

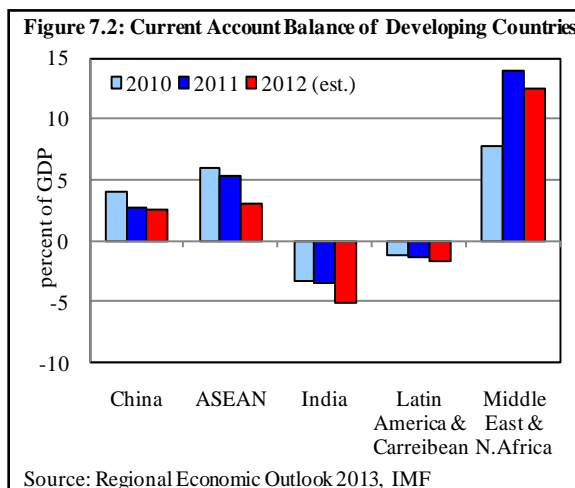
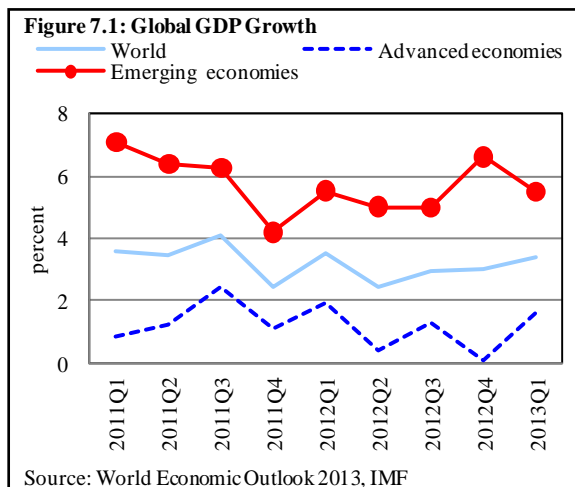
# 7 Balance of Payments

## 7.1 Global Economic Review

The global economy was facing two major threats at the start of FY13: the possible demise of the Euro, and a big fiscal contraction in the US, caused by the ‘fiscal cliff’.<sup>1</sup> However, timely policy actions were taken to address these issues. In the EU, for instance, Outright Monetary Transactions (OMTs) were launched to lower the long-term yields on sovereign bonds; there was a restructuring deal of Greek public debt; and the agreement on Single Supervisory Mechanism (SSM) was reached, to help restore confidence in the viability of the European Union.<sup>2</sup> Similarly in the US, a partial extension of Bush tax cuts was given under the American Taxpayer Relief Act 2012 (ATRA), to eliminate the revenue side of the fiscal cliff.<sup>3</sup>

Although these policy measures were able to restore some business confidence, these were, nonetheless, insufficient to pace up the economic recovery (**Figure 7.1**). In the EU, growth was constrained by fiscal consolidation; deleveraging; and tight credit conditions to repair balance sheets by financial institutions and households. In the US, growth remained lackluster throughout 2012 and early 2013, despite a pick-up in credit and housing following the launch of the third round of quantitative easing (QE3) in September 2012.<sup>4</sup>

The spillover of a slow recovery in these regions weighed on the growth in the Middle-East, Latin America and Asia. Policymakers in these regions tried to compensate for sluggish exports to advanced economies, by stimulating domestic demand via expansionary policies. However, this led to deteriorating current account balances, without any significant improvement in domestic activity (**Figure 7.2**).



<sup>1</sup> The fiscal cliff refers to massive reduction in US budget deficits January 01, 2013 onwards, as a result of expiring tax cuts and public spending.

<sup>2</sup> The agreement on SSM confers strong powers on the ECB for the supervision of all banks in the Euro area. With an objective to break the link between banks and sovereigns, this mechanism offers a single regulatory framework, and implement harmonized deposit protection schemes to limit the co-ordination failures across countries.

<sup>3</sup> For instance, under the ATRA, tax rates for income, capital gains and dividends were kept unchanged for single people making less than \$400,000 per year, and couples making less than US\$ 450,000 per year, instead of reverting to higher rates.

<sup>4</sup> The Federal Reserve launched a US\$ 40 billion per month, open-ended bond purchasing program of agency mortgage-backed securities in September 2012. In December 2012, the FOMC announced an increase in the amount from \$40 billion to \$85 billion per month.

The largest economy in Latin America – Brazil, for instance, decelerated sharply, as private investment failed to respond to an ambitious policy stimulus. The slowdown in Brazil spilled over to its regional trading partners including Argentina, Uruguay and Paraguay. In contrast, Middle Eastern countries performed well on the back of firm oil prices, as well as infrastructure expansion in the GCC countries. However, political and social unrest that followed the Arab spring (e.g., Egypt, Morocco, and Tunisia); the conflict in Syria; and weaknesses in European trading partners, offset some of the growth potential.

As far as Asia was concerned, it experienced a mixed growth pattern. Some analysts viewed China's policy of moderating and balancing its economic growth, as successful in creating a soft landing. Thereby, during the first quarter of FY13, China initiated another stimulus program, led by infrastructure investment and supportive financial conditions, which has supported the steady growth of retail sales. Japan, on the other hand, recorded a sharp slowdown in Q1-FY13 due to bearish exports; in our view, this may have triggered a radical change in its monetary policy stance to increase domestic inflation and keep the Yen weak. Most analysts would agree that *Abenomics* appears to be working, which means Japan's deflationary era may be at an end.

India, on the other hand, grew at the slowest pace in a decade during FY13. In addition to weak exports, the Indian economy also suffered a set-back from political rifts within the ruling coalition; tapering domestic investment; low business confidence; and high inflation. Although RBI has cut interest rates thrice during the year, this cumulative 75 bps cut was not sufficient to spur private investment. The space for further cuts is limited by the weakening Rupee, which has shed 20.6 percent and 5.7 percent against the US Dollar in FY12 and FY13, respectively.

The outlook for the global economy is marred by recent developments in the financial markets: capital flows to emerging markets have declined since June 2013, when the Fed flagged the need to rein in its monetary stimulus. Asset prices have remained volatile since then, and rising long-term US bond rates have triggered a flight to safety that has taken a toll on India, Turkey and Brazil. Although the Fed has delayed the QE tapering for now, the economic outlook remains uncertain due to expected spending cuts under the budget sequester,<sup>5</sup> which was delayed for two months under the ATRA. More importantly, political squabbling over the debt ceiling will become a major constraint in rebuilding confidence. The recession in the EU will continue, as balance sheet repairing continues and demand remains weak. Chancellor Merkel's recent election victory suggests that EU will remain on its path of fiscal austerity.

In light of the above concerns, the IMF in October 2013, revised downwards its forecast for global economic growth for 2013 and 2014, compared with its July 2013 forecast.<sup>6</sup> In effect, the global outlook appears weak.

## 7.2 Pakistan's External Account

Pakistan's balance of payments remained under stress throughout FY13. Similar to FY12, this stress can be traced to heavy repayments to the IMF, net outflows to other IFIs, and anemic foreign investments. Around a quarter of Pakistan's liquid FX reserves were exhausted during the year to pay for the US\$ 2.0 billion external deficit, and US\$ 2.5 billion IMF repayments (**Table 7.1**).<sup>7</sup> This

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<sup>5</sup> Budget sequester is the automatic cuts in fiscal spending which are approximately US\$ 85.4 billion for the year 2013. Social security, Medicaid, federal pensions and veteran's benefits are exempted. On aggregate, over the period 2013-2021, sequester would lower spending by US\$ 1.1 trillion compared with the pre-sequester levels.

<sup>6</sup> In its October 2013 update, IMF has projected global economic growth at 2.9 and 3.6 percent for 2013 and 2014, respectively. Earlier in July 2013, IMF had projected the same at 3.1 and 3.8 percent for 2013 and 2014, respectively.

<sup>7</sup> In addition to US\$ 2.5 billion SBA repayments, total IMF debt servicing included US\$ 0.4 billion by the government and US\$ 0.1 billion interest payments (**Chapter 6**).

caused SBP reserves to fall to US\$ 6.0 billion by end-FY13, from US\$ 10.8 billion at the start of the year. The Pak Rupee continued to depreciate throughout FY13; the exchange rate surpassed Rs 99.1 per USD for the first time on June 28, 2013.

Pressures on the balance of payments remained despite a significant improvement in the current account, which was supported by an inflow of US\$ 1.8 billion under Coalition Support Fund, and a decline in the trade deficit. In addition, worker remittances also reached US\$ 13.9 billion – just US\$ 100 million short of the target laid down in the Annual Development Plan 2013-14 (**Section 7.3**). As a result, the size of the current account deficit was smaller compared to last year, and the average of the past 4 years.<sup>8</sup> Yet, in the absence of financial inflows, this modest current account deficit was a policy challenge, as it required financing from the country's FX reserves.

In this context, the real issue in the external sector in FY13 was the drop in financial inflows. This situation was caused by an unfavorable financing mix in FY09 and FY10 (skewed towards debt finance), which necessitated large repayments in FY12 and FY13 (**Figure 7.3a**). More specifically, external debt servicing in FY13 stood at US\$ 6.0 billion; putting this burden in perspective, external debt servicing in FY13 equals the liquid FX reserves with SBP at end June 2013.<sup>9</sup> As an added strain, fresh disbursements have also declined by US\$ 0.6 billion during the year,<sup>10</sup> which has helped reducing the country's external debt stock, but at the direct cost of FX depletion (**Figure 7.3b**).<sup>11</sup> Although investment flows increased slightly in FY13 compared to last year, their levels are still very low to make much of an impact.

