5 External Sector

5.1 Overview

The country's external account continued to present a challenging picture during H1-FY19, as spiking global oil prices and a slowdown in overall exports partially offset the gains from the domestic macro adjustment policies.[1] The sizable rebound in workers' remittances and a noticeable contraction in the services deficit helped reduce the current account gap by 8.8 percent YoY in H1-FY19; nonetheless, the level of the deficit remained at an elevated level (**Table 5.1**).

Table 5.1: Performance of Key External Indicators
(million US$)

	Q2			H1		
	FY18	FY19	*difference*	FY18	FY19	*difference*
Current account balance	-4,592	-3,851	741	-8,353	-7,615	738
Trade balance	-7,444	-7,528	-84	-14,758	-15,500	-742
Exports	6,152	5,956	-196	11,831	11,841	10
Imports	13,596	13,484	-112	26,589	27,341	752
Energy imports	3,385	3,888	503	6,331	8,019	1,688
Services balance	-1,469	-929	540	-2,745	-1,894	851
Primary income balance	-1,525	-1,531	-6	-2,582	-2,642	-60
Secondary income balance	5,846	6,137	291	11,732	12,421	689
Remittances	4,955	5,473	518	9,745	11,030	1,285
Financial account balance	-4,920	-2,883	-2,037	-6,790	-5,523	-1,267
FDI inflows (net)	868	760	-108	1,633	1,319	-314
Portfolio investment (net)	2,446	-234	-2,680	2,320	-419	-2,739
Eurobond/Sukuk	2,500	0	-2,500	2,500	0	-2,500
Private FPI	-54	-234	-180	-129	-419	-290
FX liabilities (net)	2,070	2,421	351	2,887	4,505	1,618
SBP's liquid reserves (end-period)	14,107	7,199	-6,908	14,107	7,199	-6,908

Data source: State Bank of Pakistan

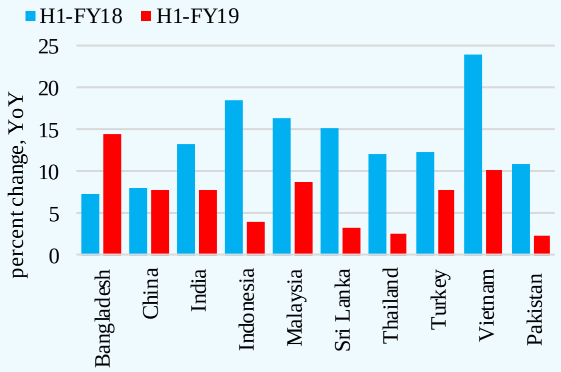
As a result, FX payment pressures persisted in the interbank, and were accentuated by maturities of short-term official debt contracted in the previous year. This led the government to seek BoP support, particularly from bilateral sources. While sizable inflows were realized from the friendly countries, they were insufficient to completely finance the current account deficit. Consequently, SBP's FX reserves

[1] Though international oil prices tapered from October 2018 onwards, they continued to be higher on YoY basis during H1-FY19 as well as most of Q2-FY19. Arab Light crude oil prices were, on average, 32.0 percent higher in H1-FY19 than in H1-FY18, and 16.4 percent higher in Q2-FY19 as compared to Q2-FY18.

declined by US$ 2.7 billion during the period, and the PKR depreciated by 12.5 percent against the US dollar.

The balance of payments challenges have arisen at a time when the global economy itself is facing significant headwinds. The major EU economies, such as Germany and France, are facing a major slowdown in consumer demand, as reflected by subdued retail sales as well as imports (**Section 5.5**).[2] While political developments are responsible for the slump in France, the German economy finds itself buffeted by the uncertainty surrounding the outcome of US-China trade negotiations.[3] This slowdown in EU economies has negative spillover for Pakistan and other emerging market exporters, which have posted subdued export performances this year (**Figure 5.1**).

Figure 5.1: Export Growth of Major Emerging Markets



Data source: Haver Analytics and Pakistan Bureau of Statistics

In addition to lower demand from the EU, Pakistan's export earnings were also dragged by lower unit prices; this was particularly true for exporters of knitwear, readymade garments and basmati rice. On the other hand, non-basmati rice exporters were finding it challenging to maintain their share in African markets owing to strong competition from Chinese exporters. Finally, the withdrawal of subsidies on wheat and sugar led to weak export performances of both commodities.

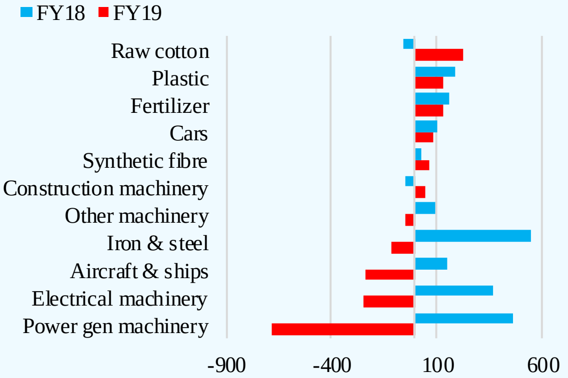
On the import side, the growth in payments tapered in H1-FY19, in response to a significant cut in development expenditures, the completion of early harvest CPEC projects and regulatory measures aimed at curtailing non-essential imports

[2] The EU's overall imports grew by a much lower 4.0 percent YoY during H1-FY19, after rising by 14.9 percent in the same period last year (source: Haver Analytics).

[3] The trade tensions between the US and China, along with the slowdown in the Chinese economy, have affected Germany's exports performance. Specifically, the growth in Germany's exports to China slowed down to 5.1 percent YoY during H1-FY19, from 13.3 percent recorded in H1-FY18. In tandem, exports, on average, contributed negative 0.1 percentage points to real GDP growth in Germany in H1-FY19, against a positive contribution to growth of 0.7 percentage points in H1-FY18 (source: Haver Analytics).

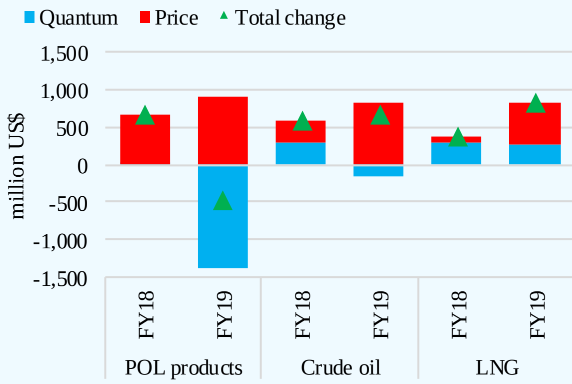
(**Figure 5.2**). The slowdown in construction activity lowered the demand for imported construction machinery as well as iron and steel. Further support came from lower payments for aircraft parts and railway locomotives, and CBU cars.

