Prime Plus

July-September 2022

A quarterly report on Pakistan's economy with a special section on economic implications of floods

Policy Research Institute Of Market Economy

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Prime Plus

Prime Plus is a quarterly report that aims at analyzing policies by the government or the regulators, and then discussing possible consequences or developments on the economy. The report would hence include federal level economic policies on a range of policies such as taxation, trade, and investment which influence business climate. Businesses can analyze and modify their planning scenarios in the light of government policies, reduce risk and improve their plans for investment and sales targets after reviewing this report.

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What this Report is about?

In the first section of the report, the recent floods in Pakistan are critically analyzed and the estimated economic and humanitarian damages to the economy of Pakistan caused by these floods have been discussed. The 2022 floods have been labelled as the greatest natural disaster in the history of the country for which the Government of Pakistan has estimated the total loss at $ 40 billion.

In Section 2 we present Economic data on major macro indicators including Inflation, Current Account, Public Debt, Foreign Direct Investment, Government borrowing, and a general trend of how the economy is behaving, where we reach the conclusion that Pakistan's economy is currently facing insurmountable challenges and not performing at its potential level.

Section 3 summarizes the economic outlook of the country. Pakistan like other countries around the globe is experiencing severe inflationary pressures and a slowdown in economic activity due to supply chain disruptions emanating from the pandemic, the continuity of the war Russia-Ukraine war, a decline in foreign exchange reserves and a fall in the exchange rate. Pakistan is currently facing food insecurity due to the Russia-Ukraine war as Ukraine as both countries are exporters of wheat. Moreover, the OPEC+ countries have indicated a cut in oil production, which will increase petroleum prices in the coming months. Resultantly, Pakistan might experience increase in current account deficit than the budgeted amount. The economic activity, especially the output of the manufacturing sector, has experienced a declining trend due to currency devaluation and energy crises at home. Therefore, proactive measures at the fiscal and monetary policy fronts are inevitable to mitigate the slowdown. Furthermore, reforms are needed in the energy sector to ensure sustainability and promote economic activity in the country.

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Section 1: Report on Flood situation in Pakistan

Floods in Pakistan 2022

The 2010 monsoon floods in Pakistan were labelled as “massive and destructive” by the National Disaster Management Authority (NDMA). 12 years later, 2022 floods have been recorded as even massive and catastrophic.

Pakistan has been hit by another series of floods that is recorded as the worst environmental catastrophe in the country’s history. The disaster has caused 1700 causalities, left 12,867 people injured, destroyed 806,387 houses completely and damaged 1,308,159 houses partially. Approximately 15% of Pakistan’s population has been affected in 84 districts (33 million) out of which 10 million children are in immediate need of support and 37% of the total population is hit by poverty post floods[1]. Besides that, 1.16 million livestock is reported to have been killed[2].

THREE EXOGENOUS SHOCKS IN THREE YEARS:

In the past few years, Pakistan has been on the periphery of an economic breakdown. From pandemic to the Russia-Ukraine War, Pakistan was hardly coping with the aftershocks of the global supply chain disruptions which further led to worsening fiscal and current account

[1] https://www.business-standard.com/article/international/economic-loss-due-to-pakistan-floods-rises-from-10-bn-to-12-5-bn-122090500090_1.html

[2] NDMA Floods (2022) SITREP - 2022 (Daily SITREP No 117 Dated 8th October 2022)

deficits. Keeping in view the country's dwindling foreign exchange reserves and its struggle to remain under the IMF program, Pakistan had to take strict and bold measures in form of fiscal tightening. Just after that, the economy was hit by the third exogenous shock that has led the government to revisit the proposed budget and scale down the GDP growth rate from 5% to only 2% for the current fiscal year. The implementation of the contractionary Federal Budget 23' and the planned fiscal consolidation has now become a challenge for the government on the accounts of floods.

THE IMMEDIATE ECONOMIC COST:

The current floods have recorded substantial economics loss. From destroyed cropped land and damaged property to people losing their lives, the scale of 2022 disaster is perceived much greater than that of the 2010 floods.

Table 1 below explains the economic loss following the recent floods in Pakistan.

Table 1: Humanitarian damage caused by Floods

	2010	**2022**
Deaths	1,980	1700
Injuries	2,946	12,867
Population affected	20,000,000	33,046,329
Calamity Hit Districts	78	84

NDMA as of 9th October 2022 and Pakistan Flood Impact Assessment 2010

Table 2: Loss of Infrastructure, Agriculture and Livestock				
	2010	**2022**	**Proportion in total 2022**	**Growth from 2010**
Roads (km)	23,831	13,115	5%	45%▼
Bridges	45	436		869%▲
Education Centers	10,192	25,993	8.5%	155%▲
Health facilities	485	2000	13.7%	312%▲
Houses Destroyed	728,192	806,387	2.5%	10%▲
Houses Damaged	392,786	1,308,159	4.1%	233%▲
Livestock Damage	1,200,000	1,163,552	0.8%	3%▼
Cropped land affected (acres)	4.4 million	5.2 million	9%	18%▲
Estimated total economic loss (USD)	10 billion	40 billion		
Estimated total economic loss (Rs.)	850 billion	9.2 trillion		
Figures are taken from NDMA Floods 2022 updates, NDMA Flood Assessment Report 2010, and news articles				

Displacement, fatalities, and injuries:

Out of an accumulated 33 million affected people, the latest death toll has risen to 1700 people including 340 women and 632 children. The injured number of people include 3,452 women and 4,006 children whereas, almost 50% of all the deaths and 66% of all the injuries were recorded in Sindh as per the recent figures.

Loss of Infrastructure:

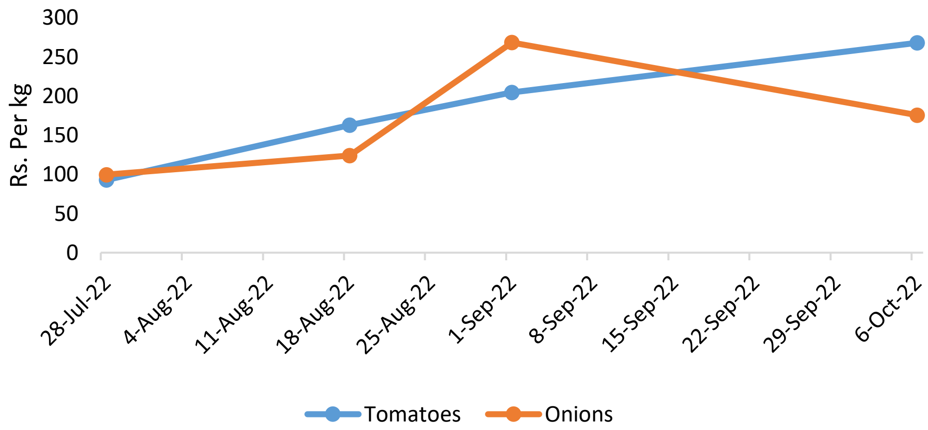
As per NDMA, a total of 2.1 million houses have been damaged. Resultantly, 7.9 million people have been displaced out of which 5,98,000 are living in relief camps. More than 13,000 km of road has been damaged whereas, 25,000+ schools and 2000+ hospitals have been reported to be affected by the floods. Moreover, 64% of the total road destruction and 38% of the total bridge damages were recorded in Sindh – the most affected province. This destruction, specifically of the transport infrastructure inhibited the ability of people to move away from the inundated areas or to access the markets for initial aid.

Agriculture Damage:

Pakistan's agriculture sector contributes 46.4% to its GDP[3] and employs about 38% of its labor force. Floods in Pakistan have significantly impacted 5.2 million acres of cropped land with a special impact on essential consumption and export items including rice, wheat, tomatoes, onions, and other vegetables. This damage has further imposed a burden on country's dwindling foreign exchange reserves as the Government of Pakistan allowed the import of vegetable from Iran to meet domestic demand, causing the import bill of vegetables to increase from USD 135 million (Jul-Aug 22') to USD 139 million (Jul-Aug 23'). Furthermore, the domestic shortage led to a price hike and different regions in Pakistan recorded an increase in prices of essential food items by more than double.