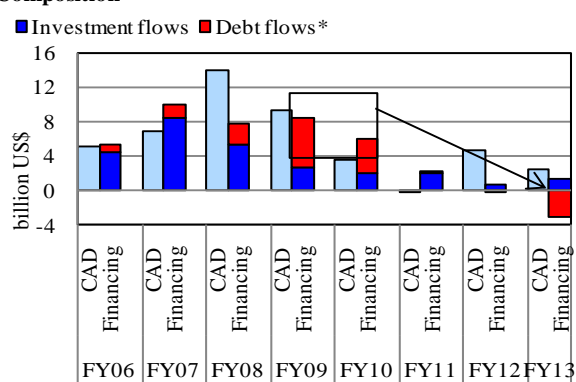
**Table 7.1: Performance of Pakistan's External Sector**

|   | FY11  | FY12  | FY13  |
|---|-------|-------|-------|
| Current account balance – billion US\$      | 0.2   | -4.7  | -2.5  |
| as % of GDP                                 | 0.1   | -2.4  | -1.0  |
| Trade balance as % of GDP                   | -4.9  | -6.7  | -6.2  |
| External debt stock as % of GDP             | 29.8  | 28.0  | 24.2  |
| <b>FX pressures</b>                         |       |       |       |
| External debt servicing* – billion US\$     | 3.5   | 4.3   | 6.0   |
| Servicing of IMF debt – billion US\$        | 0.4   | 1.3   | 3.0   |
| SBP liquid FX reserves – billion US\$       | 14.8  | 10.8  | 6.0   |
| Liquid FX reserves – billion US\$           | 18.2  | 15.3  | 11.0  |
| Week of import                              | 26.6  | 19.7  | 14.4  |
| CAB as % of liquid FX reserves**            | 1.3   | -25.5 | -16.1 |
| Debt servicing as % of liquid FX reserves** | 20.9  | 23.5  | 39.0  |
| Exchange rate (PKR/USD) – period avg.       | 85.55 | 89.25 | 96.86 |
| Sovereign rating (Moody's)                  | B3    | B3    | Caa1  |

\*including IMF; \*\*These ratios are calculated as CAB and debt servicing during the year, as % of liquid FX reserves at the start of the year.

Source: State Bank of Pakistan

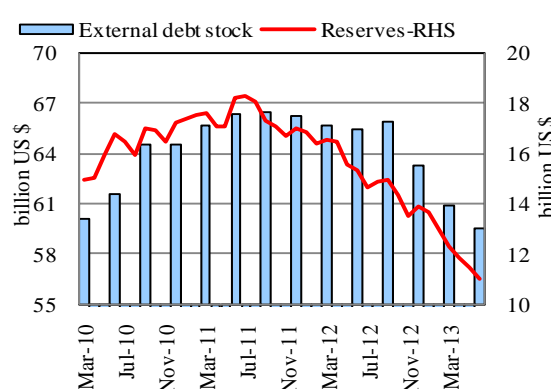
**Figure 7.3a: Current Account Deficit (CAD) and Financing Composition**



\* including IMF support

Source: State Bank of Pakistan

**Figure 7.3b: Liquid Foreign Exchange Reserves and External Debt Stock**



<sup>8</sup> The average current account deficit during FY09-FY12 was US\$ 4.4 billion. In terms of GDP, the average deficit in the same period was 2.4 percent, whereas for FY13, it stayed at only 1.0 percent.

<sup>9</sup> This includes IMF repayments.

<sup>10</sup> These disbursements include fresh loans to government and private sector (see **Annexure Tables 8.12 & 8.14**).

<sup>11</sup> As mentioned in **Chapter 6**, the stock of external debt and liabilities declined by US\$ 5.9 billion in FY13.

With such adversities, and a discomfoting level of FX reserves, the adjustment burden falls back on the current account. This adjustment is challenging because of stubborn structural problems in the current account – a legacy of sub-optimal incentive structures;<sup>12</sup> technology constraints; and entrepreneurial weaknesses. Furthermore, geographical and product concentration of our FX earnings, and import dependency on primary commodities (e.g., petroleum and palm oil), make it hard to insulate the current account against domestic and external shocks (**Box 7.1**). It is important to mention here that we cannot be complacent about the modest external deficit this year, as it was largely because of one-off CSF inflows.

While it will take some time to overcome these structural weaknesses in the economy, Pakistan has recently approached the IMF for immediate FX support. The new IMF program will focus on reforms, especially in the energy and fiscal sectors. We must reiterate that avoiding difficult reforms is not an option, as implementing only short-term stabilization policies could become problematic at a time when imports are trending down; exports are constrained by weak global demand; the country has a large burden of public debt; and is facing an energy shortage. More simply, stabilization involves only short-term demand management, and as a result, structural weaknesses remain in the system.

**Box 7.1: External Account Vulnerability**

The vulnerability of current account is typically gauged through concentration of FX earnings and payments; export and import volatility; and fluctuations in terms of trade.

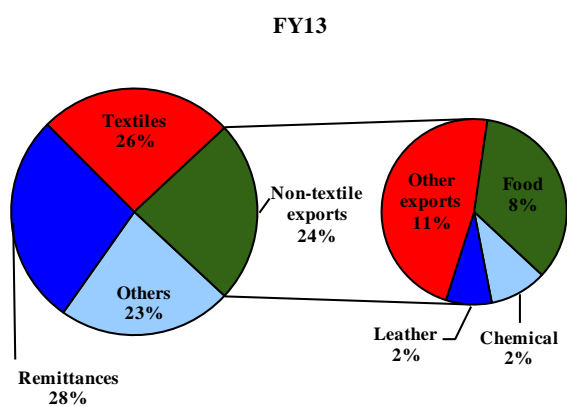
**(i) Concentrated FX earnings**

Pakistan’s FX earnings rely heavily on textile exports and worker remittances (**Figure 7.1.1**), as financial flows and other exports remain low. These two sources together make 50 percent of our gross FX earnings. Although the share of textiles in total exports has been declining in the previous few years, it still constitutes half of our exports. In fact, textiles and leather are the only two major categories where Pakistan has trade surplus; in all the other broad trade categories, we are running deficits. This dependency makes our FX earnings vulnerable to changes in cotton prices globally, as well as performance of the domestic crop. Running a net deficit in most categories basically implies that our products cannot compete well in both the domestic and export markets. There are various reasons to this: inadequate infrastructure to exploit available primary resources including coal and copper; high petroleum imports; inadequate investment in refining sector that keeps us short on important petrochemicals; lack of technological base required for producing machinery and other engineering/electrical goods; low value-addition in agro processing, etc.

**(ii) Dependence on Oil Imports**

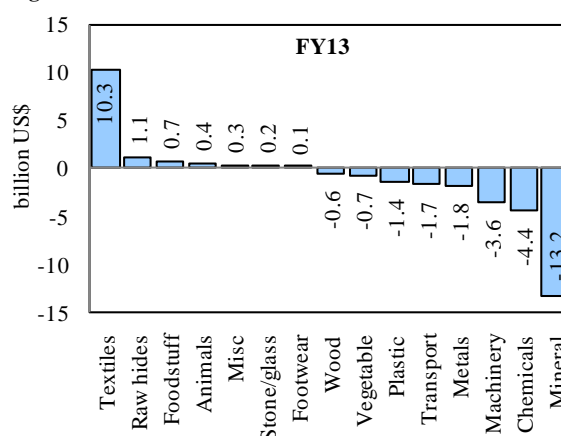
Dependence on imported oil and other essential commodities (e.g., food items, fertilizer, machinery etc.) is another factor that makes external account vulnerable. In Pakistan, the trend in trade balance closely follows the movement in oil prices,

**Figure 7.1.1 a: Composition of Pakistan's FX Earnings**



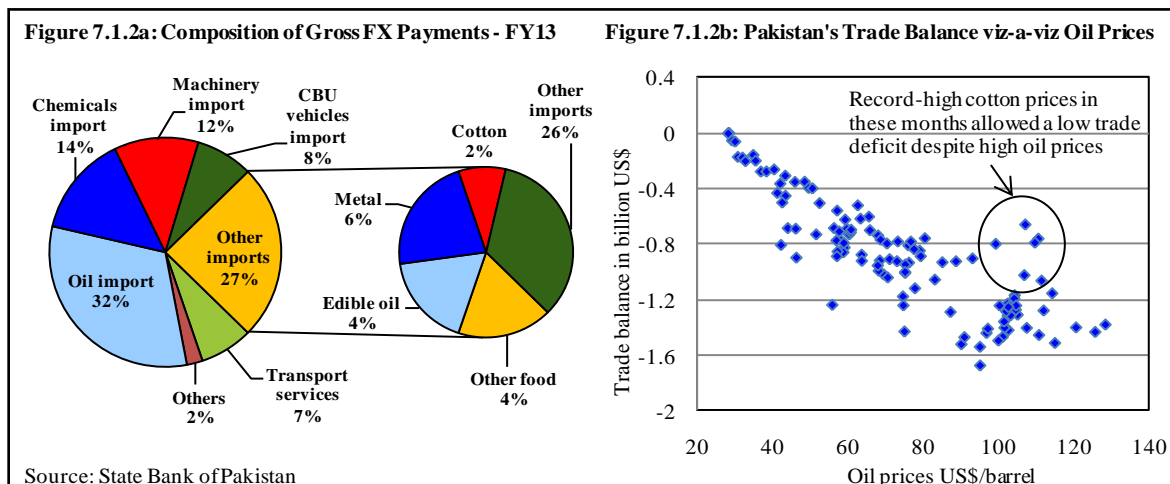
Source: State Bank of Pakistan

**Figure 7.1.1 b: Sector-wise Trade Deficit of Pakistan**



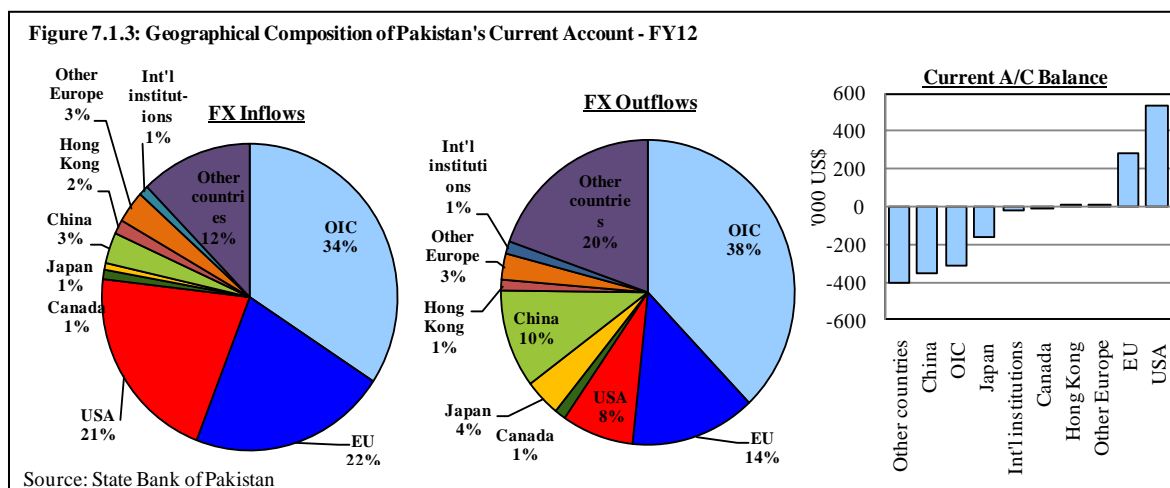
<sup>12</sup> For instance, untargeted energy subsidies and gross under-pricing of natural gas keep the import demand for energy products at high levels.

mainly because over a quarter of our import bill is comprised of petroleum imports, and there is a significant amount of volatility in these imports compared with non-oil imports (Figure 7.1.2). In addition to trade account, services account is also vulnerable to oil prices as transportation (freight charges) constitutes the largest part of our services imports.



