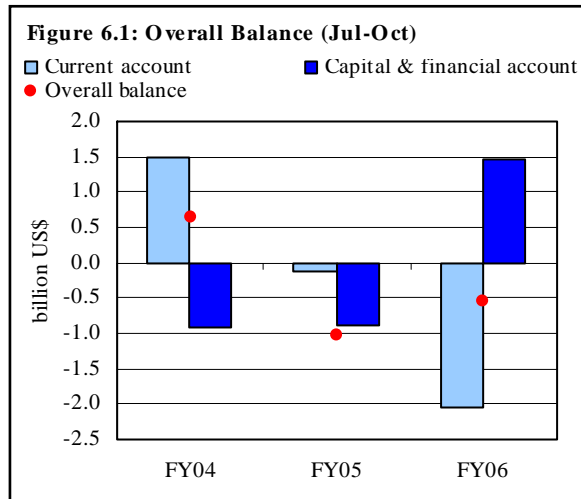


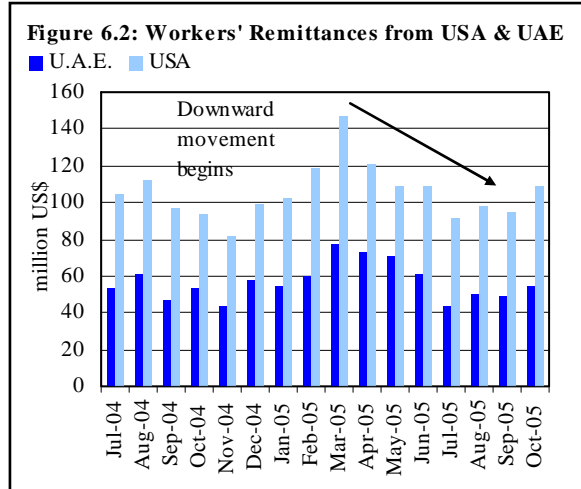
6 External Sector

6.1 Balance of Payments

The country's overall external balance witnessed a marginal improvement during Jul-Oct FY06 relative to Jul-Oct FY05, recording a deficit of US\$ 0.5 billion in the former period against a US\$ 1 billion deficit in the latter. The relative improvement was largely due to higher inflows in the financial account (see **Figure 6.1**), which offset the sharp increase in the current account deficit.



This deterioration in the current account was principally due to the 34 percent YoY rise in imports during Jul-Oct FY06, which overshadowed the healthy 14 percent YoY growth in exports,¹ pushing the trade deficit to US\$ 2.6 billion, as compared to a deficit of US\$ 1.3 billion in the corresponding period of FY05. The substantial increase in trade volumes also contributed to a 44 percent YoY



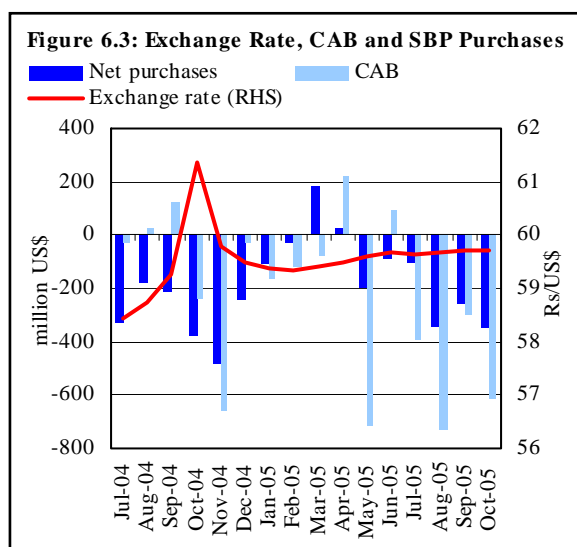
deterioration in the services account deficit during this period. Finally, unlike Jul-Oct FY05, current transfers witnessed a marginal deterioration during Jul-Oct FY06. This was largely due to a fall in net private current transfers on account of lower net inflows in the resident foreign currency accounts as well as sluggish growth in worker's remittances. The latter is a sign of concern, particularly given that flows from the USA and UAE declined (see **Figure 6.2**), although both

¹ The growth rates of exports and imports pertain to the exchange record data.

economies are performing well. While remittances from both countries improved in October 2005, this increase could simply be a consequence of the earthquake in Pakistan. Thus, it remains to be seen if the weakness in remittances is a short-term phenomenon or persists in future as well.

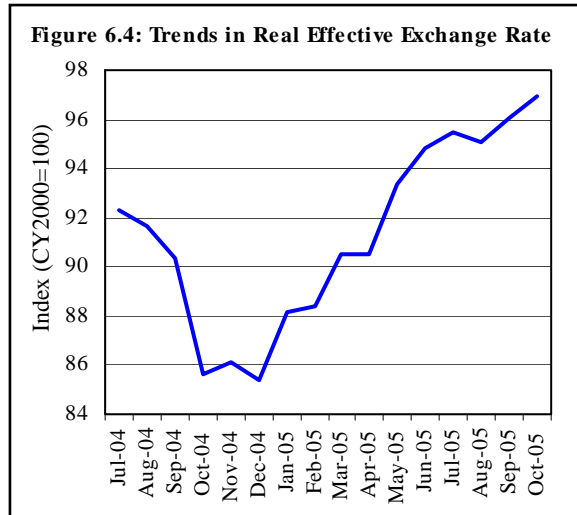
While the deterioration in the current account during Jul-Oct FY06 was offset by a substantial improvement in the financial account, it is important to examine the source of this improvement. A surplus caused by higher debt creating inflows can potentially lead to issues in debt sustainability in the long run, while the surplus caused by higher non-debt-creating flows (such as foreign direct investment), are obviously more welcome. Encouragingly, around one third of the surplus in the financial account during Jul-Oct FY06 is caused mainly by rising net foreign investment inflows, particularly FDI. If this trend sustains, the country's current account deficit would not cause significant strains on the economy.

The net deficit in the overall external balance did not significantly pressure the exchange rate during this period, with the rupee remaining practically unchanged through Jul-Oct FY06. This relative stability was principally because the SBP continued with its policy of meeting lumpy payments for key commodities imports, such as oil, wheat urea, etc. The SBP interventions, aimed at reducing market volatility, continued throughout Jul-Oct 2005 (see **Figure 6.3**), and led to a reduction in the SBP reserves.²



² It is important to note here that the need for SBP market interventions was reduced due to the additional liquidity injection into the inter-bank market through the rising volume of FE-25 foreign currency loans during Jul-Oct FY06. In fact these loans, together with the lower net inflows into resident FCAs caused a decline in commercial banks reserves also.

A part of the pressure on the SBP reserves may simply reflect the normal leads and lags in foreign currency flows in the inter-bank market. These would not be source of concern as the central bank would add liquidity in the inter-bank market to meet shortfalls and then re-purchase in times of surplus liquidity. The risk is that such interventions could lead to excessive exchange rate stability, distorting the price signals in the market. Indeed, trends in the real effective exchange rate (REER) show that rupee has strongly appreciated in real terms against the currencies of other trading partners, since February 2005 (see **Figure 6.4**). This may have adversely impacted the competitiveness of the country's exports and suggests the need to bring down the rate of inflation that has primarily caused the appreciation in REER.



On the whole, however, it seems likely that the weakness in the Pakistan's current account will persist through FY06, although the increase in the current account deficit October 2005 onward will not be as pronounced as in the initial four months of FY06.³ In particular, the trade deficit is expected to rise further during FY06, with a commensurate increase in the services account deficit. However, it is hoped that this impact will be significantly offset by worker's remittances and the receipt of cash grants. Further, the capital and financial accounts are also expected to register large surpluses due to anticipated large inflows of project grants and non-food aid (see **Box 6.1**). This suggests that the overall balance could potentially record a surplus in FY06.

It should be noted that on the one hand, the timing of the receipts of aid and grant remains unclear, while on the other hand, earthquake-related imports have already gained momentum exerting further pressure on the trade account. This mismatch in the timings of flows and imports payments could potentially exert short-term

³ The Jul-Oct FY06 current account deficit suffered in comparison to Jul-Oct FY05 due to a large one-off payment, as well as a base effect (in particular, the Jul-Oct FY06 figure incorporates the full impact of the sharp rise in international oil prices, which was not so evident in corresponding period last year).

pressures on the BoP position. Fortunately, this should be comfortably absorbed, given the country's substantial forex reserves.

Box 6.1: Channels through which earthquake related flows may affect BoP

Trade and services account: The first and the foremost area to be affected by this incident is the trade account, mainly through rising imports. The import of medicines, fuel, tents, tarpaulin & blankets, construction machinery and material is expected to rise as a result of the ongoing relief and future rehabilitation operations. Hence, the services account will also be affected by the accompanying rise in the shipment freight charges causing rise in the transportation inflows. Keeping in view the extent of losses due to the earth quake, it is certain that rehabilitation operations will continue over a number of years and so the inflow of the relevant imports. Further, the income account will also witness higher net interest payments on external debt, once the loan pledges so far made by the international community are realized.

Current transfers: This head is expected to see higher inflows in private and official transfers. For example, the workers' remittances for October 2005 were up 11.1 percent YoY, as compared to a very sluggish rise in earlier months of FY06. Similarly, the resident foreign currency accounts are also expected to receive higher inflows as the direct aid flows to NGOs are likely to be deposited in their resident FCAs. Official transfers are also expected to rise with the inflow of committed cash grants.

Capital & Financial account: Likewise the capital and financial account is also expected to see higher receipts of project grants and non-food aid, respectively. However, keeping in view the concessional nature of these loans, their servicing is not expected to have a material adverse impact on debt sustainability indicators.

On the whole, the pressures on the trade, services and income account are expected to be mitigated by the higher inflows of current transfers as well as higher grants and loans inflows.

6.1.1 Current Account Balance

The deterioration in the current account seen in FY05 accelerated during the initial months of FY06. The deficit for the period of Jul-Oct reached US\$ 2 billion as compared to a deficit of US\$ 0.12 billion in the corresponding period last year (see **Table 6.1 & Figure 6.5**). Not only did the trade and services account deficits continue to widen, this period also saw a 4 percent YoY reduction in the surplus under current transfers.

