are needed to facilitate businesses through simplifying tax filing and accelerating the payment of refunds.

Second, pricing and governance problems in the power sector need to be addressed as these not only represent significant quasi-fiscal risk, but have also dented the competitiveness of the economy. The government had devised a comprehensive strategy at the start of the year to improve the viability of the power sector and ensure a sustained decline in accumulated arrears. This strategy included a Circular Debt Reduction Plan, adopting amendments in the Nepra Act to ensure automaticity of tariff revisions and notifications, improving collections, and subsidy rightsizing. Furthermore, infrastructure investment to reduce technical losses, anti-theft drives, and upward tariff adjustments during the early months of FY20, had helped arrest the growth in arrears. However, postponement of tariff adjustments for monthly fuel and quarterly capacity payments since January, and payment deferrals from March onwards, diminished these initial gains. While the implementation of these adjustments would help correct immediate payment shortfalls, the long-term solution to the pricing issues (especially with respect to capacity payments) is more likely to be influenced by how the prospective revisions in the power purchase agreements with the IPPs roll out. Furthermore, a substantive progress on the Disco's governance, streamlining of tariff adjustments, and upgradation of transmission and distribution infrastructure, will remain key in improving the overall viability of the power sector.

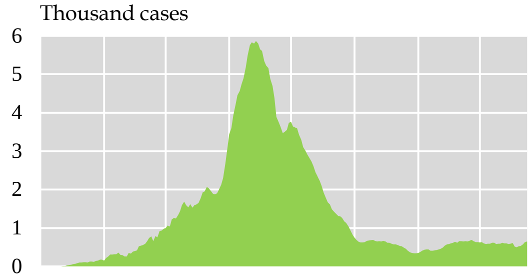
Third, Pakistan's favorable progress on the Financial Action Task Force (FATF) front will be crucial from the foreign investors' confidence perspective. Several capacity development providers have been engaged to enhance the country's capacity with respect to anti-money laundering and terror financing. As noted in the FATF's October 2020 plenary session, Pakistan has largely addressed 21 of the 27 action items, including all the primary deliverables relevant to supervision of financial institutions. In addition, the country was considered to be partially compliant with the remaining six items, and progress on these items is going at a fast pace. The adoption of the required AML/CFT-related amendments in Pakistan's legal framework – especially the Anti-Money Laundering Act and the Anti-Terrorism Act – by the Parliament, has been a major step forward. Accordingly, regulators in the country, including the SBP, SECP and Self-Regulated Bodies, have issued their updated AML/CFT regulations.

Fourth, consistent efforts are needed to consolidate the improvement in the country's financing landscape in order to promote investment, competition, businesses' growth and overall productivity. Creation of a secured transaction registry, licenses issued to private credit bureaus, and widespread adoption of digital financial services all bode well with respect to improving credit penetration and overall access to finance, especially for small and medium enterprises (**Chapter 7**). Moreover, the increased focus on low-cost housing and affordable mortgages would help deepen financial penetration and bring vibrancy in construction-allied industries. Importantly, the outreach efforts by the SBP and commercial banks for the provision of financing relief (such as SME tracing, aggressive marketing, close working relationship with business chambers, frequent stock-taking, and grievance handling) are proving helpful to ensure inclusivity.

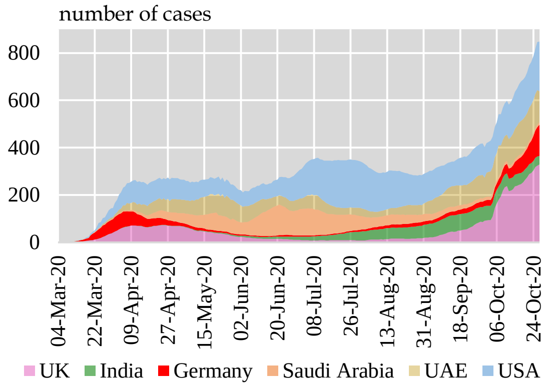
1.2 Economic Outlook

As things stand, Pakistan has managed to control the virus spread (**Figure 1.2a**). Although fresh infections have posted a slight increase in recent weeks, the overall level of active cases remain significantly lower than the peak observed in June 2020. While the prevalent risk of another spike calls for a continuation of social distancing norms, the reopening of the economy (including services) has helped reduce some of the uncertainty around the overall macroeconomic outlook.

