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A Subsidiary of National Bank of Pakistan

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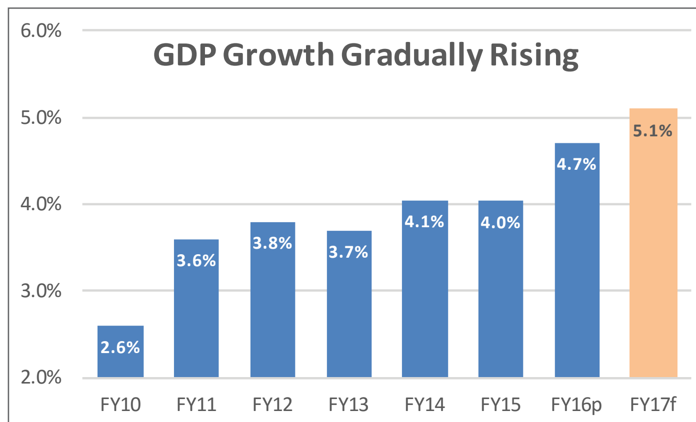
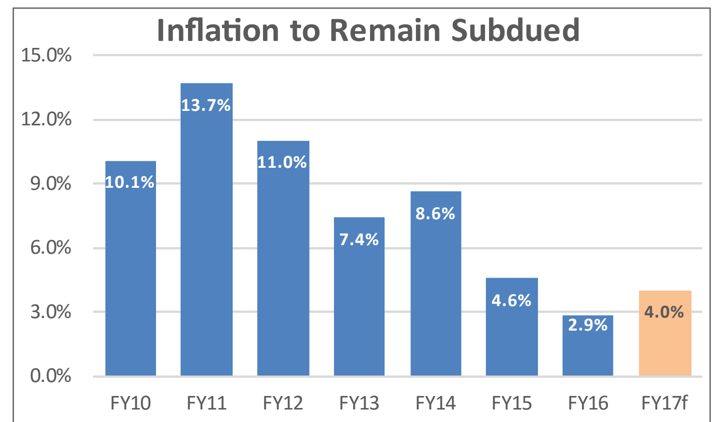
Economic Growth Intact but Current Account Deficit Deteriorating

Pakistan's economy continues to show improving trend as manifested by growth in Large Scale Manufacturing (LSM) Index which is up by 4% during 1HFY17, and China Pak Economic Corridor (CPEC) is now resulting in higher investment from both local and foreign investors. Energy shortage, which according to some estimates has dragged down GDP growth by around 2% p.a., is set to improve gradually with its full impact expected to be witnessed from 2019. On the back of improving industrial activity and better agriculture growth outlook due to low base effect and agri package, we expect the overall GDP growth for FY17 to rise to 5.0% relative to 4.7% growth seen in the preceding year. International publications and rating agencies are also increasingly looking at Pakistan from a positive perspective.

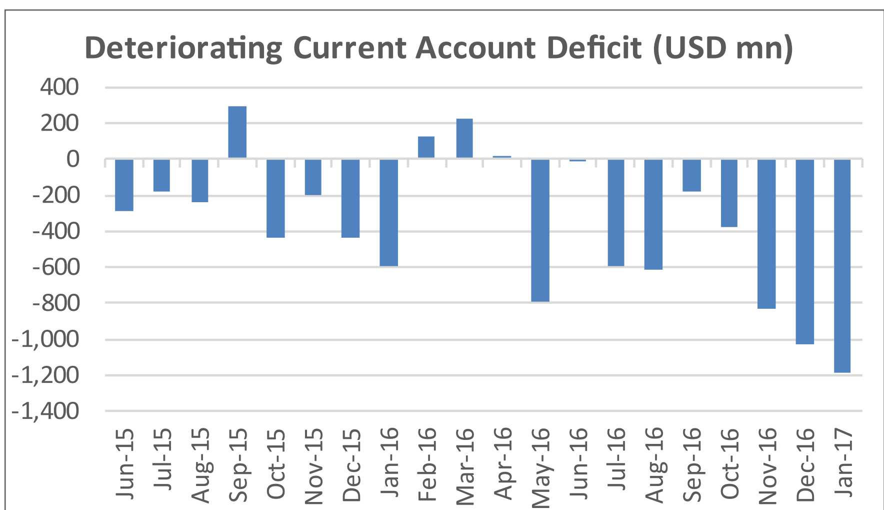




Inflation during 8MFY17 clocked in at 3.9% compared to 2.5% in the corresponding period last year. We expect overall FY17 inflation to hover around 4%, and interest rates to remain at status quo in FY17, and a gradual rise in both from 1HFY18 triggered by heightening pressure from the external account. With no IMF oversight and elections motivated spending priorities, development outlays are likely to pick-up and subsidies are expected to rise, resulting in fiscal slippages. We see overall FY17 fiscal deficit to exceed 5% of GDP given that the fiscal deficit has already reached 2.4% of GDP in 1HFY17.

The rising concern for the improving macro story of Pakistan economy is the hefty rise in monthly current account deficit, which during January-17 clocked in at USD1.2bn, taking the cumulative 7MFY17 deficit to USD4.7bn compared to USD2.5bn in the same period last year. With remittance growth also tapering off, the pressure on forex reserves is mounting. In the absence of any substantial rise in Foreign Direct Investment (FDI) the government is relying on foreign borrowing to support forex reserves. While the government has announced an export package, we feel that it may take some time for exports to recover. On the other hand, crude oil and merchandize imports are showing a hefty double digit growth. The structural issue of an overvalued currency continues to stimulate higher imports and keeps the exports at a disadvantage. We expect a significant devaluation in FY18, while expected amnesty scheme on foreign assets, and Chinese investment may lend some support to the external account going forward.

We expect the stock market to continue its upward trend post the Panama verdict and deliver a healthy double-digit return in CY17. Our sanguine view on the market is premised on robust double digit corporate earnings growth, impending inflows pertaining to up-gradation to MSCI EM, receipt from PSX divestment, likely introduction of new margin financing product, and reasonable stock market valuations as captured in forward Price-to-Earnings ratio of around 10.7 times. However, in the absence of any credible and decisive policy measures by the government, especially to mitigate the widening current account deficit, 2018 and 2019 can be challenging years for the economy and the stock market.



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