

Chapter 6

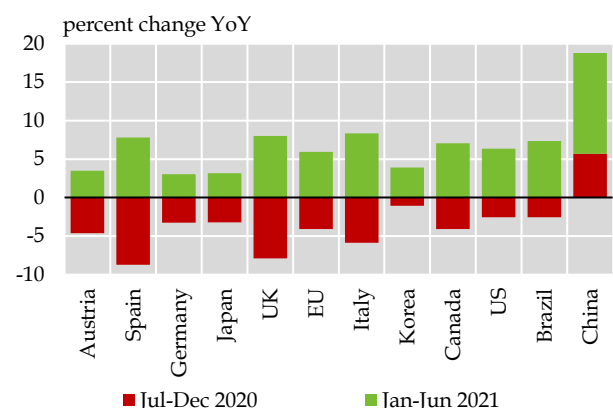
External Sector

Pakistan's external account improved significantly during FY21. The current account deficit fell to a 10-year low of US\$ 1.9 billion, primarily on the back of surging remittances and export proceeds. The Covid-related air travel restrictions, along with the market-based exchange rate, helped divert remittances to formal channels and curtailed services imports. Furthermore, Pakistan benefited from the G-20's Debt Service Suspension Initiative and the reduction in global benchmark interest rates, which reduced the interest payments on external debt. Meanwhile, the IMF program resumed in FY21, and facilitated the country's continued access to external financing from other multilateral agencies, and commercial and bilateral creditors. Pakistan also reentered the international capital markets after a gap of over 3 years and raised US\$ 2.5 billion from Eurobonds, and a state-owned firm capitalized on the global appetite for sustainable financing instruments by raising US\$ 500 million from a green bond. Under these dynamics, the country's FX reserves increased by US\$ 5.5 billion during FY21 to US\$ 24.4 billion, and the PKR appreciated 6.7 percent against the US Dollar. These positive developments notwithstanding, some challenges emerged, as the accommodative post-Covid policies and the resultant pick-up in industrial activity necessitated higher imports of both energy and non-energy products. Supply-side challenges around wheat, sugar and cotton necessitated imports at elevated global commodity price points. To ensure the external account's sustainability, the policy focus was on diversifying the source of forex earnings. This involves engaging the overseas diaspora to undertake investments, including into the Naya Pakistan Certificates, via the Roshan Digital Accounts, and incentivizing export-oriented industries.

6.1 Global Economic Review

The global economy continued to deal with the challenges of Covid-19 pandemic during FY21. To control the spread of the virus, mobility restrictions were imposed, followed by targeted lockdowns, and then the vaccine rollout.¹ Responding to the pandemic, countries implemented supportive fiscal and monetary policies to help millions of firms and households deal with the financial impact of the pandemic. However, the advanced economies (AEs) were able to mount a significantly stronger response than the developing economies,² and also managed to inoculate higher proportion of their populations by end-June 2021. As a result, the real GDP growth in many AEs rebounded from January 2021 onwards (**Figure 6.1a**) and their economies were projected to grow more strongly over the course of full-year 2021 (**Figure 6.1b**).

Average GDP Growth in Major Economies



Source: OECD/Haver Analytics

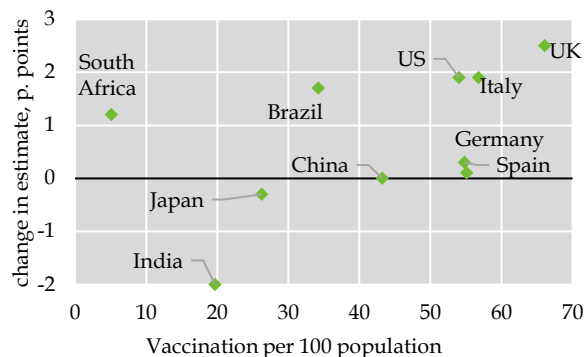
Figure 6.1a

Within the advanced economies, these trends were clearly visible in the US, where the GDP rebound in Jan-Jun 2021 was particularly strong, on the back of vaccinations, business re-openings, robust consumer spending, inventory build-ups, and low base effect. The major European economies also rebounded in Jan-Jun 2021. In the UK, growth stagnated during July 2020-June 2021 on YoY basis, as the impact of the Covid-related lockdowns on the economy was exacerbated by the culmination of the Brexit process in January 2021; nonetheless, similar to other EU economies, growth in the UK had also rebounded in the Apr-Jun 2021 quarter.³

In the emerging markets (EMs), China was the clear outperformer, as the country had broadly managed to control the virus before July 2021. Net exports accounted for a sizable share of this growth during July 2020-June 2021, as China was able to increasingly capture the

Change in GDP Forecasts & Covid-19 Vaccinations

Figure 6.1b



*change in 2021 GDP est. b/w Jan 2021 & July 2021 WEO
Source: Our World in Data/Oxford University and IMF

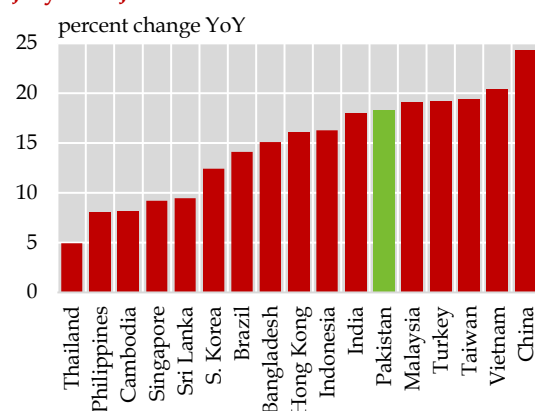
¹ The average Global Stringency Index score for all countries had peaked at 78.6 in April 2020 (100 being the most stringent), and then declined throughout July 2019-June 2020, with some intermittent spikes. By June 2021, the index average had fallen to 51.9 (source: Oxford Covid-19 Government Response Tracker).

² According to IMF estimates as of June 5, 2021, the fiscal response of advanced economies to the Covid-19 pandemic – via additional spending and foregone revenue, and equity, loan and guarantees – cumulatively amounted to 28.7 percent of 2020 GDP. In contrast, the fiscal response of emerging economies amounted to 6.7 percent of GDP.

³ The change in regulations and business disruptions, had a temporary, negative impact on output. The UK's average real GDP growth of 0.05 percent during July 2020-June 2021 was mainly due to a contraction of 22 percent YoY during July 2020-March 2021. In the Apr-Jun 2021 quarter, output had increased by a sizable 22.2 percent on YoY basis (source: OECD/Haver Analytics).

surge in demand for a wide range of consumer products amid shifts in consumption patterns away from services (such as travel and leisure) and towards goods (especially electronics, amid e-learning and remote work). Many other EMs, including Pakistan, also benefitted from this rebound in global trade, and posted higher export performances during July 2020-June 2021 (**Figure 6.2**).

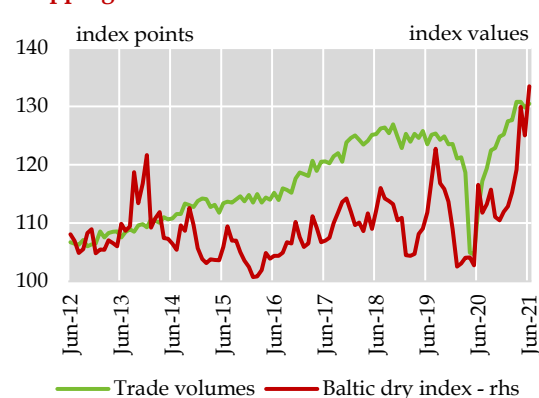
Export Growth of Major EMs during July 2020-June 2021 **Figure 6.2**



Source: Haver Analytics

This turnaround in global trade volumes was remarkable, given that there were severe supply-chain disruptions throughout the year. The strains on the logistics industry,

Surge in Global Trade Volumes & Shipping Rates **Figure 6.3a**

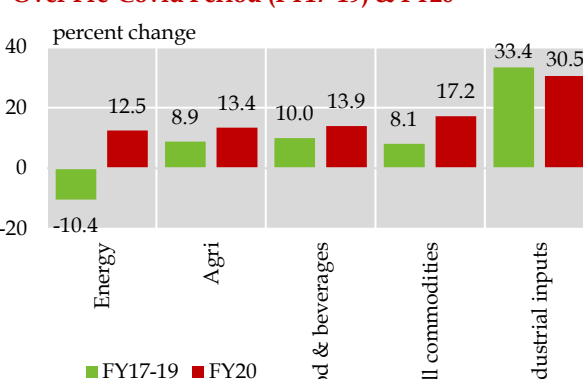


Source: CPB World Trade Monitor, Bloomberg

specifically the shipping industry, led to a sizable increase in freight rates (**Figure 6.3a**).^{4,5} These factors contributed to a so-called once-in-a-decade commodities “super cycle”, where international prices of a wide range of energy and non-energy commodities are surging at the same time (**Figure 6.3b**). Oil prices, which had fallen to under US\$ 30 per barrel in March-April 2020, more than doubled and ended June 2021 at around US\$ 75 per barrel due to production cuts by the OPEC + members and the gradual recovery in oil demand.⁶ Within non-energy commodities, food items (such as wheat and edible oil) were trading at decade-high levels by the end of FY21. This was due to lower output amid adverse weather events or labor shortages; efforts by some major global importers to preemptively build strategic reserves; and rising global shipping rates.

This surge in global commodity prices, along with the policy support to prop up aggregate demand, contributed to a build-up in headline CPI inflation across many developing and some advanced economies, particularly the US (**Figure 6.4**), during July 2020-June 2021. These inflationary outcomes have led financial markets to expect the scaling back of the Covid-related monetary support. This policy

Growth in Commodity Prices in FY21 Over Pre-Covid Period (FY17-19) & FY20* **Figure 6.3b**



*FY refers to July-June

Source: International Monetary Fund

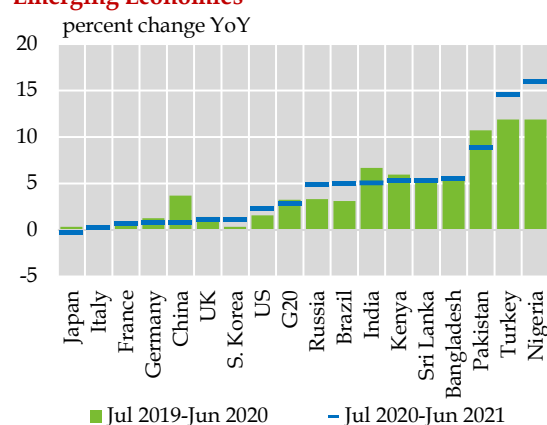
⁴ Around 90 percent of the global traded goods are transported over sea (www.oecd.org/ocean/topics/ocean-shipping/).

⁵ The Baltic Dry Index is a composite index and is widely used as a barometer of cost of transporting dry bulk cargo, and is based on quotations from leading shipbrokinghouses around the world.

⁶ Arab Light crude oil prices were, on average, 2.3 percent YoY higher in FY21 as compared to FY20. However, between end-June 2020 and end-June 2021, prices rose 112.9 percent, to US\$ 75 per barrel from US\$ 35.2 (source: Bloomberg).

normalization would begin by a winding down of asset purchases by the central banks, followed by an increase in policy rates. However, central bankers across multiple advanced economies, including the US Federal Reserve, appear to view the current inflation outturns to be “transitory” and expect the ongoing global supply chain disruptions to subside over the coming months. As such, these major central banks had yet to scale back their accommodative policies by end-June 2021.

CPI Inflation in Major Advanced & Emerging Economies **Figure 6.4**



Source: OECD & Haver Analytics

Due to the continued liquidity support from the major central banks, overall global financing conditions remained fairly liquid and conducive for borrowing by households, corporations as well as sovereigns. The sizable monetary stimulus in the advanced economies in times of near-zero short-term interest rates, has led investors to look for yields across riskier asset classes (such as equities) and markets (especially EMs).⁷ Pakistan was also among the EMs that utilized this opportunity in the global capital markets, by raising US\$ 2.5 billion via Eurobonds in April 2021, and state-owned Wapda following up by issuing the country’s first green bond for US\$ 500 million in May 2021.

6.2 Pakistan’s Balance of Payments

Pakistan’s external account improved significantly during FY21, with the country’s overall foreign exchange reserves rising US\$ 5.5 billion to US\$ 24.4 billion by end-June 2021, and the PKR being among those EM currencies that appreciated against the US Dollar (Table 6.1). The improvement in the reserves position was enabled by the accumulation of current account surpluses till November 2020, along with the availability of sizable official external financing, especially in the fourth quarter. The surge in workers’ remittances, which began in June 2020, continued throughout FY21, whereas export receipts also increased, with across-the-board growth in earnings recorded in both textile and non-textile segments. At the same time, import payments rose significantly, owing to broad-based demand-side pressures, supply-side constraints in key agricultural commodities, the substantial increase in global commodity prices, and the need to import Covid-19 vaccines.

Pakistan’s export receipts rose 13.7 percent to US\$ 25.6 billion in FY21 on YoY basis; and were also up 8.3 percent from the pre-Covid (FY17-19) average. The opportunities presented by the Covid-19 outbreak – in terms of creating demand for medicine-related textile items (such as hospital bedsheets and masks), and of pharmaceuticals and surgical instruments – played an important role in increasing the export receipts. Some shifting of textile import orders to Pakistan from competitors, including India and Bangladesh, was also noted. As a result, the export growth in major textile products, especially high value textile items, emanated from higher export volumes. In addition, mineral and metal exports, especially copper, also rose and

⁷ According to data compiled by Bloomberg, junk-rated bond issuances by EM sovereigns and corporates from January 1 to April 17, 2021, had amounted to US\$ 81 billion, which was close to the record of US\$ 89 billion these economies had raised in the same period of 2018.

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

billion US\$

	FY17-19 Average	FY20	FY21	YoY Abs. Change in FY21
Current account balance	-15.0	-4.4	-1.9	-2.5
Trade balance	-28.2	-21.1	-28.2	7.1
Exports	23.7	22.5	25.6	3.1
Imports	51.8	43.6	53.8	10.2
Services balance	-5.4	-3.3	-2.0	-1.4
Primary income balance	-5.4	-5.5	-4.6	-0.8
Secondary income balance	23.9	25.4	32.8	7.4
Workers' remittances	20.3	23.1	29.4	6.2
Capital account balance	0.3	0.3	0.2	-0.1
Financial account balance[^]*	-11.6	-8.6	-7.1	-1.4
FDI in Pakistan	2.2	2.6	1.9	-0.7
FPI in Pakistan	0.2	-0.5	2.8	3.3
Eurobond/Wapda bond	0.6	-1.0	3.0	4.0
FX Loans (net)*	9.7	6.2	3.1	-3.1
SBP*	2.2	-1.2	-2.5	-1.3
Government	4.7	5.9	5.7	-0.2
Bank & non-bank firms	2.7	1.5	-0.3	-1.5
SBP's liquid reserves (end-period)	7.3**	12.1	17.3	5.2
SBP's forward liabilities (end-period)	-8.0**	-5.8	-4.9	-0.9
PKR app.(+)/dep.(-) against US\$ (in %)	-12.6	-4.8	6.7	-

[^]Negative sign with financial account balance means a net FX inflow into Pakistan.

*Including below-the-line IMF loans. **As of end-June FY19.

Source: State Bank of Pakistan

contributed to the increase in overall export receipts.⁸

This increase in industrial and export-oriented activity, coupled with supply-side challenges across major agriculture commodities (cotton, wheat and sugar), played a major role in pushing up import payments by 23.3 percent to US\$ 53.8 billion in FY21. Data from the Pakistan Bureau of Statistics (PBS) indicates that the rise in import volumes – capturing the demand-side dynamics – had a bigger impact on the increase in import payments as compared to the higher international commodity prices (**Figure 6.5a**). Import volumes of both energy and non-energy products exhibited strong growth, even after

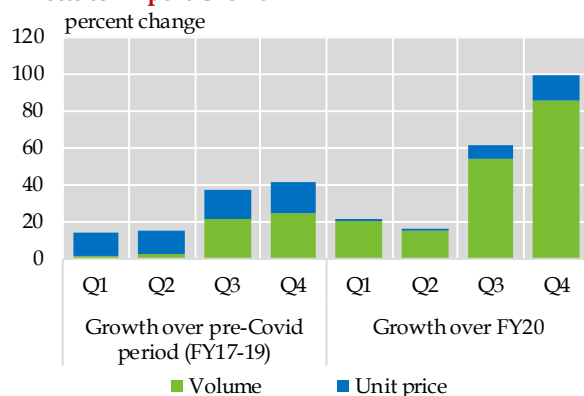
accounting for low-base effect of Covid-impacted FY20 (**Figure 6.5b**).

