5 External Sector

5.1 Overview

Pakistan's balance of payments position remained under stress in H1-FY18, as the rise in imports overshadowed a healthy turnaround in FX receipts from exports and workers' remittances.[1] The current account deficit widened to US$ 7.9 billion in the period (from US$ 4.7 billion in H1-FY17), and could not be completely financed by the surplus in the financial account. As a result, SBP's liquid FX reserves fell by US$ 2.0 billion in the first half to US$ 14.1 billion by end-December 2017. The PKR also remained under pressure, depreciating by a cumulative 5.0 percent during the period (**Table 5.1**).

Table 5.1: Summary of Pakistan's External Sector

million US$

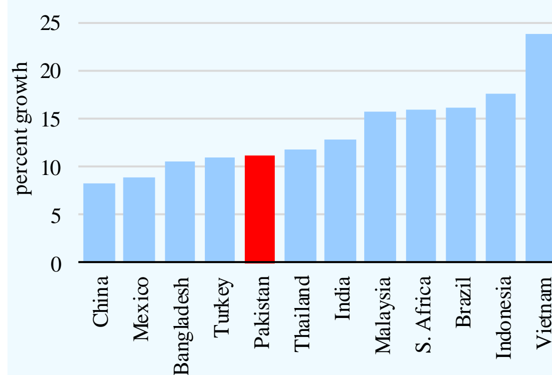
	Q2		***Change in Q2***		**H1**		***Change in H1***	
	FY17	**FY18**	**FY17**	**FY18**	**FY17**	**FY18**	**FY17**	**FY18**
Current account balance	-3,023	-4,374	-1,108	-1,351	-4,660	-7,920	-2,164	-3,260
Trade balance	-6,077	-7,371	-1,035	-1,294	-11,342	-14,643	-1,543	-3,301
Exports	5,577	6,131	112	554	10,629	11,795	-154	1,166
			(2.1)	*(9.9)*			*(-1.4)*	*(11.0)*
Imports	11,654	13,502	1,147	1,848	21,971	26,438	1,389	4,467
			(10.9)	*(15.9)*			*(6.7)*	*(20.3)*
Oil imports	2,649	3,385	578	737	4,998	6,330	214	1,332
Non-oil imports	9,005	10,117	569	1,112	16,973	20,108	1,175	3,134
Services balance	-1,099	-1,405	-36	-306	-2,256	-2,672	-815	-416
Primary income balance	-1,426	-1,489	185	-63	-2,418	-2,511	342	-93
Secondary income balance	5,579	5,891	-222	312	11,356	11,906	-148	550
Worker's remittances	4,765	4,955	43	190	9,505	9,746	-183	241
Financial account balance	-2,798	-4,730	-453	-1,932	-4,730	-6,364	-710	-1,634
FDI in Pakistan	998	795	259	-203	1,421	1,496	174	75
FPI in Pakistan	625	2,446	796	1,821	743	2,320	523	1,577
Eurobond/Sukuk	1,000	2,500	1,000	1,500	1,000	2,500	500	1,500
FX loans (net)	1,668	1,962	-966	294	2,880	2,575	-617	-305
IMF	0	0	-500	0	102	0	-1029	-102
SBP's liquid FX reserves	18,272	14,107	-220	250	18,272	14,107	129	-2,038
Exchange rate (PKR/USD)*	104.6	110.4	0.02	-4.54	104.6	110.4	0.2	-5.0

*(+)ve change shows appreciation, while (-)ve change reflects depreciation in percentage terms.
Figures in parenthesis represent growth rates.
Data source: State Bank of Pakistan

[1] Though the growth in imports is slowing down on a quarterly basis, the absolute increase in the import bill is the key driver of the current account deficit.

The country's exports posted a double-digit growth for the first time since the second half of FY11 (**Table 5.1**). A number of factors contributed to this trend reversal. The recovery in advanced economies from the latter half of 2017, with the US experiencing one of the fastest quarterly growth rates in the last three years, boosted demand for products exported by emerging economies, including Pakistan (**Figure 5.1**). Besides, the OECD economies also witnessed higher GDP growth in the third quarter of 2017. Furthermore, the recovery in global commodity prices pushed up export prices of non-basmati rice, manufactured products such as cotton yarn, hosiery, bedwear, readymade garments, and leather, and of petroleum products.

Figure 5.1: Export Performance of Developing Economies (Jul-Dec FY18)



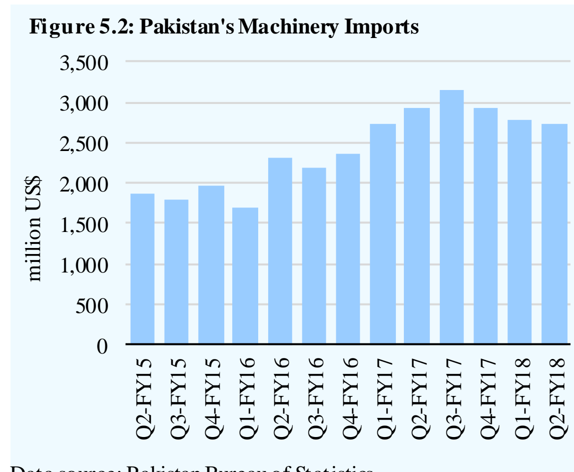
Data source: Haver

Second, the incentives announced by the government in FY17 for promoting exports may start giving results.[2] Under the Prime Minister's package announced for exporters in FY17, the government allowed duty drawback of up to 7.0 percent on the export of garments, home textiles, processed fabric, *greige* fabric and yarn manufacturing meant for export. The government also announced exemptions for the textile industry on the import of raw material (customs duty), and textile machinery (sales tax). In the presence of GSP Plus status, these incentives may have catalyzed the exports in H1-FY18, specifically to the European market.

However, as mentioned earlier, the import of goods and services continued to remain at an elevated level in absolute terms in H1-FY18. This time, the recovery in global commodity prices, specifically oil, mainly contributed to the payment burden. Almost 56.0 percent of the increase in the import of POL products in H1-FY18 came due to higher prices, with the rest of the increase driven by higher consumption, augmented by increased economic activity in the domestic economy.

[2] Last year, the government announced exemption from sales tax on the purchase of raw materials for five major export-oriented sectors: textiles, leather, sports goods, surgical goods and carpets.

Besides POL, increased demand for motorcars, palm oil, pesticides, chemicals, plastic materials, and iron and steel scrap contributed to the surge in non-oil imports. At the same time, it seems that the CPEC related projects are progressing to advanced stage, as suggested by the slowdown in machinery imports (**Figure 5.2**).



