PAKISTAN'S ECONOMY-
Trends and Indicators: Feb 2019

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Contents

All Charts and trends from Trading Economics, unless otherwise specified.

Overview

The economy is showing signs of stabilization. The current account deficit narrowed noticeably in the first half of the fiscal year, which runs through June, while the weakening of the rupee has slowed substantially in recent months. Nevertheless, S&P Global Ratings lowered its credit rating for Pakistan on February 04, 2019 to B- from B, partly due to the slow negotiations between the government and the IMF on a financial support deal. On 12 February, however, the finance minister said the two sides were “very close” to an agreement, while a Saudi state visit to Pakistan in on 17 February resulted in USD 20 billion of new investment.

The country's current account deficit narrowed down by 17% during the first seven months of this fiscal year (FY19), mainly due to lower trade deficit and rise in home remittances. According to SBP, current account posted USD 8.4 billion deficit during July-Jan of current fiscal year as compared to USD 10.12 billion recorded during the same period of last fiscal year (FY18), depicting a recovery of USD 1.7 billion.[1].

The State Bank data revealed that with USD 14.15 billion exports and USD 31.763 billion imports, the country's goods trade deficit is stable at USD 17.6 billion during July-Jan FY19. The combined deficit of goods, services and incomes sector improved slightly by 4% or USD 657 million to USD 22.824 billion in first seven months of this fiscal year against USD 23.781 billion in the corresponding period of last fiscal year.[2].

On Pakistan's request, KSA had pledged a bailout package of USD 6 billion, including USD 3 billion of placement with the SBP for one year and an additional USD 3 billion oil facility on deferred payment. Pakistan has already received $3 billion from Saudi Arabia in three installments. In addition, UAE has also pledged USD 3 billion of which USD 1 billion were released in January. The government is also negotiating with the IMF for USD 12 billion bailout program for BoP. The program is most likely to be finalized in next few months.[3].

Additionally, on the invitation of the Prime Minister of Pakistan, KSA’s Prince Muhamad Bin Salman visited Pakistan on February 17, 2019 for a two days’ visit. Investment and trade relations received high priority during the visit as demonstrated by the KSA’s announcement of investments amounting to USD 20 billion. The two sides signed a range of Agreements and MoUs in several areas which include funding for an USD 8 billion oil refinery in the city of Gwadar.[4]

Whilst the world experiences an overall economic slowdown in 2019, the intensifying cross border tensions between India and Pakistan has further escalated the economic vows of the investors. The latter half of February 2019 witnessed a series of cross border and LoC military operations and air strikes that resulted in two Indian planes being shot down by the Pakistan Air Force. Analysts fear a further slowdown in the global trade and economic activities as tensions rise between two nuclear powers. The global community has continually been stressing both the countries to exercise restraint and resort to resolution through dialogue to end this crisis.

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[1] Rizwan Bhatti| July-January current account deficit narrows down by 17 percent, February 22, 2019 (www.brecorder.com).
[2] Ibid.
[3] Ibid.
[4] Web Desk| Saudi Arabia signs $20bn in deals with Pakistan, February 18, 2019 (www.bbc.com.)

Recent Trends

Global Oil Prices

The OPEC and allies started voluntary production cuts last month, aiming to tighten the market. The global producers are currently being led by KSA and Russia to curb supply to support oil prices after they fell by 40% in late 2018. Brent crude is now hovering near USD 60 a barrel, while KSA's budget reportedly requires levels closer to USD 80.[5]

As per reports from KSA, during the month of March 2019, it plans to reduce production to near 9.8m bpd, from above 11m bpd in November 2018. Exports would also fall to near 6.9m bpd, down from 8.2m bpd three months ago. Following the publication of this production outlook, Brent crude rose USD 1.82 a barrel to USD 63.34 per barrel. Global growth, US shale production response, and Iranian sanctions are also factors that will play important roles in the months ahead. [6]

Monetary Policy

Since January last year, State Bank of Pakistan has hiked rates by 350 basis points. The last monetary policy on January 31, 2019 witnessed increase in interest rates by 25 basis points by SBP, citing rising inflationary pressures. In February 2019, core inflation rate in the country came in at 8.80%, the highest since September 2015. This is further indicative of translation of PKR depreciation against USD in the import dominated economy. PKR had already weakened by more than 20% against the US Dollar, as the government continues to implement stricter monetary policy measures. With the recent rise in policy rates by SBP, the intention is very clear to keep the inflation and PKR depreciation under check whilst attempting to control fiscal deficits and forex reserves.