Geographical concentration of net FX inflows

Pakistan's gross foreign exchange earnings are concentrated in three regions: US, EU and middle-eastern countries (Figure 7.1.3). While earnings from the US and EU are almost equally divided between export receipts and worker remittances; earnings from the Middle-East are mainly comprised of remittances. Inflows from the middle-eastern countries are more than offset by outflows, in the form of oil payments to Saudi Arabia and UAE. From the US, Pakistan's imports are limited – mainly American cotton, gas turbines, worn clothing, metal scrap and powdered milk. From EU also, our FX inflows are higher than outflows, since we rely on these countries mainly for textile and oil refining machinery, metals, turbines, etc. On aggregate, Pakistan's largest current account surplus is from the US, followed by the EU. On the contrary, Pakistan incurs a huge deficit against China, middle-eastern countries, and palm oil exporters (e.g., Malaysia and Indonesia). This heavily skewed distribution of our net inflows makes us vulnerable to shocks in the US and EU economies.



With the approval of a 3-year US\$ 6.64 billion Extended Fund Facility from the IMF, FX pressures are expected to remain muted in FY14.<sup>13</sup> With the IMF on board, financial support from other IFIs is also likely, bringing some comfort to the domestic FX market.

<sup>13</sup> Pakistan has already received US\$ 544.5 million from the Fund in September 2013.

However, the outlook on the current account is not optimistic. Political tensions in Syria and Libya have caused international oil prices to increase by 6.2 percent since end-June 2013; in addition, the stressful situation in Iraq and Sudan/South Sudan, and its possible implication on oil prices, does not bode well for our trade balance. Furthermore, we do not expect a significant revival in our exports, unless the global economy recovers more robustly, and domestic energy issues are resolved. Therefore, we expect a widening of the current account deficit to around US\$ 3.2 billion in FY14, after including the impact of inflows under CSF and 3G licenses.

### 7.3 Current Account

The current account posted a deficit of US\$ 2.5 billion in FY13, which was nearly half the deficit seen last year. As mentioned before, this improvement can be traced to the CSF inflows of US\$ 1.8 billion in FY13 (**Table 7.2**).

**Trade deficit** narrowed slightly mainly due to a decline in imports, as exports remained more or less unchanged.<sup>14</sup> Not only was the import quantum low, but bearish commodity prices (especially oil), also helped reduce the country's import bill (**Figure 7.4** and **Section 7.7** for details).

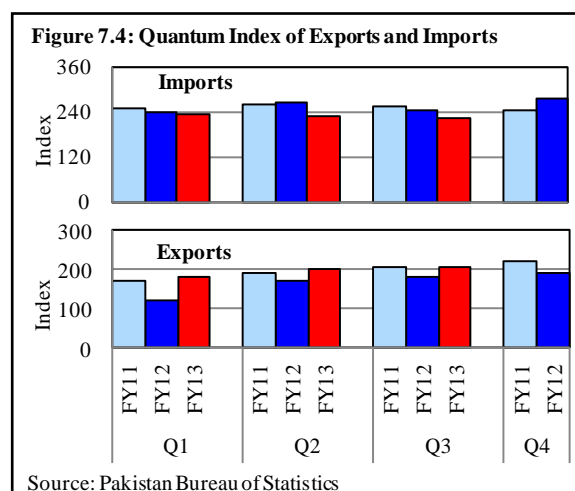
Inflows under **current transfers** continued to compensate for the deficits seen in trade, services and income accounts (**Figure 7.5**). Over the past few years, worker remittances have become one of the most important sources of FX receipts on the back of the rising number of Pakistanis seeking employment abroad, and efforts under the Pakistan Remittance Initiative to encourage use of official sources for sending money to Pakistan.

In FY13 also, worker remittances continued their increasing trend, and reached US\$ 13.9 billion, almost meeting the Annual Plan target of US\$ 14.0 billion. As shown in **Figure 7.6a**, the increase in FY13 was most pronounced from Bahrain, UK, Australia and Sweden. The Middle East showed a mixed picture: robust economic activity in Saudi Arabia, Kuwait and Abu Dhabi helped increase Pakistan's remittances, inflows from Oman and Qatar were stagnant, while inflows from Dubai and Sharjah actually fell. Furthermore, remittances from Japan and the US declined in comparison with FY12 (**Figure 7.6b**).

**Table 7.2: Summary of Balance of Payments**

| billion US\$                                 |              |              |
|--|--------------|--------------|
|  | FY12         | FY13         |
| <b>I. Current account balance (A+B+C+D)</b>  | <b>-4.7</b>  | <b>-2.5</b>  |
| <b>A. Trade balance</b>                      | <b>-15.8</b> | <b>-15.4</b> |
| (i) Export                                   | 24.7         | 24.8         |
| (ii) Imports                                 | 40.5         | 40.2         |
| <b>B. Services</b>                           | <b>-3.2</b>  | <b>-1.5</b>  |
| <i>of which:</i>                             |              |              |
| Transportation                               | -2.0         | -2.0         |
| Government                                   | 0.9          | 2.5          |
| <i>of which: Coalition support fund</i>      | 0.0          | 1.8          |
| <b>C. Income</b>                             | <b>-3.2</b>  | <b>-3.7</b>  |
| <i>Payments include:</i>                     |              |              |
| Repatriation of profit by oil firms          | 1.5          | 1.7          |
| IMF charges & interest on off. external debt | 0.8          | 0.7          |
| <b>D. Current transfers</b>                  | <b>17.5</b>  | <b>18.1</b>  |
| <i>of which: Worker remittance</i>           | 13.2         | 13.9         |
| <b>II. Capital account</b>                   | <b>0.2</b>   | <b>0.3</b>   |
| <b>III. Financial account</b>                | <b>1.3</b>   | <b>0.3</b>   |
| (i) Net foreign investment                   | <b>0.6</b>   | <b>1.3</b>   |
| FDI  | 0.7          | 1.3          |
| Portfolio                                    | -0.1         | 0.0          |
| (ii) Other investment (net)                  | <b>0.7</b>   | <b>-1.0</b>  |
| Net acquisition of financial assets          | 0.0          | -0.5         |
| Net incurrence of liabilities                | 0.7          | -0.5         |
| IV. Errors and omissions                     | -0.1         | -0.1         |
| <b>V. Overall balance (I+II+III+IV)</b>      | <b>-3.3</b>  | <b>-2.0</b>  |

Source: State Bank of Pakistan



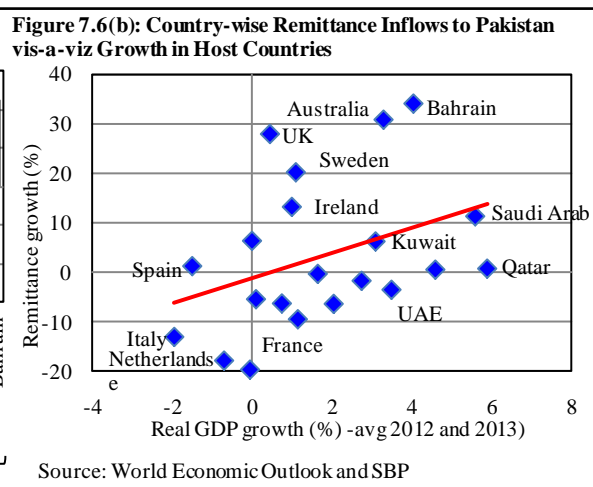
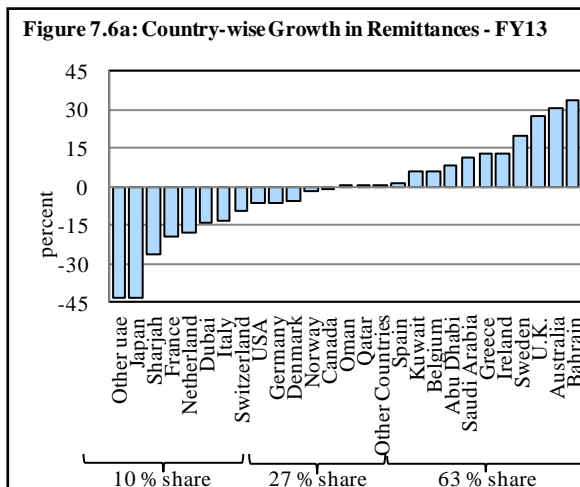
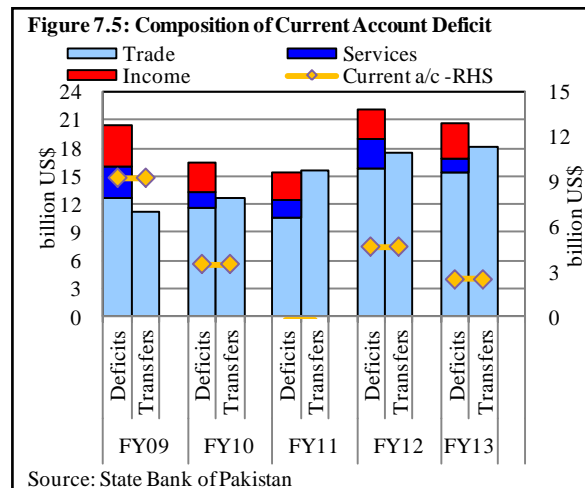
<sup>14</sup> As per SBP exchange record data.

### 7.4 Financial and Capital Account

The surplus in the financial account declined substantially during FY13 (Table 7.2). This decline can be traced to net repayments of external debts, which offset nominal increase in foreign investments during the year.

