POST COVID-19 ECONOMY AND INVESTMENT STRATEGY REPONSE

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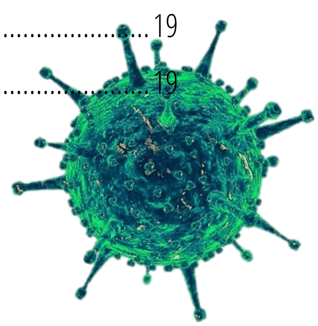


POST COVID-19 ECONOMY

The world is at war against a pandemic, with a certainty of uncertain future. Thousands of people have already perished across the continents and the numbers are rising at an exponential rate. No country — from the most developed to the poorest — has been spared. No one could have predicted that 2020 would be like this. Phrases like 'social distancing', 'lockdown' and 'pandemic' were not in our collective vernacular. But as we near the end of the first quarter of the year, we are facing one of the greatest challenges of a generation.

The most vulnerable across the world are on the front lines of this virus: the elderly, the daily wagers, those without access to health care, those with preconditions such as diabetes, high blood pressure and cancer and those who believe they are invincible and do not make the necessary precautions. The world will define itself as pre-COVID-19 and post COVID-19, much as it does with pre-WWII and post-WWII. It is in midst of a paradigm shift. The way we work has been entirely turned upside down in the span of a month. Telecommuting has realized its promise, while technology has realized its potential. However, one should not lose sight of the number of jobs that will be lost. The International Labour Organization (ILO) has estimated that almost 25 million jobs could be in jeopardy as a result of COVID-19[1]. This unemployment will affect the labor-intensive industry more than the capital-intensive industry.

A. Pre-Covid-19 Economy

Over the second half of 2019, and before the outbreak of the Covid-19 crisis, it became increasingly clear that the global economy had entered more troubled waters with slower growth across all regions and several economies contracting in the final quarter. Still, and despite the notion of limited room for policy maneuver, there was a widely shared expectation that things would gradually improve in 2020, led by the large emerging economies, with a return to potential global growth by 2021[2].

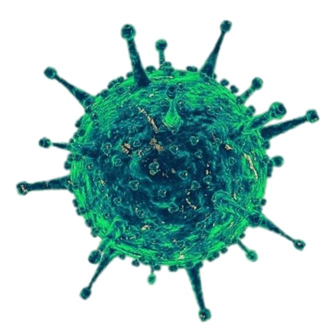
The gap between the reality on the ground, which was calling for bold and concerted policy action, and a persistent belief in sound fundamentals and a self-correcting world economy, stigmatized suggestions of a need for bolder policy interventions, deferring instead to monetary tweaking and "structural reforms".

The combination of an almost constant growth rate of 6% in China, an easing of trade tensions and a presumed acceleration of major commodity-exporting countries was expected to push global growth in 2020 up to 2.7 percent, despite the continued weak growth performance of developed economies[3]. Now that the Covid-19 shock has changed the scenario all forecasts for 2020 are being revised downward.

[1] https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_738742/lang--en/index.htm

[2] https://blogs.imf.org/2019/10/15/the-world-economy-synchronized-slowdown-precarious-outlook/

[3] https://www.imf.org/en/Publications/WEO/Issues/2020/01/20/weo-update-january2020



B. Post Covid-19 Economy

The global economy is expected to contract given the sudden stop to most of the activity and the resulting income loss in the manufacturing and services sectors across most advanced countries and China, combined with the adverse effects on financial markets, consumption (through both income and wealth effects), investment confidence, international trade and commodity prices.

The scale of the negative impact globally is so huge that some experts have indicated that it will be even worse than the Great Depression witnessed in the past century. According to Moody's rating agency, real global GDP will contract by 0.5% in 2020, followed by a pickup to 3.2% in 2021. In November last year, before the emergence of the Covid-19, the agency was expecting the global economy to grow by 2.6% this year[4], (expected GDP growth for 2020 is 2.1%). Conditions accordingly are unlikely to improve till 2021.

According to Richard Kozul-Wright, director of Globalization and Development Strategies at UNCTAD, a $2 trillion shortfall in global income is to be expected, with a $220 billion hit to developing countries (excluding China). The most badly affected economies in this scenario will be oil-exporting countries, but also other commodity exporters, which stand to lose more than one percentage point of growth, as well as those with strong trade linkages to the initially shocked economies[5].

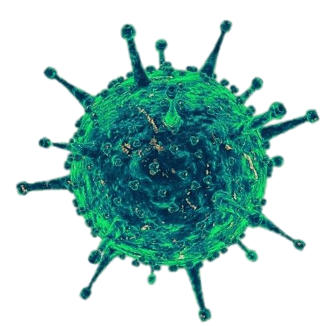
C. Global Economic Response- Lockdowns, Liquidity and Low-Interest Rates

Containment measures to stem the COVID-19 pandemic have pushed the world's largest economies into near-hibernation. Combined with historical collapse in oil prices, and record volatility in the markets, this puts significant pressure on creditworthiness around the world. Industries most exposed to the dramatic drop in global demand and much tighter financing conditions have experienced the most downgrades so far.

With the exponential rise in COVID-19 cases and causalities since the month of March, throughout Europe, America and Asia, a series of incentive packages - unparalleled in both scale and scope - have been announced by the major developed economies and China to overcome the swelling economic damage and respond to this health crisis. The G20 alone has committed to injecting more than $5 trillion into the global economy to limit job and income losses. Apart from liquidity injections to keep the banks and corporations afloat, the critical measures to avert slowdown of economic activity included government spending (particularly on health care, immunization, social outreach, social mobilization), extended unemployment benefits and cash transfers [6].

According to an UNCTAD report[7], these stimulus packages will boost the national incomes of advanced economies and China to the tune of $1.4 trillion in 2020. The impact, however, is smaller than the values of the packages themselves, it surely will have a positive effect not only on the economies themselves but the world economy also. Such stimulus is expected to prevent the current recession

[4] https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1220646
[5] https://unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=548
[6] https://www.nytimes.com/reuters/2020/03/30/world/30reuters-health-coronavirus-economy-factbox.html
[7] https://unctad.org/en/PublicationsLibrary/gds_tdr2019_covid2_en.pdf?user=1653



from turning in to a prolonged depression, by reducing the fall in the prices of both financial assets and commodities and to some extent easing the negative growth impact from the crisis on developing countries.

This is certainly not good for achieving the Sustainable Development Goals (SDGs) where prior to this crisis, the world was already falling behind in efforts to achieve them. There are at least three immediate actions and medium-term policy responses[8] required in handling the COVID-19 crisis and to ensure that adequate finance is channeled to support progress on the SDGs and those most in need. Second, governments and monetary authorities must continue to stabilize financial markets by continuing to inject much-needed liquidity. Furthermore, governments must partner with private financial institutions to roll over debt to SMEs and individuals. Lastly, policy response must be about rebuilding better towards sustainable development in several aspects. These include: (a) public and private investment in sustainable development such as building resilient infrastructure; (b) strengthening social protection systems; (c) additional investment in crisis prevention, risk reduction and planning; and (d) eliminating trade barriers and restrictions that affect supply chains.

