6 External Sector

6.1 Overview

A contraction in the current account deficit along with a continued rise in financial account surplus meant that Pakistan's external account deficit modestly declined in July-October FY08 compared to the corresponding period of FY07 (see **Table 6.1**). The improvement in current account balance was broad based, as a rise in export growth was complemented by lower growth in import as well as by a sharp rise in current transfers. However, the current account deficit is (a) still very high and (b) it is likely that even the modest Jul-Oct FY08 improvement may not be sustained in the face of the rise in the international oil prices and expected increase in competition in textile exports. This is already suggested by the leading indicators for November and December FY08, with the foreign exchange reserves under pressure, outflows from the SCRA account and weakening of Pak Rupee against the US dollar.

Table 6.1: Summary of External Balances (Jul-Oct)
billion US$

	FY06	FY07	FY08
Current A/C	-2.20	-3.51	-3.07
Capital & Financial A/C	1.47	2.37	3.10
Net errors and omissions	0.12	0.60	-0.03
Overall balance	-0.61	-0.55	-.001

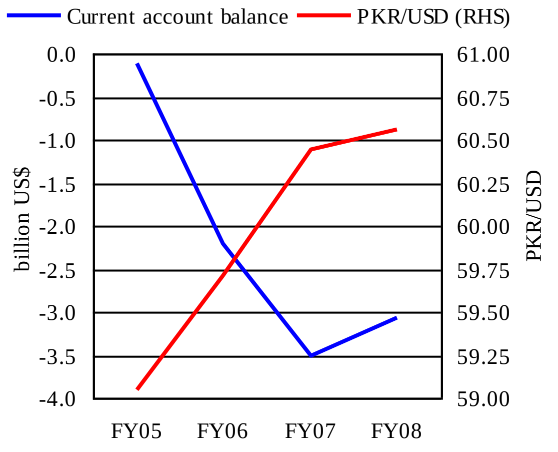
The improvement in the trade deficit helped by the small recovery in export and lower growth in import was a key development in Jul-Oct FY08. The modest revival in export growth during the period is somewhat encouraging. Export growth accelerated from 4.2 percent during Jul-Oct FY07 to 11.3 percent during Jul-Oct FY08. But, even here it is important to note that (a) the export growth is still low and (b) the growth in textile exports, which have the largest share in Pakistan's total exports, have weakened from 8.9 percent during Jul-Oct FY07 to 6.3 percent during Jul-Oct FY08. However, the non-textiles exports appear to have bounced back; registering a healthy growth of 23.1 percent during Jul-Oct FY08 compared to a decline of 2.7 percent last year.

The compression in imports growth during Jul-Oct FY08 was caused mainly by a sharp drop in imports of consumer goods;[1] imports of capital goods and raw material imports continued to register positive growth during the period. Further compression in import growth, however, is also unlikely in the months ahead.

[1] The detailed classification of imports showed that imports of consumer products fell by almost 11.6 percent during Jul-Oct-FY08.

As in the previous year, Pakistan has been able to finance its current account through the substantial surplus in the capital and financial account. During Jul-Oct FY08, Pakistan recorded a surplus of US$ 3.1 billion in the capital and financial account compared to US$ 2.4 billion last year. However, during the current year the contribution of equity flows in the surplus declined from around 74.0 percent last year to around 52.0 percent.

Figure 6.1: External Account Balance (Jul-Oct)



The improvement in overall external balance during Jul-Oct FY08 enabled the Pak rupee to maintain its parity vis-à-vis the US dollar. Pak rupee depreciation was limited to 0.5 percent during Jul-Oct FY08, against 0.70 percent depreciation last year (see **Figure 6.1**). The liquidity comfort in the inter-bank market also allowed the central bank to shift part of the oil payments to the interbank market.[2] As a result, during Jul-Oct FY08 the central bank's overall net injection of foreign exchange in the interbank market declined compared with that of last year.

The partial shifting of financing for oil payments to the interbank market together with healthy flows in the financial account increased the central bank's liquid reserves by US$ 915.0 million to US$ 14.2 billion as at end October FY08. Likewise, the country's overall liquid foreign exchange reserves increased to US$ 16.4 billion by end October FY08.

In the subsequent months (November and mid December FY08), however, the external sector indicators witnessed some deterioration. As a result, the country's overall liquid foreign exchange reserves reduced to US$ 15.5 billion by December 12, FY08 and the SCRA account experienced outflow of US$ 173.8 million since the imposition of emergency to December 13, FY08. Likewise, Pak rupee

[2] The State Bank shifted payment of furnace oil to interbank market with effect from July 4, 2007. It may be pointed out that State Bank of Pakistan was making all the oil payments from its reserves with effect from November 1, FY05.

depreciated by US$ 1.4 percent during Jul to December 12, FY08 as compared to depreciation of 1.1 percent in the same period of last year.

The external account outlook for Pakistan remains challenging. Despite the modest improvement in the initial months of FY08, the annual current account deficit remains large; current SBP forecasts indicate that the annual FY08 deficit could rise to 5.2 percent of GDP compare to 4.9 percent in FY07. While the growth in export during FY08 is expected to show a significant improvement over the anemic growth in FY07, the gains are expected to be offset by a rising oil import bill (particularly if international oil prices remain high), and a jump in imports of machinery (as power projects reach financial close).

It must also be kept in view that, so far, there is little evidence to suggest that Pakistan's economy has been substantially impacted by the turmoil in the international credit markets. The potential risk to the external account from this stems from:

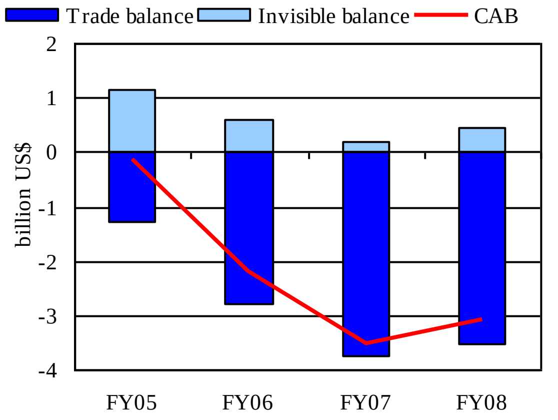
(1) Possibility of decrease in exports growth, due to slowdown in economies that account for a substantial share of Pakistan's exports, and

(2) Rise in the cost of financing the external deficit. Specifically, it would be costlier for Pakistan to raise funds from international capital market if the liquidity crises in the international financial markets were to deepen.

6.2 Current Account Balance

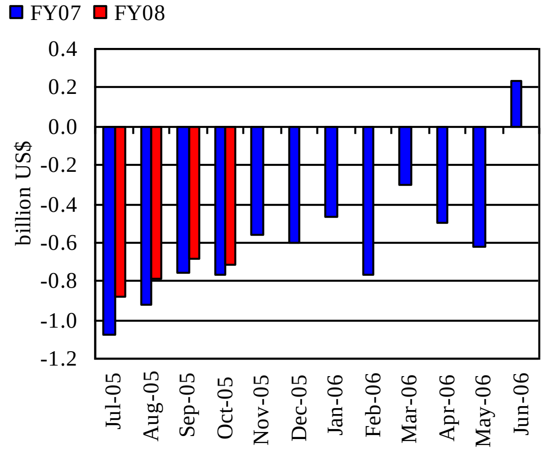
During Jul-Oct FY08, the current account deficit declined to US$ 3.0 billion compared with US$ 3.5 billion in the corresponding period of last year (see **Figure 6.2**). Encouragingly, the current account deficit remained lower than the corresponding months of FY07 through the entire Jul-Oct period of FY08 (see **Figure 6.3**). The increase in the invisible surplus contributed around 52.3 percent of the improvement, while the remaining owed to a reduction in the trade deficit.

Figure 6.2: Composition of Current Account Balance (Jul-Oct)



The increase in the surplus of invisible account, during Jul-Oct FY08, was exclusively driven by an increase in current transfers, as the services and income account deficits deteriorated during the period. The higher outflows in the latter head have been particularly strong in the last two years reflecting the strong FDI flows in profitable sectors, as well as the rise in the country's debt stock (see **Table 6.2**).

Figure 6.3: Monthly Comparison of CAD



Trade Account[3]

The trade deficit declined perceptibly by US$ 0.2 billion to US$ 3.5 billion during Jul-Oct FY08, in contrast to an expansion of US$ 0.9 billion in the same period last year. Both, the acceleration in export growth and a slowdown in import growth, contributed to this reduction in the trade deficit during Jul-Oct FY08.

The overall export growth accelerated to 11.3 percent YoY during Jul-Oct FY08 from 4.2 percent in the comparable period of FY07 on the back of strong growth of 23.1 percent in non-textile exports. The import growth on the other hand slowed down to 4.4 percent YoY during Jul-Oct FY08 from 14.5 percent YoY in the corresponding period last year.[4] The deceleration in the imports mainly emanates from a decline in the petroleum and transport group imports as well as relatively weaker imports of food items. Encouragingly, raw material and machinery imports recorded a healthy growth of 6.6 percent and 8.6 percent respectively.

Services Account

The (net) services deficit registered an increase of US$ 431 million during Jul-Oct FY08 as compared to US$ 354.0 million the same period of last year (see **Table 6.3**). This widening in services account deficit is mainly contributed by higher net

[3] This section based on exchange record data compiled by SBP that does not tally with the Custom data compiled by the FBS, and used in sub-section 6.3.
[4] For detail, see section 6.3 on **Trade Account**.

Table 6.2: Current Account Balance

million US$

	Jul-Oct			Change Jul-Oct	
	FY06	**FY07***	**FY08***	**FY06/FY07**	**FY07/FY08**
1. Trade Balance	**-2,784**	**-3,724**	**-3,513**	**-940**	**211**
Exports	5,196	5,413	6,024	217	611
Imports	7,980	9,137	9,537	1,157	400
2.Services (net)	**-1,305**	**-1,659**	**-2,090**	**-354**	**-431**
Transportation	-601	-721	-688	-120	33
Travel	-308	-365	-370	-57	-5
Communication services	25	22	23	-3	1
Construction services	-92	-15	-2	77	13
Insurance services	-48	-49	-52	-1	-3
Financial services	-47	-26	-15	21	11
Computer & information services	17	8	-6	-9	-14
Royalties and license fees	-32	-32	-39	0	-7
Other business services	-657	-655	-961	2	-306
Personal & cultural & recreational services	-2	0	0	2	0
Government services	192	174	20	-18	-154
Of which logistic support	474	159	0	-315	-159
3. Income (net)	**-801**	**-1,110**	**-1,176**	**-309**	**-66**
Investment income(net)	-802	-1,113	-1,177	-311	-64
Direct investment	-652	-936	-1,061	-284	-125
of which: profit & dividends	**-167**	**-195**	**-256**	**-28**	**-61**
purchase of crude oil and minerals	**-313**	**-480**	**-486**	**-167**	**-6**
Portfolio investment	-47	-76	-45	-29	31
Of which : Profit & Dividend	**-24**	**-52**	**-43**	**-28**	**9**
IMF charges & interest on off. external debt	-148	-151	-147	-3	4
Interest on private external debt	-32	-35	-58	-3	-23
Others (net)	-18	-18	-21	0	-3
4. Current Transfers (net)	**2,692**	**2,979**	**3,708**	**287**	**729**
Private transfers	2,662	2,899	3,689	237	790
Workers remittance	1,373	1,644	2,078	271	434
FCA - residents	53	-53	199	-106	252
Others	1,246	1,325	1,444	79	119
of which exchange companies	**821**	**788**	**776**	**-33**	**-12**
Official transfers	30	80	19	50	-61
Current Account Balance	**-2,198**	**-3,514**	**-3,071**	**-1,316**	**443**

*provisional

outflows under *other business service.* This largely reflects increase in technical fees paid to the foreigners and increased imports of architect and engineering services on the back of rising demand in construction, oil & gas exploration and power generation sectors etc.

Table 6.3: Detail of Services Account (Jul-Oct)
billion US$

	FY07	FY08	Change
Overall services (net)	-1.66	-2.09	-0.43
Transportation	-0.72	-0.69	0.03
Travel	-0.37	-0.37	0.00
Other business services	-0.66	-0.96	-0.31
Government services	0.17	0.02	-0.15
Other services	-0.09	-0.09	0.00

Besides net outflows under *other business services*, lower receipts under *government services*, on account of absence of *logistics support* receipts during the period, also adversely affected the services account balance. Nonetheless, *transportation services, communication services, financial services and construction services* witnessed marginal improvement during the period under review. In particular, net outflows under *transportation services* have declined during Jul-Oct FY08 after continuous increase in the same period of the last three successive years. The relatively lower net increase (US$ 15 million) in the import related freight charges on account of slowdown in import growth and lower payments of passengers services to the foreign airlines were the major factor behind the decline in net payments under this head during the period under review.

Income Account

The expansion in the income account deficit decelerated to 5.9 percent during Jul-Oct FY08 as compared to 38.6 percent expansion in the same period of last year. This deceleration stemmed from both, the decline in the net interest payments and a lower increase in investment income outflows, during the period (see **Table 6.4**).

The decline in net interest payments was mainly explained by the higher interest receipts on the foreign exchange reserves during Jul-Oct FY08. Moreover, the interest payments on the external debt and liabilities also witnessed deceleration during Jul-Oct FY08 as compared to the same period of FY07 (see **Table 6.5**).

On the investment income side, direct investment income accounted for almost the entire increase in the total investment income outflow.

