2 Real Sector

2.1Agri-performance

Initial data for the FY08 *kharif* cropping season indicates that the sugarcane harvest recorded a new high of 62.3 million tons. This owed not only to better water availability and favorable weather, but also reflected high sugarcane prices realized in the preceding years, that encouraged farmers to bring more acreage under sugarcane and to invest in improving the yield. The maize and rice crops also witnessed increases both in output and yield during *kharif* FY08, although the area under each of the crops declined. However, a decline in cotton and a significantly lower than targeted rice harvests, mainly as a result of lower acreage under the crops, offset much of these gains. In this background, it is clear that the realization of the 4.8 percent agriculture growth target for FY08 will now hinge on a good showing of *rabi* crops (the wheat harvest, in particular), as well as a robust performance by the livestock sub-sector.

A silver lining for the prospects of the agriculture sector is the persistent increase in prices of many agricultural products, such as wheat, milk, rice etc (see **Box 2.1**). This has been instrumental in motivating farmers to use appropriate quality and quantity of inputs, and to invest to raise productivity. Thus, even as input prices have risen, farmers' appetite for institutional credit has also increased, despite rising interest rates. It is in recognition of this demand that the central bank has set an indicative agri-credit disbursement target of Rs 200 billion for FY08, which is 18.5 percent higher than the actual annual disbursement in FY07. The disbursement trend for Q1-FY08 suggests that the eventual full-year FY08 outcome will be close to the annual target.

2.1.1 Crops

The disappointing performance of the FY08 *kharif* harvest principally reflects problems in timely and adequate availability of water in some areas, while others were hit by untimely rains and floods. Moreover, the cotton and rice crops, in particular, were hit by pest attacks.

Ironically, the excessive water was favorable for sugarcane, and as farmers were already encouraged by the high sugarcane prices in the previous season[1], the

[1] It is interesting to note that though the major use of sugarcane is to produce refined sugar, however, increasing external demand for *gur* at even higher prices than sugar also altered the farmers' choice between sugarcane and other crops.

acreage under the crop increased substantially during *kharif* FY08, at the expense of the other crops (see **Table 2.1**). As a result of the increase in area under sugarcane crop and a higher yield, the FY08 sugarcane output touched a historically high level of 62.3 million tons, up by 13.5 percent

Table 2.1: Shift in Planted Area Under Kharif Crops

(000/hectares)

Years	Rice	Sugarcane	Maize	Cotton
FY02	-263	39	-2	189
FY03	111	100	-7	-322
FY04	236	-26	12	195
FY05	58	-108	35	204
FY06	102	-59	60	-90
FY07	-39	126	2	-31
FY08[E]	-99	114	-43	-37

E: Estimates

Source: MINFAL

Box 2.1 Agri-Commodity Prospects

Increased global demand of major cereals, following low stocks and a fall in production in some key exporting countries, pushed up prices of key food commodities including wheat and rice (see **Figure 2.1.1**). FAO project that despite an increase in global wheat production, prices will increase further. Rise in prices may also be due to increased cost of production, principally attributed to higher transportation as well as energy cost. The report further stated that soaring petroleum prices have driven up prices for agricultural crops by raising input costs and by boosting demand for those crops used to produce bio-fuels.

FAO (Food Outlook) warns that the combination of high petroleum prices and the desire to address environmental issues is likely to further boost demand for feed stocks, especially sugar, maize, rapeseed, soybean, palm oil and other edible oil crops as well as wheat, for years to come. It suggested that rising prices will encourage wheat plantation during FY08. As a result of increased wheat production and assuming normal growth in consumption, global wheat prices may ease somewhat (see **Table 2.1.1**). High feed prices have also increased the cost of rearing animals and resulted in an increase in the prices of dairy products.

Figure 2.1.1: International Prices

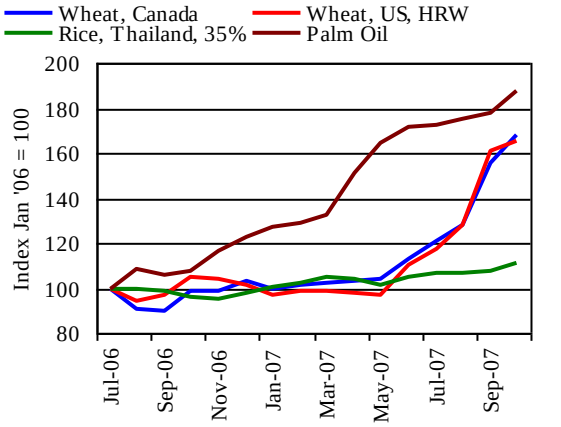


Table 2.1.1: Global Wheat Outlook

million tons

	Change in production		Change in consumption	
	FY07	FY08	FY07	FY08
World	-28.05	9.69	-7.26	0.37
China	7.07	1.53	0	-0.50
USA	-7.96	6.93	-0.32	0.28
India	0.71	5.54	3.39	2.49
Pakistan	1.69	0.70	0.40	0.50
Australia	15.47	3.10	1.0	-1.70
Canada	-0.48	-4.67	0.42	-0.24
EU-27	-7.56	-3.94	-2.03	-4.80
Russia	-2.80	3.10	-2.0	0.80
Others	-1.65	-4.20	-8.1	3.50

Source: USDA and MINFAL

YoY, on top of an impressive rise of 22.9 percent YoY seen in the preceding year.

It is worth mentioning here that the country had seen strong sugarcane harvests in earlier years as well (e.g. 53.8 million tons in FY04). However, following repeated disappointment due to lower than anticipated prices in the preceding years - prices offered were often lower than pre-announced procurement prices - and delayed crushing, farmers were loosing their interest in this crop. Therefore, to sustain a high production level of sugarcane, the pricing mechanism should be improved with timely beginning of crushing season. Delay in sugarcane crushing not only reduces the sugar output, but it is also responsible for lowering wheat sowing area and decline in yield.[2] The record FY08 sugarcane harvest has raised concerns that millers might seek to delay crushing to lower price this year as well. However, the millers' tactics may not be as effective as in previous years, since farmers now also have an attractive export market for "*gur*".

Another development favoring the sugarcane crop in recent years is the repeated incidence of pest attacks on the cotton crop. The resulting rise in pesticide usage and lower profitability is also a factor favoring the substitution away from cotton during the last three years. During FY08, the cotton yield was hit principally by the mealy bug and Cotton Leaf Curl Virus (CLCV).

In Pakistan, the cotton harvest requires higher cost for seeds, fertilizers and pesticides (particularly during excessive rains) than sugarcane. Also land vacated by cotton is less fertile than sugarcane for the following *rabi* crops. Traditionally, farmers sowing cotton were benefitting from good prices. However, in recent years, crop becomes unattractive as the gains have weaker due to high incidence of pest attacks. Thus, sustainable growth of cotton requires (1) increase in research, development and extension services, particularly in genetically modified varieties, which are more resistant to viral attacks (2) technology advancement to enhance yields, (3) availability and efficient use of irrigation water, and (4) timely availability of funds through simplifying lending procedures by the banks. The rise in the production of cotton is important amidst to its importance in the economy and growing domestic consumption.

[2] The Pakistan Agriculture Research Council (PARC) suggested on the basis of field studies/surveys that better wheat yield may be obtained, if sowing has to be completed before end November. After optimal period of sowing, wheat yield reduced sharply. The stakeholders require to strictly enforcing deadlines of sugarcane crushing by the mills and educate farmers to complete planting wheat within November to maximize the production potential levels for both crops. A wheat field study on Causes of wheat yield decline in the irrigated Punjab by Arshed Bashir, M. Ather Mahmood, A.D. Sheikh and Muhammad Kashif- published in Journal of Agriculture Research-2006, No.44.

