

5 External Sector

Pakistan's external account position continued to improve during Jul-Mar FY21. The cumulative current account remained in surplus, notwithstanding a modest deficit in Q3. The surge in remittances was sustained and contributed significantly to the improvement in the current account, with further support coming from deferred interest payments on external debt, the curtailment in international air travel, and lower international oil prices. These factors were sufficient to offset a widening in the merchandise trade deficit. Import payments rose as the revival in industrial activities and positive business sentiments increased the industrial demand for imported raw materials and capital goods. In addition, temporary supply-side bottlenecks in key agricultural commodities also necessitated sizable one-off imports of these consumer-oriented items, at elevated international prices. While multiple exporting sectors experienced healthy production activity, overall export receipts were marginally higher than last year's levels based on data reported to the SBP. On the financing side, sufficient inflows were available to allow for debt retirements without impacting reserve buffers. After a Covid-induced pause, the IMF program also resumed in late March, with the successful completion of the 2nd-5th combined reviews. In line with these developments, the SBP's liquid FX reserves rose by US\$ 1.4 billion during Jul-Mar FY21 to a three-year high of US\$ 13.5 billion, the central bank's net forward liabilities reduced by US\$ 1.5 billion, and the PKR appreciated by 10 percent against the US Dollar during the period.

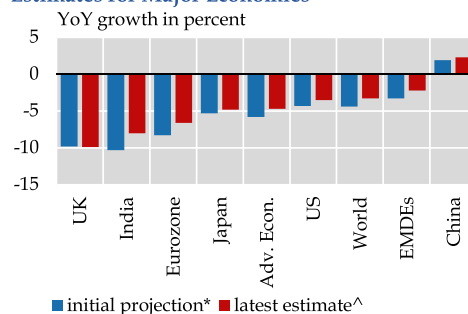
5.1 External Sector Developments

With a year having passed since the outbreak of Covid, the global economy appears poised for a relatively rapid – albeit uneven – rebound from the lows touched in Apr-Jun 2020. The real GDP contraction for the major advanced and developing economies in 2020 was less severe than expected, partly due to somewhat resilient, but still constrained, consumer spending (**Figure 5.1**). Meanwhile, the pace of Covid vaccination has also picked up since the start of 2021, especially in advanced economies. Financial markets have largely remained upbeat and conducive for this recovery process. Capital flows to EMs have remained strong as investors continue to look for higher yielding assets, though more recently, expectations of an eventual policy normalization in the advanced economies have begun to take hold amid the emergence of inflationary concerns.

The impact of these global developments, especially the accommodative policy

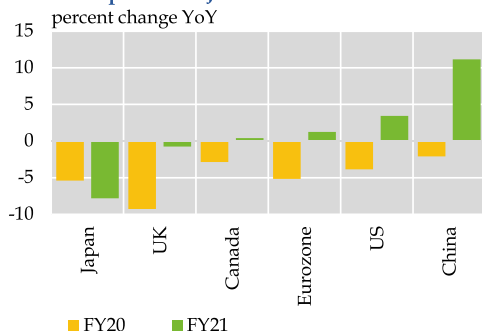
response to Covid, is playing out across both the trade and capital flow channels for EMs, including Pakistan. For instance, imports by the world's largest importers, including the US, China and Eurozone members, are higher than last year, and have helped prop up the export performance of EMs (**Figure 5.2**). Among the exporting EMs, countries that are more integrated in the global electronics supply chain, such as China, Taiwan and Vietnam, have recorded more

Updates to 2020 Real GDP Estimates for Major Economies **Figure 5.1**



*Apr-2020, ^May-2021

Source: IMF WEO (Oct 2020 & Apr 2021)

Trend in Import Growth Across Major Global Importers in Jul-Mar Figure 5.2

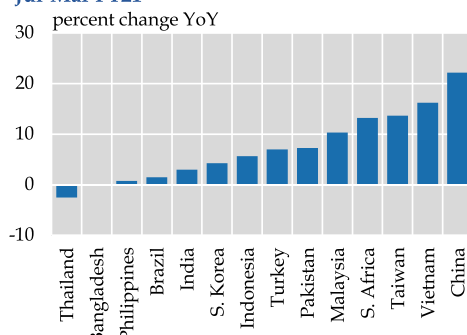
Sources: OECD/Haver Analytics

noticeable export gains (Figure 5.3), given the sizable increase in global demand for electronic gadgets and equipment after the Covid outbreak. The trade interlinkages within EMs have also played a major role in pushing up their exports and contributed to higher current account receipts.

In Pakistan's case, while exports have also grown, the significant improvement in the current account has primarily come from workers' remittances, which reached a record high of US\$ 21.5 billion during Jul-Mar FY21 (Table 5.1). Inflows from all the major corridors have maintained their rising trajectory, with multiple pull and push factors, including the incentives announced by the government and the SBP to channelize more flows via formal channels, playing key roles. Meanwhile, the ongoing air travel restrictions due to Covid continued to have a positive impact on the country's balance of payments as, in addition to helping divert remittances to formal channels, they were also the dominant reason for the nearly halving of the services trade deficit during the nine-month period.

Growth in EM's Exports in Jul-Mar FY21

Figure 5.3

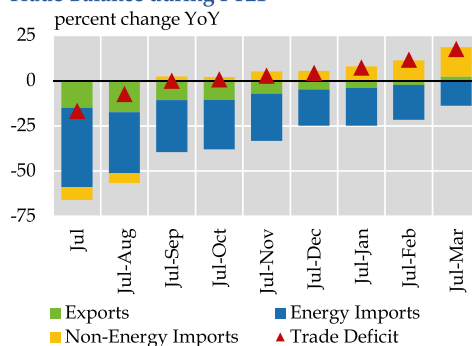


Sources: Haver Analytics & Pakistan Bureau of Statistics

On the other hand, Pakistan's merchandise trade deficit widened during Jul-Mar FY21. Monthly trade figures show that the trade gap had started to widen from September 2020 onwards, amid a strong and sustained pick-up in non-energy import payments soon after the lifting of lockdowns in early FY21 (Figure 5.4). Payments were also pushed up by the higher non-energy commodity prices and the country's need to address the domestic supply gaps across multiple key agricultural commodities by pursuing imports. On the export side, while certain sectors, notably high valued added (HVA) textiles, have seen strong growth in volumes,

Cumulative Growth in Goods Trade Balance during FY21

Figure 5.4



Source: State Bank of Pakistan

Pakistan's Balance of Payments

Table 5.1

million US\$

	Q3			Jul-Mar		
	FY20	FY21	Abs. Change	FY20	FY21	Abs. Change
Current account balance	-700	-274	426	-4,147	973	5,120
Merchandise trade balance	-4,949	-7,256	-2,307	-15,855	-18,642	-2,787
Exports	5873	6,883	1,010	18,281	18,698	417
Imports	10,822	14,139	3,317	34,136	37,340	3,204
o/w Energy imports	2,379	2,388	9	7,744	6,671	-1,074
Non-energy imports	8443	11,751	3,308	26,392	30,669	4,277
Services balance	-791	-419	372	-2,861	-1,361	1,498
Primary income balance	-1,072	-921	151	-4,135	-3,594	541
o/w interest payments	830	581	-249	2,557	1,871	-686
Workers' remittances	5,637	7,265	1,628	17,008	21,468	4,460
Financial account balance	-209	-1,057	-848	-7,354	-1,366	-5,988
Direct investment inflow	778	516	-262	2151	1396	-755
Portfolio investment inflow	-243	168	411	227	-267	-494
Build-up in fin. assets abroad	95	-277	-372	282	1,296	1,014
FX loans inflow (net)	-244	115	359	5,092	1,615	-3,477
o/w General government	-304	702	1006	4,055	3,744	-311
SBP	0	-534	-534	-498	-1465	-967
Banks	133	69	-63	-158	-551	-393
SBP's liquid reserves (end-period)*	10,845	13,493	78*	10,845	13,493	1,361*
SBP's forward liabilities (end-period)*	-3,860	-4,285	325*	-3,860	-4,285	1,164*
PKR app(+)/dep(-) in percent*	-7.1	4.6	-	-4.0	10.0	-

*Change in reserves, forward liabilities and mark-to-market PKR exchange rate during the period. Positive sign with change in the SBP's forward liabilities indicates a reduction (improvement) in the liabilities. Note: Negative sign with financial account balance means net FX inflow into Pakistan and vice versa. Negative sign for change in financial account balance means lower net FX inflow into Pakistan on YoY basis.

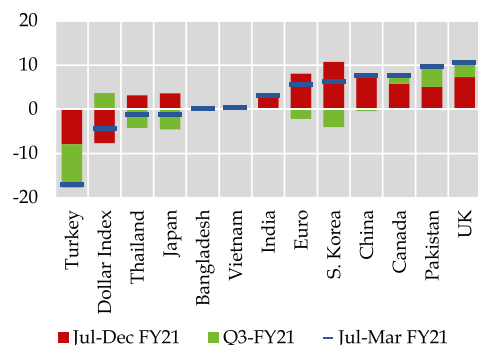
Source: State Bank of Pakistan

overall export receipts have registered a moderate growth during Jul-Mar FY21, as per data reported to the SBP.¹ A strong growth in export volumes (mostly of some major textile items) could not translate into higher export earnings, partially reflecting the impact of temporary Covid-related relaxations allowed to exporters to hold back receipts abroad for a longer period.

On the external financing side, overall financial inflows were lower on net basis during Jul-Mar FY21, reflecting: (i) weak foreign investment; (ii) lower undertaking of

new official debt; and (iii) higher official debt and liability retirements. The availability of higher current account receipts allowed the space to lower fresh (gross) official borrowings, without impacting the official reserves position. In terms of availability, official inflows were received from commercial, bilateral and multilateral sources; however, the share of commercial borrowings in the official borrowing mix increased during the period (Section 5.3). The resumption of the IMF program in Q3 also unlocked US\$ 500 million in direct financing.