Some import-dependent and inward-oriented sectors of the economy – such as automobiles and construction – contributed sizably to the import growth, benefiting from the policy-induced recovery in demand and some targeted fiscal support.⁹ Imports of machinery items, including textile machinery, increased, partially in response to the investments under the SBP's Temporary Economic Refinance Facility (TERF). Energy import payments were up by 5 percent during FY21, though the increase became more pronounced in Q4 amid the uptick in international oil prices and already-elevated import volumes.¹⁰

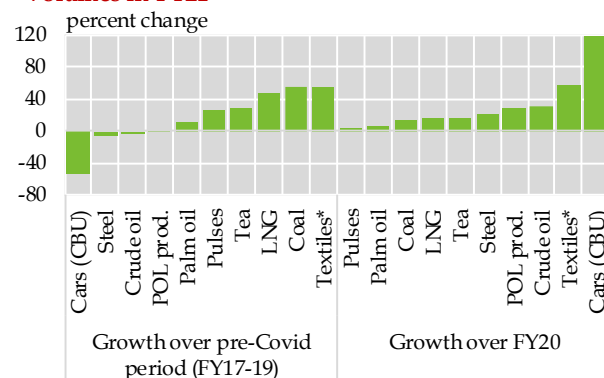
⁸ As per SBP data at the HS-8 level, refined copper was the single-largest contributor to the increase in overall export receipts in FY21, with its exports rising 79.3 percent to US\$ 456.7 million. The country's export receipts from minerals (HS-26) and metals (HS 72-83), including products, rose 64.5 percent to US\$ 1.2 billion in FY21.

⁹ Automobile financing extended by banks surged to its highest level of Rs 97.0 billion in FY21 (based on data going as far back as FY07), against a retirement of Rs 4.3 billion in FY20, and the average financing of Rs 34.6 billion disbursed in the pre-Covid period (FY17-19). In addition to increasing transport segment imports, automobiles also contributed indirectly to the steel industry's import demand.

¹⁰ Energy import payments more than doubled to US\$ 3.1 billion during Q4-FY21 on YoY basis, partly due to the low base effect of Q4-FY20, when the global oil prices had dropped significantly after the Covid-19 outbreak.

Contribution of Volume & Price Effects to Import Growth in FY21

Source: Pakistan Bureau of Statistics & SBP calculations

Figure 6.5a Broad-based Growth in Import Volumes in FY21

*Textile inputs (cotton, synthetic yarn and fiber)

Source: Pakistan Bureau of Statistics

The country's access to multilateral, bilateral and commercial creditors allowed foreign exchange reserves to continue rising throughout the year. During the third quarter, the completion of the combined 2nd-5th IMF reviews led to the disbursement of a US\$ 500 million tranche, and also facilitated the country's reentry into the international capital markets in Q4, when US\$ 3.0 billion were cumulatively raised from Eurobonds and a green bond by a state-owned entity. Furthermore, some switching was noted within official bilateral borrowings during the year, in the context of returning deposits to one partner and undertaking fresh deposits and drawing on swap lines from another.

On the other hand, foreign direct investment (FDI) inflows remained lackluster during the year. Though Pakistan was not alone within EMs to witness lower FDI inflows after the Covid-19 outbreak, the decline nonetheless also highlighted the country's reliance on very few economic sectors (such as power and telecom) and countries (China) for a large share of foreign investment.

The above discussion highlights the fact that while the country's external position improved markedly during FY21, the overall

policy mix is now geared towards supporting a higher near-term growth outcome.

Historically, such growth spurts have resulted in BoP challenges in Pakistan. However, this time, the PKR is responsive to the FX inflows and outflows in the interbank market, which is also reflected in the dual-sided exchange rate movement.

There has also been a steady diversification in the country's foreign exchange earnings.¹¹ From March 2020 onwards, FX inflows under remittances have exceeded goods exports. Furthermore, the share of the information, communications and technology (ICT) in Pakistan's overall services exports has risen consistently over the past 10 years, and especially after the Covid-19 outbreak.¹²

This creates the need for policymakers to further incentivize these two segments, by addressing any regulatory or procedural bottlenecks that might be constraining further contributions from these sectors. In this regard, there was a major policy push to integrate overseas Pakistanis with the formal banking system in Pakistan via the introduction of the Roshan Digital Accounts (RDAs) in September 2020 (Box 6.1).

¹¹ Taken as a proxy for non-debt creating inflows, foreign exchange earnings are defined as export proceeds (both goods and services), remittances and other current transfers, and foreign direct investment.

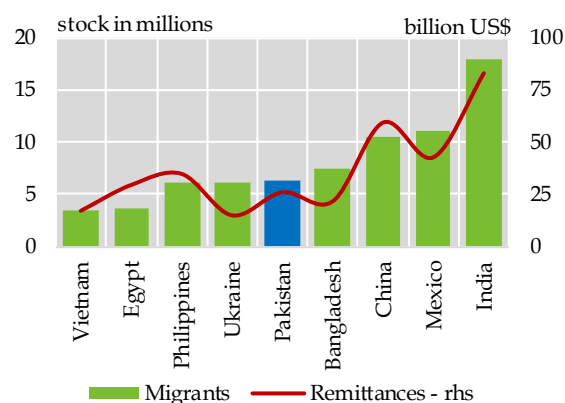
¹² Pakistan's net ICT exports have grown at a CAGR of 29 percent during FY12 to FY21, from just US\$ 123 million to US\$ 1.6 billion. The share of net ICT exports in overall services exports has risen from 2.6 percent to 26.5 percent during the same period.

Box 6.1: Integrating Overseas Pakistanis with Pakistan's Banking System – Roshan Digital Accounts

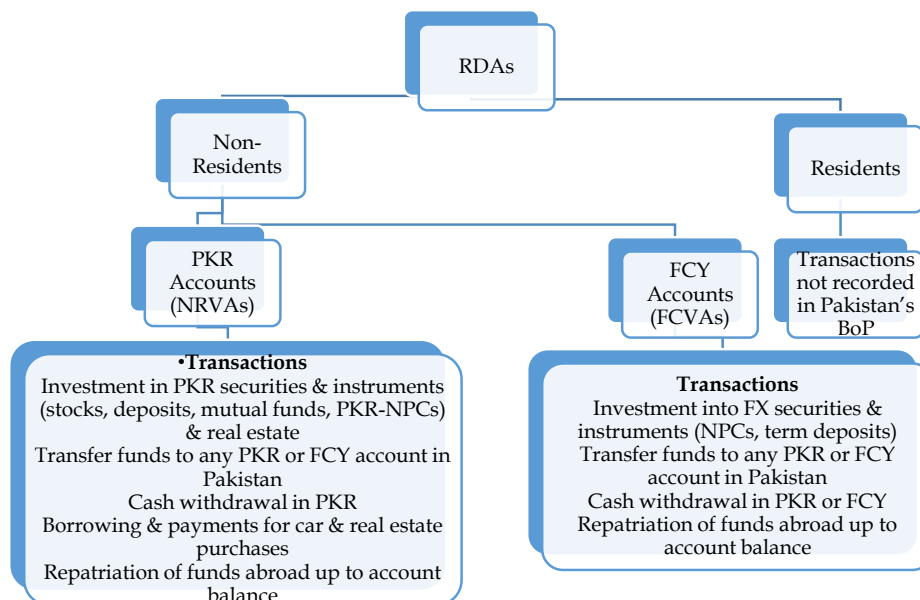
Pakistan has one of the largest diasporas in the world, with anywhere from 6.3 million (UN, 2020) to 8.8 million (GoP, 2018) Pakistanis living abroad (**Figure 6.1.1**).¹³ The foreign exchange sent by these migrants to support their families and for investment purposes, has led to the country being consistently ranked among the top 10 remittance-recipient economies. Given the importance of these inflows to the economy in general and for the external sector's sustainability in particular, there is a history of policy focus on facilitating migrants to remit funds back home. These include the formation of the Pakistan Remittance Initiative (PRI) in 2009, under which remittance processors (banks and money transfer operators) are given fiscal incentives, including the reimbursements for telegraphic transfer (TT) charges and marketing expenses, for channeling remittances into Pakistan.

More recently, there was a realization about the operational impediments in migrants investing in the stock market, mutual funds and real estate in Pakistan, via direct banking channels. The existing bank accounts for non-residents, the Special Rupee Convertibility Accounts (SCRA), were not ideally suited for individual emigrants and were geared more towards institutional investors and entities. The policy solution comprised a series of changes to the foreign exchange regulations in FY21, which allowed migrants (non-residents) and eligible residents, to digitally open bank accounts in six currencies – the US Dollar, Pounds Sterling, Euros, UAE Dirhams, Saudi Riyals and the PKR – with several

Countries with Largest Migrant Stocks Abroad & Remittances in 2020 **Figure 6.1.1**



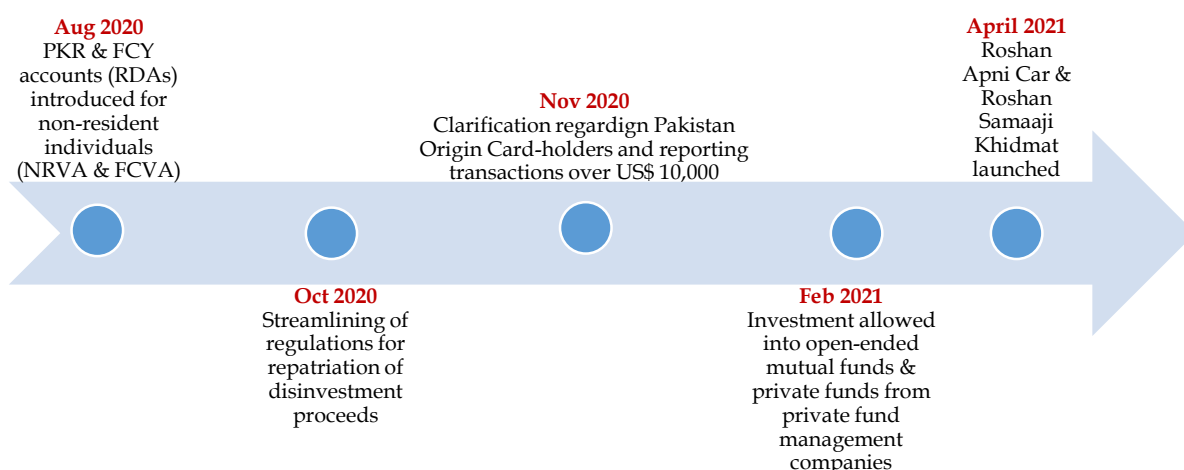
Source: UN Population Division & World Bank

Summarization of RDAs & Allowed Transactions**Figure 6.1.2**

¹³ Source: UN Department of Economic and Social Affairs, Population Division (2020), and Ministry of Overseas Pakistanis and Human Resource Development Yearbook 2017-18.

Timeline of Major Developments related to RDAs

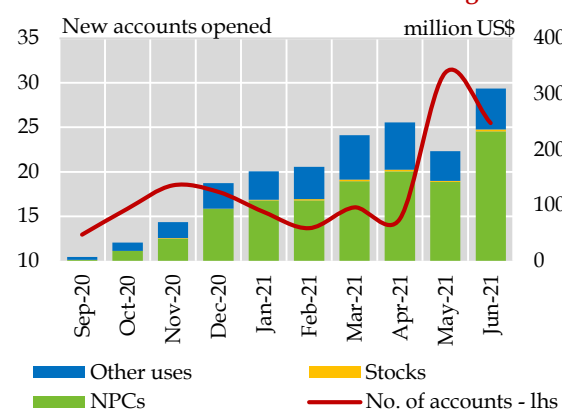
Figure 6.1.3



commercial banks in Pakistan. These accounts are now widely known as the Roshan Digital Accounts (RDAs).¹⁴ The definition for non-residents and residents is the same as in the income tax laws of Pakistan.

The RDA is a joint effort by the SBP and commercial banks to integrate the vast overseas diaspora with the country's banking system. With the continuously expanding scope of the transactions and investments that can be undertaken via these accounts, the country is able to diversify the sources of foreign exchange inflows. **Figure 6.1.2** summarizes the types of accounts within RDA, and the types of transactions that overseas Pakistanis can conduct via these accounts. **Figure 6.1.3** provides a timeline of the regulatory changes by the SBP with regards to the RDAs.

Since the introduction of these accounts by the SBP and the commercial banks and amid growing awareness, the number of accounts has steadily increased. Until end-June 2021, 181,556 RDAs had been opened by non-resident and resident Pakistanis, with cumulative inflows of US\$ 1.6 billion in gross terms (**Figure 6.1.4**). Furthermore, the available data indicates that an overwhelming amount of these funds were subsequently used to invest into Naya Pakistan Certificates (**Chapter 5**), followed by other purposes (such as family support etc), and then investments in the stock market and mutual funds. As of end-June 2021, non-residents could deposit fresh funds into the RDAs from abroad via banks only.

New RDA Accounts & Investments* **Figure 6.1.4**

*Investments are gross inflows during the month

Source: State Bank of Pakistan

The SBP subsequently expanded the types of transactions that could be conducted via these accounts. Around end-April 2021, the SBP allowed overseas Pakistanis to purchase cars via their RDAs, under the Roshan Apni Car scheme. Under this scheme, banks offer both lien- and non-lien-based loans to RDA-holders, and the car assemblers claim to deliver the cars on priority basis to RDA-holders. Under lien-based financing, the bank has a lien on the funds in the RDA or the depositor's holdings of NPCs; as such, these loans are available at relatively lower rates. Furthermore, both fixed- and variable-rate loans are offered to facilitate customers of varying risk appetites. The cost of financing under

¹⁴ The definition for residents and non-residents for the purpose of RDAs is the same as in the income tax laws (source: FE Circular No. 01 of 2020. According to the FBR, an individual is a resident Pakistani for a tax year if the individual: (i) is present in Pakistan for a period of, or periods amounting in aggregate to, one hundred and [eighty-three] days or more in the tax year; or (ii) is present in Pakistan for a period of, or periods amounting in aggregate to, one hundred and twenty days or more in the tax year and, in the four years preceding the tax year, has been in Pakistan for a period of, or periods amounting in aggregate to, three hundred and sixty-five days or more. Individuals not meeting the any of the above criteria are considered non-residents (source: www.fbr.gov.pk/income-tax-basics/51147/61148).

the available options is summarized in **Table 6.1.1**. A benefit of the Roshan Apni Car scheme over local, PKR-financed car purchases is that at least some of the import burden from the resultant car sales is offset by the FX inflows from abroad under the RDAs.

The scope of eligible transactions under the RDAs is continually being expanded, and its features are streamlined, in light of the feedback received from the overseas diaspora and from other relevant stakeholders. Already in FY22, non-residents can now apply for housing finance (under Roshan Apna Ghar), and deposit funds into the RDAs via money transfer operators (MTOs) such as Western Union and Money Gram.

Financing Rates under Apni Car Scheme

Table 6.1.1

percent	Variable Rate*	Fixed Rate**
Lien-based	SBP Floor + 1 %	8.25-9.5
Non-Lien based	KIBOR + 1 %	10.25-11.5

*SBP floor rate was 6 %, as of end-June 2021

**Fixed rates are set by banks, based on internal criteria. Data are from SBP website as of Sep 6, 2021.

Source: State Bank of Pakistan

Current Account

The current account deficit narrowed to a 10-year low of US\$ 1.9 billion in FY21, from US\$ 4.4 billion in FY20 and the pre-Covid average (FY17-19) of US\$ 15.0 billion. In fact, the cumulative current account balance (CAB) was in surplus till April 2021, before turning into deficit in the last two months. The improvement in the CAB mainly stemmed from workers' remittances, as well as the contraction in the services and primary income deficits. The net FX earnings from these sources had substantially covered the payments gap evident in the merchandise trade account, in the wake of a spike in import payments, especially in Q4.

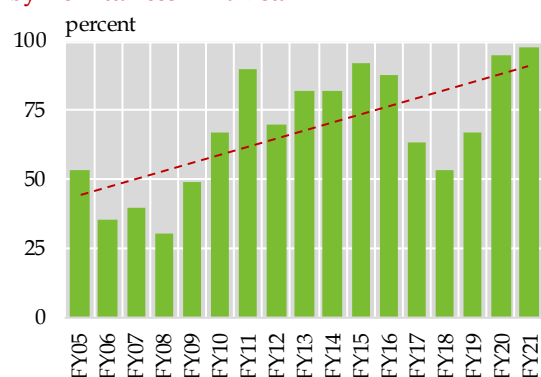
The positive impact of the curtailment in international air travel on the current account is also worth noting. The cross-border air travel restrictions directly reduced the air transport and the travel components of the services imports, and also contributed to the sizable pickup in workers' remittances by curbing cash-based FX transfers via informal channels.¹⁵

Workers' remittances

Remittances from overseas Pakistanis rose 27.0 percent to US\$ 29.4 billion in FY21. To put these FX inflows into context, remittances financed over 97 percent of the country's trade imbalance (both goods and services) during the year, thereby contributing to the FX reserves build-up and reducing the government's external financing requirements. In fact, the reliance on remittances for financing the trade gap has been growing consistently (**Figure 6.6**).¹⁶ The inflows had risen from all the major corridors in the Middle East and the advanced economies (**Table 6.2**).

