2 Real Sector

2.1 Overview

Provisional estimates put the real GDP growth for FY18 at 5.8 percent, up from 5.4 percent during FY17. This has been the highest growth achieved over the last 13 years, and is close to the overall target of 6 percent set for FY18. A healthy showing by agriculture, a sustained growth in the services, and an uptick in large-scale manufacturing output contributed to this performance.

Table 2.1: GDP and its Components

Share and growth in percent; contribution in percentage points

	Share	Growth			Contri. to growth
		FY17^{R}	FY18^{P}	FY18^{T}	
Agriculture	**18.9**	**2.1**	**3.8**	**3.5**	**0.7**
Of which					
Important crops	4.5	2.2	3.6	2.0	0.2
Livestock	11.1	3.0	3.8	3.8	0.4
Industry	**20.9**	**5.4**	**5.8**	**7.3**	**1.2**
Of which					
Mining and Quarrying	2.8	-0.4	3.0	3.5	0.1
LSM	10.8	5.6	6.1	6.3	0.7
Electricity gen. & dist.	1.8	5.8	1.8	12.5	0.0
Construction	2.8	9.8	9.1	12.1	0.2
Services	**60.2**	**6.5**	**6.4**	**6.4**	**3.8**
Of which					
Wholesale & retail trade	19.0	7.5	7.5	7.2	1.4
Finance & insurance	3.4	10.8	6.1	9.5	0.2
General govt.	7.9	5.9	11.4	3.9	0.9
GDP	**100**	**5.4**	**5.8**	**6.0**	**5.8**
Memorandum item					
Investment-GDP ratio		16.1	16.4		

R: Revised; P: Provisional; T: Target

Data source: Pakistan Bureau of Statistics

The GDP growth was supported by a host of factors, such as: (i) improved energy supply; (ii) supportive policies including low & stable interest rates and fiscal incentives through subsidies, easy credit conditions, and rising PSDP spending; iii) continuation of CPEC related investments & projects, and (iv) favorable export demand. Moreover, the economy received benefits concomitant with improved security and law and order.

On the agriculture front, impetus from livestock segment and substantial improvement in production of cotton and sugarcane crops – the latter experienced another record season - led the sector posting a growth of 3.8 percent, higher than both the last year's 2.1 percent and the targeted growth of 3.5 percent for FY18. Improved quality of inputs like certified seeds and pesticides, increased mechanization, and an uptick in credit disbursement helped to partially offset the negative impact of inadequate water availability and lower fertilizer off-take for crop sector.

The services sector is estimated to have almost achieved its targeted growth of 6.4 percent during FY18 on the back of strong performance by *wholesale & retail*, which benefitted from improvement in commodity-producing segment, a rise in import quantum and *general government services*. However, *finance & insurance* and *transport*, *storage & communication* experienced deceleration as against growth seen in the last year.

The industrial sector's performance also remained constrained mainly on account of steep deceleration in *electricity and gas generation & distribution.* This deceleration also led GDP growth miss the 6 percent mark, as the services and agriculture sector performed at or above their targeted rates. Encouragingly, improvement in large-scale manufacturing output and a turnaround in *mining and quarrying* helped keep overall growth of the sector at 5.8 percent, which stood higher than last year's performance of 5.4 percent.

The current growth paradigm stems from the strong performance of agriculture and construction (and its allied) sectors – both of these promote employment in the abundant unskilled segment of the country's labor force. A recent World Bank study for South Asia also validates this relationship between GDP growth and job creation in case of Pakistan (**Box: 2.1**).

Box 2.1: Impact of Growth on Job Creation[1,2]

Employment is considered one of the key development indicators of an economy's performance. A recent World Bank's study analyzes empirical relationship between growth and employment for the South Asian economies. According to the report, growing labor force will outpace the population growth in most of South Asia; however, increase in labor force would not be a problem if the economy creates sufficient job opportunities.

In the case of Pakistan, it needs to create around 1.3 million jobs every year to maintain its current employment level. Moreover, in order to achieve this, a certain threshold of economic growth would be required. Empirical evidence on the relationship between growth and employments suggests that every percentage point increase in growth results in creation of 0.2 million jobs. Going by these calculations, Pakistan has to attain annual economic growth of around 6.6 percent to accommodate all of its new job seekers. As the growth momentum has picked up, so has the country's ability to provide more job opportunities.

According to the study, the following factors may also create job opportunities. First, better infrastructure is one of the important ways to promote employment opportunities as it facilitates business activities. In the context of Pakistan, CPEC related infrastructure development is projected to spur business growth, especially with development of Special Economic Zones. Second, more integration with the global markets enhances productivity and thereby real wage rate. Recently,

[1] Source: World Bank Publication, "South Asia Economic Focus, Spring 2018: Jobless Growth".
[2] While the region-centric study suffers from data limitations and equivalence issues, its key takeaways are broadly applicable to Pakistan.

Pakistan's exports have started showing signs of recovery under supportive government policies and recovery in global demand. Last, planned urban development plays an important role in job creation, since metropolitan areas are hubs connecting a country to the outside world and act as engines of its growth. Mega city development projects (especially mass transit) in Pakistan have boosted economic activity and the same is expected after completion of ongoing developmental projects.

In addition to GDP growth, Pakistan can absorb more entrants per unit of growth through two sources. First, a slight change in growth mechanics can spur employment growth. In particular, SME-led growth can provide more employment opportunities than highly capital-intensive large-scale industries. Second, within SMEs, a renewed focus on women entrepreneurial incubators would yield high social welfare returns.[3] Women-led SMEs are more inclined to hire women than men-led ones.[4] A national outreach program to motivate and attract female participation could also unlock a substantial employment potential. Here, the regulatory bodies (SBP, SECP and SMEDA) need to enhance collaboration amongst them to provide a platform for SMEs to grow and expand. Moreover, they may support women-led SMEs to break the glass ceiling.

