8 Balance of Payments

8.1 Overview

Pakistan's external account registered an unexpected improvement during FY11, providing much needed breathing space to the economy. However, this improvement was attributable more to favorable developments in the global market than to domestic business environment. Specifically, it was the increase in the demand and prices of Pakistani exports along with robust growth in remittances that contributed the most to the improvement in country's external position.

Table 8.1: Summary of External Accounts
billion US dollars

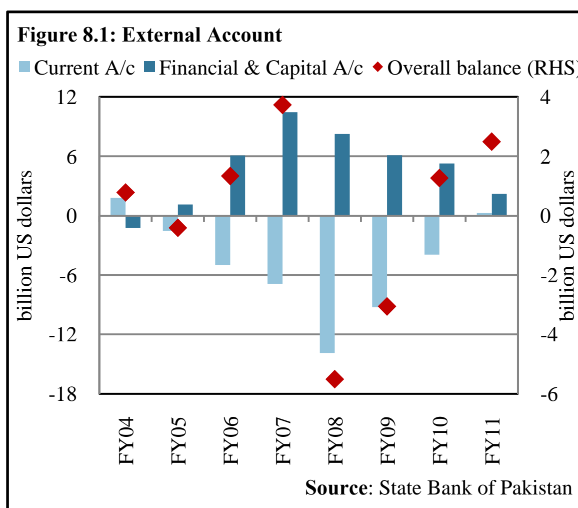
	FY10	FY11	Abs. Change	% Change
A. C/A Balance	**-3.9**	**0.3**	**-4.2**	**-107.7**
i) Trade Balance	-11.5	-10.5	-1.0	-8.7
Exports	19.7	25.3	5.6	28.4
Imports	31.2	35.8	4.6	14.7
ii) Invisible Balance	7.6	10.7	3.1	40.8
Remittances	8.9	11.2	2.3	25.8
B. Financial/Capital Balance	**5.2**	**2.2**	**-3.0**	**-57.4**
i) FDI	2.2	1.6	-0.6	-26.8
ii) FPI	-0.06	0.3	0.4	639
iii) Other Investment	3.1	-0.1	-3.2	-104.7
C. Errors & Omissions	-0.01	0.01	0.0	-281.3
D. Overall Balance	**1.3**	**2.5**	**1.2**	**96.9**

Source: State Bank of Pakistan

The absolute increase in exports during FY11 was higher than the corresponding increase in imports **(Table 8.1)**. As a result, the trade deficit, which had been a major factor in the deterioration of the external account in the past, remained in check, and contracted by 8.7 percent as compared to the preceding year. This was complemented by a 25.8 percent increase in remittances to an overall sum of US$ 11.2 million, which is an unprecedented high. Consequently, Pakistan's current account posted a surplus of US$ 0.3 billion after six consecutive years of deficits.

The financial account surplus, on the other hand, declined in FY11 compared to the previous year owing to the drying up of loans and foreign private investments. Nevertheless, improvement in the current account was large enough to offset the decline in the financial account surplus. Resultantly, Pakistan's overall external account improved in FY11, recording a surplus of US$ 2.5 billion compared to US$ 1.3 billion in the previous year **(Table 8.1)**.

Figure 8.1: External Account



Source: State Bank of Pakistan

The rise in the external account surplus manifested itself in the buildup of foreign exchange reserves, which reached a record-high of US$ 18.2 billion at the end of June 2011 compared to US$ 16.9 billion at the same time last year. With external account

position remaining comfortable through most of the year; pressure on the rupee was distinctively lower in FY11. Consequently, the rupee depreciated by just 0.7 percent during the year.

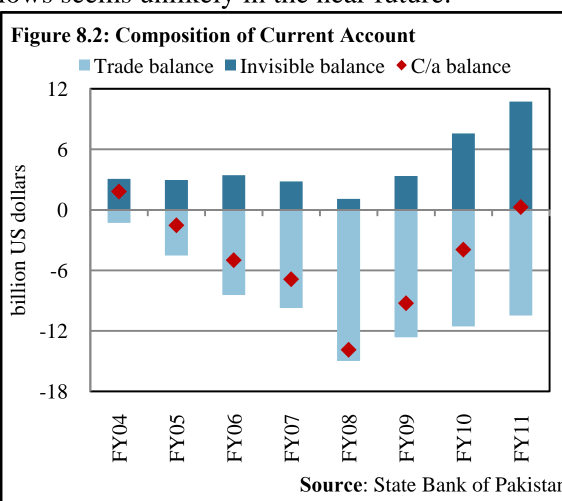
Table 8.2: Estimated Scheduled Repayment to the IMF
million US dollar (using 1 SDR = 1.5755 US$)

Period	Repayment	Total repayment for the year
Q3-FY12	407	
Q4-FY12	519	**926**
Q1-FY13	407	
Q2-FY13	670	
Q3-FY13	821	
Q4-FY13	821	**2719**
Q1-FY14	972	
Q2-FY14	972	
Q3-FY14	564	
Q4-FY14	564	**3,072**

Source: IMF

Despite an appreciable performance of the external sector in FY11, structural rigidities – with no change in the production mix and the destination of exports – still make it vulnerable. A continuous decline in capital and financial flows is also worrying. The financial account surplus declined for the fourth consecutive year in FY11 and the projections for FY12 show that this trend is likely to continue **(Figure 8.1).** Inflows - under foreign direct investment (FDI), equity securities and loans - remained lower than last year. Given the poor macroeconomic conditions and the deteriorating law and order situation, an improvement in either FDI or equity securities flows seems unlikely in the near future. Moreover, the suspension of the IMF program will also keep inflows from IFIs low. Thus, if the current account deteriorates, support from the financial account will not be available as was the case in 2006-2008. On the contrary, financial account itself would be under pressure if for nothing else, then due to the repayment of the IMF loan **(Table 8.2)**.

Figure 8.2: Composition of Current Account



Source: State Bank of Pakistan

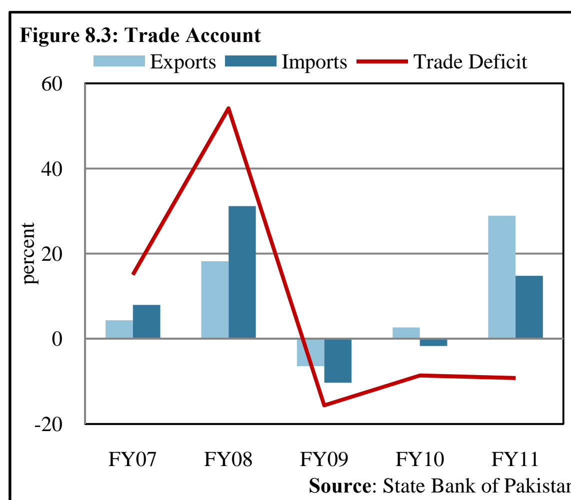
8.2 Current Account Balance

The improvement in the current account witnessed during the past two years continued in FY11 as well, with the current account posting a small surplus of US$ 0.3 billion after recording deficits for six consecutive years **(Figure 8.2)**.

8.2.1 Trade Account

Pakistan's trade deficit continued to contract for the third consecutive year in FY11. Unlike the previous year, when a fall in imports caused a contraction in the trade deficit, this year, it was sharp rise in exports that contracted the trade deficit. Although imports have also increased by 14.7 percent, the growth in exports outpaced the growth in imports **(Figure 8.3)**.

