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THE REVIEW FOR FIRST QUARTER OF 2014-15

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IPR Economic Series

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BOP	Balance of Payments
CCI	Consumer Confidence Index
CEC	Current Economic Conditions
CPEC	China-Pakistan Economic Corridor
CPI	Consumer Price Index
CSF	Coalition Support Fund
EEC	Expected Economic Conditions
EU	European Union
FAC	Fuel Adjustment Charge
FBR	Federal Board of Revenue
FDI	Foreign Direct Investment
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GoP	Government of Pakistan
Gwh	Gigawatt Hour
HESCO	Hyderabad Electric Supply Company
HSD	High Speed Diesel
IBA	Institute of Business Administration
IMF	International Monetary Fund
IPR	Institute of Policy Reforms
IRS	Internal Revenue Service
MTBs	Market Treasury Bills
NEPRA	National Electric Power Regulatory Authority
NSS	National Savings Schemes
NTDC	National Transmission and Dispatch Company Limited
PAEC	Pakistan Atomic Energy Commission
PESCO	Peshawar Electric Supply Company
PIB	Pakistan Investment Bonds
POL	Pakistan Oilfields Limited
PSDP	Public Sector Development Program
QESCO	Quetta Electric Supply Company
QIM	Quantum Index of Manufacturing

SBP	State Bank of Pakistan
SEPCO	Sukkur Electric Power Company
SPI	Sensitive Price Indicator
SROs	Statutory Rules and Orders
SUPARCO	Space and Upper Atmosphere Research Commission
T&D	Transmission and Distribution
TESCO	Tribal Areas Electric Supply Company
UAE	United Arab Emirates
UK	United Kingdom
UNOCHA	United Nations Office for the Coordination of Humanitarian Affairs
USA	United States of America
WAPDA	Water and Power Development Authority

EXECUTIVE SUMMARY

Following the stabilization of the economy in 2013-14, the Government has set ambitious targets for revival of the economy in 2014-15. This includes the achievement of a GDP growth rate of 5.1 percent; above 5 percent for the first time in seven years. Simultaneously, further stabilization is aimed at with the fiscal deficit falling to below 5 percent of the GDP and with foreign exchange reserves rising to almost three months of imports.

However, the outcome in the first quarter of 2014-15 has been somewhat disappointing. The devastating floods in September are likely to reduce the output of Kharif crops and indirectly impact on other sectors. The large-scale manufacturing sector has shown a lack of dynamism. Electricity generation has grown by less than 3 percent and high levels of power load shedding continue unabated.

Investment is beginning to be affected by the political activities in the second half of the quarter and the resultant increase in uncertainty. Imports of machinery have shown only modest growth. Releases for the PSDP have been slow and the power sector projects, in particular, have been starved of funds. There has been only a marginal flow of credit to the private sector.

The favorable development is the fall in rate of inflation. The increase particularly in food prices has moderated. International commodity prices have fallen sharply. However, this drop has not yet been transmitted to domestic prices. This should happen in coming weeks and months.

The fiscal deficit has been contained more or less, successfully in the first quarter, despite a significant shortfall in FBR revenues. Non-tax revenues have compensated for the short fall. Expenditure has also been managed by the cutback in the PSDP.

The balance of payments position has not altered significantly. While there has been a severe deterioration in the balance of trade due to falling exports and rapidly rising imports, the current account deficit has been limited by the phenomenal growth of home remittances. Inflows (including from IMF) into the financial account have been somewhat larger. Consequently, the level of foreign exchange reserves has remained, more or less, unchanged. However, the IMF had projected a significant improvement in the level of reserves in the quarter.

The level of uncertainty has increased both on the political and economic fronts the latter is due particularly to the hiatus in the IMF program. The fifth review is on-going in Dubai and it is important that it be successfully concluded.

Given that only the first quarter has ended and there is greater uncertainty, IPR makes only tentative projections for the outcome in 2014-15. GDP growth rate is expected to be in the range of 3.5 to 4 percent; inflation to fall to between 6 and 6.5 percent; the fiscal deficit to be somewhat above target at 5.5 to 6 percent of the GDP and the current account deficit to rise to about 1.5 percent of the GDP.

THE REVIEW FOR FIRST QUARTER OF 2014-15

INTRODUCTION

The PML (N) Government was able to achieve significant stabilization of the economy in 2013-14, its first year in office. The balance of payments position improved in the presence of a Fund Program. Foreign exchange reserves rose to over $9 billion and after February 2014 the rupee appreciated substantially in value with respect to the US dollar. The fiscal deficit was brought down sharply from 8.2 percent of the GDP in 2012-13 to 5.5 percent of the GDP. Non-tax revenues, in particular, showed exceptional growth of 36.9 percent on the back of record SBP profits and sale of 3-G licenses.

Therefore, for 2014-15, the focus of the Government has naturally shifted to achieving a strong revival of the growth process in the economy. This is the main objective of the Annual Plan for the year approved by the National Economic Council, chaired by the Prime Minister.

The targets in the Plan are presented in Table 1. The GDP growth target is 5.1 percent. If achieved, this will be the first time after seven years that the economy shows a growth rate of above 5 percent. An ambitious target of 7 percent has been set for the growth rate of the large-scale manufacturing sector, as compared to 4 percent last year. This sector is expected to lead the move towards a higher growth trajectory of the economy.

The rate of investment is projected to rise sharply from 14 percent to 15.7 percent of the GDP. Simultaneously, savings are expected to show a corresponding increase, thereby restricting the inflow of foreign savings to 1.1 percent of the GDP.

Despite a relatively static world economy and slow growth in global trade, exports are expected to show some buoyancy with a growth rate close to 6 percent. With, more or less, the same rate of increase in imports and fast growth in remittances, the current account deficit is projected at the same level as last year at just over 1 percent of the GDP. With net external capital inflow of over $6 billion, the level of foreign exchange reserves is projected at $13 billion. This is equivalent to an import cover of three months.

