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PAKISTAN ECONOMY 2018-19
- BELLY FLOP

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408, CONTINENTAL TRADE CENTRE, BLOCK-8, CLIFTON, KARACHI

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Preamble:

Pakistan is currently passing through a stagflation phase of the economy as inflation rates are increasing while economic growth is slowing down with resultant increased unemployment rates. GDP growth rate has slumped from 5.80% to 3.30% with a target of 4% for next fiscal year. Inflation has reached to 7.57% from preceding year's 2.40%.

Theoretically speaking, if the state of stagflation is continued till next two quarters, we may witness recession in economy next year.

The first three quarters of the Fiscal Year 2019, with respect to macroeconomic environment remained challenging. The steep rise in global crude prices coupled with Rupee devaluation were the foremost concerns, which not only reinforced the already strong pressures of inflation in the economy, but also eclipsed potential improvements in the external sector.

Lingering uncertainties with regards to the Balance of Payments (BOP) support still persist. Fiscal pressures also remained intact as expenditures rigidities allowed only a limited room for the government to maneuver. Responding to these challenges, the new political regime immediately announced cuts in development spending, partially reversed tax relief measures, and also explored avenues to bridge the external financing gap. While the ongoing macroeconomic stabilization process would continue at least over the short term, it has now become important to urgently initiate and expedite the needed structural reforms in the economy.

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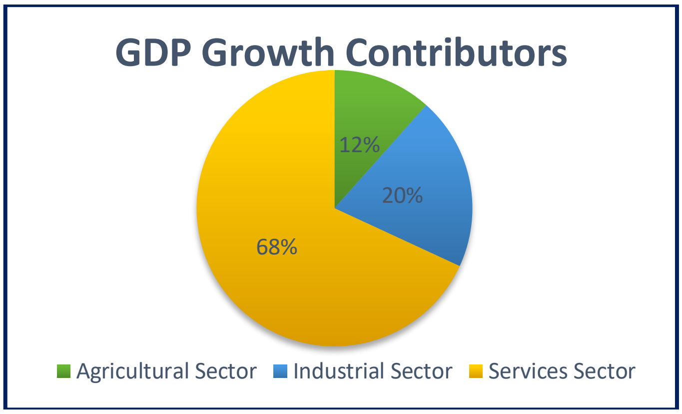
In sum, while efforts are underway to regain macroeconomic stability, the concurrent progress towards reforms is welcome. It is now important to deepen and accelerate the pace of reforms within the fiscal and energy sectors, and also spread the process across other sectors of the economy. The objective should be to rationalize the economy's incentive structure; enhance ease of doing business via embracing technology and simplifying procedures; and improve public financial management and governance. Putting right policies in place is critical, even if it takes time, to get the economy out of the boom and bust cycle. This is important also to benefit on the productivity front, in order to push the growth momentum forward. At this point, when the country's growing labor force has to be productively engaged, the country cannot afford to get caught up again in a low growth-high inflation equilibrium.

With the help of graphs and table, statistical data is summarized below with respect to the economic performance and forecast and in regard to several economic indicators, an overview is briefed below.

(Source: Pakistan Economic Survey 2018-19, State Bank of Pakistan ("SBP") and Pakistan Beaurue of Statistics ("PBS")



Items	Growth Rate 2018-19	
	Target %	Provisional %
Agriculture	3.80	0.80
Industry	7.60	1.40
Services	6.50	4.70

The sectors are further discussed below briefly:

1. Agricultural Sector

Decline in the area under sugarcane crop, water shortages at the time of sowing of kharif crops – especially cotton – and weak trends in the off-take of fertilizer indicate that agriculture sector may not repeat last year's extraordinary performance. During year 2018-19 the agricultural sector grew by 0.80%. The growth of crops during that year, was 3.83%. The growth in production of Other crops were at 1.90%, while a decline in production was estimated in Important Crops at 6.50%.

Livestock, forestry and fishing has also contributed to GDP growth and grew by 4.0%, 6.50% and 0.80% respectively.

2. Industrial Sector

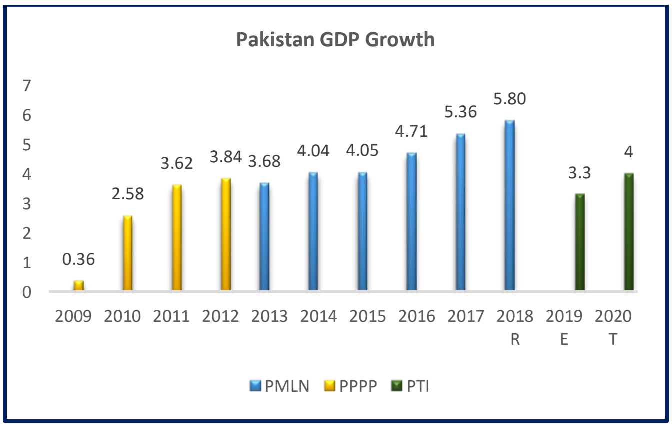
In current year the industrial sector may also witness a slowdown. Slowdown expected on reduction in consumer demand, construction and consumer durable industries may see lower growth in production. The large-scale manufacturing sector witnessed a decline of 2.00%. Major contributors to this growth were Small and household (8.20%), Slaughtering (3.50%) and Electricity Generation (40.50%).

