External Sector

Pakistan's external account remained under stress throughout FY23, primarily due to domestic uncertainty, delay in the completion of the 9th review under the IMF's EFF program, and unfavorable global conditions. Financial account recorded net outflows mainly because of honoring scheduled debt repayments on time amid inadequate external inflows. The reduced financial inflows overshadowed a considerable improvement in current account balance, largely due to policy-induced import compression that more than offset the decline in exports and remittances. Hence, SBP's liquid foreign exchange reserves declined by US$ 5.3 billion in FY23 and exchange rate remained under pressure with a significant depreciation of 28.5 percent during the year.

6

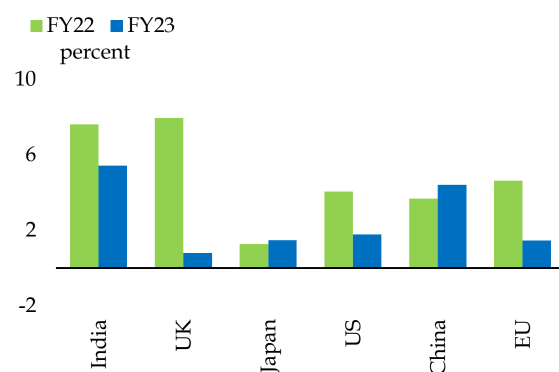
6 External Sector

6.1 Global Economic Review

Global economic activity slowed in FY23, mainly due to geo-economic concerns and a synchronized policy tightening by central banks in a bid to anchor inflation expectations and bring down inflation (**Figure 6.1**). Global inflation reached a multi-decade high in FY23, owing to sustained increase in commodity prices driven by pent-up demand and supply chain disruptions amid Russia-Ukraine conflict, and later by tightened labour markets.

The aggressive monetary policy tightening alongside adverse developments, particularly the continuing of US-China trade tensions and Russia-Ukraine conflict, contributed to weakening global economic activity. As a result, growth significantly decelerated in major economies (such as the EU, UK, USA and India) during FY23. Due to highly integrated global supply chains, slower growth in the major advanced economies (AEs) and emerging markets and developing economies (EMDEs) had a direct impact on their trading partners and, by extension, on global trade. Further, increasing trade barriers and US$ appreciation increased the cost of tradeable goods for several economies, further slowing global trade in FY23.

Real GDP Growth in Major Economies* — **Figure 6.1**



*average of four quarters

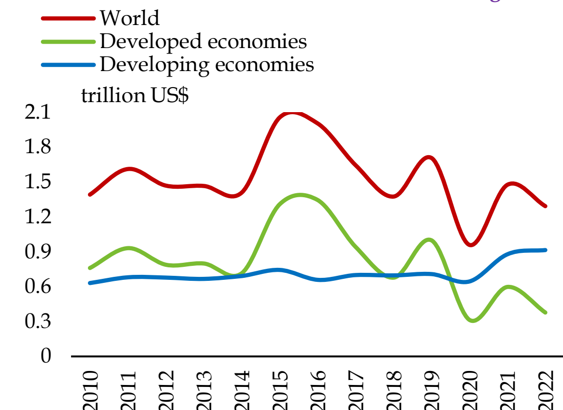
Sources: Bloomberg, OECD and PBS

Similarly, global Foreign Direct Investment (FDI) flows contracted by 12.4 percent to US$ 1.3 trillion in 2022, led by decline in investment in advanced economies, mainly because of a significant fall in international project financing, and global mergers and acquisitions **(Figure 6.2).** Unfavourable global economic conditions, including weak fiscal positions, rising debt levels and fears of recession, put investments on the hold. Moreover, the reconfiguration of global supply chains also remained a cause of concern in the wake of geo-economic fragmentation, which is adversely influencing global FDI flows (**Box 6.1**).

The remarkable surge in global commodity prices in the post-Covid period, driven by a combination of factors, including a strong recovery in demand and numerous pandemic-related supply constraints, was further fueled by Russia-Ukraine conflict. Despite significantly large drops from their peaks from mid of 2022, commodity prices remained above the pre-Covid level **(Figure 6.3)**. Moreover, freight and cargo rates, though trending down, are still higher than the pre-Covid averages (**Figure 6.4**).

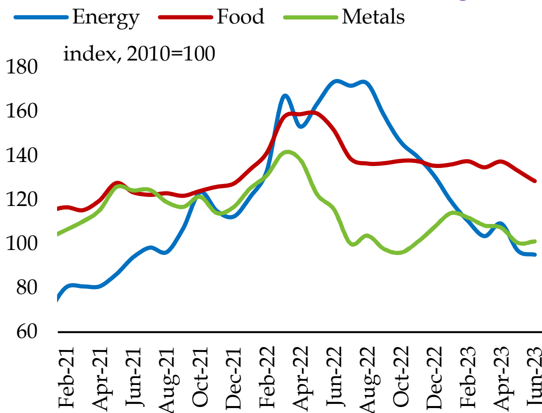
Record high inflation prompted a synchronized policy response across the globe. Almost 95 percent of the central banks raised policy rates between early 2021 and mid-2023. Even though

Global FDI Inflows — **Figure 6.2**



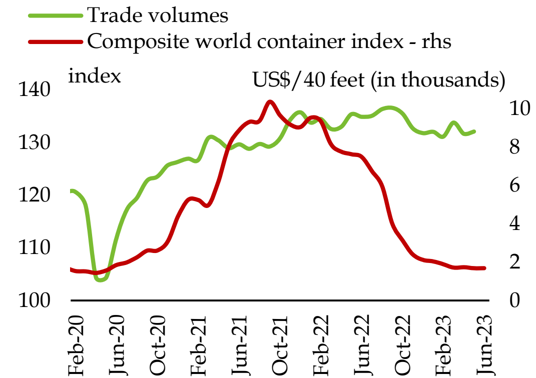
Source: United Nations Conference on Trade and Development

Global Commodity Prices **Figure 6.3**



Source: World Bank

Global Trade Volumes and Shipping Rates **Figure 6.4**



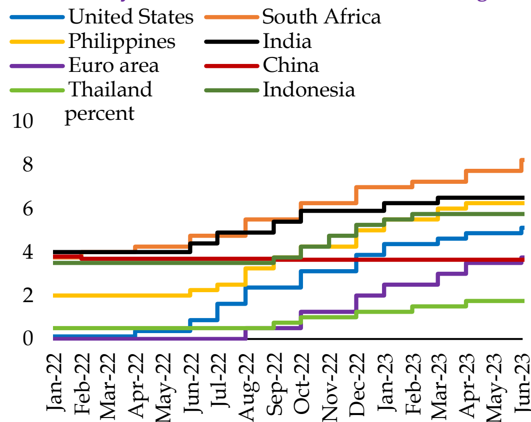
Source: CPB World Trade Monitor

the monetary tightening was at a historical pace **(Figure 6.5)**, policy rates were still lower than inflation and, in the case of some AEs, even below the expected inflation, implying negative real rates.[1] This, nevertheless, had implications for EMDEs. First, it led to capital flight from EMDEs **(Figure 6.6)**. Second, it increased cost of raising funding from international capital markets. Third, slower growth in advanced economies meant lower demand for exports.

The uncertain global macroeconomic environment alongside monetary tightening, especially in the USA, and further strengthening of US dollar weakened the capacity of EMDEs to service their existing debt. It also affected the prospects of raising new funding through issuance of sovereign bonds at a time when government debts are peaking,[2] with the pandemic already having weighed heavily on EMDEs' debt levels, and even causing some economies to default on their debts.[3]

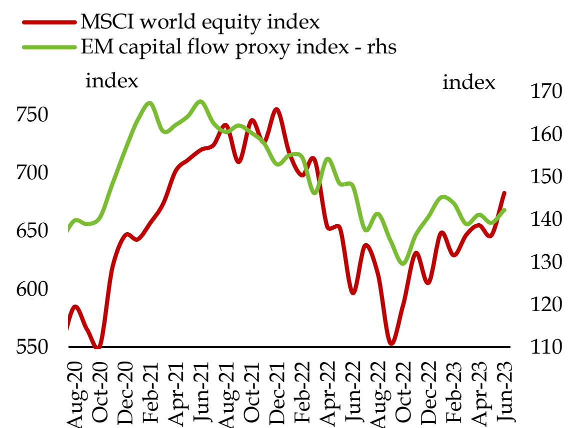
Sharp policy rate hikes and tighter financial conditions exposed some of the vulnerable banks. Valuation losses caused by inadequate risk management practices dented the confidence of depositors and investors leading to a funding crisis and the failures of two

Global Policy Rates **Figure 6.5**



Source: Bank for International Settlements

MSCI World Equity Index **Figure 6.6**



Source: Bloomberg

[1] BIS Annual Economic Report, June 2023

[2] Arteta, Kamin, Ruch (December 2022). 'How Do Rising US Interest Rates Affect EMDE's?', World Bank Working Paper.

[3] Belarus, Ghana, Malawi, and Sri Lanka defaulted on their sovereign debt during 2022, bringing the total number of countries in default to eight. Source: Global Financial Stability Report – April 2023, IMF

regional US banks, Silicon Valley Bank and Signature Bank. Later, Credit Suisse, a global systemically important bank (GSIB) in Europe, also succumbed to loss of market confidence. However, the market anxiety was contained by policymakers' timely and strong response to fend off systemic risks.[4]

Box 6.1: Geo-economic Fragmentation and a Paradigm Shift in Global FDI Flows

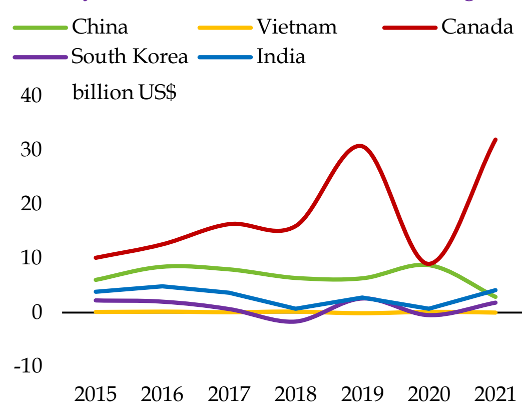
Following the Global Financial Crisis of 2008-09, the global economy began to face geo-economic fragmentation, described as policy-driven reversal of global economic integration often guided by strategic considerations. Events, such as the Brexit, growing US-China trade tensions, and the Russia-Ukraine conflict have raised questions about the benefits of increasing globalization.[5] The Covid-19 pandemic accentuated the skepticism about globalization, especially when countries adopted policies restricting the cross-border movement of goods and even banning travel in some cases. Although the lockdowns curbed the spread of the virus, some constraints, such as restrictions on the export of crucial medical products, impaired public trust in open trade policies. The start of Russia-Ukraine conflict in February 2022 created geopolitical divide between countries, disrupting trade, putting the global financial system at risk, and raising tensions as well as uncertainties.

The de-globalization, or 'slow-balization', is reflected in declining global FDI, reinforcing FDI fragmentation. The decreasing FDI is defined by differing patterns across FDI-host countries, with flows concentrated in geo-politically aligned countries, especially in key sectors of national or economic interests. Trade practices are also increasingly shifting towards trade alliances between political and economic allies, termed 'friend-shoring' by the IMF. Supply chains are re-routed to economies that are recognized as being politically and/or economically 'safer' with lower risks to prevent possible trade disruptions.[6]

The policies adopted by major economies also indicate the tendency towards 'friend-shoring'; for example, the Science Act, the Inflation Reduction Act, and the Creating Helpful Incentives to Produce Semiconductors (CHIPS) Act by the USA, and the European Chips Act.[7,8,9] These policies have targeted the strategic FDI-sectors as well, leading to stagnant FDI inflows into China, particularly in the research and development and semiconductors' sectors.

From CY20 to CY22, FDI fell by around 20 percent, when compared to the period following the GFC 2008. The decline is uneven across the globe; FDI into China fell by more than the Asian average, while FDI into the USA and emerging European economies did not fall as much (and in some cases, even rose). FDI flows from the US to China and Vietnam fell, as the country rerouted its investments to Europe, Canada and Korea, indicating that geo-political factors are at play **(Figure 6.1.1)**.[10]

Country-wise Net Outward FDI from USA Figure 6.1.1



Source: Organisation for Economic Co-operation and Development

Global FDI fragmentation may have implications for Pakistan, as FDI flows into Pakistan have been sourced from only a few countries over the years, including China (including Hong Kong), the USA, the UK, Japan and the UAE. In the recent past, there has been an upward trend in FDI inflows from China. In contrast, there has been a continuous decline in FDI

[4] Source: World Economic Outlook, IMF, April 2023
[5] Aiyar et al (January 15th, 2023). 'Geo-economic Fragmentation and the Future of Multilateralism', IMF Staff Notes.
[6] World Economic Forum, (Feb 17, 2023). 'What's the difference between 'friendshoring' and other global trade buzzwords?'
[7] Source: www.congress.gov/117/bills/hr5376/BILLS-117hr5376enr.pdf
[8] Source: www.whitehouse.gov/briefing-room/statements-releases/2022/08/09/fact-sheet-chips-and-science-act-will-lower-costs-create-jobs-strengthen-supply-chains-and-counter-china/
[9] Source: commission.europa.eu/strategy-and-policy/priorities-2019-2024/europe-fit-digital-age/european-chips-act_en
[10] Source: Organisation for Economic Co-operation and Development

from the USA, one of the major sources of FDI in the past, indicating possible implications for overall gross FDI flows into Pakistan with the downward trend.

In this background, the recent initiative, Special Investment Facilitation Council (SIFC), may help attract FDI from Saudi Arabia and other Gulf countries. The SIFC has targeted US$ 100 billion in FDI over three years, and has aimed at achieving US$ 1 trillion by FY35 in Pakistan. In line with the FDI fragmentation phenomenon, the SIFC has especially advocated attracting investment from friendly countries, especially Gulf Cooperation Council countries, such as Saudi Arabia and the UAE. This appears to further reflect the FDI fragmentation concept present on a global level.