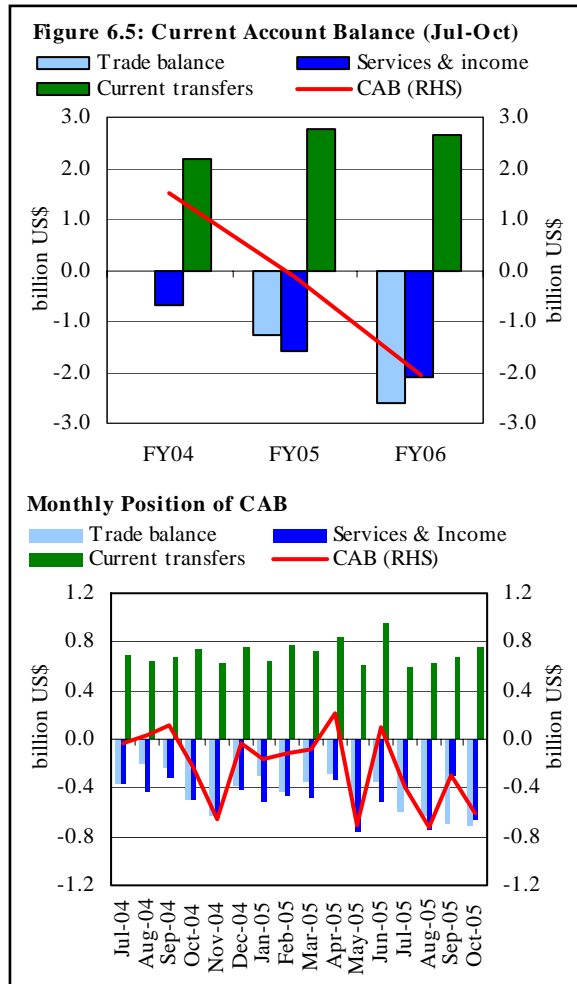
These adverse developments were compensated to a limited extent by higher growth in exports, accompanied by a rise in earnings on country's reserves and declining net interest payments on long-term external debt.

Trade Balance ⁴

The trade deficit worsened during Jul-Oct FY06 by US\$ 1.3 billion to reach US\$ 2.6 billion. As mentioned earlier, this was due principally to an extraordinary rise in imports which more than offset a steady rise in exports (for details please see section on **Foreign Trade**). As customary, the growth in imports saw a strong contribution from the rise in imports of *petroleum group* (reflecting sharp rise in oil prices in the international market) as well as of *machinery group*.

Services (Net)

The services account deficit widened significantly during Jul-Oct FY05, reflecting increased coverage of foreign exchange transactions, as well as the impact of increased activity in the domestic economy (as reflected in rising imports). It is the same two factors that further widened the net services account deficit in Jul-Oct FY06 to US\$ 1.3 billion, as compared to the US\$ 0.9 billion deficit recorded in the corresponding period of FY05.



⁴ This section is based on exchange record compiled by SBP that does not tally with more detailed custom data used in **Sub-Section 6.2**. In BoP, the trade data is recorded on accrual basis (after the realization of actual receipts and payments), while trade section is based on custom basis (which include the receipts and payments on the basis of physical movement of goods).

The larger contribution to the widening deficit was from higher outflows for *other business services*, mainly due to extended coverage of the foreign exchange transactions routed through foreign exchange companies (FECs).⁵

Table 6.1: Current Account Balance (Jul-Oct)

million US\$

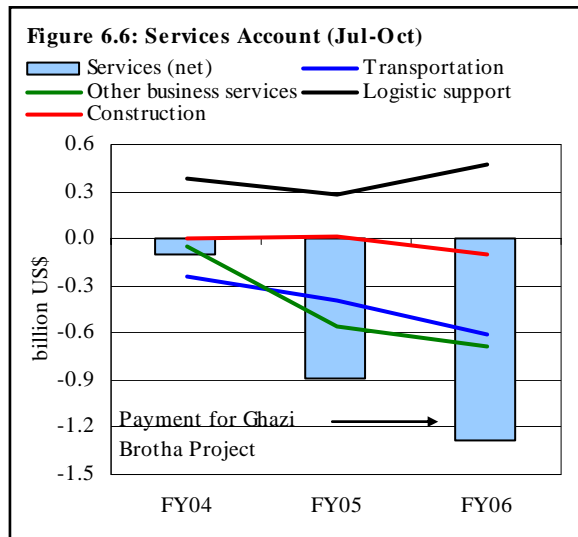
| | FY05 | FY06 | Difference FY06 over FY05 |
|--|--------------|----------------|---------------------------------|
| 1. Trade balance | -1,275 | -2,611 | -1,336 |
| Exports | 4,516 | 5,129 | 613 |
| Imports | 5,791 | 7,740 | 1,949 |
| 2. Services (net) | -886 | -1,278 | -392 |
| Transportation | -395 | -613 | -218 |
| Travel | -329 | -326 | 3 |
| Communication services | 94 | 46 | -48 |
| Other business services | -557 | -691 | -134 |
| Government services | 365 | 532 | 167 |
| Of which logistic support | 280 | 474 | 194 |
| Other | -64 | -226 | -162 |
| 3. Income (net) | -709 | -801 | -92 |
| Investment income(net) | -710 | -801 | -91 |
| Direct investment | -518 | -652 | -134 |
| Of which: Profit & dividend | -147 | -167 | -20 |
| Purchase of crude oil & minerals | -273 | -313 | -40 |
| Portfolio investment | -29 | -43 | -14 |
| Of which: Profit & dividend | -10 | -23 | -13 |
| IMF charges & interest on off. external debt | -164 | -146 | 18 |
| Interest on private external debt | -27 | -32 | -5 |
| Others | 28 | 72 | 44 |
| 4. Current transfers (net) | 2,749 | 2,647 | -102 |
| Private transfers | 2,735 | 2,618 | -117 |
| Workers remittance | 1,318 | 1,375 | 57 |
| FCA – residents | 264 | 53 | -211 |
| Others | 1,153 | 1,190 | 37 |
| Official transfers | 14 | 29 | 15 |
| Saudi oil facility | 0 | 0 | 0 |
| Cash grants | 3 | 17 | 14 |
| Current account balance | (121) | (2,043) | -1,922 |

⁵ Following the transformation of moneychangers into foreign exchange companies (FECs), the foreign exchange transactions which were previously undertaken by moneychangers are now being channelized through FECs. As explained in earlier reports (see *SBP Annual Report FY05*), the outflows under FECs have no impact on the overall current account balance as these are offset by a contra entry in the other private transfers.

Further, higher import growth caused the shipment freight charges to rise, leading to higher outflows for *transportation services*.

Moreover, apart from these routine developments, the abnormal rise in the outflows for *construction services* also contributed in the expansion of services account deficit in Jul-Oct FY06 (see **Figure 6.6**). During this period, construction services recorded a net outflow of US\$ 100 million as compared to the US\$ 13 million inflows in the corresponding period of the last year. This was due to the deferred payments for the Ghazi Brotha Dam.

Fortunately, the impact of this outflow was more than offset by receipts for logistic support; the Jul-Oct FY06 receipts totaled US\$ 474 million, up 69 percent (US\$ 194 million) from those received during the corresponding period of FY05.



Income (Net)

Investment income outflows recorded a 13 percent YoY rise during Jul-Oct FY06 to reach US\$ 801 million, with the increase largely reflecting a large jump in *direct investment* outflows.

As seen in **Table 6.2**, the outflows for direct investment recorded a rise of US\$ 131 million during this period. The decline in the repatriation of profits as well as rising repatriation of *dividends* and *reinvested earnings*, probably reflects both, increased holdings by foreigners of Pakistani assets as well as expectation of continued growth in corporate profitability.

Table 6.2: Returns on Direct Investment (Jul-Oct)
million US\$

| | FY05 | FY06 | Change |
|-----------------------|------|------|--------|
| FDI | 525 | 656 | 131 |
| Profits | 53 | 10 | -43 |
| Dividend | 94 | 157 | 63 |
| Purchase of oil & gas | 273 | 313 | 40 |
| Reinvested earnings | 103 | 178 | 75 |

Source: SBP

The outflows on account of *purchase of oil & gas* also rose substantially due to the increased production and higher prices. In particular, the purchase of gas rose from approximately US\$ 110 million during Q1-FY05 to US\$ 129 million during Q1-FY06.

However a large part of the increase in direct investment outflows was offset by a decline in interest payments on external debt and higher earnings on Pakistan's foreign exchange reserves (see **Table 6.3**).

Specifically, the interest payments to Paris club creditors registered a significant fall during Jul-Oct FY06 compared to Jul-Oct FY05. This was because the latter figure included a one-off US\$ 65.4 million payment of accrued interest on a restructured long term official loan to JBIC.⁶ In the absence of such payments, the interest payment remained lower in FY06.

Table 6.3: Details of Interest Payments and Receipts
million US\$

| | Jul-Oct | | |
|--------------------------------|-------------|-------------|------------|
| | FY05 | FY06 | Saving |
| Payments (I+II) | 246 | 288 | -42 |
| I <u>Total external debt</u> | <u>208</u> | <u>225</u> | <u>-17</u> |
| Public & publicly guaranteed | 177 | 190 | -13 |
| Long-term | 147 | 128 | 19 |
| Military | 11 | 8 | 3 |
| Euro bonds | 17 | 47 | -30 |
| Commercial loans/credits | 2 | 2 | 0 |
| IDB | 0 | 5 | -5 |
| Private loans/credits | 27 | 32 | -5 |
| IMF | 4 | 3 | 1 |
| II <u>External liabilities</u> | <u>38</u> | <u>63</u> | <u>-25</u> |
| Foreign currency deposits | 5 | 5 | 0 |
| Special US\$ bonds | 10 | 9 | 1 |
| Central bank deposits | 7 | 18 | -11 |
| Others | 16 | 31 | -15 |
| Receipts | 55 | 122 | 67 |
| Interest on reserves | 36 | 81 | 45 |
| Others | 19 | 41 | 22 |
| Net Payments | -191 | -166 | 25 |

Source: State Bank of Pakistan

On the other hand, the interest payments on Eurobonds witnessed a significant rise of US\$ 30 million during this period. Although the payments for the Eurobonds are expected to remain high in future (see **Box 6.2**), this is expected to be compensated by the fall in the interest payments on long term debt as a result of the re-profiling of Paris club bilateral debt, the substantial write off of the US bilateral debt stock and the prepayment to ADB and private external creditors.

The interest payments on external liabilities also remained high especially due to the payments representing the interest on foreign currency loans extended to

⁶ During Q1-FY05, Pakistan paid 80 percent of interest in respect of bilateral agreement signed between JBIC and Government of Pakistan. Under bilateral rescheduling agreement in December 2001, all interest payments falling between 30th November 2001 and 30th June 2002, and 20 percent of annual interest payments accrued on restructured debt for FY03 and FY04 were deferred.

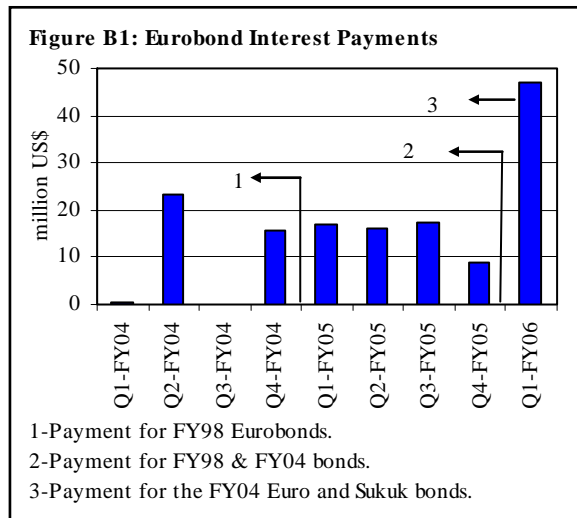
Pakistani traders,⁷ and (2) higher interest payments made by the foreign companies for the working capital requirement. However these higher outflows were more than offset by the higher interest payments on reserves, leading to a net saving of US\$ 25 million during Jul-Oct FY06.

