2 Real Sector

2.1 Overview

The Annual Plan for 2016-17 envisaged a further gain in growth momentum: the GDP growth target was set at 5.7 percent, higher than the 4.7 percent realized during the previous year. The better economic performance assumed a rebound in the industrial sector, a pickup in the private sector credit and an improved security situation.

A modest recovery in cotton crop and another healthy harvest of sugarcane this year are encouraging signs for the agriculture sector. Similarly, within the services sector, telecom and transport sectors performed well during Q1-FY17. The large scale manufacturing (LSM), on the other hand, recorded a slowdown from the last year, mainly due to lower production of POL, cigarettes, caustic soda and jute products. Encouragingly, a number of other industries have shown a sustained growth, like automobile, fertilizer, pharmaceuticals and construction related industries.

Thus, the growth outcome for FY17 would depend on how the LSM responds going forward to better availability of energy; recent cut in gas tariffs for industries; low cost of borrowing; and ongoing infrastructural projects. This is important because a pickup in LSM growth would also have strong spillover impact on *wholesale and retail trade*, which is one of the major subsectors under services.

2.2 Crop sector

Preliminary information on *kharif* season reveals some upturn in the crop sector, as cotton, sugarcane and maize crops (contributing 44.8 percent of the value addition by major crops) exceeded the last year's production. However, the improved performance of the crop sector was not without its challenges, as the rice crop fell below last year's level, and the recovery in cotton remained significantly short of the target.

The situation on the agriculture inputs has improved considerably. All three critical factors in agriculture production (i.e., water availability, agri financing and fertilizer uptake) have surged significantly. Finally, the global prices of cotton and sugar have now started inching up, which will benefit domestic growers going forward.

Cotton

According to the latest estimates, the overall production of cotton in FY17 is likely to reach 10.5 million bales, showing an increase of 6.3 percent over last year, but lower than the target of 14.1 million bales by a considerable margin (**Table 2.1**).[1]

The weaker-than-expected recovery in cotton output is mainly due to a sharp contraction in the sowing area in the Punjab province. In particular, exceptional losses from previous year's crop (due to pest infestation) and low domestic cotton prices at the sowing time, pushed growers away from cotton to other crops (e.g., sugarcane and maize).[2] The area under cotton cultivation in Punjab therefore saw a reduction of more than 20 percent over last year.[3,4]

Table 2.1: Performance of Cotton Crop

	FY15	FY16	FY17		Growth in %	
			Target	Estimate	FY16	FY17
Area in 000 hectare						
Punjab	2,323	2,243	2,310	1,776	-3.4	-20.8
Sindh	596	621	660	636	4.2	2.4
Pakistan	2,961	2,902	---	2,452	-2.0	-15.5
Production in 000 bales						
Punjab	10,277	6,343	9,500	6,903	-36.8	8.8
Sindh	3,573	3,476	4,500	3,600	-2.7	3.6
Pakistan	13,960	9,917	14,100	10,542	-29.0	6.3
Yield in kg/hectare						
Punjab	752	493	699	661	-34.4	34.1
Sindh	1,019	952	1,160	962	-6.6	1.1
Pakistan	802	581	---	731	-27.6	25.8

Sources: Cotton Crop Assessment Committee; Planning Commission

According to available information, a shift to maize and sugarcane crops explains around 35 percent of this decline in area. While some area has gone into minor crops, there are reports that growers have left their fields fallow for this season (**Box 2.1**). As far as crop yields are concerned, a sharp rise was insufficient to meet the production target of 9.5 million bales for the province.[5]

[1] Cotton Crop Assessment Committee (CCAC), in its meeting held on 5th December 2016, revised the crop estimates to 10.5 million bales from 11.0 million projected earlier.

[2] The cotton crop suffered heavy losses in FY16 when pest and insect attacks in Punjab contained the overall output to 9.9 million bales – markedly lower than the average crop size of over 13 million bales during the preceding four years. The growers faced further challenge when the available cotton stocks with mills kept the domestic prices in check, despite severe damages to the crop. Meanwhile, cotton imports also became cheaper as the global prices, which were already soft, touched a 6-year low in March 2016.

[3] Punjab province generally contributes above 70 percent of the country's cotton production.

[4] This was the lowest area under the cotton crop in Punjab after 1985-86, when the crop area was 1,746 thousand hectare.