D. Understanding Economic Disruptions of Covid-19 on Pakistan

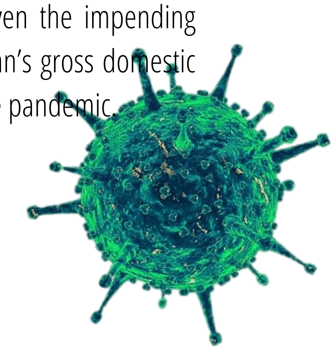
Recession, economic pressure and incentives, all need to be put into a perspective that aligns with the problem at hand. In general terms, there are three channels of an economy, namely supply, demand and finance. Any economic problem is bound to disrupt at least one of them, while others adjust to rectify the problem. Same three channels of disruption can prove to be the main transmission mechanisms via which the Covid-19 virus can be expected to infect developing economies like Pakistan over the forthcoming months.

1. Demand Channel

The social distancing necessary to stop the contagion has already led to economic shutdown in many developed and developing countries affecting most of the world's population. A sharp, sudden fall in employment is already happening. While developed countries have the administrative capacity and (generally) the fiscal space to buttress their social protection systems and protect private incomes, in developing countries sharp contractions of incomes are all but inevitable along with falling fiscal revenues. Tighter fiscal space and weaker healthcare and social protection systems expose developing countries to higher human and financial toll while limiting their ability to respond, triggering a potentially dangerous vicious circle. Moreover, with fast increasing need for imports of specialized goods and services to deal with the health crisis the balance of payments constraint can only expect to tighten further.

The effects on demand are more difficult to gauge but it is critical from an economic policy point of view to get a sense of them because we have more confidence about how to deal with demand (through monetary and fiscal tools) than with supply deficiencies. Already witnessing a slowdown in the economy, with consumer-led growth of 2018 waning, Large Scale Manufacturing (LSM) slowing down, inflation peaking, and purchasing power declining over the past year, the sudden halt owing to COVID-19 has further eroded the aggregate demand to a bare minimum. The situation will worsen given the impending unemployment, as an aftermath of a lockdown. Moody's Investors Service has also downward revised Pakistan's gross domestic product (GDP) to 2 – 2.5 percent for the current fiscal year (2020) from earlier forecast of 2.9 percent due to the pandemic.

[8] https://developmentfinance.un.org/press-release-financing-sustainable-development-report-2020



Former Finance Minister Dr Hafiz Pasha has indicated that unemployment rate of 5.8 percent reported by the Labour Force Survey 2017-18 may surge to 8.1 percent in fiscal year 2020-21[9]. According to another estimate[10], Pakistan could expect 12.3 million to 18.53 million layoffs out of those employed in different sectors of economy in the aftermath of partial or complete shutdown due to the countrywide outbreak of COVID-19 across the country. These layoffs may result from reduced domestic and foreign demand for textiles and other agriculture products. The most hit sectors remain wholesale and retail trade (6.49 million), agriculture (12.82 million), manufacturing (2.16 million), and transport and communication (1.95 million). These layoffs will certainly decrease the disposable income of these households thereby sending a demand shock throughout the economy.

This is then augmented by the expected decrease in the remittances, another big component of Pakistan's national income, which is expected to take a hit of 10 to 50%, depending on the spread of the virus and the measures taken to contain it[11]. Both these hits to the disposable income of the economy are expected to decrease the aggregate demand, with an expected fall in private consumption expenditure of 4 to 8 percent[12], there by ensuing a chain of events that will not only change the economic outlook of the country but will also change the lifestyle of its masses.

2. Supply Channel

On the supply side, it is not wrong to assume that a sudden stop of manufacturing activity in the most affected regions will cause bottlenecks in Global Value Chains (GVC). Inventory decumulation can support supply for a while, but with today's just-in-time globalized production structures, it seems reasonable to assume that the duration and magnitude of the Covid-19 outbreak has already exhausted inventory stocks. Such disruption will in turn trigger widespread factory closures for lack of intermediary inputs, even in zones still immune to the virus. The concern is that exports of both manufactured final goods and of commodity inputs will begin to weaken sharply, further affecting earnings and employment. Despite all unknowns, a moderate hypothesis is that profits will be initially hit and, if the crisis persists, employment and wages will also decline. The consequences of disruptions on the supply side can therefore contaminate aggregate demand, as well as threatening financial stability, as laid out next.

During the last two decades China has become crucial to the global economy. China's rising importance in the global economy is not only related to its status as a manufacturer and exporter of consumer products. China has become the main supplier of intermediate inputs for manufacturing companies abroad. As of today, about 20 percent of global trade in manufacturing intermediate products originates in China (up from 4 percent in 2002)[13].

Although the impact on global FDI has been felt initially through the ripple effects caused by production stoppages and supply chain disruptions in East Asia, and in economies that are closely integrated in global value chains, it is now evident that pandemic mitigation

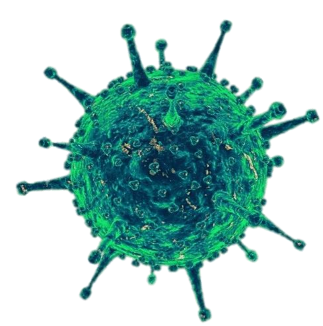
[9] https://www.brecorder.com/2020/03/31/585150/coronavirus-economic-impact-and-relief-package/

[10] https://pide.org.pk/pdf/PIDE-COVID-Bulletin-4.pdf

[11] https://sdpi.org/publications/remittances-and-covid-19-is-pakistan-ready-for-a-likely-decline-in-flows/

[12] https://www.brecorder.com/2020/03/31/585150/coronavirus-economic-impact-and-relief-package/

[13] https://unctad.org/en/PublicationsLibrary/ditcinf2020d1.pdf



efforts and lockdowns around the world will have devastating effects on all economies, independent of their links to global supply networks.

As per UNCTAD[14] estimates in 2020 alone, the impact on global production networks will be around USD 50 billion, considering only the February slowdown of China. And this does not yet include the decline in demand from China, which will certainly hit commodity exporters from many developing countries.

Pakistan is closely linked with China on more than one economic fronts, an estimate showing the global effects of China's slowdown through global value chains ranks Pakistan amongst the list of 20 most affected economies, with a potential exposure of $44 million from a 2 percent reduction of China exports in intermediate inputs. These inputs interestingly are only for use in Textile and Apparels, the biggest exporting sector of Pakistan[15].

As the virus makes its way through the economies corroding the supply chains, the biggest impact will be seen on the international trade. Pakistan's economy is projected to face a loss of up to 4.64 percent in GDP because of disruptions in trade, both in imports and exports after the outbreak of COVID-19[16]. This could be roughly quantified to around Rs700 to Rs800 billion losses in the April-June period of FY2020 if the exchange rate in terms of the dollar versus rupee is estimated at Rs165 against the dollar.

The major reason behind this unfortunate decline in output is the fact that, out of the five major trade partners (with more than 50% share in trade) of Pakistan (China, USA, UK, Japan, and Germany), four (China, USA, UK, Japan, and Germany) also happen to be the worst hit countries by the COVID-19. These estimates do not include the effect of an internal slowdown or shutdown, which when factored in would amplify the supply shock estimates.

