# 5 External Sector

## 5.1 Overview

Pakistan's overall external balance recorded a deficit of US$ 1.6 billion in Jul-Mar FY17, against a surplus of US$ 1.1 billion in the same period last year. This was mainly caused by a large trade deficit on the back of high imports– without a matching performance by exports. The imports of fuel, machinery and food items (mainly palm oil and pulses), all increased sharply due to robust domestic demand and ongoing power and infrastructure development activity.[1] This dynamic pushed the current account deficit (CAD) to US$ 2.6 billion in Q3 – the highest since Q2-FY09. The higher CAD was recorded despite the receipt of US$ 550 million inflow under Coalition Support Fund in the third quarter. For Jul-Mar FY17, the current account gap amounted to US$ 6.1 billion, over twice the level recorded in the same period last year (**Table 5.1**).

**Table 5.1: Summary of Pakistan's External Sector ( million US$)**

| | Q3 | | Jul-Mar | |
|---|---|---|---|---|
| | **FY16** | **FY17** | **FY16** | **FY17** |
| **Current account balance** | **-449** | **-2,570** | **-2,351** | **-6,114** |
| *Of which* | | | | |
| **Trade balance** | **-3,933** | **-6,893** | **-13,356** | **-17,748** |
| Exports | 5,545 | 5,600 | 16,328 | 16,120 |
| Imports | 9,478 | 12,493 | 29,684 | 33,868 |
| *POL imports* | 1,614 | 2,771 | 6,398 | 7,769 |
| *Non-oil imports* | 7,864 | 9,722 | 23,286 | 26,100 |
| *Food* | 1,160 | 1,503 | 3,367 | 3,993 |
| *Transport* | 467 | 641 | 1,331 | 1,852 |
| *Machinery* | 1,532 | 2,024 | 4,602 | 5,275 |
| **Services balance** | **-746** | **-304** | **-2,033** | **-1,993** |
| *Coalition Support Fund* | 0 | 550 | 713 | 550 |
| Worker remittances | 4,699 | 4,600 | 14,388 | 14,058 |
| **Capital account balance** | 47 | 150 | 213 | 260 |
| **Financial account balance** | 107 | -1,138 | -3,372 | -4,805 |
| *Of which* | | | | |
| FDI in Pakistan | 446 | 501 | 1,425 | 1,601 |
| FPI in Pakistan | -613 | -114 | -393 | 631 |
| *Euro bond/Sukuk* | 0 | 0 | 500 | 1,000 |
| FX loans (net) | 1,109 | 229 | 3,769 | 1,964 |
| *IMF* | 503 | 0 | 1,455 | 102 |
| Overall balance* | 315 | 1,841 | -1,144 | 1,614 |

Note: The table is as per the IMF's Balance of Payments Manual 6; * Minus sign shows surplus, and plus sign shows deficit. Data source: State Bank of Pakistan

[1] The IBA-SBP Consumer Confidence Index reached its highest level of 176.5 points in March 2017, up 18.6 points from the level recorded in July 2016, which indicates increase in demand.

Though the SBP's reserves hit a peak of US$ 19.5 billion (in October 2016) as proceeds from US$ 1.0 billion Sukuk were received, sustaining that level was not possible in the wake of an increasing current account gap; lower external government financing; and the conclusion of the IMF program.[2]

Particularly, the FX reserves declined in the third quarter of FY17, as: (i) the monthly CAD crossed the US$ 1.0 billion mark in January 2017; (ii) Pakistan repaid US$ 500 million of SAFE China Deposits, also in January; and (iii) the merchandise trade deficit grew by almost US$ 3.0 billion YoY in Q3-FY17. While CSF inflows did materialize over the next two months and provided some breathing space, SBP's liquid FX reserves declined to US$ 16.5 billion by end-March FY17, from US$ 18.3 billion at end-December 2016. These were, nonetheless, sufficient to finance over four months of the country's merchandise import bill.

That said, the country did have access to funding avenues, both public and private, which partially financed the higher current account deficit. Net official external financing inflows in Jul-Mar FY17 – in the form of project, non-project and commercial loans, and sovereign bonds – stood around the same level as last year (i.e. US$ 1.9 billion). This indicates that IFIs and international capital markets are comfortable with Pakistan's growth trajectory.[3] In addition, foreign direct investment (FDI) inflows also increased; in a departure from last year, a majority of these flows came from countries other than China.[4] Net FDI from China rose marginally over last year, with investment mostly flowing into power and infrastructure projects; the 40 percent stake sale of the Pakistan Stock Exchange to a Chinese-led consortium also netted the country's foreign investment worth around US$ 61 million in March 2017.[5]

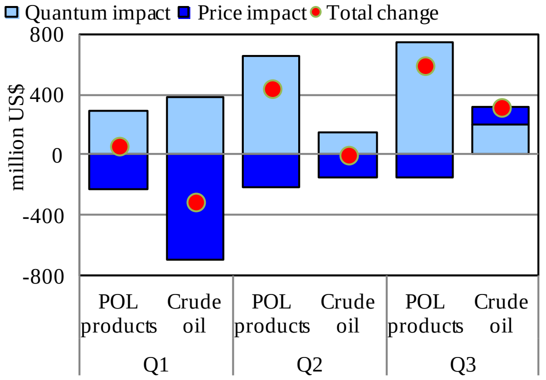
However, as mentioned earlier, these inflows were not sufficient to fully offset the widening in the current account gap. The following points are worth noting in this regard:

[2] SBP had received US$ 1.5 billion under the Extended Fund Facility in Jul-Mar FY16, and only US$ 102 million (as the residual tranche) in Jul-Mar FY17.
[3] In May 2017, the credit ratings agency Moody's maintained its B3 rating for Pakistan, with a "stable" outlook.
[4] This was mainly due to the conclusion of two acquisition deals in the food and electronics sectors by non-Chinese firms in the second quarter, which contributed a cumulative US$ 587.7 million to net FDI inflows during Jul-Mar FY17.
[5] While the total proceeds realized from the PSX stake sale amounted to around US$ 85 million, the component received from foreign investors was US$ 61.1 million (recorded as foreign investment), with the rest coming from domestic partner firms in the Chinese-led consortium.

