

## 6 External Sector

### 6.1 Overview

The improvement in Pakistan's overall external account, which emerged in November FY09, continued in the subsequent months as well. A large part of this improvement during Nov-Apr FY09 is attributed to continued contraction in current account deficit, as revival in financial inflows remained limited mainly on account of global financial crises (see **Table 6.1**). For the aggregate July-Apr FY09, however, overall external account deficit showed sizeable deterioration, as surplus generated in Nov-Apr FY09 could offset only a small part of the deficit incurred in the initial four months.

**Table 6.1: Summary of External Accounts**

billion US Dollar

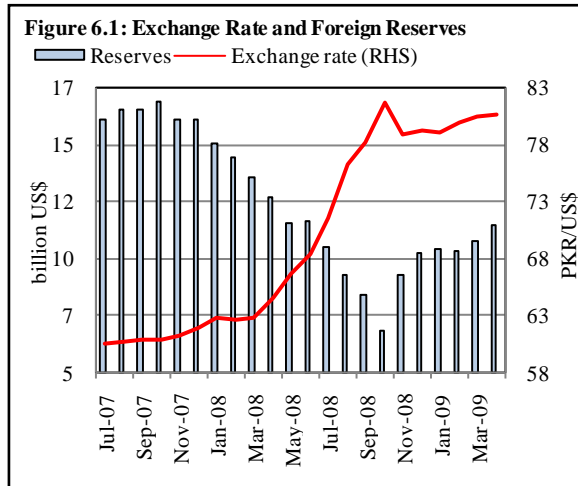
	Jul-Apr		Nov-Apr	
	FY08	FY09	FY08	FY09
A- C/A balance	-11.2	-8.55	-8.2	-2.5
i) Trade balance	-12.3	-10.8	-9.0	-4.9
Exports	16.4	16.0	10.2	8.8
YoY growth (%)	16.9	-2.6	16.3	-13.2
Imports	28.7	26.8	19.2	13.8
YoY growth (%)	28.5	-6.8	43.2	-28.2
ii) Invisible balance	1.1	2.2	0.8	2.4
Remittances	5.3	6.4	3.2	4.0
B- Financial/capital balance	6.3	3.6	2.5	2.7
i) FDI	3.7	3.2	2.1	1.9
ii) FPI	0.1	-1.0	-0.2	-0.8
iii) Other investment	2.4	1.3	0.5	1.6
C- Errors & omissions	0.4	0.3	1.0	0.2
D- Overall balance	-4.5	-4.6	-4.8	0.4

Contraction in current account deficit during July-Apr FY09 largely reflects fall in imports and strong rise in remittances. Fall in imports, in turn, mainly owes to both fall in aggregate demand as a result of monetary tightening and exchange rate depreciation as well as the impact of lower import prices. In particular, imports declined by 6.8 percent during July-Apr FY09 against the strong increase of 28.5 percent during the corresponding period last year.

Nonetheless, fall in exports amid deepening global recession and intensifying domestic power shortages together with substantial fall in earnings on foreign exchange reserves adversely impacted the contraction in current account deficit during the period under review.

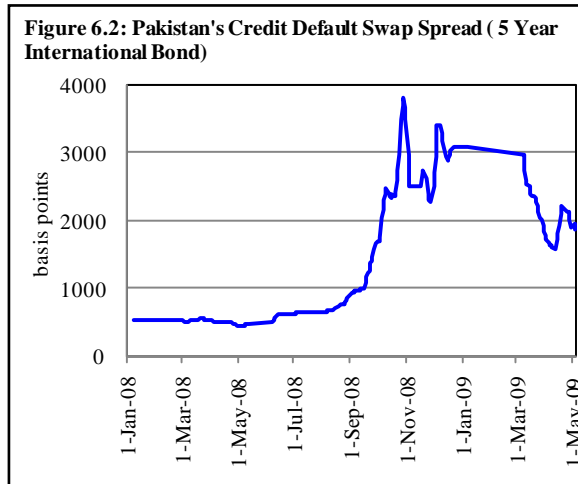
Unlike the improvement in current account, capital & financial account deteriorated sharply during July-Apr FY09. This deterioration was contributed by a fall in both investment and loan inflows. While loan inflows revived to large

extent after IMF support for macroeconomic stabilization program, foreign investment inflows continued their declining trend in the wake of worsening global financial crises. Indeed, even the improvement in financial flows principally reflects higher bilateral and multilateral receipts in contrast to significant share of private investment inflows in the previous two years.



The revival of loan inflows together with contraction in current account deficit in the post-IMF support period allowed an increase in foreign exchange reserves and stabilized exchange rate (see **Figure 6.1**). Consequently, credit default swap spread on Pakistan's five year bond also dropped (see **Figure 6.2**). However, the spread is still well above historical norms.

Notwithstanding these improvements, there are some emerging trends which are worrisome. While pressures emanating from commodity price shock have subsided, the falling growth in Pakistan's major export markets (US & EU) is hurting Pakistan's exports (see **Figure 6.3**). Likewise, the ongoing financial crisis has reduced foreign investment inflows to Pakistan (see **Box 6.1**). Moreover, job losses in source countries also poses downside risks to hitherto strong workers' remittances inflows.



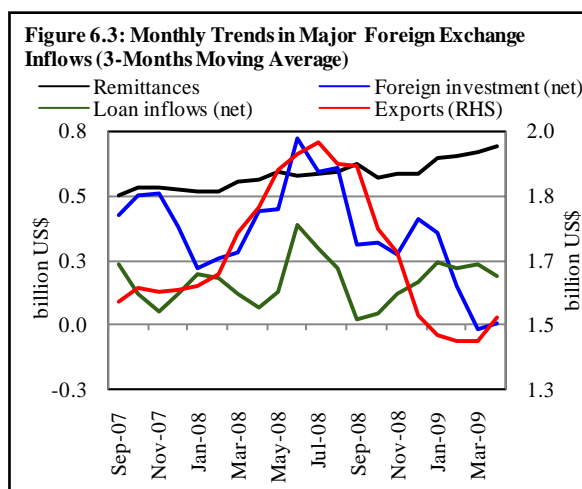
Besides fall in foreign inflows monthly trends also show compositional change in these inflows. With the fall in investment inflows, Pakistan's reliance on loan to finance current account deficit has increased (see **Figure 6.3**). The rising share of

debt creating flows in overall capital flows does not bode well for external account sustainability in the medium to long term.

It may be pointed out that external debt have increased rapidly in the last two years. In particular, Pakistan's external debt and liabilities has increased to around US\$ 50.1 billion by end Mar FY09 from US\$ 40.5 billion at end FY07.

With the anticipation of a more severe and longer global recession (see **Box 6.2**), chances of notable recovery in foreign inflows (exports and investment) remain dim in the months ahead. In this backdrop, there is need to devise a comprehensive strategy to mitigate the adverse impacts of ongoing external shocks.

In particular, after significant curtailment of import demand by macroeconomic policy tools, there is need to address the underlying causes of weakness in external accounts. For example, investment in infrastructure like power sector, manpower is critical for not only promoting exports but also attracting foreign investment. Similarly, efforts to diversify exports from advanced countries to emerging economies may also moderate the falling exports. In the same way, exports can also be promoted by channeling foreign investment inflows in the export oriented industries. Restoring law and order situation is another area which would help in attracting both the foreign buyers and investors.



#### Box-6.1: Recession in Developed Countries and Its Impact on Emerging and Developing Economies

The global financial turmoil and deepening recession in the developed countries is affecting the emerging economies through two major channels i.e. trade channel and capital inflows channel. In the former, falling prices and demand for emerging economies' exports is hampering their export growth while in the latter capital flows to emerging economies have fallen considerably.

Besides falling prices and demand, reduced trade financing has also adversely impacted exports of most of the emerging economies. Obtaining trade financing has become difficult as trade insurers,

like monolines, have cut back on their activities in the wake of excessive amount of troubled assets on their balance sheets.

As a result, export growth from emerging economies have considerably slowed down in 2008 (see **Figure 6.1.1**). With the expectations of further deepening recession in advanced economies, IMF in its recent World Economic Outlook has projected exports from emerging and developing economies to fall by more than 7.0 percent during 2009.

In addition to trade channel, global financial crunch have substantially reduced private capital flows to these economies. Specifically, while foreign direct investment is showing resilience, portfolio and other capital flows are witnessing reversal (see **Figure 6.1.2**).

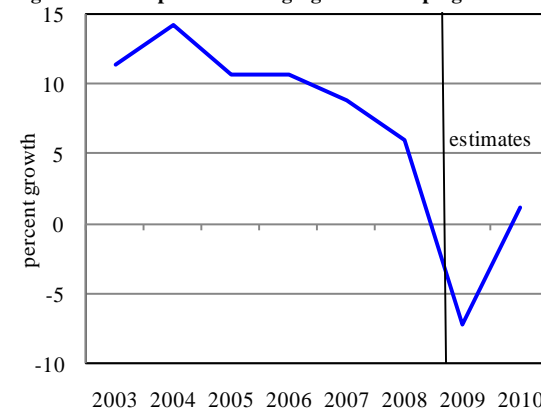
Outflow of other capital mainly reflects outflows from banks in the face of sudden stop in cross border lending and parent bank curtailed financing to emerging market subsidiaries.

IMF Global Financial Stability Report projects that falling trend in capital flows to emerging economies is expected to further strengthen in 2009. The reports further says that foreign direct investment to these economies is set to decline owing to a) diminished appetite of private equity firms, b) lack of credit available to finance acquisitions, and c) declining cyclical growth prospects in emerging economies. Likewise, outflows from portfolio and other investment are also likely to strengthen given the acute degree of stress in mature markets.

In line with the international trend, Pakistan is also impacted by the ongoing recession in the developed countries through these two channels. Specifically, a significant part of the sharp slowdown in Pakistan's exports can be attributed to the current recession in its major export markets.

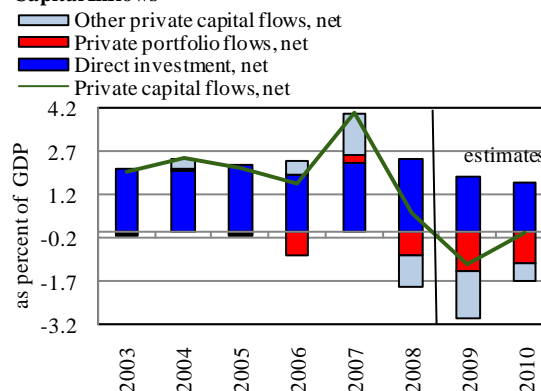
Similarly, global financial crunch has drastically reduced private capital flows to Pakistan. Composition of capital flows to Pakistan suggest that portfolio and other investment inflows are the worst hit. However, composition of other investment flows is different in Pakistan compared with most of other emerging economies. While other capital outflows in many emerging economies are

**Figure 6.1.1: Export of Emerging and Developing Economies**



Source: World Economic Outlook Data Base

**Figure 6.1.2: Emerging and Developing Economies' Private Capital Inflows**



Source: World Economic Outlook Database

driven by sudden stops in bank borrowing from abroad, Pakistan's banks have limited exposure to borrowing from abroad. Thus, fall in other investment inflows in Pakistan is mainly explained by lower public and private sector loan inflows.

#### **References**

*IMF Global Financial Stability Report, April 2009*

#### **Box-6.2: Global Recession is Likely to Deepen in 2009**

Intensified global financial crises and low confidence in financial markets has pushed the global economy to the deepest recession in the post-Great Depression period. While the US economy suffered from financial strains and continued fall in housing sector, the Western Europe and advanced Asia has mainly been hit by fall in global trade. The emerging economies, on the other hand, suffered badly through both trade and financial channels.

The uncertainty over losses on the bad assets and low confidence in the financial markets suggests the financial strains to last longer than previously envisaged. For instance, IMF in its Global Financial Stability Report (April 2009) has further increased the estimate of write downs on US originated assets by all financial institutions over 2007-10 from US\$ 2.2 trillion in January 2009 to US\$ 2.7 trillion in April 2009.

As a result, IMF in its World Economic Outlook (April 2009) has revised downward its initial projections (January, 2009) for the global economy. With across the board contraction in advanced economies, global economy is now projected to contract by 1.3 percent during 2009. Likewise, emerging economies are projected to sharply slowdown to 1.6 percent in 2009 from 6.1 percent in 2008.

The severity and duration of the ongoing recession is in line with the findings of literature on the subject. The empirical work on the recessions suggests that recessions associated with financial crises tend to be unusually severe and their recoveries are typically slow. For instance, Claessens, Stijn, M. Ayhan Kose, and Macro Terrones, (2008) comprehensively analyzed the behavior of key macroeconomic and financial variables around recessions, credit crunches and asset price busts for 122 recessions in 21 OECD countries over the 1960-2007 period. Their research shows that recessions which are associated with credit crunches and house price busts are deeper and longer than other recessions. Specifically, output losses are two to three times greater than the recessions without financial crunches.

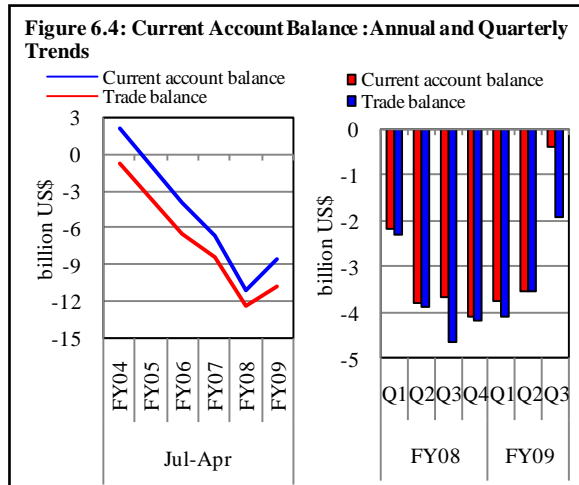
#### **References**

1. Claessens, Stijn, M. Ayhan Kose, and Macro Terrones, 2008, "What Happens During Recessions, Crunches, and Busts? IMF Working Paper 08/274.
2. IMF World Economic Outlook, April 2009

### **6.2 Current Account Balance**

Contraction in current account deficit which started in the second quarter of FY09 gained momentum in the following quarter (see **Figure 6.4**). Consequently, current account deficit in Q3-FY09 was the lowest in the last fourteen quarters. In particular, current account deficit for July-Apr FY09 contracted by 23.5 percent against the substantial expansion of 68.6 percent in the comparable period last year.