[5] The crop yields had already plummeted to 493 kg per hectare in FY16, from the average of 727 kg during the preceding four years.

Box 2.1: Changes in Area under Kharif Crop in Punjab
The area under important kharif crops in Punjab has been declining for the past two years (**Table 2.1.1**). The fall was more prominent in 2016, when sowing dropped by 356 thousand hectare. The largest decline in area was recorded under cotton crop (467 thousand hectare), followed by rice (79 thousand hectare).[6]

Table 2.1.1: Change in Area under Different Crops in Punjab
000 hectare

	Kharif 2015					Kharif 2016				
Division	**Sugarcane**	**Maize**	**Rice**	**Cotton**	**Total**	**Sugarcane**	**Maize**	**Rice**	**Cotton**	**Total**
Punjab	-5	12	-98	-80	-171	87	103	-79	-467	-356
Rawalpindi	0	-2	0	0	-3		7	0	0	7
Sargodha	-4	6	-8	-6	-12	13	-7	-9	-27	-30
Faisalabad	-5	0	-11	-4	-20	23	0	-14	-39	-30
Gujranwala	1	2	-41	0	-39	5	-4	-22	0	-21
Lahore	-6	2	-43	-3	-50	1	-8	-28	-4	-39
Sahiwal	-2	-1	4	0	0	0	55	-11	-60	-16
Multan	0	3	-6	-6	-10	8	55	13	-197	-121
DG Khan	-1	2	-2	-21	-22	7	-1	-1	-53	-48
Bahawalpur	11	0	10	-38	-17	29	5	-6	-86	-58

Source: Crop Reporting Center, Punjab

Detailed information shows that a part of the area shifted from cotton to maize, particularly in Sahiwal and Multan divisions. Similarly, sugarcane is another crop which is gaining more area (e.g. in Bahawalpur, Faisalabad and Sargodha Divisions).

More importantly, around 65 percent of the area loss under cotton and rice remains unaccounted for. While a part of this area has gone into vegetable and pulses, there are reports that some area in DG Khan (which gets affected due to recurrent floods) has been left fallow this season.

Encouragingly, farmers were better prepared this year to deal with insect and pest attacks to the standing crop, as a result of the awareness campaign by the government.[7] In addition, the surge in domestic cotton prices offered growers some room to invest more in the pest management.[8] Thus, despite a higher infestation of pink ballworm this year, the damages to cotton crop have largely remained limited. In fact, some of the farmers may wait for the third or fourth picking of their crop to benefit from higher prices. Despite all these positives, the

[6] Multan, Bahawalpur, Sahiwal and DG Khan Divisions accounted for around 85 percent of total decline in cotton crop area during this season.
[7] Provincial governments of Sindh and Punjab launched aggressive awareness campaigns in the cotton belt against infestation.
[8] The reports of weaker-than-expected crop in Pakistan, low inventories, and the gradual recovery in global prices gave an upward push to domestic prices in the cotton market. Thus, the price of cotton phutti has increased by over 35 percent during Q1-FY17 on YoY basis.

overall production would still remain short of the domestic demand, thereby requiring cotton imports this year as well.[9]

A welcome development from the growers' perspective is the gradual strengthening of cotton prices in the global markets since March 2016.[10] This trend is likely to be sustained going forward, as evident from an upward revision in the forecast for cotton prices by International Cotton Advisory Committee (ICAC) on the back of rising consumption in China and the cut in global production estimates for 2016-17.[11] In fact, according to ICAC, the global cotton consumption would exceed the production for the second consecutive year in 2016-17. The global uptrend in cotton prices would also influence the price outlook in the domestic market where growers have been suffering from persistent sluggish prices for the past several years.

Sugarcane

The initial estimates on sugarcane crop paint a very promising picture, as the output is expected to cross 71 million tons, comfortably exceeding the target of 67.5 million tons for the year (**Table 2.2**). As mentioned earlier, the frequent distress faced by the cotton crop for the past many years made the sugarcane crop safer and more remunerative option for growers (particularly in Punjab). In addition, marginally higher yields also contributed to the improved production.