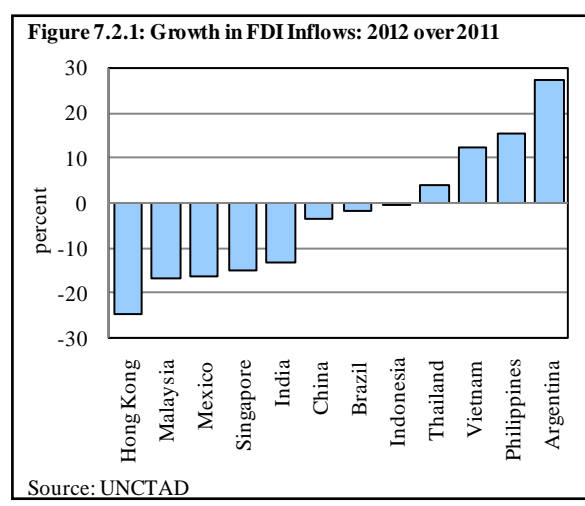
#### Foreign direct investments

Foreign investments picked up in FY13 to reach US\$ 1.3 billion, compared with just US\$ 0.6 billion last year. This is a welcome increase, but the level of FDI remains glaringly low due to: election-related political uncertainty; security concerns; and the vulnerability of Pakistan’s external account. In addition to domestic factors, the global investment environment was not conducive: FDI in both developed and developing countries has struggled to recover (Box 7.2).

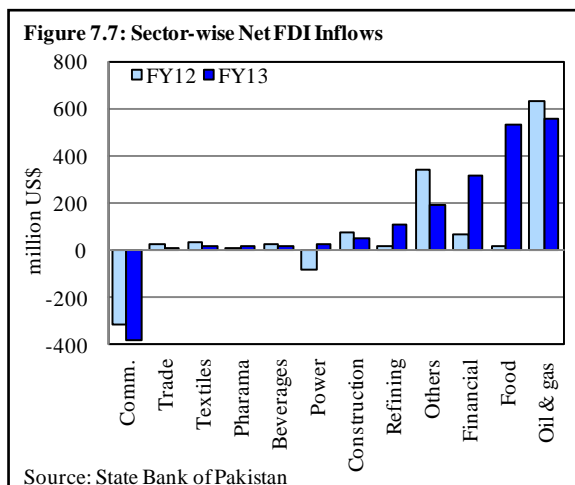


**Box 7.2: Prospects of Global FDI**  
 According to the UNCTAD report on Global Investment Trend Monitor, global FDI flows declined sharply by 18 percent during the calendar year 2012. This decline basically represents investor uncertainty, which is driven by weak macroeconomic indicators, including GDP, capital formation, employment, etc.; and also, policy related risks especially with reference to Eurozone crisis, fiscal cliff in the US, and political transitions in a number of economies. Prospects for FDI growth in 2013 and 2014 are also not much bright. FDI could only rise moderately as economic recovery is expected to be slow and uneven. Moreover, the downside risks remain given the structural weaknesses in most developed economies, and fragility in the global financial system. Fiscal policies and investment regulations are crucial factor in setting the investors’ confidence.

Source: UNCTAD Report on World Investment Report 2013



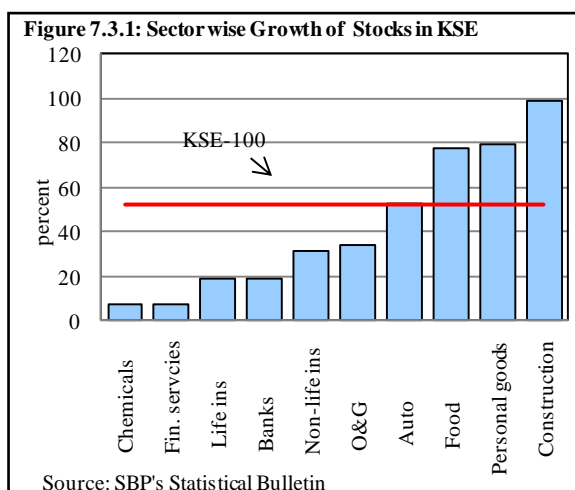
As shown in **Figure 7.7**, less than half of the reporting economic sectors recorded *higher* FDI during FY13 compared to last year. In terms of volumes, only two – FMCGs and oil and gas exploration – accounted for over 70 percent of the FDI realized last year (**Figure 7.7**). The investment in FMCGs was in the form of a buyback of shares worth US\$ 500 million by Unilever, during the fourth quarter of FY13. The UK parent company has increased its stake in the business by acquiring 24.9 percent of issued shares in Pakistan. The reason is clear: Pakistan’s FMCG sector has been thriving in recent years due to rising incomes, especially in semi-urban and rural sectors (**Box 7.3**).<sup>15</sup>



**Box 7.3: Investment Prospects in Fast Moving Consumer Goods**

The FMCG is one of the most thriving sectors in Pakistan. In the previous few years, the profitability of FMCGs has outpaced that of the other sectors by a wide margin. Their performance in the stock market is glaringly above others, and the sector provides lucrative investment opportunities (**Figure 7.3.1**).

There are several factors that have caused these trends: at first, Pakistan’s population is growing at a pace of 2 percent – largest in Asia. This coupled with high propensity to consume is a major factor supporting FMCGs growth. Penetration of electronic media in the rural areas is also seen as an important factor in marketing FMCGs in these areas. Moreover, a decent growth in rural incomes in the previous few years has also supported their purchasing power: the country has enjoyed a series of bumper crops along with price increases. Therefore, just marketing through electronic media enabled them to significantly increase their sales in the rural areas.

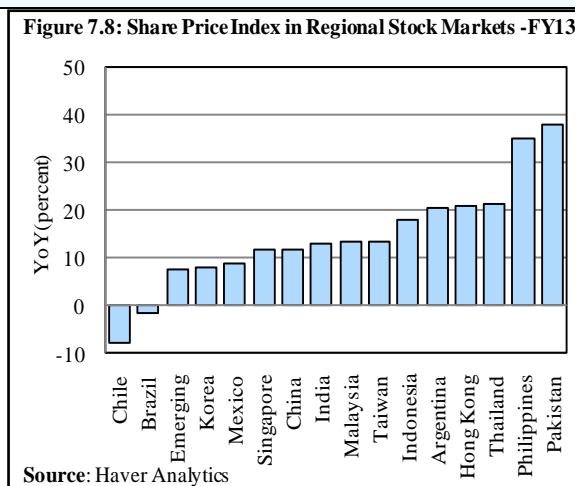


Prospects for investment in FMCGs are also strong. Per capita consumption of key food and non-food personal items is very low in Pakistan. Furthermore, in the food sector, roughly 80 to 90 percent sales are still in unpackaged form, where the adulteration rate is very high. With strong media campaigns to urge consumers to switch to packaged products, major food packaging firms are working hard to increase their niche.

In addition to FMCGs, the financial sector and petroleum refining also attracted higher FDI during the year. While the inflows into the financial sector mainly represent reinvested earnings, investment in refining was in the form of equipment supply to one of the newly established refineries in the country.

**Portfolio investment**

Despite the strong performance of domestic stocks compared to other emerging economies, Pakistan was unable to attract portfolio inflows in FY13



<sup>15</sup> It is important to mention here that Unilever has also increased its stake in Hindustan Lever.



(Figure 7.8 and Table 7.2). Unlike FDI, which remained low due to both domestic and global factors, absence of portfolio investments in Pakistan appears to be driven only on account of domestic issues: investments recovered in other emerging economies in 2012 and 2013, but not in Pakistan despite its outperforming market (Figure 7.9). Excessive monetary easing in the advanced economies induced investors to shift funds to emerging economies in search of better yield, but Pakistan could not offer stable returns due to the growing FX strains.<sup>16</sup>

#### Debt (and liability) flows

As mentioned earlier, absence of debt flows was the major drag on Pakistan's financial account. This drain was seen in both the government and the private sector, including banks. However, some support to these flows came from drawing down the currency swap line with the Bank of China (Table 7.3 and Box 7.4 on currency swap agreement).

As shown in Table 7.3, there was a smaller increase in government loans, as disbursements remained lower than FY12, whereas amortization increased sharply (Table 7.3 and Chapter 6). Most of the decline in fresh loans was seen in bilateral government loans from China, which had provided US\$ 500 million support last year. In addition, multilateral loans from the World Bank group (including IDA and IBRD) also declined during the year. Given the commitment from IFIs for debt support, it is expected that these inflows will recover in subsequent years.<sup>17</sup>

As far as deposit taking corporations are concerned, the decline in liability inflow indicates both, net withdrawals from non-resident foreign currency accounts, as well as net retirement of short-term external borrowings.

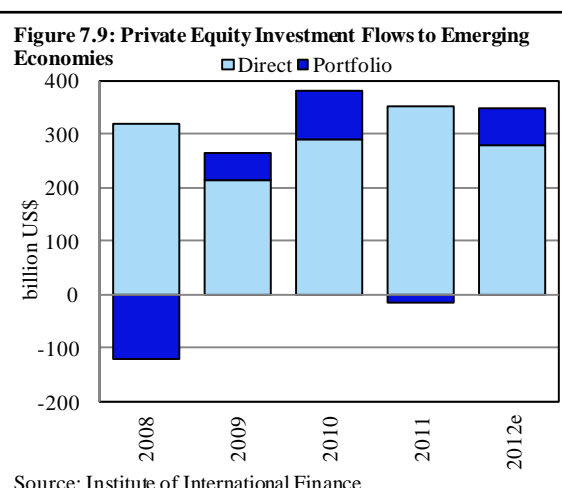
#### 7.5 Reserves

Pakistan's liquid FX reserves were depleted by US\$ 4.3 billion during FY13, compared to a

**Table 7.3: Debt and Liability Inflows**

| million US\$                                       |            |             |
|--|------------|-------------|
|  | FY12       | FY13        |
| <b>Net incurrence of liabilities (FX inflows)*</b> | <b>671</b> | <b>-451</b> |
| I. Central Bank                                    | -105       | 710         |
| II. Deposit-taking corporations                    | 220        | -1,117      |
| (i) Non-resident deposits                          | 316        | -244        |
| (ii) Short-term borrowings                         | -81        | -637        |
| (iii) Other  | -15        | -66         |
| III. General Government                            | 998        | 218         |
| (i) Disbursements                                  | 2,633      | 2,500       |
| Credit and loans with the IMF**                    | 0          | 0           |
| Other long-term                                    | 2,633      | 2,203       |
| Short-term   | 0          | 297         |
| (ii) Amortization                                  | 1,577      | 2,282       |
| Credit and loans with the IMF**                    | 0          | 361         |
| Other long-term                                    | 1,477      | 1,530       |
| Short-term   | 100        | 391         |
| (iii) Other Liabilities (net)                      | -58        | 31          |
| IV. Other Sector                                   | -442       | -262        |
| (i) Disbursements                                  | 558        | 409         |
| (ii) Amortization                                  | 638        | 618         |
| (iii) Other Liabilities (net)                      | -362       | -53         |

\*Total external debt stock showed a net decline of US\$ 5.7 billion during FY13. This decline was explained principally by repayment of IMF SBA loan (US\$ 2.5 billion), as well as revaluation gains (US\$ 2.6 billion) – both items are not reflected in the above table (for details, see Data Explanatory Note No. 7).  
\*\*This does not include IMF borrowings for BoP support  
Source: State Bank of Pakistan



<sup>16</sup> For instance, when Fed begins quantitative easing through asset purchase program, it lowers bond supply from the market; increases the liquidity; and reduces the yield of US papers. Investors use the liquidity available in the US system to invest in countries which offer higher yield.

