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The Pakistan Economy
～Looming FX Shortage: Slowdown of Domestic Demand and Enhanced FX Earning Capacity Required～

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〈Abstract〉

- The Pakistan economy has continued to perform well to date with its real GDP growth rate reaching 5.3% in the fiscal year 2016/17, supported by the Extended Fund Facility (EFF) of the IMF and investment relating to the China Pakistan Economic Corridor (CPEC).

- As part of CPEC investment, the Pakistan government has especially put a lot of effort into improvement of atomic power generation, and the power shortage which had been a long-standing agenda has been being resolved. Also the public safety has tended to improve.

- The ruling party Pakistan Muslim League (Nawas) (PML-N) enjoyed a high support until recently. However, it suffered a defeat in the general election that took place in July to the Pakistan Movements for Justice (PTI) which had rapidly gained popularity under the support of the military after the scandal over the Panama Papers which involved the ruling party, relinquishing the position of the leading party.

- In the meanwhile, there has been an accumulation of external imbalances as an adverse side effect of the favorable economic conditions, with the current account deficits growing. The

foreign exchange reserves fell to below the two-month equivalent of imports, while the fiscal deficits have also been increasing due to dole-out policies taken looking forward the general election. Both deficits have ballooned to around 5% of GDP, which will impose a burden on the economic management of the new administration.

- These situations warrant belt-tightening policies after the election. If Pakistan fails to reduce the twin deficits, the country will not only face a difficulty in repaying the loans to the IMF and China, but also it will have to be prepared to the need to ask for support from the IMF again. There is a news report that the U.S. is reluctant for the support to Pakistan. But if Pakistan cannot get the support from the IMF, its economy will fall into bankruptcy or otherwise its dependence on China will be further strengthened. The international community, including the United States, will not be able to easily give up Pakistan since it is a nuclear power that lies side-by-side with an unstable area of Afghanistan.

- Pakistan has a pile of problems in the medium-term, too. There is a substantial question in CPEC as to its economics. Although the electricity condition has improved with CPEC investment, there is no improvement in its ability to earn foreign currencies. It is expected that Pakistan will continue to rely on assistance aids, with ever higher dependence on China. The existence within the nation of cautious opinions against the subordination to China may increase political conflicts in Pakistan.

〈Full Text〉

1. The Pakistan Economy

(1) Recent Developments

Until FY 2012/13[1] the Pakistan economy continued to grow by only 2 to 3%, experiencing slower growth than other emerging economies under the administration of Pakistan People's Party (PPP) that took office during 2008-2013. Although it came to agree with the IMF[2] on a loan totaling $7.6 billion (additional $3.2 billion in the following year) in FY 2008/09, the loan program ended in September 2011 with $4.0 billion unrepaid mainly due to a massive flood in 2011 and delay of reforms of energy and tax system that had been conditions to the IMF loan, As the repayment to the IMF started in FY 2011/12, foreign exchange reserves declined to $6.0 billion, inducing a worrying voice over the balance of payments crisis. Thus, the economic crisis worsened under the PPP administration. The exchange rate of the rupee depreciated and

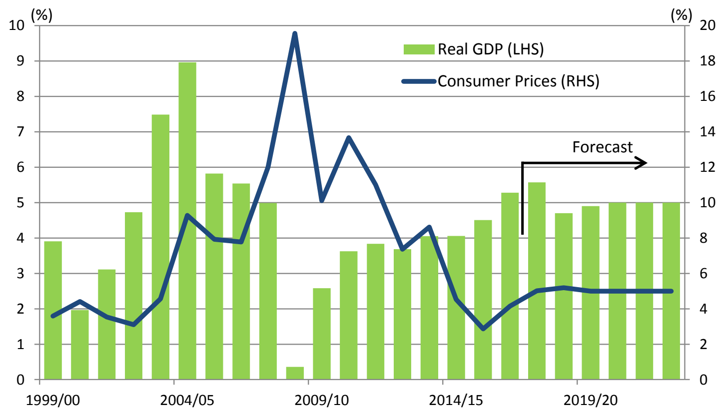
[1] Fiscal year in Pakistan starts in July and ends next June, and the fiscal year, for instance, of July 2012 to June 2013 is expressed as FY2012/13. Economic outlook and other indicators are often expressed on this fiscal year base.
[2] Pakistan received 12 IMF assistance programs in the past 28 years up to 2018.

the fiscal deficits increased, while the unimproved electricity shortage seriously hampered the economic activities.

The failure of PPP administration in the economic management led to a victory of the PML-N headed by Mr. Sharif in the election of members of National Assembly where the party won the majority votes with Mr. Sharif taking office as Prime Minister. He immediately requested the IMF for a provision of Extended Fund Facility (EFF), which was approved in September 2013 on a provision of a three year loan of $6.6 billion. Pakistan generally met the conditions[3] set by the IMF which included reduction of fiscal deficits, strengthening of independence of the central bank, increase of revenues, reforms of state owned enterprises (electricity, airlines, steel), and the program was completed in August 2016.

Owing to efforts of the government of Pakistan, the economy continued to expand favorably after the start of the EFF program, recording a high real GDP growth of 5.3% in FY 2016/17. Reflecting an increased demand following the economic recovery and a rise in energy prices, the consumer price index rose by 4.1% in FY 2016/17, somewhat accelerating from FY 2015/16, yet maintaining a relatively low level of inflation for the country.

（Figure 1） Real GDP Growth and Inflation in Pakistan



(2) Results of the IMF Article IV Consultation

The EFF program ended in August 2016 with its final review. In June 2017, the IMF released the report for the Article IV Consultation with Pakistan. At that point of time, the IMF had projected that the real GDP growth would improve to 6% level in the medium term, and consumer prices would stabilize after a small rise. On the other hand, it pointed out that the improvement of budget deficits which narrowed helped by the support of EFF program would slow down, and there was a possibility that the country could not meet the target for the FY

3 The numerical goals included an improvement of economic growth rate to over 5.0% by FY 2015/16, control of inflation under 7.0%, holding of international reserves equivalent of over 3.5 months of imports and reduction of fiscal deficit to below 3.5%.

2016/17 budget deficit of 4.2% of GDP while the current account deficit would worsen to 3.0% of GDP in FY 2016/17 due to increasing imports of capital goods and energy resources.

The IMF had emphasized the need for structural reforms while it appraised the efforts the Pakistan authorities had made in the improvement of macro-economy. First of all, (i) it advised the authorities to promote fiscal consolidation especially through broadening of tax base, strengthened administration of tax collection, restraints of public servants salaries, and reduction of subsidies to electric sector. Then (ii) it emphasized the importance of monetary policy and advised them to strengthen the independence of the central bank and increase the flexibility of exchange rate. Specifically regarding the energy sector, (iii) it advised the authorities to tackle the problem of unpaid electricity fees to eliminate it.

