Country Report

Pakistan

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The Economist Intelligence Unit

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Executive summary

Highlights

October 2008

Outlook for 2009-10

- Political stability is unlikely to improve significantly in 2009-10. Inter-party political rivalry will continue unabated, and the country's security problems will remain unresolved.
- Relations with the US are likely to deteriorate as a result of the newly announced US policy of conducting military operations in Pakistani territory without the permission of the Pakistani government.
- Economic policy will remain focused on crisis management for the remainder of 2008 and into 2009. Despite a shortfall of US$10bn to meet short-term liabilities, Pakistan is loathe to turn to the IMF for assistance.
- The government's focus on reining in the fiscal deficit means that it will attempt to cut back on expenditure. Nevertheless, the Economist Intelligence Unit expects the deficit to reach 6.2% of GDP in fiscal year 2008/09 (July-June).
- We forecast that real GDP growth (expenditure measure) will slow to 4.2% in 2008/09, from 6% in 2007/08. Accelerating price rises will depress real wages, and thus consumer spending. GDP growth will increase to 4.7% in 2009/10.

Monthly review

- The *de facto* leader of the Pakistan People's Party, Asif Ali Zardari, was elected president on September 6th.
- A suicide bomb attack on the Marriott hotel in the capital, Islamabad, killed more than 50 people and injured hundreds on September 20th.
- US forces have conducted raids in Pakistani territory in pursuit of Islamist militants. Pakistan's army chief, General Ashfaq Kayani, condemned the incursions, and reports emerged of Pakistani and US forces exchanging fire.
- The finance minister, Syed Naveed Qamar, announced an economic stabilisation package in mid-September designed to raise Pakistan's foreign-exchange reserves to the equivalent of 2-3 months of import cover.
- As part of the stabilisation package, the government withdrew its subsidy on gas and announced that the subsidy on electricity would be eliminated June 2009.
- Foreign-exchange reserves fell by US$690m to US$8.1bn in the week ending September 27th. The Pakistan rupee has fallen to a record low, and Pakistan's sovereign debt outlook has been downgraded by credit-rating agencies.
- Remittance inflows increased by an average of 24% year on year in July-August 2008, to a total of US$1.2bn.

Outlook for 2009-10

Political outlook

Domestic politics

The election of the *de facto* leader of the Pakistan People's Party (PPP), Asif Ali Zardari, as president in early September has coincided with a rapid escalation of economic and security problems in Pakistan. The government will have to struggle with these problems at the same time as addressing the country's political crisis, and the risk of failure is high. Issues that divide Mr Zardari's PPP, which leads the coalition government, and the Pakistan Muslim League (Nawaz), or PML (N), the second-largest party in parliament, remain unresolved. Inter-party rivalry will continue to undermine political stability as tensions over specific issues persist, highlighting the differences in the parties' priorities and strategies and the extent to which disputes are based on conflicting personal agendas.

Two issues remain at the top of the political agenda: the role of the president, and the restoration of the Supreme Court judges dismissed by the former president and army chief, Pervez Musharraf, in 2007. The PML (N) had sought the immediate restoration of all the judges, including the chief justice, Iftikhar Mohammed Chaudhry, by executive order. Instead, the government—firmly controlled by the PPP since the PML (N)'s withdrawal from the ruling coalition in August 2208—has been reinstating judges piecemeal. This is unlikely to satisfy either the PML (N) or the legal community, and the fate of Mr Chaudhry, in particular, is likely to prove contentious. Several opposition parties are planning a march for early October to protest against the government's failure to restore all the judges, although some opposition parties say that they will not participate on the grounds that adding to instability at a time when Pakistan has so many other grave problems would be irresponsible.

Meanwhile, Mr Zardari has remained ambiguous on the subject of amending the constitution to curtail the powers of the president—despite the PPP's having insisted alongside the PML (N) that such a step was a crucial part of dismantling Mr Musharraf's legacy. On September 20th, in his first address to a joint session of parliament, Mr Zardari proposed that a parliamentary committee "revisit" the 17th amendment to the constitution, which retroactively validated decisions taken by Mr Musharraf between 1999 and 2004, when the amendment came into force, and also the infamous Article 58[2](b), which allows the president to dissolve parliament. On October 1st the prime minister, Yusuf Raza Gilani, said that parliament would vote on the future of the amendment and the article on October 17th. In the meantime, Mr Zardari, and not Mr Gilani, will continue to act as the country's leader—despite the professed desire to return Pakistan to a fully democratic parliamentary system.

The political scene is increasingly dominated by the security situation, which continues to worsen at an alarming rate. US pressure on Pakistan to combat Islamist extremism is increasing the tension between Mr Zardari and the Pakistani military. The chief of army staff, General Ashfaq Kayani, has emphasised his desire to keep the military out of politics, and so a return to military rule seems unlikely in the near future. Nevertheless, the army is obviously more concerned than the government about recent US military activity in Pakistan. The worse this split becomes, the greater the likelihood of a return to military rule.

International relations

Pakistan's relations with the US, which have been deteriorating since June, plunged to new lows in September, when it was disclosed that the US president, George W Bush, had authorised US military forces to conduct ground raids in Pakistan without the permission of the Pakistani government. The US has been critical of what it sees as insufficient efforts on the part of the government in tackling Islamist militancy, and claims that there has been an increase in attacks by militants on US and NATO forces in the regions bordering Afghanistan in recent months. General Kayani reacted strongly to the US announcement, asserting that Pakistan would defend its sovereignty and territorial integrity "at all cost". The army has thus been ordered to fire on US troops if they enter Pakistani territory, and an exchange of fire actually occurred near the Afghan border in early September. Nevertheless, the two countries reaffirmed their close strategic co-operation and bilateral ties at a one-day meeting in, the US capital, Washington, on October 1st.

The schizophrenic relationship between the US on one side, and the Pakistani government and military on the other, is only one factor that is likely to complicate the fight against growing Islamist militancy in Pakistan. The US administration has resigned itself to working with the civilian government, but the US's overriding interest in security issues means that it must also continue to work with the Pakistani army. Given the hostility that exists between the army and the government in Pakistan, the US will have to maintain a delicate balancing act. The lack of co-ordination between the government, the army and the local paramilitary force, the Frontier Corps, and the often-conflicting agendas of these entities, will continue to frustrate US officials and will constitute a major obstacle to tackling Islamist militancy. Pakistan's increasing geopolitical importance means that it is likely to continue to receive financial support from the international community, which fears that a full-blown economic crisis would allow Islamist militants to increase further their influence in the country.