In this regard, SBP has also announced a policy for promotion of SME Finance in December 2017. The policy has 9 key pillars, which include improving regulatory framework, upscaling of microfinance banks, risk mitigation strategy, simplified procedures for SME banking, program-based lending & value chain financing, capacity building & awareness creation, handholding of SMEs, leveraging technology and simplification of taxation regime. Simultaneously, the SBP SME framework set certain benchmarks for 2020, which include (i) an increase in SME share in private sector credit, from existing 8 percent to 17 percent and (ii) increase in number of borrowers from existing 164,000 to 500,000. These actions are likely to contribute towards employment generation going forwards.

2.2 Agriculture

The agriculture sector experienced a broad-based improvement of 3.8 percent in FY18, comfortably surpassing both the targeted growth of 3.5 percent and last year's performance of 2.1 percent. Important crops posted a growth of 3.6 percent compared to 2.2 percent last year, with notable contributions coming from fisheries and cotton ginning sectors (**Table 2.2**). The crop sector growth is attributed largely to record performance by sugarcane and rice, contributing a share of 15.2 percent and 13.1 percent to the important crop sector. Record production of sugarcane and rice and

Table 2.2 Agriculture Sector Value-addition

Share and growth in percent; contribution in percentage points

	Share	Growth			Contribution to Growth	
	FY18	FY17^R	FY18^T	FY18^P	FY17^R	FY18^P
Crop Sector	36.9	0.9	-	3.8	0.3	1.4
Important crops	23.6	2.2	2.0	3.6	0.5	0.8
Other crops	10.8	-2.7	3.2	3.3	-0.3	0.4
Cotton ginning	2.5	5.6	6.5	8.7	0.1	0.2
Livestock	58.9	3	3.8	3.8	1.7	2.2
Forestry	2.1	-2.4	10	7.2	-0.1	0.1
Fishing	2.1	1.2	1.7	1.6	0	0
overall	**100**	**2.1**	**3.5**	**3.8**		

Data Source: Pakistan Bureau of Statistics, R: Revised, T: Target, P: Provisional

[3] Female participation in labor force is still low in Pakistan, even by South Asian standards.
[4] Source: "Women-led Businesses", An independent report by BDRC, February 2015.

double-digit growth in cotton, hence more than offset the negative growth shown by wheat and maize (**Table 2.3**).

The improved crop performance, despite a lower availability of certain inputs such as fertilizer and water supply, can be attributed to higher yields on the back of supportive government policies (attractive support prices and subsidies) along with availability of other quality inputs (certified seeds and pesticides) and expansion in agriculture credit.

Table 2.3 Production of Important Crops

million tons; cotton in million bales; growth in percent

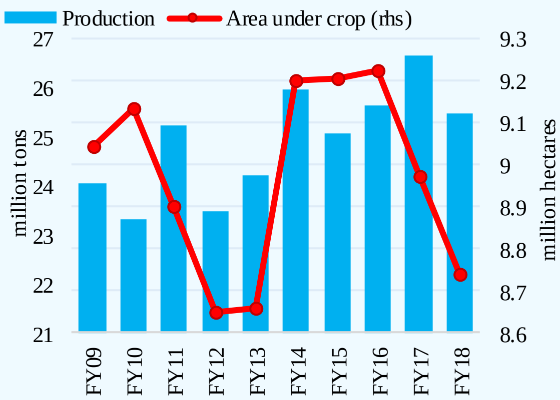
	Share in important crops %	Production			Growth	
		FY17	FY18[T]	FY18	FY17	FY18
Cotton	23.3	10.7	13.6	11.9	*7.6*	*11.8*
Rice	13.1	6.8	6.8	7.4	*0.7*	*8.6*
Sugarcane	15.2	75.5	68.5	81.1	*15.3*	*7.4*
Wheat	38.4	26.7	26.5	25.5	*4.1*	*-4.4*
Maize	10.0	6.1	5.6	5.7	*16.4*	*-7.0*

Data Source: Pakistan Bureau of Statistics, T: Target

Crop Sector: Inputs

A review of major inputs reveals an uptick in agriculture credit, while a reduction in fertilizer off-take and water availability during Jul-Mar FY18. Agriculture credit disbursements increased by 40.8 percent during Jul-Mar FY18 compared to 23 percent growth during the same period last year. Similarly, fertilizer off-take in Jul-Mar FY18 went down by 2.9 percent and 5.2 percent for urea and DAP respectively. Irrigation water availability was also reduced by 6.1 percent in Jul-Mar FY18, compared to same period last year. Decline in fertilizer off-take and water availability was more pronounced in Rabi season, which adversely impacted wheat and maize crops.

Figure 2.1: Wheat Production and Area



Data source: Pakistan Bureau of Statistics

Wheat:

Wheat production stood at 25.5 million in FY18, down 4.4 percent from last year, and missing the target of 26.7 million tons set for FY18. According to revised estimates by PBS, FY17 witnessed record wheat production of 26.7 million tons with yield displaying a YoY growth of 6.9 percent compared to FY16. The country was not able to match last year's performance as both area and yield declined in FY18 by 2.7 and 1.8 percent respectively

(**Figure 2.1**).

Wheat production suffered mainly due to four factors. First, delay in sugarcane crushing led to unavailability of land for wheat cultivation. Second, water availability declined significantly during *Rabi* FY18. This was evident from 14.5 percent lower irrigation flows compared to same period last year. Third, fertilizer off-take remained lower during the season for phosphate nutrient[5], which witnessed a 13.3 percent contraction on a YoY basis. Fourth, higher than normal temperatures in March also adversely impacted the yield of wheat crop in Punjab and Sindh.

Despite contraction in wheat output, FY18 witnessed another bumper crop, which further increased the stockpile. While government agencies are set to procure around 6.9 million[6] tons of wheat this year, the stocks at end April (start of procurement season) are already standing at 6.9 million tons; the estimated wheat stockpiles with government storage houses would easily cross 10 million mark this year.

