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THE STATE OF PAKISTAN'S ECONOMY
Third Quarterly Report for 2000/2001[1]

1. Overview

The continuing drought and water shortages have taken a heavy toll on Pakistan's economy. Most recent estimates indicate that overall GDP growth in FY01 will decline to below 3 percent. Therefore, per capita income is likely to remain stagnant. Despite a falling share of agriculture in Pakistan's economy, production of major crops has a very direct impact on the manufacturing sector and purchasing power in rural areas.[2] On a positive note, the country was able to post a current account surplus in its balance of payments in the third quarter of this year.

Table 1.1: Quarterly Economic Indicators

(Percent)

Growth rates	July-March		
	FY99	**FY00**	**FY01**
Large-scale manufacturing	3.6	3.5	8.8
Exports	-11.7	8.9	8.4
Imports	-14.9	13.1	7.2
Home remittances	-31.5	-9.1	16.8
Tax revenues	2.0	18.2	14.9
CPI (3Q over 3Q)	6.3	3.4	4.8
Private sector credit	11.3	5.4	14.0
Money supply (M2)	3.5	3.2	4.7
*As % of GDP**			
Trade deficit	3.6	2.3	1.7
Current a/c deficit	3.8	1.6	1.6
Fiscal deficit	6.1	6.5	5.3

* Numbers relate to full year

Returning to the drought, a shortfall in the production of major crops (cotton, sugarcane, wheat and rice) also requires import of primary products. Adding to this burden, the water shortage has impaired the country's ability to generate hydel power, which has fueled Pakistan's huge oil import bill in the first three quarters of this fiscal year. The estimated impact of the drought on the country's balance of payment is shown in **Table 1.2.**

[1] Date of commencement: May 7th 2001. Date of completion: May 21st 2001.
[2] In terms of its impact on manufacturing, *textiles* and *food, beverages and tobacco* are the two largest sectors of value addition in large-scale manufacturing. On the other hand, the crop size of cotton and wheat is critical in determining the volume of purchasing power in the rural sector.

Table 1.2: Impact of Drought on Balance of Payments for FY02

	Cotton mln bales	Rice mln tons	Wheat mln tons	Sugar[3] mln tons
Production				
Without impact of drought	11.0	5.0	20.5	3.3
With impact of drought	10.5	4.6	18.5	2.0
Consumption	9.5	2.5	20.5	3.3
Exportable surplus[1]				
Without impact of drought	2.0	3.2	3.5	n/a
With impact of drought	1.5	2.8	1.5	n/a
Possible export				
Without impact of drought	1.5	2.5	2.2	n/a
With impact of drought	0.5	2.2	1.2	n/a
Export price (US$ / unit)[2]	48.5	261.0	144.0	n/a
Export earning (mln US$)				
Without impact of drought	272.8	652.5	316.8	n/a
With impact of drought	90.9	574.2	172.8	n/a
Loss	**181.9**	**78.3**	**144.0**	**343.2**
Total loss from primary commodities			US$ 747	million
Additional oil import (drought)			US$ 180	million
Total BOP loss expected in FY02			**US$ 927**	million

Source: All numbers are from Finance Division. MOF
1: Accounts for opening balance of primary products
2: Export price of cotton is in cent/lbs.
3: Import of sugar

Against a *provisional* growth rate of 9.6 percent for major crops in FY00 (which increased aggregate growth to 4.5 percent last year), the revised estimate this year could be as low as *negative* 5.4 percent. Despite this exogenous development, Pakistan's cotton crop this year will not be impacted. An early sowing season and the fact that this is a less water intensive crop (compared to the other major crops), have been its saving grace.

Large-scale manufacturing (LSM) recorded strong growth of 8.8 percent compared to 3.5 percent last year. LSM growth was driven by a sharp reversal in the production of refined sugar and high value addition in petroleum refining.

Since this year's cotton crop is 4.5 percent less than the previous year, the textile sector was only able to post 4.6 percent growth against an impressive 13.5 percent in the first three quarters of last year. Assisted by an increase in the production of automobiles (cars, motorcycles and light commercial vehicles) and certain consumer durables (air-conditioners and refrigerators), this was able to compensate for textiles.

In terms of Pakistan's fundamental imbalance, tax collection has been able to show an improvement in the tax/GDP ratio for the second consecutive year with an increase of 14.9 percent this year. Nevertheless, there have been slippages vis-à-vis IMF revenue targets for two consecutive quarters (end-December and end-March). Given the cumulative nature of revenue collection, Pakistan will have to request a waiver for the end-June target. The fiscal deficit on the other hand, is expected to remain unchanged from the original target of 5.3 percent of GDP. Most of the fiscal adjustment is likely to be made by curtailing expenditures.

Looking at the other targets that are part of the IMF's stabilization program, the ceiling on SBP's net domestic assets (NDA) was easily met in end-March 2001. A much-needed relaxation on this target (given the problems faced in end-December) was negotiated in mid-February, with the result that banks helped SBP shift GOP debt to their books. However, the need to increase Pakistan's liquid reserves to meet the end-March target for SBP's net foreign assets (NFA), did result in heavy purchases of foreign exchange from the kerb market. Against US$ 1.37 billion in the first three quarters of FY00, SBP managed to buy US$ 1.56 billion from the kerb market this year. In terms of worker remittances, the larger inflows this year was largely because of exceptional inflows on account of compensation from Kuwait (for Gulf war affected Pakistanis) and the Hajj sponsorship scheme.

The performance of Pakistan's external sector has been lackluster. Exports have not done as well as targeted, and if the trend witnessed in first three quarters of this year persists (an 8.4 percent increase), exports are likely to reach US$ 9.2 – 9.3 billion for the full year. Export revenues continued to suffer from low international prices despite increased volumes for the second consecutive year. The most disappointing results have been in the textile sector; given its share in total exports, textiles have adversely affected the country's export performance.

Oil imports have already exceeded US$ 2.5 billion during the period under review. Nevertheless, the growth in Pakistan's import bill has been below export growth, resulting in the second consecutive improvement in the trade deficit from 2.3 percent to 1.7 percent (of GDP) this year (see **Table 1.1**).

The upshot of this is that Pakistan was able to post a current account *surplus* in the third quarter of FY01. This is largely because Pakistan's non-oil import bill is almost stagnant in the first three quarters of this year compared to FY00. However, this did not ease pressure on the Rupee, as the third quarter witnessed continuous depreciation as SBP support to the interbank market (in terms of supplying hard currency) was gradually reduced. Helped by lower economic growth this year, the ratios of the external imbalances (trade and current account deficits as a percentage of GDP) have narrowed.

In terms of the financial sector, despite the fact that the third quarter witnesses an increase in bank liquidity, SBP could not ease its monetary policy by lowering T-bill rates. With strict stabilization targets (especially government borrowing from the central bank) and a stagnant Rupee deposit base, lowering T-bill rates would have made it harder to meet these targets. Despite tight liquidity conditions during the course of this year, private sector credit posted a sharp increase on account of the textile sector (which no longer had to resort to self-finance as it had last year)[3], sugar and automobiles. The rise in production of consumer durables can also be traced to the increasing popularity of leasing facilities. This in turn explains the active role of leasing companies in mobilizing long-term funds from the bond market to sustain their operations.[4]

Looking ahead, the fact that Pakistan has successfully met the IMF's quarterly targets has enhanced the country's credibility with the International Finance Institutions (IFIs). Pakistan's performance in the last 6 months has been greeted by pledges of further assistance from the World Bank and the Asian Development Bank. Still, adverse external developments may put pressure this quarter in building up liquid reserves. If end-June targets are successfully met, the chances of converting the stabilization program (SBA) into a longer-term structural adjustment program (PRGF) by September 2001 are quite strong. This

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[3] In terms of working capital loans, against Rs 8.9 billion disbursed in the first three quarters of FY00, this year witnessed net lending of Rs 25.0 billion.
[4] Out of 6 new corporate bonds issued this fiscal year, 5 were by leasing companies with a combined mobilization of Rs 1.6 billion.

will provide the breathing space to implement sector-specific reforms in the banking system, capital markets, the energy sector, restructuring of public sector enterprises, and allow a revival of the privatization drive.

The good standing with the IFIs has not yet helped revive widespread investment, nor has the pace of economic activity picked up to meet the expectations of the public at large. This situation has been further exacerbated by the drought, low international prices for Pakistan's exports, depressed demand in the industrialized world and inadequate capital flows. Unless Pakistan receives medium-term assistance on soft terms to offset these adverse effects, the external payment position will remain under severe strain. The balancing act between keeping the debt burden under control and achieving a healthy balance of payments will remain the biggest challenge facing the country in the next few years.

2. Executive Summary

Real Sector

Developments in the third quarter of FY01 were dominated by the acute water shortage in the country. Since agriculture has strong spillovers on the rest of the economy, the downward revision in the size of Pakistan's major crops will not only tone down economic growth projections, but will also require urgent actions to reduce the degree of vulnerability of the agricultural sector to weather conditions. Declining levels of rainfall for the third consecutive year, which resulted in the drawing down of water reservoirs last year (to support bumper crops in wheat and rice), does not bode well for the future. Given the country's dependency on irrigated farming, water management will become a critical aspect of economic policymaking.

The adverse impact of the drought on Pakistan's major crops may result in negative 5.4 percent growth this year, compared to a target of 3.2 percent set at the beginning of the year. If this were to happen, overall agricultural growth will be almost stagnant this year (growth of only 0.2 percent), compared to 3.9

percent last year.[5] This significant decline will have serious consequences for poverty and living standards in rural areas.

As shown in **Table 1**, cotton is the only major crop that should be able to meet the target set at the beginning of the year. Two factors are responsible: first, as a Kharif crop that is sown at the end of the fiscal year, the water shortage did not impact cotton as strongly as it has others; and second, cotton is not a water intensive crop. On the other hand, water intensive crops like sugarcane and rice have had to bear the brunt of the water shortage – against full year targets for this year, actual production is expected to show a shortfall of 15.3 percent (for sugarcane) and 5.9 percent (for rice).

To add to this problem, impact of the water shortage has not been even in the two main agriculture provinces of Pakistan (Sindh & Punjab). Other than endowment differences in terms of the flow of irrigated water and the larger proportion of brackish groundwater in Sindh, Punjab was able to cope with this crisis more effectively. The results speak for themselves; area under cultivation for wheat and rice in Sindh fell by 29.5 and 20.9 percent, respectively, while the national average declines were only 1.7 and 5.5 percent. A sustainable longer-term solution requires a more consistent strategy across provinces to build small dams/bunds, and to allocate existing canal water more strategically.

Fortunately, the performance of the manufacturing sector has been much better for the first three quarters of this year. Large-scale Manufacturing (LSM) was up by 8.8 percent compared to 3.5 percent for the corresponding period last year. As shown in **Table 2**, the source of this reversal is the sharp increase in value addition by *food, beverages and tobacco*. More specifically, positive value addition by sugar, strong growth in the production of vegetable ghee & cooking oil, and a very sharp reversal in the production of cigarettes, allowed this sub-sector to grow by 10.0 percent in the first three quarters, against negative growth of 17.1 percent in the corresponding period last year. After textiles, this is the largest sub-sector of value addition in LSM.

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[5] If the wheat crop in FY00 is revised upward to 21.2 million tones (which is not the case in the 9.6 percent growth shown by major crops last year), the agriculture sector will shrink by 1.3 percent during FY01.

The food sub-sector was able to overshadow the lower growth posted by textiles, as production of ginned cotton and yarn were lower this year. The refining of petroleum products (which is the third largest source of value addition in LSM) showed strong growth compared to FY00, which was supported by higher imports of crude petroleum. These two sectors were clearly the swing factors in the high growth shown by LSM.

For the second consecutive year, production of automobiles and chemicals has shown rising growth rates. The production of cars, motorcycles and light commercial vehicles (LCVs), has been strong enough to compensate for the shortfall in the production of trucks and tractors. On the supply side, the introduction of new brands of compact cars played a large role, while the increasing use of leasing enhanced demand for such products. In the chemicals group, the largest increases were shown in paints, varnishes/polishes and the production of chlorine gas. As complementary goods, these products are used by the automobile sector, while chlorine gas is used in the preparation of vegetable ghee.

Excluding outliers, the trimmed growth during the first three quarters of this year was 9.5 percent against 6.6 percent in the corresponding period last year. This can be seen in **Table 3.2.1**, where extreme growths (both negative and positive) are less common this year; in fact, the sharp negative growth in *food, beverages & tobacco* last year that has been reversed this year, has played a pivotal role in narrowing the difference between overall and trimmed growths in the two years.

To summarize, low growth in agriculture has been compensated by strong growth in manufacturing, which is spearheaded by the food group (especially sugar). Despite indications that the country will meet the cotton target this year, the fact that this crop is 4.4 percent lower than last year, has pulled down growth in the textile sector. On the upside, the increasing popularity of leasing consumer durables has boosted demand for cars, motorcycles and air-conditioners/refrigerators.

Fiscal Developments

Tax collection in the first three quarters of this fiscal year is up 14.9 percent over last year. Keeping in mind the impact of the drought on Pakistan's GDP, growth

of tax revenues should exceed nominal growth, which means the tax to GDP ratio will improve this year. However, even with this impressive growth in revenues, the IMF's quarterly targets for end-December and March were not met. As a consequence, the end-June 2001 targets stands revised at Rs 417.3 billion, from an original target of Rs 430.2 billion. Tax collected so far represents 98.3 percent of the third quarter target, and 66.3 percent of the full year revised target. It should be noted that ambitious targets set at the onset of the fiscal year (IMF program year), paints a bleaker picture than is actually the case, which undermines the perceived improvement in revenue collection. In terms of the fiscal deficit, driven by higher than projected non-tax revenue and stricter expenditure controls, the budget deficit for 1H-FY01 was 0.7 percent (of GDP) lower than targeted under the IMF program.

Monetary Developments

Unlike developments in Q2-FY01, the financial sector was reasonably calm last quarter. The sharp retirement of commodity financing to banks, the on-going maturity of government securities held by banks, and the seasonal plateau of private sector credit during Q3-FY01, allowed commercial banks to be more comfortable in terms of liquidity. Nevertheless, following the events in end-December, banks were hesitant about locking in funds and were not forthcoming in the fortnightly primary auctions.[6] It was only after the IMF relaxed its end-March net domestic asset (NDA) target, did banks place more funds in government securities.[7] Given the self-fulfilling nature of expectations, once banks were less panicky about this target and more forthcoming in the auctions, it allowed SBP to meet the NDA target almost effortlessly.[8]

Money supply actually fell during Q3-FY01, but is to be expected for this period of the year. In aggregate terms, money supply increased by Rs 66.1 billion in the first three quarters against a full year target of Rs 147.0 billion. In the remaining part of this year, except for commodity financing in end-May and June 2001,

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[6] This is the main avenue of bank lending to the government.
[7] In broad terms, this target tries to limit government borrowing from SBP, commercial banks and non-bank financial institutions (NBFIs).
[8] If banks had remained hesitant, this would have either forced SBP to sharply tighten monetary policy or resort to other methods to meet the target.

there is likely to be a fall in net domestic assets of the banking system in the last quarter. However, with an ambitious net foreign asset (NFA) target for end-June, monetary growth for the full FY01 will increase from the end-March level, but should not exceed last year's increase in M2 (which was Rs 120.1 billion). In effect, although inflationary pressures will remain, this is primarily on account of cost-push factors and not because of excessive purchasing power in the economy.

In terms of sectoral distribution, working capital loans to the textile sector increased sharply (see **Table 7**). Two inter-related factors are responsible: first, the textile sector relied more on self-financing last year; and second, the increase in lint cotton prices raised demand for bank financing. The sugar sector also increased borrowing from the banking system on account of an increase in the market price of sugarcane and a sharp reversal in the production of refined sugar. The bulk of the increase in term financing, on the other hand, was driven by the textile and automobile sectors.

Despite an increase in market liquidity compared to Q2-FY01, T-bill rates were stable with a mild increase of 50 to 60 basis points in March. SBP could not afford to reduce interest rates for two distinct reasons: (1) this would have made it difficult to meet the NDA target for end-March, and (2) although the third quarter witnessed a *gradual* depreciation of the Rupee, SBP feared that if its monetary policy was eased, this could unhinge the foreign exchange market. The unfortunate consequence of this monetary stance was the increase in export refinance rates (in both early January and early April) and the expected increase in early FY02.

Prices

Annualized average inflation rates have been 4.8 and 6.7 percent for CPI and WPI, respectively (for end-March 2001), but price increases in the third quarter have been subdued compared to the first two quarters. Although the inflationary impetus once again comes from non-food items, the overall impact of this category was contained; while retail gas prices increased by an average 20 percent on March 17th, retail petrol prices were reduced by 7.0 percent while diesel prices dropped by 15.7 percent on March 15th, on account of the fall in international oil prices (see **Figure 6.1.1**).

In terms of food items, 70 out of 163 posted a price increase during the third quarter of FY01. Although only 47 items showed a decline, the sensitive nature of these items (e.g. sugar, rice, milk and edible oil) appeased the public view on prices.

Capital Markets

The Karachi Stock Exchange (KSE) displayed bearish sentiments in the third quarter of this fiscal year. Other than expected movements in the KSE index following the announced results of heavyweight companies[9], the real damage followed a report from Merrill Lynch that was published on February 19th. Selling pressures following the decision of a large foreign fund to close its position in Pakistan resulted in a fall in the KSE index from 1,511.6 on Feb 19th to 1,324.4 by the end of March (see **Figure 7.1**). Corresponding to this sell-off, the country's foreign exchange reserves were depleted by US$ 64 million during the course of the quarter.

In terms of the dispute between KSE and SECP that surfaced in end-December (see previous *Quarterly Report*), a mutually satisfactory solution was achieved. In spite of this, the market's resentment did not disappear. In early May 2001, issues relating to capital market reforms advocated by SECP (specifically the movement towards the T + 3 regime) has become contentious.

Looking at the bond market, the issuing of corporate bonds (Term Finance Certificates) by leasing companies continued last quarter. Although only one company entered the market during Q3-FY01, out of the 18 new issues since FY96, 6 have been issued this year. The growing interest in issuing long-term bonds by leasing companies, which account for 5 of the 6 bonds issued this year, is directly related to the increasing popularity of leasing consumer durables.

External Sector

Pakistan's external sector was able to show a current account surplus in the third quarter of this year. Although this narrowed the gap in the balance of payments

[9] In a nutshell, we had negative results for PTCL on January 25th; positive for Engro Chemicals on January 31st; negative for Shell and positive for PSO in mid-February.

(BOP) for the first three quarters (from US$ 1.03 billion last year to US$ 575 million), the need to build up liquid reserves during the course of Q3-FY01, meant the authorities had to monitor the foreign exchange market very closely (see **Figure 8.3.1**). In fact, the urgency to increase liquid reserves during the quarter resulted in record levels of outright purchases from the kerb market; SBP's purchases are already US$ 1.56 billion during the first three quarters (see **Special Section 1**). This, coupled with lumpy inflows of remittances on account of Hajj receipts and compensation for Kuwait war affecties, allowed the country to narrow its current account deficit.

Looking at detailed trade numbers using custom records, the US$ 1.32 billion trade deficit during the first three quarters of FY01, was marginally above the deficit in the corresponding period last year. The main reasons for this are: (1) weak international prices for Pakistan's main textile exports, (2) higher imports of machinery on account of the textile sector's BMR drive, (3) import of sugarcane and pulses to compensate for low domestic production, and most importantly, (4) the ballooning oil bill that has already exceeded US$ 2.5 billion in the first three quarters of this year.

For the second year in a row, growth in export revenues came on the back of substantial quantitative increases. The total quantity effect during the period July-March 2001 was positive US$ 759.4 million, which was undermined by a negative US$ 432.9 million price effect. It should be noted that the bulk of these effects are driven by textile exports.

The water shortage has also impacted Pakistan's trade deficit. Other than higher imports of sugar and pulses, low water reservoir levels have impaired the generation of hydel power. To make up for this shortfall, reliance on thermal power generation has increased, with the resulting import of more crude petroleum. Looking ahead, this issue will continue to pressure the external sector (see **Table 1.2**). To finalize this summary, given the free-float of the exchange rate and the fact that the underlying fundamentals are still weak, the Rupee continues to witness a gradual depreciation.

3. Real Sector

3.1 Agriculture

The agricultural sector is expected to post dismal growth this year on account of the severe water shortage and bumper crops last year. As shown in **Table 1**, production of kharif crops particularly rice and sugarcane (which are water intensive) have been adversely impacted by the dry spell and lag behind the production targets by a large margin. The water shortage extended into the sowing period of rabi crops (approximately October to January), and hit both wheat and gram production. Given the role of major crops in agricultural growth, and its spillover to manufacturing, the severity of the water shortage will lead to further downward revisions of aggregate growth this year.

Rainfall

The sharp fall in the availability of irrigation water can be gauged by the withdrawal of canal water during the sowing period of the rabi season (see **Table 3.1.1**). The sharp fall in FY01 actually builds upon an already bad FY00; viewing the availability of water over the past two years, usage of canal water this year is only 70 percent of what was utilized during FY99. Diminishing rainfall in the past several years is the root cause of the present drought-like situation. The extended dry spell in most parts of the country, is posing a serious challenge to sustainable growth in both the crop and non-crop (livestock, fisheries,etc.) sectors of agriculture.

Table 3.1.1: Canal Withdrawals

(October 1st 2000 to January 20th 2001)

(Million acre feet)

Provinces	FY98 (1)	FY99 (2)	FY00 (3)	FY01 (4)	% (4)/(3)
Punjab	13.0	13.6	13.2	10.0	-24.3
Sindh	12.2	12.2	10.1	7.5	-25.6
Balochistan	0.6	0.9	0.8	0.8	-7.9
NWFP	0.3	0.2	0.3	0.4	35.7
Total	**26.1**	**27.0**	**24.4**	**18.7**	**-23.6**

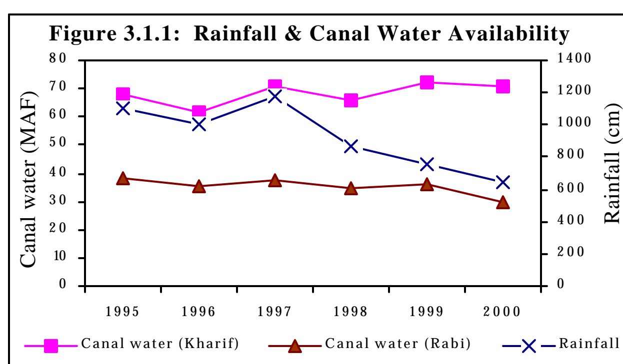
Source: Federal Committee on Agriculture.

Rainfall impacts the crop sector directly and indirectly; the former refers to agriuicultural produce that does not have an irrigation system and depends soley on rainfall, while the latter effect arises as rainfall is the source of water for dams and groundwater that feeds tubewells. The land that is solely dependent on rain (*barani* areas), which produced around 6.3 percent of the total production of wheat last year and a sizeable share in the production of pluses, have been hit the

hardest. Since Sindh has a higher ratio of *barani* land relative to Punjab, the shortage of rainfall has worsened the regional disparity of agricultural growth and the resulting income distribution. Collectively, Pubjab and Sindh account for over 85 to 90 percent of the total production of major crops in the country.

Data compiled by FBS on 21 selected cities to gauge rainfall patterns in the country, show a 14.0 percent decline in rainfall in calender 2000 over the previous year. As shown in **Figure 3.1.1**, the three consecutive years of falling rainfall have reduced the availability of canal water. During 1999 and 1998, rainfall declined by 13.2 percent and 26.2 percent, respectively. In comparing rainfall and usage of canal water, there is a clear positive correlation with the exception of calendar 1999: following the sharp fall in rainfall during the year, the authorities made special arrangements to release additional water from reservoirs even at the risk of damaging the power generating dams.[10] In effect, the bumper crops during FY00 were sustained by drawing down water reservoirs. This deteriorating situation will continue to plague the country unless the authorities are able to plan out the likely developments in the next few years, and take urgent steps to conserve and improve the efficient utilization of this resource.

Figure 3.1.1: Rainfall & Canal Water Availability



Impact on cultivated land

As shown in **Table 1**, the lack of irrigation water has reduced area under cultivation for all of Pakistan's major crops; this can be seen in **Figure 3.1.2**. Considerable declines of 5.5 percent and 4.9 percent were recorded for rice and sugarcane, respectively, while smaller declines were observed for less water intensive crops like cotton and wheat. The shortage of water has hit the

[10] If the water level in generating dams falls below a certain benchmark, there is the risk that the collected silt could damage the turbines in the dams.

sugarcane crop in Sindh the hardest, with yield per hectare falling by 16.1 percent compared to the year before. However, Punjab was more proactive in terms of addressing the persistent water shortage; a concerted campaign was launched by the provincial government to inform and train farmers in the selection of high yielding varieties of sugarcane, and disseminating information on the latest production techniques. Hence, despite the fall in sugarcane yield in Sindh, Punjab was able to increase its average yields by 7.4 percent in the same period.

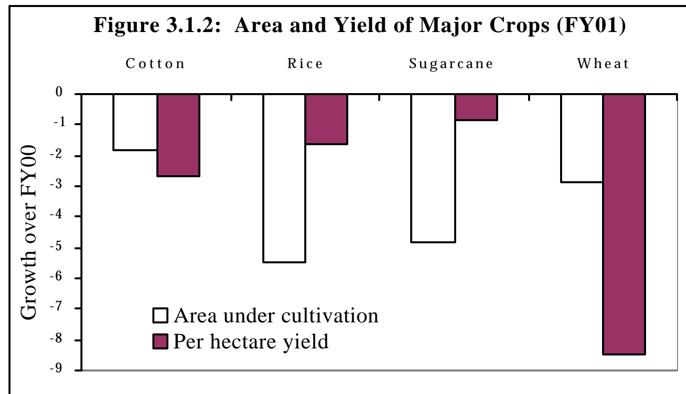


Figure 3.1.2: Area and Yield of Major Crops (FY01)

The shortage of water during the sowing period of the rabi season (see **Table 3.1.1**), has worsened with time. It is estimated that the availability of irrigated water at the end of the rabi season was 70 percent and 60-65 percent less for Punjab and Sindh respectively. In Sindh, brackish groundwater limits the use of tubewell irrigation. In Punjab, about 79 percent of the Indus Basin contains fresh groundwater that is suitable for irrigation, while the usable portion of the Indus Basin in Sindh is only 28 percent. Hence, despite a sharper fall in the flow of irrigated water in Punjab, the authorities were able to manage the situation better by diverting irrigated water to areas with brackish groundwater, while resorting to tubewells in sweet water zones. On account of this, cultivated area for cotton, rice and wheat, declined more in Sindh than any other province of Pakistan.

On the basis of data for the period FY96 to FY00, Sindh's share in the production of major crops is: 22.6 percent of total production of cotton, 43.0 percent of rice, 30.6 percent of sugarcane and 14.4 percent of wheat. The area under cultivation in this province declined by 17.6 percent for cotton, 20.9 percent for rice, and 29.5 percent for wheat. The disproportionate impact on Sindh can be gauged by looking at the national average declines: 1.8 percent (for cotton), 5.5 percent (rice), and 1.7 percent (wheat). However, area under

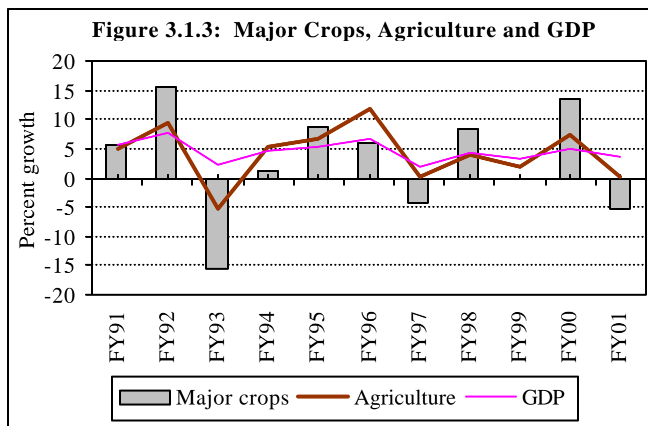
sugarcane cultivation in Sindh did increase by 3.5 during FY01, but this was primarily because land that could not be cultivated last year on account of the cyclone was brought under cultivation this year.

The declining cultivation in Sindh corresponds closely with the pattern of water shortage this year. While the availability of irrigated water was 19.3 percent lower in October to January 2000 (over the same period the year before), the problem deepened further in April to July 2000, when a shortfall of 32.8 percent over the previous kharif season was recorded. It must be realized that the base-year benchmarks were themselves very low of account of the worsening rainfall patterns in the last three years. Although the gravity of this water shortage has pushed the Sindh government to implement water management more seriously, a more permanent solution requires the strategic construction of smaller dams and bunds in the province. This issue has already been discussed at the Federal level, and action is expected in the near future.

Impact on economic growth

The dominant role of Pakistan's major crops in aggregate growth of GDP is well known. Past experience also shows that growth sentiments in the agricultural sector, filters down to other sectors of the economy (see **Figure 3.1.3**). Contrary to its impressive contribution to GDP growth last year, the agriculture sector will depress overall growth this year. The shortfall in targeted production of rice, sugarcane, gram and wheat, will outweigh the growth in minor crops and the non-crop sector of agriculture. Using latest crop estimates, the expected *loss* in value added could be as large as 5.4 percent for major crops, against a targeted increase of 3.2 percent during FY01 (this is an abrupt reversal compared to the 9.6 percent growth recorded last year). This fall in the production of major

Figure 3.1.3: Major Crops, Agriculture and GDP



crops will pull down the agricultural growth rate from 3.9 percent to only 0.2 percent in FY01 (see **Table 3.1.2**). If the actual production of wheat last year is revised upwards to 21.1 million tones (as is expected soon), growth of major crops last year will be higher than 9.6 percent, which in turn will further depress the growth that will be realized this year. Internal calculations suggest that if this revision is factored in, agricultural growth could fall to negative 1.3 percent this fiscal year.

Table 3.1.2: Shortfall in Major Crops (FY01)

(At constant factor cost of 1980-81)

	(Rs billion)			Growth Rates		
	FY00 Prov.	FY01		FY00 Prov.	FY01	
		Targets	Estimates		Targets	Estimates
Agriculture Sector	167.6	174.0	168.0	5.5	3.9	0.2
Major crops	70.6	72.8	66.8	9.6	3.2	-5.4
Minor crops	31.2	33.3	33.3	2.7	6.9	6.9
Livestock	59.4	61.1	61.1	2.8	2.8	2.8
Fishing & forestry	6.4	6.8	6.8	3.0	6.7	6.7

Estimates on major crops have been prepared by SBP.

If the existing drought also impacts minor crops and the non-crop sector (livestock and fisheries), the dismal growth scenario could be much worse. On the basis of available information, GDP growth is likely to be less than 3.0 this year.

Availability of credit

To facilitate and enhance the supply of credit to farmers and other operators in the agricultural sector, SBP has taken several steps in the recently revitalized Agricultural Credit Advisory Committee. The more prominent steps that have been approved and should have beneficial medium-to-long-term implications are: (1) remove the restriction that banks can only disburse funds within their designated region (or within their Union Councils), (2) increase the limit on loans against personal "sureties" (implicit guarantees) from Rs 50,000 to Rs 100,000 per farmer per year, (3) introduce the concept of revolving credit, (4) allow asset valuation based on the sale price of land, (5) allow banks to count

lending to corporate farms as part of their mandatory lending to farmers[11], and (6) let banks count their lending to Agricultural Development Bank of Pakistan (ADBP) and select NGOs towards their mandatory disbursement to the sector. Furthermore, SBP has eased the eligibility criteria for disbursement of agricultural credit.

Within the context of the water shortage and given its role in agricultural financing, early this year ADBP allocated Rs 1.4 billion for small irrigation projects including installation of tubewells, construction and lining of watercourses, and other related items,. Considering the increasing gravity of the water shortage, this amount has been raised to Rs 2.0 billion. Implementation of this initiative has been impressive: during the first nine months of FY01, Rs 872 million had been disbursed for the installation of 5,248 tubewells compared to Rs 560 million disbursed for 3,476 tubewells during the corresponding period last year. In view of the growing urgency, ADBP expects to finance a further 4,752 tubewells in the last quarter of FY01.

3.2 Large-scale Manufacturing[12]

During the first three quarters of FY01, large scale-manufacturing (LSM) sector recorded strong growth of 8.8 percent, compared to 3.5 percent in the same period last year (see **Table 3.2.1**). This sharp recovery is impressive considering the dismal performance during 1H-FY01, when LSM grew at 3.1 percent mainly due to negative growth in *food, beverages & tobacco*.[13] Interestingly, the robust performance during the first nine months is also attributable to the *food,*

Table 3.2.1: Growth in LSM (July-March)

(Percent)

	FY00	FY01
Overall	3.5	8.8
Excluding sugar	7.1	9.1
Trimmed	6.6	9.5

[11] Given their existing network, only the large Pakistani banks (HBL, NBP, UBL, MCB and ABL) are given mandatory floors for lending to farmers.

