# Day Break

Friday, 27 April 2018

## Economy

Exhibit: GDP growth component wise

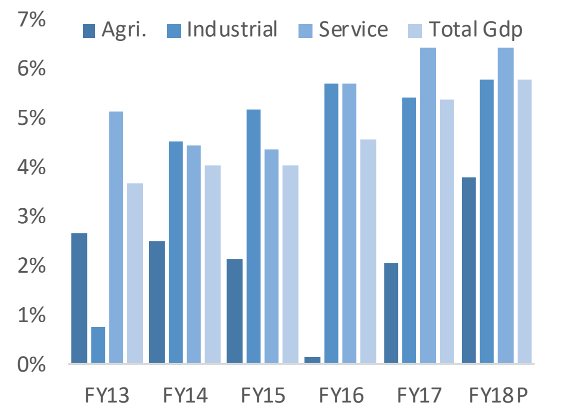



Exhibit: Contribution to GDP growth

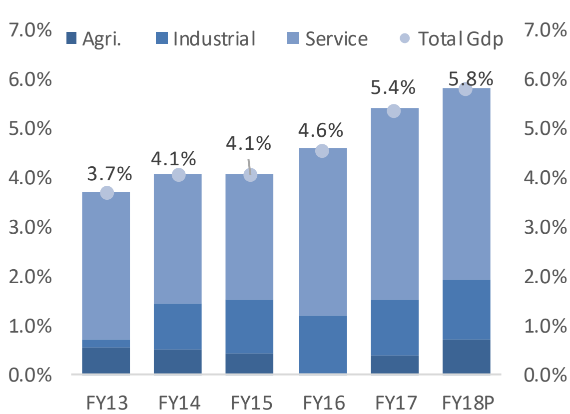
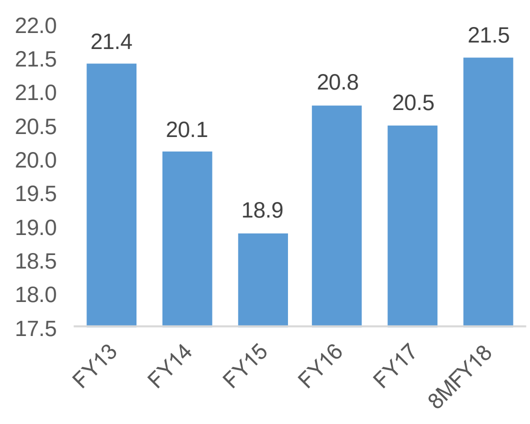



Exhibit: External debt as a % of GDP




Source: SBP, MoF & IGI Research

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## Economy

# Pakistan Economic Survey 2018: Higher Debt, Investments and Growth

- Pakistan's economy grew by +5.8%, fastest in past 13yrs owing to accommodative monetary and expansionary fiscal policies
- Subdued inflation left monetary policy accommodative but this also fueled higher consumption more than investment and simultaneously led to wider trade imbalances. As a result, country's C/a deficit reached its all-time high, causing government to raise more debt and debt burden
- Looking ahead, maintaining GDP growth rate of 6% will be challenging in our view.

### Economic Survey of Pakistan 2018 review

With budget 2018-19 just in the horizon, we review FY18 Economic Survey of Pakistan published on the 26th of Apr-18. As per the report, during the year, Pakistan's economy grew by +5.8%, lower than initial target of +6.0%. Growth has been impacted by the twin shocks of rising trade deficit and depleting foreign exchange reserves. Amongst the rest of the indicators, we highlight three key factors which marked 2018 performance;

- Higher economic growth
- Higher investments to GDP ratio
- Higher debt level

Nevertheless, +5.8% growth still offers some consolation given that it's the fastest growth rate in the past 13yrs and survey suggests that economy is on the recovery path and is expected to gather momentum in coming years.

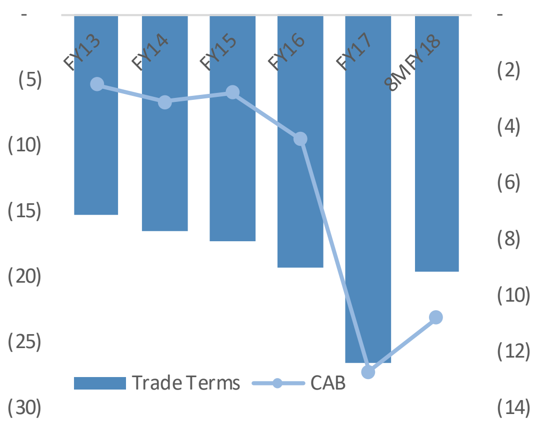
### GDP growth rise to a 13yr high

Starting from country's GDP growth, major support came from accommodative monetary policy and better supply situation along with ongoing infra/power spending under the wing of CPEC enabled renewed confidence in the private sector, which helped maintain fiscal discipline to a certain extent. Key improvements in macroeconomic indicators include, subdued inflation growth, rise in private sector credit, higher FDI and stable remittances. Moreover, better energy supply and strengthening banking sector helped lift up industrial sector growth to +5.8% (highest since 2008) led by automobile assemblers and steel sectors. However, overall share of industrial contribution remained relatively unchanged at ~21%. Services sector continued the trend, registering impressive growth rate of +6.4% (compared to +5.5% average in past 3yrs) taking its total share to ~60% of GDP. Agricultural sector growth picked up during the year to +3.8% compared to +1.5% on average in the past 3yrs. Major relief came from higher credit growth to farmers through government led schemes such as Kissan Package.