6.2 Pakistan's Balance of Payments

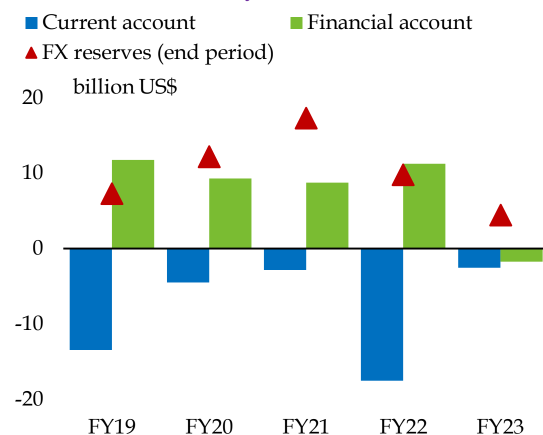
Pakistan's external account remained under pressure in FY23 on account of reduced financial inflows, despite a substantial narrowing of current account deficit (CAD). The financial account witnessed net outflows of US$ 1.8 billion during FY23, in a sharp contrast to net inflows of US$ 11.3 billion during FY22 (**Table 6.1**).

Financial inflows in the form of foreign investment, and official and private foreign loan disbursements were insufficient to finance even lower CAD and meet external obligations (**Figure 6.7**). Moreover, due to the delay in completion of the IMF's Extended Fund Facility (EFF) program and tight global financial conditions, other multilateral and bilateral creditors withheld their financing to Pakistan. This was at a time when increase in the country's risk premium and downgrading of credit ratings made it challenging to borrow from commercial sources (**Figure 6.8**).

The CAD contracted primarily due to large decline in trade deficit where the policy-induced import compression more than offset the decline in exports and workers' remittances. In line with the goods trade account, the services account deficit also narrowed sharply. On the other hand, primary income account deteriorated during FY23 as the increase in interest payments on external debt more than offset the drop in repatriation of profits on foreign investments.

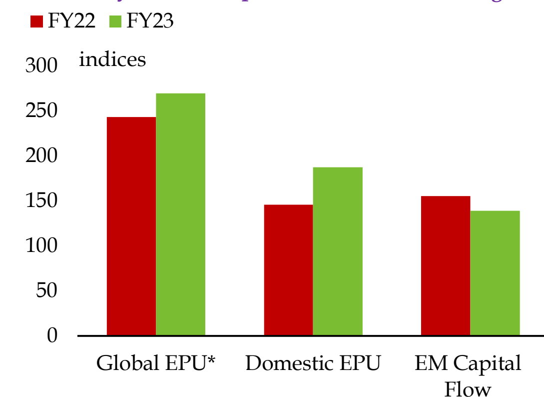
These developments led to drawdown in SBP's liquid FX reserves by US$ 5.3 billion to US$ 4.5 billion by the end of FY23. Particularly, the repayment of long-term multilateral loans, maturing Eurobond in December 2022 and repayment of commercial borrowings, contributed to depletion in the country's forex reserves. With persisting external account pressures and strengthening of US$,

Pakistan's Balance of Payments — **Figure 6.7**



Source: State Bank of Pakistan

Uncertainty and EM Capital Flows — **Figure 6.8**



* Economic policy uncertainty

Sources: SBP, FRED and Bloomberg

Pakistan's Balance of Payments **Table 6.1**

million US$

	FY21	FY22	FY23	FY23	
				Abs. Change	YoY Change (%)
Current account balance	**-2,820**	**-17,481**	**-2,387**	**15,094**	**-86.3**
Merchandise trade balance	**-28,634**	**-39,050**	**-24,076**	**14,974**	**-38.3**
Exports, of which	**25,639**	**32,493**	**27,903**	**-4,590**	**-14.1**
Textile exports	14,415	18,442	16,628	-1,814	-9.8
Non-textile exports	11,224	14,051	11,275	-2,776	-19.8
Imports, of which	54,273	71,543	51,979	-19,564	-27.3
Energy imports	9,747	18,743	17,539	-1,204	-6.4
Non-energy imports	44,526	52,800	34,440	-18,360	-34.8
Services balance	**-2,516**	**-5,840**	**-761**	**5,079**	**-87.0**
Primary income balance, of which	**-4,400**	**-5,248**	**-5,732**	**-484**	**9.2**
Interest payments	2,176	2,994	4,840	1,846	61.7
Secondary income balance, of which	**32,730**	**32,657**	**28,182**	**-4,475**	**-13.7**
Workers' remittances	29,450	31,279	27,027	-4,252	-13.6
Financial account balance*	**-8,768**	**-11,261**	**1,781**	**13,042**	**-115.8**
Direct investment (net)*	-1,648	-1,702	-316	1,386	-81.4
Portfolio investment (net)*, of which	-2,774	55	1012	957	1740.0
Eurobonds/Sukuk	3,000	1,000	-1,012	-2,012	-201.2
Build-up in FX assets abroad	**1,345**	**2,613**	**-1,032**	**-3,645**	**-139.5**
FX loans & liabilities	**5,691**	**12,226**	**-2,127**	**-14,353**	**-117.4**
Banks	**499**	**846**	**1,242**	**396**	**46.8**
General government	**5,738**	**6,117**	**-2,075**	**-8,192**	**-133.9**
Disbursements	9,808	11,256	9,896	-1,360	-12.1
Amortization	5855	8,343	11,660	3,317	39.8
Other liabilities (net)	1,785	3,204	-311	-3,515	-109.7
Other sectors	**922**	**2,491**	**-1,294**	**-3,785**	**-151.9**
Disbursements	2,163	3,271	434	-2,837	-86.7
Amortization	1,253	1,111	1,666	555	50.0
Other liabilities (net)	12	331	-62	-393	-118.7
SBP's liquid reserves (end-period)	**17,299**	**9,815**	**4,467**	**-5,348**	**-54.5**
PKR app(+)/dep(-) in percent	**-1.3**	**-9.8**	**-28.5**		

*as per BPM6, negative sign means net FX inflow into Pakistan and vice versa

Source: State Bank of Pakistan

PKR depreciated against US dollar by 28.5 percent during FY23.

The fall in foreign exchange reserves with foreign payments outpacing foreign inflows, has become a recurring concern. The drawdown in FX reserves not only hurts country's ability to meet foreign obligations, but also affects investors' confidence that further exacerbates the prospects of sustained foreign inflows. In this context, maintaining adequate level of FX reserves hinges upon enhancing exports by addressing longstanding structural issues pertaining to narrow manufacturing-cum-export base.

Current Account

The current account deficit narrowed to US$ 2.4 billion in FY23, from US$ 17.5 billion recorded in

the previous year (**Figure 6.9**). This sharp improvement mainly stemmed from significant contraction in goods and services trade deficit despite a fall in goods' exports. Export receipts witnessed a decline of 14.1 percent during FY23 due to economic slowdown in Pakistan's major export destinations, increased cost of production, supply chain constraints and flood-induced losses to agriculture produce. Moreover, workers' remittances declined by 13.6 percent, first time in the last six years, to US$ 27.0 billion in FY23.

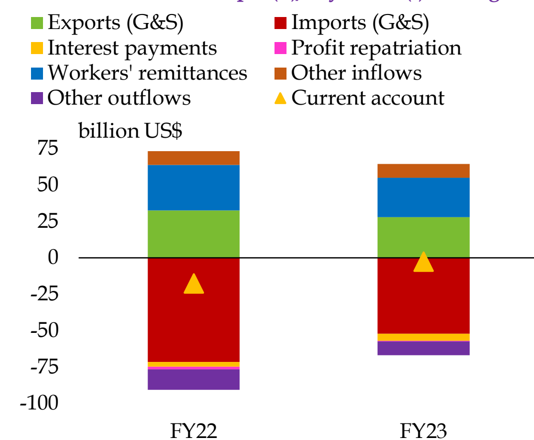
The broad-based decline in imports was mainly led by slowdown in domestic demand; continued policy and administrative measures taken by the SBP[11] and the government over the last two years; foreign exchange constraints; and a downtrend in global oil prices. Meanwhile, the services import also plunged by 37.7 percent compared to last year, tracking the decline in merchandise import bill mainly due to lower outflows on account of freight payments.[12]

In contrast to the improvement in the goods and services trade balance, the primary income deficit increased by 9.2 percent. The widening of the deficit can be traced to higher interest payments that offset the impact of lower repatriations of profits on foreign investment.

Services Account

The services trade deficit narrowed sharply to US$ 0.8 billion in FY23, from US$ 5.8 billion in the preceding year. Notably, the services imports decreased by 37.7 percent to US$ 8.1 billion in FY23, from US$ 12.9 billion in FY22. The decline was mainly driven by substantially lower freight payments, attributed to drop in merchandise imports (**Table 6.2**). This is also substantiated by the decline in number of imports' containers during the year (**Figure 6.10**). Moreover, fall in global shipping rates to pre-pandemic levels also contributed to the lower freight payments. It may be noted here that freight costs peaked out in FY22, following the post-Covid surge in global trade volumes that had put strain on freight rates. These pressures faded as global trade normalized in FY23, leading to decline in freight costs.[13] (**Figure 6.11**).

Current Account: Receipts (+)/Payments (-) Figure 6.9



Source: State Bank of Pakistan

Number of Import Containers Figure 6.10

Sources: Bloomberg and State Bank of Pakistan

[11] Imposition of cash margin requirements on additional 177 items in April 2022 (www.sbp.org.pk/bprd/2022/CL9.htm), along with reporting requirements for banks to report CMR collected on the related imports, sunset clause of which was later extended to March 31, 2023 (www.sbp.org.pk/bprd/2022/CL37.htm); Requirement for banks to obtain prior approval from SBP before opening L/Cs of 25 high value capital goods, including CKD cars in May 2022; (www.sbp.org.pk/epd/2022/FECL9.htm), to which complete Chapters 84 and 85 of HS codes were included in July 2022 (www.sbp.org.pk/epd/2022/FECL11.htm)

[12] The average CIF ratio was declined to 4.0 in FY23 from 5.1 in FY22.

[13] Freight factor remained lower at 4.1 percent in FY23 compared to 5.2 percent in FY22.

Breakdown of Services Trade Account **Table 6.2**

million US$

	Import (M)		Export (X)		Trade Balance (X-M)	
	FY23	Change from last year	FY23	Change from last year	FY23	Change from last year
a) Transport, of which	**3,917.2**	**-3,487.9**	**893.9**	**79.9**	**-3,023.3**	**3,567.8**
Sea freight	2,856.4	-3,268.8	250.5	103.9	-2,605.9	3,372.6
Air passengers	785.0	53.1	419.7	-7.7	-329.3	-60.8
Air freight	51.4	-298.3	24.1	-8.8	-27.3	289.9
b) Travel, of which	**1,878.2**	**465.4**	**974.0**	**431.8**	**-904.2**	**-33.6**
Education exp.	337.9	72.3	11.6	0.8	-325.8	-71.5
Other (personal)	1,525.9	393.2	948.5	423.9	-577.0	30.6
c) ICT Services, of which	**298.0**	**-313.8**	**2,593.3**	**-25.706**	**2,295.3**	**288.1**
Telecom	37.5	-31.4	488.8	-15.7	451.2	15.8
Computer services	253.9	-275.2	2,099.0	-10.4	1,845.1	264.8
Total services	**8,063.4**	**-4,879.0**	**7,303.0**	**200.6**	**-760.5**	**5,079.7**

Source: State Bank of Pakistan

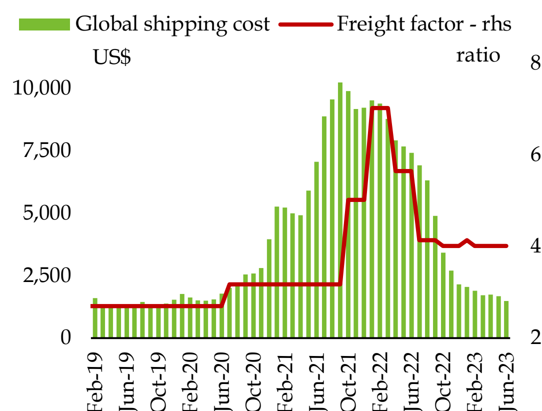
On the other hand, import of travel-related services recorded an uptick and reached US$ 1.9 billion in FY23, from US$ 1.4 billion in the previous year. With the resumption of international flights, the payments constituting personal air travel, especially for education and religious purposes, increased by 33.1 percent from FY22. The increase also reflects costlier airline tickets due to higher international oil prices.

Meanwhile, export of services grew by 2.8 percent to US$ 7.3 billion in FY23. The information and communication technology (ICT) services, which have the largest share in services export, almost maintained its FY22 level of US$ 2.6 billion in FY23 (**Figure 6.12**). The plateauing of ICT exports despite addition of new firms in the market may be attributed to decline in imports of state-of-the-art IT equipment for production of high-end software and exporters not bringing their remittances due to exchange rate volatility.

