THE STATE OF PAKISTAN'S ECONOMY
First Quarterly Report for FY04

1.1 Overview

Preliminary information on economic developments during Q1-FY04 suggests that the domestic economy is likely to register an acceleration in real GDP growth for the third successive year in FY04, and meet most macroeconomic targets despite the decelerating improvement in a few indicators (see **Table 1.1**). In particular, the commodity-producing sector is performing well; the current account continues to witness a substantial surplus; the exchange rate has largely remained within a narrow range; the growth in monetary aggregates has moderated, keeping within annual plan targets (after breaching targets for two successive years); private sector credit has shown an unusual upsurge and the quarterly budgetary target remains consistent with the annual target. Also, while interest rates have inched up, and some inflationary pressures are also evident, these movements probably represent a correction after reaching unsustainable historic lows in FY03. On the other hand, deceleration, or less than expected performance has been witnessed in the case of home remittances, cotton production and foreign private investment.

Table 1.1: Economic Indicators

	July-September		
	FY02	**FY03**	**FY04**
growth rates(percent)			
Large-scale manufacturing[1]	3.4	3.7	11.7
Exports	1.8	14.3	14.7
Imports	-8.3	10.9	12.1
Tax revenues (CBR)	-3.1	16.6	4.1
CPI (12 month moving average)	4.1	3.6	2.6
Private sector credit (CBs)	-1.8	-4.2	2.5
Money supply (M2)	-0.5	2.1	2.1
million US Dollars			
Total liquid reserves[2]	3,295.0	8,244.0	11,388.6
Home remittances[3]	263.8	926.6	906.5
Foreign private investment	21.9	167.4	88.9
percent of GDP[4]			
Fiscal deficit	1.7	1	0.9
Trade deficit	0.4	0.3	0.2
Current a/c balance	-0.1	2.1	1.6

[1] Based on 91 items.
[2] With SBP & with banks. End September.
[3] Excluding receipts on a/c of Kuwait war affectees & Hajj.
[4] Calculated by taking fiscal year GDP but variable numbers on quarter basis.

The GDP growth is expected to be quite broad-based with a strong performance by industry being complemented by a good output of the agriculture and services sectors. In particular, the large scale manufacturing (LSM) output growth is likely to remain robust on the back of the existing order inventories (e.g. automobiles,

textiles) as well as the momentum of auxiliary demand (cement, electricity and gas); this view is also supported by the exceptionally strong growth in both credit and non-food non-oil imports, which are typically leading indicators of economic activity. In fact, the only concern on the prospects of LSM growth stems from a possible decline in sugar production, but given the commencement of the crushing season in November 2003, this drag is not expected to be very severe.

Similarly, while preliminary statistics place the aggregate performance of major FY04 *kharif* crops a little below expectations (due to the late season damage suffered by the cotton harvest), this nonetheless represents a substantial improvement over the FY03 *kharif* output. Moreover, the substantial improvement in water availability, the encouragement from good agri-product prices in FY03, as well as a further improvement in agri-credit access during FY04, is expected to help keep the overall agriculture growth on track to meet the FY04 target[4].

The evident improvement in economic activity during Q1-FY04 is reflected in the Rs 94.1 billion tax receipts that are above the Rs 92.2 billion quarterly target. In particular, while the 8.4 percent rise in income taxes may partially reflect the impact of the FY03 economic performance (due to collection lags), the substantial, above-target, customs duty collections is clearly associated with the higher level of, capital goods and industrial raw material, imports. As a result of the strong aggregate quarterly receipts and disciplined spending, the Q1-FY04 budgetary deficit of 0.9 percent of GDP is in accordance with the annual 4.0 percent of GDP annual target. However, a point of concern appears to be the 5.0 percent decline in sales tax receipts[5] during the quarter relative to Q1-FY04; the sales tax is the largest contributor to aggregate CBR tax collections, and a continuation of the weak receipts could jeopardize the budgetary deficit target.

Another point of concern is the up trend in *marginal* inflation, although average CPI inflation remains low. While price pressures are clearly growing in the economy, the rise in marginal inflation is primarily due to food and energy prices. Whether this up trend is caused by factors exogenous to monetary developments, or is resulting from the lagged effect of monetary expansion in FY03, remains unclear. More relevant in this regard are: (1) the trend of the non-food, non-oil inflation (which though rising, was still quite subdued); and (2) developments in

[4] A substantial improvement in the wheat harvest (aided by the timely increase in the support price) will play a pivotal role in the realization of this expectation. It is therefore very important to support the farmer's efforts by ensuring adequate availability of fertilizer, weedicides, etc.
[5] A small *part* of this decline may be explainable by the removal of a short-lived GST on medicines (that had boosted Q1-FY03 collections).

the external account (such as NFA driven growth in reserve money and the offsetting impact of rupee appreciation). It should also be noted that *some* inflationary pressure is to be expected with increasing economic activity and is, indeed, welcome. Moreover, the SBP has to be mindful that a premature tightening of monetary policy could choke off growth in the economy. Nonetheless, if the acceleration in CPI inflation continues through December 2003 and beyond, the monetary stance may need to be re-aligned accordingly.

Interestingly, at least a part of the recent increase in inflationary pressures may be attributable to a rise in consumer demand due to rising availability of consumer credit. Traditionally, given the credit constrained economy, banks had not focused on the development and marketing of consumer finance products. However, this picture changed totally following the exceptional liquidity influx since FY01; the resulting availability of consumer finance products, easing of regulations, development of banks' infrastructure, and above all, significant improvement in consumer awareness, is expected to support the growth of this market segment even if interest rates were to rise. Another related (and very significant) development, that became visible during Q1-FY04, was that for the first time, lending by commercial bank for agricultural finance and housing finance outstripped the lending by the specialized banks in the respective areas. In other words, the financial sector reforms of the past decade (including changes in the legal framework such as making bounced cheque a criminal offence, and permitting financial institutions to repossess property falling defaults without recourse to the courts), coupled with the fiscal prudence seen in the last two years, is now making a significant real contribution to the economy by expanding the availability of goods and services to a larger segment of consumers.

