

# ADB News Release

PAKISTAN RESIDENT MISSION, ASIAN DEVELOPMENT BANK

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## ADB Releases Economic Update

The present report provides an analysis of economic developments and trends in Pakistan in the first quarter of fiscal year (FY) 2004, and presents outlook for the economy for rest of the fiscal year. The report also discusses Government's economic policies and reforms and reviews poverty related expenditures in FY2003.

Economic recovery, which had started last year, continued in the first quarter of FY2004, with both domestic and external sectors remaining buoyant. The Government pushed forward with its economic reform agenda and made further progress in privatization of public sector enterprises. Data on poverty related public expenditure, now available for the full FY2003, also shows a appreciable growth, reflecting the Government's commitment to poverty reduction.

### Domestic Sector

**Growth:** The real sector of the economy showed a robust growth in the first quarter of FY2004. In the **agriculture sector**, rice and sugarcane crops are estimated to be larger than last year, while the cotton crop is estimated to be smaller. Growth of **manufacturing** production in the first quarter of FY2004 was twice that in the same quarter of last year. The growth was broad-based, with increases being particularly large in the case of cement, electronics, and automobiles. Financial sector, telecommunications, electronic media, and construction led growth in the service sector.

**Prices, Money and Capital Market:** Inflation decelerated further in the first quarter of FY2004, with the annual rate of inflation based on the Consumer Price Index (CPI) declining to 2.6 percent in September 2003 from 3.1 in June. In an environment of stable prices and appreciating Pak Rupee, the State Bank of Pakistan (SBP) continued to pursue an easy monetary policy. There was a remarkable increase in private sector credit in the first quarter of FY2004 in contrast with a substantial net retirement in the corresponding quarter of FY2003. Yields on 6-month treasury bills and lending rates charged by banks, despite increasing somewhat, remained at historically low levels. The stock market remained buoyant and the KSE-100 index increased by 24.8 percent in the first five months of FY2004.

**Fiscal Policy:** The Government continued to pursue the policy of fiscal stabilization during the first quarter of FY2004, and was able to further reduce the overall fiscal deficit to an annual rate of less than 4 percent of GDP by containing the increase in expenditure. Expenditure on subsidies and interest payments was much lower than last year. However, there was a discernable slowdown in tax collection in the first quarter of FY2004, with gross

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tax collection by the Central Board of Revenue (CBR) stagnating at the level realized in the corresponding quarter of FY2003.

## External Sector

**Balance of Trade:** Exports and imports continued to grow at a robust double-digit rate in the first four months of FY2004, and exceeded the targets given in the Trade Policy announced in July 2003. Exports increased by 14.2 percent and imports by 12.9 percent. As in FY2003, textiles led growth in exports, which increased by 15.6 percent and accounted for 71.3 percent of the total export growth. Growth in imports was broad-based with all commodity groups, except food and petroleum, showing significant increases. The trade deficit in the first four months of FY2004, at \$310 million, was slightly lower than in the corresponding period of FY2003.

**Current Account:** The current account of the balance of payments continued to show a comfortable surplus (\$819 million) in the first quarter of FY2004, although the size of the surplus shrank after consistently increasing in the preceding seven quarters. Overseas workers' remittances, which had been an important factor in the upward trend in the current account surplus in the past two years, declined to \$906 million compared with \$1,053 million in the corresponding last year. This was partly offset by continued decline in interest payments on external debt, and a smaller trade deficit.

**Capital Account and Foreign Exchange Reserves:** Deficit in the capital account increased to \$347 million in the first quarter of FY2004 compared with \$217 million in the corresponding period of FY2003, because of a sharp decrease in disbursement of foreign long-term loans and credits and lower foreign direct investment. Foreign exchange reserves continued to increase, but their growth seems to be tapering off after very sharp increases seen in the preceding two years. Foreign exchange reserves held by the SBP increased from \$9.5 billion as of end June 2003 to \$10.0 billion by the end of September. At this level, reserves are sufficient to cover about nine months' imports projected for FY2004. Slowdown in accumulation of reserves held by SBP reflects the central bank's recent policy of letting the Rupee appreciate. The Rupee appreciated from Rs 57.82/US\$ on 30 June 2003 to Rs 57.20/US\$ on 25 November 2003.

## Outlook

With robust growth in the real sectors of the economy and presence of a number of factors conducive for growth, prospects for the realization of the **overall growth target of 5.3 percent** for the whole year look good. The growth in **agriculture** sector may be less than last year, but still it should be in the range of 3.0-3.5 percent. With the end of the drought, livestock production is also expected to show a robust growth. The **manufacturing** sector is likely to post a higher growth than last year, with textile industry getting a boost from continuing double-digit growth in textile exports. Domestic demand for manufactures boosted by higher cash income of cotton farmers and sharp increase in consumer credit should also support the strong performance by the manufacturing sector. The **service sector** also looks set to record higher growth with non-traditional sectors emerging as growth leaders. The financial results for most banks in the first quarter show a large improvement over the corresponding period last year. Telecommunications, particularly cellular phone services, and electronic media are also expanding at a rapid pace

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which should accelerate further with deregulation of the sector and issuance of licenses to new operators.

The **overall deficit target** of 4.0 percent of GDP in FY2004 is likely to be met. However, there is a need to accelerate CBR reforms and ensure that the tax revenue targets for the rest of the fiscal year are achieved. With tight fiscal policy, continued excess capacity in the manufacturing sector, appreciation of the Rupee, and global price stability, the annual inflation rate is likely to remain below 4.0 percent.

Robust growth in exports, as well as high level of remittances in the first quarter of FY2004, point to a comfortable balance of payments position for the whole year. With global recovery gaining momentum and domestic economic upturn continuing, both exports and imports are expected to maintain a double-digit growth during the year. We expect the current account for the year to remain in surplus, although the magnitude of the surplus will be lower than last year.

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