THE STATE OF PAKISTAN'S ECONOMY
Second Quarterly Report for 2000/2001

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Overview

Pakistan's economic performance during the first half of the current fiscal year indicates two diverging trends. On the positive side, Pakistan formalized an agreement with the IMF in November 2000, it achieved most of the performance criteria for end-December, there was an amicable resolution of the Hubco dispute, and the authorities paved the way towards another round of debt rescheduling. These have helped improve the government's credibility with the international financial institutions, credit rating agencies and bilateral creditors. However, these developments will take time before they translate into higher investment. The government is still hoping that the special focus on the Oil & Gas sector, Information Technology and textiles, will see fresh investment in the near future.

Quarterly Economic Indicators

(Percent)

Growth rates	July-December		
	FY99	FY00	FY01
Large-scale Manufacturing[2]	3.6	7.8	3.1
Exports	-12.0	8.1	8.4
Imports	-19.9	11.7	10.2
Home Remittances	-35.4	-10.9	17.7
Tax Revenues	-1.0	20.8	13.5
CPI	6.5	3.4	4.9
Private Sector Credit	9.1	4.3	14.0
Money Supply (M2)	4.7	2.8	5.4
*As % of GDP**			
Trade deficit	3.6	2.3	1.8
Current a/c deficit	3.8	1.6	1.6
Fiscal Deficit	6.1	6.5	5.2

* Numbers relate to full year

More specifically, the forward linkages from investment in Oil & Gas should demonstrate the benefits of substituting from imported oil to natural gas within a

[1] Date of commencement: February 12th 2000. Date of completion: February 20th 2000.
[2] These numbers are internally reworked and differ from FBS data. See section on Large-scale Manufacturing for more details.

short period of time, if this conversion is undertaken soon. On the other hand, since the base of Information Technology is small and will require adequate infrastructure, the contribution of this sector to overall GDP and exports is likely to be negligible in the near future. On a more positive note, with the textile sector currently undergoing balancing, modernization, and replacement of its obsolete machinery, efficiency gains are expected within the next year. Having said this, the textile sector must gear up for greater international competition following the country's commitment to the WTO agreement.

On the negative side, higher than expected international oil prices, shortage of irrigation water, sharp depreciation of the Rupee, tight liquidity conditions in the banking system, and slowdown in the US economy, have put the desired rate of recovery at risk. Higher oil prices have strained the country's external reserves position, and forced a curtailment of non-oil imports. Insufficient rainfall resulted in a shortage of irrigation water, which has impacted the production of major crops (particularly rice and sugarcane), and will reduce rate of agricultural growth in FY01.

Depreciation of the Rupee in September 2000, has raised prices of imported inputs and final consumption goods during the first half of FY01, and is likely to stoke inflationary pressures in the next quarter; the sharp increase in the retail petroleum prices in end-December 2000 will add to this pressure. Looking at the world economy, the economic slowdown in the US and its implications for the global economy are likely to adversely impact demand for Pakistani exports. The intensity and duration of this slowdown are still unknown and therefore the impact is difficult to measure.

As against these elevated risks, there have been some mitigating developments. The manufacturing sector (excluding sugar) grew by 7.6 percent against 6.8 percent last year. Private sector credit seems to have overcome the nervousness of the last two years, and has reached its pre-1998 level. Export growth, although below the half-year target, has shown an increase in quantitative terms compared to last year. Had unit prices of textiles not declined this year, the actual outcome would have been closer to target.

On the basis of these developments, State Bank of Pakistan has revised its forecast of GDP growth in FY01 to slightly below 4 percent, compared to 4.5

percent projected in our last *Annual Report*. Recent fiscal data suggests that CBR has achieved 95 percent of the six-month target, and is short by just Rs 7.9 billion. Government expenditures have been curtailed by 1 percent of GDP, which means the fiscal deficit in the first half of this year is 2.2 percent of GDP less than last year. If this trend continues, the fiscal deficit target of 5.2 percent for the full year should be within reach.

The trade-off between harsh measures that seek to rectify deep-rooted structural problems in the economy and resumption of high aggregate growth is clear. These measures are painful but necessary to improve the country's productive capacity in the medium term. Unfortunately, past implementation of structural reforms has been piecemeal and incomplete, and this unpleasant experience is still fresh in the minds of economic agents. The current challenge facing the government is how to convince the public at large (and important opinion makers in the country) that these pains will, in fact, be compensated by better living conditions in the near future. Promises of such gains have not borne fruit during the last decade, while building up a track record and delivering results takes time.

2. Executive summary

For the sake of continuity with previous Quarterly Reports, the data presented will focus on the first half of FY01 (1H-FY01), but the analysis will concentrate on the second quarter of FY01 (Q2-FY01). Readers interested in the developments in the first quarter of FY01 should refer to SBP's first quarterly report for FY01. In overall terms, the important developments in Q2-FY01 can be categorized in the following areas: (1) agriculture, (2) money/credit, and (3) the external sector.

Agriculture

With the end of the *Karif* season in November, preliminary estimates for sugarcane and rice show that the targets set for FY01 were optimistic, while the base effect from last year will work against agricultural growth this year. Against original targets for FY01, preliminary estimates show a 19.1 and 11.4 percent *decline* in the production of sugarcane and rice (see **Table 1**). Amongst other factors, the main culprit is a shortage of irrigation water. Given the role of agriculture in Pakistan's economy, not just in terms of its share in GDP but also

the pass-through to the manufacturing and services sector, the estimate for aggregate growth has been revised downwards to less than 4 percent.

The persistent increase in the price of lint cotton during the first half of FY01 reflects a stronger link with international prices (see **Figure 7**). Unlike the sharp fall in domestic prices last year, which was driven by a supply overhang that had been built up on account of the uncertainty in the government's stance on support prices, there is a clear policy this year. In effect, the desperate selling last year forced down prices, while the upturn in international prices has pushed up lint cotton prices in the domestic market. In a related development, as opposed to what happened during this period last year, when abnormal profits accruing to the textile sector encouraged self-financing, Q2-FY01 witnessed a sharp increase in bank credit availed by the textile sector. Although this sector is still buoyant as shown by the quantitative increase in Pakistan's exports, adverse international prices continue to undermine export revenue growth.

Money & credit

In the financial sector, three inter-related developments need to be highlighted: (1) the sharp increase in private sector credit, (2) the shifting pattern of government borrowing from the banking system, and (3) the tight Rupee liquidity conditions during the course of Q2-FY01.

Private sector lending

In terms of the sharp increase in private sector lending during the first half of FY01 (from Rs 24.4 billion in 1H-FY00 to Rs 80.6 billion), there are two mutually exclusive reasons for this – an increase in borrowing by the textile sector, and lower *gross* lending by commercial banks during FY00 (see **Table 5**). As stated above, the increase in the price of lint cotton coupled with greater comfort in borrowing from banks, resulted in a sharp increase in net credit availed during the last quarter.[3]

In analyzing the sharp increase in private sector lending this year, it is important to realize that this includes both gross lending by banks and repayments on past

[3] In terms of working capital loans, against net lending of Rs 11.7 billion in the first half of FY00, the textile sector borrowed Rs 25.3 billion in the corresponding period this year.

loans. Since gross lending (actual loans sanctioned by banks) was hit last year by both the perceived threat of accountability and greater profitability of the textile sector, net lending fell sharply during FY00.[4] Therefore, repayments on private sector loans this year are much lower than previous years. With normal fresh lending during the first half of this year, *net* lending to the private sector has posted a very sharp increase. In effect, the outstanding volume of bank credit used by the private sector has increased this year.

Government borrowing

Although the end-December 2000 figure suggests that the government relied less on the banking system to finance its fiscal deficit, this is not factually the case. Against net borrowing of Rs 12.9 billion during the first half of FY00, bank borrowing in the corresponding period this year was actually negative Rs 9.4 billion (see **Figure 1**). The reasons for this capture the real difference this year. In broad terms, the change in the government's borrowing patterns from the banking system can be traced to three inter-related factors: (1) IMF targets that are part of the Stand-By Arrangement (SBA), (2) an abrupt change in SBP's monetary stance in late September 2000, and (3) a systemic shortage of liquidity in the banking system.

Looking at the impact of IMF targets on government borrowing, **Figure 1** shows that while GOP borrowed less from the banking system during FY01 compared to the corresponding period last year (looking at end-December figures), the path of government borrowing reflects another picture. Borrowing from the banking system during the course of 1H-FY01 was *actually* higher because non-bank borrowing (from NSS) and external financing (from Special US Dollars Bonds and other sources) this year were much lower than last year.[5] Despite a tighter fiscal deficit target in FY01, the fact that net inflows from NSS have fallen while frozen FCAs are not being converted into Special US$ Bonds at the same pace as last year, forced the government to rely more on bank borrowing. The inability

[4] This was because while gross (fresh) lending fell last year, repayments (on loans issued in FY99) continued.

[5] Against net inflows of Rs 35.1 billion in the first half of FY00 (from NSS and Prize Bonds), mobilization from non-bank sources in the corresponding period this year was only Rs 14.0 billion. Having said this, net inflows of Rs 14.4 billion from the sale of PIBs was only realized in December & therefore did not impact the government's credit needs till the end of the calendar year.

to meet the IMF's performance criteria for revenue collection during 1H-FY01 only compounded the government's credit needs.

The other issue that impacted the pattern and volume of government borrowing were certain abrupt changes in SBP's monetary stance. The increase in cash reserve requirements (CRR) from 5 to 7 percent on October 7th was done to quell the panic in the foreign exchange market. Although designed to halt speculative activity that had triggered a free fall of the exchange rate[6], it also ushered in a period of liquidity shortage that was to remain for the rest of the quarter. With banks seeking SBP liquidity for most of the quarter (with the exception of 9 days in early-December), this respite was short lived as SBP had to prepare the commercial banks to take on a large fraction of government debt from SBP. In view of the acute liquidity shortage in the banking system, there were concerns whether SBP could in fact transfer this debt to commercial banks. With two weeks to meet SBP's NDA target (see section on money market), the central bank had to transfer Rs 89.6 billion of government debt to commercial banks.

Rupee liquidity

The systemic shortage of Rupee liquidity *also* ties in with the changing pattern of government borrowing discussed above. More specifically, it can be traced to four distinct factors: (1) actions taken by SBP during the course of Q2-FY01, (2) the unanticipated increase in demand for currency, (3) higher than expected private sector credit demand (which has already been discussed), and (4) the inability of banks to retain (or grow) their Rupee deposit base.

Actions taken by SBP

Although banks took over two months to overcome the shortage created by the increase in CRR in October, as stated earlier, this respite was short-lived. Given the magnitude of the liquidity shortage in the market, the central bank took the following steps to shift government borrowing to commercial banks:

[6] Although it is a well established fact that there is a stubborn imbalance in Pakistan's external account, it is SBP's view that this structural imbalance cannot be rectified by a price (exchange rate) adjustment. In effect, without quelling the panic in the foreign exchange market, there was a real fear that the Rupee would experience a free fall. Given the degree of skepticism in Rupee savings since residents can save in foreign exchange (coupled with the consistent depreciation of the Rupee during the 1990s), this free fall had to be avoided to ensure individual depositors do not return to Dollarization.

- SBP temporarily converted 2 percent of CRR into 1-month T-bills in mid-December;
- Special deposits placed with SBP (against rescheduled FE 45 swap funds) were also converted into T-bills (in the last week of December) for a period ranging from 1-week to 1-month depending on the bank's preference; and
- The discount window was closed on 31st December, since any liquidity provided by the central bank is treated as fresh lending to commercial banks, which increases SBP's net domestic assets.

Demand for currency

Although there is an increase in demand for currency that coincides with the surge in private sector lending, the increase in the past two years has been abnormally high. As argued in the detailed text, an increase in currency in circulation is driven by demand factors, which suggests that the growth witnessed in the second quarters of FY00 and FY01 (at Rs 53.4 and Rs 70.8 billion, respectively – **see Figure 3**), against more tempered growth in the past, deserves an explanation.[7]

The bulk of the increase in currency demand this year is on account of the sharp rise in net private sector borrowing and the fact that Eid fell in the last week of December. Last year, however, the increase was not on account of these reasons, but due to the uncertainty following the change in government in October 1999, specifically the threat of the accountability drive. This year, the increase in currency demand is too sharp to be justified by these reasons alone. It is the market view that the preannounced decision to impose UN sanctions on Afghanistan in December 2000 may be playing a role in the increase in demand for Pakistani Rupees. Since the sanctions are likely to erode the value of the Afghani, the Pak Rupee may be taking over as a medium of exchange. If Rupee notes are being used as currency in Afghanistan, this implies that the magnitude of the seasonal fall in currency demand may not materialize as it had in the past.

Contrary to popular opinion, an increase in currency in circulation does not mean greater liquidity in the system – in fact it goes the other way. If people are

[7] The role of Eid needs to be highlighted. With the exception of this year, the last three years have seen Eid falling due in January, which creates a seasonal increase in currency in circulation.

hoarding currency notes, this means liquidity is not returning to banks, which simply compounds the shortage facing the banking system in Pakistan.

Deposit mobilization

Despite the liquidity squeeze imposed on the banking system in early October 2000, and the fact that banks remained tight for almost the entire second quarter of FY01, important players in the banking system did little to improve their Rupee deposit base (see **Special Section 2**). This lethargy is even more surprising given the 2.9 percentage point increase in T-bill rates at the beginning of Q2-FY01. An efficient monetary transmission mechanism means that changes in T-bill rates are reflected in equivalent changes in bank lending/deposit rates after a brief time lag. Although it has been over 4 months since T-bill rates were increased, banks have allowed their deposit rates to fall since end-June 2000, and have therefore not managed to shore up their Rupee deposit base.

Although bankers claim that their deposits are interest rate insensitive (especially Rupee deposits), the fact that these banks were willing to borrow short-term liquidity from SBP at penal rates, as opposed to taking concrete steps to increase deposit mobilization, does not speak well for the strategic management of these banks. Although a certain degree of insensitivity may arise because of the demand for Rupees outside Pakistan, banks must step up their efforts to lure in Rupee deposits. This is especially relevant in the remaining part of the year, when the private sector begin to retire its credit and liquidity returns to the banking system. Commercial banks must realize that while the period ahead may not be as tight as it was in the second quarter, the NDA target that created an unprecedented liquidity shortage in December 2000, is actually more binding for end-March. Banks must begin to gear up for this.

External sector

The second quarter of FY01 continued to experience problems, as liquid reserves were pressurized largely because of oil payments. Although there was a great deal of volatility in the international oil prices during the first half of FY01 (see **Figure 8**), the average price trend in this period was stagnant. However, since there is a 3-month time lag for oil prices to actually impact oil payments, and international oil prices posted a very sharp increase since early April 2000, Pakistan's oil import bill increased from US$ 1.2 billion in 1H-FY00 to over

US$ 1.8 billion in the first half of this year. Despite per-unit price increases of 28.5 and 43.7 percent for crude and petroleum products, respectively, quantitative imports of petroleum also increased by 10.4 percent. Given the uncertainty of the movement of international oil prices, and recent indications that this may remain at current levels, some mechanism must be devised to contain domestic consumption when prices rise. Nevertheless, total imports increased by only US$ 500 million in 1H-FY01 relative to the year before, a clear indication that non-oil imports had to be curtailed to ensure that import financing does not further deplete Pakistan's liquid reserves.

In terms of exports, international prices once again worked against the country. Although total export value increased by US$ 345.4 million in the first half of FY01 (to US$ 4,473.8 million – see **Table 14**) relative to the same period last year, textile exports only increased by US$ 88.0 million. Even in this category, looking at the four largest export items (fabrics, yarn, knitwear and garments), three posted a fall in unit prices while all four showed positive growth in quantities. The real improvement took place in manufactured leather and carpet exports, with these two largest non-traditional exports showing impressive growth of 31.1 and 8.8 percent, respectively.

Looking at actual net foreign exchange flows into SBP, the trade deficit narrowed by US$ 257 million to US$ 763 million during 1H-FY01. As shown in **Table 12**, this is the third consecutive year where the trade deficit has fallen, a clear reflection that despite upward pressure on oil prices, Pakistan's economic managers have managed to live within the constraints imposed after the international sanctions in June 1998. This is more impressive when one looks at the current account deficit, which fell from US$ 1.5 billion in 1H-FY99 to US$ 681 million in the corresponding period this year. Stronger remittances and higher outright purchases have helped narrow Pakistan's *actual* foreign exchange gap.

Despite some financial assistance from the IFIs during the second quarter of this fiscal year, total reserves only increased by US$ 85.3 million, while unencumbered reserves (excluding FE 13 deposits) increased by just US$ 23.9 million. This is because outright purchases are used to top up reserves, which are depleted on account of oil and debt payments; in fact, SBP had to step up purchases from the kerb market this year to finance higher oil payments. Since

SBP was accommodating these payments directly, the Rupee managed to maintain some semblance of stability despite oil payment pressures.

To conclude this summary, one interesting observation is the negative correlation between the official exchange rate (FIBR) and the kerb premium (see **Figure 1.1**). As discussed in **Special Section 1**, this negative correlation suggests that the kerb rate *responds* to changes in the interbank rate. In fact, we have shown that before the introduction of the composite exchange rate in July 1998, the kerb rate would lead (Granger cause[8]) the official rate. This means that before the floating exchange rate regime, if the kerb premium began to rise, this would put pressure on SBP to devalue the Rupee. Since the introduction of the composite exchange rate, but more specifically since the free float in July 2000, it is the interbank rate that now leads the kerb rate. More simply, changes in the official rate now *cause* a change in the kerb rate. This suggests that the kerb rate is not as accurate an indication of supply/demand shifts as one would have thought. More specifically, the sticky nature of the kerb rate is clearly shown after October 2000, where changes in the interbank rate are almost mirror reflected in the kerb premium (see **Figure 13**). This suggests that the kerb rate adjusts to changes in the official rate with a certain time lag.

[8] This refers to a rigorous statistical test whereby it is possible to test the causality between two variables. More specifically, it is able to identify if one variable *instigates* a corresponding movement in the other.

3. Real Sector

3.1 Agriculture

The latest data on agriculture indicates lower than targeted growth in most of the major crops during first half of the current fiscal year (see **Table 1**).[9] Amongst *kharif* crops[10], sugarcane and rice, registered a decline in area under cultivation as well as production; Cotton, recorded a slight increase of 1.5 percent in area under cultivation compared to the target, but the production is provisionally estimated at 10.6 million bales, which is fairly close to the target of 10.7 million bales. The output of sugarcane and rice registered a considerable decline of 19.1 percent and 11.4 percent, respectively.

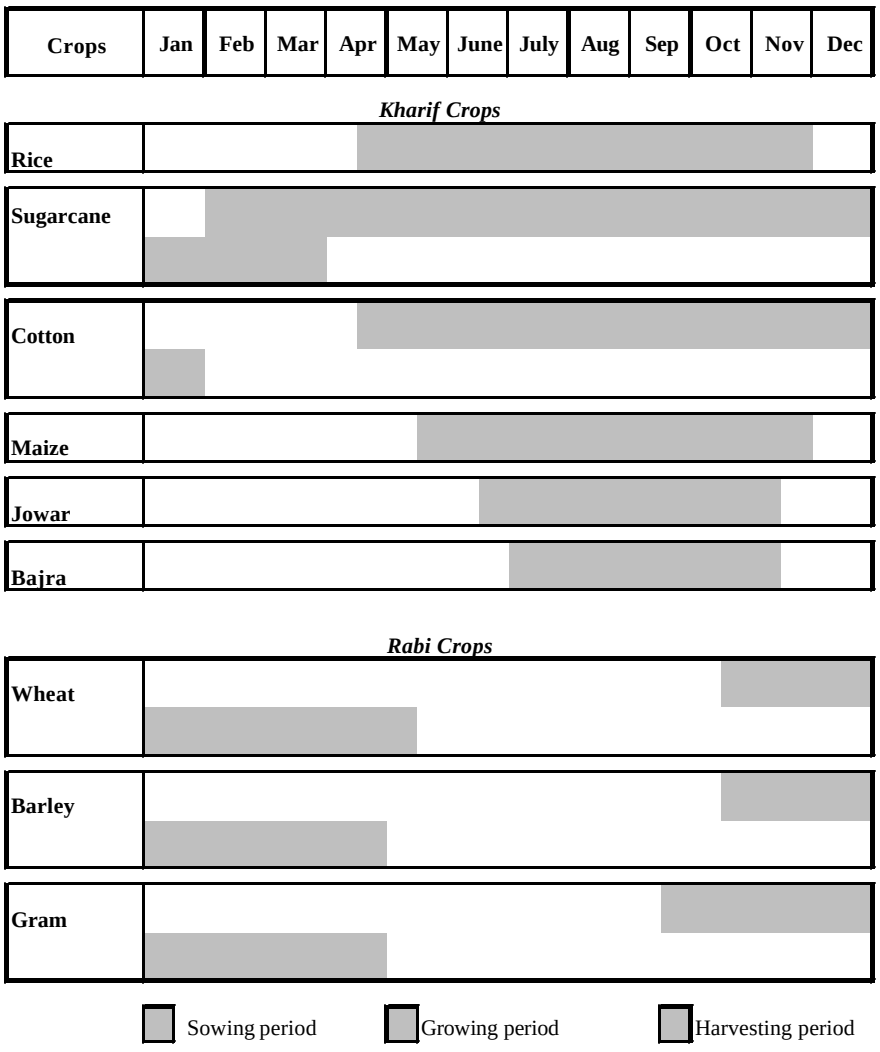
This deficit in the production of major crops is primarily on account of the ambitious targets set for FY01. The sugarcane target was fixed at 51.7 million tonnes, which is close to the average production in the last three years, two of which were record production. Similarly, rice was targeted at the previous year's record production of 5.2 million tonnes. Farmers were forced to bring less area under sugarcane and rice due to the continued shortage of irrigation water. It is estimated that canal water flows in Punjab were 15 percent lower during April-July 2000 compared to the corresponding period last year. Sindh was hit badly, and the area under rice crop declined 22.4 percent, and that under sugarcane by 4.8 percent.

In Punjab, which accounts for almost 60 percent share in total production, sugarcane was sown on 581 thousand hectares against a target of 650 thousand hectares. Due to canal water shortages, following lower rainfall, and Wapda's move to metered consumption of electricity (as opposed to a flat rate tubewell), the crop suffered a severe shortage of water. The attack of pyrilla virus also

[9] Availability of data on agriculture sector with State Bank during any fiscal year is limited to major crops only. As of end December, i.e. by close of second quarter, provisional estimates are available in the Bank on production of major kharif crops (rice, sugarcane, cotton and maize with a combined weight of around 26.4 percent in agriculture sector). Estimates on production of major rabi crops (wheat, barley, gram and tobacco, with combined weight of 14.6 percent in agriculture sector) are available by end April.

[10] Please see **(Chart 1)** for a composition and seasonality of major *kharif* and *rabi* crops.

Chart 1: Crops Calender of Pakistan



Adapted from "Crops of Pakistan" a book published by Muslim Commercial Bank Limited

affected the crop in some areas. However, production in NWFP, with 10 percent share in total production, was close to the target.

With around 47 percent share in total production, area under rice cultivation in Punjab also registered a 4.1 percent fall against the target for FY01. Overall, there was an 11.4 percent fall in the size of the rice crop.

At present, two major crops of the *rabi* season, wheat and gram, are currently under cultivation. Provisional estimates of wheat, based on area under cultivation and availability of other inputs, limit the size of the expected crop to 18.8 million tonnes against the Annual Plan target of 20.5 million tonnes. The carry over reserves from the last crop, and the current year's output will be able to meet the consumption needs of the country.

Although there has been a marginal increase in area under cultivation for wheat (from a target of 6.08 million hectares to 6.12 million hectares) in Punjab, this was more than offset by a shortfall fall of 0.33 million hectares in Sindh. The main reason for this decline was once again the same - the acute shortage of irrigation water in Sindh. In addition to this, higher prices of DAP (Di-Ammonium Phosphate) will compel farmers to use less fertilizer this year.

Production of gram is expected to improve marginally if rain is forthcoming. The size of the crop has been estimated at 700 thousand tonnes against an Annual Plan target of 772 thousand tonnes.

Following the European Union's up-gradation of Pakistan seafood exports, by placing its name on the harmonized countries' list, anecdotal evidence suggests that production in this sub-sector of fisheries has risen. This improvement was made possible by the government's efforts along with exporter initiatives. Due to better hygiene conditions at harbors and improved seafood processing procedures, the number of certified seafood units allowed to export to the European Union, has increased from seven at the end of FY00 to eleven by end-December 2000; certification for another three is underway.

As cotton, sugarcane, rice, wheat and gram together account for around 94 percent of the production in major crops, and 40 percent of the value addition in agriculture, these shortfalls in their output will have a large adverse impact on

the agriculture sector. Consequently, aggregate economic growth rate will also slide downwards from the postulated level.

However, it should be noted that irrespective of the expected decline in agricultural produce, demand for food grains will be met through domestic sources and there exists, as such, no threat to national food security. If any imports are made, this would only be to maintain buffer stocks.

3.2 Large-scale Manufacturing[11]

Growth Rates in LS Manufacturing

(Percent)

	1H-FY00	1H-FY01
Overall Growth	7.8	3.1
Excluding Sugar	6.8	7.6
Trimmed Growth	8.9	5.3

Compared to 7.8 percent growth during the first half of FY00, large-scale manufacturing only grew by 3.1 percent during 1H-FY01. Given its overall weight in GDP and the slowdown of growth, the manufacturing sector will also contribute to the downward adjustment in aggregate growth in FY01. However, once again, sugar production played an adverse role: excluding sugar, the growth rate of large-scale manufacturing stood at 7.6 percent compared to 6.8 percent last year. Excluding outliers (both positive and negative), the trimmed growth rate stood at 5.3 percent in the first half of FY01, compared to 8.9 percent last year. This more unbiased picture shows that the manufacturing sector is not growing as projected; only nine of fourteen industrial groups showed positive growth, while only four of these nine improved upon last year's performance (see **Table 2**).

Looking at growth by sector, textiles slowed down on account of higher cotton prices and the perceived shortage on account of a lower preliminary estimate of the size of the cotton crop. Lint cotton prices picked up in the middle of October (peaking at Rs 2,600 per maund in end-December), which led to slower ginning

[11] Manufacturing growth rates are based on period-to-period changes, weighted by the share of certain industries in total value-added by Large-scale manufacturing. Actual production data allows for customized analysis (e.g. to compute the trimmed growth rate). These numbers will differ from growth rates yielded by the Quantum Index of Manufacturing (QIM), which is released by FBS. The QIM is an index of the growth rate of manufacturing using 1980/81 data as the base.

and spinning activities this year. However, the weaving sector maintained the momentum it achieved last year.

As discussed earlier, production of sugar fell sharply during 1H-FY01 largely because of the 19.1 percent downward revision in the size of the sugarcane crop. Since harvesting of the crop will extend into March 2001, there is the possibility that this estimate will again be revised downwards. The existing shortage of sugarcane is likely to be further aggravated by the lingering dispute between growers and mill owners over prices and timely payments. This agitation has intensified with the start of the harvesting season in October and may continue well into the third quarter of FY00. As in the past, farmers stopped supplying sugarcane to mills to prop up prices, forcing a halt to crushing in the beginning of the season. As a result, some mills in Sindh and NWFP were forced to shut down their operations temporarily. However, farmers still feel that large mills use their geographic monopoly to delay crushing, forcing growers to dump their harvest. The only gainers in this dispute are manufacturers of *gur*, who have been especially active in NWFP in terms of procuring higher supplies of sugarcane.

Cooking oil production increased due to better availability of canola and the sales tax exemption provided to oil extracting units in the middle of November 2000. On the other hand, production of ghee continued to decrease in the first half of this year, mainly due to the closure of certain ghee mills and the increasing cost of production on account of furnace oil prices.

