



MCB Bank Limited

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**Treasury & Investment Banking Group**

## *Quid Pro Quo*

### ECONOMIC REPORT

#### POST MUSHARRAF

August 20th, 2008

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General Pervez Musharraf's resignation did not come as a surprise to many. The embattled President was facing immense pressure from the ruling coalition to step down and his resignation has put to rest uncertainty surrounding Pakistan's political future by assuring a return to democracy. Despite this there are still several political roadblocks the coalition government has to clear, including the reinstatement of judges and appointment of the new President. Therefore, we are yet to see the spotlight return to the economy in order to get it back on track. This paper will seek to analyze Gen. Musharraf's tenure in government from the economy's perspective and what is required of the new government to build on the existing institutions and infrastructure.

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## **GONE MUSHARRAF GONE!**

General Pervez Musharraf resigned on Monday August 18, 2008, avoiding a confrontation with the coalition that according to him would have been detrimental to Pakistan's progress and to the office of the Presidency. In the aftermath, political supporters of the government rejoiced citing his resignation as a victory for democracy.

Although it can be argued that the people and political parties successfully carried through their mandate and completed a transition to democracy, Gen. Musharraf's resignation is all but one dimension of a much more complex scenario. The much debated restoration of judges is still a roadblock in the coalition government's ambitions to work in unison, along with the vital decision on who will become the next president and the growing militancy that is threatening to escalate into a full military offensive. Therefore, it would be wise to hold back the victory parade for now and take a somber look at where Pakistan is headed, since there are still several important political issues and differences to iron out. Signs are the economy will have to wait longer before the government is able to give it due attention.

## **END OF AN ERA**

The ease with which Gen. Musharraf's resignation went through is a bit anti-climatic and suggests a lot of backroom squabbling, corridor meetings and close door agreements were conducted to ensure a safe passage of the now former President, not to mention weighing in from several countries. Even so, Gen. Musharraf's decision was right given the circumstances and is in the best interests of the nation. However, as the last chapter closes a new one is being written and we are thrust into uncharted territory in the short run. As mentioned above, there are still several major policy agreements for the coalition to chalk out and then there is the grave situation of the economy weakening rapidly. Pakistan's economy can ill afford being left on the outskirts as political heavyweights battle it out.

Despite widespread opposition to Gen. Musharraf's rule, his term did mark a significant turnaround in the economy's fortune from the time he took over. National accounts witnessed remarkable growth and the economy grew by an average 6.7% in the past five years. Arguably the highlight of his reign in power has been the sound policies and their successful implementation, ranging from reforms in the central bank, agriculture sector, manufacturing sector and the free media we enjoy today.

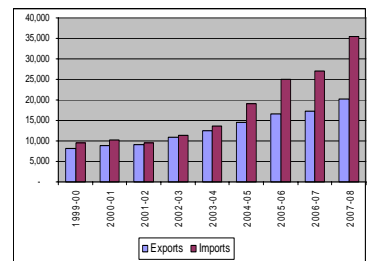
## HOW THE ECONOMY PERFORMED

During Gen. Musharraf's entire nine year tenure the economy grew by an average 5.4% per annum from 1999-2008, this is significantly better than the 4.5% average in the preceding decade. Manufacturing benefited the most during his time growing by nearly 9% on average every year more than double the average compared to 1989-1999 period's 4.7% growth, the highest growth came in FY2003-04 when LSM grew by 14.01%. The services sector has arguably been one of the most consistent performers, averaging 6.07%, with the highest growth rate in FY2006-07 of more than 8.5%. Pakistan also enjoyed considerable investment at an average of 15.7%, highest growth was by more than 32% in FY2005-06. This is in addition to the Karachi Stock Exchange (KSE) reaching a record level of 15,676 in April 08 from 994 in June 1999, which is an unprecedented growth of around 1500%. Looking at these impressive figures international rating agencies like the S&P and Moody's improved Pakistan's ratings, increasing the economy's appeal for foreign investors by reducing cost of risk. Also Pakistan was put on the 'Next 11' list after the BRIC (Brazil, Russia, India and China) nations, as pointed out by Gen. Musharraf in his resignation speech.

