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Review of the Economy: July-December 2016-17

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About the Author

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About IPR

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Executive Summary

Overview

The first half of 2016-17 saw an increase in Pakistan's twin fiscal and current account deficits. This does not bode well for the incipient revival of the Pakistan economy. The deficits are structural in nature. They are a consequence of an approach to policy making by successive governments that deal with symptoms, but not fundamental economic issues. They are a constraint on growth.

For the half year July-December 2016-17, fiscal deficit was 2.4% of GDP, almost twice that for the same period last year and well above the proportionate target for the fiscal year. Increase in current account deficit was even more serious. At 2.6% of GDP it has breached already the year's target of 1.5% of GDP. These factors mean that it will be difficult to keep some of the essential underpinnings of the economic revival.

Low discount rate of 5.75% and bank liquidity have helped stimulate private credit. Equally, import of machinery and of energy products have contributed to economic growth. An improving security situation, CPEC investments, and increase in overall development spending should begin to strengthen investor confidence.

With a rising current account deficit and increase in external debt, it is to be seen how long these growth inducing factors will stay. Already, SBP has tried to restrict import by imposing a condition of 100 percent cash margin on the import of over 400 mainly consumer items. Uptick in inflation may force SBP to increase the discount rate.

Resultantly, public debt including external debt has increased. During the half year, total public debt increased by Rs 610 Billion, including

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USD 129 Million external debt. This year's external debt amount is after revaluation gain of USD 2 Billion from depreciation of the Japanese Yen. Total external debt and liabilities grew by USD 1,063 Million because of Bank and private borrowing. Current year's increase in debt is on top of last year's Rs. 1.4 Trillion in domestic debt and USD 6.8 Billion in external debt. The economy is borrowing to stay afloat.

Looking at the major indicators, IPR expects GDP growth rate for the year to be above 5%, though perhaps it will fall short of the target of 5.7%. Against a target of a growth rate of 5.9%, LSM grew by 3.9% for the half year. The target for agriculture growth is 3.5% over last year. Production of major crops fell last fiscal year. Though there is some increase, it is yet not clear if agriculture will achieve the target growth of 3.5%. Overall crop production will be nowhere close to that of 2014-15.

There is some improvement in exports, which have been falling for two years. For the half year, export fell by 3.9% when compared with the same period last year. Accompanied by rising imports, trade deficit is on the rise. Together with fall in workers' remittances and no major increase in FDI, this has considerably stressed the balance of payment.

Growth

LSM: The Annual Plan 2016-17 estimates that industry will grow by 7.7% with 5.9% increase in LSM. Against this target, year on year growth in LSM was 3.97% during July-December 2016-17. Most major LSM industries grew, especially food and beverages, non-metallic minerals, and pharmaceuticals, though by small margins. Pakistan manufacturing's mainstay of textiles also grew by a slight margin of 0.04%. Some industries declined. These include Coke & Petroleum products, Chemicals, Leather Products, and Engineering Products. Industries within a group show diverse trends. Within autos, production of jeeps and cars and LCVs declined by 2.7% and 41.5% respectively. On the other hand, production of tractors, buses, trucks, and motor cycles grew rapidly. Overall, it appears that LSM growth for fiscal 2016-17 will be short of the target of 5.9%.

In the medium term, real manufacturing growth will come from good policies and structural reforms. In the near term, a lot depends on Pakistan's ability to quickly complete construction of CPEC industrial parks and manage them effectively. Workers' skills and access to credit are also important.

Agriculture: The six-month period saw a mixed trend in agriculture production, with some revival after major declines in fiscal 2015-16. Cotton production fell by 30% in 2015-16. This year's estimate is 7.7 Million bales, up by 10%, though well below last years' level. After a slight decline, last year, rice production is estimated to fall further this year. Pakistan produced 6.9 Million tons of rice in 2014-15, which declined to 6.8 Million tons in 2015-16. The estimate for 2016-17 is 6.64 Million tons. Sugarcane production would likely be above the target of 67.5 Million Tons. Output is expected to cross 71 million tons. Wheat production is projected to equal or slightly exceed last year's production of 25.1 Million tons. Government will count on increase in livestock, forestry, and fishing to compensate the mixed trend in crops. Data on the latter is less than robust.

Services have shown mixed performance. On the one hand, higher agriculture and industry production, a surge in vehicle sales, growth in private credit, and increase in trade suggest buoyancy. On the other, PSE losses and reduced bank profits have slowed its progress.

Low agriculture productivity and production volatility have become endemic. Production is still contingent on international prices, weather conditions, and spread of virus. Without investment in water infrastructure, improvement in water use and service delivery, and appropriate research, extension services, and policy interventions, growth of farm produce stays uncertain. There isn't enough analysis or information why production levels vary year to year.

Power supply: Power supply was again a constraint on economic activity. For the period July-November 2016, total power supply was 47,627, GWh. This was 4% higher than the power supply for the same period in 2015. The 4% increase in power supply is below the rate of increase in GDP. Government's plans for increase in generation capacity will begin to show soon. Whether addition to generation capacity is enough to ensure reliable power supply in the country is open to question. There is no improvement in DISCO level governance, which in the days of low oil prices is the key reason for circular debt. Similarly, though government has invested in transmission lines, it is not clear if this is enough to create a reliable T&D system. Increase in import of generation equipment suggests that capacity will continue to be added.

Investment: For 2016-17, the Annual Plan sets an investment target of 17.7% of GDP from private sector and public and private CPEC projects. So far, progress is good. Pakistan imported machinery worth USD 5,687 Million during July December 2016, an increase of 41% over the same period last year. This increase follows the already considerable growth in machinery import of machinery last year.

During the half year, credit to private sector increased by 31% to Rs. 357 Billion from Rs. 273 Billion. Increase in private credit will stimulate investment. A large part of this went to fixed investment.

Project execution has shown good progress as GoP released development funds at a brisk pace. For the half year, total amount released, including foreign aid, was Rs. 483 Billion, i.e. 60% of the budget of Rs. 800 Billion. Project implementation in certain sectors was rapid. These include LNG power generation, Highways, Railways, and PAEC.

Public Finance

Budget deficit for the first half was 2.4% of GDP. Actual deficit in the current year will exceed the target deficit of 3.8%. By December 2016, total federal tax revenue of Rs. 1,595 Billion was 5% above the same period last year. FBR tax collection has done better. Year on year increase for July-December 2016-17 is 6% above last year's revenue for the same period. This year's target is 16% above last fiscal's actuals. It is important to view this in perspective. Last year, FBR taxes registered unprecedented increase of more than 20%. Last year, FBR exceeded its target. One constraint this year is that government has allowed exemptions in many areas, especially to help CPEC investment. In addition, as a generic issue, increase in tax collection is the result of political decisions to amend policy.

FBR's direct tax collection has been commendable. Second quarter direct tax revenue was 17.8% above last year's second quarter direct tax. Cumulative increase in direct tax collection for the half year was 8.4%. Incentives and concessions to promote economic activity affected indirect tax revenue. Sales tax, with a share of 67% of all indirect tax declined marginally. Customs duty increased by over 22%. Non-tax revenue is a concern. Federal government's non-tax revenues were 35% below the same period last year.

Public Debt: Federal government debt has increased rapidly. In six months, GoP has added debt of about Rs. 610 Billion. Of this amount, Rs. 43 Billion is from external sources. For domestic debt, GoP has borrowed heavily short term (mostly MTBs). This grew by Rs. 1,236 Billion, while long term debt has decreased by Rs. 669.5 Billion. The net addition of Rs. 566.7 Billion is on top of last year's increase of Rs. 1,098 Billion. The economy's total external debt and liabilities grew by USD 1,063 Million during the six months because of bank and private borrowing.

