Chapter 1

Growth and Investment

Despite achieving a real GDP growth of 5.97 percent in FY2022, the underlying macroeconomic imbalances and associated domestic and international risks have dampened celebrations. The economy of Pakistan rebounded from the pandemic (0.94 percent contraction in FY2020) and continued to post a V-Shaped economic recovery which is higher than 5.74 percent recorded in last year (FY2021). This high growth, however, is also accompanied by external and internal imbalances, as has been the case historically with Pakistan economy. Historically, it has been observed that higher growth also accompanied with macroeconomic imbalances. However, external circumstances also played a critical role this time. These circumstances have placed almost all economies of the world in shambles. A highly transmissible Omicron variety began making things much worse in 2021, when the global economy had yet to recover from COVID-19's effects. Changes in Afghanistan's government after the withdrawal of US troops sparked a global discussion of misery and humanitarian crises, which further worsened due to the Russian-Ukraine conflict started in February 2022. The crisis has also upended the global economic picture and considerably increased the uncertainty for a global economy that was still struggling to recover from COVID-19 aftermath. Financial and commodity markets have felt shockwaves. Thus, energy and food prices have surged rapidly and threatens to remain further elevated. The exceedingly uncertain outcome of the crisis is another challenge for developing economies, particularly for Pakistan.

In Pakistan, during the outgoing fiscal year, inflationary pressures started rising initially due to broadly accommodative fiscal and monetary policies to cushion the impact of COVID-19 in 2020 and 2021. Further, global supply chain disruptions fueled inflation on account of a significant increase in the cost of freight. On the way, when the government was planning to start unwinding pandemic emergency measures and gradually shifting toward fiscal consolidation, the Russian-Ukraine conflict impacted the entire global economy with the prediction of slower growth and faster inflation. Impacts are transmitting through three main channels. First, increasing commodity prices, such as food and energy, driving up inflation further, diminishing the value of income. Thus, weighing on demand. Second, trading economies are grappling with disrupted trade, supply chains, and remittances. While, third, high uncertainty in international market is reducing business confidence and putting downward pressure on asset values. Further, tightening financial conditions may increase capital outflows from emerging markets. In Pakistan, CPI inflation (General) increased by 13.4 percent on a year-over-year basis in April 2022, compared to 12.7 percent in March 2022, while, it remained at 11.0 percent for July-April FY2022. Likewise, the WPI posted a growth of 23 percent during the period under discussion, which in turn intensified domestic inflationary pressure. Since the international commodity prices, especially oil and food are expressed in US dollars, therefore, the depreciation of the Rupee exchange rate vis-a-vis US dollar, also influenced the domestic prices of finished and intermediate products. It is a well-known fact that high prices erode benefits of high growth and adversely impacting the well-being of the society. Therefore, price stability is emphasized in government policies along with sustainable inclusive growth.

Contrary to significant rise in WPI, LSM which is used as proxy for domestic industrial production, posted a growth of 10.4 percent during July-March FY2022. The growth of LSM appears to be extensive, as 17 of 22 LSM sectors experienced positive growth. This significant growth in industrial sector boosted the exports growth by 28 percent during July-April FY2022. However, trade deficit in goods and services widened by 51 percent on account of 39 percent increase in imports of goods as well as 34 percent increase in imports of services according to SBP data. During this period, remittances reached US$26.1 billion posting a growth of 7.6 percent. Despite historically high remittances, trade deficit in goods and services could not be offset. Thus, current account deficit started ballooning up. Further, low performance of Financial Account, not only resulted in depletion of foreign reserves but also brought exchange rate under pressure.

On fiscal side, expenditures became unpredictable globally due to uncertain economic environment and same is the case in Pakistan as well. The significant increase in international prices of commodities especially energy and food are intensifying pressure public finances as well. Realizing the impact of inflation on masses in Pakistan, the Government attempted to protect the vulnerable segments of the society from the recent surge in international energy and food prices. The subsidy provided, thus increased government expenditures, adding fiscal costs. Though, within IMF program, Government is unable to borrow from SBP, commercial borrowing is significantly increased which crowd out the private investment. Historically, consumption always has highest share in GDP. Thus, on demand side, the share of Consumption in real and nominal GDP reached 99 and 96 percent respectively during FY2022, Thus, the imbalance between domestic production and aggregate demand caused inflation, which in turn adversely impacted price stability and sustainable growth.

To remove macroeconomic imbalances and to achieve long term sustainable and inclusive growth, there is need to focus on both the supply side and demand side management. The supply side strategy emphasizes on the extension of production capacity by stimulating and upgradation of domestic GFCF and attracting FDI. This requires conducive environment in which investors feel comfortable to take long term investment decisions. Such developments are expected to increase the growth rate of the country's potential output and employment. On the other hand, increase in productive capacity will enhance production of exportable, imports substitution, which in turn improve trade. Since Positive output gap is creating overheating situation in the economy which not only exerts pressure on domestic prices but also worsen balance of trade due to increase in imports.

Global Perspective

Soon after the recovery from COVID-19, the economic gains were threatened by the Russian-Ukraine conflict in start of 2022. due to the outbreak and evolvement of the COVID-19 pandemic. Initially, the global recovery momentum weakened due to the Delta variant followed by highly transmissible Omicron. The Russian-Ukraine conflict brought more economic damage predicting a significant slowdown in global growth in 2022 due to worldwide spillover effects through commodity markets, trade, and financial channels.

Keeping in view, the prevailing supply shocks for an unknown time length, every institution working on the global outlook has downgraded global growth. Especially IMF has downward revised global growth from early estimates made in January 2022 and October 2021. Global growth is projected to decline from an estimated 6.1 percent in 2021 to 3.6 percent in 2022 and 2023 as well. This decline is 0.8 and 0.2 percentage points lower for 2022 and 2023 than in the January 2022, while in Oct 2021, IMF was projecting 4.9 percent global growth. The most worrisome is inflationary pressure. According to IMF, the conflict will broaden price pressures. Thus, inflation is expected to remain elevated a longer period than the previous forecasts. The conflict is likely to have a protracted impact on commodity prices, affecting oil and gas prices more severely in 2022 and food prices in 2023 (because of the lagged impact from the harvest in 2022). However, the intensity of impact varies across countries, depending on trade and financial linkages, exposure to commodity price increases, and the strength of the existing inflationary pressure.

