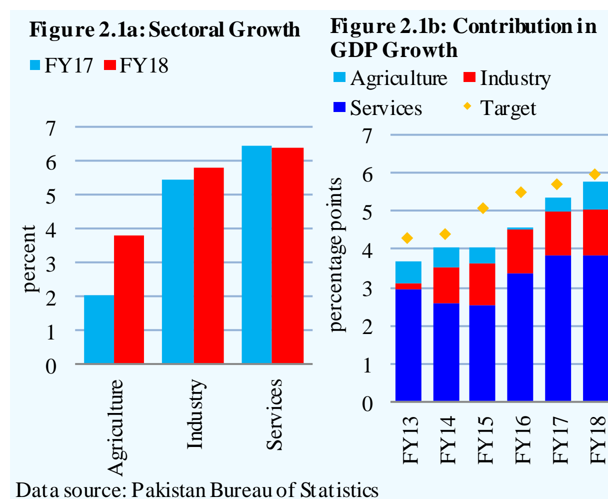
2 Economic Growth

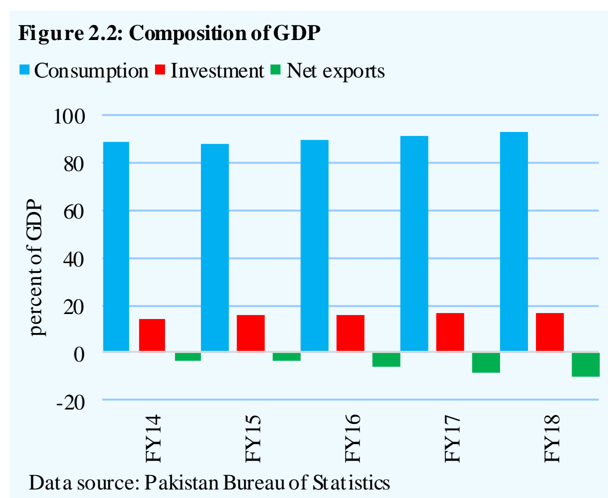
2.1 Overview

The real GDP growth picked-up further in FY18, reaching 5.8 percent compared to 5.4 percent last year. The growth not only remained broad-based, but was also the highest during the last 13 years and remained close to the target set for FY18. A healthy performance by agriculture, sustained growth in services and an uptick in large-scale manufacturing output contributed to this positive outcome (**Figure 2.1**).[1]



Data source: Pakistan Bureau of Statistics

The GDP growth was supported by a host of factors, namely: low cost of financing, fiscal incentives through subsidies, favorable business sentiments, and enhanced access to bank lending. Also, high public spending and progress on CPEC-related projects stimulated economic activities besides inducing firms to enhance their production capacities.



Data source: Pakistan Bureau of Statistics

That said, despite considerable investment undertakings in both public and private sectors, Pakistan's investment to GDP ratio remains low compared to peer countries. In fact, the dominant part of the recent increase in economic growth is attributable to boom in consumption – with its share in GDP rising to 93 percent in FY18. Higher consumption has also stimulated demand for imported consumer goods, which has led to further deterioration in net exports (**Figure 2.2**).

The sector-wise analysis reveals that growth in agriculture exceeded its target for FY18 on the back of record production of rice and sugarcane, and impetus from livestock segment. The crop sector performed well despite inadequate water availability and lower fertilizer off-take. The negative impact of these factors was offset by improvements in other inputs, such as certified seeds and pesticides, increased mechanization, and an uptick in credit disbursement. In case of wheat and sugarcane, continued price incentives kept growers' interest intact, while livestock and forestry revitalized due to various projects initiated at the provincial level.

The industrial sector recorded growth of 5.8 percent in FY18, missing the target of 7.3 percent; this was mainly due to below par growth of *electricity generation and gas distribution.* The large-scale manufacturing, however, remained a key driver to the industrial growth. Within LSM, cement, steel and petroleum sectors continued to benefit from robust domestic demand, while the performance of

[1] The GDP estimates for FY18, presented in National Income Accounts, are based on projected LSM growth of 6.1 percent.

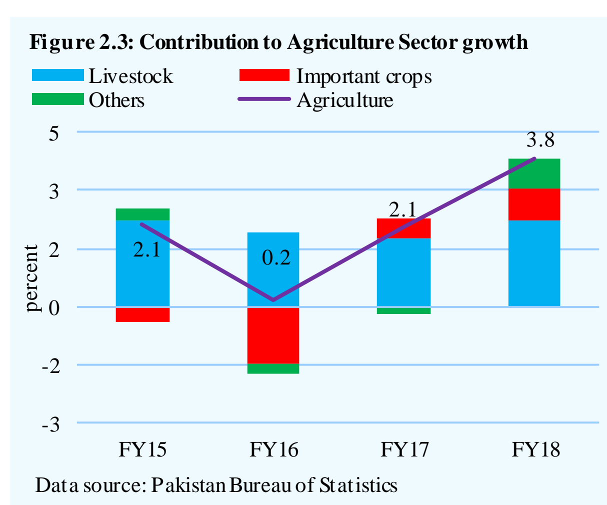
cigarettes and auto industries built upon higher capacity utilizations. However, sugar and fertilizer industries, unlike FY17, could not fully utilize capacities owing to issues related to sugarcane pricing and higher RLNG costs, respectively. With regards to consumer durables, improvement in power supply and build-up in consumer demand due to spillover effect of healthy agriculture harvest and rising real incomes led to robust growth in the segment. Similarly, the construction sector showed better performance owing to upsurge in private housing construction and high infrastructure spending.

The services sector, with more than 60 percent share in GDP, achieved its growth target for the year, building upon last year's performance. While *wholesale & retail trade* and *general government services* contributed positively to growth, the deceleration in *transport, storage & communication* was a strain on the sector's performance. Strong agriculture performance, growing manufacturing activities and persistent growth in import quantum resulted in achieving the sectoral growth target of 6.4 percent.

2.2 Agriculture:

The agriculture sector continued to exhibit a better performance in FY18, as it grew by 3.8 percent compared to 2.1 percent last year. The performance of livestock- the heavy weight within agriculture- remained high on the back of a broad-based contribution from all its sub-sectors. Similarly, the crop sector contributed substantially to agricultural growth (**Figure 2.3**). Within crop sector, sugarcane and rice recorded historic harvests, while minor crops also exhibited robust growth. This performance was attributed to higher crop yields, favorable weather conditions, subsidies on inputs, indicative pricing, and increased adoption of technology. In this backdrop, FY18 marked another year of sugar and wheat stock buildups – with production exceeding domestic consumption needs. Nonetheless, water shortages remain a risk to the sustainability of agricultural growth, and the situation is unlikely to improve substantially since temperatures continue to rise as global warming is impacting precipitation patterns.[2]

Figure 2.3: Contribution to Agriculture Sector growth



Data source: Pakistan Bureau of Statistics

Inputs:

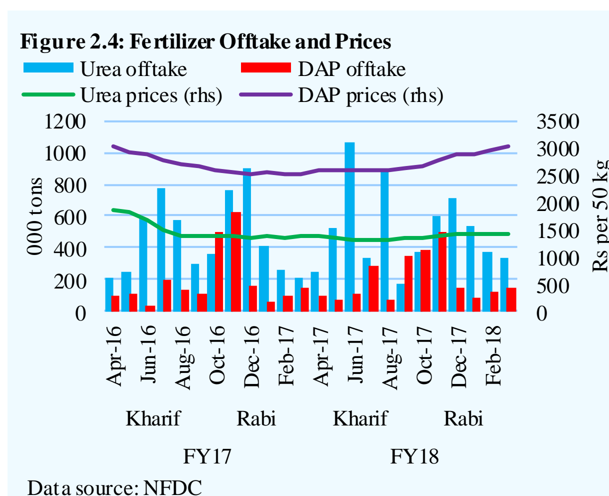
Irrigation water availability dropped 2.0 percent and 19.0 percent in *kharif* and *rabi* seasons, respectively. Growers resorted to groundwater pumping, especially in rain-fed areas where the issue of water availability worsened. Given the wide scale implications of water scarcity for the country, approval of the "National Water Policy" in April 2018 is a welcome step.

