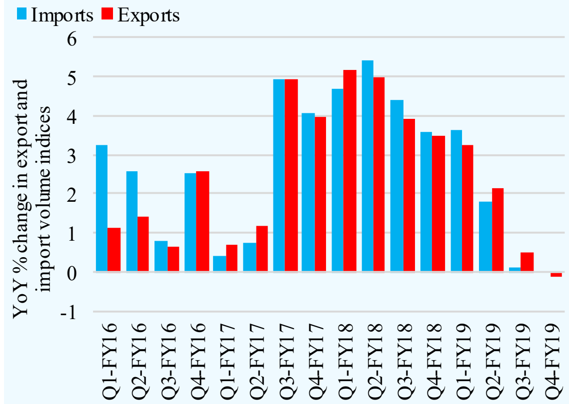
6 External Sector

6.1 Global Economic Review

As the year FY19 progressed, the global economic and political developments increasingly became less conducive for trade. The global economy started to slow down, with real GDP growth of some of the largest economies moderating significantly, after peaking out by H1-FY19. The growth in trade volumes slumped largely in response to the policy decisions in the United States in areas of trade, monetary policy, and geopolitics, with the world's largest economy getting embroiled in trade disputes with some of its largest trading partners, namely China and the EU (**Figure 6.1**). At the same time, the US' imposition of sanctions on Iran and Venezuela, continuation of OPEC+ oil supply cuts, and the slowdown in the Chinese economy, unsettled the demand-supply dynamics in the global crude oil market and led to volatility in prices.[1] Furthermore, iron and steel exports to the US by major suppliers (including China and the EU, and Vietnam from July 2019 onwards) continued to attract additional tariffs; the resultant market distortions pushed up international prices of the material.[2] In contrast, international prices of food and related items, generally remained soft, amid sufficient global production and tepid growth in demand.

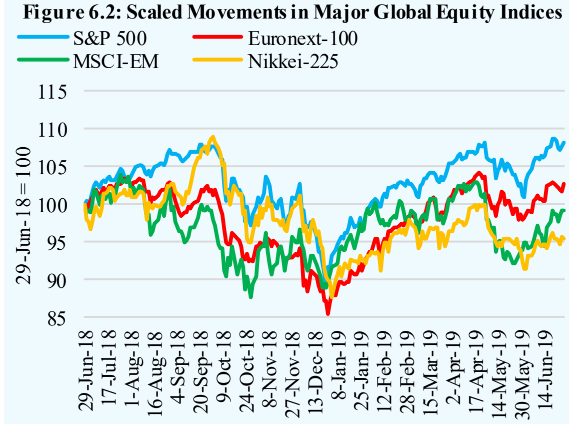
Figure 6.1: Growth in Global Trade Volumes



Data source: World Trade Organization

In the US, the Fed raised its policy rate four times during CY18, in response to upward pressure on prices stemming from an accommodative fiscal policy stance and relatively strong economic growth.[3] The growth spurt was particularly evident in H1-FY19, when real GDP growth in the US averaged 2.8 percent.[4] However, the last of these rate hikes, in December 2018, came as financial markets were already unsettled by the trade war. The rate increase triggered a collapse in global equities, wiping off trillions of dollars worth of market capitalization (**Figure 6.2**). Thereafter, the US economy started to slow down in H2-FY19, with the average real GDP growth dropping to 2.5

Figure 6.2: Scaled Movements in Major Global Equity Indices

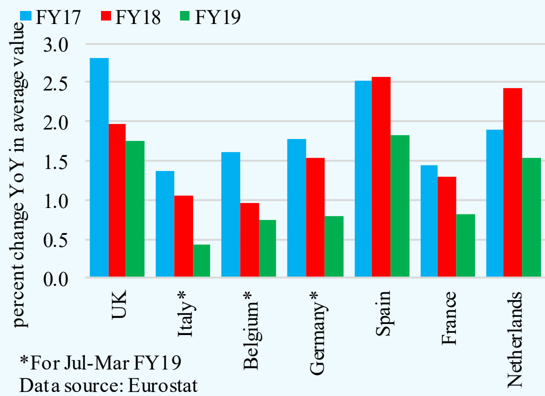


Data sources: Bloomberg & SBP calculations

[1] Oil prices had touched the US$ 80 per barrel by October 2018, before sliding over demand-side concerns. On average, Arab Light crude prices were 12.1 percent higher in FY19 as compared to FY18.
[2] International iron ore prices were, on average, 16.2 percent higher in FY19 as compared to FY18 (source: World Bank).
[3] In US, the fiscal stimulus provided by the tax cut in January 2018 stimulated both fixed investment and employment. As a result, private consumption also increased till H1-FY19. The Fed's preferred inflation metric, Personal Consumption Expenditure (PCE) index, stayed consistently at or above the 2 percent target throughout March 2018 to October 2018 (source: US Bureau of Economic Analysis).
[4] This compares with average real GDP growth of 2.6 percent in H1-FY18 (source: US Bureau of Economic Analysis).

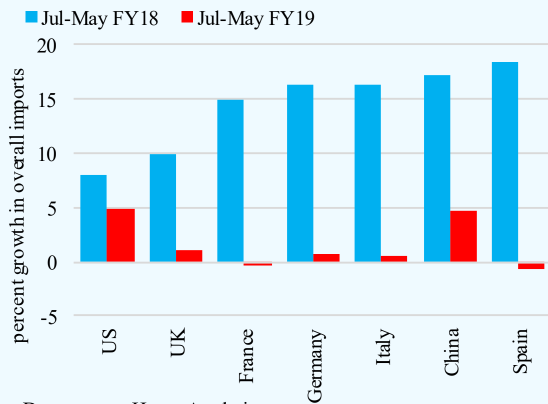
percent. This also led to easing of inflationary pressures in the economy, and prompted the Fed to hold off on further rate hikes.[5] Faced with low inflation, a slowing economy, and increased uncertainty in the global economic outlook, the Fed cut its benchmark rate in July 2019 for the first time since the global financial crisis of 2007-08.

Figure 6.3a: Growth in Real Household Consumption in Major EU Economies



*For Jul-Mar FY19
Data source: Eurostat

Figure 6.3b: Import Demand from Major Economies

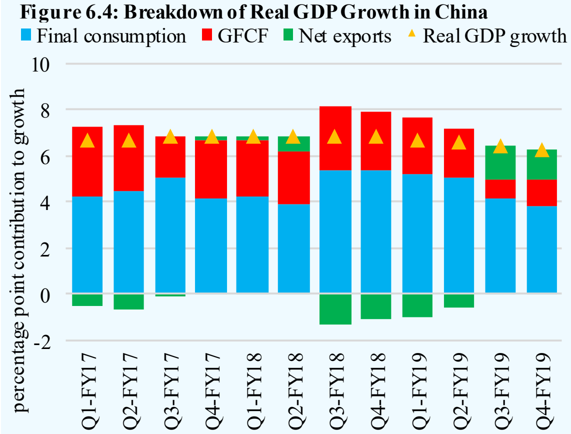


Data source: Haver Analytics

However, for the European Central Bank (ECB), the continuation of easy monetary conditions became necessary, as average real GDP growth in the EU fell to 1.6 percent in FY19 – the lowest in the past five years, and down from 2.5 percent growth recorded in FY18.[6] While factors varied from country to country, a general slowdown in household spending seemed to be common across the major economies (**Figure 6.3a**). As a result, the import demand from the EU dropped, to the detriment of export-oriented emerging markets (**Figure 6.3b**). Meanwhile, the UK struggled to exit from the EU in an orderly manner, despite the passage of three years since the *Brexit* vote. Average real GDP growth fell to 1.4 percent in FY19 from 1.8 percent in FY18; even this growth was higher than expected mainly due to inventory build-up, as businesses stockpiled in anticipation of Britain's exit from the EU.[7]

Within the emerging markets (EMs), growth in China was hit by the ongoing trade dispute with the US. Real GDP growth dropped to 6.2 percent in Q4-FY19 – the lowest since China started disseminating quarterly GDP data in 1992.[8] Buffeted by the trade dispute, China's exports suffered, which in turn had an adverse effect on its demand for imports; this had a ripple effect across the global value chains. Furthermore, fixed investment and personal consumption both started to moderate, as uncertainty gripped consumers and businesses alike about the future prospects of the economy (**Figure 6.4**).

Figure 6.4: Breakdown of Real GDP Growth in China

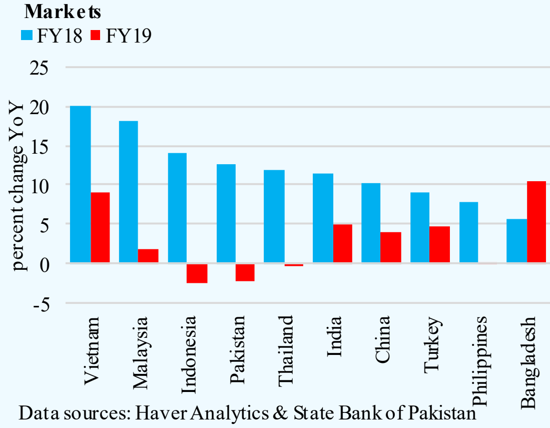


Data source: Haver Analytics

[5] The PCE-based inflation averaged 1.4 percent during H2-FY19, down significantly from 2.0 percent in H1-FY19 (source: US Bureau of Economic Analysis).
[6] Based on provisional GDP growth data for Q4-FY19 (source: Eurostat).
[7] As per the IMF's World Economic Outlook, July 2019.
[8] In FY19, average real GDP growth in China fell to 6.4 percent, down from 6.7 percent in FY18 (source: Haver Analytics).

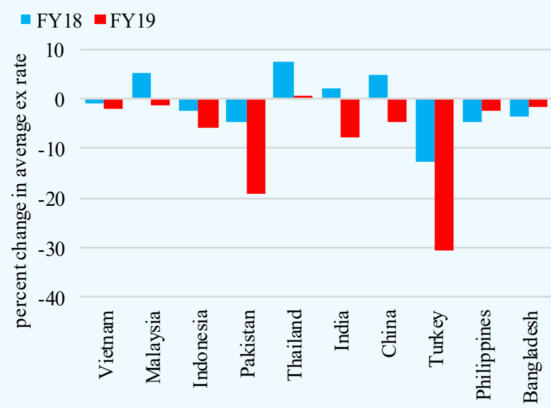
This general economic slowdown across the major economies did not bode well for other export-oriented EMs, many of whom have seen subdued exports growth in FY19 (**Figure 6.5a**).[9] The relatively lacklustre export performance came despite a weakening of EM currencies against the US dollar, with the exception of Bangladesh (**Figure 6.5b)**.