Box 6.2: Interest Payments on Eurobonds

The interest payments on the Eurobonds largely comprise of payments for three types of bonds: (1) Eurobonds of US\$ 603 million that were launched during FY98; (2) The US\$ 500 million euro bond launched in Q3-FY04; and finally (3) the US\$ 600 million *sukuk* launched in Q3-FY05.

The payments for the first category fell due in FY00, however following an agreement with the quasi-London Club creditors; this was restructured and the three issues of this market debt were converted to the realized value of US\$ 620 million. Further according to the terms of the restructured bond 10 percent rate of interest was payable semi-annually, with a final maturity of 6 years, ending in December 2005.⁸

Therefore, till Q4-FY04 the interest payment was solely for the restructured bonds worth US\$ 620 million. However from Q1-FY05 the semi annual interest payments for the Euro bond launched in Q3-FY04 also contributed to a US\$ 20 million rise in the total interest payments for Eurobonds in FY05 over FY04. Further during Jul-Oct FY06 the interest payments for the Sukuk launched during Q3-FY05 also added US\$ 30 million to the interest payments during this period as compared to Jul-Oct FY05 (see **Figure B1**). This rise in the interest payments was to moderate Q3-FY06 onwards after the maturity of FY98 bonds, since the government has planned to issue one such bond annually the decline may not materialize.



Current Transfers

Current transfers witnessed a US\$ 102 million fall during Jul-Oct FY06 compared to Jul-Oct FY05. This is largely due to lower inflows into resident FCAs, and very weak rise in worker remittance receipts.

⁷ The notional outflow of interest on these loans (*other external liabilities*) is offset by an equal inflow in '*other receipts*'.

⁸ The first three years entailed no principal payments (grace period); and the total principal payments ending in December 2005 in four installments. The first principal repayment was due on 13th December 2002.

Worker Remittances

Workers' remittances (cash) recorded 3.9 percent YoY increase, reaching US\$ 1,368.1 million during Jul-Oct FY06 as compared to the YoY 8.6 percent in Jul-Oct FY05 (see **Table 6.4**). But even this weak rise emerged due to a 10 percent YoY increase in remittance receipts during October 2005, in the aftermath of the devastating earthquake in Pakistan early in the month.⁹ To put this in perspective, Jul-Sep FY06 remittances recorded a marginal growth of 1.5 percent, in contrast to the 10.3 percent growth seen during Jul-Sep FY05.

Inflows from UK recorded a significant rise of US\$ 32.5 million during Q1-FY06. This rise was however concentrated in the months of Aug & Sep FY06 possibly due to the July FY06 bombings in London that caused Pakistani residents there to repatriate some capital to Pakistan. On the other hand, aggregate remittances from UAE and USA recorded a fall of US\$ 34 million during this period. The drop in remittances from USA suggests that the environment of strict financial checks and controls in USA imposed after Sep 11 has started to relax now.

The fall in remittances from UAE may partly be attributable to huge investments by the expatriate Pakistanis in the real estate there. In addition, the sharp rise in international gold prices might also have negatively impacted the remittances.

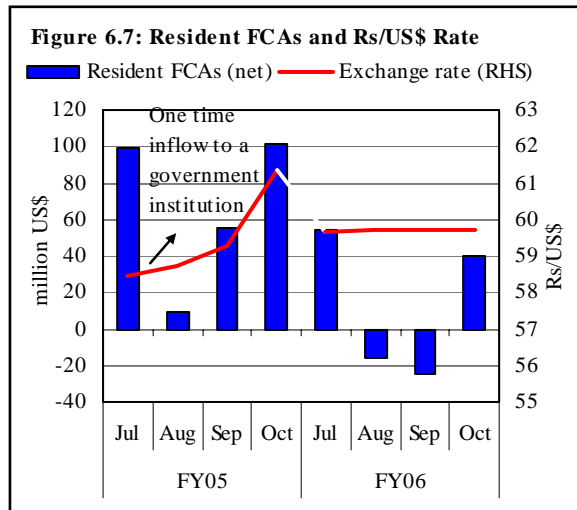
Table 6.4: Workers' Remittances
million US\$

| | Jul-Oct | | Growth rate |
|--|---------------|---------------|--------------|
| | FY05 | FY06 | |
| I. Gulf region | 585.8 | 610.1 | 4.2 |
| Bahrain | 32.3 | 31.4 | -2.8 |
| Kuwait | 66.0 | 72.6 | 10.1 |
| Qatar | 32.9 | 35.3 | 7.3 |
| Saudi Arabia | 205.6 | 232.6 | 13.1 |
| Sultanat-e-Oman | 35.1 | 42.0 | 19.7 |
| U.A.E. | 214.0 | 196.3 | -8.3 |
| II. U.S.A. | 407.4 | 391.8 | -3.8 |
| III. Other than Gulf & US | 323.6 | 366.2 | 13.2 |
| Canada | 12.8 | 26.8 | 110.1 |
| Germany | 17.6 | 19.9 | 13.1 |
| Japan | 2.7 | 2.2 | -17.0 |
| Norway | 4.7 | 5.5 | 16.6 |
| U.K. | 116.2 | 148.7 | 28.0 |
| Other | 169.7 | 163.1 | -3.9 |
| Total | 1316.8 | 1368.1 | 3.9 |
| of which: Exchange Companies | 96.6 | 220.6 | 128.5 |
| Encashment of FEBCs & FCBCs | 2.0 | 7.1 | 247.5 |
| Grand total | 1318.8 | 1375.2 | 4.3 |

⁹ Inflows from the USA and Saudi Arabia alone increased by US\$ 26 million in October 2005

Resident FCAs

The net inflows into resident FCAs recorded a fall of US\$ 211 million during Jul-Oct FY06 compared to the same period in FY05. The change in FCAs inflows is generally driven by the expectations regarding strength of US dollar versus the rupee.¹⁰ Moreover, the one time movement of funds, such as privatization proceeds and FDI related flows, also contributed to the outflows from FCAs.



During Jul-Oct FY05 due to the one-time inflows in the deposits of a government institution and the expectations regarding appreciation in the value of dollar caused increased inflows into FCAs. By contrast, Jul-Oct FY06 saw relative stability in the value of US dollar, and a one-off outflow of funds¹¹ (see **Figure 6.7**).

6.1.2 Financial Account

The improvement in the financial account evident during H2-FY05 continued into the succeeding year, with Jul-Oct FY06 witnessing a net surplus of US\$ 1.4 billion as compared to the US\$ 1.4 billion deficit in Jul-Oct FY05 (see **Table 6.5**). To put the latter in perspective however, it should be noted that the high Jul-Oct FY05 figure included one-off payments.¹² Adjusting for these non-recurring flows, the Jul-Oct FY05 financial account deficit falls to US\$ 811 million, but even then the Jul-Oct FY06 figure reflects a US\$ 2.2 billion improvement.

Encouragingly, a large share of this (adjusted) improvement in the financial account came from higher net foreign investment. Further higher receipts of project loan from IDA, supplier's credit inflows along with low payments of other liabilities also contributed in the financial account improvement.

¹⁰ Around 80 percent of total FCAs are denominated in US\$.

¹¹ Indeed if this US\$ 63.4 million outflow from the account of a private firm is excluded, the net flows into FCA during the Jul-Oct FY06 turn positive.

¹² Non-recurring flows during Q1-FY05 include US\$ 495 million of US debt write-off, and US\$ 100 million of settlement of foreign currency loans of commercial banks to repay PARCO loans.

Table 6.5: Financial Account

million US\$

| Items | Jul-Oct | | Abs. Change |
|---|--------------|-------------|-------------|
| | FY05 | FY06 | |
| Financial Account (1 through 4) | -1406 | 1430 | 2836 |
| 1. Direct investment abroad | -22 | -14 | 8 |
| 2. Direct investment in Pakistan | 275 | 466 | 191 |
| <i>of which: Equity capital</i> | 172 | 288 | 116 |
| Reinvested earning | 103 | 178 | 75 |
| 3. Portfolio investment | -5 | 191 | 196 |
| <i>of which: (Stock markets)</i> | 25 | 216 | 191 |
| <i>Special US Dollar bonds</i> | -30 | -27 | 3 |
| <i>Euro bonds</i> | -2 | 0 | 2 |
| Net foreign investment | 248 | 643 | 395 |
| 4. Other investment (I+II) | -1654 | 787 | 2441 |
| I. Assets | -699 | 343 | 1042 |
| <i>i. Outstanding exports bills (Exporters)</i> | -47 | -126 | -79 |
| <i>ii. Outstanding exports bills (DMBs)</i> | 20 | 62 | 42 |
| <i>iii. Currency & deposits</i> | -672 | 407 | 1079 |
| <i>of which: Bank</i> | -664 | 367 | 1031 |
| II. Liabilities | -955 | 444 | 1399 |
| <i>i. Foreign Long-term loans / credits (net)</i> | -265 | 303 | 568 |
| <i>of which: Project assistance</i> | 199 | 212 | 13 |
| Food aid | 0 | 0 | 0 |
| Non-food aid | 341 | 446 | 105 |
| Amortization | 805 | 355 | -450 |
| <i>ii. Private loans</i> | -126 | 42 | 168 |
| <i>of which: Suppliers credits/MNCs</i> | 12 | 167 | 155 |
| Supplier credits repayments | 138 | 125 | -13 |
| <i>iii. Short term capital, (official)</i> | -3 | -33 | -30 |
| <i>of which: Commercial banks (net)</i> | -100 | -100 | 0 |
| IDB (net) | 97 | 67 | -30 |
| <i>iv. Currency & deposits</i> | -348 | 154 | 502 |
| <i>of which: Trade financing</i> | -444 | 364 | 808 |
| <i>v. Other liabilities</i> | -213 | -22 | 191 |

Source: Statistics Department, SBP

Note= LT: Long-term, DMBs: Deposit Money Banks, ST: Short-term.

Net Foreign Investment

The net foreign investment recorded a substantial YoY rise of US\$ 395 million during Jul-Oct FY06 due to rising foreign direct investment as well as foreign portfolio investment.

Pakistan saw a US\$ 196 million increase in foreign direct investment during Jul-Oct FY06 as compared to Jul-Oct FY05 largely in the sectors of *telecommunication, financial business and oil & gas exploration*. In particular, investments in the *telecommunication* sector alone recorded US\$ 83 million rise in this period, mainly reflecting the entry of two new companies in the cellular phone market. Further, investors from USA made substantial investments in the sector of *oil and gas exploration*.

