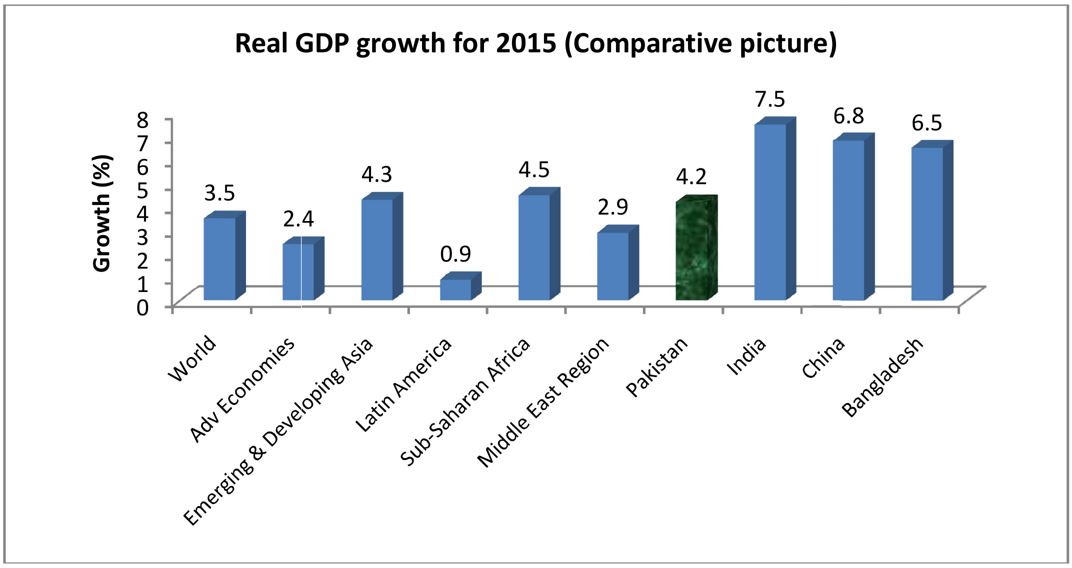
CHAPTER 1

MACROECONOMIC FRAMEWORK

The start of the current year was not encouraging. The Punjab was hit worse by the floods, which damaged infrastructure and Kharif crops. Political standoff and serious security situation shattered investors' confidence. Trade deficit widened and foreign exchange reserves depleted quickly leading to severe exchange rate volatility. Due to energy constraints, deceleration of the manufacturing sector also continued.

Despite these initial odds, there was a spate of good news towards the end of 2014. Pakistan was able to float the Ijara Sukuk Bonds worth $1 billion successfully in the international capital market, albeit at a somewhat high cost. Exchange rate stabilised and Pakistan was able to rebuild its foreign exchange reserves. Due to falling international prices, the rate of inflation came down sharply to 2.1 per cent by April 2015. The fourth and fifth reviews were completed and the IMF Board approved the release of the pending instalments of $1.1 billion. The international economic agencies and donors have appreciated the revival of Pakistan economy and have given positive outlook for 2014-15.

Growth remained stronger in advanced economies in 2015 than 2014, but remained weaker in the emerging markets, reflecting more subdued prospects for some large emerging market economies and oil exporters. The problems plaguing the growth last year, also prevailed in the current year. Ageing population, declining potential growth and global shocks, such as lower oil prices, and many country or region-specific factors, such as crisis legacies and exchange rate swings triggered by actual and expected changes in the monetary policies, remained irritants for growth, and showed that the global economies are still not out of the woods.