Production of petroleum products increased on account of Pak-Arab Refinery Limited (PARCO), which commenced operations in September 2000. This unit has an installed capacity of 4.5 million tonnes per annum. Growth in fertilizer production is also the result of a new DAP plant established by Fauji Jordan, which started commercial production in the early months of 2000. However, growth in the production of nitrogenous fertilizer remained subdued due to the closure of Pak American Fertilizer Limited.

Growth in the automobiles sector was dragged down by the sharp decline in the production of tractors (see **Table 2**). This was largely due to a sharp fall in tractor bookings on account of a reduction in financing by ADBP. However, in

view of the increased popularity of compact cars, the production of small engine cars and Light Commercial Vehicles (LCVs) continued to increase in the second quarter. As retail petrol prices increase, consumer preferences are shifting to smaller engine cars, while the leasing arrangements offered by many leading banks has boosted consumer demand. In the rural areas, higher purchasing power following the bumper wheat and cotton crops last year has also shored up demand for LCVs and motorcycles.

Growth in the chemicals sector during 1H-FY01 was much lower this year primarily because of the closure of Sindh Alkalis Limited in May 2000 due to a temporary disconnection of gas supply. Furthermore, ICI Pakistan, the second largest producer of soda ash in the country, has shifted some of its production units towards sodium hydrogen carbonate. These two developments are reflected in the negative growth of soda ash this year.

Cement production continued to be marred by problems of market oversupply, rising furnace oil prices and electricity charges. The situation was further aggravated by the selective imposition of sales tax in September 2000 (NWFP was exempted), which weakened the producers' cartel and played a role in the fall of retail cement prices. Furthermore, the interruption of gas supply to Zeal Pak Cement resulted in a 56.2 percent fall in its production during the period July – November 2000.

Production of paper & paperboard showed strong growth on the basis of robust demand and better availability of raw materials. The inputs used by this sector include straw (chaff), river grass (kahi), waste cotton, bagasse and pulpwood. Above average production of cotton, wheat and rice in the last few years, has created a sufficient supply of by-products that are used as inputs by this sector.

4. Fiscal Developments

As anticipated, the recent Stand By Agreement (SBA) with the IMF insisted on strong fiscal adjustments in the fiscal sector. Under the program annual tax revenues are projected to increase by 24.1 percent over actual collection last

year. With revenue targets set as performance criteria[12] under the nine-month SBA, the revenue and overall budget deficit target for Q2-FY01 works out to Rs 189.9 and Rs 103.8 billion respectively.

As far as revenue collection is concerned, the Rs 182.0 billion accumulated till end-December 2000 is 13.5 percent higher than the corresponding period last year (see **Table 3**). However, it is Rs 7.9 billion short of the IMF's quarterly target of Rs 189.9 billion, and by Rs 9.1 billion under the budget.[13] Under these circumstances, it is envisaged that the Central Board of Revenue (CBR) tax revenue target will be adjusted downwards. The fiscal deficit target is likely to be attained as expenditures are being curtailed to meet the revenue shortfall.

4.1 Direct Taxes

An analysis of direct tax collection shows a 16.4 percent increase over actual collection in 1H-FY00. This growth is primarily attributable to the revised Self-Assessment Scheme (SAS), and the *one-off* results of the Tax Amnesty Scheme-II (TAS-II).[14] Results of the SAS indicate that the number of returns filed increased by 77,127 over last year, contributing an additional Rs 0.4 billion to the government exchequer. Thus, views aired by certain quarters that returns filed under the revised SAS are lower than last year, can be dispelled. The second amnesty scheme (TAS-II) contributed only Rs 1.1 billion, whitening assets worth Rs 9.9 billion as most people had already availed TAS-I. The two amnesty schemes together have contributed Rs 11.4 billion, whitening assets of over Rs 110 billion.

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[12] Performance criteria targets are defined as macroeconomic indicators (usually set on a quarterly or a semi-annual basis), which must be met in order to qualify for SDR purchases under an IMF agreement.

[13] The quarterly target is worked out keeping seasonality concerns in view. With an overall budget target of Rs 430.0 billion, the quarterly targets work out to Rs 85.09 billion for Q1-FY01, Rs 191.07 billion for Q2-FY01, Rs 289.78 billion for Q3-FY01, and Rs 430.0 billion for the last quarter of FY01. Under the SBA, quarterly revenue targets are Rs 189.9 billion for Q2-FY01, Rs 291.6 billion for Q3-FY01, and Rs 430.2 billion in Q4-FY01 (there is no target for Q1-FY01, as Pakistan was not on an IMF program at that point in time).

[14] TAS-II was essentially a continuation of TAS-I meant to appease public concern with the Tax Survey.

The success of the amnesty schemes is due to the on-going Tax Survey, which forced people to whiten assets and declare their assets in order to avoid prosecution. In its first phase, the survey was simultaneously initiated in 13 big cities; in the second phase, its coverage was extended to another 13; and in the final phase, 'on the spot' assessment was introduced. The total number of forms distributed amounted to 0.8 million and 0.2 million in the first and second phase. Preliminary results indicate that a large number of residents in posh localities have declared low incomes. Additionally, discrepancies were found in the income declared by people who own moveable and immovable properties, and conservative estimates of the market valuation of these assets were recorded on the forms. As of 18th December 2000, 100,000 notices have been served to houses in posh areas in the 13 big cities where the survey was initially launched. Furthermore, the analysis of 400,000 housing survey forms shows that close to 30 percent of owners and tenants were not in the tax net. This implies that another 0.1 million persons would be served notices. Additionally, the Pakistan Revenue Automation Limited (PRAL) also reported that out of the 100,000 new National Tax Number (NTNs) holders, 75,000 people had never paid tax. These developments show the social acceptability of not paying taxes; if these actions are faithfully carried through, it will increase Pakistan's stagnant tax base and enhance revenue collection. However, the difficulty of implementing these structural changes must be appreciated since this is an effort to change counter-productive social mores.

4.2 Indirect Taxes

Sales Tax

As in Q1-FY01, sales tax revenue outgrew collection under Central Excise Duty (CED) and customs duty. But even this impressive growth of 36.0 percent was not sufficient to meet the budget target of Rs 76.9 billion. This 8.0 percent shortfall is expected to be covered from the extension of the General Sales Tax (GST) to the cement industry. Furthermore, efforts to implement GST at the retail level should help increase revenues further.[15]

[15] The implementation of the sales tax at the retail level has been postponed till the next budget under an agreement with traders (22nd August 2000).

Central Excise Duty

According to revised budget estimates[16] for FY01, CED is the only component of taxes that contributed more than the targeted amount for the year; collection under this head has so far taken care of 48.1 percent of the full year budget target. The fall in collection vis-à-vis the corresponding period last year, is not surprising as sales tax is gradually replacing CED which will be eventually phased out.

In order to better evaluate the performance of tax on domestic sales of goods and services, an analysis of the combined growth in both these taxes will be relevant; both these depict an impressive combined growth of 20.4 percent in 1H-FY01 over the same period last year. The growth witnessed is entirely the result of a widening tax base. This is expected to further expand as the implementation of sales tax on retail trade is yet to be enforced in letter and spirit (see **Footnote 15**).

Customs duty

The original assumptions underlying the customs duty collection target have not been validated. While overall imports grew by 10.5 percent (US$ 5.4 billion), *dutiable* imports only increased by 4 percent against the target of 12.7 percent.[17] Consequently, revenue collection in first half of FY01 is 8.4 percent lower than the same period last year. This decline in dutiable imports also had an adverse effect on sales tax collection from imported goods.

Conclusion

While revenue collection is impressive compared to actual collection last year, it incorporates the results of the TAS and the Tax Survey. It should also be kept in mind that collection as a percentage of target, is dependent on the size of the target. The larger the target, the worse collection looks compared to it. Although revenue collection thus far is at 42.3 percent of the annual target, the

[16] The revised estimates are from a press conference by CBR on 18th January 2001. No official intimation has been made to the SBP.

[17] This reason has been stated by the CBR in a press conference on 9th February 2001. A request for a breakdown of dutiable and non-dutiable imports, remains pending with the Board. A possible reason for the slowdown in dutiable imports can be the cash margins that were imposed during the period 5th October and 14th November 2000.

tax collection efforts in terms of widening the tax base, bringing in new taxpayers, and detecting cases of tax evasion are beginning to show some modest results. The structural changes will take some time to implement, but of they are successful they will bring about a quantum improvement in Pakistan's public finances.

5. Money and Credit

5.1 Monetary Developments

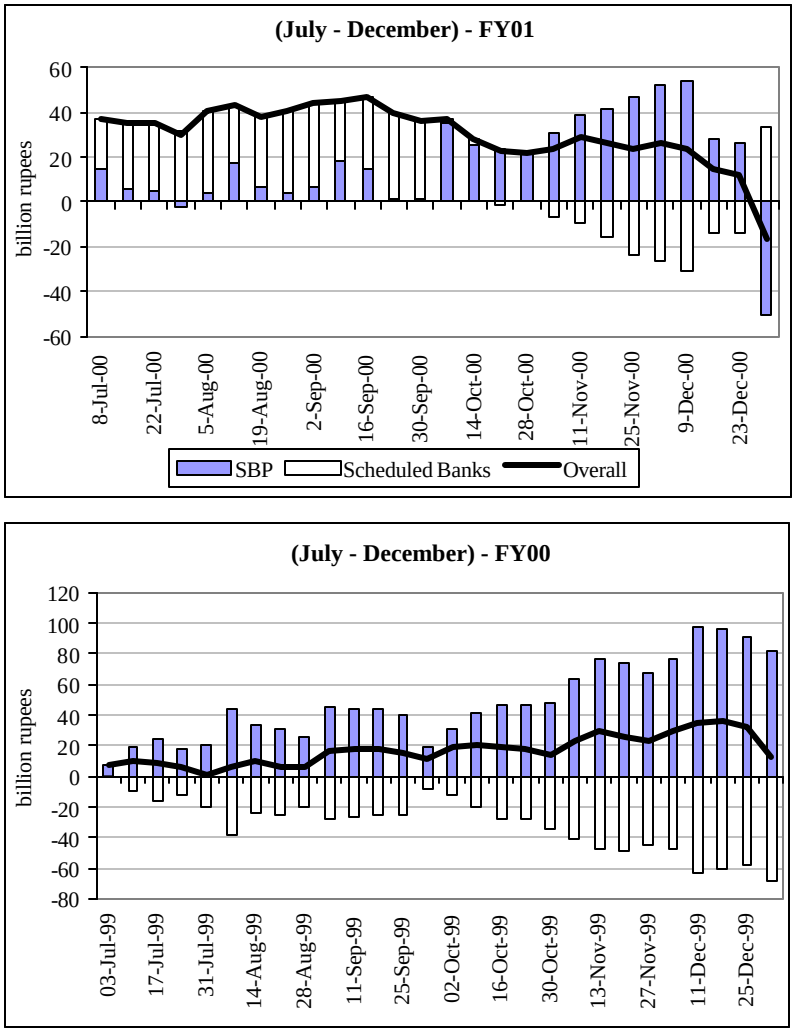
As shown in **Table 4**, growth of money supply in the first half of FY01 stood at Rs 76.0 billion against Rs 36.4 billion in the corresponding period last year. This was primarily driven by domestic credit expansion, with commercial bank lending to the private sector at Rs 80.6 billion against just Rs 24.4 billion in the first half of FY00. However, what was different this year were the binding targets on government borrowing from the banking system (SBP and scheduled banks), a systemic shortage of liquidity following the tightening of monetary policy in late September (to defend the exchange rate), and a resurgence of private sector borrowing from commercial banks. Looking ahead, the unanticipated increase in demand for currency and the stagnation of Rupee deposits, must be addressed with a sense of urgency.

With the bulk of textile financing conducted after cotton harvesting, the second quarter is the period of maximum private sector credit demand. With lower net disbursements last year, corresponding repayments on such lending were lower in FY01. This, coupled with a sharp increase in demand for credit during Q2-FY01 on account of an increase in input prices, pushed up net lending to the private sector quite sharply. Add to this the fact that government borrowing in the first half of last year was exclusively from SBP, which is not the case this year, placed additional pressure on commercial banks and highlighted the stagnant Rupee deposit base in the banking system. This shortage of liquidity has been brought into sharp focus by the binding targets on SBP's net domestic assets (NDA), which is a performance criterion in the IMF's SBA.

5.1.1 Government borrowing

As shown in **Figure 1**, although net government borrowing from the banking system fell sharply at the end of 1H-FY01 compared to the year before, the path towards this end-result shows an interesting picture. During the first half of FY00, GOP retired its debt to commercial banks by borrowing from SBP. While

Figure 1: Net Goverment Borrowing for Budgetary Support



the first quarter this year witnessed positive net borrowing from commercial banks, this abruptly changed in early October 2000. By end-September/early-October, there was a complete shift of government borrowing from commercial banks to SBP. This was primarily because of heavy discounting by banks, which entails a shift of T-bills from banks to the central bank. The fact that there was a record volume of discounting in October 2000 following the increase in CRR (daily average of Rs 14.2 billion), this shift of GOP borrowing to SBP continued till the last week of December.

In looking at the overall level of government borrowing from the banking system, it was found to be higher in FY01 compared to the first half of last year (see **Figure 1**). This is primarily because non-bank borrowing and external financing (primarily on account of Special US Dollar Bonds) were much higher in the first half of last year compared to this year.

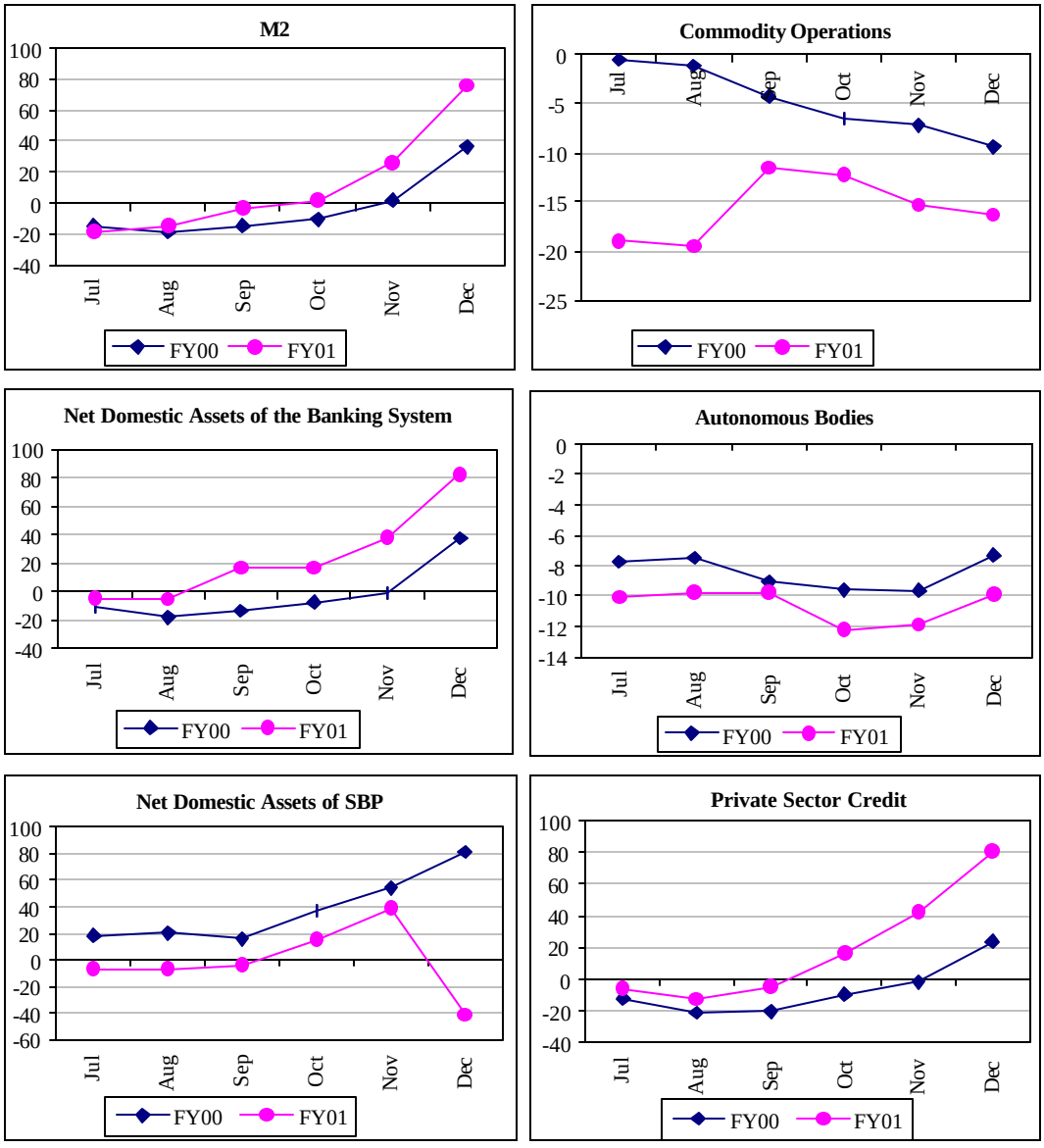
Commodity financing in the second half of FY00 was unusually high on account of a bumper wheat crop last year; this placed a severe strain on the banking system. Against lending of Rs 40.1 billion in FY00, repayments till end-December 2000 were only Rs 16.3 billion; this is a complete reversal of what took place last year.[18] This anomaly can be explained using **Figure 2**, which shows an abnormal *increase* in borrowing for commodity financing (by Rs 7.9 billion) in the month of September. Given the seasonal pattern of the wheat crop, it is clear that the purchase of wheat from farmers is complete by end-June, after which the government retires its borrowing following the sale of wheat to wholesalers.

The reason for this abnormal increase is as follows: as shown in **Figure 2,** the record volume of commodity financing during FY00 was matched by exceptionally high repayments of Rs 18.9 billion during the month of July. These repayments were primarily from the Punjab government, which was

[18] As of end-June 2000, the outstanding volume of commodity financing was Rs 107.4 billion. This overhang is significant, showing that the federal and provincial governments have built up this balance over time, a clear reflection that they have not been able (or willing) to repay banks. Since commodity financing is given priority by the government, there was a need to cap this overhang, which explains SBP's emphasis on recovery from commodity financing. This explains the recovery of Rs 9.3 billion in the first half of FY00, against net commodity financing of only Rs 3.6 billion in FY99.

Figure 2: Growth in Monetary Assets

billion rupees



surplus in wheat. Since Sindh and NWFP were in deficit, the NCBs and MCB were directed to provide credit to these provinces to purchase wheat from Punjab. However, Punjab did not return this liquidity to the banking system, for if it had, there would have been no *net* increase in commodity financing in September.[19]

In terms of borrowing from autonomous bodies, **Figure 2** shows no significant difference from what happened last year; these companies retire *en masse* in July and begin borrowing in December. The largest players were PTCL and WAPDA, which retired Rs 9.9 and Rs 1.4 billion, respectively. KESC, reflecting its cash flow problems, borrowed Rs 3.6 billion in the first half of FY01.

5.1.2 Private sector borrowings

Private sector shows a significant upsurge in terms of net lending in FY01 compared to last year (see **Figure 2**). This lends some support to the view that the cycle of gross lending and repayments on past loans was interrupted in FY00, which explains why net private sector lending was so much lower in FY00 than in previous years. With greater reliance on self-financing (following strong profitability in textiles), and the scare with the accountability drive, gross lending by banks dipped in FY00. Correspondingly lower repayments this year, coupled with buoyant gross borrowing by the textile sector, pushed net lending to the private sector to Rs 80.6 billion. In effect, the outstanding volume of credit used in the economy was higher than last year.

The distribution of private sector credit to the manufacturing sector shows the dominant role of textiles (see **Table 6**). Although a breakdown of fixed investment is not available, anecdotal evidence suggests that a large part of the net increase in 1H-FY01 is on account of Balancing Modernizing & Replacement (BMR) financing in the textile sector. Looking at working capital

[19] In a related development, since HBL was the largest lender to provincial governments and was still facing a liquidity problem, it *once again* availed the Rs 10 billion counter-finance facility from SBP in October. Backdrop: with excessive demand for commodity financing last year, HBL requested a special 6-month counter-finance facility from SBP that was availed in June 2000 but repaid in July. The fact that this facility was availed again in October did not ease the liquidity shortage in the system, but it did compound the problems facing HBL as it had to repay this amount before end-December 2000.

loans, the textile sector availed Rs 25.3 billion during the first half of FY01, against Rs 11.7 billion in the corresponding period last year. A large part of this increase was on account of the sharp increase in lint cotton prices this year. In terms of the other sectors shown in **Table 6**, the following points are insightful:

- Cement: despite a fall in output during the first half of this year, working capital loans increased because of a sharp increase in the domestic price of furnace oil. Most cement factories in Pakistan operate on furnace oil, which is the largest component of production costs.
- Sugar: the fact that this sector has posted positive borrowing this year after several years, indicates that sugarcane prices were higher this year, while bank credit was also availed to finance the import of raw sugar.
- Fertilizer: the decline in net credit was not on account of weak demand conditions, as fertilizer companies drew down inventories by almost 20 percent and also enjoyed a 15 percent increase in retail prices. As a result, this sector retired more this year.
- Automobiles: leasing companies have moved aggressively in marketing new brands of compact cars, while providing a larger share of financing to consumers. This has boosted production and sales of automobiles, and also the demand for bank credit by this sector.

Agricultural Credit

In a bid to achieve another bumper crop of wheat, on 12th October 2000 SBP advised ABL, HBL, MCB, NBP, UBL, ADBP and FBC to enhance the per acre credit limit for wheat from Rs 2,500 to Rs 4,000 with immediate effect.

Gross credit disbursement to the agriculture sector through commercial banks and specialized credit institutions during July-December 2000 were Rs 18.9 billion, marginally higher by Rs 74.9 million than the corresponding period last year. As in previous years, almost 75 percent of the total disbursement was provided by ADBP and FBC.

Of the total loans to agriculture during 1H-FY01, 80.4 percent were disbursed as production loans while the rest were development loans;[20] credit availability for

[20] Production loans are given for purchasing inputs like seed, fertilizers, pesticides, fuel for tractors and tube wells etc, while development loans include loans for plough cattle,

purchasing tractors was lower this year. This, coupled, with the discontinuation of an incentive scheme for tractor purchase in Punjab, led to a 31.6 percent decline in the production of tractors.

Disbursement of credit during July-December (Rs million)						
	July-December 1999			July-December 2000		
	Production	Development	Total	Production	Development	Total
ABL	565.8	0.1	565.9	483.0	0.4	483.4
HBL	1,508.0	289.2	1,797.2	1,412.6	239.3	1,651.9
MCB	398.3	4.1	402.4	438.6	63.7	502.3
NBP	1,583.4	77.6	1,661.1	1,862.4	89.8	1,952.3
UBL	165.2	1.4	166.6	220.3	5.6	225.8
Total CBs	**4,220.7**	**372.5**	**4,593.2**	**4,416.8**	**398.9**	**4,815.7**
ADBP	7,928.2	3,661.6	11,589.7	8,599.9	3,254.0	11,853.9
FBC	2,585.3	16.4	2,601.7	2,152.8	37.3	2,190.0
Total All	**14,734.2**	**4,050.4**	**18,784.7**	**15,169.5**	**3,690.1**	**18,859.6**

As a part of a larger campaign to improve the commercial viability of the specialized agriculture banks, the SBP decided, in October 2000, that the past practice of concessional financing to ADBP and FBC will be discontinued and all credit lines to ADBP (including any future refinancing of cooperative banks), whether new or renewed, shall be priced at the minimum annualized average rate of return on (Treasury bills) T-bills. This new financing arrangement may force specialized banks to become more prudent in their lending practices.

The recovery of agriculture loans improved by 13.7 percent to Rs 20.5 billion during July-December 2000 compared to Rs 18.0 billion during the same period last year. Despite this increase in recovery and a corresponding decline in net disbursements, the outstanding amount as on 31st December 2000 stood higher by 1.3 percent compared to the amount as on 31st December 1999. ADBP accounted for 84.2 percent and FBC for 5.6 percent of the total outstanding agriculture loans of Rs 92.5 billion. The nationalized and privatized banks provided the remaining amount.

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tubewells and other wells, tractor, orchards, farm transportation, building of godowns, land improvement and farm machinery etc.

5.1.3 Composition of money supply

One of the more disturbing developments in the financial system this year has been the sharp increase in currency in circulation (CC).[21] Although there is a seasonal hike in the second quarter of the fiscal year on account of private sector credit demand (see **Figure 3**), the increase witnessed in the past two years is abnormal. This can also be seen in **Table 7**, which shows CC increases on a cumulative basis by month. Looking at the average for the period FY93 to FY97 shows that the period October to January posts an increase in CC, which tapers off and actually declines after February. Compared to this, developments in FY00 and the first half of this year are clearly off track.

In understanding the factors behind this growth, one must realize that while government borrowing from SBP increases reserve money, it does not necessarily increase currency issued.[22] The market's demand for liquidity will increase currency issued, often at the expense of bank deposits. In effect, while government borrowing from the central bank increases the potential supply of currency (reserve money), it is market demand that actually determines the increase in currency in circulation.[23]

The fact that currency in circulation is more dependent on demand factors can be seen by looking at abnormal developments in CC over the last few years. In the case of FY00, the sharp increase in CC during the months of October (by Rs 20 billion) and November (by Rs 21.6 billion) can be linked to the change in government on October 12th, and the resulting emphasis on loan defaulters and accountability (see **Table 7**). Since currency hoarding is a convenient way to

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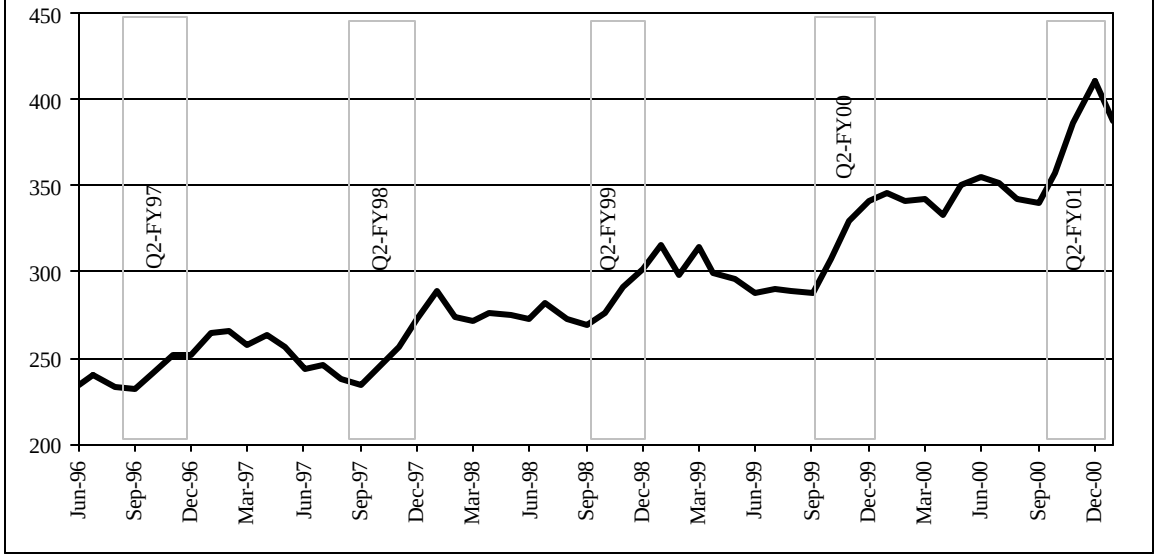
[21] This can be viewed as hoarding of currency notes.

[22] However, it is a stylized fact that government borrowing from SBP has a strong positive correlation with currency in circulation. Using weekly data since June 1998, government borrowing from SBP and CC show a correlation coefficient of 0.91.

