

PIDE Business Barometer

Based on a sample of industries listed in the Karachi Stock Exchange, gives the overall picture of business activity during the last six months and expectations for the next six months.

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Energy shortage is the biggest constraint restricting producers to produce below their capacity. Services sector is the most resilient sector of the economy. Inflation for the Fiscal Year 2013 would remain in the single digit. Business Perception Index shows slight improvement in the economy.

Overview

Overall Production has shown sluggish trends due to shortages of energy. Services sector, which are not dependent on energy relatively, is the most resilient sector. Law and order and security issues are the second biggest constraint producers are currently facing, which needs extra attention by the government. Inflation expectations based on the change in product prices by firms show that inflation would remain in the single digit; quite possibly close to 8 percent. Prices of the products are set while looking at the general inflation while cost of production has weak association with change in prices of the products. Wages are adjusted annually according to the change in prices thus it is expected that real wages are not going to decline. Business Perception Index (BPI) shows improvement in the economic activity compared to the last six months.

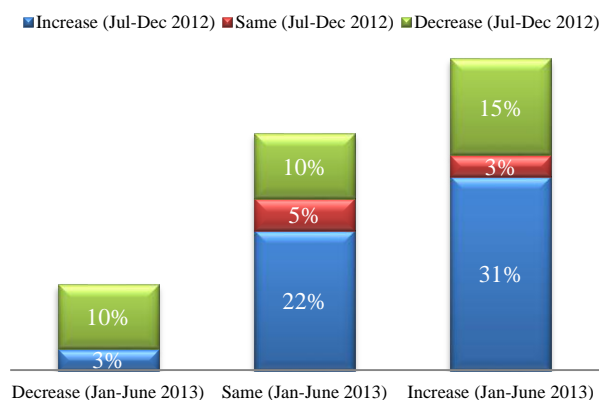
Trend of Production is Ambiguous

As expectations were being formed in the last business barometer that most of the firms were expecting their production to be increased if the energy situation improves. Quite a number of firms have recorded decrease in production during the first half of FY 2013 due to the dissolution of energy problems. Thus we can say that energy supply shortage is the biggest constraint in decline in production of the firms. Nevertheless 55 percent of the firms recorded increase in output associated with the increase in demand. Since the extent of decline in production is more than the extent of increase in production thus it is ambiguous that production has increased during July-Dec 2013 or declined. Similar trends have been observed in the textile sector which has the larger share in the industrial production. Despite slower growth, service sector

shows resilience and all the firms in the sample have positive growth.

Firms are optimistic that current situation will improve in the second half of the FY 2013. However contrary to the last Business Barometer these expectations are not based on the improvement in the energy situation rather increase in the demand for their product, which implies that firms are getting domestic and international orders despite slowed down economic activity inside Pakistan as well as worldwide. It would be interesting to see if the rise in local demand is due to the rise in informal activity which is known to be the real backbone of the economy.

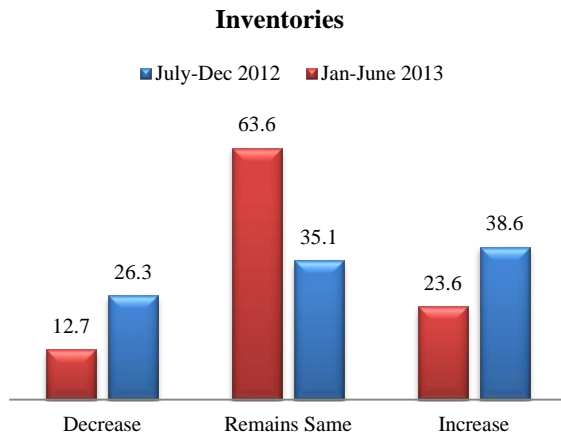
Production



Reduction in Inventories due to Decline in Production

Sales have same trends, not different from production. However, it is interesting to see that 36 percent of the firms have reported increase in the inventories of their finished goods while 26 percent had decline in the inventories of their finished goods. Decline in the inventories are strongly associated with either the

decline in production and sales of that product or no change in the production and sales of the product. This implies that if the constraints are not removed then it is possible that in future sales of these firms go down as a result of lower production due to constraints.



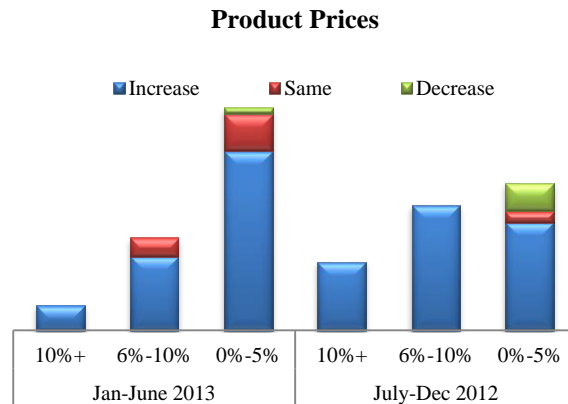
Out of total number of firms 86 percent of the firms are also exporting as well. Among them more than half had experience higher exports growth compared to others. Whereas, expectations of most of the firms were not higher during the second half of the FY2013 and that includes textile sector as well. This could be due to decline in inventories and stagnant production just to meet the domestic demands.

