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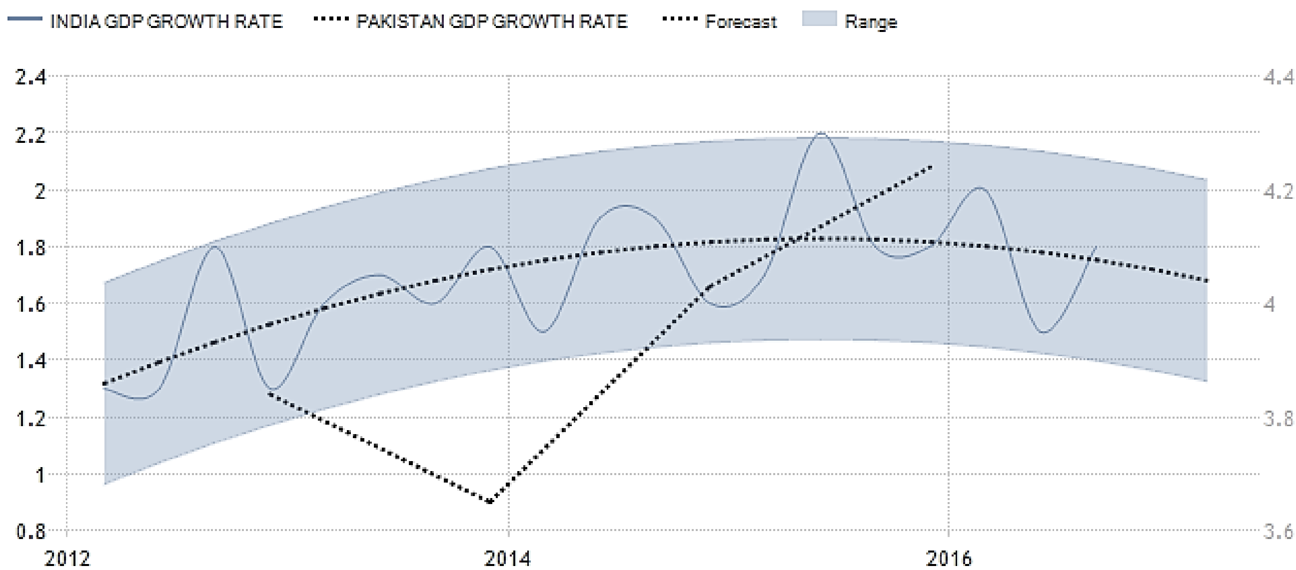
Pakistan Story- How the World Views Us and How to Make it Worthwhile

Pakistan's economic growth has improved (as boasted by many) and law and order across the country has also shown promising results as compared to the past (which is truly acknowledging).

The world now recognizes Pakistan as the next emerging success story, as CPEC takes shape.

The latest economic and financial indicators show that Pakistan compared favorably with the other regional countries and ranked third in the region whereas seventh globally in terms of GDP growth.

The economic indicators which include output, prices and jobs, trade, exchange and interest rates show that the latest GDP growth of the country has been recorded at 5.7% whereas in 2017 it has been predicted at 5.3%. The industrial production percentage and change a year ago has been recorded by +2.3% till October 2016 whereas during the same period India's industrial production percentage and change was recorded -1.9%.



This data which has been compiled by the "Economist Magazine" is validating the government's target for the GDP growth which is a positive sign; however, there is a need of reducing unemployment ratio as well. Accordingly, the reduction in export is also a worrying indicator which needed to be considered by the government seriously.

According to the Economist's data, the inflationary data as per consumer price basket has been recorded at 3.7% YoY whereas India scored 3.6% YoY in Dec 2016. The unemployment rate has been recorded at 5.9% till 2015 whereas India's unemployment was recorded at 5% in the same period.

In another indicator, India's trade balance has been recorded at -26% by December 2016 whereas Pakistan's current account balance has been recorded at -4.1% in 3Q which is -0.9% of the GDP in 2016. The budget balance has been recorded at -4.6% of the GDP.

Although, both the countries have their discount rates trailing at same levels of 6.25% (Pakistan has policy rate at 5.75%, while India's reverse repurchase rate at 5.75%), still the differential in yields is visible as, in Pakistan the yield on 3 months treasury bills has been recorded at +5.95% while in India the cut-off yield is at 6.19%.

