PakEconomiX

May Update 2024

IPIR

INSTITUTE OF POLICY INPUT & RESEARCH

A Project of WORLD TIMES

The cornerstone of a nation's economic stability and financial robustness primarily rests on its exports, remittances, investments, and reserves, crucial for financing imports and reliant on favorable economic conditions domestically and globally. The COVID-19 pandemic significantly impacted economic structures, still felt by emerging economies, while recent events like the Russian-Ukraine war have added further instability. With regards to Pakistan, internal factors have also contributed to economic instability.

Despite the instability, Pakistan's economy is expected to achieve modest growth this year, setting the basis for better future performance. Pakistan's economy is projected to expand by a modest 1.8% in the current fiscal year ending June 2024, as per the World Bank's latest Pakistan Development Update: Fiscal Impact of Federal State-Owned Enterprises. Following a contraction in FY23, economic vigor has rebounded in the first half of FY24, buoyed by robust agricultural performance. Agriculture emerged as a main driver of economic growth in the current fiscal year, registering growth of 8.6 and 5.0 percent in Q1 and Q2 of FY2024, respectively.

Externally, the current account recorded a $0.5 billion deficit for Jul-Mar FY2024, marking a significant decrease from the $4.1 billion deficit of the previous year. This improvement reflects a notable reduction in the trade deficit. In March 2024, the current account achieved a surplus of $619 million, compared to $98 million in February 2024. Foreign Direct Investment (FDI) inflows surged by 89.4 percent to $258 million, up from $136.3 million the previous month. The rise in FDI is attributed to enhancements in the investment climate and decreased uncertainty, also reflected by the Executive Board of IMF's completion of the second review under the SBA (Stand-By Agreement) for Pakistan on 29 April 2024, permitting for a disbursement of $1.1 billion, bringing the total disbursement under the SBA to $3 billion.

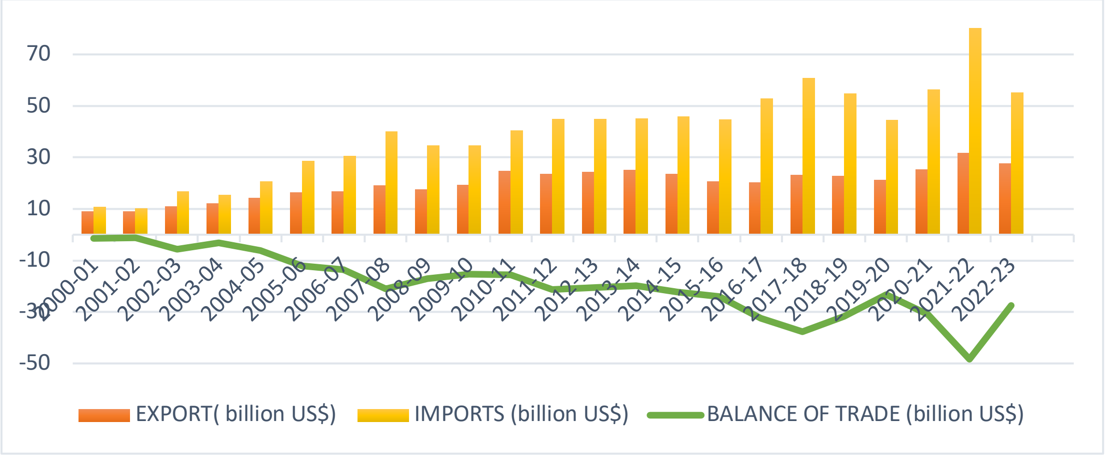
Alongside enhanced confidence, these factors also contributed to some resurgence in other sectors but the growth remains inadequate in alleviating poverty, as 40 percent of Pakistanis currently reside below the poverty line. Macroeconomic vulnerabilities persist, marked by a significant debt burden ($87.7 billion External Public Debt and PKR 43.9 trillion as of end-March 2024) and limited foreign exchange reserves ($8 billion on average from end-March to end-April 2024). Improved fiscal management is pivotal in curbing inflation which was 17.3% in April 2024 (lowest point since 2022) – despite which State Bank of Pakistan kept the policy rate at a high of 22% though it is expected to go down as inflation is curbed – narrowing the current account deficit, enhancing financial sector stability, and boosting private sector credit—integral elements for a robust economic rebound. Reforms need to be aimed at refining expenditure quality, expanding the tax base (not the taxes), alleviating regulatory constraints on private sector operations, reducing state intervention in the economy (including privatizations), addressing energy sector challenges, and amplifying public investments to enhance human development outcomes. The current macroeconomic forecast predicts growth below Pakistan's potential, with minimal poverty alleviation and continued erosion of living standards. Risks to this projection persist, encompassing uncertainties regarding policy commitments and reform execution, financial sector vulnerabilities, potential escalations in global energy and food prices amid regional geopolitical tensions, sluggish global economic expansion, and tighter-than-anticipated global financing conditions.

Special Review: Pakistan's Trade Balance

Pakistan's exports in FY23 stood at US$ 27.724 billion, experiencing a notable decline of 12.8% from US$ 31.728 billion the previous year. This decrease is attributed to reduced global demand, especially in key markets like Europe, the UK, and the US, influenced by factors such as inflation, energy costs, and fiscal policy changes post-COVID-19. Moreover, China's economic slowdown also contributed to this decline. Pakistan's primary exports include textiles, cotton, rice, and leather products, with major markets including the US, China, and the UK.

Imports in FY23 totaled US$ 55.198 billion, marking a significant 31.1% decrease from the previous year's US$ 80.137 billion, primarily due to policy changes and administrative measures. Pakistan's imports cover a wide range of commodities, including petroleum products, machinery, pharmaceuticals, and vehicles, with China being the largest import partner.

The trade balance is crucial in influencing macroeconomic policies and provides important insights into economic behavior and policy decisions. It acts as a measure of a nation's net income from global assets. The trade deficit in FY23 contracted by 43.2% to $27.474 billion compared to US$ 48.355 billion the previous year, mainly driven by the significant decline in imports. The graph below shows how imports and exports between FY 2000 and FY 2023 led to the disturbance in balance of trade.



Pakistan began its venture into foreign trade shortly after gaining independence in 1947 but concerns around trade deficit persist to date and remain more or less the same as they were during the 20th century. Pakistan joined the World Trade Organization (WTO) in 1995, but its trading terms remained unfavorable. The country's persistent trade deficit is mainly due to significant imports of items like fuel, machinery, and chemicals, while its exports are geared towards low value-added products or relatively low-value goods the main among which are related to textile. Key trade partners include the US, UAE, KSA and China, which have remained persistent for quite a number of years and Pakistan has been unable to tap new markets such as those in Latin and South America, Africa or South East Asia.

Apart from maintaining a positive balance of trade, achieving sustained medium-term recovery will necessitate a balanced macroeconomic policy blend along with reforms aimed at enhancing expenditure quality, broadening the tax base, alleviating regulatory constraints on private sector endeavors, diminishing state intervention in the economy (including through privatizations), tackling energy sector challenges, and bolstering public investments to enhance human development outcomes.

By Alveena Sardar