Day Break

Friday, 26 May 2017

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Economy

Exhibit: GDP growth component wise

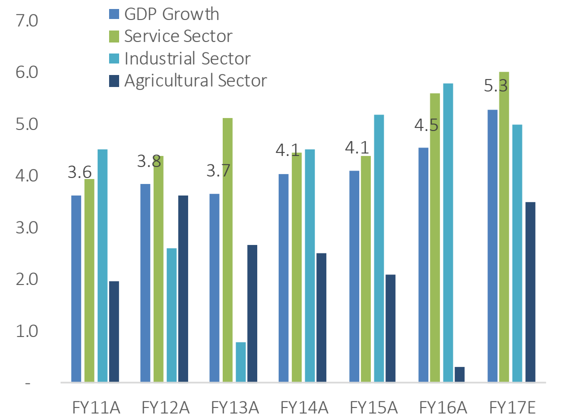


Exhibit: Saving/Investment to GDP

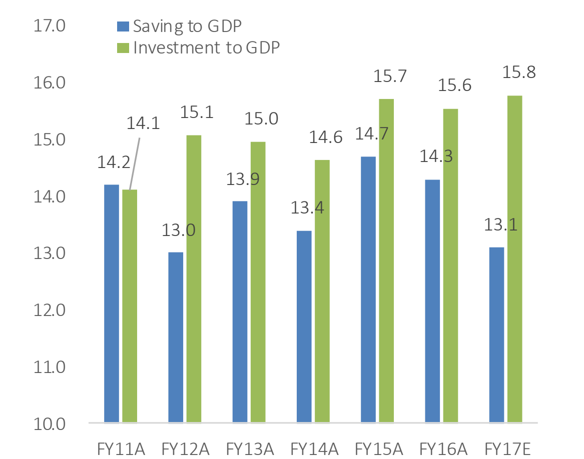
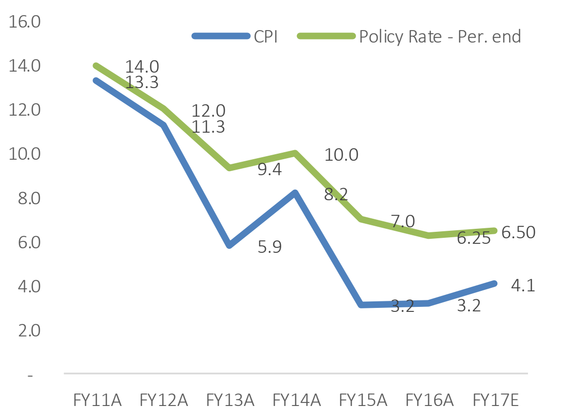


Exhibit: Inflation and Policy Rate



Source: SBP & IGI Research

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Economic Survey FY17 Review: Its's all good!

- FY17 growth ended on higher note registering 5.3% growth, a 10Yr high, led by Government pro-growth policies.
- Ignoring low tax revenue collection, Fiscal slippages have been mainly on account of higher development spending leading to higher external account imbalances.
- Despite reviving commodity prices, inflation remained subdued.
- GDP growth projected at 6.0% in FY18.

We review FY17 Economic Survey of Pakistan. FY17 growth ended on higher note registering 5.3% growth, a 10Yr high. Low interest rate environment, inflation, higher credit growth and eventually higher industrial growth are some of the key positive highlights during the year. On the flip side, the year is likely to end on record high current account deficit, while fiscal deficit is likely to stay curtailed under 5%. FY18 GDP growth outlook seems even more promising, with growth projected to surpass 6% in the coming years led ahead by public sector development projects and CPEC.

Government pro-growth policies led to higher GDP growth of 5.3% in FY17

The recent available Economic Survey of Pakistan (FY17) shows visible improvements have been witnessed due to government pro-growth policies. GDP growth momentum continued, printing a +5.28% growth in FY17 (+5.7% target and compared to +4.5% in FY16), a 10Yr high. Sector wise major rebound is noted for agricultural (~19.5% share) sector which posted a growth of +3.5% compared to +0.3% in FY16. Service (59.6% share) and industrial (20.9% share) growth looks promising registering +6.0% and +5.0%, respectively. Moody's and Fitch have raised Pakistan's economic outlook from negative to stable, while Standards & Poor's revised its rating from stable to positive.

Ignoring low tax revenue collection, Fiscal slippages have been mainly on account of higher development spending…

Fiscal deficit continued to show signs of improvements, with outgoing year expected to record a fiscal deficit of 4.4% compared to 4.6% in FY16. Although revenue collections remain weak, prudent expenditure management (ex-development projects) is a key reason for curtailed deficit. Moreover, rising proportion of public led development projects has led to increase in investment / GDP ratio, reaching 15.8% with fixed investments / GDP reaching 14.2%. As it has been the case, higher investment was led by public sector, whereby it grew by 23.6% compared to private sector investment at 6.6%. Decade low interest rate environment and better security situation is the prime reason for increase in investments, whereas supply side bottlenecks, particularly in terms of energy and infrastructure, kept investments growth rather capped. Low interest rate environment also impacted country's saving to GDP which dropped to 13.1% from 14.3%. As a result, country saving to investment gap widened to PKR 0.86trn (PKR 0.86trn last witnessed in FY08), an 8Yr high.