Finally, although prices of rice rose significantly during FY07, floods restricted farmers from increasing the area under rice. In addition, the area under rice also dropped due to farmers' preference for sugarcane. As with cotton, the rice crop was also damaged due to higher incidence of leaf blight disease, especially on the super basmati variety in the Punjab. Rice crop was further damaged by flood as well as pest attack (leaf folder) in Shikarpur, Larkana, Jacobabad, Kashmore and Qambar districts of Sindh. Despite these problems, price incentives are clearly working here too, as the crop witnessed a rise in yield during FY08 (see **Table 2.2**).

Table 2.2: Performance of Major Crop

Crops	FY06	FY07^{T}	FY07^{P}	FY08^{T}	FY08^{E}	% change in FY08 over FY07
Area under cultivation (000 hectares)						
Cotton	3,100	3,072	3,248	3,250	3,035	-6.6
Sugarcane	907	1,005	1,029	1,040	1,147	11.5
Rice	2,621	2,575	2,581	2,594	2,483	-3.8
Wheat	8,448	8,459	8,578	8,578	-	-
Gram	1,029	1,051	1,074	1,120	-	-
Maize	1,042	1,001	1,038	1,001	1,001	-3.6
Production (000 tons; cotton in 000 bales of 170.09 kg each)						
Cotton	13,019	13,820	12,856	14,140	12,775	-0.6
Sugarcane	44,651	50,500	54,871	55,871	62,300	13.5
Rice	5,547	5,693	5,439	5,721	5,489	0.9
Wheat	21,277	22,000	23,295	24,045	-	-
Gram	536	707	848	707	-	-
Maize	3,110	3,279	2,907	3,221	3,247	11.7
Yield (Kg/hectare)						
Cotton	714	724	720	740	719	-0.1
Sugarcane	49,229	50,249	53,325	53,722	54316	1.9
Rice	2,116	2,211	2,107	2,205	2211	4.9
Wheat	2,519	2,601	2,716	2,803	-	-
Gram	521	673	790	631	-	-
Maize	2,985	3,276	2,801	3,218	3244	15.8

P: Provisional, T: Target, E: Estimates

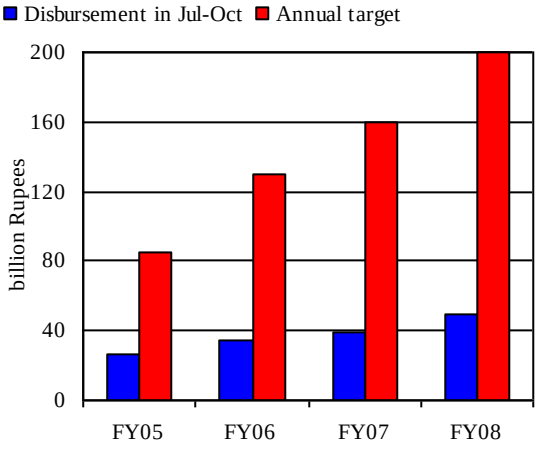
Source: MINFAL

2.1.2 Credit Disbursement

A strong growth in Q1-FY08 suggests that agri-credit disbursement is likely to be close to the target of Rs 200 billion for the year (see **Figure 2.1**). The strength in demand for agri-credit is mainly stemming from (1) higher prices of fertilizers as

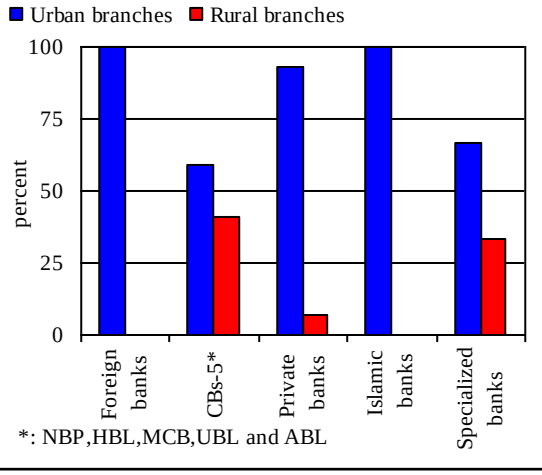
well as (2) rise in use of inputs on the back of higher prices of agriculture produce. However, it should be remembered that a weaker 12.9 percent rise in agri-credit disbursement during Jul-Oct FY07 was a result of delayed purchase of fertilizers in anticipation of announcement of subsidy. Therefore, an acceleration in disbursement (27.2 percent increase) during the first four months of FY08 may gradually dissipate in months ahead.

Figure 2.1: Agriculture Credit



Despite a continued strong growth of agri-credit disbursement, small farmers' access to institutional credit is still limited. This fact becomes a source of concern since small farmers account for 80 percent of aggregate land holding.[3] The major reason for the poor credit access to small farmers is non availability of financial infrastructure in rural areas and the poor performance of provincial governments in documentation of land titles. While rural population is approximately 67.0 percent of total population of the country, rural areas have only 33.0 percent of total bank branches (see **Figure 2.2**).

Figure 2.2: Proportion of Bank Branches



[3] Land holdings of upto 20 acres, Source: Agricultural Census 2000.

There is clearly a need to extend the outreach of bank branches to improve access to institutional credit as well as to exploit huge base of small depositors in these areas. Thus, SBP issued directives to all commercial banks that 20 percent of their new branches should be opened in rural and underserved areas.[4] This would probably help speed up financial inclusion of rural areas of the country.

Table 2.3: Agri-Credit Targets for FY08

	Amount billion Rupees	Share in total (percent)
Punjab	156	78
Sindh	28	14
NWFP	12	6
Balochistan	3	1.5
AJK & Northern Areas	1	0.5
Total	**200**	**100**
Purpose-wise Agri-credit targets		
Farm sector	160	80
Crop sector	*152*	*76*
Orchards	*8*	*4*
Livestock	22	11
Poultry	8	4
Fisheries	6	3
Others	4	2
Total	**200**	**100**

Under agri-credit policy initiatives, along with bank-wise targets, province-wise targets were also fixed for the first time in FY08 (see **Table 2.3**). This will enable banks to allocate funds for smaller provinces and regions. Furthermore, strategy paper of Agriculture Credit Advisory Council (ACAC) plans a roadmap to increase the outreach level of financial services to about 3.3 million rural clients/households upto 2010 from the existing 1.63 million.

Despite efforts, several issues regarding improvement of lending environment in Sindh, NWFP and Balochistan are not settled so far. Some of the major bottlenecks in agri-credit disbursement in these areas include: (1) the process of issuance of passbooks in Sindh is extremely slow where more than 250 thousand farmers do not have the passbooks, (2) issuance of bogus passbooks, (3) lack of one window operation facility, and (4) law and order situation in Balochistan. Issuance of passbooks through computerization could speed up the process as well as help to control the bogus issuance of passbooks. Implementation of one-window operation by all banks with friendly environment to farmers and faster process of loan applications would certainly help to increase the number of borrowers as well as the average size of agri-credit.

[4] BPRD Circular No. 15 dated October 12, 2007.

A greater focus of specialized and commercial banks is on increasing the access of the rural economy to financial services through (1) increasing branch network in remote areas (2) introduction of easy, simplified procedures with minimum documentation, as well as (3) by providing customized training to their staff dealing with farmers and relatively less educated clients.

Recovery

Similar to a robust growth in agri-credit disbursement, recoveries also witnessed an encouragingly higher growth during Jul-Oct FY08 (see **Table 2.4**). It is important to note that while the recovery performance of the commercial banks is satisfactory during the first four months of FY08, both specialized banks exhibited poor recoveries in this period. However, given their weaker growth in credit disbursement, poorer recoveries are not unanticipated.

