2 Real Sector

2.1 Agriculture

The highlight of the Q1-FY05 agri-sector performance was a bumper cotton crop that comfortably offset the impact of a below target sugarcane harvest and pushed up value-addition by important major *Kharif* crops by 4.5 percent YoY (see **Table 2.1)**. However, it is unclear whether this positive trend can be sustained in the face of the anticipated large water shortages in the coming *Rabi* season, which pose a threat to wheat in particular and thus to the overall growth of the crop sub-sector.[1]

Table 2.1: Value Addition by Important Major *Kharif* Crops
production in million tonnes; value addition in billion Rupees

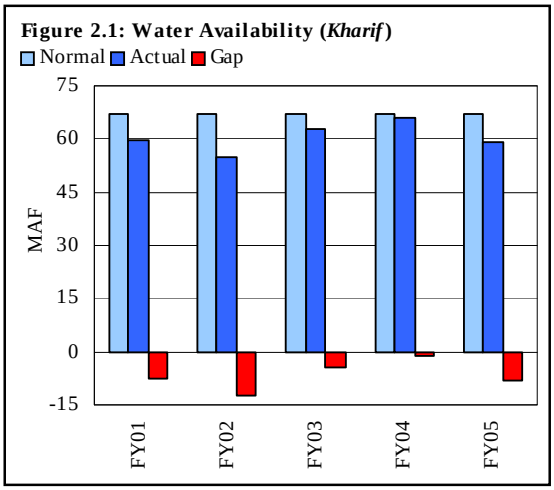
	Production		Value addition		
	FY04	FY05	FY04	FY05	YoY change
Rice	4.9	5.0	56.0	57.5	1.5
Cotton	1.7	1.9	72.9	83.7	10.8
Sugarcane	53.8	47.9	43.0	38.3	-4.7
Total			**171.8**	**179.5**	**4.5**

Source: Federal Committee on Agriculture (FCA)

2.1.1 Water Availability

After improving significantly in the preceeding two years, water availability worsened in the *Kharif* season of FY05. The shortage, which stemmed from relatively poor rains and slow snow melts, meant the shortfall in canal water withdrawals rose from just 1.6 percent below normal level[2] in FY04 to 11.9 percent in FY05 (see **Figure 2.1**). The province-wise water utilization[3] during the *Kharif* season indicates that actual utilization fell short of the shares for all provinces except NWFP. The shortage in Sindh increased from 7.3 percent last year to 9.9 percent during this year. Punjab also faced a gap of nearly 9.9 percent compared

Figure 2.1: Water Availability (*Kharif*)



[1] With wheat being the biggest contributor in terms of value-added by crops, a drop in its production will adversely affect the overall growth of the crop sub-sector.
[2] Normal water availability refers to the average water supply during 1996-2000. It equals the water availability mentioned in the 1991 Water Accord.
[3] Up to September 10, 2004 compared to the same period for 2003.

to a surplus of 3.9 percent during the preceeding *Kharif* season.

Table 2.2: Nutrient Off-take during *Kharif* Season
(000 tonnes)

	2002	2003	2004	YoY change in 2004
Nitrogen	1,116.9	1,161.8	1,287.0	10.8
Phosphate	258.4	191.5	329.5	72.0
Potash	9.0	7.2	10.2	42.9
Total nutrients	**1,384.4**	**1,360.5**	**1,626.7**	**19.6**
Urea	2,035.7	2,224.7	2,403.8	8.1
DAP	419.1	293.4	533.7	81.9

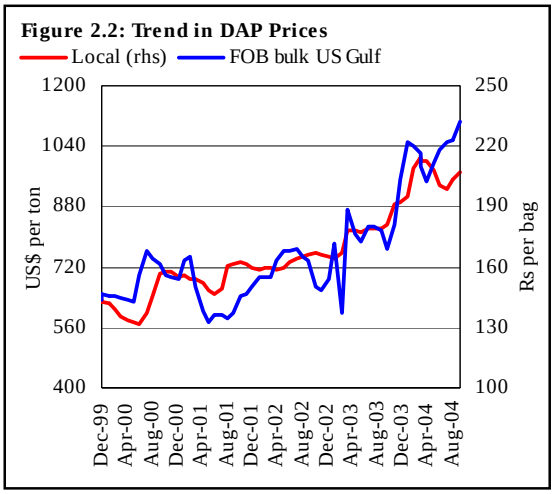
Source: FCA

2.1.2 Fertilizer Situation

Total nutrient off-take during *Kharif* FY05 showed an increase of 19.6 percent compared to the same season in the previous fiscal year (see **Table 2.2**). Demand for both Urea (up 8.1 percent YoY) and DAP (up 81.9 percent YoY) showed strong growth. Strong fertilizer demand even amidst high fertilizer prices and lower water availability suggest an improvement in farmers' incentives, higher credit availability and efficient water management.

As interntional prices of DAP have risen very sharply in recent years (see **Figure 2.2**), the government sought to provide relief to farmers through a Rs 100 per DAP bag reduction in the deemed price of DAP for computation of GST, as well as a decrease in the withholding tax at import stage from 6 percent to 1 percent. Unfortunately, these measures did not significantly impact domestic prices because: (1) initially, traders refused to cut prices until existing stocks had been sold, and (2) thereafter, international DAP prices surged higher and the rupee weakened (pushing up import costs in rupee terms).

