ISSUE BRIEF

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STANDARD & POOR MAINTAINS 'STABLE OUTLOOK' FOR PAKISTAN'S ECONOMY

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(Views expressed in the brief are those of the author, and do not represent those of ISSI)

Standard and Poor's credit rating agency has maintained a stable outlook for Pakistan's economy; negating the expected fears of downgrades, and at the same time dispelling the notion of "financial emergency" or crisis like situation at the moment.

In its bi-annual report, released on October 30, 2017, Standard and Poor (S&P), the international rating agency has affirmed Pakistan's "B" long-term and short-term sovereign credit rating along with the stable outlook.[1] The report acknowledges that the government's efforts for better law and order situation helped deplete gaps in infrastructure and energy and improved power shortages in the country. It further says that the affirmation of Pakistan's rating reflects that economic prospects remain favourable, while external and fiscal metrics of the country are unlikely to worsen significantly from their current level.

The S&P's report also expects the country's Gross Domestic Product (GDP) to grow at an average of 5.7% in the period from 2017 to 2020, as this stronger growth projection reflects large-scale investments taking place under the China-Pakistan Economic Corridor (CPEC) in energy and infrastructure sectors of the economy.

However, it acknowledges that current account deficit is high which, as it says, was mainly due to sharp surge in imports of machinery and fuels caused by robust domestic demand and implementation of energy and infrastructure related projects.

[1] Government of Pakistan-B3 Stable: Regular Updates, October 30,2017, Standard and Poor Ratings.

The report expects that the external imbalances are temporary and will reverse in the next two years. It also acknowledges that the higher than expected fiscal deficit in the Fiscal Year 2017 (FY17) was largely caused by higher than expected provincial spending and lower growth in tax revenue collection.

Furthermore, it observes that external imbalances will subside after peaking out of CPEC related investments and suggests that Pakistan, in the meanwhile, should benefit from the robust growth generated by investments in energy and infrastructure sectors of the economy.

Analysis

The international credit rating agency has taken a stable long-term view of Pakistan's economy. Although, B rating is "speculative" which can be upgraded or downgraded depending on the government's external and fiscal performances, but, the agency has maintained 'stable outlook' for the economy. This balances the potential benefits of the government's reform efforts in boosting the fiscal and external accounts (through loans or other form of commercial borrowing) against the risks these reform programs bring or any other domestic security risks which affect the overall creditworthiness of the country.

While looking at the current economic trends in the country, it is observed that Pakistan's economy is in an expansionary phase, and that during such a phase it is inevitable to have the twin-deficits of fiscal and external account. The latest annual report by State Bank of Pakistan (SBP) also confirms that the economy is expanding with the real GDP growth in FY17 being the highest during the last ten years, reaching to 5.3%.[2] A significant contribution in growth is led by a rebound in agriculture and a broad-based increase in value addition by services sector. In addition to this, the report also acknowledges that there has been a sharp increase in the imports in the country which is reflective of the fact that economic activities have picked up led by robust domestic demand and implementation of energy and infrastructure related projects under CPEC.

Also, more recently the government has raised $2.5 billion from the international capital market through Sukuk and Eurobond with a five-year Sukuk worth 1 billion at 5.625% and $1.5 billion via 10-year Eurobond at 6.875%.[3] Unlike previous bonds floated last year, this time the government was able to raise money at a relatively less rate of interest, signalling that the rating and stable outlook, given by the rating agency, has helped in restoring the investors' confidence in the economy. This

2 "Chapter 1, Economic Review", Annual report, State Bank of Pakistan, October, 2017. http://www.sbp.org.pk/reports/annual/arFY17/Chapter-01.pdf

3 "Bond auction raises 42.5 billion", Dawn, November 30,2017 https://www.dawn.com/news/1373822/bond-auction-raises-25bn

will help the government in taking pressure off its external account and will stabilize the fall in the reserves.

It is pertinent to note that although the current account deficit is high and would strain the foreign exchange reserves. However, the overall reserves are covering 4.6 months of imports, while the SBP's reserves cover 3.2 months of imports in the first quarter FY18.[4] Unlike today, in the first quarter of FY09, when Pakistan entered the IMF programme, the import cover was mere 2.4 months and that SBP's reserves had a little over one month cover of imports (1.4 months of SBP reserves).[5] Along with this, the total exports have picked up, as in the first four months of the current fiscal year (July-October 2017-18), total exports were recorded at $7.060 billion against the exports of $6.416 billion during July-October (2016-17), showing growth of 10.04%.[6] Although the rise in imports is higher, i.e., 23%, leading to higher trade deficit, but it is worth mentioning that the major increase in imports is due to higher investment and enhanced domestic demand, which are both important for economic growth in a country. According to the data released by Pakistan Bureau of Statistics, it is observed that the transport group imports are high by 37% which has led to an increase in the demand for petroleum products, contributing 23% to the total imports. This is followed by an increase of 20% in the imports of food items and other related industries.

The composition of imports is a reflection of the growth in the manufacturing and service sectors, and are important for sustaining the current growth momentum in the economy. While it is good to curb non-essential imports, however, the need is to realize that imports are not bad as whenever the economy grows over 5%, imports are bound to increase. The need is to focus on exports; along with export diversification, a gradual currency depreciation is important to attain competitiveness among the regional economies, which will help in addressing the current account deficit woes.

4 "Currency: Let it not be a steep fall", Business Recorder, November 07, 2017 https://www.brecorder.com/2017/11/07/379446/currency-let-it-not-be-a-steep-fall/

5 Ibid.

6 "Quarterly Summary of Foreign Trade, October, 2017", Pakistan Bureau of Statistics.