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THE STATE OF PAKISTAN'S ECONOMY
First Quarterly Report for FY09

1.1 Economic Outlook

The sense of crisis gripping Pakistan's economy in the initial months of FY09 has visibly eased by November 2008, as the government moved to address the most immediate risks, and entered into a macroeconomic stabilization program to support medium-term reforms under the aegis of the IMF. The disbursement of the first tranche of US$ 3.0 billion by end-November 2008 under the program meant that any immediate risk of default on external obligations receded, with a substantial improvement in FX reserve adequacy indicators. Also, exports growth has strengthened and imports growth moderated somewhat (see **Table 1.1**). This lent strength to the rupee, reducing the impact of an important generator of inflationary pressures.

This gain on the external account was supplemented by a concurrent sharp decline in international commodity prices that is expected to substantially lower the country's import bill, offering the possibility of a decline in the country's very large current account deficit, and lower inflation. This supply-side improvement has been reinforced by the reasonable good performance of crops during *kharif* FY09 cropping season. These factors appear to have already halted the persistent uptrend in inflationary pressures in the economy. Together, they could also help support a very modest improvement in the growth outlook for FY09.

There is also substantial progress on containing fiscal imbalances, with the government moving bravely to reduce subsidies, contain growth in other spending and increase revenues. The result has been an encouraging improvement in some fiscal indicators, including a sharp fall in the fiscal deficit from 1.5 percent of GDP during Q1-FY08 to 1 percent of GDP in Q1-FY09. This figure appears consistent with the annual target embedded in the macroeconomic stabilization program framework.

Notwithstanding the relative positives, there is no room for complacency. While the country's macroeconomic conditions may no longer be worsening, the imbalances are nonetheless still quite large. Resolving them will require disciplined efforts over an extended timeframe. This challenge is all the greater because of the difficult international economic environment; it has restricted the country's ability to tap international capital markets and carries risks for other external receipts (exports, remittances, FDI, etc.).

Containing and bringing down the persistent high inflation in the economy will not be easy. The November 2008 CPI inflation of 24.7 percent YoY is only a little lower than the record high of 25.3 percent seen in August 2008, and both core inflation measures persist at or close to their record highs. This persistence, and the evidence of excess domestic demand, reflected in high government borrowings from the central bank and widening current account deficit, underpinned the central bank's decision to further tighten monetary policy in November 2008 by raising the policy rate by 200 basis points.

Table 1.1: Selected Economic Indicators

		FY07	FY08	FY09
Growth rate (percent)				
LSM	Jul-Sep	11.3	7.3	-6.2
Exports (fob)	Jul-Nov	4.5	6.5	12.7
Imports (cif)	Jul-Nov	10.3	18.4	16.5
Tax revenue (FBR)	Jul-Nov	19.1	14.8	24.4
CPI (12 month MA)	Nov	7.9	7.6	19.1
Private sector credit	Jul-Nov	7.0	5.4	5.1
Money supply (M2)	Jul-Nov	3.9	4.0	-0.2
billion US dollars				
Total liquid reserves[1]	end-Nov	12.3	15.7	9.1
Home remittances	Jul-Nov	2.1	2.6	3.0
Net foreign investment	Jul-Nov	2.0	1.8	1.4
percent of GDP[2]				
Fiscal deficit	Jul-Sep	1.0	1.5	1.0
Trade deficit	Jul-Nov	3.1	4.6	4.9
Current a/c deficit	Jul-Nov	2.8	2.8	3.9

1. With SBP & commercial banks.
2. Based on full-year GDP in the denominator. For FY09 estimated full-year GDP has been used.

It is also important to note that domestic commodity prices did not decline in tandem with the sharp fall in international prices. A part of this apparent disconnect explained by the significant depreciation of the Pakistani rupee[1] since June, which offset some gains from the large decline in international prices. The downward stickiness of prices probably also owes to market structure and other issues, which may be amenable to administrative and policy interventions by the government. Transportation costs, which have impact on prices of other products and that had been increased disproportionately more when fuel prices rose, provide a case in point; transport fares of the railways, airlines, commercial vehicles, most inter-city bus services, etc. were either not adjusted downwards or saw small changes, after the decline in domestic fuel prices. Anecdotal evidence suggests that this also holds true for trucking costs in many regions of the country.

Government interventions however must tread a fine line, encouraging market driven solutions while avoiding degeneration into price setting or the provision of subsidies. In particular, broad price subsidies often prove wasteful, and in any case, entail fiscal costs which the budget can ill afford. A key test could come with

[1] Pak rupee depreciated by 13.4 percent during Jul-Dec 22 2008.

the wheat harvest. The generous support price offered earlier may not be sustainable as international prices have collapsed. Extensive government purchases to support prices at this level would entail fiscal costs, lead to wastage (as millers would prefer lower, market-driven, prices) and potentially, high imports.

The data available so far shows that the government has made a fine start to containing the fiscal deficit. However, the fiscal improvement in Q1-FY09 appears largely based on reduction of oil subsidies and a cut in development spending. This is understandable since (1) any meaningful effort to expand revenues (particularly by broadening the tax base) will only work in an extended time frame, and (2) given fiscal rigidities in current expenditures (especially interest payments) the gains will not be available in the short term. In the medium term, such measures must be supplemented by policies to discipline growth in non-development expenditures and broaden the revenue base. This will provide the necessary fiscal space to ensure appropriate level of public spending on social and development projects in the future.

A change in mind-set is also required in fiscal planning. Expenditure growth must be kept consistent with a realistic assessment of revenues, and appropriate adjustments made as the year progresses. This will ensure that the government will not crowd-out private sector investment, as the domestic banking sector would then have the space to meet the requirements of the private sector. Simultaneously, it is also imperative that the temptation for government to seek unlimited financing from the central bank be strictly restricted by law. Empirical international studies, and evidences from recent history in Pakistan, clearly demonstrate the dangers to macroeconomic stability resulting from heavy recourse to the inflationary borrowings by governments from the central bank.

Acknowledging this, the government had already committed to zero budgetary borrowings from the central bank, and this has now been incorporated into the IMF supported macroeconomic stabilization program. The resulting elimination of the demand stimulus, the contractionary monetary policy, and the declining international commodity prices will hopefully also shrink the large current account deficit.

Provisional data indicates that the growth of the current account deficit may have halted in November 2008. If as expected, a declining trend takes hold in succeeding months, this will significantly boost prospects for regaining macroeconomic stability. It must be kept in mind that the slide in rupee value during Jul-Nov FY09 was mainly a function of continued deterioration in external balances, which resulted in depletion of forex reserves and also generated liquidity problems for the financial markets.

This weakness of the rupee also contributed to the decline in investment inflows, and capital flight by investors. However, a crackdown on illegal forex transfers, and the near simultaneous entry into a stabilization program with the IMF, then helped the rupee recoup some of its earlier losses. A further boost to confidence in the local currency came from signs of slowing imports growth.

The slowdown in imports is attributed to both, the substantial downtrend in international commodity prices as well as a relative ease in domestic demand.[2] However, lower commodity prices will also hit export prospects; for example while rice export quantum rose by 19.8 percent during Jul-Nov FY09, the rise in value was only 130.6 percent. The improvements in external sector would be more visible in cumulative data during H2-FY09 and coupled with fiscal prudence could potentially have impacts on monetary policy.

First, an improvement in external accounts would enhance credibility and minimize the speculation of crisis, which would help SBP to manage liquidity in the banking system. Second, government's commitment not to resort to borrowings from the central bank would make it easier for the SBP to focus eliminating earlier overhang created by monetization of fiscal deficit. Third, absence of government borrowings from the central bank would help improve monetary policy transmission mechanism through reflecting true cost of funds in the money market. Finally, a relative contraction in fiscal deficit would help contain aggregate demand pressures, which would supplement the monetary policy.

The stabilization efforts were underway even before the initiation of IMF program as government passed through the impact of higher international oil prices to domestic prices of key fuels Q4-FY08 onwards, fiscal consolidation during the first quarter of FY09 and monetary tightening by the central bank in May and July 2008 are main reference to these efforts.

In particular, the fiscal consolidation program of the government for FY09 consists of (1) substantial reduction in overall budget deficit, as a percent of GDP, through a mix of cut in expenditures (as a share of GDP) and a rise in tax revenues

2 For example, import quantum of crude oil, palm oil, soybean oil, fertilizers, iron & steel, rubber tyres and tubes declined during Jul-Nov FY09.

(as a share of GDP), and (2) a gradual elimination of government budgetary borrowings from SBP.

Despite of these efforts, temporary liquidity shortages with the commercial banks was propagated as financial crisis in the country. This led to a fresh round of speculative attack on domestic currency. Unfortunately, these developments coincided with the global financial and liquidity crises, thus it was perceived that the domestic crisis was also triggered due to the same reasons facing by western financial institutions. The central bank assessed the situation and took important measures to ease liquidity in the financial system and stabilize the domestic currency.

1.2 Looking Forward

It is evident that Pakistan's economy needs effective policies and implementation of reforms in FY09 to regain macroeconomic stability in the midst of a challenging year. Real GDP growth is likely to be significantly be lower than the annual target and inflation will breach its target with a wide margin (see **Table 1.2**). On a positive note, both fiscal and current account deficits are estimated to improve in FY09.

Table 1.2: Projections of Major Economic Indicators

	FY08	FY09	
		Annual plan targets	Projections
	growth rates in percent		
GDP	5.8	5.5	3.5 - 4.5
Average CPI Inflation	12.0	11.0	20.0 - 22.0
Monetary assets (M2)	15.3	14.0	11.0 - 12.0
	billion US dollars		
Workers' remittances	6.5	7.7	7.5
Exports (fob-BoP data)	20.1	22.9	20.5 - 22.0
Imports (fob- BoP data)	35.4	37.2	33.5 - 35.0
	percent of GDP		
Fiscal deficit	7.4	4.7	4.3 – 4.8
Current account deficit	8.4	7.2	6.2 - 6.8

Note: Targets of fiscal and current account deficit to GDP ratios are based on Nominal GDP in the Budget document for FY09, while their projections are based on projected (higher) nominal GDP for the year.

Amongst the biggest challenges for the government will be to ensure the pass through of decline in international commodity prices to consumers, as the rise in the prices adversely impacted their lives. In this background, while recent downward adjustments in the administered prices of key fuels[3] is appreciable, the reversal in transport fares and goods transportation charges is almost negligible. This behavior is understandable given (1) when prices moves upward, generally do not come down; and therefore (2) inflationary expectations remained strong. Moreover, while commodity price shock was quite strong, it was believed that these prices will remain stubbornly high for at least a

3 Petrol, diesel, kerosene oil and LPG.

decade or so.[4] However, in a similar dramatic way, these prices have plummeted due to deepening global recession. Indeed, firms and traders will take some time to adjust their prices and margins in these circumstances. However consumer awareness, role of media, quicker settlement of import duties and other taxes may be required to accelerate disinflationary process in the economy.

Similarly, global recession and risk averse behavior of investor would likely to severely impact international trade and level of forex inflows in the economy. SBP estimates for both imports and exports have been revised downward, with a more pronounced effect on imports. Whereas in the event of shortfall of external financing, the burden of financing fiscal deficit will disproportionately fall on the domestic commercial banks since government has committed not to borrow from the central bank. In addition, FDI may be substantially lower than in recent years, in which case, pressures on forex reserves could remain strong. Both possible developments indicate continuing risk on interest rates and exchange rate, and thus the need for continued vigilance by the policymakers.

1.3 Executive Summary

1.3.1 Agriculture

Initial data suggests that agricultural growth in the current fiscal year could be significantly better than in FY08, notwithstanding a sharp fall in sugarcane harvest. This expectation is based on a record rice harvest of 6.5 million tones, a small improvement in cotton production during *Kharif* FY09, supported by the possibility of a record wheat harvest. Initial information also raises the possibility of a very good showing by minor crops and reasonable growth in the livestock sub-sectors. The improvement in the *kharif* crops is remarkable given continued water shortages. It suggests that better prices and credit availability may have encouraged farmers to increase investment in crops. Further, widespread rains during mid-December 2008, raised hopes for higher *rabi* plantation and harvesting.

Some important policy measures announced in the FY09 budget (and later) to encourage farmers may have played important role. These include: (1) increase in support prices of wheat for FY09 crop, (2) a 25 percent higher agri-credit target for FY09 compared with the FY08 target, with enhancement in indicative per acre credit limit for major and minor crops, orchards and fishery by an average 70 percent, (3) increase in subsidy for DAP, (4) starting of crop insurance scheme, and (5) exemption of GST on fertilizers and pesticides etc.

[4] http://www.fao.org/newsroom/en/news/2008/1000849/index.html

1.3.2 Large Scale Manufacturing
Large scale manufacturing (LSM) continued to decline, as it registered a negative growth of 6.2 percent in Q1-FY09 as against a reasonable growth of 7.3 percent in Q1-FY08. This decline in LSM production is broad-based. Seven sub-sectors (having 72.4 percent weight) out of fifteen registered decline, while three (having 15.3 percent weight) registered a dismal growth of less than one percent.

This disappointing outcome is a result of a number of factors including: severe energy shortages, deterioration in domestic law & order situation, impact of pass through of international oil prices, sharp depreciation in rupee parity and most importantly, weak external demand on the back of global recession and slowdown in domestic demand.

1.3.3 Services
Services sector has exhibited resilience to fluctuations in economic activity in recent years. This is also evident in yet a positive growth in FDI in the services sector, despite slowdown in overall economic activities in the country.

Key indicators of services sector during Q1-FY09 present a mixed scenario. While, some sectors such as *wholesale & retail trade* and *transportation & communication* are likely to show a weaker performance relative to the preceding year, *community & social services, finance & insurance* as well as *public administration & defence* are estimated to exhibit a strong growth for yet another year.

1.3.4 Prices
Inflationary pressures remained strong in the economy during the first five months of FY09. In particular, consumer price index (CPI) and the sensitive price indicator (SPI) have seen strong YoY increases throughout FY09 so far. However after recording strong growth (YoY) during the first two months of FY09, a significant decline in WPI inflation has been observed during the later months.

Similar to CPI inflation, both measures of core inflation, non-food non-energy (NFNE) and 20% trimmed mean, continued to accelerate during the first five months of FY09. Strength in core inflation is indicating the persistence of inflationary pressures.

1.3.5 Money and Banking
SBP undertook more aggressive monetary tightening during FY09, as it further increased the policy rate by 300 bps in two rounds. On cumulative basis, this means a 550 bps increase during the last 18 months. This policy measure was in

response to carryover of macroeconomic stresses of the preceding year, which had grown in size during the current year. For example,

(1) Although YoY CPI inflation declined from its peak, domestic inflation has remained high. While the surge in food prices have retreated somewhat, non-food inflation shows little effect of the sharp decline in international commodity prices.

(2) Furthermore, external current account deficit, which was mainly reflecting domestic demand pressures, increased sharply during FY09. There is a risk that possible weakening of exports and remittance inflows may even offset the anticipated relief in overall import bill for the country due to recent broad-based decline in international commodity prices.

(3) Moreover, continuing monetization of the deficit was not only providing a stimulus to domestic demand but has also greatly diluted the impact of earlier monetary tightening. Government budgetary borrowings from the central bank during Jul-Nov 2008 reached Rs 356.4 billion, as compared to Rs 169.4 billion in the same period last year.

The excessive government borrowings from central bank posed difficulties in liquidity management, which became more complex due to (1) a substantial drain of the rupee liquidity from the inter-bank market by October 2008 following substantial pressure on external account; (2) a heavy withdrawal of deposits owing to seasonal cash demand around Eid, and (3) rumor-induced panic withdrawal of deposits in October 2008. This induced SBP to announce a number of temporary measures to accommodate liquidity shortfalls.

In terms of monetary aggregates, the YoY growth in M2 decelerated steeply to 10.7 percent by end-November 2008 – the lowest growth seen during the last seven years. Indeed, an extraordinarily strong contraction in net foreign assets (NFA) of the banking system more than offset a sharp rise in budgetary borrowings from the central bank and continued strong demand for credit (both from public sector enterprise and private sector).

1.3.6 Fiscal Developments

The large fiscal deficit in FY08 and the adverse economic consequences of its financing from SBP placed fiscal consolidation at the top of government's macroeconomic stabilization agenda for FY09. The fiscal consolidation program of the government for FY09 consists of (1) substantial reduction in overall budget deficit, as a percent of GDP, through a mix of cut in expenditures (as a share of

GDP) and a rise in tax revenues (as a share of GDP), and (2) a gradual elimination of government budgetary borrowings from SBP.

Not surprisingly, the Q1-FY09 fiscal performance improved consequent to the policy shift, with the overall fiscal deficit estimated to have dropped to 1 percent of annual GDP. This is consistent with the annual fiscal deficit target set under the IMF stabilization program. The reduction in fiscal deficit in Q1-FY09 was brought about mainly by a drastic cut in development expenditures. This is also confirmed by further deterioration of revenue balance for Q1-FY09 despite an impressive growth of 23.1 percent in total revenues during the quarter. Primary deficit, as a share of GDP, declined to 0.2 percent in Q1-FY09 from 0.4 percent in the corresponding period last year indicating a deceleration in growth of interest payments.

1.3.7 External Sector

Balance of Payments

Pakistan's external account remained under stress through Jul-Nov FY09, as acceleration in the growth of the current account deficit, and sharply reduced financial & capital account inflows drew the country's foreign currency reserves to perilously low levels. Not surprisingly, the rupee also weakened substantially in the period, depreciating by as much as 17.5 percent against the US dollar by end-October 2008, before recovering somewhat after Pakistan gained IMF support for a macroeconomic stabilization program.

Although there were indications of slowdown in domestic demand, higher import prices during July-Nov FY09 continued to propel import growth. It was only when the slowdown in the domestic demand was complemented by lower import prices in November 2008 that the import bill declined 23.9 percent YoY. Lower import bill combined with the rise in remittances in November narrowed the trade deficit somewhat for the Jul-Nov 2008 period.

On the financing side, deteriorating economic imbalances, sharp exchange rate depreciation, and substantial fall in stock market and consequential increase in the country's default risk along with downward revision by the credit rating agencies, deterred foreign exchange inflows during the period under review. As a result, surplus in financial account recorded significant 62.0 percent fall during Jul-Nov FY09 in contrast to an increase in the corresponding periods of last three successive years.

Trade Account

During Jul-Nov FY09, strong growth in imports, mainly due to higher import prices, outpaced the otherwise substantial improvement in export growth causing the trade deficit for the period to widen by US$ 1.4 billion compared to the same period last year. Interestingly, this rise in the deficit accrued entirely during Q1-FY09; while still large, the monthly deficit saw a YoY decline in each of the next two months.

Given that (1) large share of the overall import increase was contributed by price impact, while the share of quantum impact in the total import increase was negative and (2) growth of non-food & non-oil imports recorded a sharp deceleration during Jul-Nov FY09 point toward easing of demand pressures during Jul-Nov FY09. The combined impact of lower commodity prices and easing of demand pressure are likely to reduce trade deficit going forward.

2 Real Sector

2.1 Agriculture-sector Performance

Initial data suggests that agricultural growth in the current fiscal year could be significantly better than in FY08, notwithstanding a sharp fall in sugarcane harvest. This expectation is based on a record rice harvest of 6.5 million tonnes, and a small improvement in cotton production during *kharif* FY09 (see **Table 2.1**) supported by the possibility of a *record* wheat harvest.[1] Initial information also

2.1: Performance of Major Crop

Area under cultivation (000 hectares)

Crops	FY07	FY08^T	FY08^P	FY09^T	FY09^E	% change in FY09 over FY08
Cotton	3,075	3,250	3,055	3,220	2,850	-7
Sugarcane	1,029	1,040	1,241	1,040	1,043	-16
Rice	2,581	2,594	2,516	2,594	2,916	16
Wheat	8,578	8,578	8,550	8,610	4,729*	9.3**
Gram	1,052	1,120	782	1,012	-	-
Maize	1,017	1,001	1,037	1,001	-	-
Production (000 tons; cotton in 000 bales of 170.09 kg each)						
Cotton	12,856	14,140	11,655	14,110	12,060	3.5
Sugarcane	54,742	55,871	63,920	56,516	53,689	-16.0
Rice	5,438	5,721	5,561	5,721	6,543	17.7
Wheat	23,295	24,045	20,959	25,000	-	-
Gram	838	707	554	652	-	-
Maize	3,088	3,221	3,109	3,279	-	-
Yield (Kg/hectare)						
Cotton	711	740	649	750	720	10.9
Sugarcane	53,199	53,722	51,507	54,342	51,476	-0.1
Rice	2,107	2,205	2,210	2,205	2,244	1.5
Wheat	2,716	2,803	2,451	2,904	-	-
Gram	797	631	708	644	-	-
Maize	3,036	3,218	2,998	3,276	-	-

P: Provisional,

T: Target, E: Estimates

Source: MINFAL

(*) Up to Nov-15, 2008; (**) Change over the corresponding period of 2007 raises the possibility of a very good showing by minor crops and reasonable growth in the livestock sub-sectors. The improvement in the *kharif* crops is remarkable given continued water shortages and suggests that better prices and credit availability might have encouraged farmers to increase investment in crops.

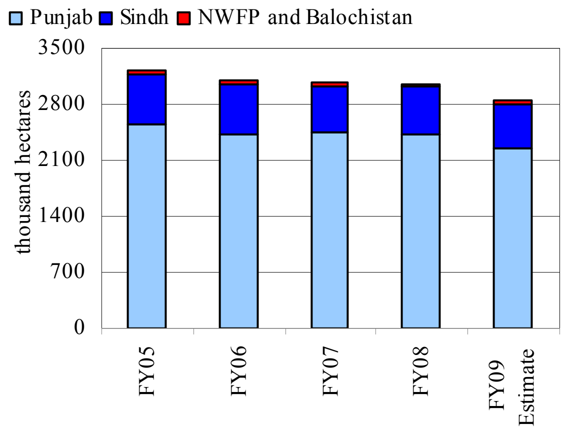
Some important policy measures announced in the FY09 budget (and later) to encourage farmers may have played a role. These include: (1) increase in support prices of wheat for FY09 crop, (2) a 25 percent higher agri-credit target for FY09 compared with the FY08 target, with enhancement in indicative per acre credit limit for major and minor crops, orchards and fishery by an average 70 percent, (3) increase in subsidy for DAP, (4) crop insurance scheme, and (5) exemption of GST on fertilizers and pesticides etc.

Kharif Crops

Rice crop primarily benefitted from increase in area on the back of record high rice prices at sowing time. Farmers switched over from cotton and sugarcane as realized prices for both the crops in the previous season had been lower than expected. Besides this, other factors also contributed in remarkable growth of rice harvest; (1) higher monsoon rains facilitated the irrigation requirements, (2) efficient use of inputs, and (3) employing yield boosting technology like plantation of hybrid rice, inter-culture practices and effective pesticide practice.

Out of total FY09 rice production, approximately 4.0 million tonnes will be available for exports. However, a domestic supply glut has coincided with ease in international prices; as a result, downward pressures on domestic rice prices and export unit value are visible.[2]

Figure 2.1: Cotton Plantation Trends



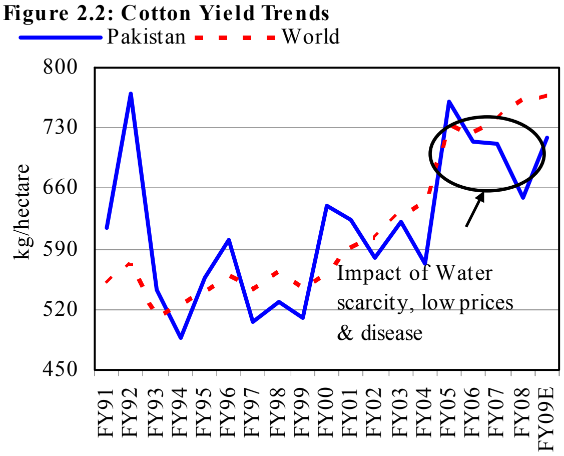
Encouragingly, cotton harvest, which had declined

[1] The highest wheat harvest achieved is 23.3 million tonnes in FY07 so far. Given a substantial rise in area, timely rains, it is likely that FY09 wheat harvest will be a new record high.

[2] Domestic rice (basmati) prices declined by 21.7 percent in November 2008 from their peak in June 2008. International prices fell by about 44.5 percent in November 2008 from their peak levels in April this year.

during the last three years rose by 3.5 percent to 12.1 million bales during FY09. However, this is still substantially lower than the target of 14.1 million bales for the year. As in recent years, FY09 cotton production suffered more due to decrease in planted area, and water scarcity at sowing time than due to damages caused by pest/disease and CLCV. Since FY05, area under cotton both in Punjab and Sindh is gradually shrinking (see **Figure 2.1**). Continued fall in area under cotton is mainly a reflection of lower earnings from this crop compared with other competing crops, since cotton prices have remained subdued and cost of production has increased manifold.

Figure 2.2: Cotton Yield Trends



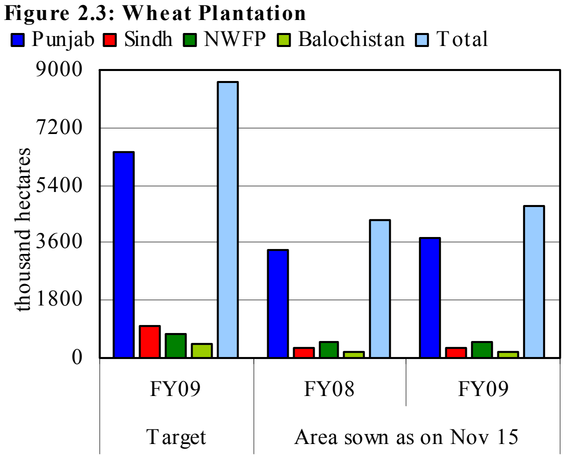
One of the major issues is the low cotton yield in the country; it dropped from a peak of 760 kg per hectare in FY05 (above global average at that time) to an average of 700 kg per hectare between FY06-FY09 (see **Figure 2.2**). The lower yield is due to: (1) eruption of deadly mealy bug, which has not been properly addressed, as yet; (2) supply of poor quality inputs, and (3) increasing cost of inputs and consequently reduced farmers interest. Cotton crop has the strongest forward linkages with the manufacturing and export sectors, therefore, appropriate policy and effective implementation are needed to support the cultivation of this important crop in the country.

Sugarcane crop suffered because of gross disappointment of farmers in the preceding season. Not only realized prices were lower than the anticipated prices (as per announced procurement prices), delays in the beginning of crushing season and payments also placed them at a disadvantageous position. As a result, for the FY09 cropping season growers switched from sugarcane to other crops. Consequently, area under sugarcane fell by 16.0 percent, which is also mirrored in decline in its harvest during FY09. The lower sugarcane production is expected to be reflected in a decline in sugar production (implying decline in LSM growth), import of sugar (implies pressures on trade deficit) as well as higher sugar prices (greater inflationary pressures). In view of all these dynamics, effective government intervention is required to resolve basic issues of price setting, commencement of the crushing season and early settlement of payments.

Rabi Crops

Wheat production target[3] has been fixed at 25.0 million tons[4] for FY09 season. Early winter rains and snowfall raised hopes for better plantation of wheat. By mid-November 2008, wheat plantation registered 9.3 percent rise over the same period of last year (see **Figure 2.3**). Wheat plantation is in full pace, and a significant increase in output is expected over the last year, principally due to policy measures including: (1) increase in support price[5] and announced before sowing time, (2) availability of adequate institutional credit, (3) launching of crop insurance scheme from *rabi* FY09 crops, (4) launching of media campaigns for promotion of production enhancing technology, (5) increase in supply of certified seeds, (6) promoting use of herbicides, (7) ensuring sufficient availability of DAP,[6] and (8) assurance by the government for wheat procurement of available stock from *rabi* FY09 crop.

Figure 2.3: Wheat Plantation



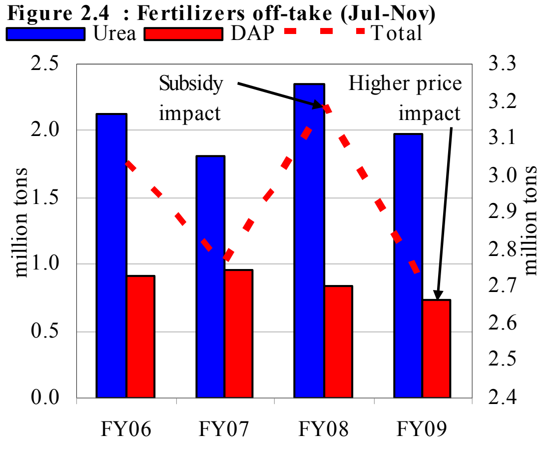
However, a better wheat output largely depends on (i) quantum of irrigation water supply at crucial stages, (ii) supply of quality inputs, (iii) use of balanced nutrients, and (iv) favorable weather. While key risks include irrigation water scarcity, high prices of DAP and sliding international as well as domestic prices of wheat.

[3] Wheat crop targets for FY09 have been fixed while considering: (i) Domestic requirements of wheat for the food year FY09. The domestic wheat requirements have been estimated from the tune of 23 million tons, (ii) average of last three years achievements of area and production, and (iii) ensuring increase in production mainly through productivity while keeping in view some area expansion also.
[4] Wheat production target has been revised upward from 24.0 million tons.
[5] Wheat support prices has been increased by 52 percent to Rs 950 per 40/kg for FY09 crop.
[6] MINFAL estimated that availability of DAP to be at 985 thousand tons (comprising 655 thousand tons of opening inventory and 330 thousand tons of local production) against off-take of 829 thousand tons, showing comfortable supply, leaving 135thousand tons for *kharif* FY10 crops.

Fertilizers off-take

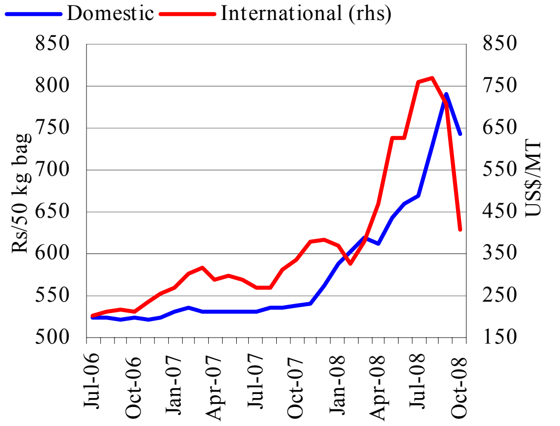
Fertilizers off-take, (both urea and DAP), decreased during Jul-Nov FY09[7] amid weak demand due to higher prices and vague market signals. Urea off-take decreased by 16.1 percent YoY during this period. DAP fertilizer off-take declined by 11.7 percent during Jul-Nov FY09 on top of 12.6 percent fall seen in the same period last year (see **Figure 2.4**). Lower off-take probably reflects cautious purchases by the farmers in anticipation of a reduction in price following the collapse of international DAP prices. However, impact of an ease in international prices is yet to be seen in the domestic market.

Figure 2.4 : Fertilizers off-take (Jul-Nov)



It is estimated that fertilizer supply will be lower than its demand entirely due to shortages in the availability of urea, while availability of DAP estimated at 985 thousand tons (comprising 655 thousand tons of opening inventory and 330 thousand tons of local production) against an estimated demand of 885 thousand tons, showing a comfortable supply and will leave 135 thousand tons for *kharif* FY10 consumption.

Figure 2.5: Urea Prices



[7] Aggregate fertilize off-take though decreased during Jul-Oct FY09, but improved in November over October, 2008.

Fertilizers Prices

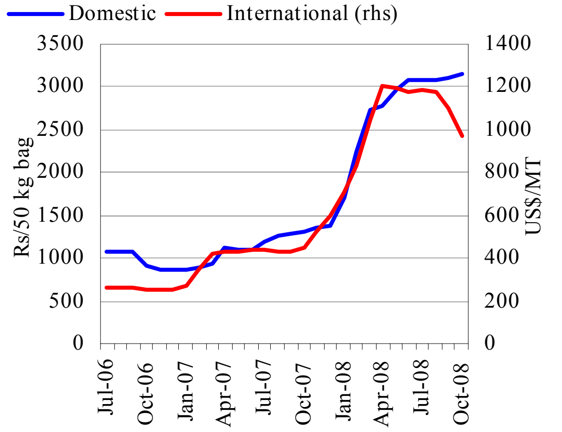
Despite high demand in rabi09 sowing season, urea prices fell to Rs 744 per 50kg bag in October, 2008 after touching a record high of Rs 790 per 50kg bag in September 2008. This decline is a direct impact of fall in the international urea prices. Surprisingly, despite a downtrend in DAP price in international market, domestic prices did not see a correction, probably due to the presence of stocks at old (higher) prices (see **Figure 2.5 & 2.6**). Admittedly, a part of decline in international prices will be offset due to depreciation of rupee, but some benefits of falling international prices need to be passed on to farmers as well.

