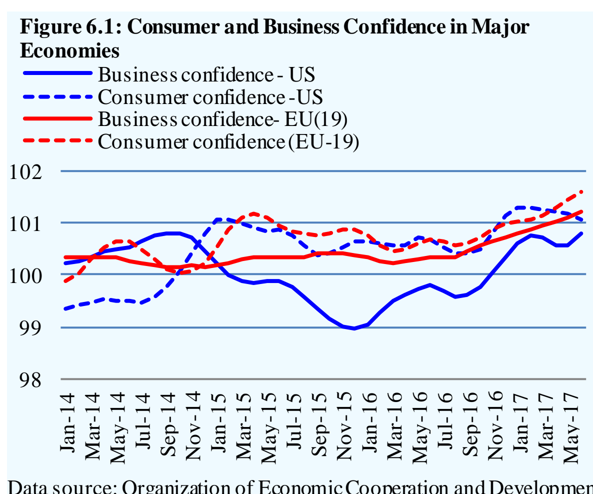
# 6 External Sector

## 6.1 Global Economic Review

Risks to economic globalization emanating from a prolonged spell of subdued growth and modest job creation in advanced economies, were accentuated further by major changes in political regimes during FY17. The presidential elections in the US installed an administration that not only pulled out of the 12-nation Transatlantic Pacific Partnership, but has constantly been holding its largest trade partners – as diverse as Germany and China – responsible for a skewed trade balance. Meanwhile, the survival of the European Union, which had sailed through a feared exit of debt-ridden countries just two years ago, was put into question again, with the planned withdrawal of its 2nd largest economy – the UK. In Asia, polarization within the Middle East increased further, as the new Saudi regime took a stern position against Qatar. With deepening stakes of Turkey and Russia in the region, reconfiguration of global alliances is underway; this will ultimately shape future economic blocs. In the middle of this paradigm shift, China progressed steadily on its One-Belt-One-Road initiative, engaging a number of Asian, African and European countries in developing the largest network of trade routes.

Amid such a challenging environment, global GDP is estimated to post a steady growth in 2017, on the back of a rebound in global manufacturing and rising trade volumes.[1] A modest recovery in investment is also in sight, which can be traced to a continuation of highly accommodative monetary policies in European and Asian economies, coupled with improving business sentiments (**Figure 6.1**). Following the pick-up in economic activity, global commodity prices posted a recovery (average prices remained 11.9 percent higher than last year), with particularly sharp increases noted in crude oil and metal prices.[2]

**Figure 6.1: Consumer and Business Confidence in Major Economies**




Data source: Organization of Economic Cooperation and Development

As crude prices recovered, shale investments bounced back in the US, providing impetus to GDP growth; a fall in these investments had lent a substantial drag to 2016 growth.[3] Consumption demand also remained strong in the wake of healthier job growth, rising household wealth, and perceptions of a business friendly regime following the November 2016 elections. Further, exports gained from a depreciating dollar (since the beginning of 2017) and strong external demand.[4] These indicators, along with the unemployment rate dropping below its longer term median and inflation floating above its target (up till March 2017), led the Fed to increase the federal funds rate by 25 bps each in

[1] Global GDP is estimated to grow by 3.5 percent in 2017, up from 3.3 percent on average during 2015-16 (source: IMF World Economic Outlook, July 2017).

[2] Average crude oil prices (WTI, Brent and Dubai Fateh) and IMF's Commodity Metals Price Index during July-June 2017 remained 16.3 percent and 17.2 percent respectively higher than the same period last year.

[3] Shale investments in the US are projected to increase 53 percent in 2017 over last year's levels (source: World Energy Investment Report 2017, International Energy Agency).

[4] The US' exports grew by 6.7 percent YoY during Jan-Jun 2017, after declining by a nominal 0.2 percent in Jul-Dec 2016 (source: US Census Bureau). The US Dollar Index (which indicates the value of the USD against a basket of 10 major currencies) declined 6.4 percent in H2-FY17 (source: Bloomberg).

December 2016 and March 2017.[5]

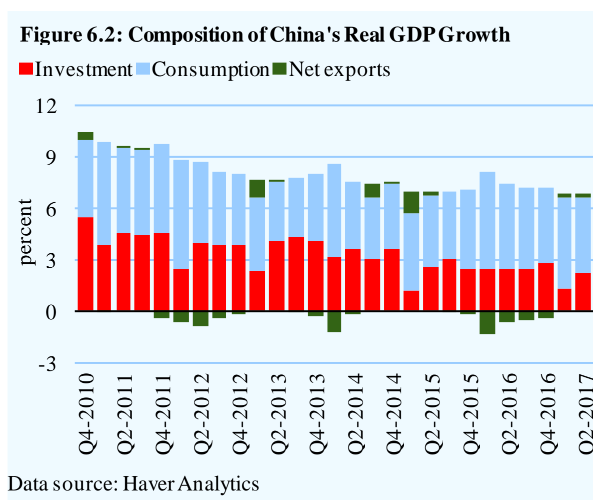
In contrast to the US, the economic situation in the euro area did not favour an increase in interest rates; the ECB kept the policy and the deposit facility rates at their historic lows of zero and negative 0.40 percent, respectively. Moreover, despite initial plans of winding down the Asset Purchase Program (APP) in March 2017, the ECB decided to continue it until the end of 2017.[6] The region is still struggling with financial system stress, as reflected in high debt levels and a sizable presence of bad loans in banks' balance sheets. Growth in the euro area is estimated to have inched up to 1.9 percent in 2017 from 1.8 percent a year earlier; however, it is expected to weaken again in 2018.[7]

Among other advanced economies, growth prospects have been mixed. In the six months following the Brexit referendum, the UK economy performed better than initially expected. However, since the start of 2017, growth began to taper, and the Jan-Jun 2017 period saw the lowest first-half growth since 2012. These developments coincided with a weaker pound, rising inflation and a fall in business investment. This was in line with expectations as firms face an uncertain future, with the Kingdom navigating through the complexity of negotiating new international trade agreements with both EU and non-EU partners.

In the emerging market (EM) and developing world, India is expected to continue on a high growth path on the back of strong domestic demand. The economy is estimated to grow by around 7.2 percent in 2017, which is the highest among EMs. Timely and heavy monsoon this year proved extremely beneficial for the agriculture sector, with positive spillover on overall consumption demand as farm incomes bounced back. This probably offset to a large extent the impact of the demonetization initiative (in November 2016), which had led to payment disruptions and contributed significantly to the reduction in 2016 GDP growth.[8] Going forward, a set of structural reforms, comprising a new bankruptcy law, Goods and Services Tax (GST), and a new inflation targeting framework – along with gradual lifting of fuel subsidies – are likely to spur private investment in the country.

Meanwhile in China, regulators are facing a delicate situation, where they are trying to deleverage the economy on one hand, while preventing any further drop in the growth rate, on the other. Real GDP growth is finally expected to hold steady at 6.7 percent in 2017, after declining consistently for the past six years. This was mainly enabled by a recovery in exports, which more than offset the drag coming from a slowdown in investment spending (**Figure 6.2**). Yet, going forward, challenges linger for the economy. First, the country's export outlook remains uncertain, amid fears of adoption of a protectionist stance by the US. And second, the country has to deal

**Figure 6.2: Composition of China's Real GDP Growth**




Data source: Haver Analytics

[5] The US unemployment rate fell from 4.7 percent in December 2016 to 4.4 percent in June 2017 (source: US Bureau of Labor Statistics).
[6] From April 2017, the asset purchases have been reduced to € 60 billion per month from € 80 billion. The ECB intends to carry on with these purchases until a sustained adjustment in inflation, below but close to the target rate of 2 percent, is observed.
[7] The IMF estimates the growth to drop to 1.7 percent in 2018.
[8] Real GDP growth in India dropped sharply to 7.1 percent in 2016, from 8.0 percent in 2015 (source: IMF World Economic Outlook, July 2017).

with its huge debt burden, built up over the years as local governments and state-owned enterprises (SOEs) relied heavily on borrowings to finance their growth. This dynamic was a major factor behind Moody's decision to downgrade China's sovereign rating for the first time since 1989.[9]

In the Middle East, subdued earnings from oil continued to weaken fiscal and external account positions, bringing the overall economic growth down to a level the Gulf Cooperation Council (GCC) countries are not accustomed to. The decision by OPEC (and Russia) to cut oil production in December 2016, along with cuts in infrastructure spending in some member countries, led to squeezed growth numbers. To strengthen their fiscal positions, governments in Saudi Arabia and UAE are introducing new taxes; scaling back energy subsidies; and also resorting to external funding. The growth outlook for the Middle East hinges significantly upon a recovery in oil prices, progress on the domestic reform process, and stable geo-political conditions.

So, in short, the global economy at the moment is characterised as much by its stability as it is by its fragility. The recovery remains uneven, with considerable downside risks. For the past 2-3 years, the modest growth in advanced countries has meant fledgling demand for imports from developing countries like Pakistan, and this has been a major contributing factor behind declining exports of the country.[10] Moreover, rising global prices have had an exacerbating impact on the trade balances of net commodity importers like Pakistan. Furthermore, growth in remittances, which had been strong in recent years, has dropped as economic slowdown and political volatility affect the remitting countries.

## 6.2 Pakistan's BoP[11]

As the economy's growth momentum picked up pace, imbalances re-emerged in Pakistan's external account. All the encouraging trends in the real sector, like improvement in energy supplies, industrial expansion, and rising consumer spending, triggered a surge in demand for imports, which grew by 17.8 percent and reached a record US$ 48.6 billion.[12] Additional stress on the import bill came from steady progress on CPEC-related power and road construction projects. With tapering foreign exchange (FX) earnings during the year and lower-than-expected financial inflows, the rise in the import burden created a deficit in the balance of payments. As a result, the country's FX reserves declined by US$ 1.7 billion during FY17, after rising for 3 years in a row (**Table 6.1**).

**Table 6.1: Pakistan's Balance of Payments[P]**
billion US dollars

| | FY15 | FY16 | FY17 |
|---|---|---|---|
| **Current account balance** | -2.8 | -4.9 | -12.1 |
| Trade balance | -17.3 | -19.3 | -26.9 |
| *Exports* | 24.1 | 22.0 | 21.7 |
| *Imports* | 41.4 | 41.3 | 48.6 |
| *POL* | 12.3 | 8.4 | 10.6 |
| *Non-POL* | 29.0 | 32.9 | 37.9 |
| Services balance | -3.0 | -3.4 | -3.6 |
| *CSF* | 1.5 | 0.9 | 0.6 |
| Primary income balance | -4.6 | -5.3 | -4.8 |
| *Repatriations on FDI* | 1.3 | 1.5 | 1.7 |
| *Reinvested earnings* | 0.3 | 0.7 | 0.2 |
| *Interest payments (net)* | 1.0 | 1.2 | 1.5 |
| Secondary income balance | 22.0 | 23.2 | 23.2 |
| *Worker remittances* | 18.7 | 19.9 | 19.3 |
| **Capital account balance** | 0.4 | 0.3 | 0.3 |
| **Financial account balance** | -5.1 | -6.8 | -9.6 |
| Direct investment in Pakistan | 1.0 | 2.3 | 2.4 |
| Portfolio investment in Pakistan | 1.8 | -0.3 | -0.3 |
| Net incurrence of liabilities | 2.2 | 5.0 | 8.9 |
| *General government* | 1.4 | 3.4 | 4.8 |
| *Private sector (excl. banks)* | -0.2 | 1.2 | 2.4 |
| *Banks* | 0.5 | 0.4 | 1.6 |
| **SBP liquid reserves (end-period)** | 13.5 | 18.1 | 16.1 |
| **Total liquid reserves (end-period)** | 18.7 | 23.1 | 21.4 |

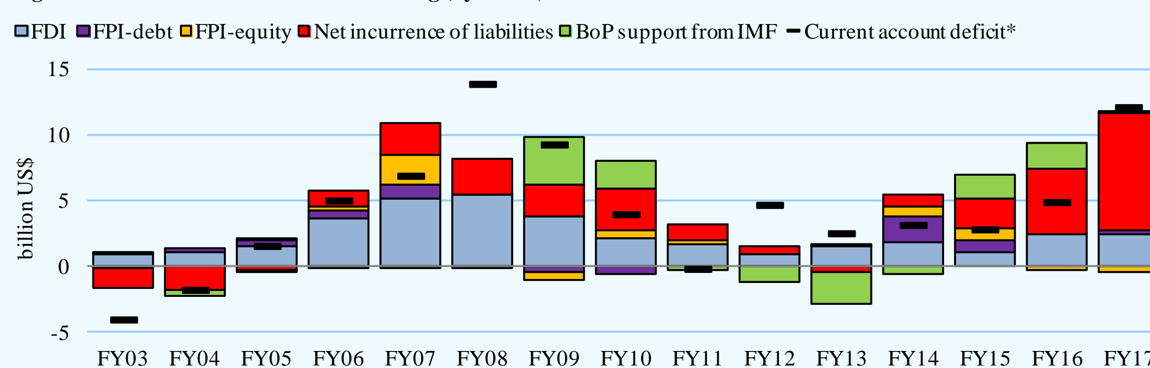
[P] Provisional
Data source: State Bank of Pakistan

[9] The IMF projects China's government and corporate debt to rise to 300 percent of GDP by 2020, from 242 percent in 2016. Such a high debt burden, along with questions about the efficacy of recent government efforts to deleverage the economy, led Moody's to downgrade China's credit rating in May 2017 to A1 from Aa3.
[10] However, demand for commodities and certain products, particularly hi-tech electronics items and components, has risen in FY17, and contributed positively to export growth of some Asian EMs (**Box 6.3**).
[11] This analysis is based on provisional BoP estimates.
[12] Capital goods contributed 48.1 percent to the total YoY increase in imports during Jul-May FY17 (source: Pakistan Bureau of Statistics).