Table 2.4: Growth in Agri-credit Recoveries (Jul-Oct)

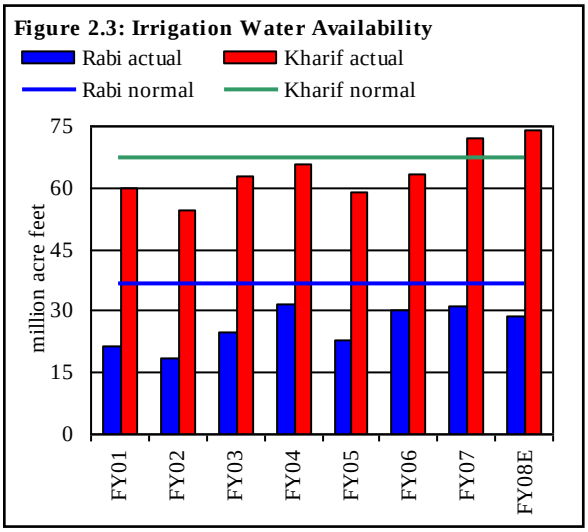
percent

	FY05	FY06	FY07	FY08
Five largest* commercial banks	53.3	54.0	11.1	51.0
ZTBL	28.9	-1.0	6.8	5.6
PPCBL	42.3	36.7	-9.7	-17.1
DPBs	233.4	182.9	28.1	116.2
Total	**47.2**	**40.6**	**11.0**	**46.1**

2.1.3 Irrigation Water

Kharif FY08 irrigation water availability at canal heads saw an improvement mainly due to substantial snow fall as well as extended heavy monsoon rains. However, water availability declined by 7.7 percent for *rabi* FY08 (see **Figure 2.3**), reflecting poor water management due to shortage of sufficient storage capacity. The impact of lower irrigation water may affect yield of wheat and other *rabi* crops. Current conditions suggest that Pakistan urgently needs to add water reservoirs to supplement the current water supplies.

Figure 2.3: Irrigation Water Availability



It is hoped that farm sector will benefit from national program for lining/development of watercourses to reduce the irrigation water losses at farm

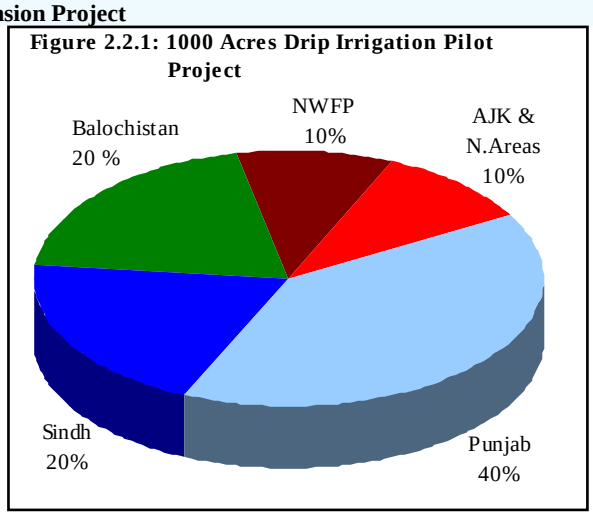
gate. By end of FY08 approximately, 18,700 watercourses will be developed, across the country. Under this four-year National Program, a total ofRs 66 billion is to be spent on improvement of 86,000 watercourses.

Improvement in watercourses coupled with soil management with land laser leveling system would be more beneficial to help reduce water losses/ consumption. It also enhances input efficiency, as smooth soil may provide maximum benefits to the plants and reduces the labor charges as well. Moreover, improvement in water management, efficiency and implementation of advanced techniques such as drip water irrigation system (see **Box 2.1**) may help to meet the future needs of water in the country.

Box 2.2: Drip Irrigation Water Expansion Project

As a policy initiative to deal with the mounting water scarcity under the impact of the global climate change and improve efficiency of present irrigation system a drip irrigation pilot project is going to be launched shortly. It is hoped that agriculture sector will benefit from an investment of Rs 315 million on two-year drip irrigation pilot project in the country, initiated by the Nuclear Institute for Agriculture and Biology of the Atomic Energy Commission of Pakistan to cope with the escalating water scarcity and maximize agriculture production.

Figure 2.2.1: 1000 Acres Drip Irrigation Pilot Project



Water irrigation experts frequently recommended the adoption of drip irrigation to help enhance water efficiency, at farm gate, by about 45-50 percent as compared with current flooding irrigation system. The high efficiency irrigation system, initially to be utilized for high-value adding crops, will allow the minimum water loss besides a substantial increase in the crop yield and allow the saved water to be used for irrigation of additional areas. The drip irrigation will also help to reduce the application of seeds, fertilizer and pesticides, as these inputs in this system are applied near the root zone, and not in the whole field. This micro drip irrigation project will be initially installed on 1,000 acres of cultivable land in all provinces and AJK and Northern Areas (see **Figure 2.2.1**). If this project is successful, further projects will be launched accordingly.

2.1.4 Fertilizers

A subsidy of Rs 470 per 50kg bag of DAP fertilizer was extended for the FY08 cropping seasons to encourage farmers to use a balanced mix of fertilizers to enhance yields. The farming sector responded well and off-take of fertilizers, both urea and Diammonium Phosphate (DAP), increased in Jul-Sept-FY08 (see **Table**

2.5). In particular, the rising market share of DAP in aggregate fertilizer off take is an encouraging sign, as growers are moving towards higher use of DAP than urea, which raises hopes for further gains in yields. This trend is likely to continue during the current *rabi* season as well, given farmers' enthusiasm on the back of high prevailing wheat prices.

However, the impact of government's efforts to increase the efficient use of fertilizers was partly offset due to (1) supply shortages particularly at sowing time, and (2) as per media reports, traders charge higher prices in various parts of the country. These issues suggest that government has to ensure smooth supply during high demand periods and take appropriate measures to discourage anti-competitive practices.

Table 2.5: Fertilizers Off-take (Jul-Sep)

thousand tons

	FY06	FY07	FY08
Urea	1337.5	1,141.50	1,451.10
DAP	397.2	173.2	316.9
Total	1,734.70	1,314.70	1,768.00
Growth (percent)			
Urea	3	-14.7	27.1
DAP	-7.2	-56.4	83
Total	0.4	-24.2	34.5
Market share (percent)			
Urea	77.1	86.8	82.1
DAP	22.9	13.2	17.9

Appreciably government has already made arrangement for import of fertilizer to meet the demand for *rabi* FY08. However, to mitigate the adverse impacts of continued rising international fertilizer prices during *kharif* FY09 cropping season, government has to formulate policies now.

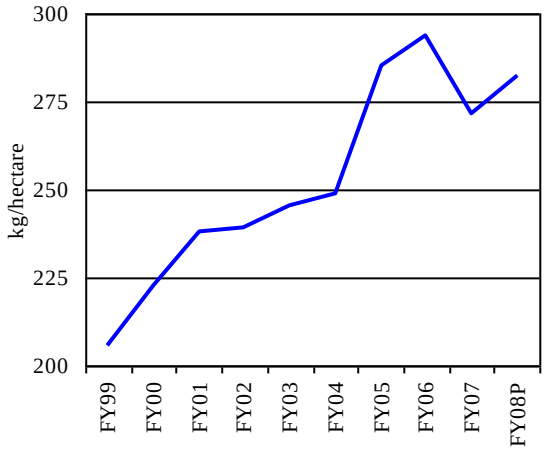
Other issues in the fertilizer industry, which are impeding its development inter-alia the growth in agriculture, are listed below:

(1) Domestic production as compared with consumption is lower. In case of urea, domestic production is 70 percent and remaining 30 percent is imported. While domestic production of DAP is only 30 percent, 70 percent is imported. Given growing demand and need to focus on raising yields, the country needs heavy investment in new fertilizer plants. This necessitates formulation of an aggressive fertilizer policy to achieve the desired results.

(2) While the participation of the private sector in fertilizer trade is encouraging, usual regulations should also be in place to protect farmers from exploitation by the traders.

(3) The per hectare consumption of fertilizers in Pakistan, though increased substantially in recent years (see **Figure 2.4**), is still significantly low. Usage in Pakistan is only at 37 percent of fertilizer per hectare consumption in Egypt, 42 percent of China, and 21 percent of that in the Netherlands. The under usage of fertilizer leads to nutrient and soil degradation. Moreover, fertilizer is not used as per recommended proportion (phosphate & nitrogen nutrients) and methods of application are also incorrect. It is therefore, important to educate farmers for balanced use of fertilizers, application at right time as per crop needs and through proper methods.

