5 External Sector

5.1 Overview

The current account showed a *surplus* of US$ 0.34 billion in Q1-FY13, from a *deficit* of US$ 1.36 billion in the corresponding quarter of FY12 (**Table 5.1**). While the steady growth in workers' remittances and a gradual contraction in the trade deficit supported the external account during the Q1-FY13, the inflow of US$ 1.12 billion under Coalition Support Fund (CSF) in August 2012, proved to be the swing factor. Excluding this, the current account would have posted a deficit of US $ 774 million in Q1-FY13.

According to SBP data, the *trade deficit* fell during the quarter due to a greater decline in imports compared to exports. The contraction in imports is driven by both lower prices and lower quantums. While declining global prices of palm oil, raw cotton and crude oil helped in containing imports, greater domestic availability of urea led to a lower import quantum. However, the import of machinery and the quantum of petroleum imports have gained pace during the quarter.

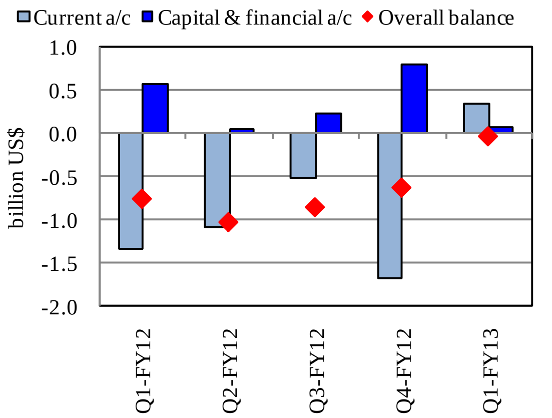
Table 5.1: Summary of External Accounts (Jul-Sep)

billion US dollar

	FY12	FY13
Current account balance	**-1.4**	**0.3**
(i) Trade balance	-4.2	-3.7
Exports	6.1	6.0
Imports	10.3	9.7
(ii) Services account balance	-0.7	0.2
CSF inflow	0.0	1.1
(iii) Income account balance	-0.6	-0.7
(iv) Current transfers	4.3	4.5
Remittances	3.3	3.6
Financial & capital balance	**0.6**	**0.1**
(i) FDI	0.3	0.1
(ii) FPI	-0.04	0.1
(iii) Others	0.4	-0.2
Errors & omissions	0.0	-0.4
Overall balance	**-0.8**	**-0.02**
Foreign liquid reserves (30th Sep)	17.3	14.9
Exchange rate (30th Sep)	87.4	94.8

Source: State Bank of Pakistan

Figure 5.1: External Account



Source: State Bank of Pakistan

The *capital & financial* account, on the other hand, deteriorated due to the persistent decline in fresh loans. Nonetheless, the surplus in the current account helped contain the overall external deficit to just US$ 28.0 million during Q1-FY13 – the lowest quarterly deficit in five quarters - compared to a deficit of US$ 759 million in Q1-FY12 (**Figure 5.1**).

Table 5.2: Inflows under CSF

million US$	
FY07	1,242
FY08	655
FY09	912
FY10	1,294
FY11	743
FY12	--
Q1-FY13	1,118

Source: State Bank of Pakistan

Consequently, the Rupee-US Dollar parity remained fairly stable during Q1-FY13. Specifically, the Rupee weakened by just 0.25 percent against the US Dollar during Q1-FY13 compared to a 1.7 percent depreciation in the corresponding quarter of FY12. However, the central bank's liquid foreign exchange reserves fell by US$ 445 million during the first quarter to reach US$ 10.4 billion by end-September 2012, which was mainly due to the payment of an IMF loan installment.[1]

5.2 Current Account

The following developments led to a turnaround in the current account:

1. *Inflow under CSF:* As mentioned earlier, Pakistan received US$ 1.12 billion as part of the CSF.[2] The country had been receiving, on average, one billion US Dollars annually (**Table 5.2**), but FY12 was an exception, since there was no such inflow.

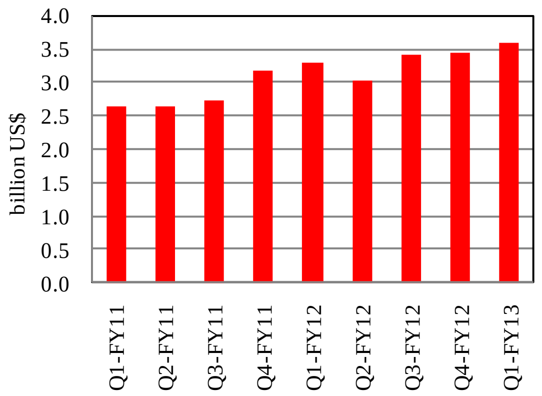
2. *Contraction in the trade deficit:* The trade deficit fell to US$ 3.7 billion during Q1-FY13, compared to US$ 4.2 billion in the corresponding quarter last year (for a detailed analysis, see the section on the **trade account**).