The first three months, July to September, of 2014-15 have come to an end. The objective of this review is to describe the developments on the economic front during these months and to make an initial assessment if the economy is on track to achieve the above-mentioned targets.

Table 1
Annual Plan Targets for 2014-15

	Unit	2013-14 (Actual)	2014-15 (Target)
GDP	**Growth Rate (%)**	**4.1**	**5.1**
Agriculture	Growth Rate (%)	2.1	3.3
Industry	Growth Rate (%)	5.8	6.8
Services	Growth Rate (%)	4.3	5.2
Rate of Inflation	%	8.6	8.0
Rate of Investment	% of GDP	14.0	15.7
Rate of Savings	% of GDP	12.9	14.6
Fiscal Deficit	% of GDP	-5.5	-4.9
Tax Revenues	Growth Rate (%)		24.0
Exports	Growth Rate (%)	1.4	5.8
Imports	Growth Rate (%)	3.9	6.2
Remittances	Growth Rate (%)	13.7	8.9
Current Account Deficit	% of GDP	-1.2	-1.1
Net External Capital Inflow*	$ million	7068	6083
Level of Foreign Exchange Reserves	$ billion	9096	13000

* Net Balance of the Capital and Financial Account of the BOP

Source: Annual Plan, 2014-15, Planning Commission, GoP

2. GROWTH

The prospects for major crops in the *Kharif season* the initial trends in industrial production.

2.1. Agriculture

The first estimates of the output of the three major kharif crops, cotton, rice and sugarcane, were on the positive side, as shown in Table 2. According to SUPARCO estimates, the cotton crop was expected to be larger by 1.4 percent, as opposed to a drop of 2 percent last year. Similarly, the increase in rice was likely to be large at over 4.7 percent and 3 percent in the case of sugarcane.

Table 2
Estimates of Output of Major Kharif crops of 2014-15

	2014-15		2013-14	
	Area (000ha)	Production (000 bales)	Area	Production
COTTON CROP (Forecast)				
Without Flood Impact	3214.5	12944		
Flood Impact		-700		
Output Forecast	**3214.5 (14.5)***	**12244 (-4.1)**	**2806**	**12769**
SUGARCANE (Forecast)				
		(Million Tons)		
Without Flood Impact	1178.4	68.5		
Flood Impact		-2.0		
Output Forecast	**1178.4 (0.0)**	**66.5 (0.0)**	**1173**	**66.5**
RICE (Forecast)				
Without Flood Impact	2884	7117		
Flood Impact		-600		
Output Forecast	**2884 (3.4)**	**6517 (-4.2)**	**2789**	**6798**

*figures in brackets are growth rates
Source: SUPARCO
IPR estimates of flood damage to crops (see Box 1)

However, the projections have been adversely affected by the floods in mid-September, which devastated parts of Punjab. Almost 2.4 million acres of cropped area was inundated. It is estimated that the cotton crop has been damaged by 5.4 percent; rice output also by 8.4 percent and sugarcane by 2.9 percent. (see Box 1)

Box 1
The Floods of 2014

The floods entered Pakistan primarily on the river, Chenab. According to estimates by the UNOCHA, 2.53 million people have been affected, 364 lives lost, 107,000 properties damaged and more than 2.4 million acres of crop area inundated. Bulk of the damage is in Punjab. The crop wise losses are given below.

Cotton: The main damage to this crop is in the districts of Muzaffergarh, Multan and Jhang. Total area affected is 504,000 acres.

Rice: The impact of floods on this crop is concentrated in the districts of Hafizabad, Mandi Bahauddin and Jhang. Altogether, the total crop area damage is on 1,045,000 acres.

Sugar: The main districts affected are Chiniot, Sargodha, Jhang and Muzaffergarh. Over 280,000 acres of this crop have been inundated.

In addition, some of the minor crops like fodder have also been hit.

Source: Provincial Disaster Management Authority, Punjab.

Therefore, cotton output in 2014-15 is estimated to be lower by 4 percent; rice by 4 percent also and sugarcane output at the same level as in 2013-14. Clearly, it is unlikely, following the floods, that the target for growth of the agricultural sector in 2014-15 of 3.3 percent will be achieved.

2.2. Industry

In the last quarter of 2013-14, the growth rate of the Quantum Index of Manufacturing (QIM) was 2 percent only, and for the year as a whole, 4 percent. During the first two months[1] of 2014-15, the performance of the large-scale manufacturing sector continues to be disappointing, as shown in Table 3. In July it was only 1.1 percent and in August, 5.3 percent. The growth rate for the two months combined in 3.2 percent.

[1] The QIM for a particular month is published by PBS after a lag of almost two months. Therefore, estimates for September 2014 are not yet available.

Table 3
Growth Rate of QIM

(%)

	2013-14	2014-15
July	4.13	1.14
August	4.58	5.27
July + August	4.35	3.19

Source: PBS

The performance of individual industries is given in Table 4. Industries which have shown buoyancy are mostly intermediate and capital goods. Low growth rates have been registered by export-oriented and / or consumer goods industries.

Textiles have a weight of almost one third in the QIM. The growth rate of production observed in the first two months is of only 1.3 percent. This is a reflection of the poor export performance and the supply-side constraint due to the shortage of electricity (see next section) and gas.

Some industries which performed exceptionally well in 2013-14 have started poorly in 2014-15. Fertilizer production had increased by 31.6 percent in the first two months of 2013-14, due primarily to the diversion of natural gas to this sector. Now, it is only 0.5 percent. Similarly, the growth of the petroleum refining industry is down from 15.9 percent to a negative 0.7 percent.

As opposed to this, significant recovery is observed in chemicals, automobiles, iron and steel products, engineering goods and rubber products. However, these industries have relatively small weights in the QIM.