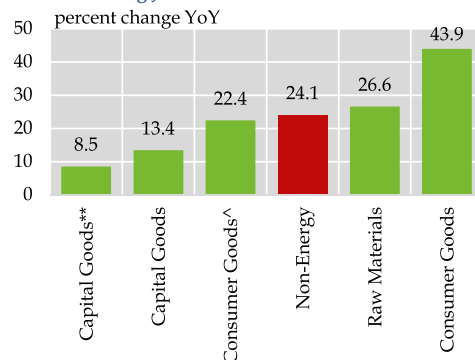
¹ According to export receipts data reported by banks to the SBP, overall export receipts rose by 2.3 percent YoY during Jul-Mar FY21. According to data reported by Customs authorities to the PBS, exports have risen by 7.1 percent in the same period (see Section 5.5: Trade Account). For details, see definitional differences provided in the Data Annexures enclosed with this report.

Nominal Exchange Rates against US Dollar **Figure 5.5**

Sources: Bloomberg, Haver Analytics

Amid these dynamics, the SBP's FX reserves rose by a cumulative US\$ 1.4 billion during Jul-Mar FY21, and the PKR appreciated 10 percent against the US Dollar during the period. The PKR's appreciation continued throughout the year, including in Q3, when the Dollar had begun to strengthen against other EM currencies (**Figure 5.5**). The PKR's relative strength in Q3 generally reflected some indigenous factors, including the successful conclusion of the IMF program reviews and the sustained growth in remittance inflows (**Section 5.4**).

While the overall external account remains stable, some emerging patterns will need to be monitored. First, the recent import profile suggests that shortfall in the domestic availability of agricultural commodities (**Figure 5.6**) – including food (wheat and sugar, but also vegetables) as well as non-food items (cotton) – are eating into the

Breakdown of Import Growth in Pakistan during Jul-Mar FY21* **Figure 5.6**

*As per PBS classifications. Excluding energy imports (HS-27) from all categories. **w/o cell phones; ^w/o wheat and sugar

Sources: Pakistan Bureau of Statistics

valuable FX earnings currently available, especially from workers' remittances.² While the imports of wheat and sugar, at least, may arguably be temporary amid expectations of better output in the coming months (**Chapter 2**), the ongoing surge in international commodity prices necessitates proactive supply management and planning to ward off import payment pressures (**Chapter 1**).

Second, while the country's gross external financing requirements are currently lower due to an overall current account surplus, the reliance on commercial and bilateral inflows to make retirements to these same sources, as observed this year, may require some active liability management. In the presence of currently modest FDI inflows, it is necessary to continue the engagement with multilateral partners and global capital investors and pursue needed reforms.

² As per the PBS' classification and data, the top contributors to the rise in consumer goods imports during Jul-Mar FY21 were wheat, sugar, dried peas, black tea, and garlic. Medicinal vaccines are also classified by the PBS under consumer goods (under HS Code 300220 at the HS-6 level), and their import values rose 31.7 percent YoY to US\$ 223.7 million during Jul-Mar FY21.

In this regard, the ongoing diversification of the country's FX earnings, especially after the introduction of Roshan Digital Accounts (RDAs) for overseas Pakistanis in September 2020, holds promise. The ongoing expansion in the scope of the RDAs, to provide further avenues to non-resident Pakistanis to pursue investments and support their families, would play a major role in channeling additional foreign exchange inflows into the country.

5.2 Current Account

The current account turned into a surplus of US\$ 973 million during Jul-Mar FY21, from a deficit of US\$ 4.1 billion in the same period last year. The surplus was accumulated over the first five months of the year, whereas modest deficits were recorded in the subsequent four months. The cumulative surplus over the period mainly originated from a sustained increase in workers' remittances, along with contractions in both the primary income and services deficits, in the wake of a drop in interest payments on external debt and lower international air travel, respectively. The net FX receipts from these sources were sufficient to offset a 17.6 percent widening in the merchandise trade deficit during the nine-month period.

Surge in workers' remittances continues

Workers' remittances to Pakistan grew by a substantial 26.2 percent and reached a historic high of US\$ 21.5 billion during Jul-Mar FY21. Inflows have been rising consistently since the start of the year, and the increase has been recorded from all major as well as relatively minor corridors (Table

Corridor-wise Remittances to Pakistan during Jul-Mar **Table 5.2**
million US\$

	FY20	FY21	Change
US	1,246.5	1,901.8	655.3
UK	1,793.2	2,900.5	1,107.3
GCC	11,259.1	12,716.6	1,457.4
KSA	4,775.7	5,731.8	956.1
UAE	4,219.1	4,526.3	307.2
Other GCC	2,264.3	2,458.5	194.1
Belgium	47.2	176.9	129.7
France	180.0	303.3	123.3
Italy	275.4	428.9	153.5
Australia	229.8	440.2	210.4
Canada	208.6	394.4	185.8
Others	1,769.0	2,205.2	436.2
Total	17,008.7	21,467.8	4,459.1

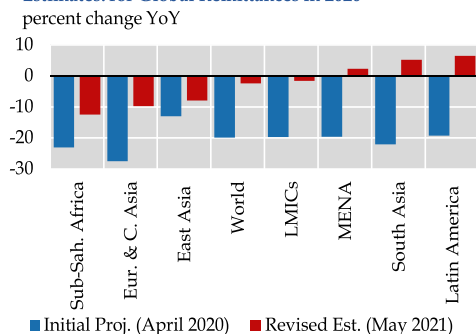
Source: State Bank of Pakistan

5.2). Moreover, inflows from virtually all the major corridors (except the US) are also at their all-time record levels.

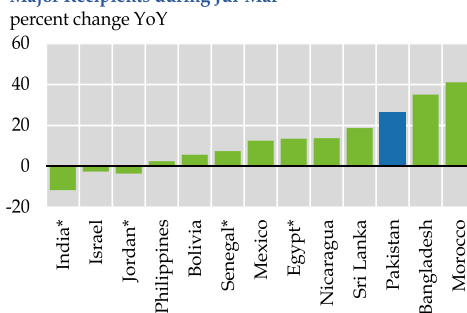
With over a year already passed since the Covid outbreak, remittances to Pakistan – along with those to some other major recipients – have been remarkably resilient, whereas those to some other countries have predictably dropped. Based on World Bank data released in May 2021, a clear diverging trend is visible in remittance flows to different regions: South Asia and Latin America have seen inflows surge in 2020, whereas Europe, Central Asia and sub-Saharan Africa have recorded declines (Figure 5.7a). These diverging growth trends across different regions, against the initial expectation of an across-the-board decline, resulted in a modest 1.6 percent YoY drop in global remittances in 2020, according to latest World Bank estimates.³

The higher remittances to South Asia were mainly driven towards Pakistan, Bangladesh and Sri Lanka, whereas inflows to India have

³ Source: World Bank (2021). *COVID-19 Crisis through a Migration Lens*. Migration and Development Brief 34. Washington, DC: World Bank.

Initial Projection & Revised Growth Estimates, for Global Remittances in 2020**Figure 5.7a**

Source: World Bank (April 2020 & May 2021)

Post-Outbreak Remittance Growth in Major Recipients during Jul-Mar**Figure 5.7b**

*During Jul-Dec (latest available data)

Sources: Haver Analytics, State Bank of Pakistan

been under pressure (Figure 5.7b). Similarly, the higher inflows to Latin America mainly went to Mexico and Brazil, whereas remittances to other countries in the region remained relatively weaker. On the other hand, the fall in remittances to Europe and Central Asia mostly originated from Russia, where the dual crises of Covid and the oil price decline severely impacted economic activities and dented migrants' ability to remit funds.

There are multiple factors at play that have driven this seemingly disparate trend in remittances to these regions. Some of these factors are clearly common across the major recipient economies, irrespective of the region. A common pull factor has been the pandemic itself. The lockdowns and the resultant loss of employment and business, along with an increase in expenditures on healthcare and other emergencies in the recipient economies, have increased families' reliance on support from relatives living abroad – factors that have also been

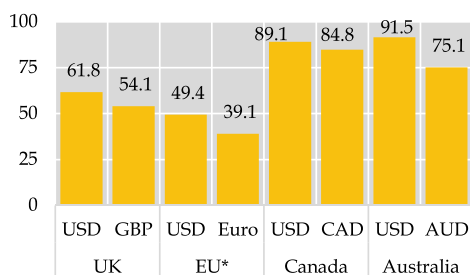
recognized by the World Bank in its latest Migration and Development Brief (May 2021).

Other pull factors are more relevant to a select group of countries. For instance, in South Asia, both Pakistan and Bangladesh have increased the incentives for migrants as well as remittance payment processors, including banks and money transfer operators (MTOs). These incentives have encouraged the banks and MTOs to increase their outreach efforts to migrants, especially via digital avenues, whereas they have also facilitated migrants to shift to formal channels for funds transfer.⁴ In Bangladesh's case, another pull factor was the heavy floods of July 2020, which further encouraged its migrants to remit higher amounts to support the recovery process.

In terms of push factors, a common one seems to be the sizable policy support in the advanced economies, especially the US and

⁴ For more details on these incentives announced after the Covid outbreak, see Chapter 5 in the SBP's State of Pakistan's Economy Report for Q1-FY21.

Remittance Growth to Pakistan in USD & Remitting Currency Terms in Jul-Mar FY21 **Figure 5.8**



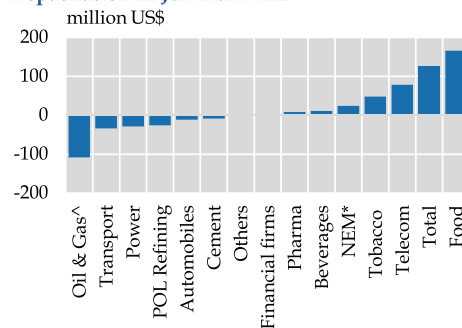
*9 top Eurozone corridors

Sources : SBP, Haver Analytics & SBP calculations

the UK, which are major destinations for international migrants. This support, including via direct cash transfers, unemployment benefits, rent and utility payment deferrals, etc, has been an important source of extra income and savings for migrants, and allowed them to remit these funds back home. It is also important to note that this policy support in the advanced economies has not only helped first generation (i.e. foreign born) workers, but also the extended family networks that have been settled abroad for longer periods.