This situation is partially explained by the fact that the recent spurt in Pakistan's economy has come at a time when global economic conditions are not supportive: (i) the price impact was still negative for many traditional export items during the year, like cotton yarn, bed-wear, readymade garments, tanned leather and fruits; this depressed their values despite an increase in their export quantum; (ii) a reversal in international commodity prices (especially palm oil), which inflated food imports; and (iii) the impact of cuts in infrastructure spending and labour indigenization measures in the Gulf countries, which reduced their demand for migrant workers. As a result of these developments, Pakistan's exports declined for the third consecutive year, with receipts dropping 1.3 percent in FY17. In case of remittances, inflows declined 3.1 percent during the year, with major drag coming from the GCC countries.[13] These trends in two major sources of FX earning – exports and remittances – do not bode well for financing of imports required to achieve the targeted higher GDP growth, without tapping on existing FX buffers.

The implications of decline in exports and remittances on the overall BoP has been evident in US$ 1.7 billion drop in the country's FX reserves in FY17, against a current account gap of over US$ 12 billion (**Figure 6.3**). Two factors were particularly helpful. First, the government was able to mobilize US$ 10.1 billion in gross financing from various bilateral, multilateral and commercial sources, effectively leveraging its multi-year progress on the reform agenda and the country's stable credit ratings. Second, CPEC-related inflows were on-hand in FY17, as represented by the 38.5 and 49.2 percent share of China in total gross official inflows (both bilateral and commercial) and FDI respectively during the year. In addition to these, the availability of sizable FX buffers that had been built up over the past three years, enabled the country to withstand rising imbalances.

**Figure 6.3: Current Account Deficit Financing (by source)**




*: +ve indicates deficit.
Data source: State Bank of Pakistan

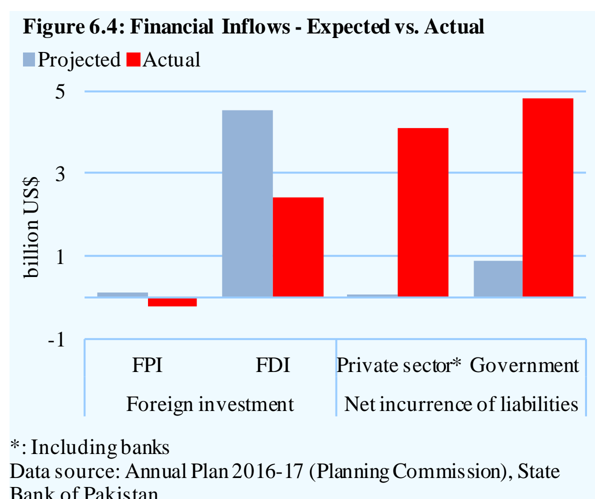
However, some concerns emerged with regards to the composition of financial inflows. In FY17, since both FDI and portfolio investment inflows fell short of the government's expectations and were less than sufficient to finance the current account gap, the country had to scale up external borrowings (**Figure 6.4**). Most of these borrowings comprised commercial loans, including short-term ones, which exposed the economy to both rollover and re-pricing risks.[14]

Therefore, the strategy for moving forward comprises measures that would revive the country's exports and worker remittances, and attract more equity inflows. In case of exports, it is encouraging to note that quantum exports of a number of traditional items posted an increase in FY17 (though a

[13] The pound's depreciation following the Brexit vote also pulled down the dollar value of remittances sent from the UK.
[14] These risks are represented by a high amount of both short-term gross disbursements and amortization during the year. Gross short-term loan disbursements to the government amounted to US$ 1,663 million in FY17, whereas gross amortization of short-term loans reached US$ 1,607 million.

negative price impact depressed their export values). On the global front, a pick-up in consumer spending in European countries figured prominently in boosting quantum textile exports, and on the domestic level, a visible improvement in industrial power supplies and availability of low-cost financing to exporting industries (i.e. SBP's refinancing schemes), were helpful.

**Figure 6.4: Financial Inflows - Expected vs. Actual**




*: Including banks
Data source: Annual Plan 2016-17 (Planning Commission), State Bank of Pakistan.

The policy focus now is on consolidating this momentum: the government has started working on removing the cash-flow constraints faced by exporting businesses by clearing stuck-up refunds of exporters. Moreover, timely disbursements under the incentive-based Rs 180 billion export package will also be ensured.

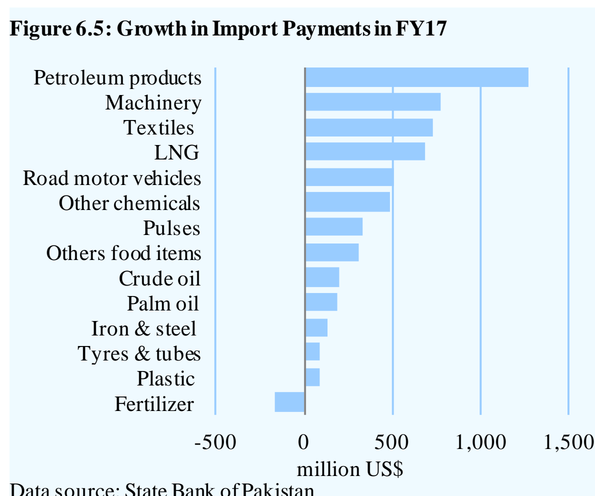
As for boosting workers' remittances, the Pakistan Remittance Initiative (PRI) has now moved beyond shifting the inflows from informal to formal channels, and towards introducing new financial products to encourage expats to repatriate their savings to the country. It is now also taking its tried and tested model of building tie-up arrangements in the GCC and UK, and implementing the same in non-traditional corridors, like Malaysia, South Africa and New Zealand. Moreover, both SBP and PRI are encouraging wider usage of the mobile banking channel in the remittance business; currently, remittance transfers have a fairly small share in overall transactions through this mode. Lastly, the PRI is constantly working to ensure that the cost of remitting funds to Pakistan remains manageable for emigrants, and that they do not switch to illegal and informal modes to transfer funds back home.

While these efforts are ongoing, it may take some time before they lead to a significant uptick in the country's forex earnings. The same is true for proposed non-power CPEC projects (like Special Economic Zones), whose benefits will become visible over the long-term, when Pakistani exporters utilise these facilities to enter new markets and diverisfy their products. In the interim period, the country has to mainly rely on external borrowings; however, stopgap measures to contain the trade deficit might be taken, if deemed necessary.

## 6.3 Current Account – Imports primary reason for the widening deficit

The increase in the current account deficit was mainly due to a 17.8 percent surge in the country's import bill, which shot up to a record US$ 48.6 billion in FY17. This rise mainly represents: (i) progress on CPEC-related power and infrastructure development projects, which has stimulated the demand for machinery, heavy vehicles and fuel (**Box 6.1**); (ii) growing energy needs of the domestic manufacturing and consumer transport sectors; (iii) a rise in global palm oil prices; and (iv) production losses in the minor crop sector, which led to higher imports of pulses and other food items (**Figure 6.5**).

**Figure 6.5: Growth in Import Payments in FY17**

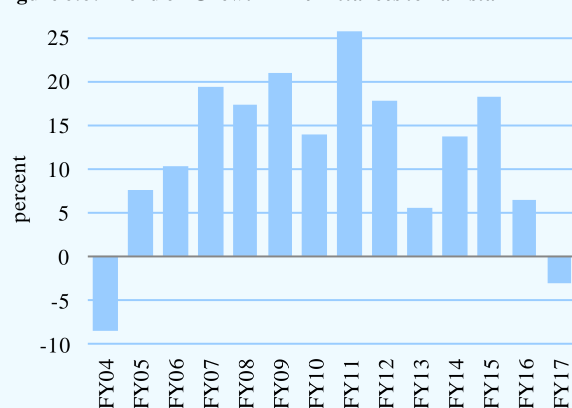



Data source: State Bank of Pakistan

With export receipts falling for the third

consecutive year, the trade deficit increased to a record-high US$ 26.9 billion in FY17. The impact of higher imports was also reflected in the services account, as freight charges increased substantially. A sharp fall in inflows under the Coalition Support Fund (CSF) put additional pressure on the services account. The impact of these developments on the current account would have been contained, had worker remittances followed their previous growth trajectory; instead, inflows fell for the first time in 13 years to US$ 19.3 billion (**Figure 6.6**).

**Figure 6.6: Trend of Growth in Remittances to Pakistan**




Data source: State Bank of Pakistan

**Box 6.1: CPEC Activity Pushes up Machinery, Transport Imports**

The CPEC agreement was reached between Pakistan and China at a time when the power shortfall was having a crippling effect on local industry. This, together with existing backlog in country's infrastructure – especially logistics – had contributed in putting Pakistan behind other EMs in terms of ease of doing business.[15] Therefore, when a large number of power and transport infrastructure projects were announced under the agreement, it was expected that businesses' concerns will be addressed to a large extent. So far, a few early harvest CPEC power projects have either already been completed or are nearing completion, and work is continuing at a brisk pace on multiple highways, including Karakoram and the Peshawar-Karachi Motorway.[16]

But this progress has only been made possible by hefty imports of capital goods, including power generation machinery and assorted equipment; heavy commercial vehicles (to transport raw materials from ports of entry to project sites); and fuel (mainly HSD) to run these vehicles. Cumulatively, imports of POL, transport and machinery grew by 22.0 percent YoY to US$ 21.1 billion in FY17 – accounting for 43.5 percent of total imports.

In case of machinery, imports of equipment related to power generation, like gas and steam turbines, solar panels, compressors, and auxiliary plants, all remained strong (**Section 6.5**). Besides, most of these imports have been sourced from China: the import of machinery items (HS Codes 84 and 85) from China had grown 31.1 percent YoY in the Jul-Mar FY17 period. Meanwhile, with progress on multiple CPEC power and infrastructure projects continuing, the required (imported) heavy machinery had to be transported to these sites. This, in turn, led to higher demand for commercial vehicles, which was mostly met through CKD and CBU imports of buses and other heavy vehicles.[17]

This surge in imports from China is not a new phenomenon: Pakistan's imports from the country have witnessed a 50 percent increase in a span of just three years (FY15-17), in-line with the onset of CPEC activities. China has the highest share in Pakistan's imports, at 22 percent in FY17; moreover, this share has been rising consistently since FY09, when it was just 9 percent. In the wake of Pakistan's declining exports to the country, the trade balance has tilted further in favour of China (**Table 6.1.1**).

