

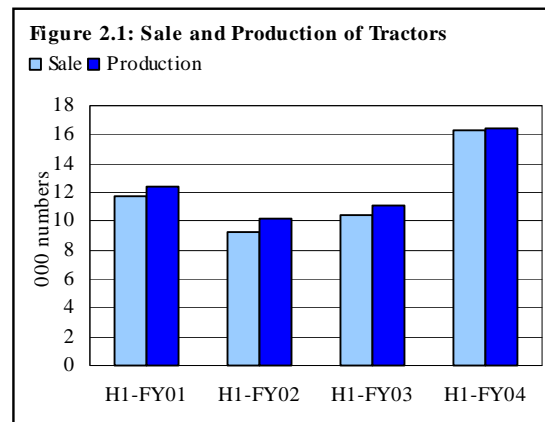
## 2 Real Sector

### 2.1 Agriculture

The latest estimates on crops suggest that the outlook for the agricultural sector remains positive; notwithstanding the decline in the cotton crop as well as the impact of the 'bird flu' crisis, the sector expected to record reasonable growth over the preceding year. This expectation is based on the visible efforts of farmers to improve productivity by capitalizing on good agri-product prices, the improved water availability and the more efficient credit disbursement by banks. As a result, if expectations of a significantly above target wheat harvest are realized, and the livestock sub-sector growth remains on target,<sup>1</sup> the FY04 agri-growth target remains achievable.

It should be noted that while the aggregate value addition by the *kharif* FY04, crops was a little below target, it was yet higher than that in FY03, i.e. farm incomes from *kharif* FY04 crops increased. This probably encouraged higher investments in the subsequent *rabi* crop. This tendency was reinforced by the rise in the procurement prices of wheat and the improved availability of water (through canal-head water and timely winter rainfall) relative to the preceding year.<sup>2</sup>

In fact, available data indicates that the expenditure on farm inputs and purchase of farm implements rose sharply during H1-FY04 compared to the corresponding period of FY03. Illustrating this trend are the 10.6 percent increase in the usage of fertilizer in *rabi* FY04 alone, and the 56.8 percent rise in the sale of tractors during H1-FY04<sup>3</sup> (see **Figure 2.1**). The higher agri-investment is also



<sup>1</sup> Since poultry has around 10 percent share in livestock, the other components would have to outperform to compensate for the poultry sub-sector losses.

<sup>2</sup> The winter rains was accompanied by snowfall in the catchments area that has also raised expectations of water availability in the early part of the next *kharif* (FY05).

<sup>3</sup> The sale and domestic production coincide because of the fact that sale orders precede the production.

evident in credit data; during July-December 2003, banks' developmental loans<sup>4</sup> to the sector rose by 46.5 percent (i.e., by Rs 2.1 billion) to reach Rs 6.5 billion.

### 2.1.1 Water Availability

FY04 has seen a significant improvement in water availability through the most part of *kharif* as well as *rabi* due to ample and well distributed rains. The good monsoon (June to September) rains helped avert the near-drought conditions that had lasted longer than expected,<sup>5</sup> and the water availability further improved through timely winter rains.<sup>6</sup>

Specifically, during crop year FY04<sup>7</sup> the total canal-head water availability was higher in both seasons compared to FY03 (see **Table 2.1**); the aggregated availability of 91.0 million-acre feet (MAF) during the crop year FY04 was 11.0 percent higher than in the corresponding period of the preceding year.

However, even with this improvement, the aggregate canal-head water availability remained in deficit, at only 88.0 percent of that in normal years,<sup>8</sup> with the shortfall seen principally in the *rabi* season (see **Figure 2.2 & 2.3**).

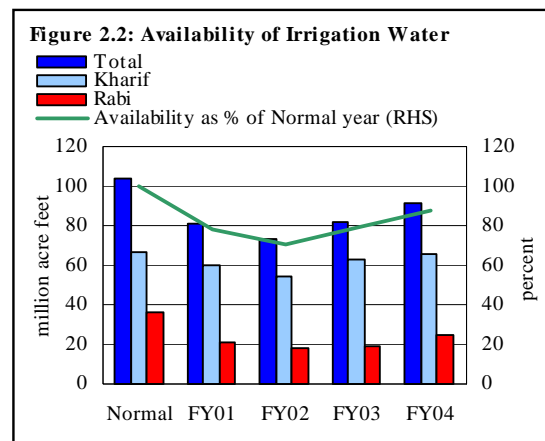
**Table 2.1: Canal-Head Water Availability During FY04**  
million acre feet

	Punjab	Sindh	NWFP	Baloch.	Pakistan
Kharif FY03	32.1	27.6	0.9	2.2	62.8
Kharif FY04	35.8	27.3	0.9	1.9	65.9
Rabi FY03	10.6	7.5	0.4	0.8	19.2
Rabi FY04	13.0	10.9	0.4	0.7	25.1

Source: Indus River System Authority

Kharif: April - September

Rabi: October - March, (latest date as of Feb. 20, 2004)



<sup>4</sup> These loans are provided mainly for purchase of tractors, tubewells, farm implements, bund construction and development of land, etc.

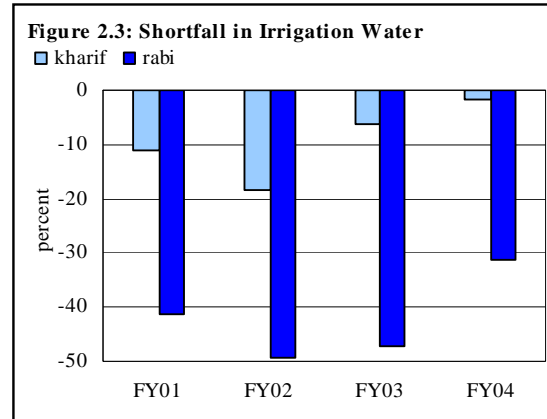
<sup>5</sup> In fact, after every three to five years of normal rains, there comes a spell of abnormality, which usually lasts for a maximum of a year or two. But, this time, the poor rains persisted for more than three years before returning to the normal in *kharif-04*.

<sup>6</sup> Moreover, the increased snowfall in catchments areas has raised hopes the water availability would continue to support water availability in subsequent seasons.

<sup>7</sup> From April 1, 2003 to February 20, 2004. Crop year = April to March.

<sup>8</sup> Normal water availability refers to the average water supply during the 1996-2000 period. This average is also equal to the water availability envisaged in the 1991 Water Accord.

The fact that the *rabi* water shortage reached 31.1 percent of normal, even though of all major water reservoirs were filled to capacity by the monsoon rains, is a telling indicator of the need to improve water storage capacity and management. In particular, there has been a major deterioration in the storage capacity of the reservoirs. This grave situation suggests an urgent need to add or reclaim storage capacity for the present and future needs.



It is worth noting that the Tarbela and Mangle dams have already lost approximately 4 MAF of storage capacity and this will increase over time due to silting. While this loss is expected to be offset by the planned 5 MAF addition to the Mangla storage capacity, even this may not be enough to meet the country's future requirements.

### 2.1.2 Crops

Comprising of the major and minor crops,<sup>9</sup> the *crops* sub-sector accounts for the heaviest share in agriculture (56.5 percent), followed by livestock (38.8 percent). As such, the growth in the agriculture is strongly linked to the crops' performance, and particularly to the major crops (that, on average, contribute more than 70 percent of the crop sub-sector's value added). The area under major crops has certainly increased in FY04, and initial estimates suggest that this may be a key factor driving crops sub-sector growth in this period.

#### *Area under cultivation*

Despite a decline in area under sugarcane cultivation, the total area under important crops<sup>10</sup> increased by 3.6 percent during FY04 with the highest increase recorded in the rice crop (see **Table 2.2**).

<sup>9</sup> Major crops consist of 12 crops including: rice, bajra, maize, jowar, sugarcane and cotton of *kharif* season and wheat, gram, barley, rapeseed and mustard, sesamum and tobacco of *rabi* season, while *minor crops* include vegetables, pulses (except gram), oilseeds, condiments, fruits and green fodder.  
<sup>10</sup> These include cotton, rice, sugarcane and wheat with 90.0 percent share in major crops.