Figure 2.2: Trend in DAP Prices

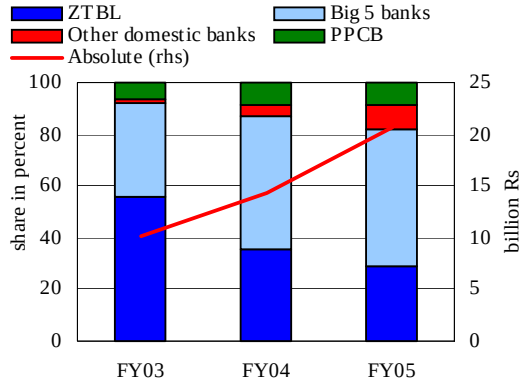


2.1.3 Agricultural Credit

Keeping in view the rising demand for financing in the agriculture sector, credit allocation for agriculture in the Credit Plan for FY05 was raised from Rs 65.5 billion in FY04 to Rs 85.0 billion – a significant increase of 16.0 percent over the actual disbursement in the previous year. A total of Rs 20.6 billion was disbursed during Q1-FY05 against Rs 14.3 billion during Q1-FY04. This offtake in credit

during the quarter indicates that the year-end targets for agriculture credit will be achieved.

Figure 2.3: Credit Disbursement to Agriculture Sector (Jul-Sep)

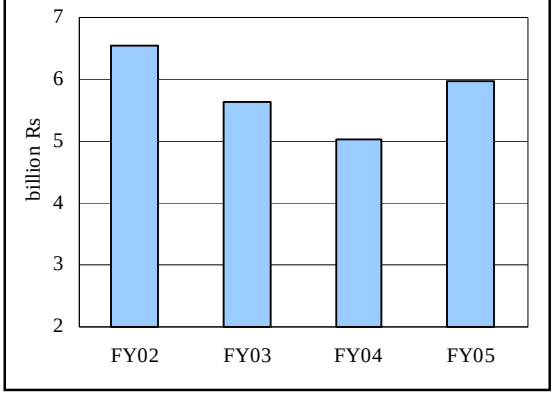


A look at the composition of agricultural credit during first quarter of recent years shows that the share of big five commercial banks as well as other credit disbursing institutions has persistently risen, whereas the share of Zarai Taraqiati Bank Limited (ZTBL) has declined. The five top commercial banks accounted for 53.0 percent of total disbursement during Q1-FY05 followed by ZTBL at 29.0 percent (see **Figure 2.3**).

Disbursements by the big five commercial banks equalled approximately Rs 10.9 billion during Q1-FY05, significantly higher than the Rs 7.4 billion in the corresponding period of FY04. Similerly, domestic private banks disbursed Rs 1.9 billion during Q1-FY05 up a substantial 211 percent YoY; the major contribution in this was by the Bank of Punjab that extended Rs 1.0 billion in agri-credit compared to Rs 0.2 billion in the preceeding year.

ZTBL managed to turn around its previous years' dismal performance and registered an increase of 18.7 percent YoY in disbursements during Q1-FY05 (see **Figure 2.4**). Initiatives that have helped improve the bank's performance include:

Figure 2.4: Credit Disbursement by ZTBL (Q1)



1. reduction in mark-up rate on loans from 14 percent to 9 percent per annum with effect from July 1, 2004.

2. withdrawal of the powers to arrest or imprison farmers from field functionaries.

3. notification of a Recovery Relief Package 2004 for borrowers with an outstanding amount up to Rs 0.5 million at national level and an additional special package for the small borrowers of calamity hit areas of Balochistan (with an outstanding amount up to Rs 0.2 million, provided they apply on or before September 30, 2004). In order to further boost crop financing, SBP raised per acre borrowing limits in July 2004 (see **Table 2.3**).[4]

Table 2.3: Per Acre Borrowing Limits by SBP
Rupees

	Previous	Revised
Cotton	6,000	10,000
Paddy	4,500	7,000
Wheat	4,000	6,600
Sugarcane	8,000	16,000
Others		as per actual cost

Source: SBP

Tractor Financing

The amount disbursed for tractor financing increased by 3.6 percent during Q1-FY05 compared to Q1-FY04 (see **Table 2.4**). As a consequence, the number of tractors financed by credit rose by 8.6 percent. The main contributor towards this rise was ZTBL which increased its disbursement by 28.1 percent and the number of tractors financed by 29.8 percent.

