Monthly Economic Update & Outlook

July 2022

Government of Pakistan
Finance Division
Economic Adviser's Wing

Contents

Executive Summary

- Rising global commodity prices, supply chain disruptions, monetary tightening and the Russia-Ukraine conflict dented the global economic recovery. IMF has predicted the year 2022 as tough, and 2023 even tougher. The US economy witnessed higher inflationary pressures as it surged to 9.1 percent in June, the highest since 1981. Global commodity prices observed a mixed trend in June 2022. Energy prices increased by 6.4 percent, while non-energy prices fell by 4 percent. Agriculture prices dropped 3.7 percent. Food prices declined by 4.7 percent, led by grains (-6.6%) and oil & meals (-5.7%). Fertilizer prices eased 0.9 percent and metal prices plunged 5.5 percent.
- **Real Sector:** According to the initial estimates reported by Crop Reporting Service Department Punjab, the overall cotton area sown was recorded at 1.485 million ha. This area comprises 81.5 percent of the target and 16.1 percent higher than the same period last year. Whereas the cotton cultivation area in Sindh registered at 0.517 million ha, 80.8 percent of the target. The total sown area stood at 2.002 million ha showing 81.4 percent of target and 6.9 percent higher than last year. During Jul-May FY2022, LSM posted a growth of 11.7 percent as compared to 10.2 percent same period last year.
- **Fiscal, Monetary & External:** The fiscal deficit in Jul-May FY2022 was recorded at 5.2 percent of GDP. The primary balance posted a deficit of Rs 945 billion. During the period 01st July – 24th June, FY2022 money supply (M2) observed a growth of 10.4 percent (Rs 2,532.9 billion) as compared to a growth of 12.5 percent (Rs 2,605.5 billion) last year. During FY2022, the current account deficit was recorded at $ 17.4 billion.

  - **Economic Outlook:** Inflationary and external sector risks are building macroeconomic imbalances in the economy. Furthermore, the ongoing political unrest is increasing economic uncertainty, which is causing the PKR to depreciate and has an impact on cost of production. All these factors are making the economic outlook uncertain.
  - The YoY inflation remained in double-digit since November 2021. This hike in inflation will continue in July 2022 and hover around the level observed in June 2022 due to the increase in international commodity prices particularly energy prices and the depreciation of PKR.
  - The MEI continues to issue a positive economic signal in June 2022, owing primarily to the continued strong performance of the industrial sector, which is known to have significant multiplier effects on other sectors of the economy.
  - In June 2022, the surge in imports of goods owing to increase in international commodity prices widened trade deficit. Workers' remittances were not enough to finance the trade deficit, as a result current account deficit widened. However, it is expected that with the government's policy measures imports will fall, while better performance of exports of goods & services and workers' remittances will bring current account deficit at manageable level in the coming months.
  - Despite difficult economic conditions, tax collection surpassed the Rs 6.0 trillion mark in FY2022. Due to broad-based growth in all revenue heads, net tax collection increased by 29 percent in FY2022 over the preceding year. However, during the first eleven months of FY2022, expenditure overrun the revenue growth, thus fiscal deficit is likely to remain at 7.1 percent of GDP in FY2022.

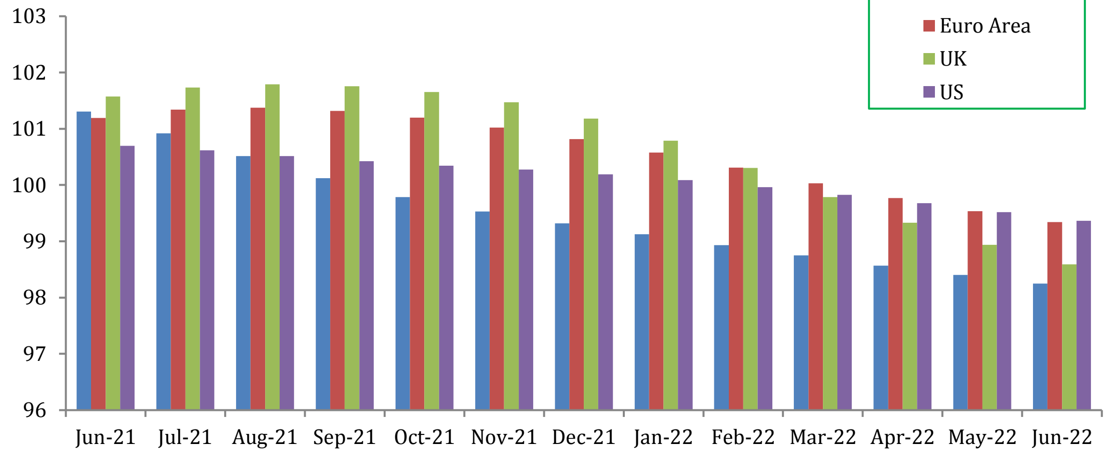
1. International Performance and Outlook

The commodity price shock from the Russia-Ukraine conflict exacerbated the cost of living for millions of people. Inflation in most of the leading economies stood higher than expected. It is expected that the US Federal Reserve could hike interest rates by a historic 1.0 percent. The Bank of Canada shocked markets by raising its base rate by a full percentage point, while the Reserve Bank of New Zealand and Bank of Korea raised their benchmark rates by 0.5 percent. The European Central Bank is under pressure to raise interest rates to combat inflation and protect the Euro against USD. Along with another expected move, this keeps heaping pressure on other central banks to follow suit to bring inflation under control.

The COVID related restrictions in China and subsequent supply bottlenecks are crimping the world's patchy pandemic recovery. The outlook remains extremely uncertain. Further disruption in the natural gas supply to Europe could plunge many economies into recession and trigger a global energy crisis. The outlook for the global economy has "darkened significantly" and the world faces an increasing risk of recession in the next 12 months. IMF has predicted the year 2022 to be tough, and 2023 even tougher.

The recession like situation in the global economy is also reflected through the Composite Leading Indicator of Pakistan's main trading partners which is available till June 2022. The persistent negative trend is obvious in Fig-1.

