2 Real Sector

2.1 Overview

Preliminary information on commodity producing sectors suggests that the economic growth is picking up modestly. An expected healthy wheat crop will partially compensate for the adverse impact of *kharif* crops (particularly cotton and rice), but the performance of livestock and minor crops would be more critical in determining growth in the agriculture sector. Similarly within services, indicators relating to transport and telecommunications sectors have particularly done well during the first half. However, performance of *wholesale and retail trade* may suffer a setback from weak showing by *kharif* crops. Encouragingly, large scale manufacturing has performed better during H1-FY16 than the last year due to improvement in energy availability, continued decline in global prices of raw materials, robust construction activities, higher PSDP spending and the launch of *Apna Rozgar* scheme.

2.2 Agriculture

While the estimates on overall performance of the agriculture sector will be available with the release of National Income Accounts later this year, the available information on crop sector (which is 25.6 percent of agriculture) does not portray a very encouraging picture. Preliminary estimates suggest that all kharif crops have missed their respective targets; cotton and rice did not achieve last year's production level.[1] In particular, the recent reports of severe pest attacks on cotton means the output would be lower than the last estimate of 10.9 million bales released by Cotton Crop Assessment Committee (CCAC) in its fourth meeting held on 14th December 2015.

On a positive note, not only did the area sown under wheat crop exceed the target, growing conditions have also remained favorable so far (e.g., supportive weather and adequate availability of inputs). Thus, barring any adverse random shock going forward, wheat crop would likely achieve the target of 26.0 million tons. This means even with best performance, wheat crop would not be able to completely offset the impact of cotton damages.

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[1] These represent estimates from Pakistan Cotton Ginners' Association; Pakistan Cotton Consultative Committee; National Fertilizer Development Centre; and the US Department of Agriculture.

Cotton

Cotton crop suffered multiple shocks this season. At first, sowing was delayed in some areas due to late harvest of FY15 wheat crop.[2] Later on, prolonged and frequent rains badly hit the standing cotton crop.[3] Additional crop losses came from severe attack of pink bollworm. While the crop generally becomes more susceptible to pest attacks during rainy season, the risks heightened further this year as the plant was still in the early stage of growth due to sowing delays. At the same time, low prices discouraged farmers from investing in fertilizer and pesticides.[4,5] In fact, in some cases, frequent rains even washed away pesticides applied to crops.[6]

Table 2.1: Cotton Crop Estimates
million bales

	Date	Punjab	Sindh	Balochistan	Total
1st estimate	1-Sep-15	9.3	3.7	0.6	13.6
2nd estimate	18-Sep-15	9.3	3.5	0.6	13.4
3rd estimate	11-Nov-15	7.4	3.4	0.6	11.4
4th estimate	14-Dec-15	7.4	3.4	0.1	10.9

Source: Cotton Crop Assessment Committee

As reports of crop damages came to light, CCAC also revised its estimate downward, with 10.9 million bales in its latest projections released on December 14, 2015 (**Table 2.1**). Since then, there are reports of more damages due to pest attack, particularly in Punjab. It is perhaps for this reason that the US Department of Agriculture (USDA) in its

Table 2.2: Cotton Arrival at Ginning Firms
million bales

	FY14	FY15	FY16
PCGA cotton arrival[1]			
1st Feb[2]	13.1	14.4	9.6
1st May	13.4	14.9	9.9
Cotton arrival converted into 170 kg bale			
If average bale size is 165 kg	13.0	14.5	9.6
If average bale size is 160 kg	12.6	14.0	9.3
Actual cotton crop	12.8	14.0	

[1] Bale size generally varies between 155-165 kg.
[2] Around 97 percent of the crop arrives by 1st Feb each year.
Source: Cotton arrival is reported by PCGA; actual cotton crop figure is taken from Pakistan Bureau of Statistics.

[2] Source: Cotton Review, Vol. 48, No. 03, Pakistan Central Cotton Committee.
[3] Rainfall during Apr-Sep 2015 was 1,661 mm more than the volume witnessed in the corresponding period last year for 12 cotton producing stations or nearby proxy areas. The stations included were Bahawalnagar, Bahawalpur, Dera Ghazi Khan, Faisalabad, Jhang, Multan, Rahimyar Khan, Sahiwal, Toba Tek Singh, Shaheed Benazirabad, Mirpurkhas and Sukkur.
[4] According to Agriculture Policy Institute, the average cost of production of 40 kg of phutti (seed cotton) remained at Rs 2,511 for the current season. On the other hand, the price of cotton seed varied between Rs 1,800 and Rs 2,000 in the early part of the harvest season. The price recovered to Rs 2,800-3,000 per 40 kg in January 2016 when reports about crop damages transpired.
[5] Cotton prices in the domestic market have remained bearish broadly in line with the global trends. It may be noted that the international cotton prices have been facing downward pressure due to weak demand and ample stocks. According to International Cotton Advisory Committee, the weak demand for cotton reflects a slowdown in China and increasing preference for alternative polyester fiber (as it has become cheaper following the sharp fall in the price of crude oil).
[6] Reportedly, growers facing financial constraints could not apply additional pesticides.