Figure 5.2: Absolute Change in Import Payments (YoY) during H1 (in million US$)



Data source: State Bank of Pakistan

Figure 5.3: Contribution of Price and Quantums to YoY Change in Energy Imports in H1



Data source: Pakistan Bureau of Statistics

However, FX savings from lower non-energy import payments were completely offset by a 27.1 percent rise in the energy import bill, which reached its highest six-monthly level ever. The elevated international prices played a dominant role here, with quantum imports of both POL products and crude oil declining during the period (**Figure 5.3**).

With these underlying dynamics in the trade account, the current account deficit (CAD) could not be curtailed significantly, despite a healthy rise in remittances and a reduction in the services deficit. The elevated CAD necessitated the need to arrange sizable external financing.

However, net financial inflows were lower than last year, as the new government did not pursue sovereign debt issuance or heavy short-term borrowings. Instead, it engaged bilateral sources for BoP support, while simultaneously entering into bailout negotiations with the IMF. The resulting FX inflows from China and Saudi Arabia cumulatively amounted to US$ 4.0 billion during H1-FY19, and allowed the government to retire both the long- and short-term debt payments falling due in the period.

5.2 Current account

In H1-FY19, the current account deficit remained at an elevated level of US$ 7.6 billion, declining by 8.8 percent YoY from the same period of last year. In H1-FY18, the CAD had risen by 76.9 percent.

Even though the merchandize deficit widened by 5.0 percent, it was entirely offset by a 31.0 percent decline in the services deficit; this kept the balance of trade in goods and services in H1-FY19 to its previous year's level. A major reason behind the services deficit decline was a drop in services imports. The lower imports were mainly a result of a strong 38.6 percent drop in FX purchases from exchange companies and banks by individuals for personal travel; this is understandable given the scale of the PKR adjustment over the past 12 months.[4] Further support to the services account came from a 20.9 percent drop in freight charges, in response to lower quantum imports.

Meanwhile, a significant 58.3 percent decline in profit repatriation on foreign investment (to US$ 628.8 million in H1-FY19) also helped alleviate some of the pressure on the current account. Repatriation under direct investment figured more prominently, as these dropped by 67.8 percent during the period. This lower repatriation also helped offset the 31.6 percent rise in interest payments during the period. The higher interest payments reflected both the rise in the stock of external debt, as well as the repricing of existing floating FX debt following a rise in global interest rate benchmarks.[5]

Table 5.2: Overseas Workers' Remittances to Pakistan
(million US$)

	FY18			FY19			Growth (in %)
	Q1	Q2	H1	Q1	Q2	H1	H1-FY19
Total	**4,790**	**4,955**	**9,745**	**5,557**	**5,473**	**11,031**	13.2
GCC	2,869	2,951	5,820	3,017	2,954	5,971	2.6
S. Arabia	1,228	1,303	2,531	1,263	1,304	2,568	1.5
UAE	1,078	1,083	2,161	1,227	1,121	2,349	8.7
other GCC	563.3	565	1,129	527	529	1,055	-6.5
Non-GCC	1,921	2,004	3,925	2,540	2,519	5,059	28.9
UK	643	707	1,350	810	837	1,647	22.0
USA	626	655	1,281	863	870	1,733	35.3
Malaysia	257	244	501	395	392	787	57.2
EU	160	155	315	166	147	313	-0.7
Other countries	235	242	478	306	273	579	21.1

Data source: State Bank of Pakistan

[4] These FX purchases by resident Pakistanis are recorded under the import of "other" services under the travel services in the SBP's balance of payments data.
[5] 12-month LIBOR averaged 2.9 percent during H1-FY19, up from 1.8 percent during H1-FY18.

Furthermore, current transfers also increased considerably. Specifically, workers' remittances witnessed a significant increase in the H1-FY19, which more than offset the net outflows from foreign currency accounts during the period.

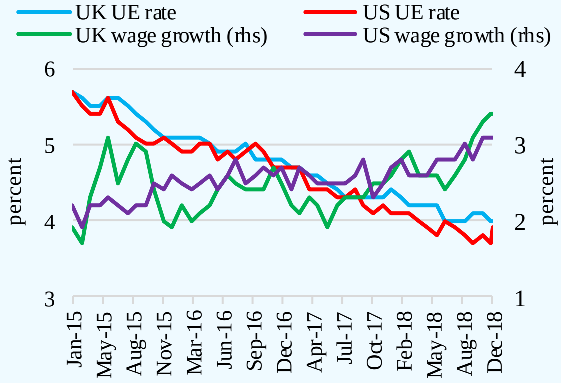
Workers' Remittances

For the first time, worker's remittances have crossed US$ 11.0 billion mark in the first half of a fiscal year, reaching US$ 11.03 billion in H1-FY19. This inflow was 13.2 percent higher from the same period last year (**Table 5.2)**. Though the growth was broad-based, the strong increase from the US and the UK provided major push to the H1-FY19 inflows.

Particularly, remittances from USA witnessed a sharp increase of 35.3 percent and rose to US$ 1.7 billion in H1-FY19. Economic turnaround in the US and the UK in the recent past resulted in declining unemployment and rising wages, and both factors contributed to a sharp rise in remittances from these countries (**Figure 5.4**).

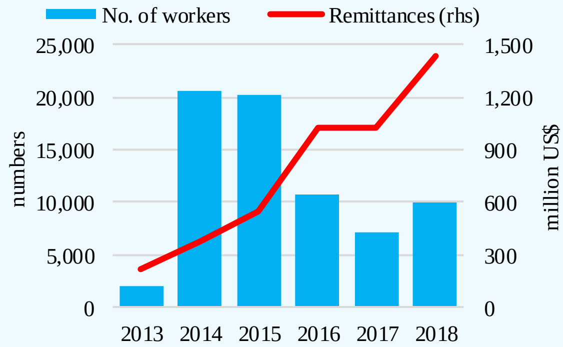
Besides the US and the UK, inflows from Malaysia also supported overall remittances in H1-FY19. Malaysia, in particular, is emerging as one of the major sources of remittances and contributed US$ 787 million in H1-FY19, up 57.2 percent higher from last year. In fact, remittances from Malaysia have been rising persistently since FY13 (**Figure 5.5**).