Table 2.2: Agri-credit Trends (July-Oct)
billion Rupees; change in percent

	Disbursement			Recoveries			Net credit		Outstanding	
	FY08	FY09	change	FY08	FY09	change	FY08	FY09	FY08	FY09
Commercia0l banks	**38.2**	**44.6**	**16.7**	**33.5**	**44.0**	**31.2**	**4.7**	**0.6**	**76.7**	**85.3**
Five large commercial banks	26.8	31.5	17.2	24.7	30.9	25.4	2.2	0.5	55.1	58.6
Domestic private banks	11.4	13.2	15.5	8.9	13.1	47.4	2.5	0.1	21.6	26.8
Specialized banks	**11.3**	**13.0**	**14.6**	**8.6**	**10.8**	**25.4**	**2.7**	**2.2**	**82.6**	**87.9**
ZTBL	10.0	12.1	20.8	7.7	9.6	25.1	2.3	2.5	73.4	78.0
PPCBL	1.3	0.9	-33.0	1.0	1.2	28.2	0.4	-0.4	9.1	9.8
Total	**49.5**	**57.6**	**16.2**	**42.2**	**54.8**	**30.0**	**7.4**	**2.8**	**159.2**	**173.2**

The decline in international fertilizers prices is attributed to slowdown in demand , decrease in fuel prices and fears of global recession. Other factors include, (1) falling food prices[8] and (2) resumption of fertilizer exports from China , previously reduced owing to high export taxes. In addition, fall in fertilizer prices also reflected by the slowing global credit crunch that has slowed down the entire fertilizer supply chain,

Figure 2.6: DAP Prices



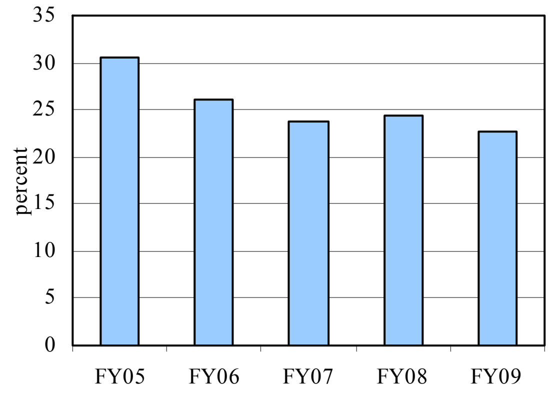
[8] World Bank Food Price Index down by 32.3 percent in October, 2008 from peak in June 2008.

leading to reduced fertilizer trading. It is expected that fertilizer prices will decline further in view of a substantial fall in energy prices

Agricultural Credit

Agricultural credit target for FY09 set at Rs 250 billion compared with Rs 211.6 billion actual disbursement during FY08, up by 18.1 percent. However, during Jul-Oct FY09, agri credit disbursements registered an increase of 16.2 percent (see **Table 2.2**),[9] significantlly lower than the 27 percent in the same period last year. The relative slowdown is also evident from a decline in agri-credit disbursement during Jul-Oct FY09 relative to the annual target ratio being the lowest in five years (see **Figure 2.7**).

Figure 2.7: Agri-credit in Jul-Oct to Annual Target Ratio



However, this is not a source of concern given the slowdown appears to be a temporary phenomenon; fertilizer off-take is expected to rise from November onward for wheat crop cultivated in an extended area. In addition, even at this moderated growth rate, FY09 agri credit disbursement target is estimated to be met comfortably.

A disaggregated analysis suggests that the deceleration in agri-credit growth is entirely attributed to a weaker rise in production related loans during Jul-Oct FY09, as disbursements for developmental purposes increased strongly. In fact, a weak disbursement of production related loans is also a reflection of weak fertilizer demand in this period. An institution-wise break-up shows that a sharp increase in these loans by the specialized banks help offset the impact of weaker growth in disbursement by the commercial banks during Jul-Oct FY09.

The breakup between the farm and non-farm borrowing showed a steady increase in the share of non-farm sector, rose to 34.3 percent in Jul-Oct FY09 from 27.9 percent in Jul-Oct FY08. It is indicating a substantial growth in disbursement for

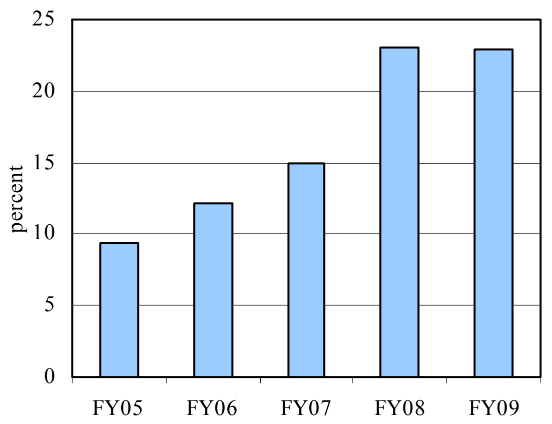
[9] Agri credit disbursements decelerated further to only 7.9 percent during Jul-Nov FY09, significantly lower than the 33.5 percent rise seen in the same period last year.

non-farm sector (43 percent YoY) relative to farm sector (5.8 percent YoY) in this period. Importantly, within non-farm sector, the livestock sub-sector is emerging as a major participant, surpassing the otherwise dominant poultry sector. This encouraging development appears to be a result of government's concious policy to facilitate small loans for livestock given its positive impact on poverty reduction in the country.

Simialrly, increase in the number of borrowers in livestock was phenomenal, beating the poultry as the prime stakeholder of agri-credit. Livestock sector borrowers rose to 20,717 in Jul-Oct FY09 from 10,150 in the same period of FY08.Despite increase the number of borrowers remained low in polutry subsector; rose from 565 in Jul-Oct FY08 to to 821 in period under review.

Among the financial institutions, the growth in agri credit disbursement by the domestic private banks (DPBs) witnessed a sharp moderation, decelerated to only 15.5 percent during Jul-Oct FY09, dropping from a strong 95.2 percent in the corresponding period of FY08. As a result, rising share of DPBs in agri credit market experienced a slight contraction for the first time since these institutions entered in this market segment (see **Figure 2.8**). This sharp slowdown in agri-credit disbursement growth by DPBs probably mirrors the impact of a severe liquidity crunch these banks were facing during the period under review. It is, therefore, expected that the share of these institutions would resume its upward trend following SBP policy actions to ease liquidity constraints in the banking sector.

Figure 2.8: Share of DPBs in Agri-credit



In contrast, despite a reasonably good performance of ZTBL, the share of specilized banks in aggregate agri credit disbursement declined during Jul-Oct FY09. This is principally due to a a sharp fall of 32.8 percent in disbursements by PPCBL during Jul-Oct FY09 on top of a decline of 17.1 percent in the same period last year.

Irrigation

Rabi FY09 season started with the IRSA forecast of 32 to 39 percent water shortage; potentially making a negative impact on the key season crop plantation and watering schedules. Less than expected rains in the period and low availibility of glacial melt meant that agricultural activity was mainly dependent upon the canal operations from the fast depleting water reservoirs or any surprise westerly rain bearing system. Rainfall in wheat sowing season has however helped the farmers towards greater acreage.

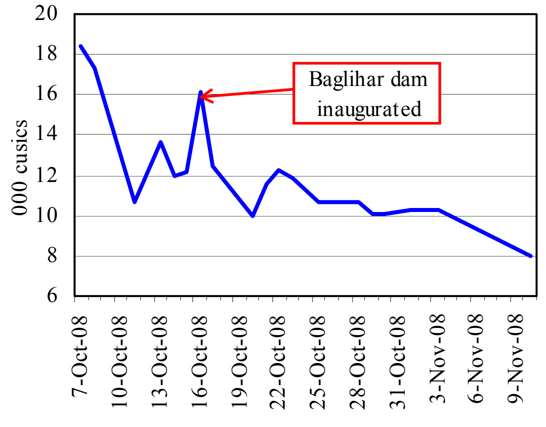
The water situation has been further worsened by low levels in Chenab river primarily impacting agricultural activity in Punjab (see **Box 2.1**). To cope with the shortages of irrigation water, some urgent measures are needed including: (1) speedup work on projects under construction, (2) adoption of technological means to increase efficiency of available resources (see **Box 2.2**), (3) measurses to reduce irrigation water losses, and (4) plantation of drought resisting seeds.

It may be mentioned here that traditionally rabi is a dry period with greater dependence upon winter rains than on canal operations. Over the years, possibly reflecting global warming, the winter rains have been sparse and insufficient for any sowing activity in the key crop areas. In order to preserve the depleting reservoirs for key wheat watering sessions; canal operations are likely to be rationed towards the end of the calendar year 2008.

Box 2.1: Impact of Baglihar Dam on Chenab Water Inflows

Farmers had to face added water shortages on account of inauguration and start of operations at the Baglihar dam along Chenab River in the Indian held Kashmir in October 2008 (see **Figure 2.1.1**). As a result, Punjab irrigation officials estimate impact on about 11 upper Punjab districts directly dependent upon upper and lower Chenab canal command areas and six districts in central and south Punjab indirectly dependent through the Ravi and Sutlej tributaries linked to Chenab. The 1960 Indus Water Treaty divided the six rivers flowing through Pakistan between the two neighbors' India and Pakistan. India got complete control of Ravi, Sutlej and Beas while Pakistan got Indus, Jhelum and Chenab. Since then, the Ravi and Sutlej command areas are supplemented by water resources from Chenab. Any shortage at sources has the consequent

Figure 2.1.1: Chenab Water

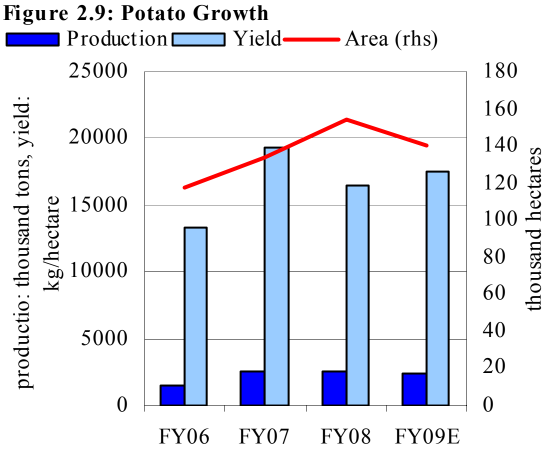


impact on water inflows along the former areas. The 11 upper Punjab districts that produce wheat and rice alternately include Sialkot, Narowal, Gujranwala, Hafizabad, Sheikhupura, Faisalabad, Nankana Sahib, Toba Tek Singh, and Jhang accounting for roughly 5 million acres of cultivable land. The ones facing indirect inflows through the Ravi linkages include the wheat and cotton belt districts like Okara, Pakpattan, Vehari, Multan, Bahawalpur and Bahawalnagar dividing amongst the areas about 3.5 million acres of cultivable land.

Minor Crops

FY09 targets for minor crops have been fixed at higher levels than actual acheivements in FY08. It is expected that farmers will use better inputs given higher prevailing prices of most of the minor crops. It is also reflected in a substantial increase in an improvement in per acre potato yield by 6.7 percent, though its output dropped by 3.2 percent mainly due to a decline in area by 9.3 percent in FY09 (see **Figure 2.9**). However, the outlook for minor crops remains favorable given recent price trend for most of fruits, vegetables and pulses. Smilarly, no evidence was found for an acute domestic shortage of minor crops, as it happened in past few years. For example, prices of moong pulse dropped by about 50 percent due to a bumper harvest in FY09.

Figure 2.9: Potato Growth



Box 2.2: Hydroponic Farming Technology

Hydroponics is a method of growing plants using mineral nutrient solutions, without soil, Terrestrial plants may be grown with their roots in the mineral nutrient solution only or in an inert medium, such as perlite, gravel, or mineral wool. This technology was discovered in the 19th century that plants absorb essential mineral nutrients as inorganic ions in water. In natural conditions, soil acts as a mineral nutrient reservoir but the soil itself is not essential to plant growth. When the mineral nutrients in the soil dissolve in water, plant roots are able to absorb them. When the required mineral nutrients are introduced into a plant's water supply artificially, soil is no longer required for the plant to thrive. Almost any terrestrial plant will grow with hydroponics. Hydroponics is also a standard technique in biology research and teaching. In recent decades, NASA has done extensive hydroponic research for their Controlled Ecological Life Support System or CELSS. Hydroponics intended to take place on Mars are using LED lighting to grow in different color spectrum with much less heat.

Researchers have obtained ground breaking results in various countries, however the process has proved it to be thoroughly practical; having an edge over conventional methods of horticulture. The two major merits of the soilless cultivation of plants are: (1) higher yield, and (2) hydroponics may be helpful in places where ordinary agriculture is impossible. That has removed constraints of cultivable land. Other benefits include (1) it saves water - it uses as little as 1/20 the amount at a regular farm to produce the same amount of produce, (2) faster growth, (3) freedom from soil diseases and weeds, (4) very consistent crops means uniform quality, (5) less labor needed, and (5) cost effective. Scientists agreed that hydroponic fruits and vegetables are sweeter and more luscious than those grown in ordinary soil. The technology is being utilized around the globe including USA, EU and Africa.

Techniques
There are two main types of hydroponics culture; namely solution culture and medium culture. The solution culture excludes roots as source of nutrition while the medium culture is based on roots as part of the process. The solution culture method is further divided into three types; namely; static solution culture, continuous flow solution culture, and aeroponics. The medium culture on the other hand is based on medium through which the root is routed; sand culture, gravel culture or rock wool culture. These media of nutrition are again subdivided into two categories; sub-irrigation and top irrigation. For all techniques, mostly plastic is used for hydroponic reservoirs, though other materials have been used; which include concrete, glass, metal, vegetable solids and wood. Experts advise that the containers should block light to prevent algae growth in the nutrient solution.

Pakistan may enhance vegetable and fruit crops yield with hydroponic farming technology, to overcome the food shortages and price hike tendency. This technology would not only raise yield but also enhance nutrition abilities of plants. A hydroponic pilot project has recently been started in Rawat (Islamabad) under the name Bio-Blitz over just five acres of land. The state-of-the-art five-acre greenhouse facility is producing hydroponic tomatoes of all varieties including tangy, elegant, cherry and others. If hydroponics farming technology is introduced properly, than country can triple the revenues earned on agriculture exports.

2.2 Large Scale Manufacturing

Large scale manufacturing (LSM) continued to decline during Q1-FY09 (see **Figure 2.10**). It registered a negative growth of 6.2 percent in Q1-FY09 as against a reasonable growth of 7.3 percent in Q1-FY08. This decline in LSM production is broad based. Seven sub-sectors (having 72.4 percent weight) out of fifteen registered decline in production (see **Figure 2.11**), while three (having 15.3

Figure 2.10: LSM Production Grwoth Rates (YoY) 6mma

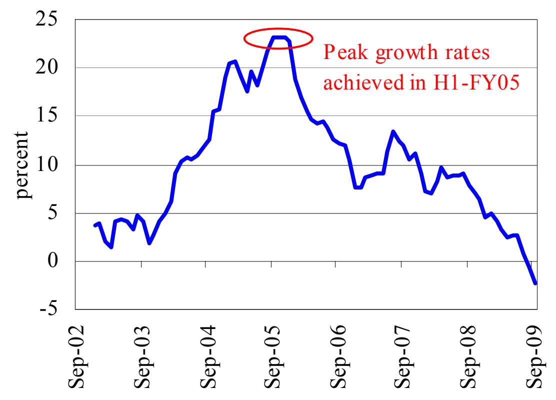
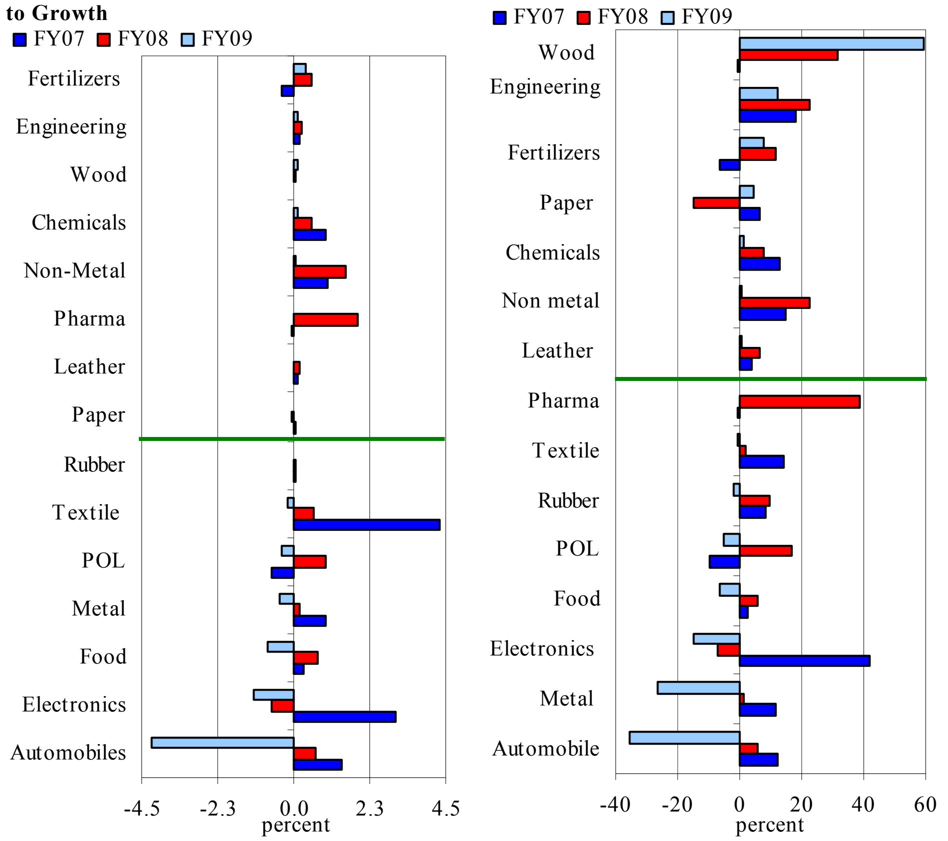


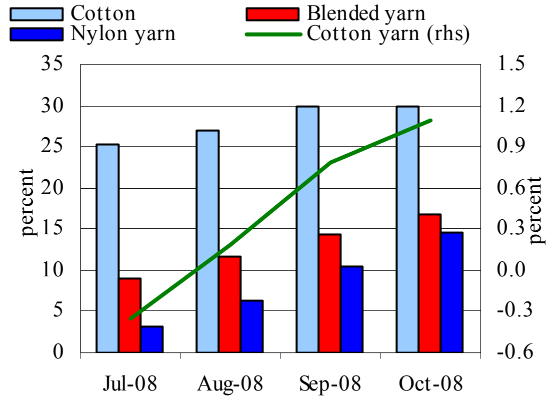
Figure 2.11: LSM Sub-sectors Contribution to Growth



percent weight) registered a growth of less than one percent.

This disappointing outcome is a result of a number of factors including: severe energy shortages, deterioration in domestic law & order situation, impact of pass through of international oil prices, rupee depreciation, and most importantly, weak external demand on the back of global recession and slowdown in domestic demand (see **Box 2.3**).

Figure 2.12: Changes in the Prices of Raw Materials of Textiles (12 mma)



Power shortages, as in FY08, continued to haunt almost all manufacturing sub-groups. Textile sector in particular, was jolted by other multiple shocks: (1) since it is an export driven sector, impact of weak external demand fell disproportionately on this sector; (2) poor law & order situation diverted importers of Pakistani products to search for new suppliers, (3) rising cost of raw materials (see **Figure 2.12**), as well as (4) as imported inputs go into textile production process, a high degree of volatility in domestic currency value created problems of costing and pricing.

It is important to point out here that domestic manufacturing sector has strong backward linkages with the agriculture sector. Therefore, performance of agri sector also affects LSM growth through agri-based industries. A classification of data according to dependence of LSM sub-sectors on agriculture sector (see **Table 2.3**) reveals that, while both agri-based and other industries registered decline in production, the fall in production in the latter was more pronounced during Q1 -

Figure 2.13: Production Growth in LSM

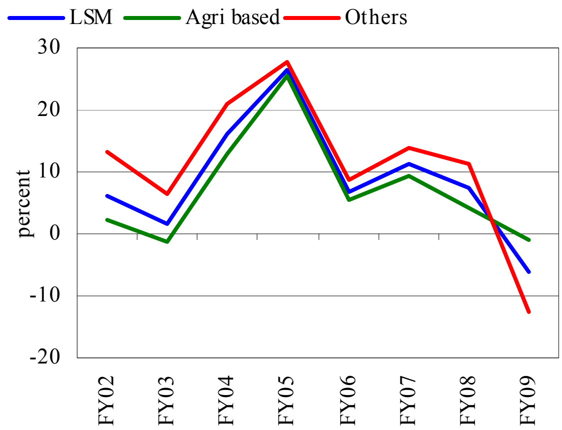


Table 2.3: Classification of LSM Sub-sectors According to Dependence on Agriculture Sector	
1- Agri Based	
Input from Agriculture	Textile, Food, Leather, Wood, Paper & Board, Starch & products, Soaps & detergents, Toilet Soaps, Matches
Input for Agriculture	Fertilizers
Machinery for Agriculture	Wheat thrasher, Chaff cutter, Tractors, Diesel engines
Input for Agri based Industry	Sugarcane Machines, Power looms, Shuttles & bobbins, Synthetic resins
2 - Others*	
	POL, Pharmaceuticals, Metal, Non-metal, Tyres & tubes, Automobiles, Chemicals, Engineering, Electronics

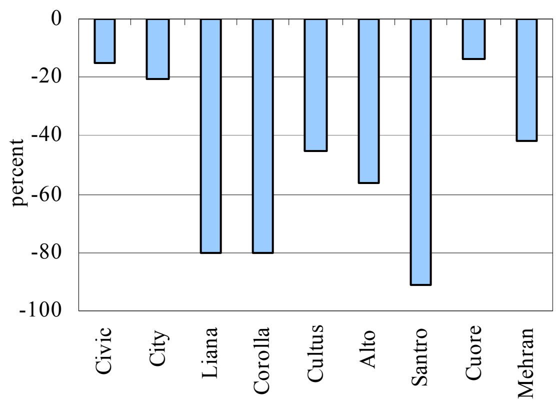
* Sub-sectors excluding the industry mentioned in agri based section

FY09. This classification also highlights the fact that LSM sector has been unable to achieve significant growth without good performance of these two sections of industry, even with high growth in recent past (see **Figure 2.13**).

Within the non agri based industries section, consumer durables (cars & jeeps, motorcycles, refrigerators, deep freezers, T.V. sets, air conditioners etc.) registered a decline of 31.2 percent in production during Q1-FY09. But when the decline in consumer durables is excluded, the negative growth in LSM production reduces to only 0.8 percent. Not only increase in rate of interest on consumer financing hit the production of consumer durables, a sharp rise in their prices also led to drop in the demand. Growth in electronics, in particular, suffered due to increased electricity tariff and power shortages in the country.

In addition, demand for consumer durables eased as increase in international prices of steel products and rupee depreciation compelled manufacturers to increase the prices of durables, surge in inflation eroded the purchasing power of middle class consumers (major market segment of durables). The impact of easing demand

Figure 2.14: Sales Growth of Local Car Brands (Q1-FY09)

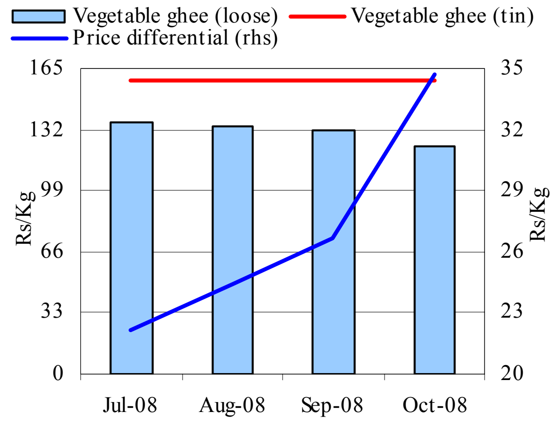


for durables is most evident in the sale of local brands of cars and jeeps; this sector registered the highest decline in LSM growth (see **Figure 2.14**).

It is important to note that impact of an ease in international commodity prices of oil and metals was overshadowed by the exchange rate depreciation. Nonetheless, delivery lags and existence of premium on immediate delivery indicate that the domestic car sales can be improved by reduction in prices and eliminating delivery lags.

A slowdown in the *food, beverages and tobacco* sub-sector (agri-based) contributed to the LSM decline. The inability of vegetable ghee and oil industry in the formal sector to adjust prices[10] in competition with the informal players of the industry (see **Figure 2.15**), and resulting substitution and income effects on consumers, resulted in substantial decline in production. In addition to this, beverages industry which has performed exceptionally well since FY05 (recording production growth of more than 20 percent) registered a decline of 17.8 percent. Wheat and grain milling also registered a decline of double digit (10.4 percent). The fall in production in this sub-sector is largely attributed to a substantial increase in the prices of food items in the country.

Figure 2.15: Price Difference in Ghee Market



Another sub-sector that remained a source of decline in LSM production is *metal*. This sub- sector registered a production decline of 16.6 percent during Q1-FY09. Higher international prices coupled with slowdown in construction activity owing to reduction in Public Sector Development Program (PSDP) and unattractive prospects in real estate for private sector were the principal causes of decline in metal production. A substantial decline in construction activities is also evident from a sharp slump in local cement dispatches, which dropped by 16 percent YoY

[10] In the back drop of falling international prices of palm, soybean and sunflower oils that has declined by 39.2, 26.3 and 15.3 percent between Jun-Sep 2008.

in Q1-FY09.[11] This sharp decline in local cement demand offset the impact of strong increase of 71 percent in export demand during this period, as cement production dropped to a mere 0.7 percent in Q1-FY09 as against a healthy growth of 23 percent in the same period last year. It is pertinent to mention here that a part of sluggishness in private construction activities is also attributed to substantially high domestic cement prices, besides rise in the prices of other construction materials.

On the contrary, fertilizers, engineering, wood and chemicals sub-sectors registered positive growth in their production. Production of fertilizers -both Nitrogenous and Phosphoric fertilizers- increased, principally reflecting an improvement in capacity after BMR in the preceding year. Engineering sub-sector registered considerable growth on the basis of higher production in safety razor blades, diesel engines (multiple uses of diesel engines in agri sector) and wheat threshers (thresher demand rise expecting bumper wheat crop).

Box 2.3: Business Perception Survey 2008[12]

OICCI conducted investor perception survey to assess the overall business sentiments in the economy. Encouragingly, the future is not that bleak as far as investment plans are concerned, more than 3/4th of the respondents (out of 110 firms) are willing to invest in next two years. However, investors showed their concerns about gloomy impression of Pakistan in global market due to deteriorating situation in a number of areas including law & order, political uncertainty, energy deficiency, high cost of operations and infrastructure bottlenecks.

Table 2.3.1: Ranking of Challenges for Business Environment in Pakistan

Rank	Issue
1	Law and order
2	Political uncertainty
3	Energy deficit
4	Cost of operations
5	Infrastructure
6	Legislation
7	Human resources
8	Copyrights and IPR
9	Approval / licensing

To divulge upon the possible factors contributing to this heartening perception, the respondents were asked about the following (1) Business environment, (2) Policies and regulations, (3) Government machinery, (4) Role of city governments, (5) Performance of ministries and regulatory bodies, (6) Availability of utilities, and (7) Law and order situation

(1) Business environment is considered to be better than the ones prevalent in other South Asian markets, except for oil & gas companies. While in case of emerging markets (India, China, Vietnam, Hong Kong, and Middle East) the situation is poorer. Majority of respondents (72 percent) were of

[11] Local cement dispatches dropped by 15 percent and export sale rose by 72.6 percent in Jul-Oct FY09.

[12] Source: Overseas Investors' Chamber of Commerce & Industry (OICCI). OICCI was established in 1860 and has representation from 175 companies comprising of all major manufacturing sectors (Oil & Gas, Energy, Engineering, Pharma, Chemicals, Fertilizers, Textiles, IT, Telecom, Agriculture etc.) Pakistan. The origin of member companies is diverse as there are 85 firms from Europe, 42 from USA, 17 from Middle East, 10 from Japan, 4 from China and 17 firms from other countries.

the view that government is trying to provide a level playing field for multinationals and Pakistan has good relations with major trading partners. However 72 percent of the respondents viewed the state of domestic economy as poor and ranked law & order as one of the major challenges (see **Table 2.1.1**).

(2) Policies and regulations covering employment, property registration, remittances and contract enforcement were hailed by the majority of respondents while they complained about high corporate tax rate (35 percent), tax on provident fund and efficient implementation of policies.

(3) Access to government machinery gauged by ease of contacting the ministries was not found to be improved with the advent of democracy since February 2008.

(4) Performance of twelve regulatory bodies included in survey was viewed as satisfactory except for WAPDA and IPOP. SBP, SECP and FBR remained the top ranked regulatory bodies as far as satisfaction of respondents with their performance is concerned.

(5) Among the five big cities, Karachi, Lahore and Islamabad were viewed as having amicable environment provided by the city governments, while Quetta emerged as the most unfavorable for investment by the foreign investors as 62 percent of respondents viewed it below acceptable levels. Faisalabad was also viewed as having satisfactory environment for investment but 35 percent of respondents marked it as non-conducive for investment.

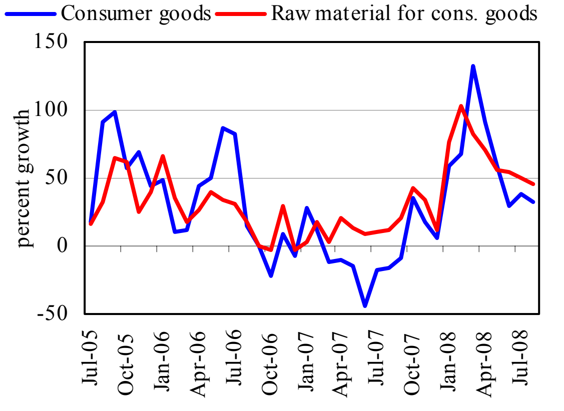
(6) Availability of utilities earned an overall positive outlook on the basis of gas availability; on the contrary, electric power availability was ranked most unreliable by 99 percent of respondents. Provision of water and sanitation facilities were also viewed as below standards by 73 percent of respondents.

(7) Prevailing law & order situation turned out to be the most unfavorable for investment decision as 96 percent of the respondents validated the perception that it is unsatisfactory. But it is encouraging to note that 83 percent of the investors contacted during survey do not intend to hold on their investment decisions because of poor law & order situation.

In view of the above, it is inevitable to restore the investor confidence to resume growth on sustained basis. Therefore, improvement in law & order, corporate governance, provide credible power supply, as well as, removing infrastructure bottlenecks are some important areas to begin with. While some of these problems may be resolved temporarily with ad hoc administrative measures, permanent solutions of these problems are hidden in investment in education, health, physical infrastructure as well as effective implementation of structural and second generation reforms.

2.3 Services

Figure 2.16: Growth in Import of Consumer Goods and Raw Materials



Services sector has exhibited resilience to fluctuations in economic activity in recent years. This is also evident in continued strong growth of FDI in the services sector,[13] despite slowdown in overall economic activities in the country. At present, while sentiments regarding performance of commodity producing sector are bleak, indicators of services sector present a mixed scenario. While, some sectors such as *wholesale & retail trade* and *transportation & communication* are likely to show a weaker performance relative to the preceding year, *community & social services, finance & insurance* as well as *public administration & defence* are estimated to exhibit a strong growth for yet another year.

Key indicators of *wholesale & retail trade* indicate a clear fall in trading activities during the first quarter of FY09 mainly due to a significant decline in manufacturing activities and relative softening demand for imported consumer goods (see **Figure 2.16**).[14] A slowdown in the latter also reflects the impact of substantial depreciation of rupee, as well as a substitution effect as people prioritize their consumption of essential goods given high inflation and unfavorable environment for employment creation in the economy. Anecdotal evidence also suggests a relative moderation in *Eid*-shopping during FY09 compared with the preceding year. A part of this moderation is due to above mentioned economic factors and partially it was a result of disturbed law & order situation in some parts of the country during Ramadan and afterwards.

In contrast to a number of adverse developments, an improvement in agriculture growth will support increase in value addition in trade sub-sector. In addition, it is important to note that while rise in aggregate imports was strong during Q1-FY09,

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[13] FDI in services increased by 2.5 percent during Q1-FY09 as against a fall of 4.4 percent in Q1-FY08.

[14] Annual data reveals that a high correlation (0.84) exists between growth in imports of consumer goods and growth in wholesale & retail trade.

moderation is already evident in November 2008, which is likely to continue going forward.

Finance & insurance sub-sector is estimated to register a strong growth for yet another year, despite a sharp deceleration in earnings of the commercial banks for the nine months of 2008 relative to the previous year. The major impetus to growth in *finance & insurance* is from an expected rise in SBP profits, which is expected to be supplemented by improved performance of insurance sector, strong FDI inflow, as well as reasonable commercial banks' profits on the back of recent SBP measures to ease liquidity constraints in the banking system.

Transportation, in FY08, constituted about 70 percent of value addition in *transport storage and communication* subsector. The unprecedented increase in fuel prices witnessed in FY08 adversely affected value addition in air, water and road transport; the effect of which is visible in Q1-FY09. The impact of increase in petroleum prices is evident from accelerating losses by PIA. It is reflecting a sharp surge in operating expenses that has offset strong growth in operating revenues during the first quarter of current fiscal year (see **Table 2.4**). Recent decline in international petroleum prices and subsequent pass through to domestic prices is likely to have a positive effect on value-addition in transportation sub-sector.

Table 2.4: Selected performance indicators of PIA

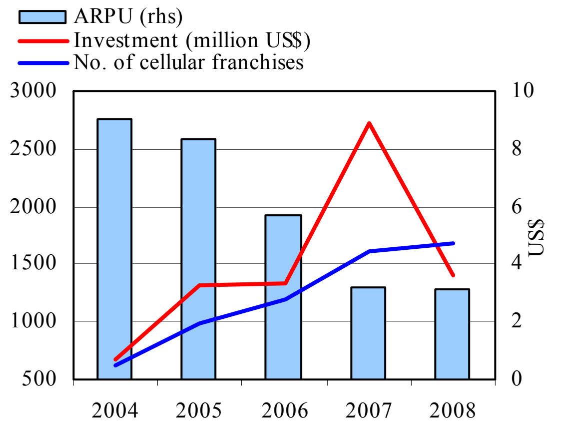
percent or mentioned otherwise

	Q1-CY08	Q2-CY08	Q3-CY08
Growth in operating revenue	0.8	14.7	33.0
Growth in operating expense	-1.9	18.2	45.5
Jet fuel price (Rs./gallon)	174.5	241.2	274.0
Fuel cost as percent of total Cost	37.2	33.9	34.0
Long term Debt (million Rs.)	83,211	87,033	99,486
Profit/(loss) after tax (million Rs.)	(5,487)	(12,601)	(20,437)

Source: Quarterly Reports, PIA

In the communications segment value addition dominated by mobile communication has exhibited strong growth in recent years. The growth followed

Figure 2.17: Selected Indicators of Mobile Telecom



government's liberalization policy, low cost and introduction of innovative products for the consumers. It may be pointed out here that probably a part of increase in cellular density is misleading as the total number of cellular connections reported also includes non-active mobile connections. The impact of that phenomenon and decline in call rates is also evident in a relative stagnation in average revenue per user per month (ARPU) (see **Figure 2.17**). Going forward, a moderation in ARPU is anticipated given strict observation of regulations for know your customer (KYC) as well as increased taxes on communication services.[15] A slowdown in FDI in telecom also reinforces the view that the growth in this sub-sector is expected to slowdown in coming months. Nonetheless, introduction of innovative applications such as mobile banking, mobile video calling as well as access to internet on mobile phones are some positive factors that would *partly offset* the impact of slowdown in this sub-sector.