Figure 6.5a: Export Performance of Major Emerging Markets



Data sources: Haver Analytics & State Bank of Pakistan

Figure 6.5b: Performance of EM Currencies Against US



Data sources: Bloomberg & SBP calculations

The future growth momentum of the key players in the global economy depends upon the successful conclusion of the ongoing trade negotiations between: the US and China; the US and the EU; and the UK and the EU. Successful resolution of these negotiations is essential for consumer demand and investment in the advanced economies and for China to bounce back, which would have positive spill-over for exporting emerging economies, such as Pakistan.

6.2 Overview of Pakistan's BoP

The global economic slowdown and high (albeit declining) level of import payments proved particularly challenging for Pakistan's external account in FY19, as the country began the year with a precarious level of foreign exchange reserves.[10] The lack of exchange rate adjustment during FY17 and H1-FY18 – along with increased fiscal expenditure, onset of CPEC-related imports, and rebound in oil prices – had pushed the current account deficit to the unsustainable level of US$ 19.9 billion in FY18. To mitigate the excess demand in the economy, at the outset of FY19, the economic policy focused on four areas: (i) shore up the country's dwindling FX reserves by urgently seeking bilateral financing; (ii) align the exchange rate policy with market fundamentals; (iii) curtail development

Table 6.1: Balance of Payments
million US$

	FY17	FY18	FY19	Change in FY19
CA balance	**-12,621**	**-19,897**	**-13,508**	**6,389**
Trade balance	-26,680	-31,824	-28,164	3,660
Exports	22,003	24,768	24,224	-544
Imports	48,683	56,592	52,388	-4,204
Services balance	-4,339	-6,068	-4,288	1,780
Primary income balance	-5,048	-5,484	-5,697	-213
Sec. income balance	23,446	23,479	24,641	1,162
Workers' remittances	19,351	19,914	21,841	1,927
Capital acc. balance	**375**	**376**	**253**	**-123**
Financial acc. balance	**-10,198**	**-14,300**	**-11,989**	**2,311**
FDI in Pakistan	2,749	3,471	1,667	-1,804
FPI in Pakistan	-251	2,209	-1,419	-3,628
Net incur. of liabilities	8,965	8,855	11,734	2,879
Government	5,040	4,894	3,909	-985
Private (excl. banks)	2,298	2,522	2,110	-412
Banks	1,631	-109	220	329
SBP's reserves	**16,144**	**9,766**	**7,281**	**-2,485**
CA as % of GDP	-4.1	-6.3	-4.8	1.6

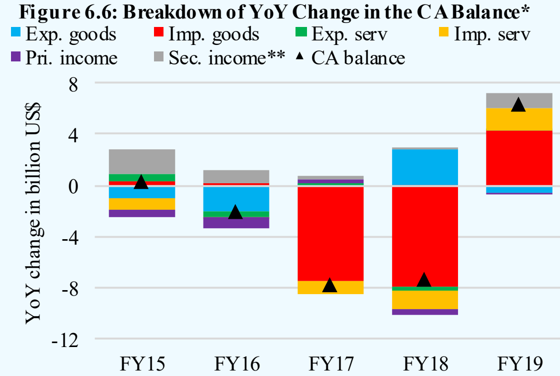
Data source: State Bank of Pakistan

[9] China was the top export destination for 31 countries in the world in 2017, and was among the top 5 export markets for dozens of other countries (source: CIA World Fact book).
[10] As on June 28, 2018, the SBP FX reserves stood at US$ 9.8 billion, adequate to finance 2.1 months of imports.

expenditure; and (iv) tighten monetary policy. Consequently, the current account gap shrunk (**Table 6.1**), largely due to squeezing of import payments (**Figure 6.6**).

The entire decline in import payments in FY19 was recorded in the third and fourth quarters of the year, as imports had risen in H1. In H2-FY19, energy import payments dropped in response to softening global oil prices (which led to a sharp deceleration in their unit prices), and some temporary administrative issues that had curtailed LNG imports in Q3. That said, quantum imports of crude oil and POL products declined throughout the year, in line with reduced demand for fuel from the power and transport sectors (**Section 6.6**).

Figure 6.6: Breakdown of YoY Change in the CA Balance*



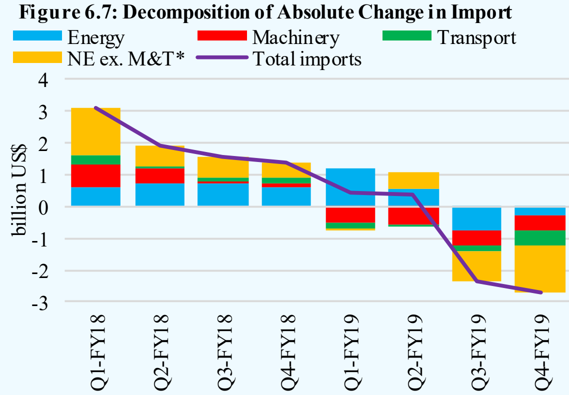
* Positive values indicate improvement & negative values show deterioration **Includes worker remittances
Data source: State Bank of Pakistan

The non-energy import payments also dropped in FY19, with major contribution coming from the machinery and transport segments (**Figure 6.7**). Moreover, the impact of the macro stabilization policy was most directly felt on imports of raw materials for the construction industry, such as iron and steel and old ships for shipbreaking (**Section 6.6**).

The decline in import payments was more than sufficient to offset the drop in export receipts. Soft international commodity prices, absence of export subsidies (on wheat and sugar) during most of the year, and a YoY decline in unit prices of key high value textile products, were responsible for the fall in exports.

At the same time, robust growth in workers' remittances contributed significantly toward reducing the CAD during FY19. Higher inflows from the UK, USA and Malaysia mainly contributed to this growth, whereas inflows from the UAE and KSA also slightly recovered. The higher remittances proved helpful in offsetting an increase in the primary income deficit, which was jacked up by an uptick in interest payments on external loans.

Figure 6.7: Decomposition of Absolute Change in Import



*Non Energy excluding machinery and transport
Data source: State Bank of Pakistan

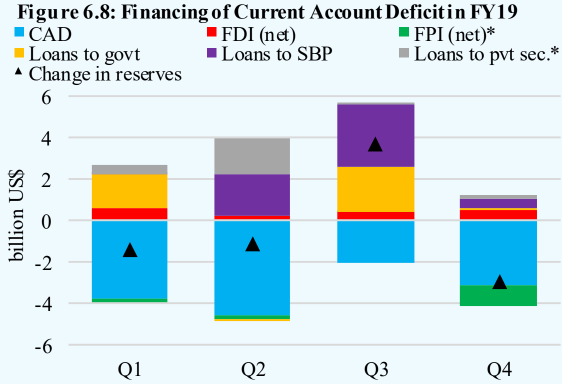
Despite the reduction in the current account gap, financing pressures remained persistent throughout the year. Arranging the required external financing was quite challenging. Overall net financial inflows were lower than last year, due to multiple factors. First, the government repaid a US$ 1.0 billion Eurobond in the fourth quarter (**Figure 6.8**).[11] Second, net FX outflows from the equity market accelerated, as foreign investors remained wary of the country's macroeconomic fundamentals. Third, with the completion of most CPEC-related projects, gross FDI into the power and construction sectors dropped

[11] This compares with an *inflow* of US$ 2.5 billion last year, as a result of issuance of Eurobond and Sukuk.

significantly. In fact, debt repayments by CPEC-related entities pushed up gross outflows from FDI; as a result, net FDI declined by 52.0 percent YoY in FY19.[12]

To arrange the external financing to plug the current account gap and meet the debt repayment obligations of both the public and private sectors, the government had to rely on commercial and bilateral sources – i.e. China (both the government as well as Chinese commercial banks), Saudi Arabia, the UAE and Qatar. The uncertainty in the lead-up to the IMF agreement led to IFIs mostly holding back from their financing (**Section 6.4**). In sum, SBP's liquid FX reserves fell by US$ 2.5 billion in FY19, against a significantly larger decline of US$ 6.4 billion recorded in FY18. However, towards the end of FY19, Pakistan reached an agreement with the IMF for a US$ 6 billion EFF loan facility, which may lead to a revival of IFI funding and capital flows into the country.

Figure 6.8: Financing of Current Account Deficit in FY19

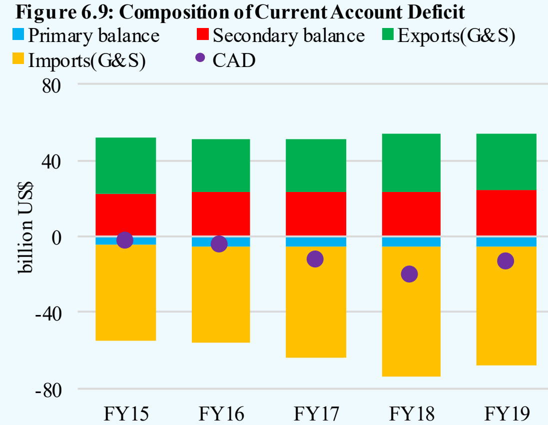


*includes Eurobond/Sukuk ** comprises banks and non-financial pvt sector companies
Data source: State Bank of Pakistan

6.3 Current Account

The current account posted a deficit of US$ 13.5 billion in FY19, which was nearly two-thirds of the deficit recorded last year (**Figure 6.9**). As mentioned before, this improvement came from significant import compression and robust growth in the workers' remittances. Importantly, decline in both merchandise and services imports contributed to this improvement. In contrast, higher interest payments on government loans, on the back of rising global interest rates and substantial medium-term borrowing, added to the CAD during FY19.

Figure 6.9: Composition of Current Account Deficit



Data source: State Bank of Pakistan

Services account

Similar to merchandise trade, services balance improved by US$ 1.8 billion, recording a deficit of US$ 4.3 billion in FY19 (**Table 6.2**). The entire improvement in services trade balance came from the fall in services import, as exports remained stagnant at last year's level. Around 60 percent of the decline in imports came from fall in travel and transportation services.

Table 6.2: Services Trade
billion US$

	FY18		FY19		Change	
	Export	Import	Export	Import	Export	Import
Overall Services	5.3	11.4	5.4	9.7	0.1	-1.7
Of which						
Transport	0.9	4	0.8	3.7	-0.1	-0.3
Travel	0.4	2.3	0.4	1.6	0.1	-0.7
Oth. business serv.	1.4	2.9	1.6	2.5	0.2	-0.4

Data source: State Bank of Pakistan

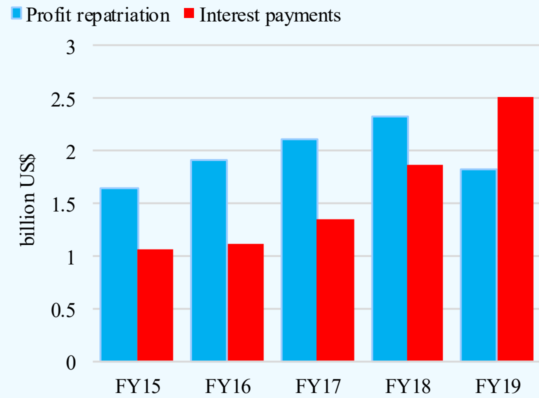
[12] In FY19, non CPEC related FDI declined by 17 percent to US$ 2.0 billion from US$ 2.4 billion realized in FY18. On the contrary, there were outflow in CPEC related FDI in FY19; US$ -267.0 million compared to US$ 1 billion inflow realized in FY18.