Balance of Payment: Table 13 shows that Pakistan's stressed balance of payment for July-February has already breached most Annual Plan's targets for the whole year. The current account and financial accounts are imbalanced. The situation could have been worse without inflows for foreign portfolio investment. These are temporary in nature. The combination of stagnant exports, dip in workers' remittance, and modest FDI increase constrains Pakistan's balance of payment. It is a growth limiting factor. Pakistan has had higher current account deficits before. But they were financed by grant aid or FDI. In other cases, we had to go for IMF arrangements. Having just ended an IMF programme, it is unclear what choice the country has now. To grow, the country must make fundamental reforms.

Pakistan's continued macroeconomic challenges affect the country's ability for sustained growth. The country needs deep reforms in many areas. They call for political will.

Review of the Economy
July-December 2016-17

1. Targets

As detailed in Budget 2016-17 and Annual Plan 2016-17, government set the following economic targets for fiscal 2016-17:

- GDP growth: A target of 5.7% has been set for GDP growth for fiscal 2016-17, with agriculture growth of 3.5%, industry 7.7%, and services 5.7%. Within Industry, large scale manufacturing is set to grow by 5.9%. These estimates are considerably above those achieved in 2015-16. Official estimate of GDP growth for 2015-16 is 4.7%, with agriculture growth at negative 0.19 %, industry and LSM at 6.1% and 3.1% respectively, and services at 5.7%[1].

- Fiscal deficit: Despite projection of a high GDP growth rate, government rightly still considers fiscal consolidation an objective, to maintain strong fundamentals. The 2016-17 fiscal deficit target is 3.8% compared to an actual of 4.3% for 2015-16[2]. This will be achieved through 15.7% increase in total revenue (with 16.7% increase in FBR taxes) and by limiting increase in current expenditure to 6.8%[3]. An important component of the federal budget is a provincial surplus of Rs. 339 Billion[4]. The 2015-16 estimate was Rs. 297 Billion, but the actual surplus was Rs. 207 Billion[5].

- Savings and Investment: GoP plans higher investment in the economy based on growth in savings and FDI. This will lead to growth in GDP. Fiscal year 2016-17 targets for savings and investments are 16.2% and 17.7% respectively. The corresponding actuals for 2015-16 were 14.6 and 15.2%[6]. IMF's preliminary actuals for the two indicators for 2015-16 are 14.2% and 15.2%[7] (the latter is gross capital formation a slightly different measure than investment to GDP ratio).

- Inflation: The target for inflation in 2016-17 is 6% compared to an increase of 3.19 in CPI for 2015-16[8]. Increase in SPI and wholesale prices was much lower while core inflation rose by 4.6%.
- External Account: GoP has set a target of 10.8% growth in exports in 2016-17, (to USD 24.8 Billion, fob). In 2015-16, exports declined by 12%. With expected increase in

[1] Planning Commission GOP, Annual Plan 2016-17, Pages 1 through 9, and National Accounts 2015-16
[2] MOF, Budget Speech by Finance Minister, June 2016, Page 5
[3] MOF, Budget in Brief Table 8
[4] MoF, Budget in Brief Page 51
[5] SBP, State of the Economy, Annual Report 2015-16
[6] Planning Commission, Annual Plan 2016-17, Page 10 Annex II
[7] IMF Twelfth Review under the Extended Arrangement, Table 4, Page 33
[8] IPR, Annual Review of the Economy 2015-16, Page 13

imports the trade balance is targeted to be USD 20.5 Billion in 2016-17[9], it was USD 18.4 Billion in 2015-16[10] (both fob). Pakistan Bureau of Statistics reports a trade deficit on goods of USD 21.2 Billion for 2015-16. The Annual Plan estimates current account deficit of 1.5% of GDP against actual of 0.9% in 2015-16[11]. FDI for 2016-17 is targeted at USD 4.5 Billion compared to USD 1.3 Billion in 2015-16[12].

- In addition to macroeconomic stability, GoP has predicated increase in growth on a number of drivers. These include growth in commodity producing sectors as well as services. The stimulus is expected to come from higher debt and equity flows from China (CPEC investments) and higher savings and investments from within the economy. An easy monetary policy with low capital cost will increase private credit and investment. The government estimates that increase in power production, telecom connectivity, and upgraded water infrastructure for agriculture will stimulate GDP growth sufficiently.

This is the first financial year for the current government to proceed largely without IMF's mandatory review. It is most likely though that from here on election politics would guide policy.

2. Economic Performance

GDP Growth: Let us look at the key determinants of growth, which include industry, especially LSM growth, as well as agriculture and services. Let's look at growth indicators to gauge economic performance for first half 2016-17.

Industry: In 2015-16, Industry contributed about 20% to total GDP. The share of manufacturing in total is about 14%. LSM has a share of about 11% of GDP[13] . The Annual Plan 2016-17 estimates that industry will grow by 7.7% with 5.9% increase in LSM[14]. Against this target, year on year growth in LSM was 3.97% during July-December 2016-17[15]. LSM growth for the corresponding period last year was 4.06%. Growth rate in January 2017 declined sharply to cause correction in year on year growth.

Most major LSM industries grew during the period, especially food and beverages, non-metallic minerals, and pharmaceuticals, though by small margins. Pakistan manufacturing's mainstay of textiles also grew by a slight margin of 0.04%. Some industries declined. These include Coke & Petroleum products, Chemicals, Leather

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[9] Planning Commission, Annual Plan Page 102
[10] SBP Export receipts, Import payments, and Balance of Trade
[11] Ibid Page 105
[12] Board of Investment, Pakistan, Foreign Investment inflows in Pakistan($Millions), FDI target from Annual Plan Page 105
[13] MoF, Pakistan Economic Survey, Statistical Appendix Table 1.1
[14] Planning Commission, Annual Plan 2016-17 Page 9
[15] Pakistan Bureau of Statistics, Quantum Index of Large Scale Manufacturing, July-December 2016-17 compared to the same corresponding period for 2015-16.

Products, and Engineering Products (see Table 1). Industries within a group show diverse trends. Within autos, production of jeeps and cars and LCVs declined by 2.7% and 41.5% respectively. On the other hand, production of tractors, buses, trucks, and motor cycles grew rapidly.

Table 1
Change in Quantum Index of Manufacturing
July-December 2016-17 over 2015-16

Manufacturing Items	Weight	% Change	YoY Growth Impact
		July-December 2016-17	Cumulative
Textile	20.915	0.14	0.04
Food, Beverages & Tobacco	12.370	6.95	1.16
Coke & Petroleum Products	5.514	-1.33	-0.09
Pharmaceuticals	3.620	7.90	0.68
Chemicals	1.717	-2.70	-0.07
Non-Metallic Mineral Products	5.364	9.31	1.02
Automobiles	4.613	6.67	0.45
Fertilizer	4.441	3.47	0.23
Leather Products	0.859	-18.93	-0.38
Rubber Products	0.262	0.45	0.00
Iron & Steel Products	5.392	15.63	0.53
Electronics	1.963	14.35	022
Paper & Board	2.314	5.69	0.19
Engineering Products	0.400	-4.63	-0.01
Wood Products	0.588	-96.41	-0.08

Source: Adapted from PBS QIM for December[16]

Despite claims about revival in manufacturing, it appears that LSM growth for fiscal 2016-17 will fall short of its target of 5.9%. When it comes, the revival will be based on a combination of factors. Real manufacturing growth will come from good policies and structural reforms. Immediately, Chinese public and private investment will stimulate manufacturing. If successful, operation of SEZs and industrial parks will give a major boost. A lot depends on Pakistan's ability to quickly complete construction of industrial

[16]Provisional Quantum Index Numbers of Large Scale Manufacturing Industries (QIM) http://www.pbs.gov.pk/sites/default/files//industry_mining_and_energy/qim/2017/qim_webnote_dec_16.pdf

parks. Several things will matter: their location, the support services (including one window), logistics, their overall management, and ability to target "backward" industries from other economies that are one or two steps higher in technology. Thus far, Chinese have invested in infrastructure projects, not in manufacturing.