（Table 1） Economic Outlook in the IMF Article IV Consultation Report
（Projections for FY 2016/17 and after）

	2015/16	2016/17	2017/18
Real GDP (%)	4.5	5.3	5.5
Consumer Prices (%)	2.9	4.3	5.0
Current Account (as of GDP, %)	-1.2	-3.0	-3.2
Foreign Currency Reserves (billion dollars)	18.1	18.5	18.8
(In Month of Imports of Products and Services)	4.0	3.8	3.6

（Source）IMF

Pakistan was able to spend relatively stable three years under the EFF programs but the result for FY 2016/17 turned out to be less satisfactory, especially in the fiscal area, than the forecasts of the IMF. In a sense, it looks like they stopped making efforts of reforms upon the end of the EFF programs.

(3) Improvement of Fiscal Balance coming to a Standstill

Figure 2 shows the developments of main indicators after the provision of EFF loans. Although the fiscal deficit that worsened under the PPP administration temporarily improved, it deteriorated in FY 2016/17 as compared to the previous year to 5.8% of GDP. It was a deterioration of 1.6% point as compared to the budget outlook in the draft budget for the fiscal year and of 1.3% point against the estimate given in the previous IMF Article IV Consultation report. The deterioration reflected the increased expenditures for provincial development which expanded by 0.7% of GDP and the revenue decrease of 0.3% of GDP. The provincial expenditures were mainly targeted at the Panjab Province which is the basis of the PML-N party and it is likely that the PML-N government implemented a substantial amount of dole out-pork barrel policy anticipating the general election of July 2018. The budget deficit for FY 2017/18 seems to have far exceeded the IMF estimate as the cumulative deficits for the first 11 months of the fiscal year already reached 6.1% of GDP.

The government has been promoting the tax reforms under the request of the IMF, implementing such measures as stricter tax collection from a wealthy class (taxation on the purchasers of first and business class air tickets, taxation on the purchase of real estates, etc.), and expanded taxation of sales tax to cover those retailers to whom sales tax had not been applied. Also the government raised in August 2017the corporate tax rate from 31% to 37.5% and in April 2018 it revised income tax rates[4].

(Table 2) Main Economic Indicators（projections for 2017/18）

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Economies						
Real GDP (%)	3.7	4.1	4.0	4.7	5.3	5.6
Consumer Prices (%)	7.4	8.6	4.5	2.9	4.1	5.0
Financial Account						
Financial Account (exc. Grants, as of GDP, %)	-8.5	-5.7	-5.4	-4.6	-5.8	-5.5
Primary Balance (as of GDP, %)	-4.1	-1.1	-0.7	-0.3	-1.6	-1.5
Public Debt (as of GDP, %)	62.3	62.5	62.0	64.8	67.2	67.2
External Public Debt (as of GDP, %)	19.6	19.2	17.7	18.7	20.6	
(as of Foreign Currency Reserves)	75.0	50.4	35.9	29.3	39.6	
Revenues (as of GDP, %)	10.0	10.5	11.0	12.4	12.5	12.9
Current Account						
Products Export (yoy, %)	0.4	1.1	-3.9	-8.6	0.1	7.6
Products Import (yoy, %)	-0.6	3.8	-0.9	-2.0	17.5	
Current Account (as of GDP, %)	-1.1	-1.3	-1.0	-0.9	-4.1	-4.8
Foreign Currency Reserves (billion dollars)	6.0	9.1	13.5	18.1	16.1	12.1
(exc. EFF, billion dollar)	*6.0*			*12.0*		
(In Month of Imports of Products and Services, months)	1.5	2.2	3.4	4.2	3.0	2.2
Monetary Sector						
Credit to Privarte Sector (yoy, %)	-0.6	12.5	5.9	11.1	16.6	
Nonperforming Loans (as of Gross Loans, %)	14.8	12.8	12.4	11.1	9.3	
Capital Adequacy Ratio (%)	15.5	15.1	17.2	16.1	15.6	

（Source）IMF

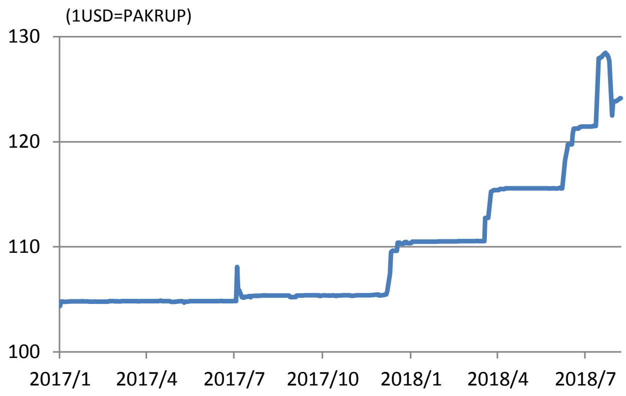
(4) Worsening External Balance Mainly due to Higher Oil Prices and CPEC

The current account deficit deteriorated to 4.1% of GDP in FY 2016/17 from 0.9% in the previous year. It mainly reflected an increase of import values that reflected various factors including increased imports of goods and parts related to CPEC investments, increase of individual demands due to economic recovery, and depreciation of the rupee. The import values for the year amounted to $50.0 billion against the export values of $19.4 billion to cause the deficit to expand to $30.4 billion. Although the government is trying to curb imports by requiring cash collateral for payment of import and raising tax rates on imports of luxuries, it has not succeeded in producing adequate results with the rupee depreciating possibly to show market’s disapproval of these policies. Specifically the rupee depreciated against the dollar by

[4] The maximum tax rate was cut to 15% from 35% while the taxable income threshold was increased from 0.4 million rupee to 1.2 million rupee.

5% during the month of December 2017.

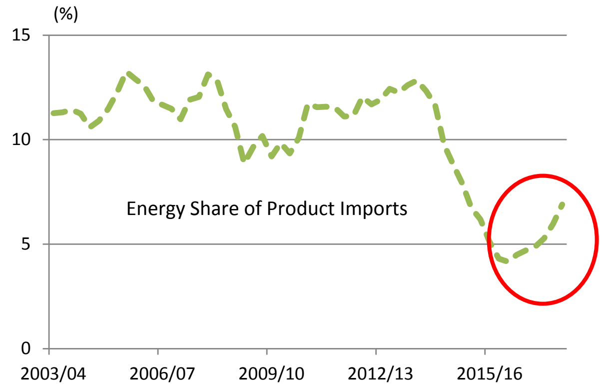
（Figure 2）Developments of Rupee/Dollar Rates



(Source) Datastream

In addition, rising oil prices which had been falling in the previous year exacerbated the current account deficit. Although the share of energy in the aggregate import amounts declined to less than 4% in 2015 and 2016 from double digit order earlier, the share returned to around 6% in the October-December quarter of 2017.