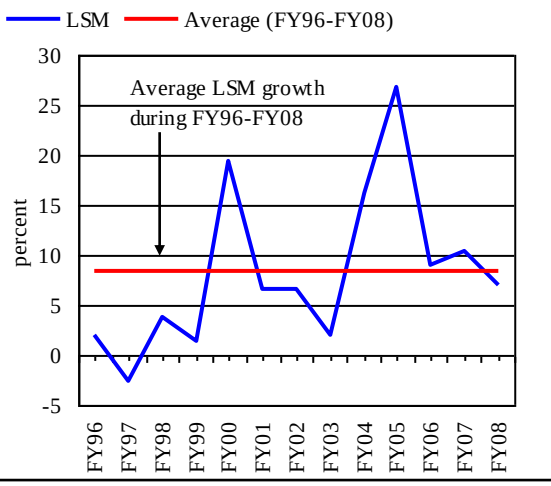
Figure 2.4: Fertilizer Per Unit Consumption Trend



2.2 Large Scale Manufacturing (LSM)

Initial data for Jul-Sep FY08 suggests a deceleration in the growth of LSM production to only 6.9 percent (see **Figure 2.5**), the lowest growth since FY03 during this period. This indicates a broad-based moderation of aggregate demand in the economy. However, a detailed analysis of the data suggests a slightly different perspective.

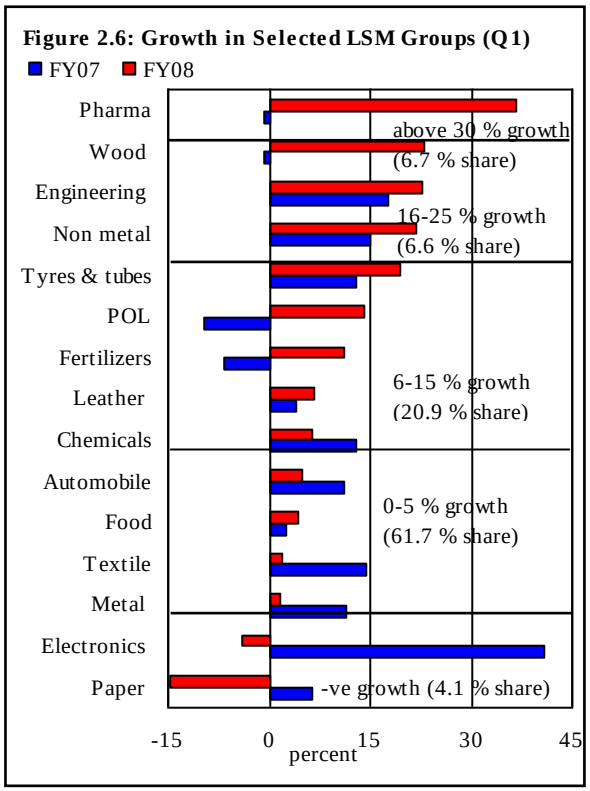
Figure 2.5: Growth in LSM (Q1)



(1) The extraordinary growth in electronics group had inflated the aggregate LSM growth during FY07 (see **Figure 2.6**). Excluding this group (which has a 2.5 percent weight in LSM), reveals that the aggregate growth rate for LSM

remained stable at around 8 percent, consistent with the trends seen during the initial months (July-September) of the preceding two years (see **Table 2.6**).[5]

(2) The above observation is also supported by the mixed trend seen in the performance of various sectors. While a majority of the sectors have seen growth decelerate, other depicts a sharp reversal from weak growth in the previous year.



In short, it appears that while aggregate demand has moderated somewhat, it still remains reasonably strong. The following reasons probably influenced the slowdown in certain manufacturing sectors; (1) growing demand for import substitutes; (2) slowdown in export demand; and (3) increase in raw material prices.

Table 2.6: Growth in LSM
percent

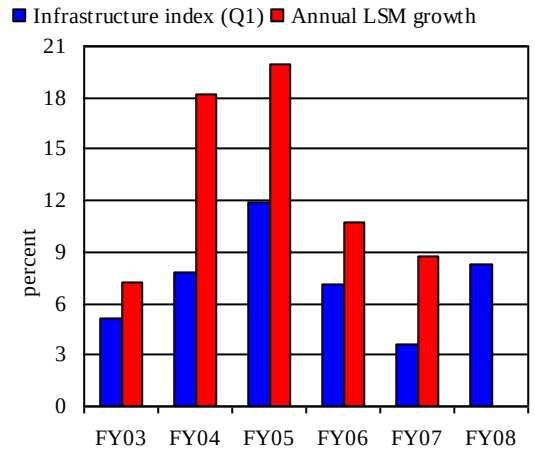
	FY06	FY07	FY08
LSM	9.0	10.4	6.9
Electronics	9.2	40.9	-4.0
LSM excluding electronics	9.0	8.1	8.0

Intriguingly, in the short run, one indicator suggests that a small revival is likely to be seen in LSM growth in months ahead. The movements in the Infrastructure Industries Index (III), a composite of seven industrial sub-sectors, has in recent years been a good leading indicator of LSM trends, and the Q1-FY08 growth of 8.3 percent in the III is significantly higher than 3.7 percent growth in the same period of last year (see **Figure 2.7**).

[5] Most of the slowdown was visible in the electronics group. Within electronics, production of air conditioners registered a sharp decline.

Over the medium to long term sustaining growth in large scale manufacturing will require the continuation of macroeconomic stability, and continued reforms by both, public and private sector, institutions. It must be recognized that in the increasingly globalized economy, there is little room for subsidized and or protected growth. Each industry needs to assess its competitive position and move to increase efficiency and productivity on its own.

Figure 2.7: Growth in Infrastructure Sector



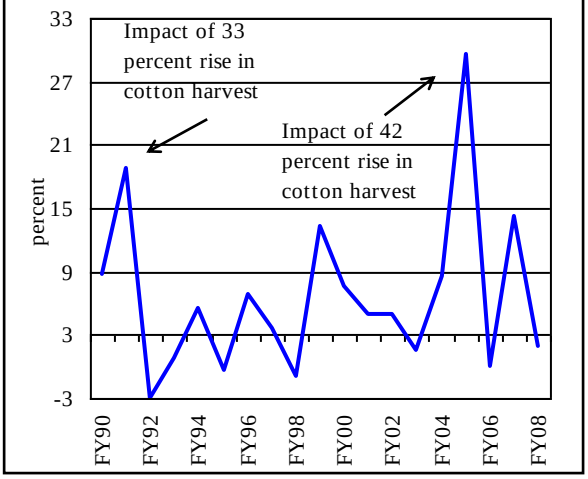
The needed reforms include those expanding the reach and competitiveness of the domestic markets, loosening bureaucratic regulation, ensuring the availability of utilities at reasonable cost etc. This is not unachievable, and Pakistan has already made significant progress in recent years. This is clearly illustrated in the World Bank studies comparing the cost of doing business across 178 countries of the World (see **Box 2.3**).

The following sections expand on developments in some key sectors of *large scale manufacturing* during the initial months of FY08.

Textiles

Textiles is the largest sector of LSM, accounting for about one-third of aggregate LSM, registered an anemic growth of 2.0 percent YoY in Q1-FY08 as compared to the 14.3 percent rise during the same period of the previous year. The current weakness in textile

Figure 2.8: Growth of Textile Industry (Q1)



Box 2.3: Doing Business in Pakistan

Pakistan's ranking in the ease of doing business from regulatory perspectives, though deteriorated slightly during 2007, is still better than most of the economies in the region. The ranking is based on 10 indicators of business regulation that follows the time and cost to meet government requirements in business start-up, operation, trade, taxation, and closure. Pakistan ranks 76th in the world and 11th in all Asian economies. Among South Asian countries, Pakistan is the second best performer after the Maldives.

