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## SBP projections for 2018-19

The SBP Annual Report on the State of the Economy in 2017-18 was released recently. This is a balanced and well-written review of the developments in 2017-18. The positive trend in the GDP growth rate and the low rate of inflation during the year are highlighted. Simultaneously, the big increases in the 'twin deficits' are focused on. The lack of sustainability of the growth process has been emphasized along with the need for strong corrective actions in 2018-19.

The Economic Review chapter in the Report makes projections of the magnitude of key macroeconomic variables in 2018-19. Assessment of the prospects is largely based on information available up to the end of June 2018. Since then there have been a number of significant developments, including the induction of a newly-elected Government. As such, developments in the first quarter of 2018-19 are likely to impact on the projections of the SBP for the year.

The projections for 2018-19 are discussed below.

GDP growth rate

The year, 2017-18, closed with a peak growth rate of 5.8 percent in the last thirteen years. There is evidence that this growth rate was overstated as 2017-18 was the year prior to the elections and there was an incentive to project the performance of the PML (N) Government.

Already, there is need to adjust downwards the growth rate of the large-scale manufacturing sector. The Pakistan Bureau of Statistics (PBS) had reported the sectoral growth rate at 6.2 percent in 2017-18, based on eight months' data. During the last four months of 2017-18, the growth rate plummeted to 3.5 percent. Consequently, the annual growth rate is down to 5.3 percent. In direct terms, this reduces the GDP growth rate somewhat. Inclusive of the impact of lower manufacturing output on sectors like wholesale and retail trade and transport and communications the overall GDP growth rate in 2017-18 is closer to 5.5 percent and possibly even lower in view of the overstatement generally as highlighted in previous articles.

What then are the growth prospects for 2018-19? The SBP report expects the GDP growth rate to range from 4.7 percent to 5.2 percent as compared to the target in the Annual Plan of 6.2 percent. As such, a significant loss of growth momentum has been projected.

However, the last few weeks have witnessed some major developments which could take the GDP growth rate to even below the lower estimate of 4.7 percent. First, the Revised Budget for 2018-19 envisages a big cutback in the Federal PSDP spending from Rs 661 billion in 2017-18 to Rs 575 billion this year. This has been followed by a big reduction of Rs 158 billion in the size of the Development Programme of the provincial government of Punjab. Given the magnitude of the 'multiplier' of almost two in Pakistan, these cuts in development spending will reduce the GDP growth rate by almost 1.2 percentage points in 2018-19.

The resulting slowdown in construction activity and other factors have led to negative growth in the manufacturing sector in the first two months of 2018-19. Major industries which are likely to experience a big loss of growth momentum are cement, iron and steel, automobiles, petroleum refining, pharmaceuticals, fertilizers and chemicals.

The new government has been compelled to take a number of actions which will impact negatively on growth. The nearly 30 percent in the fertilizer price, along with the water shortage, will significantly reduce the output of Rabi crops. Similarly, the escalation in gas and electricity tariffs will raise production costs and reduce supplies. The recent price hike in HSD oil will further exacerbate the supply situation in the country.

Overall, a more likely range of the GDP growth rate is 4 to 4.5 percent in 2018-19. International agencies, like the World Bank and the Asian Development Bank have also projected a low GDP growth rate of Pakistan in 2018-19 sometime ago. Both agencies project it at 4.8 percent.

Rate of inflation

The average inflation rate of the Consumer Price Index in 2017-18 was very low at 3.9 percent. The SBP expects this to go up to between 6.5 and 7.5 percent in 2018-19. Already, in the first quarter the average of the rate of increase monthly in the CPI has reached 5.6 percent and gone up further to 7 percent in October 2018. Inflation has actually risen to double-digit rate in the case of the Wholesale Price Index at 13 percent. This is ominous and could lead to acceleration in the increase also in the CPI with a lag.