This reflects the expectations of the farmers about higher profitability due to an increase in water availability and the better market prices prevalent during FY03.

Unlike for cotton, rice and wheat, the FY03 prices of sugarcane settled at the previous year's level. Further, the belated start of the crushing season led the sugarcane growers to resort to less profitable usage i.e., for making *gur* and as green fodder. Not surprisingly therefore, the area under the crop fell even as other major crops saw increased area under cultivation.

Provincial breakup reveals that compared to FY03, total cultivated area under cotton, sugarcane, rice and wheat witnessed increase in Punjab, Sindh, while it declined in Balochistan<sup>11</sup> (see **Figure 2.4**). The latter is a little surprising given the provincial government's incentives to crops production.<sup>12</sup>

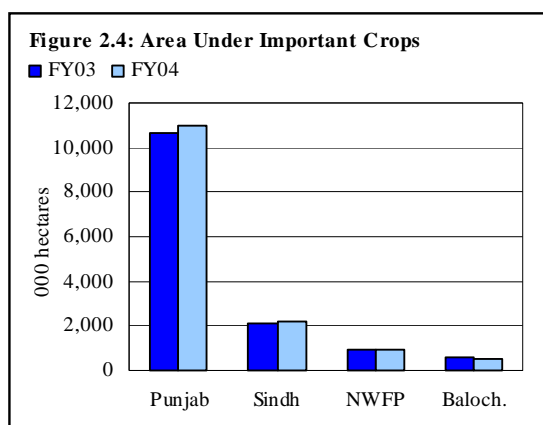
**Production of the crops**

The initial estimates on important crops indicate that the FY04 production of rice and sugarcane were not only higher than previous year but also surpassed targets (see **Table 2.3**) which helped offset the impact of losses to the cotton crop due to

**Table 2.2: Area under Important Crops**  
thousand hectares

Crops	FY03		FY04		% Change Over	
	Sown	Target	Sown	Target	FY03	Target
Cotton	2,754	2,860	2,989		8.5	4.5
Sugarcane	1,100	1,000	1,050		-4.5	5.0
Rice	2,225	2,231	2,451		10.1	9.8
Wheat	8,094	8,183	8,195		1.2	0.1
Total	14,173	14,274	14,685		3.6	2.9

Source: Ministry of Food, Agriculture & Livestock



<sup>11</sup> The area under cultivation declined in case of cotton, rice and wheat while an insignificant acreage was brought under cultivation of sugarcane in Balochistan during FY04.

<sup>12</sup> For example, despite the provision of 50 percent seeds free of cost and delivery of farm implements worth Rs 3.0 million for cotton, the area under the crop declined from 41 thousand hectares to 36 thousand hectares. In the absence of a tangible reason for the area under major crops in Balochistan, one possible explanation is that farmers in Balochistan have preferred to shift some cultivated area to minor crops such as onion and potatoes (for which data is unavailable).

heavy rainfall in Sindh and the higher incidence of pest attack in some of the cotton growing districts in Punjab.

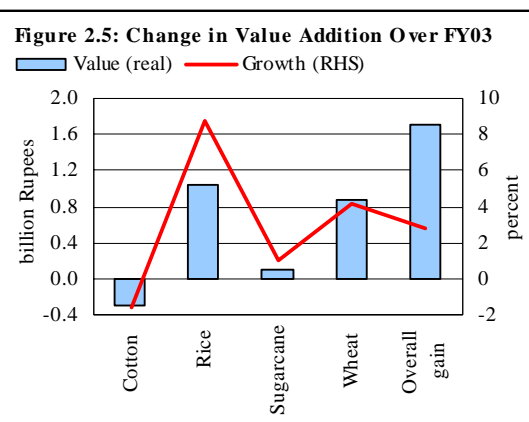
Consequently, the consolidated position of cotton, rice and sugarcane depicts a net gain by the crops sub-sector in *kharif* FY04 compared to FY03. However, this growth was below target, and as a result, the achievement of the 5.5 percent overall crops sub-sector growth target for FY04 would be possible only if a record output is achieved for the major *rabi* crops. The wheat harvest in particular, has to reach close to 21.5 million tonnes. This is by no means unachievable, given that (1) area under cultivation in FY04 is high at 8.2 million hectares;<sup>13</sup> and (2) fertilizer usage has surged during the wheat season after a 16.7 percent jump in the procurement price at sowing time. If the *rabi* crops merely remain on the FY04 targets, the overall growth in major crops will be close to 3.0 percent over FY03 (see **Figure 2.5**).

**Table 2.3: Production of Important Crops**

cotton 000' bales; other crops 000' tonnes

Crops	FY03	FY04		% Change Over	
		Target	Prel.	FY03	Target
Cotton	10,211	10,550	10,040	-1.7	-4.8
Sugarcane	52,056	52,500	52,600	1.0	0.2
Rice	4,479	4,550	4,871	8.8	7.1
Wheat	19,192	20,000	-	-	-

Source: Ministry of Food, Agriculture and Livestock



### 2.1.3 Fertilizer Off-take During *Rabi* FY04

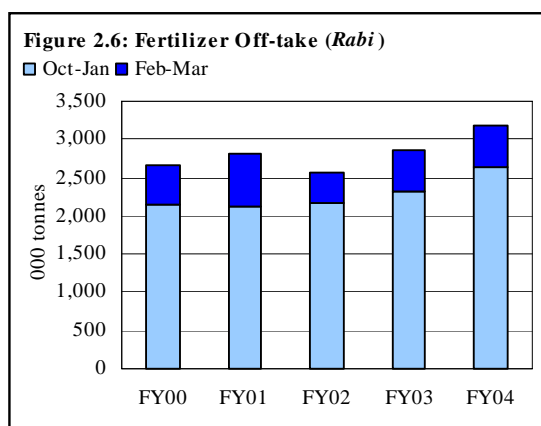
The total fertilizer off-take during *rabi* FY04 increased by 10.6 percent<sup>14</sup> to 3.1 million tonnes from 2.9 million tonnes in FY03.

<sup>13</sup>Earlier, the highest record production at 21.1 million tonnes was witnessed in FY00 when it was sown at 8.4 million hectares. Since there has been a considerable increase in the use of fertilizer in *rabi* FY04 the chances of setting new record for wheat production are bright.

<sup>14</sup> Contains projected off-take for February and March 2004. In fact, the actual increase during first four months of *rabi* FY04 (October-January), the consumption of fertilizers increased by 13.3 percent over the corresponding period in *rabi* FY03.

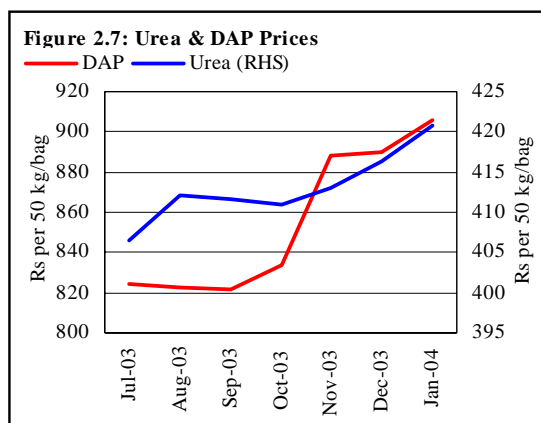
Almost all the increase in the *rabi* off-take of fertilizers was seen in the October 2003 to January 2004, the peak growing period of wheat. In the remaining period, the off-take has been projected to remain almost the same as in FY03. *Urea* fertilizer has the major share, at almost 76 percent, in the total application of fertilizers in *rabi*, and *DAP* accounted for the bulk of the remainder. Although the ratio of use of both the fertilizers, strictly speaking, should depend upon kind of soil and the crop in the fields, customarily a higher amount of *Urea* is used on account of its suitability for most of the fields/crops.