By: Sania Awan -Sr. Research Analyst (FAML Research) **January 12, 2016**

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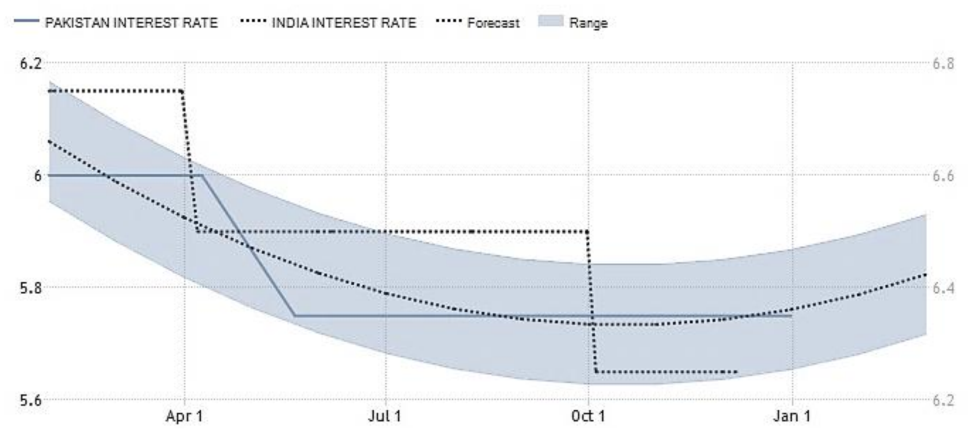
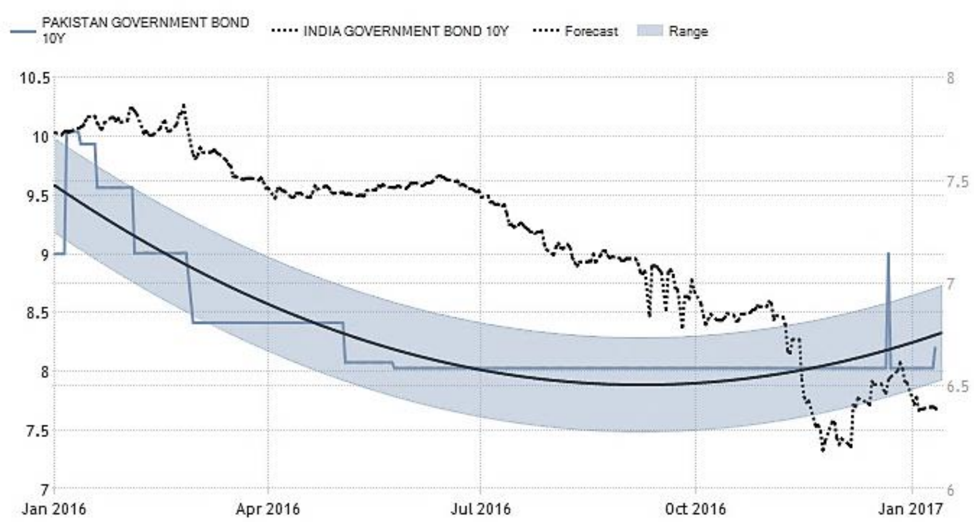


On the contrary, in the indicator of 10-year government bonds, Pakistan scored 7.80% and India offered 6.38% on the same long tenor paper.



According to analysis based on facts and figures quoted by credible sources (SBP, PBF, MoF), it goes without saying (and as pertinently highlighted in earlier reports) that Pakistan's economy maintained its momentum towards a higher growth trajectory in FY16. An enabling policy environment was one of the key factors that contributed to this impetus. Higher infrastructure spending by the government and decades' low interest rates provided a boost to domestic demand; and easing in the energy supply situation addressed a key bottleneck holding back industrial performance. An improvement in the security situation supplemented these policy measures. While some indicators were short of the targets, they still posted better position as compared to FY15.

The current account deficit during FY16 was higher than the last year, though it was comfortably financed by financial inflows. In fact, in net terms, the FX inflows during FY16 were higher than outflows, which led to accumulation of foreign exchange reserves to an all-time high level.

However, there are certain challenges that deserve the undivided attention of all stakeholders:

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First, Pakistan needs to increase its savings and investment levels. Although public investment is increasing despite resource constraints, investment by the private sector has not increased sufficiently. This has inhibited the country's potential growth. On the other hand, savings are not commensurate with required investible resources. The situation cannot be fully remedied unless the private sector, in particular, comes up with attractive savings schemes in the areas of pensions, provident fund, gratuity, old age benefit schemes; targeted marketing of such schemes (including in the rural areas) is also imperative.

