2 Real Sector

2.1 Agriculture

Encouraged by the strong FY05 agricultural performance, prospects of improved water supply, and the increased availability of institutional agri-credit the government set an ambitious growth target of 4.8 percent for FY06. This target was based principally on optimistic expectations that the strong FY06 performance by major crops would be sustained in the succeeding year.

Unfortunately, provisional data on major *kharif* crops already suggests that value-added by these crops may fall below even the levels seen in FY05, unless the wheat crop exceeds the already aggressive FY06 target by a substantial margin. In short, the achievement of the overall FY06 agricultural growth target will depend on an exceptional *rabi* harvest, as well as an above-target growth in the minor crops and livestock sectors. While direct data on minor crops is not yet available indirect evidence, in the form of a fall in prices of many minor crop products,[1] as well as some anecdotal evidence, raises hopes that production of many minor crops may exceed the targets. Similarly, it is possible that the increased focus of microfinance institutions on the livestock in recent years could lead to above target outcome in this sector as well.

Crops

The total cultivated area under the four major crops during *kharif* FY06 was 1.2 percent lower relative to that in *kharif* FY05. Most of this fall is attributed to the area under cotton and sugarcane; the area brought under cultivation for each crop during *kharif* FY06 has not only been below the annual target but also lower than the area under the crop in FY05. In fact, it was only a large jump in the area under maize, supported by a smaller (but below target) increase in area under rice, that pushed the aggregate cultivated area under major crops slightly over the FY06 target (see **Table 2.1**).

Table 2.1: Area Under Major Crops

thousand *hectares*

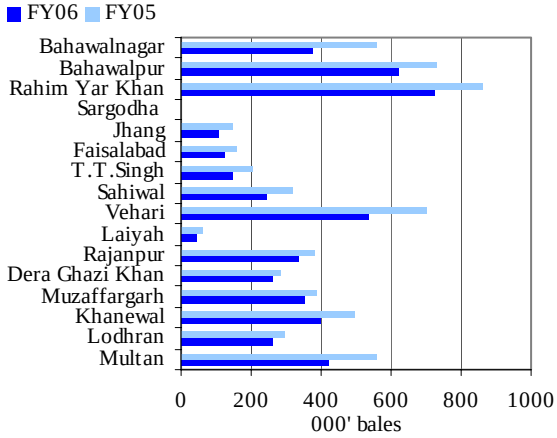
	2004-05		2005-06	
Crop	Targets	Actual	Targets	Actual
Cotton	3140	3229	3247	3120
Sugarcane	1000	967	955	900
Rice	2586	2520	2533	2531
Maize	939	946	971	1018
Wheat	8290	8359	8415	..

Source: MINFAL

[1] An increase of 34 percent (YoY) in import of onion and potato also helped to ease pressures on their prices.

Provisional estimates place the FY06 cotton production at 12.5 million bales, down 14 percent YoY, against a 3 percent fall in cultivated area. Clearly productivity too has fallen, and this is reflected in the lower production in all cotton producing districts in the Punjab (see **Figure 2.1**). It appears that the cotton crop was adversely affected by delayed sowing, untimely rains and pest attacks. In addition, unusually high temperatures in August 2005 probably also badly affected the standing cotton crop.

Figure 2.1: Cotton Production in Punjab



As with cotton, the production of sugarcane is also estimated to be lower (by 2.8 percent YoY) during FY06 (see **Table 2.2**), despite an improvement in water availability. Unlike cotton however, the fall in the sugarcane crop is probably a reflection of the dispute between growers and sugar mills.[2] Productivity in the case of sugarcane crop has increased during FY06 and the lower production is largely a result of the price and payments-related issues that led growers to switch to oilseed and other crops.[3]

Table 2.2: Production of Selected Major Crops

	2004-05		2005-06	
Crop	Targets	Actual	Targets	Actual*
Cotton (mln bales)	10.72	14.6	15.0**	12.53
Sugarcane (mln tones)	50.9	47.2	50.1	45.9
Rice (000 tones)	5114	5025	5000	5136
Maize (000 tones)	2770	2774	2905	2983
Wheat (mln tones)	20.2	21.6	22	-

(*) Initial estimates.
(**) The revised target is 12.5 million bales.
Source: MINFAL

The other two major *kharif* crops, rice and maize, have performed quite well during FY06, with the production of both exceeding the annual targets.

[2] The offer of prices by sugar mills were lower than the government's announced prices for the last two years coupled with delayed payments have probably discouraged farmers.
[3] Unlike sugarcane which is essentially a tropical grass and best suited for tropical rainy climate, oilseed crops are well adapted for temperate regions and can tolerate high temperatures. In addition, growers do not have to wait extended periods for the payment of their crops, as is the case with sugarcane.

Interestingly, while the per *hectare* yield of maize did not see any change, rice yield rose by 1.8 percent during FY06, probably helped by the improved water availability relative to *Kharif* FY05, as well as an increase in the support prices.[4] However, the recent fall in the prices of rice would adversely affect the income of rice growers and may hurt the growth prospects of this crop in future.

Fertilizers

The aggregate nutrient off-take witnessed a rise of 11.2 percent YoY during *kharif* FY06 (see **Table 2.3**), as compared to 8.5 percent YoY rise seen in *kharif* FY05. Interestingly, while the urea off-take increased by 5.7 percent YoY during the period, the off-take of DAP increased at a much faster pace, jumping 21.9 percent YoY despite a sustained increase in prices (see **Figure 2.2**). It is likely that this robust increase was supported by the increased confidence of growers (due to increased water availability and good prices) as well as the ready access to agri-credit.

