

# 5 External Sector

## 5.1 Overview

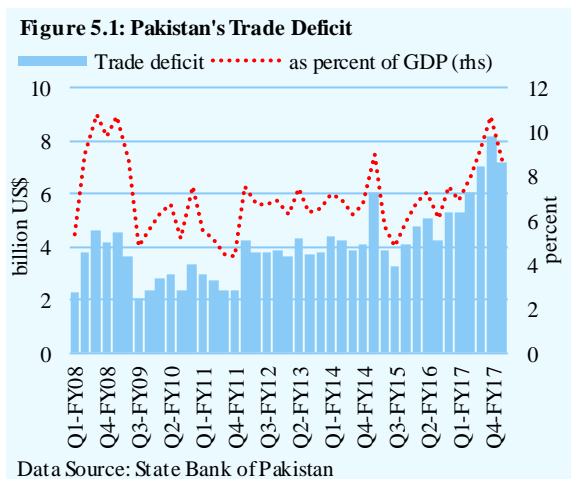
Global economic activity gathered some pace with the start of 2017. Better macroeconomic indicators in the US, EU and UK provided enough comfort to their policymakers to start rolling back unconventional monetary measures. Till September 2017, the US Fed has raised interest rates twice; the European Central Bank has downsized its asset purchase program; and the Bank of England has raised its interest rates for the first time in a decade. Meanwhile, commodity prices have stayed at low levels but posted some recovery from the slump recorded in mid-2016. These developments boded well for the emerging economies that mainly rely on two major sources of FX inflows: export earnings and workers' remittances. Encouragingly, both of these have picked up in case of Pakistan during the first quarter of FY18.

The recovery in exports was broad-based, led by strong performances by rice, leather manufactures and textiles (both low and high-value added). Pakistan's performance was particularly convincing in textiles as not just volumes, but the share of domestic products has visibly increased in our traditional export markets of the US and EU. In case of remittances, the improvement was evident in non-GCC corridors, especially the UK and US, which more than offset lower inflows from the GCC countries during Q1-FY18.

These improvements notwithstanding, concerns related to Pakistan's overall balance of payments persisted, as increased economic activities at home pushed the country's imports further up. Import payments for petroleum, machinery, metal and transport were particularly high, as the economy moved steadily along a high growth trajectory. However, two aspects are noteworthy when it comes to explaining the higher import bill during the quarter:

- (i) While domestic energy requirements have certainly been shored up (leading to increased import volumes), a 16.5 percent rise in international crude prices has contributed equally in explaining the increased payment burden, if not more. The impact is most pronounced in the case of furnace oil (FO), which constituted 44 percent of the total import of POL products (excluding crude): although FO quantum purchases have fallen by 15.3 percent YoY in Q1-FY18, payments remained higher than last year as global price of the fuel took a steep turnaround (25.6 percent up YoY); and

(ii) The growth in machinery imports has begun to lose steam, as evident in a sharp slowdown reported in customs' records. This trend was visible prominently in case of power generation machinery, where imports have posted a YoY decline. However, the payment burden in the interbank market for machinery items still appears strong, representing lagged payments for earlier shipments.



Nonetheless, with FX earnings falling increasingly short of payments, the trade deficit stayed at historic high levels (**Figure 5.1**). This took the size of the current account deficit to US\$ 3.7 billion during the quarter, which was more than twice as large as in Q1-FY17 (**Table 5.1**).

Financing of this deficit did not come easy. Although foreign direct investment (FDI) rose by 56 percent YoY, a part of this increase was offset by equity sell-off by foreign investors. That said, the key pressure point during the quarter was the realization of loan inflows that were barely adequate to take

**Table 5.1: Summary of Pakistan's External Sector**

million US\$	Q1-FY17	Q1-FY18	Abs change
<b>Current account balance</b>	<b>-1,637</b>	<b>-3,698</b>	<b>-2,061</b>
Trade balance	-5,265	-7,277	-2,012
Exports	5,052	5,676	624
Imports	10,317	12,953	2,636
POL imports	2,349	2,945	596
Non-oil imports	7,968	10,008	2,040
Machinery	1,705	2,204	499
Metal	753	1,165	411
Food	1,174	1,475	301
Transport	544	797	253
Services balance	-1,157	-1,244	-87
Primary income balance	-992	-984	8
Secondary income balance	5,777	5,807	30
Worker remittances	4,740	4,791	51
<b>Capital account balance</b>	<b>82</b>	<b>102</b>	<b>20</b>
<b>Financial account balance</b>	<b>-1,932</b>	<b>-1,098</b>	<b>834</b>
FDI in Pakistan (net)	423	663	240
FPI in Pakistan (net)	118	-128	-246
Net incurrence of liabilities	1,212	186	-1,026

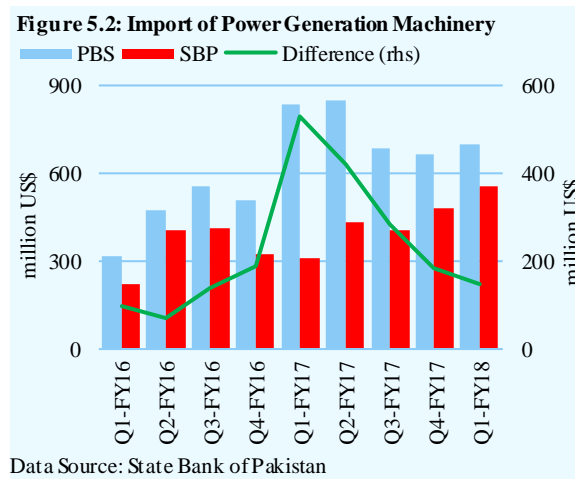
Data Source: State Bank of Pakistan

care of the bulky debt repayments during the period; as a result, the entire burden of funding the current account deficit was shifted onto the country’s FX reserves.<sup>1</sup> The depletion in SBP’s FX reserves during Q1-FY18 amounted to US\$ 2.3 billion, with the reserves reaching US\$ 13.9 billion by end-September; these can finance just over three months of the country’s import bill.

### 5.2 Current account

While FX earnings from both exports and remittances recovered in the quarter – with export receipts rising 12.4 percent and remittances up 1.1 percent – these were insufficient to offset a hefty 25.6 percent rise in the import bill in the period.