[1] Since IMF loans are meant to strengthen a country's reserve position, they are the liability of the central bank and do not have any bearing for the financial account (such loans are treated as below-the-line transactions). Hence, the repayment of such loans impacts only the reserve position of the central bank (i.e., they do not impact the financial account). In contrast, all other loans are liability of the government (i.e., they are treated above-the-line), and their repayment affects the financial account of the country.

[2] CSF receipt is a reimbursement for expenses that Pakistan has incurred while providing logistic support to Coalition forces in the war in Afghanistan.

3. *Steady growth in remittances:* Workers' remittances continued to grow strongly despite the uncertain outlook for the global economy (**Figure 5.2**). The inflow of US$ 3.6 billion in Q1-FY13 surpassed US$ 3.3 billion realized in the corresponding period last year. Monthly inflows remained more than US$ 1 billion throughout the quarter, and August 2012 saw a record inflow of US$ 1.3 billion. A country-wise breakdown suggests that inflows from Saudi Arabia were the largest contributor, followed by inflows from the UAE and the USA.

Figure 5.2: Quarterly Remittances

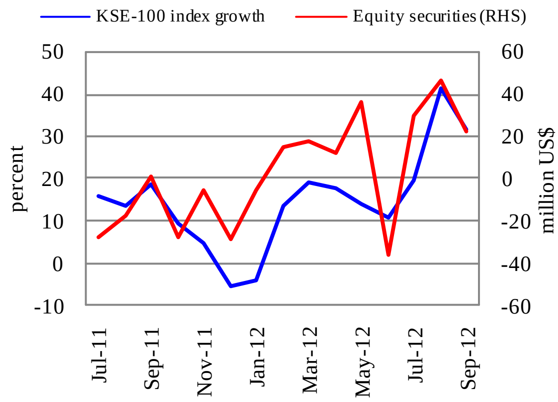


Source: State Bank of Pakistan

5.3 Capital & Financial Account

Pressure on the capital and financial accounts continued in Q1-FY13: the surplus receded to only US$ 74 million from US$ 633 million in Q1-FY12. Major inflows (net foreign direct investment and loans) fell sharply during the period under review. In particular, the outflows from the telecom sector more than offset the net inflows in the oil & gas exploration sector.[3]

Figure 5.3: Foreign Investment in Equity Securities



Source: State Bank of Pakistan

Declining fresh foreign loans are also pressuring the financial account. With a decrease in the volume of new loans,[4] and almost no change in amortization, long term loans also recorded net

[3] The overall FDI inflows fell to US$ 123 million in Q1-FY13 from to US$ 263 million in the corresponding period last year.
[4] Disbursement of fresh loans declined from US$ 455.0 million in Q1-FY12 to US$ 365.0 million in Q1-FY13.

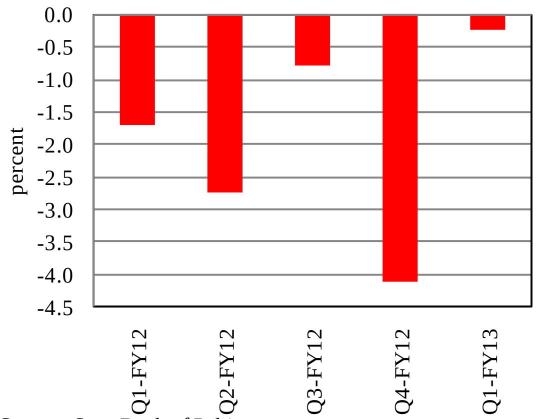
outflow of US$ 27 million in Q1-FY13, compared to *inflow* of US$ 28 million in the corresponding period last year.

Foreign investment in Pakistan's stock markets, however, experienced a major change with an *inflow* of US$ 96 million in Q1-FY13, which is in contrast to an *outflow* of US$ 45 million in Q1-FY12. This shift reflects the improved performance of the KSE-100 index during the quarter (**Figure 5.3**).

