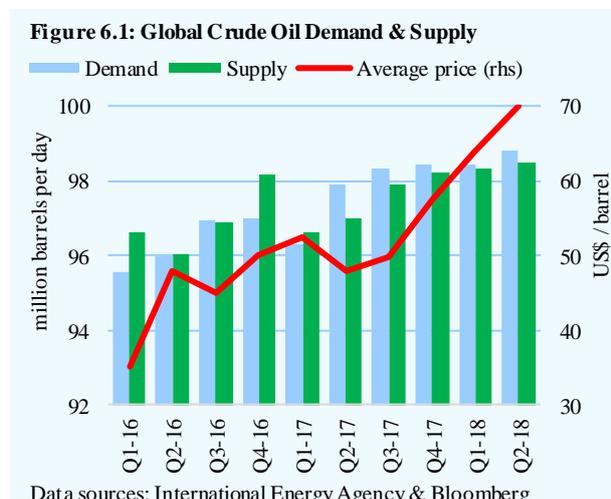


# 6 External Sector

## 6.1 Global Economic Review

Developments in the international currency and commodity markets increased uncertainty in the global economy in FY18. Trade protectionism, regional frictions and deterioration in previously assumed stable economic blocks, such as EU and the GCC, swayed economic fundamentals in a way that increased volatility in crude oil prices and strengthened the US dollar against a wide range of currencies. At the same time, a number of developed and developing economies witnessed a resurgence of growth. While growth in advanced countries is a welcome development, the rise in the global oil prices and the US dollar pose risks for growth and macroeconomic stability, specifically in emerging and developing economies.



Importantly, oil prices crossed the US\$ 80 per barrel level for the first time in four years, as supplies were squeezed due to OPEC and Russian production cuts, disruptions in Venezuela and Libya, and the situation in the Middle East. At the same time, US withdrawal from the Iran nuclear deal further aggravated this situation. While this spelled mounting trouble for oil-importing countries, the US shale industry found itself back in the game, with domestic US oil production reaching a record-high by June 2018, and partially picking up the slack in supply from OPEC. With global supply falling behind only slightly, amid hefty build-up in inventories, demand continues to be roughly balanced, as shown in **Figure 6.1**. Nevertheless, external imbalances in many oil-importing EM economies deteriorated in FY18 with widening trade deficits (**Table 6.1**).

At the same time, the US adoption of a protectionist stance against its major trading partners led equities to their record-breaking run till January 31, 2018. Besides, the US economy experienced a 12-year high growth in 2017, which was instrumental in pushing up the global economic growth to its highest level since 2011. Passage of the Tax Cuts and Jobs Act 2017 stimulated firms to invest in the economy, whereas declining unemployment and rising disposable incomes led to healthy consumer and business sentiments. These factors led to higher import demand for consumer as well as capital goods by the US. In addition to the US, positive contribution came from the euro area, as continuation of easy monetary policy stimulated robust growth and higher import of capital and consumer goods. As a result, export performances of advanced economies, such as Germany, Japan, and of emerging markets (EMs) economies like China, India and Pakistan improved significantly.

**Table 6.1: Current Account Balances of Selected EMEs**  
billion US dollars

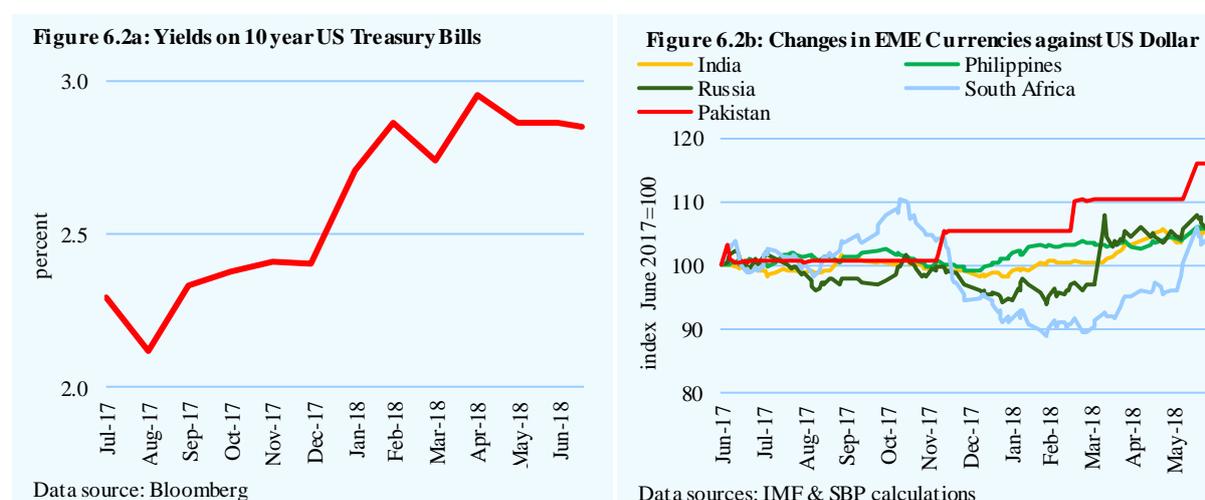
	FY17	FY18
India	-29.8	-49.5
Bangladesh	-1.3	-9.8
China	158.4	68.3
Indonesia	-13.6	-24.2
Turkey	-35.1	-57.4
Philippines	-0.8	-5.1

Data sources: Haver Analytics, Bangladesh Bank, Reserve Bank of India, Bangko Sentral NG Pilipinas

The recent growth streak in US, nonetheless, strengthened the expectation of sharp increase in domestic inflation. In response, the Federal Reserve further tightened monetary policy, raising interest

rates three times by a cumulative 75.0 basis points in FY18. The rate hikes were accompanied by asset restructuring by the Fed, where it started reducing the size of balance sheet. These twin actions led to a rising trend in 10-year US Treasury bill yields, which contributed to the increasing FX borrowing costs for EMs (**Figure 6.2a**), as their sovereign debt is widely benchmarked with this treasury rate.

Rising interest rates in the US also led to strengthening of the dollar against many EM currencies, and triggering capital outflows from some economies from Apr-Jun 2018 (**Figure 6.2b**). The consequences of this development for EM economies were adverse in terms of credit and FX liquidity risks, and debt repayment capacity (in local currency terms), as these economies often rely on external financing for BoP and budgetary support. The outflows hit the financial account balances of some EMs, and left them with no option but to finance their higher CADs by drawing down their FX reserves. This dilemma is most clearly visible in the case of Argentina, which was forced to seek a US\$ 50.0 billion bailout from the IMF in June 2018 after running high current account deficits and then witnessing sudden massive portfolio outflows from April 2018 onwards.



In this backdrop, the economies with sufficient external buffers could withstand this tide of global uncertainty. By FY17, the imbalances in Pakistan’s external account had clearly become visible; but the country was able to withstand the pressure by borrowing from abroad and utilizing its FX reserves. However, in FY18, as average oil prices rose by around 30.0 percent and the pressure of CPEC-related machinery imports started falling on the interbank market, Pakistan’s external sector came under severe strain.

## 6.2 Pakistan’s BoP

In FY18, global economic changes affected Pakistan similar to other oil importing countries. But, insufficient foreign exchange inflows magnified the impact of these developments on Pakistan’s economy. Oil prices, specifically, accentuated the country’s external imbalance by exacerbating Pakistan’s imports pressure. Had the unit value of the POL product stayed at FY17 level, Pakistan’s energy import bill, excluding LNG, would have been lowered by US\$ 2.5 billion in FY18. As per customs data, rise in the oil prices contributed almost 55.8 percent to the increase in crude imports and 219.7 percent to increase in the petroleum products’ import bills, as the quantum imports of latter actually declined.

The energy, together with the transport, food and metal imports pushed Pakistan’s import bill to a record high in FY18, and led to a historic high current account deficit (**Table 6.2**). Exports, after three years of consecutive decline, witnessed a broad based increase in FY18 on the back of growth in the US, Euro area and in other emerging economies. This rise in export receipts was, however,

insufficient to finance the rising imports.

Besides the merchandise trade, the services trade balance also deteriorated further as its exports continued to decline while its imports kept rising. In addition, rising US dollar not only magnified the stock of debt but also that of the quantum of the interest payments, which increased by 33.5 percent in FY18.

Repatriation of higher profit by foreign firms', together with the rising interest payments, increased the primary income deficit that actually declined last year; adding further to the current account imbalance. On the contrary, the strengthening US dollar and growth in advanced economies did help the workers' remittance inflows; however, these inflows remained below record receipt of FY16. The growth of 1.4 percent in remittances in FY18 was insufficient to mitigate the persistent trade deficit.

Meanwhile, the inflows under foreign investment and loans were insufficient to finance the large current account deficit.

Similar to remittances, foreign direct investment also remained stagnant in FY18. However, the country was able to mobilize significant portfolio inflows by issuing Eurobonds and *Sukuk* in the international bond market. On the contrary, the net inflow of foreign loans remained lower than the previous year.

Both the private sector and government received lower net foreign loans, whereas the banks retired their short-term obligations during the period. Nevertheless, bilateral and commercial borrowings from China dominated official disbursements in FY18, with inflows coming mainly for the budgetary support and CPEC-related projects.

As these financial inflows proved inadequate to finance the current account deficit, SBP had to resort to utilising its foreign exchange reserves, which depleted by US\$ 6.4 billion during FY18. A number of measures undertaken by SBP, including putting restriction on the movement of the foreign currency within the country, led to significant appreciation of the exchange rate within a short span of time. Going forward, realigning of expectation would require significant build-up of reserves and credible policy actions.

### 6.3 Current Account

The current account deficit in FY18 reached a high of US\$ 18.1 billion compared to US\$ 12.6 billion recorded in FY17. Yet, in terms of GDP, the deficit remained much lower at 5.8 percent in FY18 compared to FY08, when CAD of 8.2 percent of GDP caused a full-blown BoP crisis (**Figure 6.3**). While merchandise imports remained the key driver, the import of services also added significantly to this widening of the current account deficit. Moreover, workers' remittances inflows remained stagnant and failed to offset the rising trade deficit.

