CHAPTER 1

Growth and Investment

The growth momentum of the Pakistani economy, at 5.5 percent in FY2018 (with an average growth rate of 4.7 percent for period FY 2014-2018), became unsustainable due to rising macroeconomic imbalances i.e. high and increasing fiscal and current account deficits. The twin deficits always persisted in the Pakistani economy, however, in FY2018 trade deficit was historically high both in monetary value ($ 32 billion) and as a percent of GDP (10.1 percent), while the fiscal deficit reached 6.5 percent of GDP. The contained inflation and maintained exchange rate accelerated the growth in domestic demand. High consumption expenditure and government spending in turn led to massive surge in imports. Some of required adjustments on fiscal accounts and exchange rate were delayed in FY2018 being an election year, that resulted in depletion of foreign reserves and increase in monetary borrowing. As such, there was an urgent need to address these growing imbalances, particularly in external accounts, by taking strong measures to curb the growth of money supply and realign exchange rate to market conditions. These measures will have an adverse short term effect on the fiscal imbalances and there would be a need to address them in coming days and months. Moreover, over time, the government would have to make concerted efforts to tackle structural weaknesses in the economy side to avoid a repeat of similar crises in future, and ensure a sustainable growth path for the economy.

Looking back at FY2017-18, while the macroeconomic imbalances continue to rise, required adjustments could not be undertaken until August, as the caretaker government, which was in place for first two months of FY2019, was not mandated to take major economic retransformation. On August 18, 2018, the present government took office and started tackling the challenge of stabilizing the economy primarily by managing the aggregate demand and addressing the deep-rooted structural problems. They took difficult decisions in reducing the overvaluation of exchange rate and aligned it to the market value-based exchange rate; increased policy interest rate and energy prices which were kept subdued since last year. The government also achieved considerable success in mobilizing additional financing from friendly countries in the form of short- to medium-term loans, deferred payment on imported oil and temporary deposits in the central banks. Saudi Arabia provided a US$ 6 billion assistance package – US3 billion in short loan and US$ 3 billion in the shape of deferred payment on oil imports. Similarly, the UAE government provided US$ 1 billion, whereas China has given US$ 2.2 billion. These measures and inflows have strengthened Pakistan's foreign exchange reserves and reduced external vulnerabilities to some extent.

However, despite some of these positive measures, growing tensions between India and Pakistan in February 2019, had a short term adverse impact on business sentiments and investments in the country. International agencies revised downward their projections of economic growth in Pakistan. For example, the IMF has lowered its projection for economic growth in Pakistan in FY2018-19 to below 3 percent, partly due to government demand containing adjustments and partly because of the negative effects of tariff increases enacted in the United States and China earlier in the year. In view of these above mentioned factors, GDP growth in FY2018-19 remain subdued. However, as some results of the stabilization process have already started to materialize, particularly on external front, there has been a sharp reduction in the current account deficit[1]. It is expected that combination of

[1] An improvement of 27 percent in a year-on-year comparison for Jul-Apr FY19 and FY18, primarily driven by an increase in remittances and fall in imports.

adjustments and reforms measures initiated by the government, the economy will attain a more stable and robust growth momentum in coming years.

Pakistan Economic Growth and Global Perspective

Although domestically the government was following stabilization process, however globally, rising trade tensions posed a risk to the global growth outlook in FY 2019. After a strong growth in 2017 and early 2018, global economic activity slowed noticeably in the second half of last year, reflecting a confluence of factors affecting major economies. This is the reason IMF has revised downward real GDP growth for almost all countries in World Economic Outlook, April 2019 for FY2019 (Table 1).