In case of fertilizer, urea off-take receded by 8.6 percent, whereas DAP off-take improved by 4.6 percent in FY18, resulting in 5.1 percent overall contraction in fertilizer off-take during FY18 compared to 36.4 percent growth in FY17. The demand for DAP increased during *kharif* season as off-take grew 48 percent, crossing the 1 million ton mark. Against this, the DAP off-take recorded 12.7 percent contraction during the *rabi* season, partly due to increase in prices. The off-take of all nutrients also improved during *kharif* season, while *rabi* season witnessed a decline in demand for

[2] In line with global climate change, average temperatures have increased by 0.35 degree Celsius since 1960s [Pakistan Food Security Bulletin (2016), Issue 4, World Food Programme]. Temperatures have increased throughout the country with steeper rise in Sindh and Balochistan, [F. Saeed, K.M. Salik, S. Ishfaq (2016), *Climate Induced Rural to Urban Migration in Pakistan*, SPDI Working Paper, Islamabad: SPDI]

nitrogen and phosphate products. Encouragingly, potash off-take grew during the season. In order to encourage usage of potash-based products, Punjab government provided the growers a subsidy worth Rs 800 and Rs 500 per bag for SOP and MOP,[3] which led to a substantial increase in the sales in September and October 2017, compared to same period in FY17 (**Figure 2.4**).

Figure 2.4: Fertilizer Offtake and Prices



Data source: NFDC

Meanwhile, agricultural credit disbursement stood at Rs 972.6 billion in FY18, registering a healthy growth of 38.1 percent,[4] on top of 17.8 percent increase seen during FY17. More importantly, the disbursement remained broad-based, as production loans increased by 38.5 percent, while development loans grew 32.4 percent. Bank-wise analysis reveals that five major banks performed well, with credit disbursements exceeding their respective targets. However, specialized institutions in the sector, namely ZTBL and PPCBL, achieved only 66.6 percent and 71.5 percent of their targets and recorded a contraction in the disbursement amount as well. As for domestic private banks and Islamic banks, even though the disbursement fell short of their respective targets by 7.6 percent and 18 percent, their growth of around 33 percent in the year was a welcome development **(Table 2.1).**

The overall credit outreach of the banks dropped by 5.1 percent during FY18, as the number of borrowers marginally reduced to 0.94 million by end FY18, from 0.99 million at end FY17. Sector-wise breakdown reveals that in FY18 the focus of banks' lending remained tilted towards non-farm sector with 50.4 percent share in overall agriculture lending. The banks' increased lending to non-farm sector was attributable to ongoing developments in livestock and poultry segments in the country. However, the focus of specialized banks still remained on the farm sector, with more than 70 percent share in their credit disbursement.

Table 2.1: Institution-wise Agriculture Credit Disbursement

million rupees

	FY17	FY18	Growth
I. Banks			
Five major commercial banks	342,068	523,930	53.2
ZTBL	92,451	83,187	-10
PPCBL	10,880	10,724	-1.4
Domestic private banks	139,061	184,863	32.9
Islamic banks	12,326	16,392	33
Sub-Total	**596,786**	**819,096**	**37.3**
II. Microfinance			
Microfinance banks	87,772	124,756	42.1
Microfinance institutions/RSPs	19,930	28,754	44.3
Sub-Total	**107,702**	**153,510**	**42.5**
Grand Total (I+II)	**704,488**	**972,606**	**38.1**

Data source: State Bank of Pakistan and Pakistan Microfinance Network

Microfinance banks and institutions/RSPs also performed well, as their credit disbursements in the entire agriculture sector exceeded their targets by 12.5 percent and 11.5 percent respectively. Their aggregate credit outreach also witnessed substantial growth of 28.5 percent, with the number of borrowers for microfinance banks and institutions reaching 2.8 million by end of FY18, increasing from 2.2 million at end FY17. This was mainly attributed to disbursement of small amount of loans without any credible collateral. The attention of these institutions also remained in favor of non-farm sector, representing 51.8 percent share in their overall agriculture lending.

[3] Sulfate of Potash (SOP) and Muriate of Potash (MOP).

[4] The total disbursements were 2.92 percent lower than the target of Rs 1.0 trillion.

To improve growers' access to agri financial services, the provincial governments have introduced several schemes. For example, the Punjab Agriculture Department launched an interest-free e-credit scheme mainly to provide small farmers agri financing and farm technical advisory services.[5] In FY18, Rs 28.6 billion was disbursed to 392,658 borrowers through various banks, such as NRSP, ZTBL, etc.[6] Scope of the scheme was expanded recently to large farmlands of 25 and 50 acres, which is expected to enhance credit access in rural areas while utilizing branchless banking in transfer of funds through easy-paisa.[7] Even though the formal credit institutions have increased their footprint, the role of informal lenders such as Aartis and commission agents in catering to the needs of small farmers still remains effective in rural society (**Chapter 7**).[8]

Major crops:

Cotton:

Cotton production increased to 11.9 million bales in FY18 compared to 10.7 million bales last year. This improvement was largely attributed to an increase in area under cultivation in the cotton belt of Punjab (**Table 2.2**). Furthermore, the farmers' confidence grew as the domestic market remained substantially shielded from cotton imports.[9] In case of Sindh, cotton production also rose due to productivity gains of 9.2 percent in FY18, despite reduction in cultivable area due to water shortages in early sowing period, especially in lower part of the province. The high yield owed to better awareness and application of pesticides.

Table 2.2: Share in Area under Major Kharif Crops in the Dominant Cotton Districts of Punjab*

percent

	Cotton	Sugarcane	Rice	Maize
FY13	76.5	10.1	7.8	5.6
FY14	72.6	11.1	9.5	6.8
FY15	70.0	9.6	10.5	9.9
FY16	70.2	10.5	10.8	8.5
FY17	64.9	13.7	13.0	8.4
FY18	68.3	14.5	12.0	5.2

Data Source: Provincial Crop Reporting Centres
*Districts include: Bahawalpur, Rahimyar Khan, Bahawalnagar,Vehari,Lodhran,Khanewal,Rajanpur, Multan, MuzaffarGarh, D.G.Khan, Sahiwal.

Yet, cotton production not only missed the target of 13.6 million bales, but also stood lower than the textile industry's need of 13.2 million bales.[10] Two key factors are behind this performance: a) attractive profitability of competing crops which led to shifting in area under cotton cultivation over the last several years, especially in the cotton producing districts of Punjab; and b) the cotton per hectare yields is still lower than FY15 level, which indicates the possibility of further improvement in yields. These factors, together with lower quality of lint, have also encouraged imports of better quality cotton to augment production of value-added textile items: raw cotton imports stood at 3.6 million bales in FY18 compared to 2.9 million bales in FY17.

Sugarcane:

Sugarcane production reached a record 82.1 million tons during FY18. High comparative profitability due to indicative pricing, timely payments to growers by millers in FY17, and resilient nature of crop, resulted in a shift of area from competing major *kharif* crops to sugarcane. An analysis of last 6 *kharif* crops shows that in major cotton producing areas, the share of area under sugarcane increased from 10.1 percent in FY13 to 14.5 percent in FY18. Overall, better crop performance was achieved

[5] Source: Department of Agriculture, Government of Punjab.
[6] Till May 2018.
[7] The terms of subsidy and selection criteria vary for land holdings of up to 50 acres. Only 20 percent of the selected farmers will be from landholdings between 12.5 to 50 acres while rest will be from below 12.5 acres.
[8] According to SBP estimates, the banks met 72 percent of agriculture credit demand in FY18 compared to 57 percent last year.
[9] During July to December 2017, the government imposed a tariff of 4 percent and sales tax of 5 percent on imported cotton. These measures were removed after the conclusion of domestic crop harvest in January 2018.
[10] Monthly Cotton Review, June 2018, Pakistan Central Cotton Committee.

through enhanced area under cultivation by all the provinces, largely in southern districts of Punjab (**Table 2.3**).

