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.

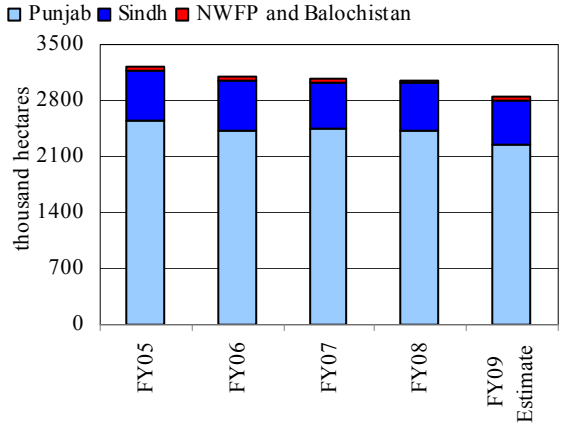
Some important policy measures announced in the FY09 budget (and later) to encourage farmers may have played a role. These include: (1) increase in support prices of wheat for FY09 crop, (2) a 25 percent higher agri-credit target for FY09 compared with the FY08 target, with enhancement in indicative 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

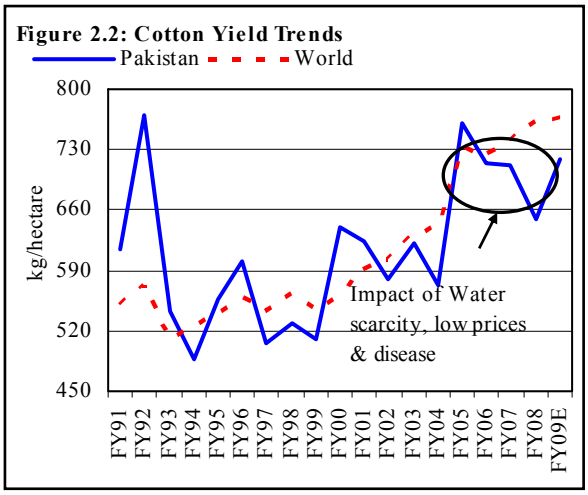
[1] The highest wheat harvest achieved is 23.3 million tonnes in FY07 so far. Given a substantial rise in area, timely rains, it is likely that FY09 wheat harvest will be a new record high.

[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.

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.

Figure 2.2: Cotton Yield Trends

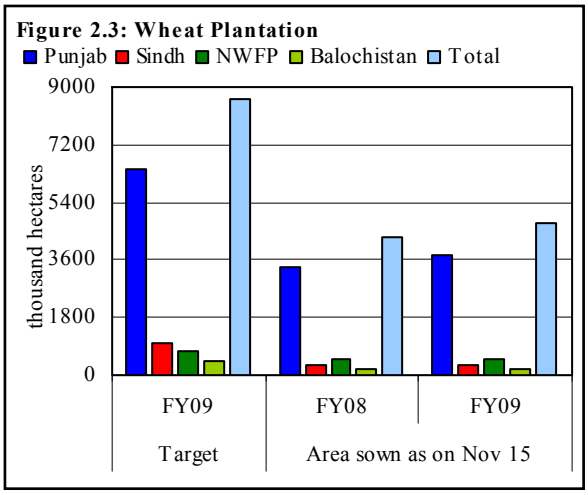


Sugarcane crop suffered because of gross disappointment of farmers in the preceding season. Not only realized prices were lower than the anticipated prices (as per announced procurement prices), delays in the beginning of crushing season and payments also placed them at a disadvantageous position. As 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.

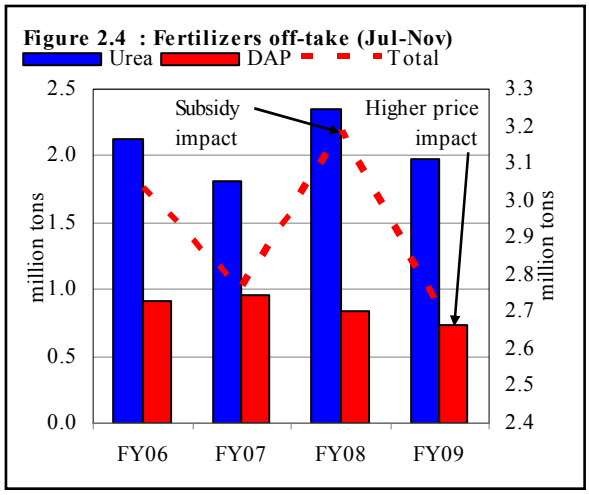
[4] Wheat production target has been revised upward from 24.0 million tons.

