



A biannual publication of PIDE about performance and expectations of the business sector of Pakistan

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PIDE BUSINESS BAROMETER



PAKISTAN INSTITUTE OF DEVELOPMENT ECONOMICS

ABOUT THE PIDE

The Pakistan Institute of Development Economics (PIDE), a premier policy Research Institute of Pakistan, has led the field in developing quality research in social sciences and informing public policy. PIDE is an autonomous body under the auspices of the planning commission, government of Pakistan.

In 2006, PIDE has been granted Degree awarding status by the Government of Pakistan and has therefore on the verge of becoming a university. In a recent restructuring, PIDE has developed several new initiatives such as the *PIDE Working Papers Series*, *PIDE Policy Viewpoint* and *Weekly Seminars*. It has been very active in the area of opinion development and formation actively breaking new ground into several areas such urban issues, governance and institutions and civil service reform.

The *Business Barometer of Pakistan* is one of the new research initiatives to provide biannual information about the business sector's assessment and expectations about the state of economic activity in Pakistan.

THE NEED FOR A BUSINESS BAROMETER

To provide independent biannual information about the state of economic activity in Pakistan, PIDE has launched *Business Barometer of Pakistan*.

The *Business Barometer* is based on the survey of firms' assessments of the economy through their own activities. We have tried to get from firms information on their production, sales, inventories, prices, wages, employment and investment. The survey was conducted in January.

We asked for information on the selected variables for the last six months, July–December, 2006. This information should be relatively easy since most managers will have a very real feel for events of the last six months even if they have not finally closed their books.

We then asked for their expectations for the same selected variables over the coming six months—January to June 2007. Once again, the information provided by firms would be very useful given that they would have good knowledge of things to come from their order books and forward contracting arrangements.

We intend to repeat the survey every June and January. This simple device allows us to access market perceptions of the economy in a very real way. And we know from global experience that market perceptions are an important source of information on the economy that both policymakers and market participants can use.

We hope that this PIDE initiative will lead to the development of a diverse set of market sentiment indicators that all economic agents as well as the government will find useful as a barometer of coming economic activity.

THE SURVEY

For this survey we are focussing on firms that are listed in the stock exchange. In that sense we are dealing mainly with large business. While this was largely because of the convenience and management of the survey, it is also true that large firms because of their weight in the economy may provide us with more information on developments in the economy.

The questionnaire was sent to all the firms listed in the Security Exchange Commission of Pakistan. The respondents included banking

sector, textile sector, sugar and allied industries, cement, oil and gas exploration companies, engineering, automobile assemblers, automobile parts and accessories, fertilisers, pharmaceuticals, chemicals, banaspati and allied industries, food and personal care products and glass and ceramics. Some 10 percent of the firms responded which gives us a fairly good sample to generalise from. We will over time improve the coverage while also ensuring that we do develop a panel of respondents to ensure comparability across semesters.

OVERVIEW

First addition of the *Business Barometer of Pakistan* is based on the views of firms listed at the Karachi Stock Exchange (KSE). It consists of their opinion about the overall performance of the economy such as growth and inflation during the second half of the year 2006 and expectations about the first half of the 2007. Further it also includes assessment of level of their activities during the survey period and expectations about the activities in the next half of the year.

The analysis reveals that overall growth of the economy during last six months remained stable. Further firms also anticipate stability in growth of the economy in the current half of the year. Although most of the firms expect the same level of growth but the net balance¹ remains negative. This implies that the growth target of 7.0 percent for the year 2007 could not be achieved.

Firms are positive about their own activities. Their future expectations about the activities are also high. Moreover there is rising trend in the wages and other input prices and they are expected to rise in the near future.

The picture about the general price level, rate of inflation, is alarming. Most of the firms' assessment is higher price in the last half of the 2006 and their expectation is that these would remain higher in current half of the 2007 also. This indicates the demand for tough policy measures by the authorities to curb looming higher expected inflation.

In summary we can say that the analysis from the survey data reveals that there is stability in current and expected growth. In case of prices, current and expected prices are high. Economic activities of the business sector indicate that current and expected production and sales are high.