[12] As discussed earlier (see **Footnote 11**) in SBP's second Quarterly Report for FY01, growth rates are computed on a period-to-period basis, weighted by the share of specific industries in manufacturing. As has been stated, these growth rates shown will not tally with the numbers based on the Quantum Index of Manufacturing (QIM) which is used by MOF.

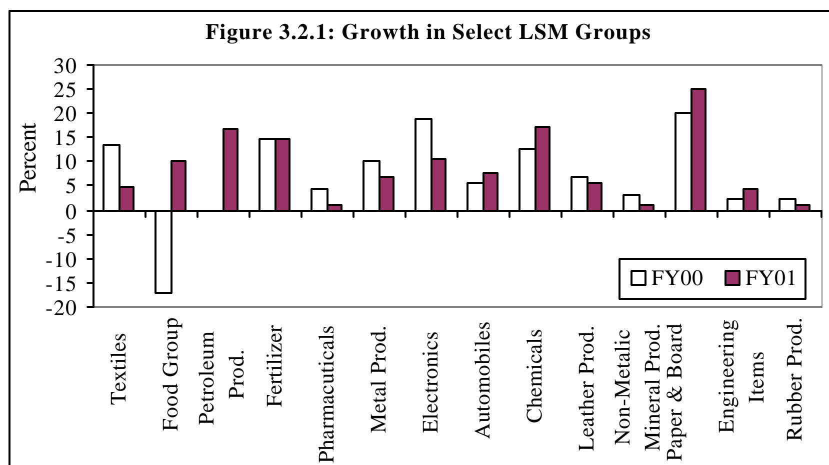


Figure 3.2.1: Growth in Select LSM Groups

beverages & tobacco group. More specifically, the production of sugar, vegetable ghee and cigarettes that had been showing negative growth over the past couple of years, exhibited much better performance in the third quarter.

In addition, production of cement has shown positive growth during the first three quarters of FY01 against negative growth in the previous quarters of the current year and during FY00. During July-March FY01, all groups showed positive growth with six groups improving over last year (See **Figure 3.2.1** and **Table 2** for more details). The trimmed growth rate, which excludes industries that have performed exceptionally well or poorly (5 outliers each), stood at 9.5 percent during the first three quarters of FY01, against 6.6 percent last year.

The following presents a group-wise analysis of the developments during the first three quarters of FY01.

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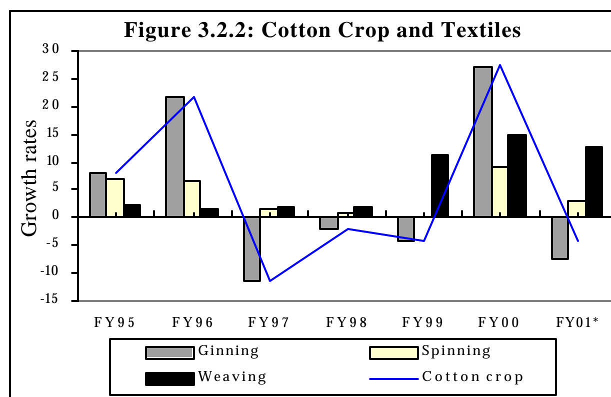
[13] The 30.6 percent fall in the production of sugar during 1H-FY01 was the driving force behind low LSM growth. More specifically, the dispute between sugarcane growers and mill owners over prices of sugarcane and timely payments intensified in the beginning of the crushing season resulting in the closure of a few sugar mills. In addition to this, negative growth in vegetable ghee, cigarettes, tea blended and cement production during this period, pulled down growth in the manufacturing sector.

Textiles (19.07 percent weight in LSM)

Textiles continued to slowdown in the third quarter of FY01, largely due to the base effect.[14] Although overall performance of the industry is determined by the size of the cotton crop, its impact varies across the various sub-sectors. As expected, ginning, which is the lowest value addition in the chain, has the strongest link with the cotton crop (see **Figure 3.2.2**). However, the impact of the cotton crop size on spinning and weaving is not as strong due to stocks carried forward and the ability to import high-count raw cotton & yarn. Looking specifically at the current fiscal year, the decline in the cotton crop by 4.5 percent, had led to negative growth in ginning, whereas spinning experienced lower growth than last year (see **Figure 3.2.2**). Furthermore, the withdrawal of export refinance facility on cotton yarn and higher lint cotton prices during FY01, has also hit the spinning industry during the first nine months of FY01.[15]

Figure 3.2.2: Cotton Crop and Textiles



Food, Tobacco and Beverages (17.34 percent weight)

<u>Sugar (8.63 percent weight)</u>

The most prominent development that took place during the third quarter of the FY01, was positive growth in sugar production despite a 5.6 percent decline in the country's sugarcane crop. This turn around is attributable to two factors: first, the processing of 0.55 million tons of imported raw sugar which did not

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[14] Textile sector had already grown by 13.5 percent during Jul-March 2000.

[15] Although lint cotton prices have fallen in Q3- FY01, in overall terms, they are higher than last year.

take place last year; and secondly, improvement in recovery due to late crushing and the usage of better quality sugarcane this year.[16]

Vegetable Ghee and cooking oil (3.45 percent weight)

As far as vegetable ghee and cooking oil are concerned, higher imports of edible oil during January-March FY01 compared to last year, led to upsurge in domestic production. Over the last couple of years, the import of oil seeds was marred by the following factor: the same imported input is used for extracting purposes to produce edible oil and also as seeds for domestic cultivation. The government attempted to encourage domestic production of the crop, but at the same time imposed a duty to discourage imports for crushing purposes. However, since the raw material is the same, there has been a fair amount of false documentation in the import of this item, since imports for cultivation were not liable for the duty. As expected, importers have been declaring cultivation as their goal, but using it for crushing. The production of vegetable ghee thus expanded by 18.7 percent this quarter.

Cigarettes (2.51 percent weight)

In the case of cigarettes manufacturing, the largest tobacco companies (Pakistan Tobacco Company and Lakson Tobacco Company) regained their market shares that had been lost to small unregistered cigarettes manufacturers by cutting prices of their middle market brands. This resulted in an increase in overall production for two reasons: first, the increase in production from registered companies that replaced the undocumented portion; and secondly, to fill the gap left by the exit of small manufacturers, major companies may have over compensated to the point that production increased more than demand would justify. Another reason for the jump in cigarettes production is increasing exports on account of rising demand abroad. The significant increase in the production of cigarettes was supported by surplus tobacco stocks, which followed the larger crop this season. As part of government policy to eradicate poppy cultivation in the 1980s, cigarette manufacturers are required to purchase tobacco leaf according to a certain formula to ensure that farmers have an assured market for their produce. Since the tobacco crop size was large this year, manufacturers had to purchase surplus tobacco.

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[16] Recovery refers to the amount of sugar extracted from the sugarcane.

Petroleum & Fertilizer (13.69 percent weight)

Production of petroleum products and fertilizer is still experiencing the impact of new plants established during the early months of calendar 2000. This is substantiated by the larger quantitative imports of crude petroleum. Production of nitrogenous fertilizer, however, showed slower growth vis-à-vis last year due to the closure of Pak American Fertilizer Limited.

Pharmaceuticals (5.80 percent weight)

Growth in the pharmaceutical sector has been declining for the last couple of years mainly due to an increase in the cost of production resulting from the depreciation of the Rupee. Since pharmaceutical industry is mainly engaged in converting imported raw materials into final medicines and packaging[17], Rupee depreciation reduced the import of medicinal raw products by 8.2 percent during July-March 2001.[18] The imposition of a 2¼ percent additional (and non-adjustable) sales tax on all locally produced packaging materials since June 2000, has also resulted in an increase in the cost of production. On the other hand, industry sources claim that retail price increase allowed on medicines has been insufficient to cover the rising cost of production.[19]

Metal Products (3.30 percent weight)

Production of metal products remained lower than last year, as Pakistan Steel Mills rationalized their production plan according to market requirements. As per plan, resources were being utilized for the production of thinner gauges of Cold Rolled (C.R.) and Galvanized Products (GP), which are technologically

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[17] The ratio of imported inputs to domestic inputs is 65 to 35 in the pharmaceutical sector.

[18] Most of raw material is imported from UK, China, Switzerland, France and the Irish Republic.

[19] Pharmaceutical products are divided into two groups: controlled and decontrolled. Controlled products include life-saving medication, and decontrolled include all other categories. Retail price increases are determined with the help of a formula given in SRO 1038(I)/94. This grouping, announced in 1993, has not been implemented in true spirit; the government strictly regulates both groups, with an allowance for slightly higher increases in the prices of decontrolled medicines. After a period of three years, prices of controlled and decontrolled medicines were raised on 19th June 2000, by 8 percent and 10 percent, respectively.

difficult and entail time-consuming processes. The other reason for lower growth was non-availability of required raw materials and inadequate machinery; more specifically, the rolling process had to operate with only one furnace, since the other was being overhauled during July to September 2000. However, the reheating capacity of these furnaces have suffered with time, and will need massive reworking and investment to bring them up to international standards.

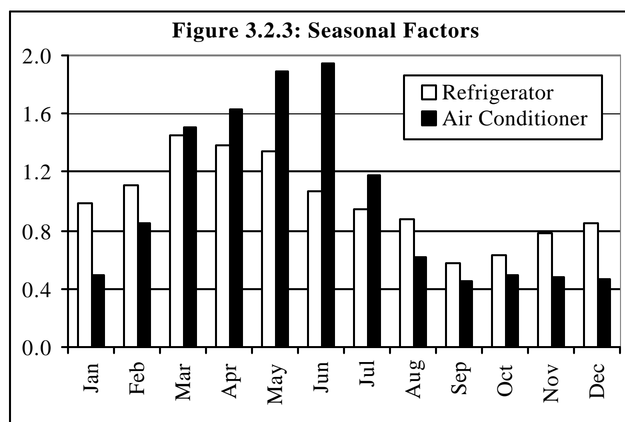
Electronics (2.98 percent weight)

Transformers (0.58 percent weight)

The demand and resulting supply of electric transformers is directly related with the expansion in the distribution network in the country. Since the two electricity distributors (WAPDA and KESC) are facing acute financial problems, the expansion of the distribution network this year has been limited. This factor severely reduced demand for transformers, with the result that production declined by 27.6 percent.

Air conditioners/Refrigerators (0.14 percent weight)

As seen in **Figure 3.2.3**, production of air conditioners and refrigerators depends on seasonal demands. Production of air conditioners starts rising in January, hitting its peak in June every year, while refrigerators peak earlier in March. As expected, the degree of seasonality is much stronger for air conditioners relative to refrigerators (see **Figure 3.2.3**). Looking at **Table 2**, even accounting for the seasonality that will kick-in in the last three months of the fiscal year, there is still a very sharp increase in production. This perceptible shift into consumer durables can be explained on account of two factors: first, the increasing



popularity of leasing arrangements; and secondly, the possibility that individuals have shifted their financial savings into consumer durables.

Automobiles (2.41 percent weight)

Cars, LCVs, and Motorcycles (0.93 percent weight)

The automobile sector continued to perform well in the third quarter of FY01, on account of sharp growth in demand for cars, jeeps, light commercial vehicles (LCVs) and motorcycles. Growth in the production of cars increased owing to the establishment of two new assembly plants. First, Dewan Farooque Motors Limited expanded its capacity by setting up a new plant with an installed capacity of 10,000 units that commenced commercial operation in January 2001. Second, Raja Group of Industries (in collaboration with Fiat Automobile Manufacturing Company of Italy), established a new plant that started commercial operation in February 2001. Demand for cars especially compact size, remained strong as CBR exempted 1.5 percent sales tax on car sales that are financed through leasing facilities.[20] In fact, the increasing use of leasing for consumer durables has played an even larger role in the sharp increase in demand for (and production of) motorcycles; the availability of financing overshadowed the increase in retail prices of motorcycles on account of the appreciation of the Yen vis-à-vis the Rupee.

Trucks, Buses and Tractors (1.42 percent weight)

Production of trucks and buses has been hit by falling demand due to the premature demise of the Urban Transport Scheme, constrained public spending and the rising prices of these vehicles on account of production costs. In addition, the replacement of large buses with small imported chassis used by private transport groups, has reduced demand for buses. As discussed in the last *Quarterly Report*, the fall in production of tractors was on account of the discontinuity in ADBP financing for the purchase of tractors. Connected to this issue, it is a stylized fact that the ADBP scheme was being abused with sold tractors being used for local transportation.

[20] In the past, leasing facilities were limited to the corporate sector only. Now, with the introduction of various leasing schemes by commercial banks, this facility is being widely availed by individual customers for purchases of almost all consumer durables.

Chemicals (2.34 percent weight)

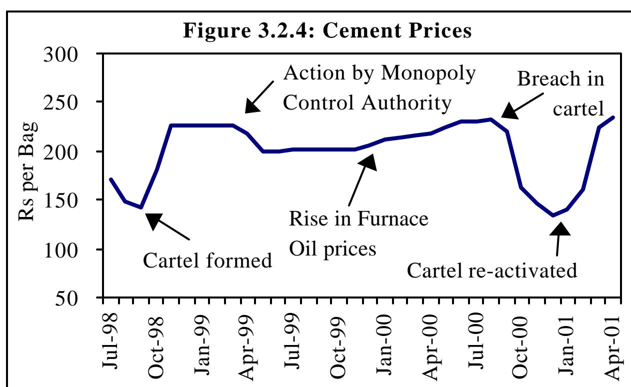
Soda Ash, Caustic Soda and Paints (1.50 percent weight)

Production of soda ash continued to decline as liquidity problems led Sind Alkalis Limited (SAL) to default on utility bills resulting in the disconnection of gas supplies; this forced the management to shut down its plant in May 2000. Furthermore, the old plant was in need of overhaul and repair, requiring substantial funding that was not available on the basis of its operational performance. Although another soda ash plant (Olympia Chemicals) has been established, its output is not sufficient to fill the gap created by closure of SAL.[21] The production of caustic soda is largely dependent on soda ash, which is the most important raw material. Since caustic soda is largely consumed by the textile sector, the slump in the production of soda ash coupled with the slowdown in textiles during the third quarter of FY01, resulted in lower growth in the production of caustic soda.

Non-metallic mineral products (1.92 percent weight)

Cement (1.85 percent weight)

The cement industry shows positive growth in the first nine months of FY01. This is the second time after FY96, when installed capacity and production increased despite modest demand. Stronger performance during the current fiscal year is the result of two factors: (1) the four units of NWFP, which enjoyed sales tax exemptions and a price edge over other production units, succeeded in temporarily increasing their market



[21] The capacity of SAL was 51,000 tons with production around 44,798 tons, whereas the capacity of Olympia Chemicals is 40,000 tons, but initial stages of production is around 5,500 tons.

share. As these units in NWFP were part of a cartel, their pricing behavior undermined the unity of the collective group, with the result that other manufacturing units followed suite with a price war to maintain their respective market share (see **Figure 3.2.4**). With the collapse of the cartel, capacity utilization increased in most of the operating units, which hiked up the production of cement, and (2) the revival of Dandot Cement Company Limited in February 2001, which has an installed capacity of 1,600 tons per day.[22]

<u>Glass Sheet (0.07 percent weight)</u>

Production of glass sheets fell this year due to the closure of Gunj Glass Works (Hasanabdal) and the rise in price of soda ash, which is one of the basic raw materials used in the production of glass sheets.

<u>Power Looms (0.05 percent weight)</u>

The power loom industry is facing a severe problem as more efficient shuttle-less looms are replacing their output. This has led to a gradual fall in the manufacturing of power looms since FY97. Furthermore, the increase in import of textile machinery under BMR during FY00 and FY01, indicates that textile manufacturers have a preference for used imported textile machinery over new domestic production.[23]

Rubber Products (0.45 percent weight)

The tyre and tube (TT) industry generally follows the performance of the automobile industry. However, during the current fiscal year, domestic production lags behind the significant expansion in automobile production, which is beginning to be a point of concern for the TT industry. Interestingly, imports of tyres have also declined since FY98. This suggests that smuggled tyres are meeting domestic demand, thereby hurting the TT industry. Despite the

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[22] Dandot Cement has been closed down since the past three years due to disconnection of utilities owing to non-payment and unsustainable debt payments. However, Gharibwal group revived it by rescheduling its long-term loans and injecting fresh capital.

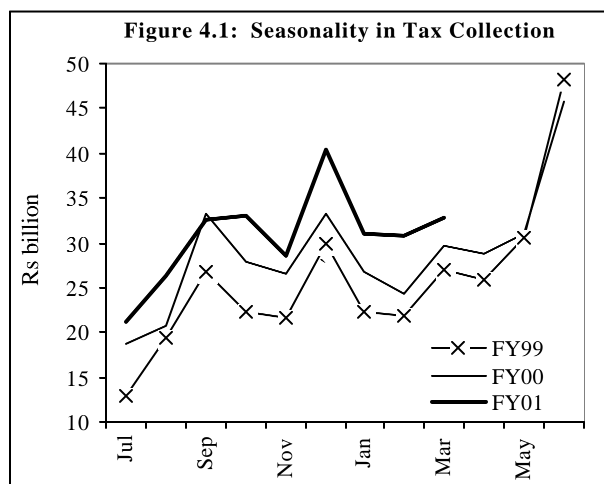
[23] With easing restrictions on the import of old textile machinery since August 2000, textile manufacturers seem to even prefer five-year old imported machinery to locally manufactured machinery (LMM). This should explain the declining usage of LMM financing (see **Section 5**).

fact that the government has reduced import duties on tyres by 15 percent to discourage smuggling, imports have not shown any improvement. In the wake of weak demand for domestic tyres, Services Industries Limited halted its production of tyres during July-February 2001.

4. Fiscal Developments[24]

As was seen last year and the first two quarters of FY01, growth of tax revenues in Q3-FY01 exceeded the nominal growth rate of GDP. Tax collection in the first three quarters of this year increased 14.9 percent compared to the same period in FY00; the improvement came mainly in sales and direct tax collection. As has been the case in past, tax collection in the first three quarters is concentrated in the October – December period, while peaks coincide with quarter ends reflecting special efforts by CBR to meet revenue targets agreed upon with the IMF (see **Figure 4.1**).

Figure 4.1: Seasonality in Tax Collection



However, as the end-December revenue target was not met and these quarterly targets are cumulative, GOP requested a waiver and modification of the performance criteria for end-March with IMF officials in February 2001. Reason citied by GOP included slower than anticipated GDP growth, a lower than targeted increase in dutiable imports, and the diversion of CBR staff towards

[24] The analysis on revenue collection is based of data for the July-March 2001 period. The sub-section on expenditures and the fiscal deficit relate only to the first half of FY01.

survey activity. Consequently, the full year target was revised downward from Rs 430.2 billion to Rs 417.3 billion. Collection in the first nine months of FY01 represents 66.3 percent of the full year revised target, and 98.3 percent of the revised quarterly target (see **Table 3**).

As can be seen in **Table 4.1**, the downward revision in revenue targets (both budget and IMF) has become a regular feature of the Federal government's fiscal agenda. In initial negotiations, CBR authorities agree to ambitious targets only to have them revised in later review meetings. Needless to say, these frequent revisions in targets have not helped CBR's credibility both at home and abroad.

Table 4.1: Tax Revenue Targets

(Rs billion)

Year	Actual	Budget Target		IMF Target	
		Original	Revised	Original	Revised
FY95	226.6	260.0	225.0	n.a.	n.a.
FY96	268.0	270.8	262.5	305.4	305.4
FY97	282.1	336.3	286.0	338.0	313.0
FY98	293.6	324.0	297.6	323.1	--
FY99	308.5	354.6	308.0	407.1	382.1
FY00	346.6	356.0	351.6	432.0	--
FY01	276.6*	435.7	417.3	430.2	417.3

*Relates to July-March 2001; n.a: Not available.

Note: Programs suspended in FY98 & FY00.

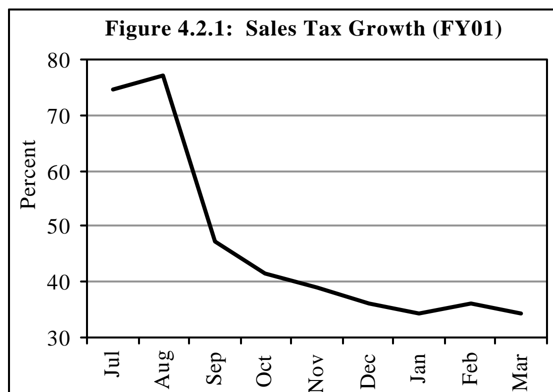
4.1 Direct Taxes[25]

Press releases from CBR state that the improvement in direct taxes is the result of both the current documentation drive and efforts to collect income tax arrears. The overshooting in terms of the revised direct tax target in Q3-FY01, is the result of seasonality factors. The sharp fall witnessed in Q1-FY01 was due to the extended deadlines for submitting income and wealth tax returns. The growth witnessed in direct tax collection in Q2-FY01 follows the revised self-assessment scheme, and the one-off results of the Tax Amnesty Scheme II, since the payment deadline was extended till November 30th. Most importantly, since commercial banks and private sector corporates close their books at the end of December, this accounts for the bulk of direct taxes realized at the end of the second quarter.

[25] No breakdown of direct taxes is available.

4.2 Indirect Taxes

As shown in **Figure 4.2.1**, the massive growth in sales tax collection in early FY01 was largely the upshot of the lower base last fiscal year – sales tax was only applied on September 1st 1999. This can be seen in the declining rate of growth of sales tax thereafter. As far as the central excise duty (CED) is concerned, since this is being replaced by sales tax, collection under this head continued to depict a fall.



As stated in earlier *Quarterly Reports*, for a more prudent analysis of sales tax and CED, it would be better to look at the combined collection under these two heads. As seen in **Table 4.2.1**, given the nature of sales tax, and the fact that there have been no rate increases, the enhanced collection is not just the result of substituting CED with sales tax, but also the wider coverage under the latter. As far as collection of custom duties is concerned, this recorded a marginal decrease over last year. As stated earlier, the growth of dutiable imports in the first half of FY01 was lower than projected. Although import growth recovered in Q3-FY01, it was insufficient to make up for the shortfall from previous quarters despite the sharp fall in duty drawbacks.

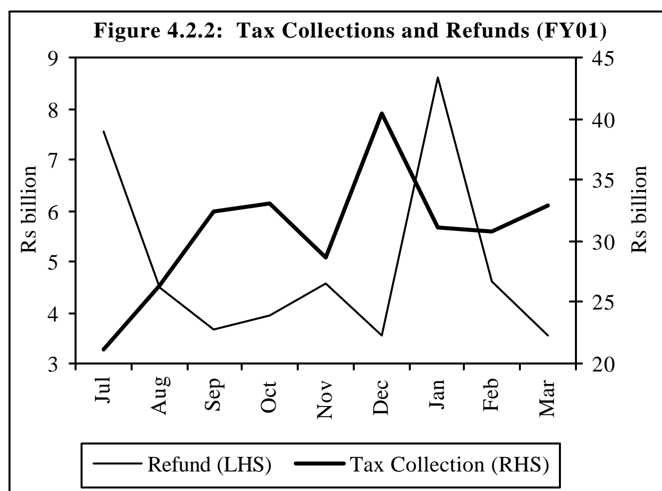
Table 4.2.1: Cumulative Sales Tax and Excise Duties

(Rs billion)

	FY00	FY01	Absolute Change
July	8.9	13.0	4.1
August	19.1	27.9	8.8
September	34.3	44.2	10.0
October	48.2	60.3	12.1
November	62.1	76.2	14.0
December	78.8	94.8	16.1
January	93.0	111.5	18.5
February	106.0	128.3	22.4
March	120.2	143.5	23.3

Exporters claim that the fall in duty drawbacks is a deliberate move on the part of CBR to boost revenues, while CBR states that the fall is the result of incomplete documentation by exporters and the consequent delays in finalizing

cases. As can be seen in **Figure 4.2.2**, rebates/refunds fall at quarter ends, resulting in larger collections.



Looking at **Table 4**, consolidated tax revenues fell short of the targeted amount by 14.1 billion in 1H-FY01. However, non-tax revenue contributed more than anticipated, but was not enough to plug the gap created by tax revenues. Although a breakdown is not available for non-tax revenues, one reason for the larger contribution could be dividend payments to GOP from PTCL.[26]

4.3 Short-Term Action Plan (STAP)

Even with impressive collections in the first three quarters of FY01, CBR needs to collect approximately Rs 140.5 billion to meet the revised revenue target for the full year. This would imply an average collection of about Rs 47.5 billion every month till the end of the fiscal year. It would be relevant to point out here that this level of collection has only been achieved in one month in the last six years.[27] Realizing the enormity of the task ahead, a STAP was launched in February 2001 in consultation with Fund authorities. The STAP, drawn up to maximize collection in the second half of the fiscal year, revolves around a seven-prong strategy, which include the following measures:

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[26] Dividends were targeted at Rs 10.0 billion for the whole year, but PTCL credited nearly the entire amount (Rs 9.0 billion) at the end of December 2000.

[27] In an effort to meet a program revenue target of Rs 382.1 billion, CBR collected Rs 48.2 billion in June 1999.

Sales tax

- An increase in sales tax audits, monthly audit targets per auditor and monthly target for overall audits;
- Setting-up Audit Management Cells in each collectorate;[28]
- The use of private sector auditors for enhanced coverage;
- Measures to reduce mounting sales tax arrears and arrear recovery targets for each collectorate;
- An increase in penalty for late payments and non-filing of sales tax returns; and
- Identification of habitual non-filers and their treatment as a separate category (force them into compliance or deregistration on settlement of any outstanding liability).

Income tax

- Increase penalty rates for late payment, strict monitoring of arrears and top defaulters, monthly targets for arrear collection, and swift prosecution of tax cases.

4.4 Tax Survey[29]

In an effort to document the economy and identify tax defaulters, CBR launched a Tax Survey and Registration Scheme on May 27th 2000. In its first phase, the survey was launched in 13 big cities, and 0.8 million forms were distributed. In the second phase, launched on 25th September 2000, the survey was extended to another 13 cities, and an additional 0.2 million forms were distributed. In its final phase, starting 12th December 2000, survey teams initiated 'on-the-spot-assessments'. A total of 27,800 visits were made yielding an increase of 53.1 percent in revenues compared to the declared amount on returned forms. On December 18th 2000, as a result of surveying 0.4 millions houses in posh

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[28] Pakistan is divided into regional collectorates for each tax head (e.g. Income Tax Collectorate, Sales Tax Collectorate), which are assigned targets based on the Federal Budget.

[29] Lacking official notification, the numbers in this section are based on newspaper reports.

localities in the 13 larger cities, 0.1 million notices were served to non and under filers. The CBR has also issued about 100,000 National Tax Numbers (NTNs) to individuals, 75,000 of which were to new tax payers.

Despite these developments, the contribution of the survey to this year revenue collection has been somewhat limited. It was initially targeted to contribute Rs 100 billion to the government exchequer. However, CBR is of the view that the surveys have generated an enormous amount of data, which will allow it to increase collections in the future.

4.5 Budget Deficit

Driven by higher than anticipated non-tax revenues and stricter expenditure controls, the budget deficit was 0.7 percentage points of GDP lower than the IMF target for the first half of FY01 (see **Table 4**). The realized deficit in 1H-FY01 and tax collection in Q3-FY01, provides sufficient evidence that the government will be able to meet its deficit target of 5.3 percent of GDP. Additionally, as gas prices have been increased, higher surcharge revenues will compensate for any shortfalls in tax collections. However, quantitative targets for total expenditure outlay and revenues may differ from those envisaged in the Federal Budget. Needless to say, broadening the tax net along with strict expenditures controls will remain the thrust of GOP's fiscal initiatives in the current and next fiscal years.

Government Expenditures

Despite an advance payment of salaries in December-2000 because of Eid, total expenditures were 8.4 percent lower than projected under Program targets. The decline in total outlays was on account of lower development expenditures, as well as better accountability and governance standards. In addition to this, 2.3 percent lower than projected interest payments also contributed to the saving on government expenditures.

Consequently, the budget deficit amounted to Rs 77.9 billion, which is Rs 26 billion below the IMF target for 1H-FY01. Of the targeted Rs 71.5 billion for external financing, only 43.6 billion was realized due to lower than projected inflows from the World Bank and Islamic Development Bank. As the government continued to retire its debt to commercial banks, non-bank borrowing contributed the bulk of the deficit financing. Comprising borrowing

from NSS and the newly launched PIBs, the government financed nearly 60 percent of its deficit from non-bank sources (see **Table 5**).

Keeping fiscal developments and the overall budget deficit target in mind, the government revised its total outlay for the full fiscal year by Rs 15 billion, mainly on account of lower spending on public sector development programs (PSDP). Towards this end, expenditures on low priority projects in PSDP including investment expenditures on National Highway Authority, Pakistan Railway and WAPDA were curtailed, while amounts allocated to social and poverty related (SAP) projects remained intact. In addition to this, provinces are being encouraged to achieve their targeted levels of expenditures on poverty alleviation and social spending. However, the government may achieve a small saving under this head because of increased efficiency, without affecting the delivery of social services.

It is without doubt that a large fiscal deficit remains the crux of Pakistan's problems, but ambitious targets at the onset of the fiscal year/IMF program paint the picture bleaker than it actually is, and undermines the improvement realized; the increasing level of documentation in the economy is exhibited in the higher than GDP growth of tax revenues. On another positive note, strict monitoring on the government's part has had a positive impact on expenditure containment. However, for the Pakistan economy to start to live within its means, revenues efforts will need to be further strengthened, tax evaders and under-filers dealt with swiftly and sternly, and a tighter leach on expenditures with stricter monitoring, governance and accountability maintained.

5. Money and Credit

5.1 Monetary Developments in Q3-FY01

In aggregate terms, money supply increased by Rs 66.1 billion in the first three quarters of FY01, against Rs 40.5 billion in the corresponding period last year. At this rate, even taking into account the commodity financing that will commence in June, the overall growth in money supply should be well below the Rs 147.0 billion annual target in the Credit Plan

Unlike the severe liquidity crunch in the last quarter, Q3-FY01 was calm for the following reasons: (1) IMF's NDA target for end-March was eased substantially,

(2) the bulk of repayments on the record volume of commodity financing in FY00 was realized last quarter, (3) the seasonal plateau in private sector credit did not create any untoward pressures on market liquidity, and (4) the gradual Rupee depreciation did not call for stringent actions on the monetary side as was the case in October 2000.

Nevertheless, despite an easing of market liquidity, T-bill rates did not fall as commercial banks were still very hesitant about placing funds in government securities. Since the leeway on the NDA target was only agreed upon in end-February, and communicated to banks (which took some convincing – see sub-section on **primary auctions**), it was not till March when they began to invest a reasonable volume of funds in the primary auctions (see **Figure 5.2.2**). With commercial banks placing erratic bids in the first two months of the quarter, SBP had to raise its 6-month T-bill rate by almost 60-basis points on March 22nd to even out a slight inversion in the yield curve from the previous primary auction.

In broader terms, despite a fall in international interest rates spearheaded by the US Federal Reserve Bank, SBP could not ease its monetary policy in Q3-FY01 for two reasons: (1) domestic interest rates are not anchored to international markets, and more importantly (2) pressure on the Rupee was beginning to build in mid-February. With on-going depreciation of the Rupee, it was deemed unwise to signal a relaxation in monetary policy for fear that this could put additional buying pressure on the Dollar. Furthermore, even with an easier NDA target for end-March, reducing T-bill rates would have made it harder for SBP to meet this target.

5.1.1 Growth in Monetary Assets

Government borrowing

Government borrowing in this period was modest compared to the first three quarters of FY00. However, most of this amount was from commercial banks.[30] In just the last week of March, the Federal government was able to retire Rs 50.3 billion of its debt to SBP and increased its borrowing from commercial banks by Rs 41.4 billion. In overall terms, the Rs 13.0 billion borrowed from the banking system was well below the Rs 19.9 billion that had been targeted for end-March.

[30] Of the Rs 13.0 billion borrowed from the banking system in the first three quarters of FY01, Rs 13.8 billion was picked up from commercial banks (see **Table 6**).

In terms of the progression of government borrowing during the first three quarters, **Figure 5.1.1** provides a more accurate picture of what happened this year relative to FY00. As stated in previous *Quarterly Reports*, the government is more dependent on bank funding this year than was the case last year. What is striking but not very surprising are the abrupt reversals in the composition of government borrowing this year. These coincide almost perfectly with the end of each quarter, which is a clear indication of IMF ceilings on GOP borrowing from the central bank. The case of end-September is interesting for two reasons: (1) there was no IMF target on SBP's NDA, and (2) the level of government borrowing remained almost at the same level before and after end-September. Nevertheless, there was an almost complete reversal of government borrowing from commercial banks to the central bank.[31]

The level of government borrowing at the beginning of the quarter does not revert to the same level in the previous quarter (see **Figure 5.1.1**) for two reasons: first, extra efforts to generate tax and non-tax revenues at quarter ends; and second, inflow of IFI assistance after meeting quarterly targets. Since the latter is an important component of external financing of the fiscal deficit, this reduces the need for domestic resources.