Table 1: Change in Real GDP growth rate forecast April 2018 – April 2019

Table-:Real GDP Growth Rates (%)	WEO, April 2018		WEO, Oct 2018		WEO, April 2019		Forecast
Group / Country Name	2018	2019	2018	2019	2018	2019	
World	3.9	3.9	3.7	3.7	3.6	3.3	↓
Euro area	2.4	2.0	2	1.9	1.8	1.5	↓
United States	2.9	2.7	2.9	2.7	2.3	1.9	↓
Japan	1.2	0.9	1.1	0.9	1.0	0.9	↓
Other Advanced Economies	2.4	2.3	2.4	2.2	2.2	1.9	↓
Emerging Market and Developing Economies	4.9	5.1	4.7	4.8	4.5	4.4	↓
ASEAN							
Indonesia	5.3	5.5	5.1	5.1	5.2	5.2	↑
Thailand	3.9	3.8	4.6	3.9	4.1	3.5	↓
Malaysia	5.3	5.0	4.7	4.6	4.7	4.7	→
Philippines	6.7	6.8	6.5	6.6	6.2	6.5	↓
SOUTH ASIA							
India	7.4	7.8	7.3	7.4	7.1	7.3	↓
Bangladesh	7.0	7.0	7.3	7.1	7.7	7.3	↑
Sri Lanka	4.0	4.5	3.7	4.3	3.0	3.5	↓
Pakistan	5.6	4.7	5.8	4.0	5.2	2.9	↓
MIDDLE EAST							
Saudi Arabia	1.7	1.9	2.2	2.4	2.2	1.8	↓
Kuwait	1.3	3.8	2.3	4.1	1.7	2.5	↓
Islamic Republic of Iran	4.0	4.0	-1.5	-3.6	-3.9	-6.0	↓
United Arab Emirates	2.0	3.0	2.9	3.7	1.7	2.8	↓
Turkey	4.4	4.0	3.5	0.4	2.6	-2.5	↓
AFRICA							
Morocco	3.1	4.0	3.2	3.2	3.1	3.2	→
South Africa	1.5	1.7	0.8	1.4	0.8	1.2	↓
Kenya	5.5	6.0	6.0	6.1	6.0	5.8	↓
Tanzania	6.4	6.6	5.8	6.6	6.6	4.0	↓

Source: International Monetary Fund, World Economic Outlook Database, April 2018, Oct 2018, April 2019

Growth in the United States, bolstered by fiscal stimuli, has continues to be robust. China's growth declined following a combination of needed regulatory tightening to rein in shadow banking and an increase in trade tensions with the United States. In the Euro Region, economic activity remained somewhat weaker during the current fiscal year owing to slowing net exports, while growth in advanced economies is estimated to have decelerated slightly (to 2.2 percent). Elsewhere, natural disasters hurt activity in Japan. Trade tensions increasingly took a toll on business confidence thus financial market sentiment worsened, with financial conditions tightening for vulnerable emerging markets in the spring of 2018 and then in advanced economies later in the year, weighing on global demand. According to World Bank report January 2019, "Global Economic Perspective", South Asia growth is expected to accelerate to 7.1 percent in 2019, underpinned by strengthening investment and robust consumption. While domestic demand continues to be the main driver of growth across the region and the cyclical upturn in the exports performance is encouraging, the region needs to redouble its policy efforts towards strengthening its international competitiveness. In fact, South Asia is lagging on several competitiveness indicators, such as attracting foreign investments, penetrating new markets and diversifying and upgrading its exports products. In addition, trade openness and regional integration remains limited. Further, global foreign direct investment (FDI) inflows declined sharply in 2018, following a 23 percent decrease in 2017 from the previous year, to $1.43 trillion, with a 41 percent estimated decrease in the first half of 2018 according to the United Nations Conference on Trade and Development (UNCTAD) report published in January 2019. The decline was largely concentrated in developed countries and was mainly due to large repatriations of foreign earnings from affiliates of foreign investors from the United States of America following tax reforms implemented by the Government of the United States. However, in external trade, for South Asia region, the performance of exports is gradually picking-up in several economies. Further, the outlook for demand from major destinations, such as the United States and the EU, remains positive.

This weak international scenario, has also effected foreign direct investment in Pakistan as well as country's exports. During July-April FY2019, foreign direct investment dropped by 51.7 percent and foreign private investment also declined by 64.3 percent. Pakistan's exports have been on a declining trend since FY2013. Overall export posted a negative growth in each of three consecutive years (FY2014 – FY2016) and was almost stagnant in FY2017. In FY2018, export grew by 12.5 percent over the level of previous year as exchange rate was adjusted by an aggregate of 14.2 percent during the year.[2] However, compared to FY2013 level, export was still lower by 0.12 percent. In FY2019, the positive trend in exports continued in the first quarter of the fiscal year as exports were 4.2 percent higher than the first quarter of FY2018. However, with economy in general and manufacturing sector in particular slowing down under the weight of economic adjustment, export started to decline. During the first nine months of FY2019, export posted an overall decline of 1.9 percent over the same period of FY2018.

During the said period, imports declined by 4.9 percent, whereas growth in imports was positive during first two quarters of the fiscal year.