Data source: Pakistan Bureau of Statistics

Meanwhile, a welcome rebound was noted in workers' remittances during the period. Higher inflows from western economies, specifically the UK and the US, offset declining inflows from Saudi Arabia (KSA) - Pakistan's largest remittance corridor. As policies in the KSA are becoming more stringent for foreign workers, a further slowdown in inflows from KSA cannot be ruled out, at least in the short term (**Box 5.1**).

In the financial account, overall FDI went up slightly, driven mostly by significant Chinese investment under CPEC. Meanwhile, the participation of foreign investors in the domestic equity market also remained subdued, mainly due to prevailing expectations of a PKR depreciation through most of H1-FY18. Nonetheless, Pakistan was able to tap the international capital market and floated a Eurobond worth US$ 1.5 billion and a Sukuk worth US$ 1.0 billion in December 2017 at favorable rates.

The sovereign debt issuance, along with other official borrowings (from commercial, bilateral and multilateral sources) helped slow down the decline in official FX reserves, *albeit* partially, to US$ 2.0 billion in H1-FY18. Due to strong pressure on reserves, PKR depreciated by 4.4 percent against the USD in December 2017. Though this depreciation might help FX receipts from exports and foreign equity investors, other structural bottlenecks, such as high cost of doing business and higher export concentration towards the textile sector, need to be addressed. Promoting Pakistan's business friendly image at the global level will be key in this context.

5.2 Current account

The current account deficit rose by almost 1.7 times on YoY basis to US$ 7.9 billion in H1-FY18. In addition to a sharp increase in the trade deficit, higher profit repatriation by multinational companies operating in Pakistan, dented the growth in worker remittances and contributed to the rising current account gap.

Workers' Remittances

After declining last year, worker remittances rose by 2.5 percent and reached US$ 9.7 billion during H1-FY18 (**Table 5.2**). The increase in inflows was more pronounced in Q2-FY18 with a growth of 4.0 percent.

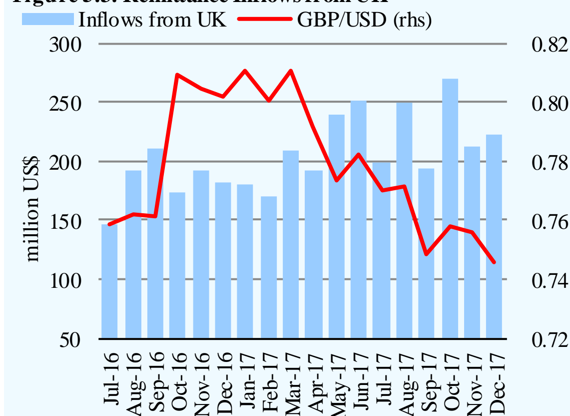
Table 5.2: Workers' Remittance Flows to Pakistan (million US$)

	FY17			FY18			% share in H1		Growth in
	Q1	Q2	H1	Q1	Q2	H1	FY17	FY18	H1-FY18
Total	**4,740**	**4,765**	**9,505**	**4,790**	**4,955**	**9,745**	**100**	**100**	**2.5**
GCC	2,975	3,052	6,027	2,869	2,951	5,820	63	60	-3.4
Saudi Arabia	1,324	1,411	2,735	1,228	1,303	2,531	29	26	-7.5
UAE	1,076	1,061	2,137	1,078	1,083	2,161	22	22	1.1
Other GCC	576	580	1,156	563	565	1,129	12	12	-2.3
UK	550	548	1,098	643	707	1,350	12	14	23.0
USA	613	559	1,172	626	655	1,281	12	13	9.3
Other countries	603	605	1,208	652	642	1,294	13	13	7.1

Data source: State Bank of Pakistan

The shares of both the US and the UK in remittances to Pakistan have increased this year. Healthy economic activity in the US and low unemployment have likely supported the growth in inflows from this corridor (**Figure 5.3**). Furthermore, a sharp depreciation of the US Dollar against the British Pound inflated the dollar value of the remittances originating from the UK.

Figure 5.3: Remittance Inflows from UK



Data source: State Bank of Pakistan

On the contrary, the share of Saudi Arabia in total inflows in H1-FY18 declined from last year; this trend is expected to continue going forward as well due to a tough regulatory climate for migrant workers in the kingdom (**Box 5.1**).

Box 5.1. Recent Important Changes in Employment and Residency Policies in Saudi Arabia

Saudi Arabia has introduced a number of economic reforms to cope with the low oil price environment. These reforms have the potential to bring important change in remittances to Pakistan, at least in the short run. The most important is the job nationalization drive, which aims to replace expatriate workers with Saudi citizens.

The key measures under job nationalization program are as follows.

- From July 2017, the Saudi government imposed a new tax of SAR 100 per dependent per month on expatriates and their dependents. This tax is expected to increase gradually every year until 2020. The tax amount has doubled to SAR 200 from January 2018, and will increase to SAR 300 in 2019 and to SAR 400 by 2020.

- From January 2018, the tax rate of SAR 200 per foreign employee per month has been increased to SAR 300 on private companies, hiring equal number of expatriates and Saudi workers. This rate will increase to SAR 500 per employee per month in 2019 and to SAR 700 in 2020.

- Companies employing more foreign workers than Saudi nationals are required to pay SAR 400 per employee per month in 2018. This tax is expected to increase to SAR 600 in 2019 and SAR 800 in 2020. Generally, the additional tax for hiring more foreign workers used to be waived in the past. However, no waiver is allowed under the new tax regime.

- Saudi Arabia, along with the United Arab Emirates, has introduced Value Added Tax (VAT) at the rate of 5.0 percent from January 2018. The VAT has been imposed on most wholesale and retail sales, including on food consumed at restaurants. This tax is likely to increase the cost of living for unskilled lower income foreigners in KSA and UAE. Saudi Arabia generally hires semi-skilled or unskilled labor from Pakistan. The VAT, being regressive in nature, is expected to affect the savings of the unskilled labor force, which will force them to send lower amounts back home.

- Lastly, the Saudi government has removed the driving ban for women from September 26, 2017. From Pakistan's perspective, this step will have repercussions, as the demand for foreign drivers is likely to decrease, going forward.

Though the taxes discussed above affect all expatriates equally, the imposition of levy on dependents and higher taxes on the companies employing foreign workers will affect the skilled and high skilled workers the most; these are the jobs for which Saudi citizens prefer competing with foreigners. Therefore, a large number of people with 'white collar' jobs will be forced to either send their families back home or quit their jobs permanently and return to Pakistan. Not surprisingly, remittances inflows from Saudi Arabia declined by 7.5 percent in H1-FY18.