Figure 1: Impact of floods on the average prices of vegetables (Islamabad)

Source: SPI



[3] Includes forward and backward linkages: estimates carried out by Bank of Punjab.

Following a 36% damage to the cotton crop, the cotton production in Pakistan is now estimated at 6.5 million bales in the current fiscal year as compared to a target of 11 million bales. Damages to the cotton production this year will further add a strain to country's limited foreign exchange reserves as about 100 small textile mills have already suspended operations while the country is also expected to spend additional USD 3 billion on the import of cotton[4]. As per the Bank of Punjab's estimates, this loss to the agriculture sector will have a 1.8x multiplier to the GDP of Pakistan such that a $2 billion loss in agriculture will translate into $3.6 billion loss to the GDP[5]. The all-time high agriculture growth in the past 17 years from 3.5% (FY 21') to 4.4% (FY 22'), which was primarily supported by favorable weather conditions, is now expected to decrease in the current FY 23'[6].

It is pertinent to mention here that although the numbers indicate a horrendous situation in Pakistan but at the same time it is important to visualize the damage as a proportion to the total resources owned by the country. For instance, Pakistan lost 5% of the total road network to floods, 8.5% of the total education centers and 13.7% of the total health facilities were affected by the floods. On the other hand, Pakistan lost less the 1% of its livestock.

Table 3: Proxy for Price Effect to measure infrastructure damage

	2010	2022
Cement prices (Rs.)	315/bag	1000/bag
Steel prices (Rs.)	69,000/ton	230,000/ton

To assess the extent of losses, it is imperative to incorporate the price effect in the total losses while making a comparison with the floods in 2010. The actual evaluation of infrastructure damage not only depends upon the number, but also on the prices of inputs. This can be illustrated by the fact that cement price in 2010 was Rs. 315 per bag, which is now in 2022 is Rs. 1000 per bag. Similarly, steel price in 2010 was Rs. 69,000 per ton and currently in 2022 is Rs. 230,000 per ton. Therefore, partially the exaggeration of 2022 infrastructure damage

[4] https://www.thenews.com.pk/print/996902-bedsheets-towels-factories-shutting-down-in-pakistan

[5] https://www.brecorder.com/news/40197591

[6] Pakistan Development Update-October 2022

due to floods i.e. loss of roads, bridges, houses, schools and hospitals, is caused by significant increase in prices and inflation that currently stands at 24% in September 2022.

POST FLOOD LOSS:

The damage caused by recent floods is not just limited to loss of infrastructure and crops, instead, the situation even aggravated as the stagnant water led to the emergence of another humanitarian crisis caused by the prevalence of water borne diseases among the flood victims. People who survived the floods could not survive diarrhea, malaria, dengue, and other skin diseases post floods. Apart from the 635 causalities, UNICEF predicts more children to die in the upcoming weeks[7].

WHO has expressed its concerns regarding the impact of water borne diseases which have been threatening the lives of the flood victims. As per the Sindh health department, more than 594,000 patients were treated for skin related diseases, diarrhea, malaria, and dengue virus[8]. According to the UNICEF, out of the 10 million affected children, 520,000 children are currently facing Severe Acute Malnutrition (SAM) and medical complications while 4 million lack access to basic first aid health services. Also, 5.5 million people do not have access to safe drinking water[9]. As per the UN Population Fund, 650,000 pregnant women in the flood affected areas are in dire need of prenatal maternal health facilities[10].

INTERNATIONAL AID INFLOW:

The Government of Pakistan's initial estimates of total losses from recent floods were $10 billion that spiraled to $40 billion (10.4% of the GDP) as the clearer picture of the damage was revealed. For collection of donations, the SBP announced the establishment of Prime Minister's Flood Relief Fund 2022 as an emergency call. In addition to that, the provincial governments also managed to create relief funds for the affected people while numerous trusted NGOs came forward and launched charity campaigns to help the flood victims.

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[7] https://www.unicef.org/press-releases/unicef-warns-more-children-pakistan-will-die-without-immediate-international-support

[8] https://www.business-standard.com/article/international/who-concerned-over-soaring-water-borne-diseases-due-to-floods-in-pakistan-122091800696_1.html

[9] https://www.unicef.org/emergencies/devastating-floods-pakistan-2022

[10] https://www.voanews.com/a/pregnant-women-vulnerable-in-pakistan-s-flood-affected-areas-/6736000.html#:~:text=The%20U.N.,report%20narrated%20by%20Aisha%20Khalid.

Where internal relief efforts were continuing, many countries including Austria, UK, and Turkiye helped on ground through raising donations for Pakistani flood victims. The table below shows the breakdown of international assistance received by the Government of Pakistan post floods 2022.

Table 4: International Aid Inflow Post Floods 2022 in USD

	Commitment	**Disbursed**
UN	816 million	90.8 million
WB	2 billion	
IMF Tranche	1.1 billion	
	Humanitarian Assistance	**Type**
US	50.1 million	
EU	29 million	
EU	350,000	Immediate Assistance
WHO	10 million	Emergency Fund to Muslim Majority Country
WHO	110 million	
WB	350 million	
Japan	7 million	
ADB	20 million	
UK	46.6 million	
Canada	28 million	Humanitarian coalition
Ismaili Community	10 million	Relief efforts
Pakistan's disbursement	264 million	Cash handouts

The accumulated humanitarian aid by international agencies so far stands at approximately **$603 million** i.e. merely 1.5% of the government's estimation of the total damage caused by floods as compared with aid received during 2010 floods i.e. **$1,870.2 million** (almost 19% of the estimated loss)[11]. Despite the positive inflow of the international assistance, experts believe that the aid remains insufficient. During the 2010 floods, just after a few weeks, 60 nations committed international assistance in comparison with a dozen countries during 2022 catastrophe, while USA pledged $600 million as compared with $50 million in 2022[12].

LONG TERM ECONOMIC COST:

The consequences of 2022 floods are far reaching as the floods have ravaged the road and communication network, agriculture, infrastructure and have left an impact on the sources of income and livelihood of the people. More than half a million people are already living in relief camps and more internal displacement is expected. This will result in possible large-scale migration towards Pakistan's urban centers, ultimately leading to congestion and increased crime rates. Moreover, the 1700 reported casualties do not just account for humanitarian loss, but also the loss of income for those households who have lost their bread winners.

Climate Change is a Serious Threat:

Pakistan is ranked as the 8th most vulnerable country to climate change as per the Global Climate Risk Index. Though the country is responsible for less than 1% of the global emissions as compared with US (21.5%) and China (16.4%), the temperatures in Pakistan have increased by more than the global average[13]. The increased temperatures due to emissions and fossil fuel burning is highly correlated with the incidence of flooding. As per the World Bank, among all the natural disasters occurred in the past 3 decades, floods have affected the highest number of people in Pakistan and has the highest average annual occurrence rate i.e. almost 40%[14]. Moreover, the European Commission's Inform Risk Index 2023 ranks Pakistan at number 24 among all the countries prone to risk (24/194 countries)

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[11] https://www.adb.org/sites/default/files/linked-documents/44372-01-pak-oth-02.pdf

[12] https://www.justsecurity.org/83004/long-term-international-climate-assistance-to-pakistan-is-a-hard-sell-but-necessary-heres-why/

[13] https://www.paradigmshift.com.pk/2022-floods-pakistan/

[14] WB's Climate Change Knowledge Portal

with a score of 7.4 out of 10 specifically in natural disasters[15].

Keeping in view these rankings, the climate change disasters are no more a surprise in Pakistan, rather have become even more predictive which must be accounted for in the government's policy and fiscal budget. The current monsoon rain in Pakistan was six times of its 30 years average annual rainfall and was 780% above the average levels[16]. This significant change in the monsoon pattern and the overall climate in the country acts as a destabilizer which has long-run implications such as climate induced migration, climate induced crop destruction ultimately causing food insecurity, increased levels of poverty, rising health risks, reduced income levels and ultimately slower growth. Therefore, there is a need for immediate policy action.