The transportation services that constitute around 40 percent share in services imports, decreased by US$ 333.5 million in FY19. Within that, the entire fall came from lower freight charges, resulting from the decline in merchandise imports. The travel services imports declined by US$ 719.6 million, reflecting increased travelling cost due to recent PKR depreciation. Similar to imports, the exports of transportation services declined; however, this was offset by an increase in exports of business services.

Primary income

The primary income account posted a deficit of US$ 5.7 billion during FY19, compared to US$ 5.5 billion last year. The widening of the deficit can be traced to higher interest payments on government loans, as profit and dividend repatriation by foreign companies declined during the period (**Figure 6.10**).

Figure 6.10: Components of Primary Income



Data source: State Bank of Pakistan

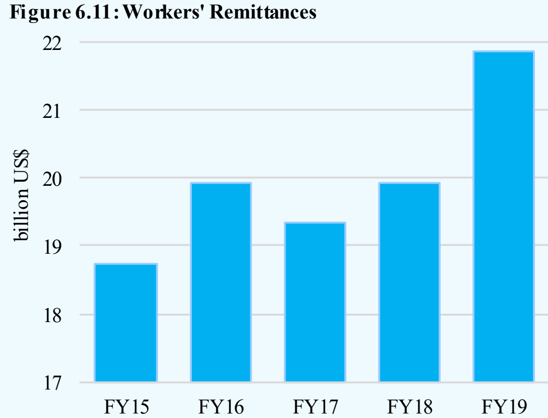
The profit repatriation by foreign companies declined by 21.3 percent during FY19, with almost equal drop in both direct and portfolio investment. Factors such as moderation in economic activities, PKR depreciation and low corporate profitability explain this trend. All major sectors, like food, oil and gas exploration, power, communication, and the financial business, repatriated lower profits as compared to last year. Despite this decline, profit repatriation was more than the net FDI received by the country.

Similarly, interest payment on loans was substantially higher compared to net FX loans into the country. The increase in the interest payments in FY19 was in line with the external borrowing trends during the past few years. Particularly, this higher growth was due to: (i) increased financing need amid high CAD, which the country had faced in FY17 and FY18; (ii) compositional shift toward commercial borrowings, which are relatively costlier than IFIs loans; and (iii) increase in the LIBOR at which most of the loans are contracted.

Workers' Remittances

After a gap of almost three years, the workers' remittances posted a strong growth of 9.7 percent during FY19, reaching a record-high level of US$ 21.8 billion (**Figure 6.11**). This robust growth provided significant cushion for the current account, specifically at the time when inflows in the financial account proved inadequate due to decline in the foreign investments. Importantly, the remittances inflows covered around one-third of the imports. Not surprisingly, Pakistan ranked 8th in terms of absolute remittance inflows during 2018, and in terms of growth, Pakistan's position improved to 8th from 18th last year.[13]

Figure 6.11: Workers' Remittances



Data source: State Bank of Pakistan

[13] Source: World Bank

The growth in remittances from USA, UK and Malaysia during FY19 was more pronounced, while the inflows from Saudi Arabia witnessed an increase after declining for the last two years (**Table 6.3**). Right at the beginning of the financial year, the government had announced a number of measures to incentivize overseas Pakistanis to send remittances through formal channels.[14] These incentives, together with the persistent efforts under the Pakistan Remittance Initiative (PRI), enhanced the remittances inflows from the legal channel. Under the PRI, domestic banks, microfinance banks (MFBs) and exchange companies (ECs) are encouraged to undertake marketing campaigns for attracting the workers' remittances.[15] Moreover, the government facilitated the recipients by exempting from withholding tax any cash withdrawals from PKR accounts that are solely fed by foreign remittances.[16]

Table 6.3: Country-wise Worker Remittances
million US$

	FY18	FY19	Change
USA	2,838.0	3,407.7	569.7
U.K.	2,892.4	3,412.4	520.0
Malaysia	1,148.1	1,551.8	403.6
U.A.E.	4,359.0	4,617.4	258.5
Saudi Arabia	4,858.8	5,003.0	144.3
Other GCC	2,158.3	2,119.1	-39.2
EU Countries	658.1	609.0	-49.0
Others	1,000.9	1,119.6	118.7
Total	19,913.6	21,840.2	1,926.7

Data source: State Bank of Pakistan

To make the process of the remittances transfer more secure and efficient, the government was accommodative to the use of innovative technological platforms. In this regard, Pakistan launched international remittance services using blockchain technology. Under the initiative, Valyou in Malaysia and Easypaisa in Pakistan joined hands to facilitate remittance through e-wallet platforms based on blockchain technology developed by Alipay.

Moreover, remittances from KSA and UAE, being the major source countries, contributed around half of the inflows during the year. Rebound in oil prices led to improved fiscal position and economic activity in GCC countries, which favoured the remittances into Pakistan.[17] Besides, the awareness campaign launched under PRI in labour camps in KSA and UAE may have led to the improved inflows from these corridors.

6.4 Financial Account

The net financial inflows amounted to US$ 12.0 billion in FY19, lower than the last's year amount of US$ 14.3 billion. Foreign direct investment declined considerably while one-off official outflows dominated the overall portfolio investment. However, substantial official debt inflows from friendly countries were sought to finance the current account gap. These inflows, to some extent, supported the country's continuously declining FX reserves.

Foreign direct investment

In FY19, the net FDI inflows dropped significantly by 52.0 percent to US$ 1.7 billion compared to US$ 3.5 billion recorded last year. At the start of fiscal year, the government had envisaged net FDI of US$ 4.1 billion on the assumption that CPEC-related infrastructure development and industrial co-operation projects would continue to attract FDI inflows. However, with the completion of phase-I of CPEC, inflows from China shrunk to only US$ 462 million – recording 77.0 percent YoY decline.

[14] For details, see SBP's First Quarterly Report for FY19 on The State of Pakistan's Economy.
[15] Under the scheme for 'Marketing of Home Remittances', domestic banks/MFBs/ECs were offered incentive for reimbursement of the marketing expenses equivalent to Rs 1 for each incremental US Dollar mobilized on inflows when exceeding 15 percent higher from the last year. Further, to promote remittances through branchless banking, incentive of airtime is increased to Rs 2 against each US Dollar received through M-Wallet.
[16] Amendment made through Finance Supplementary (Second Amendment) Act, 2019.
[17] The fiscal deficit of the GCC region went down from 5.5 percent of GDP in 2017 to 1.7 percent in 2018, while real GDP growth improved to 2 percent from -0.3 percent in 2017 (source: IMF Regional Economic Outlook: Middle East and North America, Afghanistan and Pakistan).

Nevertheless, China continued to dominate the net FDI with 27.7 percent share, followed by the United Kingdom and Hong Kong with 11.1 and 8.7 percent share respectively.

The sector-wise composition shows that the power sector, being the largest recipient of FDI last year, recorded an outflow of US$ 254 million, as one of the Chinese power company repaid the intercompany loan of US$ 530.0 million to its parent company in October 2018 (**Table 6.4**). It is important to note that with the completion of early harvest projects, the CPEC investment is directed towards transmission and distribution. Specifically, the work on energy priority project "Matiari to Lahore ±660kV High Voltage Direct Current (HVDC) Transmission Line Project" is being commenced. This is the country's first private sector transmission and distribution project under CPEC that will transmit more than 4,000 megawatts of coal-based electricity from projects in Sindh to the Punjab in main grid.

Table 6.4: Sector-wise Inflow of Net FDI in Pakistan
million US$

	FY17	FY18	FY19
Power	700	1203	-254
Construction	466	709	335
Financial Business	296	400	286
Oil & Gas Explorations	146	372	323
Pharmaceuticals	-10	16	63
Telecommunications	-91	100	-78
Electrical Machinery	7	22	166
Textile	15	50	77
Others	1,218	599	749
Total	**2,747**	**3,471**	**1,667**

Data source: State Bank of Pakistan

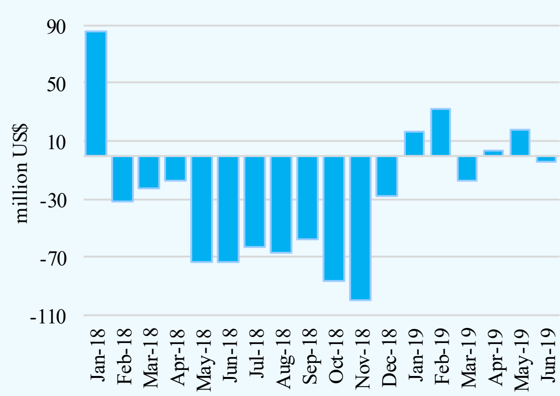
Apart from power and electrical machinery, construction, financial business and oil and gas exploration were able to attract net FDI inflows during FY19. However, the amounts of FDI of the said sectors were lower than the last fiscal year (**Table 6.4**).

The continued stabilization efforts, uncertainty over finalization of the IMF programme and frequent PKR adjustments may have dampened the sentiments of investors during the year. Furthermore, downgrading of Pakistan's credit outlook by S&P and Fitch dented further the foreign investors' confidence.

Foreign portfolio investment

Public sector outflows set the tone of the overall portfolio investment in FY19 as the government retired a Eurobond of US$ 1.0 billion in the month of April 2019. Further, Pakistan Banao Certificates (PBCs) remained ineffective to attract the overseas Pakistani investors. From its launching on January 31, 2019 till end-June FY19, the PBCs managed to attract only US$ 26.0 million. Factors that may have resulted in low demand include a narrow launch strategy with limited marketing, such as a lack of roadshows to attract investors. Moreover, the investors redeeming the certificate in foreign exchange prematurely, barring six months, had to pay a deduction on the principal invested. Also, the timing of the PBCs' launch coincided with the rising trend of US interest rates, which actually instigated portfolio outflows from developing countries.

