



MCB Bank Limited

Issue # 77

**Treasury & Investment Banking Group**

## *Quid Pro Quo*

### ECONOMIC REPORT

#### ROAD MAP

January 28th, 2009

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The Ministry of Finance's Poverty Reduction Strategy Paper (PRSP) – II, aims to “steer Pakistan back onto the path of sustained and broad-based economic growth and to create jobs and reduce poverty”. It also outlines mistakes made during implementation of the last PRSP and criticizes the last government for the current crisis.

This paper will summarize the road map outlined in PRSP II to kick start the economy. Our focus will be the real sector, which economists unanimously agree should be the main driver of growth in order to achieve macroeconomic stability and sustained development.

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## 'JOBLESS & JOYLESS' GROWTH

In the last five years the economy has grown by an average 7% annually. However, Ministry of Finance criticized the last government for poor resource allocation during this period, as most of the growth was fuelled by external financing and public sector sales to plug the growing current account deficit. Furthermore, the report predominantly points out that a consumer boom was witnessed during the last half decade with easy access to credit and low interest rates. This in turn stimulated growth in the services sector while ignoring agriculture and SME sectors altogether. As a result, few jobs were created giving rise to 'jobless and joyless growth'.

Although manufacturing and services sectors recorded impressive average growth rates between FY03-FY08 (9.55% and 7.0% respectively), agriculture grew by a modest 3.55% during the same period. This points towards the previous government's skewed policies of promoting consumption. Accordingly, agriculture suffered with an inadequate price mechanism, insufficient federal structure and lack of water resource management. It was due to this mix of weak agriculture sector and dependence on foreign inflows that Pakistan's economy went into turmoil in FY08, when hit by high international commodity prices, international financial collapse and internal law and order situation.

High consumer demand and the previous government's reluctance to cut subsidies pushed the fiscal deficit and current account deficits ever higher. Hence, when FY09 started the economy was facing decelerating growth, rising inflation, growing fiscal deficit and wide gap between aggregate demand/supply led to falling international reserves.



## PRSP II – OBJECTIVES & TARGETS

The stabilization program has laid out a five year plan to pull the economy out of recession, identifying short, medium and long term plans. First and foremost the strategy highlights the importance of macroeconomic stability to achieve long-term sustainable growth and poverty reduction. Therefore, its primary objective is to reduce the twin deficits, in order to quickly achieve macro stability, build reserves and create an investment friendly environment. Having a negative balance of payment position increases both domestic and foreign debt, something the GOP has not found difficult tapping in recent years.

The program envisages re-aligning output capacity of the economy with domestic demand to achieve sustainable external accounts. Also institutional reforms and efficient allocation of resources will aim to curtail fiscal deficit. However, these measures are likely to increase unemployment and poverty in the short run. Therefore, protecting the poor and vulnerable is a vital part of the government strategy, which is why allocation for several social safety nets will be increased.

In addition to targeting poor sections of the population, the government will actively endeavour to unlock the vast underutilized human capital and improve infrastructure to maintain the growth momentum.

Following is a table which outlines the long-term strategy of PRSP II.