Figure 5.4: Unemployment (UE) Rate and Wage Growth in the US and UK



Data source: Bloomberg

Figure 5.5: Dynamics of Remittance Inflows from Malaysia

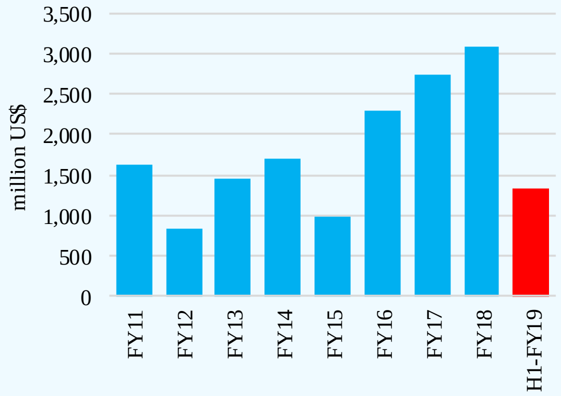


Data source: State Bank of Pakistan, Bureau of Emigration and Overseas Employment

Over the last couple of years, Malaysia has been facing workforce shortage in labor-intensive sectors, such as manufacturing, construction and agriculture. To address the problem, Malaysia raised the wages for both local and foreign workers in its minimum wage policy of 2013. The wage level was raised from RM 600/month to RM 900 per month in the Peninsular Malaysia and from RM 579/month to RM 800/month for Sabah, Sarawak and the Federal Territory of Labuan. As a result, Pakistan's labor migration to Malaysia had jumped in 2014-15 and remains at elevated level since then, compared to 2013. This may explain the persistent increase in remittances from Malaysia.

Meanwhile, the inflows from GCC, the major source of Pakistan's remittances, increased by a marginal 2.6 percent in H1-FY19 against a decline of 3.4 percent witnessed in the same period last year.

Figure 5.6: FDI Inflows in Pakistan



Data source: State Bank of Pakistan

5.3 Financial account

The net inflows in the financial account declined to US$ 5.5 billion in H1-FY19 from US$ 6.8 billion in H1-FY18, as both foreign direct investment and portfolio investment declined. These were only partially offset by official bilateral inflows from China and KSA. This long-term BoP support may also have helped in lengthening Pakistan's external debt maturity profile, which otherwise had shortened due to the short-term commercial borrowings in the last couple of years.

Foreign direct investment

FDI is slowing down after growing consistently over the last three years under CPEC (**Figure 5.6**). The inflows declined by 19.2 percent in H1-FY19 over the corresponding period of last year (**Table 5.3**). With early harvest projects nearing completion, CPEC-related power sector investments are now being shifted to the transmission and distribution side.

Though the inflows in financial business and electrical machinery increased also, these were insufficient to offset the decline in inflows in power and construction as well as higher principal loan repayments by telecom firms to their parent companies abroad.[6]

Table 5.3: Net FDI Inflows to Pakistan

(million US$)	FY18			FY19			Change in FY19	
	Q1	**Q2**	**H1**	**Q1**	**Q2**	**H1**	**Q2**	**H1**
Total FDI (net)	**765.2**	**867.0**	**1,632.2**	**558.9**	**760.3**	**1,319.2**	**-106.6**	**-313.0**
Financial business	190.1	86.0	276.1	39.8	163.5	203.4	77.5	-72.8
Electrical machinery	0.8	10.2	10.9	5.2	119.5	124.7	109.3	113.8
Power	205.3	406.6	611.9	92.4	109.5	201.9	-297.1	-410.0
Construction	124.8	226.1	350.9	180.3	107.5	287.8	-118.6	-63.1
Oil & gas explorations	52.8	53.9	106.7	74.1	60.6	134.7	6.7	28.0
Telecommunications	62.8	-78.0	-15.3	-54.2	-80.9	-135.1	-2.9	-119.9
Others	128.7	162.2	290.9	221.2	280.7	501.9	118.5	211.0

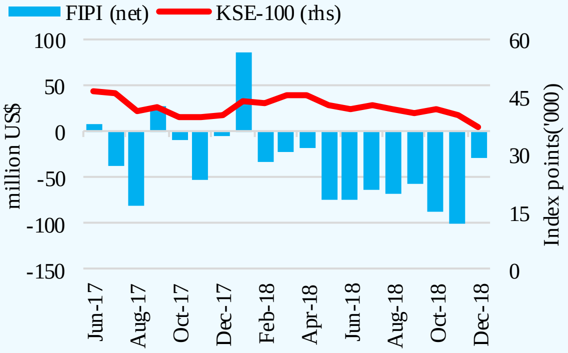
Data source: State Bank of Pakistan

By source, China continued to dominate direct investments with 57.6 percent share in net FDI inflows during H1-FY19. Apart from power and construction, electrical machinery and financial business sectors also attracted Chinese investment. Following China, direct investment from UK also increased to US$ 116.0 million in H1-FY19, mainly in food and financial business.

Foreign portfolio investment

The foreign portfolio investment witnessed an outflow of US$ 419.3 million in H1-FY19 against an inflow of US$ 2.3 billion in the same period of last year, when the government had mobilized US$ 2.5 billion by issuing Eurobonds and Sukuk.

Figure 5.7: Foreign Investment in Pakistan's Equities and PSX Performance



Data source: National Clearing Company of Pakistan Limited and Pakistan Stock Exchange

In the equity market, Pakistan witnessed net foreign selling of US$ 403.5 million in H1-FY19. Comparatively, in H1-FY18, the net foreign selling was only US$ 155.7 million (**Figure 5.7**).

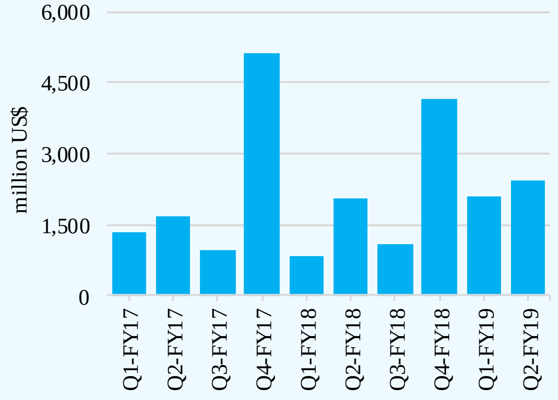
[6] These principal loan repayments to parent companies are recorded as outflows under FDI in the balance of payments data.