Some relief to wheat stocks position came from exports during Feb-Mar 2018. In December 2017, the government allowed export of 2 million tons[7] to create room for the next crop until June 2018. Attractive subsidies on 2 million tons of wheat export were offered: US$ 159 per ton by sea and US$ 120 per ton by land.[8] During Feb-Mar 2018, wheat exports achieved 0.3 million tons[9] mark (**Chapter 5**). Exports of wheat provided some respite to local procurement agencies; however, they occurred at a cost to the government in terms of export subsidies to compensate for price differential between domestic and international prices.[10]

Cotton:
According to the latest estimates, cotton production stood at 11.9 million bales during FY18, registering an increase of 11.8 percent over last year, while missing the annual plan's envisaged target of 13.6 million bales. Like wheat harvest, lower cotton production may also be attributed to substitution of area under sugarcane cultivation.

[5] Phosphate is an important nutrient for wheat crop.
[6] Source: Annual Plan 2017-18
[7] The Economic Coordination Committee allowed exports of 1.5 million tons for Punjab and 0.5 million tons for Sindh before June 30 2018.
[8] Source: Ministry of National Food Security and Research.
[9] Wheat exports are to Bangladesh, Indonesia, Vietnam, Oman and Muscat at prices of 185-200$ per ton.
[10] Public expenditure of up to $320 million is expected given the entire amount is exported at the full subsidy.

Supportive pricing policies for wheat and sugarcane have been attractive for growers hence resulting in surplus production of these commodities. Offloading stocks in the global market is hindered by low international prices without hefty subsidies. Hence, excessive stockpiles of wheat and sugar have added a significant financial strain to the government. Current scenario requires price rationalization for crops that sufficiently provide for local consumption and directing resources to other crops. Promotion of oilseeds provides one such crucial avenue given the rise in edible oil import bill (see **Box 2.2**).

Box 2.2: Oilseeds Crops in Pakistan: A Way to Crop Substitution

In spite of being an agrarian economy, Pakistan had to import[11] 2.7 million metric tons of edible oils[12] worth US$ 2.0 billion in FY17 and 2.2 million metric tons worth US$ 1.7 billion in Jul-Mar FY18[13] in order to fulfill the needs of its domestic edible oil industry. Major oilseed's[14] imports stood at US$ 0.8 billion in Jul-Mar FY18 compared to US$ 0.6 billion in the same period in FY17. As per the United States Department of Agriculture report, import of oilseeds is further expected to exceed imported edible oil imports.[15] The country is capable of producing sizeable quantities of oilseeds that will reduce the import bill majorly for oilseeds and partly for edible oil.

Current Scenario: Major oilseed crops in the country are cottonseed, sunflower, rapeseed/mustard and canola[16]. Local oil production on average remained 0.6 million tons during FY08-FY17; whereas the total edible oil availability stood at 3.2 million tons, indicating low quantity produced domestically. Furthermore, the import of seeds for poultry feed manufacturing has been on the rise too[17].

Various policies have led to lower oilseed production besides heavy reliance on imports. Supportive pricing policies for wheat and sugarcane have had a distortionary impact on oilseed production as evident from decline in area under oilseeds (**Fig2.2.1**). Oilseed cultivation is further disadvantaged by absence of adequate machinery[18]and high yielding seed varieties.[19] Furthermore, import supportive policies and free trade agreements for oil imports reduce incentives for local oilseed production. In July 2015, custom duty on soybean seed was reduced to 3 percent compared to 10 percent on soymeal imports (used in poultry feed), hence resulting in increase in imports of soybean seed compared to soymeal. Furthermore, starting July 2014 the sales tax on soybean was reduced to 6 percent compared to 16 percent on canola or sunflower for solvent extractors, resultantly the

[11] These imports form 88 percent of total edible oil supplies. Source: Pakistan Oilseeds Development Board

[12] The figure consists of soybean and palm oil imports.

[13] Source: PBS imports data.

[14] Major oilseed imports consist of soybean, sunflower and canola seed.

[15] Source: GAIN Report, 2018: Oilseeds and Products Annual Islamabad Pakistan.

[16] Source: PARC: Other oilseeds crops include groundnut, sesame, safflower, linseed, jojoba, castor, Salicornia and salvadora.

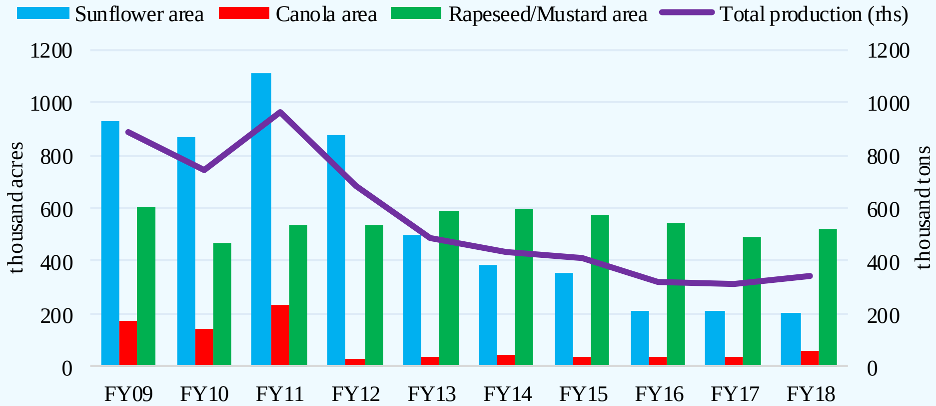
[17] Soybean seed is used to extract protein for soyameal production; a major component of poultry feed.

[18] Proper machinery, which includes planters, harvesters, and seed driers for crops such as canola and sunflower crops, is not available.