This decline in inflow may become stronger going forward, after the imposition of VAT from January 01, 2018 in both KSA and UAE.

Yet, inflows are expected to recover from other GCC countries, particularly Qatar, Bahrain and Oman. These GCC members have publicly announced a temporary deferment of the VAT.

Moreover, recent policy initiatives undertaken in Pakistan, in the form of the Asaan Remittance Account and the promotion of home remittances through m-wallets, may boost remittances in the future **(Box 5.2)**.

Box 5.2. Pakistan's Initiatives to Promote Home Remittances through Banking Channels
Pakistan launched two major schemes in December 2017. SBP, in collaboration with the Pakistan Remittance Initiative (PRI), launched the Asaan Remittance Account. Meanwhile the government, in cooperation with SBP and the financial industry, launched a scheme for promotion of remittances through m-wallets.

The key feature of the 'Asaan Remittance Account' is that it can be opened in any scheduled bank through a simplified procedure. Similar to the 'Asaan Account' launched by SBP in 2015, the one-page account opening form for the 'Asaan Remittance Account' asks for basic customer information only. The customer due diligence and other controls specified for 'Asaan Account' are applicable on the opening of the Asaan Remittance Account as well. This initiative aims to encourage beneficiaries to receive remittances in a secured banking environment instead of over-the-counter cash they receive through traditional sources.

The key feature of the m-wallet scheme is that the beneficiaries will be able to withdraw cash from ATMs, bank branches or from hundreds of thousands of branchless banking agents. Moreover, they will be able to make digital payments, for example pay utility bills, by using their m-wallets. This initiative aims to increase financial inclusion in the country, besides enhancing the pace and reducing the cost of remittance delivery.

The above two schemes are expected to improve the inflow of worker remittances, besides promoting financial inclusion, particularly in far-flung areas with limited financial infrastructure.

5.3 Financial account

The surplus in the financial account rose to US$ 6.6 billion in H1-FY18 from US$ 4.7 billion in H1-FY17. This improvement can mainly be traced to the floatation of Sukuk and Eurobond worth US$ 2.5 billion in December 2017; these issuances significantly boosted FPI inflows during the period. FDI also registered a marginal increase in the first half of the year.

Foreign direct investment

Net FDI rose by 5.3 percent in H1-FY18 over last year, despite a substantial increase in inflows from China (**Table 5.3**). FDI from China mainly arrived in the power and construction sectors.

China's share in the country's net FDI more than doubled from 28.0 percent in H1-FY17 to 71.8 percent this year. In particular, Q2-FY18 witnessed the second highest quarterly inflows of US$ 536.0 million that Pakistan has received from China, after US$ 724.7 million received in Q4-FY14 (**Figure 5.4**).

Besides power and construction, firms in exploration and production (E&P) and financial sector also attracted FDI, though their quantums remained relatively moderate.

Table 5.3: Sector-wise Net FDI in Pakistan
(million US$)

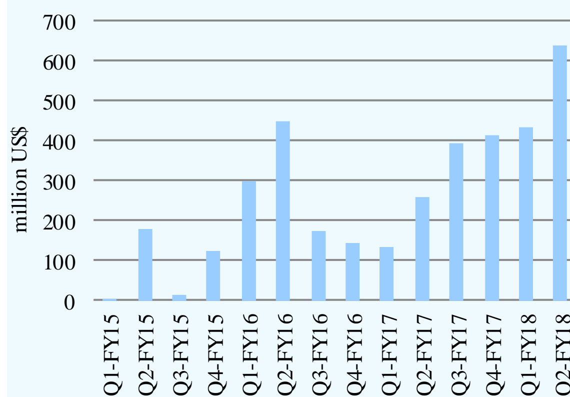
	FY17		FY18		H1		Change in
	Q1	Q2	Q1	Q2	FY17	FY18	H1-FY18
Total	**423.4**	**998.1**	**699.9**	**794.6**	**1,421.5**	**1,494.4**	**72.9**
Construction	31.4	52.4	123.6	226.1	83.8	349.7	265.9
Power	121.3	217.9	239.6	382.0	339.2	621.6	282.4
Financial business	60.1	53.8	121.5	67.5	113.9	189.0	75.1
Telecommunications	4.5	-56.1	55.8	-84.9	-51.6	-29.1	22.5
Oil & gas explorations	34.9	45.5	53.3	54.5	80.4	107.8	27.5
Electronics	4.4	134.4	6.2	8.7	138.8	14.9	-124
Food	10.3	488.9	4.0	16.4	499.2	20.4	-478.9
Others	156.6	61.2	95.7	124.3	217.8	211.6	-6.2

Data source: State Bank of Pakistan

Nonetheless, the stagnation in FDI calls for a more concerted policy effort. Though improved power supply and law and order situation have provided some comfort to the business community, a lot remains to be done to advance the business friendly image of Pakistan among foreign investors.[3]

Foreign portfolio investment
Official flows continued to dominate foreign portfolio investment in H1-FY18. Inflows of US$ 1.0 billion via Sukuk and US$ 1.5 billion via Eurobond were realized in the second quarter. These inflows not only offset outflow of foreign funds from the domestic equity market, but also helped the government retire some of its external commercial

Figure 5.4: Net FDI Inflows from China

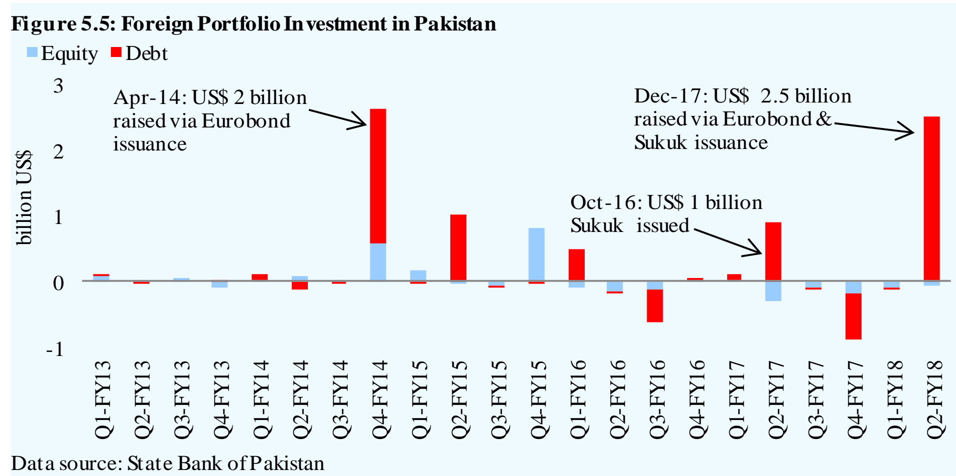


Data source: State Bank of Pakistan

[3] In the World Bank's Doing Business 2018 ranking of 190 economies, Pakistan stood at 147th position, only above Bangladesh (177) and Afghanistan (183) among regional peers. Regional countries such as Bhutan (75), India (100), Nepal (105), Maldives (136), and Sri Lanka (111) all fared better than Pakistan.

borrowings (**Figure 5.5**).

