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Economic Impacts of COVID-19 Through Trade Disruptions in Pakistan

Countries around the world have started to experience the economic impact of COVID-19. On the domestic front, the social distancing measures, especially the lockdowns, have resulted in restricted mobility and supply shortages. This, combined with the fall in global trade arising from import restrictions and postponements/cancellations of export orders, has considerably slowed the economic activity down. Countries that are part of the global value chain (GVC) would feel the hit even if spread of Coronavirus is contained now and has not disrupted the internal economic functioning of the economy.

Several sectors of the economy have been affected by the ongoing lockdown in Pakistan. This bulletin focuses on the quantification of the potential loss in economic activity for the last quarter of FY 2019-20 resulting from trade disruptions. Although Pakistan may not rank higher on the GVC, the country has enough integration with the global market to feel the impact of international lockdown. The five major trade partner (with more than 50% share in trade) of Pakistan are China, USA, UK, Japan, and Germany. Four of these partners are also the worst hit countries by the COVID-19.

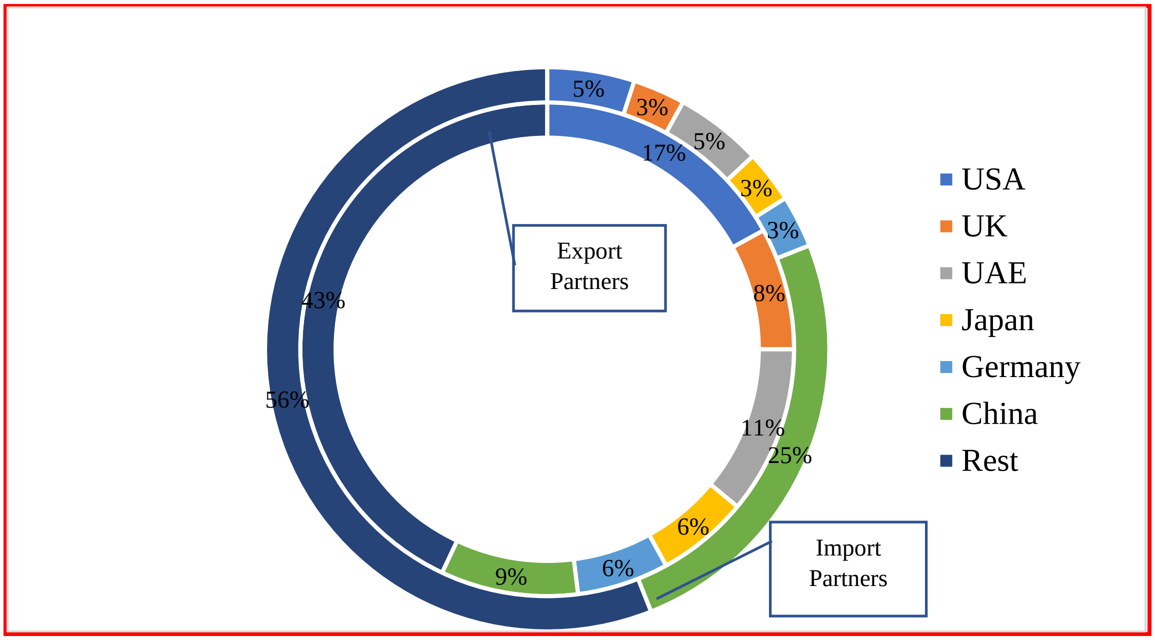
The imports and exports in the last three months (December 2019 – February 2020) for these major trade partners is shown in Figure 1. There have been significant disruptions in the international trade flows of these countries. China and Japan experienced more than 15% reduction in their exports. Rest of the three partners had a reduction of around 5%. Some of them have also experienced reductions in their imports.

Figure 1: Percentage Change in Exports & Imports for USA, UK, Japan, Germany and China
(Pakistan's Five Major Trading Partners)

Source: Authors calculations based on International Trade Center Trade Statistics

These trade disruptions of our major trade partner is a worrying situation for us. Figure 2 shows Pakistan's import (exterior circle) and export (interior circle) shares with its major trading partners. The USA and China are the major import partners and we rely heavily on them for the import of capital and intermediate goods. These goods are then utilized in the production of final goods for exports and domestic consumption. Similarly, being our major export partner, any economic downturn these economies face would directly affect our exports and therefore our GDP.