report released on February 9th, 2016 has projected cotton crop for Pakistan at 9.2 million bales.[7]

This assessment also receives support from recent data on cotton arrival reported by Pakistan Cotton Ginners Association (PCGA). As shown in **Table 2.2**, expected cotton arrival by season end would be around 9.6 million bales of 170 kg.[8,9]

Rice

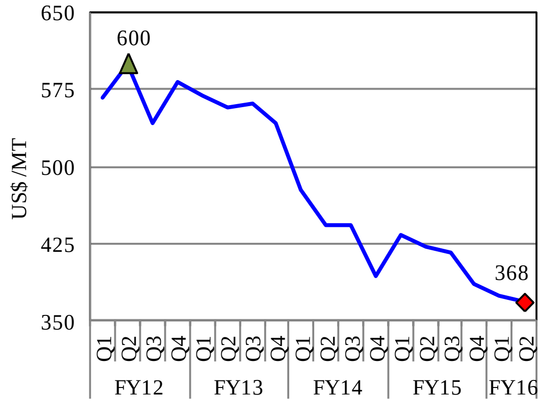
As mentioned in SBP First Quarterly Report for FY16, area under rice cultivation has declined by 4.8 percent over last year. Preliminary estimates released in October 2015 showed a lower rice crop of 6.6 million tons, against the target of 6.9 million tons and last year's level of 7.0 million tons. Though confirmed numbers are still awaited, we do not expect any major revision in this assessment. In fact, crop reporting centers of both Punjab and Sindh confirmed a decline in rice production from last year.[10,11] Rice production in Balochistan is also likely to decline this season, mainly due to a fall in area under cultivation.

Table 2.3: Rice - Domestic Availability and Consumption
million tons

	FY14	FY15
1- Production	6.8	7.0
2- After 10 percent deduction for seed, feed and wastage	6.2	6.4
3- Exports	3.7	3.9
4- Domestic availability (1-2-3)	2.5	2.5
5- Estimated domestic demand[1]	2.17	2.21
Estimated excess supply (4-5)	0.31	0.25

[1]This is based on 0.97 kg/per capita per month consumption taken from Household Integrated Economic Survey, 2011-12 by Pakistan Bureau of Statistics.

Figure 2.1: Price of Thai White Rice, 5 percent broken



Source: Haver Analytics

[7] For FY16, USDA has projected 7.2 million cotton bales of 480 pound each (which is the standard used for reporting cotton production in the US). At 170 kg for bales (which is the standard used in Pakistan), the cotton crop comes out to be 9.2 million bales.

[8] According to data released by PCGA on 15th February 2016, cotton arrival in Punjab was down by 44 percent YoY.

[9] See **Chapter 5** for the implication of weak cotton crop for imports.

[10] Crop reporting centers have reported rice production at 3.5 million tons for Punjab and 2.6 million tons for Sindh – both are down by 0.1 million tons over last year's production.

[11] Punjab and Sindh have accounted for 92 percent of total rice production, on average, over the past three years.

More importantly, growers have suffered as rice prices in the domestic market have posted a fall of 17 YoY percent during Q2-FY16. The downward pressure on prices was due to comfort in domestic rice availability from past healthy harvest (**Table 2.3**), and the continued ease in international prices (**Figure 2.1**).[12]

Sugarcane

According to recent information, sugarcane production in Sindh has recovered from its low level recorded in FY15, whereas Punjab has been able to maintain last year's production.[13] If Khyber Pakhtunkhwa also achieves its historical average, overall production would comfortably exceed FY15 output of 62.8 million tons, but would remain lower than the target of 68 million tons.

Wheat

Assuming a yield of 2,898 kg per hectare, the government has set FY16 wheat target at 26 million tons – slightly higher than 25.5 million tons wheat produced in FY15.[14] The achievement of this target was contingent on adequate availability of inputs (e.g., urea , DAP, credit and water). Wheat support price however was kept unchanged at last year's level of Rs 1,300 per 40 kg.