Fig-1: Composite Leading Indicator



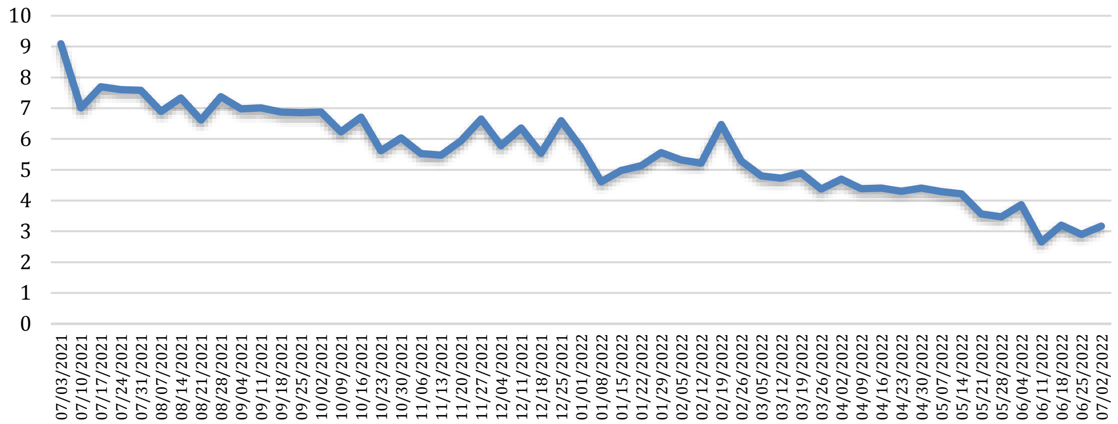
Source: OECD

US inflation jumps to 9.1 percent, the largest increase since the end of 1981. The CPI increased by 1.3 percent in June from May. This upward surge was recorded mainly due to increase in gasoline, shelter, and food costs. This was the fourth-straight month that the headline annual figure surpassed forecast estimates.

The inflation figures reaffirm that price pressures are rampant and widespread throughout the economy and taking a bigger toll on real wages, which are down the most ever in data back to 2007. The rising inflation will keep pressure on the Fed policy rate to be increased aggressively, to counter demand pressures.

Several factors such as housing stand to keep price pressures elevated for longer. Geopolitical risks along with COVID lockdowns in China and the Russia-Ukraine conflict also pose risks to supply chains and the inflation outlook. The uncertain situation during first half of 2022 also reflected downward movement of WEI compared to same period last year (Fig-2).

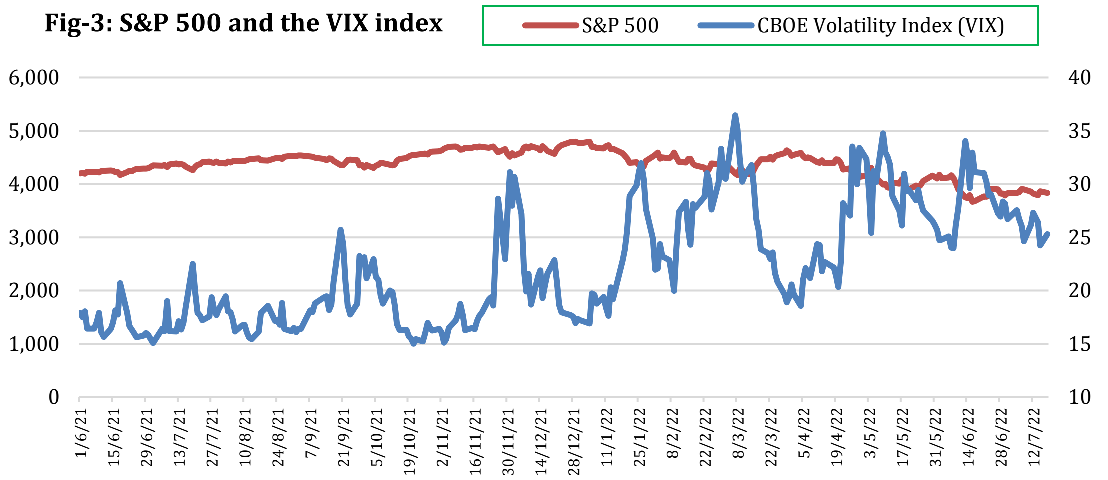
Fig-2: Growth in WEI



Source: Federal Reserve Bank of New-York

In the US, stock investors are reluctant as US stocks finished one of the worst first half of the year in decades with S&P 500 posting losses in 11 of the past 12 weeks. Investors continued to grapple over a potential US recession, high inflation, and tighter monetary policy. The panic among investors was also confirmed by the Chicago Board Options Exchange (CBOE) Volatility Index which is commonly used as a measure of investors' uncertainty recorded above 20 in recent weeks (Fig-3).

Fig-3: S&P 500 and the VIX index



Source: Investing.com

The rate of global economic expansion accelerated to a four-month high in June 2022. However, several survey indicators highlighted the ongoing fragility of the global economic upturn. The growth in new orders eased to a near two-year low, international trade declined and business confidence slumped to its lowest since September 2020.

The J.P. Morgan Global Composite Output Index clocked in at 53.5 in June, up from 51.3 in May. However, after excluding China from the calculation, the index fell from 53.9 to 53.1, further highlighting how recent volatility in the Chinese economy has impacted global economic trends. However, few sectors are performing better relatively. Worldwide manufacturing production marked growth in June, after back-to-back contractions in April and May. Growth of service sector business activity accelerated to a four-month high.

All the economies covered in the Composite Output Index marked expansion in the month of June. Brazil, India and China were the top-three ranked countries. China and Russia returned to growth following recent contractions, and rates of expansion accelerated in

Japan, the UK and Brazil.

Global jobs growth also slowed to a four-month low but remained relatively better overall. Inflationary pressures remained elevated. However, rates of increase for input costs and output prices eased to the lowest since February and January respectively.

Global commodity prices presented a mixed picture in the month of June 2022. Energy prices gained 6.4 percent, led by crude oil (6.1%) and European natural gas (15.1%). Non-energy prices fell by 4 percent. Agriculture prices dropped 3.7 percent. Food prices declined by 4.7 percent, led by grains (-6.6%) and oil & meals (-5.7%). Fertilizer prices eased 0.9 percent. Metal prices plunged 5.5 percent.