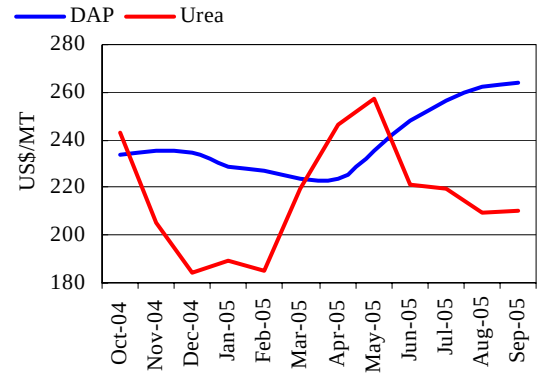
Table 2.3: Cumulative Fertilizer Off-take during Kharif

000' nutrient tones

	FY05	FY06	percent change
Nitrogen	1287	1385	7.6
Phosphate	329	402	22.2
Potash	10	21	110.0
Total nutrients	**1626**	**1808**	**11.2**
Urea	2404	2540	5.7
DAP	534	651	21.9

Source: National Fertilizer Development Centre (NFDC)

Figure 2.2: International Fertilizer Prices



As the capacity utilization in the domestic fertilizer industry is already over 100 percent and demand remains strong, the import of fertilizers increased in FY06. This trend is expected to persist through rest of the year.

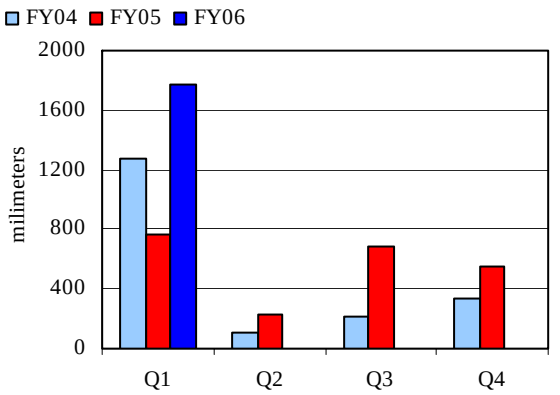
It is estimated that total imports of urea and DAP would be 388 thousand nutrient tons and 420 thousand nutrient tons respectively during *rabi* FY06. ECC has also

[4] Support prices for cotton has been raised from Rs 925 in 2004-05 to Rs. 975 for 2005-06, showing an increase of 5.0 percent. Similarly, the support prices for rice depicted an increase of 11.0 percent on average, which helped in accelerating the production of the crop.

allowed an additional import of 200 thousand nutrient tons of urea during *rabi* FY06 to keep check on prices by ensuring smooth supply and to avoid speculative trade. A total of 312 thousand nutrient tons of fertilizer has already been imported by September 2005. As a result, total urea availability is likely to be 2820 thousand nutrient tones for *rabi* FY06, as against an estimated urea consumption of about 2760 thousand tones. However, timely imports would be crucial to avoid possible shortages in December and January FY06.

At face value, the total availability of DAP at 841 nutrient thousand tons[5] during *rabi* FY06 seems quite substantial. However, it is only 19.3 percent higher than the offtake during *rabi* FY05, and the trend demand growth in recent years continues, the industry may require additional imports for the FY06 *rabi* season.

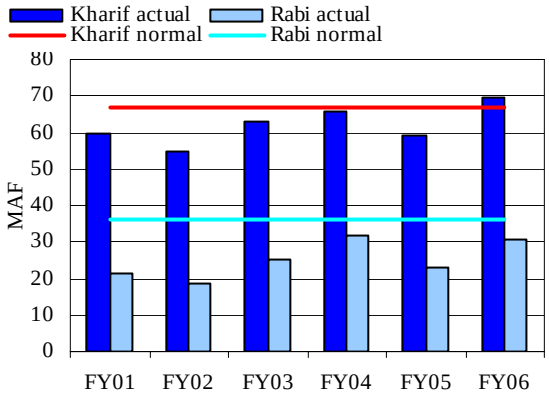
Figure 2.3: Trend in Rainfall



Water availability

As a result of heavy rains and snowfall, water availability during *kharif* FY06 was not only 18.1 percent higher than in *kharif* FY05, it reached above normal levels for the first time in six years (see **Figure 2.3**).[6] However, the picture is not so positive for *rabi* FY06. Although the heavy rains in Q1-FY06 has raised the estimated water availability for *rabi* FY06 by

Figure 2.4: Water Availability

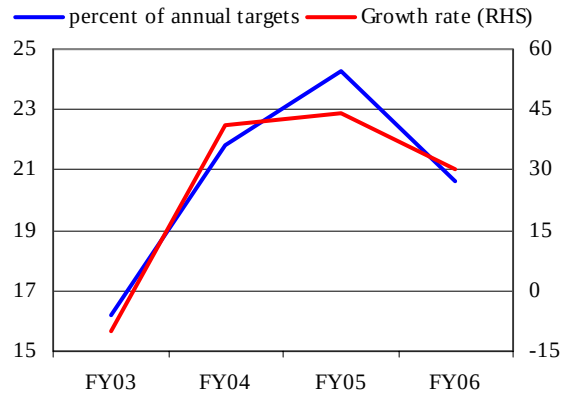


[5] The opening balance of DAP is estimated at 226 thousand nutrient tons for the *rabi* FY06 season, domestic production is likely to be 195 thousand nutrient tons. Moreover, DAP imports indicated by NFDC is about 420 thousand nutrient tons.

