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Competing Views on the Pakistani economy

State Bank of Pakistan and International Monetary Fund

The month of June symbolizes one of the most important actions to be undertaken by every Pakistani government; the announcement (and ratification) of the budget. The federal budget allows the government to run its institutions and implement its economic strategies for the coming year. The budget – which is mostly based on estimates – corroborates the government's target revenue collection and the government's fiscal expenditure for each fiscal year or timeframe. Legally speaking, the government is supposed to present the budget document to the National Assembly, where it must be approved by a majority of the parliamentarians, and then authorized by the President as the official budget document of the government for the coming fiscal year. However, in terms of Pakistan's "do-it-whatever-way-you-can" ground reality, the government is usually able to 'push' the budget through parliamentary procedures. This is why the budget document as revealed by the Finance Minister (or Finance Advisor, whatever the case may be) is considered the final document – if the law were to be respected and procedures to be followed, it would only be a template or recommendation which would later be deliberated upon – and possibly amended – by the parliament in its Budget session.

After this brief introduction into the dynamics of Pakistan's federal budget and fiscal operation, the current political and security scenario is experienced by all. Visible to everyone who cannot afford 'security protocol' or gunmen for protection, the law and order situation has been deteriorating in the midst of claims by the government (read: civilian government) that the terrorists are on the run and they will be wiped out, etc. etc. Politics has returned to the usual mudslinging witnessed in the 1990's – except that the same old faces have returned with new things to say and new ways to say them. Whatever the opinion of one person, or the other, or this scribe, may be, it is inevitable that countries go through periods of crises intermittently; so it is neither unusual nor unwarranted that Pakistan's society faces such an abysmal situation in 2010. But the very reason why it *appears* to be unwarranted is the absence of consensus and agreement on some basic principles, some fundamental rules of the games, and the common denominators which are used as base indicators upon which further growth and progress can be established.

Pakistan 'could' have easily dealt with both political instability *and* law and order/War on Terror if its economic strength had not been compromised in the twilight of this decade. Using the arrival/installation of a civilian dispensation in Pakistan's government as a standard, Pakistan's economy has registered a measly GDP growth rate not exceeding 3% per annum for the last two years. It required a reassessment of previous years' GDP growth rates to estimate a higher expected GDP growth rate for 2009-2010.

But the fact remains that Pakistan's economy – vibrant and strong in 2006 – faced an ominous threat in 2007 when the reaction to the Lal Masjid operation became an actively destabilizing force. Capital flight, lack of investor confidence in the economy, absent and deteriorating infrastructure, pervasive corruption and other factors that increase the difficulty of doing business in Pakistan were only augmented by the security situation that developed as a result of Pakistan's new role as a front-line state in the War on Terror.

Today, there are conflicting views, opinions and indicators to study the Pakistani economy – not just for citizens, or students of economics, or those interested in a simple comparative static; even the State Bank and the IMF are at odds when they comment on the current performance of the Pakistani economy; or the picture is presented that way.

The Daily Times reported that State Bank of Pakistan (SBP) painted a "gloomy"[1] picture of the national economy, saying that growth in the agriculture sector was expected to remain below estimated targets, and that the fiscal deficit would exceed earlier estimates. The report said the agriculture sector was expected to post a below-target growth rate, mainly due to water shortage and unfavourable weather conditions during the ongoing year. The SBP's third quarterly report also said that the overall external current account position would remain vulnerable; implying that Pakistan's currency situation and export capacity would not be able to easily sustain the import bill unless external financing was available. Although the fiscal deficit is expected to be above target, and must be revised upwards for other calculations to be valid, borrowings from the central bank have so far been low relative to previous years.

In its report, the SBP said that the Federal Board of Revenue's (FBR) revenue collection has showed "robust performance"[2] in the third quarter of the current fiscal year 2009-10, but stood at 65.9% of the annual budget target. The growth in taxes was large due to increased collection under the head of direct taxes and import-based indirect taxes. The FBR is required to collect

[1] Mushfiq Ahmad. "State Bank paints gloomy picture of economy". Daily Times. June 02, 2010.
[2] Staff Report. "Third Quarterly Report of SBP: Revenue collection in 9MFY10 only 66% of target". Daily Times.

more than Rs. 157 billion per month on average in the remaining month of FY10 for achieving the target.