The expansion of employment in public sector under various government initiated programs as well as ongoing anti-terrorist campaign in tribal areas of the country has led to increase in public expenditure on administration and defence during Q1-FY09 (see **Table 2.5**). This strong increase in this spending is expected to support value addition contribution by the *public administration & defense* sub-sector in FY09. Similarly, value addition by community and social services is anticipated to see a rise given ongoing relief operation in earthquake affected areas of Balochistan and rehabilitation efforts for the dislocated civilians due to anti terror campaigns in tribal areas against terror.

The overall assessment of the services sector suggests that this sector, which contributes more than half of GDP, would achieve its targeted growth of 6.1 percent for FY09. It is worth mentioning here that the FY09 target is significantly lower than the provisional growth of 8.2 percent in FY08.

[15] Federal excise duty on Telecommunication services is enhanced to 21 percent from 15 percent in July FY08. In addition withholding tax levied on telecommunication services is 10 percent.

Table 2.5: Indicators of Services Sector Performance
percent growth or mentioned otherwise

	FY07	FY08	Q1-FY07	Q1-FY08	Q1-FY09
Wholesale & retail trade	**5.4**	**6.4**			
Credit to wholesale and retail trade	-62.7	143.5	15.0	5.7	20.1
FDI in trade	46.0	1.3	107.1	-15.3	-17.1
Imports	6.9	30.9	13.3	8.5	34.3
Trade volume (imports & exports)	5.5	24.2	9.1	6.8	28.9
Transport storage & communication	**6.5**	**4.4**			
Credit to transportation storage and communication	48.3	-23.0	30.8	11.4	17.0
Petroleum crude imports	-4.9	44.8	2.3	5.3	85.8
Commercial vehicles production	7.9	2.0	5.8	0.9	10.9
Teledensity (percentage of population)	44.1	59.7	-	47.8	60.0
Cellular density (percentage of population)	39.9	54.7	-	43.6	55.9
Telecomm imports	15.2	4.0	17.7	6.4	-29.4
Transport group imports	9.2	-6.4	20.3	-7.5	-20.9
FDI in transport storage & communication	-0.5	-11.0	217.1	24.8	-27.9
Finance & insurance	**15.0**	**17.0**			
Profit of commercial banks	24 a	-1.8 a	75.9 b	12.9 b	1.3 b
FDI in financial business	182.6	72.4	948.7	-37.9	68.3
Ownership of dwellings	**3.5**	**3.5**			
Cement Production	22.5	17.6	14.3	23.0	0.6
Metal production	10.7	-12.7	11.5	1.6	-26.6
Credit to Construction	22.1	90.3	22.8	33.6	45.0
Public administration & defense	**9.1**	**10.9**			
Fiscal spending on public admin. and defense	3.3	14.1	-18.5	26.3	42.8
Community, social & personal services	**8.8**	**9.4**			
FDI in social and personal services	23.8	16.3	40.4	1.5	129.2
Total FDI in services sector	**27.4**	**13.5**	**298.4**	**-4.4**	**2.5**

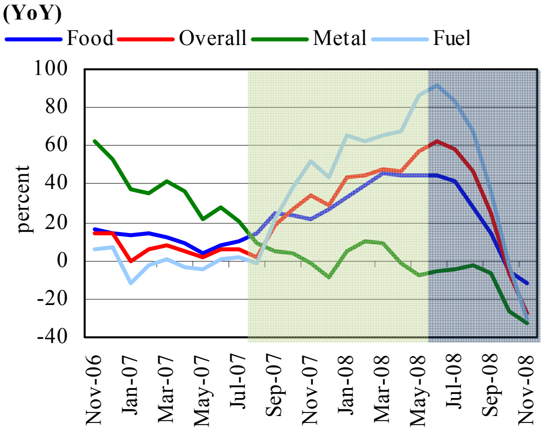
a: data pertains to Calendar Year

b: quarterly data relevant to Calendar Year

3 Prices

3.1 Global Inflation Scenario

Figure 3.1: Change in World Commodity Prices (YoY)



After touching record highs, international commodity prices have retreated sharply since June 2008[1] (see **Figure 3.1** and **Box 3.1**) primarily due to global recession. Other factors that have led to the easing of commodity prices in international markets include: (a) appreciation of US dollar against almost all major currencies, (b) improved outlook for food commodity supplies, (c) significant reduction in shipment costs, as well as, (d) removal of trade barriers by some countries imposed earlier to shield their domestic economies from rising commodity prices.

The impact of declining food prices is likely to be more pronounced for developing countries, where food expenditure accounts for a greater proportion of incomes. Moreover countries that are net importers of food and energy are likely to see improved current account and fiscal positions due to fall in commodity prices in general and sharp slide in fuel prices in particular.

The price of crude oil[2] has plummeted from a monthly peak of US$ 132.5 per barrel in July 2008 to US$ 54 per barrel in November 2008. Similarly, the prices of other major food items and metals have witnessed a significant fall from their recent peak levels (see **Table 3.1**). If the current trend in commodty prices continues, the YoY change in retail prices for a number of commodities will become negative. This risk has altered the future direction of policy responses in many economies as they are slashing interest rates due to the fear of possible deflation that will make debt more expensive by raising real interest rates. This may inflict another blow on the already depressed global economy.

---

[1] According to IMF commodity price index

[2] Simple average of three spot prices; Dated Brent, West Texas Intermediate, and the Dubai Fateh.

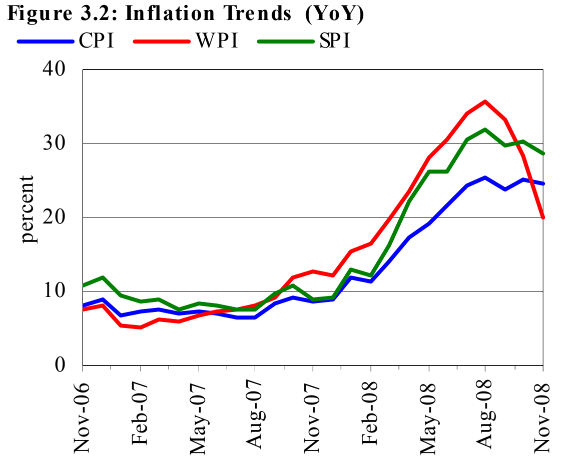
Table 3.1: Global Commodity Prices

Item	Unit	Nov-07	Nov-08	Peak Value	Peak Month	Decline since current peak (%)
Crude oil	US$/barrel	91.3	54.0	132.5	Jul 08	-59.23
Rice	US$/MT	356.5	563.3	1015.2	Apr 08	-44.52
Wheat	US$/MT	321.2	226.8	439.7	Mar 08	-48.41
Sugar	US cents/Pound	9.9	11.8	14.0	Sep 08	-15.63
Palm oil	US$/MT	877.3	433.1	1146.9	Mar08	-62.24
Soybean oil	US$/MT	988.0	728.5	1414.4	Jun 08	-48.49
Corn	US$/MT	171.1	164.3	287.1	Jun 08	-42.79
Copper	US$/MT	6957.4	3729.2	8714.2	Apr 08	-57.21
Aluminum	US$/MT	2507.2	1857.1	3067.5	Jul 08	-39.46
Gold	US$/Ounce	806.2	760.9	968.4	Mar08	-21.43
Lead	US$/MT	3319.9	1286.4	3722.6	Oct 07	-65.44

Source: IMF and www.gold.org

The reversal in commodity prices alongwith the possibility of sluggish growth prospects, have led many central banks around the world to reduce policy interest rates. However, countries,such as Pakistan and Sri Lanka, continue to suffer from high inflation emanating from countervailing domestic factors, forcing the retention of a tight monetary stance.

Figure 3.2: Inflation Trends (YoY)



3.2 Domestic Scenario

In contrast to the decline in global inflationary pressures, these remain strong in the domestic economy (see **Table 3.2**). In particular, consumer price index (CPI) and the sensitive price indicator (SPI) have seen strong YoY increases in FY09 in Pakistan so far (see **Figure 3.2**).

The strength of domestic inflation reflects the cumulative impact of strong aggregate demand, weakness of the rupee[3] as well as other factors[4] that limited the

[3] Pak Rupee depreciated by 13.3 percent during Jul-Nov FY09 (for details see **Chapter 6**) which offset a large part of the gains of falling international commodity prices.

pass-through of lower international prices to domestic consumers. The latter is suggested by the fact that CPI inflation has not, as yet, followed the abrupt slide in WPI inflation (see **Figure 3.3**).

Encouragingly, after recording strong growth (YoY) during the first two months of FY09, a significant decline in WPI inflation was seen during the later months. WPI inflation dropped to 19.9 percent in November 2008 from its peak of 35.7 percent in August 2008, mainly due to a decline in international fuel and commodity prices. This also suggests that the pass through of declining fuel and commodity prices to the wholesale prices has been quicker as compared to the retail prices.

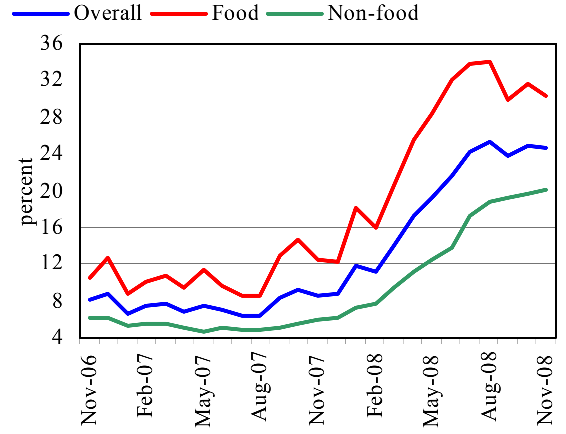
This is principally due to the very composition of the WPI basket. Prices of most of the items included in this basket are determined on the basis of international prices, for

Table 3.2: Inflation Trends
percent

	Year-on-Year[1]		12-month moving average[2]	
	Nov-07	Nov-08	Nov-07	Nov-08
CPI	8.7	24.7	7.6	19.1
Food	12.5	30.4	10.8	26.3
Non-food	5.9	20.2	5.3	13.7
WPI	12.6	19.9	7.9	25.0
Food	15.3	29.2	11.2	26.6
Non-food	10.7	12.8	5.5	23.7
SPI	9.0	28.8	9.0	23.3
Core				
NFNE[3]	6.9	18.9	5.9	12.9
Trimmed mean	8.6	21.3	7.1	16.1

[1]e.g. change in Nov 2008 over Nov 2007
[2]e.g. change in 12-month average of Nov 2008 over Nov 2007
[3]Non-food non-energy
Source: Federal Bureau of Statistics

Figure 3.3: Consumer Price Inflation (YoY)



[4] The weak pass through of falling international commodity prices by domestic manufacturers and transporters are also probably due to firms taking the opportunity to bolster margins, and/or dispute of levy of import duty as per L/C prices. For example, importers of metal and edible oil are particularly complaining about higher import duties, which hinder them from fully passing - on the impact of decline in international prices of these commodities.

example, furnace oil, mobil oil, pig iron, iron bars & sheets, coke, cotton, wires & cables etc. If the declining trend in wholesale prices continues, it may also help bring down retail prices in coming months.

Similar to CPI inflation, core inflation measured by both indicators, Non-food Non-energy (NFNE) and 20% trimmed mean, continued to accelerate during the first five months of FY09. Core inflation (YoY) measured by NFNE increased to 18.9 percent during November 2008 compared to only 6.9 percent in November 2007. Similarly, 20 percent trimmed mean core inflation (YoY) also remained strong as it increased to 21.3 percent in November 2008 from 8.6 percent in the same month last year (see **Table 3.2**). Strength in core inflation is indicating the persistence of inflationary pressures. Keeping in view stubbornly high inflation, uncomfortably high government borrowings from the central bank and almost about 100 percent increase in the current account deficit during Jul-Oct FY09, SBP tightened monetary policy during November 2008.

It is important to mention that while SBP raised policy rates by 500 basis points during CY2008 in four episodes of monetary tightening,[5] other measures were also taken to support appropriate liquidity in the banking sector and availability of credit to priority sector (for details see **Chapter 4**). Nevertheless, it should be kept in mind that the desired macroeconomic stability cannot be achieved solely by monetary policy measures. Coordination of fiscal policy is also needed. In this background, recent fiscal constraint, under IMF program, is likely to supplement monetary policy actions. Thus, inflationary pressures are expected to steadily ease going forward.

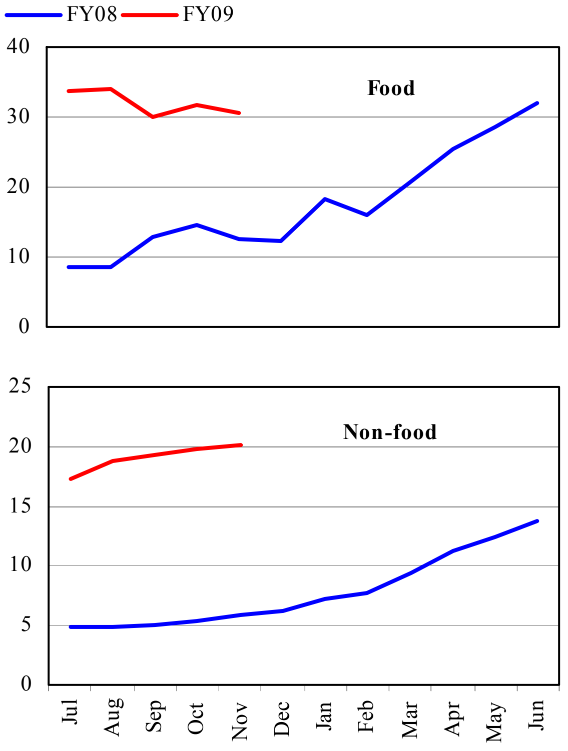
Despite easing of inflationary pressures, average CPI inflation for FY09 is likely to be in the range of 20 – 22 percent, compared with 12 percent in FY08. The persistence of inflationary pressures requires sustained macroeconomic discipline. In particular, reduction in fiscal and external deficits is necessary to achieve conducive macroeconomic environment.

[5] Two increases were announced as per usual issuance of MPS (i.e. January and July), while interim measures were also taken twice in May and November.

3.3 Consumer Price Index (CPI)

CPI inflation (YoY), which remained in single digits until Q2-FY08, started to accelerate from Q3-FY08 onwards. This rising trend continued during the first five months of FY09, and CPI inflation (YoY) reached 24.7 percent in November 2008 as against 8.7 percent in November 2007.

Figure 3.4: CPI Inflation (YoY) (percent)



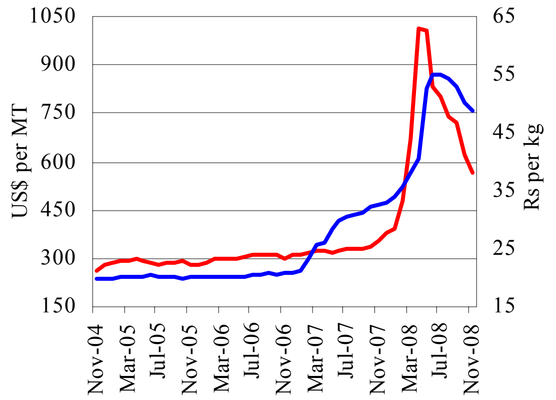
It is important to note that CPI food inflation is showing a modest downtrend in FY09 relative to a sharp upward path during FY08 (see **Figure 3.4**). In contrast, CPI non-food inflation has continued its rising trend in FY09 as a result of lagged impacts of fiscal stimulus, pass through of rising international commodity prices of key fuels to domestic consumer prices as well as second-round effects of persistently high food inflation. The recent downward adjustment in domestic prices of key fuels in response to declines in international oil prices is likely to ease non food inflation in months ahead.

This pass through of the substantial ease in international commodity prices is however likely to be considerably slow in the domestic economy as businesses seek to improve margins, as well as due to market structure issues. Acceleration of the anticipated downtrend may therefore require increased consumer awareness; the role of media in reporting wholesale and retail prices as well as support from effective monitoring by the government of the prices of essential items will be important here.

Economic literature clearly indicates that nominal prices can be downward sticky as downward adjustment in wages, profit margins and rents can be painful for businesses. For example, while the fixation of wheat support price at Rs 950 per

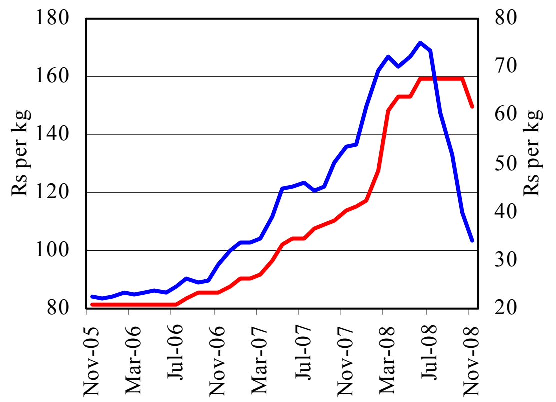
40 kg was encouraging for the farmers when international prices were high, the latter have since declined sharply, with the risk of substantial negative consequences. However, a downward adjustment in domestic wheat prices will be challenging. Similarly, while transport costs rose with the rise in fuel prices, there is little evidence of a corresponding downward revision when fuel prices declined.

Figure 3.5: Rice Prices



In the case of rice, similar disconnect was witnessed between local and international price levels. It may be noted that domestic rice prices started to increase sharply earlier than surge in international prices, however, ease in domestic prices was delayed and weaker than international prices (see **Figure 3.5**). Specifically, international rice prices came down by 44.5 percent in November 2008 relative to their peak levels. Whereas domestic prices of different varieties fell by only 11.4 – 21.7 percent from their peak levels, despite a bumper harvest of 6.5 million tonnes in FY09.

Figure 3.6: Edible Oil Prices



Similarly, domestic prices of ghee and cooking oil rose in tandem with international prices of edible oil (see **Figure 3.6**). However, downtrend in domestic ghee/cooking oil prices is relatively weaker relative to a sharp fall in international prices of key inputs, this is a source of disquiet.

There is a need to ensure a corresponding decline in domestic *rice* prices with the fall in international prices. This requires administrative actions focusing on reduction in excessive profit margins of middlemen/wholesalers. Though imposition of minimum export price is not a recommended measure at the moment, however, if market mechanism fails to determine consumer price as per demand-supply forces, administrative measures are inevitable.

3.3.1 CPI Food Inflation

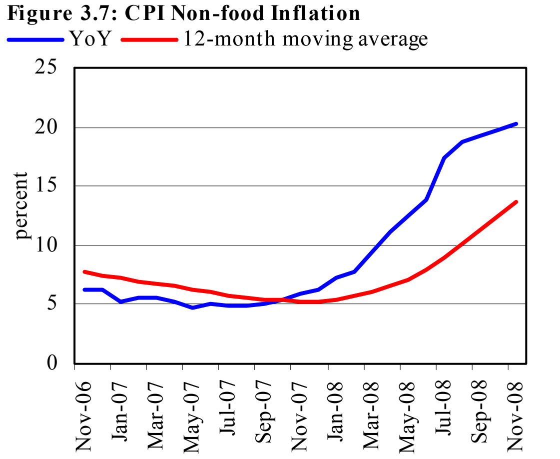
CPI food inflation remained high throughout the initial five months of FY09 and was recorded at 30.4 percent (YoY) during November 2008 as compared to 12.5 percent in the corresponding month last year. However, it seems that CPI food inflation (YoY) peaked out in August, 2008 and is likely to ease in H2-FY09.

Amongst major food commodities negative growth in sugar prices witnessed a reversal from June 2008 onwards and rose by 23.4 percent YoY in November 2008. This was mainly due to speculation supported by a 16 percent decline in sugarcane harvest, and consequent anticipated increase in domestic prices in months ahead. Wheat prices also remained strong during the first five months of FY09, showing a gradual adjustment towards a higher support price set by the government for FY09 crop. Given prospects of a bumper crop, substantial wheat imports in recent months, as well as ease in international prices, the domestic price of the commodity is likely to drop in coming months.

3.3.2 CPI Non-food Inflation

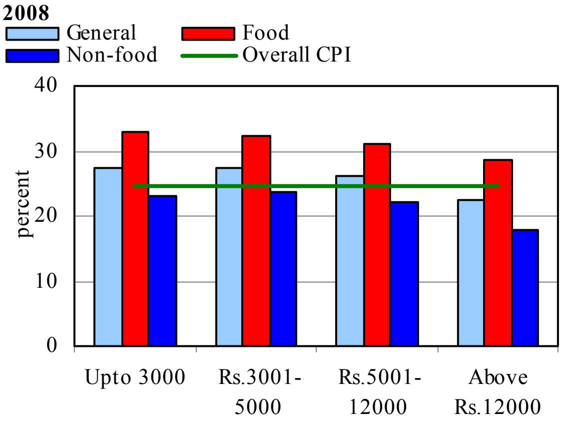
CPI non-food inflation (YoY) maintained a rising trend throughout the first five months of FY09 and was recorded at 20.2 percent during November 2008 which was 14.3 percentage points higher than the corresponding month last year (see **Figure 3.7**).

Figure 3.7: CPI Non-food Inflation



The acceleration in CPI non-food inflation was contributed by all sub-indices in the non-food group. The most significant increase, however, was registered in *fuel & lighting* and *transport & communication* sub-indices in November 2008. The increase in these sub-groups was due to an upward price adjustment of key fuels and subsequent rise in transportation charges. However, recent downward adjustment in fuel and transportation prices, in response to a decline in international fuel prices, would possibly help ease inflationary pressures in these sub-groups in coming months.

Figure 3.8: Incidence of Inflation (YoY) November 2008



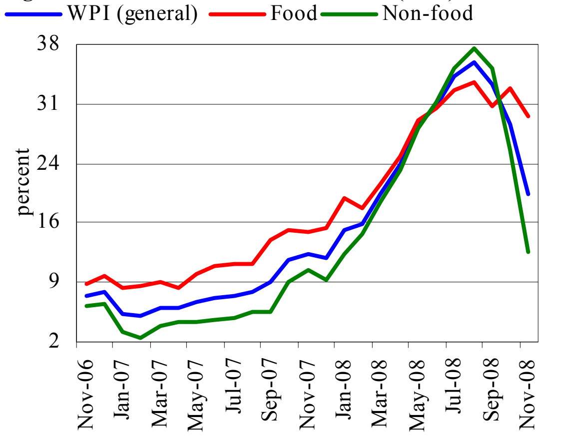
3.3.3 Income Group-wise Inflation

Income group wise data for the first five months of FY09 reveals that incidence of inflation remained high for lower income groups. Thus, in November 2008, all income groups, except the highest income group (having income above Rs 12000 per month), recorded higher inflation relative to the overall CPI inflation (see **Figure 3.8**). The high inflation for the low income earners is an evidence of strong food inflation, as food component constitutes a significant portion of lower income group expenditure.

3.4 Wholesale Price Index (WPI)

Wholesale price index (WPI) showed mixed trends during FY09. The first two months of FY09 witnessed high WPI inflation as it reached 35.7 percent (YoY) in August 2008 compared to 8.0 percent during the same month last year. However, since August 2008 a significant deceleration in WPI inflation has been witnessed (see **Figure 3.9**). The recent downtrend in WPI inflation was mainly contributed by the WPI non-food group that has registered a sharp decline since

Figure 3.9: Wholesale Price Inflation (YoY)



September 2008. On the other hand, WPI food group inflation remained hovering around 30 percent (YoY) so far. The downtrend in WPI non-food group inflation in the recent months is also reflected by the change in its weighted contribution in overall WPI inflation.

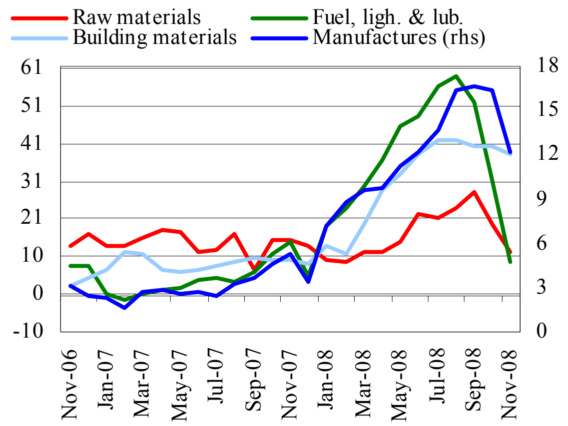
Table 3.4: Percent Contribution of Sub-indices to WPI Non-food Inflation

percent

	Nov-07	Jun-08	Oct-08	Nov-08
Raw materials	17.9	9.5	9.9	12.1
Fuel, lighting & lubricants	57.1	65.8	53.8	30.6
Manufactures	17.8	14.2	23.0	32.8
Building materials	7.2	10.5	13.4	24.5

Within non-food group, the weighted contribution of various sub-groups exhibited mixed trends. The weighted contribution of raw material, manufactures and building material sub-groups increased in November 2008 as compared to the same month of FY08. On the other hand, the weighted contribution of fuel, lighting & lubricant sub-group decreased (see **Table 3.4**). This relatively lower weighted contribution of the fuel, lighting & lubricant sub-group reflects the impact of downward revision of domestic oil prices followed by the ease in international crude oil prices.

Figure 3.10: WPI Non-food Inflation (YoY) (percent)



An analysis of YoY inflation of various WPI non-food group shows that all sub-groups registered a surge in inflation during the initial months of FY09. However, since September 2008, all sub-groups have experienced relative ease in inflation and this disinflation process is quite broad-based (see **Figure 3.10**).

Box 3.1: Major Developments in Global Commodity Markets

Crude oil prices have plummeted more than US$ 100 per barrel and reached as low as US$ 40 per barrel since hitting record heights five months ago. Global recession, tighter credit, rising non-OPEC supplies and reduced demand for crude oil particularly in US and Europe due to high oil prices helped drive oil prices down. The strengthening dollar against other currencies coupled with the decreased tension between Iran and the west also played the role in bringing down oil prices.

Wheat prices followed a downward course in the second half of 2008 as commodity demand softened amid global economic recession. Adequate rainfall and temperatures in wheat exporting countries boosted production of the crop and helped the wheat prices to end lower. As corn competes with wheat as a livestock feed, the declining corn prices further added to the downward pressure on wheat prices. Corn prices were brought lower after the demand for grains used as alternative fuel collapsed amid slumping energy prices.

Sugar prices remained under pressure in last five months of 2008 mainly on account of reduced demand amid global recession. The drop in crude oil prices also contributed to the downward trend of sugar prices by crimping demand for ethanol. Global sugar output in the year ending September 30, 2009 is expected to drop for the first time since 2005, led by cuts in India and the European Union. This implies that sugar prices may remain strong next year.

Edible oil: The second half of 2008 saw edible oil prices tumbling. The decline in demand amid global recession and increased supplies of palm oil remained responsible for pushing the prices lower. The supplies of edible oil found a boost owing to increased output in Malaysia and Indonesia and bumper crops in China and India. Fall in crude oil prices signaled lower demand for fuel substitutes and contributed to the downward pressure on palm oil prices.

Rice prices started to ease after reaching record highs in the second week of May 2008 and stayed weak until recently. The decline was helped by the globally increased supply of rice coupled with the removal of ban on its export. Farmers in the rice exporting countries started to plant more of the crop to take advantage of the high prices after prices touched the highest in May 2008. A report published by FAO expects rice prices to remain under pressure in international market in the near future mainly on account of weakening wheat prices (a substitute to rice). Prices, however, will also be strongly affected by the pattern of the monsoon in the Northern Hemisphere and Asian countries.

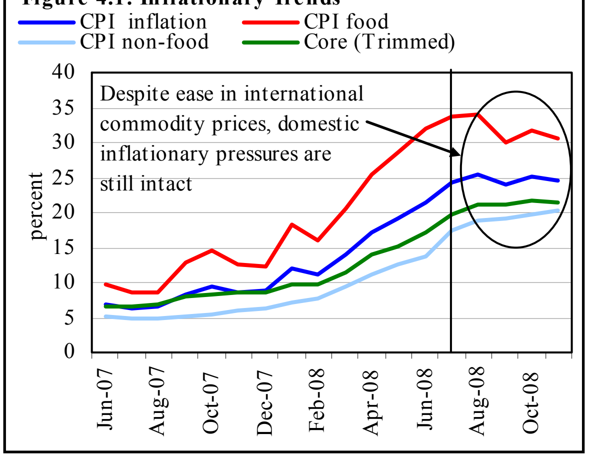
Metals prices remained on a downward track during the period July-December 2008. Demand for the metals significantly reduced after industrial growth slowed down due to global recession and the US dollar gained strength against other currencies. As the car sales plunged in Europe and America demand for aluminum, lead and platinum collapsed to bring down the prices of these metals. The price of nickel stayed under pressure owing to the falling demand from stainless steel makers. Copper prices came under pressure due to decreased demand from China, collapse of the housing market in US and rise in global stock piles of copper. The strong dollar remained as the main reason for causing the decline in gold prices during the last five month of 2008.

4 Money and Banking

4.1 Monetary Policy

SBP undertook more aggressive monetary tightening during FY09 as it further increased the policy rate by 300 bps in two rounds. On cumulative basis, this meant a 550 bps rise during the last 18 months. These policy measures were in response to carryover of macroeconomic stresses of the preceding year, which had grown in size during the current year.

Figure 4.1: Inflationary Trends



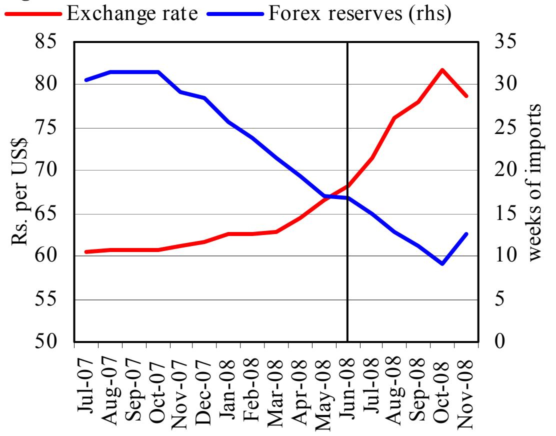
The monetary tightening of FY09 became unavoidable given the acceleration in inflationary pressures during the year. The YoY CPI inflation reached a record high of 25.3 percent in August 2008, with food inflation touching as high as 34.1 percent. Although down from its peak, domestic inflation has remained high. While food prices have retreated somewhat, non-food inflation shows little effect of the sharp decline in international commodity prices (see **Figure 4.1**). One explanation could be that the businesses are taking advantage of strong domestic demand to support their margins.

Another allied concern for the monetary policy was the rising external current account deficit, which was mainly reflecting domestic demand pressures.[1] This together with slowdown in external financing flows, led to a sharp depletion in country's foreign exchange reserves and steep depreciation of the domestic currency. Indeed, with import coverage of reserves falling to low levels (see

[1] The external current deficit is largely explained by strong growth in import demand both for oil as well as non-oil products (see Section on ***Foreign Trade*** in ***Chapter 6***).

Figure 4.2), such continuing high pressures on external account were unsustainable even in the short-term.[2]

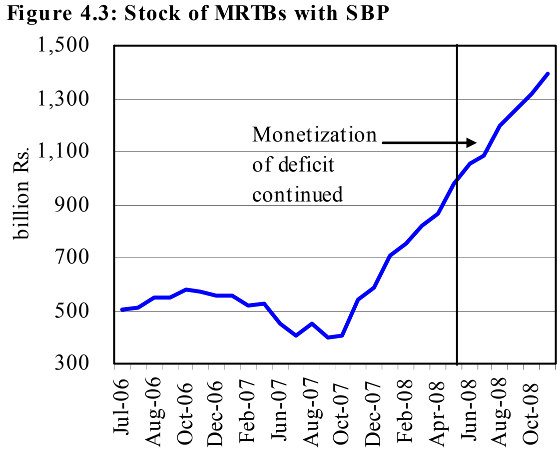
Figure 4.2: Continued Pressures on External Sector



Despite the anticipated relief in overall import bill for the country due to recent broad-based decline in international commodity prices, there is still a risk that external account pressures will persist. This is because the substantial slowdown in major economies may weaken Pakistan's exports and remittance inflows. It is therefore critical to achieve a sustained decline in overall import through demand management policies, and thus bring the external current account deficit to manageable levels.

In order to do so, it is imperative to reduce the domestic demand stimulus from continuing monetization of the deficit, which has greatly diluted the impact of earlier monetary tightening. Government budgetary borrowings from the central bank during Jul-Nov FY09 reached Rs 356.4 billion, as compared to Rs 169.5 billion in the same period last year. The stock of market related treasury bills (MRTBs) with SBP has reached Rs 1,393.4 billion by end-November 2008 (see **Figure 4.3**).

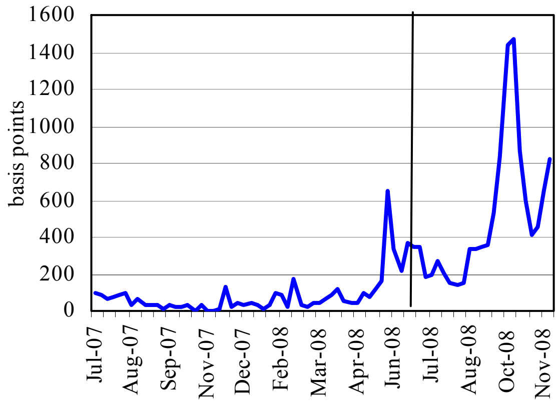
Figure 4.3: Stock of MRTBs with SBP



This undesirable rise in borrowings from the central bank during FY09 was despite an explicit commitment by the government (in the Budget for 2008-2009), for a net zero

[2] Current account deficit reached US$ 6.9 billion during Jul-Nov FY09 compared to US$ 4.7 billion in the corresponding period of preceding year.

Figure 4.4: Spread Between O/N Clean and Repo Rate



budgetary borrowings from the central bank for FY09. This strong growth led the SBP in its Monetary Policy Statement for July-December 2008, to recommend that the government retire Rs 21 billion of borrowings to the central bank in each quarter.