A detailed exercise by SBP and Ministry of Commerce has been carried out to identify the tariffs which are high and adversely effects the exports and domestic production, so that the large and small scale industries be uplifted. Other mentionable step is the establishment of Special Economic Zones (SEZs). The government is trying to remove the anomalies and giving tax incentives/exemptions to facilitate the local and foreign investors.

Box-1: Development of the Special Economic Zones

Development of the Special Economic Zones is one of the main gains from CPEC. It is a driving force for economic growth and taking the fruits of CPEC to the lesser developed regions of Pakistan. The aim is the transformation of trade corridors into Economic Corridors. After implementation of the early harvest projects, the ground is set to generate positive socio-economic impacts of CPEC by enhancing Industrial Collaboration. This will help create efficient and competitive industrial clusters to attract investment and to diversify exports.

Chinese SMEs and Start-ups are quite capable and very keen to come and invest in Pakistan. Pakistani Business community is eager to fully maximize benefits from this opportunity. There is huge potential for cooperation in the fields of engineering, automotive industry, information technology, chemicals, construction materials, textiles, agro-based industry, fisheries, marbles, small and medium enterprises particularly cottage

[2] The depreciation of rupee happened in three installments of almost 4.5 percent each in December 2017, April and June 2018.

industries.

Under CPEC, 9 sites have been identified for developing special economic zones. Pakistan's side has prepared feasibilities and bankable documents to develop these SEZs in line with the modern trends, taking input from the Chinese development model.

Government of Pakistan has already announced a comprehensive and a business-friendly incentive package aimed at up-scaling investors' relations with China and other nations, to promote the industry and employment; strengthen and form new industry clusters as well as promote exports of goods and services. Focused efforts are underway to populate these industrial zones either through investment in building infrastructure or relocation of industry. This sector encourages joint ventures in order to establish win-win platforms for Pakistani, Chinese and other foreign businessmen. It is estimated that this sector will create up to 800,000 jobs for the local population. Overall, the Industrial cooperation will support:

- Improve ease of doing business
- Skills development, transfer of technology and expansion of industrial base
- Facilitate Foreign Direct Investment (FDI)
- Develop Special Economic Zones
- Joint marketing and branding
- Formulate and refine development plans of relevant industries
- Chinese government to encourage Chinese companies to make more local procurements including raw materials and services

CPEC Proposed Special Economic Zones (SEZs)

S. No	SEZ	Province/ Region
1	Rashakai Economic Zone , M-1, Nowshera	Khyber Pakhtunkhwa
2	China Special Economic Zone Dhabeji	Sindh
3	Bostan Industrial Zone	Balochistan
4	AllamaIqbal Industrial City (M3), Faisalabad	Punjab
5	ICT Model Industrial Zone, Islamabad	Federal
6	Development of Industrial Park on Pakistan Steel Mills Land at Port Qasim near Karachi	Federal
7	Special Economic Zone at Mirpur	AJK
8	Mohmand Marble City	KP(FATA)
9	Moqpondass SEZ	Gilgit-Baltistan

To break the cycle of recurring instability, the present government has designed a roadmap for stability, growth and productive employment. In short term, sharp adjustment and infusion of external financing will be needed while in medium term planned structural reform particularly focusing on export competiveness, re-establishing fiscal stability and improving governance in key utilities and SOE's will be implemented.

Box 2: A Roadmap For Stability, Growth And Productive Employment*

Stabilization Measures

- Exchange rate Adjustment
  (19 percent devaluation since Jul 2018)
- Increase in policy rate
  (575 bps since July 2018)
- Bilateral Deposits
- Additional financing through Pakistan Banao Certificates

Structural Reform

i. Lowering the revenue-expenditure gap
   - Policy and administration reforms to improve revenue collection
   - Streamlining government expenditure

ii. Narrowing the exports -imports gap

iii. Bridging the saving-investment gap

iv. Enhancing Ease of Doing Business

v. Protecting the Poor and the vulnerable

vi. Governance Reforms

Job Creation Initiatives of Current Government

Target is to create 10 million jobs in five years. Private sector will play a key role in creation of jobs supported by the government. The key areas are:

Naya Pakistan Housing Program, which is government's initiative to provide affordable housing targeting most vulnerable segment of our economy by building 10 million houses, has a potential to create 11.9 million jobs during next five years. Similarly, 10 Billion Tree Tsunami-government's countrywide tree plantation program, National Financial inclusion Strategy-to promote SMEs and digitization of financial services. It is estimated that investments in tourism can generate over half a million new direct and induced jobs over the next five years therefore the government is giving prime importance to tourism. Development of tourism requires cross-departmental/cross-agency coordination to meet, in a consistent manner. Thus, for connectivity and transport, local government support is required for proper land use, municipal services, policing etc. Further to maintain a balance between pro-consumer and pro-business regulations, both provision of quality services as well as promotion of investment will be ensured. Thus, federal ministry and provincial tourism departments' capacity and mandate will be strengthened to perform these tasks.

