2 Real Sector

2.1 Overview

Real economic activity was somewhat subdued during H1-FY20. To an extent, this could be traced to the impact of continuing macroeconomic stabilization measures, which had a notable impact on the industrial sector. In addition, early estimates suggest that despite some improvement in area under cultivation of wheat, the drag from decline in cotton and sub-par performance of sugarcane and rice crops may limit growth of the agriculture sector in FY20. The services sector was also affected by the developments in the commodity-producing sector, as reflected in the moderation or decline in various indicators related to *wholesale and retail trade* and *transport, storage and communication*.

Specifically, the direction of growth in the agriculture sector in FY20 would depend on the output of wheat and livestock sector. While the indicators of the livestock sector are not yet available, increase in area under wheat over last year is a favorable development. That said, the wheat area is still below the target set by the government. Also, despite better input availability in the *Rabi* season, the expected increase in production may not be enough to compensate for the YoY decline in cotton.

The LSM sector started showing some positive signs during Q2-FY20. Compared to both Q2-FY19 and Q1-FY20, the growth outcome improved noticeably. Expansion was evident in the construction-allied industry that seemed to have benefited from an uptick in cement exports and an increase in government development expenditures. In addition, sugar production rose sharply owing to favorable weather conditions (which were conducive for extraction of high sucrose content from the raw material), as well as relatively timely start of the crushing season compared to last year. Textile sector's output also jumped on account of higher exports. On the negative side, performance of the automobile industry remained subdued while petroleum also played a part in dragging the growth of LSM down. Moreover, there was a slowdown in fertilizer sector due to gas supply bottlenecks. On the whole, lower domestic demand and heightened risks to global growth have increased the downside risks for the industrial sector.

The services sector's growth depends on the performance of the commodity-producing sector. Import compression and weak performance of the crop sector are likely to impede retail subsector growth, while the economic downturn will adversely affect activities in the transportation sector. This is further highlighted

by decrease in sale of POL products and commercial vehicles. The silver lining so far is bank profitability, which remained higher during H1-FY20 compared to a year earlier, attributed in part to the high interest rate scenario that prevailed at the time.

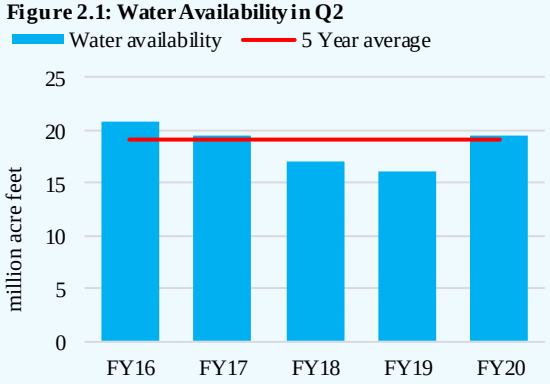
2.2 Agriculture

After a relatively subdued *Kharif* period, early indicators point to some improvement of agriculture sector during the *Rabi* season. For *Kharif*, cotton production is projected to decline by 4.2 percent over last year, hence missing the targets for FY20 by 25.7 percent. While still being below the target by about 1.5 percent, sugarcane production in FY20 is likely to be slightly higher than the last year. Similarly, FY20 turned out to be a marginal year for rice, as its overall production also missed the target by 3.0 percent and remained around the last year's level. Moving on to *Rabi* season, the input situation improved over last year. Specifically, water availability remained higher than the 5-year average, credit disbursements showed visible jump, and urea offtake rose compared to FY19. Better input situation compared to last year's *Rabi* season is likely to aid crop production, in particular the wheat crop.

Inputs

Canal water withdrawals increased during the first half of *Rabi* season compared to the 5-year average and also over same period last year (**Figure 2.1**). Major improvement was seen in Punjab and Sindh, which observed an increase in irrigation water supply during Oct-Dec 2019.[1] Moreover, increase in rainfall was recorded during the wheat sowing season over last year, especially in the provinces of Sindh and Punjab. Additionally, drop in temperatures during the germination and tillering stage of the wheat crop could prove crucial in enhancing the yields, come the harvest time.

Figure 2.1: Water Availability in Q2



Data source: Pakistan Space and Upper Atmosphere Research Commission (SUPARCO)

Agriculture credit also registered a significant increase of 16.5 percent during H1-

[1] Irrigation water supply rose by 24.5 percent in Punjab and 21.8 percent in Sindh, according to SUPARCO data.

FY20. Accounting for inflation rate of 11.1 percent during H1-FY20, real growth in credit clocked in at around 5.4 percent for the period. A notable increase in disbursements of fixed investment loans was among the highlights of agriculture credit during the period (**Box 2.1**).

Box 2.1: Highlights of Agriculture Credit during H1-FY20

Credit is a critical input for the agriculture sector, since monetary inflows and outflows depend on the crop production cycle. Given the scale of its importance in alleviation of temporary liquidity issues, the SBP encourages the formal lending institutions to provide credit to the rural sector. The primary tool at the SBP's disposal is the issuance of indicative targets. The central bank has also worked continuously on improving the regulatory oversight of lending institutions and easing the documentary bottlenecks for the borrowers. The success of these policies is evident from the fact that banks have been able to achieve their targets almost every year. From gross disbursements of Rs 260 billion in FY10, the central bank's target of Rs 1,350 billion in agriculture credit disbursement for FY20 is now within reach – a more than four-fold increase in the last decade.