3. Services Sector

Slower growth in industrial and agriculture sectors will also affect performance of the services sector. During year 2018-19, the services sector showed a growth of 4.70%. Wholesale and retail trade sector grew at a rate of 3.10% which is dependent on the output of agriculture, manufacturing and imports. Agriculture increased by 0.80%, whereas manufacturing decreased by 0.30%. Transport, storage and communication sector grew at a rate of 3.30%. Finance and insurance sector showed an overall increase of 5.10%, General government services grew by 7.90%. It is mainly driven by the increase in salaries and the inflation. Other private services also contributed positively.

4. Historical GDP growth rates

Pakistan has been successful in achieving consistently increasing growth rates during last six fiscal years which unfortunately witnessed decline in the FY 2019.



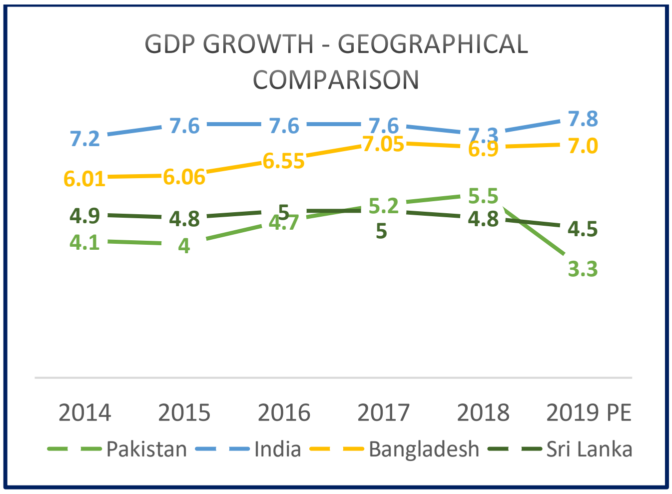
5. GDP – A Geographical Comparison

A comparison of growth with other countries of region shows Pakistan's growth has been consistent as compared to India and Sri Lanka. The GDP growth of India has been stagnant for last three years, whereas, Pakistan' GDP growth has shown improvements till FY 2019 although witnessing decline in contrast to retrospective years.

(www.data.worldbank.org)

	Pakistan	India	Bangladesh	Sri Lanka
2013	3.70	6.40	6.00	3.40
2014	4.10	7.40	6.30	5.00
2015	4.00	8.20	6.80	5.00
2016	4.70	7.10	7.20	4.50
2017	5.20	6.70	7.10	3.10
2018	5.50	7.40	7.00	4.00
Est. 2019	* 3.3	7.80	7.00	4.50
GDP Size ($ in Billion) (2018)	306.9	2690	286.27	92.5
Tax To GDP ratio (2013)	11.18	10.99	8.96	10.49

(IMF, World Economic Outlook * Economic Survey)



(IMF, World Economic Outlook)

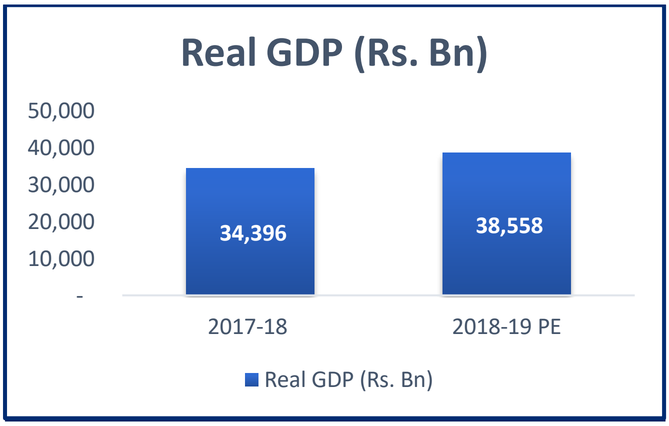
6. GDP at Current Market Prices

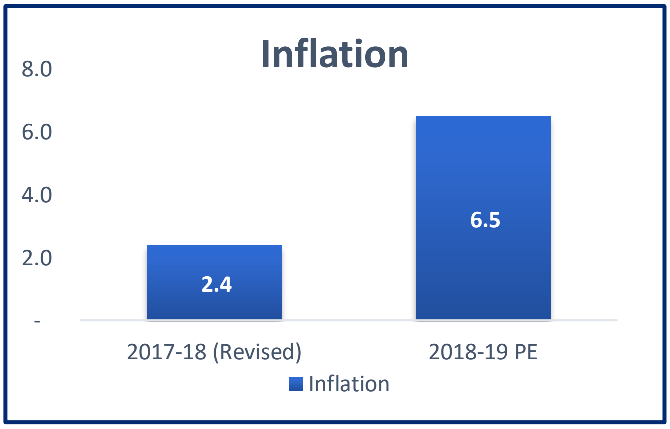
GDP at current market prices ("CMP") has also been computed and stands at Rs. 38,558 billion for 2018-19. This shows a growth of 10.79% over Rs. 34,396 billion for 2017-18. The per capita income is calculated to be

Rs. 198,454 for 2018-19. Whereas, per capita income during 2017-18 was Rs. 180,204 based on provisional figures of Population Census 2017 held in March 2017. The revised series of per capita income will be compiled after finalization of 6th Housing and Population Census result.