Around 68 percent of our import constitutes the raw material, intermediate goods, and capital goods. These are used to produce final goods which are then consumed domestically or exported to other countries. A decline in these will therefore have a negative effect on investment spending as well as on exports. The detailed estimates are reproduced below for information.

[14] *ibid*
[15] *ibid*
[16] https://pide.org.pk/pdf/PIDE-COVID-Bulletin-11.pdf

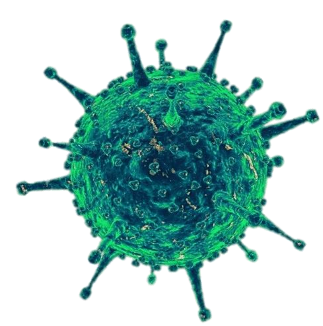


Table 2: Trade Disruption Effects on Pakistan's GDP in the Q4 of FY 2019-2020

		Scenario I	Scenario II	Scenario III
	Share in GDP	2% decline in Import only	10% decline in Import & Export	20% decline in Import & Export
Investments Spending on Imports (F)	13.2	-0.26	-1.30	-2.64
Exports (F)	2.00	-0.04	-0.20	-0.40
Export	8.00	-	-0.80	-1.60
GDP loss (%)		**-0.30**	**-2.3**	**-4.64**

Scenario 1: COVID-19 pandemic breakout in China led the country to reduce its imports by more than17 percent in January 2020. The effect is also experienced in very initial stages of breakout which is 1.5 percent fall in imports of Pakistan in Feb 2020. We take this fall in import into account and calculate the expected loss in GDP of Feb 2020.

Scenario 2: Recently World Bank (WB) have assessed through sample survey that, from March 12 to 18, 2020, export-oriented industries have experience a fall in export orders in the range of 25 - 50 percent. If half of the orders are distributed among the USA, UK, and Germany, a 10 percent decrease in exports from Pakistan can be expected.

Scenario 3: The Ministry of Commerce has estimated that the exports may fall up to $4 billion as export target might face reduction from $24 billion to $20 billion till June 2020. This is because a large number of the export orders have been canceled. Cancellation of 25-50 percent export orders and based on MOC assessment, we expect that exports would fall by up to 20% in the last quarter.

Source: PIDE COVID-19 BULLETIN No. 11: Economic Impacts of COVID-19 Through Trade Disruptions in Pakistan (Reproduced)

In the recent days, as per associations of textile exporters, close to $1.3 billion worth of orders from foreign buyers have either been cancelled or postponed, in just one month[17]. If we are to go by PIDE's estimates, we are soon to be facing Scenario 3.

The supply shocks are yet to appear on the domestic front where almost all factories have come to a halt given the lockdowns announced in a bid to control the spread of the contagion, with an exception of a few textile exporters in an attempt to avoid order cancellations[18]. Nonetheless logistical support is in a fix, with transportation sector bearing the brunt of it all. Demurrage costs are climbing with containers having been piled up at ports since the lockdowns. A gap in supply of items finished goods and otherwise, is estimated at 5 to 10 percent[19], which will send the economy into a supply shock, and ultimately create inflationary pressures.

3. Finance Channel

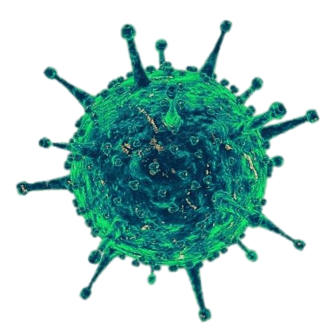
A classic transmission of exogenous shocks to the real economy is via financial markets as they become part of the problem. As markets fall and household wealth contracts, household savings rates move up and thus consumption must fall.

The increase in risk aversion since the COVID-19 shock and the usual flight to liquid assets in face of uncertainty have already pushed equity markets into correction territory. In the foreign exchange market, sharp fluctuations are still to be expected both for emerging-market currencies, as the risk-premium of primary exporting and financially-fragile countries move up, and the exchange rates between the world's main reserve currencies adjust to the response of monetary policy. Heavily indebted commodity exporters are

[17] https://www.dawn.com/news/1545182/trade-officers-to-work-on-export-order-cancellations

[18] https://www.dawn.com/news/1546013/pressure-builds-against-lockdown

[19] https://www.brecorder.com/2020/03/31/585150/coronavirus-economic-impact-and-relief-package/



likely to be on the front-line of debt-related economic stresses from the spread of the virus, particularly where foreign exchange reserves have been on a falling trend[20].

Pakistan was already experiencing rough waters before COVID-19 struck. Equity markets were already seeing a decline due an economic slowdown, Bond markets were seeing an influx of money due to high interest rates, that were kept high to combat inflation, on the other hand making it costly to venture into new businesses with debt financing. Debt had reached 68.8% of GDP[21]. However, Rupee was at a stable position against dollar, mainly due to the contraction in CAD. Forex Reserves were enough to cover 3 to 4 months' worth of imports[22]. The economic trajectory although bleak was to pick up pace given the IMF's Second successful review.

As the COVID-19 is spreading, so is its impact on the financial front. Equity market (PSX) has tipped and turned, hitting the lowest in current fiscal year on March 25th at 27,228[23]. Although, with announcement of incentive packages, from federal and provincial government the index recuperated, with the major stride witnessed with construction sector incentive package on the horizon on 3rd April, sending PSX index to 31,621.79 with an increase of 839.12 points (2.73%)[24].

Within a matter of week (20th to 27th March) forex reserves have declined by a massive $1 billion[25]. Mostly due to outflow of investments in the bond market given the policy rate cuts in the month of March. In order to provide liquidity into the financial markets, the State Bank of Pakistan (SBP) has cut its policy rate twice by a cumulative 225 basis points to 11.0 percent in the span of less than two weeks, reduced banks' capital conservation buffers (CCB) 100 basis points to 1.5pc (freeing up Rs. 800 billion of capital), relaxed terms for new and existing loans and announced other forbearance measures to increase banks' cushion against the economic effects of COVID-19[26].

Lower interest rates on loans will surely improve borrowers' repayment capacity. However, the lower rates will reduce net interest margins and diminish banks' earnings. CCB rate cut will put more loanable money on the table, and with SBP geared towards SME, and personal credit growth, it will find its way to the neediest sectors of the economy.

On the external financial front, the debt servicing payments will soon be due. Fiscal deficit will only grow in days of crisis where government is giving stimulus and the revenue collection is to be compromised as well[27]. As per an estimate this revenue loss will be partially compensated for by a decline in the cost of debt servicing worth Rs 90 billion over the next three months. Also, as the decline in the oil price gets reflected in imports, the Petroleum Levy could yield additional revenues of Rs. 100 billion by end-June 2020[28]. Simultaneously, external debt could become a headache; especially the debt repayment in next 3 to 12 months.