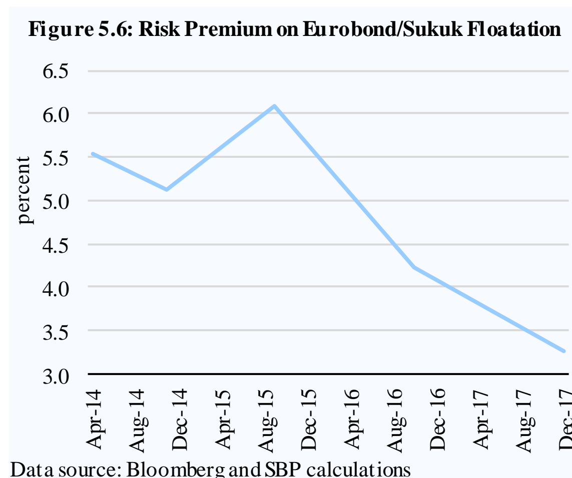
Figure 5.5: Foreign Portfolio Investment in Pakistan



Data source: State Bank of Pakistan

More importantly, the risk premium attached by investors on the 10-year Sukuk bond dipped to a recent low of 3.3 percent from a high of 6.1 percent asked by investors for the Eurobond issued in September 2015 (**Figure 5.6**).[4] This shows that foreign investors were highly confident about the performance of Pakistan's economy.

Figure 5.6: Risk Premium on Eurobond/Sukuk Floatation



Data source: Bloomberg and SBP calculations

As for private flows, the downward trend witnessed in some of the Asian equity markets during Q2-FY17 was reversed in Q2-FY18, as foreign selling pressure in anticipation of Fed rate hike and uncertainty over the new US administration eased **(Table 5.4).** However, neither China nor Pakistan benefitted from this trend reversal in portfolio inflows.

[4] Risk premium is the difference between the market yield on the 10-year Eurobond/Sukuk on the date of floatation and the monthly average of 10-year US Treasury rates. Where the 10-year bond is unavailable, the risk premium is calculated using the 5-year paper. Information of 10-year Sukuk is used for calculating the December 2017 risk premium.

Specifically in China, where Shanghai Composite Index (SCI) tumbled by over 3.0 percent during the second half of November 2017, the outflow was triggered by the structural reforms undertaken by the Chinese government to deleverage its state enterprises.

Table 5.4: Performance of Major Asian Equity Markets
(growth in percent)

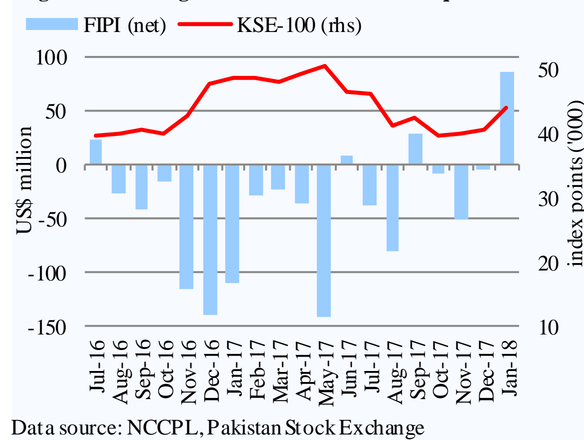
	FY17				FY18	
	Q1	Q2	Q3	Q4	Q1	Q2
India	5.1	-5.4	13.2	3.8	3.2	8.4
Indonesia	6.9	-1.3	5.1	4.7	1.2	7.7
Thailand	2.6	4.0	2.1	0.0	6.2	4.8
Pakistan	5.0	19.0	-2.3	-5.6	-8.6	2.9
Malaysia	-0.1	-0.7	6.0	1.4	-0.5	2.3
China	2.6	3.3	3.8	-0.9	4.9	-1.2

Data source: Bloomberg

By contrast, in Pakistan, active participation by local investors brought a revival in PSX performance, which after declining since Q3-FY17, posted 2.9 percent YoY growth in Q2-FY18 **(Table 5.4)**.

More recently in January 2018, foreigners purchased US$ 86 million worth of Pakistani stocks, reversing a prolonged spell of either equity sell-off or tepid foreign buying **(Figure 5.7)**.

Figure 5.7: Foreign Investment in Pakistani Equities



Data source: NCCPL, Pakistan Stock Exchange

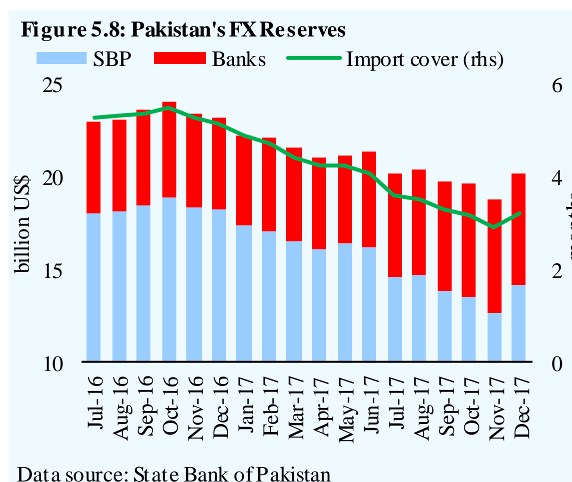
Besides attractive valuation, two factors explain this recent surge in portfolio inflows. First, the successful raising of US$ 2.5 billion through the international capital market at relatively low risk premium showed the confidence of foreign fixed income investors on Pakistan's growth prospects; this may have inspired equity investors to follow the trail. Second, market information confirms that foreign funds were holding back in anticipation of a PKR depreciation, ever since the short-lived adjustment in the PKR-USD parity in July 2017, and the continually widening current account deficit. When the PKR–USD parity finally adjusted in December 2017, foreign portfolio investors gained some comfort and re-entered the Pakistani equity market.