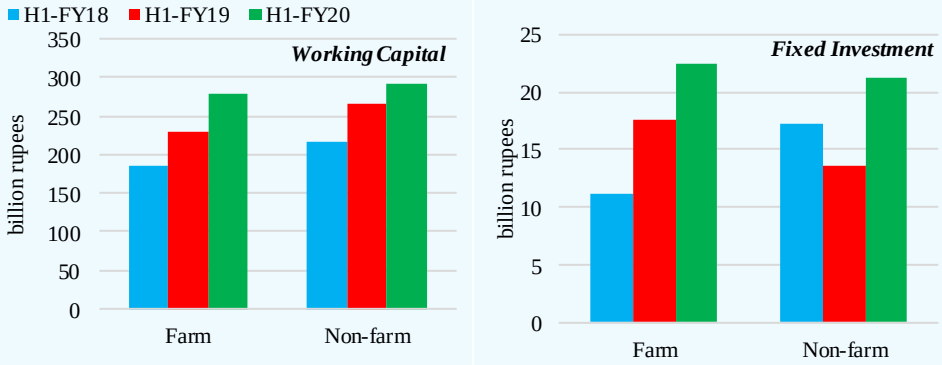
Table 2.1.1: Agriculture Credit Disbursements during H1

billion rupees, growth in percent

	FY19	FY20	Growth
Farm (I)	231	279.4	21.0
of which-Corporate farming	75.9	83.7	10.3
Non Farm (II)	265.2	291.3	9.8
of which-Poultry	61.5	120.4	95.8
of which-Livestock	132.6	148.8	12.2
Working capital (I+II=a)	496.2	570.7	15.0
Farm (III)	17.5	22.5	28.6
Non farm (IV)	13.6	21.2	55.9
of which-Poultry	1.2	6.8	466.7
Total production loans (III+IV=b)	31.1	43.7	40.5
Total credit (a+b)	**527.3**	**614.4**	**16.5**

Data source: State Bank of Pakistan

Figure 2.1.1: Gross Agriculture Loan Disbursements



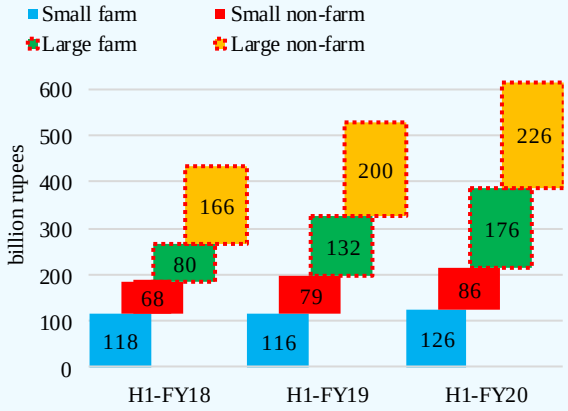
Data source: State Bank of Pakistan

In order to achieve its FY20 goals, SBP allowed Electronic Warehouse Receipt (E-WHR) financing and increased the maximum repayment tenure of development loans from 5 to 10 years in its Revised Prudential Regulations for Agriculture Financing. E-WHR would help in improving access

to credit for farmers, by allowing banks to accept E-WHRs as collateral for lending against storage of agriculture produce and commodities. In particular, it would benefit small farmers who usually find it difficult to access credit due to non-availability of agricultural land. It would also reduce post-harvest losses and increase farmer's profitability. In addition, SBP has increased indicative credit limits and updated eligible items for agriculture financing.

This approach proved to be successful, as evident from increase in development and working capital loans during H1-FY20 (**Figure 2.1.1**). On the fixed investment side, significant increase in credit uptake to poultry was observed; gross disbursements in the first half rose to Rs 6.8 billion during the review period from Rs 1.2 billion a year earlier (**Table 2.1.1**). Also, working capital loans to poultry sector almost doubled to Rs 120.4 billion in H1-FY20. The growth in loans to poultry sector both in development and working capital categories indicates the activity in this sector has increased. Meanwhile livestock/dairy and corporate farming also contributed to the increase in working capital loans.

Figure 2.1.2: Small vs Large Scale Agriculture Lending



Data source: State bank of Pakistan

Another dimension of agriculture loans during H1-FY20 was that growth was mostly concentrated in the large farm segment (**Figure 2.1.2**). The share of large farms jumped to 65.4 percent of the overall portfolio, from 56.9 percent two years ago. This switch underscores two important developments. First, banks are focusing on large-scale borrowers. Second, there is demand from large farms, especially from poultry and livestock subsectors.

From the perspective of institutional lending, the stimulus to agriculture credit growth came from conventional commercial banks, which contributed almost 90 percent to the increase in disbursements. Islamic banks contributed the rest. In contrast, the performance of the microfinance banks and institutions was subdued. It might be too early to make a definitive attribution, but recently issued guidelines designed to comply with AML/CFT regulations may have played a role in depressing the growth of Microfinance Banks and Institutions.

Fertilizer, another critical input, showed mixed trend during the ongoing *Rabi* season. Urea offtake increased by 10.3 percent, whereas DAP offtake continued to slide downwards and its offtake dipped by 11.0 percent during the period (**Figure 2.2**). The divergence in offtake reflects the farmers' preference for lower-priced urea compared to the costlier DAP. Urea remained cheaper by around 45.7 percent, despite a 15.2 percent increase in its price, compared to a 2.8 percent increase in DAP price during the period.

