COVID-19 AND PAKISTAN'S TRADE PROSPECTS

DR. ZAFAR MAHMOOD[1]

The Covid-19 is such a public-health crisis that it has increasingly become an economic threat to every economy of the world, as both production and consumption levels are simultaneously scaled back. Concomitantly, interruption in global supply chains and transportation, after major lockdowns, has resulted into a sharp decline in international trade of goods and services. It has pushed the global economy into a deep recession. IMF's World Economic Outlook has decelerated its earlier global annual economic growth forecast for 2020 from of 3.3% to below zero in 2020 due to coronavirus effect. This will result into a decline of global income by about a trillion-dollar and even beyond if crisis prolongs. The ultimate effect would thus depend on: how far and fast the virus spreads and how effective policies will be in controlling the damage to economic and social well-being.

If the virus outbreak is short-lived then a standard mix of monetary policies (e.g., a cut in the policy discount rate) and automatic fiscal stabilizers (e.g., adjustment in tax rates and transfer payments to smooth incomes, consumption, and business spending) should be sufficient to reduce adverse impacts on the economy. But if the crisis prolongs, that now appears to be the likely case due to supply disruptions owing to malfunctioning of production and supply networks, then the economic recovery will depend more on sustained liquidity injections to industries by the central bank, and pro-active fiscal, trade and investment policies.

In addition, the loss of consumer and investor confidence is the most important factor affecting the business sentiments; whereas assets price deflation, weak aggregate demand, increased debt distress, and rising poverty and income inequality would pose even bigger policy challenges.

[1] Professor of Economics and Dean Research at School of Social Sciences and Humanities National University of Sciences and Technology, Islamabad

In view of the above perspectives, an effective response from the government in coordination with the private sector requires a proactive and targeted approach.

STATE OF THE EXTERNAL ECONOMY:

In the second half of 2019, just before the outbreak of the Covid-19 crisis, Pakistan saw some signs of economic recovery especially in its external part of the economy. The country rose 28 places on the World Bank's Ease of Doing Business index compared with 2018, graduated to among the world's top-10 countries with the most improved business climate, volatility in exchange rate became minimum as overvaluation of the rupee was reduced, and China-Pakistan Free Trade Agreement became operational from 1st December 2019, which granted similar access to Chinese market as China has accorded to ASEAN countries. There was also evidence of increased FDI particularly from Chinese textiles companies. This created a confidence among different stakeholders that economy might further improve in 2020 on both internal and external fronts. But no one predicted by the end of 2019 that COVID-19 will bring wide-spread lockdowns, transport restrictions and social distancing will halt supply chains, all of which will create devastating consequences for business activities. Both demand and supply side disruption have started adversely affecting the external sector and a currency crisis is looming.

By now it is well known that the Calendar Year (CY) 2018 was an extraordinary year for Pakistan's current account balance when it faced a deficit of $19.482 billion (see, figure below). The present Government decided to curtail it drastically by introducing import restrictions across the board. It was successful in reducing the current account deficit to $7.315 billion in CY2019 but only by reducing imports by 19% (all groups of imported items witnessed a decline except petroleum and chemicals groups) and attracting 5.3% additional remittances than a year earlier (i.e., remittances was $22.20 billion in CY2019). On the other hand, exports instead of rising declined by 0.24% in CY2019. There was a minimal increase in the exports of textile and petroleum groups but these were offset by a decline in exports from food and other manufactured groups. This was because no concerted policy effort was made by the government to promote exports. Since the fourth quarter of 2019, however, there have been some positive signs of export growth and a further decline in imports. During the first two months of 2020 both exports and imports increased from the previous year's levels but current account deficit declined more sharply in February 2020. We don't have data at this time for March 2020 to assess the COVID-19 impact on Pakistan's trade. All that we know about the current situation is some information obtained from industry sources and exports firms.