OVERALL ECONOMIC ACTIVITY

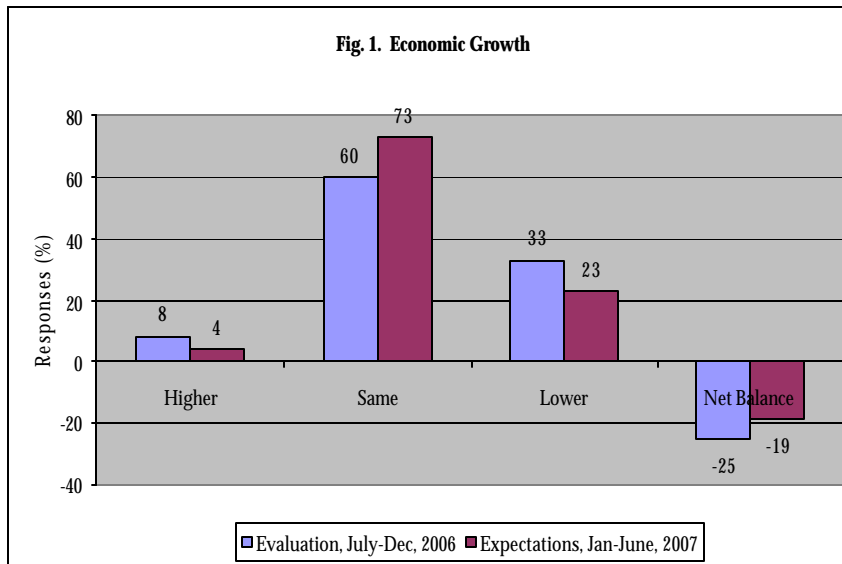
Stable Economic Growth

Looking at the last 6 months of 2006, a majority of firms, 59 percent, saw stable economic growth while 32 percent firms reported

¹Net Balance represents the percentage of respondents indicating "higher" minus the percentage of respondents indicating "lower".

slower growth than the previous year. Only 8 percent of the respondents indicated a faster growth in economy during the survey period.

In terms of their perception regarding the economic growth in the next six months, 73 percent reported that it will grow at the same pace, 23 percent reported that it will grow at a slower rate while only 4 percent expected that it will grow at a faster rate. In case of expected pace of growth majority of firms perceived that growth will remain at the same level.



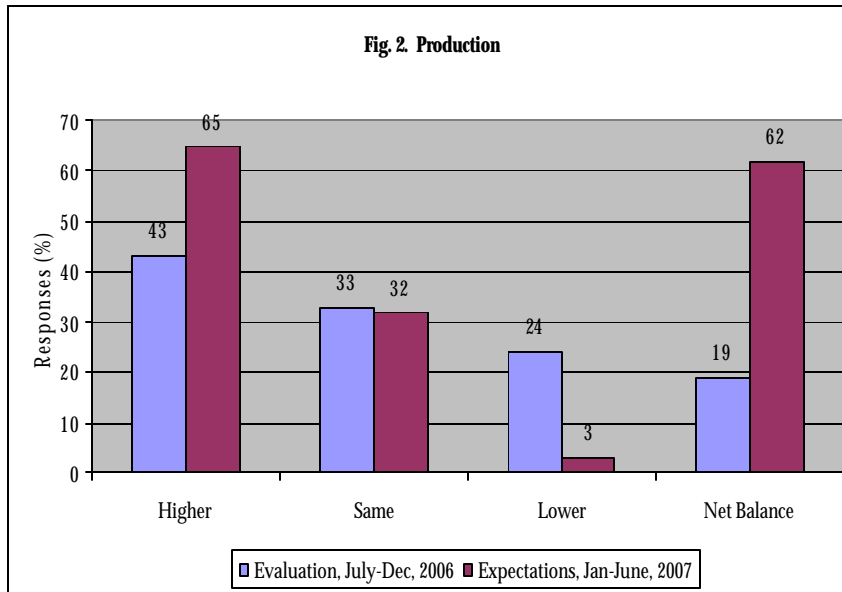
THE STATE OF FIRMS

Production is Increasing!

When asked about their production level, the picture improves. The responses indicate that during the July- Dec., 2006, 43 percent had a higher level of production as compared to first half of the same year. While 32 percent indicated no change in the volume of production, and 24 percent indicated that their production was lower than the first half of the year.

In terms of the plans for the next six months, 65 percent responded that they expect their production/size of activity to rise, 32 percent expected the same level and 3 percent expected a fall in their production. Quite clearly, business is growing and is optimistic about future growth.

