TOLA ASSOCIATES
TAX & CORPORATE ADVISORS

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PAKONOMICS

ECONOMY AT A GLANCE

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1. PROLOGUE:

Pakistan has been facing deep-rooted economic challenges, mainly on account of large fiscal and current account deficit (in terms of quantum), stagnant exports, low reserves adequacy and bleeding public sector entities. Moody's Investors Service (hereafter "Moody's") has upgraded Pakistan's economic outlook from negative to stable, on account of improvement, in the wake of balance of payments dynamics, policy adjustments and exchange rate flexibility which will reduce external vulnerability risks. Moody's have also maintained the country's local and foreign currency long-term issuer and senior unsecured debt ratings at B3.

Tight fiscal policy has weakened Pakistan's fiscal strength largely due to higher debt levels. On account of muted import growth, Moody's expects Pakistan's narrowing current account deficit to remain at an average of 2.2% of the GDP in FY20 and FY21 from 5% in FY19 and over 6% in FY18. Moody's expects the country's exports to gradually pick up on the back of depreciation of the real exchange rate over the past 18 months, which has contributed in narrowing current account deficits. However, Moody's has shown serious concerns over Pakistan's ability to contain fiscal deficit in FY20, anticipating fiscal deficit to remain elevated around 8.6% of GDP in FY20 as compared to 8.9% in FY19.

It may be noted that Pakistan has just recently received a $1.3 billion from the Asian Development Bank (hereafter "ADB") for financial assistance and energy sector reforms, which will also boost foreign exchange reserves allowing our Economy to absorb external risks and economic shocks, and will help in strengthening a slowing economy. ADB's Special Policy-Based Loan is part of a comprehensive multidoor economic reform package led by the International Monetary Fund. Moreover, the country is expecting a massive financial support of $ 38 Billion from lenders other than IMF which includes $14 Billion rollover loans, loans worth $8.7 Billion against projects, $4.2 Billion for programmes, and $8 Billion worth commercial loans for three years.

We will update the Macroeconomic Fundamentals of the country, implications and outlook forthwith in the coming paragraphs:

(ECONOMY AT A GLANCE)

Economic Indicators	Period	Status	Current Year	Last Year
Broad Money (M2)	Jul to 6th Dec		PKR 397billion	PKR 257 billion
Net government Sector Borrowing	Jul to 6th Dec		PKR 488 billion	PKR 405 billion
Credit to Non-Government Sector	Jul to 6th Dec		PKR 68 billion	PKR 473 billion
CPI Inflation	Nov 2019		12.67%	5.7%
FBR Tax Collection	Jul to Nov		PKR 1,618 billion	PKR 1,385 billion
Foreign Exchange Reserves with SBP	As of 13th Dec		US $ 10.892 billion	US$ 7.20 billion
Special Convertible Rupee Account (SCRA)	Jul to 12thDec		US$ 1.20 billion	US$ (81) million
Worker's Remittances	Jul to Nov		US$ 9.298 billion	US$ 9.281 billion
Foreign Direct Investment	Jul to Nov		US$ 850 million	US$ 477 million
Balance of Trade in Goods and Services	Jul to Nov		US$ (9.62) billion	US$ (14.44) billion
Balance of Trade in Goods	Jul to Nov		US$ (9.66) billion	US$ (14.43) billion
Balance of Trade in Services	Jul to Nov		US$ (1.61) billion	US$ (1.73) billion
Balance of Payment	Nov 2019		US$ (805) million	US$ 68 million

2. BROAD MONEY (M2):

Broad Money grew by 2.23% during 1st July to 6th Dec 2019, which stood at PKR 397 Billion as compared to Rs. 256 Billion last year, due to an increase in government borrowing for budgetary support during the last month. Tight monetary and fiscal policies, high inflation, economic slowdown, and low aggregate demand have restricted the private sector credit growth during the current fiscal year.