<sup>17</sup> The government is expecting additional external financing assurances over the IMF program period from the World Bank (\$1.5 billion), Asian Development Bank (US\$1.6 billion), the United Kingdom (US\$ 0.5 billion), the United States (US\$ 0.4 billion), and others (US\$ 1.5 billion) (Source: IMF Staff Report for the Article IV Consultation and Request for the Extended Arrangement under the Extended Fund Facility).

decline of US\$ 2.9 billion in FY12.<sup>18</sup> This decline in FY13 represented repayments to the IMF, which almost doubled compared to the previous year.<sup>19</sup> SBP's gross liquid reserves reached a 55-months low of US\$ 6.0 billion by end-June FY13 (**Table 7.4**). Of greater concern, a portion of SBP reserves are borrowed: US\$ 2.3 billion in the form of short-term forward swaps in the domestic market, and a US\$ 871 million currency swap with the Bank of China (**Box 7.4**).<sup>20</sup> Outstanding IMF credit is another US\$ 4.5 billion. Excluding these, *net* SBP liquid FX reserves become negative, which is reflected in the IMF's definition of net international reserves (NIR) that are part of the binding quarterly targets in the EFF program.

The IMF, in its recently released Staff Report for 2013 Article IV consultation with Pakistan, has emphasized the need to build SBP reserves. In fact, a floor on SBP's NIR has been included in the program: SBP must increase its NIR from US\$ -2.5 billion at end FY13, to US\$ 2.5 billion by end FY14, but this cannot be done via borrowing from the IFIs, sovereign bonds or placements from central banks. The pressure on the PKR during FY14 can be traced to prior action to purchase FX

**Table 7.4: Reserves Adequacy Indicators**

|   | Jun-08 | Jun-09 | Jun-10 | Jun-11 | Jun-12 | Jun-13 |
|---|--------|--------|--------|--------|--------|--------|
| <b>Import based adequacy</b>  |        |        |        |        |        |        |
| Liquid forex reserves as % of 3-month of import (past 12m)          | 128.9  | 156.8  | 214.7  | 203.4  | 151.1  | 110.7  |
| Liquid forex reserves as % of 3-month of import (projected for 12m) | 143.7  | 159.5  | 186.8  | 180.4  | 153.5  | 104.5  |
| SBP liquid FX reserves as percent of next 3-month import            | 108.1  | 117.1  | 144.5  | 146.2  | 108.5  | 57.0   |
| <b>Short-term debt</b>  |        |        |        |        |        |        |
| Short-term debt as percent of LFR                                   | 6.3    | 5.2    | 8.0    | 7.0    | 10.6   | 11.3   |
| Short-term debt as percent of SBP LFR                               | 8.3    | 7.1    | 10.4   | 8.7    | 14.9   | 20.8   |
| Net IMF repayments as percent of SBP reserves                       | 0.4    | -4.7   | 0.4    | 0.4    | 4.1    | 14.0   |
| Short-term debt + IMF repayments as % of SBP LFR                    | 8.7    | 2.5    | 10.8   | 9.0    | 19.1   | 34.8   |
| <b>New IMF indicators</b>   |        |        |        |        |        |        |
| ST debt + CAD as % of LFR   | 127.9  | 79.7   | 28.9   | 5.8    | 41.0   | 32.2   |
| ST debt + CAD as % of SBP LFR                                       | 169.9  | 108.5  | 37.4   | 7.2    | 58.1   | 59.0   |

Source: State Bank of Pakistan

from the interbank market. Although the market is concerned that future purchases may put further pressure on the PKR,<sup>21</sup> we believe IFIs inflows, proceeds from 3G and CSF, and structural reforms by the government, will help keep the exchange rate on a stable trajectory.

#### **Box 7.4 Currency Swap Agreement between Pakistan and China**

The currency swap agreement (CSA) between State Bank of Pakistan (SBP) and People's Bank of China (PBC), signed in December 2011, has become operational in May 2013.<sup>22</sup> The principal objective of this swap is to promote the use of regional currencies for trade settlement between the two countries. According to this agreement, Pakistan can lend Pak Rupee (PKR) 140 billion to China, and China can lend Chinese Yuan (CNY) 10 billion to Pakistan.

Throughout the tenor of the agreement, both central banks can draw on the available swap line at any time. Therefore, when local traders need CNY, the SBP can purchase CNY from PBC against PKR, and repurchase PKR with CNY on a pre-

<sup>18</sup> Liquid FX reserves includes SDRs held by the SBP; SBP nostros (excluding CRR placements by commercial banks); and FE-25 deposits held by banks adjusted by foreign currency lending to exporters and importers.

<sup>19</sup> Compared to US\$ 1.2 billion in FY12, IMF SBA repayments increased to US\$ 2.5 billion in FY13.

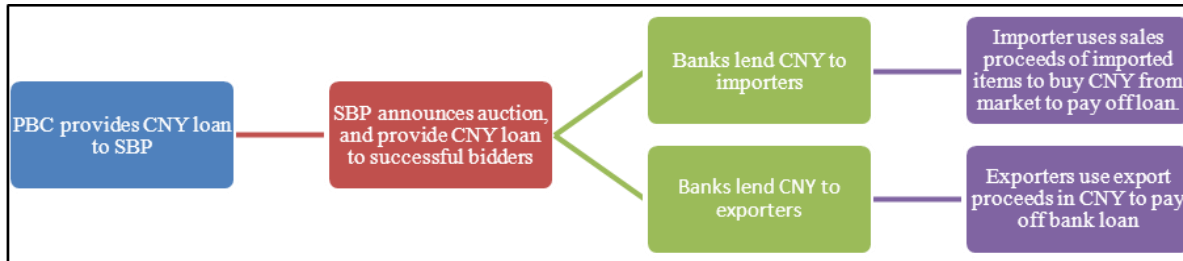
<sup>20</sup> Source: IMF Staff Report for the Article IV Consultation and Request for the Extended Arrangement under the Extended Fund Facility.

<sup>21</sup> As a prior action, the SBP was advised to purchase US\$ 125 million from the interbank market from July 01, 2013, before the IMF Board consideration of the program.

<sup>22</sup> The currency swap is a foreign exchange agreement between the two banks to exchange the equal net present value principal of a loan denominated in a different currency at a determined time, and pay the interest corresponding to each currency.

determined maturity and exchange rate. When the CNY is credited to SBP nostros, the SBP would conduct an auction for provision of CNY funding to local commercial banks so that they can on-lend the same to exporters and importers. The SBP would announce the ‘reference rate’ along with the auction details, which will be used as benchmark to the pricing of loan auction. As such, participation in CNY loan auction will be based on spread over / under the ‘reference rate’.<sup>23</sup>

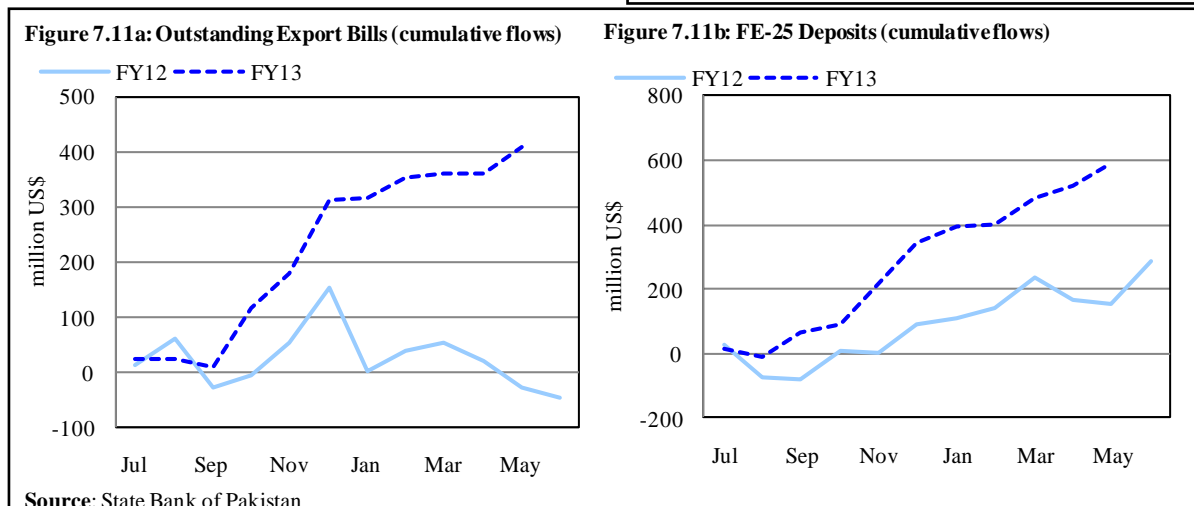
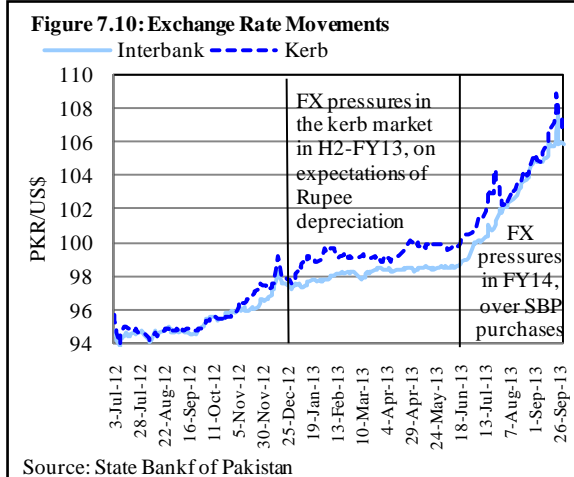
The onshore availability of CNY loan will encourage local importers to open CNY denominated letters of credit. Therefore, instead of borrowing in PKR or US dollars, importers will avail CNY financing from banks to pay off their Chinese suppliers which will save the interest rate differential between PKR and CNY loans. Upon maturity, which is 3 to 6 months, the importer will use its sales proceeds in PKR to buy CNY to pay off the CNY loan.