In line with the past trend, contraction in current account deficit during July-Apr FY09 was mainly driven by a fall in trade deficit (see **Figure 6.4**). Specifically, close to 58 percent of the contraction in current account deficit was contributed by fall in trade deficit while the remaining was contributed by increase in invisible surplus. Reduction in trade deficit was entirely driven by a fall in imports while increase in invisible surplus was largely contributed by strong increase in remittances and higher logistic support receipts.



With lower import prices and falling demand pressures along with resilience of remittance inflows and expectations of more logistic support receipts, contraction in current account deficit is likely to continue in the remaining months of FY09. However, further weakening in export growth amid deepening global recession may hamper improvement in current account deficit, to some extent, in the months ahead. Consequently, current SBP forecasts indicate that current account deficit to GDP ratio will decline to 5.0 to 5.5 percent in FY09, compared to 8.4 percent in the previous year.

### 6.2.1 Trade Account<sup>1</sup>

In sharp contrast to the 48.2 percent expansion in July-Apr FY08, the trade deficit contracted by 12.3 percent in July-Apr FY09. With the fall in exports, all of reduction in trade deficit was contributed by fall in imports.

Exports declined by 2.6 percent during July-Apr FY09 as against 16.9 percent increase in the corresponding period last year. Declining export prices and lower demand from recession hit export markets, domestic power shortages and poor law and order situation were the major contributory factors behind this dismal

<sup>1</sup> This section is based on exchange record data compiled by SBP that does not tally with the Custom data compiled by FBS due to inclusion of freight and insurance costs in the latter imports, difference in coverage, time and leads & lags involved in recording time etc.

export performance. On the other hand, 6.8 percent fall in the import bill during July-Apr FY09, largely reflected a fall in import prices and falling domestic demand pressures in the wake of a tight monetary policy and exchange rate depreciation.

### 6.2.2 Services (net)

Deficit in services trade declined by 41.3 percent during Jul-Apr FY09 against considerable expansion of 42.0 percent in the comparable period last year. Close to 90.0 percent of this reduction was contributed by fall in services imports while remaining 10.0 percent emanated from increase in services exports during the period.

Growth in services exports during the period largely reflected higher logistics support receipts and increase in foreign earnings of Pakistan's air companies (see **Table 6.2**).

Fall in services imports, on the other hand, was mainly caused by lower outflows from foreign exchange companies. As mentioned in the previous reports, outflows from foreign exchange companies have declined drastically after their outward remittances were restricted to 75 percent of their remittances mobilization during the preceding month.<sup>2</sup>

**Table 6.2: Detail of Services Trade (Jul-Apr)**

million US Dollar

<b>Major sources of increase in services exports</b>		
	<b>FY08</b>	<b>FY09*</b>
Transportation	858.0	1,002.0
Other business services	354.0	386.0
Government services	864.0	927.0
<i>of which: Logistic support</i>	282.0	465.0
<b>Total</b>	<b>2,672.0</b>	<b>2,914.0</b>
<b>Major sources of decrease in services imports</b>		
	<b>FY08</b>	<b>FY09</b>
Travel	1,340.0	907.0
<i>of which: Payments through exchange cos.</i>	1,074.0	632.0
Other business services	2,975.0	1,367.0
<i>of which: Payments through exchange cos.</i>	2,220.0	506.0
<b>Total</b>	<b>8,165.0</b>	<b>6,137.0</b>
* Provisional		

<sup>2</sup> For detail see FE circular No. 04 of 2008, dated May 09, 2008.

**Table 6.3: Current Account Balance**

million US Dollar

	FY08		FY09*	
	Jul-Apr	Nov-Apr	Jul-Apr	Nov-Apr
<b>1. Trade balance</b>	<b>-12,313.0</b>	<b>-8,995.0</b>	<b>-10,794.1</b>	<b>-4,931.0</b>
Exports	16,402.0	10,168.0	15,980.5	8,825.0
Imports	28,715.0	19,163.0	26,774.6	13,756.0
<b>2. Services ( net )</b>	<b>-5,493.0</b>	<b>-3,383.0</b>	<b>-3,223.0</b>	<b>-1,497.0</b>
Transportation	-2,056.0	-1,351.0	-1,953.0	-966.0
Travel	-1,113.0	-743.0	-721.0	-183.0
Communication services	12.0	-11.0	-5.0	1.0
Construction services	-13.0	-11.0	-34.0	-29.0
Insurance services	-90.0	-37.0	-63.0	-47.0
Financial services	-110.0	-92.0	-93.0	-59.0
Computer & information services	8.0	14.0	52.0	22.0
Royalties and license fees	-63.0	-25.0	-70.0	-53.0
Other business services	-2,621.0	-1,660.0	-981.0	-392.0
Personal & cultural & recreational services	2.0	2.0	2.0	2.0
Government services	551.0	531.0	643.0	207.0
of which: Logistic support	282.0	282.0	465.0	100.0
<b>3. Income ( net )</b>	<b>-3,090.0</b>	<b>-1,863.0</b>	<b>-3,612.0</b>	<b>-2,157.0</b>
Investment income( net )	-3,097.0	-1,869.0	-3,624.0	-2,165.0
Direct investment	-2,587.0	-1,522.0	-2,697.0	-1,573.0
of which: Profit & dividends	-546.0	-284.0	-501.0	-278.0
Purchase of crude oil and minerals	-1,226.0	-740.0	-1,403.0	-846.0
Portfolio investment	-204.0	-116.0	-362.0	-208.0
of which: Dividends	-189.0	-149.0	-155.0	-106.0
IMF charges & interest on official external debt	-532.0	-390.0	-525.0	-377.0
Interest on private external debt	-169.0	-114.0	-93.0	-45.0
Others (net)	402	279	65	46
<b>4. Current transfers ( net )</b>	<b>9,723.0</b>	<b>6,011.0</b>	<b>9,082.0</b>	<b>6,041.0</b>
Private transfers	9,296.0	5,603.0	8,936.0	5,990.0
Workers' remittances	5,317.0	3,238.0	6,356.0	4,011.0
FCA - residents	351.0	148.0	-230.0	85.0
Others	3,628.0	2,217.0	2,810.0	1,894.0
of which: Exchange companies	2,040.0	1,296.0	247.0	72.0
Official transfers	427.0	408.0	146.0	51.0
<b>Current account balance</b>	<b>-11,173.0</b>	<b>-8,230.0</b>	<b>-8,547.1</b>	<b>-2,544.0</b>
<b>Monthly average</b>	<b>-1,396.6</b>	<b>-2,057.5</b>	<b>-1,068.4</b>	<b>-636.0</b>

\* provisional



### 6.2.3 Income (net)

Deficit in net income increased by 16.9 percent during July-Apr FY09 compared to a nominal increase of 6.6 percent in the same period last year (see **Table 6.3**). While a large part (71.1 percent) of this deterioration was contributed by a fall in earnings on foreign exchange reserves, higher payments on account of purchase of crude oil and minerals also contributed considerably (33.9 percent). Fall in earnings on foreign exchange reserves is mainly the function of the lower foreign exchange reserves, while increase in purchase of crude oil and minerals probably reflects higher extraction.<sup>3</sup>

Compared with the same period last year, repatriation of profit and dividends on foreign investment remained lower during July-Apr FY09 (see **Table 6.4**). This fall largely reflected lower profitability of financial business and communication. Lower profitability of the former mainly owed to fall in bank profits in the wake of slowdown in the economy and rising non-performing loans while fall in the latter was mainly because of sharp fall in PTCL's profit owing to its Voluntary Separation Scheme.

**Table 6.4: Sector-wise Repatriation of Profit and Dividends (Jul-Mar)<sup>1</sup>**  
million US Dollar

	FY08			FY09 <sup>2</sup>		
	FDI	FPI	Total	FDI	FPI	Total
Petroleum refining	47.9	7.0	54.9	58.5	12.8	71.3
Oil & gas explorations	26.5	34.0	60.5	20.8	42.9	63.8
Power	110.8	15.7	126.5	133.7	7.4	141
Trade	10.7	7.1	17.8	56.5	3.6	60.1
Communications	78.9	9.2	88.1	39.5	5.2	44.7
Financial business	39.3	17.1	56.4	27.1	16.5	43.5
Others	140.6	42.5	183.1	115.8	24.8	140.7
<b>Total</b>	<b>454.8</b>	<b>132.4</b>	<b>587.2</b>	<b>452.0</b>	<b>113.1</b>	<b>565.1</b>

<sup>1</sup> Jul-Apr FY09 data is not available.

<sup>2</sup> provisional

### 6.2.4 Current Transfers

In sharp contrast to 15.1 percent growth in the first ten months of last year, current transfers declined by 6.6 percent during July-Apr FY09. With 19.5 percent YoY rise in workers' remittances, fall in current transfers was mainly the result of lower other private transfers and outflow from Resident Foreign Currency Accounts (RFCAs). Lower other private transfers, in turn, entirely emanated from fall in foreign exchange companies inflows.<sup>4</sup>

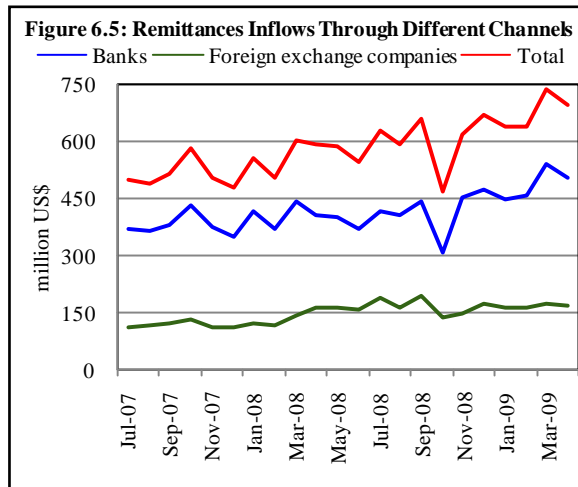
<sup>3</sup> Anecdotal evidence suggests that increased payments on account of purchase of crude oil and minerals, despite the fall in crude oil prices, mainly reflects a) higher share of gas in total purchases and b) increase extraction of oil and gas.

<sup>4</sup> As these inflows are contra entry of foreign exchange companies outflows (recorded in services account), they have no impact on current account balance.

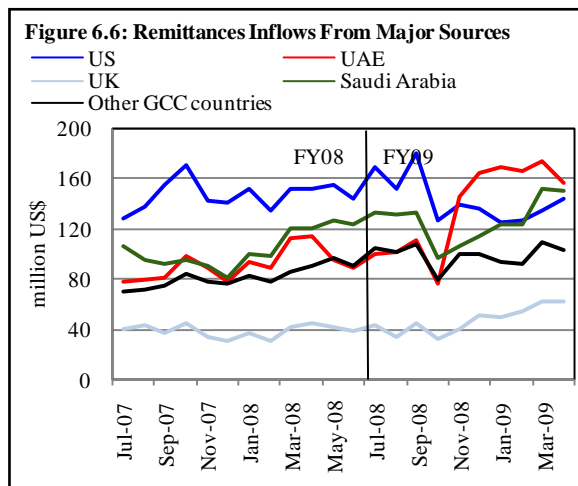
### Workers' Remittances

Remittances flows continued rising for the fifth successive year. In particular, remittances recorded YoY growth of 19.5 percent during July-Apr FY09 on the top of 19.5 percent growth in the corresponding period last year. However, the composition and sources of remittances flows in the current year were slightly different from that of the previous years. For instance, increase in remittances during July-Apr

FY09 largely owed to higher inflows through banking channel in contrast to higher inflows through exchange companies during the same period last year. Likewise, remittances growth in the first ten months of current fiscal year is largely contributed by Gulf region (88.8 percent) while almost all the regions contributed to remittances growth in the comparable period last year.



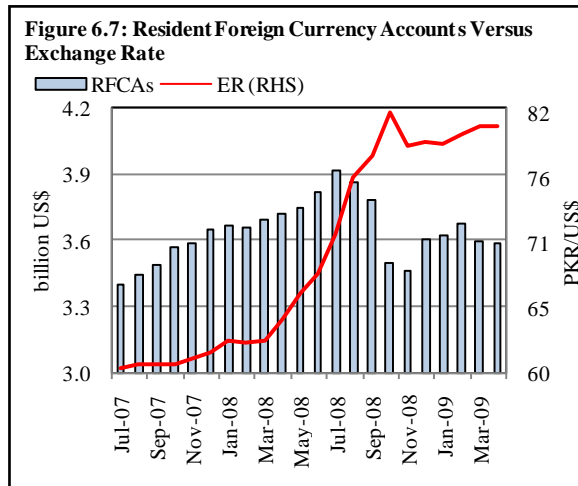
This change is more pronounced in the monthly trends. For example, after October FY09 remittances flows through banking channel increased considerably, while remittances flows routed through exchange companies remained stagnant (see **Figure 6.5**). As mentioned in the earlier report,<sup>5</sup> this change coincided with the action against undocumented fund transfers. Thus it may be argued that this action might have diverted some of the funds to banking channels which were earlier being transferred through undocumented channel.



<sup>5</sup> For detail, see SBP Second Quarterly Report for 2008-09.

Similarly, country-wise monthly data shows that after October FY09, remittances flow sourced from Gulf region (in particular United Arab Emirate) increased rapidly, while it declined from United States (see **Figure 6.6**).

A part of this sharp rise in remittances from UAE may be attributed to possible diversion of funds transfer from undocumented channel to documented channel and a part to the possible reverse capital flight to Pakistan. Decline in remittances flows from US, on the other hand, may be attributed to (a) economic recession and subsequent job losses and (b) some of the migrants might have withheld funds for the time being owing to the possibility of further crackdown against other exchange companies.

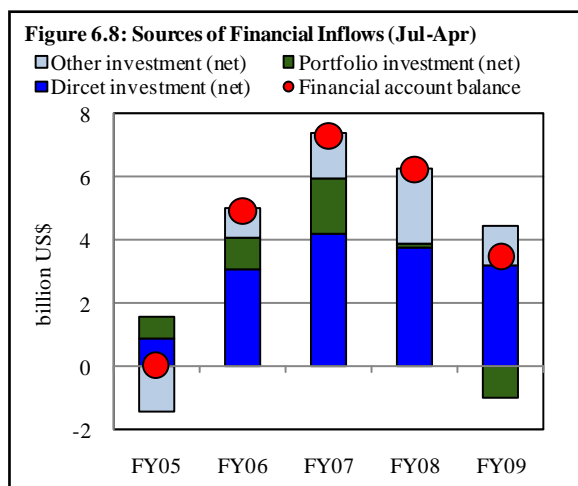


### Resident FCAs

Resident foreign currency accounts recorded net outflow of US\$ 230 million during July-Apr FY09 in contrast to net inflow of US\$ 351 million in the same period last year. Monthly trend suggests that a major chunk of this net outflow took place during October FY09 in the wake of substantial depreciation of exchange rate and rumors of possible freezing of currency accounts. However, with the stability in exchange rate in the subsequent months, resident foreign currency accounts recovered considerably (see **Figure 6.7**).