The impact of stabilization measures is amply visible from non-oil imports, which saw a contraction of 4.4% during the first half of FY19 against an increase of 19% during the same period last year. A marginal increase in exports and a healthy growth in remittances also helped contain the current account deficit. The financing of CAD, nevertheless, remained challenging as the private (FDIs and private loans) and official inflows were insufficient to completely finance the deficit. Thus, a significant part of CAD was managed by using the country's own resources, which reduced the SBP's net liquid foreign exchange reserves to USD 7.2 billion by end of December 2018. However, the realization of bilateral official flows in the last few days has helped increase SBP's net liquid foreign exchange reserves to USD 8.2 billion and the country's FX reserves to USD 14.8 billion as of 25th January 2019.[7]

Global Commodity Markets

Gold[i] prices dropped through the 1,290 level and are poised to continue to slide lower. Analysts predict the prices to remain above the January 2019 lows of USD 1,227, averaging near USD 1,243. The yellow metal is expected to remain bearish in the shorter term. This is a good indication that global markets are anticipating growth in 2019 as major countries are in the process of revising their growth forecasts[8].

> [i]*Gold price trends are of particular importance as investors buy gold as protection from either an economic crisis or inflation. In June 2016, gold prices surged $100 an ounce in six hours. Investors panicked when Great Britain voted to leave the European Union. Prices rose from $1,254.96 at 4 pm on June 23, the evening of the Brexit vote, to $1,347.12 at midnight. That's because investors bought gold as a hedge against a declining euro and British pound. (Source: "Gold Surges Following Brexit Decision," The Wall Street Journal, June 2, 2016.)*

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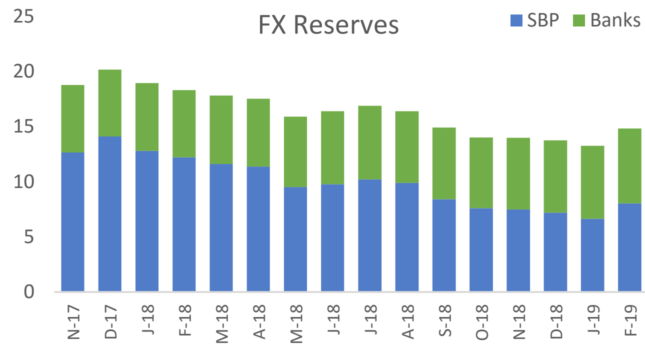
[5] REUTERS| Oil prices climb to 2019 high, February 15, 2019 (www.arabnews.com)
[6] Kevin Stecyk | Oil Update - February 2019, February 25, 2019 (www. seekingalpha.com)
[7] SBP Monetary Policy Statement, January 31, 2019
[8] David Becker| Gold Price Prediction – Prices Slide on Stronger Dollar and Negative Technicals, March 04, 2019 (www.fxempire.com)

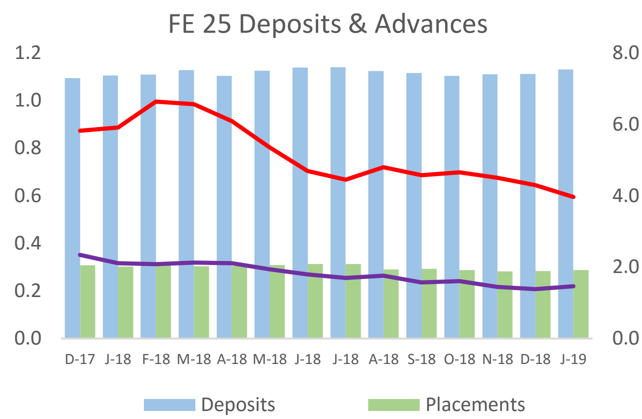
Key Indicators

Forex Reserves[9]

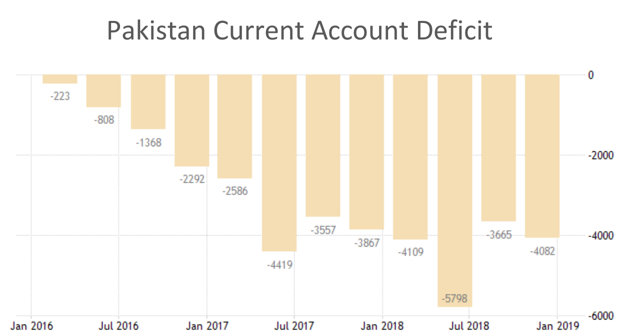
As of February 22, 2019, the forex reserves of Pakistan stood at USD 14.8 B. The country's foreign exchange reserves are on decline due to continued external debt servicing and higher current account deficit. Saudi Arabia has placed USD 3 billion with Pakistan for a period of one year, while another USD 1 billion were placed by UAE on January 24, 2019, which are supporting reserves somewhat.