Table 2.3.1: Doing Business in South Asian Countries for 2008 (Ranks)

	Pakistan		India		Bangladesh		Sri Lanka		Maldives	
	2007	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**
Starting a business	54	59	88	111	96	92	44	29	31	34
Employing workers	126	132	112	85	66	129	98	111	5	7
Registering property	68	88	110	112	59	171	125	134	172	178
Getting credit	65	68	65	36	21	48	101	97	143	135
Protecting investors	19	19	33	33	118	15	60	64	60	64
Enforcing contracts	163	154	173	177	34	175	90	133	83	94
Closing a business	46	51	133	137	70	102	59	39	114	120
Dealing with licenses	89	93	155	134	162	116	71	160	9	8
Trading across borders	98	94	139	79	158	112	99	60	91	110
Paying taxes	140	146	158	165	136	81	157	158	1	1
Ease of doing business	**74**	**76**	**134**	**120**	**99**	**107**	**89**	**101**	**53**	**60**

As apparent in **Table 2.3.1**, Pakistan's ranking has reversed in most of the indicators. However, a detailed analysis suggests that the reversal was brought about by the improvement in ranking of other countries as the regulatory indicators of Pakistan either continued to improve or remained largely unchanged (see **Table 2.3.2**). For instance, starting up business used to entail 21.3 percent of per capita income in 2006; however, in 2007 it costs only 14 percent. Similarly, the total tax rate (as percent of profit) has declined to 40.7 percent in 2007 compared with 43.4 percent in 2006.

Indicators where the Pakistan's ranking has improved during 2007 include trading across borders and enforcing contracts. The improvement in trading across borders followed from the reforms in 2006 that included introducing the electronic data interchange systems, applying risk management techniques and introducing customs administration reforms. In enforcing contracts, however, the ranking remained still quite low at 154. In fact, globally the time to enforce a contract is lengthiest in South Asian countries with India, Sri Lanka and Bangladesh amongst the 10 countries with most difficulties in enforcing contracts in terms of time and cost to resolve commercial disputes.

Table 2.3.2: Pakistan's Relative Performance During 2007

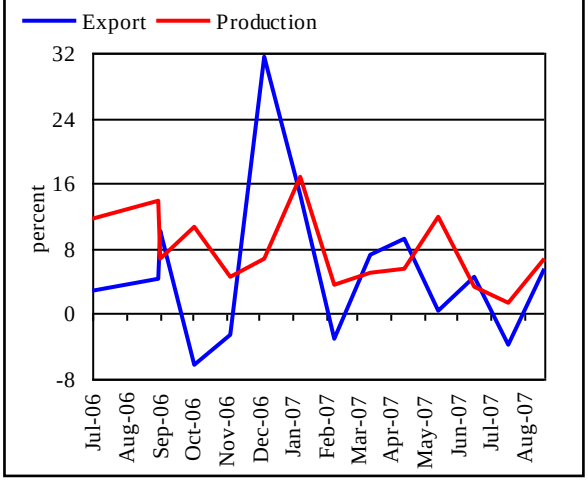
Relative Performance	**Indicators**
Improved	Enforcing contracts Trading across borders
Rank downgrade but indicators improved	start-up employing workers getting credit paying taxes
Rank downgrade and indicators also worsened	closing business dealing with licenses*\
Unchanged	Protecting investors

* Although cost has declined but the time in dealing with licenses has increased

appears to be a continuation of a cyclical pattern prevailing in the industry that a good year of performance is followed by a relatively poor performance, at least during the initial months of fiscal years (see **Figure 2.8**).

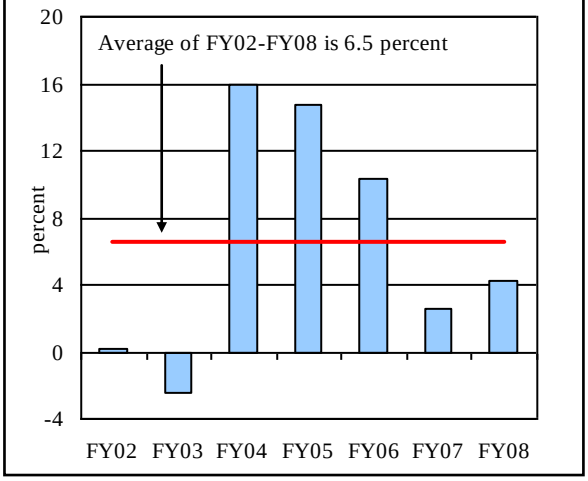
The lackluster performance of *textile* sub-group was mainly due to a disappointing cotton crop as well as weak external demand (exports of *textile* group increased by only 0.5 percent in Q1-FY08 compared with a rise of 2.5 percent in the same period of the previous year – see **Figure 2.9**).

Figure 2.9: Growth in Textile Production and Export



Within textiles, the weakness in the production of ginned cotton and cotton cloth, both reflect the smaller crop. However, the latter also incorporates the shift towards production of synthetic fabrics (which is not part of LSM data). This substitution is the continuation of the trend seen through FY07. During Q1-FY08, the production of cotton cloth declined by 1.2 percent as against 20.3 percent increase in production seen in the same period of FY07. This performance is also consistent with the 28.4 percent YoY fall in the exports of cotton fabrics during Q1-FY08 in contrast with a rise of 103.8 percent in the exports of synthetic textiles during this period.

Figure 2.10 : Growth in Food Group (Q1)

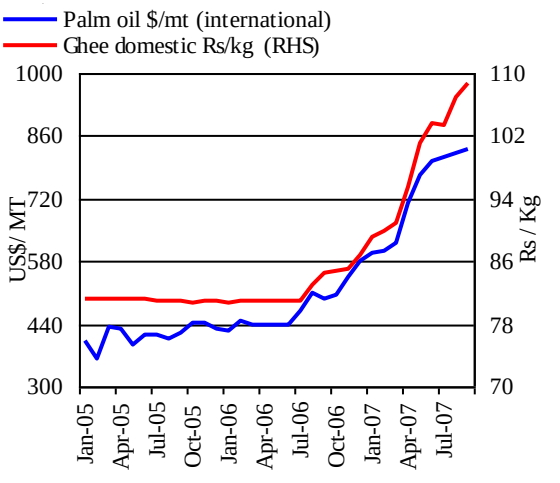


Food, beverages and tobacco

The growth in the food, beverages & tobacco sub-sector accelerated to 4.3 percent during Q1- FY08 against a slowdown of 2.5 percent in same period of FY07 (see **Figure 2.10**). This is mainly due to an increase in the production of beverages on

the back of strong demand and launch of new products, which more than offset the slowdown in the ghee and cooking oil industry. The weaker growth of ghee and cooking oil production was principally a result of softening demand following a surge in the prices of edible oils (see **Figure 2.11**). In fact, Pakistan is the third largest importer of edible oil as only around 27.0 percent of its requirement is met through domestic production. As a result of large dependency on imports, the domestic industry is sensitive to international price movements of edible oil. The issue of dependency and other concerns of ghee & cooking oil industry are discussed in **Box 2.4.**

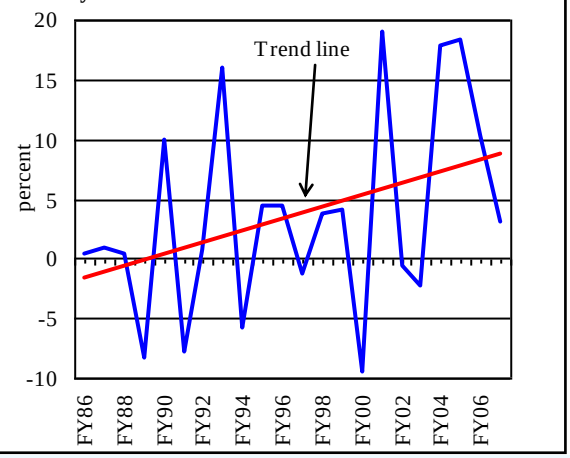
Figure 2.11: Palm oil and Ghee Prices



Box 2.4: Issues and Concerns of Edible Oil Industry in Pakistan

The ghee and cooking oil are the basic food items of human diet all over the world. With the passage of time the overall production as well as consumption of ghee & cooking oil has significantly increased in Pakistan due to growing population, increasing level of prosperity and changing lifestyle. As a result, currently the per capita consumption is around 16-18 kg/annum, which is more than 48.0 percent higher over the FY94 per capita consumption.