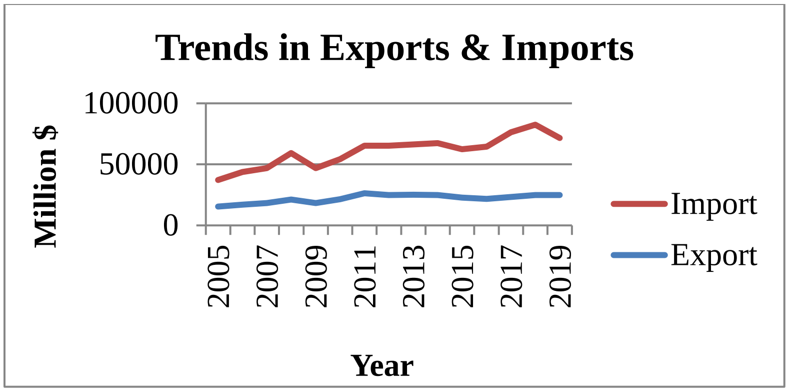

Figure 1

Pakistan's textile sector was working at full-capacity production after the government withdrew duties and taxes on import of the raw cotton in January 2020. Besides, Pakistan started getting higher exports orders mostly for textiles when China was fighting against the coronavirus. The world textile buyers then diverted their purchasing orders to Pakistan from China whose 70-80% production was disrupted.

It was then predicted that Pakistan would comfortably achieve its export target of $24-25 billion for the FY2020. Pakistani industry started claiming that it does not have the extra production capacity to take and meet additional export orders. But this euphoria turned out to be short-lived. China is back on its feet; with that Pakistani export firms have started losing export orders.

Pakistan is among the countries most affected by the global effects of China's slowdown through disruption of global supply chains. The slowdown in manufacturing in China has created a ripple effect on its economic activities. The textile sector, which accounts for 55% of total exports, is currently facing a fall in imports of the majority of the raw material –dyes & chemicals– that are required to produce textiles and are mostly imported from China.

In view of the situation, All Pakistan Textile Mills Association (APTMA) has started demanding from the government to take immediate steps to address major issues faced by the industry especially its liquidity problem. It demands to release the backlog of sales tax refunds. APTMA has also demanded additional lines of working capital and freezing of utility bills for at least two months to duck the closure of industry. Sudden cancellation and postponement of exports orders means increase in output inventories that will impose enormous cost on industry. Importers have delayed more than 50% of ready-to-shipment export orders. Consequently, industries have started lay-off of their daily-wage and temporary workers. Industry is increasingly unable to pay their workers due to liquidity crunch amidst non-payment of sales tax refunds. If crisis prolongs then industry foresee much more lay-offs.

As soon as this crisis started, Pakistan lost most of the Hot money that flowed into its reserves to make high profits from the deliberately kept high interest rates. With foreign currency reserves depleting sharply the rupee has lost about 7% of its value.

All of the above developments will likely hurt exports. Debt burden has so far increased by Rs.600 billion. FDI is declining too. There is a possibility that Pakistan seeks postponement of debt payment and perhaps new loans to meet the balance of payments obligations.

RELIEF PACKAGE OF THE FEDERAL GOVERNMENT & SBP:

In view of the hardship faced by the industry and export firms, the Government has announced the following economic package for the benefit of industries:

1. A package of Rs.100 billion ($63 million) will be provided to support small industries and the agriculture sector.
2. All ports and customs services will be kept operational.

Keeping in view the current evolving situation the State Bank of Pakistan (SBP) has decided to cut the policy rate to 11% in order to cushion the growth slowdown. SBP is also taking necessary regulatory measures in coordination with commercial banks to address pressures on cash flows of borrowers affected by Coronavirus related disruptions through facilitating deferment and restructuring of their loans.

To support exports for sustained improvement in Pakistan's balance of payments, SBP provides refinance to banks, to provide concessional credit at interest rates that vary between 3 to 6 percent to exporters for working capital and new projects under Export Finance Schemes (EFS) and Long Term Financing Facility (LTFF) schemes. The total concessional credit to exporters outstanding under both these schemes is currently approximately Rs.660 billion.

