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Pakistan Research

Economy | Market

KSE100 Closing 9687.41 (-183.75 points)

Pakistan's economic problems to continue

Policy rate kept unchanged at 12.5%

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The State Bank of Pakistan (SBP) kept policy rate unchanged @12.5% for another two months. Even though policy rate announcements manifest rampant inflation indicators, the document also contained little indignation against governmental ability on few counts, for instance:

- It moaned on lack of 'necessary infrastructure' and especially 'macro economic stability' that could steer economic initiatives;
- It highlighted 'power' failures which is now affecting very foundations of economic engine;
- Most importantly, it echoed the words of financial advisor related to chronic fiscal limitations

KSE Cap (bn)	2731.7
KSE Cap in USD (bn)	32.27
KSE Volume (mn)	73.67

Concerns on macro economic stability

We see lack of economic depth is now hurting country's macro economic outlook with apex regulator showing concern on its own foreign exchange reserves (reported estimation of USD 11.5 bn on average YTD). Firstly, no meaningful FDI's are forthcoming which could boost ailing or potentially viable assets due to falling capital flows. Secondly, if you take a glimpse of last seven-year FDI flows then you will find that they were largely skewed towards telecom/communication but somehow it was not good enough for ailing energy sector (ranging at 10% of total FDI flows in the last 4 – 5 years). This off-course is now impacting daily lives and real economy. If real economy such as small medium enterprises continues to be weakened then it would be detrimental for future economic stability in light of exacerbated inflation.

Budgetary borrowing highlights chronic fiscal limitations

The present challenge of budgetary constraints given inefficient administrative base has resulted in massive budgetary borrowing (Rs 1.3 trillion as of May 14 as against June-end target of Rs 1.13 trillion). SBP rightly highlights 'unsustainable equation of revenues and expenditures'. Again the spotlight is much maligned taxation revenue base (tax-GDP ratio shockingly low at below 10%). With weakened economic base it is easy to imagine that government again would miss revised IMF set budget deficit target viz. 5.1% of GDP (revised from 4.7%) which shows signs of economy instability.

Inflation continues to be a soaring feet

Inflation is now caused by factors that range from heavy printing of notes for budgetary support and also economic inefficiencies. As aptly mentioned in the report that limitation on 'future productive capacity of the economy' to affect economic competitiveness (widening gap between aggregate demand & aggregate supply). This again is the core cause behind rampant inflation. As for non-food group, which is also causing headache and CPI to remain at 12% - 12.25% for FY10. CPI inflation is expected to increase further if VAT is implemented in the upcoming finance bill for FY'11. Revenue collection target is not likely to achieve plus the government borrowings for budgetary support shall keep on increasing hence Pakistan malaise to continue unabated given host of factors.

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