Economic policy outlook

Policy trends

Pakistan's economy has quickly moved from a rapid rate of growth to a state of crisis. Real GDP growth is slowing sharply, the rate of inflation remains at record highs, the current-account deficit continues to balloon, foreign-exchange reserves are falling precipitously, foreign investment inflows are slowing and the fiscal deficit is surging. The crisis has at least pushed economic management, which had previously been a casualty of political in-fighting, to the top of the government's agenda—although even now it must compete for attention with the ongoing security problem. Nevertheless, continued political instability, the general weakness of the government and the global financial turmoil pose significant risks to the government's ability to mobilise a response to the crisis. The government has expressed its reluctance to turn to the IMF for assistance, despite acknowledging that it needs some US$10bn to meet its short-term liabilities. It hopes instead to receive assistance from bilateral donors, including the US and Saudi Arabia.

Fiscal policy

The budget for fiscal year 2008/09 (July-June) expected an increase in total government spending of nearly 30% compared with 2007/08, but the government has had to change tack because of the worsening economic conditions and the pressing need to address the fiscal imbalance. Pakistan's fiscal position deteriorated sharply in 2007/08 because of increased spending on food and fuel subsidies, while tax revenue growth slowed rapidly in the second half of the fiscal year and political turmoil left the government unable to respond effectively to the worsening conditions. Given that there is no prospect of an increase in revenue collection in 2008/09, the government is cutting development expenditure to try to rein in the ballooning fiscal deficit. Nevertheless, the Economist Intelligence Unit expects the deficit to average 5.4% in 2008/09, exceeding the government's target of 4.7% of GDP. It will narrow slightly, to 4.2%, in 2009/10 as the government reins in spending further.

Monetary policy

In its monetary policy statement for the first half of 2008/09 the State Bank of Pakistan (SBP, the central bank) noted that government borrowing from the central bank, which it earlier described as having reached "alarming levels" during 2007/08, had continued "unabated". In addition, the statement reported that the secondary effects of high food price inflation had become "embedded" in inflationary expectations, and also that the inflation rate continued to be stoked by "aggregate demand pressures" and, more alarmingly, by a "fall in the productive capacity of the economy". In response to these developments, the SBP raised its benchmark interest lending rate by 1 percentage point to 13%, with effect from July 30th. We forecast that headline inflation will average 15.2% in 2009, but that it will moderate to 6% in 2010. As a result, we do not expect the SBP to begin to lower interest rates until the second half of 2009—and then only if it has sufficient evidence that inflationary pressures are under control.

Economic forecast

International assumptions

International assumptions summary
(% unless otherwise indicated)

	2007	2008	2009	2010
Real GDP growth				
World	4.8	3.8	3.2	4.0
Japan	2.1	0.8	0.8	1.6
US	2.0	1.8	0.6	1.7
Exchange rates				
¥:US$	117.8	106.0	103.0	98.3
US$:€	1.37	1.50	1.41	1.37
Financial indicators				
¥ 3-month Gensaki rate	0.61	0.68	0.88	1.55
US$ 3-month commercial paper rate	5.06	2.30	2.60	3.53

International assumptions summary
(% unless otherwise indicated)

	2007	2008	2009	2010
Commodity prices				
Oil (Brent; US$/b)	72.7	110.0	91.0	100.0
Cotton (US cents/lb)	64.8	77.8	86.5	91.3
Food, feedstuffs & beverages (% change in US$ terms)	30.9	36.7	-1.5	4.0
Industrial raw materials (% change in US$ terms)	11.2	3.2	-9.8	1.7

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

Economic growth (in purchasing power parity, or PPP, terms) in the US, Pakistan's largest export market, is expected to slow to 1.8% in 2008, from 2% in 2007. In 2009-10, however, growth in the US will average only 1.2% a year as the financial crisis begins to have a greater effect on the real economy. Slow US growth will be partly offset by continued strong (albeit slowing) growth in China and India, as well as in a host of smaller economies, but world GDP growth (at PPP rates) will average only 3.6% a year in 2009-10. However, risks are firmly on the downside; the most significant of them is a worsening of the financial market crisis beyond what is currently expected, which would cause more serious disruptions to the real economy. Global inflationary risks also remain a cause for concern.

Economic growth

Gross domestic product by expenditure
(PRs m at constant 1999/2000 prices where series are indicated; otherwise % change year on year; fiscal years ending Jun 30th)

	2007[a]	2008[a]	2009[b]	2010[b]
Private consumption	3,885.6	4,214.0	4,377.9	4,593.8
	4.8	8.5	3.9	4.9
Public consumption	532.1	559.5	581.9	605.2
	-9.6	5.1	4.0	4.0
Gross fixed investment	975.7	1,008.7	1,078.3	1,147.3
	16.0	3.4	6.9	6.4
Final domestic demand	**5,393.4**	**5,782.2**	**6,038.1**	**6,346.3**
	5.0	7.2	4.4	5.1
Stockbuilding	87.9	93.2	90.0	95.0
	0.1[c]	0.1[c]	-0.1[c]	0.1[c]
Total domestic demand	**5,481.4**	**5,875.4**	**6,128.1**	**6,441.3**
	5.0	7.2	4.3	5.1
Exports of goods & services	988.5	900.6	933.0	975.6
	2.3	-8.9	3.6	4.6
Imports of goods & services	-974.8	-953.9	-995.4	-1,066.9
	-2.8	-2.1	4.3	7.2
Foreign balance	**13.8**	**-53.3**	**-62.3**	**-91.3**
	1.0[c]	-1.2[c]	-0.2[c]	-0.5[c]
GDP	**5,495.1**	**5,822.1**	**6,065.8**	**6,350.0**
	6.0	6.0	4.2	4.7

[a] Actual. [b] Economist Intelligence Unit forecasts. [c] Contribution to real GDP growth (as a percentage of real GDP in the previous year).

Pakistan is experiencing an inflationary surge, which will have a negative impact on real wages and consumer spending during the forecast period. We expect private consumption to grow by just 3.9% in 2008/09, down sharply from a rate of 8.5% in 2007/08, according to the government's provisional figures. We therefore expect real GDP growth in 2008/09 of 4.2%, down from 6% in 2007/08. Growth will rebound slightly, to 4.7%, in 2009/10 as inflationary pressures abate and private consumption growth rises to 4.9%. GDP growth will be supported by the expansion in government consumption, which will remain steady at 4% a year in 2008/09-2009/10.

Investment growth was the main driver of economic expansion in 2006/07, but it slowed sharply to 3.4%, in 2007/08, owing largely to the high base of comparison in 2006/07, when investment grew by 16%. We expect investment to remain a major contributor to economic growth throughout the forecast period, averaging 6.7% a year in 2008/09-2009/10. Pakistan is overly reliant on textile exports. The sector has been underperforming, and the wide range of factors impeding its revival, combined with strong import growth, mean that the net contribution of trade to the economy will be negative in the forecast period.