Improved macro fundamentals, at least in the short-term, has helped lower interest rate as have fall in international commodity prices. SBP's discount rate stays at 5.75%[17]. Retirement of government borrowing from commercial banks also helped. For the period 1 July to 17 March, private credit grew by 31% during 2016-17 over the same period last year[18]. Private sector borrowing was Rs. 357 Billion as compared to Rs. 273 Billion. It is likely that private CPEC projects fueled the demand. Increase in interbank liquidity brought down weighted cost of capital. GoP's preference to fund fiscal deficit from SBP and retire commercial debt helped.

- **Agriculture growth:** The six-month period saw a mixed trend in agriculture production, with some revival after major declines in fiscal 2015-16. Cotton production fell by 30% in 2015-16. It fell from 10.6 Million bales (480 lbs.) in 2014-15 to 7 Million bales in 2015-16. This year's estimate is 7.7 Million bales, up by 10%, though well below previous year's level. After a slight decline last year, rice production is estimated to fall further this year. Pakistan produced 6.9 Million tons of rice in 2014-15, which declined to 6.8 Million tons in 2015-16. The estimate for 2016-17 is 6.64 Million tons[19]. Sugarcane production would likely be above the target of 67.5 Million Tons. Output is expected to cross 71 million tons[20]. The US Department of Agriculture estimates a growth of about 9% over last year[21]. However, their production estimates are below SBP's numbers. Wheat production is projected to equal or slightly exceed last year's production of 25.1 Million tons. Estimated production is 25.3 Million tons[22]. It is to be seen if low rainfall this year may have affected total production.
- The aggregate of cotton, rice, and sugarcane has a share of 52% in total agriculture production. The above increase will reflect in GDP growth rate. Continued increase in fertilizer production, though phosphate fell slightly, suggest stable off take, especially as imports also have grown by 17% in quantity from last year[23].
- Production of oilseeds is estimated to increase by 11%. Rapeseed will grow by 56% in production and cottonseed by 10%. Their overall production volume and contribution to agriculture is limited.

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[17] Express Tribune, Monetary Policy: SBP leaves interest rate unchanged at 5.75%, 25 March 2017
[18] SBP, Provisional Data on Monetary Aggregates as on March 17, 2017
[19] All data from US Department of Agriculture, Food, and Agriculture Service
[20] SBP, State of Pakistan's Economy, Q1 FY 17, Page 14
[21] http://www.indexmundi.com/agriculture/?country=pk&commodity=centrifugal-sugar&graph=cane-sugar-production
[22] USDA, Food and Agriculture Service, World Agriculture Production
[23] Ministry of Commerce, GOP, Comparative Imports of Selected Commodities

- Government's 5.7% target for GDP growth rate is in part based on growth of 3.5% in agriculture. There was a fall of about 7% in the value of crops produced in 2015-16. This year will likely see an increase in production. Government will count on increase in livestock, forestry, and fishing to compensate. Data on the latter is less than robust.
- At the macro level, however, agriculture productivity is low and volatility is endemic. Production remains contingent on international prices, weather conditions, and virus affecting production. Without investment in water infrastructure, improvement in water use and service delivery, and appropriate research, extension services, and policy interventions, growth of farm produce remains uncertain. Adequate research does not exist. There isn't enough analysis why production levels vary year to year.

The power sector: Power supply was again a constraint on economic activity. For the period July-November 2016, total power supply was 47,627, GWh[24]. This was 4% higher than the power supply for the same period in 2015. Updated numbers for billing and recoveries by DISCO are not available. In the last few years, there have been minor annual increases in power generation. The 4% increase in power supply is below the rate of increase in GDP. Experts estimate an elasticity of over one for demand of power for each percentage point growth in GDP. Government's plans for increase in generation capacity will begin to show soon. Coal fired 1320 MW Sahiwal plant is in trial run. Chashma 4 will be in operation this year. Already, two new projects have come onstream to add 435 MW. Whether addition to generation capacity is enough to ensure reliable power supply in the country is open to question. There is no improvement in DISCO level governance, which in the days of low oil prices is the key reason for circular debt. Similarly, though government has invested in transmission lines, it is not clear if this is enough to create a reliable T&D system. Increase in import of generation equipment suggests that capacity will continue to be added.

Other Headwinds: In addition, a few headwinds stall growth. These have encumbered Pakistan's economy for some years. Despite strong resolve shown by the state, security in Pakistan remains a challenge. It would likely be so for the near future. Social tensions, regional instability, and displaced persons (though reduced in number) continue to thwart economic activity.

For the medium-term, it is important to remember that sustained growth needs strong macro fundamentals, enhancement in productivity through investment in human resource, and improved infrastructure. These factors crowd in private investment. Most social indicators show Pakistan well behind other emerging economies. More significantly, there is no thought given to job growth for the two million young Pakistanis entering the job market each year. We need a programme of workers' skills training.

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[24] Central Power Purchase Agency Guarantee Ltd. (CPPA), settlement and billing statements for November 2016 compared with November 2015.

Public investment in infrastructure must be based on judicious selection of projects with high economic returns. This is, at best, work in progress. Despite government's good work on fiscal consolidation, IPR fears that macro fundamentals would remain vulnerable as continued borrowing (especially external) for investment would increase indebtedness. Improvement in domestic savings is necessary to increase investment to contain indebtedness. Traditionally, external debt, other than IMF support, funded projects while government met current expenditure from tax and non-tax revenues, and from domestic borrowings. Presently, part of the external debt also finances current expenditure. This adds to the economy's vulnerability. This will likely continue in the future. IMF estimates savings will reach 15.1% by 2019-20[25]. To meet government's plan for increase in investment to 20% of GDP, the economy must rely on external savings by almost 5% of GDP. At current GDP value, this means additional about USD 16 Billion per year. Pakistan must very significantly increase FDI as incurring further debt is unsustainable.

3. Investment

The Annual Plan sets a target of 17.7% of GDP for total investment in fiscal year 2016-17. This target is unchanged from the target set for the last fiscal year. The Annual Plan estimates that this increase will come from private investment as well as from public and private CPEC projects. It is important to review the indicators for this increase: import of machinery, PSDP releases, and bank credit.

3A Import of Machinery

In an encouraging development, Pakistan imported machinery worth USD 5,687 Million during July December 2016, an increase of 41% over the same period previous year Machinery import increased in a range of sectors including power generation, office machinery, textiles, agriculture, construction and mining, and electrical machinery.

This increase follows upon considerable increase in 2015-16 in import of power machinery (34%), electrical machinery (50%), and for construction and mining (27%). Since 2015-16, import of power generation machinery has gained momentum. In 2015-16, Pakistan imported power generation machinery worth USD 1.8 Billion. That equals additional capacity of about 1700 to 1800 MW. Since then, an added USD 1,652 Million worth of machinery imported during the half year under review, suggests an increase in generation capacity by 1,500 MW. Pakistan should get close to its target of increasing power generation by 13,000 MW by 2020 (10,700 MW under CPEC and 2,400 MW LNG). Much of this will be on stream by 2018. Increase in import of all other machineries is a positive sign and perhaps reflects manufacturing revival.