Nonetheless, the policy of indicative pricing and the resultant bumper crops in preceding years has led to a consistent buildup of sugar stocks with mills. The stocks with provinces stood at 4.9 million tons by end-June 2018 compared to 4.5 million tons by June 2017.[11] The sugar stocks piled up further as domestic sugar consumption remained below production level and sugar exports remained uncompetitive without subsidy. The sugar mills in Sindh also suspended their operations for some time in expectations of downward revision in sugarcane prices. Consequently, the post-harvest season witnessed delays in payments to farmers. Also, the growers faced significant losses as they were paid as low as Rs 120 per 40 kg in Punjab with the official rate being Rs 180 per 40 kg.[12] Therefore, keeping in view delay in payments to farmers and the high cost of the export subsidy on sugar, a rationalization of indicative pricing mechanism is needed. Issues of non-payment in FY18 cane season and the resultant dispute between growers and millers may also affect the performance of sugarcane crop in FY19.

Table 2.3: Sugarcane Crop Performance

	Area (million hectares)		**Production** (million tons)		**Yield** (kg per hectare)	
	FY17	**FY18**	**FY17**	**FY18**	**FY17**	**FY18**
Punjab	0.8	0.9	49.6	55.1	63,786	64,099
Sindh	0.3	0.3	18.2	20.6	56,660	61,842
KP	0.1	0.1	5.6	6.4	47,460	43,131
Pakistan	**1.2**	**1.3**	**73.4**	**82.1**	**60,309**	**61,207**

Data source: Ministry of National Food Security and Research

Rice:

The rice crop grew by 8.8 percent, with production reaching a record of 7.5 million tons and comfortably surpassing the target of 6.8 million tons for FY18. Being a major export commodity, rice emerged as an attractive crop for farmers in FY18, as witnessed from the increased area under cultivation (especially in Sindh, where crop area saw a double-digit growth). Area under cultivation also increased for basmati in Punjab's northeast zone. Furthermore, increased area was allocated in Sindh for a new hybrid variety developed under joint research undertakings with Chinese enterprises, which helped boost yields in the province (**Table 2.4**).

Table 2.4: Rice Crop Variety-wise Area and Production

	Punjab			**Sindh**		
	FY17	**FY18**	**Growth**	**FY17**	**FY18**	**Growth**
			Area (million hectares)			
Basmati	1.35	1.42	4.70	0.05	0.06	8.24
Irri	0.15	0.13	-7.23	0.33	0.35	5.46
Hybrid	-	-	-	0.34	0.39	14.61
Total	***1.74***	***1.84***	***6.01***	***0.75***	***0.83***	***10.38***
			Production (million tons)			
Basmati	2.52	2.82	11.58	0.08	0.08	-1.80
Irri	0.39	0.36	-7.48	0.93	0.88	-5.54
Hybrid	-	-	-	1.63	1.86	14.30
Total	**3.48**	**3.90**	**12.17**	**2.66**	**2.85**	**7.08**

Data source: Pakistan Bureau of Statistics

The exports of rice remained encouraging this year on the back of high global prices and improved investment in processing and packaging (**Chapter 6**). Going forward, acceleration in production will be needed to meet rising domestic demand for premium rice and to exploit export opportunity in the EU, which has restricted rice imports from India due to excessive use of tricyclazole (fungicide) spray on rice farms.

Wheat:

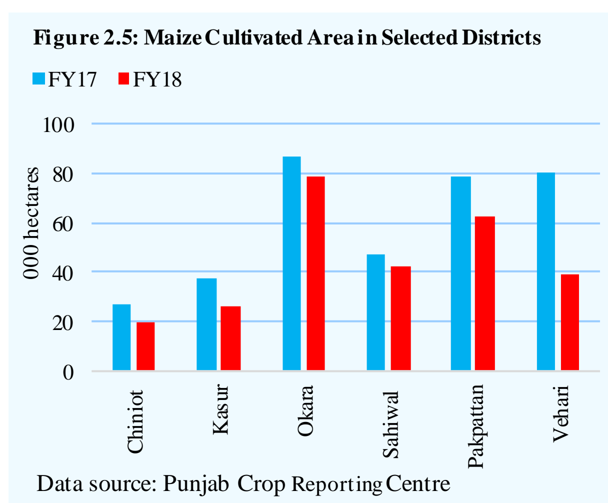
Wheat production reached 25.5 million tons in FY18, down 4.4 percent from FY17. Delays in sugarcane harvest resulted in late sowing of wheat crop in Punjab and Sindh, which led to decline in

[11] Ministry of Industries and Production. The figures are as of 12th July 2018.
[12] Pakistan SUPARCO, Monthly Bulletin, Vol 8 Issue 3, May 2018.

area under crop by 2.5 percent.[13] Furthermore, scanty rainfall affected production in the rain-fed districts of Punjab, while lower than average water availability adversely affected output in irrigated districts. Similarly, low phosphate application reduced crop yields in many areas of Punjab.

Nonetheless, the production in FY18 was more than sufficient to meet domestic demand. After the procurement of 5.92 million tons in FY18,[14] end-June 2018 stocks reached 10.7 million tons compared to 9.3 million tons at the same time last year.[15] Subsidized wheat export slightly reduced the overall stocks position towards the end of FY18, as exports rose to 1.2 million tons compared to just 4 thousand tons in FY17. In the upcoming months, more exports opportunities are expected in the wake of rise in wheat demand from Asia and Africa. Furthermore, amid forecast of lower production in major exporting countries (such as Australia, Russia and EU), international wheat price is expected to increase, which will provide Pakistan an export opportunity to sell its excessive stocks at good rates.[16]

Figure 2.5: Maize Cultivated Area in Selected Districts



Data source: Punjab Crop Reporting Centre

Table 2.5: Pulses Performance

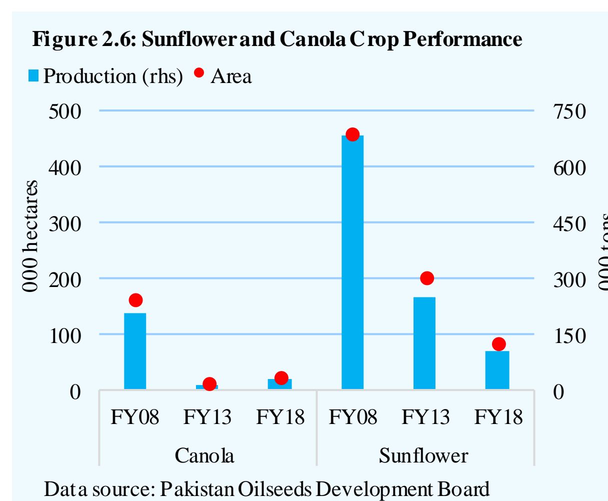
	Production (000 tons)		Area (000 hectares)	
	Gram	Other pulses	Gram	Other pulses
FY09	741	185	1081	247
FY11	496	101	1054	188
FY13	751	111	992	178
FY15	379	115	942	166
FY17	330	144	971	211
FY18	341	136	967	192

Data source: Ministry of National Food Security and Research

Maize:

The production of maize crop declined by 7.1 percent to 5.7 million tons in FY18. Despite this, the targets for area and crop production were achieved. The major reduction in the crop production was witnessed in core maize producing districts of Punjab, namely Chiniot, Kasur, Okara, Sahiwal, Pakpattan and Vehari (**Figure 2.5**). This happened due to shift in area allocation towards competing crops, such as rice, cotton and sugarcane.

Figure 2.6: Sunflower and Canola Crop Performance



Data source: Pakistan Oilseeds Development Board

Despite a reduction in area under the crop, yields improved largely because of planting of a hybrid-seed variant, which was sown in 65 percent of total planted area. Given maize output is consumed mainly as poultry and dairy feed (65 percent of corn is used in poultry feed), rising poultry demand is expected to galvanize higher output in future.

[13] Wheat area reduction was witnessed in major sugar producing areas such as Bahawalpur division (Bahawalpur, Rahim Yar Khan, Bahawalnagar).
[14] Source: Annual Plan, Provincial Food Departments and PASSCO.
[15] Provincial Food Authorities and PASSCO.
[16] Source: USDA, FAS, 'Grain: World Markets and Trade' report, July 12, 2018.

