

5 External Sector

5.1 Overview

Pakistan's balance of payments position improved notably in the first half of FY20, with the current account deficit narrowing to a six-year low. This was largely due to a significant contraction in import payments, along with encouraging nascent rebounds in receipts from exports and remittances. The lower deficit was comfortably financed via the available financial flows, including two IMF tranches, a rebound in IFI funding, and sizable portfolio flows into local currency debt instruments.¹

Table 5.1: Summary of Pakistan's External Sector

billion US\$	Q2			H1		
	FY19	FY20	Abs. Change	FY19	FY20	Abs. Change
Current account balance*	-4.3	-0.6	3.7	-8.6	-2.1	6.5
Trade balance*	-7.8	-4.7	3.1	-16.2	-9.8	6.4
Exports	6.0	6.4	0.4	11.9	12.4	0.5
Imports	13.8	11.1	-2.7	28.1	22.2	-5.9
Energy	3.9	2.4	-1.5	8.1	5.3	-2.8
Non-energy	9.9	8.7	-1.2	20.0	16.8	-3.1
Services balance*	-1.1	-0.7	0.4	-2.2	-1.8	0.4
Workers' remittances	5.5	5.9	0.4	11.0	11.4	0.4
Financial account balance**	-3.3	-3.6	-0.3	-6.2	-5.6	0.6
FDI in Pakistan	0.2	0.8	0.6	0.8	1.3	0.5
FPI in Pakistan	-0.2	0.1	0.4	-0.4	0.5	0.9
o/w Eurobond/Sukuk	-	-1.0	-1.0	-	-1.0	-1.0
Local currency debt (net)	-	1.1	1.1	-	1.5	1.5
Inflow	-	2.0	2.0	-	2.6	2.6
Outflow	-	0.9	0.9	-	1.2	1.2
FX loans (net)	3.0	2.9	-0.1	5.3	3.9	-1.4
IMF (net of repayments)	-0.04	0.3	0.3	-0.1	1.1	1.2
SBP's liquid FX reserves (end-period)				7.3	11.3	4.2
PKR app(+)/dep(-) against US\$ during period (%)	-10.6	1.0	-	-12.5	3.4	-

*+ve change shows improvement in balance **-ve value shows net FX inflow

Data source: State Bank of Pakistan

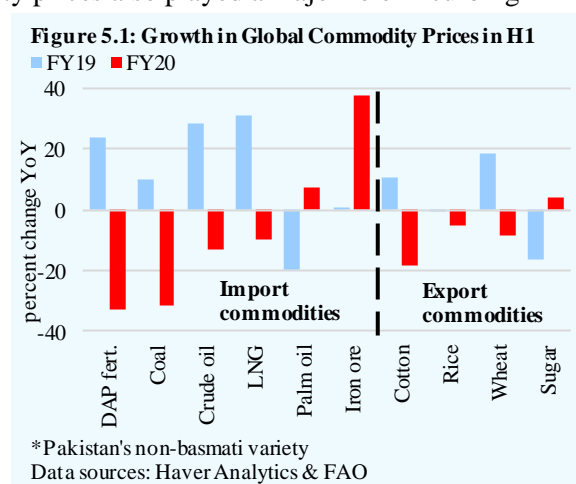
¹ In gross terms, the major sources of official inflows were the ADB (US\$ 2.1 billion), commercial borrowings (US\$ 1.8 billion), the IMF (US\$ 1.5 billion), and portfolio investment in T-bills and PIBs (US\$ 1.5 billion). The major repayments included a US\$ 1.0 billion Sukuk, US\$ 767 million commercial loan to a Chinese bank, and US\$ 500 million of deposits placed by Qatar last year.

Besides plugging the current account gap, these inflows also allowed the country to make bulky retirements without putting pressure on the foreign exchange reserves. In fact, SBP's liquid reserves reached a 20-month high by end-December 2019, whereas the Pak Rupee appreciated by 3.4 percent against the US Dollar in the period (**Table 5.1**).

The significant reduction in the current account deficit mainly reflected the impact of macroeconomic stabilization measures undertaken over the past year, which have significantly curtailed the import demand of a wide range of non-energy and energy products. The ongoing slump in domestic auto sales figured prominently, as it not only hit automakers' demand for imported parts, but also contributed to a reduction in the steel industry's demand for imported raw materials and finished products. Regulatory measures – such as the imposition of anti-dumping duties on imports of finished steel products from Russia and Canada, and ongoing restrictions on used car imports – further curtailed transport and steel imports.

Meanwhile, low global commodity prices also played a major role in curbing

import payments (**Figure 5.1**), particularly those of the energy group. A 15.3 percent reduction in average global oil prices on YoY basis was instrumental in lowering energy import payments to a three-year low, despite an increase in the quantum imports of fuels like LNG, coal and petrol. Policy-driven reorientation of the energy mix towards coal and LNG and away from furnace oil (FO) also had ramifications for energy imports, as the import profile shifted away from crude oil and POL products (**Section 5.5**).²



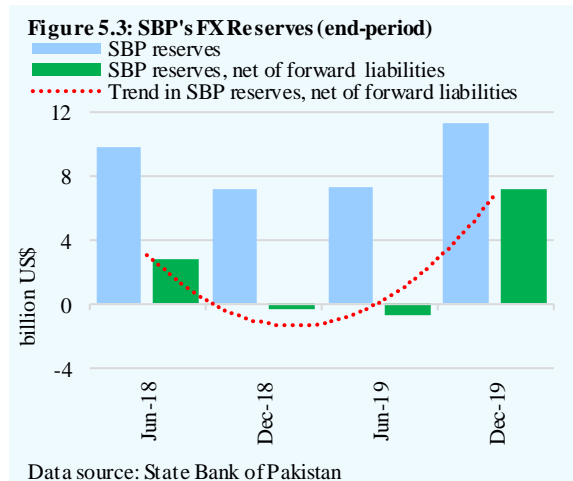
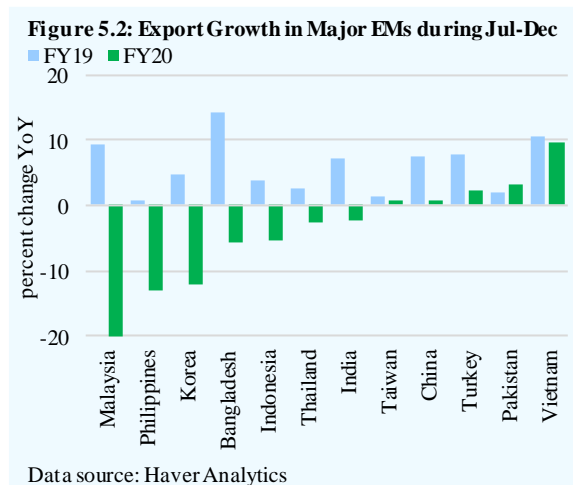
On the flip side, the lower international prices also suppressed export earnings of many emerging markets (**Figure 5.2**), including Pakistan's. Unit prices of

² With FO demand from the power sector dropping continuously, refineries are faced with a buildup in FO stocks. To avoid further adding to this glut, refineries have reduced their capacity utilization, which has lowered their demand for crude oil.

Pakistan's major export products – i.e. textiles and rice – continued to drop, suppressing export earnings. Furthermore, the slowdown in the global economy also affected export performances of emerging markets (EMs).³ However, Pakistan was able to overcome these challenges, and in case of textiles and rice, the country's export volumes rose significantly, as exporters managed to increase their market shares in key

destinations. In the case of textiles, Pakistani exporters benefitted from China's retreat from the US market amid the trade war (**Section 5.5**), and continued concessionary market access to the EU. In case of rice also, Pakistan's share in major African, Middle Eastern and European markets increased on the back of sizable increase in shipments.