Table 2.2: Performance of Sugarcane

	FY15	FY16	FY17		Growth in %	
			Target	Estimates	FY16	FY17
Area in 000 hectare						
Punjab	711	706	690	792	-0.7	12.2
Sindh	317	313	320	318	-1.2	1.7
KP	113	113	114	115	0.2	2.0
Pakistan	1,141	1,132	1,125	1,225	-0.8	8.2
Production in 000 tons						
Punjab	41,074	41,961	43,000	47,115	2.2	12.3
Sindh	16,614	17,984	19,000	18,289	8.2	1.7
KP	5,107	5,498	5,500	5,592	7.7	1.7
Pakistan	62,826	65,575	67,535	71,023	4.4	8.3
Yield in kg/hectare						
Punjab	57,802	59,460	62,319	59,489	2.9	0.05
Sindh	52,459	57,495	59,375	57,513	9.6	0.03
KP	45,396	48,786	48,246	48,626	7.5	-0.33
Pakistan	55,087	57,934	60,031	57,978	5.2	0.08

Source: Ministry of National Food Security and Research

[9] The import demand for cotton is likely to remain high in FY17 too (despite a higher crop than the last year), as mills have used up some of their inventories.
[10] The price of 'A' index cotton reached US$1,729 per ton in October 2016, from US$ 1,443 in March 2016.
[11] Specifically, ICAC has recently revised its production estimates for 2016-17 to 22.4 million tons from 23 million tons issued in June 2016. The projections for 2016-17 ending stock also came down from 19.7 million tons to 17.8 million tons.

For the past several years, the government has been protecting growers against the risk of low prices for their produce by keeping support price for sugarcane high.[12] While the policy ensured stable returns to growers, particularly when international prices of sugar plummeted (to around US$ 250 per ton by mid 2015 from over US$650 in early 2011), this incentive also attracted more area under the sugarcane crop.

Lately, the shrinking global stocks are pushing up prices of refined white sugar in the international market.[13] As a result, the export of surplus domestic stock of sugar has become a viable option for the industry.[14]

Rice

According to recent estimates, rice production is likely to fall short of both the target for FY17 and previous year's level (**Table 2.3**). The decline was concentrated in Punjab, where the basmati variety is dominant. The fall in export quantum, particularly of basmati variety, has led to a decline in domestic prices of rice, which in turn reduced the area under the crop cultivation.[15, 16] In some cases, growers have shifted to sugarcane and maize crops, as mentioned earlier.

Table 2.3: Performance of Rice

	FY15	FY16	FY17		Growth in %	
			Target	Estimates	FY16	FY17
Area in 000 hectare						
Punjab	1,877	1,789	1,800	1,702	-4.7	-4.9
Sindh	782	720	750	745	-7.9	3.6
Pakistan	2,891	2,748	2,794	2,657	-4.9	-3.3
Production in 000 tons						
Punjab	3,648	3,512	3,500	3,348	-3.7	-4.7
Sindh	2,653	2,573	2,600	2,664	-3.0	3.6
Pakistan	7,003	6,811	6,838	6,640	-2.7	-2.5
Yield in kg/hectare						
Punjab	1,944	1,963	1,944	1,967	1.0	0.2
Sindh	3,393	3,574	3,467	3,574	5.3	0.0
Pakistan	2,423	2,478	2,447	2,499	2.3	0.9

Source: Ministry of National Food Security and Research

[12] Thus the domestic price of sugar remained firm despite considerable easing in the global market. The support policy, however, made sugar exports impossible without seeking a subsidy from the government.

[13] The global sugar stocks are down 17.5 percent from previous calendar year and are forecasted to decline by a further 13 percent in 2017. As a result, sugar prices reached $490 per ton by October 2016, compared to $307 a year earlier.

[14] It may be noted that before the start of the crushing season 2016-17, domestic reserves of sugar stood at 1.8 million tons. The bumper crop this year would also add to the existing stock.

[15] Rice export quantity has declined by 23 percent, whereas in value terms rice exports are down by 20 percent or US$ 160 million in Q1 FY17.

[16] On the domestic front, basmati prices declined in the range of 4 to 11 percent YoY, while that of irri remained stagnant.

The rice production in Sindh, however, recovered from the last year's decline. This improvement was mainly driven by an increase in area under cultivation, as the crop yields remained unchanged over last year. It may be noted that the irri and hybrid rice are the most common varieties being cultivated in Sindh.

Input situation

Overall input side situation remained comfortable throughout the *kharif* season. The availability of the irrigation water improved sharply by 9 percent compared to previous year, which compensated for a significant dip in rainfall in the cotton belt in Punjab.