[6] Normal availability is the average water availability during 1996-2000 that is 103.5 MAF or the agreed availability of 103.6 MAF mentioned in the 1991 water accord.

32.8 percent YoY, it will nonetheless remain 15.8 percent lower than normal levels (see **Figure 2.4**).

Figure 2.5: Credit Disbursement in Q1

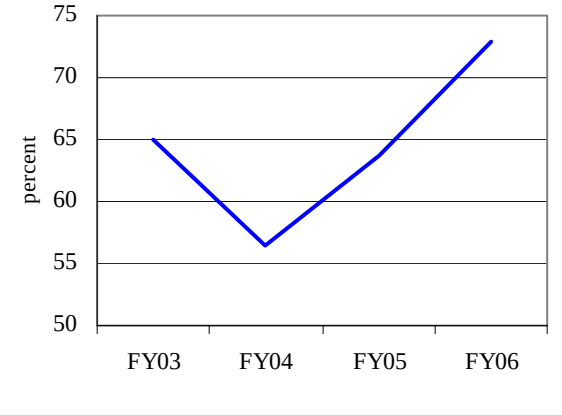


Agriculture Credit

The above-target agri credit disbursement of Rs 108.6 billion during FY05 provided the base to set a record Rs 130 billion target for FY06. However, the growth in agri-credit disbursment has slowed in FY06, pushing down the Q1-FY06 disbursement as percent of the annual target to 20.6 percent compared with a corresponding figure of 24.3 percent recorded in Q1-FY05, but it nonetheless remains a very robust 30.0 percent YoY (see **Figure 2.5**).

Also, quite encouragingly, the growth in recoveries is substantially higher than the growth in disbursements. As a result, the ratio of recovery-to-disbursement ratio rose sharply to 72.9 percent during Q1-FY06 compared with 63.7 percent in Q1-FY05 (see **Figure 2.6**). This improvement in recovery is expected to encourage banks to increase their agri credit operations in years ahead.

Figure 2.6: Recoveries as % of Disbursements

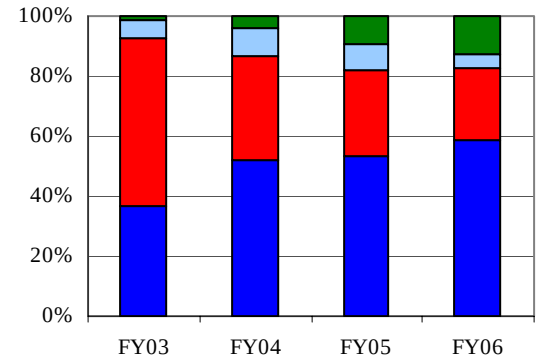


A possible reason for the rise in the receovery ratio is the increase in the share of commercial banks in the agri-credit market. A glance at **Figure 2.7** shows that the share of big five commercial banks (B5) and Domestic Private banks (DPBs) is increasing whereas that of specialized institutions (ZTBL and PPCBL) is declining.

Within the B5, National Bank of Pakistan and Habib Bank Limited are the mjor contributors with an over two-third of the total agri-credit disbursement in Q1-

FY06. Interestingly, the share of HBL increased during Q1-FY06, whereas the share of other banks either declined or remained unchanged. Amongst the DPBs, the share of three banks (Bank of Punjab, Bank Al-Falah and Askari Bank) in agri credit disbursement is a dominant 81 percent. This is mainly due to their aggresssive marketing and introduction of innovative products.

Figure 2.7: Contribution in Agri Credit



Tractor Financing

The amount disbursed for tractor financing exhibited a rise of 15.3 percent YoY during Q1-FY06 compared with an 11.1 percent YoY rise in Q1-FY05. The B5 banks and ZTBL together accounted for approximtely 89 percent of the total tractor financing during Q1-FY06.

Outlook for *Rabi* FY06

The latest available estimates[7] indicate that, so far, wheat cultivation has been completed on an area of 6.2 million hectares, which represents 74 percent of the FY06 target, and is 0.9 percent lower than that achieved in the corresponding period of FY05 (see **Table 2.4**). While Sindh recorded an increase of 12.9 percent in the area under wheat, this was offset by the Punjab and NWFP, which recorded declines of 1.2 and 6.9 percent YoY respectively. Late cotton picking, slow harvesting of rice and slow sugarcane lifting are the main reasons for the slowdown in wheat sowing in the Punjab. On the other hand, the shortfall in the NWFP may be attributed to the chaos caused by the earthquake that hit the region in October 2005. However, all in all, it is likely that the marginal decline in the areas under wheat may not threaten the prospects of the

Table 2.4: Area Under Cultivation
thousand *hectares*

	Punjab	Sindh	NWFP	Balochistan	Total
FY04	6256	878	742	335	8210
FY05	6379	887	767	326	8359
FY06 T	6403	900	767	345	8415
FY05 Dec.	5034	373	667	205	6279
FY06 Dec.	4975	421	621	205	6222
percent change	-1.2	12.9	-6.9	0.0	-0.9

T=Target.