Importantly, MSCI has dropped UBL and Lucky Cement from the MSCI Global Standard Index in its semi-annual review. This caused a significant decline in the weights of Pakistani stocks in the MSCI EM index. A portfolio capital outflow in these stocks was, therefore, expected. [7]

Besides the external factor, domestic macroeconomic developments such as declining foreign exchange reserves, rising inflationary pressures and uncertain exchange rate policy may have also dented the investors' confidence.

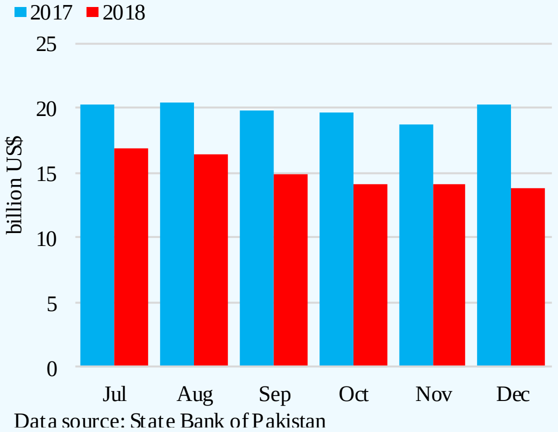
Net incurrence of liabilities: In H1-FY19, the net inflow of FX liabilities amounted to US$ 4.5 billion, mainly via US$ 2.0 billion deposits received from each of Saudi Arabia and China (**Figure 5.8**). In net terms, disbursement of government loans remained lower (US$ 1.6 billion in H1-FY19 compared to US$ 1.7 billion realized in H1-FY18). The government took this opportunity to lengthen the maturity profile by retiring some of the short-term FX debt. These retirements amounted to US$ 1.2 billion in H1-FY19, as compared to US$ 607.0 million in the same period of last year.

Figure 5.8: Net Flow of FX Liabilities



Data source: State Bank of Pakistan

Figure 5.9: Pakistan's Liquid FX Reserves (Jul-Dec)



Data source: State Bank of Pakistan

5.4 Exchange Rate and Reserves

Pakistan's liquid foreign exchange reserves declined by US$ 2.7 billion in H1-FY19 compared to the US$ 1.2 billion fall registered in H1-

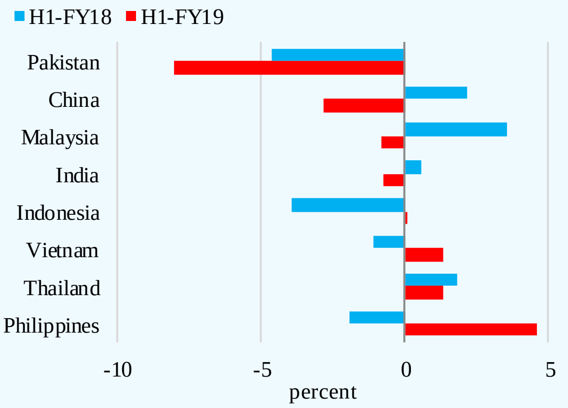
[7] According to market experts, after the exclusions, Pakistan's earlier assigned weight in the MSCI EM index is likely to fall from 0.075 percent to 0.037 percent.

FY18. SBP's reserves, specifically, witnessed a steep decline from US$ 9.8 billion to US$ 7.2 billion between end-June to December 2018 (**Figure 5.9**). Though the floatation of Eurobond and Sukuk had provided some comfort to the falling liquid FX reserves last year, in H1-FY19, Pakistan had received US$ 4.0 billion in financial support from China and Saudi Arabia.

Meanwhile, given the elevated current account deficit, the PKR continued to be under pressure and depreciated 12.5 percent against the US dollar in H1-FY19. That said, the currency was more strained in the second quarter, when the current account gap widened to US$ 3.9 billion from US$ 3.8 billion in Q1-FY19; also bilateral BoP support from Middle Eastern countries had yet to fully materialize. As a result, the PKR depreciated by a relatively higher 10.5 percent during Q2-FY19, as opposed to a more contained drop of 2.2 percent during Q1-FY19.

In real terms, the PKR weakened by 8.0 percent in H1-FY19, against a depreciation of 4.6 percent observed last year (**Figure 5.10**). This was mainly driven by a sharp NEER depreciation, as the local currency weakened significantly against all the major currencies during the first six months of FY19.

Figure 5.10: REER of Selected Asian Currencies



Data source: Haver Analytics and State Bank of Pakistan

5.5 Trade Account[8]

The trade deficit declined 5.3 percent YoY to US$ 16.8 billion in H1-FY19, with the drop in overall imports offsetting the impact of decelerating export growth. The second quarter was more prominent, as overall imports declined more sharply than they did in Q1 (**Figure 5.11**).[9]

Notably, the growth in energy imports in Q2-FY19 slowed down to its lowest in the past nine quarters, as relatively moderate growth in quantum LNG imports and continuously declining quantum imports of both POL products and crude oil

[8] This section is based on customs data reported by the PBS. The information in this section may not tally with the SBP data reported in **Section 5.1**. To understand the difference between these two data series, please see Annexure on data explanatory notes.

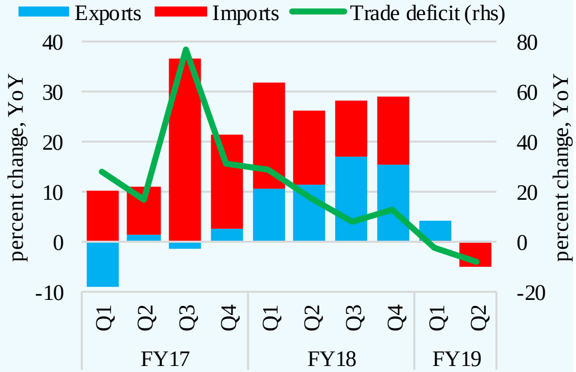
[9] In fact, imports of *all* product categories or their growth rate dropped more significantly in Q2 than they did in Q1.

partially suppressed the upward pressure from higher international oil prices during the period.[10]

The deepening of the import decline is in response to the ongoing slowdown in economic activity in the wake of policy efforts to achieve macro stabilization, as well as the drop in CPEC-related machinery imports.[11] With regards to the policy side, hefty cut in development spending; the exchange rate adjustment; and the hiking of regulatory duties on non-essential consumer imports, all played a role (**Table 5.4**).[12] In response to the cut in PSDP, the construction activity contracted, which, in turn, lowered the import demand of raw materials of the domestic steel industry.[13]

Yet, at the same time, the export growth slowed down to just 1.9 percent in H1-FY19, against the rise of 10.9 percent recorded in H1-FY18. In case