Furthermore, a fall in prices of fertilizers under the government sponsored subsidy program fuelled the demand for both Urea and DAP in the current *kharif* season.[17] For FY17, the government has announced fertilizer subsidy worth Rs 28 billion (Rs 17.2 and Rs 10.8 billion for urea and DAP respectively). The government also decided to reduce GST on urea from the prevailing rate of 17 percent to 5 percent. The subsidy regime has not only provided a much needed thrust for the current crop, but would also enhance productivity in the forthcoming *rabi* season especially that of wheat.

Table 2.4: Agri Credit During Kharif

billion Rs

	2015	2016	Growth in percent	
			2015	2016
Production loans	255.7	291.1	23.3	13.8
Development loans	31.6	25.5	19.6	-19.2
Total	**287.3**	**316.6**	**22.9**	**10.2**

Source: State Bank of Pakistan

Agriculture credit growth during kharif 2016 was 10.2 percent, on top of 22.9 percent growth realized in the corresponding season last year (**Table 2.4**). The development loans on the other hand showed a decline on account of lower disbursement for tractor purchase.

2.3 Large scale manufacturing (LSM)

The overall LSM grew by 2.2 percent during Jul-Sep FY17, showing a significant slowdown from 3.9 percent in the same period last year (**Table 2.5**). While a high base effect of last year partly explains this lower growth, a major drag came from cigarettes, leather, POL, jute goods and caustic soda. On the other hand, construction related industries, automobile, fertilizer and pharmaceuticals recorded sustained growth during the period under review.

[17] Not only did the prices of urea and DAP register a fall of more than a 25 percent (YoY), their off-take also increased by 11.5 and 68.1 percent respectively during the season.

We expect the manufacturing sector to benefit from better availability of energy; continued low cost of borrowing; positive economic outlook of the country; and ongoing infrastructural projects. Moreover, the recent recovery in cotton prices would provide some relief to the textile sector – a major contributor both in overall LSM and exports of the country.

Table 2.5: YoY Growth in LSM Jul-Sep FY17
percent

		YoY Growth		Contribution in Growth	
	wt.	**FY16**	**FY17**	**FY16**	**FY17**
LSM	70.3	3.9	2.2		
Textile	21.0	0.7	-0.03	0.23	-0.01
Cotton yarn	13.0	1.3	0.3	0.27	0.06
Cotton cloth	7.2	0.6	0.2	0.07	0.02
Jute goods	0.3	-19.4	-52.8	-0.07	-0.14
Food	12.4	4.4	-0.9	0.66	-0.13
Sugar	3.5	0.0	0.0	0.00	0.00
Cigarettes	2.1	-4.2	-42.8	-0.09	-0.88
Vegetable ghee	1.1	3.9	-0.1	0.06	0.00
Cooking oil	2.2	7.7	3.0	0.28	0.11
Soft drinks	0.9	12.7	17.1	0.42	0.61
POL	5.5	4.5	-3.4	0.32	-0.24
Steel	5.4	-5.3	13.0	-0.20	0.45
Non-metallic minerals	5.4	4.7	9.2	0.49	0.97
Cement	5.3	4.8	9.5	0.49	0.98
Automobile	4.6	31.4	3.8	1.73	0.26
Fertilizer	4.4	15.1	6.5	0.92	0.43
Pharmaceutical	3.6	7.2	8.0	0.60	0.69
Paper	2.3	-22.6	6.1	-1.03	0.21
Chemicals	1.7	13.9	-4.1	0.35	-0.11
Caustic soda	0.4	36.7	-20.5	0.16	-0.12
Leather products	0.9	-0.2	-19.1	0.00	-0.36

Source: Pakistan Bureau of Statistics

Encouragingly, a number of firms in cement and steel sectors are already making investment for capacity expansions; refineries are upgrading their plants; and a number of textile firms are undergoing Balancing, Modernization and Replacement (BMR) and installing coal fired or captive power plants, etc.[18]

Furthermore, several foreign companies are keen on partnering with local investors to launch projects in different sectors of the economy.[19]

Sectoral analysis

Automobile

The growth in the automobile sector slowed down during Jul-Sep FY17, mainly reflecting the completion of Apna Rozgar

[18] Pakistan's cement industry has entered into an expansionary cycle with total capacity announcements reaching 22mn tons (firms in Northern region would add 14.7mn tons and those in South 7.3mn tons). In the steel sector, Amreli Steels is set to more than double its production capacity with the addition of a new plant having estimated capacity of 300,000 tons per annum. Similarly, refineries are gearing up to upgrade petrol quality, as the government plans to replace the existing petrol with the higher-grade motor gasoline.