Table 2.4: Tractor Financing (Jul-Sep)
million Rupees

	No. of tractors		Amount disbursed	
	FY04	FY05	FY04	FY05
CBs	2,131	1,882	631.8	593.8
ZTBL	1,860	2414	462.2	592.2
PPCB	436	4,73	147.2	164.1
DPBs	459	539	135.1	178.9

Source: FCA

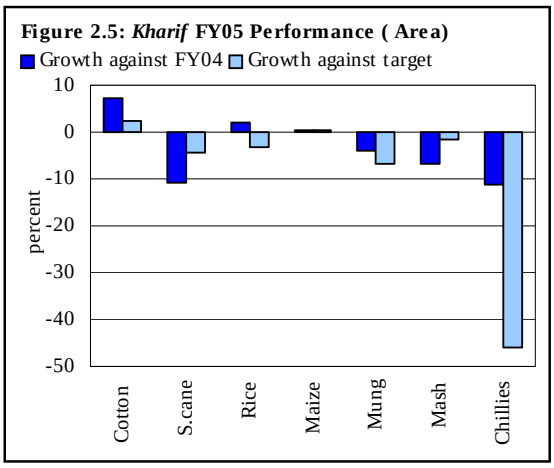
2.1.4 *Kharif* Performance

Typically four major crops, wheat, rice, cotton and sugarcane together account for 91.0 percent of value-added in the crop sector. Of this, approximately 52.0 percentage points are contributed by the latter three (*Kharif)* crops. Thus, the performance of the *Kharif* crops provides a good leading indicator of the overall annual performance of the crop sub-sector.

Area under Cultivation

The total area under cultivation of important *Kharif* crops marginally increased to 8.0 million hectares during FY05 from 7.8 million hectares in FY04, but this was slightly lower than the target of 8.1 million hectares.

[4] *State Bank of Pakistan's Circular Letter No. ACD/2014-2034 /PD(P)-08/2004.*



A major decline of 10.8 percent in the area under sugarcane cultivation (compared to FY04) can be attributed to water shortages and the lower remuneration received by the farmers (for the second consecutive year) during FY04. Moreover, delays in the start of crushing season had also adversely affected the farmers in the last two seasons. The government tried to resolve this problem by exporting surplus sugar at a subsidised rate and permitting the production of industrial alcohol from molasses for export purposes in order to keep the sugar industry profitable and indirectly benefit farmers.

Area under rice cultivation also fell short of the target but increased in comparison to the previous year (see **Figure 2.5**). A significant increase of 7.4 percent was observed in the area under cotton production compared to last year. This rise in area under rice and cotton cultivation was a function of the higher prices that prevailed in the previous season.[5]

A look at the province-wise changes in area brought under *Kharif* cultivation reveals that both Punjab and Sindh showed an impressive increase in the area under cotton, as a result of which the total area under cotton not only exceeded

Table 2.5: Province-wise Performance of *Kharif* Crops during FY05 (Area)
percentage change

	Cotton		Sugarcane		Rice	
	Target	**FY04**	**Target**	**FY04**	**Target**	**FY04**
Punjab	1.38	6.16	-3.89	-11.89	-2.25	2.9
Sindh	3.56	8.91	-10.32	-13.77	-6.25	-2.03
NWFP*			4.00	-0.92	-6.15	-1.14
Balochistan*					-4.76	0.13
Total	**1.75**	**6.99**	**-4.71**	**-11.28**	**-3.4**	**1.52**

*Agriculture Departments of NWFP and Balochistan estimates on area sown for cotton were unavailable.
Source: FCA

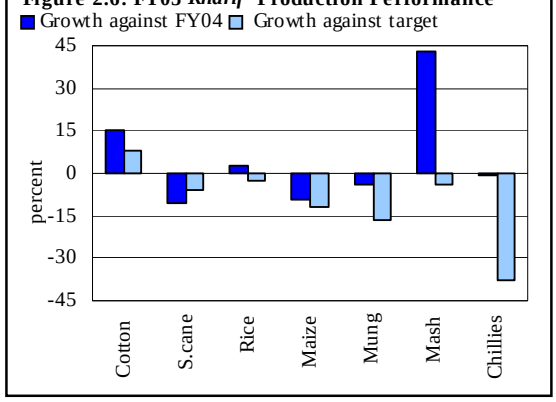
[5] Rice procurement prices rose by 20 percent for the FY04 crop.

that in FY04 but also the current year's target level. Both provinces also exhibited a sharp decline in sugarcane area whereas Sindh also witnessed a fall in the area under rice cultivation (see **Table 2.5**). This decline in area under cultivation in Sindh is mainly attributable to water shortage in the province.

Production of Kharif Crops

In contrast to Q1-FY04, production of sugarcane and rice fell short of their respective targets during Q1-FY05 whereas cotton production surpassed its target by an impressive 8.2 percent (see **Figure 2.6**).

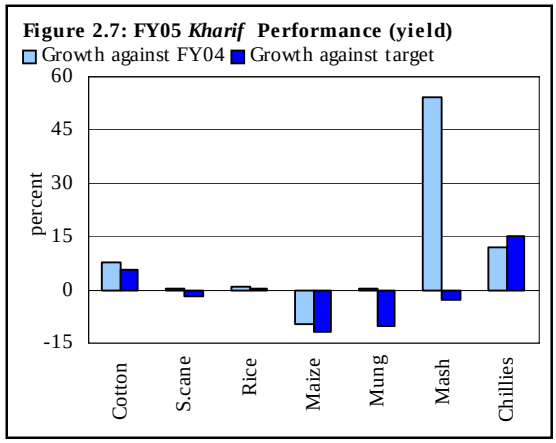
Figure 2.6: FY05 *Kharif* Production Performance



Conducive weather conditions helped improve cotton yields, leading to a bumper cotton crop of 11.6[6] million bales, up sharply from the 10.1 million bales produced during FY04. On the other hand, water shortages hurt both sugarcane and rice production. The fall in production was particularly evident in sugarcane.