Wheat outlook appears encouraging so far: area under cultivation has exceeded the target (**Table 2.4**), and not only have prices of fertilizer (DAP and urea) remained soft, its off-take has also grown strongly.[15,16] Furthermore, weather conditions proved conducive: rainfall in October ensured timely sowing of wheat in rain-fed cultivation areas; and rains in second half of January provided much needed precipitation and brought down mercury levels, which bodes well for germination (**Table 2.5**).[17] Moreover, water

Table 2.4: Area Under Wheat Crop
thousand hectares

			FY16	
	FY14	**FY15**	**Target**	**Actual**
Punjab	6,778	6,910	6,677	6,937
Sindh	1,122	1,107	1,150	1,155
KPK	740	778	746	756
Balochistan	399	385	400	333
Pakistan	**9,038**	**9,179**	**8,973**	**9,181**

Source: Ministry of National Food Security & Research

[12] The local price of rice may, however, get some support from the expected increase in rice exports following the removal of international sanctions on Iran.
[13] Sindh and Punjab contribute over 90 percent of the sugarcane crop in the country.
[14] The historical maximum yield achieved in Pakistan is 2,833 kg per hectare for the 2010-11 crop.
[15] SPI data reveals that price of one bag of DAP declined by 13 percent during Jul-Feb FY16, while price of one bag of urea remained stable during the same period.
[16] DAP off-take posted an increase of 26.4 percent YoY during *rabi* season, whereas urea off-take recorded 8 percent growth.
[17] Source: Pakistan-Satellite based Crop Monitoring System, December 2015, Suparco.

availability remained adequate and credit disbursement recorded significant increase.[18]

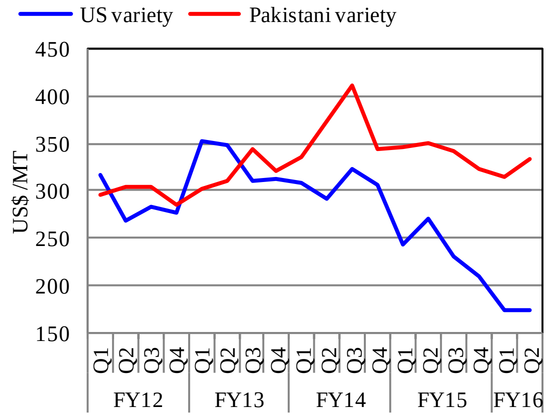
Table 2.5: Input Situation (Oct-Dec)

	FY14	FY15	FY16
Fertilizer off-take (000 MT)			
Urea	1,702	1,530	1,659
DAP	876	954	1,206
Irrigation water (MAF)	20.6	22.1	20.9
Pesticides import (million US$)	29.1	41.6	38.9
Agriculture credit (billion rupees)	88.5	121.4	149.9

Source: NFDC for fertilizer; Suparco for water availability; Pakistan Bureau of Statistics for import; State Bank of Pakistan for credit

While the likely promising wheat crop would partly offset losses from badly hit cotton crop, this would also pose some major policy challenges. For example, given that wheat stocks in the country have already reached four-year high of 7.4 million tons, this severely weakens the government's ability to procure large quantities from growers without first depleting existing reserves. The policy challenge becomes more complex as international wheat prices continue to remain lower than domestic prices, which makes export of wheat unfeasible despite the subsidy allowed by the government;[19] global wheat prices are likely to remain soft going forward due to abundant supply (**Figure 2.2**).[20]

Figure 2.2: Wheat Prices in International Market



Source: Haver Analytics and Pakistan Bureau of Statistics

2.3 Large-scale manufacturing (LSM)

The overall growth in LSM improved to 3.9 percent during H1-FY16, from 2.7 percent during the corresponding period of last year (**Table 2.6**). More encouragingly, this broad-based growth was achieved despite a decline in sugar production and closure of Pakistan Steel Mills (PSM) since July 2015.[21,22]

[18] Agriculture credit disbursement registered an increase of 23.5 percent in Q2-FY16 compared to 37.1 percent growth in the same period last year.
[19] Wheat exports remained almost nil during H1-FY16.
[20] Global wheat stocks are projected to increase by 24 million tons this year and reach a record level of 233 million tons (source: USDA Report on "Wheat: World Markets and Trade", February 2016).
[21] Given that sugarcane crop performed better in FY16 than last year, sugar production is likely to increase going forward.

Excluding sugar and PSM, large-scale manufacturing grew by 4.7 percent during H1-FY16, compared to only 2.2 percent in H1-FY15.