Further, recent increases in energy and POL prices and devaluation of the rupee have not yet fully registered their impact on the overall price index. As such, there is a fairly high likelihood that the actual inflation in 2018-19 will be significantly higher than the rate projected by the SBP. It could lie in the range of 8.5 to 9.5 percent, with monthly inflation crossing the double-digit rate by early 2019.

Exports

The SBP projects a growth rate of merchandise exports of 9 percent to 13 percent in 2018-19. This represents an increase from $24.8 billion in 2017-18 to between $27 and $28 billion in 2018-19.

The first quarter of 2018-19 has witnessed slower growth in exports of 4 percent. Exports of textiles have shown growth of 6 percent, while exports of other manufactures have actually declined by 5 percent. The only group which has shown fast growth of 29 percent is of food items.

The global trading environment is becoming more restrictive and competitive with the onset of a trade war, especially between the US and China. Even strong currencies like the Chinese Yuan and the Indian Rupee have depreciated by 4 percent and 6 percent, respectively, in the last four months.

Pakistan will need to take more measures to preserve the relative competitiveness of its exports. Otherwise, the growth rate of exports is unlikely to exceed 5 percent, significantly below the growth projection by the SBP.

Imports

The level of imports in 2017-18 was $55.8 billion. The SBP expects imports to go up to between $59.5 and $60.5 billion, thereby registering a growth rate of 6.6 to 8.4 percent in 2018-19.

The first quarter has witnessed a growth in imports of 6 percent. The increase is primarily due to the big 40 percent jump in the oil import bill, because of the rise in the international oil prices. Therefore, the growth in imports over the next three quarters will hinge largely on what happens to oil prices, especially in the aftermath of the second set of US sanctions that seeks to target Iran's industry and crude oil. At this stage, the SBP projection of the level of imports appears to be in the right range.

Current account deficit

The SBP projections of the level of imports and exports in 2018-19 imply a trade deficit of $32.5 billion. This will represent an increase of $1.5 billion over last year's level. However, there appears to be some uncertainty about the size of the current account deficit in 2018-19, as implied by the large range in the projected level by the SBP.

The current account deficit is forecast by the SBP at between $15 and $18 billion in 2018-19. This is in comparison to the recently revised level of $19 billion in 2017-18.

There is the likelihood, as indicated above, that the growth rate of exports in 2018-19 will be less than that of imports, in contrast with the SBP projections. This could lead to a trade deficit of over $33.5 billion and a current account deficit of $20 billion or more. Consequently, the external financing requirements may approach $31 billion in 2018-19, representing a jump of over 24 percent over last year's level. The vulnerability to a big drawdown of foreign exchange reserves will persist, even with support from friendly countries.

Fiscal deficit

The revised budget for 2018-19 presented in September by the new government envisages a reduction in the overall fiscal deficit to 5.1 percent of the GDP. The SBP expects it to range from 5 to 6 percent of the GDP.

The likelihood of a higher deficit than targeted for is due to the absence of sufficiently aggressive effort at resource mobilization and absence of any economy in the level of current expenditure in the revised budget. The cut in the PSDP alone does not appear to be adequate to bring the deficit down from 6.6 percent of the GDP in 2017-18 to almost 5 percent of the GDP in 2018-19. As such, as compared to the SBP projection, the likely range in the size of the fiscal deficit is between 5.7 percent and 6.2 percent of the GDP. This is, of course, conditional on the provincial governments combined generating a cash surplus of almost 0.7 percent of the GDP and on FBR coming closer to achieving its revenue target for 2018-19. Apparently, there has already been a shortfall of Rs 60 billion in the first four months.

Overall, despite the somewhat somber nature of the SBP projections of the key macroeconomic variables, perhaps surprisingly they are still optimistic in nature. There is the likelihood in relation to these projections that the GDP growth rate may be even lower; the rate of inflation higher and current account and fiscal deficits larger. Of course, the impact of implementation of the conditionalities in the event of an IMF Programme has not been factored into these projections.

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