[20] https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1220646
[21] http://www.sbp.org.pk/ecodata/Summary.pdf
[22] http://www.sbp.org.pk/ecodata/Balancepayment_BPM6.pdf
[23] https://dps.psx.com.pk/historical
[24] ibid
[25] http://www.sbp.org.pk/ecodata/forex.pdf
[26] http://www.sbp.org.pk/press/2020/Pr-26-Mar-20.pdf
[27] https://tribune.com.pk/story/2188246/2-fbr-collects-rs3-06tr-taxes-misses-target/
[28] https://www.brecorder.com/2020/03/31/585150/coronavirus-economic-impact-and-relief-package/

Pakistan is getting an access to IMF's RFI (rapid finance instrument) that is designed for such kind of unexpected events. The country will get $1.4 billion which is likely to be disbursed in April. Its process is to be expedited to cut the red tape[29]. Similarly, WB and ADB are speeding their promised disbursements. The government is expecting $1 billion to come in from WB in the next few weeks - $300 million is the new facility while remaining is already approved but was supposed to be disbursed slowly. Likewise, ADB will release remaining 80 percent of its $1.2 billion commitment[30] .

These additional debts will ease some external pressure and give rightly needed fiscal stimulus. The economy is not likely to recover in FY21. But the external financing is going to be high in next 12 months. Around $13.5 billion is to be paid in 2020. It was expected that foreign portfolio investment may create buffers for debt repayment[31]. That is no more the case. This not a time to issue bonds. There are multilateral, bilateral, and commercial loan repayments. These are to be restructured and interest payments are to be deferred.

Pakistan's external debt is growing and is at $111 billion. Annual debt servicing cost can be estimated at $10-12 billion[32]. With exports falling and remittances slowing down, this cannot be financed solely by import saving. Loans are to be renegotiated and new loans are to be solicited to provide for the fiscal space government needs to get out of this crisis.

E. Socio-Economic Disruptions of Covid-19 and New Opportunities

In addition to its economic disruptions, social countermeasures to fight COVID-19 is causing substantial social disruptions. Social distancing has changed the dynamics of religion, education, hospitality, travel, entertainment, sports. A shock of this scale will create a discontinuous shift in the preferences and expectations of individuals as citizens, as employees, and as consumers. These shifts and their impact on how we live, how we work, and how we use technology will emerge more clearly over the coming weeks and months. Institutions that reinvent themselves to make the most of better insight and foresight, as preferences evolve, will disproportionally succeed.

Clearly, the online world of contactless commerce could be bolstered in ways that reshape consumer behaviour forever. But other effects could prove even more significant as the pursuit of efficiency gives way to the requirement of resilience—the end of supply-chain globalization, for example, if production and sourcing move closer to the end user.

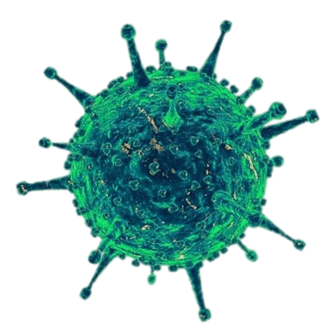
These disruptions reveal not just vulnerabilities but opportunities to improve the performance of businesses. Business leaders will need to reconsider which costs are truly fixed versus variable. Decisions about how far to cut operations without loss of efficiency will likewise be informed by the experience of closing much of global production. Technology adoption will be accelerated by rapid learning about what it takes to drive productivity when labour is unavailable. The result will be a stronger sense of what makes business more resilient to shocks, more productive, and better able to deliver to customers.

[29] https://www.thenews.com.pk/print/635786-additional-1-4-bn-lending-through-rfi-imf-assures-help-to-pakistan

[30] https://nation.com.pk/02-Apr-2020/wb-approves-additional-financing-of-dollar-700m-for-dasu-power-project

[31] https://tribune.com.pk/story/2009794/2-pakistans-external-debt-estimated-130b-fy23/

[32] http://www.sbp.org.pk/reports/stat_reviews/Bulletin/2020/Mar/DomesticExternalDebt.pdf



On a macro socio-economic level, countries have been forced to release the havoc that a pandemic like this can cause. Social security measure around the world have been expended for mitigating the impact on the common people. The recurrence of these epidemics and pandemics in the past century or so, should force countries to keep enough reserves with themselves to be used in combating situations like this, and not rely on economic injections through loans and grants that in turn put them at the risk of bankruptcy. The governments should be pragmatic about dealing with such catastrophes and look inwards for effecting a better stimulus generating strategy.

Pakistan is not any different from the rest of the world. PSDP funded projects like Ehsaas Program and BISP have been used as tools for dissemination of cash directly to the most affected. The government should create a separate head in the fiscal budget and create a disaster fund that could be utilized in times like these without straining the economy to mitigate against the socio-economic impacts.

F. Post Covid-19 FDI

Given the impaired liquidity position of potential investors and heightened risk perceptions, there is likely to be a big fall in private investment in coming months when faced with industrial closures and the obvious reluctance of banks to take on greater risk following the likely growth of non-performing loans. Not only that, with respect to inviting FDI in, many countries have been clampdown on foreign investments to prevent countries from acquiring strategically important assets. As of now, Australia[33] and European Union[34] has given such directives, that put extraordinary checks on investment proposals. Such measures have been reported taken to prevent China from investing in these economies.

The COVID-19 pandemic may bring a 30-40 percent drop in global foreign direct investment (FDI) flows during 2020 and 2021, according to a report released by UNCTAD[35]. As per the report, on average, 30 percent of reduction in earnings in 2020 was estimated by the top 5,000 multinational enterprises (MNEs), among which those in the energy and basic material industries, airlines and the automotive industry are the hardest hit.

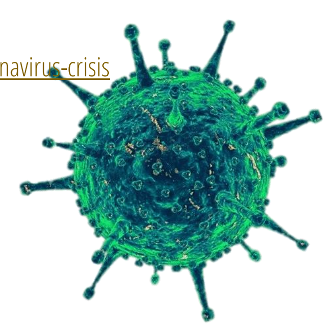
FDI in any country is a culmination of long-term commitment to towards expending the business into a country other than home. It involves deep research into the suitability of the socio-economic structure of that host country, its laws, economic outlook, and other related factors. The drop in FDI as estimated above, may be witnessed due to the utter financial shock that has eroded trillions of dollars from the world economy. The reduction in profit due to economic slowdown will take away a major component of FDI that is the reinvested earnings. These reinvested earnings make up 40% of the FDI for developing countries like Pakistan.

The situation will start to get better as the investor confidence rebuilds, which will be visible once the so-called curve starts to shrink in addition to getting flatter. This will depend on the efficacy of the global response in containing this contagion. Currently cases are growing at an exponential rate, once that growth rate gets below 1 the new cases will shrink drastically and will soon reach zero. However, this is contingent upon the investment we put into mass testing.