Figure 2.2(a): Urea Offtake and Price in Q2

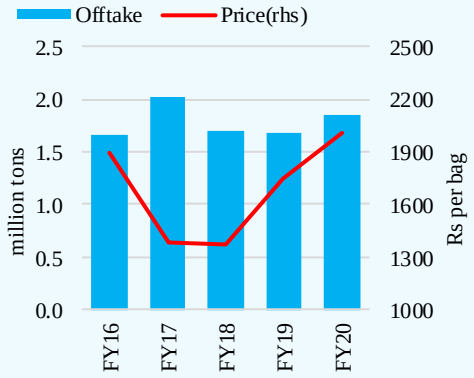
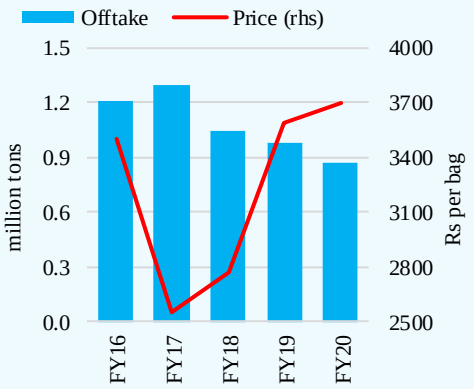


Figure 2.2(b): DAP Offtake and Price in Q2



Data source: National Fertilizer Development Center

Review of *Kharif* Crops[2]

It was another below-par year for the cotton crop, as production dipped below last year's level by 4.2 percent to around 9.5 million bales **(Table 2.1**). The target of 12.7 million bales was optimistic, given the performance of the last few years. Provisional estimates suggest that the target was missed by 25.7 percent. Unfavorable weather and low water availability during important stages of plant development played a critical role, along with pest attacks (pink bollworm and whitefly). Even though the overall area increased by 5.9 percent over last year, the overall performance remained below par due to lower yield, most noticeably in Sindh.

Table 2.1: Cotton Crop Estimates

					Growth in %	
	FY18	FY19	FY20^{T}	FY20^{P}	FY19	FY20
Area ('000 hectares)						
Punjab	2,053	1,888	2,145	1,860	-8.0	-1.5
Sindh	612	448	640	615	-26.8	37.3
Pakistan	2,700	2,373	2,895	2,513	-12.1	5.9
Production ('000 bales)						
Punjab	8,077	6,826	7,900	6,671	-15.5	-2.3
Sindh	3,776	2,938	4,600	2,680	-22.2	-8.8
Pakistan	11,946	9,861	12,720	9,451	-17.5	-4.2
Yield (Kg/hectares)						
Punjab	669	615	626	610	-8.1	-0.8
Sindh	1,049	1,115	1,223	741	6.3	-33.5
Pakistan	753	707		639	-6.1	-9.5

T=Target; P=Provisional
Data source: Cotton Crop Assessment Committee; Federal Committee on Agriculture; Pakistan Bureau of Statistics and SBP calculations

[2] Analysis in this section is based on minutes of FCA meeting, held on October 10, 2019. For cotton, assessment is on the basis of publications of the Cotton Crop Assessment Committee March 13, 2020.

In this backdrop, the country may need to import raw cotton, given that the domestic mill consumption tends to be well above 12 million bales per year on average. It implies imports of more than 2.5 million bales of cotton in FY20. During H1-FY20, imports have remained below last year's level, but this may change in the next half.

The revised production estimate of sugarcane crop suggests an increase of 0.7 percent over last year's output to 67.7 million tons. It was 1.5 percent lower than the target. Fall in area under sugarcane crop – particularly in Punjab – was the reason behind this performance, while increase in overall yield was recorded.

Rice production remained stagnant at 7.2 million tons in FY20 (**Table 2.2**). While there was an increase of 8.2 percent in area under the crop, driven in part by higher domestic prices and availability of inputs on subsidized rates, decrease in rice yield in Sindh dragged down the overall production.

Table 2.2: Rice Crop Performance

					Growth in %	
	FY18	**FY19**	**FY20^{T}**	**FY20^{P}**	**FY19**	**FY20**
Area ('000 hectares)						
Punjab	1,841	1,904	1,869	2,029	3.4	6.6
Sindh	828	690	770	776	-16.7	12.4
Pakistan	2,901	2,810	2,877	3,041	-3.1	8.2
Production ('000 tons)						
Punjab	3,898	3,979	4,000	4,144	2.1	4.1
Sindh	2,851	2,571	2,710	2,374	-9.8	-7.7
Pakistan	7,450	7,202	7,432	7,206	-3.3	0.1
Yield (kg/hectare)						
Punjab	2,117	2,090	2,140	2,042	-1.3	-2.3
Sindh	3,443	3,726	3,519	3,060	8.2	-17.9
Pakistan	2,568	2,563	2,583	2,370	-0.2	-7.5

T=Target; P = Provisional
Data source: Ministry of National Food Security and Research, and Federal Committee on Agriculture

***Rabi* season - Wheat**

Early estimates point to an increase in the area under wheat crop for the ongoing *Rabi* season. Overall, a 3.2 percent rise was witnessed, but it still fell short of the target set by the Federal Committee on Agriculture (FCA) by 2.4 percent (**Table 2.3**). Half of the increase in area under wheat can be traced to Punjab, where it exceeded last year's level as well as the target. Meanwhile, Sindh also witnessed a relatively sharper increase of 7.5 percent in area under wheat cultivation despite it being lower than the target by around 1.6 percent