However, sanctions imposed on Russia by the world community will hamper financial and trade linkages between Russia and other countries due to the fact that some countries in Eastern Europe and Central Asia have large trade and migration links with Russia. Thus, with a delay in conflict settlement, the repercussions will be far-reaching. Moreover, increased global polarization will also impede the cooperation essential for long-term prosperity. It is also mentionable that recent lockdowns in key manufacturing and trade hubs in China will likely compound supply disruptions elsewhere.

On the financial sector, an increase in core sovereign interest rates before the conflict had already placed pressure on borrowers in some emerging and developing economies. Markets have so far differentiated across countries depending on their debt exposures and trade linkages to advanced economies. Countries with higher debt levels and larger gross financing needs have usually been vulnerable to more extreme stress in such episodes. In these countries, increases in domestic long-term yields largely reflect increases in risk premia, over and above the effects of increases in domestic policy rates. To the extent that higher core rates may reflect more robust nominal demand in advanced economy trading partners, countries with stronger trade ties to advanced economies are less exposed. Summarizing, the global economy faces 'its biggest test' since WWII due to Russian-Ukraine conflict as concluded in World Economic Forum meeting held in Davos, recently. It was recorded in the meeting that rising interest rates are adding to pressure on countries, companies and households with big piles of debt. Further, market turbulence and ongoing supply chain constraints are also posing risks. Moreover, the other important risk is the climate change.

Impact of Global Economic Uncertainty on Pakistan's Economy

Economic activity in Pakistan is influenced by economic growth in its main trading partners. The cyclical position pf Pakistan's major trading partners, measured by the weighted average Composite Leading Indicators (CLI), showed a strong V-shaped recovery up till the end of 2021. In 2022, the cyclical position of Pakistan's trading partners gradually moved back to the normal position.

The cyclical position of Pakistan's manufacturing sector, which exerts positive multiplier effects on the rest of the economy, is known to be correlated with the foreign CLI. In Pakistan, potential output kept on growing in 2022 due to which Pakistan's growth performance remained up to the mark in FY2022.

However, higher overall commodity prices especially international inflation had negative consequences for Pakistan's economy. Inflation accelerated and the balance of trade in goods and services deteriorated significantly. As a result, Pakistan's international reserves depleted and currency depreciated significantly, feeding further into domestic inflation. The high rate of inflation eroded the real disposable income of the population, especially of its lower income segments. Fiscal measures were taken to protect against these income losses, which aggravated the fiscal deficit putting further pressure on inflation.

Furthermore, foreign interest rates started rising, because of inflationary expectations and Central banks' intentions to raise interest rates, especially in the US and the UK. And same was followed by other countries, especially Emerging Market and Developing Countries.

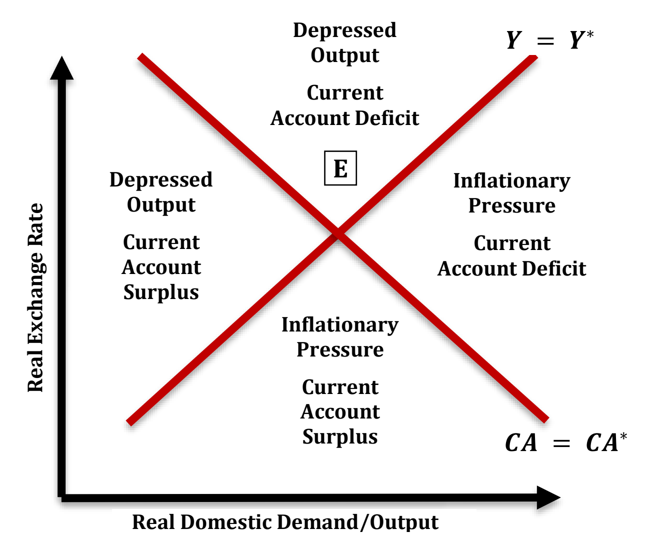
Thus, high inflation, external imbalances, excessive fiscal deficits, and higher interest rates may compromise Pakistan's future short-term growth prospects.

Box - I: Effects of Internal and External Imbalances on Prices and Economic Growth

Macroeconomic diagnostics of the economy help in assessing the state of the economy and gauge economic performance. It further allows us to map the risks and vulnerabilities faced by the economy. In this regard, it is important to understand:

Internal Balance: A situation in which real output is at or close to its capacity or potential level and the inflation rate is low and stable

External Balance: Current account position that can be sustained by capital flows on terms compatible with the growth prospects of the economy without resorting to restrictions on trade and payments (or depletion of reserves).



The internal balance schedule, where **Y=Y***, is upward sloping. Along this line the output gap is zero. This zero-output gap can be attained by different combinations between real demand and the exchange rate: higher demand would be inflationary, which can be overcome by exchange rate appreciation. The external balance schedule, **CA=CA***, is downward sloping. Along this line, the CA is equal to its target. This target can be reached by different combinations between real demand and the exchange rate. Too high demand worsens the CA, which can be compensated by exchange rate depreciation and vice versa.

Note: Y-axis: higher values = RER appreciation

Pakistan has been plagued by regular BOP crises and had to look for IMF assistance to help finance these external imbalances. External imbalances were mainly driven by trade deficit as imports of goods and services always remained higher than exports in magnitudes. Further, trade deficit could not be financed by remittances and other components of the current, capital and financial accounts of the BOP. The origins of the excessive trade balance deficits were either from external or internal sources or a combination of both. Regarding internal imbalance, over time, it was seen that observed economic growth exceeded the potential growth of the economy (driven by GFCF) mainly due to expansionary fiscal and monetary policies, which made real domestic demand higher than domestic production, and therefore economy was overheated. All these resulted in a significant increase in imports.