In nominal terms, the POL group contributed the most to the YoY increase in import payments, followed by machinery, metals and food groups. As for machinery, it is important to note that the payment pressure, including those for CPEC projects, is finally falling on the interbank. This can be gauged by the fact that whereas imports of power generation machinery, as reported by PBS, declined by 16.6 percent YoY in Q1-FY18, import payments for power generation machinery (reported by SBP) grew 79.9 percent YoY. This dynamic has also led to a gradual shrinkage in the difference between machinery imports reported by SBP and PBS (**Figure 5.2**).



Meanwhile, the rebound in exports was reflected in both traditional products – rice (both basmati and non-basmati), textiles (both low and high-value added), and leather manufactures – as well as non-traditional items, including seafood and footwear items (**Section 5.5**). From the markets’ perspective, the recovery in export earnings was broad-based and not just concentrated in the two key markets (i.e., Europe and the US); export receipts from some non-traditional markets (particularly Afghanistan and China) were also higher as compared to the same period last year. Here, it is important to sustain this trend of higher exports to

<sup>1</sup> Gross official FX loan disbursements amounted to US\$ 1,413 million in Q1-FY18, whereas gross repayments came in at US\$ 1,351 million, leading to a net inflow of just US\$ 62 million.

non-traditional markets, both from the standpoint of export diversification and to create a buffer to guard against any abrupt or adverse changes in trade policies of the US and EU.

#### Workers' remittances

Remittances sent by overseas Pakistanis rose 1.1 percent to US\$ 4.8 billion in Q1-FY18. This was entirely due to a rebound in inflows from non-GCC corridors, which more than offset the drag coming from the six-nation GCC (**Table 5.2**). Encouragingly, remittances from the US – the fourth largest source of these inflows – extended their growing streak into the third straight quarter in Q1-FY18, despite a quite challenging (and costly) regulatory environment for cross-border funds transfers.

While the reversal of the declining trend in overall remittances observed during most of FY17 is welcome, there are some important reasons to remain cautious about the continuity of this trend going forward.

Specifically, favorable currency movements likely played a role in pushing up inflows recently, particularly from the UK and other EU countries.

The US dollar's depreciation against both the sterling and the euro (**Section 5.4**) has propped up the dollar value of remittances from the UK and other EU countries. During Q1-FY18, the sterling has appreciated 2.1 percent and the euro 3.0 percent against the dollar. It may be recalled here that the exact opposite of this – i.e., the sterling's sizable depreciation against the dollar in the months after the June 2016 Brexit vote – had suppressed the dollar value of remittances from the UK in Q1-FY17.

**Table 5.2: Corridor-wise Worker Remittances in Q1**

million US\$	Values		
	FY16	FY17	FY18
<b>GCC</b>	<b>3,148</b>	<b>2,975</b>	<b>2,869</b>
Saudi Arabia	1,441	1,324	1,228
UAE	1,115	1,076	1,078
Other GCC	593	576	563
UK	672	550	643
USA	715	613	626
EU	94	123	160
Others	336	480	492
<b>Total</b>	<b>4,966</b>	<b>4,740</b>	<b>4,790</b>

Data Source: State Bank of Pakistan

**Table 5.3: Remittance Growth Projections for CY17**

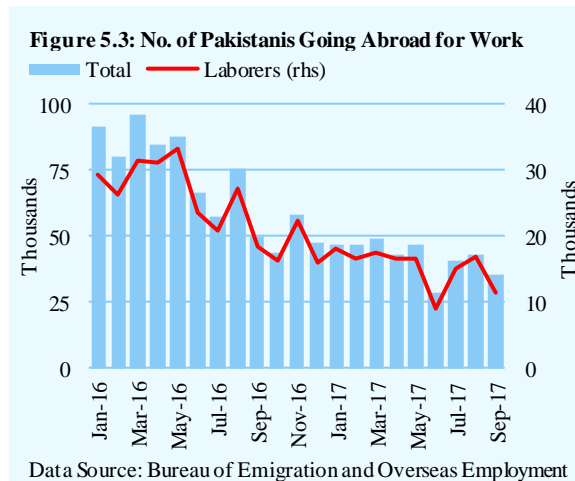
percent change, YoY	2016	2017*
<b>South Asia</b>	<b>8</b>	<b>1.1</b>
Pakistan	2.4	0.2
India	-8.9	4.2
Bangladesh	-11.4	-5.2
Sri Lanka	3.7	-8.1
<b>East Asia &amp; Pacific</b>	<b>-2.6</b>	<b>4.4</b>
Philippines	4.5	5.3
Indonesia	-7.1	-3.5
<b>Latin America</b>	<b>-6.1</b>	<b>1.1</b>
Mexico	9.3	6.5
<b>World (Overall)</b>	<b>-1.4</b>	<b>3.9</b>

\* Projected

Data Source: World Bank

Meanwhile, remittances from the largest source – the GCC – continued to decline in Q1-FY18, in line with the challenging labor market conditions in the region for migrant workers. The South Asia region is particularly impacted by this scenario, given that the GCC is the top destination for low-skilled workers from India, Pakistan and Bangladesh. This is one reason why remittances to South Asia region had declined the most in CY16, and are projected to grow by the lowest rate in CY17, according to the World Bank (**Table 5.3**). This is in stark contrast to regions like East and Central Asia, and Latin America (particularly countries like Philippines and Mexico), whose remittances mostly originate from major advanced economies: the US and EU, and recovering economies like Russia.

For Pakistan, the problem appears to be structural in nature. First, Pakistan mostly exports low-skilled migrants to the Middle East; over the past two years, over one-third of Pakistanis who went abroad for work (mainly to the GCC) and registered with the Bureau of Emigration and Overseas Employment (BEOE), were laborers. Demand for these types of low-skilled jobs is often cyclical and depends heavily on initiation of new projects. In the wake of the oil price crash and subsequent fiscal retrenchment in the GCC, there has been a marked slowdown in construction activities across the region, and particularly in Saudi Arabia. This, in turn, has reduced the region’s demand for laborers; unsurprisingly, the number of Pakistani laborers going abroad for work has been declining for over a year now (**Figure 5.3**), and the trend is likely to continue.



Another issue is the relatively high cost that Pakistani emigrants have to pay recruiting agents in return for job placement in the Middle East. According to World Bank estimates, a Pakistani worker is likely to pay a recruiting agent as much as US\$ 5,500 to land a job in Saudi Arabia – or 3.6 times the highest cost incurred by an Indian worker to find a job in the kingdom (US\$ 1,500). The significantly high charges can be explained by the limited physical network of recruiting agencies, which leaves word-of-mouth as the principal way through which prospective emigrants find out about job opportunities in the Gulf. Each of

these so-called sub-agents (both formal and informal ones) then charge a commission from the prospective worker, which leads to a ballooning in the total cost of recruitment incurred by the emigrant.