(i) *The Q3-FY17 import bill hit an all-time high, pushing the Jul-Mar FY17 imports to* their *record as well*. This occurred as non-oil imports kept on their rising trajectory, largely reflecting: (a) progress on power generation and road infrastructure projects, as well as capacity expansions and upgradation pursued by industries like textiles and cement (which boosted machinery imports); (b) a drop in domestic production of minor crops (mainly pulses), which necessitated higher purchases from abroad; and (c) a price-driven hike in palm oil imports.

Meanwhile, the US$ 1.4 billion increase in the POL import bill in Jul-Mar FY17 (contributing 32.6 percent to the overall *rise* in import payments in the period) is largely driven by higher quantums.[6] Despite the recovery in international oil prices, unit values of Pakistan's POL product imports are still lower as compared to last year (**Figure 5.1**). While the price impact for crude oil turned positive from Q3-FY17 – in line with the movement in international oil prices[7] – yet, higher quantums still seem to be driving the increase in Pakistan's overall energy imports.

**Figure 5.1: Breakdown of YoY Change in POL imports in FY17**




Data source: Pakistan Bureau of Statistics and SBP's calculations

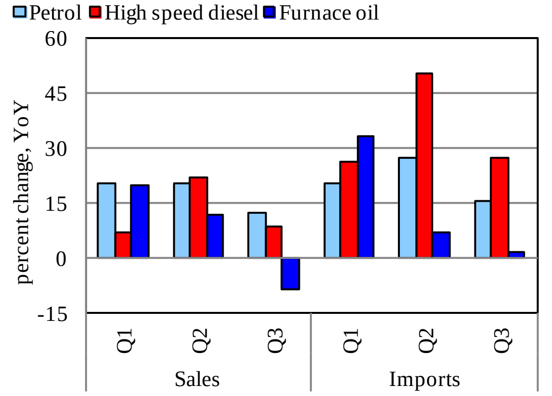
On this front, the government's decision to partially pass on the increase in global oil prices to domestic POL prices from December 2016 onwards, seems to have had a dampening effect on demand for POL products, as reflected by a slowdown in sales growth of both HSD and petrol in Q3-FY17 (**Figure 5.2**).[8] Per litre prices

[6] Another factor has been the rise in LNG imports into the country. According to SBP data, the LNG import bill amounted to US$ 844.0 million in Jul-Mar FY17, up 129 percent on YoY basis.
[7] Average Saudi Arabian Light oil prices during Q3-FY17, at US$ 52.9 per barrel, were 77.3 percent higher than they were in the same period last year (source: Bloomberg).
[8] In case of petrol, it is also possible that some consumers who had shifted to the fuel from CNG after the sizable reduction in petrol prices in 2016, have now switched back to CNG, following the increase in POL prices from Q2-FY17 onwards. Though per litre petrol and per unit CNG prices technically should not be compared due to differences in the nature of the fuels, it can be used as a rough proxy for discerning shifts in consumer behaviour. In January 2016, petrol prices were Rs 6.1 higher than per unit CNG prices. This differential had turned a *negative* Rs 5.9 in March 2016 (i.e.

of the two fuels were raised by Rs 5.8 and Rs 5.6 respectively in the third quarter, after having been kept almost unchanged during the previous two quarters.[9]

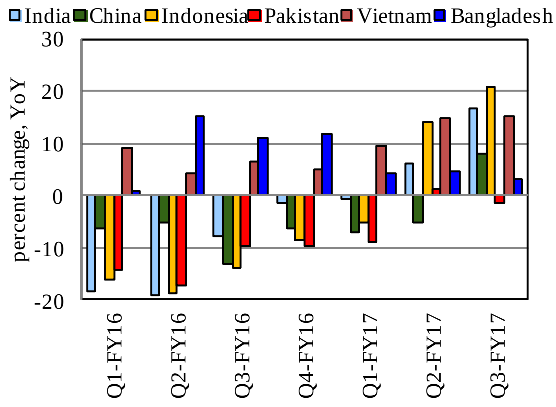
(ii) *Pakistan's export recovery lags* behind *other EMs'*. Like many other emerging markets (EMs), Pakistan also faced a challenging export environment over the last two years – with subdued commodity prices, muted demand from key western markets, and decline in shipments to China. However, many of these external dynamics had reversed by mid-2016: international cotton prices increased during Jul-Mar FY17,[10] and overall imports of key markets like the EU also rebounded.[11]

**Figure 5.2: Sales and Imports of POL Products in FY17**




Data source: Oil Companies Advisory Council

**Figure 5.3: Export Performance of Some Emerging Markets**




Data source: Haver Analytics

The confluence of these developments and the positive demand shock they generated, have contributed to a recovery in exports of multiple emerging markets (EMs) from Q2-FY17 onwards (**Figure 5.3**).[12] However, Pakistan's export performance during this period looks weak.

per unit CNG prices were Rs 5.9 higher than petrol prices). But after declining consistently since then, this differential had again reversed to a positive Rs 1.2 by March 2017.

[9] Petrol and HSD prices were unchanged during Jul-Nov FY17, before rising by Rs 2.8 and Rs 3.2 respectively in December 2016.

[10] Average international cotton prices during Jul-Mar FY17 were 14.5 percent higher as compared to Jul-Mar FY16 (source: Bloomberg).

[11] Overall imports of EU-28 countries rose by 3.7 percent YoY in Jul-Mar FY17, after declining by 11.6 percent in the same period last year (source: Eurostat).