[5] Wheat support prices has been increased by 52 percent to Rs 950 per 40/kg for FY09 crop.

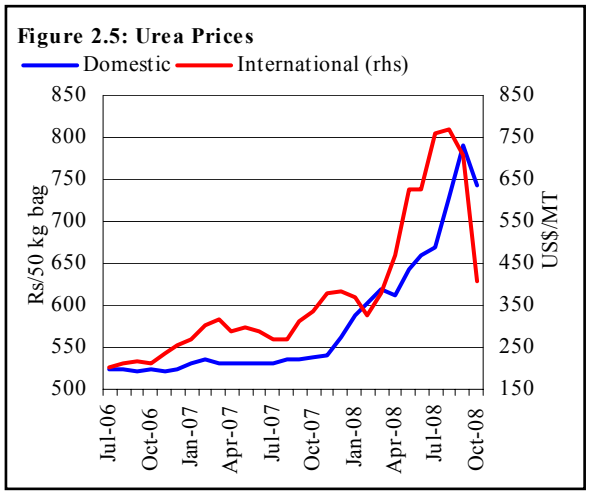
[6] MINFAL estimated that availability of DAP to be at 985 thousand tons (comprising 655 thousand tons of opening inventory and 330 thousand tons of local production) against off-take of 829 thousand tons, showing comfortable supply, leaving 135thousand tons for *kharif* FY10 crops.

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.



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.



[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.

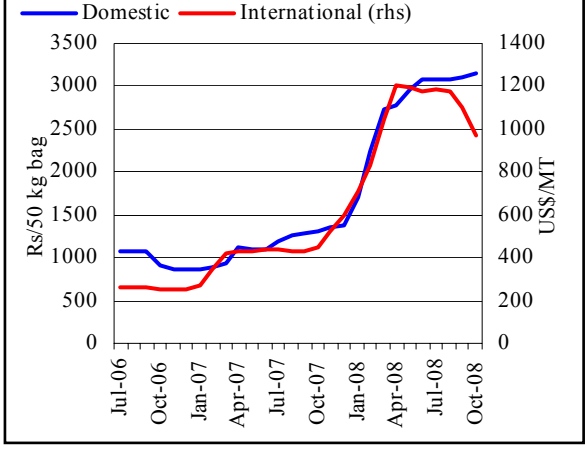
Table 2.2: Agri-credit Trends (July-Oct)

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



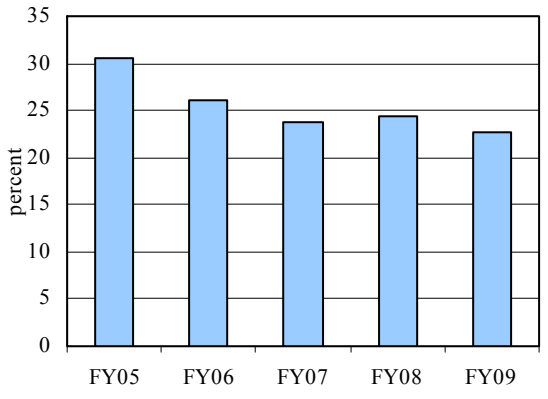
[8] World Bank Food Price Index down by 32.3 percent in October, 2008 from peak in June 2008.

