MPS Decision for May-July 2017 (As on May 20, 2017)

MPS Decision Preface- Key Statistical Chronology

Pre-monetary policy announcement, in the advent of this month, the government raised PKR 354.74bn from the auction of Pakistan MTBs of various tenors held on May 11, smaller against the received bids of PKR 409.24bn. It was however, higher against the auction target of PKR 350bn.

Of the total raised amount, three month T-bills fetched the highest PKR 259.45bn at a cut off yield of 5.99%, followed by six month T-bill PKR 92.88bn at 6.01% and 12-month T-bill PKR 2.40bn at 6.02%.

Three month T-bill attracted the highest amount of PKR 283.96bn: six month T-bill PKR 119.57bn, and 12-month T-bill PKR 5.70bn.

While on May 17, the auction of Pakistan Investment Bonds was held which was completely scrapped (second time in a row as April 20 auction was also rejected).

Deposits and other accounts of all scheduled banks stood at PKR 11,070.49bn after a 1.28% decrease over the preceding week's figure of PKR 11,214.04bn, according to the weekly statement of position for the week ended May 05. Compared with last year's corresponding figure of PKR 9,667.62bn, the current week's figure was higher by 14.51%.

Borrowings by all scheduled banks decreased in the week under review by 1.90%. Compared to last year's corresponding figure, the current week's figure is higher by 29.92%.

Deposits and other accounts of all commercial banks stood at PKR 10,996.66bn against preceding week's deposits of PKR 11,140.12bn, showing a decline of 1.29%. Deposits and other accounts of specialised banks stood at PKR 73.83bn, lower by 0.12% against previous week's figure of PKR 73.92bn.

Total assets of all scheduled banks stood at PKR 15,503.50bn, lower by 0.96% over preceding week's figure of PKR 15,653.06bn. Current week's figure is higher by 15.42% compared to last year's corresponding figure of PKR 13,431.80bn.

Total assets of all commercial banks stood at PKR 15,258.36bn, lower by 0.94% over previous week's figure of PKR 15,403.73bn, while total assets of specialised banks at PKR 245.14bn, were smaller 1.68% over the previous week's PKR 249.33bn.

Gross advances of all scheduled banks stood at PKR 5,805.25bn, higher by 0.50% over the preceding week's figure of PKR 5,776.68bn. Compared with last year's corresponding figure of PKR 4,957.68bn, current week's figure is higher by 17.09%.

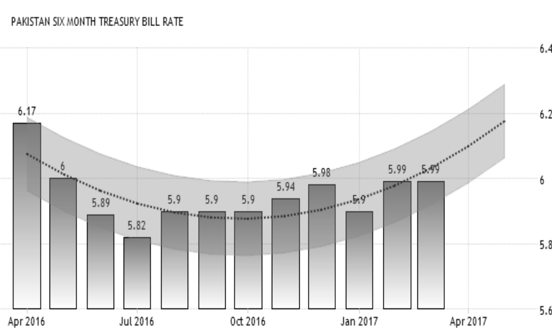
Advances by all commercial banks increased to PKR 5,636.76bn from previous week's PKR 5,608.29bn indicating a rise of 0.50%, whereas advances of specialised banks stood at PKR 168.49bn against previous week's PKR 168.39bn.

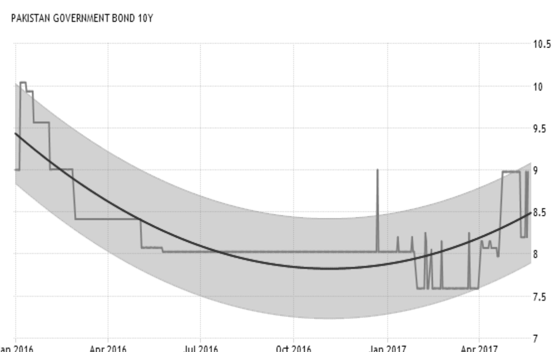
Key Facts/ Statistics

Latest MPS: 20th May, 2017
Market Stance: 25 bps rise

FAML Fund Management Stance: Status quo

Previous MPS: March 25, 2017
Decision: Unchanged at 5.75%





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Borrowings by all scheduled banks decreased in the week under review. It fell by 1.90% to PKR 2,231.01bn against previous week's PKR 2,274.21bn. Compared to last year's corresponding figure of PKR 1,717.24bn, current week's figure is higher by 29.92%.

Borrowings by commercial banks in the week at PKR 2,203.90bn were lower by 1.96% against previous week's PKR 2,247.94bn. Borrowings by specialised banks stood at PKR 27.10bn against the previous week's PKR 26.26bn.