[12] Yet, at the same time, clouds of protectionist and anti-trade sentiments swirl overhead and threaten the sustainability of this EM export rally. In fact, these sentiments prompted the IMF to note in its

One reason is that Pakistan's clothing and home textile products are fetching lower unit values in the key EU market than those of its competitors (**Section 5.4**). Both the product quality and competitive pricing issues seem to be at play here; exporters are also reported to be undercutting their margins by trying to out-price their competitors. For low-value added textile products, the recovery in international cotton prices over the past 12 months has translated into higher unit prices, but their export receipts are being pulled down by lower quantums. On an encouraging note, *basmati* rice exports recovered in Q3-FY17, mainly as a result of higher shipments to the UAE and Iran.[13]

(iii) *The decline in remittances has been offset by lower profit repatriations*. The nominal YoY decline in worker remittances amounted to US$ 330 million in Jul-Mar FY17. However, the decline in remittance inflows was more than offset by a US$ 371 million YoY decline in outflows in the form of profit and dividend repatriations, particularly by foreign oil and gas firms.

To sum up, Pakistan's external account has come under pressure due to an unfavorable trade balance. While a large share of imports is geared for growth-oriented activities, sluggish exports are more worrisome. To rectify this imbalance, the private sector needs to take the lead, by demonstrating an entrepreneurial spirit and investing in physical and human capital, in order to offer more competitive products in international markets.

Moreover, the changing global economic scenario also offers enhanced trade prospects, as the IMF now projects a brighter outlook for advanced economies.[14] This is particularly true for the US, where the new administration's fiscal policy proposals (a combination of hefty tax cuts and ramp up in infrastructure spending) are fuelling optimism. Besides, Europe and Japan are also expected to benefit from a recovery in global manufacturing and trade. That said, only those EMs can hope to benefit from this evolving dynamic, that have: a strong reliance on

World Economic Outlook April 2017 that " the post-World War II system of international economic relations is under severe strain despite the aggregate benefits it has delivered – and precisely because growth and the resulting economic adjustments have too often entailed unequal rewards and costs within countries".

[13] Pakistan's trade with Iran is likely to improve in the coming months, after SBP and the central bank of Iran devised a payment settlement mechanism (in Euros and Yen) for trade transactions between the two countries. In this regard, SBP issued relevant directions to Pakistani banks in May 2017, via FE Circular No. 4 of 2017.

[14] According to the IMF's World Economic Outlook for April 2017, advanced economies are likely to grow by 2.0 percent in 2017, up from last year's rate of 1.7 percent. The latest 2017 growth projection is also higher (by 0.1 percent) than the Fund's projection in January 2017.

regional trade; competitive industries; and a policy regime that shows flexibility and prioritizes market efficiency at the same time.

Pakistan can capitalize on these opportunities if it pursues long-lasting structural reforms, while private businesses in the country do a fundamental rethink about the way they operate and prioritize long-term growth over short-term profits. While the country did utilize the window of opportunity provided by low oil prices and IMF support over the past few years by building up FX buffers and addressing some supply-side bottlenecks, keeping up the reform momentum will be important, going forward.

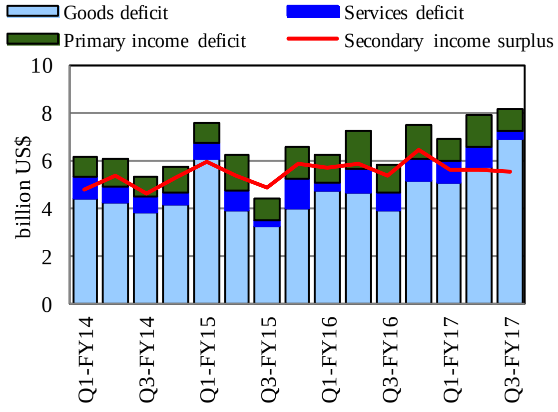
Meanwhile, rationalizing domestic POL prices with international rates (**Chapter 3**), minimizing market distortions, and discouraging unnecessary consumer imports by utilizing the full extent of regulatory measures at the disposal of fiscal and monetary authorities, are some steps that should be taken in the short-term to create financing space for critical capital goods imports.

### 5.2 Current account

The current account posted a deficit of US$ 6.1 billion during Jul-Mar FY17, more than double the level recorded during the same period last year. This deterioration was mainly attributed to the surging trade deficit, which hit an all-time high of US$ 6.9 billion in Q3-FY17. The import bill, in particular, has increased on the back of a strong demand for fuel, machinery and food items. In addition, remittances also dropped by 2.3 percent YoY during Jul-Mar FY17.

On the other hand, the services deficit has exhibited a slight improvement, based on relatively better performance of exports of telecom services, and a lower travel deficit. The primary income deficit has also narrowed by 17.4 percent providing some relief to the current account balance (**Figure 5.4**).

**Figure 5.4: Composition of Current Account Balance**




Data source: State Bank of Pakistan

Worker remittances

The global remittance business has not yet recovered, as the magnitude of cross-border flows were further squeezed during CY-2016.

Remittance flows to developing countries fell 2.4 percent in CY-2016, after declining 1.0 percent in CY-2015. This trend also prevailed in the South Asian region, which witnessed an overall decline of 6.4 percent during CY-2016.[15]

During Jul-Mar FY17, remittances to Pakistan dropped by 2.3 percent. The decline was observed from all major corridors, including Saudi Arabia, UAE, US and UK (**Table 5.2**); however, different factors – all exogenous in nature – were responsible for each destination (**Figure 5.5**).