Other Crops:
Within other crops, pulses and oilseeds performed comparatively better. Gram, the largest pulse crop, witnessed an encouraging increase of 3.5 percent in production, mainly owing to improved yields despite reduction in area under cultivation. Production of pulses, including mash, mung and masoor, have dwindled over the last few years due to changes in cultivated area and productivity variations (**Table 2.5**). Being a major food item, pulses demand is largely met through imports, which drains foreign exchange.[17] Hence, there is need for a policy support to encourage local production.

In case of oilseeds, canola production rose from 16,000 tons in FY17 to 30,000 tons in FY18, as area under crop doubled given the cash subsidies in place. This has been the highest production in the last six years. On the other hand, sunflower production marginally declined, as area under sunflower reduced 4.7 percent (**Figure 2.6**). This was also attributed to shift in area allocation towards more profitable crops.

Livestock:
The livestock sector - which contributes 59 percent in the agriculture sector's value addition - grew by 3.8 percent in FY18 compared to 2.9 percent in FY17. The better performance was attributed to livestock products (milk, meat, wool, hides, etc) and poultry products (eggs and poultry meat), which grew by 2.9 percent and 7.8 percent respectively on the back of rising demand (**Table 2.6**). In the context of livestock production, the initiatives for import of cattle for cross breeding and programs related to animal health and prevention of major diseases played an important role. In particular, the National Progressive Control of FMD, worth Rs 726 million, was launched to control the Foot and Mouth Disease and improve animal health.[18] The program is also aimed at strengthening diagnostic capabilities and curbing a major cattle disease in the country.

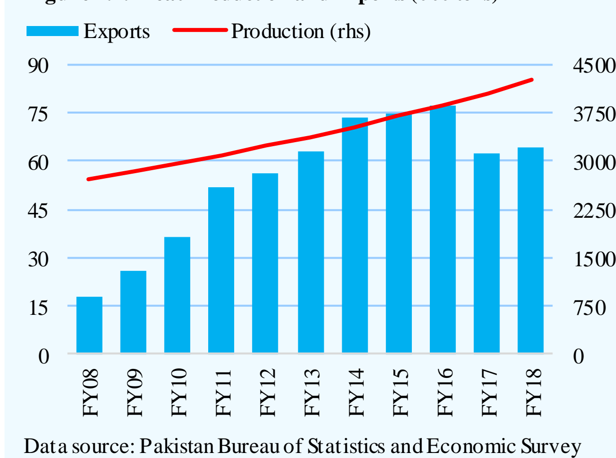
Table 2.6: Value Added in Livestock
billion rupees

	FY1[R]	FY18[P]	Growth	
			FY17	FY18
A. Gross output	1,611	1,666	3.4	3.4
Animal sold for slaughtering	370	381	2.9	2.9
Natural growth & regeneration	231	238	2.9	3.0
Livestock products	847	872	2.9	2.9
Poultry products	163	175	7.7	7.8
B. Intermediate consumption	292	299	5.6	2.7
C. Gross value added (A-B)	1,319	1,367	2.9	3.6
D. Other GVA*	8	10	14.6	31.1
E. Total GVA	**1,327**	**1,377**	**2.9**	**3.8**

R: Revised, P: Provisional, * hunting & animal husbandry
Data source: Pakistan Bureau of Statistics

The increase in livestock production also created export opportunities. Especially, the export of meat and meat products witnessed slight improvement of 3.7 percent in FY18 against a contraction of 19.5 percent last year (**Figure 2.7**). The exporters were able to explore some of the GCC markets, especially Bahrain, Kuwait, Oman and UAE as the Halal certification process strengthened.[19] Going forward, the export volumes of meat products can further be enhanced by diverting more attention towards improvement in product quality and taking more

Figure 2.7: Meat Production and Exports (000 tons)



Data source: Pakistan Bureau of Statistics and Economic Survey

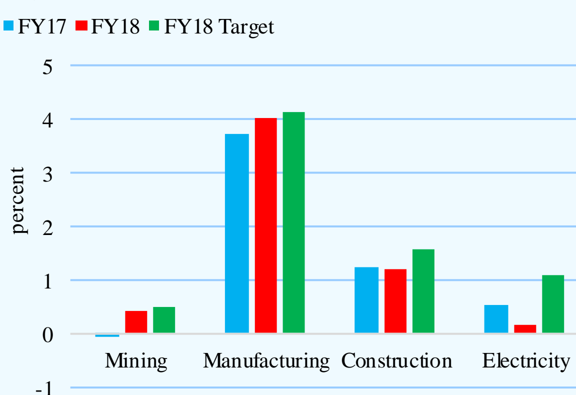
[17] The import value for pulses on average during FY14-FY18 is US$ 0.6 billion.
[18] Livestock Wing, Ministry of National Food Security and Research
[19] In FY18, the livestock department and private firms reached out to markets of China and Russia for future exports of meat and meat products. As regards to poultry, lifting of ban by the UAE on Pakistan's imports in FY18 is another opportunity worth exploiting.

initiatives to reach out to diversified markets abroad. Moreover, there is a need for provision of real time information on animal population, which is crucial for developing appropriate policies at the federal/provincial level. On this front, a livestock census in 2018 for Punjab is a welcome development which reveals information regarding animal fertility, per day milk availability and provides reliable data on animal head count and health.[20]

2.3 Industry:

Growth in the industrial sector improved to 5.8 percent in FY18 from 5.4 percent in FY17; however, it remained lower than the target of 7.3 percent. Encouragingly, the uptick in growth remained broad-based. In particular, manufacturing and construction contributed considerably to the overall growth. Meanwhile, major drag came from the *electricity generation and gas distribution* subsector, which contributed only 0.2 percent to industrial sector growth against 1.1 percent envisaged in the Annual Plan for FY18 (**Figure 2.8**). This happened despite an improvement in electricity generation. The substantial rise in input prices led to an increase in cost of production of this sub-sector. On the other hand, growth in revenues was hampered by a partial adjustment in power prices. Consequentially, increased intermediate consumption cost coupled with depressed output (i.e. electricity) prices resulted in lower gross value addition (GVA) of this sub-sector.

Figure 2.8: Contribution to Industrial Growth



Data source: Pakistan Bureau of Statistics

Table 2.7: Growth in LSM

	weight	Growth		Contribution in Growth	
		FY17	FY18	FY17	FY18
LSM	70.3	5.8	5.4	-	-
Textile	20.9	0.8	0.4	0.2	0.1
Cotton yarn	13.0	0.7	0.1	0.1	0.0
Cotton cloth	7.2	0.4	0.0	0.0	0.0
Jute goods	0.3	8.1	23.9	0.0	0.0
Food	12.4	11.7	2.8	2.4	0.6
Sugar	3.5	37.8	-6.8	2.5	-0.6
Cigarettes	2.1	-35.8	72.0	-0.7	0.8
Vegetable ghee	1.1	3.1	2.1	0.0	0.0
Cooking oil	2.2	2.7	0.0	0.1	0.0
Soft drinks	0.9	13.7	8.4	0.4	0.2
POL	5.5	2.8	13.2	0.2	0.8
Steel	5.4	20.5	21.8	0.7	0.8
Non-metallic minerals	5.4	4.4	11.0	0.5	1.2
Cement	5.3	4.5	11.1	0.5	1.2
Automobile	4.6	11.2	17.8	0.7	1.2
Jeeps and cars	2.8	5.4	21.4	0.2	0.7
Fertilizer	4.4	1.7	-9.9	0.1	-0.6
Pharmaceutical	3.6	9.1	2.9	0.8	0.3
Paper	2.3	9.6	9.4	0.3	0.3
Electronics	2.0	21.6	32.4	0.4	0.6
Chemicals	1.7	-2.3	-0.2	-0.1	0.0
Caustic soda	0.4	-0.6	20.7	0.0	0.1
Leather products	0.9	-16.5	-0.2	-0.3	0.0
Excluding sugar	66.8	3.5	6.5		

Source: Pakistan Bureau of Statistics

The accelerated growth in manufacturing sector was attributed to a host of factors, including smooth energy supplies, lower cost of financing, improved business sentiments and high development spending. In particular, the enhanced public spending on power and infrastructure projects stimulated the growth in construction-allied sectors of cement and steel. Besides, an increase in rural income - due to better agriculture harvest – added to demand for consumer durables.

