DAWN

26th March, 2019

State Bank slashes growth forecast, again

KARACHI: Growth in the current fiscal year will “moderate significantly”, the State Bank of Pakistan (SBP) said in its second quarterly report released on Monday.

It is now projected to land in a range between 3.5 and 4 per cent, indicating sharp decline compared to 5.2pc growth in FY18 or the target of 6.2pc for the current fiscal year.

The sharp deceleration is already visible across the board, according to the report, and is attributable to slower growth in agriculture as well as “stabilisation measures taken to preserve macroeconomic stability.”

In the previous quarterly report the SBP had downgraded the growth forecast to a range between 4.0 and 4.5pc, significantly lower from the starting year target of 6.4pc. With the further downgrade the growth rate is approaching nearly half of what it was expected to be when the fiscal year began.

Second quarterly report paints picture of slowing economy, rising inflation, persistently high fiscal and external deficits

The report is based on data from the first half of the fiscal year, running from July till Dec 2018, which has otherwise already been widely pored through by independent analysts in the media. But a few surprises remained.

It presents a picture of the economy at sharp odds with the comparatively rosier assessments offered by the finance minister at that time.

For example in December, Finance Minister Asad Umar claimed that the economy was showing signs of improvement, and pointed to data for private sector credit offtake as an example. “[I]f you look at private sector credit offtake — a useful metric to measure business investment — it was five times more in the first quarter of this year than in the first quarter of last year”, he told Arab News in an interview.

But a deeper look at that same data by the State Bank reveals a less rosy picture. “As for the private sector credit, an additional uptake of Rs570.4 billion has been observed during first half of this fiscal year, compared to Rs296.3bn in the same period last year. This trend [rising private sector credit offtake] is largely due to the rising cost of imported inputs and higher energy prices on account of the rupee depreciation and liquidity constraints owing to a higher level of unsold inventories (in POL, steel, autos, fertilisers, electronics and sugar sectors) along with circular debt in the energy sector,” said the report.

But the SBP sees stalling growth, persistently high fiscal and current account deficits (despite sharp cuts in development spending and imports), and the highest inflation “in 17 consecutive quarters” with further inflationary pressures building. Tight monetary policy was constraining demand as well as investment, and the government’s debt profile shifting extensively to State Bank financing and “higher re-pricing risks” for the government as tenors on government debt grew ever shorter.

“The fiscal deficit continued to stay high despite a sharp cut in development spending since the beginning of FY19,” said the report, adding that revenue collection declined and current expenditures increased substantially.

The overall fiscal deficit increased to 2.7pc of GDP, up from 2.2pc in the same period of last year. Similarly, a sharp growth in current expenditures led to a significant increase in the revenue deficit, which increased to 1.7pc of GDP in first half of 2018-19 from 0.5pc last year.

“Given that public development spending, a key driver for private sector industrial activities, is unlikely to pick up anytime soon, the full year outlook for manufacturing activities remains subdued,” said the SBP report.

“Taking stock of the evolving developments in the economy, most importantly the high level of fiscal and current account deficits, it is evident that measures addressing structural issues are needed,” the report noted, as a ginger pointer towards the urgent need for more substantive reforms.

Private consumption is going to remain lower due to tighter monetary policy and pass through of exchange rate depreciation that has resulted in both higher energy prices and core inflation.

In addition, the prospects for the upcoming wheat crop remain subdued in terms of growth. All these aspects are going to constrain the services sector in the coming months as well, said the report.

“Monetary policy tightening, exchange rate adjustments, reduction in Public Sector Development Programme (PSDP) spending and regulatory measures have impacted domestic economic activity,” said the report, adding that the underperformance of major kharif crops added to this slowdown.

This is also reflected in a contraction in large-scale manufacturing (LSM) output, decline in imports and moderation in the fixed investment component of private sector credit.

The industrial sector is facing the brunt of the slowdown in both public and private consumption. LSM contracted by 1.5pc during July-December period of FY19 relative to a healthy growth of 6.6pc in the same period last year. The slowdown in LSM became more pronounced in second quarter as it declined by 2.4pc compared to a growth of 3.7pc in the corresponding period of 2017-18.

Sharp decline in PSDP spending and uncertainties in the property market are impacting the cement and steel sectors, while lower sugar production amid inability to offload accumulated stocks which has dampened the food sector’s growth.

The lacklustre performance of the textiles sector indicates some moderation in domestic demand. The automobiles sector’s growth remained positive, but much lower than the last year’s level during the first half.

In the agriculture sector, during the first half of FY19 there has been a broad-based decline in production of major kharif crops mainly due to water shortages. Cotton crop is affected the most as according to official estimates its production has remained short by 25pc from its target.

The SBP said inflation continued to increase mainly due to cost factors and some persistence in underlying demand. In particular, during October-December, the CPI-based inflation hit 17-quarter peak.

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