In aggregate, *Urea* and *DAP* off-take recorded increase of 12.9 and 3.7 percent respectively during *rabi* FY04 (see **Figure 2.6**). The sharp rise in *Urea* off-take is primarily due to timely availability of stocks with dealers and somewhat stable prices (see **Figure 2.7**). Moreover, due to continued rising trend in *DAP* price, the farmers substituted the *Urea* for *DAP*.



### 2.1.4 Trend in Crop Prices

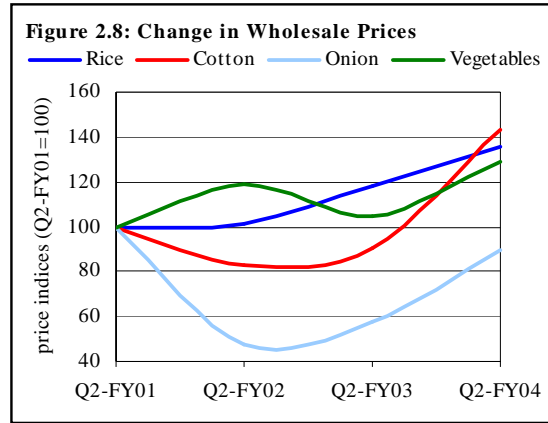
The wholesale prices of raw cotton and rice saw a strong increase during Q2-FY04 even over the already high prices prevailing during Q2-FY03 (see **Figure 2.8**).<sup>15</sup> Since these two commodities constitute around 45 percent of the total value addition of the major crops, the higher prices gave a considerable boost to farmers' income during *kharif* FY04. This



<sup>15</sup> October to December covers the larger part of the harvest of cotton and rice.

price gain is expected to be further supplemented by the recent increase in the procurement price of wheat.

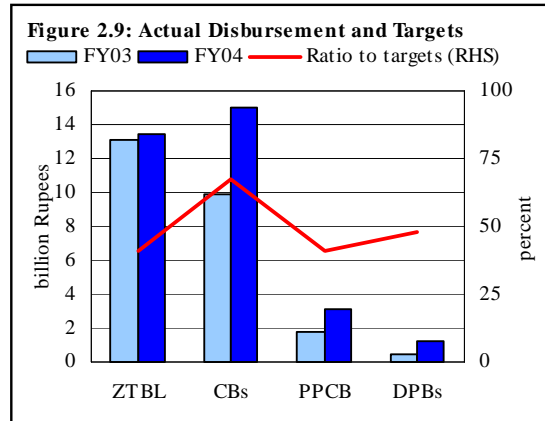
The rise in the price of rice, despite YoY increase in domestic production, was solely the result of higher prices, in the international market. On the other hand, the price hike of raw cotton was contributed by both, a decline in the domestic output as well as the increase in international prices. The domestic and international prices of raw cotton witnessed an increase of over 50 percent in Q2-FY04 over Q2-FY03.



### 2.1.5 Agricultural Credit

#### Disbursement

Achievement of more than 50 percent of the indicative agri credit growth target by mid-FY04 and an across-the-board increase in disbursements by all the banks were the two prominent features in agri-credit profile during H1-FY04. Commercial Banks (CBs) exceeded the target during H1-FY04 by a wide margin and helped to compensate for the below-target disbursements by the other institutions i.e. ZTBL and the PPCB (see **Figure 2.9**). As a result, CBs have overtaken the specialized banks in disbursement of agri-credit.<sup>16</sup>

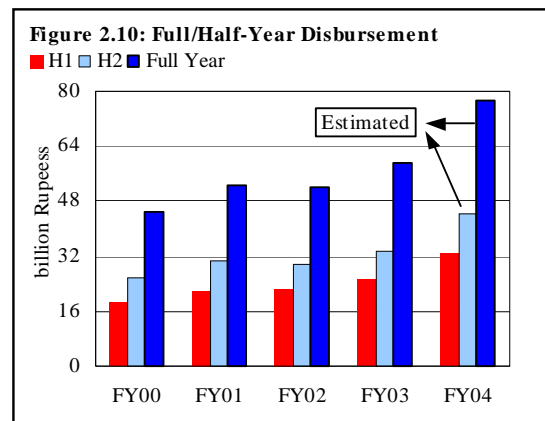


<sup>16</sup> The edge of CB in agri-financing over ZTBL, which first established in Q1-FY04, further strengthened in Q2-FY04.

The record first-half disbursement in FY04 suggests<sup>17</sup> that the full-year disbursement for FY04 will be considerably higher than the target of Rs 65.6 billion (see **Figure 2.10**).

The exceedingly good performance of the CBs pushed the credit disbursed to the agri-sector to a record of Rs 32.8 billion during H1-FY04 (see **Table 2.4**); i.e.,

more than twice the of Rs 15.4 billion disbursed during whole FY94 and almost equal to the Rs 32.7 billion disbursed during the whole of FY98. Similarly, Domestic Private Banks (DPBs),<sup>18</sup> who first time entered in agri-business in FY02, also did extraordinary well, nearly tripling their credit extension to the sector during H1-FY04 relative to H1-FY03.



**Table 2.4: Credit to Agriculture Sector**  
million Rupees

	Disbursement			Recovery			Net Credit <sup>1</sup>	
	H1-FY03	H1-FY04	% Change	H1-FY03	H1-FY04	% Change	H1-FY03	H1-FY04
ZTBL	13,061	13,450	3.0	11,077	13,024	17.6	1,983	426
CB <sup>@</sup>	9,911	15,046	51.8	8,012	10,203	27.4	1,900	4,842
DPBs <sup>2</sup>	439	1,274	190.2	300	777	159.3	139	497
PPCB	1,754	3,057	74.3	1,620	2,132	31.6	134	925
<b>Total</b>	<b>25,164</b>	<b>32,826</b>	<b>30.4</b>	<b>21,008</b>	<b>26,136</b>	<b>24.4</b>	<b>4,156</b>	<b>6,690</b>

<sup>1</sup>Net Credit = disbursement minus recovery

<sup>2</sup>Domestic Private Banks started lending in FY02

This fast growing trend can also be maintained in future, because, at present, out of the total 6.6 million farms<sup>19</sup> only 1.0 million have the access to the institutional

<sup>17</sup> Based on seasonality in agricultural financing, disbursement in second half always exceeds the disbursement in first half. The ratio between the H1: H2 is 1: 1.43.

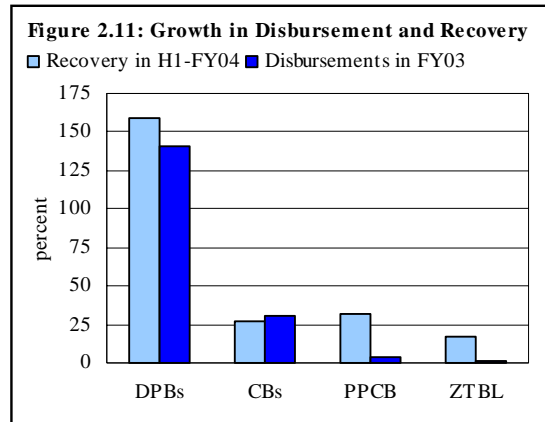
<sup>18</sup> Include; Askari Commercial Bank Ltd., Bank Al-Habib Ltd., Bank Al-Falah Ltd., Bolan Bank Ltd., Faysal Bank Ltd., Metropolitan Bank Ltd., PICIC Com. Bank Ltd., KASB Bank Ltd., Prime Com. Bank Ltd., Saudi Pak Com. Bank Ltd., Soneri Bank Ltd., The Bank of Khyber, The Bank of Punjab and Union Bank Ltd.

<sup>19</sup> According to Agricultural Census 2000.



credit. Therefore, the future growth in agricultural credit mostly depends upon the outreach of the banks and the innovations they bring in this field.

Higher disbursements were recorded both in short as well as medium term loans<sup>20</sup> by 26.9 percent and 46.5 percent respectively. The strong growth in medium term loans indicates the farmers' increased confidence in the sustainability of agricultural growth (and increased credit access) that pushed up investment in tractors, installation of tubewells, etc.



