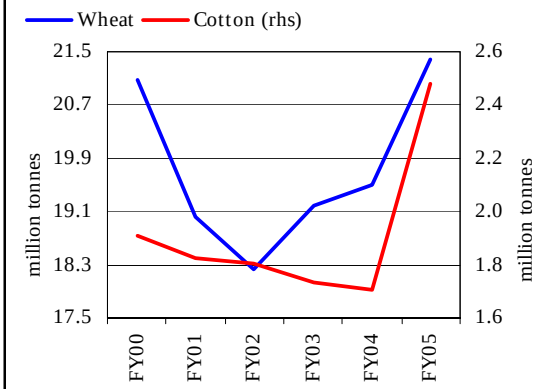
2 Real Sector

2.1 Agriculture

As the *rabi* FY05 cropping season draws to a close, provisional estimates suggest that the crop sub-sector will show exceptional performance in FY05. Not only has the cotton production estimate been upgraded yet again, pushing up the value-addition by *kharif* crops, the value addition by *rabi* FY05 is also expected to be above target as the concerns over the wheat crop have largely dissipated with the FY05 wheat crop expected to touch a record 21.4 million tonnes[1] (see **Figure 2.1**). The other important *rabi* crops, gram and maize, also seem to be doing well. Similarly, the production of most of the minor crops appears satisfactory, belying earlier fears of severe damage to these crops due to heavy and extended rains. Therefore, if the other agri sub-sectors, especially livestock, perform in line with expectations, the agricultural growth for FY05 will substantially exceed the annual target of 4.0 percent.

Figure 2.1: Wheat and Cotton Production



While increased water availability and favorable weather played key roles in this improved performance of the crop sub-sector, the impact of these was clearly supplemented by the easy access to farm credit. In particular, credit disbursement during the first nine months of FY05 was 54.0 percent higher than the preceding year – a record Rs 73.8 billion level against the full year target of Rs 85.0 billion. Not only did crops benefit from the available institutional credit (as evident from the high fertilizer offtake despite high prices, and the sharp jump in the sale of tractors), the livestock sub-sector also benefited from special credit schemes.

As a result of such large availability of finances for purchasing inputs, farm incomes and economic activities in the rural economy are expected to increase significantly. In turn, the aggregate domestic demand for consumer items as well

[1] This is even 1.4 percent larger than the earlier record 21.1 million tonnes production for FY00.

as for agri inputs is likely to rise. Finally, a boost in the rural economic activity is expected to help reduce poverty in the country.

2.1.1 Crop Sub-sector Performance

Major Crops

The timely and ample winter rains have clearly rescued the *rabi* FY05 crops, most of which are now projected to witness significant improvements in harvests. In particular, the wheat crop is projected to reach 21.4 million tones, in contrast to fears of a decline in production earlier in the year (before the advent of the rains). The combination of an increase in the support prices, ample availability of credit and good fortune have clearly paid rich dividends. Principally as a result of the good wheat harvest and the record cotton crop, the value-addition by the four important major crops[2] is estimated to rise by a robust 14 percent YoY during FY05 (see **Table 2.1**) – this would be the strongest growth since FY96.

Table 2.1: Value Addition by Important Major Crops

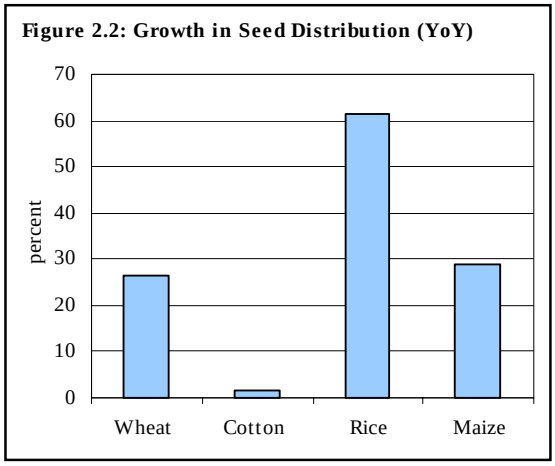
billion Rupees

	FY04	FY05	Growth (%)
Rice	56.0	57.6	3.0
Cotton	72.9	106.4	46.0
Sugarcane	43.0	36.2	-15.8
Wheat	130.7	143.4	9.7
Total	321.8	368.4	14.5

Note: Value additions were computed by using production data of FCA and prices data of Pakistan Economic Survey.

The improvement in the fortunes of the *rabi* crops is not restricted to the wheat harvest. Less important major crops such as grams and maize also witnessed exceptionally strong harvest, with production rising by an estimated 27.3 percent and 29.0 percent respectively during the FY05 cropping season.

Figure 2.2: Growth in Seed Distribution (YoY)



An important contribution to the exceptional growth rates in many of the major crops is also attributable to higher quality seed distribution

[2] These typically account for over 90 percent of the aggregate value-added for major crops.

during FY05, both for *rabi* and *kharif* seasons (see **Figure 2.2**). This is particularly evident for the water intensive rice crop, where yields improved even when water availability during *kharif* was relatively poor. The substantial increase in the availability of improved seed probably also contributed to the strong maize harvest, where yields rose from 2,290 kg per hectare to 2,934 kg per hectare during FY05.

Minor Crops

Minor crops exhibited a mix performance. While *mash* and *moong* pulses witnessed strong growth rates during FY05, the production of *masoor* declined. The area under both *mash* and *masoor* witnessed a decline, but an improved yield due to timely rains partially compensated for the area loss under *masoor*. The yield gains were even more pronounced in the case of *mash*, and its production registered a significant increase of 48.0 percent during FY05. Similarly, production of *moong* pulses increased by 14.6 percent during FY05 due to the gains of a marginal increase in area compounded by improved yield amidst sufficient rains. Although both *potatoes* and *onion* registered a positive growth, their yield saw a fall of 5.0 percent each during FY05, largely due to heavy rains (see **Table 2.2**).