**Table 6.2: Balance of Payments**

million US dollars

	FY16	FY17	FY18	Change in FY18
<b>Current account balance</b>	<b>-4,867</b>	<b>-12,621</b>	<b>-18,130</b>	<b>-5,509</b>
Trade balance	-19,283	-26,680	-31,074	-4,394
Exports	21,972	22,003	24,772	2,769
Imports	41,255	48,683	55,846	7,163
Energy	8,360	10,607	13,263	2,656
Non-Energy	32,895	38,076	42,583	4,507
Services balance	-3,406	-4,339	-5,311	-972
Primary income balance	-5,347	-5,048	-5,282	-234
Secondary income balance	23,169	23,446	23,537	91
Workers' remittances	19,917	19,351	19,625	274
<b>Capital account balance</b>	<b>273</b>	<b>375</b>	<b>376</b>	<b>1</b>
<b>Financial account balance</b>	<b>-6,790</b>	<b>-10,198</b>	<b>-12,298</b>	<b>-2,100</b>
FDI in Pakistan	2,305	2,749	2,770	21
FPI in Pakistan	-329	-251	2,211	2,462
Net incurrence of liab.	5,029	8,965	7,489	-1,476
Government	3,445	5,040	4,823	-217
Private (excl. banks)	1,173	2,298	1,240	-1,058
Banks	406	1,631	-122	-1,753
<b>SBP's liquid reserves</b>	<b>18,143</b>	<b>16,145</b>	<b>9,789</b>	<b>-6,356</b>
<b>Current account (% of GDP)</b>	<b>-1.7</b>	<b>-4.1</b>	<b>-5.8</b>	<b>-</b>
PKR app/dep. against USD (%)	-2.91	-0.02	-13.70	-

Data source: State Bank of Pakistan

### Trade in Services<sup>1</sup>

The services deficit worsened by 22.4 percent in FY18 and reached US\$ 5.3 billion. The services exports, weighed down by the absence of the Coalition Support Fund (CSF), fell 6.7 percent to US\$ 5.2 billion in FY18. The import growth, though decelerated, took the total services import bill to US\$ 10.5 billion (Table 6.3). The absence of CSF was only partially offset by higher receipts from telecom, transport and travel services exports (Figure 6.4).

The deficit in transport services in FY18, the largest contributor to the services deficit, rose by a small 3.7 percent as opposed to an increase of 36.7 percent observed last year. Within transport, the freight deficit grew by 12.4 percent, despite a higher jump in the country's merchandise import bill and a significant uptick in international oil prices. In fact, increase in the freight services export kept the freight deficit exports in check. The telecom, computer & information services exports rose to US\$ 1.1 billion, up from US\$ 939.5 million in FY17. The telecom imports also increased by a quarter to US\$ 479.0 million.<sup>2</sup>

### Primary income balance

In FY18, the primary income deficit increased to US\$ 5.3 billion registering a growth of 4.6 percent, after declining 5.6 percent in FY17. Increasing magnitude of outflows, which rose by 5.1 percent to US\$ 6.0 billion in FY18, dwarfed the US\$ 0.7 billion inflows under this head.

While both profit and interest payments have risen in FY18, the rise in the latter was more pronounced compared to the former (Figure 6.5). In FY18, Pakistan paid US\$ 2.7 billion in interest on foreign loans and bonds, 33.5 percent higher from FY17. Though rate of debt accumulation has increased this year, the rise in the US treasury rate and LIBOR is also driving current increase in the interest payments. Going forward, as the global interest rates are expected to rise further, the interest income payments may increase substantially.

A break up of the sector-wise profit repatriation shows that food, communication, oil and gas exploration, power, financial business, chemical, and automobile all remitted significant profits to their parent companies abroad. The

Figure 6.3: Current Account Balance

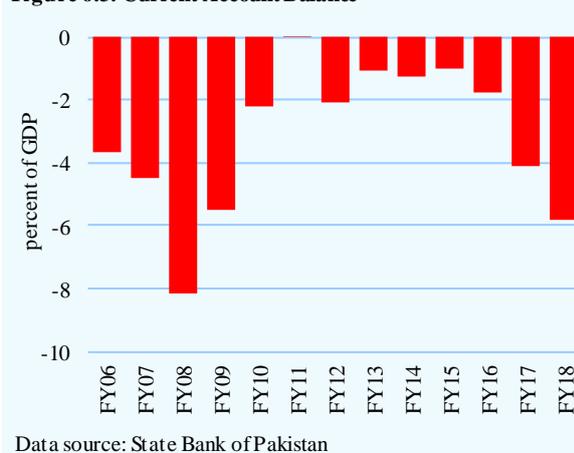
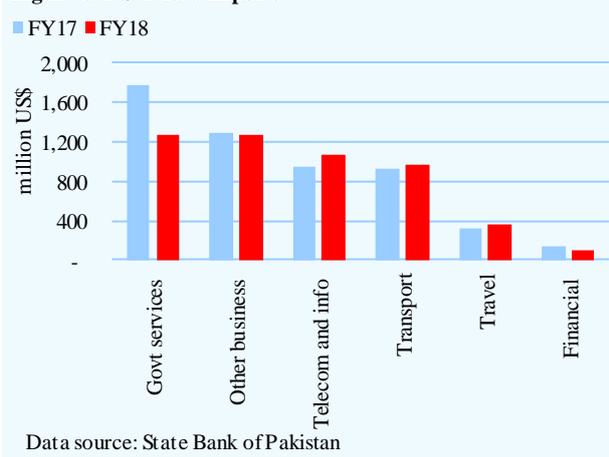


Table 6.3 Trade in Services

	Value (billion US\$)			Growth (percent)	
	FY16	FY17	FY18	FY17	FY18
Exports	5.5	5.6	5.2	1.8	-6.7
Imports	8.9	9.9	10.5	11.6	6.1
Trade Balance	-3.4	-4.3	-5.3	-27.4	-22.4

Data source: State Bank of Pakistan

Figure 6.4: Services' Exports



<sup>1</sup>Analysis in this section is based on data compiled by State Bank of Pakistan. The data is compiled as per BPM6(EBOS-2010) classification and is aligned with MSITS-2010.

<sup>2</sup>Resultantly, net telecom sector exports rose to US\$585.6 million in FY18, from US\$ 555.4 million in FY17.

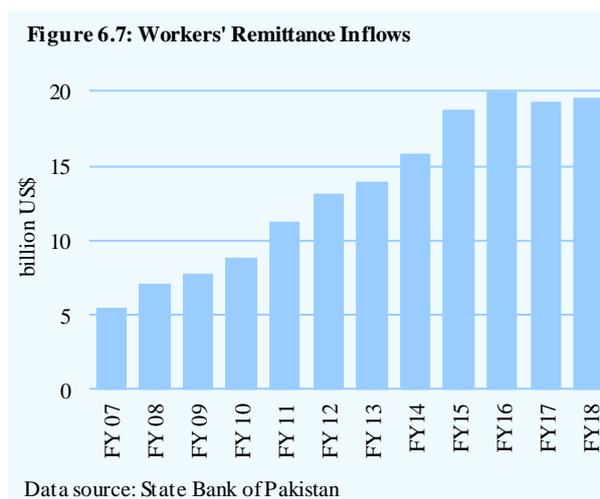
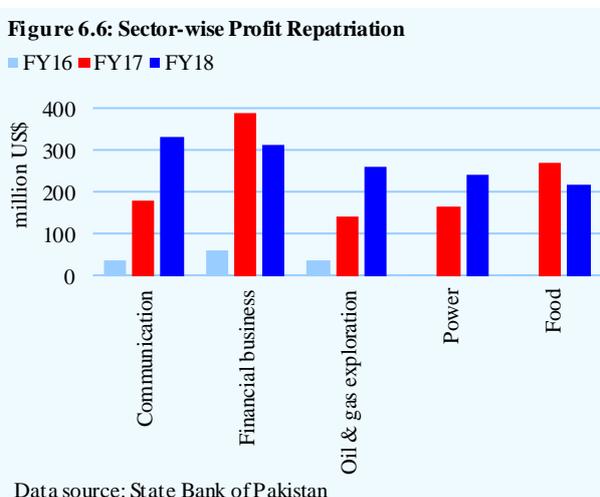
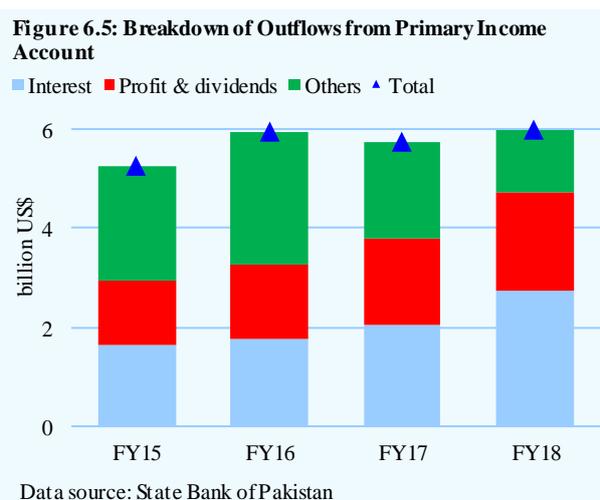
communications sector, specifically telecommunication, repatriated the highest profit of US\$ 327.8 million, whereas it had repatriated a much lower US\$ 177.8 million in FY17 (**Figure 6.6**).

#### Workers' remittances

Workers' remittances though increased marginally by 1.4 percent to US\$ 19.6 billion in FY18, remained short of the peak inflows of US\$ 19.9 billion recorded in FY16 (**Figure 6.7**). The marginal increase in FY18 shows that the downward trend that resulted in 2.8 percent decline in inflows in FY17, has apparently reversed. Various factors may have contributed to this.

First, the movement in oil prices played a key role. Not surprisingly, the increase in the GCC countries share in Pakistan's remittances inflows coincided with the increase in oil prices (**Figure 6.8**). Although oil prices peaked in FY14, remittance inflows from the GCC continued to increase until FY16. Only after FY16, when low oil prices resulted in fiscal imbalances in the GCC countries, did inflows from these economies decline. The GCC countries adopted various fiscal consolidation measures since then, including but not limited to, imposing value added tax (VAT) that squeezed the savings of the low-income unskilled foreign workers, and introducing job nationalization programs. These measures were more prominent in Saudi Arabia, which imposed various taxes on hiring and stay of expats and their families in KSA.<sup>3</sup> As a result of these measures, remittances from the GCC have been declining since FY16.