### 6.3 Financial Account

After sharp rise in FY06 and FY07, financial account surplus declined considerably from



FY08 onwards (see **Figure 6.8**). In particular financial account surplus declined by 44.1 percent during July-Apr FY09, compared to 14.8 percent fall a year earlier. Part of this deterioration is attributed to risk averse behavior of foreign investors in the face of global financial crisis and a part to domestic factors such as poor law and order situation, weakening domestic growth prospects, large economic imbalances and weak performance of stock market.

Nonetheless, IMF support for macroeconomic stabilization program has helped in reviving some of the financial inflows (net). For instance, this support has not only significantly decelerated retirement against FE-25 loans, a function of exchange rate stability, but also helped in increasing loan inflows from other sources. However, investment inflows continued falling even after this support, probably because of the deepening global financial crisis.

Looking ahead, while ongoing financial crisis is likely to maintain its downward pressure on investment inflows, loan inflows could further strengthen if pledges (worth US\$ 5.28 billion) made in Friends of Democratic Pakistan (FODP) conference materialize.

### 6.3.1 Net Foreign Investment

As in the previous year, net foreign investment declined sharply during the current year. Specifically, foreign investment inflows fell by 42.7 percent during July-Apr FY09 on the top of 35.0 percent fall recorded in the corresponding period last year. Like previous year, both the lower inflows in foreign direct investment and net outflows from portfolio investment, contributed to this decline (see **Table 6.5**). As mentioned earlier, substantial recovery in foreign investment inflows is subject to the normalization of international financial market conditions and improvement in Pakistan's macroeconomic indicators.

**Table 6.5: Net Inflow of Foreign Investment in Pakistan (Jul-Apr)**  
million US Dollar

	FY08	FY09	Growth (%)
<b>Foreign investment</b>	<b>3,862.5</b>	<b>2,212.9</b>	<b>-42.7</b>
<b>I. Private investment</b>	<b>3,818.0</b>	<b>2,753.9</b>	<b>-27.9</b>
Foreign direct investment	3,719.1	3,205.4	-13.8
<i>of which: Privatization proceeds</i>	<i>133.2</i>	<i>0</i>	<i>-</i>
Portfolio investment	98.9	-451.5	-556.5
Equity securities	98.9	-451.5	-556.5
Debt securities	0	0	0.0
<b>II. Public investment</b>	<b>44.5</b>	<b>-541</b>	<b>-1,315.7</b>
<i>of which: Debt securities*</i>	<i>44.5</i>	<i>-541</i>	<i>-1,315.7</i>

\* Net sale/purchase of Special US Dollar Bonds, Eurobonds, FEBC, DBC, T bills and PIBs

### Foreign Direct Investment

Foreign direct investment declined by 13.8 percent during July-Apr FY09 against 11.0 percent decline in the comparable period last year.

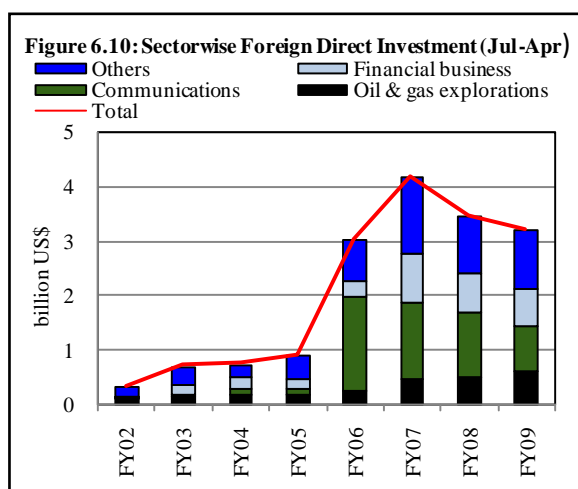
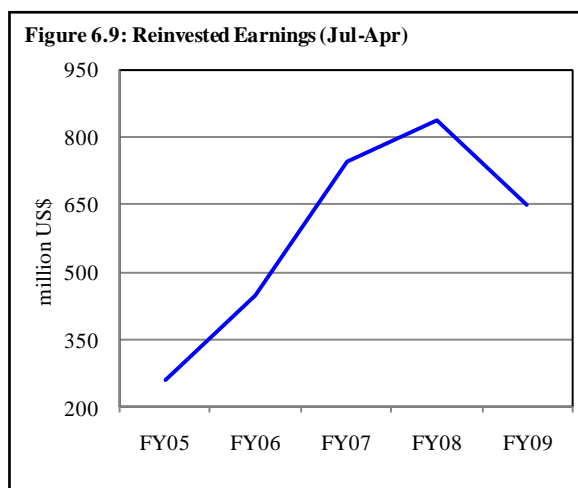
This decline may be attributed to a combination of factors such as worsening law and order situation, absence of privatization proceeds, fall in reinvested earnings in the face of lower profitability and continued global liquidity constraints.

Specifically, around 36.6 percent of the decline in foreign direct investment was driven by fall in reinvested earnings

during the period. It may be pointed out that reinvested earnings fell first time in July-Apr FY09 after rising continuously in the last five years (see **Figure 6.9**). Fall in reinvested earning, in turn, was contributed by lower profits and higher losses. For example, reinvested earnings of financial business fell on account of lower profits of banks while that of power sector witnessed net outflow mainly due to losses of KESC.

Absence of privatization proceeds, on the other hand, accounted for 25.9 percent of the fall in foreign direct investment during the period under review.

Sector wise data shows that a large part of the decline in foreign direct investment during July-Apr FY09 period emanated from financial business and communication sectors. It may be mentioned here that these two sectors along with



traditional oil & gas exploration sector accounted for a major chunk of investment inflows during the boom period (FY05-FY07). Thus with the absence of a congenial international and domestic environment, these sectors witnessed large decline in foreign investment (see **Figure 6.10**). Nonetheless, investment in oil & gas exploration continued its rising trend in July-Apr FY09 as well.

Other major sectors, which witnessed decline in foreign investment during July-Apr FY09, included cement, transport equipments (automobiles) and tourism. On the other hand, power, food packaging and petroleum refining were the major sectors which attracted higher investment inflows during the period.

#### **Foreign Portfolio Investment**

Foreign portfolio investment recorded net outflow of US\$ 1.0 billion during July-Apr FY09, against net inflow of US\$ 142 million in the corresponding period last year. This largely reflects outflows from stock market on account of risk averse behavior of foreign investors and maturing Eurobond worth US\$ 500 million.

Country-wise data suggests that close to 70 percent of the outflow from stock market during the period originated from USA, which is worst hit by ongoing financial crises (see **Table 6.6**).

**Table 6.6: Country-wise Investment in Stock Market (Jul-15 May)**

million US Dollar

	Inflow	Outflow	Net
Australia	9.9	22.9	-13.0
Chile	20.9	9.9	11.0
Hong Kong	60.1	84.3	-24.2
Luxembourg	30.1	19.4	10.7
Mauritius	1.2	0.0	1.2
Singapore	9.6	47.2	-37.6
Switzerland	44.9	91.0	-46.1
UAE	24.0	10.5	13.5
UK	66.9	169.0	-102.0
USA	275.7	673.3	-397.5
Others	23.3	15.2	8.1
<b>Total</b>	<b>566.7</b>	<b>1,142.7</b>	<b>-576.0</b>

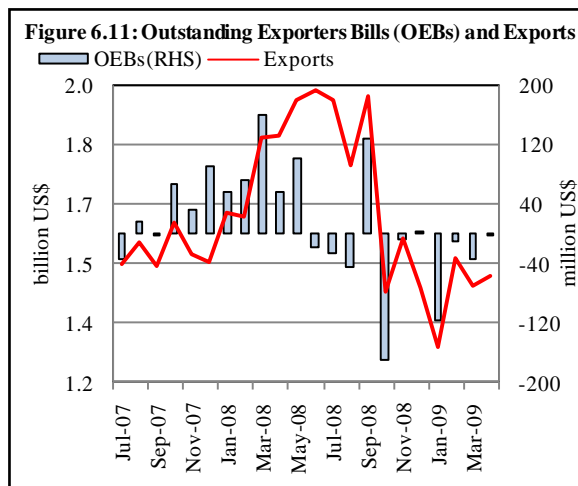
#### **6.3.2 Outstanding Export Bills**

Against increase of US\$ 432 million in the same period last year, aggregate stock of outstanding export bills declined by US\$ 532 million in July-Apr FY09. This decline largely owed to weak export growth (see **Figure 6.11**). Moreover, exchange rate stability post SBA and the central bank tight monitoring of overdue outstanding export bills might also have discouraged the deferral of export proceeds.

### 6.3.3 Currency and Deposits (Assets)

Currency and deposits declined by US\$ 64 million during July-Apr FY09 compared with the decline of US\$ 1375 million in the corresponding period last year. This was mainly because of a fall in banks assets.

It may be pointed out that under new methodology<sup>6</sup> bank assets also include trade Nostros along with FE-25 Nostros. While FE-25 Nostros increased on account of retirement of FE-25 loans, fall in trade Nostros more than offset the increase in the former during July-Apr FY09.



### 6.3.4 Official Long Term Loans

Despite higher amortization, long term loans net inflow worth US\$ 718 million during July-Apr FY09 was considerably higher than that of US\$ 664 million in comparable period last year. Higher loan inflows mainly reflect US\$ 485 million from World Bank and US\$ 693 million from Asian Development Bank. Relatively higher amortization, on the other hand, mainly stemmed from payments of World Bank, Asian Development Bank and Islamic Development Bank.

### 6.3.5 Official Short Term Loans

Official short term loans recorded net repayment of US\$ 45 million during July-Apr FY09 against net withdrawals of US\$ 559.0 million in the comparable period last year. Major repayments during the period included US\$ 590 million of Islamic Development Bank and US\$ 150 million of other commercial loans. However, in Nov-Apr FY09, short term loans recorded net withdrawal of US\$ 292 million which are entirely sourced from Islamic Development Bank.

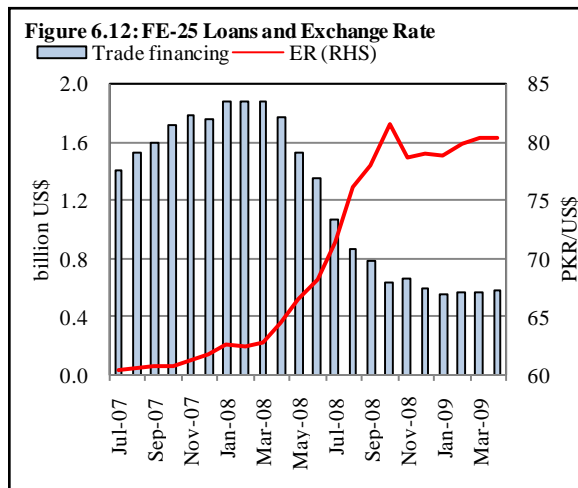
<sup>6</sup> Under the revised methodology, trade nostros are excluded from the claims of reserve assets of SBP and included in the bank assets.

### 6.3.6 Private Loans

Net inflow in private loan increased to US\$ 529 million during July-Apr FY09 from US\$ 262 million in the same period last year. More than 90 percent of this net inflow was witnessed after macroeconomic stabilization program at end October FY09 (see **Table 6.7**). Main contributors to the higher loan inflows during the period were Engro chemical, Warid Telecom, Mobilink and KESC.

### 6.3.7 Currencies and Deposits (liabilities)

Currency and deposits recorded net outflow of US\$ 440 million during July-Apr FY09 against the net inflow of US\$ 233 million in the same period last year. This net outflow largely reflects retirement of FE-25 loans by importers and exporters. A large part of this retirement took place during July-Oct FY09 amid sharp depreciation in exchange rate. However, with the macroeconomic stabilization program and stability in exchange rate, retirement of FE-25 loans have decelerated significantly in the subsequent months (Nov-Apr FY09) ( see **Figure 6.12**).





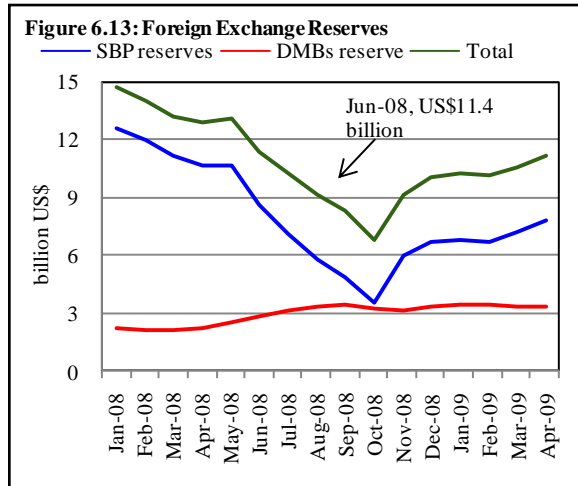
**Table 6.7: Financial Account**

million US Dollar

	<b>FY08</b>		<b>FY09*</b>	
	<b>Jul-Apr</b>	<b>Nov-Apr</b>	<b>Jul-Apr</b>	<b>Nov-Apr</b>
<b>Financial account (net )</b>	<b>6,224.0</b>	<b>2,434.0</b>	<b>3,476.4</b>	<b>2,657.4</b>
<b>Direct investment abroad</b>	<b>-41.0</b>	<b>-32.0</b>	<b>14.0</b>	<b>14.0</b>
<b>Direct investment in Pakistan</b>	<b>3,719.0</b>	<b>2,143.0</b>	<b>3,206.0</b>	<b>1,876.0</b>
Equity capital	2,882.0	1,627.0	2,557.0	1,571.0
of which: Privatization receipts	133.0	133.0	0.0	0.0
Reinvested earnings	837.0	516.0	649.0	305.0
<b>Portfolio investment</b>	<b>142.0</b>	<b>-169.0</b>	<b>-1,002.0</b>	<b>-821.0</b>
Equity securities	98.0	-244.0	-461.0	-296.0
Debt securities	44.0	75.0	-541.0	-525.0
<b>Net foreign investment</b>	<b>3,820.0</b>	<b>1,942.0</b>	<b>2,218.0</b>	<b>1,069.0</b>
<b>Other investment</b>	<b>2,404.0</b>	<b>492.0</b>	<b>1,258.0</b>	<b>1,588.0</b>
Assets	943.0	130.0	596.0	-41.0
1-Outstanding export bills (exporters)	-512.0	-467.0	286.0	170.0
2-Outstanding export bills (DMBs))	80.0	54.0	246.0	21.0
3-Currency and deposits	1,375.0	543.0	64.0	-232.0
of which: banks	1,269.0	505.0	-66.0	-333.0
Liabilities	1,461.0	362.0	662.4	1,629.4
1-Foreign long-term govt loans / credits ( net )	664.0	216.0	718.4	475.4
Project loans	929.0	484.0	638.4	378.4
Non- project loans	643.0	296.0	1,301.0	736.0
Amortization	908.0	564.0	1,221.0	639.0
2-Private loans	262.0	159.0	529.0	491.0
of which: Supplier credits	525.0	362.0	870.0	692.0
Suppliers credit repayments	263.0	203.0	341.0	201.0
3-Short term capital (official)	559.0	394.0	-45.0	292.0
of which: IDB (net)	675.0	410.0	55.0	292.0
4-Currency and deposits	233.0	2.0	-440.0	-16.0
5-Other liabilities	-307.0	-409.0	-100.0	387.0
* provisional				

## 6.4 Foreign Exchange Reserves

The relative improvement in Pakistan's external accounts was reflected in foreign exchange reserves, which recorded sustained improvement Nov 2008 onwards. Consequently by April 30 2009, foreign exchange reserves had climbed back to almost the end-June level of US\$ 11.4 billion after hitting a low of US\$ 6.8 billion in Oct 2008 (see **Figure 6.13**).