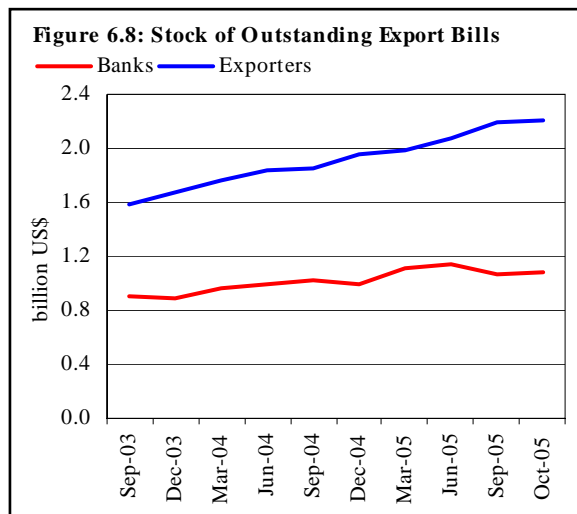
Portfolio investment also recorded a remarkable improvement; moving from a net outflow of US\$ 5 million in Jul-Oct FY05 to a net inflow of US\$ 191 million during Jul-Oct FY06. A larger share of this rise was contributed by the investors from USA and the UK.

Outstanding Export Bills (OEBs)

The stock of outstanding export bills recorded a US\$ 64 million rise during Jul-Oct FY06 as compared to the US\$ 27 million rise during Jul-Oct FY05. Detailed analysis shows that the OEBs held by exporters witnessed an increase in this period, whereas the OEBs with deposit money banks (DMBs) recorded a significant decline (see **Figure 6.8**).

OEBs held by exporters witnessed US\$ 126 million rise as compared to the US\$ 47 million rise during Jul-Oct FY05. This is probably owing to higher exports during this period.

On the other hand, OEBs of banks witnessed a significant decline of US\$ 62 million as compared to the decline of US\$ 20 million in Jul-Oct FY05. This is due to higher realization of export proceeds to banks that might have outweighed



the discounting of OEBs by exporters, leading to a fall in the OEBs stock of DMBs.

Currency and Deposits

In contrast to the US\$ 672 million increase seen in Jul-Oct FY05, *currency and deposits* assets recorded a US\$ 407 million fall during Jul-Oct FY06.¹³ The latter was largely caused by a decline in banks' FE-25 Nostro holdings by US\$ 367 million, mainly because of (1) a fall in foreign currency deposits, and (2) increased lending in the trade financing by US\$ 364 million (as compared to net retirement of US\$ 444 million during Jul-Oct FY05).

Foreign Long-term Loans

The long-term official loans registered a net inflow of US\$ 303 million during Jul-Oct FY06 as compared to the US\$ 265 million net outflow during Jul-Oct FY05. Moreover, it

should be noted that the latter figure includes the notional outflow of

US\$ 495 million representing the debt relief provided by the US; however the net inflows during Jul-Oct FY06 remain higher even after making this adjustment (see **Table 6.6**). The rise in the net flows during Jul-Oct FY06 is attributable to the receipt of around US\$ 200 million concessional loan from IDA during Oct FY06.

Table 6.6: Adjusted Official Long-Term Loans

| million US\$ | Q1-FY05 | Q1-FY06 |
|--------------|---------|---------|
| Receipts | 540 | 658 |
| Amortization | 310 | 355 |
| Net flows | 230 | 303 |

Private/Short-term Loans

Private loans witnessed a net inflow of US\$ 42 million during Jul-Oct FY06 as compared to the net outflow of US\$ 126 million in Jul-Oct FY05 largely due to higher inflows in the *transport, storage and communication* sector.

Short term loans contain commercial loans along with the IDB financing for oil imports. This head witnessed a higher net outflow of US\$ 33 million during Jul-Oct FY06 as compared to the US\$ 3 million outflow during Jul-Oct FY05.

Analysis reveals that during the period of Jul-Oct FY06, although higher inflows from IDB worth US\$ 163 million were received, however due to repayment of US\$ 96 million, the net inflows remained lower during Jul-Oct FY06. On the other hand the US\$ 100 million outflows in the commercial loans reflect the rolled-over amount.

¹³ This head comprises of currency and deposits held by monetary authorities, general government, commercial banks and other sectors.

FE-25 Related Trade Financing and Other Liabilities

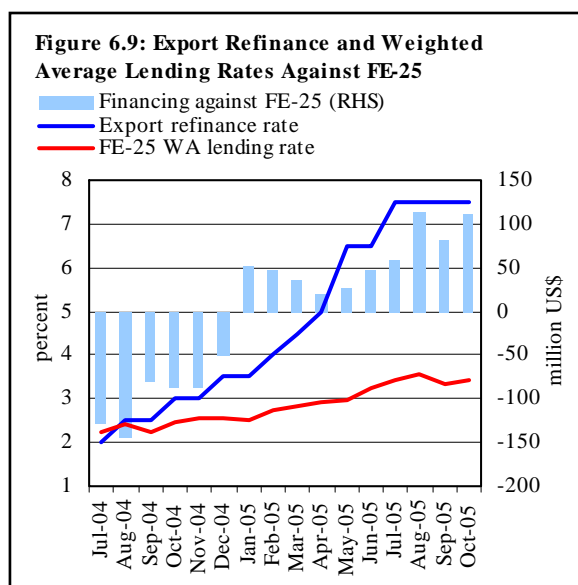
Trade financing against FE-25 deposits recorded a US\$ 364 million rise during Jul-Oct FY06 opposed to the US\$ 444 million net retirement during Jul-Oct FY05.

This trend largely resulted from a change in the lending rates of export finance scheme (EFS) as compared to the weighted average lending rate for trade financing against FE-25 deposits. The sharp rise in the EFS rates since July FY04 has made borrowing against FE-25 more attractive for exporters (see **Figure 6.9**).

However keeping in view the change announced by SBP in the method of calculation of EFS rates since June FY05, the widening difference between these two rates might narrow in future. This can possibly

result in a reversal of the Jul-Oct FY06 trend by lowering trade financing extended to exporters against FE-25 deposits. Further the strong growth of imports also might have raised the need of trade financing for importers.

Outflows under *other liabilities* also witnessed a considerable fall of US\$ 22 million as compared to the outflow of US\$ 213 million in the corresponding period of the last year. However, the sharp increase in net outflows of *other liabilities* during Jul-Oct FY05 however, reflects the settlement of foreign currency loans (US\$ 100 million) arranged by the commercial banks in Q4-FY04 to repay PARCO loans. In the absence of this one off effect, outflows remained lower in FY06.

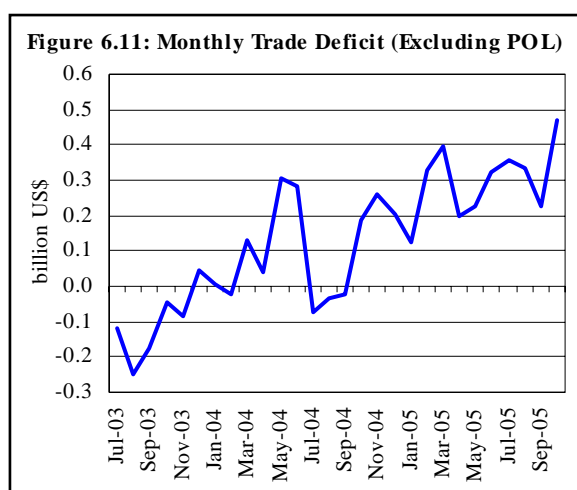
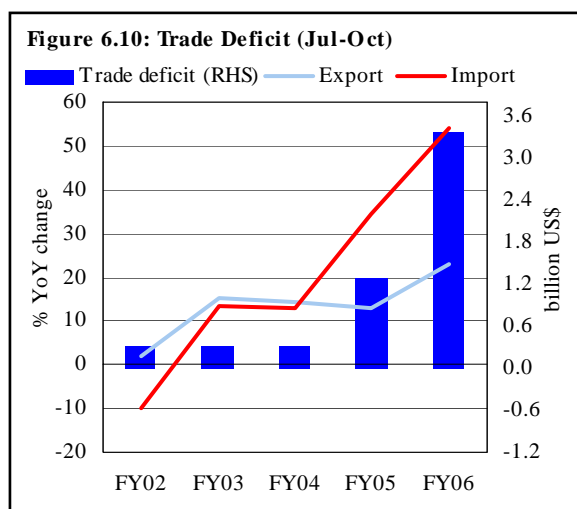


6.2 Foreign Trade¹⁴

Although Jul-Oct FY06 exports rose by a very robust 22.8 percent YoY, imports increased at a much faster pace (54.0 percent YoY), thereby sharply widening the trade deficit for the period (see **Figure 6.10**). Indeed, this US\$ 3.4 billion trade deficit for Jul-Oct FY06 was more than double the US\$ 1.3 billion deficit recorded during the corresponding period previous year.

A significant contribution to the exceptionally strong imports growth during the Jul-Oct FY06 was from international oil prices. Petroleum group imports for the period totaled US\$ 2.1 billion for Jul-Oct FY06, up 73.2 percent YoY, with the increase being driven almost entirely by higher prices (import volumes fell by 2.2 percent YoY). In fact, the higher prices have led to an increase of US\$ 924 million in import bill during Jul-Oct

FY06. However, even on excluding the oil bill, the import growth remains an exceptionally strong 48.8 percent. Indeed, a look at **Figure 6.11** shows that the monthly trade deficit ex-oil imports continues to expand. Thus, even though Pakistan's oil import bill could shrink somewhat in the months ahead as international oil prices retreat from their peaks (see **Figure 6.12**), this may be



¹⁴ The analysis is based on the provisional data provided by Federal Bureau of Statistics, which is subject to revisions. This data may not tally with the exchange record numbers reported in the section on *Balance of Payments*.

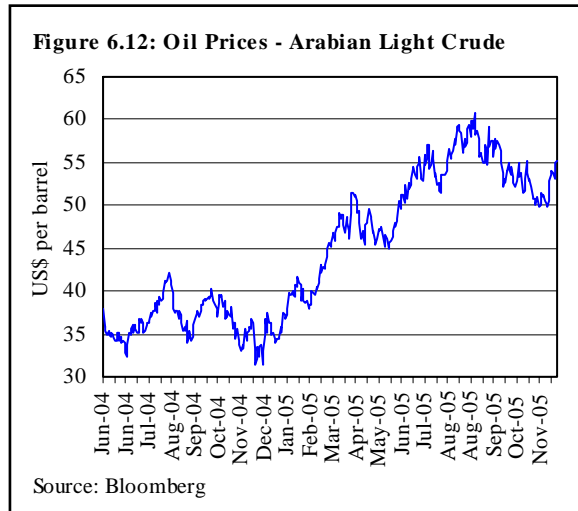
offset by the growth in non-oil imports (particularly machinery, raw material and imports to support relief efforts in areas affected by October 2005 earthquake). This suggests that even efforts to reduce domestic oil consumption through higher prices may still not help substantially, even while fueling inflation.

As shown by a number of studies, Pakistan's imports have proved to be highly income elastic in the short run, and this tendency would probably have been strengthened by the liberalization of the external sector in recent years.¹⁵ This suggests that short of substantially compressing aggregate demand, and thereby GDP growth, the rise in imports is unlikely to be contained in the short run.¹⁶

However, the same studies also show that in the long run, the import and export elasticities are likely to converge.

