Third Quarter Economic Review for 2021-22

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Pakistan Economy

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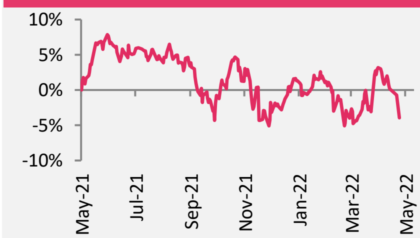
Key Data	
KSE100 Index	43,393
KSE-All Share Value (PKRmn)	9,238
KSE-All Share Value (USDmn)	49.3
KSE-All Share Volume (Shmn)	305.2
Market Capitalization (PKRtn)	7.2
Market Capitalization (USDbn)	38.5
1Year High	48,726
1 Year Low	42,876

Source: PSX, Next Research

1 Year KSE100 Index Performance



Source: PSX, Next Research

INTRODUCTION

The economy of Pakistan is increasingly mired in a difficult situation with the economy approaching 'stagflation.' The rate of inflation has remained double-digit throughout the third quarter of 2021-22. The initial optimism that the GDP rate would rise above 5 percent has given way to the more modest expectation that it will remain closer to 4 percent. The world economy had continued to demonstrate a strong recovery at the beginning of 2022 and international commodity prices had maintained a rising trend. There was optimism that the global economy would show a high growth rate of over 5 percent in 2022. The commencement of the Russia – Ukraine war has dampened expectations. The large-scale supply disruptions due to the sanctions imposed on Russia have contributed to further escalation in commodity prices, especially of oil. The price of crude oil initially jumped to $130 per barrel and has since stabilized at close to $105 per barrel. The end of the third quarter has been followed by a change of government in Islamabad. There is some uncertainty about the political and economic outlook in coming months.

THE GLOBAL ECONOMY

The rate of increase in global commodity prices is of critical importance to the economy of Pakistan. The burgeoning current account deficit in the first three quarters of 2021-22 could see a further widening in the fourth quarter if the high prices persist or even rise.

The trends in the World Bank Commodity Price Index are given in Table 1.

Table 1: World Bank Commodity Price Index (2010 = 100)

	January – December 2021	January – March 2022	March 2022
ENERGY	**94.5**	**136.9** **(44.8) ***	**160.9** **(17.5) ****
FOOD			
Grains	123.8	143.5 -15.9	158.7 -10.6
Edible Oil	123.1	156 -26.7	173.1 -11
RAW MATERIALS	84.5	87.2 -3.2	87.1 (-0.1)

*Growth rate from average for January-December 2021 to average for January-March 2022

** Growth rate from average for January-March 2022 to average for March 2022

Source: World Bank

Table 1 indicates that the biggest increases in prices have been of energy, especially oil and palm oil. For example, the price of energy items was up in March 22 by almost 70 percent compared to the average level in 2021. It is not surprising that the oil bill has gone up by 96 percent up till February 2022.

THE REAL SECTOR

The pattern of growth of the large-scale manufacturing sector is a mixed one in the first eight months of 2021-22, as shown in Table 2. Overall, the Quantum Index of Manufacturing (QIM), with the new base of 2015-16, has shown a healthy growth rate of 7.8 percent during these months. However, there is wide variation in the industry wise growth rates. Amongst heavy weights, the fastest growth in production of over 59 percent has been of automobiles followed by wearing apparel and cigarettes of almost 21 percent and 20 percent, respectively. In the cigarettes' case, this may be attributed to the implementation of the track and trace system. Industries which have registered declines include vegetable ghee, fertilizer, and pharmaceuticals. This is primarily attributable to the big jump in domestic prices due to higher import prices and fall in the value of the rupee which have reduced domestic demand.