	2017-18 (Revised)	2018-19 (Provisional)
GDP at CMP (Rs Billion)	34,396.49	38,558.76
Inflation (in %)	2.40	6.50
Investment and Savings (% of GDP)		
Total Investment	16.50	15.40
National Savings	10.4	10.70
Foreign Savings (External Resource)	6.30	4.70

(Source: PBS)



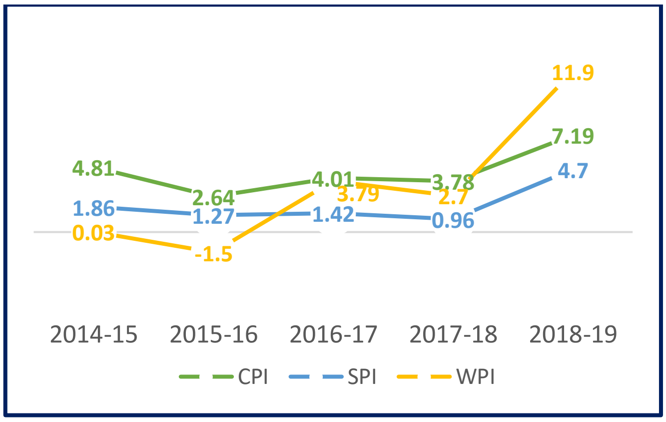


7. Inflation

Average headline CPI inflation increased to 7.19 percent during FY 2018-19 compared to 3.78 percent in FY18. This is the highest level of inflation observed since Q1-FY15.

The Scheduled Price Index (SPI) and the Wholesale Price Index (WPI) mirrored the same as CPI as both increased significantly to 4.65 and 11.90 respectively in the FY 2018-19 as compared to FY 2017-18 reflecting 0.96 and 2.70 respectively.

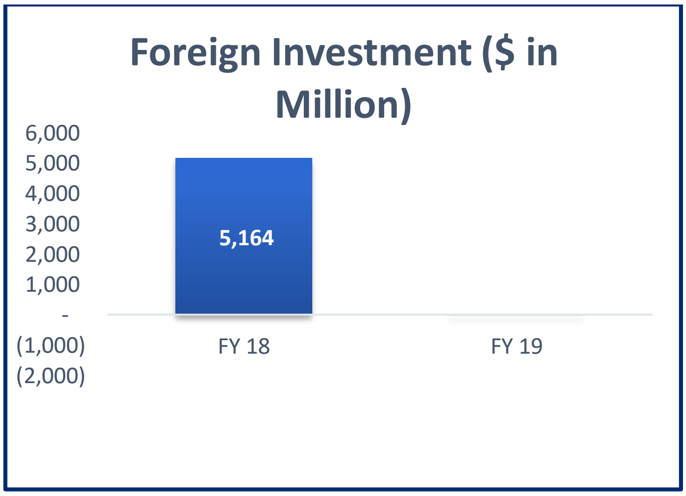
	2014-15	2015-16	2016-17	2017-18	2018-19
CPI	4.81	2.64	4.01	3.78	7.19
SPI	1.86	1.27	1.42	0.96	4.65
WPI	0.03	-1.50	3.79	2.70	11.9



(Source: PBS)

8. Foreign Investment in Pakistan

The foreign investment in Pakistan for period FY 2019 stood at negative $22.60 million as compared to $ 5,163 million FY 2018 showing a withdrawal of $5,185.6 million worth of investment. (Source: SBP)



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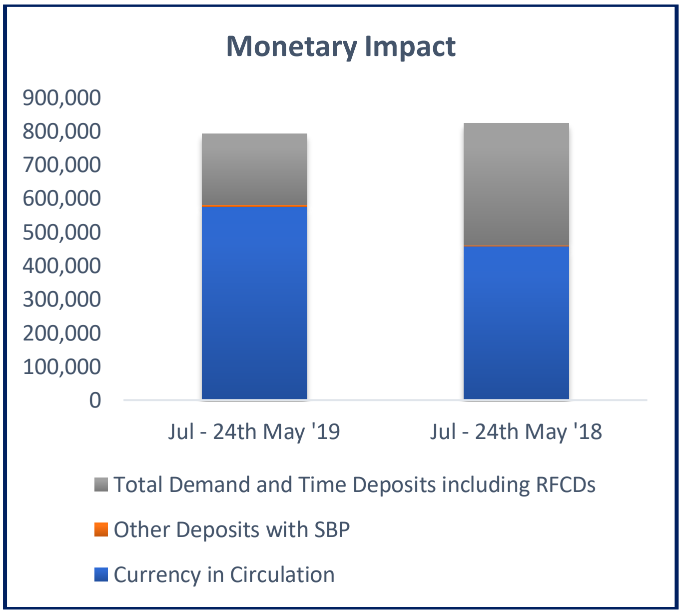
9. Broad Money (M2):

	Stocks at end June 2018	Monetary Impact since 1st July to 24th May, 2019	Total Stock at End 24th May, 2019
	(Rs. In million)		
Currency in Circulation	4,387,828	574,195	4,962,023
Other Deposits with SBP	26,962	7,092	34,054
Total Demand and Time Deposits including RFCDs	11,582,372	210,497	11,792,869
Broad Money (M2)	**15,997,162**	**791,784**	**16,788,946**
Growth		4.95%	

(Source: SBP)

Money supply, during 1st July 2018 to 24th May 2019, increased to Rs. 574,195 million (20.50%), which stood at Rs. 456,540 million at 24th May 2018.



