Economy Alert

PAKISTAN ECONOMY – PANDEMIC ENCUMBRANCES

1. PREAMBLE:

The coronavirus has altered the position of global economies, as unprecedented measures of social distancing and lockdowns have been taken worldwide. The coronavirus is set to cause unprecedented internal and external shocks to the global economies including Pakistan, and has significantly exhausted fiscal capacities, and the same is likely to persist going forward. We have evaluated the impact coronavirus may have on our domestic economy, which includes best-to-worse case scenarios in terms of our GDP, amongst other key economic indicators.

ECONOMY AT A GLANCE			
Economic Indicators	**Status**	**FY20**	**FY19**
Pakistan Projected GDP	↓	1.26% best case; 0.94% moderate case; -0.38% worst case	3.29%
Current Account Deficit	↑	$7.5 billion	$13.83 billion
Projected Remittances	↓	$19.12 billion	$21.83 billion
Outstanding Hot Money	↑	$998 million	0.1
FBR projected Tax Collection	↑	Rs. 4000 billion	Rs. 3,829 billion
Projected Fiscal Deficit	↑	9.0% to 9.5% of GDP	8.9% of GDP
Possible Unemployment	↑	10 million	3.7 million

A comparison of Pakistan's GDP, after taking into account the spillover effects of the pandemic	
Source	**GDP growth 2019-20 (Projection)**
World Bank	1.10%
IMF	2.40%
Moody's	2.50%
State Bank of Pakistan	3%
Estimates published by Dr. Hafeez Pasha	Below 1.5%
Our Estimates	–0.38% to 1.26%

2. PAKISTAN'S GDP FORECAST FOR 2019-20:

Sectors	Growth rates		
	Best Case	**Moderate case**	**Worst Case**
Agriculture	0.19%	0.19%	0.19%
Industrial sector	0.34%	-0.89%	-1.04%
Services sector	1.89%	1.78%	-0.34%
GDP Impact	1.26%	0.94%	-0.38%
Real GDP (billions Rs.)	43,316	43,195	42,684

- The Gross Domestic Product ("GDP") of the country, for fiscal year 2019-20 ("FY 20"), is estimated to post a growth in the range of -0.38% to 1.26%, based on the situations of the lockdown and economy.
- The best case scenario depicts that the current lockdown and tight economic situations will gradually ease, while the 'worst case scenario' represents that the current situation will persist till the end of FY 20.
- Reduced production of cotton bales, unseasonal rainfalls and delay of kharif season crops due to the coronavirus has had a negative impact on the crops.
- Moreover, livestock, forestry and the fishery sector is also expected to underperform due to the lock down and lower economic activities are expected therefrom in the last quarter of FY 20.
- Overall, the **Agricultural sector** is expected to grow by only 0.19%.
- Mining and Quarrying, electricity distribution and slaughtering are expected to grow as per their target growth rates.
- Large scale and small-scale manufacturing are expected to post a negative growth.
- Construction sector is also expected to slow down due to the lock down and shift in investment priorities of both businesses and population due to the said pandemic.
- The special incentive package for the construction industry will only yield in the years forthcoming.
- Overall, the **industrial sector** is expected to post a growth ranging from -1.04% to 0.34%, as compared to FY 19.

- In the **service sector**, wholesale and retail trade is not expected to grow, instead, the activity is expected to decline due to the closure of wholesale and retail markets, and due to disputes arising out of amendments introduced vide Finance Act 2019.
- Consumption in the month of Ramadan, including annual Eid shopping of the masses, is also expected to drastically reduce due to the low purchasing power of the public-at-large, because of the lockdowns and erosion of savings during lockdown.
- There will be shortage of available stocks on retail outlets for the season of Eid, as manufacturing of the same could be delayed. Moreover, activities under transportation and housing services sector are also expected to decline in the last quarter.
- Finance and insurance, general government services and other private services are expected to achieve their target growth.
- Overall **service sector**, which contributes approximately 61% to the GDP, is expected to grow in the range of -0.34% to 1.89%.

3. PAKISTAN CURRENT ACCOUNT DEFICIT PROJECTIONS:

Against the IMF's current account deficit projections of $6.69 billion, as per our calculations, the projected current account deficit of Pakistan would be $3.0 billion in 4QFY20 (including March 2020) and $7.5 billion in FY20.

The main reasons for the increased deficit are as under:

- Trade will be suppressed due to cancellation and/or deferment of exports. However, imports will also be reduced due to favorable oil prices and a reduction in demand.
- Remittances will also be affected due to an international lockdown in major countries such as the USA, UK and Middle East – the major sources of remittances.

4. IMPACT ON UNEMPLOYMENT

As per the estimates of the Asian Development Bank, the unemployment in Pakistan could reach upto 946,000 if the pandemic persists for six months.