Figure 5.11: Growth in Pakistan's Exports, Imports and Trade Deficit



Data source: Pakistan Bureau of Statistics

Table 5.4: Import of Selected Consumer Goods during H1
(values in million US$ and change in percent)

	FY18	FY19	Change
Food items			
Almonds, walnuts & pistachios	75.3	12.0	-84.1
Cocoa & cocoa items	18.1	22.2	22.5
Butter and cheese	8.3	6.8	-18.6
Fish and seafood	12.5	6.8	-45.9
Fresh apples and pears	29.5	13.8	-53.2
Tea and coffee	306.0	288.9	5.9
Fruit juices	6.9	3.2	-54.2
Electronics items			
LCD TVs	47.7	27.7	-41.9
Cellular phones	376.5	364.0	-3.3
Air-conditioners (inc. parts)	56.5	49.4	-12.7
Electric fans	6.2	7.4	19.8
Bulbs and lamps	63.0	40.7	-35.4
Personal care items			
Perfumes and colognes	2.76	2.83	-2.5
Make-up items and prep	16.4	13.3	-18.9
Hair preparations (inc. shampoos)	14.8	13.2	-11.0
After-shave, deodorants, bath salts	6.2	4.7	-23.7

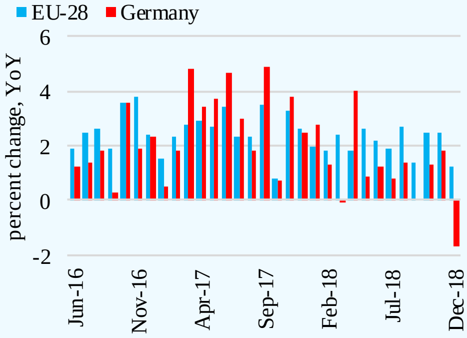
Data source: Pakistan Bureau of Statistics

[10] Quantum LNG imports grew by 19.1 percent YoY during Q2-FY19, after growing at a much higher rate of 44.3 percent during Q1-FY19.
[11] The large-scale manufacturing declined more sharply in Q2 (by 2.5 percent) than in Q1-FY19 (0.6 percent).
[12] The PKR depreciated by 10.5 percent during Q2-FY19, after dropping by a more contained 2.2 percent during Q1-FY19. Development spending continued to be curtailed during the period as well, dropping by 32.5 percent YoY in Q2, after declining by 42.9 percent in Q1-FY19.
[13] The drop in demand for this imported raw material corresponded with an 8.5 percent decline in domestic steel production in H1-FY19. In comparison, local production had risen 38.1 percent in the same period last year.

of many exporting items, particularly high value added textiles like readymade garments, overall export values were pulled down by lower unit prices in dollar terms following the PKR depreciation.[14]

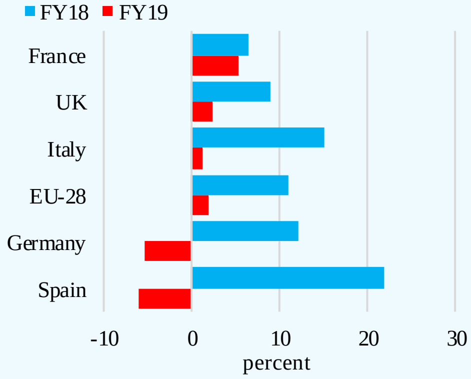
In terms of export destinations, the key EU market has emerged as a major concern. Political unrest is taking its toll on the French and Italian economies, whereas Germany finds itself in the crosshairs of the US-China trade war.[15] The unfolding developments have led to a slump in consumer demand in the bloc, and is reflected in a slowdown in retail sales (**Figure 5.12a**). As a result, the bloc's demand for imported products has also been hit, to the detriment of Asian exporters like Pakistan (**Figure 5.12b**).

Figure 5.12a: Growth in Retail Sales in the EU & Germany*



* Excluding auto sales, seasonally adjusted by source
Data source: Eurostat

Figure 5.12b: Growth in Pakistan's Exports to EU Countries during H1



Data source: Pakistan Bureau of Statistics

<u>Exports</u>

Pakistan's exports rose 1.9 percent to US$ 11.2 billion in H1-FY19, after rising 10.9 percent YoY in the same period last year. The major reason was a sharp pullback in the textile sector's export growth, which remained stagnant in the six-month period. The second quarter presented an even starker picture, as textile exports declined for the first time in a quarter since Q1-FY17.

Lower unit prices suppressed export values of the key knitwear and readymade garment segments, largely offsetting the healthy rise in their quantum exports (**Table 5.5**). By contrast, heavy quantum decline in yarn and cotton led to a drop

[14] With a depreciating PKR, Pakistan's export earnings (in dollar terms) will only rise if the rise in quantum exports more than offsets the drag from lower unit prices.
[15] Real GDP growth in the EU averaged 1.6 percent during H1-FY19, down from 2.7 percent in H1-FY18. Growth in Germany slowed even more sharply, from 2.7 percent to just 0.9 percent. Similarly, the Italian economy grew just 0.4 percent, from 1.7 percent (source: Haver Analytics).

in their export values. Lower quantums were also responsible for suppressed exports of key agricultural commodities, i.e. sugar, wheat and rice. In case of sugar and wheat, exporters could not compete in the international market in the wake of tapering export subsidies.[16]