Low oil prices, at the same time, also contributed to the ongoing recovery in the advanced economies, specifically the USA, UK and countries in European Union. Therefore, the remittances inflow gained momentum from these economies at a time when inflows from GCC corridors except UAE, started declining. Increase in share of the non-GCC countries in the Pakistan's remittances inflow is a good omen, as higher diversification lowers the risk of sudden drop in these inflows.



<sup>3</sup> For details, please see Chapter 5 in SBP's Second Quarterly Report on The State of Pakistan's Economy FY18.

Second, even within GCC, the inflows from the UAE remained stable despite imposition of VAT in the emirate in tandem with KSA (Table 6.4). The UAE economy is least dependent on oil and therefore remittances from the country remained unaffected from the oil price decline. Moreover, the UAE government adopted a new anti-money laundering law in 2014. As informal inflows from UAE started entering Pakistan through formal channels, remittances from the UAE have persisted at around US\$ 4.3 billion<sup>4</sup> since then.<sup>5</sup>

Importantly, the decline in remittances from the GCC corridor may reverse going forward as oil prices have recovered substantially in FY18. However, the job nationalization drive may pose significant hurdle for the emigration of workers to the GCC, specifically KSA. The number of Pakistanis going to the Kingdom fell by more than a half in FY18 as compared to FY17 (Table 6.5). To reverse this trend, the government's support for manpower export is required.

For example, the Bangladesh government got the ban on employment of Bangladeshi workers in KSA overturned, after prolong negotiations with the Kingdom.<sup>6</sup> Similarly, the Pakistani government may ask for more quota for Pakistani workers in the KSA and other GCC countries. Qatar may be a good starting point in this context. Despite a widespread decline in the number of Pakistani workers going to most of the GCC for work, Qatar remained an exception and witnessed an increase of 67.9 percent emigration in FY18. The improvement in Pakistan's trade and diplomatic relationship with Qatar may have supported this increase.

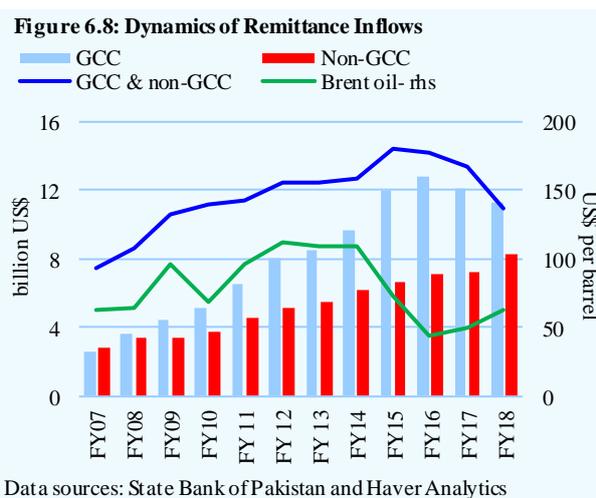
## 6.4 Financial Account

The surplus in the financial account rose to US\$ 12.3 billion in FY18, from US\$ 10.2 billion in FY17, largely due to one-off official portfolio investment inflows. In FY18, Pakistan raised US\$ 2.5 billion in Eurobond and Sukuk. However, FDI inflows remained stagnant, rising by US\$ 21.0 million only. Besides, bilateral and commercial loans also declined in net terms.

<sup>4</sup> For details, see Chapter 5 in SBP's Third Quarterly Report on The State of Pakistan's Economy FY18.

<sup>5</sup> Anecdotal evidence suggests that there could be a third factor. A significant part of the proceeds from Pakistan's software exports are being received in personal accounts which, if true, may be causing an under reporting of software export proceeds, and at the same time, over reporting of workers' remittance. To circumvent this misreporting problem, government has incentivized reporting of software exports in Digital Pakistan Policy in 2017.

<sup>6</sup> Source: World Bank, Migration and Development Brief 27, April 2017.



**Table 6.4: Workers' Remittances by Source**

	Value (million US dollar)			YoY growth (%)	
	FY16	FY17	FY18	FY17	FY18
<b>GCC</b>	<b>12,756</b>	<b>12,123</b>	<b>11,351</b>	<b>-5.0</b>	<b>-6.4</b>
KSA	5,968	5,470	4,859	-8.4	-11.2
UAE	4,365	4,328	4,333	-0.9	0.1
Kuwait	774	764	774	-1.3	1.4
Oman	819	761	657	-7.1	-13.6
Bahrain	448	396	356	-11.6	-10.3
Qatar	381	404	371	6.2	-8.2
USA	2,525	2,453	2,714	-2.8	10.6
UK	2,580	2,342	2,763	-9.2	18.0
EU	418	483	656	15.5	35.9
Others	1,638	1,951	2,140	19.1	9.7
<b>Total</b>	<b>19,917</b>	<b>19,351</b>	<b>19,623</b>	<b>-2.8</b>	<b>1.4</b>

Data source: State Bank of Pakistan

**Table 6.5: Number of Pakistani Emigrants in Selected Countries**

	Number (thousands)			Growth (percent)	
	FY16	FY17	FY18	FY17	FY18
Saudi Arabia	585	229	111	-60.8	-51.6
UAE	307	286	231	-7.0	-19.2
Qatar	10	11	18	1.2	67.9
Oman	49	44	33	-10.5	-24.5
Kuwait	0	1	1	125.1	-46.4

Data source: Bureau of Emigration and Overseas Employment

### Net incurrence of liabilities

The net inflow of foreign liabilities into the country amounted to US\$ 7.5 billion in FY18, compared to US\$ 9.0 billion during the previous year. The decline in net inflows was seen in both government and private sectors. In fact, commercial banks retired their obligations during FY18 (**Figure 6.9**).

Net government loans amounted to US\$ 4.8 billion, slightly lower than last year. The share of short-term loans in the government's overall disbursement and amortization also rose significantly.<sup>7</sup> It seems that the government continued to finance its short-term obligation by raising short-term commercial loans.

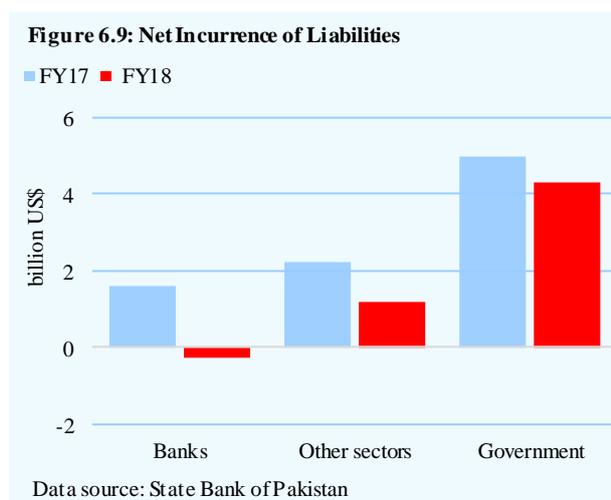
In terms of sources, the gross borrowings from China, both bilateral and commercial, dominated official disbursements in FY18, as inflows were recorded mainly for BoP support and CPEC related projects (**Table 6.6**).

Meanwhile in private loans, short-term repayments by commercial banks exceeded disbursements, leading to a net retirement of US\$ 122.0 million during FY18. However, in FY17, commercial banks were net borrowers of US\$ 1.6 billion.

### Foreign direct investment

While FDI inflows to South Asia dropped in 2017, Pakistan continued to attract foreign investment, mainly from China for CPEC-related projects.<sup>8</sup> During FY18, net FDI inflows to Pakistan increased, albeit marginally, to US\$ 2.8 billion from US\$ 2.7 billion last year. The power and construction sectors attracted more than half of the net FDI (**Table 6.7**). The telecommunications sector also witnessed higher inflows, due to the acquisition of telecom tower services by a Malaysian firm from a leading cellular service provider in Pakistan for US\$ 110.3 million.

China remained the top investor in Pakistan, with the bulk of its investments going into the power and construction sectors. Although China's outward direct investment has dropped for the second consecutive year since FY16, its share in Pakistan's net FDI inflows rose from around 44.1 percent in



**Table 6.6: Official Borrowings by Source**

million US dollars*			
	FY17	FY18	Change
<b>Total external loans</b>	<b>10,553</b>	<b>10,918</b>	<b>365</b>
China	3,955	4,011	56
Bilateral	1,655	1,811	156
Commercial banks	2,300	2,200	-100
Bonds	1,000	2,500	1,500
Other commercial banks	2,270	1,516	-754
IDB (short-term)	456	987	531
ADB	1,495	871	-624
Others	1,377	1,033	-345

\*Gross disbursements

Data source: Economic Affairs Division

**Table 6.7: Sector-wise Inflow of Net FDI in Pakistan**

million US dollars			
	FY17	FY18	Change
Power	700	885	185
Construction	466	707	241
Financial Business	296	276	-20
Oil & Gas Explorations	146	195	49
Food	526	106	-420
Telecommunications	-91	72	163
Electronics	145	51	-94
Others	558	476	-83
<b>Total</b>	<b>2,747</b>	<b>2,778</b>	<b>21</b>

Data source: SBP

<sup>7</sup> The short-term gross borrowing recorded at US\$ 1.5 billion against disbursement of US\$ 1.2 billion in previous year, whereas gross amortization amount stood at US\$ 1.4 billion, against US\$ 1.4 billion in FY17.

<sup>8</sup> The contraction in investment to South Asia was driven by lower FDI flows to India in 2017 (source: World Investment Report 2018, UNCTAD).

FY17 to 57.3 percent in FY18.<sup>9</sup>

Inflows from the US and UK remained almost unchanged in FY18 from last year. Interestingly, inflows from Hong Kong grew significantly, mainly due to a native firm’s joint investment with a leading Chinese energy firm in Pakistan’s power sector.

### Foreign portfolio investment

Foreign portfolio investment in FY18 was dominated by public inflows, as the government mobilized US\$ 2.5 billion by issuing Eurobonds and Sukuk.<sup>10</sup> On the contrary, foreign private investment witnessed an outflow of US\$ 240.7 million; this was almost half the level recorded last year. Foreign investors from mainly Luxembourg (US\$ 341.0), Hong Kong (US\$ 187.0), Egypt (US\$ 171.2) and the UK (US\$ 93.0) withdrew their funds from Pakistan. Meanwhile, portfolio investors from the US remained net contributors of US\$ 545.2 million during FY18.