[33] https://www.theguardian.com/world/2020/mar/29/australian-authorities-to-check-every-proposed-foreign-investment-during-coronavirus-crisis

[34] https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf

[35] https://unctad.org/en/PublicationsLibrary/diaeiainf2020d3_en.pdf

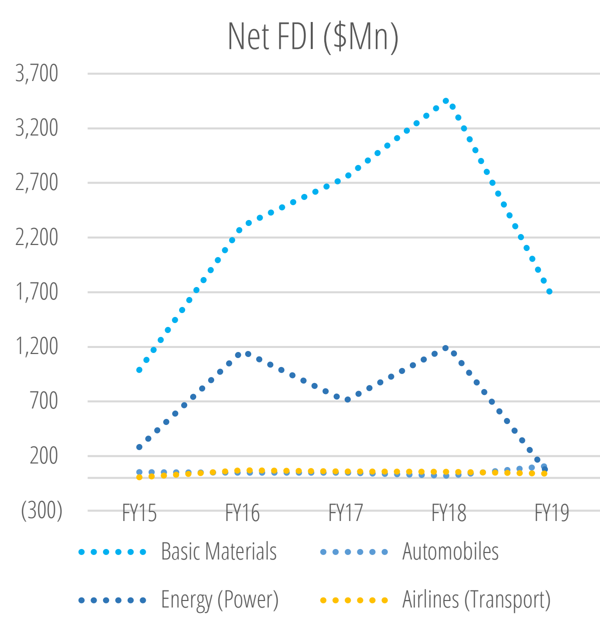


Rank	Top 5 Sectors	$ Mn	Rank	Top 5 Countries	$ Mn
1	Power	3,098.69	1	China	5,060.56
2	Construction	1,610.84	2	U. K	1,027.15
3	Financial Business	1,528.50	3	Netherlands	622.21
4	Oil & Gas Explorations	1,390.66	4	Hongkong	574.72
5	Food	539.11	5	U.A. E	544.21

Greenfield investment projects that are already ongoing will also be affected by this. However, as new investment projects have a long gestation period and a lifecycle that can span decades, the immediate impact on existing investments and investment projects under construction is likely to be limited.

Putting things in context of Pakistan[36], given the 4 disruptions, looking at the sources of FDI for the past 5 years can help preliminarily quantify the FDI drop. Power, Construction, Financial Business, Oil & Gas Explorations, and Food are the top 5 sectors that witnessed a growth in their Net FDI stock from FY15 to 19. Whereas the most investment came from China, this can be attributed to the infrastructure and power projects during the period under CPEC. However, looking closely at the Net FDI figures for the period it is evident that the investments in all 36 sectors as categorised by SBP, have been erratic.

Scoping the FDI sectors with a focus on the ones pointed out by UNCTAD, reveals, Basic materials industries to have been on a downward trend since FY18. For Energy the investments have been made mostly with G2G collaborations that will continue, given our counterparts do not have policy changes in that regard. Automobiles sector has been a promising outlet for attracting foreign investment in the past couple of years, with its own policy guiding and incentivizing many landmark investments. However, with the decline in LSM output in the Second Quarter of FY20, automobiles industry has been struggling, with big names like Honda, contemplating shutdowns. And that started even before Covid-19 hit. Any investment into this sector was already a hard sell, even with a lucrative incentive package in the shape of Automotive Development Policy (2016-21).



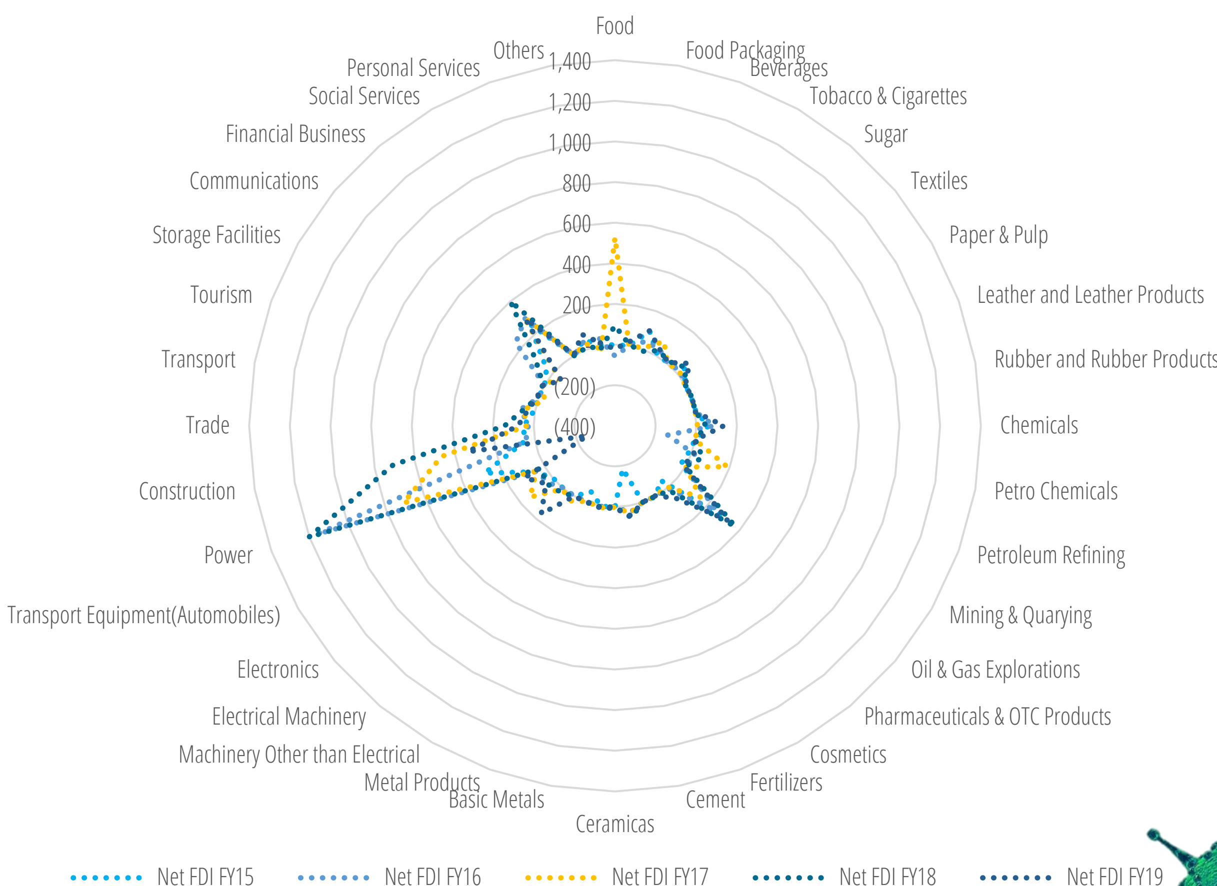
Using the factor estimates of the UNCTAD study for developing countries, on the Net FDI for FY19, a preliminary estimate of the FDI hit can be estimated as follows:

[36] Calculations have been done using FDI figures shared by SBP with BOI.

	NET FDI FY19 ($ Mn)	Expected Reinvestment @ 40%	Expected drop in earnings	FDI Hit ($Mn)
Basic Materials	1,668.05	667.22	20%	133.44
Automobiles	112.88	45.15	47%	21.22
Energy (Power) *	-	-	208%	-
Airlines (Transport)	37.13	14.85	116%	17.23
Total	1,818.07	727.23	-	171.90

*Sectors with -ve Net FDI in FY 19 have been ignored, assuming absence of earnings.

Of the sectors i.e. energy and basic material industries, airlines (proxied by transportation sector that includes airlines) and the automotive industry, that are expected to be the hardest hit, the most we need to worry about is the basic materials as it includes all the raw materials that are used in other industries. Being rich in resources, puts Pakistan in line with the countries that will struggle in utilizing their resources. The FDI stock (FY2002-Sep20) in this sector amounts to $11.57 bn, that is 28% of the total FDI stock of Pakistan. Any adverse implications, in the form of divestment, can affect other sectors as well.