Both inflows and outflows in forex reserves of the country increased substantially during Jul-Apr FY09 compared to the same period last year (see **Table 6.8**).

The bulk of the outflow was as usual on account of forward swap maturities, SBP sales for oil and market support. During July-Apr FY09, however, the debt related payments and other miscellaneous payments were significantly higher than in corresponding period of the previous year.

Moreover, while outflows were particularly strong in the initial month of FY09, the inflows were concentrated mainly in the middle of the July-Apr period (see **Figure 6.14**). This mismatch in the inflows and outflows, along with expansion in the current account deficit during the period, resulted in sharp depletion of reserves and pressure on the exchange rate till Oct 2008. In later months, capital inflows from IMF and other donor agencies

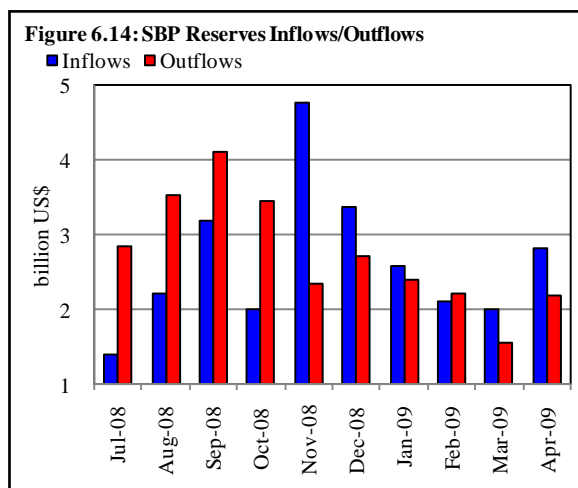
**Table 6.8: Major Inflows/Outflows from SBP Reserves**  
million US Dollar

	Jul-Apr	
	FY08	FY09
<b>Inflows</b>	<b>12,157.6</b>	<b>26,458.7</b>
Loans	1,975.4	5,984.8
Logistic support	281.7	465.5
Privatization proceeds	643.5	0.0
Miscellaneous receipts	161.4	1,309.1
<b>Outflows</b>	<b>15,777.5</b>	<b>27,296.7</b>
Debt servicing	1,015.1	1,822.0
Eurobonds	169.2	609.4
Wheat L/C - TCP	808.9	866.8
Miscellaneous payments	214.3	741.7

Source: DMMD

enabled SBP to build up reserves. This also alleviated pressures on the exchange rate, helping it to stabilize in the range of 78.8 and 80.8.<sup>7</sup>

While commercial banks' reserves also increased by US\$ 0.5 billion during July-Apr FY09, the increase in the overall foreign exchange reserves largely stemmed from the improvement in SBP reserves. These rose by almost 121.1 percent during Nov-Apr FY09, reaching US\$ 7.8 billion by end-Apr 2009, up from US\$ 3.5 billion at end October 2008 (see **Table 6.9**).



Major factors that contributed to SBP reserves accumulation

were long-term loans from donor agencies and the receipts under the logistic supports during July-Apr FY09. While the 79.5 percent YoY growth in debt servicing and payment for euro bond exerted downward pressure on the central bank reserves during the period under review (see **Table 6.8**).

The rise of US\$ 0.5 billion in the commercial banks' reserves owes largely to the retirement of foreign currency loans by traders that replenished the pool of foreign exchange reserves with commercial banks. During July-Mar FY09, trade financing decline to US\$ 0.6 billion against US\$ 1.3 billion as of end-June 08.

**Table 6.9: Foreign Exchange Reserves**  
million US Dollar

	Jun-08	Oct-08	Apr-09
<b>SBP</b>	8,577.0	3,529.7	7,805.2
<b>Commercial banks</b>	2,822.0	3,231.9	3,366.7
<b>Total</b>	11,399.0	6,761.6	11,171.9

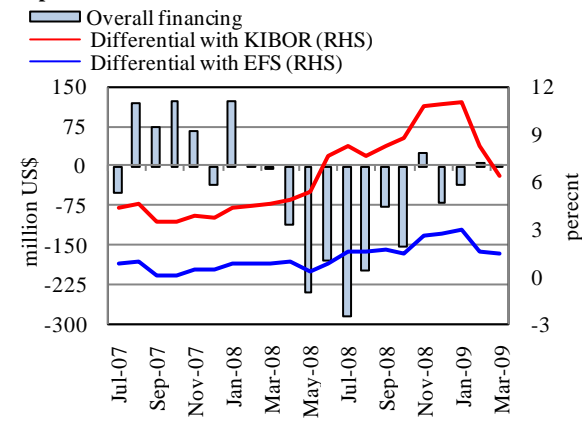
In the initial months of FY09, despite increased differential in WAFC (weighted average foreign currency) and local currency lending rates (both EFS and KIBOR) retirement of forex loans appears to stem from the expectations of the Rupee depreciation against US dollar, as retirement of these loans subsided with the stability in exchange rate Nov 2008 onwards (see **Figure 6.15**).

<sup>7</sup> Between Dec 1<sup>st</sup>, 2008 and Apr 30<sup>th</sup>, 2009.

### Reserve Adequacy

The import coverage ratio, one of the measures of reserve adequacy also recovered to 17.1 weeks of imports by end-Apr 2009. It may be recalled that reserves adequacy had dropped to mere 9.1 weeks in Oct 2008. Although this level is still lower than the average level of 25.6 weeks of imports recorded in FY08, it is nevertheless significant improvement over Oct 2008 position. This recovery in import coverage ratio owes to both, improvements in foreign exchange reserves as well as decline in import bill in the later months of July-Apr FY09 (see **Figure 6.16**).

**Figure 6.15: Trend in Overall Financing Through FE-25 Deposits**



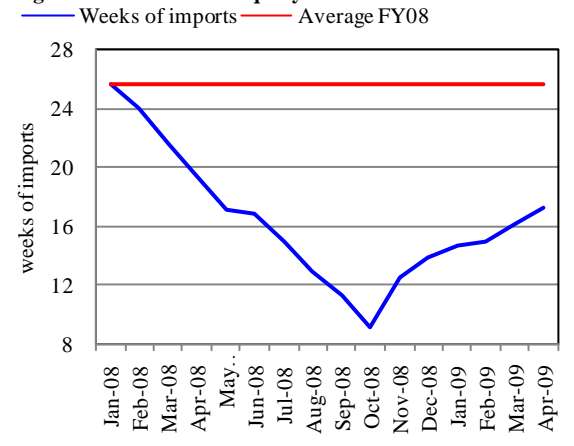
### 6.5 Exchange Rate

After depreciating by 13.3 percent during July-Nov FY09, rupee exhibited relative stability against US dollar during Dec-Apr FY09. As against the July-Nov period, rupee depreciation was limited to 2.2 percent in Dec-Apr period.

The post October 08 relative stability of the Pak rupee against US dollar mainly stemmed from (1)

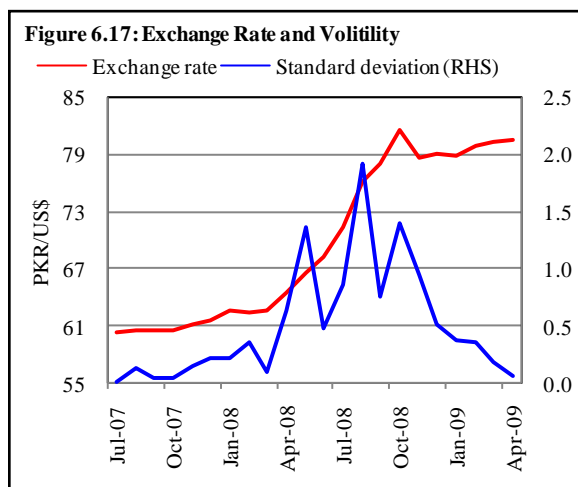
improvement in overall external balance, (2) consistent capital inflows, (3) crackdown on exchange companies involved in cross border smuggling of US dollar, and (4) SBP's interventions in the inter-bank market to reduce the volatility in the foreign exchange market. Furthermore, pledges from friends of Pakistan, and signals from the US of increase in the non-military aid have further calmed the foreign exchange market.

**Figure 6.16: Reserve Adequacy**



Consequently volatility (as measured by the deviations from the mean) in the exchange rate also declined significantly during the Nov-Apr period. Standard deviation dropped from 3.87 in July-Oct 2008 to 0.74 in the post Oct period (see **Figure 6.17**).

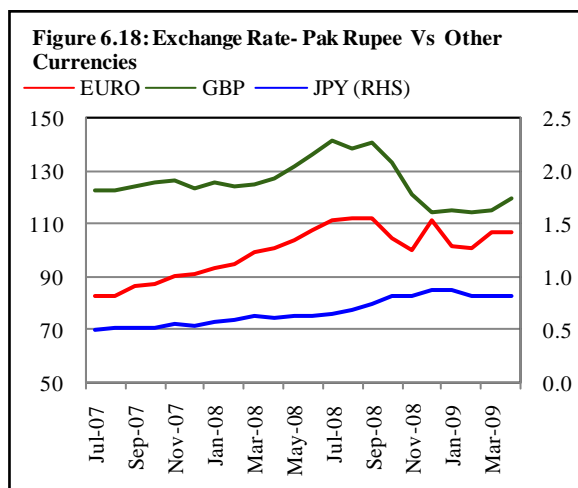
As against weak performance of the Pak rupee against the US dollar, Pak rupee showed relatively better performance against Euro and Pound. While against Japanese yen, Pak rupee depreciated significantly. During July-Apr FY09, Pak rupee appreciated by 0.6 percent and 14.2 percent against euro and pound respectively. On the other hand, Pak rupee depreciated by 22.1 percent against the Japanese yen (see **Figure 6.18**).

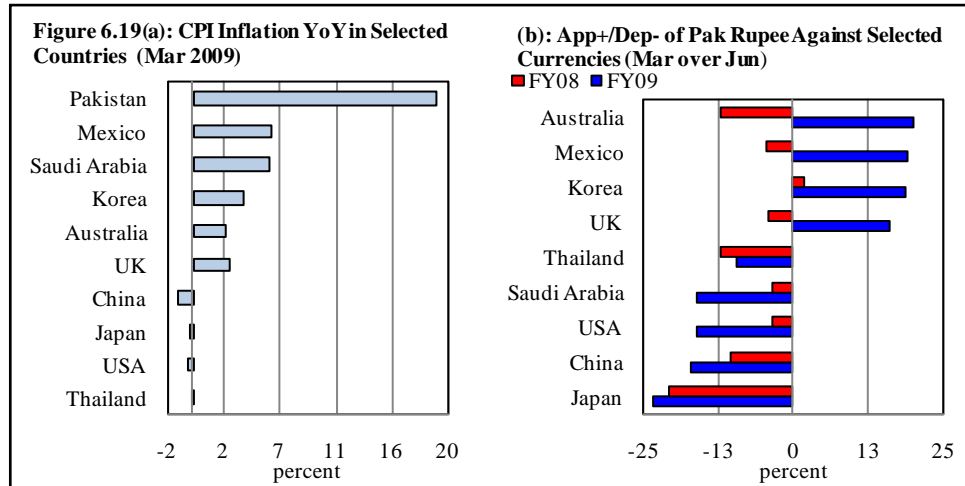


### Real Effective Exchange Rates

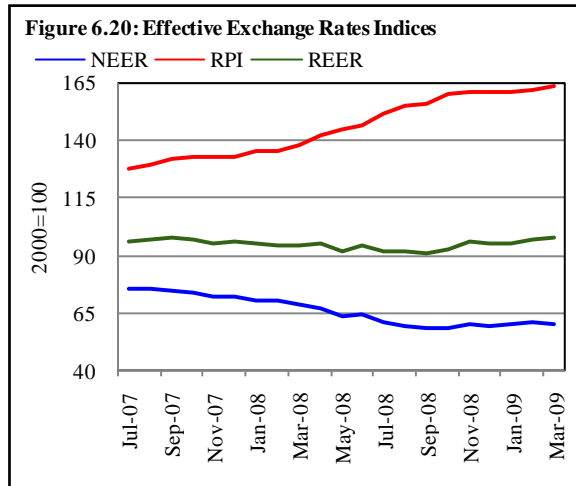
During July-Mar FY09, Nominal Effective Exchange Rate (NEER) depreciated by 6.4 percent as compared to 10.3 percent depreciation in the corresponding period of previous year. Since NEER is the weighted average exchange rate of basket of currencies, its overall value depends on the performance of the Pak rupee against the currencies of trading partner countries.

Pak rupee depreciated against more than half of the currencies in the basket of trading partners. Although rupee appreciated against some of its trading partner currencies but this was offset due to depreciation of Pak rupee against its major trading partners having relatively greater trade weights.