POST FLOOD REHABILITATION:

Post 2010 floods, the Government of Pakistan took several steps for the revival and rehabilitation through aid and grants. However, none of them were sustainable. Studies show that the Government of Pakistan spends more resources on ex-post steps such as relief, rescue and supply of food and shelter as compared to ex-ante measures which include preventive measures from such disasters. Despite the relief efforts made by the country, many flood sufferers have to adopt coping strategies other than relying on the relief provided by the government. To overcome the crisis, 38% of the households relied on borrowing while 29% had to dispose off their assets as compared with 30% of the victims who relied on government's cash transfers during previous floods in Pakistan[17].

Several months after the 2022 floods, the government is still trying to supply the basic relief items to the flood victims while the international community is also restricting most of the aid to immediate rescue and recovery efforts. Though these efforts are much appreciated and play a pivotal role during natural calamities, most of the relief being provided by the donor agencies has not even reached to the most affected areas. According to Faisal Edhi, Head of Edhi Foundation, about 90% of the flood hit areas during the current floods, did not receive

[15] https://drmkc.jrc.ec.europa.eu/inform-index

[16] https://www.bloomberg.com/news/articles/2022-08-27/highest-rainfall-in-30-years-threatens-pakistan-s-recovery#xj4y7vzkg

[17] https://pide.org.pk/research/socio-economic-losses-of-flood-and-households-coping-strategies-evidence-from-flood-prone-district-of-pakistan/

any kind of assistance[18]. Even though Pakistan is still receiving humanitarian assistance regardless of its magnitude, there is a need to channelize and prioritize the already available assistance rather waiting for billions of dollar inflow.

Following are the ***Immediate Policy Actions*** to be taken care of:

1. Digital Flood Dashboard:

During mid of September 2022, the Government of Pakistan launched a Digital Flood Dashboard that would be responsible for frequently updating the general audience, international institutions, development partners and other donor agencies over flood relief assistance and its distribution. The initiative is well appreciated as it ensures overall transparency through maintaining complete inflow and outflow information. However, the dashboard has not been implemented yet and there is no source of reliable information on the inflow of assistance and the channel of disbursement. As the world is still pledging support and the assistance is flowing in, the **government needs to digitize the system to remain focused while setting rehabilitation priorities.**

2. Reprioritize Federal Budget 2023:

Since Pakistan was halfway through negotiations with the IMF, the government announced a contractionary budget for the current FY 23'. However, implementation of policy tightening became a challenge as the country was hit by massive floods. The government therefore decided to slash the PSDP by Rs. 100 to Rs. 150 billion from the total development budget of Rs 800 billion in the current fiscal year and divert the resources towards rehabilitation.
At the end of August this year, the IMF approved a $1.17 billion bailout as Pakistan's foreign exchange reserves continued to fall. However, unlike the 2010 floods, when IMF announced $450 million as relief, it did not hint on the provision of any emergency funding during floods this year. As the estimated damage caused by floods lie beyond the country's internal resources, **Pakistan needs to have a dialogue with IMF to consider providing a Budget adjustor as it did during the COVID 19 pandemic** which will ultimately provide space to the government to respond to emergencies and reconstruction activities.

[18] https://www.justsecurity.org/83004/long-term-international-climate-assistance-to-pakistan-is-a-hard-sell-but-necessary-heres-why/

3. Debt Restructuring:

The recent numbers indicate a $40 billion loss to the economy caused by the floods this year. According to the figures on domestic and foreign debt, Pakistan's total debt stands at $275 billion as of FY22'[19]. During the pandemic, Pakistan became the largest beneficiary of the G-20 Debt Service Suspension Initiative (DSSI) which either suspended or rescheduled Pakistan's $3.7 billion debt since 2020. The DSSI however covers the period of May 2020 to December 2021. **The Government of Pakistan needs to negotiate and try extending this program beyond 2021 to provide sufficient fiscal space considering huge debt repayments.**

4. Immediate Flood Water Drainage:

The topography of the Sindh province is extremely flat with mild slopes. It has been months since the flood has hit Pakistan and the stagnant water from monsoon rains which had to flow into the rivers is not receding due to flood protection bunds. The flood water has further triggered water-borne diseases. The only ways of water drainage were evaporation and deep drainage which have not worked due to decreasing temperatures. **The government immediately needs to identify how and where to drain out the water to avoid further damages.**

5. Ensuring Aid reaches all:

As discussed above, most of the flood affected areas did not receive immediate assistance months after the incidence of floods, while many victims are still waiting for support. Given the scale of destruction, many parts of flood hit Pakistan remained unapproachable and thus the people remained deprived of medicines, food, and tents. As per sources, the authorities were unable to rescue many residents in the remote areas till mid of September 2022[20]. Although different NGOs have been actively participating in aid delivery, **the role of both federal and provincial government in ensuring the provision of assistance to each affected area must be the immediate response towards an emergency.**

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[19] https://www.sbp.org.pk/reports/stat_reviews/Bulletin/2022/Mar/DomesticExternalDebt.pdf

[20] https://www.dw.com/en/pakistan-is-international-aid-reaching-flood-victims/a-63061020

Rethinking a Future Development Model:

Pakistan is still in the damage control mode and has not entered the recovery phase yet. Although being prepared for the shorter-term post emergency is the current priority of the government, long term preventive measures must be the next action plan.

6. Construction of Reservoirs:

Following the updates from the NDMA, all the dams in Pakistan were running above their maximum capacity to hold water. Also, the storage capacity of Pakistan's mega dams – Tarbela and Mangla has been falling due to silting and sedimentation. A lot of focus has been given to building mega dams which the country could not construct in the past many years due to lack of financing and supportive policies. Considering the frequency and magnitude of rainfall in recent years, **the government should try diverting resources towards construction of small storage dams that will help conserve rainwater at a fractional cost of larger dams.**

7. Supportive Infrastructure:

Due to poor planning and lack of policy implementation, many concrete structures built on the riverbanks were destroyed because of recent floods. Resultantly, many locals lost their assets and tourists lost their expensive vehicles to the floods. Despite having a River Protection Act, provincial governments lack implementation and credible punishment towards violation of the Act. **The government must come up with a strict plan that stops any commercial or residential construction along the rivers to avoid such destruction in the future.**

8. Crop Insurance Mechanism:

Crop like cotton is extremely prone to damage caused by the floods and is also a key contributor towards exports. Considering the expected frequency of floods, farmer's motivation to grow cotton in Pakistan might reduce soon. **There is need to have innovative disaster risk reduction methods in Pakistan like crop insurance which can act as an effective tool for mitigating damages caused by natural shocks.** The farmers located in the most vulnerable and risk prone areas can be offered insurance for their crops that will eventually help reduce loss of income to the farm households.

9. Preparing for future climate shocks through more investment in climate change:

Rising temperatures and melting of the glaciers will increase the frequency of flood incidents in the future. There is a need for more investments in disaster management. The failure of the government to immediately cope with 2022 floods calls for sustainable rural and urban development projects that are more resilient and inclusive of climate changes in Pakistan. According to a study, Pakistan's climate adaption needs range between $7 billion to $14 billion for which the country relies on external sources[21]. **Keeping in view the limited resources of developing countries like Pakistan, a concrete and evidence-based climate change action plan is needed that must be incorporated into the macro-fiscal policy of the country.**

CONCLUSION:

Due to lack of planning and government's supportive policies, the scale of destruction caused by the recent floods exacerbated outside the country's capacity and resources. Apart from short-term flood relief, Pakistan needs long-term assistance to help it become more resilient to climate change and better cope with such catastrophic incidents. The Government of Pakistan and the international community must not repeat the mistakes from 2010 floods while the aid agencies try not to restrict their financial and technical assistance to the short term. There is a dire need to take a long view on climate assistance through investments in technological and scientific support, sustainable climate adaption policies, vocational training and skill development programs, capacity building and creating awareness on climate change. To sum it up, climate change is a global phenomenon and any contributions towards eliminating this problem must not be considered aid rather a long-term investment.