Primary Income Account

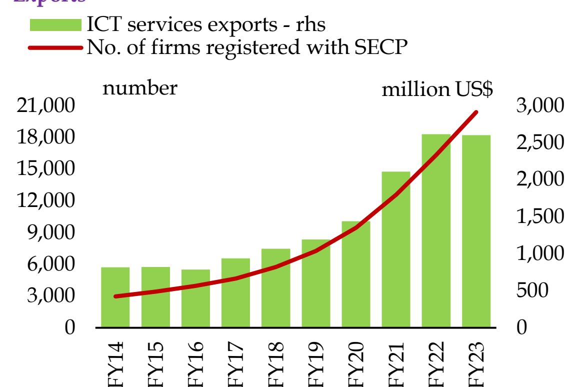
The primary income deficit increased to US$ 5.7 billion in FY23, from US$ 5.2 billion in the previous year. The increase is largely on the back of higher interest payments on FX loans that offset a decline in repatriation of profits on foreign investment (**Figure 6.13**). Interest

Global Shipping Cost and Freight Factor **Figure 6.11**



Sources: Bloomberg and State Bank of Pakistan

Growth of ICT Services Firms and Exports **Figure 6.12**



Sources: Securities & Exchange Commission of Pakistan and State Bank of Pakistan

Remittance Inflows to Pakistan from Major Corridors **Table 6.3**

million US$

	FY20	FY21	FY22	FY23	Change in FY23	
					Absolute	Percent
US	1,743	2,600	3,087	3,091	4	0.1
UK	2,569	4,091	4,493	4,057	-436	-9.7
Germany	392	432	509	530	21	4.2
France	240	423	488	443	-45	-9.3
Australia	340	598	753	593	-160	-21.3
Canada	313	595	708	551	-157	-22.2
GCC	15,135	17,223	17,226	14,287	-2939	-17.1
Saudi Arabia	*6,613*	*7,726*	*7,754*	*6,446*	*-1308*	*-16.9*
UAE	*5,612*	*6,165*	*5,846*	*4,649*	*-1198*	*-20.5*
Other GCC	*2,910*	*3,332*	*3,625*	*3,191*	*-434*	*-12.0*
Other countries	2,399	3,489	4,015	3,477	-538	-13.4
Total remittances	**23,132**	**29,450**	**31,279**	**27,028**	**-4251**	**-13.6**

Source: State Bank of Pakistan

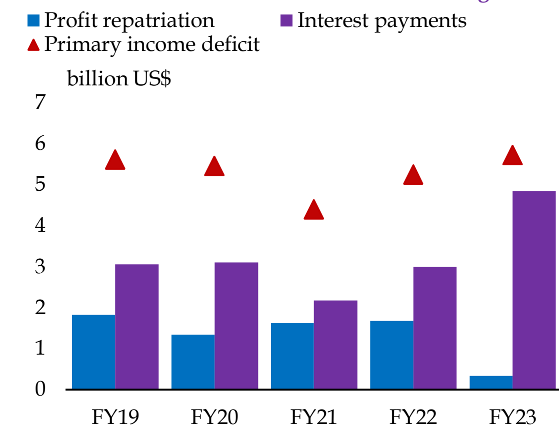
payments on external debt rose to US$ 4.8 billion in FY23, from US$ 3.0 billion in FY22. The rise in interest payments largely reflects global factors, including synchronous global monetary tightening, and the expiration of the DSSI[14] that resulted in accumulation of both long and short term debt servicing.

However, there was a decline in profit repatriation to US$ 331 million in FY23, from US$ 1.7 billion in the previous year. The dip in repatriation can partially be explained by foreign exchange constraints, and decline in profits of some of the foreign corporations due to slowdown in domestic economy. Sector-wise analysis shows that the drop in profit repatriation was led by financial firms, followed by communication (particularly telecom), power (especially thermal power), and the food sectors (**Figure 6.14**).

Workers' Remittances

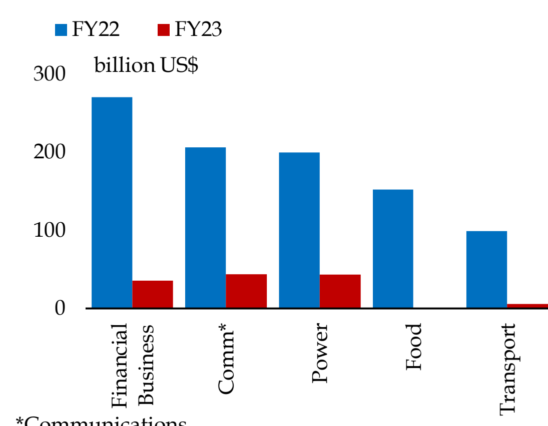
Workers' remittances recorded a decline in FY23 for the first time in last six years. After reaching

Pakistan's Primary Income Account **Figure 6.13**



Source: State Bank of Pakistan

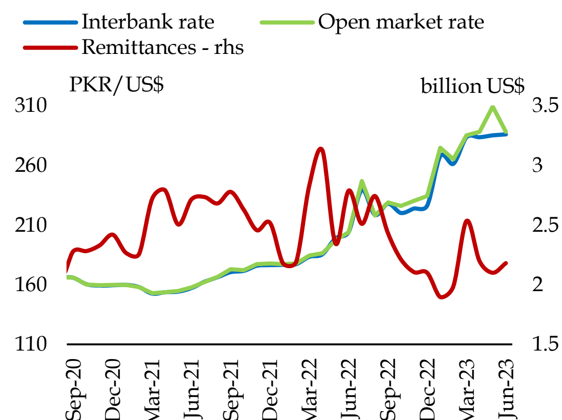
Sector-wise Profit Repatriation **Figure 6.14**



*Communications
Source: State Bank of Pakistan

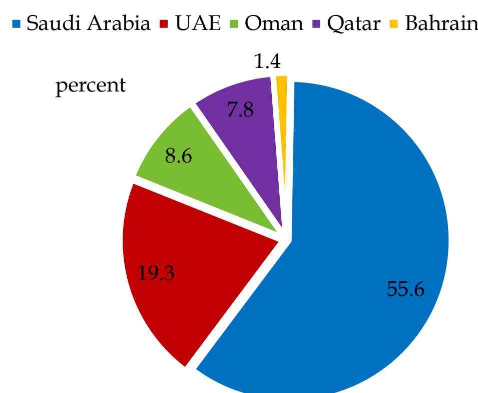
[14] Except with South Korea. (www.ead.gov.pk/NewsDetail/OGFkNWU3MDQtYTRiZC00ZjA5LWJkY2YtMGI1MDY0YjlhZTQ1)

Remittances and Exchange Rate **Figure 6.15**



Source: State Bank of Pakistan

Top Five Destinations for Pakistani Migrants - FY23 **Figure 6.16**



Source: Bureau of Emigration & Overseas Employment

a record US$ 31.3 billion in FY22, remittances dropped by 13.6 percent to US$ 27.0 billion in FY23. Remittance flows declined from all major corridors, except for the US. On the basis of annual remittances received during FY23, Saudi Arabia, UAE, UK and US remained top remittance corridors **(Table 6.3)**.

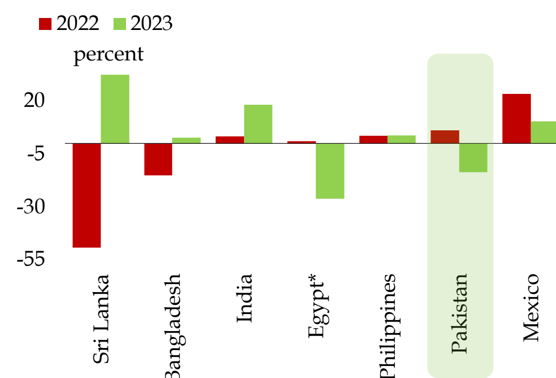
The waning impact of fiscal stimulus provided during the pandemic to support economic activity, along with monetary contraction to contain higher inflation, led to economic slowdown in high-income countries. The global slowdown also impacted the Gulf Cooperation Council (GCC) economies through lower global oil demand and moderating crude oil prices. While slower economic activity restrained job opportunities, the increase in inflation and higher interest rates reduced savings. Together, these factors had bearing on the remitting capacity of Pakistani workers.

In addition to global developments and domestic economic and political uncertainties, increased exchange rate volatility and high kerb market premium also led to decline in remittance flows through formal money channels (**Figure 6.15**). Some remittance inflows may also have been routed through informal channels after the resumption of international air travel, as several blue-collar workers (particularly from the KSA and UAE) depend on the personal networking to send remittances back home.

Contrary to declining remittances, 0.8 million Pakistani workers were registered through Bureau of Emigration and Overseas Employment (BEOE) and Overseas Employment Corporation (OEC) during FY23. Out of this, number of workers registered for Saudi Arabia, UAE, Oman and Qatar were 55.6 percent, 19.3 percent, 8.6 percent and 7.8 percent respectively (**Box 6.2**) (**Figure 6.16**).

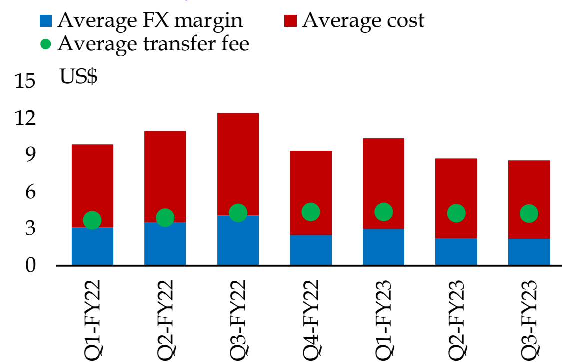
While remittance flows to major recipient countries improved during FY23, remittances to Pakistan and Egypt recorded a significant decline (**Figure 6.17**). These two countries experienced increased gap between interbank and open market exchange rates.

Growth in Remittances to Major Recipients **Figure 6.17**



Growth rate; *Jul-Mar
Sources: Haver Analytics and State Bank of Pakistan

Cost of Sending Remittances* to Pakistan from Major Corridors# — **Figure 6.18**



*transaction amount of US$ 200; #UAE, Saudi Arabia, USA & UK

Source: World Bank Remittance Prices

As per the World Bank (WB) estimates, remittance flows to low and middle-income countries (LMICs) have increased by 8.0 percent to US$ 647 billion in 2022 and remained a larger source of external finance relative to FDI, official development assistance (ODA) and portfolio investment flows. Most of this growth is backed by the developments during H1-FY23.[15] Similarly, remittance flows to South Asia reached US$ 176 billion in 2022, mainly owing to remittance flows to India crossing the US$ 100 billion milestone.

Cost of sending remittances to Pakistan

Total cost of remittances is composed of transfer fee and foreign exchange margin. As shown in (**Figure 6.18)**, the fluctuations in the average cost of sending remittances to Pakistan from major corridors has largely been due to volatility in the average foreign exchange margin, while average transfer fee remained almost unchanged.[16]

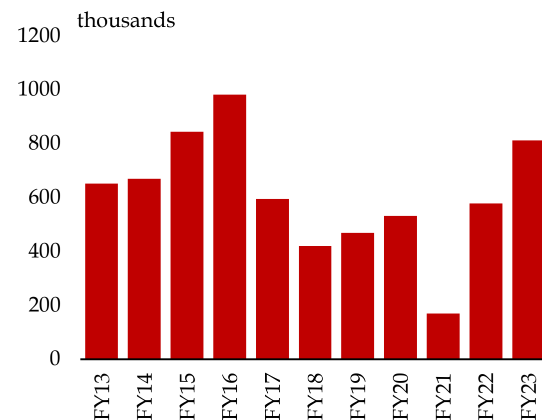
Average foreign exchange margins charged by money transfer operators (MTOs) and exchange companies in Saudi Arabia, UAE, US and UK initially increased in Q1-FY23, but declined in the subsequent two quarters.

Box 6.2: Pakistan's Migration Trends and Remittances[17]

Pakistan has witnessed a significant increase in labour migration in FY22 and FY23 compared to the preceding two years. However, according to annual migration data of BEOE, the recent surge in emigration is not the first of its kind, as the country has previously experienced similar spikes as well, such as during FY15 and FY16 (**Figure 6.2.1**).

Pakistan's labour migration flow by skills composition shows that highly-qualified and highly-skilled labour force each account for only 2.0 percent (on average) of the overall emigration between FY20 and FY23. Number of migrants under each skill composition increased during FY23 and FY22 after a significant dip during FY21 (**Figure 6.2.2**). The recent spike in emigration could also be due to post-pandemic resumption of international travel and opening up of host economies.

Labor Migration Trend of Pakistan — **Figure 6.2.1**



Source: Bureau of Emigration & Overseas Employment

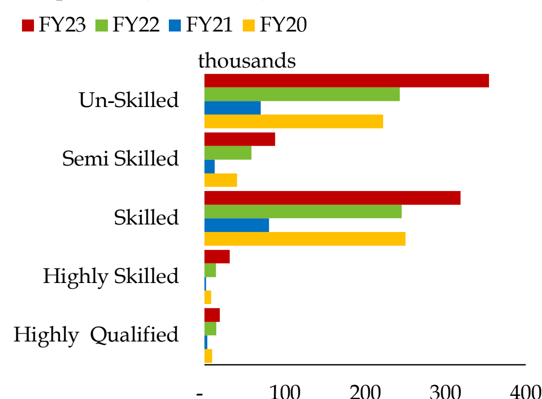
Overall migration under occupational trades identified as highly-qualified and highly-skilled has been increasing between FY20 and FY23 (**Figure 6.2.3**). As they constitute a very small portion of emigrants, they can hardly have

[15] Such as stronger labour market in the US and OECD countries, increased labour demand led by oil boom in GCC and FIFA World Cup 2022 in Qatar, and a sharp rise in Russian remittances to the neighboring Central Asian countries. Migration and Development Brief 38, June 2023 (Source: World Bank)

[16] For remittances sent through banks / exchange companies benefitting from Government's T.T Charges Reimbursement Scheme, the fee component borne by the remitter stands at zero.

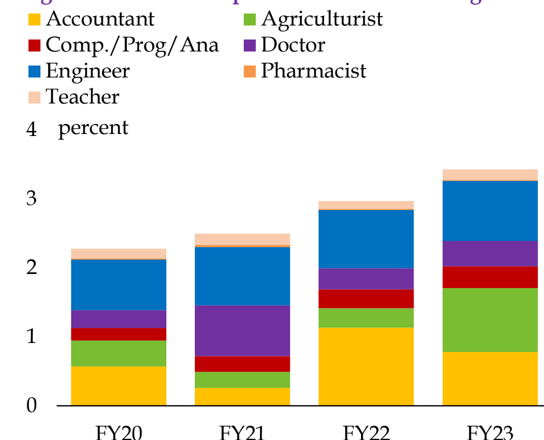
[17] This analysis is based on the data for workers registered with BEOE for employment abroad. This data does not cover the number of workers returning to Pakistan.