Source: *World Economic Outlook, April 2015*

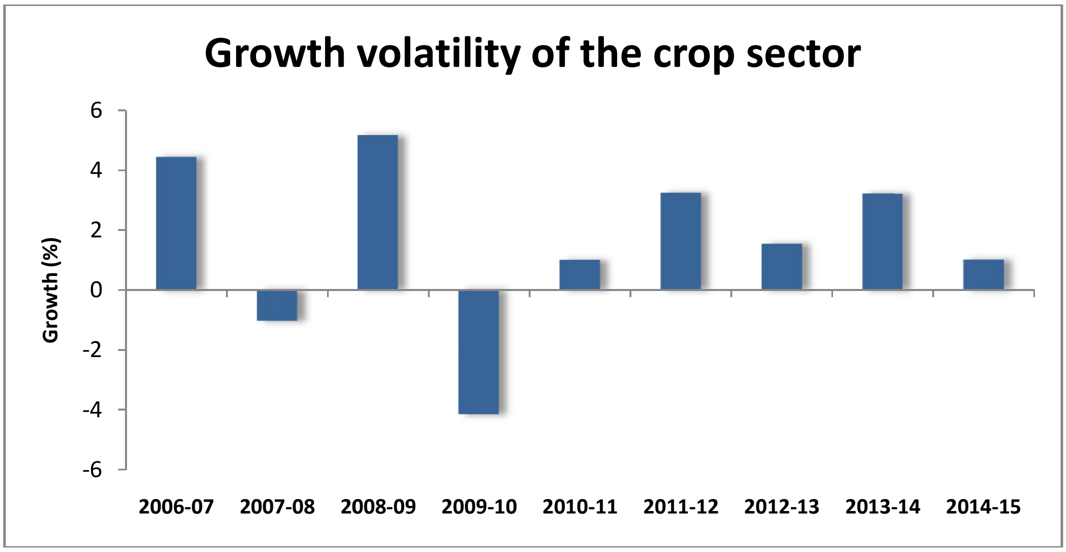
The Indian economy is back on track and expanded at its fastest pace in the last two-and-a-half years, primarily due to a boost from the government spending and higher business investment. China's economic growth is moving towards moderation as the country rebalances its growth model towards growth driven by domestic consumption. Pakistan economy is also gradually heading towards stability but the pace of growth is very slow.

Performance review 2014-15

The Annual Plan for 2014-15 envisaged real GDP growth of 5.1 per cent, which is based on sectoral growth projections for agriculture, industry, and services sectors at 3.3 per cent, 6.8 per cent, and 5.2 per cent respectively. The assumptions underlying the growth target included: implementation of the proposed reforms envisaged in the budget, enhanced fiscal prudence, financial discipline, improved energy availability, resolution of inter-corporate circular debt and improvement in enabling environment for investment.

Agriculture

The agriculture sector not only has significant contribution towards the GDP growth, it also provides employment to more than 44 per cent of the labour force. Pakistan has enormous potential to enhance economic contribution of the agriculture sector through improved productivity and value-addition. However, Pakistan lags behind its regional comparators in yields of many important crops. The Vision 2025 has reiterated the importance of bridging these yield gaps, and envisaged reduction of 40 per cent yield gap by 2025. The Food and Agriculture Organization (FAO) has estimated that Pakistan cannot achieve its overall GDP growth target of seven to eight per cent unless its agriculture sector grows at least by four per cent[1]. The sustainability of the agriculture sector growth is a prerequisite for the overall GDP growth, but unfortunately the crop sector of Pakistan is highly vulnerable to the weather conditions as indicated by the chart below.



Source: *Pakistan Bureau of Statistics*

During the current year**, a**griculture showed mixed patterns in growth of its components. The crop sector remained under stress as initially Kharif crops were hit by floods in the Punjab and

[1] FAO Pakistan Country Programming Framework 2012-17

afterwards wheat productivity was affected due to prolonged winter, late rains and hailing. The sugarcane area under-cultivation got reduced due to the low price received by the grower in the last season. This is also reflected in 7.1 per cent reduction in the sugarcane output.

Rice is showing resilience for the last few years and its output is gradually increasing. During 2014-15, area under rice cultivation increased by 2.1 per cent, while production touched the record level of seven million tonnes. The cotton crop revived this year after dismal performance of the last year. Both area and production increased significantly, but the signals from the commodity markets are not encouraging, and it price is persistently dropping in the international market. Moreover, the Chinese decision of lesser cotton imports this year will have a strong bearing for the next crop due to the Cobweb phenomenon.

Rice and cotton crops showed impressive performance and grew by 3.1 and 9.5 per cent respectively. Although three out of five important crops registered negative growth, but the livestock sub-sector posted 4.1 per cent growth, which is the highest in the last decade. Area and production of important crops is given below in Table 1.