Investments of all scheduled banks stood at PKR 7,791.52bn against preceding week's figure of PKR 7,794.31bn, showing a decrease of 0.04%. Compared to last year's corresponding figure of PKR 6,822.66bn, current week's figure is higher by 14.20%.

Investments by all commercial banks stood at PKR 7,736.49bn, smaller by 0.13% against preceding week's figure of PKR 7,746.50bn, whereas investment by all specialised banks stood at PKR 55.03bn against preceding week's figure of PKR 47.81bn.

Notes in circulation stood at PKR 3,795.23bn during the week ended May 05, according to the State Bank of Pakistan, against PKR 3,731.47bn a week earlier, showing a rise of 1.70%. Compared to last year's corresponding figure of PKR 3,254.29bn, current week's figure is higher by 16.62%.

MPS Decision Trail

In line with FAML expectations as stated in appended email, the State Bank of Pakistan (SBP) has left the key interest rate unchanged at 5.75% for the next two months. The central bank has maintained the discount rate at 5.75% since May 2016, which is at its lowest level in four decades. The rate was in double digits (at 10%) in the first half of fiscal year 2012-13.

Analysts expected the central bank to keep the status quo as real interest rate currently stands at a comfortable level, leaving room for the SBP to support government's ambitious growth targets (6% GDP growth) in fiscal year 2017-18.

However, market observers say that there is a likelihood of reversal in the interest rate cycle due to the anticipation of mounting inflationary pressures.

Increasing vulnerabilities on the external front in the form of soaring current account deficit and falling foreign reserves also strengthen the case for a hawkish monetary policy.

With further improvement in economic activity along with pass through of the recovering global oil prices to domestic motor fuel cost, headline Consumer Price Index (CPI) inflation has also edged up in recent months, was largely believed by SBP. However, the central bank expects uptick in inflation in coming months.

Key Facts/ Statistics

Latest MPS: 20th May, 2017

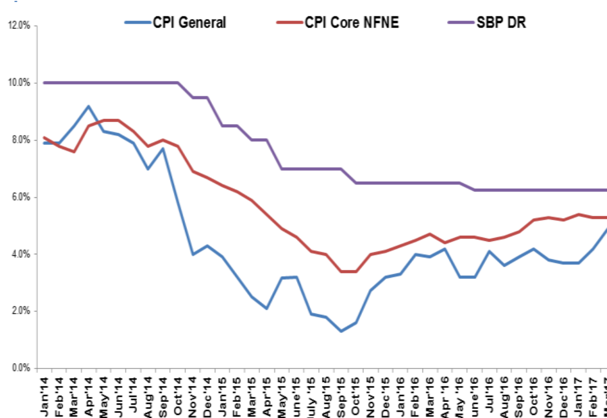
Market Stance: Mixed (Unchanged to 25 bps rise)

FAML Fund Management Stance: Status quo

Previous MPS: March 25, 2017

Decision: Unchanged at 5.75%

Consumer prices in Pakistan increased 4.94% YoY in March of 2017, following 4.22% rise in the previous month. It was the highest inflation rate since October 2014, as prices rose at a faster pace for food (4.64% vs. 3.1% in February) and transport (4.4% vs. 0.4%). On a monthly basis, prices went up 0.84%. Inflation Rate in Pakistan averaged 7.85% from 1957 until 2017, reaching an all-time high of 37.81% in December of 1973 and a record low of -10.32% in February of 1959.



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Going forward in fiscal year 2017-18, current trends of rising income, surge in imports, and accelerating credit to private sector are expected to increase the CPI inflation; however, the Central bank expects it is likely to remain within the target.

In a manner of speaking, SBP announces a target rate every two months, which serves as the benchmark interest rate for overnight funds in the interbank market. It is one of the tools the central bank uses to ensure price stability in the economy.

Decreasing the target rate poses the risk of high inflation, but also stimulates economic growth by making credit cheaper. In contrast, raising the target rate restricts the level of liquidity, which subdues consumer prices in the economy. The central bank tries to strike a balance by targeting the overnight cost of funds at a level that promotes maximum economic growth without causing high inflation.

The central bank mentioned the expected improvement in real GDP growth of 5.3% – highest in last 10 years – in fiscal year 2016-17.

It said that the major backing came from the ongoing public and private investment particularly in infrastructure and power sector. Moreover, consumer spending has also expanded with a stable inflationary environment and banks' renewed interest in consumer financing.

The private sector continues to take loans and undertake capacity expansions during the first 10 months (Jul-Apr) of the ongoing fiscal year.

The credit flow to private businesses remained broad-based with major impetus from textile and with the expansion in the economic activity, private sector credit uptake is expected to continue in fiscal year 2017-18, it has been predicted.