Table 4
Growth in Industrial Production
(July and August)

Industry	2014-15	2013-14
Textiles	*1.3*	*2.6*
Yarn	1.4	3.5
Cloth	0.2	1.0
Food, Beverages and Tobacco	*1.3*	*2.6*
Sugar	-	-
Cigarettes	2.1	-3.1
Vegetable Ghee	2.0	6.5
Petroleum Products	*-0.7*	*15.9*
Pharmaceuticals	*4.5*	*1.8*
Chemicals	*8.8*	*1.4*
Automobiles	*5.2*	*-7.4*
Cars	-2.0	-6.2
Iron and Steel Products	*10.5*	*3.2*
Fertilizers	*0.5*	*31.6*
Electronics	*12.1*	*21.2*
Leather Products	*3.0*	*20.0*
Paper and Paper Board	*1.0*	*9.4*
Engineering Products	*17.4*	*-21.1*
Rubber Products	*16.7*	*-7.2*
Non-Metallic Mineral Products	*1.4*	*-6.7*
Wood Products	*-75.1*	*-16.2*
OVERALL	**3.2**	**4.5**

Source: SBP, PBS

2.3. The Power Sector

Increased generation/ supply of electricity is vital for boosting the growth rate of the economy. However, the performance of the power sector in the first quarter of 2014-15 is not promising, as shown in Table 5. This is a continuation of trend observed in 2013-14 (See Box 2).

Table 5
Growth in Electricity Generation*

(Gwh)

	2013	2014	Growth Rate (%)
July	9894	10353	4.6
August	9739	10340	6.2
September	9379	9125	-2.7
TOTAL	**29012**	**29818**	**2.8**

*excluding self-generation by K-electric.
Source: NEPRA

Box 2
Performance Indicators of the Power Sector

Data provided by WAPDA indicates the following:

(i) Total electricity generation* has increased from 82518 Gwh in 2012-13 to 87331 Gwh in 2013-14, indicating a growth rate of 5.8 percent, as compared to less than 2 percent in 2012-13.

(ii) Transmission and distribution losses have remained high at 17.5 percent of the electricity purchased by DISCOs. The highest T&D losses are in PESCO, TESCO, HESCO, SEPCO and QESCO.

(iii) Billing losses have increased from 6 percent to 10 percent. In absolute terms, the amount not recovered has increased by Rs 52 billion, to Rs 100 billion.

(iv) Non-recovery is much higher at 15 percent in the case of government consumers, as compared to 6 percent for private consumers in 2013-14. The former loss has increased sharply.

(v) The actual billing per Kwh in 2013-14 is 11.49 Rs. This represents an increase of 16 percent over the level in 2012-13. In October 2013, power tariffs were raised on average by about 30 percent.

*excluding K-electric.
Source: WAPDA

The total electricity supplied to NTDC has shown a growth rate of only 2.8 percent. The increase in demand is about 4 percent. Therefore, the underlying load shedding situation is unlikely to have improved.

Turning to the sources of electricity, the distribution is given in Table 6. The negative development is the decline in the share of hydro electricity while the positive change is the rise in the share of natural gas and a fall in the share of thermal (based on furnace oil and HSD) power.

Table 6
Distribution of Electricity Generated by Source

(%)

	Hydel	Gas	Thermal	Others	Total
July to September					
2013-14	41.6	18.1	33.3	7.0	100.0
2014-15	38.9	19.8	31.7	10.4	100.0

Source: NEPRA

The cost per Kwh of different fuel sources is given in Table 7.

Table 7
Cost per Kwh of different Fuel Sources

	July	August	September
Gas			
2013-14	5.00	4.96	4.84
2014-15	4.98	4.89	4.30
Furnace Oil			
2013-14	1q5.87	15.48	15.60
2014-15	15.95	15.74	15.66
Overall			
2013-14	6.56	6.57	6.40
2014-15	7.30	6.61	6.57
Fuel Adjustment Charge (FAC)			
2014-15	0.4331	-0.3016	0.5171

Source: NEPRA

International oil prices have been falling, including that of furnace oil. However, any impact of this is not visible in Table 7. In fact, over the three month period, the fuel adjustment charge (FAC) is positive at Rs 0.6486 per Kwh. This needs to be investigated.

3. INVESTMENT

Three indicators have been used to assess the short-term trend of investment, both public and private, in the economy, as follows:

(i) Imports of machinery
(ii) Status of releases of funds for the Federal PSDP
(iii) Bank Credit to the private sector.

3.1. Imports of Machinery

The level and growth of imports of machinery in the first quarter of 2014-15 is given in Table 8. There has been only a modest pickup in the imports of machinery of 5.2 percent. The level is 0.5 percent of the GDP in the quarter, which is still very low. Imports of power generating machinery and telecom equipment have shown growth. However, imports of textile machinery and electrical machinery have declined.

Table 8
Growth in Imports of Machinery
(July – September)

($ Million)

	2013-14	2014-15	Growth Rate (%)
Power Generation Machinery	161	182	13.0
Textile Machinery	136	130	-4.4
Electrical Machinery	215	186	-13.5
Telecom Equipment	316	334	5.7
Other Machinery	462	525	13.6
TOTAL	**1290**	**1357**	**5.2**
% of GDP	***0.5***	***0.5***	

Source: SBP

3.2. Releases for PSDP

The salient features of the federal PSDP for 2014-15 is given in Box 3. More recent data is available, as of 24th of October, on releases for execution of federal PSDP projects. The sector wise percentage released is given in Table 9. Almost 27 percent of the annual PSDP should have been released by the end of the third week of October. Instead, the release is less than 17 percent, indicating a shortfall of over Rs 52 billion.

Table 9
Status of PSDP Releases*

(% of Annual Allocation

	Amount *(Billion Rs)*	**%**
Textiles	*140.2*	*26.7*
Actual	*88.7*	*16.8*
• Higher Education Commission	4.0	20.0
• Health Services	5.6	20.7
• PAEC	23.7	46.0
• Planning and Development	0.2	0.6
• Railways	7.5	18.9
• Water and Power (Water)	7.3	16.8
• National Highways Authority	18.9	16.9
• WAPDA (Power)	2.7	4.2
• Special Areas	12.1	29.9
• Others	6.7	9.0

*as of 24th of October

Source: Planning Commission, GoP.