Figure 8.3: Trade Account



Source: State Bank of Pakistan

The surge in exports was primarily a result of

higher international cotton prices. Better unit prices of textile related products supported textile exporters. Although the quantum of textile exports also recorded a marginal rise, prominent factor was the price impact. Apart from textiles, exports of engineering goods, chemicals & pharmaceuticals, leather products, fruits and fish also posted positive growth.

In the case of imports, both petroleum and non-petroleum imports increased. As with exports, the prominent factor in inflating the import bill was the rise in the prices of international commodities, especially the rise in the prices of petroleum products, palm oil and sugar **(Section 8.4** for detail discussion on Trade**).**

8.2.2 Invisible Account

The invisible account, which is comprised of services (like travel, insurance, communication, etc.), income from abroad and current transfers, posted a surplus of US$ 10.7 billion in FY11 with a growth of more than 40.8 percent over last year.

Table 8.3: Current Transfers (million US dollars)

	FY09	FY10	FY11
Current Transfers (net)	11,154	12,562	15,683
Private transfers	10,991	12,006	14.863
Workers remittance	7,811	8,906	11,201
Of which: Exchange Cos.	*2,019*	*1,504*	*1,243*
FCA - residents	-271	629	367
Others	3,451	2,471	3,295
Of which: Exchange Cos.	*247*	*101*	*331*
Official transfers	163	556	821
Cash grants	142	491	512
Others	21	65	309

Source: State Bank of Pakistan

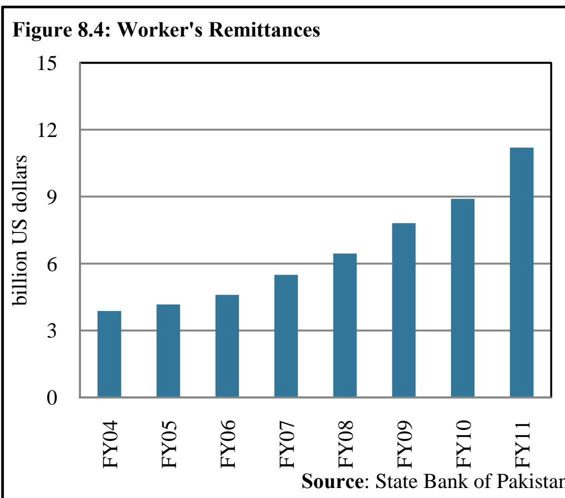
Current transfers increased by 24.8 percent in FY11 compared with an increase of 12.6 percent last year. The persistent increase in workers' remittances, which reached a historic high, was the main driving force behind the increase in current transfers. In fact 60 percent of increase in invisible account was due to the rise in remittances (**Table 8.3**).

Workers' remittances

The rising trend in remittances continued for the sixth consecutive year in FY11 as remittances for the year totaled US$ 11.2 billion (**Figure 8.4**). A number of factors can be attributed to this growth in remittances which include: (1) lack of investment opportunities abraod; (2) SBP and government efforts to channelize remittances through the banking system;[1] (3) a reduction in the kerb market premium; (4) an increase in the skill level of workers[2]; and (5) support from expatriates for flood-affected households.

In contrast to FY10, remittances from all the major expatriate countries increased in FY11 **(Figure 8.5).**

Figure 8.4: Worker's Remittances



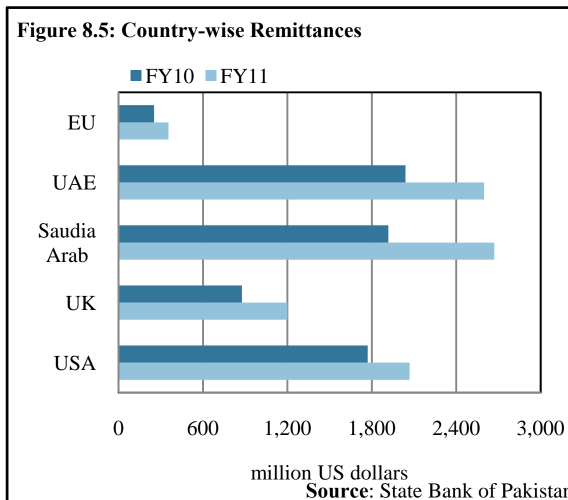
Source: State Bank of Pakistan

[1] Initiatives under PRI such as Xpress money, incentives in the form of interbank transfer facility and Easy-paisa by Telenor Pakistan has helped in increasing the remittances through formal *channels.*

[2] *IMF Working Paper, Remittances in Pakistan - Why have they gone up, and w*hy aren't they coming down? August 2011

It may be pointed out that the entire increase in remittances was due to the rise in inflows through the banking system whereas inflows through exchange companies declined significantly during this period.[3] The rise in inflows through the banking channel is a result of a host of factors including: (1) a decrease in the cost of sending funds due to incentives offered by the government;[4] (2) a decrease in the time taken to send funds due to the collaboration of domestic banks with foreign entities; and (3) the crackdown on some of the exchange companies.

Figure 8.5: Country-wise Remittances



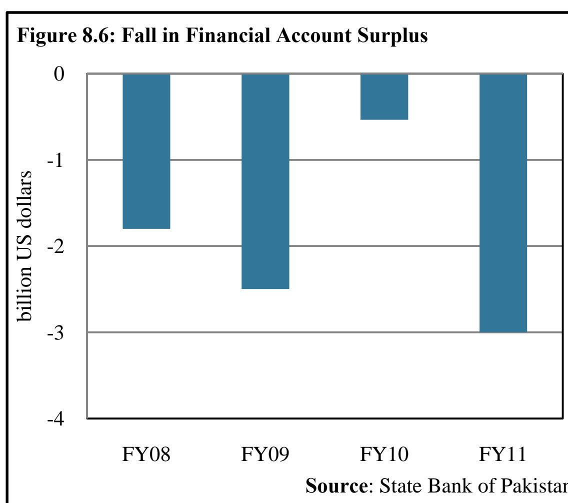
Source: State Bank of Pakistan

Among the other components of the invisible account, the services account deficit increased by 13.9 percent during FY11 as compared to a contraction of 50.0 percent in FY10. This contraction in services account deficit is due to lower inflows under the coalition support, which fund fell sharply by 42.5 percent from US$ 1.3 billion in FY10 to US$ 0.7 billion in FY11.

The deficit in the investment income account declined for the second consecutive year in FY11 as inflows increased by US$ 143.0 million on account of rising investment income. A major part of this rise was due to the increase in interest earned on reserves, and interest income earned by banks on their investments abroad.[5] [6]

Although outflows on account of IMF charges and interest on official and private external debt increased (not principal repayments), it was more than offset by the decrease in outflows on account of both foreign direct and portfolio investment. Resultantly, overall outflows declined by US$ 110 million in FY11.

Figure 8.6: Fall in Financial Account Surplus



Source: State Bank of Pakistan

8.3 Financial Account

The financial account surplus declined for the fourth consecutive year in FY11. In absolute terms, the financial account surplus decreased by US$ 3.0 billion in FY11 - the highest fall recorded during the past four

[3] Remittances through exchange companies declined by 15.5 percent in FY11.

[4] The average share of remittances through banks increased from 83 percent in FY10 to 89 percent in FY11.

[5] Investment income covers receipts and payments associated with resident's holdings of external financial assets and liabilities. SBP's reserves were also higher by US$ 2.6 billion on average during F11.