Inflation

Year-on-year consumer price inflation reached another record high of 25.3% in August, up from a rate of 24.3% in July. The continued surge is still mostly being driven by rapid food price inflation, which reached 34.1% in August—the 12th consecutive month of double-digit increases. We expect inflationary pressures to remain strong over the next few months, owing to continued rapid growth in the money supply, higher import duties and increases in utility prices. The fuel price rises announced in March, June and July have triggered another round of inflation as rising transport costs have further increased goods prices. This, in turn, will cement inflationary expectations. The cycle will be exacerbated by the additional fuel price rises announced in September. We forecast that consumer price inflation will slow to 15.2% in 2009, as oil prices moderate, from an estimated 21% in 2008. Greater economic stability should see consumer price inflation slow further, to 6% in 2010.

Exchange rates

The Pakistan rupee depreciated by 25% in the nine months to September 2008, reflecting investors' fears over poor political prospects, rising prices and slowing growth. The rate of depreciation has accelerated in recent months, reaching 14.6% quarter on quarter in the third quarter of 2008, compared with 8.7% in the second quarter. Assuming that Pakistan is able to secure external financial assistance and does not default on its sovereign debt, we estimate that the rupee will average PRs70.1:US$1 in 2008 and forecast that it will fall to PRs80.5:US$1 in 2009, compared with PRs60.7:US$1 in 2007. However, given the high rate of inflation in Pakistan, the real rate of depreciation will average only 3.6% annually over the two years. In 2010 the nominal rate of depreciation will ease to 1.2% (with the currency averaging PRs81.5:US$1), compared with an average of 13.1% a year in 2008-09. Inflows of foreign investment and remittances from Pakistanis working overseas will be the main factors mitigating the weakness of the rupee in 2010.

External sector

The current-account deficit reached US$8.3bn, equivalent to 5.7% of GDP, in 2007. In 2008 we estimate that export growth will remain weak, and this, combined with high oil prices and faster import growth (fuelled by strong private consumption growth in the first half of the year and a revival of investment expansion in the second half), will result in a deficit of US$12.3bn, or 7.2% of GDP. Our central forecast is that Pakistan will receive external financing that will relieve some of the pressure on the current-account position. Under this scenario, the current-account deficit is forecast to narrow in 2009, to US$10.5bn (6.4% of GDP). Lower international oil prices next year will also facilitate this improvement by reducing the import bill. Although export growth will remain weak, the import bill (in US dollar terms) will contract slightly in 2009, reflecting a high-base effect as well as slowing overall economic growth. In 2010, however, the opposite trend will be evident. Import growth will accelerate again in line with higher oil prices and, as a result, the current-account balance will rise to US$11.5bn (6.9% of GDP).

Forecast summary

(% unless otherwise indicated)

	2007[a]	2008[b]	2009[c]	2010[c]
Real GDP growth[d]	6.0	6.0[a]	4.2	4.7
Industrial production growth	5.4	4.6	0.8	6.0
Agricultural production growth[d]	3.7	1.5[a]	2.7	2.8
Unemployment rate (av)	7.6[b]	7.4	7.6	7.7
Consumer price inflation (av)	7.6	21.0	15.2	6.0
Consumer price inflation (year-end)	14.6[b]	17.8	10.3	5.9
Short-term interbank rate	9.3	10.9	11.3	10.6
Central government balance (% of GDP)[d]	-4.5	-6.7	-5.4	-4.2
Exports of goods fob (US$ bn)	18.1	20.8	22.5	24.9
Imports of goods fob (US$ bn)	-28.8	-35.3	-35.1	-38.9
Current-account balance (US$ bn)	-8.3	-12.3	-10.5	-11.5
Current-account balance (% of GDP)	-5.7	-7.2	-6.4	-6.9
External debt (year-end; US$ bn)	38.8[b]	42.9	45.2	47.9
Exchange rate PRs:US$ (av)	60.7	70.1	80.5	81.5
Exchange rate PRs:¥100 (av)	51.6	66.1	78.2	83.0
Exchange rate PRs:€ (av)	83.1	104.8	113.3	111.2
Exchange rate PRs:SDR (av)	93.2	112.0	125.0	126.1

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts. [d] Fiscal years (ending June 30th).

Monthly review: October 2008

The political scene

Asif Ali Zardari wins the presidential election

On September 6th the *de facto* leader of the Pakistan People's Party (PPP), Asif Ali Zardari, won a resounding victory in the country's presidential election. The president is chosen by an electoral college which comprises the upper and lower houses of the federal parliament and the four provincial assemblies. Mr Zardari won 481 of the 702 votes cast, although a further 368 parliamentarians did not vote in the election. The other candidates, Saeeduzzaman Siddiqui, representing the Pakistan Muslim League (Nawaz), or PML (N), and Mushahid Hussain, of the Pakistan Muslim League (Quaid-i-Azam), or PML (Q), won 153 and 44 votes respectively. Many members of the PML (Q)—the party that supported Pervez Musharraf while he was president—voted for non-PML (Q) candidates, suggesting a recognition that it is soon likely to become a fringe party.

Although Mr Zardari has demonstrated that he has considerable political acumen, his credibility has declined following his failure to honour successive deadlines to restore members of the judiciary who were suspended by Mr Musharraf. Whether or not he removes some of the presidency's wide-ranging powers will be another indication of his commitment to democracy, and the outcomes of these issues are likely to determine his relationship with the PML (N), which holds the second-largest number of seats in parliament but which withdrew from the ruling coalition in August. Mr Zardari gained almost unanimous support in Sindh, Baluchistan and the North West Frontier Province (NWFP), but in Punjab—the largest and most politically important province—he trailed the PML (N) candidate, Mr Siddiqui.

Islamabad suffers a major terrorist attack

The scale of the domestic security threat facing Pakistan faces was highlighted on September 20th by a suicide bomb attack at the Marriott hotel in Islamabad, the most heavily guarded hotel in the capital. More than 50 people, including the Czech ambassador, were killed, and over 250 were injured in the blast, which destroyed the hotel. It is unclear whether there was a specific target; suggestions that the president, the prime minister, the speaker of parliament and the military leadership were supposed to have been dining at the hotel were denied by the owners.

The blast has succeeded in increasing fear and paranoia within Islamabad, which increasingly resembles the Iraqi capital, Baghdad, or Kabul, the capital of Afghanistan, with concrete barriers intended to slow traffic down springing up around the city and the number of no-go areas for ordinary Pakistanis increasing. Several countries and multilateral agencies have moved their staff out of the country, including British Airways, which suspended flights to Pakistan in the wake of the attack. The deterioration in the security situation is also harming the economy. A Polish oil company, Geofizyka Krakow, announced that it would withdraw from Pakistan after a Polish employee was kidnapped and his driver, bodyguard and translator were killed. This incident followed the kidnapping of Afghanistan's ambassador-designate, Abdul Khaliq Farahi, in Peshawar earlier in September. Reports that Mr Farahi had been released have not been confirmed.

