

Pak fiscal deficit to be in range of 8 to 17pc of GDP

ISLAMABAD: Amid whopping fiscal losses faced by Pakistan so far escalating to \$14 billion after outbreak of deadly coronavirus, Pakistan's fiscal deficit is projected to be in the range of 8 to 17 percent of GDP in the upcoming fiscal year depending upon the duration of lockdown period.

With projection of the budget deficit up to 17 percent that had never been witnessed by Pakistan so things are quite fluid as cautioned by the authors of this special research report prepared by prestigious Pakistan Institute of Development Economics (PIDE).

The Planning Commission's affiliate research arm and think tank PIDE's researchers including Mohammad Nasir, Mohammad Khalid, Abdul Jalil and Naseem Faraz prepared special research study titled "Post-COVID-19 scenario for Pakistan's Economy" on the basis of best and worst scenarios and stated that in the baseline scenario, which assumes that the lockdown would completely come to an end of outgoing fiscal year FY20, the annual growth rate for next fiscal budget year (FY21) is expected to bounce back to 2.16 percent - a projection consistent with IMF's projection for Pakistan.

In the worst-case scenario, where the pandemic and consequent economic disruptions are expected to continue until the third quarter (end March 2021) of the next fiscal year, the growth rate would be negligible (0.4 percent).

"The fiscal deficit is expected to range between 8 percent to 17 percent of the GDP for the two extreme scenarios," it further stated. Inflation, however, may not be a big concern as it is expected to remain in the range of 5 percent-7 percent in the FY2021.

A single-digit and stable interest rate is also expected. Although the current account deficit is expected to hover around 1 percent-2 percent of the GDP, there would be significant fluctuations in the volume of exports and imports across scenarios. Remittances are expected to drop substantially by the end of the next fiscal year.

In the worst-case scenario, layoffs could increase to 18 million thereby pushing 87 million people into poverty. The expected annualised growth for FY20 could range between 0.62 percent and -1.36 percent. The respective loss in the GDP in the fourth quarter ranges between 12 percent and 19 percent of the expected pre-COVID-19 fourth-quarter GDP. These GDP estimates lie between the projected growth rates by the Planning Commission (2.0 – 2.5 percent) and the IMF and SBP (-1.5 percent) for FY20.

The range of growth for the industry would remain in the red, whereas that of the agriculture is expected to remain positive. The services sector, on the other hand, could experience positive or negative growth depending on the range of a decline in transport and wholesale and retail trade. For instance, lifting the ban on public transport, or providing the option of secured and trusted online shopping by retail outlets could turn things around for these sectors.

The fiscal cost (projected revenue loss and increased expenditure) is expected to be \$14 billion. The fiscal support for COVID-19 is estimated to be more than 3 percent of GDP in FY20. In the baseline scenario, it will effectively be close to zero in the next fiscal year. However, under scenarios 2 and 3, additional fiscal support would be required for FY21 (see, for instance, scenario 3 with 4.8 percent of the GDP).

Fiscal deficit was expected to be around 8 percent of the GDP in the pre-COVID-19 scenario. Now it is projected to be around 14% of the GDP for FY20. This will primarily be the result of an increase in fiscal deficit (increase in expenditures and reduced revenues) and a decrease in GDP as a denominator. For the best (baseline) and the worst-case scenarios, these are expected to be around 8% and 17% of GDP, respectively, for FY21.

Considerable commitments from donors (\$1.7 billion) would ease the burden on the domestic credit market, especially the banking sector. Although the lockdown was imposed only in the last quarter of the current fiscal year, owing to a higher deficit, we still expect the net borrowing from the domestic credit sector to increase by about 28% in FY20 as compared to FY19. However, in the baseline scenario for FY21, we expect a decline of 39% in financing from the domestic credit market as compared to FY20. The reduced inflow from the non-banking sector (mainly National Saving Scheme) due to reduction in the policy rate from SBP and reduced requirement for financing would release significant resources for the private sector credit operations in FY20.

Savings are expected from a decrease in debt servicing due to the reduction in the policy rate. Similarly, on the external front, G20 debt service relief of USD 1.2 billion is also expected. This, along with donor assistance, may help prevent a deterioration in the foreign exchange reserves and thereby maintaining the exchange rate.

The V-shaped recovery exhibits a quick recovery and should not be surprising at all. As discussed earlier, once the lockdown is lifted, certain sectors such as transport will surge back quickly within the next few months. This quick recovery will not be limited to the services sector only. According to a SMEDA survey, 85% of the SMEs plan to rehire laid-off workers within three months of the end of the lockdown. Since the demand side may take some time to fully recover (due to consumers restrain from the purchase of durables and investors to invest), the recovery will be partial. The pre-COVID-19 projected growth for FY21 was 3%. It will take a couple of more years to be back on the pre-COVID-19 growth trajectory.

This document uses the Monetary Policy Statement (MPS) of State Bank of Pakistan (SBP) as a guideline for interest rate predictions. The SBP indicates ZERO REAL INTEREST RATE. We also assumed zero interest rate in the crisis period and then follow the historical path of real interest rate (around 1 percent to 1.5 percent) in the recovery period, which is the end of FY2021.

It is expected that the interest rate will move around the inflation rate considering the assumption of zero interest rate, as indicated in the latest Monetary Policy Statement and as practised by other emerging economies. Therefore, our projections hover around projected inflation rates, as shown in Table 4.

Oil Prices: Oil prices are taken according to the IMF assumption, and monthly paths are extracted from futures. Electricity, gas, tax structure, domestic petroleum products are assumed to remain at the same level.

Exchange Rate: The main drivers of the exchange rate will be the import pressures and debt repayment. However, there is no sign of pressure in the last quarter of the FY20 due to improvement in the current account. The impact of flight of the hot money has been already transmitted in the previous two months. There is, however, considerable uncertainty about FY2021. According to the baseline scenario, the economic activities will be on a path of recovery in the next fiscal year. The revival of economic activities will hit the current account. As per the market feel, the exchange rate parity will hover around 160 to 175 Rs/USD. However, this evidence is anecdotal.