Table 1: Comparative position of area and production of important crops

	Area '000' hectares		Percentage Change	Production '000' tonnes		Percentage change
	2013-14	2014-15		2013-14	2014-15	
Cotton (Mn. bales)	2,806	2,961	5.54	12.8	13.9	9.50
Sugarcane	1,173	1,141	-2.73	67,460	62,652	-7.13
Rice	2,789	2,891	3.64	6,798	7,005	3.05
Wheat	9,199	9,180	-0.22	25,979	25,478	-1.93
Maize	1,168	1,130	-3.27	4,944	4,695	-5.04

Source: *Pakistan Bureau of Statistics 2015*

The performance of other crops, comprising minor crops like onion, potato, tomato, fruits, etc., during 2013-14 remained below as it recorded negative growth of 5.4 per cent. Keeping in view the cyclical nature of the crop sector, it was expected that other crops would post a healthy growth; however, it could manage only a growth of 1.1 per cent. Forestry and fishing sub-sectors surpassed the targets by posting growth of 3.2 and 5.8 per cent respectively. Overall, the agriculture sector grew by 2.9 per cent, which is lower than the envisaged target growth of 3.3 per cent, but higher than the growth of 2.7 per cent achieved during the last year [Annexure-I]. The structural problems and composition of the agriculture sector is constraining its growth at about or below four per cent even when crop production is considered good.

Industry

The industrial sector has shown slight improvement over the previous year and has registered a growth of 3.6 per cent as against the target of 6.8 per cent during 2014-15. Energy shortages, low foreign investment and security issues are responsible for slow industrial growth during the current fiscal year. Energy shortages have also been one of the main factors for low uptake of credit by the private sector.

Manufacturing

During 2014-15, the manufacturing sector grew by 3.2 per cent against the target of 6.9 per cent. The sector has shown lower-than-expected growth. The Large Scale Manufacturing (LSM) experienced severe energy crunch and witnessed a growth of 2.4 per cent during 2014-15 against the target of seven per cent. Besides energy shortages, the LSM growth has been adversely affected by declining cotton and edible oil prices, rising cost of production and weak external demand for cotton yarn, cloth and cement.

During July-March 2014-15, positive growth was recorded in iron and steel products (35.63 per cent), automobiles (17.02 per cent), leather products (9.62 per cent), electronics (8.21 per cent), pharmaceuticals (6.38 per cent), chemicals (5.94 per cent), coke and petroleum products (4.73 per cent), non-metallic mineral products (2.56 per cent), fertilizers (0.95 per cent), and textile (0.50 per cent). The sectors, which fell in the negative zone, were: wood products (-78.46 per cent), engineering products (-10.68 per cent), paper and board (-7.26 per cent), and food beverages and tobacco (-1.03 per cent).

Jeeps, cars, Light Commercial Vehicles (LCVs) and trucks have shown significant performance. In addition, huge increase in the production of tractors (44.65 per cent) was a result of a cut in the GST from 16 per cent to 10 per cent in the current fiscal year. The textile industry has been facing severe challenges in the recent years. Despite energy constraints, low international demand and inefficiencies, the textile sector has managed to record a positive growth of 0.50 per cent. On the other hand, the fertilizer sector, one of the major sectors of the LSM, has shown a crawling growth due to shortfall in gas supply.

As far as the negative items of the QIM are concerned, significant decrease in the production of the wood products is due to closure of one main unit of chip board in Kotri, Sindh. Similarly, production of paper and board in the Punjab has suffered due to gas shortages, which forced the two largest manufacturers located in the province to decrease their production. Low cultivation of sugarcane in the Punjab has ultimately led to lower output of sugar.

The mining and quarrying sub-sector was targeted to grow by 6.5 per cent, but has posted a growth of 3.8 per cent. Small and household sub-sector posted a growth of 8.2 per cent against the target of 8.4 per cent during the current fiscal year. The construction sub-sector grew by 7.1 per cent against the target of 7.5 per cent. The main reasons for the sector’s robust growth are the ongoing mega projects, such as Rawalpindi-Islamabad Metro Bus Service, Multan-Faisalabad Motorway, and other projects in ports and energy sectors. Value addition in electricity, gas and water supply sub-sector remained 1.9 per cent during 2014-15 against the target growth of 5.5 per cent.

Services sector

As developing and emerging economies seek to emulate the focus of developed countries on the services sector, there are certain sectors that are gaining momentum globally. The International Labour Organization (ILO) predicts that globally private sector services (business and administrative services, real estate), combined with the accommodation and restaurant industry, will create jobs at the fastest rate during the next five years. These industries within the services sector are expected to employ more than a third of the global workforce in 2015-20. While public services in healthcare, education and administration are now increasing at a slower pace in terms of employment, these still retain considerable significance with 15 per cent of the total employment and denote the rise of a large care industry.

For the last decade or so, the services sector has dominated the Pakistani economy and emerged as the leading sector in terms of its share in the GDP. In 2014-15, the services sector contributed 58.8 per cent to the Gross Value Added (GVA) at constant basic prices. A decade ago, this figure was around 56 per cent, which shows that the growth rate is relatively slow, while the trend remains upward and increasing.