While the export environment continued to be challenging, the introduction of a market-based exchange rate system and foreign investors' positive sentiments about the sustainability of this system; successful completion of the first EFF review; and ongoing progress in reform-related efforts, played a large role in helping the country attract sizable external financing in the period. These cumulative inflows allowed the SBP to rebuild its reserves and start unwinding its net short position in the forwards market

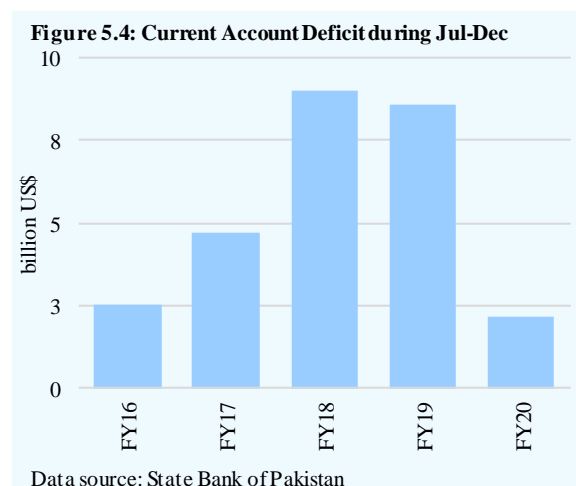


³ Global economic growth slowed down to an estimated 2.9 percent in 2019, from 3.6 percent in 2018 (source: IMF World Economic Outlook, January 2020).

(Figure 5.3), which led to a US\$ 3.8 billion reduction in net forward liabilities during the six-month period.

5.2 Current Account

A steep decline in import payments, along with encouraging growth in exports and remittances, limited the overall deficit in the current account during H1-FY20 to almost a quarter of the level seen in the same period last year (Figure 5.4). Receipts from both exports and remittances witnessed nearly 8 percent growth in second quarter and helped narrow the CAD in H1-FY20. The primary income, however, recorded a higher deficit, as both profit repatriation and interest payments increased in the period.



Workers' remittances

During CY 2019, the growth in the global remittance flows slowed substantially as compared to the previous year. A number of factors played a role, such as decelerating growth in advanced economies, lower oil prices and weakening of currencies of some of the source countries against the greenback, thereby lowering the US dollar value of remittance flows.⁴

Remittances inflows in Pakistan have decelerated to 5.3 percent in CY 2019, compared to 6.9 percent growth registered in CY2018. Despite the slowdown, growth in remittances appears reasonable when compared to other countries and regions (Figure 5.5).⁵

However, during H1-FY20, workers' remittances witnessed a growth of 3.3

⁴ The World Bank estimates that around half of remittance flows to low and middle-income countries are in US dollars and a number of source country currencies depreciated against the US dollar during the year.

⁵ In case of South Asian countries, Pakistan has contributed significantly to overall remittances growth. The remittances to India increased by 4.6 percent, while that of Sri Lanka went up by 2.9 percent. Flows to Bangladesh, however, grew by 12.7 percent in 2019 (source: World Bank).

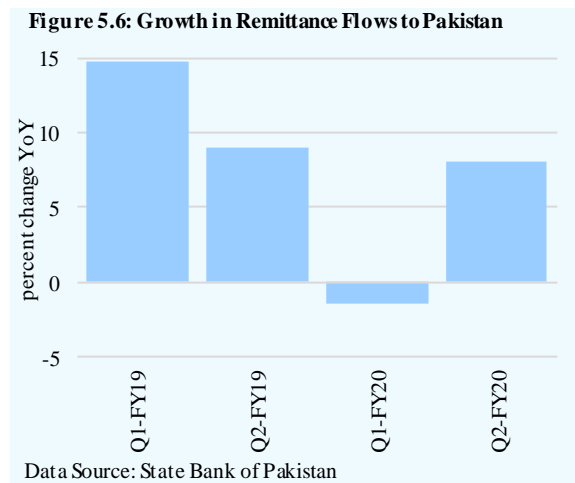
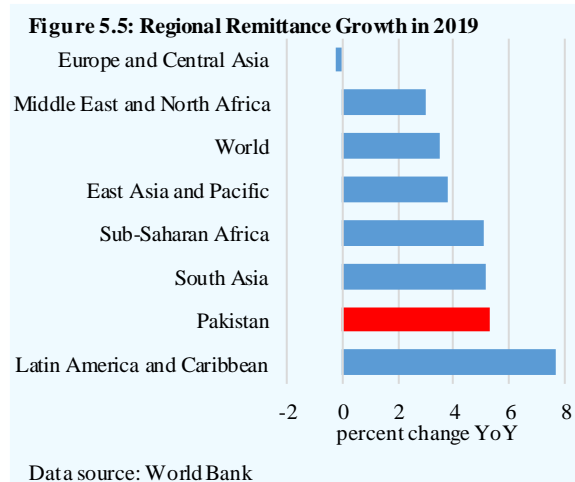
percent. This can be traced to: (i) an increase in number of Pakistanis going abroad for work (**Table 5.2**); (ii) improved economic condition in GCC countries due to higher non-oil GDP growth;⁶ (iii) a competitive exchange rate in interbank relative to open market, as the kerb premium remained negative during most of the first half; and (iv) an increase in the cost of living in Pakistan.

Quarterly break-up shows that after declining in Q1-FY20, the remittances rebounded in the second quarter (**Figure 5.6**). While the decline in Q1 could be largely traced to lower inflows from GCC countries (especially UAE), the recovery in Q2-FY20 was broad-based.

To support remittance inflows through formal channels, the government of Pakistan continued providing various incentives to customers, banks

and exchange companies. These included relaunching of the reimbursement scheme, which had been introduced last year, for marketing charges to banks at the rate of Re 1 for each incremental US dollar for over 15 percent remittance growth.

Furthermore, the scope of scheme for reimbursement of telegraphic charges was enhanced by introducing one more tier. Now, the reimbursement of Saudi



⁶ The GCC countries' non-oil GDP is estimated to grow by 2.4 percent in CY2019 from 1.9 percent in CY2018. However, the overall GDP growth remained suppressed at 0.7 percent, mainly due to decline in oil GDP by 1.4 percent (source: IMF).

Arabian riyal (SAR) 10 will also be made for home remittance transaction between US\$ 100-200, in addition to reimbursement of SAR 20 for transactions over US\$ 200. The transaction limit for business to customer (B2C) and (C2B) has also been revised.⁷

Table 5.2: Number of Pakistani Registered for Overseas Employment

	2017	2018	2019	Change
Saudi Arabia	143,363	100,910	332,713	231,803
U.A.E.	275,436	208,635	211,216	2,581
Oman	42,362	27,202	28,391	1,189
Qatar	11,592	20,993	19,327	-1,666
UK	340	587	903	316
USA	229	339	505	166
Total	496,286	382,439	625,203	242,764

Data source: Bureau of Emigration & Overseas Employment

The country-wise remittance to Pakistan shows that flows from the GCC have slowed down from 2.5 percent in H1-FY19 to 1.4 percent in H1-FY20 (**Table 5.3**). Among the GCC countries, Saudi Arabia (KSA) and UAE were the major source countries contributing to the remittances growth. In case of KSA, the remittances recorded higher growth during H1-FY20, reflecting improved non-oil private sector activities on the back of rising government expenditures.⁸

Meanwhile, remittances from the US and the UK registered 9.1 and 6.4 percent growth in H1-FY20 respectively. In case of the US, labor market condition remained tight, as the unemployment rate hovered around 3.5 percent in July-December 2019 and led to higher wages, specifically in the 'blue collar' jobs. Though economic activity slowed in the UK in the wake of Brexit-related uncertainty, the situation benefited the labor market, with the unemployment rate dipping to 3.8 percent in fourth quarter of CY2019.⁹