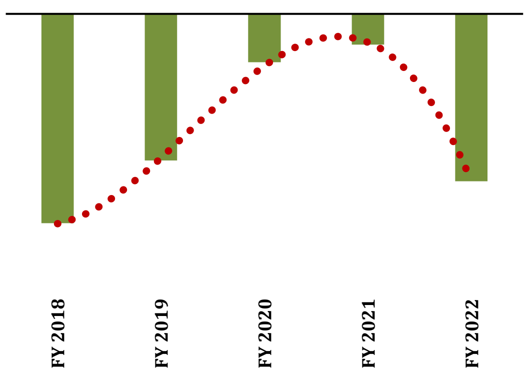
If a country like Pakistan is confronted with external imbalances, either its reserve assets will decline, or its exchange rate will depreciate or a combination of both will happen. From the monetary side, too low Net Foreign Assets (NFA) may lead to speculation and enhance currency depreciation which in turn fuel domestic inflation.

However, in such circumstances, a country can respond only with a restrictive stance on fiscal and monetary policies. But these restrictive monetary and fiscal policies will adversely affect the labor market. Thus, in the long run, there is intense need to implement structural measures that generate high potential economic growth accompanied with the necessary equilibrium stance of fiscal and monetary policies.

Pakistan Economic Performance FY2022

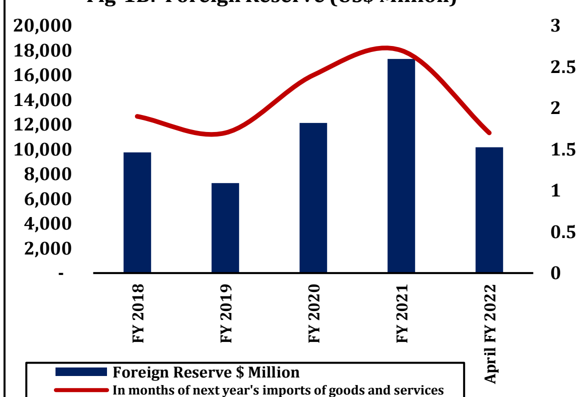
International Financial Institutions like IMF, WB, ADB, etc., appreciated various policy measures taken by the Government to contain the pandemic and put the economy on the path of the recovery. However, the economy started overheating on account of significant growth in workers' remittances translated into consumption, thus raising aggregate demand. Further, improvement in Financial Account was not enough to offset the current account deficit, which exerted severe pressure on the exchange rate. For July - April FY2022, the current account deficit reached to US$ 13.8 billion against the deficit of US$ 0.5 billion last year implying widening in the Saving-Investment Gap started which in turn depleted foreign exchange reserves. Currently, Pakistan foreign reserves are equal to 1.7 months of imports of goods and services.

Fig-1A: Saving - Investment Gap (US$ Billion)



Source: SBP

Fig-1B: Foreign Reserve (US$ Million)

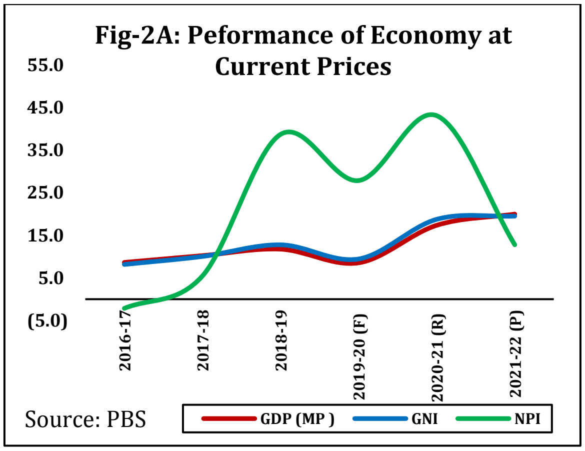


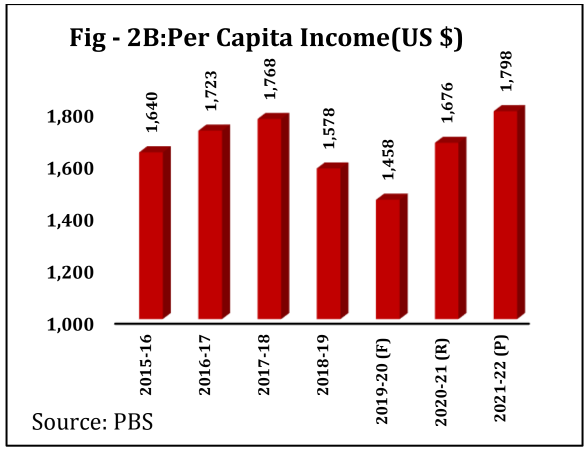
Source: SBP

As far as exchange rate is concerned, during July-May FY2022, the exchange rate depreciated significantly and was recorded at 1US$ = Rs 197.87 on June 1, 2022 compared to 1US$ = Rs 157.55 on June 30, 2021, showing 20 percent depreciation.

Aggregate Demand Analysis

For aggregate demand analysis, Nominal GDP (MP) i.e., GDP(MP) at current prices is used. For FY2022, GDP at current market prices stands at Rs 66,950 billion showing a growth of 20.0 percent over last year (Rs 55,796 billion). In dollar term, it remained US$ 383 billion, higher than GDP observed in FY2021 (US$349 billion). Gross National Income (GNI) is also used for measuring and tracking a nation's wealth which is calculated by adding Net Primary Income (NPI) to GDP (MP). Although movement of GNI and GDP (MP) follow similar pattern. However, after FY2018, significant growth was observed in Net Primary Income (NPI) mainly due to substantial growth in workers remittances on account of travel restrictions. During July-April FY2022, workers' remittances posted a growth of 7.6 percent, however, NPI in rupees term posted a growth of 13 percent compared to 43 percent growth recorded last year (Fig – 2A). Regarding per capita income in dollar terms, there was a rebound seen in FY2021 which continued in FY2022. In FY2022, per capita income was recorded at US$ 1,798 which reflects an improvement in prosperity due to the fact that economic growth per person significantly improved. (Fig – 2B).





Consumption: In Pakistan, household consumption is estimated on a residual basis due to the non-availability of National Accounts on Expenditures approach. The household consumption has a significantly large share in GDP. This implies that household consumption remained intact even during high inflation. The higher shares households spending fueled imports since domestic production could not meet growing consumers' demand. Thus, bringing imported inflation.

