Sample Report

PRIME PLUS

A Quarterly Report on Economic, Institutional and Policy Environment in Pakistan by PRIME

PRIME is an independent economic policy think tank based in Islamabad. It is ranked amongst top 100 think tanks in Asia Pacific region by the University of Pennsylvania.

About PRIME: Policy Research Institute of Market Economy is a public policy research and advocacy organization striving for an open, free, and prosperous Pakistan. PRIME was established in Islamabad in 2013 and has played a leading role in advancing ideas and policies for open trade and economic efficiency in Pakistan through its research and public education. PRIME is included in Top 100 think tanks in Asia-Pacific region.

Prime Plus: is a subscription based quarterly report published by PRIME that provides economic, institutional and policy analysis explaining developments, opportunities, and challenges, at both micro and macro levels of Pakistan's economy.

Prime Plus Research Team:
Sarah Javaid – Research and Policy Analyst
Tuaha Adil – Research and Data Analyst

Published by: Policy Research Institute of Market Economy (PRIME) 2021

For inquiries please contact:
Nazia Aman – Finance Manager
Email - nazia@primeinstitute.org

Mailing Address:
PRIME Institute
Office 305, Imperial Square
E-11/2 Markaz,
Islamabad, 44000, Pakistan
Tel: 00 92(51) 8 31 43 37 – 38

www.primeinstitue.org

Prime Plus

Prime Plus quarterly report aims at analyzing policies by the government or the regulators, and then discussing possible consequences or developments on the economy. The report would hence include federal level economic policies on a range of policies such as taxation, tariffs, and prices which influence business climate. Businesses can analyze and modify their planning scenarios in the light of government policies, reduce risk and improve their plans for investment and sales targets after reviewing this report.

TABLE OF CONTENTS

01 What this report is about? 05

02 Section 1: News & Policy 06

- **2.1** News Review 07
- **2.2** Policy Review 09

03 Section 2: Policy Analysis 11

04 Section 3: Economic Analysis 30

- **4.1** Macro Economic Indicators 32

05 Section 4: Macro Economic Outlook 34

- **5.1** Where is Economy Heading? 35
- **5.2** End Note 36
- **5.3** Annexure 37

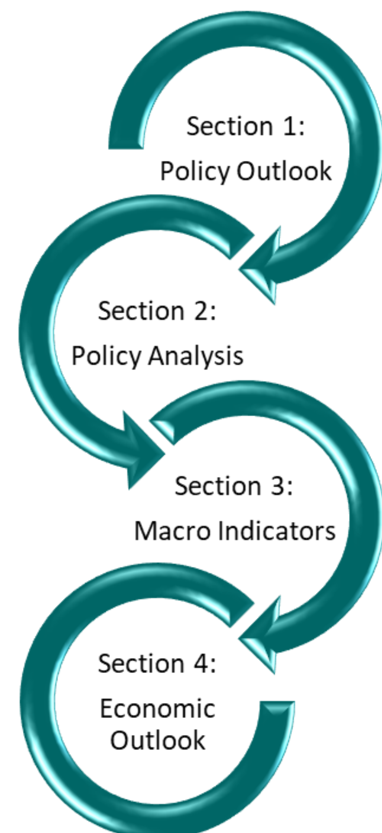
What this Report is about?

In the first section of the report, we bring to you the overall policy outlook of the economy for Fiscal Year 22. Starting from monetary tightening and a move towards comparatively less fiscal expansionary measures, the section gives you a closer look of Monetary and Fiscal sides of the economy.

Section 2 discusses a deeper impact of some main policy reforms by FBR, SBP, IMF and mainly by the Federal government on the business climate specifically and economy. It's pertinent to mention how the various reforms introduced in this fiscal year bring in investment opportunities, export schemes, transparency in tax system and accountability of the Central Bank. Unfortunately, the institutional system lacks on implementation of these policies. The significant risks associated with the economy - subsequent current account deficit, inflationary pressure and external debt, pose skepticism on the long run effect of these reforms.

In Section 3 we present Economic data on major macro indicators including Inflation, Current Account, Public Debt, Foreign Direct Investment, Government borrowing and a general trend of how the economy is behaving, where we reach to the conclusion that Pakistan's economy is currently not performing at its potential level.

The Last Section summarizes the future economic outlook of the country. The economy is struggling with myriad challenges emanating from global petroleum and commodity price hikes, which translates into domestic inflation and higher current account imbalances. The performance of manufacturing sector has shown resilience during pandemic but is now facing slowdown due to rising input and energy prices. The growing domestic demand and subsequent higher imports prompted the government to raise policy rate to curb inflationary pressures. However, the challenges are insurmountable and may contribute to slowdown in the economy in the coming months if global energy and commodity prices do not subside.



Section 1: News & Policy Review

News Review

September 2021

- Air Link Communication (ALC) – a smartphone assembler and exporter in Pakistan – raised the single-largest investment worth Rs6.43 billion through selling 90 million shares to institutional and rich individual investors at the Pakistan Stock Exchange (PSX)
- SBP instructs banks to give loans for under-construction projects - secured through mortgage.
- Two Pakistani startups, Airlift and Bazar, have been in the spotlight because of successfully securing a sizeable investment – foreign investors showing interests in startup culture in Pakistan.
- Government to slash export cargo charges by 50% - Port Qasim Authority approved reduction.
- NEPRA suggests a cap on tariff for Electric Vehicle charging stations at Rs.45 per unit – business community requests the regulator to leave the tariff uncapped and let the market forces determine rates.
- Telecom auction fails as only Ufone participated in the bidding – government bids to sell additional spectrum at $ 1 billion
- Government approves Rs.44 billion bailout for PIA.

October 2021

- Government decides to increase power tariff by Rs 1.39 per unit in base power tariff.
- Government to withdraw Rs 330 billion sales tax exemptions.
- Government to drop existing tax incentives for existing oil refineries and offer tax incentives to new and up-grade projects – to be executed before December 31st 2025. Refineries share increased to 70%
- Government agrees to pass withheld power tariff raise of Rs. 1.39 per unit on to consumers
- OGRA has notified increase in prices for consumers of SNGPL by Rs. $0.4294 per mmbtu and SSGC by $0.4362 per mmbtu for October.
- FDI reduced by 4% in first quarter of FY22 due to fall in China's investment by 50% as compared to FY21.
- FBR considers withdrawing Rs 334 bn GST exemptions under IMF program.
- The government is set to increase the local gas tariff by 10-22 percent by November 1, 2021 as per the undertaking extended to the IMF
- Qatar Petroleum (QP) and Pakistan based firms to establish a "merchant model" imported LNG terminal in the country – owning 49% and 51% stake respectively.
- Saudi Arabia agrees to provide $4.2 billion to Pakistan in the shape of cash assistance and oil on deferred payment
- The Competition Commission of Pakistan (CCP) cleared state-run Qatar Energy's bid to acquire 49 per cent stakes in an upcoming private sector LNG terminal, paving the way for Qatar's first direct investment in Pakistan's energy market

November 2021

- Expansion of Thar coal Block II approved to 12.2 million tonnes per annum – reduces coal price from $60 to $27 per tonne (DAWN)
- Government to withdraw subsidized gas rates of $6.5 per unit of industrial sector
- Government decides to increase wheat support price from Rs 1800 to Rs 1950/40 kg by Rs 150
- OGRA has instructed state run gas producing companies; SNGPL, SSGC to withhold 25% of total sales dues of companies
- Sugarcane support price has been fixed at Rs 225 per maund
- Cement dispatches decline by 12.17% - exports reduced by 49.95% as production falls from 1.131 m tons (Sep 20) to 0.572 m tons (Sep 21)
- Commerce Ministry has enhanced age limit of imported used buses from 3 – 5 years
- Government has announced an investment of Rs 111 billion during next three years in Power transmission sector. (Nation)
- Government plans to impose higher tax rate on underutilized cement plants – ECC to decide extent of increase. (Dawn)
- LSMI output increased by 5.15 % in first quarter of current Fiscal Year as compared to last Fiscal Year.
- FBR has installed Track and Trace system on 78 sugar mills across country to gauge the real production.

Policy Review

The Federal budget 2021-22 outlay for Pakistan was Rs 8 trillion whereas, expected government expenditure stood at Rs 8.487 trillion i.e. 19% higher than the last fiscal year (Rs 7.136 trillion). With that, government's GDP growth target of 4.8% by the end of current fiscal year, might become onerous but still achievable. Achieving inclusive and sustainable growth, limiting the current account deficit to 0.7%, financing circular debt, raising government's revenue without increasing taxes and supporting construction sector remain government's priorities for the fiscal year. Also facilitating overseas, providing initiatives for the poor such as Ehsaas Program, creation of jobs through public sector development spending and bringing in initiatives for farmers' support remain central part of the budget.

On the fiscal side, as per FBR, provincial net collection grew by 36.8% to Rs 1347.5 billion, as compared to last year. Whereas domestic tax collection increased by 35.9% to Rs. 1,551 billion in July-October FY22' against Rs 1,141 billion in last fiscal year. The revenue generation crossed its target by Rs. 235.9 billion in the same time period yet we see a fiscal deficit of 0.8% of GDP i.e. Rs 438.5 billion in first quarter of current fiscal year.

