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Editorial

SBP lays emphasis on reform process

State Bank of Pakistan's (SBP's) first quarterly report for the period July-September, 2019, released on 6th January, 2020 contains a comprehensive view of Pakistan's economy together with its prospects for the remaining part of the current fiscal. A distinctive feature of the present report is a greater emphasis on the implementation of reform process agreed with the International Monetary Fund (IMF). According to the report, Pakistan's economy has moved progressively along the adjustment path and stabilization process has picked up momentum with the initiation of the IMF's EFF programme. While the SBP continues to keep the monetary policy consistent with the medium-term inflation target, consolidation efforts are visible on the fiscal front and the documentation efforts were actively pursued. Inter-bank foreign exchange market has adjusted relatively well after the implementation of a market-based exchange rate system and "the government [has] avoided deficit monetization, including rollover of SBP debt." The payoff from ongoing stabilization efforts has become visible in the form of declining twin deficits. Current Account (C/A) deficit during Q1-FY20 fell to a less than half of last year's level due to significant compression in imports. Growth of exports remained low owing to low unit prices. Overall fiscal deficit also remained lower and the primary balance recorded a surplus for the first time in 7 quarters.

According to SBP, achieving the real GDP growth rate target of 4.0 percent appears unlikely as the production of important Kharif crops is likely to fall short of the target and large-scale manufacturing witnessed a decline of about 6 percent in Q1-FY20 on YoY basis. Inflation reached 11.5 percent in the first quarter of FY20, extending the steep upward trend since the beginning of FY19. This level of quarterly inflation was the highest since Q4-FY12 and was attributed to the lagged pass-through of the exchange rate depreciation towards the end of FY19, rationalization of energy tariffs and revenue-led fiscal measures taken in the budget for 2019-20. On the external front, the balance of payments (BoPs) continued to improve during Q1-FY20. The C/A gap was plugged by the available financial flows. This helped the SBP increase its foreign exchange reserves by dollar 656 million and reduce its net liabilities by dollar 1.3 billion during the quarter.

Going forward, it is important for the government to address structural vulnerabilities and put the economy on a balanced and sustained growth trajectory. There is of course a need to build on the gains on the ease of doing business front. It is also equally important for the firms to leverage on the facilitation policies and gain a foothold in the global value chains (GVCs). "Increased participation in the GVCs would not only align the country's product mix with trends in global demand, but also put the exports on a sustainable growth path," according to SBP.

We feel that the analysis of the economy contained in SBP's quarterly report is quite objective and relevant to the current state of the economy. A salient feature of the report is that there is no unnecessary positive spin to please the government or give a false hope to people at large. As should be the case, while the report contains various macro-economic gains during the first quarter of FY20, it has not stopped short of highlighting the vulnerabilities of economy in an equal measure. The biggest gain has of course been a sharp turnaround in the external sector of the country's economy. This improvement has come on the back of significant contraction in imports, a small expansion in exports and the ongoing shift towards renewable and indigenous coal in the energy mix. The number of gains would have been bigger if the unit value of exports had not declined because exports in quantitative terms were higher during the quarter. A much better foreign exchange reserve position has avoided the risk of default and increased the confidence of foreign investors in the solvency of the country. Another gain was a substantial improvement in the fiscal position of the country which resulted in overall reduction in fiscal deficit and a surplus in primary balance which was a conditionality of the IMF under the EFF programme. It was, however, not highlighted that the tax collections of the FBR have been much lower than the target during the quarter. The FBR usually attributes this phenomenon to compression in imports but, in our view, such a negative development needs a highly objective analysis. Another achievement has been the alignment of monetary policy with the relevant variables like the price situation and the balance of payments (BoPs). SBP continues to maintain a tight monetary stance despite sharp criticism by the business community. It would, hopefully, ease its stance when the situation permits.

The most disconcerting development is a very slow pace of GDP growth rate. It is not only likely to fall much below the target of 4.0 percent for FY20 but would increase unemployment in the country and reduce the chances of improvement in the standards of life of ordinary people. The level of inflation also continues to be at an elevated level which has depressed the spirits of the poor and ordinary households in a disproportionate manner due to an abnormal rise in the prices of food items. This is particularly troubling when the top officials of the government, especially the Prime Minister, are raising the expectations of the common man by incorrectly claiming consistently that hardships of the people are nearly over and the year 2020 is going to be the time when the economy will be on an upward trajectory. Of course, people will be disappointed to see that nothing of the sort has happened. In fact, the government may have to further tighten its belt and ask people to wait for more time for the promised relief. The government's hands are almost tied because of the conditionalities of the IMF under the EFF arrangement. The country may be on the way to recovery but the path to recovery is certainly long and arduous to tread.