Increase in wheat cultivation area in the two provinces (that produce almost 90 percent of the overall output), coupled with higher yields, is likely to reflect positively on production. Better input

Table 2.3: Area under Wheat Crop (Hectares)

	FY19	**FY20**	
	Actual	**Target**	**Estimate**
Punjab	6,495.9	6,560.0	6,636.7
Sindh	1,052.7	1,150.0	1,131.5
Khyber Pakhtunkhwa	724.1	900.0	747.2
Balochistan	389.6	550.0	427.2
Pakistan	8,662.3	9,160.0	8,942.6

Data source: Ministry of National Food Security and Research

situation compared to last year and lower temperatures during the early sowing season, also bode well for the prospects of the wheat crop in FY20. Specifically, increase in urea offtake and higher credit disbursements are expected to play a positive role. That said, the threat posed by locust attacks is a downside risk; by February 2020, a national emergency was declared over the locust swarms, and assistance was sought from the FAO and China to combat the locust threat, according to MNFSR press releases.

Regarding procurement, the government has raised wheat procurement price from Rs 1,300 in FY19 to Rs 1,365 in FY20. While this increase is not commensurate with the level of inflation, the revision in procurement price may affect wheat output. If the procurement agencies are able to procure the targeted 8.25 million tons of wheat, it will create additional public demand for the crop at harvest that was lacking last year.[3] However, the target seems optimistic, given that the government was able to procure around 6 million tons of wheat on average in the last 5 years. In the bigger picture, the fallout of the weak procurement drive by the provinces last year (when the country produced its lowest output since FY13) is being felt in FY20 in the shape of wheat and flour shortages. Sindh did not procure wheat last year, while Punjab also missed its procurement target. In this backdrop, it is imperative to redefine the optimal level of official wheat reserves at the national and sub-national levels.

Table 2.4: Minor Crops (*Rabi)*
Area in '000 Hectares; production in '000 MT; growth in percent

	FY19 Output		FY20 Target		Targeted growth (%)*	
	Area	**Production**	**Area**	**Production**	**Area**	**Production**
Potatoes	188	4,748	192	4,869	2	3
Onion	148	2,080	148	2,106	0	1
Gram	943	447	983	526	4	18
Tomatoes	38	414	54	601	39	45
Lentil	13	6	17	9	33	46

* FY20 target/FY19 output
Data source: Ministry of National Food Security and Research

Minor crops

While the first estimates of production of minor crops for the *Rabi* season were still forthcoming, the FY20 targets gave an initial sense of what to expect during H2-FY20 (**Table 2.4)**. The most notable increase, with respect to targeted area and production collectively, relates to the tomato crop. Keeping in mind the

[3] The wheat procurement target of 8.25 million tons was set by the Economic Coordination Committee in February, 2020. This represents one-third of the total wheat harvest based on last 5-year production.

developments during Q2-FY20, when tomato prices rose sharply, the envisioned increase in production would be a step in the right direction for self-sufficiency.

2.3 Large-Scale Manufacturing[4]

There are glimpses of some improvement in the output of the industrial sector during Q2-FY20 over the previous quarter. Specifically, LSM output's contraction decelerated sharply during Q2-FY20. It recorded a meager increase of 0.02 percent (YoY) as compared to the decline of 5.7 percent during Q1-FY20 **(Table 2.5)**. This outcome is heavily attributed to an increase in sugar production, excluding which LSM growth would have declined by 2.7 percent in Q2-FY20. This is an encouraging performance, but the seasonality factor linked with timely sugar production this year, as compared to the delayed start in FY19, means that it is hard to conclude if this trend can continue during Q3-FY20.

Table 2.5: LSM Growth (YoY)

percent

	wt.	H1		Q1		Q2	
		FY19	FY20	FY19	FY20	FY19	FY20
LSM	70.3	-1.7	-2.8	-0.5	-5.7	-2.9	0.0
Textile	20.9	-0.2	0.4	-0.2	0.2	-0.3	0.5
Cotton yarn	13	0.0	0.1	0.0	0.2	0.0	0.1
Cotton cloth	7.2	0.1	0.2	0.1	0.1	0.2	0.3
Jute goods	0.3	-8.0	-5.3	-8.1	-14.8	-8.0	3.5
Food	12.4	-3.3	3.9	1.9	-8.8	-7.6	15.4
Sugar	3.5	-37.2	97.1	-	-	-37.2	97.1
Cigarettes	2.1	6.8	-29.3	4.4	-34.5	9.1	-24.3
Vegetable ghee	1.1	1.7	5.1	4.1	2.0	-0.7	8.3
Cooking oil	2.2	1.3	7.0	6.9	0.2	-3.8	13.9
Soft drinks	0.9	-1.7	-12.0	-6.7	-13.5	8.1	-9.5
POL	5.5	-4.9	-10.3	-5.4	-14.5	-4.4	-5.9
Steel	5.4	-7.6	-12.3	-2.9	-17.0	-12.4	-6.8
Non-metallic minerals	5.4	-1.2	2.9	0.1	-0.9	-2.3	6.3
Cement	5.3	-1.6	2.7	0.1	-1.4	-3.0	6.3
Automobile	4.6	-3.8	-36.4	-1.2	-33.9	-6.4	-39.1
Jeeps and cars	2.8	2.3	-46.4	4.7	-38.6	-0.2	-54.6
Fertiliser	4.4	6.5	4.9	-4.8	15.9	19.2	-5.1
Pharmaceutical	3.6	-10.1	-6.2	-4.8	-11.9	-14.6	-0.7
Paper	2.3	-2.0	7.2	3.9	-1.3	-7.5	16.0
Electronics	2	20.1	1.9	16.9	11.0	23.1	-6.1
Chemicals	1.7	-3.3	-4.7	-6.7	-8.9	0.3	-0.4
Caustic soda	0.4	5.3	-14.7	17.2	-21.4	-5.3	-7.4
Leather products	0.9	-1.9	11.2	0.5	6.3	-4.1	16.0