Due to the COVID-19 pandemic, the Pakistani exporters are currently facing declining demand in foreign markets and problems in executing existing export orders. To support exporters in these circumstances and to prevent current liquidity problems from turning into solvency problems amongst exporters, SBP has announced some proactive measures on March 20, 2020. These include the following:

1. **Relaxation in matching amount.** Availing cheaper credit under EFS is linked with the export performance. Earlier, exporters are required to export twice the amount of borrowed funds. In case of failure in meeting the requirement penalties were imposed with reduction in the credit limit for the next year. SBP has reduced the performance requirement from twice to 1.5 times that will be effective for the current year as well as for FY21.
2. **Extension in time period to meet performance requirements.** Exporters were required to show performance under the EFS schemes by end-June 2020. This period has been extended by 6 months to end December 2020. Since the additional period will also be counted towards setting new limits, this will help the exporters in availing higher limits for the fiscal year 2021.
3. **Extension in time period to ship goods.** Exporters availing the concessional credit schemes are required to ship their goods within 6 months of availing credit under EFS. In case of failure, penalties are imposed. This period has now been extended from 6 to 12 months. Therefore, exporters will not be liable to pay penalties due to breach of this condition during January to June 2020.
4. **Relaxation in conditions for Long Term Financing Facility.** Exporters who want to avail credit under LTFF are required to have exports worth 50%, or USD 5 million, of the total sales to become eligible. This limit has been reduced to 40% or USD4 million for all the borrowings under LTTF during the period January 01, 2020 to September 30, 2020. Moreover, under the requirement of annual projected exports performance for four years to avail LTFF for new or BMR projects has been extended by another one year. Now the projected exports performance will be measured in 5 years.
5. **Other relaxations.** Another major relaxation has been provided to the exporters on foreign exchange side. Keeping in view the difficulties faced by the exporters, SBP has also allowed banks to enhance the time period for realization of exports proceeds from existing requirement of 180 days to 270 days on a case by case basis provided the delay is related to COVID-19. This would help exporters to provide extended time to their buyers in making payment due to COVID pandemic. Likewise, to facilitate importers, SBP has extended the time period for import of goods into Pakistan against advance payment from existing requirement of 120 days to 210 days.

The above measures are expected to facilitate exports. The SBP has assured that it will take additional measures as the situation related to COVID-19 and its impact on the economy evolves.

Some Additional Suggestions:

Pakistan can easily manage this crisis if supply chains are opened and industrial workers move rather freely to their work. Evidently, clients from east Europe are asking for fast delivery of textiles and garments. Government, therefore, needs to make all efforts to keep intact the supply chains and availability of transportation for in time cargo handling.

One of the most effective measures to address this crisis is by obtaining timely and correct information. Local industry association and trade bodies as well as trade missions abroad need to play their active roles effectively to capitalize different opportunities coming up globally by collecting information and forwarding it to the right quarters.

Increase social spending, further lower interest rates, stabilize exchange rate, provide credit lines for the timely payment of company payrolls and seek international and regional cooperation in all aspects of the economy.

Pakistan should immediately arrange and avail IMF-World Bank facility to postponement of debt payment. Government has reportedly reached IMF for $1.4 billion new loan.

Focus more on trading with China as it has started its rehabilitating phase more vigorously, income loss in China should provide an opportunity for Pakistani exporters to sell their low quality products that will be more in demand in China.

China is now back to business and has taken certain policy measures. For instance, it has increased export tax rebates for its exporters that have started putting out Pakistan's export orders at risk, some have already been cancelled. Our government needs to take new and effective measures to counter such moves by China and others.

European Union has relaxed certification rules for the import of fruits, vegetables and other food items to ensure good supplies of such items in their domestic markets. Pakistani exporters of food items, vegetables and fruits need to benefit from this rules relaxation and rising prices in EU.

Pakistani exporters should also capitalize the opportunity that is coming from increased demand for medical instruments, health clothing, pharmaceutical products, bed linen, towels, and simple garments and clothing. All of these are normally produced by the Pakistan industry. But all of these require that supply chains domestically and globally be kept intact.

Government announced to keep ports open and customs service operational. But clearance of imported cargoes has been interrupted as customs agents are not exempted from traveling restrictions. So clearance agents need to be fully facilitated if port operations are to be fully functional without any congestion and hindrance for trade expansion.

All in all, the effective implementations of the government announced policies and above suggestions would help the country to minimize the deleterious effects of Coronavirus on the external economy of Pakistan.