2. Monthly Performance of Pakistan's Economy

Pakistan's economy is witnessing high inflationary and external sector pressure especially on PKR. However, the government is taking all possible measures to counter these pressures so that economy could achieve the growth target of 5.0 percent in FY2023.

2.1 Real Sector

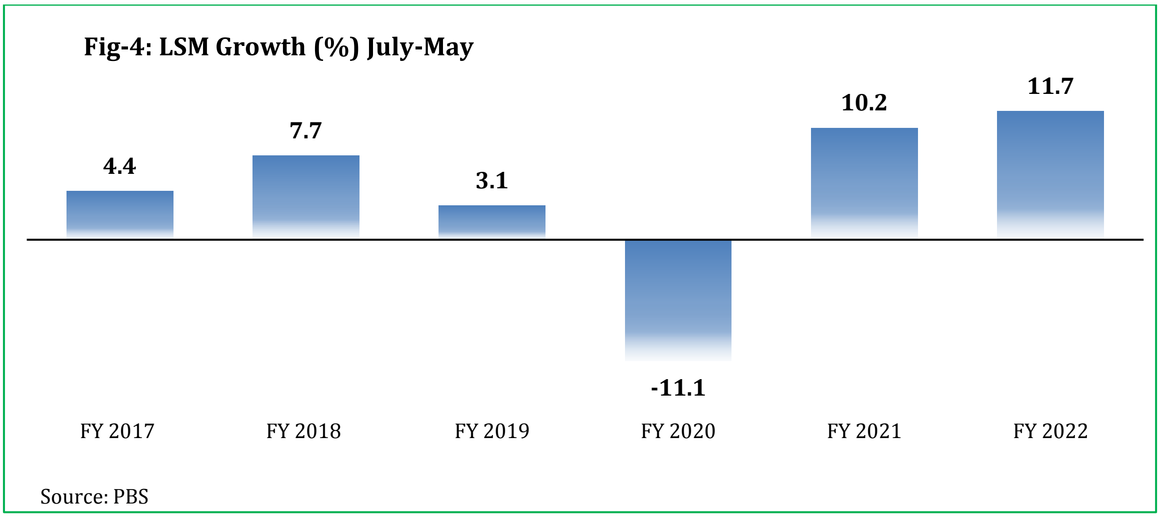
2.1-a Agriculture

The cultivation of cotton crop during 2022-23 season is in final stages in Punjab whereas sowing in Sindh has been completed. According to the initial estimates reported by Crop Reporting Service Department Punjab, the cotton area sown was recorded at 1.485 million ha which comprises 81.5 percent of the target (1.821 million ha). It is about 16.1 percent higher than the same period last year. Whereas cotton cultivation area in Sindh registered at 0.517 million ha, 80.8 percent of the target which is about 13 percent lower than the previous year. The total sown area of both provinces stood at 2.002 million ha showing 81.4 percent of target and a 6.9 percent increase as compared to last year. Further, improved quality of cotton seed has been used both in Punjab and Sindh which would contribute to higher yield.

The climate-smart agriculture is a dire need of time due to temperature variance and unexpected rainfall patterns observed to date. The other important inputs are sufficiently available. For Jul-Jun FY2022, farm tractors production stood at 58,880 showing an increase of 16.0 percent and its sales also jumped to 15.8 percent compared to the same period last year. During Jul-May FY2022, the agriculture credit disbursement increased by 2.3 percent to Rs 1,219.3 billion as compared to Rs 1,191.6 billion last year. During Kharif 2022 (April-June) urea off-take recorded at 1,615 thousand tonnes showing an increase of 7.5 percent while DAP off-take reached to 355 thousand tonnes witnessing increase of 16.5 percent over the same period of previous year.

2.1-b Manufacturing

Despite having twin challenges of elevated inflation and widening trade deficit, LSM kept momentum with 11.7 percent growth during Jul-May FY 2022, against 10.2 percent growth in the corresponding period last year. The growth remained broad-based as, out of 22, 18 subsectors of LSM have witnessed growth. The outstanding performance was observed in Food, Tobacco, Wearing apparel, Textile, Chemicals, Automobiles, Iron & Steel Products, Leather Products, and Paper & Paperboard. On YoY, LSM increased by 21.5 percent in May 2022 while on MoM basis, LSM declined by 1.3 percent.



The performance of automobile is also encouraging in FY2022 as Car production and sale increased by 49.2 percent and 54.9 percent, respectively, Trucks & Buses production and sale increased by 44.3 percent and 49.5 percent while tractor production and sale increased by 16.0 percent and 15.8 percent, respectively.

In June 2022 total cement dispatches inched up 0.95 percent to 5.26 mn tonnes (5.21 mn tonnes in June 2021). Domestic consumption increased by 6.65 percent to 4.97 mn tonnes against 4.66 mn tonnes in the same month last year while exports dropped by 47.6 percent to 0.28 mn tonnes from 0.54 mn tonnes. During FY2022, total cement dispatches were recorded at 52.89 mn tons, which were 7.91 percent lower than the dispatches of 57.43 mn tons a year earlier.

During FY2022, total oil sales increased by 15.9 percent to 22.6 mn tonnes (19.5 mn tonnes last year). On MoM basis, oil sales declined by 11.0 percent and clocked in at 1.9 mn tonnes in June 2022 against 2.1 mn tonnes in May 2022 while on YoY basis it remained the same.

2.2 Inflation

CPI Inflation recorded at 21.3 percent in June 2022 as against 9.7 percent in same month last year. On MoM basis, it increased by 6.3 percent in June 2022 as compared to an increase of 0.4 percent in May 2022.

During FY 2022, inflation stood at 12.2 percent, compared to 8.9 percent in the same period last year. Rising food prices remained the primary driver followed by vehicle fuels and electricity charges. The recent acceleration in inflation was due to supply chain disruptions, high transportation charges, and surging global commodity prices.

In response to elevated inflationary pressure, SBP raised the policy rate by 125 basis points to 15.0 percent. Along with tightening monetary policy and high inflation, the government has also introduced measures to dampen import demand, notably by banning the imports of nonessential and luxury items such as luxury motor vehicles and cosmetics.

The conflict between Russia and Ukraine has caused major disruptions to the supply of commodities in the international market. Both countries are major exporters of energy and agricultural products. The disruptions have exacerbated existing stresses in commodity markets following an already sluggish recovery from the COVID-19 pandemic.

