2 Real Sector

2.1 Overview

The economy experienced a noticeable moderation as the real GDP growth decelerated to 3.3 percent in FY19, compared to 5.5 percent growth last year.[1] This slowdown had already been anticipated on account of policy measures taken to rein in the persistent twin deficits. While the resultant weakening in economic activities was broad-based, the industrial sector, particularly manufacturing activities, bore the brunt of these measures. At the same time, the agriculture sector remained beset with water shortages and increased cost of major inputs, which constrained the production of important crops. The services sector also faced the fallout from the weak performance of commodity-producing sectors, with its growth slowing down visibly compared to last year (**Table 2.1**).

Among the commodity-producing sectors, industrial output was well subdued, registering a growth of 1.4 percent in FY19 compared to 4.9 percent a year earlier. The decline in LSM, construction, and mining and quarrying stood out in particular. The underwhelming industrial performance was primarily attributed to cuts in PSDP spending. Moreover, it reflected the impact of factors such as monetary policy tightening, exchange rate adjustments, regulatory measures, and uncertainty among certain quarters of the business community regarding the future path of economic policies, which

Table 2.1: GDP and its Components
growth in percent; contribution in percentage points

	Growth			Contribution
	$FY18^R$	$FY19^P$	$FY19^T$	
Agriculture	**3.9**	**0.8**	**3.8**	**0.2**
of which				
Important crops	3.6	-6.6	3.0	-0.3
Livestock	3.6	4.0	3.8	0.4
Industry	**4.9**	**1.4**	**7.6**	**0.3**
of which				
Mining and quarrying	7.7	-2.0	3.6	-0.1
LSM	5.1	-2.1	8.1	-0.2
Electricity gen. & dist.	-9.1	40.5	7.5	0.6
Construction	8.2	-7.6	10	-0.2
Services	**6.2**	**4.7**	**6.5**	**2.8**
of which				
Wholesale & retail trade	6.6	3.1	7.8	0.6
Transport, stor. & com.	2.1	3.3	4.9	0.4
Finance & insurance	7.0	5.1	7.5	0.2
General gov. services	11.8	8.0	7.2	0.6
GDP	**5.5**	**3.3**	**6.2**	**3.3**

R: Revised; P: Provisional; T: Target (from Annual Plan 2018-19)
Data source: Pakistan Bureau of Statistics

[1] According to provisional figures released by PBS in May 2019.

set the tone for the broader economic slowdown.[2] In contrast, electricity and gas generation and distribution was an exception, and showed an encouraging increase compared to last year.

Agriculture also had a disappointing year overall, posting a growth of 0.8 percent during FY19, compared to 3.9 percent last year. Important crops could not deliver, as cotton and sugarcane experienced sizeable declines, while wheat production was also marginally lower compared to FY18. The low crop output was mainly a result of water shortages during important times and adverse weather conditions, while higher input prices (especially those of fertilizer) also had a dampening effect. Encouragingly, however, the livestock subsector was able to maintain its growth momentum in FY19.

Table 2.2: Agriculture Sector Value-addition
share and growth in percent; contribution in percentage points

	Share	Growth			Contr. to growth
	FY19	**FY18^R**	**FY19^T**	**FY19^P**	**FY19^P**
Crop Sector	35.3	4.7	3.6	-4.4	-1.6
Imp. crops	21.9	3.6	3.0	-6.6	-1.5
Other crops	11.2	6.2	3.5	2.0	0.2
Cotton ginning	2.1	8.8	8.9	-12.7	-0.3
Livestock	60.5	3.6	3.8	4.0	2.3
Forestry	2.1	2.6	8.5	6.5	0.1
Fishing	2.1	1.6	1.8	0.8	0.0
Overall	**100**	**3.9**	**3.8**	**0.8**	**0.8**

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

The weak performance of the commodity-producing sectors spilled over into the services sector, as its growth moderated to 4.7 percent in FY19, compared to 6.2 percent last year. Given its strong linkages with the commodity-producing sector, it was hardly a surprise that growth in *wholesale and retail trade* nearly halved during the review period compared to FY18. The slowdown in *general government services* was also quite pronounced compared to last year, though the segment managed to surpass its FY19 growth target (**Table 2.1**).

2.2 Agriculture

The performance of the agriculture sector remained subdued during FY19, growing marginally by 0.8 percent; this was significantly lower than the 3.9 percent growth in FY18 and the target of 3.8 percent for the year (**Table 2.2**). It owed primarily to a considerable contraction in the crop sector, which declined by 4.4 percent compared to a growth of 4.7 percent in FY18. There was a marked decline in production of a number of major crops (**Table 2.3**). This was largely

[2] The uncertainty among the business community during the Jul-Mar FY19 period was partially linked to an anticipated IMF bailout, since the build-up to the eventual staff-level agreement in May 2019 featured protracted negotiations between the Pakistani authorities and the visiting IMF mission.

attributable to reduction in area under cultivation, mainly caused by sowing period water shortages, and hike in prices of basic inputs such as fertilizer, seeds and pesticides. Meanwhile, livestock, the dominant sub-sector within agriculture, managed to grow by 4.0 percent. Its contribution not only compensated for the loss in crop sector, but also helped the overall agriculture sector to post marginal growth.

Table 2.3: Production of Important Crops
million tons; cotton in million bales; growth in percent

	Production			Growth	
	FY18	**FY19^T^**	**FY19^P^**	**FY18^R^**	**FY19^P^**
Cotton	11.9	14.4	9.9	11.9	-17.5
Rice	7.5	7.0	7.2	8.8	-3.3
Sugarcane	83.3	70.0	67.2	10.4	-19.4
Wheat	25.1	25.6	25.2*	-6.0	0.5
Maize	5.9	6.0	6.3	-3.8	6.9

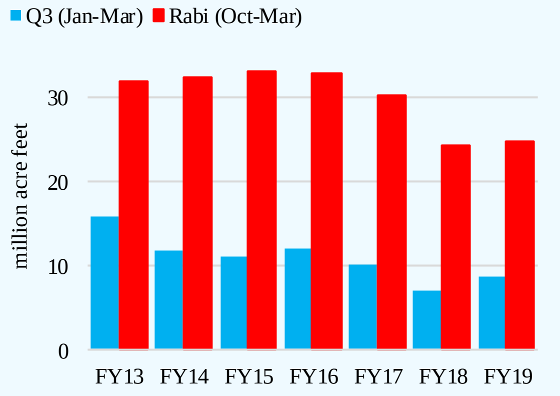
R: Revised, T: Target, P: Provisional. Targets are from the Annual Plan, except for wheat. These might vary from the FCA targets.
*Production numbers as given by NAC; however, the latest numbers by MNFSR, after accounting for rain damages, place production at 24.3 million tons.
Data source: Pakistan Bureau of Statistics

During *kharif* season in particular, there was a considerable decline in the area under cultivation, especially in Sindh where water shortages were more pronounced. The total area sown under *kharif* crops for FY19 declined by 7.2 percent over FY18. Moreover, water shortages and lower fertilizer off-take also had an adverse impact on crop yields. Thus, in overall terms, the contribution of *kharif* crops in the gross value addition (GVA) of the agriculture sector fell significantly below the FY18 level.