While the further decline in global commodity prices benefited many industries in Pakistan (e.g., food, auto, cement, and chemical), a number of policy developments also helped manufacturing sector post this improved performance (**Table 2.7**). For example, (i) increased Public Sector Development Program (PSDP) utilization (from Rs 269.4 billion in H1-FY15 to Rs 378.0 billion in H1-FY16) supported construction and allied industries; (ii) weighted average lending rate on marginal lending reached 7.3 percent in December 2015, which is the lowest level since 2005; (iii) the PKR remained relatively stable; (iv) Punjab government launched Apna Rozgar Scheme that required delivery of 50,000 vehicles during Dec 2014 to Feb 2016 to unemployed youth on soft terms;[23] and (v) improved gas availability facilitated manufacturing of fertilizer and cement.

Table 2.6: YoY Growth in LSM (Jul-Dec)

percent

		Growth rate		Contribution to growth	
	wt.	FY15	FY16	FY15	FY16
LSM	70.3	2.7	3.9		
Textile	21.0	1.2	1.0	13.4	8.0
Cotton yarn	13.0	1.4	1.8	10.8	9.2
Cotton cloth	7.2	0.0	0.7	0.1	1.6
Food	12.4	-1.9	0.1	-12.9	0.4
Sugar	3.5	-17.5	-14.2	-5.8	-4.2
Vegetable ghee	1.1	1.5	4.4	0.8	1.6
Cooking oil	2.2	-0.5	8.9	-0.7	8.5
Soft drinks	0.9	15.8	6.4	14.4	4.6
POL	5.5	5.3	6.8	12.6	11.6
Steel	5.4	31.0	-8.6	34.7	-8.6
Private	4.4	27.5	8.2	1.2	0.4
PSM	1.0	6.1	-100	0.1	-0.7
Non-metallic minerals	5.4	4.2	6.7	16.1	18.3
Cement	5.3	4.4	6.7	16.9	18.1
Automobile	4.6	13.6	32.3	24.3	44.3
Jeeps and cars	2.8	18.5	47.2	15.3	31.3
Fertilizer	4.4	-1.6	15.0	-3.6	22.9
Pharmaceutical	3.6	4.8	6.8	14.4	14.7
Paper	2.3	-2.8	-14.1	-4.5	-14.8
Chemicals	1.7	6.2	11.8	5.4	7.4
Caustic soda	0.4	-1.4	26.1	-0.2	2.8
Paints & varnishes	0.4	21.0	18.7	1.9	1.6
Leather products	0.9	16.6	1.2	10.7	0.6
Excl. sugar	66.8	3.3	4.4		
Exc. PSM	64.9	1.9	4.3		
Excl. sugar & PSM	61.4	2.2	4.7		

Source: Pakistan Bureau of Statistics

[22] The bailout package announced in FY15 had allowed PSM to increase its production by 117.3 percent in FY15. However, capacity utilization could reach only 13.4 percent in FY15. PSM, which has been struggling to operate on a sustainable basis over the past several years despite multiple bailout packages from the government, completely ceased production in July 2015 when Sui Southern Gas Company Limited (SSGCL) suspended its gas supply over non-payment of bills.

[23] It may be noted that unlike H1-FY16, the corresponding period of FY15 did not include the full impact of '*Apna Rozgar* Scheme', which was introduced by the Punjab government in December 2014. Under this scheme, the provincial government has committed to provide vehicles to unemployed youth on installments at a discount of Rs 70,000 over market price. The markup on the loans will also be paid by the government.

Going forward, we expect sugar sector to post some recovery as the crushing cycle matures. In addition, construction and allied industries would further gain from the development work on projects announced under China-Pakistan Economic Corridor (CPEC) gains more pace. The overall manufacturing sector would also benefit from a recent cut in electricity tariff by Rupees 3.0/unit, which would bring tariffs down to a single digit. Finally, a better law and order situation would help in improving investors' confidence.[24]

Table 2.7: International Commodity Prices

Commodities	US$*	Change over (percent)		
		3-months	6-months	12-months
Crude oil				
WTI (bbl)	37	-18.7	-34.9	-30.5
Brent (bbl)	37.3	-22.5	-38.2	-35
Arabian light (bbl)	31	-32.2	-48.9	-43.3
Coal (mt)	49.3	-1	-16	-22.5
Urea (mt)	240	-12.7	-23.8	-36
Gold (oz)	1,061	-6.8	-9.2	-10.2
Cotton (lb)	63	5.5	-6.1	-3.3
Copper (mt)	214	-8.4	-19.3	-24.6
Steel (lb)	391	-6.5	-17.7	-35.4
DAP (mt)	418	0	-9.7	-18.1
Rubber (kg)	114	-7.7	-25.3	-25.3
Iron (mt)	42	-19.7	-21.4	-38.4