Table 5.3: Country-wise Remittance Inflows (H1)
million US\$; growth in percent

	FY19	FY20	Growth
GCC	5,972	6,057	1.4
Saudi Arabia	2,567	2,618	2.0
U.A.E.	2,348	2,349	0.0
Other GCC Countries	1,056	1,089	3.2
US	1,733	1,890	9.1
UK	1,647	1,753	6.4
EU	313	339	8.4
Others	1,204	1,394	15.8
Total	11,030	11,395	3.3

Data source: State Bank of Pakistan

5.3 Financial Account

The financial account in H1- FY20 saw a surge in the portfolio investment in local currency government securities, as foreign investors increased their focus on Pakistan due to reforms initiated in the exchange rate market and to encash the

⁷ <http://www.sbp.org.pk/epd/2019/FECL14.htm>

⁸ Source: World Bank's Economic Updates for Saudi Arabia and UAE (October 2019).
<https://www.worldbank.org/en/country/gcc/publication/saudi-arabia-economic-update-october-2019>
<https://www.worldbank.org/en/country/gcc/publication/uae-economic-update-october-2019>

⁹ Office of National Statistics, UK.

available risk-adjusted returns in fixed income securities. Beside portfolio investment, some improvements were noticed in FDI inflows and long-term borrowing by the government from multilateral sources; while commercial borrowings also witnessed a sharp increase.

Foreign direct investment

In H1-FY20, net foreign direct investment in Pakistan grew sharply by 68.2 percent YoY to US\$ 1.3 billion compared to 19.2 percent decline in the same period last year. This high growth was the result of lower outflows in H1-FY20, as the gross inflows of US\$ 1.7 billion remained close to the US\$1.9 billion received in same period of previous year (**Table 5.4**). In H1-FY19, both power and telecommunication sectors had witnessed substantial outflows, which led to a lower base effect for this year.¹⁰

Besides this base effect, a one-off inflow of US\$ 478 million fetched by the three mobile phone operators for renewal of their operating licenses in Pakistan also helped the growth in net FDI in H1-FY20. As a result, telecommunication became the largest recipient in H1, with US\$ 505 million inflows, ahead of the traditionally high FDI-attracting sectors, i.e. construction and power. Nonetheless, the power sector continued to attract significant inflows (US\$ 359 million) due to ongoing work on CPEC-related projects. Within the power sector, Thar Coal Block-1 (power plant) and Suki Kinari hydropower station projects fetched US\$ 152 million in Q2-FY20. Apart from power and telecommunication sectors, other major sectors witnessed lower inflows during H1-FY20 as compared to last year.

Table 5.4: Sector-wise Foreign Direct Investment
million US\$

	H1-FY19			H1-FY20		
	Inflow	Outflow	Net	Inflows	Outflows	Net
Construction	296	8	288	16	6	9
Power	243	573	-330	359	69	290
Financial business	279	77	202	193	31	162
Exploration & prod.	159	1	157	115	2	113
Electrical machinery	125	0	125	118	0	118
Pharmaceuticals	46	1	45	27	2	25
Transport equipment	60	5	54	54	9	45
Telecommunications	72	209	-137	505	85	420
Others	569	177	392	346	187	159
Total	1,848	1,051	797	1,732	391	1,341

Data source: State Bank of Pakistan

¹⁰ Last year, a Chinese power company had repaid an intercompany loan of US\$ 530 million in October 2018 to its parent company, which not only increased the gross outflows but also depressed the net FDI in Pakistan during FY19.

Foreign portfolio investment

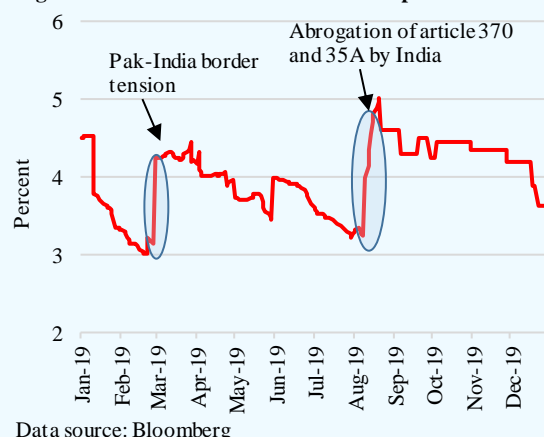
Inflows into local currency government securities (T-bills and PIBs) dominated the overall portfolio investment, which rose to US\$ 1.4 billion in H1-FY20. However, net inflows in portfolio investment account were relatively lower at US\$ 471.0 million, due to retirement of a US\$ 1.0 billion 5-yr Sukuk issued in November 2014.

Foreign fund managers invested into the T-bills and PIBs not only in chasing the risk-adjusted returns offered by Pakistan on the government securities, but also in response to the sharp improvement in the BoP, the reserves buffers (**Section 5.4**), and particularly reforms initiated in the exchange rate market. Previously, foreign portfolio investors were wary about the sustainability of the country's exchange rate system. However, investors' concerns have largely been addressed after the SBP adopted market-based exchange rate regime in May 2019.

Moreover, the country's creditworthiness has improved with the initiation of the EFF program and the successful conclusion of its first review in November 2019. In addition, in December 2019 Moody's upgraded Pakistan's outlook to stable from negative and affirmed the government's local and foreign currency long-term issues and unsecured debt rating at B3. These developments led Pakistan's credit default swap rate to

decline significantly and reach 3.4 percent by end-December 2019, from a high of 5.0 percent in August 2019 (**Figure 5.7**).

Figure 5.7: Pakistan's Credit Default Swap Rate



Besides inflows into debt securities, FPI into equities also witnessed a trend reversal, with a net inflow of US\$ 19.0 million in H1-FY20 against an outflow of US\$ 420 million last year. This further reflects foreign investors' increased confidence over Pakistan's economy.

Net incurrence of liabilities

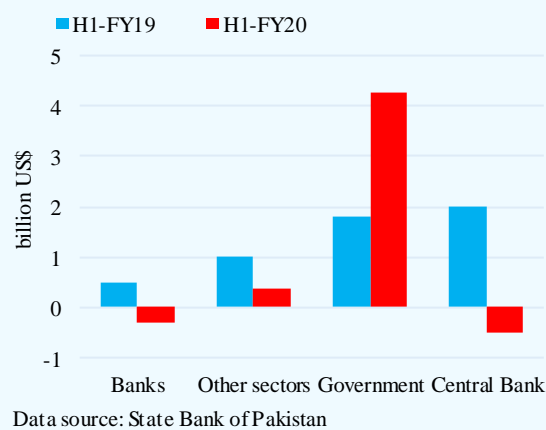
The net inflow of FX liabilities into the country amounted to US\$ 3.9 billion in H1-FY20, down 27.3 percent from the same period last year. This decline was

recorded due to net retirement by central bank and private commercial banks. However, government loans more than doubled to US\$ 4.3 billion as compared to US\$ 1.8 billion realized last year (**Figure 5.8**).

The disbursement in H1-FY20 in the government account stood at US\$ 7.0 billion. Sizable long-term inflows were received from the ADB, the IMF and commercial banks, which aided the government in lengthening maturity profile of the external debt. This has, to some extent, mitigated the rollover risk. On the other hand, H1-FY20 witnessed a retirement of US\$ 2.8 billion.

Contrary to the government borrowings, the central bank repaid the US\$ 500 million deposited by Qatar last year. Private commercial banks also retired their short-term obligations amounting to US\$ 422 million. However, other private sectors loan witnessed a net inflow, albeit in lower quantum compared to last year.