To deal with these structural issues, the government is working on a comprehensive policy for migrant welfare. One of the key objectives is for the BEOE to coordinate with provincial technical and vocational training authorities to train workers in areas where demand for imported manpower exists. Some other proposals are aimed at reducing work-related costs incurred by prospective emigrants by streamlining the recruitment process. That said, these structural adjustments would only start having an impact in the medium- to long-term.

For the interim period, the Pakistan Remittance Initiative (PRI) is continuing its efforts to ensure that migrants use formal channels to send remittances. It is now working on a nationwide advertising and marketing campaign, to raise awareness among the public about the ease and cost-effective manner in which they can send money through banks and MTOs, and about the danger in using illegal money transfer services (i.e. hundi/hawala). Efforts are also being made to better utilize the existing branchless banking setup in the country for remittance transfers. Meanwhile, the government continues to reimburse commercial banks for the TT charges they incur in processing remittances transactions, to ensure that the end-cost of remitting funds for migrants stays minimal, if not zero.

#### Primary income

The deficit in the primary income account during Q1-FY18 was virtually of the same magnitude as in Q1-FY17 (**Table 5.1**). While profit and dividend repatriation on FDI by firms increased 25.6 percent (especially FMCGs, finance and telecom), these were offset by a YoY drop in repatriation of oil and mineral proceeds. Meanwhile, net interest payments (on both public and private debt) rose by a significant 66.7 percent to US\$ 390 million in Q1-FY18.

#### Services account

The deficit in the services account also remained broadly unchanged in Q1-FY18 compared to the same period last year. A healthy rebound in net software services exports, which reached US\$ 51.8 million in the period, boosted net exports of the overall telecom, computer and information group by 21.3 percent in the first quarter. Apart from telecom and computer services, net exports of government services, and other business services exports (mainly technical and trade-related), also performed relatively better as compared to last year.

The improvement in these accounts was quite important, as it helped offset a 30.4 percent increase in the freight deficit in the quarter. Freight, which is the largest component in the services account, posted a deficit of US\$ 596.0 million in Q1-FY18. The higher freight charges were a direct result of the 25.6 percent increase in overall merchandise imports in the quarter.

### 5.3 Financial Account

During the first quarter of FY18, the level of total foreign investments remained almost the same as last year – an increase in net FDI inflows was offset by an almost equal decline in net FPI (Table 5.1). This, along with lower inflow of external loans, was unable to finance the higher current account gap in Q1-FY18.

#### Foreign direct investment

With a threefold-increase in investment from China (mostly in power and construction), net FDI in Pakistan grew by 56 percent in Q1-FY18 over the same period last year (Table 5.4). In addition, the vibrancy in Pakistan’s telecom sector attracted an investment of over US\$ 100 million from Malaysia, during the period.

**Table 5.4: Sector-wise inflow of FDI in Pakistan**

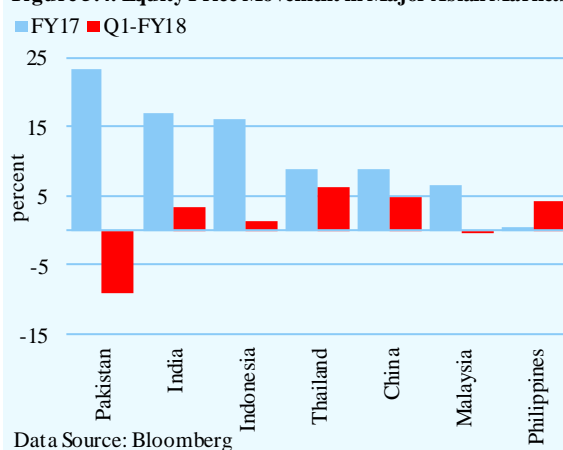
million US dollars			
	Q1-FY17	Q1-FY18	Abs change
Power	121	268	147
Coal	54	173	119
Hydel	22	64	42
Thermal	45	31	-14
Construction	31	124	92
Financial Business	60	71	11
Telecommunication	4	65	60
Oil & gas exploration	35	49	14
Others	171	85	-86
<b>Total</b>	<b>423</b>	<b>663</b>	<b>239</b>

Data Source: State Bank of Pakistan

#### Foreign portfolio investment

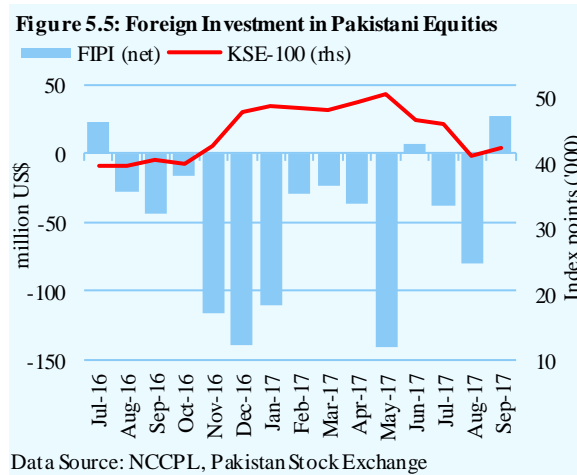
Starting in early 2017, portfolio flows to the Asian equity markets revived mainly on the region’s strong fundamentals and improved investor sentiment about the global economy. In particular, Pakistan had outperformed the regional equity markets in FY17, which primarily reflected the exuberance of domestic investors over strengthening fundamentals (Figure 5.4).

**Figure 5.4: Equity Price Movement in Major Asian Markets**



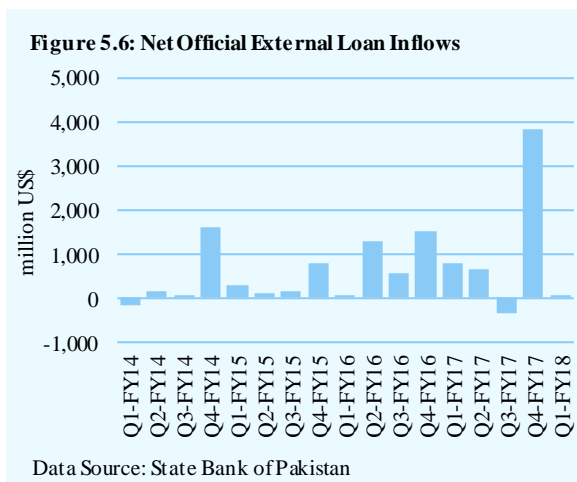
Data Source: Bloomberg

However, Pakistan’s equity market began to lose steam from May 2017 onwards, as both foreign and local investors seemed cautious due to growing political noise and rising external imbalances (**Figure 5.5**). As a result of these factors, the market was not able to benefit from inclusion in MSCI emerging market index in June 2017. Foreign investors were particularly wary of sentiments surrounding the PKR before they could take fresh position in the market. As a result, the net FPI recorded an outflow of around US\$ 128 million, against an inflow of around the same amount last year.