(Figure 3) Share of Energy in Imports

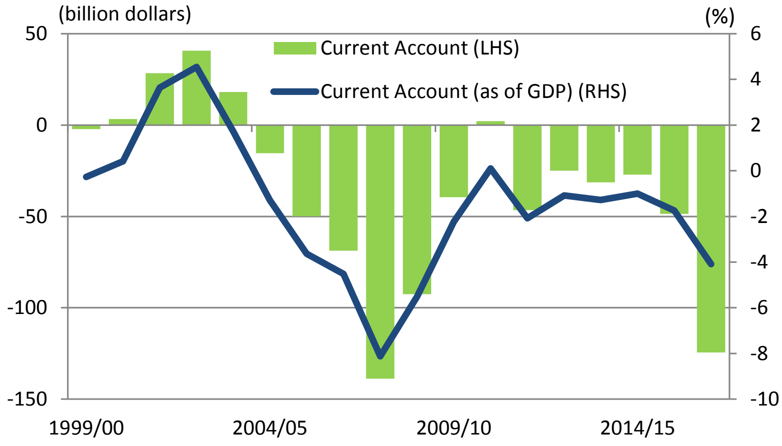


（Note）moving average of each 4 quaters （Source）

The trade deficit is estimated to further increase in FY2017/18. While exports increased 15.2% yoy in the first 11 months of the fiscal year due to depreciated rupee, imports also increased by 14.3% yoy, and the trade deficit already exceeded the annual target of $25.7 billion to reach $33.0 billion.

In sections (3) and (4) above, we have seen the development of fiscal deficit and current account deficit. In order to control the expansion of these deficits, Pakistan should overcome such issues as strengthening tax administration, reduction of subsidies to power sector, and correction of trade deficits. Naturally the policies should include not only those on the micro level but also the tightening policies on the macro level.

（Figure 4） Developments of the Current Account Balance

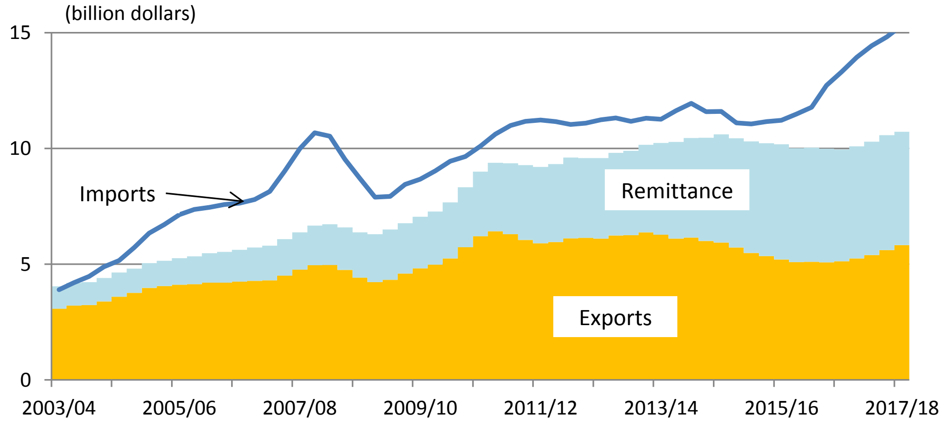


(Source) IMF

The remittances of migrant workers are one of the major sources of foreign exchanges to Pakistan. With the Pakistan Remittances Initiative (PRI) that was introduced in 2009 and construction booms in the Gulf countries reflecting rising oil prices, many Pakistanis migrated to work abroad. Accordingly, their remittances are on a rising trend, increasing from $8.0 billion in FY 2009/10 to $19.4 billion in FY 2016/17[5]. The remittances from Saudi Arabia accounted for the largest amount, followed by the United Arab Emirates (Dubai, in particular). However, the aggregated amounts of receipts of remittances and exports still underrun the amount of imports.

[5] Official provision of an incentive to allow remittances through banks also promoted the remittances. In FY 2012/13 remittances through banks expanded to account for 90% of the total remittances.

(Figure 5) Exports /Imports and Workers' Remittances



(Note) moving average of each 4 quaters (Source) Datastream

Due to an expanded current account deficit and repayment of EFF related loans, international reserves declined to $16.1 billion at the end of June of 2017 from the previous year. In addition, the accelerated depreciation of the rupee decreased the reserves to $12.7 billion, or 2.2 months equivalent of imports by the end of February 2018. Market intervention by the central bank to defend the rupee also spurred the decrease of the reserves, which was worse than the IMF estimate as shown in Table 1 above. External public debts also have increased. According to the IMF projections, external public debt outstanding amounted to $71.3 at the end of FY2017/18[6], and there are local reports that it ended with $92.2 billion (72.0% of GDP). This is a deterioration to 9.6 times of foreign exchange reserves, much worse than the IMF projection of 5.9 times of reserves. Some regard the public debt of 70% of GDP as a rough indicator of a risk level in emerging economies[7], which level Pakistan is exceeding.

(Table 3) Pakistan: Foreign Exchange Reserves and External Debts

	2014/15	2015/16	2016/17	2017/18 IMF Forecast	2017/18 Local News
Foreign Currency Reserves (billion dollars)	13.5	18.1	16.1	12.1	9.6
(In Month of Imports of Products and Services)	3.4	4.2	3.0	2.2	n.a.
Public Debt (as of GDP, %)	62.0	64.8	67.2	67.2	72.0
Public External Debt (billion dollars)	51.9	59.0	63.7	71.3	92.2
(as of Foreign Currency Reseves)	3.6	2.9	4.0	5.9	9.6
Public and Private External Debt (billion dollars)	65.1	73.1	83.0	93.3	n.a.

(Source) IMF、Local News

6 The short-term debts accounted for 54% in total public debts at the end of FY 2016/17.

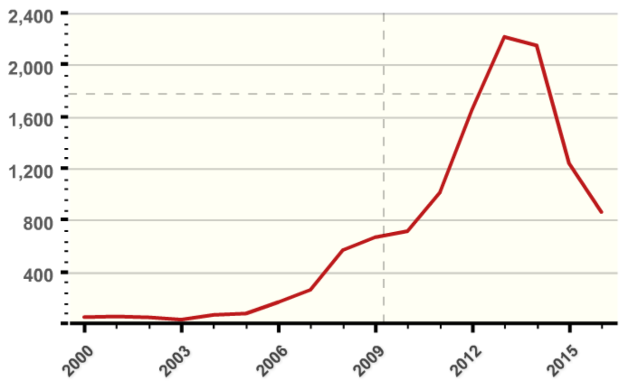
7 IMF Fiscal Monitor, April 2018: footnote on p.6. Rough indicator of 70% of GDP is a threshold of debt sustainability set by the IMF beyond which it is considered vigilance is needed for a currency crisis and a balance of payment crisis.

(5) Improved Civil Order is a Good News for the Pakistan Economy

The Global Terrorism Index (GTI) puts Pakistan on the fourth country with the highest impact from terrorism. In 2015 Pakistan had 1086 deaths caused by terrorism with cumulative total victims from terrorism from 2000 to 2015 counting at 15,908. Economic impact from terrorism is not limited to a direct destruction. It leads to increased expenditures for police and military with heightening uncertainties in the financial market, together with such adverse impacts as decreased foreign investment and diverted trade.

The civil order, which had been greatly deteriorated, has been improving. The former Sharif administration strengthened its anti-terrorism measures, triggered by the terrorist attack of the Pakistani-Taliban Movement[8] which assailed at an elementary school in December 2014, killing 132 children. With this incident, the government formulated a National Action Plan and reinforced the powers of the National Counter Terrorism Authority (NACTA). Based on that policy, an anti-terrorism court was established under a temporary legislation for two years until January 2017, and carried out detection by the military of terrorist bases in the western mountain areas and clearing operations on terrorists in the urban areas. As a result, the number of terrorism decreased to 800-strong in 2016 from over 2000 annual cases once recorded.