Table 2: Rate and Pattern of Growth of Industries July 2021 to February 2022 – (%)

FALLING GROWTH RATE*			RISING GROWTH RATE		
	July – February	February		July – February	February
FOOD			**WEARING APPAREL**	**20.6**	**36.6**
Vegetable Ghee	-2	0.5	**COKE & PETROLEUM**	**1.2**	**6.8**
Tea	13	7.8			
Tobacco	19.6	4.1	**NON-METALIC MINERAL PRODUCTS**		
			Cement	-3	0.8
CHEMICALS					
Fertilizer	1.6	19.4	**IRON & STEEL PRODUCTS**	**17.3**	**15.5**
			AUTOMOBILES	**59.8**	**38.1**
TEXTILES			**OTHER TRANSPORT EQUIPMENT**	**-1.9**	**6**
Yarn	0.7	0.4			
Cloth	0.3	0.2			
LEATHER PRODUCTS	**3.1**	**-7.2**			
PAPER & PAPER BOARD	**8**	**7**			
PHARMACEUTICALS	**-2.3**	**5.2**			
ELECTRICAL EQUIPMENT	**-1.1**	**7.5**			
FURNITURE	**345.2**	**86.5**	**QIM**	**7.8**	**8.6**

* Fall in growth rate in January compared to earlier months

Source: PBS

There is need to emphasize that there are serious doubts about the high growth rate of 7.8 percent in the QIM. With the old base of 2005-06 the growth rate falls sharply to 4.6 percent. The primary reason for this dichotomy is the addition of the new industry of furniture in the QIM. This industry has shown an unprecedented growth rate of over 345 percent. This small industry, with a weight of only 0.5 percent, has accounted for almost 23 percent of the overall growth of the large-scale manufacturing sector from July 2021 to February 2022. Output of Rabi crops has been affected by water shortage and decline in use of fertilizer due to less availability and much higher prices. The wheat output is likely to be lower by 4 percent in comparison with last year's output. Consequently, a higher quantity of wheat will have to be imported at a substantially higher price.

INVESTMENT

One of the key indicators of the level of investment in the economy is the size of imports of machinery. Table 3 presents a summary picture of these imports.

Table 3: Total Imports of Machinery ($ million)

	2020-21	2021-22	Growth Rate (%)
July to December	4240	5917	39.6
January to March	2892	2767	-4.3
July to March	7132	8684	21.8

Source: PBS

Investment appears to have been buoyant in the first six months of 2021-22 and imports of machinery showed a rapid growth of almost 40 percent. since then, there appears to have been a big loss of momentum. Imports of machinery have shown a decline in the last quarter, probably due to the rise in interest rates.

The composition of imports of machinery is shown in Table 4.

Table 4: Imports of Machinery by Type July 21 to March 22 ($ million)

	2020-21	2021-22	Growth Rate (%)
Power Generating Machinery	1,356	1,236	-8.2
Textile Machinery	378	622	64.6
Construction & Mining Machinery	105	138	31.4
Electrical Machinery and Apparatus	1,101	1,515	37.6
Telecom	1,923	2,136	11.1
Others	2,270	3,038	33.8
TOTAL	**7,133**	**8,685**	**21.8**