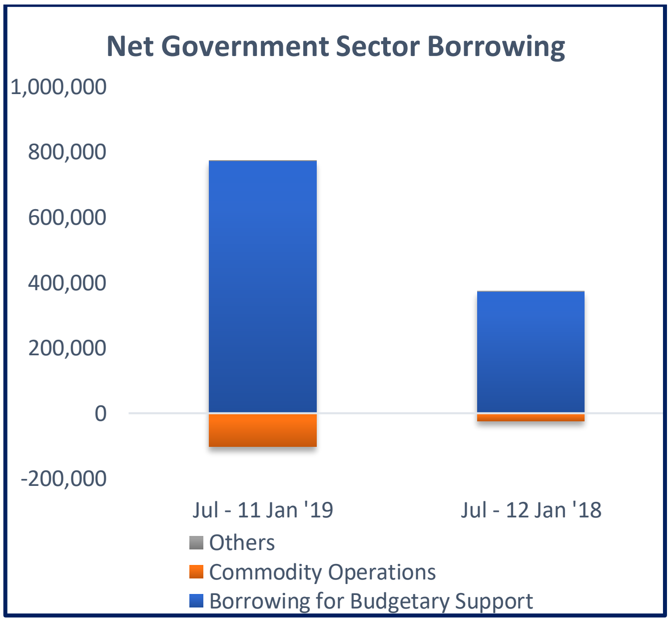
(Source: SBP)

10. Net Government Sector Borrowing

Net Government Borrowing was Rs. 1,146.52 billion during July 2018 to 24th May 2019, which was Rs. 988 billion for the similar previous periods. The Government borrowings were majorly utilized to support budgetary deficit (Rs. 1,218.20 billion) while maintaining borrowing position in commodity operations (Rs. 72.17 billion).

	July to 24 May 2019	July to 24 May 2018
	(Rs. In Million)	
Borrowing for Budgetary Support*	1,218,208	900,861
Commodity Operations	(72,173)	82,841
Others	489	4,371
Net Government Sector Borrowing	1,146,523	988,073

(Source: SBP)



11. Credit to Non-Government Sector

Credit to non-government sector during 1st July 2018 to 24th May 2019 was higher at at Rs. 879,573 million in comparison with similar periods of previous year (Rs. 729,197 million). Rs. 558,461 million credit to Private sector while Rs. 319,388 million were provided to public sector enterprises.

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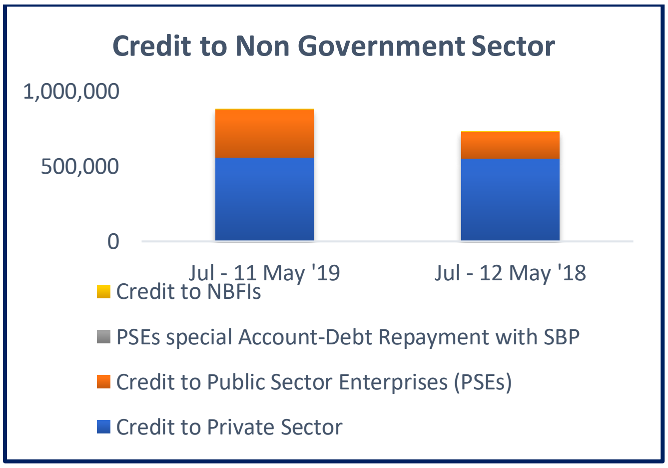
	July to 24th May 2019	July to 24th May 2018
	(Rs. In Million)	
Credit to Private Sector	558,461	552,904
Credit to Public Sector Enterprises (PSEs)	319,388	175,353
Credit to NBFIs	1,724	940
Credit to Non-Government Sector	879,573	729,197

(Source: SBP)



(Source: SBP)

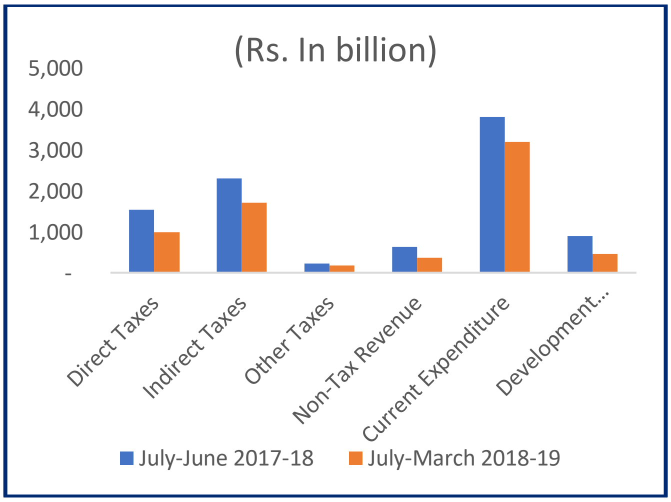
12. Fiscal Operations

During the period of July 2018 to March 2019, Rs. 997 billion of direct taxes were collected. During similar period of previous fiscal year Rs. 1,537 billion were collected i.e. a 35% drop in collection. Collection of indirect taxes were Rs. 1,707 billion as compared to Rs. 1,619 billion collected during similar preceding period. Indirect taxes include Customs Duties, Sales Tax and Federal excise duty, collections of which were Rs. 507 billion, Rs. 1,048 billion and Rs. 151 billion respectively, during 9 months. Collection of other taxes which comprise of Islamabad Capital Territory Tax, Airport Tax, Gas Infrastructure Development Cess, Natural Gas Development Surcharge ("NGDS") and petroleum levy ("PL") were Rs. 6 billion, Rs. 0.018 billion, Rs. 18 billion, Rs. 5 billion and Rs. 141 billion respectively. Collection of other taxes were 31.63% low as compared to similar preceding period. Major fall was in revenue collection of NGDS and PL.