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

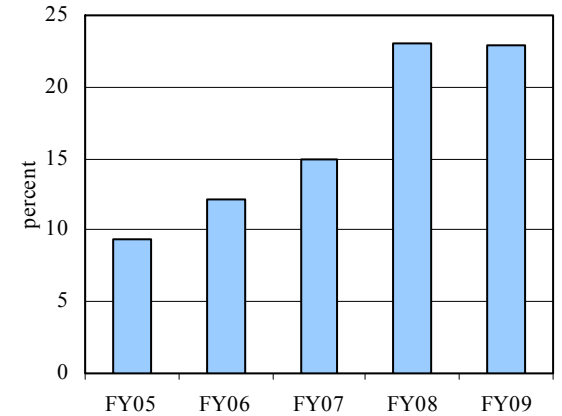
[9] Agri credit disbursements decelerated further to only 7.9 percent during Jul-Nov FY09, significantly lower than the 33.5 percent rise seen in the same period last year.

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.

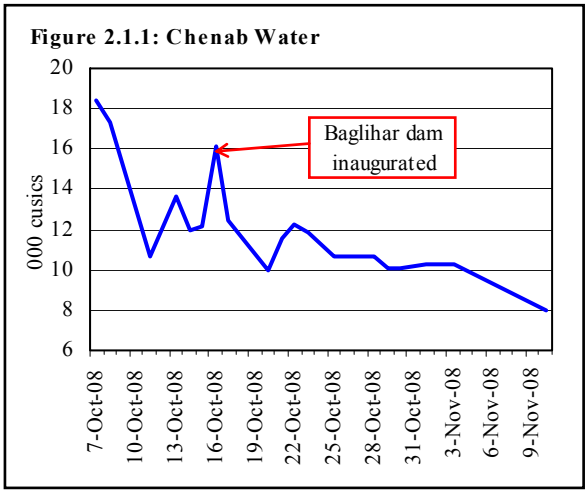
The water situation has been further worsened by low levels in Chenab river primarily impacting agricultural activity in Punjab (see **Box 2.1**). To cope with the shortages of irrigation water, some urgent measures are needed including: (1) speedup work on projects under construction, (2) adoption of 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, possibily 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

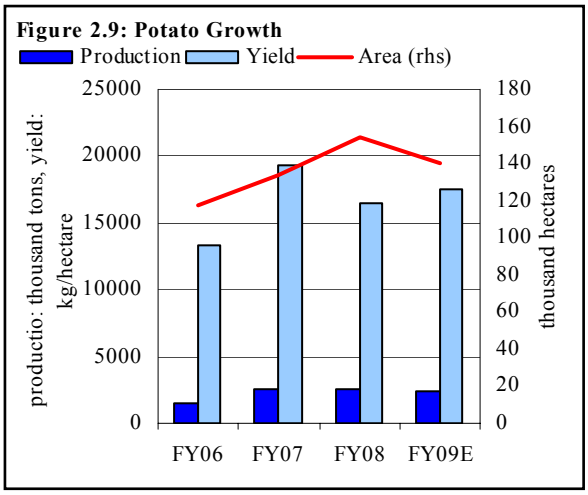


impact on water inflows along the former areas. The 11 upper Punjab districts that produce wheat and rice alternately include Sialkot, Narowal, Gujranwala, Hafizabad, Sheikhupura, Faisalabad, Nankana Sahib, Toba Tek Singh, and Jhang accounting for roughly 5 million acres of cultivable land. The ones 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