Figure 2.4.1: Growth in Ghee & Cooking Oil Industry

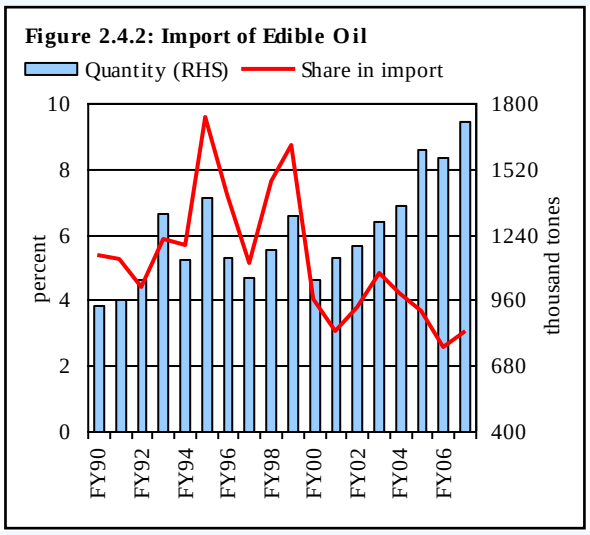


There are about 150 units of edible oil and oil extraction in Pakistan, involved in extraction and production of various types of cooking oil and ghee. The share of ghee & cooking oil in large scale manufacturing is 7.4 percent (the share of vegetable ghee and cooking oil in LSM is 5.7 percent and 1.8 percent respectively). During the last seven years (FY01-FY07) the average annual growth for ghee/edible oil production is about seven percent (see **Figure 2.4.1**). Following are the main issues and concerns of the ghee & cooking oil industry in Pakistan.

Import dependency

Despite an agrarian economy, the ghee & cooking oil industry in Pakistan relies heavily on the imported edible oil and spends a hefty foreign exchange on the payment of edible oil imports. Currently, Pakistan spends about US$ 1.0 billion per annum on the import of edible oil. Though the share of edible oil in total imports is trending downward, the quantum has upward trend (see **Figure 2.4.2**). To reduce the dependency of ghee/oil industry on imported edible oil and reduce foreign exchange requirements, there is a need to promote domestic cultivation of oilseeds in the country.

Figure 2.4.2: Import of Edible Oil



Import Substitution

Pakistan Oilseed Development Board (PODB) was established in 1995 to enhance the indigenous oilseed production, to reduce import bill and production of import substitution in the country. Moreover, the purpose of the PODB is the promotion of the oilseed sector as a whole and serving as an important national institution for the development, regulatory and policy framework to oilseed sector in the economy. Board is currently engaged in development and production of major oilseed crops viz. canola, sunflower and oil-bearing trees like oil palm, olives and coconut.

Unprocessed Vegetable Ghee and Oils

In Pakistan, sub-standard and unprocessed ghee and vegetable oils are available in the market, which captured a big portion of the market. The availability of such types of ghee/cooking oil is a threat for the health of general public especially for lower income groups. There is a need to ensure that all edible products available in market should be safe for human consumption.

Environmental hazards

The environmental degradation by the ghee/oil industry is another serious apprehension. The process of de-gumming, neutralization, bleaching, deodorization and hydrogenation generates huge quantity of waste water, emission of carbon monoxide, air pollution due to the flue gases from boiler, unsafe dumping of spent nickel, as well as and earth and soil pollution due to spills. These wastages create a lot of environmental problems, which are dangerous for the health of industry workers as well as resident around the factories. The oil mills can improve their operation to reduce the above mentioned impacts through the implementation of resources conservation and pollution preventive measures also known as Cleaner Production Options.

General Sale Tax (GST) in FATA/PATA

The ghee industry in Pakistan believes that taxes and duties are not only very high but also have different rates in various part of the economy. The non-imposition of GST on tin-plate in FATA/PATA, duty free import of edible oil for industries located in FATA/PATA etc. are the good examples of such discriminated policy, which is damaging the industry located in other parts of the economy.

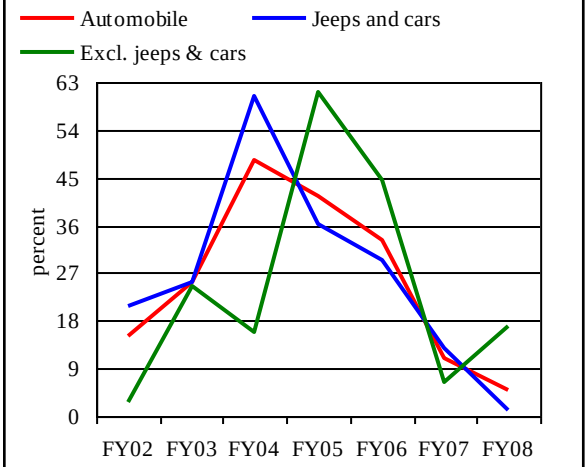
Underutilization of Capacity
Currently the annual capacity in vegetable ghee & cooking oil industries is more than three million tons which remains mostly unutilized. At present the capacity utilization of ghee/edible oil is about fifty five percent. A probable reason for this under utilization is the existence of unregistered ghee and cooking oil-processing units in the country.

Sale at Utility Stores
Recently, the industry has also opposed the sale of ghee/edible oil at subsidized rates at utility stores. The manufacturers are of the view that if government gives these subsidies to the manufacturers they will pass through these concession to the consumers. However, government's objective appears to facilitate low income group through a targeted subsidy rather than offer a general subsidy.

Automobiles

The automobiles industry witnessed a growth of only 5.0 percent during the first quarter of FY08, compared with 11.1 percent achieved in the same period of FY07. The Q1-FY08 growth is the lowest first quarter growth since FY02.

Figure 2.12: Growth in Automobile Sector (Q1)



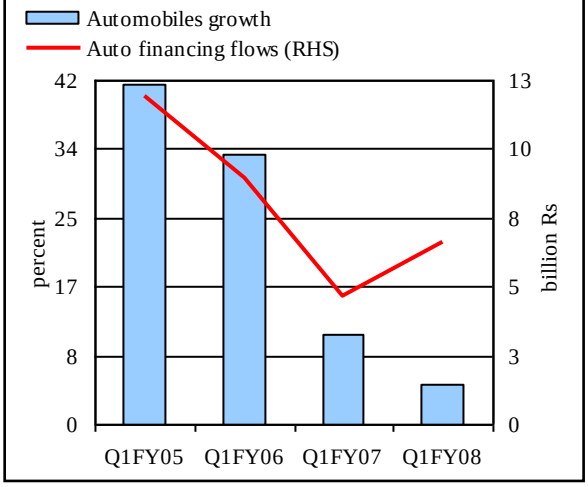
The growth in the automobile industry is generally influenced by the growth in the production of cars & jeeps with 64.1 percent weight in the sector[6] (see **Figure 2.12**). During Q1FY08, the production growth of cars & jeeps dropped to only 0.9 percent compared with 12.7 percent in Q1-FY07. Excluding the performance of cars & jeeps, growth in automobile sector accelerated to 17.1 percent, mainly contributed by rise in the production of motorcycles, LCVs and buses during Q1-FY08.