A clear trend in both FY00 and FY01 is the gradual tendency of the government to retire its debt to commercial banks while increasing its dependency on SBP. Not only does this reflect a stagnant Rupee deposit base (and the unwillingness of banks to invest fresh money in government securities), but is also indicative of the large volume of maturing government bonds held by commercial banks. The gradual retirement of government debt to banks stems from these maturing payments that are financed by the central bank.

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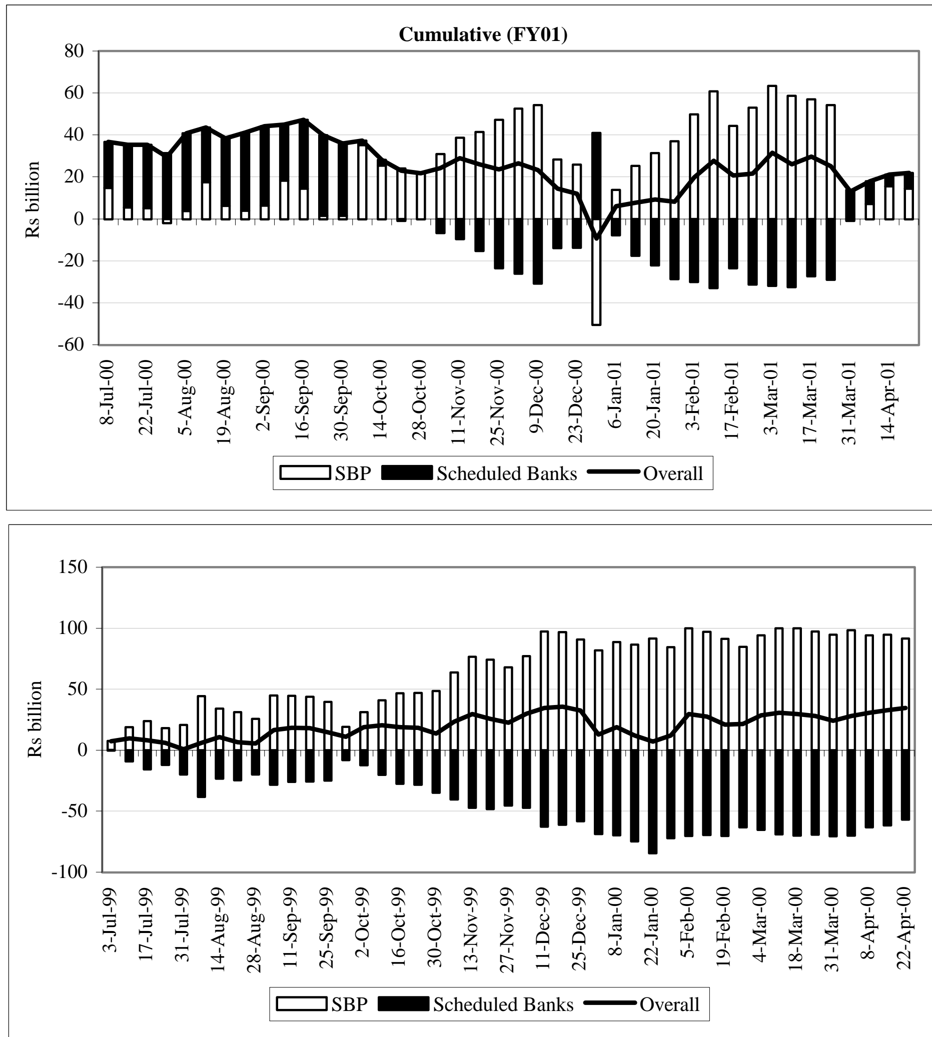
[31] The reason is very simple; in the third week of September there was tremendous pressure on the exchange rate as the Rupee/Dollar parity increased from Rs 55.2 to Rs 58.0 in just one day. SBP was forced to dry up Rupee liquidity by increasing cash reserve requirements by 2 percent, with the result that many banks had to discount heavily to procure liquidity. This systemic shift into discounting implies that bank holdings of T-bills (government debt) shifted to the central bank by the end of the first week of October. As shown in the previous *Quarterly Report*, October 2000 witnessed a record discounting of Rs 438.2 billion.

Figure 5.1.1: Net Borrowing for Budgetary Support from Banking System



Commodity operations

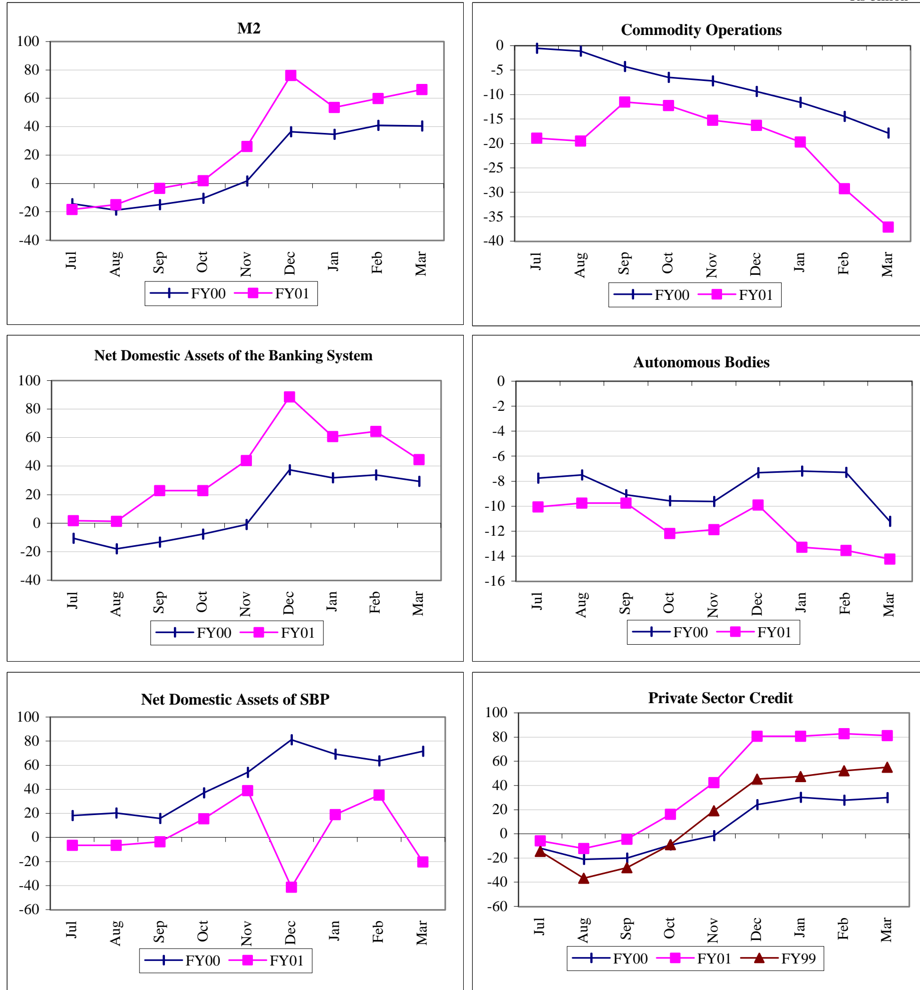
In aggregate terms, commodity financing played a large role in neutralizing the overall increase in net domestic assets of the banking system, which in turn contained money supply growth. Against net retirement of Rs 16.3 billion in the first half of FY01, the large Pakistani banks (NCBs) realized an *additional* Rs 20.8 billion in the third quarter itself. As shown in **Figure 5.1.2**, most of this was realized in the months of February and March. Even if this pace of retirement continues in the next month (which is unlikely) and a wheat crop of 18.7 million tons is realized, it will not be possible to meet the end-June target of zero net funding for this purpose.

Despite the large inflow of liquidity into the banking system in Q3-FY01, limited credit off-take by the private sector (see **Figure 5.1.2**), and the net retirement of government debt to commercial banks on an on-going basis, banks did not seem willing to invest in government securities. Although banks were generally liquid during the quarter (except for the first week of January), they did not want to lock in this liquidity till after March; this issue will be discussed in more detail in **Money Markets**.

Autonomous bodies

As shown in **Figure 5.1.2**, retirement by Autonomous bodies was slightly higher in the third quarter this year compared to the corresponding period last year (Rs 4.3 billion in Q3-FY01 against Rs 3.9 billion in Q3-FY00). What helped this year was that retirement took place in the month of January, which provided much needed liquidity to the market following the crunch of end-December. The bulk of this retirement was done by KESC, which returned Rs 2.6 billion in early January to repay a bridge loan that had to be availed since ADB's US$ 350 million facility (which was expected in October 2000) was realized on January 2nd. PTCL was the other large player retiring over Rs 1.3 billion during the month of January. Unlike KESC, retirement by PTCL is part of its overall plan to limit use of bank credit: while KESC has actually borrowed Rs 840 million during the first three quarters of FY01, PTCL actually retired 11.4 billion during the same period.

Figure 5.1.2: Cumulative Changes in Monetary Assets



Private sector credit

Figure 5.1.2 captures the broad thrust of what happened to private sector credit in this period. The seasonal plateau is clear for the past three years, but also shows the marked difference in the level realized this year relative to FY00. This has already been explained in detail in the last *Quarterly Report*, suffice to say that certain exogenous factors responsible for the abnormally low disbursements last year have not been repeated this year. Looking ahead, developments this year should provide a better benchmark to evaluate what happens in FY02.

In terms of net private sector lending, the third quarter of FY01 witnessed an increase of only Rs 612 million, against an increase of Rs 5.9 billion in the corresponding period last year. In itself this relative movement is not that important as credit disbursement last year suffered from a scare following the change in government in October 1999. Although the mild upward movement in Q3-FY00 against a flat Q3-FY01 can be seen in **Figure 5.1.2**, of greater relevance is the usage of this funding.

Table 7 highlights the following points:

- The sharp increase in lending for fixed investment is primarily because of a dismal performance last year. The emphasis on loan recovery and general accountability hit both the demand for term financing (by uncertain investors), and also made banks cautious about such lending. The bulk of term financing this year was for the upgradation of textile machinery and to a lesser extent by the automobile sector to establish assembly units for new compact cars and light commercial vehicles (LCVs). Most large spinners have realized the need to move their production into higher value added items like fabrics (albeit low-count fabric) given the comparative advantage Pakistan has. Movement into garments has been limited given the unavailability of higher-count raw material.
- The textile sector posted strong appetite for working capital loans as self-financing began shrinking with its profit margins (see **Table 7**). With the increase in lint cotton prices during September – December 2000, and prospects of another good cotton crop this year, the bulk of this financing had already been availed in the first half of FY01. The numbers for the third quarter of FY01 suggest no major change, which implies that maturing

working capital loans (average maturity of 6-months) have simply been availed again.

- The sugar sector shows an interesting picture. The almost 10-fold increase in working capital loans this year simply builds upon the *status quo* that existed in end-December 2000. Since sugar financing begins in earnest in December, the third quarter of this year posted an increase of Rs 5.3 billion against an increase of 4.3 billion in the corresponding period last year. A large part of this increase in credit off-take is because the market price of sugarcane increased substantially this season relative to last year. The market price last year was almost the same as the government's support price of Rs 36 per 40 Kgs. This year, there was a provincial difference in the purchase price that mill owners had to pay; in Punjab, this price hovered around Rs 65 per 40 Kgs, while in Sindh it was lower at about Rs 60. Perhaps reflective of this, sugar mill owners began procuring credit in November, which is usually a month of retirement. For the next four months, credit availed by the sugar sector exceeded monthly volumes procured last year.

Agricultural credit

In overall terms, gross credit disbursement to the agricultural sector in the first three quarters of this year stood at Rs 29.1 billion, 4.3 percent higher than the corresponding period last year. As expected, ADBP's share to total credit was 64.8 percent during July-March FY01 (see **Table 8**). Of the total loans extended during first nine months of current fiscal year, 78.1 percent was disbursed as production loans, while the rest went for development purposes.[32] The fall in ratio of development to total loans (from 23.1 percent last year to 21.9 percent this year) was primarily because the higher price of tractors discouraged farmers from availing term financing for the purchase. Correspondingly, production of tractors declined by 18.7 percent during the first three quarters of FY01, compared to the corresponding period last year (see section on **manufacturing**).

[32] Development loans are used to finance the purchase of ploughs and cattle, tubewells, tractor, orchards, farm transportation, building of godowns, land improvement and farm machinery. Production loans are working capital loans to purchase variable inputs.

In terms of the annual target, gross disbursement during the first three quarters of FY01 stood at 59.1 percent compared to 52.7 percent last year. This improvement is due to a lower (more realistic) target of Rs 49.3 billion for FY01, against Rs 52.9 billion that had been set for last year. The recovery of agriculture loans this year was 13.5 percent higher than the three quarters of FY00 (Rs 32.3 billion was recovered this year). The ratio of recovery to outstanding loans also improved from 31.6 percent last year (July to March 2000) to 35.8 percent this year. Of the total volume of outstanding loans (Rs 90.4 billion in end-March 2001), 90.0 percent belongs to ADBP and FBC; despite these institutions' focus agricultural credit, these specialized banks lag behind commercial banks in terms of recoveries.

5.1.2 Composition of money supply

As highlighted in the previous *Quarterly Report*, the changing composition of money supply was, and remains, a cause for concern. Whereas the apprehension in 1H-FY01was the sharp increase in currency in circulation (see **Special Section 2**), the concern last quarter is the stagnant growth of M2 and a growing impetus from resident-FCAs. More specifically, although currency in circulation (CC) has fallen during the course of the quarter (with the exception of early March which experienced a seasonal hike on account of Eid – see **Figure 5.1.3**), Rupee deposits have actually fallen in nominal terms, while resident FCAs have increased by 11.4 percent.

Looking at the first three quarters of this year, Rupee deposits only increased by 1.2 percent, while resident FCAs posted positive growth for the first time since the freeze of these deposits (RFCAs grew by 22.3 percent in the nine-month period – see **Table 9**). This interest in Dollar accounts follows the substantial loss in the value of the Rupee since it was freely floated in July 2000. As mentioned earlier, this trend needs to be reversed to halt the financial dis-intermediation that is taking place in real terms, as mobilization of Dollar deposits does not help banks secure Rupee liquidity. A further indication of the this trend is the growing presence of CC in total money supply; end-March the CC/M2 ratio had increased from 25.2 percent in 1999, to 25.9 percent in 2000, to 26.3 percent for 2001. Although these ratios show a gradual increase and may foster complacency, it is worrisome. A sustained increase in this ratio coupled with low growth in money supply, is a clear indication that the banking system is not aggressively mobilizing deposits. A strategy to privatize the NCBs and

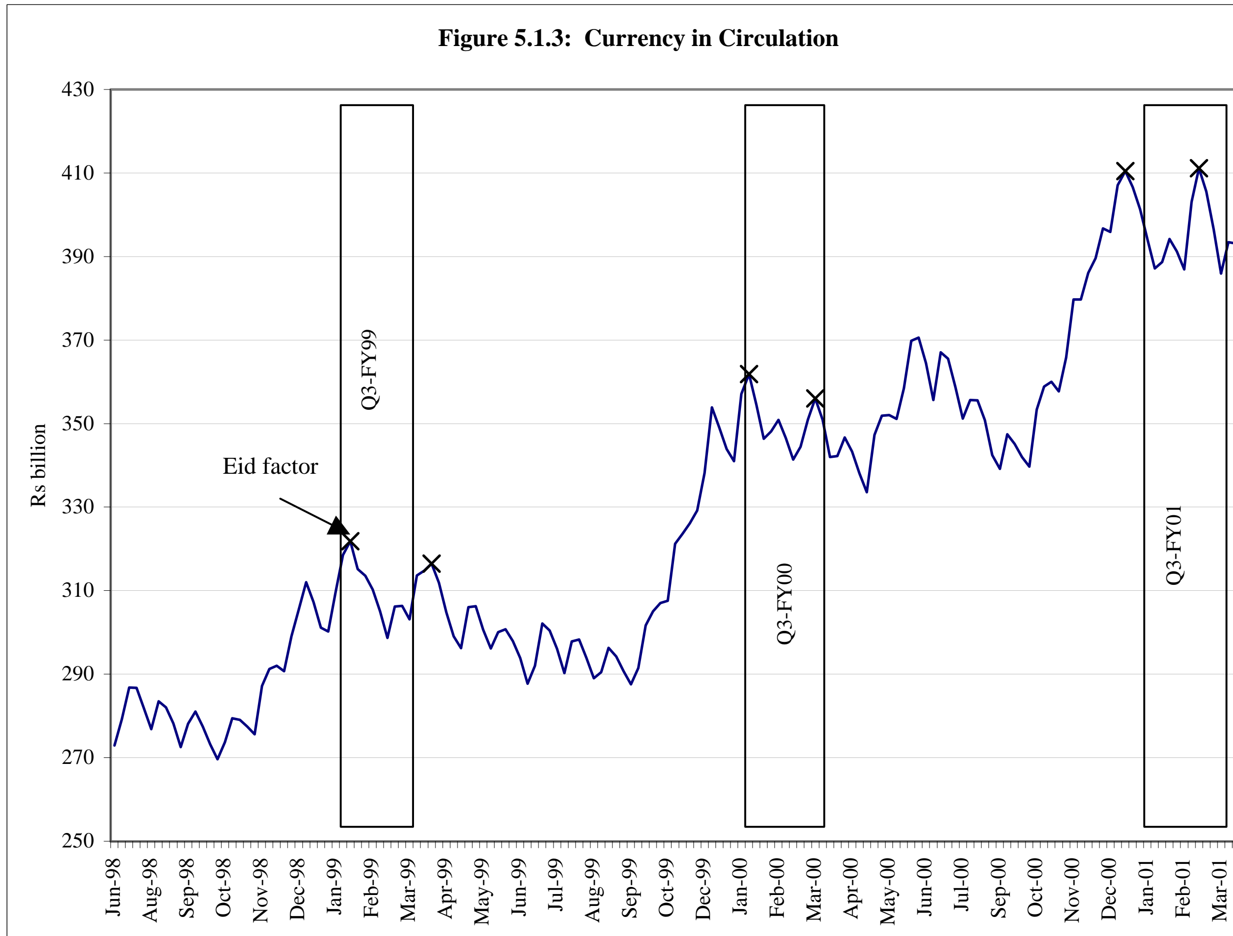


Figure 5.1.3: Currency in Circulation
Rs billion
430
410
390
370
350
330
310
290
270
250
Eid factor
Q3-FY99
Q3-FY00
Q3-FY01
Jun-98
Aug-98
Sep-98
Oct-98
Nov-98
Dec-98
Jan-99
Feb-99
Mar-99
Apr-99
May-99
Jun-99
Jul-99
Aug-99
Sep-99
Oct-99
Dec-99
Jan-00
Feb-00
Mar-00
Apr-00
May-00
Jun-00
Jul-00
Sep-00
Oct-00
Nov-00
Dec-00
Jan-01
Feb-01
Mar-01

encourage mergers amongst the private domestic banks will perhaps reinvigorate the system.

5.2 Money Market

Unlike the second quarter of FY01, **Figure 5.2.1** shows a reasonably liquid money market as evidenced by overnight rates in the interbank market. Except for two episodes where banks discounted, the overnight interbank rate was low enough that deficit banks could square themselves from the interbank market. What was surprising for the banks but heartening for SBP was the fact that the overnight rate on March 31st was only 9.1 percent, which meant that banks did not have to approach SBP for discounting. After the experience of end-December and the fact that SBP was still bound to meet the NDA target in end-March, there was no need to resort to exceptional steps to suck up market liquidity to meet this target.

5.2.1 Discounting

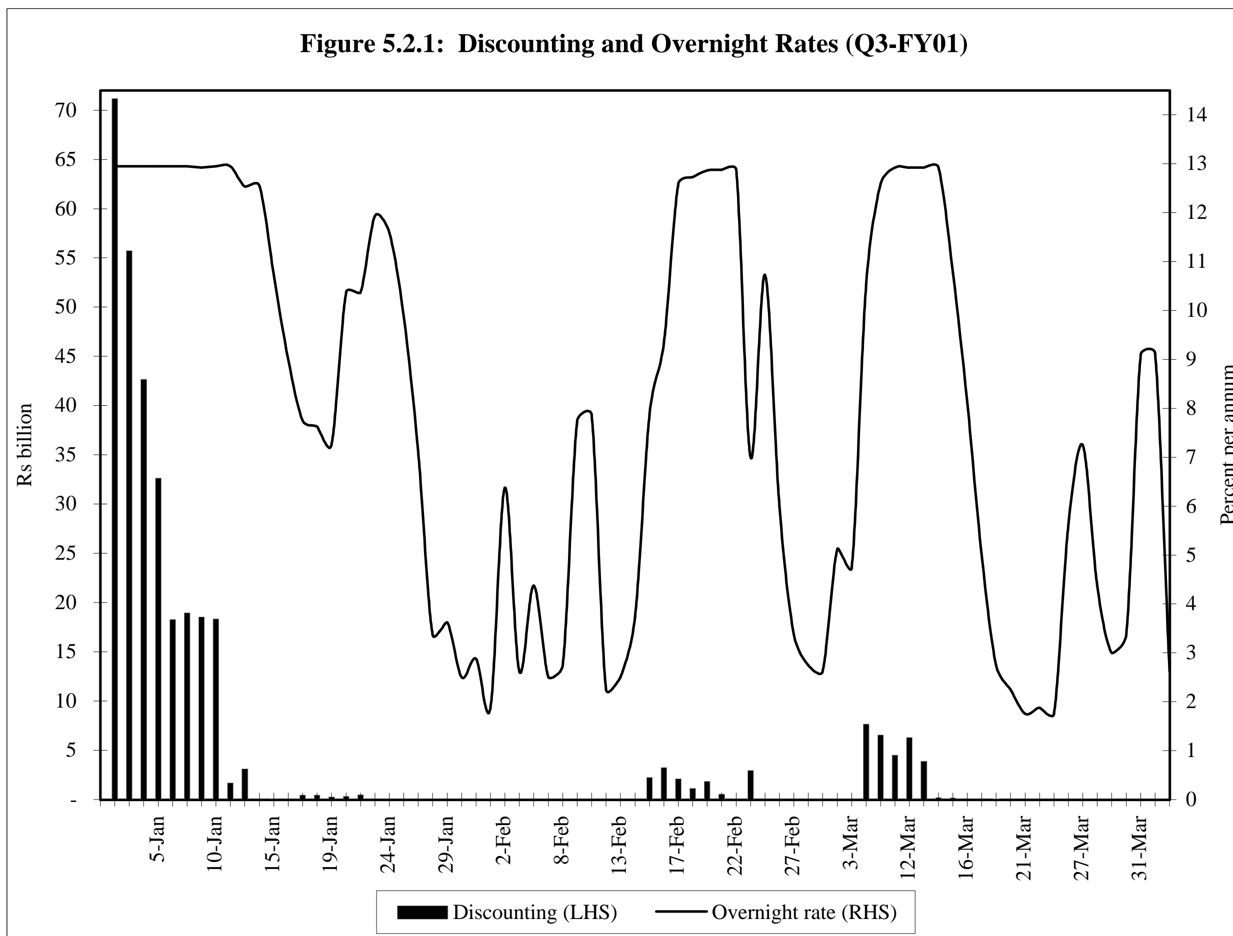
As mentioned earlier, heavy discounting in the early part of the quarter was a remnant of efforts to meet the end-December NDA target. For the remaining part of the quarter, there were two periods when banks discounted: (1) in mid-February when the Rs 15.5 billion placed in PIBs resulted in heavy outflows of institutional deposits from banks, and (2) in early March because of Eid and the corresponding seasonal demand for cash.

As shown in **Table 10a**, during March, the total volume of discounting was lower than the corresponding months in the previous two years. The average discounting per visit also reaffirms the view that the market was generally liquid.

5.2.2 Primary auctions

As shown in **Figure 5.2.2** and discussed earlier, despite a liquid money market the volumes offered by the banks were lower than the corresponding periods in the last two years. More specifically, the volumes offered were: Rs 180.2 billion in Q3-FY99; Rs 105.8 billion in Q3-FY00; and only Rs 52.3 billion in Q3-FY01. In terms of the volume of bids that were accepted (which is a function of the pricing of offered money and SBP's own view of interest rates), this was much higher as a proportion of total bids than the previous two years. This reflects the fact that the relative stability in T-bill rates last quarter allowed banks to price their bids more confidently, knowing that well priced bids would be accepted.

Figure 5.2.1: Discounting and Overnight Rates (Q3-FY01)



This contradicts the view that important players in the money market were unsure about the direction of monetary policy.

Even during the quarter, there was a perceptible change in the attitude of banks. Not only did the volume of bids increase, but were also better priced (i.e. a smaller spread around the previous cut-off price). The most plausible reason for this change in heart could be that the end-March NDA target was eased. Against a target of negative Rs 39.6 billion for SBP's NDA for the period July to March 2001, the target was revised to positive Rs 8.0 billion.[33] In effect, banks became more forthcoming in the primary auctions at the end of February once this information becomes widely known.

The increase in 6-month T-bill rates in the March 22nd auction was designed to rectify a slight inversion in the 3-month and 6-month cut-off price from the previous auction (dated March 8th). In overall terms, T-bill rates were increased by 50 to 60 basis points during the quarter. As discussed and shown earlier, the second half of the fiscal year is a period where liquidity returns to banks resulting is less pressure on market interest rates. However, looking at **Figure 5.2.2**, SBP could not ease T-bill rates for two reasons: (1) the volume of bids in January and February were too low as banks were hesitant about parting with liquidity, and (2) even with an easier NDA target for end-March, SBP could not afford to reject bank funds since this would have made it progressively harder to shift government debt to commercial banks.

Another interesting observation is the positive correlation between changes in T-bill rates and the percentage of bids that are accepted. This makes intuitive sense, as a downward movement in interest rates (assuming market sentiments remain unchanged) will only be possible by accepting a lower fraction of total bids. This is clearly shown in Q3-FY99, where the increase in 6-month T-bill rates is supported by a growing fraction of accepted bids, while the sharp fall in

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[33] However, since this adjustment required the approval of the IMF's Executive Board (which is effectively a formality since the visiting mission does have the power to change macro performance criteria), the change in target could not be *formally* communicated to the banks. Although SBP did call in the large banks to communicate this information to the market, it took some time for this to gain acceptance following the events of end-December.

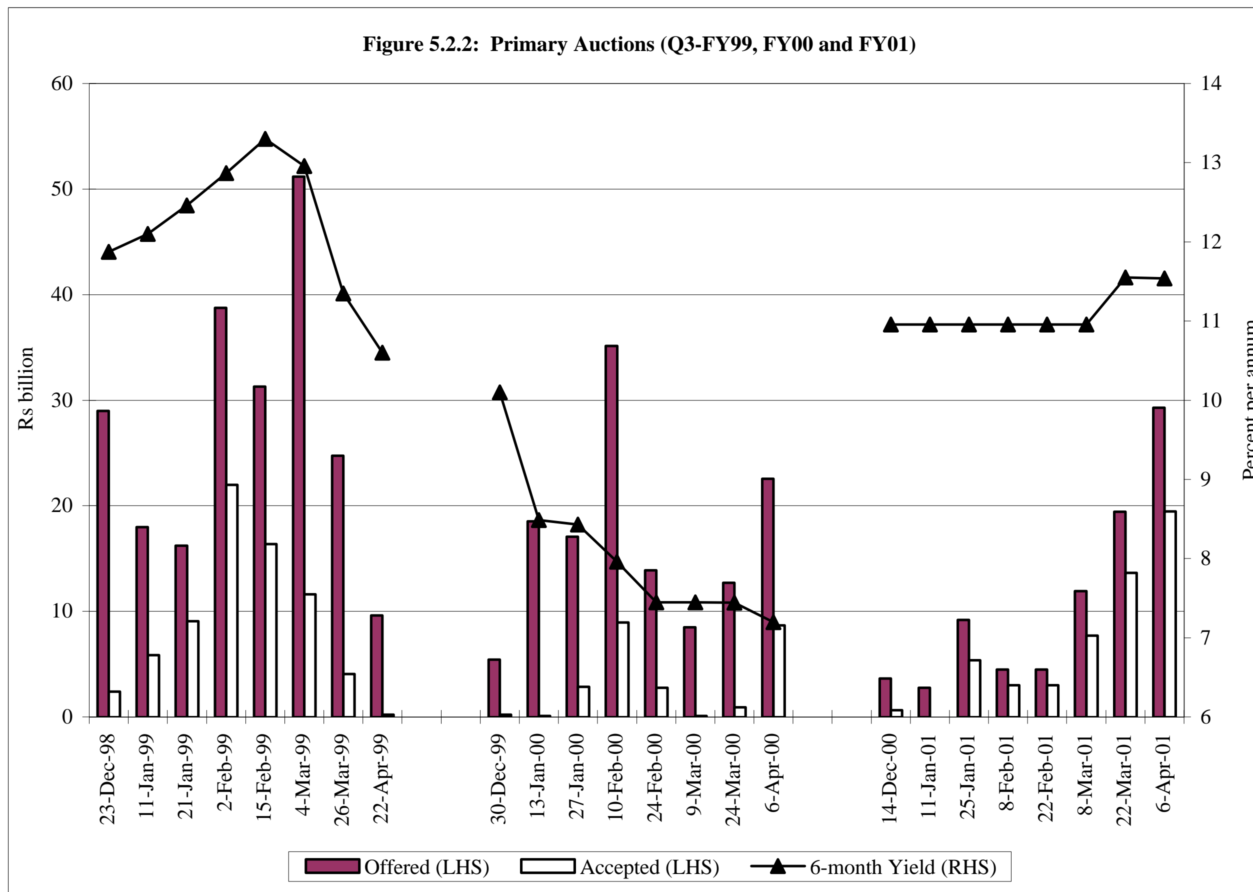
Figure 5.2.2: Primary Auctions (Q3-FY99, FY00 and FY01)
Rs billion
Percent per annum
60
50
40
30
20
10
0
14
13
12
11
10
9
8
7
6
23-Dec-98
11-Jan-99
21-Jan-99
2-Feb-99
15-Feb-99
4-Mar-99
26-Mar-99
22-Apr-99
30-Dec-99
13-Jan-00
27-Jan-00
10-Feb-00
24-Feb-00
9-Mar-00
24-Mar-00
6-Apr-00
14-Dec-00
11-Jan-01
25-Jan-01
8-Feb-01
22-Feb-01
8-Mar-01
22-Mar-01
6-Apr-01
Offered (LHS)
Accepted (LHS)
6-month Yield (RHS)

March 1999 is pulled down by an equally sharp fall in accepted bids (see **Figure 5.2.2**).[34]

In view of this, the developments in the third quarter of FY01 are insightful. The fraction of accepted bids remained well above the quarterly average for the past two years and remained stable. If this degree of stability is to remain (both in terms of T-bill rates and the pricing of bids), SBP should be able to channel a robust flow of funds from the banks to GOP. In itself, this will facilitate efforts to meet the end-June NDA target without having to revert to steps that will disrupt the money market at the end of this fiscal year.

5.2.3 Open market operations (OMOs)

In terms of investing funds in government securities, OMOs are strictly short-term placement. Given the hesitancy of banks to place money that would mature after March, they played it safe by preferring to approach OMOs rather than primary auctions (see **Table 10b**). The larger fraction of accepted offers in OMOs during Q3-FY01, reflects the fact that SBP could not leave surplus liquidity in the money market for fear that this would create buying pressure on the Dollar/Rupee exchange rate.

Looking at **Table 10b**, it is interesting to compare the third quarters of FY00 and FY01. Although banks offered to place short-term liquidity with SBP last year, less than 10 percent was accepted. At the same time, however, banks were also requesting short-term liquidity from SBP, which was largely provided. The developments in Q3-FY00 reflect a market abnormality, since banks generally either want liquidity from SBP or want to park liquidity with SBP. However, banks both offered and requested liquidity from SBP at each OMO[35], but SBP was more consistent in *either* offering liquidity or absorbing it (see **Table 10c**). This abnormality in market behavior could reflect the uncertainty surrounding the sharp fall in T-bill rates in that period and the large inflows of IFI assistance in the early part of Q3-FY00.

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[34] Looking at the last three primary auctions in Q3-FY99, the average 6-month T-bill rate fell from 13.3 percent to 12.9 percent and then to 11.3 percent; the corresponding fractions of accepted bids were 52.3, 22.7, and 16.4 percent, respectively.