**Table 6.8: Performance of Major Asian Equity Markets**  
return in percent

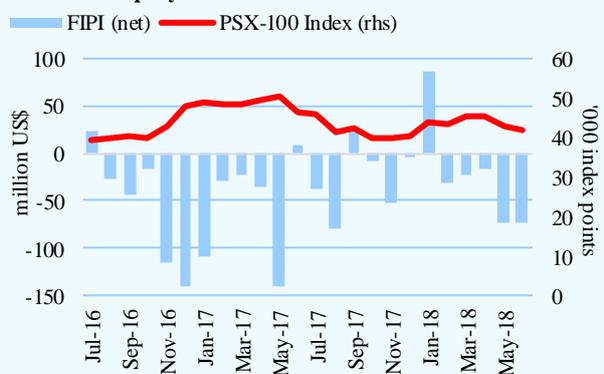
	FY17	FY18
China	8.8	-10.8
Pakistan	23.2	-10.0
Philippines	0.6	-8.2
Malaysia	6.6	-4.1
Bangladesh	26.5	-4.4
Indonesia	16.2	-0.5
Thailand	8.9	1.3
India	14.5	14.6

Data source: Bloomberg

The increase in the Fed’s policy rate, amid healthy economic growth and higher inflation expectation in the US, and trade protectionist posture adopted by the US and China, instigated uncertainty in global portfolio flows. As a result, foreign investors relocated their funds from riskier emerging markets to US securities to bolster their portfolio yield. Most Asian equity markets, except India and Thailand, posted negative returns during FY18. The Indian equity market remained relatively insulated from outflows as the local investors absorbed the equity sell-off by foreign investors (**Table 6.8**).

On the contrary, Pakistan’s equity market witnessed net foreign selling of US\$ 288.6 million during FY18, compared to net selling of US\$ 652.1 million last year (**Figure 6.10**). Though the global financial landscape was experiencing increased uncertainty this year, the strategic alignment of portfolios by foreign investment firms kept the private equity-related outflows lower than last year.

**Figure 6.10: Foreign Investors' Net Buying(+)/Selling(-) in Pakistan's Equity Market**



Data source: National Clearing Company of Pakistan Ltd. & Pakistan Stock Exchange

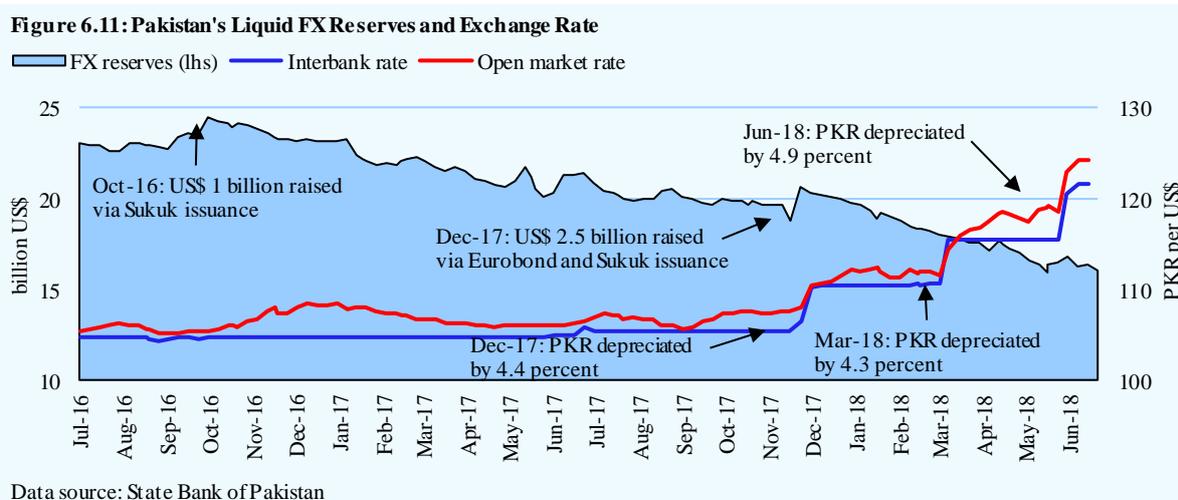
## 6.5 Exchange rate and reserves

Pakistan’s deteriorating current account balance continued to exert pressure on the country’s foreign exchange reserves in FY18. While the total liquid FX reserves dropped by US\$ 5.0 billion, Pak rupee depreciated *vis-à-vis* US dollar by 13.7 percent during FY18. The PKR-USD exchange rate adjusted in three episodes: 4.4 percent in December 2017, 4.3 percent in March 2018 and 4.9 percent in June 2018 (**Figure 6.11**).<sup>11</sup>

<sup>9</sup> China’s total outward direct investment declined from US\$ 244 billion in FY16 to US\$ 107 billion in FY18 (source: Haver Analytics).

<sup>10</sup> The government floated US\$ 1.5 billion worth of Eurobond and US\$ 1.0 billion of Sukuk in December 2017 at 5.625 and 6.875 percent returns respectively.

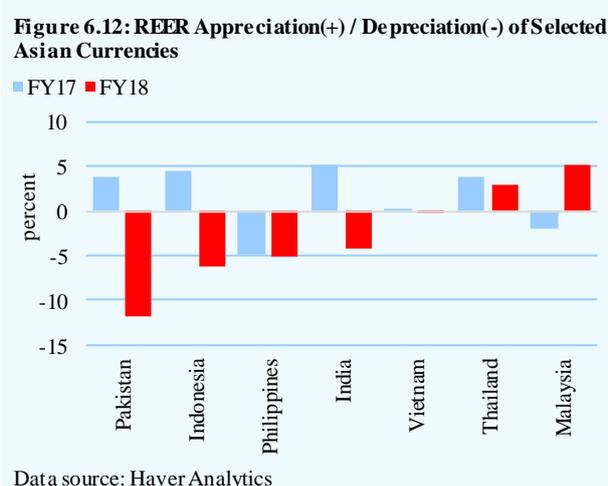
<sup>11</sup> Except one episode of July 2017, when rupee depreciated by 0.5 percent against the greenback during the month.



In fact, the country's forex reserves started to deplete after a month of completion of IMF's Extended Fund Facility arrangement in September 2016. Even the issuance of Eurobond and Sukuk in December 2017 was unable to arrest the downward trajectory in reserves, as the country's import payments outpaced FX receipts from exports, workers' remittances and FDI.

Amid global strengthening of US dollar, a persistent depletion in country's FX reserves strengthened the market's anticipation of PKR depreciation. Despite a stable exchange rate in the interbank market, the kerb market rate diverged frequently and significantly showing a mounting pressure on Pak rupee (**Figure 6.11**). Eventually, rupee depreciated but in phases which may have inculcated expectation of further depreciation.

Rupee weakness was broad based, as it also depreciated against other international currencies, such as Euro (-15.5 percent), British pound (-14.8 percent) and Japanese yen (-14.7 percent) during FY18. This led the Pak rupee REER to depreciation by 11.0 percent in FY18 – the highest among major Asian currencies. While some Asian currencies, such as Indonesian rupiah, Philippine peso and Indian rupee lost their values on the back of capital outflows, others like Malaysian ringgit and Thai baht managed to appreciate on improved growth outlook (**Figure 6.12**).<sup>12</sup>



Although the recent market-driven adjustment in PKR-USD exchange rate bodes well for Pakistan's export competitiveness, the persistent depletion in foreign exchange reserves poses a serious challenge for the country's balance of payment position in case of any external shock. Under the circumstances, it is important to assess the adequate level of foreign exchange reserves that the country needs to meet its payment obligations. **Box 6.1** briefly discusses the optimal level of foreign exchange reserves for developing countries, with special reference to Pakistan.

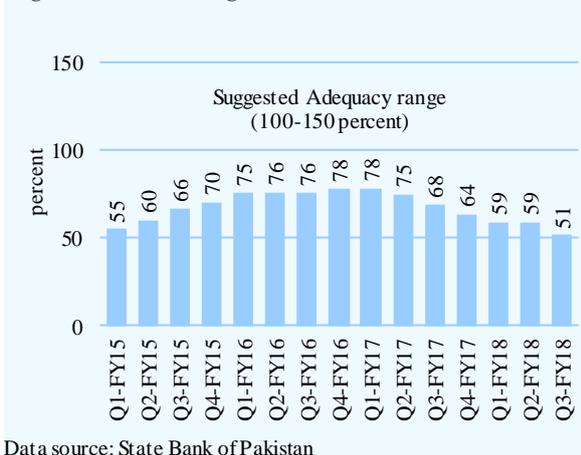
<sup>12</sup> During FY18, the Federal Reserve Bank raised interest rates three times: December 2017, March and June 2018, which led the US dollar to strengthen – mainly in the last quarter of FY18.

**Box 6.1: Assessing Reserve Adequacy in Pakistan**

While the East Asian Crisis, at the terminal of the last millennium, reinforced the importance of holding adequate level of foreign exchange reserves, there is little consensus on what constitutes this ‘adequate level’. Traditionally, level of reserves necessary to finance a certain number of months, say three months, of imports was viewed as adequate. More recently, the short-term payment obligations that in fact triggered the East Asian Crisis become an important constituent of the reserve’s adequacy benchmark in addition to the import coverage.

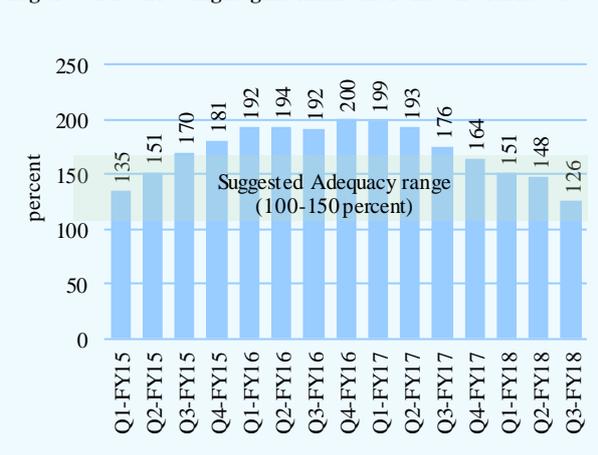
However, reserve adequacy accounting only for the import cover, say for three months, and short-term debt, say by 100 percent, are narrowly based and may often fail to provide necessary cover in case of external sector shock.