The available indicators suggest that the continued excessive borrowings from the central bank are mainly due to (a) a relative decline in financing receipts during the first quarter of FY09, both from non-bank sources and from external sector, and (b) scheduled banks' reluctance to invest in government papers at the prevailing interest rates through Jul-Oct FY09. SBP in the past has repeatedly highlighted the difficulties in liquidity management and increased risk to inflation outlook due to continued monetization of budget deficit. Monetary tightening was therefore essential (a) to reduce the burden on central bank for government financing, and (b) to contain excess demand which was stressing the external account and putting pressures on exchange rate and foreign exchange reserves.

Indeed, the steep fall in foreign exchange reserves and sharp depreciation of the exchange rate (both driven by external account pressures) led to a substantial drain of the rupee liquidity from the inter-bank market by October 2008, and contributed to inability of the government to raise more funds from the scheduled banks.

The resulting decline in banks' liquidity and lower T-bill holdings with scheduled banks, both led to a sharp jump in call rates in the inter-bank market. Thus, the spread between call and repo rose to exceptionally high levels (see **Figure 4.4**).

The liquidity crunch became severe following a heavy withdrawal of deposits owing to seasonal cash demand around Eid. In October 2008, banking system also experienced rumor-induced panic withdrawal of deposits.[3] SBP responded by

[3] See ensuing section on '***Deposit mobilization***' in this chapter.

introducing a number of temporary measures aimed at accommodating extraordinary liquidity shortages in the banking system.[4]

As a result of SBP's timely response, the liquidity concerns have considerably subsided. There is, however, a need to continue policy focus on addressing macroeconomic imbalances, namely high inflation, exceptional pressures on external account and continued reliance of government on borrowings from the central bank. Recognizing this, the government and SBP have already developed a macroeconomic stabilization program, which is being currently implemented. The Stand-By Arrangement for 23 months agreed with International Monetary Fund, is one key element of this entire package which will also help in mobilizing resources from other International Financial Institutions (IFIs). Not surprisingly, the program agreed with the Fund also aims to bring down inflation, protect country's reserve

Table 4.1: Inflation and Interest Rates

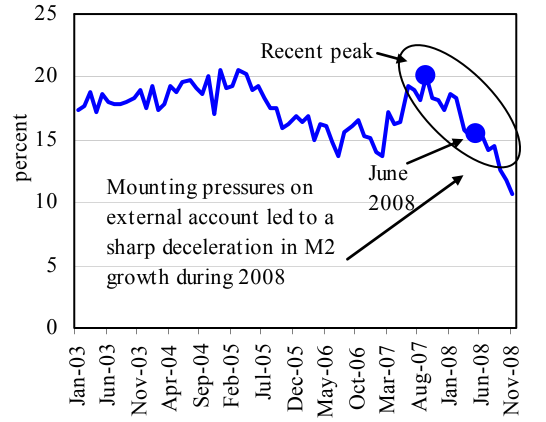
percent

	Inflation YoY		Policy Rate		
	Nov-07	Nov-08	Previous	Current	w.e.f
USA	3.5 *	3.7	1.0	0.25	Dec 08
UK	2.1 *	4.5	3.0	2.0	Dec 08
Eurozone	3.1	2.1	3.3	2.5	Dec 08
Canada	2.4 *	2.6	2.3	1.5	Dec 08
Australia	1.9 #	5.0	5.3	4.3	Dec 08
Japan	0.3 *	1.7	0.5	0.3	Oct 08
China	6.9	2.4	6.7	5.6	Nov 08
S. Korea	3.5	4.5	4.0	3.0	Dec 08
Malaysia	1.9 *	7.6	3.8	3.3	Nov 08
Thailand	3.0	2.2	3.8	2.8	Dec 08
Philippines	3.2	9.9	5.8	6.0	Aug 08
India	5.5 *	10.4	7.5	6.0	Dec 08
Pakistan	8.7	24.7	13.0	15.0	Nov 08
Sri Lanka	18.2 *	20.2	10.0	10.5	Oct 08
Vietnam	10.0	24.2	13.0	12.0	Oct 08
Indonesia	5.6	11.7	9.3	9.5	Oct 08

* data pertains to October # Quarterly data

Source: Bloomberg, The Economist

Figure 4.5: YoY Growth in M2



[4] See SBP document '***Interim Monetary Policy Measure, November 2008***'.

position, and eliminate SBP financing of the government.

It is also important to recognize that the economic stresses faced by Pakistan are quite different from what other countries in the region, and across the globe, are facing following unfolding of the international financial crisis. Thus, one should expect wide variance in policy response in Pakistan and other countries. While macroeconomic situation in Pakistan requires continued monetary tightening (well supported by fiscal measures), other countries are facing the risk of economic recession, which is reflected in their monetary policy responses (see **Table 4.1**).

Table 4.2: Monetary Aggregates (from end June till Nov 29)

	Flows in billion rupees		YoY growth (%) in stocks	
	FY08	**FY09**	**FY08**	**FY09**
Broad money (M2)	171.4	-10.8	19.3	10.4
NFA	-99.9	-356.3	38.5	-64.8
SBP	-34.5	-363.0	42.9	-84.5
Scheduled banks	-65.4	6.7	17.7	47.7
NDA	271.3	345.5	15.1	30.3
SBP	153.6	292.4	-10.6	250.2
Scheduled banks	117.7	53.1	18.5	8.3
of which				
Govt sector	168.0	270.9	18.4	62.7
Net budgetary support	191.3	263.1	24.3	62.5
from SBP	169.5	356.4	2.4	170.2
from scheduled banks	21.9	-93.3	60.4	-51.2
Credit to PSEs	4.5	54.8	61.2	97.9
Credit to private sector	133.9	145.8	15.6	16.1
Memorandum item				
Total domestic credit[1]	306.7	471.5	17.1	31.2
Reserve money	76.1	-38.6	14.9	12.0

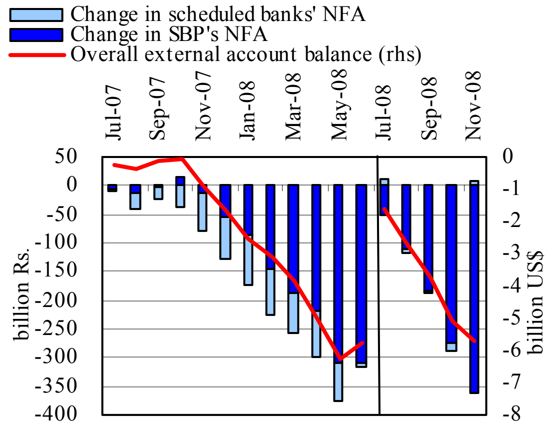
[1.] Sum of government and non-government credit.

4.2 Developments in Monetary Aggregates

An extraordinarily strong contraction in net foreign assets (NFA) of the banking system led to a net drain of Rs 10.8 billion in broad money aggregate (M2) from the system during Jul -Nov FY09. The contraction in NFA was partially offset by a sharp rise in government borrowings form the central bank (see **Table 4.2**). Nonetheless, M2 growth YoY decelerated steeply to 10.7 percent by end November 2008 (see **Figure 4.5**) – the lowest growth seen during the last seven years.

Given that the contraction in NFA owes to strong demand for imports, and that domestic credit growth (both for public as well as private credit) remains robust, the slowdown in M2 during Jul-Nov FY09 should not be misconstrued as a weakness in domestic aggregate demand. Indeed the exceptional rise in government borrowings from the central bank is aggravating already high demand pressures in the economy.[5] Such pressures are well evident in an unusual rise in total domestic credit that has grown by 31.2 percent on YoY basis by end November 2008 compared to 17.1 percent increase an year earlier.

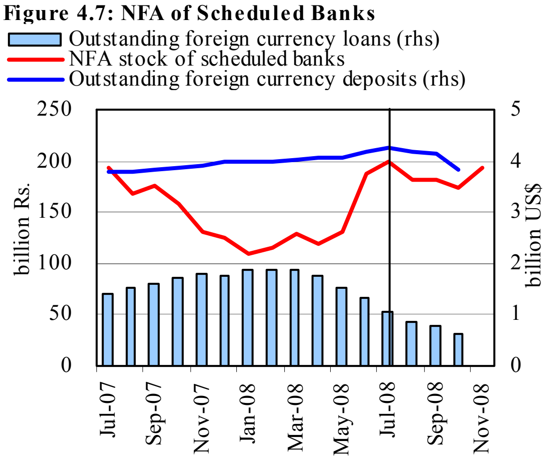
Figure 4.6: External Account Pressures and NFA



Net Foreign Assets (NFA)

The contraction of Rs 356.3 billion in net foreign assets of the banking system during Jul-Nov FY09 was even higher than the decline of Rs 317.4 billion recorded in NFA during the *entire* fiscal year of 2007-2008 (see **Figure 4.6**). The pressure on NFA of the banking system mirrors the sharp worsening of external account position of the country.

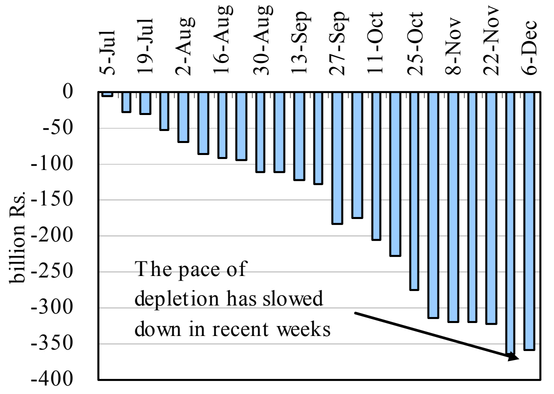
Figure 4.7: NFA of Scheduled Banks



The considerably high growth of 21.6 percent in imports during Jul-Nov FY09 (mainly due to rising oil bill) lead to sharp increase in the external current account deficit over the corresponding

[5] When government borrows from scheduled banks, this leads to diversion of resources from private sector to government (that causes shifting of demand from one segment of economy to other). The budgetary borrowings from SBP on the other hand are most inflationary as this means injection of *fresh* funding in the economy (with no curtailment in resources available to private sector).

Figure 4.8: Depletion in SBP's NFA (cumulative weekly flows)



period of FY08. Payment pressures compounded as external financing inflows slowed down, thus accelerating the depletion of foreign exchange reserves, particularly of the central bank.[6] Indeed, during Jul-Nov FY08, SBP's support for oil payments were US$ 6.1 billion – more than twice the US$ 2.9 billion provided during the corresponding period of previous year. This implies that the contraction was far greater in NFA of the central bank.

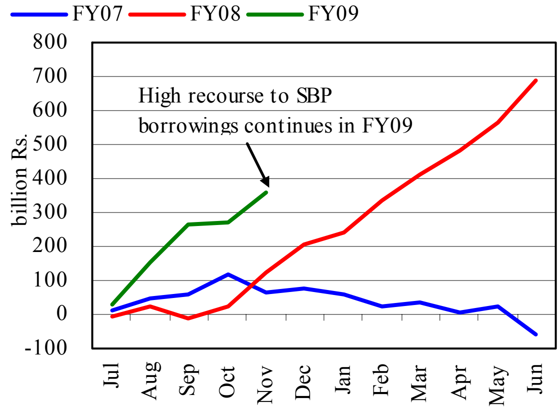
Pressures on NFA of scheduled banks during Jul-Nov FY09 were relatively moderate compared to corresponding period of FY08. During initial months of FY08, NFA of scheduled banks came under pressures following a rise in foreign currency loans which were encouraged by both (a) expectations of relatively stable Pak rupee exchange rate, and (b) higher interest rate differential between the rupee-based borrowings and foreign currency borrowings.

During FY09, though the interest rate differential widened, depreciation of rupee against major currencies made foreign currency loans costlier and riskier. This prompted traders to retire their foreign currency obligation.[7] The resulting rise in banks' foreign assets even helped in moderating the strong downward pressures on NFA following heavy withdrawals of foreign currency deposits towards the end of September and early October 2008 (see **Figure 4.7**).

[6] The drain on foreign exchange reserves was pronounced during FY09 as the government could not mobilize external financing for the budget. This was because Pakistan's ability to tap international capital markets was constrained due to worsening global financial condition as well as domestic economic uncertainties that led to downward adjustments in country's sovereign credit rating. The heightened risk also accelerated foreign exchange outflows (particularly portfolio investment flows) and forced importers to advance their demands for payments in foreign currency.

[7] Since foreign currency loans are banks' liability on residents, these are treated as a part of banks' domestic assets in monetary accounts. Thus foreign currency loans lead to switching of banks foreign assets (which for example, were placed abroad) with their domestic assets, and vice versa when a foreign currency loan is retired.

Figure 4.9: Government Budgetary Borrowings from SBP



A review of the latest weekly trends in SBP's NFA indicates that the pressures on country's external account have already started to show some signs of ease (see **Figure 4.8**). This is mainly on account of recent decline in oil and other commodity prices in the international markets, relative calm in sentiments of the exchange market following various measures taken by the central bank (including the monetary tightening) and inception of stabilization program with IMF support.

It is expected that the Stand-By Arrangement (SBA) negotiated with the IMF and the implementation of macroeconomic stabilization package would help in restoring confidence on Pakistan's economy and pave the way for more financial assistance from other multilateral and bilateral sources. This, in turn would strengthen the forex reserves position of the country.[8] Nonetheless, a sustained decline in overall import demand is critical to avoid any further loss in reserves, particularly when weakening global economies could lead to a slowdown in both, export growth and remittance inflows.

Net Domestic Assets (NDA)

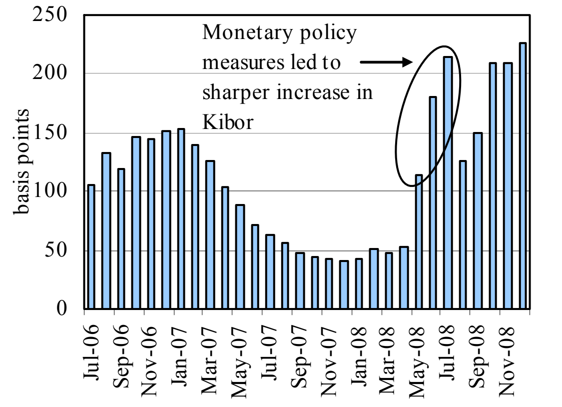
The YoY growth in NDA which was unusually high at 30.6 percent during FY08 remained strong at 30.3 percent even during Jul-Nov FY09. Persistently high government budgetary borrowings from the central bank and the strong demand for credit, both from public sector enterprise (PSEs) and private sector; all acted to further increase the NDA growth during the period under review. The government's high recourse to the central bank financing and retirement of its obligations to scheduled banks made SBP the main contributor to NDA growth.

[8] Pakistan has already received the first tranche of US$ 3.1 billion from the IMF on November 26, 2008 which raised SBP's reserves to US$ 6.2 billion. It should however be noted that the net foreign assets of SBP (and the money supply) remained unchanged on receipt of IMF tranche. This is because the IMF loan, which is essentially for balance of payment support, also creates a corresponding liability on the central bank.

Government budgetary borrowings

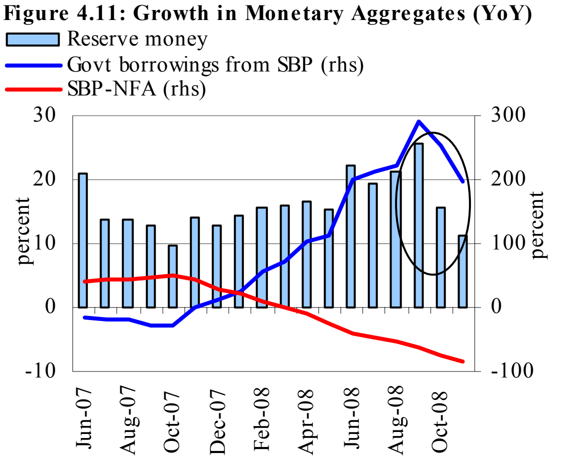
Government budgetary borrowings from the SBP continued unabated during FY09, reaching Rs. 356.4 billion during Jul-Nov FY09 (see **Figure 4.9**). Consequently, stock of market related treasury bills (MRTBs) with SBP increased to Rs 1393.4 billion by November 29, 2008 compared to Rs 1053 billion at end-June 2008.

Figure 4.10: Spread between 3M Repo Rate and 3M Kibor



So far, the emerging trends in fiscal account for FY09 are in line with the government's commitment to bring down its budgetary deficit to 4.2 percent of GDP for FY09.[9] It was therefore the decline in external financing,[10] and inability of the government to raise funding from non-SBP sources, that explain the higher reliance on borrowings from the central bank.

Figure 4.11: Growth in Monetary Aggregates (YoY)

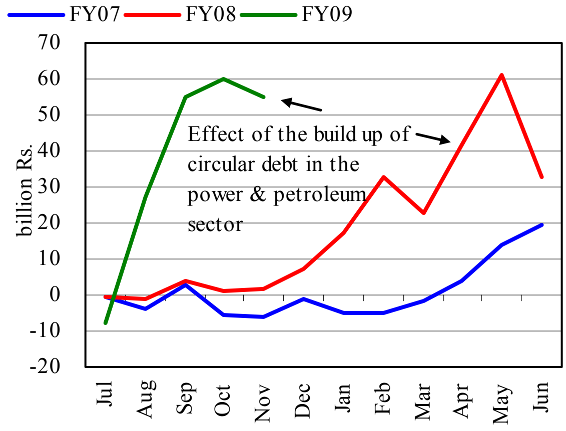


The financing burden fell on the central bank as scheduled banks were reluctant to provide financing to the government through Jul-Oct FY09 at the then; prevailing auction cut off rates. This was largely because (a) the private sector credit (that was growing quite strongly) was offering higher returns to banks (see **Figure 4.10**), and (b) expectations that very high inflation would soon lead to higher rates. This tendency was heightened by

[9] The fiscal deficit for Q1-FY09 was Rs 139.5 billion (or 1 percent of the projected GDP for FY09) lower than Rs 158.1 billion in Q1-FY08 (or 1.5 percent of the GDP).
[10] The external financing during Q1-FY09 was almost zero compared to net receipt of Rs 36.8 billion in Q1-FY08.

liquidity crunch in October 2008. As a result, government was unable to even roll-over its maturing debt securities held by scheduled banks.[11] Thus, government has made retirement of Rs 69.0 billion to scheduled banks during Jul-Nov FY09.

Figure 4.12: Credit to PSEs (Cumulative flows)



Besides adding to the already high inflationary pressures in the economy, continued borrowings from central bank posed various challenges to SBP. For example, the unpredictable and large borrowings made liquidity management more difficult and weakened the transmission of monetary policy signals to retail rates. The task of liquidity management became daunting as the falling stock of T-bills with scheduled banks (as banks were not much interested in rolling over their investments in government papers) constrained their ability to raise funds in the repo market.[12] This had two implications: (1) banks had to meet their funding needs more from the call market (thereby adding to volatility in overnight inter-bank call rates).[13] (2) SBP's ability to address liquidity shortages in the inter-bank market (through OMOs and discount window) was also impaired.

The extent of difficulty in monetary management by SBP is also reflected in continued high growth in reserve money during FY09. As evident from **Figure 4.11**, the slowdown in reserve money growth in recent months was realized only when the pace of government borrowings from SBP slowed down in relative terms.

[11] During Jul-Dec 2007, after adjusting for auction maturities, government was able to mobilize Rs 137.0 billion through T-bill auctions. In comparison, during Jul-Dec 2008, total acceptance in auctions fell short of maturities by Rs 18.9 billion.

[12] Government papers are liquid assets which the banks use as collateral while accessing SBP's discount window, raising funds in inter-bank repo market. These papers are also used in open market operations (OMOs).

[13] Some banks, which were holding low volume of liquid assets, had to face abnormally high call rates in the inter-bank market.

In view of complications due to government borrowings from the central bank, it is essential that sources of budgetary financing are diversified. In this regard, government has already phased out most subsidies and increased interest rates on National Saving Schemes. The outstanding credit to PSEs increased sharply during Jul-Nov FY09 (see **Figure 4.12**) as continuing delays in settlement of claims by the government has pushed the major power utility and the oil marketing company in public sector to seek finance from scheduled banks. In addition, banks have also extended credit to the airline operating in public sector.

Table 4.3: Growth in Private Sector Credit
percent

	Jul-Nov	
	FY08	FY09
Private sector credit	**5.4**	**5.1**
Business sector	**5.0**	**7.1**
of which:		
Fixed investment	-1.1	17.2
Working capital	4.9	4.4
Trade finance	18.1	-1.7

4.3 Credit to Private Sector[14]

Growth in private sector credit remained strong at 5.1 percent during Jul-Nov FY09; slightly lower than that in the corresponding period last year. This was despite negative contribution from trade financing during the period under review (see **Table 4.3**). Demand for working capital and fixed investment, on the other hand, remained strong.

There are a number of factors that explain this rise in private sector credit during Jul-Nov FY09. For example,

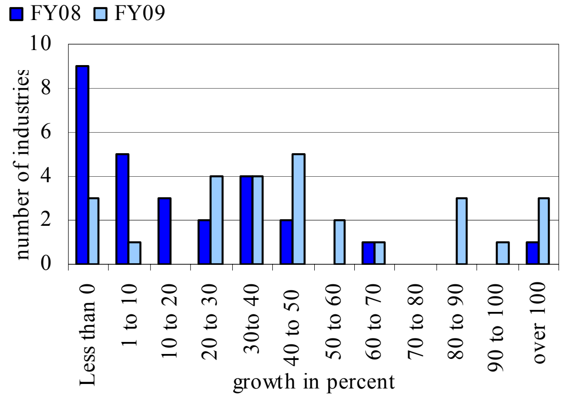
(1) Non-availability of other non-bank sources of financing. As mentioned in earlier SBP reports that during FY08 part of the credit demand was met through non-banks' investments in corporate debt papers (i.e., Sukuk and TFCs).[15] In the absence of any new issuances of these instruments during FY09, credit demand from the bank sources were understandably higher.

(2) Similar to last year, the working capital requirements of Independent Power Projects (IPPs) and Oil Marketing Companies (OMCs) continued to rise

[14] The reported credit numbers comprises of banks' investments and advances to the corporate sector. This data is based on monetary survey, while the sector-wise discussion covers the period of Jul-Oct FY09.
[15] During FY08, a few corporates preferred to issue Sukuk and TFCs to refinance expensive banks' credit and in some cases to fund expansion related activities.

unabatedly in FY09.[16] In addition to price differential claims with the government, the delay in settlement of furnace oil and natural gas claims with WAPDA led to an upward pressure on credit demand during initial months of FY09 (see **Box 4.1**). The magnitude of the inter-corporate debt can be gauged from the fact that till September 2008, a few IPPs and OMCs had exhausted their prescribed credit limits with the domestic banking system. The resulting credit constraints could possibly explain the lower credit extension during October 2008.

Figure 4.13: Frequency Distribution of YoY Credit Growth in Manufacturing Units in September



(3) It must also be noted that the regulatory measures taken by the SBP to contain the forex market pressures evident in the initial months of FY09 also added some pressures on the credit demand. Anecdotal evidence suggests that temporarily suspension of forward cover against all types of imports in July 2008[17] led to higher demand for rupee financing by a few importers to hedge their exchange rate exposure.[18]

(4) A sharp depreciation of rupee against US dollar in the initial months of FY09 made derivate instruments, such as cross currency swaps, unattractive for corporates.[19] As a result, a large number of such deals un-winded during the period of Jul-Oct FY09. Anecdotal evidence suggests that a few banks, having significant exposure in CCS, arranged rupee funding for their client to unwind such deals.

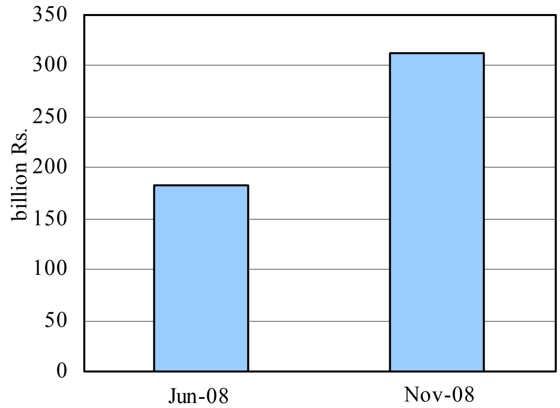
[16] Indeed, in FY08 OMCs had borrowed from the banking system (against government guarantee) in wake of delays in price differential claims between the international oil prices and the domestic consumer prices. However, government had settled a large amount against OMCs by end June 2008.
[17] For detail see Foreign Exchange Circular No.08 of 2008.
[18] It is cited that in expectation of further depreciation of rupee a few importers borrowed rupee from the banking system to buy dollar to hedge against exchange rate losses.
[19] In view of stable exchange rate and rising domestic interest rates in the recent pasts, a few corproates preferred to engage in cross currency swaps by switching their Kibor-based interest payments with Libor-based loans.

The confluence of above mentioned factors was particularly strong during September 2008. Though the credit off-take season generally begins in September every year, the credit growth during September 2008 was exceptionally strong.[20] Further analysis shows that this credit growth was driven mainly by increased demand for running financing, largely coming from manufacturing, power, construction, commerce & trade

Box 4.1: Circular Debt

The issue of inter-corporate debt[21] which emerged in FY08, became larger and more complex during initial months of the current fiscal year.

Figure 4.1.1: Inter-Corporate Debt



Based on information collected from selected corporates

Looking retrospectively, the issue of inter-corporate debt during FY08 rose mainly as the government was providing subsidy on fuel prices to domestic consumers and power utilities faced losses. The delays in the settlement of oil price differential[22] claims by the government and the utilities forced a few OMCs to borrow from the banking system (against government guarantees) in FY08. Although the government was also subsidizing electricity throughout FY08, this did not enlarge the outstanding amount of circular debt in the power and petroleum sector. This was because (1) the volume of price differential claims of the major power utility in public sector remained low,[23] and (2) Independent Power Projects (IPPs) had sufficient cash to meet payments to their creditors.

During the initial months of FY09, circular debt situation worsened despite the fact that government has phased out subsidy on fuel prices. The exceptional increase in outstanding debt held by OMCs and IPPs this year (see **Figure 4.1.1**) is because of sharp rise in differential claims against a state owned power company. Indeed, the public sector

[20] The credit expansion during September 2008 was exceptionally high at Rs 111.8 billion compared to the average rise of Rs 49 billion for the same month in the last four years.
[21] Inter-corporate debt is a situation where a company withheld payments to its suppliers thereby resulting into a situation where suppliers also stop making payments to their creditors.
[22] This refers to the differential between the international oil prices and the domestic consumer prices.
[23] This was probably due to the fact that in the budget for that year, government had earmarked financing amount for the subsidy on electricity.

power companies have developed large payable to (1) IPPs for the electricity purchased for distribution purpose; and (2) fuel supply companies for furnace oil and natural gas used in production of electricity. Ironically, IPPs in turn are also facing difficulties in making payments to their fuel suppliers.

Thus, facing pressures on their cash flows, IPPs, OMCs and public sector gas distribution entities too stopped clearing payments to their creditors and thus leading to build up of inter-corporate debt.

and telecom sectors. Within manufacturing sector a large number of industries had seen credit growth in the vicinity of 20 to 50 percent during September 2008 (see **Figure 4.13**).

There was, however, an unusual break in credit cycle this year; unlike previous year, credit growth could not maintain its momentum after September 2008 (see **Figure 4.14**).[24]

This slowdown in credit growth, which was mainly visible under working capital loans, was probably due to liquidity crunch in the banking system and the consequent rise in the lending rates. In the meanwhile, a relative fall in raw material prices in recent months[25] has also lowered the working capital requirements from

Figure 4.14: Cumulative Growth in Private Sector Credit

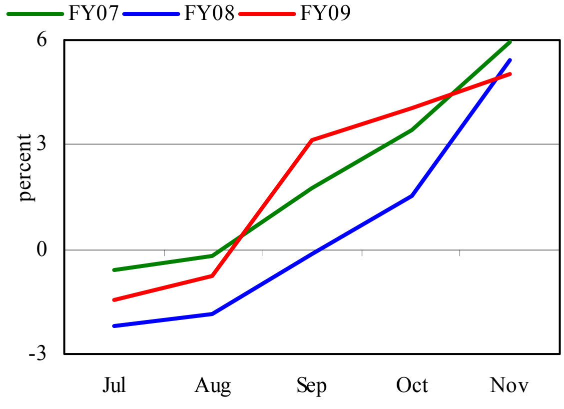
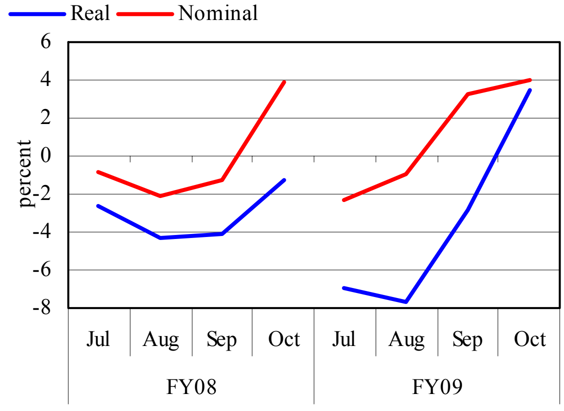


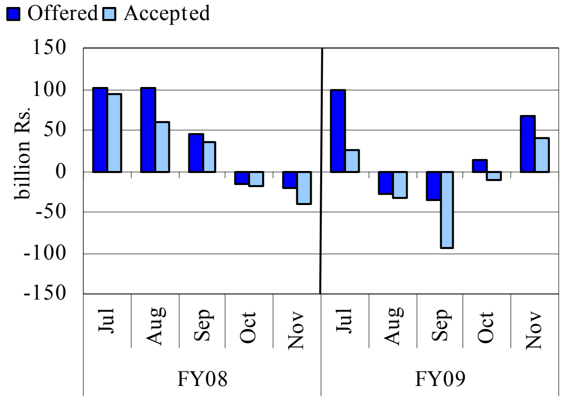
Figure 4.15: Cumulative Growth in Working Capital Loans



[24] The private sector credit during Oct-Nov FY09 saw an increase of Rs 55.5 billion compared to Rs 136.8 billon in the corresponding period of previous year.
[25] The YoY growth in WPI index for non-food group dropped sharply to 25.2 percent and 12.8 percent in October and November 2008 respectively compared with 37.4 percent YoY rise in August 2008.

corporates.[26] This impact is evident from the lower variance between real[27] and nominal demand for working capital loans during Jul-Oct FY09 (see **Figure 4.15**). It can be argued that though the impact of liquidity crunch on private sector credit would disappear after some time, slowdown in credit demand owing to falling prices of raw material may persist going forward.

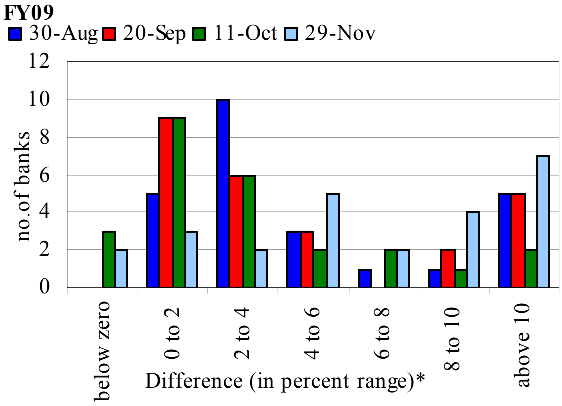
Figure 4.16: Banks' Participation in Government Paper (Net of Maturity)



Banks' participation in credit supply

Banks were able to comfortably fund the strong credit demand particularly during September 2008. This was because (a) banks were using their excess statutory reserves with SBP, and (b) the government has been retiring its borrowings from scheduled banks.

Figure 4.17: Liquidity Position of Banks during FY09



* Maintained minus required

As discussed earlier, the latter point also reflects banks' unwillingness to invest in government papers, partly due to expectations of higher interest rate as inflationary pressures were rising, and partly on account of exceptionally strong credit demand during Aug-Sep 2008. Thus, banks were not willing to rollover their investment in maturing T-bills (see **Figure 4.16**).[28]

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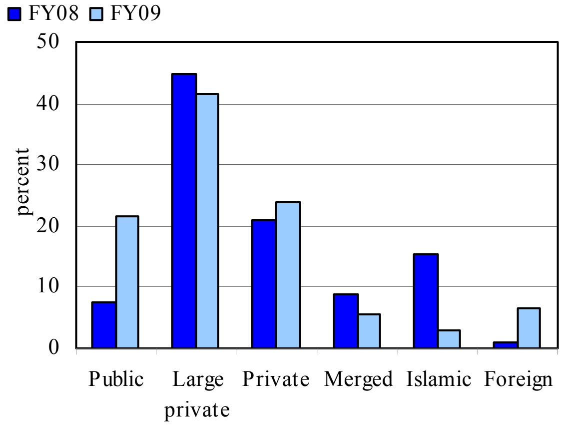
[26] Since July 2007, working capital requirements from corporates rose markedly due to unprecedented hike in raw material prices (both in the domestic and global markets).
[27] The stock of total working capital loans has been deflated by the WPI index for non-food group.
[28] Typically, low private sector credit demand (before the start of credit cycle) allows government to mobilize substantial amount through treasury auctions. During Aug-Sep 2008, however total

Figure 4.18: Bank-wise Share in Incremental



Banks, however, started facing stress on their rupee liquidity holding with the fall in their excess statutory reserves with SBP. This liquidity condition tightened further following a rumor-induced, abrupt and sizeable withdrawal of deposits in mid-October 2008 (see **Figure 4.17**).[29] Following a series of measures undertaken by SBP,[30] the liquidity strains of banks have averted to an extent. This can be viewed from the large number of banks having excess liquidity ratio[31] over 4 percent by end-November 2008 compared with the mid-October 2008 position (see **Figure 4.17**). Notwithstanding SBP's temporary liquidity support, banks now have to put greater focus on deposit mobilization so as to meet private sector credit demand.