[35] This includes two special OMOs on February 7th & 21st, which were announced to reverse the large injections in January 2000.

5.2.4 Pakistan Investment Bond (PIB)

The third auction of the PIB was conducted on February 13th with settlement of accounts the next day. Against a target of Rs 8 billion that had been suggested by the Primary Dealers (PDs), offered bids (at premium or par) totaled Rs 17.8 billion (see **Table 10d**). Comparing this with bids in February, a peculiar picture emerges: while banks were hesitant about investing their liquidity in T-bills (despite stable rates), institutional investors even surprised the PDs in terms of their demand for the PIB.[36] Another indication of this enthusiasm can be gauged by the range of bid prices in the third auction. Despite the fact that the coupon return on the PIB did not change, discount bids, which were forthcoming in the previous two auctions, were not realized in the February 2001 auction. Against a target of Rs 8 billion, SBP accepted Rs 15.5 billion at lower weighted average yields than in the previous two auctions.

This huge outflow of liquidity from the banking system did two things: (1) banks were forced into discounting for several days as institutional deposits were drawn down *en masse*, and (2) since these funds are largely categorized as non-bank borrowing, the overwhelming success of the third auction reduced the government's credit needs from the banking system. The resulting lower demand for bank credit helped SBP meet its NDA target for end-March without undue disruption in the money market.

The success of this auction compared to the placement of funds in 3, 6, and 12-month T-bills during February, signals a certain segmentation of the market. Banks are the main source of short/medium term funding and were cautious about their liquidity position vis-à-vis the quarter end and also factored in a possible increase in T-bill rates[37]; but institutional investors, which are the only

[36] The PDs are supposed to advice SBP about the market demand for the PIBs. Given their underwriting commitment of only 24.5 percent of the target amount and the bids received in the first 2 auctions, they should not be *too* risk averse in terms of suggesting a low target to avoid the risk of having to hold unwanted PIBs. In discussions with the PDs, it was their view that Rs 8 billion would be an ambitious enough target, and they feared that if demand was not forthcoming, this would not reflect well on the PIB.

[37] Market information suggests that an increase in T-bill rates (or a further tightening of monetary policy) had been hinted to banks in their meeting with the visiting IMF mission in mid-February. Hence, banks were pricing their bids above market rates in the hope of capitalizing on an increase in T-bill rates.

source of long term funding, were either surplus in funds or viewed the coupon rates on the PIB as very attractive. In effect, while banks were offering small amounts and trying to force SBP to increase T-bill rates, institutional investors were throwing long-term money at the government at below existing interest rates.

This segmentation is to be expected given the initial stages of development of the long-end of the money market. Once secondary market trading of the PIB begins and institutional investors become more sophisticated fund managers, the usage of different strategies in placing short/medium and long-term money in government securities, should eventually disappear.

5.2.5 Meeting SBP's NDA target for end-March

Unlike the exceptional steps that were needed in end-December, meeting the end-March NDA target was smoother. Contrary to market expectations that discounting would not be allowed on March 31st, SBP was comfortable enough that it did not close its discount window. This comfort came from the conversion of Special Deposit Accounts (SDAs – against FE 45 funds still with SBP) into T-bills for a one-week period. This, coupled with cautious monetary management, allowed SBP to meet this target with a leeway of Rs 19.3 billion. It also taught certain banks a lesson: expecting a liquidity shortage in end-March, some banks had started hoarding liquidity in anticipation that SBP would close the discount window on the 31st and they would be able to place this liquidity at exorbitant overnight rates. When these banks realized that a liquidity shortage would not manifest itself, they were desperate to offload their holdings.[38] This was realized in larger bids for government securities in the March 29th OMO (see **Figure 5.2.2** & **Table 10c**).

6. Prices

During the first nine months of the current fiscal year, a higher average annual rate of inflation was recorded in all three price indices compared to the same

[38] During the last week of March, against an average CRR of 5 percent, Citibank was holding 10.8 percent of its DTL in cash, while MCB held on to 9.6 percent. Since this is their average holding over the week, their cash positions were much larger on March 24th and 26th.

period last year. More specifically, the annualized average rate of inflation based on the CPI, WPI and SPI increased by 4.8, 6.7 and 5.4 percent, respectively, over the corresponding period of FY00 (**Table 11**). Although, the 12-month moving averages of all three indices increased from their end December 2000 level, the increase was subdued in Q3 compared to the earlier two quarters of FY01 (**Figure 6.1).** As shown, the WPI and SPI indices actually declined during the quarter, while CPI growth was passive compared to Q1 and Q2 this year. A declining non-food index (March 2001 vs. December 2000) was the cause for this negative growth in WPI, which fell primarily because of decreases under the sub-group *fuel lighting & lubricants, raw material* and *building materials*.

6.1 CPI during Q3-FY01

During Q3-FY01, both Food and Non-Food groups showed subdued increases of 0.2 and 0.3 percent, respectively, compared to 1.3 and 0.8 percent in the corresponding period last year. At 0.6 and 1.2 percent, stronger inflationary pressure was observed in the food and non-food group during Q2-FY01 (see **Table 11.a**).

Food Group

In the food basket of CPI[39], prices of 70 items (with combined weight of 26.7) increased between January to March 2001. Most of these increases were due to seasonal factors, with the exception of tea and pulses, which increased on account of Rupee depreciation in the first half of this fiscal year. During Q3-FY01, the prices of 47 items (with a weight of 13.8) declined on account of the following factors:

- A fall in international sugar prices on the back of higher world production, helped ease pressure on domestic consumers;
- Last year's record production of rice and a decline in its export, put downward pressure on domestic prices;
- Higher domestic production of milk resulted in a fall in its prices in the local market; and

[39] There are 163 items in this group with a combined weight of 49.3507.

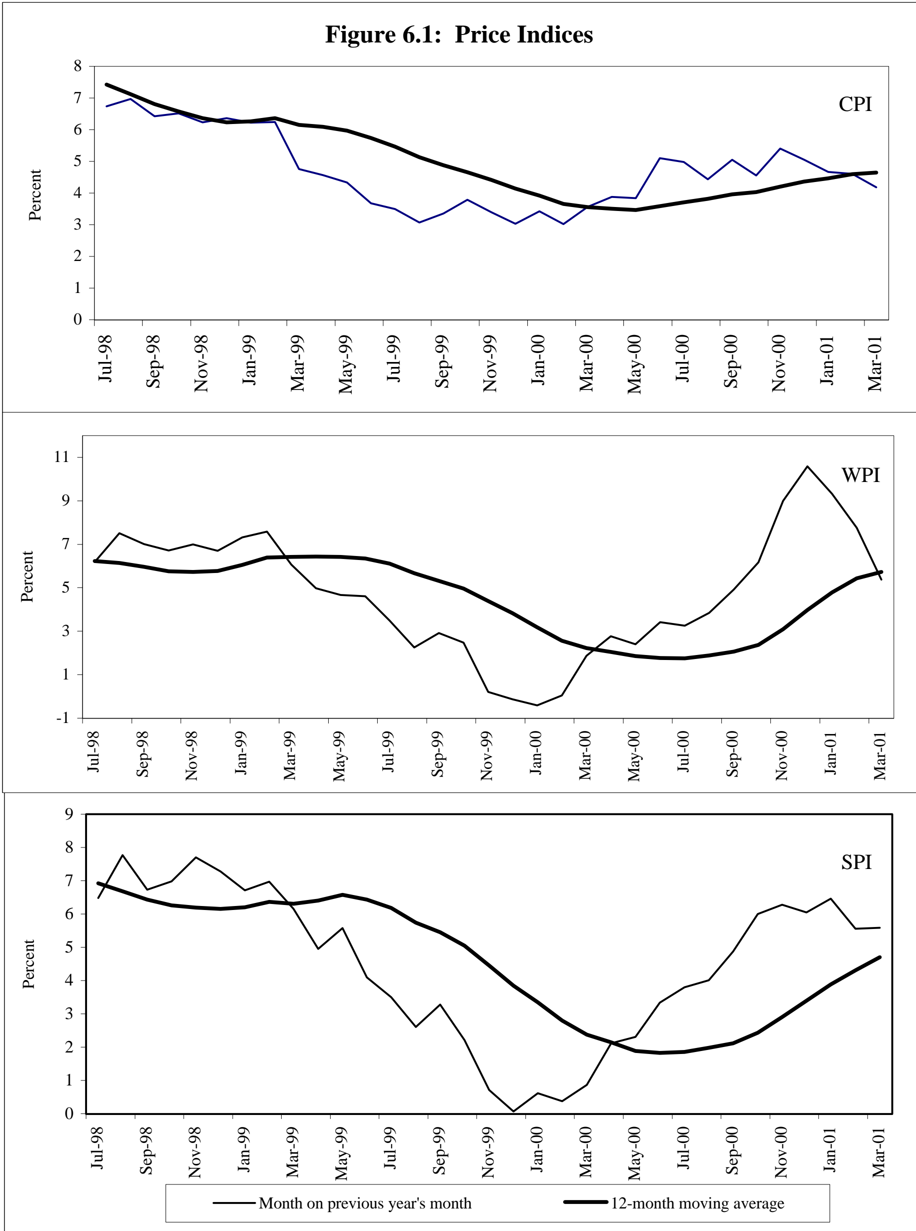


Figure 6.1: Price Indices
CPI
Percent
8
7
6
5
4
3
2
1
0
Jul-98
Sep-98
Nov-98
Jan-99
Mar-99
May-99
Jul-99
Sep-99
Nov-99
Jan-00
Mar-00
May-00
Jul-00
Sep-00
Nov-00
Jan-01
Mar-01
WPI
Percent
11
9
7
5
3
1
-1
SPI
Percent
9
8
7
6
5
4
3
2
1
0
Month on previous year's month
12-month moving average

- A decline in international edible oil prices made oil and ghee cheaper for domestic consumer.

Given the weight these items have in the CPI basket, the fall in the index was largely contained.

Non-Food Group

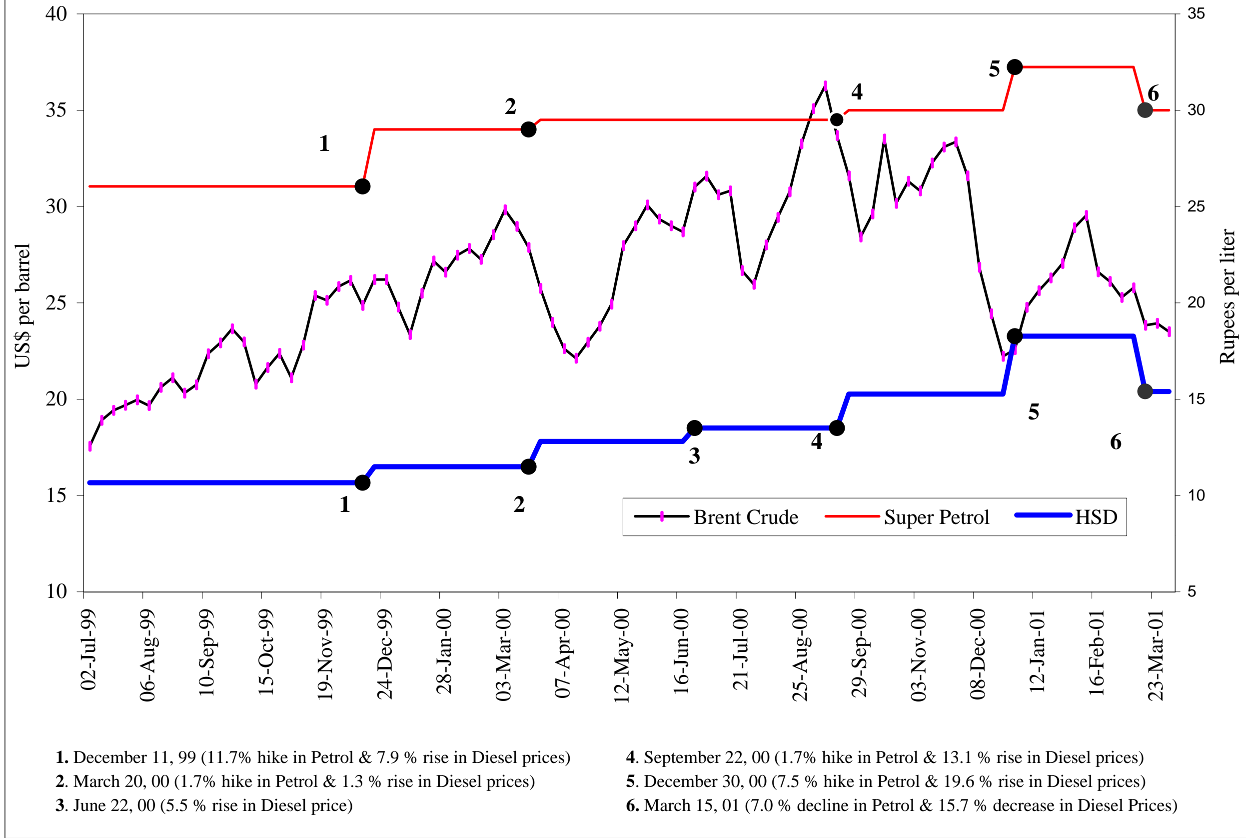
As expected, growth in prices in this group was the driving factor behind CPI inflation during the first two quarters of the current fiscal year. However, in Q3-FY01, with the exception of *transport and communication* and *household furniture & equipment*, all sub group indices displayed moderate price increases compared to the same period last year. In Q2-FY01, the pressure on non-food inflation was coming from an increase in diesel and gas cylinder prices. Kerosene prices, which increased by 18.5 percent in Q2-FY01 and fueled inflationary pressure in the *fuel, lighting & lubricants* sub-group last quarter, declined by 4.0 percent during Q3-FY01. This blunted the increase in this sub-group, which would have otherwise shown higher growth on account of a 20.8 percent (average) increase in gas prices on March 17th 2001.

The sub-group *transport & communication,* which showed strong inflationary pressure in first six months of FY01 (and was expected to grow further), actually declined because of the downward revision of petrol prices on March 15th 2001 (see **Figure 6.1.1**). The easing in international oil prices and the formula to link these to domestic retail prices, was responsible for this.

6.2 WPI during Q3-FY01

During the third quarter of the current fiscal year, both Food and Non-Food indices of WPI declined, with the later contributing more (**see Table 11.b**). Falling prices in the *fuel, lighting & lubricant, raw material* and *building material* sub-groups were the primary reason behind the 2.4 percent decline in the Non-Food Index during the quarter; only *manufacturing* (Non-Food) increased by 0.4 percent in the period. *Tube* and *tyres* posted the sharpest growth of 18.1 and 9.9 percent, respectively, during the third quarter of FY01. Decline in domestic production and imports due to smuggling, created a supply shortage, which coupled with rising automobile production in the country, put upward pressure on the prices of these items (see **Manufacturing**).

Figure 6.1.1: Brent Crude, Petrol & Diesel Prices



Non-Food Group

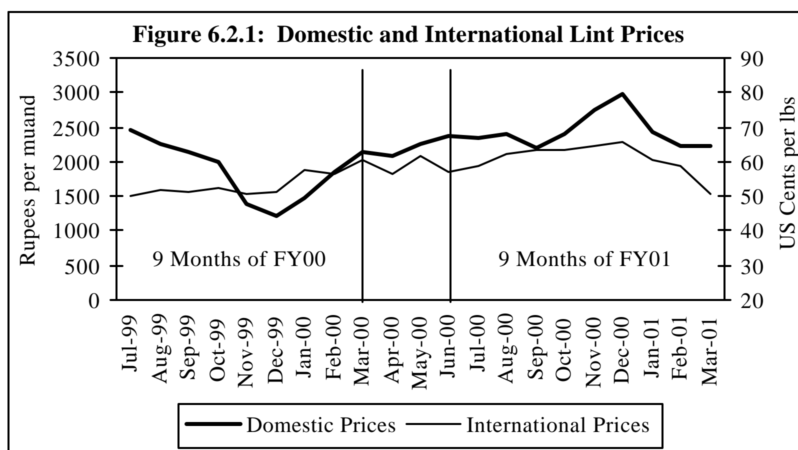
Fuel, Lighting & Lubricants

During Q3-FY01, this sub-group index declined by 5.2 percent mainly because of a fall in retail prices of petrol and diesel on March 15th 2001 (see **Figure 6.1.1**). This resulted in negative growth in the *motor fuel* and *other oils* indices by 14.3 percent and 16.4 percent, respectively. However, the increase in retail prices of gas (in March) pushed up the *natural gas* and *lubricants* indices by 14.4 percent and 6.4 percent, respectively, during the same period. Since petroleum products have a larger weight, the price increase shown in gas & lubricants did not overshadow the fall in petroleum prices in this index.

Raw Material

An improvement in cotton supply in the domestic market and a decline in international cotton prices (see **Figure 6.2.1**) were the main reasons behind the 11.7 percent fall in domestic cotton prices during the third quarter. Although the price indices of *cotton seed*, *hide*, *skin* and *ground nuts*, increased during Q3-FY01, the raw material index declined by 2.8 percent against an increase of 14.1 percent during Q2 this year and 17.3 percent in the corresponding period last year. This is on account of the smaller weight of these items vis-à-vis cotton.

Figure 6.2.1: Domestic and International Lint Prices



Building Material

The price index of building material declined by 1.7 percent in Q3 this year against a rise of 0.1 percent in the same period last year. A 4.5 percent fall in cement prices due to increased supply, was the main driving force for the decline.

To summarize this section, limited pressure in the non-food group allowed the CPI index to show a subdued increase in Q3-FY01, which was supplemented by SBP's tight monetary stance. However, continued pressure on the Rupee has led to a 4.7 percent depreciation, which may cause imported input prices to rise next quarter. Additional pressure is expected from crude oil prices, which had been falling till March 2001, but have started rising because of production cuts by OPEC and buying pressure from the US to build up its oil reserves. In effect, cost-push factors will continue to stoke inflation, while demand-pull will remain weak on account of the IMF's stabilization program.

7. Capital Markets

The performance of the Karachi Stock Exchange (KSE) remained dismal during Q3-FY01. Amendments in the Article of Association of KSE by the Securities and Exchange Commission of Pakistan (SECP) that became effective since December 31st 2000, set the bearish mood in early January 2001.[40] Although the conflict between KSE and SECP was amicably resolved without much delay, the index continued to decline throughout the quarter with a few exceptions. During the course of the quarter,

Table 7.1: Highlights of KSE for Q3-FY01
As on March 31st, 2001
(Rs & shares in billion)

Listed companies at KSE	760
Change in KSE-100 Index since June 2000 (%)	-12.9
YoY change in KSE-100 (%)	-33.8
Listed capital at KSE	236
Total market capitalization at KSE	331.4
Shares traded at KSE during the quarter	8.17

[40] According to SECP these amendments are in line with the recommendations of the Inquiry Committee, which looked into the market crash in May/June 2000. These changes were aimed at strengthening investor confidence and improving the transparency of KSE's operations.

the constrained external position, selling pressure from a major foreign fund and lack of concrete progress on the privatization front, kept market sentiments bearish. The KSE-100 Index declined by 193.5 points during the quarter and closed at 1,324.4. However, the average daily volume of trades showed an improvement of 4.5 percent over the quarter (see **Table 7.1** & **7.2**).

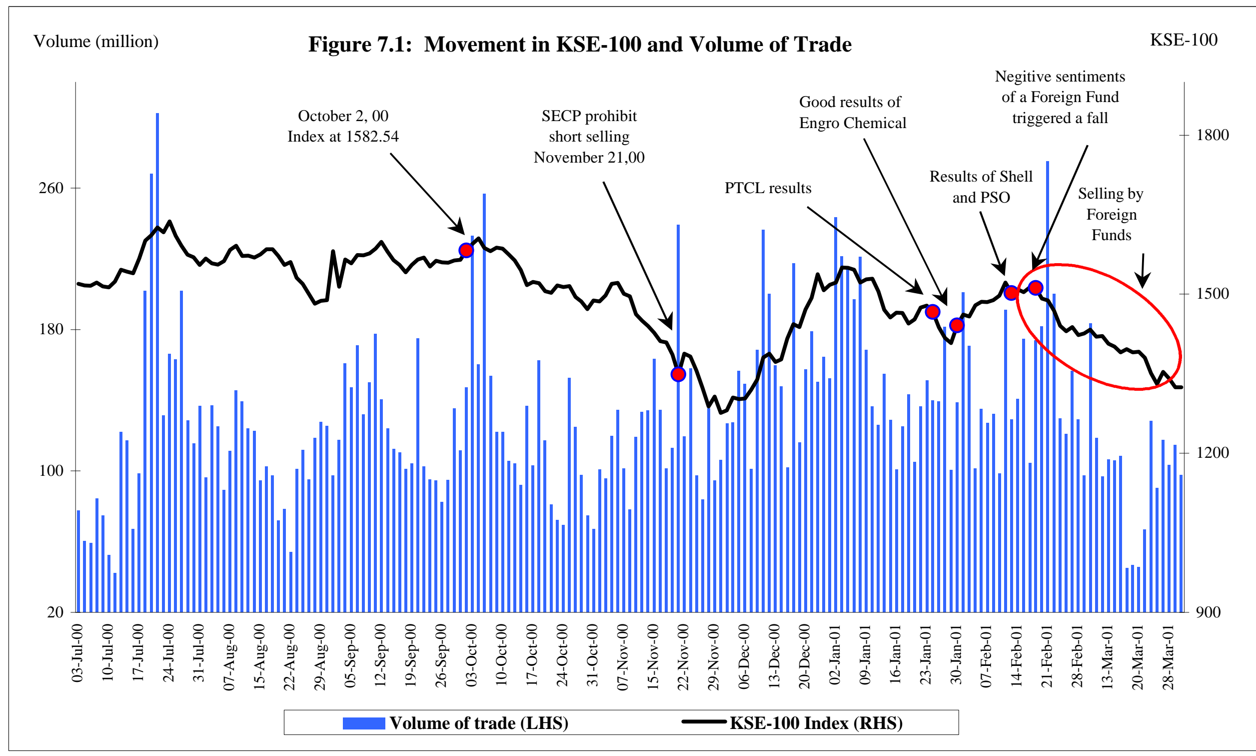
Table 7.2: Shares Traded at KSE During Q3-FY01

	Turnover (million shares)	Average daily turnover (million shares)	Market capitalization (Rs billion)
January	3,626	158	372.6
February	2,837	151	360.3
March	1,674	98	331.4

Looking specifically at the KSE-100 index during Q3-FY01, it peaked at 1550.4 on January 3rd 2001, and declined thereafter (see **Figure 7.1**). Although this fall was triggered by the dispute between KSE and SECP, the tight liquidity position in the money market at the beginning of the quarter pushed up Badla rates, which in turn reduced trading volumes specially in the carry over trades (see **Figures 7.1** & **7.2**). In addition, the 17.1 percent decline in net profits of heavyweight PTCL in the first half of FY01, which was announced in January 25th, added to the slide. For the entire quarter, PTCL under-performed the KSE Index (see **Figure 7.3** & **7.4**). In fact, PTCL alone accounted for 27.2 percent of KSE's traded volume during the quarter, which is a clear indication of the high market concentration (see **Figure 7.5**).[41]

However, by the end of January, strong results announced by Engro Chemical Ltd, revered the downward trend in the index. Positive sentiments regarding Hubco sustained this upward movement throughout the first week of February; investors were expecting good results and dividend payouts by Hubco. Although the company had declared good results during the course of the quarter, it has delayed dividend payouts till its agreement with WAPDA is fully ratified.[42] Like PTCL, Hubco is also a large player in the KSE and accounted for 28.7 percent of market volume traded during Q3-FY01. Mixed results from Shell (negative) and PSO (positive), and an announcement by the Privatization Commission inviting Expression of Interest (EoI) for the sale of 26 percent of PTCL's shares, did not

41 As part of bi-annual strategy, the Karachi Stock Exchange recomposes its KSE-100 Index by changing the composition of the scrips to make the index more representative.
42 Hubco has announced an interim dividend payment in mid-May 2001.


Volume (million)
Figure 7.1: Movement in KSE-100 and Volume of Trade
KSE-100
October 2, 00
Index at 1582.54
SECP prohibit
short selling
November 21,00
PTCL results
Good results of
Engro Chemical
Results of Shell
and PSO
Negitive sentiments
of a Foreign Fund
triggered a fall
Selling by
Foreign
Funds
260
180
100
20
1800
1500
1200
900
03-Jul-00
10-Jul-00
17-Jul-00
24-Jul-00
31-Jul-00
07-Aug-00
15-Aug-00
22-Aug-00
29-Aug-00
05-Sep-00
12-Sep-00
19-Sep-00
26-Sep-00
03-Oct-00
10-Oct-00
17-Oct-00
24-Oct-00
31-Oct-00
07-Nov-00
15-Nov-00
22-Nov-00
29-Nov-00
06-Dec-00
13-Dec-00
20-Dec-00
02-Jan-01
09-Jan-01
16-Jan-01
23-Jan-01
30-Jan-01
07-Feb-01
14-Feb-01
21-Feb-01
28-Feb-01
13-Mar-01
20-Mar-01
28-Mar-01
Volume of trade (LHS)
KSE-100 Index (RHS)

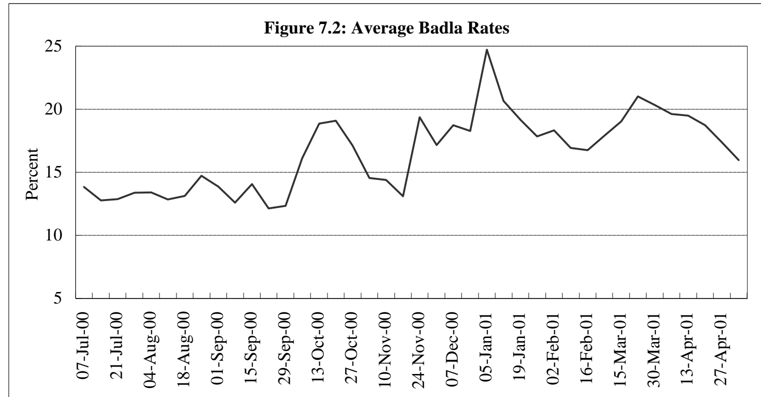


Figure 7.2: Average Badla Rates

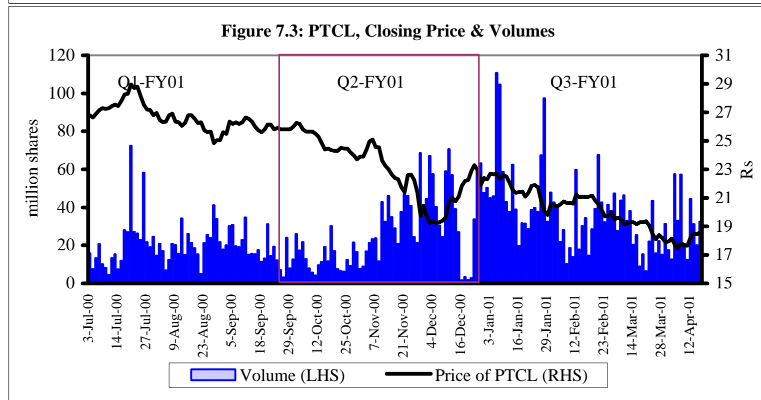


Figure 7.3: PTCL, Closing Price & Volumes

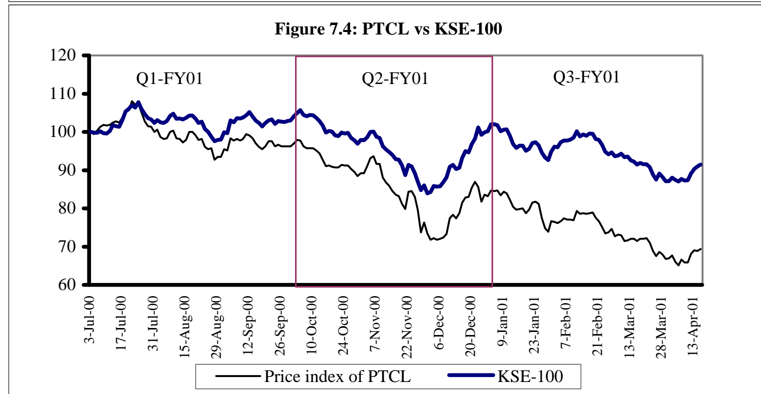
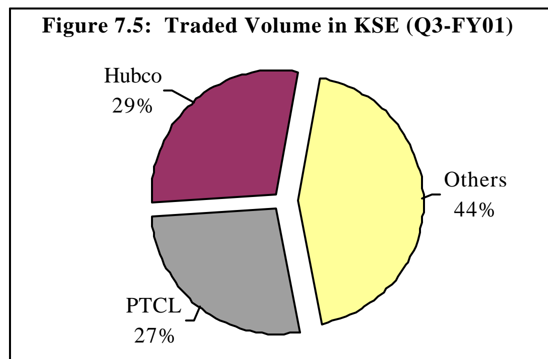


Figure 7.4: PTCL vs KSE-100

create any perceptible trend in the 2nd and 3rd week of February, but a report by Merrill Lynch containing negative views on the investment climate in Pakistan, did start a clear downward trend in the index after February 19th.

These views were based on its assessment that Pakistan would be unable to continue its IMF program on account of CBR's inability to meet revenue targets for end-March. Furthermore, lower than expected GDP growth (on account of agriculture), tight monetary policy against an international easing, and the depreciation of the Rupee during the course of the first two months of the quarter, created a very negative outlook for Pakistan. Although foreign investors kept selling from their portfolio during the year, the pace increased sharply during the 3rd quarter.[43] Moreover, during the 3rd week of March, Morgan Stanley Dean Witter announced the liquidation of its Pakistan Investment Fund by end-May or June. This sentiment obviously did not allow the market to recover.

Figure 7.5: Traded Volume in KSE (Q3-FY01)



In order to curb *insider trading* in Pakistan's equity markets, on March 27th, SECP implemented a law – Listed Companies (Prohibition of Insider Trading) Guidelines, which defines the individuals who are categorized as *insiders* in a company. Furthermore, SECP also listed the unpublished information that is considered sensitive. All insiders are now explicitly prevented from either dealing directly or indirectly in the securities of the said listed company (see **Box 7.1**).

On the reforms front, KSE decided to convert its settlement system to the T + 3 regime. The new system was to be implemented effective from April 30th, starting with two companies in the first phase. Gradually, more companies would be inducted, after carefully viewing the merits and demerits of the system.

[43] US $64 million flowed out during the last quarter, as against US$68 million during the 1H-FY01.

This system has following benefits: (1) speculative trading and over-trading beyond the financial capacity of the brokers will be strictly monitored, (2) settlement risk will be lower between execution of the trade and settlement, and (3) these changes will provide greater comfort to foreign investors as this system is used globally.

7.1 Corporate Debt Market

The corporate debt market has performed well following certain reforms by government.[44] The bearish trend in the equity markets also induced investors into more secure Term Finance Certificates (TFCs). Nevertheless, secondary market trading of TFCs is still negligible as most investors prefer to "buy and hold". The momentum in the bond market during the first half of FY01, continued with Pilcorp and Orix Leasing issuing TFCs in early March and April. Against 18 new issues of TFCs since FY96, a total of 6 have originated this year including 5 from leasing companies (see **Table 7.3**). Furthermore, anecdotal

Table 7.3: Corporate Debt

Security	Issue Date	Maturity	Issuance Size (Rs million)	Coupon Rate (Percent p.a.)
ICI	30-Sep-96	Sep-01	1000	18.70
GATRON	17-Jun-98	Jun-03	274	18.00
INTER-BANK	1-Dec-98	Dec-03	300	17.50
SPLC	28-Jan-99	Jan-03	250	18.25
KESC	31-Jan-99	Jan-04	11500	17.50
DSFL	24-May-99	May-04	863	19.00
NDLC	1-Dec-99	Dec-04	550	17.00
PILCORP	21-Dec-99	Jan-05	287.5	18.00
SIGMA LEASING	18-Jan-00	Jan-03	100	17.00
PARAMOUNT LEASING	2-Aug-00	Aug-04	250	16.25
ATLAS LEASE	27-Sep-00	Sep-05	200	15.00
NETWORK LEASING	4-Oct-00	Oct-05	100	16.25
AL-NOOR SUGAR	31-Oct-00	Oct-05	204	(16.5-18.5)*
PILCORP (2nd issue)	2-Mar-01	Mar-04	325	15.60
ORIX LEASING	7-Apr-01	Apr-05	742	14.00

* Floating rate with floor at 16.5 % and ceiling at 18.5 %. Floor will shift upwards if SBP Discount + 250bps exceeds 16.5 %.

[44] The important reforms are the reduction in returns on National Saving Schemes (NSS), the ban on institutional investment in NSS and the launch of the Pakistan Investment Bond (PIB) in December 2000.

evidence suggests that more leasing companies are expected to enter the market within next couple of months.