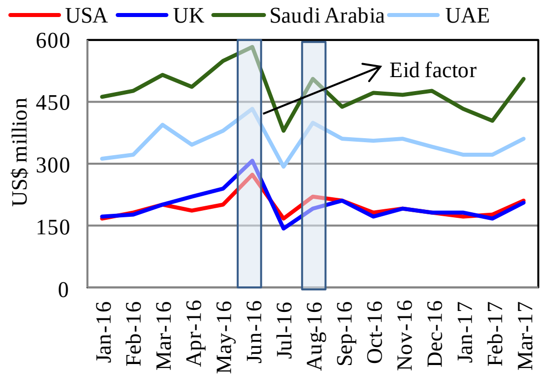
**Table 5.2: Country/ Region-wise Worker Remittances**

million US$

| Country/ Region | Jul-Mar | | | |
|---|---|---|---|---|
| | FY16 | FY17 | % Change | % Share |
| USA | 1,858.7 | 1,729.6 | -6.9 | 12.3 |
| U.K. | 1,807.9 | 1,655.1 | -8.5 | 11.8 |
| Saudi Arabia | 4,348.9 | 4,078.1 | -6.2 | 29.0 |
| UAE | 3,203.7 | 3,124.4 | -2.5 | 22.2 |
| Other GCC | 1,774.2 | 1,706.0 | -3.8 | 12.1 |
| EU | 286.0 | 332.5 | 16.3 | 2.4 |
| Others | 1,085.5 | 1,422.9 | 31.1 | 10.1 |
| Total | 14,387.8 | 14,057.7 | -2.3 | 100.0 |

Data source: State Bank of Pakistan

**Figure 5.5: Monthly Remittances Inflow from Major Source Countries**




Data source: State Bank of Pakistan

For GCC countries, subdued oil prices have led to adoption of fiscal consolidation measures, which in turn, caused workers layoffs.[16] The lower inflows, particularly from Saudi Arabia, seems to have been partially influenced by the Kingdom's tightening of labor market policies, such as discouraging hiring of foreign workers in order to lower the unemployment rate of nationals.[17]

This decline in inflows from

[15] Nevertheless, the magnitude of drop in remittances varied across countries during CY-2016. For example, India, Bangladesh and Nepal witnessed declines of 8.9 percent, 11.1 percent and 6.7 percent respectively during this period (Source: Migration and Development Brief 27, World Bank, April 2017)

[16] Besides layoffs, the number of Pakistani workers who proceeded to Saudi Arabia for work during Q3-FY17 dropped by more than 70 percent over the same period last year (source: Bureau of Emigration and Overseas Employment).

[17] Saudi Arabia has decided to restrict foreigners to work in the Kingdoms' shopping malls mainly to boost employment opportunities for its citizens as part of a long-term economic overhaul (Source: Bloomberg, 20 April 2017).

Saudi Arabia is expected to be compensated by a gradual pick up in inflows from other GCC countries, going forward. For instance, Kuwait's recent decision to lift visa restrictions on Pakistani citizens; the Expo 2020 in Dubai; and the FIFA World Cup 2022 in Qatar, are all expected to have a positive impact on remittance inflows. Furthermore, the government is planning to launch Pakistan Development Fund for the Pakistani diaspora in order to channelize their remittances more effectively.[18]

Services account

The services deficit has contracted by 2.8 percent in Jul-Mar FY17, as compared to an increase of 15.6 percent in the same period last year. This improvement occurred despite a widening in the freight deficit (due to a recovery in oil prices in the international market), and lower CSF inflows.[19] Higher exports of telecom services and a lower travel deficit mainly explain this development.

Nonetheless, it is worth noting that the persistent stagnation in Pakistan's services exports, along with the recent decline in export of goods, does not bode well for the country's current account balance. Further, Pakistan's services export to GDP ratio is lower than its regional peers (like India, Sri Lanka, Vietnam, Thailand, Indonesia and Malaysia) – mainly on account of challenging security environment in the country.[20] However, with the improved security situation, there is a need to pay more attention towards such exports, like computer services, so as to tap adequately their export potential.

Primary income account

The primary income deficit narrowed by 17.4 percent during Jul-Mar FY17 compared to the corresponding period last year. This happened primarily due to lower repatriation by oil and gas firms. Excluding this sector, the repatriation of profits and dividends on FDI grew slightly by US$ 58 million. Higher repatriations by food and petrochemical sectors were more than offset by lower repatriations by telecom and financial firms.

## 5.3 Financial account

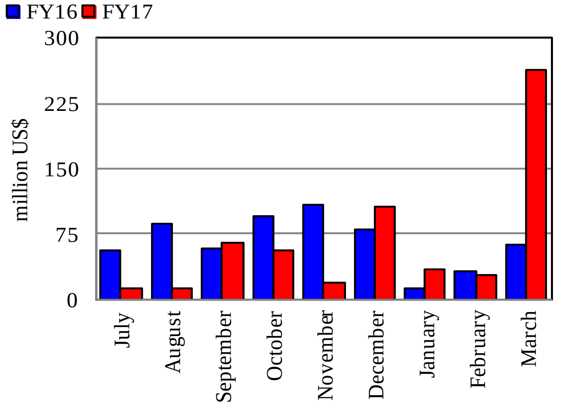
Net financial inflows increased during Jul-Mar FY17 over the same period last year; though official inflows were close to last year's level. Major inflows so far this year have come from: (i) a US$ 1.0 billion Sukuk issued in October 2016; (ii) US$ 851.5 million from the Asian Development Bank; (iii) US$ 1.0 billion in

[18] Source: Ministry of Finance press release dated April 26, 2017.
[19] During Jul-Mar FY17, average Arab Light Oil prices rose to US$ 48.0 per barrel, from US$ 40.1 in the same period last year (source: Bloomberg).
[20] Source: World Bank data (2015).

mostly project loans from China; (iv) commercial loans (both short- and long-term) of US$ 1.3 billion; and (v) around US$ 673 million in proceeds from stake sales of three local companies.[21] Commercial banks also borrowed heavily from commercial lenders, to the tune of US$ 848 million in Jul-Mar FY17, to ensure adequate dollar supplies in the wake of a surging current account deficit.[22]

In case of FDI, China continued to be the top contributor, accounting for 37.1 percent (US$ 594.8 million) of total net inflows of US$ 1.6 billion during Jul-Mar FY17. It is worth noting that slightly less than half of this Chinese FDI (i.e. US$ 262.5 million) materialized in March 2017 alone, mainly in electricity generation and construction sectors (**Figure 5.6**)[23]; the focus areas under the CPEC initiative. That said, FDI in the power sector declined 36.6 percent on YoY basis to US$ 389.3 million in Jul-Mar FY17;[24] at the same time, direct investment to the construction sector increased to US$ 264 million, from just US$ 34.8 million in Jul-Mar FY16.[25]