Among other factors, cross-currency movements against the US Dollar have also played an important role in driving up remittances in USD terms. In this regard, the substantial 61.8 percent growth in remittances to Pakistan from the UK during Jul-Mar FY21 stands out, given that the British Pound (GBP) has appreciated by over 10 percent against the USD during the

YoY Change in Profit & Dividend Repatriation in Jul-Mar FY21 **Figure 5.9**



[^]oil & gas exploration.*non-electrical machinery

Sources: State Bank of Pakistan

period. An appreciation in the remitter's currency (the GBP, for remittances sent from the UK) will translate into a higher amount of remittances when converted into USD, even if the migrant would send the same amount in their currency. Similar appreciation trends in currencies of other major sending countries, including the Eurozone members, Canada and Australia, have also pushed up the volume of remittances from these corridors in USD terms. After adjusting for currency movements, the growth rates in remittances from some major advanced economies would have moderated slightly, though they would still be at fairly elevated levels (**Figure 5.8**).⁵ For the 12 countries in the graph, the exchange rate impact (i.e. an appreciation of their currencies against the USD) has led to an additional 14.9 percent (US\$ 318.4 million) cumulative increase in inflows from these corridors in USD terms to Pakistan.

⁵ The growth in remitting currency terms in Figure 5.8 is calculated by converting the monthly remittances received in US Dollar terms from these economies into the remitting currency (to GBP for inflows from the UK, for instance) at the average monthly exchange rate (GBP/USD), then aggregating the monthly data for the Jul-Mar periods of both FY20 and FY21, and lastly calculating the YoY growth.

Primary income deficit curtailed by lower interest payments

The primary income deficit contracted 13.1 percent to US\$ 3.6 billion during Jul-Mar FY21. The improvement stemmed almost entirely from a sizable 26.8 percent reduction in interest payments on external debt, which fell to US\$ 1.9 billion during the period. The reduction mainly reflected the temporary relaxations availed by Pakistan from the G-20's Debt Service Suspension Initiative (DSSI), under which a wide range of mainly multilateral creditors has deferred principal and interest payments on external debt (Chapter 4). Initially, debt and interest payments falling due until December 2020 were deferred under the DSSI; the initiative has been extended multiple times since then, and now covers payments that are falling due until end-December 2021.⁶ Furthermore, the sizable reduction in global interest rate benchmarks after the Covid outbreak has helped curtail the repayments on floating rate debt.⁷ For instance, the six-month LIBOR rate had fallen from 0.37 percent at end-June 2020 to 0.21 percent by end-March 2021.⁸

Meanwhile, profit and dividend repatriations by foreign investors (both direct and portfolio) rose 12.5 percent to US\$ 1.1 billion during Jul-Mar FY21. The repatriations were most visible across sectors where foreign investors' footprint is higher, and where profitability has also surged over the past year, such as FMCGs, telecom and tobacco

(Figure 5.9). However, lower repatriations from the energy sector, including both the upstream (exploration) and downstream (refining and retail sales) segments, mainly due to the lower global oil prices, helped contain the increase in overall repatriations during the period.

Lower international travel helped shrink services deficit

The services trade deficit shrank 52.4 percent to US\$ 1.4 billion during Jul-Mar FY21. Nearly all the improvement came from the import side, as payments fell by a sharp 20.4 percent during the period; export receipts, on the other hand, were stagnant at around last year's levels.

As detailed in the SBP's State of the Economy Report for Q2-FY21, the fall in services import payments is mainly driven by imports under two categories, which are both linked with international air travel and have been deeply impacted by the Covid pandemic (Table 5.3). The sizable reduction in payments for air transport services imports, which basically represent the purchase of air tickets of foreign airlines by Pakistani residents, is the primary factor behind the improvement in the overall services account. Closely related is the import of air travel services, which includes hard FX cash purchases by Pakistani residents for international travel purposes.

⁶ Source: World Bank Brief, dated May 28, 2021, available at:

www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative

⁷ Major sources of floating rate external debt outstanding for Pakistan include multilaterals (including the Paris Club), commercial banks, development banks, and bilateral partners. (Source: Pakistan Economic Survey 2019-20). Most of these loans are either entirely based on floating rate, or have a fixed component and a floating component. In contrast, the Eurobonds and Sukuk are contracted at fixed rates.

⁸ Source: ICE Benchmark Administration.

**Breakdown of Services Balance
during Jul-Mar***
million US\$

Table 5.3

	FY20	FY21	Change [^]
Transport	-1,894	-1,575	319
Air passengers	-447	83	530
Freight	-1,399	-1,516	-117
Travel	-699	-221	478
ICT Services	762	1,111	349
Exports	1,053	1,512	459
Imports	291	401	110
Others	-1,030	-678	351
Services Balance (net)	-2,861	-1,363	1,497

*Negative balance means deficit and a positive sign means surplus. [^]Positive sign shows YoY improvement & vice versa

Source: State Bank of Pakistan

In contrast, freight import payments underwent a trend reversal and rose 8.4 percent during the nine-month period, with the entire increase coming due to a surge of 37.9 percent YoY in Q3.

On the services export front, the information and communications technology (ICT) sector recorded a healthy 43.6 percent growth in receipts, which reached US\$ 1.5 billion during Jul-Mar FY21. The country's IT services firms continue to make deeper inroads into the global market, utilizing the explosive growth in demand amid the pandemic for a wide range of IT services. However, the encouraging ICT exports were almost completely offset by a weakening in receipts from other services sectors, including the local shipping and airlines industries.

5.3 Financial Account

The net financial flows into the country dropped to US\$ 1.4 billion during Jul-Mar FY21 – a fraction of the US\$ 7.4 billion inflows received in the same period last year. This sizable reduction was in response to a few major developments. First, the net FX payment pressures in the economy were relatively muted, as the overall current account remained in surplus during the nine-month period. On one hand, this surplus reduced the country's external financing requirements, and allowed the government to lower its gross borrowings without compromising the official reserves position. On the other hand, the surplus was reflected in a build-up in foreign assets abroad of Pakistani banks and other entities, which lowered the net financial flows recorded in the balance of payments data.⁹

The second major development was the higher debt and liability repayments by the government and the central bank, which lowered the inflow of loans on net basis. Third, foreign investment inflows were lower than last year, as foreign direct investment (FDI) dropped on YoY basis, while a net outflow was recorded from foreign portfolio investment (FPI). And last, the resumption of the IMF program from Q3-FY21 onwards unlocked around US\$ 500 million in direct EFF financing during the quarter, and also facilitated the country's foray into the global capital markets by end-March 2021.¹⁰

⁹ The current account surplus partially contributed to a US\$ 1.3 billion build-up in foreign assets held abroad by Pakistani banks and other entities during Jul-Mar FY21, which is treated as an FX outflow from Pakistan in the balance of payments data.

¹⁰ While Pakistan had issued Eurobonds on March 31, 2021, the actual proceeds from the issuance arrived during early April 2021, and were therefore not reflected in the end-March reserves position.

**Sector-wise Net FDI during
Jul-Mar**
million US\$

Table 5.4

	FY20	FY21	Change
Food	20.4	14.2	-6.3
Textiles	31.3	13.3	-18.0
Chemicals	-1.2	16.6	17.8
Oil & gas exploration	218.3	158.3	-59.9
Oil refineries	3.5	-38.1	-41.7
Information tech.	25.6	50.2	24.6
Electrical machinery	143.4	104.9	-38.4
Automobiles	55.5	19.7	-35.8
Power	742.4	737.8	-4.6
Telecom	464.8	-62.6	-527.4
Financial firms	210.5	192.1	-18.4
Others	235.8	188.6	-47.2
Total	2,150.3	1,395.0	-755.2

Source: State Bank of Pakistan

Foreign direct investment

Net FDI to Pakistan dropped 35.1 percent to US\$ 1.4 billion during Jul-Mar FY21; investment fell throughout the three quarters on YoY basis. Similar to last year, the power sector continued to dominate the FDI inflows, accounting for 52.9 percent of the total direct investment that arrived in the country during the period. Nearly half (46.7 percent) of this investment arrived from China, which remained the single-largest source of FDI for Pakistan.

Global direct investment has been constrained ever since the outbreak of Covid, with flows declining quite sharply in 2020 to levels that were even lower than the troughs witnessed during the last global financial crisis of 2008-09.¹¹ Advanced economies experienced the sharpest declines, though FDI flows to developing economies were also

weaker than the previous year. China and India, however, were major exceptions to this trend, as FDI to both these economies rose; firms in the high-tech and ICT industries witnessed higher inflows amid mergers and acquisitions (M&A), whereas Chinese pharmaceutical firms also received fresh FDI inflows from abroad.

Nonetheless, the overall weak global trends were also partially responsible for the tepid FDI flows to Pakistan so far in FY21. At the same time, some indigenous factors were also at play. First, there was a lack of triggers that could have stimulated fresh investment into sectors that have been receiving higher FDI over the past few years, such as telecom and power. In case of telecom sector, cellular service firms had borrowed from their foreign parent companies last year to deposit their license renewal fees with the government. These firms did not need to make large licensing payments this year, and did not need receive any significant fresh investment from abroad for other business or operating activities (**Table 5.4**). In fact, some of the firms repaid their intracompany loans this year, which slightly increased the gross FDI outflows from telecom sector this year.