This interest by leasing companies is not too surprising, since they need long-term funds to match their lease portfolios. However, the popularity of leasing consumer durables by households (cars, motorcycles, electronics, etc.) and the Shariat compliance of this mode of financing is the root cause for this activity in the bond market.

Box. 7.1

LISTED COMPANIES (PROHIBITION OF INSIDERS TRADING) GUIDELINES

To protect small investors against excessive volatility in prices due to the use of privileged information, SECP issued a draft of the proposed law to solicit public opinion in the first week of October 2000. After due deliberation, SECP implemented the "Listed Companies (Prohibition Of Insiders Trading) Guidelines" on March 27th 2001. This law will increase the degree of transparency in the market and protect small investors from such losses. These guidelines list the following individuals to be insiders:

- A person who is a director, chief executive, managing agent, chief accountant, secretary or auditor of a listed company. Also, beneficial ownership (direct or indirect) of more than 10 percent of the shares of a listed company; or
- A person who is or was connected with the company, or is deemed to have been connected with the company, and who is expected to have access (by virtue of such connection) to unpublished price sensitive information on the company, or who has received or has had access to such unpublished information.

Such persons are now explicitly prevented from either dealing directly or indirectly in the securities of the said listed company. Moreover, SECP has included the following as insider information:

- Financial results of the company (both half-yearly and annual);
- Intended declaration of dividends (interim and final);
- Shares issued by way of rights, bonus, etc.;
- Major expansion plans or execution of new projects;
- Strategy on amalgamation, mergers and takeovers;
- Exit strategy for either the entire company or a part thereof;
- Any information that may affect the earnings of the company; and
- Any changes in policies, plans or operations of the company.

In order to implement these new rulings, SECP has been authorized to investigate and inspect the accounts and records of individuals deemed to be insiders and associated members of the stock exchange.

8. External sector

A snapshot of the balance of payments (BOP) for the first three quarters of FY01, shows one very important development: a sharp fall in Pakistan's current account deficit to US$ 575 million, the lowest in the 1990s (down from US$ 3.34 billion in the first three quarters of FY96). This containment has been achieved despite the growing payments for oil imports.[45] However, the financing of this deficit is still a major constraint; with Pakistan's liquid reserves edging down during the course of this year (see **Figure 8.3.1**), despite the smaller gap last quarter, the authorities have had to monitor external sector payments very closely.

Even though official remittances increased and higher inflows were realized in resident FCAs, SBP stepped up its purchases sharply in last quarter primarily to shore up unencumbered (free) liquid reserves. This coupled with a lower *realized* trade gap (using exchange records from SBP) are responsible for the fall in the current account deficit.

Looking at customs data, although export revenues have increased by 13.9 percent in the first three quarters of this year (relative to last year), the growth in textile receipts has only been 4.1 percent. As was the case in the past two years, international prices have worked against Pakistan, and the nominal growth posted this year has only been possible on the basis of strong quantitative increase in towels, bed-ware, synthetic textiles and readymade garments. On the import side, oil continues to dominate, accounting for 31.5 percent of the country's import bill in the first three quarters this year compared to 25.9 percent last year. At this pace, Pakistan's oil import bill will easily surpass US$ 3.0 billion for the full year. For a country that is constrained for foreign exchange and dependent on imported oil, this has been the main concern in the external sector.

Since the BOP is compiled on a cumulative basis starting end-June, and developments in the capital account are lumpy (with events in the first half of the year already analyzed in the last *Quarterly Report*), the itemized analysis of the

[45] The current account deficit does include oil imports financed by the Saudi Oil facility, and therefore overstates the actual financing gap.

BOP will focus primarily on the third quarter.[46] As shown in **Table 8.1.1,** what is noteworthy is the fact that Pakistan actually ran a current account *surplus* in these three months primarily on the basis of an increase in resident FCAs and heavy outright purchases. As hinted earlier, with the need to increase liquid reserves, SBP has already purchased US$ 1.56 billion from the kerb market in the first three quarters of this fiscal year. A more detailed look at SBP purchases and its impact on the kerb premium is contained in **Special Section 1**.

8.1 Current Account

Within the context of Pakistan's BOP (using SBP's exchange records), the trade deficit narrowed by US$ 351 million on the basis of strong growth of realized export receipts (see **Table 12**). However, this improvement was almost neutralized by higher service payments (profit repatriation) by multinational oil extracting companies, and lower foreign exchange revenues earned by PTCL. For the third consecutive year, overseas travel by Pakistanis placed a growing burden on the country's foreign exchange reserves.

The US$ 303 million increase in current transfers in the third quarter of the year, driven by larger inflows of resident FCAs and heavier outright purchases by SBP, was able to convert the third quarter current account deficit into a surplus this year (see **Table 8.1.1**). The sharp

Table 8.1.1: Current Account (January-March)

(US$ million)

Items	FY99	FY00	FY01
1. Trade Balance	**-260**	**-440**	**-336**
Exports (fob)	1948	1995	2249
Imports (fob)	2208	2435	2585
2. Services (Net)	**-598**	**-797**	**-824**
Shipment	-184	-180	-210
Other transportation	42	6	29
Travel	-62	-79	-78
Investment Income	-410	-562	-550
Interest payments on public debt	-342	-413	-400
Profit and Dividend	-97	-149	-150
Other goods, services & income	16	18	-15
3. Current Transfers (Net)	**685**	**951**	**1254**
a) Private Transfers -net	639	895	1245
i) Workers' Remittances	226	214	245
ii) FCA (Residents)	167	79	179
iii) Outright Purchases	220	695	810
b) Official Transfers	46	56	9
4. Current Account Balance (1+2+3)	**-173**	**-286**	**94**

[46] See **Annexure 1**.

depreciation of the Rupee in September 2000 coupled with the unceasing pressure was sufficient to generate interest in FCAs despite the penal Dollar returns given to depositors.

As foreign exchange reserves were consistently being drawn down on account of lumpy oil and debt payments, SBP's had to step up its purchases, which reached a level of over US$ 250 million per month during the course of the third quarter. The impact of this heavy buying on the kerb premium within the context of SBP's past behavior is discussed in detail in **Special Section 1**.

Looking at official remittances, FY01 seems to be heading in the right direction. If this pace remains, it should be possible to meet the annual target of US$ 1.2 billion (see **Table 13**). With hindsight, however, these inflows still pale against what was realized before the nuclear tests, and are much lower compared to what was flowing in throughout the 1980s. In terms of Pakistan's comparative advantage in the export of semi-skilled labor, remittances are still not playing the role that they should, or have in the past. Given this country's advantage with manpower, it stands to reason that Pakistan *should* run a trade deficit that is financed by large inflows of remittances, so that in overall terms, the country has a balanced current account (if not a surplus). However, throughout the 1990s, the authorities had not paid sufficient attention to the declining or stagnant flow of remittances, which resulted in a strengthening of the Hundi system was able to mature and is now clearly out-performing the banking system. Despite efforts to improve the efficiency of remitting funds through banking channels, the results so far have not been encouraging.

Table 13 lists the source of official remittances. These flows also include the compensation to Pakistani workers from Kuwait on account of the Gulf war (which started in November 1998). Since these payments are part of a one-off development, they do not reflect normal remittances and should not be included in gauging the growth of *voluntary* remittances.

Excluding these staggered payments, the picture looks less heartening.[47] Accounting for this, remittances from the Gulf region have only increased from US$ 441.0 million in July – March 1999 to US$ 481.3 million in the

[47] During the first three quarters of FY99 to FY01, payments in this head were US$ 32.6 million, US$ 57.6 million and US$ 78.3 million, respectively.

corresponding period this year. Although this may seem a reasonable growth rate, when viewed in the context of the flows realized before May 1998, and the oil-price induced boom in the Gulf, worker remittances from this region are abysmal. Since the bulk of overseas Pakistanis are based in the Gulf, and given the pivotal role this region played in the mid-1980s, it is clear that efforts to solicit remittances have not been successful. Given the fact that the Hundi system is based in Dubai, this stagnation reflects the growing use of the Hundi system, which clearly is not an optimal arrangement from the viewpoint of official reserve accumulation.

A slightly more disturbing qualifier to the remittance story is the existence of the Hajj Sponsorship scheme. This allows expatriate Pakistanis to sponsor an expense paid Hajj trip for a resident on payment of a certain amount of foreign exchange (last year the amount per head was US$ 1,600). These sponsorships are forthcoming from all countries with expatriate Pakistanis. Given the nature of this transaction, these flows are categorized as worker remittances and included in the numbers shown in **Table 13**.[48] In terms of the amount received on behalf of the Hajj Sponsorship scheme, the inflows in the first three quarters of the fiscal year were US$ 68.0, US$ 79.8 and US$ 92.8 million for the years FY99 to FY01, respectively. Furthermore, these hard currency inflows are not exactly transfers, since the bulk of the per head sponsorship cost is used to finance external payments for travel, lodging, and spending money.[49]

8.2 Trade Account[50]

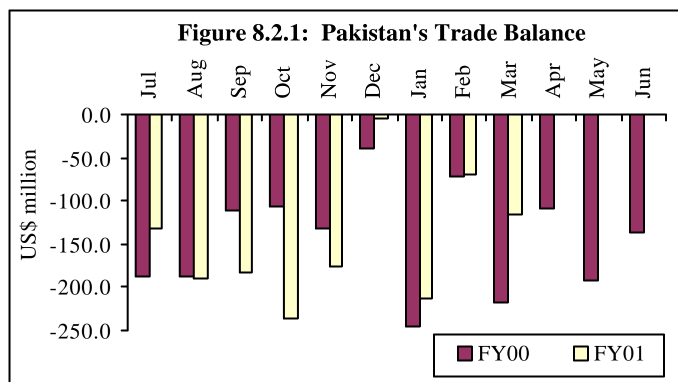
Against a Trade Policy target of (-) US$ 964.0 million for the full year,[51] Pakistan's trade deficit stood at US$ 1.32 billion at the end of Q3-FY01 up

[48] Unfortunately, data on inflows realized under the Hajj Sponsorship scheme are only available going back to FY99. However, anecdotal evidence, which is borne out by the figures for FY99 to FY01, suggests that inflows in this scheme have been increasing with time as awareness of this scheme (and satisfactory results) has enhanced usage.

[49] In the balance of payments, these hard currency payments are shown in the *Services* account.

[50] The sub-section is based on customs data, which provides a more detailed look into Pakistan's trade performance. The numbers will not tally with those in the balance of payments as they are based on exchange records. For a look at the cause of the discrepancy, please see **Special Section 3** in SBP Q1-FY01 report.

marginally compared to last year's Q3 deficit of US$ 1.30 billion (see **Figure 8.2.1**). Reasons behind this deterioration include:



- Weakening per-unit prices for our largest export items; had prices remained at last year's level, exports would have been US$ 517.8 million higher.
- A ballooning oil import bill. End Q3-FY01 saw a US$ 595 million *increase*, which exceeds US$ 2.5 billion and accounts for more than 31.5 percent of Pakistan's total import bill,
- An increase of US$ 136.0 million in textile machinery imports on account of the BMR drive, and
- Higher imports of sugar (up US$ 217.0 million) and pulses on account of low domestic production.

<u>Exports</u>

Exports in the first three quarters of FY01 amounted to US$ 6.7 billion (see **Table 14)** compared to a target of US$ 7.3 billion set in the Trade Policy. On the whole, Pakistan's top exports, including cotton fabrics, bed ware, yarn, synthetic textiles, rice and carpets, continued to show impressive quantitative increases over last year; the total quantity effect for the July-March 2001 period is close to US$ 759.4 million. [52] However, per unit prices deteriorated over the

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[51] The Trade Policy was announced on June 28th, 2000, after the Federal Budget. The document highlights the targets set for the trade regime, and the measures to be taken to achieve these targets.

[52] The price and quantity effects are calculated on the basis of detailed data available on 27 items covering 79.5 percent of total exports. Hence, it underestimates the actual impact of the price and quantity effects.

same period resulting in an overall negative price effect of US$ 432.9 million. In terms of growth, although exports grew by 8.4 percent during the first nine months of FY01, monthly export performance remained erratic. The following presents an analysis of export performance by category:

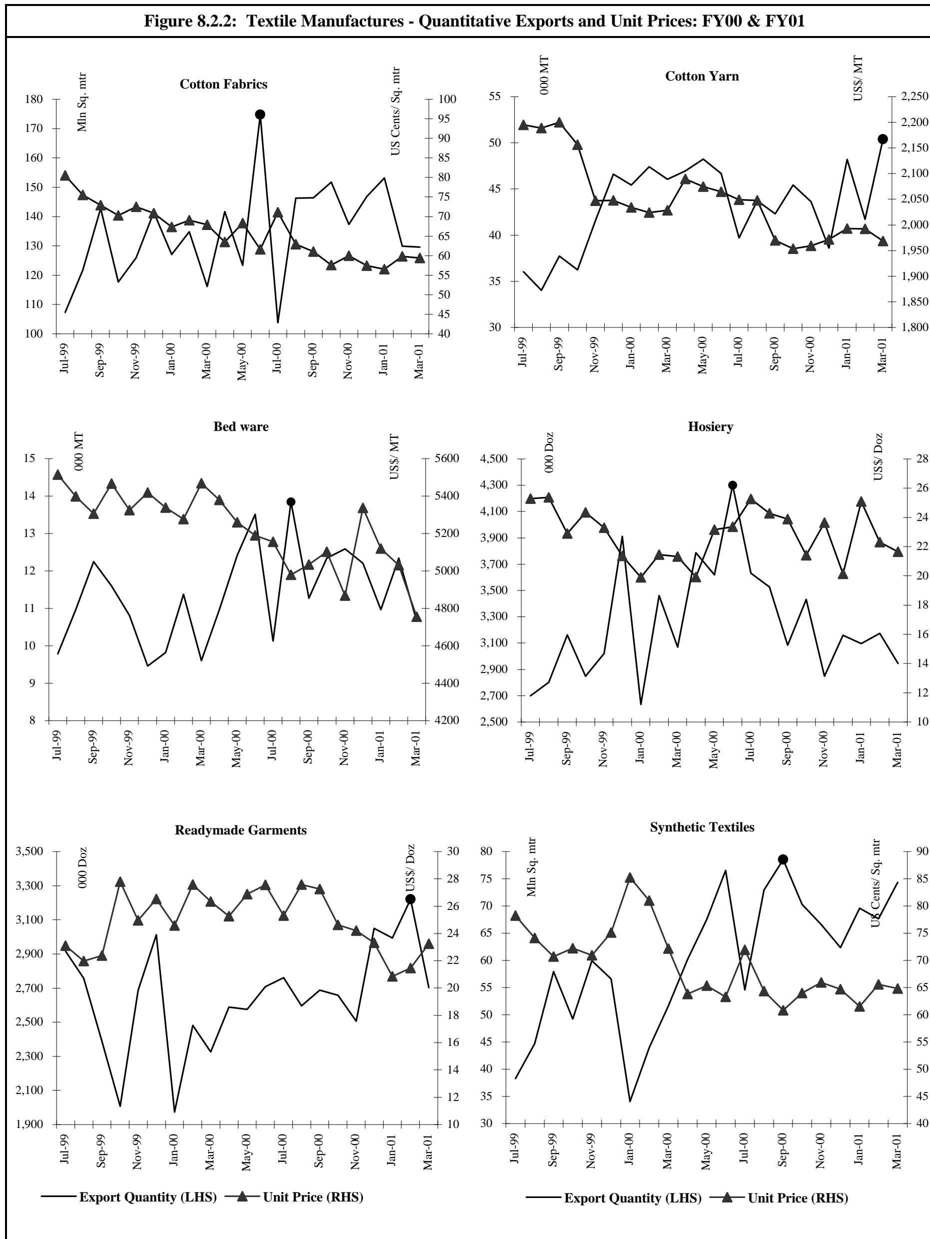
Textile Manufactures

Export of textiles amounted to US$ 4.2 billion in the first three quarters of the current fiscal year. Falling export prices has impacted this category, and more recently, quantities have also taken a hit. However, compared to last year, quantitative export performance has been impressive; of the total quantity effect on exports, nearly 60.0 percent was on account of textiles alone. However, this category also experienced a negative price effect of US$ 310.0 million. The fall in prices is due to pressure from competition in the international market, forcing Pakistani exporters to accept lower prices for their output (see **Figure 8.2.2**). The leeway to reduce prices comes from two sources: (1) the depreciation of the Rupee provides a cushion to exporters who are able to lower prices and still retain their Rupee profit margins, and (2) higher supply of raw materials has led to an improvement in capacity utilization.

The following points highlight the more notable developments in this area:

- Larger *raw cotton* exports reflect the enlarged exportable surplus from two consecutive bumper cotton crops. The current crop is estimated at 10.7 million bales, while last year's production was 11.2 million bales.
- *Cotton yarn* exports amounted to US$ 782.9 million, showing a marginal improvement over the comparable period last year. The decline in unit prices was nullified by a positive quantity effect of US$ 47.3 million. As can be seen in **Figure 6.2.1**, domestic prices of lint cotton have risen sharply since November 1999, indicating declining profitability for yarn exporters. It is tempting to conclude that exporters are selling off their stocks at low prices in order to decrease inventories and hedge themselves against further decreases in international prices. Additionally, market sources claim that the export of yarn at low prices is creating difficulties for Pakistani exporters of higher value added textile items. This year, the main buyers of Pakistani yarn have been the Far Eastern countries, Bangladesh and Korea.

Figure 8.2.2: Textile Manufactures - Quantitative Exports and Unit Prices: FY00 & FY01



Primary Commodities

Of the total export of primary commodities, the strong performers this fiscal year include raw cotton and seafood. Even with a quantitative increase in rice exports, lower revenues were realized compared to last year on account of the 25.5 percent fall in price. The more notable developments in the export of primary commodities were:

- During the first nine months of FY01, revenues from *rice* exports at US$ 400.6 million registered a 2.4 percent decline over the corresponding period last year. Even though quantities increased by 30.9 percent over last year, falling prices *this year* exerted a negative price effect of US$ 136.9 million. This more than neutralized the gain of US $126.9 million from enlarged export quantum. Pakistani rice prices have been hit due to stiff competition from Thailand, Vietnam and China. Exporters have had to cut prices for the IRRI-6 variety in a bid to thwart cheaper rates offered by key rival Thailand to capture a larger share of the international market.[53]
- Compared to the same period last year, *seafood* (fish and fish preparations) exports have witnessed a healthy growth of 7.0 percent to US$ 109.2 million during the course of the first three quarters. Even though the volume of exports fell, higher prices were able to increase export revenues. It should be noted that the enhanced revenues are the result of higher average prices on account of an increasing share of shrimp exports that fetch better prices in the international market. As far as export markets are concerned, the European Union remains the largest market: exports to this region are expected to grow further based on two factors: (1) an increase in demand for white meat following the mad cow and foot & mouth disease in Europe, and (2) meeting international hygiene standards, the EU has now approved a total of 14 plants that are eligible for exporting to the region. With the planned improvement in fishing infrastructure, processing technology and marketing/branding, exports to these countries are expected to rise.
- Despite an improvement in exported quantities, Pakistan's *fruit* export revenues decreased marginally by 0.3 percent to US$ 60.5 million, on the

[53] Since IRRI-6 is a low quality rice, a fall in prices has helped our exports to African countries that tend to prefer cheaper qualities.

back of a fall in realized unit prices.[54] One of the larger items under the fruit category, mango exports have been suffering due to a ban by the US, which has been in effect since the 1960s following the fear of fruit flies in Pakistani produce. Following suit, Australia and Japan also banned Pakistani mangoes imports.[55] Furthermore, poor transportation, lack of storage facilities, weak preservation, and substandard packaging, are severely undermining Pakistan's export potential.[56]

Other Manufactures

- *Carpet* exports in the first nine months of FY01, rose on the basis of higher quantities to US$ 199.5 million. During the period, a total of 4.3 million square meter of carpets was exported, up 23.9 percent over last year, but at lower per unit prices. Historically, Europe in general and Germany specifically, were the biggest buyers of Pakistani oriental hand-knotted carpets, but the focus has begun shifting to America.
- Pakistan's export revenues from *leather* and *leather manufactures* posted an impressive increase during the first three quarters of FY01, fetching the country US$ 479.6 million. Higher demand in the US and European countries have helped tremendously in achieving 76.4 percent of the Ministry of Commerce target for FY01. Leather exports contributed US$ 155.8 million, up 30.9 percent over the same period last year despite a negative price effect. The spread of foot and mouth disease in Europe, and the subsequent mass incineration of animals (including their hides and skins) may have helped. Although this would imply that prices should rise, in an effort to make inroads into new markets, exporters have cut prices on their products. The delays in the duty scheme impacts the liquidity of exporters making it harder for small and medium sized exporters to procure raw materials for their products.

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[54] A compositional breakdown of the fruit category is not available, and hence it is not possible to pinpoint which particular sub-group (in the fruit category) contributed the most to the fall in overall revenues. Anecdotal evidence suggests that citrus fruits fetch better prices in the international market, which could imply that the share of citrus fruits in this year's exports has fallen.

[55] With the help of Japan, a new 'Vapor Heat Treatment Plant' is being setup in Karachi, which should allow the country to resume exports to these regions.

[56] An estimated 30 percent of the crop is lost on the way from farms to markets.

Although Pakistan's exports have risen on a quantitative basis, falling international prices continue to impact export revenues. As can be seen in **Table 8.2.1**, FY00 did see an improvement in Pakistan's exports towards higher value added products. However, the data so far this year suggests a reversal. Keeping in mind that FY00 & FY01 have seen bumper cotton crops, this reversal is hardly a heartening development.

Table 8.2.1 Share in Total Exports

(Percent)

	FY 99	FY00	FY01*
Primary Commodities	12.9	12.9	13.6
Textile Manufactures	63.9	65.2	62.7
Yarn	12.1	12.5	11.6
Value-added Textiles	51.8	52.7	51.1
Other Manufactures	14.1	15.1	16.8
Others	9.0	6.7	6.9

*Up till Q3-FY01.

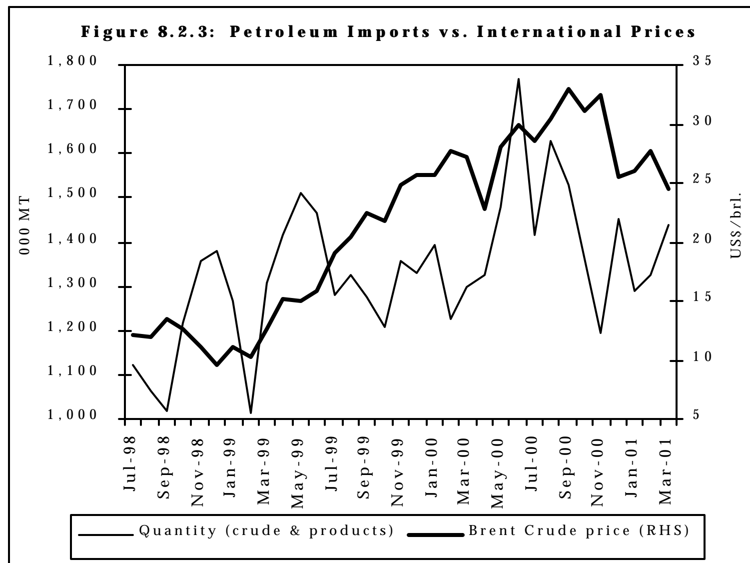
Imports

Imports during the first nine months of FY01 stood at US$ 8.0 billion, registering a 7.2 percent increase over the same period last year. Despite a saving of US$ 262.9 million on account of lower imports of wheat, the increase in Pakistan's import bill was mainly due to a US$ 595.1 million rise in POL imports, and the unexpected import of sugar worth US$ 217.0 million (see **Table 15**). Excluding POL, imports actually declined by 1.0 percent, while non-food non-oil imports showed a meager rise of 0.6 percent.

The following discussion highlights the major developments in Pakistan's import performance during the period under review:

Petroleum, Oil and Lubricants (POL)

Pakistan's petroleum imports (both crude & products) amounted to US$ 2.5 billion during the first three quarters of FY01. A sharp rise in international oil prices, and higher import volumes were responsible for this 30.7 percent increase over the corresponding period last year. Brent crude prices rose by 20.5 percent during the period, resulting in a US$ 438.5 million positive price effect, while imported quantities rose to post a US$ 156.6 million quantity effect. However, Brent crude prices fell by 3.7 percent during Q3-FY01 despite production cuts by



the OPEC (see **Figure 8.2.3**).[57] Since oil imports are made on short-term purchase contracts, the impact of lower international prices will ease Pakistan's oil bill in coming months.

Food Group

- *Sugar* production, which had registered declines over the last two years on account of problems between growers and mill-owners[58], was hit by water shortages this year. Domestic consumption needs are at 3.3 million tons, of which 2.3 million tons is produced locally, and the rest imported. In the first nine months of the current fiscal year, imports of sugar amounted to 803.3

[57] The production cuts by OPEC were done to keep prices between the US$ 22- 28 per barrel range. Under a price band mechanism, production by OPEC is raised by 0.5 million b/d if the average price of OPEC's 'reference basket' of seven crudes remained above a specified level over 20 business days. Similarly, if price falls below the specified range, production cuts are put into effect. The specified price range under the mechanism is US$ 22–28 per barrel. In December 2000, OPEC crude price dipped below the lower limit of US$ 22/b of the price band. As stated, two production cuts of 1.5 mln barrels/day and 1.0 mln b/d effective February 1st, 2001 and April 1st, 2001, were carried out by OPEC to keep prices within the stated range.

[58] For a more detailed discussion, please see SBP's Annual Report for FY00.

thousand metric tons at a cost of US$ 218.1 million. However, lower international prices have helped the country. International prices have fallen due to strong sugarcane production in the large exporting countries (Brazil, Cuba and India).

- *Edible oil* currently represents the largest item under food imports. The total domestic requirement of 1.6 million tons, is made-up of 0.6 million from domestic production, while the rest is imported (usually palm and soya bean oil). Cultivation of oil seeds has traditionally been low in Pakistan due to a low support price that does not cover the farmer's input cost. It is not treated as a primary crop and is hence sown on saline infected or marginal land. Since crop production is down from last year, imported quantities were 12.8 percent higher.
- At over 22 million tons, a bumper *wheat* crop last year created an exportable surplus for the first time in Pakistan's history. However, the inability to sell this wheat may be a blessing in disguise in view of the fall in production this year due to drought conditions in the country.

Machinery Group

Since FY97, imports of machinery have shown a steady decline primarily due to lower imports of power generating machinery. However, during the first nine months of FY01, imports rose by 5.4 percent over the corresponding period last year because of machinery imports by the textile sector. Textile machinery imports have risen by 108.2 percent to US$ 261.6 million during the current period, primarily on account of the BMR drive in the industry, along with the boom created by bumper cotton crops in two successive seasons.

Looking ahead, water shortages in the country will add pressure on the import bill. In addition to the shortfall in agriculture production, the drought has hit hydel power generation, which in turn has increased the country's dependency on thermal energy. This is having a more direct impact on Pakistan's import bill.

This may explain the higher quantities of oil that has been imported, despite the increase in international prices. On the other hand, a slowing world economy, on the back of a US recession, is unlikely to help Pakistan's exports. This factor may lead to a widening of the trade gap in coming months. Additional pressure is expected after the government cuts the maximum tariff rate from 35 to 30

percent from July 1st 2001, in line with WTO regulations and IMF conditionalities.

8.3 Capital account

As shown in **Table 12**, the capital account posted a very sharp contraction this year compared to FY00. From an 'outflow' of US$ 2.4 billion in the first three quarters of FY00, the capital account deficit in the corresponding period this year was only US$ 568 million. The bulk of this adjustment was because of the accounting treatment of external loans/liabilities that were rescheduled or rolled-over last year (prominent are the non-resident FCAs).

The most disturbing development in capital flows this year has been a decline in foreign investment– both direct and portfolio. Although headline numbers suggest that outflows this year have been lower than the year before (outflows of US$ 132 million in the first three quarters of this year against US$ 282 million last year), this is primarily because of a notional outflow of US$ 310 million in FY00 on account of the rescheduling of Pakistan's Eurobond. Excluding this transaction, there was a net inflow of hard currency into the stock markets last year. The scenario this year is less positive; with the bearish performance of Pakistan's stock markets this year, the outflow of US$ 68 million in the first half of this fiscal year gained momentum with a further outflow of US$ 60 million in the third quarter itself. Possibly linked to a negative assessment of the country by Merrill Lynch, a prominent Pakistan Fund operated by Morgan Stanley liquidated its holding during the last quarter. Foreign direct investment also declined from US$ 362 million in the first three quarters of FY00, to US$ 234 million in the comparable period this year.

Beyond foreign investment, specific developments in the capital account are analyzed in **Annexure 1**. In broad terms, the sharp fall in 'outflows' from US$ 891 million in Q3-FY00 to US$ 181 million last quarter, is primarily on account of non-resident FCAs (more specifically, the roll-over of FE 45 deposits last year). This notional outflow overshadows the fact that fresh inflows of long-term assistance (project aid, non-food aid, etc.) actually fell in Q3-FY01 compared to the third quarter of last year. As shown in **Table 16**, inflows fell from US$ 755 million in Q3-FY00 to US$ 671 million last quarter. Despite IFI interest to resume stalled structural adjustment programs in Pakistan, this reflects the realization of pipeline funding during FY00 that have still not been activated

on account of the international sanctions. This allows for an interesting insight: while bilateral assistance has stopped on account of the sanctions (e.g. from Japan, the US, Germany and France), foreign assistance is beginning to be channeled through the IFIs. Since the IFIs will only disburse with the collective consent of the large donors (primarily the US), long-term assistance to Pakistan is now controlled by fewer players than was the case when bilateral assistance was forthcoming.

In terms of the relative impact of the rescheduling in the past quarter, **Table 8.3.1** explains why the exceptional financing gap has fallen so sharply. The first thing to note is that the debt relief from Paris Club has not fallen as the headline number would suggest. This is to be expected, since a rescheduling agreement with the Paris Club was in place for both the third quarters of FY00 and FY01. The real difference is Pakistan's commercial debt; more specifically, while FY00 witnessed the rollover of FE 45 deposits, central bank deposits and the restructuring of Pakistan's Eurobonds (which are shown as positive entries), the last quarter saw payments on behalf of rescheduled commercial debts. Since the exceptional financing gap is a counterpart entry to show rescheduled debts in the capital account, the above explanation should be kept in mind when comparing the capital account this year against FY00.