(Figure 6) Number of Terrorist Attacks

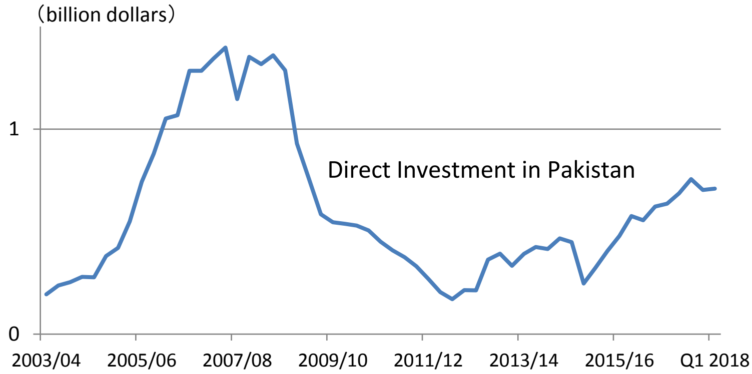


(Source) Global Terrorism Database

Foreign direct investment (FDI) in Pakistan began to recover recently after declining from around FY2009/10. Improvement of domestic security will give a positive impact on the increase of FDI. CPEC related investment will also continue to be implemented. Inward investment is expected to continue to be strong in the future despite a recent sign of decline that possibly reflected a wait-and-see attitude before the election.

8 Tehreek-e-Taliban Pakisutan (TTP). It is an organization of radical Islamic Sunnis which aims to overthrow the government.

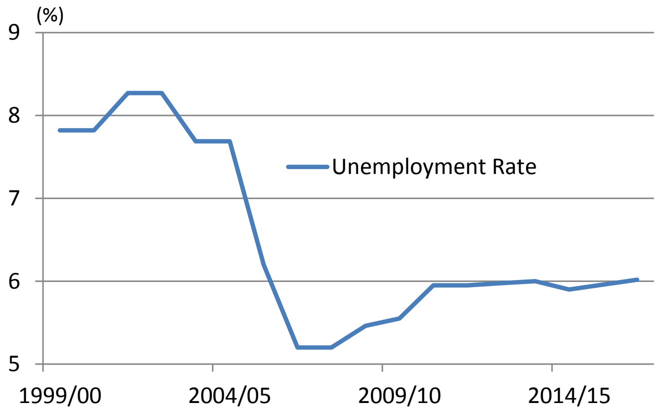
(Figure 7)　Foreign Direct Investment in Pakistan



(Note) moving average of each 4 quaters　(Source) State Bank of Pakistan

Although it is feared that unemployed young people easily tend to approach terrorist organizations, unemployment rate continues to be flat. It is also expected that continued expansion of the economy will increase employment opportunity and further help improve the public security.

(Figure 8) Unemployment Rate



(Source) IMF

2.　Power Shortage Improving while Circular Debt Accumulation Problem Remaining

The poor aspect of Pakistan's infrastructure is seen in every field including roads, ports and sanitation, but the area of most serious concern is the electric power sector. In FY 2011/12, annual power production amounted to 95.3 billion KWh (cf. 1043.7 billion KWh in Japan), with electrification rate of 62% (100% for Japan). However, the actual power production capacity was only for 14 million KWh, which was in short supply by 6 million KWh against the peek-time demand of 20 million KWh.

The power sector had the most serious problem among the state owned enterprises suffering from continued deficits, and the lengthy blackout through stolen power and electrical leakage damaged the industrial sector, driving down the economic growth rate by about 2% and exacerbating the circular debt problem[9]. The power sector in Pakistan is operated by separate companies for generation, electric transmission, and retail, respectively. As the government had kept electricity charges at a low level, retailors had long been in deficit and, triggered by the cut of government subsidies to retailors after the financial crisis, a problem of circular debt accumulation emerged. The circular debts started to grow in 2009 to reach 872.4 billion rupees (about $8.66 billion) as of June 2012, but it was reported that the problem was once resolved in around July 2013 by the provision of EFF loans amounting to $6.6 billion. The circular debt problem gradually rekindled, however, and it is reported that the debts ballooned by May 2018 to one trillion rupees (about $8.6 billion) including those of Power Holding Private Limited (PHPL) [10]. How to reduce these debts is a big challenge for Pakistan.

On the other hand, the serious power shortage has been improving. This year is the final year of the National Power Policy 2013-18 under which efforts had been made to reform the power sector. The government has been tackling the problem with such efforts as expansion of production capacity of electric power, shift to cheaper fuels (gas, coal and hydraulic), improvement of efficiency of power generation, improvement of transmission and distribution system, and strengthening collection of charges[11]. Revenues from power charges which had amounted to $5.6 billion in FY 2014/15 increased to $6.7 billion by early June of FY 2017/18. The government achieved a certain level of results in its efforts that included eliminating supply/demand gap, reducing the transmission and distribution loss to under 16%, raising the collection rate of power charges to 95%.

Shift in power sources is also advancing. With the cooperation of China, the government has promoted construction of power generation facilities based on hydro, wind and nuclear sources. Specifically capacity of nuclear power generation increased by 13.8% on annual average since 2000, compared to the annual rise of 2.1% for thermal power generation. As a result, power generation capacity exceeded 26 million KW in FY 2015/16. As the peak time demand stands at slightly more than 20 million KW, there was much improvement in the supply-demand gap that year.

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9 A problem that “debts arising from unpaid electricity bill of users and loss in transmission and theft” cause in turn “arrears in payment by electricity transmission companies to electricity producers”, then “arrears in payment by electricity producers to fuel suppliers (such as oil refiners)”. It has triggered a vicious circle of inability of fuel suppliers to import fuel which causes the lower electricity production by electricity producers to lead to a frequent occurrence of blackout.

10 An institution in the power sector established to deal with borrowings from private banks.

11 Please also refer to the annex 1 below.

(Table 4)　Developments of Electric Generation Capacity

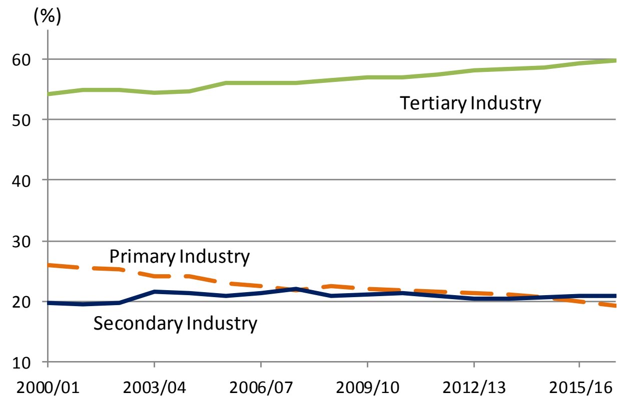
		1989/90	1999/00	2009/10	2014/15	2015/16	Average of Annual Growth Rate since 2000 (%)
Capacity of Electrical Plants (10 thousand KW)	Thermal	483	1244	1332	1554	1732	2.1
	Hydro	290	483	656	703	712	2.5
	Renewables	-	-	-	44	81	-
	Nuclear	14	14	46	75	109	13.8
	Total	787	1741	2034	2376	2634	2.6
Electricity Production (100 million KWh)	Thermal	2072	4606	6437	6789	7849	3.4
	Hydro	1693	1929	2851	3247	3247	3.7
	Renewables	-	-	-	80	99	15.9
	Nuclear	29	40	289	580	421	3.7
	Total	3794	6575	9577	10696	11616	4.3

(Source）IAEA

3. Agriculture: an Important Sector for Political Stability

GDP in the secondary industry exceeded that in the primary industry for the first time in FY 2014/15 helped by the improved power shortage situation. The share of the primary industry in aggregate GDP has been gradually declining. But Pakistan used to play a role of food supplying area before independence, that is, in the days under the British control. Population in Pakistan is on an increasing trend and numbered 199,110 thousands in FY 2016/17. Since securing employment is an important agenda for the government, the agricultural sector is regarded as an important sector with high job absorption capacity.