The FE-25 deposits profile has been stable throughout the last twelve months except for import advances which were higher during the start of the last calendar year and have now eased off a bit to remain around USD 0.60 B from USD 1 B. Export advances on the other hand have not shown any growth despite the appreciation of USD exchange rate of more than 20% during last year. During the recent past, the exchange rates had been maintained stable by SBP through open market operations, therefore, the corrections are normally expected to require at least 6 – 12 months' time for exports to recover.

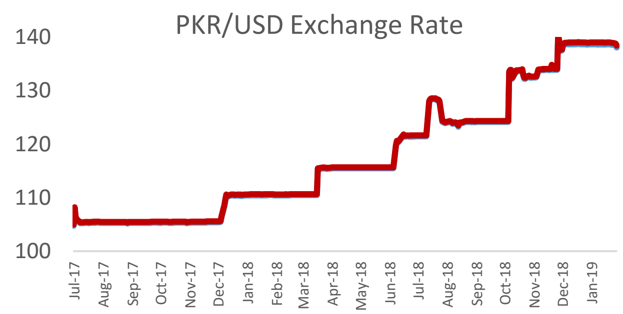


The pressure on current account deficit (CAD) of Pakistan eased off by 4.4% to USD 8.0 billion, driven by a fourth quarter decline of 10 per cent, according to data released by the State Bank of Pakistan (SBP). A marginal increase in exports and growth in remittances also helped contain the current account deficit. The financing of CAD, remained challenging area for the government due to insufficient private (FDIs and private loans) and official inflows to completely finance the deficit, therefore, the country's own resources were used to manage a significant part of CAD.[10].



[9] State Bank Of Pakistan
[10] Ibid.

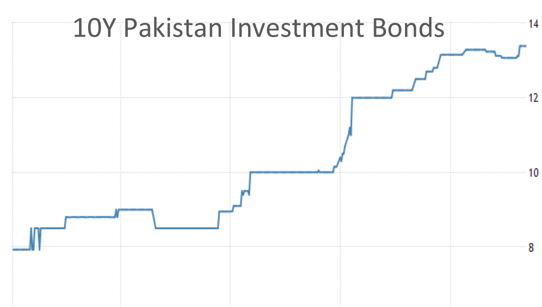
The pressure on PKR/USD exchange rate eased off a bit as the exchange rate remained below PKR 139/USD during this month. The improvement is mainly attributable to the 12.2% increase workers' remittances during the current fiscal year and the announcements of investment and placement offers by the friendly countries[11].



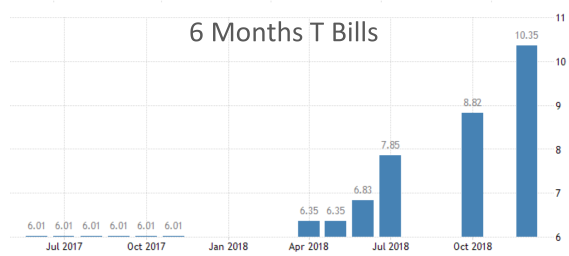
With tighter fiscal measures in place to control the economic spending and import bill, backed up by the receipt of support packages from friendly countries, the exchange rate should remain stable in the short term. However, with the government currently working towards securing more foreign direct investments in the country and redemption of Eurobonds worth USD 1 billion in April 2019, it will be interesting to see how exchange rate is managed ahead, as the market expects further depreciation to PKR 155/USD by the end of 2019[12].

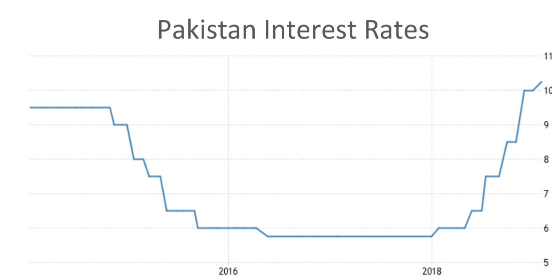
Pakistan Interest Rates

Pakistan 10Y traded at 13.38% on Tuesday March 05, 2019, however, the SBP's rate is 10.25%. The higher spread is indicative of the rising inflation expectations with S&P assigning B- rating February 2019. It is pertinent to mention here that the rising spread is indicative of the longer term inflation expectation that the investors foresee in the current market.