For a better estimate of what FDI losses amount to lower consumer spending and low confidence in the economy, a detailed analysis of new FDI contracts, loans/credit for private investment, and sector-wise, expectations regarding flow of investment (including FDI) in the coming months, and any pre-emptive measures taken need to be examined[37].

G. Worsening Investment Climate and China's Out-Bound FDI

In the backdrop of the established disruptions, Chinese integration on trade and investment through CPFTA-II and CPEC, respectively, puts Pakistan in a unique position. Therefore, in Post-Covid-19 economy and the investment climate therein it is bound to be affected by the Covid-19 impact on China and the policies that are devised by it afterwards.

As per an estimate, outbreak may have cost China as much as 1.38 trillion yuan ($196 billion) in the last two months because of huge dips in consumer spending and tourism[38]. Given that China has been deterred by the tremendous pressure from the outbreak, it is only logical that China will soon direct its future development strategies and priorities toward improving its domestic economy instead of pursuing outbound investment. Consequently, this also means that the country's plan of "going out" into the international economic and geopolitical scene would have to be put on hold for the time being.

According to a report[39], the trend of Chinese companies' overseas investment declined in the first half of 2019, with the country suffering a 9.8 percent and 31 percent loss in outbound direct investment and the amount of announced overseas mergers and acquisitions (M&A), respectively. Data published by the China's Ministry of Commerce[40] showed that China's industry-wide outbound direct investment in 2019 was $117.12 billion, a 9.8 percent decline year-on-year, and non-financial outbound direct investment was $110.6 billion, an 8.2 percent decline. Moreover, Chinese regulators have been tightening the approval of outbound investment in the past two years, all of which points to an even more obvious slowing trend in China's outbound investment.

The recent outbreak of the COVID-19 will have a significant impact on overseas investment and China's external strategic development. The suspension of economic activities resulting from efforts to control the outbreak will inevitably delay any activities relating to outbound investment. The slowdown in outbound investment will be further exacerbated by China's decision to direct its focus "inwards", to improve its domestic economy, which will certainly hurt the CPEC. The domestic market needs to "recuperate" and replenish its resources following the outbreak. Thus, it makes sense to halt all of China's outbound investments in response to the outbreak's impact – and that's aside from the broader slowdown and delay of overseas investment that will come as a by-product of the outbreak forcing China to shift its focus inwards.

To mitigate any adverse effects on CPEC, action needs being taken on war-footing to not only retain the existing investors but also to ensure that commitments under CPEC are fulfilled. In lieu of that Prime Minister of Pakistan has ordered resumption of the CPEC

[37] https://www.pide.org.pk/pdf/PIDE-COVID-Bulletin-6.pdf
[38] https://www.scmp.com/economy/china-economy/article/3051909/covid-19-likely-slash-us185-billion-chinas-economy-january
[39] https://www.ey.com/cn/en/newsroom/news-releases/news-2019-ey-overview-of-china-outbound-investment-in-h1
[40] http://english.mofcom.gov.cn/article/statistic/foreigntradecooperation/202002/20200202933533.shml

work amid lockdowns. This shows the intent towards making sure these commitments are not set aside by the Chinese counterparts in favour of "domestic recuperation" or better locations.

On the digital front, China has been aggressively pursuing its plans to build a global digital superhighway that runs through Pakistan. The global project will include 5G wireless networks deployment in BRI (Belt Road Initiative) member nations. In the wake of supply chain disruptions opportunities abound for full digital value-chain for digital BRI activity, from ICT companies to e-commerce platforms, including firms which are well established throughout the BRI geography such as Huawei, Alibaba, and Tencent.

As for the CPEC SEZs, as per a report[41], in the second-round effect, the SEZs will be the most effective tool to harness benefit out of the crisis. It is believed that there is a serious thought going on in businesses in G-8 countries to diversify global supply chains so that in case of emergency in one country they could fall back upon other sources of supply. Even some business giants in China also subscribe to this thought, as they would want to re-locate their production houses in different countries. Pakistan on the back of its infrastructure availability could be a contender to benefit from global business opportunities precipitation from the impacts of COVID-19.

H. New Investment Avenues

Necessity is the mother of invention, and the response towards Covid-19 using the digital tools has not been short of an invention. The social and economic disruptions while threaten the reality as we know it, they also bring significant opportunities. In response, companies in multiple sectors are already transforming their products, processes, and business models. As per a Sectoral Risk Assessment, FDI is expected to witness a major decline in Tourism, Entertainment, Retail, Luxury goods, Aviation, Real estate, Coal, Oil & Gas, and Automotive due to the social restrictions, price wars, lock downs and shutdowns. However, there are growth opportunities that can be harnessed in the following sectors:

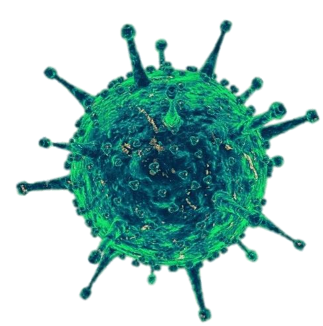
1. Food Processing

Due to health hazards that unpackaged food poses, the demand for canned food, and packaged food is expected to increase. Even the food items that are to be consumed fresh, will need proper air-tight, and sanitized packaging to be acceptable for consumption given the wide-spread of the virus. Moreover, being a necessity for human survival, the government has ensured movement of food related items and has allowed factories to remain in production in order to keep up with the demand. Such exception is keeping these businesses afloat while others have been facing shutdown.

2. Consumer Goods

The need for sanitization will radicalize the consumer goods and other household products. Hand sanitizers, cleaners, anti-bacterial soaps, anti-bacterial detergents, and such other household products with anti-bacterial properties will be what a consumer looks for in the shelves. There will be a clear rise in the demand for such products. As of now, only a handful of companies were catering

[41] https://www.thenews.com.pk/print/649613-cpec-projects-may-face-delay-disruption



to this niche, however, Covid-19 has redefined this niche and has created a mass market of 200 million people for it. Foreign companies can be attracted to invest in this sector to reap the fruits of this newfound demand.

3. Logistics

The dependence on the traditional logistical solutions has proved to be detrimental in the wake of this crisis. Digitally equipped, and contactless logistical solutions are the need of the hour. The global value chains are expected to transform into regional and local value chains. Ecommerce is the future mode of trade. Investment opportunities will present themselves, in businesses that use technology to deliver physical goods without involvement of human hands. Courier services will need to use drones as has been done in various developed countries to deliver packages. With dependence on traditional logistical solutions, Pakistan needs new and innovative solutions. This lack can be marketed as an investment opportunity to companies like DHL, FedEx etc. to bring in the solutions and capitalize on this untapped potential.

4. Entertainment and Communications

Beyond necessities, the "quarantined economy," which describes services that revolve around in-home entertainment and communications, is expected to perform well during this crisis period. Zoom, a video conferencing service, and streaming services such as Netflix and Amazon Prime have experienced a rise in usage. Sports events are now being rethought with the fans sitting in their living rooms. Virtual rooms have become a real solution to the problems posed by social distancing. With a large part of population comprising of Millennials that have just started earning, Pakistan is primed for such entertainment and communications solutions that are available at the palm of their hands. Such untapped market provides an opportunity for IT companies to invest in Pakistan.