Table 2.2: Highlights of Important Minor Crops

percent change in FY05 over FY04

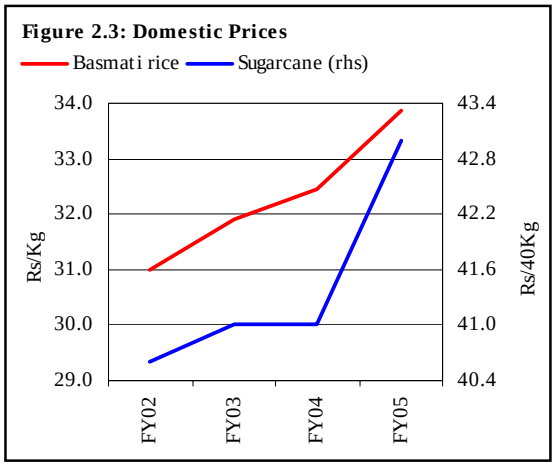
	Area	Production	Yield/hac
Masoor	-4.1	-1.7	2.4
Moong	2.3	14.6	12.0
Mash	-6.3	48.0	57.2
Potatoes	9.0	1.3	-5.0
Onion	18.0	15.4	-5.0
Chillies	4.6	13.2	8.0

Source: Federal Committee on Agriculture.

Target for *Kharif* FY06

At first glance, the preliminary targets for the *kharif* FY06 seem conservative. This is particularly true for the rice crop, where the target area for *Kharif* FY06 has been set only 1.2 percent higher than that for FY05. This appears puzzling given that farmers were probably discouraged in FY05 due to an expected rise in water shortages, and relatively low prices at

Figure 2.3: Domestic Prices



sowing time. Since both water availability and prices (see **Figure 2.3**) are favorable for upcoming crop season, it seems likely that the actual area brought under rice in *kharif* FY06 will exceed the target.[3]

Similarly, the target area for the *kharif* FY06 sugarcane crop may prove to be low. As with rice, the area under sugarcane was probably adversely affected by fears of a water shortage during *kharif* FY05. It is therefore expected that both the area and harvest is likely to be above target during *kharif* FY06 due to (1) the ample availability of water, as well as (2) increased prevailing prices following a fall in the production of sugarcane during FY05 (see **Figure 2.3**).

However, the anticipated decline in the area and production for cotton crop seems realistic. On the one hand, it is uncertain whether FY06 will see a repeat of the favorable conditions seen in FY05, and on the other, given the prevailing high moisture levels, farmers may be discouraged by the increased probability of viral attack on the cotton crop (see **Table 2.3**). Interestingly, while a global bumper cotton crop in FY05 resulted in a sharp fall in the international cotton prices, these have once again started to move upwards amidst projections of a decline in the global cotton crop in FY06. This suggests that those farmers who will be planting cotton would reap substantial gains by improved yields from a conscious monitoring of cotton crop with appropriate usage of pesticides and protective measures.

Table 2.3: Production and Target Setting of Important Crops

Cotton in million bales; other crops in 000' tonnes

	FY05		FY06	% change in FY06 target over	
Crops	Target	Prel.	Target	actual prod of FY05	target FY05
Cotton	10.7	14.6	12.0	-17.8	12.1
Sugarcane	50,875	45,295	51,245	13.1	0.7
Rice	5,114	4,992	5,225	4.7	2.2

Area Under Important Crops

thousand hectares

	FY05		FY06	% change in FY06 target over	
Crops	Target	Sown	Target	actual prod of FY05	target FY05
Cotton	3,140	3,229	3,180	-1.5	1.3
Sugarcane	1,000	947	955	0.8	-4.5
Rice	2,586	2,502	2,533	1.2	-2.0

Source: Ministry of Food, Agriculture and Livestock

[3] In addition, given comparatively higher prices during FY05 and the government's policy to encourage quality rice, it is likely that the farmers would enthusiastically increase the area under *basmati* rice during *kharif* FY06.

2.1.2 Fertilizers Offtake

The offtake of fertilizers rose strongly during the FY05 cropping season. While the 14.9 percent YoY rise in the offtake of urea marked the continuation of a medium term trend, the 14.2 percent YoY jump in DAP offtake was unusually strong (see **Figure 2.4**). Interestingly, the monthly usage of DAP remained stronger throughout *kharif* FY05 as compared to the preceding two years (see **Figure 2.5**).

It is particularly encouraging to note that the fertilizer offtake has increased sharply despite a substantial increase in prices; urea and DAP prices rose 8.2 percent and 10.4 percent respectively during Jul-Feb FY05 (see **Figure 2.6**). This rising consumption thus testifies to the increased confidence of farmers as a result of reasonably strong harvests and

Box 2.1: Fertilizer Use in FY06

According to *NFDC Fertilizer Use Survey 2003-04* (see **Table 1**), fertilizer offtake is expected to strengthen further during the FY06 cropping season, especially given that farmers will be seeking to benefit from the ample availability of water projected for FY06 Moreover, continued easy access to institutional credit would also help them to maximize the benefits of water availability with complimentary rise in fertilizer. Unfortunately, country has to import a substantial amount of fertilizer (particularly DAP) given that the domestic fertilizer industry is facing capacity constraints.