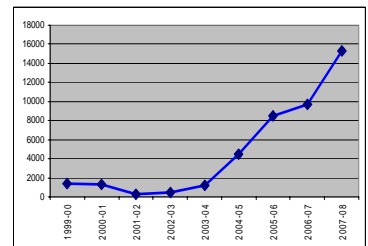
As a result, it is no wonder that Gen. Musharraf's government enjoyed wholehearted support of the business community, which benefited from his liberal policies. Exports took off averaging 12% growth during the nine year tenure, compared to merely 5% average export growth between 1989 and 1999. Imports also took off at an average growth rate of 17% in nine years, as local businesses expanded their operations and thereby their appetite for raw materials. Consequently, foreign reserves went up considerably from USD 3.2 bn in 2000 to a peak of USD 16.48 bn in Oct 07.

Sizeable foreign investment flowed in, particularly in the telecommunication industry. Number of mobile phone users increased almost ten fold, as competition, better prices and overall growth in the economy increased their demand. Inflation was under control, averaging 5.5% (discounting for the last year when oil prices surged to almost \$150 a barrel and commodity prices in general went up) compared to average 10.7% inflation from 1991 to 1998. The economy thrives on stability and consistent growth, with foreign investment flowing in and the economy growing in leaps and bounds the exchange rate provided further stability, staying around the USD/PKR 60 parity from the end of 2001 calendar year to the beginning of FY08.