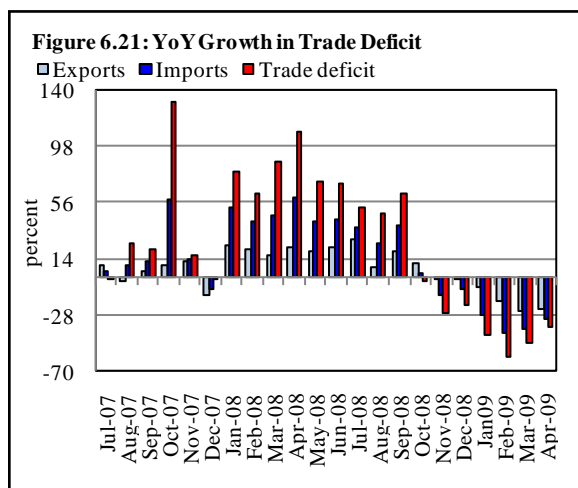


Movements in the Real Effective Exchange Rate (REER) are reflective of the cumulative movements in the NEER and Relative Price Index (RPI). The continuous rise in the domestic inflation compared to its trading partners resulted in the appreciation of the REER. Despite a sharp deceleration, domestic CPI inflation remained high as compared to CPI inflation in the major trading partners in recent months (see **Figure 6.19**). Therefore, due to 11.2 percent growth in RPI, REER appreciated by 4.1 percent by end-Mar 2009 relative to end-Jun 2008 (see **Figure 6.20**).

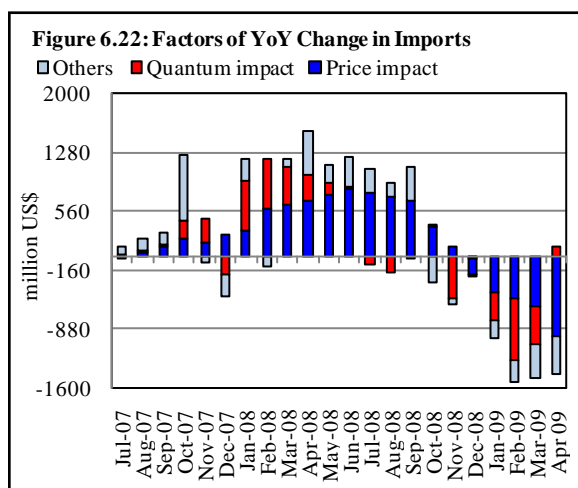


## 6.6 Trade Account

Pakistan's cumulative trade deficit recorded a significant 15.9 percent YoY fall, reaching US\$ 14.1 billion during July-Apr FY09 – the first time in seven years that trade deficit recorded a decline in the ten months period. This improvement was contributed by a 9.8 percent YoY fall in imports that more than offset 3.0 percent YoY fall in exports during this period. In fact country's trade account is witnessing a continuous improvement since October 2008; but, a larger share of this contraction was observed during the last four months, due to a sharp dip in imports (see **Figure 6.21**).



Contractionary fiscal and monetary policies, better domestic supply situation of some major import categories<sup>8</sup>, a large depreciation in the value of rupee and a general slowdown in economic activity all contributed to significantly squeeze import demand during July-Mar FY09. The effect of contracting demand was complemented by YoY fall in the import unit values from December 2008 (see **Figure 6.22**). The fall in import unit values, which became more pronounced in Q3-FY09, reflected the lagged impact of the sharp decline in international commodity prices from the start of FY09 (see **Table 6.10**). As the fall in import prices and quantum is likely to persist in the



<sup>8</sup> For instance raw cotton and fertilizer manufactured.

remaining months of FY09, the annual import bill is likely to record a significant YoY fall in FY09.

**Table 6.10: Average International Commodity Prices**

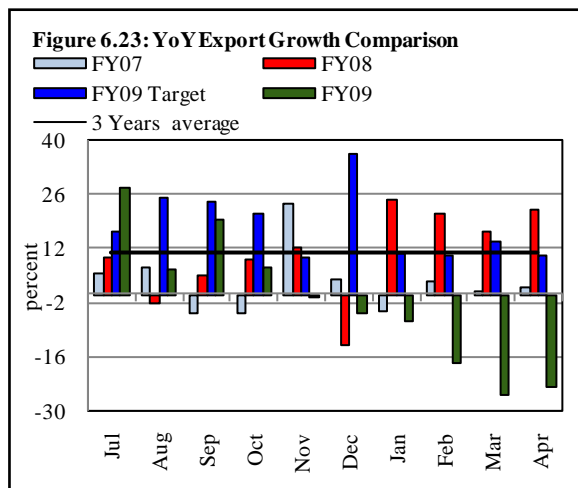
		FY08				FY09		
	Unit	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Arabian light								
oil	US\$/barrel	71.3	85.2	93.7	117.2	113.8	54.9	38.8
Palm oil	US\$/MT	746.4	861.6	1,081.1	1,088.9	828.4	453.3	536.3
DAP	US\$/MT	432.5	522.1	860.2	1,191.6	1,153.7	663.3	362.2
Wheat	US\$/MT	274.9	341.9	411.4	346.5	317.7	228.1	231.7

In the case of exports, slackening external demand and various domestic issues, particularly the energy crisis, resulted in an accelerated YoY downturn in export growth since November 2008 (see **Figure 6.21**). In fact with the exception of rice and cement all major export categories recorded YoY decline during July-Mar FY09. These issues are likely to continue to hamper the YoY export growth during Q4-FY09 as well, leading to a moderate fall in exports for the whole of FY09.

On the whole, given the expectation that the decline in imports will be much larger than the fall in exports, the trade deficit is expected to continue to decline in the remaining months of FY09. Thus the overall, trade deficit for FY09 is likely to be much lower than that in FY08.

## Exports

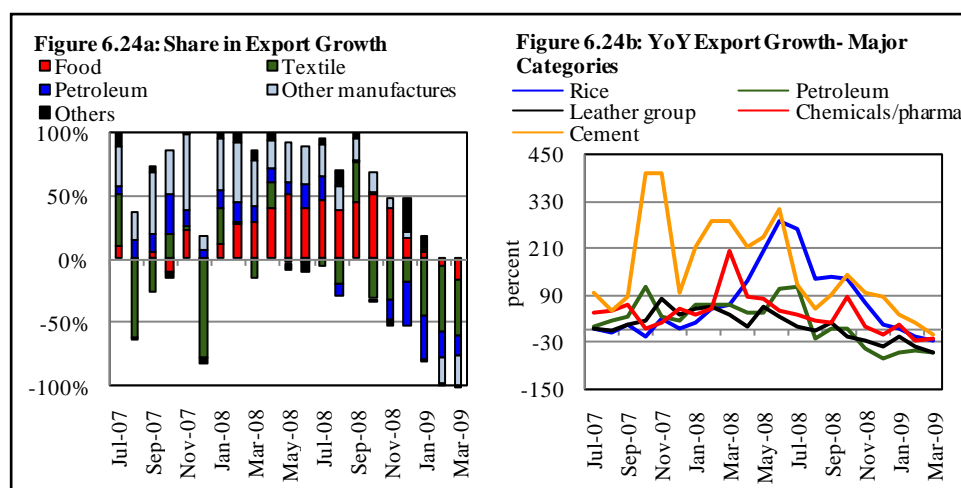
A confluence of domestic and external factors suppressed YoY export growth to negative 3.0 percent during Jul-Apr FY09 as compared to a healthy 8.5 percent growth recorded during the same period last year. In terms of monthly performance, an accelerated deterioration started to emerge in export growth from November 2008, with growth in April 2009 being the lowest-ever since June 1997. In addition, exports remained





below the target level during Aug-Apr FY09 (see **Figure 6.23**). A comparison of Pakistan's export growth with that of some other regional countries, however, shows that country fared relatively better than some of other competitors, at least during H1-FY09. But from the start of CY09 with growing intensity of the various impediments faced by this sector the situation has started to worsen for Pakistan as well (see **Box 6.3**).

Analysis of export performance of the major categories reveals that domestic energy crisis, circular debt issue, worsening law and order situation, and government intervention in the rice trade were some of the major setbacks to the export sector. In addition, the political issues in the country that disrupted transportation of export goods further worsened YoY export growth in the month of April 09. The impact of these domestic impediments was complimented by deepening international recession from Q4-CY08, which further squeezed external demand for country's major exports.



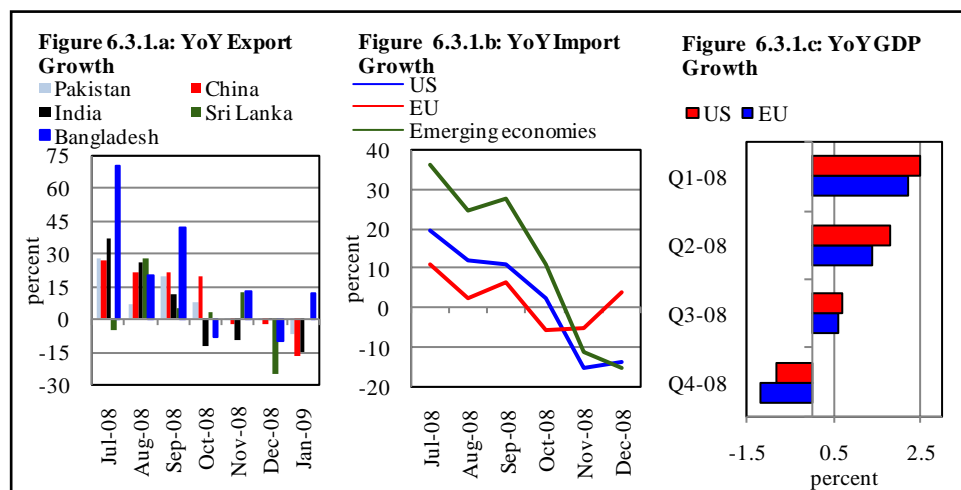
These factors resulted not only in worsening of textile export performance during July-Apr FY09, but they also moderated or even reversed the growth observed in some strong performing non- textile categories e.g., rice, petroleum products, leather, etc (see **Figure 6.24 b**). In overall terms, the largest declines were observed in the categories of textile and petroleum group, which overshadowed the growth recorded in food group and some categories of other manufactures (see **Figure 6.24a & Table 6.11**). The growth observed in the food group was also almost solely contributed by price impact in the rice export, as the quantum of rice exports has declined during Jul-Apr FY09.

**Box 6.3: Pakistan's Export Performance in Regional Perspective**

After displaying a decent performance during July-Oct FY09 Pakistan's exports are recording continued deterioration since Nov08. The average monthly YoY export growth that was as high as 15.4 percent in July-Oct FY09, fell to the level of -10.4 percent during Nov-Mar FY09. This lackluster export performance reflects the effect of both 1) falling external demand and 2) - worsening domestic issues, particularly the energy crisis.

However, a comparison of Pakistan's export performance with that of some other regional countries shows that Pakistan's exports are performing relatively better than some of its regional competitors. Global recession started taking its toll on developing countries exports from the last quarter of CY08. Resultantly, with a fall in developed countries GDP and imports from the last quarter of CY08, exports of most of the Asian economies witnessed YoY decline during this period (see **Figure 6.3.1a, b & c**).<sup>9</sup> This belief is also strengthened by a study of the Asian Development Bank (2009) which shows a strong positive correlation between developing Asia's exports and G3<sup>10</sup> non-oil imports.

In terms of the extent of the impact of weakening external demand, exports from China and India were more severely hit till January 2009<sup>11</sup> as compared to Pakistan, whereas Sri Lanka and Bangladesh were at relatively comfortable positions. This is evident from a steeper average 7.5 and 8.8 percent fall in China and India's exports during Nov-Jan 09 as compared to 2.9 percent fall recorded in Pakistan's exports during this period. The explanation to this fact lies in the analysis of composition of exports, which reflects that slowdown in exports is broad based with consumer durables and heavy manufacturing items, being the most severely hit categories (see **Figure 6.3.2.a**)<sup>12</sup>. This at least partially explains a greater fall in China and India's exports, as they have stronger market presence in these products.



<sup>9</sup> In view of Pakistan's export concentration in textile, this analysis includes those countries which are Pakistan's competitor in this category.

<sup>10</sup> G3 includes US, EU and Japan.

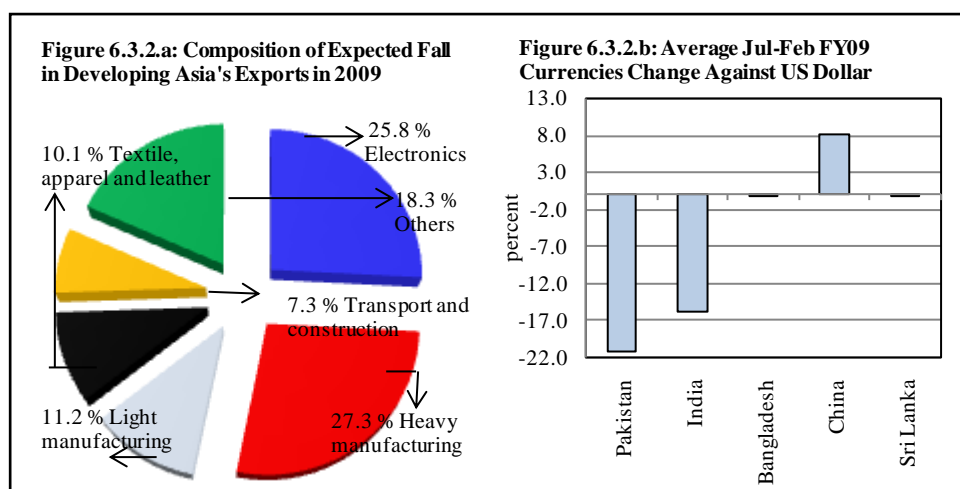
<sup>11</sup> Comparable data for India, China, Pakistan and Bangladesh is available till Jan 2009, while for Sri Lanka till Dec 2008.

<sup>12</sup> Source: Asian Development Outlook 2009: Rebalancing Asia's Growth.

In this scenario Pakistan's relatively comfortable position, emerged from a large depreciation of rupee against US dollar during July-Feb FY09, which bolstered country's export growth during this period (see **Figure 6.3.2.b**). However, from February 2009 Pakistan's exports have also started to record sharp YoY fall largely on the back of sharply falling textile exports. This implies that growing intensity of domestic issues have started to weaken textile sector's ability to face international competition. Further, reportedly textile and clothing demand has also started to undergo sharp contraction since the start of CY09. In the absence of data of other countries' comparative position cannot be analyzed for this period.