Table 1: Impact of increased water availability in fertilizer use (percent, n=sample size)

	Punjab (n=1732)	Sindh (n=720)	NWFP (n=432)	Baloch (n=288)
Use of fertilizer increase	99	91	99	99
Use of fertilizer decrease	0	1	0	0
No change	0	7	0	0
No response	1	1	1	1
Total	100	100	100	100

Source: NFDC, Fertilizer Use Survey 2003-04

Figure 2.4: Urea & DAP Offtake (Kharif)

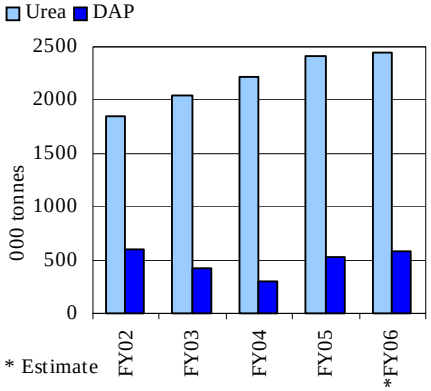
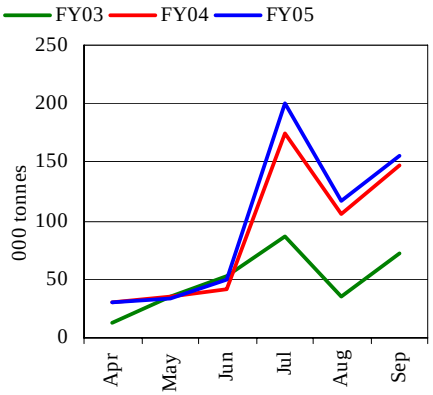
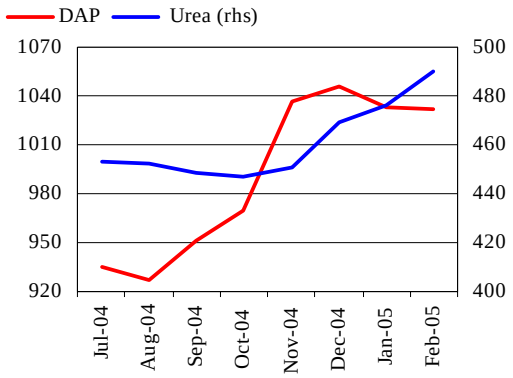


Figure 2.5: Use of DAP



relatively high prices of agri-produce. In addition, improved water availability indicates that the fertilizer offtake would remain strong during *kharif* FY06 as well (see **Box 2.1**). The higher fertilizer prices in turn reflect both a supply-shock (principally as a consequence of a jump in international prices), as well as the strength of domestic demand amidst capacity constraints.

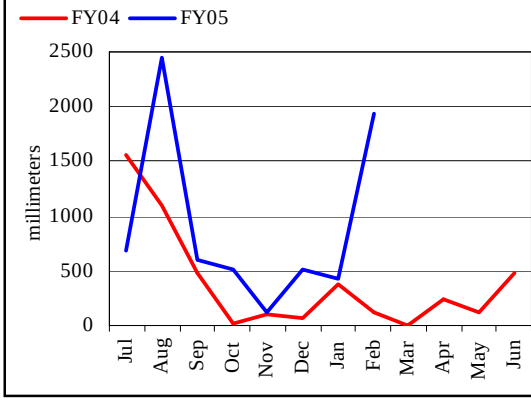
Figure 2.6: Urea & DAP Prices (Rs/ 50kg bag)



2.1.3 Water Availability

Water availability has played a vital role in brightening the growth prospects of agriculture for FY05. Earlier, serious water shortage had been anticipated during H1-FY05. Indeed, while the water shortage for *kharif* FY05 had been recorded at 11.9 percent (Sindh & Punjab), initially a 47.0 percent water shortage was projected for *rabi* FY05. This was subsequently revised downwards to 38.0 percent (Sindh & Punjab) following the initial winter rains. However, extended winter rains during the latter half of *rabi* FY05 led to emergence of water surplus (see **Figure 2.7**). Current estimates suggest that there will be no water shortage during *kharif* FY06 due to the ample availability of water in reservoirs and expected further increase due to snowmelt (above average snowfall was recorded in the country during FY05).

Figure 2.7: Rainfall in Pakistan

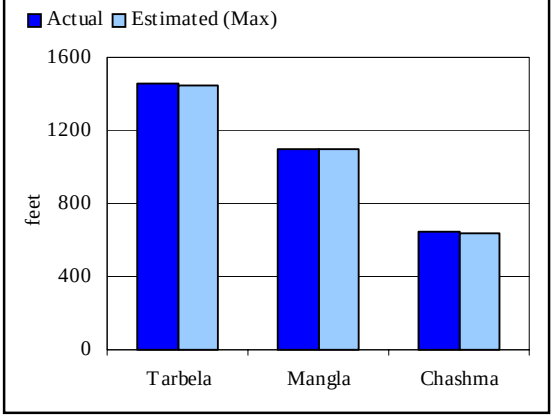


The actual water level of 1456 feet at Tarbela (as on April 9, 2005) is 13.8 feet above the estimates (see **Figure 2.8**). Similarly, water level is 1.8 feet and 4.1 feet above the anticipated level at Mangla and Chashma respectively at this point of

time. This implies that all provinces will get their required water during *kharif* FY06, raising hopes for a good harvest that season as well.

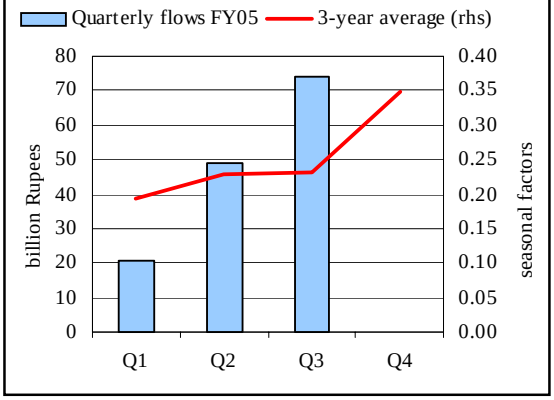
2.1.4 Agriculture Credit

Figure 2.8: Reservoir Levels on April 9, 2005



The pace of rise in agriculture credit which began in FY03 strengthened further in Jul-Mar FY05. The increase in agri credit is a result of active participation of commercial banks in this market. Traditionally, only specialized institutions were largely extending credit to the agriculture sector (infact commercial banks often preferred to pay penalties against non-compliance of mandatory targets for this sector during direct credit control regime). The emergence of agriculture lending as a viable market segment is thus indeed a welcome development for the overall economy.