5. Financial Services

Although banks were already providing internet-based solutions, the usage of these services was only by a specific demographic. The Post Covid-19 world will see a sharp increase in the internet based financial solutions, with banks ensuring inclusivity. With a large demographic still not privy to the benefits of contactless banking, the investment in such solutions by banks will prove profitable. Lucrative investment opportunities exist in the financial sector of Pakistan, in strategies that focus market penetration.

6. eCommerce

With a budding eCommerce industry, and an investor friendly eCommerce policy, Pakistan was already working towards attracting investment in the eCommerce sector. With Covid-19 and its social impact the sector is about to move past the traditional physical commerce. Foreign investment opportunities will present in the form of increased online retail demand and a minimal number of solutions available in Pakistan.

7. EdTech

Social disruptions have changed the dynamics of education around the globe. Online classes have replaced the traditional classrooms. Virtual spaces are being used to conduct parent teacher meetings. However, the world has still to figure out how to conduct exams. In this new world, investment in technology-based education solutions will prove to be profitable. Solutions like Udemy, Skill share, Edex, and Linda will now be widely in demand, in developed and developing countries alike.

8. HealthTech

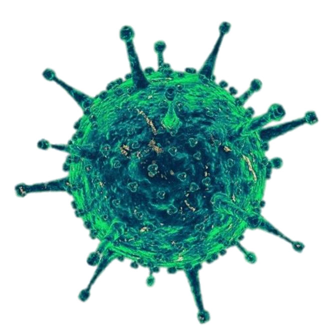
Covid-19 has not only exposed the vulnerabilities in our health systems, but also has established a new form of heath solutions in HealthTech. From disinfectant walkthrough to health chatbots, this pandemic has pushed technology into providing us with health solutions. Use of Internet of Things (IoT) and simulations, is speeding up the process of testing new medicine. Technology powered by artificial intelligence (AI) is helping track the outbreak, clean hospitals, deliver supplies and develop vaccines, with governments encouraging universities and corporations to expedite innovations. Investment in such solutions is not only the need of the hour but is demanded by the future as well.

9. Protection in Digital World

As organizations evolve so shall the amount of data being generated and used by them. This data deluge could lead to organizations facing newer threats for which they shall have to adopt advanced security practices or leverage professional services from firms specializing in the relevant field. This would mean not just protecting the organization from unauthorized access but also ensuring that adequate measures are in place to protect the privacy of the individual from being leaked outside of the organization. One of the implications could also be to implement a risk framework to build a secure organization with the right people, processes and technologies. The risk framework shall include not just the organization but all other relevant stakeholders which have a bearing on the value chain and impact the ecosystem. These needs would mean new product offerings in the digital world that are sophisticated and effective enough to protect information from conventional and non-digital channels, while bearing in mind that one size doesn't fit all, and customizable solutions are needed. Investment in data protection solutions that can successfully be deployed in organizations, and are customizable given different risk appetite are needed, along with appropriate set of policies and guidelines to offer a well-rounded response.

10. Fashion and Textile Sector

With the outbreak of Covid-19, and increased demand of Personal Protection Equipment, many apparel companies recalibrated their processes to come to rescue. The focus now is to produce masks and overalls, instead of bridal wear. The Post Covid-19 world of fashion will be radically different from what we used to know. Instead of outlets packed with consumers driving their sales, the companies will need to up their online presence and invest more into digital solutions providing them enough room to manage flash sales. Instead of using traditional materials, and cuts, the designers will be forced to provide solutions to the now health conscious, germophobe populous. This transformation will require investment and more than that governmental support to see it through.



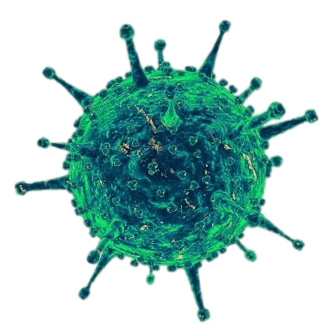
11. Tourism

Pakistan's Civil Aviation Authority (CAA) has reported losses of around $18 million in March 2020 and Pakistan International Airlines (PIA) could be sending its workforce on paid leaves on a rotational basis. The initial assessment fears that KP's tourism sector alone will face a loss of $20 million in revenues and could slash around 260,000 formal jobs[42].

The public and private sector need to collaborate to help the industry cope with the impact of COVID-19 while preparing it for responsible tourism when the travel restrictions are lifted. To support the tourism sector, purposeful restrictions on outward travel and encouraging local tourism as a substitute (e.g. by easing private loans while industry itself will work with price incentives) can be an immediate response as the lock down restrictions are eased. Domestic travel and tourism can be expected to substitute foreign tourism demand, at least for the time being. However, this will not nearly be enough, especially in terms of generating foreign currency revenues.

Another option will be organizing virtual events to showcase cultural and heritage resources. Vested organizations, graphic designers, IT experts, filmmakers and photographers need to work collaboratively to digitize all these resources, creating electronic and virtual tourism options. In this cause, Small Medium Enterprises (SMEs) in the tourism value chain will need to be supported by the government to keep afloat as they will act as the driving force behind the industry's recovery.

[42] https://blogs.worldbank.org/endpovertyinsouthasia/covid-19-delays-activities-pakistans-domestic-tourism-industry



Proposed Investment Strategy Response

Government has for the past several years focused on export-led growth; however, COVID-19 has exposed the vulnerability of betting only on trade and disregarding investment, with almost 4.64% expected loss in the GDP. The often separately considered topics of trade and investment must be thought about as one if Pakistan is to build the economy of the future. Pakistan needs an investment strategy response in order to reverse some of the Post COVID-19 distress on investment and trade. In the wake of the disruptions caused by Covid-19 and the new opportunities they provide, following 10-point agenda can act as a preliminary strategy response for attracting investment into Pakistan:

1. Industrial Relocation:

CPEC Industrial Cooperation, although is geared towards relocation of Chinese companies into Pakistan, with Covid-19 and expected shift of China to focus inwards, might get stalled in 2020-21. Albeit, Chinese government can be pushed to realize IC, the real investor i.e. the Chinese companies, might not feel confident in relocation that soon. However, other companies have started shutting down and are moving towards other countries in the region. Bangladesh is the most suitable in that as it not only has cheaper labour than Vietnam and Pakistan (half!), but also has the SEZs at its disposal to relocate the industry. In purview of this, it is proposed that the scope of CPEC-IC be evolved to bring in the non-Chinese companies that have started to leave China in droves. The strategic geographical position of Pakistan, along with cheap labour (more to be Post Covid-19), and construction sector incentives, can attract these units into the developed SEZs.