Labour Migration Flow by Skill Composition (FY20 - FY23) **Figure 6.2.2**



Source: Bureau of Emigration & Overseas Employment

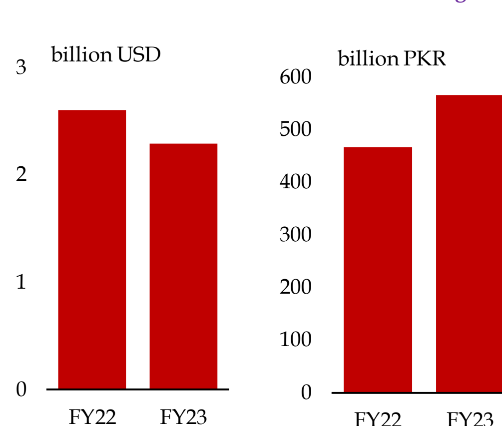
Migration Under Occupational Trades **Figure 6.2.3**



Source: Bureau of Emigration & Overseas Employment

any significant impact on remitances. However, top occupational trades recruited for overseas work during FY23 consist of mostly blue-collar jobs. Further, comparison shows that remittances in US$ have declined during FY23, whereas remittances in PKR were on a rising trend **(Figure 6.2.4)**. This implies that: (i) exchange rate depreciation has lowered remittances in US$, as lower dollar amount results in higher remittance in rupee terms compared to the previous year; and (ii) the contnuing dominance of blue-collar workers in total migration mix leads to lower average ticket size and hence lower US$ denominated remittances. Provided that global and domestic economic conditions begin to improve going forward, increasing migration may improve the flow of remittances to Pakistan.

Workers' Remittances in USD vs. PKR **Figure 6.2.4**



Sources: State Bank of Pakistan

Financial Account

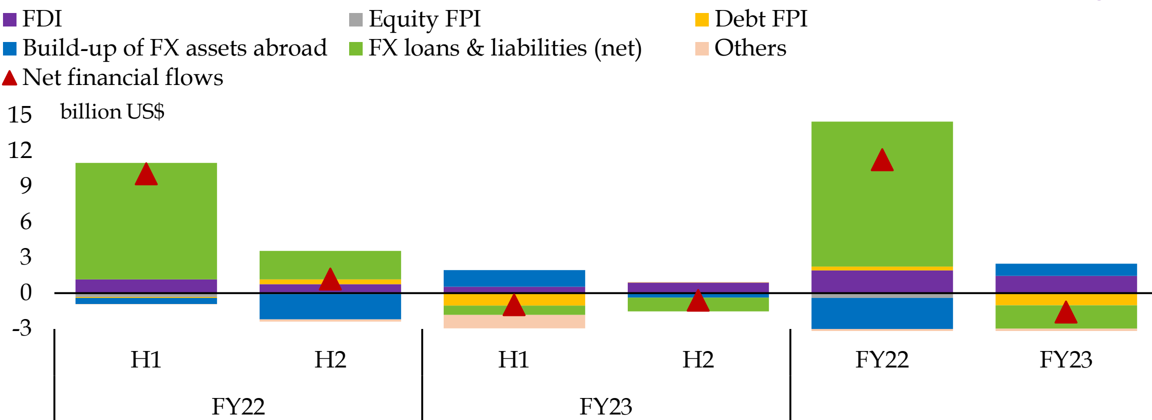
Financial account witnessed a net outflow of US$ 1.8 billion in FY23, compared to net inflows of US$ 11.3 billion during FY22, following the decrease in disbursement of official loans, higher amortization of official and private loans, and drop in private inflows (**Figure 6.19**). Delay in the completion of the 9th review under the IMF's EFF program had a domino effect on disbursements from other multilateral and bilateral partners. The resulting fall in inflows increased strains on external account in FY23, with only 47.1 percent of the budget estimates of loans being disbursed during the year.[18] Private inflows also dwindled amidst turbulent global geopolitical environment, prevailing domestic uncertainties, and volatility in exchange rate. Portfolio flows were particularly affected by global financial conditions amidst across-the-board monetary policy tightening and the downgrading of Pakistan's sovereign ratings.

Foreign Direct Investment

Net FDI inflows into Pakistan fell to US$ 1.5 billion in FY23, from US$ 1.9 billion in FY22. Lower FDI inflows are attributed to economic slowdown, and domestic uncertainty. Moreover, with the completion of CPEC-related projects in FY23, FDI from China in power sector also dropped. However, China's share in FDI remained dominant with 29.7 percent,

[18] There was a 116 percent decline in realized disbursements of FX loans in FY23.

Financial Account Breakdown **Figure 6.19**



Source: State Bank of Pakistan

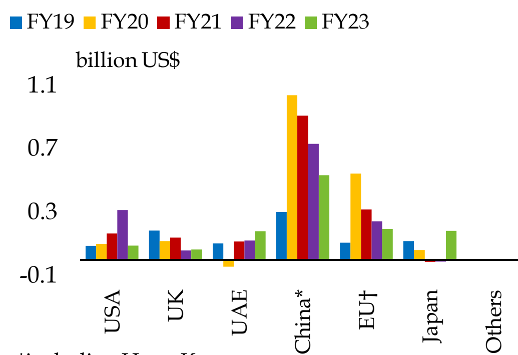
followed by the UAE and Japan with 12.4 and 12.6 percent share, respectively.

Over the years, Pakistan's sources of FDI inflows have been limited to a few countries and sectors. China (including Hong Kong), the USA, the UK, Japan and the UAE have remained as main sources of FDI in the country, with the EU's role declining recently. For instance, CPEC projects have managed to attract significant FDI since the inception of the corridor; resultantly, a bulk of FDI has been flowing from China into Pakistan over the years. This marks the concentration of FDI into CPEC-centered sectors. (**Figure 6.20**). However, as these projects reached the completion phases, investment started to taper off.

Sector-wise gross FDI inflows show that power sector continued to dominate in FY23, followed by financial business, and transport and its equipment. The inflows in power sector, amounting to US$ 660.2 million, largely came from China, mostly into coal-powered power projects under the CPEC, including the Thar Coal Block project, which was completed in FY23. Inflows into the power sector also came from France for a newly-inaugurated Uch power project (**Figure 6.21)**.

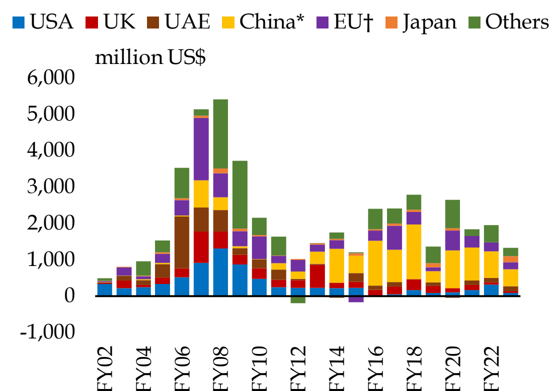
Financial business received US$ 348.8 million in FDI inflows mainly in banking sector. Foreign shareholders of a few banks opted to reinvest their earnings instead of repatriation due to exchange rate depreciation and foreign exchange constraints.

Country-wise FDI Inflows in Pakistan **Figure 6.20**

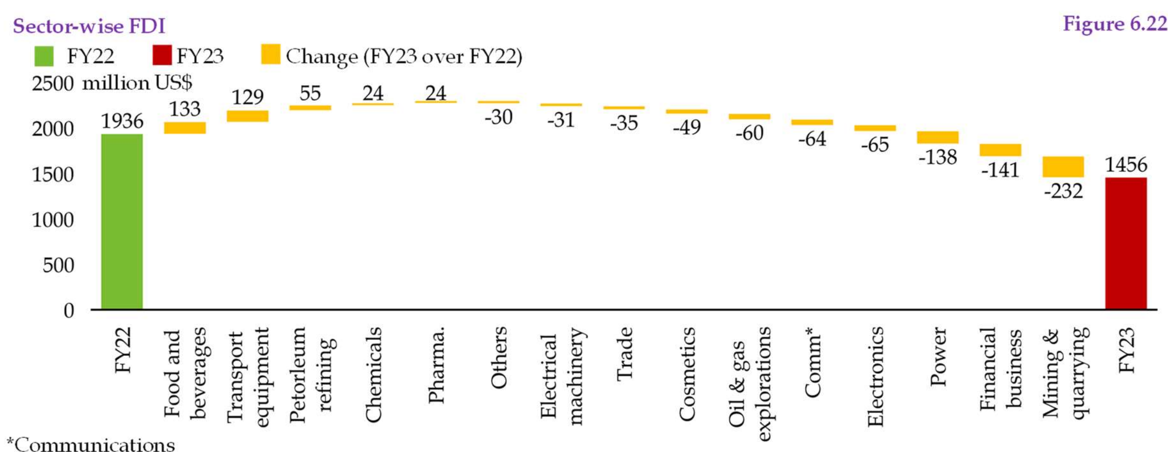


*including Hong Kong
†includes 10 EU countries that have invested in Pakistan
Source: State Bank of Pakistan

FDI Trends **Figure 6.21**



*including Hong Kong
†includes 10 EU countries that have invested in Pakistan
Source: State Bank of Pakistan



*Communications

Source: State Bank of Pakistan

From the perspective of FDI outflows, the largest outflow was recorded from mining and quarrying sector in FY23, followed by communications, financial business and power sectors (**Figure 6.22**). The outflow from mining and quarrying sector is explained by the settlement of the disputed Reko Diq case between the government and Tethyan Copper Limited.[19]

The communications sector also underwent significant gross FDI outflows due to high corporate taxation environment and lower average revenue per user (ARPU) that affected earning prospects of telecom companies – the country has an ARPU of US$ 0.80 per month, compared to the global average at US$ 8.26 per month.[20] The majority of the outflows from the communications sector were to Norway during FY23, followed by the UAE, Malaysia and China.

The oil and gas exploration sector witnessed a decline in gross FDI inflows in FY23 compared to the previous year mainly from Hong Kong, Italy and the UK. These developments appear in the midst of a natural depletion of non-renewable resources in Pakistan and fewer new discoveries of oil or gas fields.[21]

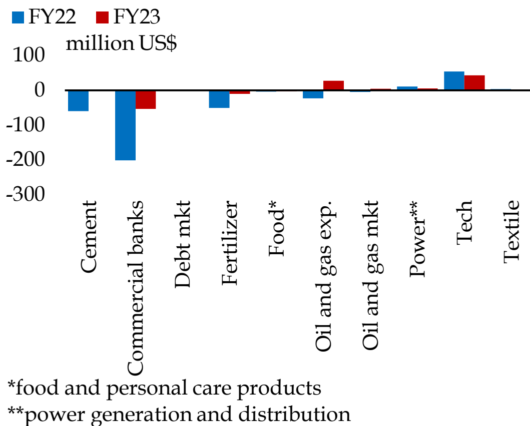
Foreign Portfolio Investment

Pakistan witnessed higher net FPI outflows in FY23, amounting to US$ 1.0 billion against outflows of US$ 79 million during the same period last year. The outflow in FY23 was almost entirely due to one-off US$1.0 billion repayment of Sukuk bond that matured in December 2022. Flows in other debt instruments and equity were almost balanced out. A sector-wise breakdown of net FPI showcases outflows from sectors including commercial banks, fertilizer, cement, food and personal care products (**Figure 6.23**).

Inflows under the foreign portfolio investment were affected by both the domestic and external factors. Lower corporate profits amid high inflation, rising interest rates and depreciating currency, super tax on high-earning firms, uncertainties surrounding the IMF program, and domestic political environment were the major factors that kept the equity market under pressure (**Figure 6.24**).[22] Among the external factors, the most prominent was higher global

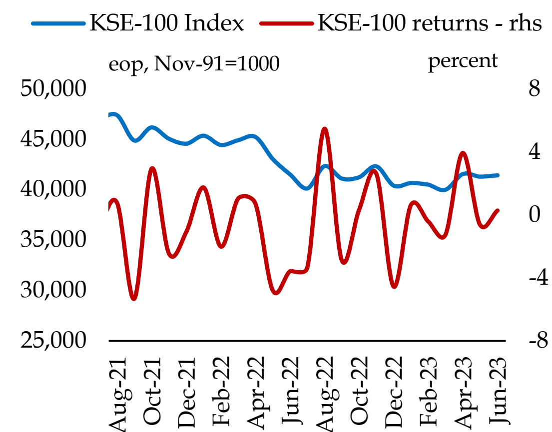
[19] Source: UNCTAD, Investment Policy Hub (www.investmentpolicy.unctad.org/investment-disputesettlement/cases/463/tethyan-copper-v-pakistan)
[20] GSM Intelligence, 2022/23
[21] Source: Pakistan Energy Outlook Report, 2021-2030
[22] Financial Stability Review, State Bank of Pakistan, 2022

Sector-wise Net FPI Flows **Figure 6.23**



*food and personal care products
**power generation and distribution
Source: National Clearing Company of Pakistan, Ltd

KSE-100 Index **Figure 6.24**



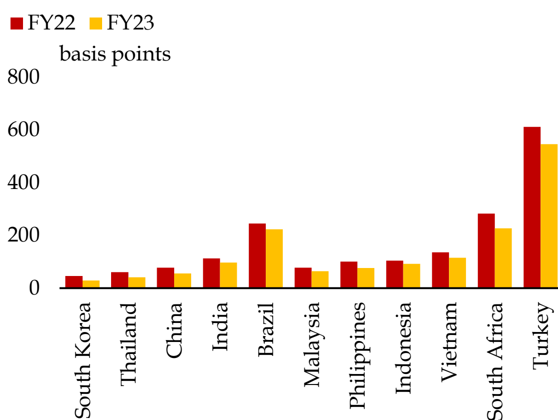
Sources: State Bank of Pakistan and Haver Analytics

interest rates that led to outflows from EMDEs, and Pakistan was no exception. Further, downgrading of Pakistan to a frontier market by the MSCI and cut in sovereign credit rating by Moody's, Fitch and S&P also contributed to drop in FPI inflows into the country. [23]

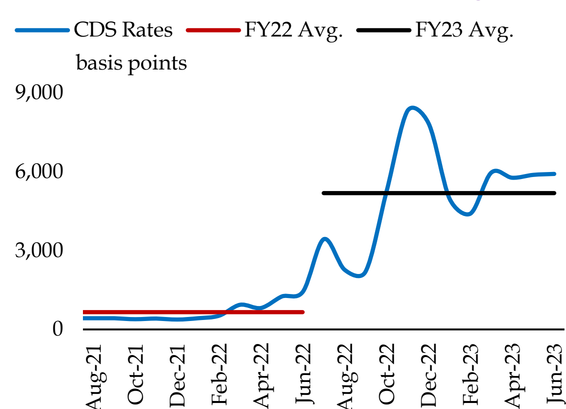
Also, the scheduled bond issuance of US$ 2.0 billion could not be initiated due to the prevailing domestic uncertainties and unfavorable conditions in the international capital markets. Higher interest rates in the AEs, and domestic policy uncertainties led to higher bond yields and surge in credit default swaps (CDS) rates of Pakistan. The CDS rates reached record levels, much higher compared to many emerging markets (**Figure 6.25 a & b**).