On the monetary side, SBP raised its policy rate first time in last 15 months by first 25 basis points to 7.25% as a signal for the policy makers and business community, followed by a further increase of 125 bps increasing the rate to 8.75% and finally, SBP has raised its policy rate by 100 bps to 9.75% - a total increase of 250 bps. We see the central bank redirecting its monetary policy from accommodative towards more tightening.

Economy would still have to deal with macro risks of inflationary pressure, consequent rupee depreciation, international oil, and commodity prices, though we see a reduction in oil prices internationally, domestic power crisis in the economy remain an issue.

With reference to the external sector, government is trying to move towards an inclusive export led growth by enhancing the previous export promotional schemes and re branding it as Export Facilitation Scheme 2021, under which the government has reduced custom duties on imported raw material for exporters. The Large-Scale Manufacturing has shown a growth of 5.15% in first quarter of current fiscal year against a growth of 4.53% in same period last year. At the same time, declining interest of foreign investors is evident as already negligible amount of FDI inflow has further reduced to $439 million (Aug-Oct FY22) from $457 million in same period last year. The leading investor in Pakistan – China, has also shown falling interests in the economy in shape of declining FDI inflow in current fiscal year since the country has still to pay $1.5 million to Chinese firms operating in Pakistan.

At the same time, to bring retailers in tax net, government has introduced systems like Point of Sales for tier 1 retailers which is a good initiative to broaden tax net and enhance transparency however this also means that small retailers and informal businesses will remain out of the tax system. With that, FBR has been extending the grace period for digital payments of corporate taxpayers that shows inability of the Board to implement its policies.

According to IMF, Pakistan's GDP would grow to 4% however Ministry of Finance predicts a GDP growth close to 5% in current fiscal year. This target in case of Pakistan does not seem quite

achievable looking at the current trade deficit and soaring inflation. As per IMF's report, global inflationary pressure in Pakistan would be at its peak in final months of the current year which would gradually fall in mid of next year. However, for Pakistan, it seems like uncertainty would remain and inflation would increase for a variety of reasons.

Current IMF deal has stabilized to some extent the rocky Pak-US relationship which gives a signal towards stabilization of Pak rupee, modification of reforms, macroeconomic stability, and amplification of interests of foreign investors, given that, the government must remain disciplined in its spending in coming months. The autonomy of central bank would allow the Bank not to make reactive policies backed by vested interests and on the cost of consumers.

After the IMF program, the current policy structure has shifted towards less expansionary fiscal policy and a less accommodative monetary environment. The ability of various reforms in FY 22' depends upon government's execution on debt management and to prove the current bailout to be different from prior bailouts. Otherwise, economy of Pakistan, just like previous decades, is the same three Ps - same position, with same problems and same prescription.

Section 2: Policy Analysis

Can FDI become a Major Player?

The Board of Investment has announced formation of strategies to attract $50 billion investment in the country by 2023, from world's leading economies USA and China, targeting several sectors including textile, automobile, agriculture, sports, and Personal Protective Equipment (PPE). Since 2014, 21 Special economic zones (SEZ) have been attracting, although negligible, domestic and foreign direct investment.

The data from SBP reveals that FDI has actually decreased in the first quarter of FY 22' ($439 m) as compared to the same period in last fiscal year ($457m) due to the pandemic fueled international travel restrictions and Kabul's takeover by the Taliban. Amid pandemic, disrupted investment plans of the potential foreign investors have led to investors holding back investments in their units located in Pakistan.

Investment inflow from world's leading economies UK, China and USA have been recorded as $30.3m, $76.9m and $100.9m during the first quarter of FY22. Chinese investors have brought $260m of investment in the steel sector of Rashakai Special Economic Zone (SEZ) and a total of $758m investment in Pakistan for last fiscal year – the major investor in Pakistan so far. In an effort to attract even more investment from China in form of Joint Ventures, and other opportunities, BOI has appointed eight honorary investment counselors in different potential regions of China and has laid special emphasis on the importance of SEZs.

This initiative is a productive step since the CPEC SEZs focus sectors for investment are Textile, automobile, pharmaceutical, building material, warehousing, electronics and engineering goods. These export-led sectors in Pakistan need to attract more investments as textile group exports have shown a 27% increase in first quarter of FY 22', a 7% growth in pharmaceutical sector, 34% in auto parts and accessories, and engineering goods export has gone up by 11% as compared to the same period in last fisca l year. In the past year we have seen Chinese investor's trust in full bloom as according to Security & Exchange Commission of Pakistan, out of 117 foreign firms registered in 2020, the maximum firms belonged to China. Unfortunately, Pakistan has not been keeping up with the foreign investor's confidence in its economy. Currently, government has failed to make payments worth Rs. 230 billion to Chinese firms operating under the CPEC project, because of which no new Chinese investment is expected in Pakistan unless government clears all the dues. These Chinese investors are paid Rs 5 billion to Rs 6 billion less than the actual amount every month on average – accumulating to a circular debt. Also, government's plan on opening a bank account of revolving fund that would include deposits equivalent to 21% of the power generation is still not implemented. Investors are finding future investment in Pakistan even riskier due to the vicious cycle of circular debt.

Government's developmental initiatives for Rashakai SEZ can still facilitate local investors by providing business friendly opportunities as this SEZ has predominantly local and foreign investment feasibility. Investor's confidence is the primary tool to attract FDI which we see

falling drastically. Government must retain this by paying the payables to foreign investors otherwise BOI's $ 50 billion policy would fail to pave an export oriented and growth augmenting path if FDI starts falling and sectors fail to receive desired investment.

One good initiative by BOI to enhance FDI in coming years, is the introduction of Investment Relation Management System (IRMI) which selects priority sectors for investment through a structured sector scanning process. Major FDI engaging sectors in Pakistan are Power Sector, Financial Sector, Communications and IT and Oil & Gas, where trade and textile sectors have failed to attract higher FDI. One major sector in Pakistan i.e. Construction, has received a negative net FDI. Power sector and Oil & Gas have shown contraction where financial sector and communications grew comparatively.

Net FDI inflow in Major sectors Q1 FY22'	
	Million $
Power sector	131
Financial sector	100.5
Communications & IT	88.4
Oil & Gas	63.6
Trade	10.1
Textiles	7.7
Construction	-3.6

Data: BOI

Together these four sectors (Power, financial, communications and oil) have attracted $384m in the first quarter which is almost 87% of the total net FDI (Q1 FY22). The necessity for economic growth i.e. power sector, constituting a 30% share in net FDI, accompanied by a 14% share of oil & gas, is a signal that Pakistan is preparing itself to become an **energy-self-sufficient economy** soon.

What's even pertinent to mention is that the FDI inflow should be hitting export-oriented sectors in Pakistan which have received almost no FDI. Different studies find a positive impact of FDI on export growth. One example is China and Vietnam whose exporting firms have benefited from foreign investors. If Pakistan adopts these practices, the presence of foreign investors would be having positive spillover effects on domestic firms in form of imitating best production techniques and modern skills. It would be very unfortunate of Pakistan to miss huge opportunity and great access to global supply chain, technology know-how, branding and designing if it fails to attract FDI in exporting sectors. The performance of economy depends upon sustainability of growth. In last fiscal year, Pakistan could hardly attract $2 billion of FDI. How would this overshadow huge trade deficit and worsening balance of payment condition?

Strategically important industry and service sectors are crucial portions of growth. The contracting FDI ratio in these areas would never bring a significant developmental change in the economy. An average $2 billion investment is no good. Pakistan needs to develop its strategies that may focus on attracting FDI inflow not from just China and USA rather from as many countries as it can. The four FDI investors jointly contributed 62% of the total FDI inflow for first quarter.

Iran, Turkey, Australia, Canada, Russia, and Singapore in their recent meetings with Pakistan have showed interest in investing in sectors like car manufacturing, agriculture, energy, steel and financial services. It's good to welcome China always, but even more important is to 'sustain' these investors. Also, BOI should speed up in making deals with and finalizing investment projects with the countries mentioned above – that too in their area of interest.

Recent investment in locally manufactured mobile phones by Pakistan in partnership with China and Korea can bring in more FDI inflows in the IT sector. In near future we can see an

increase in exports following this development if a business-friendly environment is created and implementation policies for investors are eased out. According to a World Bank study[1], foreign owned firms in Pakistan are 66% more efficient than domestically owned firms. The SEZs in Gwadar, Faisalabad, Dhabeji and Rashakai under second phase of CPEC are at advanced stages for the establishment of their industrial units. Many Chinese companies due to an increase in their costs are relocating their work to Vietnam but due to the political relations with Pakistan and access to new port, China despite not paid for many projects, is still ready to choose SEZs in the country. What's missing in Pakistan is its response in form of meeting China's capacity and speed and clearing out its payments.

Afghanistan's trade with many countries including Pakistan has shown a declining trend. If the political situation of the former improves, other countries might set up manufacturing units in Pakistan to import to Afghanistan and other Central Asian economies. Also, the goods manufactured in Pakistan's SEZs would become more attractive to the consumers of Central Asian Economies if transported under Transports Internationaux Routiers (TIR) convention.