The global recession is likely to continue to squeeze export demand during 2009, as ADB (2009) forecasts major Industrial countries' GDP to undergo a 2.6 percent contraction during 2009. In this situation Pakistan seems to be at a weaker position due to a variety of domestic issues which are complementing the adverse impact of weakening external demand.

The current international recession has highlighted the risks attached to over dependence on developed countries as export markets have brought home the importance of greater export market



diversification. For Pakistan, this can be achieved by entering into FTAs and PTAs with other regional countries. In view of greater concentration of country's exports in textiles, country should attempt to acquire more access for its textile and clothing exports through these preferential arrangements. For the region as a whole this can be done by entering into some preferential regional arrangement aiming at increasing trade flow among Asian countries.

**Table 6.11: Major Exports (July-Apr)**

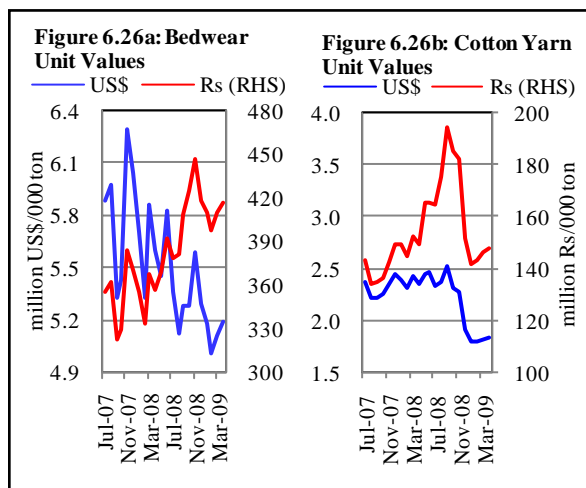
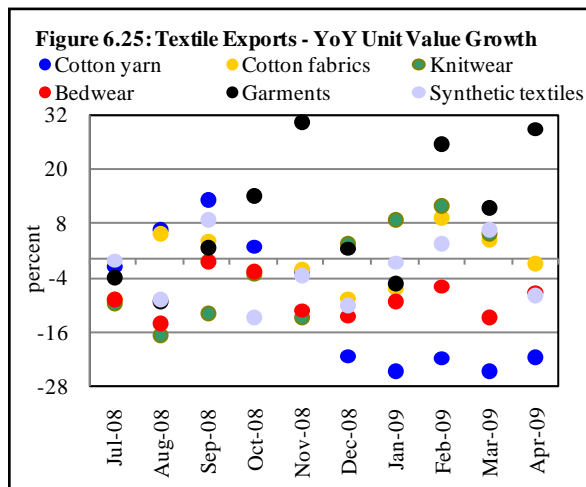
million US Dollar

	Units	FY08		FY09(P)		% YoY Δ			
		Value	Unit value	Value	Unit value	Abs.Δ value	Qty	Value	Unit value
<b>Food group</b>		<b>2,050.0</b>		<b>2,560.3</b>		<b>510.3</b>		<b>24.9</b>	
of which:									
Rice	MT	1,237.0	546.2	1,680.3	810.5	443.3	-8.5	35.8	48.4
<b>Textile group</b>		<b>8,706.4</b>		<b>7,898.9</b>		<b>-807.5</b>		<b>-9.3</b>	
of which:									
Cotton yarn	MT	1,082.9	2,324.7	909.9	2,120.1	-173.1	-7.9	-16.0	-8.8
Cotton fabrics	SQM	1,626.3	1,004.8	1,638.5	1,002.1	12.3	1.0	0.8	-0.3
Knitwear	DOZ	1,529.1	18.5	1,427.1	16.8	-102.6	3.2	-6.7	-9.6
Bed wear	MT	1,583.9	5,736.2	1,390.8	5,282.9	-193.1	-4.7	-12.2	-7.9
Towels	MT	500.7	4,074.0	517.0	3,674.1	16.3	14.5	3.3	-9.8
Readymade garments	DOZ	1,183.6	37.1	1,010.2	41.6	-173.4	-23.8	-14.7	12.0
Synthetic textiles	SQM	363.5	0.9	241.2	0.9	-122.3	-30.2	-33.6	-5.0
Other textile made-up		436.0	---	408.7	---	-27.3	---	-6.3	---
Other textile material		226.2	---	191.3	---	-34.9	---	-15.4	---
<b>Petroleum group</b>		<b>974.0</b>		<b>702.4</b>		<b>-271.6</b>		<b>-27.9</b>	
<b>Other manufactures group</b>		<b>2,926.2</b>		<b>2,938.8</b>		<b>12.6</b>		<b>0.4</b>	
of which:									
Chemicals and pharmaceuticals		499.9	---	509.7	---	9.8	---	2.0	---
Molasses	MT	37.5	64.1	85.5	102.0	48.0	43.3	127.9	59.1
Cement	MT	308.1	53.8	470.1	58.2	162.0	41.0	52.6	8.2
<b>Others</b>		<b>566.3</b>		<b>661.7</b>		<b>95.4</b>		<b>16.9</b>	
<b>Total exports</b>		<b>15,222.9</b>		<b>14,762.9</b>		<b>-460.7</b>		<b>-3.0</b>	

**Textile** exports have seen a steady YoY decline since October 2008 and recorded a large 9.3 percent YoY fall during July-Apr FY09. This weakness resulted from both, supply and demand side factors, as mentioned before. In addition to these factors liquidity constraints faced by this sector are also hampering its performance. This issue is originating from two channels. 1) - with the deepening global recession, international buyers are either opting for default or are increasingly demanding extension in payment periods; 2)- due to rising NPLs

banks have become more cautious in extending loans to textile companies. Composition of the fall: In terms of composition, this fall was recorded due to both falling quantum and unit values in almost all major categories, with the fall in the latter being greater. The unit values of most of the textile export categories recorded a decline almost throughout July-Apr FY09 (see **Figure 6.25**). This effect probably reflects the impact of falling external demand, to offset which exporters are lowering their export unit values.

In fact a large 15.2 percent depreciation in the value of rupee against US dollar during July-Apr FY09 has provided exporters some room for maneuvering. To retain their market shares they are sharing the depreciation gains with importers, by lowering their US dollar export unit values. While their rupee export unit values either remained at their last year's level or recorded increases (see **Figure 6.26a** & **Figure 26b**). Unlike some other competitors, this has so far enabled Pakistan's textile exports to resist a large fall in the major markets of US and the EU (see **Table 6.12**) in the face of weakening demand. Thus despite, a fall in the US Dollar unit values, rupee depreciation has supported rupee earnings of this sector.<sup>13</sup>



<sup>13</sup> In rupee terms textile sector recorded 14.7 percent YoY growth during July-Mar FY09.

Category-wise analysis: In terms of categories, during July-Apr FY09 the largest declines were recorded in *bed wear*, *cotton yarn* and *ready-made garments*. The decline in *bed wear* exports resulted from a sharp fall in demand in EU and the US markets. The bed wear imports of both of these destinations recorded large declines during CY08. Specifically, Pakistan is losing share to China in both of these markets (see **Table 6.13**), while, India is improving its market share in the *printed sheets* market segment of the US market by moving into higher value chain. Since January 2009, for Pakistan the competition has further increased in US market, because of the removal of safeguard restrictions imposed on China.

**Table 6.12: Textile & Apparel Export Performance - International Comparison**  
percent

	Textile		Apparel	
	FY08	FY09	FY08	FY09
<b>USA (Jul-Jan)</b>				
World	4.8	-8.9	-1.2	-3.4
Bangladesh	9.5	4.3	-0.8	15.4
China	10.3	-4.5	4.0	3.6
India	3.2	-2.4	-0.7	-4.8
Mexico	3.0	-18.2	-14.9	-10.7
Pakistan	-7.3	-3.3	-0.9	-1.4
Sri Lanka	5.5	-19.6	-11.2	-3.0
Turkey	12.3	-19.6	-29.5	-28.2
<b>EU (Jul-Dec)</b>				
World	4.4	-5.8	4.0	3.6
Bangladesh	13.0	5.7	-2.4	6.8
China	14.1	3.8	9.9	18.1
India	6.2	-8.8	3.4	3.1
Pakistan	9.0	-3.6	3.3	3.5
Turkey	1.1	-12.1	7.7	-14.8
Vietnam	8.7	-8.6	35.8	6.1

Source: US Census Bureau & Euro Stat

**Table 6.13: Bed Wear Exports Analysis**

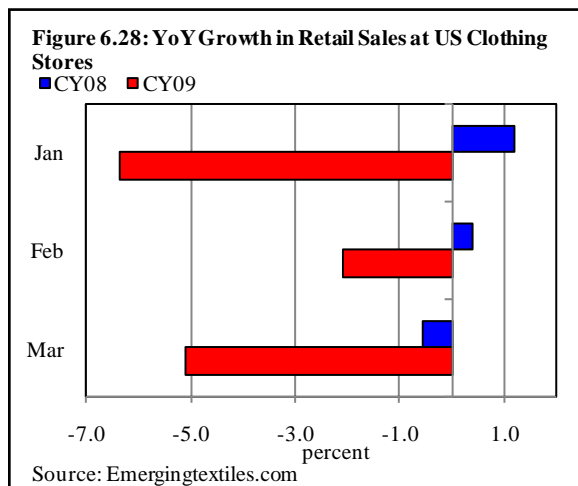
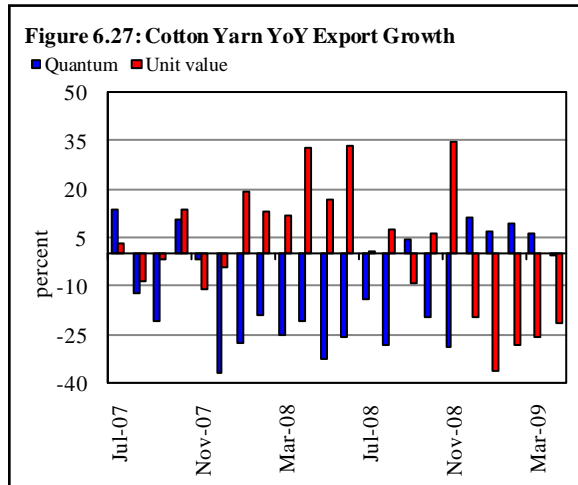
percent

	US market						EU market	
	Volume shares		Volume growth		Unit value growth		Value growth	
	CY05	CY08	CY07	CY08	CY07	CY08	CY07	CY08
<b>Printed sheets</b>								
World	100.0	100.0	9.9	-17.5	-5.4	3.2	17.7	2.7
Pakistan	48.9	45.9	1.1	-26.1	-1.5	-0.5	21.4	-0.5
China	15.0	28.0	19.7	7.5	-13.7	-1.1	77.0	41.8
India	9.0	6.6	57.0	-25.8	-8.1	22.3	-1.9	4.0
<b>Non-printed sheets</b>								
World	100.0	100.0	-28.0	-7.0	17.2	-4.9	17.9	-3.0
Pakistan	37.5	16.6	-56.6	-45.3	10.0	-15.8	55.0	7.1
China	27.4	46.3	-27.0	31.1	1.6	-14.1	24.5	12.2
India	4.7	10.0	67.0	-13.0	7.0	24.6	1.6	18.8

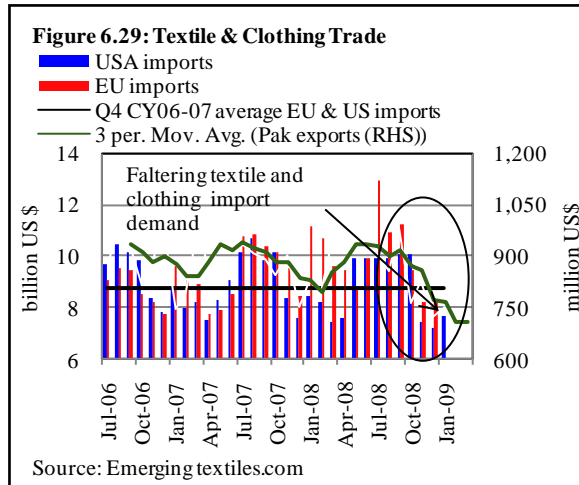
In the EU market, however, the situation is likely to improve after the removal of antidumping duty on Pakistan's bed wear exports in March 2009.

The fall in *cotton yarn* exports is attributable to lower demand both from the developed markets and the far eastern countries. In fact cotton yarn exports are recording quantum decline since FY08. This is due to falling demand for cotton products internationally. However, a small revival of demand has been witnessed since December 2008, which coincides with the fall in export unit values of this category (see **Figure 6.27**).

*Readymade garments* exports have been recording a decline in quantum since the start of FY09. This is attributable to intensifying domestic issues faced by exporters that led to reported switching of orders to other suppliers like China and India. In addition, the effect of domestic issues is being complimented by contracting external demand. A large (40 percent) share of country's garments exports is directed to the US market. With the deepening international recession, clothing demand is being worst hit in the US. This is confirmed from the available data for US clothing sales during Q3-FY09 (see **Figure 6.28**). This has probably led to further shrinking demand for country's garments exports resulting into a large fall in the export of this category.



Going forward, the competition faced by this sector is likely to stiffen further due to a steep fall in external demand. This belief is based on the analysis of monthly import trend of EU and US, which are Pakistan's major textile export markets. The textile and clothing imports of these countries undergo a seasonal contraction during the last quarter of each CY and bounce back in the first quarter of the subsequent year. In the period under review, however, the contraction observed during the last quarter of CY08 was steeper than the average of last two years, whereas the expected recovery was also not observed in January 2009<sup>14</sup> (see **Figure 6.29**). Thus the steep fall observed in Pakistan's textile export growth from October 08 is likely to continue.



On its part SBP has been taking various measures from time to time, to address the issues faced by textile sector.<sup>15</sup> However, in the absence of strong demand and persistence of structural issues, textile exports are likely to remain subdued for most part of CY09.

#### **Non-textile exports**

*Rice* is the most important non-textile export of the country. During July-Apr FY09 rice exports recorded an impressive 35.8 percent YoY rise mainly on account of higher export unit values. Though international rice prices are witnessing a downward slide since May 2008, on average these are still at a higher level than the FY08 average (see **Figure 6.30**). This difference materialized into US\$ 581.7 million price impact during July-Apr FY09.

<sup>14</sup> CY09 data is not available for EU, whereas for US this data is only available for Jan 09.