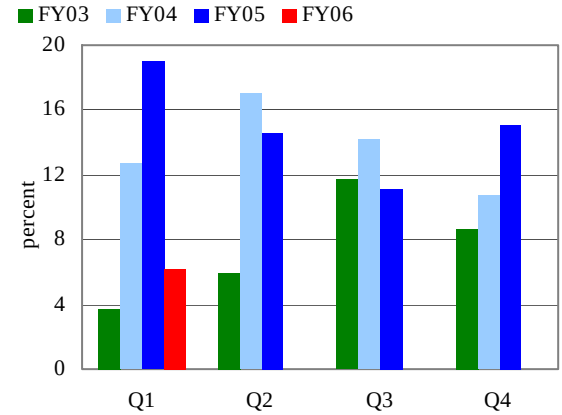
[7] As of December 3, 2005.

wheat crop, given the likelihood of adequate fertilizer availability, the timely announcement of support prices, ample agricultural credit and improved water availability.

2.2 Industrial Production[8]

The *Index of Industrial Production* (IIP[9]), indicates that industrial growth weakened during Q1-FY06, registering a single digit growth of 6.1 percent, in contrast to the 19.0 percent growth witnessed during Q1-FY05. In fact, the Q1-FY06 industrial growth indicated by the IIP is not only lower than the 9.6 percent target for the year, it is the lowest quarterly growth since Q2-FY03 (see **Figure 2.8**).

Figure 2.8: Growth in Industrial Production (IIP)



The slowdown in the Q1-FY06 individual growth rate was visible in all three sub-sectors of the IIP i.e. *LSM*, *electricity generation* and *mining & quarrying*, but the biggest contribution was from LSM. This was caused by a number of factors, including a high base effect, capacity constraints, etc. (for details see **Section on capacity utilization)**.

Similarly, the deceleration in *mining & quarrying* was mainly the result of weak production of gas & coal as well as a reduction in crude oil production, which declined by 1.1 percent in the first quarter of FY06 as compared with a 5.0 percent growth during the same period of FY05. Finally, *electricity generation* sub-sector recorded a lower growth of 0.9 percent YoY in Q1-FY06 as against a 5.4 percent YoY growth during the first three months of FY05. The slowdown in electricity generation is, however, puzzling given that the overall *electricity generation* by WAPDA rose by 9.4 percent[10] YoY during the Q1-FY06 as compared to the

[8] This analysis is based on the provisional data on *large scale manufacturing* (LSM) supplied by the Federal Bureau of Statistics.
[9] IIP is used as a proxy for industry to estimate the industrial production.
[10] Though, data on electricity generation by KESC are not available, its sale figures indicate a rise of 9.9 percent during Q1-FY06.

corresponding period of previous year. While during Q1-FY06 the thermal generation decreased by 8.1 percent YoY, hydel generation witnessed a significant rise of 31.8 percent YoY, reflecting the improved water situation in the country.

Infrastructure Industries[11]

The Index of Infrastructure Industries output, a combination of seven industrial sub-sectors, registered a 0.9 percent fall during Q1-FY06 as against a rise of 9.8 percent during the corresponding period of the previous fiscal year (see **Table 2.5**). Though, all sub-sectors of infrastructure industries exhibited a lower growth in Q1-FY06, the trend reversal is mainly attributed to a sharp decline of 57 percent YoY in the basic metal industries.[12]

Table 2.5: Growth in Infrastructure Industries (Q1)

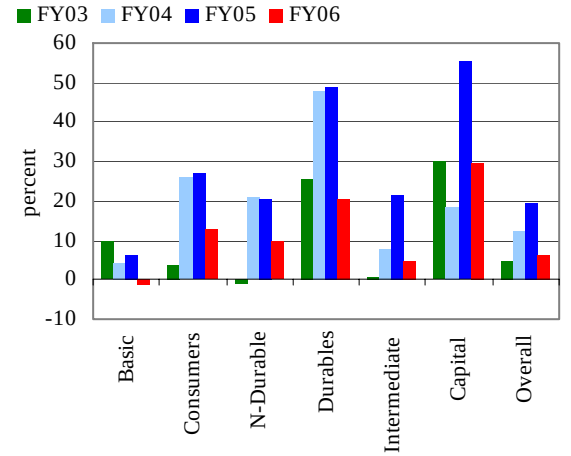
percent

Industries	FY05	FY06
Power	5.4	0.9
Natural gas	20.7	2.7
Crude oil	5.0	-1.1
Coal	17.3	4.5
Basic metals	-0.2	-57.0
Cement	17.2	14.6
Petroleum	17.2	1.3
Overall	9.8	-0.9

Analysis of Industries by End-Use (UBQI)[13]

During Q1-FY06, the User Based Quantum Index (UBQI) recorded a growth of 6.5 percent YoY growth, which is significantly lower than the 19.3 percent growth registered during Q1-FY05 (see **Figure 2.9**). The weakness in the various sub-indices of the UBQI reflects the trend seen in the *LSM* and *mining & quarrying* sub-sectors. While *consumer goods, intermediate*

Figure 2.9: Industrial Production by End-use (Q1)



[11] The infrastructure industries comprise of power, coal, gas, metal, cement, crude oil and petroleum industries. These industries are almost 26 percent of the total industrial sector in Pakistan. This index is a leading indicator.

[12] The decline in the production of Pakistan Steel was due to problems with the function of one of the blast furnaces and coke-oven batteries.