The months following the Covid-19 outbreak have been quite remarkable for workers' remittances to Pakistan as well as to many other major recipients. The Covid-induced lockdowns around March 2020 across most countries had led to a sizable increase in unemployment, and contributed to

Magnitude of Trade Gap Financed by Remittances in Pakistan* **Figure 6.6**



*trade gap of goods & services

Source: State Bank of Pakistan

¹⁵ The average number of commercial flights tracked by Flightradar24 amounted to 78,356 in Jan-Jun 2021, which were up 18.8 percent from the Covid-impacted period of Jan-Jun 2020, but still 42.5 percent below the pre-Covid (Jan-Jun 2019) average.

¹⁶ From financing just 53.3 percent of the goods and services deficit in FY18, remittances financed 66.7 percent of the deficit in FY19, 94.7 percent in FY20 and finally 97.4 percent in FY21.

Corridor-wise Remittances to Pakistan

million US\$

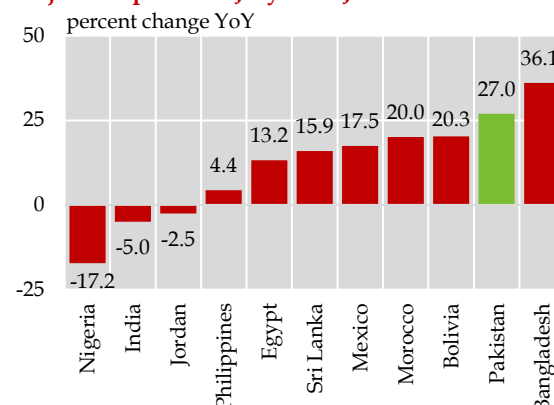
	FY20	FY21	Change
US	1,742.8	2,754.2	1,011.3
UK	2,569.0	4,067.1	1,498.0
GCC	15,135.4	17,090.9	1,955.4
KSA	6,613.5	7,667.0	1,053.6
UAE	5,611.8	6,114.0	502.2
Other GCC	2,910.2	3,309.9	399.7
Belgium	78.6	251.8	173.2
France	240.4	419.8	179.4
Italy	361.3	600.8	239.6
Australia	339.8	593.5	253.7
Canada	313.4	586.0	272.6
Others	1,948.7	2,849.9	901.2
Total	23,132.3	29,370.9	6,238.6

Source: State Bank of Pakistan

apprehensions that global remittances would drop quite significantly.¹⁷ However, instead of the expected drop in inflows, remittances to most major recipient economies surged during July 2020-June 2021, after the Covid-19 outbreak (**Figure 6.7**). A few factors behind this development are discussed below.

Diversion of flows to formal channels, especially via digital channels

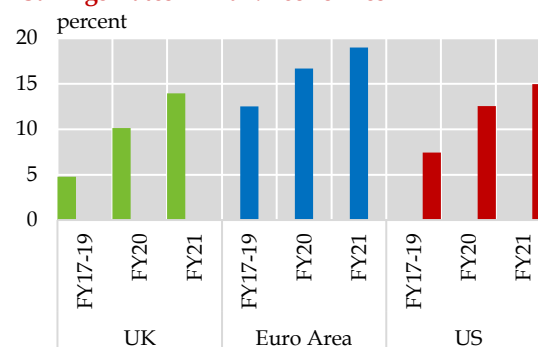
The curbs on international air travel, which began immediately after the Covid outbreak and continue to be in place (albeit with lesser stringency) have contributed to the channelization of flows via formal channels, and therefore resulted in an increase in FX inflows in the interbank market, as well remittances in the BoP statistics. This has also been confirmed empirically by Kpodar et al. (2021), who found the formalization of flows to be a statistically significant contributor to the surge in remittances to a sample of 52 countries (including Pakistan).¹⁸ Specifically, the researchers found that a 100 percent (i.e. complete) drop in air flight arrivals in the countries would lead to a 10 percent increase in remittances for the next 2 months, with the increase then gradually fading.

Table 6.2**Figure 6.7**
Growth in Workers' Remittances to Major Recipients in July 2020-June 2021

Source: Haver Analytics & State Bank of Pakistan

Increase in emigrants' savings, and higher need for support in home countries

Savings rates across the advanced economies, which are also host to large numbers of emigrants, have risen significantly after the Covid-19. This may initially appear counterintuitive, given the scale of the layoffs after the virus outbreak. However, fiscal support in these economies – via cash transfers and moratoriums on rent/utility payments – and lower expenditures (including on travel and leisure), helped increase household savings in the advanced economies (**Figure 6.8**). This allowed migrants to remit higher amounts to their home countries.

Figure 6.8
Pre- & Post-Covid Household Savings Rates in Adv. Economies*

*FY refers to July-June

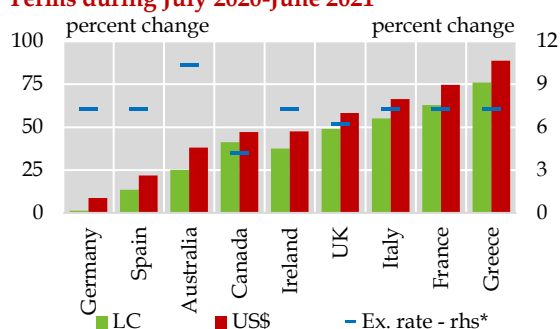
Source: Office of National Statistics (UK), Eurostat, US Bureau of Economic Analysis

¹⁷ In April 2020, the World Bank had projected a 19.9 percent drop in global remittances in CY-20, and a 23 percent drop in inflows to Pakistan.

¹⁸ K. Kpodar, M. Mlachila, S. Quayyum and V. Gammadigbe (2021). *Defying the Odds: Remittances during the Covid-19 Pandemic*. IMF Working Paper 21/186. Washington D.C.: IMF.

The need for financial support for families in the home countries was also higher after the Covid outbreak, in the wake of income losses, higher medical expenses and an inflationary environment (in some developing countries). Furthermore, Kpodar et al. (2021) found a statistically significant and positive relationship between the increase in remittances into an economy and the trend of Covid cases, after controlling for the domestic economic activities. The combination of these pull and push factors contributed to the broad-based surge in remittances to Pakistan during FY21.

Growth in Remittances from Major Corridors in Local Currency & US\$ Terms during July 2020-June 2021 Figure 6.9



*change in local currency against US\$ during July 2020-June 2021

Source: SBP, Haver Analytics & staff calculations

Cross-currency exchange rate movements increased remittances in US Dollar terms

In addition, the US Dollar's depreciation against multiple advanced economy currencies during FY21 contributed to an increase in remittances to Pakistan in USD terms. For instance, if the Dollar depreciates against the currency in which a migrant is remitting funds (such as Euros, for a migrant in Germany), a higher amount of Dollar remittances would be recorded, even if the migrant were to remit the same amount of

funds in the host country's currency (Euros, in this case). This was indeed the case in FY21, when the USD depreciated, on average, against the Pound Sterling, Euro, and the Australian and Canadian Dollars. In case of the corridors depicted in Figure 6.9, this exchange rate impact contributed an additional 7.1 percent (US\$ 516.3 million) to the cumulative increase in remittances in USD terms to Pakistan.¹⁹

Primary Income

The primary income deficit contracted 15.5 percent to a six-year low of US\$ 4.6 billion in FY21. The lower deficit originated entirely from a 27.6 percent drop in interest payments on external debt (Figure 6.10a), which offset a 20.5 percent increase in profit and dividend repatriations by foreign firms during the year.

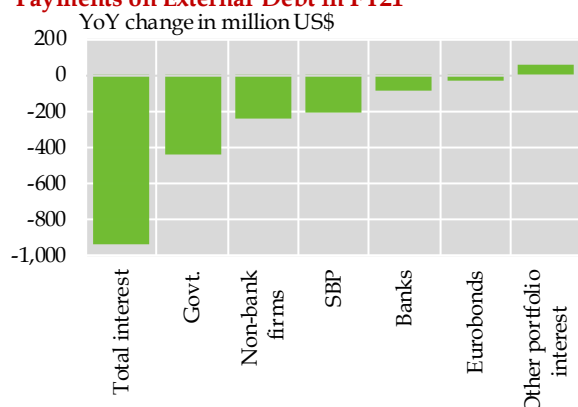
The reduction in interest on external debt can be mainly attributed to the debt deferment under the G20's Debt Service Suspension Initiative (DSSI), of which Pakistan has been the largest beneficiary in absolute terms of potential payment deferrals.²⁰ During FY21, the country's repayments of external debt (both principal and interest) reduced by an estimated US\$ 2.3 billion. Furthermore, the reduction in the benchmark LIBOR from the pre-Covid levels (Figure 6.10b), contributed to lowering the interest payment on floating rate debt during the year.²¹

The FX savings from the reduction in interest payments proved instrumental in offsetting the increase in the profit and dividend repatriation by foreign firms operating in the country. Sectors that posted a substantial increase in profits after the Covid-19 outbreak, such as multinationals in food, chemicals (including pharmaceutical and cleaning

¹⁹ The growth in remitting currency terms in Figure 6.9 is calculated by converting the monthly remittances received in US Dollar terms from these economies into the remitting currency at the average monthly exchange rate (GBP/USD), then aggregating the monthly data for FY20 and FY21, and then calculating the YoY growth.

²⁰ The potential debt deferment for which Pakistan is eligible under the DSSI is around US\$ 7.3 billion during May 2020 to December 2021, according to World Bank estimates.

²¹ A large share of the country's external debt is floating rate. For instance, of the US\$ 26.2 billion in new official borrowings between FY19 to Jul-Mar FY21 (excluding IMF and currency swaps), loans worth only US\$ 3.8 billion (14.7 percent) were contracted on fixed rate, with the remainder on floating rate or on a combination of fixed and variable rates (source: Economic Survey of Pakistan 2020-21).

Change in Source-wise Interest Payments on External Debt in FY21**Figure 6.10a**

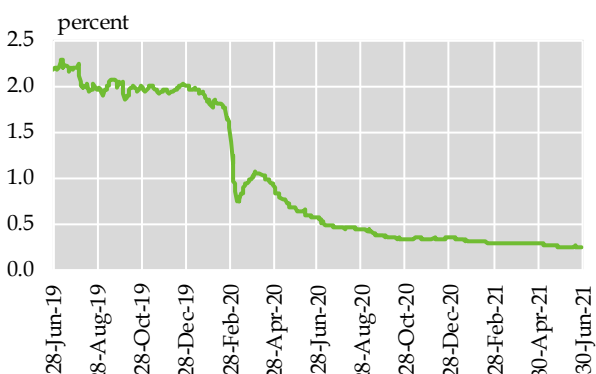
Source: State Bank of Pakistan

supplies companies), as well as banks, also recorded higher profit and dividend repatriations (**Figure 6.11a**). Conversely, sectors with weaker profitability, including those in the oil and gas (refining) sectors, witnessed lower profit repatriations during the year (**Figure 6.11b**).

Trade in Services

The services trade deficit contracted 41.0 percent to US\$ 2.0 billion in FY21, from US\$ 3.3 billion in FY20 (**Table 6.3**), largely due to Covid-related air travel restrictions, which lowered imports of air transport and travel services. Support to the services account also came from a 46.8 percent YoY improvement in net ICT exports in FY21.

The impact of international air travel restrictions was felt on two major services components: air transport and travel. The

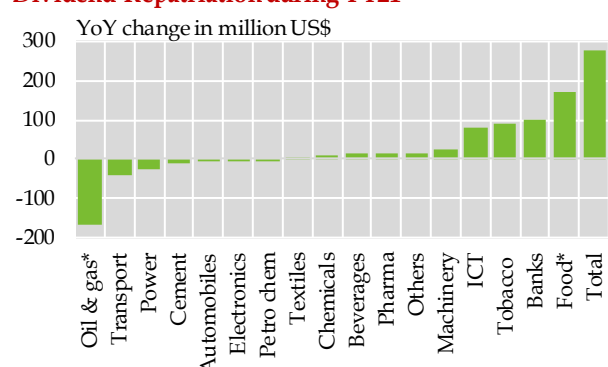
Trend in 12-m US\$ LIBOR Rate**Figure 6.10b**

Source: ICE/US Federal Reserve

curtailment of flight operations by multiple foreign airlines in the country after the Covid outbreak reduced the import of air passenger services by a sizable 76.9 percent as compared to last year.

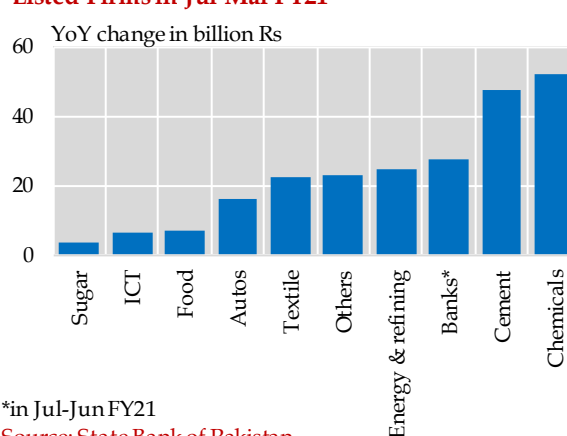
Furthermore, the FX purchases and payments by Pakistani residents for travel – including travel for religious purposes, such as Hajj, and for medical treatment – was also impacted by the air travel restrictions. These FX payments are considered as an import of travel services, and their magnitude in FY21 more than halved from last year's level.

Meanwhile, annual ICT exports crossed the US\$ 2 billion mark for the first time in FY21 and reached US\$ 2.1 billion. While the share of Pakistan in global ICT exports is still quite small, it is among those countries whose ICT exports have risen the fastest since Covid-19

Change in Sector-wise Profit & Dividend Repatriation during FY21**Figure 6.11a**

*including POL refining

Source: State Bank of Pakistan

Change in After-Tax Profits of Major Listed Firms in Jul-Mar FY21**Figure 6.11b**

*in Jul-Jun FY21

Source: State Bank of Pakistan

Breakdown of Services Balance**Table 6.3**

million US\$

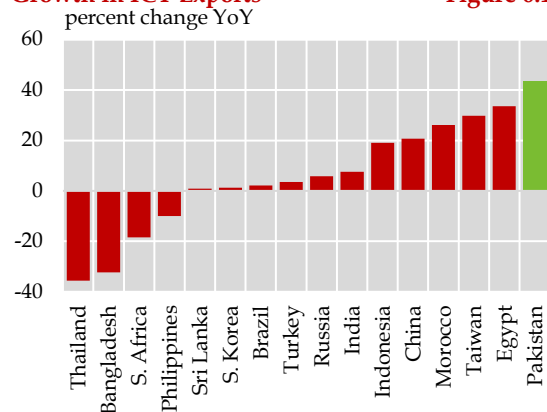
	FY20	FY21	Change**
Transport	-2,295.0	-2,385.1	-90.1
o/w Air passengers	-431.5	84.1	515.6
Freight	-1,753.9	-2,274.1	-520.2
Travel	-739.1	-323.8	415.3
ICT Services	1,055.1	1,564.2	509.1
Exports	1,440.0	2,114.1	674.1
Imports	384.9	549.9	165.0
Financial Services	-333.0	-157.0	176.0
Other Services	-1,004.0	-655.7	348.3
Services Balance (net)	-3,316.0	-1,957.4	1,358.6

*Negative balance means deficit and a positive sign means surplus.

**Positive sign shows YoY improvement in services account & vice versa

Source: State Bank of Pakistan

(Figure 6.12).²² This growth mainly originated from telecom, software development and consultancy, and other computer service-related segments.

Growth in ICT Exports***Figure 6.12**

*During Jul 2020-Mar 2021 (latest available data w/ WTO)

Source: World Trade Organization

Financial Account

The net financial flows into the country amounted to US\$ 7.1 billion during FY21 (including below-the-line IMF repayments), down from US\$ 8.6 billion in FY20 and from

the pre-Covid average of US\$ 11.6 billion (during FY17-19). The lower net inflows were mainly due to higher official debt and liability retirements by both the government and the SBP; sharply lower external borrowings by the non-bank firms; and a drop in net foreign direct investment. Most of the YoY reduction in financial flows was recorded during the first three quarters; inflows during Q4 were quite high (US\$ 6.5 billion), owing to bond issuances (US\$ 3 billion) and commercial borrowings (US\$ 1 billion).

Foreign direct investment

The net FDI to Pakistan dropped 28.3 percent to US\$ 1.9 billion during FY21, due to both lower inflows and higher outflows. Quarterly breakdown shows that inflows had dropped in the first three quarters, and then picked up marginally during Q4.