Non tax revenues also declined by 41.48% during the nine month period. Steep decline were recorded in revenues of Markup (PSEs and others), Dividend and surplus profit of State Bank of Pakistan which deteriorated by 83.60%, 43.98% and 40.72%, respectively. The dismal revenue performance was largely attributed to poor fiscal policy.

Total Expenditures during nine months were Rs. 3,655 billion as compared to 4,704 billion. The decline in expenditure of 22.30% is also alarming as the drop was not due to current expenditures, but due to decrease in development expenditures. A negative 49.10% change was recorded in development expenditure from Rs. 890 billion to Rs. 453 billion. Current expenditure was also reduced, but only by a meagre 16%. Rs. 286 billion additional were paid towards interest payments on account of domestic and foreign debt servicing which attributed to increase in policy and resultant Rupee devaluation. Expenditure on Defense Affairs and Services also reduced by 24.80% from Rs. 1,030 billion to Rs. 774 billion.

	July-March 2017-18	July-March 2018-19
Direct Taxes	1,536,636	997,411
Indirect Taxes	2,305,512	1,707,117
Other Taxes	223,640	169,896
Non-Tax Revenue	630,378	368,892
Current Expenditure	3,814,468	3,202,418
Development Expenditure and net lending	889,833	452,775

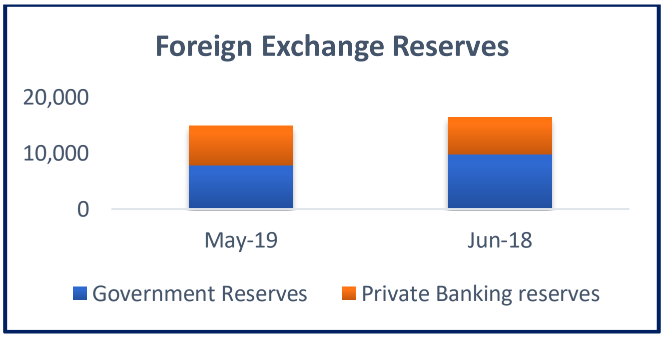


13. Foreign Exchange Reserves

Foreign exchange reserves, as on 31st May 2019 were down to $ 14.80 billion (1.20%) as compared to last years' (end of June 2018) $ 16.40 billion. Private banking reserves seen a rise of 5.83% from last year (end of June 2018), whereas, government reserves were down by 19.50 %.

	31st May 2019	30th June 2018
	($ In Million)	
Government Reserves	7,862	9,765
Private Banking reserves	7,028	6,618
Total	**14,890**	**16,383**

(Source: SBP)



(Source: SBP)

14. Regional Currency Comparison

USD parity with Pakistani Rupee took a hike of 25% as compared to its values in December 2017. USD parity with PKR remained bit consistent during past years with the exception of recent devaluation during Last six months.

As per Bloomberg Pakistani rupee was the most stable currency in November 2017, whereas, in short span of 18 months it became the most unstable and volatile currency expecting another devaluation of 15% to 17%.

USD Parity with				
As on	PKR	Chinese Yuan	Bangladeshi Taka	Indian Rupee
Jun-19	148.06	6.90	84.56	69.32
Dec-18	139.85	6.87	82.25	69.71
Dec-17	110.70	6.51	82.69	63.87
Dec-16	104.40	6.95	78.92	67.92
Dec-15	104.75	6.49	78.25	66.15
Dec-14	100.55	6.21	77.93	63.04
Dec-13	105.40	6.05	77.67	61.80

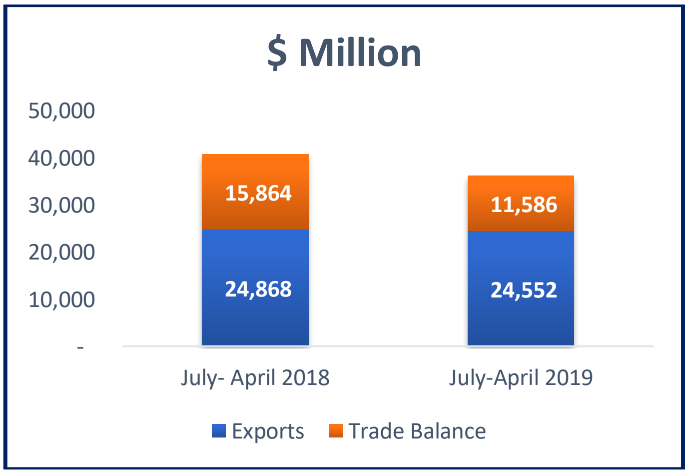
(Source: SBP)

15. Balance of Payments:

The Current Account Deficit accumulated at 3.30 percent of GDP in Jul-Feb FY19 compared to 3.70 percent in Jul-Feb FY18. Overall imports contracted by 1.60 percent (y-o-y) but exports also declined by 0.10 percent (y-o-y) in spite of the exchange rate depreciation. Over the same period, remittances experienced healthy growth, but foreign direct investment declined. By mid-January international reserves had fallen to US$6.6 billion (or 1.3 months of imports). With short term financing from the Kingdom of Saudi Arabia, United Arab Emirates and China reserves increased to US$10.50 billion (or 2 months of imports) by end-March 2019. Meanwhile, the government continues to negotiate a support package with the International Monetary Fund. Large increases in debt servicing and defense expenditures resulted in higher fiscal deficit in Q1-FY19 which reached 2.70 percent of GDP (compared to 2.20 percent in Q1-FY18). The FY19 fiscal deficit is projected between 6.80-7.0 percent of GDP, a slippage of 2.70-2.90 percentage points compared to the budgeted target.