It is interesting to note that despite monetary tightening, consumer financing for automobiles showed a recovery during Q1-FY08 (see **Figure 2.13**). The contradictory trends in the growth of car production and auto financing are a result of extension of auto financing for used and imported cars by some banks. In addition, increased premium on immediate delivery of some high capacity cars

[6] This weight scheme needs to be reconsidered especially when motorcycle production has increased almost by 10 times and cars and jeeps production has increased by 5 times only, similarly the production of other component industries of automobile sector has changed significantly.

and the substantial imports of cars also indicate that domestic demand pressures remain strong. The domestic automobile sector needs to improve efficiency by investing heavily in order to meet the growing domestic as well as external demand. Government in an effort to protect local automobile industry from competition reduced the proposed 2007-08 budget withholding tax levy of 5 percent to 2.5 percent and allowed import of only less than three years old vehicles.

Figure 2.13: Auto Financing and Production Growth



Construction related industries

Production in the construction related industries such as cement, wood, paint & varnish continued to show acceleration or remained stable during the first three months of FY08. These appear to echo, the strong growth was observed in foreign investment; FDI in construction sector reached to US$ 65.0 million (see **Table 2.7**), showing an increase of 265.9 percent during the first quarter of FY08, on top of the 88.5 percent growth in the corresponding period of FY07.

The major portion of FDI came from four countries.[7] Similarly, the housing finance is another encouraging factor for the growth of construction sector in Pakistan; increased by Rs 5.1 billion in Q1-FY08 from Rs 2.2 billion in same period of last year. The share of house financing in total private credit is about 2.2 percent in FY07. While this ratio in developed countries is about 50 percent, in developing economies is 15 percent and in India is about 5 percent. Given a significant shortage of houses, a rise in housing finance could help boost construction activities in the country. Issues related to housing finance are discussed in **Box 2.5**.

[7] The shares of U.A.E, U.S.A, U.K and Saudi Arabia remained 28 percent, 20 percent, 17 percent 7 percent respectively in FY07 as compared with 28 percent, 32 percent, 8 percent and 3 percent share in the corresponding period last year.

Table 2.7: Construction -Performance Indicators during Jul-Sep

	Unit	FY05	FY06	FY07	FY08
Private credit for housing finance (flow)	billion rupees	3.7	3.9	2.2	5.1
Development expenditure	-do-	33.4	50.6	65.2	129.8
Foreign direct investment *	million US$	6.4	9.4	17.8	65.0
Workers' remittances	-do-	1.0	1.0	1.2	1.5
Wages of construction workers	percent	7.5	16.7	14.8	14.2
Production of steel (Pak Steel)	000 tons	1,391	1,357	1,501	1,630
Import of iron & steel	000 tons	13,397	23,620	20,806	28,055
Import of construction & mining machinery	million rupees	2,126	2,054	2,860	3,341
Cement dispatches	000 tons	4,094	4,474	5,418	7,282

* It includes the FDI in construction, cement, metal and basic metal groups.

Box 2.5: Housing Finance[8]

This note focuses on the problems faced by financial institutions in providing housing finance facilities and on possible remedial policy measures. The financial institutions faced some macro level issues while developing and providing housing finance products including (a) lack of standard national legal framework for affecting clean transfers of title of property, tenancy, rent control and foreclosure of immoveable property, (b) irrational transaction costs in the shape of stamp duty and registration fee etc., (c) ill managed and non-integrated land registration system, (d) lack of land holdings (by low income group) eligible for housing finance schemes, (e) no registration and credit rating of large scale real estate developers, (f) non-availability of centralized comprehensive and reliable information mechanism for housing market, (g) no institutional facility of liquidity mismatch management for long term housing finance projects, (h) lack of housing investment trusts for the development of real estate and (i) low capacity of mortgage finance institutions.

The solutions for the aforementioned obstacles to the growth of institutional finance are as following:

(a) Transfer of title of property should not be allowed without registration with the authorities to avoid prolonged litigation in case of disputes and to make the property eligible for availing finance facilities; standard tenancy and rent control laws at national level should be drafted instead of provincial or even smaller government body laws. It is important to mention here that institution of Rent Controller has actually caused harm to the settlement of cases process and opened ways for corruption so an alternate should be looked at. The Financial Institutions Ordinance 2001 that empowers financial institutions to foreclose the property without recourse to the court of law should be implemented in its true spirit, so that the institutions become able to recover their losses in case of default.

(b) Currently a land owning activity has to bear significant amount of transaction cost (in the shape of accessing the land documents i.e. transportation and opportunity cost (in the shape of time and money spent on trips as well as informal payments in addition to the prescribed

[8] This note is mainly based on the *Housing Advisory Group's Recommendations for Nationwide Provision of Housing Finance, March 2007*.

official charges. Financial costs can be reduced by implementing National Housing Policy 2001 recommendations concerning stamp duty and registration fee on conveyance deeds (1 percent aggregate rate) and on mortgage deeds (0 percent). The land titling system can be improved and opportunity cost can be reduced by the introduction of automation schemes for land records.

(c) Present fragmented and ill equipped system of land registration should be centralized through a land registration authority on the lines of NADRA which is working on land registration in collaboration of National Reconstruction Bureau in three district of Punjab only (Lahore, Gujrat and Rahim Yar Khan). In this endeavor, private sector participation may be involved in big cities. As a beginning, capacity building of existing system for automation should be considered on a fast track basis.

(d) Utilization of the allotted land should be made sure as speculators get plots in developed areas of cities and horde them to increase prices and leave less land for real needy people. Regularization and registration of title of ownership in *katchi abadis* will make this land holding eligible for availing finance facilities. Vertical alongside horizontal land allocation policy should be formulated and implemented to provide more housing near the city centers. Land provision by government bodies should be more frequent and regular to bring the prices of land in affordable range and to discourage speculators from investing in land holdings.

(e) Real estate development projects by developers often fail to deliver the land or flats on time due to lack of finances available through monthly installments of allottees. So there is need for registration of builders and developers with ABAD to become eligible for credit from financial system. This will make credit rating of registered companies possible and also the projects initiated by these companies hence making companies and projects with good ratings suitable to get additional financing and other facilities. Furthermore, it will help make the documentation process of banks simple and will lead to standardization of valuation methodology for real estate (that will increase acceptable value of collateral available to the developers for availing finance facility). Thus increased finance facility will make it possible for builders to offer more schemes on standardized completely built house basis.

(f) Credit provisioning by financial institutions to any sector depends on the quantity and quality of information available with them. So there is need for the establishment of information system regarding key variables of interest for the financial sector like new home starts location, existing home sale, size of houses in demand, demographic information etc. In this regard House Building Finance Corporation and Mortgage Bankers Association can play their role by putting information available with them on their websites for the benefit of others, may be for subscribers only format.

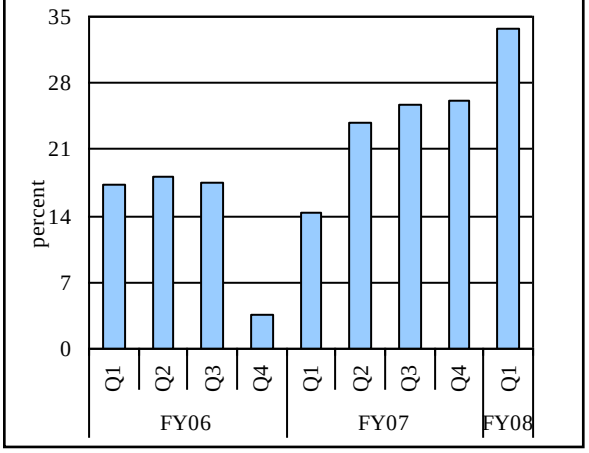
(g) Housing finance is a long term venture for the financial institutions that creates asset liability maturity mismatch for banking sector as banks are not having sufficient long term deposits. This in case of more housing finance ventures leads to liquidity crunch for the banking sector. Therefore, sustainability of housing finance facility through banking system requires establishment of mortgage refinance arrangements.

