

# Economic Scenario

The fiscal year 2008-2009 which started with macro economic asymmetries and increasing exposure of vulnerability of sustainable growth model, was further adversely affected by unprecedented set of challenges during 2008-09. The key challenges were domestic security and political challenge, stabilisation plan to address policy induced macro economic balance, deterioration in external terms of trade compounded by supply shocks, adverse effect of turmoil in global financial markets and deepening of the global financial crisis, in the form of collapse of external demand for exports and decline in availability of external capital to finance twin deficits.

The macro economic asymmetries are gradually being ameliorated, but the outlook for the economic growth remained pessimistic which has resulted in a significant loss of growth momentum, despite recovery in terms of the yawning twin deficits. The IMF's US\$ 7.6 billion has helped to stabilise the external account. The continuation of judicial crisis and political instability till March 2009 has had its own toll on the economic scenario resulting in outflow of portfolio investment and sharp decline in FDI's. The stellar high GDP growth during 2000-2007 being non inclusive brought hardly any solace to the majority of the population. This in itself has been a great challenge for political government which has won its writ to govern through popular vote. The government did identify nine

areas as priorities for deep, broad ranging and sustained policy intervention for new equitable economic growth. The nine point medium term plan has been:

- Macroeconomic stabilisation and real sector growth
- Protecting poor and vulnerable through social development including social protection
- Agriculture – increasing productivity and value addition
- Industrial competitiveness
- Human capital development
- Integrated energy development programme
- Capital markets to mobilise capital and finance for development
- Public private partnership for infrastructure
- Institutional / administration reform to ensure governance for a just and fair system

All of the above priorities are to be focused on a concurrent basis but the key driver should be the welfare of the people by having a marshal plan to address unemployment, poverty and inequity with an overall focus to substantially improve domestic security and political consensus and support to weed out extremism and militancy from our society.

The comparison of GDP growth in various sectors as per revised estimates for 2007-08 and projections for 2008-09 is summarised as follows:

	2007-08		2008-09
	Economic Survey 07-08	Economic Survey 08-09	
GDP (FC)	5.8	4.1	2.0
GNP (FC)	6.1	4.1	2.6
Commodities Producing Sector			
Agriculture	3.2	1.4	0.2
Major Crops	1.5	1.1	4.7
Minor Crops	(3.0)	(6.4)	7.7
Livestock	4.9	10.9	3.6
Manufacturing	3.8	4.2	3.7
Large Scale Manufacturing	5.4	4.8	(3.3)
Small Scale	4.8	4.0	(7.7)
Construction	7.5	7.5	7.5
Electricity, Gas Distribution	15.2	(3.9)	(10.8)
Service Sector	(14.7)	(22.0)	(3.7)
Finance and Insurance	8.2	6.6	3.6
	17.0	12.9	(1.2)

- The overall GDP growth for 2007-08 which was estimated according to last survey at 5.8 percent has now been revised downwards to 4.1 percent (i.e. by 29.3 percent). The revision of GDP (FC) for 2006-07 and 2007-08 has resulted in reduction of GDP for 2007-08 from Rs. 5,493.8 billion to Rs. 5,404.5 billion. The revisions in estimates are always expected on finalisation of data for the year but sharp revision to this extent did reflect adversely on the credibility of the data and statistics and at times could lead to misleading conclusions.

- In the context of the above scenario, the economic data indicates a sharp decline in the GDP growth from even the revised target of 4.5 percent to 2 percent which was mainly caused due to failure to generate growth in manufacturing sector resulting in a major drag on the growth achieved through agriculture. Further, even the service sector did not achieve the expected growth mainly due to decline in finance and insurance sector by 1.2 percent as against the growth of 12.9 percent according to revised estimates of 2007-08.

- GDP growth of 2.0 percent in 2008-2009 (2007-2008 4.1 percent) has been contributed as follows:

	Sectoral Contributions to the GDP growth (Percent Point)		
	2006-07	2007-08	2008-09
Agriculture	0.9	0.24	1.00
Industry	2.3	0.45	-0.92
Services	3.6	3.41	1.92
Real GDP	6.8	4.10	2.00

- Per capita income increased by 0.3 percent in dollar terms from US\$ 1,042 to US\$ 1,046 per annum.
- The target for inflation for the year was set at 12 percent. However, as of 30 April, it has been at 22.4 percent and the average for the year 2008-09 is expected to be 21 percent i.e. 9.0 percent over the target.