[25] IMF Twelfth Review

Table 2 Machinery Imports July-December USD Million			
	2015-16	**2016-17**	**Growth %**
Power Generation Machinery	790.2	1651.7	109.0
Office Machinery	149.5	258.6	73.0
Textile Machinery	232.4	258.6	11.3
Construction & Mining	161.9	250.8	54.9
Electrical Machinery	892.4	982.5	7.9
Telecom	694.5	660.1	-5.0
Agriculture Machinery	43.5	50.0	15.0
Other Machinery	1059.2	1574.3	48.53
Total	**4,023.6**	**5,686.6**	**41.3**
Source: Trade Statistics, Ministry of Commerce based on PBS data[26]			

3B PSDP Releases

Project execution has shown good progress as development fund released at a brisk pace. For the half year, up to 6 January 2017, total amount released, including foreign aid was Rs. 483 Billion, i.e. 60% of the budget of Rs. 800 Billion. Project implementation in certain sectors was rapid. However, progress was uneven across sectors, which suggests government's preference. Release of funds was high in LNG power generation, highways, Railways, and PAEC. It was slow in some key sectors including water sector, health, and HEC. Selected sectoral releases are in Table 3.

Roads and motorways is a stated priority of the government. Roads also are a major part of CPEC's public investment and have merited top-level monitoring.

Releases do not necessarily mean that money has been spent. Economic growth and further progress of project depend on actual expenditure. Compared to the Rs. 482.7 Billion released, the amount spent and booked by Finance Ministry for the first two quarters is Rs. 198 Billion. There is an inherent lag in amount released and spent.

[26] Comparative Imports of Selected commodities July-Dec 2016-17 and July-Dec 2015-16 http://www.commerce.gov.pk/wp-content/uploads/2017/01/Comparative_Imp_Selected_Comodities_July-Dec_2016.pdf

Table 3 PSDP Releases 2016-17 Rs. Billion				
	Budget Full Year		Releases 2016-17 Up to 06-01-2017	% Released
	2015-16	2016-17		
HEC	20.5	21.5	8.5	39.5
Health	20.7	24.9	9.7	38.9
PAEC	30.4	28.7	17.3	60.3
Railways	41.0	41.0	24.3	59.3
Water Sector	30.1	31.7	9.4	29.6
NHA	159.6	188.0	149.8	79.7
Power	112.3	130.0	108.8	83.7
Others	285.4	334.2	154.9	
Total	**700.0**	**800.0**	**482.7**	**60.3**
Source: Planning Commission, Status of PSDP Releases as on 10-03-2017[27]				

Public investment is important to increase economic productivity and to crowd in private investment. While it is encouraging to see a 14% increase in total federal PSDP budget this year (from Rs. 700 Billion in 2015-16 to Rs. 800 Billion in 2016-17, Table 3), IPR is concerned at some of government's priorities. Higher education and national health services have reduced budgets when compared with fiscal 2014-15. The water sector is one third lower than its budget for 2014-15. These three sectors are important determinants of growth and productivity. More importantly, they could defuse the time bomb posed by the youth bulge. In the coming years, water scarcity could pose a greater challenge to the country than power does at present. It has begun to affect seriously our agriculture. It could likely lead to friction among provinces as well as with neighbouring countries. Each year, highways receive a disproportionate increase in allocation. The economic return on grand highways projects is yet to be proven in Pakistan. IPR welcomes increase in allocation for the power sector. It is concerned though that the exclusive focus of the increase is on two LNG power projects[28]. The medium term economic viability of LNG generation is yet unproven. Many questions remain unanswered about LNG power projects.

For it to be an engine of growth, public investment needs well considered project selection as well as quality governance. Public investment increases output and jobs as well as help efficiency all around. However, public projects at inflated costs, with further cost and time overruns, and the presence of prestige projects in the portfolio, reduce economic impact. Increased spending levels, however, will have immediate gains for short-term economic growth.

[27] http://pc.gov.pk/uploads/archives/ReleaseSummary2016-17_10-03-2017.pdf
[28] PC, PSDP 2016-17, Items 756 and 757

As said before, government's macro-economic framework sets a target of 17.7% as investment to GDP ratio and 16.2% for savings to GDP. These targets are above the actual for 2015-16 of 15.2% and 14.6 % respectively. The target for total fixed investment is 16.1%. Of this, public investment is 3.9% and private is 12.2%. As in earlier years, savings will fall short of target. The estimate includes workers' remittances of 1.5% of GDP, an increase from last year's 0.4%. However, workers' remittance has declined this year by 2.5% by February 2017. Just on this account savings will be shy by 1% of GDP.

Overall, Pakistan's investment/GDP ratio is well below growth economies. By comparison, in 2015, China, India, and Vietnam invested 46%, 32%, and 28% of GDP respectively. The growth rate of these economies that year was 6.9%, 7.6%, and 6.7% respectively[29].

With respect to public sector investment, GoP's budgeted public sector development programme (different from public investment[30]) is Rs. 1,675 Billion or 5.6%. Against this amount, IMF projects PSDP expenditure of Rs. 1,255 Billion for FY 2016-17 (Table 8). Last year, combined PSDP spending amounted to Rs. 1,186 against the budget of Rs. 1,514 Billion (these figures do not include other development expenditure). However, this year pace of expenditure of both provincial and federal expenditures is better than last year.

The fixed investment target of 16.1%, depends on private investment of 12.2%. Last year, private investment was 9.8% of GDP. Machinery imports suggest higher overall investments and likely private investment (Table 2 above). SBP data shows increase in credit to the private sector. At USD 1,285 Million for July-February 2016-17, FDI too has increased by 6% over the corresponding period last year[31]. We expect private investment to do better than last year and come close to the target of about 12.2% of GDP.

3C Bank Credit

A look at net assets of the banking system shows increase in borrowing by government as well as the private sector. During current fiscal, net borrowing by government up to 17 March 2017, was 26% above the same period last year. A key feature this year is that government borrowed funds from SBP and retired scheduled bank debt. Net government borrowing in the current fiscal year is Rs. 603 Billion up to 17 March 2017, up from Rs. 478 Billion. During the same period, credit to private sector increased by 31% to Rs. 357 Billion from Rs. 273 Billion[32]. Increase in private credit will stimulate investment. During the first quarter, all private loans went to fixed investment. Accompanied by strong increase

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[29] IPR, Reengineering Economic Structure, March 2017

[30] Public investment estimates are derived by PBS from MOF and PC data about actual development/investment component in current and development expenditures.

[31] BOI Country wise FDI flows in Millions http://boi.gov.pk/foreigninvestmentinpakistan.aspx and SBP Summary Balance of Payments

[32] State Bank of Pakistan, Provisional Data on Monetary Aggregates as on 17 March 2017, http://sbp.org.pk/ecodata/BroadMoney_M2.pdf

in machinery imports, this suggests "BMR in existing manufacturing as well as progress in energy and infrastructure related projects under the CPEC"[33].

3D Inflation

GOP's Annual Plan for 2016-17 targets a 6% inflation rate[34]. Based on government's fiscal consolidation measures and fall in international commodity prices, inflation has been well under control for two years. However, all inflation measures show an uptick compared to last year. From now on, SBP and government must keep an eye on increase in inflation. For the period July 2016 to December 2016, year on year CPI was 3.88% compared to 2.08% for the corresponding period in the previous year. For the same period, Sensitive Price Index increased to 1.35% from 0.26, and WPI has turned around from -2.35 to 3.06. In December 2016, core inflation that includes items other than food and energy was 5.2% compared to 4.1% in December 2015. Also, core inflation (non-food non-energy) is higher than CPI, SPI, and WPI[35]. This also suggests a revival in overall demand in the economy.