Figure 2: Pakistan's Export and Import Shares with Major Trading Partners



Source: Authors calculations based on International Trade Center Trade Statistics

Pre- and Post-COVID -19 Trade Situation of Pakistan with Major Partners

To understand what potential impact the trade disruptions could have on Pakistan's economy, it is important to first examine the pre and post COVID-19 trends in the import and export with major trading partners. This is provided in Figure 3 where trade situation with UK, USA, China and Germany is shown. The vertical lines in these panels shows the breakout of COVID-19 in China. We may add here that at the time of this analysis data was available till February 2020, and does not include any day of March when the situation worsened in most countries. In case of China, it could be accessed only till January 2020. There was trade ban with China after the outbreak and this could be the possible reason for the unavailability of data for the month February.

It is interesting to see that in post-COVID outbreak in China, Pakistan's export to other major partner were on the rise in February. This could possibly be because of trade halt of these countries with China as the later closed its border and stopped trade with rest of the world. The resulting vacuum was filled by Pakistan through exports to these countries. This trajectory, however, may not continue in the coming months because of: (i) disruptions in our imports of intermediate and capital goods; (ii) China recovering from the outbreak; and (iii) reduced demand by the partner countries due deterioration in their economic activity. We can also see a decline in our imports from Germany and UK. If we have data for China for February and March, we would also see decline in imports. All this can have detrimental effects on our economy.

Figure 3: Pre and Post COVID-19 Trade Trends of Pakistan for Major Destinations

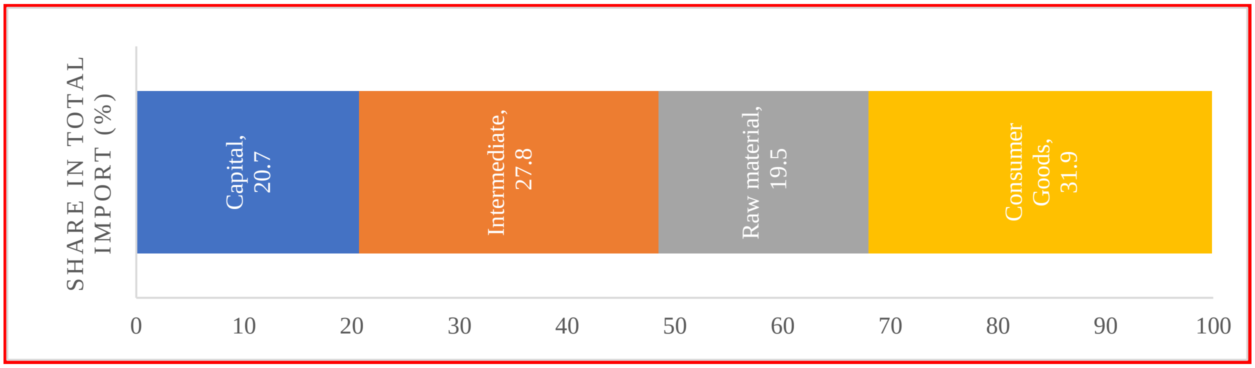
Source: Authors calculations based on International Trade Center Trade Statistics

GDP Loss through the Trade Disruptions

Before we calculate the potential loss of GDP for fourth quarter of FY 2019-2020, let us examine the composition of our imports. Figure 4 shows that 32% of our imports are in the form of final goods. Reduction in these would not affect the GDP. However, the rest of 68 percent constitutes the raw material, intermediate goods, and capital goods. These are used to produce final goods which are then consumed domestically or exported to other countries. A decline in these will therefore have a negative effect on investment spending as well as on exports. Consequently, the country will experience in a loss in GDP.[1,2]

