Economic Scenario

The Fiscal year 2007-2008 has exposed the vulnerability of sustainability of the growth over medium to long term due to high inflation (both core and food) and burgeoning Fiscal and Current Account deficits. These factors have already started straining the Reform Process and putting pressure on a delicate balance between fiscal and monetary policy initiatives to manage the economy. The year did have its own uniqueness in terms of continuing judicial crisis, imposition of emergency and the new government which emerged as a result of February 2008 Elections.

The new democratically elected government has inherited an economy which after a few years of continuing high growth of around 6 to 7 percent is being threatened by domestic and global market issues. The domestic factors are both political and economic policy failures, continuing political uncertainty, judicial crisis and inadequate focus on structural weakness in key sectors such as energy, agriculture and exports, high food and core inflation and increasing sense of deprivation in lower income groups.

The weak and bearish sentiments across global markets, potential recession and slow down in developed economies, global commodity shortage and high prices and continuing increase in crude oil prices, have further aggravated the situation.

The economic data indicates a decline in GDP growth which is not broad based and three fourths of the growth was contributed by Services sector alone.

- GDP growth of 5.8 percent in 2007-2008 (2006-2007 6.8 percent) has been contributed as follows:

	Sectoral Contribution to the GDP growth (Percent Point)		
	2005-06	2006-07	2007-08
Agriculture	1.4	0.8	0.3
Industry	1.1	2.1	1.3
Services	3.3	3.9	4.2
Real GDP	5.8	6.8	5.8

A number of key targets have been missed which are generally summarized as follows:

	(Percentages)	
	Target	Projected
GDP	7.2	5.8
Agriculture	4.8	1.5
Manufacturing	10.9	5.4
Large Scale Manufacturing	12.5	4.8
Investment	23.3	21.6
National Savings	18.3	13.9
Overall Fiscal Deficit	4.0	6.5
CPI based inflation	6.5	10.3
Current Account Deficit	6.0	8.0

The composition of GDP growth in various sectors has been summarized in the table below:

	(Growth in Percentage)		
	2005-2006	2006-2007	2007-2008
GDP (Constant Factor Cost)	5.8	6.8	5.8
Manufacturing	8.7	8.2	5.4
Large scale manufacturing	8.3	8.6	4.8
Small scale manufacturing	8.7	8.1	7.5
Construction	10.2	17.9	15.2
Electricity, Gas distribution	-14.7	-26.6	2.5
Agriculture	6.3	3.7	1.5
Major Crops	-3.9	8.3	-3.0
Minor Crops	0.4	-1.3	4.9
Livestock	15.8	2.8	3.8
Services sector	6.5	7.6	8.2
GNP (Constant Factor Cost)	5.6	6.7	6.1

- Per capita income increased by 17.2 percent in dollar terms from $925 to $1085 per annum.
- The target for inflation for the year was set at 6.5 percent. However, as of 30 April, it has been at 10.3 percent and the average for the year 2007-08 is expected to be 11 percent i.e. 4.5 percent over the target.
- The overall position of inflation, based on CPI (Consumer Price Index), has been as follows:

	2006-07	2007-08
Overall inflation	7.8	10.3
Food inflation	10.3	15.0
Non-food inflation	6.0	6.8
Core inflation	5.9	7.5
SPI (Sensitive Price Index)	6.9	13.7
WPI (Wholesale Price Index)	10.8	14.1

- The structure of savings and investment as percent of GDP is given in following table:

Description	(Percentages of GDP)			
	2004-2005	2005-2006	2006-2007	2007-2008
Total Investment	19.1	22.1	22.9	21.6
Changes in Stock	1.6	1.6	1.6	1.6
Gross Fixed Investment	17.5	20.5	21.3	20.0
- Public Investment	4.3	4.8	5.7	5.7
- Private Investment	13.2	15.7	15.6	14.3
Foreign Savings	1.6	3.9	5.1	7.6
National Savings	17	18.2	17.8	13.9
Domestic Savings	15.4	16.3	16.0	11.7