Food inflation has grown at a rate below overall CPI. In December 2016, year on year food inflation was 2.43%, though rate increase of perishable items was higher at 3.02%. Food items whose prices increased included Eggs (6.86%), Tea (3.0%), Cigarettes (2.21%), Gram Whole (1.69%), Fish (1.32%), Besan (1.1%) and Vegetable Ghee (1.02%). Decrease was seen Potatoes (19.88%), Fresh Vegetables (19.8%), Sugar (13.44%), Chicken (9.94%), Gur (4.74%), Pulse Mash (4.34%), Tomatoes (2.97%), Onion (2.7%), Pulse Masoor (2.24%), and Pulse Moong (2.11%)[36].

Table 4
July-December 2017 Inflation and YoY Changes

Percentage

	Averages Changes %			YoY Changes for December %		
	2016-17	2015-16	2014-15	2016	2015	2014
CPI	3.88	2.08	6.08	3.70	3.19	4.30
SPI	1.35	0.26	3.47	0.53	2.91	0.77
WPI	3.06	-2.35	2.13	3.08	-0.42	-0.89

Source: Reproduced Table from PBS Monthly Review of Price Indices December 2016[37]

[33] SBP State of the Pakistan Economy, Q1 FY 17, Page 32, Table 3.4
[34] Planning Commission, Annual Plan 2016-16, Page 10 (Annexure II)
[35] Pakistan Bureau of Statistics, Monthly Review of Price Indices, December 2016, Table 1 and Table 1.1
[36] Pakistan Bureau of Statistics, Monthly Review of Price Indices, December 2016,Notes to Table 2 and Annexure A
[37] http://www.pbs.gov.pk/sites/default/files//price_statistics/monthly_price_indices/2017/cpi_review_december_2016.pdf

As fall in inflation is worldwide, it helps to place in context price changes in Pakistan. Table 5 compares Pakistan's CPI with selected countries:

Table 5
Inflation Country Comparison

%

Country or Region	CPI 2015	CPI 2016	GDP growth 2016
Pakistan	3.2	3.7	5.0 to 5.5
China PRC	1.4	2.0	6.6
India	4.9	4.9	7.6
Vietnam	0.6	2.0	6.1
Bangladesh	6.4	6.7	6.9
USA	0.1	1.2	1.6

Source: IMF data Market Sector by Indicator for all, Pakistan national data PBS and IPR estimate for GDP

The CPI for 2015 was universally lower than for 2014, but sees an uptick in 2016. Pakistan's CPI reflects our fiscal consolidation preference. Inflation in India and Bangladesh is higher than in other countries. This is perhaps because they have pursued aggressive growth policy, including correction in the value of their currencies. Regardless, fall in commodity prices was a world phenomenon that began in 2014. World economy also has grown at a slow rate since 2008 and demand worldwide seemed to have plateaued. Inflation and growth rates in China and Vietnam suggest a lack of correlation between the two indicators in these countries. Clearly, their growth comes from higher productivity increases rather than fiscal policy.

IPR has some observations on computation of inflation indices. In its report for July-December 2014, IPR discussed the dampening effect on inflation for procedural and methodological reasons. These pertain to jerks in housing rent assessment that may lead to effect on monthly and quarterly CPI calculation. Inflation is underestimated also as PBS does not include fuel charge adjustments and the many surcharges in power tariff. This understates electricity prices. The fall in inflation may have been limited by frequent increase in indirect taxes. Also, PKR lost value by a few percentage points in recent months.

Table 6 Inflation in Major Food Items, Commodities, and Services, December 2017 YoY		
	Weight in CPI	**Inflation %**
General CPI	**100.00**	**3.70**
Food Group	**34.83**	**2.43**
Wheat flour	4.16	1.72
Rice	1.58	2.44
Meat	2.43	3.48
Chicken	1.36	-12.37
Milk (fresh)	6.68	3.45
Cooking oil	1.75	1.02
Vegetable ghee	2.07	2.76
Fresh fruits	1.86	9.50
Pulses	0.95	24.45
Vegetables	1.66	22.04
Sugar	1.04	11.54
Tea	0.84	-5.44
Cigarettes	1.39	11.60
Clothing and Footwear	**7.57**	**4.40**
Cotton cloth	1.73	4.64
Readymade garments	0.97	5.10
Tailoring	0.88	7.82
Housing, Electricity, Gas	**29.41**	**4.93**
House rent	21.81	6.65
Electricity	4.40	0.00
Gas	1.57	0.00
Health	**2.19**	**8.35**
Drugs and Medicines	1.27	8.83
Doctors’ fee	0.59	8.90
Transport	**7.20**	**-3.20**
Motor Fuel	3.03	-7.15
Transport Services	2.70	-2.54
Communication	**3.22**	**0.74**
Recreation & Culture	**2.02**	**1.47**
Education	**3.94**	**11.51**
Restaurants and Hotels	**1.23**	**4.87**
Misc. Goods and Services	**2.75**	**5.08**
Source: PBS, Monthly Review of Prices, Annexure A, December 2016[38]		

[38]http://www.pbs.gov.pk/sites/default/files//price_statistics/monthly_price_indices/2017/cpi_review_december_2016.pdf

4. Public Finance

Details of fiscal operations released by Finance Ministry show positive signs:

- Budget deficit for the first half was 2.4% of GDP[39]. It appears that actual deficit will exceed target deficit of 3.8% for the fiscal year[40].
- By December 2016, total federal tax revenue of Rs. 1,595 Billion was 40% of target for the year[41]. Though 5% above the same period last fiscal, it is a little below revenue collection trend of recent years, when 43 to 44% was collected by the half way mark. Total federal taxes collected last year was 44% of the 2015-16 target[42]. Budget estimate of Rs, 3,956 Billion for federal taxes for fiscal 2016-17 is 17% above last fiscal's actual collection of Rs. 3,377 Billion[43].
- FBR tax collection is better. Year on year increase for July-December 2016-17 is 6% above last year's revenue for the same period. The collection was 41% against full year target of Rs. 3,621 Billion. This target is 16% above last fiscal's actuals. It is important to view this in perspective. Last year, FBR taxes registered unprecedented increase of more than 20% over the previous fiscal. FBR exceeded the tax collected target last year. Moreover, government has enhanced tax exemptions in a number of areas, especially to facilitate CPEC investment. Given the inelasticity of the tax structure and the political economy call for political decisions.
- FBR's direct tax collection has been commendable. Second quarter direct tax revenue was 17.8% above last year's second quarter direct tax. Cumulative increase in direct tax collection for the half year was 8.4%. Incentives and concessions to promote economic activity affected indirect tax revenue. Sales tax, with a share of 67% of all indirect tax declined marginally. Customs duty increased by over 22%.
- Budget estimate 2016-17 for Other Taxes is 26% above last year's actual. However, actual collection for the half year July December 2016 was 3% below the corresponding period last year[44].
- Federal government's non-tax revenues are a concern as July-December 2016-17 collections are 35% below the same period last year, though collection improved in Q2. Government may have to watch this head, as its budget estimate for the year is a high (perhaps unrealistic) 36% above last year's collection. Collection in all non-tax heads have declined[45]. Dividend and profits from oil companies have fallen with low oil

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[39] Ministry of Finance, Summary of Consolidated Federal and Provincial Budgetary Operations, July-December 2016-17, Table 1
[40] MOF, Budget Speech by Finance Minister, June 2016, Page 5
[41] MoF Fiscal Operations, July-December 2016, Table 4
[42] MoF, Budget in Brief and Fiscal Operations
[43] Ibid
[44] Op.Cit 33 Table 4
[45] ibid

prices. Also, profits from the State Bank of Pakistan have fallen. Pakistan would likely miss the target of Rs. 959 Billion, even if markup and energy prices rebound.