5.4 Reserves and Exchange Rate

The higher current account deficit amid insufficient financial inflows meant that the payments gap had to be met by reserve drawdown: SBP's liquid FX reserves

fell by US$ 2.0 billion in H1-FY18. The drop was sharper in the first five months of FY18, when official reserves decreased by US$ 3.5 billion (**Figure 5.8**). The issuance of US$ 2.5 billion worth of Eurobond and Sukuk partially slowed this drawdown, with SBP's reserves ending December 2017 at US$ 14.1 billion.

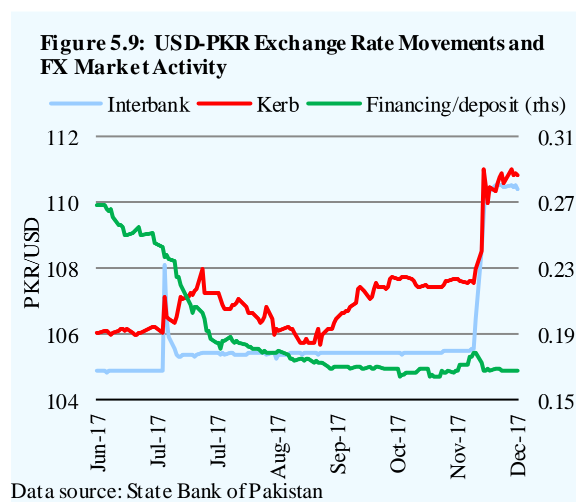
Figure 5.8: Pakistan's FX Reserves



Data source: State Bank of Pakistan

Contrary to the pressure on SBP's reserves, the commercial banks' reserves in H1-FY18 increased by US$ 812.1 million. Anecdotal evidence suggests that retail investors and the general public, in anticipation of a PKR depreciation, purchased dollars from the kerb market and deposited them in foreign currency accounts.

Figure 5.9: USD-PKR Exchange Rate Movements and FX Market Activity



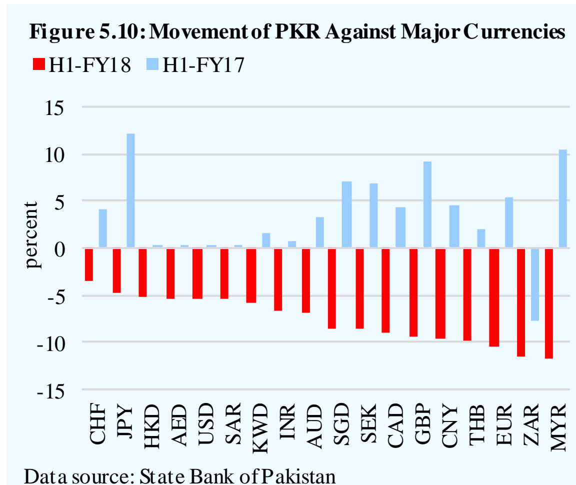
Data source: State Bank of Pakistan

The deposits under these accounts grew by 4.9 percent in H1-FY18.[5] Moreover, FE-25 financing declined by 26.0 percent during July-November 2017, indicating that private businesses stayed away from FX borrowing to avoid exchange rate risk. Consequently, the FE-25 financing to deposit ratio declined sharply by 30.2 percent (**Figure 5.9**).

[5] FE-25 deposits increased by 6.0 percent between July and November, 2017.

Nevertheless, following the PKR's 4.4 percent depreciation against the US Dollar in December 2017, market expectations of a further currency adjustment dissipated; as a result, the kerb premium almost disappeared by end-2017 **(Figure 5.9).** Notably, the PKR depreciation came at a time when most currencies of developed and developing economies were strengthening against the US Dollar **(Figure 5.10)**.

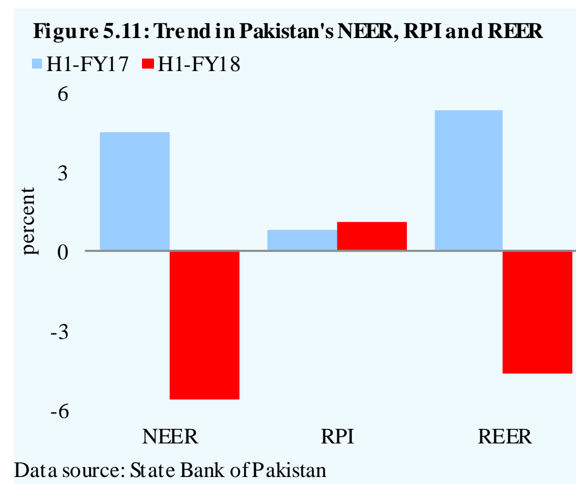
Figure 5.10: Movement of PKR Against Major Currencies



Data source: State Bank of Pakistan

Meanwhile, in line with the significant depreciation against most important currencies, Pakistan's nominal effective exchange rate (NEER) depreciated by 5.7 percent during H1-FY18. The real effective exchange rate (REER), on the other hand, depreciated by 4.6 percent, driven mainly by NEER; this suggests that the Rupee's competitiveness in real terms *viz-a-viz* currencies of other trading partners has improved **(Figure 5.11)**.

Figure 5.11: Trend in Pakistan's NEER, RPI and REER



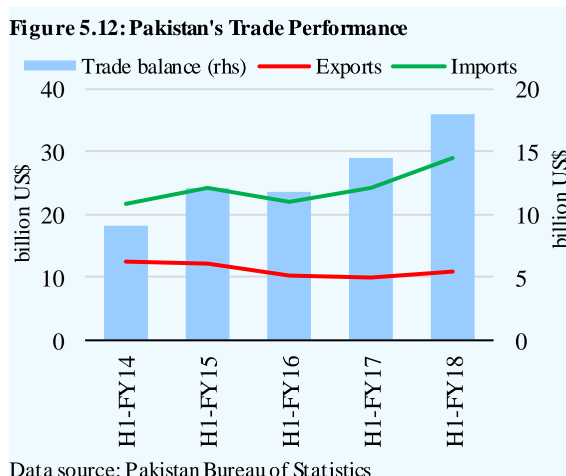
Data source: State Bank of Pakistan

5.5 Trade Account[6]

The trade deficit widened by 23.0 percent YoY to US$ 17.7 billion in H1-FY18. A strong recovery in exports was not sufficient to offset the rise in imports, which increased to US$ 28.7 billion **(Figure 5.12)**. The uptick in exports, which started in Q4-FY17, gathered steam on the back of strong performances by textiles, rice

[6] The analysis is based on the provisional data provided by Pakistan Bureau of Statistics. This data may not tally with the exchange record numbers reported in the section on *Balance of Payments*. To understand the difference between these two data series, please see Annexure on data explanatory notes.

and manufactured items. On the other hand, recovering global oil prices and burgeoning domestic demand in the transport sector played a key part in pushing up imports in H1-FY18.