In *rabi* season, relatively improved water availability provided some relief. However, delayed sowing, lower fertilizer offtake and unfavorable weather conditions resulted in lower yields for wheat crop.

Inputs:
A review of the inputs situation shows that in 2018-19, both crop seasons *(kharif* and *rabi)* were characterized by stressed water flows. That said, the situation regarding water shortages faced in early *rabi* improved in Q3-FY19 as a result of adequate rainfall during the period. Consequently, irrigation water flows for *rabi* 2018-19 marginally improved by 2.3

Figure 2.1: Irrigation Water Flows



Data source: Indus River System Authority percent compared to same period last year (**Figure 2.1**).

Table 2.4: Agriculture Credit Disbursement (July-March)
billion Rupees and growth in percent

	Q3		Percent Change		Jul-Mar		Percent Change	
	FY18	**FY19**	**FY18**	**FY19**	**FY18**	**FY19**	**FY18**	**FY19**
Farm sector								
A. Production[1]	112.4	137.3	32.2	22.2	298.7	368.3	36.0	23.3
All crops	60.6	58.6	8.0	-3.3	169.7	169.2	16.7	-0.3
Corporate Farming	30.6	41.4	130.1	35.3	70.4	117.3	109.5	66.6
B. Development[2]	5.7	6.3	54.1	10.5	16.8	23.8	36.6	41.7
Tractor	1.6	1.0	33.3	-37.5	4.2	3.2	40.0	-23.8
C. Total farm sector (A+B)	118.1	143.6	33.1	21.6	315.5	392.1	36.1	24.3
Non-farm sector (Working Capital and Fixed Investment)								
Livestock/dairy	60.7	67.7	52.1	11.5	177.4	210.6	43.5	18.7
Poultry	30.1	36.8	27.0	22.3	85.2	99.5	38.8	16.8
Other	25.3	29.7	33.9	17.4	88.0	102.9	56.9	16.9
D. Total non-farm sector	116.1	134.2	40.7	15.6	350.6	412.9	45.4	17.8
Total agriculture (C+D)	234.2	277.8	36.8	18.6	666.1	805.0	40.8	20.9

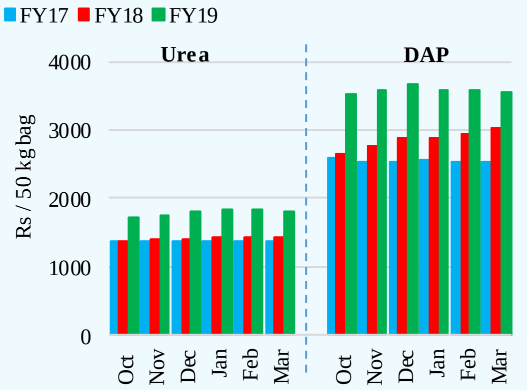
[1] Production loans are for purchase of inputs such as seeds, fertilizer, pesticides etc.
[2] Development loans are for tractors, tube wells and other agricultural machinery.
Data source: State Bank of Pakistan

However, the improvement was overshadowed by reduced fertilizer offtake, as well as relatively restrained growth in credit disbursements to crops sector, especially production loans, compared to last year. Total nutrient offtake continued to contract in Q3-FY19 as well; consequently, fertilizer offtake declined by 3.5 percent for *rabi* 2018-19 compared to *rabi* 2017-18. Product-wise breakdown shows that even though urea offtake expanded by 3.0 percent, it was offset by a significant contraction in DAP offtake of 17.0 percent. Decline in DAP offtake can be largely attributed to higher prices compared to last two *rabi* seasons, despite provision of various subsidies at the provincial and federal levels[3] (**Figure 2.2**). In keeping with the trends of weak crop sector performance and increased interest rates, loans to crop sector contracted marginally by 0.3 percent during Jul-Mar-FY19, while the disbursements for tractors declined by 23.8 percent on YoY basis.[4] Overall agriculture credit disbursements during the period, however, registered growth of 20.9 percent on top of healthy showing during the same period last year (**Table 2.4**).

[3] Feed gas is being provided at cheap rate (Rs. 185 per MMBTU), whereas price of fuel gas is Rs. 780 per MMBTU. In this way subsidy of Rs. 714 per bag is given.
[4] Largely due to hike in tractor prices and rising interest rates, tractor sales declined by 27.8 percent in *rabi* 2018-19 compared to same period last year.

Despite contraction in farm activities, there was an increase in loans for production purposes, mainly due to a broad-based rise in input prices. Unlike the preceding *rabi* season, where price hike in diesel was the only major source of input cost increases, the situation worsened in FY19, given increase in prices of all inputs, namely tractors, fertilizer, insecticides and pesticides. Hence, farmers faced liquidity constraints due to both escalated input prices and lower crop returns (**Table 2.5**). Meanwhile, within the non-farm sector, growth was derived mainly from higher working capital requirements for livestock/dairy and poultry sub-sectors. This trend is in line with the 4.0 percent growth of the livestock sector during FY19.

Figure 2.2: Average Monthly Prices



Data source: National Fertilizer Development Centre (NFDC)

Wheat:

Data from Pakistan Economic Survey shows that the wheat production rose marginally by 0.5 percent to 25.2 million tons in FY19 **(Table 2.3)** as the government revised FY18 wheat output downwards by 0.4 million tons. However, according to the latest estimates by the Ministry of National Food Security and Research (MNFSR), wheat production for FY19 had been recorded at 24.3 million tons which instead shows a contraction of 3.2 percent compared to revised production of 25.1 million tons in FY18.

Table 2.5: Agricultural Input Prices for Rabi Crop (Oct-Mar)

YoY % Change in Wholesale Price Index

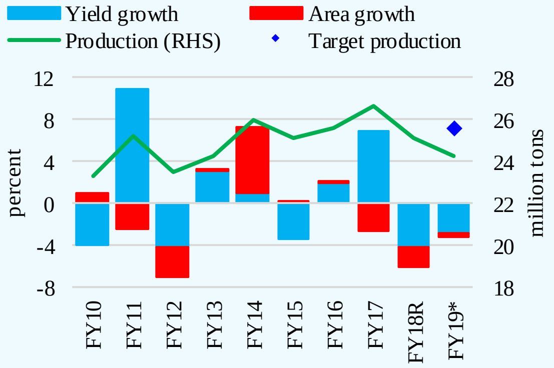
	2017-18	**2018-19**
Tractor	0.0	11.6
Fertilizer	2.7	17.8
Pesticide	0.8	2.4
Insecticide	-0.4	6.2
Cultivators	-7.1	0.0
Diesel	21.5	29.9
All Farm Inputs	***12.2***	***23.5***

Data source: Pakistan Bureau of Statistics

The discrepancy between the estimates provided by PBS and MNFSR may be attributed to the former one not accounting for production levels due to untimely rains and hailstorms at peak harvest time. The forthcoming Annual Report for FY19 could shed more light on the performance of the wheat crop as by then the datasets would have reconciled. The analysis below is based on the latest estimates provided by MNFSR.