Figure 6.12: Foreign Portfolio Investment in Pakistani Equities



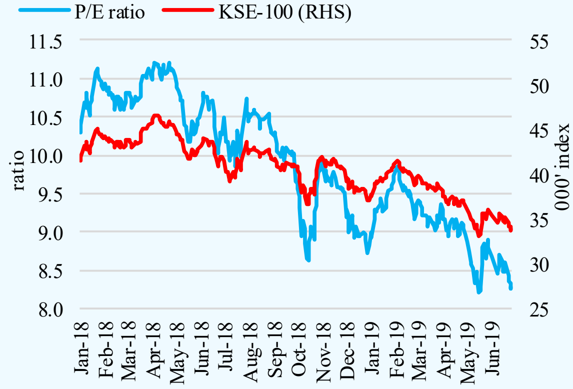
Data source: NCCPL

Meanwhile, the outflows from foreign private investment almost doubled to US$ 415 million in FY19 compared to last year. Substantial sell-offs from portfolio investors were witnessed in the first half of

FY19; however, the trend of foreign selling eased up to some extent in the second half. In fact, in the latter half of FY19 foreign portfolio investors were net buyer of US$ 48.0 million (**Figure 6.12**).

There could be multiple reasons of these portfolio inflows during H2-FY19. First, on the policy front, foreign investors were wary of expected movements in the interest rate and the exchange rate. After the significant increase in policy rate and depreciation of the Pak rupee against the US dollar, investors' confidence on the economic fundamentals may have strengthened. Second, during the course of FY19 the Pakistan Stock Exchange shed almost 9,000 points, which made the Pakistani equities attractive for investors as suggested by price-to-earnings ratio (**Figure 6.13**).[18] The P/E ratio of equities is continuously declining because of the local investors, who are pulling out funds from the local bourse amid uncertainty in the tax policy. Lastly, after the MSCI dropped UBL and Lucky Cement from the MSCI Global Standard Index, the market was expecting that Pakistan probably would be reclassified to frontier market from emerging market status. However, MSCI in its review held in May 2019 retained the country's place in the MSCI EM Index, largely from buffer and index continuity rules. Coupled with P/E ratio and PKR adjustment, this might have further reinforced the foreign investor's confidence in the Pakistani equity market.

Figure 6.13: Price/Earning Ratio of Pakistani Stock and PSX's Performance

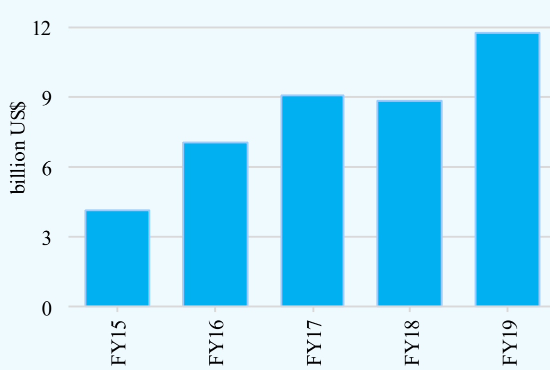


Data sources: State Bank of Pakistan and Bloomberg

Net incurrence of liabilities

The net inflow of FX liabilities into the country witnessed a hefty increase of 36.1 percent and reached to US$ 11.7 billion against US$ 8.9 billion recorded last year. This was mainly due to the inflows realized from bilateral sources, specifically from Saudi Arabia (US$ 3 billion), UAE (US$ 2 billion) and Qatar (US$ 500 million) (**Figure 6.14**). These loans were meant to stabilize BoP pressure originating from substantial external payments. Within external borrowing, net government loans amounted to US$ 3.9 billion, 20.1 percent lower than last year. In the short-term, the retirements were more than the disbursements, as the government realized US$ 1.1 billion against amortization of US$ 1.5 billion. However, in the long-term, the inflows exceeded the retirement as government disbursement stood at US$ 6.5 billion against retirement of US$ 4.4 billion.

Figure 6.14: Net Incurrence of FX Liabilities



Data source: State Bank of Pakistan

In terms of sources, the gross borrowings from China, both bilateral and commercial, continued to dominate the official disbursements (**Table 6.5**). From the total gross disbursement of US$ 10.5 billion, the share of borrowings from China stood at 45.0 percent, which was higher than last year.

[18] A high P/E could mean that a stock's price is high relative to earnings and possibly overvalued. Conversely, a low P/E might indicate that the current stock price is low relative to earnings.

6.5 Exchange Rate and Reserves

As discussed above, the Pak rupee adjustment initiated during FY18 continued, as the rupee depreciated *vis-à-vis* the US dollar by 24.1 percent during FY19. In real terms, the PKR weakened by 15.4 percent in FY19, against a depreciation of 11.2 percent observed last year (**Figure 6.15**). This was mainly due to a sharp 19.8 percent depreciation in NEER. Meanwhile, the Relative Price Index (RPI) increased by 5.6 percent. This indicates that inflation in Pakistan remained higher compared to its trading partners.[19]

Table 6.5: Source-wise Official Government Borrowings*
million US dollars

	FY18	FY19	Change
Total external loans	**10,918**	**10,485**	**-433**
China	4,011	4,721	710
Bilateral	2,311	4,187	1,876
Commercial banks	2,200	2,534	334
Bonds	2,500	-	-
Other commercial banks	1,516	1,564	48
IDB (short-term)	987	820	-167
ADB	871	497	-374
Others	533	883	-350

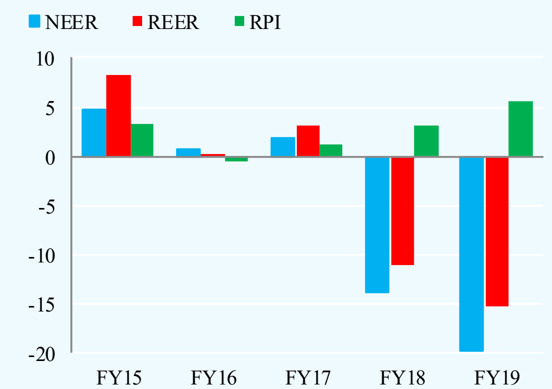
*Gross disbursements
Data source: Economic Affairs Division

Though the real depreciation in the currency may have supported the improvement in the current account during FY19, still in absolute terms, the quantum of the deficit remained high. Amid higher amortization and insufficient investments inflows, the financing of CAD had to be borne by the country's FX reserves. The total liquid FX reserves dropped by US$ 1.9 billion to US$ 14.4 billion, as on end-June 2019. Particularly, repayment of long-term multilateral loans, maturing Eurobond (in April 2019) and repayment of commercial borrowing (in May 2019) depleted the country's forex reserves. These outflows were funded through additional borrowings from the foreign commercial banks and the bilateral sources such as KSA, UAE and Qatar.

6.6 Trade Account (Customs Records)[20]

The trade deficit contracted by a sharp 15.4 percent to US$ 31.8 billion in FY19, after rising 15.7 percent in FY18. The entire improvement came from the import of non-energy products, which shrunk substantially enough to offset a YoY decline in exports and a marginal uptick in energy imports in the year. Also, most of the deficit reduction occurred in the second half (**Figure 6.16**), as (i) the decline in non-energy imports intensified, and (ii) the growth in energy imports decelerated, amid a hefty decline in quantum imports and a softening in global oil prices.

Figure 6.15: Exchange Rate Depreciation(-)/Appreciation(+)



Data source: State Bank of Pakistan

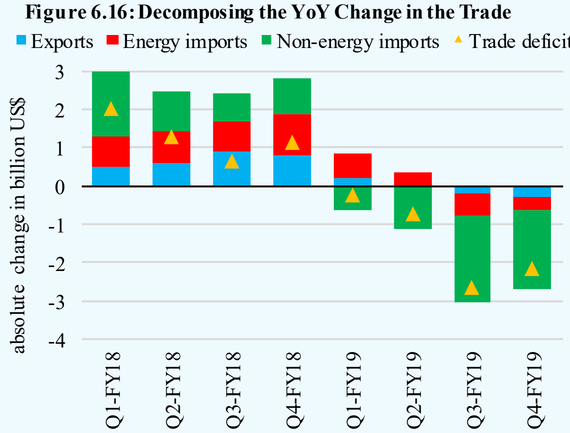
The decline in non-energy imports was mostly driven by two product categories – machinery and transport. Within machinery, the decline was concentrated in power generation and electrical items whose imports had surged during the first phase of CPEC-related power projects. These imports started to normalize in FY19 (**Figure 6.17**), and contributed significantly to the decline in overall imports. Furthermore, the cut in development expenditures, relatively subdued private real estate activity, and businesses holding back on making fresh fixed investments in the wake of a slowing

[19] Based on revised REER data by SBP, using the updated trade weights and list of new countries. The new weights are calculated by the IMF on the basis of 2013-15 trade patterns in the global economy. In case of Pakistan, this update led to increase in number of basket currencies to 37 which were previously 25 based on 2010-12 trade data. The new weights reflect the change in trade dynamics for Pakistan. For example, the share of China and other Asian economies in trade with Pakistan has risen considerably.

[20] 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.

economy (**Chapter 3**) all contributed to the slump in demand for imported raw materials, such as iron and steel. Imports of home appliances and related components, which are classified under electrical machinery, also declined, as domestic manufacturers and retailers passed on the increase in prices following the PKR depreciation to their customers.[21] Lastly, transport imports were mainly pulled down by a normalization in purchases of aircraft and railway locomotives (including associated parts), and of ships for shipbreaking purposes.

Figure 6.16: Decomposing the YoY Change in the Trade



Data source: Pakistan Bureau of Statistics

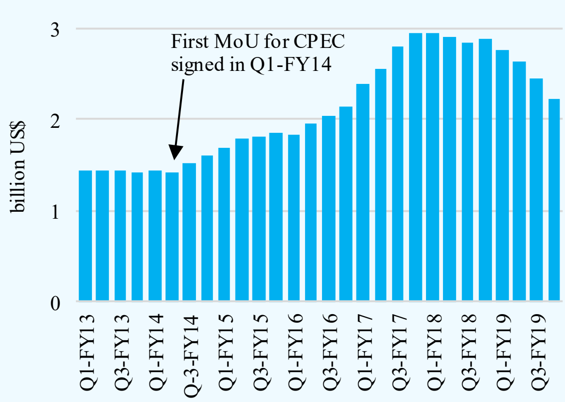
Meanwhile, energy imports stayed virtually flat in value terms in FY19, with heavy declines in quantum imports of crude oil and POL products offsetting the upward pressure from higher international oil prices in the year.[22] The decline in quantums mainly owed to the phasing out of furnace oil (FO) from the country's power generation mix and lower demand for crude oil from refineries as they reduced throughput amid operational hiccups.