This sector has registered a growth of five per cent against the target of 5.2 per cent for FY15. Major contributors are 9.4 per cent growth in the government services, 6.2 per cent growth in finance and insurance and 4.2 per cent growth in transport, storage and communication. The wholesale and retail trade sub-sectors could not meet the target of 6.1 per cent due to the subdued performance of the agriculture and industrial sectors. However, it managed to grow at 3.4 per cent only.

Transport, storage and communication, in terms of its value-addition in the services sector, stood second. Commencement of various infrastructure projects, purchase of locomotives and increased usage of 3G and 4G bands in the communication sector supported this sub-sector to grow at 4.2 per cent against the target of 4.5 per cent.

Performance of the finance and insurance sectors performance is gauged through the Financial Intermediation Services Indirectly Measured (FISIM). The growth in total advances of scheduled banks for July FY14 to April FY15 was 4.3 per cent. During 2014-15, in the finance and insurance sector there is 6.4 per cent growth in the Gross Value Addition (GVA) from banks predominantly contributed by 26 per cent growth (GVA) in the non-Scheduled banks, and 6.1 per cent growth (GVA) in the scheduled banks.

For the last five years, the housing services have constantly been contributing 6.7 per cent to the GDP with its own growth rate of four per cent. This sector has performed on the expected trend of four per cent growth due to new private housing societies with an initiative of the government as the Ashiyana Housing Scheme.

The government services have shown a phenomenal growth of 9.5 per cent against a target of 4.3 per cent. Other private services were targeted to grow at 5.8 per cent in 2014-15. Even due to social and economic hazards, the private services crossed the target and grew by 5.9 per cent.

Investment and savings

The investment-to-GDP ratio has declined substantially from 19.2 per cent in 2007-08 to 15 per cent in 2012-13 and 2013-14. It has inched up to 15.1 per cent in the current fiscal year. Both domestic and Foreign Direct Investment (FDI) contributed to this downslide. The fiscal dominance over financing needs crowded out private sector investment. Other contributing factors included: peculiar security environment and structural rigidities surrounding governance and regulatory environment. The public sector investment has inched up to 3.9 per cent of the GDP from 3.4 per cent last year, while the private sector investment declined from 10 per cent of the GDP in 2013-14 to 9.7 per cent in 2014-15 (Annexure – II). Long spells of power outages, law and order situation, and level of regulatory bottlenecks are main reasons of low private investment.

The national savings have improved to 14.5 per cent of the GDP from 13.7 per cent in 2013-14. Pakistan's reliance on foreign savings has decreased as marginal increase in investment is somehow compensated with increase in the national savings. The SBP decision to ease monetary policy has not yet impacted the investment climate, this implies that structural problems should also be resolved to take the full benefits of low interest rate scenario.

Distribution of the private investment in various sectors during the last decade shows that major recipients of the investment are housing services, agriculture, transport and communication and manufacturing. However, during the period under review, over this period of time a declining trend has been observed for the manufacturing sector. The success of developing countries in achieving their target growth is reliant on the level of investment in the economy. In this regard, the low rates of savings are an obstacle to achieve sustained high-level growth and development (like missing the target of 5.1 per cent GDP growth). Dependence on the developed countries for resources is not sustainable, implying the importance of mobilising domestic savings in the economy.

Outlook 2015-16

Agriculture

The agriculture sector is targeted to grow by 3.9 per cent on the basis of expected contributions of important crops (3.2 per cent), other crops (4.5 per cent), cotton (5 per cent), livestock (4.1 per cent), fishing (three per cent) and forestry (four per cent) [Annexure–I]. Agriculture research and marketing need to be prioritised for harnessing the potential of this sector. This will prove to be profitable for the farmers and responsive to the changing demand patterns of the domestic and international markets.

The livestock sub-sector is expected to perform better due to better availability of fodders and green pastures. The increased demand for processed food and dairy products are stimulating the private sector for investment in the livestock and dairy sectors. Moreover, strong inflow of workers' remittances from abroad has also promoted off-farm economic activities like dairy farming. Pakistan's dairy sector has an enormous potential, but it is still untapped. Resultantly, Pakistan is a net importer of milk and its products. Moreover, the poultry sector has huge potential for value-addition, and Pakistan can tap on the international halal food market. In a nutshell, due to water availability and revival of minor crops and increased productivity of livestock, the agriculture sector is well-poised to achieve the envisaged growth of 3.9 per cent in 2015-16.