[19] In FY08,1.1 million acres was area under sunflower with production of 643,000 tons. In FY17, the area reduced to 0.2 million acres and production to 104,000 tons.

import of soybean for solvent extraction went up from a mere 50,000 thousand tons in FY15 to 640,000 tons in FY17.[20]

Fig 2.2.1 Oilseeds Area & Production



Data source: Pakistan Oilseeds Development Board

Glut of wheat and sugar in the market provides opportunity for oilseed crop promotion to shift farmers focus away from surplus-producing crops.[21]

Required Policy Actions:

- **Oilseed Policy**: The Pakistan Oilseed Development Board needs to develop an Oilseeds Policy for promotion of oilseeds in the country, in collaboration with all stakeholders22 and get it approved by the government at the earliest. In this regard, special focus is required on the demarcation of responsibilities and goals for federal and provincial governments respectively.
- **Production of quality seeds and development of hybrid seeds**: Several projects are already underway to develop quality oilseeds. In this regard, Pakistan Agriculture Research Council (PARC) has developed a hybrid canola seed variety and planted the same in Northern Punjab and KPK. Furthermore, the olive plantations have been initiated in the Potohar valley. Despite this, more focus is still required on production of quality hybrid seeds locally mainly to reduce input costs of ultimate beneficiaries.
- **Incentivizing farmers:** Pricing support or subsidy may be provided to oilseed growers in order to bring their profitability at par with crops, such as wheat. For Rabi crop FY18, the government of Punjab has announced a cash payment of Rs.5000 per acre for upto two acres for sowing of canola and sunflower crops. As a result, the area and production under these crops increased, thereby indicating the significance of maintaining incentives in boosting up oilseeds production.

[20] This is distortionary in a sense that soybean oil extraction ratio is only 17-18 percent, compared to sunflower's 47 percent and rapeseed/canola's 43 percent.

[21] Sugarcane was planted on an area of 1.3 million hectares, with cane production of 81.1 million tons in FY18. This will produce about 6.3 million ton sugar, whereas the country's requirement is around 3.4 million ton (16.3 kg per capita consumption). This means 0.6 million hectares is cropped extra than required which can be used for oilseed cultivation. Source: Pakistan Oilseeds Development Board.

[22] Stakeholders consist of farmers, solvent extractors and poultry feed manufacturers.

- **Tariff rationalization and fixation of quota on imported oilseeds and edible oil:** Tariff on import of oilseeds and edible oil may be rationalized so as to promote domestic oilseed production. Furthermore, quota fixation may be introduced in order to limit oilseeds imports. Especially, the imports of oilseeds and edible oil may be discouraged during the harvesting seasons mainly to protect local oilseed production.

2.3 Industry[23]

Industrial production has witnessed the highest growth in the current fiscal year since FY08. The performance can be traced to noteworthy contributions from construction and manufacturing activities. Public sector development program (PSDP) and CPEC related expenditure have had a spillover impact on manufacturing sub-sectors such as steel, cement and automobiles. All of these industries posted record production numbers.

However, the industry could not achieve the growth target set for FY18 on account of a lower increase in gross value addition (GVA) by *electricity generation and gas distribution*. Higher cost of production due to an uptick in international fuel prices, along with limited revenue growth under an administered pricing mechanism, led to slowdown in GVA of this sector. Further, the closure of inefficient furnace oil based power plants in a phased-manner also contributed to lower GVA. In this backdrop, it could only manage 1.8 percent growth over last year's performance of 5.8 percent, despite an improvement seen in electricity

Table 2.4: YoY Growth in LSM Jul-Mar
percent

		YoY Growth		Contribution in Growth	
	wt.	FY17	FY18	FY17	FY18
LSM	70.3	5.4	5.9		
Textile	20.9	0.8	0.4	0.2	0.1
Cotton Yarn	13.0	0.8	0.1	0.1	0.0
Cotton Cloth	7.2	0.5	0.0	0.0	0.0
Jute Goods	0.3	-7.9	33.4	0.0	0.1
Food	12.4	10.0	2.7	2.2	0.6
Sugar	3.5	29.3	-11.7	2.5	-1.2
Cigarettes	2.1	-42.5	84.9	-0.9	0.9
Vegetable Ghee	1.1	2.3	-1.8	0.0	0.0
Cooking Oil	2.2	1.1	15.6	0.0	0.5
Soft Drinks	0.9	22.2	5.9	0.5	0.2
POL	5.5	-0.3	12.3	0.0	0.7
Steel	5.4	16.6	27.5	0.6	1.0
Non-Metallic Minerals	5.4	7.1	12.1	0.8	1.3
Cement	5.3	7.2	12.2	0.8	1.3
Automobile	4.6	11.4	19.0	0.7	1.3
Jeeps and Cars	2.8	4.7	22.1	0.2	0.7
Fertiliser	4.4	1.3	-8.3	0.1	-0.5
Pharmaceutical	3.6	9.0	4.4	0.7	0.4
Paper	2.3	9.8	9.0	0.3	0.3
Electronics	2.0	18.0	45.2	0.3	0.8
Chemicals	1.7	-2.4	-0.4	-0.1	0.0
Caustic Soda	0.4	-0.6	21.1	0.0	0.1
Leather Products	0.9	-18.8	-9.1	-0.4	-0.1
Excl. Sugar	66.8	3.2	7.9		

Data source: Pakistan Bureau of Statistics

[23] This section is based on actual data up to March 2018. Therefore, number reported in this section would not tally with those presented in Table 1, which are annual estimates.

generation.[24]

Large-scale manufacturing

LSM marginally improved on a YoY basis, growing by 5.9 percent during Jul-Mar FY18, compared to 5.4 percent in the corresponding period last year (**Table 2.4**)[25]. The factors which facilitated LSM growth mainly included: (i) increased capacity utilization due to ease in energy supplies; (ii) high credit off-take owing to low interest rates; (iii) output stimulus in associated industries due to widespread construction activities; and (iv) an improved business environment on the back of CPEC related projects and favorable law and order situation.

Construction allied and consumer durable industries registered a notable growth. However, sugar industry was not able to capitalize on record sugarcane production; in stark contrast to last year, when it was the main driver of LSM growth. Barring sugar, LSM registered remarkable growth of 7.9 percent during Jul-Mar FY18 compared to 3.2 percent during the same period last year. A detailed industry-wise analysis is as follows:

Automobile

The automobile subsector grew by 19.0 percent during Jul-Mar FY18 on top of the 11.4 percent growth witnessed during the same period last year **(Table 2.4)**. A healthy performance by the passenger car and tractor segments, coupled with a rebound in production of light commercial vehicles, contributed to this improved performance (**Table 2.5**).