Yet, it must also be pointed out that a part of the CPEC-related imports is being financed by financial inflows from China. Private firms operating in the power and construction sectors, have seen sizable levels of financing

**Table 6.1.1: Pakistan's Trade and Financial Transactions with China**

million US dollars

| | FY15 | FY16 | FY17 |
|---|---|---|---|
| Exports to China | 2,321 | 1,905 | 1,622 |
| Imports from China | 7,025 | 8,824 | 10,531 |
| Trade balance | -4,704 | -6,919 | -8,909 |
| FDI (net) | 319 | 1,064 | 1,186 |
| Portfolio investment | 11 | 6 | 48 |
| Official bilateral loan disbursements (gross)[1] | 1,161 | 1,042 | 1,594 |
| Official commercial loans by Chinese banks (gross)[1] | - | - | 2,300 |

Data source: State Bank of Pakistan, [1]: Economic Affairs Division

[15] Pakistan ranked 144th out of 190 economies in the Ease of Doing Business 2017. Emerging market peers like South Korea (5), Malaysia (23), Vietnam (82), Indonesia (91) and India (130) were ranked much higher (source: World Bank).
[16] The Sahiwal coal-fired plant (two units of 660MW each), and a couple of wind power farms in Sindh, have been completed under CPEC and are operational (source: Planning Commission of Pakistan).
[17] The domestic production of trucks & buses, pick-ups and tractors has risen at CAGRs of 39.8 percent, 11.6 percent and 16.1 percent respectively (source: Pakistan Automobile Manufacturers Association).

from their Chinese sponsors and commercial banks either in the form of equity injections (FDI), or commercial loans from Chinese banks. In addition, Chinese banks and DFIs are also lending FX support to the government of Pakistan as well as to Chinese banks operating in Pakistan.

*Worker remittances- decline most prominent from the GCC*

Worker remittances could not maintain their growth momentum in FY17, as inflows dropped 3.1 percent in the year. The decline was concentrated in the six oil-rich Gulf Cooperation Council (GCC) countries; lower inflows from both the US and the UK exacerbated this decline (**Table 6.2**).

**Table 6.2: Worker Remittances (by source)**

**Value in US dollar; growth in percent**

| | Values | | | Growth | |
|---|---|---|---|---|---|
| | **FY15** | **FY16** | **FY17** | **FY16** | **FY17** |
| **GCC** | **12,035** | **12,756** | **12,104** | **6.0** | **-5.1** |
| Saudi Arabia | 5,630 | 5,968 | 5,470 | 6.0 | -8.3 |
| UAE | 4,232 | 4,365 | 4,310 | 3.1 | -1.3 |
| Kuwait | 748 | 774 | 764 | 3.5 | -1.3 |
| Oman | 686 | 819 | 761 | 19.4 | -7.1 |
| Bahrain | 389 | 448 | 395 | 15.2 | -11.8 |
| Qatar | 350 | 381 | 404 | 8.9 | 6.0 |
| USA | 2,703 | 2,525 | 2,444 | -6.6 | -3.2 |
| UK | 2,376 | 2,580 | 2,338 | 8.6 | -9.4 |
| EU | 364 | 418 | 483 | 14.8 | 15.6 |
| Others | 1,242 | 1,638 | 1,935 | 31.9 | 18.1 |
| **Total** | **18,720** | **19,917** | **19,304** | **6.4** | **-3.1** |

Data source: State Bank of Pakistan

The hit to remittances from the GCC can be traced to oil price recession which had set in from mid-2014 onwards. The demand for fresh migrant workers by the Gulf economies has slowed down considerably over the course of two years. In the wake of burgeoning budget deficits, the GCC countries have responded by slashing their infrastructure spending, which has particularly affected construction activities in the region.[18] This was especially true in H1-FY17 (basically the entire CY-16), as the fiscal crunch forced governments to delay payments to contractors, who, in turn, withheld salaries of workers and slowed down their fresh recruitment drives. The labor nationalization drives in many of these economies have also contributed to the underlying challenging environment, particularly for aspiring white-collar emigrants.[19]

**Table 6.3: No. of South Asian Workers Going to Saudi Arabia & UAE**

in thousands

| | 2014 | | 2015 | | 2016 | |
|---|---|---|---|---|---|---|
| | S. Arabia | UAE | S. Arabia | UAE | S. Arabia | UAE |
| Pakistan | 313 | 351 | 523 | 327 | 463 | 296 |
| India | 330 | 224 | 307 | 226 | 165 | 164 |
| Bangladesh | 11 | 24 | 58 | 25 | 144 | 8 |

Data source: Bureau of Emigration and Overseas Employment Pakistan, Ministry of Expatriates' Welfare & Overseas Employment Bangladesh, and Ministry of External Affairs India

Pakistan and India have been particularly affected by these developments. These two countries have traditionally supplied the bulk of low-skilled laborers who work on construction projects or become a part of maintenance crews at office towers, airports etc in the Gulf. As shown in **Table 6.3**, the number of emigrants from both Pakistan and India going for work to Saudi Arabia and the UAE has seen significant drops in 2015 and 2016. However, Pakistani emigrants have not been impacted to the *extent* that their Indian peers may have been in the kingdom.

At the same time, it is also possible that firms in Saudi Arabia are meeting part of their demand for migrant workers from Bangladesh now, at the expense of those from Pakistan and India. The number of Bangladeshis going to Saudi Arabia for work, though much smaller than Pakistanis, has been rising steadily since 2014. The upsurge in 2016 can be partly traced to the lifting of a six-year ban on the

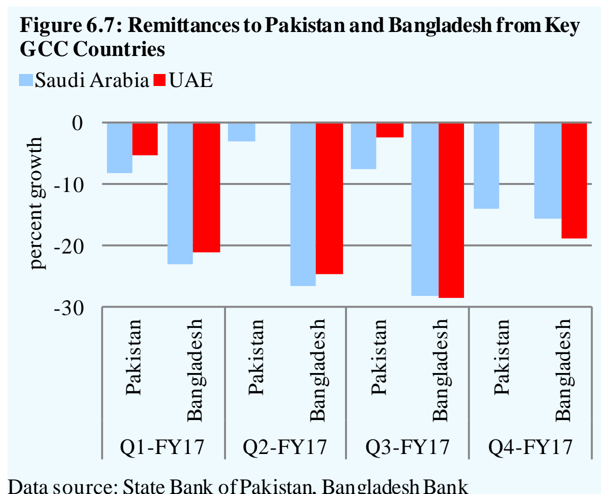
[18] The overall fiscal balance (as percent of GDP) of the GCC countries went from a surplus of 3.1 percent in CY 2014, to a deficit of 9.4 percent in CY 2015, which worsened further to 12.0 percent in CY 2016. However, the deficit is projected to decline to 6.5 percent of GDP in CY 2017, as the impact of fiscal consolidation measures introduced in 2015-16 start to kick in; the slight recovery in oil prices from late 2016 onwards will also lend support (source: IMF Regional Economic Outlook for MENAP, April 2017).

[19] For instance, the unemployment rate in Saudi Arabia rose to 12.3 percent in 2016, from 11.5 percent in 2015 (source: Haver Analytics).

recruitment of male Bangladeshi workers by the kingdom, after intense diplomatic efforts by Dhaka.[20] This underscores the need for Pakistan to also become more proactive diplomatically to ensure a favourable working environment and employment prospects for its citizens.[21] Nonetheless, despite the higher export of manpower to Saudi Arabia, remittances to the country from the kingdom fell more sharply than they did for Pakistan (**Figure 6.7**).

Meanwhile, remittances from the US to Pakistan declined 3.2 percent YoY to US$ 2.4 billion in FY17; this represented a YoY decline in inflows for the second straight year. As we have highlighted before, the combination of more stringent regulations regarding global cross-border money transfers, coupled with a special emphasis on due diligence requirements for institutions involved in remitting funds to and from the MENAP region, have constricted remittances from the country.

**Figure 6.7: Remittances to Pakistan and Bangladesh from Key GCC Countries**




Data source: State Bank of Pakistan, Bangladesh Bank

*Primary income - Lower oil and gas repatriation offset higher interest payments*

The primary income account improved significantly in FY17 over last year, with the deficit declining by US$ 592 million. The better performance was almost entirely due to a sizable reduction in the FX repatriated as oil and mineral proceeds from the country (**Table 6.4**). Savings realized on this front were more than sufficient to offset higher repatriations from other sectors, as well as an increase in interest payments during the year.

**Table 6.4: Profit and Dividend Repatriation on FDI**

million US dollars

| | FY15 | FY16 | FY17 |
|---|---|---|---|
| **Total repatriations** | **3,327** | **3,807** | **3,007** |
| *of which* | | | |
| Oil and mineral proceeds | 1,734 | 1,546 | 1,042 |
| Profit and dividends | 1,328 | 1,512 | 1,734 |
| Food | 112 | 129 | 266 |
| Financial business | 337 | 364 | 262 |
| Telecom | 254 | 175 | 177 |
| Power | 100 | 158 | 152 |
| Beverages | 60 | 45 | 79 |
| Others | 447 | 583 | 757 |

Data source: State Bank of Pakistan

Oil and gas firms could not recover from heavy losses incurred in FY16, as crude prices remained range-bound throughout FY17. In contrast, strong domestic demand and healthy sales led to higher profitability of fast-moving consumer goods (FMCG) companies in the country; this was reflected in a more than doubling of profit and dividend repatriations by the food sector in FY17.[22] In fact, food emerged as the top source of FX outflows through this mode, with its repatriations exceeding those by the banking industry for the first time in six years.[23]

[20] Ministry of Foreign Affairs Bangladesh, press release dated 11th August 2016.

[21] The government is mulling over measures to capture the manpower market of UAE, especially in the context of Expo 2020-related infrastructure spending in Dubai. Expecting an increase in the demand for skilled labour, the Bureau of Emigration and Overseas Employment (BEOE) is working in close coordination with the National Vocational and Technical Training Commission (NAVTTC) and Technical Education and Vocational Training Authority (TEVTAs) to upgrade curriculums for skill development as per international standards. Moreover, BEOE is also involved in highlighting the issues faced by Pakistani migrant workers at various international platforms including International Labour Organization, International Organization of Migration, Colombo Process, Abu Dhabi Dialogue, Global Forum on Migration and Development, World Health Organization and Budapest Process, etc.

[22] All indicators suggest that the sector's profitability increased this year; importantly, the food sector posted a strong YoY production growth of 11.5 percent in FY17. Leading sub-sectors like soft drinks and juices posted double-digit rises in production (9.8 percent and 12.1 percent respectively). The food sector in the country enjoys strong foreign investor participation; in fact, it was the second-highest recipient of FDI in the country in FY17, courtesy a major merger and

Meanwhile, in line with the low interest rate environment and a shift in the government's borrowings away from commercial banks, profits of the banking sector declined during FY17; subsequently, a YoY drop in profit repatriations by financial firms was noted in the year. Yet, the industry was still the second-highest source of repatriation outflows from the country.

With regards to interest payments, the US$ 1.5 billion YoY net outflow in FY17 is in tandem with the rise in the external debt stock during the year (**Chapter 4**). The fall in payments on Eurobonds/Sukuk was more than offset by higher payments on other longer term government debt.[24] Interest payments by the non-financial private sector also increased over FY16.

*Services account – Improved IT exports overshadowed by lower CSF*

The services deficit increased by a marginal US$ 167 million YoY and reached US$ 3.6 billion in FY17. This slight worsening was entirely due to a US$ 387 million decline in CSF inflows in the year; excluding these, the services account improved by US$ 220 million over last year (**Table 6.5**).

**Table 6.5: Services Account**
million US dollars

| | FY15 | FY16 | FY17 |
|---|---|---|---|
| **Services balance** | **-2,970** | **-3,406** | **-3,573** |
| Government services | 1,768 | 1,476 | 1,177 |
| o/w CSF | 1,452 | 937 | 550 |
| Telecom, computer & info services | 425 | 412 | 555 |
| Transport | -2,843 | -2,160 | -2,574 |
| o/w Freight | -2,622 | -1,638 | -1,944 |
| Air transport (passenger) | -245 | -513 | -517 |
| Travel | -1,216 | -1,516 | -1,438 |
| Insurance & pension services | -195 | -202 | -132 |
| Financial services | -122 | -93 | -119 |
| Other business services | -592 | -1,056 | -814 |

Data source: State Bank of Pakistan

The deficit in transportation – which has the highest share in the services account – rose 19.2 percent to US$ 2.6 billion in FY17, mainly because of an 18.7 percent increase in the freight deficit. This was somewhat expected, given that the freight deficit tends to track the direction of the merchandize import bill. Higher average crude prices in the year also contributed to the increase in freight charges.[25]

The impact of the lower CSF and higher freight on the services account overshadowed the improvements recorded in telecom services during the year. Net telecom exports increased almost five times to US$ 173.3 million, which pushed overall telecom, computer and information services exports to US$ 554.6 million – up 34.6 percent from FY16's level of US$ 411.9 million.

## 6.4 Financial Account – Commercial borrowings remained strong

The surplus in the financial account rose to US$ 9.6 billion in FY17 – the second-highest level ever – and was 41.2 percent higher than last year's surplus. These higher inflows proved helpful in partially financing the current account deficit, and therefore moderated the decline in the country's FX reserves. Most of the inflows were debt-creating in nature, as government, banks, and private firms all borrowed heavily from external creditors to meet their financing needs.