Pakistan has also been adversely affected, being a net importer of food items especially wheat, pulses, crude and edible oil. The impact of global price movement is realized in domestic prices. However, the government made best efforts to minimize the impact of global increase in prices on domestic consumers while keeping fiscal discipline.

2.3. Fiscal

During Jul-May FY2022, the fiscal deficit increased by 5.2 percent (Rs 3,468 billion) against 3.9 percent (Rs 2,197 billion) in the comparable period of last year. Similarly, the primary balance posted a deficit of Rs 945 billion (1.4 percent of GDP) in Jul-May FY2022 against the surplus of Rs 139 billion (0.2 percent of GDP) last year.

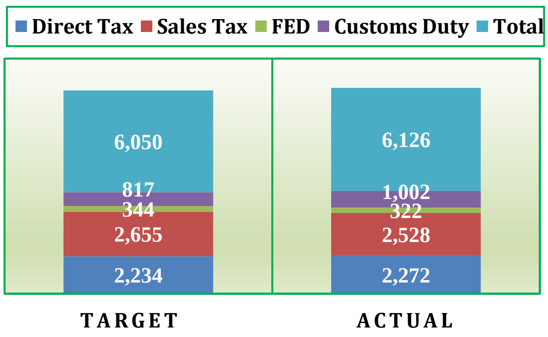
Net federal revenues grew by 11.6 percent to Rs 3,350 billion in Jul-May FY2022 against Rs 3,003 billion last year. The growth in revenues has been realized on the back of the significant rise in tax collection. On the other hand, total expenditure witnessed a sharp increase owing to a 33.1 percent growth in current spending. Higher growth in subsidies and grants jacked up the current spending during the period under review. While PSDP spending increased by 7.5 percent to Rs 518 billion in Jul-May FY2022 against Rs 482 billion in the comparable period of last year.

FBR Tax Collection

FBR tax collection has surpassed the Rs 6.0 trillion mark for the first time in its history. The fiscal year 2022 ended up by posting 29 percent growth with a net tax collection of Rs 6,126 billion, compared to Rs 4,745 billion in FY2021. During FY2022 FBR exceeded its upward revised revenue target of Rs 6,050 billion by Rs 76 billion. The provisional net collection in June 2022 was Rs 778 billion, up from Rs 582 billion in June 2021, representing a 34 percent YoY growth.

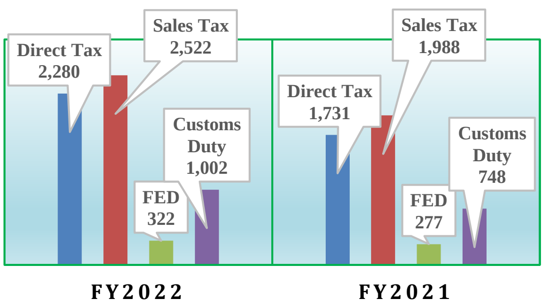
The tax collection has witnessed a broad-based growth in all its revenue heads during FY2022. Domestic tax collection posted a growth of 28 percent. Within domestic tax collection, direct taxes increased by 31 percent, sales tax by 27 percent, and FED by 16 percent. While customs duty grew by 34 percent during FY2022.

Fig-5: Actual Vs Target



Source: FBR

Fig-6: FBR Tax Collection (Rs Billion) Jul-Jun



Source: FBR

<u>Box–I: FBR's Major Initiatives</u>

Inland Revenues

- **The Track and Trace System:** It has been rolled out for Tobacco & Sugar Sectors and its rolling out for Cement, Beverages, and Fertilizer Sectors is in progress. This enables FBR to trace the supply chain of manufactured goods.
- **Point of Sales (POS):** It is a computerized system for recording sales data, managing inventory, and maintaining customer data. It is a real-time sales documentation system that links the electronic systems at the outlets of all tier-1 retailers with the FBR via the internet. The system is aimed to ensure that all sales

are reported in real-time to FBR and are duly accounted for in the monthly sales tax returns of such retailers and the Sales Tax collected by the retailers is duly deposited in the government Treasury.

- **Automated issuance of refunds:** To facilitate taxpayers, a centralized automated refund system has been introduced with no requirement for manual application and verification.
- **Single Sales Tax Portal/Return:** This facility will enable taxpayers to file single monthly Sales Tax returns instead of multiple returns on different portals; thereby, significantly reducing the time and cost of compliance.
- **E-hearing:** To provide faceless tax administration, reducing compliance costs, and saving precious time of the taxpayers the mechanism of e-hearing has been devised. Enabling legal provisions for admissibility of evidence collected during e-hearing has been introduced through Section 227E of the Income Tax Ordinance, 2001.
- **Electronic filing of an appeal:** The mechanism of online filing of appeals before Commissioner Inland Revenue (Appeals) has been made available to the taxpayer.
- **Tax Asaan:** It is a mobile application to facilitate taxpayers, available free of cost for Android as well as iOS-based smartphones.
- **IREN and Joint Anti-smuggling field intelligence exercise:** Inland Revenue Enforcement Network (IREN) has been established to check smuggling and counterfeit products. Inland Revenue Service and Pakistan Customs Service have joined hands for an anti-smuggling field intelligence exercise.
- **Risk-based Audit:** FBR has developed a centralized Risk-based Audit Management System (RAMS) for the selection of audit cases centrally based on pre-determined risk parameters.
- **Transformation of traditional audit processes through e-Audits:** FBR is also moving toward Instituting Data analytics for E-Audit through a transformation in the traditional audit processes. In this system, the correspondence between taxpayers and the tax department would totally be electronic till the conclusion of audit proceedings.
- **Automation of audit monitoring system:** A software solution is under process to provide continuous monitoring of the audit cases with sufficient documentation and assistance to the auditors.