Figure 5.8: Net Incurrence of FX Liabilities

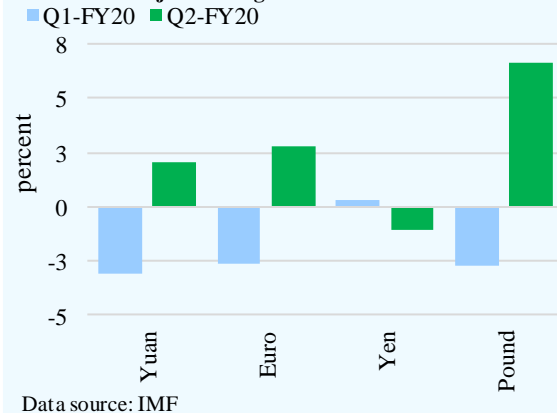


5.4 Exchange Rate and Reserves

Pakistan's total liquid foreign exchange reserves increased to US\$ 17.9 billion by end-December 2019, up by US\$ 3.5 billion over end-June 2019. The breakup of reserves accumulation in this period shows that the SBP's reserves increased by US\$ 4.1 billion, against US\$ 603 million depletion in commercial bank's reserves.

While the rise in SBP's liquid reserves seems substantial, an almost equivalent reduction in

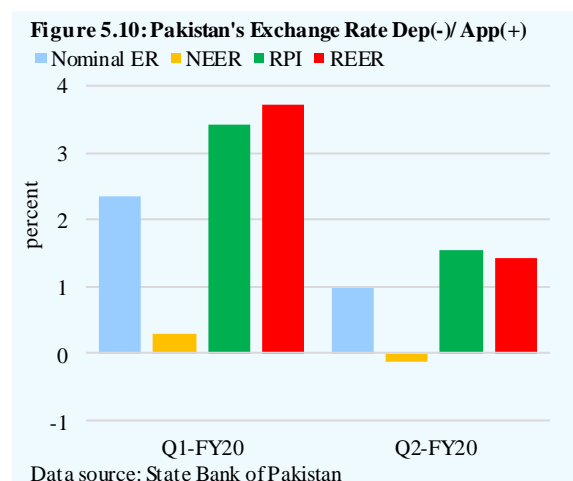
Figure 5.9: Exchange Rate Dep(-)/App(+) against US\$ of Pakistan's Major Trading Partners



net forward liabilities suggests that actual reserve accumulation by SBP over this period is much higher. Reserves, net of forward liabilities increased to US\$ 6.0 billion by end-December 2019 compared to negative US\$ 759.6 million at end-June. By end-June, the country's forward FX liabilities were more than the liquid FX reserves, which meant net liquid reserves were effectively in negative territory.

The reserve accumulation during H1-FY20 was a result of higher official disbursements and sufficient market purchases by the central bank. While IFI loans revived with the inception of IMF program, better market conditions allowed the SBP to make FX purchases.

The improvement in the country's FX reserves led to a 3.4 percent appreciation of Pak rupee against US dollar during H1-FY20. Though PKR appreciated in both quarters of FY20, the NEER depreciated in the second quarter (against appreciation in Q1), as the currencies of other major trading partners appreciated against the US dollar (**Figure 5.9**). However, the higher RPI, due to higher domestic inflation, resulted in REER appreciation in both quarters of FY20 (**Figure 5.10**).



5.5 Trade Account¹¹

The trade deficit contracted by 30.3 percent YoY to US\$ 11.7 billion in H1-FY20; the drop was sharper than the decline of 5.3 percent recorded in the same period last year. This was mainly due to a sharp and broad-based drop in imports, which fell to a four-year low.

Lower import quantum of a wide range of energy and non-energy products played a dominant role in the import reduction, with declines in international

¹¹ This section is based on customs data reported by the PBS. The information in this section does not tally with the payments record data, which is reported in **Section 5.1**. To understand the difference between these two data series, please see Annexure on data explanatory notes.

prices of key commodities, such as crude oil, LNG and coal, playing a supplementary role. Exports, meanwhile, recovered marginally, mainly due to quantum-led increases in rice, apparel and home textiles products.

Exports

Total exports rose 3.1 percent to US\$ 11.5 billion in H1-FY20, the highest first half exports since H1-FY15; the growth was also higher than the 1.9 percent increase recorded in H1-FY19 (**Table 5.5**). Importantly, Pakistan was among the few countries within the competitor EM economies that witnessed a notable increase in its exports (as shown earlier in **Figure 5.2**). A sharp decline in REER since Q2-FY18 and the government's initiative to provide cheaper electricity to the textile sector have enhanced the competitiveness of the Pakistani products vis-à-vis its competitors in the global market. Moreover, FBR expedited refunds claims of major exporting sectors, which alleviated liquidity constraints of exporters thereby augmenting their capability to export more.¹²

Table 5.5: Pakistan's Major Exports during H1
million US\$

	FY19	FY20	Abs. change	Quant. impact	Price impact
Food group	1994.8	2199.7	204.9	-	-
Rice	817.9	1033.0	215.1	232.3	-17.1
Wheat	97.2	11.4	-85.8	-87.1	1.3
Sugar	74.9	70.7	-4.2	-21.1	16.8
Fruits & veg.	312.1	345.2	33.1	-14.1	47.2
Meat & prep	102.6	155.8	53.2	48.7	4.5
Textile group	6,644.3	6,905.1	260.8	-	-
Raw cotton	14.1	15.3	1.3	4.5	-3.3
Cotton yarn	548.4	544.4	-4.3	38.5	-42.8
Cotton fabrics	1052.3	1013.1	-39.2	24.3	-63.3
Apparel	2735.3	2999.4	264.1	246.5	17.6
Bedwear	1161.2	1197.9	36.7	125.5	-88.9
Towels	378.0	379.5	1.5	27.7	-26.2
POL group	269.5	168.0	-101.5	-61.1	-40.4
Crude oil	145.9	110.3	-35.5	-19.1	-16.4
POL products	86.1	23.8	-62.3	-58.9	-3.4
Other manuf.	1708.1	1620.0	-88.1	-	-
Leather tanned	128.3	104.2	-24.0	-18.4	-5.7
Leather manufactures	247.4	274.7	27.4	17.3	9.9
Plastic	155.7	152.5	-3.3	31.4	-34.7
Chemicals	318.8	210.3	-108	-	-
Cement	157.0	145.3	-11.7	5.1	-16.8
Total Exports	11,181.2	11,524.3	343.1	820.8	-440.5

Data source: Pakistan Bureau of Statistics and SBP calculations

Rice, readymade garments (RMG) and hosiery (knitwear) were major contributors to this year's export growth, with higher quantum offsetting the lower price effects. On the other hand, exports of POL group, tanned leather, chemicals and cement were major drags on the overall growth.

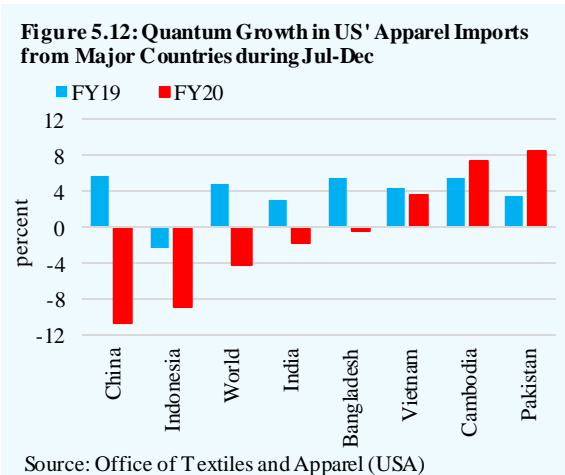
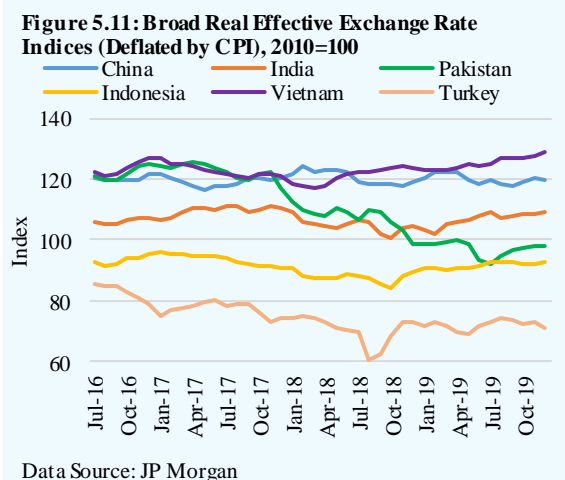
¹² Through introduction of new electronic refund claims system (FASTER), FBR expedited the release of Rs 75.5 billion refunds in H1-FY20, Rs 20.4 billion more than the same period last year. Out of total refunds, sales tax refunds increased by 100 percent YoY to Rs 27 billion (source: FBR).