Direct investment income outflows are explained by the higher repatriation of *profits and dividends* and increase in *reinvested earnings*. The largest amount of repatriation of profits & dividends came from *financial business* reflecting the

Table 6.4: Major flows in the Income Account (Jul-Oct)

million US$

				Change	
	FY06	**FY07**	**FY08**	**FY07**	**FY08**
Inflows	**195**	**225**	**441**	**30**	**96**
1. Direct investment	5	8	4	3	-4
2. Portfolio investment	67	78	243	11	165
i)-Equity	0	2	3	2	1
ii)-Debt	67	76	240	9	164
3. Other investment	122	136	193	14	57
i)-Interest on reserves	81	99	150	18	51
ii)-Banks	24	24	34	0	10
iii)-Other sectors	17	12	6	-5	-6
4. Others	1	3	1	2	-2
Outflows	**996**	**1335**	**1617**	**339**	**282**
1. Direct investment	657	944	1065	287	121
i)-Profit &dividends	167	195	256	28	61
ii)-Reinvested earnings	178	268	321	90	53
iii)-Purchases of crude oil and minerals	313	480	486	167	6
2. Portfolio investment	114	154	288	40	134
i)-Equity (Dividends)	24	52	43	28	-9
ii)-Debt	90	102	245	12	143
a) Interest on Euro /Sukuk bonds	47	74	62	27	-12
b) Other interest	43	28	183	-15	155
3. Other investment	225	237	264	12	27
i) General government	145	146	144	1	-2
a)-Interest on public long term loans	134	129	126	-5	-3
b) Interest on public short term loans	7	11	12	4	1
c)-Foreign currency loans bonds	4	6	6	2	0
ii)-Banks	10	21	23	11	2
iii)-Other sectors	50	53	79	3	26
Of which interest on private sector debt	32	35	58	3	23
iv) others	20	17	18	-3	1
4. Other	0	0	0	0	0
Income account balance	**-801**	**-1110**	**-1176**	**-309**	**-66**

high earnings of the foreign banks operating in Pakistan. The financial business was followed by power and food sectors in terms of repatriation of profit & dividends (see **Figure 6.4**).

Similarly, during Jul-Oct FY08, reinvested earnings also registered an increase in the high growth sectors such as financial business, cement, telecommunication and transport equipments.

Current Transfers

Current transfers, on the back of impressive growth in worker's remittances, recorded a significant growth of 26.4 percent during Jul-Oct FY08 as against a modest growth of 10.4 percent in Jul-Oct FY07. Besides commendable growth in remittances, the increase in other transfers and resident foreign currency account also contributed considerably in the current transfer growth during the period under review. In absolute terms, the current transfers increased by US$ 729 million during Jul-Oct FY08 to touch US$ 3.7 billion (see **Figure 6.5**).

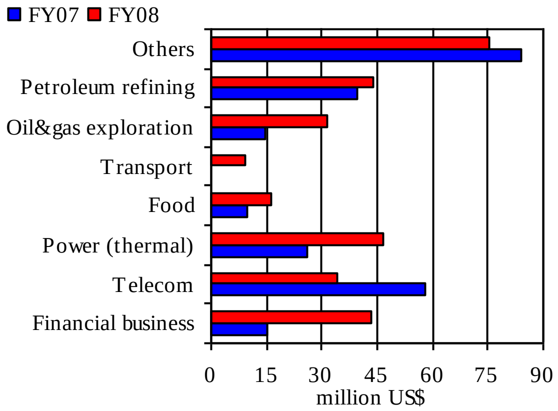
Workers' Remittances

As in the Jul-Oct period of the last three successive years , the worker's remittances registered a commendable growth during Jul-Oct FY08 In absolute terms, the remittances reached a historic

Table 6.5: Details of Interest Payments & Receipts (Jul-Oct)
million US$

				Savings	
	FY06	**FY07**	**FY08**	**FY07**	**FY08**
Payments (I+II)	**285**	**315**	**329**	-30	-14
1.Total external debt	**223**	**254**	**261**	-31	-7
Public & publicly guaranteed	188	214	200	-26	14
Long-term	127	122	126	5	-4
Military	7	7	0	0	7
Euro bonds/Sukuk	47	74	62	-27	12
Commercial loans/credits	2	4	10	-2	-6
IDB	5	7	2	-2	5
Private loans/credits	32	35	58	-3	-23
IMF	3	5	3	-2	2
II. External liabilities	**62**	**61**	**68**	1	-7
Foreign currency deposits	3	7	9	-4	-2
Special US$ bonds	9	3	2	6	1
Central bank deposits	17	12	15	5	-3
Others	33	39	42	-6	-3
Receipts	**122**	**135**	**190**	13	55
Interest on reserves	81	99	150	18	51
Others	41	36	40	-5	4
	163	**180**	**139**	**-17**	**41**

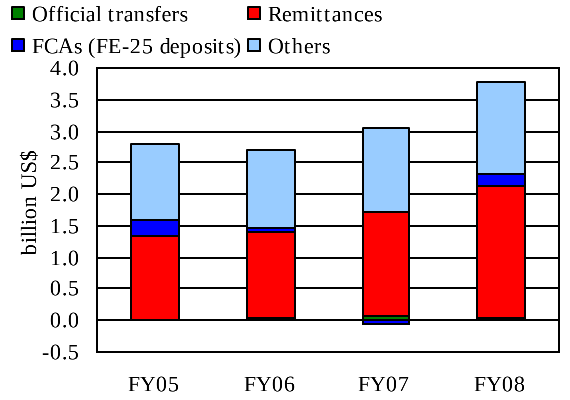
Figure 6.4: Sectorwise Repatriation of Profit & Dividend (Jul-Oct)



peak of US$ 2.08 billion during Jul-Oct FY08, relative to the first four months of the previous years.

The remittances from Gulf region and US contributed around 52 percent and 39 percent respectively in the overall remittances growth during Jul-Oct FY08. The other major sources of remittances, such as U.K, Germany and Canada, also contributed positively in the overall remittances growth (see **Table 6.6**).

Figure 6.5: Major Components of Current Transfers (Jul-Oct)



The increase of US$ 227.4 million in remittances from Gulf region, during Jul-Oct FY08, probably reflects the increased economic prosperity as a result of higher oil prices (see **Figure 6.6**). It may be pointed out, that share of workers' remittances routed through Foreign Exchange Companies increased to 23.3 percent during Jul-Oct FY08 as compared to 16.6 percent in the same period of last year.

Table 6.6: Country wise Workers Remittances (Jul-Oct)

million US$

	FY07	FY08	Change
Gulf Region	**800.5**	**1,027.9**	**227.4**
Bahrain	*41.7*	*46.8*	*5.1*
Kuwait	*90.0*	*120.4*	*30.3*
Qatar	*48.9*	*68.2*	*19.3*
Oman	*50.9*	*66.8*	*15.9*
UAE	*250.7*	*334.8*	*84.1*
Saudi Arabia	*318.2*	*390.9*	*72.7*
USA	**421.8**	**590.8**	**169.1**
U.K.	**138.5**	**164.5**	**26.1**
Canada	**28.9**	**33.9**	**4.9**
Germany	**25.6**	**28.5**	**2.9**
Others	**228.0**	**235.3**	**7.3**
Total	**1,643.2**	**2,080.8**	**437.6**
Encashment of FEBC & FCBCs	1.0	0.7	-0.4
Grand total	**1,644.2**	**2,081.5**	**437.3**

Resident FCAs

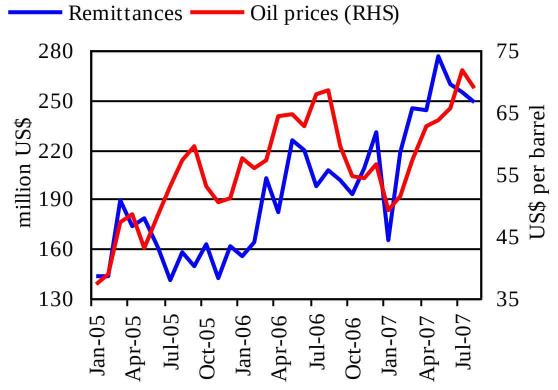
The Foreign Currency Account (resident) experienced an inflow of US$ 199 million during Jul-Oct FY08 in contrast to the outflow of US$ 53 million in the comparable period of last year (see **Figure 6.7**). The decomposition of FCAs suggests that the major inflows were witnessed in demand deposits (US$ 86 million) and time deposits (US$ 80 million). A part of the rise in the US dollar value of FCAs could be attributed to the revaluation (in dollar terms) of foreign currency deposits denominated in currencies other than the

US dollar. Such accounts comprise almost 20 percent of the total foreign currency deposits.

6.3 Financial Account

Following the trend of previous years (since 2005) the financial account continued to record surplus during FY08. Specifically, the financial account recorded a surplus of US$ 3.08 billion during Jul-Oct FY08 as compared to the surplus of US$ 2.2 billion in the corresponding period of last year (see **Table 6.7**).

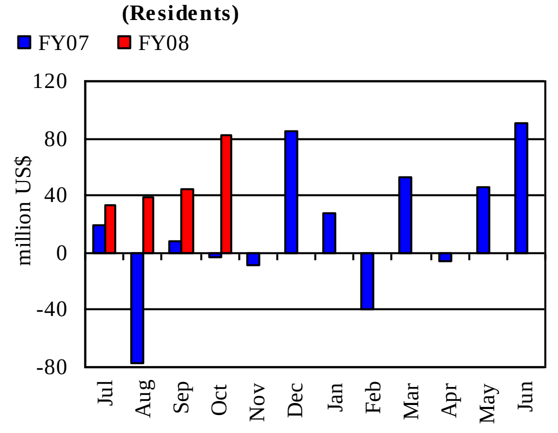
Figure 6.6: Relationship between Workers' Remittances from Gulf Region & Crude Oil Prices



Nonetheless, the sources of the financial account surplus during Jul-Oct FY08 were different from those of the comparable period of the previous year.

Unlike Jul-Oct FY07, where foreign direct investment and portfolio investment together constituted around 76.0 percent of the growth in the financial account surplus, in Jul-Oct FY08 the rise in the financial account surplus owed principally to receipts under "other investments" (see **Figure 6.8**). The higher inflows in the latter head reflected the greater availability of non-food loans (worth US$ 587 million), relatively higher inflows in bank's FE-25 nostros and net inflows (US$ 261 million) of IDB short term loans.

Figure 6.7: Inflows in Foreign Currency Accounts (Residents)



Net Foreign Investment (NFI)

Although the NFI witnessed a decline of 1.6 percent during Jul-Oct FY08 in sharp contrast to 151.8 percent growth in the corresponding period of last year, in

Table 6.7: Financial Account
million US$

	Jul - Oct			YoY Change	
	FY06	**FY07***	**FY08***	**FY07**	**FY08**
Financial account (net)	**1418**	**2238**	**3082**	**820**	**844**
Direct investment abroad	**-13**	**-52**	**-6**	**-39**	**46**
Direct investment in Pakistan	**480**	**1250**	**1319**	**770**	**69**
Equity Capital	302	981	998	679	17
Of which: Privatization receipts	0	133	0	133	-133
Reinvested earnings	178	268	321	90	53
Portfolio investment	**189**	**454**	**313**	**265**	**-141**
Equity Securities	221	445	344	224	-101
Of which: stock market debt securities	-32	9	-31	41	-40
of which : Eurobond	-2	-1	-23	1	-22
Net Foreign Investment	**656**	**1652**	**1626**	**996**	**-26**
Other Investment	**762**	**555**	**1410**	**-207**	**855**
Assets	337	151	217	-186	66
1. Outstanding Export Bills (exporters)	-126	-70	-45	56	25
2. Outstanding Export Bills (DMBs)	62	97	27	35	-70
3. Currency and Deposits	401	124	235	-277	111
Of which banks	365	96	170	-269	74
Liabilities	**425**	**404**	**1193**	**-21**	**789**
1. Foreign long-term loans / credits (net)	305	210	517	-95	307
Project loans	214	298	248	84	-50
Non-project loans	446	211	587	-235	376
Amortization	355	299	318	-56	19
2. Private Loans	41	23	34	-18	11
Of which supplier credits	166	129	133	-37	4
suppliers credit repayments	125	106	99	-19	-7
3. Short term capital (official)	-34	-38	261	-4	299
Of which IDB (net)	66	62	261	-4	199
4. Currency and deposits	160	117	230	-43	113
Other liabilities	**-47**	**123**	**197**	**170**	**74**

*provisional

absolute terms the NFI was only marginally lower by US$ 26 million. The decline in NFI during Jul-Oct FY08 was mainly driven by lower growth (5.5 percent) in foreign direct investment and a decline (31.1 percent) in portfolio investment. The lower growth in the foreign direct investment is partially because a payment tranche for the PTCL privatization is expected to be received later in the year and partially on account of lower growth in the reinvested earnings. The decline in portfolio investment, on the other hand, is mainly attributed to the absence of planned GDRs issues and TFCs floatation (mainly because of the unfavorable developments in international financial markets), as well as an outflow of investment in government securities (PIB & T-bills) during the period under discussion.