The central bank also pointed out the extraordinary widening of the current account deficit due to upsurge in imports and decline in exports. A sustained increase in other private inflows – foreign direct investments and export earnings in particular – is required to fully finance the surge in imports.

However, the SBP expects official inflows to provide support to foreign exchange reserves. On a positive note, the regulator observed that the current growth momentum led by China Pakistan Economic Corridor (CPEC) related investments is likely to boost foreign direct investment (FDI) inflows.

In a recently released development update on Pakistan, the World Bank has summarised the state of Pakistan's economy aptly, wisely and succinctly. The report is slick, well-written, and buttressed by all the right facts, figures and graphs.

Even non-economists like me can read it. The report heaps praise on Pakistan's government where it should, and paints a realistic picture of the emerging challenges where it must.

The report acknowledges that Pakistan's economy continues to grow strongly, emerging as one of the top performers in South Asia.

Key Facts/ Statistics

- The government missed its annual GDP growth rate target of 5.7%
- However, at 5.3%, Pakistan's economic growth has finally attained the pace it had before the crisis hit the country in 2008
- Almost two-thirds of the growth came from the services sector
- Current account deficit target has been missed by a wide margin and government expects a $8.3 billion current account deficit by June this year
- Contraction in exports remained a big challenge due to lack of focus on value-addition sectors
- Out of 20 key growth indicators, 11 hit the government's targeted growth rates
- Agriculture sector grew at a pace of 3.5%, equivalent to the annual target
- Pakistan missed all its targets for the industrial sector
- Services sector grew by almost 6% against a target of 5.7%

TOP 25 COUNTRIES BY 2050 (2016 RANKING IN BRACKET)

RANKED BY PROJECTED GDP AT PURCHASING POWER PARITY IN TRILLIONS OF U.S. DOLLARS

Country	GDP
1. China (1.)	$58.5
2. India (3.)	$44.1
3. U.S. (2.)	$34.1
4. Indonesia (8.)	$10.5
5. Brazil (7.)	$7.5
6. Russia (6.)	$7.1
7. Mexico (11.)	$6.9
8. Japan (4.)	$6.8
9. Germany (5.)	$6.1
10. U.K. (9.)	$5.4
11. Turkey (14.)	$5.2
12. France (10.)	$4.7
13. Saudi Arabia (15.)	$4.7
14. Nigeria (22.)	$4.3
15. Egypt (21.)	$4.3
16. Pakistan (24.)	$4.2
17. Iran (18.)	$3.9
18. South Korea (13.)	$3.5
19. Phillippines (28.)	$3.3
20. Vietnam (32.)	$3.2
21. Italy (12.)	$3.1
22. Canada (17.)	$3.1
23. Bangladesh (31.)	$3.1
24. Malaysia (27.)	$2.8
25. Thailand	$2.8

SOURCE: PWC NATIONAL POST

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Despite an uncertain global climate, Pakistan's economic growth is expected to accelerate to 5.2% in FY17 from 4.7% in FY16. Services, which comprise 59% of the economy, are expected to grow at a steady 5.6% in FY17.

Similarly, Inflation has remained within a tolerable range. Pakistan's investment-to-GDP ratio is expected to increase slightly in FY17 due to CPEC-related infrastructure projects. CPEC can unleash positive externalities over the short to medium term. Similarly, Pakistan's fiscal position has improved significantly over the past three years as the consolidated fiscal deficit (excluding grants) declined from 8.5% of GDP in FY13 to 4.6% in FY16.

The most remarkable story has been the stellar growth exhibited by Pakistan's equity market, with the benchmark PSX-100 Index growing 45.7% in 2016. This growth has occurred in part due to equity market reforms, including the integration of the country's three stock exchanges and improved governance and risk management. In what has become a major victory for the Pakistani economy, U.S.-based Morgan Stanley Capital International (MSCI) reclassified Pakistan as an emerging market after categorizing it among frontier markets for the past nine years.

As the benchmark PSX-100 index skyrocketed 400 points to reach 52,700 level at the open earlier this week, a new all-time high, the MSCI upgraded the Pakistan Stock Exchange (PSX) to Emerging Market status. That paved the way for foreign investors that track the index and have between $1.4 trillion and $1.7 trillion available.

So the World Bank's update is full of glowing remarks for Pakistan? Not exactly. The report issues numerous warnings that not all is well. Revenue growth is slowing, with the fiscal deficit growing for the first time in three years. Exports continue to fall as imports grow, substantially increasing the current account deficit. Investments rates - already low - fell further in FY16. The energy sector circular debt has resurfaced. There is a possibility that Pakistan may lose its impressive gains achieved over the past four years.