This *rabi* season, the yield for wheat declined by 2.9 percent while the area under wheat contracted by 0.4 percent. This second consecutive seasonal decline in wheat production was mainly due to three developments: (1) delayed cane crushing led to decline in area under cultivation; (2) insufficient nutrient offtake, specifically for phosphate, resulted in lower yield; and (3) untimely and intermittent rains and hailstorm in the harvest period led to a portion of the crop being damaged, particularly in Southern Punjab (**Figure 2.3**).

Figure 2.3: Wheat Production and Growth Rates



Data source: Pakistan Bureau of Statistics. FY19* figure is post-rain estimate reported by MNFSR. Target by FCA.

Another reason for low yield is the usage of non-certified seeds in certain areas. Largely, losses in yield have been reported in districts such as Chakwal where desi varieties were planted, as opposed to new weather- and pest-resistant varieties. These varieties have inadequate resistance to weather changes. Lower adoption of certified seeds might have been caused partly by unchanged support price of Rs 1,300 per 40 kg for the season. Major losses were estimated in Punjab, specifically in southern region, where yields have declined by 4.0 percent compared to provisional numbers calculated before damage assessment.[5]

In a climate-changing scenario, adoption of certified and climate resistant seeds is crucial in mitigating losses from unpredictable and erratic seasonal patterns. Furthermore, resilience of small farmers through climate smart adoption and insurance practices is also needed. Recognizing this fact, the latest Punjab Crop Insurance Program aims to indemnify small landholders for yields losses, enhance productivity, and promote the adoption of climate smart practices such as new varieties of seeds. Under this program, *rabi* 2018-19 wheat yield losses will be compensated for farmers covered under the program (**Box 2.1).**

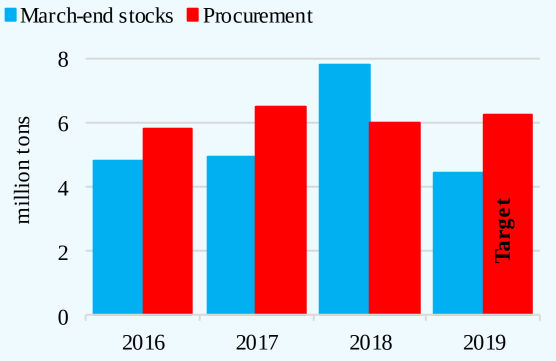
The position of wheat stocks held by provincial food authorities and PASSCO at end-March 2019 were 4.5 million tons, compared to 7.3 million tons in March

[5] Initial yield of Punjab according to FCA meeting in start of April was 2,951 kg per hectare while the latest loss adjusted yields are 2832 kg per hectare. Latest estimates were reported by MNFSR.

2018 (**Figure 2.4**). Despite lower than target wheat output, carryover stocks are still sufficient to cover the domestic consumptive requirements of 25.8 million tons.[6] Although depreciation of PKR did result in some export of wheat[7], it is hardly sufficient to reduce mounting pressures on provincial governments' wheat financing costs.

This year, the government had announced the target of 6.3 million tons for procurement, which was comparably higher than last year's target of 6.1 million tons and actual procurement of 5.9 million tons in FY18. That said, the actual procurement was still not confirmed by majority of provincial authorities as of end-March 2019. It bears mentioning that an absence of storage facilities at the farm level, and thus a reduced ability to save the crop from moisture damages, often results in sale of wheat at cheaper rates in case of non-procurement by the government.

Figure 2.4: Wheat Stocks and Procurement



Target: set as on May 15, 2019.
Data source: Ministry of National Food Security and Research

Box 2.1: Punjab Crop Insurance Program – Pilot Project Features and Lessons Learned

The Crop Insurance Program (CIP) was introduced as an essential component of the Government of Punjab's strategy to transform agriculture in the next five years in line with the goals of the World Bank's SMART[8] program to enhance productivity of crops, increase competitiveness, and improve resilience of smallholder farmers to climate change and natural disasters. Two rounds of pilot projects were launched, first in *kharif* 2018 for cotton and rice, and second in *rabi* 2018-19 for wheat. Due to lower than expected cotton crop yields, payout to cotton farmers in Sahiwal district was also made in the *kharif* 2018 season. The pilot projects have helped to identify several issues. While the improvements in input adoption and yield enhancement will take time to unfold, this Box highlights the key features of the program and the lessons learned.

Current situation

The existing federal level Crop Loan Insurance Scheme (CLIS), in place since 2008, is a catastrophe

6 This is based on the 120 kg per person per annum requirement. Source: MNFSR

7 Jul-Mar exports for FY19 were 0.56 million tons, compared to 0.31 million tons for same period in FY18.

8 The crop insurance program was to be developed and rolled out under the World Bank financed US $300 Million project for "Strengthening Markets for Agriculture and Rural Transformation in Punjab" Program-for-Results (SMART Punjab PforR) from 2018 to 2022.

loss of yield program that is only triggered when the authorities declare calamity in a certain area and yield loss is above 50 percent. The scheme then pays out the lending institution the crop loan amount owed by farmers who default, hence it does not directly benefit the small land holder for yield loss.

Key goals and features of CIP

- Indemnify small land holders of Punjab with less than 5 acres for the loss in yield due to pest attacks and/or natural disasters
- Improve crop yields and production by linking crop insurance with credit lines; farmers will be incentivized to invest in high yielding seeds and fertilizer.
- Increase adoption of climate smart technology by subsidizing premiums and incentivizing uptake in the first 5 years. As highlighted in SBP's Second Quarterly Report for FY19, the risks of climate change for Pakistan are significant in terms of loss of yield.

Table 2.1.1: Uptake Details till March 2019

	Farmers	Area Insured (Acres)
Kharif 2018 (4 districts)	**16,750**	**42,779**
Cotton	12,357	31,874
Rice	4,393	10,905
Rabi 2018-19 (9 districts)	**41,375**	**97,773**
Wheat	41,375	97,773
Total	**58,125**	**140,552**

Data source: Program Implementation Unit- Crop Insurance Program Punjab

The program uses the Area-Yield-Index-Insurance (AYII) model for the crop insurance that compensates farmers for yield loss beyond the insured yield in a certain geographical area termed as Unit Area of insurance, (UAI) such as tehsil, or markaz. Hence, an individual farmer-level loss is based on an average area yield, rather than individual farm historical level.