Box 3
The Federal PSDP for 2014-15

- The size of the federal PSDP has been set at Rs 525 billion in 2014-15, 19 percent above last year's actual level.
- A large number of new mega projects has been added to the PSDP. The throw forward (remaining cost) of on-going projects is Rs 4218 billion. The cost of new projects is Rs 3540 billion. Therefore, the portfolio has been expanded by 84 percent in one year to Rs 7758 billion.
- The major addition is in the WAPDA (Power Sector) of Rs 1595 billion followed by projects in the China-Pakistan Economic Corridor (CPEC) of Rs 746 billion.
- It will now take over fourteen years on average to execute a project.
- Many of the Projects which have been given allocations in the PSDP currently have 'unapproved status'. This is a major violation of the rules of business.

Source: Planning Commission, GoP

The worrying aspect is the low priority attached to WAPDA (Power Sector). It has received only 4 percent of the annual allocations. Preference has been rightly to PAEC. Special areas (AJ&K, Gilgit-Baltistan) have also been given higher priority in initial allocations.

The total PSDP expenditure, in almost four months, remains low at 0.3 percent of the projected GDP. It will need to be substantially augmented in coming months.

3.3. Bank Credit to Private Sector

As of the 24th of October, increase in bank credit to the private sector by scheduled banks is only Rs 5 billion, as compared to Rs 32 billion in the corresponding period of the previous year.

Overall, the short-term trends in investment are not encouraging. First, there is only modest growth in imports of machinery. Second, releases for the federal PSDP have been slow. Third,, there has been only marginal expansion of bank credit to the private sector.

4. INFLATION

4.1 Rate of Inflation

The average rate of inflation in 2013-14 was 8.6 percent. It was beginning to moderate in the later part of the year due to the significant revaluation of the Rupee. In June 2014, the rate of inflation on a year-to-year basis was down to 8.2 percent.

The decline has continued in the first quarter of 2014-15, as shown in Table 10. The average rate of inflation in the quarter is recorded at 7.5 percent in the Consumer Price Index (CPI). The fall in non-food prices inflation is somewhat more pronounced than in food prices.

The Sensitive Price Index (SPI) records the movement in prices of essential items, especially food. It is at 7.1 percent for the quarter. ‘Core’ Inflation is a measure developed by the SBP to determine the underlying demand pressures in the economy. It averaged 8 percent during the quarter.

The group wise inflation within the CPI is given in Table 11. A high rate of inflation is observed in perishable food items of 16 percent. This partly reflects the supply shortages that emerged during and after the floods. The other group with high inflation of over 22 percent is beverages and tobacco. This is primarily due to the higher taxation.

Table 10
Trend in Price Inflation

(%)

	CPI			SPI	'Core' Inflation
	Food	Non-Food	General		
Year-to-Year					
June	7.4	8.9	8.2	8.0	8.7
July 2014	7.0	8.5	7.9	7.6	8.3
August 2014	5.6	8.1	7.0	6.8	7.8
September 2014	7.2	8.0	7.7	6.9	8.0
July – September 2014 Average	**6.6**	**8.2**	**7.5**	**7.1**	**8.0**
Month-to-Month					
June	1.0	0.3	0.6	1.2	0.4
July 2014	2.7	1.0	1.7	1.8	1.1
August 2014	0.6	0.2	0.3	0.4	0.2
September 2014	0.0	0.6	0.4	0.0	0.7

Source: SBP

Table 11
Group Wise Inflation

(%)

	Year-to-Year September 2014
General	*7.7*
1. Food and Beverages	6.5
Non-Perishable	4.8
Perishable	16.0
2. Beverages and Tobacco	22.4
3. Clothing and Footwear	9.0
4. Housing, Electricity and Fuels	8.8
5. Transport	5.4
6. Others	**7.0**

*as of 24th of October

Source: Planning Commission, GoP.

Relatively low inflation is observed in other groups, especially transport (5.4 percent) and non-perishable food items (6.5 percent). The Housing and Utilities group has shown inflation of 8.8 percent. This is actually understated. It does not record the increase in electricity tariffs fully. Inclusion of this increase raises the overall rate of inflation in SPI from 7.1 percent to almost 10 percent and in the CPI from 7.5 percent to above 8 percent.

Focusing on individual items, the highest inflation is observed in potatoes at 99.7 percent, cigarettes at 22.6 percent, pulses at 13.5 percent and fresh fruits at 12 percent. It is interesting to note the relatively high inflation in the price of various services, including doctor's fees at 11 percent, transport services at 11 percent also, education at 15.3 percent and so on.

4.2 Import Prices

The major development during the last few months is the, more or less, general fall in commodity prices internationally. This is on the back of slow growth in the world economy. For example, spot crude oil has fallen by 10.6 percent between end–June and end–September 2014, as shown in Table 12. Similarly, wheat and cotton prices and down by 20 percent.

Table 12
International Prices of Commodities

(%)

	Unit	2013	06-2014	09-2014	% Change*
• Cereals					
Wheat	$ / MT	312.2	305.9	243.7	-20.3
Rice	$ / MT	518.8	504.4	436.5	-13.5
• Palm Oil	$ / MT	764.2	726.2	657.0	-9.5
• Tea	cts /kg	266.0	244.9	233.0	-4.9
• Cotton	cts / lb	90.4	91.8	73.4	-20.0
• Spot Crude**	$ / bbl	104.1	107.3	95.9	-10.6

Source: IMF Commodity Prices

The big question is the extent to which the major fall in international commodity prices has already been or will be transmitted to domestic prices. A comparison is made in Table 13. As of end September, the impact is limited. Perhaps there is a lagged effect here and domestic prices will respond to the fall in international prices in coming weeks and months. If this happens then the rate of inflation could moderate substantially in Pakistan. The outlook for the prices of the major commodities beyond September is given in Box 4.