Exhibit: Current Account Balance

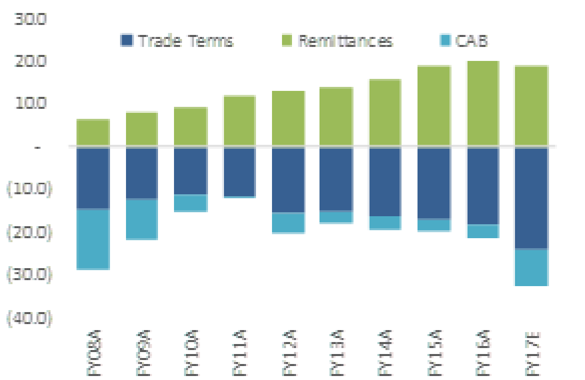
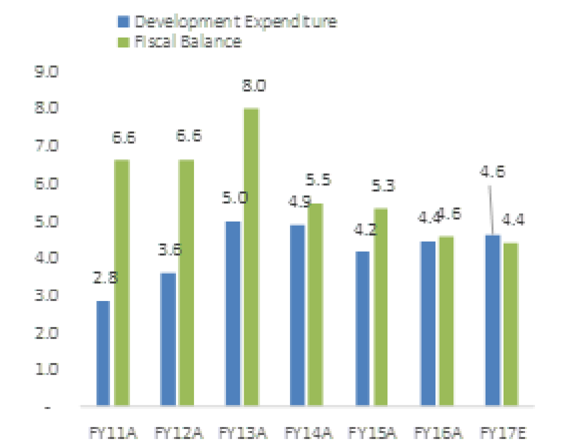


Exhibit: Fiscal Accounts



Source: SBP & IGI Research

...and higher development spending also responsible for higher external account imbalances

Replicating increase in saving-investment gap is country's increased current account deficit, whereby in 9MFY17 it reached USD 6.1bn compared to USD 2.4bn in corresponding period last year. Exports dropped by 1.6% to USD 16.1bn whereas imports recorded an increase of +14% to USD 33.9bn, led by increase in machinery imports and increase in quantity of petroleum product. Worker's remittances and lower Coalition Support Fund (CSF) both declined, reaching USD 14.1bn (down by 2.3%) and USD 550mn (down by 23%) respectively.

Despite reviving commodity prices, inflation remained subdued

On prices front, average headline inflation during 10MFY17 recorded a growth of 4.1%, well below the full year target of 6%. The food group with 37.5% weight in CPI basket showed an increase of 3.9%, compared to 2.1% in the corresponding period last year. The uptick in inflation is mainly due to global revival of international commodity and oil prices, along with rise in domestic demand as depicted by country's credit growth of +11.1% in 9MFY17 (+7.2% in same period last year). The State Bank of Pakistan (SBP) reduced the policy rate only once by 25bps to 5.75% which overall helped keep market liquidity conditions at ease during the outgoing year.

Outlook

Going forward, government expects low interest rate environment to prevail and expects increase in credit off-take which will eventually drive Industrial sector growth. On prices the government identifies key supply side concern are rising international oil prices and other commodity prices. Whereas expected increase in agricultural production and food supply security is likely to mitigate that impact. However, we think the otherwise country's rising demand, as depicted by rising consumption to GDP which by FY17 reached ~80% (78% in FY16) – showing ~6% 3Yr CAGR, will likely lead to demand pull inflation. Moreover, broad money growth has remained sluggish during 9MFY17 (M2 growth up by 5.9%) we expect widening c/a deficit and higher debt financing to eventually seep into higher broad money growth, pulling overall inflation level. To note, country's core inflation during 10MFY17 recorded a growth of 5.1% compared to 4.1% corresponding period last year. Second to demand pull inflation, we expect falling Foreign exchange (FX) reserves could potentially lead to weaker PKR in coming months, which will not only exacerbate the c/a deficit but also induce higher imported inflation. Henceforth we expect policy rate to rise no longer than 1HFY18.

GDP growth projected at 6.0% in FY18

On growth, country's GDP is projected to grow by 6.0% in FY18 as government expects increase in investment to GDP ratio. Removal of supply side bottlenecks, namely energy, will be key in achieving that we think. Moreover, curtailing c/a deficit and fiscal deficit will be crucial in keeping credit growth firm. Special sections this year around commented on China-Pakistan Economic corporation (CPEC) long-term benefits and short-terms headwinds that economy might suffice.

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