Table 7
FBR Tax Collection

Billion Rs.

	Budget 16-17	July-Dec 15-16	Jul-Dec 16-17	% Growth 15-16	% Growth 16-17
Direct Tax	1,558	541	586	17.8	8.4
Indirect Tax	2,063	830	881	16.4	6.1
Total	3,621	1,371	1,467	17.0	7.0
	October-December 15-16		**October-December 16-17**		
Direct Tax	301		355		17.8
Indirect Tax	484		487		0.7

- With respect to expenditures, total current and development expenditure of the federal government are within proportional budget. Total federal expenditure increased by 3.85 over the same period last year and current expenditure grew by about 2%. Federal PSDP booked expenditure for July-December 2016 is 25% of the budget for the year. However, it is 26% above the amount spent during the same period last year. Table 3 shows that amount released July-December 2016-17 is 60% of budget. There is lag between release and booking of expenditure. All indications are that the trend of development expenditure is positive. Federal development budget for fiscal 2016-17 (including Other Development expenditure), is 33% over actual for 2015-16. As is the norm, development expenditure should pick up in the second half of fiscal year.
- Government's overall expenditure, including federal and provincial governments, has grown by 10.7%, 6.5% current and 15.5% development.
- The budget deficit for July-December is Rs. 799 Billion. This is 2.4% of GDP compared to 1.7% of GDP in December 2015. As indicated before, proportionately, this exceeds the annual estimate of 3.8%. That target itself is contingent on provincial surplus of Rs. 339 Billion[46]. So far, the provincial surplus is Rs. 91 Billion[47]. Last year, provinces generated a surplus of Rs. 207 Billion against a target of Rs. 297 Billion[48]. It appears that the combination of revenue shortfall (especially from non-tax revenue)

[46] Budget in Brief, Page 51
[47] Mof Fiscal operations Table 10
[48] MOF, Fiscal operations 2015-16

and lower than estimated provincial surplus will lead to a fiscal deficit that is higher than the target.

- So far, interest payment too is on track. First half's payment is 48% of the budget. While servicing of domestic debt is within proportionate budget, it is marginally higher for foreign debt. This trend could continue as GoP has taken large amount of high interest external debt in recent years. In October 2016, GoP again floated a sukuk bond for USD 1 Billion[49]. In addition, GoP received net loans of USD 1.4 Billion, including USD 900 Million commercial borrowing[50].

- MoF's fiscal operations do not give details of organizations in receipt of subsidy. However, six months' expenditure is already equal to budget for the year. Though vary, importantly, power circular debt is again climbing. One estimate puts it at Rs. 414 Billion[51]. State minister for Water and Power mentioned a figure of Rs. 320 Billion. In its annual State of the Pakistan Economy report for 2014-15, SBP cites total circular debt at end-June 2015 as Rs 648 billion[52]. This amount includes Rs. 335 Billion as stock of past debt. Circular debt must be liquidated at some point, which will affect fiscal deficit and other macro economy indicators. The issue of circular debt will remain until government does not reduce line losses and bills and recovers amount due from consumers. Otherwise, increase in generation capacity will increase circular debt. Without governance improvement, the power sector's sustainability will be questionable. That this has happened during a period of low energy prices and three surcharges to help meet the deficit, is surprising. Government has the tariff rationalization surcharge, debt servicing surcharge, and Neelum Jhelum surcharge. Subsidy for other PSEs also will remain as they have neither been reformed or privatized.

- Several other expenditures are likely to weigh on the budget. These include continued expenditure on the pressing need for border and internal security and on settlement of IDPs.

- Of the Rs. 799 Billion deficit financing needs for July-December 2016-17, government has sourced Rs. 241 Billion externally. Of the balance Rs. 558 Billion from internal sources, GoP has financed Rs. 151 Billion from non-banking sources and Rs. 407 Billion from bank[53]. External financing equal 29% of the budgeted amount for the year.

With the economy showing signs of recovery, it is critical that GoP ensure macro stability. However, fiscal and external imbalances (see below) are more than a minor challenge that require immediate action.

[49] Reuters UPDATE, Pakistan says to issue $1 billion sukuk bond within hours
[50] SBP State of the Pakistan Economy, Second Quarterly Report FY17, Pages 4-5
[51] Dawn, Industry Profile: Circular debt cycle, 6 March 2017
[52] SBP State of the Pakistan Economy Annual Report 2014-15, Page 35
[53] MOF, Fiscal operations, Table 10

Table 8
Summary of Public Finance
Budget 2016-17, IMF Projections, Fiscal Operations

Rs. Billion

	Budget 2016-17	**IMF Projections 2016-17**	**Actual Fiscal Operations July-Dec 2016**	**July- Dec % of Budget**
A. Revenue		**5,248**	**1,991**	
A.1Tax Revenue	**4,267**	**4,265**	**1,741**	**40.8**
Federal	3,956	3,921	1,595	40.3
FBR	3,621	3,621	1,467	40.5
Direct	1,558	1,461	586	37.6
Indirect	2,063	2,160	881	42.7
Other taxes	335	295	266	74.9
Provincial	311	344	146	46.9
A.2 Non-Tax Revenue	**--**	**983**	**249**	
Federal	959	874	214	22.3
Provincial		110	35	
B. Expenditure		**6,498**	**2,732[a]**	
B.1 Current Expenditure		**5,248**	**2,242**	
Federal	**3,400**	**3,554**	**1,473**	**43.3**
Interest Payments	1,360	1,362	647	47.6
Defence	860	860	336	39.1
Subsidies	141	154	--	NA
Grants	442	581	141	31.9
Others	597	2,192	103	17.3
Provincial		1,694	768	
B.2 Development Exp & Net Lending		1,250	491	
PSDP	**1,962**	**1,255**	**446**	**22.7**
Federal	800	620	198	24.7
Provincial	875	635	247	28.2
Other Development	157		52	33.1
Lending and grants	94	(5)	(6,424)	6834
E. Fiscal Deficit % GDP	**3.8**	**…….**	**2.4**	**63.2**
F. Financing Net (after provincial surplus of Rs. 297 Billion)	**1,276**	**1,205**	**799**	**62.6**
External	234	424	241	103
Domestic	1,042	782	558	53.5
Bank Non-Bank Grant	453 589	547 234		120.7 39.7
Memorandum Item				
Nominal GDP		**33,130**	**33,509**	

Source:
1. Pakistan revenue and expenditure from MoF Fiscal operations
2. Federal revenue and expenditure estimates from MoF, Budget in Brief
3. IMF Projects from Twelfth Review, Staff Report, Page 35
4. Actuals from MoF Fiscal Operations, various tables
5. In federal non-tax revenue, discrepancy of Rs. 100 Billion between SBP and MoF. The latter source adopted

4A IMF projections

Table 8 compares budget estimates for 2016-17, with fiscal operations for the July-December 2016-17, and IMF's projections:

- GoP and IMF have similar federal tax and non-tax revenue estimates. IMF's projection of direct taxes is Rs. 97 Billion below GoP. Both may have overestimated federal non-tax revenue, though IMF's estimate is Rs. 85 Billion below GoP.
- IMF's estimate of federal government current expenditure is higher by Rs. 154 Billion. IMF estimates higher subsidies and grants payments.
- The budgeted Federal PSDP is Rs. 800 Billion. Provincial budgeted amount is Rs. 875 Billion to total Rs. 1,675 Billion. IMF's corresponding projections are Rs. 620 Billion (22.5% below budget), Rs. 635 Billion (27.5% below budget) and Rs. 1,255 Billion (25% below budget)[54].
- Government estimate for 2016-17 fiscal deficit is Rs. 1,276 Billion. IMF projects a lower number of Rs. 1,250 Billion[55].