## PRSP II – OBJECTIVES & TARGETS

Growth, Savings and Investment FY08-FY13

Items	Unit	Bench- mark	Projections				
		FY 2007/08	FY 2008/09	FY 2009/10	FY 2010/11	FY 2011/12	FY 2012/13
<b>Agriculture</b>	%	<b>1.5</b>	<b>3.0</b>	<b>3.4</b>	<b>3.8</b>	<b>4.0</b>	<b>4.3</b>
- Major Crop	%	-3.0	3.5	4.0	4.0	4.0	4.5
- Livestock	%	3.8	3.2	3.5	4.0	4.3	4.5
<b>Manufacturing</b>	%	<b>5.4</b>	<b>1.5</b>	<b>4.0</b>	<b>5.1</b>	<b>5.7</b>	<b>6.9</b>
- Large Scale Manufacturing	%	4.8	0.0	4.0	5.3	6.0	7.5
<b>Services</b>	%	<b>8.2</b>	<b>4.2</b>	<b>5.8</b>	<b>6.1</b>	<b>6.7</b>	<b>7.8</b>
- Wholesale & Trade	%	6.4	4.5	4.8	5.0	5.5	7.2
- Financial Businesses	%	17.0	3.0	12.0	11.0	12.0	13.0
<b>Real GDP Growth</b>	%	<b>5.8</b>	<b>3.4</b>	<b>5.0</b>	<b>5.5</b>	<b>6.0</b>	<b>7.0</b>
<b>Inflation (CPI Based)</b>	%	<b>12.0</b>	<b>23.0</b>	<b>13.0</b>	<b>7.0</b>	<b>6.5</b>	<b>5.0</b>
<b>Nominal GDP Growth</b>	%	<b>20.0</b>	<b>27.2</b>	<b>18.6</b>	<b>12.8</b>	<b>12.9</b>	<b>12.3</b>
<b>GDP (Current mp)</b>	Rs. Billion	<b>10,478</b>	<b>13,384</b>	<b>15,880</b>	<b>17,926</b>	<b>20,237</b>	<b>22,736</b>
<b>As % of GDP</b>							
<b>Investment</b>	%	<b>21.6</b>	<b>19.9</b>	<b>21.3</b>	<b>23.8</b>	<b>24.5</b>	<b>24.8</b>
- Fixed Investment	%	19.9	18.4	19.8	22.3	23.0	23.3
-Public Investment	%	5.7	3.0	3.8	5.5	5.9	6.2
-Private Investment	%	14.2	15.4	16.0	16.8	17.1	17.1
<b>National Savings</b>	%	<b>13.3</b>	<b>13.4</b>	<b>15.6</b>	<b>19.2</b>	<b>20.5</b>	<b>21.2</b>
<b>Foreign Savings</b>	%	<b>8.4</b>	<b>6.5</b>	<b>5.7</b>	<b>4.6</b>	<b>4.0</b>	<b>3.6</b>
<b>Memo Items</b>							
Nominal Exchange Rate	Rs / \$	62.5	82.0	92.7	97.3	101.6	104.7
Nominal GDP	US \$ Billion	167.5	163.2	171.3	184.3	199.2	217.3
Population	Million	161.0	163.8	166.6	169.3	172.1	174.8
Per Capita GDP	US \$	1040	997	1029	1089	1158	1243

Source: Finance Division, Economic Advisor Wing, Government of Pakistan, December 2008



## MEDIUM TERM

Due to low domestic saving and low foreign direct investment, financing the medium-term has been identified as the key to unlocking PRSP II 's success. Pakistan has found it far too easy plugging its negative balance of payment position with foreign savings in the form of international borrowings. This trend has to be reversed by implementing a sustained drive to increase domestic saving.

In order to do so, incentives have to be increased for households to invest in financial assets and not physical ones like land, dollars, gold etc. Contractual savings (specially medium to long term) have a huge role to play in this endeavour; pension funds, mutual funds, insurance companies etc. can play a crucial role in helping to increase domestic savings. Furthermore, developing debt market for government securities and corporate bonds will be equally important in mobilizing savings.

As mentioned earlier, easy access to foreign savings and printing base money at will are the main causes of poor domestic savings ratios. The latter is actively being controlled by the current government under the watch of IMF (GOP has agreed to net zero borrowing for Oct-Jul FY09 period).

Apart from mobilizing domestic savings, the government will also trim fiscal deficit to 4.2% in FY09, a statistic it plans to achieve by phasing out subsidies (for oil and energy), better prioritizing development spending and increasing tax-to-GDP ratio. Tax administration will be strengthened, minimizing interaction between taxpayer and tax official, implement full value-added tax (VAT) with minimum exemptions and most importantly harmonizing income tax and GST laws also with minimum exemptions. Furthermore, the GOP acknowledges that increasing the tax base is important to increase the ratio and ensure fairer distribution of the tax burden. The services sector (including wholesale and retail) and agriculture will be considered for taxing in the future. PRSP II unequivocally states the GOP's objective of at least 3.5% increase in tax revenue in the medium term (upto FY12). These policies will help finance the medium term.



