Institute for Policy Reforms

Press Release

Weak fundamentals are signs of a deeper malaise

Pakistan's real economy is performing well with favourable signs for GDP growth rate, inflation, consumption, and private sector economic activities. Weak economic fundamentals, however, detract from this positive picture. This was stated by Institute for Policy Reforms in its six-months review of the performance of the economy

IPR's report said that budget deficit for fiscal 2018 will exceed target while the current account deficit for the year will end at an unprecedented high. It said that Pakistan is effectively in a debt trap where new borrowing is servicing past debt. Both domestic and external debt are at an all-time high. Continued weak fundamentals will damage the real sector and reduce growth rate. The longer the country postpones addressing the real causes of economic difficulties, the worse would be its effect.

While tabling this fiscal year's budget, GoP had announced a combination of macro stabilizing and growth measures to achieve its target GDP growth rate of 6% in FY 18. These measures included higher revenues and lower current expenditure, as well as increase in investment, especially through FDI from China and a large PSDP.

Continuous growth in government revenue for three years running has helped limit the fiscal deficit. During July-December 2017-18, FBR revenue grew by a further 18%. On the other hand, investment has not kept pace with plans.

Actuals for the half year show GDP growth rate will be close to target and above last fiscal. LSM has grown by 5.55%, 0.8% off target. With a favourable monetary policy, demand has fueled production of consumer durables. Estimates for growth of major crops are favourable and half-year power supply grew by 11.8% over last year.

There are signs that this positive picture may not continue for long. Growth inducing machinery import declined by 3%, import of power generation machinery fell by 26% and construction machinery by 24%. So far, GoP had attributed the economy's runaway current account deficit to such imports.

Private sector bank credit declined during July-December 2017-18, compared to the same period last year. Just 10% of bank credit went to fixed investment. Government has also reduced PSDP envelope as well as the pace of release of funds.

The challenge of structural twin deficits continues. Fiscal deficit for half year was 2.2% of GDP but is expected to go up to 5.5% by year end. Fiscal operations show also a primary deficit suggesting government is borrowing even to pay markup.

Current account deficit is a grave concern. The deficit for July-February 2017-18 was USD 10.8 billion, 4.8% of GDP. It already exceeds the annual target USD 8.9 Billion or 2.6% of GDP and is expected to climb to USD 16.2 Billion for the year.

Total external debt and liabilities reached USD 88,891 Million in December 2017, growing by USD 5.8 Billion in six months. Ballooning forex obligations has caused severe pressure on the reserves. In one year, between February 2017 and February 2018, net SBP foreign reserves fell by over USD 4.8 Billion now down to less than three months' import.

Government policy has been adrift and two months before elections the economy is sliding into a morass of its own making. The immediate cause of this lies in what was until recently adamant defence of a high Rupee value. For years, this Institute cautioned about the impending finale, as an obviously overvalued Rupee had distorted the economy. This was the time when GOP celebrated its performance based on cursory reports by foreign media and extensive exemptions by an ever-accommodating IMF. Regrettably, hubris and hyperbole are no substitutes for strategy.

Pakistan's perennially poor macro indicators are symptoms of a deeper malaise. Elitist economic policies have caused chronic social and infrastructure deficit. This is also why we do not have a competitive economy or long-term economic growth. Exports are dependent on fiscal incentives. It has made Pakistan permanently dependent on foreign aid. Governance has not improved with no action to reduce the cost of doing business. We face today the outcome of deeply flawed policies of decades. Decision makers are focused on macro numbers without concern for what drives those indicators.

Sustained economic growth needs higher savings and investment, including public investment. Inevitably, this will need higher imports, and more external capital. Breaking out of this circular logic that constrains the economy is government's challenge. It can be solved only by committing to well thought out policy over the long-term.