* As of 31st December, 2015

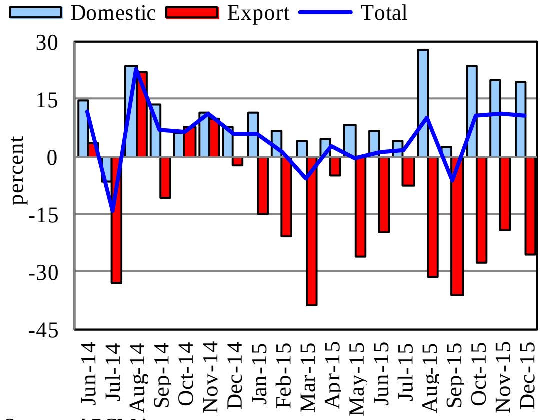
Source: Bloomberg

<u>Sectoral performance</u>

Better performance of construction allied industries

The demand for construction related products (cement, steel, paints and varnish) remained robust during H1-FY16, primarily due to increased focus of the government on PSDP projects and the development work in recently launched private sector housing schemes. While the cement and chemical industries came out as clear beneficiaries of this higher demand, the steel industry could not maximize gains from vibrant construction activities (see section on Steel).

Figure 2.3: Cement Sales Growth (YoY)



Source: APCMA

[24] Overseas Investors Chamber of Commerce and Industry's (OICCI) 11th survey of business confidence already shows significant improvement in overall business sentiment during last six months.

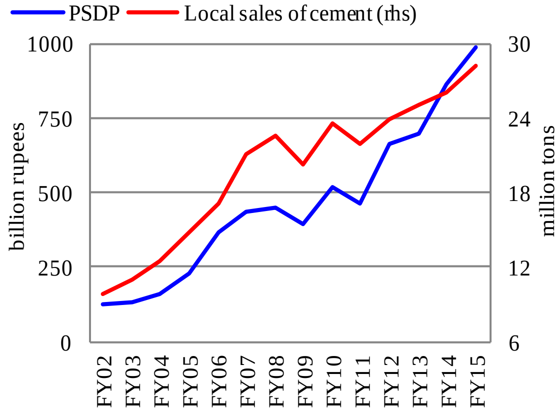
Cement

Cement manufacturers benefitted further from a steep fall in the global price of coal – a primary energy input constituting one-third of the production cost. Specifically, prices of coal from South Africa fell by 24.4 YoY percent in December 2015, which reflects slowing global economy as well as a shift away from coal-based power generation. At the same time, freight cost on import of coal also reduced in line with the softening of global oil prices. More benefits to the domestic cement industry came from lower cost of borrowing when SBP reduced its policy rate to historic low of 6 percent. The manufacturers, however, did not pass on these benefits to consumers, as the retail price for cement fell by 1 percent YoY only in December 2015.[25]

As mentioned earlier, the cement industry also gained from vibrant construction activities. The local sale of cement therefore posted an impressive growth of 16.3 YoY percent in H1-FY16, compared to 9.1 percent in H1-FY15. The cement exports, on the other hand, fell by 25.7 YoY percent during H1-FY16 (**Figure 2.3**). In particular, exports to South Africa suffered from imposition of antidumping duty and devaluation of Rand, whereas those to Afghanistan fell due to slower growth in development spending and tough competition from cheap Iranian cement.[26] Nonetheless, the sizeable increase in domestic sales more than offset the loss of export volumes. Indeed, strong local demand and improved margins[27] encouraged firms to increase their capacity utilization from 77 percent during H1-FY15 to 80 percent in H1-FY16.[28]

Encouragingly, in view of expected demand from development projects under PSDP and CPEC (**Figure 2.4**), and the ongoing housing

Figure 2.4: PSDP Utilization and Local Cement Sales



Source: APCMA, Ministry of Finance

[25] The average price of 50 kg cement fell from Rs 518.2 in December 2014, to Rs 513.4 in December 2015.

[26] Afghanistan and South Africa are the two major markets, having about 80 percent share in Pakistan's total cement exports.

[27] Gross profit margins increased by about 30 percent as evident from financials of thirteen cement companies, listed on Pakistan Stock Exchange.

[28] Source: All Pakistan Cement Manufacturers Association (APCMA).

schemes in the public and private sector, the cement industry is looking forward to expand its production capacity, from existing level of about 46 million tones to approximately 53 million tons in next two to three years.[29]

Chemicals

The chemical industry performed exceptionally well during H1-FY16, mainly due to: (i) a healthy growth in paints and varnish segment owing to robust construction activity and higher automobile production; and (ii) start of the commercial operation by a large caustic soda producing unit from June 2015. The overall growth of chemical production almost doubled to 11.8 percent during H1-FY16, from 6.2 percent during corresponding period of FY15.