__________End of Section 1__________

[21] https://pide.org.pk/research/pakistans-options-for-climate-finance/

Section 2: MACROECONOMIC ANALYSIS

Economic Analysis

Countries around the globe are struggling to manage their finances domestically and externally on the back of supply chain disruptions caused by the pandemic, continuity of the Russia-Ukraine war, and the surge in commodity and petroleum prices. Although petroleum prices have fallen in the past few months, they will again start to gain momentum as oil producing and exporting countries have indicated cutting output as a result of the global recessionary trend. Resultantly, developing, and underdeveloped economies will continue to face difficulty in managing the affairs of the state.

In Pakistan, the first quarter of FY2023 (July-September) remained challenging due to change in the government and the weak macroeconomic fundamentals of the country comprising inflation, high current account deficit, low foreign exchange reserves, declining output of the manufacturing sector and steep currency devaluation. The economic prospects further deteriorated by the havoc caused by the floods where the country suffered overwhelming losses and the government is in the process to estimate the extent of the losses. The government succeeded to resume the stalled IMF program after meeting the prior conditions and received a $1.17 billion tranche. Notwithstanding, the foreign exchange reserves continued to dwindle, and the local currency remained highly volatile reaching an all-time low of Rs. 240 against $1 twice in the quarter.

Inflation

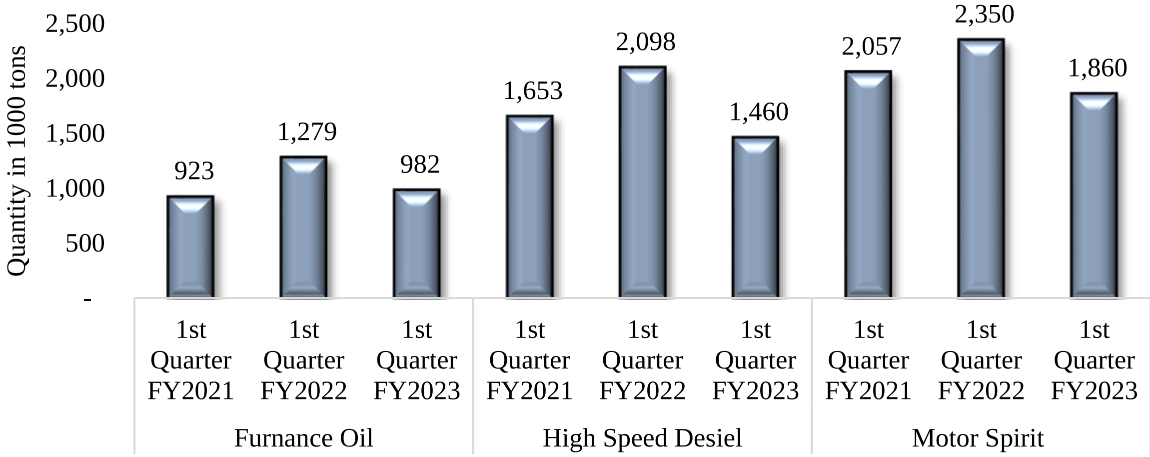
Inflation remains one of the biggest challenges faced by the country where people are struggling to maintain their standard of living and lower income groups face food insecurity. There has been a decrease in the rate of inflation, but it remains high. In the first quarter of FY2023, the average National CPI stood at 25.1 percent compared to 8.58 percent last year, SPI stood at 30 percent compared to 21.3 percent last year and WPI stood at 39.5 percent compared to 32 percent last year. On a MoM basis, CPI inflation stood at 4.3 percent in July, 2.4 percent in August and 1.2 percent in September compared to 0.8 percent in March, 1.6 percent in April and 0.4 percent in April. The unabated supply chain disruptions and increase in global commodity and petroleum prices from the pandemic and Russia-Ukraine war are still prevalent thus contributing to domestic inflation. Political uncertainty and currency devaluation are also factors contributing to inflation. Moreover, the recent floods have exacerbated the crises and pushed more people into food insecurity.

Fiscal Sector

The government is likely to face fiscal constraints on the back of the devastation caused by the floods. In the first quarter of FY 2023, the government has disbursed Rs. 57 billion as cash transfers and benefits as a flood relief assistance through the Benazir Income Support Program. On the expenditure side, the government decided to cut the development spending (PSDP) by Rs. 98 billion from the budgeted amount of Rs. 146 billion. The Ministry of Finance disbursed only Rs. 48 billion against the approved amount of Rs. 120.6 billion to divert funds towards floods' relief and rehabilitation activities, which should be appreciated.

On the revenue side, FBR surpassed the revenue target by Rs. 22 billion and collected Rs. 1.63 trillion against the target of Rs. 1.61 trillion. The government has budgeted a collection of Rs. 855 billion from the petroleum development levy (PDL) but high prices have declined consumption and may contribute to lower than expected revenues. The sale of furnace oil (FO) declined by 23 percent from 1.27 million tons in first quarter of FY 2022 to 0.9 million tons in first quarter of FY 2023. The sale of high speed diesel (HSD) declined by 30 percent from 2 million tons in first quarter of FY 2022 to 1.46 million tons in first quarter of FY 2023. The sale of motor spirit (MS) declined by 21 percent from 2.3 million tons in first quarter of FY 2022 to 1.86 million tons in first quarter of FY 2023. Therefore, the government may find it difficult to achieve the desired target.

Figure 2: Quarterly Trend in Petroleum sales



Source: Business Recorder

The government borrowed Rs. 227 billion in the first two months of the first quarter of FY 2023 as compared to the retirement of Rs. 40 billion in the corresponding period last year. The total domestic borrowing of the government stood at Rs. 20 trillion. In July and August, the government retired Rs. 689 billion of loans to the State Bank of Pakistan (SBP), and the total borrowing from SBP cloaked at Rs. 4.49 trillion. However, the government borrowed Rs. 916 billion by selling securities to the banks and total borrowing by selling securities to banks stood at Rs. 15.5 trillion.

The government borrowing domestically and internationally for budgetary and external financial obligations contributed to the build-up of public debt. In the first two months of FY 2023, the public debt (central government debt) increased by Rs. 1.7 trillion and stood at Rs. 49.5 trillion. On the domestic side, the domestic debt increased by Rs. 1.1 trillion in the first two months of the first quarter of FY 2023 and stood at Rs. 32.1 trillion. The external debt increased by Rs. 700 billion and reached Rs. 17.4 trillion in the period under review.

Foreign Investment

Foreign investment in Pakistan slowed down in the first quarter of FY 2023. In July and August, the net FDI to Pakistan stood at $170 million as compared to $230 million in the corresponding period last year and $583 million in the 4th quarter of FY 2022. The inflow of FDI was $114 million and $134 million in July and August while the outflow was $55.3 million and $23 million. The global uncertain economic environment, recessionary trends, continuity of the Russia-Ukraine war and unstable domestic economic environment are the factors resulting in the reluctance of foreign investors to invest in Pakistan.

Credit to Private Sector

The private sector borrowing illustrated a declining trend in the first quarter of FY 2023. The total private sector borrowing declined by Rs. 31 billion in first two months of FY 2023 i.e. July and August as compared to a decline of Rs. 78 billion in first two months of FY 2022. The total private sector borrowing stood at Rs. 7.1 trillion till August 2022. The long-term fixed financing (LTFF) increased by Rs. 16 billion in July and August as compared to June and the total LTFF stood at Rs. 645 billion. The short-term financing (working capital) declined by Rs. 7 billion in July and August as compared to June and total short-term financing stood at Rs. 279 billion. The export financing decreased by Rs. 22 billion in July and August as compared to June and total export financing stood at Rs. 706 billion. The overall decline in private sector borrowing can be contributed to the high cost of borrowing. In July 2022, the Monetary Policy Committee (MPC) increased the policy rate by 125 basis points to 15 percent and maintained it till September.

Manufacturing Sector

The performance of large-scale manufacturing (LSM) declined in the first month of the first quarter of FY 2023. LSM declined by 16.5 percent in July as compared to June and declined by 1.4 percent as compared to July last year. The output of the textile sector declined by 1.4 percent, food by 1 percent, petroleum products by 10 percent, chemicals by 10 percent, wearing apparel by 7 percent, and pharmaceuticals by 64 percent. The decline in manufacturing output comes from import restrictions imposed by the government, power and gas outages, an increase in utility tariffs, an increase in the policy rate and a significant increase in the prices of inputs due to currency devaluation.