Figure 2.9: Trends in Agriculture Credit



The additional credit allows farmers to buy more inputs and farm equipment, it also motivates them to put more efforts to reap the maximum benefits of their investment. This coupled with favorable weather resulted in exceptional agriculture growth. The number of borrowers in agriculture sector (during the full FY04) has crossed 1 million households due to the extensive outreach of the commercial banks. Most of these farmers own less than 12.5 acres of land (see **Table 2.4**). It would be fair to deduce that the poor farmers have been the main beneficiaries of this upsurge in agriculture credit. Moreover,

both the number of borrowers and amount, witnessed a continued rise during H1-FY05 as well.[4]

Disbursement

The total disbursement in agriculture sector during Jul-Mar FY05 stood at Rs 73.8 billion, up 54.0 percent YoY, which is 86.8 percent of the full year target of Rs 85 billion. Moreover, seasonal pattern in agriculture credit suggests that the disbursement in the final quarter generally witnesses more than one-third of credit due to *kharif* sowing period (see **Figure 2.9**). If this trend is repeated, the FY05 agri credit is likely to surpass Rs 100 billion mark comfortably.

Table 2.4: Disbursement of Credit in Farm and Non-farm Sectors

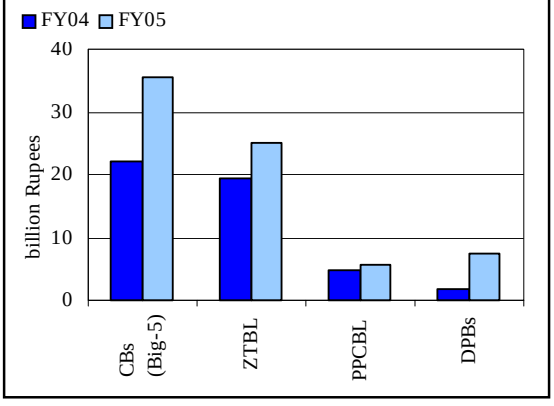
amount in billion Rupees, borrowers in thousand numbers

	FY04		Jul-Dec FY04		Jul-Dec FY05	
	Borrowers	**Amount**	**Borrowers**	**Amount**	**Borrowers**	**Amount**
Farm credit:						
Subsistence holdings	938.2	44.6	445.6	19.5	448.7	28.5
Economic holdings	122.5	14.7	57.0	6.7	63.7	9.7
Above economic holdings	17.2	4.0	8.9	2.1	9.2	3.5
Sub-total	1,077.9	63.4	511.5	28.3	521.6	41.7
Non-farm credit:						
Small farms	57.6	5.3	24.3	2.4	31.8	3.4
Large farms	0.4	4.9	0.2	2.0	0.4	3.9
Sub-total	58.0	10.1	24.5	4.4	32.2	7.3
Grand total	1,135.9	73.5	536.0	32.7	553.8	49.0

Source: Agriculture Credit Department, SBP

While all financing groups posted a positive growth in disbursement, more than half of the rise was shared by the big five commercial banks (see **Figure 2.10**). However, the innovative schemes and aggressive marketing by domestic private banks (DPBs) has allowed these institutions to rapidly expand their agri loan portfolios.

Figure 2.10: Credit Disbursement (July-March)



[4] The latest detailed data is available upto Jul-Dec FY05.

Indeed, the share of DPBs in total agri disbursement rose from a negligible 3.5 percent during Jul-Mar FY04 to above 10 percent in Jul-Mar FY05. Notably, DPBs are focusing on production loans. The share of production loans in the aggregate agri portfolio has risen from 48.1 percent in Jul-Mar FY04 to 77.6 percent during the first nine months of FY05.

Disbursement of Development Loans

Although, in absolute terms, there is a sharp 34.8 percent increase in development loans during Jul-Mar FY05 as compared to Jul- Mar FY04, the pace of this rise is lower than the growth in the overall agri loans. As a result, the share of development loans in the total agri credit fell from 21.3 percent during Jul-Mar FY04 to 18.6 percent during Jul- Mar FY05. This is largely attributable to a decline in development loans by a big commercial bank and a subdued growth in ZTBL's development loans portfolio probably due to restructuring of the institution.

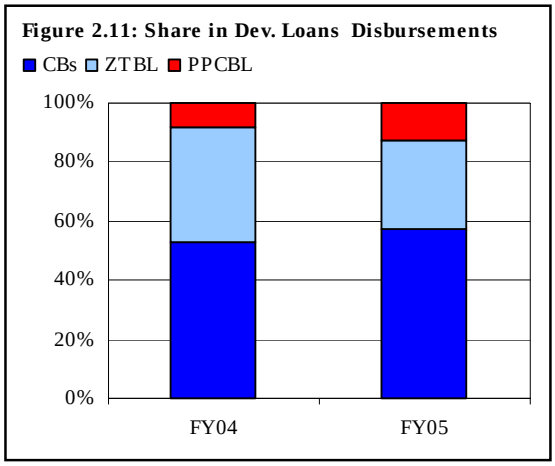
Table 2.5: Share in Total Agri Credit Disbursement (Jul-Mar)

percent

	Production Loans		Development Loans	
	FY04	**FY05**	**FY04**	**FY05**
CBs (big-5)	79.4	82.6	20.6	17.4
ABL	94.7	96.3	5.3	3.7
HBL	56.2	68.1	43.8	31.9
MCB	98.8	94.0	1.2	6.0
NBP	88.8	86.8	11.2	13.2
UBL	72.2	87.3	27.8	12.7
DPBs	48.0	77.6	52.0	22.4
ZTBL	79.8	83.5	20.2	16.5
PPCBL	81.9	69.4	18.1	30.6
Total	**78.7**	**81.4**	**21.3**	**18.6**

Source: ACD, SBP

On one hand, a decline in the share of development loans is not a source of concern as long as the absolute amounts keep rising. On the other hand, the marginal decline in the share of development loans also shows both the differing demand pattern and the preferences of the lending institutions (see **Table 2.5**). An encouraging development in this respect is the shift in the shares of development loan towards commercial



banks (see **Figure 2.11**). Earlier ZTBL was the only major institution providing development loan, but now commercial banks[5] are also extending loans for development purposes.

