

ADB News Release

PAKISTAN RESIDENT MISSION, ASIAN DEVELOPMENT BANK

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ADB Releases Pakistan Economic Update March 2004

(Islamabad – 21 March 2004):

The present report, which is the seventh in the series prepared by the Asian Development Bank Pakistan Resident Mission, provides an analysis of macroeconomic developments and trends in Pakistan in the first half of fiscal year (FY) 2004, and presents the 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.

Economic growth gained further momentum in the first half of FY2004, and the growth forecast has been raised to 5.5 percent. Strong revenue growth so far indicates that the revenue and fiscal targets for the current year should be easily achieved. Robust growth in exports, as well as high level of remittances, point to a comfortable balance of payments position for the year. Thus the economy seems to be moving to a high growth path.

Domestic Sector

Growth: The two main commodity-producing sectors, namely agriculture and large-scale manufacturing, have shown substantial improvement in the first half of FY2004. Of the three major summer crops, rice and sugarcane are estimated to be larger than last year. The initial estimates show an increase in area under wheat over last year. Growth in large-scale manufacturing production in the first half of FY2004 was almost three times the growth last year, with more pronounced increases being in automobiles, electronics, leather products, cement, and metal products.

Prices, Money and Capital Market: Inflation in the first half of FY2004 was lower than that in the first half of FY2003. However, it started to rise in October 2003. Despite an upturn in inflation, the State Bank of Pakistan (SBP) continued its easy monetary policy in order to sustain the economic recovery. The broad money supply increased by 9.1 percent in the first half of FY2004 compared with an expansion of 8.6 percent in the corresponding period of last year. Private sector credit growth more than doubled, as economic recovery strengthened. Except for a decline in September and October 2003, share prices continued their

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rising trend through most of the first eight months of the current year, when the KSE-100 index increased by 42.3 percent.

Fiscal Policy: There was a substantial improvement in fiscal position in the first half of FY2004, with the fiscal deficit declining to 0.8 percent of GDP compared to 1.6 percent in the first half of FY2003. Revenues increased by 13.9 percent, while expenditure increased by only 3.6 percent. The Government was able to contain increase in expenditure as interest payment on domestic debt and subsidies declined.

External Sector

External Trade: Exports grew by 13.1 percent and imports by 14.2 percent in the first half FY2004. Import growth has accelerated since July 2003 and export growth has also picked up in the last two months. Textile exports maintained a double-digit growth, benefiting from both rising volumes and higher unit prices. In imports, there was a sharp increase of 24.8 percent in non-oil, non-food imports. Despite increase in international prices of petroleum, Pakistan's oil import bill declined, because of a reduction in the quantum imports of petroleum products.

Current Account: The current account of the balance of payments continued to show a comfortable surplus in the first half of FY2004, although the size of the surplus decreased. The reduction in the current account surplus was caused by lower remittances, which declined by 12.8 percent to \$1,874 million, and an increase in payments for services.

Capital Account and Foreign Exchange Reserves: Deficit in the capital account increased to \$633 million in the first half of FY2004 compared with \$146 million in the first half of FY2003. Deterioration in capital account was caused largely by significant declines in foreign direct investment and disbursement of foreign loans to both the Government and the private sector. Foreign exchange reserves held by the SBP increased from \$9.5 billion as of end-June to \$10.5 billion by the end of December 2003. These are sufficient to cover 11.1 months' imports.

Outlook

With robust growth in the real sectors of the economy in the first half of FY2004 and presence of a number of factors conducive for growth, the GDP growth forecast has been raised to 5.5 percent. The agriculture is expected to grow at 4.2 percent, as prospects of winter crops have improved due to greater availability of water, increase in support price of wheat, a sharp increase in disbursement of agriculture credit, and larger off-take of fertilizers. The manufacturing sector is expected to post a higher growth (9-10 percent) because of continuing double-digit growth in textile exports and higher domestic demand for consumer durables fuelled by increase in consumer credit and higher cash incomes of farmers resulting

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from higher cotton prices. The service sector looks set to record strong performance with robust growth in the financial sector, telecommunication, particularly cellular phone service, and electronic media.

Tax receipts, which exceeded the target in the first eight months, are expected to be above the target for the whole year. Public expenditure is expected to remain under control. Hence the fiscal deficit target of 4.0 percent of GDP should be achieved in FY2004. With tight fiscal policy, continued excess capacity in the manufacturing sector, and appreciation of the Rupee, the annual inflation rate, while higher than last year, is not likely to exceed 4.2 percent.

Double-digit growth in exports, as well as high level of remittances in the first half 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 double-digit growth during the year. The current account for the year will remain in surplus, although the magnitude of the surplus will be lower than last year.

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