[13] The UBQI covers about 62 percent of the industrial sector, with basic goods, consumer goods (durable & non-durables) and the capital goods.

goods and *capital goods* sub-indices recorded a deceleration in growth, the *basic goods* recorded a fall in output. The major reasons for the decline in the production of basic goods industries were the slowdown in electricity generation and a fall in the production of crude oil and coke.

Within *consumer goods*, the growth in the production of *non-durables* decelerated to 9.6 percent YoY in Q1-FY06, compared to the 20.4 percent YoY growth in Q1-FY05. While production growth accelerated in a number of these industries such as *vegetable ghee, tea (blended), beverages* and *pharmaceuticals*, the impact of this was offset by the significantly slower growth in the remaining industries (that account for 60 percent weight in *consumer non-durables*). While the growth in the production of *consumer durables* also fell sharply from the exceptional 48.8 percent in Q1-FY05, it nonetheless remained very strong at 20.6 percent YoY during Q1-FY06. The major drivers for the low growth in the production of *consumer durables* were deceleration in the production of *electronics & automobiles* sub-sectors (probably due to a high-base) and decline in the production of *rubber industry* during Q1-FY06 (in aggregate, these industries have an aggregate weight of approximately 86 percent in the *consumer durables* sub-index*).*

The *intermediate* goods industry recorded a modest growth of 4.8 percent during Q1-FY06 as compared with 21.2 percent YoY growth seen during the first quarter of FY05. The deceleration was mainly due to the fall in the production of *iron & steel* as well as slower production growth in *textiles, chemicals* and *fertilizers* (the latter industry faces capacity constrains in increasing the production of urea).

The *capital goods* production recorded a29.7 percent YoY growth during Q1-FY06 mainly due to the continued demand for *trucks, electric meters, electric motors and engineering goods*. While this growth is substantially lower than the 55.6 percent recorded in Q1-FY05, it must be noted that the latter is higher only because of the low production base in FY04.

Large Scale Manufacturing (LSM)

During Q1-FY06 LSM grew by 8.7 percent, substantially lower than 24.9 percent YoY growth recorded during the corresponding period of FY05, and also well below the average for FY02-05 (see **Figure 2.10**). While the deceleration in LSM growth is not unexpected, given the high base set by the exceptional FY05 performance and capacity constraints faced by some industries, the Q1-FY06 is a source of some disquiet as it is far below the 13 percent YoY annual growth target. LSM performance will have to improve substantially in the succeeding quarters if this target is to be met.

As seen in **Table 2.6** & **2.7** the deceleration in LSM growth is quite broad-based. While a majority of sub-sectors (accounting for 54.0 percent of the LSM) had seen growth accelerate in Q1-FY05, growth in a majority of sub-sectors (with a dominant share of 83.8 percent) has decelerated in Q1-FY06. This picture is reinforced by the distribution of the growth rates as well. In particular, the number of sub-sectors witnessing growth in excess of 10 percent has fallen from 11 (with 84.8 percent share in LSM) in Q1-FY05 to 8 (with a 26.5 percent share in LSM) in Q1-FY06.

Figure 2.10: Growth in LSM Index (YOY)

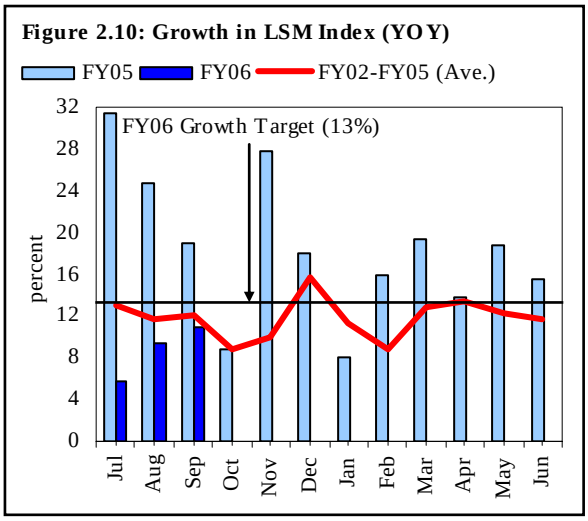


Table 2.6: Growth Performance of Selected Industrial Groups (Q1)

FY06						FY05					
Acceleration in growth		Deceleration in growth		Decline in growth		Acceleration in growth		Deceleration in growth		Decline in growth	
1	Leather	1	Textile	1	Tyres & tubes	1	Textile	1	Food, beverages & tobacco	1	Leather
2	Paper & board	2	Food, beverages & tobacco	2	Metal industries	2	Petroleum	2	Pharmaceuticals		
3	Engineering	3	Petroleum			3	Fertilizers	3	Chemicals		
4	Pharmaceuticals	4	Chemicals			4	Electronics	4	Automobile		
		5	Automobile			5	Engineering	5	Metal industries		
		6	Fertilizers			6	Tyres & tubes	6	Paper & board		
		7	Electronics			7	Wood				
		8	Non metallic			8	Non metallic				
		9	Wood								

One of the stronger contributions to the deceleration in LSM growth is from the textile sector. During Q1-FY06, the textile sub-sector recorded 7.2 percent YoY growth as against 29.6 percent YoY growth in Q1-FY05. A part of this fall in the Q1-FY06 growth rate reflects a base effect of the exceptional Q1-FY05 growth, and this impact is compounded by the smaller FY06 cotton crop. This is particularly visible in the cotton ginning industry where growth slowed from a robust 45.3 percent YoY in Q1-FY05 to a mere 2.8 percent YoY in Q1-FY06 (see **Table 2.8**).