New Covid-19 Cases in Pakistan (7-day rolling avg.) **Figure 1.2a**



New Covid-19 Cases per million (7-day rolling average) in Selected Economies **Figure 1.2b**

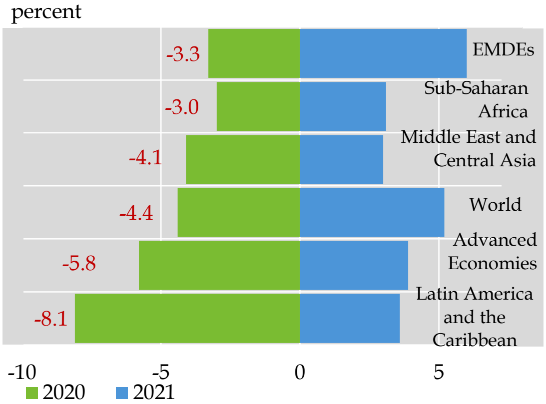


Source: WHO

However, the global containment of the virus still remains elusive. Active cases in the US, the UK, India, France, and Italy remain high (**Figure 1.2b**). Advanced European economies are bracing for another wave, with rising number of cases witnessed in the UK, Belgium, Italy and Greece. Social distancing norms and localized mobility restrictions are being re-introduced in many countries, whereas recent mobility data also suggests plateauing recovery across many countries. As a result, while a rebound in growth is expected in nearly all the regions in 2021, downside risks remain high (**Figure 1.3**).

For now, with the ease in containment measures, retail sales have recovered in the US and the major EU economies, though this recovery was mainly concentrated in groceries, healthcare supplies, and consumer electronics. Clothing retail sales have yet to recover, as they continued to decline in double digits between June and August in the US and EU. The overall global economic outlook also remains uncertain due to the still-high infection rate in some countries, expiration of temporary unemployment support measures in the US, and continuation of the US trade dispute with China. These uncertainties continue to present downside risks to

Real GDP Growth Projections for Major Regions **Figure 1.3**



Source: IMF WEO October 2020

Pakistan's exports growth. Preliminary customs' records for the first quarter of FY21 show a decline of 0.7 percent YoY in the country's exports, although a 7.0 percent increase was recorded in the month of September. For the full year, SBP expects export values within the range of US$ 23.4 – 23.8 billion in FY21 – higher than the US$ 22.5 billion recorded in FY20 (**Table 1.2**).

Similarly, the SBP expects full-year imports to remain higher than last year, given the anticipated pickup in economic activity following the lifting of lockdowns, and firms' efforts to replenish inventories. In particular, the concessions for the construction industry and progress on housing finance would revive steel imports. In addition, lower domestic production and supply-management issues have necessitated imports of wheat and sugar. Energy imports, however, would depend on

Key Macroeconomic Targets and Projections **Table 1.2**

		FY21	
	FY20	**Target[1]**	**SBP Projections[2]**
	percent growth		
Real GDP	-0.4	2.1	1.5 – 2.5
CPI (average)	10.7	6.5*	7.0 - 9.0
	billion US$		
Remittances	23.1	21.5	22.0 – 23.0
Exports (fob)	22.5	22.7	23.4 - 23.8
Imports (fob)	42.4	42.4	42.8 - 43.7
	percent of GDP		
Fiscal deficit	8.1	7.0	6.5 - 7.5
Current a/c deficit	1.1	1.6	1.0 - 2.0

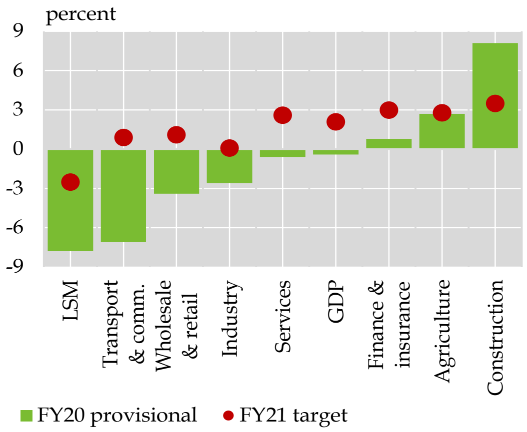
*Projection for CPI inflation, Annual Plan 2019-20, Planning Commission

Source: [1]Ministry of Finance; Planning Commission; [2]SBP

the ongoing substitution trend between imported and local fuel sources. As for oil prices, though having more than doubled from 19-year lows (US$ 19/bbl) in April 2020, Brent still hovered around US$ 40 per barrel by end-October. Through the end of CY-2021, the crude oil market is projected to remain range-bound – due to weaknesses in the aviation sector and the risk of re-imposition of lockdowns amid a still high number of active Covid cases.

Given this stability in oil prices, domestic fuel prices are likely to remain steady during FY21. However, as previous adjustments in the power and gas tariffs are due, there is an upside risk to overall energy inflation. Conditions in the domestic food market are also subject to risk. The recent resurgence in wheat and sugar prices continues to highlight commodity-management problems in the country. Moreover, food prices may also come under pressure due to widespread torrential rains and increased risks of flooding, which may cause crop losses. In contrast, the non-food-non-energy segment of CPI is

Growth Targets for GDP and Major Sectors for FY21 **Figure 1.4**



Source: PBS and Planning Commission

expected to ease further, as chances of a significant pick-up in domestic demand remain low due to weak financial position of businesses and households. Overall, the SBP expects headline inflation to fall within the range of 7-9 percent in FY21.