On the other hand, although exports posted a substantial growth in terms of volume this year, the overall export receipts declined in terms of value. This decline is explained by a reduction in the unit values of the following major exporting products, which otherwise experienced impressive growth in volume terms: apparel (i.e. knitwear and readymade garments), cotton fabric, basmati rice, and leather garments. The fall in unit values of exporting commodities was also experienced by our regional competitors. At the same time, the muted export subsidies on wheat and sugar from Q2 onwards led to a drop in their exports.

Exports

Pakistan's exports decreased by 1.1 percent to US$ 23 billion in FY19, after rising 13.7 percent last year. The decline in values came despite a healthy increase in quantum exports of major products, particularly in the textiles segment (**Table 6.6**). In the non-textile group, the absence of export subsidies on sugar and wheat during most of the year impacted their export quantums, and largely explained the YoY fall in their export values. The export decline also deepened as the year progressed, though this was partially due to the high base effect of H2-FY18, when subsidies had pushed sugar exports to an all-time high.[23]

Figure 6.17: Quarterly Moving Average of Machinery Imports



Data source: Pakistan Bureau of Statistics

[21] For instance, average price of a color TV set was 3.0 percent higher in FY19 as compared to last year. In FY18, average prices of the same appliance had risen by 1.2 percent over FY17. LCD TV imports (both parts and complete sets) declined 44.7 percent to US$ 45.1 million in FY19.
[22] Arab Light oil prices were, on average, 12.1 percent higher in FY19 as compared to FY18.
[23] In both quantum and value terms, sugar exports had reached their historic high in H2-FY18.

Textile exports

Overall textile exports declined by 1.4 percent YoY to US$ 13.3 billion in FY19, after growing by 8.6 percent in FY18. In absolute terms, the largest source of the decline was cotton yarn, whose exports fell by 18.0 percent to US$ 1.1 billion in the year. Among other low value added items, exports of cotton fabric – Pakistan's single largest export item – also dropped 4.6 percent; however, lower unit prices were entirely responsible for the drop in this case, as quantum fabric exports rose significantly over last year. Meanwhile, raw cotton exports declined 65.0 percent to US$ 20.4 million in FY19. Lower quantum exports were almost entirely responsible for the decline; it is worth noting that there was a 15 percent drop in local cotton production in the year, which drastically reduced the exportable surplus available with the country.

Table 6.6: Pakistan's Major Exports

million US$

	FY18	FY19	Abs. change	Quant. impact	Price impact
Food group	**4,797.8**	**4,607.4**	**-190.4**	**-**	**-**
Basmati rice	581.9	634.5	52.6	102.2	-49.6
Non-basmati	1,453.8	1,435.1	-18.7	-30.8	12.1
Wheat	236.3	153.3	-83.1	-100.5	17.5
Sugar	508.3	222.9	-285.5	-269.0	-16.5
Textile group	**13,521.1**	**13,328.2**	**-192.9**	**-**	**-**
Raw cotton	58.2	20.4	-37.8	-36.8	-1.1
Cotton yarn	1,371.9	1,125.4	-246.5	-232.2	-14.3
Cotton fabrics	2,203.6	2,101.8	-101.8	452.7	-527.5
Knitwear	2,711.2	2,899.9	188.7	309.9	-121.2
Bedwear	2,261.1	2,261.8	0.7	227.0	-226.2
Towels	797.4	786.1	-11.3	-48.3	37.0
R.M garments	2,577.2	2,653.7	76.5	1,006.7	-930.2
POL group	**393.6**	**477.2**	**83.5**	**54.8**	**28.8**
Crude oil	190.4	285.4	95.1	73.9	21.2
POL products	147.5	127.8	-19.6	-32.8	13.2
Other manuf.	**3,399.3**	**3,361.6**	**-37.6**	**-**	**-**
Leather	330.2	252.3	-78.0	-61.1	-16.8
Leather manuf.	522.9	485.7	-37.2	-30.1	-7.1
Plastic	238.0	318.6	80.5	51.5	29.0
Pharma	194.9	211.7	16.8	72.2	-55.4
Cement	222.8	271.7	48.9	90.3	-41.4
Total exports	**23,212.0**	**22,958.3**	**-253.7**	**1,700.8***	**-2,090.1***

*Items for which both quantum and price data is available

Data sources: Pakistan Bureau of Statistics data & SBP calculations

Yarn and fabric

Pakistan's yarn exports dropped 18 percent to US$ 1.1 billion in FY19. Here, it is important to highlight the lack of geographical diversification in the country's yarn exports. On average, 68 percent of Pakistan's overall yarn exports have gone to China during the past two years, with another 4.2 percent going to Turkey. During FY19, these two countries were collectively responsible for almost 80 percent of the YoY decline in Pakistan's quantum yarn exports. In case of Turkey, additional duties as well as emerging trends in the country's textile industry, reduced its overall import of yarn, including from Pakistan. At the same time, China's apparel exports to the EU have plummeted, which has reduced its demand for intermediate products, like yarn.[24]

In addition to lower demand from China, domestic factors were also not conducive for yarn exports this year. Local yarn production was flat, whereas demand for yarn by domestic spinning and weaving mills was quite strong, which led to a hefty increase in local yarn prices.[25] Yarn manufacturers therefore preferred to cater to local demand instead of actively pursuing export markets.

At the same time, higher local usage of yarn led to an increase in fabric production,[26] which allowed exporters to ship higher quantities of fabric as compared to last year.[27] However, due to a drop in unit prices, fabric export values declined 4.6 percent to US$ 2.1 billion in FY19. In terms of markets,

[24] According to Chinese customs data, there was a decline of 4.9 percent in exports of garments and clothing accessories (in US$ terms) during Jan-Jun 2019 over the same period last year. Chinese customs authorities do not release quantum export data for garment and clothing items.

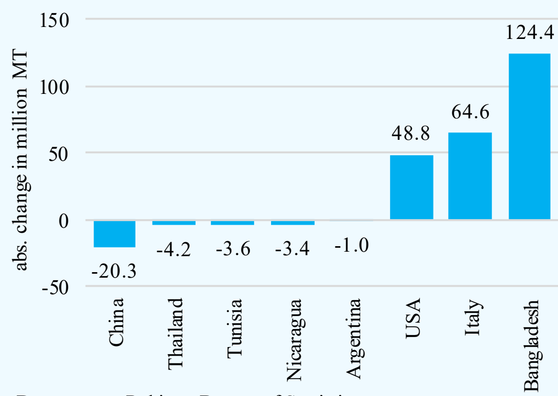
[25] Local yarn prices were, on average, 23.6 percent higher in FY19 as compared to FY18.

[26] The strong activity of the spinning and weaving industries, which manufacture cotton fabric from yarn, is not fully reflected in the fabric production data that is prepared and disseminated by the PBS. This is mainly due to the serious gaps in coverage of the companies (along the entire textile value chain) operating in the country, which leads to an underreporting of production of textile items (**Chapter 2**).

[27] In FY19, quantum fabric exports rose by a healthy 19.3 percent YoY.

hefty increases in fabric shipments to Bangladesh, the US and some European countries was recorded, which offset decline in exports to Argentina, China and Turkey during FY19 (**Figure 6.18**).

Figure 6.18: Growth in Quantum Fabric Exports to Major Destinations during FY19

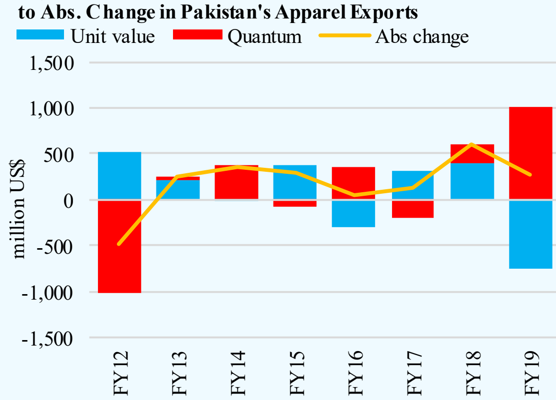


Data source: Pakistan Bureau of Statistics

Apparel

Pakistan apparel exports (comprising readymade garments and knitwear) rose 5.0 percent YoY to US$ 5.6 billion in FY19; the growth was much lower than the 13.0 percent recorded in FY18. Despite the slowdown in export growth (in value terms), data from customs authorities indicated that Pakistan had exported a record amount (quantity) of apparel in FY19. A favourable domestic policy mix, including the government's duty drawback facility of 4 percent on garments and 3 percent on other textile made-ups (carpets, sleeping bags, etc.),[28] along with continuation of concessionary external financing scheme, played an important role in boosting quantum apparel exports.[29] Nonetheless, following the significant PKR depreciation, the unit value of Pakistan's apparel exports declined by 19.7 percent in US dollar terms; this compares with the 8.0 percent growth in unit values recorded in FY18.[30] Due to the lower unit values, export values of apparel products grew at a much lower pace than last year (**Figure 6.19**).

Figure 6.19: Contribution of Unit Value & Quantum Effects to Abs. Change in Pakistan's Apparel Exports



Data sources: Pakistan Bureau of Statistics & SBP calculations

In terms of major markets, demand dynamics tended to vary. In case of the European Union, Pakistan's continued concessionary access to the bloc under the GSP Plus played a major role in keeping apparel exports on a rising trajectory. In fact, Pakistan's quantum apparel exports to the EU grew at the highest pace (6.6 percent) as compared to its major competitors in FY19 (**Table 6.7**). This growth was particularly impressive, because the bloc's quantum apparel imports from all supplying countries actually declined in the year. It is possible that the prevalent higher unit prices in the bloc, amid weakening economic growth, may have dented consumer demand for imported clothing. In this environment, only those exporters managed to benefit that were able to keep their unit prices in check. Pakistan was in this group, as the GSP Plus status and the significant PKR depreciation against the euro allowed exporters to keep their unit prices low, thereby boosting quantum exports to the bloc.

[28] Ministry of Textile and Commerce (Textile Division) notification No.1 (42-B)TID/18-TR-II or Duty Drawback of Taxes Order 2018-21. 50 percent drawbacks to be provided unconditionally and 50 percent upon YoY increase in value exports by 10 percent.

[29] Credit amounting to Rs 10.1 billion was disbursed under the Export Finance Scheme in FY19. This compares with a retirement of Rs 7.8 billion under EFS noted in FY18.

[30] The unit value of export of any item is the value (in US$) received per unit of that item. It is calculated as the value exported of the item during a certain period (month, year etc) divided by the quantity exported of that item in the same period.

In addition, early signs indicate that Pakistan is capturing some of Bangladesh's share in the EU market, after the wage increase for Bangladeshi textile workers came into effect in early 2019. Also, the entire growth in the EU's quantum imports from Bangladesh had come during the Jul-Mar period, with a 0.4 decline noted in Q4-FY19. It is likely that European countries had brought forward their purchases from Bangladeshi suppliers before the minimum wage hike set in. Following the wage increase, the EU's purchases shifted to other low-cost suppliers with duty-free access, including Pakistan. In fact, Pakistan's quantum apparel exports to the bloc rose by a sizable 12.2 percent YoY during Q4-FY19; this was despite a 0.8 percent decline in the EU's overall apparel imports in the quarter.