Responsibility for the attack on the Marriott was claimed by an unknown Muslim group, Fida'iyin-e-Islam, but most observers assume this group to be linked to the Pakistani Taliban, based in the Federally Administered Tribal Areas (FATA) and led by Baitullah Mehsud. Mr Mehsud is held responsible for the assassination of Benazir Bhutto, Mr Zardari's wife and a former prime minister, in December 2007. In September this year the government claimed that Mr Mehsud had slipped into a diabetic coma and died, although this was denied by the Pakistani Taliban.

Fighting in FATA intensifies

The Pakistani armed forces are undertaking a massive military operation against Islamist militants in the tribal areas, and particularly in them district of Bajaur, on the border with Afghanistan in FATA. Pakistan's military claimed to have killed 1,000 Islamist militants, including five senior figures, during September in a huge offensive in Bajaur. According to the army, militancy will be defeated in Bajaur by the end of 2008. Furthermore, if Bajaur is retaken by the government, it will have a knock-on effect on neighbouring areas. However, the validity of the army's claims is widely disputed.

According to the UN, some 20,000 Pakistanis have sought refuge from the fighting in the neighbouring Afghan province of Kunar. A further 300,000 have moved to other parts of Pakistan to escape the fighting. The UN Refugee Agency has requested US$17m in aid to assist those displaced by fighting and flooding in north-western Pakistan.

Relations with the US deteriorate sharply

The ongoing security problems are also damaging Pakistan's relations with the US. In early September it was announced that the US president, George W Bush, had authorised incursions by US forces into FATA without obtaining the permission of the Pakistani government. Although both countries' leaders continue to pledge a shared commitment to tackling Islamist militancy, US military operations and the increasing use of unmanned drone aircraft within Pakistani sovereign territory are clearly unsettling both Pakistan's military and its government. The army has stressed that it will repel any "attacks" on Pakistan's territory—Pakistani troops have fired at US military helicopters, and there have been several reports of Pakistani and US troops exchanging fire.

During his visit to the UN General Assembly meeting in New York in mid-September, Mr Zardari met Mr Bush and promised Pakistan's continued support for the fight against terrorism, but stressed that Pakistan alone would take responsibility for fighting terrorism within its territory. US activity within Pakistan places even greater constraints on Mr Zardari than were faced by his predecessor, Mr Musharraf. Balancing widespread anti-US sentiment among the Pakistani population and the need to maintain the support of his own military with the need to preserve US co-operation appears, at present, nigh on impossible.

Mr Zardari's position is further weakened by the apparent arbitrariness of US attacks within the region. Although US forces may have targeted the houses of

Taliban commanders, many civilians also appear to have died in the attacks. The situation is further complicated by the lack of independent reporting from the region—a number of journalists reporting in FATA have been killed over the past few years. However, reports have also emerged of civilian casualties as a result of Pakistani military action. Because of the increasing numbers of civilian deaths and the displacement of tens of thousands of residents, there is increasing evidence that local hostility towards both the US and the Pakistani government and military is growing.

The ISI command is reshuffled

The US has also been putting pressure on Pakistan to clamp down on its military intelligence agency, the Inter-Services Intelligence (ISI). US officials, as well as most independent analysts, believe that elements within the ISI continue to support the Taliban, either directly or indirectly. General Kayani appointed a new ISI chief in September as part of a broader reshuffle of the army high command. Ahmed Shujaa Pasha replaced Nadeem Taj as director-general of the ISI. General Pasha was previously the director-general of military operations, and had overseen operations in FATA and parts of the NWFP. It remains to be seen, however, whether the appointment will translate into real change in the organisation's strategies or priorities.

Economic policy

An economic stabilisation package is announced

In an attempt to address the growing economic crisis, the finance minister, Syed Naveed Qamar, announced an economic stabilisation package in mid-September. The immediate goal of the package, according to the governor of State Bank of Pakistan (SBP, the central bank), Shamshad Akhtar, is to raise Pakistan's foreign-exchange reserves to 2-3 months of import cover by reducing both the fiscal deficit and the current-account deficit. At US$12bn in 2008, Pakistan's annual oil import bill alone may soon be twice as high as its foreign-exchange reserves. The government estimates that it needs US$8bn-10bn to meet its short- and medium-term obligations.

The package stipulates reductions in government expenditure and a reduction in government borrowing from the central bank. The government intends to borrow from non-bank sources and issue monetary instruments such as commercial paper instead of using central bank loans, which exacerbate inflation. It also intends to boost revenue collection, partly by stepping up the privatisation programme, although in the light of the dire security situation and the speed at which investors are leaving the country, it is questionable how many buyers for state assets may be found at this time.

The other important element of the stabilisation package is the elimination of government subsidies on fuel. Mr Qamar specified that the subsidy on gas would be withdrawn immediately and that the subsidy on electricity would be eliminated by the end of fiscal year 2008/09 (July-June). This will, however, have the unwanted effect of stoking consumer price inflation, which was already running at above 25% year on year in August, even further.

Pakistan seeks external funding

Mr Qamar took pains to emphasise that the economic package that he had unveiled was "indigenous", echoing Mr Zardari, who has categorically ruled out approaching the IMF for assistance (the president termed the conditions attached to assistance from the Fund as "anti-growth"). Nevertheless, the paucity of domestic options available to tackle Pakistan's economic crisis is evident from the relief with which a loan from another multilateral organisation was greeted. Pakistan received a US$500m loan from the Asian Development Bank in early October as part of the bank's Accelerating Economic Transformation Programme. A second tranche of US$500m will be disbursed by June 2009, and the final one, of US$400m, by June 2010. The funds are intended to improve the local power sector, and one of the conditions for the funding was that Pakistan would eliminate power subsidies by the end of June 2009. The government confirmed its intention to do so when it announced its stabilisation package, but the move will result in an increase in power costs of around 30%.

Meanwhile, Mr Zardari took the opportunity of his visit to New York in September to establish the so-called Friends of Pakistan forum, aimed at helping Pakistan to fight Islamist militancy. It appears, however, that Pakistan intends to use the forum as a means of fundraising. The group is set to meet in the capital of the UAE, Abu Dhabi, in November, when Mr Zardari plans to ask for a US$100bn grant to prevent Pakistan's economic collapse. His argument is premised on the idea that without this support, Pakistan risks becoming a failed state. Nevertheless, Mr Zardari insisted that the money he sought was not aid. "I'm looking for temporary relief for my budgetary support and cash for my treasury which does not need to be spent by me", he asserted in early October in a US financial publication, *The Wall Street Journal*.

The forum comprises the foreign ministers of Australia, Canada, France, Germany, Italy, Japan, the UK, Turkey and the UAE, and representatives of China, the EU and the UN. It is co-chaired by Mr Zardari along with the foreign ministers of the UAE, the UK and the US. However, the severity of the financial crisis engulfing the US, the UK and the EU makes it far from certain that they will be receptive to this plea for funds, given that they have already pledged hundreds of billions of dollars to stabilise their own financial sectors, or are likely to have to do so in the near future.