Table – 1, presents the components of Aggregate Demand. It is worth mentioning that final consumption expenditure of Non-Profit Institutions Serving Households (NPISH) has been estimated for the first time. The NPISH is covered under two categories i.e., Non-Profit Institutions (NPIs) and Membership Organizations. The PBS conducted a special survey namely NGOs Survey 2015-16, to assess the value-added contribution of NPIs engaged in education, health, social work, and other activities based on the frame provided by the Pakistan Centre for Philanthropy. In the NGOs survey. A total of 1,1781 NGOs were covered including 676 in the census part, 10,967 in the survey part and 138 international NGOs. It is usually one percent of GDP.

With regard to the household private consumption expenditures, it was observed that even an increase in interest rate and depreciation of Pak rupee exchange rate has not altered the consumption pattern in FY2022. This private consumption expenditures may happen on account of an increase in workers' remittances and cash transfer to the low segment of society through the Ehsaas Cash Emergency Programme. Similarly, a slight decrease in the share of the Public Consumption in GDP was observed. However, the growth rate in Public Consumption increased to 11.3 percent during FY2022 mainly due to increase in increase in government consumption expenditures as well as increase in interest payments.

Table 1: Composition of Aggregate Demand (at Current Prices)-

	2019-20	2020-21	2020-22	2019-20	2020-21	2020-22	2019-20	2020-21	2020-22
	As percent of GDP (MP)			Growth Rates (%)			Point Contribution		
Household Consumption	80.5	82.4	85.2	5.4	20.1	24.2	4.5	16.2	19.9
NPISH Consumption	1.0	1.0	0.9	12.2	12.1	5.3	0.1	0.1	0.1
General Government Consumption	11.8	10.9	10.1	19.0	8.9	11.3	2.0	1.0	1.2
Total Consumption [C]	**93.3**	**94.3**	**96.2**	**7.0**	**18.6**	**22.5**	**6.7**	**17.4**	**21.2**
Gross Fixed Investment	13.1	12.9	13.4	3.2	15.8	24.6	0.4	2.1	3.2
Private	10.3	10.0	10.0	4.7	13.7	20.6	0.5	1.4	2.1
Public including General Public	2.8	3.0	3.4	(2.1)	23.4	37.9	(0.1)	0.7	1.1

Table 1: Composition of Aggregate Demand (at Current Prices)-

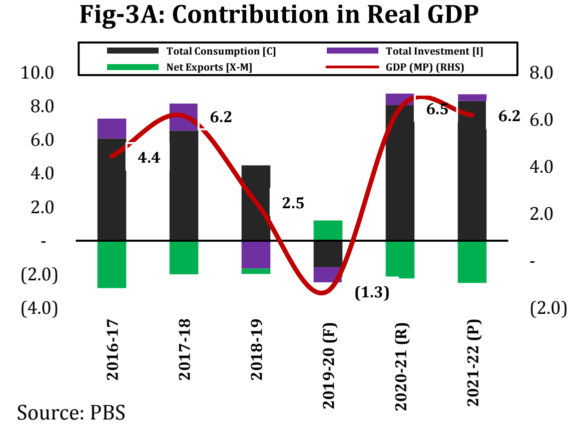
	2019-20	2020-21	2020-22	2019-20	2020-21	2020-22	2019-20	2020-21	2020-22
	As percent of GDP (MP)			Growth Rates (%)			Point Contribution		
Changes in Stock + Valuables	1.7	1.7	1.7	8.5	17.4	20.0	0.1	0.3	0.3
Total Investment [I]	**14.8**	**14.6**	**15.1**	**3.8**	**16.0**	**24.1**	**0.6**	**2.4**	**3.5**
Exports (Goods & Services) [X]	9.3	9.1	10.5	7.5	14.3	38.7	0.7	1.3	3.5
Imports (Goods & Services) (M]	17.4	18.0	21.9	(3.1)	21.2	45.7	(0.6)	3.7	8.2
Net Exports [X-M]	**(8.1)**	**(8.9)**	**(11.4)**	**(12.9)**	**29.1**	**52.9**	**1.3**	**(2.4)**	**(4.7)**
Aggregate Demand [C+I+X]	**120.3**	**117.4**	**118.2**	**6.6**	**17.9**	**23.9**	**7.9**	**21.1**	**28.2**
Domestic Demand [C + I]	**110.2**	**107.4**	**108.2**	**6.6**	**18.2**	**22.7**	**7.2**	**19.7**	**24.7**
GDP (MP)	**100**	**100**	**100**	**8.5**	**17.4**	**20.0**	**8.5**	**17.4**	**20.0**

NPISH: Non-profit institutions serving households

Source: Pakistan Bureau of Statistics

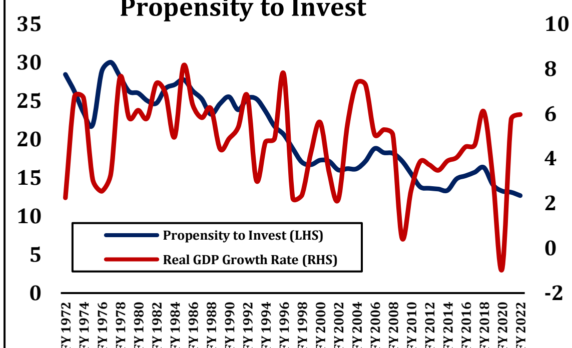
Investment: It is mentionable that increase in consumer spending can increase international trade, and businesses. This will in turn increase investment in capital spending which may positively impact the level of domestic production of goods and services which in turn result in economic growth. In Pakistan, the investment to GDP ratio is stuck between 14 to 15 percent, thus placing it 133 among 151 countries for year 2021[1]. Even in Bangladesh, the investment to GDP ratio is 30.5 percent. The contribution of investment to real GDP is shown in (Fig – 3A).

