DAWN

26th August, 2019

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The unsurprising contraction

Manufacturing in Pak-istan is in recession. The latest numbers released by the Pakistan Bureau of Statistics (PBS) early last week show that large-scale manufacturing (LSM) posted a negative growth of 3.6 per cent in the last fiscal year for the first time in 10 years.

Contraction in LSM comes at a difficult time for the economy and deepens serious concerns over potential job losses and the government's ability to collect the targeted tax revenue of Rs5.5 trillion going forward if the trend does not reverse in the near term. The reduction in the industrial output coupled with plunging global commodity prices could also hit the country's exports.

The last time manufacturing had contracted in Pakistan by just over 6pc was in 2009 amid severe global financial and economic crises. For the next three years through 2012, LSM had grown in the narrow range of 0.4-1.7pc.

The slump in manufacturing has, however, surprised no one. The warning signs have been obvious and piling up for too long. Cement consumption was falling, car and motorcycle sales were slumping, textiles and other exporters have been voicing concerns, consumer durables were selling less than before, diesel use was declining and what not.

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Manufacturers have stopped hiring new people for several months, started cutting shifts, reducing production and putting their expansion plans on hold as a direct consequence of plummeting demand for their wares, mostly in the urban centres of the country.

Surprisingly, job losses have so far not been as extensive as one might have feared some time ago. But for how long? Many firms, especially the small and medium-sized companies, have begun furloughing and laying off workers to save costs.

The central bank's tight monetary policies have lead to a steep devaluation of the rupee and extremely high interest rates that target the current account gap. The government's fiscal plan involves reducing public spending sharply, hiking taxes and increasing energy prices to cut the primary deficit to 0.6pc from 1.8pc last year.

Together, these policies have adversely impacted the purchasing power of people, caused massive demand contraction and increased the cost of production at the expense of industrial output.

Analysts like Ali Asghar Poonawala are of the view that the manufacturing sector will continue to contract at least during the first half of the ongoing fiscal year to December. There are modest chances of recovery in the latter half of the year if the economy doesn't get a new shock in the shape of an interest rate hike, currency devaluation or 'mini-budget'.

“This is just the beginning. LSM’s decline is going to be sharper in the first two-quarters of the present fiscal year as manufacturers are expected to continue to decrease inventories. The recovery in the second half of the financial year will largely depend on an end to the uncertain business environment. A slight change in any variable is likely to further drag down the manufacturing sector,” he said.

The five top underperformers responsible for the sharp contraction in LSM growth include automobiles, iron and steel products, coke and petroleum products, pharmaceuticals and food and beverages sectors. Fertilisers, leather products, engineering products, electronics, rubber and wood products, on the other hand, showed very modest growth.

“The business confidence is dipping and the job market is weakening,” insists Syed Nabeel Hashmi, a medium-sized business owner. He is of the view that the government should also evolve an index to gauge growth or otherwise of small and medium-sized manufacturing industry where jobs are actually created to get the real picture of the economic slowdown.

He agreed that the slowdown in LSM has affected the small and medium industry. “The small and medium units like auto-part producers who are part of a supply value-chain and sell their wares to the large-scale industry are affected the most because of the ongoing demand contraction for the last one year. Others who produce consumer items supplied directly to the market are still in much better shape despite losses in production and sales.”

In spite of the stress under which the manufacturing finds itself at present, the contraction in imports is creating some space for the domestic industry. “We may not see investment in capacity expansion and new projects in the next year. But you cannot discount the chances of businessmen investing generously once the economy absorbs these monetary and fiscal shocks, and interest rates start coming down,” concludes Ijaz A Mumtaz, a pharmaceutical company owner.