External Sector

The exports of Pakistan declined by 15.5 percent from $8.4 billion in first quarter of FY 2022 to $7.1 billion in first quarter of FY 2023. The merchandise exports of the country in July, August and September were $2.25 billion, $2.48 billion and $2.38 billion respectively. The imports of the country declined by 22.7 percent from $21.1 billion in first quarter of FY 2022 to $16.3 billion in first quarter of FY 2023. The merchandise imports of the country in July, August and September were $4.99 billion, $6.1 billion and $5.26 billion respectively. The trade deficit declined by 27.5 percent from $1.27 billion in first quarter of FY 2022 to $9.2 billion in first quarter of FY 2023. The underlying reasons for decline in exports are rise in energy prices and shortages, low output of manufacturing sector, higher cost of inputs from currency devaluation and decline in the global demand. Whereas the decline in imports resulted from import restrictions such as banning import of certain commodities, blockage of LCs and 100 percent cash margin requirement.

Remittances play an important role in the managing inflow and outflow of foreign exchange and fulfilling the country's external obligations as the country's exports are much lower than the country's imports. Pakistan received remittances of $5.24 billion in the first two months of the first quarter of FY 2023 as compared to an inflow of $8.21 billion in the fourth quarter of FY2022. The remittances in July and August were $2.5 billion and $2.7 billion respectively.

The performance of the country on the external front remained weak as a result of higher external financial obligations. The government was able to slow down the current account deficit on the back of import restrictions and administrative controls like imposing restrictions of 100 percent cash margin and blocking letters of credit to carry out imports. The current account deficit in July and August was $1.2 billion and $700 million respectively. In contrast, the current account deficit in May and June was $1.4 billion and $2.2 billion.

The demand for dollars for import payments and servicing of debt has put significant pressure on the foreign exchange reserves of the country. The foreign exchange reserves of the government declined by $1.9 billion from $9.8 billion in June to $7.9 billion at the end of September. In the first quarter of FY 2023, Pakistan received a tranche of $1.17 billion from International Monetary Fund (IMF) but remained unable to build reserves. Resultantly, the country's reserves are sufficient to carry out imports of one and a half months only; whereas, the international standard of minimum reserves level should cover at least three months of imports.

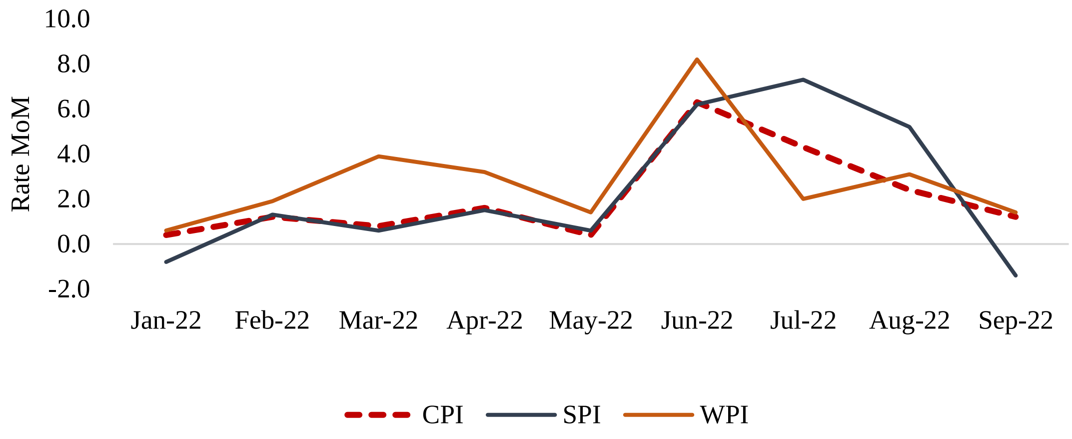
The decline in forex to low levels, which are not sufficient to finance imports of even two months, and rising external financial obligations contributed to the depreciation of the local currency. The fall in the exchange rate in the 1st quarter was 13 percent to Rs. 231.2 at the end of September from Rs. 204.9 at the end of June.

Business Environment

The economic certainty deteriorated significantly in the 1st quarter of FY 2023 due to a colossal increase in the current account deficit in FY 2022, a drop in the foreign exchange reserves, and a depreciation of the rupee. Furthermore, the receipt of $1.17 billion tranche from the IMF could not restore the market sentiments and resultantly, the rupee continued to depreciate against the dollar. Therefore, the performance of the stock market reflected the uncertain economic environment of the country. The KSE-100 Index dropped by 284 points from 41,297 at the end of the fourth quarter of FY 2022to 41,013 at the end of first quarter of FY 2023. Moreover, the market capitalization dropped by Rs. 162 billion from Rs. 6.9 trillion at the end of June to Rs. 6.7 trillion at the end of September.

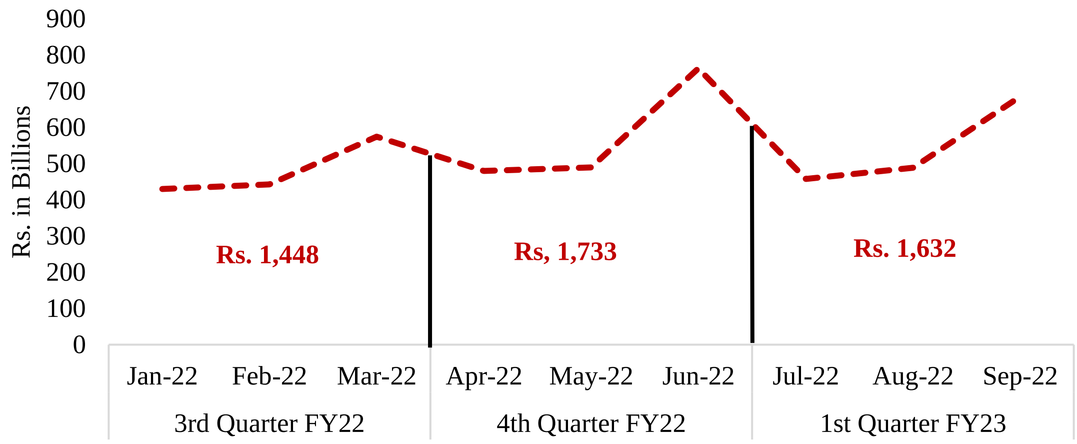
Macroeconomic Indicators

Figure 3 : Inflation



Source: Pakistan Bureau of Statistics

Figure 4: Revenue Collection



Source: Federal Board of Revenue

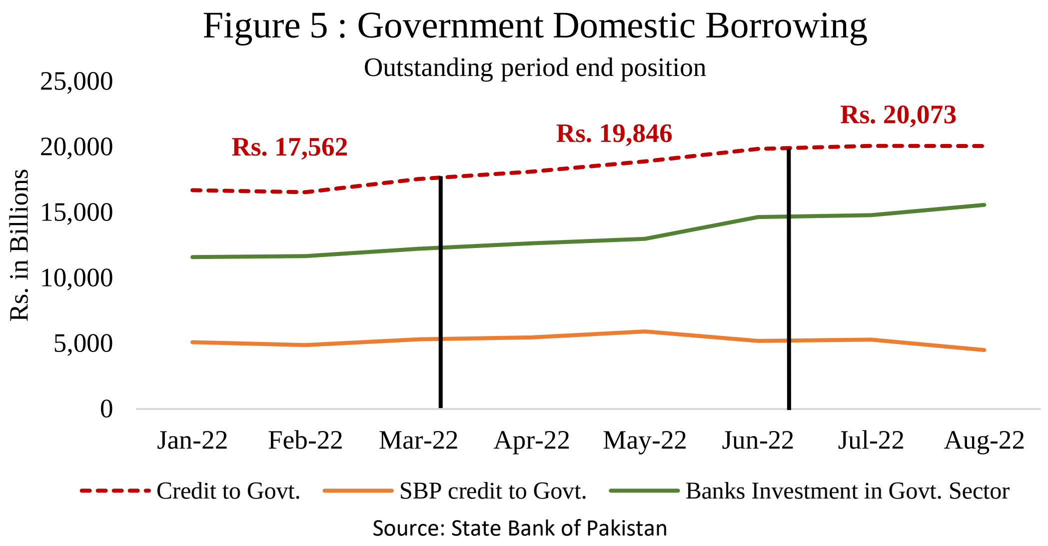


Figure 5 : Government Domestic Borrowing
Outstanding period end position
25,000
20,000
15,000
10,000
5,000
0
Rs. in Billions
Rs. 17,562
Rs. 19,846
Rs. 20,073
Jan-22
Feb-22
Mar-22
Apr-22
May-22
Jun-22
Jul-22
Aug-22
Credit to Govt.
SBP credit to Govt.
Banks Investment in Govt. Sector
Source: State Bank of Pakistan