On the other hand, the Express Tribune reported that the IMF sees stabilization taking root in Pakistan, and that the economy was "improving"[3]. Stating that Pakistan's economy is "getting back on an even keel", the IMF's representative in Islamabad, Paul Ross, was of the view that Pakistan was suffering from a balance of payments crisis that began over 18 months ago, and remains both vulnerable to shocks, while also being perceived as a risky market for investors. Ross said political uncertainty, chronic insecurity and a budget deficit inflated by spending to tackle militancy are the main threats to Pakistan's economic recovery.

However, Ross said the outlook is still "brighter" than the one two years ago; inflation has dropped to 13%, foreign reserves are in a better position (i.e. they can sustain four months of imports) and the current account deficit has come down to approximately 3% of GDP this year. Inflation in 2008 was 25%, central bank reserves had fallen drastically and current account deficit climbed to 8.5%.

Can this be? Could nuclear-armed Pakistan, a critical U.S. ally fighting to quell a growing Islamist militancy, have started to show signs of stability after struggling to revive its sluggish economy?

With due deference to the professionalism of Pakistan's free media, the abovementioned news reports seem contrasting at first. However, the Daily Times also reported on Paul Ross' interview with Reuters on Pakistan's economy[4]. "In terms of the economy, stabilisation seems to be taking hold ... progress has been made," Paul Ross of the International Monetary Fund said in an interview with Reuters. Providing a context to this report, it is stated that the government turned to the IMF for an emergency package of loans in November 2008, when inflation was 25%, central bank reserves were the equivalent of just one month of imports and the current account deficit had widened to 8.5% of gross domestic product for fiscal year 2007-08; these facts and figures are already mentioned above.

Elucidating further on Pakistan's 'strategic location and positioning' given its current circumstances, Ross purported that among the risky "frontier markets", Pakistan is seen as "too long a shot" for many investors due to its insecurity, poor governance, corruption and crippling power shortages. Indeed, foreign direct investment (FDI) has almost halved over the past year,

[3] "Pakistan's economy improving: IMF". The Express Tribune. May 25, 2010.
[4] "Economic stability taking hold in Pakistan: IMF". Daily Times. May 26, 2010.

standing at just $1.77 billion in the first 10 months of fiscal 2009/10 fiscal year. In Vietnam, by comparison, the government expects FDI of $10-11 billion in 2010. However, there has been an upturn in foreign portfolio investment as the economy has improved, with net inflows into the stock market of $508.7 million in the first 10 months compared with an outflow of $392 million in the year-earlier period. The status of Pakistan's stock markets will also be addressed in due course.

Paul Ross pointed to a narrowing of the spread on Pakistan's sovereign credit default swaps, or CDS, used to insure against sovereign debt default, as a signal of returning confidence in the country's economy. The 5-year credit default swap spread started to drop steadily at the end of February from levels above 900 basis points.

Returning to the question at hand; why is the State Bank of Pakistan painting a dismal and demoralizing picture of the Pakistani economy just days after the IMF presented a positive and upbeat assessment of the country's economic direction? One answer could be that the IMF is conducting an assessment of the past few years, whereas the State Bank is forecasting estimates and indicators for the future. Another answer could be that the SBP is a state organization that actually serves to provide the official numbers and figures of Pakistan's economy, as opposed to the IMF, which is a lender and views Pakistan through a specific perspective; the way a lender purveys a debtor.

The SBP also revealed its assessments on Pakistan's growth in its third-quarterly report: Pakistan's real gross domestic product (GDP) growth will rise to 4.1% in the current fiscal year against an anemic 1.2% last year[5]. "The growth for the current fiscal year is estimated on the back of above target growth of livestock, large-scale manufacturing and services sectors," according to the State Bank of Pakistan's (SBP) third quarterly report on the state of economy. It is further stated that the current account deficit "sharply declined" with foreign exchange reserves improving. Exports were targeted at $20 billion, and imports at $31 billion, while the inflation target was revised to 12.5% from 12%.

The SBP's projections for the current account deficit reveal an "improved" picture; the deficit is now expected to fall even lower (in the range of 2.2% to 2.8% of the GDP) during FY10, substantially lower from earlier forecasts of 3.2% to 3.8% of the GDP, and the actual deficit of 5.7% of the GDP seen in FY09. "This improvement is mainly due to an impressive performance of exports and workers' remittances," the report said.