From the demand side, rising incomes, prevalent low interest rate environment, introduction of new variants, and the widening scope of ride hailing services in major urban areas of the country helped maintain consumers and businesses interest in the passenger car segment high, which had the highest weight in the automobile sector. In response, the industry players resorted to double shifts and continued to invest in various debottlenecking activities[26] during the period to meet the rising demand. The high demand also allowed the manufacturers to pass on impact of the PKR depreciation in the form of increased prices without an adverse impact on sales. High demand facilitated the production of the jeeps and cars to grow by 22.1 percent during Jul-Mar FY18 compared to 4.7 percent growth observed during the corresponding period of last year.

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[24] During Jul-Mar FY18, electricity generation increased by 12.9 percent compared to same period last year.

[25] The GDP estimates for FY18 compiled by National Income Accounts are based on projected LSM growth of 6.2 percent.

[26] Indus Motors' debottlenecking has added about 10,000 units annual capacity.

Table 2.5: Automobile production during Jul-Mar

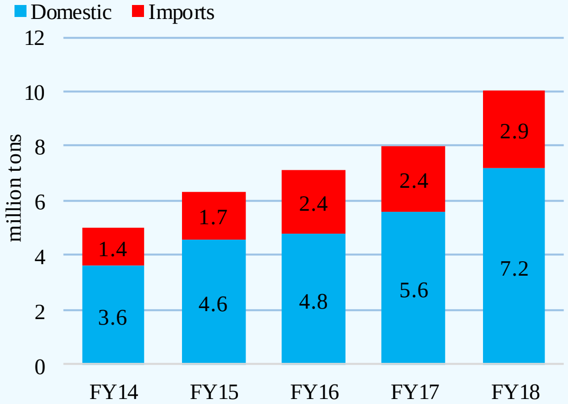
				Growth (percent)	
Units	FY16	FY17	FY18	FY17	FY18
All Cars	**137,067**	**143,317**	**166,166**	**4.6**	**15.9**
Cars <800 cc	53,130	45,390	53,705	-14.6	18.3
Cars between 800-1000 cc	19,139	26,180	38,377	36.8	46.6
Cars >1000cc	64,798	71,747	74,084	10.7	3.3
Trucks	**3,940**	**5,489**	**6,907**	**39.3**	**25.8**
Buses	**746**	**893**	**555**	**19.7**	**-37.8**
Light Commercial Vehicles	**29,529**	**18,637**	**22,605**	**-36.9**	**21.3**
Sports Utility Vehicles	**621**	**812**	**7,034**	**30.8**	**766.3**
Tractors	**21,942**	**37,938**	**52,551**	**72.9**	**38.5**
Motorbikes	**998,040**	**1,211,454**	**1,410,034**	**21.4**	**16.4**

Data source: PAMA

Improved purchasing power in the rural areas on the back of a rise in agriculture output, a rise in agri-lending, and lower sales tax led to strong demand for tractors. This, in turn, contributed to a 38.5 percent growth in tractor production on top of the 72.9 percent increase achieved during Jul-Mar FY17.

LCV sector rebounded strongly in Jul-Mar FY18, growing by 21.3 percent, after contracting 36.9 percent during corresponding period last year.-In the HCV segment, trucks continued on their upward trajectory. Truck production benefitted from pickup in trade activities, alongside various CPEC and public sector led infrastructure projects underway in the country.

Figure 2.2: Supply of Finished Steel Products (Jul-Mar)



Data source: Pakistan Bureau of Statistics, SBP

Steel

The domestic steel industry continued to benefit from a host of factors. Increase in construction activities under PSDP and CPEC, imposition of anti-dumping duty on finished steel products, housing schemes in private sector, and a surge in demand for appliances and automobile drove growth of the industry. The overall increase in steel production stood at 27.5 percent during Jul-Mar FY18 against 16.6 percent growth witnessed during the same period last year (**Figure 2.2**).

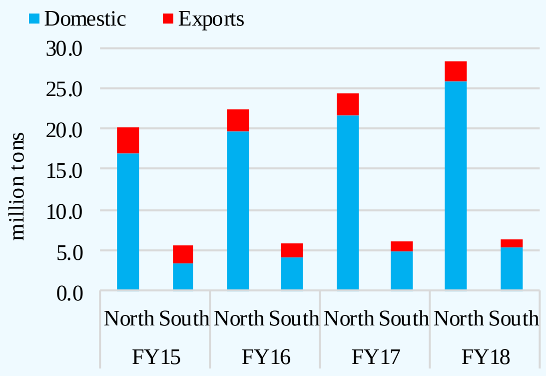
The overall demand for steel outpaced the growth in domestic supplies by a significant margin, which led to continuing reliance on imports to cover the deficit. Resultantly, the country imported 20 percent more finished steel products during the first nine months of FY18 compared to last year. Encouragingly, leading private producers have fast-tracked their expansionary plans (which are expected to come on-line in the next two to three years) to consolidate their market share.

Cement

Cement manufacturing witnessed an increase of 12.2 percent during Jul-Mar FY18 compared to 7.2 percent during the same period last year. Strong local dispatches (which rose by 17.9 percent) enabled this performance. On the other hand, cement exports continued to slide. Exports shrank by a further 8.2 percent in Jul-Mar FY18 in continuation of the contraction of 14.8 percent witnessed during same period last year. This occurred despite a significant rise recorded in shipments to Madagascar, Senegal and Afghanistan during the period (**Figure 2.3**).

Similar to steel, the growth in cement industry is also driven by CPEC related projects, public sector development spending and private housing schemes. Anticipating growing demand in the years ahead, the industry players are investing heavily in capacity expansions, mainly to consolidate their positions in a high margin market.