- The overall position of inflation, based on CPI (Consumer Price Index), has been as follows:

	2007-08	2007-08 (Jul-Apr)	2008-09 (Jul-Apr)
Overall inflation	12.0	10.2	22.4
Food inflation	17.6	15.0	26.6
Non-food inflation	7.9	6.8	19.0
Core inflation	8.4	7.5	17.8
SPI (Sensitive Price Index)	16.8	14.1	26.3
WPI (Wholesale Price Index)	16.6	13.7	21.4

- The structure of savings and investment as a percentage of GDP is as follows:

Description	(Percent of GDP)			
	2005-06	2006-07	2007-08	2008-09
Total investment	22.1	22.5	22.0	19.7
Changes in stock	1.6	1.6	1.6	1.6
Gross fixed investment	20.5	20.9	20.4	18.1
- Public Investment	4.8	5.6	6.9	4.9
- Private Investment	15.7	15.9	15.2	13.2
Foreign Savings	3.9	5.1	8.5	5.3
National Savings	18.2	17.4	13.5	14.3
Domestic Savings	16.3	15.6	11.5	11.2

- The overall Fiscal deficit for 2008-09 was targeted at Rs. 582 billion i.e. 4.3 percent of GDP which is expected to be Rs. 562 billion i.e. 4.3 percent of GDP.
- Exports were targeted at US\$ 23.0 billion, 10.2 percent over last year. However, the ten months exports (up to April 2009) have been US\$ 14.8 billion i.e. 3.0 percent lower

than exports for the corresponding period of last year. The projected exports for the year are expected to be US\$ 19 billion.

- Imports were targeted at US\$ 37.2 billion. However, the imports for the ten months have been US\$ 29.0 billion and are showing a decrease of 9.8 percent, as against 28.3 percent increase last year. The overall imports are projected at around US\$ 31 billion.
- Trade deficit has decreased to US\$ 14.2 billion in the first ten months as against US\$ 16.8 billion, for the corresponding period, last year.
- Current account deficit during July – April 2008-09 has been US\$ 8.5 billion as against US\$ 11.2 billion in comparable period last year, showing an improvement of 23.5 percent.
- Remittances are of US\$ 6.4 billion for the last ten months against US\$ 5.3 billion for the corresponding period.
- Foreign exchange reserves stood at US\$ 11.6 billion in May 2009 against US\$ 11.4 billion as of June 2009. The reserves as of May 2009 were sufficient for 18.0 weeks of imports, up from 16.8 weeks in June 2008.
- The overall foreign investment for the ten months (July' 08 to April' 09) of the current year has declined by 42.7 percent and was US\$ 2.2 billion as against US\$ 3.9 billion in the

corresponding period, last year.

- Public debt decreased from 57.4 percent of GDP in 2007-08 to 55.5 percent of GDP 2008-09.
- Domestic debt is at Rs. 3,758.6 billion as of 31 March 2009, against Rs. 3,217.2 billion as of 30 June 2008.
- Domestic debt as a percentage of GDP has declined from 31.3 to 28.7 percent.

	Outstanding Domestic Debt (Rupees in billions)				
	2005	2006	2007	2008	2009
Permanent Debt	526.2	514.9	562.5	616.7	660.4
Floating Debt	778.2	940.2	1107.7	1589.6	1923.5
Unfunded Debt	854.0	881.7	940.0	1010.9	1174.7
Total	2158.4	2336.8	2610.2	3217.2	3758.6
Percent of GDP	33.2	30.7	30.1	31.3	28.7

- The external debt and foreign exchange liabilities (EDL) as of 31 March 2009 stood at US\$ 50.1 billion, increasing by US\$ 3.8 billion or 8.2 percent as against US\$ 46.3 billion as of 30 June 2008. The EDL represents 30.2 percent of GDP as against 52 percent as of 30 June 2000 and 28.1 percent as of 30 June 2008. The EDL as a percentage of Foreign Exchange earnings as of 31 March 2009 was 144.3 percent against 124.3 percent on 30 June 2008.
- The share of interest payments as percentage of revenue and expenditure has been as follows:

	As percentage of				
	1999-2000	2005-2006	2006-2007	2007-2008	March 2008-2009
Total Revenue	41.0	18.8	22.1	29.6	30.5
Tax Revenue	51.8	25.2	32.3	42.2	41.8
Total Expenditure	29.6	14.4	16.0	19.5	23.0
Current Expenditure	33.5	19.6	20.9	23.9	29.4
GDP	5.5	2.7	3.3	4.3	4.2

## Monetary Policy

- The tight monetary policy was continued by SBP under the macroeconomic stabilisation programme. The discount rate was raised by 200 bps on 13 November 2008 resulting in cumulative increase of 300 bps. The monetary policy was also supported by adjustments in the exchange rate during March – October 2008. These measures did result in easing the persistent demand pressure in the economy resulting in deceleration in domestic inflation, slowdown in import growth and private sector credit and reduction in fiscal deficit.
- SBP in view of demand compression reduced discount rate by 100 bps on 20 April 2009.
- The M2 supply growth during July-May 2009 slowed to 4.6 percent as compared to 9.3 percent during the corresponding period of financial year 2007-08. The Net Domestic Assets (NDA) of the Banking system registered an expansion of Rs. 443.8 billion during July-May 2009 as against the expansion of Rs.