*(i) Net incurrence of liabilities*

The net inflow of foreign loans into the country reached US$ 8.9 billion in FY17, compared to US$ 5.0 billion in the preceding year. The government had a dominant share (around 54.2 percent),

acquisition transaction. By end-Dec 2015 (latest data available), outstanding FDI in Pakistan's food sector amounted to US$ 2.7 billion, or 7.9 percent of the total stock of FDI in the country at the time.

[23] From FY12 to FY16, the banking sector repatriated the highest amount of FX in the form of profit and dividend repatriation on FDI on an annual basis.

[24] Interest payments on sovereign bonds dropped US$ 66 million in FY17. However, these were offset by a US$ 208 million YoY increase in payments on long-term government debt.

[25] In FY17, average crude prices (Brent, WTI and Dubai Fateh) were 16.3 percent higher than FY16 (source: IMF).

followed by the private sector (mostly power companies), and banks. Most of these borrowings were commercial in nature, and were sourced from foreign banks.

In the case of the government, commercial borrowings emerged as the top source of official FX inflows in FY17 (**Table 6.6**). A sizable share of these borrowings was short-term in nature, entailing important implications in terms of rollover and re-pricing risk of the country's external debt.[26] The share of short-term loans in the government's overall debt servicing also rose: in FY17, amortization of short-term loans accounted for 36.7 percent of overall amortization of government loans, up from 27.0 percent last year.

**Table 6.6: Sources of Official Commercial Borrowings***
million US dollars

| | Q4-FY17 | FY17 |
|---|---|---|
| China Development Bank | 1,000.0 | 1,700.0 |
| Bank of China | 300.0 | 300.0 |
| Industrial and Commercial Bank of China | 0.0 | 300.0 |
| Standard Chartered Bank, London | 697.9 | 697.9 |
| Consortium financing (local + foreign) | 650.0 | 650.0 |
| Noor Bank, UAE | 130.0 | 445.0 |
| Citi Bank | 275.0 | 275.0 |
| Total commercial borrowings | 3,052.9 | 4,367.9 |
| Total official loans | 5,053.8 | 10,123.9 |

* These figures are provisional, gross disbursements.
Data source: Economic Affairs Division, Ministry of Finance

Moreover, the timing and magnitude of these borrowings indicate that they were meant to stabilize FX liquidity levels in the interbank market, particularly in the last few months of FY17. Official external borrowings surged in Q4, just as the current account deficit hit a record high.[27] In fact, 79.1 percent of net loans to the government, and almost half of gross official commercial loan inflows in full-year FY17, were recorded in the fourth quarter (**Table 6.6**).

Meanwhile, commercial banks continued to receive short-term FX support from their offshore branches and parent companies, though the magnitude of this support was considerably higher than last year: these borrowings rose to US$ 1.6 billion in FY17, from just US$ 295 million in FY16.

*(ii) Foreign direct investment*

At the start of the year, the government had envisaged net FDI of US$ 4.5 billion for FY17.[28] The key assumption was that CPEC-related power projects would receive the bulk of this higher foreign investment. However, as it turned out, the actual inflow of FDI into the power sector declined 31.4 percent in the year (**Table 6.7**). Moreover, the sector's share within total FDI, as well as in overall FDI received from China, declined significantly over last year.[29] Most of the power firms that had received Chinese FDI in FY16 continued to receive investment from the country in FY17, albeit in lower volumes.

These trends do not imply that funding for CPEC projects is drying up. In fact, a large portion of the envisaged financing for CPEC power projects came into the country, but in the form of direct borrowings from Chinese banks (i.e. FX coming in the interbank market).[30] That said, in most cases,

[26] This can be judged from the fact that gross short-term loan disbursements to the government amounted to US$ 1,663 million in FY17, whereas gross amortization of short-term loans reached US$ 1,607 million. While the net inflow was a nominal US$ 56 million, the sizable amounts of gross disbursements and amortization recorded in the year is a bit worrying, and might indicate the country's rising susceptibility to rollover risk.

[27] Net debt flows to the government (excluding Eurobond/Sukuks) amounted to US$ 3.8 billion in Q4-FY17, against the full-year flows of US$ 4.8 billion. The Q4 current account deficit stood at US$ 4.4 billion.

[28] Source: Annual Plan 2016-17, Planning Commission

[29] In FY16, 82.8 percent of net FDI from China had gone into the power sector; in FY17, the sector received a relatively lower 50.6 percent of net FDI from the country.

[30] For instance, in their application for a generation license to NEPRA, the foreign sponsors of the Sahiwal coal-fired power project mentioned the project's total cost as US$ 1.8 billion. Of this, the sponsors were expected to inject US$ 356.4 million as equity (20 percent), with the remaining 80 percent (US$ 1.4 billion) coming in the form of a loan from ICBC (source: http://www.nepra.org.pk/Licences/Licence percent20Application/2015/Generation percent20License percent20App percent20of percent20Hunaneg percent20Shdong percent20RUYI.PDF)

offshore borrowings were used to purchase power generation machinery to be sent to Pakistan, and to pay foreign contractors working on the CPEC projects (i.e. import of goods and services).

**Table 6.7: Sector-wise Inflow of Foreign Direct Investment in Pakistan**
million US dollars

| | FY15 | | | FY16 | | | FY17 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Inflow | Outflow | Net FDI | Inflow | Outflow | Net FDI | Inflow | Outflow | Net FDI |
| Power | 333 | 51 | 282 | 1,217 | 58 | 1,159 | 815 | 20 | 795 |
| *Thermal* | *94* | *51* | *44* | *438* | *57* | *382* | *207* | *14* | *194* |
| *Hydro* | *178* | *0* | *178* | *244* | *1* | *243* | *213* | *6* | *207* |
| *Coal* | *61* | - | *61* | *535* | - | *535* | *395* | - | *395* |
| Oil & gas exploration | 305 | 5 | 301 | 267 | 18 | 249 | 162 | 5 | 158 |
| Telecommunication | 948 | 882 | 66 | 378 | 131 | 247 | 106 | 115 | -9 |
| Information technology | 36 | 62 | -25 | 19 | 30 | -11 | 38 | 0 | 38 |
| Financial business | 407 | 151 | 256 | 392 | 103 | 289 | 100 | 36 | 64 |
| Construction | 56 | 2 | 54 | 50 | 3 | 47 | 472 | 4 | 468 |
| Food | 49 | 51 | -2 | 33 | 89 | -56 | 493 | 0 | 493 |
| Electronics | 32 | 32 | 0 | 50 | 16 | 34 | 171 | 28 | 143 |
| **Total** | **2,797** | **1,809** | **988** | **3,165** | **860** | **2,305** | **2,814** | **403** | **2,411** |

Data source: State Bank of Pakistan

The information on such imports was not initially available, as neither did the payment burden fall on domestic commercial banks nor did SBP have details of transactions of the firms involved. As a result, import payments as well as financial account inflows remained grossly underreported in the balance of payments. Importantly, the discrepancy between customs data and payments records increased.

To align the trends in two data sets, and also to get a better handle on the subject, SBP instructed banks to collect additional information regarding offshore foreign currency accounts (FCAs) of their power sector client firms banks were also told to submit revised information from July 2015 onwards. In July 2017, after receiving and compiling the detailed data regarding transactions in offshore FCAs of power companies, SBP issued revised backdated (from July 2015 onwards) balance of payments statistics.[31] As expected, data for imports, FDI and loans to *other sectors* were all revised upwards.

Meanwhile, FDI (as well as official loans from China) into the construction sector spiked this year, as work progresses on multiple road projects under the CPEC umbrella.[32] Among other sectors, food and electronics stood out, mainly because of completion of stake sales of two local companies to foreign investors. On the other hand, a net outflow was noted from the telecom sector in FY17, against an inflow US$ 246.8 million last year. It is worth noting that net FDI into the sector last year was higher as a result of telecom firms borrowing from their parent companies abroad to either purchase a 4G license (Telenor), or to acquire a smaller competitor (Mobilink); such activity was largely absent in FY17.

[31] The instructions were issued via EPD Circular Letter No. 14 of 2016. As mentioned before, the need for the measure had risen because of a widening differential between import payments data available with SBP and imports reported by Customs authorities to PBS. Definitional and operational factors (like cost of freight and insurance; import of cars under the baggage scheme; gold imports etc.), could only partially explain the differences. For further details, see Box 5.1 titled “Financing of CPEC imports: Addressing gaps in data” in SBP’s *Second Quarterly Report on the State of Pakistan’s Economy 2016-17*.
[32] Projects receiving bilateral official loans from China included the realignment of Karakoram Highway (US$ 11.3 million); the Havelian-Thaikot section of KKH (US$ 290.7 million); the Sukkur-Multan section of the Peshawar-Karachi Motorway (US$ 676.4 million); and the Orange Line project in Lahore (US$ 269.7 million). Source: Economic Affairs Division.

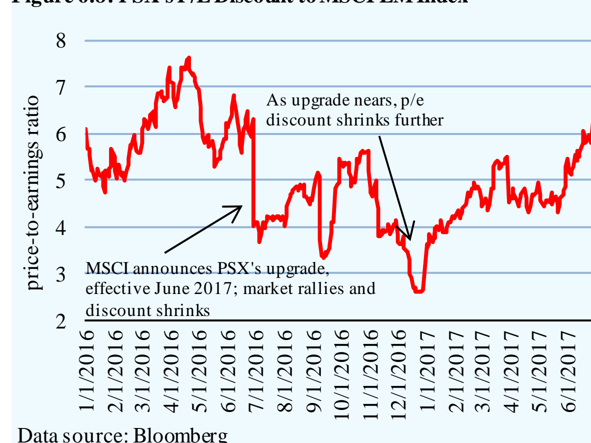
*(iii) Foreign portfolio investment*

Private sector outflows weighed on overall portfolio investment in the year, and exceeded a net inflow of US$ 250 million into public sector securities.[33] In terms of destinations, Luxembourg, the UK and Hong Kong were the major recipients of portfolio outflows from Pakistan. This is likely due to the strong presence of equity desks of global banks and foreign funds in these countries.

The trend of net private FPI outflows from Pakistan has now stretched on for two straight years; foreign investors pulling out funds from a Pakistan Stock Exchange (PSX) that has been giving decent returns, is a bit paradoxical. The fact that the PSX's performance relative to other emerging markets (as measured by the performance of the MSCI Emerging Markets Index) has also been strong during this time, adds to the perplexity of why foreign investors are pulling out from the domestic market (**Box 6.2**). Moreover, a hefty net portfolio outflow immediately following Pakistan's reclassification into the MSCI EM Index in June was contrary to expectations.

Three major reasons explain these unmet expectations. First, large, actively managed foreign funds looking to exit the PSX utilized the huge liquidity available in the market on May 31 (as inflows from passive funds came in) to offload their positions. Relatively speaking, PSX is still a shallow market, with daily turnover averaging US$ 102 million over the 12 months leading to the eve of the MSCI upgrade. However, on May 31, turnover surged to US$ 475 million, offering big foreign funds a chance to offload their holdings.

**Figure 6.8: PSX's P/E Discount to MSCI EM Index**




Data source: Bloomberg

Second, Pakistani equities had become relatively overvalued. The price-to-earnings (p/e) discount at which the PSX was trading against the MSCI EM Index had consistently narrowed till December 2016, because of strong local investor activity. While the p/e discount then started to widen from January 2017 onwards as the PSX's rise moderated (mainly on account of local developments), it was still higher on the eve of the MSCI upgrade than it was at the time of the original MSCI announcement in June 2016 (**Figure 6.8**).[34]

Third, Pakistan was originally supposed to have a weightage of around 0.2 percent in the MSCI EM Index, which was later lowered to slightly over 0.1 percent. This reduction likely had a direct impact on gross inflows coming from passive funds that track the MSCI EM Index.

**Box 6.2: Portfolio Outflows amid Rising PSX during FY16 and FY17**

The domestic stock market has performed quite well over the past two years, giving a return of 6.8 percent in US Dollar terms in FY16, and 23.1 percent in FY17. In the same two-year period, FPI outflows from Pakistani equities have amounted to a sizable US$ 850 million. This box attempts to explain the factors behind this dynamic, where foreign investors are seemingly unconcerned by the performance of the PSX (which has tended to be better than that of other emerging markets), and have instead been pulling out their funds from Pakistan. For this analysis, we can divide the PSX's performance and the direction of FPI flows into four distinct phases (**Figure 6.2.1**).