[23] FY00 saw a substantial increase in currency issued (by Rs 68.4 billion), while government borrowing from SBP increased by Rs 135 billion. During the first half of FY01, currency issued increased by Rs 55.6 billion, while government borrowing from end-June 2000 till December 9th was only Rs 54.2 billion. The choice of December 9th 2000 has been made to filter out the efforts to reduce government borrowing from SBP in the latter half of December.

Figure 3: Currency in Circulation (Stocks)

Jun-96 to Jan-01



hide wealth, this could also explain the abnormal increase witnessed in May and June 2000 as the Tax Survey began to impact popular sentiments.

Following this line of reasoning, as the scare of accountability subsided, there was a sharp fall in CC during the months of July and August 2000.[24] Looking at FY01, although the seasonal increase in currency demand does reflect the sharp increase in net private sector credit and the fact that Eid fell in end-December, these factors alone may not justify the actual increase in CC.

It is the market view that the preannounced plan to impose UN sanctions on Afghanistan in December, could partially explain this abnormal increase in currency demand. If Afghanis feel the sanctions will erode the value of their currency, it stands to reason that they will seek an alternative medium of exchange that will retain its value. Given the existing trade links with Afghanistan (formal and informal) and porous borders, perhaps the sharp increase in demand for Rupees could be on account of this. If this is indeed the case, this liquidity is unlikely to return to Pakistani banks in the near future.

Having said this, commercial banks operating in Pakistan have not done enough to shore up their deposit base (see **Special Section 2**). Since existing foreign currency accounts (FE 25) do not provide counterpart Rupees (and actually reduce available liquidity), the fact that Rupee deposits have only increased from Rs 992.7 to Rs 1,007.7 billion during 1H-FY01 is not a heartening development. However, even this marginal increase is an improvement over the 2.7 percent decline in the corresponding period last year (see **Table 8**).[25]

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[24] It is tempting to think that since the IMF targets for SBP's NDA and NFA were formulated in September 2000, the reduction in CC in the previous months may have signaled a much needed reduction in currency demand. It is this surplus liquidity that could be used to retire GOP borrowing from SBP. However, as will be discussed later, the banking system has faced an acute shortage of liquidity during Q2-FY01, which did not allow GOP to retire its debt to SBP (as envisaged), or shift its borrowing to scheduled banks (with the exception of the last week of December 2000).

[25] The fall last year was because frozen Foreign Currency Accounts (FCAs) worth Rs 36.3 billion were converted into Rupees, while bank deposits only increased by Rs 10.7 billion in the same period.

Looking at the current year, Rupee deposits only increased by Rs 16.0 billion in the first half of FY01. This poor mobilization is the real reason behind the acute liquidity shortage witnessed in December as SBP tried to meet its NDA target. One must realize that this growth compares very poorly against an estimated nominal economic growth of 4 to 5 percent in the first half of FY01. It is obvious that in real terms, Pakistan's banking system is experiencing financial dis-intermediation. It is also clear that banks have not picked up on the sharp increase in T-bill rates in September/October 2000.

Although this failure of the monetary transmissions mechanism could be explained by the abrupt increase in T-bill rates to defend the Rupee, the market expected rates to fall after the Rupee stabilized. However, since rates were not reduced subsequently, this should have been sufficient indication that SBP had increased the interest rate benchmark. Banks claim they were hesitant about following this increase given the conditions under which they were raised, and rumors that rates would fall by the end of the calendar year. This view was confirmed with the signing of the government's Letter of Intent (LOI) to the IMF, which was made public in early December. However, with the systemic shortage of liquidity on account of poor deposit mobilization by banks, the central bank could not afford to signal a reduction in T-bill rates for fear that it would not be able to shift government borrowing to scheduled banks (which is relatively less inflationary), and that banks may reduce deposit rates further eroding their funding base.[26]

5.2 Money Market[27]

Figure 4 captures developments in the money market during Q2-FY01. With the free fall of the Rupee in mid-September 2000, SBP had to tighten its monetary policy to defend the exchange rate. With CRR increased to 7 percent on October 7th, except for a brief period between December 6th and the 23rd, the overnight rate remained at 13 percent throughout the quarter.

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[26] Since the monetary transmission mechanism in Pakistan does not show two-way efficiency, there was a fear that if T-bill rates were reduced, commercial banks may use this as a justification to reduce deposit rates. Despite maintaining T-bill rates at October levels, large Pakistani banks still reduced their deposit rates during 1H-FY01 (see **Special Section 2**).

[27] Given the nature of this sub-section, the data will focus only on the second quarter of FY01.

What is surprising is the fact that banks continued to lend to the private sector despite discounting throughout the second quarter of FY01. However, telltale signs were becoming clear as the volumes offered in T-bill auctions fell in the latter part of the quarter. In view of the liquidity shortage, banks were not willing to offer funds to the government despite increased yields on government paper. Hence, net government borrowing from scheduled banks dropped sharply as repayments on past borrowing continued (see **Figure 1**).

Discounting

With the unprecedented tightness in the money market, commercial banks availed Rs 859.7 billion from the central bank in Q2-FY01, against Rs 120.0 and Rs 85.8 billion for the second quarters of FY00 and FY99, respectively.[28] As shown in **Table 9a**, the first two months of the second quarter witnessed discounting almost every day.[29] **Figure 4** shows that the unexpected increase in CRR imposed an immediate crunch on the system, which only tapered off in the first week of December, when overnight rates dipped below the discount rate on December 9th. However, this respite was only temporary since the end-December NDA target still had to be met.

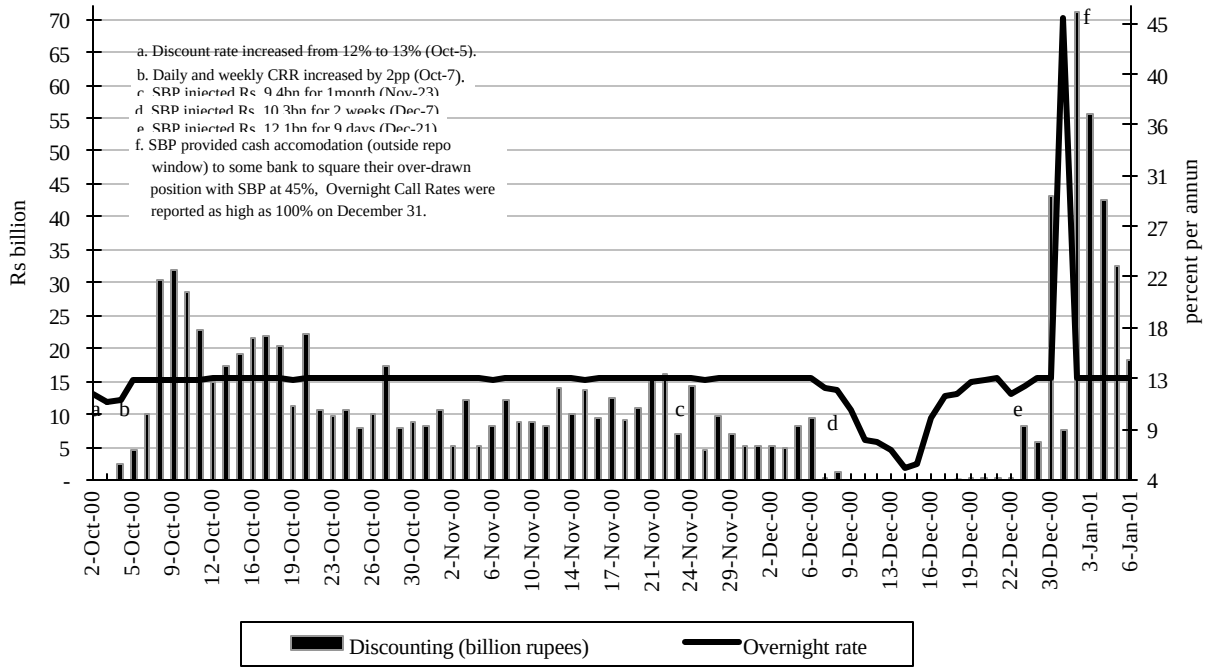
Open Market Operations

As touched upon earlier and shown in **Table 9b and 10c**, given the liquidity shortage in the banking system, SBP did not absorb any funds from the market simply because banks did not offer funds. In fact, in the month of December, the central bank tried to ease the liquidity crunch by injecting Rs 22.4 billion into the market.

[28] Since discounting is the last resort for banks, these numbers suggest that the liquidity shortage takes into account the net impact of SBP's open market operations and the primary auctions.

[29] The convention used to indicate usage of the discount window looks at this as a 3-day facility to include the possibility of a holiday falling due the next day. Hence, the number of days shown in **Table 10a** should be gauged against the number of days in that month.

Figure 4: Discounting and Overnight Rates



Primary auctions

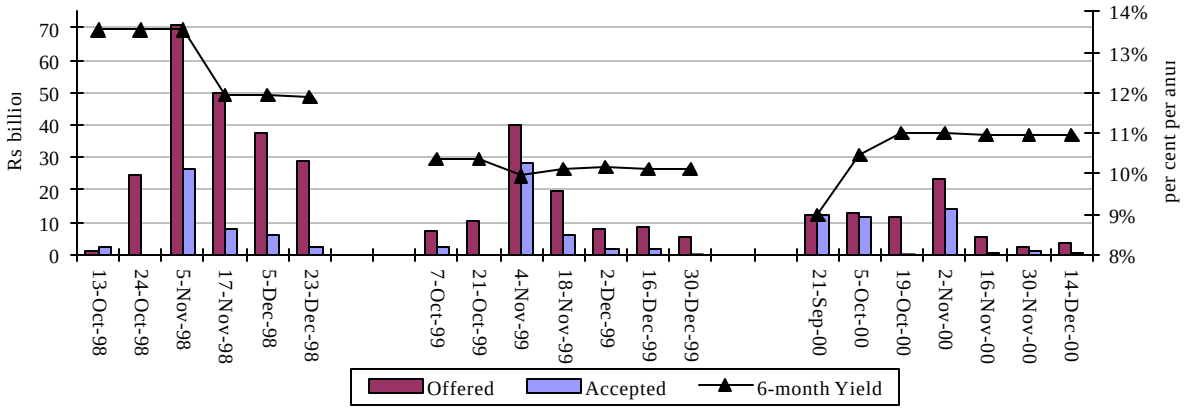
As expected, despite the sharp increase in T-bill rates in end-September/early-October, total bids in the primary auctions actually fell (see **Figure 5**). The relative stability in rates after October 19th shows that low demand by banks could not be explained by uncertainty about the direction of T-bill rates. In fact, higher demand for T-bills in the November 2nd auction suggests that banks did respond to the hike in rates. However, the poor showing in the last three auctions in Q2-FY01, is an indication of the seasonal increase in private sector credit demand, poor deposit mobilization, and the fact that banks were unwilling to part with liquidity knowing that efforts to meet SBP's NDA target would create a further shortage.

5.2.1 Pakistan Investment Bond (PIB)

The month of December witnessed the successful launch of a new long-term bond. The pre-requisite for this was the selection of primary dealers (PDs) who were chosen on the basis of their treasury expertise and infrastructure, past performance as market players, and capital adequacy. These players were given the explicit responsibility of developing an active secondary market by supplying non-PDs and institutional investors with PIBs. The resulting shortlist of PDs include: (1) ABN-AMRO Bank, (2) American Express, (3) Citibank, (4) Habib Bank Limited, (5) National Bank of Pakistan, (6) Standard Chartered Grindlays, and (7) Union Bank.

GOP had agreed that the resulting yield curve following the launch of this instrument would be used to price long-term NSS instruments with effect from January 2001. Given the delay in short-listing PDs and the need to have a robust yield curve, two auctions were conducted in the month of December (see **Table 10d**). The intent was to have auctions every two months, but given the commitment to benchmark National Saving Scheme (NSS) instruments (specifically Defence Savings Certificates), two auctions were scheduled. As shown in **Table 10d**, both auctions were successful, in the sense that bids exceeded targets, and the total accepted volumes (in the two auctions) were either at premium or at par. Following the launch, SBP's coupon rates on the PIBs are clearly an accurate market view of long-term interest rates.

Figure 5 : Auctions Summary 2nd Quarter FY99, FY00 and FY01



On the downside, since both the auctions coincided with the liquidity shortage in December, this added to the crunch. In response, one primary auction of T-bills was scrapped to make way for the PIB. Working with the PDs who are operating as the arm of SBP, special attention was required to ensure that this temporary shortage of liquidity did not reflect in terms of inflated long-term interest rates.

5.2.2 Movements in SBP's NDA

Before listing the steps taken to reduce the growth of SBP's net domestic assets (NDA) in 1H-FY01, it is important to understand what this means and the rationale for the binding ceiling that was imposed. In simple terms, the central bank's NDA refers to its holdings of domestic assets. In the case of SBP, this refers to net claims on: (1) the federal/provincial governments, (2) scheduled banks (the outstanding volume of refinance availed for exports, agriculture, Locally Manufacturing Machinery (LMM), etc.), and (3) claims on NBFIs. Of these, the first two categories show large changes on a regular basis. Furthermore, these targets are imposed on an incremental basis since end-June, in an effort to contain the growth in SBP's domestic assets, which is necessary to contain the growth of money supply.

Since the central bank does not have a deposit base to finance its lending, fresh lending (or asset creation) is generally done by printing currency notes. Since currency in circulation and bank deposits with the central bank (e.g. CRR, special deposits and any surplus cash kept with SBP) make up *reserve money*, the goal of limiting SBP's NDA is to contain the growth of reserve money.[30] This becomes clearer by looking at the following equation:

$$NDA_{SBP} + NFA_{SBP} = \text{Reserve Money} = CC + BD \text{ (bank deposits with SBP)}$$

[30] In view of the sharp increase in reserve money in FY00 on account of excessive government borrowing from SBP, the SBA seeks to curtail growth of reserve money this year. However, since Pakistan's foreign exchange reserves are low and a reserve build up does increase SBP's NFA, there are adjusters that allow for greater growth in reserve money if this is driven by inflows of foreign exchange. In fact, since there is a floor on NFA and a ceiling on NDA, reserve money growth during the course of the year is actively managed on the basis of certain adjusters on the quarterly targets for SBP's NFA and NDA during the course of the year.

Given the sharp increase in government borrowing from SBP during FY00, the target this year is to reduce central bank lending during the course of FY01; more specifically, the performance criterion on SBP's NDA is to show a net decline of Rs 26.3 billion by end-December 2000; a decline of Rs 39.6 billion by end-March 2001, and a full year decline of Rs 35.5 billion by end-June 2001. [31]

As of 14th December 2000, SBP's NDA was in *excess* by 89.6 billion.[32] To bring this in line with the end-December target, the government had to reduce its overall borrowing from the banking system by Rs 21.9 billion, and shift the remaining amount (Rs 67.7 billion) to scheduled banks. Given the liquidity shortage in the banking system, shifting this debt from SBP to scheduled banks required certain exceptional steps.[33]

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[31] These targets, however, are subject to adjustments due to certain factors described in the technical memorandum of understanding for the current SBA.

[32] Against an end-December target of Rs – 26.3 billion for SBP's NDA, the actual position on December 14th was Rs 63.3 billion.

[33] These were done in the following order:

1. The 7 percent CRR was reduced to 5 percent on December 16th, and banks were asked to place the freed 2 percent in a special deposit with the central bank. They were then given the option of purchasing T-bills for one month using this special deposit. By December 18th, about Rs 23.9 billion were shifted into T-bills, which reduced SBP's NDA by the equivalent amount.
2. Commercial banks and NBFIs that had special deposits with SBP against rescheduled FE 45 deposits, were asked to purchase government T-bills for a period of 1-week to 1-month. Between December 23rd and 31st, almost Rs 41 billion were shifted to T-bills, which means that government borrowing of this amount shifted from SBP to banks and NBFIs.
3. To be on the safe side, the discount window was closed on December 31st. Since discounting implies central bank lending to commercial banks, this facility increases SBP's NDA. The discounting of Rs 43.1 billion on December 30th threatened to breach the target; by closing this window on the 31st, SBP was able to reduce its NDA by that amount on the 31st.

However, these steps forced 8 banks to be overdrawn from SBP on December 31st. In the interest of safeguarding the payment system and to ensure that banks were not overdrawn on December 31st (when their balance sheets are formalized), SBP provided a special 1-day facility for these banks to square themselves. Given the special nature of this facility, the fact that the central bank had officially closed the discount window on that day, and the acute shortage in the money market, SBP provided *emergency* funding

Despite successfully meeting the end-December NDA target, the liquidity crunch did not disappear thereafter. Record levels of discounting were seen on the first working day of 2001, as banks approached the central bank for almost Rs 71.2 billion on January 2nd (see **Figure 4**).[34] Although the volume of discounting did fall gradually in the first week of January 2000, it was only on January 15th that banks were able to square themselves in the market without approaching the central bank as lender of last resort.

The poor growth of Rupee deposits and higher private sector borrowing in 1H-FY01, created the shortage of liquidity in the banking system. Furthermore, since SBP's NDA target for end-March 2001 is also binding, this should be a clear hint that banks must step up deposit mobilization. Also, since the focus should be on relatively stable individual deposits, banks must put into place price and non-price efforts to mobilize Rupee deposits.[35] Having said this, on a positive note, the fact that the period ahead shows seasonal retirement of private sector credit suggests that the liquidity crunch may not be as severe. However, banks must make the effort to increase their deposit mobilization on a priority basis.

6. Prices

The annual average rate of inflation, which started rising in the first quarter of FY01, continued this trend in the second quarter. All three 12-month moving

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of Rs 7.6 billion at 45 percent, which was the indicative overnight market rate (see **Figure 4**). This was sufficient to square all banks operating in Pakistan.

Despite the funding provided by SBP, and the understanding that banks may not be able to maintain their average CRR level in the last week of December, the overall cash reserve in the banking system was *only* 1.4 percent of DTL (demand & time liabilities) on December 31st. On this day, 8 banks were below 1 percent of their DTL, while 3 were below 0.5 percent. Four banks were not even able to maintain their weekly average CRR holdings.

[34] Excessive borrowing from SBP was mainly to meet the 5 percent CRR (weekly average holdings). Since most of the banks were below this floor on December 31st, they had to exceed the 5 percent cash holding to average out for the week.

[35] It is a stylized fact that corporate and PSE deposits tend to shift from bank to bank, and seasonally leave the banking system *en masse*. Banks that are concerned about their liquidity should target deposits that are not volatile or follow seasonal movements.

average indices increased from their end-September 2000 levels (see **Figure 6**); in the case of both CPI and WPI, non-food items contributed more towards inflationary pressures.

More specifically, the subcategories *fuel & lighting* and *transport & communication* recorded the largest increases in the CPI basket. The most prominent increase in WPI is raw materials, which was driven by rising lint cotton and skin prices (**Figure 7**).[36] Also, the price index of *fuel, lighting & lubricants* during Q2-FY01 was the other main factor behind the upward pressure on non-food items. As shown in **Figure 8**, the lagged pass-through of international oil prices and the quarterly adjustments in retail prices, is largely responsible for the latent inflationary pressures. With the increase in retail petroleum prices in end-December, this pressure is likely to remain.

On a comparable half-yearly basis, WPI has shown the largest increase of 6.3 percent, followed by a 5.2 percent increase in SPI and a 4.9 percent rise in CPI (see **Table 11**). Looking at the month-on-month inflation rates, the impetus in November/December comes largely from the WPI. In terms of consumer items, on account of the fact that Eid fell in end-December, the CPI actually indicates a slight dip to reflect government's efforts to ensure that the prices of basic food items were not pressurized during the month of Ramadan.

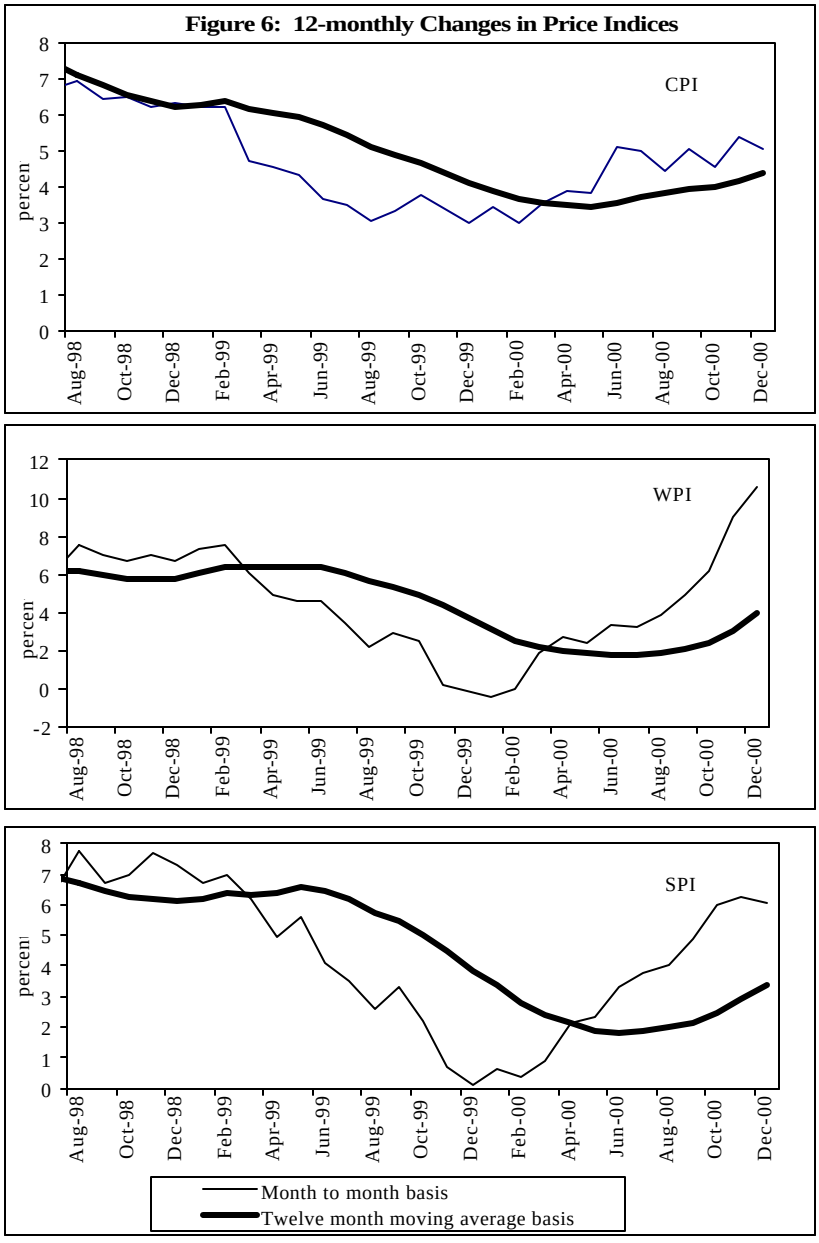
6.1 CPI Basket during Q2-FY01

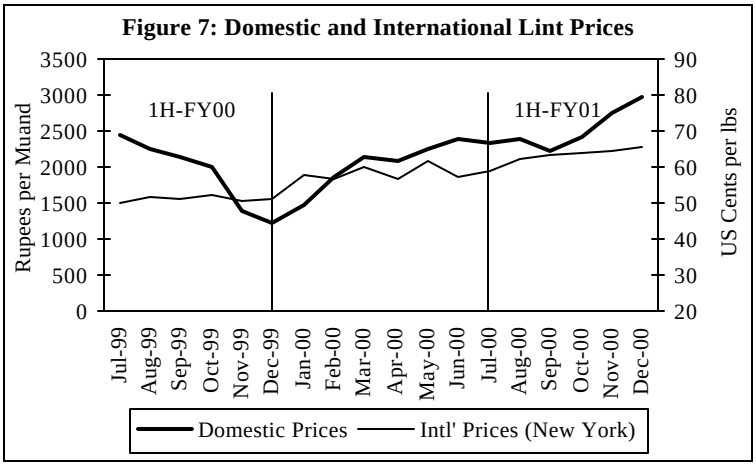
Food Group

The food group price index grew by 0.6 percent during Q2-FY01, against a 0.4 percent decline in Q2-FY00. As stated above, government measures to control

[36] Skins refer to hides from various animals, which are used as raw material in the production of leather and associated products like fur coats, shoes and baggage.

Figure 6: 12-monthly Changes in Price Indices





prices during Ramadan, and improved availability of most kitchen items (especially sugar, rice, milk etc.) eased pressure on food items in the CPI basket. More specifically, the following measures were taken to control prices of essential food items in December: (1) government-owned utility stores sold essential food items at a discount of 5 to 10 percent from pre-Ramadan levels, and (2) extensive price monitoring was undertaken to control profiteering on essential items.

Non-Food Group

With the exception of *fuel & lighting* and *transport & communication*, pressures in non-food items remained subdued in Q2-FY01. The more important developments in these two subcategories are discussed below:

Fuel & Lighting:

- During Q2-FY01, the *fuel & lighting* index grew by 3.1 percent mainly because of Kerosene prices (which increased by 18.5 percent) and gas cylinders (15.0 percent increase).

Transport & Communication:

- This index increased by 3.1 percent during the quarter compared to the same period last year, primarily on account of the retail price of diesel, which was

increased by 13.1 percent in end-September 2000. This has filtered through in terms of higher charges on public transportation.

- Looking ahead, the sharper increase in retail petroleum prices on December 30th 2000 (in the range of 6.8 percent and 22.6 percent - see **Figure 8**) is likely to have a direct impact on the *transport & communication* index in Q3-FY01, and lagged indirect effects on most other items in the basket.

6.2 WPI basket during Q2-FY01

As in the case of CPI, pressures in the WPI also originated from the non-food group. The resulting increase in the price indices of *raw material* and *fuel, lighting & lubricant,* is discussed below.

Raw Materials:

- During Q2-FY01, the raw material index increased by 14.1 percent, against a 6.7 percent decline in the first quarter of this fiscal year. Growth in the price of lint cotton (by 35.9 percent, see **Figure 7**) and skins (10.8 percent) were the prime reasons for this increase.

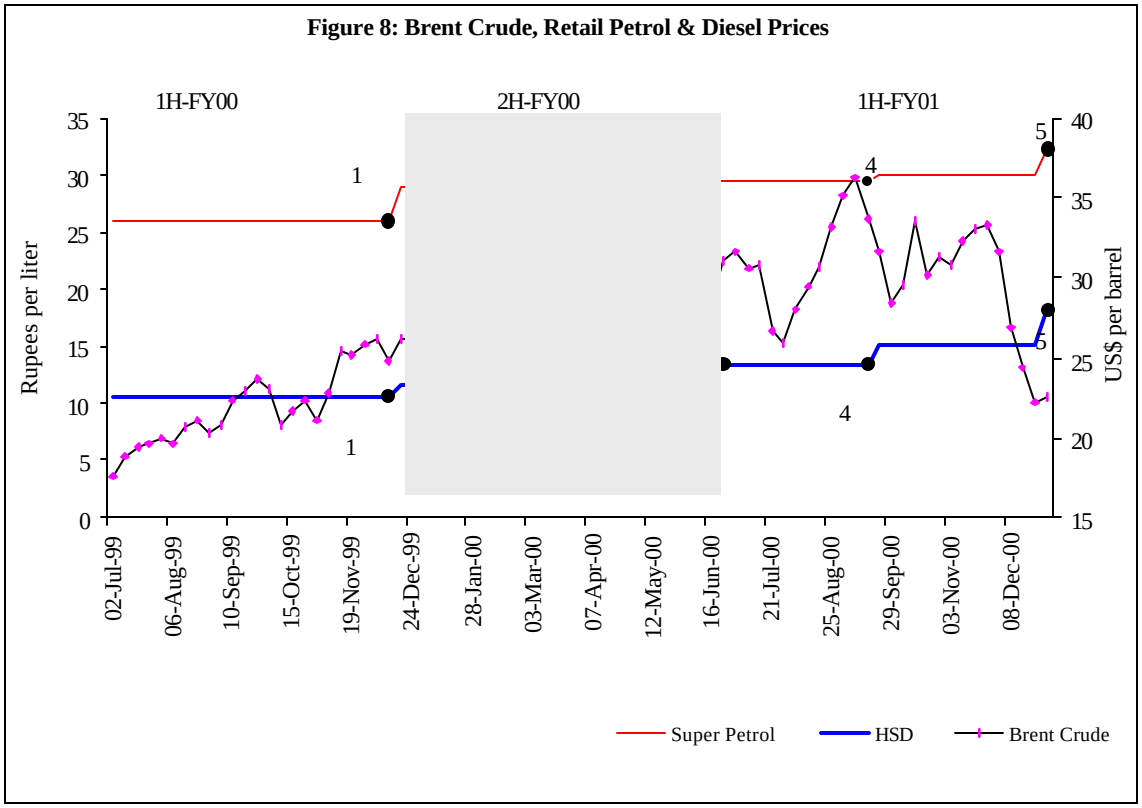
Fuel, Lighting & Lubricants:

- The increase in retail prices of *motor oil* (16.4 percent) and *other oils* (13.4 percent), put upward pressure on the *fuel, lighting & lubricant* index, which grew by 7.3 percent in Q2-FY01. The lagged impact of international oil prices and the cost-push implications following the depreciation of the Rupee, are obvious.