Table 8.3.1: Exceptional Financing

(US$ million)

	Q3-FY00	Q3-FY01
Exceptional financing	**1,084**	**(6)**
Debt Relief from Paris Club	379	268
Central bank deposit	300	0
Rollover of FE-45	293	(190)
PTMA	0	(62)
Eurobond	160	0
NBP deposits	0	0
Others	(48)	(22)

Pakistan's liquid reserves

As shown in **Figure 8.3.1**, the country's liquid reserves are acutely sensitive to lumpy inflows. In between the peaks, however, there is a gradual draw down that reflects a persistent structural imbalance in the external sector. This means that looking at regular inflows and outflows of hard currency (or items in the current account), SBP has had to inject hard currency into the foreign exchange market to finance net outflows. This is to be expected given the *most binding* structural problem in Pakistan's external sector – the routing of an increasingly large fraction of total remittances through the Hundi system. If these inflows

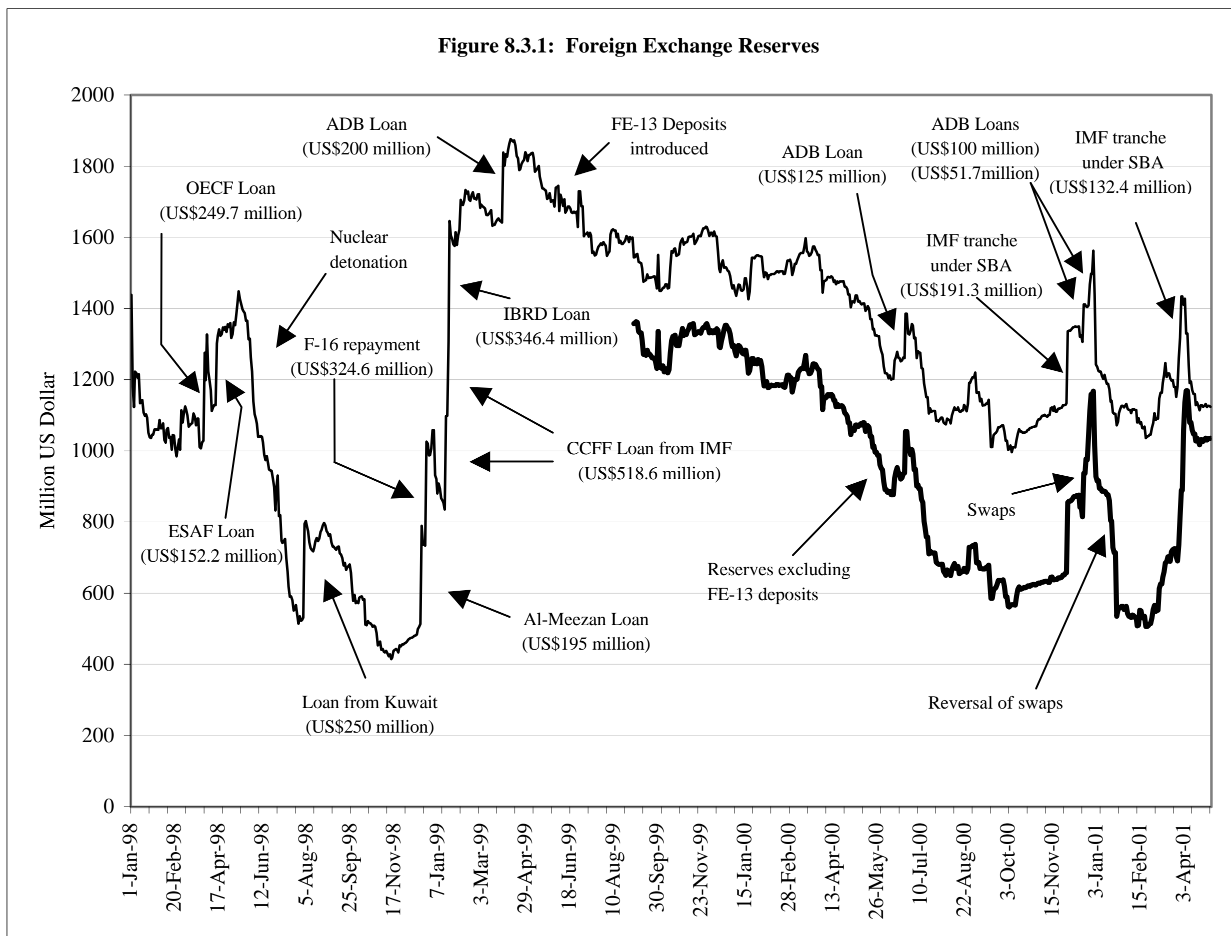


Figure 8.3.1: Foreign Exchange Reserves
Million US Dollar
2000
1800
1600
1400
1200
1000
800
600
400
200
0
ADB Loan
(US$200 million)
FE-13 Deposits
introduced
ADB Loan
(US$125 million)
ADB Loans
(US$100 million)
(US$51.7million)
IMF tranche
under SBA
(US$132.4 million)
OECF Loan
(US$249.7 million)
Nuclear
detonation
IMF tranche
under SBA
(US$191.3 million)
IBRD Loan
(US$346.4 million)
F-16 repayment
(US$324.6 million)
CCFF Loan from IMF
(US$518.6 million)
Swaps
ESAF Loan
(US$152.2 million)
Reserves excluding
FE-13 deposits
Al-Meezan Loan
(US$195 million)
Loan from Kuwait
(US$250 million)
Reversal of swaps
1-Jan-98
20-Feb-98
17-Apr-98
12-Jun-98
5-Aug-98
25-Sep-98
17-Nov-98
7-Jan-99
3-Mar-99
29-Apr-99
18-Jun-99
10-Aug-99
30-Sep-99
23-Nov-99
15-Jan-00
28-Feb-00
13-Apr-00
26-May-00
10-Jul-00
22-Aug-00
3-Oct-00
15-Nov-00
3-Jan-01
15-Feb-01
3-Apr-01

were realized by the official sector, SBP would face little (if any) difficulty in financing its trade deficit on the basis of worker remittances, without any pressure on the exchange rate.

In terms of managing external payments this year, the picture has changed slightly during the course of the fiscal year. The peaks witnessed in end-December and end-March are lumpy, since they reflect concerted efforts by SBP to shore up Pakistan's reserves at the quarter-ends. The fact that these inflows exit just as hastily after the quarter-end, is a clear indication that these are effort to meet IMF targets (see **Figure 8.3.1**).

Even during the course of the third quarter, Pakistan's total reserves fluctuated within a range of US$ 1 to 1.4 billion. It peaked on March 30th at US$ 1,433.8 million, with its lowest level on February 20th when it touched US$ 1,035.6 million (see **Figure 8.3.1**). The sharp increase in total reserves during the last 4 working days in March (when reserves increased by US$ 282.5 million), is on account of the IMF tranche of US$ 132.4 million received on March 30th, and short-term swaps of US$ 211.0 million conducted with commercial banks. The fact that the increase in reserves is less than the lumpy inflows realized in these few days, is an indication of heavy debt servicing payments that were due at end March.

Looking at free reserves (which exclude FE 13 deposits), the picture is more revealing (see **Figure 8.3.1**). The first thing to note is the gradual decline in total reserves after March 1999, and the sharper fall in unencumbered reserves after inflows of new FCAs were included as part of SBP's reserves[59], is an indication of the pressure on the country. The movements in the current fiscal year also confirm the fact that lumpy inflows from the IFIs have a more lasting impact on the country's reserves. For example, inflows of IFI assistance have been able to shore up the level of reserves or have stemmed the gradual draw down (see December 2000 and end-March 2001 in **Figure 8.3.1**). Although the system for computing Pakistan's liquid reserves has been changed since April 2nd (on account of the decision to return FE 13 deposits back to the banks), the downward trajectory of Pakistan's reserves seems to have been halted.

[59] This coincides with FE Circular # 13 issued in July 1999.

What is interesting are the peaks witnessed in end-December and end-March 2001. Other than IFI inflows in these two months, the dips in FE 13 deposits, which are shown as a narrowing gap between total and unencumbered reserves, reflect the shifting of FCAs into one-month placements with SBP. The reversal of these transactions is very clear in the third week of January (see **Figure 8.3.1**), where there has been an abrupt increase and decrease in unencumbered reserves within a gap of a month.

The case of end-March is a bit different; although the increase in unencumbered (free) reserves follows the IMF tranche, FE 13 swaps and other time-bound placements by banks, a reversal does not seem to have taken place. This is because with the release of FE 13 deposits[60], there has been a change in the treatment of FCAs – unfrozen FCAs (total FE 25 deposits) are liable to 5 percent CRR and 20 percent SLR, which are kept with SBP and treated as part of unencumbered reserves. Hence the tapered fall in liquid reserves in April is the result of the inflow of 25 percent of outstanding unfrozen FCAs.

8.4 The exchange rate

As shown in **Figure 8.4.1**, the third quarter of this fiscal year has been a period of relative calm in the foreign exchange market compared to the previous quarter. Although pressure on the currency did result in a depreciation till it almost breached Rs 62 per US Dollar in the first week of April, stronger inflows from exporters and tight monetary management allowed some ground to be recovered. Looking specifically at the third quarter, there were two periods when pressure on the Rupee resulted in rapid loss of value: in the first week of January, when the Rupee lost Rs 1.41 against the US Dollar, and a Rs 0.65 loss in mid February. Beyond these two episodes, there was a gradual loss in the value of the Rupee from Rs 58.28 in end-December to Rs 61.15 at the end of March.

The depreciation in early January was the combined impact of three factors: (1) very tight liquidity in the money market in the last week of December, resulted in an appreciation of the Rupee despite high debt payments, (2) with the new year, the market began testing to see if SBP would defend a Rupee/Dollar

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[60] Shown as the narrowing gap between total and unencumbered reserves (see **Figure 8.3.1**).

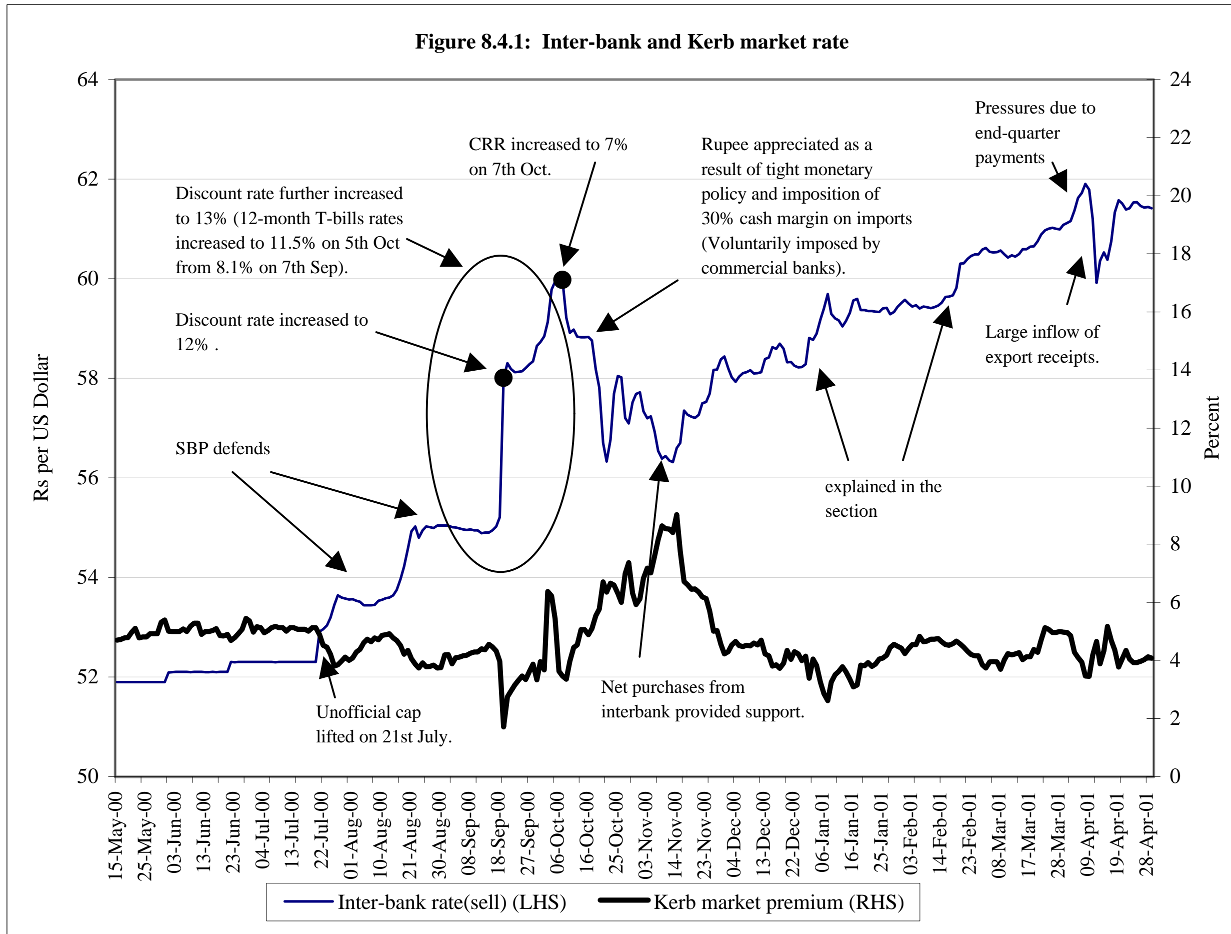


Figure 8.4.1: Inter-bank and Kerb market rate
Rs per US Dollar
Percent
CRR increased to 7% on 7th Oct.
Rupee appreciated as a result of tight monetary policy and imposition of 30% cash margin on imports (Voluntarily imposed by commercial banks).
Pressures due to end-quarter payments
Discount rate further increased to 13% (12-month T-bills rates increased to 11.5% on 5th Oct from 8.1% on 7th Sep).
Discount rate increased to 12% .
SBP defends
explained in the section
Large inflow of export receipts.
Net purchases from interbank provided support.
Unofficial cap lifted on 21st July.
Inter-bank rate(sell) (LHS)
Kerb market premium (RHS)

benchmark knowing that the sharp fall in liquid reserves would not allow SBP to explicitly defend any rate, and (3) Hubco had its bi-annual loan repayment of US$ 50 million that had to be paid on 6th January.[61]

In terms of the mid-February depreciation, this was primarily because of the 2-month extension given to exporters regarding their overdue export proceeds. With the leeway to surrender such proceeds by April 14th 2001, the flow of export revenues dried up in mid-February. With normal import payments on an on-going basis, the resulting shortage of foreign exchange forced the Rupee/Dollar parity to rise. **Figure 8.4.1** illustrates the movements in the exchange rate and also explains the abrupt changes witnessed in April.

In terms of the kerb premium, this is discussed in more detail in **Special Section 1**. Suffice to say, despite very heavy purchases in the period December 2000 to March 2001, the kerb premium still hovered around the 4 percent mark. As shown in the previous *Quarterly Report*, the kerb premium is not an accurate indicator of the supply/demand imbalance in the kerb market, but tends to follow changes in the official exchange rate. The impact of the increasing Rupee/Dollar parity on the real effective exchange rate is shown in **Figures 8.4.2** & **8.4.3** (the index values of the various REER indices are reported in **Table 17**).[62]

[61] In terms of the last point, given the shallow foreign exchange market, Hubco's consortium of banks began buying in the first week of January.
[62] For an explanation of the various REER indices, see **Special Section 1** in the first *Quarterly Report* for FY01.

Figure 8.4.2: REER Indices Developed by the SBP
(January 1995=100)
105
100
95
90
85
80
75
Jan-95
Apr-95
Jul-95
Oct-95
Jan-96
Apr-96
Jul-96
Oct-96
Jan-97
Apr-97
Jul-97
Oct-97
Jan-98
Apr-98
Jul-98
Oct-98
Jan-99
Apr-99
Jul-99
Oct-99
Jan-00
Apr-00
Jul-00
Oct-00
Jan-01
REER(Exports)
REER(Imports)
REER(Competitors)

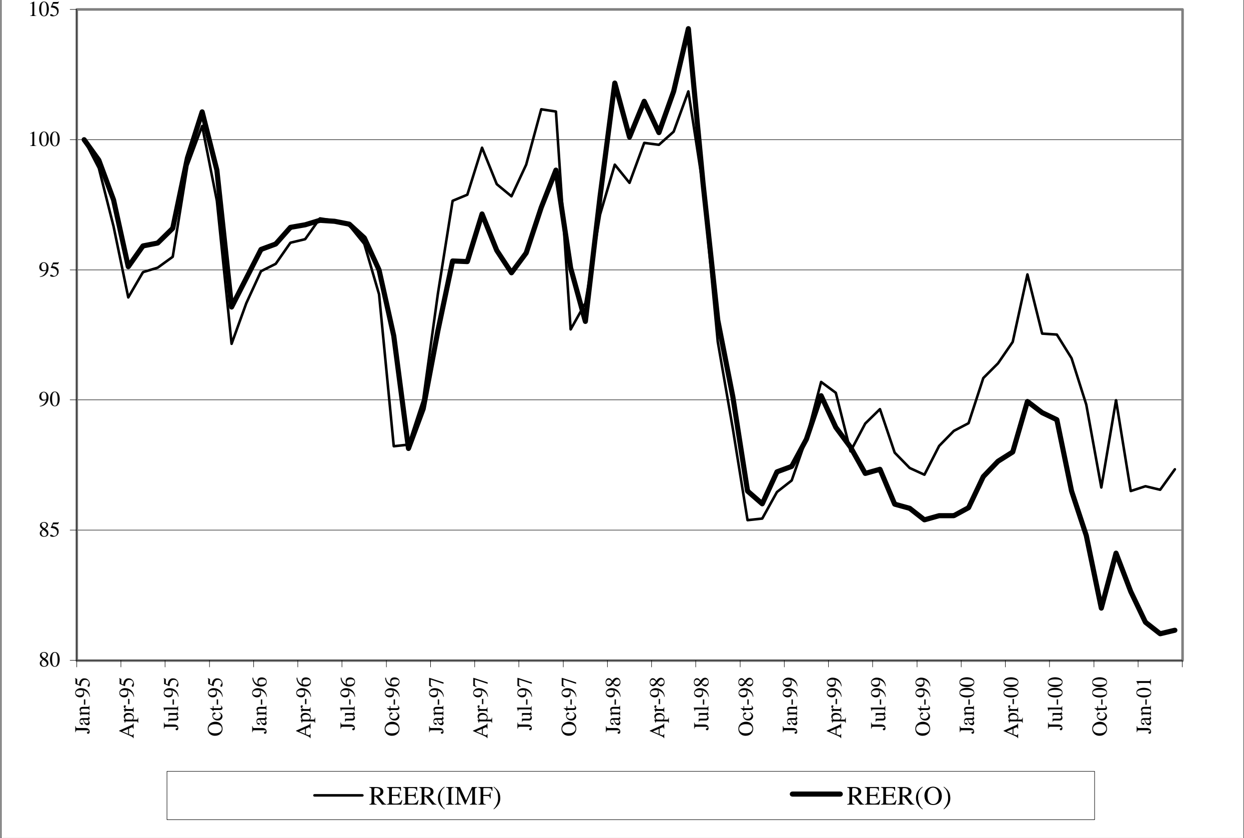


Figure 8.4.3: Comparison of SBP's and IMF's REER Indices
(January 1995=100)
105
100
95
90
85
80
Jan-95
Apr-95
Jul-95
Oct-95
Jan-96
Apr-96
Jul-96
Oct-96
Jan-97
Apr-97
Jul-97
Oct-97
Jan-98
Apr-98
Jul-98
Oct-98
Jan-99
Apr-99
Jul-99
Oct-99
Jan-00
Apr-00
Jul-00
Oct-00
Jan-01
REER(IMF)
REER(O)

Annexure 1. Details of the Capital Account

Since the previous *Quarterly Report* dealt with the item-by-item analysis of the capital account in the first half of FY01, this section will only focus on the third quarter of this year since transactions in 1H-FY01 remain the same. This is based on **Table 16**.

Net foreign investment

As far as direct investment (abroad) is concerned, the outflow of US$ 27.0 million represents losses incurred by the overseas network of a nationalized commercial bank. Since the NCB is incorporated in Pakistan, the outflow from its head office to cover the losses is recorded under this head. In terms of direct foreign investment (DFI), given the government's recent initiatives for investment in oil and gas, chemicals, fertilizers and the metal industry, DFI flows have picked up. In terms of portfolio investment, the outflow of US$ 61 million is due to the liquidation of the Morgan Stanley Fund operating in Pakistan (see **Capital Markets**). The larger portfolio outflows shown for Q3-FY00, is notional since it reflects the rescheduling of Pakistan's Eurobond, which is not the case this year.

LT Capital (official)

The changes under this head are on account of Item 4.2, which represents *net* flows under project, food and non-food aid, after accounting for amortization outflows. The primary reason behind the fall in inflows is lower project aid last quarter. Since assistance from G-7 countries had been suspended following the international sanctions against Pakistan (which have still not resumed), the lower inflows this year indicates no new commitments and the drawing down of pipeline assistance that had already been agreed upon before the nuclear tests.

Other reasons include a fall under non-food aid, and no new inflows under food aid. The inflow recorded under non-food aid largely represent the Saudi Oil Facility, which itself has fallen this year. This is dependent on the international price of oil, which was higher during Q3-FY00 against last quarter. The inflows under food aid last year were on account of the wheat facility by the Australian Wheat Board and the US PL-480 scheme. Because there was a bumper wheat crop last year, sufficient stocks were available for domestic consumption due to which no new contracts for wheat imports were availed this year.

LT Capital (others)

Although there has been a minor change in the overall figure vis-à-vis last year, substantial compositional changes have taken place. Specifically, outflows fell on account of lower repayments on Pakistan's private loans and credits (Item 6.2); after the IMF's SBA arrangement, such loans and credits are also to be rescheduled on 'comparable terms' with the Paris Club. However, repayments of a par swap of US$ 225.0 million resulted in higher outflows during the last quarter. As the settlement was carried out in Rupees with the consent of both parties, this represents a notional outflow. This was neutralized by inflows of US$ 211.0 million on account of swaps with commercial banks in an effort to meet the end-March NFA target.

ST Capital (official sector)

The positive entry under item 7.2 represents fresh commercial borrowings by Pakistan primarily for import financing. The category also incorporates outflows of short-term placements with SBP.

ST Capital (deposit money banks & others)

The sharp fall in outflows in these two heads this year, primarily recorded the roll-over and Rupee conversions of FE 45 deposits that had been mobilized by commercial banks and NBFIs. Since most of the deposits were either rolled-over or converted to Rupees last year, and no such activity has taken place this quarter, outflows have fallen substantially.

Special Section 1: Some insights on SBP purchases from the kerb market[63]

Backdrop

Pakistan has a long history of structural imbalances in the external account, with heavy reliance on unrequited transfers to finance the growing trade deficit. In particular, worker remittances have been used to pay for a large portion of the trade gap. However, after reaching a peak of US$2.9 billion in FY83, remittances are increasingly routed through the Hundi system, as it is more efficient and provides a better Rupee conversion rate. In the early 1990s, a foreign currency account (FCA) scheme for resident Pakistanis was introduced, which further depleted the annual flow of *official* remittances as a portion of these funds was directed into resident FCAs.[64]

However, after the freeze of FCAs in May 1998, this avenue for financing the trade deficit is no longer available. Although, the resulting fall in domestic dollarization had reduced the physical inflows of foreign exchange into the country, such hard currency balances have been building up abroad. Outright purchases, which simply tap into these balances at the existing kerb rate, have now become one of the major sources for financing the trade deficit. Although unorthodox, these purchases have a major advantage over FCAs in the sense that they neither incur a foreign exchange liability nor constrain the monetary policy of the State Bank of Pakistan. Over the past 2½ years, SBP has purchased over US$ 3.7 billion from the kerb market. This note attempts to highlight certain issues relating to these purchases.

Table 1: Quarterly Kerb Purchases

(US$ million)

	FY99	FY00	FY01
Q1	--	240	227
Q2	158	556	528
Q3	220	576	806
Q4	153	261	--
Total	**531**	**1,633**	**1,561**
Total purchases since Nov'98			***3,725***

[63] Ownership for this section goes to Syed Sajid Ali (Assistant Director, GERD).
[64] Resident FCAs were also being used to channel foreign currency flows from the kerb market to the banking system.

Kerb purchases and forex reserves

Pakistan's reserves position has strong implications for the volume of kerb purchases. For example, purchases remained low at US$531 million during FY99, since foreign assistance in the pipeline prior to May 1998, became available during FY99, thereby supporting Pakistan's foreign exchange reserves.[65] However, with the on-going sanctions imposed by the G-7 countries, such pipeline loans dried up in the following year. In response, outright purchases increased to over US$1.6 billion during FY00.

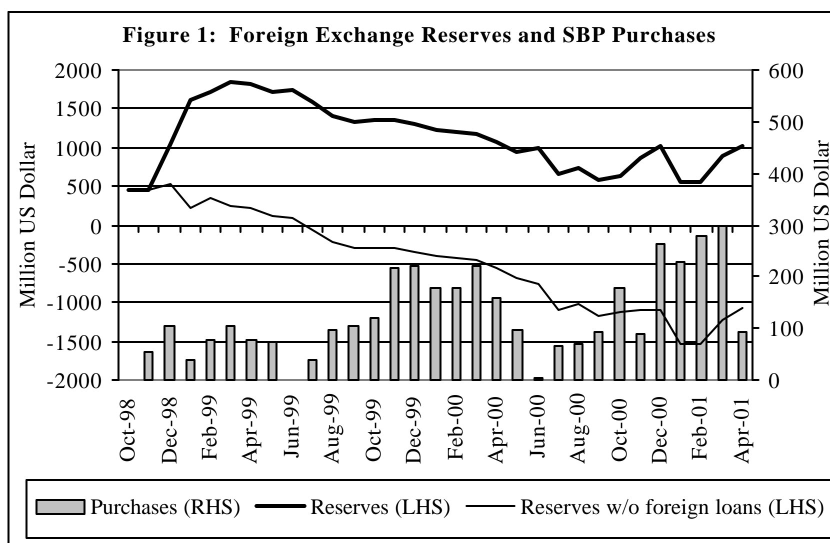


Figure 1 shows the trends in foreign exchange reserves and purchases. Since the inclusion of foreign loans makes it difficult to gauge the impact of kerb purchases on reserves, major loans from the IFI's and friendly countries have been excluded from the overall reserve position. It is evident from the **Figure 1** that whenever SBP reduces its monthly purchases, it results in a perceptible fall in the forex reserves; this is apparent in periods around January 1999, June-September 1999, and March-June 2000. Similarly, an increase in the volume of

[65] Pakistan received major loans from the IMF, World Bank and ADB, beside repayment on account of the settlement against the undelivered F-16 planes during FY99.

purchases helped to stabilize reserves; most notable is the increase in purchases during January-March 2001 period.[66]

The main reason for kerb purchases is to stabilize liquid reserves, which are depleted on account of the persistent trade deficit. **Figure 2** represents kerb purchases as a percentage of the cumulative trade deficit (f.o.b. basis). It is evident from the chart that during FY00, SBP purchases covered a maximum of 115 percent of the cumulative trade deficit till June 2000, whereas during FY01, the maximum coverage of 140 percent was achieved in the month of March 2001. In other words, SBP has been more aggressive with its purchases in FY01 compared to last year. It is interesting to note that while the entire FY00 was spent without an IMF program, Pakistan has successfully realized two tranches of the existing SBA program and has already purchased US$ 1.56 billion in the first three quarters of this year.

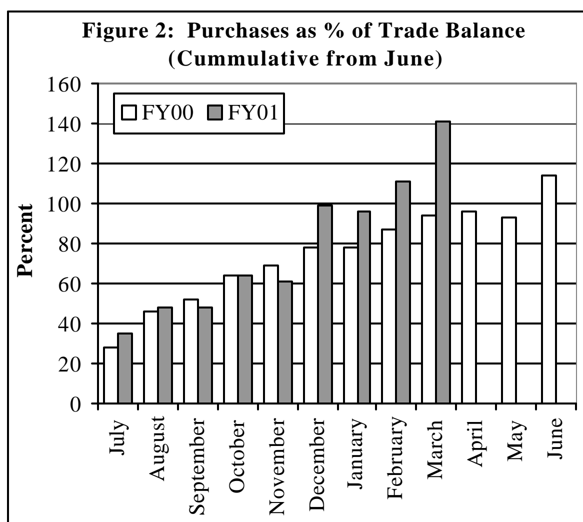
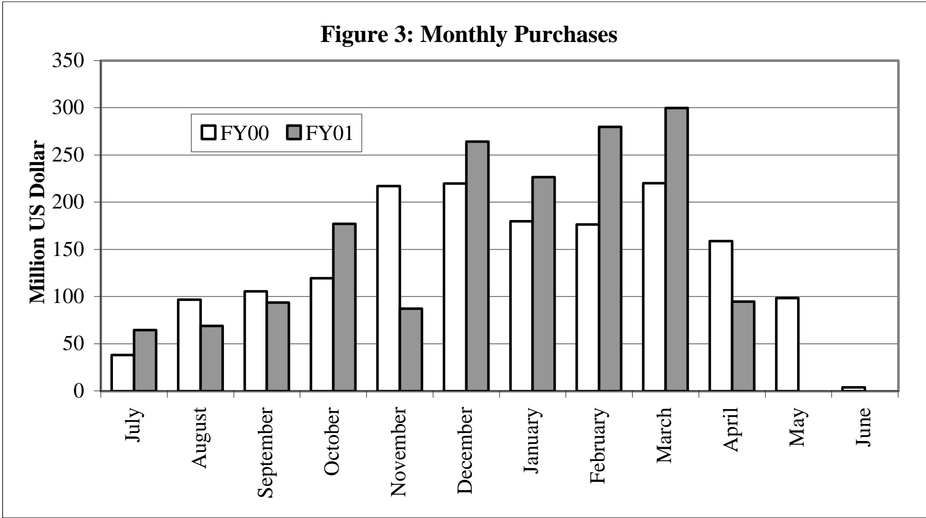
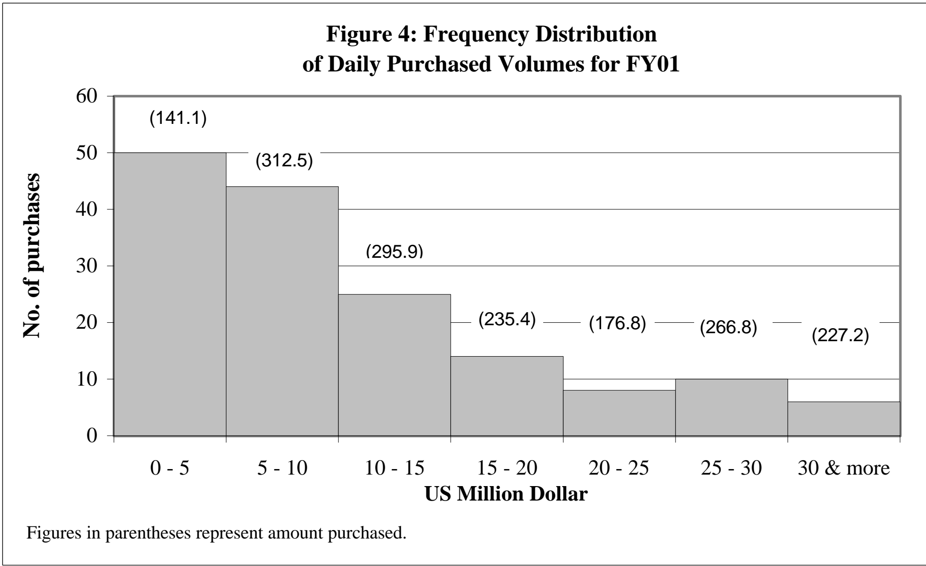


Figure 3 shows monthly purchases during the last two years. Purchases remain low during the first quarter of the fiscal year, but pick up sharply during October-March, mainly due to pressures on foreign exchange reserves from lumpy debt payments. However, one exception is November 2000, when purchases remained relatively low. This was due to the fact that the interbank market was fairly liquid during this month, which enabled SBP to buy hard currency from this market, instead of the kerb. Furthermore, inflows from the IMF were also expected during this month.

[66] The dip in forex reserves in January follows the maturity of short-term dollar placement with SBP.





Figures in parentheses represent amount purchased.

The frequency distribution of daily purchases this year is shown in **Figure 4**. As expected, SBP purchases of less than US$10 million per day, cover 60 percent of the number of purchase transactions, which enabled SBP to procure US$ 426.6 million. This clearly indicates that SBP is wary of putting pressure on the kerb market and generally buys smaller amounts on a regular basis. However, the average volume of purchases was very high during December to March, which was critical to ensure that liquid reserves increased (See **Figure 5**).

Although, SBP is the largest buyer in the kerb market, it pays more than the market rate. This is because SBP purchases are from dealers who have the ability to accumulate large forex balances. Such dealers must accumulate foreign exchange from various smaller suppliers, and pass on this cost to SBP. **Figure 6** shows the difference between the kerb selling rate as reported in newspapers and the rate at which SBP buys from the market; negative values indicate that SBP pays more than the market rate, whereas positive values indicate gains to the SBP. It is evident that the average difference is negative.

Daily purchases and the kerb premium

SBP purchases have implications not only for the kerb rate but also the floating interbank rate (FIBR), for two reasons: (1) these purchases are used to support the interbank market, and (2) there is a causal relationship between these two rates.[67] However, the impact of these forces is contradictory; on the one hand, purchases may place upward pressure on the kerb rate and increase the premium, while the causal link should cap movements in the premium. It is generally argued that in order to reduce the kerb premium, SBP should not only reduce its purchases from the kerb but also lessen support in the interbank market. However, this argument assumes a strong relationship between purchases and the kerb premium, and a regular pattern of SBP purchases and market support.

Figure 7 clearly shows that these relationships are at best tenure. The following observations can be made:

1. A weak one-sided relationship between kerb purchases and premium is visible during July to mid-September 2000; a fall in purchases reduces the premium in the 3rd week of July, but higher purchases in mid-August also

[67] For discussion on the direction of causation between the kerb and interbank rate, see **Special Section** in the previous *Quarterly Report* of SBP.