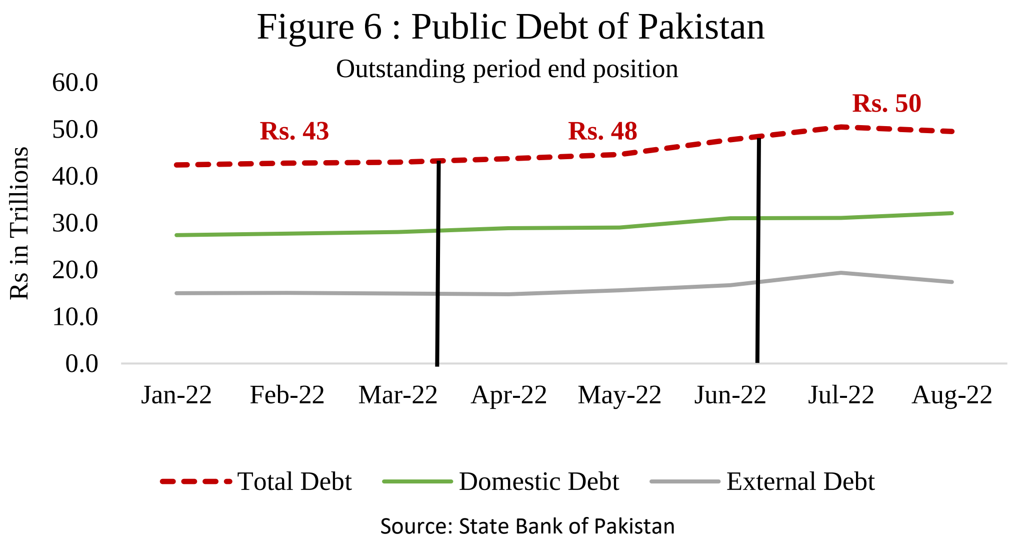
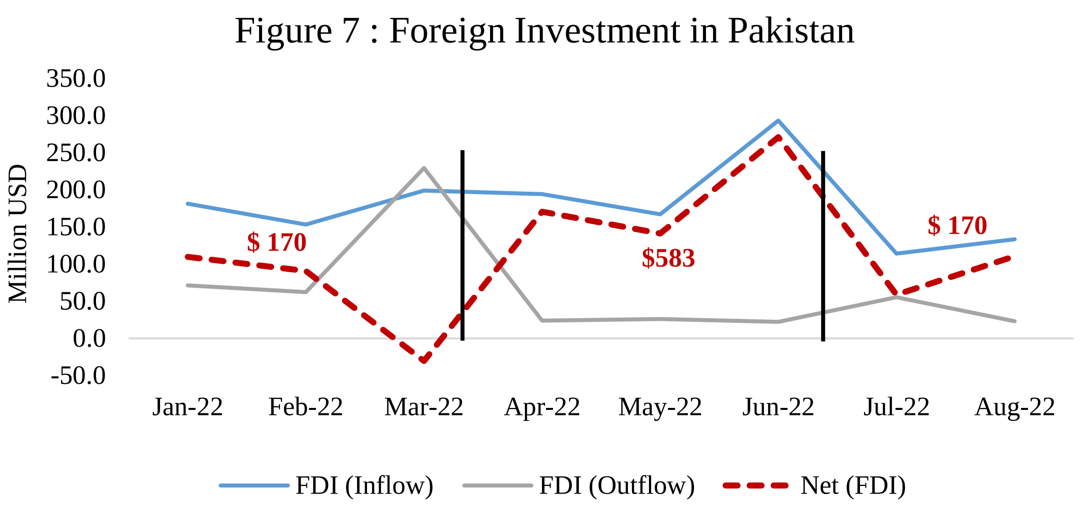
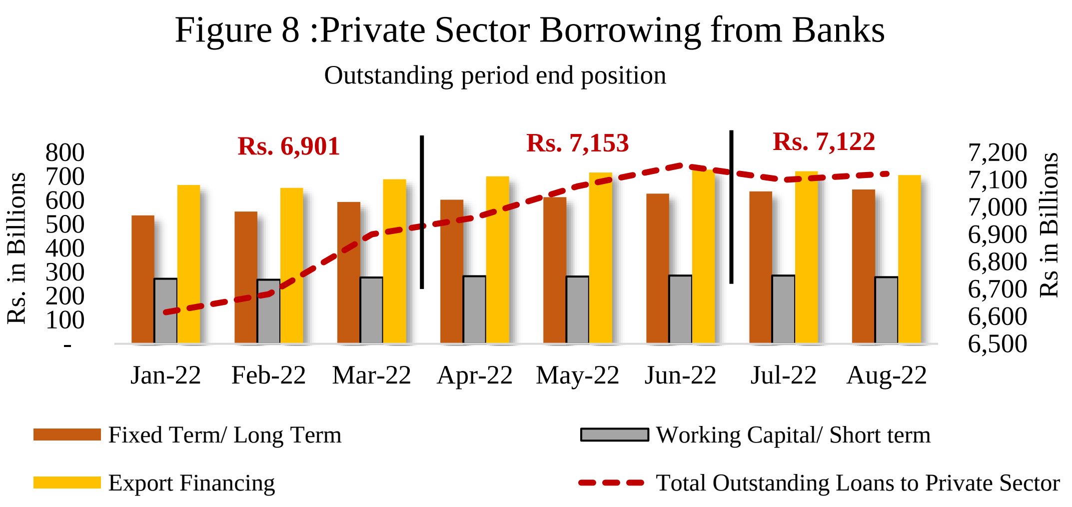


Figure 6 : Public Debt of Pakistan
Outstanding period end position
60.0
50.0
40.0
30.0
20.0
10.0
0.0
Rs in Trillions
Rs. 43
Rs. 48
Rs. 50
Jan-22
Feb-22
Mar-22
Apr-22
May-22
Jun-22
Jul-22
Aug-22
Total Debt
Domestic Debt
External Debt
Source: State Bank of Pakistan