5.5.1 Exports

Pakistan's exports staged a comeback with a growth of 11.0 percent in H1-FY18. The recovery was broad-based, with textiles (up 8.1 percent), food (17.0 percent), and manufactured items (11.3 percent) figuring prominently (**Figure 5.12**). The rising exports suggest that the easing of some structural barriers, such as energy supply and security situation, have finally started to benefit key exporting industries.

On the demand side, a synchronized upswing in the global economy is translating into consistently strong demand from traditional western markets. Pakistani exports, particularly of rice, made significant inroads into new markets in the OECD countries.

Textile

Textile exports rose 8.1 percent to US$ 6.6 billion in H1-FY18, and accounted for 60.5 percent of overall exports during the period **(Table 5.5)**. Globally, higher commodity prices along with robust demand from the EU and the US are sustaining the growth momentum, which started from Q3-FY17. Specifically in the presence of the GSP Plus status and the depreciation of US Dollar (and PKR) against the Euro provided much needed impetus to Pakistan's exports to the EU market.

Supplementing favorable demand-side conditions, the recent heavy import of machinery by the textile industry, availability of cheap credit, disbursement of sales tax refunds, and broadening of the scope of the export package announced in FY17, all contributed to higher textile exports in the period.

Table 5.5:Export of Major Items during Jul-Dec
(Values in million US$; growth in percent)

		Quantum			Values		
	Units	FY17	FY18	YoY growth	FY17	FY18	YoY growth
Food group		**-**	**-**	**-**	**1,653.7**	**1,934.4**	**17.0**
Rice	000 MT	1,660.0	1,796.5	8.2	712.8	849.7	19.2
a) Basmati	000 MT	190.3	183.4	-3.6	177.1	195.1	10.2
b) Others	000 MT	1,469.7	1,613.1	9.8	535.7	654.6	22.2
Fish and fish prep.	000 MT	66.9	79.5	18.8	183.5	200.6	9.3
Fruits	000 MT	295.5	220.9	-25.2	198.1	180.5	-8.9
Meat and meat prep.	000 MT	30.3	26.9	-11.2	104.4	147.4	41.2
Textile group		**-**	**-**	-	**6,146.6**	**6,642.5**	**8.1**
Raw cotton	000 MT	20.9	32.2	54.1	35.9	53.3	48.5
Cotton yarn	000 MT	230.9	256.2	10.9	657.2	661.5	0.7
Cotton fabrics	M SQM	1,006.1	1,015.8	1.0	1,067	1,066.9	0.0
Hosiery (knitwear)	000 DZ	51,163.0	52,908.0	3.4	1,177.6	1,334.8	13.3
Bedwear	000 MT	178.1	185.5	4.2	1,058.5	1,124.4	6.2
Towels	000 MT	91.1	101.1	10.9	380	385.6	1.5
Readymade garments	000 DZ	16,589	18,776.0	13.2	1,100.1	1,249.5	13.6
Synthetic textiles	M SQM	65.1	143.1	119.6	83.5	148.0	77.4
Petroleum group		**-**	**-**	-	**89.3**	**163.6**	**83.1**
Solid fuel incl. naphtha	000 MT	46.6	58.8	26.1	15.6	23.3	48.9
Other manufactures		**-**	**-**	-	**1,529.1**	**1,701.4**	**11.3**
Leather manufactures		**-**	**-**	-	260.5	265.3	1.8
Foot wear	000 pair	4,682.0	4,473.0	-4.5	46.9	50.0	6.7
Pharmaceuticals	000 MT	5.5	5.3	-2.6	109.4	103.0	-5.8
Electric fans	000 No.	535.0	452.0	-15.5	10.2	9.5	-7.6
Cement	000 MT	2,802.4	2,360.4	-15.8	145.6	118.6	-18.6
Others		**-**	**-**	-	**475.6**	**539.3**	**13.4**
Total exports		**-**	**-**	**-**	**9,894.4**	**10,981.2**	**11.0**

Data source: Pakistan Bureau of Statistics

Specifically, in December 2017, the government extended the purview of the export package unveiled earlier by announcing an additional 2.0 percent duty drawback on exports to non-traditional markets. Moreover, the reimbursement of 50.0 percent of the duty drawback amount under the export package scheme was exempted for exporters demonstrating an increase in their foreign sales. The remaining 50.0 percent reimbursement was allowed upon posting an increase of

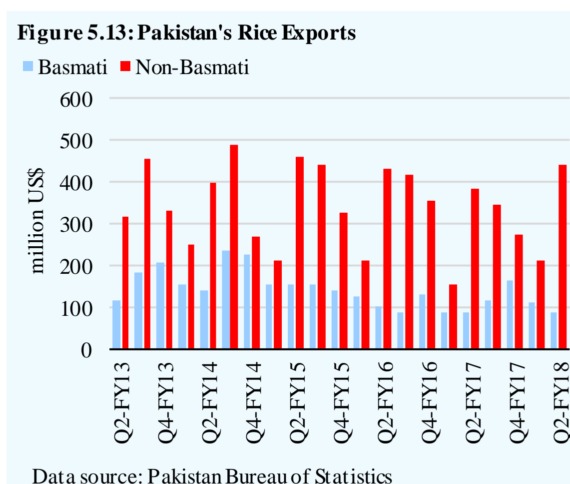
more than 10.0 percent.[7]

Resultantly in H1-FY18, textile exports benefitted from both increased prices and higher quantum sales. Among different segments, the surge in quantum exports of cotton yarn and readymade garments was particularly impressive. Significant increases were also observed in quantum exports in the case of bed wear, knitwear and raw cotton items. On the other hand, the price effect was more dominant in knitwear. (**Table 5.5**).

Rice

Among food items, non-basmati rice exports recovered from a disappointing performance last year, and grew by 21.7 percent in H1-FY18 (**Figure 5.13**). This can be attributed to a variety of factors, specifically efforts of rice exporters to adopt enhanced processing quality techniques, better marketing strategies (to increase their share in existing markets), and exploring new markets. Consequently, Pakistan's rice exports to the Middle East, Australia, Canada and Europe increased significantly.