Figure 5: Average Volume Procured Per Day in FY01 (US Dollar Million)

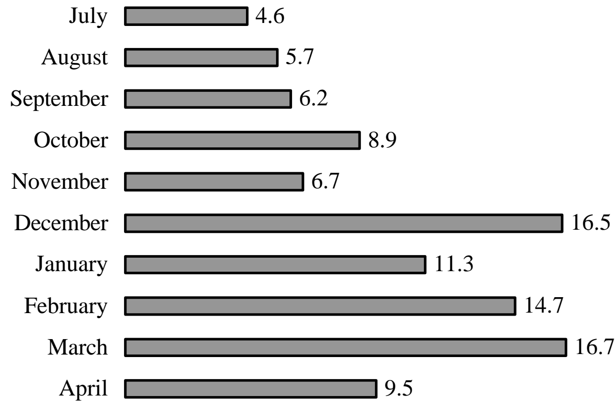


Figure 6: Kerb Selling Rate Less SBP Buying Rate from the Kerb

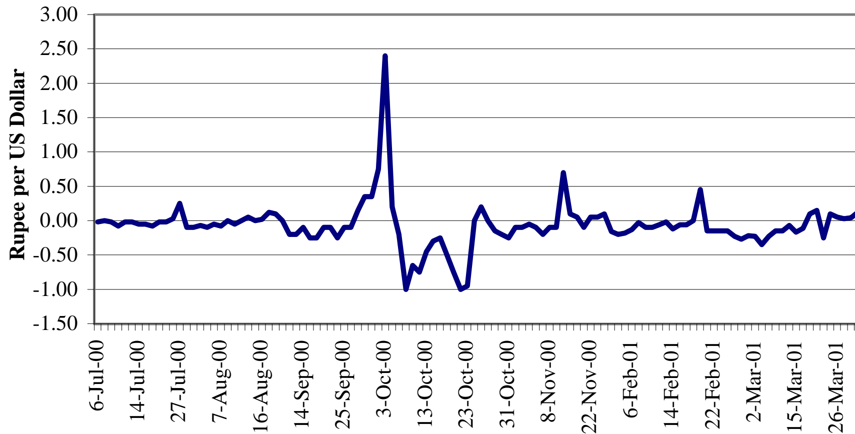
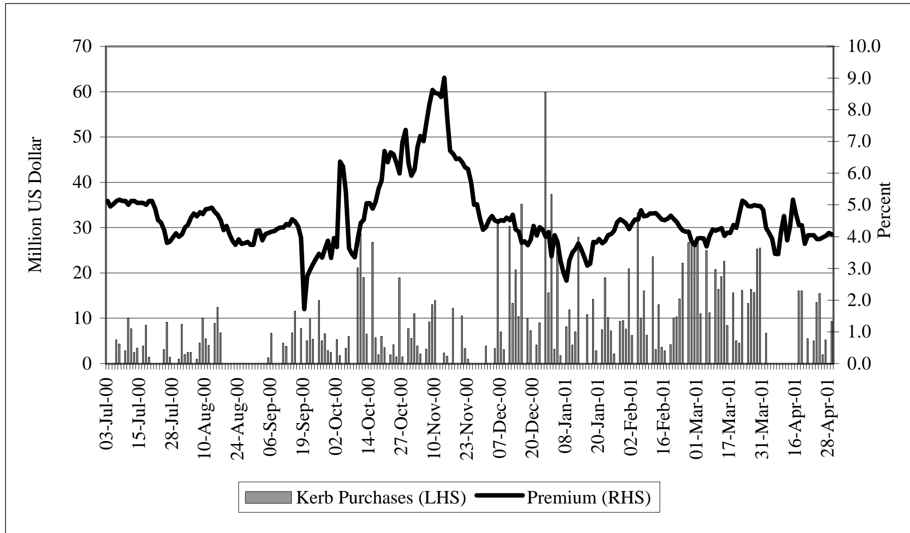
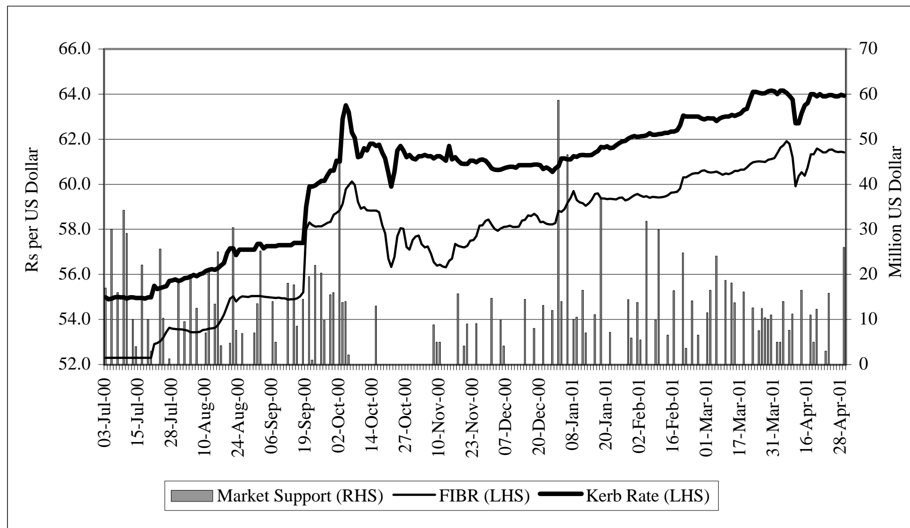


Figure 7: Kerb Purchases and Premium





reduces the premium. Furthermore, zero purchases do not seem to reduce the premium below the 4 percent benchmark. As a matter of fact, during the last week of August 2000, the premium was increasing despite nil purchases.[68]

2. On September 21st, FIBR moved sharply and increased by Rs 2.79 per US Dollar[69]; the kerb rate, on the other hand, moved by Rs 1.60 to Rs 59 per US Dollar. As a result, the premium almost touched 1.7 percent. While FIBR continued to depreciate and reached Rs 59.80 on October 6th, the kerb rate posted a much larger adjustment and touched Rs 63.50. Overcompensating the adjustment in FIBR, the kerb premium touched 6.2 percent on October 4th despite negligible purchases.
3. Although, SBP reduced its purchases in the 3rd week of October 2000, the premium continued to move up, reaching 9.0 percent on 14th November 2000. What is even more surprising is the fact that the interbank forex market was fairly liquid, which allowed FIBR to appreciate to Rs 56.09 despite SBP purchases from the interbank (especially in end-October and early November).[70] The kerb market considered this a temporary event and its rate remained sticky at around Rs 61.20 (see **Figure 7**).[71] As a result, the kerb premium went up despite a decline in purchases. After this, the kerb premium declined to 4.5 percent on account of the gradual depreciation of FIBR coupled with a *stubborn* kerb rate.
4. Despite heavy purchases from the kerb market during December to March 2001, the kerb premium was *remarkably* stable around 4 percent. This means that the kerb market was maintaining an almost fixed wedge over FIBR, irrespective of the volumes purchased.[72]

On the basis of this casual empirical evidence, it can be argued that there exists *no consistent* relationship between kerb purchases and the kerb premium during

[68] SBP was supporting the FIBR with net sales to the interbank market during this period.
[69] FIBR fell from Rs 55.21 per US Dollar to Rs 58 per US Dollar.
[70] This reduced the demand for kerb purchases.
[71] Note the adjustment in FIBR and the corresponding change in the kerb rate (see **Figure 7**).
[72] It may be noted that FIBR has been gradually creeping upward since December 2000 as SBP lessened its support to the interbank market.

FY01. This may be due to erratic demand by SBP or some stickiness in the kerb rate on account of market power of the large suppliers of foreign exchange in the kerb market. In terms of movement in FIBR, this analysis shows two very clear issues: (1) SBP support is obviously motivated by the need to stabilize the FIBR; and (2) the level of support has tapered significantly since the beginning of 2001.

An econometric analysis

The relationship between purchases and the premium was also examined using econometric approach. For this purpose, the following determinants of the kerb premium were identified:

1. Real effective exchange rate (REER) index: The participants in the interbank market generally follow purchasing power parity to determine the long-run path of the FIBR. Since the kerb rate follows changes in FIBR, kerb participants also implicitly pursue the purchasing power parity hypothesis.[73] After floating the Rupee in July 2000, the REER should be a relevant explanatory variable.

2. SBP purchases from the kerb market.

3. Changes in reserves: As discussed earlier, reserves management is the root cause for SBP purchases. It can be argued that substantial increase in reserves should lower demand for kerb purchases.[74]

4. IMF visits: Since large adjustments in the exchange rate (FIBR) are usually associated with IMF visits, such visits affect market expectations. In order to capture this, a dummy variable is used.

In effect, the following equation was estimated:

Kerb premium = f (REER, purchases, changes in reserves, IMF visit)

The above equation was estimated with OLS using daily data for the period July 1st 2000 to end-April. Estimation results are reported in **Table 2**.

Interpreting the results, REER is statistically significant with a positive coefficient. Using a more academic interpretation, an increase in REER (which reflects an *appreciation* of the Rupee in real terms or a misaligned exchange rate), leads to an increase in the kerb premium. However, an alternative

[73] See **Special Section** in the previous *Quarterly Report* of SBP.
[74] Changes in reserves have been adjusted for kerb purchases.

explanation, which is more relevant to Pakistan is as follows: an increase in REER due to an appreciation of the FIBR, leads to rise in the kerb premium as the kerb rate is sticky downwards.

Table 2: Estimation Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Constant	-23.77	3.75	-6.3	0.00
REER	0.32	0.042	7.6	0.00
Purchases (-1)	0.003	0.002	1.3	0.19
Changes in Reserves (-10)	-0.0007	0.0005	-1.2	0.22
IMF visit	0.39	0.19	2.1	0.04
AR(1)	0.93	0.02	38.7	0.00
R-squared	0.90	Adjusted R-squared		0.898
F-statistic	387.67	Prob (F-statistic)		0.000
Durbin-Watson stat	1.88			

Although, SBP purchases from the kerb market have the correct sign (intuitively), the insignificant impact (both in terms of the coefficient and its statistical significance) confirms our earlier finding that purchases do not affect the kerb rate. Similarly, reserve changes were also found to be insignificant. However, as expected, expectations formulated on the basis of IMF visits, had a significant impact on the kerb premium.

From this analysis, it would seem that SBP purchases do not have any significant impact on the kerb premium. This suggests that large suppliers in the kerb market are following FIBR with a wedge of around 4 percent, irrespective of the volume SBP purchases.

Appendix

Economic Policy Measures during January-March, 2001[75]

Agriculture

Tax exemption

- On 30th January 2001 Central Board of Revenue announced exemption from custom duty in excess of ten percent ad volarem on import of agriculture machinery and equipment not manufactured locally. This exemption would be available on machinery required for:
  1) Land development or reclamation of barren, deserted and hilly land for agriculture purpose,
  2) Modernization and development of irrigation facilities and water management
  3) All livestock farming and breeding activities.

Research and Development

- A US-based agro-chemical firm and a local sugarcane growers' association have jointly introduced a water conservation chemical, called 'Qemi Soyal' in Pakistan to help farmers to overcome the problem of water shortage. The chemical, cross-linked polymers, has the ability to ensure the sustained release of water to the plants when applied. Every gram of chemical has the capacity to retain half-a-liter of the irrigation water as it blankets the water in the form of a membrane, thus limiting the chances of its evaporation. One time application of the chemical can help ensure optimum use of irrigation water for about five years.
- Central Cotton Research Institute has evolved three colored varieties of cotton i.e. brown, green and off-white and its commercial production

[75] The policy measures have been classified according to development in various sectors keeping in view not only the apparent nature of the measure but also underlying objectives. However, reader may find some subjectivity in this categorization.

would start depending upon demand of the varieties in the domestic and international market.

- Pakistan Atomic Energy Commission (PAEC) has introduced radiation and radioisotopes techniques to increase agricultural production and extending the storage life of different food commodities thereby.
- Ministry of Food, Agriculture and Livestock, Pakistan and the International Atomic Energy Agency (IAEA) have agreed to co-operate on a plan envisaged to cultivate salt tolerant crops, trees and fodder grass on the 5,000 acres saline and waterlogged land in the country. This step will not only go a long way in converting the deserts into green lands but also have a far-reaching impact on the ecological environment of the country.

Industrial Sector

Tax Incentives:

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

- The Central Board of Revenue (CBR) on 18th January 2001, announced repayment of customs duty on the import of different types of raw materials used in the manufacturing of goods exported by Popular Industries, Sialkot.
- On 23rd January 2001, CBR withdrew the regulatory duty on the import of Medium Density Fibre Board below 4 mm thickness. Previously the government was charging 10 percent regulatory duty on its import.
- Through a notification issued by the CBR on 29th January 2001, the Federal Government offered exemption in duties to entire textile and leather industries on import of machinery, plant and equipment.
- On 2nd February 2001, the CBR allowed duty drawback facility to all vegetable ghee-manufacturing units in the country. The vegetable ghee producers can enjoy repayment of custom duty on the import of certain

raw materials. The extent of repayment of customs duty was fixed at Rs 9681.83 per tonne.

- The CBR, through a notification issued on 6th February 2001, exempted the shoe industry from the payment of custom duties and sales tax on the import of unit soles and heals for use in export footwear.
- The CBR through a circular issued on 9th February 2001, removed additional 1.5 percent sales tax on car sales through leasing business.
- The CBR, on 10th February 2001, exempted from sales tax the import of various types of hides, skins, finished leather; accessories and components to be used for export purpose. The exemption would be admissible with effect from November 24, 1996.
- On 12th March 2001, the CBR introduced concessionary duty tariff for the import of various types of steel bars and rods with immediate effect. Now the importers would pay 15 percent ad valorem custom duty on import of bars and rods of stainless steel instead of 25 percent custom duty and 15 percent regulatory duty.

Protection:

- To protect the domestic Industry from unfair competition, the President of Pakistan promulgated an Anti-Dumping Duties Ordinance on 2nd January 2001, which empowers the National Tariff Commission to impose anti-dumping measures on the products that are imported into Pakistan at a price "less than its normal value" or lower than that prevailing in an exporting country.
- To provide relief to domestic industry, the Economic Co-ordination Committee (ECC) of the Cabinet on 9th February 2001 decided to introduce regulatory duty on the import of electrical sheets.

Revival of Sick Units:

- The government has revived 9 additional sick industrial units through Corporate and Industrial Restructuring Corporation during Q3-FY01. Since June 2000, a total of 93 sick industrial units have been revived.

Fiscal Measures

- In January 2001, CBR initiated an audit of around 1000 companies, which are claiming more input tax. At the initial stage the senior auditors of the CBR will conduct audit of around 200 units involving the amount of Rs 3.5 billion.
- An Ordinance, banning the sale of industrial raw material to unregistered taxpayers, was promulgated on 7th February 2001.
- The government has decided to spend Rs 19.2 billion on poverty alleviation program in current fiscal year as compared to Rs 3.5 billion in FY00.
- On 3rd March 2001, CBR notified that withholding tax is not levied on the consumption of commercial and industrial gas consumers, therefore, it should not be included in the supply value of gas for the levy of sales tax.
- On 13th March 2001, CBR issued an SRO to exempt import of burned carpets for the purpose of re-export. The facility is subject to the condition that repaired carpets or finished product should be exported.
- CBR has replaced "No Duty No Drawback Rules, 1988" with "Duty and Tax Remission for Export Rules, 2001" with effect from 22nd March 2001. The revised rules exempt exporters from the payment of custom duties, sales tax, income tax and central excise duty on import of all type of raw materials using as input in export products.

Money and Credit Measures

Banking Regulation and Credit Measures

- On 13th February 2001, banks were allowed to install (Automatic Teller Machine) ATM or share this facility with other banks at places other than authorized one, without prior approval of SBP.
- With a view to supplement government's efforts in achieving growth and export targets, SBP on 15th February, 2001, put in place a system to ensure credit availability to Small Business Finance Corporation (SBFC)

for locally manufactured Auto/Air-jet /Shuttle less looms and accessories thereof. The new arrangement would enable the manufacturers to provide their machinery at a reduced rate to the small, medium and emerging enterprises, presently having limited access to bank credit primarily due to inadequate securities.

- On 26th March 2001, the SBP issued the following general guidelines with a view to provide adequate safety parameters for the growth of domestic credit card operations:

    i. The domestic credit card operations shall be deemed to be a part of bank's lending activity and as such shall be governed by the rules and regulations relating to the grant of loans and advances. Accordingly, banks shall monitor the credit card portfolio regularly and ensure to institute proper machinery for speedy recovery of dues and effective follow-up of unpaid dues.

    ii. Terms and conditions regarding the issue and use of the credit cards shall be properly documented in the form of a written contract between the bank and the credit card holders. These conditions must clearly highlight the cardholder's liabilities and obligations, eligibility conditions, fees, charges, service fee rate and their method of calculation etc. No charge shall be recoverable from the credit card holders other than agreed to as per the contract.

    iii. Banks shall provide the credit card holders with the statements of account at monthly intervals, unless there has been no transaction or no outstanding balance on the account since last statement.

    iv. Banks shall be liable for all transactions not authorized by the credit card holders after it has been properly served with a notice that the card has been lost/stolen. However, the bank's liability shall be limited to those amounts wrongly charged to the credit card holder's account.

    v. The banks engaged in domestic credit card business are required to furnish the SBP with a quarterly report on their domestic credit card operations within 15 days of the close of each quarter. The

banks shall also report to the SBP cases of frauds/forgeries in credit card operations as and when occurred.

- On 26th March 2001, the SBP made certain changes in the relevant regulation regarding limit on Banks' exposure against Unsecured Advances. According to these changes no bank would provide financing facility in any form of a sum exceeding Rs 100,000 and in case of credit cards Rs 500,000 to any one individual or person without obtaining realizable securities of the value not below the outstanding amount. Financing facilities granted without securities including those granted against personal guarantees would be deemed as 'clean' for the purpose of credit regulations. It was further provided that at the time of granting a clean facility, banks would obtain a written declaration to the effect that the borrower in his own name or in the name of his family members, had not availed of such facilities from other banks so as to exceed the prescribed limit of Rs 100,000 and in case of credit cards Rs 500,000 in aggregate;

    i. No clean facility would be granted to frustrate the objective of credit restrictions in force for the time being; and

    ii. The purpose for which a clean facility was sanctioned would be expressly stated in the sanction letter.

For the purpose of this regulation the following would be excluded/exempted from the per party limit of Rs 100,000 or clean facilities.

i. Facilities provided to finance the export of commodities eligible under Export Finance Scheme,

ii. Financing covered by the Export Credit Guarantee Insurance Scheme,

iii. Loans/advances given to the employees of a bank in accordance with their entitlement and Loans/advances exempted by the SBP from time to time. The aggregate exposure of a bank against all its clean facilities would not, at any point of time, exceed the amount of the bank's Capital and General Reserves. Failure to comply with the above instructions would render the bank and official

concerned liable for fines under Banking Companies Ordinance, 1962.

- In order to standardize information regarding credit processing, it was decided that effective from 1st April 2001 no financing facility (whether fund based or non-fund based including renewal and enhancement) would be provided by any bank/NBFI unless the Loan Application Form (LAF) was accompanied by a Borrower Basic Fact Sheet prescribed by the SBP.
- The requirement to obtain prior permission of SBP for opening a new branch has been abolished with effect from 1st April 2001. The banks have been provided an opportunity to take a medium term view of their branch expansion plan based on their own business needs.

Export Finance

- The maximum rate of finance to be charged by the banks from their borrowers are as under

  I. Export Finance Scheme for all eligible commodities (except bleached/unbleached cloth) and Export Sales Part-B of LMM Scheme

Effective from	Rate of finance	Rate of refinance
17th January, 2001	9 percent	7 percent
1st April 2001	10.5 percent	9 percent

  II. Bleached /unbleached

Effective from	Rate of finance	Rate of refinance
17th January, 2001	11 percent	9 percent
1st April 2001	12.5 percent	11 percent

- A new Foreign Currency Export Finance (FCEF) facility was announced by the SBP on 28th March 2001 under Asian Development Bank loan. This facility was aimed at providing support to domestic manufacturers

requiring foreign inputs for exportable goods and increase access to export financing by small and medium size exporters and contribute towards export growth. Effective from 1st April, 2001, market based export finance was made available to Small and Medium sized Direct Exporters (DE) and also their suppliers i.e. Indirect Exporters (IDE) for inputs linked to an export order up to a maximum of US$ 0.5 million per export order. The facility will run parallel to the existing Export Finance Scheme (EFS) of the SBP as an additional and alternate facility. The SBP will make the facility available to participating banks through a special dollar window at mark-up rates notified from time to time. But since the facility is self-liquidating the markup would not apply on the borrowers; they would simply use the facility both on pre and post-shipment basis to finance inputs for exports. The scheme would be effective as from 2nd April 2001. On April 21, 2001 the SBP announced markup rate of 5 percent p.a. on pre-shipment and post shipment financing, 7.15 percent p.a. on post shipment financing where post shipment insurance cover has been obtained by the exporter and 5.65 percent p.a. rate of markup for refinance to be charged by SBP from the Banks under the Foreign Currency Export Finance (FCEF) facility. These markup rates shall remain applicable until new rates are notified.

Changes in Prudential Regulations

- A minimum paid up capital of Rs.500 million was fixed for investment bank whereas for housing finance companies and discount houses, this requirement was set at Rs.300 million. Any institution short of the required capital on 31st January 2001 would meet 50 percent of the shortfall latest by 1st January 2002 and the remaining 50 percent by 1st January 2003.
- To safeguard the interest of depositors and promote healthy banking culture SBP made the following major changes in the relevant prudential regulation with effect from 17th March 2001:
    i. All terms and conditions of operation of an account shall be duly made known to the opener of the account at the time of opening of the account.

ii. All account opening forms shall be filled in by the account holder in duplicate, one copy of which shall be returned to the account holder duly verified by the authorized officials of the branch under proper acknowledgement.

iii. Terms and conditions of maintaining an investment account or other deposits for fixed periods shall be alterable only with the written consent of the depositor. In case the depositor does not consent to the proposed alterations, the bank shall have the right to close the account after giving 7-days notice to the depositor.

iv. Non-remunerative deposit accounts and accounts opened on profit & loss-sharing basis shall not be subject to the levy of any service charges in any form what so ever.

v. All sums maintained by the depositors on PLS basis, even if such balances have at any point of time fallen below the prescribed minimum, should be remunerated as per the rates declared by the banks. The banks can realize the penalty for violating prescribed minimum balance provided the depositor is duly notified and the condition is disclosed at the time of the opening of the account.

- In order to further liberalize foreign exchange regime banks/NBFIs were allowed to freely utilize Foreign Currency Deposits mobilized by them under F.E. 25 for lending/investment /placement in Pakistan and/or abroad with effect from 2nd April 2001. Such deposits if maintained abroad would not count towards banks' Nostro Limits. Every bank / NBFI would be required to maintain cash reserves in US$ equivalent to not less than 25% of their total deposits on daily basis with SBP (5% Cash Reserve and 20% Special Cash Reserve). The cash reserve account would be non-remunerative while SBP would remunerate special cash reserve account on daily product basis on rates notified by it at end of each month. For the purpose of determining of reserve requirements, all deposits mobilized under FE 25 in foreign currencies other than US Dollar, would be converted in US Dollar at the closing rates of exchange prevailing on the first day of each month of the respective banks/NBFIs. For any subsequent deposits, the prevailing exchange rates on the date of such deposits would apply.

Other

- On 5th January 2001 banks/NBFIs intending to initiate any action in respect of imprudent loans, defaulted loans or re-scheduled loans were directed to take approval from SBP for filing a formal reference to NAB or otherwise.

External Sector

Trade Policy

- Ministry of Commerce announced the Textile Quota Management Policy for the period 1st January 2001 to 31st December 2004. The policy envisaged transparent procedures for management and allocation of quotas and their auction.
- The Federal Government on 11th January 2001 has banned the import of 'any edible product not fit for human consumption' through an amendment in the Import Trade and Procedures Order, 2000.
- On 25th January 2001 Central Board of Revenue (CBR) exempted the finished leather from the payment of custom duty.
- The CBR on 3rd February 2001 allowed the duty drawback facility to the manufacturers of knitted blankets exported by woolen mills. The extent of repayment of custom duty ranges from 7.47 - 8.38 percent of the f.o.b. value depending on the types of manufactured product.
- On 10th February 2001, the Federal Government exempted the machinery, equipments and materials, either for exclusive use within the limits of Export Processing Zone or for making exports there from, and goods imported for warehousing purpose in Export Processing Zone from payment of sales tax.
- The CBR on 10th February 2001 allowed duty drawback facility to the manufacturers of double knit sweaters and cardigans exported by knitting mills. The extent of repayment of custom duty ranges from 5.93 - 7.92 percent of the f.o.b. value depending on the types of manufactured product.

- The Federal Government on 16th February 2001 increased tin plate import duty from 35 percent to 100 percent to protect domestic producers. The new regulatory duty (import duty) on tin plates has been fixed on value of import (value quoted in London Metal Exchange) plus one hundred dollar per ton that comes to 100 percent. In addition, a 15 per cent sales tax is also being charged on import of tin plates.
- On 23rd February 2001 the Federal Government extended the period up to 5th March 2001 for which goods may remain in the warehouse. The government also decided to remit penal surcharge in the case of goods removed from the warehouse within the period from 26th February 2001 to the 5th March 2001.
- The ECC of the Cabinet on 12th March 2001 banned the import of sugar from India to discourage dumping of inferior quality sugar in the country and to give protection to local industry.
- Following a clarification received from the CBR, the Collectorate of Customs (Export) has restored the rebate rate of 7.7 percent on knitted garments with immediate effect. All knitted garment consignments accepted at the lower rate (4.8 percent) of rebate are to be treated at the higher rate.
- The ECC on 29th March 2001 approved simplified procedure for export of six items to Afghanistan and through Afghanistan to Central Asian Republics via land route. The Pakistan Embassy/Consulates in Kabul, Kandahar and Jalalabad would verify arrival of export consignments from Pakistan and packages/retail packing would be clearly marked with the expression "for export only".
- On 29th March 2001 an Export Facilitation Center (EFC) has been set up at Air Freight Unit (AFU) at the Quaid-e-Azam International Airport for expeditious processing of bills of export. The center, set up through joint efforts of the Collectorate of Customs (Export) and Pakistan Revenue Automation Ltd (PRAL), has provided courier companies direct link to the Customs computer system for electronic preparation and submission of bills of exports pertaining to samples, gifts and export documents.

- The Ministry of Commerce has allowed the export of rice on consignment basis in addition to exports against Letter of Credit. The importers would be able to import Pakistani rice without opening LCs and may pay in foreign exchange after receiving the consignment.

Measures relating to Authorized Money Changers

- On 2nd January 2001, SBP revised terms and conditions for grant of Authorized Money Changer's License. Accordingly, AMCs license shall be granted only to Pakistan nationals and resident Pakistani firms companies on payment of prescribed application processing fee. Further, a minimum net worth/capital of Rs 5 million is required for applicants wishing to establish more than one branch whereas in case of a single office this condition is Rs. 2 million. An existing money changer having a valid license were required to fulfill this requirement by 31st December, 2001. An applicant for more than one branches should be a tax payer of at least Rs 70,000/- p.a. and for single branch license Rs 25,000/- p.a. Tax and bank loan defaulters will not be eligible for grant of license.
- SBP also revised the code of conduct for Authorized Money Changers (AMC). Activities of money changer were restricted to purchase/sale of foreign currency notes/coins only. However, there will be no restriction on bringing in foreign currency through banking channels from outside the country. All dealings between AMCs and Customers were to be supported by receipts. They were not entitled to make any purchases of foreign currency notes/coins from any Authorized Dealer against payment in rupees. They were to maintain proper books of account and provide all data, information, books of accounts and other record relating to their business to SBP. SBP has powers to visit the premises, inspect the records, books of accounts of the AMCs. SBP may withdraw the license granted to any authorized money changer upon violation of certain restrictions.
- Standing permission for outflow of foreign currencies other than US Dollar to the Forex Association for the purpose of exchanging the same into US Dollars was withdrawn with effect from 18th April 2001. Outflow/inflow of foreign currencies by the money changers will now be

conducted through NBP. Later, NBP was allowed to transfer 25 percent of dollars purchased through the sale of foreign currency notes to the money changers.

Other

- Business Travel Exchange Quota was enhanced to US$ 300 per day subject to a maximum of US$ 9,000 with effect from 9th May 2001. Previously, business visits are allowed exchange facility at the rate of US$ 200/- per day subject to a maximum of US$ 6,000/- per person.
- On 18th April 2001 SBP authorized all bank branches throughout the country to purchase or encash foreign currency notes, coins, travellers' cheques and foreign demand drafts, presented by the public. Earlier, only bank branches holding Authorized Dealer's license were allowed to undertake such transactions. The step has been taken to liberalize dealings in foreign currency in the country.

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	2,928	10.73	624
Sugarcane	1,010	46,333	45,883	1,000	51,647	51,647	961	43,721	45,505
Rice	2,515	5,156	2,050	2,411	5,102	2,116	2,377	4,802	2,021
Maize	894	1,351	1,512	900	1,501	1,668	899	1,430	1,591
Mung	203	95	468	200	100	500	223	107	479
Mash	43	24	547	66	33	526	46	26	559
Chilies	87	116	1,330	87	146	1,684	93	162	1,742
Wheat	8,443	21,094	2,498	8,430	20,000	2,372	8,198	18,750	2,287
Gram	972	565	581	1,086	716	659	963	493	512
Potato	111	1,868	16,909	113	1,950	17,257	89	1,531	17,187
Onion	110	1,648	15,100	99	1,430	14,444	111	1,685	15,219

Area = 000 Hectares

Production = 000 Tonnes

Yield = Kgs /Hectares

Sources: i) Ministry of Food, Agri. & Livestocks (Economic wing)
ii) Federal Committee on Agriculture.

Note: Figures of cotton production are in million bales (1bale=170.09 Kilograms).

Table 2: Production of Selected Large-scale Manufacturing Items
July-March

Items	Weights	Percentage Change			Items	Weights	Percentage Change		
		FY99	FY00	FY01			FY99	FY00	FY01
Textile	**19.069**	**0.21**	**13.50**	**4.63**	**Electronics**	**2.976**	**38.48**	**18.74**	**10.73**
Cotton Yarn	8.85	-0.63	9.10	2.95	Elec Transformers	0.577	90.97	-12.84	-27.62
Cotton Cloth	4.881	7.56	15.39	12.02	Storage Batteries	0.451	12.06	3.14	4.43
Cotton Ginned	3.893	-4.20	27.75	-3.89	T.V Sets	0.363	25.14	8.44	-20.01
Other Five Items	1.445	-7.67	-4.30	12.90	Airconditioners	0.12	-42.89	82.81	462.05
Food, Beverages & Tobacco	**17.336**	**3.47**	**-17.11**	**10.00**	Refrigrators	0.015	17.95	8.43	30.78
Sugar	8.630	-1.51	-24.08	6.43	Other Six Items	1.45	36.09	33.55	-1.92
Vegetable Ghee	3.004	12.41	-14.53	18.66	**Automobile**	**2.413**	**-5.81**	**5.58**	**7.82**
Cigarettes	2.505	6.87	-15.42	27.58	Trucks	0.698	-48.46	-6.36	-2.97
Tea Blended	1.785	-3.10	-7.52	-13.73	Tractors	0.593	-0.93	55.79	-18.73
Beverages	0.964	27.54	10.01	11.30	LCVs	0.369	-19.31	-43.25	43.97
Cooking Oil	0.448	-5.40	-5.93	14.17	Cars & Jeeps	0.309	10.98	-23.54	26.73
Petroleum Products	**7.824**	**3.88**	**-0.22**	**16.62**	Motor Cycles	0.249	-3.45	-3.71	36.78
Fertilizer	**5.871**	**4.31**	**14.66**	**14.59**	Buses	0.13	198.53	52.52	-14.88
Nitrogenous	5.441	4.81	7.83	5.79	Diesel Engines	0.065	-13.18	33.04	5.37
Phosphatic	0.430	-2.13	101.13	125.91	**Chemicals**	**2.335**	**4.92**	**12.53**	**17.29**
Pharmaceuticals	**5.798**	**11.12**	**4.44**	**1.24**	Caustic soda	0.621	5.64	18.22	3.03
Tablets	2.705	18.18	0.74	-2.77	Soda Ash	0.32	4.77	1.93	-13.07
Syrup	1.602	12.85	6.54	4.51	Other Six Items	1.394	4.63	12.43	30.61
Injections	0.466	-4.96	-2.69	5.20	**Non Metallic Minerals**	**1.915**	**-1.60**	**3.20**	**0.92**
Capsules	0.228	20.40	2.37	-4.55	Cement	1.846	-1.94	3.48	1.40
Other Five Items	0.471	-9.57	17.58	7.65	Glass Sheets	0.069	7.50	-4.47	-11.96
Metal Industries	**3.303**	**-7.05**	**10.18**	**6.70**	**Paper & Board**	**1.359**	**0.36**	**20.27**	**24.90**
Pig Iron	1.477	-1.27	11.00	-1.09	**Engineering Items**	**0.691**	**17.15**	**2.15**	**4.22**
Coke	1.319	-9.71	8.71	11.72	Bicycles	0.348	12.37	3.19	12.15
Billets	0.311	-23.87	19.56	18.73	Metal Containers	0.153	16.86	-0.13	6.71
Razor Blades	0.109	-5.67	-15.32	31.98	Sewing machines	0.052	-17.11	-13.33	-4.05
H.R Coils & Sheets	0.088	-6.56	18.85	-11.50	Power Looms	0.051	61.63	-65.02	-53.75
C.R Coils & Sheets	0.013	-4.80	6.45	-14.02	Other Five Items	0.087	31.20	50.65	7.05
Leather Products	**2.333**	**-7.80**	**6.72**	**5.75**	**Rubber Products**	**0.452**	**2.46**	**2.52**	**1.11**

Source: Federal Bureau of Statistics

Table 3: Federal Tax Collections During (July-March)

(Rs billion)

Head	Targets For		Tax Collection in Q3			Target Achieved as % of		Percentage Change over FY00
	FY01	Q1-Q3	FY99	FY00	FY01	FY01	Q1-Q3	
Direct Taxes	133.90	85.94	68.78	74.37	86.88	64.88	101.09	16.83
Indirect Taxes	283.30	195.42	134.99	166.52	189.80	66.99	97.12	13.98
Sales Tax	166.20	111.83	47.25	80.69	108.35	65.19	96.89	34.27
Central Excise	52.50	36.88	42.48	39.54	35.19	67.02	95.41	-11.02
Customs	64.60	46.71	45.27	46.28	46.26	71.61	99.04	-0.04
Total	417.20	281.36	203.77	240.88	276.67	66.32	98.33	14.86

Table 4: Summary of Consolidated Federal and Provincial Budgets

(Rs billion)

Head	FY01			1H-FY01	
	Budget Target	IMF Target[1]	IMF-Target[3]	IMF Target[2]	IMF Actual[1]
Total Revenue	608.5	585.2	570.4	256.3	251.9
Tax Revenue	497.8	487.7	471.4	218.9	204.8
of which					
CBR Revenue	435.7	430.2	417.3	189.9	182.4
Surcharges	38.0	33.0	31.6	16.3	13.1
Non-Tax Revenue	110.7	97.5	99.0	37.4	47.1
Total Expenditure	770.7	770.9	756.1	360.2	329.8
Current Expenditure	658.5	663.7	659.5	310.2	303.1
of which					
Interest	249.1	239.0	237.0	113.9	105.2
Defense	133.5	157.5	157.5	66.4	70.7
Dev. Exp. & Net Lending	112.2	107.2	96.6	50.0	26.7
Budget Balance	-162.2	-185.7	-185.7	-103.9	-77.9
Financing	162.1	185.6	185.7	103.9	77.9
External	90.9	130.9	122.0	71.5	43.6
Internal	71.2	54.7	63.7	32.4	34.3
Bank	-2.3	-16.9	-14.4	6.5	-9.4
Non-Bank	73.4	71.6	78.1	25.9	43.7

1= Provisional; 2= Original program target; 3=Revised

Table 5: Budgetary Financing in 1H-FY01

(Rs billion)

Heads	1H-FY01	
	Target	**Actual***
Total Financing (I+II)	103.8	78.3
I) External (net) (a-b)	71.6	43.0
a) Disbursements	115.7	86.3
Project Aid	19.9	20.2
Commodity aid (non food)	22.2	8.4
Food aid	0.0	0.0
Other loans (IDB)	18.5	12.0
FEBC, US$BCs and FCBCs	-1.1	1.6
Saudi Oil Facility	23.7	22.7
S. Debt Repayment a/c	32.5	21.3
b) Repayments	44.1	43.3
Long Term Loans	--	39.2
Short Term Loans	--	4.0
II) Domestic	32.3	35.3
Bank Borrowing	--	-9.4
Non Bank	--	44.7
of which		
Prize Bonds	--	3.1
Pakistan Investment Bonds	--	14.2
National Saving Schemes	--	9.3

*The numbers do not match with the previous numbers because of revisions to data. These numbers are as of 24th March 2001, and are available on MOF's website.