The net balance (difference between the percentages expecting improvement over the percentage expecting a decline) is positive and growing—reconfirming that the situation may be improving for trade and industry. The significant increase in the net balance is noteworthy and a sign of the confidence of the business community.

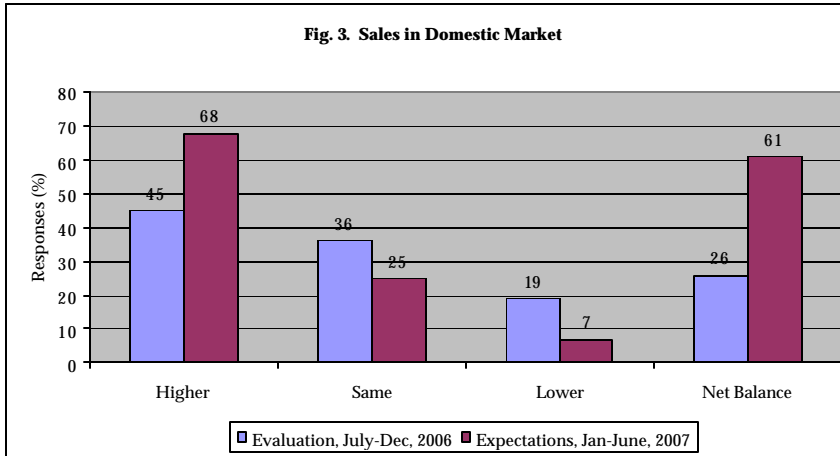


Sales Increased with High Expectation

The picture on sales appears to be confirming the positive situation. It shows that domestic demand is strong and expected to remain strong. However the demand for exports remains uncertain.

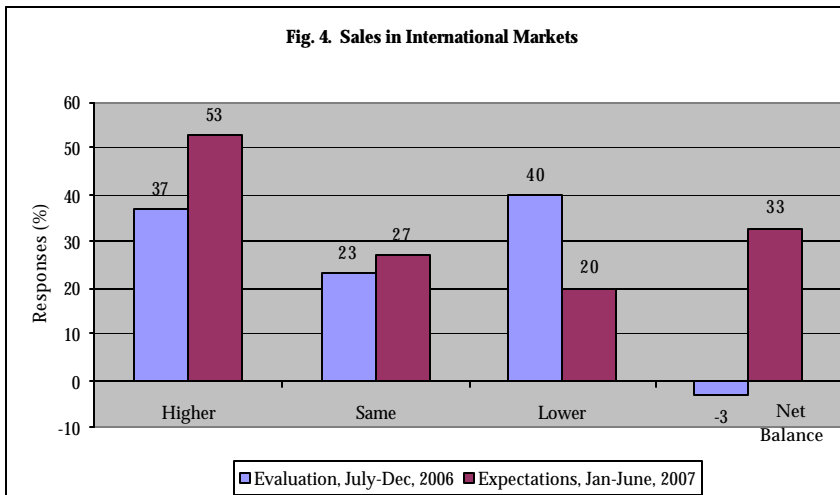
45 percent of firms indicated that their sales in the domestic market during the last 6 months of 2006 were higher than the previous half of the year. 19 percent firms recorded decrease in their sales. However, there is no significant change in the sales of 33 percent firms.

Majority of firms (68 percent) are expecting that their sales in the domestic market would increase in the first 6 months of 2007, 24 percent expected it to stay the same while 7 percent expected a fall in their activity in the domestic market.



Interestingly, in international market, 40 percent reported a decrease in the sales, 36 percent reported an increase in the sales activity in the international market, and 23 percent reported no significant change. The net balance is -3 percent confirming some difficulties in export markets in the last 6 months.