To summarize this section, the broader impact of the September depreciation of the Rupee has started to be felt in imported inputs and consumer items. Additionally, the sharp increase in retail petroleum prices in December 2000 will be felt next quarter even if demand pressures are contained for the remaining part of this fiscal year. Furthermore, with no extraordinary measures to check the prices of food items in end-March 2001 (unlike last December), the inflationary impact of food items will add to the imported inflation.[37]

[37] This refers to domestic price pressures on account of an increase in international prices of imports.

Figure 8: Brent Crude, Retail Petrol & Diesel Prices



7. Capital Markets

Performance of the Karachi Stock Exchange (KSE)

After the settlement crises in May/June 2000, the market experienced some consolidation during the first quarter of FY01. The KSE index moved within a range of 155 points in Q1-FY01 (between 1482 and 1637), which widened to 329 points (between 1276 and 1605) during the second quarter of FY01. The larger range of movement in the second quarter is also reflected in trading volumes; daily trade volumes increased to 133 million shares in Q2-FY01, from an average of 120 million in the preceding quarter (**see Figure 9**).

Highlights of KSE-100 for Q2-FY01

As on Dec 31,2000

(Rs & Shares in bln)

Listed Companies at KSE	762
Change since June 2000 (percent)	-0.86
YoY (percent)	7
Listed Capital at KSE	236.46
Total Market Capitalization at KSE	382.73
Shares traded at KSE during the Quarter	7.98

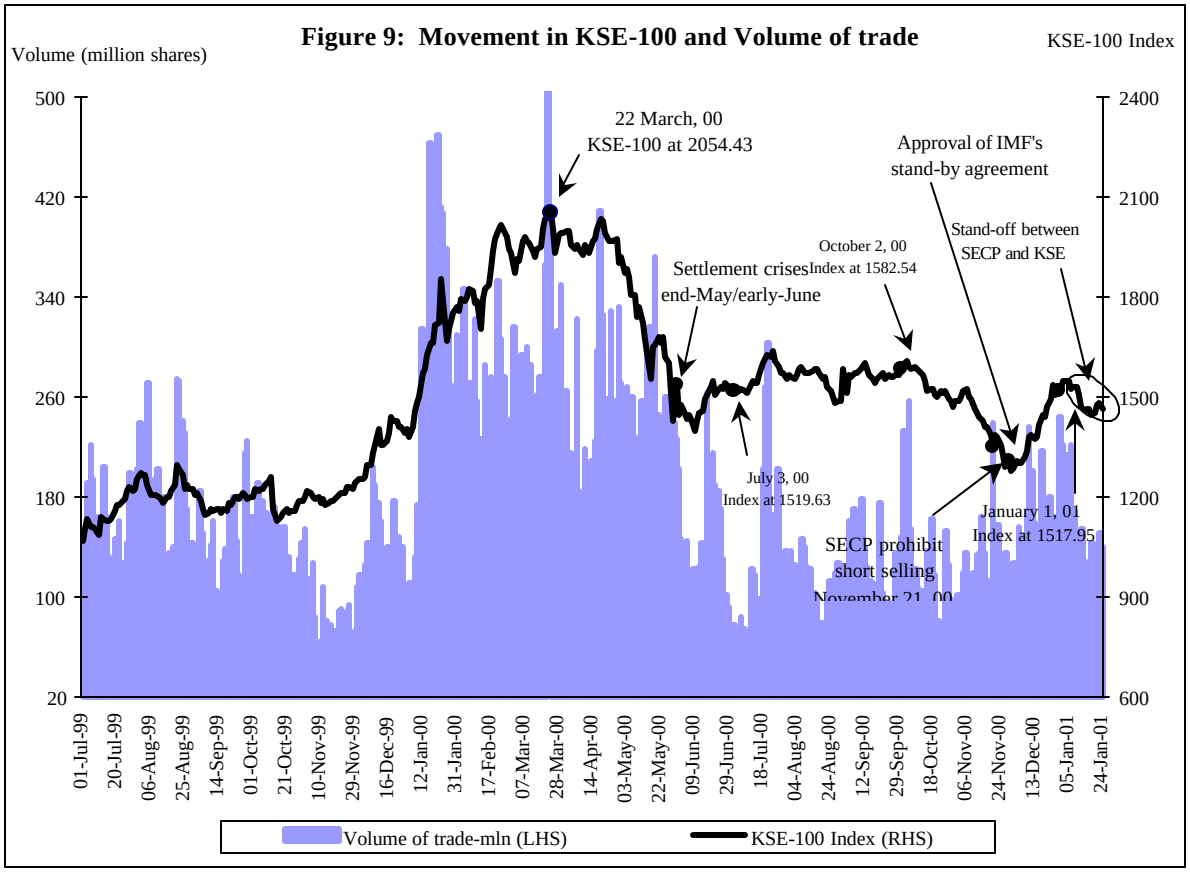
Shares Traded at KSE during the Quarter

Month	Shares in mln		Mkt. Capt (Rs bln)
	Turnover	Ave. daily turnover	
October	2,757	125	386.08
November	2,564	122	337.88
December	2,661	157	382.73

In mid-October 2000, developments in the Hubco-Wapda saga had taken a turn for the worse, defusing sentiments that a tariff agreement was in the offing in the near future. With hindsight, perhaps this downturn in events was necessary for the agreement that was eventually signed on December 16th 2000. By early-November, the market started sliding as investor expectations concerning certain blue chip companies and the textile sector, turned sour.

Worse than expected financial results of Pakistan State Oil (PSO) for FY00 dampened the index, as it became clear that bonus shares (payouts) were not likely this year. Historically, these bonus payouts by PSO are an important part of the overall return on the scrip. Hence, investors take positions in PSO (largely

Figure 9: Movement in KSE-100 and Volume of trade



in the second quarter of the fiscal year) in anticipation of these bonus payouts. Since there was no payout this year, this undermined the attractiveness of PSO (**see Figure.10**). The absence of bonus payouts was attributed to a decline in profitability due to low inventory gains booked by the company. Since PSO has the largest storage capacity in the country, and holds inventory depending on existing and future oil prices, inventory holdings were low last fiscal year. This was on account of high international oil prices and the likelihood that prices would dip.

Furthermore, the index heavyweight – ICI, unveiled its proposed restructuring plan for its PTA plant by end-October. Since this did not meet the market's expectations, the adjustment in investor sentiment pushed the KSE Index lower (**see Figure 11**).

Box: Short-selling

When investors sell scrips they do not own, it is referred to as short selling. This is done in the hope of buying the stock in the future at a lower price. Initially, the short seller places an order to short sell, say 100 shares of a stock, which he or she believes is overvalued. The broker will find a willing buyer at, say, Rs 30 per share and execute the sale. On settlement day the broker will have to borrow shares in order to deliver to the buyer. The buyer receives the 100 shares and pays Rs 3,000. The lender of 100 shares, however, will demand collateral for the shares lent, the most likely collateral being Rs 3,000 received from the buyer. Typically, the cash collateral is provided without any interest paid by the short seller. This arrangement makes it obvious why many speculators are willing to lend shares. They still have an ownership claim to the shares, but now have additional cash that can be invested elsewhere. Now assume the share price actually does fall to say Rs 20. The short seller will cover his position by asking the broker to buy 100 shares. The new seller will receive Rs 2,000 and give up 100 shares, which are returned to the lender. In turn, the lender gives the Rs 3,000 collateral back to the broker, who retums Rs 1,000 profit to the short seller. Short selling is a tool for sophisticated traders who are quick and correctly predict future price movements.

In term of the textile sector, rising domestic input prices signalled an end to the abnormal profits realized during FY00, which in turn downgraded the outlook for the textile sector. During the downward movement in the KSE index in November, heavy speculation in the form of *short selling* compounded the fall (see **Box**). In order to stabilize the market and stem this speculative activity, on November 21st SECP prohibited *short selling* in

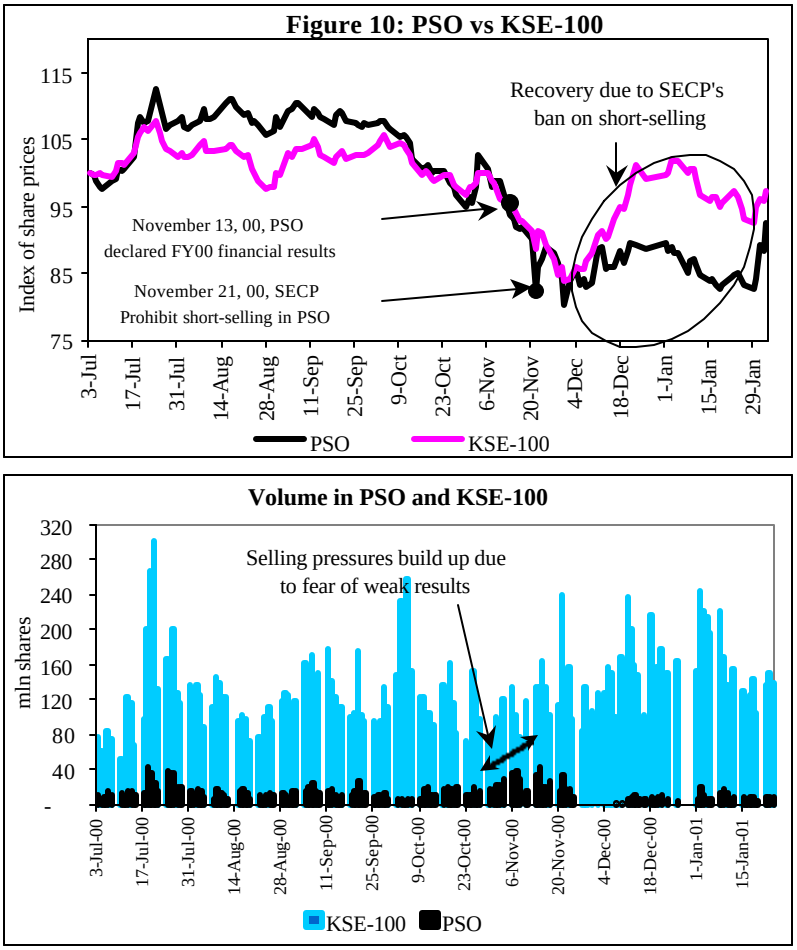
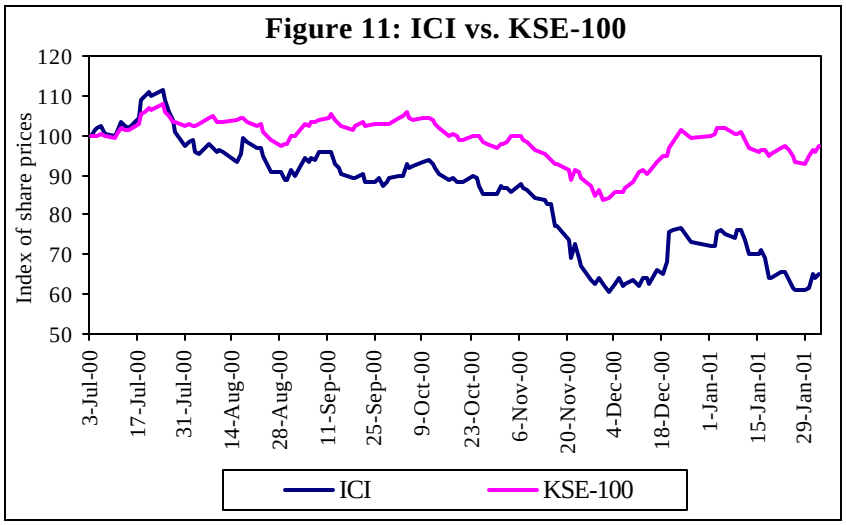


Figure 10: PSO vs KSE-100
Index of share prices
115
105
95
85
75
Recovery due to SECP's ban on short-selling
November 13, 00, PSO declared FY00 financial results
November 21, 00, SECP Prohibit short-selling in PSO
3-Jul
17-Jul
31-Jul
14-Aug
28-Aug
11-Sep
25-Sep
9-Oct
23-Oct
6-Nov
20-Nov
4-Dec
18-Dec
1-Jan
15-Jan
29-Jan
PSO
KSE-100
Volume in PSO and KSE-100
mln shares
320
280
240
200
160
120
80
40
-
Selling pressures build up due to fear of weak results
3-Jul-00
17-Jul-00
31-Jul-00
14-Aug-00
28-Aug-00
11-Sep-00
25-Sep-00
9-Oct-00
23-Oct-00
6-Nov-00
20-Nov-00
4-Dec-00
18-Dec-00
1-Jan-01
15-Jan-01
KSE-100
PSO

PSO, PTCL, Hubco and ICI.[38] This restriction was subsequently imposed on all scrips. Although this intervention by SECP halted the downward slide of Index, market players were very critical, claiming this was undue intervention by the regulators. Nevertheless, this action temporarily boosted the prices of affected stocks, which in turn, supported the KSE-100 index.

Figure 11: ICI vs. KSE-100



By the beginning of December, the Index started to move upwards as Pakistan succeeded in securing an agreement with the IMF. By mid-December, this upward movement got another boost by way of the Hubco resolution.

In order to strengthen investor confidence and improve transparency in KSE operations, SECP ordered some amendments in the Article of Association of the Karachi Stock Exchange. The changes that are binding after 31st December 2000 include the following:

- Only the Board of Directors of KSE will choose the Chairman, as against the existing procedure whereby the General Body (members of KSE) chooses the Chairman.

[38] In terms of trading volumes, just these 4 companies account for 80 to 85 percent of total trading volume in KSE (end-November data).

- The office of the Vice Chairman was removed.
- Out of the existing 18 directors in the Board, the existing system allows SECP and the Board to nominate 2 each, large institutional investors (NIT, etc.) can nominate 3, and the General Body nominates the remaining members. In the proposed change, SECP would nominate 7 *outside* members to the Board.
- SECP would have final say on the appointment, removal and termination, (including non-renewal of contract) of the Managing Director of KSE, and
- To restrict the Board's authority, the bulk of these responsibilities on operational matters were moved to the Managing Director.

However, the Karachi Stock Exchange rejected all these amendments, again citing too much interference by the regulator. According to SECP, all these suggestions are in line with the recommendations of the Inquiry Committee, which looked into the market crash in May/June 2000. KSE and SECP have met and resolved most of the issues.

8. External Sector

Looking at external payments, Pakistan's balance of payments showed some signs of improvement on account of contained non-oil imports, increase in quantitative exports, and balance of payment support from the IFIs that resumed in the first half of FY01. The current account deficit narrowed to US$ 681 million from US$ 747 million in the corresponding period last year, largely due to higher worker remittances and a higher volume of outright purchases. This narrowing of the current account deficit was possible despite higher net payments on the services account (see **Table 12**).

Services payments increased from US$ 1.3 billion to US$ 1.6 billion during 1H-FY01. These payments were driven by higher shipment charges, but more importantly, because of larger interest payments (on public debt and Special US$ Bonds) along with higher profit/dividend payments by multinational companies (MNCs) engaged in extracting crude oil in the country.

As far as the capital account is concerned, it reveals a much lower outflow of US $ 391 million during 1H-FY01, as against outflows of US $1,499 million in the corresponding period last year. This is largely due to: (1) a sharp fall in *notional*

outflows on account of institutional non-resident FCAs,[39] (2) lower repayments of commercial credit[40], and (3) fresh inflows of IFI assistance that were not available during FY00.

Given the accrual basis of Pakistan's BOP, the treatment for debt payments that have not actually been made are shown in the exceptional financing gap (see **Table at page 56**). Since the capital account shows a lower volume of outflows in 1H-FY01, the corresponding size of the exceptional financing gap has fallen sharply from US$ 1,868 million to only US$ 652 million in the first half of this fiscal year.

8.1 Current account

Actual payment pressure on account of the trade deficit[41] continued to narrow in 1H-FY01, primarily on account of stronger export growth. However, like the recent past, this increase is based on a positive quantity effect, which implies that the international price of Pakistan's exports continue to work against the country. In terms of imports, oil payments once again dominate as both the price and quantity effects contributed to the US$ 640.0 million increase witnessed in the first half of FY01. A fall in non-oil imports during this period allowed for a smaller increase in the country's import bill.

Looking at net service payments, all heads in this category show larger outflows. This is spearheaded by profit/dividend payments by multinational corporations (MNCs) and higher interest payments on account of the Special US Dollar Bonds. Unrequited transfers, on the other hand, posted an increase of US$ 101 million during the first half of FY01, because of a larger volume of outright purchases from the kerb market to finance higher oil payments. This is impressive since purchases in the first quarter of FY01 were actually lower than

[39] Either rescheduled or converted to Rupees in FY00, but not to the same extent this year.

[40] Commercial credit that was rescheduled during FY00 was partially paid this year (as in the case of the Pakistan Trade Maintenance Agreement - PTMA, and FE45 swap funds) or rolled over for a period of *greater* than one year.

[41] Based on exchange records, which report the actual hard currency inflows and outflows.

the corresponding period last year, but more than caught up in the second quarter of FY01 despite greater volatility in the floating interbank rate (FIBR).

Worker's remittances increased by 17.8 percent during July-December FY01 over the corresponding period last year, but this increase was tempered in the second quarter of FY01 (see **Table 13**). In terms of cash remittances, the US$ 84.6 million increase witnessed in the first half of this year, is evenly distributed between the Gulf region and the West, while the increase witnessed in the first quarter of the last two fiscal years showed a much larger role for the Gulf. This is to be expected since the bulk of the increase in remittances from the Gulf (in the first quarter of FY01), was driven by lumpy payments on account of inflows from Kuwait (war affecties) and Hajj receipts.[42] In overall terms, although remittances have shown an increase over the past two years, they still lag behind the flows realized before the international sanctions imposed after the nuclear tests in May 1998.

To encourage worker remittances through banking channels, in November 2000, SBP decided to reduce the minimum limit for reimbursement of TT charges (for inward remittances) from US$ 200 to US$ 100, or the equivalent for other currencies. Furthermore, this Circular also increased the amount that banks would receive for each remittance above US$ 100. It remains to be seen whether this incentive will succeed in increasing official remittances for the rest of this fiscal year.

As shown in **Table 12**, looking at the first half of the last three fiscal years, there has been an impressive containment in Pakistan's current account deficit. Since this determines the actual financing needed, it is an encouraging sign that despite adverse international prices and limited IFI assistance, Pakistan has managed to cope with the restrained environment after the nuclear tests. Nevertheless, additional efforts are required to ensure that the current account deficit is narrowed further.

[42] In fact, sponsorship funding for Hajj was called in earlier this year (August and September), which explains the increased inflows from UAE.

8.2 Trade account[43]

Pakistan's trade deficit was US$ 921.7 million during the first six months of FY01, 20.2 percent higher than the same period last year. The reasons for this deterioration are: (1) continued pressure from rising international oil prices, (2) higher imports of sugar and pulses on account of low domestic production, and (3) depressed international prices of Pakistan's largest export items (cotton fabrics, yarn, bed wear, synthetic textiles and rice). As a result, the ratio of exports to imports came down from 84.3 percent in the first half of FY00 to 82.9 percent during the period under review.

Exports

During the first half of FY01, export revenues stood at US$ 4.5 billion, short of the US$ 5.0 billion target set in the Trade Policy. Although exports in this period recorded an 8.4 percent rise over the corresponding period in FY00, export performance during Q2-FY01 is disappointing, largely due to the 5.9 percent fall in the month of December 2000.

Total exports during the second quarter of FY01 grew by just 2.8 percent over the corresponding period last year, neutralizing the 14.6 percent growth achieved in Q1-FY01. The worrisome factor in this slowdown is the decline in the export of almost all major items of textiles. However, the reason for this is the sharp fall in the unit value of Pakistan's major exports, with a negative price effect amounting to US$ 290.1 million.

Stepping back, the following points highlight Pakistan's export performance in 1H-FY01 (see **Table 14**):

- Exports of textile manufactures stood at US$ 2.8 billion in the first half of FY01, up 3.2 percent over the comparable period last year. One of the reasons cited by a number of exporters for this poor performance of the textile sector, is the issuance of SRO 417 by CBR, which changed the rules

[43] The section is based on customs data (which is more detailed), and will not tally with figures shown in the balance of payments. See **Special Section 3** in SBP Q1-FY01 report.

governing the refund of sales tax.[44] These rules were finally amended by CBR on January 25th 2001.

Pakistan's textile exports (price and quantity effects)

US$ Mln	Exports in 1H-FY00	1H-FY00		Exports in 1H-FY01	1H-FY01	
Sub-category		Price effect	Qty effect		Price effect	Qty effect
Textile manufactures	2,735.3	(228.5)	441.4	2,823.2	(196.5)	273.1
Cotton fabrics	556.8	(128.5)	153.8	509.4	(102.8)	55.4
Cotton yarn	495.3	(33.8)	76.6	504.5	(35.9)	45.2
Hosiery	435.0	(3.0)	55.5	455.5	(8.7)	29.2
Readymade garments	384.2	(10.4)	52.4	411.9	15.8	11.9
Bed wear	350.4	(20.9)	72.0	367.3	(23.6)	40.6
Synthetic garments	224.7	(21.3)	25.1	263.3	(33.7)	72.3
Towels	89.6	(9.7)	(1.7)	111.9	(5.2)	27.4

The price and quantity effects are computed on the basis of the previous year's data.

- The table above shows the price and quantity effects for textile exports. As can be seen, a strong cotton crop has led to commendable quantitative increases, which have unfortunately been overshadowed by negative price effects. International prices for textile exports have continued to weaken this year; however, the negative price effect recorded for this year is *lower* than the comparable period last year.
- The US$ 87.8 million export of raw cotton during this period reflects the bumper cotton crop recorded last year (see **Table 14**). This is because domestic consumption is given priority; the surplus (if any) is exported. This year, cotton production has also been strong, on the basis of which, there is a possibility that raw cotton will also be exported next year. The

[44] Allegedly, the new rules are lengthy, cumbersome, and require extensive documentation of refund claims; they also provide discretionary powers to sales tax officers to scrutinize such claims. Additionally, the refunds are to be provided in stages; 50 percent within thirty days, and the rest after verification and audit. As a result, exporters claim that they have to face long delays in tax refunds and duty drawbacks, which has been creating liquidity problems for them.

exact output remains uncertain due to several factors, including late planting, water shortages, pest damage, and efforts to maximize returns by extending the harvest. The cotton production this season is expected to be 10.4 million bales, which is estimated to yield 9.9 million ginned bales.

- During 1H-FY01, rice exports totaled US$ 225.5 million, showing a US$ 15.3 million fall over the corresponding period last year. A positive quantity effect of US$ 30.8 million was overridden by a stronger negative price effect of US$ 46.0 million. Pakistani rice prices have been hit because of lower Asian demand, especially from its largest buyer, Indonesia. Additionally, China is offering rice at much lower prices to countries, which usually imported from Pakistan. Rice exports have also been impacted by the dispute between growers and millers over domestic prices.[45] More recently, prospects of exporting IRRI-6 (low quality rice) have increased as floods have damaged crops in major rice producing countries.
- Exports of fish and fish preparations have shown an 8.5 percent increase during the period rising to US$ 82.0 million. Although, Pakistan exported a smaller quantity this year, better prices resulted in a US$ 14.6 million positive price effect. This was due to the up-gradation of Pakistan's status in EU veterinary list.[46] Other major importers of Pakistani seafood include the USA, Japan, Gulf countries and China. As canned food prices fetch better prices in the European market, concerted efforts need to be undertaken to explore this potential.
- Fruit exports increased by 10.3 percent to US$ 42.0 million during the period under review, due to both higher quantum and better prices. Despite its potential, the lack of facilities for storage and preservation, and substandard packaging are hindering the promotion of this fruitful avenue of increasing Pakistan's export revenues.
- With the use of modern techniques, diversification in designs and meeting international quality standards, carpet exports have increased from US$ 123.1 million to US$ 133.8 million in 1H-FY01, marking a 8.8 percent rise. Nevertheless, the departure from traditional carpets has lowered the overall

[45] Farmers allege that they are not getting the minimum prices set by the government, while accumulation of large stocks has forced some mill-owners to suspend operations.
[46] An EU mission recently visited Pakistan to evaluate hygiene conditions at the Karachi fish harbor. Satisfied with the seafood packaging techniques, Pakistan was upgraded on the list of countries from which animal produce can be imported.

quality of carpets exported. Hence, in quantity terms, exports have shown an increase of 18.8 percent, while realized unit export prices fell by 8.4 percent compared to 1H-FY00.

- Pakistan's leather exports that had remained sluggish since FY95, witnessed a 30.7 percent growth in the first half of FY01. A large quantitative increase of US$ 31.8 million was partly offset by a negative price effect of US$ 7.8 million.

Imports

Imports during the first six months of FY01 stood at US$ 5,395.5 million, depicting a of 10.2 percent growth compared to the corresponding period last year. This growth in imports exceeded export growth, resulting in a larger trade deficit. The following points highlight the major developments in Pakistan's import performance during the first half of the current fiscal year.

- Pakistan's oil bill posted a 53.3 percent increase in 1H-FY01 on account of a sharp rise in international oil prices (see **Table 15 & Figure 8**). Brent crude prices remained at the US$ 30 per barrel mark, even after concerted efforts by Oil Producing and Exporting Countries (OPEC) to increase supply. In US$ terms, compared to the same period last year, Pakistan's oil bill increased by US$ 640 million from US$ 1,201 to US$ 1,841 million in the first six months of FY01; this accounted for 34 percent of Pakistan's total import bill. The impact of higher prices is visible in the US$ 515.3 million positive price effect, which was further aggravated by a US$ 124.8 million quantity effect. More recently, crude prices have begun to ease and reached US$ 22 per barrel in the last week of December. This is largely on account of three factors: (a) a mild European winter, (b) production hikes by OPEC and non-OPEC members, and (c) the resumption of oil supplies from Iraq.
- On account of a poor sugarcane crop in Pakistan, imports increased to US$ 187.9 million in 1H-FY01. Lower international prices mitigated the full impact of the quantitative increase; the price and quantity effect amount to (-) US$ 44.2 million and US$ 231.5 million, respectively. The existing gap between sugar production and consumption this year has widened by 1.0 million tons due to the reported diversion of 17 million tones of sugarcane to manufacture *gur*. In order to meet domestic sugar consumption needs,

Letters of Credit (L/Cs) worth US$ 263.8 million have been opened between July 1st and December 30th 2000.[47]

- Edible oil imports during the first half of FY01 amounted to US$ 176.0 million, indicating a US$ 37.2 million fall over the same period last year. Weak international prices were responsible for this decline (to the tune of US$ 57.5 million), while imported quantities increased by 9.5 percent. Importers of palm oil took advantage of depressed demand in major consumer countries like India and China.
- Imports of machinery, which have shown a steady decline since FY97, rose by 0.3 percent during the first six months of FY01 from US$ 974.5 million in the corresponding period last year (see **Table 15**). This reflected the strong performance by the textile sector, whose machinery imports rose by US$ 87.2 million to US$ 164.0 million during the period. The BMR process that is currently underway in the textile industry, has resulted in imports of US$ 400 million against the target of US$ 1.0 billion.
- Another exception in the machinery group is the import of office equipment (primarily computers), which has shown sustained growth over the years in response to intensive efforts by successive governments to promote information technology. Imports of office machinery totaled US$ 111.0 million during the period, showing an increase of 58.8 percent over the corresponding period in FY00.
- In the wake of a bumper domestic crop last year, wheat imports during the first half of FY01 fell by 93.6 percent to US$ 9.4 million. However, rising international prices exerted a positive price effect of US$ 2.7 million, which mitigated the negative US$ 139.8 million quantity effect.