<sup>15</sup> These include one year extension in mark-up subsidy for spinning sector (SMEFD Circular No. 05, 2009, SBP), provision of 100 percent financing to banks against export finance provided to exporters (SMEFD Circular No. 03 of 2008, SBP), provision of one year moratorium on loans availed under the Long Term Financing Facility (SMEFD Circular No. 01, 2009, SBP), extension in the period of refinancing under EFS (SMEFD Circular No. 04, 2009, SBP), and provision of EFS to some categories of cotton fabrics (SMEFD Circular Letter No. 04, 2009, SBP) and provision of LTFF to various spinning sectors (SMEFD Circular No. 08, 2009, SBP).

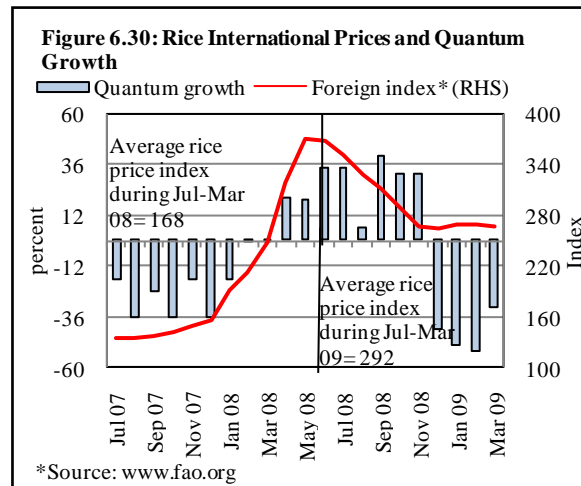


Ironically, despite harvesting a bumper rice crop during 2008, country's rice exports are recording a YoY quantum decline since December 2008. This is due to various factors: 1) - The

government procurement of rice by Pakistan Agricultural Services and Supply Corporation (PASSCO) prevented an expected large fall in the domestic prices of this commodity, thus hampering its export competitiveness.

Reportedly Thai rice exporters are also facing the same issue as the Thai government has also announced a rice intervention scheme to support farmers.<sup>16</sup> 2) – The 2008 paddy season

recorded bumper crops in some of the world's major rice importing countries e.g., Bangladesh, Indonesia, the Philippines, Africa and Turkey<sup>17</sup>, resulting into lowering rice demand.



Cement exports recorded a significant 52.6 percent YoY rise during July-Apr FY09, largely on account of rising export quantum. In view of the 12 percent duty imposed by India on these exports, which is a large market occupying 10-12 percent share in country's total cement exports, this is an encouraging development.

An analysis of monthly export performance of this category reveals that cement export unit values have been declining from January 2009, after the imposition of duty from India (see **Figure 6.31**). In fact during July-Apr FY09 international coal prices have undergone a large reduction.<sup>18</sup> Since coal is the most important cost component of cement production, a fall in its prices provided cement exporters a margin to reduce their export unit prices. This has also helped them in maintaining their share in the Indian market despite the imposition of duty. Apart from that, a reported fall in domestic cement sales also increased the exportable surplus of this category.

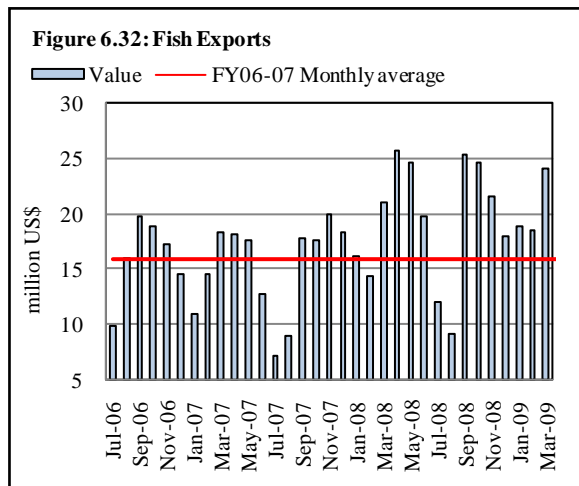
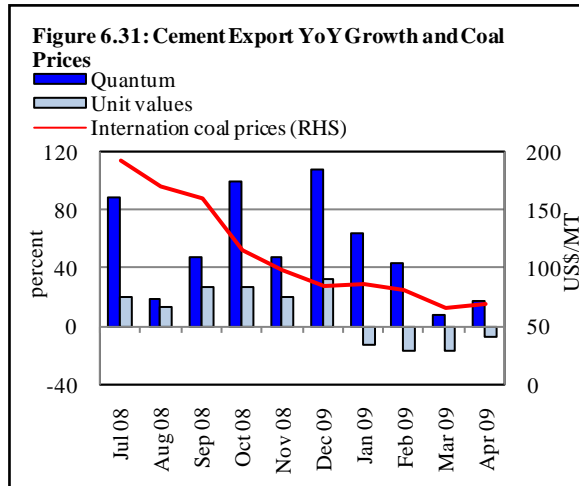
<sup>16</sup> <http://oryza.com/news/Asia-Pacific/Thailand-Market/9648.html>

<sup>17</sup> [http://www.fao.org/es/ESC/en/15/70/highlight\\_71.html](http://www.fao.org/es/ESC/en/15/70/highlight_71.html)

<sup>18</sup> The international coal prices in Mar 09 recorded 66 percent fall as compared to their July 08 levels.

*Petroleum products* exports continued with the declining trend witnessed since November 2008 mainly due to falling naphtha exports. Naphtha production recorded 19 percent YoY decline during July-Mar FY09. This is due to lower crude import by refineries due to the financial problems. However, the easing of financial constraints in recent months could translate into higher production and hence export of naphtha going forward.

*Fish & fish preparations* export recorded an impressive 17.3 percent YoY growth during July-Apr FY09. Encouragingly, this growth was observed both in terms of quantum and value. Country's fish exports are facing restrictions from the EU market since 2007 due to non-compliance with Sanitary and Phyto Sanitary Standards (SPSS) of WTO. However, after remaining subdued during FY07 and some part of FY08, export of this category rebounded during July-Mar FY09 (see **Figure 6.32**). This improvement came from two sources: 1) – establishment of fish processing units along the Baluchistan coastal highway in 2008, which led to improved fish catch and export; 2) – greater focus on other fish



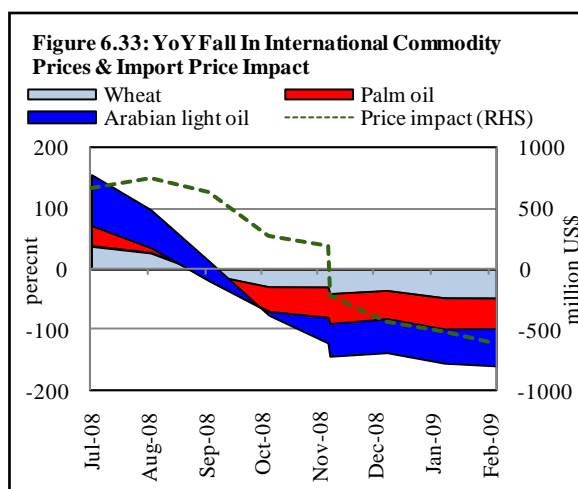
markets as Malaysia, Indonesia, UAE and Thailand which provide better prices.<sup>19</sup> In addition depreciation in the value of rupee has also increased the bargaining power of exporters to attract more demand.

*Molasses* export recorded a sharp 127.9 percent YoY rise during July-Apr FY09 due to both rising quantum and unit values. However, since molasses is a raw material for ethanol which is a high value added product, government has recently imposed 15 percent duty on the export of this category in a bid to support ethanol production. To facilitate *ethanol* exports SBP has also provided Long Term Financing Facility (LTFF) to this sector from January 2008.<sup>20</sup>

In overall terms country's export sector is passing through testing times. On the one hand there is a demand crunch internationally, while on the other hand domestic issues are also constraining growth in most of the export categories. Although, some of the developmental categories are still performing well this is not sufficient to offset the adverse performance of the categories occupying large shares in total exports. Going forward, due to the fall in external demand which is hampering export of a large number of commodities, the overall export growth is likely to be subdued in remaining part of FY09.

### Imports

A combination of contracting domestic demand and falling international commodity prices caused import bill to record a 9.8 percent YoY decline in July-Apr FY09. Though imports had started to record decline since Q2-FY09, a large share of the total fall was concentrated in Q3-FY09. This was due to a large fall in both price as well as quantum impact during this period. In fact the international commodity prices



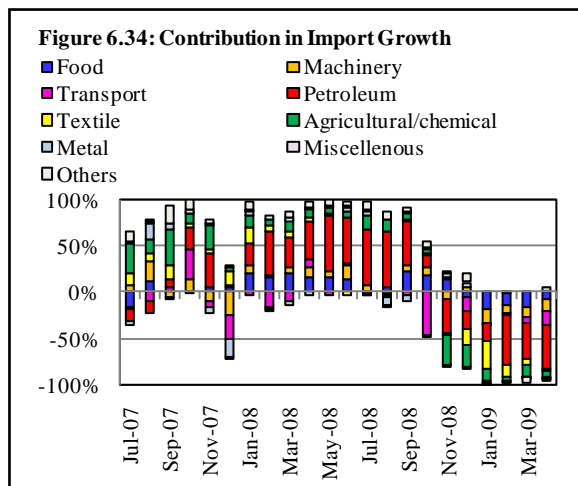
<sup>19</sup> At the time of imposition of ban by EU fish export unit was 2.31-3.31\$/kg in this market. As compared to this price exporters obtained 1.7\$/kg in Malaysia, 1.4\$/kg in Thailand, 3\$/kg in Indonesia and 3.2\$/kg in UAE in Jul-Nov FY09.

<sup>20</sup> SMEFD Circular No. 02 of 2009, SBP.

had started to soften since the start of FY09, however, their lagged translation in overall YoY fall in import price impact started from December 2008 (see **Figure 6.33**).

As regards, the YoY fall in import quantum, this has resulted from import demand compression of a large number of categories during July-Apr FY09. This can be attributed to: 1) – conscious policy efforts – tight monetary policy by SBP until the recent easing announced in April 2009 and increase in import duties and sales tax on luxury goods ; 2) – some sector specific matters as financial crunch faced to the POL sector that reduced its capability to import and improved domestic availability of cotton that reduced its import needs; 3) – a large depreciation in the value of rupee that increased the rupee cost of imports and 4) – a general economic slowdown in the country.

In terms of categories, the fall recorded in imports was broad based and with the exception of wheat, petroleum products and power generating machinery almost all major categories recorded YoY declines during July-Apr FY09. Specifically, transport and textile had the largest shares in the overall import decrease during the period under review (see **Figure 6.34 & Table 6.14**). The fall observed in the transport group during July-Apr FY09, however, also reflects the absence of a large one-off payment in the category of aircrafts, ships and boats that occurred during the same period last year.



The sharp 40.4 percent YoY fall in *fertilizer manufactured* imports during July-Apr FY09 was witnessed due to falling import quantum (see **Figure 6.35**). The import in this category contains a large share of DAP fertilizer, while urea imports also occur to complement its domestic supply whenever there are shortages. The fall in import quantum recorded during July-Apr FY09 is attributable to large

piled up domestic inventories of DAP during this period.<sup>21</sup>

**Table 6.14: Major Imports (Jul-Apr)**

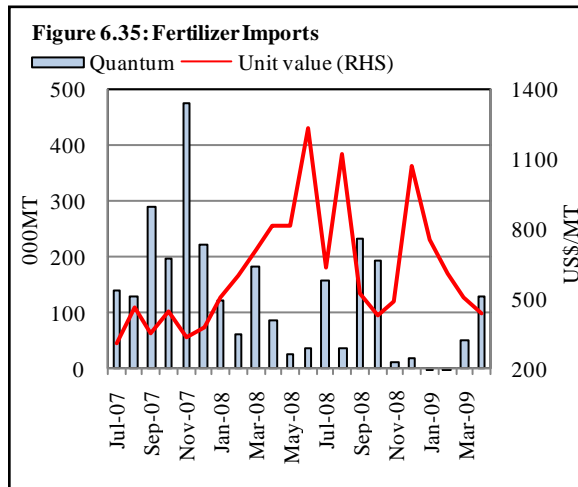
million US Dollar

		FY08		FY09(P)			% YoY Δ			
	Units	Value	Unit value	Value	Unit value	Abs .Δ value	Qty	Value	Unit value	
<b>Food group</b>		<b>3,527.4</b>		<b>3,419.6</b>		<b>-107.9</b>		<b>-3.1</b>		
of which:										
Wheat	MT	819.8	471.6	946.2	466.3	126.4	174.2	15.4	-1.1	
Palm oil	MT	1,218.9	856.5	1,125.6	819.2	-93.3	-9.5	-7.7	-4.4	
<b>Machinery group</b>		<b>5,902.1</b>		<b>5,503.9</b>		<b>-398.2</b>		<b>-6.7</b>		
of which:										
Power generating machinery		857.2		1,427.3		570.1		66.5		
Telecom		1,897.4		857.1		-1,040.3		-54.8		
<b>Transport group</b>		<b>1,958.3</b>		<b>1,044.7</b>		<b>-913.6</b>		<b>-46.7</b>		
of which:										
Road motor vehicles		1,083.1		754.6		-328.5		-30.3		
Aircrafts, ships and boats		851.0		283.0		-568.0		-66.7		
<b>Petroleum group</b>		<b>8,670.4</b>		<b>8,012.7</b>		<b>-657.6</b>		<b>-7.6</b>		
Petroleum products	MT	4,650.7	569.5	4,608.1	540.1	-42.6	0.7	-0.9	-5.2	
Petroleum crude	MT	4,019.7	572.2	3,404.6	541.2	-615.0	-8.6	-15.3	-5.4	
<b>Textile group</b>		<b>2,031.9</b>		<b>1,300.7</b>		<b>-731.1</b>		<b>-36.0</b>		
of which:										
Raw cotton	MT	1,166.6	1,430.2	477.2	1,621.6	-689.4	-63.3	-59.1	13.4	
<b>Agricultural and other chemical group</b>		<b>4,756.4</b>		<b>4,391.9</b>		<b>-364.6</b>		<b>-7.7</b>		
of which:										
Fertilizer manufactured	MT	823.9	425.7	491.2	494.5	-332.6	-61.1	-40.4	16.2	
Other chemicals		2,356.3		2,429.4		73.1		3.1		
<b>Metal group</b>		<b>2,167.1</b>		<b>2,169.7</b>		<b>2.6</b>		<b>0.1</b>		
of which:										
Iron and steel scrap	MT	524.0	280.9	515.4	307.9	-8.6	-24.3	-1.7	9.6	
<b>Miscellaneous group</b>		<b>607.5</b>		<b>542.2</b>		<b>-65.2</b>		<b>-10.7</b>		
<b>All other items</b>		<b>2,438.3</b>		<b>2,536.9</b>		<b>98.6</b>		<b>4.0</b>		
<b>Total imports</b>		<b>32,059.4</b>		<b>28,922.4</b>		<b>-3,137.0</b>		<b>-9.8</b>		

<sup>21</sup> During FY08 a large quantum of DAP fertilizer was imported in the wake of closure of the single DAP manufacturing plant in the country for BMR purposes. This, however, resulted in the piling up of huge domestic inventories, since as a result of a sharp increase in international DAP prices its domestic off take remained very low. Whereas, the government also did not implement its decision of providing Rs.1000/bag subsidy as announced in FY09 budget. The huge inventories have eliminated the need of further DAP imports during July-Apr FY09.