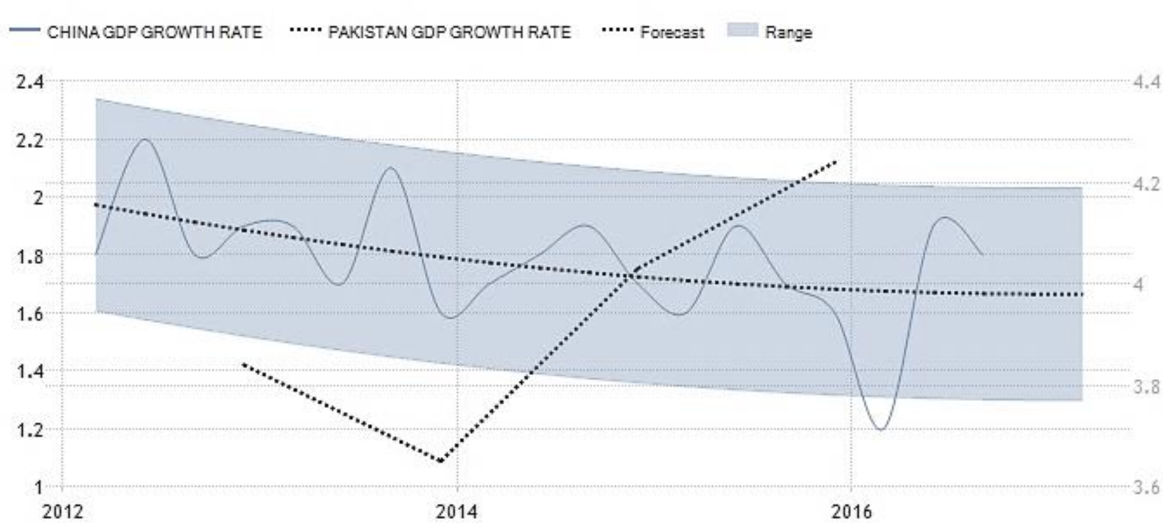
Another most important element of focus and a major challenge for the government is the lagging exports as they continue to pose a major challenge for a sustainable external account. Some recent policy fixes (like zero rating of exporting sectors and release of refunds) are welcome steps and will have positive impact, but structural issues in the export industry should also be resolved. In fact, these shortcomings magnify the impact of falling global commodity prices (for example, the decline in unit prices suppressed export values of certain commodities).

While ongoing fiscal consolidation measures are welcoming and have been widely appreciated by both local and foreign stakeholders, the reliance of the tax structure on stop-gap measures (like imposition of regulatory duties in November 2015) is creating distortions in the economy. As sectors like telecommunication and energy yield hefty revenues, others like agriculture are hardly contributing their worth in total taxes.

Moreover, the country has been unable to spend nearly as much on social sector development as it needs to. Be on health or education, Pakistan spends much less as percentage of GDP than many developing countries. Despite some improvements in areas like poverty alleviation, maternal and child mortality, and primary school enrolment, the country was unable to meet a majority of the targets set under the Millennium Development Goals (MDG) framework. With the Sustainable Development Goals having replaced MDGs last year, a deep rethink is required across all levels of the government – federal, provincial, and local – to have any meaningful chance of meeting the SDGs.

Having considering all such anomalies, the optimism for Pakistan has been enhanced as it is forecasted to be the world's fastest-growing Muslim economy in 2017 ahead of Indonesia, Malaysia, Turkey and Egypt, according to London's The Economist magazine.

Pakistan's estimated GDP growth – 5.3% – is also ahead of 4% GDP growth of Israel. This makes Pakistan world's fifth fastest-growing economy in the world, only behind India and China and two other countries.



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This data reinforces a Harvard University study which predicted Pakistan to grow by more than 5% in the next decade.

The 2017 forecast (by the Economist) of 5.3% growth is, however, lower than the 2016's 5.7% forecasted growth rate, government must take steps to put economy on the path of irreversible growth, especially with 2018 electoral rolls on the way. In 2014, The Economist had forecasted Pakistan to be world's sixth fastest-growing country.

Despite rising economy, Pakistan still hampered by image problem. This year, the four world economies ahead of us are: India (7.5%), Vietnam (6.6%), China (6.4%), and Philippines (6.4%). And we are ahead of large Muslim economies such as: Indonesia (5.2%), Malaysia (4.6%), Egypt (4.0%), and Turkey (2.9%). All of these countries except Malaysia are going to be among the top 20 economies in the world in 2050.

On the global radar, even World Bank remained bullish on Pakistan's growth prospects for the next three years, revising its earlier projection notches up on large cross-border infrastructure investment, reforms and restoration of investor confidence, estimating the growth rate at 5.2% for 2017 against 4.7% for 2016.