Net incurrence of liabilities

The net inflow of external loans into the country amounted to US\$ 186 million in Q1-FY18 – down significantly from debt inflows of US\$ 1.2 billion recorded in the same quarter last year. The lower inflows were mainly a result of: (i) lower gross disbursements and higher gross repayments of official loans; and (ii) net retirements by non-financial private sector firms.



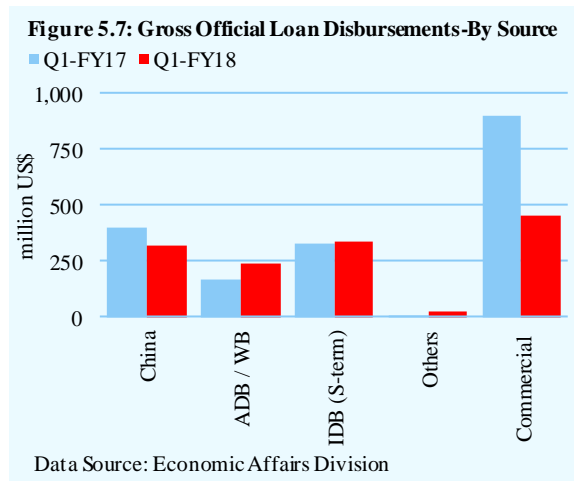
Nonetheless, an increase in short-term FX borrowings by commercial banks was also noted; this contributed to exchange rate stability in the interbank.

With regards to official inflows, it appears that the government borrowed just enough in the preceding quarter to make the external debt payments that were coming due, without having to dip into the FX reserve stockpile. In Q1-FY18,



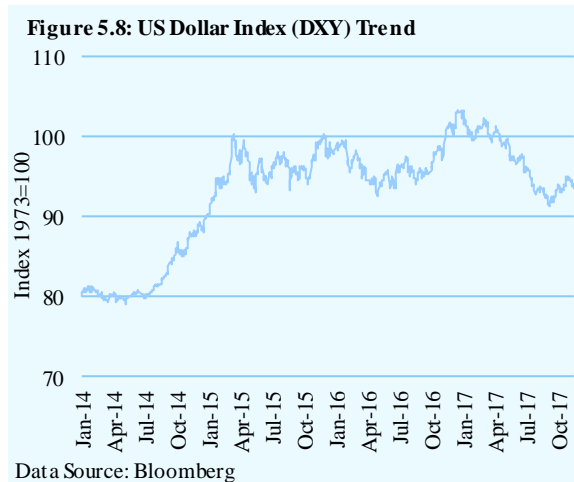
there was a minor net borrowing of US\$ 62 million, compared to a net borrowing of US\$ 785 million recorded in the same period last year (**Figure 5.6**). From rollover risk standpoint, long-term loan repayments far exceeded disbursements during the quarter, and were partly financed out of short-term loans that were contracted in the period.<sup>2</sup>

In terms of source, commercial borrowings continued to dominate official loan disbursements in Q1-FY18, though the magnitude of these borrowings was markedly lower as compared to the same period last year (**Figure 5.7**). However, gross inflows from key IFIs – World Bank and the Asian Development Bank (ADB) – were also higher on YoY basis; the continuation of this IFI support is important in sustaining foreign investors’ confidence in the Pakistani economy.<sup>3</sup>



#### 5.4 Exchange Rate and Reserves

The strength accumulated by the US dollar in run-up to the US elections began to lose steam soon after swearing in of the newly elected president in January 2017. Additional pressures on the greenback came from growing geopolitical tensions between the US and North Korea. Even the two interest rate hikes by



<sup>2</sup> There was a net long-term official loan retirement of US\$ 214 million in Q1-FY18. On the other hand, a net inflow of US\$ 213 million was noted in official short-term loans during the period.

<sup>3</sup> Gross official loan disbursements by the World Bank amounted to US\$ 118.6 million in Q1-FY18, up 111.4 percent YoY. Meanwhile, gross disbursements by the ADB were also 1.3 percent higher on YoY basis (and reached US\$ 117.3 million) in the period (source: Economic Affairs Division).

the Fed in March and June 2017 were unable to arrest the dollar’s falling trend. Further, the two hurricanes (Harvey and Irma) in the US also contributed to the fall of already weak dollar – US dollar index fell below 92 in Sep 2017 (the level last seen in Jan 2015), as shown in **Figure 5.8**.

The weaker dollar helped lead to a rebound in other major currencies, like the Euro, Japanese yen, British pound and Chinese yuan, which had all depreciated in the second quarter of FY17. The Euro outperformed all the major currencies in 2017, on the back of fading political risks (particularly, since the French presidential elections in April 2017), as well as improved confidence in the euro area recovery.

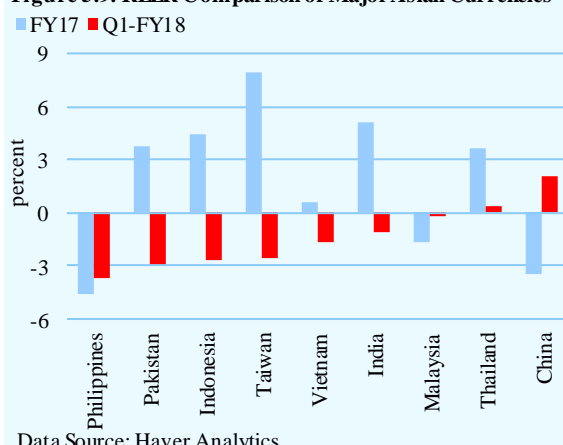
While most of the regional currencies also recovered against the US dollar in early 2017, the PKR was an exception – it depreciated by 0.8 percent up during Jan- Sep 2017; of this, 0.5 percent depreciation was recorded in Jul-Sep 2017 alone. As such, against the currencies of a number of trading partners and competitors (e.g., China, EU, UK, Thailand and Singapore), the PKR recorded a more pronounced depreciation (**Table 5.5**). In real terms also, the PKR posted depreciation of 2.7 percent in Q1-FY18, partly offsetting the appreciation seen in FY17 (**Figure 5.9**).