Components	Stocks at June end 2019	Flows		Monetary Impact since 1st July to	
		FY18	FY19	6-Dec-19	7-Dec-18
	(PKR in Million)				
Currency in circulation	4,950,039	476,516	562,210	484,851	287,919
Other deposits with SBP	33,636	4,270	6,674	220	886
Total Demand and Time deposits including RFCDs	12,814,820	935,497	1,232,448	(87,296)	(31,117)
Broad Money (M2)	17,798,495	1,416,283	1,801,332	397,775	256,889
Growth		9.71%	11.26%	2.23%	1.61%

(Source: SBP)

3. NET GOVERNMENT SECTOR BORROWING:

Government has re-profiled a substantial portion of the domestic debt, from short-term T-bills into longer-term floating rate bonds, reducing reliance on T-bills by lengthening domestic maturities. Government borrowing for budgetary support has increased to PKR 550 billion on account of deficit financing as compared to PKR 481 billion last year. Overall net government sector borrowing stood at PKR 488 billion during 1st July to 6th Dec 2019 vs. PKR 405 billion last year.

(PKR in million)	Monetary Impact since 1st July to	
	6-Dec-19	7-Dec-18
Borrowing for Budgetary support	550,095	481,852
Commodity Operations	(63,321)	(76,106)
Others	1,340	(368)
Net government Sector Borrowing	488,114	405,378

(Source: SBP)

4. CREDIT TO NON-GOVERNMENT SECTOR:

Private sector credit offtake has remained subdued thus far in the current fiscal year and stood at PKR 78 billion during 1st July to 6th Dec 2019 vs. PKR 357 billion last year in the wake of an overall economic slowdown.

(PKR in million)	Monetary Impact since 1st July to	
	6-Dec-19	7-Dec-18
Credit to Private sector	78,753	357,279
Credit to Public Sector Entities (PSEs)	(11,218)	114,725
Credit to NBFIs	701	1,522
Credit to Non-Government Sector	68,236	473,526

(Source: SBP)

5. CONSUMER PRICE INDEX ("CPI") INFLATION

According to the Pakistan Bureau of Statistics (hereafter "PBS"), on account of a hike in food prices, CPI inflation of the country has hit 12.67% in November 2019 touching a 9-year high (base year 2015-16) as compared to 5.7% in 2018. On a year-on-year basis, CPI has appreciated by 1.34% over October 2019 mainly because of a substantial increase in the prices of essential commodities.

Persistent spikes in food prices has pushed the overall inflation to a 9-year high on account of supply side issues as prices of Tomatoes have increased by 437%, Onions by156%, Pulse moong by54%, Potatoes by 42%, Pulse mash by 41%, Fresh vegetables by40%. Moreover, prices of the following have also increased; Sugar by 33%, Butter by32%, Gur by 30%, Condiments and Spices by 19%, Tea by 17%, Vegetable ghee by 17%, Wheat flour by 16%, Cooking oil by 15%, Pulse masoor by 15%, Wheat by 15 %, Meat by 13.4%, Pulse gram by 12%, and Milk powder by 11% on a year-on-year basis.

(Base year 2015-16)	National CPI	Food		Core CPI	
Period		Urban	Rural	Urban	Rural
Nov-19	12.67%	16.60%	19.30%	7.50%	8.40%
Nov-18	5.70%	1.70%	0.90%	7.70%	7.10%

(Source: PBS)

Food inflation has skyrocketed to 16.6% in Urban and 19.3% in Rural Areas during November 2019 as compared to 1.7% urban and 0.9% rural during November 2018.Core inflation rate in urban and rural dipped to 7.5% and 8.4% in November from 7.7% & 8.4% in October, indicating that once food inflation spikes in Urban (16.6%) and Rural (19.3%) Areas drops down, overall inflation that stood at 12.7%, may come down in near future. Moody's has also not ruled-out possibility of monetary easing towards the end of FY20.

6. TAX REVENUE COLLECTION:

FBR's tax revenue appreciated by 18% that stood at PKR 334 billion in November 2019 as compared to PKR 281 billion in November 2018. Against tax target of PKR 382 billion in November 2019. A shortfall of PKR 48 billion was recorded which has escalated the cumulative tax-gap to PKR 211 billion during July-Nov FY20 as compared to the previous year. Overall tax collection grew by 16% to PKR 1,614 billion during July-Nov FY20 as compared to PKR 1,385 billion last year.

(PKR in Billion)	Nov-19	Nov-18	% Change Y/Y	July-Nov FY20	July-Nov 2019	% Change Y/Y
FBR tax collection	334	281	18.86%	1618	1385	16.82%

Under the economic slowdown and on account of lower tax collections against the targets which have been set, the ambitious tax revenue targets set by the IMF seem challenging and difficult to meet.