Foreign Exchange Reserves & Exchange Rate

Despite an improvement in the overall external account, Pakistan's liquid foreign exchange reserves had fallen to US$ 14.9 billion by 30th September 2012, from US$ 15.29 billion at end-June FY12. The decline in SBP's FX reserves was because of higher debt servicing payments to the IMF. Foreign exchange reserves of the scheduled banks, however, remained unchanged at US$ 4.5 billion.

Figure 5.4: Rupee Depreciation against US$



Source: State Bank of Pakistan

With the improvement in the country's overall balance, and the weakening US Dollar against major global currencies,[5] the Rupee-Dollar parity remained more stable during Q1-FY13, compared to the corresponding quarter of last year (**Figure 5.4**).[6]

Nevertheless, the nominal effective exchange rate (NEER) suggests that the Rupee depreciated by 2.1 percent against a representative basket of currencies during Q1-FY13.[7] However, the intended competitive gains to exports were partially offset by higher domestic inflation, compared to countries included in the index. In effect, the Rupee still showed a *real* depreciation of 1.6 percent during Q1-FY13, compared to a real appreciation of 2.8 percent in the corresponding quarter last year.

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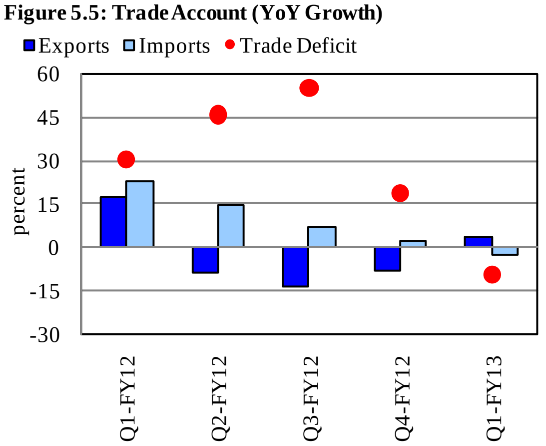
[5] The US dollar depreciated by 2.3, 3.7 and 2.3 percent against Euro, GBP and Yen respectively by the end of Q1-FY13.
[6] The Rupee traded within the range of Rs 94.0-95.0 against the US Dollar during Q1-FY13.
[7] NEER is a broader index for tracing performance of the Rupee against a basket of currencies of Pakistan's major trading partner and competitors.

5.4 Trade Account[8]

The country's trade deficit eased considerably during Q1-FY13 (**Figure 5.5**).[9] Both, a decline in imports, and a rise in exports, contributed to this improvement. Specifically, imports fell by US$ 264.4 million, whereas exports rose by US$ 225.2 million.

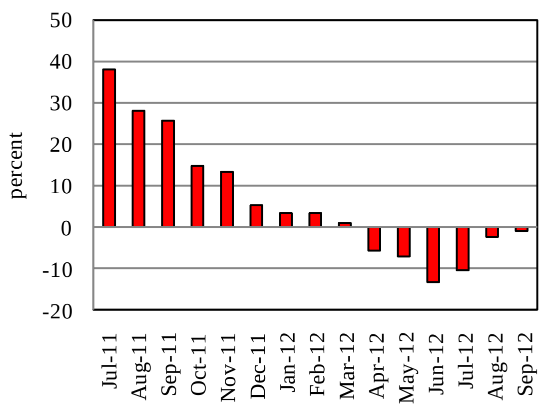
Figure 5.5: Trade Account (YoY Growth)



Source: Pakistan Bureau of Statistics

Except for machinery and petroleum groups, imports of all other major groups recorded a fall. While the greater availability of urea in the domestic market (due to the last year's imports) explains decline in import quantity this year, it was lower global commodity prices during Q1-FY13 that led to a greater contraction in the import bill (**Figure 5.6**).

Figure 5.6: Global Commodity Prices (YoY change)



Source: IMF

However, these prices have been inching up in recent months. Having said this, it will be the trend in oil prices, which would determine the outcome of the trade deficit in FY13.[10]

[8]The analysis is based on provisional data provided by the Pakistan Bureau of Statistics, which is subject to revisions. This data may not tally with the exchange record numbers posted in the section of *Balance of Payments.* While BoP data indicates a marginal YoY contraction in exports during Q1-FY13, the PBS data shows a growth of 3.9 percent over the same period.

[9] Trade deficit saw a *contraction* of 9.6 percent in Q1-FY13 compared to an *expansion* of 30.5 percent in Q1-FY12.