702.5 billion during last year. The increase in NDA, was mainly due to high government borrowings for budgetary support particularly due to contraction of Net Foreign Assets of Rs. 227.3 billion (NFA), caused by weakness in external balance of payments position.

- The borrowing by government for budgetary support has recorded an increase of Rs. 332.2 billion, as compared to Rs. 322.8 billion in the corresponding period last year.

## Budget 2009-2010

- The total outlay of budget 2009-10 is Rs. 2,482 billion. This size is 23.8 percent higher than the size of budget estimates of 2008-09.
- The resource availability during 2009-10 has been estimated at Rs. 2,318 billion against Rs. 1,836 billion in the budget estimates of 2008-09.
- Net revenue receipts for 2009-10 have been estimated at Rs. 1,371.5 billion, indicating an increase of 23.5 percent over the budget estimates of 2008-09.
- The provincial share in federal revenue receipts is estimated at Rs. 655 billion during 2009-10 which is 15.3 percent higher than the budget estimates for 2008-09.
- The capital receipts (net) for 2009-10 have been estimated at Rs. 190.5 billion, against the

budget estimates of Rs. 221 billion in 2008-09.

- The external receipts in 2009-10 are estimated at Rs. 510 billion. This shows an increase of 79 percent over the budget estimates of 2008-09.
- The overall expenditure during 2009-10 has been estimated at Rs. 2,482 billion of which the current expenditure is Rs. 1,699 billion and development expenditure is Rs. 783 billion. Current expenditure shows an increase of 3.5 percent over the revised estimates of 2008-09, while development expenditure will increase by 68.1 percent in 2009-10, over the revised estimates for 2008-09.
- The expenditure on General Public Services (inclusive of debt servicing, transfer payments and superannuation allowance) is estimated at Rs. 1,189 billion, which is 70 percent of the current expenditure.
- The size of Public Sector Development Programme for 2009-10 is Rs. 646 billion, while for Other Development Expenditure an amount of Rs. 157 billion has been allocated. The PSDP shows an increase of 54 percent over the revised estimates for 2008-09.
- An amount of Rs. 200 billion has been allocated in budget estimates 2009-10 to provinces for their development expenditure.

- PSDP allocation for the Power Sector has been increased by 100 percent from Rs. 11.4 billion to Rs. 22.8 billion for 2009-10 to improve energy crisis.
- A number of measures have been taken to resolve the issue of circular debt, In order to improve the liquidity of power sector, the government / holding company will assume certain liabilities of PEPCO.
- An amount of Rs. 25 billion has been allocated to Earthquake Rehabilitation Authority (ERRA) in 2009-10.
- The size of current expenditure in total budget outlays for 2009-10 is 68.5 percent as compared to 79 percent in revised estimates for 2008-09.

#### Key objectives for the Budget 2009-10:

- Provide protection to poor and vulnerable against the current economic downturn.
- Revive manufacturing and industry, especially export oriented industry.
- Broaden tax base, instead of overburdening the existing tax payer.
- Restrain unnecessary imports to improve the Balance of payments position.

In order to achieve the above, the following macro-economic targets are being set-up.

- During the Fiscal Year 2009-10, real GDP is expected to grow by 3.3 percent.
- This will be contributed by sectoral growth rates as follows:
  - Agriculture - 3.8 percent;
  - Manufacturing - 1.8 percent; and
  - Services - 3.9 percent.
- For Fiscal Year 2009-10, the inflation target is 9.5 percent.
- A targeted decrease in current expenditure to 15.3 percent of GDP in FY 2009-10, owing to elimination of unproductive subsidies is planned in order to maintain the fiscal deficit at sustainable levels.
- The Government is going to take all necessary measures to ensure documentation of the economy and broadening of the tax base in order to shift reliance on domestic resource mobilization.
- Total revenue will grow by 15.7 percent and Federal Board of Revenue collection is projected to grow by 16.8 percent.
- Revenue as a percentage of GDP is projected at 14.7 percent in Fiscal Year 2009-10.

## Conclusions

The Budget 2009-10 has been announced at a very crucial juncture of our history where we are faced with both global and domestic unprecedented challenges in the form of global

recession and financial crisis, domestic security, law and order threat, ever increasing level of unemployment and increased miseries for people living under poverty line.