Economic performance

The government attempts to forestall a food crisis

The government announced in September that it would raise the wheat procurement price for farmers, increasing the price for a 40-kg bag of flour from PRs625 (US$8) to PRs950. The move is intended to encourage farmers to grow wheat. However, a range of other problems remain in the agricultural sector. According to the Indus River System Authority, a shortage of irrigation water of 34% is likely to have a negative impact on the yields of both wheat and sugarcane crops. As a result of the water shortage, the area of land on which wheat can be sown is likely to be 15-20% smaller in 2008 than in the previous harvest, according to the Ministry of Food and Agriculture. In addition, a lack of fertiliser will also negatively affect agricultural yields, and hoarding by traders will exacerbate the shortage. The government's move to prop up prices leaves these supply-side issues unaddressed.

Foreign-exchange reserves plummet

The pace at which Pakistan is depleting its foreign-exchange reserves continues to accelerate. In the week ending September 27th reserves fell by a staggering US$690m to US$8.1bn, the 14th consecutive week of decline. However, the figure for total reserves does not include forward liabilities; if these are included, reserves may be as low as US$3bn. Reserves have fallen from a high of US$16.5bn in October 2007.

The decline has had an immediate impact. The local currency fell to a record low against the US dollar of PRs78.5:US$1 on October 4th. Moody's, a credit-rating agency, downgraded its outlook for Pakistani government bonds to negative from stable on September 23rd. On October 6th Standard & Poor's, another ratings agency, cut its foreign-currency rating for the country from B to CCC-plus, and revised its outlook from stable to negative. The local currency debt rating was also lowered from BB-minus to B-minus.

One option that would help Pakistan's current-account position—and thus its reserves position—immensely, is a mooted plan to receive oil imports from Saudi Arabia on a deferred-payment basis. Pakistan wishes to restore, in one form or another, the so-called Saudi Oil Facility that was offered in the late 1990s. However, the plan had not been agreed as of early October, and analysts are speculating that it will not materialise unless the Saudi authorities receive assurances from the US that it supports the plan.

The government plans a remittance-backed bond issue

Remittances from Pakistanis working overseas—mainly in the Middle East—remain one of the few bright spots for the economy. Remittance inflows increased by an average of 24% year on year in July-August 2008, totalling US$1.2bn. The government is eager to make use of this rare good news. It is unlikely to turn to international financial markets to raise funds, given its worsening credit rating (which will increase the cost of such funding) and the US-led credit crisis, and will probably not consider a sovereign bond issue, but it is planning to issue a Workers' Remittances Securitisation Bond worth US$500m-700m before the end of 2008.

Data and charts

Annual data and forecast

	2004[a]	2005[a]	2006[a]	2007[a]	2008[b]	2009[c]	2010[c]
GDP							
Nominal GDP (US$ bn)	98.0	109.9	127.3	145.7	171.2	163.2	166.6
Nominal GDP (PRs bn)	5,641	6,500	7,623	8,723	10,478[a]	12,289	13,498
Real GDP growth (%)	7.4	7.7	6.2	6.0	6.0[a]	4.2	4.7
Expenditure on GDP (% real change)							
Private consumption	10.1	12.9	1.0	4.8	8.5[a]	3.9	4.9
Government consumption	1.4	1.7	48.3	-9.6	5.1[a]	4.0	4.0
Gross fixed investment	-6.1	13.5	19.9	16.0	3.4[a]	6.9	6.4
Exports of goods & services	-1.5	9.6	9.9	2.3	-8.9[a]	3.6	4.6
Imports of goods & services	-8.6	40.5	18.7	-2.8	-2.1[a]	4.3	7.2
Origin of GDP (% real change)							
Agriculture	2.4	6.5	6.3	3.7	1.5[a]	2.7	2.8
Industry	16.3	12.1	4.1	8.0	4.6[a]	3.2	6.0
Services	5.8	8.5	6.5	7.6	8.2[a]	5.2	4.8
Population and income							
Population (m)	155.3	158.1	160.9	163.7[b]	166.4	169.2	172.1
GDP per head (US$ at PPP)	2,026	2,153	2,317	2,480[b]	2,666	2,817	2,963
Recorded unemployment (av; %)	7.7	7.7	7.7	7.6[b]	7.4	7.6	7.7
Fiscal indicators (% of GDP)							
Central government revenue	14.1	13.3	14.0	12.7	14.9	15.2	15.9
Central government expenditure	16.1	16.5	18.2	17.2	21.6	20.5	20.1
Central government balance[d]	-2.0	-3.2	-4.2	-4.5	-6.7	-5.4	-4.2
Net public debt	56.6[b]	53.9[b]	51.5[b]	50.6[b]	49.8	48.6	49.2
Prices and financial indicators							
Exchange rate PRs:US$ (end-period)	59.12	59.83	60.92	61.22	75.30	81.00	82.10
Consumer prices (end-period; % change)	7.4	8.5	9.4	14.6[b]	17.8	10.3	5.9
Stock of money M2 (end-period; % change)	20.5	16.5	14.6	19.5	19.7	18.3	10.3
Lending interest rate (av; %)	5.0	8.2	9.9	10.6[b]	11.6	11.5	9.5
Current account (US$ m)							
Trade balance	-3,396	-6,340	-9,647	-10,640	-14,443	-12,675	-14,033
Goods: exports fob	13,297	15,433	17,049	18,121	20,815	22,460	24,890
Goods: imports fob	-16,693	-21,773	-26,696	-28,761	-35,258	-35,135	-38,923
Services balance	-2,584	-3,830	-4,912	-5,006	-6,517	-7,127	-7,783
Income balance	-2,363	-2,514	-3,131	-3,693	-4,395	-5,220	-5,835
Current transfers balance	7,526	9,079	10,941	11,084	13,021	14,538	16,177
Current-account balance	-817	-3,605	-6,750	-8,255	-12,334	-10,484	-11,474
External debt (US$ m)							
Debt stock	35,547	33,173	35,909	38,799[b]	42,902	45,232	47,868
Debt service paid	4,266	2,425	2,281	3,759[b]	2,885	3,837	3,906
Principal repayments	3,519	1,698	1,427	2,691[b]	1,908	2,735	2,667
Interest	747	727	854	1,067[b]	976	1,102	1,239
Debt service due	2,566[e]	2,425	2,281	3,759[b]	2,885	3,837	3,906
International reserves (US$ m)							
Total international reserves	10,616	10,948	12,816	15,689	6,133	9,626	10,381

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts. [d] Fiscal years (ending June 30th). [e] Difference compared with total paid is owing to debt prepayment.

Source: IMF, *International Financial Statistics*.