[6] SBP's reserves, part of which is invested were higher by US$ 2.6 billion on average during F11.

years **(Figure 8.6).** While foreign direct investment declined due to lingering issues such as terrorism, energy shortages, corruption etc., portfolio investment registered a relative improvement **(Figure 8.7).**[7]

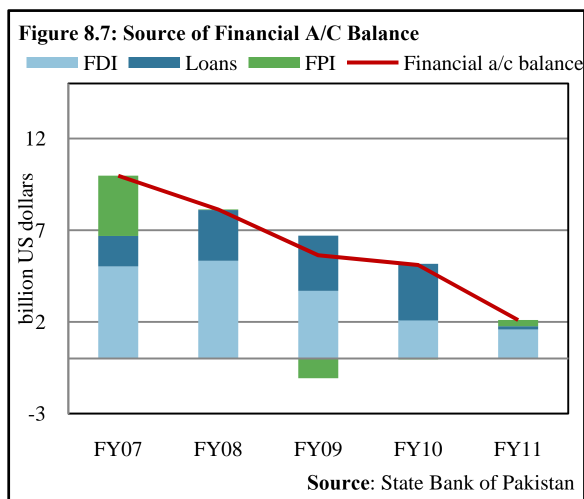
The disbursement of loans also declined sharply in FY11 in contrast to the rise in FY10. This fall is attributed to the suspenion of the IMF stand-by agreement in May 2010, which also impacted inflows from other IFIs and bilateral donors. The amortization of loans, on the other hand, increased, which put further pressure on the financial account.

Going forward keeping in view the uncertainty surronding the global economy and governemnt's exit from the IMF program, presures on the financial account are likely to continue.

Net foreign investment

The net inflow of foreign investment into Pakistan fell by 8.1 percent during FY11. The main contributing factor behind this decline was a substantial fall of US$ 800.6 million in foreign private investment which more than offset an increase of US$ 632 million in foreign public investment (**Table 8.4**).

Figure 8.7: Source of Financial A/C Balance



Source: State Bank of Pakistan

Table 8.4: Net Inflow of Foreign Investment
million US dollars

	FY10	FY11	Absolute	%age
Foreign Private Investment	2,738	1,938	-800	-29
Direct Investment	2,150	1,595	-577	-27
Portfolio Investment	588	364	-223.4	-38
Equity Securities	601	364	-236.4	-39
Debt Securities	-13	-	13	100
Foreign Public Investment	-652	-20	632	97
Portfolio Investment	-652	-20	632	97
Debt Securities	-652	-20	632	97
Total	**2,086**	**1,918**	**-168**	**-8**

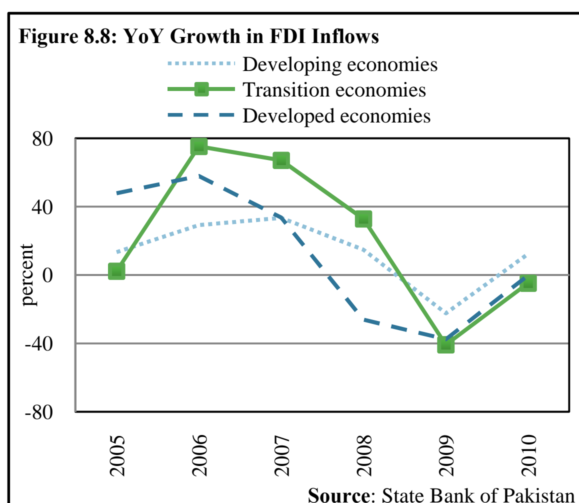
Source: State Bank of Pakistan

Foreign direct investment

The decline in foreign direct investment continued for the third consecutive year. A year-on-year decline of 26.8 percent in foreign direct investment was contributed to by a decline in both equity capital and in reinvested earnings. Equity capital recorded a fall of 22.6 percent whereas reinvested earnings declined by 83.7 percent during FY11 **(Table 8.4).**

It is important to mention here that global economic conditions improved in 2010 compared to 2009. Foreign direct investment flows to developed, developing and transition economies rebounded sharply in 2010

Figure 8.8: YoY Growth in FDI Inflows

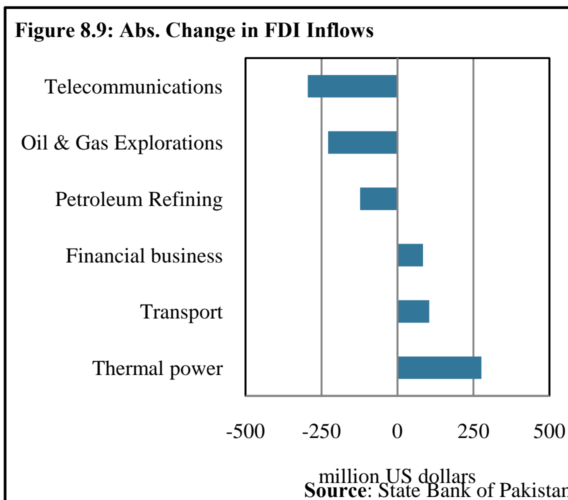


Source: State Bank of Pakistan

[7] Global Competitiveness Index 2010-11 shows that Pakistan is the second worst place in the world (ranked 138 out of 139) as far as business cost of terrorism is concerned.

(Figure 8.8). Despite better global economic conditions, FDI flows to Pakistan declined further in 2010 owing to a number of domestic issues that substantially increased the cost of doing businesses in Pakistan. Sector-specific issues such as saturation in the telecom sector and acute energy shortages also deterred the investment flows.

Figure 8.9: Abs. Change in FDI Inflows



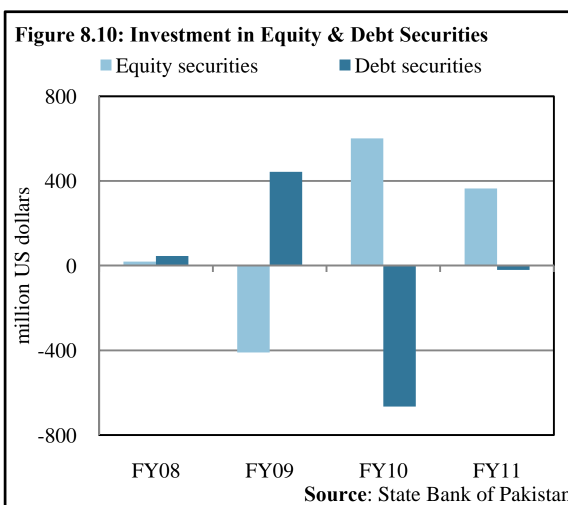
Source: State Bank of Pakistan

Sector-wise data on FDI shows that the major fall in investment was registered in the telecommunication and oil & gas exploration sectors, whereas FDI flows to the power and financial sectors recorded a modest rise **(Figure 8.9)**. The decline in the telecommunication sector probably reflects saturation in this sector. Moreover, stiff competition, rising advertisement costs, utilities costs and energy costs have squeezed the profits of telecommunication companies. On the other hand, the law & order situation (increased incidents of attacked on gas pipelines & oil fields in Baluchistan and KP) is a major hurdle in attracting fresh FDI in the oil & gas exploration sector as this issue is proving to be the major constraint on companies looking to expand their operations.