Inflation would remain in the single digit

Inflation expectation play vital role in determining actual inflation since wages and prices of the products are adjusted accordingly to the inflation if real wage would remain unchanged and product prices represent increase in inflation. Our survey reveals that prices of the products of 71 percent firms have increased while decreased in only in 5 percent. Half among them have reported that price was increased by 0-5 percent while other half said either 6-10 percent or more than 10 percent. This implies that increase in the prices had remained around 5 percent in the first half of the FY 2013 if not more than 5 percent. General inflation is among the major cause of increase in the prices followed by increase in the cost of production.

Our survey reveals that 71 percent of the firms are expecting that prices of their products will go up in the second half of the FY 2013. Among them more than fifty percent are those firms who had already increased their prices in the first half of FY2013 as well.

Nevertheless it is an alarming situation but the extent shows that most of the firms are expecting to raise their prices by less than 5 percent. Since one of the major rationales of increase in product prices is general inflation thus we can safely predict based on the actual increase in prices in the first half of FY 2013 and expectations in the second half of the FY 2013 that inflation will remain in the single digit, around 8 percent during the FY 2013.



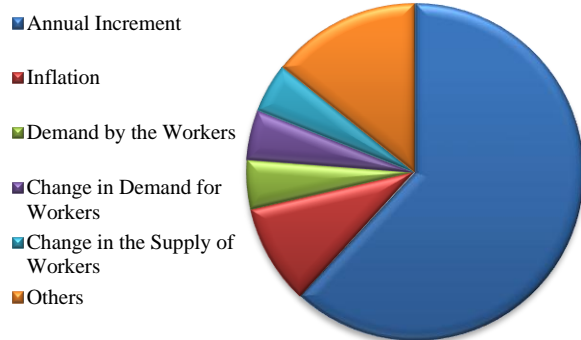
Wages are adjusting according to change in prices

Among the significant role of inflation expectations are the wage settings by the firms. Our survey reveals that 62 percent of the firms increased their wages while wages of 36 percent firms remained the same. Interestingly, more than half of the firms increased their wages by more than 10 percent while 30 percent of the firms increased by 6-10 percent, which is more than the increase in inflation. Thus real wage may increase in the FY 2013 if it was constant before that. Although all the firms increase wages once a year but apart from one time increment per year increase in inflation and demand by labor were also the main contributors to increase in the wages by the firms. Interestingly two third of the firms increase their wages are those firm who increase prices of their products while one third did not increase their wages even though prices of their products has increased.

Even though 62 percent has already increased their wages but 47 percent of the firms are going to increase their wages in the second half of the FY 2013. However, half of the firms are expecting this increase to be between 0-5 percent while one third of the firms believe that it will be between 6-10 percent. While looking at the current ongoing inflation, expectation of

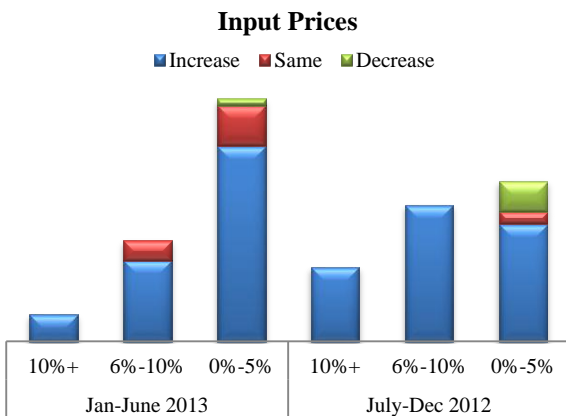
increase in the prices of the products we can safely state that real wages remain the same if not increase.

Reason for Change in Wages



Input Prices are increasing rapidly

As per expectation were formed in the last Barometer 88 percent of the firms reported that input prices has increased during the first half of FY 2013. Among these 88 percent of the firms, 35 percent said increase was between 0-5 percent while 42 percent said 5-10 percent and 23 percent said more than 10 percent in the first half of the FY2013. More than half of the firms which had experienced higher input prices are expecting their input prices to go up further in the second half of the FY 2013. Nevertheless, they are expecting that increase in the input prices would be lower than the first half of the FY 2013.



It is interesting to note here that even though extent of increase in input prices is more than 10 percent but firms did not increase their prices accordingly. Moreover, one fourth of the firms did not increase prices of their products even though input prices have increased. Adding more to the point most of the firms have associated their increase in prices with the general

inflation and not with the cost of production thus we can safely say that input prices not always increase the cost of production or they have low share in the overall cost of production. This is also confirmed with our calculation that only 20 percent of the firms who reported that input prices are increased have increase in their cost of production is the major source of increase in the prices of their product.