The uptick in activity was spurred by a combination of low commodity prices, rising infrastructure spending, and reforms that lifted domestic demand and improved the business climate, the Washington-based lender viewed in its flagship report issued lately.

It forecasted the GDP growth in the South Asia's second biggest economy at 5.2% for 2017, adding that the growth is expected to accelerate from 5.5% in 2018 to 5.8% in 2019, reflecting improvements in agriculture, infrastructure, energy and external demand.

In June last year, World Bank forecasted the GDP growth rate at 4.5% for 2017 and 4.8% for 2018. Yet, international regulators still identified that persistent security and political tensions and rising debt levels are domestic, while jump in oil prices and prolonged slowdown in key export markets are external risks to the growth outlook. WB has advised soft key policy rate to spur growth. As accommodative monetary policy stance is expected to support activity.

It is worth noting that, the investment growth has recovered in a number of countries, including Pakistan, however, it remains below its long-term average in more than half of all commodity-importing countries.

The successful conclusion of the International Monetary Fund's (IMF) extended fund facility program, aimed at supporting reforms and reducing fiscal and external sector vulnerabilities, has lifted consumer and investor confidence.

Pakistan implemented various reforms under the IMF program and World Bank's development policy credits, tackling key structural challenges, such as reforms to ease energy constraints, tax policy and administrative reforms to raise revenues, and strengthening independence of the State Bank of Pakistan to reduce vulnerabilities.

The much acclaimed China-Pakistan Economic Corridor (CPEC) project is deemed to increase investment in the medium-term, and alleviate the transportation bottlenecks and electricity shortages.

The appreciating trade-weighted real exchange rate weakened the export competitiveness in Pakistan and India. Lower energy import bills mitigated the negative impact of reduced exports and remittances on current account balances which, except for Bangladesh, mostly continued to be in the deficit.

Pakistan's soft inflation was due to fiscal restraint and pass-through of nominal exchange rate appreciation. Budget consolidation in Pakistan brought down the fiscal deficit to 4.6% in 2016. Reductions in energy subsidies and an

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increase in excise taxes eased spending pressures in India, Pakistan and Sri Lanka. Reiterating, an accommodative fiscal policy ahead of general elections may cause widening of fiscal deficit.

Privatization proceeds from state-owned enterprises both in Pakistan and India fell short of expectations. Large-scale borrowing to fund infrastructure projects in Maldives, Pakistan and Sri Lanka has led to elevated public debt.

Since, Afghanistan was the weakest country in the region in terms of growth estimated at 1.2% in 2016, largely due to slowing domestic demand, deteriorating security, and drought which affected agriculture output, furthermore, the resettlement of returning refugees from Pakistan further exerted fiscal pressure, constraining infrastructure investment.

Last but not the least, the Forbes Magazine also acknowledged Pakistan’s growth story terming is as a hot topic in the region, under the captioned report “after beating India in equity markets, Pakistan beats India in another metric recently: Geopolitics.” The country’s leaders have skillfully leveraged Pakistan's strategic geographic location to extract a series of benefits from America and China. In fact, the performance of Pakistan’s equity markets and geopolitics isn’t reflective of their independence from each other. Geopolitics has been, and will be, a major driver for the country’s financial markets.

Back in 2001, Pakistan leveraged its proximity to Afghanistan to extract a big benefit from America: a write off for a big part of its foreign debt — the spark of Pakistan’s fifteen-year bull market.

America needed Pakistan as an ally in its war against Afghanistan. And Pakistan's leadership offered to do just that in exchange for the US brokering debt relief for their large external debt — 60% of the country’s GDP, with debt servicing accounting for 30% of exports.

Indeed, in December 2001, the Paris club did just that, cutting Pakistan’s debt by $12 billion, with IMF providing the country additional funding.

The rest is history. Pakistan’s currency strengthened as foreign expatriate remittances and foreign capital flowed into the country, with a good chunk of it ending in financial markets--which took off, until the 2008-9 financial crisis.

Then China came along to re-ignite Pakistan’s market, once again. Beijing needed a western route to the Middle East, and Africa--China's second continent. Ideologically that can explain why Beijing committed $46 billion to China-Pakistan Economic Corridor (CPEC). In addition, China has been investing in Pakistan’s infrastructure companies-which has not been very pleasing for the world economies.

Thus, with more regional partners willing to join CPEC oriented plans and journey- Pakistan Story is unquestionably promising as long as effective policies that cushion our fiscal leakages (like the much awaited and welcomed by all stakeholders- export package announced by PM) are streamlined in an economically viable and timely manner.

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