Steel

Robust construction activity also created substantial demand for iron and steel products.[30] The local industry, however, could not take the full advantage from this demand surge, as the production of iron and steel recorded a *decline* of 8.6 percent during H1-FY16, compared to a remarkable growth of 31.0 percent during the corresponding period of FY15.

The availability of cheap imports from China and Ukraine hurt private producers in the domestic markets. Specifically, falling prices in the global market increased import of iron and steel by 20.1 YoY percent during H1-FY16 on top of 42 percent during H1-FY15.[31] While the import of iron and steel scrap, which witnessed an increase of about 50 YoY percent in H1-FY15, remained sluggish with a growth of only 2.7 percent during H1-FY16. Hence, the growth in iron and steel production by private manufacturers declined to 8.2 percent during H1-FY16, from 27.5 percent in the corresponding period last year. The overall production of iron and steel came under further pressure when continuing financial constraints forced PSM to close down its production in July 2015.

On a positive note, we expect some recovery going forward as the government has recently imposed anti-dumping duties for four months on imports of cold-rolled

[29] Cherat, Attock, Lucky and DG Khan Cement have all formally announced plans to enhance their annual manufacturing capacity by 1.3 million tons, 1.1 million tons, 2.6 million tons, and 2.7 million tons respectively.

[30] As per international standards, every five tons of cement used in infrastructure projects requires one ton of steel. This means, an increase in domestic sales of 2.1 million tons of cement during H1-FY16 would have created demand for additional 0.427 million tons of steel during this period.

[31] The import unit value of finished steel declined by 13 percent YoY during H1-FY16.

coils and sheets from China and Ukraine.[32] However, the closure of PSM would continue to overshadow performance of private producers.

While the demand for iron and steel would continue to grow due to a persistent surge in construction activities, there is a need to reduce the country's dependence on imported products. In Pakistan, most of the manufacturing plants are small-sized and therefore lack benefits from economies of scale. Even the technology used in production is obsolete and energy inefficient in most cases. PSM, which has the largest production capacity in the country, is using outdated technology and is far from self-reliant due to administrative and financial constraints. As a result, domestic iron and steel products struggle to compete with cheap imports from countries where manufacturers enjoy scale benefits and use advanced technology. Challenges to manufacturers are compounded further due to inconsistent policies and lack of effective control over malpractices in imports (**Topical Section on Steel**).

Auto sector continued to grow strongly

Auto sector recorded a growth of 32.3 percent during H1-FY16, compared to 13.6 percent growth in same period last year. Manufacturers gained from a decline in global steel prices, stable exchange rate, and low funding cost.[33] At the same time, sales volume remained healthy due to: (i) continuation of concessional Apna Rozgar Scheme launched by the Punjab government; (ii) continued appetite for passenger cars, with introduction of new models last year; and (iii) renewed focus of commercial banks on auto financing (**Table 2.8**).[34] Higher demand for automobiles allowed manufacturers to pass on the additional duty imposed on the import of CKDs/CBUs to end-consumers. In addition to passenger cars, demand for motorcycles and three wheelers also contributed to higher production in the auto sector.

Table 2.8: Segment-wise Sales of Automobiles (units)

	FY15		FY16		Growth in H1-FY16 over H1-FY15
Category	**Q1**	**Q2**	**Q1**	**Q2**	
Cars	27,630	31,097	44,372	45,452	53.0
Trucks	830	799	1,039	1,155	34.7
Buses	126	129	192	259	76.9
Pick-ups	3,983	4,145	10,198	11,276	164.2
Total	**32,569**	**36,170**	**55,801**	**58,142**	**65.8**

Source: PAMA

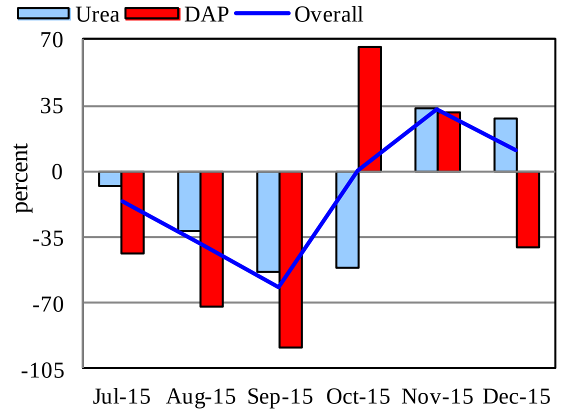
[32] These import duties, which were imposed in January 2016, vary in the range of 8.3 and 19.0 percent.
[33] International steel prices declined further by more than 17.7 percent during H1-FY16, while cost of borrowing (weighted average lending rate) declined further by 96 bps during H1-FY16.
[34] During H1-FY16, banks extended Rs 13.3 billion for auto finance, compared to Rs 7.4 billion during same period last year.