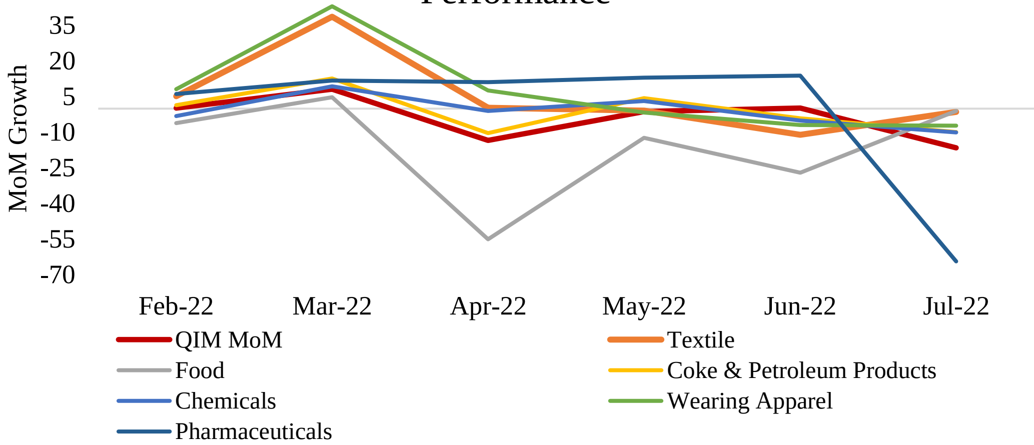


Source: State Bank of Pakistan



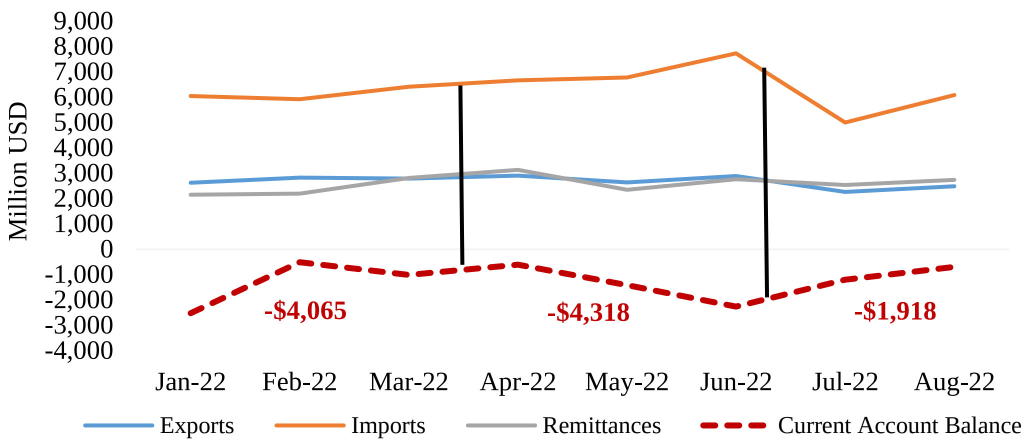
Source: State Bank of Pakistan

Figure 9 : Large Scale Manufacturing Sector Performance



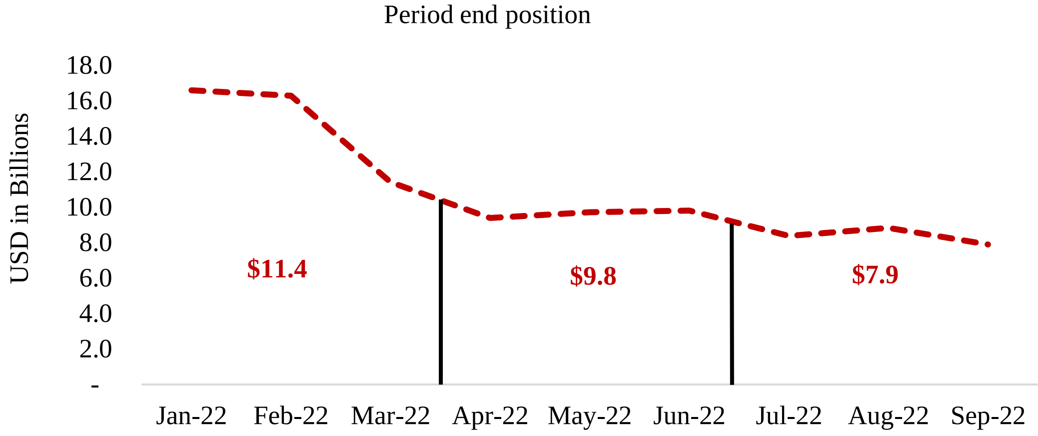
Source: Pakistan Bureau of Statistics

Figure 10: Current Account Balance



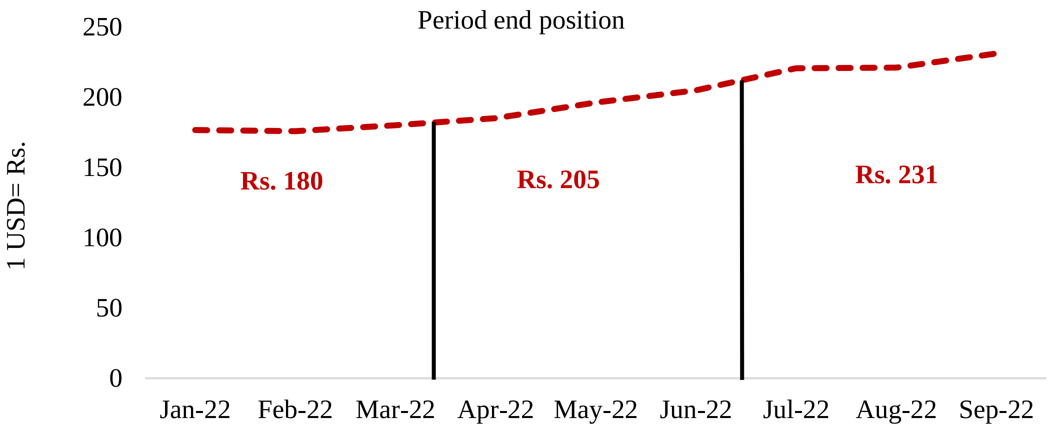
Source: Pakistan Bureau of Statistics

Figure 11 : Foreign Exchange Reserves of Government



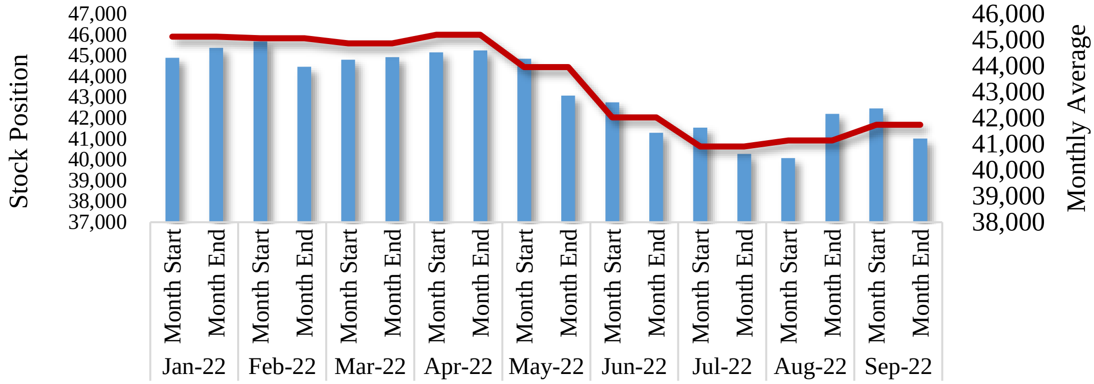
Source: State Bank of Pakistan

Figure 12: Exchange Rate Trend



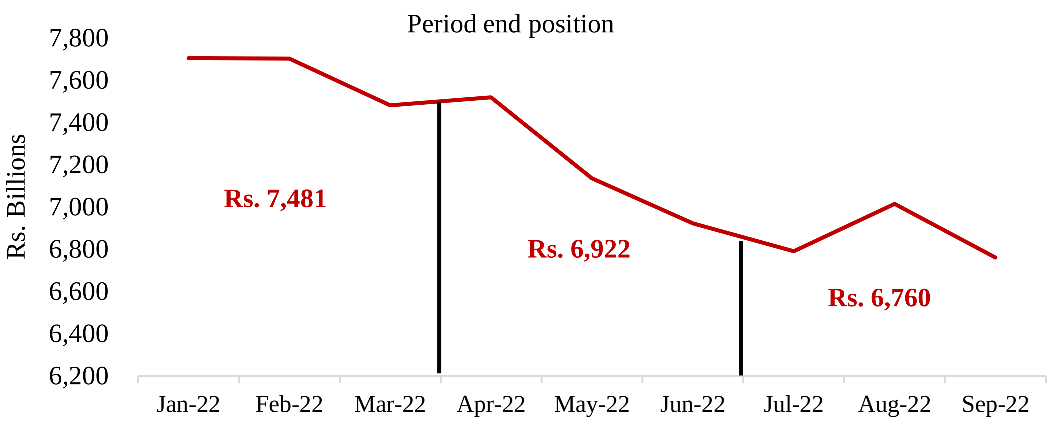
Source: State Bank of Pakistan

Figure 13: Stock Market Performance



Source: Pakistan Stock Exchange

Figure 14 : Market Capitalization in Stock Market



Source: Business News, Dawn

__________End of Section 2__________

Section 3: MACROECONOMIC OUTLOOK

Macroeconomic Outlook

Pakistan is at a crossroads where the country is facing insurmountable challenges on the domestic and external front. Pakistan managed to stay afloat in the pandemic domestically but border closures, trade restrictions and an enormous supply-demand gap globally continued to prevail and was exacerbated by the continuity of the Russia-Ukraine war. The world experienced a steep hike in global commodity and petroleum prices, which pushed developing countries near to default. Pakistan is among those countries which narrowly escaped. The recent floods will have a long-lasting impact on the state of the economy of Pakistan until the restoration of damaged infrastructure is completed.