The large-scale manufacturing sector remained the key driver of growth in industrial production. Cement, steel and petroleum industries took advantage of enhanced capacity and robust demand, while cigarette and auto

[20] Conducted through the virtual governance program, where real-time data was provided to the system. The 9211 Virtual Governance System is a database of millions of livestock farmers across Punjab that captures details of livestock and mapping of services provided by the Livestock and Dairy Development department. The application also connects farmers to livestock specialists who provide technical advice regarding various animals.

industries benefited from higher capacity utilization. The two prime exceptions in the otherwise favorable performance in FY18 were the fertilizer and sugar industries. Smaller fertilizer units did not receive domestic gas supplies and production on imported RLNG became unprofitable for them. This led to almost closer of operations of these units. Meanwhile, lower international sugar price had a knock-on effect on the domestic sugar industry. The producers, already flush with a substantial stockpile, were not willing to crush sugarcane excessively under the prevalent indicative price of sugarcane, that made the domestic industry uncompetitive in the international market.

Large-scale manufacturing:
Large scale manufacturing (LSM) exhibited a growth of 5.4 percent during FY18 on top of 5.8 percent growth observed during FY17 (**Table 2.7**). The factors which facilitated LSM growth mainly included increased capacity utilization due to ease in energy supplies, high credit off-take owing to low financing cost, output stimulus in associated industries due to spillover impact of widespread construction activities and supportive business environment.

Overall, the LSM presented encouraging performance with notable contribution coming from construction allied and consumer durable industries. However, sugar industry was not able to capitalize on record sugarcane production. This was in stark contrast to last year, when sugar was the main contributor to overall LSM growth. Resultantly, LSM growth excluding sugar stands at an appreciable level of 6.5 percent during FY18, compared to 3.5 percent last year.

Steel:
The steel industry posted a notable growth of 21.8 percent during FY18 on top of 20.5 percent growth last year. Both the demand and supply side factors contributed to this performance. From the demand side, steel needs of infrastructure projects, housing schemes and auto and appliances industries stayed elevated. While, from the supply side, the imposition of anti-dumping-duties last year led major players to take the opportunity to increase their market share through capacity enhancements. In addition to capacity increases, other factors also influenced the market (for instance, improved electricity situation proved beneficial for the energy intensive industry). **Box 2.1** expands on this narrative to provide an overview of recent developments in the sector.

Box 2.1: Developments in the Steel Sector of Pakistan
Pakistan's steel manufacturers are undertaking significant investment to expand operational capacity and enhance product quality. This is mainly due to continuous rise in domestic demand. The industry has recovered from a contractionary phase that started with the closure of operations of Pakistan Steel Mills in FY15, and posted an encouraging growth of over 20 percent during FY17 and FY18.

Table 2.1.1: Major Players in the Domestic Steel Industry

Major Players	Main Products	Capacity Utilization in FY18 (percent)	Existing Capacity (thousand tons)	Expected Capacity after Expansion (thousand tons)	Online Date of new capacity
Aisha Steel Mills Limited	CRC and planned galvanized coils	95	220 CRC	450 CRC; 250 galvanized	mid-2019
Amreli Steels Limited	Bars and Billets	85	425 Steel Re-Bars; 100 Billets	750 rebars; 600 billets	mid-2019
Crescent Steel & Allied Products Limited	Steel Pipes (road networks)	161	66.7 piped; 85 billets	85	mid-2020
International Steels Limited	Galvanized Coils, CRC, color-coated	72	462 galvanized; 550 CRC; 84 color coated	462 Galvanized; 1000 CRC; 84 color coated	end-2018
Ittefaq Iron Industries Limited	Billets and de-formed bars	44	120	120 (no plans)	-
Mughal Iron & Steel Industries Limited	Long-rolled Bars and Billets	68	688	1000	early-2019

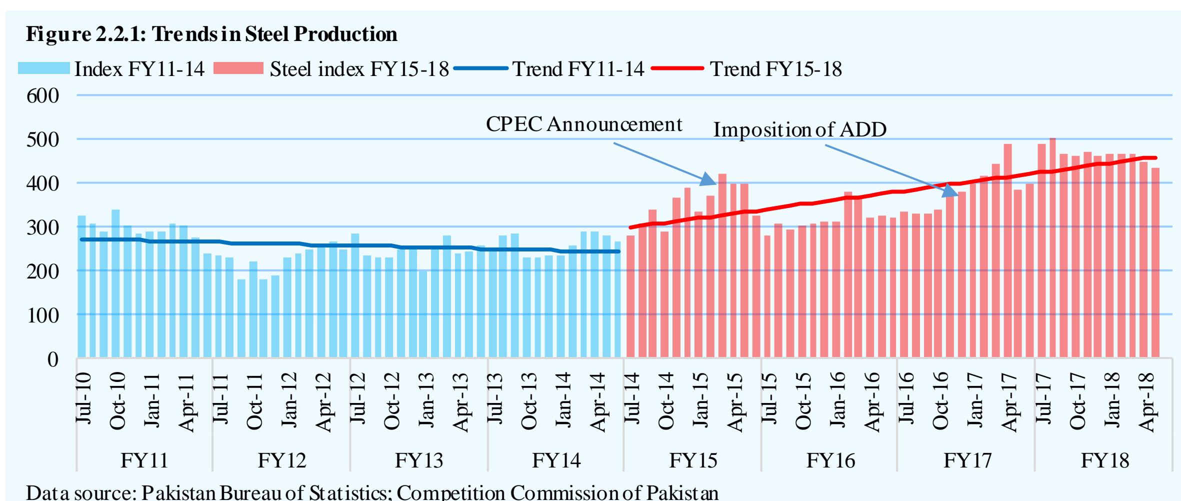
Data Source: Companies' financials; Pakistan Stock Exchange

Steel products are generally classified into four broad categories: long steel products (re-rolled bars); flat steel products such as Hot Rolled Coils (HRC), Cold Rolled Coils (CRC), and Hot Dipped Galvanized Coils (HDGC); piped products for use in road construction, etc.; and semi-finished products that are sold to other manufacturers or consumed internally for processing into finished products. **Table 2.1.1** lists the major private sector steel manufacturers and details their products. Cumulatively, the domestic manufacturers cater around 50 and 60 percent of the total domestic demand for galvanized and CRC, respectively. High imports, even after record domestic production, illustrate high demand for steel products. On the demand side, four factors stand out. First, there is now a dynamic customer base for steel commodities in automotive, defense, transportation and appliances sectors. Second, an increase in overall industrial activities has created further room, as most of the construction-allied industries are investing heavily in expansions. Third, population surge has created a housing shortage and the private housing projects are gearing up to cater to this shortfall. Fourth, higher public spending and CPEC related infrastructure undertakings are fueling further demand for steel. Going forward, these four developments would continue to increase overall demand for steel.

From the supply side, the domestic manufacturers face tough competition from imported finished products, particularly from China. Competitive in terms of both price and quality, the imported products are especially impacting sales of domestic small players, who are unable to compete due to high costs of doing business and double taxation across the industry. Recently, the industry has had some respite after the government imposed anti-dumping duty (ADD) on top of already imposed regulatory duties on finished steel products (**Figure 2.2.1**).

This favorable interplay between the demand and supply dynamics has incentivized the domestic industry to invest in capacity expansions and product diversification. International Steel, for instance, increased its CRC capacity from 250,000 to 550,000 during FY15 and FY16 after converting their compact cold rolling mill to a twin-stand reversing mill. Similarly, their galvanizing capacity increased from 150,000 tons to around 460,000 tons after adding a second galvanizing line. They are currently in the process of upgrading their CRC capacity from 550,000 tons to 1.0 million tons at an estimated cost of Rs 5.6 billion. Amreli Steels, meanwhile, has diversified its product base, producing billets as well as rebars. Their capacity for rebor production has grown from 180,000 to first 300,000 and eventually 425,000 and for billets from 100,000 to 600,000. Going forward, it intends to expand the CRC capacity to 750,000.