	July-April 2019	July-April 2018
	$ Million	
Exports	24,552	24,868
Imports	51,703	55,722
Trade Balance	-11,586	-15,864
Current Account Deficit (CAD)	11,557	15,832
CAD % of GDP	-4.80	-6.00

(source: SBP)



16. Workers' Remittances

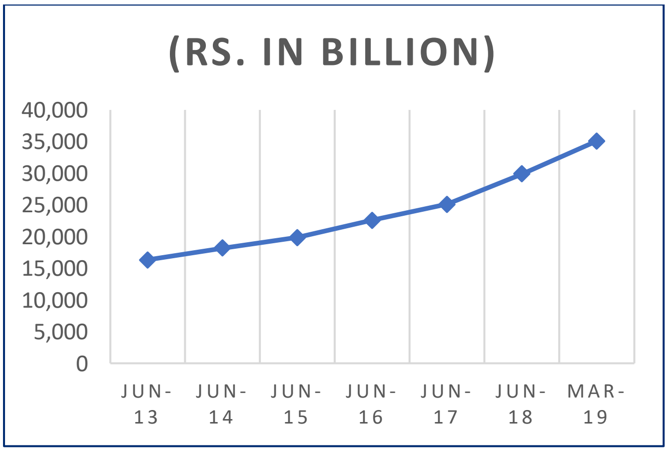
Pakistan's Workers' Remittances data was reported at 17,875.23 million USD in FY 2019 as compared to 16,481.82 million USD in FY 2018 last year.

17. Debts and Liabilities

a. Total Debt and Liabilities

As on March 2019 total debt and liabilities were Rs. 35,095 billion, a 17.45% jump since June 2018 figure of Rs. 29,879 billion. Government domestic debt stood at Rs. 18,171 billion while government external debt stood at Rs. 9,626 billion. Balances of last five years are provided below.

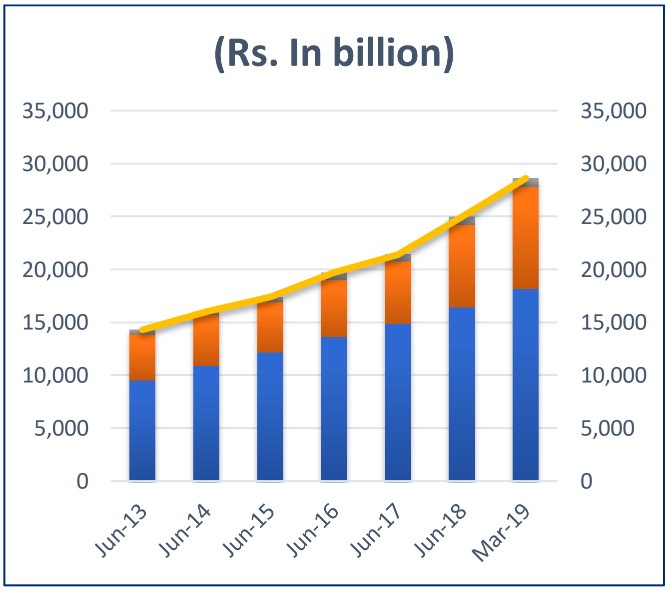
Rs. In Billion						
June 2013	June 2014	June 2015	June 2016	June 2017	June 2018	March 2019
16,338	18,214	19,849	22,577	25,114	29,879	35,095



b. Gross Public Debt

Pakistan's Gross public debt as on March 2019 reached to Rs. 28,608 Billion from Rs. 24,953 billion since June 2018, posting an increase of 14.64%. The components of gross public debt i.e. Government Domestic Debt, Government External Debt and Debt from IMF stood at Rs. 18,171 billion, Rs. 9,6251 billion and Rs. 811 billion, respectively. Balances of last five years are provided as under.

Rs. In Billion							
	June 2013	June 2014	June 2015	June 2016	June 2017	June 2018	March 2019
Government Domestic Debt	9,520	10,907	12,193	13,626	14,849	16,416	18,171
Government External Debt	4,336	4,786	4,770	5,418	5,919	7,796	9,626
Debt from IMF	435	298	418	633	641	741	811
Gross Public Debt	**14,292**	**15,991**	**17,380**	**19,677**	**21,409**	**24,953**	**28,608**



c. External Debt and Liabilities (in dollars)

Total External Debt and Liabilities soared to USD 99,686 million as of 28th February 2019 which was USD 48,694 million, USD 59,592 million and USD 96,060 million on 30th June 2009, 30th June 2013 and 30th June 2018, respectively. The historical figures are presented on next page:

(Continued on next page)