Table 5.5: Pakistan's Major Exports during H1

	FY18	FY19	Abs. change FY19	Quantum impact	Price impact	Contribution to Growth FY18	Contribution to Growth FY19
	million US$					percentage points	
Food group	**1,935.1**	**1,994.9**	**59.8**	**-**	**-**	**2.8**	**0.5**
Basmati rice	203.7	244.2	40.5	53.0	-12.5	0.3	0.4
Non-basmati	645.9	573.8	-72.1	-101.6	29.5	1.1	-0.7
Wheat	0.0	53.5	53.5	126.4	-72.9	0.0	0.5
Sugar	181.5	79.5	-102.0	-85.4	-16.7	0.0	-0.8
Seafood	200.6	183.6	-17.0	-9.7	-7.2	0.17	-0.2
Fruits & veg.	243.9	312.0	68.1	109.0	-41.0	-0.13	0.6
Textile group	**6,641.6**	**6,644.3**	**3.1**	**-**	**-**	**5.0**	**0.0**
Raw cotton	53.3	14.1	-39.2	-38.9	-0.3	0.2	-0.4
Cotton yarn	661.5	548.4	-113.1	-128.9	15.8	0.04	-1.0
Cotton fab.	1,066.9	1,052.3	-14.6	287.9	-302.4	0.0	-0.1
Knitwear	1,334.6	1,475.6	141.0	165.2	-24.1	1.6	1.3
Bedwear	1,124.4	1,161.2	36.8	182.3	-145.5	0.7	0.3
Towels	385.8	378.0	-7.8	-51.9	44.0	0.1	-0.1
R. garments	1,249.4	1,259.7	10.3	328.0	-317.7	1.5	0.1
Other Manuf.	**1,702.3**	**1,708.1**	**5.8**	**-**	**-**	**1.8**	**0.2**
Leather	159.7	128.3	-31.4	-28.1	-3.4	-0.1	-0.3
Leather manuf.	265.2	247.4	-17.8	-5.7	-12.2	0.1	-0.2
Plastic	114.3	155.7	41.4	2.0	31.0	0.2	0.3
Cement	104.8	157.0	52.2	65.8	-27.4	-0.27	0.4
POL group	**163.6**	**269.5**	**106.0**	**-**	**-**	**0.8**	**1.0**
Crude oil	75.2	145.9	70.7	37.4	33.3	0.4	0.6
All other items	**533.8**	**564.4**	**30.6**	**-**	**-**	**-**	**-**
Total exports	**10,976.4**	**11,181.2**	**204.8**	**954.4**	**-817.0**	**10.9**	**1.9**

Data source: Pakistan Bureau of Statistics

In this scenario, the petroleum group actually emerged as the single-largest contributor to the export growth in H1-FY19, with higher quantities of crude oil condensate being exported to a couple of African countries, and jet fuel to Afghanistan under a government-to-government contract. Higher international oil

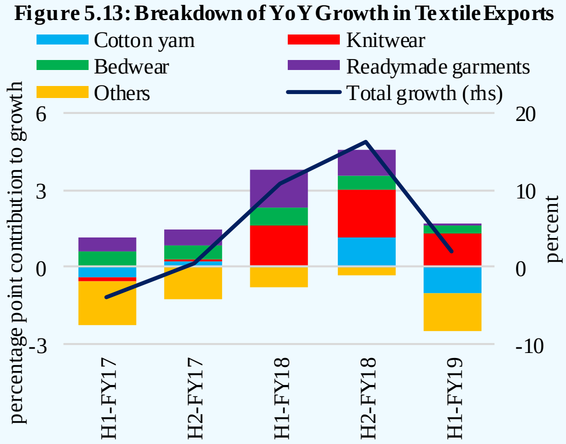
[16] For wheat, freight subsidies had pushed up quantum exports during Q1-FY19, and their absence during Q2-FY19 corresponded with an abating of shipments going abroad. Of the total wheat exports of US$ 53.5 million during H1-FY19, US$ 49.1 million (or 91.7 percent) were realized during Q1-FY19.

prices on YoY basis further supported export values from this segment.

Slowdown in EU suppresses textile exports

The overall textile exports stayed almost flat at US$ 6.6 billion in H1-FY19. In terms of products, a deceleration in exports of high value added items, specially readymade garments, and a decline in exports of low value added items (particularly yarn) was mainly responsible for this stagnation (**Figure 5.13**).

Figure 5.13: Breakdown of YoY Growth in Textile Exports



Data source: Pakistan Bureau of Statistics

So far this year, garment exporters across the world are facing challenges in the EU, as the bloc's quantum imports of textile and apparel items has slowed down dramatically from last year (**Table 5.6**). China and India have borne the brunt of this slowdown. Pakistan, which, along with Bangladesh and Cambodia, enjoys zero-rated access to the bloc, managed to increase its apparel shipments to the EU during the period.

Table 5.6: Growth in the EU's Quantum Textile & Apparel Imports

percent change

	H1-FY18	H1-FY19
Bangladesh	6.2	9.3
Cambodia	17.7	7.9
China	-0.1	-6.8
India	-0.9	-4.5
Indonesia	-2.5	-4.3
Pakistan	13.0	4.3
Turkey	3.4	6.2
Vietnam	7.2	3.1
Total extra-EU imports	**4.1**	**1.4**

Data source: Eurostat

However, Pakistan and Cambodia were also not completely immune from the slowdown in demand from the EU, as their quantum of textile and apparel exports to the bloc grew at a much lower rate this year than last year. In contrast, the growth in Bangladesh's quantum textile and apparel exports accelerated in H1-FY19. One possible reason can be that European importers brought forward their purchases from Bangladesh in anticipation of higher prices in the future. A pick-up in Bangladesh's export prices is expected after the government announced a minimum wage hike for garment workers effective from February 2019.

Meanwhile, the US' textile and apparel market is in flux, as uncertainty surrounds the outcome of the country's trade negotiations with China.[17] As such, US importers are said to be bringing forward their purchases from China, as well as looking to other markets to line up alternative supplies in case of an adverse outcome. Resultantly, China's quantum textile and apparel exports to the US rose significantly, along with its market share. On the other hand, Pakistani exporters are facing challenges in the US market, with quantum textile and apparel exports staying flat on YoY basis (**Table 5.7**).

Table 5.7: Growth in US' Quantum Textile & Apparel Imports
percent change (YoY)

	H1-FY18	H1- FY19
Bangladesh	1.8	3.7
Cambodia	8.2	11.3
China	5.8	8.7
Honduras	-9.7	-0.2
India	6.9	10.3
Indonesia	-8.8	-2.5
Pakistan	4.6	0.5
Vietnam	7.1	0.3
Total imports	**4.0**	**7.4**

Data source: OTEXA

Mindful of the challenging external environment and the necessity to boost export earnings, the government is providing subsidized energy to the exporting industry, and the rates on SBP's financing schemes for export refinancing and fixed investment are still unchanged at low levels, despite the 425 bps hike in the policy rate over the past 12 months. Moreover, the government has proposed to ease the industry's liquidity constraints from stuck-up refunds by issuing promissory notes, and further lower the cost of production by abolishing regulatory duty on cotton imports.

However, all this support would not amount to much-desired forex earnings if the exporters continue to chase the same markets without making concerted efforts to improve their product quality and brand image. Exporters ought to diversify from the EU and US markets and focus on areas like the Middle East, where they currently have minimal presence.[18]

Underwhelming non-basmati rice exports offset healthy basmati performance
Pakistan's overall rice exports presented an unimpressive picture, with export values declining 3.7 percent YoY to US$ 817.9 million in H1-FY19. The decline was driven by a quantum-led drop in non-basmati exports.