Textile exports

After staying flat last year, textile exports rose 3.9 percent to US\$ 6.9 billion in H1-FY20; the highest level achieved since H1-FY14. Power subsidy provided to this sector in January 2019, when government had announced 7.5 cents/KWh flat power tariff, led to the increased value addition and improved export performance of this sector in H1-FY20.¹³ Moreover, exchange rate adjustment of PKR against USD over the last two years brought REER down sharply, which kept unit prices of Pakistani textile exports in check and made Pakistani exports competitive (**Figure 5.11**).

Higher textile exports came on the back of quantum growth in high value added products, particularly readymade garments. The improved performance of RMG was noteworthy, given negative growth in quantum apparel imports of the USA and the European Union in H1-FY20. Besides, home textiles (mainly bedwear and towels) saw their exports rise in the first half with higher shipments to the European Union.¹⁴

In case of the USA, its quantum apparel demand was 4.3 percent lower in H1-FY20 than the last year (**Figure 5.12**). It was mainly due to lower Chinese



¹³ Power cost had been fixed at 7.5 cents/KWh vide S.R.O. 01(I)/2019 to S.R.O. 12(I)/2019, dated Jan 1, 2019 (source: Ministry of Energy).

¹⁴ Substitution towards the higher value added product, in consequence, created drag in the low value added products exports, particularly cotton fabrics and yarn.

shipments as the US applied additional tariffs on Chinese apparel imports from September 2019. At the same time, the US buyers switched to low-cost suppliers that included Vietnam, India and Pakistan.¹⁵ Pakistan was able to capture part of China's market, as it experienced higher growth than any of its competitors in H1-FY20 (Figure 5.12).

The European Union's apparel imports from Pakistan accelerated from last year, both in value and volume terms, despite the decline in the bloc's overall apparel imports by 2.2 percent in Jul-Dec 2019 (Figure 5.13). Weakening of Euro against US dollar and currencies of major apparel exporters except for the Pak Rupee led to the decline in the EU's apparel imports. The European buyers were attracted by continuously weakening PKR since Q4-FY18, as unit prices fell only for Pakistan in H1-FY20 vis-à-vis its competitors (Table 5.6). Price effect was further reinforced by duty-free/quota-free access under the GSP Plus agreement.

Besides, similar to the US market, China's share in EU's apparel market has been receding in last two years, declining from 40.7 percent (in quantum terms) in H1-FY18 to 36.0 percent in H1-

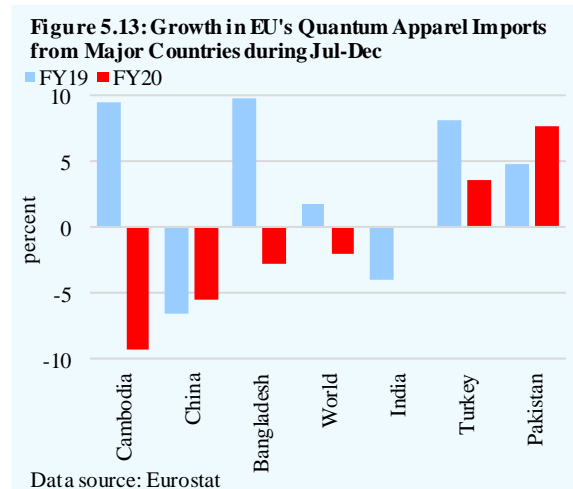


Table 5.6: Growth in Unit Values of EU's Apparel Imports from Major Countries, Jul-Dec

	Unit Values*		Currency**	
	FY19	FY20	FY19	FY20
Pakistan	-0.4	-0.7	-15.6	-13.9
India	1.5	1.8	-6.9	4.1
China	10.9	4.0	-1.1	1.8
Bangladesh	1.2	5.9	0.3	3.4
Cambodia	1.7	7.9	2.5	3.8
Turkey	-3.4	1.2	-32.4	1.4
World***	4.5	4.1	3.1	4.0

*In euros **YoY app(+)/dep(-) of respective currencies against Euro Jul-Dec ***USD against Euro

Data sources: Eurostat, Bloomberg and SBP calculations

Table 5.7: Shares in EU's Apparel Imports, Jul-Dec

	FY18	FY19	FY20
China	40.7	37.5	36.0
Bangladesh	22.0	23.8	23.6
Turkey	8.4	8.8	9.3
Pakistan	4.4	4.5	5.0
Cambodia	4.9	5.2	4.8
India	4.5	4.3	4.3

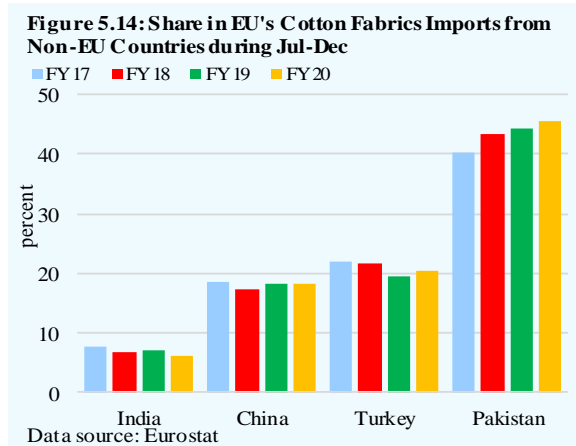
Data source: Eurostat

¹⁵ A US Fashion Industry Association (USFIA) survey found earlier in 2019 that 83 percent respondents expected to decrease sourcing from China over the next two years.

FY20. At the same time, Bangladesh, Turkey and Pakistan have been able to increase their exports to the bloc (**Table 5.7**).¹⁶

In low value added textile products, cotton yarn shipments increased 7.0 percent YoY in H1-FY20. However, dollar receipts were pulled down by lower unit prices, which were in line with the declining prices in the international market.¹⁷

Despite decline in its overall apparel exports, China's demand for Pakistan's cotton yarn saw a decent uptick in H1-FY20, as it appeared to shift its yarn demand away from India and towards Pakistan.¹⁸ This shift came as the two countries worked on reaching the second phase of Pak-China FTA. It is important to mention here that in cotton fabric imports of the European Union (in quantum terms), Pakistan has the highest share, which has also been rising over the last few years (**Figure 5.14**).¹⁹ Home textiles (mainly bedwear and towels) also rose slightly to US\$ 1.5 billion in H1-FY20, in response to higher demand in the EU, the largest export destination of Pakistan's home textiles.



Non-textile exports

Non-textile exports decelerated to 1.8 percent in the first half of FY20, down from 4.7 percent a year earlier. While petroleum group caused a drag, the growth in food group exports, specifically rice, provided the needed support to non-textile exports. Besides, low prices created drag on the cement exports, which decreased from last year.

Rice exports grow stronger

Overall rice exports increased about one-fourth to US\$ 1 billion for two main reasons. First, Pakistan's share in total rice imports of EU has been rising

¹⁶ Bangladesh and Pakistan enjoy preferential trade treatment in trade with the EU.

¹⁷ China, India and Pakistan witnessed 15.5 percent, 10.5 percent, and 10.4 percent decline in unit prices of yarn (in US\$ per Kilo) respectively. (Source: Emerging Textiles)

¹⁸ In H1-FY20, China imported 16.9 percent more yarn on YoY basis from Pakistan (source: PBS)

¹⁹ They made up around 9 percent of Pakistan's total exports in the first half.

consistently ever since the bloc restricted Indian rice imports over excessive use of pesticides (**Figure 5.15**).²⁰ Second, currency movements of the competitor countries provided Pakistan an edge in its established African market.