The most important component that needs immediate attention is political stability in the country. The incumbent coalition government is weak and has a short tenure to address all economic woes but it is crucial to take necessary steps in the right direction and promote a business conducive environment in the country. **The confusion and uncertainty from frequent alterations in the budget have disrupted economic activity in the country and the imposition of new taxes has hindered the expansion of business**. Therefore, it is imperative to facilitate businesses by improving the ease of doing business.

The floods have affected 33 million people and a significant proportion of the population is facing food insecurity. The crops destroyed by the floods will put more strain on the government to import food items to meet the domestic demand, which will put pressure on the foreign exchange reserves of the country.

The energy sector of the country is a ticking time bomb where the power sector's circular debt has reached Rs. 2.4 trillion and gas sector circular debt has crossed Rs. 1 trillion. The uninterrupted supply of power and gas to industry and households is extremely important. The recent hikes in power tariffs are an attempt of the government to manage the situation but the resolution of underlying problems will bring stability to the sector. In short term, the problem will continue to prevail and economic activity in the country will remain below the optimal level.

Inflation remains a challenge for the government and the public at large. Given the macroeconomic fundamentals, the government envisaged that inflation will remain in the range of 18 to 20 percent in FY 2023; however, the recent developments on the back of floods will push inflation beyond the budgeted range. The oil producing and exporting countries have indicated a reduction in output which will increase petroleum prices and contribute to more inflation at home. This calls for a proactive approach from the government on the fiscal and monetary front. The government needs to reform the taxation system to increase the tax base by reducing the number and rates of taxes to encourage compliance. The government also needs to curtail its borrowing to control the money supply.

The higher cost of inputs and energy bottlenecks will contribute to a slowdown in manufacturing activities as experienced in the first quarter of FY 2023. In addition, the SBP's decision to keep the policy rate unchanged at 15 percent will stem the businesses from expansion as the cost of borrowing is too high.

The continuous borrowing for the servicing of external debt will build up the external financial liabilities of the country and put pressure on the foreign exchange reserves of the country. Instead of relying on quick solutions, the government needs to attract foreign investment in the country by creating a business enabling environment and reducing excessive bureaucratic procedures. Moreover, the policy of banning imports or blocking LCs will not prove to be fruitful; therefore, the government needs to pay attention to increasing exports by opening new avenues for local products through free trade agreements and inclusion into trading blocs like the Regional Comprehensive Economic Partnership (RCEP).

__________End of Section 3__________

Annexure

Table 5: Current Account Indicators of Pakistan				
Month	Exports	Imports	Remittances	Current Account Balance
	Million USD			
Jan-22	2,614	6,036	2,144	-2,531
Feb-22	2,820	5,907	2,190	-519
Mar-22	2,740	6,186	2,810	-1,015
Apr-22	2,897	6,661	3,125	-618
May-22	2,626	6,777	2,333	-1,425
Jun-22	2,887	7,722	2,761	-2,275
Jul-22	2,254	4,993	2,524	-1,215
Aug-22	2,482	6,071	2,724	-703
Sep-22	2,387	5,269	2,430	-

Table 6: Foreign Direct Investment in Pakistan			
Month	Net	Inflow	Outflow
	Million USD		
Jan-22	110.0	181.6	71.6
Feb-22	90.8	153.2	62.4
Mar-22	-30.4	199.0	229.4
Apr-22	170.6	194.4	23.8
May-22	141.2	167.3	26.1
Jun-22	271.1	293.4	22.3
Jul-22	58.9	114.2	55.3
Aug-22	110.7	133.6	22.9

Table 7: Large Scale Manufacturing Sector Growth						
Month	**QIM**	**Textile**	**Wearing Apparel**	**Food**	**Chemicals**	**Pharmaceuticals**
Feb-22	0.3	5.21	8.14	-6.09	-3.14	6.18
Mar-22	8.2	38.7	43.1	4.8	9.4	11.9
Apr-22	-13.3	0.43	7.67	-55	-0.96	11.2
May-22	-1.3	-0.77	-1.64	-12.3	3.24	13.1
Jun-22	0.2	-11	-6.94	-27	-5.02	13.9
Jul-22	-16.5	-1.37	-7.17	-0.9	-10	-64.3

Table 8: Inflation			
Month	**CPI**	**SPI**	**WPI**
Jan-22	0.4	-0.8	0.6
Feb-22	1.2	1.3	1.9
Mar-22	0.8	0.6	3.9
Apr-22	1.6	1.5	3.2
May-22	0.4	0.6	1.4
Jun-22	6.3	6.2	8.2
Jul-22	4.3	7.3	2
Aug-22	2.4	5.2	3.1
Sep-22	1.2	-1.4	1.4

Table 9: Public Debt of Pakistan			
Month	**Public Debt**	**Domestic Debt**	**External Debt**
	Rs. in Trillions		
Jan-22	42.4	27.4	15.0
Feb-22	42.8	27.7	15.1
Mar-22	43.0	28.1	14.9
Apr-22	43.7	28.9	14.8
May-22	44.6	29.0	15.5
Jun-22	47.8	31.0	16.7
Jul-22	50.5	31.1	19.4
Aug-22	49.5	32.1	17.4

Table 10: Domestic Borrowing of Government			
Month	**Total Credit**	**SBP Credit to Government**	**Banks Credit to Government**
	Rs. in Trillions		
Jan-22	16.7	5.1	11.5
Feb-22	16.5	4.8	11.6
Mar-22	17.5	5.3	12.2
Apr-22	18.1	5.4	12.6
May-22	18.9	5.9	12.9
Jun-22	19.8	5.2	14.7
Jul-22	20.0	5.3	14.8
Aug-22	20.1	4.5	15.6

Table 11: Private Sector Borrowing (Rs. in Billions)				
Month	Total Loans to Private Sector	Fixed Term/ Long Term	Working Capital/ Short term	Export Financing
Jan-22	6,615	536	272	664
Feb-22	6,682	552	268	653
Mar-22	6,901	594	277	689
Apr-22	6,961	603	283	700
May-22	7,077	613	281	716
Jun-22	7,153	629	286	728
Jul-22	7,100	637	285	722
Aug-22	7,122	645	279	706

Table 12: Exchange Rate and SBP Reserves		
Month	Exchange Rate	SBP Reserves (USD Billions)
Jan-22	176.7	16.6
Feb-22	175.9	16.3
Mar-22	180.1	12.0
Apr-22	185.1	10.5
May-22	196.3	9.7
Jun-22	204.9	10.2
Jul-22	220.6	8.4
Aug-22	221.1	8.8
Sep-22	231.2	7.9

Table 13: Performance of Stock Market				
Month	KSE-100 Index Status		Monthly Average	Market Capitalization (Rs. in Billions)
	Month Start	Month End		
Jan-2022	44,887	45,375	45,131	7,705
Feb-2022	45,675	44,461	45,068	7,703
Mar-2022	44,804	44929	44,866	7,481
Apr-22	45,152	45,249	45,200	7,519
May-22	44,841	43,078	43,960	7,136
Jun-22	42,756	41,297	42,026	6,922
Jul-22	41,540	40,276	40,908	6,790
Aug-22	40,075	42,195	41,135	7,015
Sep-22	42,460	41,013	41,737	6,760

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