High tariffs and domestic industry's dependency on imported raw material, acts as an obstacle to a drastic increase in exports. Also, due to rising energy and international commodity prices, exports might not increase the way they should. One reason is that major focus of our export sector has remained in a few unskilled or even semi-skilled labor-intensive sunset exports such as textile and leather. These account for about two thirds of our export basket whereas, the share of hi-tech exports has not been even 2% in past decades. To attract FDI in the export-oriented sectors of the country, we need to move away from the traditional and stagnant exports towards more growth augmenting products. For that, an economic transformation in terms of resource re-allocation in more sophisticated goods is required. This sophistication to produce is the productive capacity of an economy that allows it to integrate regionally and globally. Pakistan has gradually decelerated in the Economic Complexity Index from 102 in 1995 to 95 in 2018. This can be done with a private-government partnership, ensuring active participation from the business community in the presence of quality governance.[2]

[1] Internationally Linked Firms, Integration Reforms and Productivity : Evidence from Pakistan, Lovo, Stefania; Varela, Gonzalo. 2020

[2] New Vision for Economic Transformation: Rethinking Resource Allocation and Productive Structures by Economic Advisory Group (EAG)

Export Facilitation Scheme 2021
Would this facilitate the constant CA deficit?

The newly inaugurated "Export Facilitation Scheme 2021" by the Federal Board of Revenue is welcomed by Manufacturers – cum – Exporters across Pakistan. The already operational schemes like Manufacturing Bond, DTRE and Export Oriented Scheme will run parallel to the new scheme for the next two fiscal years. Initially, users of this Scheme included Exporters: Manufacturers cum Exporters, Commercial Exporters, Indirect Exporters, Common Export Houses, Vendors, and International Toll Manufacturers which were later extended to all sort of exporters by the FBR within the same quarter.

In past, FBR has promoted many other export schemes including Manufacturing Bond Rules 2001, Duty and Tax Remission for Exporters (DTRE), Temporary Importation Scheme 2009, The Export Oriented Units (EOUs) and Small and Medium Enterprise (SMEs) Rules. As per the Pakistan Bureau of Statistics data, from 2017-19, DTRE was the most utilized scheme by the exporters. However, the total percentage of the exporters in these schemes was just 5% in 2017-18 and 6% in 2018-19 due to which the share of these schemes in total exports was 31% and 37% in both years – showing limited export diversification of exporters. The driving cause was tough eligibility criteria for exporters and complicated application process.

For the past thirty years, Pakistan's share of world exports has dropped from 0.2% to 0.17% as compared to its competitors, India and Bangladesh. Export to GDP ratio of Pakistan has fallen from 17% to 10%.Where we see a stagnant growth in exports, the export basket too has not changed in last three decades, even in the presence of previous export promotion schemes.

	% Share of world exports	Exports as % to GDP 2020
Pakistan	0.2	10.03
Bangladesh	1.24	11.9
India	1.71	18.66

Data: World Bank

This time the revenue body has tried to address these issues with already running schemes and broaden export net in Pakistan through promotion of Export Facilitation Scheme 21. This policy stresses upon acquisition of duty- and tax-free import of inputs or acquisition of domestic inputs by authorized users under the scheme for the defined period. Also, the exporters are allowed to sell duty free 20% of the exports domestically and above 20% based on additional surcharge; idea is to enhance the export-oriented sector of the economy and ultimately earn foreign exchange to address the current account deficit issues. The scheme is not subject to any export targets for exporters. However, export targets create incentive for exporters to compete and increase their production more efficiently. Also, the acquisition of imported inputs; duty and tax free shall be granted based upon the export performance of the exporters for the last two fiscal years and firm's export contract. Around 60% of Pakistan's exports are textiles. This means more textile exporters would be encouraged to avail the scheme as compared to others, leaving less incentive for them.

The acquisition of EFS 21 would meet desired export production if the scheme successfully attracts the exporters from sectors other than

textile as well. For that, firms must undergo exporter's training programme to fill the gaps in the skill sets. The training program should include short courses where the exporters would be introduced to new technologies. Sectoral training sessions can be introduced by the exporting firms since different technologies are used in production of different products for example, promoting a separate program for each sector like textile, automobile parts, pharmaceutical products etc. Considering the high costs of training, exporting firms can collectively arrange such programmes. In that case, this would be an upturn for SMEs who struggle to gain a footing in the market. This initiative would allow small businesses and many others under the scheme to expand sales and capture some market share. Under the scheme, exporting firms can also purchase domestic inputs. According to research**[3]**, exports are a good proxy for internal manufacturing at an aggregate level, translating into source of employment in domestic industry.

Also, the acquisition of imported inputs, duty and tax free shall be granted based upon the export performance of the exporters for the last two fiscal years and firm's export contract. Tariffs on imports of raw material and intermediaries are said to be an export tax. According to a number of studies, the reduction in import duties has actually led to a reduction in the total cost of production of downstream industries, eventually making them more competitive in international markets. Small exporters should utilize this scheme to gain international market exposure. Imports of raw material and hi-tech goods is essential for economic growth of the country, which should be financed by export earnings and foreign direct investment to avoid accumulating current account deficits. For example, in iron and steel industry, 90% of the inputs are imported, which also face high tariffs. Exporters of this industry must avail inputs under this scheme along with training courses as discussed before, in order to augment their final production and hence exports.

Exporting improves a firm's performance and good firms become exporters. Employment opportunities, growth prospects and survival probabilities are higher for exporting firms. According to a study**[4]**, profitability of small firms increases by 26% if they're given opportunities to export. Where, Pakistan exporter Survey Report 2021 by Ministry of Commerce reveals that large exporters find it relatively easier to build and maintain connections with their buyers as compared to small exporters. This policy would enable firms to uplift their work performance and increase profitability. For small firms to benefit from the scheme, exporting firms must open themselves to international consultancies. One evident obstacle is high costs, but of course without considering large benefits in the long run. Even if large exporting firms can welcome international consultancies once, the benefits from that would motivate small exporters as well. These firms should welcome management consultancies in areas like inventory management, supply chain management, factory layouts etc. and should seek sustainable recommendations in implementation.

With trade in good, comes trade in knowledge and expertise – Learning by Exporting. If the authorized users avail the benefits from this scheme, it may result in an increase in overall gains from trade and can push the SMEs into global value chains through reducing their costs

[3] Sustaining Employment Growth: The Role of Manufacturing and Structural Change UNIDO

[4] Trading up : The benefits of exporting for small firms; Atkin et al, 2017

of and barriers to trade. However, small firms with a poor export history or no history at all might find it very difficult to compete.

The new export led system is fully digitalized under WeBOC (Web Based One Customs) and PSW (Pakistan Single Window) systems and allows the users and regulators to communicate through this system. Exporters can avail the EFS 21 after getting themselves registered online through the WeBOC system. It's good to see how the economy is transiting more towards an automated system from conventional record keeping methods. This would benefit both the authorized users as well as the regulators through reduction in time and cost, transparency augmentation, enhancement in security control and increase in revenue yield. According to the Chief Coordinator of Pakistan Hosiery Manufacturers and Exporters Association (PHMA) , exporters under this scheme are already getting refunds online smoothly and are experiencing limited public dealing. He has assured PHMA support to the Customs department in facilitating through implementation of EFS 21.

A user may also sell excess production of goods manufactured above 20% in domestic market subject to payment of duty and tax on filing of goods declaration. Any input imported under the scheme but not used to manufacture the output within the period, must be disposed of in a manner prescribed by EFS 21. This would incentivize the users to abstain from storing excess amount of imported input. With that, if partially manufactured goods are removed outside the manufacturing premises for manufacturing purposes, they would be subject to sales tax and FED. Where the final goods must be sent directly from the vendor to the custom station.

The World Bank's Pakistan Development Update Report 2021 portrays the low and slow export sector of Pakistan, which remained $13 per $10,000 of world's exports in 2010 and $11 per $10,000 of world's exports in 2020. Also, export response to PKR depreciation (increase in exports) is very low as compared to export response towards currency's appreciation (decrease in exports). Reason being that firms in Pakistan struggle to become more productive as they grow older. Regular Exporters (those who export every year), stand the pace and are able to compete. Where non-exporters (firms never exported) and exporters to be (firms trying to enter export market), need a pathway towards international market in form of less entry barriers, minimum protection and export enhancing schemes.

The policy makers need to identify the root cause of stagnant export growth in the economy. Pakistan has been relying on slow growing, semi-skilled labour-intensive exports rather than sophisticated products. About two third of the exports have been those which are in dire need of staff training. Not just this but the export basket has not changed for past many decades. Schemes like EFS 21 cannot bring in desired results unless accompanied by systematic reforms in the entire system including reforms in FBR and other regulators.

Banks to give loans for Under-Construction Projects

Construction sector has become a complete industry, where Pakistan's construction industry contributes Rs 380 billion to country's GDP. The total projects in progress under construction and housing sector contributes to Rs 1.1 trillion. Projects like CPEC and rising population growth has augmented growth in infrastructure sector. Not to forget how important this sector is for generation of employment in the country for unskilled, semi-skilled and skilled work force. And has always been a source of income for both formal and informal sectors. However, the sector remains low ebb based upon per capita consumption of cement i.e. 164 kgs as compared to 312 kgs in India.