For the youth, the government has launched a new program – the **Kamyab Jawan Program**. Under this program, the National Bank of Pakistan, Bank of Punjab and Bank of Khyber will provide low cost loans to the youth (agreed between 21 – 45 years) for establishing of small businesses enterprises. These loans will be classified in three tiers.

Tier I: Loans between Rs 100,000 and 0.5 million, with a debt-equity ratio 90:10 at interest rate of 6 percent. The government will pay the difference between the applied interest rate and KIBOR + 500 bps.

Tier II: Loans between Rs 0.5 and 10 million; with a debt equity ratio of 80:20 and carrying an interest rate of 8 percent. The government will pay the difference between the applied interest rate and KIBOR + 400 bps.

Tier III: Loans between Rs 10 and 25 million; with a debt equity ratio defined by bank's lending policy; and carrying an interest rate of 9 percent. The government will pay the difference between the applied interest rate and KIBOR + 400 bps.

Over the next 5 years, it is estimated, that 138 thousand youth will benefit from Kamyab Jawan program, with banks disbursing a cumulative sum of Rs 200 billion and interventions in tourism industry will create approximately 0.4 million, 3 million, and 0.6 million jobs respectively, cumulatively leading to creation of 14 million new jobs in next five years.

Power Sector Reforms

The electricity sector needs to overcome some key issues, including price distortions, insufficient collections, costly and poorly targeted subsidies, governance and regulatory deficiencies, low efficiency in energy supply and distribution. The Government has started working on a new electricity policy. This policy will be a major update and expansion of the existing policy approved in July 2013. In parallel the renewable energy policy is being updated to clearly quantify and qualify the renewable energy share and addition to the national grid.

As short-term measures in Power sector reform is bringing tariffs to cost recovery level, along with cost-cutting and efficiency measures to reach full cost recovery in the electricity sector along-with tariff adjustments to stop the buildup of circular debt. The notification of National Electric Power Regulatory Authority (NEPRA) determined tariffs for FY 2018 has been done on January 01, 2019. This notification i.e. (11 percent increase) will ensure recovery of PKR. 1,465 billion out of determined revenue requirement (RR) of PKR. 1,611 billion by NEPRA for the future tariff period of twelve months, including subsidies for the sector. Further Industrial support package of Rs. 3 / unit has been announced by the Government to ensure competitiveness of local industry. To eliminate flow and buildup of circular debt beyond FY 2018-19, elements contributing individually to the buildup of CD will be addressed. These will include;

i. Attaining recovery level as determined by NEPRA;
ii. Meeting the losses determined by NEPRA;
iii. Budgeting of subsidies and creating revenue stream for other subsides;
iv. One of the key elements is an automaticity in quarterly adjustments.

*: Detail Document is available on:
http://www.finance.gov.pk/A_Roadmap_for_Stability_and_Growth_April_8.pdf

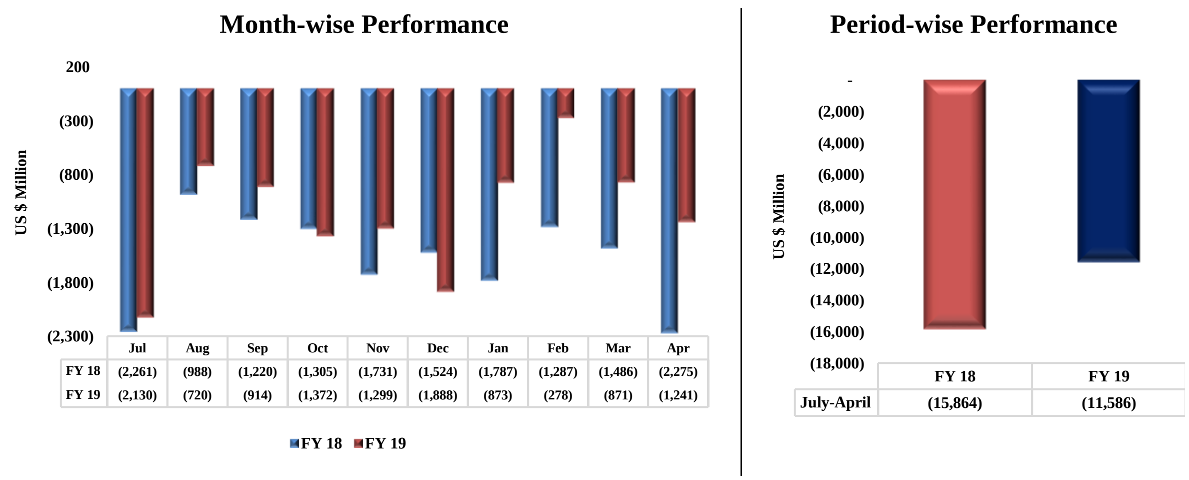
Right from August 2018, it is the endeavor of the present government to take stabilization measures with a view to overcome the economic imbalance but also to contribute towards structural reforms. The trade-off between the two is recognized explicitly and the phasing and design of policy interventions are aimed at social cost minimization in the short run and growth maximization in the medium run.