**Figure 6.1.1a: Fixed Regime ARA and Pakistan's FX Reserves**



Data source: State Bank of Pakistan

**Figure 6.1.1b: Floating Regime ARA and Pakistan's FX Reserves**



Consequently, IMF (2011), proposed an alternate approach for assessing the adequate level of FX reserves based on ARA (Assessing Reserve Adequacy) metric. Their composite model benefits from the regulatory requirement approach on the bank capital, in which potential source of risk is assigned weights to attain risk-weighted reserves. Therefore, these weights do not need to add to one.

Moreover, they have identified the four potential risky asset classes that could have a toll on foreign exchange reserves. These asset classes are, (a) potential loss of export income, (b) stock of liquid domestic asset that could be sold and transferred as a foreign asset, (c) rollover risks of short-term debt, and (d) risk of portfolio and long-term debt outflows.

Based on the historical experience of the external sector crisis, weights are assigned as per the exchange rate regime followed in a particular country (Table 6.1.1). Precisely, ARA metric for a country with fixed exchange rate regime will be calculated as follows:

$$ARA \text{ metric} = \text{short-term debt} (0.3) + \text{other liabilities} (0.2) + \text{broad money} (0.1) + \text{exports of goods and services} (0.1)$$

**Table 6.1.1: Assessing Reserve Adequacy (ARA) - % weights**

Exchange rate	Short-term debt	Other Liabilities	Broad money	Exports
Fixed	30	20	10	10
Floating	30	15	5	5

Data source: IMF

The IMF (2017) reported that Pakistan’s reserves were only 73.0 percent of ARA metric in Dec 2016, below a minimum adequate level of 100. Pakistan’s foreign exchange reserves were at comfortable levels until FY16. Since then, the pressure on country’s reserves magnified with growing demand for imports, slowdown in workers’ remittance inflows and lower export receipts. Consequently, the import cover dropped from over 5 months in end-June 2016 to below 3- months in end-March 2018. At the same time, reserves to ARA metric dropped from 78.0 percent in end-June 2016 to only 51.0 percent in end-March 2018.

Interestingly, calculation of ARA number is critically dependent on the assumption of exchange rate regime. IMF assumes Pakistan’s exchange rate regime as ‘fixed’ for calculation of ARA metric. However, assuming the country’s exchange rate regime as floating, the FX reserves as percent of ARA metric fell within the adequacy range in end-March 2018 (Figure 6.1.1 b).

**References:**

IMF (2011), Assessing Reserve Adequacy; Policy Paper, Washington D.C IMF, [imf.org/external]  
 IMF (2017), Pakistan: Article IV Consultation Country Report No. 17/212, Washington D.C IMF.

## 6.5 Trade Account<sup>13</sup>

In FY18, Pakistan witnessed a record trade deficit of US\$ 37.6 billion; 15.7 percent higher from last year. The broad-based and quantum-led rebound in exports – after consecutive declines over the last three years – was overshadowed by surging imports, which almost touched the US\$ 61.0 billion mark. Adverse movement in global oil prices, coupled with strong demand for industrial raw materials - metals and allied products - was mainly responsible for the higher imports. Resultantly, the country's balance of payments came under severe strain during the year (**Section 6.2**).

### Exports

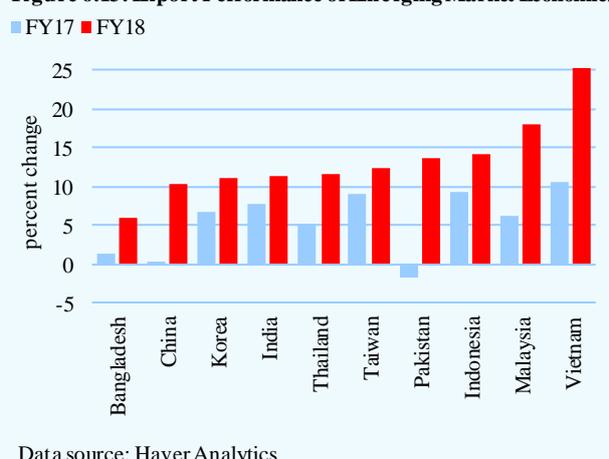
After three years of successive decline, Pakistan's exports rose by 13.7 percent to US\$ 23.2 billion in FY18; nonetheless, in value terms, these were still below the level recorded in FY15. With favourable global demand dynamics in play, Pakistan finally joined the EM economies that all posted healthy export performances in the period (**Figure 6.13**).

While exports of both high and low value-added textile items dominated, those of non-traditional items like seafood, and POL also picked up. Importantly though, higher quantum played a dominant role in boosting Pakistan's exports, as unit prices of some key items, like sugar, wheat and cotton fabrics, were lower compared to last year (**Table 6.9**).

### Food

Pakistan's food exports grew 29.3 percent to US\$ 4.8 billion in FY18 largely due to higher shipment of rice, wheat and sugar. While increased global demand supported rice, substantial subsidies announced by the government led to strong growth in sugar and wheat exports.

**Figure 6.13: Export Performance of Emerging Market Economies**



**Table 6.9: Pakistan's Major Exports**

	FY17	FY18	Abs. change	Quant impact	Price impact
<b>Food group</b>	<b>3,711</b>	<b>4,798</b>	<b>1,087</b>	-	-
Basmati rice	453	582	129	89	40
Non-basmati	1,153	1,454	300	182	119
Wheat	1	236	235	311	-75
Sugar	161	508	347	609	-262
Seafood	394	451	57	106	-49
<b>Textile group</b>	<b>12,451</b>	<b>13,521</b>	<b>1,070</b>	-	-
Raw cotton	44	58	15	17	-2
Cotton yarn	1,244	1,372	128	181	-53
Cotton fabrics	2,136	2,204	67	334	-267
Knitwear	2,362	2,711	350	34	315
Bedwear	2,138	2,261	123	116	7
Towels	801	797	-3	25	-28
Readymade garments	2,319	2,577	258	95	164
<b>POL group</b>	<b>189</b>	<b>394</b>	<b>204</b>	-	-
Crude oil	77	190	113	76	38
POL products	71	148	77	51	26
<b>Other manufactures</b>	<b>3,097</b>	<b>3,399</b>	<b>303</b>	-	-
Leather	346	330	-15	43	-58
Leather manufactures	491	523	32	-	-
Plastic	218	238	20	7	14
Pharma	214	195	-19	-19	0
Cement	238	223	-15	2	-17
<b>Total exports</b>	<b>20,422</b>	<b>23,212</b>	<b>2,790</b>	<b>2,584</b>	<b>-121</b>

Data source: Pakistan Bureau of Statistics

In fact, quantum sugar exports reached a record-high of 1.5 million MT, as exporters utilized a good share of the 2.0 million MT quota on which the government had announced subsidy.<sup>14</sup> Similarly,

<sup>13</sup> This section is based on customs data reported by the PBS. The information in this section does not tally with the payments record data, which is reported in **Section 6.1**. To understand the difference between these two data series, please see Annexure on data explanatory notes.

<sup>14</sup> Despite delays in sugarcane crushing and an eventual decline in domestic sugar production, ample stocks were available in the country following record production last year (**Chapter 2**). Facing such a situation, the government allowed exports of 0.5 million MT of sugar in November 2017, at a subsidy of up to US\$ 97 per ton. Later, the export quota was enhanced to 2.0 million MT.

quantum wheat exports hit their second highest level in history, as the government allowed their exports at a heavy subsidy of US\$ 120-159 per MT;<sup>15</sup> this, coupled with rising international prices in H2-FY18, pushed up wheat exports to US\$ 236.3 million.<sup>16</sup>

Meanwhile, rice exports, after declining for three years straight, rose by a solid 26.7 percent YoY and reached US\$ 2.0 billion in FY18, amid rising demand from key rice consuming countries in Asia and Africa.<sup>17</sup> FX receipts from both basmati and non-basmati varieties rose by double digits, as Pakistani exporters along with competitors from India, Thailand, and Vietnam, benefitted from higher international prices as well as strong external demand (**Figure 6.14**).

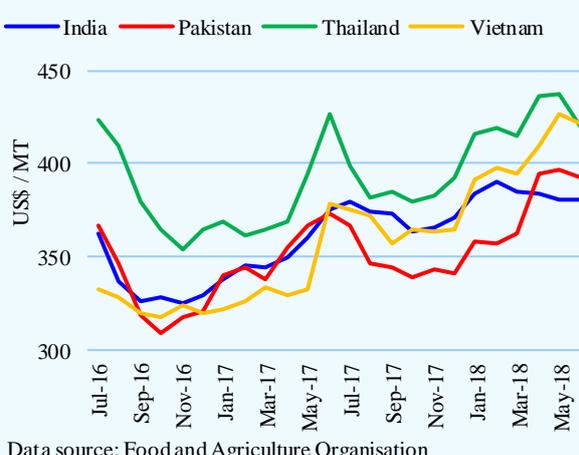
In case of Pakistan's basmati exports, most of the quantum increase can be traced to higher demand from European countries like the UK, Belgium, Italy and Spain, from December 2017 onwards. Pakistani exporters boosted their presence in this lucrative market, after the EU banned basmati rice purchases from India due to its excessive application of certain pesticides.<sup>18</sup>

That said, Indian exporters were able to make up for their loss of access to the EU market (from December onwards) by entrenching their presence in some of the largest rice markets, namely Iran and Saudi Arabia. While Pakistan also exported more basmati rice to Saudi Arabia this year, its shipments to Iran declined sharply, owing to what industry channel checks suggest were banking bottlenecks. Pakistani exporters were said to face difficulty in finding local banks that were willing to transact with their Iranian counterparts. Indian exporters, on the other hand, did not face such constraints.<sup>19</sup>

Meanwhile, exports of non-basmati rice surged 15.8 percent in FY18 in quantum terms, owing to strong demand from African countries like Madagascar, Benin and Senegal. African countries are among the largest importers of broken and husk rice varieties due to rising demand of the staple. As a result, these countries played an important role in boosting rice exports of Thailand, India and Pakistan.<sup>20</sup>

Apart from these countries, demand for non-basmati rice from Bangladesh and Indonesia also stayed

**Figure 6.14: Rice Export Prices for Major Producers**



Data source: Food and Agriculture Organisation

<sup>15</sup> Source: Ministry of National Food Security and Research notification, dated January 3, 2018.