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[33] The government had issued a US$ 1.0 billion Sukuk in October 2016, and repaid a maturing Eurobond of US$ 750 million in June 2017; this led to a net public portfolio inflow of US$ 250 million.

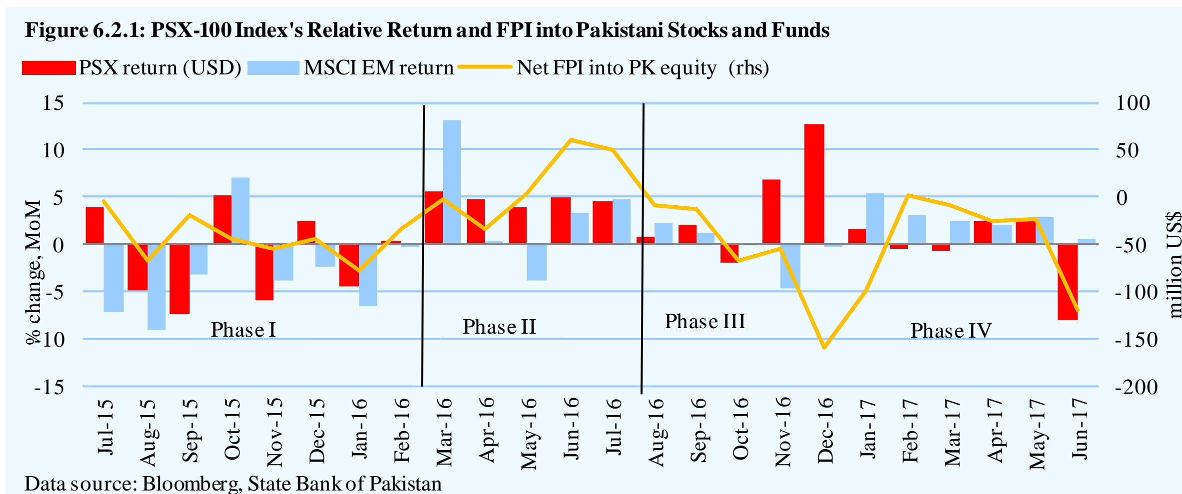
[34] The PSX's p/e discount to the MSCI EM Index on June 10, 2016, stood at 6.5 percent. (The original MSCI announcement was made on June 14, 2016). On May 30, 2017 (i.e. the day before the actual reclassification), the discount stood at 4.8 percent (source: Bloomberg). (Note: the lower the PSX's p/e discount to MSCI EM Index, the less attractive Pakistani stocks are relative to their peers in other countries, in the eyes of foreign investors).

**Phase I**: The performances of both the PSX and the MSCI EM Index generally remained subdued in this period, with consistent net FPI outflows noted from Pakistani equities and funds; similar capital outflows were reported by other EMs as well. The key factor was the culmination of the seven-year-long quantitative easing in the US (in December 2015), which prompted global funds to readjust their portfolios accordingly. The Chinese yuan's abrupt and sizable devaluation (in August 2015), and geo-political tensions between Russia and Turkey, also contributed to the tough situation for EM capital flows.

**Phase II**: Local equities outperformed the MSCI EM Index almost throughout this period, mainly because local investors seemed to be building up positions while increasingly factoring in the PSX's impending upgrade into the MSCI EM Index. Net FPI also turned positive in anticipation of, and immediately following the upgrade announcement (in mid-June 2016).
**Phase III**: FPI outflows resumed, this time in response to expectations of further monetary tightening in the US (with the Fed rate hike materializing in December 2016). The outflows then accelerated during November-January, as global investors started factoring in the results of the US presidential elections; the initial expectation was that the policy proposals of the new administration would trigger inflationary pressures in the country, pushing the Fed to raise interest rates more rapidly. EMs across the board faced capital outflows during this time, and Pakistan was no different.

Interestingly, as FPI outflows gathered steam in Pakistan, local investors went on a buying spree (particularly in November and December 2016), partly buoyed by the diffusion of political uncertainty as the apex court decided to hear petitions related to the Panama Papers case. This local buying not only completely absorbed the selling by foreign investors, but pushed the PSX-100 index to new highs.

**Figure 6.2.1: PSX-100 Index's Relative Return and FPI into Pakistani Stocks and Funds**




Data source: Bloomberg, State Bank of Pakistan

**Phase IV**: A consolidation phase set in at the PSX, with the benchmark index declining by 3.0 percent during Jan-Apr FY17. Domestic investors adopted a cautious stance, and market liquidity was said to have become a bit tight. The investors' cautiousness reportedly stemmed from a couple of brokers fleeing the country with their clients' funds; and the capital market regulator launching investigations against multiple brokers for "market manipulation", while simultaneously working on introducing a new margin financing product and related regulations. The magnitude of FPI outflows fell sharply, though fresh inflows were scant on net basis.

These factors, coupled with concerns about the country's external account position and unfolding political developments, likely reduced the attractiveness of Pakistani stocks relative to their peers in other emerging markets for foreign investors, thereby deterring them from taking sizable fresh positions. Going forward, it is increasingly likely that the absolute returns (in dollar terms) offered by the PSX, in and of itself, might no longer be attractive enough for foreign investors. Conversely, it also seems that the *extent* to which the local equity market's performance is determined by foreign investors, has lessened considerably.

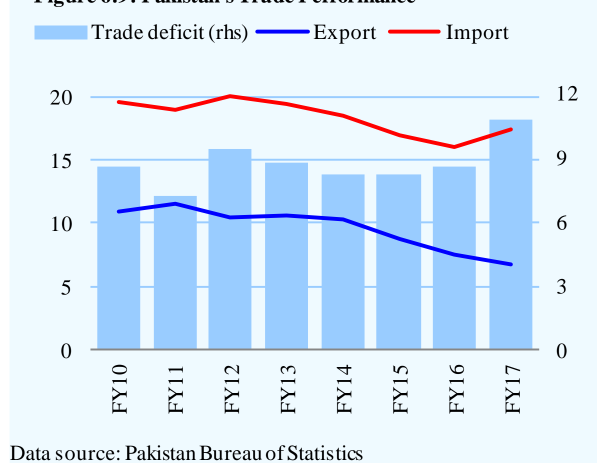
## 6.5 Trade Account[35]

In line with the pick-up in real GDP growth to a decade high of 5.3 percent in FY17, on the back of a favourable policy mix and higher CPEC and PSDP related spending, the country's imports increased by 18.5 percent to a record US$ 53.0 billion. While some comfort may be drawn from the fact that

[35] 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 6.1**. To understand the difference between these two data series, please see Annexure on data explanatory notes.

more than half of the increase in imports has come from capital goods, these also contributed significantly in taking the country's trade deficit to an all-time high of US$ 32.5 billion in FY17. At the same time, declining exports – both in terms of absolute value as well as in percent of GDP – pose a clear challenge for the external sector's stability (**Figure 6.9**).

**Figure 6.9: Pakistan's Trade Performance**




Data source: Pakistan Bureau of Statistics

The drop in Pakistan's exports looks particularly concerning when seen in the context of the recent recovery in exports of multiple emerging markets. However, it appears that more than competitiveness issues, the divergence in this trend mainly reflects product mismatch: items that are driving the recent export growth of EMs primarily comprise high-tech items, such as electronics, components for consumer electronics, machinery items etc, and commodities (**Box 6.3**).

## Exports

Pakistan's exports declined by 1.7 percent in FY17, compared to a much bigger fall of 12.2 percent recorded in FY16. The drop was concentrated in H1-FY17, which more than offset a marginal growth of 0.5 percent during H2-FY17. The overall export performance largely mirrored that of the textile group, whose exports grew by 1.9 percent in H2, after dropping by 1.8 percent in H1 (**Table 6.8**). However, exports of major non-textile, especially non-basmati rice, leather, footwear and cement, declined throughout the year.

**Table 6.8: Growth in Exports**

percent

| | H1 | H2 | FY17 |
|---|---|---|---|
| **Food group** | **-11.2** | **-3.3** | **-7.0** |
| Basmati rice | -22.6 | 19.3 | -1.9 |
| Non-basmati | -16.4 | -18.1 | -17.3 |
| Seafood | 10.3 | 32.6 | 21.2 |
| **Textile group** | **-1.8** | **1.9** | **0.03** |
| Raw cotton | -49.9 | 52.2 | -43.1 |
| Cotton yarn | -6.3 | 4.1 | -1.7 |
| Cotton fabrics | -3.9 | -3.1 | -3.5 |
| Knitwear | -1.2 | 1.0 | -0.1 |
| Bed wear | 6.2 | 5.4 | 5.8 |
| Towels | -6.2 | 5.6 | -0.4 |
| Readymade garments | 5.8 | 5.5 | 5.6 |
| **Other manufactures group** | **-5.9** | **-2.6** | **-4.3** |
| Leather | -7.9 | -1.4 | -4.7 |
| Leather manufactures | -4.4 | -8.8 | -6.5 |
| Foot wear | -6.4 | -18.1 | -13.2 |
| Plastic | 14.8 | 14.1 | 14.5 |
| Pharmaceutical | 3.1 | 4.3 | 3.7 |
| Cement | -14.6 | -38.9 | -26 |
| **Total exports** | **-4.0** | **0.5** | **-1.7** |

Data source: Pakistan Bureau of Statistics

*Non-textile exports depict mixed performance*

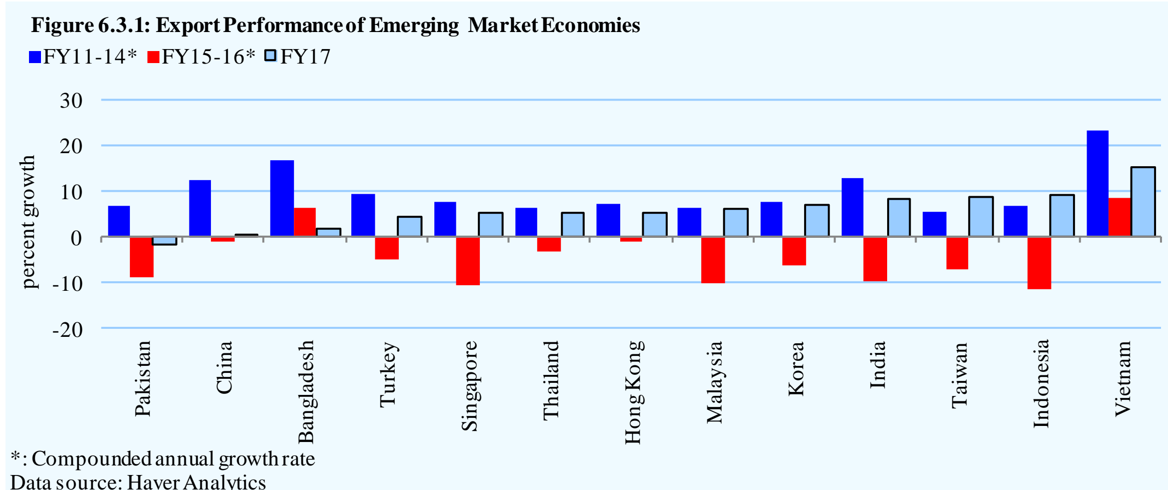
Overall *food* exports fell 7.0 percent in FY17, mainly due to lower shipments of non-basmati rice, meat, and fruits & vegetables; these more than offset the growth noted in exports of seafood, spices and tobacco. In case of non-basmati rice, the decline is evident mainly in the Chinese market, where a glut-like situation has been developed due to excessive stockpiling over the past two years.[36] Not only has China reduced its import of the commodity, it has also started offloading its stocks in some African countries (particularly Côte d'Ivoire, Zimbabwe, Mozambique, and Malawi), which were earlier sourcing this product from Pakistan.[37] In addition to this, increased domestic rice production in Ghana, Guinea, Nigeria and Senegal reduced their demand for Pakistani varieties.[38]

[36] Rice stocks in China are projected to rise to a nearly two-decade high of 75.7 million tons by the end of the 2017-18 season (source: US Department of Agriculture Rice Outlook July 2017).
[37] On aggregate, these four countries imported 176,841 MT in Jul-May FY17, compared to 332,873 MT in the same period last year.
[38] In Nigeria, initiatives such as the Growth Enhancement Support Scheme (GESS) and the Presidential Initiative on Fertilizers, are aimed at promoting growth and helping the country attain self-sufficiency in rice. Similarly, state

**Box 6.3: The Recovery in EM Exports – the Key Driving Factors and Outlook**[39]
As the global commodity price recession set in from FY15 onwards, exports of many Asian emerging market economies started to decline (**Figure 6.3.1**). Quantum exports also suffered, as demand for imported goods from the developed economies (which were going through a phase of sub-par growth), and from China (which was trying to strategically exit low valued product segments and graduate into more hi-tech production), remained subdued.