**Recovery**

Recovery of agricultural loans registered an across-the-board improvement during H1-FY04. The amount collected during the period was 24.4 percent higher than the recovery made in H1-FY03. The credit for this accrues mainly to ZTBL and PPCB, which recovered a significant amount from their past-due loan portfolios. The recovery was also significantly higher in case of CBs and DPBs but that was largely the reflection of the recent expansion in their loan portfolio (see **Figure 2.11**).

<sup>20</sup> Short term loans are extended for a period of six to nine months for purchase of seeds, fertilizers, pesticide and fuel for tractors' etc., while medium term loans are advanced for a period of five to ten years and are given for investment purposes like purchase of tractors, installation of tubewell, bunds construction, etc.

**Box 1: Poultry Crisis & its Impact on Pakistan's Poultry Industry**

The spread of the avian influenza virus has badly affected the poultry industry in several Asian countries including South Korea, Japan, Vietnam, Taiwan, Cambodia, Pakistan, Indonesia, Thailand and China. Fortunately, Pakistan and Taiwan have struck by a milder variant of the avian flu, caused by H7 and H9 virus. Nonetheless, even reports on the health risks faced by other countries have severely hit Pakistan's poultry industry.

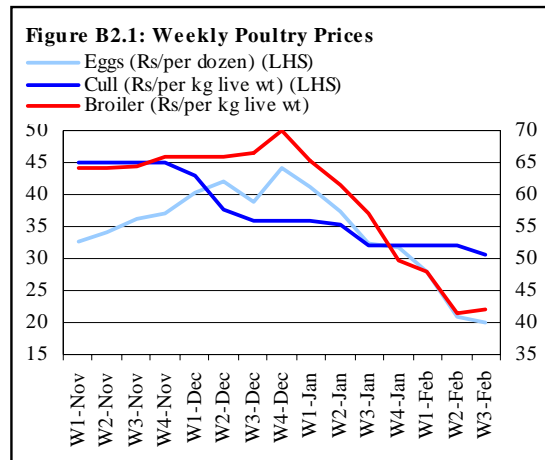
The virus started affecting the poultry farms in and around Karachi during November and December 2003. Fortunately, the virus could not affect the Punjab (accounting for 73 percent to total poultry business) and the Frontier provinces, but even these were impacted by the countrywide fall in demand for chicken products.

Immediately after the spread of the news on poultry virus, by the last week of December 2003, the demand for chicken products throughout the country declined abruptly, causing prices to crash (see **Figure 1**). At one stage the retail prices reached a ten-year low.

This poultry crisis has resulted into the immediate income losses to farm owners, and adversely affecting the upstream production in hatcheries, feed industry, etc. In Pakistan there are around 300 million chicken birds in the country and more than 20,000 poultry farms with Rs 60 to 70 billion investment in poultry sector.

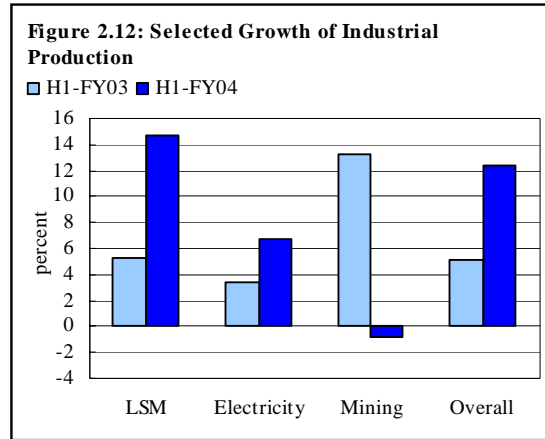
According to the Pakistan Poultry Association (PPA) the avian influenza caused an estimated loss of Rs 5.4 billion. This loss when adjusted in the value addition shows a decline of 1.3 percent in the growth of livestock sub-sector. This has dampened the chances of achieving the target growth of the livestock sub-sector, unless other contributors to the livestock sub-sector (90 percent) exceed the targeted growth.

In the wholesale market the sale price of almost all poultry products during January-February 2004 remained far less than the cost of production for many poultry farmers. This has led to concerns of a shortage of poultry products in future, raising the prospects of a sharp spike in poultry product prices when the concerns over the bird flu subside.

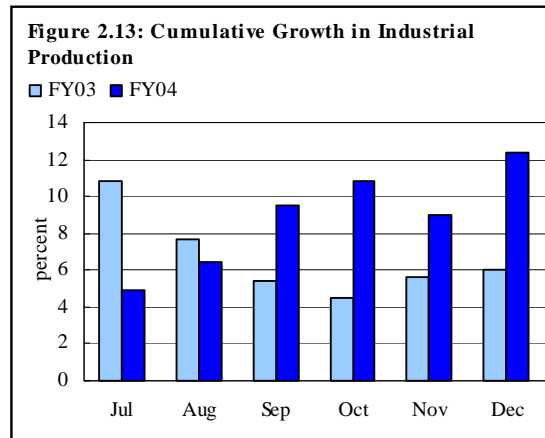


## 2.2 Industrial Production<sup>21</sup>

Industrial production surged strongly during the first half of FY04, with the index of industrial production (IIP) rising 12.6 percent by H1-FY04 compared to the growth of 5.1 percent recorded in the same period last year.<sup>22</sup> This performance was dominated by the very strong growth by both, *large-scale manufacturing (LSM)* and *electricity generation*, which easily offset the impact of the negative contribution of *mining industries* stemming from the fall in crude oil and coal output (see **Figure 2.12**).



The strength of the industrial growth is testified by the sustained acceleration witnessed in most months of H1-FY04. The only hiccup in the growth trend is visible in November 2003 when growth *fell* by 1.1 percent YoY, due to the confluence of a number of negative factors, including the delayed sugarcane crushing, a temporary supply glut that



<sup>21</sup> While analyzing the performance of industrial production, it is important to flag some data limitations. *First*, the weights used in quantum indices of manufacturing and minerals, were worked out on the basis of ‘Census of Manufacturing Industries’ (CMI) conducted in 1980-81 and Census of Mining Industries in 1982-83. *Secondly*, some of the industries (such as value added textiles, plastic products, electrical appliances—washing machine, electric iron, fans etc., food items—mineral water, dairy products etc., copper) are either excluded or under covered.

<sup>22</sup> The State Bank of Pakistan has developed an Index of Industrial Production (IIP) to analyze more representative trends in industrial sector of Pakistan. The IIP comprises large-scale manufacturing, electricity generation and mining industries. It represents approximately 60 percent of industrial value addition during 1980-81 (for details, see **Box 2.2**, Annual; Report for FY03).

led to a slowdown in POL refining operations<sup>23</sup>, the impact of Ramadan (and the subsequent Eid holidays), etc. (see **Figure 2.13**).

The factors such as higher domestic consumption complemented by expanding exports, stability in exchange rate, larger public sector development expenditures and a pick up in construction have been major stimuli to industrial activities during FY04. Moreover, higher agriculture output with strong prices of key crops further boosted consumer spending that had already been fueled by the increased access to relatively cheap consumer credit.

Encouragingly, the sustained strength of aggregate demand seen in recent quarters has led to a significant jump in capacity utilization in many industries which, together with the low funding costs, is clearly adding momentum to investment activities in the economy (see **Section 2.2.3** for details).

#### **Growth in Use-based Industrial Groups**

In terms of use-based classification, all the sectors continued to depict acceleration, with output growth in each major category rising YoY during H1-FY04 (see **Table 2.5**).

The consumer goods, however, contributed more than half of the industrial growth during H1-FY04.

Higher output of consumer goods, particularly in durables, was the reflection of higher consumer spending, while higher growth in the production of capital goods, along with rising imports, shows the resumption of investment demand amidst increasing confidence in the economy (see **Figure 2.14**).