Table 4.4: Break-up of Growth in Advances

percent

	Jul-Oct		Aug-Sep
	FY08	FY09	FY09
Business sector of which:	**0.5**	**6.1**	**4.9**
Fixed investment	-6.9	11.4	2.9
Working capital	0.5	5.2	7.0
Trade financing	16.0	-0.4	0.9
Consumer financing	**4.1**	**-6.0**	**-2.8**

The bank-wise data on credit shows that more banks have contributed in credit expansion during Jul-Nov 2008 (see **Figure 4.18**). In particular, small private banks, which traditionally have lower share in credit supply, lent more aggressively to private sector during the initial months of FY09. This largely stemmed from two banks in this category.[32] It must however be noted that the

acceptance in T-bill auctions fell short of maturity by Rs 125.6 billion compared with the average net acceptance of Rs 94.9 billion in the corresponding months last years.

[29] See section on **Deposit Mobilization** for more details.

[30] These mainly include reduction in reserve requirements, liquidity injection through OMOs and discount window. For details see ***Interim Monetary Policy Measure***, November 2008.

[31] Excess liquidity ratio is computed as the difference between the actual and required liquidity maintained by banks divided by the total time and demand liabilities.

[32] Interestingly, these banks witnessed marginal increase in deposit during Aug-Sep FY09.

liquidity crunch of October 2008 affected some small banks more severely. As a result, their share in incremental credit dropped sharply during Oct-Nov 2008 period.

Trend in Private Sector Advances

Growth in advances to the business sector rose by 6.1 percent during Jul-Oct FY09, compared to nominal growth of 0.5 percent during the corresponding period previous year.[33] As evident from **Table 4.4**, most of the demand for business sector advance has been for fixed investment and working capital loans. Trade related loans, on the other hand, registered a net retirement.

Figure 4.19: Trade Finance Excluding Forex Loans

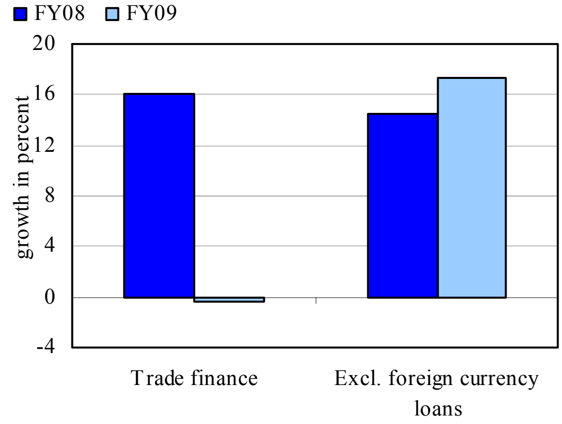
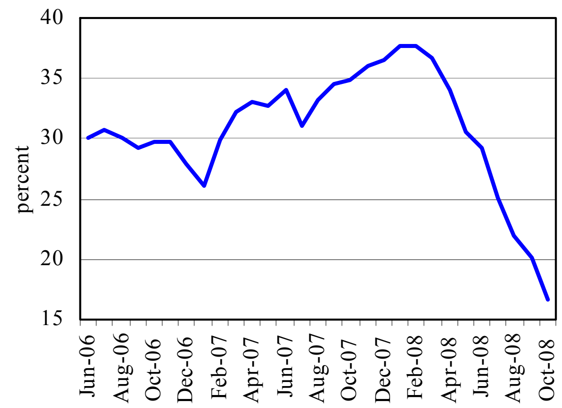


Figure 4.20: Share of Foreign Currency Loans in Trade Finance



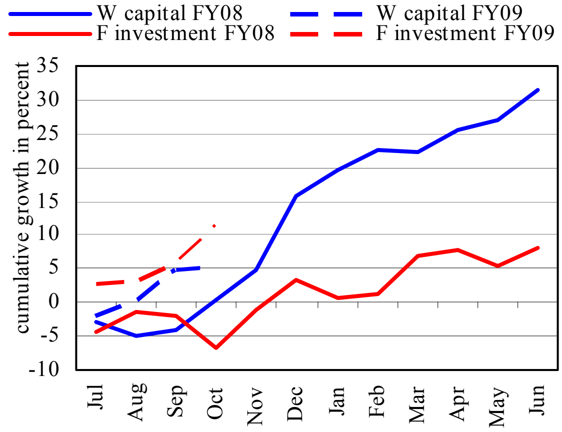
The fall in trade finance during Jul-Oct FY09 was primarily due to sharp decline in demand for foreign currency loans (mainly by importers) following a sharp depreciation of the rupee against US dollar. Thus, excluding the net retirements under the foreign currency loans, advances for trade finance depict a stronger growth of 17.4 percent in Jul-Oct FY09, which is in line with the acceleration in growth of aggregate trade volume in the same period (see **Figure 4.19**).[34] Resultantly, the share of foreign currency loans in total trade

[33] The consumer loans, on the other hand, witnessed a sharp slowdown during Jul-Oct FY09 as compared to net lending in the corresponding period last year.

[34] Within rupee trade loans, the disbursement under EFS loans increased to Rs 147.5 billion in Jul-Oct FY09 compared with Rs 135 billion in the corresponding period last year.

finance dropped steeply from 37.8 percent in January 2008 to 16.6 percent in October 2008 (see **Figure 4.20**). A monthly analysis shows that, unlike previous year, pickup in demand for fixed investment and working capital loans was unusually high since August 2008 (see **Figure 4.21**). For example, the growth in advances for working capital loans (which rose by 5.2 percent during Jul-Oct FY09 compared with 0.5 percent in Jul-Oct FY08) is mainly concentrated in the month of August and September 2008. Indeed, it was a deceleration in working capital loans in the month of October 2008 that had actually restricted the cumulative growth to 5.2 percent during Jul-Oct FY09.

Figure 4.21: Pattern of Financing



A sectoral breakup of working capital loans during Aug-Sep FY09 suggests that the demand for these loans stemmed primarily from the manufacturing sector (see **Table 4.5**). Apart from this, acceleration in demand from the power sector was expected, to an extent, mainly due to non-payment of dues by the government entities to IPPs.

Table 4.5: Breakup of Working Capital Loans during Aug-Sep

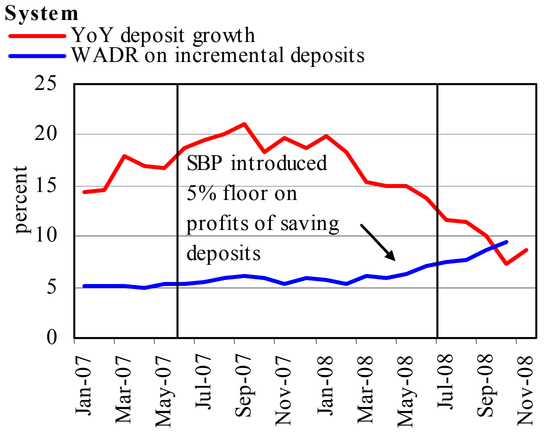
(amount in billion Rs, growth in percent)

	Absolute increase		Growth	
	FY08	FY09	FY08	FY09
Working capital loans	**-12.4**	**82.1**	**-1.4**	**7.0**
A. Agriculture	**4.9**	**0.2**	**4.8**	**0.1**
B. Manufacturing	**-13.4**	**59.5**	**-3.0**	**10.3**
a. Textile	4.0	12.1	2.4	5.3
Spinning of fibers	0.5	14.1	0.5	11.6
b. Refined petroleum products	0.3	11.0	2.7	94.4
c. Chemicals and chemical products	-4.3	19.0	-10.6	33.8
d. Manufacture of machinery &equipment	0.7	3.1	7.0	26.7
C. Power	**2.8**	**11.7**	**14.7**	**20.4**
D. Transport & communications	**-7.6**	**1.6**	**-32.8**	**4.2**
E. Other business activities	**1.9**	**9.5**	**4.0**	**15.3**
F. Other	**-1.1**	**-0.4**	**-1.1**	**-0.1**

Within the manufacturing sector, the advances grew by 10.3 percent during Aug-Sep FY09 compared with net retirement in the same period last year. This growth

mainly came from the textile spinning, fertilizer and refined petroleum product industries.
The demand for fixed investment loans remained strong throughout the period of Jul-Oct FY09 and posted a growth of 11.4 percent in contrast with a fall in the corresponding period last year. Major sectors that registered an increase in fixed investment loans were power, fertilizer, telecom and construction. The rise in fixed investment demand in power sector is the outcome of continued expansion related activities by power companies. It must be noted that in FY08, fertilizer sector mainly finance their expansion plans through non-bank sources such as Sukuk, TFCs and rights issue. In absence of any new issuances of these instruments in Jul-Oct FY09, dependence on bank's advances for meeting fixed investment demand was expected in this sector.

Figure 4.22: Growth in Deposits of the Banking System



4.4 Deposit Mobilization

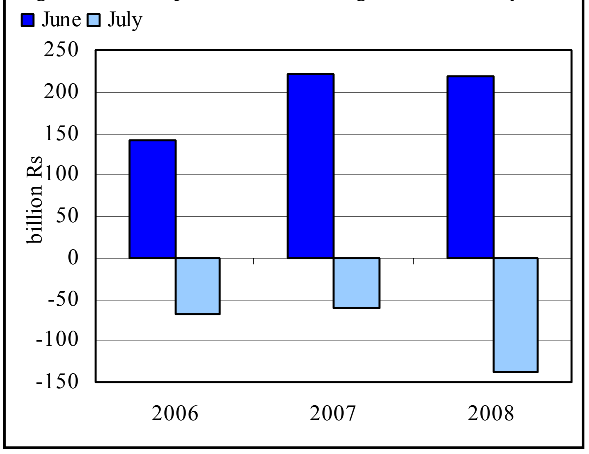
The pressures on deposit mobilization by the banking industry intensified further during FY09 as the YoY deposit growth weakened to 8.7 percent by November 2008 from 13.8 percent in June 2008 and 19.7 percent in November 2007 (see **Figure 4.22**). This deceleration in deposit growth was despite a relatively steep rise in weighted average return on deposits.

Though a number of factors explain the slowdown in deposit growth, it was the abrupt withdrawal of Rs 96.5 billion in deposits during the first two weeks after Eid-ul-Fitr that took a heavy toll on deposit mobilization efforts of banks. Indeed, seasonal deposit withdrawals (around Ramadan and Eid) were exacerbated this year by rumor-fed concerns over the stability of local banks in the backdrop of the international financial crisis (see **Box 4.2** for more details).

Other factors that explain the slowdown in deposit growth include the following:

1. The banking sector in Pakistan generally experiences a sharp jump in deposits during June each year, which is followed by withdrawal during subsequent months. In July 2008, the deposit withdrawal was exceptionally high (see **Figure 4.23**)

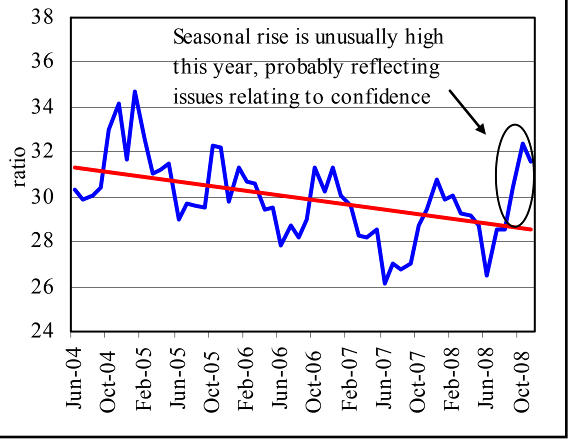
Figure 4.23: Deposit Flows During June and July



2. There is also a significant shift in public preference away from deposits. Probably reflecting the effect of rising inflationary pressures, this has also led to a decline in deposit multiplier and thus weakening deposit growth (see **Figure 4.24**).

3. The significant rise in external account outflows also acted to contain the deposit growth.[35] This is because the central bank was providing the foreign currency to meet the net external outflows. The equivalent Rupee payment eventually hit deposits of the banking system.

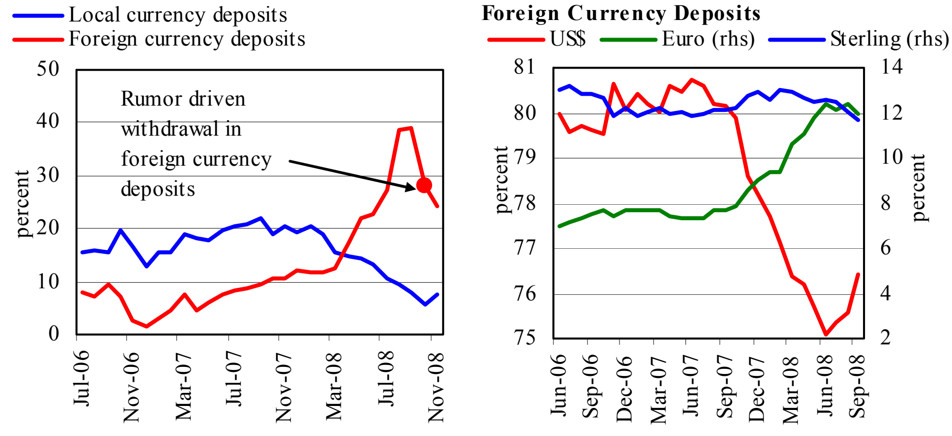
Figure 4.24: Currency/Deposit Ratio



4. Finally, with the relative slowdown in GDP growth and attendant ease

[35] The overall external account balance for Jul-Nov FY09 is showing a huge deficit of US$ 5.7 billion compared to a deficit of US$ 908 million during the corresponding period of 2007.

Figure 4.25: YoY Growth in Deposits

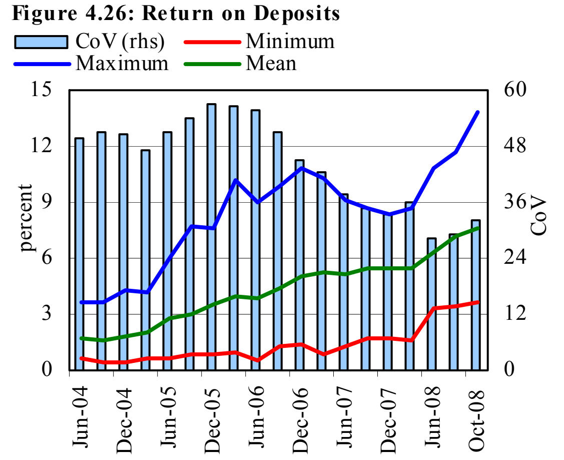


Share of US$ Denominated Deposits to Foreign Currency Deposits

in economic activities some deceleration in deposit growth was to be expected.[36]

The currency-wise composition of deposits suggests that despite continued slowdown in rupee deposits growth, the foreign currency deposits increased sharply particularly after March 2008. This was mainly due to expectations of exchange gains from weakening local currency.[37] The growth momentum in foreign currency deposits remained intact until October 2008 when bank deposit withdrawals also affected the foreign currency accounts.

Figure 4.26: Return on Deposits



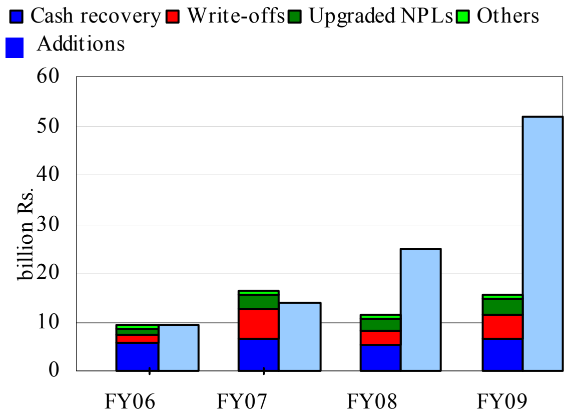
Within the foreign currency deposits, the growth was more pronounced in US dollar denominated accounts. As a result, the share of dollar deposits increased strongly since June 2008 onwards (see **Figure 4.25**).

[36] GDP growth for FY09 is projected to slowdown to 3.5-4.5 percent from 5.8 percent in FY08 (see Chapter 1).

[37] The monthly average exchange rate of the rupee depreciated from Rs 62.7 per US$ in March 2008 to Rs 81.6 per US$ in October 2008.

The rise in rate of return on deposits is relatively steeper during FY09. Besides SBP's decision to impose a minimum 5 percent floor on saving deposits, the recent squeeze in rupee liquidity in the inter-bank market has led to higher return on deposit. As evident from **Figure 4.26**, in addition to minimum interest rates on deposits, the maximum return offered by banking industry has increased quite sharply in recent month. The impact on weighted average return on deposits was, however, muted due to considerably large share of low (or zero) remunerative deposits in the banking system.

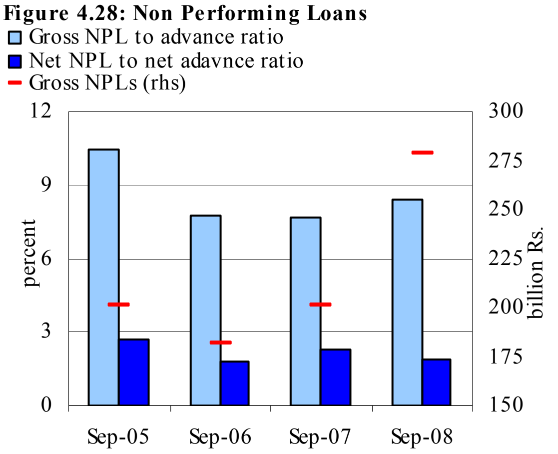
Figure 4.27: Movements in NPLs (Jul-Sep)



4.5 Non Performing Loans

The gross non-performing loans (NPLs) reached Rs 278.1 billion by end-September 2008 from Rs 241.3 billion at end-June 2008. Further analysis shows that NPLs for Q1-FY08 recorded an addition of Rs 51.7 billion which was partially offset by cash recoveries, upgraded NPLs and write offs (see **Figure 4.27**). Moreover, sector-wise analysis shows that bad loans in corporate, SME, agriculture and consumer sectors have contributed to the deteriorating asset quality during the quarter under review.

Figure 4.28: Non Performing Loans



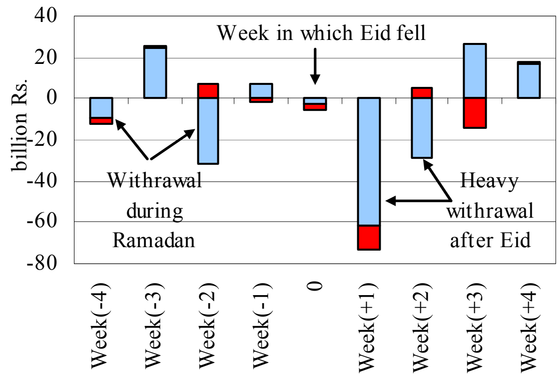
Despite the stress on loan portfolio, the overall banking sector is quite resilient as the infection ratio currently stands at 8.4 percent of advances, which further falls to as low as 1.9 percent once an adjustment is made for amount of provisions held against NPLs (see **Figure 4.28**).[38]

Box 4.2: Stress on Banking Sector Deposits in October 2008

The banking sector which had been struggling over the last 1¼ years to enhance deposit growth, suffered a major setback in October 2008 when there was an abrupt withdrawal of Rs 96.5 billion from the banking system in just two-week period immediately following the Eid-ul-Fitr.

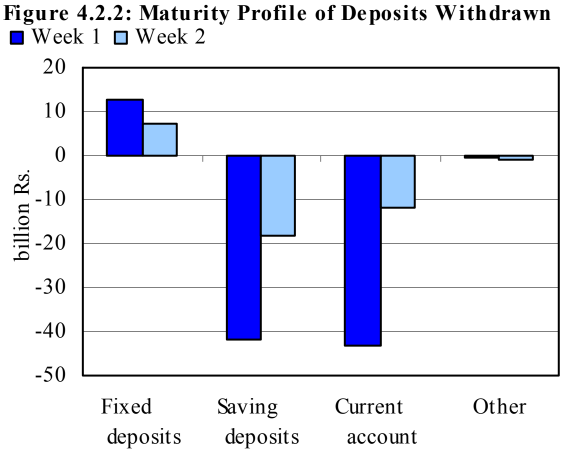
As evident from **Figure 4.2.1**, deposits of the banking system were already under stress during the month of Ramdan. These pressures intensified after Eid. Several events contributed to this pressure on deposits.

Figure 4.2.1: Weekly Fluctuations in Total Deposits Around Eid-ul-Fitr 2008



For example, there were some concerns among depositors about the likely impact of the global financial crisis on domestic banking system. Such worries deepened following the freeze on issuance and redemption of open-end mutual funds (with direct exposure to equity securities) in early October. At the same time, call rates in the money market jumped to exceptionally high levels for some banks which were falling short in their holding of liquid assets. In the foreign exchange market, the rupee also came under severe pressure and depreciated sharply from Rs 78.04 per US$ at end-

Figure 4.2.2: Maturity Profile of Deposits Withdrawn

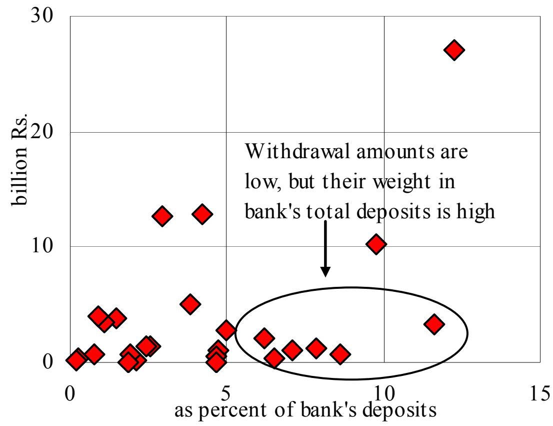


[38] Infection ratio is NPLs as percent of loans and advances.

September 2008 to Rs 83.5 by mid-October, 2008. All these adverse developments provided an ideal breeding ground for spate of rumors, ranging from freezing of foreign currency account and sealing of lockers to stories focusing on some of the local private banks.

In this situation, some depositors became nervous and rushed to take out their deposits. In the beginning, both local currency as well as foreign currency deposits experienced substantial withdrawals (see **Figure 4.2.1**).

Figure 4.2.3: Bank-wise Deposit Withdrawal



A further break up of deposits withdrawal during the first two weeks after Eid gives following insights:

1. Though the deposit withdrawal affected almost all banks, some of the banks experienced substantial run on their deposits. To put this in perspective, over 70 percent of the deposit withdrawal during October 4-8, 2008 took place in only 5 banks.

2. As expected, the withdrawal pressures were mainly savings and current accounts (see **Figure 4.2.2**).

3. The complexity of this near run on deposits was greater for central bank. This was because for some of the small private sector banks, though the volume of deposit withdrawal was low in absolute terms, this was still significant when compared to their total deposits (see **Figure 4.2.3**). This highlights the need for quick liquidity support by the central bank to stem the run on sound banks.

5 Fiscal Developments

5.1 Overview

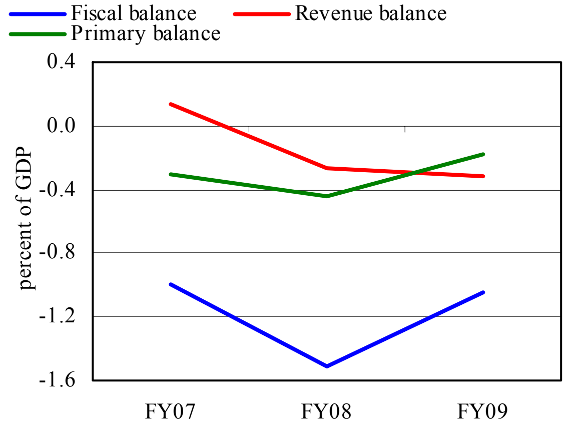
The large fiscal deficit in FY08, and the adverse economic consequences of its financing from SBP, placed fiscal consolidation at the top of government's macroeconomic stabilization agenda for FY09. The fiscal consolidation program of the government for FY09 consists of (1) substantial reduction in overall budget deficit, as a percent of GDP, through a mix of cut in expenditures (as a share of GDP) and a rise in tax revenues (as a share of GDP), and (2) a gradual elimination of government budgetary borrowings from SBP.

Not surprisingly, the Q1-FY09 fiscal performance improved consequent to the policy shift, with the overall fiscal deficit estimated to have dropped to 1 percent of annual GDP. This is consistent with the annual fiscal deficit target set under the IMF stabilization program. The fiscal improvement in Q1-FY09 has largely based on reduction of oil subsidies and a cut in development spending. This is understandable since (1) any meaningful effort to expand revenues (particularly by broadening the tax base) will only work in an extended time frame, and (2) given fiscal rigidities in current expenditures (especially interest payments) the gains will not be available in the short term. In the medium term, fiscal reforms will enable both discipline in non-development expenditures and a larger revenue base that will allow for necessary fiscal space to ensure appropriate level of public spending on social and infrastructure projects in the future. It is precisely in this context that the macroeconomic stabilization program being approved by IMF has specific conditionalities on fiscal performance.

5.2 Fiscal Performance Indicators

After sizeable slippage in FY08, overall fiscal balance showed quantitative recovery in first quarter of FY09 (see **Figure 5.1**). Primary deficit, as a share of GDP, declined to 0.2 percent in Q1-FY09 from 0.4 percent in the corresponding period last year indicating a deceleration

Figure 5.1: Fiscal Performance Indicators (Q1)



in growth of interest payments.

Table 5.1: Summary of Consolidated Public Finance During Jul-Sep
billion Rupees

	Jul-Sep				YoY change (%)	
	FY06	**FY07**	**FY08**	**FY09**	**FY08**	**FY09**
Total revenue	236.6	255.7	312.6	385.0	22.3	23.1
Tax revenue	158.4	191.6	215.6	276.8	12.5	28.4
Non-tax revenue	78.1	64.1	97.0	108.1	51.5	11.5
Total Expenditure	274.3	342.4	470.7	524.4	37.5	11.4
Current	219.8	244.2	340.0	427.8	39.2	25.8
Development and net lending	50.6	65.2	112.9	40.7	73.3	-64.0
Unidentified expenditure	3.9	33.0	17.8	55.9	-46.3	215.1
Budget deficit	-37.7	-86.7	-158.1	-139.5	82.3	-11.8
As percent of GDP						
Total revenue	3.1	2.9	3.0	2.9	--	--
Tax revenue	2.1	2.2	2.1	2.1	--	--
Non-tax revenue	1.0	0.7	0.9	0.8	--	--
Total Expenditure	3.6	3.9	4.5	3.9	--	--
Current	2.9	2.8	3.2	3.2	--	--
Development and net lending	0.7	0.7	1.1	0.3	--	--
Unidentified expenditure	0.1	0.4	0.2	0.4	--	--
Budget deficit	-0.5	-1.0	-1.5	-1.0	--	--

Source: Ministry of Finance

The reduction in fiscal deficit in Q1-FY09 was brought about mainly by a drastic cut in development expenditures. This is also confirmed by further deterioration of revenue balance for Q1-FY09 despite an impressive growth of 23.1 percent in total revenues during the quarter. This deterioration in the revenue balance could be understated. Q1-FY09 has seen a large increase in “unidentified” spending. Thus the deterioration would be even greater if a part Rs 55 billion in “unidentified expenditure” recorded for the quarter pertains to current spending.

5.3 Revenues

First-quarter total revenues posted an impressive YoY growth for the second consecutive year. Specifically, total revenues rose to Rs 385.0 billion, registering YoY growth of 23.1 percent during Q1-FY09 as compared to 22.3 percent growth in Q1-FY08 (see **Table 5.1**). However, the contribution to growth in total revenues in Q1-FY09 saw a reversal from that of Q1-FY08. In particular, the strong rise in total revenues during Q1-FY09 is mainly due to substantial rise in tax revenues which offset the impact of a deceleration in the growth of non-tax revenues.

Tax revenues in Q1-FY09 stood at Rs 276.8 billion, with a YoY increase of 28.4 percent compared to 12.5 percent rise in Q1-FY08. The acceleration in tax revenues is largely on account of substantial receipts from indirect taxes, which surpassed the target for Q1-FY09. In particular, receipts from taxes on goods and services increased by Rs 38.6 billion in Q1-FY09, registering a growth of 39.4 percent YoY compared to 18.9 percent YoY in Q1-FY08. This large addition to tax revenues was caused by (1) raise in the rate of sales tax from 15 percent to 16 percent, (2) inflated tax base of POL products and natural gas due to realignment of market prices, (3) enhancement of rate of FED on cement, and banking, insurance and franchise services.

Also, taxes on international trade experienced robust growth during Q1-FY09 as a result of strong growth in the rupee value of imports, which in turn was triggered by higher international commodity prices and a steep depreciation of the rupee. In addition, duty rates on many non-essential items were raised up to 35 percent.

The growth in non-tax revenues witnessed a big deceleration in Q1-FY09, despite large inflows on account of logistic support reimbursements. The decline in interest income as well as transfer of SBP profits were the major factors behind the decline in growth of non-tax revenues during Q1-FY09. However, decline in growth of non-tax revenues during Q1-FY09 is not necessarily meaningful on a full year basis, as it may simply represent changes in timing of receipts. For example, SBP passed on Rs 28 billion to the government in Q1-FY09 compared to Rs 47.3 billion transferred in Q1-FY08. Given the unprecedented government borrowings from the central bank, receipts from transfer of annual SBP profits are expected to be strong, with corresponding impact on annual transfers to the government. Furthermore, petroleum surcharge for Q1-FY09 is not comparable to corresponding receipts in previous years as the latter also included the amount realized on account of discount retained on crude oil (see **Table 5.2**). Adjusting previous definition, to keep this figure comparable, it is seen that petroleum surcharge revenues show an increase of 43 percent YoY in Q1-FY09. The growth in these receipts could be stronger in the remaining months of FY09 if the benefit of decline in international oil prices is passed on to domestic consumers with lags.

5.4 Expenditures

Growth in consolidated public expenditure decelerated in Q1-FY09 as development spending experienced a 64.1 percent decline. Consequently, as a share of GDP, development expenditures dropped to 0.3 percent in Q1-FY09 (the lowest level of spending in preceding seven years) compared to 1.1 percent in Q1-FY08. Meanwhile current expenditures grew by 25.8 percent YoY in Q1-FY09 compared to 39.2 percent YoY in Q1-FY08. However, the apparent deceleration

Table 5.2: Composition of Tax and Non-tax Revenues (Jul-Sep)
billion Rupees

	Jul-Sep			YoY change (%)	
	FY07	**FY08**	**FY09**	**FY08**	**FY09**
Tax revenues	**191.6**	**215.6**	**276.8**	**12.5**	**28.4**
Direct taxes	70.2	79.2	89.7	12.8	13.3
Taxes on property	1.5	1.0	1.8	-31.2	73.1
Taxes on goods and services	82.4	98.0	136.6	18.9	39.4
Taxes on international trade	27.9	29.1	38.2	4.5	31.0
Other taxes	9.6	8.2	10.5	-14.0	28.2
Non-tax revenues	**64.1**	**97.0**	**108.1**	**51.5**	**11.5**
Profits from PTA/Post Office Dept	0.1	0.0	0.0	-70.0	120.0
Interest (PSE and others)	3.2	12.6	1.6	294.2	-87.1
Dividends	15.7	2.0	9.5	-87.2	372.2
SBP profits	15.0	47.3	28.0	215.3	-40.8
Defence	0.6	1.3	29.2	126.4	2070.2
Surcharges	13.6	8.8	8.2	-35.3	-6.6
Petroleum	7.6	4.2	1.8	-45.1	-55.6
Gas	6.0	4.6	6.4	-22.9	37.4
Discount retained on crude oil	--	--	4.1	--	--
Royalty on oil/gas	6.9	11.3	10.4	62.7	-7.8
Others	9.0	13.7	17.1	51.9	24.7
Total Revenue	**255.7**	**312.6**	**385.0**	**22.3**	**23.1**

Source: Ministry of Finance

in growth of current expenditures during Q1-FY09 could be deceptive. The correct position cannot be ascertained precisely due to the large unidentified expenditures. If these are correctly part of current spending, then the seeming lower growth reverses to 35.2 percent YoY increase (see **Table 5.3**). In any case, Q1-FY09 current expenditure growth is quite strong and needs to be brought down for sustained fiscal consolidation.

The continued strong rise in current expenditure during Q1-FY09 reflects (1) a surge in grants to non-government, (2) discharge of claims of oil refineries/OMCs, and (3) acceleration of defence expenditures probably on account of extended anti-terrorism operations of the armed forces.

Despite elimination of oil subsidies, unpaid claims from preceding months on account of oil price differential continued to exert considerable payment pressures on the current account of the budget, as reflected by the fact that spending under "economic affairs" almost doubled to Rs 50.6 billion in Q1-FY09. This amount

Table 5.3: Composition of Current Expenditures

billion Rupees

	Jul-Sep			YoY change (%)	
	FY07	**FY08**	**FY09**	**FY08**	**FY09**
Current expenditure	**244.2**	**340.0**	**427.8**	**39.2**	**25.8**
of which					
Interest payments	60.3	111.1	115.0	84.3	3.5
Domestic	49.1	98.5	101.0	100.7	2.5
Foreign	11.2	12.6	14.0	12.2	11.1
Grants (other than provinces)	9.7	7.7	15.8	-20.5	103.7
Defence	45.6	57.5	82.2	26.3	42.8
Economic affairs	7.9	25.6	50.6	222.7	97.7
Health	0.9	1.1	1.1	24.1	-0.2
Education affairs and services	3.7	5.0	5.3	34.8	6.3
Provincial	83.1	102.6	115.1	23.5	12.2
Memorandum item:					
Current expenditures (incl. unidentified expenses)	277.2	357.7	483.7	29.1	35.2

Source: Ministry of Finance

includes payment of Rs 40.8 billion to oil refineries/OMCs on account of outstanding price differential claims.

5.5 Financing

With net outflow on account of external financing in Q1-FY09, the government had to generate from domestic sources the full amount of budget deficit plus an additional Rs 27 million to cover net external outflows. In the absence of any receipts from privatization and a fall in non-bank resource mobilization, banking system met three-fourth of the Q1-FY09 financing requirement of the government (see **Table 5.4**).