Based on the historical yields, insured yields are set and compared with current yields; the loss of yield is paid by the insurance company. For example, in the district Chichawatni, the cotton historical yield was 726.3 kg per acre (which is essentially the AYII), and the coverage was 80 percent; thus, 581 kg per acre was the insured yield. Since the current yield was 485 kg per acre for the tehsil of Chichawatni, the loss ratio was 16.4 percent. In rupee terms, the insured amount for cotton was set at Rs 50,000 per acre. Hence the insurance company paid 16.4 percent, equivalent to Rs. 8,171 per acre to all farmers insured in the Chichawatni tehsil.

Pilot projects of *kharif* and *rabi* FY19

Starting from April 2018, up till March 2019, a total of 58,125 farmers with holdings over an area of 140,552 acres were insured. The crops covered were cotton, rice and wheat (**Table 2.1.1**). The initial pilot project was rolled out in 4 districts in *kharif* 2018 and expanded to 9 in *rabi* 2018-19.

- The target group comprised of the borrowers of Punjab Kissan E-Credit and federal CLIS, insured from plantation to time of harvest.
- The coverage was ground up (0-80 percent of expected yield) for E-credit borrowers and top-up (50-80 percent of expected yield) for CLIS borrowers. The initial bundling of the scheme with E-credit allows for the insurance companies to manage scale and risks, and save on marketing and other costs. The coverage was mandatory for all borrowers of E-credit and optional for CLIS.
- Sum insured is based on the CLIS crop indicative limits set by SBP which is the value of the crop. E-credit borrowers were insured for Rs.50,000 per acre for *kharif* and Rs.30,000 for wheat while CLIS were only insured Rs. 20,000 per acre. Premium subsidies were provided to farmers of E-credit at 100 percent for farmers with less than 5 acres of land, while above 5 acres farmers

were given a 50 percent subsidy. Majority of the farmers were E-credit borrowers with very limited CLIS borrowers. (**Table 2.1.2**).

Table 2.1.2: Premium Details

	Premium Amount (PKR/acre)			Subsidy (percent)	Premium Share by Farmers (PKR/acre)		
	Cotton	**Rice**	**Wheat**		**Cotton**	**Rice**	**Wheat**
E-Credit Borrowers							
0-5 acres	1,250	750	570	100	0	0	0
5.01-12.5 acres	1,250	750	444	50	625	375	222
CLIS Borrowers							
0-25 acres	600	200	444	50	300	100	222

Data source: Program Implementation Unit- Crop Insurance Program Punjab

Results and Cost of the program

For *kharif* 2018-19, decline in yield of cotton crop, triggered insurance in Sahiwal districts. The per farmer payout was Rs 8,171 per acre; with 1,986 famers paid out and an affected area of 5,193 acres, the total claim was Rs 32.9 million (**Table 2.1.3**). Claims for wheat 2018-19 crop are still to be calculated since the process of measurement of crop losses is still underway.

Table 2.1.3: Cotton Claim Payout for Sahiwal (Chichawatni)

No. of farmers	Area Effected	Insurance Index	Current Index	Yield Decline	Per farmer payout	Cost of production of cotton crop	Actual Calculated Claim
	Acres	**Kg/acre**	**Kg/acre**	**percent**	**PKR/acre**	**PKR/acre**	**Million PKR**
1,986	5,193	581	487	16.3	8,171	59,666	32.9

Data source: Program Implementation Unit- Crop Insurance Program Punjab

Lessons learned

- Development of the insurance market over time would be one of the key outcomes of this program.
- It was observed that the uptake was still lower than the initial target given the low level of farmer awareness and understanding of the purpose of the program.
- The uptake was larger for 0-5 acres where premium subsidy was 100 percent with very few farmers paying out the premium.
- The effect on yield and adoption of climate smart technology will unfold once the farmers realize the purpose of the insurance scheme and benefits it entails.
- The policy can support major crops without distorting the market through support prices.
- Farmers were paid out by insurance companies without much delay. This is expected to increase farmers' trust in the system and hence future rounds, with enhancement of awareness programs, are expected to improve yields through adoption of climate smart technology, high yielding seed varieties, and fertilizer uptake.
- Insurance for farmers is necessary to protect them against calamities and yield losses should be implemented in other provinces as well.

References:

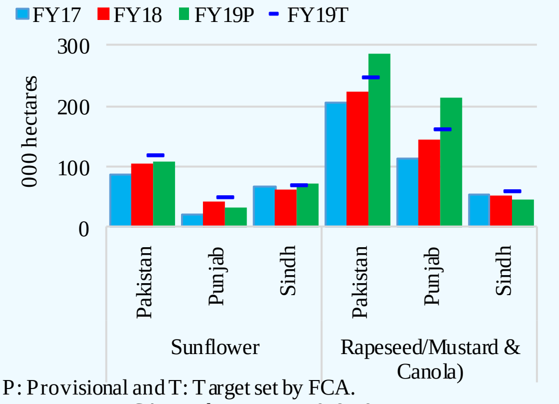
Mirza Waseem. 2019. Pilot Project Report- *Kharif* 2018. Crop Insurance Program Punjab

Stutley, Charles; Kalavakonda, Vijayasekar; Jansen, Johannes Georges Pius. 2018. *A Feasibility Study: Assessing the Potential for Large-Scale Agricultural Crop and Livestock Insurance in Punjab Province, Pakistan.* Washington, D.C.: World Bank Group.

Minor crops:

For the oilseeds crops, growth of 20.5 percent in total area was estimated, which is expected to lead to higher production. Rapeseed/mustard and canola cultivation remained higher than target as per provisional estimates, while the sunflower crop could not achieve its target (**Figure 2.5**). Two observations are noteworthy. First, a shift in area from sunflower to canola and rapeseed/mustard in Punjab occurred despite a promise of subsidy on sunflower at the time of sowing.[9] This happened because the subsidy scheme for sunflower was characterized by operational delays and shortages of seeds. Second, area under sunflower in Sindh improved, while simultaneously area under canola and rapeseed/mustard declined. Lack of clarity regarding the scheme in Punjab resulted in transfer of seed sales by private seed companies at lower rates to farmers in Sindh, since the sowing season in the latter begins earlier than in Punjab.

Figure 2.5: Area under Oilseeds Cultivation



P: Provisional and T: Target set by FCA.
Data source: FCA Working Paper 2019-20.

2.3 Industry[10]

As the impact of macroeconomic stabilization measures intensified, the performance of the industrial sector slowed to 1.4 percent during FY19.[11] The impact of macroeconomic stabilization policies coupled with regulatory measures was most evident in construction and manufacturing activities.

On one hand, fiscal consolidation measures resulted in reduced public sector development spending, while CPEC related expenditure also witnessed marked deceleration during FY19. On the other hand, regulatory measures such as increase in regulatory duties, ban on non-filers to purchase new car and property[12], and shifting from furnace oil based electricity generation had a spillover impact on construction-allied activities, pharmaceuticals, automobiles, and POL production.