**Table 2.5: Growth of Industrial Production –Use-based Classification during H1**

Percent				
Sectors	Weights	FY02	FY03	FY04
Basic goods	18.8	21.8 (86.5)	4.3 (22.2)	6.0 (12.5)
Intermediate goods	40.2	4.0 (30.5)	2.9 (24.4)	6.8 (23.0)
Consumer goods	37.3	-2.8 (-15.2)	8.5 (47.2)	23.5 (57.1)
- Non-durables	35.1	-4.5 (-20.9)	3.8 (17.9)	16.7 (31.9)
- Durables	2.2	7.4 (5.6)	34.0 (29.3)	48.7 (25.3)
Capital goods	3.7	-5.3 (-1.8)	18.2 (6.2)	46.6 (7.3)

Source: Based on data from FBS

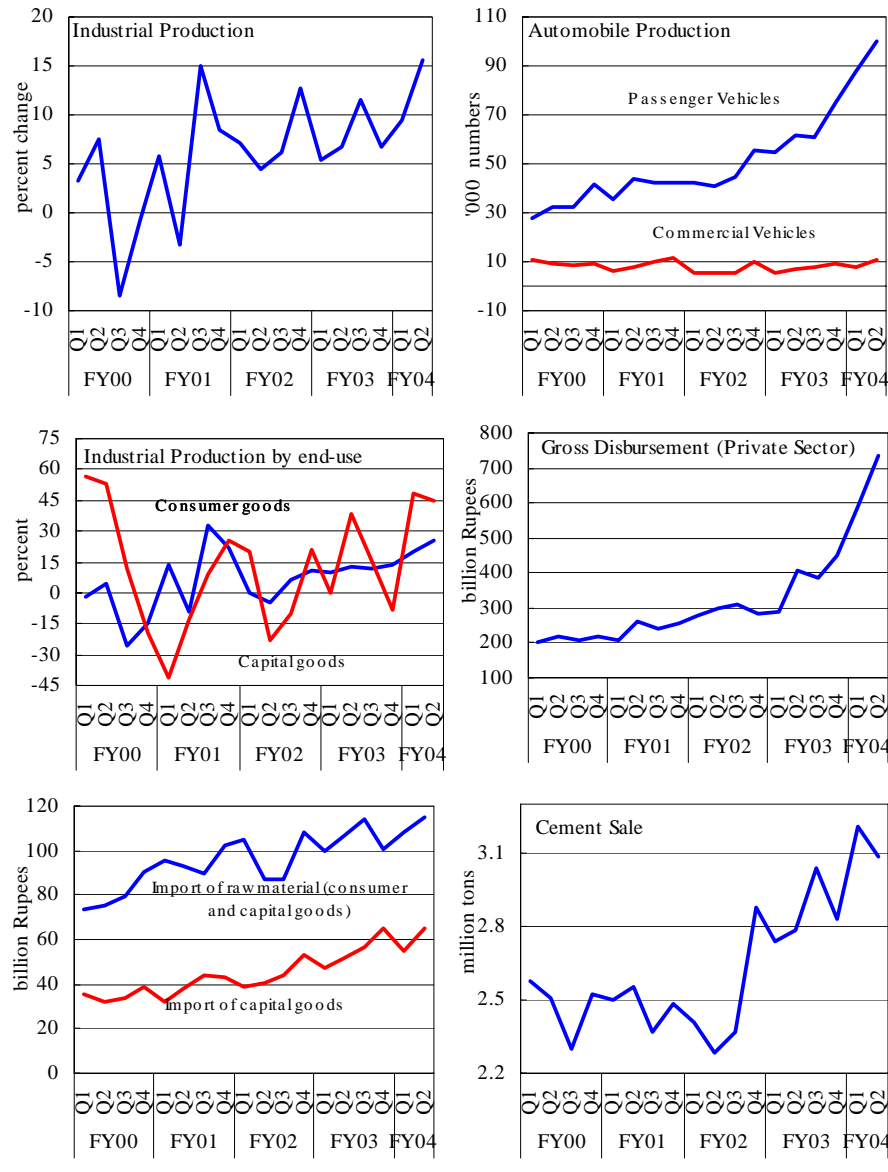
Note: Figures in parenthesis represents weighted contribution to industrial growth.

<sup>23</sup> Demand for fuel oil i.e. furnace oil also declined due to substitution of thermal with hydel power and greater availability of gas. While the export of furnace oil from Pakistan has not yet started.

**Table 2.6: Components of Use-based Sectors**

<b>Basic goods</b>	<b>Consumer goods</b>	<b>Intermediate goods</b>
Electricity	<b>A. Non-durables</b>	Cotton (ginned)
Coke	Sugar	Pig Iron
Coal	Vegetable ghee	Billets
Crude oil	Cigarettes	H.R Sheets/Strips
Hydrochloric acid	Tea Blended	C.R coils/Plates/Sheets
Limestone	Beverages	Formed sections
Chlorine gas	Cooking oil	Caustic soda
Rock Salt	Tablets	Soda ash
Aragonite marble	Liquid/Syrup	Natural gas
Barites	Injections	Cotton yarn
China clay	Capsules	Jute goods
Gypsum	Galenicals (tincture)	Woolen & carpet yarn
Sulphuric acid	Ointment	Knitting wool
Chromite	Polishes & creams	Paints & varnishes (liquid)
Arg-Clay	Bulbs	Paints & varnishes (solid)
Antimony	Electric tubes	Petroleum products
<b>Capital Goods</b>	Cotton cloth	Nitrogenous
Electric transformers	Paper & board	Phosphatic
Electric meters	Leather footwear	Upper leather
Electric motors	Safety razor blades	Sole leather
Trucks	<b>B. Durables</b>	Cement
Tractors	T.V Sets	Glass plates & sheets
L.C.Vs	Air conditioners	
Buses	Refrigerators	
Diesel engines	Cars & jeeps	
Power looms	Motor cycles	
Wheat thrashers	Bicycles	
Chaff cutters	Sewing machines	
Sugarcane machines	Motor tyres	
Shuttles	Cycle tyres	
Switch gear	Cycle tubes	
Bobbins	Motor tubes	

**Figure 2.14: Industrial Indicators**

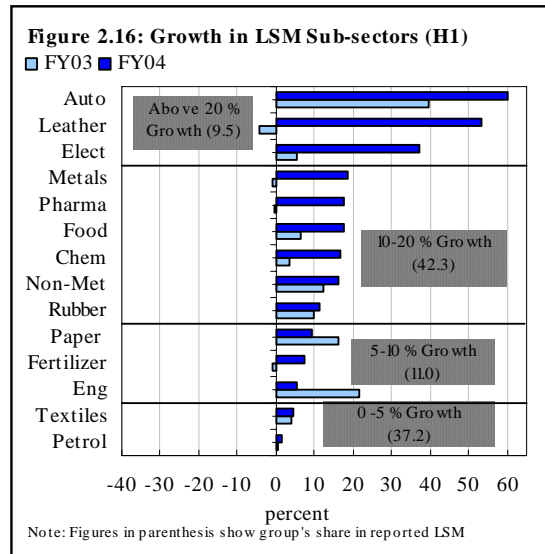
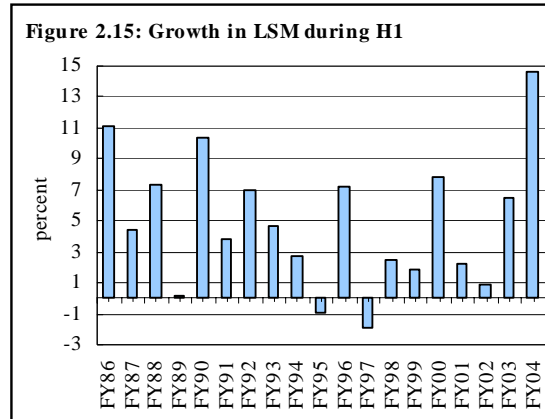


### 2.2.1 Large Scale Manufacturing

The upturn in manufacturing output during Q1-FY04 further strengthened during Q2-FY04; the Quantum Index of Manufacturing (QIM), based on 91 LSM items, grew by 17.3 percent during Q2-FY04, compared to the 11.7 percent seen in Q1-FY04. This helped push the aggregate H1-FY04 LSM growth to a remarkable 14.7 percent—the strongest increase in LSM output for the first half of a fiscal year at least for the last 19 years (see **Figure 2.15**).