- The overall Fiscal deficit for 2007-08 was targeted at Rs. 398 billion i.e. 4.0 percent of GDP which is expected to be Rs. 683.4 billion i.e. 6.5 percent of GDP.
- Revenue balance is expected to be a deficit of Rs. 287 billion or 2.7 percent of GDP.
- Exports were targeted at US$19.0 billion, 10.2 percent over last year. However, the ten months exports (up to April' 08) have been US$15.3 billion i.e. 3.6 percent higher than exports for the corresponding period for last year.
- Imports were targeted at US$28.0 billion i.e. 2.1 percent lower than the last year. However, the imports for the ten months have been US$32.1 billion and are showing an increase of 28.3 percent, as against 8.9 percent increase last year.
- Trade deficit has increased to US$ 17.0 billion in the first ten months as against US$11.0 billion for the corresponding period, last year. However, as a percentage of GDP, it is expected at 12.3 percent in 2007-08 and is likely to be around US$20.5 billion.
- Current Account deficit for the year 2007-08 is expected to be 8.0 percent of GDP.
- Remittances of US$5.3 billion for the last ten months against US$4.5 billion for the corresponding period.
- Foreign exchange reserves stood at US$12.3 billion in April 2008 against US$13.7 billion in April 2007 and US$15.6 billion as of 30 June 2007. The reserves as of April 2008 were sufficient for 19.4 weeks of imports, down from 30.6 weeks in June 2007.
- The overall foreign investment for the ten months (July' 07 to April '08) of the current year has declined by 32.2 percent and was $3.6 billion as against $5.3 billion in the corresponding period, last year. The detailed components of new inflow of foreign investment are summarized as follows:

(in Million US$)				
	2006-2007	July - April 2006-2007	July - April 2007-2008	Change percent
Foreign Private Investment	6960.0	5278.1	3580.5	- 32.2
Foreign Direct Investment	5139.6	4180.8	3481.6	- 16.7
Portfolio Investment	1820.4	1097.3	98.9	- 91.0
Foreign Public Investment	1468.3	671.4	20.5	- 96.9
	8428.3	5949.5	3601.0	- 39.5

- Public debt declined from 55.2 percent of GDP in 2006-07 to 53.5 percent of GDP in 2007-08.
- Domestic debt is at Rs. 3,020 billion as of 31 March 2008, against Rs. 2,610 billion as of 30 June 2007.
- Domestic debt as a percentage of GDP has slightly increased from 30.0 to 30.3 percent.

	Outstanding Domestic Debt (Rupees in Billions)			
	2005	2006	2007	2008
Permanent Debt	526.2	514.9	562.5	615.7
Floating Debt	778.2	940.2	1107.7	1407.2
Unfunded Debt	854.0	859.2	940.0	997.2
Total	2158.4	2314.3	2610.2	3020.1
percent of GDP	32.8	30.0	30.0	30.3

- The external debt and foreign exchange liabilities (EDL) as of 31 March 2008 stood at US$45.9 billion which represent an increase of $5.4 billion or 13.3 percent as against $40.5 billion as of 30 June 2007. The increase comprise of $4.2 billion as exchange translation difference and $1.2 billion as net additional disbursement of EDL. The EDL represents 26.9 percent of GDP as against 52 percent as of 30 June 2000 and 28.1 percent as of 30 June 2007. The EDL as percentage of Foreign Exchange earnings as of 31 March 2008 was 127.1 percent against 121.6 percent on 30 June 2007.
- The share of interest payment as percentage of revenue and expenditure has been as follows:

	As percentage of			
	1999-2000	2005-2006	2006-2007	2007-2008
Total Revenue	41.0	18.8	22.1	21.6
Tax Revenue	51.8	25.2	32.3	29.0
Total Expenditure	29.6	14.9	17.2	17.0
Current Expenditure	33.5	19.6	23.0	23.1
GDP	5.5	2.7	3.3	3.0

Monetary Policy

The Monetary policy had undergone a gradual shift, over the last few years, from a relaxed monetary policy to a current aggressive tight monetary policy to address the inflationary pressure.