Table 6.7: Growth in EU's Apparel Imports from Major Countries

	Quantum		Values*		Unit Values*		Currency**	
	FY18	FY19	FY18	FY19	FY18	FY19	FY18	FY19
Bangladesh	10.5	5.3	1.3	10.9	-8.4	5.3	-5.9	3.4
Cambodia	15.8	1.9	5.9	7.5	-8.5	5.5	-1.4	4.7
China	-1.6	-7.6	-6.1	2.5	-4.6	10.9	0.0	-0.2
India	-0.4	-3.2	-3.0	0.0	-2.6	3.3	-7.6	-3.5
Pakistan	11.1	6.6	2.8	8.4	-7.4	1.7	-15.6	-14.6
Turkey	3.8	3.5	2.8	2.2	-1.0	-1.3	-25.0	-28.0
Vietnam	13.3	-4.9	1.5	11.2	-10.4	16.9	-3.0	1.2
Total Imports	**4.6**	**-0.3**	**-0.5**	**5.7**	**-4.8**	**6.0**	**-**	**-**

*In euro terms **Change in domestic currency against euro
Data sources: Eurostat & Bloomberg

However, a different dynamic was in play in the US market: here, the country's overall quantum apparel imports grew at a much higher pace than last year, but Pakistani exporters were not able to adequately benefit from this increase in demand.[31] At the same time, import values also rose, after staying flat in FY18 (**Table 6.8**).

A couple of developments stand out. First, US imports of apparel items from China have yet (as of October 1, 2019) to formally attract the additional tariffs. Nonetheless, the threat of US tariffs being placed on Chinese apparel products has been consistently there, ever since the first round of tariffs went into effect in July 2018. As Chinese apparel manufacturers are heavily integrated in the global textile value chain, it is not feasible for American retailers to immediately shift their purchases to other suppliers. The result was that some US importers accelerated their apparel purchases from China (before apparel products come under the tariff regime), explaining the marked increase in the US' quantum apparel imports from China in FY19. At the same time, some US importers have shifted their purchases to other countries, particularly to Bangladesh and India. As a result, the US' quantum apparel imports from these countries also grew at a higher rate than last year.

Table 6.8: Growth in US's Apparel Imports from Major Countries
percent

	FY18			FY19		
	Quantity	Value	Unit Value	Quantity	Value	Unit Value
Pakistan	6.2	5.32	-0.83	4.8	9.5	4.5
Vietnam	3.6	6.92	3.24	6.6	8.7	2.0
Bangladesh	1.7	0.41	-1.29	7.0	11.9	4.5
China	-0.4	-2.66	-2.26	4.7	2.7	-1.9
Cambodia	10.2	9.89	-0.24	2.5	9.5	6.8
India	2.3	3.2	0.93	5.8	7.6	1.7
World	**0.2**	**1.0**	**0.79**	**4.6**	**5.4**	**0.8**

Data sources: US Office of Textile and Apparel (OTEXA)

Amid this global repositioning, Pakistani exporters could not position themselves accordingly, with the growth in the country's quantum apparel exports to the US decelerating from last year. However, due to an increase in unit prices, Pakistani apparel exporters were able to increase their export revenues from the US market by 9.5 percent YoY (as indicated earlier in **Table 6.8**).

Food exports

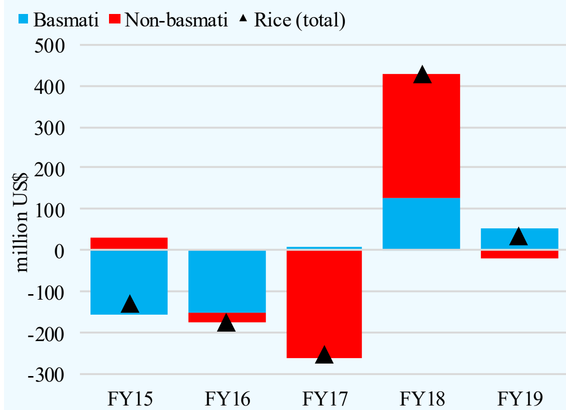
Food exports declined by 4.0 percent YoY to US$ 4.6 billion in FY19, with quantum-led declines in exports of sugar, wheat and non-basmati rice offsetting slight increases in exports of basmati rice and meat products.

[31] Strong demand in the US was reflected by a 2.3 percent growth in retail sales of clothing and accessories in FY19; this compares with a growth of 2.1 percent in retail sales recorded in FY18 (source: US Census Bureau).

Rice

Overall rice exports grew by 1.7 percent to US$ 2.1 billion in FY19, after surging by 26.7 percent in FY18. The slowdown in export growth mainly stemmed from a quantum-led drop in non-basmati rice. In contrast, basmati rice exports continued to grow, with quantums rising sufficiently enough to offset a decline in unit prices (**Figure 6.20**). However, the headline export numbers for the full year do not give the full picture of the developments that took place in H2-FY19.

Figure 6.20: Absolute YoY Change in Rice Export Values



Data source: Pakistan Bureau of Statistics

Detailed export data indicates that a significant shift occurred in the second half of FY19, both in case of basmati and non-basmati rice. Up until H1, the trend in basmati rice exports was similar to last year, where quantum exports to major European markets kept on rising, offsetting the drop in exports to Middle Eastern markets. In case of non-basmati rice, quantum exports had declined heavily in H1, with industry sources stating that China was unloading its stockpile in key African markets and pricing competitors out.[32]

However, in H2, a dramatic shift was noted, when China's own rice purchases – of both basmati and non-basmati varieties – from Pakistan surged dramatically (**Table 6.9**). In fact, it appeared that Pakistani exporters had diverted some of their exports towards China, away from European markets. The surge can be partially traced to an agreement reached between Pakistan and China in November 2018 during the Prime Minister's visit to China, where China had agreed to buy Pakistani rice. Since China typically buys non-basmati rice (for its domestic consumption as well as exports), Pakistan's non-basmati exports witnessed a relatively larger jump in H2. Further impetus to rice exports in H2-FY19 came from the major Middle Eastern markets – Saudi Arabia and the UAE – where Pakistani exporters also shipped higher quantities. However, this increase in H2 was still not sufficient to completely offset the decline in non-basmati exports recorded in H1; as a result, quantum non-basmati exports declined 2.1 percent YoY during FY19.

Table 6.9: Absolute Change in Pakistan's Quantum Rice Exports to Major Destinations

metric tons

	Basmati Rice		Non-Basmati Rice	
	H1-FY19	H2-FY19	H1-FY19	H2-FY19
China	14,978	29,618	14,978	246,991
Netherlands	6,560	-8,205	11,539	19,061
UK	15,942	-26,749	9,376	28,717
Saudi Arabia	-3,691	11,006	6,132	5,878
Belgium	-4,515	-23,941	3,514	32,106
UAE	-2,708	50,435	-3,583	27,143
Indonesia	535	-454	-24,429	-180,249
Madagascar	-16	-20	-187,979	16,050
Total	**49,815**	**48,722**	**-251,298**	**176,377**

Data source: Pakistan Bureau of Statistics

Sugar

Sugar exports decreased by 56.2 percent YoY to US$ 222.9 million in FY19, after rising three-folds in FY18. The drop mainly reflected the impact of withdrawal of federal export subsidies, which led to a 52.9 percent drop in quantum exports in the year.[33] International sugar prices were also trending

[32] According to Chinese customs data, the country's quantum rice exports had risen 299.7 percent YoY during Jan-Dec 2018. During Jan-Jun 2019, its rice exports had risen by a further 92.1 percent YoY.

[33] The Economic Coordination Committee (ECC) had allowed sugar exports of 2.0 million MT over the course of FY18; the quota (and subsidies) were utilized by the end of Q1-FY19.

downward, making it challenging for exporters to sell their product abroad.[34] In terms of destinations, most of the decline in quantum exports was accounted for by Afghanistan and India, where the ongoing geo-political situation also played a role. While the Punjab government did announce an export subsidy in Q3-FY19, it did not lead to a meaningful pickup in exports, as the amount of subsidy was lower than the federal subsidy that had expired earlier in Q1.[35]

Wheat
Wheat exports declined by 35.2 percent to US$ 153.3 million in FY19. The drop was entirely due to a 42.5 percent decline in quantum exports, whereas an 12.9 percent increase in unit prices provided some respite. Exports decreased to major destinations like Bangladesh, Malaysia, Oman, Qatar and Sri Lanka, overcoming the increased exports to Indonesia, Somalia and the UAE. Like sugar, most wheat exports were made in the first quarter, when subsidies were available. They also picked up very slightly in H2-FY19, after the government allowed export of 0.5 million MT of the commodity in November 2018. The quota was split between PASSCO and the Sindh and Punjab governments, with the federal and provincial governments subsidizing the exports by PASSCO and private entities, respectively.

Cement
Cement exports rebounded in FY19, rising by 21.9 percent YoY to US$ 271.7 million. With the increase in installed capacity and the simultaneous slowdown in domestic construction activity, local demand for cement was impacted. This forced manufacturers to look towards foreign markets, particularly South Africa, Sri Lanka, Madagascar and Mozambique.[36] Furthermore, Pakistani exporters were more focused on clinker as opposed to Portland (finished) cement. Being a low value added product that is further processed to produce cement, clinker exports fetched much lower unit prices. However, manufacturers exported sizable quantities of the material, which completely offset the downward pressure from unit prices.

Imports
Pakistan's imports declined 9.9 percent to US$ 54.8 billion in FY19, after recording an increase of 14.9 percent in FY18. The depreciation of PKR is a key explanation for the import contraction, and it was complemented by the macro stabilization efforts (reduction in PSDP spending, a rise in of regulatory duties, and monetary tightening). Furthermore, the completion of early-harvest CPEC projects, normalization of aircraft imports (**Table 6.10**) and a softening global commodity prices (in H2-FY19) were also quite helpful.

The impact of stabilization measures was directly felt on imports of raw materials for construction and transport industries – namely iron and steel (both scrap and finished products), old ships for shipbreaking, and rubber tyres and tubes. The policy decision to phase out furnace oil (FO) from the energy mix also factored in; in absolute (value) terms, FO was the single largest contributor to the decline in overall imports in FY19. Meanwhile, the indirect impact of the policy measures was perhaps felt most on imports of transport fuel products, such as petrol and high speed diesel (HSD). Domestic demand for the fuels slowed down considerably this year amid the pass through of the impact of the PKR depreciation and higher international oil prices to retail prices, reducing the need for their imports.