Recovery

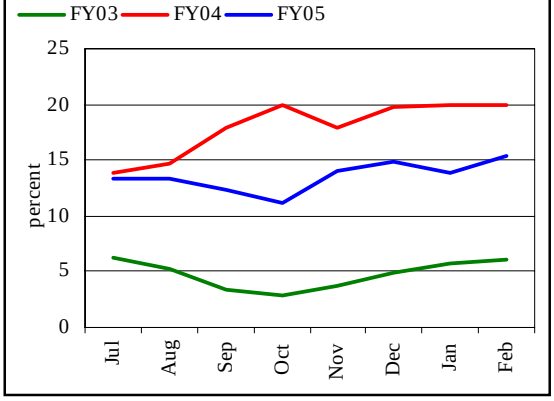
In parallel to the exceptional growth in disbursements, the recovery of loan also witnessed a sharp rise of 39.7 percent during Jul-Mar FY05, as compared with only a 17.7 percent YoY growth in Jul-Mar FY04. Moreover, this occurred despite a slowdown in the recovery by both specialized agri credit institutions (ZTBL and PPCB). The slowdown in the recovery of these specialized institutions probably stems from the relief in payments announced for the areas affected by heavy rain/snowfall. As a result of these developments, while the share of commercial banks in total agri loans increased by only 1.9 percent during Jul-Mar FY05, their share in aggregate recovery increased substantially by 7.4 percent in this period.

[5] Including both CBs (Big-5) and Domestic Private Banks DPBs.

2.2 Industrial Production[1]

Index of industrial Production (IIP), is used as a proxy to measure industrial production on account of *large scale manufacturing* (LSM), *electricity generation* and *mining & quarrying* sub-sectors. According to the IIP, industrial production rose by 15.3 percent YoY during Jul-Feb FY05, lower than 19.9 percent YoY growth recorded in the same period of FY04 (see **Figure 2.12**). However, the growth is considerably higher than the 9.8 percent annual growth target.

Figure 2.12: Growth in IIP (YoY)



The slowdown in the Jul-Feb FY05 growth rate relative to the preceding year is on account of deceleration in the growth of LSM sub-sector (comprises 72 percent of the IIP). On the other hand, *electricity generation* and *mining & quarrying* sub-sectors witnessed higher growth of 17.7 percent and 13.7 percent during Jul-Feb FY05 compared with growth rates of 2.2 percent and 12.5 percent respectively in the same period of FY04. In particular, the stronger growth in *electricity generation* was due to improved water availability and higher imports of furnace oil during Jul-Feb FY05 as compared to the same period of FY04. Similarly, growth in *mining & quarrying* during this period is mainly stemmed from increased gas production (see **Box 2.2**).

Box 2.2: Gas Production

The average share of gas production is about 6.3 percent in the index of industrial production (IIP). The gas production reached 3.6 bcfd (billion cubic feet per day) during Jul-Dec FY05, up 17 percent.

This robust performance was achieved on the back of record growth of 28 percent during Dec-FY05 in OGDCL's gas production due to higher production from its two major gas fields, Qadirpur and Uch.

Similarly, gas production of PPL also increased by 9 percent to 960 mmcfd due to additional production of 100 mmcfd from Sawan field.

[1] Estimated data is used for the months of Jan-Feb FY05.

2.2.1 Infrastructure Industries

Infrastructure industries output index constitute almost 42 percent of the overall industrial index of production Infrastructure industrial index (based on domestic production only) recorded a robust growth of 14.5 percent during Jul-Feb FY05, significantly higher than 6.3 percent growth in the same period of FY04 (see **Table 2.6**). Inclusion of the imports under the heads of infrastructure industries further augmented this rise to 19.9 percent during this period mainly due to a substantial rise in the imports of *coal*, *basic metals* and *petroleum & petroleum products*. The higher growth was observed on account of all of the elements of infrastructure industries. Moreover, while domestic production of *basic metals* declined, a significant rise in the quantum of its imports increased its overall availability by 62.0 percent in the country during Jul-Feb FY05.

Table 2.6: Growth in Infrastructure Industries (Jul-Feb)

percent

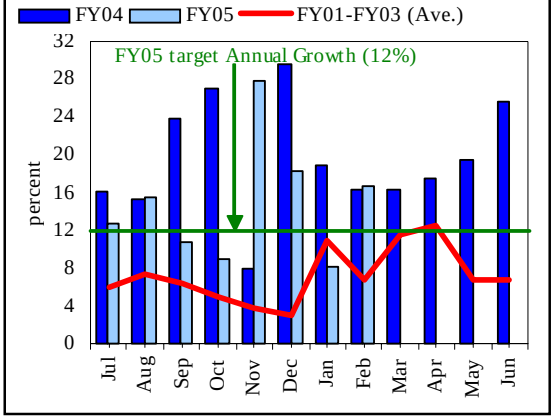
	Domestic		Total (domestic + imports[1])	
	FY04	FY05	FY04	FY05
Power	2.2	17.7	2.2	17.7
Natural gas	21.5	14.9	21.5	14.9
Crude oil	-4.4	5.6	-4.4	5.6
Coal	-9.1	22.2	228.7	102.0
Basic metals	10.3	-2.0	18.6	62.0
Cement	14.1	17.7	14.1	17.7
Petroleum	3.2	11.9	-17.2	9.9
Overall	**6.3**	**14.5**	**4.2**	**19.9**

Note: Index of Infrastructure Industrial is based on the performance of the above 7 industries.