[10] POL imports account for around 35 percent of the total import bill.

Exports, on the other hand, managed to post a nominal growth of 3.8 percent – sharply lower than the 17.4 percent growth in Q1-FY12. Even this moderate growth can be traced to a sharp increase of US$ 562.9 million in jewelry exports during Q1-FY13.[11] Excluding this one-off item, export revenues are much lower than last year. Textile exports, on the other hand, are recovering, but the focus remains low-value added items.

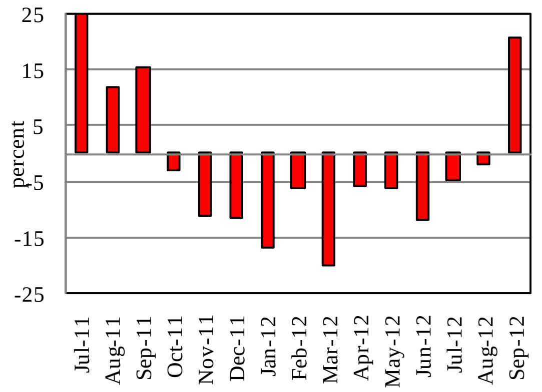
5.4.1 Exports

Exports grew by 3.8 percent during the first quarter of FY13. This increase was driven mainly by a sharp YoY rise of 20.8 percent in September 2012 (**Figure 5.7**), almost entirely on account of jewelry exports. Excluding this, Q1-FY13 exports actually fell by 5.8 percent on YoY basis (**Figure 5.8**).

Within non-textiles, items such as gloves, electrical machinery, and cement recorded higher YoY growth during Q1-FY13 (**Table 5.3**).

Cement exports continued to rise for the fourth consecutive quarter. This is in contrast to the first half of FY12, when duties on the import of cement by Afghanistan, and enhanced production capacity in Saudi Arabia, had suppressed cement exports from Pakistan. However, exports to India through land routes have increased in recent quarters, and have led the rise in overall cement exports.

Figure 5.7: Trend in Exports (YoY Growth)



Source: Pakistan Bureau of Statistics

Figure 5.8: Jewelry Exports and International Gold Prices

Source: indexmundi.com; and Pakistan Bureau of Statistics

[11] Discussion with the jewelry exporters reveled that this rise reflects the off-loading of gold stocks by local investors, to gain from relatively higher prices during September 2012.

Wheat exports declined to US$ 29.3 million during the first quarter of FY13, compared to US$ 93.6 million last year. This trend may change in the coming months as the global demand-supply gap has widened due to adverse weather conditions in Russia and Kazakhstan.[12] Hence, a sufficient carryover stock in Pakistan offers an opportunity to export more wheat in FY13. However, this will depend on the size of the forthcoming domestic harvest.[13]

Table 5.3: Non-Textile Exports (Jul-Sep)

	Value in million US$		YoY Growth (%)	
	FY12	**FY13**	**FY12**	**FY13**
Food	**993.4**	**906.9**	**38.5**	**-8.7**
Rice	422.0	316.9	-10.9	-24.9
Fish	59.1	63.4	12.1	7.3
Fruits	64.4	63.8	41.3	-1.0
Meat & preparation	46.5	59.0	30.0	27.0
Wheat	93.6	29.2	-	-68.8
Other Manufacture	**1,140.1**	**1,643.0**	**19.5**	**44.1**
Jewelry	167.3	730.1	26.3	336.5
Cement	112.0	146.5	-4.6	30.8
Leather	163.4	141.8	5.2	-13.2
Plastic material	111.3	101.3	75.2	-9.0
Sports Goods	76.5	75.8	1.4	-0.9
Medical Inst.	74.3	72.8	25.5	-2.0
Total Exports	**5,939.1**	**6,764.4**	**17.4**	**3.8**
Non-textile	**2,761.2**	**2,906.9**	**27.5**	**5.3**
excl. Jewelry	**2,593.9**	**2,176.8**	**27.6**	**-16.1**

Source: Pakistan Bureau of Statistics

Rice exports also saw a decline during Q1-FY13: both *basmati* and *irri* rice fell by 34.4 and 11.5 percent (on YoY basis) respectively. More importantly, lower export can be traced to a fall in quantum, as international prices remained higher in Q1-FY13, compared to the same period last year. Indeed, Pakistan's rice exports have been unable to recover after being priced out of the Iranian market.[14]