Customs

- **Pakistan Single Window (PSW):** To achieve trade facilitation in an automated environment, reduce clearance times for legitimate trade, improved compliance through increased access to regulatory information and functions, the system of PSW has been launched.
- **Automated process for Scanning of Cargo:** FBR's Pakistan Customs Wing has introduced a new automated process in WeBOC system for scanning containerized import consignments of industrial raw materials for their speedy clearance at ports. The introduction of the Non-Intrusive Inspection System aimed at replacing the physical inspection of cargo and reducing the dwell time at ports by using the latest scanning technology in line with international practices
- **Removal of requirement for I-form, e-form**: Removal of the requirement for I-form, e-form, and other documents implemented since 31st December 2021. It would help reduce compliance time and documentation.
- **Development of Authorized Economic (AEO) Module:** The AEO Module has been developed. It will help in reducing the port dwell time and customs clearance
- **The Threshold for Electronic/Digital Mode of Payment:** The Threshold for Electronic/Digital Mode of Payment has been lowered from Rs 500,000 to

Rs 200,000. The Module has been developed. It will streamline the payment process and would reduce the processing time.

- **Common Bonded Warehousing Module:** The Module is developed and deployed. It will help streamline the matters relating to Common Bonded Warehouse.

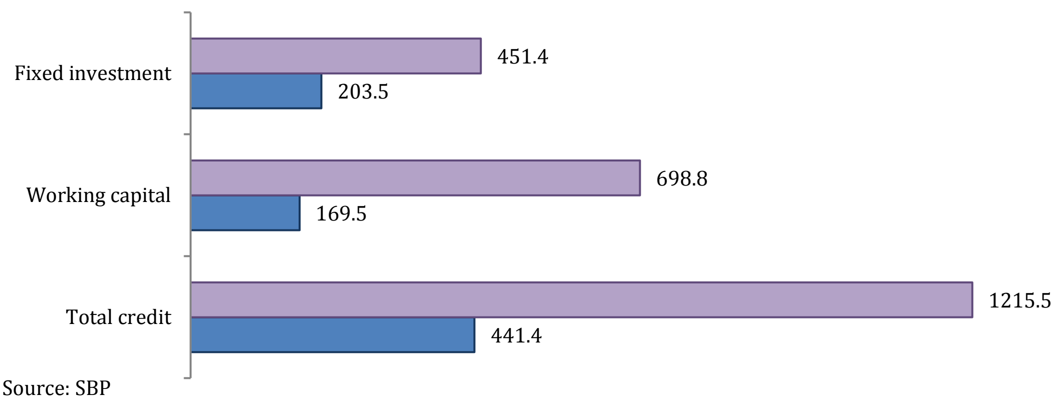
Source: FBR

2.4. Monetary

Recently, SBP has increased the policy rate by 125 basis points to 15.0 percent. SBP has linked Exports finance Schemes (EFS) and Long-Term Finance Facility (LTFF) to the policy rate to strengthen monetary policy transmission while continuing to incentivize by presently offering a discount of 500 bps relative to the policy rate. The decision of monetary tightening since September 2021, on account of an exceptionally challenging and uncertain global environment would stabilize economic activity, prevent a de-anchoring of inflation expectations, and provide support to the Rupee in the wake of multi-year high inflation and record imports.

During the period 01st July – 24th June, FY2022 money supply (M2) observed a growth of 10.4 percent (Rs 2,532.9 billion) as compared to a growth of 12.5 percent (Rs 2,605.5 billion) last year. NFA witnessed a contraction of Rs 1,441.7 billion as compared to an increase of Rs 1,010.7 billion last year. Whereas NDA of the banking sector increased by Rs 3,974.6 billion as compared to Rs 1,594.8 billion last year. Private Sector has borrowed Rs 1,443.3 billion as compared to Rs 594.8 billion last year.

Fig-7: Loans to Private Sector Businesses Rs billion



Source: SBP

2.5 External Sector

The Current Account posted a deficit of $ 17.4 billion for FY2022 as against a deficit of $ 2.8 billion last year. Current account deficit widened due to constantly growing import volume of energy and non-energy commodities, along with a rising trend in the global prices of oil, COVID-19 vaccines, food and metals. Exports on fob grew by 26.6 percent during FY2022 and reached $ 32.5 billion ($ 25.6 billion last year). Imports on fob grew by 32.8 percent during FY2022 and reached $ 72.0 billion ($ 54.3 billion last year). Resultantly the trade deficit (FY2022) reached to $ 39.6 billion as against $ 28.6 billion last year.

As per PBS, during FY 2022, exports increased by 25.6 percent to $ 31.8 billion ($ 25.3 billion last year). The exports grew by 7.0 percent in June 2022 to $ 2.9 billion against $ 2.7 billion last year. The major export commodities which have shown tremendous performance during the review period include Readymade garments (28.7 percent in value & 49.4 percent in quantity), Bed wear (18.7 percent in value & 11.0 percent in quantity), Cotton Yarn (18.7 percent in value and quantity declined by 14.1 percent), Cotton Cloth (26.9 percent in value & 3.8 percent in quantity), Knitwear (34.2 percent in value despite decline in quantity by 5.4 percent), Chemical & pharma products (36.5 percent in value), leather manufactured (10.4 percent in value) and Basmati rice (22.1 percent in value & 21.2 percent in quantity). The increase in overall exports is contributed by the growth in exports of value-added goods with almost 40 percent share in total exports.

The total imports in FY2022 increased to $ 80.2 billion ($ 56.4 billion last year), thus posting a growth of 42.2 percent. The main commodities imported were Petroleum products ($12.1 billion), Medicinal products ($ 4.1 billion), Petroleum crude ($ 5.6 billion), Liquefied Natural gas ($ 4.9 billion), Palm Oil ($ 3.5 billion), Plastic materials ($ 3.1 billion) and Iron & Steel ($ 2.9 billion). In addition, other commodities include Textile machinery, Electrical machinery & apparatus, Power generating machinery, and raw cotton. Higher imports of these commodities indicate growth in the related sectors as well.

2.5.1 Foreign Investment

In FY2022, FDI reached $ 1867.8 million ($ 1820.5 million last year) increased by 2.6 percent. FDI received from China was $ 531.6 million (28.5 percent of total FDI), the United States $ 249.6 million (13.4 percent), Switzerland $ 146.2 million (7.8 percent), UAE $ 143.9 million (7.7 percent) Hong Kong $ 137.7 million (7.4 percent) and Singapore $ 114.7 million (6.1 percent). Power sector attracted highest FDI of $ 737.6 million (39.5 percent of total FDI), Financial business $ 405.3 million (21.7 percent), Oil & Gas exploration $ 195.3 million (10.4 percent) & Information Technology $ 148.0 million (7.9 percent).