Figure 2.2.1: Trends in Steel Production



Data source: Pakistan Bureau of Statistics; Competition Commission of Pakistan

Aisha Steels is also vertically expanding its operations. It plans to produce galvanizing products as well as CRC. An investment of Rs 3.9 billion would take its capacity from 220,000 to 450,000 for CRC while introducing new capacity of 250,000 for galvanized coils. Lastly, Mughal Steel is investing around Rs 1 billion to increase its total capacity from around 690,000 to 1 million tons.

The industry is also focusing on extensive BMR activities to achieve efficiency gains. For example, Aisha Steels has installed a roll grinder procured from Germany to improve the thin gauge CRC quality, while an electrostatic oiler has also been installed to strengthen the products' resistance to corrosion. Amreli Steels also has plans to start using the multi-slit rolling technology acquired through Primetals, a leading global engineering and plant construction company. Meanwhile, some players are enhancing their own electricity production capacities to cater to the growing demand. Mughal Iron and Steel, for instance, has restarted operations of 9.3 MW gas-fired captive power plant. It has obtained approval for further captive power generation from SNGPL for 2.8 MMCFD of gas, up from 1.8 MMCFD.

In the piped steel segment, a key industry player is working overtime to cash in on the rising demand. There are also instances where companies are investing in other industrial activities (such as fragmentation and cotton yarn spinning) and then intending to use the surplus profits to invest in the steel segment. The fabrication unit of Crescent Steel manufactures

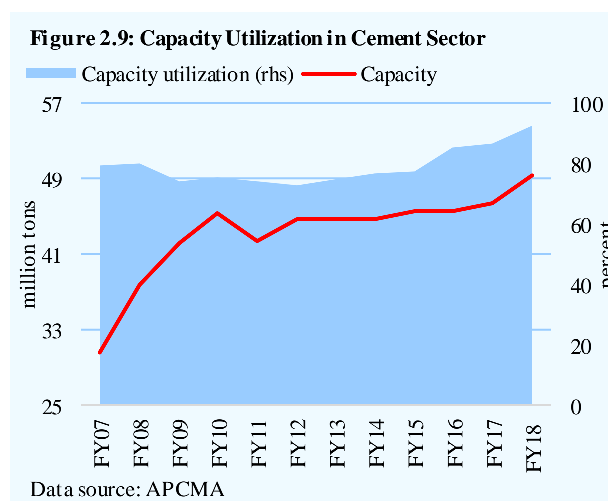
and supplies products as diverse as cane-shredders, centrifugal machines, stainless steel spray clusters, multi-jet condensers, and high voltage condenser tanks, etc.

The sector is also intensifying efforts to reduce import dependence on raw materials. While scrap imports would continue to increase (given that the domestic scrap materials do not yield quality products), the industry players have started expanding their billet manufacturing, which is further processed into long bar products by the manufacturers. Overall, the domestic steel industry is benefiting from an encouraging investment and operational stimulus. However, as the new capacity comes online, the profitability of the manufacturers would depend on the overall activities in real and construction sectors going forward.

Cement:

The cement industry, with more than one-fifth share in overall LSM growth, registered a growth of 11.1 percent during FY18 compared to 4.5 percent last year (**Figure 2.9**). The industry benefited from improvements in capacity utilization as well as increase in production potential. While industrial capacity grew 6.6 percent to reach 49.4 million tons during FY18, the utilization levels also reached historical high of 93.0 percent. This facilitated the industry to meet demand of widespread construction activities, as reflected by strong figures of local dispatches, which surged 15.4 percent during the year. Encouragingly, quantum of cement exports also witnessed an increase of 1.8 percent after eight consecutive years of contraction (average contraction of 10 percent during last eight years). This occurred on the back of significant rise witnessed in shipments to Afghanistan, South Africa, Madagascar and Senegal during the period (**Chapter 6**).

Figure 2.9: Capacity Utilization in Cement Sector



Data source: APCMA

However, the domestic demand for cement has far outpaced exports in recent years. It may be noted that the industry used to export around a quarter of its annual output during FY01-09, the share of which has now came down to only a tenth. This decline in exports share is conceivable due to installation of industrial units in the key cement export destinations such as South Africa and Afghanistan that may impose high tariffs on cement imports to protect their own industries.

Similar to steel, the growth in cement industry is also driven by CPEC related projects, public sector development spending and the ongoing construction of private housing schemes. Anticipating further demand in the years ahead, the industry players are investing heavily in capacity expansions, mainly to consolidate their positions in a high margin domestic market as well as major export destinations.[21]

Nevertheless, the absorption of excess cement output in future would depend on: a) the continued work on housing schemes to bridge the housing deficit, especially in urban areas; b) the demand emanating from public sector projects which also rely on the utilization of budgeted PSDP, and c) the continuity of projects and special economic zones under the CPEC umbrella. Furthermore, the enhanced capacities of the industry may also lead to improving external competitiveness and induce cement industry to explore new markets.

[21] For more information, refer to Special Section 1 titled "Cement Industry-Current Dynamics and Future Prospects" in SBP's Third Quarterly Report on the State of Pakistan Economy for FY18.

Automobile:

The growth momentum of the automobile industry continued in FY18, with production rising by 17.8 percent, on top of the 11.2 percent growth observed during FY17 (**Table 2.8**). A double-digit growth was recorded in almost all the sub categories. The sector's robust performance is indicative of rising auto demand in the country. Despite increased capacity utilization by local manufacturers, the industry could not fully meet the demand. Resultantly, increase in imports of used cars was observed during the year.

Table 2.8: Automobile Production

	FY16	FY17	FY18	Growth	
				FY17	FY18
All Cars	**179,944**	**186,936**	**217,774**	**3.9**	**16.5**
Cars <800 cc	66,957	57,842	69,078	-13.6	19.4
Cars between 800-1000 cc	26,276	35,313	49,848	34.4	41.2
Cars >1000cc	86,711	93,781	98,848	8.2	5.4
Trucks	5,666	7,712	9,187	36.1	19.1
Buses	1,070	1,118	784	4.5	-29.9
Light commercial vehicles	35,836	24,265	29,055	-32.3	19.7
Sports utility vehicles	773	3,530	13,364	356.7	278.6
Tractors	34,914	53,975	71,894	54.6	33.2
Motorbikes	1,362,096	1,632,965	1,926,688	19.9	18.0

Data Source: Pakistan Automobile Manufacturing Association

Several factors have contributed to the robust demand for automobiles. First, the low interest rate environment has made purchase of cars on credit more affordable. The increase in auto and personal loans is indicative of this development.[22] Second, ride hailing services have made further inroads in the domestic market, creating additional demand, especially for the fuel efficient hatchbacks. After a lackluster performance of this segment in FY17, the hatchbacks made a commendable recovery in FY18, posting a growth of 28 percent. Third, the previously untapped and under-marketed SUV segment continued to garner widespread popularity resulting in noteworthy growth for this sub-sector. Fourth, impressive growth of agriculture led to an increase in rural incomes, which in turn created substantial demand for tractors and motorbikes. Finally, increase in overall business activities - substantiated by continued growth in commercial vehicles – created room for widespread demand for variety of automobiles in the country.

In spite of this, the existing players hardly added to their existing capacity while entry of new manufacturers is still awaited. The existing players have resorted to double shifts to meet the increasing demand. However, lack of capacity expansions led to an increase in vehicle delivery times. For some models, the customers had to wait for more than 6 months for deliveries after the initial booking.[23]

Although automobiles exhibited record production figures, the reliance on imported vehicles was high. Imported vehicles, especially hatchbacks, are popular due to higher fuel efficiency and standard security features that the local producers do not provide. Moreover, the demand for imported vehicles remained strong despite substantial PKR depreciation. Moving forward, further PKR depreciation, tariff and non-tariff barriers and restrictions on purchase of new vehicles for non-tax filers is expected to hamper demand for vehicles.

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[22] Refer to **Chapter 3** for more detail.

[23] In the case of Toyota Corolla, Honda City and Civic, the delivery times were upto nine months.