**Table 5.5: PKR Against Selected Currencies**  
percent

	Country	Trade Wt. (%)	FY17	Q1-FY18
1	USA (USD)	19.5	-0.02	-0.5
2	China (CNY)	13.99	2.0	-2.4
3	Germany (EUR)	8.45	-2.4	-3.8
4	Japan (JPY)	7.44	8.9	-0.0
5	UK (GBP)	5.49	3.8	-3.4
6	Italy (EUR)	4.69	-2.4	-3.8
7	France (EUR)	3.91	-2.4	-3.8
8	India (INR)	2.41	-4.2	0.5
9	Turkey (TRY)	2.27	22.0	0.5
10	Netherlands (EUR)	2.26	-2.4	-3.8
11	Spain (EUR)	2.23	-2.4	-3.8
12	Thailand (THB)	2.17	-3.4	-2.3
13	Singapore (SGD)	2.08	2.3	-1.8
14	Belgium (EUR)	1.95	-2.4	-3.8
15	Malaysia (MYR)	1.73	6.6	-2.1
16	Indonesia (IDR)	1.37	0	1.0

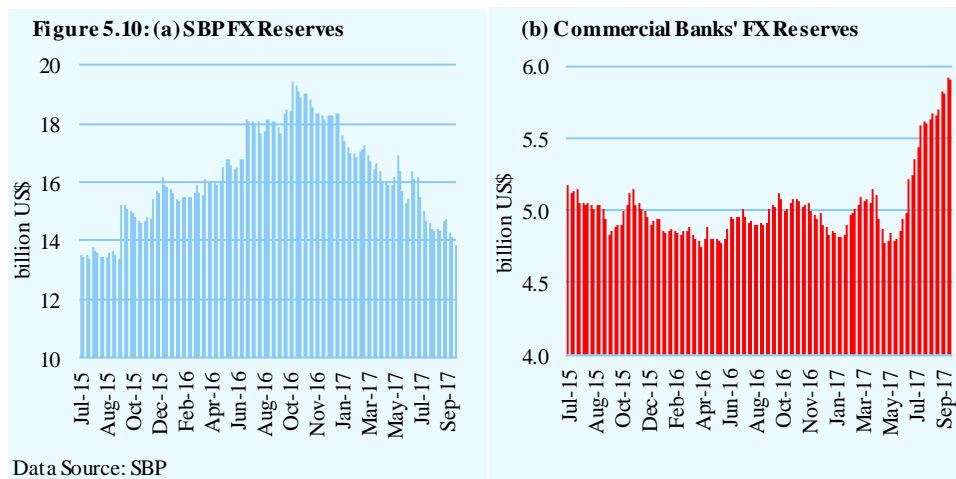
Data Source: State Bank of Pakistan

**Figure 5.9: REER Comparison of Major Asian Currencies**



Data Source: Haver Analytics

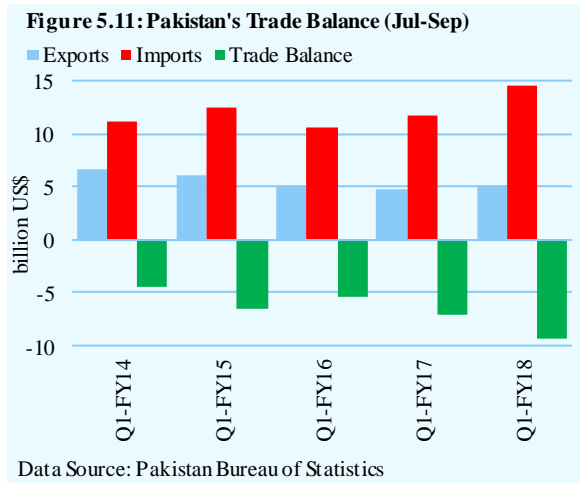
Pakistan’s foreign exchange reserves witnessed a decline of US\$ 1.6 billion in Q1-FY18 as imbalances in the external account deepened. This decline was primarily driven by a fall in SBP reserves. On the other hand, FX reserves of commercial banks posted an increase of US\$ 660 million in Q1-FY18, which primarily represents retirements of foreign currency loans by importers (**Figure 5.10**).<sup>4</sup>



### 5.5 Trade Account<sup>5</sup>

The trade deficit witnessed a sharp YoY increase of 29.8 percent in Q1-FY18. A rebound in export earnings did not suffice to contain the pressure of increasing imports; as a result, the trade deficit expanded to US\$ 9.1 billion (**Figure 5.11**).

The increase in imports was broad-based, with transport and petroleum imports surging by a



<sup>4</sup> The amount for trade financing is deducted from FE-25 deposits to calculate liquid FX reserves of commercial banks. Thus a net retirement of trade loans contributes to a rise in these reserves.  
<sup>5</sup> The analysis is based on the provisional data provided by Pakistan Bureau of Statistics. This data may not tally with the exchange record numbers reported in the section on *Balance of Payments*. To understand the difference between these two data series, please see Annexure on data explanatory notes.

third and food imports rising by 19.3 percent. Exports, meanwhile, in an encouraging break from declining trend of the past couple of years, grew by 10.8 percent in Q1-FY18.

### Exports

The double-digit growth in exports took place on the back of strong performances of rice, value-added textile, and petroleum, and was well supported by machinery, chemicals, pharmaceuticals, and medical and surgical instruments. While the prices exhibited a mixed trend, positive quantum played a more dominant role in raising the export revenues in general (**Table 5.6**).

**Table 5.6: Export of Major Items during Jul-Sep**  
values in million USD; growth in percent

	Unit	Values			Quantum		
		FY17	FY18	YoY growth	FY17	FY18	YoY growth
Rice	000MT	242.7	320.2	32.0	482.4	621.1	28.7
a) Basmati	000MT	88.8	90.9	2.4	92.3	86.7	-6.1
b) Others	000MT	153.9	229.3	49.0	390.1	534.4	37.0
Seafood	000MT	64.1	75.4	17.6	22.0	28.5	29.6
Sugar	000MT	0.0	42.0		0.0	92.0	
Meat	000MT	52.8	44.8	-15.2	15.2	11.4	-25.0
Raw Cotton	000 MT	17.5	29.6	69.1	10.2	17.8	74.0
Cotton Yarn	000 MT	307.0	320.9	4.6	107.1	123.3	15.1
Cotton Fabrics	M SQM	547.6	528.7	-3.4	536.4	450.2	-16.1
Hosiery (Knitwear)	000 DZ	592.3	647.6	9.3	25,708.0	29,674.0	15.4
Bed-wear	000 MT	528.9	567.0	7.2	89.6	91.1	1.8
Towels	000 MT	178.6	180.2	0.9	42.3	40.3	-4.7
Readymade garments	000 DZ	524.4	608.1	16.0	7,686.0	9,136.0	18.9
Solid Fuel incl. naphtha	000 MT	178.6	15.1	-91.5	6.7	40.5	504.5
Leather Manufactures		127.3	132.3	4.0			
Foot wear	000 pair	26.9	25.2	-6.3	2,631.0	2,222.0	-15.5
Pharmaceuticals	000 MT	52.2	50.7	-2.8	2.5	1.5	-40.0
Electric fans	000 No.	7.1	4.8	-32.4	364.0	1,61.0	-55.8
Cement	000 MT	77.3	62.7	-18.9	1,489.3	1,223.6	-17.8