7. FOREIGN EXCHANGE RESERVES:

According to the updated released by the State Bank of Pakistan (hereafter "SBP"), the foreign exchange reserves of the SBP have crossed $10 billion as of 13th Dec 2019. During current fiscal year, SBP's reserves increased by $3.612 billion that stood at $10.89 billion as compared to $7.28 billion by the end of June 30th, 2019 on account of mainly release of IMF tranche and SCRA inflows.

($ in million)	13-Dec-19	28-Dec-18
Net Reserves with SBP	10,892	7,203
Private Banking Reserves	6,762	6,553
Total Forex Liquid Reserves	17,654	13,756

(Source: SBP)

Country's foreign exchange reserve adequacy low, which has fluctuated around $7-8 billion over the past few months, import cover stood just 2-2.5 months of goods imports.

8. SCRA ("SPECIAL CONVERTIBLE RUPEE ACCOUNT") UPDATES:

As per SBP, foreign capital 'SCRA' (Special Convertible Rupee Account) inflows have reached to $1.20 billion in FY20 to 12th Dec 2019.

Cumulative net inflows in Equity, T-Bills and PIBs				
During current fiscal year, July to 12th Dec 2019				
(thousand US $)	Equity	T-Bills	PIBs	Total
Net inflows	(16,557)	1,214,624	10,290	1,208,357

Overseas investors are capitalizing on one of the highest returns (interests' rate differentials + exchange rate appreciation) in the debt market of Pakistan. According to SBP, overseas investors have so far invested their 'hot money' amounting to $1.121 billion in T-bills and $10.29 million in PIBs. Out of $1.16 billion hot money inflows, country have received $604million from United States, $553million from United Kingdom, $45 million from Luxembourg, $20 million from United Arab Emirates, $5 million from Sweden and $2 million from Oman. Although such hot money inflows increased foreign exchange reserves of the country but have not contributed in the economic development of the country.

To learn more about 'Hot Money', please refer to the article of Mr. Ashfaq Tola (President Tola Associates) in Business Recorder https://www.brecorder.com/2019/12/10/551928/hot-money-the-giant-killer/

9. WORKER'S REMITTANCES:

Overseas Pakistani worker's remitted amounted to $9.29 billion during July-Nov FY20 which has remained stagnant as compared to $9.28 billion July-Nov FY19 on account of lower remittances from Saudi Arabia and UAE. Worker's

Remittances from UAE and Saudi Arabia have dropped by 3.77% and 0.36% respectively. On a month-on-month basis, overseas workers' Remittances have dropped by 9% which stood at $1.81 billion in November 2019 vs. $2 billion in October 2019. The Country received lower remittances from USA, UK, Saudi Arabia, UAE, other GCC countries and EU countries which should be a cause for concern for the finance ministry.

Country-wise Worker's Remittances						
($ million)	**Nov-19**	**Oct-19**	**M/M change**	**5MFY20**	**5MFY19**	**Y/Y change**
USA	299	322	-7.36%	1,533	1,456	5.25%
UK	286	329	-13.12%	1,429	1,379	3.58%
Saudi Arabia	407	468	-12.97%	2,145	2,153	-0.36%
UAE	384	399	-3.81%	1,922	1,997	-3.77%
other GCC countries	172	192	-10.18%	883	881	0.24%
EU countries	53	61	-13.42%	283	265	6.76%
Others	219	229	-4.37%	1,103	1,149	-4.00%
Total	1,819	2,000	-9.02%	9,298	9,281	0.18%

(Source: SBP)

10. FOREIGN DIRECT INVESTMENT

Pakistan's foreign direct investment (FDI) appreciated by 78% amounting to $850 million during July-Nov FY20 as compared to $477 million during the same months last year.

(US $ million)	July-Nov FY20	July-Nov FY19	% Change
FDI	850	477	78%

(Source: SBP)

On year-on-year basis however, the FDI has dropped by 30% that stood at $200 million in November 2019 as compared to $285 million during last year.

Overall, country's net foreign investment crossed $2 billion during July-Nov FY20 Vs $146 million last year which has appreciated by 1,267%. In absolute terms, foreign investment in the country grew by $1.85 billion mainly on account of hot money inflows in debt securities.