State Bank of Pakistan has issued guidelines to the banks and Development Finance Institutions (DFIs) to extend loans to under construction housing sector which would provide financing and hence facilitate buyers of under-construction houses. Because of the unavailability of titled documents, banks have been reluctant to provide loans to builders/developers due to the default risk from customers. Banks previously hesitating to provide any such financing facility because of financial risks involved, are now provided a framework by the SBP to mitigate associated risk factors through registration of mortgages. Also, payments to the builders would be secured through escrow accounts.

In its press release, SBP has guided mortgage providers to provide housing finance for under construction housing units. Secondly, according to the Bank, builders complain about lack of housing finance for these units. However, the second issue shouldn't be a problem since in general practice, mortgage is provided on the completion and transfer of a building rather on under construction units. In other words, mortgage providers do not have a reason to take risk for an under-construction project.

According to this policy by the SBP, if the builder/developer gets defaulted, the commercial lender owns the right to sell the specific unit to recover the finances. Instead of this practice, the bank can alternatively takeover the building and get it completed. Selling an under-construction housing unit would contribute towards losses to both the buyer and construction lenders.

As far as commercial banks are concerned, in Pakistan, commercial banks have their investments in government's profitable securities, where for most of them, the board of directors include skilled professionals with international experiences. The SBP should develop trust and confidence in commercial banks in term of risk assessment and construction finance management and should allow them to take necessary actions under this scheme. The kind of instructions should be given to the banks which do not carry the capacity to deal with adequate risk assessments.

With that, State Bank has provided the framework to secure all transaction through an escrow account. However, for an under-construction project, it's quite difficult to do that as the builder would have already utilized part of the equity for purposes like purchase of land. Instead, separate project accounts can be

constructed by commercial lenders where payments can be traced. This policy would be helpful in keeping record and would promote transparency, but effective implementation would be a problem.

On the other side, new incentives offered by the government in construction sector including Naya Pakistan Housing Scheme, has led to an increase in demand for construction material like cement, steel, bricks, resultantly increase in their prices. The production and price for cement and steel have gone up respectively – in past ten years the production of iron and steel has risen from 1.6 m tonnes to 4.7 million tonnes. The cement sector currently has an excess of orders than it can produce. Local demand is met through domestic sales as well as imports. This has led to an increase in cost of construction for a general consumer as well. For the last fiscal year, total local dispatches of cement were recorded as 40 million MTs. Reopening of businesses also led to increase in business activity where government has been filling the supply gap with import of cheaper cement from Iran.

This policy has a good side as well. Because of the secured and monitored payment system in escrow account, the purchasers of financed housing will be more benefited than the buyers of houses on full payment due to reduction in costs and timely transfer of the property to the purchasers, which would lead to increased demand for financed under construction housing units – giving boost to the overall construction sector.

By 2050, Pakistan would be the fifth most populated country because of its current growth rate. Housing sector in Pakistan has been facing a shortfall of 11.4 million units which might grow to 17.2 million by 2025.

More interestingly, this shortage is prevalent despite the government's initiative to construct 5 million new housing units under Naya Pakistan Housing Scheme. The Government of Pakistan is looking forward to formation of regulatory body, **Pakistan Housing Bank**, which would enable the private sector housing companies to enter the financing scheme more easily. Currently, three companies; Trellis Housing Finance Company, Asan Ghar Finance Ltd., and Pakistan Housing Finance Company (licensed by SECP) have come under the financing scheme of under construction projects. Since 50% of the demand for housing comes from the low-income group in the country, the government must ensure that prevailing financing schemes and other programs in future must cater the needs of the said group and that the government must not de-track itself from the objective of serving and facilitating those who cannot afford.

Considering government's budget of Rs 30 billion for Naya Pakistan Housing Scheme and Rs 3 billion as a markup subsidy for Naya Pakistan for construction of 7000 units across Pakistan, government's tax reliefs in the construction sector in form of reduction in sales tax on raw material, also considering the growing demand for housing units while banks providing mortgage for a 20 years duration under projects like Roshan Apna Ghar at rate of 3%, 5%, and 7%; we can project a growth in construction sector specifically for housing units and also the raw material industries of cement and steel; if production hindering causes are curtailed in these sectors.

Corporate Taxpayers Digital Payment System

For the second time, the Federal Board of Revenue has extended the grace period for implementation of digital payments for corporate taxpayers. Making the third amendment in the Income Tax Ordinance 2001, the government, to improve documentation, introduced the digital payment mode for corporate entities. Under the new income tax law, any entity making an annual payment beyond Rs 250,000 from a single account would not be permitted as an expense, if not done through digital account.

The policy can be a revamping tool for the entire tax system if implemented cautiously since the idea is to broaden tax net in the economy through moving towards digitalization and moving away from traditional modes of transactions including grey transactions i.e. hidden or suppressed sales invoices, unreconciled revolving cheque or cash payments, third party payments in the informal sector - and hence, formalizing the grey economy within the supply chain.

The FBR data reveals that out of an estimated 4 million traders in the economy, just 312,361 traders filed their tax returns in 2018-2019. Whereas the portion of retail and wholesale traders is not even 5%. Also, there was no formal way for the government to keep a check on these grey transactions.

The retail market sequence in Pakistan is translated as manufacturers/exporters to distributers, distributers to retailers and then finally retailers to consumers i.e. worth an estimated Rs.125 billion. Implementation of the digital payment can help the entire system in several ways. The retail market in Pakistan, for most of the part, relies upon paper-based payments, which include rider costs, invoice costs and others. Also, any salary payment worth Rs 25,000 previously made through cross cheques or direct transfer of funds, would be made through digital payments under the new law. The policy not just brings in transparency but also maintains connections of businesses with banks, suppliers, and other stakeholders in the market. Digitalization of payments shall bring in competition within the banking sector of the economy. Also, digitalization of payments requires necessary documents of the individual running the business. A person with dual Id card or illegal personal documents would be brought into accounts. The policy would also bring in up-gradation since entrepreneurs and employees who lack financial understanding or quantitative analysis, would try to rehab their skills. Over and above, this is going to pave way towards registration of the informal economy or un-registered retailers. According to the Security and Exchange Commission (SECP), several non-registered businesses from the list of 100 companies have been falsely claiming their registration with the SECP and FBR and collecting deposits from the public in form of investment and trading. Digitalization of payments would force such businesses to get themselves registered with the SECP along with liable penalties for false registrations.

This can only be done through harmonization and coordination between various regulators.

There is a tremendous gap between formation and effective implementation of a policy in our institutional structure and the problem comes here!

Despite the benefits of the modern policy, the retail market is hesitant towards the law of digital payments and traders have been acting against the move. One obvious reason is tax evasion. The total sales of any business are used to gauge tax liability. Declaration of invoices through digital payments would pull the retailers into tax net, which they don't like. Many businesses might try to move towards grey economy but not due to the digitalization of payments but because of the high rate of tax in the country. For the reason, corporate taxpayers have been demanding extensions to switch over to the new law. One solution is flat, low-rate and broad tax rate that means - taxes should not be used as a means to disicentivize businesses. Furthermore, the magnitude of lack of digital readiness among the corporate taxpayers further impedes the implementation of the policy.

Ensuring implementation must be prioritized. Instead of extending the dates, the FBR must make necessary actions to ensure effective execution of the law through creating an awareness among the trader community regarding the digital payment policy via training programs. Furthermore, FBR should engage SBP in creating an enabling environment for the corporate businesses through motivating the banking sector for the creation of related facilities. Also, FBR must realize the importance of time which further translates into the credibility of the law-making body. The board must not provide further extensions to the business community rather it should take necessary actions against those businesses who still do not switch towards the new policy by year end.**[5]**

[5] Towards Flat, Low-Rate, Broad and Predictable Taxes by Huzaima Bukhari and Dr. Ikramul Haq

FBR to penalize non-compliance with POS – augments fear among retailers

The Federal Board of Revenue has stressed upon widening the tax base and bringing more reforms in the Point of Sales system through digital filing and bringing the economy under documentation. According to the FBR's order, non-compliance of Tier-1 Retailers (T1Rs) with mandatory integration of the POS system would result in the deduction of their adjustable input tax by 60% following a Rs 1 million fine, discontinuation of gas and electricity connections and sealing of the premises after the given extensions.

The Ministry of Finance among its targets in FY22' has set a revenue generation target of Rs 50 billion in additional taxes to be generated through the documentation of large number of T1Rs. These retailers include manufacturers, and traders from large to med to small scale businesses. The government has incentivized the mandatory integration of POS through sales tax exemption or reduction to 14% for locally manufactured garments, textile leather and artificial leather. Apart from that, the finance ministry has announced disbursement of prizes worth Rs 250 million among the customers of compliant retailers.