Figure 6.8: Major Sources of Financial Account Surplus (Jul-Oct)

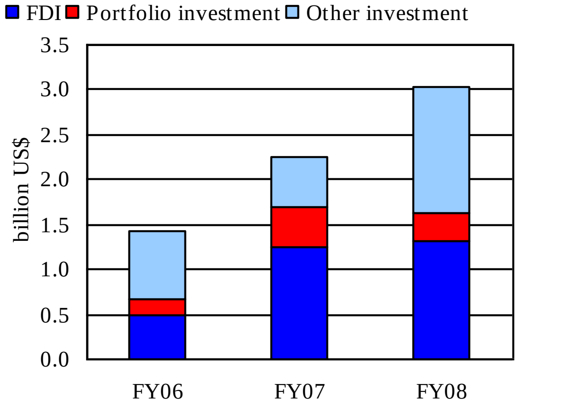


Table 6.8: Major Sector Wise FDI (Jul-Oct)

million US$

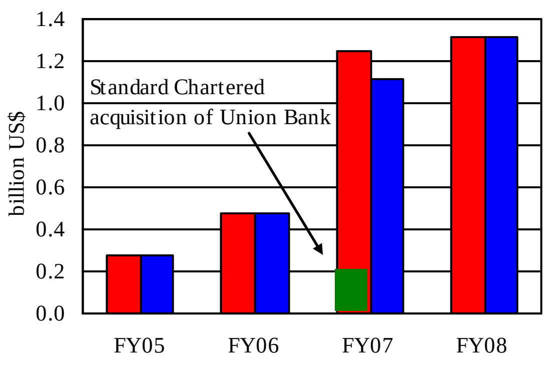
	FY07	FY08	Change
Communications	359.7	462.2	102.5
Financial business	351.4	244.2	-107.2
Oil & gas explorations	198.7	173.2	-25.5
Trade	77.4	58.1	-19.3
Cement	8.3	73.2	64.9
Transport equipment (automobile)	15.7	39.1	23.4
Construction	28.4	31.0	2.6
Petroleum refining	19.1	27.6	8.5
Power	53.5	25.6	-27.9
Transport	7.1	20.1	13.0
Chemicals	16.9	14.6	-2.3
Pharmaceuticals & OTC products	10.1	11.4	1.3
Mining & quarrying	2.9	10.1	7.2
Food	5.2	8.3	3.1
Social services	0.9	9.9	9.0
Textiles	26.3	8.5	-17.8
Others	68.5	82.3	13.8

Foreign Direct Investment (FDI)

The FDI maintained its increasing trend for the fourth successive year. Nonetheless, the rate of increase in FDI during Jul-Oct FY08 was lower as compared to the corresponding periods of last three years (see **Figure 6.9**).

The FDI during Jul-Oct FY07 included inflows on account of acquisition of Union Bank worth US$ 195.4 million by Standard Charted Bank and US$ 133 million on account of the PTCL privatization proceeds, both of which were one offs.[5] With the absence of the aforementioned inflows this year, and the high base set last year, the lower growth in the FDI is not surprising. Adjusting for the PTCL privatization receipts alone increases the FDI growth to a healthy18.1 percent from nominal increase of 5.5 percent.

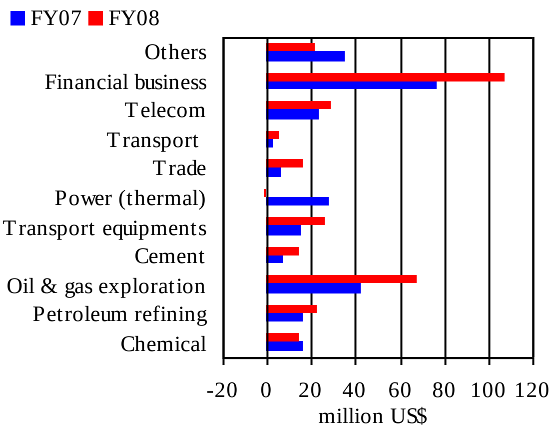
Figure 6.9: Foreign Direct Investment During Jul-Oct (Equity & Reinvested Earnings)



Detailed analysis of FDI during Jul- Oct FY08 reveals a mixed trend. While the communication, cement, transport equipment, petroleum refining and transport sectors witnessed an increase in FDI, the financial business, oil & gas exploration, power and textile sectors witnessed a decline during Jul-Oct FY08 as compared to same period of FY07.

The encouraging aspect of FDI during Jul-Oct FY08 is the rising share of the FDI in the manufacturing sector. During Jul-Oct a significant increase in the foreign investment was witnessed in the export oriented cements and import oriented automobile industry. The foreign investment in cement industry is likely to boost cement exports, which has enormous potential in the wake of rising cement demand from oil rich Middle East, fast growing India and reconstruction in Afghanistan and Iraq.

Figure 6.10: Sectorwise Reinvested Earnings (Jul-Oct)



[5] Two tranches of PTCL privatization proceeds worth US$ 267 million are scheduled to be realized in FY08.

With regard to breakup of FDI flows into cash and reinvested earnings, almost all the increase in overall FDI, during Jul-Oct FY08, was contributed by increase in reinvested earnings as the cash investments declined marginally by US$ 3.0 million during the period. The major sectors which witnessed increase in reinvested earnings during Jul-Oct FY08 include financial business, telecommunication, oil & gas exploration and petroleum refining (see **Figure 6.10**).

Portfolio Investment

Against the substantial growth of 140.2 percent during Jul-Oct FY07, portfolio investment registered a decline of 31.1 percent during Jul-Oct FY08. As a result, the total portfolio investment fell to US$ 313.0 million during Jul-Oct FY08 from US$ 454 million during the corresponding period last year (see **Figure 6.11**). The decline in the portfolio investment during Jul-Oct FY08 was contributed by lower inflows in equity securities and net outflow from debt securities.

Figure 6.11: Analysis of Foreign Portfolio Investment (Jul-Oct)

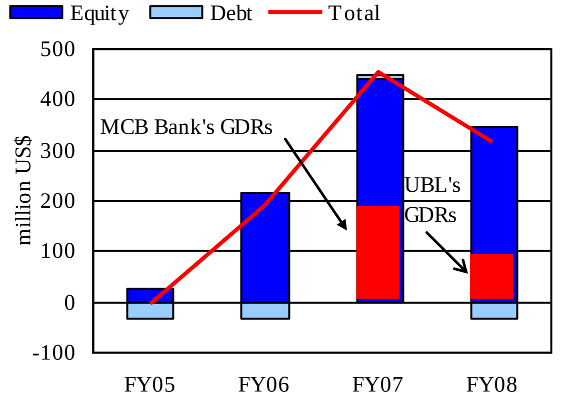
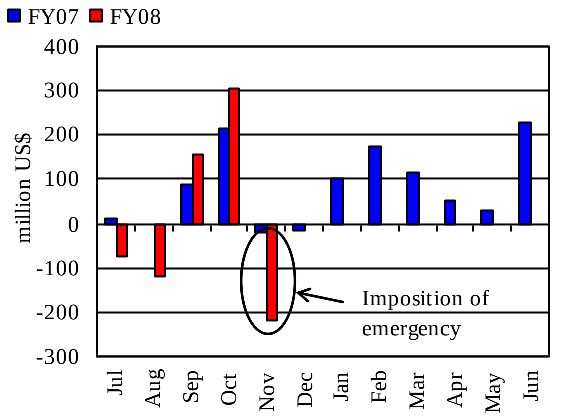


Figure 6.12: Monthly SCRA Position



The flow in equity securities declined from US$ 445 million during Jul-Oct FY07 to US$ 344 million during Jul-Oct FY08 mainly on account of lower amount realized through issuance of GDRs (US$ 90 million) relative to the same period last year in which GDRs' worth US$ 150 million were issued. Moreover, lower investment in the stock market also contributed to the decline in investment in equity securities (see **Figure 6.12**).

The investment in debt securities, on the other hand, witnessed an outflow of US$ 31 million during Jul-Oct FY08 as compared to inflow of US$ 9 million in the same period of last year. The outflow from the public securities (PIBs and T bills) was the major contributory factor behind decline in investment in debt securities.

The foreign portfolio investment is likely to remain subdued in the short-run due to political uncertainty which may keep investors on the side lines. This is apparent from the net withdrawal of US$ 219.3 million from Special Convertible Rupee Account (SCRA) since the imposition of emergency up to end November, FY08. This is the largest outflow in a single month so far. Moreover, it would be costlier for the private and public sector to raise funds from international capital market by issuing GDRs or sovereign bond in the wake of Standard & Poor's downward revision (from stable to negative) of Pakistan outlook on the long term foreign and local currency sovereign credit rating.[6]

Outstanding Export Bills (OEBs)

The stock of outstanding export bills held by exporters and commercial banks recorded an increase of US$ 18 million during Jul-Oct FY08 as compared to US$ 27 million decline in the same period last year. The outstanding export bills of exporters registered an increase of US$ 45 million during Jul-Oct FY08 as against US$ 70 million increase in the comparable period of last year. The exchange rate stability may be one of the contributory factors behind this lower increase in exporters' outstanding bills. The outstanding export bills held by the commercial banks on the other hand declined by US$ 27 million, compared with US$ 97 million decline in the corresponding period of previous year. The aforementioned decline may reflect either lower discounting of outstanding export bills by the exporters or higher realization of export proceeds against these outstanding export bills during the period under review.

Currency and Deposits

The currency and deposits increased to US$ 235 million during Jul-Oct FY08 as compared to US$ 124 million in the corresponding period of last year. This increase was mainly contributed by the increase in FE-25 Nostros from US$ 96 million during Jul-Oct FY07 to US$ 170 million during the corresponding current period of FY08.

[6] For instance, one of the cement manufactures has delayed its decision to issue GDRs worth US$ 139 million due to the uncertain political conditions in the country.

Official Long-term Loans

The official long-term loans witnessed a relatively higher net inflow during Jul-Oct FY08, compared with the same period of last year (see **Table 6.9**). The higher net inflow in the former period are attributed to non-project loans including Asian Development Bank loan of US$ 546 million and World Bank loan of US$ 41 million. Moreover, the amortization of the long term loans increased to US$ 318 million during Jul-Oct FY08 from US$ 299 million in the same period of last year.

Table 6.9: Government Long Term Loans (Jul-Oct)

million US$

	FY05	FY06	FY07	FY08
Receipts	540	660	509	835
Amortization	805	355	299	318
Net flows	-265	305	210	517

Official Short–term Loans

The short term official loans (net) increased by US$ 261 million, entirely on the back of inflows from Islamic Development Bank (IDB) during Jul-Oct FY08 against net payments of US$ 38 million during the same period of last year.

Private loans

During Jul-Oct FY08, private sector loans showed a net inflow of US$ 34 million as compared to US$ 23 million during Jul-Oct FY07. In gross terms, the private sector loans experienced an inflow of US$ 133 million during Jul-Oct FY08, of which US$ 45 million was contributed by Karachi Electric Supply Corporation (KESC) loans and US$ 87.96 million from a loan taken by a cell phone company. In the former period, the amortization increased to US$ 98 million while the gross receipts touched US$ 133 million.

Box: 6.1 Differences in the Trade data – FBS & SBP

The exchange record data shows a trade deficit of US$ 3.7 billion during Jul-Oct FY08, while the deficit based on FBS data reached to US$ 5.6 billion during the same period. The major reason for this difference is that while the FBS records data on the physical movement of goods; the trade figures compiled by SBP are based on the exchange record data depending on actual receipt and payments of foreign exchange.

SBP in its various reports has already explained the reasons for the discrepancy in the two data sets and also reconciled the two data sets. Nevertheless, given that the misconception still exists, this note provides explanation for the variance between the two datasets.[7]

Imports

The imports by banks are variably reported either on a 'free on board' (f.o.b.) basis or on 'cost, insurance & freight' (c.i.f.) basis. In order to make these imports comparable with the FBS imports, the cost of freight and insurance is subtracted from both the SBP record and FBS import data.[8]

[7] It may be pointed out that this section draws heavily from the ***Special Section 3 of Q1-FY01***.

The variance between custom record and exchange record arises also due to difference in coverage. Specifically some of imports which are reported in the customs data are not included in imports reported by banks. Such imports are *added* to imports based on exchange record. For example,

Table 6.1.1: Reconciliation of imports compiled by FBS & SBP
million US$

FBS Data			SBP Data		
	Jul-Oct			Jul-Oct	
	FY07	FY08		FY07	FY08
FBS imports (c.i.f)	**9557.0**	**11443.2**	**SBP imports (c.i.f)**	**9084.4**	**9519.8**
Less freight & insurance	860.2	1030.0	Less freight & insurance	726.8	761.6
FBS (Adjusted)	**8696.9**	**10413.3**	**SBP imports (adjusted)**	**8357.6**	**8758.2**
			Plus	**641.8**	**662.2**
			a) Unclassified imports	294.4	100.0
			of which wheat\sugar\urea	*182.2*	*0*
			b) Imports NRI, sale of duty free shops	57.7	54.2
			c) Imports under foreign assistance	218.7	483.7
			d) Land borne imports with Afghanistan	24.0	13.0
			e) PIA & PNSC	28.0	25.3
			f) Imports through Exchange Companies	4.2	0.3
			g) Imports by EPZ	30.0	52.0
			h) Refund & rebate	-15.0	-21.3
FBS total imports	**8697.0**	**10413.0**	**SBP total imports**	**8999.4**	**9420.4**
Difference				**302.4**	**-992.6**

Source: Statistics Department, State Bank of Pakistan

- The non-repatriable investment (NRI) that consists of (a) small investments made by expatriate Pakistanis transporting machinery into the country that has been bought and paid for abroad; and (b) the purchases made from the *duty-free shops*

- The imports of wheat, sugar, urea and some other commodities done by TCP are added to the SBP imports under the title of unclassified imports.

- FEA (foreign economic assistance) is project-specific and materializes as physical transfer of development or investment goods, such as machinery, rather than a direct inflow of foreign exchange.

[8] In the case of exchange record, actual value of freight and insurance reported by banks is subtracted from imports. However, since the information on freight and insurance is not available for FBS data, a fixed proportion of 9 percent is subtracted from the FBS imports as the cost of freight & insurance.