**Figure 5.6: Net FDI Inflows from China**



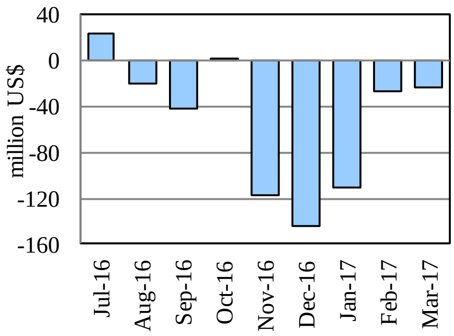

Data source: State Bank of Pakistan

[21] The inflow figures for ADB, China and commercial borrowings are in gross terms, as reported by the Economic Affairs Division, Ministry of Finance.
[22] In net terms, however, banks had retired US$ 263 million of short-term commercial loans during Jul-Mar FY16.
[23] During Jul-Feb FY17, net FDI from China had amounted to US$ 332.4 million, down 37.2 percent from the same period last year. A probable reason for the significant jump in inflows recorded in March 2017 is that the reporting of CPEC-related investment inflows by Pakistani commercial banks has improved, following the coming into force of EPD Circular Letter No. 14 of 2016, which had enhanced reporting requirements for transactions under special foreign currency accounts of power companies. For details, see Box 5.1 in SBP's State of the Economy Report for Q2-FY17.
[24] While most of this YoY decline (US$ 157.7 million) was noted in thermal power generation, net FDI into coal-fired power projects during Jul-Mar FY17 was down by a relatively smaller US$ 59.6 million.
[25] Some construction projects that have received FDI from China in FY17 include the Havelian-Thaikot section of the Karakoram Highway, Sukkur-Multan section of the Peshawar-Karachi Motorway, and the Lahore Orange Line project, according to the Economic Affairs Division, Ministry of Finance.

Besides CPEC-related investments, the country also received significant FDI from three merger and acquisition transactions in food, consumer electronics and financial services industries this year.[26]

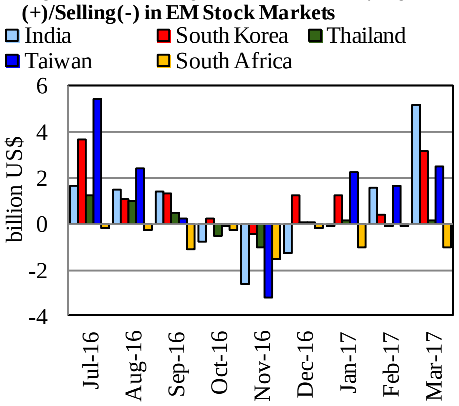
Meanwhile, portfolio investment was dominated by public sector inflows in Jul-Mar FY17 (as a result of the Sukuk), with private investors pulling out their funds from the local stock market on net basis. Most of these outflows (81.1 percent) were noted in the three month period of November 2016-January 2017, with the pace of foreign selling having slowed down considerably since then (**Figure 5.7a**).[27] This corresponds with the trend of foreign fund outflows from many EMs following the outcome of the US presidential elections (in November 2016), and the December 2016 federal funds rate hike.

**Figure 5.7a: Foreign Investors Portfolio Investment (flows) in Pakistan Stock Exchange**




Data source: National Clearing Company of Pakistan Limited

**Figure 5.7b: Foreign Investors' Net Buying (+)/Selling(-) in EM Stock Markets**




Data source: Bloomberg

However, after the brief volatile period, foreign funds started flowing back to some EMs from February 2017 onwards (**Figure 5.7b**). This dynamic didn't seem to change after the US Fed raised its benchmark rate for the second time in three months (in March 2017). As the rate increase was widely expected, global equity markets barely shrugged at the development.

[26] These included: US$ 458 million from the majority stake sale of Engro Foods to Dutch conglomerate FrieslandCampina; US$ 127.7 million from the complete sale of Dawlance Pakistan to Turkish firm Arcelik; and US$ 61 million from a 40 percent stake sale of the Pakistan Stock Exchange to a Chinese-led consortium.

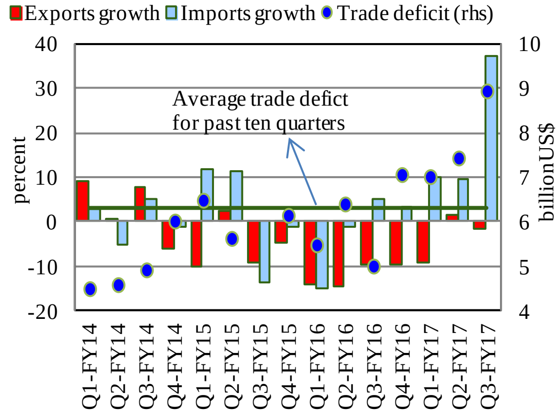
[27] Foreign investors have sold US$ 459 million worth of equities at the PSX during Jul-Mar FY17; of this, selling worth US$ 372.4 million was recorded in Nov-Jan FY17 (source: National Clearing Company of Pakistan Ltd).

In Pakistan's case, market analysts believe that foreign investor activity at the bourse in the short-term will be mainly driven by passive foreign funds, as the country formally rejoins the Morgan Stanley Capital International's (MSCI) Emerging Market Index in June 2017.

## 5.4 Trade account[28]

The trade deficit widened by 38.5 percent YoY during Jul-Mar FY17 to US$23.4 billion, against US$16.8 billion in the same period last year. This expansion was largely witnessed in the third quarter, when the deficit increased by 79.0 percent YoY and reached its highest level of US$ 8.9 billion (**Figure 5.8**). A hefty rise in imports alongside a decline in exports contributed to the widening deficit.