Tenders for Sale of 3 - Month, 6 - Month & 12 - Month GoP Market T- Bills were invited by SBP through Primary Dealers on February 27, 2019 with settlement date on February 28, 2019. Auction Target was PKR 2,000 billion. The cut off yield was set at 10.5500% whereas weighted average yield was 10.5498%. With the monetary policy announcement, a month ahead, the auction results are in line with the recently announced policy rate.



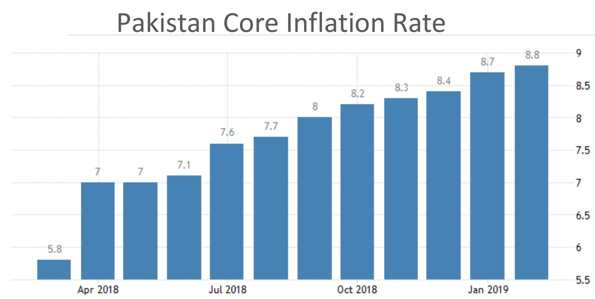


The SBP raised key interest rates by 25 basis points on January 31, 2019, citing the impact of stabilization measures implemented so far in gradual unfolding and improvement in confidence amidst reduced economic uncertainty, but the fiscal deficit is yet to show signs of consolidation despite a reduction in PSDP spending; although a gradual improvement in current account deficit is visible, it remains high. A marked shift in the pattern of government borrowing from scheduled banks to SBP entails

[11] Shoaib Ur Rehman| Oversease Pakistani workers' remittances up 12.22pc in Jul-Jan, February 11, 2019 (www.brecorder.com)
[12] *SCB Economics Unit*

inflationary concerns; and even as stabilization measures gradually work through the economy, underlying inflationary pressures persist[13]. It was the sixth rate hike during the last twelve months, bringing borrowing costs to the highest in six years, amid intensifying speculation about an IMF bailout. Since January 2018, SBP has hiked rates by 350 basis points. Also, policymakers have devalued the currency four times since December 2017. In February 2019, core inflation rate in the country jumped to 8.8%, the highest since September 2015. Policymakers forecast inflation rate for the FY19 of 6.5%-7.5%, higher than the annual target of 6% and GDP growth slightly above 4%. The current inflation outlook, the market is expecting the interest rates to remain in double digits in six months' time. Insights from one of the leading banks in Pakistan expect interest rates to be at 11.50% by end 2019[14].

Pakistan Core Inflation Rate



Core inflation is the change in costs of goods and services, but does not include those from the food and energy sectors. This measure of inflation excludes these items because their prices are much more volatile. It is most often calculated using the consumer price index (CPI).

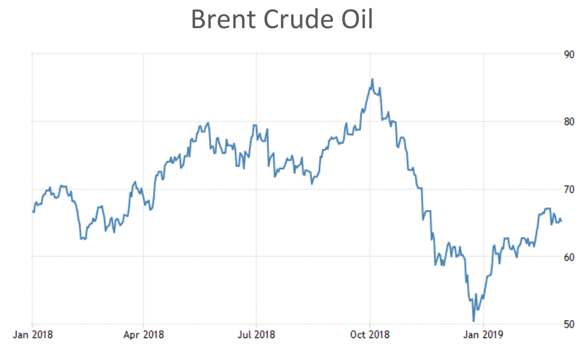
Core consumer prices in Pakistan increased 8.80% in February 2019 over the same month in the previous year. The narrowing gap between the key interest rate and the core inflation was the main reason leading to interest rate hikes recently as the policy makers strive to control the headline inflation through monetary and fiscal measures.

PSM 100 Index

The stock market has had a bearish trend since July 2017 with uncertainty around Pakistan's future economic outlook and global realignment of investment portfolios in the light of rising US interest rates. Aside material developments on the FDI front during the month, the index continued to shed points due to rising cross border tensions with India, thereby losing the 2019 momentum to close at 38,692 points. The index had started off the new year at a bull run on the first day of year 2019 and closed at 40,420 points on January 31, 2019. Foreign outflows and uncertainty over terms of USD 12 billion IMF bailout package played a catalytic role in the bearish close. The index witnessed three volatile sessions during the month, shedding nearly 3,000 points due to cross border tensions with India[15].