In case of non-basmati, in H1-FY20, broken rice and other varieties saw an increased supply to Africa from US\$ 184.0 million to US\$ 332.0 million. Apart from Africa, some Asian markets, such as China, Indonesia, and Kazakhstan, also imported more non-basmati.

Milled basmati rice performed particularly well as it fetched US\$ 380 million in the first half of FY20, around fifty percent more than last year. In H1-FY20, quantum exports of milled rice increased substantially to the major markets in the Middle East, which were collectively responsible for about 59.5 percent of total exports in the period (**Figure 5.16**). Anecdotes suggest that some of these shipments, specifically to the UAE, are being transshipped to Iran, Oman, Yemen, Somalia and Iraq.²¹

Husked (brown) rice, which is mostly basmati variety, performed quite well in the European Union—mainly Belgium, Italy, the Netherlands and the UK—in H1-

Figure 5.15: Share of non-EU Countries in EU's Quantum Rice Imports during Jul-Dec

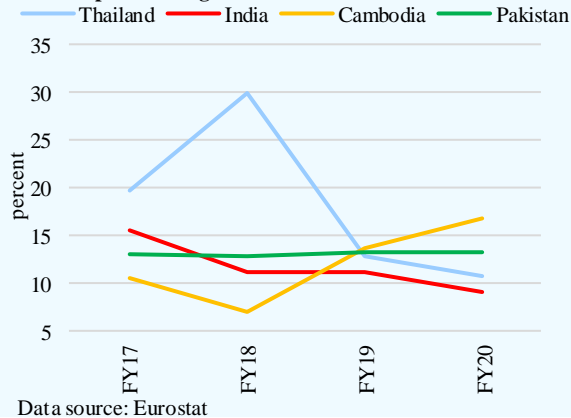
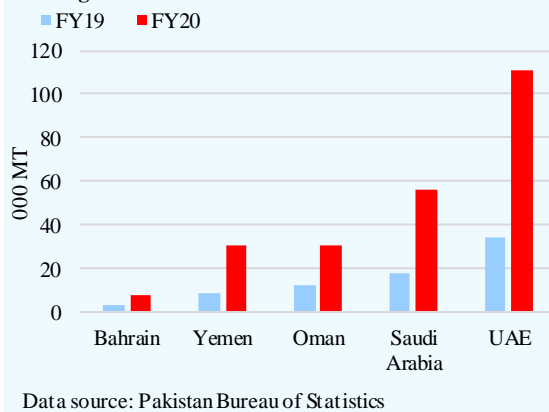


Figure 5.16: Milled Basmati Rice Exports to Middle East during H1



²⁰ Maximum residue limit set for Tricyclazole use on basmati rice to be exported to EU after Dec 31, 2017 is 0.01 mg/kg.

²¹ Since the UAE is a massive and dynamic market complemented by well-established seaport facilities, international traders there are well positioned to import rice from abroad, and export the same to regional markets.

FY20. This rice is further processed by mills to produce white rice that is commonly used in the European countries. White (milled) basmati attracts 175 Euro/1000 KG in tariff in European Union against zero percent tariff on brown basmati rice.²² This also explains the decrease in share of milled basmati rice exports to the bloc, from 36.3 percent in H1-FY19 to 11.5 percent in H1-FY20.

Depressed performances of non-rice exports

The petroleum group fetched about US\$ 101.5 million lesser receipts in first half of current fiscal year over last year, as import demand from Afghanistan witnessed a fall in response to declining engagement of foreign forces there.²³ Moreover, petroleum crude (condensates) exports declined 24 percent to US\$ 110.3 million in the first half, as refineries are increasingly using condensate with low-gravity imported crude.

Meanwhile, cement and cement product exports decreased by 7.5 percent in H1-FY20 compared to 32 percent increase in the same period of FY19. However, Pakistani cement exports this year have become more diverse in terms of market access compared to last year, when India was the key importer of Pakistani Portland cement, importing one-fourth of Pakistan's quantum cement exports in H1-FY19. In H1-FY20, Pakistan exported 41.8 percent higher shipments to other destinations like Afghanistan, Madagascar and Sri Lanka.

Besides, Pakistan shipped significant quantum of clinker in the first half. The demand for the raw material was created in Bangladesh when Vietnam's exports to the country had started to recede as it redirected its supplies towards a much bigger market – China.²⁴ While overall clinker shipments of Pakistan rose 14.6 percent in H1-FY20, Bangladesh's share in Pakistan's clinker exports increased from 77 percent from a year before to 87 percent in the same period this fiscal year. Overall value of cement and clinker was pulled down by low unit prices.

Imports

The country's imports dropped 17.0 percent YoY to US\$ 23.2 billion in H1-FY20 – the lowest level in four years. Import demand for a wide range of energy and non-energy products was suppressed, as industries and consumers adjusted to the second-round impact of the currency adjustment, tight monetary conditions, and some sector-specific policies (in case of oil refineries and steel). Lower import

²² Source: Market Access Database, European Commission

²³ Quantum jet fuel exports decreased by 70 percent YoY in H1-FY20.

²⁴ The largest consumer of cement and clinker is substituting its cement production with clinker imports for environmental concerns. Vietnam is mainly supplying clinker to China.

quantums were complemented by lower international commodity prices (of crude oil, LNG, coal and metals) (**Table 5.8**).

The transport sector's import demand was especially hit, as auto assemblers, after significantly raising prices following the currency adjustment, are now faced with slumping domestic sales (**Figure 5.17**). The firms responded to the lower consumer demand by cutting back on production, which reduced their imports of CKD kits and other auto parts. Meanwhile, the regulatory restrictions on car imports under the gift and baggage schemes continued to dent CBU imports. As a result, overall transport imports fell to a 10-year low in H1-FY20.

The spillover of the downtrend in auto production was felt across the steel industry, whose demand for imported finished products

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

Items	FY19	FY20	Abs. change	Quantum impact	Price impact
Energy group	7,665.0	6,142.2	-1,522.8	-143.2	-1,379.5
POL prods.	3,415.1	2,591.1	-824.1	-324.3	-499.8
Crude oil	2,460.0	1,771.3	-654.8	-351.8	-303.0
LNG	1,709.3	1,626.8	-82.5	446.4	-528.9
Agri and chem	4,584.1	3,821.7	-762.4	-	-
Fertilizer	646.2	433.1	-213.1	-101.3	-111.8
Other chem.	2,194.0	1,848.4	-345.2	-	-
Transport group	1,507.6	837.0	-670.6	-	-
Cars	582.8	260.6	-322.2	-	-
CBUs	156.4	31.7	-124.8	-	-
CKDs	426.4	229.0	-197.4	-	-
Truck & buses	282.7	128.7	-153.9	-	-
Aircraft & ships	166.3	210.7	44.4	-	-
Metals group	2,500.4	2,072.7	-427.7	-	-
Steel scrap	765.5	806.3	40.7	-156.0	-196.8
Iron & steel	1,124.6	763.3	-361.1	-341.5	-19.7
Food group	2,966.2	2,566.5	-399.7	-	-
Tea	301.7	228.9	-72.8	-43.7	-29.1
Palm oil	931.7	842.4	-89.2	10.6	-99.9
Soybean oil	48.8	40.8	-7.9	-4.9	-3.1
Pulses	287.8	245.7	-42.1	-12.1	-30.0
Textile group	1,344.5	979.6	-364.8	-	-
Raw cotton	120.2	87.0	-33.2	-28.8	-4.4
Syn. yarn	302.2	272.8	-29.4	-16.2	-13.2
Machinery group	4,479.3	4,433.1	-46.3	-	-
Power gen	661.9	650.4	-11.5	-	-
Electrical	881.2	1,192.3	311.1	-	-
Construction	129.8	80.9	-49.0	-	-
Cell phones	364.0	616.1	252.1	-	-
Other machinery	1,606.6	1,184.8	-421.8	-	-
All other items	2,359.2	1,920.8	-438.4	-	-
o/w Coal	795.6	669.5	-120.0	35.5	-185.7
Total imports	27,952.5	23,194.6	-4,757.8	-	-