Fig-3A: Contribution in Real GDP



Source: PBS

Fig - 3B: Real GDP Growth & Propensity to Invest



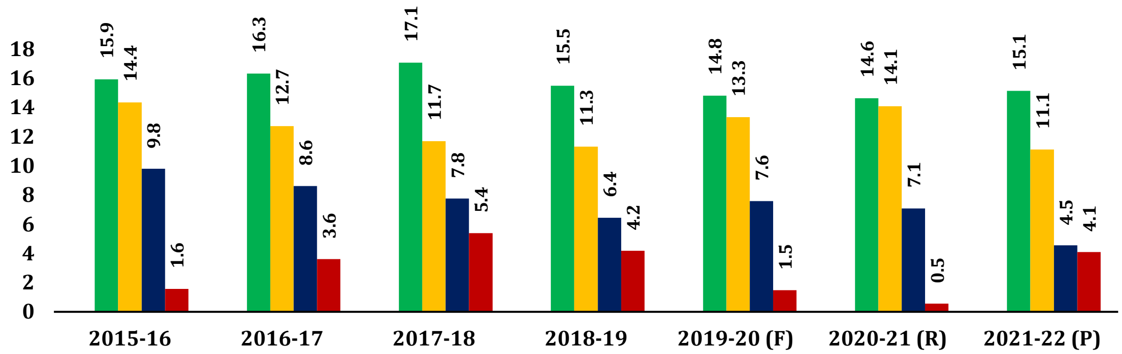
Source: EA Wing Calculation

It is well established fact that high growth in Pakistan determined by the propensity to investment. However, after the mid-1980s, the propensity to investment fell dramatically. One of the implications deduced is that the Total Gross Fixed Capital Formation (TGFCF) is not driver of economic growth. (Fig – 3B).

Thus, Pakistan remained trapped in a low-saving and low-investment situation, which has constraint its economic potential. It is also said that the economic conditions remained unable to attract investment both domestically and Foreign Direct Investment. Thus, Average of Incremental Capital Output Ratio of Pakistan became much lower compared to countries in the region. Further, low savings rate limits the volume of investible funds. In turn, low investments make growth unsustainable. In FY2022, high growth was due to high foreign savings (current account deficit) resulted in low domestic and national savings. Thus, current savings and investment level is insufficient to boost growth momentum (Fig -4)

[1] https://www.theglobaleconomy.com/rankings/investment_percent_of_gdp/

Fig - 4: Investment and Saving as % of GDP (%)



Source: PBS & M/o PD &SI

Total investment consists of Gross Fixed Capital Formation (GFCF), changes in inventories, and net acquisition of valuables. Changes in inventories refer to the value of physical change in the stocks of raw material, work-in-progress and finished goods held by industries and producers of government services. However, Valuables are not used primarily for purposes of production or consumption but are held as stores of value over time. Valuables are expected to appreciate or at least not decline in real value, nor deteriorate over time under normal conditions. These consist of precious metals and stones, jewelry, works of art, etc. GFCF is defined as the net acquisition of fixed assets, used in the production process for more than one year.

In FY2022, the Gross Fixed Capital Formation (GFCF) stood at Rs 8,992 billion against Rs 7,217 billion in FY2021, thus, posting a growth of 24.6 percent as compared to 16 percent growth in FY2021. During the same period, the GFCF in the private sector was estimated at Rs 6,704 billion against Rs 5,557 billion in FY2021 showing a growth of 20.6 percent. The GFCF in Public Sector remained at Rs 481 billion during FY2022 compared to Rs 419 billion last year registering a growth of 14.9 percent. Likewise, the GFCF in the General Government sector during FY2022 stood at Rs 1,808 billion compared to Rs 1,241billion during FY2021, posting a growth of 45.6 percent.

Private Sector GFCF: During FY2022, GFCF in Agriculture has the highest share of 27 percent in Private Sector GFCF which is almost consistent since FY2016. Within agriculture sector, livestock share is around 20 percent. Real Estate activities is having second-highest share of 18 percent in Private Sector GFCF as compared to 15 percent in FY2016. The share of Manufacturing in Private Sector GFCF declined from 20 percent in FY2016 to 16 percent in FY2022. However, within Manufacturing, the share of Large Scale stood at 12 percent, while it was 18 percent in FY2016. The share of Transport and Storage reached at 11 percent in FY2022 as compared to 7 percent in FY2020.

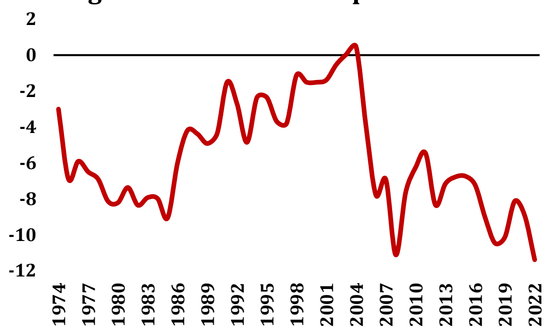
The private sector GFCF in agriculture, forestry, and fishing recorded at Rs 1,787 billion in FY2022 compared to Rs 1,513 billion in FY2021, posting a growth of 18.1 percent on account of an increase in imported agriculture machinery and increase in the value of stock in the livestock. In real estate activities, private sector GFCF has registered a growth of 35 percent on account of higher growth of deflator. The private sector GFCF in large scale manufacturing for FY2022 reached Rs 785 billion against Rs 761 billion during FY2021, showing a growth of 3.1 percent. The conservative reporting of provisional capital formation by private companies is the main reason behind this relatively slow growth. Regarding private sector GFCF in Transportation & Storage industry, it posted a growth of 38 percent as its value increased to Rs 751 billion in FY2022 from Rs 545 billion in FY2021 on account of higher imports as well as domestic sales of transportation equipment.

Public Sector Enterprises GFCF: During FY2022, the major industries showed an increase in GFCF compared to FY2021. For instance, construction (Rs 14.0 billion against Rs 9.8 billion due to Capital Development Authority and Lahore Development Authority), Transportation & Storage (Rs 117.0 billion against Rs 60.8 billion due to Port Qasim Authority, Pakistan National Shipping Corporation, and National Logistic Cell), Information & Communication (Rs 79.0 billion against Rs 34.2 billion due to PTCL and Ufone on machinery & equipment), and Finance & Insurance (Rs 18.8 billion against Rs 11.4 billion due to Nationalized Banks and EOBI). However, a decline was observed in Mining & Quarrying (Rs 13.8 billion against Rs 25.3 billion due to OGDC on machinery & equipment), Manufacturing (Rs 13.9 billion against Rs 14.4 billion due to Pak Arab Refinery), and Electricity Gas & Water Supply (Rs 224.2 billion against Rs 262.6 billion due to Water & Power Development Authority and companies relating to machinery & equipment).