[1] Fox, D.R. and McCully, C.P. "Concepts and Methods of the U.S. National Income and Product Accounts." Bureau of Economic Analysis, NIPA Handbook. 2017; https://www.bea.gov/national/pdf/all-chapters.pdf,
[2] https://research.stlouisfed.org/publications/page1-econ/2018/09/04/how-do-imports-affect-gdp

Figure 4: Composition of Pakistan's Import



Source: World Integrated Trade System

We examine the impact of reduction in imports and exports on national output for three scenarios (details given in Table A in appendix). The estimated losses are given in Table 2. In the first scenario, when there is only 2 percent decline in import the overall loss to GDP is negligible. In scenario II, with 10 percent decline in the intermediate and capital goods, that will likely bring a big fall in investment, as well as a similar reduction in exports, would result in a loss of 2.3 percent of GDP in the fourth quarter of FY2020. A 20 percent decline in export and import, as assumed in scenario III, would result in a loss of 4.6 percent of GDP.

It is worth mentioning here that this is the impact entirely related to trade disruptions. We have not considered the impact of internal lockdown, potential decline in FDI and remittances, and disruptions in other sectors such as aviation, tourism and hospitality etc. in this analysis (these will be covered in forthcoming bulletins).

Table 2: Trade Disruption Effects on Pakistan's GDP in the Q4 of FY 2019-2020

		Scenario I	**Scenario II**	**Scenario III**
	Share in GDP	2% decline in Import only	10% decline in Import & Export	20% decline in Import & Export
Investments Spending on Imports (F)	13.2	-0.26	-1.30	-2.64
Exports (F)	2.00	-0.04	-0.20	-0.40
Export	8.00	-	-0.80	-1.60
GDP loss (%)		**-0.30**	**-2.3**	**-4.64**

Sources: Authors calculations based on Pakistan Bureau of Statistics (PSB), 2019: Table 3 and Trade Statistics Table Feb 2020 and Appendix Table A

Conclusion

We have presented very preliminary estimates of likely impact of the trade disruptions caused by the emerging Corona economy. It is almost certain that the 4th quarter growth will be negative and could be as high as 4 percent even in these preliminary estimates. More than likely as things emerge there will be a larger negative impact on the economy. After all, the Corona event is a big event where any previous estimates will no longer be valid. We will only learn as we go along. Here at PIDE we will continue to update you with different methodologies and approaches (and without relying on outdated models and estimated parameters) on how the economic impact of the Corona crisis unfolds.

It is worth noting in passing that there has been much policy and business talk on diversification but without real progress on that front. Our dependence on commodity exports with falling commodity prices amid the Covid-19 shock and reliance on intermediate products for export productions with importing countries shutting down their supplies such as China have hurt our exports. Resilience to such shocks could have been built if domestic commerce and supply chains had been built to lead to a diversification of exports (See Haque, 2006).

Reference

Haque, Nadeem Ul, Awake the Sleeper Within: Releasing the Energy of Stifled Domestic Commerce https://pide.org.pk/pdf/Working%20Paper/dom_comrce_paper%5b1%5d.pdf

Table A: Scenarios

Scenario 1: COVID-19 pandemic breakout in China led the country to reduce its imports by more than17 percent in January 2020. The effect is also experienced in very initial stages of breakout which is 1.5 percent fall in imports of Pakistan in Feb 2020. We take this fall in import into account and calculate the expected loss in GDP of Feb 2020.
Scenario 2: Recently World Bank (WB) have assessed through sample survey that, from March 12 to 18, 2020, export-oriented industries have experience a fall in export orders in the range of 25 - 50 percent. If half of the orders are distributed among the USA, UK, and Germany, a 10 percent decrease in exports from Pakistan can be expected.
Scenario 3: The Ministry of Commerce has estimated that the exports may fall up to $4 billion as export target might face reduction from $24 billion to $20 billion till June 2020. This is because a large number of the export orders have been canceled. Cancellation of 25-50 percent export orders and based on MOC assessment, we expect that exports would fall by up to 20% in the last quarter.

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PIDE COVID-19 Bulletin is an initiative by the Institute in response to the current pandemic, which is bound to have serious consequences for the country, specifically for its economy. The Bulletin would carry research that would aid in an informed policymaking to tackle the issue.

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