[1] There is no imports under *cement*, *power* and *natural gas* industries.

Since, the growth in infrastructure industries is a leading indicator of the industrial activities in the economy, a double digit growth during the first eight months of FY05 reinforces the view that industrial sector is likely to witness a robust and above target growth during FY05.

Figure 2.13: Growth in LSM Index (YoY)



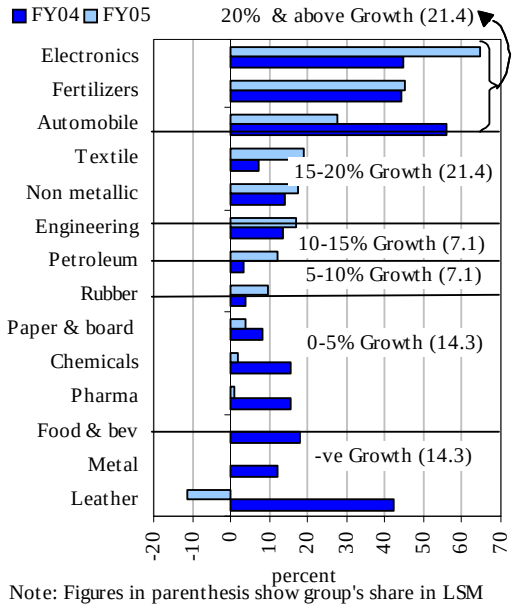
2.2.2 Large Scale Manufacturing (LSM)

Despite an evident weakening of the growth momentum, LSM growth during July-Feb FY05 remained quite strong. More specifically, while the 15.0 percent YoY growth during the period is distinctly lower than 17.5 percent YoY increase seen in FY04, it is still

substantially stronger than the average growth of 7.2 percent during FY01-FY03 (see **Figure 2.13**). In fact, only in January 2005 did the monthly LSM growth fall below average for earlier years, falling to 8.2 percent YoY (the lowest since November 2003). However, LSM growth bounced back again to above average in February 2005 to a robust 16.7 percent. It is quite likely that the LSM production will remain relatively strong through the remaining months of the financial year allowing the annual LSM growth to comfortably exceed the FY05 target.

A look at the growth profile of the various LSM categories (see **Figure 2.14**) suggests that the relative weakness in the dispersal of growth rates is quite wide. It ranges from negative growth rates in *metals* and *leather* industries to above 20 percent growth in the *electronics*, *fertilizers* and *automobile* industries. Taking the mean growth rate of 15 percent, industries accounting for 43 percent of the share in LSM showed above average growth while industries with an equivalent share exhibited below average growth. The relative contribution from the rapidly growing industries - *electronics, fertilizer* and *automobile* has increased by 0.5 percentage points during the current period (see **Table 2.7**).

Figure 2.14: Growth in LSM Sub-sector (Jul-Feb)



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

Table 2.7: LSM Growth Rate (Jul-Feb)

percent

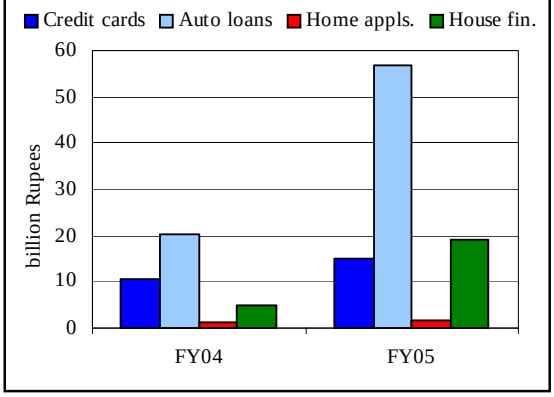
	FY03	FY04	FY05
Overall	5.9	17.5	15.0
Excl. fertilizer	6.8	16.6	13.7
Excl. automobile	3.7	14.6	13.8
Excluding electronics	4.4	16.3	12.2
Excluding fertilizer & electronics	5.3	15.3	10.7
Excl. automobile, electronics & fertilizer	2.9	11.9	8.9

Source: Federal Bureau of Statistics.

The growth in the *auto* and *electronics* continued to be driven by the availability of consumer credit, as evident from **Figure 2.15**. Specifically, *auto* financing

rose by a remarkable 181 percent YoY, similarly, credit for house appliances also saw a growth of 10.0 percent YoY during Jul-Feb FY05.

Figure 2.15: Outstanding Position of Consumer Loans (Jul-Feb)



Not surprisingly, the *auto* sub-sector witnessed an impressive growth of 27.7 percent during Jul-Feb FY05, though lower than the 55.9 percent registered in Jul-Feb FY04. The growth momentum is likely to continue in this sector due to (1) recently enhanced capacity, (2) entry of new manufacturers and (3) some large domestic banks with wide branch network also joined and started aggressive marketing for *auto* financing.

As a result, the latest available data upto Jul-Mar FY05 indicates that *auto* assemblers produced[2] 86.9 thousands cars as compared with 68.6 thousands cars in the same period of FY04 (see **Table 2.8**), up by 26.6 percent. Moreover, total car sales climbed by 29.6 percent YoY from 68 thousand cars in Jul-Mar FY04 to 88.1 thousand cars in the first nine months of the current fiscal year.

Within the automobile sector, the production of *light commercial vehicles* (*LCVs)* witnessed the strongest growth of 73.0 percent during the first nine month of FY05 against 4.7 percent in the same period of last year. This extraordinary growth was due to start of the production of LCVs by two Chinese brands, a low base effect as well as a rise in investment in the transport sector on the back of credit availability, particularly for small & medium scale enterprises.