Data Source: Pakistan Bureau of Statistics

### Textile

Textile exports jumped by 7.9 percent during Q1-FY18, after posting a decline of 6.3 percent in the same period last year. The recovery is attributable to a strong growth in value added products (knitwear, bed wear, readymade garments and synthetic textiles), which contributed nearly 40 percent to the overall increase in total exports (**Table 5.7**). Steady recovery in Pakistan's traditional export

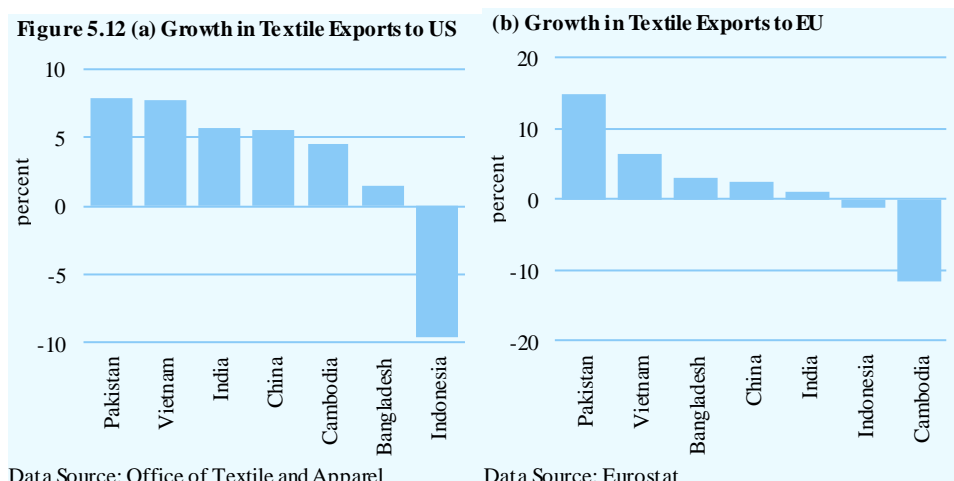
destinations such as the US and the EU continues to give a boost to Pakistani exports. For instance, US customs data shows an increase of 7.9 percent in shipments of textile and apparel products from Pakistan in Q1-FY18, as compared to a decline of 10.8 percent in Q1-FY17.<sup>6</sup>

**Table 5.7: Pakistan's Exports of Major Textile Products (Jul-Sep)**

	Value in Million USD				Growth (%)		
	FY15	FY16	FY17	FY18	FY16	FY17	FY18
Raw Cotton	50	55	17	30	11.0	-68.5	69.7
Readymade Garments	478	506	524	608	5.9	3.6	16.0
Hosiery (Knitwear)	630	630	592	648	0.0	-6.0	9.5
Bed-wear	554	514	529	567	-7.2	2.9	7.2
Cotton Yarn	468	383	307	321	-18.1	-19.9	4.6
Towels	185	214	179	180	15.9	-16.7	0.9
Cotton Fabrics	631	561	548	529	-11.1	-2.4	-3.4
<b>Total Textile Exports</b>	<b>3,410</b>	<b>3,221</b>	<b>3,018</b>	<b>3,257</b>	<b>-5.6</b>	<b>-6.3</b>	<b>7.9</b>

Data Source: Pakistan Bureau of Statistics

In terms of growth, Pakistan outperformed all its regional competitors in the first quarter (**Figure 5.12a and 5.12b**). However, share of Pakistani textile products in total US imports remains low at 3.55 percent against India's 7.23 and Vietnam's 7.13 percent.



Data Source: Office of Textile and Apparel

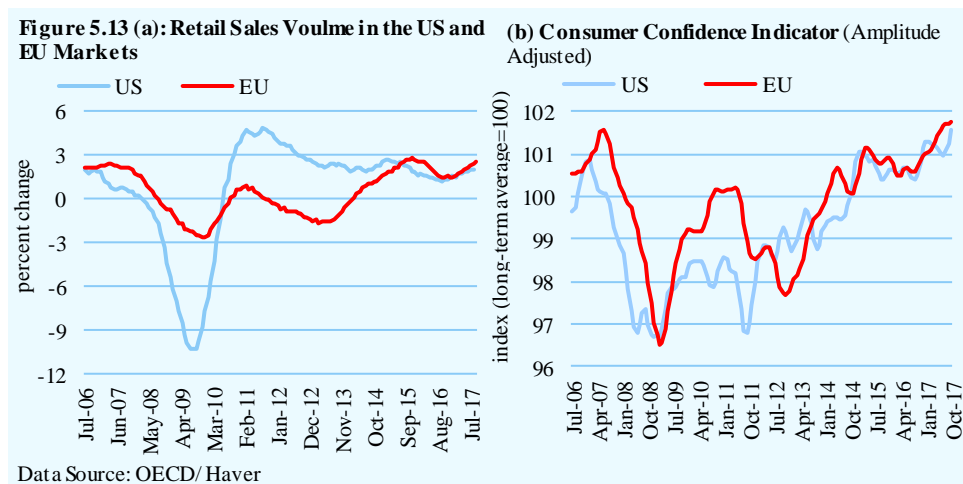
Data Source: Eurostat

The uptick was also visible in primary textile items. Increased quantum on the back of stronger demand from China, a major market for Pakistan's primary textile exports, explained the surge. It needs to be kept in mind that China's

<sup>6</sup> Source: Office of Textile and Apparel, Department of Commerce, US.

cotton stock stands at a multi-year low, which partly contributed to the surge in demand for imported cotton.

Going forward, consistently strong demand from the EU market, recovery in US demand (**Figure 5.13a and 5.13b**), strengthening commodity prices, and domestic policy measures to create a favorable export environment, and a considerable rise in import of textile machinery, should all bode well for textile exports.