[5] Shahnawaz Akhter. "SBP's third quarterly report GDP growth seen at 4.1pc in FY10". The News. June 02, 2010.

Additionally, the country has to move "aggressively" to attract fresh investment by implementing additional reforms to increase economic efficiency and improve the business environment, the report said. Steps to increase investment must also accompany measures to foster savings, it said, adding that the central bank is looking to "increase the access of people to the financial system" and also introducing projects to improve the transmission of policy rates to savers. The State Bank also said that the "implementation of the Value-Added Tax (VAT) could be an appropriate remedy if supported by appropriate systems to curtail misuse of VAT refunds".

Hence, a thorough analysis of different news reports reveals that while agencies and institutions are performing their role, different news organizations are pursuing their own agenda – if not their own opinion on the economic situation of the country – or their own interpretation of the SBP's third-quarterly report.

Reuters says on May 22, 2010, that Pakistan's economy "likely" grew by 4.1% in the fiscal year ending on June 30, above a target of 3.3%, and is expected to grow even faster in the next fiscal year[6]. The government had earlier expected 3.3% economic growth in the 2009/10 (July-June) fiscal year, but officials said a "rebound" in the large-scale manufacturing sector and a strong performance in services sector contributed to the higher growth projection. Basing its assessments on the statement of the Planning Commission of Pakistan, Reuters reported that the services sector surpassed its 3.9% target and grew by 4.6% in the 2009/10 fiscal year, adding that the next year's target has been set at 4.7%. The agriculture sector's growth fell to 2% in 2009/10 against 4% last year, but it was "showing signs of stability", the Planning Commission official told Reuters. Lower production of major crops, including that of sugar, was a major reason for the decline. The commission has recommended an inflation target of 8% for the next fiscal year, the official said. The central bank has forecast inflation for the whole of 2009/10 to average between 11.0% and 12.0%. The consumer price index (CPI), a key indicator of inflation, rose 13.26% in April from a year ago. The SBP is widely expected to keep its key policy rate unchanged at 12.5% when it sets monetary policy for the next two months on Monday, as inflation still poses a threat, it has said.

Given the assessments of both the Planning Commission and the SBP, it is also pertinent to mention that rumours regarding the resignation of Governor SBP Salim Raza had been doing

[6] Augustine Anthony & Jeremy Laurence. "Pakistan's economy grows 4.1 percent in 2009/10". Reuters. May 22, 2010.

the rounds since late May, only to be confirmed on June 03, 2010. Amir Zia reported on June 02, 2010, that "State Bank of Pakistan (SBP) Governor Syed Salim Raza is seen on his way out without completing his three-year term and the government has already started a hunt for his replacement"[7]. Raza, who took charge of the central bank's top slot in January 2009, was supposed to retire from his office in February 2011, but government sources said that he wants to quit early after being unable to get an extension in service under the State Bank of Pakistan Act that does not allow a person exceeding the age of 65 years to hold this position. "Raza wanted an extension, which is not possible under the SBP Act," said a senior government official on the condition of anonymity. "Therefore, he plans to quit early. It is now the question of when he leaves not of whether he will."

However, till the filing of Zia's report, the spokesman for the SBP denied reports that Raza was on his way out. "I have no knowledge (about the possible change)," said SBP spokesperson Syed Wasimuddin. "He (Raza) came to the office today. As far as I know that the third quarterly report on the state of Pakistan's economy has been issued under his signatures."

But the SBP insiders say that the matter was "not that simple". Another senior SBP official said that for the last couple of months, the governor was "avoiding" attending important official meetings and engagements. "Instead, he is sending his deputy to represent the bank. His body language and the lack of interest in the affairs of the bank say a lot."

On June 03, 2010, Ghazanfar Ali reported that the SBP Governor had tendered his resignation to the President, which had been accepted. The Finance Division verified this information. "Coming just three days before the announcement of the federal budget 2010-11 on June 5, the resignation has given rise to many questions. Raza was a key member of the Pakistan team holding continuous talks with the International Monetary Fund's on the $11.3 billion loan programme."[8] "I do not know any reason for the resignation of the SBP governor," State Bank spokesman Syed Wasimuddin told The Express Tribune. Ghazanfar Ali also makes note of the rumours that had been circling around the capital regarding the SBP Governor's inability to obtain an extension, and his subsequent wish to "call it quits" as soon as possible.