### Subdued inflation left monetary policy accommodative…

On prices front, average headline inflation during 9MFY17 recorded a growth of +3.8%, lower than +4.0% in the same period last year and well below the full year target of +6.0%. The food group with 37.5% weight in CPI basket showed an increase of +2.0%, compared to +3.8% in corresponding period last year. However, due to increase in education and house rent index, non-food prices showed a strong growth of +5.0% in the 9MFY18. Yet, as a result of stable food prices, inflation remained contained despite upward trend in oil prices as well as rise in domestic demand as depicted by average growth of +5.45% in core inflation. Consequently, the State Bank of Pakistan (SBP) raised the policy rate only once by 25bps to 6.00% to strike a balance between low

Exhibit: Trade and C/a Balance (PKR bn)




Source: SBP & IGI Research

inflation and burgeoning external account pressures and to anchor expected rise in inflation due to recent PKR depreciation.

### …but this also fueled higher consumption more than investment

Reflecting better domestic liquidity owing to accommodative monetary policy along with improving business confidence led to improvement in overall investments. Investment to GDP inched up to ~16.7% compared to average of ~16.2% in past 3yrs, depicting a +7.5% cumulative annual growth rate. However higher investment growth failed to translate into higher GDP growth rate. In comparison, GDP growth during the past 3yrs registered a +5.6% growth. Partially this could be explained by higher credit growth feeding consumption rather than investments. Private sector, which accounts for nearly ~60% of the total investments registered a 4.2% 3yr cagr compared to total credit offtake registering +12.5% in the same period.

### ...and simultaneously led to wider trade imbalances

Higher private consumption was also one of the reasons for widening trade deficits. During the outgoing year, trade deficit widened to USD 19.7bn (Jul-Feb) compared to USD 16.7bn last year same period. As such country's export to import cover dropped to 45% in 2018 compared to 62% back in 2013. Key to rise in trade deficit was ~18% rise in overall import bill during the year, compared to flattish exports growth. Much of the imports comprised of machinery, petroleum products and automobile, which was necessary for ongoing development. On the outlook, the report highlights that trade deficit is expected to shrink on account of lower machinery imports while rising petroleum prices will be a concern. On exports, government export packages managed to rescue dwindling exports (8MFY18 exports up +12%). Progress on GSP plus status has been rather slow, (in past 4yrs exports under GSP plus increased by a mere USD 1.5bn or USD 0.4bn p.a.), but government expects recovery in EU and US will be crucial in keeping export growth trend intact.

### …and C/a deficit reached its all-time high

Amid widening trade balance, the largest concerning indicator was rising C/a deficit which by Feb-18 reached USD 10.4bn compared to USD 6.2bn last year same period. In terms of GDP this translates to 4.1%*. Reflecting this FX reserves dropped by nearly 2bn to ~18.3bn by Feb-18 (ex-IMF EFF FX reserves drop to USD 11.7bn). Moreover, problem is exacerbated due to thin financial inflows. Primary financial inflows (FDIs and PIs) recorded USD 0.34mn outflow in 8MFY18 largely owing to USD 2.3bn outflow compared to an inflow of 993mn last year same period.

### Causing government to raise more debt and debt burden

To finance rising C/a deficit and domestic consumption the government has taken up nearly PKR 8.5trn worth of public debt by 1HFY18 since 2013, which translate into PKR ~5bn per day addition. By 1hFY18 total public debt to GDP stood at 66.3% (44.9% domestic debt to GDP) above government indicative range of 60%. External to domestic debt composition by 2017 stood at 44% compared to 50% back in 2013, albeit rising to 48% in 1hFY18 (of which USD 2.5bn was raised in 2QFy18) through Eurobond/Sukuk). As of this mix, overall servicing cost and maturity schedule improved. But upcoming external debt repayments (an estimated USD 25-27bn in the next 5yrs) will certainly be a drag on overall external and fiscal finances.

### A weak start to FY19

On growth, country's GDP is projected to average 6.0% in the next 3yrs. However, with interest rates expected to inch up amid rising country debt burden, widening external imbalances and lower public development spending, eyeing a 6%+ growth trajectory will be challenging in our view. Removal of supply side bottlenecks, namely energy under CPEC, will be crucial, delays in which could potential delay growth cycle as well, we think. Moreover, curtailing c/a deficit and fiscal deficit will be critical 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.