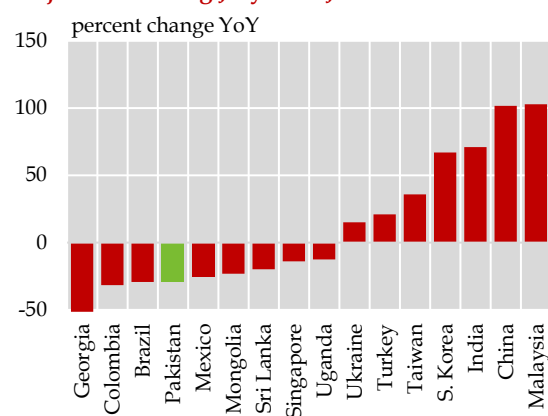
Globally, greenfield investments have been particularly impacted over the past year, due to a couple of factors. First, the Covid-19 outbreak and the resultant mobility restrictions dissuaded major corporations and investors from starting new projects in many industrial sectors. Also, the sharp drop in global oil prices after the Covid-19 outbreak had rippled across fresh investment into both upstream (extraction) and downstream (refining and retail) oil sectors.²³ Second, increased concerns over climate change and environmental sustainability have prompted major investors and financial institutions to discourage fresh investments into fossil fuel-based power projects, especially those that run on coal. China – the world's largest coal consumer – is also reassessing coal's usage as a major fuel source within its own borders, as well as for power projects under the Belt and Road Initiative (BRI).²⁴

²² Pakistan's share in global ICT exports is estimated at around 0.2 percent (source: Digital Pakistan: A Business and Trade Assessment, WB, May 2020).

²³ Global greenfield investment into the coke and petroleum sector was projected to have declined 69 percent during CY-20 to US\$ 30 billion, whereas the number of projects declined by 50 percent from CY-19 (source: World Investment Report 2021, UNCTAD).

²⁴ According to Beijing-based International Institute of Green Finance, Chinese investment in energy sectors of BRI countries were concentrated in gas, oil and hydropower projects during H2-FY21, and that no investments were made into coal-fired projects (source: Nedopil Wang, Christoph (July 2021): "China Belt and Road Initiative (BRI) Investment Report H1 2021", Green BRI Center, International Institute of Green Finance, Beijing".

Growth in Net FDI Received by Major EMs during July 2020-June 2021 **Figure 6.13**



Source: Haver Analytics

Under these macro dynamics, many emerging markets, including Pakistan, have been facing a challenging environment with respect to FDI (**Figure 6.13**).²⁵ For instance, while net FDI into the power sector increased 18.4 percent during the year, the entire increase came from an uptick in investment into non-coal-based power projects, whereas FDI into coal power projects declined slightly (**Table 6.4**). Similarly, FDI into the oil and gas sector (both upstream and downstream) dropped 41.0 percent YoY, mainly due to lower inflows into a few major exploration companies, and outflows from a couple of oil refineries and oil marketing companies.

However, apart from these global factors, the lower FDI inflows to Pakistan in FY21 also reflected some indigenous factors. First, in the wake of no major telecom spectrum issuance or license renewals, FDI into the telecom sector dropped quite sharply from last year's elevated levels. In FY20, the government had received license renewal fees from 3 major cellular service providers in the country. Telecom firms tend to take intercompany loans from their foreign sponsors to make such payments, and these loans had pushed

up the FDI inflows into the telecom sector in FY20.

Sector-wise Net FDI Inflows to Pakistan **Table 6.4**

million US\$	FY20	FY21	Change
Food*	27.5	13.1	-14.4
Textiles	37.7	6.9	-30.7
Trade	43.2	146.8	103.6
Oil & gas**	311.4	183.8	-127.6
Information tech.	41.5	73.2	31.7
Electrical machinery	153.4	114.3	-39.2
Automobiles	53.9	19.0	-34.9
Power	765.6	906.1	140.5
o/w Coal	545.0	511.9	-33.1
Non-Coal	220.6	394.1	173.6
Telecom	622.5	34.8	-587.7
Banks	274.8	235.5	-39.3
Others	266.0	128.2	-137.8
Total	2,597.5	1,862.8	-734.7

*incl. food packaging **incl. exploration & refining

Source: State Bank of Pakistan

The FDI into Pakistan is lately being driven by sector-specific activity in a few segments of the economy for many years now, and is primarily dependent on progress on CPEC-related projects. For telecom, this includes spikes in FDI whenever the government conducts auctions of telecom spectrums or when license fees of cellular firms become due. Meanwhile, since the advent of CPEC in FY16, the sizable investments into the power sector have primarily originated from China. As such, there is a need to actively pursue the second phase of CPEC, while also utilizing the opportunities presented by the upcoming special economic zones (**Chapter 7**) to attract FDI from China. In addition, a further enabling in the policy environment, including by simplifying and easing relevant regulations, may attract foreign investment into more dynamic sectors of the economy, such as ICT.

Foreign portfolio investment

²⁵ FDI into India has risen significantly after the Covid-19 pandemic, mainly due to mergers and acquisition activity in its telecom and technology sectors. One of the largest FDI inflows were recorded into Jio Platforms, the country's largest telecom firm, as the company looks to expand from a telecom and data services provider into a manufacturer of low-cost cell phones. The company has sold partial stakes to Silicon Valley giants like Facebook and Google in CY-20.

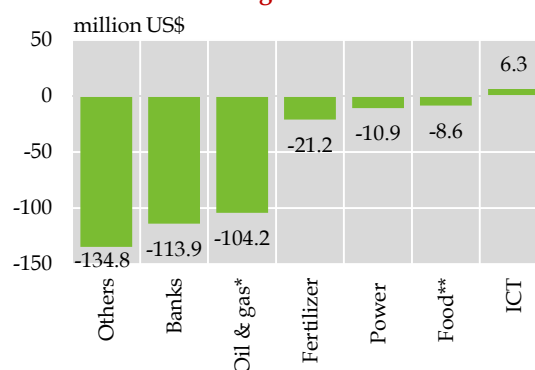
Net FPI inflows into the country rose to US\$ 2.8 billion in FY21, against net outflows of US\$ 0.5 billion recorded last year. The current year's inflows were dominated by proceeds from the issuance of Eurobonds (US\$ 2.5 billion) and a green bond by Wapda (US\$ 0.5 billion) during Q4. Meanwhile, outflows from the local equity market amounted to US\$ 0.3 billion, almost the same as the outflows recorded in FY20.

The Eurobond issuance marked the country's first entry into international capital markets in over 3 years. The global markets were fairly liquid, in the wake of the sizable monetary stimulus implemented by especially the advanced economies, whereas investors' appetite for higher yielding assets was also high. In addition, Pakistan had just successfully completed the combined 2nd-5th IMF program reviews, and received a tranche of US\$ 0.5 billion from the Fund.

As such, on balance, this provided a good opportunity for the country to tap the international capital markets. Of the US\$ 2.5 billion raised by the issuance, US\$ 1 billion were raised each from 5-year and 10-year bonds, and US\$ 0.5 million from 30-year bonds (Chapter 5).

Apart from the Eurobonds, local currency debt securities attracted marginal interest from foreign investors, to the tune of US\$ 41 million on net basis in FY21, against US\$ 746 million last year. It may be recalled that before the Covid-19 outbreak, the country had received sizable FPI into PKR-denominated government bonds amid the high interest rate differential with the advanced and EM economies, the realignment of the exchange rate with market fundamentals, and the initiation of the IMF program in July 2019. These capital flows had then reversed after the Covid outbreak, in line with similar movements across other EMs. In FY21, FPI continued to flow into longer tenor PKR government bonds, though outflows were recorded from shorter tenor bonds.²⁶

Net Foreign Buying(+)/ Selling(-) in Pakistan Stock Exchange in FY21 **Figure 6.14**



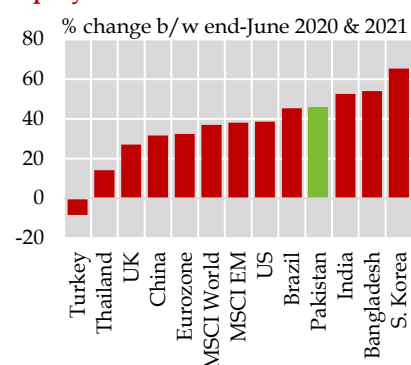
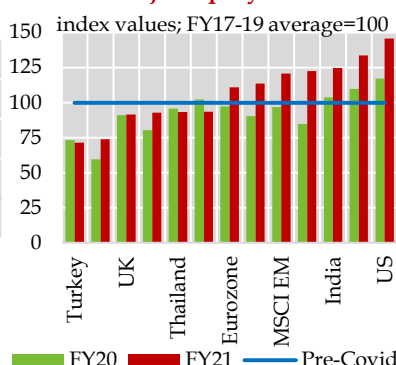
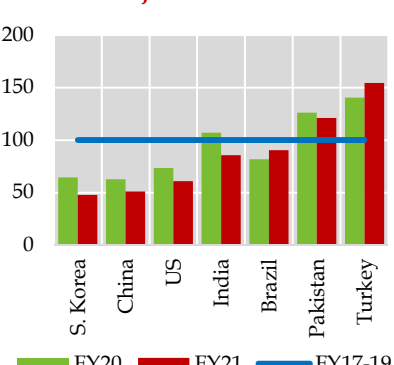
*incl. exploration & OMCs **incl. personal care items

Source: National Clearing Company of Pakistan Ltd.

In contrast to debt securities, equity securities recorded capital outflows of US\$ 292 million during FY21, almost unchanged from outflows of US\$ 282 million last year. Equity selloff was noted across almost all the major sectors, as indicated in **Figure 6.14**. The continued equity market selloff was somewhat intriguing, because the Pakistan Stock Exchange was among the best performing markets globally during July 2020-June 2021 (**Figure 6.15a**).

A couple of reasons likely explain this disconnect between market performance and capital flows. First, equity markets had recovered across the board during FY21, mainly due to the low-base effect from FY20, when equities had dropped sharply after the Covid outbreak. However, while many equity markets had recovered to their pre-Covid (i.e. average during July 2018-June 2019) levels during July 2020-June 2021 in US Dollar terms, the PSX was among those exchanges whose performance had not recovered to the pre-outbreak levels (**Figure 6.15b**). Second, investors continued to attach relatively higher risk premium to Pakistan. Pakistan's risk premium – as captured by credit default swap rates – had declined in July 2020-June 2021 on YoY basis, but was still marginally higher than the pre-Covid (average of July 2018-June 2019) level (**Figure 6.15c**). This was a likely deterrent for foreign investors, given that

²⁶ During FY21, net FPI into PKR-denominated debt securities amounted to US\$ 41 million. The breakdown shows that there was a net inflow of US\$ 317 million into longer tenured securities, and a net outflow of US\$ 276 million from shorter tenor securities.

Abs. Return of Major Equity Markets****Figure 6.15a Pre- & Post-Covid Trend in Major Equity Indices******Figure 6.15b Trend in 5-yr CDS Rates of Major Economies***

*FY refers to July-June

**Equity indices in 6.15a & b are in US Dollar terms

Source: Bloomberg & staff calculations

equities in some of the major advanced economies with lower risk premiums, especially the US, were also offering high returns during the year.

FX Loans & Liabilities

The net inflow of FX loans into the country, including repayments of previous IMF loans, amounted to US\$ 2.9 billion during FY21 – down significantly from US\$ 6.2 billion received last year.

A couple of factors explain these developments. First, a significant part of the country's external financing requirements was met by the US\$ 3 billion raised from Eurobonds and green bonds issued during Q4.²⁷ Second, the financing requirements till Q3 were quite contained, given the sizable reduction in the current account gap during this period. Third, the central bank made higher liability retirements this year, which lowered the net inflow of external loans during the year (Table 6.5). And fourth, the external borrowing by non-banking firms, including those in the private sector, dropped quite sharply, from US\$ 1.6 billion last year to only US\$ 27 million in FY21.

Among the major sources of official external financing, some shifts were noted during FY21. First, financing from the IMF was sizably lower as compared to last year; one tranche of US\$ 500 million was released in

March 2021 after the completion of the 2nd-5th combined EFF reviews. At the same time, the country was also making repayments of previous loans to the Fund. On net basis, Pakistan repaid US\$ 0.6 billion to the IMF in FY21. This is in contrast to FY20, when two EFF tranches – worth a cumulative US\$ 1.5 billion – were received, along with US\$ 1.4 billion under the Rapid Financing Instrument (RFI) after the Covid-19 outbreak; on net basis, financing from the Fund had amounted to a sizable US\$ 2.1 billion last year (Figure 6.16).

Breakdown of Net Official FX Loan & Liability Inflows to Pakistan**Table 6.5**

million US\$

		FY20	FY21
Government	IMF	2,834	499
	Bilateral Inflows*	37	1,783
	Other Inflows	10,347	9,304
	Repayments	-7,299	-5,855
SBP	Bilateral Inflows*	0	1,536
	Other Inflows	3	3
	IMF	-745	-1,080
	Bilateral Outflows*	-501	-3,007
Official**	Inflows	13,221	13,125
	Outflows	-8,545	-9,942
	Official Inflows-Net	4,676	3,183

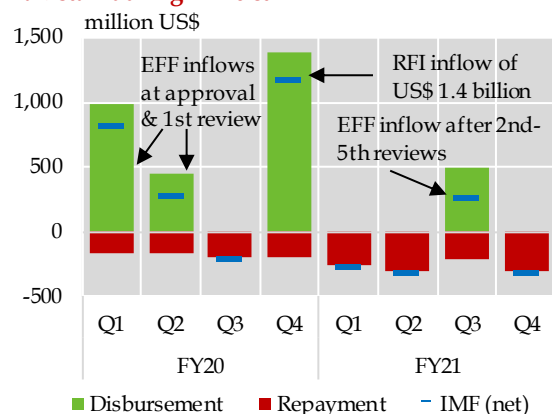
*Bilateral inflows/ outflows are in the form of FX deposits and swaps with foreign central banks

**Official comprises government & SBP

Source: State Bank of Pakistan

The lower Fund financing was offset by inflows under the Eurobonds, as well as from commercial loans. In fact, commercial loans

²⁷ Proceeds from Eurobonds bonds are recorded under FPI and not FX loans in the balance of payments data.

Breakdown of IMF Lending to Pakistan during FY20 & FY21**Figure 6.16**

Source: State Bank of Pakistan

were the single-largest source of official inflows (in gross terms) during the year (Table 6.6). Among other sources of external financing, the continued engagement with multilaterals, such as the World Bank and ADB, among others, contributed to the receipt of official loans during the year. The financing from multilaterals was focused on Covid-related support, infrastructure development (including renewable energy and agriculture-related), social sector programs, economic reforms, and financial-sector development.

Major Sources of Gross Official External Financing***Table 6.6**

million US\$	FY20**	FY21	Change
World Bank (IDA+IBRD)	1,376.0	2,035.5	659.5
ADB	2,824.0	1,365.9	-1,458.1
Bonds***	-	2,500	2,500.0
IDB (incl. short term)	879.0	623.9	-255.1
Bilateral deposits	-	1,000.0	1,000
Commercial loans	3,373.0	4,721.2	1,348.2
Others	2,208.0	1,785.9	-422.1
Total	10,660.0	14,032.4	3,372.4

*Excl. IMF (US\$ 2 billion in FY20, US\$ 500mn in FY21)

**Rounded to nearest full number, as per available data

***Excluding Wapda's bond of US\$ 500mn in FY21

Source: Economic Affairs Division, Ministry of Finance

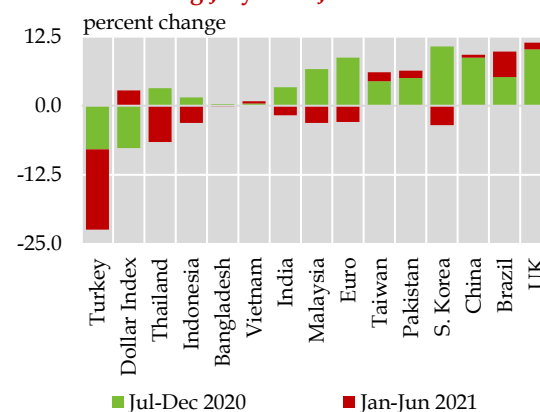
6.3 Exchange Rate and Reserves

The strengthening in the country's external account during FY21 was reflected in a consistent build-up in the SBP's FX reserves position, which rose by US\$ 5.2 billion to reached US\$ 17.3 billion by end-June 2021.

The central bank's net forward liabilities also reduced by US\$ 0.9 billion during the year. In line with this improvement, the PKR appreciated 6.7 percent against the US Dollar during FY21.

That said, the yearly data breakdown shows that during Jul-Dec 2020, the cumulative current account surpluses had led to an accumulation in the FX reserves of commercial banks (in Jul-Sep 2020) and the SBP (in Oct-Dec 2020). At the same time, the US Dollar itself was weakening against many EM currencies during this period, mainly due to the relatively earlier re-openings and pickup in industrial activity in the developing economies. Due to these factors and similar to other EMs, the PKR appreciated 5.1 percent against the US Dollar during Jul-Dec 2020 (Figure 6.17).