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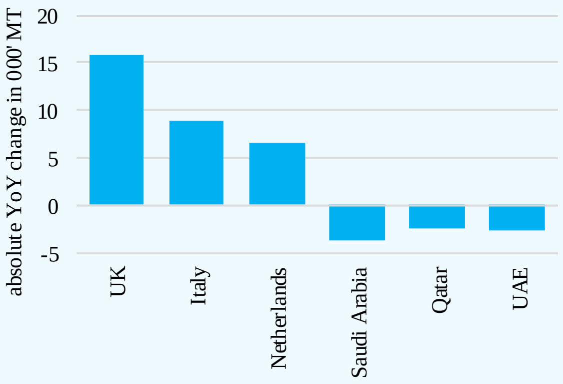
[17] China's textile and apparel exports are currently not attracting additional tariffs, but this may change if the US administration follows through on its threat to target all the Chinese products that are currently not attracting the tariffs in case the ongoing negotiations fail.
[18] For instance, in the UAE's textile and apparel market of US$ 5.2 billion, Pakistan had only a 3.2 percent share as of 2017 (source: International Trade Center).

The top markets for Pakistani non-basmati rice, namely Kenya, Madagascar, Benin and Guinnea-Bissau, were responsible for the decline in quantum exports this year. Pakistani exporters are facing a tough time against Chinese competitors in these markets, as the latter are said to be offloading their record stockpiles at lower prices. According to Chinese customs data, the country's rice export quantums rose by a mammoth 299.7 percent during Jan-Dec 2018. The USDA has also estimated China's rice exports to have almost doubled in 2018 over 2017.

By contrast, during H1-FY19, basmati rice exports extended their growth momentum to the second consecutive year, with a solid 26.0 percent uptick in quantum exports entirely offsetting the drag from lower international prices.[19] As a result, export values rose 19.9 percent to US$ 244.2 million during the period. Major European markets, such as the UK, Italy and Netherlands, accounted for the bulk of the increase in quantum exports, and compensated for the continuing decline in Pakistan's share in the Middle East market (**Figure 5.14**).

Figure 5.14: Growth in Pakistan's Basmati Exports to Major Markets during H1-FY19



Data source: Pakistan Bureau of Statistics

Non-traditional items emerge as saving grace

Among other products, the withdrawal of subsidies and completion of earlier announced quotas led to an expected drop in sugar exports, which fell 56.2 percent to US$ 79.5 million during H1-FY19. This drop was large enough to wipe out the meager US$ 53.5 million in export earnings from wheat during the period.

However, weak export performances of these two major agricultural commodities were compensated by a healthy quantum-led uptick in exports of vegetables and fruits (**Table 5.5**). Within this segment, exports of potato remained quite strong, on the back of a good harvest and comfortable domestic supplies.[20] The GCC

[19] Export prices for Pakistan's basmati rice were, on average, 14.5 percent lower in H1-FY19 as compared to H1-FY18 (source: FAO).

[20] Pakistan's potato exports rose 97.3 percent YoY to US$ 37.8 million during H1-FY19. Domestic potato production had rebounded strongly last year, rising by 35.1 percent YoY on the back of a significant increase in yields (source: Economic Survey of Pakistan 2017-18). Comfortable

economies, particularly the UAE, along with Sri Lanka, emerged as key buyers of Pakistani potatoes. Meanwhile, Pakistan's mango exports also increased by 78.4 percent to US$ 51.7 million during H1-FY19, with most of the increase coming from Middle Eastern and European countries. The mango segment has recently received support from USAID, which may have helped Pakistan to market quality mangoes.[21]

Among other products, cement exports grew 32.4 percent to US$ 157.0 million during H1-FY19, led by a 55.5 percent growth in shipments. In the wake of significant capacity additions and faced with declining domestic sales, cement manufacturers have turned to foreign markets, such as Sri Lanka, South Africa, Madagascar and Mozambique. However, exporters are facing a challenging external environment with declining unit prices.

Table 5.8: Pakistan's Major Imports during H1
(million US$)

Items	FY18	FY19	Abs. change	Quantum impact	Price impact
Energy group	**6,675.1**	**7,665.0**	**989.9**	-1,335.8	2,325.6
POL prods.	3,881.2	3,415.1	-466.1	-1,384.8	918.8
Crude	1,756.1	2,426.0	669.9	-170.7	840.6
LNG	876.2	1,709.3	833.1	271.3.1	561.8
Agri and chem	**4,278.8**	**4,584.1**	**305.3**	-	-
Fertilizer	512.8	646.2	133.3	53.0	80.3
Plastic mat.	1,090.4	1,080.4	-10.0	26.7.1	-36.8
Transport group	**2,012.6**	**1,507.6**	**-505.0**	-	-
Cars	670.4	582.8	-87.6	-	-
Truck & buses	305.1	282.7	-22.4	-	-
Aircraft & ships	358.0	166.3	-191.7	-	-
Metals group	**2,566.1**	**2,500.4**	**-65.7**	-	-
Steel scrap	777.3	765.6	-11.7	-41.7	30.1
Iron & steel	1,135.9	1,124.6	-11.3	-30.6	19.2
Food group	**3,242.1**	**2,966.2**	**-275.9**	-	-
Tea	283.6	301.7	18.1	70.1	-52.0
Palm oil	1,037.4	931.7	-105.7	90.9	-196.7
Pulses	269.9	287.8	17.9	146.8	-128.9
Textile group	**1,378.5**	**1,344.5**	**-34.0**	-	-
Raw cotton	97.1	120.2	23.1	12.3	10.8
Syn. yarn	321.5	302.2	-19.3	-26.9	7.7
Machinery group	**5,501.9**	**4,479.3**	**-1,022.6**	-	-
Power gen	1,239.3	661.9	-577.4	-	-
Electrical	1,075.1	881.2	-198.9	-	-
Construction	190.2	129.8	-60.4	-	-
Cell phones	376.5	364.0	-12.4	-	-
Other machinery	1,678.3	1,606.6	-71.7	-	-
All other items	**2,386.9**	**2,394.2**	**7.3**	-	-
Total imports	**28,694.9**	**27,952.5**	**-742.4**	**-1,144.4**	**2,015.5**

Data source: Pakistan Bureau of Statistics

Imports

In H1-FY19, Pakistan's imports declined for the first time in a half-yearly period since H1-FY16, as macro stabilization measures took hold and the economy showed signs of slowing down. A heavy decline in non-energy imports completely offset a price-led increase in energy imports.

domestic supplies, despite exports, kept local potato prices 23.0 percent lower, on average, in H1-FY19 as compared to the same period last year.

