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A Subsidiary of National Bank of Pakistan

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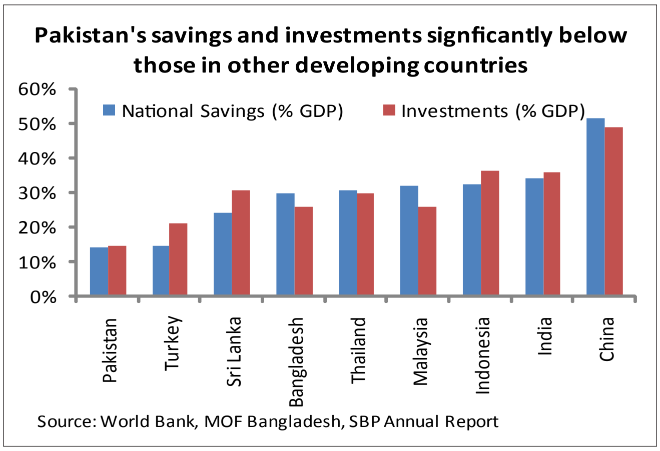
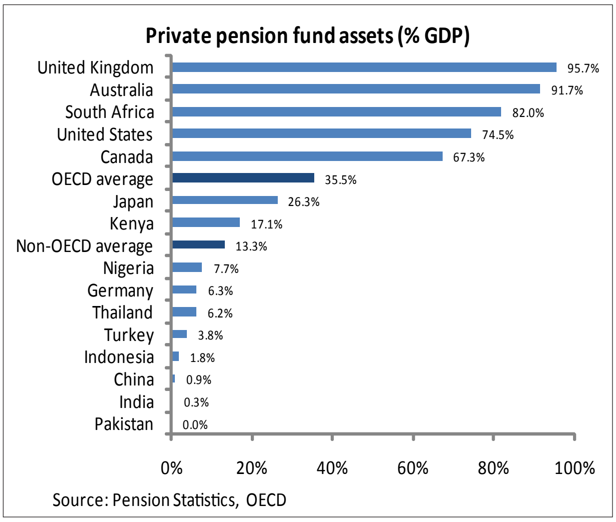
Pakistan's Low Savings Rate

Domestic Savings are an important determinant of economic growth of a country because higher savings lead to higher investment in productive capacity of the economy, which in turn results in faster GDP growth. To attain high level of growth, economies with low domestic saving rate have to rely on foreign sources. Much of the difference in economic performance between Pakistan and other developing countries over the last few years could be attributed to low rates of savings and investment in Pakistan. As depicted in the following graph, Pakistan's national savings and investment rates are much lower than those of other developing countries. More alarmingly, savings and investments are on the declining path to critically low levels in the last few years. National savings currently stand at just 13.8% of GDP, less than half the level in Bangladesh and about one-third of India. Research shows that financial deepening increases the domestic savings.



This lowers the borrowing cost which stimulates investments. Lower savings rate in low income countries such as Pakistan is attributed to the financial repression (keeping the interest rate at artificially low level). High real interest rate induces savings, which in turn increases investment leading to higher economic growth. Public savings have declined due to widening fiscal deficits and heavy losses incurred by State-owned enterprises. Private savings are low because of the following:

1. Negative inflation-adjusted return on most of the savings products particularly bank deposits.
2. Lower financial deepening due to lack of awareness about and restricted access to alternate saving/financial products such as stocks, mutual funds, bonds etc.
3. Due to cultural reasons, a large number of people keep their savings in the form of livestock, gold, and local and foreign currency in their home and lockers.
4. Low level of contractual savings in Pakistan. Existing occupational saving and pension schemes exist predominantly for some government and private sector corporate employees. The federal and provisional governments are only marginally funding pensions of their employees. These underfunded pensions liabilities of government employees are estimated in trillions of rupees, and could result in huge financial crisis in the country in the coming years. Most companies in the private sector are also not funding gratuity payments of their employees. If some of these companies go bankrupt the employees will be left with no pension benefits. According to the latest OECD global pension statistics, private pension assets in Pakistan form less than 0.1% of GDP compared to 35.5% for OECD countries and 13.3% for non-OECD countries.



At present, Pakistan's economy is facing formidable infrastructure bottlenecks and capacity constraints as investments as a percentage of GDP have dropped from 19.2% in 2008 to 14.2% in 2013. The above has capped economic growth to less than 3.0% per annum on an average during the last 5 years. Theoretically speaking, in order to raise GDP growth to 7%, the investment/GDP ratio has to be increased to 28%, assuming an Incremental Capital Output Ratio (ICOR) of 4 times. The regulations should be passed where governments start funding their employees' pension benefits immediately. Also, regulation should force private sector companies to fund gratuities/pensions of their employees. Efforts should also be made to enhance the savings rate in line with rising investment requirements of the economy via financial deepening, attracting foreign remittances, improving real interest rates, and enhancing awareness of savings products and avenues.