[9] The subsidy scheme only available in Punjab offers a buyback assurance of Rs 3,000 per 40 kg and a disbursement of Rs 4,000 on verification of planting of crop at time of harvesting.
[10] This section is based on actual data up to March 2019. Therefore, numbers reported in this section may not tally with those presented in Table 2.1, which are annual estimates.
[11] During the previous five years, the industrial sector had grown by 5 percent on average.
[12] The ban was ultimately reversed.

At the same time, tight monetary policy increased financial costs, and exchange rate depreciation also impaired activities of certain industrial segments. Bank credit to the private sector, especially working capital loans, surged substantially due to increase in inventories and prices of raw material, further escalating costs, while loans for fixed investment witnessed deceleration during FY19.

Table 2.6: YoY Growth in LSM (Jul-Mar)

growth in percent; contribution in percentage points

	Weight	YoY Growth		Contribution to Growth	
		FY18	FY19	FY18	FY19
LSM	70.3	6.3	-2.9	-	-
Textile	20.9	0.6	-0.3	0.2	-0.1
Cotton Yarn	13.0	0.1	0.0	0.0	0.0
Cotton Cloth	7.2	0.0	0.1	0.0	0.0
Jute Goods	0.3	33.4	-14.1	0.1	0.0
Food	12.4	-0.3	-4.7	-0.1	-1.0
Sugar	3.5	-11.7	-13.3	-1.2	-1.1
Cigarettes	2.1	84.9	7.2	0.9	0.1
Vegetable Ghee	1.1	7.4	0.8	0.1	0.0
Cooking Oil	2.2	2.9	0.5	0.1	0.0
Soft Drinks	0.9	-7.6	-4.2	-0.2	-0.1
POL	5.5	12.3	-6.0	0.7	-0.4
Steel	5.4	27.5	-11.0	1.0	-0.5
Non-Metallic Minerals	5.4	12.3	-5.0	1.3	-0.6
Cement	5.3	12.4	-5.4	1.3	-0.6
Automobile	4.6	18.9	-7.6	1.3	-0.6
Jeeps and Cars	2.8	22.1	-0.1	0.7	0.0
Fertilizer	4.4	-8.3	4.5	-0.5	0.2
Pharmaceutical	3.6	4.2	-8.4	0.4	-0.7
Paper	2.3	9.0	-3.9	0.3	-0.1
Electronics	2.0	106.6	23.7	1.8	0.8
Chemicals	1.7	0.5	-3.9	0.0	-0.1
Caustic Soda	0.4	21.1	-4.7	0.1	0.0
Leather Products	0.9	-8.2	1.0	-0.1	0.0

Data source: Pakistan Bureau of Statistics

Despite these adverse developments during the year, some sectors managed to register healthy performances; for instance, small scale and household manufacturing and the *electricity generation and distribution and gas distribution*. Growth in the latter sub-sector touched historical highs as relatively efficient CPEC-related (RLNG and coal-based) energy projects replaced inefficient furnace oil-based plants, coupled with an upward adjustment in energy prices.

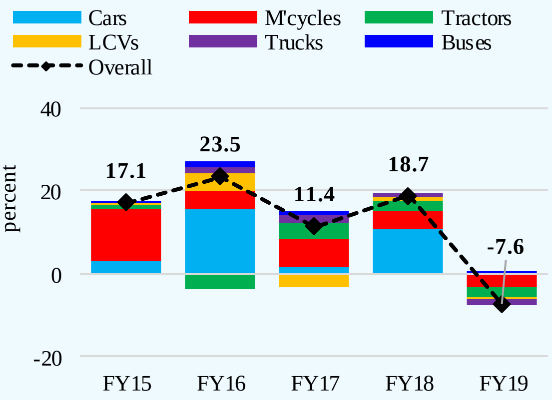
LSM

Large-scale manufacturing activities witnessed a broad based contraction (11 out of 15 major industries). Barring fertilizer sector, all the leading sectors posted decreases over the previous corresponding period **(Table 2.6)**.

Automobile

The downslide in automobile sector became more noticeable during Q3-FY19 compared to the previous two quarters. Resultantly, the sector contracted by 7.6 percent during Jul-Mar FY19 compared to an impressive growth of 18.9 percent during the same period last year (**Figure 2.6**).

Figure 2.6: Automobile Sector Growth (Jul-Mar)



Data source: Pakistan Bureau of Statistics

Policy measures like regulatory restrictions prohibiting non-filers from purchase of vehicles,[13] and increase in interest rates dented the demand in the automobile segment to some extent.[14] Furthermore, significant depreciation of PKR increased the cost of production, resulting in escalated prices and dampening the demand further. The severity of dip in economic activities, especially agriculture incomes, was more evident in tractors and motorcycles (mainly rural demand) and commercial vehicles that showed double-digit contraction in growth (**Table 2.7**).

Table 2.7: Automobile Sector Production (Jul-Mar)

	Absolute values				Percent growth	
	FY16	FY17	FY18	FY19	FY18	FY19
All Cars	111,830	127,893	148,899	156,038	16	5
Cars <800 cc	27,893	29,966	36,438	30,649	22	(16)
Cars 800-1000 cc	19,139	26,180	38,377	45,627	47	19
Cars >1000cc	64,798	71,747	74,084	79,762	3	8
SUVs	621	812	9,841	5,745	1,112	(42)
LCVs	29,529	18,637	22,605	19,098	21	(16)
Trucks	3,940	5,489	6,907	5,027	26	(27)
Buses	746	893	555	649	(38)	17
Tractors	21,942	37,938	52,551	37,457	39	(29)
Motorbikes	982,174	1,211,454	1,425,453	1,342,185	18	(6)

Data Source: Pakistan Automotive Manufacturers Association

The car segment managed to grow by 5 percent during Jul-Mar FY19, benefiting largely from earlier bookings which partially diluted the impact of regulatory restrictions (especially on non-filers). The delivery times were 6-9 months for certain popular variants until June 2018, before the enforcement of regulatory measure requiring buyers to be active tax filers. The impact of earlier bookings

[13] The ban remained intact from July 2018 to March 2019.
[14] Bank lending for auto financing declined from Rs 13.9 billion in Q3-FY18 to Rs 5.9 billion during Q3-FY19.

lasted till December 2018. Subsequently, the production of cars contracted by 12 percent in Q3-FY19, compared to a growth of 4.6 percent in H1-FY19. Besides, the stringent imported used-car policy also helped in diverting consumers towards domestically produced cars, evident from reduced influx of imported used cars during FY19.

Construction Allied Industries

Construction sector witnessed a sharp contraction of 7.6 percent in FY19 from 8.2 percent growth during FY18. Other than the aforementioned macroeconomic factors, sector-specific issues like restriction on purchase of immovable property worth more than four million by non-filers and court proceedings against a leading property developer dampened demand in the property market.