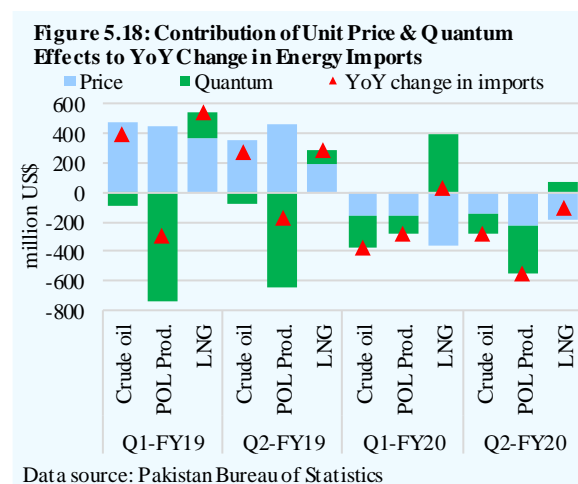
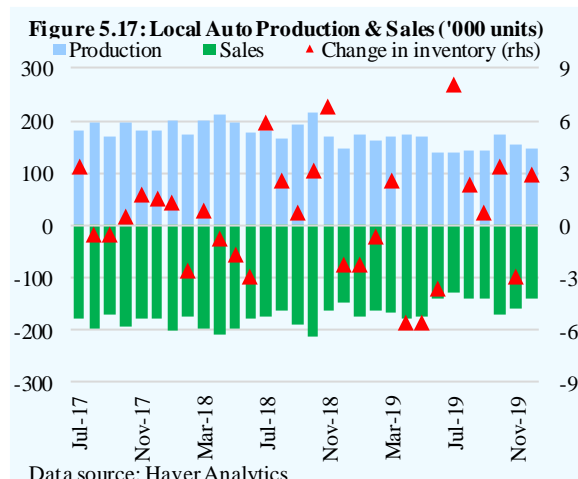
Data source: Pakistan Bureau of Statistics

declined.²⁵ Finished steel imports were further suppressed after Pakistan imposed anti-dumping duties on some Russian and Canadian steel products into the country in September 2019.²⁶ Lastly, imports of items whose domestic production increased this year, such as DAP fertilizer, also declined.

Energy imports

Pakistan's energy imports fell by a sizable 19.9 percent to US\$ 6.1 billion in H1-FY20; the drop was steeper than the 14.8 percent reduction recorded in the same period last year. Import quantum and unit prices were both lower than last year (Figure 5.18). International oil prices were, on average, 15.3 percent lower in the period, and contributed sizably to curbing energy imports.

From the energy demand perspective, the lower import quantum mainly reflect changing power sector dynamics in H1-FY20. The first is that the *pace* of increase in power generation in the country witnessed over the past few years has now slowed, given that many



²⁵ For instance, Aisha Steel Mills mentioned in its Q1-FY20 report that the “local demand remained depressed throughout the period. The auto sector, in particular, was hit hard by the macro-economic adjustments, leading to slow offtake of CRC [cold rolled coil], the main raw material for the sector”.

²⁶ The National Tariff Commission, on September 20, 2019, announced provisional anti-dumping duties of 13.94 percent ad valorem on “cold rolled coils/sheets/strips” imported from Canada and Russia. The duties would be in place for four months, and the NTC would make a final determination by end-March 2020 (source: National Tariff Commission).

of the large-scale power plants under CPEC are now operational.²⁷ As a result, the power sector's overall energy demand is now rising at a relatively lower rate than it was earlier on. Second, the *composition* of the energy mix is also changing, with reliance on FO declining significantly and greater emphasis placed on generation from coal (both imported and indigenous) and LNG. And third, the lower domestic demand for FO has created a glut-like situation and forced oil refineries to reduce their throughput, thereby reducing their demand for imported crude oil.

While some refineries are trying to diversify their output mix away from FO and towards other hydrocarbons, like bitumen and lubricants, the industry's operations are still constrained by sizable FO production. FO's share in overall domestic POL production has barely changed over the past four years, indicating the lack of needed investment by refineries to alter their output mix.²⁸

Overall POL product imports fell by 24.1 percent to US\$ 2.6 billion in H1-FY20, with lower quantum and unit prices almost equally responsible for the decline. Product-wise data shows that quantum imports of FO and HSD dropped quite sharply, to the extent that they offset a rise in petrol imports during H1-FY20. While the drop in FO imports was linked with lower demand from the power sector, HSD imports dropped in response to subdued demand from the heavy vehicle transport segment.²⁹ HSD sales declined 10.2 percent during H1-FY20. And even though the fuel's domestic production also dropped, the decline in demand was such that the gap did not have to be filled by additional imports. The heavy vehicular transport segment is passing through a soft patch owing to the slowdown in industrial activity and the heavy contraction in overall imports.

In contrast to HSD, domestic demand for petrol was relatively stronger and given the 8.7 percent fall in its local production, the country had to import higher quantities of the fuel. The higher domestic demand for petrol can be attributed to a few factors. First, OMC executives have indicated that due to the non-availability of CNG in Q2, many consumers had switched to petrol, pushing up

²⁷ During Jul-Dec FY20, overall power generation (excluding K-Electric) rose 2.0 percent YoY. This compares with the growth of 5.4 percent in the same period last year (source: NEPRA).

²⁸ FO had a share of 20.4 percent, on average, in domestic POL production during H1-FY20. This is marginally lower than the previous five-year average of 21.3 percent.

²⁹ However, there is also ample anecdotal evidence that a sizable part of local HSD demand is being met via gray channel imports from Iran.

the fuel's demand in the period (**Table 5.9**).³⁰ Second, the rapid growth of two van pool services in a couple of major cities has seen a heavy deployment of small vans and coasters on the streets; depending on their configuration, these vans mostly operate on petrol. With these companies constantly introducing new routes and increasing fleet sizes, some upward pressure on fuel demand from this segment is also likely.

Table 5.9: Growth in Quantum Sales, Production & Imports of POL Products during FY20
percent change YoY

	Q1			Q2			H1		
	Sales	Prod.	Imports	Sales	Prod.	Imports	Sales	Prod.	Imports
HSD	-15.6	-15.3	-6.3	-5.0	-4.6	-25.7	-10.2	-10.2	-17.9
Petrol	1.8	-15.3	10.3	7.3	-1.3	4.7	4.5	-8.7	7.4
FO	-21.4	-18.2	-84.3	-17.4	-9.3	-100.0	-19.8	-14.1	-90.7
Total products	-10.2	-14.5	-7.0	-2.5	-5.9	-11.7	-6.5	-10.3	-9.5

Data sources: OCAC & Pakistan Bureau Statistics

Meanwhile, crude oil was the single largest contributor to the import decline, with import values falling 27 percent. As mentioned earlier, refineries reduced their throughput to avoid adding to their FO stockpiles, which reduced their demand for crude oil. Also, some refineries have started utilizing locally extracted crude oil (in the form of condensate); this has also contributed to their lower demand for imported crude oil.