The key challenges for policy makers therefore are how to: (1) encourage and accelerate this long-run convergence in export and import elasticities; and, (2) to finance the trade deficit in the interim period.

Historical evidence suggests that fiscal measures to contain imports are unlikely to be very effective. In particular, custom tariffs would be capped by WTO commitments, and would create other distortions in the economy, e.g. possibly reinvigorating the demand for foreign exchange in the kerb market to finance import demand in the parallel economy. This suggests a greater role for exchange rate policy in containing import demand in the short run (incidentally, this would also boost exports in the short run). However, it must be recognized here that such policies carry significant risks (and are effective primarily in the short run), and

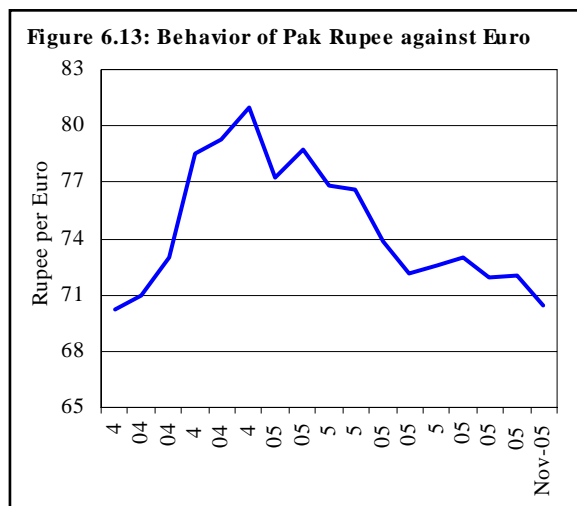


¹⁵ In fact, deregulation of other sectors of the economy such as telecommunication also has contributed to higher import growth in recent years.

¹⁶ This expectation is further supported by the need for imports to support the relief and rebuilding efforts for the regions devastated by the October 2005 earthquake in Pakistan.

cannot correct the imbalances at their own. Moreover, it must be noted that a significant portion of the imports are also essential for generating exports.

Perforce, policy attention must therefore shift increasingly to fostering exports. Here, Pakistan is already enjoying some success, with Jul-Oct FY06 registering export growth well in excess of the 19.5 percent target for the period. Moreover, this good performance was seen despite a number of shocks, including: (1) antidumping duty imposed on bed linen by the European Union (EU); (2) a substantial decline in the prices of textile and clothing in the international market; (3) the relatively disadvantageous position of Pakistan after losing preferential access in EU market under Generalized System of Preference (GSP), while competitors such as Bangladesh and Sri Lanka etc continue to enjoy duty-free access to EU market under GSP plus;¹⁷ and (4) the appreciation of the Rupee against the Euro (see **Figure 6.13**) and rising domestic interest rates.



The emphasis on export growth would require more focus on competitiveness. It may be pointed out that appropriate exchange rate policy is only one element of the overall competitive challenges faced by Pakistani exporters. What is more important for them is to respond to increasingly demanding markets through efficient and innovative practices. Under the new trading system, diversification, reliability, delivery time lines and quick adjustment to the changes in international market have become important sources of competitiveness. The role of the government would be to provide trade support infrastructure and strive for market access through regional preferential or free trade arrangements.¹⁸

¹⁷ While duty free access is provided under *GSP plus* to least developing countries by the EU, the *GSP general* entails market access with some duty concessions as compared to the duty on the imports of other countries into the EU market.

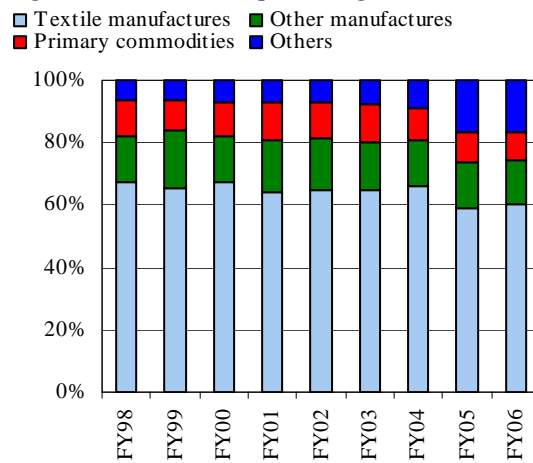
¹⁸ The government is making efforts to improve market access in various countries (e.g., China, Sri Lanka, Malaysia, USA, Thailand, Turkey, Bangladesh etc.) through various trade arrangements.

6.2.1 Exports

The overall export depicted an impressive growth of 22.8 percent during Jul-Oct FY06 which was higher than the 19.5 percent target¹⁹ for period as well as the growth of 12.8 percent during the corresponding period of FY05. This performance is encouraging given the decline in the prices of textile and clothing as a result of intensified price competition in the international market, imposition of antidumping duty on bed linen exports to EU together with end of the special Generalized System of Preference (GSP) incentive by EU, and appreciation of Pak Rupee against Euro (see **Figure 6.13**).

The export growth was mainly driven by the textile sector, the share of which in total exports has increased to 60.3 percent during Jul-Oct FY06 against 58.8 percent during the corresponding period of last year. However, from the perspective of the need to diversity exports, it is heartening to note that the share of the traditional textile exports nonetheless remained below the 64-67 percent range seen in years prior to FY05 (see **Figure 6.14**).

Figure 6.14: Share of Export Categories (Jul-Oct)



Of greater importance however, is the performance of exports after the complete phase out of the MFA, i.e. January 2005 onwards. In order to assess this performance during January-October 2005, the monthly growth of total exports and textile exports during the period is compared with the monthly averages growth of total exports and textile exports during the

Table 6.7: Textile Export Growth during Post MFA
percent

| | 5Years averages | | | |
|-----|-----------------|------|------|------|
| | T | Te | T | Te |
| Jan | 1 | 20.2 | 5.0 | -3.4 |
| Feb | 8.2 | 10.5 | 28.7 | 18.9 |
| Mar | 8.8 | 10.3 | 31.5 | 12.8 |
| Apr | 12.5 | 1 | 18.4 | -5.0 |
| May | 1 | 9.6 | 29.6 | 17.0 |
| Jun | 9.7 | 9.8 | 2 | 1 |
| Jul | 15.0 | 1 | 7.5 | 3.4 |
| Aug | 1 | 9.0 | 18.6 | 21.1 |
| Sep | 9.8 | 5.8 | 34.7 | 51.3 |
| Oct | 8.3 | 7.2 | 33.2 | 33.1 |

¹⁹ The target is set by Pakistan's export promotion bureau (EPB).

preceding five years. Heartening, on average, the total exports as well as textile exports performance improved in the post-MFA regime (see **Table 6.7**).

Table 6.8: Major Exports (Jul-Oct)

Value: million US\$; Unit value: US\$

| | Unit | FY05 | | FY06 | | Abs chg. in value | % change in Jul-Oct FY06/Jul-Oct FY05 | | |
|---|-------|----------------|---------------|----------------|---------------|-------------------------|--|-------------|---------------|
| | | Value | Unit value | Value | Unit value | | Qty | Value | Unit value |
| | | | | | | | | | |
| A. Primary commodities | | 449.9 | | 524.4 | | 74.5 | | 16.6 | |
| 1 Rice | MT | 214.5 | 360.4 | 299.2 | 394.3 | 84.7 | 27.5 | 39.5 | 9.4 |
| 2 Raw cotton | MT | 17.8 | 1043.2 | 21.5 | 1012.1 | 3.7 | 24.7 | 21.0 | -3.0 |
| 3 Raw wool (excl wool tops) | MT | 0.1 | 1569.4 | 0.0 | 521.7 | -0.1 | 0.0 | -66.8 | -66.8 |
| 4 Fish & fish preparations | MT | 48.3 | 1841.0 | 61.8 | 1510.2 | 13.5 | 56.0 | 27.9 | -18.0 |
| 5 Leather | SQM | 101.2 | 16.5 | 80.7 | 16.8 | -20.5 | -21.8 | -20.3 | 1.9 |
| 6 Guar and guar Products | MT | 8.2 | 1270.4 | 2.1 | 1153.7 | -6.1 | -71.8 | -74.4 | -9.2 |
| 7 Fruits | MT | 39.0 | 335.0 | 37.5 | 372.3 | -1.5 | -13.4 | -3.8 | 11.1 |
| 8 Vegetables | MT | 10.4 | 361.6 | 7.0 | 346.4 | -3.3 | -29.1 | -32.1 | -4.2 |
| 9 Crude animal material | MT | 6.1 | 3765.7 | 10.0 | 16771.9 | 3.9 | -63.4 | 63.2 | 345.4 |
| 10 Oil seeds & nuts etc. | MT | 4.1 | 811.4 | 4.4 | 683.5 | 0.3 | 27.0 | 7.0 | -15.8 |
| B. Textile manufactures | | 2,637.5 | | 3,322.4 | | 684.9 | | 26.0 | |
| 1 Cotton yarn | MT | 291.6 | 2129.5 | 434.3 | 2030.5 | 142.6 | 56.2 | 48.9 | -4.7 |
| 2 Cotton fabrics (woven) | SQM | 563.9 | 0.7 | 751.0 | 0.8 | 187.1 | 21.9 | 33.2 | 9.3 |
| 3 Hosiery (knitwear) | DOZ | 683.6 | 24.5 | 613.9 | 22.9 | -69.7 | -3.9 | -10.2 | -6.5 |
| 4 Bedware | MT | 371.7 | 5468.1 | 670.9 | 5445.0 | 299.2 | 81.3 | 80.5 | -0.4 |
| 5 Towels | MT | 157.2 | 3839.4 | 202.9 | 3743.9 | 45.7 | 32.4 | 29.1 | -2.5 |
| 6 Cotton bags and sacks | MT | 4.3 | 3980.2 | 1.1 | 4075.2 | -3.3 | -75.7 | -75.1 | 2.4 |
| 7 Readymade garments Tarpaulin & other canvas | DOZ | 258.2 | 33.3 | 461.7 | 34.5 | 203.6 | 73.0 | 78.8 | 3.3 |
| 8 goods | MT | 16.0 | 2554.9 | 11.8 | 2346.0 | -4.2 | -19.5 | -26.1 | -8.2 |
| 9 Tule, lace, embroidery etc. | (-) | 3.7 | --- | 1.0 | --- | -2.7 | --- | -73.0 | --- |
| 10 Synthetic textiles | SQM | 116.3 | 0.7 | 23.5 | 0.7 | -92.8 | -78.9 | -79.8 | -4.3 |
| 11 Other textile made up Waste material of textile | (-) | 169.2 | --- | 149.5 | --- | -19.7 | --- | -11.6 | --- |
| 12 fibres/fabrics | MT | 1.9 | 551.2 | 0.9 | 826.3 | -1.0 | -69.0 | -53.6 | 49.9 |
| C. Other manufactures | | 661.5 | | 758.7 | | 97.1 | | 14.7 | |
| 1 Carpets, rugs & mats | SQM | 75.4 | 58.5 | 75.2 | 56.1 | -0.1 | 4.2 | -0.2 | -4.2 |
| 2 Petro and petro products | MT | 118.2 | 334.2 | 195.3 | 475.1 | 77.1 | 16.2 | 65.3 | 42.2 |
| 3 Sports goods | (-) | 92.0 | --- | 89.7 | --- | -2.3 | --- | -2.5 | --- |
| 4 Leather manufactures | (-) | 163.5 | --- | 225.1 | --- | 61.7 | --- | 37.7 | --- |
| 5 Surgical & medical instru | NO | 58.8 | --- | 44.2 | --- | -14.6 | --- | -24.9 | --- |
| 6 Cutlery | GR | 10.4 | 24.4 | 11.3 | - | 0.9 | -77.6 | 8.5 | --- |
| 7 Onyx manufactured | MT | 3.2 | 1651.3 | 4.4 | 1621.3 | 1.3 | 43.3 | 40.7 | -1.8 |
| 8 Chemicals & pharmaceuticals | (-) | 105.0 | --- | 105.6 | --- | 0.7 | --- | 0.7 | --- |
| 9 Molasses | MT | 29.8 | 52.6 | 6.4 | 85.1 | -23.5 | -86.8 | -78.6 | 61.8 |
| 10 Sugar | MT | 5.3 | 248.9 | 1.3 | - | -4.0 | -84.7 | -75.7 | --- |
| D. Others | | 733.6 | --- | 900.7 | --- | 167.1 | --- | 22.8 | --- |
| Total | | 4,482.6 | | 5,506.2 | | 1,023.6 | | 22.8 | |