Electronics:
Electronics sector gained further traction as production rose sharply by 32.4 percent during FY18 on top of 21.6 percent increase in FY17. This result can be attributed solely to increase in production of electric motors, which surged by 132.6 percent in FY18 compared to 25.8 percent in FY17. This performance was attributable to improvement in power supplies on the back of increased public investment in the electricity generation and distribution. Besides electric motors, the usual contributors like refrigerators, deep freezers, and air conditioners have recorded either slowdown or contractions during the year.

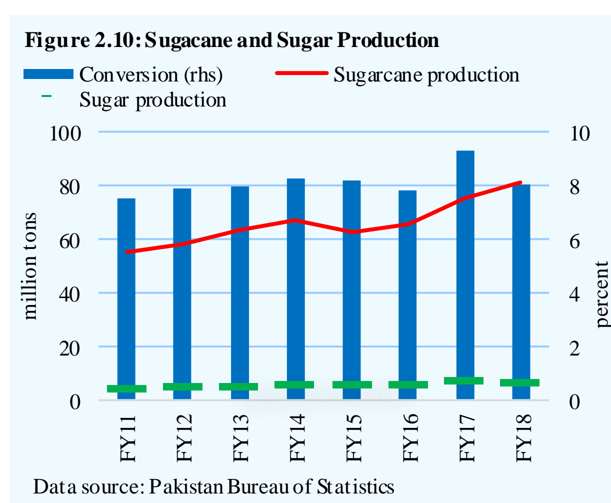
POL:
The POL sector grew by 13.2 percent during FY18 compared to 2.8 percent in FY17- outshining last year's performance by a significant margin of 10.4 percent. Both the demand and supply side factors helped keep the POL production high. From the demand side, enhanced power generation, improved trade and commercial activities, higher income levels, and rising demand for private transportation, especially through ride hailing services, aided this growth. On the supply side, capacity expansions, upgradation of technology, and recovering international oil prices played a key role.

While overall performance of the sector was commendable, it could have been even better, had the government not ordered the closure of inefficient and costly furnace oil-based power plants. This measure created an indirect impact on the performance of the POL industry, as furnace oil is one of the major products of oil refineries. Ad hoc closure of furnace oil-based power plants led to a build-up of furnace oil stockpile for which there was no significant domestic buyer except the power generation industry. Therefore, some refineries had to cease their operation during Q2-FY18, and this negatively affected the performance of the POL industry.

Food:
Growth in the food sector remained subdued during FY18. It was mainly a contraction in the production of sugar that held back the otherwise promising recoveries witnessed in cigarette and edible oil segments. Overall, the sector managed to grow by 2.8 percent in FY18 against growth of 11.7 percent in FY17, during which the food group**,** owing to sugar, was the key contributor towards LSM growth.

Sugar:
Sugar industry recorded a decline of 6.8 percent in production during FY18. Last year was an outlier, as the industry had yielded 7 million tons from the then record sugarcane output of 75.5 million tons, which points to a historic conversion rate of 9.3 percent. For FY18, this rate fell to 8.1 percent from a record high sugarcane harvest of 81.1 million tons, in line with historical trend (**Figure 2.10**). This year, the sugar industry was not able to crush all the raw material that was on offer owing to a number of factors. Primary reason was sugarcane pricing. After the 18th Amendment, provincial governments announce sugarcane procurement prices for the sugar mills based on market fundamentals in conjunction with the

Figure 2.10: Sugacane and Sugar Production



Data source: Pakistan Bureau of Statistics

growers and sugar mills representatives.[24] In the international market, the sugar price remained depressed since February 2017, while locally the provincial authorities set a high procurement price. The contrast set the tone for this year's performance of the sector.
In Sindh, sugar mills suspended their operations for a few weeks to put pressure on regulatory authorities to revise the sugarcane prices downward. The mill owners were eventually successful as a provincial judicial court revised sugarcane price downwards.

Meanwhile, in Punjab, the court ordered suspension of crushing at a few sugar mills on the basis of unlawful relocation. The affected mills were later allowed to resume their operations. However, the sector's overall crushing activity was severely affected by then. Consequently, growers had to bear significant losses: with record harvest, they had to sell their output at massive discounts.

From the millers' perspective, surplus stock amid low international sugar prices and limited export quota remained major concerns. In fact, the sugar industry has been producing surplus sugar for the past few years, which led to build up of stocks. For the last two years, on average, the country produced about 7 million tons of sugar, two million tons more than domestic consumption. With depressed international prices, exports were not possible without subsidy.

The country was able to export 1.5 million tons out of allowed quota of 2.0 million tons, on the back of hefty subsidies by the federal and provincial governments. The subsidy at the rate of Rs 10.7 per kg put an extra burden of Rs 16.0 billion on the national exchequer. Rationalizing the prices more in line with the international prices would not only reduce the fiscal strain but also induce allocative efficiency in the agriculture sector. Artificial profitability created by the indicative sugarcane pricing has adversely affected production of other crops like cotton and edible oil.

Cigarette:
The cigarette industry experienced a turnaround in FY18. The impact of three-tier structure of federal excise duties was felt strongly, as the industry posted a growth of 72.0 percent in FY18 in stark contrast to a contraction of 35.8 percent in the preceding year. Introduction of the third tier for cheaper cigarettes allowed domestic variants to compete with low-priced illicit foreign brands. A further impetus came from crackdown by the government on counterfeits, smuggling and tax evasion. The impact of this substitution was observed during the year, as financial returns of the major players increased substantially.

While the initiatives have worked well, the same may not be true regarding the welfare cost to the society. Cheaper cigarettes may plug the revenue shortfall to some extent, but a desirable way would be to reduce cigarette consumption regardless of the fact that supplies come from formal or informal sources. A crackdown on illicit/smuggled cigarette trade should continue for the benefit of the domestic formal industry, while tax rates may be increased across the tiers to discourage overall consumption of cigarettes from a health point of view.

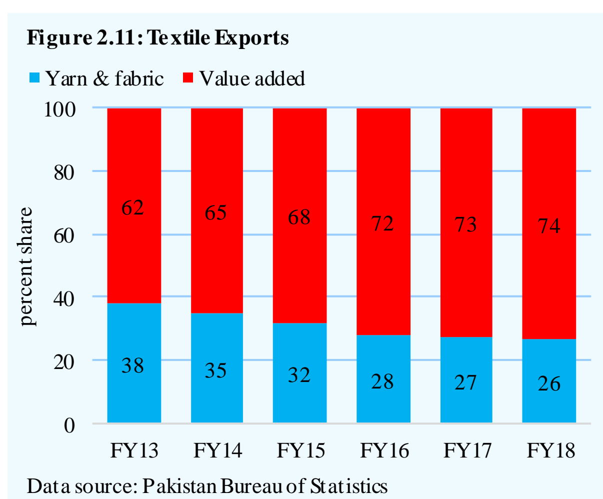
Textile:
Textile sector could only manage a growth of 0.4 percent during FY18 compared to preceding year's growth of 0.8 percent. The production of cotton yarn and cotton cloth, with a combined weight of 20 percent in LSM, remained stagnant during the year, and this was a deciding factor behind below par performance of textile manufacturing. Although the non-cotton based products such as jute and woolen products showed marginal growth, they could not bring any change in the performance of the sector as a whole. This lackluster performance took place despite an increase in cotton production and enhanced focus by the government to revive the ailing textile sector via the exports package. The

[24] This includes domestic cost of sugarcane production, area under the crop, international prices etc.

government further relaxed the custom duties and sales tax, while lowering the threshold of performance-based duty drawback concessions during the course of FY18 from 10 percent to 5 percent.

Encouragingly, textile exports grew by 8.6 percent in FY18. This happened despite a marginal growth witnessed in textile manufacturing. The discrepancy in these numbers is primarily attributed to low coverage of textiles in LSM, which reports yarn and cloth items. While export data is more intensive that also includes value-added items mainly manufactured in the SME sector such as hosiery, knitwear, towels, readymade garments etc. (**Figure 2.11**).