**Figure 5.8: Trade Account**

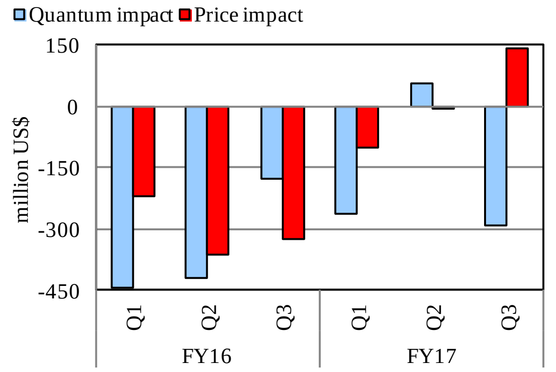



Data source: Pakistan Bureau of Statistics

Exports

Exports declined by 3.1 percent YoY during Jul-Mar FY17, after declining 13.0 percent in the same period last year. This was mainly due to a significant drop recorded in the first quarter, when both lower prices and quantums were in play. While the subsequent recovery in international commodity prices (mainly of cotton and rice) held some promise (particularly in the third quarter), their impact was more than offset by a decline in quantum exports of these commodities (**Figure 5.9**).[29]

**Figure 5.9: Breakdown of YoY Change in Exports***




* 27 Items whose quantum & price data are available and having 82 percent share in total exports.
Data source: Pakistan Bureau of Statistics and SBP's calculations

[28] This section is based on customs data reported by the PBS, which is different from payments record data compiled by SBP: SBP reports both exports and imports as free on board (fob), while PBS records exports as free on board (fob) and imports include the cost of freight and insurance (cif). For further detail, see Annexure on data explanatory notes.

*Textile*

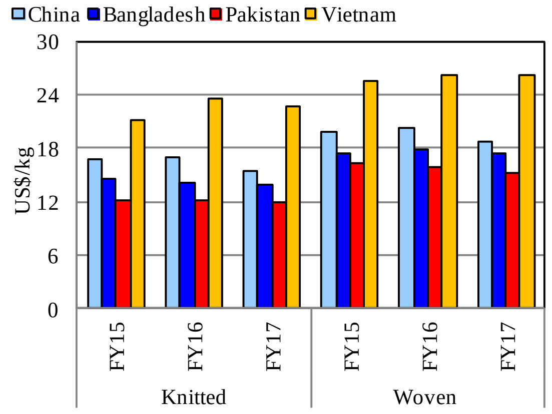
Textile exports fell by 1.0 percent during Jul-Mar FY17, after declining by 8.2 percent in the same period last year. The drop is mainly explained by lower quantum exports of low value-added products like cotton and fabric, as global cotton prices rebounded in the period under review. Exports of some high value-added items, like bedwear and readymade garments, increased during Jul-Mar FY17; encouragingly, their better performance was largely a result of higher quantums (**Table 5.3**), mainly due to a recovery in demand from the key EU market.[30]

**Table 5.3:Textile Exports Price & Quantum Impact (YoY) during Jul-Mar FY17**

| million US$ | Quantum | Price | Abs. change |
|---|---|---|---|
| **Textile group** | | | **-91.4** |
| *of which* | | | |
| **Low value-added** | **-186.9** | **23.4** | **-163.5** |
| *Raw cotton* | *-40.3* | *3.6* | *-36.7* |
| *Cotton yarn* | *38.1* | *-85.8* | *-47.6* |
| *Cotton fabrics* | *-174.9* | *104.2* | *-70.7* |
| *Others* | *-9.8* | *1.3* | *-8.5* |
| **High value-added** | **69.9** | **34.9** | **104.8** |
| *Knitwear* | *-57.9* | *45.8* | *-12.1* |
| *Bedwear* | *123.5* | *-40.2* | *83.3* |
| *Towels* | *4.5* | *-17.0* | *-12.5* |
| *Tarpaulin* | *25.9* | *12.9* | *38.7* |
| *Readymade garments* | *109.1* | *-13.5* | *95.7* |
| *Synthetic textiles* | *-135.2* | *46.9* | *-88.4* |

Data source: Pakistan Bureau of Statistics

**Figure 5.10: Unit Values of Clothing in EU market (Jul-Mar)**




Data source: Eurostat and SBP's calculations

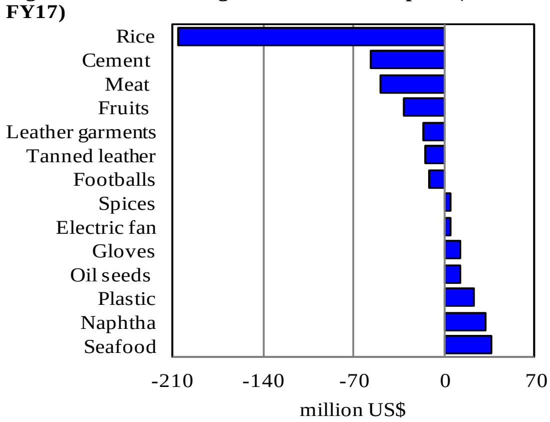
Nonetheless, in terms of price factor, the gains in export values are still not appearing. In fact, Pakistan's high value-added exports to advanced economies face tough competition from regional competitors. To make products more attractive, exporters slash their prices. In this way, they tend to maintain their product share in the international market. This situation has been clearly visible in the EU market this year, where Pakistani exporters have received lower unit prices for clothing items (both knitted and woven clothes), as compared to their regional competitors (**Figure 5.10**).

[29] This analysis is based on 27 items whose quantity and price data are available with PBS. They represent around 82 percent of the country's total exports.
[30] Textile and clothing imports of EU-28 countries rose by 4.1 percent YoY in terms of quantity during Jul-Mar FY17, after declining by 3.5 percent in the same period last year (source: Eurostat).

This performance is despite ample policy support available to the textile industry, which includes the Drawback of Local Tax and Levies (DLTL), tax rebates, and export finance schemes etc. In fact, the textile industry has been making good use of record-low interest rates and other policy incentives this year: imports of textile machinery and fixed investment borrowing by the sector have both recorded healthy increases in Jul-Mar FY17 (**Chapter 3**). More recently, a Rs 180 billion export incentive package has been announced to support the five key exporting industries.