<sup>16</sup> International wheat prices were, on average, 8.8 percent higher in H2-FY18 over H1-FY18 (source: Bloomberg).

<sup>17</sup> These favorable global demand dynamics as well as higher domestic rice production also stimulated local rice processing mills to invest in their plants. Fixed investment borrowing by these mills rose 28.0 percent YoY in FY18.

<sup>18</sup> For details regarding the imposition of the ban on Indian basmati rice imports by the EU, refer to Section 5.5, Chapter 5, of the State of Pakistan's Economy Report for Q3-FY18.

<sup>19</sup> India has traditionally enjoyed strong trade linkages with Iran. During the previous round of sanctions on Iran, India got a waiver from the US on the condition that it will gradually reduce its oil imports from Iran. Initially, India used a Turkish bank to pay 55.0 percent of its imports from Iran in euros; the remaining 45 percent was credited into Iran's Indian Rupee (INR) account in India. When the sanctions were tightened in 2013, all of India's import payments were made in INR and credited into Iran's INR account. Iran used this account for its own import payments from India, which were mainly concentrated in food items, like rice and sugar.

<sup>20</sup> For instance, quantum rice imports by Benin have risen by 40.6 percent between 2013 and 2017. In fact, Benin was the third-largest rice importer in the world in 2017; it purchased 2.0 million MT of the staple from abroad in the year. Another African country, Mozambique, was the largest rice importer in the year (source: International Trade Centre).

elevated. In Bangladesh's case, lower domestic production in 2017 following heavy rains necessitated higher imports, whereas the impetus from Indonesia reflected the country's efforts to increase their strategic rice stock amid stable international prices.

Nevertheless, the outlook for rice exports looks a bit uncertain. Demand for rice imports in Bangladesh is expected to taper amid a recovery in domestic production. Similarly, Indonesia's rice-buying spree appears to be cooling of, as the country has stockpiled enough of the commodity to meet consumption requirements till March 2019.<sup>21</sup>

### Textile

Pakistan's textile exports, after depicting a lacklustre performance in FY17, rebounded in FY18 by growing 8.6 percent to US\$ 13.5 billion. Almost all product categories earned higher foreign exchange than they did last year, with quantum playing a more dominant role than prices.

Higher demand from key advanced economies for finished textile and apparel products contributed to an uptick in their exports (Figure 6.15). While Pakistani exporters of high value added items met some of this demand directly, producers of low value-added items, like yarn and fabrics, supplied more of the raw materials to countries like China, Vietnam and Bangladesh, which stand higher up on the textile and apparel value chain. In the US, Pakistan joined other major apparel exporters in benefitting from robust consumer demand in the country (Figure 6.16).

While the revival in textile exports to the US is welcome, it is also worth noting that Pakistan's share in that country's textile and apparel imports has stagnated at around 0.7 percent over the past three years. In addition to concerted efforts to strike deals with bulk contractors supplying apparel to retail stores in the US, Pakistani exporters need to diversify their product profile away from cotton-centric

Figure 6.15: Retail Sale of Clothing and Accessories in US



Figure 6.16: Quantum of Textile & Apparel Exports to US

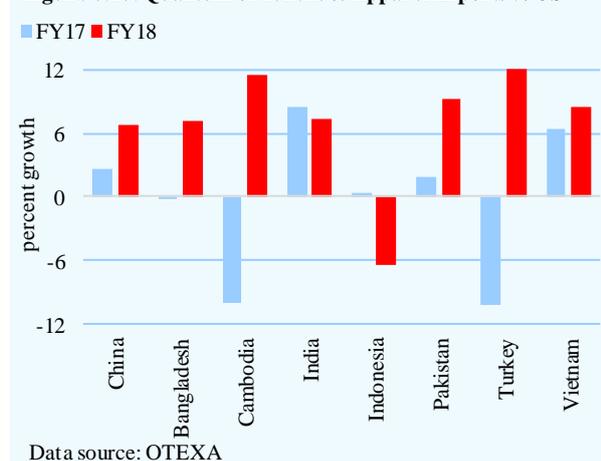
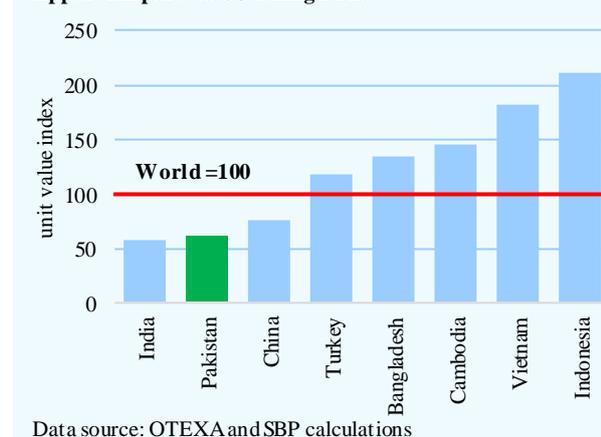


Figure 6.17: Comparison of Selected Economies' Textile and Apparel Exports to US during FY18



<sup>21</sup> Source: Indonesia's Bureau of Logistics (BULOG) press release dated August 3, 2018. Pakistan exported 336,387 MT of rice to Indonesia in FY18, up 183.2 percent from last year. In value terms, rice exports to Indonesia yielded US\$ 138.8 million in foreign exchange this year, up significantly from US\$ 38.2 million earned last year.

items, towards higher concentration of man-made synthetic fibres, which are in demand in the advanced economies.<sup>22</sup> Currently, Pakistan’s textile and apparel exports fetch much lower unit prices as compared to competitors’ (Figure 6.17), mainly due to their cotton-centric nature.

Meanwhile, in case of the EU, Pakistani exporters managed to increase their share in both the apparel and home textiles segments. At the same time, China’s gradual pullback from the segment created space for other countries, particularly those enjoying concessionary market access to the EU, like Pakistan and Bangladesh (Table 6.10a, b). As a result, Pakistan’s apparel and home textile exports to the EU continued on their rising trajectory this year as well, aided by the GSP Plus status as well as the PKR’s 13.0 percent average depreciation against the euro in FY18.

#### Other exports

Among other major categories, exports of seafood items hit their record high in FY18, fetching foreign exchange worth US\$ 451.0 million. While shipments of raw seafood items, like crabs, shrimp, lobsters, and clams rose significantly, those of semi-processed products, like fish filets, also witnessed an increase this year. Major markets for Pakistani seafood items included China, Korea, Thailand, Vietnam and the UAE.

Quantum cement exports, meanwhile, ended their four-year consecutive decline in FY18, rising by a 1.0 percent on YoY basis. Surplus availability of the material, in the wake of additional capacities coming online in H2-FY18 in the South region, seems to have stimulated some firms to look towards export markets through the sea, mostly to African markets.

At the same time, tightening of border controls with Afghanistan appears to have partially shifted the cement trade to formal channels. Customs data indicates that Afghanistan accounted for the highest YoY increase in Pakistan’s quantum cement exports in FY18. This, coupled with a strong rebound in shipments to African countries (particularly South Africa and Mozambique), offset the drag from lower exports to India and Sri Lanka in the year. In case of India, border tensions with the country in FY18 appear to have affected the cement trade, with dispatches declining by 3.2 percent YoY, after rising 26.3 percent in FY17.<sup>23</sup>

Going forward, Pakistan’s cement exports to Afghanistan are expected to maintain their rising trend, as supply from Iran – a major supplier of the material to that country – may come under pressure due to re-imposition of financial sanctions by the US.

**Table 6.10a: EU's Import of Clothing from Major Countries**  
percent

	Quantum Growth		Value Growth		Share in Quantum	
	FY17	FY18	FY17	FY18	FY17	FY18
China	1.4	-1.5	-4.9	2.8	37.9	35.7
Bangladesh	4.7	10.6	4.8	10.8	23.5	24.8
India	2.9	-0.3	-2.9	6.4	5.6	5.3
Cambodia	6.8	15.9	6.5	15.8	4.2	4.7
Pakistan	8.6	11.2	7.4	12.7	4.4	4.7
Turkey	-3.4	3.9	-5.5	12.4	8.9	8.8
Vietnam	2.9	13.3	3.4	10.9	2.8	3.1
<b>Total</b>	<b>2.1</b>	<b>4.7</b>	<b>-1.1</b>	<b>8.8</b>	-	-

Data source: Eurostat

**Table 6.10b: EU's Import of Home Textile from Major Countries**  
percent

	Quantum Growth		Value Growth		Share in Quantum	
	FY17	FY18	FY17	FY18	FY17	FY18
China	6.8	7.2	1.2	8.5	39.7	39.8
Bangladesh	5.8	14.8	6.6	19.8	4.2	4.6
India	7.0	13.3	2.6	17.2	14.7	15.6
Cambodia	17.8	36.7	14.8	32.4	0.2	0.2
Pakistan	5.6	6.8	5.7	12.1	14.4	14.4
Turkey	0.6	-2.5	-1.8	6.5	9.4	8.6
Vietnam	6.0	10.6	7.2	13.1	2.8	2.9
<b>Total</b>	<b>5.6</b>	<b>7.0</b>	<b>1.9</b>	<b>10.6</b>	-	-

<sup>22</sup> SBP has repeatedly highlighted this issue in its quarterly and annual publications on the State of Pakistan’s Economy, most recently through a special section titled “Synthetic Textiles is Key to Sustaining Export Growth Momentum” in the Q3-FY18 report.

<sup>23</sup> Source: All Pakistan Cement Manufacturers Association.