The policy is a good initiative for businesses in many ways. First, a POS system can help the integrated retailers save both time and money, reduce losses through preventing waste and helps avoid human errors, can track performance of their businesses through stored information and can have a check on inventory online. This can help businesses control theft and can develop customer loyalty as businesses can notify their customers through email or SMS regarding any developments or promotions. Almost 60% of the exports in Pakistan are fueled by the textile sector. Therefore, it needs to be documented and digitally equipped to perform competitively. The POS system helps identifying movement of goods from T1Rs which include manufacturers and commercial importers. To avoid taxation, these T1Rs have not been declaring the true value of their imported goods. Where, according to the FBR, the supply chains below T1Rs remain out of the tax net. Despite many efforts by the tax authorities including tax laws and enforcement measures, thousands of retailers falling under Tier 1 have not yet integrated their sales with the POS system. The reason remains evident! RT1s include individual businesses and sole proprietors mostly whose stock and inventories are undocumented. In case of an increase in their sales due to installation of the POS system, they won't be able to justify their stock and inventory purchases. Where, retailers involved in trade have huge stocks for business purposes which would further encourage them not to get their sales integrated with the POS to evade taxes.

Further, merchants need input taxes to pay for output tax. Retailers not integrated with the POS yet, would be liable for the 60% reduction in their input tax by the FBR. The implementation of the system becomes even worse off due to the documentation of POS (feeding HS codes in the system) and complex taxation procedure. According to FBR's data, 1658 T1Rs have integrated their sales with the POS out of which 260 are leather retailers. Yet enforcement of this law on the end of small-scale manufacturers remains cumbersome due to the complexities involved in the procedure. The supply chain

under T1Rs hesitate to provide invoices for their purchases and remain nowhere in the POS system. Result - the burden lies on small scale retailers. Adding to this, 30% of Pakistan's economy is undocumented due to the prevalence of smuggling. If such illegal activities are not controlled by the Customs department, policies like POS will not bring incentives for retailers.

To sum up, reduction in the adjustable input tax by 60% for T1Rs liable but not integrated with the POS system can be an efficient policy if the government extends the deadline for POS integration to 3 months which is currently just 5 days as per the notification by the FBR.

To include small-med size T1Rs in the system, FBR must arrange consultations regarding the documentation procedure and operational issues. A campaign can be launched to educate the retailers as well as the customers on the benefits of bringing T1Rs under POS system. Penalty without educating retailers about long term benefits of the system and catering their fears cannot sustain this policy. To reduce burden on retailers, FBR must bring supply chain under POS system. Lastly, POS system has been picking cases which do not fall under T1R category. Considering all the shortcomings, the system needs refinement to be implemented effectively.

State Bank Pakistan raises the interest rate by 100 basis points

The Monetary Policy Committee of the State Bank of Pakistan has again raised the interest rate by 100 basis points and SBP's policy rate now stands at 9.75 percent, finding it an "appropriate policy mix" while noting that recovery after COVID situation has "exceeded expectations" following an increase in domestic demand and thus the new hike in the policy rate is a compulsory remedy to curb inflationary pressure and growth in the current account deficit which in November has risen to $5 billion as per PBS statistics.

For the first time in past 15 months, the bank decided to increase the interest rate by a small percentage in September 21'– a quarter increase (25 bps), then by 150 bps again in November 21', and now finally SBP has increased the policy rate by 100 bps to a total of 9.75%, where the bank seems worried about the subsequent increase in trade deficit from $1.94 billion in November 2020 to $5.107 billion in the same time period in 2021 which was mainly driven by an all-time high import bill in November of almost $ 8 billion as compared to $4.12 billion over corresponding month last year. The deficit and imported inflation following a hike in oil prices have posed a serious threat on the external side of the economy. One obvious reason for the Central Bank to go for a monitory tightening in October was to give an indication to different stake holders regarding further rise in the policy rate to slow down the accumulating imports in the country. However, despite this indication, the economy observed an all-time high import bill in November 2021 due to a number of factors. The Bank has also increased the Cash Reserve Ratio from 5% to 6% to limit monetary expansion. The money supply in the economy has increased to Rs. 7 trillion from Rs. 3.4 trillion in 2016, being a contributing factor towards soaring inflation i.e. headline inflation 11.5% y-o-y (November) and core inflation 7.6% and 8.2% (urban and rural)

Since SBP has raised the CRR from 5% to 6%, this now means that less money would be available with the banks for lending and investing purposes, every time banks' deposits increase, they would be keeping 6% of those deposits aside with the central bank, which then cannot be used for lending purposes. This is one money supply regulation tool that works to reduce liquidity with the banks. Therefore, the policy will be heading towards low investment by businesses and industries in the economy. We see an increasing trend in total loans to the private sector i.e. from the start of the first quarter – Rs 5,298 billion to all private businesses other than SMEs and Rs 452 billion to the SMEs; and till the end of October 2021 – Rs 5661 billion and Rs 483 billion; highest being lent to the manufacturing sector. On the other hand, we see manufacturing sector struggling to maintain a positive output growth on m-o-m basis. This lending trend did not increase because of any structural reforms or lending policies in the banking sector but has gone up due to the slow progress the manufacturing sector is experiencing. In other words, more loans are an indication towards the unmet demand. Contributing 13.5% to the GDP and being a catalyst to growth, manufacturing sector specifically large-scale manufacturing has been a driving source of employment in the economy. But impact of bank lending on the output growth

in the manufacturing sector would be evident after a lag.

For banks, earning of profits can be satisfied through more lending because of which they might run out of cash in times of unexpected need of repayments. The new monetary policy means that the cash balance to be maintained by commercial banks should not be less than 6%, which would keep banks on the safer side as well as the depositors since a certain fraction of their deposit is now reserved in case of a surge demand for funds.

Also, an increase in the CRR would dissuade banks from lending more and hence curb inflation through limited flow of money. Central bank's policy was designed to control inflation in the economy through falling domestic demand, but the question appears whether the interest rate hike can tame inflation in coming months? What's quite evident is that energy prices are one of the main origins of inflation in the economy which seem to be increasing and are expected to increase even more as per the conditions levied by the International Monetary Fund. Although international prices have fallen but the government has not reduced oil prices domestically as a tool to collect the un-collected petroleum levy. The international food prices are increasing more than domestic prices. According to the Food and Agriculture Organization of the United Nations, the global food price index has hit the highest since July 2011 and averaged at 133.2 points in October 2021 which is a 31.3% increase from October 2020. This would affect food prices in the domestic economy. Food price inflation in economy was caused due to increased prices of wheat (urban 3%, rural 3.4%) and sugar (urban 1.1% and rural 2%) of our CPI basket.

Considering that imports in Pakistan are mostly inelastic (automobile, mobile phones) and the raw material imported is used as an input to produce domestically, we do not see trade deficit getting any better unless substantial reforms to promote exports are introduced. Where rising imports is a problem, stagnant growth and unchanged export basket is even a bigger hurdle. With that, the demand for most of the imports is inelastic, increase in interest rate would not be able to curb increasing imports in the coming months rather is more like a signal for the stakeholders to slow down their businesses. Mostly imports that are used as an input to domestic production or exports, should be substituted with domestic raw material in that case. Pakistan was importing more CBU mobile phones as compared to mobile phone components that costed $794m (Jul-Nov20), however, after the introduction of mobile phone assembling policy, more of mobile parts and less CBUs are being imported, costing an import bill of $834m (Jul-Nov 21'). Government's vision to make Pakistan a hub of manufacturing exports would help earn foreign exchange provided that a sustainable cost-effective business environment that shifts the sector from assembling towards manufacturing of mobile phones.

Although the government seems to be concerned regarding the risks to the external sector of the economy, the deficit on the current account is expected to overtake the projection i.e. 2% to 3% of the GDP since the country does not have sufficient foreign exchange reserves to sustain huge current account deficits. The exports which have increased by 28% for the first quarter in FY22 as compared to the same time period in FY21', were primarily due to the recovery from the pandemic and the reopening of businesses and not because of any substantial growth in the sectors. An interest rate increase would increase the price of borrowing for the exporters as well as importers.

The monetary policy would work accompanied by a sound fiscal policy. As mentioned by the bank, for the first two months of the FY22, the FBR revenue grew by over 40% which is 44% of their budgeted amount. Where, 30% of the total revenue generated by FBR is through strict tariff policies causing prices to rise domestically and resulting in illegal practices like smuggling. A prudent fiscal policy would take place when the tax revenue growth is fueled by factors other than imports.

Government must focus on production enhancing policies rather demand dampening monetary tightening in order to address the real issues in the economy. SBP in its previous monetary statements has identified its goal of moving towards a positive real interest rate i.e. interest rate greater than inflation in the economy. We find the said goal being achieved. Therefore, there is no indication of further interest rate hike in near future.

IMF revives $ 6 billion Loan Program to Pakistan

Since its membership, IMF has given loans to Pakistan on 22 occasions out of which, it has bailed-out the country for 13 times. Once again, the country has been obliged to pursue IMF's strict domestic conditions, where so far, the incumbent government has received $3 billion out of the total $6 billion package; $600 million in 2019, $1.4 billion in April 2020, and $1 billion in 2021 provided that the government needs to push the economy through fiscal and institutional reforms.