- Goods carried over Pakistan's borders from Afghanistan are classified as *land borne imports,* which do not directly enter the exchange record, as cash payments made in Rupees do not go through authorized dealers.

- The purchases of spare parts and other imports made by Pakistan International Airlines (PIA) and Pakistan National Shipping Corporation (PNSC) at foreign airports or seaport for which payments are made are also added in the SBP import numbers.

- The value of imports for which forex is provided by the exchange companies and imports made by EPZ are also added in the SBP imports.

Finally the refunds and rebates made to importers are subtracted from the SBP imports.

Exports
In order to make export figures comparable, SBP figures are adjusted for freight and insurance, while FBS records are corrected for double counting (due to short shipments, cancellation, etc). *Short shipments* refer to customs-registered export shipments that are not shipped out in the total amounts recorded due to transport shortages, last-minute clearance issues, etc.

In addition, FBS numbers must be adjusted for cancellations of registered export orders, as well as *ship stores,* which refers to export consignments that lie in warehouses after registration, due to unanticipated delays.

Table 6.1.2: Reconciliation of exports compiled by FBS & SBP
million US$

FBS Data			SBP Data		
	Jul-Oct			Jul-Oct	
	FY07	FY08		FY07	FY08
FBS exports	**5515.9**	**5865.1**	**SBP exports**	**5190.5**	**5784.6**
			Less freight & insurance	181.4	151.6
			SBP exports (adjusted)	**5009.1**	**5633.0**
Less			Add	**355.1**	**332.0**
a) Shorts shipment	-	-	a) Outstanding export bills	-27.0	18.1
b) Cancellation	-	-	b) Crude oil	0	0
c) Ship stores	-	-	c) Land borne exports	294.0	220.0
			d) Exports credit	-	-
			e) Export of sample	1.1	1.7
			f) Export by EPZ	87.0	92.2
FBS total exports	**5515.9**	**5865.1**	**SBP total exports**	**5364.2**	**5965.0**
Difference				**-151.7**	**99.9**

Source: Federal Bureau of Statistics

The SBP exports on the other hand are adjusted for the following factors:

- *Outstanding bills* are added to SBP fob numbers, comprising all unrealized exports for which there exist customs records but no currency inflows to date.

- *Crude oil* represents the percentage of oil extracted in Pakistan which, by agreement, belongs to the foreign investors drilling here and is transported out of the country upon extraction becoming a physical 'export' for which no foreign exchange is forthcoming.

- *Land-borne exports* are similar to the entry in imports and refer to exports made to Afghanistan.

- *Export credit* refers to one-time bilateral trade credit offered by GOP to certain countries. Another such transient item is *samples*, which are the samples given to prospective buyers by domestic exporters.

- Finally, the exports from EPZs are also added in the SBP data.

Despite these adjustments to rationalize the differences in FBS and SBP figures, discrepancies still exist. This is primarily on account of leads and lags. Discrepancies in exports arise due to differences in valuations and commodity classification between SBP and FBS. Agency charges not remitted through ADs further interfere with SBP's tracking of export revenues.

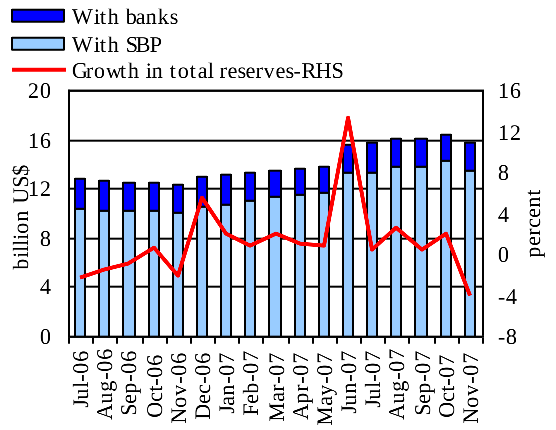
To sum up, this inconsistency primarily arises due to the difference in the data compilation procedure and as such, essentially, both data sets are correct. Furthermore, the difference in the two data sets is not unique to Pakistan and almost all countries have similar differences. For instance, there is difference of US$ 5.7 billion in the trade deficit figures compiled by the Director General of commercial intelligence and statistics and BPM5 in India. Similarly, difference of US$ 1.7 billion exists in the two data sets in Philippines and US$ 12 billion in Thailand. Interestingly in case of Thailand, the BPM5 data indicates surplus in the trade balance while the customs data show a deficit.[9]

6.4 Foreign Exchange Reserves

Pakistan's Foreign exchange reserves reached US$ 15.6 billion[10] by mid December, 2007 after peaking at an all time high US$ 16.4 billion by end October 2007(see **Figure 6.13**).

During the Jul-Oct FY08 period, reserves swelled by 5.1 percent due to an improvement

Figure 6.13: Foreign Exchange Reserves



[9] State Bank of Pakistan Annual Report for FY06. Data for India pertains to Apr-Mar 2006 and CY2005 for others.
[10] December 13th, 2007 figure.

in the current account balance and a rise of 21.8 percent YoY in the financial account surplus. However, the month of November 2007 witnessed a reversal with reserves dropping to US$ 15.7 billion by end November 2007, and remaining under pressure in the subsequent month as well.

The greater part of the volatility in the overall foreign exchange reserves seen during Jul-Dec FY08 stemmed from SBP reserves (see **Table 6.10**). SBP reserves went up by 6.7 percent during Jul-Oct FY08 reaching US$ 14.2 billion by end October 2007, up from US$ 13.3 billion as at end June 2007. This surge in SBP reserves during Jul-Oct 2007 period was caused by rise in net purchases by SBP complemented by other long-term (ADB, IBRD) loan inflows.

Table 6.10: Foreign Exchange Reserves
million US$

	Jun-07	Oct-07	Dec-07*
SBP	13,328.4	14,243.4	13,344.2
Commercial banks	2,283.0	2,242.6	2,238.2
Total	15,611.4	16,486.0	15,582.4

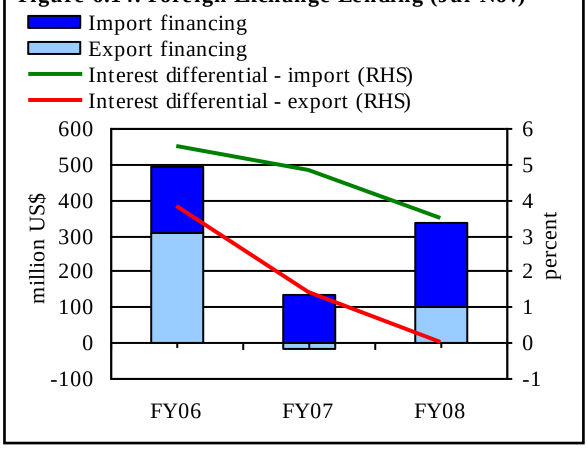
* As on December 14th 2007

Thereafter, SBP reserves witnessed an outflow of US$ 899.2 billion through the month of November till mid December 2007. This decline is mainly a reflection of SBP foreign exchange sales and a rise in debt servicing requirements. The rise in SBP sales during Nov 2007 in turn reflects (a) higher oil payments on the back of rise in international oil prices and (b) net outflows from SCRA amounting to US$ 219.3 million. Besides intervening in the market in the form of increased sales, SBP also cut the Special Cash Reserve Requirement on FE-25 deposits from 15 percent to 5 percent, in order to address the liquidity in the market.

Commercial bank reserves have also come down during Jul-Dec 2007 and stood at US$ 2.24 billion by mid December 2007 down from US$ 2.28 billion by end June 2007. This is mainly on account of the increase in FE-25 loans.

FE-25 lending during the period Jul-Nov FY08, witnessed a steep rise and remained much higher than last year. The rise is due to higher borrowing from

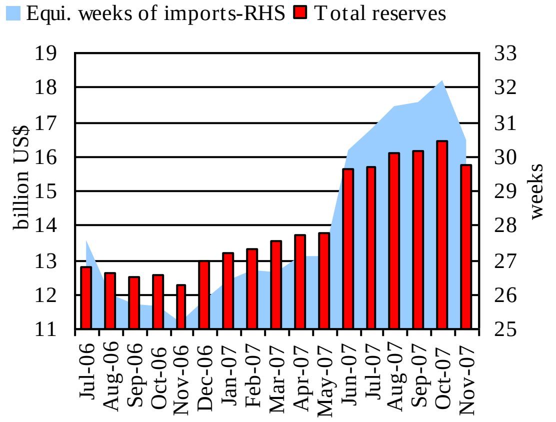
Figure 6.14: Foreign Exchange Lending (Jul-Nov)



importers as well as exporters (see **Figure 6.14**). This is mainly due to lower costs of borrowing on FE loans.

The change in trends in the foreign exchange reserves is also reflected in the country's reserve adequacy ratio (weeks of import coverage). This rose from 30.2 in June 2007 to a peak of 32.2 weeks by end October 2007 (see **Figure 6.15**). Despite the recent weakening, the ratio is still quite comfortable at 30.5 weeks of imports by end November FY08, well above the average for FY07.

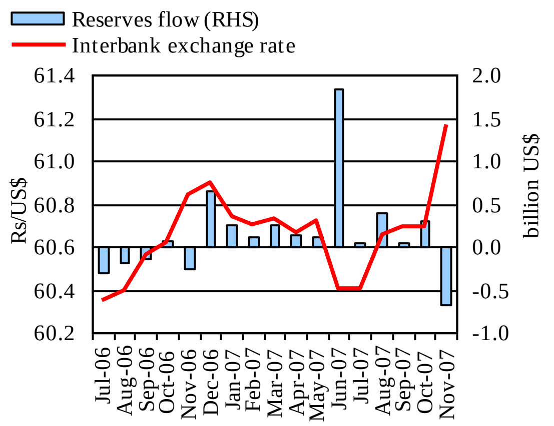
Figure 6.15: Reserve Adequacy



6.5 Exchange Rate

The interbank Rs/US$ exchange rate returned to the level last seen in November 2004, dropping to Rs. 61/US$ level in mid November 2007, and depreciating to Rs 61.25/US$ by December 13th, 2007. Depreciation of the rupee against US$ during Jul-Dec FY07 by 1.4 percent marked a trend reversal of appreciation seen since December 2006 (see **Figure 6.16**).

Figure 6.16: Reserve Flows vs Exchange Rate



During the period Jul-Oct FY08, the interbank market remained mostly stable and range bound with PKR depreciating by 0.53 percent during this period. However, in November 2007, pressure on the exchange market emerged due to foreign exchange outflows in the wake of emergency imposed in the country, as reflected in net outflows from Special Convertible Rupee Accounts (SCRA) as well as higher import payments (possibly due to rise in international oil prices).

The Pak rupee exchange rate against a basket of currencies measured by Nominal Effective Exchange Rate (NEER) depreciated by 3.2 percent during Jul-Oct FY08 (see **Figure 6.17**). Real Effective Exchange Rate (REER) on the other hand appreciated by 1.93 percent during Jul-Sep 2007, due to a persistent rise in Relative Price Index (RPI).[11] During the month of October however, Real Effective Exchange Rate (REER) depreciated by 0.48 percent reflecting an improvement in the purchasing power parity of Pakistan against its trading partners.

Figure 6.17: Changes in Effective Exchange Rate (Jul-Oct)

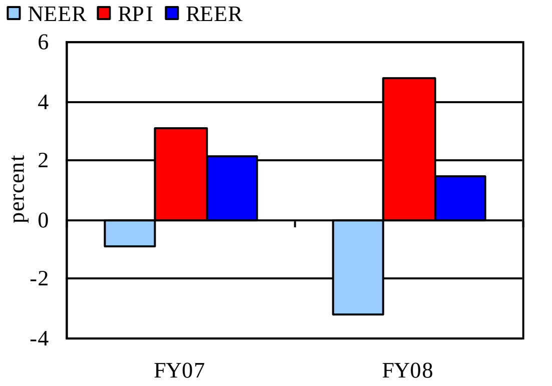


Table 6.11: Pattern of Trade Deficit (Jul-Nov)

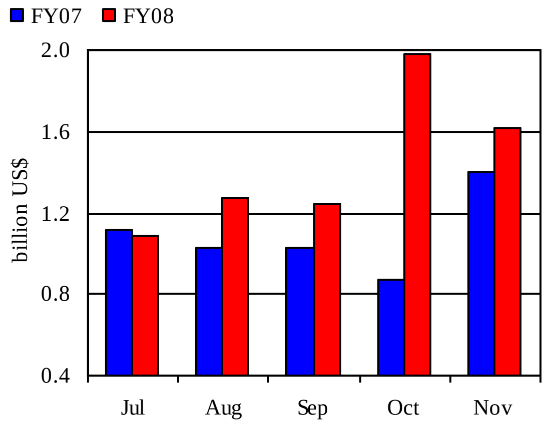
value: billion US$,

	FY05	FY06	FY07	FY08
Trade Deficit	-1.9	-4.6	-5.4	-7.2
% change YoY	316.5	147.5	18.7	32.3

6.6 Foreign Trade[12] [13]

Despite a small recovery in exports, Pakistan's trade deficit witnessed 32.3 percent deterioration during July-Nov FY08, compared to a worsening of 18.7 percent in the comparable period of FY07 (see **Table 6.11**). However, most of this acceleration in trade deficit was seen in October 2007 (see **Figure 6.18**), which accounted

Figure 6.18: Monthly Trade Deficit



[11] Relative price index appreciated by 6.2 percent during Jul-Oct 2007 against 3.1 percent rise during the same period, in FY07.

[12] This analysis is based on the provisional data provided by Federal Bureau of Statistics, which is subject to revisions. This data may not tally with the exchange record numbers reported in the sections on *Balance of Payments* (see Box 6.1).

