# Institute for Policy Reforms

Press Release, 22 December 2017

## Despite growth, major risks to the economy

Despite revival of growth, the economy faces serious risks and vulnerabilities. This was stated today by the Institute for Policy Reforms in the Review of the Economy for First Quarter 2017-18. Economic growth has improved with revival in manufacturing and agriculture. Rapid increase in tax revenue has strengthened public finance.

However, there are major foreign financing challenges. At 4.4% of GDP, the current account deficit grew by 120% over the same quarter last fiscal and far exceeds the target set by government. Foreign reserves have fallen despite hefty external borrowing. So far, government has attributed the runaway increase in current account deficit to growth inducing machinery imports. Machinery import, however, did not grow during the quarter. Import of power generation equipment fell by 17%.

The report asserts that Pakistan is dependent on external savings and the economy is exposed to continuous loan rollover and re-pricing risks. Recent correction in Rupee value may reduce imports and the deficit. Central bank estimates foreign exchange financing gap of USD 12 Billion in FY 18 (later retracted). IPR says that the gap will be higher. Next year's foreign financing gap is a major economic risk.

Fiscal deficit too is higher than target. This has increased government indebtedness, both domestic and external. These macroeconomic factors prevent sustained and long-term growth of the economy. They are the result of years of economic decision making that prioritizes firefighting to solve immediate problems, but does not show resolve to deal with structural issues. The problems point to an economic structure that does not allow the economy to substantially increase investment. It is the result of a political economy that favours the privileged at the expense of everyone else.

The report cautions against despondency though because that is the last thing the market needs today. It affirms that Pakistan has the potential to turn the economy around if all institutions show firm intent.

LSM grew by a healthy 8.4% during first quarter. This was because of improved power supply, better security, low interest rates, low inflation, and past years' investments. Agriculture has recovered from higher fertilizer offtake, higher credit and mechanization, support price for wheat.

GDP growth will be higher than last year's 5.28%. An expansionary monetary policy coupled with largely steady exchange rate (despite 5% correction in December) and some agriculture and industrial revival have stimulated growth. Continuous growth in public sector investment and CPEC development projects also have given impetus. Exports grew by 10.8% during the quarter and by an equal margin during July-November 2017. Remittances grew by 2% during the quarter after falling 3% last fiscal. FDI saw a healthy increase of 57% for the July-November 2017 period.

Without reforms, Pakistan's weak macroeconomy will affect further growth, especially new investments. Year on year, government external borrowing grew by USD 4,521 Million in September 2017, and by USD 767 Million during July-September 2017. Total external debt and liabilities grew by USD 9,290 Million, year on year, and by USD 2,071 Million since July. Repayment of principal and interest during the quarter was USD 2.1 Billion, of which USD 1,600 Million was for government debt alone.

The report notes also that revival in industry and agriculture is not because of structural reforms. Pakistan has made no progress in moving up the technology ladder, in reducing cost of doing business by governance improvements, or in providing access to credit to small and medium businesses. High entry barriers remain in manufacturing. Similarly, agriculture productivity is still low, and production and price volatility endemic. Production remains contingent on international prices, weather conditions, and virus proliferation. Without investment in water infrastructure, improvement in water use and service delivery, quality research, extension services, and policy interventions, sustained growth of farm produce remains uncertain. There isn't enough analysis why production levels vary year to year.

Exports have not grown because of higher competitiveness. For one, this growth is on a lower base because of three years of decline. Also, they came after large fiscal incentives by government. Exports must grow by 18% this fiscal to reach its last peak of June 2014. Several structural and competitiveness factors prevent Pakistan from becoming a major export economy. Without increase in exports, Pakistan will have to continue external borrowing to finance capital imports. So far, FDI has not increased at the pace needed, though it has improved considerably. FDI must grow by 120% from June 2017's level to reach the peak of USD 5.3 Billion in 2007-08.