In case of the power sector also, FDI was nearly unchanged at last year's level of US\$ 0.7 billion. Some CPEC-related power generation and distribution projects, which had received significant FDI last year, received relatively lower investments this year as the projects neared completion, whereas FDI outflows were also recorded from some power projects.

¹¹ Global FDI inflows were projected to have dropped 42 percent in 2020 to an estimated US\$ 859 billion. For comparison, worldwide FDI in 2008 had amounted to US\$ 1.5 trillion (down 21.2 percent YoY) and to US\$ 1.2 trillion in 2009 (down 17 percent), before recovering. (Source: World Investment Trends Monitor Report, January 2021, United Nations Conference for Trade and Development)

Furthermore, some industry-specific developments, such as the volatile oil prices and corporate consolidation at the global level, triggered some portfolio rebalancing by investors. In Pakistan's case, this led to a marked slowdown in fresh investments into the oil and gas exploration sector; at the same time, FDI outflows were recorded from the downstream (refining and retail) oil sector.

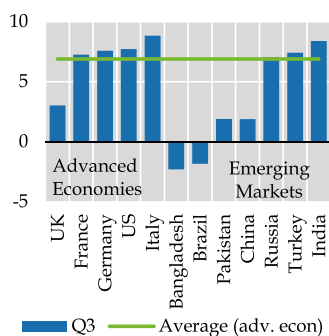
In this context, it is important for the country to attract foreign investment in the more vibrant sectors of the economy. From the policy and regulatory perspective, the focus has been on providing a facilitative environment. In this regard, some recent measures include the ease in FX regulations for services firms (especially ICT firms), whereas sector-specific policies for the cell phone manufacturing and electric vehicle industries have the potential to attract investors with potentially long-term investment horizons. Meanwhile, any progress on the second phase of CPEC, with its focus on setting up special economic zones and attracting foreign firms to relocate their production to Pakistan, could also drive FDI flows to the country.

Foreign portfolio investment

At the global level, investors' risk appetite is still at an elevated level in the wake of the unprecedented Covid-related liquidity injections and stable and low policy rates across both advanced and developing economies. This dynamic has fueled investments into a wide range of relatively riskier assets, across different asset classes, such as equities and higher yielding debt (by corporates as well as sovereigns). However, a few interesting patterns are visible. First, there appears to be geographical dispersion of foreign investment into different asset classes. Specifically, from the end of Q2 and throughout Q3-FY21, equity market returns have been relatively much higher across the major advanced economies, especially the US, and these higher returns have helped equity markets in these economies to attract stronger capital flows (Figures 5.10 & 5.11). Meanwhile, equity market performances of some major EMs, though decent in absolute terms, have been relatively muted as compared to the returns in advanced economies, leading to relatively weaker FPI inflows to EM equities (Figure 5.12). Instead, EMs have seen foreign capital flows enter

Equity Returns in Adv. & EMEs in Q3-FY21

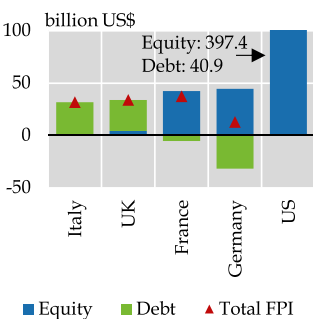
Figure 5.10



Source: Haver Analytics

Net FPI Inflows to Advanced Economies*

Figure 5.11

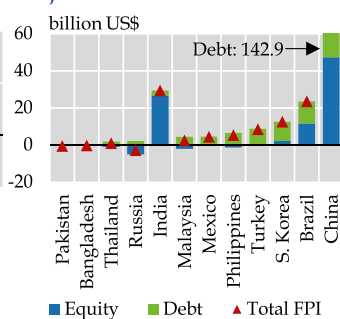


*Jul-Dec FY21 (latest data)

Sources: IMF/Haver Analytics

Net FPI Inflows to Major EMs*

Figure 5.12



*Jul-Dec FY21 (latest available data)

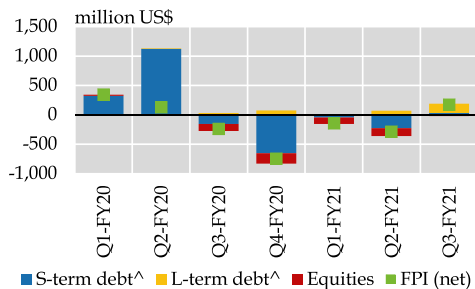
Sources: IMF/Haver Analytics

their local currency debt securities, as global investors continue to hunt for higher yielding fixed income securities.

To some extent, these global trends were also visible across the portfolio investment flows to Pakistan during Jul-Mar FY21. While overall FPI saw a net outflow of US\$ 267 million during the nine-month period, the outflows were concentrated within equities, the entire outflows were recorded in the first half of the year, and there was a trend reversal in these investment flows during Q3 (Figure 5.13). FPI into long-term local currency debt securities (Pakistan Investment Bonds, specifically) started rising from Q2 onwards and increased further in Q3. The entry of foreign investors into longer tenured bonds likely reflected the favorable sentiments in the wake of the resumption of the IMF program. At the same time, the country's interest rate differential with other advanced and emerging economies also held steady, allowing investors to lock in the higher rates for a longer period (Chapter 3).

The higher FPI into local debt securities helped partially offset continued outflows from equity securities during the period. Data from the National Clearing Company of Pakistan Limited (NCCPL) indicates that selling by foreign investors was noted across nearly all sectors, and the heaviest selling was observed across sectors where foreign ownership is also higher, namely banking, oil & gas, and cement.¹² The textile sector was an exception to this broad-based selling trend, as foreign investors were net buyers of listed textile equities over the nine-month

Breakdown of FPI Inflows into Debt & Equity Securities in Pakistan* Figure 5.13



*excluding Eurobond/Sukuk. ^short-term/long-term

Sources: State Bank of Pakistan

period, though the buying was of a relatively modest amount (US\$ 3.2 million).

Net incurrence of liabilities

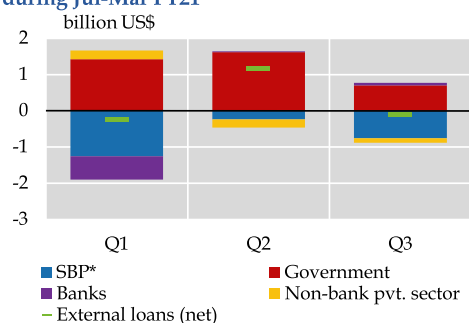
The net inflow of external loans amounted to US\$ 1.6 billion during Jul-Mar FY21, which was over three times lower than the US\$ 5.1 billion received in the comparable period of last year. Quarterly data breakdown shows that over 91 percent of the net flows were realized in the second quarter, whereas heavy repayments in the first and third quarters curtailed the net debt flows in these quarters (Figure 5.14).

The fresh borrowings were dominated by commercial loans, and inflows from bilateral and multilateral sources; the financing from most multilateral sources was mostly for Covid-related budgetary support. Within multilaterals, the Asian Development Bank (ADB) dominated, with gross inflows amounting to US\$ 1.2 billion from the lender during Jul-Mar FY21 (Table 5.5). The ADB

¹² During Jul-Mar FY21, foreign investors were net sellers of US\$ 295.1 million worth of Pakistani equities. The highest selling was noted across stocks in banking (US\$ 98.3 million), followed by oil and gas exploration & production (US\$ 45.8 million) and cement sectors (US\$ 40.5 million). (Source: National Clearing Company of Pakistan)

Net Inflow of External Loans during Jul-Mar FY21

Figure 5.14



*including below-the-line IMF repayments

Sources: State Bank of Pakistan & SBP calculations

financing was concentrated in Covid-related support, and for projects to improve the country's trade competitiveness and to further develop the domestic capital market. Other major inflows included US\$ 750 million jointly from the World Bank and the Asian Infrastructure Investment Bank (AIIB) under the Resilient Institutions for Sustainable Economy (RISE) program for budgetary support and fiscal reforms after the Covid outbreak. Commercial borrowings were higher on gross basis this year and were the single-largest source of official flows in gross terms; however, higher repayments of commercial loans led to a slowdown in the net build-up in these loans during the period under review.

Meanwhile, the resumption of the IMF program in March 2021 unlocked around US\$ 500 million in a combined tranche (for the second through fifth reviews) of the EFF program.¹³ However, the country has also been repaying previous IMF loans, which lowered the stock of IMF debt on the SBP's books. On net basis, the country made a

Major Sources of Official External Loans during Jul-Mar*

Table 5.5

	FY20	FY21	Change
Commercial	1,799.2	3,119.7	1,320.5
ADB	2,221.6	1,247.3	-974.3
World Bank	323.3	905.3	582.0
IDB	780.6	462.2	-318.4
AIIB	6.5	252.1	245.6
Other multilateral	82.6	65.7	-16.9
Bilateral inflows	1,516.1	1,360.9	-155.2
Overall official loans	6,729.9	7,413.3	683.4

*in gross terms. Excluding US\$ 500 EFF tranche (FY21) & central bank liabilities

Source: Economic Advisor's Wing, Ministry of Finance

retirement of US\$ 280 million to the Fund during Jul-Mar FY21.

5.4 Exchange Rate and Reserves

The country's overall foreign exchange reserves rose by US\$ 1.7 billion over the nine-month period and reached US\$ 20.6 billion by end-March 2021. A large share of this increase came from the SBP's FX reserves, whereas banks' reserves rose by a relatively smaller magnitude. Over the same period, the SBP retired its net forwards liabilities by US\$ 1.5 billion.

Most of the improvement in the official reserves position was noted in the second quarter (Table 5.6). With the current account in surplus, the availability of net financial flows was also higher in Q2 amid borrowings from commercial and bilateral sources. Official loan repayments were also relatively lower in Q2 as compared to the other quarters and contributed to the reserves build-up during the period. That said, the net build-up in official reserves slowed down in Q3, in the wake of higher loan repayments

¹³ The current EFF allows the program financing to be used for budgetary support as well, and is being recorded under the general government's external borrowing in the balance of payments data.

by both the central bank and the government.