The recent staff level agreement with IMF is expected to rebuild the confidence of local and foreign investors in Pakistani economy.

Addressing Saving – Investment Gap

In FY2018, there was rise in consumption both by private sector and general government because of contained inflation and maintained exchange rate. Considering both goods and services, imports increased to US$ 68 billion in FY2018, whereas the exports remained US$ 30 billion. Consequently, the trade deficit ballooned to US$ 37.9 billion. The problem of this large increase in trade deficit was compounded by a flattening of workers' remittances at about US$ 19.9 billion. As a result, the current account deficit (CAD) which is by definition Saving-Investment gap[3] soared to US$ 19.9 billion in FY2018 thus leading to an outflow of US$ 8 billion from SBP reserves. The government made a sizeable adjustment in the interest and exchange rates to contain the aggregate demand and ease the pressure on the balance of payments. These efforts helped in reducing Saving-Investment gap, which has been contained by 27 percent (Fig-1) during July-April FY 2019 compared to 70 percent expansion during same period last year. It happened mainly because, trade deficit declined by 7 percent while last year it recorded 23 percent growth primarily due to containment in imports. Imports declined by 5 percent while workers' remittances posted significant growth of 9 percent during the period under discussion.

Fig-1: Month-wise and period-wise performance of Saving-Investment Gap



Source: State Bank of Pakistan

Aggregate Demand Analysis

During FY 2018, consumption fueled acceleration in economic growth caused the economy to overheat to a stage where surging aggregate demand expanded the size of external current account deficit to an unprecedented level (6.3 percent of GDP). Historically, Pakistan's economic growth is characterized as consumption-led growth and this is true for decades. In fact, the dominant part of

[3] By definition, savings are part of income not consumed. These are measured indirectly through national income identities by Planning Commission, which uses information about investment estimated by Pakistan Bureau of Statistics; and current account deficit compiled by SBP. Given the data for investment and current account balance, National Savings are worked out as a residual from the identity, which says "savings and investment gap is always equal to the current account balance".

the recent increase in economic growth is attributable to a boom in consumption. Even in FY2019, increase in inflation and borrowing costs amid depreciation of PKR seems not to alter much consumption patterns in the country and its share in GDP had risen to 94.8 percent almost the same level as similar to last year (94.2 percent). The share of Public Consumption in the GDP increased to 12.6 percent during FY2019 from 11.7 percent in FY2018 while the share of Private Consumption in the GDP remained almost stagnant at 82 percent. One reason of high consumption pattern is less saving opportunities because consumers find no incentive to divert resources away from consumption towards saving. Further, high rate of population growth keeps the age dependency ratio high which continues to expand consumption at the expense of saving. The high consumption thus leading to very low domestic saving while as a percent of GDP, domestic saving is also falling. Domestic saving in FY2019 remained at 4.2 percent of GDP much lower than the level achieved in FY2004 where it was 15.6 percent of GDP. The other worrisome point is that the savings are parked in real estate and abroad, thus are poorly leveraged to finance investment and economic growth. Thus the most important factor behind inadequate level of investment is the low level of saving.

As mentioned above, government's stabilization measures have started to take effect, as public and private investments both contracted as a percentage of GDP (a 5 percentage point in Private investment and 8 percentage point in Public including general government investment). In FY 2019, Private Investment as percentage of GDP dropped to 9.8 percent from 10.3 percent in FY2018 while Public including General Government investment also slowed down to 4.0 percent from 4.8 percent during the period under discussion. The fall in Public investment, including general government investment, is mainly due to squeezing PSDP spending.

