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# Pakistan's current account in cross-countries perspective

UNRULY exchange rate adjustments and a repeat customer-status with the IMF are largely attributable to Pakistan's recurrent current account problems.

Every five years or so, the country faces an external financing gap, triggered by one or more of the following: a spending or investment boom gone awry, turmoil associated with political transition, or an adverse global economic development (such as a surge in oil prices).

This time round, it has been no different. The current account deficit rose from $2.7 billion (1 per cent of GDP) in 2015 to $18.2bn (5.9pc of GDP) in 2018, on the back of rising import spending (including for CPEC projects); a protracted crisis leading up to the July elections; and an uptick in oil prices (which is now abating).

The key question, though, is why we seem to end up in a crisis more often than our peers do. They face similar realities, but they do not end up at the door of the IMF. Is it because these countries have larger financial buffers, or are less open to trade (so are less buffeted by terms of trade shocks), or have more robust current account and financing structures?

The idea is to better understand the structural roots of Pakistan's current account malaise.

These are obvious questions to ask and answer, especially, if — as Finance Minister Asad Umar says — this is to be the last time we approach the IMF.

To this end, this article offers a through-the-cycle analysis of Pakistan's current account structure and its financing components relative to key comparator countries. These include Bangladesh, Egypt, India, Indonesia, Malaysia, Morocco, the Philippines, Sri Lanka, Thailand, Tunisia, Turkey and Vietnam. (A table, based on IMF international financial statistics, has been included here.)

The idea is to better understand the structural roots of Pakistan's current account malaise, so that permanent, not conjunctural, fixes can be found in the context of an IMF programme.

A few big-picture observations upfront:

Pakistan's current account deficit is not large relative to comparators: averaging 2.5pc of GDP over 2008-17, it is only slightly above India's 2.2pc of GDP, and well below those for Egypt, Morocco, Sri Lanka, Turkey, Tunisia and Vietnam.

This dispels the hypothesis that Pakistani nationals have systematically spent more than they earned over the past decade.

That said, at 2.5pc of GDP, the annual volatility of Pakistan's current account over 2008-17 was the second largest among peers (if we exclude the richer countries: Malaysia, Thailand and Turkey).

However, this volatility does not stem from very high openness to trade (and the attendant exposure to terms of trade shocks). Indeed, at about one-third, Pakistan's trade-to-GDP ratio is the lowest in the group.

The main issue seems to be low foreign exchange reserve buffers to guard against the volatility: Pakistan's forex reserves have averaged a mere 5pc of GDP vs a group average of 19pc of GDP, and an impressive 35pc or so of GDP for Malaysia, the country our leadership wants us to emulate.

Let's now dig deeper into the structure of the current account.

It’s clear that the bulk of our external imbalance is accounted for by the goods deficit which, at 7pc of GDP, is noticeably large among peers.

There is clearly a significant competitiveness gap vis-à-vis the Asean countries (Indonesia, Thailand and Malaysia), and even Vietnam and Bangladesh, that all have surpluses or smaller deficits. Interestingly, our goods deficit is less than India’s.

But whereas India’s net services exports (3.4pc of GDP) — supported by the tourism and ICT sectors — has countervailed the goods deficit, Pakistan’s net services balances have added an average of 1.4pc of GDP to the deficit. Indeed, Pakistan’s combined trade deficit of goods and services (at 8.4pc of GDP) is on the high side in the group.

The foregoing reveals a substantial underlying competitiveness deficit. Fortunately, or unfortunately, it has been concealed by very large remittances from overseas Pakistanis (especially those based in the Gulf countries): Pakistan’s income balance of 6pc of GDP is the highest among peers, with only Bangladesh, Morocco and the Philippines with larger surpluses.

While this lends credence to the view that overseas Pakistanis are an asset for the country, it also highlights the risks attached to this source of income. Should Pakistan’s relations sour with Gulf countries (or the West), or oil prices dwindle on a permanent basis affecting Gulf economies, this income source could get dented. Even if it failed to grow, it would result in larger current account deficits.

The financing side of Pakistan’s current account deficit is less standout, but there are still a couple of interesting takeaways.

There is clear scope for foreign direct investment to increase very substantially if, like Vietnam, Pakistan is to become China’s factory in the coming years. Foreign portfolio investment (foreigners buying Pakistani stocks and bonds) has been virtually nil on average, and lower than the levels achieved by neighbouring India and Sri Lanka.

Although portfolio inflows are a kind of hot money and can reverse quickly, they shed value in the process (unlike foreign borrowing), and thus imply a degree of risk-sharing with the investor. This may be an appropriate avenue for the government to pursue vis-à-vis overseas Pakistanis (for instance, via diaspora bonds).

Finance Minister Asad Umar is right to point out the need for structural reforms. The analysis here suggests that these reforms should focus on permanently and substantially upgrading our foreign exchange reserve buffers to help deal with external shocks (learning from the Malaysians); boosting Pakistan’s global integration and competitiveness, especially in the services sector (learning from India and Sri Lanka); and attracting more foreign capital via direct and portfolio channels to allow reduced reliance on foreign borrowing (learning from Indonesia, Turkey and Vietnam).

To do this right, we will need to save more during good times, show a genuine openness to learn from peers, and engage more with global investors.

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