Table 2.7: Distribution of Sectoral Growth Rates (Q1)

number

	(-ve)	0-5%	5-10%	10-15%	15-20%	20% and above
FY02	3	5	2	1	1	3
FY03	4	3	1	4	0	3
FY04	1	1	2	2	3	6
FY05	1	3	0	3	3	5
FY06	2	1	4	2	4	2

Table 2.8: Textile Production (Q1)

Items	Units	Weights in LSM	FY04	FY05	FY06	Growth rate	
Cotton yarn	000' Tonnes	13.1	487.0	570.5	622.6	17.1	9.1
Cotton cloth	million Sq.m	7.5	159.5	229.9	244.1	44.1	6.2
Cotton (ginned)	000' Tonnes	3.4	427	621	638	45.3	2.8
Woolen & carpet yarn	Tonnes	0.3	647	628	718	-2.9	14.3
Jute goods (total)	000' Tonnes	0.2	24.3	25.8	25.0	6.0	-4.6
Knitting wool	Tonnes	0.0	899	843	850	-6.2	0.8

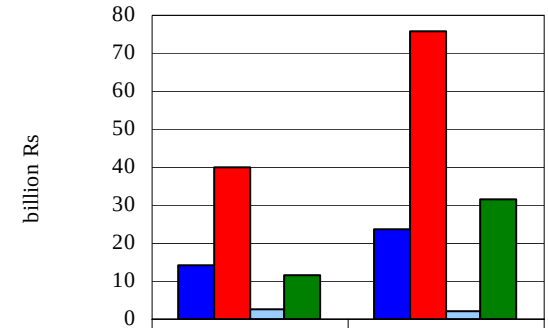
Encouragingly however, textile exports continue to perform well, with strong increases in the quantum of exports compensating for lower prices to push up the value of textile exports during Q1-FY06 by 23.8 percent YoY against a modest 1.5 percent growth in the first quarter of FY05. It is particularly heartening to note that this growth has been achieved despite significant challenges faced by exporters, including rising financial costs, loss of preferential access, etc. Clearly, the domestic textile industry has benefited somewhat from the end of exports quotas in the post-MFA period (i.e. January 2005 onwards), raising hopes that the performance of the sector will improve in succeeding quarters.

As with textiles, the automobile sector also witnessed a deceleration in growth. During Q1-FY06, the sectoral growth fell to 32.3 percent YoY, down sharply from the 40.2 percent YoY increase seen in Q1-FY05. However, even this lower growth was amongst the strongest for any LSM sector in FY06.

The remarkable growth of automobile sub-sector is driven by both, rising demand and increased supply. The continuing demand is led by the availability of credit (particularly supporting car sales and tractors), and strength of the domestic economy (supporting the sales of trucks and buses), while rising supply mirror increased investment in the preceding years.

- Though, auto financing extended during Q1-FY06 at Rs 9.8 billion is considerably lower than Rs 12.4 billion in Q1-FY05, auto-financing continues to play a major role in the growth of automobile sub-sector (see **Figure 2.11**).
- Indeed, although auto manufacturers expand production capacity[14], capacity utilization nonetheless rose by an impressive 16.1 percentage points in Q1-FY06.

Figure 2.11: Outstanding Consumer Loans (Q1)



	FY05	FY06
Credit cards	14.5	23.6
Auto loans	40.2	75.7
Home appls.	2.4	2.0
House fin.	11.5	31.3

Within the automobiles sector, the production of trucks saw a remarkable 165 percent YoY growth during Q1-FY06 as against a decline of 12.9 percent in the first quarter of the preceding year. The reason for this extraordinary growth of trucks was the initiative of the production line of Dong Feng trucks by Sindh Engineering (Pvt) Limited. Similarly, the production of light commercial vehicles (LCV) witnessed growth of more than 58 percent YoY in Q1-FY06, as compared with 84.9 percent YoY growth during Q1-FY05. The high growth rates in both years reflect the increasing production by two new entrants, capacity expansions by incumbent producers, as well as the availability of bank credit for purchases.

Similarly the growth in the output of *cars & jeeps*, though decelerated, was a robust 29.5 percent YoY in Q1-FY06 as compared with a growth of 36.4 percent YoY during the same period of FY05. Interestingly, during the last three years the

[14] During Q1-FY06, the industry attracted FDI of US$ 8.1 million.

share of high engine capacity cars (1000cc and above) in total sales rose from 39 percent to 44 percent. The production of *motorcycle & auto rickshaw* industry was also strong, rising by 29.4 percent YoY in Q1-FY06 as against 51.6 percent YoY in the first quarter of the preceding year. The expansion in production capacity by one manufacturer of cars and one in motorcycle & auto rickshaw was the main contributing factors for these growths.[15]

As in the *automobiles* sector, consumer financing continued to play an important role in the demand for *electronics products*. Production registered an increase of 9.8 percent YoY during Q1-FY06 as against a significant 71.3 percent YoY increase in Q1-FY05. This lower growth is a function of high base effect, and possibly weaker demand following rising interest rates.