General Government GFCF: For FY2022**,** GFCF related expenditure for the Federal Government has been recorded at Rs 566 billion compared to Rs 477 billion last year, posting a growth of 18.5 percent. Similarly, GFCF related expenditures by Provincial Governments were increased by 63 percent as these were recorded at Rs 1,064 billion in FY2022 compared to Rs 654 billion last year. These were mainly related to buildings and structures in Punjab (from Rs 254.2 to 423.7 billion), Sindh (from Rs 179.3 to 322.4 billion), KP (from Rs 154.2 to 201.3 billion) and Balochistan (from Rs 66.1 to 116.4 billion). Moreover, expenditure on GFCF incurred by District Governments also increased to Rs 178.2 billion in FY2022 from Rs 110.4 billion in FY2021, posting growth of 61.4 percent. Industry-wise disaggregation of GFCF of General Government suggests that there was 48.0, 34.2 and 25.1 percent increase in Public Administration & Social Security, Education and Human Health & Social Work, respectively during FY2022.

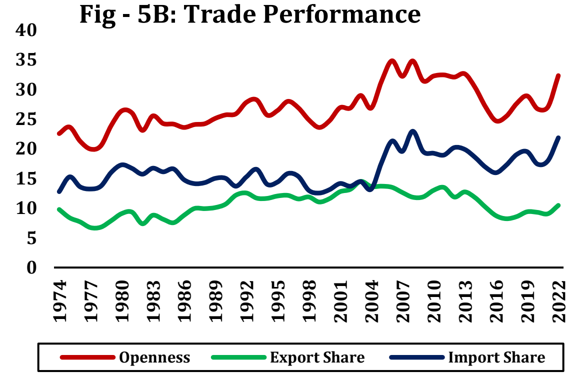
Net Exports: The contribution of Net Exports in aggregate demand, remained negative, mainly due to the massive decline in imports on account of the pandemic. As per National Accounts data, Exports of Goods and Services posted a growth of 39 percent, while Imports of Goods and Services posted a growth of 46 percent in FY2022. Since 1972, a dramatic decline has been seen in the share of Net Exports in GDP (Fig-5A). Usually, trade openness is frequently used to measure the importance of international transactions relative to domestic transactions. It is defined as the ratio of exports plus imports over GDP. Pakistan's openness to trade improved little after 2005, but reflecting two markedly divergent trends: import share rose and export share declined (Fig-5B).

Fig - 5A: Share of Net Exports in GDP



Source: EA Wing Calculation based on PBS Data

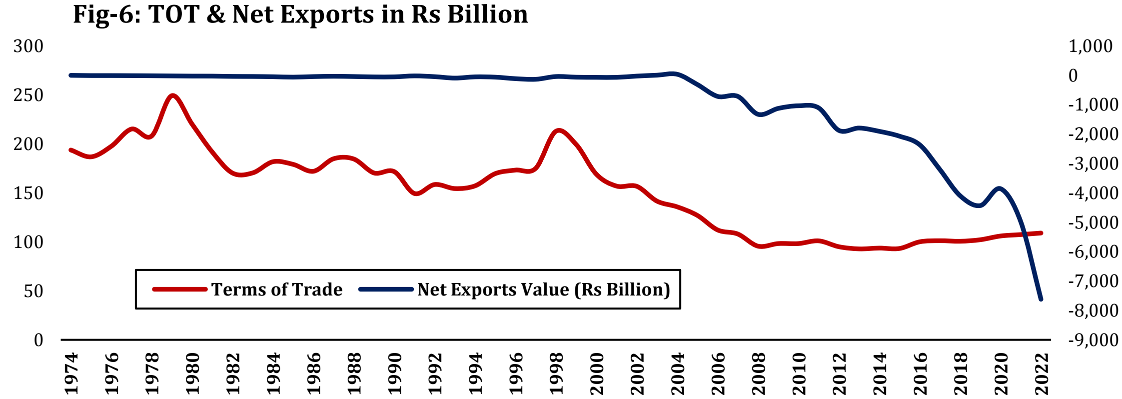
Fig - 5B: Trade Performance



Source: EA Wing Calculation based on PBS Data

A significant increase in imports caused to decrease the share of Net exports dramatically. However, due to a strong increase in consumption, both government and private households, Pakistan's economy was confronted with several BOP crises. Moreover, the Term of Trade (TOT) declined substantially, hence the value of net export fallen down dramatically, putting a severe limit on demand-driven growth, since the mid-2000's (Fig-6).

Fig-6: TOT & Net Exports in Rs Billion



Source: EA Wing Calculation based on PBS Data

Sectoral Growth Analysis – Production Side

Pakistan's economy has shown a strong recovery after being depressed due to the pandemic which resulted in lockdown. For FY2022, Real GDP (GVA at basic prices 2015-16) posted a growth of 5.97 percent on account of 4.40 percent growth in Agriculture, while 7.19 and 6.19 percent growth in Industry and Services respectively. This growth is slightly above the growth of 5.74 percent recorded for FY2021.

Box - II: Rebasing of National Accounts from basic prices of 2005-06 to 2015-16

Recently, the Pakistan Bureau of Statistics has revised National Accounts at basic prices of 2015-16.

Thus, rebasing of National Accounts Series means replacing the old base year used for compiling the constant price estimates with a new or more recent base year for computing constant price estimates

Real GDP is considered more important which is estimated with reference to some base year considered as constant prices. While constant price data have the advantage of being additive, the pattern of relative prices in the base period becomes increasingly irrelevant with the passage of time. As a result, the base period must be updated to reflect current conditions. Actually, the System of National Accounts (SNA) is a set of internationally agreed standards for measuring economic activity. SNA 2008 is presently in place. It is also mentionable that most of the countries, namely Bangladesh, Hong Kong China, India Nepal, Philippines, Sri Lanka, and Thailand undertake their rebasing exercise at a gap of 10 years.