## INVESTMENT-SAVING GAP

Keeping in line with reducing the investment-saving gap, the PRSP II aims to increase investment rate from 21.6% in FY08 to 24.8% in FY13 (Please check table). To achieve this investment target, the GOP will focus on people at the bottom of the pyramid. Hence, this strategy will see more focus shifted towards small businesses and creating jobs for lower classes.

While public sector investment will focus on developing human capital and infrastructure, private investment will take the lead in reinvigorating the production sectors. With projected national savings of 21.2% in FY13 compared to 13.3% in FY08, the investment-saving gap is expected to reduce to 3.6% from 6.5% in the same period.

Increasing investment from domestic components will also help increase exports and reduce the trade deficit. This inevitably will assist in reaching the overall aim of reducing current account deficit and establishing macroeconomic stability.

## CONCLUSION

The PRSP II aims to emulate the 5-7% growth achieved in the last few years, however, it attempts to put in place a more robust and sustainable system that will be more resilient if faced with similar internal and external shocks witnessed in FY08.

On paper, the strategy covers all bases like stimulating production sector, creating employment, improving income distribution, developing human capital/infrastructure, liberalizing the economy, deregulating and privatizing the economy to attain macroeconomic stability and establishing an investment friendly environment. However, reality bites and reaching goals on paper is an entirely separate task altogether. Failing to achieve the target of the Fiscal Responsibility and Debt Limitation Act (FRDLA) 2005 is a case in point.

## ECONOMIC SNAPSHOT

Fiscal Year 2008-09														
	Units	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<u>Inflation</u>														
Headline Inflation	%	8.8	11.9	11.3	14.1	17.2	19.3	21.5	24.3	25.3	23.9	25.0	24.7	23.3
Core inflation	%	7.2	7.8	8.1	9.3	10.8	12.3	13.0	14.7	16.4	17.3	18.3	18.9	18.8
Food inflation	%	12.2	18.2	16.0	20.6	25.5	28.5	32.0	33.8	34.1	29.9	31.7	30.4	27.9
Non-food inflation	%	6.3	7.3	7.8	9.4	11.2	12.5	13.8	17.3	18.7	19.2	19.7	20.2	19.8
<u>T-bill (Wgt Avg)</u>														
3 month	%	9.1	9.1	9.4	9.6	9.6	10.0	11.3	12.2	12.4	12.6	13.8	13.8	14.0
6 month	%	9.3	9.3	9.6	9.9	9.9	9.9	11.5	n/a	n/a	n/a	14.0	14.0	14.0
12 month	%	9.5	9.4	9.9	10.1	10.1	10.3	11.7	n/a	n/a	n/a	12.8	n/a	14.3
<u>External Sector</u>														
Export	Mln US\$	1,500	1,634	1,591	1,833	1,862	1,954	1,089	1,921	1,726	1,779	1,926	1,572	1,438
Import	Mln US\$	2,910	3,316	2,909	3,549	3,406	3,241	7,869	3,117	3,153	3,806	3,647	2,253	2,478
Trade balance	Mln US\$	(1410)	(1637)	(1637)	(1716)	(1,544)	(1,287)	(6,900)	(1,196)	(1,427)	(2,027)	(1,721)	(674)	(1040)
<u>Remittances</u>	Mln US\$	479	557	502	602	590	584	547	627	592	660	466	621	674
<u>Forex Reserves</u>	Mln US\$	15,589	14,657	14,031	13,232	12,362	11,258	11,285	10,282	9,111	8,212	6,716	9,081	9,662



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