(Figure 9)　Composition of GDP



(Source）JETRO

In emerging countries famines and sharp rise in food prices often lead to a change of administrations and therefore the importance of agricultural industry cannot be ignored also in Pakistan. 30-40% of harvested crops have been lost in Pakistan due to low level of technology in storage and transportation equipment. Especially in the Punjab Province with a fertile soil which was brought by the Indus, irrigation facilities and canals were built in the days of British rule, but they are now greatly outdated. Many parts of the area are vulnerable to natural environment and the productivity of agriculture is low there because its production is much affected by the weather. Although the land area for agricultural use in Pakistan is eight times as broad as in Japan, its GDP of the primary sector is smaller than that of Japan.

The Pakistani government has introduced a market economy to the agriculture sector to improve its competitiveness. It also has transferred its authority of agricultural policies to local governments to tackle to solve the problems of retarded technology of water management, lack of agricultural finance, injurious insects, etc. However, there is still little progress in the reform of the agricultural system where rice and cotton have been still subject to national tax while fertilizer has been still subsidized and it will therefore take a considerable time to improve the competitiveness of the agriculture industry.

(Table 5) Comparison of Pakistani Agricultural Scale with Japan (2015)

	Pakistan	Japan
Real GDP (billion dollars)	113	4,845
Primary Industry of above (billion dollars)	21.3 (18.9% of GDP)	38.8 (0.8% of GDP)
National Territory (billion ha)	796	378
Agricultual area of above (billion ha)	3,62.5 (45.5%)	45.2 (12.0%)

(Source) Ministry of Agriculture, Forestry and Fisheries

Cotton yarn and cotton products are a main export item to Pakistan. Currently the international market price of raw cotton has fallen dramatically, making Pakistan’s export environment deteriorate. The government has promoting exports of ready-made clothes with higher value-added rather than the raw cotton, but decline of exports of fiber products as a whole has not been halted, which demands the government to make further efforts on the reforms.

（Table 6）Exports of Fiber Products

(billion dollars, %)

		2014/15		2015/16		2016/17	
		Amount	Growth	Amount	Growth	Amount	Growth
Exports of Fiber Product	Total	1,132	-0.4	1,065	-5.7	1,029	-3.2
	Cotton Cloth	208	-8.8	195	-6.2	178	-8.3
	Cotton Yarn	151	-13.2	110	-27.2	94	-14.5
	Ready-Made Clothes	170	11.9	179	5.4	189	5.6

(Source) JETRO

4. China Pakistan Economic Corridor (CPEC）

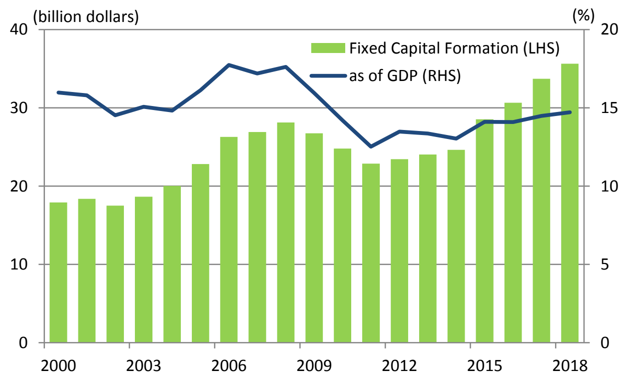
（1）Outline of CPEC

CPEC is a project that Pakistan and China have been promoting since the 2000s and constitutes a part of the “One Belt One Road” Initiative that China initiated in 2013. It is a project that constructs by 2030 a land road (total length of about 2000 km) to connect Kashgar, Xinjiang Uighur Autonomous Region which is located in the inland area at the west end of China with the Gwadar Port on the Arabian Sea across the whole Pakistan. It focuses on construction of traffic routes and investment on electric power, by which the energy shortage in Pakistan is expected to be resolved. Total budget was increased to the current $62 billion from the initially planned $46 billion. The government of Pakistan stresses that CPEC has raised each year’s real GDP growth rate substantially, and created about 60 ,000 new jobs during three years from 2014/15 to 2016/17. Further it is estimated that CPEC will create 800 thousands of new jobs by 2029/30.

Relationship with India is not so good for both Pakistan and China. On the other hand, Pakistan and China have had a friendly relationship politically, although their economic relationship had been tenuous. When the United States and India began to approach each other after the turn of the 21st century, the relations between Pakistan and China became closer as if to counter it, giving birth to CPEC.

Under the CPEC framework, various infrastructure investments have been implemented including road construction, revamping of railroads, construction of gas pipelines, development of power generation plants, revamping of power grids. For instance, Pakistan’s main artery was completed by the construction of Burhan-Havelians highways. As Table 4 above shows, the electricity production also increased by 9 million KW over the period from FY1999/2000 to FY20105/16[12].

(Figure 10) Development of Fixed Capital Formation



12 The projection of the government at the time of announcement of CPEC set at an increase of 10.4 million KW. So the development is considered to be making a good progress.

(2) What does CPEC mean to China?

China has political and military purposes as well as that for maintaining security in promoting CPEC.

The use of the Gwadar Port is the greatest one. The Gwadar Port is located at the throat of the Persian Gulf on the Arabian Sea, which is a strategic place on the maritime route connecting Africa/Europe region and Asia/Pacific region. Since the port was sold to Pakistan by Oman in 1958, it had been managed by the United States and Singapore, and in 2013 China obtained it on a lease for 43 years from Pakistan. The Gwadar port, a terminal point of CPEC, is not only the gateway to the Indian Ocean and the Arabian Sea, which has been a cherished target for China to reach, but constitutes an intersection of land and sea lanes in the "One Belt and One Road" Initiative of China. Recently Chinese companies have been increasingly expanding their business in Africa and the Gwadar port is regarded as an important base for transportation of goods and people, as well as an emergency base for the Chinese Navy.

Also it is an important purpose to restrain independence movement and control the penetration of Islamic extremists in Xinjiang Uighur Autonomous Region. China is vigilant of the independence movement organization "East Turkestan Islamic Movement"[13]. Besides, the border area of Pakistan and Afghanistan has been a hiding place for extremists after the war in Afghanistan. If the extremist forces come to penetrate into Kashgar from this area, it will be a great threat to China. Although President Trump is considering to boost troops in Afghanistan, he has no chance for the conflict in this area to be resolved, and China is supporting Pakistan's political and military stability for the sake of its own stability.