Moreover, the H1-FY04 LSM growth remained remarkably broad based. Not only did all 14 LSM sub-sectors see an increase in output, most witnessed acceleration, even over the already high growth in the same period last year (see **Figure 2.16**). As a result, as many as 80 out of the 91 LSM items covered in the QIM saw increase in output during H1-FY04 (see **Table 2.7**).

Interestingly, the expected drag on LSM growth due to the delayed sugarcane crushing during FY04 was not very evident in H1-FY04. This was probably attributable to record high production during the month of December 2003, which has more than offset the



shortfall in refined sugar production during preceding months of H1-FY04.<sup>24</sup> This was because of higher capacity utilization by mills as well as the higher recovery rate from crushed cane by virtue of the late crushing.<sup>25</sup>

**Table 2.7: Production of Selected Large-scale Manufacturing Items during H1**

Items	Weights	Percentage		Items	Weights	Percentage	
		FY03	FY04			FY03	FY04
<b>Textile</b>	<b>12.930</b>	<b>3.8</b>	<b>4.7</b>	<b>Chemicals</b>	<b>1.583</b>	<b>3.5</b>	<b>16.5</b>
Cotton yarn	6.001	6.3	1.9	Caustic soda	0.421	2.5	15.0
Cotton cloth	3.310	-2.2	17.5	Soda ash	0.217	28.3	3.3
Cotton ginned	2.640	-3.7	3.3	Other six items	0.945	-2.2	22.7
Other five items	0.980	15.3	19.8	<b>Electronics</b>	<b>1.512</b>	<b>5.6</b>	<b>37.3</b>
<b>Food, beverages &amp; tobacco</b>	<b>11.755</b>	<b>6.4</b>	<b>17.5</b>	Electric transformers	0.391	38.9	71.3
Sugar	5.852	13.6	23.5	TV sets	0.246	127.7	-9.3
Vegetable ghee	2.037	-1.6	4.6	Air conditioners	0.081	-13.0	656.5
Cigarettes	1.699	-9.1	11.8	Refrigerators	0.010	15.4	71.5
Tea	1.210	1.9	1.5	Other five items	0.783	-12.8	50.7
Beverages	0.654	-1.5	19.2	<b>Automobile</b>	<b>1.592</b>	<b>39.5</b>	<b>60.2</b>
Cooking oil	0.304	11.2	19.8	Trucks	0.473	141.9	13.7
<b>Petroleum products</b>	<b>5.305</b>	<b>0.6</b>	<b>1.6</b>	Tractors	0.402	9.0	47.7
<b>Fertilizers</b>	<b>3.981</b>	<b>-1.0</b>	<b>7.4</b>	LCVs	0.250	47.9	4.4
Nitrogenous	3.689	1.5	5.0	Cars & jeeps	0.210	41.3	70.0
Phosphatic	0.292	-37.3	65.4	Motorcycles	0.169	38.2	63.0
<b>Pharmaceuticals</b>	<b>3.583</b>	<b>-0.5</b>	<b>17.8</b>	Buses	0.088	91.1	-19.1
Tablets	1.834	-1.7	16.5	<b>Non metallic minerals</b>	<b>1.299</b>	<b>12.5</b>	<b>16.2</b>
Syrup	1.086	2.0	20.8	Cement	1.252	10.5	16.7
Injections	0.316	-3.3	11.0	Glass sheets	0.047	80.0	6.7
Capsules	0.155	-1.9	29.6	<b>Paper &amp; board</b>	<b>0.921</b>	<b>16.2</b>	<b>9.2</b>
Other two items	0.192	0.3	8.5	<b>Engineering items</b>	<b>0.483</b>	<b>21.3</b>	<b>5.3</b>
<b>Metal industries</b>	<b>2.166</b>	<b>-0.8</b>	<b>18.6</b>	Bicycles	0.236	13.7	1.4
Pig iron	1.002	-2.3	20.1	Safety razor blades	0.074	3.4	-1.4
Coke	0.894	-3.5	20.2	Diesel engines	0.044	1810.	34.9
Billets	0.211	1.3	16.6	Sewing machines	0.035	10.4	27.2
H.R/coils and plates	0.050	15.7	10.0	Power looms	0.035	28.6	49.4
C.R coils/plates/sheets	0.009	11.6	10.3	Other five items	0.059	-0.7	1.9
<b>Leather products</b>	<b>1.582</b>	<b>-4.5</b>	<b>53.5</b>	<b>Tyres &amp; tubes</b>	<b>0.306</b>	<b>9.8</b>	<b>11.4</b>

Note: The weights of the individual industries are adjusted so as the total weight turn out to be 49.008, exactly the same as the share of LSM in industrial value added during 1980-81.

<sup>24</sup> Carry over stock (727,652 tons) with mills and depressed sugar prices were the major factors behind delayed crushing during FY04.

<sup>25</sup> Due to delayed crushing, the farmers increased supplies to mills enabling them to start full fledge crushing. Also, the delay resulted in mature crop that yields higher sugar.



A further analysis shows that the overall LSM growth during this half of FY04 remained well above 10 percent even if high performers such as sugar, automobile and electronics are excluded from the calculations (see **Table 2.8**).

**Table 2.8: Summary of Growth Rates**  
percent

	H1-FY02	H1-FY03	H1-FY04
Overall	0.9	5.3	14.7
Excl. sugar	0.9	4.7	14.0
Excl. automobile	1.1	3.6	11.6
Excl. electronics	0.6	5.3	13.6
Excl. auto & electronics	0.7	3.5	10.3

Source: Based on data from Federal Bureau of Statistics

This depicts the robustness of H1-FY04 growth compared to that in the comparable periods of the preceding two years.

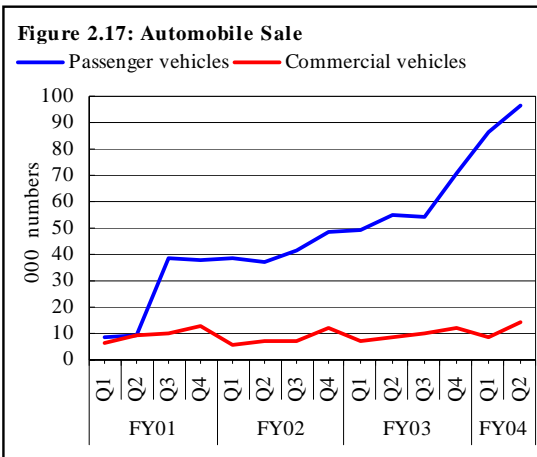
Consumer financing (auto, mortgage—housing finance and personal loans), higher farm income and lower interest rates have largely contributed in raising domestic consumption (see **Table 2.9**). The impact of higher domestic consumption was particularly visible in the production of consumer durables, cement and other related industries such as paints, glass, basic metals, industrial chemicals, tyres & tubes, packaging material etc.

**Table 2.9: Outstanding position of Consumer Financing**  
billion Rupees

Heads	Q1-FY04	Q2-FY04
Credit cards	8.0	8.9
Auto loans	16.9	22.2
Home appliances	0.6	1.6
Housing finance	3.4	4.1
Others (personal loans)	25.0	28.7
<b>Total</b>	<b>53.8</b>	<b>65.6</b>

The Q2-FY04 auto loan figures also include Rs 2 billion lease from NIB.

More specifically, the steep rise in the sale of passenger vehicles (cars, jeeps and motorcycles), has mainly been on the back of consumer financing (see **Figure 2.17**).