In Jan-Jun 2021, the PKR appreciated by a lower magnitude (1.0 percent); though the entire appreciation was noted during Jan-Mar 2021. The PKR's strength reflected the country's relatively better performance in controlling the second and third waves of Covid, continued economic recovery, and the successful completion of the 2nd-5th combined

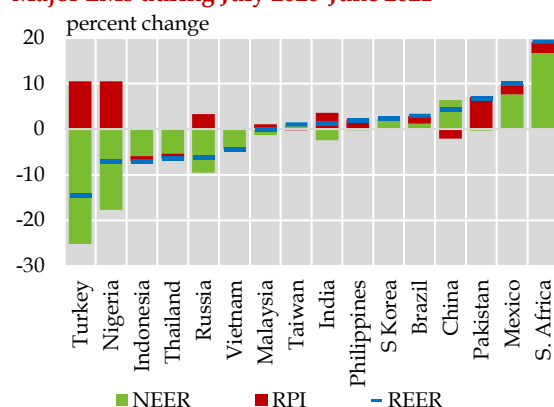
Trend in EM Exchange Rates against US Dollar during July 2020-June 2021**Figure 6.17**

Source: Bloomberg

IMF reviews.

However, from April 2021 onwards, the import payment pressures became more prominent and could not be completely offset by the export receipts and remittances. Resultantly, the current account deficit widened considerably during Apr-Jun 2021.

Breakdown of Change in REERs of Major EMs during July 2020-June 2021 **Figure 6.18**



Source: JP Morgan/Haver Analytics

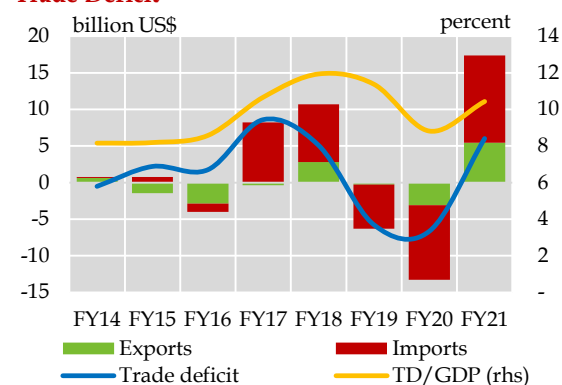
These payment pressures were reflected in the market-based exchange rate, which depreciated 3 percent during the quarter.

On the other hand, the country's Real Effective Exchange Rate (REER) appreciated 6.8 percent during July 2020-June 2021, though the entire appreciation was recorded during July 2020-March 2021, followed by a slight depreciation in Q4.²⁸ The breakdown of the change shows that the entire increase in REER originated from the increase in price levels in the country relative to its major trading partners; against this, the Nominal Effective Exchange Rate (NEER) remained mostly stable, dropping by a negligible 0.3 percent during the year (Figure 6.18). Such inflationary pressures, as measured by a rise in the Relative Price Index (RPI) were also noted across some other major EMs, such as India, Turkey and Nigeria; however, in their cases, the depreciation in their NEERs either partially or completely offset the rise in their RPI.

6.4 Trade Account²⁹

Pakistan's merchandise trade deficit increased to US\$ 31.1 billion in FY21 – closer to pre-covid FY18 deficit of US\$ 37.6 billion. While exports witnessed a significant turnaround and grew by 18.3 percent, this increase was

Trade Deficit to GDP ratio and Breakdown of YoY Change in Trade Deficit **Figure 6.19**



Source: Pakistan Bureau of Statistics

insufficient to offset the 26.6 percent growth in imports. As a result, trade deficit widened by 34.3 percent, amounting to US\$ 7.9 billion, on YoY basis in FY21.

The deficit in FY21 expanded after contracting consecutively in the preceding two years, which makes this rapid rise relatively unexpected in contrast to FY18. In FY18, the trade deficit grew by 15.7 percent, while in FY17, this growth was 35.9 percent (Figure 6.19). Moreover, in terms of GDP, the trade deficit in FY21 was only 10.4 percent, lower than 11.9 percent noted in FY18, and slightly above the average of 9.6 percent realized during FY12-20. Therefore, this increase was mostly in line with the recovering demand in the economy (Figure 6.19).

Importantly, exports in FY21 increased by 18.3 percent; a record over last 15 years, to US\$ 25.3 billion, while in FY18 it achieved a relatively lower growth of 13.7 percent YoY. This growth in FY21 stemmed mainly from apparel and home textiles, and also reflected some impact of the low base effect from last year. Moreover, the accommodative fiscal and monetary policies adopted to spur the economic growth after the initial Covid shock, and the surge in the international commodity prices, contributed to a 13-year high growth in imports during FY21. Additionally, incentive

²⁸ Pakistan's REER had appreciated 6.8 percent during Jul-Mar FY21, and then depreciated 0.3 percent during Q4-FY21, as per the CPI-deflated JP Morgan Broad Effective Exchange Rate Index (source: Haver Analytics).

²⁹ This section is based on PBS data, based on inputs received from customs. The information provided here may not reconcile with Section 6.1, which is based on the SBP (payments record) data. To understand the difference between these two data series, please see Annexure on data explanatory notes.

announced under Naya Pakistan Housing Scheme increased activity in the housing sector. As a result, Machinery, Transport, Metal, and Agriculture & chemicals groups witnessed a strong growth in imports.

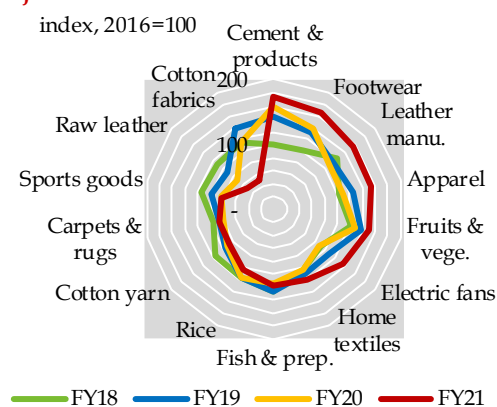
Exports

As per Customs data, Pakistan's exports increased by 18.3 percent to US\$ 25.3 billion in FY21 (Table 6.7), from US\$ 21.4 billion in FY20. This increase of US\$ 3.9 billion is partly attributable to a low base effect from the last quarter of FY20, when exports had declined by around 33 percent after the Covid outbreak. That said, this year's export performance fared better than pre-COVID levels as well (Table 6.7). Exports increased by 14 percent in FY21 over the average exports during FY17-FY19, from US\$ 22.2 billion to US\$ 25.3 billion. As such, it appears that the export growth during FY21 was also driven by the market forces of demand and supply, beyond the low base effect.

It is important to note that many of Pakistan's major export products – such as fruits and vegetables, apparel, home textiles, leather manufactures (leather garments and gloves), footwear, cement and products, and electric fans – recorded volumetric increases in FY21 as compared to recent years as well (Figure 6.20).

Quantum Exports of Pakistan's Major Products

Figure 6.20



Source: Pakistan Bureau of Statistics

Pakistan's Major Exports during Jul-Jun

Table 6.7

Groups/Items	FY17-19 Avg.	FY20	FY21	Abs. change in FY21 over	
				FY17-19 Avg.	FY20
Textile group	13,100	12,527	15,399	2,299	2,872
Non-textile group	9,097	8,867	9,905	808	1,038
Textile	13,100	12,527	15,399	2,299	2,872
Low-end textiles*	3,394	2,815	2,938	-456	123
Apparel	5,174	5,347	6,848	1,674	1,501
Home textiles	3,015	2,862	3,709	694	847
Other textile made-ups^	668	591	756	88	165
Food	4,372	4,361	4,392	20	31
Rice (a+b)	1,904	2,176	2,042	138	-134
a) Basmati	557	783	570	13	-213
b) Non-basmati	1,347	1,392	1,472	125	80
Fish & prep.	428	407	415	-13	8
Fruits & vegetables	618	730	800	182	70
Meat & prep.	230	304	332	102	28
Petroleum	353	273	182	-171	-91
Petroleum crude	184	186	107	-77	-79
Petroleum products	115	41	43	-72	2
Other Manufactures	3,286	3,036	3,467	181	431
Raw leather	309	184	162	-147	-22
Leather manufactures	500	474	562	62	88
Medical instruments	369	356	428	59	72
Chemicals & pharma	1,020	1,008	1,149	129	141
Cement & products	244	259	268	24	9
Total Exports	22,198	21,394	25,304	3,106	3,910

*Low-end textiles: cotton yarn and cotton fabrics; ^excluding bedwear and towels

Source: Pakistan Bureau of Statistics

Textile exports increased from US\$ 12.5 billion in FY20 to US\$ 15.4 billion in FY21, accounting for around three-fourth of the growth in total exports. Apparel (knitwear and readymade garments) and home textiles (bedwear and towels) were the leading product categories, followed by other textile made-ups (which include items like washing and dish cloth, curtains, table linen). Exports of pharmaceuticals and surgical goods also posted higher exports amidst the pandemic. In contrast, rice exports, despite amounting to over US\$ 2 billion, declined during the year.

The recovery in overall exports during the year was facilitated by the measures taken by the government and the SBP to support the industrial activity after the Covid outbreak. These measures facilitated higher capacity utilization by the value-added textile firms, which received and delivered more orders than last year. Some of these supportive policy measures included: extensions in the validity of the erstwhile zero-rating certificates to provide power and gas subsidies to top five export sectors until November-2020; gas and power subsidies under the industrial support package from November-2020 onwards; and the reduction in the policy rate from 13.25 percent to 7.0 percent between mid-March and June-2020, which lowered the working capital cost for industries.^{30, 31}

Moreover, the government upgraded FASTER to FASTER Plus to further expedite sales tax refunds for exporters.³² Overall, sales tax refunds were up significantly during the year, bolstering the liquidity positions of exporters, especially the textile firms.³³ Regulatory duty and customs duty on imported cotton yarn were also removed in December 2020 and May 2021, respectively, to reduce the imported cost of the raw materials

for the export-oriented industry amidst domestic shortage of the items.³⁴

Apparel and home textiles register highest levels in both value and quantum terms

Apparel and home textiles, high value-added textile products, registered a cumulative increase of 28.6 percent to US\$ 10.6 billion in FY21, as compared to US\$ 8.2 billion last year.

Apparel grew by 28.1 percent to US\$ 6.8 billion in FY21. Higher export volumes played the dominant role, with the country shipping around 39 percent higher volumes than last year. The growth in volumes came mainly from the US, UK and the EU-27, and partially reflected the low base effect from last year. However, there was also higher demand for Pakistan's apparel, amidst the circumstances created under the pandemic. It is evident by the fact that apparel imports of these advanced economies from Pakistan were higher than the pre-Covid (FY19) levels as well. In contrast, the apparel imports of these major markets from Pakistan's competitors – such as India, Indonesia and Bangladesh – either declined or did not rise sufficiently enough to cross their FY19 levels.

During July 2020-June 2021, imports of the US and UK from Pakistan rose by about 37.4 percent and 32.4 percent, respectively (**Figures 6.21 and 6.22**). It was despite the fact that the US' and UK's overall imports from the world had declined for the better part of this period. Not only that, imports of the US and UK from some competitor countries of Pakistan – for instance, India, Cambodia and Bangladesh –

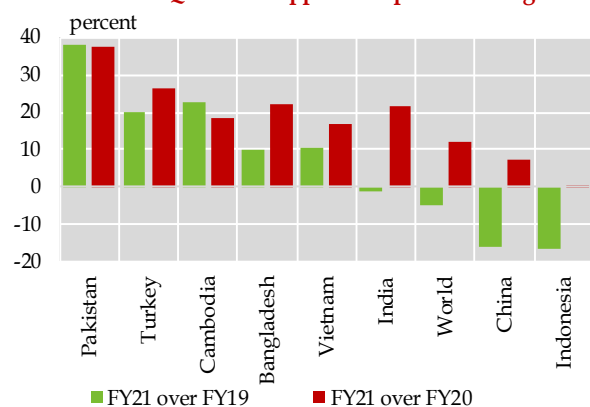
³⁰ For more details, see Chapter 5: External Sector of SBP's State of the Economy Report for Q2-FY21.

³¹ For instance, net borrowing under the Export Finance Scheme by the textile sector amounted to Rs. 59 billion in FY21.

³² FASTER (Fully Automated Sales Tax e-Refund), introduced by the FBR in July 2019, was upgraded to FASTER Plus in October 2020 due to some technical issues in the system. (source: FBR Press Release, fbr.gov.pk/pr/fbr-upgrades-faster-to-faster-plus-system-for/152507)

³³ Sales tax refunds increased to Rs 155 billion in Jul-Mar FY21, which were 158 percent higher than last year's comparable refunds of Rs 60 billion (source: FBR).

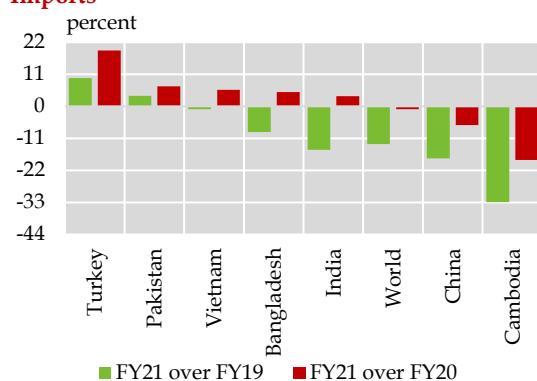
³⁴ Source: FBR SROs 1352(I)/2020 and 533(I)/2021 dated 23-12-2020 and 05-05-2021 respectively.

Growth in US' Quantum Apparel Imports*

*FY refers to July-June

Source: Office of Textiles & Apparel (USA)

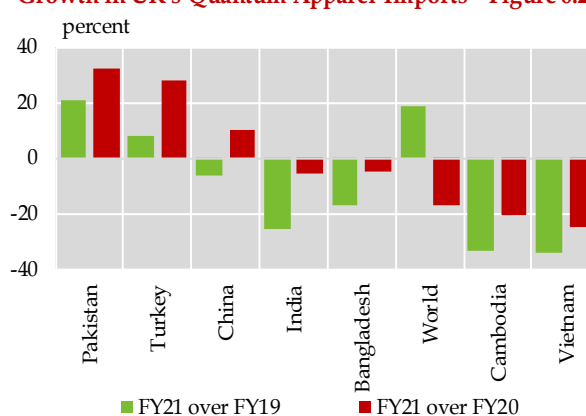
had declined simultaneously as well.³⁵ It could be explained, in part, by the anecdotal evidence that Pakistan was on the receiving end of some deflected orders from countries whose exporters were impacted more profoundly by the pandemic.³⁶

Growth in EU-27's Quantum Apparel Imports*

*FY refers to July-June

Source: Eurostat

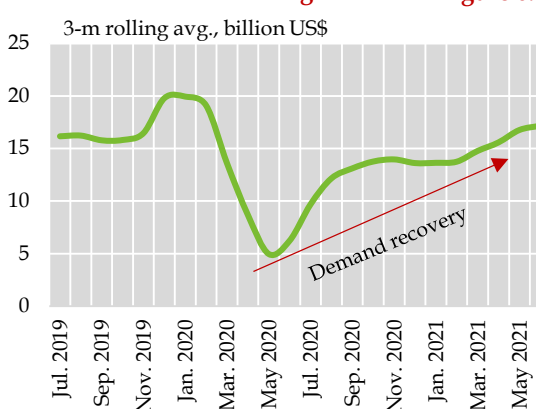
In case of the EU-27 as well, there was an increase of 6.9 percent YoY in quantum apparel imports from Pakistan during July 2020-June 2021 (Figure 6.23). Although, there

Figure 6.21 Growth in UK's Quantum Apparel Imports* Figure 6.22

*FY refers to July-June

Source: UK Trade Info

had been a decline in these imports of the bloc in July 2020-March 2021, it was very limited in comparison to the country's major competitors. One factor behind higher demand for Pakistan's apparel was gradual recovery, despite being interrupted, in retail demand for these consumer goods in the advanced economies following the first wave of the pandemic; Figure 6.24 depicts this trend in the US' case. This gradual recovery initiated in the second half of CY-20, and proceeded

Retail Sales at US' Clothing Stores Figure 6.24

Source: US Census Bureau

³⁵ "Due to the pandemic, all economic activities except for the essential goods and services came to a standstill. The textile and apparel industry was no exception to this ... Due to the uncertainty across the market, international and domestic buyers cancelled or suspended their orders, adding to the woes of the industry." (Indian Textile and Apparel Industry Annual Report 2021, Apparel Export Promotion Council, India).

³⁶ For example, in India, Covid-19 resulted in permanent loss of jobs in key textile manufacturing hubs there, such as Bengaluru, as noted in Chapter 5 of SBP's State of the Economy Third Quarterly FY21 report. Moreover, India also witnessed massive labor displacements as migrant workers moved back to their far-flung home states to see off the Covid outbreak. That led to massive labor shortages, especially of skilled workers, in the southern Indian knitwear hub of Tipuru and other places, amidst strongly recovering demand from the advanced economies. (www.just-style.com/features/skilled-worker-shortage-latest-to-hit-india-exporters/)

onwards. Pakistani exporters benefited from recovering demand on the one hand and orders diverting from competitors due to Covid-related disruptions on the other.