Similarly, growth in the production of *motorcycle* & *auto rickshaw* and *tractors,* though slowed, was recorded at 41.3 percent and 24.3 percent respectively during the Jul-Mar FY05. The slowdown in their growth is mainly attributed to capacity constraints, as these industries are operating at above 100 percent level.

[2] Production and sale of motorcycles, farm tractors and other vehicles by the manufacturers who are not the members of Association is not included in this table. Their share in the total production and sale of motorcycle is around 20 percent, farm tractors 10 percent and LCVs 20 percent.

Table 2.8: Production & Sales of Selected Automobiles During July-March

production & sales in thousand numbers, growth in percent

	Production				Sales			
			growth				growth	
	FY04	**FY05**	**FY04**	**FY05**	**FY04**	**FY05**	**FY04**	**FY05**
Cars (1300cc and above)	26.9	36.6	65.1	35.9	26.7	36.7	65.1	37.2
Cars (800cc and 1000cc)	41.7	50.3	63.0	20.6	41.3	51.4	62.3	24.6
Jeeps	4.0	5.7	17.7	41.9	4.0	5.5	17.0	37.2
Trucks	1.4	1.6	2.6	18.2	1.3	1.7	5.7	31.0
Buses	1.0	1.3	2.3	30.7	1.0	1.1	-11.6	15.3
LCV's	5.8	10.1	4.7	73.0	5.8	10.1	6.2	73.9
Tractors	25.2	31.3	43.3	24.3	25.2	29.7	44.1	17.9
Motorcycles/rickshaw	213.6	301.9	82.4	41.3	210.1	303.1	86.2	44.3

Sources: Pakistan Automotive Manufacturers Association

By contrast, the 45.4 rise in *fertilizer* production during Jul-Feb FY05 reflects both an increase in capacity, following the resumption of production by the phosphatic unit of a local producer, as well as strong domestic demand. The latter resulted from a number of factors including (1) the high international prices (that reduced competition from imports), (2) increased water availability, (3) high prices for farm produce, and (4) ample credit availability (which encouraged farmers to increase fertilizer offtake). Unfortunately, while the fertilizer demand is likely to remain intact, capacity constraints and a high-base effect is expected to substantially push down growth in the sector in the final quarter of FY05.

Similarly, a few other sectors have actually seen a small *acceleration* in growth during July-Feb FY05 relative to the corresponding period of FY04.

The most notable of these is the strong 18.9 percent YoY growth in the textiles sector during the first eight months of FY05, up sharply from the 7.1 percent YoY increase seen in the comparable period of FY04. This growth momentum is important as (1) the share of textile sector is almost one-third of the overall LSM, (2) the dominance of textile exports in total exports, and (3) growth in large scale textile units are clearly suggesting downstream improvement in the small scale supporting textile units.

The present growth momentum in textile sector appears to reflect both, the record cotton production during FY05 (see **Table 2.9**), as well the expectation that domestic industry would benefit from the post-quota regime. As a result of global bumper cotton crop, cotton prices fell sharply. This coupled with the

opportunities offered by quota free textiles trade from January 2005 probably encouraged the production of cotton cloth, which increased by 30.2 percent (by 131,895 thousands square meters) during the first eight months of FY05. The production of cotton yarn also witnessed an increase of 7.1 percent (by 91,930 tons) during Jul-Feb FY05. However, despite the substantial rise in domestic production of textiles, its exports rose by only 2.0 percent during Jul-Mar FY05. This unimpressive outcome is because of (1) imposition of anti-dumping duty on Pakistani bed wear by EU, and (2) probably buyers postponed their orders in anticipation of more competitive prices post-Jan 2005.

Table 2.9: Textile Production

	Units	Weights in LSM	Jul-Feb		Growth rate
			FY04	FY05	
Cotton yarn	000 tonnes	13.066	1,288.1	1,380.0	7.1
Cotton cloth	million sq.m	7.549	436.9	568.8	30.2
Cotton (ginned)	000 tonnes	3.368	1,139.2	1,587.7	39.4
Woolen & carpet yarn	tonnes	0.323	1,530	1,511	-1.2
Jute goods(total)	tonnes	0.174	69,245	68,195	-1.5
Knitting wool	tonnes	0.012	2,350	2,140	-8.9

Another sector that saw growth accelerate amidst persistent strong domestic demand was the petroleum sub-sector, which recorded an 11.9 percent YoY increase in production during Jul-Feb-FY05 as compared with a rise of 3.2 percent in the corresponding period of FY04. This rise mainly stemmed from starting of commercial production by Bosicor in FY05, a rapid rise in the number of automobiles in the country, a sustained growth momentum in LSM and increased thermal power generation. The strong domestic demand was partially filled by a rise in the domestic petroleum production and remaining by increase in imports of POL, which were up by 14.0 percent YoY during Jul-Feb FY05.

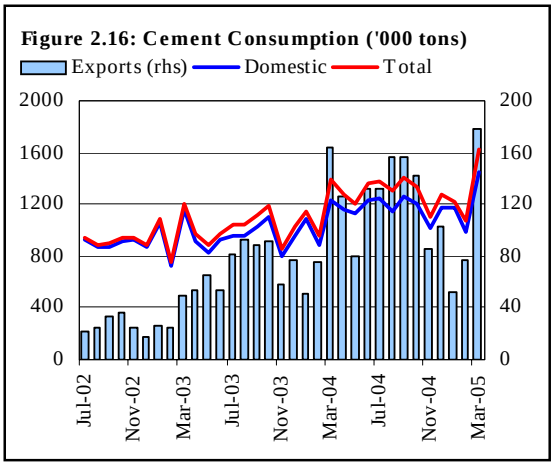
Similarly, the sustained growth momentum in the *construction* and *housing* sector pushed the growth in allied industries such as cement, paints & varnishes, glass sheets and wood etc. The performance of construction sector is summarized in **Table 2.10**. In particular, the production of cement registered a 17.7 percent growth during July-Feb FY05 compared with 14.1 percent YoY growth in the corresponding period of FY04. This growth was a result of increased domestic as well as external demand. While the local cement dispatches rose by 18.3 percent,

the exports witnessed an increase of 47.1 percent during this period[3] (see **Figure 2.16**).