Figure 5.13: Pakistan's Rice Exports



Data source: Pakistan Bureau of Statistics

A notable push to non-basmati rice exports came from Bangladesh. Pakistan's exports to the South Asian neighbor in H1-FY18 increased nearly ten-fold and crossed US$ 5.0 million. The demand from Bangladesh is likely to stay strong as the country is reeling from floods that damaged local crops, and led domestic prices to reach a record high.[8] Meanwhile, Pakistan's export of basmati rice increased by 10.2 percent.

H1-FY18 also saw a healthy growth in the export of chemicals and pharmaceutical, 'medical & surgical instruments' and cutlery items. Moreover,

[7] Notification No. 1(42-A)TID/17-TR-II, Ministry of Textile & Commerce (Textile Division), Islamabad.

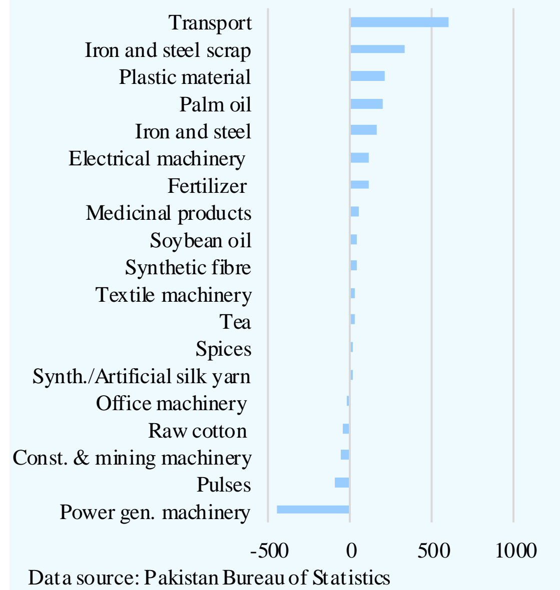
[8] According to FAO, Bangladesh's rice imports jumped from 0.1 million tonnes in 2016 to 2 million tonnes in 2017. Moreover, in November 2017, the government announced purchase of 300000 tonnes of rice, at USD 464 per tonne, up from USD 393 per tonne offered a year earlier.

keeping in view the sugar surplus in the country, the government lifted the export ban and announced a subsidy; this led to sugar exports of nearly half a million tonnes (leading to FX earning of US$ 118.5 million).[9]

5.5.2 Imports

Imports surged by 18.1 percent to reach US$ 28.7 billion in Jul-Dec FY17. Transport group recorded the highest increase of 43.0 percent, followed by petroleum, metal and food groups, whose imports rose by 33.4 percent, 30.9 percent and 13.2 percent, respectively. Machinery imports reversed their recent rising trend and recorded a YoY decline of 2.9 percent in H1-FY18 (**Figure 5.14**).

Figure 5.14: Major Non-oil Imports during Jul-Dec FY18
(Absolute YoY change in million US$)



Data source: Pakistan Bureau of Statistics

<u>Transport</u>

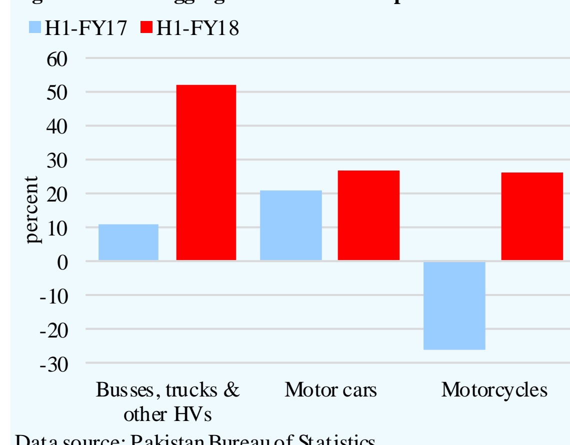
Transport imports increased by 43.0 percent in H1-FY18, compared to a rise of 6.2 percent recorded in the same period last year. Import of parts and accessories for local assembly of commercial and private vehicles (CKD/SKD) remained strong. Within this, the import of 'buses, trucks & other heavy vehicles' rose by 39.5 percent, and motor cars and motor cycles increased by 27.0 and 26.0 percent, respectively.

The significant growth in the import of auto parts corresponded with strong sales of locally assembled vehicles **(Chapter 2).** Besides, surging imports of these items points to carmakers' expectations of sustained high demand going forward, as the industry tends to import kits and accessories on the basis of advance booking orders.

[9]The Economic Coordination Committee (ECC) allowed the export of 1.5 million tonnes of sugar with a subsidy of Rs 10.70 per kilogram in late November 2017.

Within Completely Built Units (CBU), motor car imports increased by 64.1 percent on YoY basis to US$ 275.8 million during Jul-Dec 2017 (**Figure 5.15**). Passenger vehicles, including motor cycles, are witnessing a burgeoning demand due to growing ride-hailing business in the country and a sharp rise in auto financing by commercial banks (**Chapter 3**).

Figure 5.15: Disaggregated Growth in Import of CKD/SKD



Data source: Pakistan Bureau of Statistics

The commercial import of CBUs is allowed only under personal baggage, gift scheme and transfer of residence scheme. As most motor cars are imported under the transfer of residence scheme, in October 2017, the government imposed mandatory requirement of paying duties and taxes in foreign currency through account of the sender of the car. However, these mandatory requirements were withdrawn on 23rd February 2018.[10]

The October 2017 measure was unable to dent the bullish sentiment in the imported car market. In fact, car imports under CBU jumped by 64.1 percent YoY in H1-FY18. The import of commercial vehicles in CBU, on the contrary, has started declining; went down by 29.6 percent YoY during H1-FY18.

POL

Petroleum group imports rose by 29.0 percent YoY to US$ 5.6 billion in H1-FY18, from US$ 4.4 billion in the same period last year. The price impact proved relatively stronger in case of POL imports, accounting for 66.4 percent of the YoY increase in the first half. On the other hand, the growth in quantum was moderate, increasing by 9.7 percent YoY in H1-FY18.

A sharp rise in the demand for crude oil and HSD was noted, in contrast to a sharp fall of 18.8 percent in volumetric imports of furnace oil (**Table 5.6**). While crude oil imports surged on the back of an increase in the country's oil-refining capacity, HSD and petrol imports rose on account of stronger demand from the transport sector.

[10] Through Commerce Division's SRO 126(1)/2018

The fall in furnace oil imports can be attributed to the government's policy decision, announced on October 27 2017, to close less-efficient power plants in a phased manner and to convert furnace oil-based plants to gas.[11] As a result, electricity generated through furnace oil dropped by 1,444 GWh in H1-FY18. On the other hand, gas based power plants, on the back of 71.2 percent increase in the RLNG imports, produced 2,940 GWh of additional electricity in H1-FY18 as compared to last year (**Table 5.7**).