Source: Federal Bureau of Statistics

Primary Commodities

The primary commodities depicted YoY growth of 16.6 percent during the Jul-Oct period of current fiscal year against 8.2 percent growth during the corresponding period last year. Despite this impressive growth, the contribution of this export category in total export growth is just 7.3 percent. As a result, the group share in total exports has declined to 9.5 percent during Jul-Oct FY06 which is lowest as compared to average share of the group for Jul-Oct period during the past several years (see **Figure 6.14**). The items which showed reasonable export growth includes *rice* and *fish & fish preparation* (see **Table 6.8**).

Rice exports recorded substantial YoY growth of 39.5 percent during Jul-Oct FY06 as against 4.6 percent during the same period last year. This was contributed by increases in export values as well as higher unit values. The higher export volumes may be the result of the increase in rice production as the timely rains benefited the crop to record production of 5.0 million ton during the current year surpassing the production of 4.8 million tons realized last year. Thus export of rice is likely to pick up further in the remaining period of FY06. However, rice exports to Kenya might be affected adversely due to the introduction of a pre-shipment inspection requirement, which adds to the cost of exporters.

Despite falling unit values, the fish and fish preparation exports observed 27.9 percent YoY growth during Jul-Oct FY06 as compared to the YoY *decline* of 23.1 during the corresponding period last year.

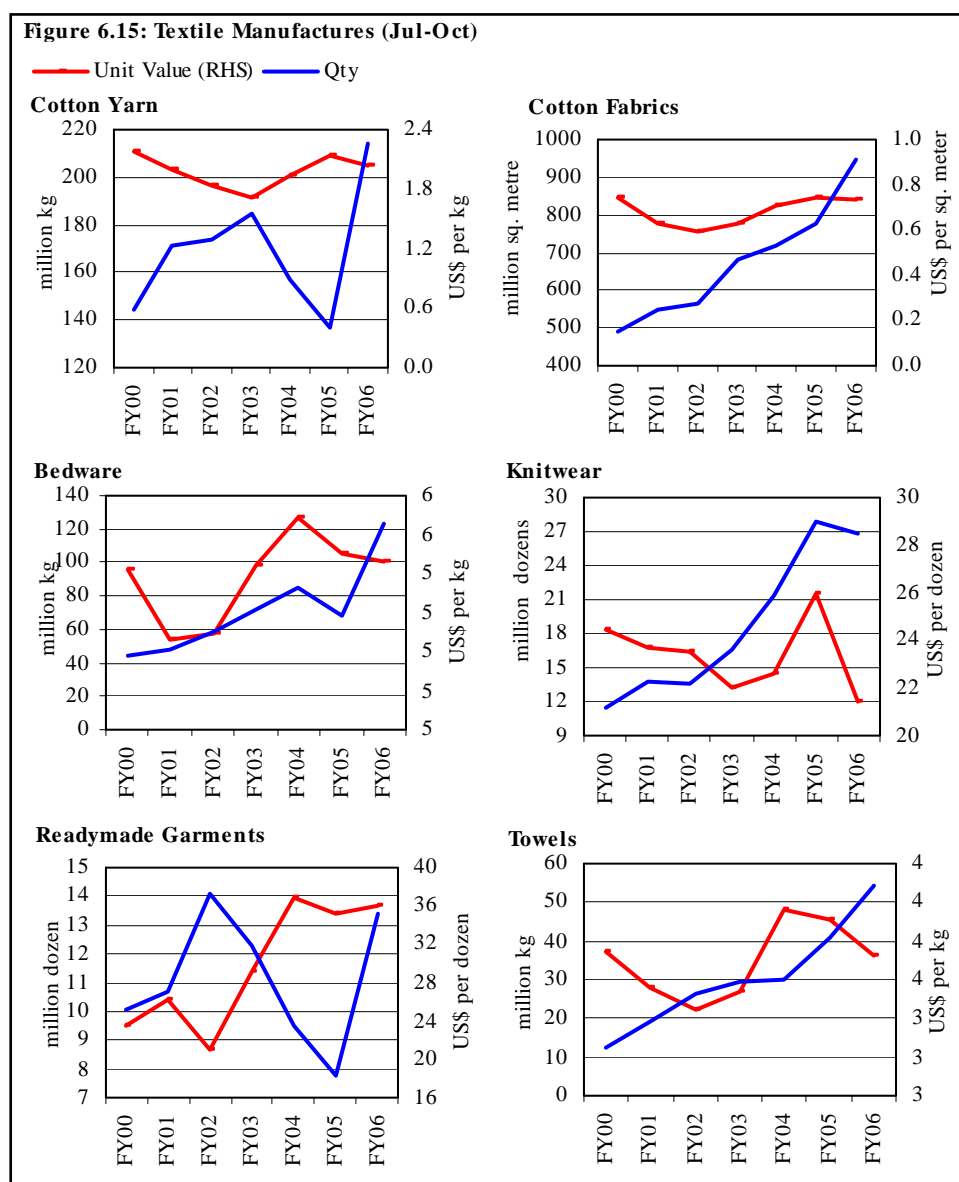
The raw cotton exports witnessed 21.0 percent YoY growth during Jul-Oct FY06 even over the substantial growth of 57.6 percent during the same period last year. However, the share of raw cotton exports in total exports of primary commodities is still very low. Interestingly, the unit vales of raw cotton fell during Jul-Oct FY06. However, it is expected that with the low cotton production in major producer countries (such as USA, China, Pakistan, Brazil, Australia etc.) together with the projected increase in global demand, unit prices of raw cotton would rise in 2005-2006 season;²⁰ this in turn may impact the unit values of export of textile manufactures.

Textile Manufacture

The textile manufacture exports witnessed substantial YoY growth of 26.0 percent during Jul-Oct FY06 as compared to a nominal YoY growth of 0.5 percent during

²⁰ While the cotton production in China (Mainland) is expected to decline by 9 percent, the consumption forecasts are up by 10 percent. The resulting higher import demand by China is likely to raise international cotton prices (Source: International Cotton Advisory Committee, Press Release, December 1, 2005).

the corresponding period of FY05, despite the substantial constraints discussed earlier, as well as lower prices (see **Figure 6.15** and **Table 6.9**). The major contributors to the textile manufacture exports were *bedware*, *ready made garments*, *cotton fabrics*, *cotton yarn* and *towels*. On the other hand, exports of *synthetic textiles*, *other textile made up* and *knitwear* declined.



An important development is the Sino-US textile trade agreement whereby the growth of China's textile exports under selected categories to the US market have been capped during 2006, 2007 and 2008 to 10 percent, 12.5 percent and 16 percent respectively. While the safeguard measures by US on textile exports from China are unfortunate, this provides Pakistani textile exporters some room to revisit their business strategies accordingly.

Table 6.9 shows that the unit values of all the major textile manufactures increased in the pre-MFA period (Jan-Oct 2004), thereby increasing major textile exports by US\$ 303 million. However, the unit values declined after the complete quota phase-out period (Jan-Oct 2005) as a result of intensified price

Table 6.9: Impact of Unit Value Changes

| million US\$ | | |
|-------------------------|--------------|--------------|
| | Jan-Oct CY04 | Jan-Oct CY05 |
| Cotton yarn | 170 | -128 |
| Cotton fabrics (woven) | 36 | 156 |
| Hosiery (knitwear) | 44 | -35 |
| Bedware | -1 | -33 |
| Towels | 5 | -27 |
| Readymade garments | 48 | -52 |
| Total impact | 303 | -119 |

competition to gain share in the international market, consequently having adverse impact worth US\$ 119 million on the major textile exports. Interestingly the impact on unit values varies inversely with the degree of value addition.

Despite the impact of anti-dumping duty imposed by the EU and fall in its unit values, the *bedware* exports were able to record impressive YoY growth of 80.5 percent during the Jul-Oct FY06 in contrast to negative growth of 23.0 percent in the corresponding period of the previous year. This suggests the low base effect as the dominant factor behind this substantial growth. Furthermore, the high growth in the presence of anti dumping duty in EU market indicates that *bedware* exporters are diversifying their export market outside the EU region.

Similarly, the exports of *ready made garments* depicted 78.8 percent YoY growth during Jul-Oct FY06 as compared to the negative growth of 26.2 percent YoY during Jul-Oct FY05. However, it is encouraging to note that the unit values of *ready made garments* exports have also increased during this period.

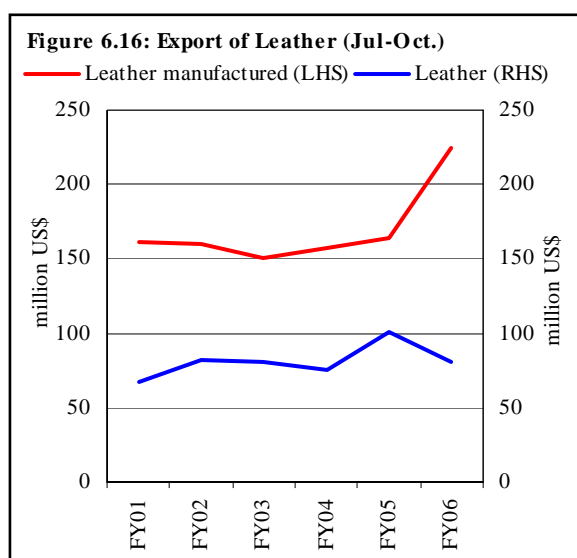
The increase in unit values is more pronounced in *cotton fabric* exports. This, together with rise in export quantity enabled the *cotton fabrics* to record YoY growth of 33.2 percent during Jul-Oct FY06 in comparison with the YoY growth of 10.8 percent during the corresponding period last year.

