ISSUE BRIEF

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PAKISTAN'S MACROECONOMIC OUTLOOK 2022

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

Introduction

In the first five decades of its independence, Pakistan has been a high-growth, low inflation economy. Now it has become a low-growth, high inflation economy. Over the past 20 years, economic growth has stagnated. In 2020, the economy shrank by 0.9 percent, it is for the first time that the economy experienced negative growth in 68 years. In 2022, stagnation of economic growth continues with two additional rather worrisome indicators: macroeconomic imbalances and a serious balance of payments crisis.[1]

Pakistan currently is faced with political and economic instability. Its foreign exchange reserves have fallen sharply in the past two months. The new government hopes to stop the bleeding with an enhanced IMF package and more short-term loans from China and Saudi Arabia. Supplies of electricity to households and industry have been cut as the cash-strapped country can no longer afford to buy coal or natural gas from overseas to fuel its power plants.[2]

1 Farrukh Saleem, "Do we have an economic growth strategy?" News, May 12, 2022, https://www.thenews.com.pk/print/957069-do-we-have-an-economic-growth-strategy
2 Yusuf Nazar, "Pakistan's economy is on the brink," Financial Times, May 4, 2022, https://www.ft.com/content/23f50890-c184-4ee8-bb53-794db2673171

Key Challenges

As recent talks with the IMF were inconclusive, winning a loan from the multilateral lender might involve trade-offs, including the politically tough decision of raising fuel prices. Pakistan is seeking the release of USD 3 billion from the IMF. That amount would augment the nation's foreign-exchange reserves, which at USD 10.2 billion cover less than two months of imports. The government is staring at a USD 45 billion trade deficit this year. A massive rise in foreign debt is another concerning issue for Pakistan as the external debt has risen from around USD 95 billion in 2018 to over USD 130 billion. Pakistan needs to repay the foreign debt of around USD 2.5 billion during the ongoing quarter (April-June) of the current fiscal year.[3]

Pakistan's economy enjoyed a strong recovery and grew 5.6 percent in FY21 following measures taken by the Government to mitigate the adverse socio-economic impacts of the COVID-19 pandemic. While economic activity maintained its momentum during July-December 2021, high demand pressures and rising global commodity prices led to double-digit inflation and a sharp rise in the import bill during this period. These developments have had an adverse impact on the rupee trading at over Rs 200 in the interbank market having depreciated more than 25 percent since the start of the year.[4]

Moreover, long-standing structural weaknesses of the economy including low investment, low exports, and low productivity growth pose risks to a sustained recovery. Structural impediments the Pakistani economy is currently faced with includes extensive government borrowing from the financial sector that crowds out supply of credit to the private sector and deepens the sovereign-bank nexus. It is further impeded by low domestic savings, underdeveloped capital markets, and low financial inclusion. Sharp and deep adjustments on the fiscal front suggested by the IMF might trigger stagflation, lowering GDP growth and rising inflation at an accelerated pace. The boom-and-bust cycle would persist, and Pakistan would again suppress demand by tightening fiscal and monetary policies.[5]

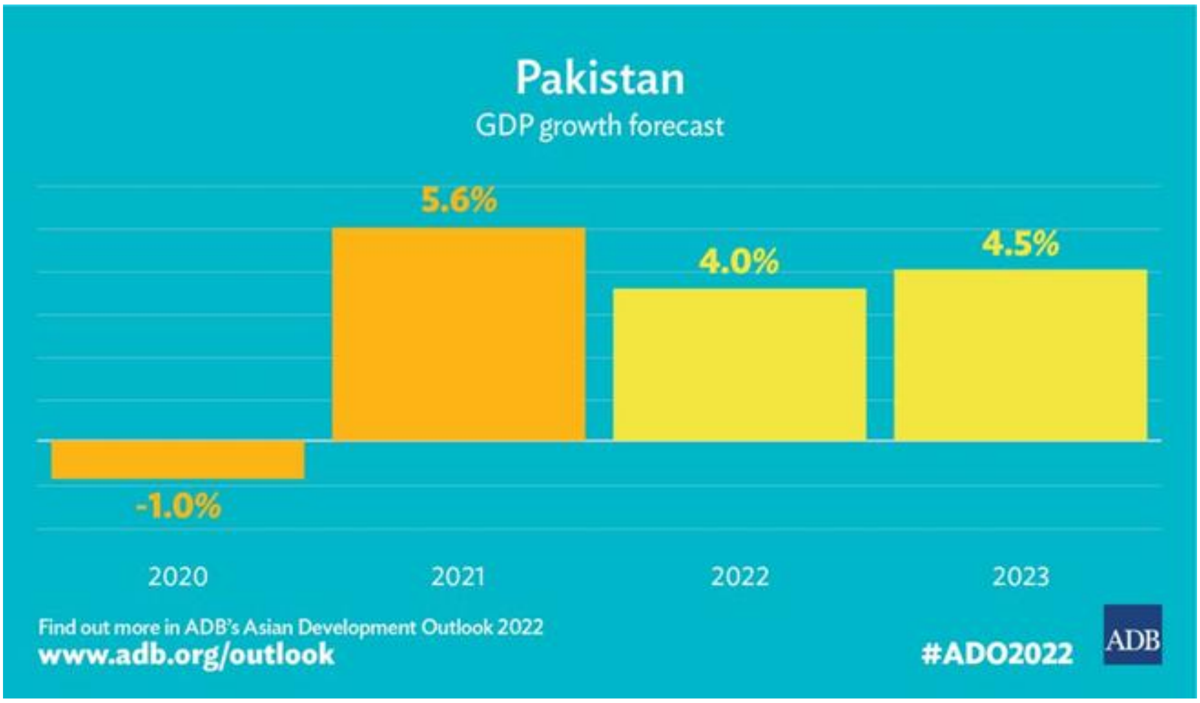
3 Faseeh Mangi and Ronojoy Mazumdar, "Investors start to worry as Pakistan's IMF bailout not final yet," Aljazeera, May 25, 2022, https://www.aljazeera.com/economy/2022/5/25/investors-start-to-worry-as-imf-bailout-not-firmed-up-yet