Data source: Pakistan Bureau of Statistics

[4] The analysis in this section is based on Quantum Index for January 2020 of LSM industries.

Some other sub-sectors also performed better. The fertilizer sector's output expanded during HI-FY20; however, it lost some steam during Q2-FY20 as two smaller urea producing units ceased production in December 2019. The cement industry registered growth of 6.3 percent during Q2-FY20 in contrast to contraction in the previous quarter, owing to both higher exports as well as some revival in domestic demand. However, the steel sector, although having some complementarity with cement, was not able to post positive growth in Q2-FY20 despite improvement from Q1-FY20.

Meanwhile, other major industries continued to slide in line with the economic downturn. Automobile sector alone accounted for major portion of contraction in LSM during H1-FY20; however this performance did not include the production activity of the new entrants in the automobile industry. The petroleum industry, in addition to lack of demand, still continued to recover from the government's decision to phase out furnace oil based power plants. Growth in production of electric motors, that had driven the electronics industry's growth in the past few quarters, slowed down sharply as demand for the water extraction pumps subsided due to ample water availability in the *Rabi* season.

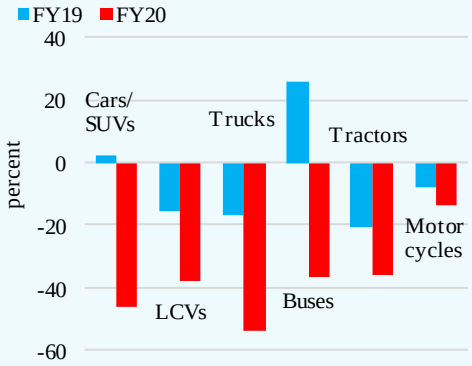
To sum up, LSM contracted by 2.8 percent during H1-FY20 on YoY basis, which is still more than the corresponding period in the last year. As the growth prospects look challenging, especially when production activity in sugar and fertilizer production is expected to decelerate in the coming months, the bottoming out phase of the industrial sector cannot be determined with any degree of certainty as yet.

Automobile

The automobile sector's output contracted 36.4 percent in H1-FY20. This is a record low growth since the rebasing of LSM in FY06. In addition, the sector decelerated further in Q2-FY20 compared to the preceding quarter. Major contributor to this performance – due to its weight in LSM Index – was the passenger car segment. That said, output of other subsectors also dipped sharply (**Figure 2.3**).

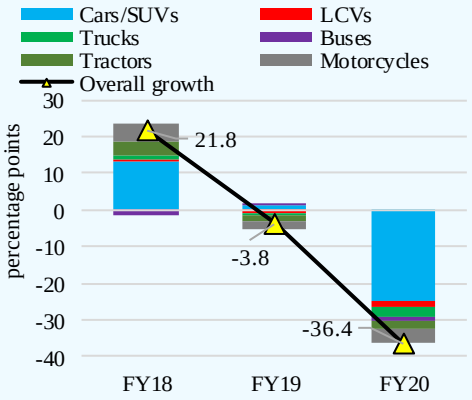
Focusing on LSM data for automobile sector, large increase in prices on account of exchange rate adjustment remained the major reason for decline in demand for automobiles. This was partially the result of low level of localization of auto parts. Moreover, the decline in output of the auto sector can also be traced to fiscal consolidation and tight monetary policy. In particular, the public sector's demand for vehicles waned as fiscal austerity measures took hold.

Figure 2.3a: Automobile Sector Growth in H1 (YoY)



Data source: Pakistan Automotive Manufacturers Association

Figure 2.3b: Auto Sector Growth & Contribution in Growth in H1

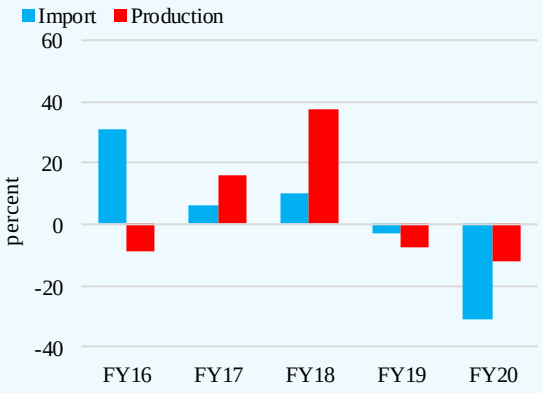


New entrants have somewhat altered the dynamics of the automobile industry. Since they are giving competition to existing players in multiple vehicle categories, this aspect is further accentuating the speed and extent of contraction in automobiles sector. At present, production data of these firms is not part of the LSM. If the output of these firms had been recorded in the LSM information set, the contraction may not have been so steep.