Industry

Performance of the industrial sector has not been impressive during the current fiscal year as it missed the target of 6.8 per cent. However, it is expected that the sector will grow by 6.4 per cent during FY16 on the back of improved energy supply and planned investment under the CPEC. The mining and quarrying sector is projected to grow by six per cent, manufacturing by 6.1 per cent, LSM by six per cent, small and household manufacturing by 8.3 per cent, construction by 8.5 per cent and electricity generation and gas distribution by six per cent during 2015-16.

Several fast-track energy and infrastructure projects under the CPEC will play a significant role in the industrial growth during FY16. The LSM growth will also go up when these activities will pick up pace. It will result in a sharp increase in demand for cement and steel. Moreover, the record high remittances will also help maintain a high demand for durable items. The discovery of huge mineral deposits of iron, copper and gold at Rajoa, near Chiniot, will help the mining sector grow further. These along with other reserves of the country need to be tapped effectively as envisaged by the Vision 2025.

Services

The services sector is planned to grow at 5.7 per cent with contributions of 6.1 per cent from transport, storage and communication, 5.5 per cent from wholesale and retail, 6.5 per cent from finance and Insurance, four per cent from housing, six per cent from the general government services and 6.4 per cent growth in other private services. Growth in the services sector will be heavily dependent upon prospective growth in commodity producing sectors. It is anticipated that commodity producing sector will thrive on due to easy availability of inputs, increase in aggregate demand because of low level of inflation along with improved investors' confidence. Increased investment in the transport, storage and communication sectors, mainly due to the CPEC projects such as highways, dry ports and warehouses, will trigger growth in this sub-sector. Consequently, the finance and insurance sectors is expected to grow as well, particularly, due to easy monetary policy scenario.

Investment and savings

The investment is targeted to improve from current level of 15.1 per cent of the GDP to 17.7 per cent. The increase in investment will be primarily contributed by the private sector. Investment the CPEC will be a significant contributor to this growth. Fixed investment will inch up from 13.5 per cent to 16.1 per cent of the GDP. The promotion of entrepreneurship and innovation as envisaged in the Vision 2025 are likely to boost private investment in the country. Inadequacy of the national savings to finance investment has always led to increased dependence on the foreign savings. However, the national savings are expected to improve by increasing the outreach of the banking and non-banking companies, and strengthening the overall financial sector.

Investment in transport, communication and storage

Sustained growth, development and progress are built on advanced infrastructure. High-level connectivity within borders and across borders is important for dealing with the issue of inequality and impoverishment. Through advancement in transportation and communication, the masses are able to connect to different social and economic services. The key to control massive urbanisation, is provision of speedy and reliable transportation services to the dwellers of peri-urban and rural areas

Investment in transportation and communication not only increases the pace of economic development, but is also helpful in accessing the social services. Pakistan has moved on to the path of enhanced regional connectivity, and it has cemented a multi-sectoral agreement with China under the China-Pakistan Economic Corridor (CPEC), which is a wide-ranging package of cooperative initiatives and projects, encompassing various areas of connectivity, information network infrastructure, energy cooperation, industries and industrial parks, agricultural development and poverty alleviation, tourism, financial cooperation as well as social development in the context of municipal infrastructure, education, public health and people-to-people communication.

The CPEC includes about $10.3 billion worth of transportation infrastructure projects. These projects encompass road projects, rails sector projects, various infrastructure projects in Gwadar and cross-border optical fibre cable. Completion of multi-level projects under the CPEC will have sustained impact on the growth, economic integration and economic stability. Investment in infrastructure will have multiplying effects on the well-being of the economy.

Nation branding and investment

Nation branding is nothing new. Countries have long sought to cultivate their certain images in the global mindset, often reaffirmed by the characteristics of their major companies and exports. Trnik (2007) contended that for investment promotion having a suitable investment climate alone is not enough as information gaps exist; so there is need for modern investment promotion techniques. Typically, the techniques involve collaboration of the government and Investment Promotion Agencies (IPAs) in creating an attractive image of the country as a favourite investment destination by providing information and services to potential and current investors and also addressing misconceptions, if any. These are then communicated through advertising, public relations events, international mass media campaigns and investor forums. However, correcting brand image prior to these activities is essential to ensure effectiveness.