4 Press Release, "Long-standing Structural Challenges Pose Risks to Pakistan's Sustained Growth: World Bank Bi-Annual Pakistan Development Update Report," World Bank, April 19, 2022, https://www.worldbank.org/en/news/press-release/2022/04/19/long-standing-structural-challenges-pose-risks-to-pakistan-s-sustained-growth-world-bank-bi-annual-pakistan-development-

5 ANI, "Structural weakness of Pakistani economy driving away investors: Report," Business Standard, May 3, 2022, https://www.business-standard.com/article/international/structural-weakness-of-pakistani-economy-driving-away-investors-report-122050300388_1.html

For Pakistan, as for several other developing economies, the implications of globally rising price-falling growth combination are likely to be significant. The first 10 months of the current financial year have seen a healthy 25.5 percent increase in exports. A drop in exports, by itself, is not likely to significantly pull back Pakistan's overall economic growth, as exports account for less than 9 percent of GDP. However, if the increasing trade deficit, which reached USD 39 billion during FY22 (July-April), forces the introduction of import compression measures, economic growth rate may significantly fall. Being a net food and net fuel importing country, Pakistan is likely to see a big jump in food and energy import bill.[6]

Pakistan's soaring inflation is one reason the country's central bank hiked its interest rate for the second time in more than two months. The annual inflation rate in Pakistan increased to 13.4 percent in April from 12.7 percent in the previous month. According to the SBP the economy's sustained and vigorous rebound after the initial Covid shock has meant policy tightening is needed to counter elevated inflation. Many countries are struggling with high inflation as prices rise to multi-year highs. In Asia, inflation in developing countries stayed below the global trend last year, but was expected to rise, according to the Asian Development Bank.[7]



6 Hussain Zaidi, "Global economic outlook and Pakistan," Tribune, May 16, 2022, https://tribune.com.pk/story/2356762/global-economic-outlook-and-pakistan
7 Weizhen Tan, "Pakistan hiked rates to cool soaring inflation, central bank acting governor says," CNBC, May 24, 2022, https://www.cnbc.com/2022/05/24/pakistan-central-bank-acting-governor-on-economy-rising-inflation.html

Policy Recommendations

- Pakistan desperately needs a new economic growth strategy. Sustaining the economic recovery requires addressing long-standing structural weaknesses of the economy and boosting private sector investment, exports, and productivity.

- Once macroeconomic stability is achieved and maintained, the next step is to resume the path for socially inclusive economic growth, job creation and poverty reduction.

- Government should encourage and enhance Small and Medium Enterprises (SMEs) since they increase jobs, promote employment and household savings, and lead to an overall inclusion of people and businesses in the development model..

- The openings Pakistan has been making under CPEC in terms of infrastructure, connectivity, business to business investments, technology transfers, and joint ventures need to be made into a base for economic strength, and production.

- To mitigate immediate macroeconomic risks, the Government should focus on containing the fiscal deficit at a level which ensures debt sustainability, closely coordinate fiscal and monetary policy, and retain exchange rate flexibility.

- In Pakistan political instability has had a significant negative effect on the economic growth and the government should take immediate measures on war footings to bring political stability, which was a prerequisite for a sustainable economy.

- Government must come up with innovative ideas to fetch additional tax revenues and restrict increasing expenditures to narrow the yawning budget deficit. Furthermore, it will need to shift focus toward higher exports and remittances to increase reliance on non-debt creating dollar inflows during the next fiscal year.