Table 9
Federal Government Debt

Billion Rs.

	December 2015	June 2016	December 2016	Increase July-Dec 2016-17
Total Domestic Debt	**12,879.6**	**13,625.9**	**14,192.6**	**566.7**
Long-term	**7,849.6**	**8,624.2**	**7,954.7**	**-669.5**
Market Loans	2.8	2.8	2.8	0
Federal Government Bonds	4.607.6	5,286.6	4,505.7	-780.9
PIBs	4,396.0	4,921.4	4,140.5	-780.9
Prize Bonds	586.8	646.4	707.2	60.8
Unfunded Debt	2,647.6	2,683.7	2,734.3	50.6
NSS	2,494.6	2,526.5	2,579.4	52.9
Foreign Currency Loans	4.7	4.7	4.7	0
Short Term	**5,030.0**	**5,001.7**	**6,237.9**	**1,236.2**
Market Treasury Bills	2,655.8	2,771.4	3,402.4	631
External Debt	**5.072.9**	**5,417.7**	**5,460.7**	**43.0**
Long term	4,941.2	5,240.9	5,310.5	69.6
Short Term	131.8	176.8	150.1	-26.7
Total Federal Government Debt	**17,952.5**	**19,043.6**	**19,653.2**	**610.3**
SBP: Central Government Debt[8]				

[54] For PSDP, Planning Commission, PSDP 2016-17, for IMF projection Twelfth Review,
[55] For GoP estimate, Budget in Brief 2016-17, Page 51, for IMF projection Twelfth Review, Table 6a, Page 35

4B Public Debt

Federal government debt has increased rapidly. In six months, GoP has incurred additional debt of Rs. 609.6 Billion. Of this amount, Rs. 42.9 Billion is from external sources. Within domestic debt increase of Rs. 566.7 Billion, GoP has borrowed heavily short term (mostly MTBs). Short term debt has grown by Rs. 1,236 Billion, while long term debt has decreased by Rs. 669.5 Billion. This addition of Rs. 566.7 Billion is on top of last year's increase of Rs. 1,098 Billion.

5. Balance of Payment

Export performance has been mixed. Though the second quarter of the fiscal year saw improvement, exports have been in free fall for over two years. In 2014-15, they declined 8% from the previous fiscal year. In 2015-16, they fell by a further 12.4% and have taken another hit of 3.8% for the first half 2016-17[56]. Despite some improvement during the second quarter, this is an unsustainable trend. During the fiscal year, exports have fluctuated. Month on month export for February 2017 alone fell by 8.3%. Exports for October, November, and January increased from the earlier year, but fell in all other months for which data is available.

With increase in import, merchandise trade deficit grew by 22% for July-December 2016-17 and by 34% for July-February 2016-17. The trade deficit of USD 20.1 Billion for July-December 2016-17 is 4.7% of GDP. SBP has voiced concern stating that "it must be acknowledged that while imports are essential … there is a need for equivalent increase in foreign exchange earnings to finance these imports and thereby maintain the external sector's stability"[57]

Yet there may be partial revival. Looking at the July-December 2016-17 data, export of some of Pakistan's major items, knitwear, and bed linen, have increased in quantity and value, including unit value. To an extent, the export package seems to have helped.

Table 10 looks at performance of those textile products whose annual export is above USD 500 Million. Although, exports have declined in value this fiscal (except readymade garments), quantity exports have risen for cotton yarn, knitwear, bedwear, and garments. We may term this an improvement. The decline in exports is because of low unit value. Two observations are important. That Pakistan's exports continue to be locked in low value added textile. Second, that Pakistan follows a price competitive strategy. This strategy means that there will always be new low cost entrants to compete on price and that our exporters must reduce prices further. This is true especially during periods of slow growth in trade. It is possible to reduce export decline, by diversifying into new products and by pursuing a product differentiation strategy within textiles.

[56] All figures based on PBS and MoC data.
[57] SBP State of the Pakistan Economy Q2 FY 17, Page 5

Table 10 Change in exports year on year July-February 2016-17 %change			
	Value	**Quantity**	**Unit Value**
Cotton yarn	-6.14	3.9	-9.66
Cotton cloth	-6.3	-14.2	9.2
Knitwear	-0.7	2.08	-2.71
Bedwear	5.07	8.95	-3.56
Towels	-5.33	-3.87	-1.52
Readymade Garments	4.3	3.32	0.96
Total	**-3.90**		

However, what is surprising is a lack of serious analysis about the reasons for the up and down movements. A proactive and concerted effort to increase competitiveness is needed. The economy also does not have a robust enough manufacturing base. The decline in our export has been across the board in a wide range of products.

For some years, world trade has fallen. Moderate GDP growth rates in China may not revive soon. These will affect medium term demand. Lower oil prices may have begun to affect home remittances (discussion below). Once in operation, increased import of LNG and coal for power plants will burden future trade flows of the country, even with low energy prices. Import of machinery is also likely to increase. Yet these are productive imports (apart from the environmental issues related to coal). Sustainability depends on how efficiently our economy uses these imports to create high returns and increase payback ability.

The impact of falling exports on current account deficit is significant. Declining exports, lower remittances, slow pickup in FDI (has increased by 6% July-February), and increase in import of capital equipment, means that external debt finances Pakistan's BoP. Debt sustainability will be a concern in coming years. Estimates for added forex obligations on account of CPEC projects is USD 3.5 Billion annually[58].

Pakistan has had higher current account deficits before. But they were financed by grant aid or FDI. In other cases, we had to go for IMF arrangements. Having just ended an IMF programme, it is unclear what choice the country has now. To grow, the country must make fundamental reforms.

[58] Dawn, Financing burden of CPEC, Ishrat Hussain, 11 February 2017

Table 11 Trend in Trade July May 2015-16 compared with July- May 2014-15					
Exports					**Million USD, %**
Commodity	**July- Dec 2015-16**	**Share in total export %**	**July-Dec 2016-17**	**Share in total export %**	**Change in value %**
Food Group	1,863.0	18.1	1,659.1	16.7	-10.9
Textiles	6,259.8	60.7	6,156.6	62.1	-1.6
Petroleum & Coal	93.6	0.9	89.2	0.9	-4.6
Other Manufactures	1,624.3	16.4	1,510.9	15.2	-7.0
Chemicals and Pharmaceuticals	406.6	4.1	394.1	4.0	-3.1
Engineering Goods	86.1	2.3	84.0	2.9	-2.4
Others	465.2	4.5	496.0	5.0	6.6
Total	10,305.8	100.0	9,911.8	100.0	
Imports					**Million USD, %**
Commodity	**July-Dec 2015-16**	**Share in total import %**	**July-Dec 2016-17**	**Share in total import %**	**Change in value %**
Food	2,626.2	11.9	2,864.1	11.7	9.0
Machinery	4,023.5	18.2	5,666.7	23.2	40.8
Transport	1,322.2	6.0	1,407.4	5.8	6.4
Petroleum	4,488.6	20.3	4,992.2	22.5	11.2
Textile	1,558.1	7.0	1,346.2	5.6	-12.4
Chemicals	3,768.3	17.0	3,595.0	14.7	-4.6
Metal	1,906.8	8.6	1,959.0	8.0	2.8
Miscellaneous	538.6	2.4	574.1	2.4	6.6
Others	1,929.4	8.7	1,978.6	8.1	2.5
Total	22,162.1	100.0	24,402	100.0	
Trade Deficit	**11,856.3**		**14,490.2**		
Source: Ministry of Commerce Statistics, based on PBS data[59]					