Table 5.4: Sources of Financing

billion Rupees

	Jul-Sep				Percent share	
	FY06	**FY07**	**FY08**	**FY09**	**FY08**	**FY09**
Total financing of budget	**37.7**	**86.7**	**158.1**	**139.5**	**100.0**	**100.0**
External resources (net)	5.0	27.8	36.8	-0.0	23.3	0.0
Internal resources	32.7	58.9	121.3	139.5	76.7	100.0
Banking system	14.9	34.5	69.9	104.6	44.2	75.0
Non-bank	14.3	10.0	51.4	34.9	32.5	25.0
Privatization proceeds	3.5	14.4	--	--	--	--

Source: Ministry of Finance

5.6 FBR Tax Collection

The Federal Board of Revenue (FBR) surpassed its revenue target of Rs 413.2 billion for Jul-Nov FY09, despite a shortfall of Rs 12.3 billion in direct tax collections. This was made possible by above-target collection for all three components of indirect taxes (see **Table 5.5**). As a result, indirect taxes reached Rs 290.8 billion during Jul-Nov FY09; up by 28.3 percent YoY compared to a 13.4 percent YoY rise in the corresponding period last year.

Table 5.5: FBR Tax Collection

billion Rupees

	FY09 Target		Net Tax receipts (Jul-Nov)		FY09 receipts as % of		YoY change (%)	
	Annual	**Jul-Nov**	**FY08**	**FY09**	**Annual target**	**Jul-Nov Target**	**FY08**	**FY09**
Direct taxes	499.0	144.5	113.4	132.2	26.5	91.5	17.6	16.6
Indirect taxes	751.0	268.7	226.7	290.8	38.7	108.2	13.4	28.3
Sales tax	470.0	173.8	144.0	185.1	39.4	106.5	14.6	28.5
FED	112.0	41.2	31.7	44.2	39.4	107.2	27.0	39.2
Customs	169.0	53.7	50.9	61.6	36.4	114.6	3.6	20.9
Total taxes	**1250.0**	**413.2**	**340.1**	**423.0**	**33.8**	**102.4**	**14.8**	**24.4**

Source: FBR, Islamabad

Though welcome, the strong growth in indirect taxes should not be taken as an indication of higher tax buoyancy since a significant part of this increase was contributed by a rise in international commodity prices and steep depreciation of the Pakistani rupee. With recent declines in POL product prices and presence of considerable scope of further downward adjustment, the tax base, and, consequently, the tax receipts, could decelerate in remaining months of FY09. Furthermore, the deceleration in direct tax collection could intensify with possible declines in withholding tax receipts from contracts as a result of large cuts in development expenditures.

5.6.1 Direct Tax Collection

Growth in direct taxes decelerated marginally from 17.6 percent YoY during Jul-Nov FY08 to 16.6 percent YoY in comparable period during FY09. However, category-wise data on direct taxes, available for Jul-Sep FY09, reveal a substantial deceleration in advance tax payments in Q1-FY09. Specifically, advance taxes registered a growth of 13.2 percent YoY in Q1-FY09 compared to 21.6 percent increase in the corresponding period last year. Since advance tax is paid on the basis of self-assessed expected income within the PAYE regime, the deceleration in advance taxes could indicate weakening profitability of the corporate sector.

Collection on account of demand creation jumped to Rs 8.9 billion in Q1-FY09 reflecting a growth of 118 percent (see **Table 5.6**). The large increase in collection on demand and the fact that almost this entire rise was generated by current demand clearly indicates increased focus of FBR on audit and assessment of tax returns.

Table 5.6: Direct Tax Collection during Q1

billion Rupees

	Jul-Sep		Growth %	% Share in total (net)	
	FY08	FY09		FY08	FY09
Gross income tax	76.7	92.5	20.5	99.2	104.8
Collection on demand	4.1	8.9	118.0	5.3	10.1
Voluntary payments	30.3	31.8	5.0	39.1	36.0
Withholding taxes	42.3	51.7	22.3	54.7	58.6
Others	0.1	0.0	-60.2	0.1	0.0
Other direct taxes	4.6	1.6	-65.6	5.9	1.8
Gross direct taxes	81.3	94.1	15.7	105.1	106.6
Refunds	3.9	5.8	48.1	5.1	6.6
Net direct taxes	77.4	88.2	14.0	100.0	100.0

Source: FBR, Islamabad

Withholding tax receipts consolidated its share in net direct taxes from 54.7 percent in Q1-FY08 to 58.6 percent in Q1-FY09. In absolute terms Rs 51.7 billion were generated through withholding tax in Q1-FY09 against Rs 42.3 billion in the corresponding period of last year showing a robust growth of 22.3 percent (see **Table 5.7**). Major heads contributing to withholding tax receipts were contracts (Rs 17.2 (up 23.3 percent), imports (Rs 8.0 billion, up 23.5 percent), and salaries (Rs 5.4 billion, up 26.2 percent). Furthermore, the relative contribution of various components to total withholding taxes in Q1-FY09 has remained largely unchanged from that of Q1-FY08. With larger increases in withholding taxes as well as collection on demand, the share of voluntary payments in total direct taxes (net) during Q1-FY09 declined by 3.1 percentage points.

Table 5.7: Withholding Tax Collection during Q1

billion Rupees

	Jul-Sep			Growth %	
	FY07	FY08	FY09	FY08	FY09
Imports	6.8	6.4	8.0	-5.8	23.5
Salaries	3.2	4.3	5.4	34.4	26.2
Dividends	0.7	1.1	1.6	57.6	45.9
Securities	3.1	3.3	3.2	5.3	-1.4
Contracts	9.9	13.9	17.2	40.9	23.3
Exports	2.5	2.3	3.6	-7.1	54.6
Cash withdrawal from banks	1.0	1.3	2.2	33.3	71.0
Electricity bills	1.2	1.3	1.6	8.7	25.9
Telephone	2.8	4.4	4.9	57.9	12.8
Others	3.0	4.1	4.1	33.1	0.9
Withholding tax (gross)	**34.1**	**42.3**	**51.7**	**23.9**	**22.3**

Source: Federal Board of Revenue

5.6.2 Indirect Tax Collection

Indirect tax receipts surpassed the revenue target set for Jul-Nov FY09 with a wide margin of Rs 22.2 billion, offsetting the revenue shortfall in direct taxes for the period. In absolute terms, indirect taxes increased to Rs 290.8 billion during Jul-Nov FY09 against Rs 226.7 billion in the corresponding period last year, showing a growth of 28.3 percent. Relatively strong growth of indirect taxes along with the deceleration in direct taxes led to decline in share of direct taxes in total taxes.

The domestic component of indirect taxes recorded the strongest growth during first five months of FY09. Specifically, sales tax on domestically produced goods and services during Jul-Nov FY09 rose by 53.7 percent (see **Table 5.8**) while FED (domestic) increased by 43.6 percent during the same period. The exceptional growth in domestic share of indirect taxes during Jul-Nov FY09 is explained, in large part, by strong inflationary pressures in the economy, particularly the energy sector. Top ten contributors to sales tax (domestic) during first five months of FY09 reveal that the big increase is largely fed by collections from POL products (Rs 46.7 billion, up 267.4 percent), natural gas (Rs 6.1 billion, up 20.3 percent), and electrical energy (Rs 2.5 billion, up by 188.8 percent).

Table 5.8: Gross Sales Tax (Domestic): Top 10 Contributors
billion Rupees

	Jul-Nov		Growth %	Share in total	
	FY08	FY09		FY08	FY09
POL products	12.7	46.7	267.4	20.8	49.7
Telecommunications	18.2	19.1	4.8	29.8	20.3
Natural gas	5.1	6.1	20.3	8.3	6.5
Sugar	4.2	3.9	-7.4	6.8	4.1
Cigarettes	2.9	3.3	12.8	4.7	3.5
Electrical energy	0.9	2.5	188.8	1.4	2.6
Services	2.5	2.4	-2.1	4.1	2.6
Aerated waters/beverages	1.9	1.8	-5.5	3.2	1.9
Cement	1.4	1.3	-4.1	2.3	1.4
Tea	1.1	1.0	-5.2	1.8	1.1
Others	10.3	5.8	-43.4	16.9	6.2
Grand total	61.1	93.9	53.7	100.0	100.0

Source: FBR, Islamabad

Customs duty added Rs 61.6 billion to the national exchequer during Jul-Nov FY09, up by a healthy 20.9 percent compared to a mere 3.6 percent in the corresponding period last year.

Details of custom duty for Jul-Sep FY09 show that POL products were the major source of custom receipts, contributing Rs 7.6 billion in Q1-FY09 as compared to Rs 2.2 billion in Q1-FY08. Custom receipts on vehicle imports declined by 8.0 percent but these still form the second largest component of custom duties, adding Rs 5.7 billion in Q1-FY09 compared to Rs 6.2 billion in Q1-FY08. Other major sources of custom receipts during Q1-FY09 comprise of electrical machinery (Rs 4.1 billion), edible oil (Rs 3.5 billion), and iron and steel (Rs 3.4 billion).

Table 5.9: Summary of Consolidated Provincial Finance During Jul-Sep
billion Rupees

	Jul-Sep				YoY change (%)	
	FY06	**FY07**	**FY08**	**FY09**	**FY08**	**FY09**
Total revenue	**76.7**	**98.7**	**119.4**	**160.3**	**20.9**	**34.3**
Provincial share in federal revenue	55.2	78.5	90.9	124.4	15.7	36.9
Provincial taxes	8.9	9.8	9.5	12.6	-3.5	32.8
Property taxes	2.0	1.5	1.0	1.8	-31.2	73.1
Excise duties	0.5	0.5	0.6	0.6	25.0	-2.7
Stamp duties	2.3	2.4	2.7	2.6	14.8	-4.6
Motor vehicle tax	2.0	2.0	2.3	2.1	18.7	-9.2
Other	2.1	3.5	2.8	5.5	-20.5	98.2
Provincial non-tax	5.7	4.9	18.4	8.4	275.0	-54.0
Interest	0.0	0.0	9.5	0.0	52667	-99.9
Irrigation	0.5	0.5	0.5	0.4	13.3	-13.3
Others	5.2	4.4	8.3	8.0	88.6	-4.3
Federal loans and transfers/grants	6.8	5.4	0.7	14.8	-87.9	2159.1
Loans (net)	-0.7	-1.5	-7.3	1.5	384.7	-121.0
Grants	7.5	6.9	8.0	13.3	15.1	66.6
Total Expenditure	**90.4**	**111.7**	**167.8**	**140.1**	**50.2**	**-16.5**
Current expenditure	72.6	88.2	107.1	119.4	21.5	11.5
Interest payments to federal govt	5.7	5.1	4.4	4.2	-12.3	-4.2
Other current expenditure	67.0	83.1	102.6	115.1	23.5	12.2
Development expenditure	17.8	23.5	60.7	20.8	158.0	-65.8
Overall balance	**-13.8**	**-13.0**	**-48.4**	**20.1**	**272.9**	**-141.6**

Source: Ministry of Finance

5.7 Provincial Fiscal Operations

Provincial public finance exhibited a noticeable improvement during Q1-FY09 as total expenditures witnessed a sizeable decline accompanied by a large increase in revenue receipts (see **Table 5.9**). Consequently, overall balance in Q1-FY09 turned into Rs 20.1 billion surplus compared to a deficit of Rs 48.4 billion in Q1-FY08. However, the reversal from a sizeable deficit to a moderate surplus in overall balance carries certain costs as this was achieved with large decline in development expenditures across all the four provinces (see **Table 5.10**).

Table 5.10: Provincial Finance during Jul-Sep
billion Rs

	Punjab		Sindh		NWFP		Balochistan	
	FY08	FY09	FY08	FY09	FY08	FY09	FY08	FY09
Total revenue	**63.2**	**70.9**	**29.8**	**46.7**	**17.5**	**23.9**	**9.0**	**18.8**
Provincial share in Federal revenue	44.5	59.8	28.0	37.4	10.8	15.5	7.7	11.7
Provincial taxes	5.2	5.7	3.4	6.2	0.6	0.6	0.2	0.2
Provincial non-tax	12.9	3.7	1.6	0.8	3.5	3.5	0.3	0.4
Federal loans and transfers/grants	0.6	1.8	-3.3	2.2	2.6	4.3	0.7	6.5
Total Expenditure	**96.6**	**68.1**	**41.1**	**46.6**	**19.5**	**17.0**	**10.5**	**8.4**
Current expenditure	51.6	56.8	34.7	41.3	12.4	14.5	8.4	6.9
Development Expenditure	45.0	11.3	6.5	5.4	7.1	2.5	2.1	1.5
Overall balance	**-33.4**	**2.8**	**-11.4**	**0.0**	**-2.1**	**6.9**	**-1.6**	**10.4**

Source: Ministry of Finance

Federal tax assignments to provinces during Q1-FY09 rose by 36.9 percent against 15.7 percent in the corresponding period last year. The high growth in provincial share in federal revenues during Q1-FY09 was caused by larger divisible pool following strong growth in indirect taxes. Provincial non-tax receipts declined by Rs 10 billion in Q1-FY09, however, the fall in non-tax revenues was more than offset by Rs 14.1 billion rise in federal government loans and grants to the provinces.

5.8 Domestic Debt

Despite a decline in fiscal deficit in Q1-FY09, growth in domestic debt accelerated reflecting non-availability of financing through external sources. During Jul-Oct FY09, domestic debt increased by 6.3 percent (or Rs 205.1 billion); significantly higher than the 4.6 percent growth in the same period of the preceding year (see **Table 5.11**). Although the government raised substantial amount from long term instruments, short term debt continued to have the major share, ending up at 87.4 percent in total domestic debt in Jul-Oct

Table 5.11 : Key Developments of Domestic Debt
billion Rupees

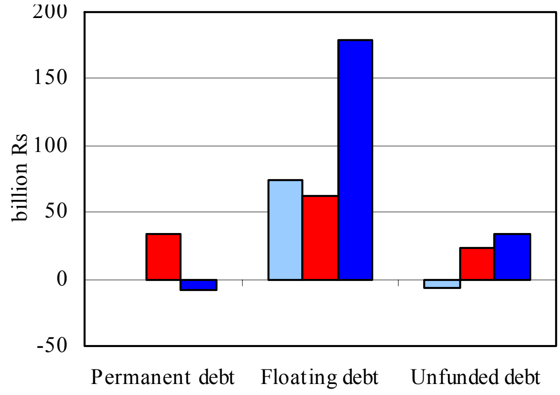
	Jul-Oct	
	FY08	FY09
Growth in domestic debt (percent; since June)	4.6	6.3
Contribution of LT debt	57.8	25.8
Contribution of ST debt	61.6	179.3
Addition to stock of domestic debt	119.4	205.1
Domestic debt stock outstanding (end-Oct)	2,720.0	3,471.2

FY09. The strong growth in short term debt is mainly due to heavy government borrowings from the central bank.

Components of Domestic Debt

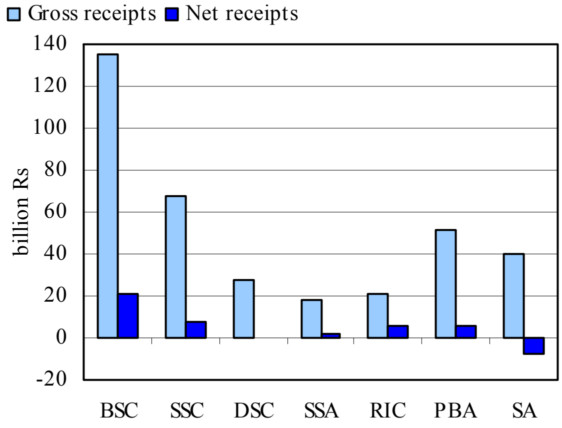
The sharp rise in domestic debt during Jul-Oct FY09 was mainly contributed by a large increase in floating debt (see **Figure 5.2**). On the other hand, the stock of permanent debt declined by 8.4 percent reflecting poor gross mobilization of funds through PIBs. In fact, gross receipts in PIBs during Jul-Oct FY09 were nearly one-fourth of the maturing stock of PIBs in the same period. The poor response by investors in PIB auction probably indicates their expectations of upward movement of the long term interest rates under tight monetary policy stance.

Figure5.2: Domestic Debt Outstanding (Jul-Oct)



Another important development within the permanent debt is the issuance of the Ijara Sukuk bond by the Government of Pakistan. Again, the government only succeeded in fetching Rs 6.5 billion against a target of Rs 10.0 billion through first auction of Ijara Sukuk bonds in mid-September 2008.

Figure 5.3: Gross & Net Receipts of NSS (Jul-Oct)



Unfunded debt witnessed a moderate growth of 3.3 percent in Jul-Oct FY09 compared to 2.5 percent in the corresponding period last year. However, the hefty rise in floating debt during Jul-Oct FY09 resulted in fall in the share of unfunded debt by three percentage points to

16.5 percent.

Despite significant gross receipts in major NSS instruments (see **Figure 5.3**), the aggregate outstanding stock of these instruments showed subdued growth reflecting sizeable repayments. Given that the government has increased interest rate twice on NSS instruments, the large inflows probably indicate (1) reinvestment of maturing amount to NSS instruments (2) switching within NSS instruments towards BSC and PBA because of their relatively attractive rates of return.

Table 5.12 Gross Receipts and Payments of T-bills (Jul-Oct)

billion Rupees

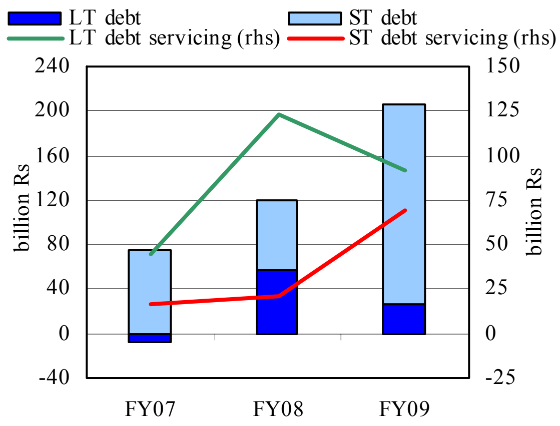
	FY08		FY09	
	Gross Receipts	Repayments	Gross Sales	Repayments
MTBs	223.9	115.7	405.3	499.6
MRTBs*	229.7	276.3	750.5	482.9
Total	453.6	392.0	1,155.8	982.5

* MRTBs are used for replenishment and MTBs are issued in auction

The floating debt, comprising of zero coupon T-bills, increased by 10.9 percent in Jul-Oct FY09 as compared to a moderate increase of 5.6 percent in the corresponding period last year. Within floating debt, the stock of treasury bills with SBP ended up at Rs 1373.9 billion at end-October 2008 with net addition of Rs 321.3 billion during Jul-Oct FY09 (see **Table 5.12**). On the other hand the stock of T-bills with commercial banks reported a fall of Rs 94.3 billion, clearly reflecting the dependence of the government on central bank financing. It is hoped that the substantial increase in the policy rate in recent months would help the government to attract more liquidity from the commercial banks and to off load the existing stock of MRTBs to the market.

Interest payments on domestic debt reached at Rs 160.9 billion in Jul-Oct FY09, registering a growth of 37.3 percent (see **Figure 5.4**). Despite a fall in the share in

Figure 5.4: Domestic Debt Servicing (Jul-Oct)



domestic debt servicing, the long term interest payments continue to have the largest share. In absolute terms, Rs 91.6 billion accounted for permanent and unfunded interest payments during Jul-Oct FY09. The cost incurred against maturing DSCs still constitutes a major share in the long-term debt servicing.

The share of interest payments on short term debt in total domestic debt servicing has increased significantly from 14.4 percent in Jul-Oct FY08 to 43.1 percent in Jul-Oct FY09. This seems to be consistent with the rising stock of the floating debt amid rising rate of financing from the central bank. However the substantial increase in the rate of return on the NSS instrument would increase the debt servicing cost of the government on unfunded debt in future.

6 External Sector

6.1 Overview

Pakistan's external account remained under stress through Jul-Nov FY09, as acceleration in the growth of the current account deficit, and sharply reduced financial & capital account inflows drew the country's foreign currency reserves to perilously low levels. Not surprisingly, the rupee also weakened substantially in the period, depreciating by as much as 16.3 percent against the US dollar by end-October 2008, before recovering somewhat after Pakistan gained IMF support for a macroeconomic stabilization program (see **Table 6.1**).

Table 6.1: Summary of External Balances (Jul-Nov)
billion US$

	FY07	FY08	FY09
Current A/C	**-4.0**	**-4.7**	**-6.9**
Trade balance	-4.4	-4.8	-6.6
Exports	*6.9*	*7.7*	*8.6*
Imports	*11.3*	*12.5*	*15.2*
Invisible balance	0.4	0.1	-0.3
Remittances	*2.1*	*2.6*	*3.0*
Capital & financial A/C	**2.7**	**3.8**	**1.4**
FDI	1.5	1.7	1.6
FPI	0.6	0.1	-0.2
Other investment	0.6	2.0	0.0
of which			
Public sector loans (net)	*0.1*	*0.6*	*0.1*
Private sector loans (net)	*0.0*	*0.1*	*0.1*
Error & omission	**0.6**	**0.0**	**-0.3**
Overall balance	**-0.8**	**-0.9**	**-5.7**
Memorandum Items			
Foreign reserves (end period)	12.3	15.7	9.1
Exchange rate (end period)	60.8	61.2	78.8

As in the later half of FY08, the expansion in current account deficit during Jul-Nov FY09 was mainly driven by a substantial acceleration in import growth. This acceleration owed considerably to the steep rise in import prices. While global food and petroleum prices had already begun to retreat sharply in FY09 from their peak levels, the average prices during the period under review have remained considerably higher than the average for the same period of last year.[1] Moreover, Pakistan's import prices reflected the decline in international prices only with a lag due to the differences at the time of the placement of orders and delivery. Thus, it was only by November 2008 that the import bill declined 23.9 percent YoY as slowing domestic demand was complemented by lower import prices.

[1] For instance, petroleum group prices were 61 percent higher during Jul-Nov FY09 period compared with the same period of last year.

Accordingly, the substantial worsening in the current account deficit is attributable entirely to the Jul-Oct FY09 period (see **Table 6.2**). During November 2008, the current account deficit narrowed somewhat helped by a lower trade deficit and strong remittances. Notwithstanding the November 2008 improvement the July-Nov FY09 current account deficit was a record for the period.

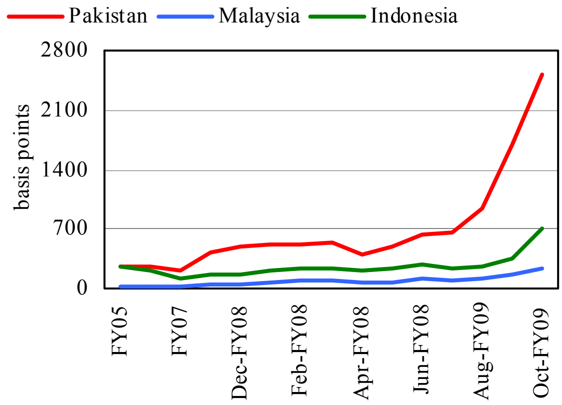
Table 6.2: Monthly Averages of External Accounts

million US$

	FY08		FY09	
	Jul-Oct	**Nov**	**Jul-Oct**	**Nov**
Current A/C	**-748.2**	**-1752.0**	**-1511.3**	**-810.0**
Trade balance	-838.9	-1451.0	-1482.0	-674.0
Exports	*1546.3*	*1531.0*	*1758.9*	*1595.0*
Imports	*2385.2*	*2982.0*	*3240.9*	*2269.0*
Invisible balance	90.8	-301.0	-29.3	-136.0
Remittances	*519.8*	*506.0*	*586.3*	*620.0*
Capital& financial A/C	**777.8**	**678.1**	**281.0**	**320.0**
FDI	329.8	393.0	331.5	276.0
FPI	77.8	-207.0	-45.5	-1.0
Other investment	371.3	484.1	-7.3	46.0
of which				
Public sector loans (net)	*147.0*	*4.1*	*-7.8*	*88.0*
Private sector loans (net)	*25.8*	*30.0*	*9.3*	*41.0*
Error & omission	**-52.6**	**257.9**	**-88.0**	**46.0**
Overall balance	**-23.0**	**-816.0**	**-1318.3**	**-444.0**
Memorandum Items				
Foreign reserves (end period)	16451.0	15680.0	6761.6	9136.2
Exchange rate (end period)	60.7	61.2	81.6	78.8

Thus, as weakening economic fundamentals and deteriorating law & order situation discouraged investment flows and the global financial crisis restricted the country's ability to tap international capital markets, depletion of the country's foreign exchange reserves accelerated. By November 25, 2008 the country's foreign exchange reserves had declined further by US$ 5.0 billion from end-June position, as compared to a fall of US$ 4.2 billion recorded for the whole of FY08.

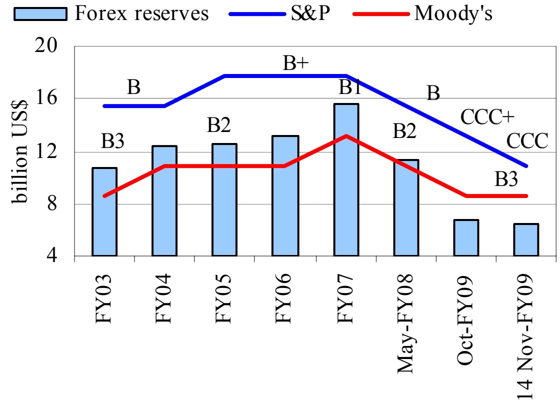
Figure 6.1: Sovereign Credit Default Swap Spreads (5 year international bonds)



The substantial fall in foreign exchange reserves on account of severe balance of payment pressure impaired the country's ability to meet its external obligation. This was reflected in a sharp rise in sovereign credit default swap spread of Pakistan's five year international bond (see **Figure 6.1**) and downward revision of Pakistan's credit rating by the international credit rating agencies (see **Figure 6.2**).

In this backdrop, Pakistan had limited options and was finally forced to approach the International Monetary Fund to support a macroeconomic stabilization program.

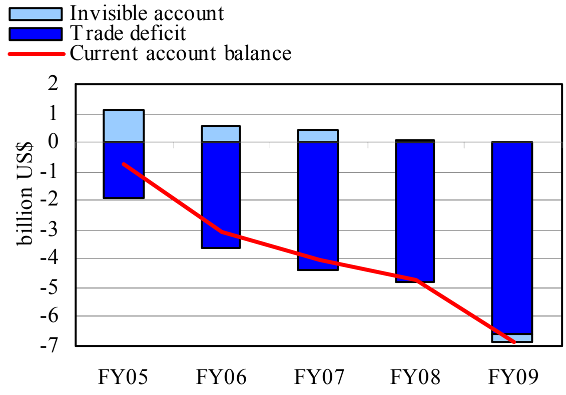
Figure 6.2: Forex Reserves and Foreign Currency Long Term Credit Rating



The balance of payment support worth US$ 3.0 billion from IMF by end November FY09 not only helped directly building up foreign exchange reserves but also increased loan inflows from other donor agencies thereby stabilizing the exchange rate (see **Table 6.2**). With the improvement in forex inflows S& P also upgraded Pakistan's credit rating to CCC+ from CCC on 18th December 2008.

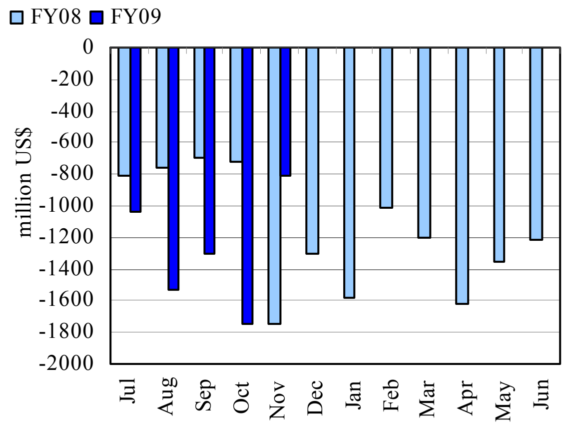
Looking ahead, improvement in current account is likely to continue in the wake of expected slowdown in import growth on account of substantial reduction in petroleum and commodity prices in international market, slowdown in domestic economy, significant depreciation in exchange rate, tight monetary policy, and other tariff and non-tariff barriers. However, there exist significant risks to this outlook, with a possibility of a sharp fall in exports due to domestic structural problems (like power shortages) and recession in Pakistan's major export markets. The reduction in commodity prices could

Figure 6.3: Composition of Current Account Balance (Jul-Nov)



also adversely affect Pakistan's chief non-textile exports: rice and cement. It is therefore imperative to implement policies to further contain domestic demand and to promote exports.

Figure 6.4: Monthly Current Account Deficit



6.2 Current Account Balance

Pakistan's current account deficit increased considerably in Jul-Nov FY08 compared with the same period of last year (see **Figure 6.3**). The invisible account that was in surplus till last year, also recorded a deficit during Jul-Nov FY09. This added to the already worsening current account deficit. While the deterioration in trade deficit was mainly explained by the strong import growth, the deficit in the invisible account was contributed by a slowdown in workers' remittances, outflows from resident foreign currency accounts and lower interest earnings on foreign exchange reserves.[2]

Current account deficit for November 2008, however, shows significant improvement (see **Figure 6.4**). This welcome contraction in the current account deficit is mainly the result of a fall in import bill and strong remittances growth.

Trade Account[3,4]

The strong import growth of 21.6 percent outstripped a healthy 11.9 percent rise in export during Jul-Nov FY09. As a result, trade deficit expanded to US$ 6.6 billion during the period under consideration compared with US$ 4.8 billion in the same period of last year.

The higher import growth mainly resulted from substantial rise in petroleum and food group imports owing to their higher unit prices. The healthy export growth

[2] The substantial fall in other current transfers from exchange companies was offset by lower outflows from the companies recorded in services account. Thus these flows have no impact on invisible and current account balance.

[3] This section is based on exchange record data compiled by SBP that does not tally with the Custom data compiled by FBS.

[4] For detail, please see section on trade account.

Table: 6.3 Current Account Balance
million US$

	Jul -Nov			YoY Change	
	FY07	**FY08**	**FY09P**	**FY08**	**FY09**
1. Trade Balance	**-4415**	**-4807**	**-6602**	**-392**	**-1795**
Exports	6884	7716	8631	832	915
Imports	11299	12523	15233	1224	2710
2.Services (net)	**-1951**	**-2844**	**-2061**	**-893**	**783**
Transportation	-901	-943	-1157	-42	-214
Travel	-552	-573	-609	-21	-36
Communication services	25	22	-14	-3	-36
Construction services	-11	-7	-25	4	-18
Insurance services	-55	-67	-18	-12	49
Financial services	-35	-28	-48	7	-20
Computer & information services	9	-8	38	-17	46
Royalties and license fees	-44	-38	-24	6	14
Other business services	-839	-1255	-649	-416	606
Personal & cultural & recreational services	0	0	0	0	0
Government services	452	53	445	-399	392
Of which logistic support	425	0	365	-425	365
3. Income (net)	**-1533**	**-1705**	**-2051**	-172	-346
Investment income(net)	**-1535**	**-1707**	**-2056**	**-172**	**-349**
Direct investment	**-1191**	**-1320**	**-1448**	**-129**	**-128**
of which: profit & dividends	-267	-309	-311	-42	-2
purchase of crude oil and minerals	-590	-609	-692	-19	-83
Portfolio investment	**-91**	**-152**	**-235**	**-61**	**-83**
of which: profit & dividend	-81	-89	-69	-8	20
IMF charges & interest on off. External long term debt	-322	-331	-306	-9	25
Interest on private external debt	-43	-64	-51	-21	13
Others (net)	114	162	-11	48	-173
4. Current Transfers (net)	**3874**	**4611**	**3859**	**737**	**-752**
Private transfers	**3772**	**4578**	**3755**	**806**	**-823**
Workers remittance	2093	2587	2965	494	378
FCA - residents	-61	216	-352	277	-568
Others	1740	1775	1142	35	-633
of which exchange companies	1013	959	247	-54	-712
Official transfers	**102**	**33**	**104**	**-69**	**71**
Current Account Balance	**-4025**	**-4745**	**-6855**	**-719**	**-2110**

on the other hand is mainly attributed to the strong growth in non-textile exports, as the textile export could not pick up amid global recession and severe power shortages.

Services (net)

In sharp contrast to 45.7 percent expansion in the comparable period of last year, deficit in services trade declined by 27.5 percent during Jul-Nov FY09. This decline is mainly attributed to logistic support receipt and lower outflow from foreign exchange companies for other business (see **Table 6.4**).

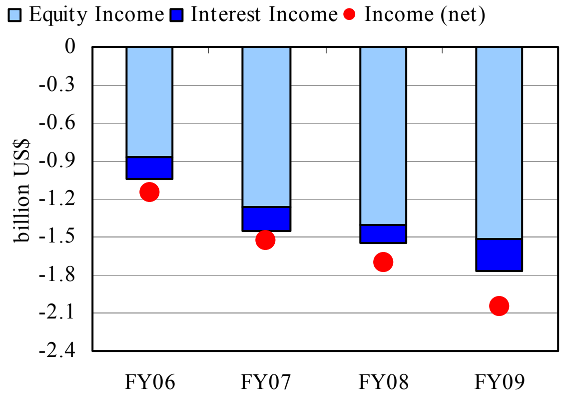
The substantial fall (US$ 568 million) in outflow from the foreign exchange companies is mainly attributed to changes in the SBP regulations whereby exchange companies' outflows for legal transaction were restricted to 75 percent of the home remittances mobilized by them during the preceding month.[5]

Table 6.4: Services Account (net)
million US$

	Jul-Nov		
	FY07	**FY08**	**FY09**
Transportation	-901	-943	-1157
Travel	-552	-573	-609
Other business services	-839	-1255	-649
of which exchange companies	-819	-1040	-425
Government services	452	53	445
of which logistic support	425	0	365
Others	-111	-126	-91
Services (net)	**-1951**	**-2844**	**-2061**
a)Adjusted for logistic support	-2376	-2844	-2426
b)Adjusted for exchange companies flows	-1132	-1804	-1636
c)Adjusted for (a) and (b)	-1557	-1804	-2001

Within the services account deficit, however, the deficit in transportation and travel further deteriorated during the period under review. The deterioration in the former was caused by higher import related freight charges while increase in the latter was explained by higher Hajj related outflows and lower tourist's services export.

Figure 6.5: Major Factors Behind Income Account Deterioration (Jul-Nov)



Income (net)

The income account deficit increased by 20.3 percent during Jul-Nov FY09 compared with 11.2 percent deterioration in the same period of last year. A large part of this deterioration was contributed by net increase in interest income related outflow. Moreover, increase in investment income outflow also added to deterioration in income account (see **Figure 6.5**).