Table 5.6: Quantum Import of Major POL Items in H1

	Quantity (000' tonnes)			**Growth** (percent)	
	FY16	**FY17**	**FY18**	**FY17**	**FY18**
HSD	1,306.8	1,837.2	2,103	40.6	14.5
Furnace oil	3,000.2	3,632.1	2,950.5	21.1	-18.8
Crude oil	4,640.1	4,261.1	5,135.5	-8.2	20.5
Petrol	2,068.7	2,558.9	2,688.7	23.7	5.1
Other	58.5	61.2	117.6	4.7	92.2

Data source: OCAC

Table 5.7: Power Generation by Source (GWh)

Fuel Source	**H1-FY17**	**H1-FY18**	**Abs Change**
Hydro	19,654	18,069	-1,585
Gas	15,016	17,956	2,940
Furnace oil	15,541	14,097	-1,444
Coal	37	3,883	3,846
Nuclear	2,507	4,355	1,849
Others	717	1,930	1,213
Total	**53,473**	**60,291**	**6,819**

Data source: NEPRA

Interestingly, the composition of Pakistan's energy imports is changing, with a tremendous increase in coal and RLNG imports. **Box 5.3** further discusses the changing composition of Pakistan's energy imports.

Box 5.3: Changing Composition of Pakistan's Energy Imports

Pakistan's energy mix has observed significant changes in recent years. From being predominantly oil-based, the economy's fuel choices have now spread to coal and liquefied natural gas. These developments are welcome from both diversification point of view, as well as from lowering the overall energy cost.

Table 5.3.1: Coal Based Power Plants under CPEC

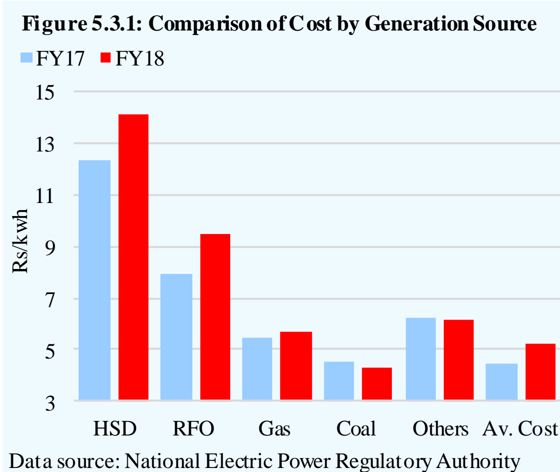
Serial No	**Project description**	**Capacity (In MW)**	**Project status**
1	Sahiwal Plant, Punjab	1,320	Operational
2	Engro Thar Block II	660	In progress
3	Port Qasim Karachi	1,320	In progress
4	Gwadar, Pakistan	300	In progress
5	SSRL Thar Coal	1,320	In progress
6	CPHGC, Hub Balochistan	1,320	In progress
7	Rahimyar Khan	1,320	In progress
8	Muzaffargarh, Punjab	1,320	To be initiated
Total installed capacity planned		**8,880**	

Data source: Planning Commission (http://cpec.gov.pk/energy)

[11] Prime Minister Office's press release, October 27, 2017, available at: http://pmo.gov.pk/press_release_detailes.php?pr_id=2065

In H1-FY18, Pakistan imported coal and related products worth US$ 500.4 million, which was double the imports of only US$ 255.2 million in H1- FY17. This surge was primarily driven by coal-based Sahiwal power plant of 1,320 MW capacity, which was completed under the CPEC. **Table 5.3.1** shows that almost seven coal based power projects, of a total 8,880 MW installed capacity, are envisaged under CPEC, of which only one is currently operational. Therefore, going forward, the country's coal imports will rise significantly when all these plants become operational.

Figure 5.3.1: Comparison of Cost by Generation Source



Data source: National Electric Power Regulatory Authority

As coal-based power generation is cheaper compared to furnace oil or LNG, it is likely to get a higher place in the 'Operational Merit Order' if the current price scenario continues (**Figure 5.3.1**). This is evident from the increase in power generation from coal to 3,883 GWh in H1-FY18 from a meager 37.0 GWh in H1-FY17. If this trend continues, the overall power generation cost is expected to decline going forward. From competitiveness perspective, these developments are welcome provided the environmental concerns are taken care of.

Palm oil

The country's palm oil imports crossed the US$ 1.0 billion mark in H1-FY18, primarily due to a volumetric increase of more than 168.6 thousand MT over the corresponding period of last year. Higher quantums accounted for nearly 71.0 percent of the increase in palm oil imports during the period. Appreciation in Malaysian Ringgit and increased demand from non-traditional segments (such as tea whitener) contributed to the 23.0 percent YoY increase in the palm oil imports.

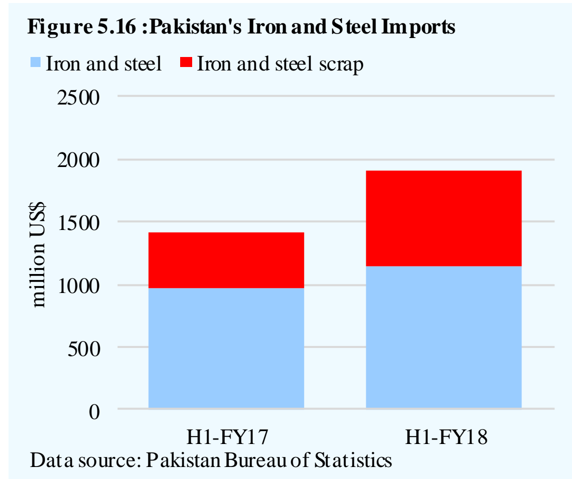
Among other food items, soybean oil imports grew by 76.2 percent in the period. Soybean production in major producing countries, such as Brazil and Argentina, increased significantly, bringing international price of this commodity down. The lower price, in turn, induced importers to substitute other soft oils such as canola and sunflower with soybean, thereby pushing up its imports.

Iron and Steel

Within the metal group, steel imports rose by 16.8 percent on YoY basis to US$ 1.1 billion. A more pronounced increase was witnessed in the import of iron and

steel scrap, which went up by 76.0 percent to US$ 777.3 million in H1-FY18 (**Figure 5.16**). The imposition of regulatory and anti-dumping duties on finished products, along with growing demand from construction and transport sectors, are the prime reasons behind elevated scrap imports.

Figure 5.16 :Pakistan's Iron and Steel Imports



Data source: Pakistan Bureau of Statistics