[19] For example, Ghandhara Nissan Limited is set to join hands with Renault, the 10th largest global automobile manufacturer. The project will attract investment of around $100 million including approximately 60 percent foreign investment. Similarly, companies like Turkish home appliances maker Arcelik AS and Dutch dairy giant Royal Friesland Campina NV are also making acquisitions in Pakistan.

scheme last year. Adjusting for this scheme, all segments in the auto sector registered a healthy growth during Q1-FY17 (**Table 2.6**).

Table 2.6: Vehicles Production and Sales
Number of units

	Q1-FY17		Q1-FY16		Growth %	
	Production	Sales	Production	Sales	Production	Sales
Passenger Cars	**43,659**	**41,405**	**45,133**	**44,372**	**-3.3**	**-6.7**
Exc. Apna Rozgar Scheme	38,601	36,715	35,403	34,476	9.0	6.5
Trucks	**1,798**	**1,662**	**1,127**	**1,039**	**59.5**	**60.0**
Buses	**372**	**331**	**222**	**192**	**67.6**	**72.4**
LCVs, Vans & Jeeps	**7,018**	**6,095**	**10,478**	**10,198**	**-33.0**	**-40.2**
Exc. Apna Rozgar Scheme	1,899	1,585	1,175	1,101	61.6	44.0
Farm Tractors	**7,237**	**7,004**	**7,316**	**6,745**	**-1.1**	**3.8**
Motorcycles & Three-Wheelers	**362,955**	**362,554**	**326,191**	**321,389**	**11.3**	**12.8**

Source: Pakistan Automotive Manufacturers Association

In the car segment, a new model for a passenger car launched by a local manufacturer has received immensely good response from customers.[20] Likewise, the rise in tractor sales can be attributed to 5 percent reduction in General Sales Tax in the Federal Budget for FY17 and the support announced under the Kissan package.[21] Similarly, the increased focus on developmental projects by the government and better law and order situation in the country fueled the demand for commercial vehicles (trucks and buses).

Cement and Steel

The performance of cement and steel remained encouraging in response to continued robust demand from ongoing public sector development work and mega private sector housing projects. In fact, the cement industry alone contributed around 45 percent in overall LSM growth during Jul-Sep FY17 (**Figure 2.1**).

The sector has been able to improve its margins despite a recent surge in global prices of coal – a key input that contributes more than 30 percent to the overall cost of cement manufacturing.[22, 23] The strong local demand made it possible for

[20] The response from customers was quite overwhelming, as during the first two months of the launch more than 10,000 bookings had been made for the new model.

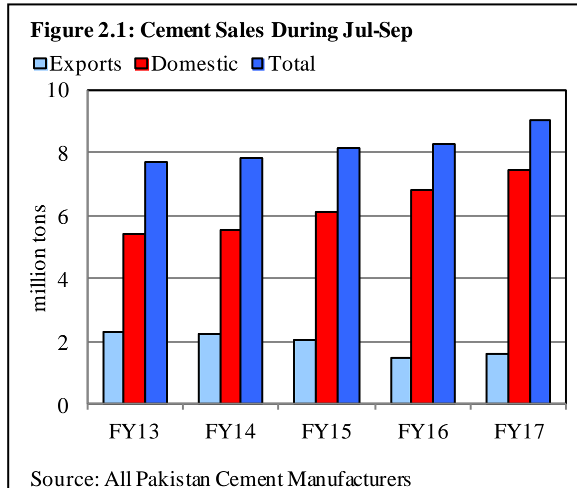
[21] While the tractor sales have risen during Q1-FY17, the disbursement of loans for tractor purchase during the kharif season has experienced a decline (see Section on Input Situation in this chapter).

[22] Global coal prices have increased sharply to over US$90/ton in October 2016, from US$53.2 in June 2016. The price surge came after China's decision to cap its mining output and reduce the number of mining days from 330 days to 276 days. Additionally, China has adopted stricter

the industry to fully pass on the impact of higher coal prices to consumers. Interestingly, the coal prices which went up sharply (in response to China's decision to cap its mining output) may ease again as China has recently reversed the restrictions imposed earlier.