Among the other *Kharif* crops, mash registered a sharp increase in production yet did not reach the targeted output (see **Figure 2.7**). The sharp increase in the yield of mash compared to FY04 is probably the result of a base effect as the crop had performed significantly below target in terms of yield during the previous season.

Figure 2.7: FY05 *Kharif* Performance (yield)



2.1.5 Outlook for the *Rabi* Season

IRSA has indicated that total water availability for the *Rabi*

[6] According to FCA (October 13, 2004); however some other sources suggest even much higher production.

season in FY05 would be 20.2 MAF (see **Table 2.6**), which is 36.1 pecent and 44.6 percent lower than the FY04 *Rabi* season and average requirement during the *Rabi* season respectively (see **Figure 2.8**). Moreover water shortage for Punjab and Sindh is 47.0 percent against average requirement and IRSA has projected three possible scenarios, varying on the basis of water losses for *Rabi* FY05 (see **Figure 2.9**).

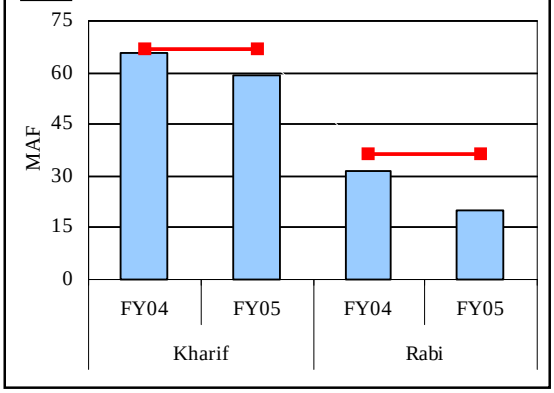
Table 2.6: *Rabi* FY05 Water Availability

	Availability of Water	MAF
1	Utilization Oct 1-Nov 20	7.4
2	Storage component on Nov 20	
	a) Tarbela	1.8
	b) Mangla	1.6
	c) Chashma	0
	Total (a+b+c)	3.4
3	Expected river inflows (minimum) for the balance period Nov 21, 2004-Mar 31, 2005	9.1
4	Total (1+2+3)	19.8

Source: IRSA

Given this situation, improvements in water management by concerned authorities as well as the farmers will be crucial in minimizing the adverse impact of water shortage during *Rabi* FY05. In particular, minimization of water losses, including canal seepages and theft, is the key factor in managing the limited resource. A major initiative aimed at minimizing the losses is the introduction of automatic telemetry system[7] from November 9, 2004 for accurate distribution and monitoring among provinces. Earlier a manual system was in operation that had a lot of shortcomings. Not surprisingly, the anticipated large shortfall in water availablity poses a serious threat to the FY05 *Rabi* crop. In particular, there are concerns that the targeted increases in the cultivated area (and crop production) may not be achieved, and consequently that the FY05 crop sub-sector growth turn negative.

Figure 2.8: Availability of Water



The impact of varying wheat harvests is analysed in **Table 2.7,** which adds the value addition by the wheat crop under different scenarios to the estimated value addition by the *Kharif* FY05 crop, since the composite value

[7] This system operates at 23 sites, covering Tarbela to Kotri including all the rivers under Indus Basin in Pakistan and includes two dams, 16 barrages/head works, 47 canals and 8 monitoring locations.

added provides a very good estimate of the overall crop sub-sector growth. Scenario 3 in particular assumes a wheat harvest of 18.2 million tonnes, which is the harvest achieved in FY02 (when water availablity was close to that projected for FY05). However, if the improvements in water management, credit availability and fertilizer offtake are better than expected, the wheat harvest should comforably exceed the FY02 level, leading to growth ranging between 2.5-4.0 percent for the major crop sub-sector.

Figure 2.9: Different Possibilities of Actual Water Availability for *Rabi* FY05 vs Normal Level

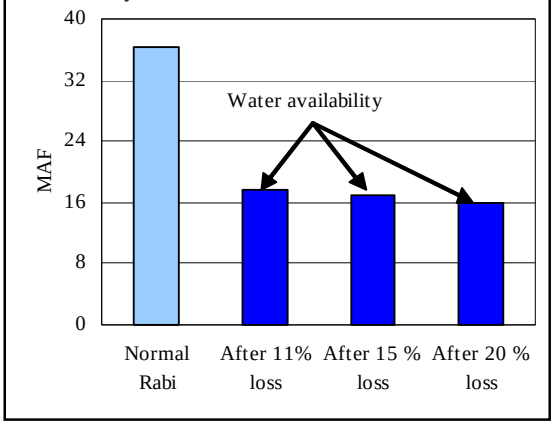


Table 2.7: Impact of Wheat on Growth of Major Crops
production in million tonnes; value-addition in billion Rupees

	Production	Value-addition	FY05 growth in major crops (%)[1]
Kharif [2]	54.9	179.4	
Assumed wheat production			
Scenario 1	20.2	135.4[2]	4.1
Scenario 2	19.5	130.7	2.5
Scenario 3	18.2	122	-0.4

[1] estimated
[2] cotton, rice and sugarcane

Area and production-wise targets for gram and lentil for FY05 have been kept the same as targets for FY04 (see **Table 2.8).** However these targets are higher than the actual performance of the preceding year. In contrast, area and production-wise targets for potato were set higher than the actual performance and targets during FY04.