8.3 Capital account

The capital account revealed a significant improvement in 1H-FY01, as net outflows fell from US$ 1,499 million last year to only US$ 391 million. As shown in **Table 16**, although inflows (shown as credit entries) increased marginally to US$ 1.7 billion in the first half of FY01, outflows posted a sharp fall from US$ 3.1 billion to only US$ 2.1 billion in 1H-FY01. As stated earlier, this is because of the nature of the rescheduling of commercial debt,[48] and the

[47] It is estimated that 0.69 million tons has already arrived in the country.

[48] A portion of this debt was maturing in FY00 and was therefore rescheduled; on the other hand, FY01 did not witness maturity according to the original terms of this debt.

fact that the momentum of conversion from non-resident FCAs to Rupees has fallen appreciably in FY01.[49] This fall in the capital account deficit is reflected in a smaller exceptional financing gap in the first half of FY01.

Annexure 1 should help explain why the exceptional financing gap this year is so much smaller compared to last year. As discussed in previous SBP publications, this gap refers to notional *inflows* required to balance out payments that have been shown in the capital account. A clearer picture can be gauged by looking at the following Table.

Exceptional financing		
US$ millions	**1H-FY00**	**1H-FY01**
Total	**1868**	**652**
Of which		
Debt relief (Paris Club)	784	646
FE 45	534*	(71)**
Special deposits w/ SBP*	300	250
PTMA	152*	(117)**
Eurobond	150	0

*Rescheduled/rollover; **Actual payments.

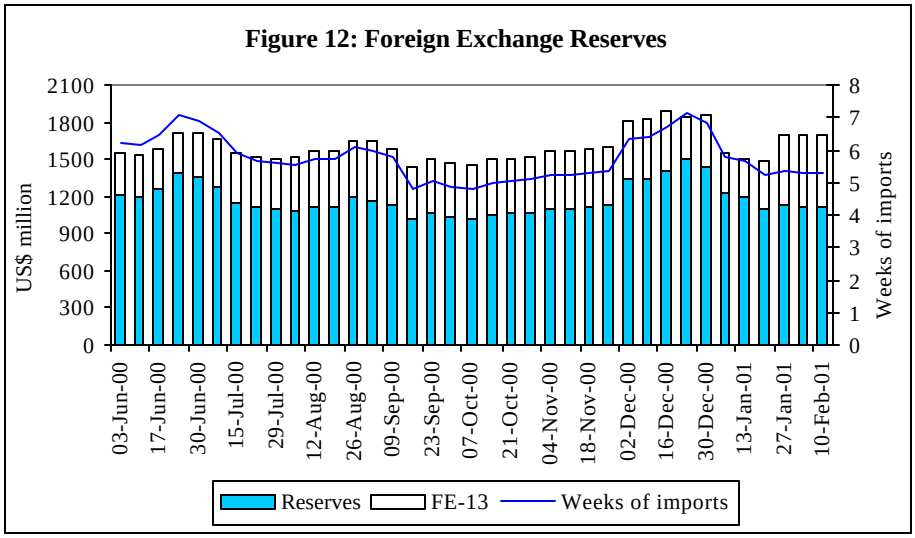
As shown, the debt relief from Paris Club has fallen slightly in FY01. However, this is more a reflection of the various loans rescheduled under the original agreement with sovereign creditors than any exogenous development. The reversal shown for FE 45 deposits is due to the actual payment of US$ 71 million this year, while a much larger volume had been rolled over in FY00. Looking at PTMA, a similar story unfolds. Against rescheduling of US$ 152 million last year, SBP has made a payment of US$ 117 million at the end of December 2000, as part of the agreement with creditor banks. And finally, the rescheduling of Pakistan's Eurobond that covered FY00 provides a grace period of three years before *principal* payments begin. Although interest payments on this consolidated bond already began in FY00, these payments are shown in the current account.

[49] This latter point has the same impact on the capital account as rescheduling; the only difference is that whereas rescheduling creates a counter-entry in Pakistan's exceptional financing gap (showing inflows to counter the notional outflows shown in the capital account), while conversion to Rupee shows a positive entry in *Errors & Omissions* to reflect a reduction in the country's foreign exchange liability.

Pakistan's Liquid Reserves

In terms of Pakistan's liquid reserves, the first half of FY00 witnessed a fall of US$ 264.1 million, with total reserves at the end of December 1999 at US$ 1.47 billion and unencumbered reserves (excluding FE 13 deposits) at US$ 1.30 billion. Although liquid reserves actually increased in the first half of FY01 (from US$ 1.35 to US$ 1.44 billion in end-December 2000), unencumbered reserves actually fell this year. This does not, however, show up in the official figures on account of the 1-month foreign exchange swaps conducted with commercial banks, which used their FE 13 deposits (which are placed with SBP) to procure Rupee liquidity at the end of December 2000 (see **Figure 12**).[50]

Figure 12: Foreign Exchange Reserves



8.4 The Exchange Rate

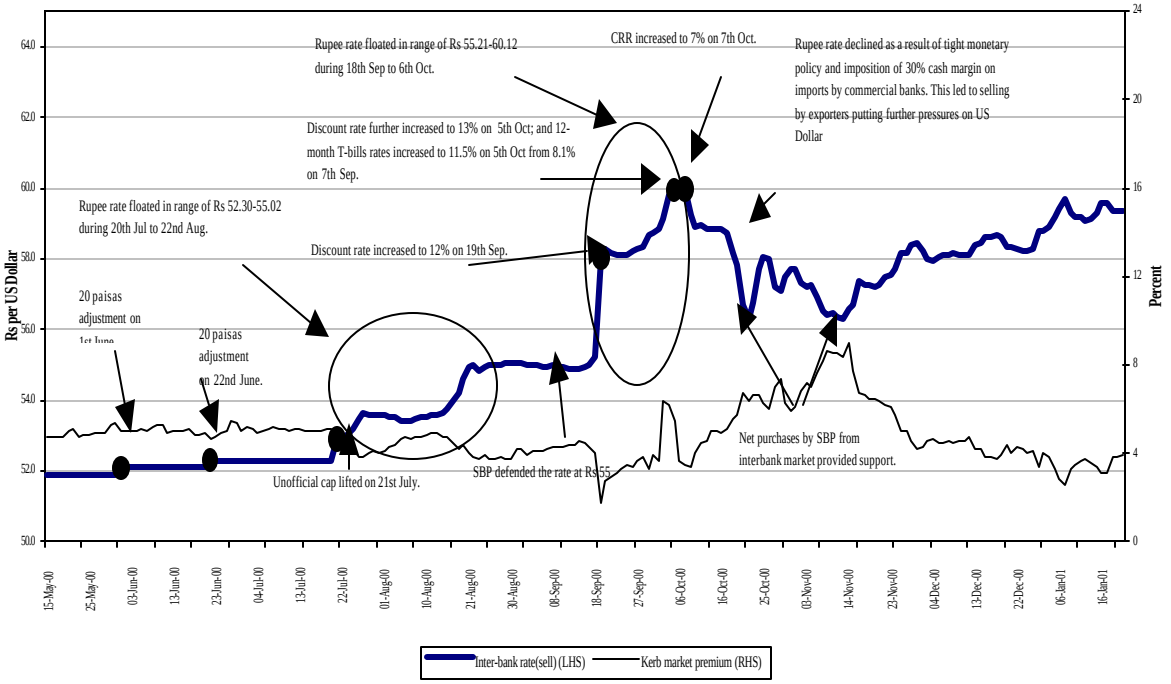
Figure 13 is an illustrative depiction of all important developments in the exchange rate since the beginning of the fiscal year. It clearly shows the sharp depreciation in mid-September, and the use of monetary policy to quell the panic in the first week of October. Since then the official rate has shown some

[50] As of end-December 2000, commercial banks had swapped about US$ 179 million with SBP using their FE 13 deposits. In effect, SBP's unencumbered reserves temporarily increased at the end of the year by that amount.

volatility, with SBP purchasing hard currency from the interbank market in November and December to reverse the net injections by the central bank in the past. These actions were also designed to reduce volatility in the exchange rate and to shore up liquid reserves.

With growing pressure on account of service payments and a war of nerves with exporters (who were holding off receipts in an effort to realize better Rupee rates), the interbank rate continued to edge upwards after the third week of November. In looking at **Figure 13**, an interesting observation is the almost mirror like behavior of the official rate and the kerb premium after mid-November. As discussed in more detail in **Special Section 1**, this is a clear indication that changes in the official rate now provoke movements in the kerb rate. Another way to view this, is to say that the kerb rate is not as efficient an indication of supply/demand imbalances, and generally responds with a lag to changes in the official rate. For example, when the official rate appreciated, the kerb rate did not respond quickly with the result that the kerb premium posted significant increases. In other words, the kerb rate is sticky in a downward direction, which supports our view that this market is controlled by a few large sellers who are able to resist downward movements in the kerb rate.

Figure 13: Inter-bank and Kerb market rate



8.5 Annexure 1: Details of the capital account

This Annexure uses Table 16 exclusively.

Net foreign investment

The fall in foreign investment in the first half of FY01 reflects lower net inflows of direct foreign investment (DFI), and larger net outflows from the stock market. Although this may seem disappointing compared to last year, realized DFI flows suffer from a significant time lag, which means that investment decisions contingent on positive developments in the host country, may actually be realized well after. The fall in DFI relative to 1H-FY00 (from US$ 307 to US$ 143 million) may seem surprising since Pakistan was moving away from the IMF in the first half of FY00, while the period this year was spent formalizing a fresh arrangement.[51] In terms of portfolio inflows, whereas the first half of FY00 witnessed a bullish period in the stock markets, the corresponding period this year was quite stagnant.

Long-term capital (official)

Official long-term capital posted a sharp increase in net outflows from US$ 26.0 million during 1H-FY00 to US$ 250.0 million during the first half of this year. This was driven by the rollover for two years of a US$ 250 million loan facility that matured in August 2000 (see item 4.4 in **Table 16**). As this repayment has not taken place, it is shown as an outflow in the capital account and balanced off by an equivalent inflow in the exceptional financing gap.

Long-term capital (others)

Long-term capital (others) includes non-contractual flows from parent companies to MNCs operating in Pakistan, suppliers credit and PAYE schemes. The net impact under this head shows a fall in outflows from US$ 195 million during 1H-FY00 to US$ 125 million in the corresponding period this year. Although fresh inflows of non-guaranteed credit to the private sector (item 6.2) have fallen, a lower volume of repayments on past loans has overshadowed this decline in inflow. Certain local corporates (IPPs and a fertilizer company) that had borrowed from various international lending agencies, have been asked to

[51] An agreement with the IMF provides comfort for fresh foreign investment in countries that have structural problems in the external sector.

renegotiate their repayment schedule to make it consistent with the rescheduling of Pakistan's official debt (to Paris Club members) and government guaranteed commercial debt solicited through multinational banks.

Short-term capital (official)

Official short-term capital (obligations of 1-year maturity or less) showed a sharp reversal in 1H-FY01, from outflows of US$ 284 million in July-December 2000, to inflows of US$ 135 million in the corresponding period this year. This inflow reflects short-term borrowing from the Islamic Development Bank (IDB), which increased from US$ 85 million in the first half of FY00, to US$ 219 million in the corresponding period this year. The foreign exchange flows shown in item 7.3, refers to the placement of short-term debt with SBP and repayments on past loans. This item depicts net inflows of US$ 23 million against *outflows* of US$ 192 million in 1H-FY00, largely because of a US$ 300 million rollover in FY00 that was not necessary this year.[52]

Short-term capital (deposit money banks)

Short-term capital (commercial banks) also shows a sharp reversal in net outflows. Against outflows of US$ 662 million during July-December FY00, the period this year shows a very nominal outflow of US$ 3 million. This difference is concentrated in item 8.5, which refers to FE 45 (swap) funds that were frozen following the nuclear tests. More specifically, during the first half of FY00, US$ 333 million had to be paid as originally contracted (but has been rescheduled), while US$ 274 million was voluntarily converted into Rupees by creditors. These two items, combined with fresh inflows of non-resident FE 25 deposits, are shown as net outflows of US$ 585 million. Compared to this, net outflows in 1H-FY01 only amount to US$ 43 million. This sharp fall in 1H-FY01 is because FE 45 funds did not have to be rescheduled this year, while the conversion to Rupees also tapered off to only US$ 66 million.

Short-term capital (others)

An almost identical story exists for FE 45 funds brought into Pakistan by non-bank financial institutions (NBFIs – primarily investment banks). Item 9.3

[52] The notional outflow last year was reduced by a fresh placement of US$ 109 million by NBP in 1H-FY00.

shows an outflow of US$ 367 million in 1H-FY00, against outflows of only US$ 6 million this year. This is because FE 45 deposits of US$ 202 million were rescheduled last year, while conversion to Rupees was US$ 188 million; the values this year (1H-FY01) are US$ 0 and US$ 21 million, respectively. The increase in outflows posted under 'ST assets' refers to outstanding export receipts maintained by exporters themselves. Since export orders are credited in the trade account, receipts that are still held by exporters are shown here as outflows. The fact that outstanding export receipts have increased in the first half of FY01 compared to the corresponding period last year, is a clear indication that exporters are holding on to their Dollar receipts in an effort to realize a higher Rupee conversion rate. The fact that the official rate has shown more volatility and greater loss of value this year is clear motivation for this behavior on the part of exporters. In effect, exporters are speculating against the Rupee.

Special Section 1: The changing causation between the Kerb and Interbank exchange rate[53]

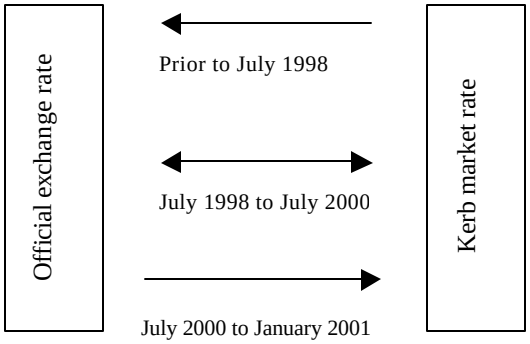
This section investigates the causal relationship between the kerb and interbank exchange rate using cointegration and Granger causation techniques.

Summary of analysis and results

Deviations between the kerb and official rate are often used as proxy for the degree of misalignment of the official exchange rate in developing countries. More specifically, the premium in the kerb market is taken as a reflection of the excess demand for foreign exchange resulting from certain restrictions that entail capital account controls.

However, in Pakistan's case, changes in the exchange rate regime over the last three years have not only impacted the underlying relationship between the two rates, but also have implications for the validity of the kerb premium as an indicator of overvaluation. Prior to July 1998, the kerb rate was adjusting to market conditions whereas the official rate was announced on a daily basis by SBP. The overvaluation of the *pegged* exchange rate was directly on account of restrictions that limited only certain 'approved' transactions that could be executed at the official exchange rate. However, since July 22nd 1998, when the dual exchange rate mechanism was adopted, the official rate has been adjusting to market conditions.[54]

Chart 1
Direction of causation in different periods



[53] Ownership for this section goes to Syed Sajid Ali (Assistant Director, GERD).

The main findings of the study are summarized in **Chart 1**. As shown, prior to July 1998, the official rate (as determined by SBP) followed the kerb rate. This implies that a sustained upward movement in the kerb rate would pre-empt or lead a devaluation of the exchange rate. This also means the kerb market was able to correctly predict changes in the official rate, and the resulting activity in the open market would increase the kerb premium just before an official devaluation.

Between July 1998 to July 2000, on the other hand, when the Rupee was in a transitional stage towards pure float, causation ran in both directions. More simply, it is hard to determine one-sided causality. However, after 21st July 2000, when the Rupee was fully floated, a stronger causation runs from the official to the kerb rate. This means that changes in the official rate now determine almost equivalent changes in the kerb rate.

The behavior of the kerb market premium is shown in **Figure 1.1**. It is evident that the premium in the kerb market has been fluctuating widely since July 21st 2000, when SBP did not provide an indicative FIBR, rising to as high as 9 percent in mid-November 2000. Interestingly, we found strong negative correlation (-0.92 to - 0.99) whenever the interbank rate experienced sharp fluctuations. This means, the kerb rate is *not* adjusting quickly enough to changes in the interbank rate. This is particularly obvious when the exchange rate *appreciated* in the interbank market by Rs 3.8 per US Dollar, from Rs 60.1 on October 9th 2000 to Rs 56.3 on 24th October 2000. The pass-through to the kerb rate was limited, resulting in a high premium (see **Figure 1.1**).[55] This implies that the kerb premium is not reflecting *transaction costs* and excess demand pressures and should not be used as an indicator of overvaluation. In fact, given the strong negative correlation between the official rate and the kerb premium, it is tempting to say that the kerb rate adjusts to changes in the official rate with a certain time lag.

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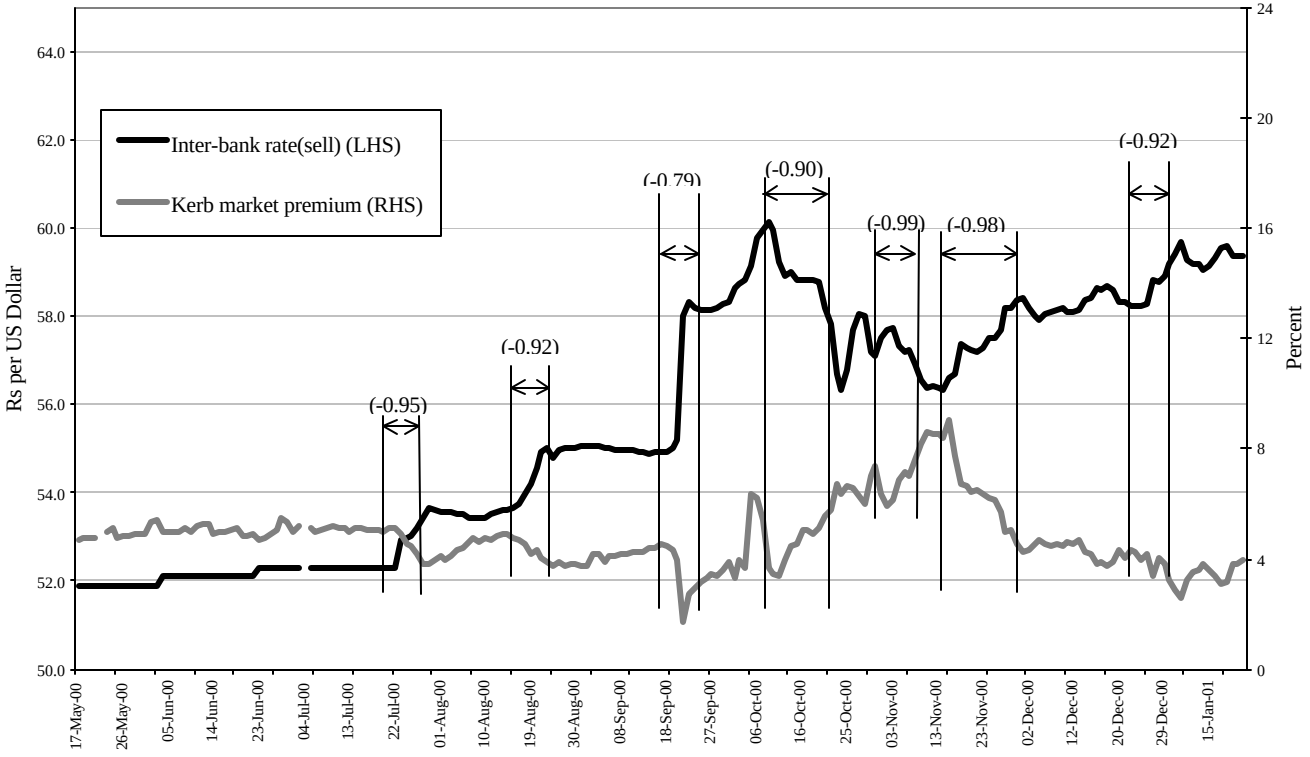
[54] SBP was nevertheless managing the interbank market using an unofficial cap. However, since 21st July 2000, the interbank rate is free to reflect demand and supply conditions, with SBP only financing lumpy oil and debt payments.

[55] The kerb rate appreciated by Rs 2.5 per US Dollar from Rs 62.2 to Rs 59.7 during this two-week period.

Figure 1.1: Inter-bank and Kerb market rates



Figures in parantheses are co-efficient of correlation.

The following section is meant for readers with an adequate background in econometrics.

Methodology

The concept of causality associated with Granger, C.W.J. (1969), is widely applied in empirical analysis for examining the causation between economic variables. According to this approach, information relevant to the prediction of y_t is contained in its past values. However, if the inclusion of lagged values of another variable (x_t) significantly improves the prediction of y_t (or y_t is better predicted by past values of y_t and x_t than past values of y_t alone), then it is said that x_t *causes* y_t in a Granger sense. The statement "x_t Granger causes y_t" does not imply that y_t is solely dependent on, or is the result of x_t; it reflects only precedence and does not indicate causality in the more common use of the term.

We can distinguish four patterns of causality: (a) unidirectional causality from x_t to y_t, (b) unidirectional causality from y_t to x_t, (c) bi-directional causality, and (d) no causality. For official rate (x_t) and kerb rate (y_t), the official rate influences the kerb rate, i.e., case (a), kerb rate influences the official rate i.e., case (b), both rates have influence on each other i.e., case (c), or two rates are independent of each other i.e., case (d).

For a simple bivariate model, causality can be examined by estimating regression of x_t and y_t on all the current and lagged values and then testing the appropriate hypotheses.

$$y_t = a_0 + \sum_{i=1}^{m} a_i y_{t-i} + \sum_{j=1}^{n} b_j x_{t-j} + \varepsilon_t \text{.....(1)}$$

$$x_t = c_0 + \sum_{i=1}^{r} c_i x_{t-i} + \sum_{j=1}^{s} d_j y_{t-j} + \eta_t \text{.....(2)}$$

where ε_t and η_t are uncorrelated white noise series. Direction of relationship between x_t and y_t can be determined by testing the null hypothesis that $b_j=d_j=0$ for all j.

It may be mentioned here that recent econometric theory and practice have focussed more on the time series properties of the data used in regression

analysis.[56] The non-stationary problem can be removed by pre-filtering the data and rendering them stationary before attempting to estimate a functional relationship. However, this approach causes a significant loss of information, particularly the long-run properties of the series. Another approach is the cointegration technique that advantageously exploits the nonstationary problem of the series. Behind this technique lies the idea that even if each time series is nonstationary, there might exist linear combinations of such time series that are stationary. More importantly, the existence of cointegrating relationship among multiple time series implies presence of a linear long-run equilibrium relationship between them. Moreover, if series are cointegrated, then some series must adjust in the short run so as to maintain equilibrium among multiple series. That implies the presence of short run feedback (and hence Granger causality) among these series[57]. Therefore, before applying Granger causality tests, we will have to ensure that the two series are non-stationary and there exists a cointegrating relationship between them.

Stationarity test: A non-stationary time series y_t is integrated of order d if it achieves stationarity after being differenced d times i.e., $y_t \sim I(d)$. Therefore, an $I(0)$ series is stationary. The stationarity of the two series was examined using Dickey-Fuller unit root tests. In particular, the unit root tests are performed by estimating the Augmented Dickey Fuller equation of the form

$$(1-L)y_t = \alpha + \beta t + \gamma y_{t-1} + \sum_{i=1}^{k} \delta_i (1-L) y_{t-i} + e_t \ldots\ldots\ldots\ldots\ldots(3)$$

[56] A large number of time series used in economic analysis are non-stationary (i.e., they have a persistent tendency to increase or decrease over time), which implies a number of restrictions on their use in regression analysis. In particular, regression of one non-stationary series on another, can give rise to spurious regression, whereby the results obtained suggest that there are statistically significant relationships between the variables in the regression model when in fact all that is obtained is evidence of contemporaneous correlation rather than meaningful causal relations. In addition, neither the mean nor variance are meaningful concepts for non-stationary variable, therefore conventional t and F tests may lead to incorrect statistical inferences.

[57] Granger (1988) points out that if two series are cointegrated, then there must be Granger-causation in at least one direction.

where L is the lag operator, t is linear time trend, e_t is an error term, k is the number of lagged first differences of y_t necessary to make e_t serially uncorrelated.[58] The null hypothesis of unit root (nonstationary series) $g = 0$ is tested against the alternative of $g \neq 0$.[59] If the calculated t-ratio is less than the critical t-value, then the null hypothesis is rejected implying that the series is stationary. It may be mentioned here that choice to include a constant and a linear trend is important since the asymptotic distribution of the t-statistic under the null hypothesis depends on assumptions regarding these deterministic terms.[60]

Cointegration test: If it is found that the individual time series x_t and y_t are integrated of the same order, the next step is to test for cointegration. We have used the approach proposed by Engle and Granger, denoted hereafter as the EG procedure. This approach is implemented by regressing one series on the other and then testing whether the residuals from the regression are stationary or not. If the residuals are stationary, then the two time series are cointegrated.[61] This test requires estimation of following equations:

---

[58] The procedure is to start with some bound on k say *(k-max)*, chosen a priori. Apply the ADF with k set at *k(max)*. If the last included lag is significant (using the standard normal asymptotic distribution), select k=k(max). If not, reduce the order of the estimated autoregression by one until the coefficient of the last included lag is significant. If none is significant, select k=0.

[59] It is important to note that although these statistics are calculated as t-ratios, they do not have standard t-distribution because under the null hypothesis of non-stationarity, the variance is unlimited.

[60] One approach is to include both a constant and a linear trend since the other two cases are just special cases of this more general specification. However, including irrelevant regressors in the regression reduces the power of the test, possibly concluding that there is a unit root when, in fact, there is none. The general principle is if the series seems to contain a trend (whether deterministic or stochastic), include both a constant and trend in the test regression. If the series does not exhibit any trend and has a nonzero mean, include only a constant in the regression, while if the series seems to be fluctuating around a zero mean, include neither a constant nor a trend in the test regression.