The leather products sub-sector witnessed a 17.9 percent remarkable growth rate during Q1-FY06 in contrast with a decline of 8.8 percent in first three months of last year. This performance was the outcome of the fulfillment of demand of the manufacturers-cum-exporters of leather products for the levy of a 20 percent export duty on the raw-hides and skins of web blue leather.[16] This levy increased availability of raw material at lower cost, and improved the export competitiveness of the industry. This is reflected in a 40.9 percent rise in leather exports during Q1-FY06 compared with 4.6 percent YoY growth in exports during the same period last year. The production of leather footwear, leather sole and upper leather registered a quick turnaround from a decline of 16.2 percent, 10.0 percent and 6.6 percent in Q1-FY05 to a growth of 18.6 percent, 11.1 percent and 19.9 percent YoY respectively during Q1-FY06.

The production of *food, beverages & tobacco* group, witnessed considerable growth on account of the acceleration in the production of *vegetable ghee, blended tea and beverages* sub-sectors, which have a 33.7 percent share in the *food* group. During Q1-FY06 food sub-sector recorded 10.0 percent YoY growth as compared with a 13.5 percent YoY in Q1-FY05. Within the *food group,* the *vegetable ghee* industry registered 12.2 percent growth in Q1-FY06 as against a modest growth of 5.8 percent in Q1-FY05. The main reason for the growth in the production of

[15] Indus Motors Company Limited and Pakistan Cycle Industrial Cooperative Society Limited (Sohrab) made expansion in production capacity of cars and motorcycles by 16000 and 18000 units respectively.

[16] Government had provided many incentives to the *leather* industry, which would help exporters to export more leather & leather-made goods; (1) removal of sales tax on leather exports, (2) reduction in income tax from 6 percent to 1 percent, and (3) cut the customs duties on the import of 95 percent of the chemicals used as raw material by leather goods' manufacturers.

vegetable ghee was a rise in the exports to Afghanistan, which increased by 7.8 percent YoY during the first three months of FY06. Amongst the food sub-sector, the weakest growth was observed in cigarettes industry with 0.5 percent YoY growth during Q1-FY06 in contrast with 8.1 percent YoY growth in Q1-FY05, The deceleration in tobacco industry was largely attributed to decline in the external demand for *tobacco* and *cigarettes*, which fell by 65.6 percent YoY during the first quarter of current fiscal year.

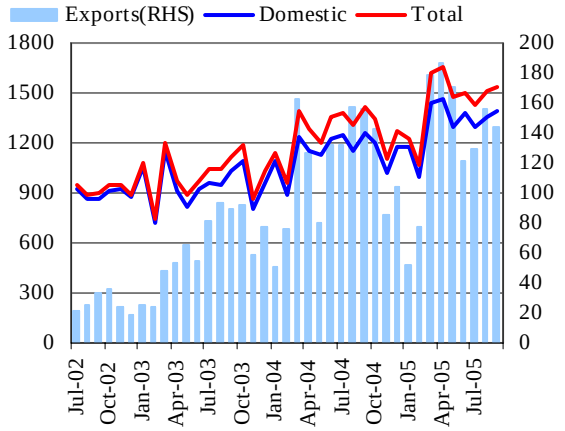
Table 2.9: Construction--Performance Indicators(Q1)

	Unit	FY02	FY03	FY04	FY05	FY06
Cement production	000' tons	2438	2607	3061	3587	4111
Production of steel (Pakistan Steel)	000' tons	222	250	256	271	93
Import of iron & steel	000' MT	425	317	416	708	863
Import of construction & mining machinery	billion Rupees	2.3	1.5	1.7	2.1	2.0
Private credit for construction	billion Rupees	27.4	12.9	15.0	20.8	34.4
Public sector development programm	billion Rupees	10.7	14.6	24.9	32.0	50.7

Construction-related industries such as *cement, paints & varnishes, wood, iron & steel* etc. exhibited a mix picture during Q1-FY06, as can be seen from **Table 2.9**.

The cement industry recorded a 14.6 percent YoY growth in Q1-FY06, which was less than 17.2 percent YoY growth during Q1-FY05 (see **Figure 2.12**). The local cement dispatches reached at 4.5 million tons during Q1-FY06 indicating a growth of 10.8 percent YoY compared to a 23.7 percent YoY growth of Q1-FY05. In contrast, exports of cement fell to 0.43 million tons, down by 3.4 percent YoY, despite a rise in exports to Afghanistan.

Figure 2.12: Cement Consumption (000' tons)



The rise in the production of *iron & steel* sub-group derived from the activities in *construction* as well as from the *automobiles* sub-sector. In Q1-FY06, the demand was met by 21.9 percent YoY rise in imports of *iron & steel* followed by a decline

in domestic production of metal industry by 62.1 percent. In contrast, the *paints & varnishes* industry witnessed a growth of 38.7 percent during Q1-FY06, slightly higher than 34.2 percent growth in the same period of the preceding year.

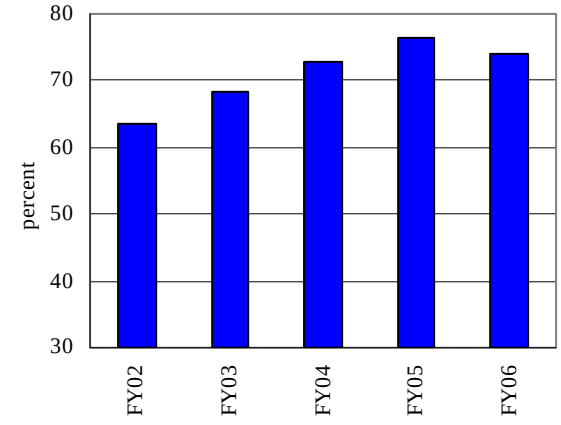
The *engineering* sub-sector has shown consistent acceleration in growth during the first quarter of the last three years from 13.6 percent in Q1-FY04 to 35.4 percent in Q1-FY06. This remarkable growth was attributed to rise in the production of *capital goods* such as *diesel engines, sugarcane machines, sewing machines, shuttles & bobbins* and *wheat thrashers,* which contributed more than 63 percent production in the engineering group. Within the engineering sub-sector, production of *diesel engine* recorded the extraordinary 98.1 percent growth during the first quarter of the current fiscal year as compared to 41.8 percent rise in Q1-FY05, mainly due to higher income of farmers and easier access to agri credit. The growth in *sewing machines* (18.2 percent) and *shuttles & bobbins* (19.4 percent) was attributed to 23.6 percent rise in the exports of *textile* sector especially of *readymade garments* (with 113.8 percent growth in external demand).