Decline in the employment in the industrial sector

Governments in general are keen to create employment in the private sector. Industrial sector employment is one of the cores of that policy. Textile and other sectors lay off several employees especially the contractual employees during the last few years after the problem of energy shortage had emerged. During July-December 2012 job opportunities in the industrial sector remained the same both for permanent and contractual employees. 24 percent of the firms had increase in the permanent employees while 13 percent fired their permanent employees. Extent of increase and decrease in the permanent employees show that overall there is a decrease in employment in the industrial sector. On the other hand 76 percent of the firms do not hire or fire their contractual employees while 12 percent reported that they hired new contractual employees and 12 percent had fire their contractual employees.

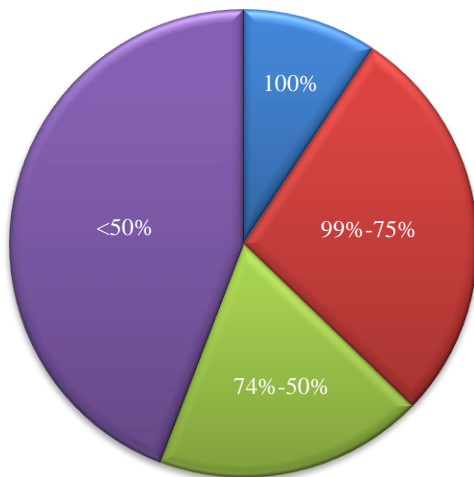
It is worthy to note that hiring permanent employees is associated with the increase in production, whereas if the production remains same or decrease then firms lay off contractual workers but not the permanent workers. Response in the survey reveals that the trend would remain the same compared to the first half of the FY 2013. No major hiring is expected of permanent as well as the contractual employees in the second half of the FY2013.

Capacity utilization is less than fifty percent

Firms while facing constraint may not be able to produce at full capacity. During the first half of the FY 2013 one third of the firm have reported increase in their capacity utilization compared to the second half of the FY 2012. However, more than fifty percent of the firms among those are still producing at below 50 percent even though most of these firms have enhanced their production capacity in that period. Most of these firms have different constraints which need special

attention to enhance their production using the existing capacity installed. Although 41 percent are optimistic in enhancing their capacity utilization by avoiding constraints and increasing their production capacity but most of among them still think they cannot produce more than 50 percent of their installed capacity. Several constraints are prohibiting industries to run efficiently including allocative efficiency, availability of skilled labor etc. However, several constraints had arisen in the last few years. Survey revealed most important constraints currently to the industrial sector are energy shortage (42.5 percent of the firms) followed by law and order and security, inconsistent government policies and higher taxes.

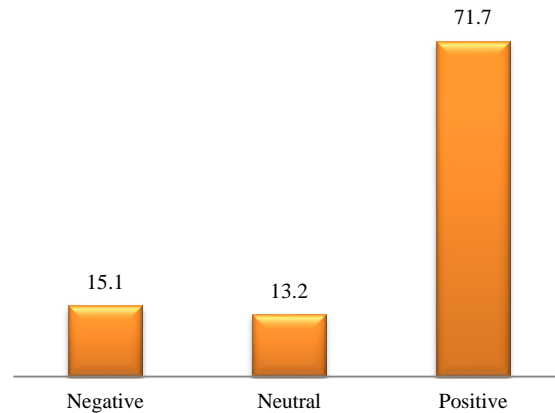
Capacity Utilization



Impact of Discount Rate Change will be positive

Since June 2012 State Bank of Pakistan has reduced its discount rate from 12 percent to 9.5 percent in December 2013 in a hope that private sector starts taking credit at lower interest rate. When we asked from the business persons most of them are in favor of reduction in discount rate, however, some says it will have negative impact but since they did not report their reasons thus we are currently fail to understand their logic. Even though we got positive response due to decline in interest rate private sector did not respond well to decline in interest rate; credit creation remained stagnant during the first half of FY 2013. Among different reasons energy shortage could be the prime restraint of lower private sector credit creation.

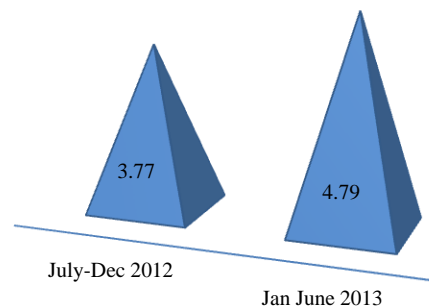
Perception of Impact of Reduction in Discount Rate



Business Perception Index (BPI)

For the last few issues of the Business Barometer firms were asked to rank the state of the economy to get an idea about the overall business/economic environment. The index ranges from zero to ten, where zero implies the worst and 10 the best. Most of the firms ranked either 4 or 5 in the current issue. On average BPI for the second half of the FY2013 is 4.79 compared to 3.77 in the first half of the FY2013, which is still below average but improving.

Business Perception Index



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