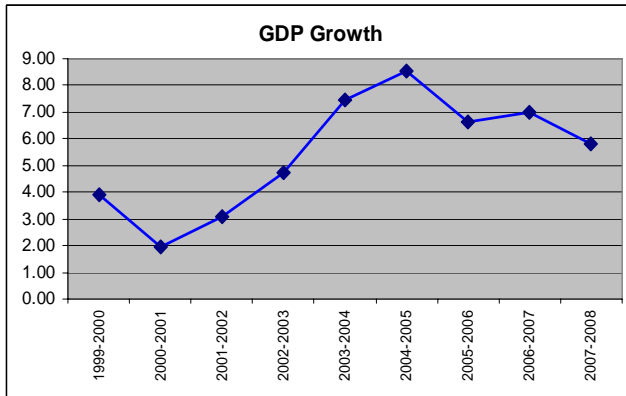
**Import/Export 1999-2008**



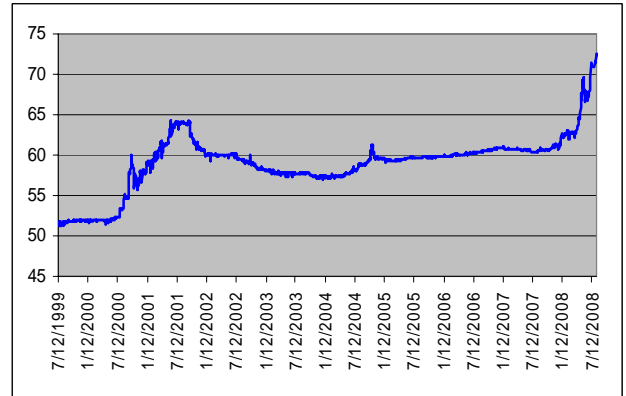
**Balance of Trade 1999-2008**



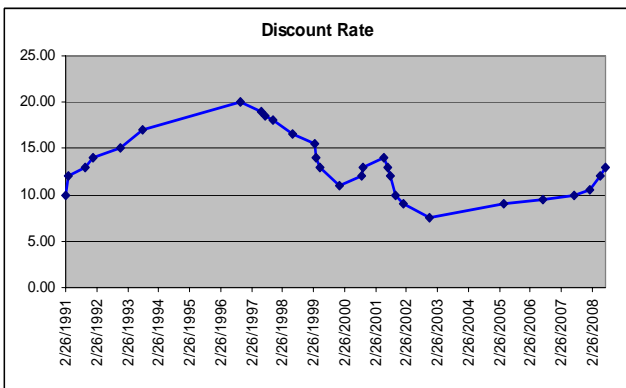
### GDP Growth 1999-2008



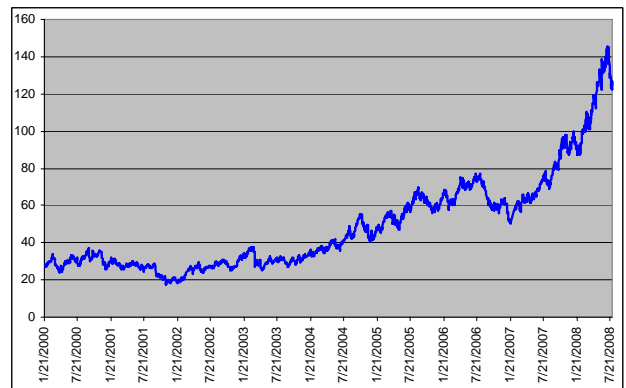
### PKR 1991-Present



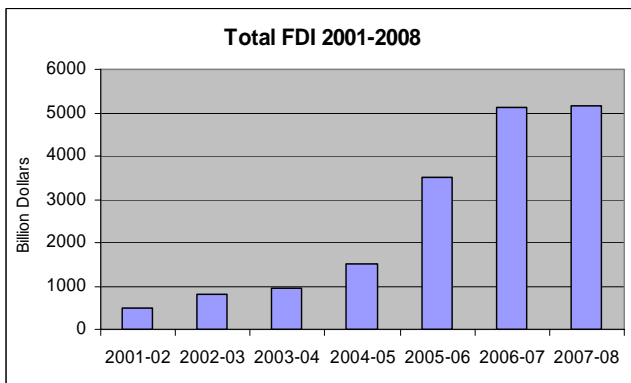
### Discount Rates 1991-2008



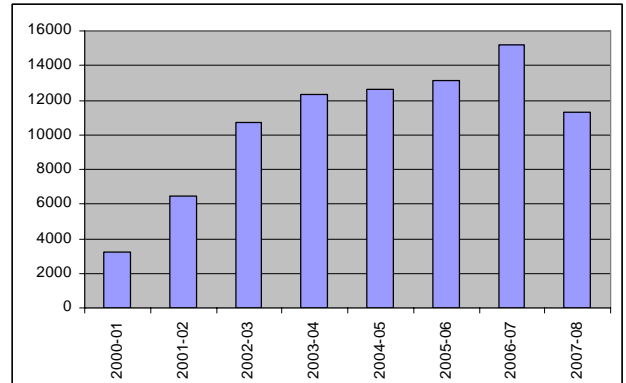
### Oil 2000-Present



### Total FDI 2001-2008



### FOREX Reserves 2000-2008





## CURRENT SCENARIO

Immediately after the President's resignation, jubilant scenes were shown on news channels as opposition supporters came out claiming a victory for democracy. The KSE went up by a massive 460 points or 4.6% as uncertainty surrounding the fate of the President came to an end. The rupee also strengthened to USD 73 on the back of this positive news in the eyes of the international community, as it signals stability on the political front. However, jubilation was short lived, because only two days after the resignation announcement KSE fell by 393 points and the rupee weakened to the USD 76 level.

The resignation was a major stumbling block, but there still are many hurdles to be cleared. Most notably, issue of judges reinstatement will test the resolve of a seemingly fractured coalition government. To add to this, continued fighting in Khurram agency and election of the new President will further stress the political climate. Political stability is still eluding investors and market players, keeping them on the byline until the current political scenario stabilizes.

From an economic stand point we are back to square one. The Government in short run is unable to give attention to the ailing economy, this will only serve to weaken it further. It will be some time before the economy can breathe a sigh of relief and move towards permanence.