Foreign Private Portfolio Investment has registered a net outflow of $ 388.1 million during FY2022. Foreign Public Portfolio Investment recorded a net inflow of $ 309.5 million. The total foreign portfolio investment recorded an outflow of $ 79.0 million during FY2022 as against an inflow of $ 2761.9 million last year. Total foreign investment during FY2022 reached $ 1788.9 million ($ 4582.4 million last year).

2.5.2 Worker's Remittances

In FY2022, workers' remittances increased by 6.1 percent to $ 31.2 billion ($ 29.4 billion last year). MoM, remittances increased by 18.4 percent in June 2022 to $ 2.76 billion compared to May ($ 2.33 billion). YoY, remittances increased by 1.7 percent to $ 2.76 billion in June 2022 ($ 2.71 billion in June 2021). Share of remittances (FY2022) from Saudi Arabia remained 24.8 percent ($ 7743.3 million), UAE 18.7 percent ($ 5841.8 million), UK 14.4 percent ($ 4486.8 million), USA 9.9 percent ($ 3081.6 million), other GCC countries 11.6 percent ($ 3622.5 million), EU 10.8 percent ($ 3361.0 million), Malaysia 0.5 percent ($ 144.2 million), and other countries 9.3 percent.

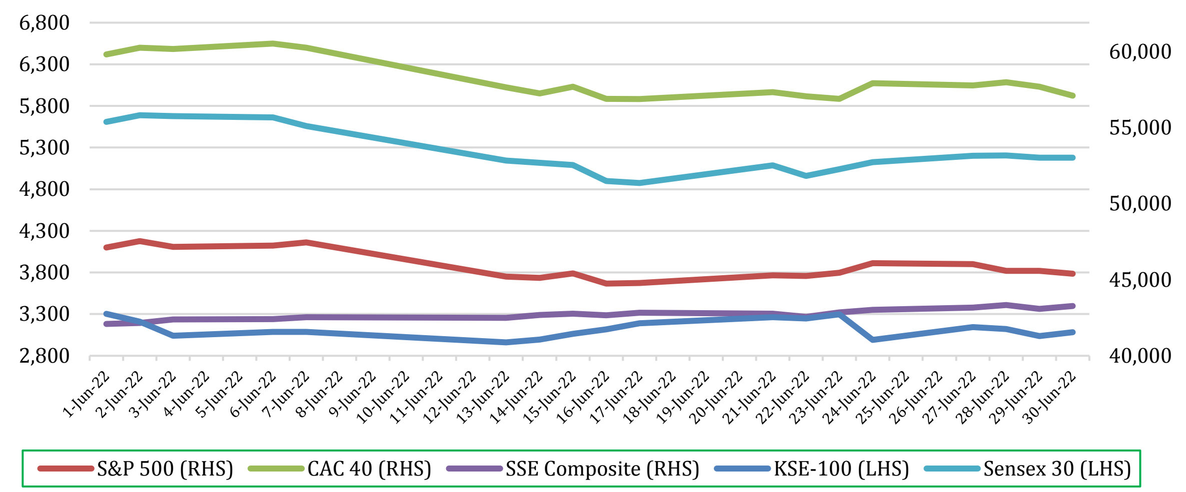
2.5.3 Foreign Exchange Reserves

Pakistan's total liquid foreign exchange reserves stood at $ 14.4 billion on July 25, 2022, with the SBP's reserves recorded at $ 8.5 billion, while commercial banks' reserves remained at $ 5.8 billion.

2.6 Performance of KSE Index

The KSE-100 index closed at 41,541 points as on 30th June 2022 while market capitalization settled at Rs 6,957 billion. The trend of major world indices is depicted in Fig-8:

Fig-8: Major World Indices



Source: PSX, Investing.com

2.7 Social Sector

- PPAF through its 24 Partner Organizations has disbursed 46,829 interest-free loans amounting to Rs 1.96 billion during the month of June 2022. Since the inception of the interest-free loan component, a total of 1.94 million interest-free loans amounting to Rs 70.23 billion have been disbursed to the borrowers.
- Bureau of Emigration and Overseas Employment has registered 70,924 emigrants during June 2022 for overseas employment in different countries.
- Under Kamyab Jawan Youth Entrepreneurship Scheme (PMKJ-YES) the government has disbursed Rs 47,964 million till May 2022 to the youth for businesses.
- Till 19 July 2022, number of confirmed COVID-19 cases are recorded at 1.55 million with 1.50 million recoveries and 30,445 deaths.
- As on 19 July 2022, the total number of vaccine doses administered is reported at 280 million with 137 million individuals partially and 128 million fully vaccinated.
- The US government presented four mobile laboratories to the National Institute of Health to strengthen Pakistan's capacity to diagnose COVID-19 and other communicable diseases, especially in remote locations where access to testing may be limited.
- Ministry of National Health Services, Regulation & Coordination in collaboration with NADRA on July 18, 2022, established a system for issuing Polio and Yellow Fever vaccine certificates to facilitate international travelers.

3. Economic Outlook

High international prices are still adversely affecting external positions even in the start of FY 2023. There was an intense need for the successful completion of the IMF 7th and 8th reviews of Pakistan's Extended Fund Facility (EFF). The government has taken all difficult decisions to make reviews successful, reaching a staff-level agreement for a $ 1.17 billion loan tranche. However, ongoing political unrest is not only creating governance problems but on the other hand, intensifying the uncertainties depicted by exchange rate depreciation which will, in turn, impact the cost of production. Halting investment decisions is further making the outlook blurry.

3.1 Inflation

There are concrete evidence that external and internal factors drive Pakistan's inflation. Not only international commodity prices, especially oil and food prices but the depreciation of the exchange rate influences domestic inflation. No doubt, mostly inflation in the last two months is also coming from supply shocks whose impacts have overshadowed government efforts in maintaining prices. The higher interest rate followed by monetary contraction is also adversely affecting the perception about the outlook of the economy. The recent decline of petroleum prices by the government resulted in a decline in weekly SPI. But market expectations and supply side factors are contributing to inflation.