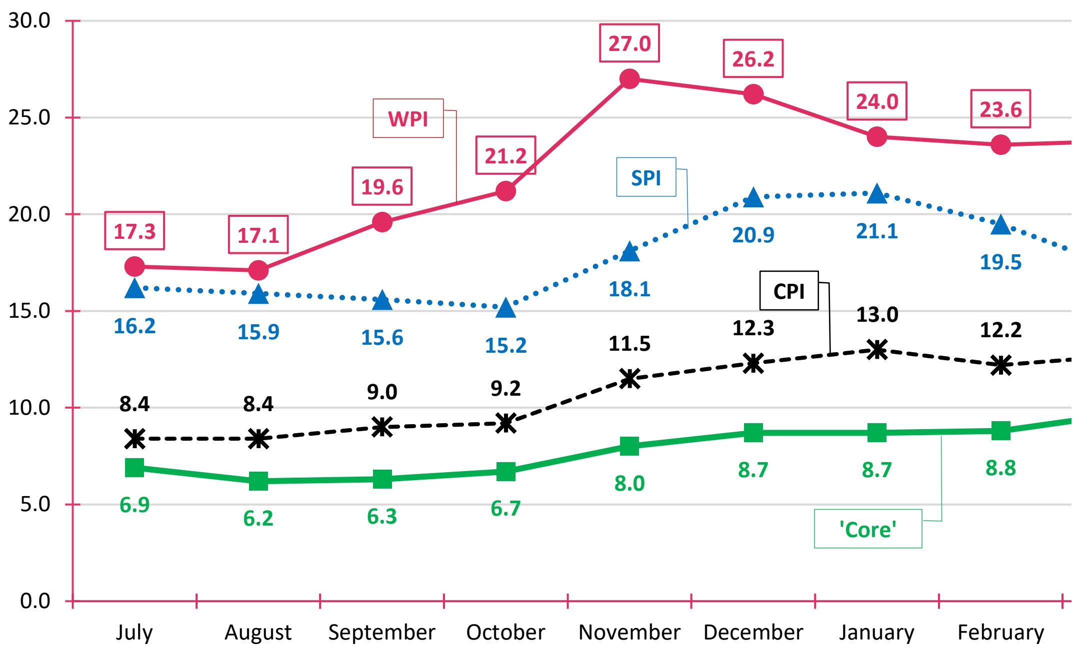
Source: PBS

Imports of all kinds of machinery, except for power generation, have shown rapid growth. Imports of textile machinery have increased by as much as 79 percent, thereby augmenting the capacity for higher exports. A major contributory factor has been the low level of interest rates. The policy rate of the SBP remained low at 7 percent after the onset of the COVID-19 attack. By mid- December it was raised to 9.75 percent. Recently, it has been increased further to 12.25 percent. The loss of momentum in investment is likely to be even more pronounced now.

INFLATION

As highlighted earlier, the rate of inflation has remained persistently high. As shown in Figure 1, it has averaged 12.6 percent in the third quarter as compared to 9.8 percent in the first two quarters of 2021-22.

Figure 1: Monthly Rates of Inflation on Year- to- Year Basis



Source: PBS

By and large, the rate of inflation has been rising.

There are two significant developments. Food prices are showing exponential growth as shown in Table 5. The year-to-year inflation was 8.1 percent in July 21. It has risen sharply to 15.1 percent by March 2022. The rise in prices is having a more adverse impact on the lower income groups. As opposed to this, non-food price inflation reached the peak rate of 13.8 percent in December 2021. Since then, it has moderated to 11.7 percent in March 2022. One of the reasons for the moderation is the reduction in the price of motor spirit and HSD oil of Rs 10 per liter by the previous government as part of a relief package. Another major development is the rise in the 'core' rate of inflation. As shown in Figure 1, it has risen from 6.9 percent in July 21 to a peak of 9.7 percent in March 22. 'Imported' inflation has also contributed to higher non-food and non-fuel prices. Items like washing soap/detergents, drugs and medicines, readymade food, appliances, and transport services have shown double-digit rates of inflation.

Table 5: Year-to-Year rate of inflation in Food and Non-Food Prices (%)

	Food Prices	Non-Food Prices	Overall CPI
July	8.1	8.5	8.4
August	9.5	7.5	8.4
September	9.8	8.3	9
October	8.1	9.9	9.2
November	9.9	12.6	11.5
December	10.1	13.8	12.3
Six Months Average	-9.3	-10.1	-9.8
January	12.4	13.5	13
February	14.4	11.3	12.2
March	15.1	11.7	12.7
Three Months Average	**-14**	**-12.2**	**-12.6**
Nine Months Average	**-10.9**	**-10.8**	**-10.8**

Source: PBS

PUBLIC FINANCES

There is a growing apprehension that the budget deficit will rise to a record level in 2021-22. This is attributable to the following factors:

(i) The petroleum levy was expected to generate Rs 610 billion in 2021-22. The upsurge in international prices of petroleum products has led to a withdrawal of the levy. The estimated yield now is Rs 130 billion, implying a big shortfall of Rs 480 billion.

(ii) The policy rate was 7 percent at the time of presentation of the budget. It has since increased to 12.25 percent. This will add Rs 450 billion to the budgeted level of debt servicing in 2021-22.

(iii) Subsidies are likely to be higher by Rs 300 billion because of the relief package.

(iv) Although FBR revenues have shown rapid growth of over 29 percent up to March, there is likely to be a shortfall of Rs 100 billion in relation to the annual target which has been enhanced from Rs 5829 billion to Rs 6100 billion.

A summary of the likely budgetary position is shown in Table 6.