However, exceptionally sustained rise in demand has meant that delivery lags did have declined substantially, and the premium for prompt delivery persists (although they have declined somewhat in recent months). The perceived failure of the industry to narrow the supply

demand imbalance has prompted the government to permit import of cheap used vehicles. This measure is bitterly opposed by manufacturers concerned over the fate of industry and potentially devastating impact on current and planned investment (for details see **Box 2.2**).

During H1-FY04, sale of tractors also increased as commercial bank financing increased that more than offset decline in financing from Zarai Traqiati Bank for the purchase of tractors.<sup>26</sup> However, sales of other commercial vehicles' (trucks and buses) are yet to follow the trends in passenger vehicles' sale. One reason for this has been the increasing import of buses under the Urban Transport Schemes.

Construction is another sector that benefited from the increased availability of consumer financing, which bolstered the activity generated from higher public sector development expenditure. The higher activity is clearly proxied by the rising demand in industries such as cement, paints, glass, home fitting & fixtures and basic metals as well as the rising disbursement of housing finance loans during H1-FY04 (see **Table 2.10**).

**Table 2.10: Construction Indicators during H1**

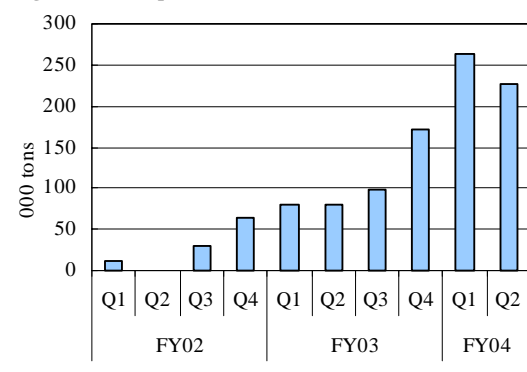
	Unit	FY02	FY03	FY04
Cement sale	Million tons	4.7	5.5	6.3
Iron & steel (Pakistan Steel sale plus imports) <sup>1</sup>	-do-	0.97	1.17	1.19
Import of construction & mining machinery	Million Rupees	3329.7	2734.3	2960.9
Housing finance (Disbursement for construction) <sup>2</sup>	Million Rupees	3.8	227.4	968.3

<sup>1</sup>Excluding the import of iron & steel scraps.

<sup>2</sup> FY04 also includes disbursement from commercial banks also.

The rising demand has contributed to the hike in building material prices since January 2003. While, revival of manufacturers cartel in March 2003 had already pushed cement prices up (Rs 220-235 per bag), the manufacturers did not pass on the impact of reduction in excise duty (by 25 percent) in federal budget for FY04. In

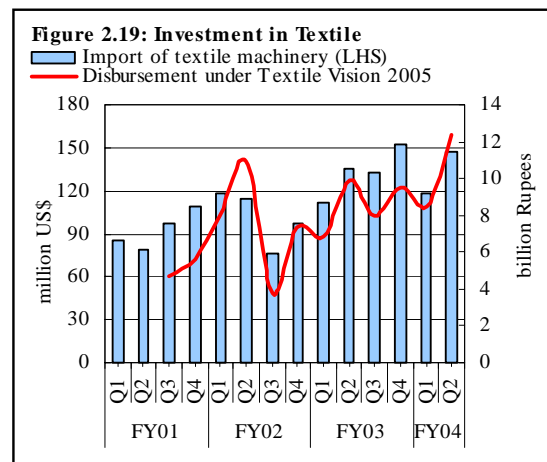
**Figure 2.18: Export of Cement**



<sup>26</sup> The financing for the purchase of tractors (by commercial banks and ZTBL) doubled from Rs 1.5 billion during H1-FY03 to Rs 3.0 billion in H1-FY04.

addition to demand from domestic construction, the cement production has also received boost from exports to Afghanistan (see **Figure 2.18**). On the other hand, the prices of iron bar and bricks increased by 37.8 and 25.2 percent in December 2003 compared to last year. The rise in steel prices principally followed the trend in world steel prices that further bolstered by the growing demand from automobile and engineering goods and exports to Afghanistan during H1-FY04. This state of affairs, if continued, may lead to slowdown in construction activities in particular, and the related industries in general.

The production of textiles<sup>27</sup> also kept pace with the growth in most other LSM sub-sectors, despite record high cotton prices. This resilience of the Pakistani textile industry appears to owe much to strong export demand as well as the low funding costs and the ongoing investment in installed capacity and in Balancing, Modernization and Replacement (BMR). Import of textile machinery since FY01 has reached a level of US\$ 1.6 billion. The disbursements under Textile Vision 2005, increased by 7.7 and 24.5 percent respectively during H1-FY04 (see **Figure 2.19**).



A remarkable growth in pharmaceutical products during H-FY04 (17.8 percent increase compared a decline of 0.5 percent in the same period last year), was mainly attributable to a 33.5 percent increase in exports.<sup>28</sup> On the other hand, higher growth in fertilizers was largely demand driven and also due to resumption of DAP production at a large domestic unit.

<sup>27</sup> This has been mainly due to higher growth in cotton cloth production. In fact, the FBS started to include production estimates from large informal sector from July 2003.

<sup>28</sup> According to a notification of CBR (S.R.O.112/2003) all the pharmaceutical raw materials imported for the manufacture of exportable products will get duty drawback facility: Tablets at the rate of 4.15 percent, Liquids 2.50 percent, Creams/Ointment 2.62 percent, Injections 3.31 percent and Intravenous solutions 2.04 percent of the f.o.b. value.

### Capacity Utilization

During H1-FY04, capacity utilization in many industries saw a marked improvement over the preceding year. Significant gains were recorded by food, consumer durables, while industries like chemicals, fertilizer, petroleum refining, paper & paper board, etc. continued to strengthen. Data in **Table 2.11** shows that there has been an across-the-board increase in capacity utilization by all industry groups. This answers the often repeated question as to how LSM sector can record double-digit growth rates when there has been no new investment in these manufacturing industries. Thus new investment is underway in cars, industrial chemicals, and steel as the existing capacity can no longer meet the burgeoning demand.

**Table 2.11: Capacity Utilization in Selected Industries**

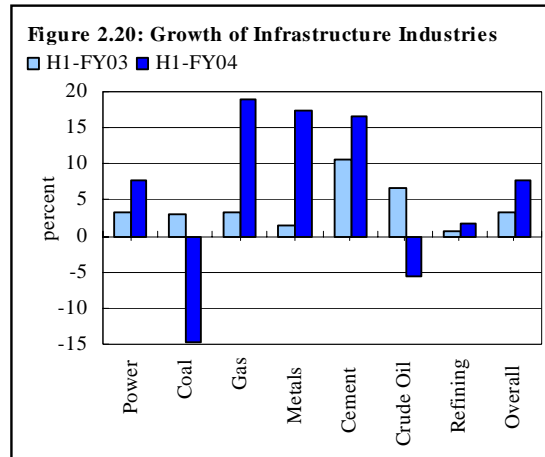
Industry (by groups)	Capacity Utilization			
	FY02	FY03	H1-FY03	H1-FY04
Food (ghee & cooking oil)	34.7	32.6	41.1	64.0
Consumer durables	46.7	60.4	54.6	86.6
Cars Jeeps & LCVs	42.8	65.0	59.9	97.6
Trucks & Buses	22.9	33.7	33.2	32.5
Tractors	73.7	80.3	67.5	99.6
Appliances (Refrigerators and air conditioners)	26.9	34.1	24.2	43.8
Cement	60.5	67.8	65.2	75.0
Steel (Pakistan Steel)	81.0	91.0	81.4	96.4
Industrial chemicals (soda ash and caustic soda)	86.1	94.5	92.5	100.1
Fertilizer	88.0	90.7	96.4	103.8
Petroleum refining	81.2	83.3	95.0	96.5
Paper & paper board	82.7	95.1	95.3	104.1

### 2.2.2 Infrastructure Industries

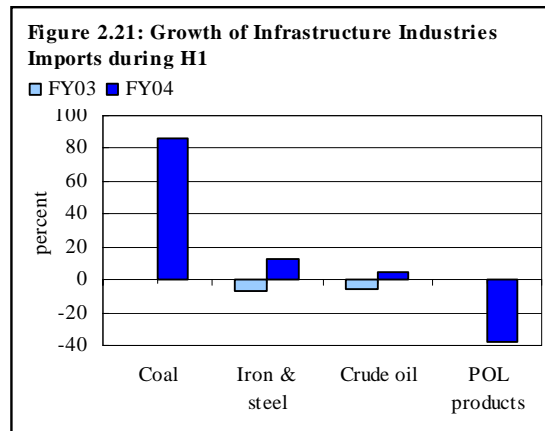
The overall growth of infrastructure industries accelerated during H1-FY04. The composite index of seven infrastructure industries, with a combined weight of 19 percent in IIP, saw an increase of 7.7 percent during H1-FY04 compared to a rise of 3.2 percent in the same period last year. The output of five infrastructure industries increased sharply while that of coal and crude oil declined (see **Figure 2.20**).