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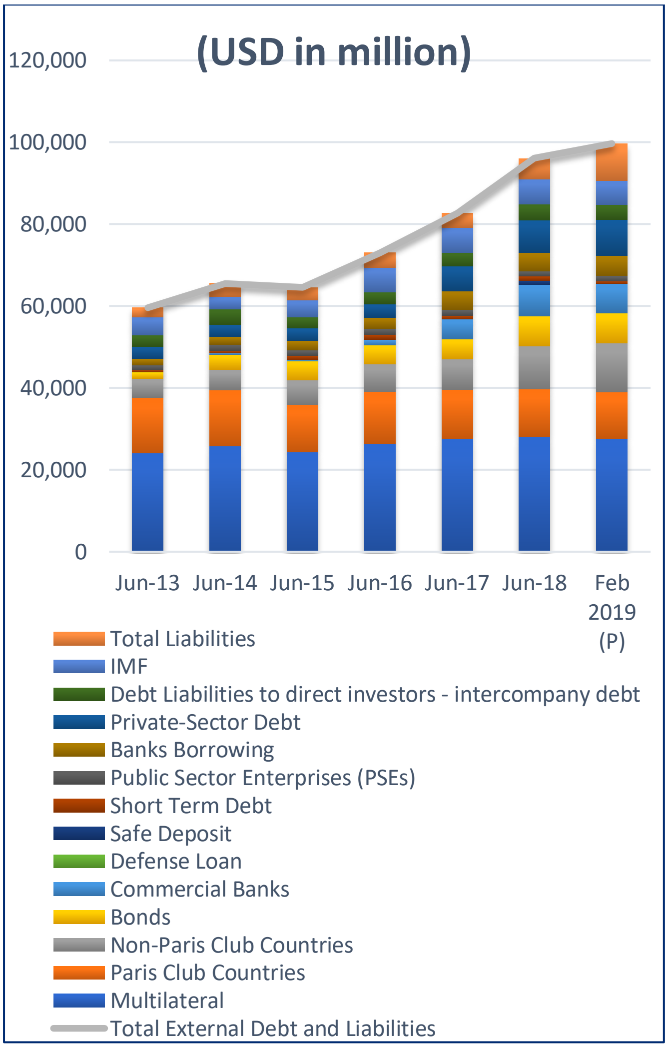
USD in million							
	June 2013	June 2014	June 2015	June 2016	June 2017	June 2018	Feb 2019 (P)
I. Public and Publicly Guaranteed Debt (sum a-g)	44,353	48,984	47,867	52,978	57,617	67,272	66,060
a. Multilateral	24,073	25,854	24,281	26,387	27,584	28,082	27,659
b. Bilateral (sum i and ii)	18,236	18,643	17,657	19,437	19,524	22,185	23,312
i. Paris Club Countries	13,548	13,607	11,664	12,678	11,973	11,643	11,324
ii. Non-Paris Club Countries	4,687	5,037	5,993	6,759	7,551	10,542	11,988
c. Bonds	1,560	3,680	4,611	4,585	4,851	7,300	7,300
d. Commercial Banks	-	323	300	1,457	4,826	7,661	7,206
e. Defense Loan	71	71	36	-	-	-	-
f. Safe Deposit	-	-	-	-	-	1,000	-
g. Short Term Debt	413	413	983	1,112	832	1,043	583
II. Public Sector Enterprises (PSEs)	1,258	1,650	1,359	1,515	1,548	1,275	1,314
III. Banks Borrowing	1,554	1,934	2,340	2,730	4,531	4,487	4,924
IV. Private-Sector Debt	2,919	2,929	3,052	3,295	6,080	7,917	8,771
V. Debt Liabilities to Direct Investors - Intercompany Debt	2,829	3,746	2,676	2,853	3,264	3,895	3,647
VI. IMF	4,387	3,020	4,103	6,043	6,109	6,095	5,890
Total Liabilities (sum I – VI)	2,292	3,281	3,145	3,600	3,564	5,119	9,080
Total External Debt and Liabilities	**59,592**	**65,544**	**64,543**	**73,014**	**82,714**	**96,060**	**99,686**

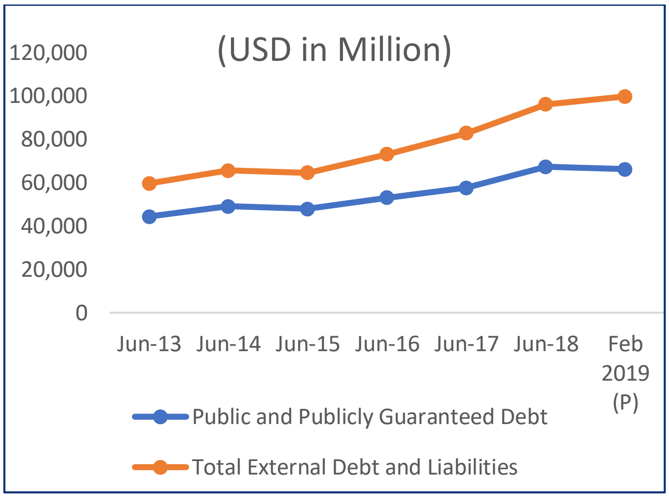


Out of total external debt and liabilities, public and publicly guaranteed debt component declined by USD 1,212 million, during July 2018 to February 2019, due to repayment of safe deposit amount of USD 1,000 million to China and short-term debt repayment of USD 460 million.

Outstanding balances of PSEs, Bank borrowings, Private Sector Debt and other total liabilities rose by USD 39 million, USD 437 million, USD 854 million and USD 3,961 million, respectively during the eight-month period.

The narrative of the government, that the borrowings are being made to repay old debts, is wrong as in such a case, the outstanding balances should remain unchanged instead of increasing as in the above case. Moreover, there is an additional repayment of Rs. 286 billion during nine months on account of debt servicing, as compared to similar period of preceding year due to increase in policy rates. A 1% increase in interest rates give rise to additional yearly repayments of Rs. 150 billion approximately.

It is interesting to note that liabilities towards bank deposits from China and Saudi Arabia have been classified under Item VII under foreign exchange liabilities. The same should have been classified under Item 1 i.e. 'Public and Publicly Guaranteed Debt'.