While the expected completion of Apna Rozgar Scheme in February 2016 may ease automobile sales, the overall demand would benefit from an improved availability of auto finance and the likely rise in demand for commercial vehicles (particularly trucks) following the start of infrastructure projects in the pipeline. More importantly, the industry is awaiting announcement of the auto policy.[35] This policy would bring more clarity on key issues relating to auto sector (e.g., fair competition, implementation of safety standards, import of new and used cars), and is expected to pave the way for new potential entrants from South Korea and Europe.

Despite several challenges, performance of fertilizer sector remained impressive
The overall environment remained challenging for fertilizer sector due to persistent decline in international urea prices. Global urea prices, which had already been trending downward due to supply glut, fell further during H1-FY16 in line with low oil/gas prices and expectations of subdued demand.[36] The softening of import prices weakened the sector's ability to pass on the impact of increase in gas prices to consumers.[37] The fertilizer sector therefore had to absorb most of the increase in gas prices.

Nonetheless, an improved availability of gas to fertilizer plants during H1-FY16 led to a strong growth of 15.0 percent in production, compared to a contraction of 1.6 percent during the same period last year.[38]

Figure 2.5: YoY Growth in Fertilizer Off-take



Source: National Fertilizer Development Centre

Two major factors that kept fertilizer off-take sluggish during Q1-FY16 were increase in urea and DAP prices in early September 2015, and the fact that farmers were waiting

[35] The auto policy, which was due in 2013, is still under review.
[36] The average price of urea produced by Ukraine fell from US$ 504 per metric ton in September 2011 to US$ 214 in January 2016 (source: Haver Analytics).
[37] From September 1st 2015, urea manufacturers increased their prices by Rs 160 per bag following 63 percent and 23 percent hike in feed and fuel stock prices respectively.
[38] Fertilizer sector received 150-200 mmcfd *additional* gas during HI-FY16, compared to the same period last year.

for notification on fertilizer subsidy announced in the Federal Budget for 2015-16. Implementation of Kissan Package and discounts offered by domestic companies (by absorbing increased gas prices) helped in recovery of fertilizer off-take during Q2-FY16 (**Figure 2.5**).[39]

Food sector benefited from improved economy and lower commodity prices
Overall production index of the food sector remained low during H1-FY16, mainly due to a decline in sugar production. Oil and ghee on the other hand posted a recovery; with the international price of palm oil having bottomed out, millers used their inventories of palm oil imported last year to meet increased local demand for oil and ghee. Meanwhile, cooking oil recorded growth of 8.9 percent during H1- FY16, compared to a production decline of 0.5 percent during the same period last year.

Sugar
Sugar production fell by 14.2 YoY percent during H1-FY16 on top of 17.5 percent decline recorded in H1-FY15. Cane crushing has already been started and we expect sugar production to gain momentum in coming months. The overall sugar production for FY16 is likely to increase over last year's level, largely due to improvement in sugarcane crop.[40]

Both domestic and external factors kept textile growth low
The performance of textile, the largest subsector in LSM, remained lackluster during H1-FY16 due to several factors: (i) subdued demand from importing partners (e.g., the EU and China) in view of global economic slowdown; (ii) inability of producers to adjust their products in response to change in consumer preferences; and (iii) ongoing domestic energy shortages. Resultantly, the sector was unable to benefit fully from GSP Plus status in the EU, declining cotton and energy prices, and lower cost of borrowing.

Meanwhile, following the addition of more efficient spindles by India, China and Bangladesh, it is not possible for our textile sector to compete internationally. To catch up with competitors, textile industry in Pakistan needs to invest heavily in balancing, modernization and replacement. Broadly speaking, the textile industry has to focus more on value-added items.

[39] The government notified the subsidy on 15th October, 2015.
[40] Sugarcane crop posted improvement from 62.8 million tons in FY15 to 65.4 million tons during the current season.

2.4 Services sector

While it is too early to make a robust assessment of services sector performance for the full-year, most of the indicators suggest a positive trend (**Table 2.9**). Transport and telecommunications sectors have particularly done well during the first half.