Roshan Digital Accounts also recorded outflows in FY23, with decline in investment in both the conventional and Islamic Naya Pakistan Certificates (NPCs) due to domestic uncertainties and higher country risks (**Figure 6.26)**. This was despite upward revision in return on NPCs.

Average CDS Rates **Figure 6.25a**



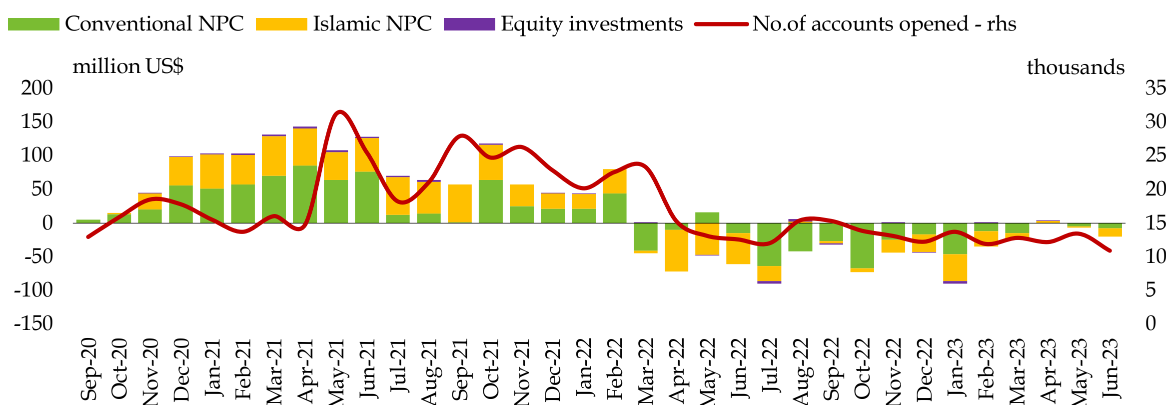
Pakistan's CDS Rates **Figure 6.25b**



Source: Bloomberg

[23] Reuters (www.reuters.com/markets/asia/moodys-slashes-pakistans-rating-amid-payment-crisis-2023-02-28/); Bloomberg (www.bloomberg.com/news/articles/2022-12-22/pakistan-downgraded-by-s-p-as-fiscal-economic-outlook-worsens); Fitch Ratings (www.fitchratings.com/research/sovereigns/fitch-downgrades-pakistan-to-ccc-14-02-2023#:~:text=Fitch%20Ratings%20%2D%20Hong%20Kong%20%2D%2014,of%20'CCC%2B'%20or%20below)

Roshan Digital Account Flows **Figure 6.26**



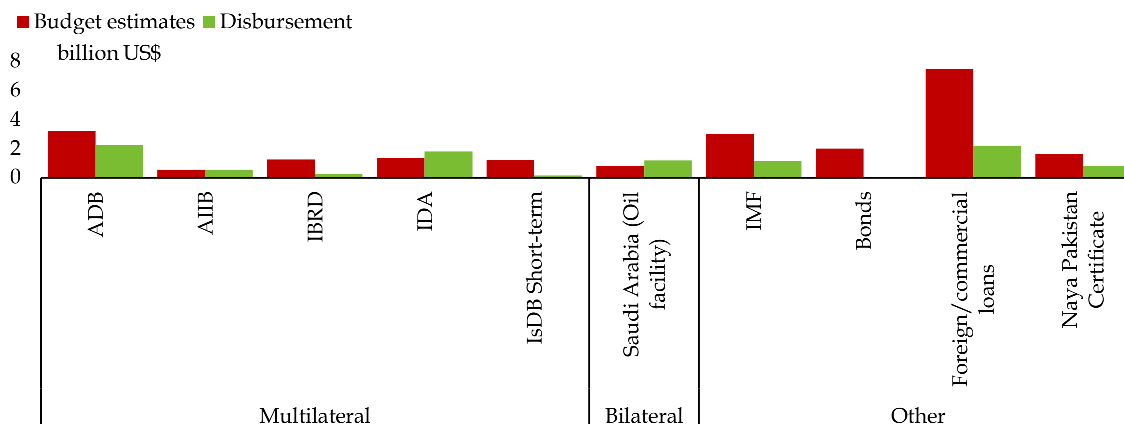
Source: State Bank of Pakistan

FX Loans and Liabilities

During FY23, net outflows of FX loans amounted to US$ 2.1 billion, compared to net inflows of US$ 12.2 billion in FY22. Loan disbursements stood at US$ 10.7 billion during FY23 – about 47 percent of the budgeted US$ 22.7 billion – compared to US$ 15.2 billion in FY22 (**Figure 6.27**).[24] The delay in the release of the IMF tranche under the EFF was the key reason behind the shortfall in disbursements, which also impacted inflows from other multilateral and bilateral creditors.

In case of multilateral loan inflows, Asian Development Bank (ADB) dominated via Building Resilience with Active Countercyclical Expenditures program that aims to alleviate the aftereffects of the economic turmoil in the country through social protection measures, enhanced business support, and food security efforts.[25] The entire US$ 2.05 billion of the program funding was disbursed during FY23. Inflows from the ADB also included those received under the Integrated Social Protection Development Project to support the government's efforts in implementing the Ehsaas Program's prioritized objectives.[26]

FX Loans - Budget Estimates vis-a-vis Disbursed **Figure 6.27**



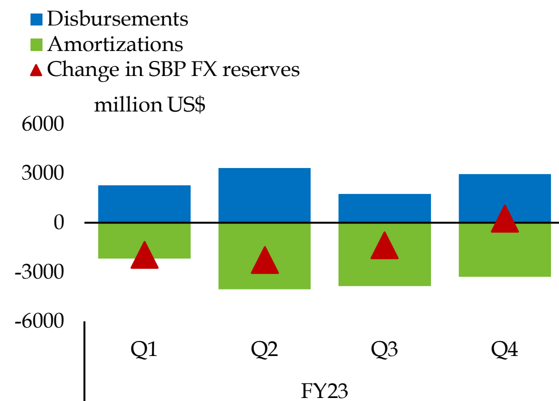
Source: Economic Affairs Division

[24] Source: Monthly Disbursements Report of Foreign Economic Assistance, June 2023 - Economic Affairs Division
[25] Building Resilience with Active Countercyclical Expenditures Program, Asian Development Bank (www.adb.org/projects/56148-001/main)
[26] Integrated Social Protection Development Program, Asian Development Bank (www.adb.org/projects/45233-007/main)

Among bilateral loans, the largest external inflows was Saudi oil facility, amounting to US$ 1.2 billion, as part of the Import of Saudi Goods (Petrol) Project and Saudi Fund for Development (SFD) for import of oil products.[27] Other inflows included foreign commercial loans totaling US$ 2.2 billion and disbursement of US$ 1.2 billion under the IMF's EFF program. However, another tranche was initially planned to be disbursed in FY23, but was delayed due to prevailing economic and political uncertainties in the country. Nonetheless, rollovers of loans amounting to US$ 7.0 billion (US$ 4.0 billion from China and US $3.0 billion from Saudi Arabia) along with re-financing of Chinese commercial loans of US$ 1.3 billion eased pressures on foreign exchange reserves.

Inflows from the World Bank included US$ 249 million from International Bank of Reconstruction and Development (IBRD) and US$ 1.8 billion from the International Development Association (IDA) arm of WB. Most inflows from IDA were disbursed for Crisis Resilient Social Protection program as part of Benazir Income Support Programme (BISP), followed by inflows for Pakistan Meteorological Department to strengthen the early warning system (US$ 161 million) and the Sindh Flood Emergency program (US$ 143 million). Disbursements from the IDB (both long-term and short-term) amounted to US$ 161 million during FY23 as short-term credit.

Disbursements, Amortizations & FX Reserves — **Figure 6.28**



Source: State Bank of Pakistan

Amortization of official loans during FY23 amounted to US$ 11.7 billion, compared to US$ 9.5 billion in FY22. Most of the amortization was of long-term loans, totaling US$ 10.4 billion, while short-term amortization was US$ 1.3 billion.

6.3 Exchange Rate and Reserves

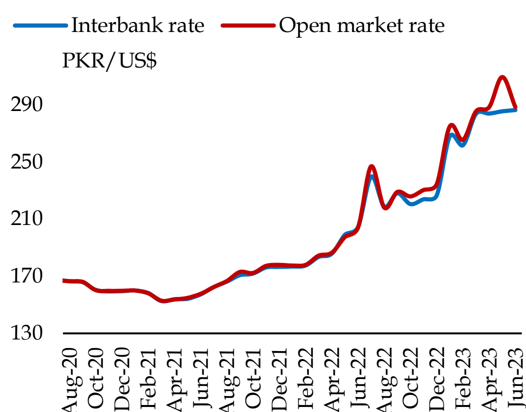
Pakistan's foreign exchange reserves fell for the second consecutive year in FY23. Higher scheduled payments, lower FDI, net outflows from debt and equity securities, and lower than budgeted loan disbursements led to fall in SBP's foreign exchange reserves by US$ 5.3 billion in FY23. On the other hand, commercial banks' reserves dropped by US$ 920 million mainly on account of outflows under trade financing, albeit lower than the previous year, and drawdown of FE-25 deposits.[28]

In the first quarter of FY23, SBP's liquid forex reserves dropped by US$ 2.0 billion mainly on account of amortization of loans of US$ 2.2 billion that more than offset the materialization of US$ 1.2 billion tranche after the completion of 7th and 8th review under IMF's EFF and US$ 1.1 billion under other multilateral and bilateral inflows. In Q2-FY23, though financial inflows picked up predominantly on the back of long-term loans, quarterly amortizations reached a record high of US$ 4.0 billion (including repayment of US$ 2.3 billion and US$ 1.0 billion under commercial loans and Sukuk bond respectively), resulting in SBP's reserves depleting by another US$ 2.3 billion to US$ 5.6 billion by end-December 2022. In Q3-FY23, amortization stood at US$ 3.8 billion, whereas official financial inflows remained scanty (US$ 1.7 billion). During Q4-FY23, an uptick in multilateral inflows and commercial loans combined with slightly lower amortization provided respite to continuously declining SBP's

[27] The Saudi Fund for Development, United Nations Development Programme (www.undp.org/pakistan/saudi-fund-development)

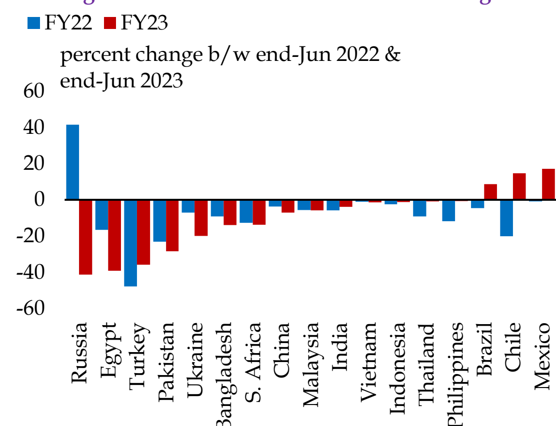
[28] FE-25 deposits dropped by US$ 718 million during FY23.

Exchange Rate Movement **Figure 6.29**



Source: State Bank of Pakistan

Exchange Rate Movements - EMEs **Figure 6.30**



Source: Haver Analytics

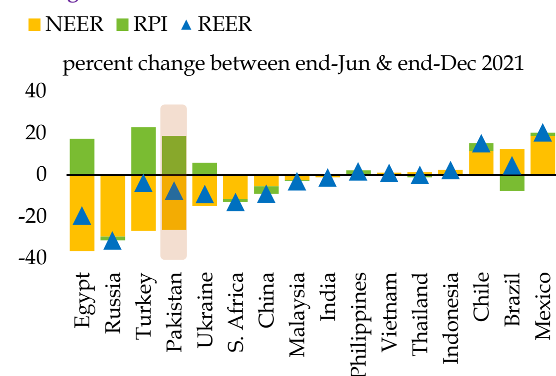
liquid FX reserves, which rose by US$ 259 million after consecutively dropping for six quarters (**Figure 6.28**).

The external account pressures, together with domestic political uncertainty and continuous strengthening of US$, resulted in PKR depreciating by 28.5 percent against US dollar during FY23. Except for a slight QoQ appreciation of 0.6 percent observed during Q2-FY23[29], PKR remained under pressure throughout the year. The persistence of external pressures and associated volatility in exchange rate also resulted in widening spread between interbank and open market exchange rates during FY23. The deviation of open market rate from the interbank rate, particularly during Q2 and Q4 of FY23, reflected prevailing economic uncertainties, especially related to the IMF program **(Figure 6.29)**. Moreover, there were some seasonal factors contributing to increase in demand for foreign exchange in Q4. Other than usual tourism-related travel, this year saw increased number of Pakistanis traveling for Hajj, as Saudi government allowed the full quota for first time since the pandemic.