Similarly, exporters can also avail CNY financing from banks: they can borrow CNY and convert the same in PKR to finance working capital requirements. Upon maturity, exporters can use their export proceeds denominated in CNY to pay off bank loan. Thus local exporters can now avail loans in three currencies: PKR under EFS loans; US Dollar under FE-25 loans; and now CNY under CSA.

### 7.6 Exchange Rate

Despite a sharp fall in the country’s FX reserves in FY13 compared to last year, the depreciation of Pak Rupee was limited. Pak Rupee depreciated by 4.5 percent during FY13, compared with 9.1 percent in FY12. Moreover, movements in the exchange rate were also less volatile, especially in the second half of the year (Figure 7.10). This improvement can be traced to a reduction in the current account deficit in FY13, which reduced pressure on the Pak Rupee. It is important to mention here that the interbank caters to authorized inflows and outflows (i.e., current



<sup>23</sup> Minimum participation amount will be CNY 25 million and in multiples thereof.

account transactions) and foreign investments flows, but does not directly finance debt repayments to the IMF and other IFI, which come directly from SBP’s FX reserves. Since debt repayments in FY13 were much higher than in FY12, there was a steeper fall in FX reserves in FY13 but with less pressure on the PKR parity in the interbank market.

Nonetheless, market expectations for further depreciation of Rupee have been unhinged over the looming IMF repayments, and the resulting strain on FX reserves. These expectations had encouraged people to increase their holdings of US Dollars, both inside and outside the banking system: mobilization under the FE-25 deposits was higher in FY13 compared to FY12; exporters delayed FX selling in the interbank to repay working capital loans (**Figure 7.11**); and the kerb premium remained high through most of H2-FY13.

Nominal depreciation in Pak Rupee, coupled with the decline in headline inflation, led to an improvement in the REER during the year. Compared with an appreciation of 4.5 percent last year, the REER depreciated by 1.0 percent in FY13 – a trend, which, if sustains, bodes well for the competitiveness of our goods and services.

### 7.7 Trade Account<sup>24</sup>

Pakistan’s trade deficit during FY13 was US\$ 20.4 billion,<sup>25</sup> a contraction of 4.0 percent during the year, compared with a sharp increase of 36.4 percent last year. Improvement in the trade account was entirely on account of a recovery in exports, which increased by 3.5 percent in FY13 compared with a decline in FY12 (**Table 7.5**). Main impetus to exports growth came from food, textiles and jewelry. Moreover, duty free access of 75 items to the EU market also helped.

On the other hand, imports remained stagnant at last year’s level. This sluggishness was mainly because of a decline in the import of food, transport, POL, fertilizers and other agriculture items, which offset the rise in the import of machinery, textile and metal.

While the trade balance improved, Pakistan’s terms of trade (ToT) deteriorated for the second consecutive year. Although unit value indices for both exports and imports declined in recent years, the decline was higher in case of exports.

#### Exports

Exports were US\$ 24.5 billion in FY13 showing a growth of 3.5 percent, compared with a *decline* of 4.8 percent last year. This slight recovery was seen in both textile and non-textile exports (**Figure 7.12**). In our view, the duty-free access

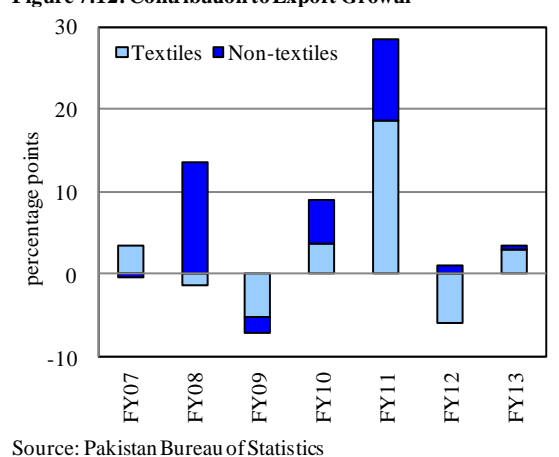
**Table 7.5: Trade Indicators**

Value: billion US\$; ratios and growth in percent

|             | Trade deficit         |          |      | % Growth |        |               |
|-------------|-----------------------|----------|------|----------|--------|---------------|
|             | Value in billion US\$ | % of GDP | TOT  | Export   | Import | Trade deficit |
| <b>FY09</b> | 17.1                  | 10.6     | 56.9 | -7.2     | -12.9  | -18.1         |
| <b>FY10</b> | 15.4                  | 8.9      | 56.9 | 9.1      | -0.3   | -10.0         |
| <b>FY11</b> | 15.6                  | 7.3      | 58.6 | 28.6     | 16.4   | 1.3           |
| <b>FY12</b> | 21.3                  | 10.0     | 55.1 | -4.8     | 11.1   | 36.4          |
| <b>FY13</b> | 20.4                  | 9.0      | 53.8 | 3.5      | 0.1    | -4.0          |

Source: Pakistan Bureau of Statistics

**Figure 7.12: Contribution to Export Growth**



Source: Pakistan Bureau of Statistics

<sup>24</sup> The discussion in this section is based on custom data provided by the Pakistan Bureau of Statistics (PBS), which may vary from trade numbers compiled by the SBP. See Tables 9.13 and 9.14 of Statistical Supplement of this Report for reconciliation of the two data sets.

<sup>25</sup> After incorporating re-exports (of US\$ 285 million), trade deficit becomes US\$20.2 billion in FY13.

of 75 items to the EU market, and higher demand of cotton yarn and fabrics by China and Hong Kong, are primarily responsible.

Category-wise analysis of export earnings during the year reveals that the main impetus came from fruits, spices and meat in food group; cotton yarn, cotton fabrics, towels and readymade garments in textile group; and cement, onyx manufacture, and jewelry in other manufactures. The increase in these exports can be attributed to a mix of quantum and price impacts. In case of food and other machinery, the average price impact was positive, while the quantum impact was negative; both these impacts were positive in case of textiles.

#### **Export diversification**

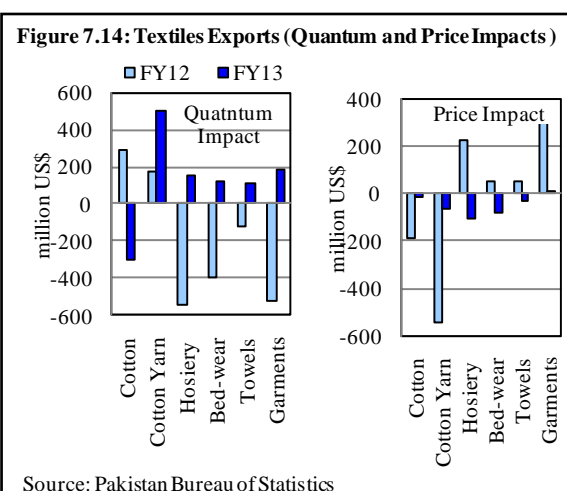
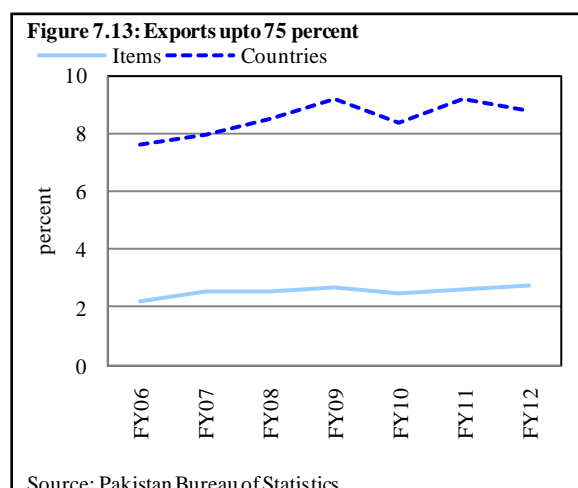
As discussed in **Box 7.1**, high geographic and product concentration of exports increases the risk to external account sustainability. Pakistan's exports are highly concentrated in terms of commodities and destinations. According to custom data, about 3 percent of the total items (which are 3,592 in number) accounts for 75 percent of total exports (**Figure 7.13**).<sup>26</sup> Items relating to textile, rice, and petroleum (naphtha) are major contributors to exports of Pakistan.

A similar situation is seen in geographical concentration: less than 10 percent of countries (out of 215 exports destinations) account for about 75 percent of the country's export value. US has been the top destination for Pakistani exports (15 percent share), followed by the UAE, Afghanistan and China. Although individual countries in Europe have lower shares in Pakistani exports, the European Union as a group constitutes more than 20 percent of total exports. Thus, the economic performance of a few countries can impact our export performance quite substantially.

#### **Textile exports**

Textile exports increased by 5.9 percent during FY13, in contrast to a 10.6 percent decline last year. The gain was mainly due to the rise in quantum of cotton yarn, hosiery, towels, bed-wear and readymade garments (**Figure 7.14**). This improvement largely emanated from higher demand of cotton yarn and fabrics from China; duty free access of 75 items to the EU; and some improvement in exports to the US.

Demand for cotton yarn and fabrics from China (and Hong Kong) remained strong due to continuously rising labor wages and government policy of minimum support price to cotton growers, which has increased the cost of producing yarn there. Pakistan can benefit from this trend as it possesses an abundance of low-cost labor and a large cotton production base, backed by some level of vertical integration in the weaving, ginning and spinning sectors. Moreover, the announcement of duty waivers on



<sup>26</sup> This is based on harmonized system-8 digit (HS-8) commodity wise data.