Another major factor was the decline in margins of the real estate developers. With prices of imported raw materials rising, the cost of construction increased substantially. The increase in financing costs further escalated the cost of production. Also, restrictive regulatory measures created uncertainty in the real estate markets. However, the increase in costs was not commensurate with increase in prices of housing units. As margins weakened, more projects became unviable for developers due to the prevailing market dynamics.

Cement

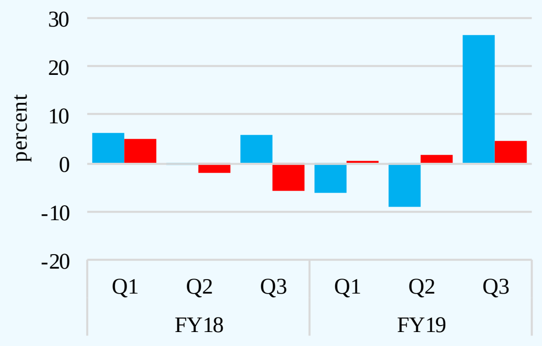
Cement production recorded contraction of 5.4 percent during Jul-Mar FY19, compared to double-digit growth of 12.4 percent in the same period last year; this was the first decline in last eight years during Jul-Mar period. The decline may have been greater had it not been for cement exports, which partially offset the weakness in domestic demand.

The cement sector has been going through a major expansionary phase in recent years, mirroring the increase in economic activity in the country. Public sector development spending, complemented by CPEC outlays on infrastructure, provided a boost to the cement industry. However, this type of support may not be as forthcoming during the ongoing phase of macroeconomic stabilization.

Steel

Steel industry witnessed a double-digit decline of 11.0 percent during Jul-Mar FY19 compared to remarkable increase of 27.5 percent during the same period last year. In addition to policy related impact, the exchange rate depreciation played a detrimental role in the sector's outcome as price of imported raw material (i.e. scrap and coal) soared. Upward adjustment in electricity prices further dented domestic steel producers' margins. On the international market front, US-China trade tensions kept steel prices suppressed in the global market, which put the importers in the driving seat (**Figure 2.7**). Consequently, the earlier imposed anti-dumping duties on imports became ineffective, adding to the already challenging business environment for the domestic steel producers.

Figure 2.7: Growth in Quarterly Average Prices



Data source: Pakistan Bureau of Statistics

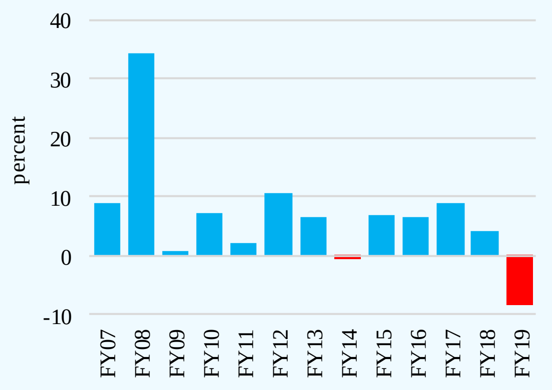
POL

The petroleum industry registered a decline of 6.0 percent during Jul-Mar FY19 against the growth of 12.3 percent in the previous period. The industry's output suffered from: (a) the policy move to shift away from furnace oil and towards RLNG for electricity generation, which hampered the demand for furnace oil (one of the major products of the local refineries); (b) increase in prices of petroleum products due to exchange rate depreciation; and (c) overall slowdown in economic activities, which also affected demand. Government's move to shift from expensive electricity generation to efficient and environment friendly electricity generation like RLNG, hydel, solar, wind based generation is a step in the right direction.

Pharmaceutical

The pharmaceutical industry witnessed its worst period in well over a decade as its production contracted by 8.4 percent during Jul-Mar FY19 against 4.2 percent growth in same period last year (**Figure 2.8**). One of the major explanations was the price adjustment mechanism in the country. During the course of the year, the pharmaceutical firms and regulatory authority, DRAP, were at odds about the

Figure 2.8: Pharmaceutical Sector Growth (Jul-Mar)



Data source: Pakistan Bureau of Statistics price-setting mechanism. This situation led to an increased dependence on imported pharmaceutical products. Resultantly, imports of medicinal products rose by 9.7 and 7.3 percent in quantum and value terms respectively.

Another possible reason of this decline in pharmaceutical production was the shifting of some production units from Sindh to Punjab, which created temporary disruption.

Food

The food processing industry during Jul-Mar FY19 was pulled down by sub-par performance of the sugar sector, which accounts for more than one-fourth of the total food industry. Prospects of the sugar industry were uncertain from the start of the year since the raw material was scarce; sugarcane cultivation posted 17.9 percent decrease over last year. Lack of implementation of indicative sugarcane prices and water scarcity in certain parts of the country mainly resulted in lower sugarcane cultivation this year.

Table 2.8: Distortions in the Sugar Industry vis-à-vis Inefficient Pricing Mechanism

	million tons				Indicative Cane (Rs./40Kg)	Prices (Rs./Kg)		
	Cane harvested	Sugar Prod. (I)	Sugar Cons. (II)	Surplus (I -II)		Domestic Sugar (III)	Global Sugar (IV)	Differential (III-IV)
FY15	62.8	5.1	4.6	0.5	180	57	48	10
FY16	65.5	5.1	4.8	0.3	180	63	41	21
FY17	75.5	7.0	5.1	1.9	180	65	39	26
FY18	83.3	6.6	5.3	1.3	180	55	34	21
FY19	67.7	6.5[E]	5.3	1.2	180	57	33	24
Min.	62.8	5.1	4.6	0.3	180	55	33	10
Max.	81.1	7.0	5.3	1.9	180	65	48	26
Range	18.3	1.9	0.7	1.6	0	11	14	16

Data source: Pakistan Bureau of Statistics, USDA, Estimate (USDA)

For several years now, the government's intervention in the sugarcane market has been broadly ineffective. It could neither provide price security to growers at times of bumper crops, nor ensure smooth supply of sugarcane to the millers. The government has kept the price of commodity at the same level in the past few years, while the production has remained erratic and prices have not reflected the scarcity (or oversupply) of the product in the market (**Table 2.8)**.

This inefficient sugarcane pricing mechanism has repercussions for the external sector as well. High price of domestic sugar relative to global benchmarks means that the country can export surplus sugar only with export subsidy. With ample capacity to produce exportable surplus, the government needs to reconsider its pricing mechanism such that it reflects the true cost of resource usage, incentivizes market agents to make decisions in the wake of prevailing market dynamics and enhances the possibility of exporting sugar without any subsidy.

Meanwhile, the cigarette sector's growth was recorded at 7.2 percent during Jul-Mar FY19. The government's prudent policy of three tier duty structure[15] and crackdown on illicit production continues to propel the sector towards formal market mechanism.