Pakistan is on a way for building good image and branding Pakistan. One nurtured example of investment branding is France. In 2004, it launched a three-year-long 35 million Euros investment promotion campaign through the Invest in France Agency (IFA). Under the slogan 'The new France, where the smart money goes', it aimed to attract investment and build the country's image. Using tools of advertisements, micro-site, billboard advertisements and internet banner advertisements, France managed to attract high amount of the FDI, $171 billion stemming from the USA alone and created 40,000 new jobs. Pakistan by branding on the lines of France can attract high-level of the FDI. The government is working on presenting good face of Pakistan, as the government by providing information and assistance, has a strong impact on the decision-making of investors, which will be transited in the form of an enhanced fixed investment as well as the FDI. The major concern is security and terrorism. The government is proactive in dealing with this issue and branding Pakistan. The government's concern in dealing with security is evident from decision of launching a successful initiative of the Zarb-e-Azb operation and empowering the security forces with resources.

Annexure-I

Gross Domestic Product
(2005-06 prices)

% Change

Items	2013-14	2014-15		2015-16
	Revised	Target	Prov.	Target
1. Commodity producing sectors	**3.5**	**5**	**3.2**	**5.1**
A) Agriculture	**2.7**	**3.3**	**2.9**	**3.9**
Important crops	8	1.5	0.3	3.2
Other crops	-5.4	4.5	1.1	4.5
Cotton ginned	-1.3	5	7.4	5
Livestock	2.8	3.8	4.1	4.1
Fishery	1	2	5.8	3
Forestry	-6.7	2	3.1	4
B) Industry	**4.5**	**6.8**	**3.6**	**6.4**
Mining and quarrying	1.6	6.5	3.8	6
Manufacturing (I+II+III)	**4.5**	**6.9**	**3.2**	**6.1**
I) Large-Scale Manufacturing	4	7	2.4	6
II) Small and Household	8.3	8.4	8.2	8.3
III) Others*	3.4	3.6	3.3	3.7
Construction	7.2	7.5	7	8.5
Electricity generation and gas distribution	5.6	5.5	1.9	6
II) Services	**4.4**	**5.2**	**5**	**5.7**
Transport, storage and communications	4.6	4.5	4.2	6.1
Wholesale and retail trade	4	6.1	3.4	5.5
Finance and insurance	4.2	5.8	6.2	6.5
Housing services	4	4	4	4
General government services	2.9	4.3	9.4	6
Other private services	6.3	5.8	5.9	6.4
GDP(bp)	**4**	**5.1**	**4.2**	**5.5**

Source: *PBS, and Planning Commission*
**Covers slaughtering of animals in accordance with the Islamic Shariah (Zabiha)*

Annexure-II

Macroeconomic framework
(Current market prices)

Items	2012-13	2013-14	2014-15	2015-16	% Growth		
	Final	Revised	Provis.	Target	2013-14 / 2012-13	2014-15 / 2013-14	2015-16 / 2014-15
	(Rs billion)				% Growth		
GDP (bp)	21,497	23,904	25,822	28,873	11.2	8	11.8
Indirect taxes (net)	882	1,164	1,562	1,799	31.9	34.2	15.2
GDP (mp)	22,379	25,068	27,384	30,672	12	9.2	12
Net factor income from abroad	1,162	1,429	1,678	1,825	23	17.4	8.8
GNP (mp)	23,541	26,497	29,061	32,497	12.6	9.7	11.8
Total resources/ uses	**23,782**	**26,819**	**29,227**	**32,792**	**12.8**	**9**	**12.2**
Total consumption	**20,434**	**23,063**	**25,087**	**27,354**	**12.9**	**8.8**	**9**
Total investment	**3,348**	**3,756**	**4,140**	**5,438**	**12.2**	**10.2**	**31.4**
Fixed investment	2,990	3,355	3,702	4,948	12.2	10.3	33.7
Public incl. general govt.	788	842	1,057	1,212	6.8	25.6	14.7
Private	2,202	2,513	2,645	3,735	14.1	5.2	41.2
Changes in stocks	358	401	438	491	12	9.2	12
National savings	**3,107**	**3,434**	**3,974**	**5,144**	**10.5**	**15.7**	**29.4**
	As % of GDP (mp)						
Total investment	15	15	15.1	17.7			
Fixed investment	13.4	13.4	13.5	16.1			
Public incl. general govt.	3.5	3.4	3.9	4			
Private	9.8	10	9.7	12.2			
National savings	13.9	13.7	14.5	16.8			
External resources inflow (net)	1.1	1.3	0.6	1			
Memo items							
Inflation	7.1	6.9	3.6	6			
GNP (mp) per capita (Rs)	1,28,968	1,42,312	1,53,060	1,67,915	10.3	7.6	9.7

Source: *PBS and Planning Commission*