75 products by the EU in November 15, 2012 provided some impetus to value-added textile exports, which can further increase with the status of *GSP plus* in 2014 (**Box 7.5**).

**Box 7.5: GSP plus Status of Pakistan**

The European Union (EU) has approved preferential access of Pakistani made ups to EU market under the Generalized System of Preferences (GSP) plus, effective from January 2014. GSP plus provides trade concessions to developing countries which (1) are not categorized as high or upper middle income; (2) have below 2 percent share in EU's total GSP imports<sup>27</sup>; (3) have more than 75 percent of their exports to EU concentrated in seven largest sectors; and (4) have signed and implemented 27 international conventions pertaining to human rights, environment, governance, etc.

Pakistan formally applied to the European Commission for grant of GSP plus in May 2013. The International Trade Committee (INTA) of the EU parliament approved this status for Pakistan on November 5, 2013, which allows about 20 percent of Pakistani exports to enter EU market at zero duty and the rest at preferential rates. Pakistan mainly exports textile products to European countries. With the status of GSP plus, export of Pakistani textile to EU, which is currently subject to more than 10 percent tariffs, will benefit. At present, Pakistan's textile export to EU is about US\$ 4 billion, which is 1.6 percent of EU's total imports eligible for GSP plus. Now Pakistan can potentially increase its share to 2 percent, which implies additional exports of about US\$ 1 billion.

In order to exploit this opportunity, textile industry has to increase its production and quality. It should be noted that there are more than 25 countries that are eligible for GSP plus which also include some of our close competitors. Thus our products still have to face competition despite preferential tariff in the EU market. We have to put our house in order for providing a conducive environment to businesses, which are currently struggling with energy issues, law and order and poor governance.

Some of the key opportunities from GSP plus are: (1) Foreign investors, particularly from China who are facing high labor cost in their domestic economy, can be attracted to invest in sectors with the potential of rapid export expansion; (2) Economic activities in other sectors having backward and forward linkages with GSP eligible sectors can be stimulated – which will have a favorable impact on overall GDP growth; (3) A number of industries, which currently are running below potential, will increase their operating hours by generating more employment; (4) The GSP plus status would also discourage shifting of industrial units outside Pakistan; and (5) It would also help revive some of the sick units in textile sector.

However, there are also some risks associated with this facility. GSP Plus status will be awarded for a period of 10 years with a review by EU after every two years of compliance status. Thus, it will be important for Pakistan to continue observing 27 conventions, which requires effective coordination among federal and provincial governments. It should be kept in mind that Sri Lanka, who lost GSP status in 2010 due to EU reservations related to human rights and governance, experienced closure of hundreds of garments factories and thousands of workers unemployed. The private sector also needs to ensure and maintain effective implementation of relevant labor, human rights and environmental laws at industry level – otherwise they will lose the market.

Moreover, ongoing energy crisis and law and order situation may prevent the exporting sectors to capitalize from the full benefits of GSP Plus. If both these issues are not addressed urgently, Pakistan would not be able to exploit the potential benefit of increased market access.

**Non-textile exports**

*Food* exports posted strong growth of 12.1 percent on the back of double-digit growth in the exports of spices, meat, vegetables, and fruits (**Figure 7.15**). Export of meat products has shown impressive growth, increasing 9-fold since FY06, mainly due to higher demand from Saudi Arabia, after it banned meat imports from some African countries.

However, ongoing smuggling of live animals to Iran and Afghanistan, and official export of live animals are likely to hit the downstream meat packaging sector. Livestock exports, which were previously banned, were allowed in May 2009. Although this measure will benefit the livestock business, it will hurt the meat packaging sector, which has higher value addition.

<sup>27</sup> About 6,400 products are eligible for the GSP plus arrangements including a number of agricultural and fish products listed in HS chapters 1–24, and almost all processed and semi-processed industrial products, including ferro-alloys, that are listed in HS chapters 25–97, except for those in chapter 93.

*Fruits and vegetable* exports also increased significantly by 17.6 percent during FY13; however, the volume of exports is still far below potential – this is particularly true in the case of fruits. According to market sources, Pakistan exports only 12 per cent of its total fruit production, despite strong demand in the international market. Pakistan produces around 14 million tons of fruits and vegetables, of which nearly 25 percent is wasted post-harvest because of poor packaging and supply chain issues. This wastage is the result of poor documentation of produce in absence of quality controls, improper transport, packaging and cooling facilities, and lack of knowledge regarding potential markets.

Pakistan also lags behind other countries in marketing packaged fruits. In order to penetrate the international market, Pakistani exporters continue to under-price their products, to compensate for high wastage in the delivery stage. There is a need to take concrete steps to address various infrastructural weaknesses. For example, establishment of a cold chain system is needed to maintain quality during transportation. This will also increase the shelf life of fruits and vegetables and make the supply chain more efficient. Similarly, proper documentation of produce is necessary to meet stricter quality standards of retailers in the GCC and Europe.

Export of *Rice*, which is the largest export item in the non-textile group, declined in FY13 despite favorable prices in the international market. Pakistan exported US\$ 1.9 billion worth of rice during the year, which is 6.8 percent lower than last year. One third of this total is basmati rice, but its export declined sharply by 19.5 percent during the year due to the new hybrid variety of rice introduced by India. This new variety is very close to basmati rice in terms of taste and fragrance. Although export of non-basmati rice, the major export variety of Pakistan, showed a growth of 1.7 percent, it was not sufficient to make up the losses incurred in basmati rice exports.

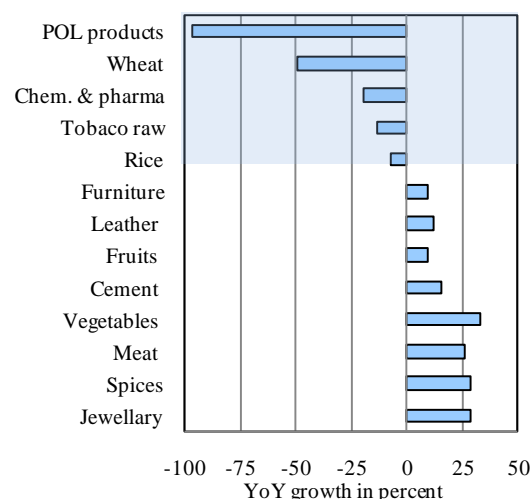
According to exporters, the jump in rice prices in local markets, as a result of unchecked smuggling to Afghanistan and domestic hoarding, has not only made the commodity uncompetitive in other foreign markets, but has also resulted in the loss of the lucrative markets (**Box 7.6**).

#### **Box 7.6: Rice Exports – Pakistan Losing its Market Share**

Rice has been one of the important drivers of export growth in Pakistan. It is third largest crop after wheat and cotton, and second largest source of export receipts after textiles. However, exports of rice recorded fall for the third consecutive year. This decline is because of lower export quantum. Specifically, Pakistan's basmati rice exports faced a heavy set back due to introduction of India's new hybrid rice variety. In case of non-basmati rice, Vietnam and Thailand are giving tough time to Pakistan due to their lower prices. Pakistan is gradually losing its major markets such as Iran, China, Kenya and UAE to its competitors. The major reason for this is the price instability of Pakistani rice in international markets that forced existing buyers to switch to other suppliers with lower unit values.

- **Pakistani basmati rice lost Iranian market to India** due to better prices offered by India and introduction of new variety of hybrid rice. Iran was the second largest market of basmati rice in FY12. India has come up several new varieties in recent years – the latest variety is known as 1121, and it has not only long grain but also has good taste. Above all, Indian exporters keep innovating rice product; after introducing parboiled rice in the world market, they now moved to steam technology which gives them an edge over Pakistan in the world market.
- **We are also losing Chinese market to Vietnam** in case of non-basmati rice mainly due to the issues of quality and price. Pakistan's rice export to China has almost come to a halt in recent years.

**Figure 7.15: Performance of Non-textile Exports (FY13)**



Source: Pakistan Bureau of Statistics

- **South Africa** has been an important market for Pakistani rice, as the annual demand of South Africa is approximately 600,000 tonnes. In FY09, Pakistan exported 146,000 tonnes, which was worth \$66 million. But we are losing this market too to India, Vietnam and Thailand, mainly due to uncompetitive price. In FY13, we could sell just 4,500 tonnes of rice to South Africa.
- **Kenya** has been another important market of our non-basmati rice. However, exports of this category to Kenya may also decline in months ahead due to the increase in import duty on rice by Kenya. Pakistan is feared to lose this market as well to India or Vietnam.

**Table 7.6.1: Rice Exports – YoY change in percent**

|              | Basmati Rice     |              |              |             |              |              |
|--------------|------------------|--------------|--------------|-------------|--------------|--------------|
|              | FY11             |              | FY12         |             | FY13         |              |
|              | Quantity         | Value        | Quantity     | Value       | Quantity     | Value        |
| Afghanistan  | -                | -            | 57.2         | 65.2        | -38.6        | -28.6        |
| Bahrain      | -6.5             | -11          | -37.8        | -31.7       | -12.4        | 2.3          |
| Iran         | -21.9            | -30.4        | -9.2         | -12.3       | -67.4        | -56.7        |
| Oman         | 65.9             | 59.3         | -26          | -19.7       | -5.9         | 8.3          |
| Saudi Arabia | -16.3            | -9.7         | -16          | -18.6       | -3.9         | 23.0         |
| UAE          | 11.9             | 16           | -26          | -20.5       | -35.3        | -27.1        |
| UK           | 23               | 17.7         | -40.8        | -35.3       | -3.6         | 20.1         |
| <b>Total</b> | <b>13.4</b>      | <b>36.7</b>  | <b>-15.6</b> | <b>-8.4</b> | <b>-29.3</b> | <b>-12.4</b> |
|              | Non-Basmati Rice |              |              |             |              |              |
|              | FY11             |              | FY12         |             | FY13         |              |
|              | Quantity         | Value        | Quantity     | Value       | Quantity     | Value        |
| Afghanistan  | -34.7            | -17.7        | -16.9        | -22.7       | -37.0        | -21.9        |
| China        | -                | -            | -            | -           | 43.0         | 41.6         |
| Kenya        | -34              | -19.2        | 51.5         | 50.9        | 0.2          | 9.1          |
| Mozambique   | 18.4             | 33.6         | -19.3        | -15.2       | 24.8         | 31.6         |
| Saudi Arabia | -8.6             | 1.2          | -39.6        | -39.7       | 42.0         | 67.3         |
| UAE          | 4.8              | 22.4         | -50.3        | -47.1       | -8.2         | 7.7          |
| <b>Total</b> | <b>-23.9</b>     | <b>-12.9</b> | <b>-0.3</b>  | <b>-5.1</b> | <b>1.1</b>   | <b>7.8</b>   |

Source: Pakistan Bureau of Statistics

Pakistan could not adopt modern technology for polishing and grading of rice, whereas India, Vietnam and Thailand are more innovative and aggressive in marketing their product.