However, the growing use of natural gas in industry and transportation (CNG), coupled with higher exploration and development of gas fields, led a remarkable growth (more than 15 percent) in its production during H1-FY04 compared to a moderate growth of 3.3 percent in the same period last year.

The higher growth in electricity generation was mainly due to improvement in water availability following the good FY04 monsoon and the initiation of commercial operations by the Ghazi Brotha project. As a result, capacity utilization in hydel power projects increased (and that of thermal went down slightly), which was also translated into lower demand for fuel oil, particularly during the month of November 2003.



Surprisingly, the output of crude oil declined despite the fact that outflow of foreign exploratory companies' profits increased during the first half of FY04. On the other hand, the decline in the production of coal is partially explained by rising imports. The import of coal witnessed an increase of more than 80 percent despite higher world prices (see **Figure 2.21**).<sup>29</sup> Another possible reason was under reporting by coal mines (in private sector) to avoid a 15 percent GST.

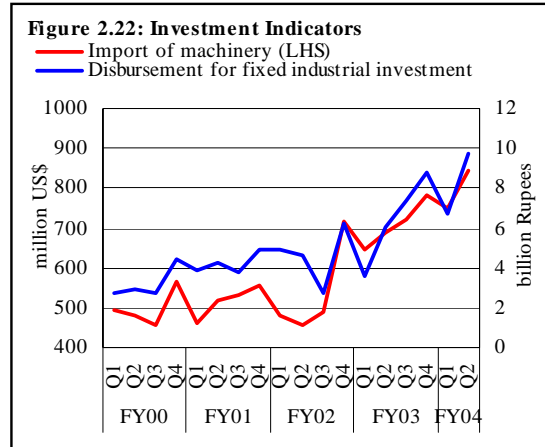


<sup>29</sup> The major reason behind growing imports is that imported coal remains cheaper in terms of heating content.

### 2.2.3 Investment Scenario

The indicators such as project financing, flow of foreign direct investment and rising import of machinery, coupled with domestic production of capital goods reflects the improvement in investors' confidence. The trend in disbursement for fixed industrial investment (project financing) since Q3-FY03 has been significantly higher than the quarterly average seen during the preceding two years (see **Figure 2.22**).

The textile sector attracted the major part of industrial investment, followed by the sugar, cement and transport sectors. Bank disbursement for fixed industrial investment reached Rs 10 billion by the end-December 2003 from Rs 6.0 billion by the end-December 2002.



**Box 2.2: Liberalizing New/Used Car Imports and the Domestic Industry**

During the last two years, the easy availability of consumer credit has catalyzed a huge surge in demand for automobiles, especially cars and motorcycles. The demand for cars, in particular, far outstripped supply, resulting in a long waiting period for customers. However, the rising demand, coupled with prevalent low interest rates, provided speculators with an incentive to accumulate stocks in order to charge a premium for early delivery. The industry responded to rising demand by sharply ramping up production, with FY04 production expected to reach close to 90,000 units, more than twice that in FY01 (see **Table 1**). While the sharp increase in production certainly helped reduce delivery lags, as well as the premium for immediate availability, these problems have not yet been eliminated. Thus, consequent to the growing public demand for relief, the government announced its intention to: (1) reduce the import duty on cars as well as car parts (by an unspecified margin); and (2) permit limited import of used cars.

**Table 1: Production of Cars**

FY01	40,032
FY02	41,165
FY03	63,267
H1-FY04	44,433

The public case for the removal/reduction in protections for the auto-industry is simply based on the belief that domestic manufacturers were taking undue advantage of the privilege market access to reap windfall gains with little benefit to the country in terms of transfers of technology, increased investments, and job creation. Moreover, there is seemingly little point in protecting a domestic market that is apparently uncompetitive internationally, given that Pakistan is soon expected to accede to a WTO- mandated reduction in tariff and non-tariff barriers. However, as often the case, the argument for the retention or removal of protections for the auto industry is not quite as simple as it appears. A closer look at the issues suggests that the government has to strike a very delicate balance between consumer welfare and the need to develop engineering industry and foster investor confidence by avoiding abrupt policy shifts.

***The arguments for the industry view***

There is no doubt that the automobile industry can act as a catalyst for the development of engineering and other supporting industries, which has led countries such as Malaysia and India to protect their automobile industries (Even the Malaysia has obtained temporary exemption from Asian Free Trade Areas members till 2005 and the import duty is as high as 200 percent). Though India has lately allowed import of second hand cars, the import duty is the same as applicable on the import of new cars (105 percent plus other duties).

This route was also followed by Pakistan<sup>30</sup> and has led to large investments by the auto assemblers and vendors have made an investment of approximately US\$ 1 billion, providing thousands of jobs and contributing billions in taxes to the national exchequer of rupees and to GDP over the years. More to the point, the surging demand in recent years has encouraged the industry to plan major capacity expansions, to redouble production again over the next years and reap economies of scale that would help bring down prices, as well as reduce delivery lags for consumers (see **Table 2**).

<sup>30</sup> As consequent to heavy protection (import duty on various engine capacity cars ranging 110 to 445 percent in early 1990s; 75 to 150 percent in FY04 and banning import of used cars),

**Table 2: Automobile Industry's Contribution in Economy (2001-02)**

	Unit	Assemblers	Vendors	Total	Projected till June 2004
Investment	million US \$	210	699	909	1707.0
Foreign exchange saving	million US \$	84	280	364	1252.0
Contribution to GDP	billion Rupees	25	23	48	153.9
Contribution to national exchequer	billion Rupees	7	5	12	51.5
Employment	000 numbers	n/a	n/a	140	171

Source: Experts Advisory Cell and Pakistan Auto Manufacturers Association

The industry also argues that relatively low investment growth pre-FY01 and the relatively inefficient (costly) production was significantly attributable to policy shocks (import based “yellow cab scheme, permission to import reconditioned cars, etc) as well as the absence of economies of scale. There is certainly *some* merit in these arguments. Moreover, the presence of the auto assemblers *has* led to the development of an internationally competitive vendor industry in the country, as indicated by the fact that exports of auto parts have jumped from Rs 328 million in H1-FY03 to Rs 637 million in H1-FY04.

Further, the industry also argues that current shortage in supply is artificial, due to speculative demand. Accordingly, it has demanded administrative measures such as delivery of cars only in the name of initial buyers and imposition of a material financial charge for early transfer of ownership to discourage such demand. However, despite the obvious merits of such measures, these have apparently not found favor with the provincial governments.

The industry's arguments in support of the retention of barriers to encourage investment and improve efficiency would typically be less compelling in an environment of growing global integration. In this environment, the only compelling reason for the continuation of protections to the auto industry circle on the need to:

- (1) reassure investors against abrupt policy shifts, and
- (2) allow the domestic industry some *limited* breathing room to adjust to the inevitable exposure to international competition.

However, given that industry protections involve loss of consumer welfare, even time-bound benefits can be offered to the domestic industry only against assurance of continued investment to increase efficiency, and ensure time-bound increase in production to ensure the elimination of the shortages and associated premiums for immediate delivery against orders.