Foreign portfolio investment

The overall position of portfolio investment improved in FY11 as outflows in debt securities remained much lower than in FY10. However, the investment in equity securities declined in FY11 **(Figure 8.10).** This decline of US$ 222.0 million is a function of weak economic prospects and investors' bleak view of listed Pakistani companies. Regarding debt securities, payments worth US$ 21.0 million were made in FY11 compared to US$ 652.4 million in FY10, which was made on account of maturing Sukook bonds.

Figure 8.10: Investment in Equity & Debt Securities



Source: State Bank of Pakistan

Foreign long-term loans (net)

Foreign long-term loans (net) declined substantially by 61.7 percent in FY11 in contrast to a modest rise of 1.5 percent in FY10. This sharp fall was the outcome of a 30.2 percent drop in overall disbursements. Moreover, amortization of official loans increased by 15.4 percent, which further deteriorated the position of loans (net). The ratio of realized to pledged loans declined considerably since the suspension of the IMF program. The World Bank and the ADB pledged more than US$ 1.0 billion each, however only US$0.5 and US$0.4 billion respectively have been realized so far.

Outstanding export bills (OEB)

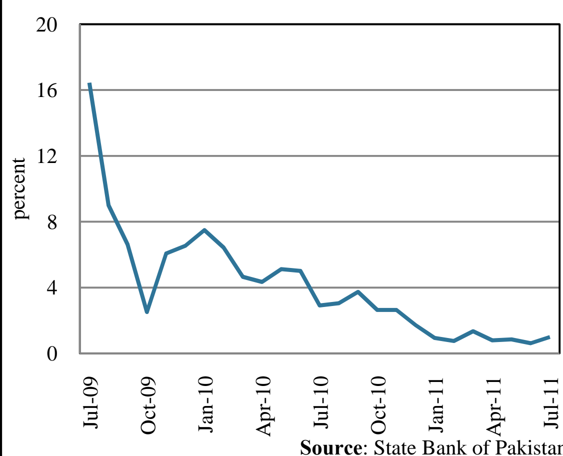
In line with the historic level of export earnings, the stock of aggregate outstanding export bills increased by US$ 793 million in FY11 as compared to an increase of US$ 422 million in FY10. OEB's are generally 2.0-3.0 percent of total merchandise exports. In FY11, OEB's were 3.2

percent of total exports. Stock of OEBs held by both exporters and commercial banks led to this increase.

Exchange rate

As discussed earlier, Pakistan's external account position remained comfortable through most of FY11, with inflows matching outflows though most of the year. This comfort in the inter-bank market was reflected in the relative stability of the Pak rupee/US$ exchange rate during FY11. The Pak rupee depreciated nominally by 0.7 percent during FY11 against 4.7 percent in FY10. A monthly analysis also reveals the absence of any episode of a sharp depreciation in the exchange rate during FY11 **(Figure 8.11)**.[8]

Figure 8.11: Depreciation of Pak Rupee

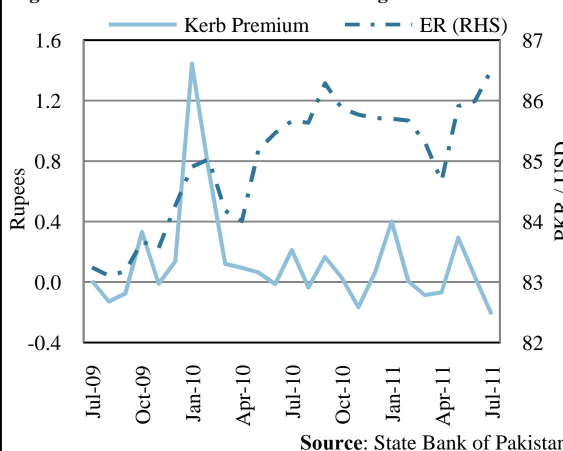


Source: State Bank of Pakistan

Kerb premium and exchange rate

The comfort in the external sector, the improvement in foreign exchange reserves and the relative stability in Pak rupee also aided in keeping the kerb premium much lower in FY11 compared to FY10. The average kerb premium in FY11 remained Rs 0.07 against the average premium of Rs 0.23 in FY10. There were also no episodes of sharp rises in the kerb premium as was witnessed in FY10 **(Figure 8.12)**.

Figure 8.12: Kerb Premium and Exchange Rate

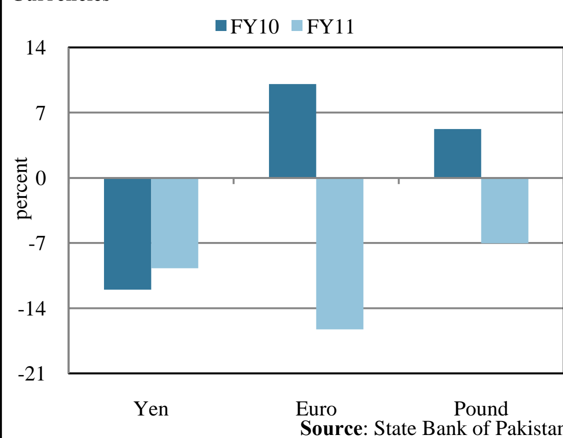


Source: State Bank of Pakistan

Pak rupee versus other major currencies

Although the Pak rupee remained relatively stable against the US dollar, it depreciated by 9.7, 16.3 and 7.0 percent against the Yen, the Euro and the Pound Sterling. This depreciation of the Pak rupee was in line with the movement of these currencies in the global foreign exchange market. The Yen, the Euro and the Pound Sterling appreciated against the US$ by 5.2, 6.6 and 4.0 percent respectively during FY11**(Figure 8.13)**. Prospects of slower recovery in the US along with delays in resolution of US public debt limit were the the main underlying factors for the weakness of US$.

Figure 8.13: App (+)/ Dep (-) of Pak Rupee Against Major Currencies



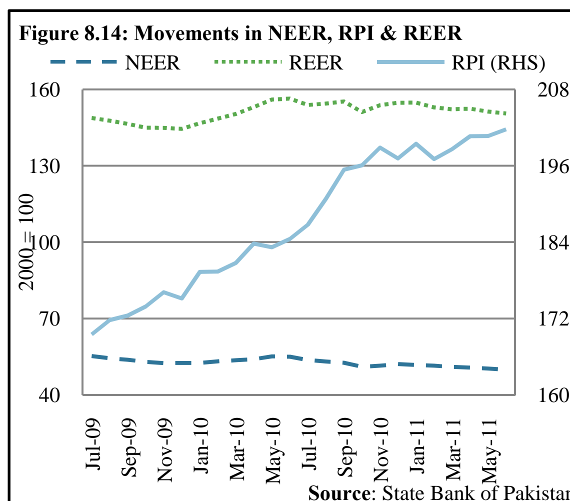
Source: State Bank of Pakistan

[8] Though some pressures in the inter-bank market were noticeable in Sep-10 due to increased demand for foreign exchange by oil marketing companies.

Effective exchange rate

Although the rupee-dollar parity was relatively stable, the nominal effective exchange rate (NEER) depreciated by 9.2 percent in FY11 – significantly higher than the depreciation of 2.1 percent in FY10 - highlighting the weakening of the rupee against other major currencies. The real effective exchange rate, on the other hand, depreciated by 0.76 percent in FY11 against an appreciation of 8.3 percent in FY10, **(Figure 8.14)** showing some gain in competitiveness.