In the *other* manufactures group, exports of leather, footwear, engineering goods, jewelry and cement recorded an increase; however, this rise was partially offset by a decline in the exports of carpets, sports goods, medical and surgical instruments, chemicals and pharmaceuticals.

*Chemicals and pharmaceutical* exports recorded a decline of 18.6 percent during FY13, in sharp contrast to an 18.1 percent rise last year. This decline can be traced to a reduction in major categories of plastics and other chemicals. Plastics declined by 16.4 percent due to lower quantum and unit values.



Cement exports continued to rise for the third consecutive year, and recorded a growth of 15.8 percent in FY13 entirely on account of higher prices. Exports to traditional markets like Afghanistan and Bahrain have also increased. Along with the rising share of these traditional markets, exploration of new markets in Africa and Sri Lanka also helped. However, cement exports remained under pressure during the second half of FY13, when Afghanistan imposed duties on cement imports from Pakistan. Moreover, competition from smuggled Iranian cement also led to a decline in our exports to Afghanistan. On the flipside, improved relations with India are expected to help increase cement exports to India.

### Imports

Imports recorded an inconsequential increase of 0.1 percent during FY13, compared to a significant increase of 11.1 percent last year. Composition of imports shows that positive growth in machinery, textile and metal groups was offset by a fall in imports of food, transport, agriculture and petroleum (Table 7.6). Lower prices of non-food commodities; the increased domestic production of fertilizer in February and March 2013; and a decline in import of motor vehicles (due to the absence of Punjab government yellow cab scheme)<sup>28</sup> kept the import bill stagnant. Commodity specific assessment of key imports is given below (Figure 7.16):

- (1) Palm oil imports showed negative growth of 17.3 percent, in value terms, as its unit value declined due to a reduction in export duties by Malaysia. However, the quantum of imports increased as importers tried to take advantage of the lower price. Quantum of soybean oil imports also increased sharply by 75 percent, as lower prices and ample availability in the world market incentivized Pakistani importers to bring in more.<sup>29</sup>
- (2) Machinery imports posted 1.3 percent growth during FY13. Category-wise data reveals that import of electrical, construction, and telecom machinery increased, which overshadowed the negative growth in imports of textile, agricultural,

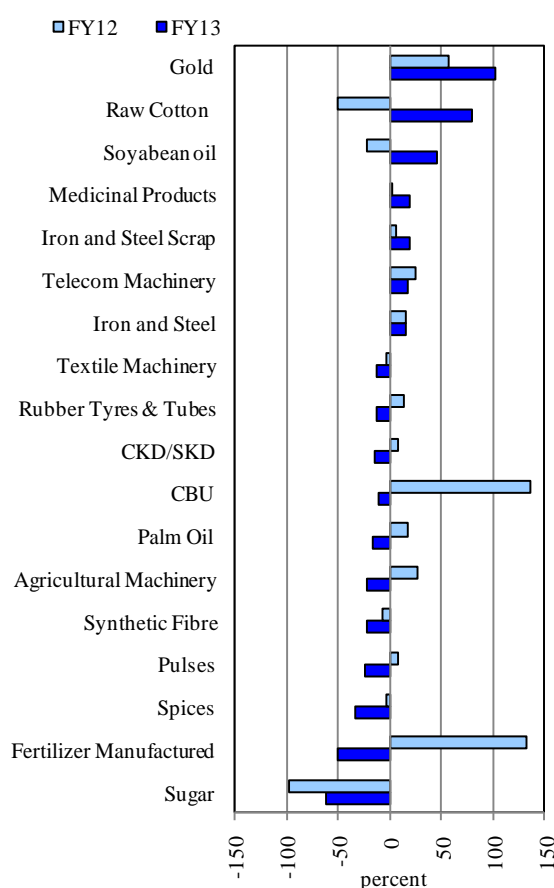
**Table 7.6: Import Performance**

(growth in percent, contribution in percentage points)

|               | YoY Growth  |            | Contribution in Growth |            |
|---------------|-------------|------------|------------------------|------------|
|               | FY12        | FY13       | FY12                   | FY13       |
| Food          | -2.0        | -16.8      | -0.3                   | -1.9       |
| Machinery     | 5.7         | 1.2        | 0.8                    | 0.1        |
| Transport     | -2.6        | -6.7       | -0.1                   | -0.3       |
| Petroleum     | 33.1        | -2.2       | 9.5                    | -0.7       |
| Textile       | -18.6       | 8.9        | -1.4                   | 0.5        |
| Agri. & chem. | 14.7        | -10.8      | 2.3                    | -1.7       |
| Metal         | 7.2         | 18.2       | 0.5                    | 1.1        |
| Misc.         | -1.7        | -10.2      | 0.0                    | -0.2       |
| Others        | 0.8         | 41.6       | 0.8                    | 3.2        |
| <b>Total</b>  | <b>12.0</b> | <b>0.1</b> | <b>12.0</b>            | <b>0.1</b> |

Source: Pakistan Bureau of Statistics

**Figure 7.16: Import Performance (YoY Growth)**



Source: Pakistan Bureau of Statistics

<sup>28</sup> Furthermore, car manufacturers in Pakistan discontinued the assembly of Suzuki Alto and Daihatsu Cuore models. Last year more than 20,000 cabs were produced for Punjab government yellow cab scheme.

<sup>29</sup> China's soybean oil imports declined 15 percent which resulted into piling up of world stocks of the commodity.

and power generating machinery- the latter is not surprising given the lack of investment in the power sector in recent years.

(3) Gold imports increased sharply in FY13, mainly because of higher exports of jewelry. As per policy, Pakistani exporters can import gold bars up to 70 percent of the total value of exported jewelry. As Pakistani jewelry exports grew substantially (by 29 percent) in FY13, it also boosted the import of gold.<sup>30</sup>

(4) Fertilizer recorded a decline due to a lower quantum of imports, which offset the impact of higher international price. This fall in demand resulted from a very high level of domestic fertilizer prices, which lowered urea off-take during the period under review.<sup>31</sup>

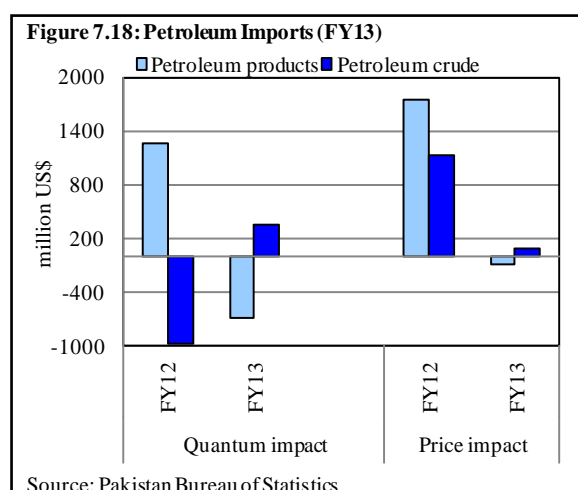
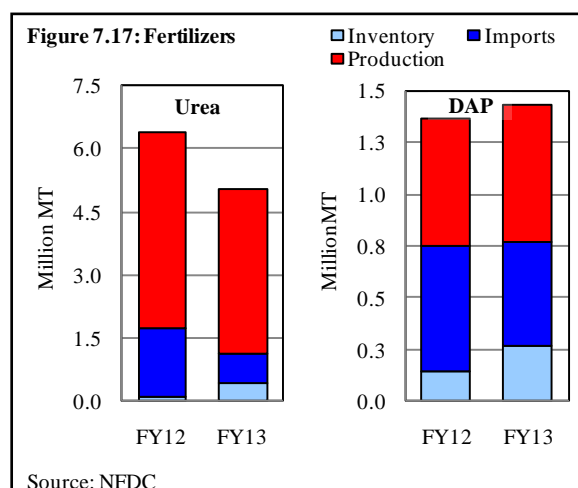
Moreover, large domestic inventories (due to high imports in FY12) also discouraged imports during FY13 (**Figure 7.17**).

(5) *Iron and steel* imports increased by 15.4 percent during FY13, reflecting increased construction activities. The rise in construction activities is also evident by the increase in local cement dispatches (**Chapter 2**).

(6) Imports of road motor vehicles fell by 12.8 percent during FY13, mainly due to a fall in the category of motor vehicles - both Completely Built Unit (CBU) and Completely Knock Down (CKD) kit. Lower imports of CKD kits can be attributed to lower production of specific cars in the country (the Suzuki Alto and Daihatsu Cuore models were discontinued in FY13). Moreover, during FY12, more than 20,000 cabs were produced for the Punjab government's yellow cab scheme. With CBUs, the reduction in the age limit of used cars by the government, and subsequent depreciation of the Pak Rupee against the Dollar, are among the main factors behind the decline in transport imports.

(7) *Petroleum group* imports recorded a nominal 1.8 percent decline during FY13 (**Figure 7.18**). Within this group, import of *petroleum products* declined by 7.4 percent, as both quantum and prices declined compared to the year before. However, the fall in petroleum product imports was partially offset by 9.8 percent rise in *petroleum crude* imports.

(8) Despite falling unit values, *raw cotton* imports increased sharply during FY13 due to: lower domestic cotton production in FY13; and higher demand in the domestic spinning sector, as Pakistani producers were producing more cotton yarn to fill Chinese demand.



<sup>30</sup> S.R.O 266(I)/2001 dated 7<sup>th</sup> May 2001, from Ministry of Commerce, requires value addition on imported gold (4.0 percent for plain gold bangles and chains, 6.0 percent for other plain jewelry and 9.0 percent for studded or embedded jewelry).

<sup>31</sup> Urea off-take recorded 4,629 thousand MT during Jul-May FY13 compared to 4,957 thousand MT for the same period last year.