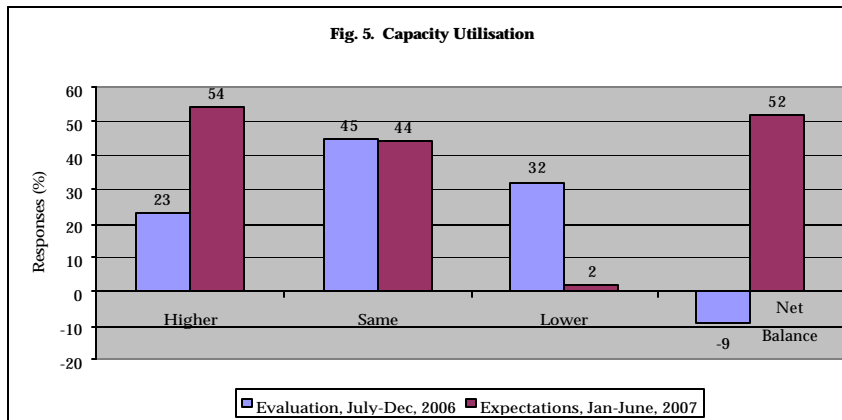
Firms are optimistic about the international market. Most of the firms (53 percent) are hoping that their sales would increase. Unlike current situation only 20 percent are expecting that sales may decline, and the rest are expecting no change. The net balance has changed to a +33 percent indicating that the order books for exports have turned around.



Capacity Utilisation Confirms the Picture!

Despite continued growth in recent years, firms appear to have the space to expand capacity and are expecting to increase the use of their capacity in the coming period. 45 percent reported that there is no change with respect to previous year, 22 percent reported that their capacity utilisation is approaching the full capacity. However 32 percent firms reported that it declined during the second half of 2006.

Majority of firms (i.e., 54 percent) are expecting an increase in their productive capacity utilisation, 44 percent are expecting it to stay the same for the next six months while 2 percent expecting a decline in their productive capacity utilisation.

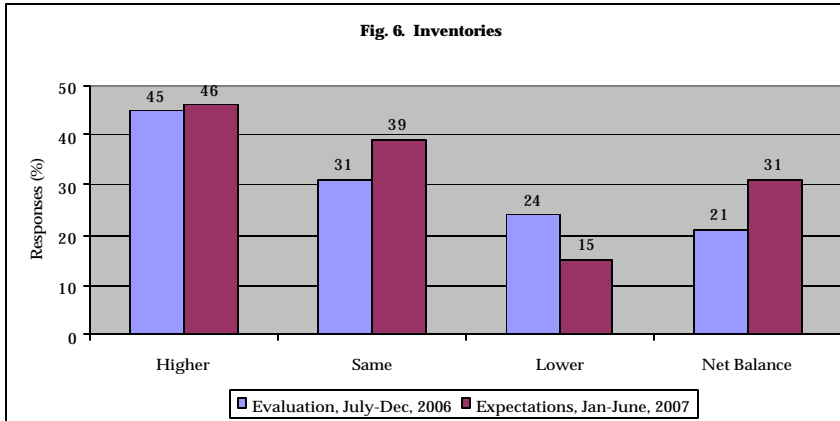


Firms are Building Up Inventories!

Interestingly enough, while, as noted above, most firms are reporting an increase in growth, production, sales, orders and capacity utilisation, inventories are building up. Most of the firms, 45 percent, reported a rise in the inventories, 31 percent kept it as the same level while 23 percent decreased their inventories in the second half as compared to the first half.

In the next six months 46 percent firms expected an increase in their inventory, 39 percent expected it to stay at the same level while 15 percent expected a decline in their inventory.

The net balance on inventories which was already quite high at 21 percent is expected to top 30 percent. This may be a sign of a maturing cycle and a slowing down of the current boom.



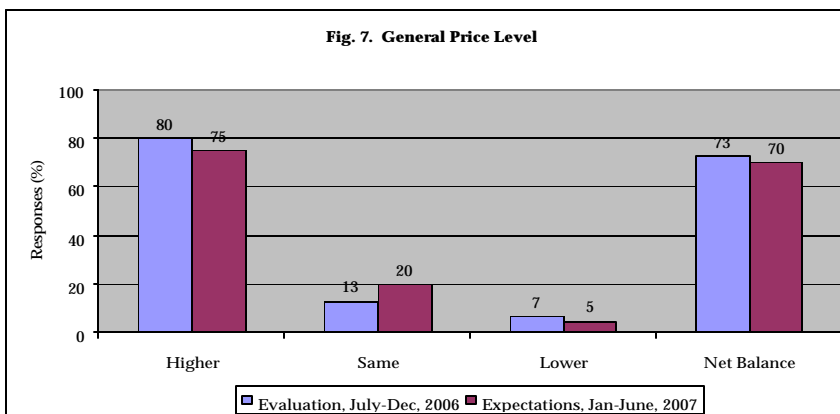
PRICES AND WAGES

Inflationary Expectations Remain Robust!