[21] USAID had provided 13 mango graders under a grant program in 2017.

Imports of power, electrical and construction machinery, along with railway locomotives, were markedly lower this year in the wake of a hefty drop in PSDP spending and completion of early harvest CPEC projects (**Table 5.8**). The slowdown in construction activity also curtailed the demand for imported raw materials by the domestic steel industry (i.e. old ships for shipbreaking, and iron and steel scrap).

The lower ship imports contributed to a sizable drop in transport imports, accentuating the impact of a drop in purchases of aircraft- and railway-related parts. Furthermore, lower international palm oil prices suppressed import values, despite an increase in the commodity's quantum imports during the period.

The broad-based and quantum-led slowdown in import growth implies that the PKR's 24.1 percent depreciation since November 2017, along with other demand compression measures, have had some impact. Specifically, the growth in imports of consumer items and associated raw material fell to just 4.0 percent YoY this year, against a much higher 12.9 percent rise recorded last year.

Energy imports

The country's energy imports grew 14.8 percent to US$ 7.7 billion during H1-FY19; this growth was much lower than the 33.4 percent uptick recorded during H1-FY18. The increase stemmed from the fact that international oil prices, though trending downwards from early October 2018, were still at a higher level on YoY basis for even most of Q2-FY19. Arab Light prices were, on average, 16.4 percent higher in Q2-FY19 as compared to the same period in FY18.

As a result, in case of crude oil, the higher prices pushed up import values by a hefty 38.1 percent during H1-FY19, completely offsetting the effect of a 9.7 percent drop in quantum imports. Refineries have curtailed their crude oil imports to prevent a glut of domestic furnace oil (FO) from building up as a result of the crude refining process. Given the switch from furnace oil-based power generation to LNG and coal, refineries have found it challenging to offload their FO stocks.[22]

On the other hand, the drop in POL product imports intensified during H1-FY19, as the country severely curtailed its furnace oil purchases from abroad (**Table 5.9**). Further support came from a 35.9 percent drop in HSD imports, as per OCAC data. Importantly, the imports declined despite lower domestic

[22] Power generation from furnace oil declined 60.0 percent YoY during H1-FY19 (source: NEPRA). In tandem, both local production and quantum imports of furnace oil dropped heavily as well (by 12.2 percent and 61.2 percent respectively during H1-FY19, according to the PBS and the OCAC).

production of the fuel. Demand for HSD seems to have tapered this year, in line with the slowdown in construction and broader economic activity, as well as the wrapping up of transport needs of vehicles involved in early harvest CPEC projects.

Table 5.9: Growth in Energy Production, Sales & Imports (Quantum) during H1 (in percent)

	Production[1]		Sales[2]		Imports[2]	
	FY18	**FY19**	**FY18**	**FY19**	**FY18**	**FY19**
Furnace oil	5.4	-12.2	-13.3	-61.2	-18.8	-90.4
HSD	7.5	-4.7	12.5	-20.6	14.5	-35.9
Petrol	11.6	13.1	12.6	0.3	5.1	-0.4
Total products	8.1	-4.9	2.8	-27.2	-2.8	-43.7
Crude oil	-	-	10.5	2.5	20.5	-7.1
LNG	-	-	-	-	57.6	31.0

Data source: [1]:Pakistan Bureau of Statistics, [2] Oil Companies Advisory Council

In case of petrol, a marginal growth in demand this year was met by a 13.1 percent increase in domestic production, which negated the need for higher imports. The production gains materialized after a few refineries had upgraded their facilities to produce higher quantities of petrol instead of naphtha during the crude refining process. These upgrades started coming online from Q4-FY18 onwards, and have led to a healthy uptick in local petrol production this year.[23]

Table 5.10: Breakdown of Transport Imports during H1

(million US$)	**FY18**	**FY19**	**Abs. change**
Aircrafts, ships and boats	358.0	169.4	-188.6
Aircraft (complete)	53.1	4.9	-48.2
Aircraft (parts)	89.4	32.0	-57.4
Ships for shipbreaking	261.7	98.3	-163.4
Cars	670.4	584.8	-85.6
CBU	275.8	156.4	-119.3
CKD	394.6	428.4	33.7
Buses & trucks	305.1	295.6	-9.6
CBU	118.8	77.4	-41.5
CKD	186.3	218.2	31.9
Other transport equipment	191.9	19.3	-172.5
Railway locomotives & parts	194.6	20.1	-174.2
Motorcycles	55.5	54.9	-0.5
Transport group	**2,012.6**	**1,510.7**	**-501.9**

Data source: Pakistan Bureau of Statistics

Meanwhile, LNG imports continued to be the biggest contributor to the rise in energy imports. In value terms, LNG imports surged by 95.1 percent and reached US$ 1.7 billion during H1-FY19; higher international prices were responsible for 67.4 percent of this YoY increase. The higher quantum LNG imports reflected both the shift in the energy mix away from furnace oil towards gas-based generation, as well as the government's decision to provide LNG to the industrial sector during the winter months at subsidized rates.

Non-energy imports

Non-energy imports contracted by 7.9 percent during H1-FY19, after rising 14.0 percent in H1-FY18. The sharp pullback in power generation and electrical

[23] Expectedly, domestic production of naphtha declined by a massive 41.6 percent during H1-FY19.

machinery imports drove most of this decline, with further relief coming from the transport and food segments. Within transport, most of the decline came from the aircraft and ship category, followed by CBU cars and *other transport equipment* (**Table 5.10**).

CBU car imports declined significantly in the wake of subdued consumer demand, following the PKR depreciation as well as the ban on non-filers from purchasing vehicles. Customs data indicates that a total of 31,644 cars were imported in the country during H1-FY19, down 42.4 percent from 54,961 units imported in the same period last year. Meanwhile, imports of *other transport equipment* (dominated by railway-related parts and locomotives), were quite strong last year and have dropped this year.

Among other non-energy products, a decline in construction activity amid cuts in PSDP spending has led local steel firms to cut back on their production. This, in turn, has lowered their demand for imported raw materials, which tend to be either in the form of scrap, or old ships that are acquired and then disbanded at ship breaking yards to produce scrap. Quantum imports of both these product categories declined this year, leading to lower import values.[24] Cotton and fertilizer imports were much higher than last year, with lower domestic production of both items necessitating purchases from abroad.

[24] Quantum iron and steel scrap imports declined 5.9 percent YoY during H1-FY19. Pakistan also imported 20 ships for breaking during H1-FY19, down from 62 units imported in the same period last year.