Construction-Allied Industries

The output of the steel industry declined by 12.3 percent during H1-FY20 (**Figure 2.4**); however, the pace of contraction slowed during Q2-FY20, compared to the previous quarter. On overall basis, the decline during H1-FY20 was more visible in billets, which is indicative of subdued construction activity in the economy. Scrap imports that are intermediate inputs for the steel industry, small-scale producers in particular, registered a 17.0 percent quantum drop as well. Finished steel products also saw significant fall in growth of 28.3 percent during the period. However, the demand for flat products (steel sheets) remained intact.

Figure 2.4: Steel Production and Import Growth in H1

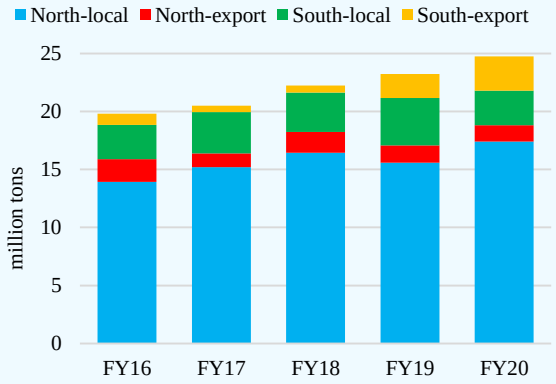


Data source: Pakistan Bureau of Statistics

Activity in the cement industry picked up pace in Q2-FY20. One of the main reasons for this uptick was the rise in clinker exports. Another factor was the relative improvement in domestic demand at the back of higher development expenditures and an increase in remittance inflows that may have contributed in expenditures on private construction.

All Pakistan Cement Manufacturers Association (APCMA) data on cement dispatches shows that growth reached 9.9 percent in Q2-FY20 from 2.6 percent in preceding quarter. The performance was driven in equal measure by local and export sales, as opposed to being predominantly export-driven previously. Furthermore, disaggregated data shows that the growth in local sales was driven entirely by the north region while the south contributed to export performance (**Figure 2.5**).

Figure 2.5: Cement Dispatches (H1)



Data source: All Pakistan Cement Manufacturers Association

Clinker exports were mainly to Bangladesh, whose previous supplier, Vietnam, diverted its supplies to Chinese market.[5] This benefited the domestic industry. The share of clinker in overall cement exports in quantum terms increased to 47.5 percent in H1-FY20 from 29.2 percent in H1-FY19. Meanwhile, Portland cement exports were recorded at almost the same level as last year, despite no exports to the Indian market that had consumed more than a quarter of our exports during FY17 and FY18 (**Chapter 5**).

As the decline in steel output is in contrast to cement industry's results given their complementarity in construction, healthy margins after depreciation of PKR and surplus capacity indicates that cement producers are well realigning their growth strategy towards exports. On the contrary, steel manufacturer's current output is still well below the domestic requirements, which is necessitating imports.

[5] In the process of fine-powdered Portland cement, clinker is produced, which reflects lumps or nodules. Clinker is grounded to produce Portland cement.

Another possible explanation of this mismatch could be the outdated LSM survey sample that does not reflect the present ground realities of the two industries. The LSM was last rebased in FY06 and since then, no major revisions have been made. This is notable, as apart from establishment of new firms, existing ones in both the sectors have also invested heavily in capacity expansion during this period.

Fertilizer

The fertilizer industry maintained its upward trajectory, growing by 4.9 percent during H1-FY20 compared to 6.5 percent growth in same period last year. Detailed data of the fertilizer industry highlights that growth was driven by the urea units, particularly the small scale units. However, the output of other fertilizers such as DAP, SSP, and NP declined further. Given the imbalance in fertilizer application in the country, this is not a good development as farmers would have to rely relatively more on imported fertilizer substitutes.[6]

Beginning with urea sector results, its growth was recorded at 7.8 percent in H1-FY20, slightly lower compared to 8.5 percent last year based on National Fertilizer Development Center (NFDC) data. Large urea units kept up growth momentum for the third year running, as their cumulative production grew by a further 2.3 percent during the period.

In addition, smaller units built on last year's performance and registered growth of 84.2 percent during H1-FY20. This production was the highest since FY11. As has been identified in the past reports, the performance hinges on the supply of gas to these units. During H1-FY19, these units received gas supplies predominantly during Q2 only. Small scale units were able to secure gas supplies for 5 out of 6 months during H1-FY20, and that helps to explain the jump in performance.

Urea production ceased during December 2019 due to disruption of gas supplies to small units. As there was ample availability of urea, it may not affect the domestic

Table 2.6: Fertilizer Balance in H1
million tons

	FY16	FY17	FY18	FY19	FY20
Opening inventory	0.2	1.7	1.1	0.1	0.2
Imported supplies	0.3	0.0	0.0	0.1	0.1
Domestic production	2.8	3.0	2.8	3.0	3.3
Total availability	3.3	4.7	3.9	3.2	3.6
Offtake	2.7	3.7	3.2	3.1	3.3
Export	0.0	0.0	0.4	0.0	0.0
Write off/on	0.0	0.0	0.1	0.0	0.0
Ending inventory	0.6	1.0	0.3	0.2	0.2

Data source: National Fertilizer Development Center

[6] According to FAO data, the fertilizer application is highly skewed in favor of Nitrogenous fertilizers in Pakistan due to its low cost and availability. As a result of imbalanced use, crop yields are low in Pakistan.

market for now (**Table 2.6**). Going forward, the government needs to devise a clear strategy for these units to keep them operational. The current policy of supplying subsidized gas when there is domestic shortfall for urea and withdrawing it when production exceeds a certain level is hurting the performance of these firms as well as the country's economic growth. This trend should also entail some uniformity in production level throughout the year.