### Imports

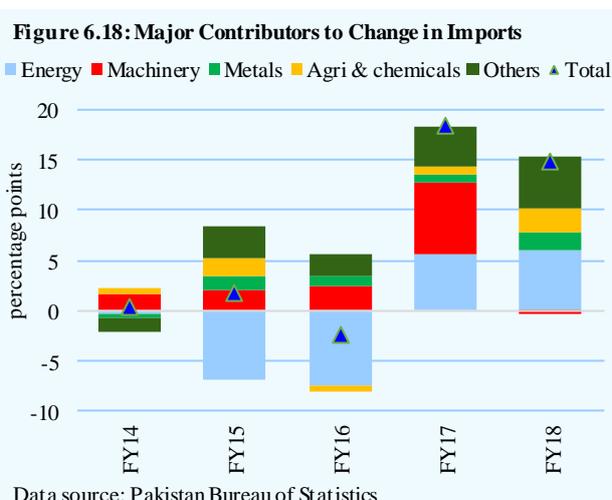
Pakistan's imports reached the unprecedented level of US\$ 60.8 billion in FY18, up 14.9 percent from last year. Rising international oil prices was the major driver, as it heavily contributed to the uptick in energy imports, and completely offset the drag from lower machinery imports in the year (Table 6.11). This is a reversal from last year, when non-oil imports - especially machinery - was driving the YoY growth in overall imports (Figure 6.18).

At the same time, it must be noted that the country still imports hundreds of consumer goods every year. These imports squeeze the amount of FX available to finance essential energy and capital goods imports. Both the government and SBP have taken regulatory measures, like hiking regulatory duty (RD) and imposing 100 percent cash margin requirement, to discourage these non-essential imports. In some cases – like shampoos and electric fans – the measures have worked, as indicated in Table 6.12. However, imports of other items, particularly cars, have continued to surge, indicating that it is difficult for measures, such as cash margins and RDs to achieve the desired results.

#### Energy imports

Pakistan's energy import bill shot up 32.1 percent to US\$ 14.4 billion in FY18, mainly due to a substantial increase in international oil prices. In fact, the higher prices not only led to a ballooning of the crude import bill, but also offset the impact of a YoY decline in quantum POL product imports. Besides, due to higher oil prices, the energy group emerged as the leading category, with 23.7 percent share, in Pakistan's total imports in FY18.

Importantly, quantum crude oil imports rose by a solid 29.2 percent in FY18, against the previous five years' growth of 5.6 percent. The increase mainly reflected higher demand from a local refinery, which underwent a capacity expansion in FY18. These higher quantum imports, coupled with rising international oil prices, pushed up crude imports by 66.0 percent to US\$ 4.2 billion in value terms.



**Table 6.11: Pakistan's Major Imports**

million US dollars

	FY17	FY18	Abs. change	Quantum impact	Price impact
<b>Energy group</b>	<b>10,923</b>	<b>14,430</b>	<b>3,507</b>		
POL prod.	6,838	7,476	638	-764	1,402
Crude	2,547	4,229	1,682	744	938
LNG	1,313	2,454	1,141	799	342
<b>Machinery group</b>	<b>11,755</b>	<b>11,562</b>	<b>-193</b>		
Power gen	3,034	2,663	-371		
Electrical	2,322	2,184	-137		
Telecom	1,352	1,532	181		
Mobiles	710	764	56		
Other mach.	3,355	3,670	315		
<b>Transport group</b>	<b>3,327</b>	<b>4,388</b>	<b>1,061</b>		
Cars	1,091	1,264	173		
Trucks & buses	569	640	71		
Aircraft & ships	525	1,142	617		
<b>Food group</b>	<b>6,143</b>	<b>6,184</b>	<b>41</b>		
Tea	524	552	28	-35	63
Palm oil	1,905	2,040	135	173	-38
Pulses	952	535	-418	-340	-78
<b>Textile group</b>	<b>3,358</b>	<b>3,664</b>	<b>306</b>		
Raw cotton	810	1,078	268	148	120
Synthetic yarn	635	664	29	8	21
<b>Agri and chemicals</b>	<b>7,583</b>	<b>8,918</b>	<b>1,335</b>		
Fertilizer	641	833	192	168	24
Plastic material	1,919	2,347	428	408	20
Other chemicals	3,889	4,492	603		
<b>Metals group</b>	<b>4,412</b>	<b>5,357</b>	<b>945</b>		
Iron & steel scrap	1,121	1,584	463	273	190
Iron & steel	2,121	2,440	319	246	74
<b>Total imports</b>	<b>52,910</b>	<b>60,795</b>	<b>7,885</b>	<b>2,234</b>	<b>2,941</b>

Data source: Pakistan Bureau of Statistics

In FY18, quantum POL product imports declined by 11.9 percent, according to data from the Oil Companies Advisory Committee (OCAC); this mainly reflected a hefty 33.1 percent drop in furnace oil (FO) imports (**Table 6.13**). Besides an increase in local production, the government's policy decision to shift the power generation mix away from FO to LNG and coal also played role in lowering furnace oil imports.<sup>24</sup>

Specifically, three LNG-based power projects, worth a cumulative installed capacity of 3,561 MW, which started contributing to the national grid in FY18. In addition, two coal-fired projects with installed capacity of 2,563 MW also commenced operations during the year.<sup>25</sup> Consequently, the share of gas and coal in power generation increased to 35 and 10 percent respectively in FY18, from 10 percent and an almost negligible amount in FY14. As expected, the completion of these projects boosted demand for both these fuels: quantum LNG imports rose 60.9 percent during FY18,<sup>26</sup> whereas quantum of coal purchases from abroad more than doubled in the same period.<sup>27</sup>

Besides furnace oil, quantum petrol imports also slowdown this year. Similar to FO, local production of the fuel rose by 18.7 percent in FY18, which diluted the demand for imported fuel. Moreover, the government's decision to pass on the increase in international oil prices to domestic retail prices, led to muted growth in fuel sales, which further dampened demand for its imports (**Figure 6.19**).

### Machinery

Pakistan's machinery imports declined 1.6 percent YoY to US\$ 11.6 billion in FY18. The decline was concentrated in power generation and electrical machinery, reflecting tapering demand as early harvest CPEC power projects progress towards completion. Major machinery items whose imports declined during the year included gas and steam turbines (and their parts), semiconductors and diodes, etc.

Meanwhile, as the number of cell phone subscribers continued to increase in the country, telecom sector imports – comprising cell phones as well as associated network equipment, such as voice and

**Table 6.12: Import of Selected Consumer Goods**

million US dollars			
	FY16	FY17	FY18
<b>Food items</b>			
Cocoa & cocoa items	33.2	33.9	37.0
Pasta/bread/ cakes/ biscuits	13.8	15.0	18.9
Butter and cheese	12.1	15.8	16.7
Fish and seafood	15.3	20.4	15.7
Fresh apples and pears	33.0	36.0	32.8
Tea and coffee	517.1	528.4	556.9
Fruit juices	13.4	16.7	11.9
<b>Electronics items</b>			
Laptops, PCs and accessories	212.7	402.2	379.0
LCD TVs	62.8	74.9	81.6
Cellular phones	753.7	709.7	761.7
Earphones and loudspeakers	15.6	22.7	26.6
Air-conditioners (inc. parts)	132.1	194.4	184.6
Refrigerators / freezers (inc. parts)	81.5	98.4	112.2
Electric fans	18.5	36.0	14.5
Bulbs and lamps	109.6	97.0	121.8
SIM cards	16.6	13.2	15.7
<b>Personal care items</b>			
Perfumes and colognes	8.1	6.3	6.3
Make-up items and prep	23.3	27.5	30.0
Hair preparations (inc. shampoos)	43.3	46.6	29.6
After-shave, deodorants, bath salts	11.3	11.7	12.4
Soap and washing detergents	34.5	32.2	27.2
<b>Total</b>	<b>2,161.5</b>	<b>2,439.0</b>	<b>2,382.9</b>

Data source: Pakistan Bureau of Statistics

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

	Quantity (mil. tonnes)			Growth (%)	
	FY16	FY17	FY18	FY17	FY18
High speed diesel	3.1	3.9	3.8	26.2	-1.1
Furnace oil	6.0	6.6	4.4	10.4	-33.1
Petrol	4.2	4.9	5.1	16.5	4.9
Other	0.1	0.1	0.3	0.2	118.2
<b>Total products*</b>	<b>13.4</b>	<b>15.5</b>	<b>13.7</b>	<b>15.9</b>	<b>-11.9</b>
Crude oil*	8.5	8.7	10.5	2.5	20.1
LNG **	1.2	3.7	5.9	195.9	60.9

\*Data sources: Oil Companies Advisory Council

\*\* Pakistan Bureau of Statistics

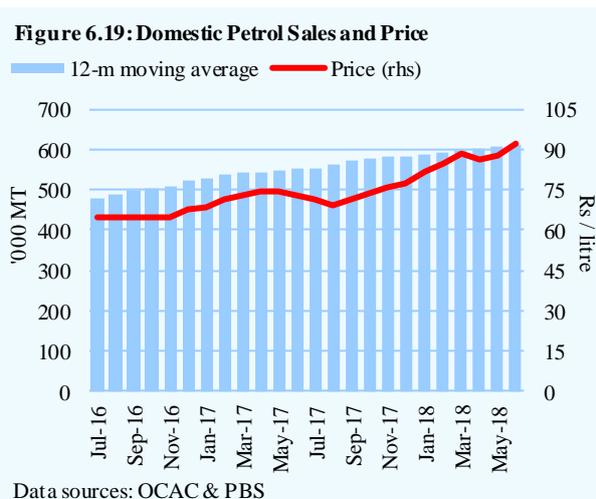
<sup>24</sup> Domestic furnace oil production grew 8.2 percent on YoY basis in FY18.

<sup>25</sup> Source: Economic Survey of Pakistan 2017-18.

<sup>26</sup> Over 60 percent of the imported LNG is consumed by the power sector (source: Economic Survey of Pakistan 2017-18).

