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Economic outlook for 2020

The single most important development in 2019 on the economic front was the entry by Pakistan into a three year Extended Facility with the IMF. The Program envisages very intensive and fast moves to achieve a big reduction in the current account deficit in 2019-20 and thereafter. The target is set at $6.6 billion, involving a further 53 percent curtailment from even the reduced level in 2018-19.

The major steps undertaken during the year have included, first, continuation of the devaluation of the rupee. In the month of June 2019, for example, the currency fell by almost Rs 15 per dollar. Currently, the rupee is stable and stands at close to 155 Rupees per dollar. The Budget announced on June 2019 envisages a record level of taxation of Rs 735 billion so as to bring down the primary deficit very sharply from 3.5 percent of the GDP in 2018-19 to 0.6 percent of the GDP in 2019-20. The objective is to curtail aggregate demand and lead to import compression. FBR revenues are expected to show an unprecedented growth rate of 44 percent. Electricity and gas tariffs and prices of petroleum products continue to rise while the SBP Policy rate has remained unchanged at the high level of 13.25 percent. Development spending has been limited to only 9 percent of the annual budgeted size of the national PSDP in the first quarter of 2019-20. There has been a growing shortfall in FBR revenues in the first six months with the growth rate much lower than the target at 16 percent.

The good news is that considerable success has been achieved in containing the current account deficit. It has shrunk by 73 percent in the first five months of 2019-20 and there was, in fact, a surplus in October. However, bulk of the reduction has been due to severe contraction in imports of as much as 21 percent. Exports have shown only a 5 percent growth.

The unfortunate reality is that the strong measures taken to contain the current account deficit have led to ‘stagflation’ in the country. The real economy is in the grips of a recession while the rate of inflation has risen to double-digits and approached 13 percent. Large-scale industrial production has declined sharply in the first four months by 6.5 percent. 9 out of the 15 industrial groups have registered negative growth rates. The cotton crop has failed and the shortfall is likely to be almost 5 million bales. Other sectors like transport, wholesale and retail trade and construction are also suffering contraction. A growth rate above 2 percent in 2019 looks unlikely. More than one million workers are likely to get unemployed and almost nine million people could fall below the poverty line in 2019.

Therefore, as the end of 2019 approaches, rising unemployment and growing poverty are forcing the Government to make an important decision. Should the process of stabilization be relaxed somewhat and some measures taken to revive the economy? The problem is that the IMF Program requires fulfillment of various performance criteria and indicative targets on a quarterly basis. The two key performance criteria relate to the floor of the level of net international reserves and the limit to the size of the primary deficit in public finances. The Government was able to undergo a successful first review by the IMF in November and the second tranche was released recently.

There will probably be efforts, therefore, to stimulate more economic activity in 2020, within the limits set by the IMF Program. Development spending and expenditure on programs like the BISP and EHSAAS will be accelerated. CPEC projects will be given greater priority in implementation. Some initiatives will be undertaken to promote investment especially in low cost housing. The flow of refunds and concessional financing to exporters will be increased and so on.

The scenario for 2020 will hinge crucially on the movement of the exchange rate. If the containment in the current account persists then the currency is likely to remain stable. This will imply a slowdown in the rate of inflation. The rate of increase in the CPI could become single-digit once again by June 2020 and gradually decline thereafter. However, recent escalations in gas and electricity tariffs will imply more cost push inflation in coming weeks. Further, the rise in tensions between the US and Iran could cause a spike in oil prices.

Overall, the year 2020 could witness a modest recovery in the economy with the GDP growth rate rising to 3.5 percent. Simultaneously, the average inflation rate for the year is likely to remain in the range of 8 to 10 percent. Of critical importance is the outlook for food prices. Given the huge rise in prices of vegetables in recent weeks there is likely to be a big supply response next year and these prices could come down once again as happened in 2018, contributing thereby to lower inflation.

The somewhat positive scenario for 2020 will hinge on two factors. First, that Pakistan continues to operate successfully under the IMF Program thereby sustaining positive perceptions especially by donors and rating agencies. Second, that there is success in meeting the external financing requirement of the country of over $20 billion in 2020. This will also require access to borrowing from international commercial banks and flotation of Sukuk/Eurobonds. If some difficulties emerge in obtaining the necessary financing then the rupee could become unstable once again and the economy will start floundering like what happened between May and September 2019.

Overall, the people of Pakistan are paying a heavy price in the process of stabilization of the economy. The Government will have to demonstrate the highest quality of economic management in achieving a transition to somewhat higher growth and lower inflation while sustaining the path of stabilization in 2020.

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