However, these measures have yet to translate into a broad-based improvement in textile exports. The real benefits of this financial support will be realized when the exporters make the required efforts to increase their efficiency, improve product quality, explore new markets and keep track of changing customer preferences in their key markets. Also, they have to invest more in upgrading physical and human capital so that they could offer high-quality products at competitive prices.

**Figure 5.11: YoY Change in Non-Textile Exports (Jul-Mar FY17)**




Data source: Pakistan Bureau of Statistics

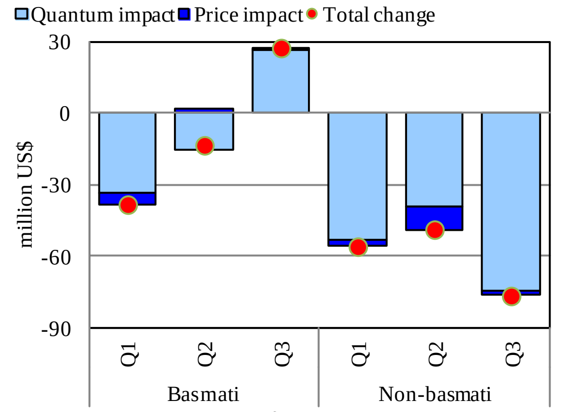
*Non-textile*

The drop in non-textile exports moderated to 6.4 percent during Jul-Mar FY17, from 19.3 percent in the same period last year. Out of three major categories – food, other manufactured goods, and petroleum – only the POL group recorded an increase (of 8.0 percent YoY) during the period (**Figure 5.11**).

In the food group, the growth in fish and oil seeds exports were offset by a decline in rice, meat and fruit shipments. The exports of rice (both basmati and non-basmati) fell 14.9 percent YoY in Jul-Mar FY17. That said, the entire decline in basmati exports was witnessed in the first half of FY17, as consignments grew by 31.3 percent YoY in the third quarter (**Figure 5.12**). This increase was driven by higher quantums, as demand from two markets – UAE and Iran – improved during the period. Moreover, basmati exports to Iran are likely to increase further in the coming months, as the Iranian government has removed import restrictions and lowered the import duties on brown/husked and milled rice.[31]

In contrast, weaker demand for non-basmati rice from our traditional markets (i.e. African countries, Malaysia and Philippines) has suppressed export quantums throughout the year; this has more than offset the positive spillover of a recovery in global prices of the commodity since October 2016. Import restrictions by some African countries put further pressure on the export of non-basmati rice varieties.[32]

**Figure 5.12: Breakdown of YoY Change in Rice Exports**

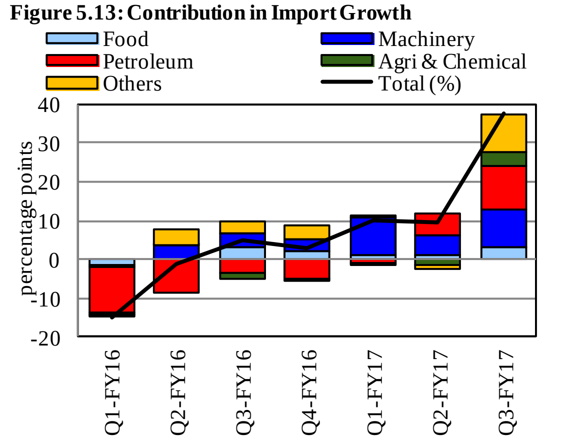



Data source: Pakistan Bureau of Statistics and SBP's calculations

Imports

The imports continued to surge and reached a historic peak of US$ 38.5 billion in Jul-Mar FY17. Most of this increase was observed in Q3-FY17, when imports of *petroleum, machinery and chemical* items all rose significantly (**Figure 5.13**): in fact, machinery and petroleum imports contributed around 55 percent to the overall increase in imports in Q3-FY17.

**Figure 5.13: Contribution in Import Growth**




Data source: Pakistan Bureau of Statistics and SBP's calculations

[31] Iran reduced import duties on husked and milled rice to 5 and 26 percent from 32 and 40 percent respectively from January 2017. The surcharge of US$ 154 per ton was also abolished on both products.
[32] Nigeria placed a 50 percent levy on the import of husked and milled rice in December 2016. Senegal suspended rice imports from December 2016 as well, in order to facilitate the placement of privately held local stockpile.

*Petroleum*

POL imports during Jul-Mar FY17 were entirely driven by higher quantum product imports, with crude oil shipments declining during the period on YoY basis (**Table 5.4**). The rise in petroleum product imports reflected strong domestic demand by the transport and power sectors: sales of high speed diesel (HSD) and petrol increased by 12.9 percent and 17.4 percent YoY respectively. Meanwhile, furnace oil imports rose by 7.3 percent YoY during the period.[33] Infrastructure development activities under CPEC boosted the demand for HSD, which is mainly used by heavy commercial vehicles. This was also reflected by rising imports as well as sales of heavy vehicles.[34] On the other hand, the increase in furnace oil imports corresponded with a rise in power generation from the fuel during the period.[35]

**Table 5.4: Contribution in POL Import Growth (Jul-Mar)**

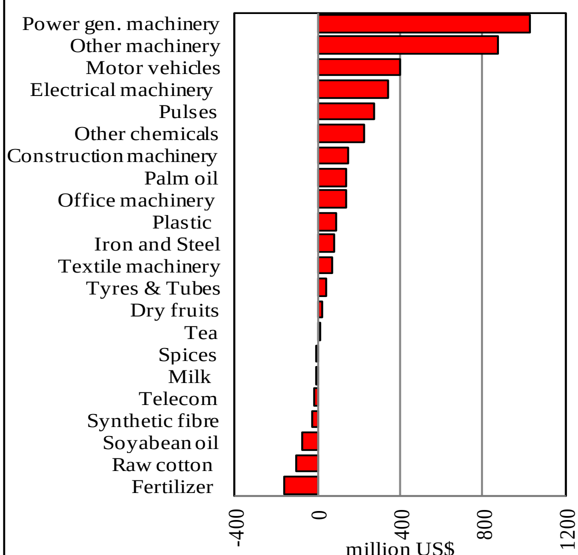
| percentage points | FY16 | FY17 |
|---|---|---|
| Petrol | 6.0 | 4.0 |
| High speed diesel | -0.8 | 4.5 |
| Furnace oil | -1.7 | 4.1 |
| Other products | 0.2 | 0.1 |
| Crude oil | 4.9 | -2.4 |
| **Total (%)** | **8.6** | **10.2** |

Data source: Oil Companies Advisory Council

*Non-POL*

Imports of all major non-oil industries rose significantly during Jul-Mar FY17 (**Figure 5.14**). This was entirely an outcome of higher quantums, as the unit values of most items (except palm oil) fell during the period.

