PAKISTAN

Table 1	2020
Population, million	220.9
GDP, current US$ billion	264.5
GDP per capita, current US$	1197.6
International poverty rate ($1.9)[a]	4.4
Lower middle-income poverty rate ($3.2)[a]	35.7
Upper middle-income poverty rate ($5.5)[a]	76.2
Gini index[a]	31.6
School enrollment, primary (% gross)[b]	95.4
Life expectancy at birth, years[b]	67.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2018), 2011 PPPs.
(b) WDI for School enrollment (2019); Life expectancy (2018).

Pakistan's economy was severely impacted by the COVID-19 shock in FY20 leading to an increase in poverty. With the lifting of lockdown measures, the economy is showing signs of a fragile recovery. Growth is expected to gradually strengthen but remain muted in the medium-term. Fiscal deficit and debt levels are projected to remain elevated but to gradually improve. Risks to the outlook include new waves of COVID-19 infections and delays in the implementation of critical structural reforms.

Key conditions and challenges

Pakistan's economy has been growing slowly over the past two decades. Annual per capita growth has averaged only 2 percent, less than half of the South Asia average, partly due to inconsistent macroeconomic policies and an under-reliance on investment and exports to drive economic growth. Short periods of rapid consumption-fueled growth frequently led to sizable current account and fiscal deficits, that ultimately required policy tightening, resulting in recurrent boom-bust cycles (Figure 1).

In early FY20, which runs from July 2019 to June 2020, following one such episode of external and fiscal imbalances, the country entered a 39-month IMF-Extended Fund Facility. The associated adjustment measures, including fiscal consolidation, contributed to a reduction of the imbalances over the year and improved macroeconomic stability.

However, the containment measures adopted in response to the COVID-19 pandemic led to a collapse in economic activity during the final quarter of FY20. As a result, GDP growth is estimated to have contracted by 1.5 percent in FY20. Half of the working population saw either job or income losses, with informal and low-skilled workers employed in elementary occupations facing the strongest contraction in employment. As a result, poverty incidence is estimated to have increased in FY20 from 4.4 to 5.4 percent, using the international poverty line of $1.90 PPP 2011 per day (Figure 2, Table 2), with more than two million people falling below this poverty line. Moreover, 40 percent of households suffered from moderate to severe food insecurity. The government, therefore, focused on mitigating the adverse socioeconomic effects of the pandemic, and the IMF program was temporarily put on hold.

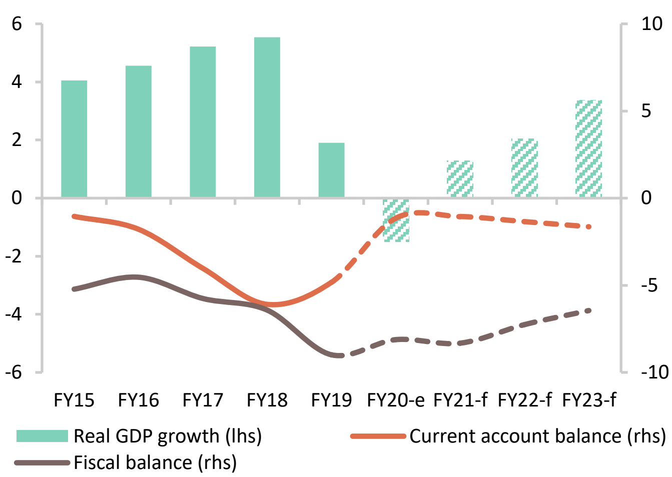
Major risks to the outlook include the possibility of new waves of infections, the emergence of new vaccine-resistant strains, and setbacks in mass vaccinations. In addition, more delays in the implementation of critical structural reforms could lead to further fiscal and macroeconomic imbalances.

Recent developments

Over the first half of FY21 (July to December 2020), there have been signs of a fragile recovery. With increased community mobility, private consumption has strengthened, aided by record official remittance inflows. Investment is also estimated to have slightly recovered, as machinery imports and cement sales both recorded double-digit growth rates.

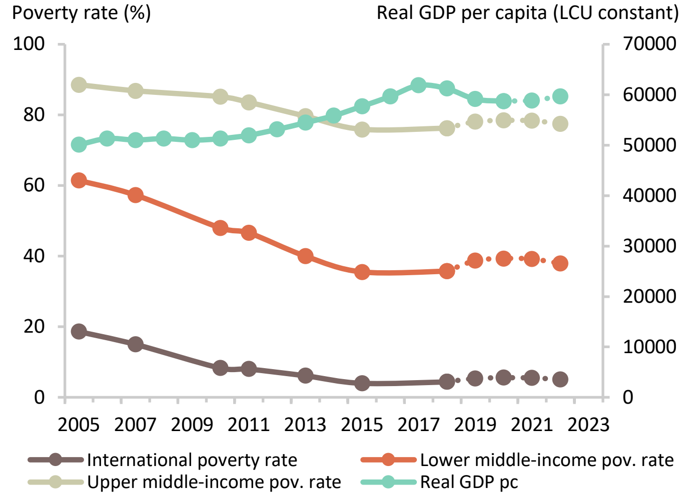
On the production side, crop production was relatively weak in the first six months of FY21, as cotton production was adversely affected by heavy monsoon floods. Following the phased lifting of lockdown measures from May 2020 onwards, indicators of industrial and

FIGURE 1 Pakistan / Twin deficits and real GDP growth



Sources: Ministry of Finance and World Bank staff estimates.
Note: Pakistan reports data on fiscal year (FY) basis. The fiscal year runs from July 1 through June 30.