The production of other fertilizer products recorded decline for the fourth year in a row. The output was the lowest since FY13. To increase agriculture productivity, the country needs balanced use of nutrients. The recommended usage of fertilizer is not being met and it is one of the reasons for slower growth in crop yields compared to other countries. In this backdrop, the decline in production of other fertilizer products means that the country has to import more quantities of these commodities.

Tobacco

Cigarette production fell by 29.3 percent in H1-FY20 compared to last year. The re-introduction of two-tier excise duty structure, uncertainty regarding the implementation and mechanism of track and trace system, and continued competition from counterfeits and smuggled alternatives hindered the industry's progress in H1-FY20.

The government reverted to two-tier duty structure for cigarettes to discourage tobacco usage and increase revenue collection. Notwithstanding the ensuing scale of decline in production, consumption may not have fallen by the same rate in such a short time, since cigarette use generally tends to be relatively inelastic in nature. It may have driven the consumers away from the formal market and towards the informal sector. In such scenario, the federal government may not be able to generate its targeted revenue.

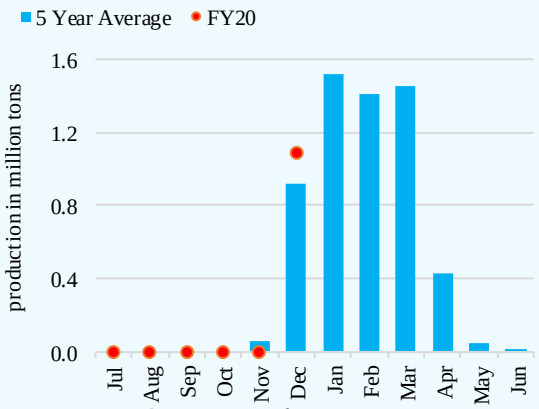
Sugar

The sugar industry's output surged by 97.1 percent during December 2019 against a contraction of 37.2 percent in the same month last year. A typical sugar production cycle in Pakistan is from November to April, with more than 90 percent of the activity concentrated in the 4 months of December to March. Favorable weather, depleting carryover stock of sugar from the last year, and competition among sugar mills, compelled firms to crush more sugarcane earlier this year (**Figure 2.6**).[7] Timely commencement of cane crushing, as compared to

[7] Cold weather is beneficial for sugar production as it increases sucrose content in the crop, which in turn increases sugar recovery yield.

the delay in FY19, led to an unusually high growth rate in sugar production due to the base effect. However, on an overall basis, processing is expected to remain around last year's level as estimates point to only a marginal increase in sugarcane production during FY20.

Figure 2.6: Sugar Production (Last 5 Years vs FY20)



Data source: Pakistan Bureau of Statistics

Over time, another aspect affecting the sugar industry is the lingering disagreements about sugarcane price-setting mechanism amongst growers, millers and the government.[8] Since sugarcane crop takes more than 12 months to mature, indicative pricing mechanism at the time of harvest does not favor the stakeholders. For instance, farmers who invest time and resources want returns commensurate with their investment. The cost of production varies and demand and supply situation tends to change over the cultivation period. As the situation changes, the indicative pricing at the start of the sugarcane crushing season affects the profitability of the crop for farmers. On the other hand, procuring sugarcane at indicative price announced by the government makes domestic sugar mills uncompetitive compared to international producers. The country has the potential to produce surplus quantity of sugar; however, persisting differences between stakeholders related to price-setting are creating volatility in sugarcane and sugar output.

Textile

The textile sector performance in H1-FY20 showed signs of recovery as it managed a growth of 0.4 percent in production compared to decline of 0.2 percent in H1-FY19. Impetus to growth came primarily from the yarn and cloth segments while woolen and jute goods registered substantial decline in production. On the export front, textile group grew 3.9 percent during H1-FY20 to US$ 6.9 billion, which was the highest level since H1-FY14.

The mismatch between the LSM and export data sets is widening as the textile industry continues to upgrade to products higher up in the value chain that are not

[8] This issue was earlier highlighted in the State Bank of Pakistan's State of Pakistan's Economy, First Quarterly Report for FY19.

covered in the industrial production data. Apparel exports grew sharply during the period while primary products were a drag on the export performance (see **Chapter 5**). A few producers have focused their attention on the export market while using in-house manufactured primary inputs (yarn, cloth, etc.), which were earlier contributing to LSM in the shape of final products.