In June 2022, average international oil prices continued to increase. Since January 2022, the average MoM international oil price inflation was around 8.5 percent per month. On the other hand, in June, the international food price index declined, but its average MoM inflation since January remained at 3 percent per month. These international inflationary impulses in the US dollar became amplified by the accelerated depreciation of the Rupee against the US dollar. International spike in dollar rates and domestic uncertainty depreciated Pakistani rupees to almost 11.5 percent in the first 20 days of FY2023. These cost-push inflation drivers feed into the domestic retail prices. Up to May 2022, Government policies among which the use of taxes and subsidies, temporarily and partially postponed their pass-through into the CPI. Furthermore, usually in the month of July, a positive seasonal factor appears to contribute upwards to the MoM inflation rate. All these critical factors will influence domestic inflation. Thus, YoY inflation in July 2022, may hoover around the level observed in June which is also due to a low base of 8.4 percent in July 2021.

3.2 Agriculture

The input situation remained favorable during the period except for weather conditions. The agriculture sector will continue to grow on account of supportive government policies. However, the unprecedented rains causing floods may hamper cotton and other minor crops.

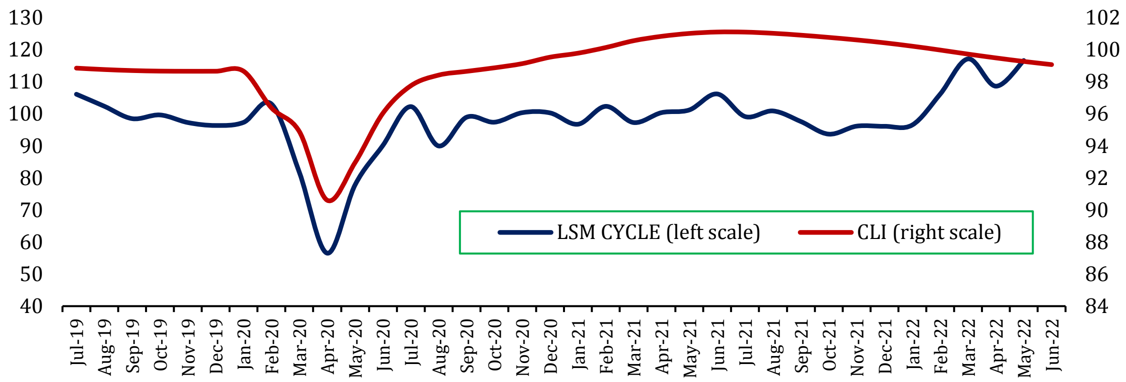
3.3 Industrial Activities

Industrial activity, measured by the LSM index is the sector that is most exposed to external conditions. Its exposure to developments in international markets is illustrated in Fig-9 which compares the cyclical component of LSM with the weighted average CLI in Pakistan's main export markets. The CLI of some individual countries is constructed by the OECD to reflect the deviation of current GDP from its potential level. The cyclical component of Pakistan's LSM output is obtained by extracting the stochastic trend from the seasonally adjusted LSM series. LSM index is published with a time lag of two months, whereas CLI is published with a one-month lag.

The LSM cycle is following the cyclical movements in the main trading partners, but since it is focused on the main industrial sectors and not on total GDP, it is somewhat more volatile than the cyclical component of GDP in Pakistan's main export markets. Nevertheless, although the cyclical position of Pakistan's main trading partners has deteriorated month after month since August 2021, LSM's cyclical pattern is holding on remarkably well.

As expected, LSM output slightly contracted in May as compared to April, but its YoY growth rate remained on a positive trend. The negative seasonal effects may have hindered LSM's MoM expansion in June, but on YoY basis, LSM is expected to show continued solid growth.

Fig - 9: Relationship between CLI and LSMI cycle



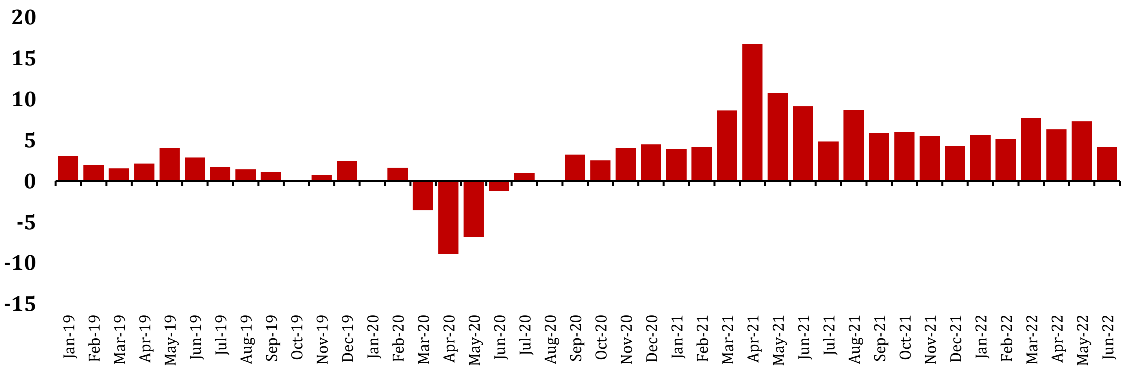
Source: EA Wings'Calculation

3.4 Overall economic activity

The Monthly Economic Indicator (MEI) is developed as a tool to distribute the past annual GDP numbers, as reported by the PBS, on a monthly/quarterly basis and to nowcast on that same frequency GDP growth for the FY in which the National Accounts are not yet available. It is based on combining monthly data of indicators that are proven to be correlated with GDP at constant prices. Fig-10 presents the MEI on monthly basis since January 2019 adjusted to the new rebased National Accounts.

In June 2022, mainly due to the continuing strong performance of the industrial sector, which is known to exert significant multiplier effects on other sectors of the economy, the MEI continues to issue a positive economic signal.

Fig-10: Monthly Economic Indicator (MEI) Growth (percent)



Source: EA Wings'Calculation

3.5 External

Amid the international scenario, exports of goods and services as per BOP data are on an increasing trend. However, a strong surge in international commodity prices also increased imports thus widening the trade deficit. Workers' remittances were not enough to finance this trade deficit, thus current account deficit widened. Though in month of June 2022, FDI posted a growth of almost 92 percent but over the whole fiscal year, financial account could not grow enough to offset current account deficit which in turn was the basis of FOREX depletion. With all these factors, along with political uncertainties, the market-based exchange rate significantly depreciated especially in the first twenty days of FY 2023.