Textile

During FY19, cotton production declined by 17.5 percent, compared to last year. This prevented the textile sector from taking full advantage of the recent bouts of exchange rate depreciation, as exports barely grew from last year's level. Despite all concessions and incentive packages, the performance of the textile sector remained anemic.[16]

Higher production costs, especially the high cost of electricity, imported machinery and labor cost, amid depressed prices in the international market, have eaten into the margins of the industry. As profitability has waned over time, so has the investors' interest. Leading domestic textile firms continued to shift their attention to the domestic markets, where the margins have tended to be higher compared to exports. As a result, the exportable surplus has waned. Therefore, the economy kept on missing out on a significant chunk of foreign exchange earnings that the textile sector could potentially have generated.

Fertilizers

The performance of fertilizer industry depends on availability of concessionary gas to fertilizer plants. In current fiscal year, some small urea plants managed to resume operations that helped the industry to post a growth of 4.5 percent during Jul-Mar FY19 whereas in preceding year production had shrunk by 8.3 percent. Government had earlier provided relief to the small urea producers by providing mix of domestic and imported RLNG at subsidized rates.[17] The government extended the subsidy up till October 2019 to ensure availability of urea at affordable rates.[18]

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[15] Last year, duty structure on cigarettes was revised by FBR in which duty on lower tier cigarettes was reduced to merely Rs 800 per thousand cigarettes (Source: SRO 407(I)/2017)

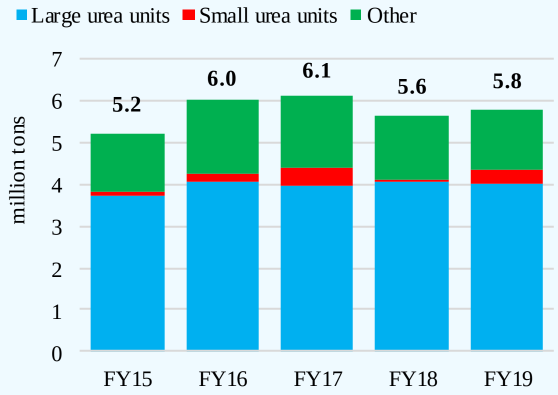
[16] Prime Minister's Export Package and multiple incentives in form of taxes and interest rate relaxations relative to other industries.

[17] Ministry of Finance Press Release No. 9 (September 3, 2018)

[18] Ministry of Finance Press Release No. 88 (February 19, 2019)

Despite this relief offered by the government, the fertilizer industry was unable to recover to the production level of FY17. The industry managed to recover only 2.4 percent during Jul-Mar FY19 in terms of urea production, compared to 8.3 percent decline in same period last year. Some recovery in production owed largely to the resumption of activities at the smaller fertilizer units. Meanwhile, the production of larger firms, that contribute almost 90 percent of total urea output, declined by 1.3 percent; last year, these firms had witnessed growth of 2.1 percent **(Figure 2.9)**.[19]

Figure 2.9: Fertilizer Production by Type of Unit



Data source: National Fertilizer Development Centre

Prices of fertilizers rose sharply during Jul-Mar FY19 period on YoY basis; specifically, prices of urea increased by 27.0 percent and DAP 16.6 percent. This reflects the increase in cost of production plus price adjustment after exchange rate depreciation. Increase in prices of fertilizers provided reprieve for the manufacturers by keeping their margins intact. While imported DAP price is mainly reflective of international benchmarks, urea is still highly discounted compared to the international market.

Table 2.9: Performance of the Services Sector

growth and share in percent, contribution in percentage points

	Share in GDP FY19	Growth		Contribution to Services in FY19
		FY18^R	FY19^P	
Wholesale and retail trade	18.9	6.6	3.1	1.0
Trans, storage & comm.	12.9	2.2	3.3	0.7
Finance and insurance	3.5	7.0	5.1	0.3
Housing services	6.6	4.0	4.0	0.4
General government services	8.4	11.8	8.0	1.1
Other private services	11.0	8.1	7.0	1.2
Services	**61.2**	**6.2**	**4.7**	**4.7**

Data source: Pakistan Bureau of Statistics

2.4 Services

The services sector grew by 4.7 percent during FY19.[20] This represented a slowdown compared to last year, and was

[19] Reason being constrained domestic gas supply to large producers.

[20] The dominance of the services sector within the economy (relative to industry and agriculture) continued to grow; its share in GDP rose from 60.4 percent in FY18 to 61.2 percent during FY19. If left unchecked, the evolving dynamics of domestic consumption relative to production may further exacerbate the gap between demand and supply.

also much lower than the annual target of 6.5 percent (**Table 2.9**).

Growth in the *wholesale and retail trade* segment more than halved during FY19 compared to last year. On one hand, the lackluster performance of the commodity-producing sectors dragged the output of the subsector to some extent. On the other hand, despite a net contraction in LSM and crops, the increase in *wholesale and retail trade* still reflects higher price impact of imports, due to exchange rate depreciation, despite the decline in their growth in FY19.

Transport, storage and communication performed better during FY19 compared to a year earlier (**Table 2.10**). Growth in road transport, one of the heavyweight segments, nearly doubled compared to last year. Also noteworthy was the continuing improvement in the railways segment. According to official sources, Pakistan Railways generated higher earnings during Jul-Mar FY19 compared to a year earlier, having introduced 24 new trains as well as a trains tracking system which helped improve fuel efficiency.[21] On the other hand, growth in the air transport segment remained at 3.4 percent, similar to last year. The Q3-FY19 period appeared to offer some respite to PIA, as the national flag carrier claimed to have reached operational break-even during the period.[22] Elsewhere, in the telecom sector, cellular teledensity continued to rise, from 72.8 percent as of June 2018 to 75.9 percent by end-March 2019; similarly, broadband penetration increased from 28.3 percent as of June 2018 to 32.6 percent as of March 2019.[23] The Q3-FY19 period was an eventful one for PTCL, with profits for the three-month period nearly doubling

Table 2.10: Transport, Storage & Communication

	GVA		Growth	
	FY18^R	**FY19^P**	**FY18^R**	**FY19^P**
Railways	7,068	9,820	338.1	38.9
Water transport	62,998	60,676	20.5	-3.7
Air transport	101,671	105,108	3.4	3.4
Pipeline transport	1,970	1,941	4.1	-1.5
Communication	250,286	255,305	-4.1	2.0
Road transport	1,140,789	1,184,667	2.0	3.9
Storage	42,552	43,797	6.7	2.9
Total	**1,607,333**	**1,661,314**	**2.2**	**3.4**

Data source: Pakistan Bureau of Statistics

[21] For details, see the Associated Press of Pakistan news report titled 'Railways earns Rs 39 billion till March 2019', dated 5 May 2019.
[22] According to anecdotal evidence, contributing factors included an improvement in the seat occupancy per flight, the return of four planes previously grounded for repair and maintenance to the operational fleet, employee cutbacks, lower ticket reservation cost, better cargo load factor, and more flights on profit-making routes.
[23] Data sources: PTA Annual Report 2018 for June 2018 figures; PTA website for March 2019 figures. Broadband penetration is the ratio between the number of subscribers and total population, multiplied by 100 to represent broadband penetration per 100 inhabitants.

compared to a year earlier.[24]

Finance and insurance also witnessed a slowdown compared to last year (**Table 2.11)**. Lower growth in gross value addition by scheduled banks, which have the greatest share in the segment, set the tone for the moderation in the face of subdued growth of deposits while their investments declined. Meanwhile, performance of the equity market remained dismal. Since the portfolio of insurance companies and mutual funds is largely dominated by investments in equity market, that also adversely effected the segment's performance.