Table 6: Monetary Survey (Cumulative Flows)

(Rs million)

Description	Credit Plan FY01	Q3-FY99	Q3-FY00	Q3-FY01
I. Government Sector Borrowing (net) (A+B+C+D)	-2,200	-62,868	3,289	-26,173
Gross budgetary borrowing	29,800	15,353	72,773	40,820
Special account (debt repayment)	-32,000	-60,664	-48,708	-27,781
A) Net budgetary borrowing	-2,200	-45,311	24,065	13,039
i) From State Bank of Pakistan		29,388	94,675	-803
ii) From Scheduled Banks		-74,699	-70,610	13,842
B) Commodity operations (commercial banks)		-14,447	-17,887	-37,119
C) zakat funds/privatization proceeds etc.		-3,332	-2,529	-2,453
D) Others (Credit to NHA & CAA by commercial banks)		222	-360	360
II. Non-government Sector (A+B)	89,200	79,639	24,864	76,809
A) WAPDA, KESC, OGDC, PTC, SSGC, SNGPL & PR	4,000	3,039	-11,525	-14,231
B) Net credit to private sector & PSEs	85,200	76,600	36,389	91,040
a) Commercial banks	94,400	57,318	37,555	92,575
i) Public corporations other than II(A)		1,866	7,330	11,329
ii) Private sector		55,452	30,225	81,246
(export finance)	(25,000)	(16,503)	(1,740)	(4,825)
b) Specialized Banks	2,400	9,645	3,797	1,829
c) Other financial Institutions	3,000	9,637	377	-237
d) PSEs special account with SBP (debt repayment)	-14,600	0	-5,340	-3,127
III. Other items (net)	0	-4,988	1,115	-6,074
IV. Net domestic assets (I+II+III)	87,000	11,783	29,268	44,562
V. Foreign assets of the banking system (net)	60,000	30,292	11,219	21,565
i) State Bank of Pakistan		17,452	-11,655	571
ii) Scheduled Banks		12,840	22,874	20,994
VI. Monetary assets (IV+V)	147,000	42,075	40,487	66,127

Table 7: Private Sector Credit (Cumulative Flows)

(Rs million)

	Q3-FY99	Q3-FY00	Q3-FY01
Manufacturing	26,556	20,916	45,803
a) Locally manufactured machinery (LMM)	-86	76	-792
b) Manufacturing	26,642	20,840	46,595
i) For fixed investment	11,270	1,939	6,396
ii) For working capital	15,372	18,901	40,199
Automobile	2,570	-1,667	202
Cement	1,272	1,205	944
Fertilizer	2,853	-652	-651
Sugar	-1,109	585	5,818
Textiles	5,274	8,856	24,619
Others	4,512	10,574	9,268

Table 8: Disbursement of agricultural credit (July-March)

(Rs million)

Name	FY00			FY01		
	Production	Development	Total	Production	Development	Total
ABL	658.9	0.1	659	690.3	84.8	775.1
HBL	2,069.80	439.2	2,509.10	1,967.90	348.2	2,316.10
MCB	468.7	5	473.7	801.9	206.1	1,008.00
NBP	2,276.60	116.1	2,392.70	2,593.30	125.4	2,718.60
UBL	173.2	2	175.2	224.1	6.8	230.9
Sub-Total	5,647.20	562.4	6,209.60	6,277.50	771.2	7,048.80
ADBP	12,199.20	5,850.90	18,050.20	13,306.80	5,551.90	18,858.70
FBC	3,632.00	20.8	3,652.80	3,152.80	41.2	3,194.00
Total	21,478.50	6,434.10	27,912.60	22,737.10	6,364.30	29,101.40

Table 9: Components of M2 - Stocks

(Rs million)

End Period	CC	DD	TD	ODwSBP	RFCD	M2
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
Jan-01	387,177	353,872	577,842	7,186	128,039	1,454,116
Feb-01	386,898	351,834	580,089	9,993	132,425	1,461,240
Mar-01	385,907	347,380	587,844	8,283	137,345	1,466,759

Table 10a: Discounting

(Rs million)

Month	No. of Visits to Repo Window			Amount			Average/visit		
	FY01	FY00	FY99	FY01	FY00	FY99	FY01	FY00	FY99
January	19	10	23	309,448	106,860	152,398	16,287	10,686	6,626
February	8	4	9	16,186	12,656	18,351	2,023	3,164	2,039
March	9	14	5	33,853	42,616	37,400	3,761	3,044	7,480
Quarterly	36	28	37	359,487	162,132	208,149	9,986	5,790	5,626

Table 10b: OMOs (month-wise)

(Rs million)

Month	Absorption			Injections		
	FY01	FY00	FY99	FY01	FY00	FY99
January	-	-	-	13,550	35,610	-
February	27,850	3,400	23,975	-	27,600	-
March	22,400	-	-	-	1,800	-
Total	50,250	3,400	23,975	13,550	65,010	-

Table 10c: OMOs (date-wise)

(Rs million)

Date	Sale		Purchase	
	Amount Offered	Amount Accepted	Amount Bid	Amount Injected
4-Jan-01	-	-	38,578	13,550
18-Jan-01	8,200	-	10,300	-
1-Feb-01	26,150	12,350	-	-
15-Feb-01	19,050	15,500	400	-
1-Mar-01	19,450	10,400	-	-
15-Mar-01	7,500	5,500	-	-
29-Mar-01	12,200	6,500		
	92,550	50,250	49,278	13,550

Table 10d: PIB Auctions - Summary of Results

(Rs million)

Auction	Tenor	Coupon rate	Amount offered	Range of Price offered /Rs.100	Amount accepted	W. A. % p.a.	Amount Accepted (In percent)
3rd Qtr	3 Years	12.50%	1,308.5	100.00-100.35	1,205.5	12.4270%	7.79%
	5 Years	13.00%	953.4	100.00-100.30	451.6	12.9457%	2.91%
	10 Years	14.00%	15,575.1	100.00-100.36	13,845.5	13.9551%	89.29%
Total	-	-	17,837.0	-	15,502.6	-	100%

Table 11: Inflation Trend

(in percent)

Indices	Cumulative January to March		Cumulative July to March		Annualized Inflation									
					Month to Month Basis		Quarter to Quarter Basis		Half Year to Half Year Basis		3Q to 3Q Basis		12-Month Moving Average Basis*	
	2000	2001	2000	2001	Mar-00	Mar-01	Q-3 00	Q-3 01	1H-00	1H-01	Mar-00	Mar-01	Mar-00	Mar-01
CPI	1.06	0.23	3.5	2.6	3.6	4.2	3.3	4.5	3.4	4.7	3.4	4.8	3.6	4.7
WPI	3.50	-1.37	2.2	4.1	1.9	5.4	0.5	7.5	0.7	8.0	1.4	6.7	2.2	5.7
SPI	0.31	-0.13	0.0	2.2	0.9	5.6	0.6	5.9	0.8	6.0	1.6	5.4	2.4	4.7

Table 11.a: Inflation in Different Groups of CPI Basket

(in percent)

Groups/Sub-groups	January - March	
	FY00	FY01
i. Food Group	**1.3**	**0.2**
Food, Beverages & Tobacco	1.3	0.2
ii. Non-Food Group	**0.8**	**0.3**
Apparel, Textile & Footwear	0.8	0.3
House Rent	1.0	0.6
Fuel & Lighting	0.6	0.1
Household Furniture & Equipment	0.3	0.9
Transport & Communication	1.6	-0.3
Recreation, Entertainment & Education	1.0	0.0
Cleaning, Laundry & Personal Appearance	0.7	0.5
Medicines	0.2	0.2
Overall	**1.06**	**0.23**

Table 11.b: Inflation in Different Groups of WPI Basket

(in percent)

Groups	January - March	
	FY00	FY01
i. Food Group	**1.7**	**-0.1**
Food	1.7	-0.1
ii. Non-Food Group	**5.1**	**-2.4**
Raw Materials	17.3	-2.8
Fuel, Lighting & Lubricants	4.2	-5.2
Manufactures	2.5	0.4
Building Materials	0.1	-1.7
Overall	**-2.0**	**-1.4**

Table 12: Balance of Payments (July-March)

(US$ million)

Items	FY99	FY00	FY01	Δ Q3-FY01/Q3-FY00	
				Absolute	Percent
1. Trade Balance	**-1517**	**-1460**	**-1109**	**351**	**-24.0**
Exports(fob)	5579	5770	6572	802	13.9
Imports (fob)	7096	7230	7681	451	6.2
2. Services (Net)	**-1930**	**-2124**	**-2439**	**-315**	**14.8**
Shipment	-598	-570	-615	-45	7.9
Other transportation	83	32	59	27	84.4
Travel	-109	-115	-139	-24	20.9
Investment Income	-1347	-1529	-1716	-187	12.2
interest payments on public debt	-1046	-1224	-1251	-27	2.2
Profit and Dividend	-301	-305	-465	-160	52.5
Other goods, services,& Income	41	58	-28	-86	-148.3
3. Current Transfers (Net)	**1764**	**2551**	**2973**	**422**	**16.5**
a) Private Transfers -net	1635	2441	2876	435	17.8
i) Workers' Remittances	807	731	855	124	17.0
ii) FCA (Residents)	349	246	360	114	46.3
iii) Outright Purchases	378	1372	1562	190	13.8
b) Official Transfers	129	110	97	-13	-11.8
4. Current Account Balance (1+2+3)	**-1683**	**-1033**	**-575**	**458**	**-44.3**
5. Financing	**1683**	**1033**	**575**	**-458**	**-44.3**
I. Capital Account(net)	**-1600**	**-2390**	**-568**	**1822**	**-76.2**
a) Foreign Investment	335	81	63	-18	-22.2
i) Direct investment in Abroad (Net)	-33	1	-39	-40	
ii) Direct investment in Pakistan(Net)	368	362	234	-128	-35.4
iii) Portfolio investment in Pakistan(Net)	0	-282	-132	150	-53.2
of which: stock markets	-36	32	-128	-160	-500.0
b) Foreign long-term loans/credit (Net)	396	-273	-278	-5	1.8
i) Disbursements	2249	1734	1496	-238	-13.7
Project Aid	1115	807	578	-229	-28.4
Food Aid	193	191	0	-191	
Non Food	819	585	751	166	28.4
Others	122	151	167	16	10.6
ii) Amortization	1853	2007	1774	-233	-11.6
Official	1488	1510	1389	-121	-8.0
Others	365	497	385	-112	-22.5
c) Official Assistance (Net)	-492	-304	229	533	-175.3
d) FCA (Non-residents)	-1796	-1551	-89	1462	-94.3
e) Others	-43	-343	-493	-150	43.7
II. Changes in Reserves (-Inc/+Dec)	**-817**	**23**	**-57**	**-80**	**-347.8**
Assets	-1273	225	-181	-406	-180.4
SDRs	2	0	-134	-134	
Forex (State Bank of Pakistan)	-955	227	50	-177	-78.0
Forex (Commercial Banks)	-320	-2	-97	-95	4750.0
Liabilities	456	-202	124	326	-161.4
Use of Fund Credit	456	-202	124	326	-161.4
Purchases/drawings	575	0	324	324	
Repurchases	-119	-202	-200	2	-1.0
III. Errors & Omissions	**834**	**449**	**554**	**105**	**23.4**
IV. Exceptional financing	**3266**	**2952**	**646**	**-2306**	**-78.1**
SBP reserves	1838	1513	1436	-77	-5.1
SBP reserves (excluding FE 25)	1838	1186	891	-295	-24.9

Table 13: Region-Wise Worker's Remittances

(US$ million)

Countries	July-March			D Q3-FY01/Q3-FY00	
	FY99	FY00	FY01	Absolute	Percentage
Gulf Region:	**473.6**	**508.4**	**559.6**	**51.2**	**10.1**
Bahrain	21.6	22.6	18.2	-4.4	-19.5
Kuwait	62.2	86.3	113.6	27.3	31.6
Qatar	9.5	10.6	10.6	-0.1	-0.5
Saudi Arabia	245.1	236.0	230.9	-5.1	-2.2
Sultanate-e-Oman	33.3	36.1	28.8	-7.3	-20.1
U.A.E.	101.9	116.7	157.4	40.7	34.9
Other than Gulf Region:	**180.4**	**169.7**	**244.3**	**74.6**	**44.0**
Canada	2.4	3.0	3.5	0.5	16.3
Germany	8.8	8.3	7.2	-1.1	-13.2
Japan	2.9	1.1	2.8	1.6	142.1
Norway	3.9	4.3	4.6	0.4	8.4
U.K.	55.8	52.7	63.2	10.5	19.9
U.S.A.	63.0	56.9	95.3	38.4	67.5
Others	43.7	43.4	67.8	24.4	56.1
TOTAL	**654.0**	**678.1**	**803.9**	**125.8**	**18.6**
Encashment FEBCs & FCBCs	151.0	53.5	50.7	-2.8	-5.3
Total (incl. FEBC & FCBCs)	805.0	731.6	854.6	123.0	16.8

* Total number includes encashment of FEBCs & FCBCs

Table 14: Major Exports

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

Commodities	Unit	Q3-FY01		Q3-FY00		Abs. Δ	% Δ in Q3-FY01/Q3-FY00		
		Val.	Unit Val.	Val.	Unit Val.	in Val.	Qty.	Val.	Unit Val.
A. Primary Commodities		**914.3**		**805.4**		**108.8**	---	**13.5**	---
1 Rice	MT	400.6	209.2	410.6	280.7	-10.0	30.9	-2.4	-25.5
2 Leather	SM	155.8	13.1	119.0	13.7	36.7	37.0	30.9	-4.5
3 Raw Cotton	MT	127.0	1,031.1	37.0	803.2	90.1	---	---	28.4
4 Fish and Fish Preparations	MT	109.2	1,751.6	102.1	1,542.2	7.1	-5.8	7.0	13.6
5 Fruits	MT	60.5	314.5	60.7	338.0	-0.2	7.2	-0.3	-6.9
6 Vegetables	MT	25.6	195.6	30.4	183.4	-4.8	-20.9	-15.7	6.6
7 Guar and Guar Products	MT	15.5	978.0	28.7	1,372.7	-13.2	-24.2	-46.0	-28.8
8 Crude Animal Material	MT	11.4	490.4	11.8	648.0	-0.3	28.3	-2.9	-24.3
9 Oil Seeds & Nuts etc.	MT	8.0	509.5	4.1	507.1	3.9	93.5	94.5	0.5
10 Raw Wool (Excl. Wool Tops)	MT	0.5	1,271.7	1.0	1,332.3	-0.5	-46.7	-49.1	-4.5
B. Textile Manufactures		**4,216.9**		**4,052.1**		**164.8**	---	**4.1**	---
11 Cotton Yarn	SQM	782.9	1,988.5	777.0	2,093.9	5.8	6.1	0.8	-5.0
12 Cotton Fabrics (Woven)	MT	750.7	0.6	814.4	0.7	-63.7	9.7	-7.8	-16.0
13 Hosiery (Knitwear)	Doz	667.7	23.1	627.0	22.7	40.7	4.7	6.5	1.7
14 Readymade Garments	Doz	606.3	24.1	562.4	24.9	43.9	11.6	7.8	-3.4
15 Bed Wear	MT	536.3	4,995.2	515.4	5,387.0	20.8	12.2	4.0	-7.3
16 Synthetic Textiles	SQM	398.6	0.6	326.6	0.7	72.0	41.4	22.0	-13.7
17 Other Textile Made up	(-)	244.6	---	222.3	---	22.3	---	10.0	---
18 Towels	MT	172.2	3,584.1	135.6	3,802.6	36.6	34.7	27.0	-5.7
19 Tarpaulin & Other Canvas Goods	MT	32.1	2,222.0	41.8	2,495.1	-9.8	-13.9	-23.3	-10.9
20 Cotton Bags and Sacks	MT	13.8	4,101.5	14.6	4,377.8	-0.9	0.5	-5.9	-6.3
21 Tule, Lace Embroidery etc.	(-)	7.5	---	10.5	---	-3.0	---	-28.8	---
22 Waste Material of Textile Fibers	MT	4.3	536.5	4.3	611.9	0.0	14.3	0.2	-12.3
C. Other Manufactures		**1,094.9**		**909.3**		**185.6**	---	**20.4**	---
23 Leather Manufactures	(-)	323.8	---	252.0	---	71.9	---	28.5	---
24 Carpets, Carpeting Rugs & Mats	SQM	199.5	45.9	182.6	52.1	16.9	23.9	9.2	-11.8
25 Sports Goods	(-)	188.1	---	186.8	---	1.3	---	0.7	---
26 Petroleum and Petroleum Prod.	MT	122.2	222.9	67.3	181.9	54.9	48.2	81.6	22.5
27 Chemicals and Pharmaceuticals	(-)	118.7	---	69.1	---	49.5	---	71.6	---
28 Surgical and Medical Instruments	Nos	88.1	---	84.9	---	3.2	---	3.8	---
29 Molasses	MT	26.1	33.2	33.8	23.0	-7.7	-46.5	-22.9	44.2
30 Cutlery	Gr	19.6	33.1	16.7	46.7	2.8	65.2	16.8	-29.3
31 Onyx Manufactured	MT	8.9	1,734.8	6.8	1,687.0	2.1	27.5	31.1	2.8
32 Sugar	MT	-	---	9.3	309.7	-9.3	---		---
D. Others		494.9	---	431.7	---	63.2	---	**14.6**	---
Total Exports:		**6,720.9**		**6,198.5**		**522.4**		**8.4**	
excl.Major Food Items and Raw Cotton		*6,027.9*		*5,516.1*		511.8		9.3	
excl.Major Food Items, Raw Cotton and Cotton Yarn		*5,245.0*		*4,739.0*		506.0		10.7	

Source: Federal Bureau of Statistics.

Table 15: Major Imports

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

Commodities	Unit	Q3-FY01		Q3-FY00		Abs. Δ	%Δ in Q3-FY01/Q3-FY00		
		Val.	Unit Val.	Val.	Unit Val.	in Val.	Qty.	Val.	Unit Val.
A. Food Group	**---**	**796.1**	---	**879.5**	---	**-83.4**	---	**-9.5**	---
1. Edible Oil	MT	261.9	292.5	318.7	401.6	-56.9	12.8	-17.8	-27.2
Soya bean	MT	36.3	340.3	69.7	444.1	-33.3	-31.9	-47.8	-23.4
Palm Oil	MT	*225.5*	*286.0*	*249.1*	*391.1*	-23.5	23.8	-9.4	*-26.9*
2. Sugar	MT	*218.1*	*271.5*	*1.1*	*336.0*	217.0	---	---	*-19.2*
3. Tea	MT	165.6	1,887.4	160.4	1,936.5	5.2	5.9	3.3	-2.5
4. Pulses	MT	83.7	324.2	52.4	304.3	31.2	49.7	59.5	6.5
5. Dry Fruits	MT	28.1	499.3	36.0	953.1	-8.0	48.7	-22.1	-47.6
6. Milk & Cream incl.Milk Food for Infants	MT	16.2	1,882.3	23.1	1,687.7	-6.9	-37.2	-29.9	11.5
7. Spices	MT	13.2	1,388.3	15.3	1,158.0	-2.1	-28.0	-13.6	19.9
8. Wheat Unmilled	MT	9.5	203.4	272.4	139.3	-262.9	-97.6	-96.5	46.0
B. Machinery Group	**---**	**1,509.1**	---	**1,431.5**	---	**77.6**	---	**5.4**	---
1. Textile Machinery	---	261.6	---	125.6	---	136.0	---	108.2	---
2. Road Motor Vehicles	---	240.2	---	238.9	---	1.4	---	0.6	---
3. Office Machinery	---	173.3	---	102.2	---	71.0	---	69.5	---
4. Power Generating Machinery	---	145.6	---	105.9	---	39.7	---	37.5	---
5. Electrical Machinery & Apparatus	---	94.8	---	108.1	---	-13.4	---	-12.4	---
6. Aircraft, Ships and Boats	---	57.7	---	138.6	---	-80.9	---	-58.4	---
7. Construction & Mining Machinery	---	50.4	---	65.3	---	-14.9	---	-22.8	---
8. Agricultural Machinery & Implements	---	16.9	---	37.4	---	-20.5	---	-54.8	---
9. Railway Vehicles	---	17.1	---	38.6	---	-21.5	---	-55.7	---
10. Other Machinery	---	451.4	---	470.8	---	-19.3	---	-4.1	---
C. Petroleum Group	**---**	**2,535.0**	200.7	**1,939.9**	165.9	**595.1**	**8.1**	**30.7**	**20.9**
1. Petroleum Products	MT	1,484.6	200.6	1,346.2	162.1	138.4	-10.9	10.3	23.8
2. Petroleum Crude	MT	1,050.4	200.7	593.7	175.4	456.6	54.6	76.9	14.4
D. Textile Group	**---**	**122.1**	---	**112.9**	---	**9.2**	---	**8.2**	---
1. Synthetic Fiber	MT	61.2	1,282.6	55.4	1,201.3	5.8	3.5	10.5	6.8
2. Synthetic & Artificial Silk Yarn	MT	42.9	1,741.3	35.1	2,089.1	7.7	46.4	22.1	-16.6
3. Worn Clothing	MT	18.1	305.2	22.4	365.9	-4.3	-3.3	-19.3	-16.6
E. Agricultural and Other Chemicals Group	**---**	**1,434.9**	---	**1,471.1**	---	-36.2	---	**-2.5**	---
1. Plastic Materials	MT	260.1	858.6	245.0	838.6	15.2	3.7	6.2	2.4
2. Medicinal Products	MT	178.0	23,041.2	190.3	22,078.5	-12.3	-10.4	-6.5	4.4
3. Fertilizer	MT	168.8	178.9	170.2	176.2	-1.4	-2.3	-0.8	1.5
4. Insecticides	MT	50.7	3,100.6	72.4	3,782.0	-21.7	-14.5	-29.9	-18.0
5. Others	---	777.2	---	793.2	---	-16.0	---	-2.0	---
F. Metal Group	**---**	**258.0**	---	**274.8**	---	-16.8	---	**-6.1**	---
1. Iron and Steel	MT	202.3	336.8	227.9	349.5	-25.6	-7.9	-11.2	-3.6
2. Aluminum wrought & Worked	---	28.2	---	31.4	---	-3.2	---	-10.1	---
3. Iron and Steel Scrap	MT	27.5	116.0	15.5	125.5	12.0	92.1	77.6	-7.6
G. Miscellaneous Group	**---**	**188.0**	---	**189.2**	---	-1.2	---	**-0.6**	---
1. Paper and Paper Board & Manuf.	MT	86.6	770.7	82.2	664.4	4.3	-9.2	5.3	16.0
2. Rubber Tyres & Tubes	Nos.	47.3	24.1	50.7	24.9	-3.4	-3.7	-6.7	-3.1
3. Rubber Crude	MT	29.4	666.0	26.7	655.3	2.7	8.2	10.0	1.6
4. Jute	MT	16.8	258.1	14.9	278.0	1.8	20.9	12.3	-7.1
5. Wood & Cork	---	8.0	---	14.6	---	-6.6	---	-45.4	---
H. Others	---	**1,197.2**	---	**1,202.0**	---	**-4.9**	---	**-0.4**	---
Total Imports:		**8,040.4**		**7,500.8**		**539.6**		**7.2**	
excl. POL group		5,505.4		5,560.9		-55.5		-1.0	
excl. Food Group		7,244.3		6,621.4		622.9		9.4	
excl. POL & Food Group		4,709.3		4,681.4		27.9		0.6	

Source: Federal Bureau of Statistics.

Table 16: Capital Account

(US$ million)

Items	Q3-FY99			Q3-FY00			Q3-FY01		
	Cr.	Dr.	Net Credit	Cr.	Dr.	Net Credit	Cr.	Dr.	Net Credit
1. Direct investment abroad	1	11	-10	1	0	1	0	27	-27
2. Direct investment in Pakistan	120	0	120	55	0	55	91	0	91
3. Portfolio investment	0	73	-73	0	113	-113	0	62	-62
(of which stock market)	33	0	33	61	0	61	0	61	-61
4. Long-term capital-official sector	1,436	801	635	570	488	82	377	443	-66
4.1. Assets	0	353	-353	0	0	0	0	0	0
4.2. Loans drawn	1,083	448	635	564	488	76	377	443	-66
4.3. Loans extended	0	0	0	0	0	0	0	0	0
4.4. Other Liabilities	353	0	353	6	0	6	0	0	0
5. Long-term capital-Deposit money banks	0	0	0	0	2	-2	0	0	0
5.1. Assets	0	0	0	0	0	0	0	0	0
5.2. Loans	0	0	0	0	0	0	0	0	0
5.3. Other Liabilities	0	0	0	0	2	-2	0	0	0
6. Long-term capital-Other Sectors	50	128	-78	56	166	-110	94	208	-114
6.1. Assets	0	0	0	0	0	0	0	0	0
6.2. Loans	22	128	-106	45	166	-121	94	145	-51
6.3. Other Liabilities	28	0	28	11	0	11	0	63	-63
7. Short-term capital-Official Sector	14	198	-184	2	22	-20	96	86	10
7.1. Assets	0	5	-5	2	0	2	0	6	-6
7.2. Loans	14	138	-124	0	11	-11	96	19	77
7.3. Other Liabilities	0	55	-55	0	11	-11	0	61	-61
8. Short-term capital-Deposit Money Banks	37	457	-420	30	626	-596	4	26	-22
8.1. Assets	37	0	37	16	0	16	4	0	4
8.2. Bilateral balances-assets	0	0	0	0	0	0	0	0	0
8.3. Bilateral balances-liabilities	0	0	0	0	0	0	0	0	0
8.4. Liabilities under NR A/cs	0	39	-39	14	0	14	0	16	-16
8.5. Other Liabilities	0	418	-418	0	626	-626	0	10	-10
9. Short-term capital - Other Sectors	1	166	-165	41	229	-188	9	0	9
9.1. Assets	1	0	1	41	0	41	3	0	3
9.2. Loans	0	0	0	0	0	0	0	0	0
9.3. Other Liabilities	0	166	-166	0	229	-229	6	0	6
Capital Account	**1,659**	**1,834**	**-175**	**755**	**1,646**	**-891**	**671**	**852**	**-181**

Table 17: Real Effective Exchange Rate Indices (Jan., 1995=100)

	REER(E)	REER(I)	REER(C)	REER(O)	REER(IMF)
Jan-97	90.7	90.9	85.1	92.7	94.1
Feb-97	93.2	93.0	86.2	95.3	97.7
Mar-97	93.2	92.8	86.0	95.3	97.9
Apr-97	95.0	94.5	87.3	97.1	99.7
May-97	94.2	93.6	86.8	95.7	98.3
Jun-97	94.0	93.3	86.4	94.9	97.8
Jul-97	94.5	94.2	86.6	95.6	99.0
Aug-97	95.6	96.3	87.3	97.4	101.2
Sep-97	95.9	97.9	88.9	98.8	101.1
Oct-97	91.4	94.4	85.6	95.1	92.7
Nov-97	88.6	92.6	84.5	93.0	93.7
Dec-97	91.5	97.5	91.0	97.8	97.1
Jan-98	93.4	101.6	96.0	102.2	99.0
Feb-98	93.1	99.0	94.0	100.1	98.3
Mar-98	94.7	100.1	94.3	101.5	99.9
Apr-98	93.8	99.0	92.1	100.3	99.8
May-98	94.4	100.6	93.5	101.9	100.3
Jun-98	95.4	102.6	95.7	104.3	101.9
Jul-98	89.9	96.6	89.0	98.3	98.2
Aug-98	85.2	91.8	83.7	93.1	92.2
Sep-98	83.2	89.0	83.2	90.1	88.9
Oct-98	81.3	86.0	81.2	86.5	85.4
Nov-98	81.4	85.5	80.1	86.0	85.4
Dec-98	82.8	86.9	81.5	87.2	86.5
Jan-99	83.2	87.1	82.1	87.4	86.9
Feb-99	84.1	87.9	82.5	88.5	88.5
Mar-99	85.6	89.3	83.7	90.2	90.7
Apr-99	84.6	87.9	82.8	88.9	90.3
May-99	83.8	87.2	81.7	88.2	88.0
Jun-99	83.5	86.4	80.5	87.2	89.1
Jul-99	84.0	86.6	80.8	87.3	89.7
Aug-99	83.0	85.7	81.0	86.0	88.0
Sep-99	83.2	85.8	81.6	85.8	87.4
Oct-99	82.9	85.5	81.4	85.4	87.1
Nov-99	83.6	85.7	81.2	85.6	88.2
Dec-99	84.1	85.7	81.2	85.6	88.8
Jan-00	84.2	85.7	81.4	85.9	89.1
Feb-00	85.2	86.8	81.5	87.1	90.8
Mar-00	86.2	87.6	82.3	87.6	91.4
Apr-00	86.7	88.0	82.9	88.0	92.2
May-00	88.6	89.7	83.9	89.9	94.8
Jun-00	87.9	89.3	84.6	89.5	92.6
Jul-00	87.4	88.9	83.8	89.2	92.5
Aug-00	85.3	86.1	80.7	86.5	91.6
Sep-00	83.9	84.5	79.6	84.8	89.8
Oct-00	81.2	81.8	75.9	82.0	86.6
Nov-00	83.2	83.8	77.9	84.1	90.0
Dec-00	80.9	81.9	77.2	82.6	86.5
Jan-01	79.0	80.4	76.4	81.5	86.7
Feb-01	78.9	80.1	76.2	81.0	86.6
Mar-01	78.5	80.1	77.2	81.2	87.3