### Rice

Rice exports also exhibited a strong recovery of 32 percent in Q1-FY18, after witnessing a decline of 28.0 percent in Q1-FY17. While the uptick in basmati rice exports was a meager 2.3 percent, it was non-basmati exports which increased by almost a half to reach US\$ 229.3 million, up from US\$ 154 million last year. Data available for the first two months of the quarter indicates increased shipments to the Middle East, China and African countries.

In case of basmati, exported quantities continued to fall, but higher unit values prevented the overall export growth in Q1-FY18 from going into negative. Pakistan has been losing share in the global basmati trade since FY11. However, a silver lining may have emerged: the European Union, a key basmati market, imposed a new import restriction that calls for a substantial reduction of maximum residual limit of Tricyclazole (a pesticide used to prevent attack of pesticides on rice crop). While the use of this pesticide is minimal in Pakistan, for Indian exporters it could mean a virtual ban in the short-run. A significant uptick in basmati exports, therefore, seems likely.

**Cement**

Cement exports fell by 18.9 percent to US\$ 67.2 million in Q1-FY18. Growth of 14.6 percent in dispatches to Afghanistan failed to offset a sharp fall of 27.3 percent in exports to India (**Table 5.8**). Moreover, buoyant local demand (as observed in higher local dispatches) and capacity constraints are also straining cement exports.

**Table 5.8: Pakistan's Cement Exports to Major Destinations**

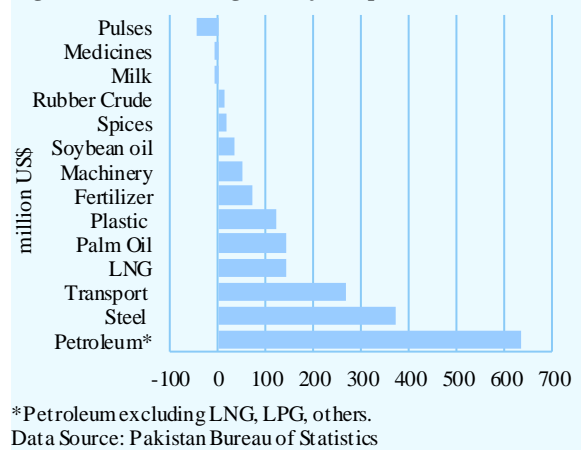
(000 Metric Tons)	Quantum		% Growth	
	Q1-FY17	Q1-FY18	Q1-FY17	Q1-FY18
Afghanistan	574,735	658,488	6.9	14.6
India	379,764	276,246	143.0	-27.3
Other	590,648	352,337	-18.6	-40.4

Data Source: APCMA

**Imports**

The YoY growth in the country's import bill more than doubled to 22.2 percent in Q1-FY18, after growing by 10.2 percent YoY in the same period last year. Increase in imports was broad-based with the petroleum group accounting for 24 percent, and increases in food and transport each contributing 10 percent, to the total increase in the import bill. Unlike last year, the contribution of machinery items to import growth in Q1-FY18 was negligible (**Figure 5.14**). Similarly, textile imports also fell due to lower imports of raw cotton.

**Figure 5.14: YoY Change in Major Import Items in Q1-FY18**

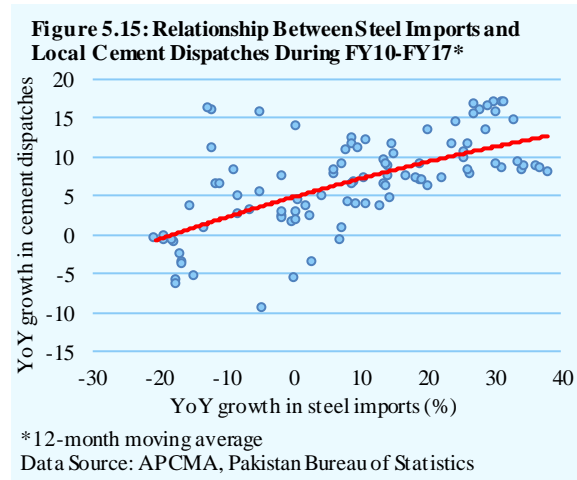


**Steel**

Metal imports continued to grow on the back of strong demand from domestic construction activities, and growing appetite of the automobile and telecom industries. As shown in **Figure 5.15**, activity in the construction sector has a strong positive correlation with steel consumption in the country.

Within steel, a huge jump of 114 percent was observed in the import of scrap. This can be traced to some shift in the demand from ready-to-use products towards scrap following the measures taken by the government to support local steel industry. These included: (i) the imposition of regulatory duty on major final

products (which was first introduced in the range of 5 to 15 percent in January, and was raised further to up to 35 percent in June 2017); and (ii) imposition of 24 percent anti-dumping duty on products imported from China, effective from June 2017. The impact on local steel production has been quite encouraging: while domestic billets production increased by 63.4 percent YoY in Q1-FY18, production of hot/cold coils posted an increase of 33.0 percent. Importantly, in addition to import of steel scrap, manufacturers of steel products have also increased the use of fragmented steel obtained from ship-breaking activities.<sup>7</sup>



### Transport

Fueled by cheap car financing schemes, government initiatives like Prime Minister Youth Business Loan, and the need to bridge the shortage in public transport infrastructure, the demand for passenger as well as commercial vehicles is on the rise. Transport imports, therefore, rose by 38.2 percent during Q1-FY18, following an increase of 8.4 percent in Q1-FY17.

The impetus to transport imports mainly came from passenger cars and auto parts. Within the group, import of completely knocked down or semi knocked down units (CKD/SKD) increased by almost a quarter, with those for heavy commercial vehicles taking the lead, rising by 35.7 percent. The burgeoning imports of CKD/SKD in this category have translated in improved domestic manufacturing numbers. The import of completely built units of motor cars and motorcycles also saw a significant increase. Besides household use, fuel-efficient imported cars are finding strong demand, particularly from individuals who intend to get registered with ride-hailing services (Uber and Careem).

<sup>7</sup> While the detailed 8-digit data of PBS is still not available for Q1-FY18, SBP records show that payments for vessels import for breaking rose from US\$ 69.9 million in Q1-FY17 to US\$ 134.7 million in Q1-FY18.