## WHAT THE FUTURE HOLDS – ALL IS NOT LOST

All is not lost, was the message given by the outgoing President in a lengthy address, and in our opinion it is not an inaccurate assessment as the economy is still in a relatively strong position. Although FOREX reserves have come down they are reasonably supple at USD9.92 bn as off 9<sup>th</sup> August 2008. Current account and trade deficits for July FY09 are USD1 bn and USD1.196 bn respectively, although these are higher than July FY08 figures, it is mainly due to the inflated oil and commodity prices in the global economy. High prices are also the reason why momentum in inflation is yet to stall. However, despite these economic indicators, FDI (Foreign Direct Investment) has continued to flow in, reaching USD340.7 mn in July FY09 compared to USD193.5 mn last FY, this is an increase of 76.1%. This shows the international community is backing Pakistan to bounce back from its trough and continue the remarkable growth witnessed in recent years. Moody's rating service stated that it is not yet downgrading Pakistan's sovereign rating despite credit stresses remaining in place and FOREX reserves going down. Also home remittances have remained strong at a record USD627 mn in July FY09 compared to USD 495 mn in July FY08.

The manufacturing sector under Gen. Musharraf went through rigorous policy reforms and rapid growth. That apparatus is in place, giving the government an opportunity to build upon it further. The budget announced for FY09 has taken steps to stimulate LSM growth, boost exports and reduce imports. More importantly the budget has returned focus to the agriculture sector, introducing numerous subsidies, tax benefits and exemptions to boost agricultural output after this year's meager growth of 1.49%.

However, introducing sound policies and measures are futile without proper implementation, something that is difficult for the coalition government, since it is currently grappling several political crises simultaneously. Macroeconomic indicators are going to take time to return to normal, hence there is no time to waste and the sooner the coalition is able to solve its differences the better it will be for the economy.



## ANXIOUS WAIT

Undoubtedly there is tremendous pressure on the government to deliver, not only domestic market proponents but the entire international community is watching their every move. Gen. Musharraf's term proved fruitful for the economy and his resignation may have helped limit political polarization. But to emulate and build upon his past performance, the government has to swiftly and decisively strengthen policy implementation and reign in economic indicators.

## ECONOMIC SNAPSHOT

Fiscal Year 2008-09														
	Units	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	July
<u>Inflation</u>														
Headline Inflation	%	6.4	6.5	8.4	9.3	8.7	8.8	11.9	11.3	14.1	17.2	19.3	21.5	24.3
Core inflation	%	6.0	6.0	6.1	6.5	6.9	7.2	7.8	8.1	9.3	10.8	12.3	13.0	14.7
Food inflation	%	8.5	8.6	13	14.7	12.5	12.2	18.2	16	20.6	25.5	28.5	32.0	33.8
Non-food inflation	%	4.9	4.9	5	5.4	5.9	6.3	7.3	7.8	9.4	11.2	12.5	13.8	17.3
<u>T-bill (Wgt Avg)</u>														
3 month	%	8.69	9.05	9.05	9.05	9.05	9.09	9.09	9.38	9.59	9.59	9.95	11.3	12.2205
6 month	%	8.9	9.12	9.12	9.12	9.21	9.29	9.29	9.61	9.86	9.86	9.86	11.5	n/a
12 month	%	9.16	9.39	9.39	9.39	9.4	9.49	9.44	9.87	10.13	10.13	10.32	11.7	n/a
<u>External Sector</u>														
Export	Mln US\$	1,434	1,475	1,463	1,593	1,524	1,500	1,634	1,591	1,833	1,862	1,954	1,089	1,921
Import	Mln US\$	2,423	2,206	2,150	2,555	2,864	2,910	3,316	2,909	3,549	3,406	3,241	7,869	3,117
Trade balance	Mln US\$	(989)	(731)	(687)	(962)	(1340)	(1410)	(1637)	(1637)	(1716)	(1,544)	(1,287)	(6,900)	(1196)
<u>Remittances</u>	Mln US\$	495	489	516	580	505	479	557	502	602	590	584	547	627
<u>Forex Reserves</u>	Mln US\$	15,723	16,106	16,145	16,354	15,807	15,589	14,657	14,031	13,232	12,362	11,258	11,285	9,920



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