Figure 2.3: Cement Sales (Jul-Mar)



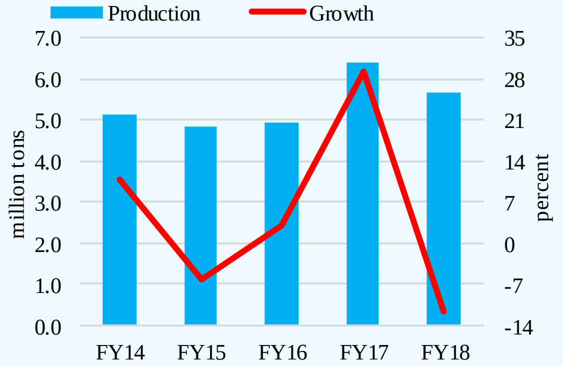
Data source: APCMA

Addition of 3 million tons production capacity so far in FY18 has affected market dynamics of the industry. Analysis of financials of major cement companies reveals that their profitability has gone down by 6 percentage points during the period under review. This is a direct consequence of increased competition and difference in pricing, particularly in the northern parts of the country. This trend is likely to continue until the dust settles on market shares in the wake of expansionary phase (**see *Special Section 1: Cement Industry: Current Dynamics and Future Prospects***).

Food

The food industry grew by 2.7 percent during Jul-Mar FY18 compared to a growth of 10.0 percent during Jul-Mar FY17. Contraction in the production of sugar offset the otherwise appreciable performance of rest of the sector. Cigarette production rebounded, while the edible oil subsector maintained its growing momentum during the period under review.

Figure 2.4: Trend in Sugar Production (Jul-Mar)



Data source: Pakistan Bureau of Statistics

Despite a record crop harvest, the production of sugar industry contracted 11.7 percent during Jul-Mar FY18, after witnessing a 29.3 percent increase during the same period last year (**Figure 2.4**). Start of the crushing period was delayed due to: (i) price disputes between the growers and the millers; and (ii) a court order in Punjab affected the operations of some manufacturers; resulted in below par performance of the industry. However, growth in sugar production gained some momentum during Q3-FY18, following indicative price adjustments in Sindh and the temporary permission by court for relocated sugar mills in Punjab to resume production. Provided that the crushing season continues during Q4-FY18, the industry can be expected to at least match, if not surpass, last year's production level.

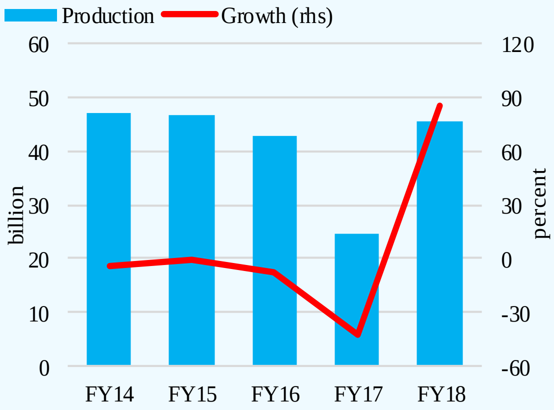
It is pertinent to point out here that domestic breakeven price remained around 30 percent higher than international price.[27] Sitting atop significant stockpile already, surplus production will further add to the sugar reserves during FY18. The federal government announced an export subsidy for sugar to the tune of Rs 10.7 per kilogram and allowed exports of 2.0 million tons of the commodity. Subsequently, the country was successful in offloading around 1 million ton by end March 2018. While this helped reduce the excess reserves, the cost of the subsidy so far has been Rs 10.8 billion during Jul-Mar FY18.

A sharp recovery was witnessed in the production of cigarettes during Jul-Mar FY18 with a growth of 84.9 percent compared to a contraction of 42.5 percent

[27] Ministry of Industries and Production calculated the breakeven price of domestic sugar at US$ 499 per ton.

during the same period last year (**Figure 2.5**). Introduction of a third tier in Federal Excise Duty (FED) and crackdown on illicit trade has proved to be beneficial for the formal cigarette industry. The rebound of formal cigarette industry shows that the government initiatives are working; however, this comes at a social cost.[28] The cigarettes in the third tier are cheaper than they were a year before.[29]

Figure 2.5: Trend in Cigarette Production (Jul-Mar)



Data source: Pakistan Bureau of Statistics

Pharmaceuticals

The pharma sector managed to register growth during Jul-Mar FY18, growing by 4.4 percent in addition to the 9.0 percent growth witnessed during the same period of last year. The government allowed increase in drugs prices in Q3-FY18 under Drugs Pricing Policy which helped boost incomes of pharmaceutical firms.

Meanwhile transformation of public healthcare systems at the federal and provincial levels led to efficient and effective health management. This is evident from the Prime Minister National Health Program and Sehat Sahulut Program in KPK. Such programs have already enrolled millions of people from the targeted lower income group.

Electronics

Improvement in energy supplies and significant demand from the consumers played important role in healthy performance of the electronics sector. It posted a 45.2 percent increase during Jul-Mar FY18 compared to 18.0 percent during the same period last year. Electric motors, electric transformers and air conditioners were the key contributing products.

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[28] The three-tier duty structure may bring in revenues but it would escalate health cost for the government in future.

[29] Financials of duopoly of Pakistan Tobacco Company and Philip Moris Pakistan showed combined revenues increased by 31 percent while cost of sales surged by only 13 percent during the first 9 months of FY18 compared to same period last year. The profitability jumped to 254 percent during the same comparison period.

While performance of electric motors improved due to enhanced data coverage of the sector, the government's increased focus on electricity distribution segment resulted in enhancing demand for transformers. Meanwhile, the early onset of summer season, improvement in energy efficiency of air conditioners, stable prices and rising incomes helped appliance producers to cash in on higher demand.

POL

The performance of POL sector, albeit impressive, was not commensurate with the substantial expansion in the industry's operational capacity during the period under review. This was mainly on the back of a month long shutdown of furnace oil based power plants (the biggest consumers of the product) in the country during Q2-FY18; the industry suffered two consecutive months of production contractions on a YoY basis. However, after the relaxation in earlier policy measures on imports and production of furnace oil, the POL sector, rebounded strongly. It posted a healthy overall growth of 12.3 percent during Jul-Mar FY18 compared to a stagnation observed during the corresponding period of last year.

