Day Break

Thursday, 08 March 2018

IGI Securities
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Economy

Exhibit: Fiscal imbalance

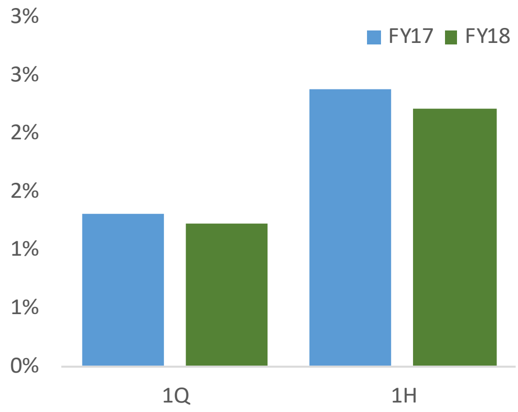
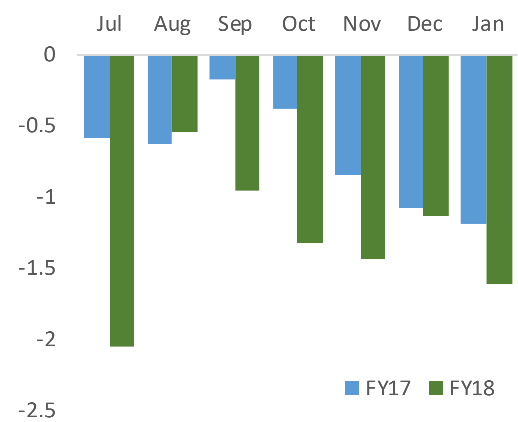


Exhibit: Rising current account balance



Source: SBP, PBS & IGI Research

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Economy

IMF underlines Macroeconomic instability

- IMF statement had a positive view on near term economic growth but underlined concern regarding macroeconomic stability of the country
- The IMF expects GDP growth to clock in at 5.6% while we have a slightly higher estimate at 5.7%
- IMF suggested revenue generation and curtailment of current expenditures to control fiscal slippages, estimated at 5.5%
- Outlining the need to control external imbalance, the statement added the need to further tighten monetary policy.
- Pakistan's ability to service IMF debt in the medium term came under question with the IMF singling it out as one of the concerns.

Macroeconomic challenges highlighted

As per the press release by IMF, the Executive Board of the International Monetary Fund (IMF) concluded its first Post-Program Monitoring Discussions with Pakistan on the 5th March, 2018. The statement had a positive view on near term economic growth but underlined concern regarding macroeconomic stability of the country, particularly the twin deficits and its resultant impact on debt servicing capacity.

Healthy GDP growth projected for FY18

The IMF expects GDP growth to clock in at 5.6% given better power supply, recovery in agriculture, robust consumption growth and CPEC related investments. We tend to agree with the IMF and estimate GDP growth to clock in at a slightly lower rate of 5.5%, but much lower than Government's estimate of 6% due to relatively slower growth in manufacturing as depicted by decline in LSM index (down 1.4%YoY in Dec-17).

Fiscal balance expected to worsen to 5.5% of the GDP

On fiscal imbalance, the assessment report of the Executive Board says that the fiscal deterioration is partly to blame for external sector challenges. They suggested revenue generation and curtailment of current expenditures to control fiscal slippages. To recall, during 1HFY18, fiscal deficit reached 2.2% of the GDP compared to 2.3% in same period last year. However, it must be noted that since this is the election year, public expenditure is expected to increase rapidly in 2HFY18, a concern also shared by the IMF. As per the IMF projections, fiscal balance is expected to touch 5.5% in FY18, below our estimate of 5.7%.

Exhibit:
Updated IMF estimates

	FY15	FY16	FY17	FY18E
Real GDP at factor cost (%)	4.1	4.5	5.3	5.6
Budget balance (ex. grants, % of GDP)	-5.4	-4.6	-5.8	-5.5
Current account balance (% of GDP)	-1	-1.7	-4.1	-4.8
Import cover based on next year's imports	3.2	3.7	3	2.2

Source: IMF

External sector vulnerabilities the main challenge

Outlining the need to control external imbalance, the statement added the need to further tighten monetary policy. To recall, 7MFY18 CA deficit is currently at ~9.1bn and SBP increased target rate by +25bps in Jan-18, citing the same issue as one of the key reasons. Further PKR flexibility was also emphasized to promote external buffers and competitiveness. The IMF expects CA deficit to clock in at 4.8% of the GDP, slightly higher than our estimate of 4.7% of the GDP.

IMF raises concerns regarding debt repayment capacity

Consequent to the aforementioned reasons, Pakistan's ability to service IMF debt in the medium term came under question with the IMF singling it out as one of the concerns. We at IGI do agree that there is significant risk due to continuously rising imports and declining reserves with import cover down to 2.6 months (Jan-17). However, the resultant growth from CPEC related projects may offset these pressures in the medium term, in our view.

Exhibit:
Declining import cover

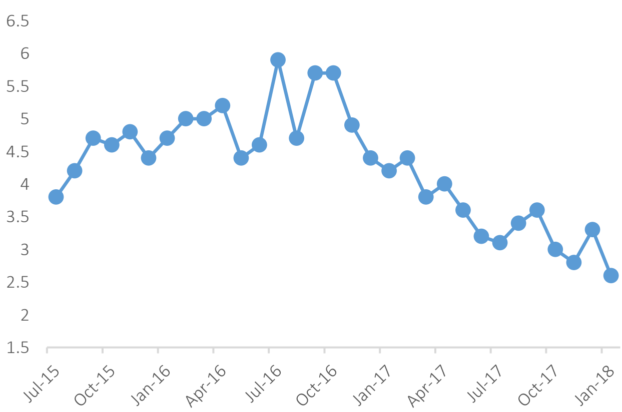
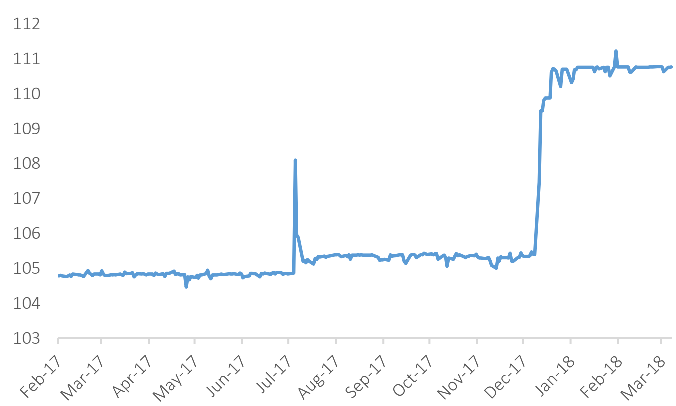


Exhibit:
Sharp PKR depreciation in Dec-17 after a long period of stability



ource: IGI Research, SBP, PBS

Concluding remarks

Pakistan's economy yet again faces significant challenges. The press release from the IMF underscored need for structural reforms, enhanced competitiveness while strengthening fiscal federalism and monetary and financial policy frameworks.

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