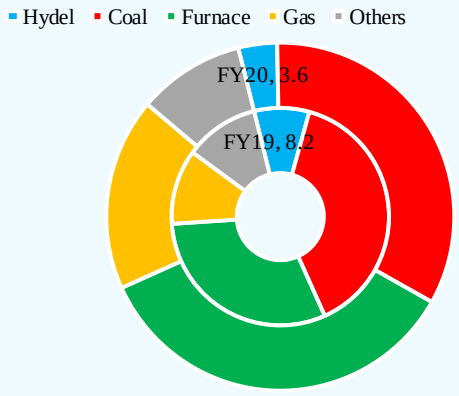
Electronics

The performance of electric motors was predominantly responsible for growth of electronics sector during the past few years. As the growth of electric motors started to slow down, it dragged the electronics industry's growth to only 1.9 percent in H1-FY20 compared to growth of 20.1 percent during same period last year. After growing by 10.9, 303.3 and 31.3 percent in H1 of past three years, production of motors recorded a meager growth of 4.1 percent during H1-FY20. The slowdown in electric motor segments can be attributed to contained demand from the rural sector for water extraction, concomitant to sufficient water availability in the country during the past few months.

Petroleum

The petroleum sector contracted by 10.3 percent during H1-FY20. However, comparing the performance of Q1 versus Q2 of FY20, the contraction was relatively well-contained during the latter. [9]

Figure 2.7: Electricity Generated from Furnace Oil



Data source: National Electric Power Regulatory Authority

With minor exceptions, there was a broad-based decrease in almost all the product categories. The phasing out of furnace oil and higher input prices hurt the supply side, while higher end-consumer prices and reduction in commercial activities curtailed the demand side, particularly for High-Speed Diesel. Production of furnace oil, petrol and diesel products contracted as a result. Improvement in electricity supplies from coal and hydel power stations also reduced the demand for furnace oil and diesel, which in turn adversely affected the industry's performance (**Figure 2.7**).

[9] Petroleum sector production declined 14.5 percent during Q1-FY20. The decline in Q2-FY20 was 5.9 percent.

2.4 Services

Wholesale and retail trade activity, which accounts for the bulk of services sector output, was subdued during H1-FY20. Proxy indicators like YoY growth in LSM and sectoral credit offtake declined during the first half (**Table 2.7**). By contrast, sectoral credit flows had been in the positive territory by the half-way point last year, and even so, the services sector had missed its FY19 full year target. Imports also dropped sharply, which could be attributed to the continuing macroeconomic stabilization measures.

Table 2.7: Selected Services Sector Indicators in H1

	FY19	FY20
Wholesale and Retail Trade (18.9%)		
Sectoral credit off take*- flow (billion Rs)	52.2	-38.8
Imports (billion US$)	28.0	23.2
LSM (YoY growth)	-1.8	-3.4
Agri credit (disbursements – Rs bln)	527.3	614.4
Transport, Storage and Communication (12.9%)		
POL sales to transport sector (million MT)	7.2	6.3
Commercial vehicle sales (units)	24,559	11,488
Cellular teledensity (%)	72.7	78.2
Broadband users (million)	50.5	78.0
Finance and Insurance (3.5%)		
Assets (billion Rs)*	19,682.1	21,991.3
Deposits (billion Rs)*	14,254.2	15,953.5
Profit after tax (billion Rs)	72,753	88,030
Infection ratio	8.0	8.6
General Government Services (8.4%)		
Expenses on general govt & defense*** (Rs billion)	1,796.7	2,450.3

Note: Values in brackets are sectoral shares in GDP, as of FY19.
* With adoption of ISIC-4 classification by SBP, the *wholesale and retail trade* and t*ransport, storage and communication* categories have been modified. Thus, one-to-one mapping of sectoral credit offtake numbers may not be possible in each case
** Stocks, as of end-December 2019
***Only Federal Government
Data source: SBP, PBS, OCAC, PAMA, PTA and MoF

Within the *transport, storage and communication* segment, there was a steep drop in commercial vehicle sales during H1-FY20 compared to last year, along with lower POL sales to the transport sector. In addition, the axle load issue (which appeared to be addressed by October 2019) resurfaced, prompting an eight-day strike by goods transporters in January 2020. In this backdrop, the downside risks emanating from the transport sub-segment may remain in play during the remainder of the year.

Meanwhile, in the communication sub-segment, cellular teledensity continued to rise and the number of broadband users grew appreciably. Imports of mobile phones also rose 69.2 percent during H1-FY20 compared to last year (in USD value terms).[10] Moreover, activities related to communication services may receive a further boost in the medium to long-term following the inauguration of the Digital Pakistan initiative in December 2019, which emphasizes access and

[10] Specifically, mobile phone imports rose from USD 364 million in H1-FY19 to USD 616.1 million in H1-FY20.

connectivity as key pillars.

Regarding *finance and insurance*, the after tax profits for the banking system as a whole rose by 21.0 percent during Jul-Dec 2018 compared to a year earlier. At the same time however, the infection ratio rose to 8.6 percent by December 2019, with outstanding (gross) NPLs amounting to Rs 761 billion. The total NPL amount includes the loans against sick industrial units. There is potential for such loans to be revived and rehabilitated after the establishment of the Pakistan Corporate Restructuring Company Limited (PCRCL) in January 2020.[11] Prompt restructuring and injection of fresh equity by the sponsors of sick units could help make this initiative a success.

[11] PCRCL was established by ten commercial banks, namely Habib Bank, National Bank of Pakistan, United Bank, MCB, Allied Bank, Meezan Bank, Bank Alfalah, Bank Al-Habib, Habib Metropolitan Bank and Faysal Bank. For details, see SBP's press release titled 'Banking industry join hands to create Pakistan Corporate Restructuring Company Limited (PCRCL)', dated January 10, 2020.