13 SBP Monetary Policy Statement, January 31, 2018
14 *SCB Economics Unit*
15 Web Desk| Stocks end flat following tumultuous session, February 28, 2019 (www.thenews.com.pk

Crude Oil



Brent crude oil climbed above USD 65 a barrel to its highest this year as OPEC-led supply cuts and this week's announcement of a higher-than-expected cut by KSA encouraged investors.
The international oil benchmark reached USD 65.20 late on February 15, 2019, the 63 cent gain equating to a rise of about 1%. Brent approached near three-month highs and was set for a gain of nearly 5% on the week to close at USD 65.03 on February 28, 2019.
WTI futures were also up about 1%, rising 53 cents to USD 54.94.

The OPEC and allies led by Russia started voluntary production cuts last month, aiming to tighten the market. On the other hand, sanctions on Venezuela's oil industry have important implications for the global oil market. The loss of Venezuelan barrels could counter add the upward pressure on global oil prices that OPEC production cuts hope to apply.

A more suitable indicator to benchmark against would be Platts-500 ppm which typically refers to any contract mechanism that derives its value by referencing the average of a set of Singapore-based oil price assessments published by Platts. Currently the value of trading stands at USD 81.174 and the benchmark futures are currently being traded USD 81.174 for April 2019. This is an unusual trend, as the spot and two months' futures are same. The outlook however eases off a bit to USD 80.895 for July 2019, which is evident of the effect of Venezuela's current crises and its translation into the oil market outlook. [16].

This is of particular importance for a country like Pakistan, where country sales had dropped by more than 21% primarily due to higher oil prices. For an economy that is primarily dependent on energy driven through fossil fuel, a change in global oil prices directly impacts the inflation and in turn economic spending.

Areas of Focus

Growth is seen slowing this fiscal year, as Pakistan grapples with economic imbalances and remittance growth likely moderates. Analysts forecast growth of 4.3% in FY 2019, down 0.2% from last month's estimate, and 4.2% in FY 2020.

Aside some long awaited prospective news from the international investors especially the recent visits of KSA and UAE crown prince to Pakistan and subsequent signing of multibillion dollar MoUs, the country's major area of concern continues on the neighboring front with India. The rising cross border tensions with India, followed by series of aerial military retaliations and closure of Pakistan air space have again pulled the reins of the economic development that the country aspires to achieve. On the other hand, the relations with Afghanistan remain a key to the positioning of Pakistan economic activities. The cross border tensions with India have resulted in suspension of trade route between Afghanistan and India via Pakistan, a setback that is affecting Pakistan, being the only trade route to Afghanistan after Iran.

[16] Singapore Gasoil 500 ppm (Platts) Futures Quotes, January 30, 2019 (www.cmegroup.com)

The situation is of particular importance for a country like Pakistan that carries a history of uncertain security environment that has refrained FDI entry in the country.

The reserves have maintained their levels, stock market performance has shown signs of recovery, worker's remittances have risen, import bills have eased down, global oil prices are steadier and there are promising intents by the friendly countries of exploring further investment opportunities in Pakistan. The outlook appears to be on a positive trend as the government has so far been successful in keeping the CAD in check, the next couple of months will set the tone for the future economic position in the light of recent geo political situation especially with particular reference to India.

Going forward, key areas which will impact economy and future prospects include:

- ✓ Impact of cross border tensions on the economic activities of the country
- ✓ Impact of upcoming monetary policy announcement on economic spending and exchange rates.
- ✓ Translation of impact of current trend in global oil prices and the impact on country demand.
- ✓ Impact of PKR depreciation on competitiveness of exports.
- ✓ Impact of maturity of USD 1 Billion Euro Bond on April 19, 2019 payable by Pakistan

Structural elements appear to be being put in place to positioning for growth in 2019, but impact of oil prices on balance of payments and economy overall, remains. This, along with general security environment, are the key factors critical for the overall macro-economic environment of the country.

Recommendations

The shorter term focus continues to be on calibration of treasury and borrowing strategies on the following key modalities:

- ✓ Investment in short term financial instruments to leverage the impact of rising interest rates through SBP's monetary policy.
- ✓ Strategizing the investment through secondary market processes for greater flexibility towards upcoming monetary policy changes.
- ✓ A realignment of budgeting strategies in the light of future demand and revised growth prospects of the economy.
- ✓ Financing arrangements in USD denominations should be considered to position for better chances of lower total borrowing costs in lieu of increasing interest rates (Curr. 3M US LIBOR 2.69%)
- ✓ Import arrangements through deferred pricing strategies/clauses for increasing the likelihood of gaining advantage of unstable crude prices in the short term until effectiveness of OPEC production cuts becomes clear.
- ✓ A realignment of aspired returns through revisions in long term borrowing mix and strategies.
- ✓ A re-evaluation of CAPEX estimates (in equivalent PKR) in the light of changes to the USD-PKR parity.