Towel exports recorded 29.1 percent YoY growth during Jul-Oct FY06 on the top of YoY growth of 31.2 percent during Jul-Oct FY05. The growth performance is remarkable given the high base impact and fall in unit values during the period.

The *knitwear* exports however recorded YoY *decline* of 10.2 percent during Jul-Oct FY06 as compared to 41.8 percent YoY growth during the corresponding period last year. The decline in export quantum was reinforced by falling unit values.

Other Manufactures

The export of *other manufactures* posted a YoY growth of 14.7 percent during Jul-Oct FY06 on the top of 14.3 percent YoY growth during the corresponding period of FY05. Within this group the *petroleum & petroleum products* and *leather manufactures* were the major contributor registering 65.3 percent and 37.7 percent YoY growth rate respectively during the period under review. Moreover, it is encouraging to note that the exports of *leather manufacture* are substituting the raw leather exports (see **Figure 9.16**).

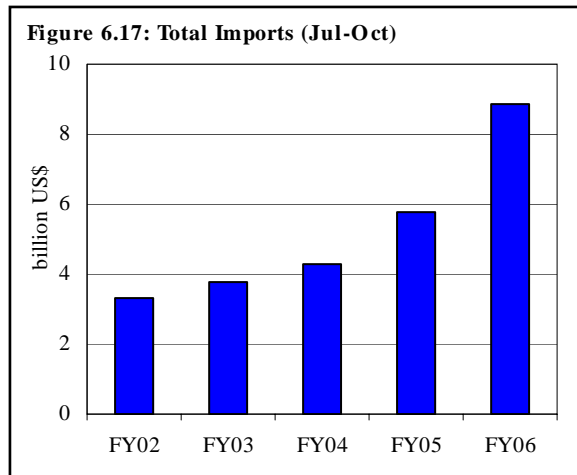


Imports

The unusually high oil prices in the international market and persistent rise in the demand for machinery stemming from increased economic activity, contributed the bulk of the exceptionally strong 54.0 percent YoY rise in imports during Jul-Oct FY06. As seen in **Figure 9.17**, the US\$ 8.9 billion imports bill for this period marks the continuation of a secular rise in the imports bill in recent years, and this trend is unlikely to subside in the near term.

In particular, since Pakistan's import demand is relatively highly elastic with respect to domestic income in the short run as well as in the long run (as evident from empirical research work on Pakistan Trade elasticities), the higher demand for import of machinery and raw material was expected to persist to support the

domestic economic activity.²¹ The extraordinary 77.2 percent YoY increase in unit prices of petroleum group imports during Jul-Oct FY06 as compared to almost 36 percent increase during the corresponding period last year inflated the petroleum group import bill, contributing substantially in the total import surge during the period. Unlike the corresponding period of FY05 whereby the increase in the import of



petroleum group was contributed by both, the quantum impact (39.2 percent) and price impact (60.8 percent), the recent surge in petroleum import during Jul-Oct FY06 is entirely contributed by the price impact (103.1 percent) as the import volume fell by 3.1 percent. Although the international oil prices have receded from their peak level in recent months, their impact on overall import bill is not yet evident due to sharp rise in non-oil imports.

Furthermore, the efforts of the government to contain domestic food inflation by ensuring enough supply of sugar through imports led to an increase the food group imports. In addition, the real appreciation of Pak Rupee against the trading partner's currencies might have increased the demand for imported goods.

Food Group.

The import of sugar as a part of the government efforts to contain rising domestic inflation led the food group imports to register 42.3 YoY growth during Jul-Oct FY06 on the top of 24.6 percent increase in the corresponding period last year (see **Table 6.10**). However, the share of food imports in total growth in imports has increased marginally from 5.4 percent during Jul-Oct FY05 to 5.5 percent during Jul-Oct FY06.

²¹ For reference to relevant empirical work see the trade section in *SBP's Annual Report* for FY05.

Since the domestic production of sugar and wheat fell short of the domestic demand, their imports are likely to increase in the remaining period of the current fiscal year. Moreover, the attempt to set up vegetable oil refineries in Pakistan with the assistance of Malaysia to increase the vegetable oil refining capacity would lead to import substitution of refined palm oil with the import of relatively cheaper crude palm oil.

Table 6.10: Contribution in Growth (Jul-Oct)

| Groups | FY-05 | | FY-06 | |
|------------------------|-------------|-----------------|-------------|-----------------|
| | Growth | Share in growth | Growth | Share in growth |
| | | | | |
| Food | 24.6 | 5.4 | 42.3 | 5.5 |
| Machinery | 33.5 | 23.7 | 62.2 | 27.8 |
| Petroleum | 35.7 | 21.8 | 73.2 | 28.8 |
| Textile | 28.7 | 1.7 | 69.8 | 2.5 |
| Agri & other chemicals | 35.0 | 21.1 | 11.3 | 4.4 |
| Metal | 60.0 | 8.2 | 64.5 | 6.7 |
| Miscellaneous | 21.1 | 1.8 | 22.1 | 1.1 |
| Others | 59.2 | 24.0 | 75.8 | 23.3 |
| Total Imports: | 34.5 | 100 | 54.0 | 100 |

Machinery Group.

The machinery group imports portrayed a substantial growth of 62.2 percent YoY during Jul-Oct FY06 over 33.5 percent YoY growth witnessed during the corresponding period of the last year. Also, the share of machinery imports in total imports during Jul-Oct FY06 was 25.5 percent, marginally up from 24.2 percent share during Jul-Oct FY05.

The road motor vehicles depicted 99.7 percent YoY growth during Jul-Oct FY06 as

compared to 28.0 percent growth in the corresponding period of last year (see **Figure 6.18** and **Table 6.11**). Consequently, the share of road motor vehicles in total machinery imports has increased to 22.3 percent during Jul-Oct FY06 from its share of 18.1 percent during Jul-Oct FY05 (see **Table 6.12**).

Another significant contribution in import growth of *machinery group* came from *office machinery*. The *office machinery* increased by YoY US\$ 180.4 million

Figure 6.18: Imports of Machinery (Jul-Oct)

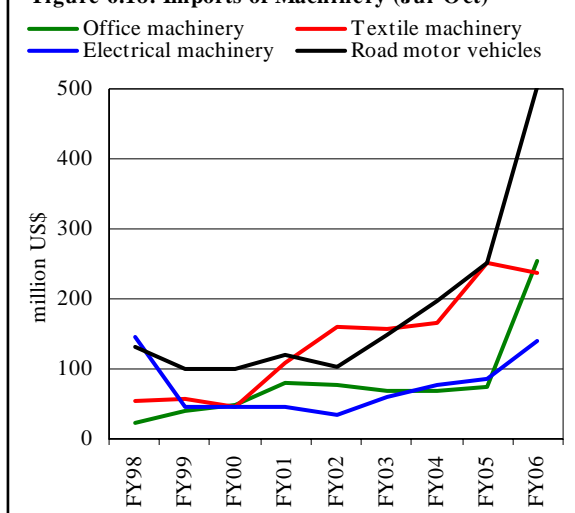


Table 6.11: Major Imports (Jul-Oct)

Value: US\$ million; unit value US\$

| | | | | | | | % chg in Jul-Oct FY06/Jul-Oct FY05 | | |
|--|-------|--------------|---------------|--------------|---------------|------------------|---------------------------------------|-------|---------------|
| | | Jul-Oct FY05 | | Jul-Oct FY06 | | Abs | | | |
| Commodities | Units | Value | Unit Value | Value | Unit Value | chg. In value | Qty | Value | Unit value |
| | | | | | | | | | |
| A. Food group | | 407.6 | --- | 580.2 | --- | 172.6 | --- | 42.3 | --- |
| 1.Milk & cream incl. milk food for infants | MT | 7.0 | 1,951.6 | 14.4 | 3,444.8 | 7.4 | 16.7 | 106.0 | 76.5 |
| 2.Wheat un milled | MT | - | - | 0.4 | - | - | - | - | - |
| 3.Dry fruits | MT | 9.9 | 616.0 | 17.4 | 527.9 | 7.5 | 105.4 | 76.0 | -14.3 |
| 4.Tea | MT | 72.8 | 1,673.4 | 68.9 | 1,659.1 | -3.9 | -4.5 | -5.4 | -0.9 |
| 5.Spices | MT | 18.4 | 825.4 | 16.0 | 636.3 | -2.4 | 12.6 | -13.2 | -22.9 |
| 6.Edible Oil | MT | 263.8 | 502.2 | 251.2 | 536.9 | -12.5 | -10.9 | -4.8 | 6.9 |
| <i>Soyabean</i> | MT | 19.3 | 1,057.1 | 5.4 | 758.2 | -13.9 | -60.9 | -71.9 | -28.3 |
| <i>Palm Oil</i> | MT | 244.5 | 482.2 | 245.8 | 533.4 | 1.3 | -9.1 | 0.5 | 10.6 |
| 7.Sugar | MT | 0.9 | 288.9 | 159.8 | 326.1 | 158.9 | --- | --- | 12.9 |
| 8.Pulses | MT | 34.8 | 301.1 | 52.1 | 418.9 | 17.3 | 7.5 | 49.6 | 39.1 |
| B. Machinery group | | --- | 1,394.6 | --- | 2,261.8 | --- | 867.1 | --- | 62.2 |
| 1.Power generating machinery | --- | 107.0 | --- | 128.5 | --- | 21.4 | --- | 20.0 | --- |
| 2.Office machinery | --- | 75.0 | --- | 255.5 | --- | 180.4 | --- | 240.5 | --- |
| 3.Textile machinery | --- | 250.2 | --- | 237.5 | --- | (12.7) | --- | (5.1) | --- |
| 4.Construction & mining machinery | --- | 51.5 | --- | 46.5 | --- | (5.0) | --- | (9.7) | --- |
| 5.Electrical machinery & apparatus | --- | 85.2 | --- | 139.2 | --- | 54.0 | --- | 63.4 | --- |
| 6.Railway vehicles | --- | 11.1 | --- | 15.5 | --- | 4.4 | --- | 39.6 | --- |
| 7.Road Motor vehicles | --- | 252.2 | --- | 503.7 | --- | 251.5 | --- | 99.7 | --- |
| 8.Aircraft, ships and boats | --- | 27.4 | --- | 31.5 | --- | 4.1 | --- | 15.2 | --- |
| 9.Agricultural machinery & Implements | --- | 12.1 | --- | 39.4 | --- | 27.3 | --- | 225.5 | --- |
| 10.Other machinery | --- | 522.9 | --- | 864.5 | --- | 341.6 | --- | 65.3 | --- |
| C. Petroleum group | | MT | 1,224.0 | 252.5 | 2,120.6 | 447.5 | 896.6 | -2.2 | 73.2 |
| 1.Petroleum products | MT | 506.6 | 271.5 | 837.6 | 495.6 | 331.0 | -9.4 | 65.3 | 82.5 |
| 2.Petroleum crude | MT | 717.4 | 240.6 | 1,283.0 | 420.9 | 565.5 | 2.2 | 78.8 | 74.9 |
| D. Textile group | | MT | 109.9 | --- | 186.6 | --- | 76.7 | --- | 69.8 |
| 1.Synthetic fibre | MT | 50.0 | 1788.9 | 74.3 | 1725.1 | 24.3 | 54.0 | 48.5 | -3.6 |
| 2.Synthetic & artificial silk yarn | MT | 46.7 | 1783.2 | 97.9 | 2,023.9 | 51.2 | 84.9 | 109.8 | 13.5 |
| 3.Worn clothing | MT | 13.2 | 328.9 | 14.4 | 325.9 | 1.2 | 10.1 | 9.1 | -0.9 |
| E. Agricultural and other chemicals group | | MT | 1,203.1 | --- | 1,338.7 | --- | 135.6 | --- | 11.3 |
| 1.Fertilizer | MT | 129.4 | 253.5 | 182.0 | 274.5 | 52.7 | 29.9 | 40.7 | 8.3 |
| 2.Insecticides | MT | 76.9 | 3377.3 | 66.8 | 3217.4 | -10.2 | -8.9 | -13.2 | -4.7 |
| 3.Plastic materials | MT | 254.2 | 1057.4 | 331.3 | 1,204.5 | 77.0 | 14.4 | 30.3 | 13.9 |
| 4.Medicinal products | MT | 82.7 | 21929.7 | 100.2 | 32,077.5 | 17.4 | -17.2 | 21.1 | 46.3 |
| 5.Others | --- | 659.8 | --- | 658.5 | --- | (1.4) | --- | (0.2) | --- |
| F. Metal group | | MT | 322.7 | --- | 530.9 | --- | 208.3 | --- | 64.5 |
| 1.Iron and steel scrap | MT | 57.9 | 181.3 | 106.3 | 252.9 | 48.4 | 31.5 | 83.5 | 39.5 |
| 2.Iron and steel | MT | 237.6 | 417.4 | 391.5 | 569.5 | 153.9 | 20.8 | 64.8 | 36.4 |
| 3.Aluminum wrought & worked | --- | 27.1 | --- | 33.2 | --- | 6.0 | --- | 22.3 | --- |
| G. Miscellaneous Group | | | 149.3 | --- | 182.3 | --- | 33.0 | --- | 22.1 |
| 1.Rubber crude | MT | 30.4 | 1056.4 | 34.8 | 1044.3 | 4.4 | 16.0 | 14.6 | -1.1 |
| 2.Rubber tyres & tubes | No. | 42.6 | 25.0 | 54.9 | 23.9 | 12.3 | 34.8 | 29.0 | -4.3 |
| 3.Wood & cork | --- | 10.1 | --- | 11.5 | --- | 1.4 | --- | 14.3 | --- |
| 4.Jute | MT | 7.4 | 282.8 | 8.1 | 359.6 | 0.8 | -13.4 | 10.1 | 27.2 |
| 5.Paper, paper board & manufacture | MT | 58.9 | 608.1 | 72.9 | 704.2 | 14.1 | 7.0 | 23.9 | 15.8 |
| H. Others | | | 955.7 | | 1679.7 | | 724.0 | --- | 75.8 |
| Total imports | | | 5,766.9 | | 8,880.9 | | 3,113.9 | | 54.0 |