Table 13
September 2013 to September 2014
Rate of Change in

(%)

	International Price[a]	Domestic Price
Wheat	-25.0	1.2
Rice	-11.4	2.3
Cotton	-25.1	-16.7[b]
Palm Oil	-13.8	0.6
Crude Oil	-16.3	-0.4
Sugar	-11.4	12.3

[a] inclusion of exchange rate effect | [b] Wholesale price

Source: IMF, SBP

Box 4

The Outlook for Commodity Prices

The projections by IMF for the next nine months, that is, the remainder of 2014-15, for different commodities are given below, in terms of the probability of a change in price from the level of 29th September 2014.

	Probability (%)	
	of decrease	of increase
Crude Oil	80	20
Wheat	72	28
Rice	90	10

Source: IMF

5. PUBLIC FINANCES

5.1 FBR Revenues

Significant changes have occurred in the taxation structure of FBR in 2013-14, as described in Box 5.

Box 5
Changes in the Taxation Structure

- The positive development in 2013-14 is the increase in the share of direct taxes to 39 percent.
- The share of withholding taxes in the income tax regime has gone up sharply from 56 percent to almost 63 percent in 2013-14. Some of the withholding taxes are regressive in nature.
- IRS has raised lower demands by 10 percent in 2013-14.
- Total collection of taxes at the import stage has increased from 38 percent to 40 percent.
- Within indirect taxes of FBR, the largest contribution is by POL products of 30 percent.
- The incidence of indirect taxes on manufacturing is high at 29 percent of the value added.
- Refunds have fallen in 2013-14.

Overall, the greater reliance on withholding taxes is making the tax system more regressive. This has been magnified by the increase in the sales tax rate. The burden on the manufacturing sector needs to be reduced. The high reliance of FBR on POL products makes it vulnerable to a fall in oil prices.

The collection of taxes by FBR in the first quarter is given in Table 14. The total revenue mobilized is Rs 540 billion. This represents a growth of 13.6 percent in collection over the first quarter of 2013-14. The annual target growth rate of FBR revenues is 24 percent. Therefore, there has already been a shortfall in revenues of Rs 49 billion in the first quarter.

Direct taxes have shown some buoyancy with a growth rate of almost 19 percent. Also, customs duty revenue has increased by over 23 percent. This can be attributed to the relatively big increase in dutiable imports, withdrawal of SROs and levy of a minimum duty of 1 percent. The area of concern is the performance of the domestic component of the sales tax. The growth rate is less than 2 percent. This may reflect the sluggishness of the manufacturing sector. Also, refunds which were held back in the latter part of 2013-14 may have been paid in the quarter. Similarly, excise duties have shown negative growth. The rate of taxation of cigarettes may have been raised too high, which is leading to tax evasion.

Table 14
Trend in Q1 Collection of FBR

(Rs in Billion)

Taxes	Q1 2014-15	Q1 2013-14	Growth Rate (%)
A. Domestic Taxes (1 to 3)	**475.6**	**422.9**	**12.4**
1. Direct Taxes	192.0	161.7	18.7
2. Sales Tax (a + b)	259.0	235.8	9.8
a) Sales Tax Imports	143.0	121.7	17.5
b) Sales Tax Domestic	116.0	114.1	1.7
3. Federal Excise	24.6	25.4	3.1
B. Customs	**64.5**	**52.4**	**23.1**
TOTAL (A + B)	**540.1**	**475.3**	**13.6**

Source: FBR

The information on Fiscal Operations is released by the Federal Ministry of Finance with a lag of almost three months. Therefore, it is not possible to get an estimate of the fiscal deficit by adopting the 'above the line' approach, which is the difference between total revenues, tax and non-tax, expenditure. The alternative is to adopt the 'below the line' approach, which is the borrowing from different sources. This is attempted below.

5.2. Flotation of Bonds / Bills

The prime instruments for government borrowing from scheduled banks or non-banks / corporate entities is, first, in the form of Pakistan Investment Bonds (PIBs), with maturity ranging from three to 20 years. Second, there are Ijara-Sukuk Bonds, which are a form of Islamic borrowing. Third, short-term borrowing is undertaken in the form of Market Treasury Bills (MTBs).

The incremental borrowing through these instruments is given for the quarter, July to September 2014, in Table 15. The major share, 70 percent, of borrowing is in the form of PIBs. These bonds reduce the rollover risk, but they carry a higher markup. This increases the cost of debt servicing.

According to Table 15 the total borrowing in the form of bonds / bills was Rs 332 billion. 59.3 percent of this amount was picked up by scheduled banks. The rest, 40.7 percent, went to non-bank and corporate entities.

Table 15
Flotation of Government Bonds / Bills
(July to September 2014)

(Rs in Billion)

	June 2014	September 2014	Change
Scheduled Banks	**4067.4**	**4264.5**	**197.1**
MTBs	1603.3	1677.4	74.1
PIBs	2170.5	2290.3	119.8
Ijara-Sukik Bonds	293.6	296.8	3.2
Non-Banks / Corporates	**1361.1**	**4264.5**	**197.1**
MTBs	275.6	299.5	23.9
PIBs	1053.1	1167.3	114.2
Ijara-Sukik Bonds	32.8	29.5	-3.3
TOTAL	**5428.9**	**5760.8**	**331.9**
MTBs	1878.9	1976.9	98.0
PIBs	3223.6	3457.3	233.7
Ijara-Sukik Bonds	326.4	326.4	0.0

Source: SBP

Table 16 presents the markup/yields in different auctions of PIBs. The yield on these bonds has increased steadily since July 2013 by over 300 basis points in the case of three year bonds, despite a falling trend in the rate of inflation.

The yield curve is not very steep. It increases by 84 basis points from three to ten year bonds. Bonds with 20 years maturity are seldom subscribed to and if this is to be encouraged then higher returns will have to be offered.