Through CPEC, Pakistan has strengthened its military ties with China. China exports a great deal of weapons to Pakistan. On the other hand the U.S. exports of weapons to Pakistan has continued to decline to $21 million in 2017 against $514 million from China.

(3) Problems of CPEC----Doubtful Economic Efficiency and Possibility of Future Repayments Becoming a Heavy Burden

One of the problems of CPEC is an increase of imports to Pakistan. With the CPEC projects, imports from Chinese companies of machinery, transportation equipment, and capital equipment have been greatly increasing. Trade volume with China amounts to around $10 billion annually, of which less than 80% is accounted for by the imports of Pakistan. The Chinese trade deficit accounts for about 30% of total trade deficits of Pakistan, showing that the high economic dependence on China constitutes a big factor of the current account deficit[14].

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13 Islamic extremist group in Xinjiang Uighur Autonomous Region. It has relationship with Taliban and Al-Qaeda and was involved in such incidents as police attack which took place in Kashgar in July 2011.

14 As CPEC has been implemented as part of "One Belt One Road" Initiative, it will be pursued even in a small economic slowdown, but a possibility cannot be denied that the projects will be stalled if the growth rate of the

(Table 7) Pakistan's Trade with China

(billion dollars, %)

	2014/15		2015/16		2016/17	
	Amount	Growth	Amount	Growth	Amount	Growth
Exports to China	190	-15.4	159	-16.5	136	-14.3
Imports from China	573	17.3	650	13.4	788	20.3
Trade Values with China	763		809		924	

(Source) JETRO

The Gwadar port has its weakness. Not only it is located away from the nearest city of Karachi by 623 Km, but it suffers from serious shortage of water, which makes it a high-theft area of water especially in the dry-season. In addition, despite no Pakistanis being employed, the Pakistani government has deployed 25,000 military personnel in the coastal area to secure the safety of Chinese workers, which has cost the government a lot of money.

Also, to encourage investment in the Gwadar Port, the Pakistani government has implemented tax exemption measures for the period of 20 years to companies that have invested in that area. The Gwadar port initially used to be operated by a Singaporean company and has currently been managed by a Chinese company. Many believe that after all it is the Chinese companies backed by the Chinese government that reap the benefit, creating no increase of income on the side of Pakistan.

CPEC involves not only significant cost for security but also for transportation. For instance, the sea-born shipping of goods from the Persian Gulf to Shanghai currently takes 20 days but they can be transported in 5 days if CPEC opens. However, it is estimated the transportation cost will increase by 4 to 5 times. Even though Pakistan can hardly expect to increase tax revenues from CPEC that has no economic rationality, repayment of loans to China will start soon. It is feared that this will force Pakistan to have to start to again use its foreign exchange reserves to make repayments, further causing fiscal deterioration and decline in growth rate.[15]。

5. Results and Background of General Election held in July 2018

(1) Review of results of the election of the National Assembly (lower house) of 2013

Pakistan had been under the military junta for almost 30 years since its foundation of state in 1947. Later, in the election held in 2013 which took a toll of deaths of more than 200, the Sharif administration was established, realizing for the first time in its history a civilian government serving for the second consecutive term. For Mr. Sharif, it was his first comeback to the government since 1999. His party Pakistan Muslim League -N (PML-N) gained a majority 190

Chinese economy should decline sharply.

15 Although the repayment schedules of the CPEC projects are not disclosed, the IMF guesses that the repayment has already started.

seats out of the total 342, followed by the Peoples Party of Pakistan (PPP) gaining 45 seats, and Pakistan Movement for Justice (PTI) 35 seats.[16]

(2) Impact of the Panama Papers on the Pakistani political circles

The publication of the Panama Papers in April 2016 revealed an allegation of money laundering and other corruptions of Mr. Sharif's three children who were found to hold properties through paper companies in the British Virgin Islands. The Supreme Court of Justice decided in July 2017 that Mr. Sharif did not meet the qualification for the membership of the National Assembly that the Constitution sets and in April 2018, the Court sentenced a permanent exile to Mr. Sharif from holding public offices.[17]

(3) Results of elections for Senate and National Assembly in 2018

During the five years governed by the PML-N, the economy in Pakistan improved.
The EFF programs of the IMF and acceptance of investment in CPEC by China greatly contributed to the improvement. The government promoted infrastructure construction of buildings and transportation networks, improved civil order. It also implemented agricultural land reforms in the Punjab Province which is the main electoral base of the PML-N.

An election of the members of the Senate (half of its 104 members to run for the election) was held in March 2018 as a prelude to the general election for the National Assembly, in which the PML-N won maintaining the dominant political force. Despite the forecast that the PML-N would lose its momentum after the indictment of Premier Sharif, the party won 33 seats combined with the seats uncontested this time. In the meanwhile, PPP ended with disappointing 20 seats while PTI gained 12 seats.

These were the numbers of seats for each party before the election for the National Assembly to be held in July, but the election results found the PTI with 115 seats, the PML-N with 64 seats, and the PPP with 43 seats, pushing the PTI to a leading party in the National Assembly. The victory of the PTI was mostly due to (i) the support given by the military which was trying to strengthen its dominant position politically, and (ii) campaign addresses by the TPI candidates who advocated the failure of the PML-N in the handling of the government. The military had

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16 Pakistan consists of four provinces (Punjab, Sindh, Khyber Papkhtunkhwa and Balochistan), Islamabad Capital Territory, and Federally Administered Tribal Areas. Article 18 of the Constitution was amended in 2010 to transfer the authorities excluding defense, diplomacy, currency and some others to provinces, which gave the four provinces a great deal of discretion.

The Sindh Province in the South has been a base area of the PPP for long and the PPP had a victory in the general election of 2013. On the other hand, in the Punjab Province situated in the Northeast of the country and with the population of more than half concentrating, the PML-N won a crushing victory and Mr. Shabas Sharif, younger brother of the Prime Minister Sharif, has taken the office of chief minister of the province. The PTI achieved a landslide victory in the Northernmost Province of Khyber Papkhtunkhwa.

17 For more details, see Annex 2 at the end of this article.

previously supported the PTI, reacting against the PML-N that moved to mending the relationship with India while ordering the Supreme Court to oust Mr. Sharif in relation to the Panama Papers. The PTI also intensified its criticism on the PML-N by promising the citizens to publish the details of CPEC asserting that Pakistan is on the brink of falling into a debt crisis due to CPEC projects. As a result, the PTI became the largest party in the National Assembly.

Since the election of 2013, the PPP has been placed in inferior positions. The recent unpopularity of the PPP reflects several reasons including heavy burdens asked in the past to the citizens to strictly meet the conditionality of the EFF program of the IMF. In 2008, the PPP government raised various service prices following the instructions of the IMF, but the wage increase of the citizens did not catch up with the high rise of inflation at all. In addition, the government neglected efforts to improve the electricity problems, while it was preoccupied with the dole-out policies targeted at its base area of Sindh Province, with rampant corruption within the government. Against these background, the popularity of the PPP has been flagging since the big defeat in 2013 to date.