11. BALANCE OF TRADE IN GOODS AND SERVICES:

According to State Bank, Pakistan balance of trade in goods and serves has dropped by 33.39% from $14.44 billion during July-Nov FY19 to $9.62 billion mainly because of massive import contraction. On-month-on-month basis, country's exports of goods and services have dropped by 7% that stood at $2.52 billion in November 2019 vs. $2.71 billion in October 2019. While, imports of goods and services of the country depreciated by 0.35% that stood at $4.315 billion in November 2019 vs. $4.33 billion in October 2019

($ in Million)	Nov-19	Oct-19	% change M/M	Nov-19	Nov-18	% change Y/Y	July-Nov FY20	July-Nov FY19	% change Y/Y
Exports of Goods and Services	2,011	2,024	-0.64%	2,011	1,839	9.35%	9,545	9,109	4.79%
Imports of Goods and services	3,940	4,074	-3.29%	3,940	4,581	-13.99%	19,213	23,548	-18.41%
Balance of Trade in Goods and Services	(1,929)	(2,050)	-5.90%	(1,929)	(2,742)	-29.65%	(9,668)	(14,439)	-33.04%

(Source: SBP and PBS)

11.1. BALANCE OF TRADE IN GOODS:

According to Pakistan Bureau of Statistics (PBS), Pakistan's exports have dropped by 0.64% in terms of the US dollar and 1% in terms of the Pakistani Rupee on a month-on-month basis, that stood at $2.011 billion in November 2019 over $2.024 billion in October 2019. However, the country's exports grew by 9.35% in terms of the US dollar and 27% in terms of the Pakistani Rupee during November 2019 on a year-on-year basis as compared to $1.83billion in November 2018. Moreover, as per PBS, a US dollar averaged at Rs. 155.3674 in November 2019 vs. 133.5041 in October last year.

On the other hand, country's imports dropped by 14%in terms of the US dollar but not in terms of Rupee, that stood at $3.940 billion during November 2019 over $4.581 billion during November 2018. While on a month-on-month basis, imports dropped by 3% in terms of the US dollar and the Rupee which were recorded at $3.940 billion in November 2019 over $4.074 billion in October 2019

Overall, the country's trade deficit dropped by 33% in terms of the US dollar and 17% in terms of the Pakistani Rupee during July-November 2019 that stood at $9.668 billion as compared to $14.439 billion last year on account of import compressions while exports remained stagnant. Reduction in the trade deficit will further improve external imbalances of our country, leading to a sizeable improvement in the current account deficit going forward, however, at the cost of an economic slowdown.

($ in Million)	Nov-19	Oct-19	% change M/M	Nov-19	Nov-18	% change Y/Y	July-Nov FY20	July-Nov FY19	% change Y/Y
Exports	2,011	2,024	-0.64%	2,011	1,839	9.35%	9,545	9,109	4.79%
Imports	3,940	4,074	-3.29%	3,940	4,581	-13.99%	19,213	23,548	-18.41%
Balance of Trade in Goods	(1,929)	(2,050)	-5.90%	(1,929)	(2,742)	-29.65%	(9,668)	(14,439)	-33.04%

(Source: PBS)

11.2. BALANCE OF TRADE IN SERVICES:

According to State Bank, on account of drop in government goods and services exports which includes embassies and consulates and military units and agencies etc. and transportations services, country's exports of services dropped by 21% that stood at $417 million in November 2019 vs. $530 million in October 2019. While, imports of services of the country has dropped by 4% that stood at $667 million in November 2019 vs. $698 million in October 2019 on account of declined in transportation services and telecommunication, computer and information services. Overall, export of services only grew by 2.95% during July-Nov FY20 vs drop of 1.38% in import of services during July-Nov FY19, which has dropped country's services deficit by 6.63% to $1.61 billion during July-Nov FY20 vs. $1.734 billion last year.