Figure 8.14: Movements in NEER, RPI & REER



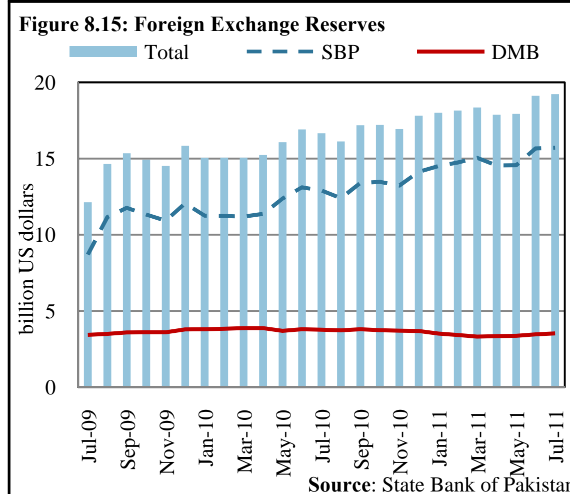
Source: State Bank of Pakistan

Foreign exchange reserves

The improvement in the overall external balance despite the contraction in financial account surplus helped build up foreign exchange reserves during FY11. Thus, by the end of June 2011, Pakistan's overall foreign exchange reserves stood at a record level of US$ 18.2 billion.

The breakup of total reserves shows that the rise in country's reserves was entirely due to the increase in SBP reserves as the reserves held by commercial banks declined by US$ 333 million during FY11. SBP reserves on the other hand registered a substantial increase of US$ 2.6 billion and stood at US$ 15.7 billion by end June 2011 **(Figure 8.15)**.

Figure 8.15: Foreign Exchange Reserves

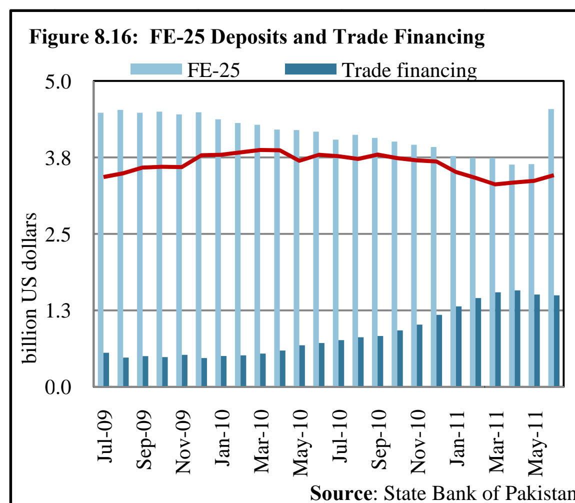


Source: State Bank of Pakistan

It is pertinent to mention here that both the inflows and outflows in SBP reserves remained lower in FY11 compared to FY10. Fortunately, weak inflows in FY11 were offset by significantly lower outflows. A surplus in the current account and the postponement of oil payments limited the need to inject foreign currency into the inter-bank market. As a result, SBP remained a net purchaser from the interbank market almost throughout the period under review.

In contrast to SBP reserves, reserves held by commercial banks witnessed a net outflow and stood at US$ 3.5 billion by end June FY11. The decline in commercial bank reserves is mainly due to the increased demand for foreign currency loans and the decline in FE-25 deposits **(Figure 8.16).** The increase in trade financing reflects both the rise in trade volume and the stability of exchange rate during the period under review. Trade financing thus rose by US$ 778 million during FY11 and FE-25 deposits increased by only US$ 367 million in the same period. Out of the US$ 778 million used for trade financing, the proportion used by importers (US$ 415 million) is more than that utilized by exporters (US$ 313 million). It is important to mention that trade financing improves dollar liquidity in domestic market and thus supports the exchange rate.

Figure 8.16: FE-25 Deposits and Trade Financing

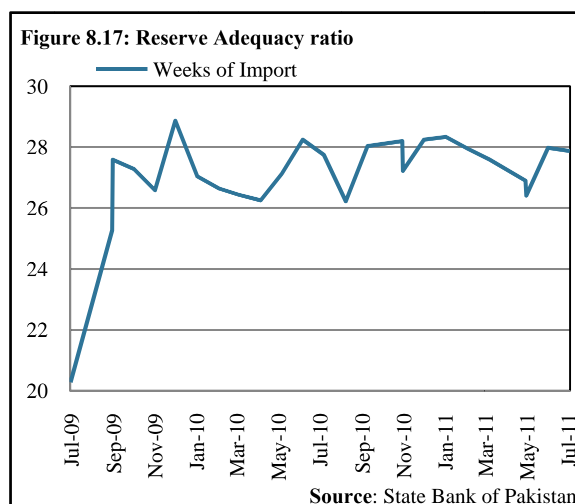


Source: State Bank of Pakistan

Reserve adequacy

The reserve to import ratio - widely used to measure reserve adequacy and a reflection of the financial soundness of the country – remained comfortably at 27.9 weeks of imports in FY11. This was almost the same as in FY10. A monthly analysis of the reserve adequacy ratio indicates that import coverage remained relatively higher in FY11 compared to FY10 **(Figure 8.17)**. This improvement is commendable given the sharp rise in the import bill during FY11.

Figure 8.17: Reserve Adequacy ratio

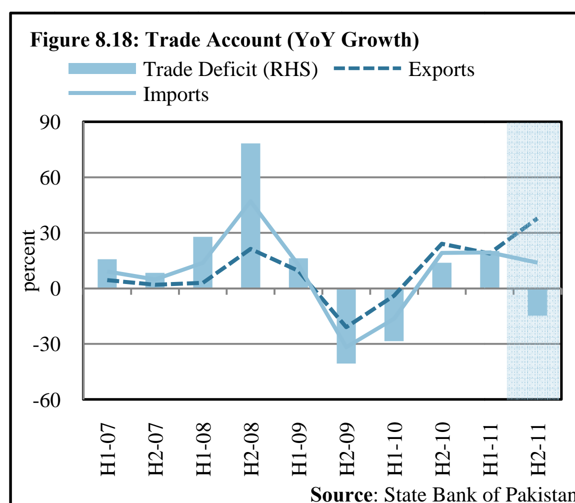


Source: State Bank of Pakistan

8.4 Trade Account[9]

As per the *FBS* data, Pakistan's trade deficit widened by 0.9 percent in FY11 after contracting during the previous two years. This deterioration in trade account was due to relatively large increase in imports compared to exports, which otherwise posted a decent growth of 28.9 percent. While the growth in exports was concentrated in the H2-FY11, that in imports was more pronounced in the H1-FY11 **(Figure 8.18)**.

Figure 8.18: Trade Account (YoY Growth)



Source: State Bank of Pakistan

The16.4 percent rise in imports during FY11

[9] The discussion on this section is based on custom data provided by the Federal Bureau of Statistics (FBS) which may vary from trade numbers compiled by the SBP.

was driven by increase in international prices as quantum of imports actually declined; reflecting sluggish domestic demand. Exports, however, benefited from the rise in international prices as 66.0 percent of the increase in exports was due to higher prices while the remaining was due to the increase in quantum. The major impetus to exports came from cotton and textile; other groups such as: food group, petroleum group, Leather, footwear, medical & surgical instruments, cutlery and chemicals & pharmaceuticals etc also registered substantial growth.

Although performance of exports was quite encouraging during FY11, structural rigidities, energy shortages and concerns over the law and order situation continue to plague the country's exports potential. These issues have been a major hurdle in export diversification, both, in terms of commodities and destinations and have eroded country's competitiveness overtime.