On the other hand, the PML-N, making good use of investment funds available under the CPEC projects, has steadily implemented reforms of infrastructure and electric power, without putting a burden on the citizens. As a result, despite the ouster of Premier Sharif, the party strengthened its political base until the March Senate election. However, as these reforms were also dole-out policies aimed at the general election of 2018, and as they worsened the fiscal balance to the brink of a debt crisis by promoting CPEC projects that have no economic rationality, the PPP was defeated in the lower house election with its popularity plummeting since July. Actually, the fiscal deficit for FY 2017/18 is expected to worsen for the second consecutive year to the level of 5 % of GDP.

6. Prospect of external debts and some words of caution

It is of major concern that the fiscal situations will seriously deteriorate after the end of the EFF program. The local press reported that the fiscal deficit worsened to 6.1% of GDP (against 5.5% forecast by the IMF) at the end of May, eleven months past in the FY2017/18, and public debt outstanding reached 72% of GDP at the end of June. Especially repayment of loans to China has been a big burden and the investment in electric power promoted by the leadership of China is now becoming a cause for concern. It is also reported that with the rupee continuously falling the current account deficit for FY 2017/18 is estimated to grow to 6.0% of GDP, entering the cautious zone at a faster speed than expected.

According to the IMF, it is expected the repayments of foreign currency denominated loans will increase gradually in the future. The State Bank of Pakistan states that the payments in foreign currency due under the arrangements will amount to $9.5 billion (3.5% of GDP) in the coming year. According to the IMF, the amount of repayment will increase hereafter, reaching to 6% of GDP in FY 2019/20, and 7% of GDP in FY 2021/22.

(Table 8) Scheduled Repayments of Loans within one year as of March 2018[18]

(billion dollars, %)

	Total	Up to 1 month	More than 1 and up to 3 months	More than 3 and up to 1 year
Foreign Currency Loans	-9.5	-1.6	-1.5	-6.3
Principal	-7.7	-1.4	-1.3	-5.0
Interest	-1.8	-0.3	-0.2	-1.3
Forward Leg of Currency Swaps	-6.7	-3.5	-3.1	-0.1
Short Positions	-6.7	-3.5	-3.1	-0.2
Long Potisions	0.0	-	-	0.0

（Source）State Bank of Pakistan

The external debts of public sector and private sector combined will increase from now on. The IMF estimates that the foreign currency needs[19] have been increasing year after year to reach $24.5 billion (7.5% of GDP) in FY 2017/18, projected to balloon to $45 billion (9.9% of GDP) in FY 2022/23 as the CPEC related repayment will begin in earnest hereafter. Interest payment in FY 2017/18 amounted to $2.5 billion, which is also a big burden to Pakistan. As it is inevitable for the country to purchase further foreign currencies to serve debts in foreign currencies, its external debts which is estimated to have reached $93.3 billion (28.5% of GDP) in FY 2017/18 will further increase in the future.

(Table 9) Pakistan's Requirements of Foreign Currencies (i)

	2014/15	2015/16	2016/17	2017/18
Gross External Financing Requirements (billion dollars)	9.1	11.4	21.5	24.5
Current Account Deficit	2.7	4.9	12.4	15.7
of which Interest Payments	1.9	2.2	2.4	2.5
Amortization of Medium-and-Long-Term Debt	3.7	3.2	4.5	3.2
Maturing Short-Term Debt	2.7	3.3	4.6	5.6
Gross Financing Needs (as of GDP, %)	3.4	4.1	7.1	7.5
Total Gross External Debt (as of GDP, %)	24.1	26.2	27.3	28.5

（Source）IMF

The table below shows that the borrowings from China have been increasing replacing the ending EFF. Among the official creditors China accounts for $2 billion but since the majority of external private creditors is represented by the Chinese companies, it is considered that substantial amounts of borrowing have been made each year from China with public and private sectors combined.

18 Remaining amount in the yuan swap arrangement stood at $1.03 billion but swap line with China was expanded to $3.13 billion in May.

19 Total of repayments of debts and the current account deficits.

Recently the roll-over of short-term debts has been also increasing, suggesting Pakistan is getting into funding difficulties.

(Table 10) Pakistan's Requirements of Foreign Currencies (ii)

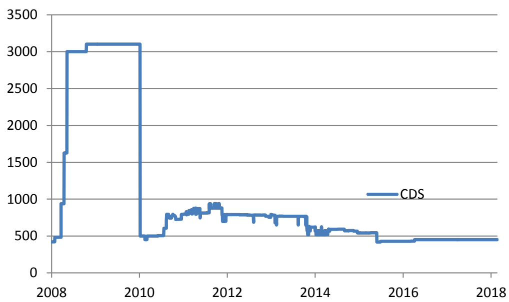
(billion dollars)

	2014/15	2015/16	2016/17	2017/18
Gross External Financing Requirements	9.1	11.4	21.5	24.5
Abilable Financing	6.5	12.1	19.2	20.7
Net FDI	0.9	2.3	2.6	3.2
Medium-and-Long-Term Borrowing	5.5	7.1	11.7	11.5
From External Private Creditors	2.4	2.6	3.6	5.4
From External Official Creditors	3.1	4.5	8.1	6.1
World Bank	1.2	1.7	1.0	0.7
China	0.6	1.2	2.9	2.1
Roll-Over of Short-Term Debt	1.3	3.4	4.1	5.5
Reserve Assets (decrease=+)	-2.6	-2.7	1.9	3.7
EFF	2.6	2.0	0.1	-

(Source) IMF

Whether the PTI can continue to make stable government administration will much depend on if it can stop another deterioration of the economic indicators that had improved over the years from 2013 to 2016. If an expansion of the fiscal deficits continues, it will inevitably have to increase the burden of citizens like in the PPP administration, and if it allows an increase in the trade deficits it may lead to a depreciation of the rupee with a possible rekindling of inflation. If the international reserves keep decreasing, it will make the repayment of the EFF to the IMF difficult, necessitating another request of support from the IMF. Currently the CDS remains on a relatively low level, suggesting that at least the market considers that the international community including the U.S. cannot easily abandon Pakistan which is a nuclear nation. To what extent it will force the citizens to bear burden to stabilize the fiscal condition, and to what extent it can improve its capacity to earn the foreign currencies, the handling of government by the PTI administration will be closely watched.

(Figure 11) CDS of Pakistan



(Source)Datastream

(Supplement 1) Improvement of Nuclear Power Generation Capacity

Much of the improvement of electric power generation capacity depends on the power development project under CPEC. Currently under operation are Units 1 to 4 of Chashma Nuclear Power Plant (CHASNUPP) and Unit 1 of Karachi Nuclear Power Plant (KANUNPP). At the KANUNPP, another two nuclear plants are under construction. Six among the seven nuclear plants including those under construction have been purchased from the China National Nuclear Corporation (CNNC) for the total cost of $15 billion under the CPEC projects. The total power production capacity of the seven plants amounts to 36.66 million KW and the government plans to add to these another atomic reactor with the capacity of 8.8 million KW by 2030. Prime Minister Abbasi expects that a series of nuclear energy development projects will overcome the rotating blackout problem. Thus far, 70% of national regions have been relieved from the rotating blackout which used to last for 8 to 10 hours a day.