FIGURE 2 Pakistan / Actual and projected poverty rates and real GDP per capita



Sources: World Bank. Notes: see Table 2.

services activity have recovered, with "Large Scale Manufacturing" and business confidence indexes exceeding pre-COVID levels in December 2020. As a result, the majority of the informal workers affected by the crisis are expected have been able to return to work.

Although headline inflation fell over July-February FY21 (y-o-y), it is still high at 8.3 percent on average, mostly on account of high food inflation. Since July 2020, the State Bank of Pakistan (SBP) has maintained the policy rate at 7.0 percent to support the economy. The capital adequacy ratio at end-December 2020 remained well above the minimum regulatory requirement, indicating banking sector resilience over the first half of the fiscal year.

Compared to a deficit of US$2.0 billion for June-December 2019, the current account recorded a surplus of US$1.1 billion for June-December 2020, the first half-yearly surplus in almost a decade, as strong official remittance inflows more than offset a wider trade deficit. Both foreign direct investment and portfolio investment inflows decreased during this period, but the improved current account supported a balance of payments surplus.

The Pakistani rupee appreciated by 5.4 percent against the U.S. dollar, from end-June 2020 to end-December 2020, and official foreign exchange reserves increased to US$14.9 billion at end-December 2020, equivalent to 3.3 months of imports of goods and services.

The fiscal deficit widened over the first six months of FY21 (y-o-y), as expenditure growth outpaced an increase in revenues. In line with the recovering of economic activity, total revenues grew by 3.7 percent. Over the same period, total expenditures rose by 6.2 percent, partly driven by higher interest payments. Public debt, including guaranteed debt, reached 87.9 percent of GDP at end-December 2020, up from 86.7 percent of GDP at end-December 2019.

Outlook

Output growth is expected to recover gradually over the medium-term, averaging 2.2 percent over FY21-23, mostly due to contributions from private consumption. However, sectors that employ the poorest, such as agriculture, are expected to remain weak, and therefore poverty is likely to remain high. The baseline outlook is predicated on the absence of significant infection flare-ups that would require more extensive lockdowns.

The current account deficit is projected to narrow to 0.8 percent of GDP in FY21, as a wider trade deficit is more than offset by stronger remittances inflows. However, it is expected to increase over the medium term. Exports are projected to grow from FY22 onwards, as external conditions become more conducive and tariff reforms gain traction, but imports are also expected to increase in line with stronger domestic activity and higher oil prices.

While fiscal consolidation efforts are expected to resume, the deficit is projected to remain elevated at 8.3 percent of GDP in FY21, partly due to the settlement of arrears in the power sector. As critical revenue-enhancing reforms gain pace and expenditure rationalization efforts resume, the fiscal deficit is projected to gradually narrow over the medium-term. Still, public debt will remain elevated in the medium term, as will Pakistan's exposure to debt-related shocks.

TABLE 2 Pakistan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2017/18	2018/19	2019/20 e	2020/21 f	2021/22 f	2022/23 f
Real GDP growth, at constant market prices	5.8	1.0	-1.5	1.3	2.0	3.4
Private Consumption	6.2	2.9	-1.0	2.5	2.5	3.4
Government Consumption	8.6	0.8	5.6	0.1	2.2	3.0
Gross Fixed Capital Investment	11.2	-12.8	-17.9	-4.2	1.1	3.7
Exports, Goods and Services	12.7	14.5	-8.6	-1.7	3.0	5.5
Imports, Goods and Services	17.6	4.3	-10.5	0.9	4.3	4.8
Real GDP growth, at constant factor prices	5.5	1.9	-1.5	1.3	2.0	3.4
Agriculture	4.0	0.6	1.5	0.5	2.3	2.6
Industry	4.6	-2.3	-5.0	1.5	1.7	3.5
Services	6.3	3.8	-1.3	1.4	2.1	3.6
Inflation (Consumer Price Index)	4.7	6.8	10.7	9.0	7.0	6.0
Current Account Balance (% of GDP)	-6.1	-4.8	-1.1	-0.8	-1.3	-1.7
Net Foreign Direct Investment (% of GDP)	0.9	0.5	1.0	0.7	0.8	1.0
Fiscal Balance (% of GDP)	-6.4	-9.0	-8.1	-8.3	-7.7	-6.9
Debt (% of GDP)	75.9	89.9	93.6	93.9	94.4	94.1
Primary Balance (% of GDP)	-2.1	-3.5	-1.8	-2.1	-1.7	-1.1
International poverty rate ($1.9 in 2011 PPP)[a,b]		4.4	5.4	5.6	5.6	5.1
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]		35.7	38.7	39.3	39.2	37.9
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]		76.2	78.1	78.4	78.3	77.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.

(a) Calculations based on SAR-POV harmonization, using 2018-PSLM .Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021to 2023.

(b) Projection using neutral distribution (2018) with pass-through = 1 based on GDP per capita in constant LCU.