Table 6: Projected Public Finances in 2021-22 (Rs in Billion)

	Budget Estimate	Projected
A. FEDERAL		
Revenues	**4,497**	**4,088**
Tax Revenues	5,829	6,000
Non-Tax Revenues	2,080	1,600
Less Provincial Share	-3,412	-3,512
Expenditure	**8,487**	**8,887**
Current	7,523	8,223
Development	964	664
Budget Deficit*	**-3,990**	**-4,799**
B. PROVINCIAL CASH SURPLUS	**570**	**570**
C. CONSOLIDATED DEFICIT	**-3,420**	**-4,229**
% Of GDP	**-6.3**	**-7.7***

* The budget deficit could be even higher if supplementary grants are made to reduce the circular debt

Source: MOF

The consolidated budget deficit is expected to reach the level of Rs 4229 billion equivalent to 7.7 percent of the GDP in 2021-22. This is likely to be the outcome even after a cut in the federal PSDP of Rs 300 billion. There will be a primary deficit of 1.3 percent of the GDP.

The net Government debt position is given in Table 7.

Table 7: Size of Government Debt (Rs in Billion)

	2020-21 (End June)	2021-22 (End February)	Change
DOMESTIC DEBT	**26,265**	**27,705**	**1,400**
Permanent Debt	15,904	18,518	2,614
Unfunded Debt	3,646	3,615	-31
Floating Debt	6,680	5,523	-1,157
Others	35	49	14
External Debt	**12,434**	**15,056**	**2,622**
Total Government Debt	**38,699**	**42,761**	**4,062**
% Of GDP	81	82	0
Change in Debt	**3,592**	**4,062**	
Due to Deficit	4,449	2,354	
Depreciation of Rupee	-857	1,708	

Source: SBP and MOF

There appears to have been only a minor change in the Government Debt to GDP ratio up to February 2022, which remains close to 81 percent of the GDP. The depreciation in the value of the rupee has contributed 42 percent to the increase in the absolute size of the debt.

INTERNATIONAL TRADE

The growth rate of exports, imports and the balance of trade are presented in Table 8. Over the nine-month period from July 21 to March 22 imports have grown by 49 percent, while exports have registered growth of 25 percent. Consequently, the trade deficit has increased very substantially by over 70 percent. Fortunately, the third quarter from January to March has seen a big moderation in the growth rate of imports, due to the higher base level of imports in 2020-21 as the process of recovery get underway after COVID-19. Also, the average monthly level is over 10 percent less than the level in the first six months. Exports have sustained the same growth rate in the third quarter as in the previous quarters.

Table 8: Growth Rate of Exports and Imports, July – March 2021-22 ($ billion)

	July – December		g	January- March		g	July – March		g
	2020-21	2021-22	(%)	2021-22	2020-21	(%)	2020-21	2021-22	(%)
Exports	12.1	15.1	**24.8**	6.6	8.2	**24.2**	18.7	23.3	**24.6**
Imports	24.5	40.6	**65.7**	15	18.3	**22.2**	39.5	58.9	**49.1**
Trade Deficit	-12.4	-25.5	**105.6**	-8.4	-10.1	**20.2**	-20.8	-35.6	**71.1**

Source: PBS

The growth rates of different types of imports by volume, price and value are presented in Table 9. It is perhaps surprising that despite the jump on average in dollar prices of 36 percent, the overall volume of imports has increased by 13 percent. This is due to the trebling of imports of medicines, especially COVID-19 vaccines, higher import of petroleum products, automobiles and of machinery, in the presence of low interest rates.

Table 9: Growth in Volume, Price, and Value of Imports July – March 2021-22

Group	GROWTH IN IMPORTS – (%)		
	Volume	Price ($)	Value
Food	-9.5	25	15.5
Machinery	n.a.	n.a.	21.8
Transport Equipment	n.a.	n.a.	67.5
Petroleum	13.8	82.3	96.1
Textiles	-7.9	33.5	25.6
Agriculture + Chemicals	24.4	50.6	75
Metals	6.9	38.4	31.5
TOTAL IMPORTS*	**13**	**36.1**	**49.1**

*Only where volume details are available

Source: PBS

Exports have performed exceptionally well in the first nine months of 2021-22, as shown below in Table 10. The boom in international prices has also benefitted Pakistan's exports. Exports of textiles have shown a peak growth rate of almost 25 percent.