Another factor was that, due to loss of purchasing power, some apparel consumers developed greater propensity for cheaper apparel products as the world toiled through the pandemic. At the same time, retailers and brands, mostly running in losses from the pandemic, were also looking for discounts on new orders. Under these circumstances, Pakistan offered lower prices than most of its competitors, such as Cambodia, India and Indonesia.

Average Unit Values of EU-27's Imports of Home Textiles by Origin* **Table 6.8**

US\$/100 KG

	Absolute			Growth	
	FY19	FY20	FY21	FY20	FY21
China	611	604	590	-1.2	-2.3
Pakistan	622	596	614	-4.2	3.0
Bangladesh	691	698	687	1.1	-1.6
India	687	689	710	0.3	3.0
Turkey	864	849	896	-1.8	5.5
World	689	672	684	-2.4	1.8

*FY refers to July-June

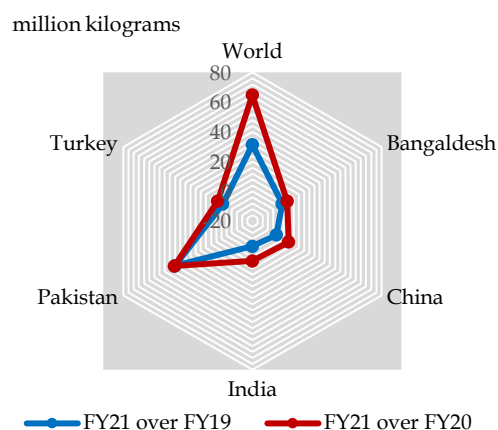
Source: Eurostat and Haver Analytics

Meanwhile, home textiles (comprising bedwear and towels) also made significant contribution to the textile exports, by bringing in US\$ 3.7 billion in FY21. These exports were US\$ 847 million higher than last year, and similar to apparel, had surpassed their pre-Covid (FY19) levels as well, in terms of both value and volumes. Both the price and quantum effects contributed to the higher home textile exports.

The price effect came about as the input cost of the home textiles grew over the last year in response to elevated cotton prices in the domestic and international market. Faced

with domestic shortage, the country had to import cotton fiber in sizable quantities.³⁷ It may be noted that the increase in Pakistan's unit values was in line with the international trend (Table 6.8). That said, as the year progressed, Pakistan also started to receive deflected orders from competitors.³⁸ That, combined with the low base effect, resulted in a positive quantum effect for the entire fiscal year. Quantum imports of home textiles by the EU-27, Pakistan's major market, had risen around 17.7 percent during July 2020-June 2021. The country's shipments also rose over FY19 levels by a large margin, especially in contrast to India and other competitors (Figure 6.25).

Absolute Change in EU-27's Quantum Home Textiles Import* **Figure 6.25**



*FY refers to July-June

Source: Eurostat

Pakistan was able to increase its shipments to the bloc even at slightly higher per unit cost, indicating its established market there and deflection of some orders. It may be noted that despite an increase, Pakistan's unit values were still lower than those of Bangladesh, India and Turkey, making it competitive even at nominally higher unit values (Table 6.8).

³⁷ Pakistan imported 0.86 million tons of cotton fiber in FY21, around three-fourth more than annual average of 0.49 million tons between FY16 and FY20, as per Customs data. The country's cumulative imports of cotton fiber from the US and Brazil increased by 31 percent to 0.50 million tons in FY21, up from 0.38 million tons last year.

³⁸ Talking about not being able to meet demand for home textiles completely due to lockdowns in India during its second wave, managing director of a textile mill told Just-style that: "The risk of not meeting this demand is clear. Two of [our] clients shifted some of their orders to Pakistan and Bangladesh to ensure they met their own commitments." (Source: www.just-style.com/features/skilled-worker-shortage-latest-to-hit-india-exporters/).

Besides, Pakistan's exports of 'other textile made-ups' also rose by a sizable 28 percent to US\$ 756 million in FY21. This product category includes personal protective equipment (PPE) and medical items, such as cleaning cloth, whose international demand had risen quite strongly after the Covid outbreak.³⁹

In the low value-added segment, cotton yarn and fabric exports rose by a cumulative 4.4 percent to US\$ 2.9 billion in FY21. The growth in exports of these items was mainly due to higher unit values, which could be, in turn, attributed to higher cotton prices in the domestic and international market. In the domestic market, higher input prices were reflective of a shortfall in the cotton crop output. Moreover, demand from high value-added textile segment left low exportable surplus of the intermediary products like cotton yarn and fabric, which translated into lower export shipments; in particular, shipments of cotton fabrics fell precipitously throughout the year. Besides, international demand for Pakistan's cotton yarn and fabric was also lower YoY due to global disruptions in apparel trade.⁴⁰

Rice exports faced increased competition

Rice exports declined by 6.1 percent to US\$ 2 billion in FY21, in contrast to an increase of 5.1 percent in FY20. Lower export volumes were the dominant factor for the decline in exports, overcoming the positive price effect of higher unit values. Pakistan's rice shipments fell at the expense of India mainly on account of

price competitiveness, which, in turn, could be traced to the latter's massive rice stocks, among other reasons.⁴¹ Within rice categories, volumes of basmati rice witnessed much sharper decline than non-basmati rice.

Basmati rice exports decreased by 27 percent to US\$ 576 million in FY21. Slightly positive price effect was completely overcome by the negative quantum effect. Pakistan's quantum exports to the major basmati markets in the Middle East – Bahrain, Iraq, Oman, Saudi Arabia, UAE and Yemen – almost halved in FY21, whereas, India's shipments to the region increased by 5.8 percent in Jul-Apr FY21. Average unit value offered by India on its basmati rice decreased from US\$ 941 per ton in Jul-Apr FY20 to US\$ 856 per ton in Jul-Apr FY21.⁴² In contrast, Pakistan's average unit value rose from US\$ 905 per ton to US\$ 919 per ton in FY21.

On the other hand, non-basmati rice exports increased slightly by 5.3 percent to US\$ 1.5 billion in FY21. It was the result of a significant and positive price effect (**Figure 6.26**). There were two major reasons behind this development. Initially, Pakistani unit values had risen amidst tight supplies in the first quarter ahead of a new crop. Later, after the arrival of a new crop in Sep-Oct, the country witnessed significant demand for the grain from China compared to last year, which further pushed up its export prices.^{43, 44} Nevertheless, these higher unit values induced major African buyers to switch to Indian suppliers, who had offered more competitive

³⁹ Rising exorbitantly by 1,083 percent YoY in Q4-FY20, global imports of Covid-related medical textile made-ups (HS 630790) kept up a rising momentum until Q4-FY21, when they tapered due to high base effect from last year. In Jul-Mar FY21, they had risen by 239 percent to US\$ 38.5 billion, up from US\$ 11.3 billion during same period last year. (Source: ITC)

⁴⁰ For instance, Pakistan's shipments of cotton fabric more than halved to some major destinations like China, Bangladesh, Germany, UK, Spain and Italy. (PBS)

⁴¹ "India rice exports have been supported by large supplies and successive bumper crops, the world's most competitive pricing, and improved export infrastructure capable of shipping rice in bulk." source: USDA 2021: *Grain World Trade Report*. June issue. Washington, DC: USDA.

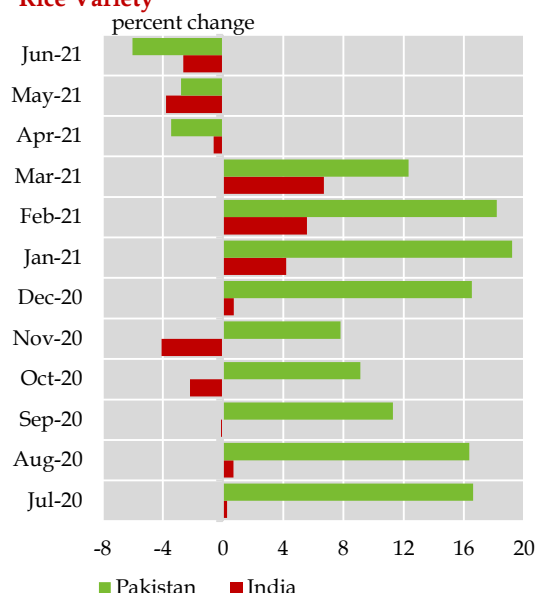
⁴² Ministry of Commerce and Industry, India and SBP calculations.

⁴³ Accounting for about 0.9 million tons out of a total of 3 million tons non-basmati rice exports, Pakistan's China-bound shipments were 2.5 times, or 148 percent, higher in FY21 than the same period last year. (PBS)

⁴⁴ Impact of higher Chinese imports on Pakistan's non-basmati rice quotes was also identified in a market research report. "... A trader described the market as a 'mini rollercoaster' that moved according to the volume of Chinese demand." (Source: S&P Global Platt's Rice Weekly Feb 26, 2021)

Percentage Change (YoY) in Pakistani and Indian Non-Basmati Rice Variety*

Figure 6.26

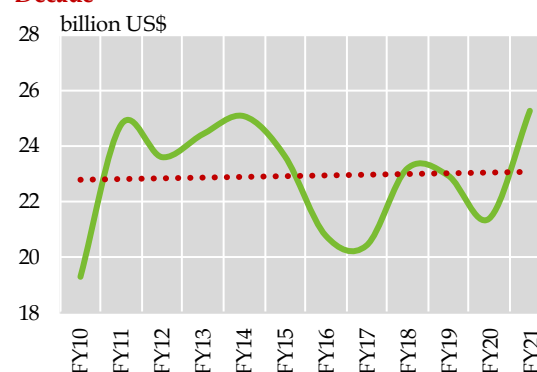


rates.⁴⁵ Lower shipments to Africa offset the impact of higher demand from China, dragging down overall shipments. That said, the fall in non-basmati rice volumes was moderate as compared to basmati rice.

In FY21, Pakistan's exports witnessed decent YoY growth of 18.3 percent to US\$ 25.3 billion.

Pakistan's Exports over the Last Decade

Figure 6.27



As discussed before, major factors that contributed to this growth included: accommodative monetary and fiscal policies, market-based exchange rate system, governments' facilitative policies to revive the industrial activity, as well as the export sector, in the wake of the Covid outbreak in early 2020, and deflection of orders of some key export products. That being said, over the years, Pakistan's exports have, however, not grown sustainably, resulting in stagnancy (Figure 6.27). Box 6.2 discusses some major factors behind this phenomenon.

Box 6.2: Factors Impacting Sustainable Growth in Exports: Why Pakistan Lags Behind Some Peer Countries

In the last decade, growth in Pakistan's exports has been sporadic and unsustainable. In comparison, some peer countries, such as India and China, have fared better than Pakistan. These countries have not faced any recurrent BOP crises, whereas Pakistan has. As per World Integrated Trade Solutions, between CY10-19, Pakistan's exports have risen by mere US\$ 2 billion; whereas, for India and China the absolute changes amount to US\$ 103 billion and US\$ 921 billion, respectively. In the same period, Pakistan's exports averaged US\$ 23 billion; while, India and China averaged US\$ 293 billion and US\$ 2.2 trillion, respectively. In terms of GDP, in 2019, exports of Pakistan, India and China were around 9 percent, 11 percent and 17 percent, respectively. Already paltry, Pakistan's share of world exports has declined from 0.13 percent in CY10 to 0.12 percent in CY19. On the other hand, India's global share has increased from 1.31 percent to 1.57 percent; and China's from 9.37 percent to 12.17 percent. Based on several studies, we briefly summarize four main reasons as to why exports of Pakistan have not risen sustainably.⁴⁶

a) Labour productivity

⁴⁵ Pakistan's quantum non-basmati exports to Kenya, Tanzania, Mozambique, Somalia, Togo, Senegal in East Africa and West Africa more than halved to 0.5 million tons (15 percent of the total non-basmati exports) in FY21 from one million tons (32 percent) last year. Whereas, India's rice exports to both East Africa and West Africa reached 4.7 million tons in Jul-Apr FY21, registering an eight times increase over last year. (PBS and Ministry of Commerce and Industry, India)

⁴⁶ It may be noted that these reasons are by no means exhaustive.

According to Deshmukh and Pyne (2013), there is an extensive evidence of the self-selection hypothesis, which states that firms that are more productive are more likely to enter the export market and ship out more of their output. Melitz (2003) and Ghironi and Melitz (2005) also found a link between a firm's productivity and its ability to enter into the export market. They showed that more productive firms would export, the less productive firms would stick to the domestic market and the least productive firms would exit.

One of the major determinants of a firm's overall productivity level is its labour productivity. Labour productivity, measured as output per worker and determined mainly by the quality of human and physical capital, and technological innovation, varies across the countries under consideration. National productivity levels of China and India are higher than Pakistan, which partly explains differences in their export profiles over the years. In 2017, China and India's labour productivity levels (in 2010 constant dollars) were 3.4 times and 1.4 times that of Pakistan.⁴⁷

Furthermore, on a sectoral level, manufacturing sector is the cornerstone of a country's exports. For instance, Soderbom and Teal (2002), while attributing economic success of Taiwan, Hong Kong, Singapore and South Korea to their export performances, held manufacturing exports as the leading variable. Reis et al. (2013) also noted that manufactures are the most important products in international trade of goods. Pakistan's labour productivity in manufacturing lags behind India and China by large margins as well. In 2017, Pakistan's manufacturing productivity (in 2011 PPP exchange rate) stood at US\$ 12,000, India at US\$ 22,000 and China at US\$ 35,000.⁴⁸

b) Product diversification

Product diversification can help boost export earnings in the long run, making them sustainable as well, argue McMillan, Rodrik and Verduzco-Gallo (2014). It is particularly true for developing countries vulnerable to terms of trade shock due to products concentration, such as Nigeria. Moreover, Feestra and Lee (2004) showed that a 10 percent increase in export diversification in all industries of a country would lead to a 1.3 percentage point rise in a country's productivity growth.

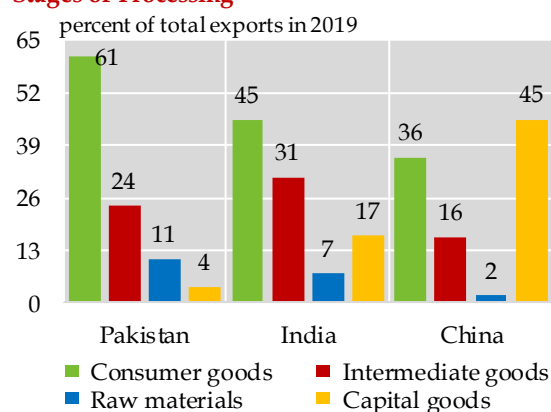
On this front, Pakistan's export basket lacks diversity, especially in comparison to India and China (**Figure 6.2.1**).

On an aggregate level based on stages of processing, Pakistan's exports pie is predominantly occupied by consumer goods – over 60 percent. Whereas, export baskets of India and China are more evenly divided among consumer goods, intermediate goods and capital goods.

On a disaggregated HS-2 level, Pakistan's exports are dominated by a few categories of consumer and intermediary goods, namely apparel (knitwear and woven clothes), home textiles and other textile made-ups, cotton and its articles, and cereals, which together make around 65 percent of total exports. In 2019, these exports raked in US\$ 15.5 billion out of a total of US\$ 23.8 billion.

For India, at HS-2 level, a number of categories of products represents the mix, which shows more diversity than Pakistan. They include mineral oils and fuels, precious stones and metals, pharmaceutical products, machinery and mechanical appliances, iron and steel, cereals, plastics and products, etc. In 2019, these groups together accounted for around 60 percent of India's overall exports. Similarly, China's major product categories are also well-spread across various HS-2 chapters, which include: electrical machinery and equipment, machinery and mechanical appliances, furniture, plastics, optical devices, vehicles, textile made-ups, toys, iron and steel and articles thereof, apparel, organic chemicals, footwear, etc. In 2019, these groups were responsible for around 73 percent of China's exports.

Product Diversification Based on Stages of Processing **Figure 6.2.1**



Source: World Integrated Trade Solutions

⁴⁷ A. Dieppe, S. Kilic Celik, and G. Kindberg-Hanlon (2020). "Global Productivity Trends". In A. Dieppe (eds.). *Global Productivity: Trends, Drivers, and Policies*. Washington, DC: WB.

⁴⁸ Ibid footnote 47.

Furthermore, at HS-6 level, Pakistan's lack of product diversification is also reflected in the fact that its top 50 export products (in terms of USD value in 2019) occupy around 63 percent of total exports. Whereas, in case of India and China, top 50 products account for about 49 percent and 38 percent, respectively.

c) Market diversification

Market diversification leads to new opportunities of higher and more sustainable earnings, while making exporting firms less vulnerable to market-specific demand fluctuations (Ghani, Mehmood, Din, 2012). Pakistan's export destinations are far less diverse than India and China. To understand the gap, first consider World Integrated Trade Solutions' regionalization of the world, as shown in Figure 6.2.2.