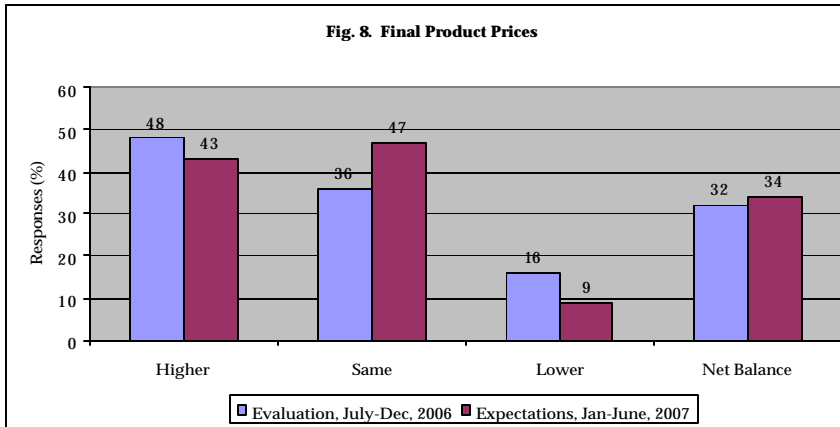
Inflationary expectations have not been revised downwards despite many policy pronouncements and efforts to contain them. About 80 percent of the respondents indicated that during the last six months the general price level increased as compared to the first half of the year 2006. 12 percent reported that it stayed the same while 7 percent indicated that it declined.

For the first half of the year 2007, 75 percent are anticipating an increase in the general price level, 20 percent are expecting the same while only 5 percent are anticipating a fall in the general price level.

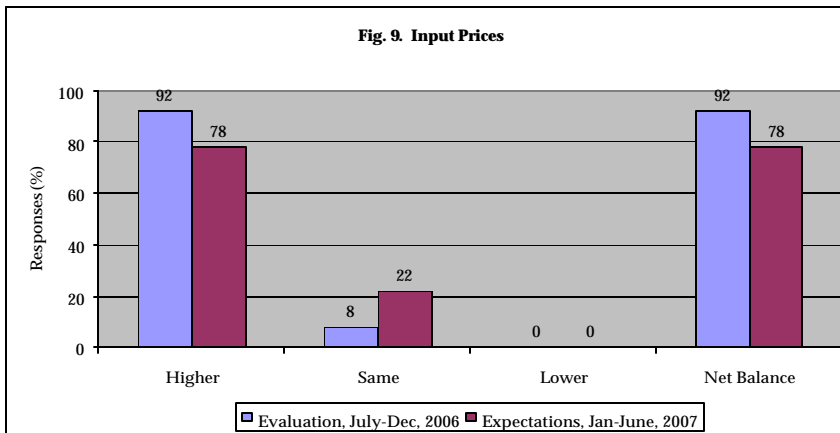
The net balance confirms a large majority of firms are holding on to higher inflationary expectations. This finding is of policy significance since research has shown that inflationary expectations can be self-reinforcing.



Looking at the prices of final goods, 48 percent of the respondents experienced an increase in the prices of their product in the last six months of 2006. 35 percent said that it remained the same, while for 16 percent the prices fell from the first half of the year. In the coming six months 47 percent reported that it will stay the same, 43 percent firms are expecting that the price of their product is going to increase, while 9 percent are expecting a fall in the price of their product.