Advantages of Rebasing

- It helps in getting the most reliable and accurate estimations of GDP (GDP). Further, estimates of new GFCF involve broadening of the scope and coverage of macroeconomic data. Thus, the estimates become in accordance with the System of National Accounts (SNA) standards.
- The rebasing of Pakistan's macroeconomic data is required by government, policymakers and decision makers, researchers, and other national and international users for appropriate policies implications

In Pakistan, prior to recent rebasing, the National Accounts of Pakistan had been estimated on current prices until the base was set as 1959-60, which was adopted in 1962-63. The first change of base took place in 1987 when the year 1980-81 was adopted as the base year. The next change of base was adopted in 2003 setting the base as 1999-2000. Then in 2013, the base year was changed to 2005-06.

	1980-81		1999-00		2005-06		2015-16	
Rs Million	**Base Year 1959-60**	**Base Year 1980-81**	**Base Year 1980-81**	**Base Year 1999-00**	**Base Year 1999-00**	**Base Year 2005-06**	**Base Year 2005-06**	**Base Year 2015-16**
Agriculture	71,699	71,399	779,692	923,609	1,457,222	1,775,346	6,749,966	7,306,957
Industry	61,495	56,013	676,369	830,865	1,923,698	1,616,157	5,308,368	5,939,635
Services	114,402	115,419	1,465,927	1,807,546	3,777,607	4,324,274	15,343,961	17,261,613
GDP at basic prices	**247,596**	**247,831**	**2,921,988**	**3,562,020**	**7,158,527**	**7,715,777**	**27,402,295**	**30,508,205**
GDP at market prices	**277,961**	**278,196**	**3,147,167**	**3,826,112**	**7,623,205**	**8,216,160**	**29,075,633**	**32,725,049**

Change in Key Macroeconomic Variables Ratios

Indicators	**Fiscal Year 2021**		**% Change**
	Base Year 2006	**Base Year 2016**	
	Real Sector		
GDP Size (current) (Rs mn)	47,709,325	55,795,515	16.9
GDP Size (current) (US$ mn)	298,650	348,678	16.8
Per Capita Income (US$)	1,542	1,676	8.7
Population	211.9	222.6	5.0

Indicators	**Fiscal Year 2021**		% Change
	Base Year 2006	Base Year 2016	
Fiscal Sector			
Total Revenue (Rs mn)	6,903,370	6,903,370	
Total Revenue (% of GDP)	14.5	12.4	↓
Tax Revenue (Rs mn)	5,272,699	5,272,699	
Tax Revenue (% of GDP)	11.1	9.4	↓
Total Expenditures (Rs mn)	10,306,691	10,306,691	
Total Expenditures (% of GDP)	21.6	18.5	↓
Current Expenditures (Rs mn)	9,084,010	9,084,010	
Current Expenditures (% of GDP)	19.0	16.3	↓
Fiscal Deficit (Rs mn)	3,403,321	3,403,321	
Fiscal Deficit (% of GDP)	7.1	6.1	↓
Public Debt (Rs bn)	39,861	39,861	
(% of GDP)	83.5	71.8	↓
Primary Deficit (Rs mn)	653,592	653,592	
Primary Deficit (% of GDP)	1.4	1.2	↓

Sectoral point contribution is given in Table – 2.

Table 2: Sectoral Point Contribution at Constant Prices 2015-16

	2019-20	2020-21	2021-22		2019-20	2020-21	2021-22		2019-20	2020-21	2021-22
	As percent of GDP				**Growth Rates (%)**				**Point Contribution**		
A. Agriculture	23.5	23.0	22.7		3.9	3.5	4.4		0.88	0.82	1.01
B. Industry	18.5	18.9	19.1		(5.7)	7.8	7.2		(1.1)	1.45	1.36
Commodity Producing Sector (A+B)	42.1	41.9	41.8		(0.6)	5.4	5.7		(0.2)	2.27	2.37
C. Services Sector	57.9	58.1	58.2		(1.2)	6.0	6.2		(0.7)	3.48	3.59
GDP (GVA)	**100**	**100**	**100**		**(0.94)**	**5.74**	**5.97**		**(0.94)**	**5.74**	**5.97**

Note: Figures in parenthesis indicates negative growth
Source: Pakistan Bureau of Statistics

Agricultural Sector: The agriculture sector posted growth of 4.4 percent mainly due to 6.6 percent growth in Crops and 3.3 percent growth in Livestock. The growth in crops was recorded on account of 7.2 percent growth in Important Crops, 5.4 percent growth in Other Crops, and 9.2 percent growth in Cotton Ginning.

The better performance of Agriculture is mainly due to 18.1 percent growth in Private Sector GFCF in agriculture, forestry, and fishing. Further, extensive outreach of the Prime Minister's Agriculture Package also helped significant agriculture growth. Important Crops has 56.2 percent share in Crops Value Addition. The growth in production of important crops namely Cotton, Rice, Sugarcane, and Maize is estimated at 17.9, 10.7, 9.4, and 19.0 percent, respectively. The cotton crop increased from 7.1 million bales to 8.3 million bales, while Rice production increased from 8.4 million tons to 9.3 million tons. Likewise, Sugarcane production increased from 81.0 million tons to 88.7 million tons, while Maize production increased from 8.9 million tons to 10.6 million tons. There was a decrease in Wheat production which decreased from 27.5 million tons to 26.4 million tons. Other crops showed growth of 5.4 percent mainly because of an increase in the production of pulses, vegetables, fodder, oilseeds, and fruits.

Livestock sector which constitutes almost 62 percent share in agriculture, posted a growth of 3.3 percent. The other components of agriculture, forestry and fishing posted growth of 6.1 and 0.3 percent, respectively.

Industrial Sector: Industrial sector recorded a growth of 7.2 percent in FY2022 compared to 7.8 percent growth in FY2021.