The steel sector recorded a growth of 13.0 percent during Jul-Sep FY17, compared to contraction of 5.3 percent during the same period last year. It may be noted Pakistan Steel Mills – the largest steel manufacturer in the public sector – has been non-functional since July 2015. In this situation, the private steel firms have taken full advantage of the growing demand for construction related materials. While a higher capacity utilization helped them to lower cost of production, some support also came from the levy of regulatory duty (RD) on steel imports and increase in Chinese steel prices.[24,25] However, profit margins for the private manufacturers came under pressure due to (1) fall in prices of reinforcement steel; (2) hike of Rs 1/kWh in GST on electricity; and (3) increase of 1 percent in custom duty on scrap.

Figure 2.1: Cement Sales During Jul-Sep



Source: All Pakistan Cement Manufacturers

Pharmaceuticals

The pharmaceuticals industry grew by 8.0 percent during Jul-Sep FY17, compared to 7.2 percent growth realized in the corresponding period of the previous year. We however expect this performance to improve further due to clarity on price structure following the announcement of drug policy last year.

transportation rules which also pushed utilities to import coal. However, in November 2016, China reversed the restrictions imposed earlier in a bid to control surging prices and boost production.

[23] Net profit margins increased to 28 percent for Q1-FY17, that showed an improvement of 300 basis points on YoY basis, despite over 40 percent increase in effective taxes (source: Companies financial).

[24] As a result of 30 percent RD, volumes of imported Chinese reinforcement steel bar have dropped significantly, providing a boost to production by local manufacturers.

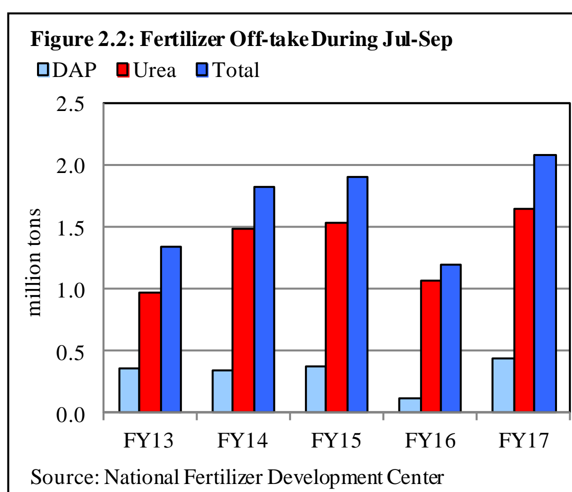
[25] The prices of steel products from China have risen by nearly 50 percent this year, after smelters recorded losses of US$ 10 billion last year (Source: the Economist –Steel trap, 29th October 2016).

Another positive development for the pharmaceuticals industry is the newly launched 'PM Health Insurance Scheme 2016' under which about 1.2 million families will get free health insurance and each card holder will get Rs 0.3 million health facilities each year. When implemented, this would rapidly increase demand for pharmaceutical products in the country.

Fertilizer

Smooth supply of natural gas (both due to diversion from the power plants and import of LNG) allowed the fertilizer industry to grow during Jul-Sep FY17. However, the main challenge faced by the industry was the all time high stock of fertilizer in the country due to the depressed demand last year. Though fertilizer sales have witnessed some recovery in Q1-FY17, this was not sufficient to absorb the accumulated total fertilizer stock of 2.6 million tons (**Figure 2.2**).[26] The demand may recover going forward with expected reduction in prices following the abolishment of Gas Infrastructure Development Cess (GIDC).[27] The export of urea to combat supply glut in the market would be challenging, as the locally produced urea remains uncompetitive in the global market.[28,29]

Figure 2.2: Fertilizer Off-take During Jul-Sep

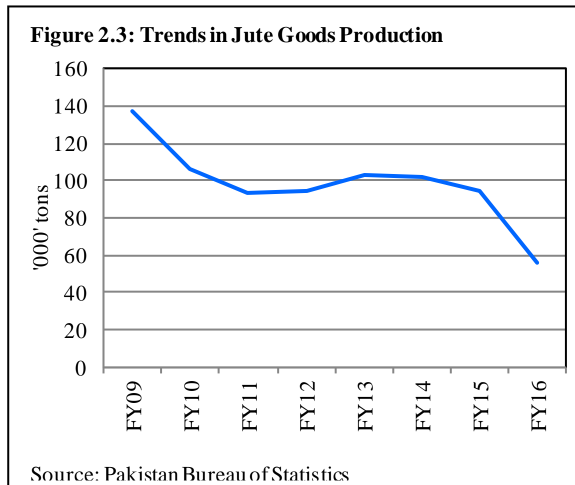


Source: National Fertilizer Development Center

Textile

The performance of the textile sector remained sluggish mainly due to a 52 percent fall in the manufacturing of jute goods during Jul-Sep FY17 (on YoY basis) (**Figure 2.3**). At the same time, the production of cotton yarn and cloth showed a moderate growth.

