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False starts, faltering economy

BACK in December 2018, Finance Minister Asad Umar was telling almost everyone he met that the economy has turned the corner, that improvements have begun to materialise, that green shoots are growing. For evidence, he would point to a few indicators, like the slide in reserves that had slowed mainly due to the arrival of the first billion from Saudi Arabia and rising offtake of credit from the private sector, which he pointed to as a sign of health returning to the economy.

In late December, he tweeted this: "Jul to October private sector credit offtake this year is Rs.360 billion vs only Rs.110 billion last year in the same period. Agriculture credit in Jul to Nov this year is Rs 212 billion, increase of 36pc vs Rs. 156 billion same period last year."

And only a week earlier he had given an interview to Arab News in which he said: "I'm sure you would have heard (people say), 'Business is not investing (in Pakistan) anymore'," Umar said. "But if 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."

In that same interview he drew a contrast between himself and his critics, and this is how the paper paraphrased him: "The minister said despite 'doom-and-gloom' scenarios painted by critics, he owed his optimism about Pakistan's future to the fact that he was a 'data-driven person'."

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I'm using these two as examples only, but there are numerous other places where the finance minister was trying to manufacture optimism using the same data points. So in the telling of this tale the fact that credit disbursements to the private sector and agriculture were rising was a sign of economic dynamism returning.

But last week, looking at the same data, the State Bank arrived at the opposite conclusion. In its second quarterly report, it spoke of a "notable deceleration in economic activity" along with rising inflation. Moreover, in large-scale manufacturing (LSM), it said the contraction "became more pronounced" in the second quarter (October to December 2018) compared to the first quarter (July to September 2018).

In the first half of the fiscal year, from July to December, LSM actually contracted by 1.5 per cent compared to a growth of 6.6pc in the same period last year. Inflation similarly rose, and with the fiscal deficit continuing to rise even more sharply (driven by higher interest payments and "a sharp increase in defence expenditure") controlling inflation is becoming even more challenging, it said. From a look at the data from the first half of the fiscal year, the State Bank further downgraded the economy's growth rate by half a percentage point, saying it is now more likely to come in somewhere between 3.5pc to 4pc by the end of the year; the original target was more like 6.2pc.

So what do we make of the higher credit disbursements touted by the finance minister? How come he saw an economic turnaround at that time, but looking at the same data, the State Bank sees a "notable contraction" and further deceleration in the pace of economic activity? How does it explain a sharp increase in private-sector credit offtake in the midst of a contraction of industrial activity?

This is how: "This trend is largely due to the rising cost of imported inputs and higher energy prices on account of PKR 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."

The report notes that while a few industries (power, textiles and cement) may have continued borrowing for capacity expansion (meaning investment), the majority of the credit offtake was not for investment purposes. Rather the higher credit disbursement to the private sector was a result of their costs rising sharply and they were borrowing to stay afloat. Far from being a sign of a return to health, the higher figure in this context is because of the intensifying struggle to stay afloat for industrial enterprises.

What about agriculture disbursements? The report first notes a sharp deceleration in the growth of major crops as well as the services sector connected to the handling of agriculture outputs, linking this to the shortage of water and rising prices of DAP fertiliser among other things. "Agriculture-credit disbursements decelerated from 39.4 percent during Q2-FY18 to 14.2 percent in Q2-FY19", meaning the absolute figures may look high, but in fact there is a slowdown.

And why is the actual figure higher? Because of a 16.7pc increase in the price of fertiliser, along with an increase in the price of DAP fertiliser due to higher international prices that were compounded by the depreciation of the exchange rate.

So in agriculture the trend is similar to industry: farmers find themselves having to borrow more to stay afloat even as acreage under cultivation falls, major crop output declines, prices of inputs rise and a water shortage bites hard. The increased disbursement figures in both the industrial and agricultural sectors, far from suggesting the return of economic health, point towards a growing desperation to survive.

Earlier, the government was being attacked because the figures for the external debt showed a sharp increase. They argued back — correctly so — that the bulk of the increase was attributable to the depreciation of the exchange rate and not fresh borrowing. They were right. The two data points did not tell the story if looked at in isolation, outside of any context.

But then the finance minister turned around and did the exact same thing and started touting a recovery of some sort on the basis of two data points. Now, when those same two data points (agriculture and industrial credit disbursement) are looked at within their context, it turns out they tell a story opposite to what the finance minister tried to spin.

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