Table 16 Rates of Mark-up on PIBs (Average Yield, %)						
Date	Amount (Rs in Billion)	3 Years	5 Year	10 Years	20 Years	Rate of Inflation (Y to Y)
16th July 2013	17.6	10.33	10.78	11.53	-	-
29th August 2013	30.0	11.01	11.49	11.90	-	-
26th September 2013	17.1	11.62	12.09	12.51	-	7.4
21st November 2013	45.2	11.95	12.48	12.91	-	9.1
19th December 2013	59.4	12.09	12.56	12.87	13.29	10.9
30th January 2014	201.6	11.76	12.30	12.61	12.90	9.2
27th February 2014	248.3	12.03	12.49	12.87	-	7.9
27th March 2014	535.5	12.00	12.45	12.83	-	8.5
24th April 2014	427.4	12.07	12.53	12.88	-	9.2
22nd May 2014	243.9	12.08	12.54	12.88	-	8.3
19th June 2014	203.4	12.08	12.55	12.92	13.00	8.2
17th July 2014	63.3	12.35	12.74	13.16	13.11	7.0
13th August 2014	89.8	12.42	12.82	13.24	-	7.7
Source: SBP						

5.3. National Savings Schemes (NSS)

National savings schemes consist of defense savings certificates, regular income certificates, special saving certificates, behbood certificates, prize bonds, etc. These are mostly acquired by households as a form of saving. The total amount mobilized in the quarter is given in Table 17, at Rs 66.1 billion. This is almost 51 percent higher than the amount mobilized in the corresponding quarter of the previous year. The rates of return of NSS were not changed in the quarter.

Table 17
Savings Mobilized by NSS

(Rs in Billion)

	2013	2014	Growth Rate (%)
July	13.3	21.4	60.9
August	13.3	21.4	68.8
September	12.9	15.0	16.3
TOTAL	**43.8**	**66.1**	**50.9**

Source: SBP

5.4. Borrowing from State Bank of Pakistan

The borrowing from the State Bank of Pakistan has been a negative Rs 39 billion. This strategy of retirement of some debt has been adopted in the line with the quantitative performance criteria for the quarter in the IMF program.

5.5. Net External Borrowing

According to the balance of payments data of the State Bank of Pakistan, the net inflow of financial assistance was negative $167 million, equivalent to Rs 17 billion.

5.6. Provincial Cash Surplus

The combined cash surplus of the four Provincial Governments is estimated at about Rs 10 billion at the end of September 2014.

5.7. The Fiscal Deficit

Based on aggregation of the different sources of borrowing, the fiscal deficit of the federal and provincial governments combined is estimated at Rs 332 billion. This is about 16 percent larger than the deficit in the first quarter of 2013-14. It is equivalent to 1.2 percent of the projected GDP in 2014-15.

The annual fiscal target is 4.9 percent of the GDP. The size of the deficit in the first quarter is consistent with the attainment of the annual deficit target. However, the question is how the fiscal deficit has been contained despite a significant shortfall in FBR revenues, highlighted above. This has been achieved, first, by a big cutback in releases for the PSDP (see Section 3.2), second, by receipt of two tranches of CSF money and, third, possibly higher revenues from the Petroleum Levy.

Table 18 Estimated Consolidated Fiscal Deficit in July – September quarter, 2014 (Rs in Billion)	
	Amount
PIBs	2337
MTBs	98.0
Inflow into NSS	66.1
Borrowing from SBP	-39.0
Net External Borrowing	-17.0
Provincial Cash Surplus	-10.0
TOTAL FISCAL DEFICIT	**331.8**
% OF GDP	**1.2**
Source: SBP	

6. BALANCE OF PAYMENTS

The balance of payments of Pakistan improved substantially in the second half of 2013-14. Consequently, by end June, foreign exchange reserves had risen to $9.1 billion, equivalent to over two months of import cover.

This upward trend has not been sustained in the first quarter of 2014-15. The developments in each component of balance of payments during the quarter are described below.

6.1. Exports

A worrying development is the significant fall in exports, as shown in Table 19, of 5 percent. The level of textile exports has remained unchanged. Export of food items is up by 4.3 percent, although rice exports have fallen by 2 percent.

Within textiles, there has fortunately been significant increase in exports of value added items like knit wear, bed wear and readymade garments. The big decline of over 18 percent is in other exports.

The question is whether the fall in exports reflects the fall in international prices described earlier. Table 20 distributes the change in value of exports of individual items between the change in quantity and change in price respectively. Out of the 17 items covered, there has been a fall in quantity exported in as many as 12 items. For example, the quantity of cotton yarn and cotton cloth has fallen sharply by 16.5 percent and 38.5 percent respectively. Similarly, the volume of rice exports has fallen by 7.6 percent.

Table 19
Export Performance

($ Million)

	July to September		
	2013-14	**2014-15**	**Growth Rate (%)**
Food Group	**867**	**905**	**4.3**
Rice	403	395	-2.0
Others	464	510	9.9
Textile Group	**3463**	**3465**	**0.0**
Cotton Yarn	561	445	-20.7
Cotton Cloth	726	654	-10.0
Knitwear	553	603	9.0
Bedwear	502	579	15.3
Readymade Garments	439	509	15.9
Others	682	675	-1.0
Others	**1944**	**1590**	**-1.8**
Petroleum Products	250	297	18.8
Sports Goods	132	155	17.4
Leather products	147	140	-4.8
Surgical Goods	95	101	6.3
Pharmaceuticals	295	319	8.1
Cement	142	118	-16.9
Others	883	460	-48.0
TOTAL	**6274**	**5960**	**-5.0**

Source: SBP

The negative price effect is less pronounced. It is observed in nine out of the 17 items. The biggest falls are in the export price of knitwear and towels of 14.9 percent and 19.4 percent respectively. The prices of rice exports have fallen only marginally by less than 3 percent. Some prices have gone up significantly, like the increase of 25 percent in the case of cotton cloth and 36 percent for leather manufactures.

The larger negative quantity effect tends to highlight that there may be supply-side constraints which are affecting exports. In particular, the textile industry, especially of Punjab, has been severely impacted by power load shedding and shortage of gas. These constraints will need to be removed if exports are to show buoyancy once again.