Meanwhile, commercial banks' reserves rose by US\$ 356 million during Jul-Mar FY21 and reached US\$ 7.1 billion by end-March. However, the data breakdown shows that there was a lot of variation within the period. Specifically, banks reserves (i.e. foreign currency account deposits, net of trade financing) and trade nostro balances, had cumulatively risen substantially in the first quarter, reflecting the accumulation of net current account earnings abroad.¹⁴ However, over the next two quarters, the banks' reserves stabilized around the US\$ 7.1-7.2 billion mark, as they increased their trade financing activities and as import payment pressures started to emerge. These developments were also reflected in a drawdown in the banks' nostro balances in Q3.¹⁵

Meanwhile, similar to a few other EM currencies (**Section 5.1**), the PKR has continued to strengthen against the US Dollar throughout this year, with the appreciation amounting to 10 percent during Jul-Mar FY21. The appreciation in Q3 (4.6 percent) was higher than in the other quarters (1.4 percent in Q1 and 3.7 percent in Q2). The PKR's strengthening in the third quarter reflected overall positive sentiments, in the wake of the successful conclusion of

**Change in Liquid FX Reserves
& SBP's Forward Liabilities (net)
during Jul-Mar FY21**
million US\$

Table 5.6

	Q1	Q2	Q3	Jul-Mar	Stock [^]
SBP's reserves	22	1,262	78	1,361	13,493
Banks' reserves	477	-135	14	356	7,110
Overall reserves	499	1,127	92	1,717	20,604
SBP's net forward liability.*	0	-1,164	-325	-1,489	-4,285

[^]Stocks as of end-March 2021. Negative sign with stock of forward liability indicates a net short position.

*Negative sign for change in forward liability indicates net retirement of liabilities (i.e. improvement)

Sources: State Bank of Pakistan

the EFF program review, the country's impending return to the international capital markets, expectations of a stable current account balance amid the continued surge in remittances, effective management of Covid's second wave without resorting to stringent mobility restrictions, and the encouraging industrial performance.

In Real Effective Exchange Rate (REER) terms, a mixed trend was noted across the EMs during Jul-Mar FY21, with Pakistan among those countries whose REER appreciated during the period (**Figure 5.15**).¹⁶ In Pakistan's case, almost the entire increase in REER came from an increase in domestic prices relative to those of the country's other major trading partners, as captured by the

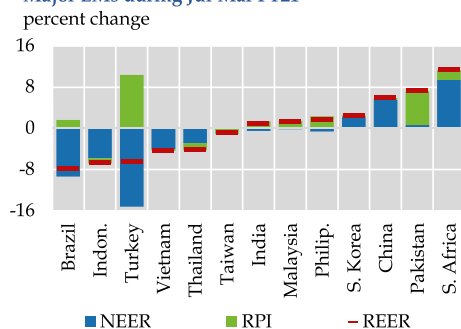
¹⁴ Banks' liquid foreign exchange reserves are defined as the balance in their foreign currency accounts (FE-25 deposits), after netting out the FX loans they have extended to importers and exporters for trade financing. These reserves had risen US\$ 477 million during Q1-FY21. Meanwhile, banks' nostro balances – which are not included in the calculation of their liquid reserves position – had increased by a further US\$ 408 million during the quarter.

¹⁵ Banks' trade nostro balances had peaked at US\$ 566 million by end-October 2020, and have been declining steadily since then, reaching US\$ 26 million by end-March 2021.

¹⁶ The appreciation (depreciation) of REER is often confused with the concept of currency overvaluation (undervaluation). These are two separate concepts; for details, see the SBP's explainer video on the REER, available at: www.youtube.com/watch?v=RX0Oa7oevLg

Breakdown of Change in REERs of Major EMs during Jul-Mar FY21

Figure 5.15



Sources: JP Morgan/Haver Analytics

Relative Price Index (RPI). Similar price pressures had also played a dominant role in REER appreciation of some other EMs, including China and South Africa. Pakistan's Nominal Effective Exchange Rate (NEER), on the other hand, remained stable during the Jul-Mar FY21 period.

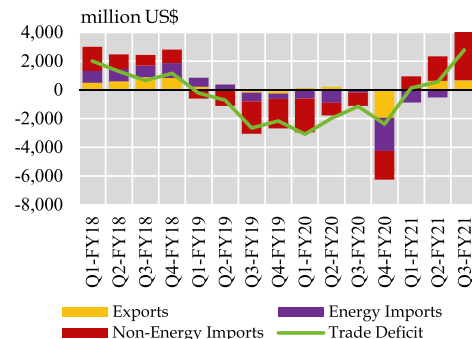
5.5 Trade Account¹⁷

After declining over the last two consecutive years, the trade deficit rose by 19.9 percent YoY to US\$ 20.8 billion during Jul-Mar FY21, on the back of a sharp increase in non-energy imports (**Figure 5.16**). Food, transport, textile and machinery groups largely contributed to the increased imports. Energy imports, on the other hand, remained subdued, due to higher base effect.

Meanwhile, exports also rose, but less sharply as compared to the increase in imports. Value-added textiles contributed the most to the expansion in exports during Jul-Mar FY21. Among non-textile exports,

Breakdown of YoY Change in Trade Deficit

Figure 5.16



Source: Pakistan Bureau of Statistics

the increase in rice exports remained moderate, as higher non-basmati rice exports partly arrested the decline in basmati rice exports.

Exports

Based on Customs data, exports increased 7.1 percent to US\$ 18.7 billion in Jul-Mar FY21, reaching the highest level since FY14. Growth in exports was led by the textile group (**Table 5.7**). Within textiles, value-added items contributed the most to the growth. These items included apparel, home textiles (bedwear and towels), and other textile made-ups (personal protective equipment, etc.). Among non-textile items, higher non-basmati rice exports partially offset the impact of lower basmati rice exports; whereas, chemicals, pharmaceuticals, and medical instruments also contributed positively to the overall export growth. Lastly, exports of petroleum crude and POL products declined significantly.

¹⁷ This section is based on Customs data reported by the PBS. The information in this section does not correspond with the payments record data, which is reported in Section 5.1. To understand the difference between these two data series, see Annexure on data explanatory notes.

The SBP and government's policies to support the revival of economic activity in the wake of the pandemic have facilitated growth in the leading export sectors. They included, among others: sharp decline in policy rate, which lowered the cost of financing; subsidies on gas and power supply to industries; faster sales tax refunds; enhancement in the limits of refinancing under the Export Finance Scheme (EFS) and the Long-Term Finance Facility (LTFF) by Rs 100 billion and Rs 90 billion respectively¹⁸; and the launch of the Temporary Economic Refinance Facility (TERF).¹⁹ As explained in the next section, these conditions complemented the favorable conditions under which Pakistan received some deflected orders from other countries for its major products (apparel and home textiles).

Textile exports reached highest nine-month level

Responsible for around three-fourth of the overall growth in exports, textile exports grew 9.1 percent to US\$ 11.4 billion in Jul-Mar FY21. Both volumes and unit values played pivotal roles in achieving this level. Exports of apparel and home textiles registered a cumulative increase of 14.2 percent and reached US\$ 7.8 billion in the period. Due to the peculiar circumstances created by the pandemic and the government's facilitative policies, there was limited impact of Covid on Pakistan's industrial activity, as indicated by the LSM index. This led to an opportunity for the country's value-added textile exporters to boost their output and exports.

Pakistan's Major Exports during Jul-Mar

Table 5.7

million US\$

Groups/Items	FY20	FY21	Abs. Change
Textile group	10,413	11,355	942
Non-textile group	7,030	7,332	301
Textile	10,413	11,355	942
LVA* textiles	2,384	2,141	-243
Apparel	4,471	5,049	579
Home textiles	2,354	2,744	390
Other textile made-ups	492	566	73
Food	3,395	3,331	-63
Rice (a+b)	1,594	1,560	-34
a) Basmati	570	408	-162
b) Non-basmati	1,024	1,152	128
Fish & prep.	317	304	-14
Fruits & vegetables	637	624	-13
Meat & preparations	233	247	14
Petroleum	239	116	-123
Petroleum crude	153	63	-90
Petroleum products	40	21	-19
Other Manufactures	2,426	2,566	140
Raw leather	151	113	-38
Leather manufactures.	401	428	27
Medical instruments	303	324	21
Chemicals & pharma	734	844	110
Cement & products	210	210	0
Total Exports	17,443	18,687	1,244

* low value-added (cotton fiber, yarn, cloth)

Source: Pakistan Bureau of Statistics

Growth in apparel exports, which stood at US\$ 5.0 billion, was mainly due to an

¹⁸ After the Covid outbreak, the SBP implemented various measures to facilitate exporters. They included a reduction in the performance requirement from twice to one-and-a-half times and extension in time period to meet performance requirements by 6 months, etc. For more details, visit: www.sbp.org.pk/corona-others.asp

¹⁹ For details on some of these schemes, see Chapter 3: Monetary Policy and Inflation.

impressive quantum effect. After posting negative year-on-year growth rate in the first quarter, the quantum of apparel exports, driven by knitwear, picked up significantly in the second and third quarters.

Higher apparel exports could be traced to the US and the UK, whose quantum of apparel imports from Pakistan increased by 21.1 percent and 15.4 percent, respectively, in Jul-Mar FY21 (**Tables 5.8 and 5.9**). It is pertinent to note here that apparel imports of these markets had decreased not only from some of Pakistan's major competitors, like India, Indonesia, Bangladesh, but also in overall terms.²⁰ This substantiates the anecdotal evidence that Pakistan's apparel exporters were the beneficiaries of orders deflected from some competitor countries whose export industries were more heavily and more persistently impacted by Covid. Higher shipments to the US and UK markets, it should be noted, more than offset the slight decline to the EU-27 market (**Figure 5.17**).