The increase in investment income was mainly caused by higher purchase of crude oil and mineral as the repatriation of profit & dividends registered a decline during

[5] For detail see FE circular No. 04 of 2008, dated May 09, 2008.

the period under consideration. The main sectors which depicted decline in the repatriation of profit & dividends include financial business, communication and power.

The interest income related outflows (net) on the other hand increased by around US$ 102 million during Jul-Nov FY09 in contrast to a decline of US$ 5 million in the corresponding period of last year. This higher net outflow was largely

Table 6.5: Financial Account
million US$

	Jul-Nov			YoY Change	
Items	**FY07**	**FY08**	**FY09P**	**FY08**	**FY09**
Financial account (1 through 4)	**2,566**	**3,775**	**1,436**	**1,209**	**-2,339**
1. Direct investment abroad	**-54**	**-10**	**-**	**44**	**10**
2. Direct investment in Pakistan	**1,480**	**1,712**	**1,602**	**232**	**-110**
of which: Equity Capital	1,130	1,305	1,172	175	-133
privatization proceeds	133	133	-	-	-133
Reinvested earning	348	407	430	59	23
3. Portfolio investment	**576**	**104**	**-183**	**-472**	**-287**
Equity securites	419	51	-146	-368	-197
Debt securites	153	56	-17	-97	-73
Net Foreign Investment	2,002	1,806	1,419	-196	-387
4. Other investment	**564**	**1,969**	**17**	**1,405**	**-1,952**
Assets	201	838	270	637	-568
i. Outstanding Exports Bills (Exporters)	-85	-76	123	9	199
ii. Outstanding Exports Bills (DMBs)	73	78	145	5	67
iii. Currency & deposits	212	836	2	624	-834
of which:Bank	145	751	-49	606	-800
Liabilities	363	1,131	-253	768	-1,384
i.Foreign Long-term loans / credits (net)	103	528	139	425	-389
Project Assistance	355	659	338	304	-321
Non-Food Aid	211	390	494	179	104
of which earthquake loans	130	405	16	275	-389
Amortization	463	521	693	58	172
ii. Private loans	10	133	72	123	-61
of which: Suppliers Credits/MNCs	134	214	228	80	14
Supplier Credits Repayments	124	81	156	-43	75
iii. ST Capital, (official)	-42	64	-82	106	-146
of which: Commerial Banks (net)	-100	-100	-	-	100
IDB (net)	58	164	-82	106	-246
iv. Currency & deposits	134	287	-427	153	-714
*of which: Trade financing**	135	257	-397	122	-654
v. Other liabilities	158	69	39	-89	-30

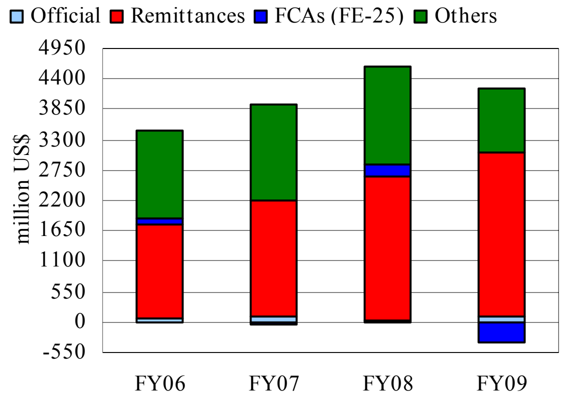
Source: Statistics Department, SBP

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

* Trade financing for preshipment loans

contributed by the substantial fall on foreign exchange earnings. Moreover, higher interest payment on foreign currency deposits asserted additional pressure on interest income outflow during the period under consideration.

Figure 6.6: Major Components of Current Transfers (Jul-Nov)



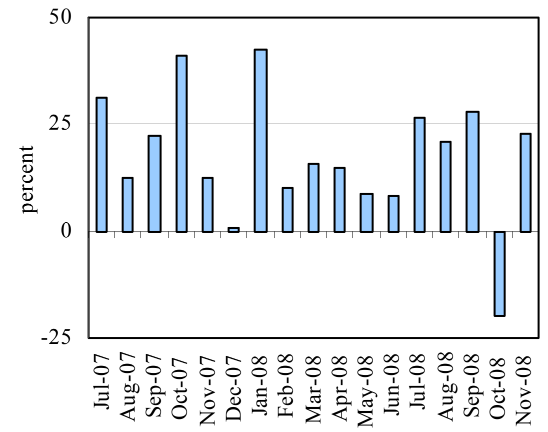
Current Transfers

After enjoying healthy growth during Jul-Nov period for last five consecutive years, current transfers declined by US$ 752 million during Jul-Nov FY09. This decline resulted from a fall in private transfers as public transfers recorded increase during the period under review. Within private transfers a substantive part of the fall was contributed by fall in other transfers and net outflow from resident foreign currency accounts during the period under review (see **Figure 6.6**). Moreover, slowdown in workers' remittances growth during the period under review also contributed to this decline.

Workers' Remittances

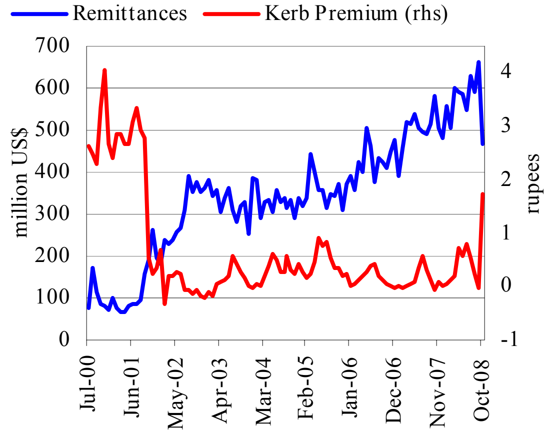
Growth in workers' remittances decelerated to 14.6 percent during Jul-Nov FY09 from 23.6 percent in the comparable period of last year. A large part of this deceleration occurred during October 2008 as YoY growth in remittances during Jul-Sep FY09 period was quite strong (see **Figure 6.7**).

Figure 6.7: YoY Growth in Workers Remittances



The decline in workers' remittances in October appears to be the result of a combination of factors. These factors range from seasonal impact of Ramadan and Eid festival to dollar hoarding amid abrupt depreciation in exchange rate, worldwide slowdown in workers' remittances in the wake of global recession, and possibly to a shift of workers' remittances to informal channel as a result of significant rise in kerb market premium.

Figure 6.8: Remittances and Kerb Market



The data suggests that kerb premium was highest in October 2008 during the last seven year period post 9/11. The kerb premium and workers' remittances are negatively correlated (-0.74), this negative relationship is explained by the fact that higher kerb premium (better rate) along with speedy delivery provide incentive to the migrant to divert their remittances to informal channel (**see Figure 6.8**).

Country wise remittances data suggest that a major part of deceleration in remittances growth was driven from United States, United Kingdom and United Arab Emirates (see **Table 6.6**). An economic slowdown in the U.S and the U.K could be possible reason behind this deceleration in remittances growth.

Table 6.6: Country-wise Workers' Remittances

million US$

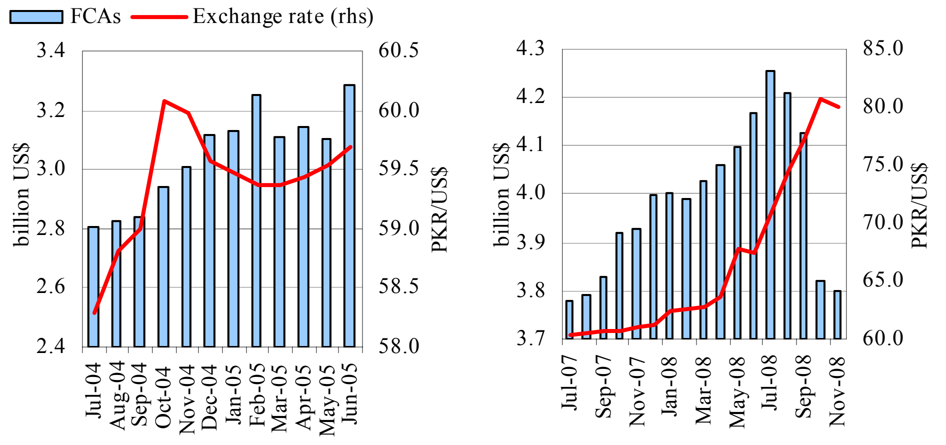
	Jul-Nov			Growth	
	FY07	**FY08**	**FY09**	**FY08**	**FY09**
1) Cash	**2091.6**	**2586.1**	**2966.2**	**23.6**	**14.7**
USA	533.5	733.8	767.1	37.5	4.5
U.K.	180.1	197.4	189.0	9.6	-4.3
Saudi Arabia	399.0	481.8	600.3	20.8	24.6
UAE	318.1	423.0	534.3	33.0	26.3
Other GCC countries	291.5	380.0	496.2	30.4	30.6
EU countries	62.6	76.1	81.0	21.6	6.5
Norway	8.0	11.3	10.7	42.6	-5.9
Switzerland	6.9	9.6	7.6	39.4	-20.5
Australia	12.2	14.5	13.5	18.9	-6.7
Canada	35.3	42.2	34.0	19.7	-19.4
Japan	2.1	1.5	1.9	-30.3	29.0
Other countries	242.6	214.9	230.7	-11.4	7.3
2) Others*	1.2	1.0	0.3	-17.1	-67.0
Total	**2092.8**	**2587.1**	**2966.5**	**23.6**	**14.7**

* Other includes encashment and Profit in Pak Rs of Foreign Exchange Bearer Certificates (FEBCs) & Foreign Currency Bearer Certificates (FCBCs)

Resident FCAs

In sharp contrast to an inflow of US$ 216 million in comparable period of last year, RFCAs declined by US$ 353 million during Jul-Nov FY09. Importantly, more than 80 percent of this decline was recorded in October 2008 alone when exchange rate depreciated substantially.

Figure 6.9: Foreign Currency Accounts and Exchange Rate



Historically RFCAs tend to rise with the depreciation in exchange rate (see **Figure 6.9**). The changed trend during the current episode of depreciation may be attributed to uncertainty surrounding the financial health of some of the institutions. It may be recalled that rumors of bank defaults and possible freezing of foreign currency accounts were rife in October 2008, which may have prompted individuals to withdraw foreign currency deposits. Demand for foreign currency notes also rose sharply during this month.

Figur 6.10a: Foreign Exchange Inflows through Exchange Companies

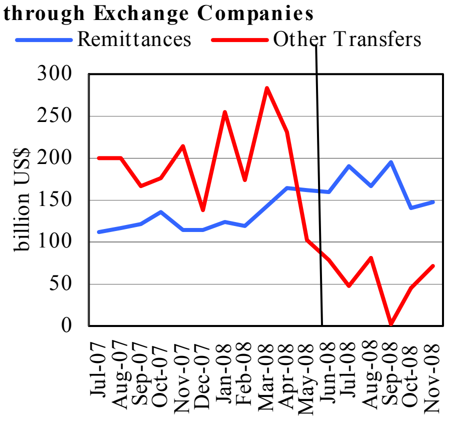
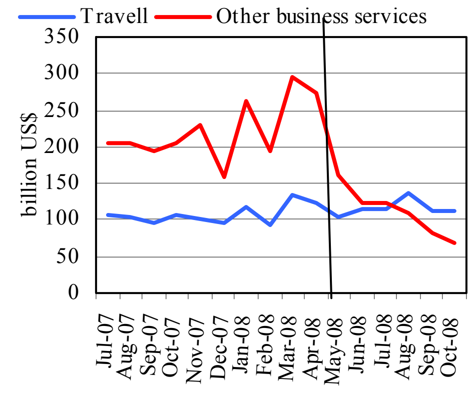


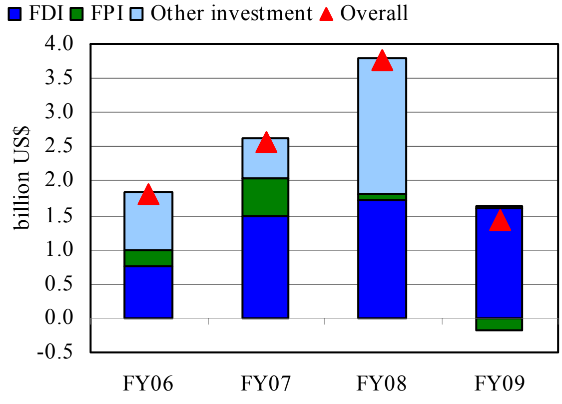
Figure 6.10b: Foreign Exchange Outflows through Exchange Companies



Other Transfers

Inflows in other private transfers registered a massive decline of US$ 633 million during Jul-Nov FY09 compared with inflow of US$ 35.0 million in the same period of last year. Importantly, the entire decline stemmed from the fall in inflows routed through exchange companies (see **Table 6.3**). It may be pointed that other transfers inflows has witnessed sharp decline after May 2008 when exchange companies outflows were restricted to no more than 75 percent of the workers' remittances collected by the company in the preceding month (see **Figure 6.10a**). However, workers' remittances routed through exchange companies increased after this measure. It may be mentioned here that reduction in exchange companies' inflows have no impact on overall current account balance as the outflow from exchange companies recorded in services account declined by an equivalent amount (see **Figure 6.10b**).

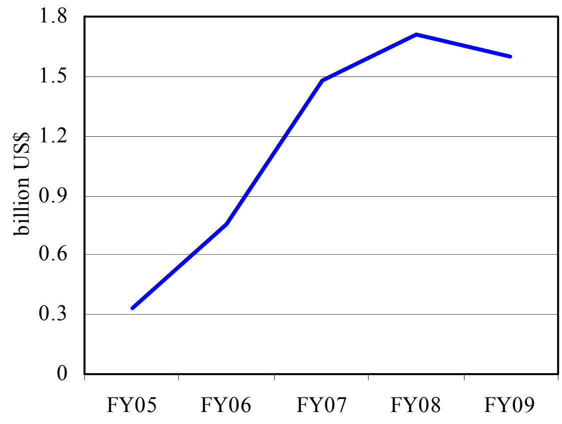
Figure 6.11: Sources of Financial Account Surplus (Jul-Nov)



6.3 Financial Account

Confluence of domestic and external factors led to drying up of major financial inflows (except foreign direct investment) during Jul-Nov FY09 (see **Figure 6.11**). In particular, deteriorating economic imbalances, sharp exchange rate depreciation, and substantial fall in stock market (and introduction of a floor on prices) and increase in the country's default risk deterred foreign exchange inflows during the period under review. Specifically, inflows categorized as *other investment* and portfolio investment fell substantially during the period under review. As a result, surplus

Figure 6.12: Foreign Direct Investment (Jul-Oct)



in financial account recorded significant 62.0 percent fall during Jul-Nov FY09 in contrast to an increase in the corresponding periods of last three successive years (see **Table 6.5**).

Table 6.7: Sector-wise Foreign Direct Investment (Jul-Nov) (million US$)

	Value		Share (%)		Growth
	FY08	FY09	FY08	FY09	(%)
Oil & gas explorations	232.6	275.5	13.6	17.2	18.5
Transport equipment	46.1	38.7	2.7	2.4	-16.1
Power	29.4	63.6	1.7	4.0	116.7
Construction	38.8	18.1	2.3	1.1	-53.4
Trade	69.0	70.6	4.0	4.4	2.3
Communications	624.2	388.7	36.5	24.2	-37.7
Financial business	297.8	444.1	17.4	27.7	49.1
Personal services	42.6	49.4	2.5	3.1	15.9
Others	332.0	254.6	19.4	15.9	-23.3
Total	**1712.5**	**1603.3**			**-6.4**

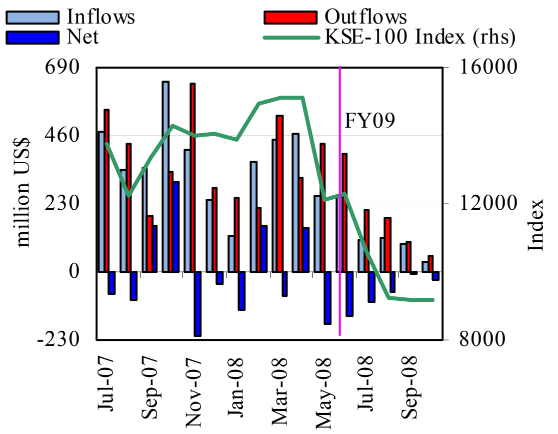
Net Foreign Investment

Net foreign investment declined by 21.4 percent during Jul-Nov FY09 against a 9.8 percent decline in the same period of last year. This fall was mainly due to net outflow from portfolio investment as decline in the foreign direct investment inflows was only US$ 110 million.

Foreign Direct Investment

Foreign direct investment recorded a decline of 6.2 percent during Jul-Nov 09 over the corresponding period last year (see **Figure 6.12**). This decline during the period is attributed to fall in the FDI during October and November 2008, as Q1-FY09 figures depict a healthy 10 percent rise over the same period last year. A part of this deceleration in later month may be attributed to increased country risk, absence of privatization proceeds and a part to tight liquidity condition in the international capital markets.

Figure 6.13: Special Convertible Rupee Accounts



With the largest share in overall FDI, lower investment in communication sector was the dominant factor behind this deceleration in FDI growth. The other major sectors which witnessed decline in foreign inflows during the period included trade, construction and transport (see **Table 6.7**).

Nonetheless, investment in financial business, oil & gas exploration and power sectors recorded robust growth during the period. The higher investment in financial business mainly resulted from US$ 194 million receipts from May Bank while higher investment in oil & gas exploration was mainly recorded in PB Pakistan, ENI Pakistan limited and BHP petroleum Pakistan. Likewise, the growth in power sector inflows mainly reflected investment in the Uch power project and KESC.

Table 6.8: Net Inflows of Foreign Portfolio Investment

	Jul-Nov		Change
US$ million	FY08	FY09	
Private sector	**50.4**	**-146.1**	**-196.5**
Equity securities	50.4	-146.1	-196.5
of which GDRs	*90.5*	*0*	*-90.5*
Debt securities	0	0	0
Public sector	**55.6**	**-16.8**	**-72.4**
Equity securities	0	0	0
Debt securities	55.6	-16.8	-72.4
Total	**104**	**-183**	**-287**

Portfolio Investment

The portfolio investment was worst hit by the unfavorable domestic and external developments during the period under review. Both the private and public sectors witnessed net outflow during Jul-Nov FY09 (see **Table 6.8**). The outflow from private sector was mainly driven by steep fall in stock market (see **Figure 6.13**) and later to the artificial floor on prices, while the outflow from public sector stemmed from the debt securities (T-bills).

Outstanding Export Bills

Aggregate stock of outstanding export bills declined by a sizeable amount during Jul-November FY09. This decline is witnessed in the stock of both the exporters and banks.

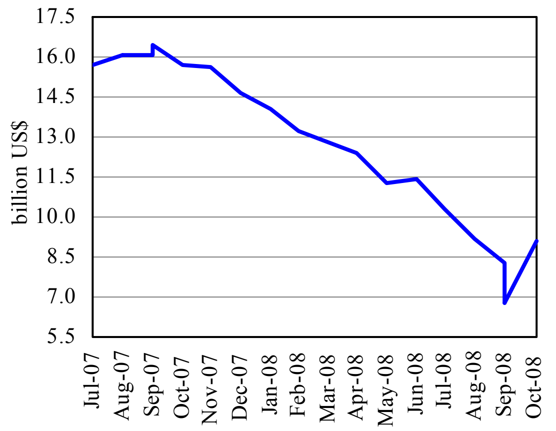
Currency and Deposits (Assets)

Currency and deposits recoded a nominal decline of US$ 2.0 million during Jul-Nov FY09 against considerable decline of US$ 836 million in the same period of last year. This lower decline is attributed to increase in commercial banks' FE-25 nostros in the face of retirement against FE-25 deposits.

Official Long Term Loans

Net inflows in the official long term loans fell considerable during Jul-Nov FY09 compared with the same period of last year. This decline was mainly driven by markedly lower earthquake loans and relatively higher amortization. It may be pointed out that only 5 percent of the full year earthquake loan estimate was realized in the first four months. This suggests that earthquake loan receipts are likely to increase in the rest of the current fiscal year. The higher amortization mainly reflects the payments of Islamic Development Bank (US$ 201 million), Asian Development Bank (US$ 112 million) and IBRD (US$ 113 million). Nonetheless, US$ 500 million loan receipts from Asian Development Bank (ADB) supported these inflows to some extent.

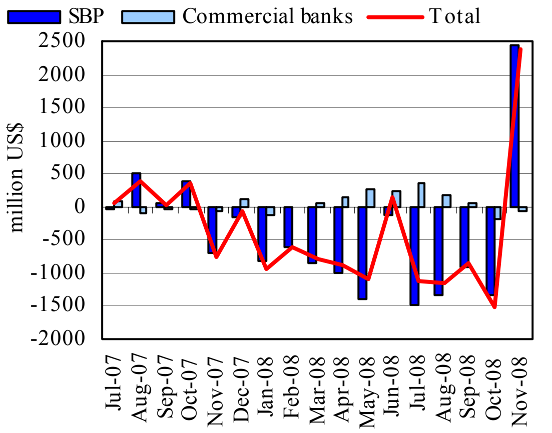
Figure 6.14: Foreign Exchange Reserves



Official Short Term Loans
As a result of debt payment of US$ 282 million to Islamic Development Bank and fresh withdrawal of US$ 200 million, official short term net outflows increased by US$ 82 million during Jul-Nov FY09.

Currency and Deposits (Liabilities)
Currency and deposits witnessed a net outflow of US$ 427 million during Jul-Nov FY08 compared with net inflow of US$ 231 million in the comparable period of last year. This outflow is almost entirely driven by the fall in trade financing on account of FE-25 loans retirement by exporters and importers.

Figure 6.15: Foreign Exchange Reserves



6.4 Foreign Exchange Reserves
Pakistan's foreign exchange reserves declined substantially in the initial months of FY09, dropping from US$ 11.4 billion at end June 08 to a low of US$ 6.4 billion by 25th Nov 2008 (see **Figure 6.14**). This US$ 5.0 billion fall was greater than the fall in the FX reserves for the whole of FY08.

The subsequent partially recovery in November 2008 owed essentially to the inflow of US$ 3.0 billion from the IMF following Pakistan entry into a macroeconomic stabilization program.

SBP Reserves

SBP's reserves registered a steady decline to US$ 5.9 billion by end November, 08. The SBP's reserve flows remained negative throughout the current fiscal year except for the month of November, during which IMF tranche of US$ 3.0 billion was received (see **Figure 6.15**). Causative factors for the change in SBP reserves are presented in **Table 6.9**

Table 6.9: SBP Reserves

million US$

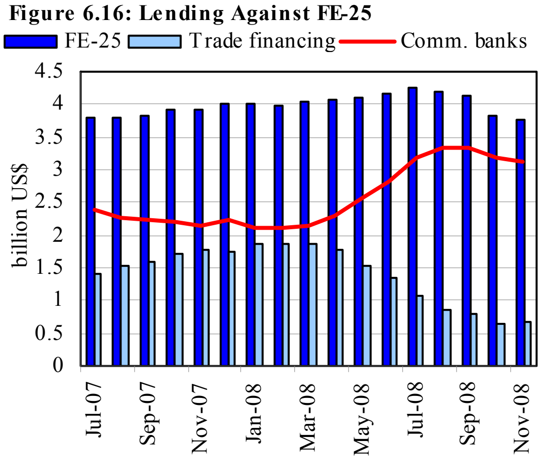
	Jul-Nov	
	FY08	FY09
Inflows	6,367	13,566
Purchases	2,843	2,015
Loans & grants	1,229	4,044
ADB	671	615
IMF	4	3,056
Others	2,994	7,507
Forward maturities	1,128	6,736
Logistic supports	0	365
Privatization proceeds	643	0
Outflows	6,122	16,256
Sales	3,270	7,168
Inter-bank sales	365	1,065
Oil support	2,905	6,103
Debt servicing	570	917
Others	2,282	8,170
Forward maturities	1469	6,426
Wheat L/C - TCP	12	671
Net change in reserves	245	-2,689

Source: DMMD

Commercial Bank Reserves

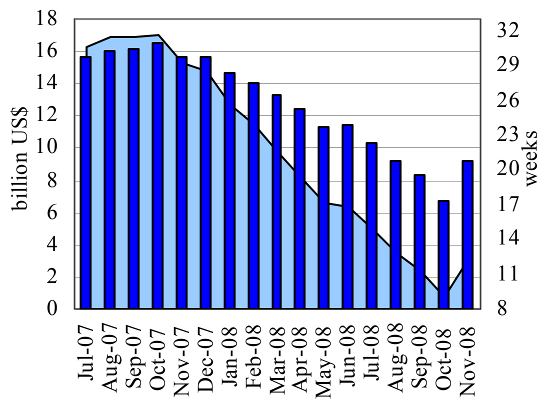
Although monthly flows of commercial banks reserves, depicted a falling trend throughout Jul-Nov 2008, on a cumulative basis DMBs reserves at US$ 3.2 billion in November 2008 were slightly higher than the end June 08 position of US$ 2.8 billion. Improvement in commercial banks reserves was largely contributed by the retirement of foreign currency loans availed against the FE-25 deposits. During Jul-Nov FY09, trade financing showed consistent decline to US$ 0.6 billion by end November 2008 against US$ 1.3 billion as of end-June 2008 (see **Figure 6.16**)

Figure 6.16: Lending Against FE-25



Despite the increase in the interest rate differential between WAFC (weighted average foreign currency) lending and KIBOR, the volume of FE lending to importers declined by US$ 381 million. The reduction in FE lending to importers was probably driven by the weakening rupee (and consequent expectations of further rupee depreciation) the resulting risk of a sharp increase in the effective cost of FE-25 loans.

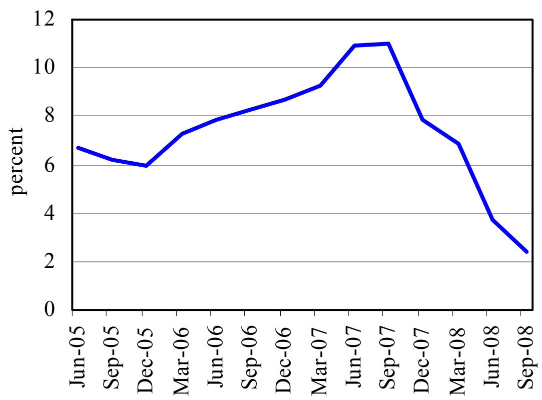
Figure 6.17: Reserve



Reserve Adequacy

The considerable depletion in foreign exchange reserves weakened the country's ability to meet its external obligations. The import coverage ratio declined to an uncomfortable level of 9.1 weeks as of end October 08 from 16.8 weeks of imports as of end June 08. However, the US$ 3 billion IMF's assistance in November 08 provided some cushion, improving the import coverage ratio to 12.3 weeks of imports (see **Figure 6.17**)

Figure 6.18: Reserves to Short Term Debt & Liabilities

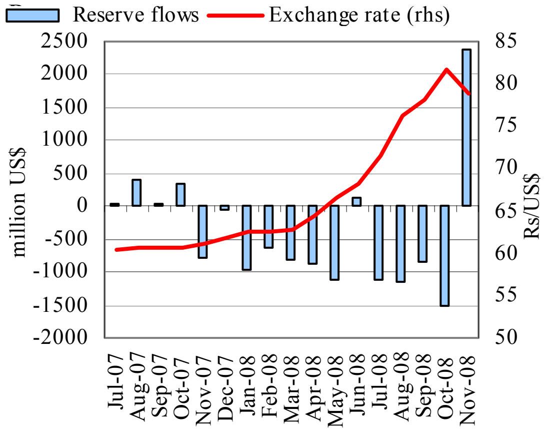


Another measure of reserve adequacy is reserves to short term debt and liabilities ratio. This ratio also deteriorated during Q1-FY09. Although short term obligations showed a slight fall during Q1-FY09, huge depletion of foreign exchange reserves during the next two months resulted in fall of this ratio from 3.7 to 2.4 (see **Figure 6.18**)

6.5 Exchange Rates

The decline of the rupee had been gathering pace since February 2008. Thus, in order to stabilize inflows and calm market sentiments SBP took number of measures early into FY09. These included suspension of forward booking of dollars, reduction in trading time and curtailment of advance payments against imports from 50 percent to 25 percent[6]. Moreover, to ensure that export proceed are materialized timely, SBP issued instructions to exporters to submit their overdue export proceeds. In this regard banks were advised to launch a campaign for realization of overdue export bills[7]. As a result, the stock of outstanding export bills held by exporters declined by US $ 123 million during Jul-Nov FY09.

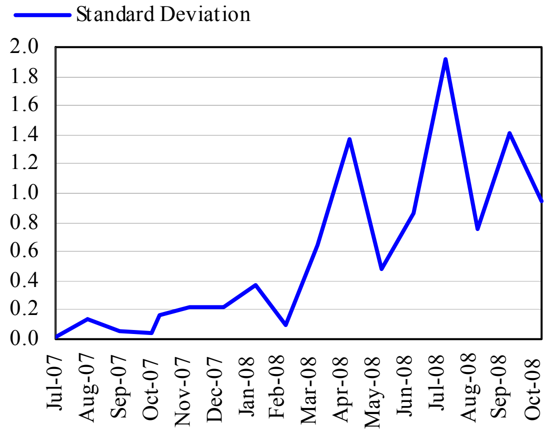
Figure 6.19: Foreign Reserves and Exchange



However, due to deteriorating fundamentals the depreciation of rupee accelerated. The rupee fell 16.3 percent during Jul-Oct FY09, reflecting the substantial loss of FX reserves, and heavy buying by businesses seeking to avoid exchange losses on imports. The speculations were strongest in October and as result rupee touched record lows of Rs. 83.46/US $ on October 17, 2008.

The situation in the forex market improved only after Pakistan's entry into an IMF program, and a crackdown on exchange companies involved in smuggling of US dollar. Consequently, Pak Rupee recovered some of its earlier losses against the US dollar and registered a net depreciation of 13.3 percent for the Jul-Nov FY09 period (see **Figure 6.19**). Along with steep depreciation, exchange

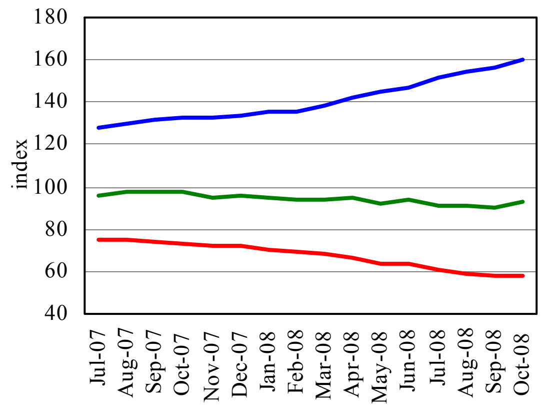
Figure 6.20: Volatility in Exchange Rate



[6] EPD circular No.08 dated July 08, 2008.
[7] EPD circular No. 06 dated July 11, 2008.

rate volatility also increased over the period. Standard deviation of the inter-bank market exchange rate was extremely volatile and in August and October 2008 (see **Figure 6.20**)

Figure 6.21: Effective Exchange Rate

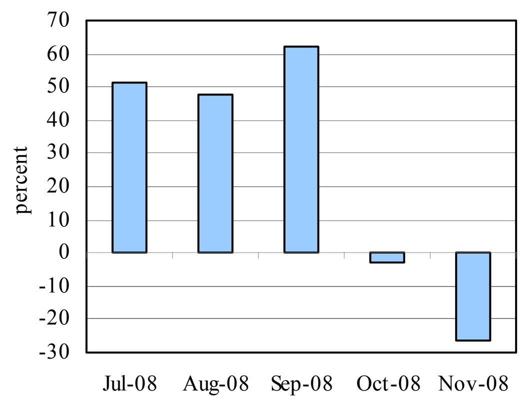


As against US dollar, the exchange rate against basket of currencies as measured by Nominal Effective Exchange Rate (NEER) also showed 9.2 percent depreciation during Jul-Oct FY09 as compared to the depreciation of 3.2 percent during the same period last year. However, continuous rise in inflationary pressures evident in 8.8 percent rise in Relative Price Index (RPI), depreciation in Real Effective Exchange Rate (REER) was limited to 1.2 percent (see F**igure 6.21**).

6.6 Trade Account

During Jul-Nov FY09, strong growth in imports, mainly due to higher import prices, outpaced the otherwise substantial improvement in export growth causing the trade deficit for the period to widen by US$ 1.4 billion compared to the same period last year (see **Table 6.10**).[8] Interestingly, this rise in the deficit was accrued entirely during Q1-FY09; while still large, the monthly deficit saw a YoY decline in each of the next two months (see **Figure 6.22**).

Figure 6.22: Monthly YoY Growth Pattern in Trade Deficit



[8] The price and quantum impact is based on 60 percent of total imports for which detail data is available.

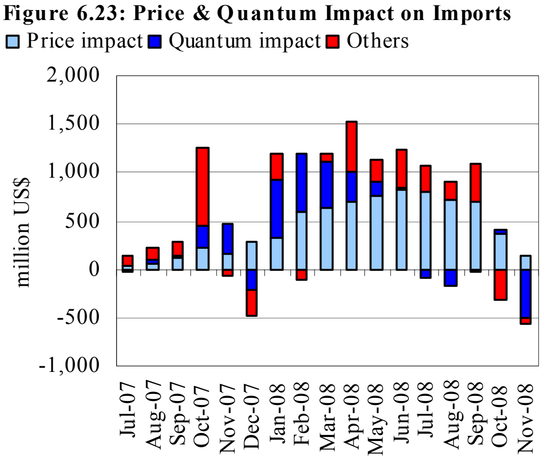
A closer look at the import growth for these five months of FY09 shows that during the first quarter demand growth may have begun to taper off, but sharply higher import prices ensured that the trade deficit continued to grow strongly. By October 2008, both demand and import prices began to weaken. Thus, after recording a large YoY increase during Q1-FY09, imports witnessed a fall in Oct-Nov FY09 (see **Figure 6.23**). [9]

Table 6.10: Composition of Trade Deficit (Jul-Nov)
billion US$

	FY07	FY08	FY09
Trade deficit	**5.4**	**7.3**	**8.7**
Absolute change in imports	**1.2**	**2.3**	**2.4**
Percent share in abs. Δ			
of which			
Price impact	32.2	34.2	103.4
Oil price impact	14.6	14.7	78.3
Non-oil price impact	17.6	19.4	25.1
Quantum impact	15.0	16.2	-6.6
Absolute change in exports	**0.3**	**0.4**	**0.9**
Percent share in abs. Δ			
Textile	90.7	-7.5	-10.7
Non-textile	9.3	107.5	110.7

In fact international commodity prices witnessed a significant downtrend throughout Jul-Nov FY09 (see **Table 6.11**), but as this impacts Pakistan's trade figures with a lag, it is only during the later months that a significant import price decline is visible. On the other hand, a part of lower import during Oct-Nov FY09 may be due to one off factors[10] that may not be present in months ahead. Thus, while imports may continue to shrink from a downtrend in international prices and slowing domestic demand, the improvement may not be as sharp as seen in November 2008.