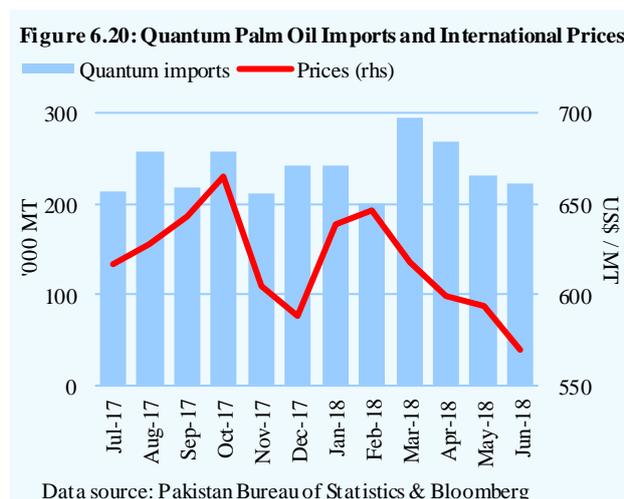
<sup>27</sup> The surge in coal imports is also a result of an 11.1 percent uptick in domestic cement production in the year. Coal is used as a raw material in cement manufacturing.

image transmitting and routing machines, etc – grew by a strong 13.4 percent.<sup>28</sup> Despite attracting customs duty and 100 percent cash margins, cellular phone imports surged 7.7 percent to US\$ 764.2 million in FY18. It must be noted that instead of imposing *ad volarem* customs duty on imported cell phone, the government imposed a flat Rs 250 duty on each mobile set, regardless of its price. As a result, even though the number of mobile phones imported declined by 28.7 percent during FY18, the value of the imported sets increased. One possible reason could be that consumers are increasingly opting for feature-rich smartphones, which cost more than simple mobile phones, and that a nominal Rs 250 increase in their prices did not affect their purchase preferences.<sup>29</sup>



### Food

Food imports stayed virtually stagnant at US\$ 6.2 billion in FY18, as an uptick in palm and soybean oil imports was offset by a decline in pulses purchases. With regards to palm and soybean oil, their import values remained high in H1-FY18, reflecting the trend in international prices at the time. However, international palm oil prices had peaked in September 2017, and closed June 2018 down 8.8 percent from their peak. This favorable trend in global prices, along with uncertainty surrounding the Pak rupee, encouraged domestic edible oil manufacturers to stockpile the raw material. As a result, quantum imports of palm oil rose 5.0 percent in H2-FY18, whereas its import value declined 5.6 percent during the period (**Figure 6.20**).



At the same time, due to rising competition in the edible oil industry as well as increasing consumer awareness about healthy eating, oil mills have turned their attention to soybean, canola and sunflower oil extracts and seeds.<sup>30</sup> Quantum soybean oil imports, though much lower than those of palm oil, grew by 70.3 percent in FY18 on YoY basis.

Meanwhile, quantum pulses imports normalized to 0.8 million MT, after crossing the 1.2 million MT-mark in each of the past two years. Ample domestic availability of carryover stock (amid virtually unchanged domestic production) not only lowered the demand for imports, but also translated into double-digit decline in average local prices of the staple.

<sup>28</sup> The total number of cell phone subscribers rose from 139.8 million at end-June 2017 to 150.2 million by end-June 2018 – depicting an increase of 7.5 percent (source: Pakistan Telecommunication Authority).

<sup>29</sup> Another reason could be that higher proportion of low-value cell phones are now coming into the country through informal channels, including through *khepias*.

<sup>30</sup> The number of edible oil mills (producing cooking oil, vegetable ghee and Vanaspati, etc) registered with the Securities and Exchange Commission of Pakistan increased from 458 by end-June 2017 to 473 by end-June 2018.

### Transport

Pakistan's transport imports grew 31.9 percent to US\$ 4.4 billion in FY18. Almost half of the YoY increase came from the aircraft, ships and boat imports (**Table 6.14**). The higher ship imports reflected an uptick in demand for scraps from the steel industry, given the 22.2 percent YoY growth in domestic steel production in FY18. Old ships were imported for breaking at the Gadani ship-breaking yard to yield scrap for the steel industry. The country imported ships and vessels worth US\$ 706.1 million – a 78.6 percent increase over last year, mainly from Singapore, South Korea and the UAE.

Besides ships, aircraft imports (both parts and complete airplanes) also rose significantly and reached US\$ 147.5 million in the year.

Multiple private sector entities obtained

Regular Public Transport (RPT) license to enter Pakistan's aviation sector. One of the conditions for obtaining this license is possession of a minimum three aircrafts (for passenger travel, either on lease or ownership basis).<sup>31</sup> At least one new airline commenced operations in the country in FY18, and others are expected to join the sector going forward.

Meanwhile, cars were the second-highest contributor to the increase in transport imports in FY18. Continually rising demand from consumers and ride-hailing services for fuel-efficient cars in the 600-1,000cc range, fuelled imports of both CBUs and CKDs. Launch of a new variant of a 1,000cc locally assembled car also contributed to uptick in CKD imports.

Interestingly, the government tried to limit CBU imports in October 2017 by tightening loopholes in the customs duty framework. Specifically, it required Pakistani nationals sending used cars of all engine capacities through the baggage and other schemes, or those receiving the vehicles, to essentially pay customs duty on their imports in foreign exchange.<sup>32</sup> The senders of the vehicles had to provide banking documents proving that they had remitted the required amount of CD into either their or a family member's bank account in Pakistan, and that this FX had been converted into PKR and the equivalent customs duty paid. The requirement to provide paper trail would have curbed the use of illegal money transfers (i.e. hundi/hawala) to pay for these car imports, and therefore limited the amount of FX going out of the country through informal mode. And the measure seems to have worked: **Figure 6.21** shows that there was a sharp slowdown in the import of CBUs from October 2017 to February 2018. However, in February 2018, the Economic Coordination Committee reversed the decision, leading to a rebound in CBU imports.

### Metals

Imports of the metals group grew by 21.4 percent to US\$ 5.4 billion in FY18, mainly due to higher imports of both finished iron and steel products and scraps. Ideally for a developing economy like Pakistan, higher scrap imports – as opposed to finished products' imports – suggests the presence of a

**Table 6.14: Breakdown of Transport Imports**

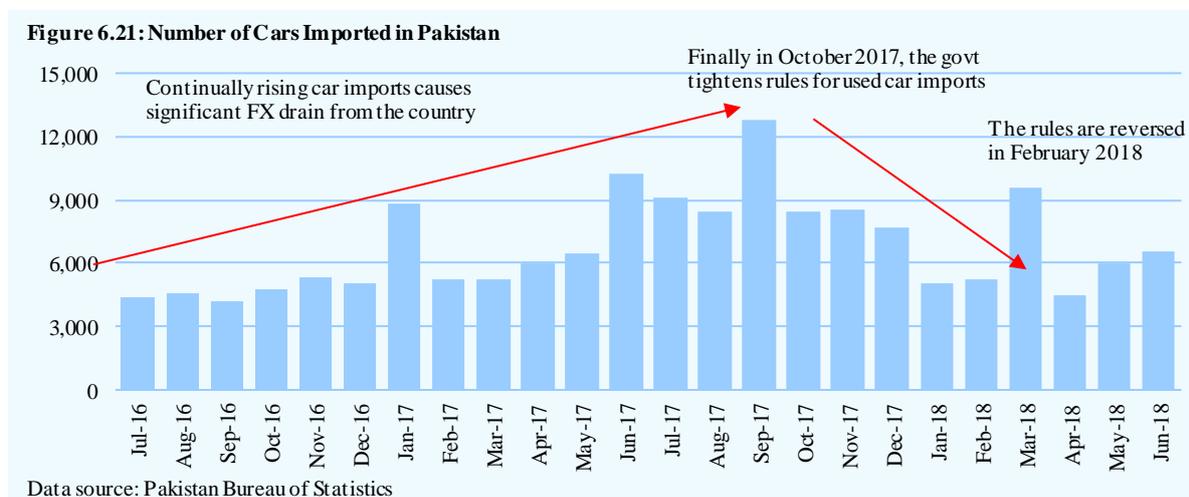
million US dollars	FY17	FY18	Abs. change
<b>Aircrafts, ships and boats</b>	<b>525</b>	<b>1,146</b>	<b>621</b>
Tankers		276	276
Aircraft (complete)	8	87	78
Aircraft (parts)	51	61	10
Ships for shipbreaking	395	706	311
<b>Cars</b>	<b>1,091</b>	<b>1,264</b>	<b>173</b>
CBU	432	455	24
CKD	660	809	149
<b>Parts</b>	<b>500</b>	<b>604</b>	<b>104</b>
<b>Buses &amp; trucks</b>	<b>569</b>	<b>640</b>	<b>71</b>
CBU	316	242	-74
CKD	252	398	146
<b>Other transport equipment</b>	<b>287</b>	<b>350</b>	<b>62</b>
<b>Motorcycles</b>	<b>96</b>	<b>112</b>	<b>16</b>
<b>Others</b>	<b>259</b>	<b>277</b>	<b>18</b>
<b>Transport group</b>	<b>3,327</b>	<b>4,388</b>	<b>1,061</b>

Data source: Pakistan Bureau of Statistics

<sup>31</sup> Source: Civil Aviation Authority (<https://www.caapakistan.com.pk/AT/AT-LC-RPT.aspx>).

<sup>32</sup> Before October 2017, this rule only applied to the import of *new* vehicles of 1,800cc and above, and on 4x4 vehicles. The government amended this rule via SRO No. 1067(I)/2017 in October 2017, by stipulating that this rule was now applicable on "all vehicles in new/used condition". However, in February 2018, the government, via SRO 261(I)/2018, reversed the changes introduced in October 2017.

robust steel industry that is able to meet other domestic sectors' demand for this critical industrial raw material. In FY18, Pakistan's quantum scrap imports grew 24.4 percent and reached their highest level in history.<sup>33</sup> This corresponded with a 22.2 percent growth in domestic steel production, which was much higher than last year's comparable growth of 21.3 percent.



Yet, at the same time, the quality of locally manufactured steel products continues to be a concern for some industries that use these items as raw material. This is particularly true for the auto industry.<sup>34</sup> As newer and relatively more sophisticated cars are now being assembled in the country, automakers' demand for higher quality steel products has also increased – and this demand continues to be mostly met through imports. In FY18, imports of such items (like printed and varnished steel sheets) rose significantly over last year.<sup>35</sup>

<sup>33</sup> In fact, Pakistan became the 28<sup>th</sup> largest steel producer in the world in 2017, up from 36<sup>th</sup> position just a year earlier (source: World Steel Association).

<sup>34</sup> Almost 60 percent of car bodies made worldwide comprise advanced high strength steel (source: World Steel Association).

<sup>35</sup> These particular type of steel sheets were the 7<sup>th</sup> highest contributor to the YoY increase in import payments for the metal group in FY18.