Pakistan's apparel exports increased as demand recovered, on MoM basis, in the major destination markets.²¹ In case of the US, the retail sales data shows that soon after experiencing significant decline in clothing sales in the first half of 2020, markets in the country normalized afterwards (**Figure 5.18**). In case of the UK, the retail sales index for

US' Apparel Imports from Major Countries during FY21 **Table 5.8**

	Unit Value (US\$/m ²)	Percentage Change in Quantum Imports		
	Jul-Mar	H1	Q3	Jul-Mar
China	1.7	-11.5	34.8	-1.5
Pakistan	2.2	17.1	28.7	21.1
Cambodia	2.4	15.3	11.6	14.1
Bangladesh	2.7	7.5	1.0	4.9
India	3.2	-3.3	-3.9	-3.5
Vietnam	3.2	5.1	9.3	6.6
Indonesia	3.7	-11.7	-14.5	-12.8
Turkey	6.7	-1.1	14.6	3.9
World	2.7	-5.8	11.6	-0.6

Source: OTEXA (US Department of Commerce)

UK's Apparel Imports from Major Countries during FY21 **Table 5.9**

	Unit Value (GBP/kg)	Percentage Change in Quantum Imports		
	Jul-Mar	H1	Q3	Jul-Mar
Pakistan	9.1	10.9	24.4	15.4
Bangladesh	11.4	-18.3	-24.3	-20.4
India	15.9	-23.4	-17.3	-21.4
Cambodia	17.7	-28.6	-19.4	-26.3
Turkey	18.6	19.5	8.0	16.3
Vietnam	20.6	-33.6	-27.3	-31.9
China	23.1	7.3	6.1	7.1
World	19.5	-11.7	-16.0	-12.9

Source: UK Trade Info

'textile, clothing and footwear stores' showed marked improvements in the months of Aug-Nov 2020.²² Subsequently, the index showed a decline from December onward during the second wave of Covid. Nevertheless, the

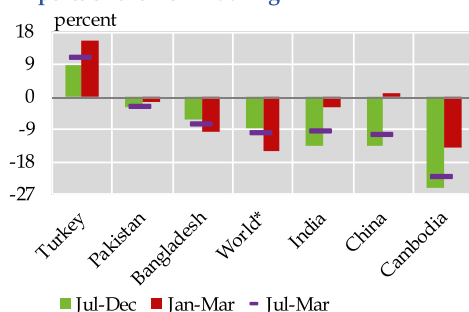
²⁰ In the neighboring India, Covid has caused some permanent garment factory closures, resulting in loss of hundreds and thousands of jobs. For example, in one of the garment manufacturing hubs, Bengaluru, 50-62 percent of the workforce was forced to resign due to low revenues and losses. (Source: GATWU and ALF (2021). *Forced Resignations, Stealthy Closures*, India. Garment and Textile Workers Union and the Alternative Law Forum)

²¹ Nishat (Chunian) Limited's Jan-Mar 2021 report noted that: "As glut of demand for value added textile business has come forth with retail sector opening up worldwide post Covid-19 lockdown, companies are already operating at full capacity to grasp this opportunity as exports for this period are already quite impressive".

²² While it was still quite below last year's comparable levels, the average monthly index improved 53.1 percent during Aug-Nov as compared to four months prior. (Source: Office of National Statistics, UK).

Growth in Quantum Apparel Imports of the EU-27 during FY21

Figure 5.17



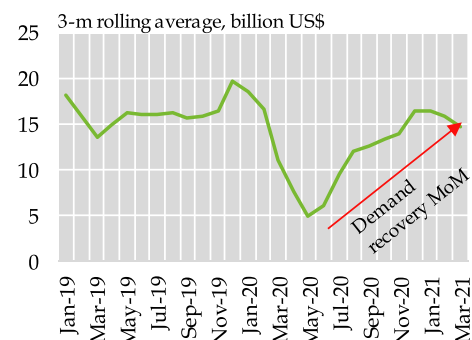
*March data not available yet

Source: Eurostat

UK's shipments still rose from Pakistan, despite falling by one-fourth in overall terms, further adding credence to the deflected orders argument.

Moreover, prompted by the pandemic, the change in consumers' behavior in some parts of the world, including the US, has possibly led to cost-cutting among some consumers.²³ With Pakistan offering cheaper apparel imports vis-à-vis its competitors, some western buyers likely pivoted to the country amidst the pandemic (Tables 5.8 and 5.9).^{24,25} Although China's per unit cost was the lowest to the US, it ended up sending lesser shipments to the country in Jul-Mar FY21 over the same period last year.²⁶ This could be explained by the US-China trade tensions,

Retail Sales at US' Clothing Stores **Figure 5.18**



Source: US Census Bureau

which nudged American buyers away from China and towards other sources, including Pakistan.

Favorable demand-side dynamics were also accompanied by some supply-side factors, which enhanced exporters' competitiveness. The government and SBP's facilitative measures played a crucial role in improving liquidity position—hence higher capacity utilization—of high-end textile exporters, who were able to process and deliver more orders during Jul-Mar FY21 than the year before. While some of these measures have already been mentioned, they included, among others: extensions in the validity of erstwhile zero-rating certificates to provide

²³ "Some 20 percent of US consumers expect the crisis to affect their personal or household finances for more than a year, and 27 percent say they will trade down to more inexpensive items to save money." (Source: McKinsey and Co., and Business of Fashion (2020): The State of Fashion 2021)

²⁴ "According to an analysis by Just Style of full-year US import data for 2020, Pakistan was the second cheapest supplier of apparel to the US, with its per-unit cost for clothing sitting at \$2.22." (Source: www.just-style.com/analysis/us-apparel-imports-continued-to-gain-ground-in-january_id140909.aspx)

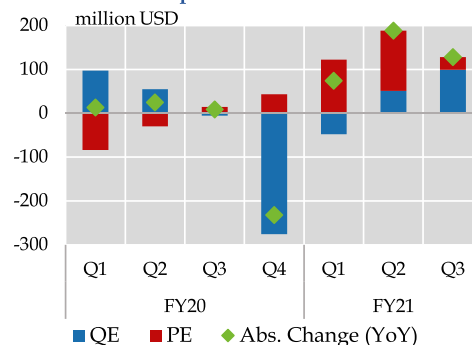
²⁵ In case of the UK, Pakistan offered cheapest imports among major competitors in Jul-Mar FY21. (Source: UK Trade Info)

²⁶ It may be noted that the US experienced massive growth in quantum imports from China in Q3-FY21 mainly due to the low base effect from the same period last year, when these imports had declined 32 percent, as Covid-related lockdowns had gone in effect in China. (Source: OTEXA)

power and gas subsidies to top-five export sectors until November 2020; gas and power subsidies under the industrial support package from November onwards; and the reduction in the policy rate from 13.25 percent to 7.0 percent in a short span of time from mid-March to June 2020, which helped lower the financing cost for industrialists.²⁷ Moreover, the government upgraded FASTER to FASTER Plus to further expedite sales tax refunds for exporters.²⁸ Overall, sales tax refunds were up significantly during the period under review, further bolstering the liquidity positions of exporters, especially the textile firms.²⁹ Customs duty on import of cotton yarn was also removed in December 2020.³⁰

Besides apparel in value-added category, home textile (bedwear and towel) exports increased 16.6 percent to US\$ 2.7 billion in Jul-Mar FY21. Overall, it was the positive price effect that lifted these exports (**Figure 5.19**). This price effect reflected among other things, the knock-on impact of higher cotton prices in both the domestic and international markets.³¹ That being said, the country also exported higher shipments as the year progressed; its share in the EU-27's quantum imports increased from around 48 percent in Jul-Mar FY20 to 51 percent in Jul-Mar FY21

Breakdown of Absolute Change in Home Textiles Exports **Figure 5.19**



Source: Pakistan Bureau of Statistics

(**Table 5.10**).³² This shows that in the home textiles segment, Pakistan, which has an established market share in the EU market, was able to increase its export volumes even

Share in EU-27's Quantum Home Textiles Imports **Table 5.10**
percent

	Jan-Mar		Jul-Mar	
	FY20	FY21	FY20	FY21
Pakistan	67.5	72.3	47.6	50.5
China	26.6	27.6	23.2	22.6
Turkey	21.5	22.0	16.7	16.8
India	14.4	14.2	10.2	9.9
Bangladesh	7.5	8.5	5.6	6.1

Source: Eurostat

²⁷ For more details, see Chapter 5: External Sector of SBP's State of the Economy Report for Q2-FY21.

²⁸ FASTER stands for Fully Automated Sales Tax e-Refund, and it was introduced by the FBR in Jul-2019. Owing to some technical and other glitches in its system, it was upgraded to FASTER Plus in October 2020 (Source: FBR Press Release, www.fbr.gov.pk/pr/fbr-upgrades-faster-to-faster-plus-system-for/152507)

²⁹ Sales tax refunds increased to Rs 155 billion in Jul-Mar FY21, which were 158 percent higher than last year's comparable refunds of Rs 60 billion. (Source: FBR)

³⁰ Source: FBR SRO 1352(I)/2020

³¹ At Karachi Cotton Association, quoted price of Pakistan cotton rose 8.8 percent year-on-year to US 74 cents/lb. in Jul-Mar FY21, from US 68 cents/lb in the same period last year. Except for India, there was double-digit growth in cotton prices for Brazil, China, and the US. (Source: Emerging Textiles)

³² Source: Eurostat

at slightly higher unit prices.³³ Moreover, as in the case of apparel, the unit value offered by Pakistan was lower than its major competitors (except for China), despite showing an increase.³⁴

In low value-added textiles, exports of cotton yarn and fabrics registered a cumulative 9.6 percent decline and reached US\$ 2.1 billion in Jul-Mar FY21. Amidst a shortage of cotton raw materials in the local market, these intermediary goods were diverted towards domestic production of finished textile products, which, as discussed earlier on, witnessed higher global demand in the period under review. This resulted in low exportable surplus of these goods, and hence lower exports.