($ in Million)	Nov-19	Oct-19	% change M/M	July-Nov FY20	July-Nov FY19	% change Y/Y
Exports of Services	531	403	31.61%	1,226	1,267	-3.21%
Imports of Services	698	938	-25.62%	2,429	2,343	3.67%
Balance of Trade in Services	(184)	(535)	-65.64%	(1,203)	(1,076)	11.81%

(Source: SBP)

12. BALANCE OF PAYMENT:

On account of drop in remittances and exports of goods and services, Pakistan's current account balance has turned into deficit to $319 million in November 2019 from a surplus of $70 million in October 2019 because of three key reasons which are; 1) Overseas workers' Remittances have dropped by 9% which stood at $1.81 billion in November 2019 vs. $2 billion in October 2019 on a month-on-month basis. 2) According to State Bank, country's exports of goods have declined from $2.189 billion in October 2019 to $2.110 billion in November 2019. 3) While, exports of services depreciated from $530 million recorded in October 2019 to $417 million in November 2019.

Pakistan Balance of Payment comparison November 2019 with November 2018			
US$ in million Period	Nov-19	Nov-18	% Change Y/Y
Current Account Balance	*-319*	*-1,166*	*-73%*
Trade Balance	*-1,538*	*-2,305*	*-33%*
Exports	*2,110*	*1,897*	*11%*
Imports	*3,648*	*4,202*	*-13%*
Service Balance	*-250*	*-367*	*-32%*
Primary Income	*-453*	*-467*	*-3%*
Secondary Income	*1,922*	*1,973*	*-3%*
Worker's Remittances	*1,820*	*1,664*	*9%*
Capital Account Balance	*12*	*17*	*-29%*
Financial Account Balance	*-984*	*-1,374*	*-28%*
FDI in Pakistan	*-199*	*-283*	*-30%*
Portfolio investment	*-706*	*4.0*	*NA*
Net incurrence of Liabilities	*279*	*1,109*	*-75%*

Overall Balance	*-805*	*68*	*NA*
SBP Gross Reserve	*9,112*	*7,502*	*21%*
Current Account % of GDP	*-1.4*	*-4.9*	

(Source: SBP)

Pakistan's current account balance has dropped by 73% to $319 million in November 2019 vs. $1.116 billion in November 2018. Overall country's current account deficit has depreciated by 73% that stood at $1.821 billion during July-Nov FY20 as compared to $6.733 billion last year on account of massive contraction in the import bill which not only improved forex reserves but also stabilized PKR against US dollar.

In absolute terms, country's imports squeezed by around $5 billion that stood at $18.31 billion during July-Nov FY20 as compared to $23 billion last year. On the other hand, Pakistan's exports remained stagnant so far and have not shown sizeable improvement. On a month-on-month basis, Pakistan's exports decreased by 0.64% in terms of the US dollar and 1% in terms of Rupee that stood at $2.011 billion in November 2019 over $2.024 billion in October 2019. However, country's trade deficit has contracted by 33% in terms of US dollar during July-November 2019 that fell to $9.66 billion from $14.43 billion last year.

During July-Sept FY20, foreign private investment grew substantially from $146 million during July-Nov FY19 to $2 billion during July-Nov FY20 mainly because of SCRA inflows in debt securities. SCRA (Special Convertible Rupee Account) speculative inflows have increased to $1.21 billion in T-bills as of 17th Dec 2019. Country's overall balance of payment position stood at negative $805 million in November 2019 as compared to $68 million surplus in November 2018.

13. OUTLOOK:

1. Moody's has shown serious concerns over Pakistan's ability to contain fiscal deficit in FY20, anticipating fiscal deficit to remain elevated around 8.6% of GDP in FY20 as compared to 8.9% in FY19.
2. Pakistan's current account deficits to remain lower in coming months which will further reduce external account risk going forward.
3. Foreign exchange reserves of Pakistan to improve further on account of over $1 billion ADB funding which will reduce external risks and economic shocks in short term. IMF approved second tranche of $452.4 million on account of completion of the first review, bringing total disbursements to SDR 1,044 million or about $1.44 billion
4. Foreign exchange reserve adequacy to remain lower due to the complexities of quantifying external risks and vulnerabilities.
5. Hot money inflows in debt markets are likely to increase as tight monetary policy regime seems to remain intact due to consistent inflationary pressures within the economy.
6. Effects of persistent food price spikes are also still to be seen on account of supply side factors, failure of the governance of the Provincial Government and mismanagement, which will further increase inflation in the country.
7. Pakistan's energy imports bill likely to remain lower on account of gradual transition in power generation away from diesel to coal, natural gas and hydropower.
8. The Finance Division plans to float Ijara Sukuk bond by the end of January or by mid-February next year in the domestic capital market to finance the deficit.

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