Textile

Textile production remained constrained during the period under review. The sector grew by a marginal 0.4 percent – half the level achieved during the corresponding period last year. However, the industry managed to increase its exports in value terms by 10.8 percent during the first 9 months of FY18.

2.4 Services

The services sector continued on its upward momentum and achieved a growth of 6.4 percent during FY18 on top of the 6.5 percent improvement observed last year. Major thrust came from *wholesale & retail trade* and *general government services*, while *finance & insurance* and *transport, storage & communication* experienced deceleration during the period under review. Overall, the share of services in real GDP has now crossed the 60 percent mark for the first time (**Table 2.6**)

Table 2.6: Performance of the Services Sector

	Share in GDP	Growth (percent)		Contr. to Services Growth	
		FY17^R	FY18^P	FY17^R	FY18^P
Wholesale and retail trade	19	7.5	7.5	35.7	36.4
Transport, storage and communication	13	4.4	3.6	15.6	12.4
Finance and insurance	3.4	10.8	6.1	9	5.4
Housing services	6.5	4.0	4.0	7	6.9
General government services	7.9	5.9	11.4	11.6	22.3
Other private services	10.4	8	6.1	21	16.5
Services	**60.2**	**6.5**	**6.4**	100	100

Data source: Pakistan Bureau of Statistics

The *wholesale & retail trade* segment was a direct beneficiary of the improved agriculture and manufacturing performances. This, coupled with a continued rise in import quantum, led to the subsector surpassing the growth target of 7.2 percent and witnessing a 12-year high growth of 7.5 percent during FY18.

On the other hand, the slowdown in growth of *transport, storage & communication* continued for the third consecutive year, as the sector posted a growth of 3.6 percent compared to 4.4 percent during FY17. This was mainly on the back of subdued performance of *road transport* and *communication* (**Table 2.7**).

Table 2.7: Transport, Storage & Communication

	GVA (Rs billion)		Growth (percent)	
	FY17^R	**FY18^P**	**FY17^R**	**FY18^P**
Railways	1,778	4,755	-74.6	167.4
Water transport	52,415	49,387	13.4	-5.8
Air transport	99,742	110,693	3.6	11.0
Pipeline transport	1,890	1,496	-2.4	-1.4
Communication	262,467	267,734	5.6	2.0
Road transport	1,117,655	1,155,754	4.4	3.4
Storage	398,45	42,953	7.8	7.8
Total	**1,575,792**	**1,632,771**	**4.5**	**3.6**

Data source: Pakistan Bureau of Statistics

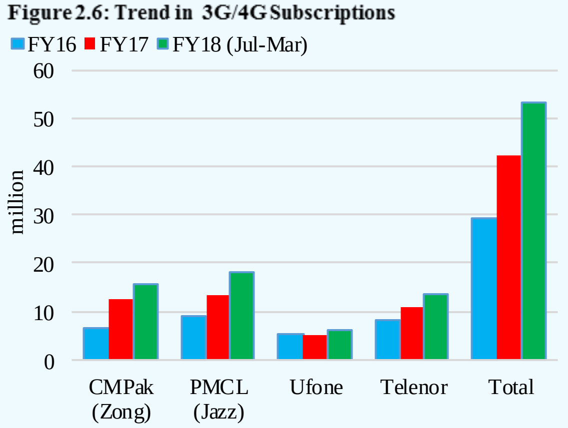
On the transport front, the deceleration in *road transport* was in sharp contrast to the increase in cargo handling activities and sales of commercial vehicles witnessed during the period under review. Encouragingly, however, both railways and air transport segment showed significant improvement on a YoY basis, with the former experiencing a turnaround by growing 167.4 percent during FY18 as against the 74.6 percent contraction last year.[30] Going ahead, the growth trend is likely to continue, with Pakistan Railways in the middle of implementing its "Revitalization Strategy" focusing on financial stability and service delivery,[31] and PIA launching a five-year strategic business plan to revamp its services model in the short-to-medium term.

The overall performance of the communications segment suffered as a result of a constrained growth in the profits of PTCL.[32] On a positive note, however, the number of broadband subscribers reached to 59.6 million, an increase of more

[30] Pakistan Railways witnessed a 26.7 percent increase in gross earnings on a YoY basis during Jul-Dec FY18, as the number of passengers carried, freight carried and freight tonnes earnings improved by 4.7 percent, 55.8 percent and 62.1 percent respectively.
[31] Ministry of Railways launched its Vision 2026 in 2014. The objective was to enhance its share in transportation sector by improving the rail infrastructure and adding new locomotives to its network – 205 wagons were to be imported from China while 595 were planned to be built at home. The first phase of the plan was completed in 2017.
[32] After accounting for the one-off expense booked by PTCL under the voluntary separation scheme introduced by the company for its employees during 2016, profit after tax effectively declined by 30.2 percent during 2017 on a YoY basis.

than 12 million in the first 9 months of the current fiscal year. Cellular network subscriptions were a major contributor in this regard (see **Figure 2.6**). As highlighted before in the SBP reports, the introduction of mobile broadband services has opened the door for digital and financial inclusion in the country. However, there is still a long way to go in terms of enabling an inclusive internet and mobile connectivity environment in the country, given that Pakistan lags behind regional economies in terms of both consumer readiness (inadequate digital literacy and skewed male/female participation ratio), and availability of relevant content (refer to **Box 2.3** for more detail).