The failure to achieve macro-economic stability and to energize manufacturing sector has resulted in substantial slippages in macro-economic indicators, including sharp reduction in GDP growth from 4.5 to 2 percent.

These slippages and unbearable inflation, particularly food inflation, have further worsened the miseries of a large proportion of our population, which is estimated at around 80 million.

The growth has again been contributed by Agriculture and Services sectors. The growth in Agriculture mainly depends on the weather conditions and any variation in weather conditions as per experience, have caused slippages and the priority on Agriculture to increase productivity and value additions has yet to bear results.

The overall objective of any elected government has to be the "Welfare of the People" and in this context, the reduction of unemployment and creation of employment opportunities, reduction of inflation particularly food inflation, enhancement of domestic security and to improve equity in distribution and income levels are the foremost targets. The targeted intervention in the form of Benazir Income Support Fund and other similar measures need to be implemented more

effectively along with a marshal plan to improve both Agriculture and Manufacturing sectors.

The economy is by no means out of woods, internal growth dampener like energy shortage, high inflation and interest rates and the perilous security situation are still huge challenges.

Pakistan, given prudent economic management and favourable external dynamics has the capacity to regain growth pattern. However due to macro-economic imbalances, severe infra-structure bottlenecks and continued political and security woes, the country could fail to make a sustained departure from a low single digit growth over the next few years.

The BMI Political risk ratings of the STPR of 46.3 and LTPR of 44.2, clearly indicate the attribution of numerous structural weaknesses including recurring twin deficits, low GDP per capita and heavy reliance on commodity imports and financial sector vulnerability.

The continuation of a balanced stabilization plan with a continued growth momentum, particularly quality and inclusive growth with good governance and successful handling of internal insurgency, coupled with continued global support could help us reap the dividends of long struggle and to reconcile the parallel goals of accelerated economic development and fiscal consolidation.

## Strengths

- Strategically geo political position post 9/11 inducing active interest of USA and other global powers in safeguarding its stability
- Strong large population base with potential to be a sizeable market
- Medium term Development framework
- IMF stabilization stand by arrangement
- Consensus on major political issues including fight against insurgency and extremism
- Sustainable external and domestic debt
- Most liberal foreign investment regime
- Tariff barriers are being reduced

## Weaknesses

- Credibility of statistics
- Quality of governance
- Low Tax / GDP ratio
- Incompatible contribution of various sectors of Economy in tax revenue
- Inefficiency in utilization of development expenditure
- High unproductive non development expenditure
- Continued trade and fiscal deficits
- Low level of Foreign Currency reserves
- Economy vulnerable to external shocks
- Dependence on aid and loans from multilateral institutions and bilateral parties
- Potential impact of global recession on exports and expats remittances
- High cost of doing business
- Poor HDI indicators
- Decline in trend of Foreign investment
- Continued subsidies for loss making public sector enterprises
- Inequality in distribution of income
- Continued increase in poverty
- Fragile political system

## Pakistan Economy Challenges

- Sustainability of growth momentum
- Addressing structural problems in energy, agriculture and exports sector
- Job creation
- Poverty alleviation
- Improving social indicators and enhancement of safety nets
- Strengthening of physical infrastructure
- Converting the demographic transitions into demographic dividend
- Leverage the current strategic role in achieving meaningful economic dividends
- Supply side improvement to match growing domestic demand
- Achieve political stability and institutional strengthening
- Harmonious relationship amongst Federation and its units
- Equitable distribution of resources between Federal, Provincial and Local governments
- Revenue generation by provinces
- Balanced approach of combination of Fiscal and Monetary Policy measures to combat inflation
- Containment of exposure to war on terror

## Opportunities

- Capacity constraints with India in IT sector
- BPO's potential
- Telecom and Media revolution
- Geo political situation
- Foreign Direct Investment
- Investment in education and health
- Lapsing of WTO multi-fibre agreement
- Global financial crisis
- Focused skills development to secure dividend from demographic advantage
- Global intent and support in our fight against extremism
- IMF stabilization program
- Friends of Pakistan Forum

## Threats

- Intensity of war against terror
- Issues in Balochistan and Northern Areas
- Worsening of situation on Western borders
- Anti Pakistan attitude in Afghanistan
- Level of corruption
- Broadening gap between Rich and Poor
- Social unrest
- Public discontent with the policies which may threaten reform process
- Increasing trend of terrorist activities
- Pressure on exchange rates
- Soaring core and food inflation
- Worsening law and order situation
- Large number of IDPs
- Increasing oil prices