[61] This EG procedure has several shortcomings: (1) the test results are sensitive to the particular series chosen as the dependent variable; (2) the test can not tell whether the number of cointegrating relationships is one or more than one; and (3) the test of

$$y_t = \alpha + \beta x_t + e_t \text{.....(4)}$$

$$x_t = \alpha + \beta y_t + \varepsilon_t \text{.....(5)}$$

If the residuals e_t and ε_t from the regression are stationary, then the variables are said to be cointegrated and hence interrelated with each other in the long run.[62]

Granger causality test: If the series are found cointegrated, then we can apply standard causality test augmented by an appropriate error correction term derived from the cointegrating equation.[63] If the time series were *I(1)*, the Granger causality tests are applied after taking their first difference. Therefore equations (1) and (2) would become

$$\Delta y_t = a_0 + \sum_{i=1}^{m} a_i \Delta y_{t-i} + \sum_{j=1}^{n} b_j \Delta x_{t-j} + \gamma e_{t-1} + \varepsilon_t \text{.....(6)}$$

$$\Delta x_t = c_0 + \sum_{i=1}^{r} c_i \Delta x_{t-i} + \sum_{j=1}^{s} d_j \Delta y_{t-j} + \gamma \varepsilon_{t-1} + \eta_t \text{.....(7)}$$

Incorporation of lagged error term from cointegrating equation provides an additional source of inferring the temporal causality between x_t and y_t, i.e., there may exist causal link from x_t to y_t even if $\sum_{j=1}^{n} b_j = \sum_{j=1}^{s} d_j = 0$ under a situation in which γ is found to be statistically significant.

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hypotheses in the cointegrating vector cannot be carried out because estimated coefficient have unknown nonstandard distribution. However, most of the limitations become invalid in the case of such bivariate model where both series have been used as dependent variable. Nevertheless, we also used Johansen and Juselius procedure, which does not suffer from any of the aforementioned problems. This test enables one to test directly for the number of cointegrating vectors and provides at the same time maximum likelihood estimates of the cointegrating vectors. Tests of hypotheses in such estimated cointegrating vectors can be easily carried out and results are not sensitive to the particular normalization chosen. The results of cointegration tests from the two approaches were found similar.

[62] e_t is in effect a linear combination of x_t and y_t. It implies that a linear combination of two or more non-stationary time series can, in some circumstances turn out to be stationary.

[63] This error term contains the useful information that would otherwise have been lost through first differencing of all variables in the equation.

This paper uses daily exchange rates (both kerb market and official exchange rates) covering period from Jan 1993 to January 2001. Granger causality test was applied after splitting the data into three sets at July 21st 1998 when dual exchange rate regime was adopted that introduced more flexibility to the official rate (composite rate), and at July 21st 2000 when the Rupee was put to complete float.

Data set 1	January 1st 1993 to July 21st 1998
Data set 2	July 22nd 1998 to July 20th 2000
Data set 3	July 21st 2000 to January 30th 2001

This would enable us to trace any impact on causation for the changes in exchange rate regime. For the purpose of estimation we made use of Econometric Views (Eviews) statistical software.

Empirical Results

First we checked for stationarity of the two exchange rates under different data sets by using ADF tests. Results of the test are reported in **Table 1.1**. As the series seems to contain trend, we included both constant and trend term. The null hypothesis of non-stationary kerb and official rates was tested against the alternative hypothesis of stationarity for all data sets. For the second data set (July 22nd 1998 to July 20th 2000), the null hypothesis of non-stationarity was rejected at 5 percent level of significance for the two exchange rates. It means that during this period, both the official and the kerb rates are *I(0)*; there is no need for a cointegration test as variables stationary in their levels are supposed to be cointegrated and Granger causality tests can therefore be applied at level form.[64] For other remaining data sets, the two series were found non-stationary in their levels. However, their first differences were stationary as the null hypothesis was rejected at the 5 percent significance level. It implies that for the two data sets, the official and the kerb rates were *I(1)* and qualify for the test of cointegration.[65]

[64] Stationarity at level form during this period reflects intensive exchange rate management by the SBP.

[65] ADF tests were also tried with constant only and without constant and trend terms. In all the formulations, the two series were found integrated of order one.

Table 1.1: ADF unit root tests

	Level	First difference	Critical values[1]	Order of integration
Data set 1				
Official rates	-1.6634[4]	-18.9507[3]	-3.4154	*I(1)*
Kerb market rates	-0.1368[2]	-19.1116[4]	-3.4154	*I(1)*
Data set 2				
Official rates	-5.3198[5]	---	-3.4198	*I(0)*
Kerb market rates	-3.5404[2]	---	-3.4196	*I(0)*
Data set 3				
Official rates	-1.8947[4]	-5.5426[4]	-3.4401	*I(1)*
Kerb market rates	-1.7779[2]	-7.0335[3]	-3.4399	*I(1)*

Figures in square parentheses are number of lags used.
1. Mackinnon critical values at 5 percent level of significance.

In order to check whether there exists any long run relationship between the two exchange rates we used EG procedure. For that purpose, equations (4) and (5) were estimated and their residuals were tested for stationarity using ADF tests. Results of cointegration tests are reported in **Table 1.2**. In the case of first data set, a cointegrating relationship was detected at 10 percent level of significance, when we regressed the official exchange rate on the kerb rate, implying existence of a long run relationship between the two exchange rates during this period. It also indicates the presence of a valid error correction mechanism for short run adjustment. Therefore, we can apply further tests of Granger causality. However, no such cointegrating relationship was found when kerb rate was used as a dependent variable, implying non-existence of causality from official rate to kerb market rate during this period. For the second data set, the cointegration test was not required as the exchange rates were found stationary at their levels. For the third data set, ADF tests on residuals support a cointegrating relationship between kerb and official rate at 5 percent level of significance. The result was similar irrespective of the choice of dependent variable. It means that we can use both equations for testing Granger causality in the next step.

Given the results of cointegration tests, our next step is to estimate equations (6) and (7) and test relevant hypothesis for Granger causality. Focusing on data set 1 (Pre July 1998), causation from official to kerb rate was not tested as no

Table 1.2: Cointegration test

A. Official rate (x_t) on kerb rate (y_t), i.e, $x_t = f(y_t)$		
Data set 1		
(x_t) = 1.6219 + (0.9190) (y_t)		
t-statistics (9.174) (192.739)		
R^2 = 0.96	F-statistics = 37148.41	DW = 0.0429
ADF on residuals (no intercept, no trend)		-1.7525 (cointegrating relation exists)
Critical value at 10 percent level of significance		-1.6157
Data set 3		
(x_t) = 4.9236 + (0.8672) (y_t)		
t-statistics (3.259) (34.234)		
R^2 = 0.88	F-statis tics = 1171.95	DW = 0.1306
ADF on residuals (no intercept, no trend)		-2.3624 (cointegrating relation exists)
Critical value at 5 percent level of significance		-1.9419
B. Kerb rate (y_t) on official rate (x_t), i.e, $y_t = f(x_t)$		
Data set 1		
(y_t) = -0.3137 + (1.0585) (x_t)		
t-statistics (-1.601) (192.739)		
R^2 = 0.96	F-statistics = 37148.41	DW = 0.0432
ADF on residuals (no intercept, no trend)		-1.4026 (cointegrating relation does not exist)
Critical value at 10 percent level of significance		-1.6157
Data set 3		
(y_t) = 1.9472 + (1.0184) (x_t)		
t-statistics (1.155) (34.234)		
R^2 = 0.88	F-statistics = 1171.945	DW = 0.1237
ADF on residuals (no intercept, no trend)		-2.2448 (cointegrating relation exists)
Critical value at 5 percent level of significance		-1.9419

cointegrating relationship exists when we used kerb rate as a dependent variable. However, the null hypothesis of no Granger causation from kerb to official rate was rejected at 5 percent level of significance (see **Table 1.3**). This implies that changes in official rate prior to July 1998 were Granger caused by kerb rate. This result seems logical, as during that period kerb rate was more flexible to

demand and supply changes, whereas official exchange rate was adjusting after some lag.

Table 1.3: F-statistics for Granger Causality

Dependent variable	F-statistics for hypotheses testing			
	Hypothesis 1	Hypothesis 2	Hypothesis 3	Hypothesis 4
Data set 1				
Official exchange rate	---	5.1206 [0.006]	2.6967 [0.101]	5.0455 [0.001]
Data set 2				
Official exchange rate	2.7487 [0.004]	---	---	---
Kerb rate		2.4382 [0.010]		
Data set 3				
Official exchange rate	---	1.7658 [0.175]	0.7455 [0.389]	1.5592 [0.202]
Kerb rate	4.8130[0.009]	---	4.4747 [0.036]	4.7969 [0.003]

Figures in parentheses show the level of significance for rejecting the null hypothesis.
Hypothesis 1: Official rate does not Granger cause kerb rate.
Hypothesis 2: Kerb rate does not Granger cause official rate.
Hypothesis 3: Causality is through the lagged error term.
Hypothesis 4: Hypothesis one or two, and three above

The standard Granger causality test was augmented by lagged error term to provide additional source of causation. The null hypothesis of no Granger causation from lag error term to official rate was also rejected at 10 percent level of significance. This suggests that official exchange was also adjusting in response to one period lagged deviation from the long-term trend between the two rates. Finally, the null hypothesis of no Granger causation from kerb rate and lagged error term to official rate was also rejected, thus supplementing earlier two hypotheses.

For the second data set (July 22nd 1998 – July 20th 2000), the standard Granger causality test was applied at level from. The results indicate presence of bi-directional causality for the official and kerb rate as hypotheses 1 and 2 were rejected at 5 percent level of significance for both official and kerb rate respectively as dependent variables.

For the third data set (July 21st 2000 – January 30th 2001), the standard Granger causality test from official to kerb rate was rejected at 5 percent level of

significance, implying that changes in kerb rate during the period are Granger caused by changes in official rate.

This result is according to expectations as official rate (interbank rate) is more responsive to market forces, and having larger coverage, it drives the kerb rate. Null hypothesis of no causation from lagged error term to kerb market was rejected at 5 percent level of significance. This means that kerb market rate is also adjusting in response to lagged error correction term. However, the standard causality test from the kerb rate to official rate could not be rejected. The null hypothesis - no causation from the lag error correction term to official rate, was also accepted. These results suggest that changes in the official rate are *followed* by changes in the kerb rate.

Summing up the results, prior to July 1998, there exists unidirectional Granger causality from kerb to official rate with the latter also adjusting in response to deviation from the long run relationship between the two rates. However, during July 1998 to July 2000 period, we found bi-directional causality between the two exchange rates. This period was characterized by transition to unified exchange rate, with rates managed by the SBP. Thus, during this adjustment period, it was difficult to determine the direction of Granger causality. However, since July 2000 when the Rupee was put to complete float, the Granger causality is from official to kerb rate with kerb rate also adjusting according to deviation from the long run trend.

Special Section 2: Deposit mobilization by the banking system

Poor deposit mobilization over the last two years is the root cause for the recent liquidity shortage in the banking sector. That this trend should persist in spite the shortage throughout the second quarter of FY01 and the sharp increase in T-bill rates in September /October 2000, is incongruous and indicative of a serious problem in the banking sector. To analyze this issue in some depth, a selection of major banks is presented in **Tables 2.1 & 2.2**. It is clear from this data that deposits have only grown by 1.9 percent between June and December 2000, despite higher nominal growth of the economy.

At the end of December 2000, of total deposits in Pakistan's banking sector, domestic constituents accounted for 94 percent (see **Table 2.1**). Hence, the focus of this section is on public sector deposits, private businesses and deposits from private individuals.

As in most countries, banks in Pakistan have clearly defined market niches. Nationalized Commercial Banks (NCBs) and privatized banks cater to the government and deposits from public sector enterprises (PSEs); foreign banks focus primarily on corporate clients (especially multinational companies) and high net worth individuals, while the larger domestic banks (public and private) cater to the middle market. Despite the introduction of private domestic banks following the liberalization in early 1990, NCBs have retained their stronghold over the banking system due to their extensive branch network. As of end-December 2000, NCBs and the two privatized banks (MCB & ABL) account for 65.3 percent of the market share in Pakistan.

However, with the launch of Pakistan Investment Bonds in December 2000, NCBs are beginning to lose an important source of deposits from public sector enterprises, which would otherwise be placed in the National Savings Scheme (NSS). After March 2000 when institutional investment in NSS was banned, several PSEs (especially Provident Funds and Insurance companies) began placing their long-term savings with the NCBs. Since these deposits will now only be parked with the NCBs (for a maximum tenor of two months) for placement in the PIB auctions, these banks must gear up their efforts to solicit

Table 2.1: Deposits by Holders of Major Banks

(Rs. Bln)

Description	All Scheduled Banks			NBP			HBL			UBL			MCB		
	Jun-00	Sep-00	Dec-00	Jun-00	Sep-00	Dec-00	Jun-00	Sep-00	Dec-00	Jun-00	Sep-00	Dec-00	Jun-00	Sep-00	Dec-00
A. Foreign Constituents	67.51	70.62	71.77	3.96	4.17	4.38	7.96	9.09	9.28	1.36	1.16	1.25	0.00	0.00	0.00
B. Domestic Constituents	1,050.25	1,063.94	1,067.44	218.92	225.85	205.04	198.67	208.79	200.82	109.28	93.23	100.03	128.97	128.72	130.55
I. Government	79.81	85.14	81.90	39.56	45.75	43.30	9.30	10.01	11.17	6.54	3.59	2.34	0.39	0.08	0.10
II. PSEs	108.63	114.41	92.87	35.90	40.73	22.10	21.15	32.77	24.22	16.04	4.87	7.40	4.53	4.63	4.28
III. Private Sector (Business)	400.70	408.75	424.90	54.02	55.52	55.06	92.09	84.73	85.82	37.62	32.09	34.44	60.24	76.65	77.99
IV. Trust Funds and NPOs	18.38	18.62	19.81	1.40	1.32	1.52	5.30	4.62	3.66	0.00	0.00	0.02	0.68	0.52	0.53
V) Personal	315.42	309.80	317.99	39.56	38.33	41.52	62.36	67.00	64.67	48.45	52.14	55.25	63.10	46.83	47.64
VI) Others	127.31	127.22	129.98	48.47	44.21	41.53	8.47	9.66	11.28	0.63	0.54	0.58	0.02	0.01	0.01
Total:	1,117.76	1,134.56	1,139.21	222.88	230.03	209.42	206.64	217.88	210.10	110.64	94.39	101.28	128.97	128.72	130.55

Description	Union Bank			Askari			CITIBANK			ABN AMRO		
	Jun-00	Sep-00	Dec-00	Jun-00	Sep-00	Dec-00	Jun-00	Sep-00	Dec-00	Jun-00	Sep-00	Dec-00
A. Foreign Constituents	0.15	2.17	2.45	0.48	0.50	0.43	6.45	7.69	7.36	4.07	4.39	4.18
B. Domestic Constituents	10.65	14.37	14.62	23.83	26.88	29.53	26.04	26.59	28.54	21.74	24.30	25.06
I. Government	0.11	0.16	0.11	6.78	8.54	8.38	0.00	0.00	0.00	0.15	0.08	0.00
II. PSEs	0.10	0.80	0.45	0.85	1.17	1.96	0.43	0.86	1.69	0.80	0.71	0.70
III. Private Sector (Business)	4.58	5.20	5.51	8.27	8.22	9.21	11.99	11.75	13.05	10.39	12.28	12.81
IV. Trust Funds and NPOs	0.10	0.16	0.45	0.66	2.08	3.37	0.01	0.02	0.00	0.24	0.23	0.22
V) Personal	5.48	6.78	6.92	5.57	5.54	5.54	2.95	3.64	2.34	0.06	0.07	0.06
VI) Others	0.29	1.27	1.19	1.70	1.32	1.07	10.68	10.32	11.46	10.10	10.93	11.27
Total:	10.80	16.54	17.07	24.31	27.37	29.96	32.49	34.28	35.90	25.80	28.68	29.25

Table 2.2: Rate of Return on Deposits by Banks

Types of Deposits	NBP		HBL		UBL		MCB	
	Jun-00	Dec-00	Jun-00	Dec-00	Jun-00	Dec-00	Jun-00	Dec-00
1. PLS Notice Deposits								
7-29 days	5.20	4.00	5.50	4.50	5.00	4.00	5.50	5.25
30 days &above	6.10	5.00	6.50	5.50	6.00	5.00	7.00	6.25
2. PLS Savings Account	**5.50**	**4.10**	**5.00**	**4.00**	**4.00-5.00**	**4.00**	**5.25**	**4.00**
Special Saving Account			8.50-11.00	7.00-8.50	5.00-9.00	4.00-8.75	7.00-10.00	6.00-8.50
3. PLS Term Deposits								
3 months & over	7.30	6.50	7.00	6.00	6.25-6.50	6.50	7.50	7.25
6 months & over	8.00	7.50	7.50	6.50	6.75-7.00	8.00	8.00	7.75
1 years & over	8.70	8.00	8.00	7.00	7.75-8.00	7.75-8.00	8.50	8.00
3 years & over	10.00	9.00	9.00	8.00	7.75-8.00	7.75-8.00	9.50	9.00
5 years & over	11.00	9.50	10.00	9.00	7.75-8.00	7.75-8.00	10.50	9.50

Types of Deposits	Askari		Union Bank		ABN Amro		Citi Bank	
	Jun-00	Dec-00	Jun-00	Dec-00	Jun-00	Dec-00	Jun-00	Dec-00
1. PLS Notice Deposits								
7-29 days	7.00	7.00	7.00	4.00	0.00-4.00	0.00-4.00	6.50-8.25	9.25-12.5
30 days &above	8.00	8.00	8.00	5.00	6.42-7.90	6.42-7.90		
2. PLS Savings Account	**8.50**	**2.00-8.50 #**	**0.00-11.50**	**0.00-11.00***	**0.00-8.00**	**0.00-8.00**	**0.50-6.50**	**0.50-8.46****
Special Saving Account	6.00-11.00	6.00-11.00						
3. PLS Term Deposits								
3 months & over	10.00	10.00	10.50-11.50	7.50	7.00-8.25	7.00-8.25	6.25-8.25	6.25-12.75
6 months & over	10.50	10.50	10.75-11.50	8.00	7.00-8.50	7.00-8.50	6.75-7.50	6.75-10.50
1 years & over	11.00	11.00	12.00	8.50	7.36-8.81	7.36-8.81	7.50-8.00	7.50-8.00
3 years & over	12.00	12.00		9.50	7.36-8.81	7.36-8.81	7.50-8.00	7.50-8.00
5 years & over	13.00	13.00		10.50	7.36-8.81	7.36-8.81	7.50-8.00	7.50-8.00

\# Lower returns introduced for smaller deposit size.

* Reduction of 1.5 percentage points (on average) for individuals, 2.5 percentage points for corporates.

** Additoinal returns for larger deposits, otherwise same.

private sector deposits given their dominant role in the banking system.[66] In fact, looking at just HBL and NBP, these banks lost Rs 27.2 billion of PSE deposits between end-September and end-December 2000 (see **Table 2.1**). Although some PSEs did withdraw their bank deposits to help the government retire its debt to the banking system, a component of this fall also reflects the placement of Rs 14.2 billion in PIBs.

Although private sector banks (both foreign and domestic) are admittedly more customer-friendly, existing market niches and limited branch networks inhibit their efforts to solicit a larger volume of deposits. Additionally, given their select range of borrowers, it may not be in their interest to step up deposit mobilization if the funds cannot be placed profitably. Moreover, foreign banks have become wary of the general economic environment following the FCA freeze in May 1998. With the loss of momentum after the freeze, foreign banks have left the market, downsized their operations, or focused their mobilization efforts towards Rupee deposits.

As cautioned in SBP's last quarterly report (Q1-FY01), the depreciation of the Rupee since September 2000 has encouraged a return to Dollarization. Since the bulk of fresh foreign currency inflows are placed in the FE 25 scheme (which does not provide counterpart Rupees to mobilizing banks), the systemic shortage of liquidity will persist unless concrete steps are taken to mobilize Rupee deposits.

Looking specifically at the breakdown of deposits with certain banks, deposit mobilization in the past 6 months and rates offered, certain points can be made (see **Tables 2.1 & 2.2**). We have focused only on the past 6 months, because this was the period when banks were short of liquidity, while SBP had signaled an increase in its benchmark rate with the change in its monetary policy stance in October 2000.

In terms of the overall banking system, looking at the weighted average lending and deposit rates since end-June 2000, a disturbing trend emerges (see **Table 2.3**). Lending rates increased during the first half of FY01, while deposit rates

[66] Most fund placed by state-owned insurance companies and provident funds, are with NCBs since these institutions generally only deal with these large Pakistani banks.

edged down. In terms of the spread between the two, this increased from 5.6 percent in end-June to almost 7.4 percent in end-December 2000. What is disconcerting is despite the liquidity shortage, banks did not increase deposit rates or do much to increase mobilization. In fact, only foreign banks have posted a marginal increase in deposit rates in this period.

In terms of the aggregate deposit base of scheduled banks, there was a very nominal growth of 1.9 percent in the first half of FY01[67], against expected nominal GDP growth of 4 to 5 percent. Although corporate deposits have posted 6.0 percent growth, personal (individual) deposits that are more important to create a stable base, remained stagnant. Furthermore, these numbers include FE 25 deposits, and therefore *overestimate* the growth in Rupee liquidity. Looking at specific banks, the following points highlight their individual performance over the past 6 months (see **Tables 2.1 & 2.2**):

- NBP: Government funds and deposits from PSEs clearly dominate. Hence, it is not too surprising that NBP witnessed a sharp fall in its deposit base especially in the second quarter of the fiscal year. Corporate and individual deposits were largely stagnant during 1H-FY01, despite the sharp fall in PSE deposits. In terms of deposit rates, NBP showed an across the board reduction, with saving accounts and 5-year term deposits posting the largest reductions. As one of the largest banks operating in Pakistan, this is hardly the example to set for the rest of the banking system.
- HBL: Showed an overall increase in its deposit base of 1.7 percent, but lost deposits in the second quarter. This was largely on account of PSEs, which pulled out their deposits in December. Nevertheless, individual deposits did not show much growth in 1H-FY01, and actually fell in the second quarter. What is more disturbing is the sharp fall in HBL's deposit rates; rates were reduced by 1 percentage point on all term deposits.
- UBL: Posted a fall in total deposits (by 8.4 percent), but this was concentrated in the first quarter of the year on account of large withdrawals by PSEs and the government. However, UBL did well to increase individual deposits, and in fact posted an increase in 6-month term deposit rates. By shifting away from demand deposits, and maintaining term lending rates

[67] This includes both Rupee deposits and FCAs.

(while others were reducing rates), UBL has done better compared to the larger Pakistani banks.

- MCB: Showed a stagnant deposit base (1.2 percent growth), with a shift from individual to corporate deposits. Although this is not a step in the right direction (as corporate deposits tend to be fickle), this shift could be on account of a classification change in their reporting to SBP. MCB has *also* cut deposit rates across the board.
- Union Bank: The first thing to note, is the fact that the figures for end-June and end-December reflect two very different banks. In June, Union Bank had not taken over the operations of Bank of America (BOA), while by end-December the takeover was complete. Hence, the 53.1 percent growth in deposits during the first quarter of FY01 reflects BOA deposits from foreign entities and individual deposits. What is surprising is that corporate deposits (the strength of BOA) did not show a marked improvement with the merger. This is perhaps because many corporate clients did not retain their relationship after the takeover. This also shows up in the deposit rate structure shown in **Table 2.2**. There is a clear shift in deposits rates posted by a private domestic bank (in end-June) to a mixture that reflects rates posted by foreign banks. Hence, despite the sharp fall in deposit rates, Union Bank has become one of the larger private domestic banks.
- Askari Bank: Showed strong growth in deposits during 1H-FY01 (23.2 percent). Although Askari was able to post increases in all deposit categories, the real increase was in Government/PSE deposits and Trust Funds. The latter is because Askari manages the provident funds of retired Army personnel.
- Citibank: Was able to show an increase in its deposit base (by 10.5 percent), on the strength of corporate and foreign constituents. In terms of deposit rates, although Citibank incentivised larger deposits, it generally maintained its deposit rate structure.
- ABN-AMRO: Posted strong deposit growth of 13.4 percent, primarily from corporates and individuals. In terms of deposit rates offered, they have been stagnant in the first half of FY01.

Looking at the mobilization of deposits and the rates offered, it almost appears that banks did not face much need to secure (or increase) deposits. Not only does this fly against the liquidity shortage they faced in the second quarter of FY01, but it also ignores the 2.9 percentage point increase in T-bill rates in

September/October. In fact, as stated, despite this sharp increase in T-bill rates, the large Pakistani banks actually reduced deposit rates. This was most telling in the case of NCBs (which reduced their average deposit rate from 6.1 percent in end-August to 5.8 percent in end-December – see **Table 2.3**) and the privatized domestic banks (rates fell from 5.9 to 5.5 percent in the same period). This is even more surprising since the second quarter is also the period of maximum private sector lending by these banks. This clearly shows that the large Pakistani banks have failed to achieve their primary objective; deposit mobilization to finance private investment. This apparent indifference towards deposit mobilization, and their failure to pick up on the change in the central bank's monetary policy needs to be explained or rectified. The fact that HBL *once again* availed SBP's refinance facility in October simply highlights this point (see **Money & Credit**).

Table 2.3: Weighted Average Lending and Deposits Rates

	Nationalized Banks		Privatized Domestic Banks		Private Domestic Banks		Foreign Banks		Specialized Banks		All groups	
	Lending	Deposit	Lending	Deposit	Lending	Deposit	Lending	Deposit	Lending	Deposit	Lending	Deposit
Jun-99	14.90	8.38	15.70	8.32	15.10	9.21	13.40	6.91	14.10	15.02	14.60	8.39
Sep-99	15.00	8.34	15.60	7.67	15.10	9.08	13.50	6.52	14.20	15.36	14.70	7.98
Dec-99	15.40	7.89	14.20	7.82	14.50	9.11	13.60	6.79	14.20	14.84	14.40	7.94
Mar-00	14.30	7.28	14.50	7.58	13.90	8.54	12.30	6.68	14.10	14.54	13.60	7.53
Apr-00	14.32	7.24	14.04	7.56	14.15	8.55	11.98	6.56	14.10	14.55	13.52	7.57
May-00	12.73	7.25	12.58	7.57	13.91	8.69	12.04	6.72	14.15	14.66	12.87	7.57
Jun-00	13.06	6.81	12.50	7.60	13.21	8.68	12.59	6.86	14.09	13.64	12.94	7.37
Jul-00	13.26	6.12	13.91	6.74	13.97	8.19	12.31	6.83	14.09	13.49	13.26	6.80
Aug-00	13.28	6.10	13.39	5.89	12.51	8.23	12.09	6.84	14.21	13.37	12.66	6.63
Sep-00	13.56	6.02	13.49	5.88	13.54	8.22	12.39	6.75	14.16	13.33	13.22	6.58
Oct-00	13.97	5.90	15.45	5.80	14.22	8.20	13.05	7.00	14.29	13.40	13.97	6.60
Nov-00	14.37	5.98	14.82	5.88	13.94	8.15	13.88	7.20	14.14	13.55	13.95	6.65
Dec-00	14.13	5.81	14.69	5.48	13.81	8.26	13.37	7.26	13.99	13.40	13.88	6.52

Note) Weighted average rates of return on deposits are excluding zero rate.

Appendix

Economic Policy Measures during October-December, 2000[68]

Agriculture

Marketing

- Pakistan Tobacco Board (PTB) approved the crop policy for 2001 on November 8th 2000, in the backdrop of a 47 percent lower requirement of tobacco. The policy contains, inter-alia, advice to growers to enter into agreement with tobacco companies of their choice before sowing so that the problems faced by farmers in marketing the crop last year can be avoided.

Agricultural Research

- In pursuance of agreement reached between USA and Pakistan, GOP has established an Agricultural Research Endowment Fund (AREF) from the sale proceeds of wheat provided by Washington as a refund of F-16 aircraft. Wheat imported under this arrangement will be sold to the provinces on a no-profit/no-loss basis and the proceeds will be placed in the fund. Pakistan Agriculture Research Council (PARC) will hold the charge of AREF and will execute Agricultural Linkage Program (ALP). The ALP is aimed at promoting the exchange of agricultural research scientist and technical knowledge and to institute long-term support cooperation between Pakistan and United States.