[34] International sugar prices were, on average, 8.8 percent lower in FY19 as compared to FY18 (source: World Bank).
[35] By end-January 2019, the Punjab government had announced a sliding-scale subsidy of Rs 5.35/kg for sugar mills in the province, up to an expenditure cap of Rs 3 billion and a quantum cap of 0.572 million MT.
[36] As per the All Pakistan Cement Manufacturers Association, domestic surplus capacity rose from 7.6 MT in FY18 to 12.6 MT by end-FY19. Also, local dispatches declined 1.9 percent in FY19, after rising 13.2 percent in FY18.

Table 6.10: Pakistan's Major Imports
million US$

Items	FY18 Value	FY18 Abs. change YoY	FY18 Quantum impact	FY18 Price impact	FY19 Value	FY19 Abs. change (YoY)	FY19 Quantum impact	FY19 Price impact
Energy group	14,430.2	3,506.9	-	-	14,441.4	11.2	-	-
POL products	7,476.1	638.2	-764.0	1,402.2	6,283.9	-1,192.2	-2,194.3	1,002.0
Crude	4,229.4	1,682.3	744.4	937.9	4,570.6	341.2	-559.0	900.2
LNG*	2,454.0	1,141.2	631.5	224.4	3,336.5	882.6	433.6	449.0
Machinery group	11,562.0	-192.6	-	-	8,921.7	-2,640.3	-	-
Power gen	2,663.0	-370.7	-	-	1,262.6	-1,400.4	-	-
Electrical	2,184.3	-137.3	-	-	1,777.6	-406.7	-	-
Telecom	1,532.3	180.5	-	-	1,379.6	-152.8	-	-
Other machinery	3,669.6	314.7	-	-	3,185.0	-484.6	-	-
Agri and chemicals	8,918.2	1,334.8	-	-	8,754.6	-163.6	-	-
Fertilizer	832.8	192.1			798.7	-34.1	-83.2	49.2
Plastic material	2,347.2	427.9			2,221.0	-126.2	36.8	-163.0
Other chemicals	4,492.3	603.5			4,452.0	-40.4	-	-
Transport group	4,388.3	1,061.1	-	-	3,085.9	-1,302.4	-	-
Cars	1,264.3	173.1	-	-	1,040.3	-224.0	-	-
Trucks & buses	639.8	71.2	-	-	496.8	-143.0	-	-
Aircraft & ships	1,141.5	616.8	-	-	694.0	-447.5	-	-
Other transp. Equipt.	349.5	62.1	-	-	85.6	-264.0	-	-
Metals group	5,356.6	944.9	-	-	4,974.2	-382.7	-	-
Iron & steel (Total)	4,023.5	782.0	518.4	263.6	3,690.3	-333.2	-484.2	150.9
Food group	6,184.2	40.8	-	-	5,668.0	-516.2	-	-
Tea	551.9	28.1	-34.9	63.0	571.7	19.8	124.1	-104.3
Palm oil	2,039.7	134.6	172.8	-38.3	1,844.6	-195.1	218.2	-413.4
Pulses	534.9	-417.5	-339.9	-77.7	506.0	-28.9	128.1	-157.0
Textile group	3,664.1	306.4	-	-	3,221.5	-442.6	-	-
Raw cotton	1,077.9	268.0	147.7	120.2	767.5	-310.4	-331.3	20.9
All other items	4,997.5	812.1	-	-	4,671.7	-325.9	-	-
Total Imports	**60,794.7**	**7,884.8**	**-**	**-**	**54,763.0**	**-6,031.7**	**-**	**-**
Import of items with Q/Price data available	27,586.8	3,988.4	1,438.8	2,549.6	25,435.7	-2,151.0	-3,334.0	1,182.9

Data sources: Pakistan Bureau of Statistics & SBP calculations

The decline in imports of power generation and electrical machinery items was expected, and in line with the completion of early harvest CPEC power projects and lower FDI flows to the sector. On the domestic front as well, the government's focus was on clearing the backlog of circular debt (which led to heavy borrowing by energy-related PSEs, as detailed in **Chapter 3**), instead of pursuing new power projects under PSDP.[37]

At the same time, the phenomenal increase in power generation witnessed in recent years started to normalize in FY19, with overall power generation rising 1.7 percent YoY in FY19 (**Figure 6.21**). As a result, the surge in demand for imported fuel for the power sector noted over the past two years – especially for LNG and coal – was largely absent this year, which led to relatively lower increases in import values for both the commodities.

Energy imports

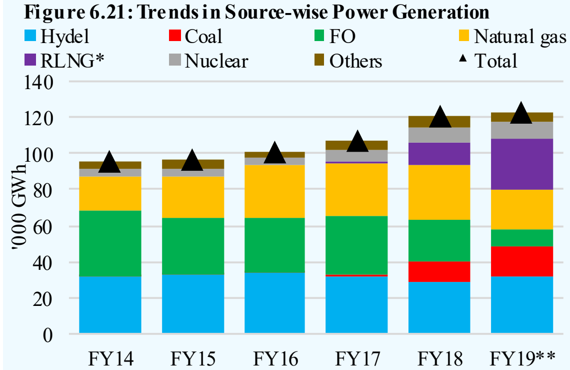
The energy imports stayed stagnant at US$ 14.4 billion in FY19, after growing by 32.1 percent YoY in FY18. In value terms, the slowdown in import growth was entirely a result of a steep drop in

[37] Overall PSDP spending was 25.6 percent lower in FY19 as compared to last year.

quantum imports of POL products and crude oil, which almost completely offset an increase in unit prices of the commodities, as well as a double-digit uptick in LNG imports in the year.[38]

In case of POL products, similar to FY18, quantum imports declined in FY19 as well. However, the reasons were very different. In FY18, local production of POL products had risen significantly after new capacity additions by a few refineries. This had led to a sizable reduction in the import demand for POL products, and simultaneously increased the demand for crude oil imports (**Table 6.11**).[39] However, in FY19, local refineries were unable to significantly alter their production mix after facing a dramatic reduction in FO demand by the power sector.[40] Unable to offload their FO stocks to IPPs, refineries had to cut back on their throughput, which led to a reduction in their demand for imported crude oil. As a result, quantum crude oil imports declined 13.2 percent YoY. However, its impact was offset by a 24.5 percent YoY increase in the commodity's unit prices, which led its import value to increase by 8.1 percent YoY to US$ 4.6 billion in the year.

Figure 6.21: Trends in Source-wise Power Generation



*NEPRA started releasing separate generation data for RLNG after February 2018 **: includes provisional data for June 2019
Data source: NEPRA

With regards to POL products, import values dropped 15.9 percent YoY to US$ 6.3 billion in the year, with lower quantum purchases entirely offsetting the impact of higher unit prices. The drop in quantum imports was most noticeable in FO and HSD. In case of FO, demand had been dropping ever since LNG-based power plants started coming online in FY18. In FY19, this declining trend not only continued, but actually deepened, as an outright ban on FO imports was in place during January to April 2019. As a result, the country did not import *any* furnace oil in 6 of the 12 months in the year.[41] In response, FO import quantums declined by 82.4 percent YoY in FY19 (**Table 6.11**), with import values dropping 78.1 percent.

Table 6.11: Growth in Quantum Energy Imports
percent change YoY

	FY18	FY19
Crude oil	29.2	-13.2
Furnace oil*	-33.1	-82.4
Petrol*	4.9	6.8
High speed diesel*	-1.1	-31.0
LNG	60.9	17.7
Coal	94.9	14.6

Data sources: Pakistan Bureau of Statistics, *OCAC for FY18 data

Meanwhile, in case of HSD, imports dropped significantly due to a slump in domestic demand. This was due to three main factors. First, lower machinery imports meant that fewer heavy commercial vehicles (HCVs) had to be deployed to transport the imported machinery upcountry to project sites. Second, the subdued construction activity also meant that fewer HCVs were needed to transport construction materials, such as cement and iron and steel products, from manufacturers to construction sites. And third, as per industry sources, the improvement in the power supply situation,

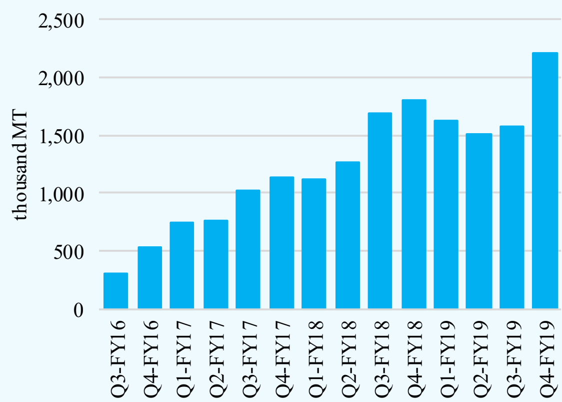
[38] Arab Light crude prices were, on average, 12.1 percent higher in FY19 as compared to FY18.
[39] In FY18, quantum crude oil imports had surged by 29.2 percent YoY, whereas imports of POL products had declined by 11.2 percent. In the same year, domestic production of POL products had risen by 13.2 percent YoY.
[40] That said, a couple of refineries had undertaken investments to upgrade their facilities, which allowed them to increase their production of petrol. For details, please see SBP's State of the Economy Report for Q1-FY19.
[41] As per data from the Oil Companies Advisory Council (OCAC). That said, the government removed the ban on FO imports in April 2019, to ensure that power plants had ample fuel available during the summer months (which also included Ramazan) to operate smoothly. Subsequently, some FO was imported during May and June 2019.

particularly in urban areas, has led to a reduction in HSD demand from households to operate diesel-powered generators. Due to lower quantums, HSD imports dropped 19.0 percent YoY in value terms. In contrast to FO and HSD, petrol's import values rose 16.0 percent YoY in FY19. In addition to higher unit prices, quantum imports of the fuel were also 6.8 percent higher. Demand for the fuel continued to grow this year, albeit at a lower pace than last year. The mushroom growth in car sales (both domestically assembled and imported) over the past few years (following growing popularity of ride hailing apps and attractive auto financing products by banks), has translated into sustained demand for petrol in the country.[42] Furthermore, the shrinking price differential between petrol and CNG has led consumers to be largely indifferent between the two fuels. Meanwhile, mainly due to refineries operating at lower throughput, domestic petrol production could not rise sufficiently enough in FY19 to cater to the rise in demand for the fuel. The gap in demand had to be plugged with imports.