Table 2.8: Performance and Targets of *Rabi* Crops

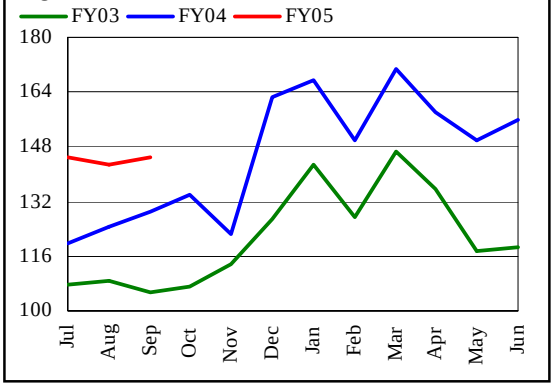
	Area (000 Hectares)			Production (000 Tonnes)		
	FY04[T]	FY04	FY05[T]	FY04[T]	FY04	FY05[T]
Wheat	8,183.0	8,209.8	8,290.0	20,000.0	19,497.4	20,200.0
Gram	1,063.2	982.4	1,063.2	580.0	611.1	690.0
Lentil	55.3	51.6	55.1	35.2	31.0	35.0
Potato	100.0	109.8	102.4	1,782.0	1,938.2	1,970.0
Onion	106.4	109.0	112.4	1,687.0	1,449.0	1,800.0

T: Target
Source: FCA

2.2 Industrial Production[1]

As in FY04 the exceptional performance by *large-scale manufacturing* (LSM) supported the strong growth of industry during Q1-FY05. However the growth rate, as measured by Index of Industrial Production (IIP) [2], visibly decelerated to 9.4 percent YoY during Q1-FY05. This deceleration is seen in all components of IIP (see **Figure 2.10)** and largely appears to be a base effect. IIP showed a growth of 9.4 percent during Q1-FY05 relative to higher 25.5 percent growth in Q1-FY04. *LSM* also witnessed a growth of 14.0 percent during Q1-FY05 mainly contributed by electronics, automobiles, fertilizer and wood products, which is slightly lower than the 15.0 percent growth in Q1-FY04. The slowdown was more pronounced in *Mining & quarrying*, which showed a 21.7 percent growth in Q1-FY05, compared to the 34.4 percent YoY growth during the same period of last year.

Figure 2.10: Index of Industrial Production



2.2.1 Large Scale Manufacturing

The exceptional growth momentum of the LSM seen throughout FY04 continued into Q1-FY05 as well, with the provisional data for the quarter showing YoY growth of 14.0 percent. This is only a little lower than the 15.0 percent YoY growth recorded in the corresponding quarter of FY04.

The slight slowdown in LSM growth is largely due to a base effect, and limited increase capacity utilization (particularly in the industries that witnessed exceptionally high growth during the preceding two years). This suggests that more investment is required to sustain the growth momentum in future.[3]

However, the Q1-FY05 growth was relatively less broad-based. This is evident

[1] Due to 6-months time lag in receiving data on mining and energy, projected production figures for the months of July-September 2004 were used.
[2] IIP is a proxy for the growth in the industry. It covers approximately 62 percent of the country's industrial output. IIP comprises of sub-sectors; *LSM*, *mining & quarrying* and *electricity generation*.
[3] There is some evidence that investment in many LSM industry has indeed increased in recent years.

from the fact that with the exclusion of the sub-groups of *automobile* and *electronics*, which recorded the highest growth rates during Q1-FY05, the LSM growth rate falls to single digits (see **Table 2.9**).

Table 2.9: LSM Growth Rates

percent

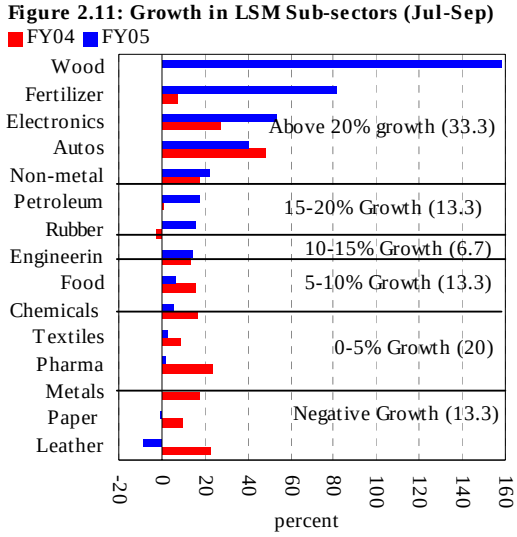
	FY03	FY04	FY05
Overall	2.14	15.04	13.96
Excl. fertilizer	4.64	15.40	11.50
Excl. automobile	0.71	12.45	11.50
Excluding electronics	0.01	14.45	11.84
Excl. automobile & electronics	0.71	12.45	9.02

Source: FBS.