A cross country analysis show that currencies of many EMEs' depreciated against US$ during FY23 (**Figure 6.30**) except a few Latin-American countries such as Mexico, Chile and Brazil which had started monetary tightening ahead of US. A large part of the depreciation of emerging market currencies was explained by strengthening of US$, driven by US monetary tightening and investors' appetite for US securities resulting in capital outflows from EMDEs.[30]

Nominal effective exchange rates (NEER) in some of the Latin-American and South-East Asian EMs appreciated during the period, whereas, Pakistan was among those EMs where NEER depreciated that outweighed rise in

Change in REERs of Major EMEs during FY23* **Figure 6.31**



*JP Morgan effective exchange rates (deflated by CPI)
Source: Haver Analytics

[29] In addition to a spike in multilateral inflows during Q2-FY23, QoQ imports also declined by 19 percent that is highest since Q3-FY09 mainly on the account of import compressing measures taken in the previous months.
[30] Obstfeld, Maurice and H. Zhou. (2022). "The Global Dollar Cycle.', Brookings Papers on Economic Activity, Fall. 361-427.

Trade Balance **Table 6.4**

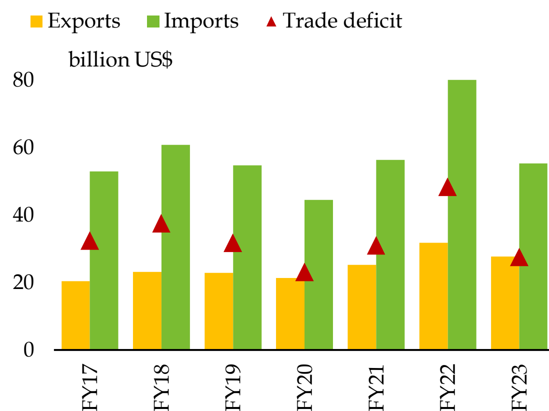
million US$

	FY22	FY23	Change (YoY)	
			Absolute	Percent
Trade Balance	**-48,354.1**	**-27,595.0**	**-20,759.1**	**-42.8**
Exports	**31,782.2**	**27,734.9**	**-4,047.3**	**-12.6**
Textile, of which	19,329.9	16,501.8	-2,828.1	-14.6
Apparel	*9,025.7*	*7,928.7*	*-1,097.0*	*-12.2*
Home textile	*4,404.2*	*3,691.2*	*-713.0*	*-16.2*
Cotton yarn	*1,206.8*	*844.3*	*-362.5*	*-30.0*
Non-textile, of which	12,452.1	11,233.1	-1,219.0	-9.7
Rice	*2,512.8*	*2,149.1*	*-363.7*	*-14.5*
Sports goods	*364.9*	*404.8*	*39.9*	*10.9*
Imports	**80,136.3**	**55,329.8**	**-24,707.5**	**-31.0**
Energy	23,318.4	17,014.6	-6,304.2	-36.8
Non-energy, of which	56,817.6	38,315.2	-18,502.2	-32.6
Palm oil	*3,549.3*	*3,640.7*	*91.4*	*2.6*
Machinery	*10,920.4*	*5,807.9*	*-5,112.5*	*-46.8*
Transport	*4,453.5*	*1,758.2*	*-2,695.3*	*-60.5*

Source: Pakistan Bureau of Statistics

relative price index (RPI). Pakistan's depreciation of 26.3 percent in NEER is also associated with appreciation (in case of Vietnam) or relatively lower depreciation (in case of India and China) in nominal exchange rates of its competitors. Further, with relatively lower inflation in these competitor countries, Pakistan's relative price index (RPI) increased by 18.8 percent during the year, offsetting the impact of large nominal depreciation from the stand point of country's competitiveness. As a result, depreciation of real effective exchange rate (REER) was limited to only 7.5 percent during FY23 (**Figure 6.31)**, which nevertheless contributed, along with other factors, in narrowing trade deficit**.**

Trade Account **Figure 6.32**



Source: Pakistan Bureau of Statistics

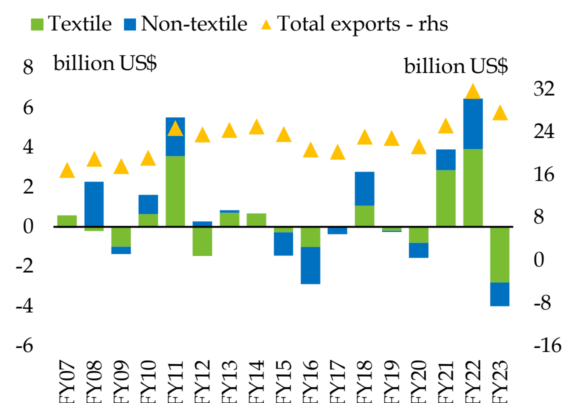
6.4 Trade Account[31]

Pakistan's trade deficit (in goods) contracted by 42.9 percent to US$ 27.6 billion in FY23, compared to US$ 48.4 billion in the previous year (**Figure 6.32**). This substantial improvement in trade balance was on account of a broad-based fall in imports, induced by various policy and administrative measures taken by the government and the SBP to contain domestic demand. Exports also edged down, relatively at a slower pace than imports, on account of both the global and domestic factors (**Table 6.4**).

It is important to note that in the long run, a sustainable trade balance, achieved by a broad-based and sustained expansion in exports is

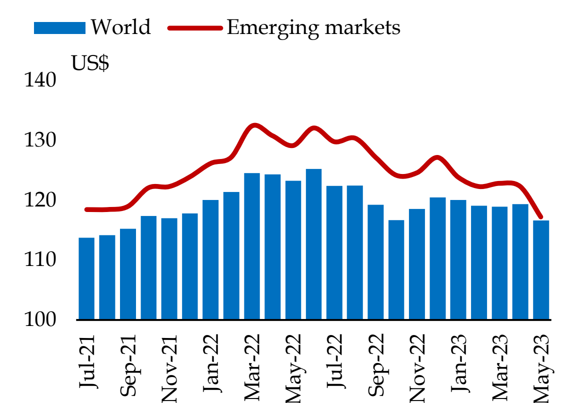
[31] This section is based on customs data reported by the PBS. The information in this section does not tally with the payments record data, reported in **Section 6.2**. The difference between the two data series is discussed in Annexure on Data Explanatory Notes.

Pakistan's Merchandize Exports and Change in Textile and Non-Textile Exports Figure 6.33



Source: Pakistan Bureau of Statistics

Unit Values of Exports from Emerging Economies Figure 6.34



Source: CBP World Trade Monitor

central to the external account stability in Pakistan. This could be achieved by addressing key structural issues in manufacturing and agriculture sectors, including low skilled human resource, use of traditional practices, and limited export outreach. Moreover, retaining the GSP+ status in the EU market is also crucial for the export sector, as it offers a competitive advantage over non-GSP+ textile exporters through preferential import tariffs on Pakistan's exports to the EU (**Box 6.3**).

Exports

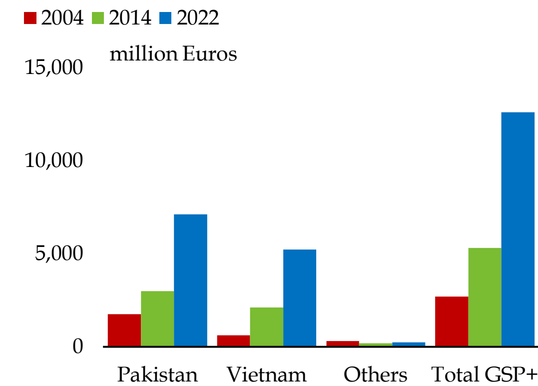
After crossing US$ 30 billion mark for the first time in FY22, Pakistan's merchandise exports contracted by 12.7 percent to US$ 27.7 billion in FY23. This decline was an outcome of both demand and supply side factors, including increased cost of production, shortage of raw materials, disruptions due to the flash floods, and slowdown in global economic activity amid monetary tightening in advanced economies. Moreover, amid PKR depreciation, the exporters had to renegotiate the export prices. Resultantly, the apparel exporters managed to overcome their losses by acquiring more orders. Meanwhile, non-textile exports declined by 9.8 percent (**Figure 6.33**). In overall terms, both volumes and unit prices contributed to decline in merchandize exports.

The slowdown in textile sector amid lower cotton production and increase in cost of borrowing, following the linking of rates on SBP's concessionary refinance scheme (LTFF) with the policy rate, reinforced the downtrend in total exports during the year. On the other hand, fall in international commodity prices resulted in lower unit values for exporters (**Figure 6.34**). In terms of destinations, the decline in exports was apparent in all traditional markets including, US, EU, China, and Bangladesh.

Box 6.3: Pakistan's Textile Exports Performance under the GSP+ Status

GSP+ is a special incentive arrangement within the standard Generalised Scheme of Preferences (GSP) of the European Union (EU). GSP+ was started in 2014 with the objective to provide additional trade benefits to the vulnerable low- and lower-middle income economies, particularly to facilitate them in achieving sustainable development, good governance, poverty eradication, and their participation in the global economy. However, these benefits are subject to strict compliance with 27 core international conventions related to human rights, labor rights, protection of the environment, climate change, and good governance.

Value Increase in Textile Exports of GSP+ Countries **Figure 6.3.1 a**



Source: Eurostats

Volume increase in Textile Exports of GSP+ Countries **Figure 6.3.1 b**

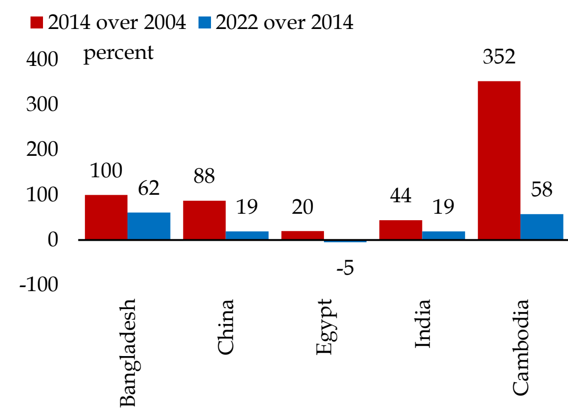
Source: Eurostats

The GSP+ program allows the eligible countries duty-free access to EU market under the available tariff lines. The scheme involves complete elimination of import duties on majority of the EU's tariff lines for all GSP+ beneficiaries, including Pakistan along with six other member states.

Pakistan has remained one of the largest GSP+ beneficiaries since the initiation of the arrangement, and is presently one of the six Asian countries that has been awarded this special status. The current GSP+ status of all the beneficiaries is valid until December 2023; the renewal of this preferential scheme is subject to its approval from the EU Council.[32] This box reviews the trade performance of Pakistan under the GSP+ status and highlights its significance in giving impetus to exports of the country, particularly the textile exports. The preferential tariff rates under GSP+ have given boost to Pakistan's trade relations with the EU, enabling duty-free access to 66 percent of the product categories for exports, such as apparel and clothing; home textile; fabric and yarn; food products; leather apparel; and surgical goods, among others. Notably, more than 78 percent of Pakistan's existing exports to the EU take place under preferential import tariffs offered in GSP+. In view of the conducive environment enabled under the GSP+, the EU market has emerged as Pakistan's most important export destination in the recent years, especially for textile and clothing, comprising 20 percent of our total textile sector exports globally—worth around EUR 7 billion.[33]

In particular, the textile exports to EU have more than doubled to EUR 7.1 billion in 2022 from EUR 3.0 billion in 2014, accounting for a volumetric increase of 94.0 percent in the same period (**Figure 6.3.1a**). It is further evident in Pakistan's textile export volumes growing at much faster pace after the introduction of GSP+ compared to the growth prior to joining the GSP+, during the period 2004 to 2014 **(Figure 6.3.1 b)**. In absolute terms, the volumes almost doubled in a span of ten years to 2022. On the other hand, the volumetric increase in textile exports of non-GSP+ competitor countries was relatively slower compared to the GSP+ countries + during the period (**Figure 6.3.2**).

Volume Increase in Exports of Non-GSP Competitor Countries **Figure 6.3.2**



Source: Eurostats

The GSP+ status of the member countries is renewed periodically by the EU, which is contingent on satisfactory assessment regarding the implementation of 27 fundamental

[32] Except for Viet Nam, which expired in January 2023.

[33] European commission: EU trade relations with Pakistan. Facts, figures and latest developments. (policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/pakistan_en)

international conventions. In this context, the current GSP+ status of all the beneficiaries is valid until December 2023; the renewal of this preferential scheme is subject to its approval from the EU. Therefore, in order to continue this preferential treatment for Pakistan, it is important to demonstrate compliance with the 27 core conventions, as well as some additional requirements pertaining to environmental safety and climate change, employment accessibility to individuals with physical disability, and abolition of child labour.

