INSTITUTE FOR POLICY REFORMS

IPR FACT SHEET

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EARLY WARNING SIGNS

ABOUT IPR

Institute for Policy Reforms is an independent and non-partisan think tank established under Section 42 of the Companies Ordinance. IPR places premium on practical solutions. Its mission is to work for stability and prosperity of Pakistan and for global peace and security. IPR operations are supported by guarantees from corporate sector.

Amid perceptions of economic stabilization and recovery, the National Economic Council (NEC), chaired by the Prime Minister, has set a number of ambitious targets in the Annual Plan for 2015-16. Realization of these targets will unambiguously confirm that the economy has finally broken out of the low growth trap.

The GDP growth rate for 2015-16 has been set at 5%. The last time a growth rate of above 5% was achieved was as far back as 2006-07. According to the Annual Plan, Industry is expected to lead the growth process, with a growth rate approaching 6.5%. Inflation is likely to average 6% over the year.

The level of investment is also projected to revive sharply, from about 15% to almost 18% of the GDP. Exports will also pick up, after four years of stagnation, with a growth rate of over 5%. Remittances are expected to continue growing, while foreign direct investment is likely to show a quantum jump of doubling over the level in 2014-15.

The focus of public finances continues to be on further stabilization, with a reduction in the fiscal deficit to 4.3% of the GDP. This is to be achieved by a 20% growth in FBR revenues and little or no growth in current expenditure at the federal level. In addition, the Provinces are expected to generate a large combined cash surplus of

4- Shami Road,
Lahore Cantt, Pakistan.
UAN: 111-123-586
www. ipr.org.pk

Rs.300 billion.

Recent developments, however, are beginning to cast some doubts about the ability of the economy to perform as well as anticipated in 2015-16. The on-going floods could end up damaging crops in an area of almost one million acres. In the presence of low commodity, prices and outstanding stocks of 0.5 million tons of Basmati rice and over two million tons of wheat, the procurement/ support prices offered last year do not appear to be sustainable. Any reduction in prices could affect the supply response of farmers. Given the sharp drop in prices of potatoes and other vegetables, there is likely to be some shift away from these crops. Overall, it is beginning to look unlikely that the agricultural sector can achieve a relatively high growth rate of 4%.

The biggest threat to growth of the manufacturing sector is the precipitous drop in exports. In the first month, July 2015, exports have plummeted by almost 17% in relation to the corresponding month of 2014. The textile industry is up in revolt after the imposition of taxes and surcharges on electricity and gas. The rupee remains significantly overvalued and this has impaired the competitiveness of our exports. Similarly, after a long time, remittances are beginning to flatten out, with less than one percent growth in July.

The year, 2014-15, witnessed a major recovery in the iron and steel products industry, primarily because of resumption of production by the Pakistan Steel Mill. Almost one third of the overall growth of the large-scale manufacturing sector was due to the iron and steel industry. But the news has come that PASMIC is shut down once again. In addition, industries like fertilizer are likely to be hit by the imposition of the GIDC. Falling exports, rising costs and factory closures render difficult the prospect of achieving 6% growth in manufacturing in 2015-16.

Turning to inflation, the good news is that the year-to-year inflation in the consumer price index is down to only 1.8% in July. In fact, the wholesale price index has been declining every month since December 2014. The economy shows signs of having entered a period of low inflation or even deflation. However, as the 'low base effect' begins to take over, the rate of inflation could start rising once again and reach up to five percent in the next five to six months. Also, low commodity prices, especially of oil, are likely to persist. The Annual Plan assumption of an average rate of inflation of 6% in 2015-16 is likely to be on the high side. This is, of course, good news for consumers but it will be very difficult to achieve a 20% growth in FBR revenues. Already, in the first month, July, these revenues have shown growth of only 11%. We are likely, therefore, to see a spate of mini-budgets, like last year.

The revival of investment will also hinge on a number of factors. First, will the noticeable fall in interest rates spur private investment. But in the first month, July, bank credit to the private sector has actually declined by Rs.68 billion. Perhaps this is seasonal in nature and subsequent months will reveal what is happening. Second, releases to the Planning Commission in the first five weeks of 2015-16 have been a paltry Rs.45 billion, equivalent to only six percent of the annual PSDP of Rs.700 billion.

There are also some movements in money supply in July, which are potentially a cause for concern if they persist. Currency in circulation has increased by almost Rs.112 billion more while deposits have shown a larger decline of Rs.38 billion. Is this the consequence of the 0.6% tax on banking transactions and/ or falling interest rates?

Overall, the outcomes in the first month of 2015 have not been very promising. Hopefully, part of this is either random or seasonal in nature. But there are some early warning signs and corrective policy actions may need to be considered sooner than later. This is third year of the present Government and it needs to demonstrate that there has been a sustained recovery in the economy, especially with increased support from international agencies and media.