[26] The stock includes 1.6 million tons urea and 0.6 million tons DAP, as of end September, 2016.
[27] The ruling by Sindh High Court that rendered GIDC Act null and void, is a big positive for the sector. However, any appeal from the government in the superior court against the decision, would again create uncertainty about pricing in the fertilizer market.
[28] The stock of urea at the end of Rabi season is expected at 1.4 million tons and after taking 0.6 million tons of buffer stock into consideration, 0.8 million tons is available for exports.
[29] The price of 50 kg urea bag in the international market comes around US$ 250 per ton, which is significantly lower than the price of locally produced urea (i.e., US$ 320 per ton).



The jute sector in Pakistan came under tremendous pressure during FY09-FY11 due to a shift towards synthetic packaging (e.g., polypropylene / polyethylene), which was useful for long-term storage and transportation of commodities.[30] In response, provincial food departments gradually started shifting their grain reserves from jute sacks to plastic bags.[31] Later on, in November 2015, Bangladesh imposed a temporary ban on jute exports, which increased the cost of raw material for jute manufacturers in Pakistan.[32] The resulting increase in the cost of jute bags made them uncompetitive against their substitutes available in the market. The industry is also under stress due to lack of research, development and innovation; and labor intensive processes.[33] As a result, the number of operational mills has now dropped to below five, from 18 mills two decades ago.[34]

Food

The decline in food production was mainly concentrated in the cigarette segment, where a substantial increase in FED in the FY17 budget not only adversely affected production, but also encouraged demand for smuggled and counterfeits in the market. The presence of a large, informal sector undermines the viability of the legitimate players in the industry and is one of the major factors in discouraging both domestic and foreign investment (**Box 2.2**).

[30] The jute bags are still preferable for long-term grain storage, but they are costlier compared to their substitute. For example, if a plastic bag is available at Rs 60, the same 100kg capacity jute bag costs more than Rs 100.

[31] The jute industry mainly depends on the government demand for storing grains, but it also exports some of its produce.

[32] Around 99 percent of the input comprises of imported raw material. Although the local industry has started promoting local cultivation of jute in Punjab, its scale is a very limited.

[33] The manufacturing wage as percentage of manufacturing cost in the jute industry is around 20 percent, while it is 7 percent in textile and 3 percent in polyester industries (Source: Pakistan Jute Mills Association).

[34] According to Pakistan Jute Mills Association, the total capacity of the industry is 100,000 tons per annum with production level of 55,377 tons in FY16.

Box 2.2: Challenge for legitimate cigarettes industry in Pakistan: Illicit market of cigarettes[35]
The tobacco industry in the formal sector is facing immense competitive pressure due to exponential growth of duty evaded segment. Specifically, the price increase due to higher FED in the Federal Budget FY17 means cigarettes which have successfully evaded excise levy are far cheaper and thus more in demand compared to the tax-paid brands.[36] As a result, not only the sale volumes of the legitimate and tax-paying segment of the industry are facing a decline¸ the government is also losing its revenues.[37]

The tax evasion on cigarettes generally takes one of the following three forms:

(1) On import for the commercial use (also known as International Transient Brands) on which applicable taxes include duties, excise and sales tax. These products may have had no taxes paid on them at all, or may have had lower taxes paid.

(2) The undeclared local production or Duty-Non-Paid (DNP) whereby products are produced and consumed but without the payment of local taxes. These products may be manufactured in approved factories but not declared to the authorities, or these may be manufactured in an informal setup.

(3) The third is counterfeit products which are also an infringement of Intellectual Property Rights (IPR). These products are identical or near identical copies of a genuine branded product. By definition such products are illegal, as the manufacturer is not authorized by the brand owner to use the counterfeited brand assets. Counterfeits may be produced for the local market or exported.

However, the overall food sector would recover in coming months as (a) a better sugarcane crop would result in higher sugar production; and (b) the liquidity position of sugar mills would ease as the recent surge in international sugar prices has made sugar exports feasible.