While the drop in commodity prices (like crude and palm oil) hurt the export performances of EMs such as Malaysia and Indonesia, the tepid demand from key western markets and China impacted many Asian exporting economies (except Vietnam and Bangladesh). Pakistan was not immune from these external developments, and the country's export earnings declined by 3.9 percent in FY15 and then by 8.8 percent in FY16.[40]

**Figure 6.3.1: Export Performance of Emerging Market Economies**

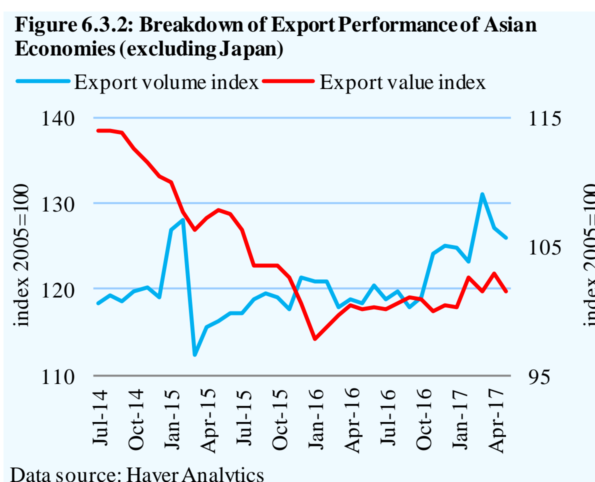



*: Compounded annual growth rate
Data source: Haver Analytics

Nonetheless, the rebound in global commodity prices in FY17 came as a relief for many EMs, whose exports generally started to recover from Q2-FY17 onwards.[41] This price rebound also coincided with a healthy recovery in demand from major importers like China and the European Union: resultantly, a visible uptick in quantum exports of many Asian economies was noted (**Figure 6.3.2**). The combined result was a double-digit growth in exports of many countries in H2-FY17 (**Table 6.3.1**).

In this backdrop, Pakistan's export performance looks unsatisfactory: after declining consistently, exports recovered by 1.3 percent YoY in Q2-FY17, then turned negative (1.7 percent) in Q3, before again turning positive (3.0 percent) in Q4. But before attributing this relatively lacklustre performance entirely to domestic factors, it is necessary to look at the drivers of the rebound in export performances of other EMs.

**Figure 6.3.2: Breakdown of Export Performance of Asian Economies (excluding Japan)**




Data source: Haver Analytics

Looking at recent trends in purchases by China – the world's second-largest importer – offers some interesting insights. The substantial recovery in China's imports in FY17 is mainly driven by commodities, machinery items and electrical

interventions in Ghana, including the recently launched Planting for Food and Jobs Campaign, have been undertaken to increase the area under cultivation of major crops (i.e. maize and rice).

[39] The information and analysis presented in this box has been gleaned from a research note by Nomura Global Research, titled "Asia's steep but short-lived export up-cycle".

[40] Pakistan's exports receipts from China dropped by 13.6 percent in FY15, and by a further 17.9 percent in FY16.

[41] The average IMF All Commodity Price Index rose by 11.9 percent YoY in FY17, after declining 30.0 percent in FY16 and 23.6 percent in FY14.

components – i.e. products that are not exported by Pakistan.[42] During Jan-Jun FY17, the top three contributors to the rise in China's overall imports were POL, iron ore, and electrical components (semiconductor chips, etc), which accounted for nearly84 percent of the increase in the country's imports during the period.[43] In contrast, China's imports of 'knitted or crocheted fabrics,' which Pakistan supplies, went up by a negligible 0.05 percent during the period.

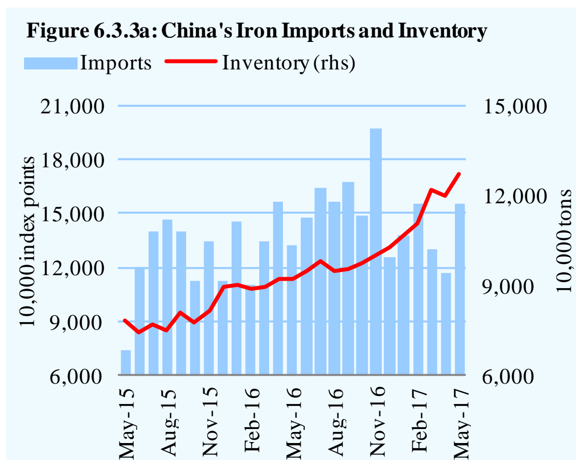
In this regard, current trends in global tech component exports deserve some special attention here. It is clearly apparent that these are currently driven by higher demand from China. First, according to foreign market research analysts, tech and telecom companies in the country have been encouraging customers since 2016 to switch to 4G handsets from the prevalent 2/3G ones, which has led to a sizable increase in demand for new smartphone variants in the country. This, in turn, has contributed to higher demand for associated electrical components such as semiconductors –which was met by South Korea, Taiwan, Malaysia and Thailand. Second, the global electronics supply chain also got a boost in the lead-up to the launch of Apple's latest iPhone series (which came on the market in September 2017); given that Chinese companies are one of the major assemblers of the smartphone, their demand for electrical parts and components has risen. In addition to tech items, demand for commodities like iron ore and manganese from China has also been increasing, largely because businesses in the country are building up their inventories (**Figure 6.3.3a**). This has contributed to the rise in international metal prices (**Figure 6.3.3b**), and therefore contributed positively to the export performances of major suppliers, including Malaysia, Indonesia and India. However, from Q3-FY17 onwards, China's commodity imports have slowed down, and a corresponding dip in metal prices has been noted as well.

**Table 6.3.1: Export Growth of EMs in FY17**
percent

| | Q1 | Q2 | Q3 | Q4 |
|---|---|---|---|---|
| Bangladesh | 4.1 | 4.7 | 3.1 | -4.4 |
| China | -7.0 | -5.3 | 8.1 | 9.2 |
| India | -0.8 | 6.0 | 18.5 | 10.0 |
| Indonesia | -4.9 | 14.0 | 20.7 | 7.8 |
| Korea | -5.0 | 1.8 | 14.7 | 16.8 |
| Malaysia | -2.1 | 1.9 | 14.4 | 11.5 |
| Taiwan | -0.3 | 11.2 | 15.8 | 10.2 |
| Thailand | 1.0 | 3.8 | 4.9 | 10.9 |
| Pakistan | -9.0 | 1.3 | -1.5 | 2.8 |
| Vietnam | 9.1 | 14.7 | 15.2 | 22.6 |

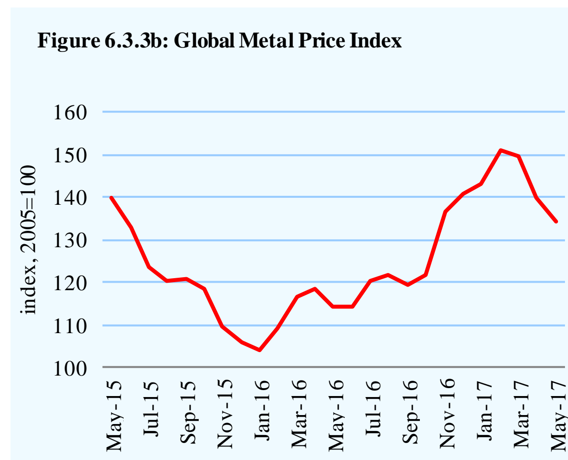
Data source: Haver Analytics

**Figure 6.3.3a: China's Iron Imports and Inventory**




Data source: Bloomberg

**Figure 6.3.3b: Global Metal Price Index**




Data source: IMF

This basically leads to the following conclusion: the factors that are driving the recent export growth of many EMs are ostensibly cyclical in nature. Demand for tech components is unlikely to extend its current strong momentum in 2018, as the strong base effect kicks in and retail sales of new electronics ebb after initial consumer enthusiasm for devices peaks.[44] Second, as indicated in **Figure 6.3.3a** and in the section on rice exports below, commodity stockpiling in China appears to have peaked, as inventory levels have risen sizably over the past year. These two factors will conceivably ensure that the strong export growth notched by EMs exporting commodities and high value added tech items, will be short-lived.

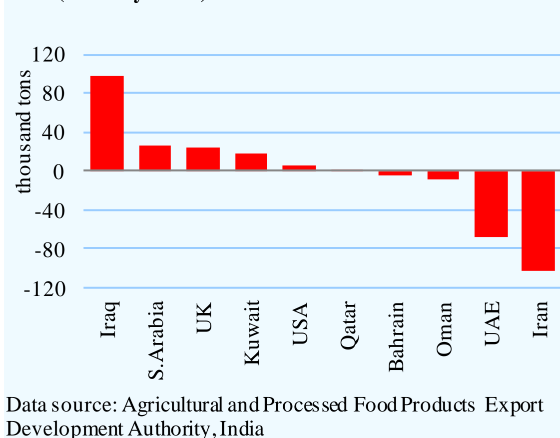
[42] In value terms, China's overall imports in FY17 were up 8.2 percent over last year, after declining 11.9 percent in FY16. Similarly, imports of EU-28 countries rose 4.1 percent YoY in FY17, after dropping 9.0 percent in FY16 in dollar terms (source: Haver Analytics, Eurostat).
[43] Source: China Customs Statistics, accessed through http://china-trade-research.hktdc.com/business-news/article/Facts-and-Figures/China-Customs-Statistics/ff/en/1/1X000000/1X09N9NM.htm
[44] This point has also been highlighted by Nomura Global Markets Research in a note titled "Asia's steep but short-lived export up-cycle".

In Pakistan's case, the net impact of these developments is likely to be negligible. This is simply because the country does not export products that are driving the current export rebound in Asian economies. Clearly, this lack of product diversification and sophistication entails serious implications for the long-term viability of the export industry. However, in the current scenario, it will also ensure that the country's export performance will not be affected when a likely reversal in cyclical factors driving the current export growth of other EMs takes place.

Meanwhile, Pakistan's *basmati* rice exports declined 1.9 percent in FY17, after dropping by a relatively larger magnitude of 25.6 percent last year. Encouragingly, even this decline was observed only in the first half of FY17, as exports recorded recovered significantly in the second half on the back of heavy purchases from UAE and Qatar. It appears that Pakistani rice exporters have outpriced their counterparts in these markets.

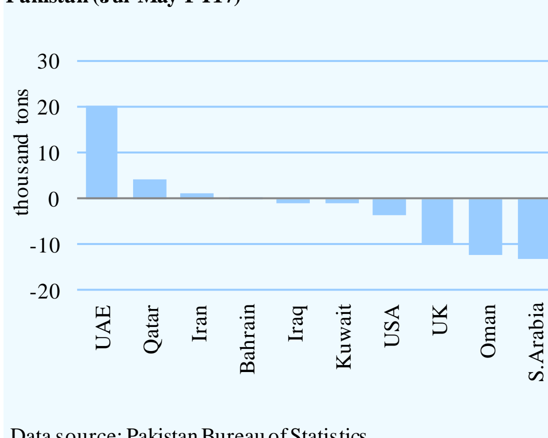
Here, a comparison of Pakistan's quantum rice exports with those of India offers some interesting insights. First, Middle Eastern economies seem to be evenly divided in sourcing the commodity from the two South Asian producers (**Figure 6.10a,b**). In the big Saudi Arabia market, Pakistan has been continuously losing its share to India. However, demand for Pakistani basmati seems to have risen from both the UAE and Iran during Jul-May FY17, likely at India's expense.