Quarterly data

	2006		2007				2008	
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
Output								
Manufacturing index (1999/2000=100)	190.2	192.4	218.4	220.0	203.3	196.7	230.2	n/a
Manufacturing index (% change, year on year)	9.8	5.6	5.8	6.8	6.9	2.2	5.4	n/a
Prices								
Consumer prices (2000=100)	140.8	143.1	143.9	146.3	150.8	155.9	161.7	174.6
Consumer prices (% change, year on year)	8.4	8.3	7.2	7.1	7.1	8.9	12.4	19.3
Wholesale general (2000=100)	149.0	150.2	150.2	154.9	161.4	168.5	176.1	197.4
Wholesale general (% change, year on year)	8.2	7.4	5.5	6.7	8.3	12.2	17.2	27.5
Financial indicators								
Exchange rate PRs:US$ (av)	60.37	60.73	60.80	60.68	60.51	60.96	61.26	66.32
Exchange rate PRs:US$ (end-period)	60.56	60.92	60.71	60.52	60.71	61.22	62.72	68.28
Discount rate (end-period; %)	9.50	9.50	9.50	9.50	10.00	10.00	10.50	n/a
Money market rate (av; %)	8.91	9.68	10.05	8.83	8.89	9.42	8.98	11.48
Treasury bill rate (av; %)	8.70	8.81	8.82	8.90	9.06	9.18	9.62	10.41
M1 (end-period; PRs bn)	2,556	2,700	2,749	2,986	3,004	3,230	3,188	n/a
M1 (% change, year on year)	18.7	17.1	11.2	16.0	17.5	19.6	16.0	n/a
M2 (end-period; PRs bn)	3,406	3,647	3,766	4,024	4,092	4,358	4,367	n/a
M2 (% change, year on year)	15.7	14.6	16.5	18.3	20.1	19.5	16.0	n/a
Stockmarket KSE 100 index (end-period; Nov 1st 1991=1,000)	10,512	10,041	11,272	13,772	13,354	14,077	15,126	12,289
Sectoral trends								
Cotton yarn production ('000 tonnes)	707.1	717.1	710.7	712.6	740.4	744.6	718.5	n/a
Cotton fabric production (m sq metres)	243.8	245.7	225.4	249.9	256.8	253.9	252.8	n/a
Foreign trade (US$ m)								
Exports fob	4,245	4,154	3,971	4,598	4,421	4,238	4,774	5,791
Imports cif	-7,349	-7,469	-7,525	-8,120	-8,056	-8,895	-11,009	-12,009
Trade balance	-3,104	-3,315	-3,554	-3,522	-3,635	-4,657	-6,235	-6,218
Foreign payments (US$ m)								
Merchandise trade balance	-2,742	-2,566	-2,312	-2,091	-2,369	-3,868	n/a	n/a
Services balance	-1,394	-1,066	-1,014	-696	-1,594	-1,702	n/a	n/a
Income balance	-840	-971	-804	-967	-908	-1,014	n/a	n/a
Net transfer payments	2,253	2,691	2,596	3,045	2,644	2,799	n/a	n/a
Current-account balance	-2,723	-1,912	-1,534	-709	-2,227	-3,785	n/a	n/a
Reserves excl gold (end-period)	10,952	11,543	12,141	14,248	14,726	14,044	11,664	9,233

Sources: State Bank of Pakistan, *Statistical Bulletin*; IMF, *International Financial Statistics*.

Monthly data

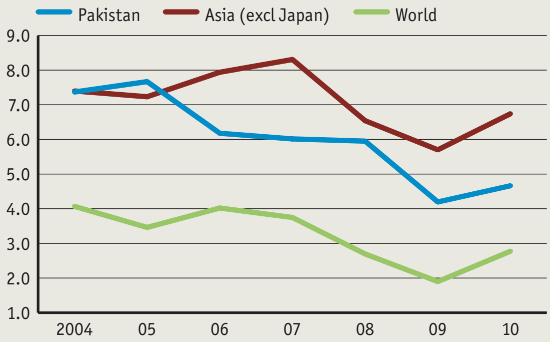
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate PRs:US$ (av)												
2006	59.85	59.88	60.00	59.98	60.07	60.19	60.29	60.33	60.49	60.59	60.71	60.89
2007	60.90	60.78	60.71	60.73	60.66	60.65	60.42	60.49	60.63	60.69	60.98	61.22
2008	61.22	61.22	61.34	63.77	67.80	67.37	70.85	n/a	n/a	n/a	n/a	n/a
Exchange rate PRs:US$ (end-period)												
2006	59.84	59.94	59.98	60.05	60.19	60.26	60.36	60.35	60.56	60.60	60.78	60.92
2007	60.77	60.81	60.71	60.73	60.76	60.52	60.40	60.65	60.71	60.75	61.22	61.22
2008	61.22	61.22	62.72	64.52	67.10	68.28	71.49	n/a	n/a	n/a	n/a	n/a
Money supply M1 (end-period; % change, year on year)												
2006	2.4	1.8	6.6	7.0	7.9	9.2	15.2	15.7	18.7	19.5	17.9	17.1
2007	17.0	16.7	11.2	11.8	13.3	16.0	15.2	18.5	17.5	16.2	17.9	19.6
2008	17.4	17.9	16.0	14.7	13.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply M2 (end-period; % change, year on year)												
2006	16.0	16.6	15.6	16.0	16.7	15.1	14.1	14.7	15.7	16.4	15.1	14.6
2007	14.0	14.4	16.5	16.2	16.3	18.3	18.2	20.4	20.1	18.5	19.7	19.5
2008	18.7	17.9	16.0	15.1	14.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Deposit rate (av; %)												
2006	2.6	2.8	2.8	2.9	2.9	2.9	3.1	3.1	3.2	3.4	3.6	3.7
2007	3.7	3.8	3.9	3.9	4.0	4.0	4.0	4.1	4.1	4.1	4.1	4.1
2008	4.2	4.2	4.2	4.2	4.2	5.2	5.5	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2006	9.8	10.2	10.1	10.3	10.2	9.9	10.2	10.6	11.0	11.1	11.0	11.2
2007	10.7	10.5	10.6	10.6	10.6	10.3	10.4	10.5	10.5	11.0	10.7	11.0
2008	10.8	10.8	10.9	10.9	11.3	12.8	13.1	n/a	n/a	n/a	n/a	n/a
Manufacturing production (% change, year on year)												
2006	4.9	20.0	10.7	11.0	16.0	20.8	13.2	9.0	7.2	4.5	10.1	2.6
2007	4.7	3.8	8.7	9.4	5.2	5.8	5.7	7.9	7.2	7.2	4.4	-4.3
2008	9.2	3.8	3.6	5.3	2.8	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Stockmarket KSE 100 index (end-period; Nov 1st 1991=1,000)												
2006	10,524	11,456	11,486	11,342	9,801	9,989	10,498	10,064	10,512	11,328	10,619	10,041
2007	11,272	11,180	11,272	12,370	12,961	13,772	13,739	12,214	13,354	14,321	13,999	14,077
2008	14,017	14,934	15,126	15,122	12,131	12,289	10,584	9,208	n/a	n/a	n/a	n/a
Consumer prices (av; % change, year on year)												
2006	8.8	8.0	6.9	6.2	7.1	7.7	7.6	8.9	8.7	8.1	8.1	8.9
2007	6.6	7.4	7.7	6.9	7.4	7.0	6.4	6.5	8.4	9.3	8.7	8.8
2008	11.9	11.3	14.1	17.2	19.3	21.5	24.3	n/a	n/a	n/a	n/a	n/a
Wholesale prices (av; % change, year on year)												
2006	10.8	9.9	8.4	8.1	9.1	9.0	8.4	8.2	8.0	6.7	7.4	8.0
2007	5.3	5.0	6.2	6.0	6.8	7.3	7.6	8.0	9.3	11.8	12.6	12.1
2008	15.6	16.4	19.7	23.5	28.2	30.6	34.0	n/a	n/a	n/a	n/a	n/a