From developing an unbiased and seemingly balanced view of the state management of the Pakistani economy, it is also necessary to look at the functions and progress of the local bourses, of which the Karachi Stock Exchange, or KSE, occupies the most significant position.

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[7] Amir Zia. "SBP governor seen on his way out, search starts for replacement". The News. June 02, 2010.
[8] Ghazanfar Ali. "SBP Governor calls it quits". The Express Tribune. June 03, 2010.

The Karachi Stock Exchange (KSE) performed "very badly" in May of the current fiscal year as its benchmark KSE 100-share index registered a sharp decline of 10.6%[9].

> The decline in the stock market was the largest single decline since December 2008 when the market was experiencing the aftershocks which kept on affecting stock trade for more than three months. Market players, citing various reasons for the prevailing negative sentiments in the market, pointed out that regional pressure threatening the outflow of foreign investment from the market, uncertainties about the upcoming budget and rumoured redemption pressures on the local funds are triggering strong bearish sentiments in the market. They said that the market is particularly worried about the capital gains tax (CGT) likely to be imposed on the bourses in the next financial year.
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> Apart from market manipulation tactics, analysts said that there are also genuine reasons for the market fall in the month of May particularly the outflow of the capital from the market during May, which otherwise remained a big booster for the market since the last couple of months. Besides the issues related to the economic side, the law and order situation could not be left out being a dampener for the market especially the bad security situation in May and a terrorist attack on a minority worship place in Lahore being claimed by Southern Punjab wing of Taliban.
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> The worst performance of the market in May made KSE the worst performer in the region, which otherwise dominates the regional scene for the strong performance. Having a negative 10.6 percent decline on the returns May, a steep decline of 45 percent was also recorded in the volumes.

Hence, real factors and government "manipulations" continued to affect KSE trading, and the expectations of investors and traders regarding the future trends of the Pakistani economy do not posit any significant change. The estimations and performance assessments of the Pakistani economy have to be taken at face value – with a pinch of salt, if you will – and it must be understood that the economy went through perhaps the most toughest and strenuous period in its history. Of course, these assessments are used to project future outcomes (which are possible, but never definite) and to evaluate policies and recommendations that can take the economy from its current condition to the desired/projected condition.

For that, we return to the SBP's third quarterly report, where it has emphasized an "aggressive" move to attract investments and increase savings while it concurrently suggested "institutional

[9] Taveer Ahmad. "KSE May performance worst since '08". Daily Times. June 02, 2010.

reforms" to expand the scope of pension funds that may cater the need for long-term savings[10]. The SBP asserted that the country had to move aggressively to attract fresh investment by implementing additional reforms to increase economic efficiency and improve the business environment. "The greater impact is likely to be through improving institutional savings, for which there is an urgent need to reform the institutional structure of pension and provident funds to foster the expansion of the pool of long-term savings," the report added.

Steps to increase investment must also be accompanied by measures to foster savings, said the SBP, adding that the State Bank is looking to increase the access of people to the financial system, and also introducing projects to improve the transmission of policy rates to savers. Though Pakistani banks have improved their skills to attract deposits, the long-term saving trend is still poor as bulk of bank deposits are kept for less than one year. The State Bank has been providing incentives to banks for attracting long-term deposits but the output is not encouraging.

The gradual pickup in the deposit base which began in September 2009 continued in the subsequent months. Resultantly, deposits of the banking industry recorded robust growth of 8.6 per cent during July-April 2009-10, in stark contrast to a contraction of 0.2 per cent in the corresponding period of FY09, said the report. The acceleration in deposit growth during the period is particularly significant because of a phenomenal rise in government deposits, and shift in the maturity profile of large privatized banks' incremental deposits towards lower cost funding, said the SBP report.

Hence, it is primarily a private solution – if not a private-public partnership – that will increase available resources and optimize resource utilization for the Pakistani economy, so as to consolidate a trend of austerity and economic strengthening in Pakistan. The 2010/2011 FY Budget, therefore, has to live up to a lot of expectations. The sociopolitical perception being built around the upcoming budget must be dissociated from divergent media viewpoints as well as derogatory political commentary. Documenting the economy and its processes – as the VAT is purportedly going to do – is still an important aspect that needs to be dealt with by the responsible institutions and the Government of Pakistan, so that there is clarity in both economic assessments (of the past), and economic projections (of the future).

[10] "SBP emphasises on wooing savings, investment". DAWN News. June 02, 2010.