[13] The broad analysis of trade deficit is based on Jul-November FY08 data. However the detail exports and imports trends are discussed for the period Jul-October FY08, since detail monthly data is not available for November FY08.

for 63 percent of the year-on-year increase in the trade deficit during Jul-Nov period.

The exceptional surge in the October 2007 trade deficit, in turn, was caused by a jump in imports, principally due to the impact of rising energy imports bill, as well as the one-off imports of aircraft and ships. As a result, the overall import growth, which was 8.5 percent by end September 2007-lower than 13.3 percent YoY for Q1-FY07-shot up to 18.4 percent for July-November FY08.

Although the exports recorded a modest recovery, with growth rising to 7.5 percent during Jul-November FY08 as compared to 4.5 percent growth in the corresponding period last year, this improvement was narrowly based. According to the July-October FY08 data almost the entire contribution came from "*other manufactures*" and "*all other items*", while other major categories recorded either negative or nominal growth. Specifically the textile sector, which until recently had been the main driver of the exports growth could only muster 1.0 percent growth, while the *food* and *petroleum* group exports declined.

Even the weak textile export growth during Jul-Oct FY08 was largely contributed by rise in the low value added category of synthetic textiles and in knitwear exports. Exports of all the middle and high value added categories including garments, bedwear and towels experienced a fall. The sluggish performance of the textile sector indicates that the sector continues to reel under the pressure of enhanced competition, and that strategies to revive this sector have not yielded any substantial results.[14]

The export performance in general and particularly of the textile sector is likely to remain hampered, in the short term, by structural issues. While the exports of the food group continue to suffer from non-compliance of the sanitary and phyto-sanitary standards (SPSS) (see **Box 6.1**); the textile sector exports may suffer from increased competition, as safeguard measures imposed on China's exports to the EU and the US are scheduled to end soon. Moreover, persistent domestic inflation and likely slowdown in the US and EU economies would increase the cost of production on one hand and lower the demand of this sector in its two major markets on the other. This suggests a possibility of further deceleration in exports in months to come. Under the circumstances, the current rise in other

[14] According to US Census Bureau Data Pakistan textile exports to the US recorded 3.9 percent fall during Q1-FY08 as compared to Q1-FY07, whereas to EU country's textile exports recorded a marginal rise of 1.2 percent during Jul-Aug FY08 as compared to the same period last year (Jul-Aug being the latest period for which EU trade data is available on Eurostat).

manufacture exports is a welcome development. There is a need to expand such gains by focusing policy efforts on sectors with growth potential.

While the exports growth is likely to remain subdued, the growth in imports may rebound, as is already evident in the Jul-Oct FY07 data. The rise in imports growth is likely to be broad based, with main impetus coming from the rise in the petroleum group imports due to both rise in prices and quantum. Machinery and food group imports may also rise on account of power generation, telecom and wheat imports. As a result there is likelihood of significant widening of the trade deficit during FY08.

Figure 6.19: Export Performnace (Jul-Nov)

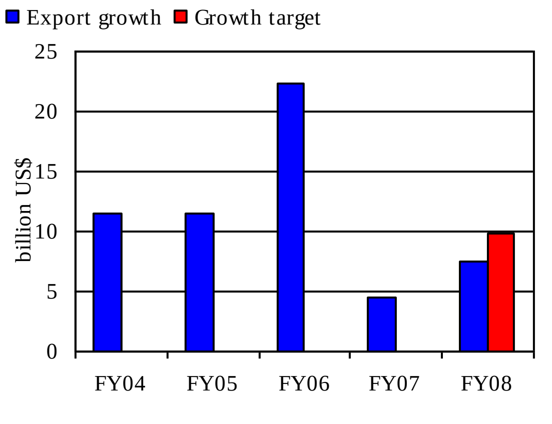
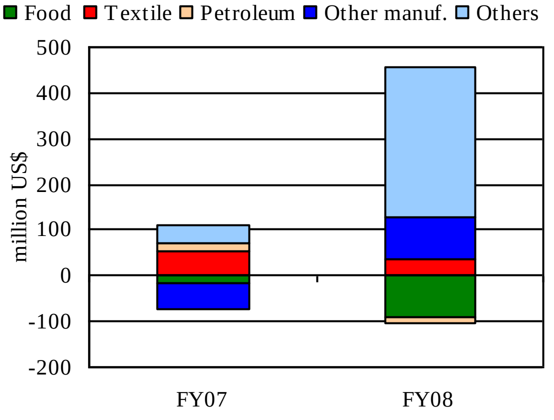


Figure 6.20: Absolute Increase in Exports (Jul-Oct)



Exports

Exports recorded 7.5 percent YoY growth during Jul-Nov FY08 to reach US$ 7.4 billion. Encouragingly this growth was higher than the 4.5 percent export growth recorded during Jul-Nov FY07, yet it remained short of the export growth target of 9.9 percent set for this period (see **Figure 6.19**).[15] With regard to the sources of this rise, unlike the last two years non-textile exports especially *other manufactures* and *all other items* had a significant share in export growth during Jul-Oct FY08 (see **Figure 6.20**).

The major categories within *other manufactures* that contributed in export growth during Jul-Oct FY08 were sports goods, plastics, chemicals, jewellary and cement exports (see **Table 6.12**). On the other hand,

[15] Monthly target are available at Trade Development Authority's website: http://www.epb.gov.pk

Table 6.12: Major Exports (Jul-Oct)

million US$

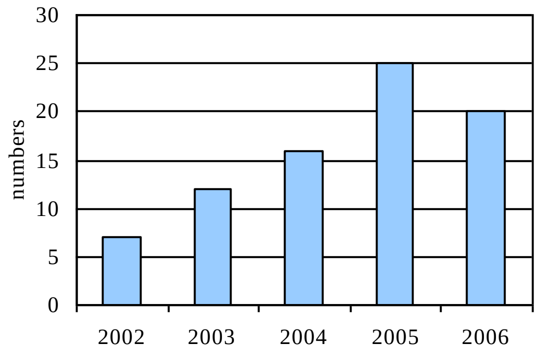
			FY07		FY08(P)			% YoY Δ		
			Value	Unit Value	Value	Unit Value	Abs.Δ Value	Qty	Value	Unit Value
A	**Food group**		**578.4**		**489.2**		**-89.2**		**-15.4**	
	Of which									
	Rice	MT	322.6	369.5	299.2	504.3	-23.4	-2.1	-7.3	36.5
	Fish and fish preparations	MT	64.4	1777.0	52.0	1459.1	-12.4	-1.6	-19.2	-7.9
	Fruits	MT	33.3	354.5	27.8	394.9	-5.5	-5.0	-16.4	11.4
	Vegetables incl. roots	MT	8.1	591.9	13.2	408.6	5.1	136.9	63.6	-31.0
	Meat and meat preparations	MT	11.4	2439.3	18.3	2918.2	6.9	33.9	60.2	19.6
B	**Textile group**		**3,612.5**		**3,49.6**		**37.1**		**1.0**	
	Of which									
	Cotton yarn	MT	452.7	1094.9	452.3	2070.7	-0.4	3.2	-0.1	89.1
	Cotton fabrics	SQM	661.7	2138.2	608.5	1006.8	-53.2	-23.7	-8.0	-2.9
	Hosiery (knitwear)	DOZ	725.8	21.0	763.6	29.8	37.8	-25.8	5.2	41.7
	Bedwear	MT	670.0	5451.3	607.8	5254.8	-62.2	-5.9	-9.3	-3.6
	Towels	MT	217.5	3770.4	174.0	3628.8	-43.5	-16.9	-20.0	-3.8
	Readymade garments	DOZ	479.1	36.4	464.8	38.6	-14.3	-8.5	-3.0	6.0
	Art silk and synthetic textiles	SQM	113.3	0.7	226.7	0.8	113.3	80.5	100.0	10.8
	Other textile made-up	---	135.2		194.1		58.9	---	43.6	---
C	**Petroleum group**		**262.4**		**245.7**		**-16.7**		**-6.4**	
D	**Other manufactures**		**856.2**		**947.9**		**91.7**		**10.7**	
	Of which									
	Carpets, rugs & mats	SQM	82.2	66.8	76.0	59.5	-6.2	3.7	-7.6	-10.9
	Sports goods excl. toys	---	96.2	---	102.1	---	6.0	---	6.2	---
	Leather exc. reptile leather	SQM	94.9	16.8	114.9	19.0	20.0	7.1	21.0	12.6
	Leather manufactures	---	206.1	---	171.0	---	-35.1	---	-17.0	---
	Foot wear	PAIR	35.8	7.9	35.4	6.7	-0.4	17.4	-1.2	-15.8
	Chemicals & pharmaceuticals	---	120.6	---	177.5	---	56.8	---	47.1	---
	Engineering goods	---	71.8	---	62.1	---	-9.7	---	-13.5	---
	Jewellary	---	7.6	---	29.9	---	22.3	---	292.9	---
	Cement and cement products	MT	49.2	57.6	66.9	66.1	17.7	18.4	35.9	14.8
E	**All other items**		**345.0**		**611.3**		**266.3**		**114.8**	
	Total exports		**5515.9**		**5865.1**		**349.2**		**6.3**	

major textile exports recorded only a marginal growth of 1.0 percent during this period. Even this marginal growth in the textile sector was secured by volume and price increase in the low value added category of synthetic textile. Almost all other textile items experienced a fall in terms of volume during Jul-Oct FY08, the major exceptions being knitwear and cotton fabrics exports, which benefitted from higher prices. Food group exports also experienced a significant fall during Jul-Oct FY08. All categories except vegetables and meat & meat preparations registered fall in exports in this period.

Food Group Exports

Food group exports recorded a broad based 15.4 percent decline during Jul-Oct FY08 as compared to the same period last year. The largest share in this fall was contributed by fish & fish preparations exports, whereas exports of vegetables and meat & meat preparations recorded substantial improvement (though in absolute terms this increase was very small). A detailed analysis of food group exports reveals that this sector has a wide scope for expansion, provided that the various SPSS[16] compliance related issues as well as problems related to inadequacy of infrastructure are addressed. Currently Pakistan is included among countries which have a low level of SPSS compliance and hence face repeated rejection of consignments by major export markets (see **Figure 6.21**).

Figure 6.21: Consignments Rejected by the EU



Source: The Rapid Alert System for Food and Feed Annual Reports, European Commission

Specifically exports of fruits & vegetable along with fish & fish preparations have a broad margin to improve. Pakistan is among one of the world's largest producer of certain categories in fruits such as dates, mangoes and kinoos, yet these categories have very small shares in overall export earnings. Similarly fish & fish preparations exports have a potential to increase if the availability of proper infrastructure helps in reducing the fish catch to wastage ratio. Besides this sector is also faced with the serious issue of non-compliance with SPS standards outlined by WTO that has resulted in the imposition of ban on the exports of this sector by some important markets. For the exports of this sector to increase there is a need to address these issues (see **Box 6.2**).

[16] SPSS are outlined by WTO. These standards ensure that items imported into a country do not harm animal, plant and human life neither in the importing country, nor in the exporting country in the manufacturing stage. These standards are based on scientific reasons and are not supposed to be used as protective tools by countries for import restrictions.

Box 6.2: Pakistan Agro-based Exports: SPSS Compliance and Infrastructural bottlenecks

Fruits and Vegetables
Pakistan's major fruit exports include kinoos, dates and mangoes, whereas potatoes and chickpeas are major vegetable exports. A comparison of the production and exports statistics of these categories with the world shows that country captures smaller export share of these fruits and vegetables in the world market as compared to their share in the world production (see **Table 6.1**). There are also some categories as apples and apricots, in which Pakistan has a reasonable share in world production but its share in world exports is minimal. The major reason for this weak performance is quality as well as infrastructure issues.

The fruits & vegetable exports to developed countries markets are often rejected due to non-compliance with quality standards as outlined in Sanitary and Phyto-Sanitary Standards (SPSS) of the WTO. Consequently, most of these exports are sent to low- priced developing countries markets which have limited SPSS management capacity and enforcement. For example Russian Federation that have a very low level of enforcement of SPS standards, occupied a large share (20.8 percent) in kinoo exports during FY07 and offered a unit price of US$ 0.27/Kg. On the other hand EU market that offered a better price of US$ 0.33/kg had only 2.6 percent share in these exports during FY07. [17]

Table 6.2.1: Pakistan's Vegetables & Fruits Production and Exports – World Comparison

shares in percent

	World ranking*			World shares *	
	Production	**Export quantum**	**Export value**	**Production**	**Exports**
Kinos	12th	5th	12th	2.3	1.2
Dates	4th	2nd	5th	11.5	8.8
Mangoes	4th	6th	7th	5.6	3.7
Apples	29th	58th	61st	0.6	0.0
Apricots	4th	45th	72nd	6.3	0.0
Potatoes	27th	22nd	28th	0.6	0.3
Chickpeas	3rd	7th	12th	7.5	1.0

Source: Food and Agriculture Organization of the United Nations.
* World ranking and world shares are calculated by taking average production and exports figures for the period 2001-05

Some of the major issues faced to this sector are discussed below.[18]

1) The quality of fruits and vegetables exported is poor largely due to pest and disease problems, premature harvesting and poor packaging. Resultantly the end product is not uniform and do not attract higher prices. This is evident from the world ranking of the quantum of these commodities exported and the values earned on these exports (see **Table 6.2.1**). For all major vegetables and exports countries' ranking in export values is lower than that of export quantum which implies lower prices received on export of these categories; 2) In some categories, namely apples and apricots,

[17] Source: FBS data.
[18] Source: Pakistan's Agro-based Exports & Sanitary and Phyto-Sanitary Compliance, Joint World Bank and UNIDO Report 2005.

lesser volumes are exported as the raw material prices in these sectors are not competitive. This is because economies of scale have not been achieved in this sector due to smaller land holdings; 3) Post harvest infrastructure e.g. transportation network and storage facilities are not adequate that affect the level of exports in this sector in general; 4) Market system for fruits and vegetables is also complex. Exporters mainly purchase their product needs from wholesalers. These purchases are then consolidated and manually handled and packed to meet individual export orders; as a result, the exporters are unable to meet large export orders.