Figure 2.6: Trend in 3G/4G Subscriptions



Data source: Pakistan Telecommunication Authority

On the *finance & insurance* side, the deceleration in growth of gross value addition of scheduled banks dragged down the subsector's growth from 10.8 percent last year to 6.1 percent during FY18 (**Table 2.8**). While low interest rates have continued to hurt the profitability margins of commercial banks, it was mainly a slower increase in deposits that affected the output of the sector.[33]

Table 2.8: Finance & Insurance

	Share in	Growth (percent)	
	FY18	FY17	FY18
Central Banking	1.9	-11.9	3.6
Other Monetary Intermediation	86.9	10.7	8.8
Scheduled Banks	82.5	9.5	7.2
Non-scheduled Banks	4.4	57.1	52.3
Other Financial Services	1.4	0.8	1.1
Insurance, reinsurance and pension fund	3.7	6.2	2.1
Activities auxiliary to financial services	6.1	24.8	-19.0
Finance and Insurance	**100.0**	**10.8**	**6.1**

Data source: Pakistan Bureau of Statistics

Box 2.3: State of Internet Inclusiveness in Pakistan

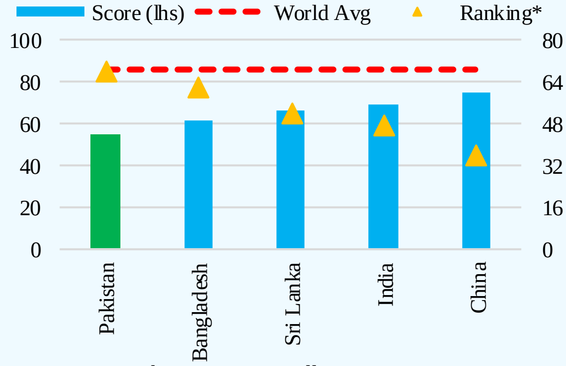
Internet penetration has been rising in Pakistan at an appreciable pace. Ever since the introduction of 3G/4G services, mobile telecom operators have led the exponential increase in broadband subscriptions in the country. This has opened the door for digitization of services provision via broadening the scale of e-commerce, facilitating the dissemination of agricultural knowledge, and enabling online access to various government-to-citizen (G2C) services, etc. However, cross-country

[33] During Jul-Mar FY18, the deposits of the banking sector grew by 4.8 percent compared to the 6.4 percent growth witnessed during the corresponding period of last year.

statistics reveal that there exists ample room of improvement in this regard, not least from the demand side.

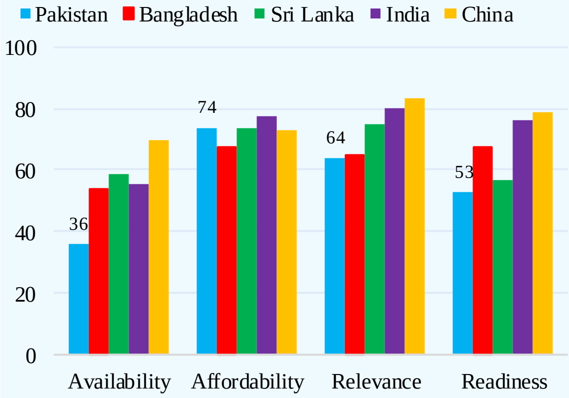
According to The Economist Intelligence Unit's Inclusive Internet Index of 2018, Pakistan ranks 68th in overall terms amongst the 86 countries surveyed, with a mean score of 54.5 relative to the South Asian average of 61 (out of 100) (**Figure 2.3.1**). Among the four dimensions considered for the ranking; namely, *availability*, *affordability*, *relevance*, and *readiness*; the country shows average to poor performance in all of them (**Figure 2.3.2**).

Figure 2.3.1 : Inclusive Internet Index Ranking



Data source: The Economist Intelligence Unit
* Ranking out of 86 countries. Importance in descending order

Figure 2.3.2: Index Score Comparison



Data source: The Economist Intelligence Unit

Under the *availability* dimension, the index compares the performance of the countries across indicators pertaining to infrastructure, electricity, usage, and quality of the internet access provided. The overall ranking of Pakistan is a lowly 77th, owing primarily to the dismal performance in the *usage* criterion. There exists a huge disparity between the number of male and female internet users in the country. In fact, Pakistan ranks lowest worldwide in the gender access parity, with a 266 percent gap in internet access rates and a 121.2 percent gap in mobile ownership in favor of men. This poses a policy challenge in light of currently underway National Financial Inclusion Strategy (NFIS).

On the *customer readiness* front, the poor literacy rate and sub-optimal level of web accessibility leads the country posting second-to-lowest score in the digital *literacy* environment indicator. However, the higher standing in the parameters pertaining to *policy* (owing to concentrated effort of the government in the form of NFIS) and *trust* (in which Pakistan ranks 15th in the world, benefitting from the existence of strong and enabling regulations and safety protocols) helped improve the country's overall dimension ranking somewhat to 68th.

On *affordability* terms,[34] the country sits in the middle of the rankings (43rd), bolstered primarily by the dominant market share of wireless internet providers and the strong level of competition between them (i.e. absence of oligarchy). Pakistan ranks joint-first in the *wireless operators* category, alongside 23 other countries.[35,36] On the consumer side, however, the performance is not at a commensurate level due to high mobile phone procurement cost and substantial pre- and post-paid tariffs.

Lastly, the *relevance* parameter measures the extent of local and relevant content available online to the public. It can be taken as an indicator of ease and usefulness of internet access in a country. Pakistan fares badly compared to regional and worldwide counterparts, with an overall ranking of 70 out of 86. While the amount of local language content is comparable to other developing countries, the absence of adequate domestically produced content (in areas of e-finance, e-health, and e-entertainment facilities) hurts the overall standing of the country. Once again, the lower level of general, and particularly digital and financial, literacy holds the country back.

In overall terms, hence, it is imperative to note that expanding the coverage by improving the digital infrastructure, though beneficial to the overall progress of the country, would not be sufficient unless there is a concurrent focus on demand side factors such as public literacy, gender parity, and specialized content generation and availability. The recently introduced Digital Pakistan Policy 2017 is a welcome development in this regard; however, concentrated and sustained efforts would be required to improve the unsatisfactory performance by Pakistan in terms of inclusive internet accessibility.

[34] The index measures affordability in terms of the cost of acquiring access to internet with respect to per capita income level of the country, and the level of competition in the internet marketplace (that helps keeps the prices down).
[35] The competitiveness parameter is calculated based on the Hirschman-Herfindahl Index.
[36] However, the absolute score was affected after Warid Telecom merged with Mobilink in mid-2016.