However, as **Figure 2.11** and **Tables 2.10 & 2.11** show**,** only two of the 15 LSM sub-groups witnessed a decline in output.[4] As in the previous year, credit availability remained a key driver of LSM growth in FY05. The direct impact of continued easy monetary policy is more evident in the sub-sectors such as *automobiles*, *electronics* and *construction*[5] related industries, each of which saw a significant growth on the back of continued availability of relatively low cost consumer financing.

One of the bigger beneficiaries of the credit growth was the *electronics* sector, which saw growth of 53.6 percent YoY substantially higher than the 27.2 percent YoY recorded in the same quarter of FY04. The production of air conditioners rose by a remarkable 351.5 percent YoY, deep freezers by 108.8 YoY percent, and refrigerators by 39.3 percent YoY. The production of power and distribution transformers also rose sharply, but this was driven principally from demand for

Figure 2.11: Growth in LSM Sub-sectors (Jul-Sep)



Note: Figures in parenthesis show group's share in LSM

[4] Unfortunately comparable data for FY04 for *wooden products* is not available; it is therefore unclear whether this represents deterioration or a relative improvement. However, the strong 157.9 percent growth in Q1-FY05 as against a decline of 25.4 percent in overall FY04, suggests that this sub-sector registered a robust recovery.

[5] *Non-metallic minerals, wooden products* etc.

domestic power utilities as well as exports.

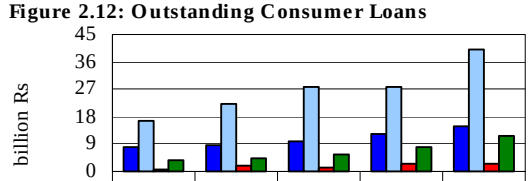
Table 2.10: Distribution of Sub-sector Growth Rates
numbers

	FY04 [1]	FY05
Negative	1	2
0-5%	1	3
5-10%	2	2
10-20%	6	3
20% and above	4	5

[1]:Excluded sub-group of wood products

Auto loans saw an even larger jump in Q1-FY05, accounting for approximately 32 percent of consumer loans during the period (see **Figure 2.12**). This underpinned the impressive 40.2 percent YoY growth by the *automobile* manufacturing sub-sector in Q1-FY05, on top of 48.4 percent growth recorded in Q1FY04.

Figure 2.12: Outstanding Consumer Loans



	Q1FY04	Q2FY04	Q3FY04	Q4FY04	Q1FY05
Cr cards	8.0	8.9	9.7	12.3	14.5
Autos	16.9	22.2	27.6	27.8	40.2
Durables	0.6	1.6	1.2	2.2	2.4
Housing	3.4	4.1	5.5	7.8	11.5

Interestingly, within the automobiles sector, the production of LCVs recorded the highest growth (84.9 percent YoY) followed by buses (65.2 percent YoY) during Q1-FY05. This is quite in contrast to trends in earlier quarters; the production of LCVs and buses had declined by 14.1 percent YoY and 38.5 YoY percent respectively in Q1-FY04.

Some other segments of the *automobile* sub-group witnessed a *relative* deceleration in growth due to a high-base effect as well as capacity constraints, but the growth in most segments remained impressive. In particular, the production of motorcycles and scooters increased by an exceptionally 52.0 percent YoY in Q1-FY05, followed by cars and jeeps (36.4 percent YoY) and tractors (36.2 percent YoY). The large jump in the production of motorcycles reflects not only the continuing impact of consumer credit but also the fall in prices following the entry of low-priced Chinese motorcycles. On the other hand, the production of trucks registered a decline of 12.9 percent in the first quarter of FY05, in contrast with the growth of 18.5 percent during the same period of last year. This is largely due

Table 2.11: Growth in the Production of LSM Industries (Jul-Sep)

