

Economic Prospects Amid Uncertainty

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Pakistani markets have been under persistent uncertainty since the beginning of the Covid-19 pandemic. The situation has been further aggravated by the Russian-Ukraine conflict, surge in global commodity prices, sharp depreciation of the Rupee, and recent havoc by the deadly floods. Overall, the uncertainty has turned into an economic scenario where the country is faced with low growth prospects, persistent current account deficit, rising public debt, and relentless inflationary pressures. Amid such an uncertain situation, the economy has been shaken by a trio of news a couple of weeks ago, i.e. Pakistan's removal from the FATF Grey List, Pakistan's low Sovereign Credit rating by Fitch, and Imran Khan's Disqualification, all signalling repercussions for the country's fiscal balances, external sector along with inflationary gravities.

With regard to the current situation, the Pakistani economy has been trapped in stagflation, with significant risks of economic default still looming on in the global markets. According to the latest estimates of the World Bank, Pakistan's economic growth is expected to range between two per cent and 3.2 per cent for financial years 2022-23, and 2023-24, which would create more dents on the precarious situation of unemployment in the country. Likewise, the current inflation rate in the country is around 24 per cent, with rural areas being the most hard hit with an inflation rate of 26.2 per cent compared to 24 per cent in urban areas. In particular, the food inflation of more than 28 per cent has made the lives of a majority of the population extremely vulnerable amid supply chain disruptions and dwindling incomes due to floods. On the external front, our current account deficit has been projected to be 4.6 per cent and 4.3 per cent of GDP for financial years 2022-23 and 2023-24, respectively. Similar is the case with the fiscal deficit, with a projected fiscal deficit of around seven per cent of GDP for the financial year 2022-23. These economic imbalances have collectively surged the public debt of the country, with domestic debt reaches to Rs 31.3 trillion and external debt reaches to around \$90 billion, both amounting to roughly 78 per cent of the country's GDP. The situation with regard to foreign currency reserves is also alarming, with reserves held by the SBP standing at \$7.5 billion as of October 28. Given these stark statistics, the overall situation is still uncertain, especially amidst a surge in domestic demand, uncertain global prices, and this triplet of news, which further reinforces uncertainty.

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As stated earlier, the economy is faced with large financing needs and macroeconomic risks; it makes the outlook highly sensitive to market perceptions. Information, in general, and news, in particular, affect the level of uncertainty which, in turn, channels economic decisions. Given, this transmission mechanism, this triplet of news is expected to shape market sentiments of the country in the coming months. Uncertainty whether it is economic or political makes the future outlook for a polity or an economy unpredictable which, in turn, enhances the risk

premium of investors. In other words, uncertainty increases the rate of return required to justify investments. Thus, in uncertain situations, investments that generate a return lower than this required rate of return become unviable. Now, given this framework, what this trio of news implies about economic prospects in the coming months? First, take the case of removal from the Grey List of FATF, it is a major positive as it would enhance the efficiency of banking transactions and would encourage FDI. In other words, it is now relatively easier for international banks and other intermediary financial institutions to make transactions with Pakistani entities as the surveillance mechanism has been made transparent, with most of the technical deficiencies have been removed from the Pakistani financial system. Likewise, Pakistani banks and other financial institutions while following the FATF compliance procedures would have unhampered access to the global SWIFT systems, the worldwide communication network of banks, and other global financial institutions. Moreover, since the government needs to raise significant foreign finance to avoid an external sector crisis, it would make it easier for the government to negotiate with multilateral and bilateral donors in the post-FATF-removal scenario. To sum up, it would enhance the overall trade and investment flows across the border.

As far as Pakistan's low sovereign credit rating by Fitch is concerned; it has raised risks to the country's external sector liquidity. With regard to multilateral donors, Pakistan has recently been successful in relaunching its IMF programme, with the first tranche of \$1.17 billion already received by the country, and is expected to receive disbursement under its current extended fund facility. Likewise, the Asian Development Bank (ADB) has pledged up to \$2.5 billion to Pakistan, of which Pakistan has received \$1.5 billion last week under its Building Resilience with Active Countercyclical Expenditures (BRACE) programme. Similar arrangements with the World Bank worth \$2 billion are under negotiations. However, low credit ratings in global markets may affect Pakistan's bilateral loan relationships. Similarly, it has raised risks with respect to raising funds through commercial sources like banks, Eurobonds, and Sukuks etc.

The third news has been that of Imran Khan's disqualification in Toshakhana reference under Article 63(1)(p) by the Election Commission of Pakistan (ECP) for making "false statements and incorrect declaration". It had already triggered protests across the country on that day, and it would enhance uncertainty further as PTI has already initiated a long march to Islamabad from October 28. Resultantly, it would not only aggravate inflationary pressures by halting supply chain disruptions but would also make investment decisions cumbersome for investors in the coming months.

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