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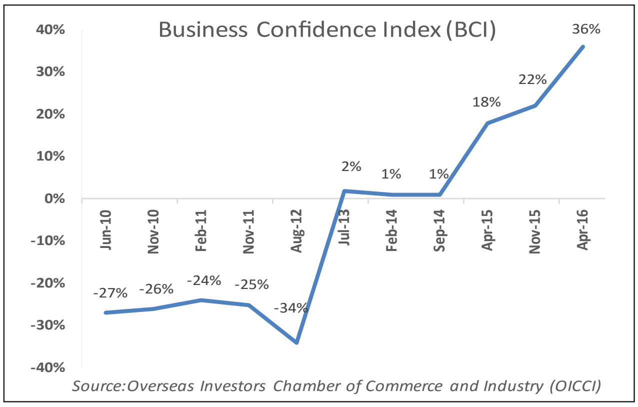
# Pakistan Economy

*Positives galore, but external account concerns warrant attention*

Prospects for Pakistan's economy look increasingly promising on the back of improving power supply position, bullish business sentiments, ameliorating law and order situation, expected progress on China Pak Economic Corridor (CPEC) related projects, continuation of benign commodity prices, and low inflation & interest rates.

Business sentiments have considerably improved as captured in the latest OICCI Business Confidence Survey which shows that economic outlook on Pakistan is at a six-year high and continuously improving. The business confidence is largely positive in all sectors, with participants expecting further improvement in security environment, improved energy supply and reduced level of load shedding, and better government policies. Majority of the respondents expect their business to expand in the next six months and 40% have plans for capital investment, mainly to increase capacity.

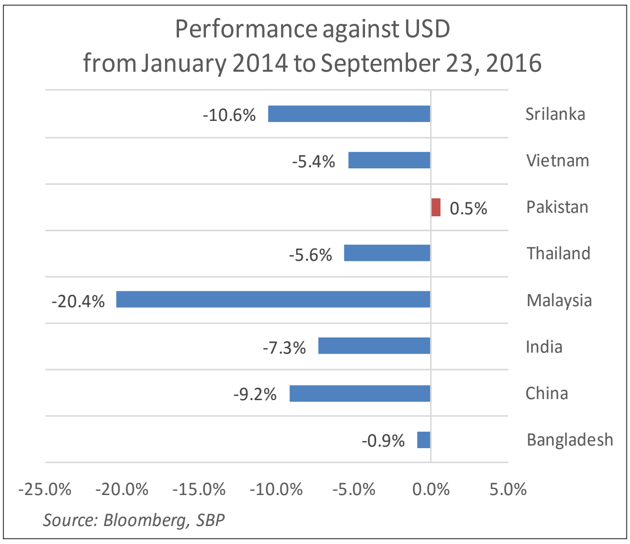


*Source:Overseas Investors Chamber of Commerce and Industry (OICCI)*

Further, energy shortages, which have crippled domestic manufacturing activity, shaving at least 2% from potential GDP growth rate, would substantially ease with the commissioning of some fast-track power generation projects in 2017 and 2018 and availability of gas to industry through imported RLNG. Though inflation is expected to mildly pick up, interest rates should still hover in mid-single digits, spurring private sector credit growth and investment. Lastly, further progress on infrastructure and energy projects under CPEC would also buttress economic growth in the coming years. For the current fiscal year, we expect GDP growth to hit 5% mark driven by robust consumption and rising investment demand.

However, recent data on external account flags latent risks, warranting decisive policy measures. Specifically, current account deficit is sharply up (92%YoY) in 2 month Fy17 to USD 1.3bn mainly due to tapering off remittances growth as a result of slowdown in Gulf economies and select developed markets; and a rising trade deficit on account of increase in imports, on strong consumption/investment demand and slump in exports.

Lackluster global GDP growth is partly blamed for dismal exports performance; structural issues such as an overvalued exchange rate, low value addition, poor productivity, and higher input costs especially energy cost are key culprits. In the above backdrop, even a moderate increase in oil prices to USD60/bbl would put sizeable pressure on external current account.



*Source: Bloomberg, SBP*

Despite a worsening current account balance, overall balance of payment position remains in surplus so far, as reflected in healthy foreign exchange reserves accumulation. However, a break-up of financial account reveals that government has resorted to heavy external borrowing to fund the current account deficit whereas FDI flows, down 53%YoY, continue to remain depressing. That said, given improving risk profile of the country and easy global liquidity conditions, the government can comfortably raise external loans to finance Pakistan's burgeoning current account deficit over the next 12 months.

However, for the long-term sustainability of the external account and to consolidate the recent growth momentum, higher export earnings and healthy FDI flows are inevitable. The above would necessitate political stability, a positive macroeconomic policy direction, ascent on high value addition, and a big push on critical pro-growth structural reforms. Otherwise, the recent economic upturn may eventually fizzle out due to intensifying macroeconomic imbalances.