Table 2: Share in GDP

As percent of GDP(mp)

Sectors	2003-04	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Total Consumption	82.6	91.8	90.7	91.3	93.2	94.2	94.8
Private Consumption Expenditure	74.9	81.0	79.8	80.0	81.9	82.5	82.1
General Government Expenditure	7.8	10.8	11.0	11.3	11.3	11.7	12.6
Total Investment	16.4	14.6	15.7	15.69	16.2	16.7	15.4
Gross Fixed Capital Formation	14.8	13.0	14.1	14.1	14.6	15.1	13.8
Private	11.3	9.9	10.4	10.3	10.1	10.3	9.8
Public including General Public	3.5	3.2	3.7	3.8	4.5	4.8	4.0
Change in Inventories	1.6	1.6	1.6	1.6	1.6	1.6	1.6
National Saving	17.7	13.4	14.7	13.9	12.0	10.4	10.7
Domestic Saving	15.6	7.7	8.6	7.8	6.5	5.1	4.2
Foreign Saving	-1.22	1.28	1.03	1.74	4.1	6.3	4.7

Source: Pakistan Bureau of Statistics

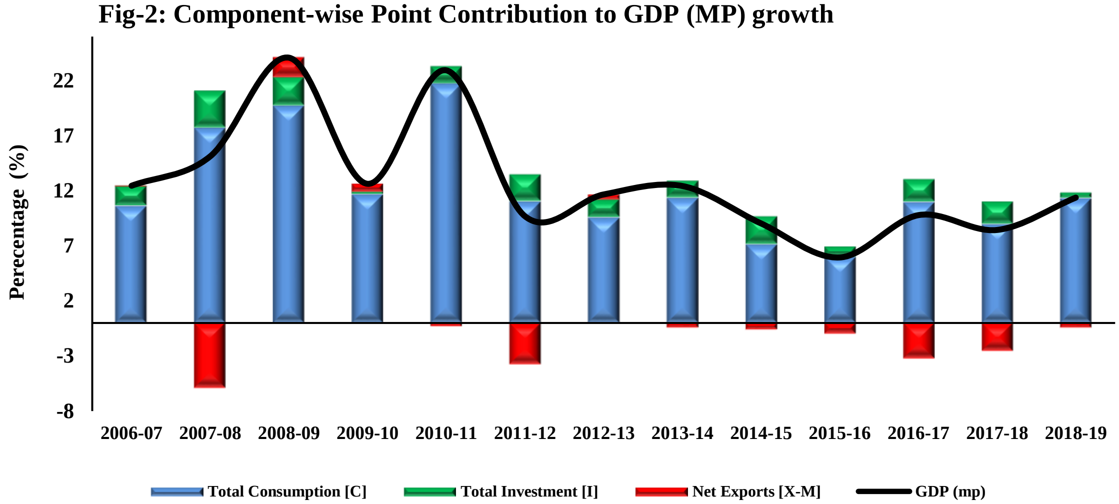
In view of large macroeconomic imbalances, SBP started to tighten the monetary policy starting January 2018, to date the SBP policy rate has been raised by a (cumulative) 650 bps to 12.25 percent till May 2019. Nonetheless, in the first 10 months of FY2019, private sector borrowing was up to Rs. 587.6 billion, against the borrowing of Rs. 532.6 billion in the comparable period last year. On average, it has posted growth of 9.8 percent during the period under discussion in FY2019 against the growth of 10.2 percent in the comparable period of FY2018. Whereas on Y-o-Y basis, it has shown a growth of 14.5 percent as on 03rd May, FY2019. As for the financing categories, the activity in working capital loans was more prominent due to rising commodity prices and input costs which increased the financing requirements of the corporate sector.

The provisional estimates of Gross Fixed Capital Formation (GFCF) for the year FY2019 stands at Rs.5,340.0 billion and posted a growth of 1.9 percent when compared to FY2019. In private sector, the GFCF is estimated at Rs.3,796.1 billion during FY2019 against Rs.3,564.0 billion in FY2018 with an increase of 6.5 percent while, in Public Sector GFCF posted a growth of 9.8 percent as it is estimated at Rs.345.3 billion during FY2019 against Rs.314.6 billion during FY2018.