In order to improve this situation there is a need to focus policy efforts on addressing these infrastructure related issues. Besides, there is also a need to create awareness among growers as to the proper timing of harvesting the crop that affects the quality of the produce to a large extent. There are some sectors as mangoes and oranges where private sector has an increasing involvement in the stage of packaging and storage, which is helping this sector in improving export profile of these two categories. Such increased private sector involvement in other potential sectors can help expand overall export revenues from this sector.

Fisheries

Fisheries sector is an important source of export earnings for Pakistan. It had a share of around 10.6 percent in food group exports during Jul-Oct FY08.[19] This sector is however facing difficulties for the past few years due to the issue of non-compliance with the SPSS. This situation has led to the imposition of frequent bans on Pakistan's fish exports to the EU which is an important market. The EU market offers a high unit price ranging between US$2.31/kg – US$ 3.31/kg during as compared to other destinations as China that offers a unit price ranging between US$ 0.99/kg – US$ 1.2/Kg and that captures around 15 percent share in Pakistan's fish exports during FY07.[20] As a result of the recent ban imposed, Pakistan's fish exports to EU recorded 58.9 percent fall during FY07 as compared to the same period last year, whereas EU's share in total fish exports fell from 22.4 percent in FY06 to 10 percent in FY07. This situation presents a discouraging scenario especially in the context of the difference in the unit prices offered by EU and other markets.

The improvements in this situation requires addressing following issues[21]; 1) The importance of controlling public health risks is not realized by the industry. The need for companies to verify appropriate control within capture of the fish, handling, storage and transport is not fully understood. The vessel owners and harbor authority lack an understanding of the consequences of poor control and have only just begun to initiate programs to achieve increased control. Similarly processors lack an understanding of Hazard Analysis and Critical Control Point (HACCP) and competitive levels of Good Manufacturing Practices[22]. Therefore there is a need to inculcate awareness among all stakeholders of fish industry regarding the importance of this issue to avoid sanctions imposed by major importers; 2) the relevant government department has weaknesses in the inspection system especially in the organization, responsibility, authority, methodology and a have a poor understanding of significance of public health risks including their causes and suitable controls.

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[19] The share of fish & fish preparations exports in total exports stood at 0.88 percent in Jul-Oct FY08. From the decade of 1990s, the highest share of this sector in total exports was witnessed in FY93, when this sector had 2.7 percent share in total exports.
[20] Source: FBS data, figures pertain to FY07.
[21] Source: Pakistan's Agrobased Exports & Sanitary and Phyto-Sanitary compliance, Joint World Bank and UNIDO Report 2005.
[22] Good Manufacturing Practice or GMP refers to the standards related to the control and management of manufacturing and quality control testing of foods and pharmaceutical products. These standards are generally notified by WHO.

There is a need to ensure proper enforcement mechanism for the SPSS; 3) there are various infrastructure related issues e.g., fishing boats have non-compliance issues since they do not have proper hand washing facilities, fuel oil control, cleanliness and design etc. Besides, the hygiene conditions at the landing site and handling operations after fish catch are poor. In addition to that auction halls also have poor infrastructure for sanitary facilities.

In this connection this is worth mentioning that the government has announced a National Fisheries policy in November FY08 with the aim of increasing production and export of fish and to reduce the catch wastage ratio. This policy envisages the establishment of a number of new fish and shrimp farms in collaboration with the private sector to increase fish production in a period of four years. However it lacks focus on addressing the quality and infrastructure related issues mentioned above. There is therefore a need to broaden the focus of such policy efforts in order to be able to obtain some worthwhile results from such efforts.

Rice exports recorded 7.3 percent fall in Jul-Oct FY08 as compared to the same period last year despite an impressive growth of 20.5 percent in the *basmati* rice exports. This fall was caused by 52.2 percent decline in quantum of the *other varieties* exports and may be attributed to lower rice production in FY07(see **Table 6.13**).

Table 6.13: Quantum & Price Impact-Rice Exports (Jul-Oct)

million US$

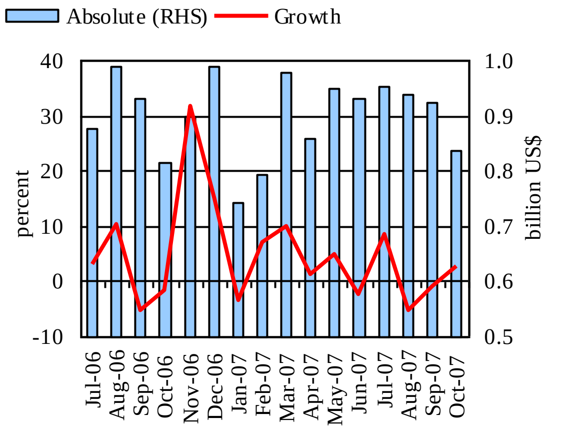
	FY07 Δ			FY08 Δ		
	Qty	Price	Abs. Δ	Qty	Price	Abs. Δ
Basmati	3.3	5.4	8.7	9.9	25.9	35.7
Others	10.1	10.2	20.3	-77.6	18.5	-59.2
Total	13.4	15.6	29.0	-67.7	44.3	-23.4

Source: Calculations based on FBS data.

Textile Group

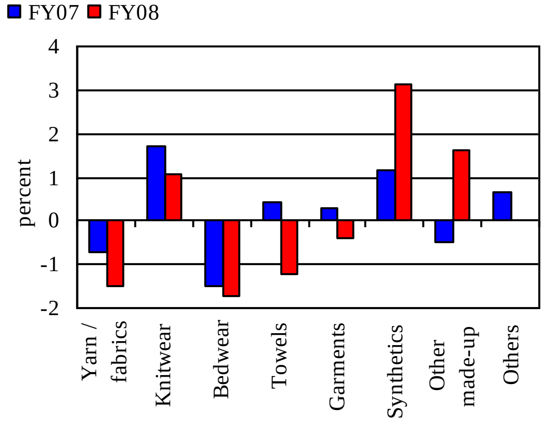
Textile exports continued the pattern of deceleration in growth witnessed since Q3-FY07 and recorded a marginal growth of 1 percent during Jul-Oct FY08 over the same period last year (see **Figure 6.22**). The breakup of total textile export earnings during Jul-Oct FY08 into the shares of major export categories reveals that this growth was achieved on the back of rising exports of synthetic textiles, knitwear and other made ups exports (see **Figure 6.23**). All other major textile export categories recorded decline in this period.

Figure 6.22: Textile Exports Growth



The analysis of price and quantum of major textile export categories reveals that the export quantum of all major export categories except that of cotton yarn and synthetic textiles recorded decline during Jul-Oct FY08 (see **Table 6.14**). The unit values of knitwear and cotton fabric exports witnessed large increases during Jul-Oct FY08.

Figure 6.23: Share in Textile Export Growth (Jul-Oct)



Encouragingly the 100 percent YoY rise in the *synthetic textile* exports during Jul-Oct FY08 was caused by both rising quantum as well as unit values. The growth in the synthetic textile exports is attributable to rising cotton prices which has caused substitution of cotton with polyester staple fibre (which is cheaper). However the prices of polyester staple fibre are also expected to come under pressure in the wake of rising oil prices that might also translate in the deceleration of synthetic textile exports going forward.

Table 6.14: Major Textile Exports - Quantum & Price Impact (Jul-Oct)
million US$

	FY07 Δ			FY08 Δ		
		Due to			Due to	
	Total Δ	Quantum	Price	Total Δ	Quantum	Price
Cotton yarn	33.9	7.0	26.9	-0.4	14.4	-14.7
Cotton fabrics	-59.7	-135.6	75.8	-53.2	-156.7	103.5
Knitwear	61.2	124.6	-63.4	37.8	-186.9	224.7
Bedwear	-53.3	-54.9	1.6	-62.2	-39.5	-22.7
Towels	16.0	17.3	-1.3	-43.5	-36.7	-6.8
Readymade garments	10.4	-7.0	17.3	-14.3	-40.8	26.5
Art Silk and synthetic textiles	40.8	34.4	6.4	113.3	91.3	22.1

Knitwear exports recorded 5.2 percent rise in Jul-Oct FY08 as compared to the same period last year. This rise was entirely caused by rising unit values since knitwear exports quantum registered around 25.8 percent fall during this period. In fact knitwear exports volumes are following a continuous declining trend since

Q1-FY07 (see **Figure 6.24(a)**). This is on account of the tough competition from India, China, Sri Lanka and Bangladesh in major export markets namely US and EU. This is especially so in the US market which is the largest destination[23] for the country's knitwear exports. Almost 88 percent of the entire volume growth during FY07 was experienced in H1-FY07, but since H2-FY07 knitwear exports to the US are experiencing sluggish growth.

Similarly *cotton fabrics* also recorded a significant decline in quantum during Jul-Oct FY08 as compared to the same period last year (see **Figure 6.24(b)**). The rise in the unit prices in the same period helped in partially offsetting the impact of this quantum decrease and overall export earnings recorded 8 percent YoY fall during Jul-Oct FY08. Clothing exports have continued the last year's trend and are witnessing fall in the US market due to weak demand.

Figure 6.24(a): Cotton Fabrics Exports

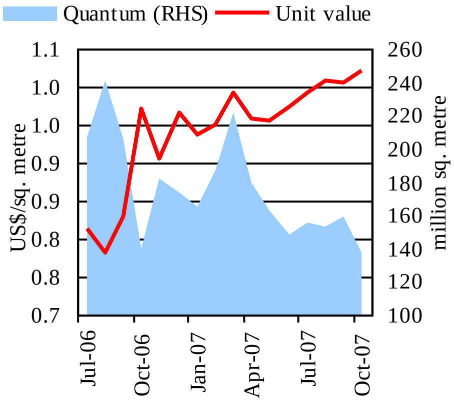
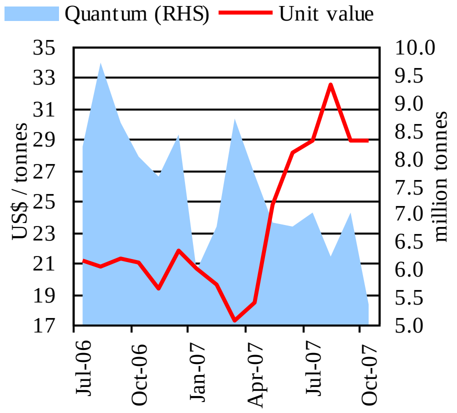


Figure 6.24(b): Knitwear Exports



Moreover, bedwear, readymade garments, towels and cotton yarn exports also recorded a decline during Jul-Oct FY08. However the provision of 3 percent markup-rate subsidy to the spinning sector effective from July 2007 [24], might lead to a rise in cotton yarn exports in the long run.

<u>*Market Analysis*:</u> The performance of textile sector highlights the tough competition faced by this sector in its major markets – US and the EU. Detailed analysis reveals that Pakistan textile exports to the US recorded 3.9 percent fall

[23] The US had around 64 percent share in country's total knitwear exports during FY07.

[24] Effective from Jul 2007 SBP announced the provision of 3 percent mark-up rate subsidy to the spinning sector for the outstanding running balances of principal amount of floating rate loans for financing of import machinery.

during Q1-FY08 as compared to Q1-FY07.[25] This fall was largely caused by declining exports of low value added textile categories, whereas textile apparel exports recorded a marginal 1.3 percent rise during this period. While for the Jan-Sep FY08 period the performance of other competitors in this market shows that the shares of Bangladesh, Vietnam and China improved; India experienced stagnation in its market share, whereas Thailand's share recorded a fall.

Going forward the competition faced by Pakistan in the US market is likely to increase, particularly since the US is considering according duty free access to Bangladesh and Cambodia.[26] Particularly, Bangladesh which has a strong position in garments exports is likely to give tough competition to Pakistan's apparel exports which are currently rising. As regards the stagnation observed in India's share in the US market, this might be attributable to adverse movements in the Indian currency that caused a loss of competitive strength for India's textile exports in the US market (see **Figure 6.25(a)**).

In the EU market Pakistan's textile exports recorded a marginal rise of 1.2 percent during Jul-Aug FY08 as compared to the same period last year. This was achieved due to rising exports of low and middle value added categories. The share of Pakistan in EU's textile apparel imports has been falling since CY05 possibly due to tough competition from Bangladesh. However the share of Pakistan's total textile and apparel exports to the EU market improved to 3.3 percent during Jan-Jul CY07 from being at 3.2 percent in CY06.[27] The rise in Pakistan's textile exports share in the EU market points towards slight improvement in country's competitive strength vis-a-vis its competitors.

A comparison of Pakistan's real effective exchange rate (REER) with that of its competitors reflects that India, Thailand and Sri Lanka are experiencing appreciation of their respective currencies which clearly improves Pakistan's competitive strength. Apart from that the comparison of real lending rates shows that since FY07 although Pakistan is experiencing rise in the lending rates but country is still in a competitive position as compared to India and Thailand (see **Figure 6.25(b**).