Source: Federal Bureau of Statistics

during Jul-Oct FY06, increasing its share in total machinery imports to 11.3 percent during the period under review compared to 5.4 percent witnessed during Jul-Oct FY05. However, excluding *office machinery*, total machinery imports still posted a YoY increase of 52.0 percent during Jul-Oct FY06.

Table 6.12: Analysis of Machinery Imports (Jul-Oct)
percent

| | FY05 | | FY06 | |
|-------------------------------------|----------------------------------|-------------|----------------------------------|-------------|
| | Share in total machinery imports | Growth | Share in total machinery imports | Growth |
| Power generating machinery | 7.7 | -0.4 | 5.7 | 20.0 |
| Office machinery | 5.4 | 7.2 | 11.3 | 240.5 |
| Textile machinery | 17.9 | 50.0 | 10.5 | -5.1 |
| Construction & mining machinery | 3.7 | 43.4 | 2.1 | -9.7 |
| Electrical machinery & apparatus | 6.1 | 11.7 | 6.2 | 63.4 |
| Railway Vehicles | 0.8 | -68.5 | 0.7 | 39.6 |
| Road motor vehicles | 18.1 | 28.0 | 22.3 | 99.7 |
| Aircraft, ships and boats | 2.0 | -50.0 | 1.4 | 15.2 |
| Agricultural machinery & implements | 0.9 | 77.9 | 1.7 | 225.5 |
| Other machinery | 37.5 | 77.4 | 38.2 | 65.3 |
| Total machinery | 100.0 | 33.5 | 100.0 | 62.2 |

The import of textile machinery showed a YoY decline of 5.1 percent during Jul-Oct FY06. This decline was expected as the textile manufactures in their efforts to prepare for the post-MFA regime had already imported textile machinery in the second quarter of the last fiscal year.

Petroleum Group

The substantial YoY increase of almost 77.2 percent in international oil prices during Jul-Oct FY06 led the *petroleum group* to record 73.2 percent YoY growth during the first four months of the current fiscal year.

Table 6.13: Petroleum Group Imports (Jul-Oct)
million US\$

| | FY05 | | FY06 | |
|------------------------|--------------|--------------|--------------|--------------|
| | Quantum | Price | Quantum | Price |
| Petroleum group | 126.0 | 195.8 | -27.5 | 924.0 |
| Petroleum products | 35.1 | 86.5 | -47.7 | 378.7 |
| Petroleum crude | 89.0 | 111.0 | 16.1 | 549.4 |

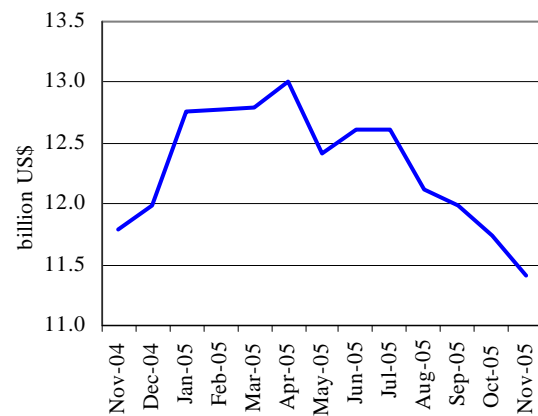
The entire increase in the petroleum bill was caused by the external oil price shock (103.1 percent) in the period under consideration as compared to relatively lower effect (60.8 percent) of the international oil prices in the corresponding period of last year (see **Table 6.13**). With the oil prices in the international market receding

from their peak levels in recent months, it is expected that the pace of the rise in petroleum product imports would slow.

6.3 Foreign Exchange Reserves

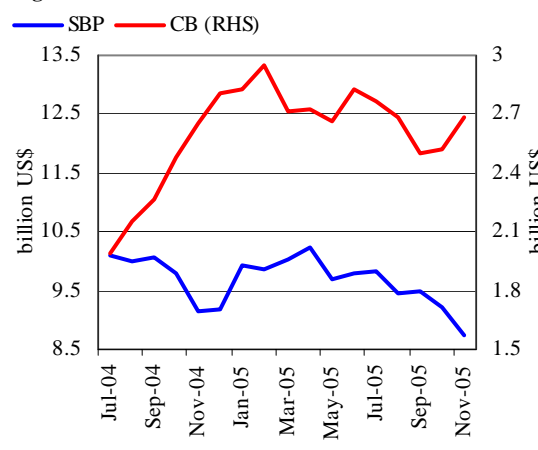
The increasing pressure on Pakistan's external account led to a steady decline in the country's liquid foreign exchange reserves during July-Nov FY06. The reserves fell US\$ 1.3 billion during the period to touch US\$ 11.3 billion by end-November 2005, down US\$ 1.7 billion from the peak level US\$ 13.0 billion reached in April 2005 (see **Figure 6.19**).

Figure 6.19: Foreign Exchange Reserves



The decline is evident in both SBP and commercial bank reserves. As evident from **Figure 6.20**, SBP's reserves declined by US \$ 900.7 million during Jul-Nov FY06, despite some major inflows, including disbursement by the IDA and Asian Development Bank (ADB), receipt from logistic support, privatization proceeds as well as the purchase from the inter-bank market. Similarly, the reserves held by the commercial banks fell by US \$ 386.8 million in the same period.

Figure 6.20: Bifurcation of Forex Reserves



During July-November of 2005, SBP sold US\$ 3,793 million in the inter-bank market. At the same time, SBP received US \$ 4,226.1 million during the period of Jul-Nov FY06, including, SBP purchases from the inter-bank of US\$ 2,371 million. Inflow of US\$ 1,854.4 million from donor agencies, logistic support and privatization proceed, during Jul-Nov FY06, provided some additional resources.

Importantly, most of the total inflows are non-debt creating in nature. The major share of inflows comprised from the US logistic receipts (US\$ 474.7 million) and privatization proceeds (US\$ 455.0 million)

The fall in the reserves held by commercial banks, however, mainly reflects the increased demand for foreign currency loans during the period. The rising demand for these loans reflects both the rising rupee interest rates and the stability of the exchange rate. Indeed, forex loans extended by domestic banks to local traders rose by US\$ 453.3 million during July-Nov FY06, but the corresponding decline in reserves of commercial banks was offset by a US\$ 67.0 million increase in their FE-25 deposits in the same period.

Reserve Adequacy

Measure of reserves adequacy indicate that Pakistan's ability to meet the external payment has weakened in Q1-FY06 (see **Figure 6.21**). The import coverage ratio, the measure of import financing, has fallen to 25.4 weeks in November 2005

from 33 weeks in April 2005. Significantly, the deterioration in the indicator owes less to the decline in reserves and more to the sharp increase in imports. STDL to foreign exchange reserves has also decreased due to the inflows of US\$ 337 million from IDB (see **Figure 6.22**). However this ratio shows that the reserves of Pakistan are still in comfortable position.

Figure 6.21: Reserve Adequacy (equivalent to weeks of Imports)

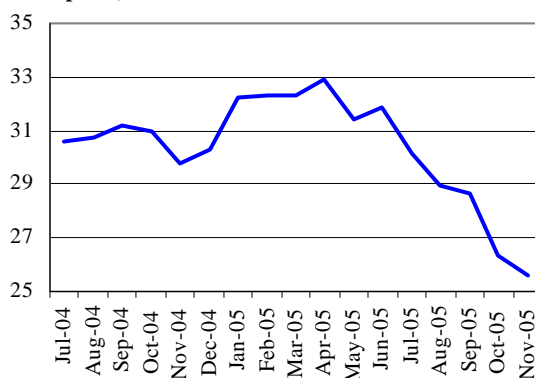


Figure 6.22: STDL to Foreign Exchange Reserves