### *Palm oil*

Within the food group, edible oil imports continued to grow. The import of soybean and palm oil grew by 78 percent and 38.5 percent, respectively. The edible oil imports, which have a causal relationship with domestic production (due to longer shelf life of vegetable oil and ghee), depict an anticipatory behavior with regards to prices. Stockpiles in drought-hit Southeast Asian producers remain lower than expected and may lead to an increase in prices as the new calendar year begins. This anticipated price appreciation may have led to higher imports in Q1-FY18, as oil mills booked higher purchases in advance.

Pakistan's dependence on imported edible oil continues unabated due to lack of any advances in domestic oilseed crop cultivation. Oilseed crops, such as sunflower, have failed to take hold on a large-scale due to farming issues such as overlapping of the sowing period with that of major crops such as wheat and cotton. Moreover, technological handicap, lack of research orientation and absence of any meaningful policy support are other major impediments to import substitution. Reliance on import duties, while failing to reform the real sector, only adds to the burden on the consumers, who face an inelastic demand.

### *Machinery*

The meteoric rise in machinery imports seems to have been arrested in Q1-FY18. Machinery imports, which had surged by 60.0 percent YoY in Q1-FY17 and reached US\$ 2.7 billion, remained almost stagnant at that level this year with a much modest 1.8 percent YoY increase witnessed in the first quarter. Import of textile machinery, however, witnessed a surge of 26.5 percent. The revival in textile exports and SBP's subsidized credit schemes are making a significant contribution in this regard.

The biggest fall was observed in office equipment machinery, followed by power generating machinery, construction and mining machinery. Within office equipment, data processing machines and other portable computers saw a significant decline. The fall in power generating machinery is in line with expectations, as early harvest projects under CPEC near final stage of completion and machinery needed for these projects may already have been imported and reported last year.

### *Energy imports*

The energy import bill shot up 34.5 percent YoY to US\$ 3.2 billion in Q1-FY18, and accounted for 22.2 percent of overall imports during the period. While quantum imports of both crude and POL products (petrol and HSD) remained

strong (**Table 5.9**), a 16.2 percent rebound in average crude prices during the period also contributed to the rising import bill.

With regards to crude, a particularly sharp rise in the quantum of imports was noted in Q1. The increase can be traced to a significant rise in the country's operational oil refining capacity, as repair works on the country's largest oil refinery (Byco Petroleum's 120,000 bpd refinery complex, which had been shuttered after a fire accident in 2015) were completed and the refinery resumed operations from Q1-FY18. As a result, the country's overall crude imports amounted to US\$ 811 million in the quarter, up 44.2 percent over the same period last year.

**Table 5.9: Import of POL Quantum in Q1**

	Quantity (million tonnes)			Growth (percent)	
	FY16	FY17	FY18	FY17	FY18
HSD	520.9	657.6	897	26.2	36.4
Furnace oil	1,626.6	2,166.1	1,833.8	33.2	-15.3
Crude oil	2,436.2	1,916.5	2,673.4	-21.3	39.5
Petrol	1,058.3	1,273.4	1,401.4	20.3	10.1
Other	49.0	118.0	119.0	140.8	0.8
<b>Total</b>	<b>5,669.7</b>	<b>6,043.5</b>	<b>6,849.2</b>	<b>6.6</b>	<b>13.3</b>

Data Source: Oil Companies Advisory Council

With an increase in the operational refining capacity and higher crude imports, domestic production of both petrol and HSD grew by double digits (**Chapter 2**). Nonetheless, given the strong demand from the transport sector (in line with the growth in domestic production and import of passenger cars as well as heavy commercial vehicles), quantum imports of both HSD and petrol grew sizably during the period.

Meanwhile, in case of furnace oil (FO), higher international prices (up 22.4 percent YoY in Q1-FY18) pushed up the value of their imports in the quarter, even though the country imported lower quantities of the fuel as compared to last year. Power generation from FO also declined during the period (**Table 5.10**). Given the

**Table 5.10: Power generation by source (in GWh)**

	Q1-FY17	Q1-FY18	Abs change
Hydro	12,407	12,187	-220
Gas	8,221	10,384	2,163
Furnace oil	8,892	8,650	-243
Coal	24	1,324	1,300
Nuclear	1,289	2,155	866
Others	1,172	2,039	867
<b>Total</b>	<b>32,005</b>	<b>36,740</b>	<b>4,734</b>

Data Source: NEPRA

government's stated objective to shift the fuel mix away from FO, use of the fuel in power generation is expected to decline further. This creates the need for more rigorous planning of FO imports by all stakeholders – independent power producers, PSO and the petroleum division – to ensure that only the required quantity of FO is imported during any period.

At the same time, the government's pledge to eliminate power outages (by end-November) and to gradually shift the fuel mix towards relatively low-cost LNG and coal from FO, put upward pressure on LNG and coal imports during the quarter.

In fact, gas-based power plants played a significant role in boosting power generation during Q1-FY18 to a record 36,740 GWh. Gas-based power plants (both piped and LNG) contributed a significant 45.6 percent to the YoY increase in the power generation.<sup>8</sup> Correspondingly, LNG imports surged 57.0 percent YoY and reached US\$ 397.4 million the quarter. The rising trend in LNG imports will continue in the coming quarters, as in addition to power generation, it is expected to be utilized to plug gas shortages for domestic consumers during the winter months, particularly in Punjab province.<sup>9</sup>

Meanwhile, import payments for coal rose 78.6 percent to US\$ 211.3 million in Q1-FY18.<sup>10</sup> This corresponded with power generation from the fuel rising to 1,300 GWh in the quarter, against a negligible 5 GWh in the same period last year. Electricity generation from coal (and coal imports) has gathered momentum from Q4-FY17 onwards, just as two units of 660MW each of the Sahiwal coal-fired project became operational (in May and July 2017, respectively).<sup>11</sup> Besides, coal is also a principal raw material in the manufacturing of cement, and its higher imports are also in-line with the 12.5 percent growth in cement production during the quarter.

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<sup>8</sup> Source: National Electric Power Regulatory Authority (NEPRA). So far, breakdown of power generation from piped gas and RLNG is not available. However, given that as many as four new LNG power plants became operational in the country in FY17, it is quite likely that the rise in power generation in Q1-FY18 from gas is owed to LNG.

<sup>9</sup> Pakistan's second LNG terminal was inaugurated in November 2017, doubling the country's LNG re-gasification capacity to 1,200 million cubic feet per day (mmcf). Multiple other LNG terminals are also being planned.

<sup>10</sup> This information is as per banking data available with SBP; detailed import data from PBS is not available beyond June 2017.

<sup>11</sup> The Sahiwal plant is among the first early harvest projects under the CPEC accord to be completed in the country.