**Exhibit: Pakistan Economics**

| FY= (Jun) | Unit | FY11A | FY12A | FY13A | FY14A | FY15A | FY16A | FY17A | FY18P | FY19F | FY20F | FY21F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Real** | | | | | | | | | | | | |
| GDP Growth | % | 3.6 | 3.8 | 3.7 | 4.1 | 4.1 | 4.6 | 5.4 | 5.8 | 5.7 | 5.8 | 6.0 |
| Service Sector | % | 3.9 | 4.4 | 5.1 | 4.5 | 4.4 | 5.7 | 6.5 | 6.4 | 6.3 | 6.2 | 6.4 |
| Industrial Sector | % | 4.5 | 2.5 | 0.8 | 4.5 | 5.2 | 5.7 | 5.4 | 5.8 | 6.6 | 7.4 | 7.6 |
| Agricultural Sector | % | 2.0 | 3.6 | 2.7 | 2.5 | 2.1 | 0.2 | 2.1 | 3.8 | 2.7 | 2.8 | 2.8 |
| Investment to GDP | % | 15.1 | 14.9 | 14.7 | 14.4 | 15.8 | 16.1 | 16.6 | 16.7 | 17.0 | 17.3 | 17.6 |
| GDP | (PKRtrn) | 18.3 | 20.0 | 22.4 | 25.2 | 27.4 | 29.1 | 31.9 | 34.4 | 38.3 | 42.6 | 47.5 |
| GDP | (USDbn) | 213.8 | 224.6 | 231.4 | 244.7 | 270.9 | 278.9 | 304.3 | 312.8 | 316.3 | 338.8 | 366.8 |
| GDP per capita | (USD) | 1,274 | 1,321 | 1,334 | 1,389 | 1,514 | 1,529 | 1,627 | 1,585 | 1,516 | 1,537 | 1,575 |
| **Monetary** | | | | | | | | | | | | |
| CPI | % | 13.7 | 11.0 | 7.4 | 8.6 | 4.6 | 2.8 | 4.2 | 3.8 | 6.1 | 6.2 | 6.2 |
| Discount Rate - Per. end | % | 14.00 | 12.00 | 9.35 | 10.00 | 7.00 | 6.25 | 6.25 | 6.50 | 6.75 | 6.75 | 6.75 |
| Broad Money (M2) | % | 16.3 | 12.7 | 17.1 | 12.2 | 12.7 | 13.2 | 13.9 | 11.5 | 13.6 | 13.8 | 14.0 |
| **External Sector** | | | | | | | | | | | | |
| Exports | (USDbn) | 26.3 | 24.7 | 24.8 | 25.1 | 24.1 | 22.0 | 21.9 | 16.0 | 22.1 | 21.8 | 21.4 |
| Imports | (USDbn) | 37.9 | 40.4 | 40.2 | 41.7 | 41.4 | 41.3 | 48.5 | 35.7 | 47.2 | 49.8 | 53.1 |
| Trade Terms | (USDbn) | (11.7) | (15.7) | (15.4) | (16.6) | (17.3) | (19.3) | (26.6) | (19.7) | (25.1) | (28.0) | (31.7) |
| Remittances | (USDbn) | 11.9 | 13.2 | 13.9 | 15.8 | 18.7 | 19.9 | 19.4 | 12.8 | 13.3 | 13.8 | 14.3 |
| CAB | (USDbn) | (0.6) | (4.7) | (2.5) | (3.1) | (2.8) | (4.5) | (12.7) | (10.8) | (8.3) | (5.8) | (3.3) |
| CAB (% of GDP) | | - 0.3 | - 2.1 | - 1.1 | - 1.3 | - 1.0 | - 1.6 | - 4.2 | - 3.5 | - 2.6 | - 1.7 | - 0.9 |
| **Exchange rate** | | | | | | | | | | | | |
| USD | | 85.5 | 89.2 | 96.7 | 102.9 | 101.3 | 104.2 | 104.7 | 109.9 | 121.0 | 125.8 | 129.5 |
| FX Reserves | (USDbn) | 18.2 | 15.3 | 11.0 | 16.0 | 18.7 | 23.1 | 20.3 | 16.7 | 20.5 | 26.8 | 35.5 |
| **Fiscal (%age of GDP)** | | | | | | | | | | | | |
| Tax Revenue | % | 9.3 | 10.2 | 9.8 | 10.2 | 11.0 | 12.6 | 12.5 | 12.6 | 12.8 | 12.9 | 13.1 |
| Current Expenditure | % | 15.9 | 15.6 | 16.4 | 15.9 | 16.1 | 16.1 | 16.3 | 16.3 | 16.3 | 16.3 | 16.3 |
| Development Expenditure | % | 2.8 | 3.7 | 5.1 | 4.9 | 4.2 | 4.5 | 5.3 | 5.4 | 5.6 | 5.7 | 5.9 |
| Fiscal Balance | % | 6.5 | 6.8 | 8.2 | 5.5 | 5.3 | 4.6 | 5.8 | 5.7 | 5.5 | 5.4 | 5.3 |
| **Debt (%age of GDP)** | | | | | | | | | | | | |
| Gross Public Debt | % | 58.9 | 63.3 | 63.8 | 63.5 | 63.2 | 66.5 | 66.1 | 66.2 | 65.0 | 63.9 | 62.8 |

*Source: IGI Research, Pakistan Economic Survey, *year to date, ^population 207mn as of 2017 census*

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