State Bank of Pakistan has thrice enhanced the discount rate and Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR). The latest package of monetary measures, were announced on 21 May 2008 and the significant features of the measures were as follows:

i) Discount rate was raised to 12 percent representing 250 basis points over the discount rate as of 1 July 2007.

ii) CRR and SLR were enhanced to 9 percent and 19 percent respectively.

iii) The minimum margin for opening of Letters of Credit for imports (excluding food and edible oil) was fixed at 35 percent.

iv) A floor of 5 percent was fixed for rate of return on PLS and Saving accounts.

v) SBP has abolished the Annual Credit plan.

The M2 supply growth was projected at 13.7 percent based on initial target of 7.2 percent GDP growth and 6.5 percent of inflation. The M2 supply growth during July-May 2008 slowed to 9 percent as compared to 14 percent during the corresponding period of financial year 2006-07. The Net Domestic Assets (NDA) of the Banking system registered an expansion of Rs. 656 billion during July-May 2008 as against the expansion of Rs. 395 billion during the corresponding period last year. The increase in NDA was mainly due to high government borrowings for budgetary support particularly due to contraction of Net Foreign Assets (NFA) due to weakness in external balance of payments position.

The borrowing requirement of the government, based on 23 May statistics, increased from Rs. 324 billion (net of privatization) to Rs. 683.4 billion representing an increase of 111 percent.

Budget 2008-2009

- The total outlay of budget 2008-09 is Rs. 2,010 billion. This size is 29.7 percent higher than the size of budget estimates 2007-08.
- The resource availability during 2008-09 has been estimated at Rs. 1,836 billion against Rs. 1,394 billion in the budget estimates of 2007-08.
- Net revenue receipts for 2008-09 have been estimated at Rs. 1,111 billion indicating an increase of 23.1 percent over the budget estimates of 2007-08.
- The provincial share in federal revenue receipts is estimated at Rs. 568 billion during 2008-09 which is 22 percent higher than the budget estimates for 2007-08.
- The capital receipts (net) for 2008-09 have been estimated at Rs. 221 billion against the budget estimates of Rs. 59 billion in 2007-2008.
- The external receipts in 2008-09 are estimated at Rs. 200 billion. This shows an increase of 16.1 percent over the budget estimates for 2007-08.
- The overall expenditure during 2008-09 has been estimated at Rs. 2,010 billion of which the current expenditure is Rs. 1,493 billion and Public Sector Development Programme (PSDP) at Rs. 550 billion. Current expenditure shows a decrease of 1.5 percent over the revised estimates of 2007-08, while PSDP will increase by 20 percent in 2008-09 over the revised estimates of 2007-08.
- The share of current expenditure in total budgetary outlay for 2008-09 is 74.3 percent as compared to 77.8 percent in revised estimates for 2007-08.
- The expenditure on General Public Services (inclusive of debt servicing transfer payments and superannuation allowance) is estimated at Rs. 930 billion which is 62.3 percent of the current expenditure.
- The size of Public Sector Development Programme for 2008-09 is Rs. 550 billion. While for Other Development Expenditure an amount of Rs. 44 billion has been allocated. The PSDP shows an increase of 20 percent over the revised estimates for 2007-08.
- The provinces have been allocated an amount of Rs. 150 billion for budget estimates 2008-09 in their PSDP.
- An amount of Rs. 27 billion has been allocated to Earthquake Reconstruction and Rehabilitation Authority (ERRA) in the PSDP 2008-09.

Key objectives for the Budget 2008-2009.

- Restore economic stability through:
  - Reduction in Fiscal and Current Account deficits.
  - Rationalization of subsidies.
  - Building Foreign exchange reserves to US$12 billion.