**Figure 6.10a: YoY change in Quantum of Basmati Exports by India (Jul-May-FY17)**




Data source: Agricultural and Processed Food Products Export Development Authority, India

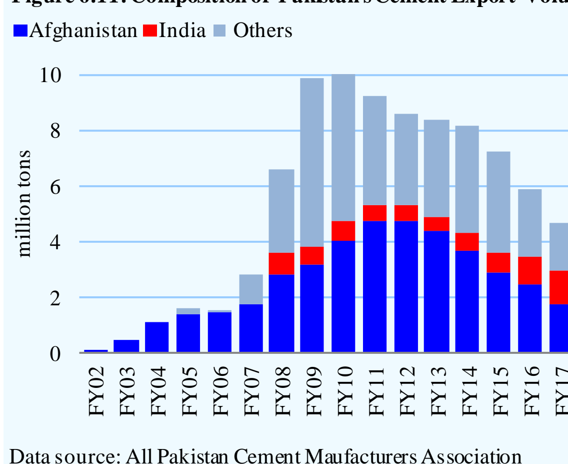
**Figure 6.10b: YoY change in Quantum of Basmati Exports by Pakistan (Jul-May-FY17)**




Data source: Pakistan Bureau of Statistics

Going forward, Pakistan might also be able to at least partially capture India's share in the EU market, as the bloc has banned Indian basmati over quality concerns, after imposing stricter rules on fungicide application.[45] Pakistan generally exports the 'super' variety of basmati rice to the EU, which is not prone to pest attacks. The fact that the EU's quantum rice imports are on the rise (up 2.0 percent in 2016), puts Pakistani rice exporters in a position to expand their reach in the bloc. Yet, doing so will only be possible if they invest more in researching new varieties and improving crop yields, and devote more time and resources to building their brand image, in order to better compete with their traditional competitors.

**Figure 6.11: Composition of Pakistan's Cement Export Volumes**



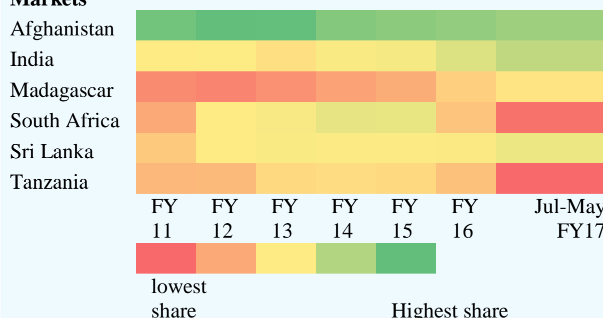

Data source: All Pakistan Cement Maufacturers Association

[45] EU has reduced the maximum residue limit (MRL) level for "Trizole", a fungicide used against blast pest on paddy, to 0.01 mg per kg from 0.03 mg per kg, effective from July 2017.

Among other key non-textile items, *seafood* exports rebounded strongly in FY17, growing 21.2 percent after declining for the last two years. This encouraging development can be traced to a rise in domestic fish production (up 3.8 percent YoY during Jul-Mar FY17). A phenomenal volumetric increase was visible in exports of crabs, shrimps and squids to China, Vietnam and Thailand.

With regards to cement, the downtrend that had set in from FY14 onwards, continued in FY17 as well (**Figure 6.11**). Exports to the top destination – Afghanistan – fell for the sixth straight year, whereas those to South Africa have become unviable since late 2015 due to imposition of anti-dumping duties.[46] In contrast, exports to India, which began in 2010, have grown by a strong 26.3 percent in FY17; India has now become the second-largest market for Pakistani cement exporters, with a 27 percent share in their total exports (**Figure 6.12**). In certain cities in the Indian Punjab (like Amritsar, Ludhiana, etc), Pakistani cement is relatively cheaper than the local manufactured one. This is because importing from plants located in Pakistan's northern region entails lower transportation cost compared to those in South India, where a third of Indian cement capacities are installed.

**Figure: 6.12: Share in Total Cement Export Volumes* - Major Markets**




*: Ranging from 1 to 60 percent, red color indicates lowest value and green represents highest value

Data source: Pakistan Bureau of Statistics

**Table 6.9:Textile Exports Price and Quantum Impact in FY17**

| | Quantum | Price | Abs. change (million US dollar) |
|---|---|---|---|
| **Textile group** | | | **4.0** |
| *of which* | | | |
| **Low value-added** | **-65.8** | **-74.4** | **-140.3** |
| Raw cotton | *-37.0* | *4* | *-33.1* |
| Cotton yarn | *96.3* | *-117.5* | *-21.2* |
| Cotton fabrics | *-115.7* | *38.3* | *-77.4* |
| **High value-added** | **134.5** | **49.2** | **183.6** |
| Knitwear | *-131.8* | *129.6* | *-2.2* |
| Bed wear | *161.0* | *-44.4* | *116.6* |
| Towels | *37.5* | *-40.5* | *-2.9* |
| Tarpaulin | *32.8* | *15.9* | *48.7* |
| Readymade garments | *167.8* | *-44.0* | *123.7* |
| Synthetic textiles | *-132.9* | *32.6* | *-100.3* |
| **Others** | | | **-39.3** |

Data source: Pakistan Bureau of Statistics

At the same time, given the ongoing public- and private sector-led activity in power, road development and real estate projects, local demand for cement is likely to stay strong.[47] Under these dynamics, it is hard to imagine a forceful push by many companies to expand their reach abroad, despite the fact that there are markets where demand for cement has been growing.[48]

*Recovery in EU demand supports textile exports*

After declining for the past couple of years, textile exports recovered from Q2-FY17 (**Table 6.9**). This was mainly a result of a sharp turnaround in the EU market of clothing and home textile products.[49] In terms of volumes, EU's overall clothing and textile imports have increased by 3.5

[46] Anti-dumping duty on different Pakistani cement manufacturers, ranging from 14 percent to 77 percent, was imposed by South Africa in December 2015; these will be in place for a period of five years.

[47] Domestic cement dispatches increased by 8.03 percent YoY in FY17 (source: All Pakistan Cement Manufacturer Association).

[48] According to the World Cement Report 2016-17, construction activity in Sri Lanka is expected to grow at an annual average of 8 percent over the next few years, driven by increasing homeownership, large government infrastructure projects and surging demand for high-rise buildings.

[49] The recovery in demand in the EU is not just reflected in its higher textile imports, but also its overall imports from the world. Specifically, the bloc's total imports grew by 4.2 percent in FY17, after declining by 8.8 percent last year (source: Eurostat). Vietnam, India, Bangladesh and Pakistan have all benefited from this rebound.

percent YoY in FY17. Encouragingly, the growth in EU's imports from Pakistan of both clothing and home textiles was the highest among Asian countries (**Table 6.10**).

**Table 6.10: EU Import of Clothing and Home Textiles from Major Countries**

growth and share in percent

| | Clothing | | | | | | Home textiles | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | FY16 | FY17 | FY16 | FY17 | FY16 | FY17 | FY16 | FY17 | FY16 | FY17 | FY16 | FY17 |
| | Quantum | | Value | | Share in value | | Quantum | | Value | | Share in value | |
| China | -10.7 | 1.7 | -10.2 | -6.3 | 35.4 | 33.9 | 1.5 | 6.7 | -2.2 | 0.1 | 41.3 | 41.0 |
| Bangladesh | 8.1 | 5.9 | 6.0 | 4.1 | 17.6 | 18.7 | 4.5 | 5.3 | -9.7 | 4.9 | 3.3 | 3.4 |
| India | -1.5 | 3.2 | -4.0 | -3.9 | 6.3 | 6.2 | 7.7 | 5.9 | -5.6 | 1.6 | 10.9 | 11.0 |
| Pakistan | 7.5 | 8.9 | 6.0 | 6.4 | 2.9 | 3.2 | 10.4 | 5.6 | 0.7 | 5.0 | 15.6 | 16.2 |
| Vietnam | 3.7 | 2.6 | 9.1 | 1.6 | 3.6 | 3.8 | 1.7 | 5.3 | -2.0 | 6.0 | 2.1 | 2.2 |
| Total | -1.5 | 2.8 | -2.8 | -2.1 | 100.0 | 100.0 | 3.0 | 5.2 | -2.2 | 1.0 | 100.0 | 100.0 |

Data source: Eurostat

*Share in US market declined*

In contrast to the EU, the US textiles market grew modestly. The US quantum imports of textile and apparel grew by only 0.7 percent in FY17, whereas its clothing purchases from abroad fell by 0.4 percent (**Figure 6.13a**). In case of clothing, all major suppliers (Bangladesh, China, India and Indonesia) saw their exports to the country decline.[50]

**Figure 6.13a: US Total Textile Import (Growth)**

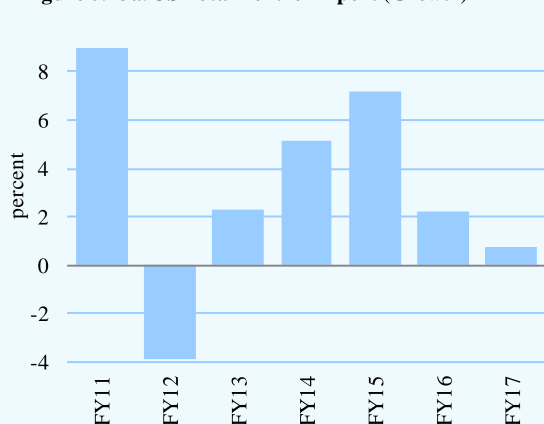



**Figure 6.13b: Share of Products in Total US Textile Import**

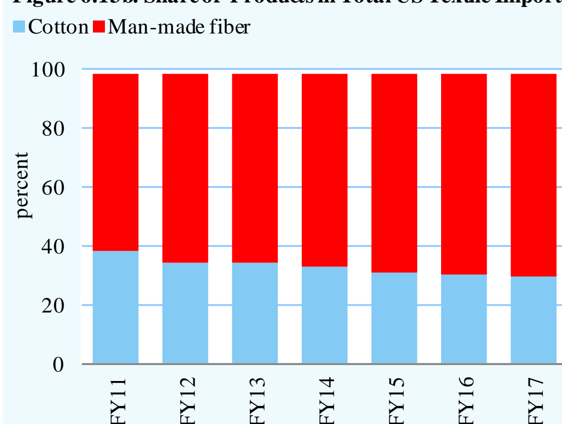



**Figure 6.13c: Share of Pakistan in Total US Textile Imports**

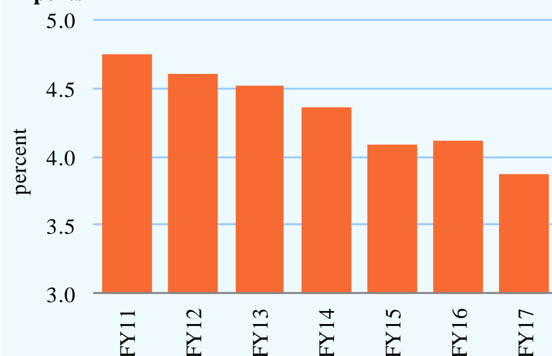
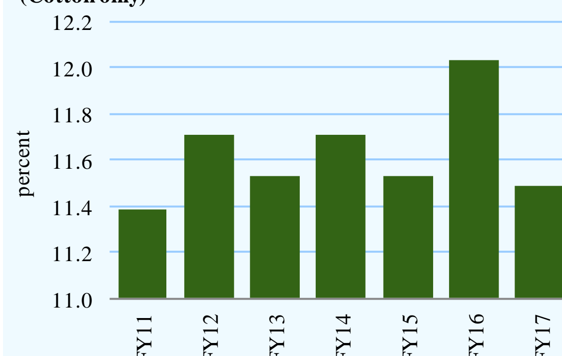



**Figure 6.13d: Share of Pakistan in US Textile Imports (Cotton only)**




Data source: Office of Textile and Apparel, USA

[50] Apparel exports of Bangladesh and China to the US fell 2.9 and 0.1 percent respectively during FY17, after rising 11.8 and 3.1 percent last year. A similar slowdown was noted by Indian and Indonesian exporters as well: apparel exports from these countries to the US grew by 1.0 and 0.01 percent respectively in FY17, compared to an increase of 4.2 and 2.5 percent recorded last year (source: OTEXA).

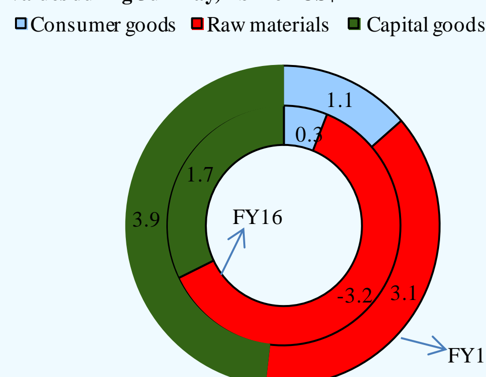
However, Vietnam was an exception, as it leveraged its relatively low-cost production of man-made fiber into producing synthetic garments that are in demand in the US; understandably, its share in the US' textile market has been growing as a result.[51] For some time now, US consumers have gradually been moving away from cotton-based items, which is why the share of cotton products in total US textiles has decreased from 40 percent in FY10 to 29.7 percent in FY17 (**Figure 6.13b**).