Estimates of GFCF in the General Government sector are based on budgetary data of federal, provincial and districts governments. The budgeted data is used in the first year which is subject to changes on the basis of actual and reconciled expenditure by various tiers of government in subsequent year. The provisional overall GFCF for general government services for FY2019 has been estimated at Rs.1198.5 billion, a decline of 12 percent over the revised estimates of Rs.1362.3 billion during FY2018. GFCF related expenditure for the federal government has been estimated at Rs.419.8 billion with growth of 15.6 percent over previous year's estimates of Rs.362.3 billion. However, GFCF related expenditure by provincial governments has declined by 29.2 percent from Rs.909.1 billion to Rs.643.8 billion. Moreover, expenditure on GFCF incurred by district governments has increased by 48.4 percent from Rs.90.9 billion to Rs.135.0 billion.

As mentioned above, consumption continued to drive economic growth and its contribution of 99.6 percent to the GDP growth while investment has contributed 4.1 percent. Thus consumption and investment together contributed 103.7 percent to the GDP growth, which was neutralized by negative contribution by net exports to the extent of 3.7 percent. The contribution of net exports has traditionally been negative for the most part of our history. (Figure-2)

Fig-2: Component-wise Point Contribution to GDP (MP) growth



Source: Pakistan Bureau of Statistics

During FY2019, Net Exports of goods and services posted a growth of 3.9 percent compared to FY 2018 mainly on the basis of 22.64 percent growth in exports of goods and services and 12.2 percent growth in imports of goods and services as recorded in expenditure on gross national product at current prices measured in rupees. However, as per balance of payment, during July-April FY2019, there was 18.6 percent decline import of services in dollar term as it declined to $ 7.7 billion compared to $ 9.4 billion during July-April FY 2018 while imports of goods declined to 4.9 percent during the period under discussion.

Composition of Aggregate demand is shown in following Table:

Table 3: Composition of Aggregate Demand

	2013-14	2014-15	2015-16	2016-17 F	2017-18 R	2018-19 P
As percent of GDP (mp)						
Private Consumption	81.0	79.8	80.0	81.9	82.5	82.1
Public Consumption	10.8	11.0	11.3	11.3	11.7	12.6
Total Consumption [C]	**91.8**	**90.7**	**91.3**	**93.2**	**94.2**	**94.8**
Gross Fixed Investment	13.0	14.1	14.1	14.6	15.1	13.9
Private Investment	9.9	10.4	10.3	10.1	10.3	9.8
Public Investment	3.2	3.7	3.8	4.5	4.8	4.0
Changes in Stock	1.6	1.6	1.6	1.6	1.6	1.6
Total Investment [I]	**14.6**	**15.7**	**15.7**	**16.2**	**16.7**	**15.5**
Exports (Goods & Services) [X]	12.2	10.6	9.1	8.3	8.8	9.7
Imports (Goods & Services) [M]	18.7	17.1	16.2	17.6	19.7	19.9
Net Exports [X-M]	**-6.4**	**-6.4**	**-7.0**	**-9.3**	**-11.0**	**-10.2**
Aggregate Demand [C + I + X]	**118.7**	**117.1**	**116.2**	**117.6**	**119.7**	**119.9**
Domestic Demand [C + I]	**106.4**	**106.4**	**107.0**	**109.3**	**111.0**	**110.2**

Source: Pakistan Bureau of Statistics

The composition of aggregate demand discussed above is actually measuring GDP through expenditure approach and many international agencies use this approach, however, according to Pakistan Bureau of Statistics (PBS), this approach is rudimental. The prime reason being that PBS follow the production approach for measuring GDP in accordance with System of National Accounts guidelines. Thus for measuring GDP through expenditure approach, public collective consumption, capital formation and exports minus imports) are calculated independently. However, the biggest summand (private consumption) is calculated as residual. This could be another reason of low national savings as it will be outcome of identity (S = Y - C). Thus, for the purpose of GDP estimation by activities (current & constant prices), the production approach is applied by PBS. Though, for some activities, especially for nonmarket activities, output is measured as the sum of primary incomes (GVA) and intermediate consumption. Therefore, it is also important to make sectoral growth analysis while discussing GDP from production side.

Sectoral Growth Analysis – Production Side

The provisional GDP growth rate for FY2019 is estimated at 3.3 percent on the basis of 0.9, 1.4 and 4.7 percent growth in agricultural, industrial and services sectors respectively. For FY2019, Commodity Producing Sectors has been again overshadowed by growth in the Services sector which contributed 2.9 percentage points or 86.4 G percent while Commodity Producing Sectors contributed to only 0.4 percentage points to overall growth.