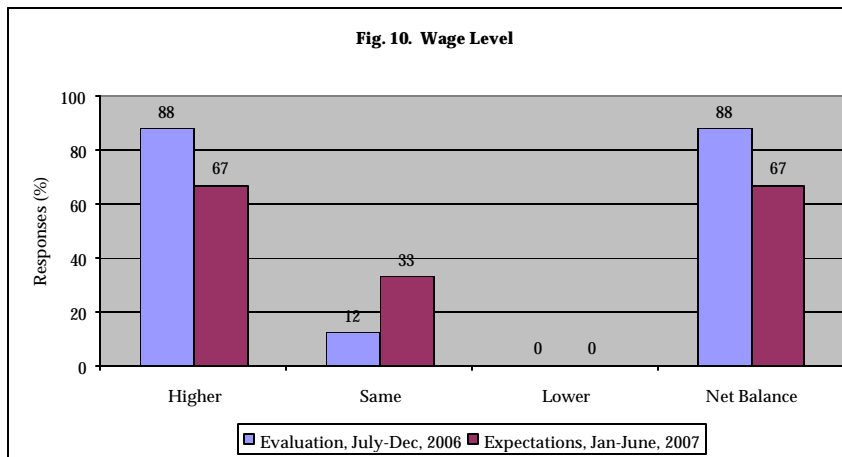


Firms are feeling the price pressure on the input side which is forcing them to raise their own final goods prices. None of the respondents reported a decrease in the prices of their inputs. Large number of them, 92 percent, indicated that their input prices increased in the last half of 2006 while 8 percent reported no change. For the coming six months, 78 percent expect a rise in the prices of their inputs, while 22 percent expect it to stay the same. None of the firms expect a fall in the prices of their inputs.



Wage Pressure is also Building Up!

In keeping up with the inflationary expectations, wage pressures appear to be building up. Neither any of the firms saw a wage decline in the last half of 2006 nor any of them are expecting wages to decline in the coming six months. While this may be understandable since economists do not expect wage declines to happen, what is of concern is the increase in wages in 2006 and expectation of further increase in 2007. 87 percent of firms reported a rise in wages in the second half of 2006 over the first half, while 12 percent reported that the wage level remained the same in both halves. In the coming six months, 67 percent continue to expect wage inflation while only 33 percent anticipate stable wages.

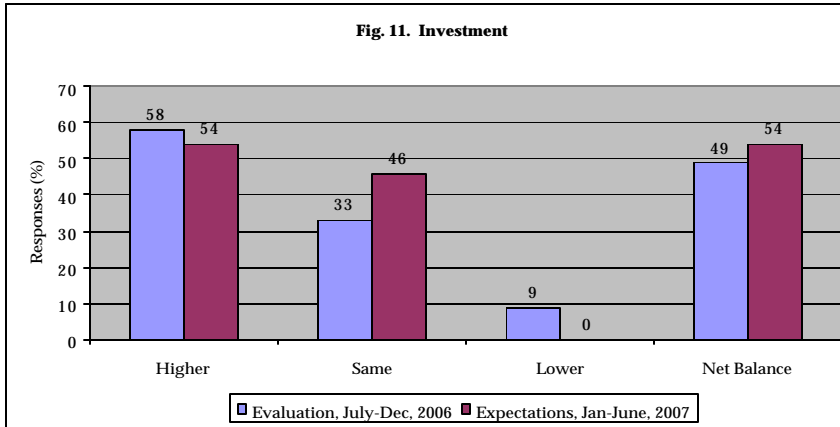


INVESTMENT AND EMPLOYMENT

Higher Investment with Higher Expectations

The stable growth picture is further reinforced when one looks at the investment behaviour of firms. Investment plans are firmly positive: 58 percent have increased their investment in the second half of the year as compared to the first and 33 percent firms reported that it stayed the same. Only 9 percent firms reported a decline in investment.

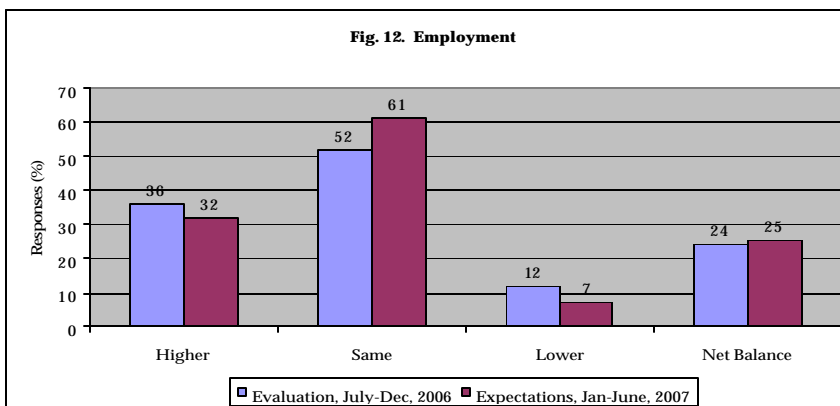
For the first half of 2007, 54 percent are anticipating an increase in investment, 46 percent plan to maintain it at the same level while none of the firms have plans to decrease their investment. Overall investment situation is encouraging for the economy.