(Table 11) Nuclear Power Plants in Pakistan

<table>
<tr><th></th><th>Nuclear Power Plants</th><th>Capacity of Plants (10 thousand KW)</th><th>Commercial Date</th><th>Operator</th></tr>
<tr><td rowspan="4">Chashma</td><td>1</td><td>32.5</td><td>2000</td><td rowspan="7">PAEC</td></tr>
<tr><td>2</td><td>32.5</td><td>2011</td></tr>
<tr><td>3</td><td>34</td><td>2016</td></tr>
<tr><td>4</td><td>34</td><td>2017</td></tr>
<tr><td rowspan="3">Karachi</td><td>1</td><td>13.7</td><td>1972</td></tr>
<tr><td>2</td><td>110</td><td>2021</td></tr>
<tr><td>3</td><td>110</td><td>2022</td></tr>
<tr><td colspan="2">Total</td><td>366.7</td><td colspan="2"></td></tr>
</table>

(Source) IAEA
(Note) PAEC: Pakistan Atomic Energy Comission

The improvement in the power sector can also be confirmed by the GDP statistics. The output of electricity and gas sector has shown positive growth over the previous year for four consecutive years. Increase of power production has given positive effect to other sectors' production. In the tertiary industry, high growth on the level of 6% was realized for the first time since the Leman Brothers collapse and for two consecutive years from FY 2015/16.

(Table 12) Real GDP by Industry

(yoy, %)	Primary	Secondary					Tertiary					GDP
			Mining & Quarrying	Manufacturing	Electrisity & Gas	Construction		Wholesale & Retail	Transport, Storage & Communication	Finance & Insurance	General Government Srvices	
2000/01	0.8	1.3	7.5	4.1	-15.5	-0.5	3.5	2.4	1.3	2.9	6.9	2.4
2001/02	4.4	7.0	10.7	7.3	2.5	4.1	5.7	6.7	4.4	7.0	7.8	5.6
2002/03	2.8	17.4	21.8	16.4	40.2	-6.9	6.4	10.7	2.9	13.1	3.3	7.7
2003/04	7.0	6.5	-15.8	16.0	-8.1	16.8	8.1	14.0	4.2	16.2	0.8	7.5
2004/05	1.3	3.6	3.6	9.4	-39.1	17.0	8.2	9.5	4.4	16.2	10.2	5.6
2005/06	3.4	7.7	7.3	9.0	-12.8	12.9	5.6	5.8	6.9	9.1	2.7	5.5
2006/07	1.8	8.5	3.2	6.1	37.2	15.4	4.9	5.7	5.5	6.3	0.2	5.0
2007/08	3.5	-5.2	-2.5	-4.2	-12.1	-9.9	1.3	-3.0	5.0	-9.6	5.6	0.4
2008/09	0.2	3.4	2.8	1.4	16.7	8.3	3.2	1.8	3.0	-3.3	8.0	2.6
2009/10	2.0	4.5	-4.4	2.5	63.9	-8.6	3.9	2.1	2.4	-4.2	14.1	3.6
2010/11	3.6	2.5	5.2	2.1	1.4	3.1	4.4	1.7	4.6	1.6	11.1	3.8
2011/12	2.7	0.8	3.9	4.8	-26.4	1.1	5.1	3.5	4.0	8.3	11.3	3.7
2012/13	2.5	4.5	1.4	5.6	-0.7	6.0	4.5	4.8	3.9	4.3	2.9	4.1
2013/14	2.1	5.2	5.0	3.9	13.5	7.3	4.4	2.6	5.1	6.3	4.8	4.1
2014/15	0.2	5.7	6.2	3.7	9.4	13.7	5.7	4.7	4.9	6.4	9.7	4.6
2015/16	2.1	5.4	-0.4	5.8	5.8	9.8	6.5	7.5	4.4	10.8	5.9	5.4
2016/17	3.8	5.8	3.0	6.2	1.8	9.1	6.4	7.5	3.6	6.1	11.4	5.8

(資料) Datastream

(Supplement 2) Overview of the Panama Papers Case in Pakistan and the Influence of the Military

In April 2016, the International Consortium of Investigative Journalists (ICIJ) published the so-called Panama Papers which contained the name of more than 210 thousand companies established in tax havens. The papers revealed the allegation of corruptly amassing fortunes by three children of Prime Minister Sharif who held properties overseas through paper companies registered in the British Virgin Islands. Upon this revelation, the PTI launched a legal action to deprive the prime minister's qualification of membership to the National Assembly. The Pakistan Supreme Court, while rejecting the argument of the PTI, made the first decision that ordered to establish a special court. The special court established a Joint Investigation Team (JIT) that involved the military, which submitted a report to the Supreme Court on the corruptive assets of PM Sharif.[20] In July 2017, the Supreme Court decided that the prime minister was ineligible to the qualification of the membership of the National Assembly set by the constitution.[21]

Although Mr. Sharif resigned from Prime Minister, he nominated former Minister of Oil and Natural Gas and also his follower Mr. Shahid Khagan Abbasi as an interim prime minister, aiming at keeping his influence by planning to replace him with his brother Mr. Shahbas Sharif eventually. However, in April 2018, the Supreme Court of Pakistan decided to impose the former Prime Minister Sharif a lifetime ban from holding public offices.

It is viewed that the military had much influenced the decision of the Supreme Court to order

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20 As part of it, it came to light anew that he did not disclose the salary from an offshore company in the UAE for which Mr. Sharif is chairman and which has been managed by his son. A series of investigations found an involvement of more than 300 politicians.

21 It defines that a member shall be "sagacious, righteous and non-profligate, honest and ameen, there being no declaration to the contrary by a court of law

the former prime minister a lifetime ban on public offices. There had been three coup d'etat attempts by the military so far in Pakistan and during much of the period since the independence the country had been governed by the military. The former Prime Minister Sharif also had a long conflict with the military. In the first Sharif administration that took office in 1990, political situation was confused over the reduction of president's authority which Prime Minister Sharif tried to achieve. Then the military intervened, resulting in the resignation of both president and prime minister in 1993. (Later Mr. Sharif achieved a comeback as prime minister.)

When the first Bhutto administration of the PPP that started in 1993 was dismissed by the military, the second Sharif administration was established in 1997. As India-friendly Mr. Sharif tried to withdraw the army from the Cashmere region with the replacement of General Musharraf as the chief of army staff, General Musharraf launched a coup d'etat to declare Mr. Sharif deportation to Saudi Arabia (Mr. Sharif returned home later). In the general election of 2008 the PPP won the victory and for the first time the military government was overthrown by the power of the parliament.

The JIT was composed of 6 members of which one was a member of the Inter-Services Intelligence (ISI) and one was a member of the Military Intelligence Service (MIS). It seems that it was why the support of the military was needed to the decision of the Supreme Court when it took the decision above. Yet it is notable that in the earlier time this kind of situation would have triggered a coup d'etat by the army/military, but this time impeachment of the prime minister was made based on a judicial ruling that is in line with the constitution, which is a big difference from the past.

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