This changing behavior of US consumers has strongly impacted Pakistan's textile exports to the country, which are still excessively focused on cotton-based textile and apparel products. Consequently, Pakistan lost its share further in the US' textile market in FY17 (**Figure 6.13c,d**). The situation is compounded by the absence of a strong domestic polyester industry, with demand for man-made fibres by exporters being largely met by imports.

## Imports

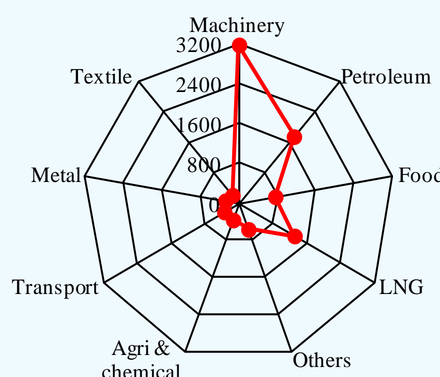
An overview of import composition suggests that over the past two years, a shift towards capital goods has been taking place. In fact, the share of capital goods in total imports has been growing continuously; whereas the share of raw materials for the production of capital goods has also increased during the last two years (**Figure 6.14**).

**Figure 6.14: Composition of Imports (YoY change in absolute values during Jul-May) - billion US$**




Data source: Pakistan Bureau of Statistics

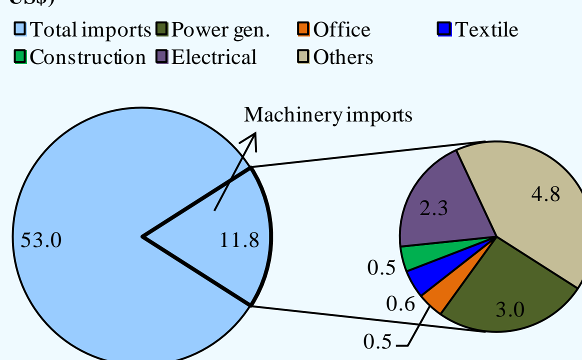
**Figure 6.15: Import Growth in FY17 (absolute changes - million US$)**




Data source: Pakistan Bureau of Statistics

Imports grew by 18.5 percent in FY17 and reached US$ 53.0 billion; in terms of GDP, it represents a three-year high (**Table 6.11**). The increase was most prominent in machinery and petroleum groups, and mainly reflected the impact of ongoing CPEC- and public sector-related activity in power and road construction; higher demand for petrol and HSD by the transportation sector, and of furnace oil by the power sector; and industrial expansions pursued by textile and cement industries (**Figure 6.15**). Some recovery in global commodity prices also contributed towards the import growth during the year.

**Figure 6.16: Machinery Imports Within Total Imports (billion US$)**




Data source: Pakistan Bureau of Statistics

[51] In case of Vietnam, the unit value of clothing was 3.2 US$/SME, in comparison with 3.4 US$/SME for the rest of the world in 2016. The share of Vietnam's exports in total US textiles imports has increased to 12.4 percent in 2016, compared to 9.0 percent in 2012 (source: Emerging textiles).

*Machinery imports*

Machinery imports continued their upward trajectory, growing 37.1 percent YoY in FY17 to US$ 11.8 billion; this compares with a growth of 15.6 percent registered last year. Most of the increase in FY17 was evident in power generating machinery and related items, in tandem with the progress on various power and infrastructure projects under CPEC and PSDP (**Figure 6.16**). Within power generating machinery, imports of gas and steam turbines, solar panels, compressors, and auxiliary plants were the strongest.[52] In addition, capacity expansions by cement manufacturers led to a significant increase in the import of grinding and crushing machinery during the year.[53]

**Table 6.11: Import Performance -Major Commodities**

million US dollars

| Items | FY16 | FY17 | Abs. change | Quantum impact | Price impact |
|---|---|---|---|---|---|
| Milk | 278.8 | 258.7 | -20.1 | 21.9 | -42.0 |
| Dry fruits | 171.9 | 180.5 | 8.6 | -2.7 | 11.3 |
| Tea | 513.0 | 523.9 | 10.8 | 65.1 | -54.3 |
| Spices | 147.3 | 138.6 | -8.7 | -24.4 | 15.7 |
| Soybean oil | 182.9 | 122.8 | -60.1 | -62.4 | 2.3 |
| Palm oil | 1,689.4 | 1,905.1 | 215.7 | -73.2 | 288.9 |
| Pulses | 595.1 | 952.3 | 357.1 | 221.0 | 136.0 |
| Machinery | 8,572.8 | 11,754.8 | 3,182 | n.a | n.a |
| Transport | 2,962.2 | 3,313.7 | 351.5 | n.a | n.a |
| POL products | 5,337.2 | 6,835.0 | 1,497.8.0 | 2,032.3 | -534.4 |
| Crude oil | 2,295.8 | 2,547.1 | 251.3 | 945.3 | -693.7 |
| LNG | 567.1 | 1,312.7 | 745.6 | n.a | n.a |
| Textile | 3,146.9 | 3,357.8 | 210.9 | n.a | n.a |
| Fertilizer | 726.4 | 640.6 | -85.7 | 103.5 | -293.5 |
| Plastic | 1,814.3 | 1,919.3 | 105.0 | 398.5 | -293.5 |
| Medicine | 921.5 | 975.3 | 53.8 | -31.8 | 85.6 |
| Steel | 3,093.2 | 3,238.2 | 145.1 | 204.9 | -59.9 |
| Rubber | 146.4 | 174.8 | 28.4 | 35.3 | -6.8 |
| Tyers &tubes | 313.9 | 350.8 | 36.9 | 113.7 | -76.7 |
| **Total imports** | **44,684.8** | **52,957.9** | **8,273.1** | - | - |

Data source: Pakistan Bureau of Statistics

*Demand-driven rise in transport, POL imports*

Transport imports increased by 11.8 percent in FY17, compared to a rise of 9.7 percent recorded last year. Imports of CKD/SKD for both motor cars and commercial vehicles (buses and trucks) remained strong, rising by 24.4 percent YoY.

The higher commercial vehicle imports correspond with power- and infrastructure development-related activities all over the country, which often require transporting imported machinery and other raw materials etc from the ports to the project sites.[54] In other transport equipment, the import of railway locomotives and their parts, railway track fixtures, and special equipped containers, also increased (**Table 6.12**).

[52] As per payments data, imports of gas turbines exceeding 5,000KW, the top item in the machinery group, increased by US$348 million during FY17. These turbines are widely used in gas-based electricity generation plants.

[53] According to latest available detailed PBS data, 21,148 units of grinding and crushing machinery for cement plants were imported during Jul-May FY17, against only 628 units purchased in the same period last year. China, Germany and the USA were the major exporting countries (**Chapter 2**).

[54] Sales of heavy vehicles (trucks and buses) increased from 5,550 and 1,017 units in FY16 to 7,499 and 1,130 units in FY17 (source: Pakistan Automobile Manufacturers Association). The higher sales of buses might reflect efforts to address pent-up demand for public transportation in the country.

As for passenger cars, the import demand was strengthened by: (i) the growing ride-hailing business in the country; (ii) the launch of new models; and (iii) a sharp increase in car financing by commercial banks. The increase was visible in both CBU and CKD imports.[55]

**Table 6.12: Composition of Transport Group Imports**

| million US dollars | FY15 | FY16 | FY17 |
|---|---|---|---|
| **Road motor vehicles** | **1,610.40** | **1,932.80** | ***2515.2*** |
| CBU | 406.7 | 546 | *751.3* |
| *Busses &trucks* | *129.8* | *217.4* | *316.2* |
| *Motor cars* | *275.1* | *325.6* | *431.5* |
| *Motor cycles* | *1.7* | *2.9* | *3.6* |
| CKD/SKD | 775.2 | 827.3 | *1004.3* |
| *Busses &trucks* | *201.6* | *214.4* | *252.3* |
| *Motor cars* | *483* | *519* | *659.9* |
| *Motor cycles* | *90.5* | *93.9* | *92.1* |
| Parts | 320.3 | 381 | *500.4* |
| Others | 108.2 | 178.5 | *259.3* |
| Aircrafts, ships and boats | 862.6 | 973.9 | *509.4* |
| Other transport equipment | 226.6 | 55.5 | *287.4* |
| **Transport group** | **2,699.70** | **2,962.20** | ***3312.1*** |

Data source: Pakistan Bureau of Statistics

*Growing energy requirements led to higher imports*

Petroleum imports rose 22.8 percent YoY in FY17, after declining consistently for the past four years. This increase mainly represents a sharp increase in thermal generation in the country, which led to higher demand for furnace oil and LNG (**Table 6.13**).[56] Notably, the use of coal also increased in thermal generation, which led to an increase in its imports.[57,58]

**Table 6.13: Pakistan's Quantum POL Imports**

| | Quantity (thousand million tonnes) | | | Growth (percent) | |
|---|---|---|---|---|---|
| | **FY15** | **FY16** | **FY17** | **FY16** | **FY17** |
| High speed diesel | 3,185 | 3,081 | 3,890 | -3.3 | 26.3 |
| Furnace oil | 6,170 | 5,990 | 6,612 | -2.9 | 10.4 |
| Crude oil | 8,254 | 8,492 | 8,708 | 2.9 | 2.5 |
| Petrol | 3,125 | 4,193 | 4,885 | 34.2 | 16.5 |
| Other | 49 | 118 | 119 | 141.8 | 0.8 |
| Total* | 20,782 | 21,874 | 24,214 | 5.3 | 10.7 |
| LNG ** | - | 989 | 3216 | - | 225.0 |

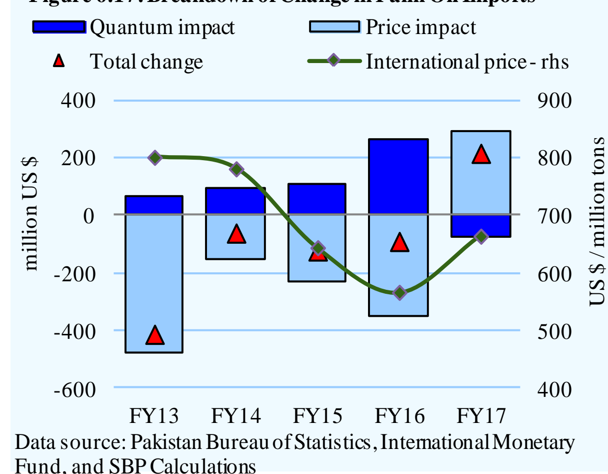
*Data sources: Oil Companies Advisory Council; ** For Jul-May (latest data available) Pakistan Bureau of Statistics

In case of LNG, the higher imports in FY17 reflected its increased usage in power, transportation (by its conversion into CNG), and certain industries (including power and fertiliser). For instance, four new power plants based on imported RLNG became operational during FY17 (**Chapter 2**). Better RLNG supplies to the fertilizer sector also helped optimize and smoothen the production process to meet the domestic demand for the raw material, which, in turn, contributed to an 11.8 percent decline in fertilizer imports in the year.

*Palm oil: Price impact is dominant*

Imports of palm oil, which has an over 30 percent share in overall food purchases from abroad, grew by12.8 percent YoY in FY17, after declining 8.0 percent, on average, in the past four years. This entire increase was an outcome of higher unit values, which reflected the strong recovery in global prices of the commodity; quantum palm oil imports declined during the year (**Figure 6.17**).[59]

**Figure 6.17: Breakdown of Change in Palm Oil Imports**




Data source: Pakistan Bureau of Statistics, International Monetary Fund, and SBP Calculations

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[55] According to latest available detailed custom's data, the import of cars less than 800CC (i.e. CBUs) increased from 15,267 units in Jul-May FY16 to 18,134 units in Jul-May FY17.

[56] Of the 5,936 GWh *increase* in power generation during FY17, 28 percent rise came from furnace oil (source: National Electric Power Regulatory Authority).

[57] According to detailed customs data, the import of coal increased from 4.3 million MT during Jul-May FY16 to 6.2 million MT in Jul-May FY17.

[58] Power generation from coal increased from just 105 GWh in FY16 to 1,013 GWh in FY 17 (source: National Electric Power Regulatory Authority).

[59] Average global palm oil prices were 17.2 percent higher in FY17 than last year. In contrast, average prices in FY16 were 12.0 percent lower than they were in FY15 (source: IMF).

However, international prices have somewhat stabilized after January 2017, on the back of comfortable supplies: in Indonesia, a major producer, the harvested area increased by 2.6 percent YoY in FY17, and the yield has also improved due to favourable weather conditions, according to the USDA. In addition, the demand for biodiesel has been dwindling in Indonesia as the government minimized the financial support for domestic use of biodiesel.