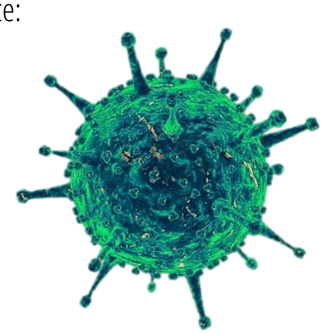
2. Special Economic Zones (SEZs) and Backward Linkages:

SEZs in Pakistan are becoming a success story with more coming online with provision of the much-needed infrastructure owing to government's commitment to make fiscal space for them in the budgetary allocations. While they are ready to act as the destination for industrial relocation from the hard-hit countries, they can also offer solutions to the domestic agriculture sector that is currently in shambles due to supply chain disruptions. It is proposed that backward linkages in may be developed for the proposed industries in these SEZs and the local agriculture sector, to shorten the supply chain, as well as offer sustained sources of livelihood for the local farmers. It will be a win-win situation in the short as well as long term. In the short run, employment avenues will emerge, and domestic consumption will get a boost. In the long run, investment will go up and industrialisation will be promoted. For this to materialize a policy is needed to incentivize such backward linkage-ing of SEZs in local agriculture sector.

3. Fast Tracking CPEC Projects:

The construction industry incentives announced by the Federal Government to stimulate the national economy and provide for the daily wagers, can be marketed towards fast tracking CPEC projects. China has the required discipline and technical knowledge to undertake construction projects and at the same time prevent the spread of COVID-19. The proposed solution will allow for fast tracking of CPEC projects in the construction sector, that are investment based projects with zero financial cost to Government of Pakistan, wherein Chinese counterparts shall undertake that such sites operate under strict Standard Operating Procedures (SOPs) in order to prevent the spread. Following is the list of CPEC projects that can be fast tracked with China's assistance:

1. Rashakai Special Economic ($128 Million Investment)
2. M-6 Sukkur to Hyderabad ($1.6 Billion Investment)



3. Karachi Comprehensive Coastal Development Zone ($2.4 Billion Investment)
4. Gwadar International Airport ($200 Million grant project)
5. Gwadar 300 MW Coal Fired Power Plant ($500 Million Investment)
6. CPEC tower project (YTD)

4. Digital Silk Road Expedited:

It will be natural for Chinese tech companies such as Alibaba's DingTalk, Tencent's WeChat Work and Huawei's WeLink to bid for market share outside of China, especially in the BRI region. China's HealthTech sector may similarly find opportunities abroad. Online doctor consultation platforms have seen consultations soar in the past few months (Alibaba Health, Ping An Good Doctor) and similar technologies may work abroad if staffed by locals, given health sector shortfalls in many BRI countries. It is proposed that the 5G deployment be expedited to enable the much-needed industrial cooperation in technology. CPEC-IC is well-positioned to spearhead the initiative and guide these investments into the right sectors.

5. Building IT Security and Capacity:

With eCommerce Policy already announced, and technology becoming a saving grace in these testing times, Pakistan needs to build its IT capacity as well, to protect and facilitate the end user. While growing use of data and digital platforms offers opportunities to overcome development challenges, including that are health-related, it is not without its own tribulations from the perspective of development. Despite the rapid uptake of digital technologies, significant divides remain, both between and within countries. The developing countries like Pakistan, are most vulnerable to threats posed by non-availability of decent data protection and security measures. While Big Data and Internet of Things are increasingly being adopted by developing countries, ensuring data privacy is becoming harder. It is proposed that proactive measures, that include policy response may be sought to accompany the digital transformation. For this leading software houses may be taken up on board to brainstorm such solutions. A balanced policy therefore may be drafted that protects against such threats while ensuring access to information is not hindered.

6. Paradigm Shift and Priority Sectors:

The world has changed and so has its needs and preferences, and more so the lifestyle. It is proposed that new sectors be prioritized for foreign direct investment, in view of the global demand. Addition of pharmaceuticals sector among the list of priority sectors is proposed, not only for the sake of bringing in investment, but also for providing our health sector with cutting edge technology and research. IT & ITes, must be pursued on war footings, with a realization of the "Digital World" that has been prematurely forced upon an agrarian economy like Pakistan. Logistics and IT must play together to create shorter supply chains and provide for supply shocks. Tourism needs to be reimagined with technology. Creation of electronic and virtual tourism options is the need of the hour to protect the sector from collapsing. Collaboration between public and private organizations can be sought to deliver IT powered tourism services.

7. Diaspora Investment Certificates:

Along the lines of a Sukuk, Diaspora Investment Certificates with fixed rate of return may be devised, to solicit funds into a portfolio of investment projects. Given the recently announced construction industry incentives, and the provisions therein of no questions asked and tax exemptions, these certificates could effectively act as an amnesty scheme, but with more benefits.

8. Industrial Transformation:

Global businesses are recalibrating and transforming to meet the needs of the new world. Assemblers of iPhones in China are making face masks. French LVMH is making hand sanitizers, Zara, one of the biggest clothing-chain is making hospital scrubs and, carmakers are ready to manufacture ventilators. Businesses are focusing on making products that are closest to their current capabilities. Pakistan currently exports different varieties of textile, dis-infectants and sterilization products. According to World Health Organization (WHO), Personal Protective Equipment (PPEs) is in shortage and one of the most urgent of needs across the world. Some of the main suppliers of Personal Protective Equipment (PPE) such as China, United States, Germany, Malaysia and Vietnam are introducing measures to restrict or ban the export of these highly urgent goods. European Union has introduced a license and permission scheme for exports to ensure these supplies are available internally. This is a huge space for Pakistani businesses to leverage. Policy reforms to support and incentivize such transformation are needed. PBS and SMEDA need to be taken on board for policy suggestions and transformation mechanism.

9. SME Survival Plan:

Small companies are likely to suffer more than others in the private sector because they are inherently vulnerable. To help small and medium-sized enterprises operating in the SEZs or otherwise, we must understand that the crisis will not hit them all at once but will affect them through a whole cycle of impacts. As small businesses ride out the days ahead, they will travel through four phases, either successively or simultaneously, from partial to full shut-down, to supply chain impacts and depressed demand, and eventually if they survive, through recovery[43]. The duty of the government is to make sure they make it till recovery. For this it is necessary to provide them with necessary working capital support to ride out the storm and give permission to operate while observing the Health and Safety protocols or SOPs. SBP has increased the credit limits of SMEs from Rs125 million to Rs180 million permanently. It is only applicable on retail SMEs. A plan needs to be devised for the rest of the services and industrial units comprising of about 31% and 21% respectively of the SMEs in Pakistan.

10. Due Diligence for Mergers and Acquisitions (M&A):

The private companies that will be adversely affected by the COVID-19 will need assistance other than that provided in stimulus packages. They will need to look for mergers and acquisitions. In doing so, they might discount the due diligence in favour of the deal itself. Considering such circumstances that may expose business to a plethora of legal/financial threats, many countries have restricted inbound FDI. Being a developing country in short supply of foreign reserves the same cannot be proposed for Pakistan. Instead, we can encourage the companies in financial distress to observe some of the essential due diligence actions in connection with M&A transactions. It is proposed that Legal Section of BOI, may devise a list of such essential actions that can prevent against such exposures. Additionally, IP wing of BOI can offer grievance services through the BOI website to facilitate investors in such testing times.

[43] http://www.intracen.org/covid19/blogs/from-shutdown-to-recovery/

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available at: www.invest.gov.pk