Items	Weights	Percentage change FY04	Percentage change FY05	Items	Weights	Percentage change FY04	Percentage change FY05
Textile	**32.62**	**8.5**	**2.4**	**Automobile**	**5.27**	**48.4**	**40.2**
Cotton yarn	17.40	2.5	0.1	Cars & jeeps	3.37	60.4	36.4
Cotton cloth	10.06	20.7	4.6	Tractors	0.93	46.2	36.2
Cotton ginned	4.49	-1.6	6.7	LCVs	0.59	-14.1	84.9
Other five items	0.68	27.6	-0.3	Motorcycles	0.18	77.4	52.0
Food & tobacco	**19.12**	**16.2**	**6.5**	Buses	0.11	-38.5	65.2
Vegetable ghee	5.65	16.9	-6.9	Trucks	0.08	18.5	-12.9
Sugar	5.53	0.0	0.0	**Metal industries**	**4.67**	**17.9**	**0.3**
Cigarettes	4.07	16.8	4.6	Pig iron	2.15	18.7	2.9
Cooking oil	1.76	18.3	35.6	Coke	1.92	22.5	3.4
Wheat milling	1.32	-	20.1	Billets	0.45	0.3	-25.0
Tea	0.42	3.2	-10.8	H.R/coils and plates	0.11	15.2	2.3
Beverages	0.37	0.5	-7.1	C.R coils/plates/sheets	0.04	4.1	17.1
Petroleum products	**6.97**	**1.0**	**17.2**	**Fertilizers**	**4.51**	**6.7**	**81.4**
Pharmaceuticals	**6.70**	**23.3**	**1.9**	Phosphatic	2.51	12.6	178.6
Tablets	3.43	21.4	1.5	Nitrogenous	2.00	2.2	-0.2
Syrup	2.03	28.6	-1.4	**Electronics**	**3.31**	**27.2**	**53.6**
Injections	0.59	17.4	12.9	Electric transformers	0.76	39.0	70.8
Capsules	0.29	9.9	17.8	Refrigerators	0.78	49.9	39.3
Other two items	0.36	31.1	-3.4	Deep freezers	0.53	-	108.8
Chemicals	**6.39**	**16.6**	**5.3**	TV sets	0.30	-4.5	19.5
Caustic soda	0.97	14.3	17.6	Air conditioners	0.10	466.2	351.5
Soda ash	0.12	3.6	1.6	Electric Fans	0.02	-	1.0
Other ten items	5.30	19.5	3.7	Other five items	0.81	31.1	2.7
Non metallic minerals	**5.58**	**17.2**	**22.0**	**Engineering items**	**0.59**	**13.4**	**14.0**
Cement	5.52	17.4	22.0	Safety razor blades	0.35	5.2	17.1
Glass sheets	0.07	-1.1	21.7	Bicycles	0.09	6.2	-15.7
Leather products	3.03	**23.2**	**-8.9**	Sewing machines	0.11	32.0	-18.3
Paper & board	0.80	**10.1**	**-1.1**	Power looms	0.02	-7.6	-2.3
Tyres & tubes	0.40	**-2.2**	**15.9**	Diesel engines	0.01	33.8	41.8
Wood Products	**0.04**	**-**	**157.9**	Other five items	0.02	-25.9	-3.8

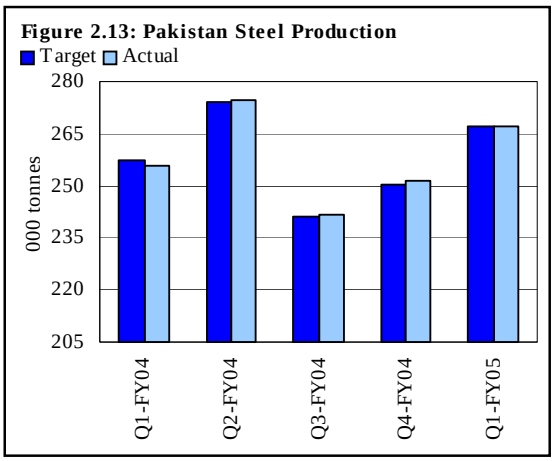
Note: The weights of the LSM industries are adjusted so as the sum of total weights become 100

Source: FBS

to suspension of manufacturing of a Japanese brand truck by a local facility as it switched to the production of a new Chinese brand. [6]

The continued access to credit, a general boom in real estate investments, together with an increase in development expenditure by the government boosted construction activities in Q1-FY05. These, in turn, fostered growth in auxiliary industries such as cement, paints and varnishes, glass sheets, wood, steel, etc.

The production in the cement industry recorded a rise of 22 percent YoY in Q1-FY05 as compared with a growth of 17.4 percent YoY in the same period of the preceding year. The rise in the production of cement reflected the combined impact of increased domestic and external demand - exports of cement, mainly to Afghanistan, rose 24 percent YoY during Q1-FY05 to reach 0.5 million tonnes, accounting for 12.0 percent of production.



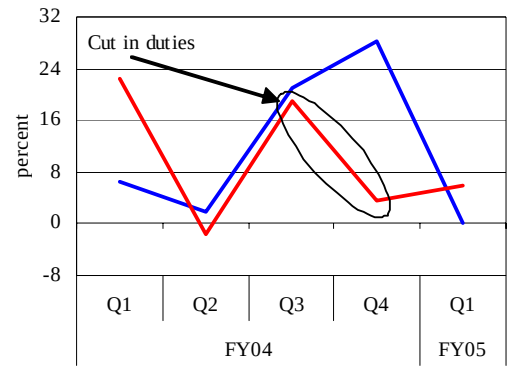
The strong construction activities further bolstered the demand for steel and iron as well. This was met by both domestic production as well as rising imports. Specifically, the output of Pakistan Steel rose 6.6 percent YoY in Q1-FY05, while imports jumped by 73.5percent YoY during the same period (see **Figure 2.13**). The growing demand for steel as well as the high international prices continued to push up domestic prices in Q1-FY05, even though the government repeatedly sought to offer some respite to the construction industry by lowering taxes & tariffs. Specifically, the prices of steel products, as measured in the WPI index, rose by 5.8 percent during the Q1-FY05[7] as compared with an increase of 22.4 percent during Q1-FY04 (see **Figure 2.14**).

[6] Sindh Engineering (Pvt) Limited switched over to new products line for assembly/manufacturing of Dong Feng vehicles from Mazda vehicles.