Major Textile Exports — **Table 6.5**

million US$

	FY22	FY23	Change	VE	PE
Apparel	9,025.7	7,928.7	-1,097.0	1,581.9	-2,678.8
Home textiles	4,404.2	3,691.2	-713.0	-798.6	85.6
Cotton fabrics	2,437.9	2,022.0	-415.9	-581.7	165.8
Cotton yarn	1,206.8	844.3	-362.5	-200.9	-161.6
Other textile made-up (excl. towels & bed wear)	849.1	692.5	-156.6		
Other textile material	761.4	713.1	-48.3		
Art silk and synthetic textiles	460.1	412.3	-47.8	-127.8	80.0
Total Textile Exports	**19,329.9**	**16,501.8**	**-2,827.1**	**-**	**-**

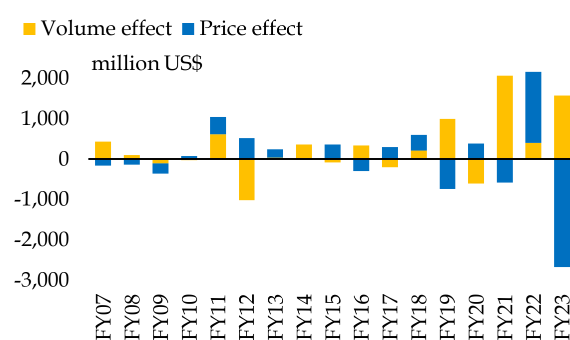
Note: VE: Volume Effect; PE: Price Effect

Source: Pakistan Bureau of Statistics

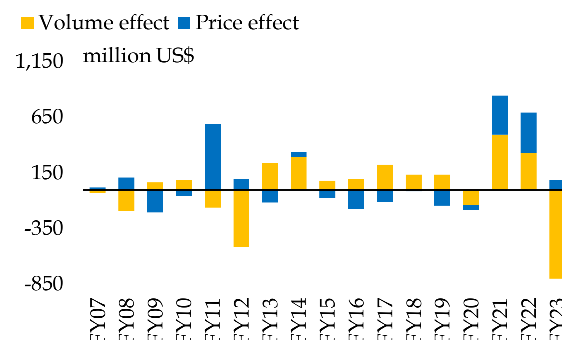
Textile Exports

Textile exports declined by 14.6 percent to US$ 16.5 billion in FY23, down from US$ 19.3 billion in FY22, accounting for around 70 percent of the contraction in total exports. The decline was broad-based as export of all leading product categories, including apparel (hosiery and ready-made garments), home textiles (bed-wear and towels) and other textile made-ups (which include items like washing and dish cloths, curtains, table linen) was significantly lower compared to the previous year (**Table 6.5**). Both the prices and volumes contributed to lower textile exports across all major categories, barring wearing apparel that witnessed an overall upsurge in volumes. In case of apparel, the disruptions in shipments from China due to its Covid-related restrictions diverted export orders, especially from EU and the US, to alternate markets, including Pakistan (**Figure 6.35 a and b)**.[34]

Breakdown of Change in Apparel Exports — **Figure 6.35a**



Breakdown of Change in Home Textile Exports — **Figure 6.35b**

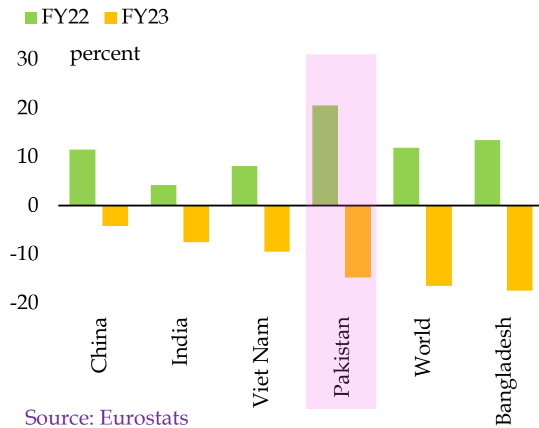


Note: Sum of volume effect & price effect equals change during a given year

Source: Pakistan Bureau of Statistics

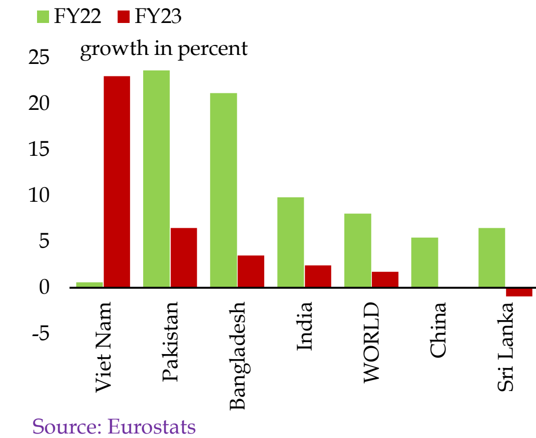
[34] US apparel volume imports from China dropped by 2.4 percent in 2022 compared to last year. While, shipments from rest of the world grew in the same period. Source: Emerging Textiles

Growth in Import Volumes of Home Textile - EU **Figure 6.36**



Source: Eurostats

Growth in Import Volumes of Apparel - EU **Figure 6.38a**



Source: Eurostats

Volume Impact

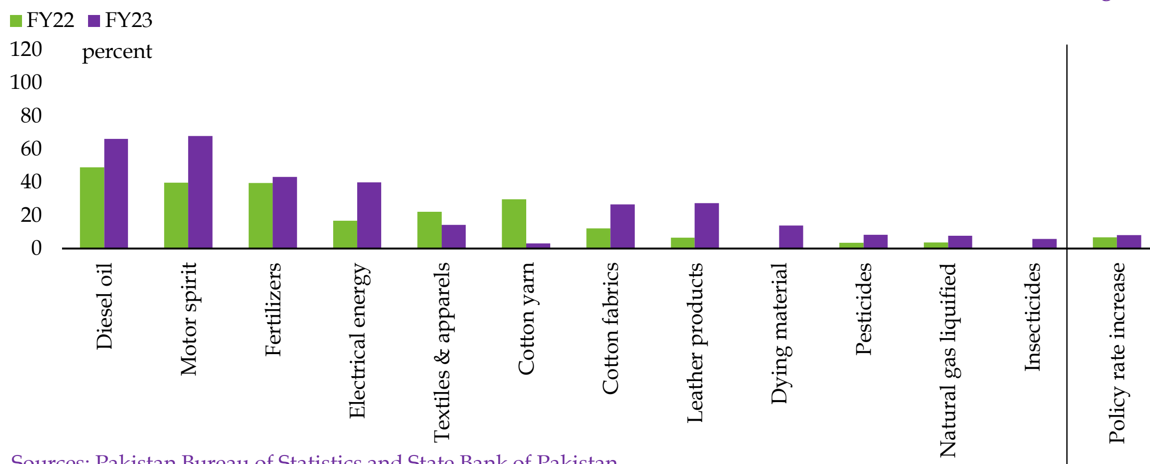
The volume of Pakistan's textile exports recorded a sharp decline in all categories, except for wearing apparel, during FY23. In this regard, both demand and supply side factors were at play. On the demand side, the slowdown in all traditional markets weighed heavily on the external demand, resulting in fall in export volumes (**Figure 6.36**). On the supply side, the increase in domestic prices of raw materials, high energy tariffs, and elevated financing costs, inflated the overall cost of production owing to which the textile sector faced challenges in continuing the growth momentum of the previous year. Moreover, in view of the flood-related agriculture losses, especially cotton, the textile sector faced severe shortages of the key raw material (**Figure 6.37**).

Within the textiles, the export volumes of wearing apparel edged up by 17.5 percent in FY23 compared to 3.0 percent last year. The uptrend in the volume effect was visible mainly on account of diversion of export orders from China to other markets including Pakistan. Meanwhile, depreciation created space for exporters to lower their PKR margins by cutting back prices amid an opportunity to capitalize on higher orders (**Figure 6.38a)**.

Price Impact

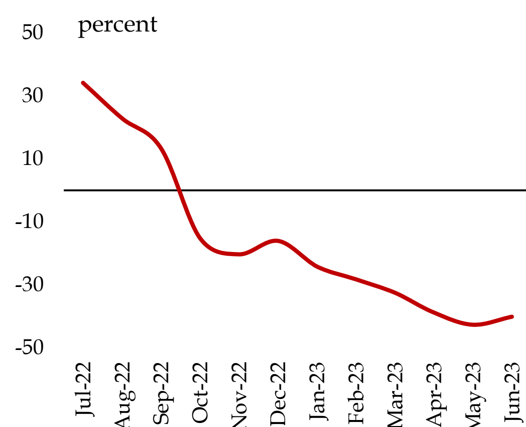
Global commodity prices started to taper off during FY23. This was mainly due to

Change in Cost of Production - Prices (percent growth) **Figure 6.37**



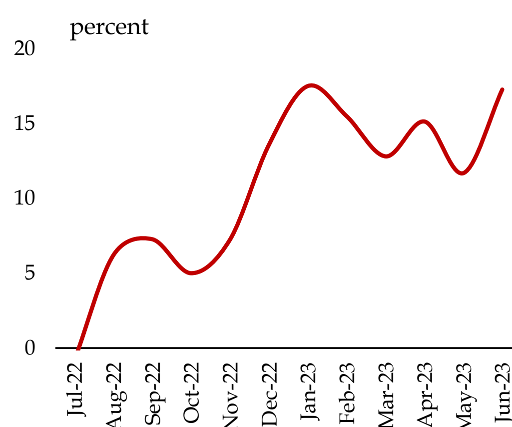
Sources: Pakistan Bureau of Statistics and State Bank of Pakistan

Growth in Global Cotton Prices — **Figure 6.38 b**



Source: World Bank

Growth in Global Rice Prices — **Figure 6.39**



Source: World Bank

normalization returning to supply chains and logistic operations. More specifically, the international cotton prices recorded a considerable decline of 40 percent in FY23 compared to the preceding year, which reduced the cost of production and was reflected in the export prices of cotton-based apparel globally (**Figure 6.38 b**).

Non-textile exports declined mainly on account of lower volumes

Non-textile exports posted a decline of 9.8 percent to US$ 11.2 billion in FY23 from US$ 12.5 billion in the previous year (**Table 6.6**). The decline was mainly visible in the agro-food products, following the agricultural production losses due to floods. Other non-textile exports, including chemicals, also registered a volume-led decline on account of higher cost of inputs.

Within the agro-food exports, there was a sharp decline in rice output as floods significantly affected the production of non-basmati rice. Therefore, export of non-basmati rice declined by US$ 319.6 million during FY23 despite higher prices. The global supply side constraints pushed the prices upward, as India imposed ban on export of rice in September 2022 in view of national food security and rising food inflation (**Figure 6.39**).

In other food exports, the government allowed sugar mills to export 250,000 MT of sugar in January 2023. Sugar export fetched US$ 104.5 million in FY23. Also, exports of meat gained

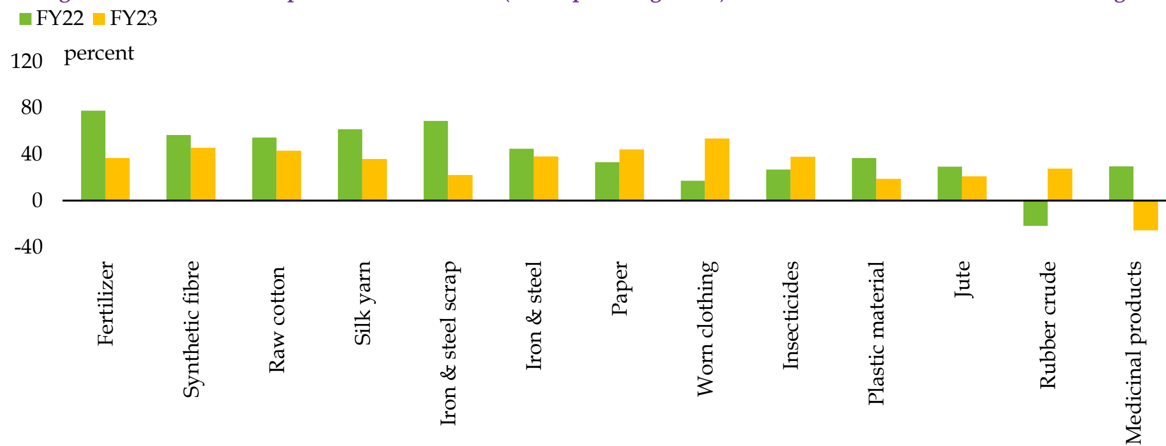
Major Non-textile Exports — **Table 6.6**

million US$

	FY22	FY23	Change
Rice, of which	2,512.8	2,149.1	-363.7
Basmati rice	*694.5*	*650.4*	-44.1
Non-basmati rice	*1,818.3*	*1,498.7*	-319.6
Fish and fish preparations	430.9	496.3	65.4
Sugar	-	104.5	104.5
Fruits	477.3	283.4	-193.9
Leather products	621.1	577.4	-43.7
Chemicals	1,569.1	1,387.0	-182.1
Sports goods	364.9	404.8	39.9
Total Non-textile	**12,452.1**	**11,233.1**	**-1,219.0**

Source: Pakistan Bureau of Statistics

Change in Unit Values of Imported Raw Materials (PKR - percent growth) **Figure 6.40**



Source: Pakistan Bureau of Statistics

further traction on account of new orders from China and Egypt during FY23. Pakistani exporters tapped the market of Egypt in H1-FY23. As a result, the meat exports increased by 25.1 percent to US$ 426.7 million in FY23 compared to US$ 341.0 million in the previous year.

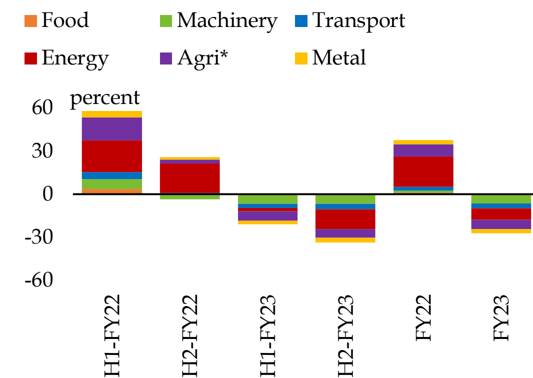
A significant volumetric decrease was witnessed in exports of leather products, as is also evident from sluggish activity in leather industry. Higher costs of raw materials, including the imported tanning chemicals and electricity subdued the production levels, which resulted in 7.0 percent decrease in leather exports during FY23 compared to a rise of 14.5 percent the previous year (**Figure 6.40**).

Export of cement and clinker registered a decline of 15.2 percent in FY23 due to lower shipments, particularly to China and Bangladesh. This volumetric decline could be attributed to weak demand in China amid a slowdown in construction activity. On the other hand, export of sports goods rose 10.9 percent in FY23 especially on account of higher demand of footballs, attributed to FIFA World Cup held in November and December 2022.