The bailout package for the teetering economy comes with strict austerity measures of reducing the budget deficit, raising power tariffs, Central Bank's autonomy, withdrawal of tax exemptions and subsidies, an increase in petroleum levy and an audit of funds lent in 2020 as a pandemic relief. So far, The Fund is satisfied with one of the prior actions for the disbursement of loan i.e. an audit report on the utilization of the pandemic fund from 2020.

Pakistan has been struggling with major currency devaluation, soaring inflation, rising current account deficit, and depleting foreign reserves. The condition of raising power tariffs to reduce the circular debt of Rs. 2.4 trillion, has augmented fear in both producers and consumers.

At generation level, power tariffs are determined on a Power Purchase Agreement (PPA) between the producers: GENCOS and IPPs and the buyer: Central Power Purchasing Agency (CCPA). At transmission level, the tariff is decided based on Use of System Charge (UOSC) that is paid to the National Transmission and Dispatch Company (NTDC). Finally at the distribution stage, the retail tariff is calculated for each Distribution Company that includes all the charges paid to power producers and NTDC where NEPRA allows the Discos to absorb some of the distribution losses as tariff build-ups. To stay in the IMF program, the government has increased the end user electricity tariff by Rs 1.68 per unit i.e. nearly 14% increase, and for commercial and other categories; Rs 1.39 increase, following withdrawal of power subsidy of Rs 72 billion in order to reduce the circular debt. This move would allow the government to earn a revenue of Rs 135 billion per year but on the cost of consumers and producers. The industrial sector is the key factor contributing towards demand for electricity - an important input to the industrial sector of the economy. The already struggling industrial sectors like large scale manufacturing (textile, automobile, petroleum), would once again hit hard by increased production costs.

First, this tariff hike, and the increase in electricity price is going to make current products relatively uncompetitive in international markets with increase in cost of production. Not just this, the tariff hike would nullify government's goal of lowering industrial costs for SMEs. The already struggling small manufacturing businesses will not be able to compete in domestic markets and if manage to export, in international markets as well.

Rising energy prices have already contributed to increase in cost of electricity. The policy would not be a definite solution in reducing circular debt, rather there is a need to address the energy sector issues for long term gains.

Central banks throughout the world are given powers to regulate and manage monetary policies. Pakistan has seen the vested interests of the fiscal authorities that have been putting pressure on the central bank's exchange rate policies to support government's political agendas. Autonomy for any macro institution is essential but it should not come on the cost of transparency. IMF's take on the state bank of Pakistan's autonomy, that is currently under the Ministry of Finance, is an appropriate policy given that the SBP would be answerable to the parliament to avoid the idea of a 'state in a state'. For that, targets for the SBP need to be set by the Parliament. Autonomy would enable the Bank to make use of all available instruments to achieve the desired goals. As a result of which government would limit its excessive borrowing from the State Bank. Also, one of the goals of the government – to achieve a market-based exchange rate system would only then be achieved. But before that, it is more important to realize whether the whole system is ready for central bank's autonomy. For a crumbling economy like Pakistan, it is pertinent to realize the role of autonomous institutions in each sector rather focus on one institution. Even if the Bank is accountable to the parliament, is the parliamentary structure viable enough for the central bank's accountability?

Price stability has been made the core objective of the Bank. Current m-o-m inflation figures are 9.2%; the autonomy cannot bring complete price stability as price administration is the Federal's duty where SBP can monitor the core inflation. But at the same time, now the Bank is solely accountable to the public and must directly communicate about its performance achievements or failures. The governor SBP will also be held responsible for any development or decay. The impact of this policy on the economy comes in form of more transparent monitory policy.

Country's fiscal budget is decided upon six major macro indicators; total expenditures, total net revenue receipts, total fiscal deficit, total federal's fiscal deficit excluding foreign grants, total public debt, and debt per capita. For FY22, total current expenditures were estimated at Rs 7,523 billion. Whereas current expenditures are increasing by 7.3% markup payments; estimated at Rs. 3,059 billion and the breakdown follows - Rs 2,757 billion domestic debt and Rs. 302 billion on foreign debt payments. On the other hand, government increased the allocation for subsidies by 58% as compared to the previous budget and allocated Rs 900 billion for PSDP spending which was a 40% increase from last year, now has been slashed back as per the new IMF programme. The budget ended up becoming a challenge for the government as it started experiencing rising fiscal deficit. Collection from petroleum development levy was budgeted as Rs. 600 billion which translates into Rs. 150 billion for each quarter against which the government could only collect Rs. 22 billion in the first quarter of FY 22'. To finance its ambitious targets, government did not reduce domestic price of oil although international oil prices have reduced to $74 a barrel. Resultantly, the inflationary pressure has remained a constant.

Severity of the impact of oil prices on the economy depends upon four indicators i.e., share of the cost of oil in overall GDP, magnitude of dependence on oil (total value of import oil), domestic consumption and dependence on alternative sources of fuel. Pakistan unfortunately has spent $11.35 billion on oil import in FY 21' and $6.1 billion from July-October FY 22', industrial sector and household's dependence is largely on kerosene oil, diesel oil and petroleum products, and alternative sources

like gas are near to deplete. In short run, the demand elasticity of petroleum products for industrial sector as well as households would be low because of the not so easy availability of alternate sources. On the other hand, the government has not reduced oil prices for the end consumer following a price fall internationally. The increased cost of production mainly for large scale manufacturers with stagnant reallocation of resources and reduced purchasing power of consumers would ultimately translate into increased burden on transporters, farmers, SMEs and general public.

Coming months will be critical to decide how the IMF bailout reacts towards the economy.

Revival of the loan would lead to rupee stabilization and hence attract investor's confidence. The long process of coming towards a staff level agreement shows the actual cost this program would bring in. However, having an overview of the previous IMF programs for Pakistan, the conditions levied by the former and the policy actions by the latter have remained the same. How serious the government is on execution of the reforms would be evident in form of future fiscal budget and circular debt management.

Section 3: Economic Analysis

Economic Analysis

The economic performance of the country, measured by GDP growth, outpaced the expectations, and cloaked at 3.9 percent in FY 2021 amid domestic and global challenges. On the back of a strong V-shaped recovery, the government of Pakistan has set the growth target of 4.8 percent for FY 2022.The opening up of borders and uptick in the global demand resulted in the surge in petroleum and commodity prices, which translated into domestic inflation.

The public debt increased by Rs.1.6 trillion in the first quarter of FY 2022 from Rs.38.7 trillion at the end of June to Rs.40.3 trillion at the end of September. Domestic debt increased by Rs.100 billion while external debt increased by Rs.1.4 trillion in the period under review.

The borrowing of government from the commercial banks increased by Rs.320 billion from Rs.13.02 trillion to Rs.13.34 trillion, as the banking sector found it more lucrative and profitable to invest money in government securities.

The private sector borrowing (LTFF) showed an increase of Rs.60 billion in the first quarter from Rs. 391 billion to Rs.451 billion at the end of September against an increase of Rs.36.8 billion in the first quarter of last year. The manufacturing sector borrowing comprises 90 percent of the private sector borrowing, which stood at Rs.410 billion at the end of September 2021.

The output of the manufacturing sector posted a negative growth of 1.22 percent in the first quarter of FY 2022 against the growth of 4.3 percent in the first quarter of FY2021.

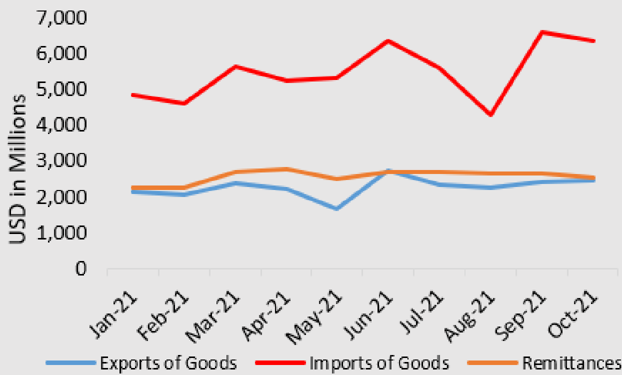
The current account deficit stood at $3.4 billion in the first quarter of 2022. The exports showed a growth of 28 percent in the first three months of FY 2022 and recorded at $6.9 billion compared to $5.4 billion last year. Similarly, imports posted a growth of 46 percent and stood at $16.5 billion compared to $11.3 billion last year. The remittances play a cardinal role in the management of the external account and are cloaked at $7.6 billion compared to $7.1 billion in the corresponding period last year.

The net FDI stood at $439 million compared to $457 million last year. The inflow of FDI stood at $665 million against the outflow of $226 million.