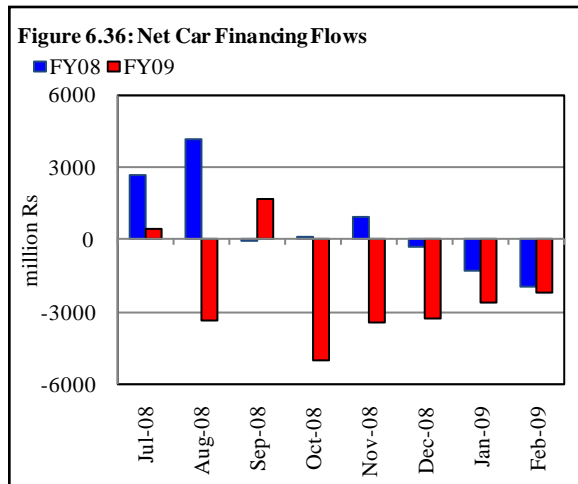
The off take of DAP fertilizer, however, has picked up in Q3-FY09<sup>22</sup>, which will lead to depletion of inventories. Hence, the need for further import is likely to arise for the sowing season in the next rabi crop. Further, government has also started the import of Urea during July-Apr FY09. This is because of its inadequate domestic production during this period, which is not sufficient to fulfill domestic demand.

<sup>23</sup> According to National Fertilizer Development Centre (NFDC) outlook for Kharif 2009, around 500 thousand tonnes of urea is likely to be imported during Q4-FY09 to avoid domestic shortage of this nutrient.



The 30.3 percent YoY fall in the import of *road motor vehicles* mainly reflects slowdown in demand on account of falling real purchasing power, rising domestic automobiles prices and higher costs of borrowing for car financing. Consumer financing for automobiles plunged during July-Mar FY09 as compared to the same period last year (see **Figure 6.36**).

Retrenchment in auto financing by commercial banks was witnessed due to large number of non-performing loans, besides, high interest rate and falling real incomes also played a pivotal role in curtailing the demand for consumer loans. <sup>24</sup> As regards falling automobiles demand, according to the latest PAMA release, auto sales (car,



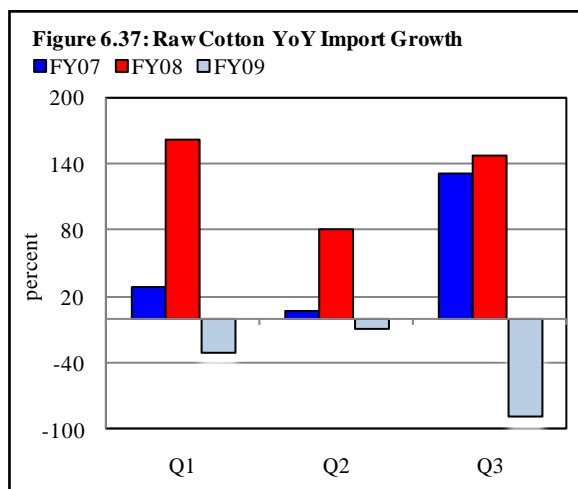
<sup>22</sup> DAP offtake recorded a sharp 104 percent YoY rise during Q3-FY09.

<sup>23</sup> NFDC, Fertilizer Situation: Mid April 2009, Rabi 2008-09 and Outlook for Kharif 2009.

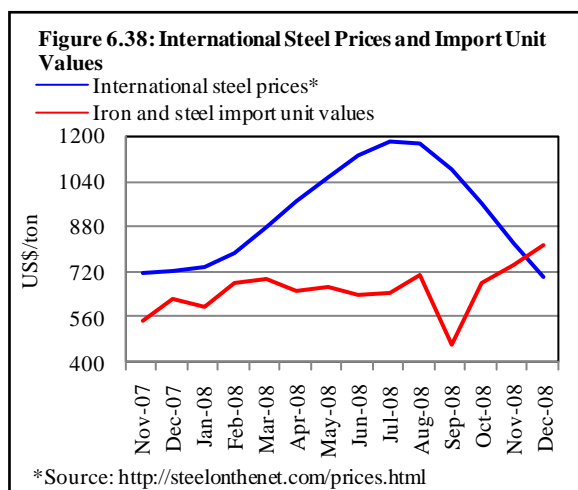
<sup>24</sup> PAMA.

LCV & pickup) during July-Mar FY09 plunged by 46 percent YoY.<sup>25</sup> In terms of import categories CBU units recorded a steeper fall during July-Mar FY09 as compared to the same period last year.

**Raw Cotton** imports declined steeply by 59.1 percent YoY during July-Mar FY09 with a greater share of the fall observed during Q3-FY09 (see **Fig 6.37**). The decline in raw cotton imports is attributable to better domestic cotton crop during 2008.<sup>26</sup> Further falling international demand for the textile and clothing sector also partly explains falling import quantum of this category. During July-Apr FY09 export of a large number of textile categories recorded quantum declines which might have resulted in lower demand for raw cotton during this period.



Import of **iron and steel** recorded a small YoY increase during July-Apr FY09. This was solely on account of rising import unit values, as in terms of quantum, this category recorded a large 13.2 percent YoY decline. The demand for steel has dropped sharply in the country; as the major consuming sectors i.e., infrastructure, housing, construction and automobiles failed to record an impressive performance. Along with the



<sup>25</sup> Car sales plunged by 49 percent YoY, and LCV pickup segment declined 22 percent YoY during July-Mar FY09.

<sup>26</sup> During FY09 cotton production recorded 3.5 percent YoY rise reaching 14.1 million bales during this period.

dull performance of industries, the row between Customs and steel importers over reduction in ITP (import trade price) of steel products also partly contributed to falling import quantum of this category. According to importers, the international steel prices are on a decline since September 2008; however, this decline was not being translated into reduction in ITP by customs authorities (see **Figure 6.38**). Customs authorities, however, announced a reduction in ITP of various steel products in March 2009, which might lead to some revival in import of this category going forward.

In overall terms **petroleum group** recorded 7.6 percent YoY fall during July-Apr FY09 due to falling petroleum crude imports (see **Table 6.14**). Detailed analysis of the data reveals that a sharp expected YoY fall in petroleum group import unit

**Table 6.15: Petroleum Group Imports - Quantum and Price Impact**

million US Dollar

	FY08				FY09		
	Q1	Q2	Q3	Q4	Q1	Q2	Jan-Apr
<b>Quantum impact</b>							
<b>Petroleum group</b>	<b>-43.4</b>	<b>180.4</b>	<b>558.2</b>	<b>195.7</b>	<b>201.6</b>	<b>-361.4</b>	<b>-236.6</b>
Petroleum products	-136.9	344.2	337.9	236.2	145.8	-201.3	106.3
Petroleum crude	93.4	-163.8	220.3	-40.5	55.9	-160.1	-343.0
<b>Price impact</b>							
<b>Petroleum group</b>	<b>-20.9</b>	<b>380</b>	<b>1,084.80</b>	<b>1,788.30</b>	<b>1,654.80</b>	<b>141.7</b>	<b>-2,085.5</b>
Petroleum products	20.9	201.3	536.5	967.4	836.9	165.7	-1,123.9
Petroleum crude	-41.8	178.7	548.3	820.9	817.9	-24.1	-961.7

values during Q3-FY09 was largely responsible for curtailing import bill during July-Apr FY09 (see **Table 6.15**). In addition, falling quantum of petroleum crude also partly contributed in the YoY fall observed in this category during the period under review. This was due to the financial crunch faced by refineries and OMCs, especially during H1-FY09 that disrupted PoL group imports during this period. The situation has improved from the last few months and petroleum products imports recorded 2.9 percent YoY rise during Q3-FY09.

Due to lower crude imports, refineries were working at lower capacity utilization rates during July-Apr FY09, which resulted in reduced production of major POL products namely HSD, furnace oil and motor spirit on a YoY basis during this



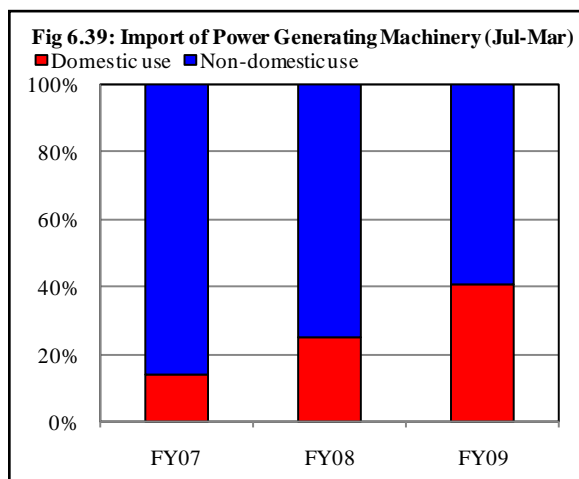
period. This fact created domestic shortages of these products, necessitating a YoY increase in their import during July-Apr FY09.<sup>27</sup>

Going forward there are certain upward pressures on the import quantum of petroleum products. Import of motor spirit is likely to rise as its domestic demand is soaring due to narrowing of the price gap between CNG and petrol. Further, the intensifying energy crisis in major parts of the country has resulted in an increased use of generators, which has created additional demand for motor spirit and diesel in the country.

The demand for furnace oil is also likely to increase from the power generating sector.<sup>28</sup> OCAC (Oil Companies Advisory Committee) in its recent annual report projected an average increase of 7 percent in demand for Furnace oil during the next five years. Looking at the sharp erosion in furnace oil price, declining gas supplies to power sector and commissioning of new power plants, FO is likely to remain a priority product for power generation in the coming period. To meet the shortage, imports of petroleum product is likely to continue. In the short term, however, a part of the rising quantum impact in this group is likely to be offset by falling price impact due to the falling international oil prices.

**Power Generating Machinery** imports grew at a rapid pace, recording 66.5 percent YoY rise during July-Apr FY09 as compared to the same period last year. The domestic power generation sector has so far failed to meet the country's energy needs. Shortage of energy and immense power generation crises are primary factors of the soaring power generating machinery imports figure.

The shortfall of electricity has increased the demand for generators, turbines, batteries and UPS units. Pakistan is



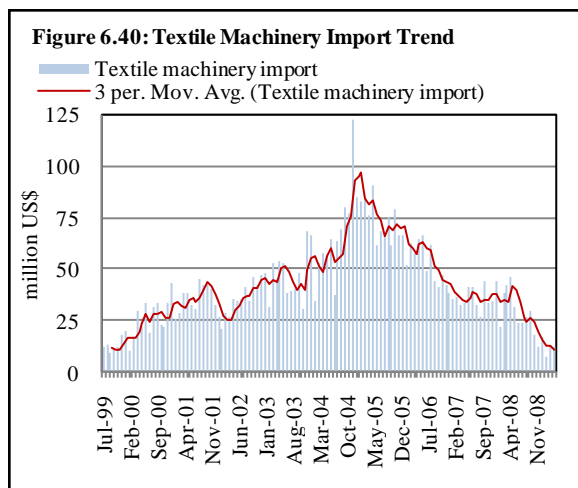
<sup>27</sup> During July-Mar FY09 domestic production of motor spirit, furnace oil and HSD recorded 3.1, 5.1 and 8.8 percent YoY decline.

<sup>28</sup> OCAC 2008 Oil report.

importing this machinery from China, USA and EU. This demand is originating from the household sector, IPPs, industries, office buildings, hospitals, etc. According to the SBP trade data the demand for generators from the household sector is increasing since the last few years (see **Figure 6.39**).

However, according to the power generating machinery importers, the recent recession in the domestic economic activity has curbed power generating machinery demand from the industrial sector during July-Apr FY09 resulting into piling up of inventories with them in this period. These importers had placed large orders for import of this machinery in anticipation of the continuation of the growth trend witnessed in this sector in the past few years. This fact points towards the possibility of a slowdown in power generating machinery imports going forward.

**Textile Machinery** imports continued the falling trend witnessed during the last few years and recorded a sharp 49.0 percent YoY fall during Jul-Apr FY09 (see **Figure 6.40**). In fact textile machinery recorded a sharp increase in period between FY02-FY05 under the the BMR programme. Since then country's import of textile machinery are recording almost a continuous decline, which represents reduced demand for further modernization in this sector. Having said this, the sharp fall during July-Apr FY09 also represents the the impact of current global recession that has depressed textile products demand from country's major export markets.



**Telecom machinery** imports recorded a sharp 54.8 percent YoY fall during July-Apr FY09. In terms of individual categories this head had the highest (33.2 percent) share in the total YoY fall observed in import bill during July-Apr FY09. This fall was contributed by both falling cell phones and telecommunication machinery imports. This might be attributable to saturation in the market,

declining purchasing power, as well as higher custom and regulatory duties on mobile sets.<sup>29</sup>

**Wheat** imports recorded a large 15.4 percent YoY rise during July-Apr FY09. In terms of monthly analysis, this rise was concentrated during Jul-Nov FY09. The government had decided to import 2.5 million tones wheat during FY09. However, the news of better crop during 2009 eliminated the need of import of such large quantity of wheat, leading to withering wheat imports during Q3-FY09.

In overall terms in the remaining months of FY09 overall imports are likely to contract further; 1) – due to a more strong negative price impact; and 2) – absence of strong demand from most of the sectors. Hence imports are expected to record a sharp YoY decline during FY09.

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<sup>29</sup> In the FY08 budget the Federal Government imposed Rs 500 duty per set and later imposed Rs 250 regulatory duty in August 2008.