Pharmaceutical is another sub-sector that witnessed 15.7 percent growth during Q1-FY06 as against a modest growth of 2.1 percent in Q1-FY05 and also significantly higher than the 5.4 percent average growth during Q1-FY02-Q1-FY05. The rise in *pharmaceuticals* group came from the acceleration in almost all of its components on the back of rise in exports of *pharmaceuticals & chemical*[17] products..

Capacity Utilization in LSM

Apparently, , the average capacity utilization in LSM *declined* by 2.3 percentage points during Q1-FY06as compared with a *rise* of 3.6 percentage points during the same period of FY05 (see **Figure 2.13**). However, this fall is mainly due to a sharp decline in the capacity utilization by Pakistan Steel. In fact, average capacity utilization in LSM excluding Pakistan Steel witnessed a rise

Figure 2.13: Average Capacity Utilization in LSM during Q1



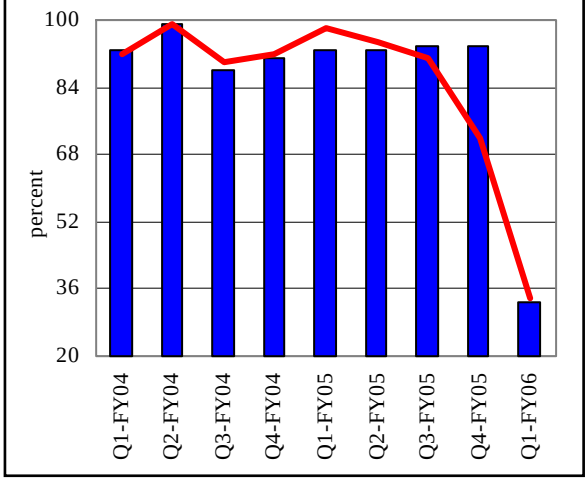
[17] Separate data on exports of these industries for Q1-FY06 is not yet available.

of 4.9 percentage points during Q1-FY06 compared with an increase of 3.0 percent in Q1-FY05. This seems even more impressive given that production capacity enhanced in various industries, reflecting increased investment in recent years (both domestic as well as foreign direct investment).

In particular, despite fresh additional capacity, a remarkable 16.1 percentage point expansion in capacity utilization was observed in the automobiles industry[18] especially in *cars, LCVs and motorcycles* which respectively saw year-on-year increases of 12.8, 32.2, and 13.8 percentage points during the quarter. Capacity utilization in the tractors industry also rose to almost 91 percent by the end of Q1-FY06, and this has attracted considerable attention from investors.[19]

Capacity utilization in the *electronics* industry stood at 26.8 percent during Q1-FY06, marginally higher than that seen in Q1-FY05. However, even this small increase is commendable given that a significant increase in the installed capacity took place during FY05.

Figure 2.14: Capacity Utilization of Pakistan Steel



During Q1-FY06 the capacity utilization in the *cement* industry fell by 4.5 percentage points to 73.7 percent relative to Q1-FY05. This drop in capacity utilization was due to the expansion in production capacity, on the back of strong domestic as well as external demand.[20]

[18] Indus Motors Company Limited, Pakistan Cycle Industrial Cooperative Society Limited (Sohrab) had made expansion in production capacity, while Adam motor limited and Master motor limited have commenced the production.

[19] With the assistance of investors from Romania and the United States, a local company Universal Tractor Pakistan (Pvt) Limited is setting up a new tractor manufacturing plant at Port Qasim. On completion, this will produce up to 8000 tractors per annum. The government has provided an incentive for new producers by allowing duty free imports of 2500 duty free tractors to new entrants. Three producers are expected to import 7,500 duty-free tractors under this scheme during FY06.

[20] Lucky Cement has begun the long-awaited commercial production of its third line of expansion project Pezu in Bannu Division of NWFP with the production capacity of 2,000 tons per day.

Similarly, *petroleum refinery* industry has also shown 3.5 percentage points decline in the capacity utilization during Q1-FY06 as compared with 7.8 percentage point's increase during the first quarter of previous year mainly due to expansion in production capacity[21] on the back of a11.9 percent YoY rise in foreign direct investment.

In Q1-FY06, the capacity utilization in Pakistan Steel Mills fell to 34.0 percent, which is 64.6 percentage points less than the capacity utilization during the corresponding period of FY05 (see **Figure 2.14**). The lower capacity utilization was due to the technical problem and outstanding repairable work in operational units, especially in coke oven batteries of the plants. The repairs are expected to be completed soon, ensuring higher capacity utilization in the subsequent quarters.

[21] ENAR has started production in current year.