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SBP projects modest growth

Forecasts Covid-hit national economy will expand 1.5-2.5% in FY21

Pakistan's central bank has projected that the Covid-hit national economy will turn around and grow 1.5-2.5% in the current fiscal year with a steady growth in the troubled agriculture sector, rebound in the stalled services sector and modest recovery in industrial output.

"With the pre-Covid improvement in macroeconomic fundamentals remaining intact and the strong policy response helping to cushion the shock, the economy seems poised to pick up from where it was before the Covid-19 shock," the State Bank of Pakistan (SBP) said in its Annual Report on the State of Pakistan's Economy for fiscal year 2019-20 released on Wednesday.

Earlier in September, the central bank had projected gross domestic product (GDP) growth of 2% for the current fiscal year. The government has set the GDP growth target at 2.1% compared to contraction of 0.4% in the previous fiscal year ended June 30, 2020. The central bank voiced hope that the economy would take off partly with support from the government-backed housing and construction sector, which could activate at least 40 allied industries including paints and wood works.

It expected improvement in the economy in the backdrop of a couple of successful Covid-19 vaccine trials conducted by US and German companies. Earlier, the business confidence rose in August as businesses applied for long-term subsidised loans for at least 338 new projects.

The central bank, however, cautioned that the pandemic would continue to pose risk to the economy till the vaccine was widely available around the world, including Pakistan.

Since the world was yet to get rid of the contagious disease, the SBP projected no growth in the inflow of remittances from overseas Pakistanis, almost flat exports but foresaw some increase in imports in the remaining eight months (Nov-Jun) of FY21.

Besides, the economy is likely to face inflationary pressure with increase in the import of steel for mass housing and construction, import of wheat and sugar to meet domestic shortfall and likely increase in electricity price, which had been due since before the Covid-19 outbreak in Pakistan in February.

In addition to this, the collection of targeted tax revenue will remain a challenge for the economic managers, according to the central bank.

Improvement in the economy is expected to come from a steady performance of agriculture and recovery in the services sector, especially finance and insurance, transport and communications. Industrial performance is also expected to show a modest recovery, primarily on account of much-contained contraction in large-scale manufacturing (LSM) as compared to FY20.

"Nonetheless, these growth projections (1.5-2.5%) are subject to risks, including from the evolution of Covid-19, extreme weather conditions, external demand, and progress on the reform front. In particular, earlier estimates for Kharif crops (especially cotton) do not seem promising, given weaknesses in farmers' financial condition and heavy rains causing losses to standing crops," the SBP stated.

Business confidence

The improvement in the Expected Business Confidence Index was more pronounced as it touched its second-highest level since the start of the survey.

Importantly, this optimism has also begun to reflect in the planned investment activity in the country.

"Funding requests under the SBP's Temporary Economic Refinance Facility (TERF) rose sharply in recent weeks. The scheme, which provides subsidised financing to businesses undertaking capex (investment) or BMR, has so far attracted 338 projects. These developments, along with optimism in the housing and construction sector, can help accelerate the economy's recovery process in FY21," the central bank noted.

Imports, exports

The overall global economic outlook remains uncertain due to the still-high Covid infection rate in some countries and the continuation of US trade spat with China.

"These uncertainties continue to present downside risks to Pakistan's export growth…For the full year, the SBP expects export values within the range of $23.4-23.8 billion - higher than the $22.5 billion recorded in FY20," the central bank added.

Similarly, the SBP expects full-year imports to remain higher than last year, given the anticipated pickup in economic activity following the lifting of lockdown and companies' efforts to replenish inventories.

In particular, concessions for the construction industry and progress on housing finance will revive steel imports. Besides, lower domestic production and supply management issues have necessitated imports of wheat and sugar. The SBP projected imports in a range of $42.8-43.7 billion in FY21. The government has targeted imports at the previous year's level of $42.2 billion.

Inflation

Given the stability in oil prices, domestic fuel prices are likely to remain steady during FY21. However, as previous adjustments in power and gas tariffs are due, there is an upside risk to the overall energy inflation.

Conditions in the domestic food market are also subject to risk. The recent resurgence in wheat and sugar prices continues to highlight commodity management problems in the country.

Moreover, food prices may also come under pressure due to torrential rains and increased risk of flooding, which may cause crop losses.

In contrast, the non-food, non-energy segment of the Consumer Price Index (CPI) is expected to ease further as chances of a significant pickup in domestic demand remain low due to the weak financial position of businesses and households.

Overall, the central bank expects the headline inflation to fall within the range of 7-9% in FY21.

Twin deficit

On the fiscal side, challenges remain as the government continues to focus on addressing Covid-related economic and social outcomes and supporting the initial economic recovery.

For the full year, the government has set the fiscal deficit target at 7% of GDP, with the primary balance also estimated to show a deficit of 0.5%.