Table 10: Growth in Volume, Price, and Value of Exports

Group	GROWTH IN EXPORTS – (%)		
	Volume	Price ($)	Value
Food	4	14.9	18.9
Textiles	8.5	16.9	24.5
Other Manufactures			
TOTAL EXPORTS	5.9	10.3	16.2

Source: PBS

BALANCE OF PAYMENTS

The balance of payments after three quarters of the on-going financial year presents a grim picture as shown in Table 11. Over the period there has been a fall in foreign exchange reserves of $5.8 billion, such that reserves at the end of March 2022 stand at $11.5 billion, enough to provide import cover of only 1.67 months, quite far from the minimum safe level of three months. Development both on the current and financial accounts have contributed to this deterioration. The entire worsening in the financial position has taken place from January and March, especially in March. The first six months of the year presented a more positive picture. The current account deficit for the first nine months is a large $13.2 billion. The last two months have witnessed some curtailment of this deficit. It was $0.5 billion in February, rising to $1 billion in March. During the previous seven months, the monthly average deficit was significantly higher at $1.7 billion. This is attributable primarily to some reduction in the monthly trade deficit in goods and higher level of remittances. The area of great concern is the severe deterioration of the financial account. It was in surplus with a large magnitude of $10.1 billion up to December. It has since gone into deficit after a long time in the third quarter by $1.6 billion, with the deficit of as large as $3.6 billion in March. What has happened in March? The net inflow into the Government account was a negative $2.3 billion. Disbursements were only $0.5 billion while there were lumpy repayments of $2.8 billion, especially to China. In addition, there was net exit of $0.4 billion of portfolio funds and $0.9 billion from banks and the private sector. There was also no net inflow of foreign direct investment in March. Clearly, a critical situation has been reached. The inflow of funds to finance the current account deficit and repayment of external debt has greatly diminished. If this situation persists and Pakistan is unable to revive the IMF program quickly, then we could move into a situation where it will be difficult to honor our external payment obligations.

Table 11: Balance of Payments, July to March, 2021-22 ($ billion)

	July – March	January – March	March
A. CURRENT ACCOUNT	**-13.2**	**-4.1**	**-1.0**
1. Balance of Trade in Goods	**-30.1**	**-9.2**	**-3.2**
Exports	23.7	8.5	3.1
Imports	53.8	17.7	6.2
2. Balance of Trade in Services	**-3.2**	**-1.0**	**-0.3**
3. Balance of Primary Income	**-3.9**	**-1.4**	**-0.5**
4. Balance of Secondary Income	**24.0**	**7.6**	**3.00**
Worker's Remittances	23.0	7.1	2.8
B. CAPITAL ACCOUNT	**0.2**	**0.1**	**0.0**
C. FINANCIAL ACCOUNT	**8.5**	**-1.6**	**-3.6**
1. FDI	1.3	0.2	0.0
2. Portfolio Investment	0.2	0.6	-0.4
3. General Government	**5.0**	**-0.8**	**-2.3**
Disbursements	11.4	2.9	0.5
Amortization	-6.4	-3.7	-2.8
4. Allocation of SDRs	2.8	0.0	0.0
D. NET ERRORS AND OMISSIONS	**-0.6**	**-0.3**	**0.0**
E. OVERALL BALANCE OF PAYMENTS	**-5.1**	**-5.9**	**-4.6**
F. USE OF FUND CREDIT	-0.7	-0.2	-0.2
G. CHANGE IN FE RESERVES	**-5.8**	**-6.1**	**-4.8**
1. Level of Reserves (end of period)	**11.5**		
2. Import Cover (months)	**1.67**		

Source: SBP

OUTLOOK

The economy is in a fragile state. Reserves have fallen sharply from January to March. The pressure of high international commodity prices is likely to persist due to supply shortages arising from the sanctions against Russia and the balance of payments of Pakistan could continue to show a deficit. The IMF in its latest World Economic Outlook has forecast a sharp fall in the growth rate of the world economy. Inflation rates in countries like the USA and the UK have risen sharply. Increasingly there is resort to tighter monetary and fiscal policies. Interest rates are on the upturn. These developments could limit the growth of Pakistan's exports and increase the cost of accessing sources of international finance. The short-term outlook for the value of the rupee and the level of share prices hinges crucially on the progress in reviving the IMF program and thereby improving access to multilateral lenders like the World Bank and the ADB. Apparently, following recent meetings in Washington, the process of the Seventh Review has been extended. The new government may also try and obtain deposits from friendly countries, but this may prove more difficult given the state of Pakistan's credit worthiness.