Imports

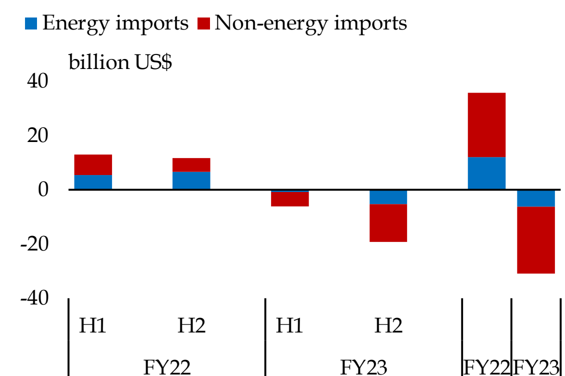
Imports declined by 31.0 percent to US$ 55.3 billion in FY23 from US$ 80.1 billion in FY22. Both energy and non-energy imports witnessed a broad-based decline **(Figure 6.41)**. While energy imports remained high in the start of the

Sectoral Contribution to Import Growth **Figure 6.41**



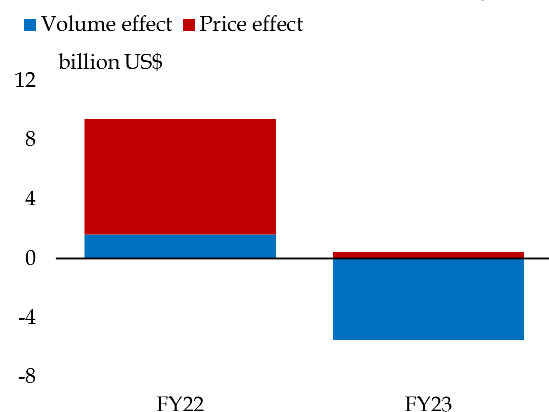
* Agri & other chemicals
Source: Pakistan Bureau of Statistics

Change in Energy and Non-Energy Imports **Figure 6.42**



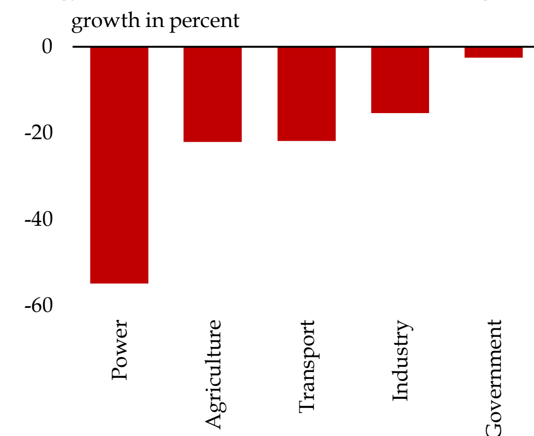
Source: Pakistan Bureau of Statistics

Volume and Price Effects in Energy Imports **Figure 6.43**



Source: Pakistan Bureau of Statistics

Energy Sales in Various Sectors **Figure 6.44**



Source: Oil Companies Advisory Committee

year, they started to fall as the year progressed **(Figure 6.42)**. This was mainly because of the administrative and regulatory measures taken by the government and the SBP, slowdown in domestic demand, and policy tightening. Further, PKR depreciation also discouraged imports.

Energy Imports

Energy imports, which more than doubled in FY22 predominantly due to higher international crude oil prices, fell by 27.0 percent to US$ 17.0 billion in FY23. The volume impact was more pronounced than the positive price impact. The decline in energy imports[35] was volume-driven **(Figure 6.43)**, reflecting lower demand as indicated by drop in POL sales to all sectors, including industry, agriculture, transport, power and government, with power sector's sales shrinking by more than half **(Figure 6.44)**.[36]

Energy prices also declined from their peaks during FY23. Average crude oil price fell by 37.0 percent in June 2023 from its recent high level at June 2022, whereas, natural gas prices declined by 81 percent from their peak in August 2022. The decline in crude oil prices was due to a mix of demand and supply side factors.[37] Natural gas prices declined on account of developments related to Europe, such as lower demand amid milder winter, a rise in relatively cheaper Japanese LNG imports, increased focus on energy conservation, and redirection of Russian mineral fuel exports (including natural gas and coal) from Europe to China, India and other EMDEs.

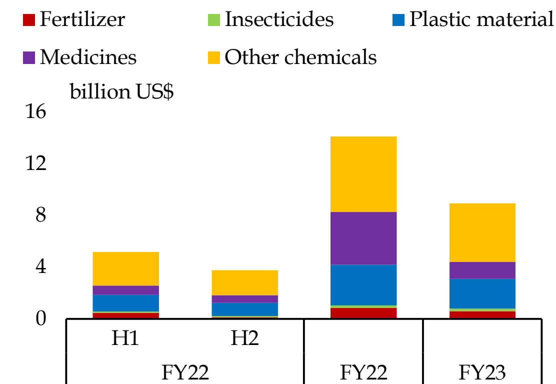
Non-energy Imports

Non-energy imports decreased by 32.6 percent to US$ 38.3 billion in FY23. While all non-energy groups recorded decline, it was more pronounced in agriculture & chemical (medicinal products, other chemicals and plastic material) and machinery (mobile phones and power generating machinery) followed by transport (especially CKD/SKD motor cars), and metal (iron and steel / scrap).

This broad-based decline in non-energy imports was mainly a result of demand compression policies and administrative measures, such as monetary policy tightening, expanding the list of items (by adding HS codes of chapter 84 and 85) requiring SBP's prior approval, increasing

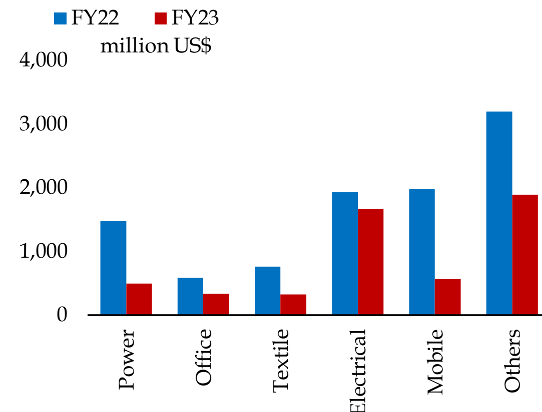
[35] Petroleum products and petroleum crude.
[36] Oil Companies Advisory Council (www.ocac.org.pk/wp-content/uploads/2022/05/New-Jul-2022-Jun-2023-ENE-Pak.pdf)
[37] On the demand side, monetary tightening in US, banking sector turmoil, and China's lackluster reopening have raised concerns about slower global economic growth and oil demand. On the supply side, global oil supply increased on the back of higher than expected oil flows from Russia. Further, introduction of a price cap by the Group of Seven (G7) industrial countries on Russian seaborne crude oil in December 2022 and oil products in February 2023 has put downward pressure on oil prices.

Imports of Agriculture & Other Chemicals **Figure 6.45**



Source: Pakistan Bureau of Statistics

Machinery Imports **Figure 6.46**



Source: Pakistan Bureau of Satistics

regulatory duty on various items, imposition of an annual limit of US$ 30,000 per person on card based cross-border transactions, tightening regulations for exchange companies, and extending the timeline for maintaining cash margins for another quarter till March 2023.

Agriculture and Chemical

Agriculture and chemical imports fell sharply during the year, contributing 6.4 percentage points to overall 31 percent decline in imports **(Figure 6.45)**. Within this group, import of medicinal products fell by 67.3 percent, mainly because of lower imports of Covid vaccines.

Since imports of plastic materials and other chemicals mostly include raw materials, which is directly linked with domestic production of plastic goods, the slowdown in domestic economic activities resulted in a substantial decrease in the imports of plastic materials and other chemicals by 27.5 percent and 22.7 percent respectively.

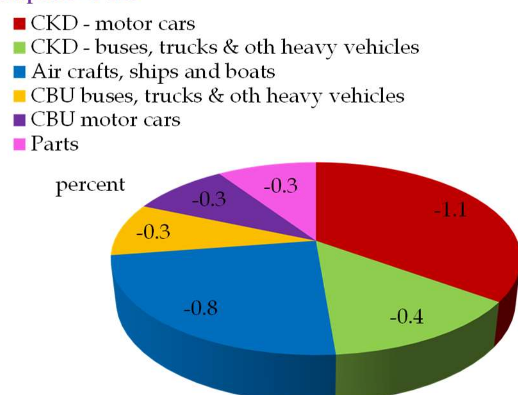
Fertilizer imports declined by 28.5 percent during FY23, mainly on account of a significant decline in volume of DAP imports. Moreover, fertilizer prices moderated from their peaks in 2022, while demand weakened due to affordability and availability amid supply-side issues such as ammonia production cuts in Europe, sanctions on Russia and Belarus, and export restrictions in China to ensure domestic availability.[38]

Machinery

A decline of 46.8 percent in machinery imports during FY23, mainly reflects the impact of regulatory and administrative measures— such as prior approval of SBP before opening L/Cs — to restrain import of non-essential items within the machinery group such as mobile phones. Monetary policy tightening, linking of LTFF rates with the policy rate, and exhaustion of TERF also affected machinery import.[39]
Within the machinery, import of mobile phones recorded the largest decline of 71.2 percent in FY23. In July 2022, as part of the regulatory measures to compress imports, chapter 85 (that also includes mobile phones) of HS codes was added to the list of items requiring SBP's prior approval before opening L/Cs. In addition, Mobile Device Manufacturing (MDM) Regulations 2021 issued by Pakistan Telecommunication Authority (PTA) also paved way for local manufacturing of mobile phones resulting in a significant decline in the import of completely built unit (CBU) phones over the last

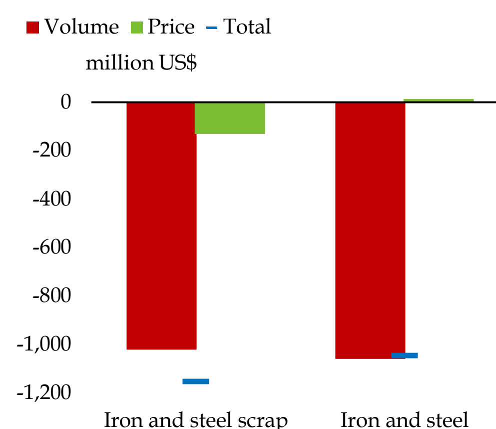
[38] World Bank Blogs (blogs.worldbank.org/opendata/fertilizer-prices-ease-affordability-and-availability-issues-linger)
[39] Fixed investment loans disbursed under TERF declined from PKR 201 billion in FY22 to PKR 54 billion in June FY23

Contribution to Growth in Transport Group Imports - FY23 Figure 6.47



Source: Pakistan Bureau of Statistics

Volume and Price Effect in Steel Imports Figure 6.48



Source: Pakistan Bureau of Statistics

few years **(Figure 6.46)**.[40] Similarly, import of power generating machinery also fell by 66.1 percent during FY23 due to constraints on imports as well as the completion of energy projects under CPEC.[41]

Transport

Imports under transport group dropped by 60.5 percent during FY23. More than 40 percent of the contraction was explained by lower CKD/SKD and CBU cars **(Figure 6.47)**, which declined considerably by 54.9 percent and 72.9 percent respectively. This is followed by the decline in import of CKD/SKD and CBU heavy vehicles.

Major factors behind this reduction are lower demand due to monetary policy tightening, administrative measures, PKR depreciation, and sharp increase in domestic prices. Import-compression measures related to transport sector, included an initial ban on imports of CBU motor vehicles (announced in May 2022[42]) which was replaced by higher duties.[43] In addition, the amended prudential regulations for consumer financing (announced in September 2021[44], and the requirement for banks to seek SBP's approval before opening LCs for high value capital goods, also contributed to the decline in CKD motor vehicles.

Metals

Metal group imports declined by 36.4 percent during FY23, mostly driven by iron and steel, and iron and steel scrap, given fall in construction activity and auto sales. The reduction in iron and steel import is primarily driven by volumes, as there was a slight increase in prices. On the other hand, falling import of iron and steel scrap is explained by the decrease in both volume and prices **(Figure 6.48)**. This trend is also in tandem with global iron ore prices. Except for the seasonal jump in global demand for iron ore due to rise in China's steel output in Q3-FY23, iron ore prices declined by 25.0 percent in June 2023 fall from its peak in March 2022.

Food

Food imports declined only slightly by 1.0 percent in FY23. This modest decline was largely due to the decline in other food imports

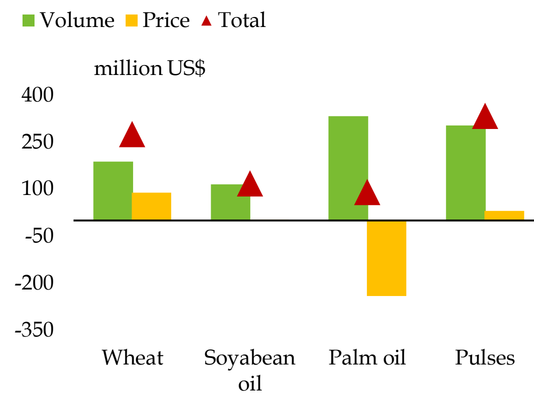
[40] Pakistan Telecommunication Authority – Annual Report 2022
[41] Source: cpec.gov.pk/energy
[42] Source: www.commerce.gov.pk/wp-content/uploads/2022/05/SRO-Ban-on-Import-of-Luxury-and-N_essential-Items.pdf
[43] Source: fbr.gov.pk/Budget2022-23/CustomsSROs/SRO-966(I)2022.pdf
[44] Source: www.sbp.org.pk/bprd/2021/CL29.htm

that was partially offset by higher increase in pulses, wheat, soybean oil and palm oil.

Pakistan, normally, starts import of wheat around August after having concrete information on domestic crop and available wheat supplies[45]. However, considering volatile international markets and uncertainty regarding wheat availability through Black Sea, Trading Corporation of Pakistan (TCP) began early tendering during May 2023.[46] This resulted into the highest wheat imports (in value terms) in the last fourteen years.[47]

Except for palm oil imports, which increased because volumetric growth offset the impact of falling prices, the import growth of pulses, wheat and soybean oil was driven by both increased volumes and prices **(Figure 6.49)**.[48]

Volume and Price Effect in Food Related Imports **Figure 6.49**



Source: Pakistan Bureau of Statistics

However, the price impact of these commodities was relatively subdued during FY23 against the substantially higher price impact recorded during FY22.

[45] USDA (2023). Grain and Feed Annual – Pakistan, (March), Washington D.C.

[46] Source: www.ppra.org.pk/elv_org.asp?orgid=32&orgname=Trading%20Corporation%20of%20Pakistan%20(TCP)&PageNo=1

[47] Source: Pakistan Bureau of Statistics (PBS)

[48] The prices of palm oil and soybean oil, however, decreased from their peaks owing to higher edible oil supplies in 2022, the BSGI, the end of several export bans, and better global supply chain conditions.