Agricultural Sector: The agriculture sector grew by 0.85 percent. The crops sector has witnessed negative growth of 4.4 percent during FY2019 mainly due to negative growth (-6.6 percent) in important crops due to decline in production of cotton, rice and sugarcane. Production of cotton, rice and sugarcane declined by 17.5, 3.3, and 19.4 percent, respectively. Among the important crops, wheat output posted a marginal positive growth of 0.5 percent while production of maize was higher by 6.9 percent. Other crops have shown growth of 1.95 percent mainly because of increase in production of pulses and oil seeds. Decrease in production of cotton crop also caused decline in Cotton ginning by 12.7 percent.

Livestock sector has shown a growth of 4.0 percent while the growth of forestry remained at 6.47 percent due to increase in production of timber in Khyber Pakhtunkhwa 26.7 to 36.1 thousand cubic meters.

Industrial Sector: During FY2019, the provisional growth in industrial sector has been estimated at 1.40 percent mainly because of decline in growth to 2.06 in large scale manufacturing sector percent while mining and quarrying sector has witnessed a negative growth of 1.96 percent. The mining and quarrying sector growth declined due to negative growth in natural gas (-1.98 percent) and coal (-25.4 percent). However, the decline in large scale manufacturing sector growth is based on QIM data (from July 2017 to February 2018) which shows that major decline has been observed in Textile (-0.27 percent), Food, Beverage & Tobacco (-1.55 percent), Coke & Petroleum Products (-5.50 percent), Pharmaceuticals (-8.67 percent), Chemicals (-3.92 percent), Non-Metallic Mineral Products (-3.87 percent), Automobiles (-6.11 percent) and Iron & Steel products (-10.26 percent). The major positive growth in LSM has been observed in Electronics (34.63 percent), Engineering Products (8.63 percent) and Wood Products (17.84 percent).

Electricity and gas sub sector grew by 40.54 percent. The main reason of this abrupt growth is due to 48.4 percent growth in expenditures at current prices on Gross Fixed Capital Formation in Electricity Generation & Distribution and Gas Distribution sector last year. During FY2018 these remained Rs.243 billion against Rs.164 billion during FY2017. Further in Private sector, 335 percent growth was observed in expenditures at current prices on Gross Fixed Capital Formation for Electricity Generation & Distribution and Gas Distribution sector for FY2018 while that for public sector remained 14.6 percent.

The construction activity has decreased by 7.57 percent due to conservative construction-related expenditure reported in rest of the economic activities.

Services Sector: Provisional estimates has shown that the services sector posted a growth 4.71 percent during FY2019. Wholesale and Retail Trade sector grew at a rate of 3.11 percent. As value added in this sector depends upon output of agriculture and manufacturing sectors and volume of imports, it is safe to say that bulk of growth in wholesale and retail sector could be attributed to increase in volume of imports and the growth in livestock. Transport, Storage and Communication sector has registered a growth of 3.34 percent due to positive contribution of Railways (38.93 percent), Air transport (3.38 percent) and Road Transport (3.85 percent).

Finance and insurance sector showed an overall increase of 5.14 percent, despite a decline (of 12.5 percent) in value add of the central bank, as scheduled banks, non-scheduled banks and insurance sub-sector posted positive growth (5.3 percent, 24.6 percent and 12.8 percent, respectively). The Housing Services grew by 4.0 percent and the General Government Services by 7.99 percent. It is mainly driven by the increase in salaries of federal, provincial and district governments. Other private services, which is composed of various distinct activities such as computer related activities, event management, education, health & social work, NGOs etc. has contributed positively 7.05 percent.

Way Forward

The present government has made significant measures to curb aggregate demand that has compounded the size of external current account deficit to an unprecedented level. During FY2019, the economy felt partial adjustments due to inertia as evident from still high consumption to GDP ratio and fiscal deficit. Irrespective of direction of cause, historically, there is significant relationship between trade deficit and budget deficit. Policy maker thus make the stand that by limiting fiscal deficit, trade deficit can be controlled. Thus optimum fiscal strategy will make tariff adjustments accordingly to stop the growth of quasi-fiscal deficits along with generating the revenue resources. The economy, therefore, still need strict stabilization policies along with extensive structural reforms even without IMF program. However, after entering IMF’s Extended Fund Facility (EFF) (US$6 billion), not only an ease in requisite external financing will be provided, but also market confidence will be strengthened and additional financial support from other development and bilateral partners which will further support the stability and moving toward high and inclusive growth.