As the government nears four years in office, progress on reforms is slowing down. Privatisation efforts have stalled, and FBR performance in tax collection is below target, even after several years of strong performance. In Punjab, the province’s economy has struggled to create enough jobs for its growing young population

Some of the reasons for these emerging challenges are as follows. As the government nears four years in office, progress on reforms is slowing down. Privatisation efforts have stalled, and FBR performance in tax collection is below target, after several years of strong performance. In Punjab, the province's economy has struggled to create enough jobs for its growing young population. Whereas Vietnam, China and other South Asian countries have increased agricultural yields, Pakistan's agricultural sector has lagged behind. Even remittances have fallen by 2.3% in the first nine months of FY17.

The big news for the Pakistani economy comes as the country is set to soak up the economic benefits of the China-Pakistan Economic Corridor (CPEC), which has for months been one of the most talked about topics among foreign investors.

Reiterating retrospective stances

The macroeconomic indicators undoubtedly have shown very encouraging signs for the past four years and the present government must be credited for making this achievement possible. The country has moved a long way from the situation when it was on the brink of a collapse.

A semblance of macroeconomic stability has been restored as almost all economic indicators are showing positive trends but any claim that the country is completely out of woods is totally unjustified. Independent analysts have long been cautioning the economic managers of the grave challenges faced by the economy of the country, and Pakistan’s foreign lenders, particularly the International Monetary Fund (IMF), too have recently started highlighting those challenges in a very subtle manner.

The government has managed to avert a balance of payment crisis, contain inflation and build-up foreign exchange reserves over the past four years. However, declining exports, low foreign investment, falling foreign remittances and almost dormant privatisation process are major challenges for the economy.

The recent figures of the country’s current account deficit show much more needs to be done to achieve durable economic stability.

In the first 10 months of the fiscal year, July-April, the external account deficit has risen to US$ 7.2 billion, more than triple the figure for the corresponding period in last year.

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The analysts have long been warning the government about burgeoning current account deficit, but the figures are being downplayed and those responsible are saying that the tremendous rise in the country's import bill is because of import of machinery for the China-Pakistan Economic Corridor (CPEC).

They argued that once those machineries are installed and started production, those fears would simply evaporate.

Fitch Ratings, one of the three big credit rating agencies, has recently said Pakistan's external finance pressures are still manageable despite enormously high external account deficit.

However, Moody's Investor Services, another credible rating agency, has forecasted that Pakistan's external debt would grow to US$ 79 billion by June – higher than initial estimates – and the country's weak fiscal base is weighing on its ability to afford this never-ending debt burden.

The independent analysts too are of the view that the current account deficit is increasing at a tremendous speed and if the government did not take appropriate measures to contain it, it would put pressure on country's foreign exchange reserves, which would ultimately force the government to seek another remedy in the shape of a new bailout package from the IMF.

Successive governments have committed these mistakes for their own convenience and the gravity of the problem could be discovered only after they left the office. The incoming governments always blamed their predecessors for these blunders but, unfortunately, repeated the same mistakes for themselves.

Low international oil prices as well as commodity prices also resulted in the drastic fall in inflation that tremendously eased pressure on the government but it seems the present government is poised to repeat the mistakes made by its predecessors.

While macroeconomic stability is an important step for economic recovery of a country, it should not be construed as the only step needed to revive a fragile economy like that of Pakistan.

Pakistan's economic woes are largely structural. What we need vitally are fundamental economic reforms. Otherwise, the dream of economic revival would remain unrealised.

The observers say the present government, which has enjoyed absolute majority in the parliament and faced no danger from within the parliament to its rule – did little to address long standing economic challenges of the country like low levels of investment and domestic savings, abysmally low-tax-to GDP ratio, falling exports, declining foreign investment, rising debt, lack of energy reforms, etc.

They say since the government failed to do anything tangible on these fronts in the first four years of its tenure, how could one expect from it to take tough and sometimes unpopular measures to address these problems in the last year of its term when it would try to take popular steps to win support from its voters.

There is a need for a broad consensus among Pakistan's political leadership on measures needed to address the deep-rooted economic woes of the country. Habitually, Pakistani political parties, while in opposition have opposed economic reforms, which they badly need to implement when they come into power.

Moreover, the political parties, dominated by powerful lobbies, have also been reluctant to take bold economic reforms for fear of backlash from the powerful political lobbies.

Therefore, introduction of badly-needed and politically-difficult structural reforms would remain a mirage until Pakistani leadership show political muscle and will to implement those reforms.

Much of the macroeconomic stability we are witnessing nowadays is propelled by foreign aid and assistance. We achieved such stability in the past too, but swiftly lost those gains once that support vanished. Unless Pakistan introduces home growth reforms under which powerful Pakistani elite takes the bitter pill of shouldering the pain of those reforms, Pakistan's economic problems were unlikely to mitigate.

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