Moreover, led mainly by higher demand for personal protective equipment (PPE) and other sanitary products during the pandemic, Pakistan's exports of 'other textile made-ups' grew 14.9 percent to US\$ 566 million in Jul-Mar FY21 – the highest ever level in this category.

Rice exports stayed muted

Rice exports declined by 2.1 percent to US\$ 1.6 billion in Jul-Mar FY21. The entire

decline was caused by quantum-led lower basmati rice exports, which fell 28.4 percent to US\$ 408 million. Unit value-led higher non-basmati rice exports did shore up falling rice exports in value terms, but fell short of making up for sharp decline in basmati rice exports.

One major factor for the decline is that Pakistan is facing stiff competition from India in the traditional markets. With abundant exportable surplus available, India has been offering the most competitive prices vis-à-vis all of its major competitors.³⁵ Pakistan basmati rice exporters were edged out by their Indian counterparts in the Middle East. Specifically, with India offering lower unit values, its overall basmati rice exports to the Middle East (Yemen, Iraq, Saudi Arabia, Oman, Yemen, Bahrain and UAE) increased nearly 11 percent to 1.5 million tons in Jul-Feb FY21, while Pakistan's decreased by around 51 percent to 0.17 million tons in Jul-Mar FY21.³⁶

Same was the case with the non-basmati rice exports. Not only did India offer lower unit values on average, Pakistan's unit values were also higher than last year (**Figure 5.20**). As a result, Pakistan's shipments to major, price-sensitive markets in Africa – Kenya,

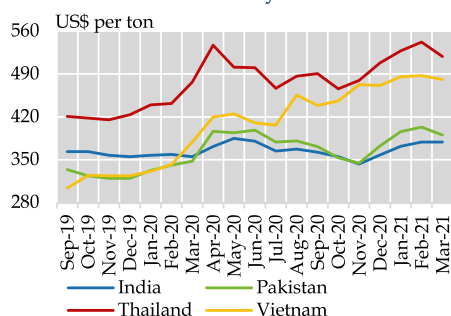
³³ In USD/100 kg terms, average unit value of EU's home textiles imports from Pakistan rose by 1.7 percent YoY in Jul-Mar FY21, as opposed to declining by 4.7 percent in the comparable period of last year. It should be noted that EU's overall unit value also showed similar trends in these two periods. (Source: Eurostat)

³⁴ Evaluated in USD/100 kg terms, average unit values during Jul-Mar FY21 were: Pakistan 607, Bangladesh 684, India 697, Turkey 886, and China 574. (Source: Eurostat)

³⁵ USDA 2020/2021: *Grain World Trade Report*. Various issues. Washington, DC: United States Department of Agriculture.

³⁶ Average unit value of India's basmati rice dropped from US\$ 983 per ton to US\$ 858 during Jul-Feb periods of FY20 and FY21. Meanwhile, Pakistan's unit values rose from US\$ 878 per ton to US\$ 956 per ton in Jul-Mar periods of FY20 and FY21. (Source: Ministry of Commerce and Industry, India, and Pakistan Bureau of Statistics)

International Price Comparison of Non-Basmati Rice Variety* **Figure 5.20**



* 25% broken

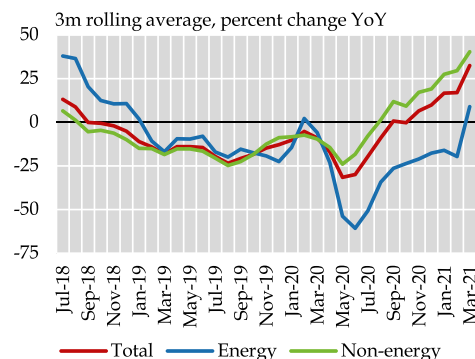
Source: Food and Agriculture Organization

Tanzania, Mozambique, Somalia in East Africa, and Togo, Senegal in West Africa – stayed muted.³⁷

Imports

Pakistan's imports rose in three consecutive quarters for the first time in the last 10 quarters, indicating that the declining trend in the imports that had appeared since Q1-FY18 has bottomed out (**Figure 5.21**). As the economic recovery gained traction, imports increased by 13.5 percent during Jul-Mar FY21, after declining by 14.5 percent in the same period of last year. Moreover, after moderate rises in the first two quarters, imports increased by 29.7 percent in Q3-FY21; the highest since Q3-FY17, when these had risen by 36.6 percent.

Growth in Pakistan's Imports **Figure 5.21**



Source: Pakistan Bureau of Statistics

On the contrary, aggregate energy imports during Jul-Mar FY21 remained below last year. However, rising international energy prices brought a sharp increase in the Q3 energy imports, specifically in March 2021.

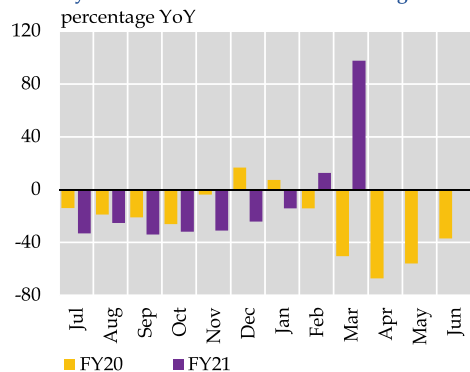
On the other hand, the Covid shock warranted the introduction of accommodative policies to stimulate economic activity.³⁸ Reviving economic activity, however, led to a broad-based increase in non-energy imports during Jul-Mar FY21 to a record 23.4 percent. Meanwhile, the import of consumer goods, on the back of higher food and medicine imports, increased by 25.9 percent during Jul-Mar FY21.

Besides, the lower than targeted wheat output last year and the government's efforts to stabilize wheat and wheat flour prices,

³⁷ Pakistan's quantum non-basmati exports to these countries decreased by 55 percent YoY to 0.38 million tons in Jul-Mar FY21. Meanwhile, India's rice exports to East Africa and West Africa rose 183 percent to around 5 million tons in Jul-Feb FY21 from a year before. (Source: Pakistan Bureau of Statistics; and Ministry of Commerce and Industry, India)

³⁸ LSM grew by 7.5 percent in Jul-Feb FY21, after declining by 2.8 percent in this period of FY20. Another indicator of the rise in economic activity was the sale of petroleum products, specifically high-speed diesel, which increased by 16.1 percent during Jul-Mar FY21; diesel sales had declined by 13.8 percent in this period of FY20.

Monthly Growth in Brent Prices



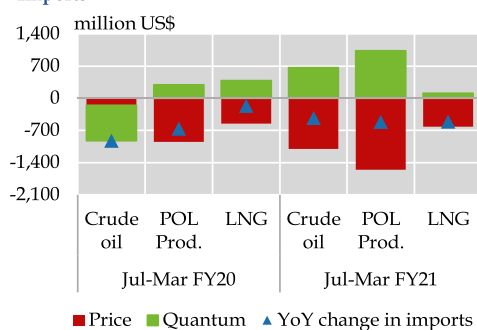
Source: World Bank

contributed to significant wheat imports. This, coupled with rising international palm oil prices, pushed up food imports to US\$ 6.1 billion, with a YoY growth of 54.5 percent; the highest addition in 9 months since 2011.³⁹

Energy imports continued to show declining trend despite recent surge in global energy prices

Global oil prices, which had started to taper since the third quarter of FY20, rebounded strongly in Q3-FY21, specifically in March 2021, which saw a 98 percent YoY increase in Brent prices (Figure 5.22). Despite this sharp jump in international oil prices in Q3, the unit value of Pakistan's energy imports during Jul-Mar FY21 remained lower compared to last year due to lower energy prices that prevailed in the first half of the fiscal year (Figure 5.23). As a result, energy imports decreased by 15.1 percent in Jul-Mar FY21, after falling 16.1 percent in the same period of last year.

Contribution of Unit Price & Quantum Effects to YoY Change in Energy Imports



■ Price ■ Quantum ▲ YoY change in imports

Source: Pakistan Bureau of Statistics

While import values have decreased, quantum energy imports increased by 24.7 percent in this period, suggesting that the economic activity is gaining momentum (Figure 5.23).⁴⁰ Moreover, sale of diesel increased by 18.2 percent while that of the furnace oil increased by 35.3 percent YoY basis (Table 5.11). Overall increase in the economic activity on the back of a significant increase in large-scale manufacturing (LSM) reinvigorated the fuel demand from the transport and power sectors.

Change in POL Product Sales during Jul-Mar FY21

Table 5.11

metric ton

	Q1	Q2	Q3	Jul-Mar
Petrol	151	127	252	530
HSD	155	273	411	840
Furnace oil	259	186	210	656
All products sales	478	528	844	1,850

Source: Oil Companies Advisory Council

³⁹ Food imports had risen by 60.6 percent during Jul-Mar FY11, due to the devastating floods in Pakistan, as well as a sharp increase in international commodity prices.

⁴⁰ Quantum imports of crude oil increased by 16.6 percent while that of the POL products increased by 30.3 percent during Jul-Mar FY21.

Food, transport, textile and machinery contributed largely to the robust non-energy import growth

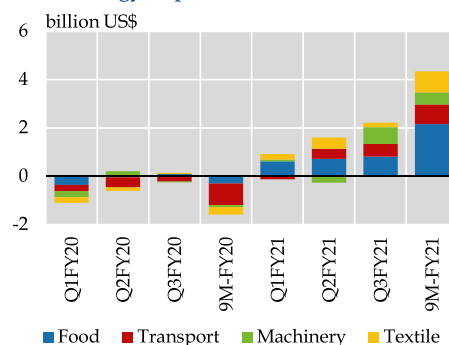
Non-energy imports gained further momentum and increased by 38.6 percent YoY in Q3-FY21 after rising consecutively in the first and second quarters.⁴¹ On aggregate, non-energy imports rose to US\$ 12.3 billion almost equaling the record import witnessed in Q4-FY18. Although this revival was broad-based, food, transport, textile and machinery contributed more than 70 percent to the Jul-Mar FY21 increase (Figure 5.24).