Petroleum, Oil and Lubricants (POL)

A policy shift to improve both quality and standards of petroleum products produced by local refineries and imported by oil marketing companies (OMCs) restricted POL performance during Q1-FY17.[38] The sales of POL products however continue to grow strongly (**Table 2.7**). Since most of the local refineries are not capable of producing 92 RON Premium Motor Gasoline (PMG),

[35] The illicit market of cigarettes in Pakistan has reached about 40 percent of the total demand (Source: Pakistan Tobacco Company, Financial Statements, September, 2016).
[36] Under S.R.O. 473(I)/2016, the government has enhanced the FED on cigarettes in two stages. During the first stage that goes up to 30-11-2016, the excise duty was fixed at Rs 4,000 per thousand cigarettes. This rate would increase further to Rs 4,400 in the second phase starting from December 1, 2016.
[37] Federal Excise Duty on cigarettes declined to Rs 5.5 billion in Q1-FY17 from Rs 10.1 billion in Q1-FY16.
[38] The government has decided to replace currently used low-quality (i.e., 87 Research Octane Number) petrol with higher grade fuel, i.e., 92 RON. This step would help in contain pollution through lower emissions and better engine hygiene, while simultaneously providing an enhanced motor vehicle experience to the customer.

dependence on refined petroleum products increased as evident from increase in imports of petroleum products during this period.[39,40] The outlook for POL sector however remains favorable in view of growing sales of cars.

Leather products

The performance of the leather industry remained subdued mainly due to declining exports on the back of higher cost of production, against competitors (e.g., China, India and Bangladesh). The export of leather and products has been declining consistently from US$ 325 million in Q1-FY14 to US$ 238 million in Q1-FY17.

Table 2.7: Industry Oil Sales
000' tons

	Q1-FY16	Q1-FY17	YoY Change (percent)
Furnace oil	2,220	2,777	25
High speed diesel	1,661	1,820	10
Motor spirit	1,372	1,661	21
Others	279	284	2
Total	**5,531**	**6,542**	**18**

Source: Oil Companies Advisory Council

2.4 Services

The government has set a growth target of 5.7 percent for the services sector in FY17 – unchanged from the level realized in the previous year. According to the Annual Plan for FY17, a better performance from the commodity producing sector (on the back of improved energy and finances) will support the targeted growth in the services sector.

A better performance of the crop sector compared to the previous year, and the expected recovery in large scale manufacturing, would have a positive spillover on *wholesale and retail trade* – the largest subsector in services. Similarly the leading indicators on transportation offer an encouraging picture. For example, sales and import of commercial vehicles and petroleum products have recorded an exceptional growth during Q1-FY17.[41] Similarly, the on-going expansion and upgradation of road network and the start of the transit trade under CPEC would greatly benefit the transportation sector in the country.

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[39] Local refineries would produce 90 RON Premium Motor Gas (PMG) except Attock Refinery. This conversion to high quality fuel requires a substantial investment to acquire compatible technology.

[40] Imports of petroleum products doubled to 4.93 million tons during Q1-FY17, compared to 2.47 million tons during same period last year.

[41] The sales of trucks and buses went up by 60 percent and 72.4 percent respectively during the same period. Imports of trucks, buses and other heavy vehicles posted an impressive increase of 50.2 percent in Q1 FY17, on top of 61.4 percent growth registered in Q1-FY16. Moreover, import of petroleum products surged by 93 percent in quantum in Q1-FY17, compared to same period last year. Finally, the sales of motor spirit went up by 21 percent during the same period.

Within finance and insurance, the after tax profits of the banking sector declined to Rs 71 billion in Q1-FY17, which were 11.9 percent lower than that in the corresponding period of the previous year (**Table 2.8**). Furthermore, the advances to the private sector remained sluggish, despite historic-low interest rates in the country. This was because some of the large corporates have sufficient liquidity at their disposal. On a positive note, deposits are rising gradually after experiencing withdrawal following the increase in withholding tax on cash transactions last year.

Table 2.8: Performance of the Banking Sector (Jul-Sep)
million Rs

	FY16	FY17
Profit before tax	80,637	71,046
Investments (net)	504,626	-196,819
Advances (net of provision)	-16,212	-127,746
Deposits	-254,751	67,903

Source: State Bank of Pakistan