However, it is expected that with government appropriate policies, imports will fall, while the continued decent performance of exports of goods and services as well as workers remittances will bring current account deficit to a manageable level.

According to BOP data, the trade deficit in goods and services was recorded at $ 4.6 billion in June 2022. Trade balance will revert back to lower levels in July 2022. It is expected that remittances will continue to remain strong. Imports of goods and services are expected to come down from exceptionally high levels observed in May and June. Taking these factors into account, as well as its other components, the current account deficit is expected to steadily decline in the coming months. However, for July 2022, based on low import growth and better performance of both exports and workers' remittances, a significant decline in the current account deficit is anticipated.

3.6 Fiscal

The expansionary fiscal policy stance throughout FY2022 widened the fiscal deficit by 58 percent during Jul-May FY2022. In terms of GDP, it increased by 5.2 percent in Jul-May FY2022 against 3.9 percent last year. The fiscal consolidation efforts were severely hampered during FY2022 owing to the relief measures introduced to offset the impact of higher energy and commodity prices. Resultantly, the expenditure side came under significant pressure and thus limited the already constrained fiscal space for growth-oriented and social development programs.

On the revenue side, despite difficult economic conditions, tax collection surpassed the Rs 6.0 trillion mark in FY2022. Due to broad-based growth in all revenue heads, net tax collection increased by 29 percent in FY2022 over the preceding year. Direct taxes, in particular, increased by 31 percent, which is consistent with the government's policy of enforcing taxation on earned income, thereby reducing the indirect incidence of taxation. During the year FBR introduced various initiatives, however, the POS system to document the retail sector and the TTS to capture LSM across the country played a significant role in improving tax collection. For FY2023, tax collection is budgeted at Rs 7,470 billion. To maintain the growth momentum and to achieve the set target during the current fiscal year, reform measures would continue to focus on facilitating taxpayers to create a congenial environment, using technology to improve documentation, and broadening the tax base, etc.

During the first eleven months of FY2022, expenditure overrun the revenue growth, and thus fiscal deficit is revised upward. It is likely to remain at 7.1 percent of GDP.

4. Way Forward

YoY inflation has accelerated more than 20 percent and may continue to remain high in the immediate short run. On the other hand, despite the gradual decline in the economic growth outlook in Pakistan's main export areas, domestic economic activity continues to be strong. But international reserves have fallen to levels that are too low according to international standards. These factors have contributed to significant upward pressure on domestic interest rates and SBP had to raise its policy rate. Furthermore, significant fiscal consolidation is in the making. These developments may put downward pressure on domestic demand and risk to slow down economic growth in the short run.

On the other hand, long-term economic policies should see through these short-term headwinds. Once the tranche from IMF is received, additional financing channels will open themselves. This should allow focusing on longer-term objectives. One of them is to secure a high sustainable growth trajectory capable of absorbing Pakistan's rapidly growing human capital while avoiding internal and external financing constraints. To avoid these constraints, effective supply-side dynamics must be combined with prudent demand management.

Economic Indicators
(28-07-2022)

	2020-21 (Jul-Jun)	2021-22 (Jul-Jun)	percent Change
External Sector			
Remittances ($ billion)	29.4	31.2	↑6.1
Exports FOB ($ billion)	25.6	32.5	↑26.6
Imports FOB ($ billion)	54.3	72.0	↑32.8
Current Account Deficit ($ billion)	2.8	17.4	↑
FDI ($ million)	1820.5	1867.8	↑2.6
Portfolio Investment-Public ($ million)	2555.3	309.5	↓87.9
Total Foreign Investment ($ million) (FDI & Portfolio Investment)	4582.4	1788.9	↓61.0
Forex Reserves ($ billion)	**24.876 (SBP: 17.830) (Banks: 7.046)** (On 23rd July 2021)	**14.358 (SBP: 8.519) (Banks: 5.839)** (On 25th July 2022)	
Exchange rate (PKR/US$)	**162.33** (On 23rd July 2021)	**229.88** (On 25th July 2022)	

Source: SBP

	2020-21 (Jul-May)	2021-22 (Jul-May)	percent Change
Fiscal			(Rs Billion)
FBR Revenue (Jul-Jun)	4745	6126	↑29.1
Non-Tax Revenue (Federal)	1281	1124	↓12.3
Federal PSDP (incl. grants to provinces)	482	518	↑7.5
Fiscal Deficit	2197	3468	↑
Primary Balance	139	(945)	↓

Source: FBR & Budget Wing

	2020-21 (Jul-May)	2021-22 (Jul-May)	percent Change
Monetary Sector			
Agriculture Credit (provisional)	**1191.6**	**1219.3**	↑**2.3**
Credit to private sector (Flows)	**594.8** (1st Jul to 25th June)	**1443.3** (1st Jul to 24th June)	↑
Growth in M2 (percent)	**12.5** (1st Jul to 25th June)	**10.4** (1st Jul to 24th June)	
Policy Rate (percent)	**7.0** (28-May-2021)	**15.0** (07-Jul-2022)	

Source: SBP

	2020-21	2021-22	percent Change
Inflation			
CPI (National) (percent)	**9.7** (Jun)	**21.3** (Jun)	
	8.9 (Jul-Jun)	**12.2** (Jul-Jun)	
Real Sector			
Large Scale Manufacturing (LSM) (percent)	**32.8** (May)	**21.5** (May)	
	10.2 (Jul-May)	**11.7** (Jul-May)	
PSX Index*	**41630** (On 1st Jul 2022)	**39894** (On 25th July 2022)	↓**4.17**
Market Capitalization (Rs trillion)	**6.96** (On 1st Jul 2022)	**6.73** (On 25th July 2022)	↓**3.30**
Market Capitalization ($ billion)	**33.99** (On 1st Jul 2022)	**29.29** (On 25th July 2022)	↓**13.83**
Incorporation of Companies (Jul-Jun)	**25644**	**26482**	↑**3.27**

*: Formerly Karachi Stock Exchange (KSE)

Source: PBS, PSX & SECP