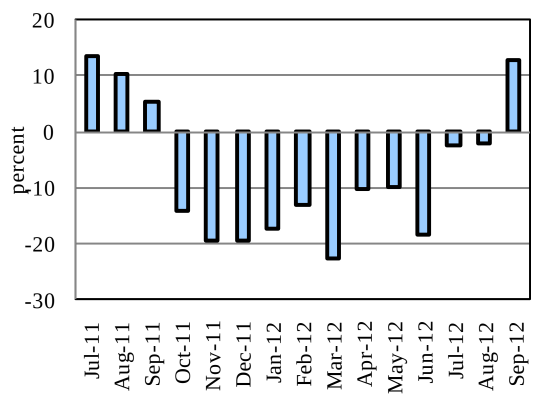
Exports of ***meat & meat preparation*** continued to grow and recorded a YoY rise of 27.0 percent during Q1-FY13 on top of the 30.0 percent increase during the same period last year. The steady increase in such exports is on account of higher demand from the Middle East, which was supported by better quality standards observed by Pakistani exporters.

[12] Russia and Kazakhstan contribute around 12 percent of the world wheat production.
[13] The outlook for the FY13 wheat crop is positive in view of an increase in wheat support price, better availability of water, higher fertilizer off-take, and favorable temperatures (see **Chapter2)**.
[14] India and Vietnam are offering lower prices compared to Pakistan.

Textile group

Textile exports grew by 2.5 percent during Q1-FY13 – still considerably lower than the 9.9 percent growth, which was witnessed in the corresponding quarter of FY12. However, monthly data indicates that these exports have finally shown a positive growth in September 2012 after falling continuously for almost a year (**Figure 5.9**).

Figure 5.9: Textile Exports (YoY Growth)



Source: Pakistan Bureau of Statistics

The growth in exports of low value added items steered this gradual recovery. In cotton yarn, the higher quantum pushed exports,[15] while in cotton fabrics, a rise in unit values led to higher export revenues (**Table 5.4**).

Table 5.4: Major Textile Exports Price & Quantum Impact (Jul-Sep)

million US$

	FY12			FY13		
	Absolute change	**Qty**	**Price**	**Absolute change**	**Qty**	**Price**
Textile Group	**285.9**			**79.5**		
Raw cotton	47.4	44.0	3.3	-29.4	-23.5	-5.9
Cotton yarn	9.8	-11.8	21.6	154.3	227.6	-73.3
Cotton fabrics	105.7	33.9	71.8	25.4	-39.8	65.1
Knitwear	62.8	-49.2	112.0	-58.8	-55.5	-3.3
Bed wear	27.5	-53.7	81.2	-77.8	-45.1	-32.7
Towels	8.3	-26.3	34.7	11.1	31.7	-20.7
Readymade garments	23.9	-80.8	104.7	32.2	50.2	-18.0

Source: Pakistan Bureau of Statistics

The export of high-value added items, on the other hand, fell during Q1-FY13. The decline was due to lower volumes and lower prices for knitwear and bed-wear. However, this was somewhat offset by an increase in the exports of readymade garments and towels.

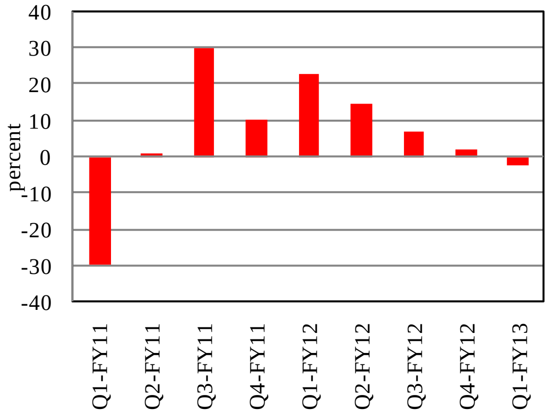
[15] While the global demand for cotton yarn is on the rise, the production capacity in Pakistan also saw some improvement last year when the textile industry imported more efficient machinery that wastes lesser cotton in the spinning process.

The outlook for textiles is positive due to the opening of duty-free access to EU markets from January 2013. Pakistan has a price advantage over its competitors (mainly India and Bangladesh) in 19 of the total 75 categories eligible for preferential treatment.[16]

5.4.2 Imports

Imports fell for the first time (on a YoY basis) in the past two years (**Figure 5.10**). More importantly, the decline is quite broad-based. With the exception of machinery and petroleum, imports in all other groups have declined. As shown in **Figure 5.11**, the fall in imports was due to lower prices as well as lower quantities.