[68] Policy Measures have been classified into various categories relating to agriculture, industry, public finance, money & credit, etc. keeping in view not only the apparent nature of a measure but also its underlying objectives. For example, if a tax measure is meant for boosting up industrial activity, it is recorded under 'Industrial Policies', and if it is meant for raising tax revenue, improving tax structure or regulating domestic prices, it is included in 'Public Finance'. However, some of the measures cannot be classified precisely to any one category. Therefore, the readers may find some subjectivity in this categorization especially in cases of Industry, Trade, & Public Finance policy measures.

- To diversify agriculture research in Pakistan, an agreement between Center for International Agricultural Research (CIAR), Australia and PARC was signed on November 13th 2000. Under the agreement, CIAR will help explore ways to increase productivity of crops in saline affected lands, and improve water management. Further, a memorandum of understanding was also signed between CIAR and PARC to control the 'gemini' virus diseases of cotton and tomato in both Australia and Pakistan.

Industrial Sector

Rehabilitation of Sick Units

- Three textile mills were revived during October 2000 by rescheduling their stuck-up loans of Rs 500 million.
- 'Non-performing Assets and Rehabilitation of Industrial Undertakings (Legal Proceedings)' ordinance was promulgated on November 18th 2000 for expediting legal remedies relating to non-performing assets.
- In its first meeting held on December 18th 2000, Corporate and Industrial Restructuring Corporation (CIRC) discussed ways and means to dispose off banks non-performing assets. It was also decided to give preference to textile, leather and electronics industries cases

Tax Incentives:

The following tax incentives were provided on industrial raw material and final produce:

- The Federal government on October 24th 2000, announced exemption of sales tax and customs duty on the import of plant, machinery and materials for the construction of another terminal at Lahore airport.
- The CBR exempted the cotton-seed oil extracting units from getting registered and filing sales tax invoices on October 4th 2000.

Protection

- The CBR withdrew the concessionary import facility for self-closing LPG cylinder valves and included this item in the list of locally manufactured items with effect from December 22nd 2000.

Credit Facilities

- Economic Coordination Committee (ECC) of the Cabinet decided on December 19th 2000 to charge a concessionary mark up of 12 percent on loans advanced for the development of small and medium enterprises.
- Pakistan Industrial Credit and Investment Corporation (PICIC) approved a lending plan of over Rs 3 billion for textile and sugar industries on November 21st 2000. The Corporation will disburse Rs 2 billion for balancing, modernization and replacement (BMR) in the textile sector, and Rs 1.5 billion as short-term working capital loans. The mark-up for BMR will be around 14 percent for five years, while working capital would be sanctioned to sugar and textile factories.

Investment

In order to make the country more attractive for investment, Cabinet Committee on Investment (CCOI) approved a number of policy measures on December 12th 2000. Prominent measures are given below:

- Tourism, housing and construction sectors have been placed in category "C" of industries, allowing them all fiscal and other facilities as available to the manufacturing sector.
- Foreign investors have been allowed to invest in any activity falling under the services sector. There will be no requirement of registration and permission from the Board of Investment (BOI). The investors may henceforth register themselves with the Security and Exchange Commission of Pakistan (SECP) and State Bank of Pakistan (SBP) for the purpose of remitting profits and royalties abroad.

- The benchmark for repatriable investment in the services and non-manufacturing sectors has been reduced from US$ 0.5 million to US$ 0.3 million.
- The mandatory period for induction of local equity in the services sector has been enhanced from two to five years.
- Non-manufacturing enterprises and fast food selling chains owned by foreigners have been allowed to remit franchise, royalty and technical fee or service charges. The initial lump sum fee would be allowed up to maximum of US$ 100,000 irrespective of number of outlets in any franchise.
- In order to provide relief to industrial units located in the Special Industrial Zone (SIZ) of Nawabshah and Winder, the deadline fixed for commencement of production extended till December 31st 2002, especially in those cases where L/Cs were opened before January 31st 1996.

Fiscal Policy Measures

Direct Taxes:

- The government has exempted small traders (distributors, dealers and unregistered firms) from the payment of 0.5 percent minimum income tax that had been levied on their turnover for FY01 (w.e.f. October 31st 2000). The exemption will apply to individuals and entities that qualify under the Self-Assessment Scheme for FY01.
- On November 2nd 2000, CBR exempted the profit earned by small traders, associations of persons, unregistered persons and Hindu undivided families from income tax.

Sales Tax

- Through Tax (Amendment) Ordinance, 2000 the sales tax coverage was extended to cement factories. The government will reduce central excise

duty from Rs 1,400 per tonne to Rs 1,000 per tonne. However, cement factories in NWFP will enjoy the exemption till June 30th 2001.

- On October 11th 2000, CBR released a list of consumer/kitchen items, which are exempted from General Sales Tax (GST). Some of the items included wheat, rice, pulses, meat, vegetables etc.
- To bring the sugar industry into the GST net, CBR has replaced a fixed Rs 2.10 per Kg sales tax on sugar with a 15 percent sales tax on the open market price of respective mills from November 1st 2000.
- The Sales Tax collectorate imposed a 15 percent sales tax on shipping agents, air cargo handlers and transporters of dry ports and goods in transit.

Central Excise

- To ease the problems faced by All Pakistan News Society, arising from the letter of credit margin, depreciation of the rupee and increase in international newsprint prices, CBR withdrew 2.5 percent central excise duty (CED) on the import of newsprint with effect from November 1st 2000. CBR also abolished CED on local manufacturing of newsprint.
- The CBR exempted the process of mixing, tinting and stirring of car paints and decorative work carried out by retailers and dealers from the levy of CED effective May 1st 2000.

Tax Amnesty Scheme

- The government announced a revised Tax Amnesty Scheme for the period of August 3rd to November 30th 2000. According to this scheme, tax rates for different months were as follows: 11 percent for August, 12 percent for September, 13 percent for October and 14 percent for November. The facility for paying in installments to ease liquidity constraints had also been offered with a payment of 50 percent tax up-front, and three equal installments with an additional tax of 1.5 percent per month on the residual amount.

Provincial Taxes

- According to an amended Agricultural Land and Income Tax Ordinance promulgated by the Sindh Governor on October 16th 2000, agricultural land tax would now be levied @ Rs 200 per acre on cropped land in an irrigated area, and Rs 100 per acre in non-irrigated areas. Orchards would have to pay agriculture income tax at the rate of Rs 700 per acre in irrigated area, and Rs 350 per acre in non-irrigated areas. The Ordinance gives an exemption from tax to the landholders of upto 12.5 acres in irrigated areas, and 25 acres in non- irrigated areas. Agricultural income tax would be charged on an income of Rs 80,000 or more with varying different slabs.

Money & Credit Measures

Liquidity Control Measures

- The minimum rate of return to be paid by recipients of financing facilities from SBP for temporary liquidity shortages and SBP 3-Day Repo facility against GOP Market Treasury Bills and Federal Investment Bonds was enhanced from 11 % to 12% on annual basis effective from September 19th 2000. The rate was further enhanced to 13 % with effect from October 4th 2000.
- SBP increased the Cash Reserve Requirement (CRR) for banks effective from October 7th 2000. Accordingly, banks were required to maintain an average balance of 7 percent of their time and demand liabilities with SBP worked out on weekly basis. This amount would not be less than 6 percent at the close of business on any day. However, with effect from December 16th 2000 CRR was again reduced to 5 percent of time and demand liabilities with minimum 4 percent balance at the close of business on any day (it was temporarily reduced to 3 percent balance at the close of business on any day for the period December 30th 2000 to January 5th 2001).

- On December 15th 2000 all scheduled banks were directed to maintain with the SBP special deposits equivalent to 2 percent of their time and demand liabilities as of December 9th 2000. The requirement was to be met latest by December 16th 2000. In order to remunerate these special deposits, scheduled banks were given the option to purchase Market Treasury Bills (MTBs) from SBP on one-month Repo basis at the rate of 10.0 percent per annum. Initially banks were not allowed to count these MTBs towards Statutory Liquidity Requirement (SLR). However, this was allowed on December 18th 2000.

Credit Control Measures

- The Pakistan Bankers Association imposed a 30 percent cash margin requirement on all import letters of credit (LCs), except crude oil and POL products on 5th October 2000. However, with the strengthening of Rupee parity against the Dollar, banks reduced the LC margin to 25 percent and exempted edible oils and DAP fertilizers with effect from 24th October 2000. Margin requirements were further reduced to 15 percent on 6th November 2000 and finally removed on 14th November 2000.
- It was decided on December 13th 2000 that loans granted by banks/NBFIs under a Government declared policy and specially those recommended by the Committee for Revival of Sick Industrial Units would not constitute a part of the outstanding amount of default.[69] In other words, while facilities granted to sick industrial units prior to the revival shall retain their existing classification, fresh facilities may be kept in a separate account and be monitored from the date the new facility was granted. These facilities will, however, be subject to the classification of the outstanding under Prudential Regulation-VIII on the strength of their specific terms and conditions.

[69] Committee for Revival of Sick Industrial Units was constituted under the Ministry of Finance Notification No. F.6(13)BKG(R&S)/2000-230 dated 3rd May, 2000 for the purpose of reviving sick industrial unit

Export Finance Scheme

- With effect from October 20, 2000 it was decided to bring "Rice Gluten" under the Export Finance Scheme.

Banking Regulations

- In order to facilitate banks and financial institutions to strengthen their competitive ability, to help them in upgrading their technology and eliminating avoidable expenses, to build up their equity structure to the levels where the interest of depositors are adequately protected and encourage the economies of scale and scope, it was decided on December 6th 2000 to revise the minimum capital requirement for banks. In the light of these revision:

  i) No banking company shall be permitted to undertake a full range of financial services unless and until it has a minimum paid-up capital, net of losses, of Rupees one billion on or after January 1st 2003;

  ii) A banking company not meeting the minimum capital requirement as set herein above, shall *ipso facto* stand de-scheduled, and converted into a non-scheduled bank (NSB) with effect from dates as determined below:

     a. On January 1, 2002 if it does not have a minimum paid-up capital, net of losses, of Rs.750 million.

     b. On January 1, 2003 if it does not have a minimum paid-up capital, net of losses, of Rupees one billion.

  iii) Where a banking company so de-scheduled is short in meeting the minimum capital requirement of Rupees one billion by more than 25%, such NSB shall not be eligible to collect deposits from individuals including partnership/sole proprietors, or provide any financial services to individuals including sole proprietors. Such NSB shall only be permitted to operate in the inter-bank market, make investment in government securities, and finance import/export business within such limits as may be specified by the SBP, on a case to case basis;

iv) Where a banking company so de-scheduled is short in meeting the minimum capital requirement of Rupee one billion by not more than 25%, the SBP may allow the banking company to continue accepting the deposit from their corporate/institutional depositors only upto the limit of total deposits mobilized by it as on December 31st 2000 or total outstanding as on November 30th 2000, whichever is lower, and provide other support financial services as may be specifically allowed by the SBP;

v) Where a bank or group of banks which meets the minimum capital requirements set up a subsidiary NSB, with the prior approval of the SBP, for undertaking any one or set of specialised banking service to a specified segment of the market, the condition of minimum capital requirement shall not apply to such an affiliated non-scheduled bank (NSB);

vi) New banking licenses specifying the range of banking activities shall be issued to all banking companies on the basis of paid-up capital to be raised by them by the due dates as stipulated above;

vii) The instruction regarding maintenance of capital and unencumbered general reserves for the purpose of the minimum capital requirements based on risk weighted assets and other instruction on the subject shall, however, remain unchanged;

- It has been decided on December 16th 2000 that banks/NBFIs may provide insurance products to their depositors provided (i) it is not mandatory and (ii) there is no discrimination in the rate of return to the depositors who may or may not opt for the insurance cover. The banks/NBFIs shall maintain secrecy of information in regard to access to their books of accounts and shall design their own internal control and procedures. The banks/NBFIs shall, however, ensure that no other rules, regulations and instructions issued by SBP from time to time are violated and the interest of depositors is fully protected.

- In view of the persistent desire of the business community and the general public for the provision of the facility of evening banking particularly for the payment of utility bills, banks were allowed, on December 16th 2000, to offer evening banking services to their clients. All banking

transactions conducted from 2.30 p.m. to 8.30 p.m. shall form part of the bank's trial balance for the next working day. The bank's planning to undertake evening banking shall inform the SBP of their such branches at least 7 working days prior to commencement of such business.

Microfinance Bank

- On October 4th 2000, SBP announced rules regarding operations of the Micro Finance Bank (MFB). These Rules may be called the Microfinance Rules. Some important rules are as follows:

  i) Per person exposure limit: While granting any microfinance facilities to poor persons, MFB shall ensure that the total exposure of such a person from MFB and Microfinance Institutions does not exceed Rs 50,000 in aggregate.

  ii) Exposure against liabilities: Liabilities excluding contingent liabilities of the MFB for the first two years of its operations shall not exceed two times of its equity. In the subsequent years, liabilities shall not exceed five times of its equity.

  iii) Exposure against contingent liabilities: Contingent liabilities of the MFB for the first two years of its operations shall not exceed two times of its equity. By the end of five years, liabilities shall not exceed five times of its equity, where after the liabilities should not exceed 10 times of its equity.

  iv) Maintenance of liquidity against certain liabilities: The MFB shall maintain a cash reserve equivalent to not less than 5 percent of its total time and demand liabilities as specified by the SBP from time to time in a current account with the SBP as required in Section 27 of the MFB Ordinance, 2000. In addition to cash reserve, it shall also invest and place 5 percent of its demand and time liabilities in government securities.

  v) Creation and building-up of reserves: MFB shall create a reserve fund to which shall be credited an amount equal to 20 percent of its profit after taxes. Not less than 10 percent of the profits after

taxation shall be credited to a Social Sector Support Fund to meet expenditure on micro credit activities of the MFB.

vi) Depositors' protection fund: MFB shall contribute toward a Depositors' Protection Fund for the purpose of providing a safety net to small depositors.

vii) Restriction on certain types of transactions: MFB shall not allow financing facility to any of its sponsors, directors or employees including their spouses, parents, and children. Further, MFB shall also not allow microfinance facilities for speculative purposes.

viii) Classification/provisioning for non-performing loans: All non-performing loans should be written-off after two years from the date of default. This shall, however, not extinguish MFB's right of recovery of such written-off loans.

ix) Investment in public limited companies, subsidiaries and associated companies: MFB may acquire or hold shares of any company, upto a maximum of 30 percent of its paid-up capital, objective of which is to provide microfinance services to the poor.

x) Minimum conditions for grant of microfinance facilities/opening of accounts: While considering proposals for fund based/non-fund based facilities, MFB shall make all reasonable efforts to determine the true identity of every applicant. Towards this end, MFB shall develop effective procedures and methods for obtaining proper identification from new customers/ borrowers.

xi) Audit and submission of accounts: The MFB shall observe an accounting year from January to December and shall submit a copy of its duly audited Annul Accounts to the SBP within a period of three months after the end of its accounting year and shall comply with the conditions with respect to appointment of auditors.

xii) Internal audit: MFB shall have an Internal Audit Department. The Head of this Department will report to the Board of Directors directly or to an Audit Committee of the Board.

xiii) Places of business: MFB shall not open new places of business without prior permission in writing of the SBP. For opening of new branches MFB should make an application to the SBP which may issue a license in this regard.

xiv) Operational policies: MFB shall prepare and formulate operational policies regarding credit, investments, internal audit rescheduling/write-off of loans/advances etc. within 3 months of commencement of its operations duly approved by the Board of Directors and submit the same for clearance of the SBP.

xv) Submission of statistical returns: MFB shall submit to the State Bank, i) Statement Showing Liquidity position, ii) Statement of Affairs, iii) Statement of Condition on prescribed formats.

xvi) Scale of penalties: The scale of penalties as notified by SBP from time to time in respect of NBFIs will be applicable in respect of various categories of violations of rules and regulations by MFB.

External Sector

Trade Policy

- In conformity of Import Trade and Procedures Order 2000-01 issued by the Ministry of Commerce dated 17th July 2000, the requirement of opening Letter of Credit for imports before shipment was removed on 20th November 2000. Thus, shipment of goods before opening of import letter of credit will no more construe a violation of the Import Trade and Procedure Order 2000.
- To ensure quality and requirement of international market, the Pakistan Standards Institution (PSI) approved the national standard for cotton yarn bleached/dyed to be adopted by all the manufacturers on November 1st 2000.
- The ECC of the Cabinet on November 27th 2000 decided to remove all restrictions on the export of wheat and allowed the private sector to come forward for its export.

- The ECC on November 27th 2000 allowed export of cement, rice, pharmaceutical, glass sheets, G.I. pipes and hardware items via land route of Afghanistan to Central Asian Republics against irrevocable LCs in foreign currency.
- The Export Promotion Bureau (EPB) on November 29th 2000 decided to withdraw minimum export price (MEP) for Irri-6 rice, with immediate effect.
- Authorized Dealers (ADs) were allowed on October 24th 2000 to certify form "E" for export of "Hand Knotted Carpets" for a tenure of up to 270 days usance instead of 180 days usance, provided export proceeds are repatriated within a period of 285 days.
- With effect from December 14th 2000, ADs were allowed to certify form 'E' in connection with exports to South America providing for repatriation of export proceeds upto a period of 180 days instead of 120 days in case a letter of credit for 180 days sight/usance is received from South America.
- The Anti-Dumping Duties Ordinance, 2000 was promulgated on December 22nd 2000 amending and consolidating the laws relating to imposition of anti-dumping duties to offset such dumping. The Ordinance shall extend to the whole of Pakistan, and came into immediate effect.

Exchange & Payment Measures

- The small indenting houses/agents whose income does not exceed Rs 5 million per annum were exempted from October 2nd 2000 from submitting half yearly statements of their commission earnings in foreign exchange to the SBP required under the instructions contained in Foreign Exchange Manual (7th Edition, 1992).
- On October 6th 2000, attention to ADs was invited that a person, who avails of the concession under New Tax Amnesty Scheme 2000 and brings in foreign exchange to Pakistan for conversion into Pak Rupees through ADs, would not be liable to any action under the Foreign Exchange Regulation Act 1947.

- Airlines/Shipping Companies/Travel Agents were allowed to sell tickets to Pakistani nationals to travel by Foreign Airlines/Shipping Companies without any annual quota w.e.f. October 13th 2000.
- Upper limit of retaining 25 percent export earning in Special Foreign Currency Accounts for payment of commission to overseas buyers and to meet other expenses such as promotional publicity, import of hardware/software and foreign consultant's fee etc., allowed earlier to Software Houses/Companies, was enhanced to 35 percent with effect from November 17th 2000.
- On November 24th 2000, it was clarified that there will be no deduction of Zakat on any type of Foreign Currency Accounts maintained by residents as well as non-residents.
- ADs were advised to follow the spot value convention i.e. t+2 days from transaction date as the standard for all their foreign exchange and money market transactions with the SBP w.e.f. 1st December 2000. They were also advised to make concerted efforts to adopt the same convention while dealing with other banks as well as clients.
- It has been decided that interests/profit on trade loans, extended to the importers and exporters under paragraph B(5) of FE 25 of 1998 is to be repaid from the inter bank market w.e.f. 7th December 2000. Previously, the interest/ profit on such loans was to be paid by the borrower from own resources.
- In order to provide more incentive to the banks to accelerate Home Remittances, the minimum amount of remittance, necessary to be eligible to qualify for reimbursement of charges, was reduced from US$ 200 to US$ 100 or equivalent to other currency (per telex/swift charges) w.e.f. November 9th 2000. The reimbursement rate was also increased from Saudi Riyal (SR) 20 to SR 25 for each remittance. ADs may share the reimbursement charges at their option instead of fixed SR 6 and remit in foreign exchange to the concerned remitting agency accordingly.

Table 1: Area, Production and Yield of Agricultural Crops

Crops	FY00			FY01 (Targets)			FY01 (Preliminary estimates)		
	Area	Production	Yield	Area	Production	Yield	Area	Production	Yield
Cotton	2,983	11.24	641	2,930	10.70	621	2,973	10.6*	606
Sugarcane	1,010	46,333	45,883	1,000	51,647	51,647	925	41,800	45,189
Rice	2,515	5,156	2,050	2,411	5,102	2,116	2,314	4,520	1,953
Maize	894	1,351	1,512	900	1,501	1,668	973	1,796	1,845
Mung	203	95	468	200	100	500	211	99	468
Mash	43	24	547	66	33	526	46	24	511
Chillies	87	116	1,330	87	146	1,684	93	196	2,110
Wheat	8,443	21,094	2,498	8,430	20,000	2,372	8,300	18,750	2,259
Gram	972	565	581	1,086	716	659	--	700	--
Potato	111	1,868	16,909	113	1,950	17,257	--	--	--
Onion	110	1,648	15,100	99	1,430	14,444	--	--	--

Area = 000 Hectares

Production = 000 Tonnes

Yield = Kgs /Hectares

Sources: i) Ministry of Food, Agri. & Livestocks (Economic wing)

ii) Federal Committee on Agriculture.

* : Latest estimates by Cotton Crop Assessment Committee

Note: Figures of cotton production are in million bales.

Table 2: Production of Selected Large-scale Manufacturing Items

(July-December 2000-01)

Groups/Items	Weights	Percentage Change 1H-FY00	Percentage Change 1H-FY01	Groups/Items	Weights	Percentage Change 1H-FY00	Percentage Change 1H-FY01
Textile	**19.069**	**11.55**	**5.96**	**Electronics**	**2.976**	**22.75**	**19.85**
Cotton Yarn	8.85	9.06	4.52	Electric Transformers	0.577	-9.43	-16.45
Cotton Cloth	4.881	12.02	18.25	Storage Batteries	0.451	5.10	8.17
Cotton Ginned	3.893	23.49	-7.47	T.v Sets	0.363	12.01	-25.42
Other Five Items	1.445	-7.01	9.44	Airconditioners	0.12	36.18	719.73
Food, Beverages & Tobacco	**17.336**	**2.73**	**-11.32**	Refrigrators	0.015	8.48	38.20
Sugar	8.630	15.66	-30.58	Other Six Items	1.45	42.76	-8.85
Vegetable Ghee	3.004	-13.98	12.96	**Automobile**	**2.413**	**13.13**	**5.48**
Cigarettes	2.505	-15.01	16.14	Trucks	0.698	-13.33	4.84
Tea	1.785	-8.13	-10.64	Tractors	0.593	108.75	-33.45
Beverages	0.964	10.09	1.67	LCVs	0.369	-58.25	40.53
Cooking Oil	0.448	-7.54	12.49	Cars & Jeeps (Two Items)	0.309	-25.16	18.65
Petrolum Products (Ten Items)	**7.824**	**-2.70**	**6.95**	Motor Cycles	0.249	-8.19	37.44
Fertilizer	**5.871**	**13.01**	**20.04**	Buses	0.13	37.63	-3.75
Nitrogenous Fertilizer (Four Items)	5.441	12.25	4.32	Diesel Engines	0.065	45.07	1.94
Phosphatic	0.430	22.59	218.97	**Chemicals**	**2.335**	**11.16**	**5.17**
Pharmaceuticals	**5.798**	**7.45**	**-1.01**	Caustic soda	0.621	17.02	2.72
Tablets	2.705	3.04	-6.59	Soda Ash	0.32	3.27	-13.72
Syrup	1.602	15.49	3.97	Other Six Items	1.394	10.36	10.59
Injections	0.466	-8.55	6.43	**Non Metalic Mineral Pro.**	**1.915**	**-0.66**	**-5.13**
Cpsules	0.228	11.42	-3.34	Cement	1.846	-0.48	-4.84
Other Five Items	0.471	14.49	4.23	Glass Sheets	0.069	-5.60	-12.97
Metal Industries	**3.317**	**9.54**	**12.43**	**Paper & Board** (Five Items)	**1.359**	**14.78**	**22.42**
Pig Iron	1.477	11.90	4.70	**Engineering Items**	**0.691**	**11.88**	**-1.67**
Coke	1.319	7.87	18.87	Bicycles	0.348	-0.97	4.79
Billets	0.311	11.74	28.14	Metal Containers	0.153	-2.74	4.75
Safety Razor Blades	0.109	-21.87	23.61	Sewing machines	0.052	-15.27	-11.59
H.R/Coils and Plates (Two Items)	0.088	25.21	-19.43	Power Looms	0.051	-53.25	-56.95
C.R coils/Plates/ Sheets (2 items)	0.013	15.37	-17.37	Other Five Items	0.087	143.39	-0.46
Leather Products (Three Items)	**2.333**	**10.41**	**1.71**	**Rubber Products** (Four Items)	**0.452**	**4.02**	**-8.64**

Table 3: Federal Tax Collections

(Rs bln)

Heads	Targets		Tax Collection in 1H			Target Achieved as % of		Percentage Change over FY00
	FY01	1H-FY01	FY99	FY00	FY01	FY01	1H-FY01	
Direct Taxes	138.44	58.82	45.36	50.10	58.33	42.13	99.17	16.43
Indirect Taxes	291.60	132.26	87.36	110.21	123.65	42.40	93.49	12.19
Sales Tax	176.67	76.86	28.82	51.99	70.68	40.01	91.96	35.95
Central Excise	50.29	23.66	28.44	26.77	24.17	48.05	102.14	-9.72
Customs	64.64	31.74	30.10	31.45	28.80	44.55	90.73	-8.43
Total	430.04	191.08	132.72	160.31	181.98	42.32	95.24	13.52

Table 4: Consolidated Federal and Provincial Budgetary Operations

(Rs bln)

Heads	Realized	Budget Target	Realized as Percent of Target
	Q1-FY01	FY01	
Total Revenue	107.70	608.58	17.70
Tax Revenue	91.43	497.82	18.37
of which			
CBR Revenue	79.94	430.04	18.59
Surcharges	4.79	38.00	12.60
Non-tax Revenue	16.27	110.77	14.69
Total Expenditure	170.48	770.66	22.12
Current Expenditure	134.27	658.47	20.39
of which			
Interest	52.75	249.07	21.18
Defense	29.41	133.50	22.03
Dev. Expenditure	8.95	112.19	7.98
Unidentified	27.26	0.00	
Overall Budget Deficit	-62.79	-162.08	38.74
Financing	62.79	162.08	38.74
External	18.10	90.92	19.91
Domestic	44.68	71.16	62.79
Bank	38.88	-2.27	-1713.71
Non-bank	5.80	73.43	7.90

Note: For CBR revenue, revised target is used.