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Total exports fob (US$ m)												
2006	1,257	1,292	1,536	1,450	1,527	1,510	1,334	1,499	1,413	1,263	1,375	1,517
2007	1,176	1,272	1,523	1,469	1,585	1,544	1,472	1,465	1,485	1,378	1,539	1,320
2008	1,464	1,538	1,772	1,791	1,946	2,054	1,905	1,584	n/a	n/a	n/a	n/a
Total imports cif (US$ m)												
2006	2,037	1,854	2,269	1,656	2,330	2,986	2,383	2,524	2,442	2,131	2,774	2,564
2007	2,330	2,572	2,623	2,574	2,750	2,797	2,574	2,747	2,735	3,385	3,161	2,349
2008	3,529	3,658	3,822	4,100	3,884	4,025	3,550	3,462	n/a	n/a	n/a	n/a
Trade balance fob-cif (US$ m)												
2006	-779	-563	-733	-206	-803	-1,476	-1,049	-1,025	-1,030	-869	-1,399	-1,048
2007	-1,154	-1,300	-1,100	-1,104	-1,165	-1,252	-1,102	-1,283	-1,250	-2,007	-1,622	-1,029
2008	-2,065	-2,120	-2,050	-2,309	-1,938	-1,972	-1,645	-1,878	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (end-period; US$ m)												
2006	9,925	9,894	9,831	11,531	11,400	11,560	11,180	11,263	10,952	11,103	11,045	11,543
2007	11,405	11,917	12,141	12,391	12,398	14,248	14,197	14,456	14,726	15,056	14,732	14,044
2008	13,464	12,800	11,664	11,098	9,207	9,233	n/a	n/a	n/a	n/a	n/a	n/a

Sources: IMF, *International Financial Statistics*; Haver Analytics.

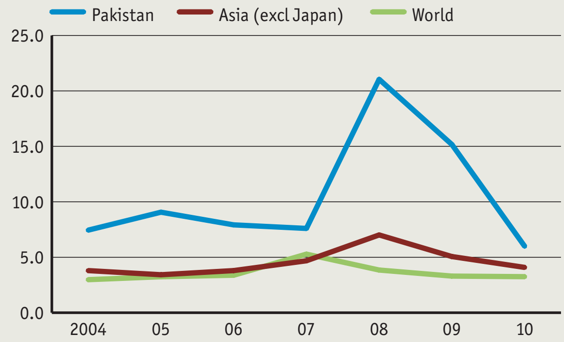
Annual trends charts

Real GDP growth
(% change)



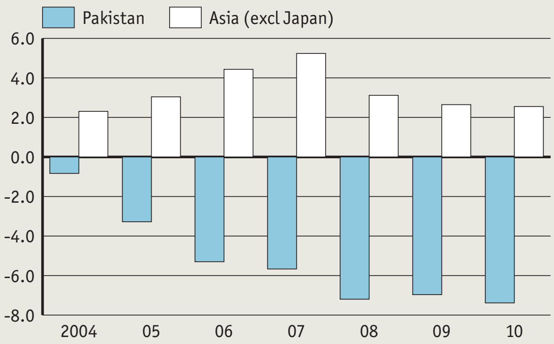
Source: Economist Intelligence Unit.

Consumer price inflation
(av; %)



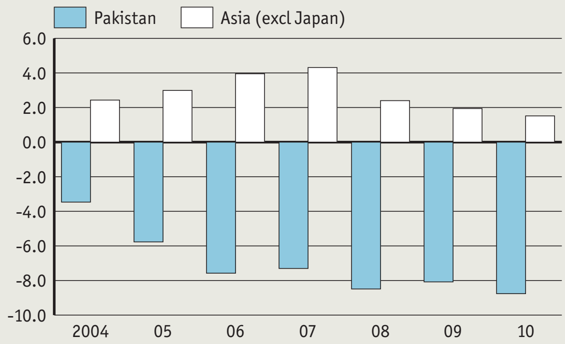
Source: Economist Intelligence Unit.

Current-account balance
(% of GDP)



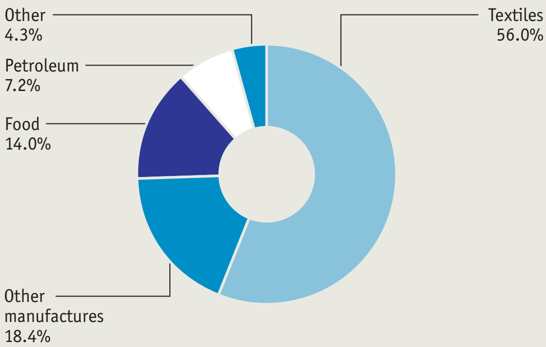
Source: Economist Intelligence Unit.

Trade balance
(% of GDP)



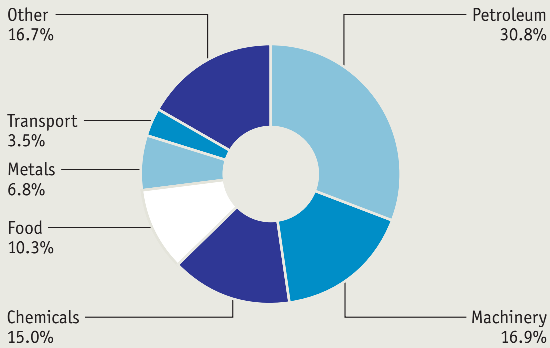
Source: Economist Intelligence Unit.

Principal exports fob, 2007/08
(share of total)



Source: Economist Intelligence Unit.

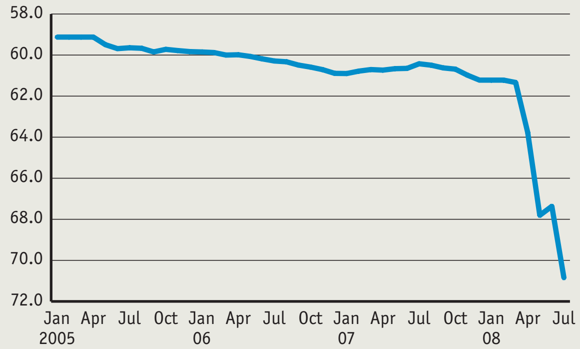
Principal imports, 2007/08
(share of total)



Source: Economist Intelligence Unit.