Figure 6.23: Price & Quantum Impact on Imports



Expectations of a slowdown in imports, stemming from

[9] POL group and fertilizer imports recorded a significant fall in import quantum during this period. In fact due to sharp draw down of country's international reserves during October FY09 government imposed a one month temporary ban on POL imports.
[10] Absence of a large one-off import in the category of ships and boats that occurred in Oct FY 2008 also contributed to the sharp YoY slowdown in imports during Oct 2009.

Table 6.11: Average International Commodity Prices

		FY08				FY09	
	Unit	Q1	Q2	Q3	Q4	Q1	Oct-Nov
Arabian light oil	US$/barrel	71.3	85.2	93.7	117.2	113.8	62.0
Palm oil	US$/MT	746.4	861.6	1081.1	1088.9	828.4	459.7
DAP	US$/MT	432.5	522.1	860.2	1191.6	1153.7	791.3
Wheat	US$/MT	274.9	341.9	411.4	346.5	317.7	232.1

easing of domestic supply pressures[11], a general slowdown in economic activity, sharp depreciation of rupee,[12] and removal of subsidies, etc., would suggest that Pakistan's trade deficit could shrink even faster in the months ahead. However, there is also a concomitant risk that slowing exports, as the global economy weakens (see **Box 6.1**), will offset part of the gains from declining imports.

It should be noted that the entire increase in exports during Jul-Nov FY09 was driven by strong growth in non-textile exports; textile exports recorded a marginal fall during the period (see **Figure 6.24**). Notwithstanding the healthy YoY increase in exports in Jul-Nov FY09, the monthly export performance shows a slowdown in export growth

Figure 6.24: Contribution in Export Growth (Jul-Nov)

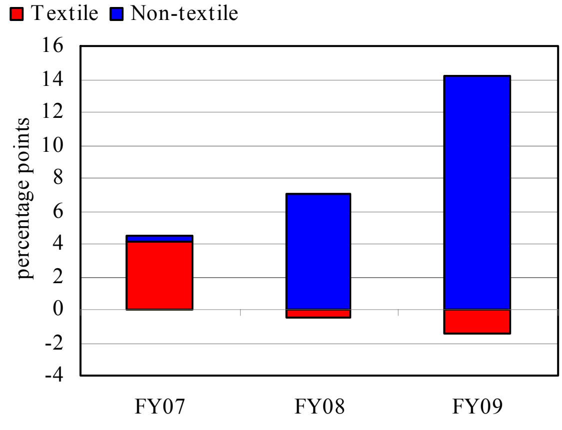
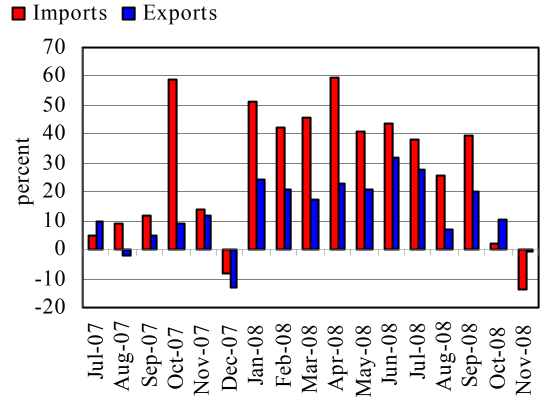


Figure 6.25: Monthly YoY Growth - Exports & Imports



[11] During FY09 the supply position of wheat and cotton is likely to be better than that in FY08 resulting in lower wheat and cotton imports during this period.

[12] Average rupee exchange rate vs US dollar recorded 21.4 percent depreciation during Jul-Nov FY09 as compared to its level in Jul-Nov FY08.

momentum from August FY09 onwards as compared to that in H2-FY08 (see **Figure 6.25**).

This deceleration partly resulted from an increase in the intensity of the existing structural issues, especially a sharp increase in power shortages and a slowdown in country's major export markets that affected export demand particularly for textile exports. While the issue of long power shortages has somewhat eased, the winter gas shortages and persistence of other structural factors is likely to hamper export growth in the remaining months of FY09.

Box 6.1: Pakistan's Export Exposure to Large Industrial Countries and Future Prospects for Exports

According to the World Economic Outlook (October 2008), world economy is heading towards a major recession due to the recent financial crisis. World GDP growth after recording a marginal deceleration in 2007 is likely to undergo a significant squeeze in 2008 and onwards, largely on account of sharp slowdown in income growth of the developed economies (see **Figure 6.1.1A**). Being more integrated with the world economy, this is inevitable that Pakistan's economy will suffer the fall out of the slowdown in economic growth of these countries. One obvious channel is a likely fall in import demand of developed countries (see **Figure 6.1.1B**). This fact, in view of around 50 percent share of developed countries[13] in Pakistan's exports (see **Figure 6.1.1C**), raises concerns for prospects of country's export growth.

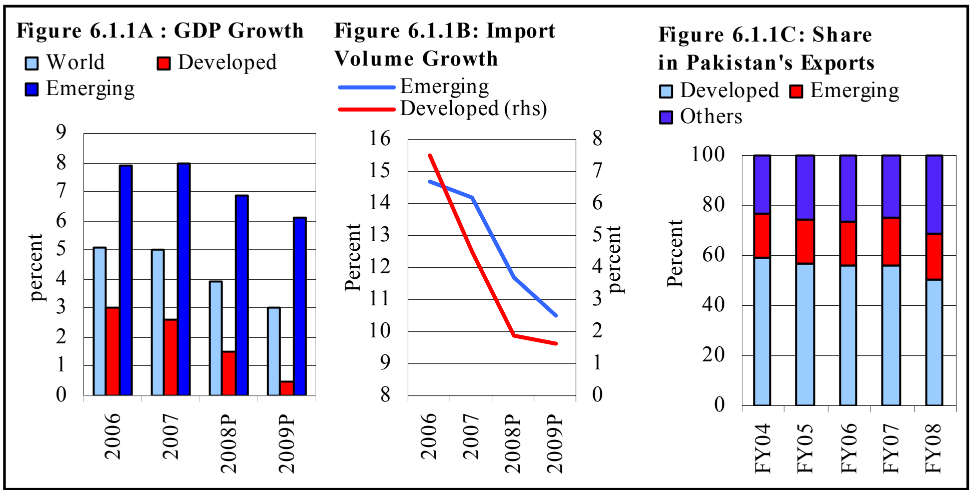
Table 6.1.1: Economic Performance of Pakistan's Major Trading Partners

percent

	GDP Growths				Share in Pakistan's Export Growth			
	2006	**2007**	**2008**	**2009**	**FY05**	**FY06**	**FY07**	**FY08**
Developed countries	**3.0**	**2.6**	**1.5**	**0.5**	**57.0**	**55.6**	**55.9**	**50.6**
USA	2.8	2	1.6	0.1	23.9	25.5	24.6	19.5
Euro area	2.8	2.6	1.3	0.2	21.9	20.3	21.5	21.8
Emerging / developing countries	**7.9**	**8.0**	**6.9**	**6.1**	**32.0**	**33.5**	**33.9**	**39.9**
Africa	6.1	6.3	5.9	6.0	4.2	4.2	3.9	4.3
Developing Asia	9.9	10.0	8.4	7.7	26.0	27.5	28.2	27.4
China	11.6	11.9	9.7	9.3	2.5	2.8	3.4	3.6
India	9.8	9.3	7.9	6.9	2.0	1.8	2.0	1.3
UAE	9.4	7.4	7	6.0	7.6	8.0	8.0	10.9

[13] According to the IMF WEO Oct (2008) classification Australia, Canada, Denmark, euro area, Japan, New Zealand, Norway, Sweden, Switzerland, United Kingdom, and United States are included in developed countries. Further in Figure 1.1C main country groups in the classification of others are Asian and African countries which are not included in emerging and developed countries classification. In terms of export market shares some of the major Asian countries are UAE and Afghanistan.

The intensity of the impact of falling world incomes on country's exports depends on two factors (1) exports market share of various country groups in Pakistan's exports; and (2) income elasticity of Pakistan's exports. In this perspective, a close scrutiny of the shares of Pakistan's major export markets point towards a subtle change since the past few years. Specifically, the market share of developed economies, especially that of USA, in Pakistan's exports is gradually falling, while the share of emerging and other developing Asian economies is recording a gradual increase (see **Table 6.1.1**). This development when seen in the perspective of relatively improved growth outlook for emerging and developing economies indicates better prospects for country's export growth.



As regards the aspect of income elasticity of exports, survey of literature reveals that Pakistan's exports are moderately elastic to changes in partner countries' income.[14] [15]In terms of composition of exports, country's largest sector of textile exports is at a risk of facing adverse effects of the slowdown in world incomes. This view is also strengthened from a YoY fall in textile and apparel imports of EU and USA during Jan-Aug and Q1-FY09. Further Pakistan's leather goods exports which come under luxury goods classification have already started to fall during Jul-Nov FY09.

In this scenario, country's export growth is likely to record moderate deceleration going forward as compared to the high growth rate that was witnessed during H2-FY08. Especially if the current power shortages and law & order issues persist the impact of world international recession might deepen due to deterioration in country's competitiveness and image.

[14] Source: Senhadji & Montenegro (1999), "Time Series Analysis of Export Demand Equations: A Cross country Analysis" and Box 7.6, SBP Annual Report FY05.

[15] The range of income elasticity of Pakistan's exports as identified in various studies surveyed in Box 7.6 SBP Annual Report FY05 is 0.375 to 2.36 in the short run and -2.26 to 1.91 in the long run. This implies that for every one percent fall in partner country's income Pakistan's exports might fall between a range of 0.375 to 2.36 percent in the short run. In Senhadji & Montenegro (1999) the range of income elasticity of exports for a group of developing and industrial countries is estimated as 0.02 to 1.15 for the short run and 0.17 to 4.34 for long run.

Table 6.12: Major Exports (Jul-Nov)
million US$

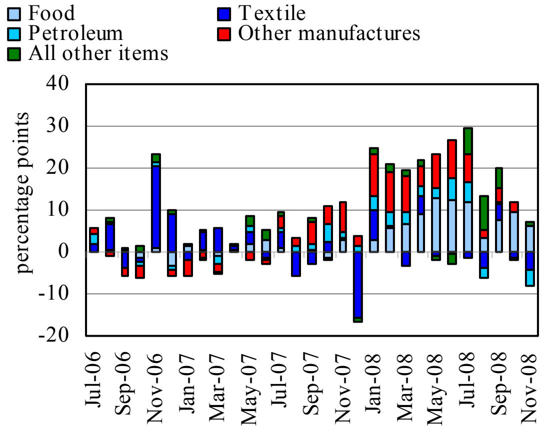
		FY08		FY09(P)			% YoY Δ		
		Value	Unit Value	Value	Unit Value	Abs.Δ value	Qty	Value	Unit Value
Food group		**785.2**		**1429.9**		**629.0**		**78.5**	
of which: rice	MT	433.9	507.1	1000.8	976.2	566.9	19.8	130.6	92.5
Textile group		**4477.3**		**4377.3**		**-100.0**		**-2.2**	
of which									
Cotton yarn	MT	587.0	2278.9	483.0	2322.8	-104.0	-19.3	-17.7	1.9
Cotton fabrics	SQM	777.2	981.7	842.4	956.2	65.2	11.3	8.4	-2.6
Knitwear	DOZ	812.9	19.3	826.8	17.0	13.9	15.1	1.7	-11.7
Bed wear	MT	829.6	5763.4	740.8	5075.0	-88.8	1.4	-10.7	-11.9
Towels	MT	235.1	4180.4	292.9	3862.9	57.8	34.8	24.6	-7.6
Readymade garments	DOZ	606.2	37.8	524.1	36.0	-82.1	-9.2	-13.5	-4.8
Synthetic textiles	SQM	209.9	0.9	243.8	0.8	33.9	25.0	16.1	-7.1
Other textile made-up		216.2		225.4		9.2	---	4.3	---
Other textile material		123.6	---	106.8	---	-16.8	---	-13.6	---
Petroleum group		**439.6**		**445.2**		**5.6**		**1.3**	
Other manufactures group		**1357.6**		**1600.9**		**243.3**		**17.9**	
of which									
Chemicals and pharmaceuticals		210.6	---	297.1	---	86.5	---	41.1	---
Molasses	MT	7.3	45.0	43.4	92.7	36.1	188.7	495.0	106.1
Cement	MT	134.0	51.9	258.6	65.5	124.5	52.8	92.9	26.2
All other items		**262.7**		**416.5**		**153.9**		**58.6**	
Total exports		**7337.9**		**8269.8**		**931.9**		**12.7**	

6.6.1 Exports

Major non-textile contributors in overall export growth during Jul-Nov FY09 were *rice, other manufactures* and *all other items* exports (see **Table 6.12**). All these categories recorded large YoY growth during this period. Some of the textile categories e.g., cotton yarn, towels and synthetic textiles also performed well, but In overall terms this group recorded a marginal YoY fall during Jul-Nov FY09.

Yet from August FY09 the review of monthly export performance indicates a slowdown in export growth of the major performing categories as compared to H2-FY08 (see **Figure 6.26**).[16]

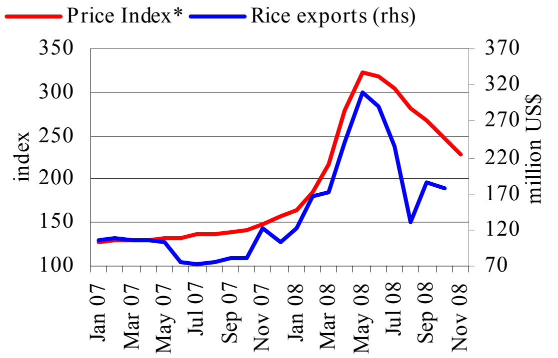
Figure 6.26: Contribution in Exports



Non-Textile Exports

A mix of external and domestic factors seems to have started taking their toll, leading to a fall in exports of leather group, textile, and jewelry (see **Table 6.13**). The export performance of leather group, which are mainly directed to EU, is weakening due to domestic factors such as rising cost of energy and raw materials, increasing power shortages and domestic law and order issues leading to diversion of export orders. In addition, the slowdown in major industrial countries is also likely to have a stronger negative impact on export demand, since these products chiefly belong to luxury goods which are relatively more income elastic. The fall in jewelry exports, however, was not unexpected; reportedly this export was being carried out to take benefit from the price differential between Dubai and domestic market prices which is no longer there.[17] Some of the major non-textile performers continued to record high growth. Specifically, rice, chemicals & pharmaceuticals and cements exports continued to record sharp growth in Jul-Nov FY09.

Figure 6.27: Pakistan's Rice Exports and International Rice Prices



* Source: www.fao.org

[16] The 12.3 percent monthly average export growth during Aug-October CY08 was significantly higher than the 4 percent YoY growth observed during the same period last year, but it was significantly lower than the 22.3 percent average monthly growth recorded during Jan-Jul CY08

[17] For details see SBP Annual Report 2007-08.

Rice was the single largest contributor having 60.8 percent share in overall export increase during Jul-Nov FY09. This rise in rice exports was recorded mainly on account of higher price impact. Moreover, rice exports are well positioned to record sizeable growth in quantum from Q2-FY09 onwards due to bumper rice crop in FY09.

Table 6.13: Absolute YoY Change in Major Export Performing Categories
million US$

	FY08				Jul-Nov	
	Q1	Q2	Q3	Q4	FY08	FY09
Rice	**5**	**13.3**	**142.4**	**552.5**	**-12.8**	**567.9**
Textile	**-71.4**	**-198.4**	**36.3**	**47.9**	**-38.5**	**-100.0**
Petroleum	**48.1**	**86.2**	**128.2**	**156.5**	**98.7**	**5.6**
Other manufactures	**146.3**	**192.7**	**370.4**	**341.9**	**202.9**	**242.3**
Leather	21.6	29	33.4	28.4	36.3	-27.5
Leather manufactures	-8.4	68.3	55.6	38.3	-8.4	-18.0
Medical/surgical instruments	19.4	18.7	22.7	15.9	27.4	5.8
Chemicals and pharmaceuticals	45.8	27	82	76.5	48	86.4
Of which						
Plastic materials	18.2	4.1	36.2	35.3	16.9	27.6
Chemicals	23.1	19.2	38.3	38.3	24.1	59.3
Jewelry	41	26.6	58.7	48.1	51	-1.0
Cement and products	32.9	53.5	78.2	112.6	51.9	124.5
Molasses	1.1	-4.2	11.3	18.5	1.5	36.1
Others	-7.1	-26.2	28.5	3.5	-4.7	9.9

Going forward, the decline in international prices of rice is expected to accelerate (see **Figure 6.27**). Reportedly, Vietnam has removed restrictions on exports to attract buyers, while Thai rice prices have crashed significantly [18] due to new arrivals. India is also likely to remove restrictions on rice exports [19] which will further cause a downward pressure in international rice prices due to the availability of large supplies in the international market. To counter these developments, government has eliminated the Minimum Export Price on *irri* and *basmati* rice in August and October FY09, but the sharp decline in prices is expected to offset some of the gains from sharply higher export volumes in H2-

[18] The FAO Rice Price Update December 2008. Thai rice prices have crashed from 764 US$/ tonnes in June 08 to 464 US$/ tonnes in November 08.

[19] http://economictimes.indiatimes.com/News/Economy/Lifting_rice_export_restrictions_to_check_international_prices/rssarticleshow/3666463.cms

FY09. .

In addition to this, two of the most important categories in the *other manufactures* group were chemicals & pharmaceuticals and cement, which continued to perform strongly during Jul-Nov FY09. Exports of these categories are at a risk of facing some deceleration in the coming period because of two factors: (1) in the chemicals group exports of ethanol might record a deceleration in H2-FY09 due to an expected fall in sugar production during FY09 and; (2) as a result of the current political tensions with India overall trade and hence cement exports to this destination might fall. Further, the reported slowdown in construction activities in UAE might also affect country's exports to this destination.

Table 6.14 : Textile and Apparel Export Growth to the Major Markets
percent

	EU*		US**	
	CY07	CY08	FY08	FY09
World	5.8	-1.1	1.3	-2.8
Bangladesh	-1.1	3.0	-1.3	12.4
China	20.3	6.4	12.5	1.0
India	2.9	-1.4	3.1	-5.7
Pakistan	6.6	-3.7	-3.9	-6.0
Thailand	-8.5	-5.5	-4.0	-5.4
Turkey	7.5	-9.5	-13.4	-21.7
Vietnam	11.8	7.2	35.3	19.8

* (Jan-Aug) source: Eurostat
** (Jul-Sep) source: US Census Bureau

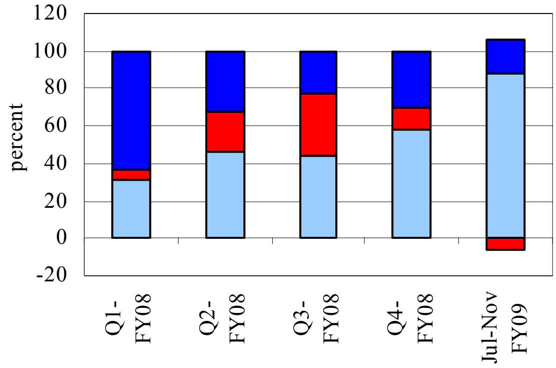
Petroleum products exports decelerated due to limited availability of crude petroleum in the domestic market which caused refineries to work at lower capacities and reduced exportable surplus of the petroleum products. Reportedly, refineries were facing problems in crude import due to huge volume of circular debt.[20] Also as a result of down grading of country's ratings by S&P from B to CCC positive in October FY09 and further to CCC in November FY09 refineries were facing problems in opening LCs for imports. As, foreign banks were doubtful about country's ability to honor its foreign exchange liabilities. However, with the agreement with IMF this situation has improved.

In this scenario, in the coming period petroleum products exports might improve if the country resumes crude petroleum import at a normal level with improvement of the international reserves position.

[20] For details see Box 4.1 in Chapter Money and Banking.

Textile exports also recorded a slight fall because of persistent structural issues and a fall in external demand due to slowdown in the major export markets (see **Table 6.14**).

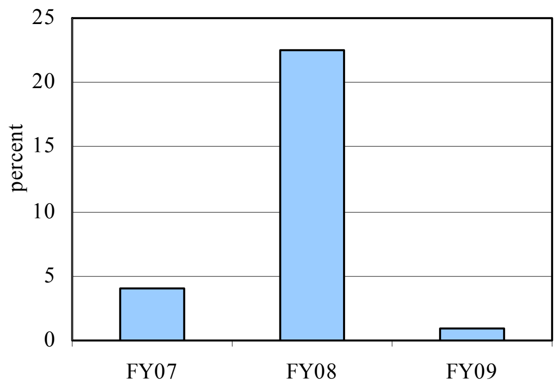
Figure 6.28: Composition of Import Increase



* Items for which quantum data is not available.

In the presence of the tough competition from other suppliers, a host of structural issues and slackening external demand, textile exports remained almost unchanged from the previous years. The performance would probably have been even weaker were it not for the large depreciation of the domestic currency. Hopefully, exports will respond positively to the decision by the SBP to provide 100 percent refinancing to banks against export finance provided to exporters. [21]This incentive would aide in improving competitiveness of textile sector -largest beneficiary of this incentive.[22]

Figure 6.29: Non-Food and Non-Oil Imports YoY Growth (Jul-Nov)



6.6.2 Imports

The underlying factors of import increase have undergone a shift during Jul-Nov FY09. Though overall imports have recorded a large YoY increase during Jul-Nov, the composition of imports increase has undergone two positive shifts during Jul-Nov FY09 as compared to that in FY08. (1) A large share of the overall import increase was contributed by price impact, while the share of quantum impact in the total import

[21] SMEFD Circular No. 03 of 2008, SBP.

[22] According to FY03-08 data around three-fourth of the total EFS financing provided by SBP is used by textile sector.

increase was negative (see **Figure 6.28**); (2) growth of non-food & non-oil imports recorded a sharp deceleration during Jul-Nov FY09 leading to a sharp fall in their share in total imports during this period (see **Figure 6.29**). Both these elements point toward easing of demand pressures during Jul-Nov FY09.

Factors responsible for shifting import demand

A large number of categories witnessed compression in import demand as reflected from their lower quantum impact as compared to the same period last year (see **Table 6.15 & 6.16**). One of the major factors leading to fall in import quantum of these categories is a sharp depreciation of rupee in this period which has raised cost of imports.[23] Further slowdown in domestic economic activity and higher interest rates have also contributed in reducing import demand in general. In addition, import demand in some of these categories was also affected by certain sector specific issues.

For instance, raw cotton imports declined in anticipation of better harvest in FY09 than in the last year. Further the continuing downturn in EU and US economies has also impacted the demand for cotton products.

Fall in fertilizer import quantum resulted reportedly from higher domestic DAP fertilizer inventories**.** During FY08 large quantum of DAP fertilizer was imported to avoid any shortages in the domestic market because of closure of a large DAP plant for BMR. However, during the rabi season of FY08[24] DAP off take remained low as compared to the same period last year[25]due to a sharp increase in international and hence domestic DAP prices, which resulted in piling of huge inventories that eliminated the need for further imports. Reportedly, due to the price factor farmers are switching to the use of Urea, which is causing additional Urea demand in the market; therefore some quantity of urea is expected to be imported in Q2-FY09. In view of high domestic inventories DAP imports are likely to remain low till the coming kharif season (Apr-Jun CY09).

Iron and steel group imports recorded decline due to a slowdown in domestic construction activities.

[23] Average rupee exchange rate vs US dollar recorded 21.4 percent depreciation during Jul-Nov FY09 as compared to its level in Jul-Nov FY08.

[24] DAP off take is seasonally higher in the rabi season.

[25] During FY08 rabi season (Oct-Dec FY08) DAP off take recorded 36.3 percent YoY fall, while during the kharif season (Apr-Jun) FY08 there was a 76.1 percent YoY fall.

Table 6.16: Major Imports (Jul-Nov)
million US$

		FY08		FY09(P)			% YoY Δ		
		Value	Unit value	Value	Unit value	Abs.Δ value	Qty	Value	Unit value
Food group		**1353.2**		**1982.3**		**629.1**		**46.5**	
of which									
Wheat	MT	41.2	473.6	693.5	411.3	652.3	1839.1	1584.1	-13.2
Palm oil	MT	568.9	784.9	636.9	1067.6	68.0	-17.7	12.0	36.0
Machinery group		**2786.6**		**2964.3**		**177.7**		**6.4**	
of which									
Power generating machinery		338.8		724.2		385.4		113.7	
Telecom		914.1		507.5		-406.6		-44.5	
Transport group		**1067.3**		**554.8**		**-512.4**		**-48.0**	
of which									
Road motor vehicles		553.3		430.3		-123.0		-22.2	
Aircrafts, ships and boats		492.8		120.5		-372.2		-75.5	
Petroleum group		**3771.5**		**5482.3**		**1710.8**		**45.4**	
Petroleum products	MT	1951.9	507.3	3065.3	763.5	1113.4	4.4	57.0	50.5
Petroleum crude	MT	1819.6	503.1	2417.0	778.2	597.4	-14.1	32.8	54.7
Textile group		**761.0**		**735.6**		**-25.4**		**-3.3**	
of which									
Raw cotton	MT	336.0	1389.4	298.3	1550.2	-37.7	-20.4	-11.2	11.6
Agricultural and other chemical group		**2327.8**		**2521.8**		**194.0**		**8.3**	
of which									
Fertilizer manufactured	MT	445.8	352.0	344.9	851.8	-100.9	-68.0	-22.6	142.0
Other chemicals		1103.2		1394.7		291.5		26.4	
Metal group		**1031.2**		**1001.0**		**-30.2**		**-2.9**	
of which									
Iron and steel scrap	MT	286.2	267.4	224.5	340.8	-61.7	-38.4	-21.6	27.4
All other metals articles		169.9		158.7		-11.2		-6.6	
Miscellaneous group		**300.6**		**299.0**		**-1.6**		**-0.5**	
All other items		**1203.0**		**1465.5**		**262.5**		**21.8**	
Total imports		**14602.1**		**17006.6**		**2404.5**		**16.5**	

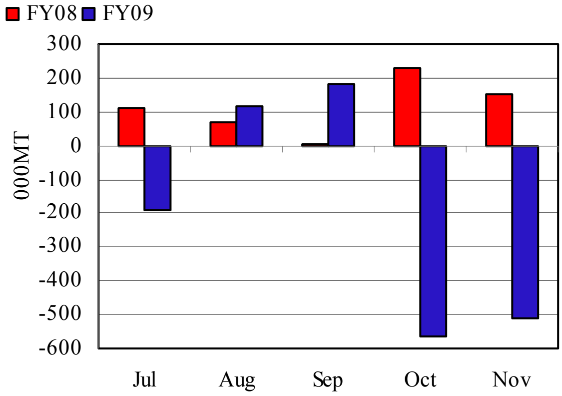
Further, slowdown in domestic automobile sales (see **Table 6.17**) has also reduced demand for rubber tyres and tubes. In fact as a result of monetary tightening and an increase in cost, domestic automobiles production has also suffered[26], leading to a fall in imports of road motor vehicles group also.

Table 6.17: Automobiles sales (Jul-Nov)
sales in numbers; growth in percent

	FY08	FY09	Growth
Cars	62815	33858	-46.1
Jeeps	7978	6006	-24.7
Trucks	1656	1182	-28.6
Buses	519	270	-48.0
LCVs	8153	9311	14.2
Tractors	20265	20249	-0.1
Motorcycles	255462	207450	-18.8

In case of petroleum crude, monthly data shows that these imports recorded quantum increase only in August & September FY09 (see **Figure 6.30**). As discussed before, this might be attributed to the circular debt issue as well as financial constraints faced by the country that resulted in downgrading of country's ratings.

Figure 6.30: Absoulte Change in Petroleum Crude Import Quantum



In overall terms, owing to removal of subsidies which resulted in a large increase in domestic prices of POL products,[27] the demand for these products is falling which is reflected from 5.4 percent YoY decline in industry sales of POL products during Jul-Oct FY09. [28] However, despite the slowdown in POL group import quantum, the overall POL import bill recorded a hefty US$ 1.7 billion YoY rise during Jul-Nov FY09, solely because of higher price impact. In this scenario the current downturn in international oil prices is likely to result in a sharp fall in POL import bill in the remaining months of FY09, even if domestic demand picks up slightly due to the recent downward revision of POL products prices.

[26] Domestic production of automobiles recorded 35.6 percent YoY fall during Jul-Nov FY09.
[27] During Jul-Oct FY09 prices for Mogas, Diesel oil, kerosene oil and other products have increased twice. However, these prices started to come down from Nov 2008 *(source: OGRA)*.
[28] Source: OCAC

The only category that recorded a very large quantum increase during Jul-Nov FY09 was wheat. The import of wheat is being carried out in pursuance of government decision to avoid any shortages in the domestic market. However, the initial wheat production target for FY09 has been revised upward, which might reduce the need of wheat import in the remaining months of FY09. In addition, power generating machinery imports also recorded a large increase due to the ongoing work on various IPPs.

Outlook for FY09 imports
The above mentioned factors reveal that import demand pressures which were obvious during FY08 have decelerated to a large extent in Jul-Nov FY09. The categories that are likely to record some demand led increase in imports are POL products, power generating machinery, other chemicals and fertilizers. POL products imports are likely to result from higher thermal power generation needs while, other chemicals imports are necessary to fulfill the industry demand. The expected increase in imports of power generating machinery and fertilizer is also in line with the sector specific issues discussed earlier. However, the demand led increase in these imports is likely to be offset substantially due to lower price impact November FY09 onwards, especially in POL group. This implies a large deceleration or even a fall in imports in the remaining months of FY09 is very much on cards.

Acronyms

ADB	Asian Development Bank
ARPU	Average Revenue per User
BMR	Balancing Modernization and Restructuring
BoP	Balance of Payments
BSC	Behbood Saving Certificate
CCS	Cross Country Swap
CELSS	Controlled Ecological Life Support System
CLCV	Cotton Leaf Curl Virus
CPI	Consumer Price Index
CRR	Cash Reserve Requirement
DAP	Di-Ammonium Phosphate
DMBs	Deposit Money Banks
DMMD	Domestic Market and Monetary Management Department
DPBs	Domestic Private Banks
DSC	Defense Saving Certificate
EFS	Export Finance Scheme
EPD	Exchange Policy Department
ER	Exchange Rate
EU	European Union
FAO	Food and Agriculture Organization
FBR	Federal Board of Revenue
FBS	Federal Bureau of Statistics
FCAs	Foreign Currency Accounts
FCBCs	Foreign Currency Bearer Certificates
FDI	Foreign Direct Investment
FEBCs	Foreign Exchange Bearer Certificates
FED	Federal Excise Duty
FE-25	Foreign Exchange Cir.No.25
FPI	Foreign Portfolio Investment
FY	Fiscal Year
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GDR	Global Depository Receipts
GST	General Sales Tax
IBRD	International Bank for Reconstruction and Development
IFIs	International Financial Institutions
IMF	International Monetary Fund
IPPs	Independent Power Projects
IRSA	Indus River System Authority

KAPCO	Kot Addu Power Company Limited
KESC	Karachi Electric Supply Corporation
KIBOR	Karachi Inter Bank Offer Rate
KYC	Know Your Customer
LIBOR	London Inter Bank Offer Rate
L/C	Letter of Credit
LSM	Large Scale Manufacturing
LT	Long Term
MINFAL	Ministry of Food, Agriculture and Live Stock
MNCs	Multi National Corporations
MPS	Monetary Policy Statement
MRTB	Market Related Treasury Bill
MT	Metric Ton
MTBs	Market Treasury Bills
NDA	Net Domestic Asset
NASA	National Aeronautics and Space Administration
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Asset
NFNE	Non Food Non Energy
NPLs	Non Performing Loans
NSS	National Savings Scheme
NWFP	North-West Frontier Province
OCAC	Oil Companies Advisory committee
OGRA	Oil and Gas Regulatory Authority
OICCI	Overseas Investors' Chamber of Commerce & Industry
OMCs	Oil Marketing Companies
OMOs	Open Market Operations
OPEC	Organization of the Petroleum Exporting Countries
PBA	Pensioners Benefit Account
PIA	Pakistan International Airlines
PIBs	Pakistan Investment Bonds
POL	Petroleum, Oil and Lubricants
PPCBL	Punjab Provincial Cooperative Banks limited
PSDP	Public Sector Development Program
PSEs	Public Sector Enterprises
PTA	Pakistan Telecommunication Authority
REER	Real Effective Exchange Rate
RFCAs	Residents Foreign Currency Accounts
rhs	right hand side
RIC	Regular Income Certiticate
RPI	Relative Price Index

S&P	Standard & Poor's
SA	Saving Account
SBA	Stand-By Arrangement
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SPI	Sensitive Price Index
SQM	Square Meter
ST	Short Term
SSA	Special saving Account
SSC	Special saving certificate
TCP	Trading Corporation of Pakistan
TFCs	Term Finance Certificates
UAE	United Arab Emirates
UK	United Kingdom
USA	United States of America
WAPDA	Water and Power Development Authority
WEO	World Economic Outlook
WPI	Wholesale Price Index
YoY	Year on Year
ZTBL	Zarai Taraqiati Bank Limited

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