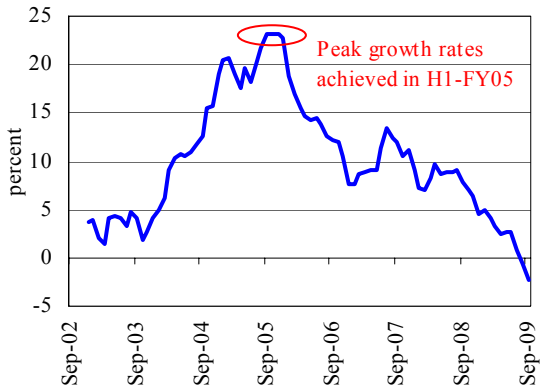
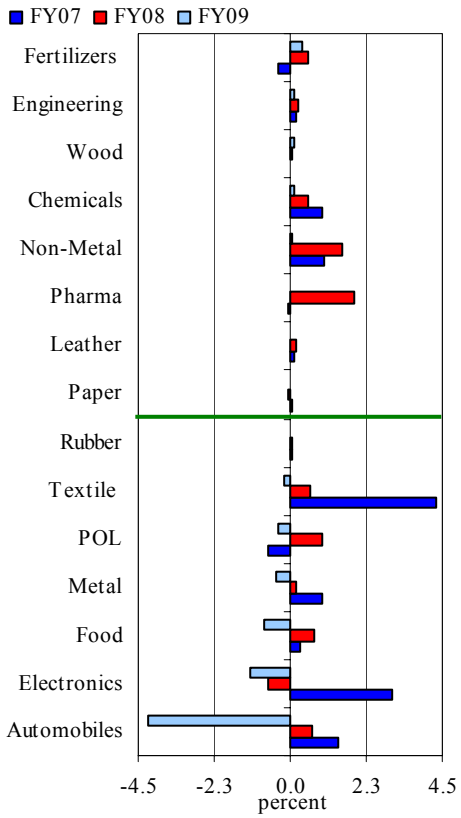
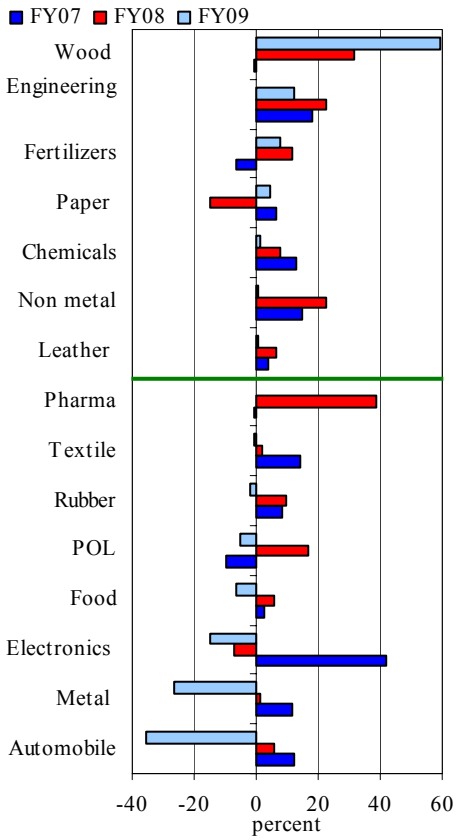


Figure 2.11: LSM Sub-sectors Contribution to Growth



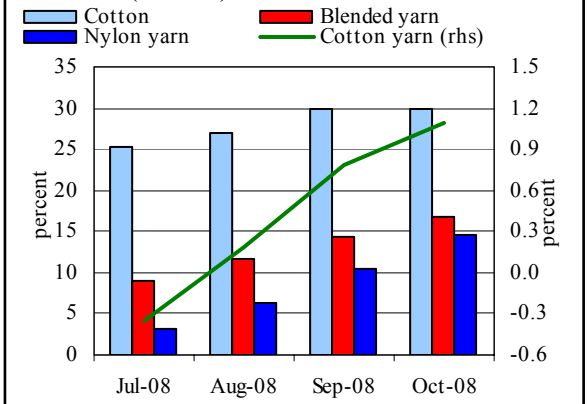
LSM Sub-sectors Production Growth



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

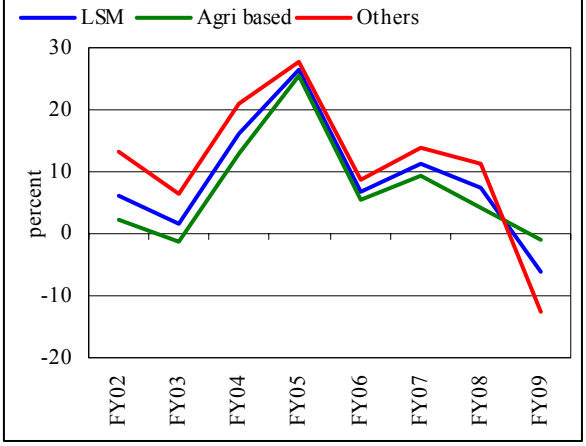


Table 2.3: Classification of LSM Sub-sectors According to Dependence on Agriculture Sector