Table 2.9: Services Sector Indicators

	% share in GDP	H1 FY15	H1 FY16
Wholesale and retail trade	**18.3**		
Credit off-take (flow) billion rupees		18.5	23.2
Imports (billion US$)		24.15	22.21
LSM (YoY growth in percent)		2.7	3.9
POL sale (000 MT)[1]		9,002.9	9,293.6
Transport, storage & communication	**13.4**		
Credit off-take (flow) billion rupees		10.3	13.2
POL sales to transport sector (000 MT)[2]		4,320.7	5,137.5
Commercial vehicle production (nos.)		17,920	43,915
Commercial vehicle sales (nos.)		16,699	43,635
Of which: Bolan and Ravi		13,012	38,468
Cargo handling (million tons)		21.7	24.5
Broadband users (million nos.)		11.4	26.3
PTCL consolidated profit (billion rupees)		-4.32	-1.30
Finance and insurance	**3.1**		
Return on assets (percent)		2.2	2.5
Return on equity (percent)		24.3	25.8
Profit after tax (billion rupees)		89	100
General government services	**7.4**		
Expenses on general govt & defence (billion rupees) [3]		1,260	1,312

Sources: Pakistan Bureau of Statistics, State Bank of Pakistan, OCAC, PAMA, PTCL and KPT.
[1] This represents total domestic sales of all POL products to all sectors for the first five months of FY15 and FY16.
[2] This includes domestic sales of all POL products to the transport sector only for the first five months of FY15 and FY16.
[3] Consolidated current expenditure, excluding interest payments and grants, used as proxy for this sub-sector.

Production and sales of commercial vehicles has registered a phenomenal growth during H1-FY16, on the back of Apna Rozgar scheme launched by the Punjab government, and an uptick in overall commercial activity in the country. Other important sources of optimism over transport sector performance include: (i) a sharp increase in petrol sales; (ii) an increase in cargo handling at domestic ports; and most importantly (iii) a drastic containment of losses borne by Pakistan Railways and Pakistan International Airlines.[41] Low oil prices and stable exchange rate have indeed played an important role in improving the financial health of these public sector entities. Pakistan Railways has also gained from growing volumes of both freight as well as passenger transport.

In case of *telecommunication* sector, the role of increased usage of 3G/4G broadband services all across the country has been dominating. Financial health

[41] PIA financials show after tax loss of Rs 5.7 billion for the quarter ended September 30, 2015, compared to Rs 10.8 billion for the same period last year.

of most telecom firms has improved, benefitting primarily from data revenues.[42] Cellular firms have also partnered with leading commercial banks in the country to support the penetration of internet banking services. These firms are also actively participating in money transfer services all across Pakistan. So, effectively, telecom sector is now playing a dominant role in modernizing Pakistan's payment system infrastructure, and is also contributing to the wider objective of enhancing financial inclusion in the country for marginalized/ unbanked segments of the society.

PTCL group, the market leader, has continued to incur losses during H1-FY16; however, it has been able to reduce its losses compared to the same period last year. It is also important to highlight that losses incurred during H1-FY15 stemmed from both the PTCL company, as well as the group (which also includes its cellular subsidy, the Ufone); however, the PTCL company was able to generate profit of Rs 2.7 billion.

Finance and insurance subsector had recorded 6.1 percent growth during FY15, which was mainly driven by exceptional increase in profitability of commercial banks. These profits improved further during H1-FY16, but its pace remains significantly lower than the last year.[43] Hence, finance and insurance would remain strong in FY16, though it may not repeat the last year's performance.

General government services had registered 9.5 percent growth against the annual target of 4.3 percent for FY15. This year also, we believe the subsector would end up registering a modest growth due to the ongoing military operation in the country and the expected settlement of the Temporarily Displaced Persons (TDPs) in their areas.

Wholesale & retail trade is likely to benefit from: (i) higher LSM growth in H1-FY16 compared to the same period last year; (ii) a continuous increase in import quantums (especially non-oil) as well as a vibrant domestic demand that is likely to keep trading margins intact; and (iii) expectations of a bumper wheat crop on the back of strong yields. These factors are likely to partially offset the losses emanating from poor *kharif* crops.

[42] Average revenue per user (ARPU) of Mobilink and Telenor has posted an increase during H1-FY16 over the same period last year. Data revenues of Mobilink have jumped from Rs 2.7 billion in H1-FY15 to Rs 4.8 billion in H1-FY16.
[43] Commercial banks' profits posted an increase of 11.7 percent YoY during H1-FY16, compared to steeply higher growth of 59.5 percent in H1-FY15.