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Erum Zaidi

Economy shows signs of improvement on IMF support

KARACHI: Economy is showing signs of stabilisation, helped by IMF support and planned capital injections in development projects during the current fiscal year, and is on track to meet the government's 2019/20 growth target of 4 percent, the central bank said on Monday.

"Development spending may play a pivotal role, since there has been an observed tendency that Pakistan's GDP growth and PSDP (public sector development program) spending move in the same direction, and similar has been the case in FY19… the government has budgeted a greater outlay for PSDP during the year compared to the actual spending in FY19," the State Bank of Pakistan (SBP) said. "Other triggers may include an improvement in market sentiments vis-à-vis the IMF (International Monetary Fund) program."

The SBP said although real GDP growth is likely to remain subdued, "the early signs of recovery are already visible". "Macroeconomic stabilisation will continue to be the cornerstone of economic policies during FY20," the central bank said in the state of economy report.

"A better showing by the agriculture sector compared to last year, and further improvement in the current account balance, may also improve the final outcome."

The SBP projected real GDP growth in the range of 3 to 4 percent for FY2020. The IMF forecast Pakistan's GDP growth to slow down to 2.4 percent in the current fiscal year compared with 3.3 percent in the last fiscal year. The country has implemented tough economic reforms under a three-year IMF loan program of $6 billion agreed in May this year.

The SBP further expected inflation to rise to 11-12 percent as against the government target of 8.5 percent. "While demand pressures have generally subsided, cost-related impact may be more pronounced in the first half of the fiscal year, taking the cue from oneoff adjustment in prices of utilities and other FY20 budget-related measures," the SBP said. "By the second half, further supported by the end of deficit monetisation by the government, price pressures may begin to recede, setting the tone for considerably lower inflation in FY21."

The State Bank believes that global slowdown and crossborder tensions might affect inflation outlook. "… crossborder tensions (which have flared up intermittently since Q3-FY19 and worsened during Q1-FY20) represent an upside risk to this outlook, given their tendency to drive up food inflation," it said. "At the same time, the global slowdown may pose a downside risk to the outlook, especially if international oil prices fall more sharply than anticipated."

On external sector outlook, the SBP is optimistic, "albeit being subject to both upside and downside risks".

The SBP projected current account deficit between 2.5 and 3.5 percent of GDP this fiscal compared with the government's target of 3 percent and as against 4.8 percent during the last fiscal year. "The current account deficit, after shrinking on YoY (year-on-year) basis during FY19, is anticipated to subside further in FY20," it said.

Exports are projected to pick up during the year, conditional on demand conditions among the country's major trading partners and buoyancy in commodity markets. Onset of fiscal stimulus and successful resolution of trade negotiations involving major economies would be instrumental in supporting global consumer demand, which would in turn bode well for exporting partners, including Pakistan, along with improved prospects of foreign investments, the central bank said.

The free trade agreement-II with China and preferential trade agreement with Indonesia may also give a boost to exports, it added. Decline in imports would be instrumental in improving the current account as the policy-induced import compression would continue on top of subdued prices, "barring any adverse shock from international oil prices".

The State Bank expects workers' remittances to remain robust in FY2020 on the back of measures taken and incentives given to overseas Pakistanis remitting under the Pakistan Remittance Initiative.

The SBP sees a budget deficit to be in the range of 6.5 to 7.5 percent of GDP. Although the State Bank sees contraction in fiscal deficit to 6.5-7.5 percent of GDP this fiscal, in line with the government's target of 7.1 percent and compared with 8.9 percent a year earlier, "the outlook for the fiscal sector, by contrast, is not straightforward".

"…achieving the ambitious tax collection target in the middle of a broader economic slowdown may present a challenge," it said. "Moreover, even if things pan out more or less according to plan, the fiscal deficit may be in the neighborhood of 7 percent nevertheless, implying that there would still be some way to go before fiscal consolidation is achieved," it said.

The State Bank said the government is expected to make a concerted effort to meet the IMF's quarterly targets, implying a measure of fiscal discipline. The budget for the current fiscal year looks to fix the deficiencies of the tax system and represents an earnest effort to increase documentation. It envisages a sizeable reduction in the deficit, by enhancing revenues and squeezing expenditures, it added.

The SBP said new opportunities are opening up in some areas, although the economy rebalances and there is reduced demand in some sectors.

The SBP, citing an example, said shrinking imports of many consumer items and finished goods amid regulatory duties and exchange rate depreciation generates an opportunity for domestic companies to step in and fill in this demand in the short to medium term.

"Moreover, alignment of the exchange rate represents improved prospects for export-oriented enterprises," it added. "The government's stated commitment to foster the ease of doing business and pursue investor-friendly policies is also welcome."