Table 5: Monetary Survey - Cumulative Flows

(Rs mln)

Description	Credit Plan FY01	1H-FY99	1H-FY00	1H-FY01
I. Government Sector Borrowing (net) (A+B+C+D)	-2,200	-17,033	1,524	-27,577
Gross budgetary borrowing	29,800	48,704	50,301	11,901
Special account debt repayment	-32,000	-48,912	-37,403	-21,263
A) Net budgetary borrowing	-2,200	-208	12,898	-9,362
i) From State Bank of Pakistan		37,061	81,789	-50,361
ii) From Scheduled Banks		-37,269	-68,891	40,999
B) Commodity operations (commercial banks)		-16,430	-9,342	-16,320
C) Net effect zakat funds/privatization proceeds etc.		-617	-1,593	-2,064
D) Others (Credit to NHA & CAA by commercial banks)		222	-439	169
II. Non-government Sector (A+B)	89,200	63,714	21,358	81,754
A) WAPDA, KESC, OGDC, PTC, SSGC, SNGPL & PR	4,000	-4,709	-7,631	-9,915
B) Net credit to private sector & PSEs	85,200	68,423	28,989	91,669
(Credit to private sector PSEs)				
a) Commercial banks	94,400	51,521	30,132	91,450
i) Public corporations other than IIA		6,634	5,772	10,816
ii) Private sector		44,887	24,360	80,634
(Export finance)	(25,000)	(10,217)	(7,014)	(6,123)
b) Specialized Banks	2,400	7,600	2,698	2,511
c) Other financial Institutions	3,000	9,302	622	-69
d) PSEs special account-debt repayment with SBP	-14,600	0	-4,463	-2,223
III. Other items (net)	0	4,453	14,518	25,825
IV. Net domestic assets (I+II+III)	87,000	51,134	37,400	80,002
V. Foreign assets of the banking system (net)	60,000	5,068	-956	-3,959
i) State Bank of Pakistan		560	-16,296	281
ii) Scheduled Banks		4,508	15,340	-4,240
VI. Monetary assets (IV+V)	147,000	56,202	36,444	76,043

Table 6: Private Sector Credit - Cumulative Flows

(Rs mln)

	1H-FY99	1H-FY00	1H-FY01
Manufacturing	27,530	17,221	43,148
a) Locally manufactured machinery (LMM)	112	-299	571
b) Manufacturing	27,418	17,519	42,577
i) For fixed investment	10,638	388	3,500
ii) For working capital	16,780	17,131	39,077
Automobile	1,494	-926	767
Cement	1,061	798	1,285
Fertilizer	2,481	-505	-872
Sugar	-4,844	-3,718	519
Textiles	11,638	11,674	25,338
Others	4,950	9,808	12,040

Table 7: Cumulative Flows of Currency in Circulation

(Rs bln)

	FY97	FY98	FY99	FY00	FY01	Average FY93-FY97
July	5.7	1.3	8.9	2.5	-4.5	2.6
August	-1.2	-6.4	-0.4	1.3	-13.3	-0.4
September	-2.6	-10.1	-3.3	-0.2	-16.0	-2.4
October	7.7	-0.9	2.7	19.9	2.0	3.0
November	17.4	12.7	17.8	41.4	30.4	11.8
December	18.0	27.9	28.2	53.3	54.8	15.1
January	30.2	44.7	42.3	58.7	31.5	25.8
February	31.1	30.1	25.7	53.7		33.1
March	23.1	26.8	41.8	54.3		28.5
April	29.2	31.7	26.1	45.8		27.3
May	22.1	31.4	23.3	63.4		28.8
June	**10.0**	**28.8**	**14.8**	**68.0**		**18.5**

Table 8: Bank Deposits and Rupee Liquidity

(Rs bln)

End period	Bank's Deposit Base			FE 25	Bank's Deposits Base excluding FE-25 (Rupee Liquidity)			Growth of Bank Deposits since June	
	(DD+TD)	(RFCD)	BD		DD+TD	RFCA	BD*	BD	BD*
	(1)	(2)	(3)=(1)+(2)	(4)	(5)	(6)	(7)=(5)+(6)	(8)	(9)
Jun-98	648.4	278.6	927.0		648.4	278.6	927.0		
Dec-98	774.4	178.9	953.3	9.4	765.0	178.9	943.9	2.8%	1.8%
Jun-99	865.7	120.9	986.6	27.1	838.6	120.9	959.5	6.4%	3.5%
Dec-99	884.9	84.6	969.5	35.7	849.3	84.6	933.9	-1.7%	-2.7%
Jun-00	924.5	112.5	1037.0	44.3	924.5	68.2	992.7	5.1%	3.5%
Jul-00	907.9	114.8	1022.7	47.2	907.9	67.6	975.5	-1.4%	-1.7%
Aug-00	914.6	118.5	1033.1	51.8	914.6	66.6	981.2	-0.4%	-1.2%
Sep-00	925.6	121.3	1046.9	52.9	925.6	68.4	994.0	1.0%	0.1%
Oct-00	911.9	121.3	1033.2	53.4	911.9	67.9	979.8	-0.4%	-1.3%
Nov-00	911.3	122.3	1033.6	48.1	911.3	71.0	982.3	-0.3%	-1.0%
Dec-00	935.8	123.3	1059.1	50.7	935.8	71.9	1007.7	2.1%	1.5%

Note: Till March 2000, the FE-25 deposits were included in DD and TD. Afterwards, these have been included as part of RFCDs. Therefore, FE-25 deposits have been excluded accordingly from calculating Rupee liquidity.

Table 9: Components of M2 - Stocks

(Rs mln)

End Period	Currency in Circulation	Demand Deposits	Time Deposits	Other Deposits With SBP	Resident Foreign Currency Deposits	M2
	(1)	(2)	(3)	(4)	(5)	Sum (1 to 5)
Jun-98	272,922	200,997	447,433	6,412	278,556	1,206,320
Jul-98	281,807	224,404	448,855	6,461	239,369	1,200,896
Aug-98	272,546	241,924	458,732	6,519	214,084	1,193,805
Sep-98	269,594	266,403	461,761	7,025	203,601	1,208,384
Oct-98	275,621	261,955	463,444	6,558	197,614	1,205,192
Nov-98	290,743	273,882	470,674	6,704	189,327	1,231,330
Dec-98	301,146	312,057	462,353	8,054	178,911	1,262,521
Jan-99	315,174	282,082	472,795	7,492	167,063	1,244,606
Feb-99	298,649	287,883	482,779	7,640	160,314	1,237,265
Mar-99	314,763	295,181	479,561	7,951	150,938	1,248,394
Apr-99	299,061	301,580	482,531	7,661	134,270	1,225,103
May-99	296,177	312,148	499,480	7,653	129,751	1,245,209
Jun-99	287,716	349,115	516,586	6,212	120,917	1,280,546
Jul-99	290,230	343,281	513,448	6,667	112,509	1,266,135
Aug-99	289,049	348,824	511,610	6,700	105,607	1,261,790
Sep-99	287,561	352,278	520,527	6,597	98,697	1,265,660
Oct-99	307,608	353,038	511,532	6,792	91,068	1,270,038
Nov-99	329,160	353,692	505,704	6,775	86,891	1,282,222
Dec-99	341,024	387,267	497,669	6,427	84,602	1,316,989
Jan-00	346,391	377,864	503,164	6,371	81,442	1,315,232
Feb-00	341,394	378,940	515,987	6,383	78,751	1,321,455
Mar-00	342,018	381,999	514,697	6,391	75,928	1,321,033
Apr-00	333,559	344,745	523,238	6,387	114,858	1,322,787
May-00	351,096	354,081	540,001	6,257	112,112	1,363,547
Jun-00	355,677	375,397	549,124	7,959	112,475	1,400,632
Jul-00	351,194	354,988	552,865	8,444	114,813	1,382,303
Aug-00	342,418	343,819	570,782	10,204	118,480	1,385,703
Sep-00	339,681	340,117	585,495	10,597	121,308	1,397,199
Oct-00	357,707	336,346	579,193	10,147	119,066	1,402,458
Nov-00	386,035	405,211	503,763	10,204	121,352	1,426,565
Dec-00	410,468	367,177	568,594	7,772	122,664	1,476,675

Table 10a: Discounting

(Rs mln)

Month	No. of Visits to Repo Window			Amount			Average/visit		
	FY01	FY00	FY99	FY01	FY00	FY99	FY01	FY00	FY99
October	28	13	23	438,180	29,458	85,790	15,649	2,266	3,730
November	30	2	0	282,664	28,230	--	9,422	14,115	--
December	22	12	0	138,921	62,280	--	6,315	5,190	--
Quarterly	80	27	23	859,765	119,968	85,790	10,747	4,443	3,730

Table 10b: OMOs (month-wise)

(Rs mln)

Month	Absorption			Injections		
	FY01	FY00	FY99	FY01	FY00	FY99
October	--	--	--	--	18,230	--
November	--	5,500	10,150	9,400	4,350	--
December	--	5,000	40,095	22,425	24,500	--
Total	--	10,500	50,245	31,825	47,080	--

Table 10c: OMOs (date-wise) (Rs mln)

Date	Sale		Purchase	
	Amount Offered	Amount Accepted	Amount Bid	Amount Injected
12-Oct-00	1,000	--	17,800	--
26-Oct-00	9,500	--	15,050	--
8-Nov-00	1,000	--	12,900	--
23-Nov-00	1,500	--	9,400	9,400
7-Dec-00	--	--	15,675	10,300
21-Dec-00	--	--	19,925	12,125
Total	13,000	--	90,750	31,825

Table 10d: PIB Auctions - Summary of Results (Rs mln)

Auction	Tenor	Coupon rate	Amount Offered	Range of Price offered/Rs. 100	Amount Accepted	W. A. % p.a.	% Accepted of Total Accpt.
1st	3 Years	12.50%	4,056.0	98.50--100.35	1,999.0	12.4507%	45.08%
	5 Years	13.00%	1,031.0	99.90--100.35	213.0	12.9490%	4.80%
	10 Years	14.00%	4,562.0	99.50--100.35	2,222.0	13.9667%	50.11%
Total	--		9,649.0	--	4,434.0	--	100.00%
2nd	3 Years	12.50%	2,026.7	99.00--100.11	506.5	12.4823%	5.20%
	5 Years	13.00%	3,066.3	99.90--100.11	3,059.2	12.9997%	31.41%
	10 Years	14.00%	7,406.3	99.50--100.18	6,174.1	13.9783%	63.39%
Total	--	--	12,499.3	--	9,739.8	--	100.00%
Grand Total	--	--	22,148.30	--	14,173.8	--	--

Table 11: Inflation Trends

(Percent)

Indices	Quarterly Inflation		Half yearly Inflation		Annualized Inflation							
	Cumulative October to December		Cumulative July to December		Month to Month Basis		Quarter to Quarter Basis		Half Year to Half Year Basis		12-Month Moving Average Basis*	
	1999	2000	1999	2000	Dec-99	Dec-00	Q2-FY00	Q2-FY01	1H-FY00	1H-FY01	Dec-99	Dec-00
CPI	0.90	0.90	2.45	2.40	3.03	5.05	3.40	5.01	3.36	4.91	4.14	4.37
WPI	-2.03	3.26	-1.28	5.56	-0.13	10.58	0.85	8.57	1.87	6.28	3.81	3.98
SPI	-1.26	-0.15	-0.28	2.33	0.07	6.05	0.99	6.11	2.05	5.17	3.85	3.40

* Percent change over preceding 12-month average

Table 12: Balance of Payments

(US$ mln)

Items	1H-FY99	1H-FY00	1H-FY01	1H-FY01/1H-FY00	
				Absolute	Percent
1. Trade Balance	**-1257**	**-1020**	**-763**	**257**	**25.2**
Exports (fob)	3631	3775	4333	558	14.8
Imports (fob)	4888	4795	5096	301	6.3
2. Services (Net)	**-1332**	**-1327**	**-1619**	**-292**	**-22.0**
Shipment	-414	-390	-405	-15	-3.8
Other transportation	41	26	30	4	15.4
Travel	-47	-36	-61	-25	-69.4
Investment Income	-937	-967	-1176	-209	-21.6
Interest payments on public debt	-704	-811	-874	-63	-7.8
Profit and Dividend	204	-156	-303	-147	-94.2
Other goods, services & Income	25	40	-7	-47	-117.5
3. Current Transfers (Net)	**1079**	**1600**	**1701**	**101**	**6.3**
a) Private Transfers -net	996	1546	1631	85	5.5
i) Workers' Remittances	581	517	609	92	17.8
ii) FCA (Residents)	182	167	181	14	8.4
iii) Outright Purchases	55	677	755	78	11.5
b) Official Transfers	83	54	70	16	29.6
4. Current Account Balance (1+2+3)	**-1510**	**-747**	**-681**	**66**	**8.8**
5. Financing	**1510**	**747**	**681**	**-66**	**-8.8**
I. Capital Account (net)	**-1584**	**-1499**	**-391**	**1108**	**73.9**
a) Foreign Investment	179	278	64	-214	-77.0
i) Direct investment abroad (Net)	-23	0	-11	-11	--
ii) Direct investment in Pakistan (Net)	248	307	143	-164	-53.4
iii) Portfolio (excl. public securities)	-69	-29	-68	-39	-134.5
b) Foreign long-term loans/credit (Net)	-133	-230	-150	80	34.8
i) Disbursements	1144	1124	1024	-100	-8.9
Project Aid	744	584	405	-179	-30.7
Food Aid	119	81	0	-81	--
Non Food	181	353	546	193	54.7
Others	100	106	73	-33	-31.1
ii) Amortization	1277	1354	1174	-180	-13.3
Official	1040	1022	934	-88	8.6
Others	237	332	240	-92	-27.7
c) Official Assistance (Net)	-918	-422	132	554	131.3
d) FCA (Non-residents)	-1167	-773	-64	709	91.7
e) Others	455	-352	-373	-21	-6.0
II. Changes in Reserves (-Inc/+Dec)	**-242**	**154**	**36**	**-118**	**-76.6**
Assets	-208	204	-73	-277	-135.8
SDRs	2	0	-11	-11	--
Forex (State Bank of Pakistan)	-129	265	-71	-336	-126.8
Forex (Commercial Banks)	-81	-61	9	70	114.8
Liabilities	-34	-50	109	159	318.0
Use of Fund Credit	-92	-130	47	177	136.2
Purchases/drawings	0	0	191	191	--
Repurchases	-92	-130	-144	-14	-10.8
III. Errors & Omissions	**526**	**304**	**448**	**144**	**47.4**
IV. Exceptional financing	**2868**	**1868**	**652**	**-1216**	**-65.1**
SBP reserves	1061	1477	1443	-34	-2.3
SBP reserves (excluding FE 25)	487	1307	1020	-287	-22.0

Table 13: Region-Wise Worker's Remittances

(US $ mln)

Countries	1H-FY99	1H-FY00	1H-FY01	Change in 1H-FY01 over 1H-FY00 Absolute	Percent
Gulf Region:	**326.5**	**369.0**	**415.7**	**46.6**	**12.6**
Bahrain	17.2	15.2	12.9	-2.4	-15.5
Kuwait	31.3	64.0	81.9	17.9	28.0
Qatar	6.6	7.5	7.5	0.0	0.1
Saudi Arabia	175.4	168.6	167.8	-0.8	-0.5
Sultanat-e-Oman	21.9	25.2	19.8	-5.4	-21.4
U.A.E.	74.0	88.6	125.9	37.3	42.1
Other than Gulf Region:	**130.9**	**118.5**	**156.5**	**38.0**	**32.1**
Canada	1.7	2.1	2.2	0.0	2.4
Germany	6.5	6.1	4.9	-1.2	-20.1
Japan	2.7	0.8	1.7	0.9	106.3
Norway	2.8	3.0	3.2	0.3	9.5
U.K.	38.3	38.0	41.3	3.3	8.6
U.S.A.	47.2	37.9	62.6	24.8	65.4
Others	31.9	30.6	40.6	10.0	32.7
TOTAL	**457.5**	**487.5**	**572.13**	**84.6**	**17.4**
Encashment FEBCs & FCBCs	**123.5**	**30.1**	**37.0**	**7.0**	**23.2**
TOTAL (including FEBC & FCBCs)	**580.9**	**517.0**	**609.2**	**92.2**	**17.8**

Table 14: Major Exports

(Value: US$ mln ; Unit Value: US$)

Commodities		Unit	1H-FY01		1H-FY00		Abs. D in Val.	% D in 1H-FY01 over 1H-FY00		
			Val.	Unit Val.	Val.	Unit Val.		Qty.	Val.	Unit Val.
A.	**Primary Commodities**		**577.4**		**496.0**		**81.5**	---	**16.4**	---
1	Rice	MT	225.5	255.0	240.7	307.0	-15.3	12.8	-6.3	-17.0
2	Leather	SM	102.2	12.9	78.2	13.9	24.0	40.7	30.7	-7.1
3	Raw Cotton	MT	87.8	1,009.2	9.5	770.5	78.3	607.9	827.2	31.0
4	Fish and Fish Preparations	MT	82.0	1,935.0	75.6	1,590.4	6.4	-10.9	8.5	21.7
5	Fruits	MT	42.0	396.2	38.1	372.9	3.9	3.8	10.3	6.2
6	Vegetables	MT	16.9	219.2	23.7	211.0	-6.9	-31.6	-28.9	3.9
7	Guar and Guar Products	MT	9.3	1,089.4	18.1	1,285.5	-8.9	-39.8	-49.0	-15.3
8	Crude Animal Material	MT	8.3	490.6	7.9	648.3	0.4	39.2	5.3	-24.3
9	Oil Seeds & Nuts etc.	MT	3.1	507.8	3.3	502.7	-0.2	-7.1	-6.2	1.0
10	Raw Wool (Excl. Wool Tops)	MT	0.4	1,257.7	0.8	1,340.9	-0.4	-43.1	-46.7	-6.2
B.	**Textile Manufactures**		**2,823.2**		**2,735.3**		**88.0**	---	**3.2**	---
11	Cotton Fabrics (Woven)	SQM	509.4	0.6	556.8	0.7	-47.4	10.0	-8.5	-16.8
12	Cotton Yarn	MT	504.5	1,991.1	495.3	2,132.9	9.2	9.1	1.9	-6.6
13	Hosiery (Knitwear)	Doz	455.5	23.1	435.0	23.6	20.6	6.7	4.7	-1.9
14	Readymade Garments	Doz	411.9	25.3	384.2	24.4	27.6	3.1	7.2	4.0
15	Bed Wear	MT	367.3	5,074.7	350.4	5,401.4	16.9	11.6	4.8	-6.0
16	Synthetic Textiles	SQM	263.3	0.6	224.7	0.7	38.5	32.2	17.2	-11.3
17	Other Textile Made up	(-)	165.8	---	150.4	---	15.4	---	10.2	---
18	Towels	MT	111.9	3,583.6	89.6	3,749.5	22.3	30.6	24.8	-4.4
19	Tarpaulin & Other Canvas Goods	MT	18.0	2,277.7	27.3	2,441.4	-9.3	-29.4	-34.1	-6.7
20	Cotton Bags and Sacks	MT	8.5	4,133.6	9.9	4,405.1	-1.4	-8.4	-14.1	-6.2
21	Tule, Lace Embroidery etc.	(-)	4.4	---	8.4	---	-4.0	---	-47.1	---
22	Waste Material of Textile Fibres	MT	2.6	535.0	3.1	646.2	-0.5	1.6	-15.9	-17.2
C.	**Other Manufactures**		**740.2**		**609.9**		**130.4**	---	**21.4**	---
23	Leather Manufactures	(-)	240.2	---	183.1	---	57.0	---	31.1	---
24	Carpets, Carpeting Rugs & Mats	SQM	133.8	46.9	123.1	51.2	10.8	18.8	8.8	-8.4
25	Sports Goods	(-)	120.2	---	122.4	---	-2.3	---	-1.9	---
26	Petroleum and Petroleum Prod.	MT	86.5	232.6	42.4	170.0	44.0	49.0	103.8	36.8
27	Chemicals and Pharmaceuticals	(-)	64.9	---	39.3	---	25.6	---	65.0	---
28	Surgical and Medical Instruments	Nos	59.0	1.3	56.8	1.3	2.2	1.4	3.9	2.5
29	Molasses	MT	15.3	32.9	21.8	22.2	-6.4	-52.3	-29.5	47.8
30	Cuttlery	Gr	13.8	32.1	10.6	49.2	3.2	99.7	30.3	-34.7
31	Onyx Manufactured	MT	6.6	1,737.8	4.1	1,632.0	2.5	50.1	59.8	6.5
32	Sugar	MT	-	---	6.3	309.2	-6.3	---	---	
D.	**Others**		332.9	---	287.3	---	45.6	---	**15.9**	---
Total Exports:			**4,473.8**		**4,128.4**		**345.4**		8.4	
excl. Major Food Items and Raw Cotton			*4,046.1*		*3,700.8*		345.3		9.3	
excl. Major Food Items, Raw Cotton and Cotton Yarn			*3,536.7*		*3,144.0*		392.7		12.5	

Source: Federal Bureau of Statistics.

Table 15: Major Imports

(Value: US$ mln; Unit Value: US$)

Commodities	Unit	1H-FY01		1H-FY00		Abs. D in Val.	% D in 1H-FY01 over 1H-FY00		
		Val.	Unit Val.	Val.	Unit Val.		Qty.	Val.	Unit Val.
A. Food Group	---	**572.8**	---	**537.7**	---	**35.1**	---	**6.5**	---
1. Sugar	MT	187.9	271.1	0.6	334.7	187.3	---	---	-19.0
2. Edible Oil	MT	176.0	312.4	213.2	414.4	-37.2	9.5	-17.4	-24.6
Soyabean	*MT*	*26.6*	*344.6*	*49.8*	*454.3*	*-23.2*	*-29.6*	-46.6	*-24.2*
Palm Oil	*MT*	*149.4*	*307.3*	*163.4*	*403.6*	*-14.0*	*20.1*	-8.5	*-23.9*
3. Tea	MT	105.2	1,933.8	98.2	1,902.6	7.0	5.4	7.1	1.6
4. Pulses	MT	57.1	328.7	29.7	311.5	27.5	82.6	92.6	5.5
5. Dry Fruits	MT	18.5	543.2	22.4	1,170.6	-3.8	78.5	-17.2	-53.6
6. Milk & Cream incl. Milk Food for Infants	MT	11.2	1,759.6	18.5	1,666.5	-7.3	-42.6	-39.4	5.6
7. Wheat Unmilled	MT	9.4	203.2	146.5	145.9	-137.1	-95.4	-93.6	39.2
8. Spices	MT	7.4	1,178.8	8.7	1,146.9	-1.3	-17.3	-15.0	2.8
B. Machinery Group	---	**977.1**	---	**974.5**	---	**2.6**	---	**0.3**	---
1. Road Motor Vehicles	---	170.8	---	154.7	---	16.1	---	10.4	---
2. Textile Machinery	---	164.0	---	76.7	---	87.2	---	113.7	---
3. Office Machinery	---	111.0	---	69.9	---	41.1	---	58.8	---
4. Power Generating Machinery	---	90.7	---	63.2	---	27.5	---	43.5	---
5. Electrical Machinery & Apparatus	---	64.0	---	67.9	---	-3.9	---	-5.7	---
6. Aircraft, Ships and Boats	---	38.5	---	110.5	---	-72.0	---	-65.2	---
7. Construction & Mining Machinery	---	34.3	---	52.8	---	-18.5	---	-35.0	---
8. Agricultural Machinery & Implements	---	10.9	---	23.8	---	-12.9	---	-54.2	---
9. Railway Vehicles	---	5.4	---	37.8	---	-32.4	---	-85.8	---
10. Other Machinery	---	287.6	---	317.3	---	-29.7	---	-9.4	---
C. Petroleum Group	---	**1,840.8**	214.5	**1,200.7**	154.4	**640.1**	10.4	**53.3**	38.9
1. Petroleum Products	MT	1,111.7	215.9	842.2	150.3	269.5	-8.1	32.0	43.7
2. Petroleum Crude	MT	729.1	212.3	358.5	165.2	370.6	58.3	103.4	28.5
D. Textile Group	---	**74.2**	---	**81.1**	---	**-6.9**	---	**-8.5**	---
1. Synthetic Fibre	MT	38.2	1,294.5	40.6	1,171.4	-2.4	-14.8	-5.8	10.5
2. Synthetic & Artificial Silk Yarn	MT	23.6	1,803.4	23.5	2,131.3	0.1	18.9	0.6	-15.4
3. Worn Clothing	MT	12.4	305.8	17.1	371.7	-4.7	-11.7	-27.3	-17.7
E. Agricultural and Chemicals Group	---	**946.5**	---	**981.4**	---	**-34.9**	---	**-3.6**	---
1. Plastic Materials	MT	164.1	880.4	155.6	865.5	8.4	3.6	5.4	1.7
2. Fertilizer	MT	125.1	185.2	129.5	173.7	-4.4	-9.4	-3.4	6.6
3. Medicinal Products	MT	114.7	23,221.7	134.1	21,635.7	-19.4	-20.3	-14.5	7.3
4. Insecticides	MT	44.8	3,106.3	67.5	3,838.1	-22.7	-18.0	-33.6	-19.1
5. Others	---	497.8	---	494.6	---	3.2	---	0.6	---
F. Metal Group	---	**156.3**	---	**190.9**	---	**-34.6**	---	**-18.1**	---
1. Iron and Steel	MT	124.5	337.2	162.4	350.4	-38.0	-20.4	-23.4	-3.8
2. Aluminum wrought & Worked	---	16.2	---	19.5	---	-3.3	---	-16.7	---
3. Iron and Steel Scrap	MT	15.6	116.6	9.0	128.7	6.6	91.1	73.2	-9.4
G. Miscellaneous Group	---	**123.2**	---	**128.8**	---	**-5.6**	---	**-4.3**	---
1. Paper and Paper Board & Manuf.	MT	52.4	763.0	54.1	656.2	-1.7	-16.7	-3.2	16.3
2. Rubber Tyres & Tubes	Nos.	32.8	24.9	36.3	24.6	-3.6	-10.6	-9.8	0.9
3. Rubber Crude	MT	19.6	672.1	18.5	647.4	1.1	2.0	5.9	3.8
4. Jute	MT	12.8	261.7	10.2	272.9	2.6	31.2	25.7	-4.1
5. Wood & Cork	---	5.6	---	9.6	---	-4.0	---	-41.6	---
H. Others	---	**704.6**	---	**800.2**	---	**-95.6**	---	**-12.0**	---
Total Imports:		**5,395.5**		**4,895.3**		**500.2**		**10.2**	
excl. POL group		3,554.7		3,694.6		-139.9		-3.8	
excl. Food Group		4,822.6		4,357.5		465.1		10.7	
excl. POL & Food Group		2,981.9		3,156.9		-175.0		-5.5	

Source: Federal Bureau of Statistics.

Table 16: Capital Account

(US$ mln)

Items	FY99			FY00			FY01		
	Cr.	Dr.	Net Credit	Cr.	Dr.	Net Credit	Cr.	Dr.	Net Credit
1. Direct investment abroad	5	28	-23			0	0	11	-11
2. Direct investment in Pakistan	248		248	307		307	143		143
3. Portfolio investment		73	-73		169	-169		71	-71
(of which stock market)		69	-69		29	-29		68	-68
4. Long-term capital-official sector	1,600	1,040	560	1,018	1,044	-26	956	1,206	-250
4.1. Assets	327		327			0			0
4.2. Loans drawn	1,044	1,040	4	1,018	1,022	-4	951	934	17
4.3. Loans extended			0			0			0
4.4. Other Liabilities	229		229		22	-22	5	272	-267
5. Long-term capital-Deposit money banks	0	0	0	0	0	0	0	2	-2
5.1. Assets			0			0			0
5.2. Loans			0			0			0
5.3. Other Liabilities			0			0		2	-2
6. Long-term capital-Other Sectors	103	237	-134	137	332	-195	204	329	-125
6.1. Assets			0			0			0
6.2. Loans	100	237	-137	106	332	-226	73	240	-167
6.3. Other Liabilities	3		3	31		31	131	89	42
7. Short-term capital-Official Sector	66	980	-914	90	374	-284	334	199	135
7.1. Assets		51	-51		8	-8	1	8	-7
7.2. Loans	66	626	-560	90	174	-84	219	100	119
7.3. Other Liabilities		303	-303		192	-192	114	91	23
8. Short-term capital-Deposit Money Banks	65	725	-660		662	-662	79	82	-3
8.1. Assets	1		1		70	-70	77	38	39
8.2. Bilateral balances-assets			0			0			0
8.3. Bilateral balances-liabilities			0			0			0
8.4. Liabilities under NR A/cs	64		64		7	-7	2	1	1
8.5. Other Liabilities		725	-725		585	-585		43	-43
9. Short-term capital - Other Sectors	31	619	-588	0	470	-470	13	221	-208
9.1. Assets	31		31		103	-103		202	-202
9.2. Loans			0			0			0
9.3. Other Liabilities		619	-619		367	-367	13	19	-6
Capital Account	**2,118**	**3,702**	**-1,584**	**1,552**	**3,051**	**-1,499**	**1,729**	**2,120**	**-391**