**Figure 5.14: YoY Change in Non-POL Imports**




Data source: Pakistan Bureau of Statistics

[33] Source: Oil Companies Advisory Council.

[34] The import of both CKDs/SKDs and CBUs of heavy vehicles increased by 34.0 percent YoY during Jul- Mar FY17 (source: Pakistan Bureau of Statistics). According to the Pakistan Automotive Manufacturers Association, the sales of heavy vehicles (trucks and buses) also increased by 38.7 percent YoY during the period.

[35] Total power generation in the country increased by 3,166GWh in Jul-Mar FY17, of which 1,130GWh was contributed by furnace oil (source: NEPRA).

*Machinery*

Machinery imports contributed more than 40 percent to the overall import growth during Jul-Mar FY17, with power, electrical and construction-related equipment leading the charge (**Table 5.5**).

**Table 5.5: Machinery Imports - YoY Growth (%)**

| | FY17 | | | FY16 | FY17 |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Jul-Mar | |
| **Machinery group** | **60.1** | **26.9** | 43.8 | **14.1** | 42.0 |
| *Of which* | | | | | |
| Power | 164.8 | 78.6 | 24.8 | 43.6 | 76.8 |
| Office | 125.3 | 31.2 | 38.2 | -26.4 | 60.4 |
| Textile | 5.7 | 16.3 | 42.8 | -1.2 | 20.8 |
| Construction | 15.3 | 122.1 | 98.2 | 12.3 | 66.8 |
| Electrical | 32.6 | -7.2 | 63.4 | 51.2 | 25.9 |
| Telecom | -12.4 | 1.1 | 4.6 | -2.2 | -1.8 |
| Agriculture | 15.1 | 23.9 | 71.3 | -20.5 | 35.2 |
| Others | 73.9 | 26.0 | 64.9 | 1.0 | 52.7 |

Data source: Pakistan Bureau of Statistics

Meanwhile, an increase in textile machinery (mainly for spinning and weaving) was observed in Q3-FY17. This basically reflects higher investment by the sector, as firms start taking benefit of various policy support measures (like the export package announced in January 2017, the removal of sales tax on import of textile machinery, and record-low interest rates).[36]

Besides, strong domestic construction activities (both CPEC and non-CPEC related) have led to a sizable increase in demand for cement in the country.[37] To cope with this surging demand, many cement manufacturers are investing in capacity expansions. This, in turn, has boosted the import of related machinery, which are classified in the "other machinery" category (**Figure 5.14**).[38] The low interest rate environment also benefitted cement manufacturers, which was reflected in the higher bank borrowing.[39]

To promote the information & communication technology sector, the exemption of sales tax on import of laptops and personal computers was granted in the budget 2016-17. This measure has led to a significant increase in the import of these

[36] This policy support already seems to be having the intended effect: outstanding financing under Long-Term Financing Facility (LTFF) increased by Rs 30 million during Jul-Mar FY17; of this, textile sector was responsible for an increase of Rs 28.4 million. Within textiles, most of the financing was availed by spinning and weaving segments.

[37] Domestic cement dispatches increased by 10.9 percent YoY in Jul-Mar FY17 (source: All Pakistan Cement Manufacturer Association).

[38] According to detailed SBP data, imports of grinding and crushing machinery for cement plants rose by US$ 105.7 million during Jul-Mar FY17, compared to a minor increase of US$14.0 million noted in the same period last year.

[39] Fixed investment and trade financing for the cement sector rose to Rs 8.7 billion and Rs 3.8 billion in Jul-Mar FY17, from Rs 0.1 billion and Rs 0.9 billion respectively in the same period last year (for further details, see **Chapter 3**).

products; laptops and personal computers have a 36 percent share in total imports of office and data processing machinery during Jul-Mar FY17.[40]

*Food*

The rise in food imports during Jul-Mar FY17 was mainly led by higher purchases of palm oil and pulses. In case of palm oil, the recovery in its international prices in FY17 is entirely responsible for the 11.5 percent YoY increase in its imports in Jul-Mar FY17; quantum imports actually declined by 7.0 percent YoY during the period (**Table 5.6**).[41] Meanwhile, lower domestic production of pulses could be the possible reason which necessitated higher imports of pulses to ensure sufficient supplies in the domestic market.

**Table 5.6: Import of Palm Oil (YoY change in abs. values)**

million US$

| | FY17 | | | FY16 | FY17 |
|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Jul-Mar | |
| Quantum impact | -85.9 | 13.4 | -14.3 | 264.7 | -86.8 |
| Price impact | 16.5 | 69.4 | 143.8 | -363.2 | 229.7 |
| Total change | -69.4 | 82.8 | 129.5 | -98.6 | 142.9 |

Data source: Pakistan Bureau of Statistics

Summing up, the trade outlook is likely to continue with the prevailing trend in the remaining period of FY17. The import bill will remain high due to robust demand for fuel, machinery and food items, whereas exports may get some boost in the wake of recently announced fiscal incentives, improved business environment, and ease in energy supplies.

40 According to SBP data, the import of laptop and personal computers increased by US$ 101.7 million during Jul-Mar FY17, compared to a rise of US$52.1 million recorded in the same period last year.

41 Global palm oil prices increased by 25.0 percent YoY in Jul-Mar FY17 as compared to last year (source: IMF).