Table 2.10: Construction: Performance Indicators

		Jul-Feb	
	Unit	**FY04**	**FY05**
Cement production	million tonnes	8.0	9.4
Iron & steel (Pakistan Steel plus imports)[1]	million tonnes	1.3	1.9
Import of construction & mining machinery	billion Rupees	3.3	5.3
Credit for construction (outstanding position as on end Feb. 05)	billion Rupees	15.2	2.6

[1] Excluding the imports of iron & steel scraps.



Unfortunately, the impact of the positive developments in the above mentioned sectors was considerably diluted by a sharp downturn in growth rates of six other LSM sub-sectors (that account for over 40 percent of the LSM index). Most of them had recorded growth in the range of 3.6 percent in the case of *bicycle* to 42 percent for *leather* industries in Jul-Feb FY04. However, both suffered significantly lower growth in FY05 (dropping to the 0-4 percent range) or else recorded a decline in output. The latter appeared to be a result of structural problems in these industries (e.g. *leather* and *metal*).

In particular, it is important to note that despite strong domestic demand on the back of increased economic activity, the production of metal industry saw a *decline* of 0.1 percent YoY during Jul-Feb FY05 in contrast to a 12.3 percent YoY *increase* in the corresponding period of FY04. This is not puzzling because the supporting *ship breaking* industry, which is a major source of raw material for the domestic iron industry, remains inactive and availability of raw material is lower

[3] According to APCMA, local cement dispatches rose by 18.1 percent during Jul-Mar FY05, whereas the exports increased by 39.2 percent during this period. In March 2005 local dispatches witnessed at a record high of 1.4 million tons.

than the required level. As a result, imports of iron & steel rose by 63.0 percent during Jul-Dec FY05 to meet the growing needs of the economy.

In contrast, *pharmaceuticals* production increased by 1.1 percent during July-Feb FY05 as compared to a robust 15.4 percent growth seen in July-Feb FY04. The slowdown is mainly attributed to the substitution of demand from the relatively expensive products of multinational companies to cheaper alternatives made by local manufacturers that do not form part of the LSM statistics.

Similarly, the aggregate output of the *food, tobacco & beverages* sub-group also witnessed a subdued growth of 0.01 percent in Jul-Feb FY05 as compared to significantly higher growth of 17.8 percent during the same period of FY04.

Box 2.3: Increased role of non-reporting units

- Lower production is reported in vegetable ghee industry. This is probably because of increasing market share of the informal sector units.
- Beverages recorded lower production. This may be due to the increasing popularity in some areas of low cost products such as lemon and soda water, the production of which is not captured in the LSM statistics.

This slowed growth was recorded on account of lower production of *vegetable ghee*, *sugar*, and *beverages* (see **Box 2.3**). While, the production of vegetable ghee decreased by 3.2 percent in Jul-Feb FY05 as compared with a growth of 17.4 percent in the same period of FY04, cooking oil recorded a significant 25.7 percent growth during Jul-Feb FY05 as compared with 22.7 percent growth during the same period of FY04. This opposite trend may be a reflection of a substitution of consumption of vegetable ghee with cooking oil due to increasing awareness regarding health issues.

Table 2.11: Capacity Utilization in Selected Industries

percent	Jul-Feb	
	FY04	**FY05**
Exceeding 100 percent		
Fertilizer	98.2	104.7
Paper & paper board	96.8	100.7
Motorcycles/rickshaws	89.5	119.4
Tractors	85.1	123.3
Approaching 100 percent		
Industrial chemicals	86.9	97.0
Steel (Pak Steel)	94.3	94.0
Between 50 and 90 percent		
Cement	71.6	80.4
Petroleum refining	84.8	86.2
Electronics (Refrig. and air con.)	45.1	83.7
Cars & LCVs	42.8	68.4
Below 50 percent		
Vegetable ghee & cooking oil	39.5	40.0
Trucks & buses	22.1	26.9

Source: EAC- Ministry of Industries & Production

Finally, a 13.0 percent decline

in the production of sugar during Jul-Feb FY05 as against a robust growth of 20.8 percent is mainly a result of a decline in the sugarcane output this year. The subsequent disruption in sugar supply has resulted in higher prices and imports during this period.

2.2.3 Capacity Utilization

Capacity utilization in the selected LSM industries continued to rise during Jul-Feb FY05 (see **Table 2.11**). The highest increase in the capacity utilization witnessed in the *electronics* and *automobiles*. Interestingly, the growth momentum in both of these industries is mainly credit driven.

More specifically, *electronics* industry witnessed the highest increase of 38.5 percentage points in the capacity utilization during July-Feb FY05 raising it to 83.7 percent. It implies that while there is some room is still available for this industry to grow, there is an urgent need to enhance the installed capacity in refrigerators, as this part of the *electronics* industry is operating at 108.6 percent during Jul-Feb FY05. Moreover, *electronics* industry has to invest in up-gradation and new technology to remain competitive.

Similarly, *automobile* industry witnessed a sharp increase in capacity utilization (by 21 percentage points) mainly on account of higher capacity utilization by tractors and motorcycles/rickshaws. Capacity utilization in tractors and motorcycles/rickshaws is already at 123.3 percent and 119.4 percent respectively in Jul-Feb FY05. It is heartening to note that new plants and expansion in the existing plants are underway to expand the production capacity in automobile sector to meet the growing domestic demand.