Food

In Jul-Mar FY21, food imports increased by 54.5 percent to US\$ 6.1 billion; the highest in 9 months since 2011 when floods had pushed up the food imports by 60.6 percent. Decline in wheat output in FY20 and some disruption in wheat supply chain created upward pressure on wheat and flour prices. Moreover, at the start of the current season, sugar stocks fell to their lowest level since FY13. To address the situation, the government decided to allow both wheat and sugar imports. As a result, Pakistan imported US\$ 983 million of wheat and US\$ 127.5 million of sugar in Jul-Mar FY21 (Table 5.12). Despite an estimated good wheat crop in FY21, the government continued to encourage wheat imports to build strategic reserves. However, expectation of good wheat crop tapered import demand, and imports declined by 42.4 percent QoQ in Q3-FY21.

Major Contributors to Increase in Non-Energy Imports

Figure 5.24



Source: Pakistan Bureau of Statistics

The import of palm oil increased by 34.8 percent in Jul-Mar FY21 to US\$ 1.9 billion, while imports had declined 0.4 percent in the same period last year. Higher imports this year are driven largely by greater unit values, as the global palm oil prices increased by 57 percent during Jul-Mar FY21.

Labor shortages and unexpected rainfall hindered the crude palm oil production in Malaysia; whereas the Indonesian government's inclination to substitute imported diesel with domestically produced palm oil-based biodiesel, also drove up the commodity's international prices. On the contrary, palm oil demand from Pakistan, India and China increased significantly. Both India and China were increasing imports to replenish their depleting stocks. Pakistan, on the other hand, was facing a shortage of oilseed due to lower cotton output and therefore imported higher quantity to support the domestic demand.⁴²

⁴¹ In Q1 and Q2 of FY21, non-energy imports rose by 11.6 percent and 18.9 percent respectively.

⁴² Source: United States Department of Agriculture.

Pakistan's Major Imports during Jul-Mar

Table 5.12

million US\$

Groups/Items	FY20	FY21	Absolute change	Quant. impact	Price impact
Energy group	8,901	7,554	-412	1,706	-2,118
POL prods.	3,965	3,448	-517	1,036	-1,553
Crude oil	2,453	2,023	-429	670	-1,099
LNG	2,237	1,732	-506	109	-615
Agri and chem	5,577	6,342	765	-	-
Fertilizer	482	440	-42	-70	28
Other chem.	2,739	3,166	427	-	-
Transport group	1,197	2,010	814	-	-
Cars	408	895	487	-	-
CBUs	65	163	99	-	-
CKDs	343	731	388	-	-
Truck & buses	217	329	112	-	-
Aircraft & ships	240	373	138	-	-
Metals group	3,075	3,621	547	-	-
Steel scrap	1,188	1,419	231	299	-69
Iron & steel	1,159	1,428	269	337	-69
Food group	3,963	6,121	2,158	-	-
Wheat	0	983	983	-	-
Sugar	2	127	125	110	15.3
Palm oil	1,380	1,861	481	95	386
Textile group	1,916	2,787	871	-	-
Raw cotton	556	1,032	476	407	69
Syn. yarn	430	500	70	245	-175
Machinery group	6,634	7,133	499	-	-
Power gen	921	1,356	435	-	-
Electrical	1,749	1,102	-467	-	-
Cell phones	980	1,536	556	-	-
Other machinery	1,746	1,872	125	-	-
All other items	2,893	3,000	105	-	-
Total imports	34,791	39,489	4,699	-	-

Source: Pakistan Bureau of Statistics

Transport

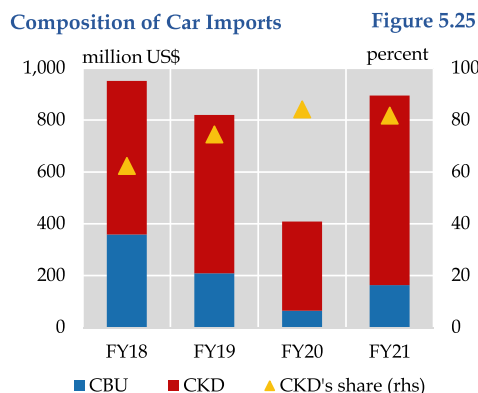
After food, transport was the second largest contributor to the increase in overall imports, with its imports rising 68.0 percent YoY during Jul-Mar FY21 compared to the 42.6 percent YoY decline in this period of FY20. Specifically, car imports witnessed a rapid growth, rising by 119.2 percent YoY to

US\$ 895 million in Jul-Mar FY21 and 191.4 percent YoY in Q3-FY21 alone (Table 5.12).⁴³

Accommodative policies adopted to support the economy in wake of the Covid supported the growth in the transport sector.

Noticeably, value of car imports in Jul-Mar FY21 is higher than the imports in the same period of FY19, when stabilization policies were rolled out. However, the import mix

⁴³ In Jul-Mar FY20, car imports had declined by 50.2 percent.



has further increased in favor of CKD (**Figure 5.25**). Incentivized by the Automotive Development Policy (2016-2021), a number of new entrants have successfully introduced new variants to cater to the demand of the high-income groups, which has also led to the rise in CKD car imports.

Nevertheless, demand for CBU cars, especially of cars with smaller engine capacities, has started rising in FY21 after bottoming out in FY20. Limited options are available to purchase under 1,000cc domestically produced cars. Demand for smaller capacity cars from middle and low-income groups remains untapped and therefore requires some policy focus, as lack of options in this category are pushing the demand for imported CBU cars.

Apart from cars, imports of trucks and buses and heavy vehicle import increased by 70.0 percent in Q3, while in Jul-Mar FY21 imports rose by 51.7 percent on YoY basis. Relatively higher export shipments and the resurgence

in overall economic activity led to increased import of the heavy vehicles.

Corresponding with the rise in transport imports, imports of rubber tyres and tubes also surged by 264.5 percent YoY in Jul-Mar FY21, against a 31.1 percent decline in the same period last year. The crackdown on smuggling by the FBR also contributed to this substantial rise in rubber tyre and tubes imports in FY21.

Textile

Pakistan imported cotton worth US\$ 1,032.1 million, with a YoY increase of 85.6 percent during Jul-Mar FY21; the highest in this period since FY08 when the country imported US\$ 1,063 million of cotton.⁴⁴ Pakistan's cotton output has continued to slide since FY15, as the area under cultivation is shrinking. To keep its textile sector running, the country resorted to importing cotton. Moreover, to facilitate the textile exporting sector, the government relaxed some of the custom duties on imports of this commodity.⁴⁵

Notably, import of worn clothing increased by 49.6 percent in Jul-Mar FY21 to a record US\$205 million, after rising by only 6.0 percent in the same period of last year. This suggests that a section of the society is switching to used clothes as their purchasing power of new clothes has declined.

Machinery

In Jul-Mar FY21, machinery imports increased by 7.5 percent, while they had declined by 1.2 percent in the same period

⁴⁴ In FY08, cotton production had declined by 9.3 percent YoY.

⁴⁵ For more details, see the SBP's State of Pakistan's Economy Report for Q1-FY21.

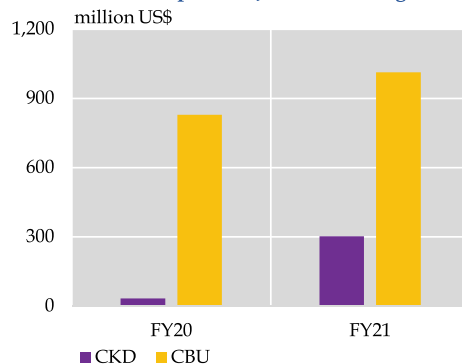
last year. Power generating machinery and telecom largely drove the overall machinery imports. Ongoing work on the power projects, such as Suki Kinyari and Karot hydropower station under CPEC, has increased the demand of the power generating machinery.

The import of mobile phones, on the other hand, increased by 56.7 percent to US\$ 1,536 million in Jul-Mar FY21. Protracted presence of Covid in the country sustained the strong demand for mobile gadgets, as educational institutions and some offices continued to rely on online activities.

Importantly, this year, CKD mobile set imports increased significantly by more than 800 percent; rising from US\$ 33 million in Jul-Mar FY20 to US\$ 303 million in Jul-Mar FY21 (**Figure 5.26**). A number of startups have started assembly of mobile sets in Pakistan, influenced by the Mobile Device Manufacturing Policy (MDMP) 2020.⁴⁶

Import of electrical machinery and apparatus, on the other hand, declined by 37 percent YoY during Jul-Mar FY21.

Mobile Phone Imports in Jul-Mar **Figure 5.26**



Source: Pakistan Bureau of Statistics

Improvement in power generation in the country by 4.8 percent YoY may have depressed the demand of these products in this period.

Higher activity in the transport sector and revitalization in the construction sector, as evident by the increase in housing finance, including loans sanctioned under Naya Pakistan Housing Scheme, increased the demand of both steel scrap and finished steel products. Quantum increases in both of these commodities largely drove their import growth during Jul-Mar FY21 (**Table 5.12**).

⁴⁶ The important features of MDMP 2020 include: i) removal of regulatory duty on imports of CKD/SKD units; ii) removal of fixed income tax on CKD/SKD manufactured mobile devices, up to \$350; iii) 3 per cent research and development allowance to be given to local manufacturers for exports of mobile devices; and iv) locally assembled or manufactured phones would be exempted from the 4 percent withholding tax on domestic sales.