On the other hand, LNG imports continued to surge, with import values rising 36.0 percent and reaching US$ 3.3 billion in the year. A 17.7 percent YoY increase in quantum imports as well as higher unit prices were responsible for the hefty increase in import values.[43] In fact, LNG emerged as the product whose import values had risen the most in absolute terms in the year (as indicated earlier in **Table 6.10**). In a span of three years (CY16-18), Pakistan has emerged as the world's 7th largest importer of LNG. The fuel's imports are expected to maintain their upward trajectory, with the government actively working to set up the country's third LNG terminal.[44]

The primary demand for LNG originates from the power generation sector, where it (along with coal) is replacing FO in the energy mix. That said, the fuel's imports are also inherently linked with effective coordination between key energy sector stakeholders, namely the Power Division, independent power producers (IPPs), oil refineries, and PSO. Off-base projections for the energy needs of the power sector, along with production outages at LNG-based power plants (either planned or unplanned) can lead to problems across the supply chain. This seemed to be the case during Q3-FY19, when quantum LNG imports actually declined on YoY basis for the first time ever, due to administrative hiccups and outages at a couple of LNG plants. However, once these issues had been resolved, and in anticipation of the rise in demand for feedstock from fertilizer manufacturers and from LNG-based power plants, quantum LNG imports surged in Q4-FY19 (**Figure 6.22**).

Figure 6.22: Pakistan's Quantum LNG Imports



Data source: Pakistan Bureau of Statistics

Lastly, coal imports rose 13.9 percent YoY to US$ 1.5 billion in FY19. The entire increase was a result of a 14.6 percent uptick in quantum imports, as unit prices of the commodity were lower (in dollar terms) as compared to last year. International coal prices had peaked out in Q1-FY19 and have been descending ever since; for full year FY19, international prices were, on average, flat at FY18 levels. Global demand for coal has fallen recently, as countries like China and Japan are increasingly shifting towards cleaner energy sources, like LNG. Meanwhile, the low international prices

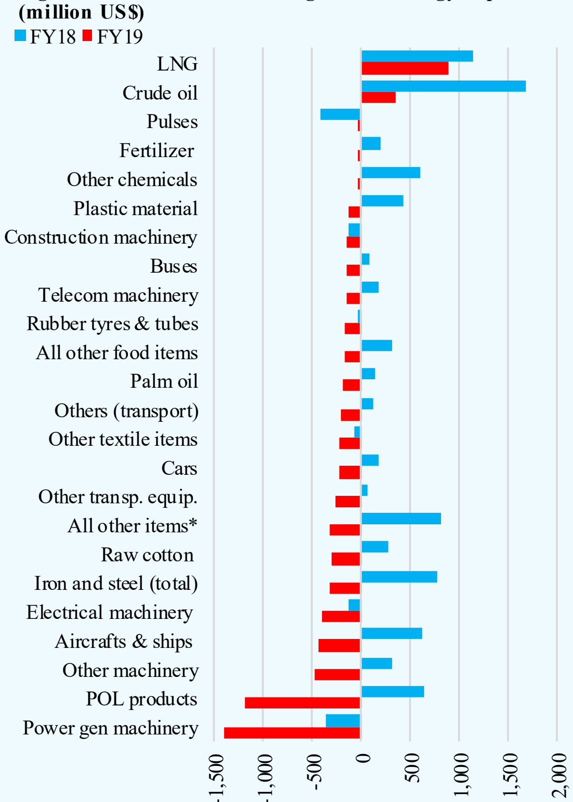
[42] Imported cars, particularly those of 660CC variety, operate exclusively on petrol, given their high fuel efficiency.
[43] Spot LNG prices were, on average, 19.0 percent higher in FY19 as compared to FY18.
[44] During the ECC meeting on July 4, 2019, the government approved some administrative requests of the Port Qasim Authority to expedite the setting up of the country's third LNG terminal (source: http://pid.gov.pk/site/press_detail/11228)

facilitated the Pakistani government's efforts to switch power generation towards coal, with the fuel's share in the country's total power generation rising to 13.3 percent in FY19, from 9.8 percent last year. On the other hand, demand for coal from the cement industry was subdued, given the 3.0 percent drop in cement production in FY19 in the wake of a slowdown in domestic demand.

Non-energy imports

Pakistan's non-energy imports declined 13.0 percent YoY to US$ 40.3 billion in FY19, after growing by 10.4 percent in FY18. While the drop was quite broad-based, some items – such as power generation and electrical machinery, aircraft and railway locomotives – accounted for the bulk of the decline in overall non-energy imports (**Figure 6.23**). At the same time, support came from lower international prices of key food items, namely palm oil, tea and pulses, which more than offset double-digit rises in their quantum imports. Lastly, as mentioned earlier, the slowdown in construction activity lowered the import demand for products associated with the industry, such as iron and steel and old ships for shipbreaking (classified under the transport group).

Figure 6.23: Absolute YoY Change in Non-Energy Imports (million US$)



* includes coal
Data source: Pakistan Bureau of Statistics

The machinery group emerged as the biggest drag on non-energy imports, with import values declining 22.8 percent YoY to US$ 8.9 billion in FY19. Within the machinery group, granular (HS-8) data indicates that most of the decline was noted in items related to power generation and electrical apparatus, such as wind power generation sets, steam boilers, gas turbines and related parts, and nuclear reactors.[45] At the same time, imports of various consumer durables, such as home appliances (TVs, lights and lamps, etc.) also declined, as higher prices in the wake of PKR depreciation suppressed the demand for consumer goods.[46]

The second largest contributor to the decline was the transport group, whose import values dropped by a sizable 29.7 percent YoY to US$ 3.1 billion in the year. As indicated in **Table 6.12**, lower purchases of aircraft, railway locomotives (including associated parts) and old ships for shipbreaking, and the absence of a one-off purchase of a tanker by a local logistics company (in FY18), were largely responsible for the decline. It may be recalled that multiple airlines had applied for commercial licenses with the Civil Aviation Authority (CAA) last year, which had led to an increase in demand for imported commercial aircraft; the absence of fresh local entrants into the aviation sector in FY19 led to normalization of aircraft (completed) imports.

Meanwhile, car imports dropped 17.7 percent YoY in FY19, after rising 15.9 percent in FY18. The

[45] According to the Planning Commission, financial close for two CPEC-related wind power projects was achieved in March 2017, and the plants became operational in June and July 2018.
[46] These products are classified under the electrical machinery category.

entire decline in FY19 came from completely built units (CBUs), whose imports were specifically targeted by the government via increase in customs duties and tightening of regulatory loopholes that had allowed massive misuse of schemes like the gift and baggage schemes by commercial car dealers.[47] This led to a 52.8 percent decline in the number of cars imported in the country in FY19, with most of the decline noted in vehicles of under 800cc.[48] At the same time, demand for locally assembled cars failed to keep up with the momentum noticed over the past two years, as local manufacturers raised car prices multiple times in order to pass-on the impact of the PKR depreciation (**Chapter 2**). The tepid sales growth prompted assemblers to curtail their production as well, which reduced the demand for CKD imports.[49]

The spillover of slowing domestic car production was also felt on imports of rubber tyres and tubes, which fell to half their level of FY18.[50] Similarly, the auto industry's demand for iron and steel sheets also suffered. In response to lower demand from automakers and the slowdown in construction activity, local steel manufacturers curtailed their production, which led to lower demand for imported scrap and old ships for shipbreaking (**Table 6.12**). Demand for finished steel products also suffered, as the brisk expansion in private real estate activity noted until FY18 started to cool down in the wake of regulatory measures to document the economy,[51] upward revision in property valuation tables, and higher prices of materials in the wake of PKR depreciation.[52] As a result of these dynamics, cumulative iron and steel imports dropped 8.3 percent YoY to US$ 3.7 billion in FY19, after rising 21.4 percent in FY18.

Table 6.12: Breakdown of Transport Imports
million US$

	FY18	Abs. Change (YoY)	FY19	Abs. change (YoY)
Transport group	**4,388.3**	**1,061.1**	**3,085.9**	**-1,302**
Aircraft, ships & boats	1,141.5	616.8	694.0	-447.5
Aircraft (compl.)	87.5	79.1	5.0	-82.5
Aircraft (parts)	61.0	10.3	65.8	4.9
Ships for breaking	706.1	310.7	156.3	-549.8
Tanker	275.8	0	-	-275.8
Other. transport equip.	349.5	62.1	85.6	-259.7
Railway loco. & parts	349.1	59.1	89.5	-260.2
Cars	1,264.3	173.1	1,040.3	-224.0
CBU	455.2	23.8	222.0	-233.2
CKD	809.0	149.3	818.3	9.2
Buses & Trucks	639.8	71.2	496.8	-143.0
CBU	242.0	- 74.2	156.0	-86.0
CKD	397.8	145.4	340.8	-56.9
Motorcycles	112.1	16.4	87.3	-24.8
Vehicle Parts & Others	881.0	121.4	681.9	-199.1

Data source: Pakistan Bureau of Statistics

Lastly, Pakistan's food imports benefited enormously from soft global prices, with import values declining by 8.3 percent to US$ 5.7 billion in FY19. Import values of key products, such as palm oil, tea and pulses, were all lower as compared to last year, despite hefty increases in their quantum imports. In fact, the 18.2 percent average reduction in global palm oil prices apparently encouraged edible oil mills to import more of the finished product, as opposed to oil seeds which can be processed to yield edible oil. Specifically, quantum imports of low-euric rapeseed, colzaseed, and sunflower seed were much lower than last year, whereas quantum purchases of palm olien and palm oil were

[47] For details, please see the SBP's State of the Economy report for Q3-FY19.

[48] This compares with a 31.0 percent YoY increase in the number of cars imported in FY18.

[49] Domestic car production declined 3.9 percent YoY in FY19, after rising by 16.5 percent YoY in FY18 (source: Pakistan Automobile Manufacturers Association).

[50] Imports of rubber tyres and tubes (classified under "miscellaneous items"), dropped to US$ 139.4 million in FY19, from US$ 313.8 million in FY18. Around 85 percent of this YoY decline was due to lower quantum imports.

[51] In the FY20 budget, the government has imposed restriction that real estate transactions over Rs 5 million can only take place via banking instruments (crossed cheque, pay order etc). The government has also doubled the rate of applicable taxes (withholding, advance and capital gains) for people not appearing on the FBR's Active Taxpayer List, and revised upwards FBR's property valuation for around two dozen large cities in the country, to bring them closer to market value.

[52] Domestic prices of metal products, such as steel bars and sheets, have risen more significantly in FY19 (19.0 percent) than in FY18 (14.3 percent).

significantly higher.[53] The low import of oilseeds also explains the stagnation in edible oil and ghee production this year.[54]

[53] Oilseed imports are classified under the "All other food items". In FY19, imports under this category declined 7.4 percent to US$ 2.2 billion.

[54] Cumulative production of edible oil and vegetable ghee declined 1.7 percent in FY19, after registering a growth of 8.3 percent YoY in FY18.