In 2010-2011 (World Economic Forum's) Global Competitiveness report **(Table 8.5)**, Pakistan's ranking has dropped to 123 from 101 last year. In the region, its overall competiveness ranking is lower than that of India's (51), Bangladesh's (107) and Sri Lanka's (62). All major determinants of competitiveness - such as macroeconomic stability, health and primary education, higher education and training and labor market efficiency - are lower in Pakistan as compared to other regional countries.

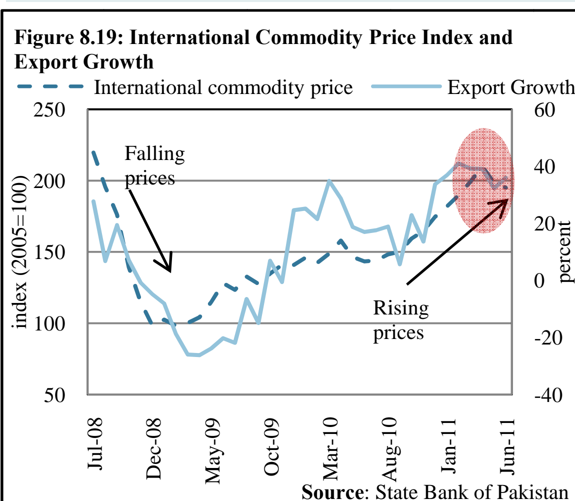
Going forward, the trade deficit is likely to increase due to the slowdown in exports particularly, textiles and cotton exports. This assessment is based on a number of factors such as: (1) the easing of international commodity prices especially cotton **(Figure 8.19)** and; (2) concerns over the recovery in advanced economies. [10] On the other hand, the overall import bill could be higher in FY12 due increase in both quantum and average prices of petroleum products.

Table 8.5: Global Competiveness Rankings

	2009-10	2010-11
Pakistan	101	123
India	49	51
Bangladesh	106	107
Sri Lanka	79	62
Nepal	125	130
Malaysia	24	26
Thailand	36	38
Philippines	87	85

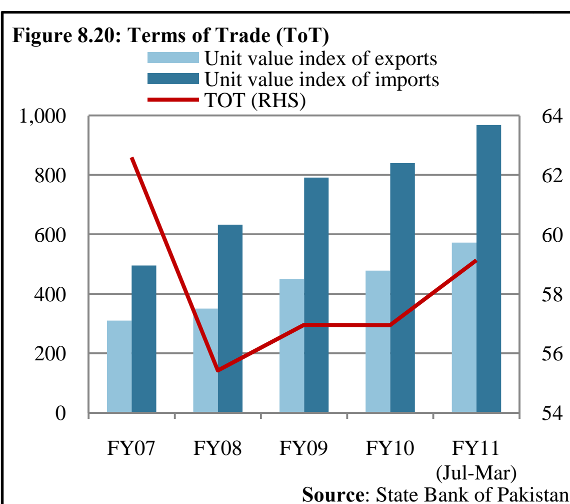
Source: The Global Competiveness Report 2010-11

Figure 8.19: International Commodity Price Index and Export Growth



Source: State Bank of Pakistan

Figure 8.20: Terms of Trade (ToT)



Source: State Bank of Pakistan

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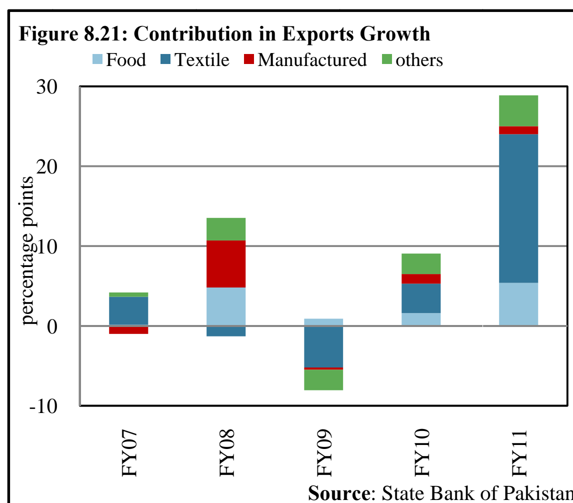
[10] Cotton prices are expected to decline significantly due to the expected increase in cotton production in Pakistan, India, China and Brazil. A part of the rise in cotton prices in FY11 was also due to speculation which has been dampened following a positive outlook about the future cotton crop.

Terms of trade

Since commodity prices started rising in FY09, Pakistan's terms of trade (ToT) have continuously improved. This has been due to a larger increase in the unit value index of exports than the increase in unit value index of imports **(Figure 8.20)**. Pakistan's main exports are low value added manufactured products whose prices have registered substantial increase in international markets during the past couple of years. On the other hand, Pakistan's imports mainly consist of oil and raw materials for consumer goods, whose prices have increased only moderately during this period.

Figure 8.21: Contribution in Exports Growth

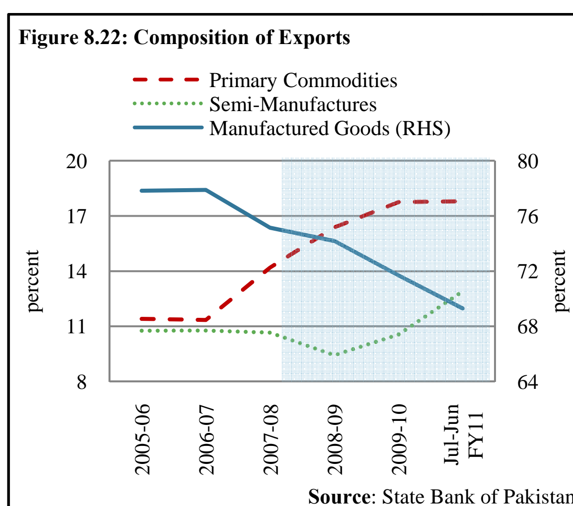


Source: State Bank of Pakistan

8.4.1 Exports

Exports recorded a sharp rise of 28.9 percent during FY11 against 9.1 in FY10. In absolute terms, exports of US$ 24.9 billion were the highest ever in the history of the country. This mile stone was achieved on the back of 35.2 percent rise in cotton and textiles related exports that were supported by impressive growths in other major groups including food, textile, leather products, chemicals & pharmaceuticals etc. **(Figure 8.21)**.

Figure 8.22: Composition of Exports



Source: State Bank of Pakistan

Monthly analysis reveals that a large part of the rise in exports occurred during H2-FY11on account of: (1) the rise in international commodity prices; and (2) 2.08 percent depreciation in the real effective exchange rate.

Notwithstanding improved export performance during FY11, it is disconcerting that the composition of Pakistan's exports is regressing from manufactured to semi-manufactured and primary commodities **(Figure 8.22)**. According to latest available figures, the share of manufactured goods in total Pakistani exports is around 71 percent compared to 88 percent in Bangladesh. In India and Sri Lanka the share of manufactured goods in exports is 67 percent.[11]

Food exports recorded strong growth

An analysis of food exports reveals that the main impetus for export growth in this category came from wheat, fish, meat, fruits, and vegetables exports with improved production and higher prices of these commodities playing an important role **(Table 8.6).**

Wheat exports accounted for more than 55 percent in of the growth in food exports, followed by vegetables (9.0 percent), fish (6.7 percent) and meat (5.1 percent). The exceptional rise in wheat exports during FY11 is attributed to; (1) higher international prices due to production losses in

[11] World Development Report 2011.