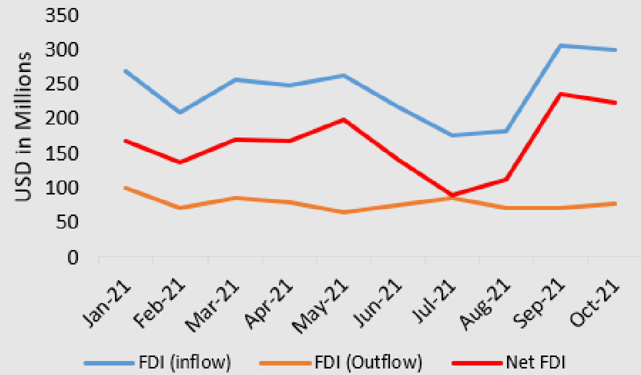
In the forex market, a surge in demand for dollars and higher spending on foreign goods resulted in the depreciation of local currency from Rs.156.6 in June to Rs.168.6 in September. Furthermore, the foreign exchange reserves of the State Bank of Pakistan increased by $2 billion from $17.3 billion to $19.3 at the end of September 2021.

Inflation, a decline in purchasing power, in the first quarter of FY2022 has shown an upward trend starting from 8.4 percent in July to 9 percent in September, an average of 8.6 percent against 8.8 percent in the corresponding period of last year. The sensitive Price Index (SPI) and Wholesale Price Index (WPI) averaged 16.2 percent and 18 percent in the period under review.

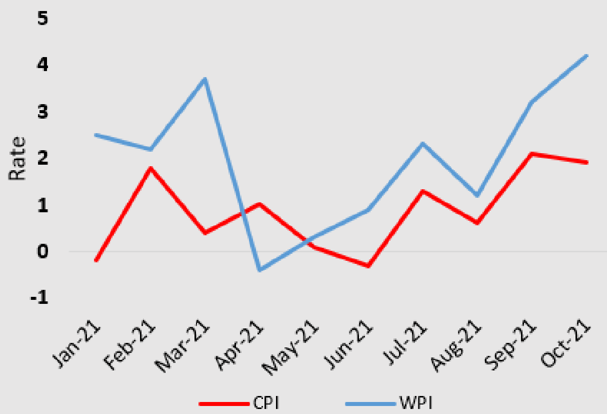
Macro Economic Indicators



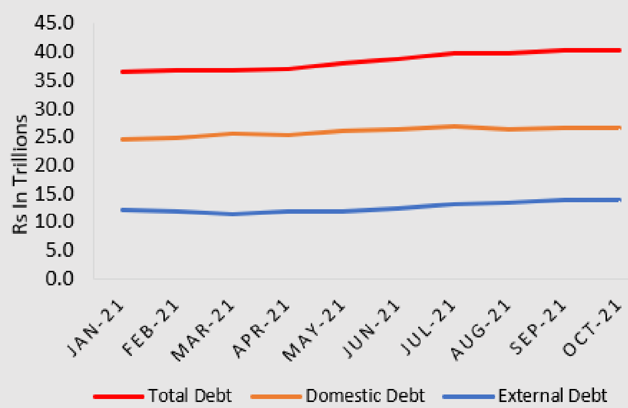
Source: Pakistan Bureau of Statistics



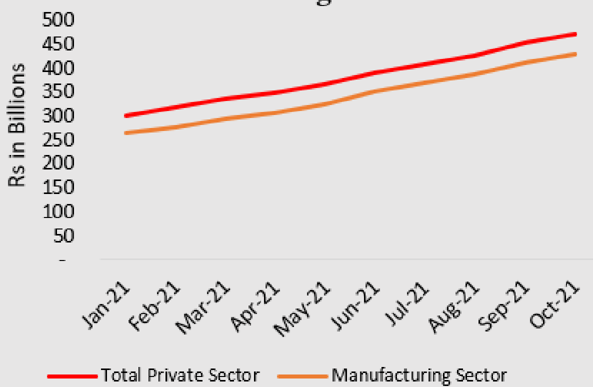
Source: State Bank of Pakistan



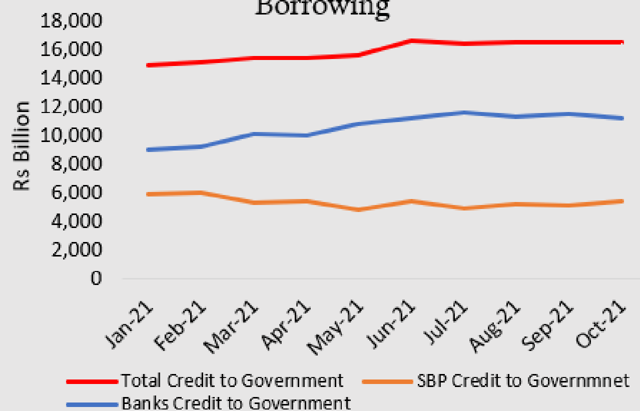
Source: Pakistan Bureau of Statistics



Source: State Bank of Pakistan



Source: State Bank of Pakistan



Source: State Bank of Pakistan

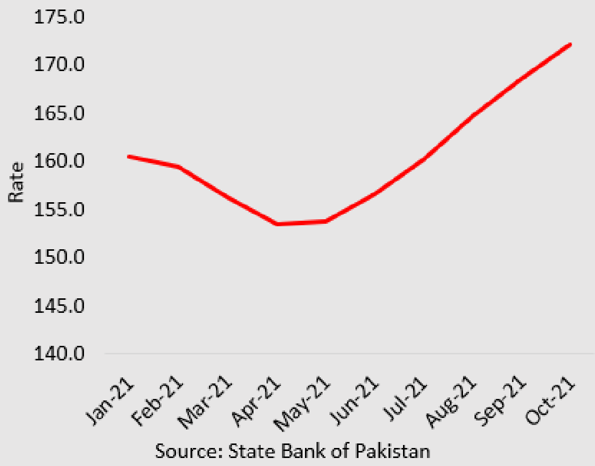


Figure 7: Exchange Rate Trend
Rate
175.0
170.0
165.0
160.0
155.0
150.0
145.0
140.0
Jan-21
Feb-21
Mar-21
Apr-21
May-21
Jun-21
Jul-21
Aug-21
Sep-21
Oct-21
Source: State Bank of Pakistan

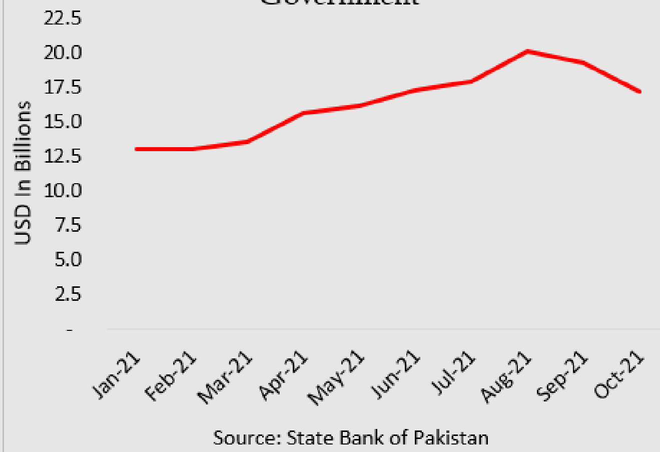


Figure 8: Foreign Exchange Reserves of Government
USD In Billions
22.5
20.0
17.5
15.0
12.5
10.0
7.5
5.0
2.5
-
Jan-21
Feb-21
Mar-21
Apr-21
May-21
Jun-21
Jul-21
Aug-21
Sep-21
Oct-21
Source: State Bank of Pakistan

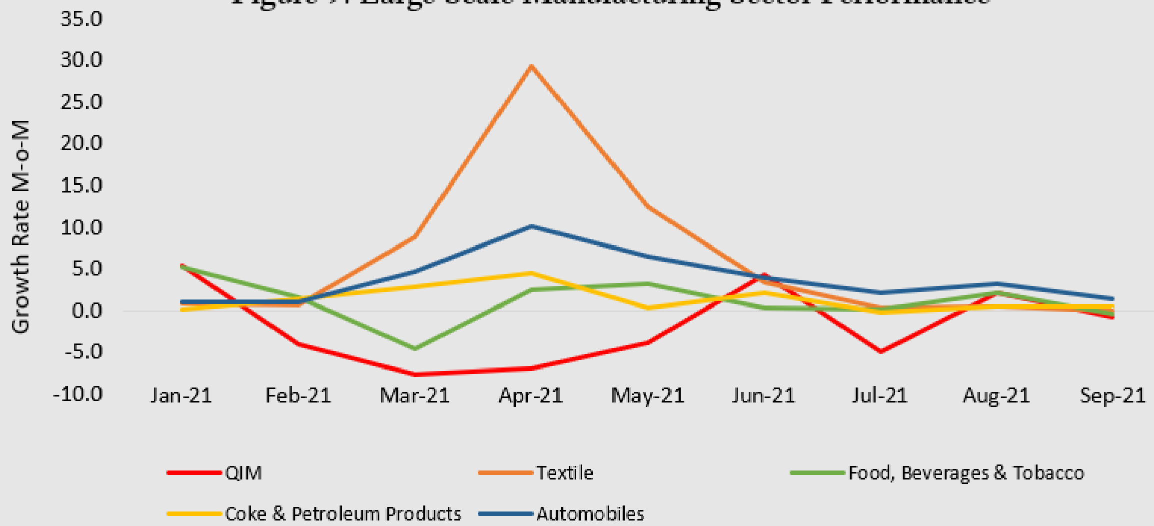


Figure 9: Large Scale Manufacturing Sector Performance
Growth Rate M-o-M
35.0
30.0
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
Jan-21
Feb-21
Mar-21
Apr-21
May-21
Jun-21
Jul-21
Aug-21
Sep-21
QIM
Textile
Food, Beverages & Tobacco
Coke & Petroleum Products
Automobiles
Source: Pakistan Bureau of Statistics

Section 4: Macro Economic Outlook

Where is the Economy heading?