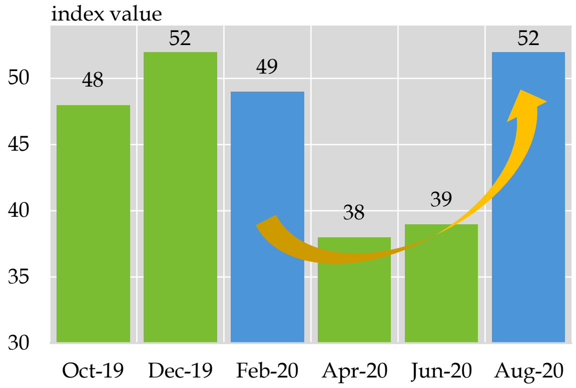
On the fiscal side, challenges remain, as the government continues to focus on addressing Covid-related economic and social outcomes and supporting the initial economic recovery. For the full-year, the government has set the target for the fiscal deficit at 7 percent of GDP, with the primary balance also estimated to show a deficit of 0.5 percent. Thus, with a tight fiscal position, a significant contraction in grants (social transfers) and subsidy outlay – the two major areas with large slippages in FY20 – is targeted for FY21. In case of any overshooting under these heads, the debt servicing relief of US$ 2.7 billion (equivalent to 1 percent of GDP) provided to Pakistan under the G-20's Debt Servicing Suspension Initiative will help create expenditure space for Covid-related spending (**Chapter 5**).

In terms of growth, the government has set the GDP growth target at 2.1 percent for FY21 (**Figure 1.4**). This year-on-year improvement is expected to come from a steady performance of agriculture and a recovery in the services sector, especially finance & insurance, and transport & communications. Industrial performance is also estimated to post a modest recovery, primarily on account of a much contained contraction in large-scale manufacturing as compared to FY20. The SBP expects GDP growth to stay within the range of 1.5 – 2.5 percent during FY21. Nonetheless, these growth projections are subject to risks, including from the evolution of Covid, extreme weather conditions, external demand, and progress on the reform front. In particular, earlier estimates for *kharif* crops (especially cotton) do not seem promising, given weaknesses in farmers' financial condition and heavy rains causing losses to standing crops.

There are also some upside risks, especially in the context of a resurgence in business confidence in the country following the ease in lockdowns and falling Covid cases. The August wave of the IBA-SBP confidence surveys suggests that the business confidence index not only posted a sharp surge compared to the previous two waves, but it has also come in positive territory after remaining in the negative zone for three consecutive waves (**Figure 1.5a**). The improvement in the expected business confidence index (a sub-component of the overall business confidence index) was more pronounced, as it touched its second-highest level since the start of this survey. Importantly, this optimism has also begun to reflect in planned investment activity in the country. As shown in **Figure 1.5b**, funding requests under the SBP's Temporary Economic Refinance Facility (TERF) have risen sharply in recent weeks. The scheme, which provides subsidized financing to businesses undertaking capex or BMR, has so far attracted 338 projects. These developments, along with optimism in the housing and construction sectors, could help accelerate the economy's recovery process in FY21.

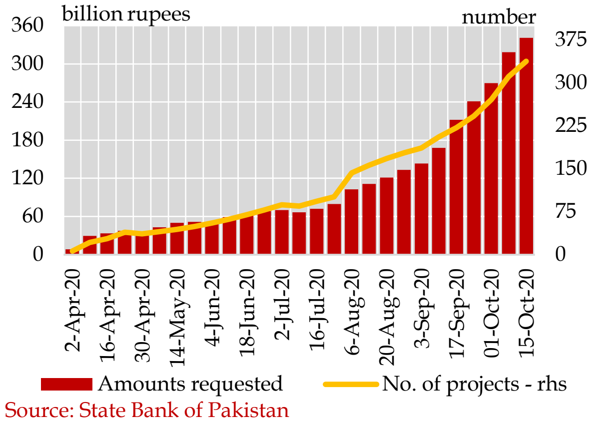
Given the fact that the TERF is geared towards supporting investment activities in the country, the uptick in its utilization is encouraging from a structural viewpoint as well. Pakistan has historically been a consumption-oriented economy, which resulted in unsustainable growth spurts and investment rates not only remaining lower than most EMDEs, but also declining in absolute terms over the past few decades. In this regard, a strong response to incentive schemes such as TERF bodes well for the future economic trajectory, as capital formation activities would help enhance and potentially diversify the output capacity of Pakistan going forward.

Business Confidence has Improved Significantly **Figure 1.5a**



Source: SBP-IBA Business Confidence Survey

Businesses' Demand for Capex Loans under TERF **Figure 1.5b**



Source: State Bank of Pakistan