In 2019, Pakistan's average number of HS 6-digit products shipped to all these regions was 47 percent of the total 2,824 products (Figure 6.2.2). In contrast, India's and China's averages were 87 percent and 90 percent, respectively, of a little over 4,400 products in each case. These numbers show untapped potential in regional markets around the globe for Pakistan, which include: Latin America and Caribbean; Sub-Saharan Africa; North America; South Asia; East Asia and Pacific.

For instance, Latin America and Caribbean countries imported textiles and clothing items to the tune of US\$ 33 billion in 2019. Imports from China and India clocked in at US\$ 13 billion and US\$ 1.6 billion, respectively. Whereas, imports from Pakistan were only US\$ 344 million.

d) Global Value Chains

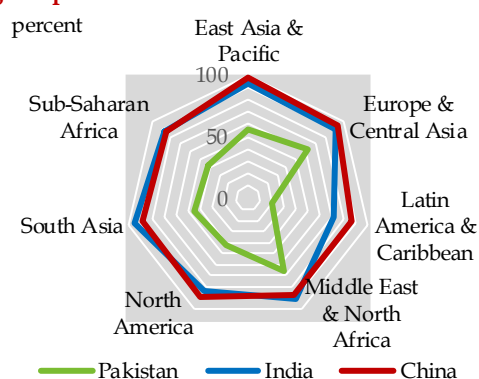
According to Global Value Chain Development Report 2019, more than two-thirds of global trade channels through global value chains (GVCs), wherein production crosses at least one border, and usually many borders, before final assembly. GVCs help accelerate growth in export through two channels. (1) Backward participation or integration, where a country imports intermediary goods to produce and export products where it may have competitive advantage. For example, Bangladesh imports cotton fibre and yarn to make and export cotton-based apparel. (2) Forward participation, where a country exports intermediary goods because it does not have the competitive advantage in making the related finished products. For instance, the US exports iPhone's design and engineering items to China for assembly, which is cheaper and more competitive.

Pakistan's GVC participation, which is a sum of backward and forward participation, has been behind that of India and China for the better part of time period since 1990 (Figure 6.2.3). Although its participation has converged in the post-2007 crisis period, it is still lagging.

SBP (2020) notes that Pakistan is still not deeply integrated into GVCs because of two major reasons. One, the country's exports are concentrated in low value added products and primary commodities which generally do not require imported inputs. Two, high protectionism – Pakistan's tariffs on intermediate goods are four times the East Asia average. World Bank (2019), while analyzing, Pakistan's textile and apparel exports, noted that the exporters are depended on low-quality cotton input, leading to lack of integration in the global textile and apparel value chain. This dependency could be traced to the domestic cotton industry and the exporters not being able to easily access synthetic fibres and high-quality cotton at world prices (due to high protectionism) and in time to fulfill orders, as in the case of Bangladesh.

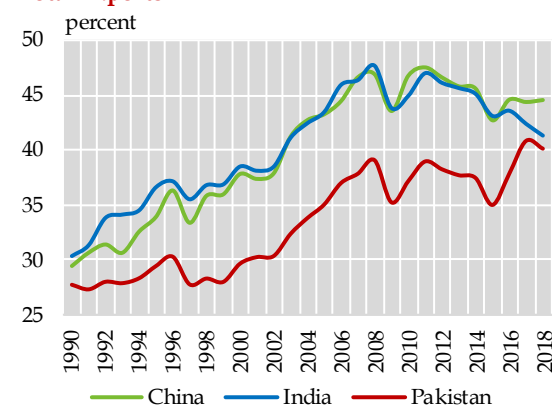
Sources and references:

Region-wise Share of HS 6-digit Products in Total Number of HS 6-digit Export Products in 2019 Figure 6.2.2



Source: World Integrated Trade Solutions

GVC Participation as Percent of Total Exports Figure 6.2.3



Source: UNCTAD EORA

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Imports

In FY21, Pakistan's imports rose to US\$ 56.4 billion from US\$ 44.6 billion in FY20. However, the imports remained well short of the record level of US\$ 60.8 billion in FY18. Imports had remained constricted in FY20 due to the strong macroeconomic stabilization policy environment prevalent in the first three quarters, and then due to the Covid-induced slump in aggregate demand in the fourth quarter. In FY21, however, three important factors contributed to the sharp growth in imports.

Necessities within consumer goods, especially food and medicines, and raw materials for consumer goods scaled up the demand for commodity imports

Higher demand for consumer necessities, such as food items (including wheat and sugar) and medicines (including Covid vaccines) drove the imports of consumer goods, which rose by US\$ 2.3 billion to US\$ 10.4 billion during FY21 (Table 6.9). Moreover, the import of raw materials for consumer goods weighed heavily, contributing 11.6 percentage points to the 26.4 percent growth in overall imports during FY21 (Figure 6.28). This category includes edible oil (comprising palm oil), textile raw materials (including raw cotton)

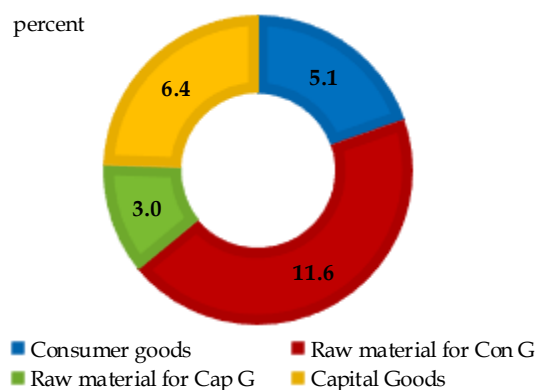
and energy imports. Together, these two categories contributed more than 64 percent of the total increase in imports during FY21. Importantly among these, most of the heavy weight items, by increase, are agricultural commodities (Figure 6.29).

Pakistan's Imports by Economic Category **Table 6.9**
million US\$

	FY20	FY21	Abs. Change
Consumer Goods	8,084	10,367	2,284
Food	5,372	7,068	1,695
Wheat	-	983	983
Sugar	3	128	125
Medicines	949	1,308	359
Vaccines	219	531	312
Raw material (A+B)	23,640	30,155	6,515
A. Consumer goods	18,847	24,025	5,178
Palm Oil	1,842	2,669	827
LNG	2,662	2,617	-45
Petroleum	4,733	5,160	427
Raw Cotton	880	1,480	600
B. Capital Goods	4,793	6,129	1,337
Capital Good	12,762	15,610	2,849
Mobile Phones	1,370	2,065	695
Road Motor Vehicles	1,279	2,458	1,179
Total	44,553	56,405	11,852

Source: Pakistan Bureau of Statistics

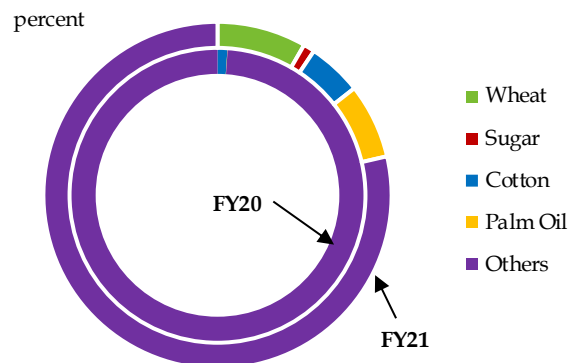
The decline in agriculture output in FY19 and adverse developments like unfavorable

Contribution to Growth by Economic Category

Source: Pakistan Bureau of Statistics

weather, locust attack and fall in the cultivation area of sugarcane and cotton, had repercussions for the agri sector outputs in FY20 and on their carry forward stocks for FY21. Pakistan had exported around 2.0 million tons of wheat in FY19 to reduce the cost of maintaining large stockpile.⁴⁹ However, below-target output in FY19-20, risks posed by climate change and pest attack to the future wheat output, and Covid-induced frequent spike in wheat and wheat flour demand, forced the government to change its stance. As a result, the government allowed the import of wheat not only to meet the domestic demand in FY21, but to also maintain large strategic reserves for future consumption.

Similarly, besides the unusual weather fluctuations and pest attack, lack of interest from farmers in producing cotton, sugarcane and edible oilseed crops warranted the import of these commodities in large volume in FY21. Specifically, Pakistan imported 3.1 million metric tons of palm and soybean oil, 8.2 percent more from FY20 and around 90 percent of its consumption need. Domestic production of the edible oilseeds and oil declined due to the fall in cottonseed, rapeseed & mustard, sunflower and canola production, as crop areas under these commodities shrunk by 21.4 percent in FY21.⁵⁰

Figure 6.28 Contribution of Key Agri Commodities in Import Growth

Source: Pakistan Bureau of Statistics

Importantly, the decline in oilseed crop and the area under its cultivation does not bode well from Pakistan's perspective, especially when international palm oil prices are increasing sharply due to the supply bottlenecks in Indonesia and Malaysia amid increased demand from China and India. China is inclined to build its edible oil reserves, whereas India has lowered the tax on palm oil imports to fight inflation.⁵¹ Pakistan requires a strategy to increase edible oilseed production, which could help in reducing edible oil import bill. While Pakistan had produced a bumper wheat crop and higher sugarcane output in FY21, which may alleviate future import pressure of these items, a more comprehensive agricultural policy ought to be designed with dual objective of increasing food security and reducing dependence on food imports. This will help curtail import pressure whenever the agriculture sector had a sluggish period.

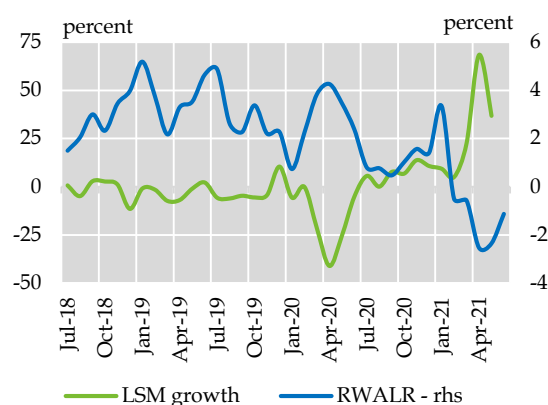
Accommodative policy delivered the necessary impetus to economy

Most of the accommodative monetary and fiscal stimulus announced after the Covid shock in late FY20 remained in place in FY21. SBP's policy measures, aftermath of Covid shock, made ample liquidity available under various schemes. Not surprisingly, the real weighted average lending rate (RWALR)

⁴⁹ USDA (2021). *Grain and Feed Annual – Pakistan*, (June), Washington D.C.

⁵⁰ Pakistan Economic Survey 2020-21.

⁵¹ SBP 3rd Quarterly Report FY21 on State of Pakistan's Economy.

Real Weighted Average Lending Rate and LSM Growth**Figure 6.30**

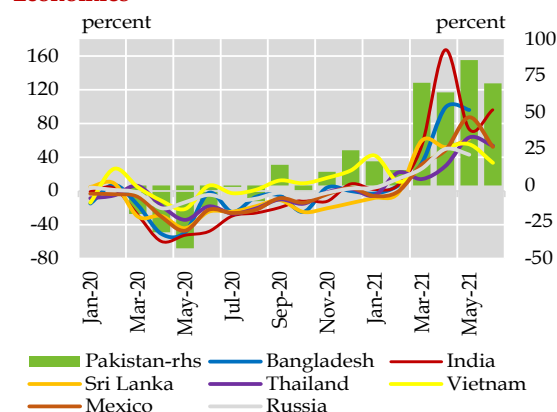
Source: Pakistan Bureau of Statistics

declined significantly as the year progressed, boosting aggregate demand, which pushed the LSM growth to 14.8 percent during FY21 (Figure 6.30).⁵² Moreover, around 27 percent increase in the workers' remittances and more than US\$ 1.5 billion inflows in the Roshan Digital Accounts during the year, of which around US\$ 500 million received by households, augmented the consumption demand of the recipient households.⁵³ Consequently, import demand responded to the reviving aggregate demand in the economy.

Rising global commodity prices buffeted imports from March 2021 onward

The unexpected increase in the global commodity prices also contributed to the increase in Pakistan's import bill, albeit at the margin. In the second half of FY21, specifically from March 2021 onwards, the global commodity prices scaled up across the spectrum (Section 6.1) supported by the stronger than expected recovery and expedited vaccination drive.⁵⁴

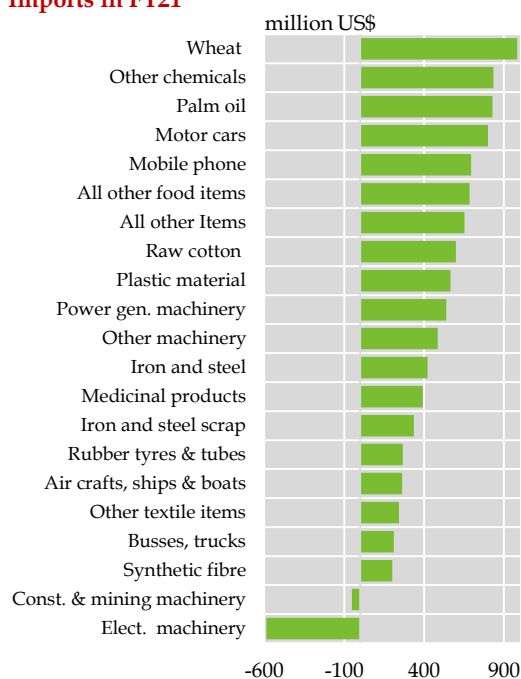
On the back of the global economic recovery and sustained production cuts by OPEC and its partners, crude oil prices reverted back to pre-pandemic level from record lows reached

Import Growth in Regional Economies**Figure 6.31**

Source: World Bank & International Monetary Fund

during the pandemic. Agricultural prices, on the other hand, pushed up by the substantial supply bottlenecks in Latin America and strengthening demand from China.

At the same time, the reviving industrial activity in China and other advanced economies, coupled with expected rollout of US fiscal stimulus package, improved the YoY Change in Major Non-Energy Imports in FY21

Figure 6.32

Source: Pakistan Bureau of Statistics

⁵² RWALR declined by 350 bps by June 2021. Moreover, during Jul-MayFY20, LSM by decline of 10.2 percent.

⁵³ www.sbp.org.pk/rda/progress.html

⁵⁴ As per World Bank, global commodity prices include prices of energy products such as, crude oil, natural gas, and coal, and host of non-energy products, including prices of agricultural products (both food and non-food items), fertilizers, metal and minerals, and precious metals.

outlook of metals. As a result, most of the emerging economies witnessed sharp increase in the import bills (**Figure 6.31**), though the fuller impact of the current price surge will be realized in second half of 2021 calendar year.

Non-Energy imports

Apart from the key agricultural commodities, including food items, raw cotton, and medicines, the overall increase in non-energy imports was broad-based (**Figure 6.32**). The notable contributors among the groups were transport, machinery and metals.

Transport

Imports of transport increased by 93.2 percent, with major thrust coming from road motor vehicles, specifically light vehicles (motor cars) and aircrafts, ships and boats sub-group. Recovering aggregated demand largely drove the demand for car imports.

Importantly, CKD/SKD imports dominated both heavy and light vehicles category, the latter increased to US\$ 2.5 billion in FY21, from US\$ 1.3 billion in FY20. Specifically, the light vehicle (motor car) imports increased by US\$ 799 million to US\$ 1.4 billion in FY 21; with CKD/SKD contributing 81.3 percent to the total car imports (**Figure 6.33**). Incentives under the Automotive Development Policy 2016-21 played an important role in facilitating the entry of new assemblers in the local auto market and the introduction of new car variants, which led to the rise in CKD/SKD imports.

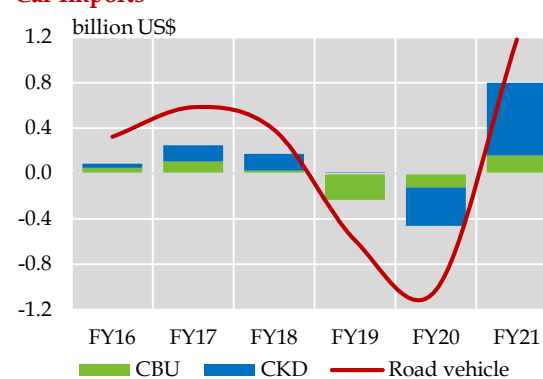
Meanwhile, CBU imports, after declining in the last couple of years, also increased by US\$ 157.2 million in FY21, to US\$ 256.2 million. Most of these cars are of 1,000cc or lower capacity. Assemblers in Pakistan are focused on producing high-end cars, and very few recognized brands were introduced in this segment in the last few years. Moreover, the existing brands carry exorbitant price tags.