Russia, USA and Canada; and (2) the availability of an exportable surplus from last year's carryover stocks and strong expectations of a bumper crop in FY12.[12]

Exports of ***meat*** continued to grow strongly for the fifth year and have increased by almost four-fold since FY07. This growth was due to both an increase in quantity and in prices. The rise in meat and meat preparation exports is on account of higher demand from Saudi Arabia after the Saudi government banned meat imports from some African countries.

Table 8.6: Food Exports (million US dollars)

	Abs. Change	Quantum Impact	Price Impact
Food Group	**1,050.9**		
Rice	-45.7	-188.4	142.6
a) Basmati	79.2	-230.6	105.7
b) Others	-124.9	55.0	15.4
Fish and Fish preparations	70.3	55.0	15.4
Fruits	26.0	-10.7	36.7
Vegetables incl. roots and Tubers	95.1	48.1	47.0
Tobacco Raw	12.6	-2.4	15.0
Wheat	580.9	340.7	240.2
Spices	9.1	-1.3	10.5
Oil Seeds & Nuts etc.	0.5	3.0	-2.5
Sugar	0	0	0
Meat and Meat Preparations	53.8	42.5	11.2
All Other Food items	248.4		

Source: Federal Bureau of Statistics

Realizing the potential in the Halal meat industry, which has worldwide sales of over US$ 1 trillion, the Sindh Board of Investment (SBI) took a number of initiatives for the promotion of the Halal meat industry in Pakistan at the start of FY11. Their efforts resulted in higher production and exports of meat, despite the floods that severely affected livestock in Sindh and Punjab. The production of meat and its exports are likely to rise further in FY12.

After declining during FY10, ***fish and fish preparation*** exports increased to US$297 million in FY11 despite the loss of Europe as an export destination[13]. Pakistan managed to fetch higher prices for its shrimp exports from Egypt and other markets such as China, UAE, Thailand, Korea, Saudi Arabia and Indonesia which not only nullified the loss – approximately $30-40 million per annum – of Europe as an export market but also increased export earnings. Overall, fish and related exports during FY11 rose to 131,700 tons ($297.3 million) compared to 106,000 tons ($227.0 million) last year. A number of initiatives are under way to further increase the exports of fish & fish preparation, including: (1) the expansion of the existing laboratory infrastructure to provide testing and certification facilities acceptable to destination markets; (2) the provision of financial support to revamp fish jetties at Gaddani, Dam, Pasni and Jewani; (3) ensuring the provision of facilities such as landing stations/jetties/ports along the Makran coast in partnership with the provincial government of Balochistan; and (d) support Korangi seafood processing companies in developing a traceability system for smoked, canned, fresh and frozen fish products. Pakistan will not be able to resume seafood exports to the EU next year since the EU mission did not include Pakistan in the list of countries to be visited in 2011 for the assessment of the country's production facilities.

Despite higher prices in the international market, rice exports, on the other hand, declined during FY11 due to production losses – around 1.7 million tons of paddy – caused by the floods. Rice production was only 4.82 million tons in FY11 compared to 6.61 million tons in FY10. The decline in rice exports was entirely due to the lower export volume of non-basmati rice, whereas basmati rice recorded an increase in quantity exported.

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[12] According to latest official estimates, the wheat production is expected to remain at 25 million tons during FY12 compared to 24.214 million tones production realized in FY11.

[13] The EU imposed a ban on seafood imports from Pakistan in April 2007 for not complying with quality requirements.

Textile exports demonstrated a broad based increase during FY11[14]

Textile exports increased sharply by 35.2 percent during FY11 compared to a 6.8 percent increase last year. This sharp acceleration emanated largely from: (1) higher prices of cotton and textile products; (2) increase in textile and clothing demand in the EU and US; and (c) Depreciation in nominal effective and real effective exchange rate.

Table 8.7: Quantum and Price Impacts (FY11)
million US dollars

	Quantum Impact	Price Impact
Raw Cotton	-30.1	171.1
Cotton Yarn	-217.5	948.6
Hosiery	398.1	138.8
Cotton Fabric	489.8	273.1
Readymade Garments	409.2	106.8
Bed wear	-84.1	425.1
Towels	-43.3	135.4
Total Effect	**1,471.1**	**2,905.3**

Source: Federal Bureau of Statistics

It is also important to mention that not only low value-added textile products such as cotton yarn and cotton fabrics show greater than 20 percent growth in FY11, but high value added products such as bed wear, towels and readymade garments also recorded strong growth. Although the price impact in all textile items remained dominant, the quantum impact in hosiery, cotton fabric and readymade garments also contributed significantly to the rise in exports **(Table 8.7)**.

Moreover, it appears that frequent disruptions in manufacturing process has limited Pakistan's ability to cater for bulk byres, to counter this, Pakistani exports are now increasingly targeting relatively smaller importers. This strategy makes sense as India, Bangladesh, Sri Lanka are catering for bulk buyers while China is shifting to provide established brands. This leaves relatively small importers whose orders could be processed with existing constraints.

Non-food, non-textile export increased by 16.0 percent during FY11 compared with a 13.3 percent rise last year. The contribution to growth came from petroleum products, leather raw and manufactured, footwear, medical and surgical instruments, chemicals and pharmaceuticals, and engineering goods. A fall in the exports of fertilizer, jewelry, cement and molasses, however, partially offset the increase in the rest of the non-food non-textile exports.

Chemicals & pharmaceutical exports posted a growth of 21.8 percent during FY11despite the fall in fertilizer and pharmaceutical exports. Other sub-sectors, such as, plastic materials and other chemicals were the main contributors to the chemicals and pharmaceutical group's export earnings. Export earnings from plastic material grew by 50.4 percent and from other chemicals increased by 20.5 percent during FY11. This rise can be attributed to an increase in import demand from India for chemicals like polyethylene and pure terepthalic acid (PTA).

Leather manufactures grew by 17.3 percent during FY11. The largest contribution came from exports of leather garments followed by leather gloves. During FY11, the export of footwear also increased by 16.5 percent. Among footwear products, the exports of leather footwear increased 26.4 percent, and that of canvas footwear by 51.0 percent. The higher export of leather manufactures and footwear is mainly due to rise in demand in traditional markets and relatively better export prices.

Pakistan's ***cement*** exports declined for the second consecutive year. This decline was on account of: (1) low demand from United Arab Emirates (UAE); (2) qualitative barriers from India on cement imports; (3) imposition of higher import duty in Afghanistan; and (4) increased production capacities in Middle East and India.

[14] See section 2.3.2 for more discussion on textile exports.

8.4.2 Imports

After declining for the last two years, imports grew by 16.4 percent in FY11 against a marginal decline of 0.3 percent in the previous year. The rise was due to increase in food, petroleum, textile and agricultural & chemical group imports, while imports of machinery, transport goods, and metals fell **(Table 8.8).** A host of factors are responsible for the increase in imports including: (1) the increase in international commodity prices, particularly that of petroleum products and Palm oil; (2) the domestic shortage of pulses, sugar and cotton due to floods in August 2010.