- Out of the total labor force of 65.50 million of the country, 72%, or 47 million of them, work in the informal sectors of wholesale/retail, construction, manufacturing, agriculture and servicing industries which are vulnerable under the current economic downturn. Under the economic recession, and due to the coronavirus, the situation could get worse and millions of people could lose jobs and fall below the poverty line.
- According to the 'Planning Commission Report 2019-20', the number of informal workers in the non-agriculture sector were 73.7 million in 2017-18, which are usually deprived of basic fundamental rights, and work on a contractual basis. Under the lockdown, 22 million or 30% of them could be under severe stress due to unavailability of adequate meals per day for their families and could fall below poverty line.
- While only 28.7 million work formally in non-agriculture sector, 8.61 or 30% of them are vulnerable due to the spillover effects of the lockdown. If the pandemic worsens and economic activities are slowed down due to the Ramadan effect, a large chunk of them are vulnerable and could be unemployed.
- Majority of the workforce in agriculture sector will be employed due to wheat harvesting in Punjab and Sindh. After this busy season, large share of them could be vulnerable, because of the seasonal nature of agriculture sector.
- Therefore, around 10 million out of 65.5 million labor force, either could be unemployed or are very vulnerable due to the lockdown, Ramadan effect and the effects of the pandemic.

5. DOWNSTREAM SHOCKS:

Pakistan has been facing 'monetary and fiscal tightening' which has pushed the country into a state of stagflation. Pakistan's national output is to deteriorate further and the country will be exposed to multiple exogenous shocks, if the severe effects of the pandemic may materialize.

a) Tax Revenue Deficit Shock

The Federal Board of Revenue's reported tax revenue stands at Rs. 3,063 billion during July-March FY20 vs Rs.3, 521 billion last year. The actual tax revenue collected by the FBR during July-March 2019-20 is Rs. 2,838 billion [outstanding sales tax refunds are Rs.150 billion (accumulated due to rescinding of SRO 1125/2011), and advances are worth Rs.75 billion), hence actual tax shortfall has elevated to Rs.918 billion vs. target of Rs. 3,756 billion during July-March FY20. The FBR needs to collect Rs. 2,400 billion within the next three months, which is next to impossible. As a result, FBR's tax revenue is likely to remain around Rs. 4 trillion in 2019-20, due to closure of trade, services industries, lockdown and contraction of economic activities in light of the pandemic, which will exhaust the fiscal space of the country.

b) Ballooning Fiscal Deficit Shock

The effects of the pandemic will deteriorate the country's fiscal position, with an increase in expenditures and a tax gap of Rs. 1503 billion. It is projected that country's fiscal deficit would be around 9 to 9.5% of GDP due to a large tax revenue shortfall and increase in expenditure. Resultantly, this will further elevate public debt, and Pakistan's debt bearing capacity will plunge, which will expose the country's vulnerabilities.

c) Large Scale Manufacturing Shock

Due to the said pandemic, Pakistan's LSM sector is likely to post a growth in negative numbers in its fourth quarter as economic activities are at a standstill. (LSM posted a negative growth of 3.37%during 7MFY20 vs last year).

d) Private Investment Shock

Due to heightened risk perceptions and uncertainty because of the pandemic, Pakistan's private investment is set to drop with the closure of businesses, and restricted private sector credit growth which is already under stress.

e) Prime Minister Social Safety Net:

Against the social safety net announced by the Prime Minister of Pakistan, actual relief for the masses stood at Rs.200 billion, while rest of the amount includes;

i. Rs.100 billion tax refunds of exporters which were already withheld by the FBR and not disbursed timely;
ii. Procurement of wheat Rs.280 billion is already budgeted;
iii. Deferment of loans or delayed servicing on debt; and
iv. BISP and Ehsaas programs beneficiaries, amount was also already budgeted, which was underutilized.

6. TAKE AWAY

- The IMF programme needs to be revisited forthwith.
- Due to the present state of stagflation and economic fallout of the coronavirus, the impact of monetary easing will be neutralized. Moreover, if the pandemic persists, it is likely that this will lead towards a recession.
- IMF's third tranche worth $452 million, which was due in April 2020, which was subject to the approval of IMF's Executive Board, has been delayed as per media sources.
- On account of an economic slowdown and economic fallout of the pandemic, our forecasted GDP growth is 1.26% in the best case, 0.94% in the moderate case and -0.38% in the worst case scenario for the year 2019-20.
- The State Bank of Pakistan must cut Policy Rate further down to 6% to revive the Pakistani economy and counter the impact of the pandemic.
- Availability of liquidity should be ensured to the private sector to stimulate the economy.
- Pakistan is also likely to get a $1.6 billion package from multilateral agencies to accelerate its effort to build its health emergency capacity and response in wake of the pandemic.
- Immediately find an alternate stream of $6-7 billion funding from Middle Eastern commercial banks, at the rate of 4% to 5% to get rid of Hot Money.
- Under the present scenario, country's remittances, exports and currency are to remain under pressure, and exports are likely to be contracted going forward.
- The Financial Action Task Force ("FATF") will review Pakistan performance against fighting money laundering and terror financing by the end of June 2020.