Industrial sector performance is more dependent on the Manufacturing sector which has a share of 65.0 percent in the industry. Within Manufacturing, Large-Scale Manufacturing (LSM) holds 74 percent while its share in the industry is 48 percent. However, LSM is reflected by Quantum Index Numbers (QIM) data. During July – March FY2022, the QIM index posted a growth of 10.4 percent. Major contributors to this growth remained Food (11.7%), Tobacco (16.7%), Textile (3.2%), Wearing Apparel (34.0%), Wood Products (157.5%), Chemicals (7.8%), Iron & Steel Products (16.5%), Automobiles (54.1%), Furniture (301.8%) and other manufacturing (37.8%).

The other components of Manufacturing, Small Scale, and Slaughtering posted growth of 8.9 and 6.2 percent, respectively. Thus, Manufacturing sector posted a growth of 9.8 percent.

It is mentionable that Mining and Quarrying which has a 9.0 percent share in Industry, posted negative growth of 4.5 percent. It is worth mentioning that during FY2022, GFCF in Mining and Quarrying posted a growth of 13 percent, while it posted negative growth of 5 percent in FY2021. Thus, there may be a lag effect of GFCF in this sector. It is also reported that the decline in Mining and Quarrying growth is mainly due to a decline in the production of other minerals such as limestone (-21.7%), marble (-3.4%), argi (-13.4%), and shale (-21.4%) clay, phosphate (-54.6) and rock salt (-19.9%).

Similarly, Electricity, Gas and Water Supply, the other sub-sector of Industry posted a growth of 7.9 percent. One reason being that there was 11 percent growth in Public GFCF during FY2021 in this sector. Further, there was an increase in subsidies from Rs 366.4 billion in FY2021 to Rs 567.0 billion in FY2022.

Finally, Construction has a 13.4 percent share in Industry, while value-added in the construction industry is mainly driven by construction-related expenditures by industries. Construction recorded a modest growth of 3.1 percent mainly due to an increase in general government spending. This moderate growth rate is due to an unusual increase of 30.1 percent in relevant deflator i.e., WPI building material.

Services Sector: Services sector still constitutes the largest share of 58 percent in GDP even in the new methodology used for the Change of Base of National Accounts on 2015-16. However, in the new methodology, the services sector has been divided into Ten sub-sectors. Sub-sectors of Services with respective shares in Services and GDP in Table – 3.

Table 3: Components of Services

	Share in Services	Share in GDP
1. Wholesale & Retail Trade	32.4	18.8
2. Transport & Storage	17.8	10.4
3. Accommodation and Food Services Activities (Hotels & Restaurants)	2.4	1.4
4. Information and Communication	4.6	2.7
5. Finance and Insurance Activities	3.2	1.9
6. Real Estate Activities (OD)	9.6	5.6
7. Public Administration and Social Security (General Government)	8.0	4.6
8. Education	5.1	3.0
9. Human Health and Social Work Activities	2.7	1.5
10. Other Private Services	14.3	8.3

Source: Pakistan Bureau of Statistics

During FY2022, the services sector continued to post a significant growth of 6.2 percent as it posted 6.0 percent growth last year.

Wholesale and Retail Trade industry posted a growth of 10.0 percent, mainly because its value addition is dependent on the output of agriculture, manufacturing, and imports.

The growth in trade value-added relating to agriculture, manufacturing, and imports stood at 4.0, 9.8, and 19.9 percent, respectively.

Transportation & Storage industry posted a growth of 5.4 percent due to an increase in railways (41.85%), air transport (26.56%), road transport (4.99%), and storage (10.01%).

Accommodation and food services activities showed growth of 4.1 percent. The growth of Information and communication remained at 11.9 percent due to improvements in telecommunication, computer programming, consultancy, and related activities.

Finance and insurance industry shows an overall growth of 4.9 percent mainly due to an increase in Financial Intermediation Services Indirectly Measured (FISIM) on deposits and loans.

Real Estate Activities posted a growth of 3.7 percent, while public administration and social security (General Government) activities posted a negative growth of 1.2 percent mainly due to high deflator.

Education has witnessed a growth of 8.7 percent due to increase in public sector expenditure. Human health and social work activities posted a growth of 2.2 percent due to the general government GFCF. Finally, other private services posted a growth of 3.8 percent.

Way Forward

Pakistan's economy faces several severe challenges. Inflation is running too high, the prospects for future growth in potential output are challenging. Fiscal deficit is at a level where its financing is becoming challenging. Further, high trade deficit is leading to external imbalances putting extra pressure on foreign reserves and on the exchange rate. Economic growth seems to be slow down next year. Moreover, high uncertainties are restricting market confidence.

In the short run, Pakistan is confronted with the challenge to finance its external finance requirements stemming from current account deficits and foreign debt servicing. Successful conclusion of the seventh review of Pakistan's reform program which is supported by an IMF Extended Fund Facility arrangement is on the right direction.

Government is very much committed to ensure the stability and confidence in the economy. Stable fiscal policy with a higher, growth promoting path for PSDP, based on physical and human capital development will be obligatory. Likewise, subsidies targeted to stimulate development of innovative industries and services will be essential. On the revenue side, growth-oriented revenue policies will be helpful.

There is intense need of creating an environment conducive for investments. Further, the investment must be capable of considerably augmenting the share of GFCF in GDP as well as increasing the efficiency to create additional welfare. Investors and consumers need to be convinced of a long term sustainable and inclusive growth project that inspires confidence in Pakistan's economic future and that induces them to take initiatives in their own and in the country's interest. Thus, well-functioning competitive markets is required.

There is also need to continue policies which brought improvement in related sectors. For example, Prime Minister's Agriculture Package and related agricultural policies remained more effective for better agriculture performance. Likewise, policies related to energy mix and efficient energy supplies. Furthermore, there is also need of stable legislative and political culture.

As a result of these, it is expected that potential output growth will be upgraded, resulting in higher employment and real income growth. It will also create additional capacity for exports and import substitution and a stable exchange rate environment. Thus, demand management fiscal and monetary policies should on average be neutral and play their role of cyclical stabilizers when temporary shocks create deviations from the long-term growth path.