Higher Current and Expected Employment

The strong economy seems to be positively effecting employment although the positive impact may not be very strong. Most of the firms (52 percent) reported that their employment situation did not change in the second half of 2006 over the first half. 35 percent reported an increase in the employment while the decline was reported by 11 percent of the respondents. Overall there would be some increase in the employment during the asking period since the net balance is increasing.

Analysis reveals that unemployment would decrease in future. 61 percent are expecting stability in employment in the first half of 2007, 32 percent are anticipating that work force would increase while 7 percent are expecting a fall in their employment level for the next six months. Once again it seems that on balance employment will increase though perhaps not to the full extent of the growth of the firm and the economy.



CONSTRAINTS ON FIRM GROWTH

On factors constraining growth, firms seem to be confirming the inventor build up story. More than half of the firms (i.e. 51 percent) reported that their production is constrained by different factors. Out of the constrained firm, 64 percent think that insufficient demand of their product is the most important constraint. This may again be an early signal of demand levelling off at the top of a cycle.

57 percent of the firms identify capital to be an important constraint to doing business while 43 percent feel that credit availability and its cost may be a problem.

Skill shortage is an issue that is felt by an almost similar number of firms as capital shortage confirming a well known perception regarding the education system.

25 percent of the firms identify imports as a constraint even though the import regime has been considerably liberalised. Perhaps this is indicative of the remaining liberalisation that needs to be done or possible anomalies in the tariff system. Nevertheless this is an area where policy research is needed.

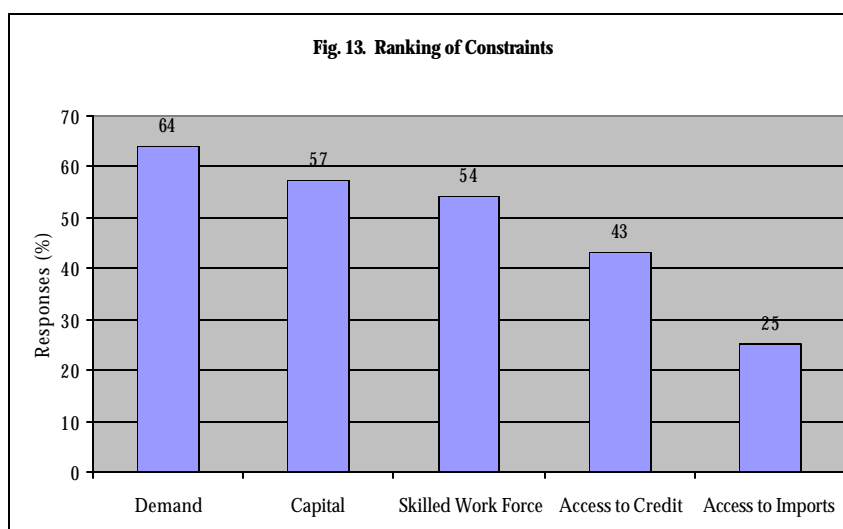


Table 1
*Survey Results: Summary of Evaluation
 for June–December, 2006*

Indicator	Higher	Same	Lower	Net Balance
Economic Growth	8	60	33	-25
Business Activity				
Production	43	33	24	19
Domestic Sales	45	36	19	26
International Sales	37	23	40	-3
Inventory	45	31	24	21
Level of Capacity Utilisation	23	45	32	-9
Prices				
Final Product Prices	48	36	16	32
Input Prices	92	8	0	92
Wage Level	88	12	0	88
General Price Level	80	13	7	73
Inputs				
Investment	58	33	9	49
Employment	36	52	12	24

Table 2
*Survey Results: Summary of Expectation
 for January–June, 2007*

Indicator	Higher	Same	Lower	Net Balance
Economic Growth	4	73	23	-19
Business Activity				
Production	65	32	3	62
Domestic Sales	68	25	7	61
International Sales	53	27	20	33
Inventory	46	39	15	31
Level of Capacity Utilisation	54	44	2	52
Prices				
Final Product Prices	43	47	9	34
Input Prices	78	22	0	78
Wage Level	67	33	0	67
General Price Level	75	20	5	70
Inputs				
Investment	54	46	0	54
Employment	32	61	7	25

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