[59]http://www.commerce.gov.pk/wpcontent/uploads/2017/01/Comparative_Imp_Selected_Comodities_July-Dec_2016.pdf . http://www.commerce.gov.pk/wp-content/uploads/2017/01/Comparative_Exp_Selected_Comodities_July-Dec_2016.pdf

The Annual Plan sets a target of 1.5% of GDP for the Current Account deficit[60]. SBP data shows that the current account deficit of 2.6% for the period July-February 2016-17 is twice as high as last year's 1.3% for the same period.[61] It has already breached the set target. SBP states that "from the external sector stability standpoint, such increase in the current account deficit does not bode well, particularly because of bottoming out of global commodity prices (especially oil prices) along with some shifts in the international capital markets due to rise in the US interest rates."[62]

Home remittance is an important external financing source for Pakistan, which could mitigate the impact of fall in exports on the current account deficit. As feared in past IPR economic reviews, workers' remittance has eased this fiscal year. GoP targeted an increase in remittances by 5% in 2016-17 over last year's home remittance[63]. Last year's actual was USD 19,917 Million[64]. For the eight months period July-February 2016-17, home remittances to Pakistan totaled USD 12,363 Billion. This is a drop of 2.5% from the same period last fiscal when workers' remittance was USD 12,677 Billion[65]. As noted in previous IPR reports, a significant part of remittances to Pakistan is from oil exporting economies. This may be the effect of declining oil prices. Whether this trend is reversed is yet to be seen.

In addition to decline in exports and remittances, low FDI inflow does not ease the stressed Balance of Payment. The Annual Plan targets USD 4,550 Million as FDI for 2016-17. This is over three and a half times above the actual for 2015-16 of USD 1,281 Million[66]. FDI received for eight months, July-February 2016-17 is USD 1,285 Million[67]. This is 6% above the corresponding period last year, though counting equity alone, the growth is 9.5%[68]. So far, increase in FDI has not come from China, as its eight-month inflow is 44% of last year's total. BOI's data shows a radical increase of 840% from "Other" sources for the period July-February 2016-17 compared to full fiscal year 2015-16. Sector wise too, the increase is in "Others."[69] This suggests inflow from Netherlands and Turkey for equity share in two Pakistani companies in the food sector and household appliances. Although private flows are hard to predict, especially with CPEC investment due as well as interest shown by companies from Japan and Europe, FDIs in 2016-17 may be short of target by about USD 2 Billion.

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[60] PC Annual Plan Page 105
[61] SBP Summary Balance of Payments as per BPM6 – February 2017
[62] SBP, The State of Pakistan Economy Q2, FY 17, Overview Page 2
[63] PC, Annual Plan Page 105
[64] SBP Summary Balance of Payments as per BPM6 – February 2017.
[65] Ibid
[66] BOI Foreign Investment inflows in Pakistan($Millions)
[67] Ibid
[68] SBP Summary Balance of Payments as per BPM6 - February 2017
[69] BOI data, Country Wise FDI Inflows ($ Million), and Sector Wise FDI Inflows ($ Million).

Table 12 Increase in External Debt and Liabilities July-December 2016 Million USD			
Head	**Amount**		
	30 June 2016	**31 December 2016**	**Increase June-Dec 2016**
A. Public External Debt	**61,357**	**61,486**	**129**
1. Government	51,714	52,099	385
Long term	50,026	50,666	640
Short term	1,688	1,432	-256
2. From IMF	6,043	5,906	-137
3. Forex Liabilities	3,600	3,482	-118
B. Public Sector Enterprises	**2,806**	**2,814**	**8**
C. Banks	**2,696**	**3,206**	**511**
Borrowing	1,618	2,133	515
Deposits	1,078	1,073	-5
D. Private Sector	**3,348**	**3,708**	**360**
E. Debt liabilities to investors	**2,857**	**2,912**	**55**
Total External Debt & Liabilities % GDP	**73,063 25.9**	**74,126 23.2**	**1,063**
Official Reserves	**18,192**	**18,380**	**188**
Public Debt including PSEs + Bank Public % GDP	**64,252 22.7**	**64,519 23.2**	**267**
GDP Billion USD	**282.5**	**319.6**	
Source: SBP[70]			

Increase in external debt has financed the increase in trade deficit. During July–December 2016-17, external debt and liabilities increased by over one billion USD. Government debt grew by a much smaller USD 129 Million. Borrowings by banks grew by USD 511 Million. Private sector borrowing increased by USD 360 Million [71]. Table 12 gives increase in external debt and liabilities for the period July-December, 2016-17.

On 31 December 2016, foreign currency reserves stood at USD 18,380 Million, $ 188 Million above the reserves of 30 June 2016 reserves of 18,192 Million. Net foreign currency reserves were USD 18,190 and 18,142 Million respectively. Though equal to about five months import, low exports and remittances will continue to force government to borrow externally.

[70] SBP Pakistan's External Debt and Liabilities-Outstanding http://www.sbp.org.pk/ecodata/pakdebt.pdf
[71] SBP Pakistan's External Debt and Liabilities - Outstanding

There are several structural and competitiveness factors that have led to decline in Pakistan's exports. In addition, Pakistan's exchange rate hasn't helped. Despite loss in value since, the Pak Rupee has gained value since December 2013 against currencies of countries that it competes with for export. Consequently, its real effective exchange rate does not help our exporters. If exports do not increase quickly, Pakistan may have to continue to borrow to finance imports. This will become a particular concern if energy prices also increase at this time. We hope that these imports would soon stimulate the economy and increase exports. For the present, Pakistan's debt sustainability stays a concern.

Pakistan may also review the tariff structure to figure out if it supports exports. We may reorient our approach to tariff policy from one where import tariff is viewed as a source of public finance to one that supports exports. Such a review would reduce average tariff rates and do away with protection that carry high economic cost.

Table 13
Summarized Balance of Payments

	Annual Plan 2016-17	Actuals July to Feb 2015-16	Actuals July-Feb 2016-17	% Change July-Feb 2016-17 over July-Feb 2015-16
1. Current Account	**-4,530**	**-2,484**	**-5,473**	**-120**
Exports	24,750	14,339	14,051	-2.1
Imports	45,210	26,472	29,446	11.2
Balance on Goods	-20,460	-12,133	-15,395	-26.8
Remittances	20,203	12,677	12,363	-2.5
2. Capital Account	**399**	**207**	**156**	**-24.6-**
3. Financial Account	**5,569**	**-3,533**	**-4,484**	**-26.9**
FDI	4,550	1,212	1,285	6.0
FPI	100	109	650	496
Net Foreign Assistance	875	1,454	1,230	-15.5
Others	44	253	351	98
4. Errors & Omissions	**0**	**-217**	**-175**	
5. BoP deficit/surplus	**1,438**	**1,041**	**-1,008**	

Most BoP indicators have worsened, especially exports, remittances, and trade deficit. The fragile current account is accompanied by a financial account that is equally unbalanced.