Table 20
Growth in Exports Value, Quantity and Rice

(%)

	July to September		
	Value of Exports*	**Quantity of Exports**	**Price of Exports**
FOOD GROUP			
Rice (Basmati)	-10.3	-7.6	-2.7
Rice (Others)	-10.1	-7.6	-2.5
Fish	-8.2	-6.8	-1.4
Fruits	-16.4	-16.4	0.0
TEXTILE GROUP			
Cotton Yarn	-21.8	-16.5	-5.3
Cotton Cloth	-13.5	-38.5	25.0
Knitwear	11.1	26.0	-14.9
Bedwear	-3.3	-3.3	0.0
Towels	3.7	23.1	-19.4
Readymade Garments	2.8	7.6	-4.8
OTHERS			
Petroleum Naptha	-53.4	-59.5	6.1
Carpets	-9.5	0.7	-10.2
Sports Goods (Footballs)	15.0	15.4	-0.4
Leather Tanned	-4.8	-31.7	26.9
Leather Manufactures (Garments)	-5.2	-18.1	12.9
Footwear	17.7	-18.2	35.9
Cement	-3.2	-3.9	0.7

*differs from SBP figures given in Table 19, as these are from PBS.

Source: SBP

6.2. Imports

The impact on the balance of trade of a fall in exports has been compounded by a steep rise in imports of 11.8 percent during the quarter, as shown in Table 21. For the first time, the level of imports has become double the level of exports. This highlights the growing lack of sustainability of the large negative balance of trade.

Table 21
Growth in Imports

($ Million)

Group	July to September		
	2013-14	2014-15	Growth Rate (%)
Food	**1109**	**1359**	**22.5**
Palm Oil	469	480	2.3
Others	640	89	37.3
Machinery	1290	1357	5.2
Transport	482	528	9.5
Petroleum	3948	4362	10.5
Textile	490	559	14.0
Agriculture & Other Chemical	1669	1714	2.7
Metal	712	832	16.8
Miscellaneous	228	237	3.9
Others	648	874	30.7
TOTAL	**10576**	**11822**	**11.8**

Source: SBP

All groups have shown increases in imports during the quarter. Large growth rates are observed in case of other food items, petroleum, textile, metal and others. Modest increases have occurred in the case of palm oil, machinery and chemical imports.

Here again, the question is why imports have shown such high growth in a period of falling international prices. The breakup of the increase in value between increase in price and quantity is given in Table 22.

The results are very striking. Out of 14 items covered, the unit price of imports has fallen in the case of as many as ten items. In some cases, prices have fallen by 15 percent to 30 percent. As opposed to this, the quantity imported has increased in 12 items. In some cases the rise in quantity is very large. For example, the import of Iron and steel is up by 80 percent, tyres and tubes by 75 percent, synthetic fibre by 80 percent, paper and paperboard by 57 percent, artificial silk yarn by 53 percent, tea by 37 percent, pulses by 33 percent and so on.

Table 22
Growth in Imports Value Quantity and Price
(July to September 2014)

(%)

	Growth in		
	Value of Imports	Quantity of Imports	Price of Imports
FOOD GROUP			
Palm Oil	4.4	0.2	4.2
Pulses	25.1	33.3	-8.2
Tea	17.1	36.6	-19.5
PETROLEUM GROUP			
Products	-0.4	2.3	-2.7
Crude	-14.2	-17.5	-3.3
TEXTILE GROUP			
Synthetic Fibre	64.4	79.8	-15.4
Artificial Silk Yarn	25.8	53.0	-27.2
AGRICULTURAL AND CHEMICALS GROUP			
Fertilizer	33.0	21.5	11.5
Plastic Materials	27.2	39.6	-12.4
Medical Products	12.4	-18.0	30.4
METAL GROUP			
Iron and Steel Scrap	33.9	30.7	3.2
Iron and Steel	64.0	80.2	-16.2
MISCELLANEOUS GROUP			
Tyres and Tubes	59.4	75.4	-16.0
Paper and Paperboard	44.9	57.0	-12.1

Source: PBS

Why have importers raised their import quantities by so much during the quarter? The answer probably lies in speculative behavior. The quarter witnessed a return to depreciation of the Rupee. Uncertainty was increased by the announcement by IMF that the fourth review had not been successful. Therefore, importers may have opted for building up inventories in anticipation of a further fall in the value of the Rupee.

6.3. Home Remittances

The deterioration in the balance of trade has been partially compensated for by the phenomenal growth in home remittances of almost 20 percent during the quarter, as shown in Table 23.

Table 23
Growth in Home Remittances by Source

($ Million)

Source	July to September		
	2013-14	2014-15	Growth Rate (%)
USA	625	692	10.8
UK	611	639	4.7
Saudi Arabia	1106	1347	21.8
UAE	784	1031	31.5
Other GCC Countries	447	545	21.9
EU Countries	109	112	2.1
Others	246	329	33.7
Month wise			
July	1404	1649	17.4
August	1240	1329	7.1
September	1283	1716	33.8

Source: SBP

Big increases in remittances are observed from Saudi Arabia, UAE and other GCC countries of 22 to 32 to percent. It is significant that the maximum growth of 33 percent is observed in the month of September, just prior to the Eid in early October. Therefore, the high growth rate may not be sustained in coming months.

6.4. Foreign Investment

Foreign direct investment (FDI) is increasingly shy and has fallen by 12.2 percent during the quarter. Fortunately, portfolio inflows have been buoyant, with a growth of 70 percent. These inflows are likely to increase as the privatization process involving sales of shares reaches a peak in the next few months.

6.5. Net Foreign Assistance

Net inflows of assistance into the government account have been negative. Amortization of loans during the quarter has exceeded disbursement by $167 million.

6.6. Net Use of Fund Credit

Early in the quarter Pakistan received $550 million following a successful third review. Thereafter, there have been repayments and the net use of IMF credit during the quarter is $273 million.