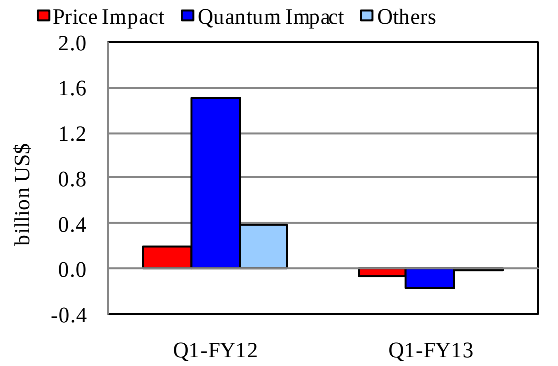
Figure 5.10: Import Growth (YoY)



Source: Pakistan Bureau of Statistics

The lower import quantum this quarter, can be traced to the decline in fertilizer imports. Domestic availability of urea was better, due to higher imports in FY12.[17] A steep fall in palm oil prices also helped contain the import bill during the quarter. In addition, lower imports under *aircrafts, ships and boats, synthetic fibre and artificial silk yarn*, and *plastic material* reduced the country's import bill for Q1-FY13.

Figure 5.11: Composition of Changes in Imports



Others refer to the items where quatities are not available.
Source: Pakistan Bureau of Statistics

Import of petroleum products, on the other hand, rose by 4.6 percent (YoY basis) in Q1-FY13 – but this was sharply lower than the 62.6 percent increase in the Q1-

[16] Some of these categories include woven cotton fibres, jackets & vests of wool, ladies' denim trousers, floor & dish clothes, curtains etc.

[17] Since Pakistan imported 2.6 million tons of fertilizer during FY12 – more than twice the 1.2 million tons in FY11 – the domestic stock position, particularly of urea, was comfortable during Q1-FY13.

FY12. Undoubtedly, the easing in international oil prices helped restrict the country's spending on imported oil.

Table 5.5: Import Performance (Jul-Sep)

percent

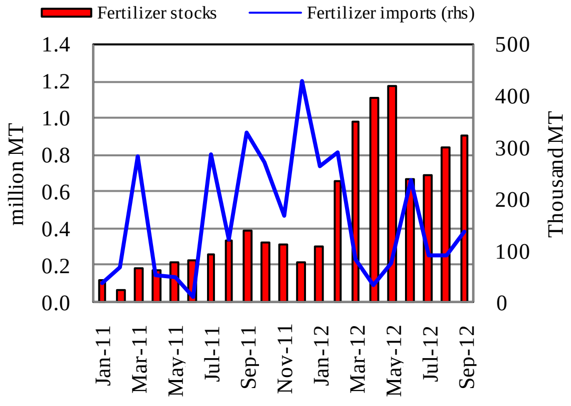
	YoY Growth		Contribution in Growth	
	FY12	**FY13**	**FY12**	**FY13**
Food	7.2	-6.2	4.0	29.3
Machinery	-12.9	13.3	-8.5	-60.4
Transport	5.2	-2.5	1.2	4.7
Petroleum	62.6	4.6	70.6	-66.1
Textiles	-0.9	-13.6	-0.3	31.7
Chemical	24.0	-18.9	17.3	133.1
Metal Group	6.3	0.4	1.9	-1.0
Miscellaneous	24.5	-17.7	2.2	15.7
Total Imports	23.1	-2.4	100.0	100.0

Source: Pakistan Bureau of Statistics

Food group imports declined by 6.2 percent YoY during Q1-FY13, with the largest fall recorded in sugar. Lower imports of tea, spices and palm oil were also recorded, due to falling international prices.[18]

Fertilizer imports fell by 40.3 percent during Q1-FY13 compared to a rise of 33.8 percent during the corresponding period last year. A fall of 45.5 percent (on YoY basis) in import quantum during the quarter more than offset the 10.9 percent rise in import unit vales (**Figure 5.12**).

Figure 5.12: Fertilizer Stocks and Imports



Source: Pakistan Bureau of Statistics

Encouragingly, *machinery* imports posted a rise of 13.3 percent during Q1-FY13, in contrast to a decline of 12.9 percent during Q1-FY12. Category-wise data reveals that imports of power generation, textiles, construction, and telecom machinery increased, whereas imports of office and agricultural machinery fell.

[18] Palm oil prices fell by 10.4 percent during Q1-Y13 in the international market.