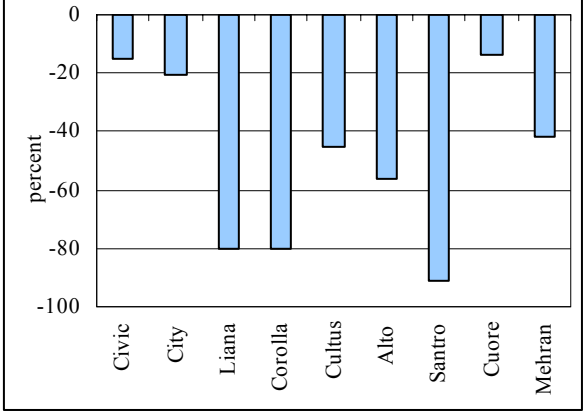
1- Agri Based	
Input from Agriculture	Textile, Food, Leather, Wood, Paper & Board, Starch & products, Soaps & detergents, Toilet Soaps, Matches
Input for Agriculture	Fertilizers
Machinery for Agriculture	Wheat thrasher, Chaff cutter, Tractors, Diesel engines
Input for Agri based Industry	Sugarcane Machines, 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.

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



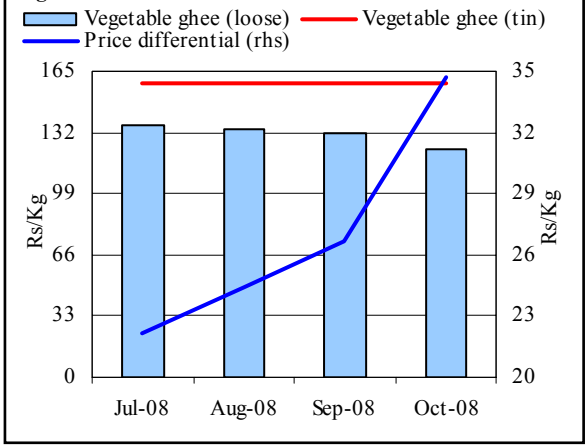
In addition, demand for consumer durables eased as increase in international prices of steel products and rupee depreciation compelled manufacturers to increase the prices of durables, surge in inflation eroded the purchasing power of middle class consumers (major market segment of durables). The impact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

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.

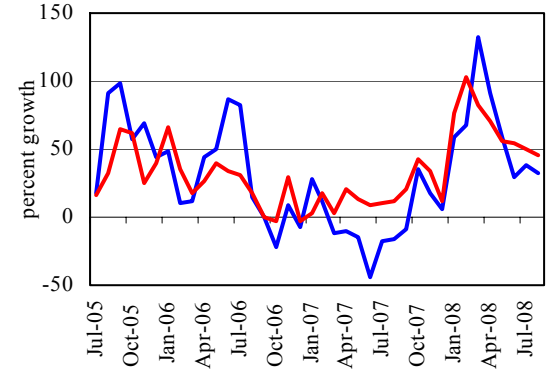
(7) Prevailing law & order situation turned out to be the most unfavorable for investment decision as 96 percent of the respondents validated the perception that it is unsatisfactory. But it is encouraging to note that 83 percent of the investors contacted during survey do not intend to hold on their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

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.

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



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,

[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.

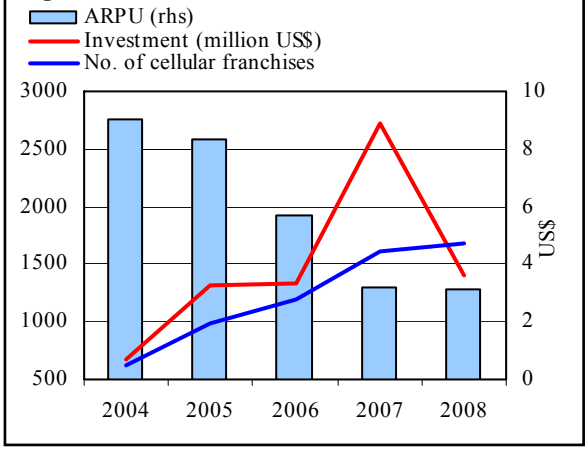
Table 2.4: Selected performance indicators of PIA

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

Figure 2.17: Selected Indicators of Mobile Telecom



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

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