6.7. Balance of Payments

The overall position of the balance of payments in the July – September quarter of 2014-15 is given in Table 24. The following conclusions emerge from the table:

(i) The current account deficit has increased marginally by $62 million in relation to the deficit in the corresponding quarter of 2013-14. It is estimated at 1.8 percent of the GDP. The month of September actually witnessed a small surplus on the current account due to the bumper remittances and inflow of CSF money.

(ii) The financial account has shown a bigger surplus of $359 million. Errors and omissions have also been positive at $273 million.

(iii) Overall, the balance of payments deficit has been substantially smaller at $333 million as compared to $1193 million in the corresponding quarter of the previous year.

(iv) After adjustment for the net inflow of IMF credit, the overall decline in foreign exchange reserves is limited to $60 million only. As of the end of September, reserves stood at $8943 million. Overall, while the balance of trade has deteriorated by almost 36 percent, this has been compensated for a boom in remittances and by larger capital inflows. This has kept foreign exchange reserves, more or less, the level prevailing at the end of 2013-14. The rupee fell by 4.4 percent with respect to the dollar in the quarter.

Table 24
Balance of Payments

($ Million)

	July to September		
	2013-14	**2014-15**	**Difference**
A. Current Account Balance	**-1268**	**-1330**	**-62**
A.1. Trade Balance in Goods	*-4301*	*-5862*	*-1561*
Exports	6275	5960	-315
Imports	10576	11822	1246
A.2. Trade Balance in Services	*-894*	*-447*	*-447*
Exports	992	1712	720
Imports	1886	2159	273
A.3. Balance on Primary Income	*-809*	*-822*	*-13*
Credit	147	99	-48
Debit	956	921	-35
A.4. Net Secondary Income	*4736*	*5801*	*1065*
Worker's Remittances	3927	4695	768
Other Income	809	1106	297
B. Capital Account Balance	**46**	**16**	**-30**
C. Financial Account Balance	**46**	**16**	**-30**
C.1. FDI (Net)	172	151	-21
C.2. FPI (Net)	107	182	75
C.3. Government Assistance (Net)	-258	-167	91
D. Errors and Omissions	**-353**	**240**	**593**
E. Overall Balance of Payments	**-1193**	**-33**	**860**
F. Net Use of IMF Credit	**-128**	**273**	**401**
G. foreign Exchange Reserves	**4693**	**8943**	**4250**
MEMO ITEMS			
GDP	61730	72276 (66039)*	
Current Account Deficit as % of GDP	-2.1	-1.8 (-2.0)*	

*IPR estimates
Source: SBP

However, it needs to be emphasized that the outcome of the balance of payments compared to the projections by the IMF, following the third review, for the first quarter of 2014-15, is adverse. In relation to these projections, the actual current account deficit is higher by $453 million. The big difference is in the financial account of $1015 million. FDI is lower by $371 million and financial assistance to government smaller by $868 million. Consequently, the over balance of payments is worse by as much as $1322 million in comparison to the level projected by the IMF.

In fact, IMF expected that foreign exchange reserves would reach the level of $10325 million by end-September as compared to the actual level of $8943 million, a shortfall of $1382 million.

7. THE OUTLOOK

Any projections for 2014-15 based on the outcome of only the first quarter must be considered tentative in character. But there are some indications of the outlook for the rest of the year which are identified below.

Growth: The impact of the floods, lack of dynamism of the large-scale manufacturing sector and continued energy shortage make it unlikely that the growth rate target of 5.1 percent for 2014-15 will be attained. The Consumer Confidence Survey of IBA-SBP indicates that respondents expect a worsening of economic conditions after September. (see Box 6)

Inflation: The outlook for inflation is more favorable. As falling international prices get transmitted into domestic prices, the inflation rate should fall significantly. However, this may be partially neutralized by mandated increases in gas prices and power tariffs as part of the Fund Program.

Public Finances: The target of bringing down the fiscal deficit to 4.9 percent may not be attained if there continues to be a large shortfall in FBR revenues in relation to the budgetary target. Also, there is the pending liability of retirement of the circular debt of over Rs 250 billion in the power sector. This will be compensated for partially by a cutback in the PSDP.

Balance of Payments: The balance of payments is fraught with some uncertainty, depending on whether Pakistan successfully completes the on-going review by IMF and receives $1.1 billion. In the event of success, reserves could start rising once again. Otherwise, Pakistan may have to depreciate the rupee more, embark on larger privatization program and accept some reduction in the level of reserves.

Box 6
Consumer Confidence Survey

The SBP and IBA have started undertaking a Consumer Confidence Survey since late 2013 every two months. The total national sample size is 1623. Indices are constructed of the respondents' assessment of current economic conditions (CEC), consumer confidence (CCI) and expected economic conditions (EEC). These are given below:

	Current Economic Conditions Index (CEC)	Consumer Confidence Index (CCI)	Expected Economic Conditions Index (EEC)
November 2013	140.43	127.80	116.76
January 2014	140.69	133.59	127.40
March 2014	151.31	141.82	133.52
May 2014	151.39	143.99	137.52
July 2014	150.74	142.26	134.85
September 2014	140.37	133.81	128.09
% change from May to September 2014	***-7.3***	***-7.1***	***-6.9***

Source: IBA-SBP Survey

All three indices highlight an improvement from November 2013 to May 2014 and a deterioration thereafter, especially in September 2014. Therefore, expectations have turned negative in the first quarter of 2014-15.

In conclusion, the first set of projections by IPR for key macroeconomic magnitudes in 2014-15 are given below.

Projections for 2014-15

Variables	Unit	Target	Projection by IPR
• GDP Growth Rate	%	5.1	3.5 – 4.0
• Rate of Investment	% of GDP	15.7	14.0 – 14.5
• Rate of Inflation	%	8.0	6.0 – 6.5
• Fiscal Deficit	% of GDP	4.9	5.5 – 6.0
• Current Account Deficit	% of GDP	1.1	1.5

Source: IPR estimates