Figure 2.11: Textile Exports

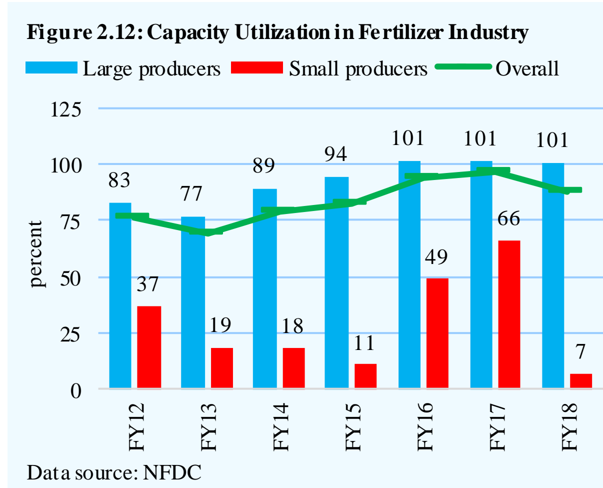


Data source: Pakistan Bureau of Statistics

Fertilizer:

Fertilizer production declined by 9.9 percent in FY18 against a modest growth of 1.7 percent last year. The detailed data suggests that the decline was primarily due to suspension of production activities by smaller fertilizer units, as production of larger firms remained at previous year's level. It is worth highlighting that smaller units do not have access to domestic gas supplies, and operating the plants on imported RLNG is unviable due to its high cost.

Figure 2.12: Capacity Utilization in Fertilizer Industry



Data source: NFDC

As more natural gas-fired power plants came online, domestic gas supplies were diverted from smaller fertilizer producing units. As a result, capacity utilization of small producers fell from 66.0 percent to just 7.0 percent in FY18, whereas larger players were not affected (**Figure 2.12**). Another likely factor that affected fertilizer production was the uncertainty regarding subsidies at the start of the fiscal year. The manufacturers had faced delays in receiving subsidy payments while the alteration in the mechanism of the subsidy payment and relaxation in applicable tax rates created ambiguities for the manufacturers.

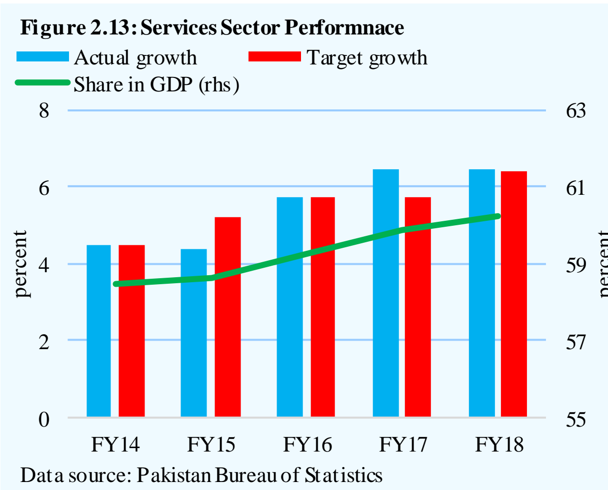
Furthermore, the international prices of the commodity registered substantial increase due to upsurge in the prices of key input; coal and RLNG. High demand and lower domestic supplies created a situation where imports were inevitable in FY18. During FY18, the country imported 37.0 percent more fertilizer products – at a higher price – in order to fill the deficit in the domestic market. This is pertinent to note, as the industry was exporting surplus stocks during last year.

2.4 Services:

The services sector almost repeated its last year's performance, posting 6.4 percent growth compared to 6.5 percent in FY17 (**Figure 2.13**). While the sector benefitted from healthy performances of the *wholesale & retail trade* and *general government services* subsectors, the *finance & insurance, transport, storage and communication*, and *other private services* witnessed deceleration during the year (**Table 2.9**).

A detailed analysis of the sub-sectors reveals that the *wholesale and retail trade* performed well on the back of strong showing of the commodity-producing segment and a continued increase in import quantum. This led to an impressive growth of 7.5 percent during FY18 – the highest in the last 12 years.

Figure 2.13: Services Sector Performnace



Data source: Pakistan Bureau of Statistics

Meanwhile, value-addition in the *transport, storage & communication* sub-sector slowed down to 3.6 percent during FY18, from 4.4 percent last year. This was due to a subdued showing of the communication segment owing to a lower increase in PTCL profits compared to last year.

Table 2.9: Performance of the Services Sector

	Share in GDP	Growth		Contr. to Services Growth	
		FY17^R	FY18^P	FY17^R	FY18^P
Wholesale & retail trade	19.0	7.5	7.5	35.7	36.4
Transport, storage & com.	13.0	4.4	3.6	15.6	12.4
Finance and insurance	3.4	10.8	6.1	9.0	5.4
Housing services	6.5	4.0	4.0	7.0	6.9
General govt. services	7.9	5.9	11.4	11.6	22.3
Other private services	10.4	8.0	6.1	21.0	16.5
Services	**60.2**	**6.5**	**6.4**	**100**	**100**

Data source: Pakistan Bureau of Statistics

However, Pakistan Railways experienced a turnaround, showing an increase of 167.4 percent in the gross value addition (GVA) in FY18 after witnessing a contraction of 74.6 percent during FY17.[25] Improved performance in passenger and freight traffic resulted in an increase of 26.7 percent in earnings during H1-FY18 - the latest information available (**Table 2.10**). Going forward, the growth trend is likely to continue, with Pakistan Railways implementing the second phase of its Vision 2026 that focuses on financial stability and improved quality of service. The enterprise is planning to import 205 wagons from China, while 595 units are to be built domestically. The aim is to enhance the share of railways in the transport sector.

Table 2.10: Performance of Pakistan Railways

	H1-FY17	H1-FY18	Growth (percent)
Number of passengers carried	26.6	27.9	4.9
Passenger traffic kms	12,132	12,785	5.4
Freight carried (million tons)	2.4	3.8	58.3
Freight carried kms	2,160.1	3,501.3	62.1
Gross earnings	1,8548.1	2,3505.5	26.7

Data source: Ministry of Railways

In case of *finance & insurance*, a deceleration in the gross value addition by commercial banks – the segment having an 82.5 percent share – slowed down the sub-sector's growth to 6.1 percent after witnessing a 10.8 percent growth during the previous year (**Table 2.11**). The slower pace of deposit generation in particular is a worrying development. During FY18, the growth in deposits fell to 8.8 percent as opposed to 12.4 percent during FY17 and the five-year average of 13.6 percent during CY12-15. Major reasons behind this slowdown in deposit growth has been the falling growth of domestic remunerative deposits and a scaling back of operations by some banks in the overseas market. This has led to increased inter-bank borrowings in order to match the growth on the assets front. The profitability of the sector has also been constrained due to the low interest rate environment, falling non-interest incomes, and a one-off settlement by a major bank on its foreign operations during Q1-FY18.

The *other private services* sub-sector grew 6.1 percent on top of the 8.0 percent growth experienced during FY17. An encouraging development in this sub-sector has been the surge in exports of the

[25] Source: Pakistan Economic Survey 2017-18.

c*omputer related activities* segment. During FY18, the official ICT exports of Pakistan crossed US$ 1.0 billion mark for the first time, with handsome contribution coming from an increase in the consultancy services provided abroad by the domestic industry.

Overall, the services sector of Pakistan has now crossed the 60 percent mark in terms of its share in the real GDP. Furthermore, the sector is slowly witnessing the adoption of information technology (IT) on a wide scale, evident from the emerging digitization of activities in the fields of retailing, commerce, and governance. While the impact of this may not be evident from the national accounts of the economy, digitization is helping increase the efficiency of the sector while having a positive and noticeable impact on the rest of the economy. This trend is being complemented by the various public and private sector efforts to nurture and support the fledgling ecosystem. **Chapter 7** builds upon this discussion by highlighting the key emerging trends in the services sector: namely e-commerce, fintech, and e-government.

Table 2.11: Finance & Insurance

	Share	Growth	
	in FY18	FY17	FY18
Central bank	1.9	-11.9	3.6
Other monetary intermediation	86.9	10.7	8.8
Scheduled banks	82.5	9.5	7.2
Non-scheduled banks	4.4	57.1	52.3
Other financial services	1.4	0.8	1.1
Insurance, reinsurance and pension fund	3.7	6.2	2.1
Activities auxiliary to financial services	6.1	24.8	-19.0
Finance and insurance	**100.0**	**10.8**	**6.1**

Data source: Pakistan Bureau of Statistics