18. Outlook for 2018-19

Below is estimated budget size for 2019-20:

	Rs. In billion
Tax Revenue (Target)	5,550
Provincial shares (57.50%)	(3,191)
	2,359
Add: Non-Tax and Other Revenue	1,600
	3,959
Add: Primary Budget Deficit allowed under IMF program (0.6 % of estimated GDP of 2019-20 (PKR 48,300 billion)	261
	4,220
Add: Estimated Debt Servicing	2,900
Gross Cash Outlay of Budget 2019-20	7,120
Less: Surplus Cash Balances of Provinces	(320)
Net Budget Outlay	6,800

Pakistan is likely to continue to face hardships in coming year despite tight fiscal and monetary policies to rein in fiscal deficits and a slowing down economy.

Macroeconomic imbalances will be required to be alleviated, without which the outlook is for slower growth, higher inflation, higher unemployment and pressure on currency. Moreover, Heavy external financing is needed to maintain even a minimal cushion of foreign exchange reserves.

Asian Development Bank warns the agricultural sector is likely to underperform for the coming fiscal year as well due to water shortages. Large scale manufacturing is also expected to underperform due to contracted domestic demand due to higher interest rates and higher prices of raw materials due to inflation and rupee devaluation.

Furthermore, a slowdown in agriculture and industry, as domestic demand shrinks, will keep services growth subdued as well.

Stabilization measures and rising inflation are likely to contain growth in private consumption and investment, while public sector development spending has already slackened. With exchange rate flexibility and declining imports, net exports are expected to contribute to growth

Current account deficit is expected to narrow a bit due to contained private consumption, however, this will be offset if the exports are not improved. Exports also looks to be stagnant if the tax incentives to textile sector are withdrawn.

Remittances are expected to revive — having already risen by 10pc in the first seven months of current fiscal year — as Pakistan rupee depreciates further, economic activity in the Middle eastern oil exporting countries — major destination of Pakistani migrants — holds broadly steady and government takes measures to facilitate remittances through official channels.

Inflows that do not incur debt such as foreign direct investment, are expected to be lower in current fiscal year as several CPEC energy projects are near completion.

Asian Development Bank's report on Asian Development Outlook highlights that Pakistan lags behind the South Asian regional average on most index indicators; business competitiveness suffers under a challenging macroeconomic environment followed by adverse terms of trade, significantly eroding production and exports.

The report adds that country's exports lack sophistication and diversification condemning them to declining shares in global trade accentuated by the high cost of doing business limiting firms' ability to compete.

The bearish oil prices in international markets may be a breath of fresh air for the economy as the drop-in prices may reduce Pakistan's import bill by 37% (according to some estimates). This will help in reducing fiscal deficit and balance of payment gap.

As macroeconomic conditions improve, and a package of structural reforms in fiscal management and competitiveness is implemented, growth is expected to recover from FY21 onwards. Together with the macroeconomic adjustments, there is an urgent need to implement structural reforms to support the growth rebound. Reforms to put the country on a stable growth path include increased exchange rate flexibility, improved competitiveness and lower cost of doing business. On the revenue front, reforms to improve tax administration, widening of tax base and facilitation of tax compliance are critical.

Unfortunately, it is foreseen that achievement of tax revenue target of Rs. 5,500 billion is next to impossible and as a result, IMF will again be involved in political landscape of Pakistan.

Additional revenues can be generated from the sources mentioned in the below table. Potential revenue can also be generated from reforming the provincial sales tax and by bringing real state at market value.

It is worth mentioned that the estimated size of parallel economy is around PKR 39, 000 billion and it is causing imbalance in the taxation structure (direct and indirect). Tapping the sources elaborated in the following table will curb the quantum of parallel economy.

Description	Rs in Billion
Add: Direct Taxes from undocumented 19% agricultural sector	586
Add: Direct Taxes from undocumented 18.6% retail/wholesale	574
Add: Estimate of Expenditures/Concessions/SROs (See Section 4)	541
Add: Under Invoicing (See Section 5) US$ 2.6 billion @ 141	366
ADDITIONAL REVENUE POTENTIAL	**2,067**

END NOTE

With respect to performances in various sectors, there was a trend of decline in all the sectors comprising of Agriculture, Industrial and Service Sector. The downwards performance in the Agriculture and Industrial sector also affected the Service sector negatively. The various economic indicators were also a sad story if their performance can be assessed or compared to previous Fiscal Years. The statistical analysis of GDP growth rate, Foreign Investment, Foreign Exchange Reserves, Balance of Payment and Currency comparison indicated the economic slump for the Fiscal Year 2019. Whereas both governmental and non-governmental borrowing increased for the period. The CPI inflation boosted in the Fiscal Year 2019 as compared to the Fiscal Year 2018, whereas both SPI and WPI witnessed the same trend. The only positive that can be carried from the FY 2019 is the increase in the worker remittances from the previous fiscal year, however, that may be attributed to returning Pakistani Expatriates from Gulf countries due to economic slowdown there.

The Statistics provided for the current fiscal year reflects the poorly visioned policies and measures introduced and applied by the current government, hence the results deflected such behaviour in the face of economic disaster that the current fiscal year reflects. Although the economic condition cannot be versed as a booming economy when the current government got hold of the country but lacklustre behaviour and non-serious attitude of the current government has detracked the situation and has widen the gap between the deficit being faced by the economy in the previous terms.

The phase in which the economy is right now or what can be extracted from this fiscal period is the one, which the current government would like to forget and move on but serious lessons can be taken on behalf of the current condition which will only deteriorate if not handled wisely.