From a long-term perspective, it is worth highlighting that gaps in logistics performance may have prevented the services sector from realizing its full potential over the years. This especially applies to segments like *wholesale and retail trade* and *transport, storage and communication*, which have the largest weight within services. More broadly, better logistics can also enhance the output of commodity-producing sectors, and thus impact real GDP growth as a whole. Thus, being mindful of and addressing the gaps in logistics performance merits high priority (**Box 2.2**).

Table 2.11: Finance & Insurance
Percent

	Share in FY19	Growth	
		FY18	**FY19**
Central Banking	1.7	15.6	-12.5
Other Monetary Intermediation	87.0	8.8	6.2
Scheduled Banks	82.1	7.5	5.3
Non-scheduled Banks	4.9	46.1	24.6
Other Financial Services	1.1	-3.7	-8.2
Insurance, reinsurance and pension fund	5.0	26.3	12.8
Activities auxiliary to financial services	5.2	-21.7	-7.3
Finance and Insurance	**100.0**	**7.0**	**5.1**

Data source: Pakistan Bureau of Statistics

Box 2.2: Logistics Performance Index Identifies Room for Improvement

Efficient logistics lie at the heart of competitiveness, both at the firm and country level. They enable firms to connect with domestic and international markets, and affect a country's prospects of integration within global value chains. Logistics impact trade, job creation, and economic development (Hofman, 2017).

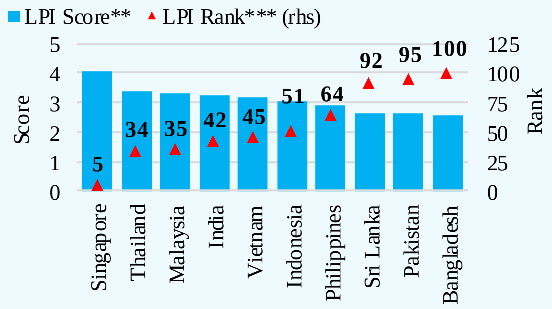
Given its importance, there is a need to track logistics performance and take corrective action as needed. To this end, the World Bank's Logistics Performance Index (LPI) serves as a benchmarking tool that scores and ranks logistics performance. The index can be further decomposed into 6 distinct components, namely:

1. *International shipments*: The ease of arranging competitively priced international shipments
2. *Logistics competence*: The competence and quality of logistics services.

[24] PTCL's profit for the three months ended 31 March 2019 (after provision for income tax) was approximately Rs 2.0 billion, compared to Rs 1.0 billion during the comparable period a year earlier. Data source: PTCL 1st Quarter Report 2019 (Unaudited).

3. *Infrastructure*: The quality of trade- and transport-related infrastructure (example, ports, roads, railroads, information technology)
4. *Customs*: The efficiency of customs and border management clearance.
5. *Timeliness*: The frequency with which shipments reach consignees within the scheduled or expected delivery time.
6. *Tracking and tracing*: The ability to track and trace consignments

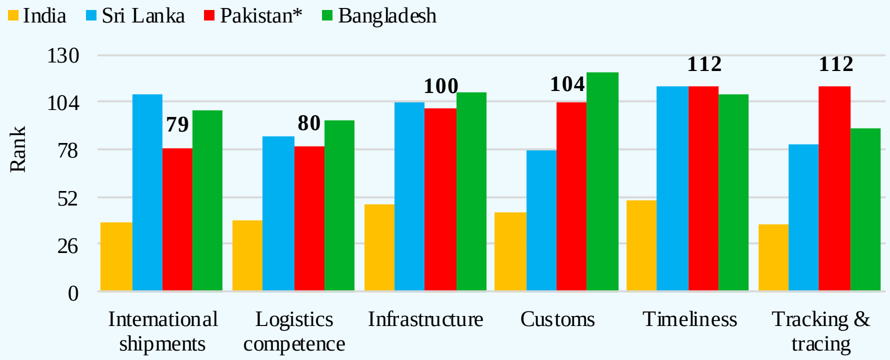
Figure 2.2.1: Aggregated LPI for Selected Countries*



* Amongst 167 countries in all, for the period 2012-2018
** Lower score indicates worse performance. Range: 1 to 5.
*** Higher ranking indicates worse performance. Ranks are labelled within the figure.
Data source: World Bank

Furthermore, the Aggregated LPI 2012-2018 provides a composite, weighted score and ranking based on four surveys, which minimizes random variations across individual surveys and facilitates comparison across 167 countries.[25]

Figure 2.2.2: Ranking Across Six Aggregated LPI Components for Selected South Asian Countries



* Only the bars representing Pakistan's ranking are labelled within the figure, for ease of reference
Data source: World Bank

Pakistan ranks 95th among 167 countries on the Aggregated LPI, trailing behind a number of its Asian counterparts (**Figure 2.2.1**). Moreover, decomposing the index into its six components reveals that the weaknesses are broad-based (**Figure 2.2.2**). In four out of six components, Pakistan's ranking ranges from 100th to 112th; in fact, the country ranks rock-bottom on the 'Tracking and tracing' component compared to selected South Asian countries.

Going forward, Pakistan's performance on the *infrastructure* component of the LPI may improve, particularly in the wake of CPEC-related development of roads, railways, and the Gwadar port. In addition, CPEC is also expected to give a boost to the prospects of the shipping industry, and

[25] The four LPI surveys in question were conducted in 2012, 2014, 2016 and 2018 respectively.

forward-thinking investors are reportedly keen to explore such opportunities.[26]

That said, a more concerted policy focus is required to tackle the shortcomings reflected in other LPI components. These can be viewed as a subset of the ease of doing business, and may thus be added to the agenda items that the country is looking to address in order to attract more FDI and boost exports.

References:

Hofman, B. (2017). Performance and Prospects of Global Logistics, Keynote speech at the CaiNiao Global Smart Logistics Conference.

[26] For instance, a Singapore-based company has expressed interest in making a US$ 2 billion investment in Pakistan's shipping sector, according to newspaper reports published in Q3-FY19.