These positive developments are likely to help textile sector during FY08. However going forward the challenge to this sector is expected to increase with

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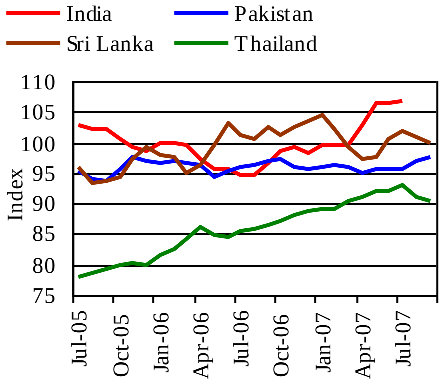
[25] Source: US Census Bureau, CenStats Databases.
[26] US have started the process of according duty free access to Bangladesh and Cambodia in November FY08.
[27] Source: Eurostat.

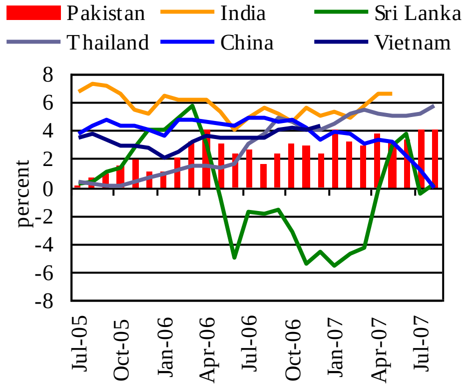
the end of the safeguard measures imposed on China by EU and the US along with the availability of duty free access to Bangladesh in the US market also.

Figure 6.25(a): REER



Source: Central banks' websites

Figure 6.25(b): Real Lending Rates



Source: IFS

There is a need for the textile sector to improve efficiency and the quality of the products to improve its standing among competitors and to take advantage of this improved price competitiveness. A major constraint in the way of quality improvement is the use of contaminated cotton produced domestically. This affects the length of the staple fiber and thus the quality of the entire textile chain. Besides, the domestic textile sector also lags behind its competitors in the field of designing. Our competitors produce innovative designs that attract higher demand in the western markets. Especially Indian textile manufactures differentiate their apparel and home textiles with rich designs and colors.

The domestic textile industry should invest in improving designing of the products. Products with innovative designs are likely to create their own demand in the western markets. Besides, for the government there is a need to address serious infrastructure issues especially the issue of power break downs. Apart from that the domestic political environment at the moment is not conducive for export growth because the uncertainty resulted by this law and order problem in the country is likely to lead buyers to switch to other suppliers. This is also likely to divert demand to other suppliers, in general, due to the distortion of country's image internationally.

Other Manufactures

Encouragingly other manufactures exports recorded a reasonable YoY growth of 10.7 percent during Jul-Oct FY08 contrary to the last year when this sector experienced 6.2 percent fall in exports during Jul-Oct FY07. Chemicals and pharmaceuticals (especially plastic materials and chemicals exports), jewellery, leather, medical & surgical instruments and sports goods (especially footballs & gloves) exports were the main drivers of this improved performance, whereas leather manufacturers exports registered significant decline in this period (see **Table 6.15**). The rise in leather export helped in partially offsetting the effect of the fall in leather manufactures exports.

Table 6.15: Other Manufactures Exports (Jul-Oct)

change: million US$; shares: percent

	Abs Δ	Growth	Share in other manufactures
Carpets, rugs & mats	-6.2	-7.6	9.6
Sports goods excl. toys	6.0	6.2	11.2
Leather exc. reptile leather	20.0	21.0	11.1
Leather manufactures	-35.1	-17.0	24.1
Foot wear	-0.4	-1.2	4.2
Medical & surgical instruments	8.0	15.1	6.2
Chemicals and pharmaceuticals	56.8	47.1	14.1
Engineering goods	-9.7	-13.5	8.4
Jewellary	22.3	292.9	0.9
Others	30.1	34.1	10.3
Total	91.7	10.7	100.0

Sports goods exports recorded 6.2 percent rise during Jul-Oct FY08, a little higher than the 6 percent growth experienced in the same period last year. This was achieved on the back of rising exports of footballs and sports gloves (see **Table 6.16**). Sports gloves exports are in fact experiencing growth since FY07. This rise is gained both in the existing markets as well as new markets in Eastern Europe and Africa are also explored for the export of this category.[28] This might be attributed to the provision of 25 percent freight subsidy to exports sent to eastern Europe (other than EU), African and pacific islands countries in FY07 trade policy.

Table 6.16: Change in Sports Goods Exports (Jul-Oct)

value: million US$

		% Δ in FY08 over FY07		
	Abs. Δ	Value	Qty	Unit value
Sports goods excl. toys	6.0	---	6.2	---
Footballs	15.8/	35.8	28.5	-5.3
Gloves	5.3	53.2	44.0	-6.0
Others	-15.0	---	-52.0	---

Source: Calculations based on FBS data.

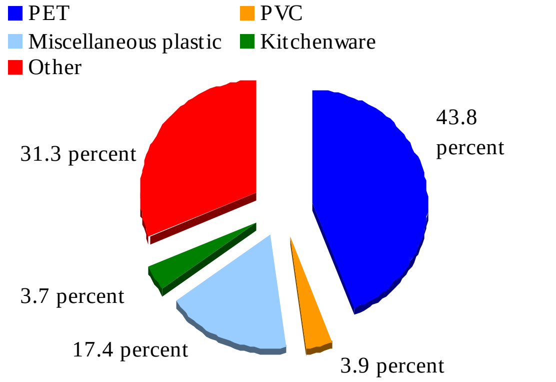
A 28.5 percent rise in the footballs exports during Jul-Oct FY08 is also attributable to the exploration of new market. Reportedly exports to the major markets for footballs namely – EU and the US – experienced fall during Jul-Oct FY08. This fall in market share might be attributable to tough competition from China besides other factors. According to the International Trade Centre Report

[28] The number of export markets for sports gloves expanded from 88 in FY06 to 113 in FY07.

(September 2007)[29] the average unit value for Pakistani footballs exports to the US stood at US$ 3.82 during 2005 as compared to US$ 2.7 per unit paid to China. In addition, the supply of machine made footballs has also caused obstacles to Pakistan's exports in this category. In the face of these challenges the rise in footballs exports is a welcome development.

Plastic material exports largely consist of bottle grade Polyethylene terephthalate (PET) resin that is used as a raw material for bottles manufacturing in the beverages industry, PVC powder and other miscellaneous articles of plastics (see **Figure 6.26**).

Figure 6.26: Shares in Plastic Exports *



* Average shares in FY06 and FY07.

From Q3-FY07 however exports of PET and kitchenware articles are witnessing slight increase and this increasing trend might have continued into Jul-Oct FY08 as well.[30] EU market has a significant (64 percent) share in Pakistan's PET exports. Encouragingly, in this market Pakistan's competitive edge has improved since November FY07 after the imposition of a definitive antidumping duty on EU's PET imports from India.[31] The PET exports to EU already started showing the effect of this improvement as during H2-FY07 these exports to EU registered 117 percent rise over H1-FY07.

Imports

Imports registered 18.4 percent YoY growth during Jul-November FY08 as compared to 10.3 percent growth in the corresponding period of last year and reached US $ 14.6 billion (see **Figure 6.27**). According to the Jul-October FY08 data the increase in overall import growth was broad based with all categories, except food group, recorded strong growth (see **Figure 6.28**). [32]

[29] "The Sports Goods Sector in Pakistan" (Sep 2007), International Trade Centre Report, European Commission Trade-Related Technical Assistance Program for Pakistan. .
[30] The category wise detailed data for Q1-FY08 is not available.
[31] Source: http://www.antidumpingpublishing.com/Anti-Dumping-News/default.aspx
[32] The detailed imports data is not available for the month of November FY08.

Figure 6.27: Import Value and Growth (Jul-Nov)

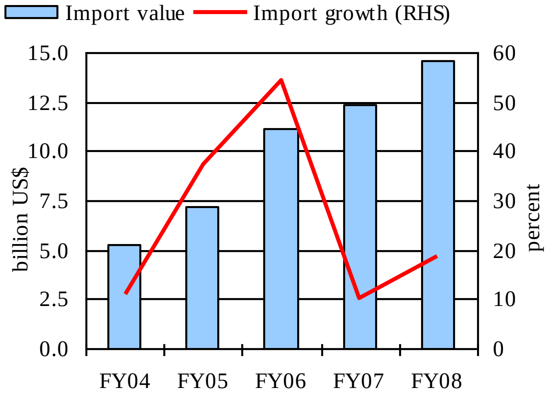
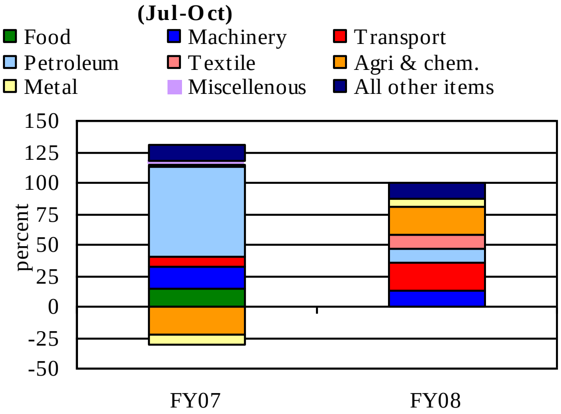


Figure 6.28: Contribution in Import Growth (Jul-Oct)



The monthly analysis reveals that import growth experienced a sharp 58.8 percent YoY rise in the month of October FY08 that drove the overall import growth up to 19.7 percent from the level of 8.7 percent recorded in Q1-FY08. This was partly due to import of one-off nature in the aircraft and ships category. Besides, rising international oil prices also started to exert influence on the POL import bill from October FY08. Nonetheless, it should be noted that import growth during Jul-Oct FY08 remains higher than the corresponding period of the last year even if adjusting for these two elements.

The rising trend in imports is likely to sustain through the remaining FY08, due to relentless rise in the international oil and commodity prices. Moreover, food group imports are also likely to expand on account of wheat imports and rise in the Palm oil prices. Similarly, imports of iron and steel scrap, power generating machinery, construction and mining machinery and agriculture machinery are also expected to increase during FY08 to cater the needs of the growing economy. This situation points to the possibility of a reversal in FY08 of the deceleration in imports growth observed in FY07 (see **Table 6.17**).

Food Group

Food group imports recorded 1.4 percent fall during Jul-Oct FY08 over the same period last year. The decline in the food group imports was mainly due to decrease in sugar imports, though decline in the imports of wheat and pulses also contributed to the overall fall in the food group imports (see **Table 6.18**).

The 97.3 percent fall in the sugar imports during Jul-Oct FY07 was on account of a good sugarcane crop in FY07 that removed the need for sugar imports. Any rise in sugar import going forward is unlikely due to ample sugar stocks and good sugarcane crop to support new crushing season.

Table 6.17: Major Imports (Jul-Oct)

value: million US$, Growth: percent

	FY07	FY08	Abs. Δ	% Δ FY08 over FY07
Food group	1063.1	1048.3	-14.8	-1.4
Machinery group	1946.5	2195.1	248.7	12.8
Transport group	548.2	968.6	420.4	76.7
Petroleum group	2631.5	2859.9	228.4	8.7
Textile group	420.9	605.2	184.3	43.8
Agricultural and chemical group	1332.0	1759.1	427.1	32.1
Metal group	786.2	907.1	120.9	15.4
Miscellaneous group	215.3	238.3	23.1	10.7
All other items	614.5	861.5	247.0	40.2
Total imports	9,557.0	11,443.2	1,886.2	19.7

Although the wheat import declined during Jul-Oct FY08 as compared to the same period last year, there is a likelihood of increase in its imports in the coming months to bridge the supply and demand gap in the country. This situation has probably arisen due to the reported smuggling of huge quantity of wheat to neighboring countries, as well as allowing wheat exports, which resulted in falling domestic stocks. In this context this is worth mentioning that prices are rising sharply in the international market[33] on account of historically low levels of stocks.[34] This means that the forthcoming wheat import bill is also likely to inflate due to the price impact.

Table 6.18: Major Food Imports (Jul-Oct)

value: million US$, growth: percent

		FY07 Value	FY08 Value	Δ in Value	% Δ FY08 over FY07 Quantity	Value	Unit Value
Palm Oil	MT	315.4	440.2	124.8	-14.4	39.6	63.0
Pulses	MT	91.7	66.5	-25.3	-51.0	-27.6	47.8
Tea	MT	71.6	60.5	-11.1	-5.7	-15.5	-10.4
Sugar	MT	246.1	8.2	-237.9	-96.4	-96.7	-7.0
Wheat un-milled	MT	26.2	5.3	-20.9	-77.1	-79.9	-12.1

Palm oil imports recorded a significant rise of 39.6 percent during Jul-Oct FY08 as compared to the same period last year. A large share of this rise was

[33] The international wheat prices of wheat during September 2007 were US$ 342/tone up from US$ 208/tonne in September 2007.

[34] According to Food and Agriculture Organization of the United States world stock to utilization ratio of wheat fell to 22.6 percent for 2007/08 as compared to 25.4 percent in 2006/07.

contributed by rising unit prices led by rise in international palm oil prices (see **Figure 6.29**).[35]

Machinery Group

The machinery group recorded relatively higher growth of 12.8 percent during Jul-Oct FY08 as compared to the 6.5 percent growth recorded during the same period of the last year. The largest share in this increase came from rising telecommunication apparatus imports, followed by the electric machinery and other machinery groups (see **Table 6.19 & Figure 6.30)**.