(h) Real estate development is largely of retail nature business that has failed to meet the needs of low and middle income group, hence there is a need to develop this industry on a large scale basis. This can be achieved through establishment of real estate investment trusts that work with the investment of large number of partners with small investments and the equity capital

of founding members. This will increase the liquidity available with the real estate developers, bring efficiency in the price discovery mechanism and will provide improved valuation of property prices.

(i) As housing finance is a comparatively new phenomenon in Pakistan the players involved in housing finance are few and commercial banks have just entered the business; the capacity of these institutions needs to be enhanced, especially in knowledge base sharing and development. In this regard the newly established Mortgage Bankers Association (MBA) needs to be strengthened with human and financial sources.

Figure 2.14: Growth in Cement Industry



The rising demand for housing coupled with massive developmental spending by the public sector resulted in a sustained growth of the cement industry (see **Figure 2.14**). The impetus to this growth also stemmed from rising external demand. In recent years, the impact of the external demand was more pronounced, as a result the share of foreign cement dispatches increased significantly (see **Figure 2.15**). Cement exports reached to 1566 thousand tons in the first three months of FY08; showing a robust growth of 136.6 percent over the same period of last year. This rising export is mainly due to rise in construction activity in Afghanistan, Iraq, UAE and India as well as the government measures to support export of cement.

The realization of sustained growth in cement production became possible due to a timely expansion in production capacity by the industry in recent years. Substantial investment (domestic as well as foreign) in the cement industry helped in capacity enhancement (see **Figure 2.16A**). As far as the production capacity is concerned, the capacity utilization moderately rose to 80.7 percent in FY08 as compared with 80.5 percent during FY07, mainly due to expansion in production capacity that reached to 36.1 million tons from 30.1 million tons in FY07 (see **Figure 2.16B**). In absolute terms, the production capacity rose by 15.4 million tons in FY07-FY08 that is almost three times higher than 5.4 million tons expansion between FY01-FY06.

The significant capacity additions in cement industry during the current fiscal year meant that at end of FY08 the industry would have an additional capacity of seven million tons. However, the industry prospects remain strong due to (1) potential for exports to Afghanistan, Iraq, Gulf Cooperation Council (GCC)[9] region, opening of trade corridor for exporting the commodity to India, which faces an acute shortage for at least next two years; and (2) domestic demand is expected to increase in the backdrop of increase in public sector development expenditure (24.8 percent estimated increase in FY08), (3) rapid infrastructure development in metropolitan cities, and (4) continued strength in the housing construction industry; reflected from the increase in per capita cement consumption, which currently stands at 133 kg compared to 109 kg in the previous year.

Figure 2.15: Cement Dispatches Destination Share (Q1)

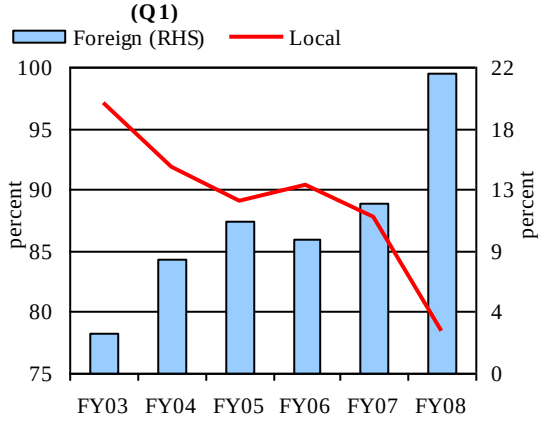


Figure 2.16A: Investment in Cement Sector (Q1)

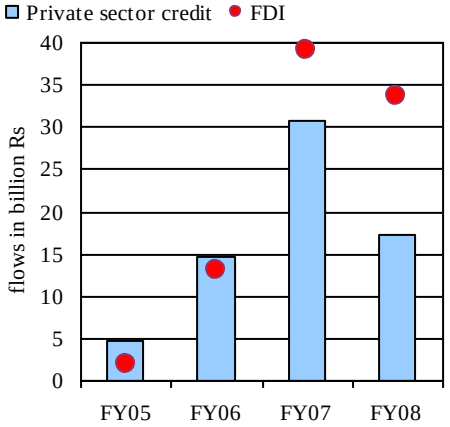
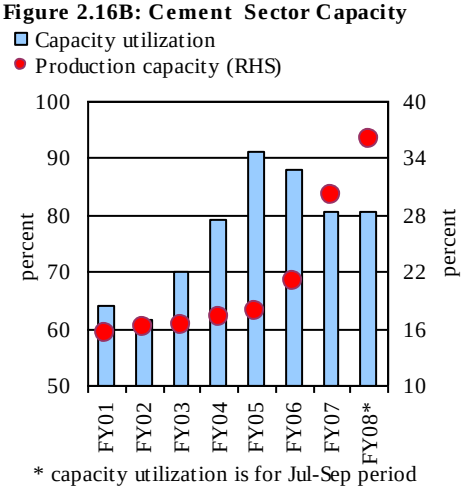


Figure 2.16B: Cement Sector Capacity



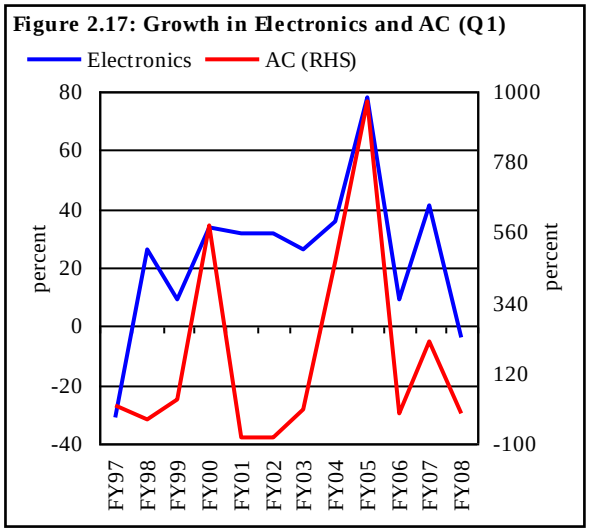
* capacity utilization is for Jul-Sep period

[9] The Gulf Cooperation Council (GCC) was established in May, 1981 and Kuwait, Qatar, Kingdom of Saudi Arabia, Kingdom of Bahrain, Oman and United Arab Emirates are the members of the council.

Electronics

Production in electronics industry witnessed a decline of 4.0 percent during Q1-FY08 in contrast to a remarkable growth of 40.9 percent seen in the corresponding period of FY07. This is the first ever decline in the electronics production since FY97. The decline is principally attributed to a fall in the production of air conditioners, which has a dominant share of about 50 percent in the industry (see **Figure 2.17**). The decline in air conditioners appears a function of (1) a rise in interest rates on consumer financing, and (2) competition with imported substitutes. The other items posting lower production during Q1-FY08 are electric transformers and electric meters, primarily a result of slowdown in installation of transformers and meters, which was initiated in yester years. In contrast, a substantial rise in the production of refrigerators, deep freezers, and electric fans helped offset the decline the part of the electronics industry.

Figure 2.17: Growth in Electronics and AC (Q1)



Petroleum & refinery

The demand-supply gap for the domestic petroleum refining has widened in recent years mainly due to requirements from power sector, industrial sector and transport sector. This is evident in an average growth of 39 percent in import of petroleum products in last three years. The current capacity in petroleum refining industry at end September 2007 could produce 13.2 million tons of petroleum products whereas the total consumption during FY07 stood at approximately 18.0 million tons.

The domestic petroleum products manufacturers have already started looking at ways to meet domestic requirements through product diversification. In specific terms, the Q1-FY08 data reflects a sharp growth in production of (1) furnace oil on the back of growing electricity requirements and frequent gas interruptions; and (2) motor spirits and high speed diesel products the demand for which grew phenomenally in recent years.

Going forward, the setting up of a coastal refinery is expected to double the existing refining capacity in the country by 2011. While the product diversification alone can reduce import dependency to a certain extent, the economy requires more of such projects so as to meet the growing domestic petroleum requirements in the long run.