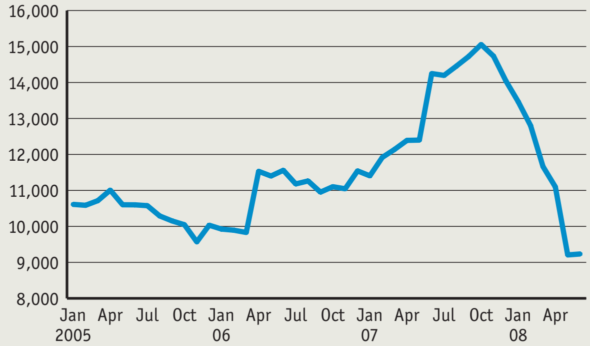
Monthly trends charts

Exchange rate
(PRs:US$; av; inverted scale)



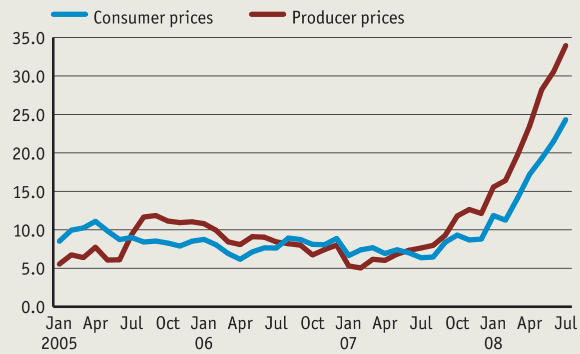
Source: Economist Intelligence Unit.

Foreign-exchange reserves
(US$ m)



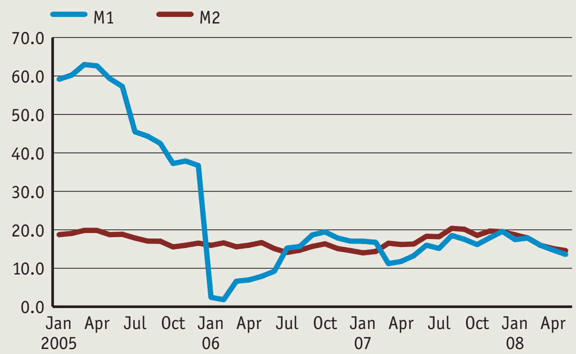
Source: Economist Intelligence Unit.

Price inflation
(% change, year on year)



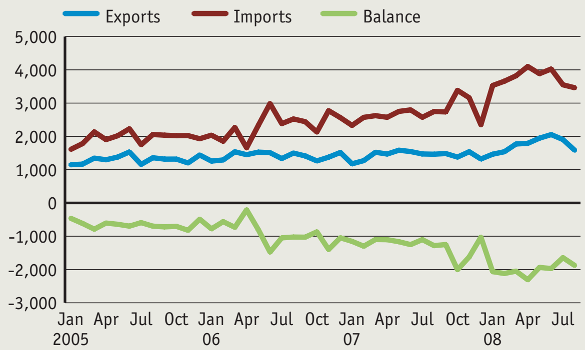
Source: Economist Intelligence Unit.

Monetary aggregates
(% change, year on year)



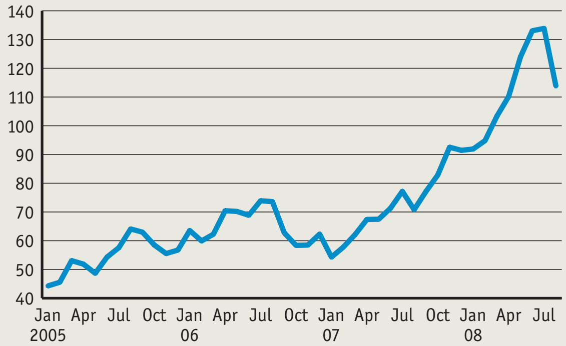
Source: Economist Intelligence Unit.

Foreign trade
(US$ m; goods only)



Source: Economist Intelligence Unit.

Oil: Brent crude price
(US$/b; av)



Source: Economist Intelligence Unit.

Country snapshot

Political structure

Official name	Islamic Republic of Pakistan
Form of state	Federal parliamentary democracy (since October 2002); however, the president retains a controlling role and can dismiss parliament, making the political system in effect a quasi-dictatorship
The executive	Asif Ali Zardari was elected president on September 6th 2008. Yusuf Raza Gilani is the prime minister and head of government
National legislature	The bicameral legislature was dissolved on November 14th 2007; a caretaker government was in place from November 15th 2007 to March 17th 2008, when a new parliament was sworn in. The National Assembly (the lower house) has 342 seats, 272 of which are elected on a first-past-the-post basis. Of the remainder, 60 are reserved for women and ten for non-Muslim minorities; they are allocated on the basis of proportional representation to parties that win more than 5% of the directly elected seats. The Senate (the upper house) consists of 100 senators. Of these, 22 are elected by each of the four provincial assemblies, eight are tribal representatives and four are representatives from the lower house
National elections	Elections for the National Assembly took place on February 18th 2008. A presidential election was held on September 6th
National government	The Pakistan People's Party (PPP) and the Pakistan Muslim League (Nawaz), or PML (N)—the two parties that won most seats in the February 2008 National Assembly election—led a coalition government until August 25th, when the PML (N) quit the coalition
Provincial government	Elections for Pakistan's four provincial assemblies were also held on February 18th 2008. The provinces enjoy considerable autonomy, but this has caused tensions with the central government
Main political organisations	PPP; PML (N); Pakistan Muslim League (Quaid-i-Azam), or PML (Q); Muttahida Majlis-i-Amal (MMA, which comprises six religious parties, including Jamaat-i-Islami and Jamiat-i-Ulema-i-Islami); Muttahida Qaumi Movement (MQM); National Alliance (comprising several small parties led by the Millat Party); Awami National Party (ANP); Tehrik-i-Insaf (TI); Jiye Sindh Qaumi Mahaz

	President	Asif Ali Zardari
	Prime minister	Yusuf Raza Gilani
Key ministers	**Defence, commerce (acting)**	Chaudhry Ahmed Mukhtar
	Finance, revenue, economic affairs & statistics	Syed Naveed Qamar
	Foreign affairs	Shah Mehmood Qureshi
	Information & broadcasting	Sherry Rehman
	Local government & rural development	Ghulam Bilour
	Ports, shipping, privatisation & investment	Syed Naveed Qamar
	Water & power	Raja Pervaiz Ashraf
Central bank governor	Shamshad Akhtar	