Amid the crumbling public transport infrastructure, the lower-end purchasers are forced to buy the imported vehicles, which offer better features at a reasonable prices. On a positive note, the government announced various incentives for local production of lower end cars in Pakistan, which may encourage other manufacturers to enter into this segment of the automobile market.⁵⁵ This may lead to some import substitution in the lower end car market, supplementing economic activity by generating employment, and may lead to lower CBU car related import bills.

In line with transport, imports of rubber tyres and tubes increased by US\$ 266.8 million to US\$ 374.8 million, a significant rise of 247.2 percent. Addition of new vehicles and the rising activity in the transport sector raised the demand for the tyres and tubes imports. Additionally, increased vigilance by the custom authorities may have diverted some of the grey-channel imports to the legal channel, resulting in the steep rise in imports of tyres and tubes in official data.⁵⁶

Meanwhile, the strategy of smart lockdown adopted helped revitalize the ship-breaking activities in the country at the time when Pakistan's competitors were struggling to contain Covid outbreak and reopen their

Changes in Total Road Vehicle Imports With Contribution from Car Imports **Figure 6.33**



Source: Pakistan Bureau of Statistics

⁵⁵ Incentives-for-AutoSector-1.pdf (www.engineeringpakistan.com)

⁵⁶ SBP's Third Quarterly Report on State of Pakistan's Economy FY21.

economies. This elevated the imports of ships for breaking to US\$ 256.6 million in FY21, from only US\$ 34.4 million during FY20.

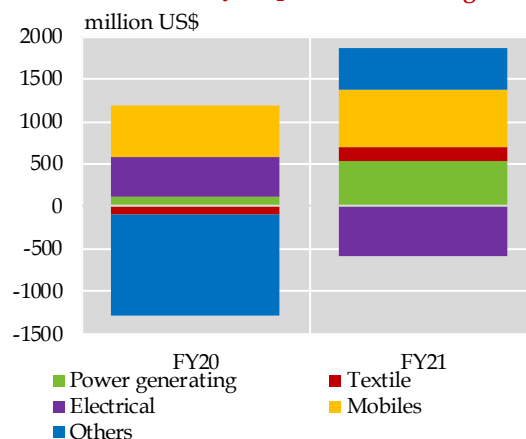
Machinery

Buoyed by SBP's TERF refinancing facility, machinery imports increased to US\$ 10.1 billion in FY21 from US\$ 8.8 billion last year; accounting for around 18 percent of the country's total import bill. Except electrical machinery, the increase in machinery imports was broad-based, with mobile phones standing out. Cell phone imports grew 50.7 percent in FY21, after increasing by 81.3 percent in FY20 (Figure 6.34).

Importantly, the mobile phone market in Pakistan has expanded significantly in FY21, largely due to the pandemic-related restrictions on educational and some office-related activities. Similar to car imports, a visible improvement is noted in product localization in this sector. In FY20, more than 19.4 million CBU mobile phones worth US\$ 1.3 billion were imported, which increased to 21.8 million sets for US\$ 1.5 billion in FY21 (Figure 6.35). A further disaggregation shows that around two-third of these mobiles were imported in H1-FY21. On the contrary, CKD/SKD exceeded the CBU phone imports

in H2-FY21, suggesting that CBU cellular imports not only decelerated in quantum and value, but also became increasingly tilted towards the high end brands in FY21.⁵⁷

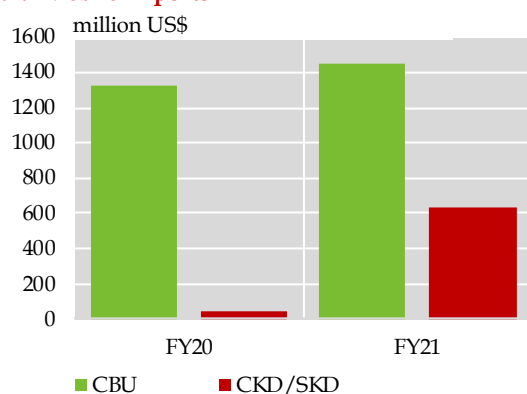
Pakistan's Machinery Imports **Figure 6.34**



Source: Pakistan Bureau of Statistics

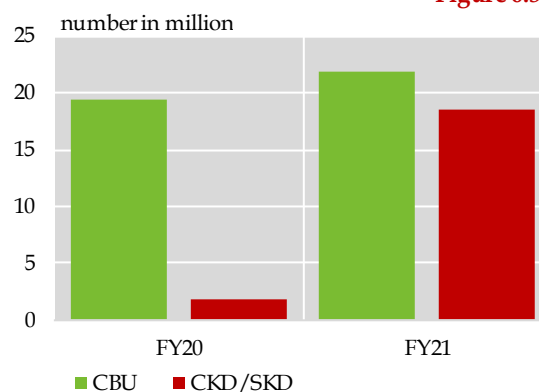
In contrast, CKD/SKD mobile imports increased from 1.8 million units (US\$ 47.5 million) in FY20 to 18.5 million units (US\$ 636.2 million) in FY21, indicating that the local production of mobile phones is gaining momentum.⁵⁸ Implementation of Device Identification Registration and Blocking System (DIRBS) to curtail the use of non-duty paid mobile in the country and incentives announced under the Mobile Device Manufacturing Policy (MDMP) 2020 have

Cellular Mobile Imports



Source: Pakistan Bureau of Statistics

Figure 6.35



⁵⁷ Among 21.8 million CBU sets imported in FY21, 14.4 million units worth US\$ 738.2 million were imported in H1, while only 7.4 million units worth US\$ 712.9 million were imported in H2. The unit values of these imports were US\$ 51.2 and US\$ 96.5 in H1 and H2-FY21 respectively.

⁵⁸ A disaggregation suggest that 7.8 million CKD/SKD mobile imports sets worth US\$ 199.9 million were imported in H1 while 10.8 million of these sets amounting US\$436.2 million were imported in H2-FY21.

started giving results. Under the MDMP 2020, regulatory duty on imports and advance income tax, up to US\$ 350, on manufacture of CKD/SKD units, were removed. At the same time, locally assembled or manufactured phones were exempt from the 4 percent withholding tax on domestic sales. Furthermore, 3 percent research and development allowance was offered to the local manufacturers for exporting mobile devices. More than 21 companies have started manufacturing/assembling mobile phones locally, which helped in increasing the quantum of CKD/SKD device imports. Meanwhile, a number of factors have led to a decline in electrical machinery and apparatus imports in FY21. The most important among these is the progress on the Matiari to Lahore ± 660 kV transmission line project, which had required large volume of imported electrical equipment in FY20. As the project is near completion and is expected to start commercial operations in September 2021, the imports of electrical equipment related to the project slowed down considerably in FY21. Additionally, the country imported a large number of electronic equipments, television sets, and transmission apparatus for radio telephones, and cordless telephones. Households and small businesses in the country are main users of these items. Both are facing hard times since the outbreak of Covid and therefore demand for these items remained muted in FY21.

Interestingly, imports of power generating machinery increased significantly by US\$ 539.5 million, after having risen by only US\$ 110.3 million in FY20. Tariff and non-tariff restrictions to curtail imports during FY19-20 had mostly exempted the machinery imports, however, the aggregate stabilization policy environment allowed only restrictive growth in this segment in FY20. A number of power projects, both CPEC- and non-CPEC-related nearing completion increased the import of power generating machinery in FY21. These projects include Hubco Thar coal power project (Thar Energy), Thal Nova Thar coal power project, 1,263 MW RLNG-based Trimmu power project, Suki Kinari hydropower station, and Karot hydropower project.⁵⁹

Textiles

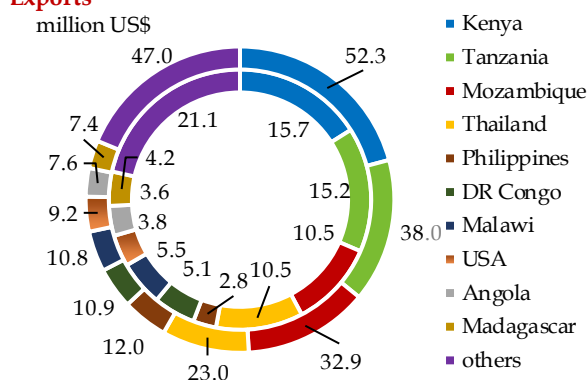
As discussed earlier, in FY21, cotton output remained low due to decline in its cultivation area. Pakistan imported raw cotton worth US\$ 1.5 billion in FY21; US\$ 600 million more from FY20. Besides raw cotton, the import of worn clothes rose to US\$ 309.6 million, rising by 83.4 percent YoY in FY21.

Traditionally, worn clothes were imported in Pakistan for domestic use mostly. However, (re)exporting industry of worn clothes has gained traction in last couple of years in the country, due to its labour intensive nature. As

Import and Exports of Worn Clothes



Figure 6.36 Destination of Worn Clothes' Exports



Source: Pakistan Bureau of Statistics

⁵⁹ For details, see Private Power and Infrastructure Board (www.ppib.gov.pk), and (www.cpec.gov.pk/energy).

a result, Pakistan exported worn clothes worth US\$ 98 million in FY20, 528 percent higher from FY19 (**Figure 6.36**). Covid outbreak in the fourth quarter of FY20 and lockdown imposed subsequently changed the dynamics of the sector further in favor of Pakistan in FY21. Pakistan gain edge over its competitors by better handling the pandemic, which allowed easing the lockdown and revival of the economic activity relatively early. This permitted the worn clothe industry to increase their imports for exporting after adding value, like sorting, mending, cleaning and packaging. Pakistan re-exported US\$251 million worn clothes in FY21, up 156.4 million YoY from FY20. Mostly African countries such as, Kenya, Tanzania and Mozambique and also some Asian countries like, Thailand and Philippine and some advance economies were the destinations of these exports (**Figure 6.37**).

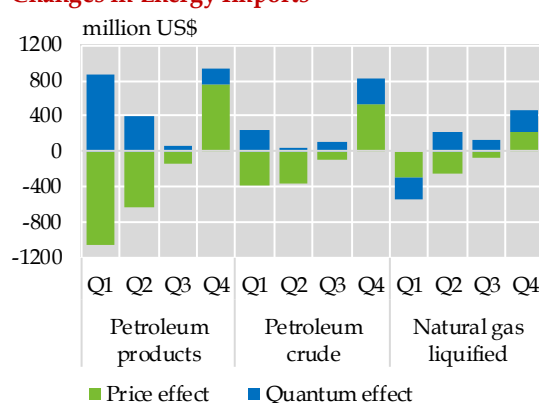
Energy imports

Energy imports (excluding coal) increased by 9.1 percent YoY in FY21, after remaining unchanged in FY19 and declining sharply by 27.9 percent in FY20. The global oil price shock in the second half of FY21, specifically in March 2021 onward, largely contributed to this increase.

In the first three quarters of FY21, lower prices depressed the petroleum and its products' imports despite quantum increase in most of

Quantum and Price Effect of Changes in Energy Imports

Figure 6.38

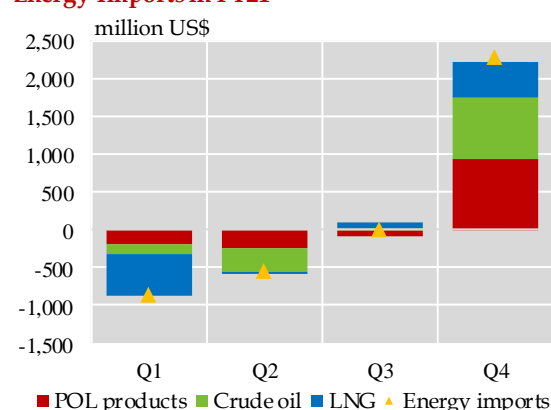


Source: Pakistan Bureau of Statistics

the products. However, in the final quarter, higher prices dominated the increase, offsetting some of the gains accrued due to the lower prices in the preceding quarters and thereby contributing to the growth in overall energy imports in FY21 (**Figure 6.38**).

Breakdown of YoY Change in Energy Imports in FY21

Figure 6.39



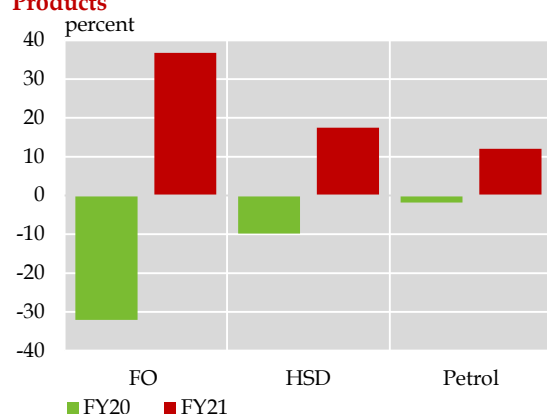
Source: Pakistan Bureau of Statistics

A closer look at the quarterly trend suggests that LNG imports actually declined in volume in Q1-FY21 (**Figure 6.39**), with quantum also decreasing from Q1-FY20 (**Figure 6.38**). Higher hydel generation in July and August and increasing use of furnace oil for power generation in September reduced the dependence on LNG imports in Q1-FY21.⁶⁰

On the other hand, crude imports in Q2-FY21 remained subdued, as its quantum imports increased by merely 4.9 percent (**Figure 6.39**). The government has directed refineries to upgrade their facilities in line with the Euro-V diesel and petrol standards, which led to disruption in crude imports in Q2.

On aggregate, the quantum of the energy imports increased by 26.6 percent YoY during FY21, as energy demand grew significantly with the reopening of the economy. Specifically, sales volume of petrol and diesel increased by 12.0 percent and 17.5 percent respectively in FY21, whereas the sales of these products had declined during FY20 largely due to the strict lockdown imposed in Q4-FY20 (**Figure 6.40**).

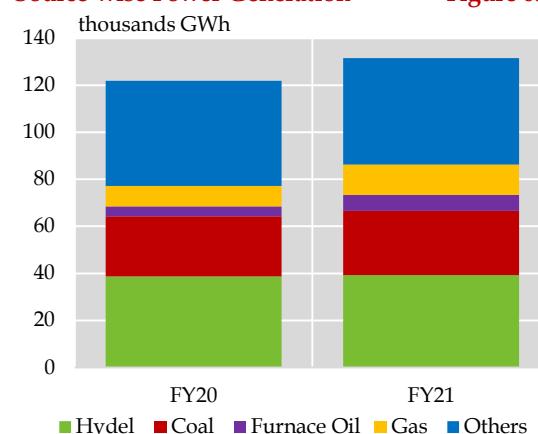
⁶⁰ In January 2019, the government banned the use of furnace oil for power generation. To cover the rising demand and slowdown in LNG supplies, government lifted the ban in July 2020.

Growth in Sale of Petroleum Products**Figure 6.40**

Source: Oil Companies Advisory Council

It is pertinent to note that amid the declining domestic gas output and moderate increase in LNG supply in FY21, the government allocated more gas to the power sector by restricting supplies to the transport sector. Besides, the gas prices were increased by Rs 17-18 per liter in July 2020 and an additional 5 percent GST was levied on LNG imports for CNG stations. These measures propelled CNG's sale price higher than that of motor spirit, and forced a number of CNG consumers to switch to petrol.

Moreover, the number of passenger vehicles on the roads has increased rapidly, growing by more than two million vehicles (including 2, 3 and 4 wheelers) in FY21. Most of these vehicles run on petrol, with exception of 3-wheeler rickshaws (which are designed to run on CNG). Non-availability of CNG also forced these 3-wheelers to run on petrol. Moreover, air and rail had restricted operation in H1-FY21. People travelling between cities opted for either personal transport or intercity buses, which also contributed to higher demand for petrol and HSD.

Source-wise Power Generation**Figure 6.41**

Source: National Electric Power Regulatory Authority

The sale of furnace oil (FO), on the other hand, also increased by 36.8 percent in FY21, as the government withdrew the ban on its use as fuel in power generation. Earlier in FY19, the government had imposed a ban on FO to mitigate growing air pollution in the country, which resulted in a decline in its sales in FY20. Despite the increasing use of FO in power generation in FY21, only 6.7 TeraWatt hour (1,000GWh) were produced on FO out of 131.5 TWh produced during the year, and higher from 4.2 TWh produced in FY20 (Figure 6.41).⁶¹

Recently, coal contributed more to the power generation in the country, with 27.3 TWh produced on this fuel in FY21, up from 25.6 TWh in FY20. Not surprisingly, coal imports increased to US\$ 1.6 billion in FY21 from US\$ 1.3 billion in FY20. However, coal import is reported as a non-energy product in the "All other items" category, as it is also used as an input in cement production; the picture of Pakistan's energy import remains incomplete without coal.⁶² Therefore, including coal, Pakistan's energy imports increased by 10.5 percent to US\$ 12.9 billion from US\$ 11.7 billion in FY20.

⁶¹ Power generation in FY21 has increased by 6.7 percent compared to 1.0 percent decline in FY20.

⁶² Besides, its quantum imports increased by 22.4 percent in FY21.