- Protect vulnerable groups through targeted program of cash transfers.
- Focus on Agriculture and Manufacturing sectors to enhance productivity and competitiveness.
- Restore Investors confidence.
- Remove key bottlenecks in supportive infrastructure for spurring growth.
- Increase social sector allocations to improve social indicators.
- Significant addition to low cost housing for low income groups.

Key Assumptions of macro-economic conditions for 2008-2009 are as follows:

		Revised Estimate
	2008-2009	2007-2008
GDP growth	5.5	5.8
Inflation	12 percent	11.0 percent
Gross Investment to GDP	25 percent	21.6 percent
Fiscal deficit	4.7 percent	6.5 percent
Current Account deficit	6.0 percent	8.0 percent
Foreign exchange reserves	US$ 12 billion	US$ 12.3 billion
Development Plan	Rs. 472.7 billion	Rs. 395 billion

Conclusions

The Budget 2008-2009 has been announced as part of development of a long term perspective plan with certain stated key objectives by a government which was elected through a popular mandate in February 2008.

The macro-economic strategy over the last few years which was hard earned by the nation through sacrifices made throughout the Reform process, have been threatened by large slippages in the Budget 2007-08. This has had multiplier effect on a large of proportion our population of around 70 to 80 million, below income level of less than two dollars due to higher food inflation and lesser job opportunities.

The trend of relying mostly on services and trading sector has continued during 2007-08 and the Agriculture and Manufacturing sectors had shown relatively poor performance during this period. In view of high poverty level and economic potential of the country the focus required a significant change and it is heartening to note that an effort has been made for 2008-09 to have more focus on Agriculture and Manufacturing sectors to ensure that our growth is broad based and sustainable. Further, the proposals have also been included for direct intervention measures to accelerate impact on a large poor section of the population and to ensure that the growth transforms into an inclusive growth.

The targets set by the policymakers are laudable but a concerted and cohesive effort will be required to ensure that targets which appear to be ‘stretched targets’ under the current scenario are achieved if not exceeded. It is imperative to note that any slippages this year could have very severe socio-political implications.

The SWOT Analysis of Pakistan Economy is given below:

Strengths

- 4-5 years of strong growth has led to higher medium term growth path
- Resilience against shock and extra ordinary jerks
- Rise in per capita income from US $ 503 in 2002 to US $ 1085 in 2007-08
- Robust Consumer spending
- Substantial increase in private sector credit
- Balance between fiscal deficit and growth
- Medium Term Development Framework
- Maintenance of external and domestic debt within limit
- Reach to Global Capital Markets
- Geo political situation post 9/11
- Higher foreign direct investment
- Reduction in poverty level
- Tight monetary policy to moderate inflationary pressure

Weaknesses

- Credibility of statistics
- Indications of doubtful sustainability of growth momentum
- Continued sharp increase in prices of food items
- Incompetent contribution of various sectors of economy in tax revenue
- Inefficiency in utilization of development expenditure
- High administrative costs
- Quality of governance
- Record trade and Current Account deficits
- Concentration of export in restricted items and markets
- High cost of doing business
- Lack of focus on agriculture sector
- Political instability
- Shortage of skilled workforce
- Energy crisis and water crisis
- Poor HDI indicators
- Decline in trend of foreign investment
- Increasing trade and current account deficit
- Continued subsidies to loss making public sector companies

Pakistan Economy Challenges

- Sustainability of growth momentum
- Addressing structural problems in energy, agriculture and exports sectors
- Job creation
- Poverty alleviation
- Improving social indicators and enhancement of safety nets
- Strengthening of physical infra-structure
- Converting the demographic transitions into demographic dividend
- 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

Opportunities

- Capacity constraints with India in IT sector
- Recent investment 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 high commodity prices
- Focused skills development to secure dividend from demographic advantage

Threats

- Political uncertainty and current judicial crisis
- 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
- Persistent high global oil prices
- Increasing trend of terrorist activities
- Pressure on exchange rates
- Soaring core and food inflation

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