[7] Pakistan Steel increased the ex-factory prices of all products. Extra charges for special grades have also been increased. The steel prices have gone up from Rs 38,000 per ton to Rs 43,000 per ton during Q1-Fy05. The continuing price pressures has prompted the government announce a further

The exceptional strength of the construction sector, in turn, contributed to the double-digit growth in the *glass sheets, paints & varnish, and wood* sub-sectors. Similarly, the *tyres & tubes* industry witnessed a strong growth on the back of the rapidly expanding *automobile* sector performance.

Figure 2.14: Changes in Steel Prices



The improved performance of the *fertilizer* sub-sector, by contrast, stems entirely from the re-commencement of production of phosphatic fertilizer by a major domestic plant. This increased substitution of imported DAP fertilizer, underpinning the robust growth of 81.4 percent by the sub-sector during Q1-FY05 against a modest growth rate of 6.7 percent in the same period last year.[8]

Strong domestic demand underpinned the acceleration in the growth of petroleum sub-sector, which surged to 17.2 percent YoY in Q1-FY05 as compared with a rise of a mere 1.0 percent YoY in the corresponding period of FY04. This reflects the increased capacity utilization of domestic refineries during Q1-FY05 to cater to rising demand from increased economic activity as well as to greater dependence on thermal power generation. In recent years, Pakistan has increasingly relied on domestic refineries for refined petroleum products, as evident in the rising share of crude oil in the total POL imports; specifically, during Q1-FY05 the imports of refined petroleum products increased by 9.2 percent YoY even as the quantum of POL imports rose by 22.9 percent.

During Q1-FY05, output of the textile sector increased by 2.4 percent against an increase of 8.5 percent in the same period of last year. The main contributors to this modest growth were cotton ginned and cotton cloth with the growth rates of 6.7 percent and 4.6 percent in Q1-FY05 respectively as against (–)1.6 percent and 20.7 percent growth in Q1FY04. A part of the deceleration is probably a base

25 percent reduction in the import tariff on steel, on December 10, 2004. Further there have been calls to restrain the alleged smuggling of steel to Afghanistan.

[8] The growth rate of phosphatic fertilizer was 178.6 percent during Q1-FY05 as compared with an increase of 12.6 percent in Q1-FY04, while the production of nitrogenous fertilizer declined marginally by 0.2 percent in Q1-FY05 against a rise of 2.2 percent during Q1-FY04.

effect, but a strong contribution was also due to the imposition of anti-dumping duty on the exports of some textile items by the European Union and a fall in prices of art silk & synthetic textiles, towels etc. As a result, the exports of textile manufacturing increased by only 4.6 percent in Q1-FY05 as compared to a robust growth of 17.3 percent in Q1-FY04.

It is expected that BMR drive, increased availability of credit and higher FDI amidst a quota free regime from January 2005 would result in a high growth in the textile production going forward. It may be added that the exports of textiles and clothing originate both from the LSM as well as the small-scale manufacturing sector and thus to correlate textile production data simply from LSM with export data will not be very meaningful.

Capacity Utilization

In response to rising demand in the economy, capacity utilization increased in the range of 3.2 to 25.7 percentage points during Q1-FY05 in most of *Large-scale manufacturing* industries (see **Table 2.12**). The major gains in capacity utilization were recorded in electronics industries by 25.7 percentage points, as the production of both refrigerators and air conditioners rose substantially. It may be noted that substantial idle capacity is still available in the air conditioner industry, while there is a need to enhance the installed capacity in refrigerator industry as the utilization has already surpassed 100 percent by end of Q1-FY05.

Table 2.12: Capacity Utilization in Selected Industries (Jul-Sep)

percent

Industry	FY04	FY05
Vegetable ghee & cooking oil	39.01	38.95
Cement	73.08	89.18
Automobile	52.82	76.54
Cars & LCVs	46.99	66.92
Trucks & buses	19.58	22.61
Petroleum refining	94.22	110.47
Industrial chemicals	83.55	95.55
Fertilizer	43.25	46.48
Paper & paper board	99.90	98.81
Electronics (Refrig. and air con.)	40.04	65.78

Source: EAC- Ministry of Industries & Production

The Automobile industry recorded an increase of 23.7 percentage points in the capacity utilization. Within automobiles, the capacity utilization in tractors industry witnessed the largest increase of 44 percentage points, followed by motorcycles/scooters, LCVs and cars & jeeps. Since the capacity utilization in motorcycle and tractor industries has reached about 112.3 percent and 113.9 percent respectively, manufacturers plan to expand the production capacity during FY05.

During Q1-FY05, capacity utilization in cement industry registered an increase of 16.1 percent. While capacity utilization in cement industry has reached 89.2 percent, many cement manufacturers have announced plans to significantly expand capacity over the next few years.

Capacity in vegetable ghee & cooking oil industries remains mostly unutilized. A probable reason for this under utilization is that unregistered ghee and cooking oil-processing units in the country are filling in the gap.

Petroleum refining recorded an enhancement of 16.2 percentage points in the first quarter of FY05 with the capacity utilization reached to 110.5 percent. There is a need to expand its capacity in future to meet the rising demand of petroleum products. The enhancement in the installed capacity in fertilizer is encouraging, not only it would enable the farmers to use the low cost domestic agri-inputs; it has further room to push up the LSM growth.