Figure 6.29: Palm Oil Imports

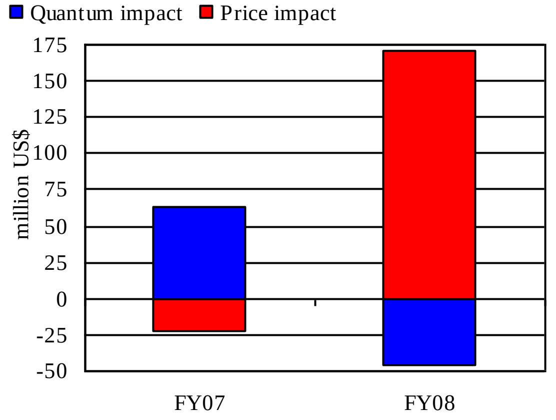
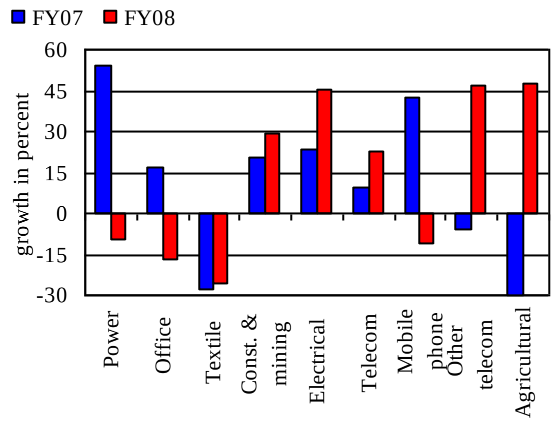


Figure 6.30: Machinery Group Imports (Jul-Oct)



Textile machinery import, which has witnessed a falling trend since FY07 largely due to fall in weaving and spinning machinery imports may have been the source of the decline in the textile machinery imports during Jul-Oct FY08 as well.[36] The provision of a mark-up rate subsidy for the import of spinning machines from Jul FY08 might lead to a rise in textile machinery imports going forward.[37] However, a look at the previous trend reveals that after experiencing sharp surge in FY05 and FY06 textile machinery import is apparently reverting back to the historical average level (see **Figure 6.31**).

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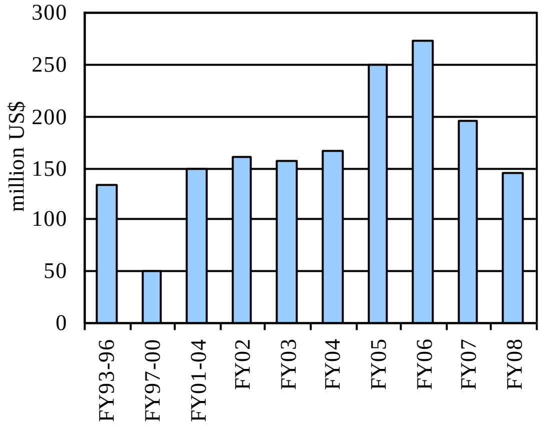
[35] International palm oil prices reached US$ 822/MT during Q1-FY08 as compared to the level of US$ 492.3/MT during Q1-FY07.
[36] The detailed FBS data is not available to confirm the trend
[37] Effective from July 1, 2007 SBP announced a 3 percent mark-up rate subsidy to spinning mills for the import of spinning machinery.

Similarly, while Jul-Oct FY08 data show decline in the power generating machinery imports, these are also expected to rise, due to ongoing investment in this sector.[38]

Figure 6.31: Textile Machinery Imports (Jul-Oct)



Transport group

Transport group posted a significant 76.7 percent growth during Jul-Oct FY08 as compared to the same period last year (see **Table 6.20**). This huge rise was witnessed due to one-off imports of aircrafts and ships. Import growth in this sector shrinks to 2.7 percent after adjusting for this one-off factor which is lower than the 10.4 percent import growth recorded during Jul-Oct FY07.

Road motor vehicles also registered 11.7 percent rise during Jul-Oct FY08 over Jul-Oct FY07. This rise was caused by higher imports of CKD/SKD units of motor cycles and buses. The CBU units of motor cars recorded a large 21.6 percent fall in this period on account of the ban imposed on the imports of more

Table 6.20: Transport Group Imports (Jul-Oct)
million US$

	FY07	FY08	Abs Δ	% Δ FY08 over FY07
Transport Group	**548.2**	**968.6**	**420.4**	**76.7**
Road motor vehicles	462.6	474.2	11.7	2.5
CBU	149.8	126.0	-23.9	-15.9
Busses, trucks/ heavy vehicles	47.3	42.9	-4.4	-9.3
Motor cars	101.3	79.5	-21.9	-21.6
Motor cycles	1.1	3.6	2.5	216.4
CKD/SKD	209.7	241.1	31.4	15.0
Busses, trucks/ heavy vehicles	49.2	60.0	10.8	22.0
Motor cars	151.0	157.5	6.6	4.4
Motor cycles	9.5	23.5	14.1	148.0
Parts	85.3	94.7	9.4	11.0
Others	17.6	12.4	-5.2	-29.3
Air crafts, ships and boats	78.9	475.4	396.5	502.4
Others transport equipments	6.7	19.0	12.3	183.7

[38] http://www.ppib.gov.pk/list.htm

than 3 years old cars.[39]

Petroleum Group

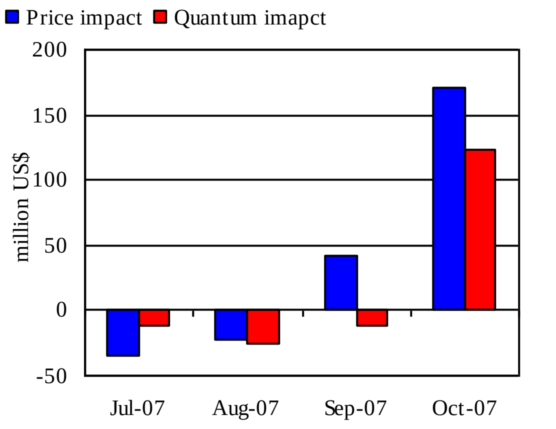
Petroleum group imports recorded a 8.7 percent rise during Jul-Oct FY08 as compared to the same period last year largely on the back of rising petroleum crude imports (see **Table 6.21**). The rise in the petroleum crude imports was contributed by large quantum impact owing to significant increase in the capacity utilization of refineries. Price impact had a small share in the increase of crude petroleum bill during Jul-Oct FY08. On the other hand petroleum products recorded a marginal 0.2 percent fall in this period due to fall in import volume.

Table 6.21: Quantum & Price Impact - POL Imports
million US$

		Δ Due to	
	Abs Δ	**Quantum**	**Price**
Petroleum group	228.40	89.10	139.30
Petroleum products	-2.35	-102.49	100.14
Petroleum crude	230.75	201.41	29.34

Going forward POL import bill is likely to expand due to substantial rise in international prices.[40] A comparison of the international oil prices with the unit values of total petroleum imports shows that the rise in international oil prices impacts the unit values with a lag of 1-3 months (see **Figure 6.32**). This is also evident from the monthly analysis that reveals that the rising international oil prices have already started to impact POL import bill from Oct FY08 (see **Figure 6.33**).

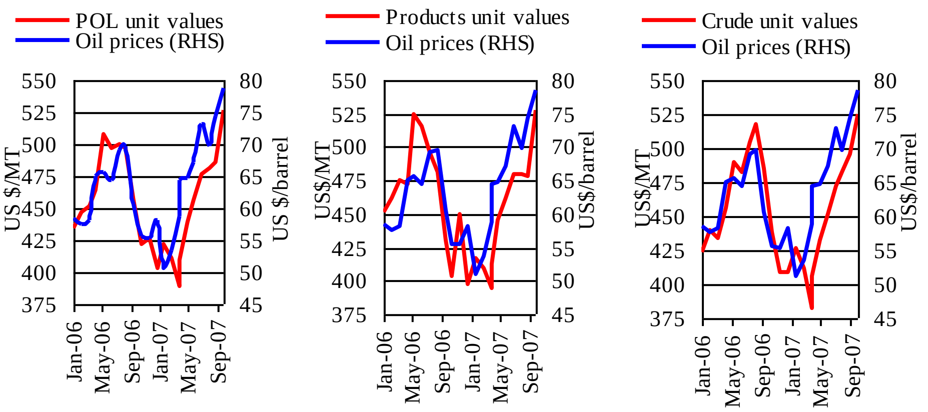
Figure 6.32: POL Group Imports



[39] Effective from July 1, 2007 government imposed a ban on the imports of used cars which were more than three years old. Later this limit was extended till August 1, 2007.
[40] The prices of Arabian light oil reached US$ 87.1/ barrel in the second week of November as compared to the level of US$ 56.9/barrel in the same month of the last year.

Besides the quantum of POL imports may also increase in the coming period on account of rise in petroleum products imports. Especially imports of white oil (Mogas) are likely to increase on account of decline in smuggling from Iran.[41]

Figure 6.33: International Oil Prices & Import Unit Values



Textile Group

Textile group recorded a significant growth of 43.8 percent during Jul-Oct FY08 over Jul-Oct FY07 (see **Table 6.22**). Textile sector imported large volumes of cotton in order to ensure ample supply of cotton in face of possible domestic shortages. Going forward also there is a likelihood of increase in cotton import since domestic prices are displaying high volatility and textile manufacturers are placing orders to import large volumes in order to avoid this volatility (see **Figure 6.34**).

Table 6.22: Textile Group Imports (Jul-Oct)

value: million US$, growth: percent

					% Δ FY08/FY07		
		FY07	**FY08**	**Abs Δ**	**Quantity**	**Value**	**Unit Value**
Textile Group	**MT**	**420.9**	**605.2**	**184.3**		**43.8**	
Raw cotton	MT	112.6	286.9	174.3	132.2	154.7	9.7
Synthetic fiber	MT	86.3	71.8	-14.5	-26.2	-16.8	12.7
Synthetic and artificial silk Yarn	MT	82.1	92.9	10.8	-1.9	13.2	15.3
Worn clothing		18.4	20.5	2.1	6.2	11.5	5.0
Other textile items		121.3	133.0	11.7	---	9.7	---

[41] Reportedly Iran has put restrictions on the sale of petrol on the border areas by starting a system of consumption permits, which ensures elimination of smuggling possibilities.

Agriculture and other chemicals group

During Jul-Oct FY08 this group posted a large 32.1 percent growth as compared to Jul-Oct FY07 (see **Table 6.23**). Around 37 percent share of this rise was contributed by rising manufactured fertilizer (especially DAP) import. This rise is partly attributable to international fertilizer prices, which is evident from 62.5 percent rise in its unit values. Besides, rising domestic demand because of the provision of subsidy on DAP fertilizer by the government also contributed in this rise. [42]

Figure 6.34: Volatility in Domestic Cotton Prices & Cotton Imports

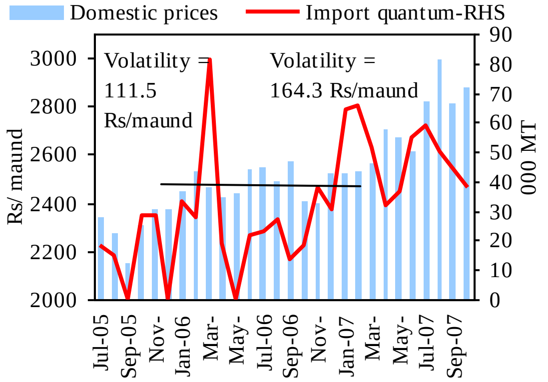


Table 6.23: Agriculture & Other Chemical Group Imports (Jul-Oct)
value: million US$, Growth: percent

					% Δ FY08 over FY07		
		FY07	**FY08**	**AbsΔ**	**Qt**	**Value**	**U Value**
Agricultural and chemical group	**MT**	**1332.0**	**1759.1**	**427.1**		**32.1**	
Fertilizer manufactured	MT	130.4	289.3	158.9	36.5	121.9	62.5
Insecticides	MT	42.7	35.5	-7.2	-23.4	-16.8	8.5
Plastic material	MT	364.0	398.2	34.1	16.8	9.4	-6.4
Medicinal products		112.1	173.4	61.2	49.0	54.6	3.7
Other chemicals		682.6	862.8	180.2		26.4	

Metal Group

Metal group imports recorded 15.4 percent YoY increase during Jul-Oct FY08 largely due to rising iron and steel scraps imports (see **Table 6.24**). A part of this increase is explained by the incentive given to the ship breaking industry in the federal budget for FY08.[43] In addition, the reported mis-declaration of other imported steel products as re-roll able scrap, in order to avoid higher custom duty might also be a factor in high import figure in this period.[44]

[42] Before the Rabi season government announced Rs 250 per bag subsidy for DAP fertilizer. The subsidy was afterwards raised to Rs 400 and then to Rs 470 per bag.
[43] In the federal budget for FY08 the assessable value for re-rollable scrap for the payment of sales tax was increased to US$ 400 million from the previous value of US$ 250 million.
[44] Other steel items imports is subject to duty ranging from 5 to 25 percent, whereas duty on iron and steel scrap was reduced from 5 percent in FY07 to 0 percent in FY08 budget.

Table 6.24: Metal Group Imports (Jul-Oct)
value: million US$, Growth: percent

					% Δ FY08 over FY07		
		FY07	**FY08**	**Δ in**	**Quantity**	**Value**	**U. Value**
Metal Group		**786.2**	**907.1**	**120.9**		**15.4**	
Gold	MT	86.9	6.6	-80.4	-93.0	-92.4	7.9
Iron and steel scrap	MT	95.2	216.3	121.0	77.4	127.1	28.0
Iron and steel	MT	349.8	402.9	53.0	-6.9	15.2	23.7
Aluminum wrought & worked		55.9	62.8	6.9		12.3	
All other metals articles		198.2	218.7	20.5		10.3	