Table 8.8: Contribution in Import Growth
percent

	FY08	FY09	FY10	FY11
Food & Agri.	9.6	-1.6	0.1	5.3
Petroleum	13.5	-4.9	1.5	5.9
Textile	2.6	-1.7	0.6	3.0
Machinery, Transport & Metal	2.3	-3.8	-2.2	-0.6
Others	2.9	-0.9	-0.3	2.9
Total	**30.9**	**-12.9**	**-0.3**	**16.4**

Source: Federal Bureau of Statistics

Table 8.9: Share in Overall Import Increase (FY11)
million US dollars

	Abs. Δ in %	Quantum impact	Price impact
Petroleum crude	28.7	581.2	1,054.6
Palm oil	12.2	186.0	516.4
Other chemicals	8.5	N.A	N.A
Petroleum products	7.3	-1,040.7	1457
Sugar	6.9	312.2	78.7
Raw Cotton	6.5	3.1	368.8
Plastic Material	5.1	295.6	-3.5
Other Textile items	5.0	N.A	N.A
Telecom	4.6	N.A	N.A
Synthetic Fiber	3.0	95.3	74.7
Total	**87.9**	**-34.3**	**4,208.9**

Source: Federal Bureau of Statistics

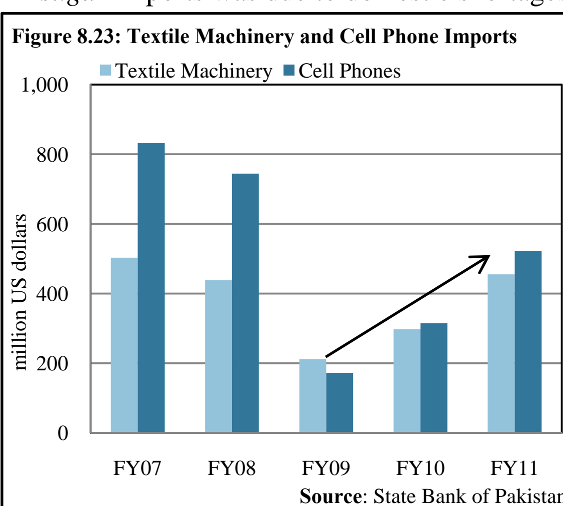
Major commodities recording increase

The import of *petroleum crude* posted a growth of 51.6 percent during FY11in sharp contrast to last year when it declined by 20.6 percent. The import of *petroleum products* recorded a moderate growth of 6.1 percent which was almost entirely due to the increase in prices. The reason behind the lower import quantity of petroleum products is the increase in domestic production of high speed diesel (HSD), furnace oil (FO) and motor gasoline (MS).

In the *food group,* the import of *palm oil* and *sugar* contributed to around 72 percent of overall growth in food imports. While the rise in prices was the main reason for the increase in Palm Oil import bill, higher quantum may have been influences by reduction in import duty on this commodity earlier in the year. The increase in *sugar* imports was due to domestic shortages. Sugar import is anticipated to decline in FY12 due to the expected rise in sugar cane production after the floods and favorable weather conditions in Punjab and Sindh.

The rise in the import of raw cotton was primarily due to higher prices in the international market, although a slight increase was recorded in quantity imported as well **(Table 8.9)**. Pakistan imports long fiber strand cotton and it is expected that the import of raw cotton will decline in FY12 following decline in cotton prices from their peak level in March, 2011. [15]

Figure 8.23: Textile Machinery and Cell Phone Imports



Source: State Bank of Pakistan

[15] Prices of cotton have dropped from 229.67 US cents per Pound in March 2011 to 116.65 cents per Pound in September 2011: Cotlook 'A Index', Middling 1-3/32 inch staple, CFR Far Eastern ports.

In tandem with last year, imports in the *telecom* sector posted sharp growth during FY11. This was mainly due to the rise in the import of mobile phones after the government allowed the import of low-priced Chinese mobile phone brands into the country.

Although imports in the machinery group as a whole registered a decline during FY11, the import of textile machinery continued to improve. Imports of textile machinery rose by 53.0 percent in FY11 compared with 41.3 percent rise last year. Higher import of textile machinery was the result of (a) replacement of old machinery mainly in the weaving sector, and (b) imports of new machinery in spinning and stitching sectors **(Figure 8.23).**

Table 8.10: CBU Imports

		Value (million US dollars)		YoY Growth (percent)	
	Age Limit	CBU	Motor Cars	CBU	Motor Cars
FY06	10 Years	563.0	371.7	-	-
FY07	5 Years	453.5	312.0	-19.5	-16.1
FY08	3 Years	444.8	237.4	-1.9	-23.9
FY09	3 Years	173.8	81.8	-60.9	-65.5
FY10	3 Years	211.3	103.1	21.6	25.9
FY11		219.4	145.8	3.8	41.5
FY11					
(Jul-Dec)	3 Years	87	48.6	-	-
(Jan-Jun)	5 Years	132.4	97.2	52.2	100.0

Source: Federal Bureau of Statistics

Similarly while imports from the ***transport group*** declined by 3.9 percent in FY11, the import of motor cars and motor cycles increased sharply. In particular, the import of CBU units of motor cars grew by 41.5 percent growth in FY11 compared with 29.5 percent last year. This growth was expected after the government's decision to increase the age limit of imported cars from 3 to five years in December 2010.[16] The imports of CBUs are directly proportional to the age limit **(Table 8.10)**. However, the impact of this decision was much lower than expected because of the exchange rate depreciation, higher interest rates and the deterioration in macroeconomic situation.

Major commodities recording fall in imports

A major fall was recorded in the import of other transport equipment, wheat, agricultural machinery, fertilizer manufactured; construction & mining machinery, and power generating machinery **(Table 8.11)**.

Table 8.11: Items Recorded YoY Fall in Imports
percent

	FY09	FY10	FY11
Other Transport equipments	-69.7	464.3	-88.6
Wheat Un-milled	25.4	-96.2	-87.3
Agricultural Machinery	-18.1	77.1	-50.3
Fertilizer Manufactured	-38.4	73.6	-43.5
Construction and Mining Machinery	7.6	-41.7	-29.9
Power Generating Machinery	48.5	-17.9	-29.4
Gold	50.1	274.2	-21.0
Aircrafts, Ships and Boats	-45.5	58.9	-19.1
Iron and Steel	5.6	-7.8	-6.6
Other Machinery	10.6	-28.6	-5.0

Source: Federal Bureau of Statistics

In case of *other transport equipment*, 88.6 percent decline in FY11 was due to the absence of one-off imports related to railway (rail maintenance vehicles and other parts for locomotives) that had inflated the import bill last year.

Wheat imports continued to decline for the second consecutive year, dropping by 87.3 percent during FY11. The fall in wheat imports was the result better domestic production and carryover stocks from FY10.

As far as imports of fertilizer ***manufacture*** group is concerned, a significant decline was recorded entirely due to the lower quantity imported as the unit value increased by 20 percent. The decline in quantum was mainly due to the enhanced production capacity of fertilizer,

[16] Increase in the age limit reduces the cost of vehicle as importers can claim higher depreciation allowance. Importer can now claim 60 percent depreciation allowance against previous 36 percent.

particularly that of urea, in the country. Pakistan has been able to increase fertilizer production capacity by 1.4 million tons in FY11.[17]

The decline in the imports of *construction & mining machinery, and iron and steel* is perhaps a reflection of lower construction activities on the back of lower domestic demand. In the case of *power generating machinery*, inventories carried forward from previous years is the main reason behind the decline in imports during FY11.

[17] During FY11, Engro added 1.3 million tons while Fatima Fertilizer added 0.1 million tons to total production capacity.