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Amin Ahmed

Economy stagnating amid big deficit, low reserves: WB

ISLAMABAD: The World Bank has said Pakistan's economy is slowing as it faces yet another macroeconomic crisis due to high twin deficits and low foreign reserves.

In the latest edition of its report titled "South Asia Focus: Making (De)centralisation Work", that was released on Sunday, the Bank noted that with an IMF extended fund facility-supported stabilisation programme in place, the country's economic growth was expected to remain low in the near term.

The outlook for medium-term growth, meanwhile, hinged on the country's ability to implement necessary structural reforms to boost competitiveness and achieve sustained growth, said the report.

Progress on poverty reduction was expected to be limited during the macroeconomic adjustment period, it added.

According to the report, measures to restore macroeconomic stability in Pakistan weigh heavily on growth, which is expected to have dropped to 3.3 per cent.

Economic policies over the past few years have resulted in increased debt levels and an erosion of fiscal and external buffers, affecting the economy's ability to absorb shocks. The country needs to restore these buffers, especially because turbulence in global financial markets could affect the country's access to private external financing. And the weakening global economy and rising trade tensions could dampen external demand.

Growth expected to remain low in the near term

"Increased pressures on the asset quality and capital adequacy buffers due to the economic slowdown and inflationary environment could hold back the forecast rebound in growth, especially when strong short-term deposit mobilisation due to recent increases in policy rates continues to be intermediated mostly towards government securities," said the report.

The main domestic risk emerges from potential difficulties in implementing the necessary adjustments and structural reforms. The vulnerable households' ability to weather the economic impact of the crisis will depend on the inclusiveness of growth, the food and non-food inflation, and the resilience of sectors relevant for their employment — agriculture, construction and wholesale and retail trade.

About the outlook, the report said growth was projected to decelerate to 2.4 per cent in the fiscal year 2020, with continued fiscal consolidation and a tight monetary policy stance. The IMF adjustment programme entailed a rebalancing from domestic to external demand.

The report said growth was expected to recover slowly, to 3pc in fiscal year 2021, as macroeconomic conditions improved and external demand picked up on the back of structural reforms and increased competitiveness. This recovery was conditional on relatively stable global markets, a decline in international oil prices and reduced political and security risks, said the report.

Inflation is expected to increase in fiscal year 2020 to 13pc but it will start declining afterwards. The increase in prices will be driven by the second-round impact of exchange rate pass-through to domestic prices.

The report said the country's commercial banks would remain well-capitalised. However, increasing public sector demand for credit, mainly federal government borrowing, and rising interest rates were expected to crowd out private credit in the near-term.

The current account deficit was expected to decline to 2.6pc of GDP in fiscal year 2020 and further to 2.2pc in fiscal year 2021, as increased exchange-rate flexibility would support a modest recovery in exports and rationalisation of imports.

The consolidated fiscal deficit including grants was projected to reach 7.5pc of GDP in fiscal year 2020 and remain elevated at 6.2pc in fiscal year 2021. The public debt-to-GDP ratio was expected to remain high in fiscal year 2021 at 80.8pc, increasing the exposure to debt-related shocks, said the World Bank report.

Fiscal consolidation across the federation would be needed for the public debt to decline, but the debt-to-GDP ratio was not expected to fall below 70pc of GDP — the debt burden benchmark for high-risk emerging markets — over the medium term. Pakistan's debt vulnerabilities would remain high due to large foreign currency debt amortisations and sizeable refinancing of short-term domestic debt.

According to the report, progress in poverty reduction, which was uninterrupted since 2001, is expected to stall during the macroeconomic adjustment period due to decelerating growth and higher inflation rates. The poverty headcount, measured using the $1.9 per person per day international poverty line, is projected to remain at the fiscal year 2019 level (3.1pc). Poverty measured using the $3.2 line is expected to decline from 31.4pc last year to 31.2pc in fiscal year 2020, while poverty measured using the $5.5 poverty line is projected at 72.5pc in fiscal year 2020, compared to 72.6pc in fiscal year 2019.

Exports grew faster than imports in the first two quarters of 2019, suggesting weak domestic demand. Thus, weakening global conditions do not seem to be affecting South Asia through the trade channel.

Apart from Pakistan, South Asian exports continued growing fast in the first quarter of this year, but export growth moderated strongly in India in the second quarter. Import growth, on the other hand, has declined severely across countries in South Asia, and imports even contracted between 15pc and 20pc year-on-year in Pakistan and Sri Lanka, according to the report.

Across South Asia, food prices have been increasing in the last few months. Food prices in 2018 were stable in Pakistan, Afghanistan and Nepal but fell in India, Maldives and Sri Lanka. However, food prices recently have been increasing in all countries except Sri Lanka.

In Pakistan, Afghanistan, Nepal and Bangladesh, food prices are more than 6pc higher than a year ago.

Suggesting that it is losing its shine, the report says economic activity is moderating in many South Asian countries in line with global developments. Most South Asian countries are expected to grow below long-run averages this year.