Among other energy items, LNG imports dropped 4.8 percent in H1-FY20 – the first decline in a six-month period since the country started importing LNG four years back. Disaggregated data show that the entire drop was recorded in the second quarter, and corresponded with a drop in LNG-based power generation during the period (**Table 5.10**). Two major LNG plants – Haveli Bahadur Shah and Balloki – were either undergoing scheduled maintenance or running at low capacities, lowering the country's import demand for LNG during the period.³¹

Lastly, coal imports declined by a sharp 15.8 percent to US\$ 669.5 million during H1-FY20, with lower unit prices accounting for the entire drop in import values. Disaggregated data indicate that quantum coal imports had fallen during Jul-Oct, before surging by 65.8 percent in November 2019, pushing up quantum imports

³⁰ Domestic gas production declined by 9 percent YoY in Q2-FY20. Despite the decline, the government had increased the gas supply to the fertilized sector in Q2, while increasing the number of load shedding hours per week for the CNG sector (source: OGRA).

³¹ Multiple power plants generally go on scheduled maintenance during the winter months, when power demand in the country goes down.

for the six-month period on YoY basis.³²

Table 5.10: Fuel-wise Power Generation during FY20* (in GWh)

	Q1		Q2**		Jul-Dec**	
	Value	Change YoY (abs)	Value	Change YoY (abs)	Value	Change YoY (abs)
Furnace oil	2,106.2	-1,846.2	384.3	-1,306.6	2,490.5	-3,152.8
LNG**	9,601.2	196.2	4,426.0	-29.0	14,027.2	167.2
Hydro	15,349.8	2,700.4	7,062.1	773.7	22,411.9	3,474.1
Coal	6,145.3	1,915.6	6,558.2	2,835.6	12,703.5	4,751.2
Natural gas	4,964.1	-1,101.3	2,995.0	-2,109.3	7,959.2	-3,210.6
Nuclear	2,230.9	185.1	1,618.5	-986.8	3,849.4	-801.7
Others	1,506.6	-465.9	1,518.6	546.9	3,025.1	81.0
Total	41,904.2	1,583.8	24,562.7	-275.5	66,466.9	1,308.4

*Excluding K-Electric **provisional data for Nov & Dec 2020
Data source: NEPRA

A corresponding increase in coal-fired power generation was also noted in November, indicating that some of the drop in LNG generation was compensated for by generation from imported coal.³³ At the same time, some downward pressure on coal imports was exerted by the operationalization of a 660MW indigenous coal power plant, along with lower demand by the steel industry (for which coal is a major raw material).

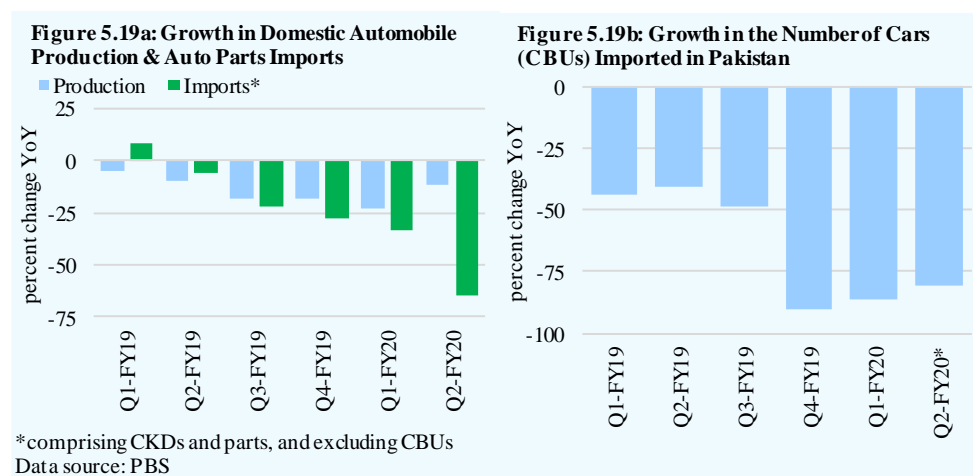
Non-energy imports

The country's non-energy imports fell 15.9 percent YoY to US\$ 17.0 billion in H1-FY20; the drop was almost double the decline recorded in the same period last year. Imports of almost all product categories dropped, especially those of transport items, iron and steel, and fertilizer and other chemicals.

Transport group imports fell 44.5 percent during the period, with the drop concentrated in the automobile segment (comprising cars, motorcycles, buses and their associated parts). Also, the decline has deepened as the year progressed, with imports in Q2-FY20 falling to an 11-year low. The trend in auto imports has closely followed that of domestic auto production; as assemblers steadily lowered their production in response to lower consumer demand, their demand for imported parts shrank substantially (**Figure 5.19a**). Moreover, the tightening of regulations governing car imports under the gift and baggage schemes severely curtailed imports of finished automobiles (CBUs), as indicated in **Figure 5.19b**.

³² Quantum coal imports rose by much lower 11.0 percent YoY during H1-FY20, after rising by 39.8 percent in the same period last year.

³³ Coal-based power generation had risen 94.5 percent YoY in November 2019 (source: NEPRA).



The impact of lower automobile production and subdued construction activity was also felt on imports of steel items, which declined heavily in quantum terms (**Table 5.8**). Steel is a major raw material for the auto industry, which uses it to make car body frames, panels and other parts.³⁴ Cumulative iron and steel imports fell by 17.0 percent in H1-FY20, with the decline entirely coming from finished products. In addition to lower demand from the auto sector, finished product imports were also curtailed after Pakistan imposed temporary anti-dumping duties on Canadian and Russian steel products in end-September. Meanwhile, demand for raw material by local steel firms – in the form of scrap and old ships for shipbreaking – was also lower, as steelmakers adjusted their production in response to the slowdown in the auto sector.

In the machinery group, imports fell 1.0 percent to US\$ 4.4 billion, after declining by 18.6 percent in H1-FY19. While imports across all sub-categories had dropped heavily last year, purchases of electrical machinery and cell phones recorded hefty increases this year.

In the case of cell phones, the 69.2 percent surge in imports was intriguing, as it appears at odds with the erosion in consumers' spending power in real terms. Two factors are likely at play. First, the Pakistan Telecommunication Authority's Device Identification Registration and Blocking System (DIRBS) went into effect

³⁴ Aisha Steel Mills Ltd., for instance, specifically cited the slump in the auto industry as a reason for its subdued sales performance. The company mentioned in its Q1-FY20 report that the "auto sector was hit hard in particular leading to slow off take of CRC, the main raw material for the sector. Both the leading players had to cut down production and adjust the prices downwards".

from December 2018, and effectively dented illicit cell phone imports by identifying and blocking non-registered cell phones that were using local SIM cards. As a result, a significant chunk of the cell phone trade occurring via grey channels has now shifted to the formal channel, leading to a surge in official import data. And second, the government had abolished a three percent value-added tax on commercial cell phone imports via the FY19 budget, which slightly reduced the cost of imports.

In the case of electrical machinery, detailed data indicate a rise in imports of heavy-duty electrical transformers (of greater than 10,000kVA capacity), and related equipment. The higher imports of these products is in line with ongoing work to expand the transmission network in the country, especially by K-Electric in Karachi. Also, as per the National Transmission and Despatch Company (NTDC), work is ongoing on 48 power transmission projects, with completion dates ranging from FY20 to FY22.³⁵

Among other items, food imports dropped 13.5 percent during H1-FY20. Lower unit prices of palm oil was a major factor, as they pulled down import values by 9.6 percent and more than offset a marginal increase in quantum imports during the period. In contrast to palm oil, quantum imports and unit prices of other food items, such as tea and pulses, were both lower than last year. In particular, tea imports dropped 24.1 percent in the six-month period, with lower import quantum playing a more dominant role. Tea companies and retailers likely built up inventories last year when quantum imports had risen significantly, and are now utilizing these stocks instead of going for fresh imports.³⁶

³⁵ Source: NTDC (<https://www.ntdc.com.pk/casa>), accessed on February 3, 2020.

³⁶ Quantum tea imports had risen 22.5 percent in full-year FY19, and then fell in both Q1 and Q2 of FY20 on YoY basis.