The impact of an increase in global energy and commodity prices remains significant and unexpected, which will translate into domestic inflation. Inflation appears to be the biggest challenge for the government, as the increase in incomes is not consistent with the increase in inflation.

The higher cost of inputs resulted in negative growth of the manufacturing sector and will contribute to stemming the sector from operating at maximum potential in the coming months. The higher petroleum prices prevented the government from collecting Rs. 150 billion, target set for first quarter, as petroleum development levy and only Rs. 22 billion could be collected in the period. Therefore, the prices of petroleum products will remain high domestically despite the reduction in the global market.

The talks with IMF prompted the government to raise revenue targets by Rs.300 billion from Rs.5.8 trillion to Rs.6.1 trillion to compensate for the lost revenues and restrict the fiscal deficit from growing. The additional revenues will be collected by rescinding the tax exemptions.

The energy sector of the country remains in hot waters, as the government is struggling to restrict the growth of circular debt, which stood at Rs. 2.4 trillion till October 2021. The government is likely to raise tariffs on electricity and gas, as the circular debt remains a point of contention between the government and IMF.

On the external front, there is a growing concern regarding the surge in current account deficit, as growth in imports is superseding the growth in exports, which will put extra pressure on the forex reserves and the exchange rate.

The SBP in its latest monetary policy meeting raised the policy to 9.75 percent to curb inflationary pressure. SBP has indicated in the previous statements that the end goal is to move towards positive real interest rate i.e. policy rate greater than inflation, which has been achieved and there is no indication of further hike in short term.

End Note

FDI although negligible in Pakistan but is considered to play a vital role in fostering economic growth of any country. The analysis in this report depicts that FDI has reduced in the first quarter of current fiscal year as compared to same time in last fiscal year. The main FDI attracting sectors like Power, IT and Financial sectors have contributed almost 87% of the net FDI, but Power and financial sectors have shown a decline as compared to same time in last fiscal year. Also, the major investor in Pakistan – China, has invested comparatively less in form of FDI following delayed payments to the Chinese firms under CPEC. The situation of FDI in Pakistan although not promising but can be altered if substantial reforms are brought in to attract foreign investors in export – led sectors by creating a friendly business climate and gaining investor's confidence.

In past three decades, Pakistan's share in world exports has dropped from 0.2% to 0.17% and the export basket has not changed. Whereas currently, export to GDP ratio of the country is less than 10%. The tariff structure in the economy has acted as an obstacle in export growth. However, the analysis reveals that even in the presence of export schemes, the exporters' integration in export promotion schemes was merely 6% in 2019 due to many factors including tough eligibility criteria and lack of skilled labor force.

Construction sector – a major driver of employment in the economy, is a huge sector but attracted a negative net FDI in first quarter of current fiscal year i.e -$3.6m and has been facing a backlog of 11.4 million units. This report highlights SBP's initiative to provide loans to under-construction housing units through secured escrow account transactions. Rising population growth rate has led to increased demand for housing units mainly from middle income group. The report sheds light on how far this policy by the government can facilitate those who cannot afford.

The economy is moving towards digitalization of payment system. FBR's latest reform on implementation of digital payments for corporate taxpayers is one way to improve documentation in the country. Where the policy will pull retailers into tax net, analysis discusses how the revenue board in collaboration with SBP must ensure execution of the policy through provision of banking sector facilities and training the trader's community and public.

According to the analysis presented in the report, another reform by FBR to broaden the tax base is compliance with Point of Sales (POS) system for tier-1 retailers. The challenges associated with undocumented economy remain evident. Unless the system brings in entire supply chain under POS, this regulation might not bring desired results.

The analysis in the report suggests how SBP and FBR have collectively created reforms in form of more transparency and documentation. On the monetary side, Central Bank's policy rate has increased to curb inflationary pressure and reduce accumulating imports. On the other hand, money supply in the economy has surged to Rs. 7 trillion from Rs. 3.4 trillion in 2016. Where, trade deficit has cloaked to almost $5 billion in November 21 – posing a serious threat on the external side of the economy.

IMF has always been there to bailout the economy. The report discusses how the conditions levied by IMF including power tariffs, sales tax exemptions and Central Bank's autonomy have a short and long-term impact on Pakistan's economy.

Annexure

Table 1: Current Account Indicators of Pakistan			
Month	Exports	Imports	Remittances
	Million USD		
Jan-21	2,146	4,820	2,257
Feb-21	2,068	4,601	2,250
Mar-21	2,364	5,631	2,703
Apr-21	2,218	5,242	2,778
May-21	1,671	5,297	2,491
Jun-21	2,728	6,352	2,688
Jul-21	2,340	5,601	2,707
Aug-21	2,247	4,297	2,658
Sep-21	2,410	6,595	2,670
Oct-21	2,448	6,334	2,518

Table 2: Foreign Direct Investment in Pakistan			
Month	Net	Inflow	Outflow
	Million USD		
Jan-21	168.33	268	99.6
Feb-21	136.97	209	71.6
Mar-21	170.37	256	85.7
Apr-21	168.05	247	79.2
May-21	198.31	263	65.1
Jun-21	141.14	217	75.6
Jul-21	89.90	176	86.4
Aug-21	113.18	183	70.0
Sep-21	236.02	306	70.3
Oct-21	223.00	300	76.6

Table 3: Inflation			
Month	CPI	SPI	WPI
Jan-21	-0.2	-0.8	2.5
Feb-21	1.8	3.1	2.2
Mar-21	0.4	5.7	3.7
Apr-21	1.0	0.4	-0.4
May-21	0.1	0.8	0.3
Jun-21	-0.3	-0.4	0.9
Jul-21	1.3	1.8	2.3
Aug-21	0.6	0.7	1.2
Sep-21	2.1	2.7	3.2
Oct-21	1.9	2.1	4.2

Table 4: Public Debt of Pakistan			
Month	Public Debt	Domestic Debt	External Debt
	Rs. in Trillions		
Jan-21	36.5	24.5	12.0
Feb-21	36.6	24.8	11.8
Mar-21	36.8	25.6	11.3
Apr-21	37.1	25.3	11.7
May-21	38.0	26.1	11.9
Jun-21	38.7	26.3	12.4
Jul-21	39.9	26.8	13.0
Aug-21	39.7	26.3	13.4
Sep-21	40.3	26.4	13.8
Oct-21	40.3	26.5	13.8

Table 5: Domestic Borrowing of Government			
Month	Total Credit	SBP Credit to Government	Banks Credit to Government
	Rs. in Billions		
Jan-21	14,935	5,916	9,019
Feb-21	15,143	5,950	9,193
Mar-21	15,382	5,281	10,101
Apr-21	15,401	5,365	10,036
May-21	15,590	4,804	10,786
Jun-21	16,628	5,408	11,220
Jul-21	16,399	4,842	11,558
Aug-21	16,548	5,213	11,335
Sep-21	16,539	5,081	11,458
Oct-21	16,516	5,358	11,158

Table 6: Long Term Private Sector Borrowing				
Month	Total Credit	Manufacturing	Agriculture	Construction
	Rs. in Billions			
Jan-21	301	265	4.6	1.7
Feb-21	318	276	3.5	6.7
Mar-21	334	293	3.6	6.7
Apr-21	346	306	4.5	6.7
May-21	365	325	3.6	6.7
Jun-21	391	351	3.7	6.7
Jul-21	409	370	3.8	6.5
Aug-21	427	387	3.8	3.9
Sep-21	451	410	4.6	3.6
Oct-21	470	430	4.5	3.4

Table 7: Exchange Rate and SBP Reserves		
Month	**Exchange Rate**	**SBP Reserves** (USD Billions)
Jan-21	2,146	13.0
Feb-21	2,068	13.0
Mar-21	2,364	13.5
Apr-21	2,218	15.6
May-21	1,671	16.1
Jun-21	2,728	17.3
Jul-21	2,340	17.8
Aug-21	2,247	20.1
Sep-21	2,410	19.3
Oct-21	2,448	17.2

Table 8: Large Scale Manufacturing Sector Growth					
Month	**QIM**	**Textile**	**Food & Beverages**	**Automobiles**	**Petroleum Products**
Jan-21	5.4	0.8	5.1	1.0	0.1
Feb-21	-4.2	0.7	1.5	1.0	1.4
Mar-21	-7.7	8.9	-4.7	4.7	2.8
Apr-21	-7.0	29.4	2.4	10.0	4.5
May-21	-3.9	12.4	3.1	6.5	0.3
Jun-21	4.4	3.4	0.4	4.0	2.1
Jul-21	-5.0	0.4	0.1	2.1	-0.2
Aug-21	2.1	0.5	2.1	3.2	0.5
Sep-21	-0.7	-0.1	-0.5	1.4	0.5