This has also contributed to a major structural shift in the credit cycle. More specifically, the first quarter of the fiscal year generally sees a net decline in credit expansion due to seasonal factors[6], but in Q1-FY04 high cotton prices, strengthening demand for consumer credit, and higher agri-credit disbursements reversed this "normal" trend. As a result, the quarter witnessed a Rs 23.1 billion increase in net credit to the private sector in contrast to a Rs 26.8 billion *contraction* recorded in Q1-FY03. If the consumer credit continues the present upward trend, private sector credit is expected to show a robust growth through FY04. The backward linkages of consumer credit to higher demand and then

[6] The exceptional rise in Q1-FY04 may include a *part* of the normal credit demand typically seen in the second quarter of the fiscal year, as mills pushed forward their cotton purchases amidst news of a below target domestic crop and high international prices.

higher domestic production of industrial goods may be gleaned by looking at the LSM sub-sector performance.

The strong rise in private sector credit was supplemented by an increase in the government's budgetary support borrowings during Q1-FY04 is in sharp contrast to the FY03 trends. Thus, while the 2.1 percent Q1-FY03 growth in monetary asset was driven solely by a rise in NFA, the 2.1 percent M2 increase during Q1-FY04 also incorporates a significant increase in NDA, which offset a deceleration in NFA growth.

It should be noted that the SBP's *ability* to maintain an easy monetary stance was aided by the external account surpluses, low core inflation, low international interest rates, and a fall in government borrowings from commercial banks. The first of these remains in place (although weaker than in FY03), and while marginal CPI inflation is perceptibly accelerating, its non-food and non-oil components depict a weaker upward momentum. Similarly, while the government's borrowings from the banking system have certainly increased relative to corresponding FY03 levels, this may simply reflect a drop in NSS receipts, as well as a mismatch in timings of revenue and expenditure flows i.e. (1) lags in inflows of external financing and (2) the fact that tax receipts are budgeted to rise sharply in the later months of the fiscal year.[7] Finally, while the recovery in major economies (US, EU regions and Japan) has increased expectations of hikes in global interest rates, these have been mitigated somewhat by low inflation rates and still-weak employment data. The above developments support the *possibility* that the interest rate rise seen in Q1-FY04 may continue into the succeeding quarters. However, given that Pakistan's economy has still to reach its long-term trend GDP growth of 6 percent, it appears desirable that an increase in interest rates (if required) be quite gradual.[8]

The current account sector surplus has declined in Q1-FY04, but is still quite substantial at US$ 1.2 billion. In fact, the fall in the surplus relative to the exceptional levels of FY03 is not worrisome, being attributable to factors that were quite expected, including: (1) a visible decline in remittances (probably reflecting the gradual decline in reverse capital flight by Pakistanis holding asset abroad, as well as the end of the Haj Sponsorship scheme); and (2) a rise in the services account deficit caused by the policy decision to reincorporate some travel-related payments into the formal system through the Exchange Companies.

[7] A small pickup in domestic inflation could also translate into higher seigniorage revenues.
[8] For example, there is still ample unused capacity utilization in many industries,

Encouragingly, exports continued to grow apace during Q1-FY04, outstripping the substantial increase in imports (due to rising raw material and machinery imports).[9] Clearly, exports have benefited significantly from the relative stability of the exchange rate, lower financial costs and increased market access during the last few years, and the continuation of these is expected to keep Pakistan on track to meet the US$ 12 billion mark for FY04. However, two concerns need to be addressed: (1) the anti-dumping duties imposed on bed wear by the EU need to be aggressively countered; (2) exports to the US could be negatively affected if the security concerns of the latter are not adequately addressed in a timely manner.

Looking Forward

To meet the post-2004 competitive pressures, it is time that a strong collaborative partnership is forged between the public and private sectors. The precise institutional setting for nurturing and maintaining such a partnership is a challenge that needs to be addressed now than later. A host of problems face the textile industry in enhancing its market share under the new trading environment, and some of the required measures include increasing availability of skilled manpower, improving quality of cotton produced and its ginning; reducing the average cost of power to industry; sales tax refund process re-engineering; setting up of textile and garment cities, shift to higher value added goods, easing of infrastructure bottlenecks, expeditious custom and port clearance procedures, quality testing, etc.

SBP Projections For FY04

Current projections by the SBP staff confirm that the target of GDP growth for FY04 will be achieved or slightly exceeded. Inflation is likely to be in the range of 3.6–4.2 percent and current account balance will surpass the original target.

The expected achievement of the target for exports and remittances is a key plank in the SBP quarterly projections (based on the available FY04 information and historical trends) that place the FY04 current account surplus at approximately US$ 2.3 billion (see **Table 1.2**). More importantly, a significant portion of this projected surplus is expected to constitute sustainable flows, reinforcing the structural shift in the current account that became visible in FY03. The expected persistence of a large current account surplus also suggests that the rupee/US$ parity is likely to remain relatively stable during FY04, in line with the trends visible through most of Q1-FY04. In fact, the rupee has already recouped its small September 2003 losses against the US$ to record a net gain in subsequent

[9] As per the customs record data, exports grew by US$ 379.2 million (14.7 percent) YoY in Q1-FY04, as compared to the YoY growth of US$ 323.9 million (14.3 percent) in Q1-FY03.

periods. It should also be noted that SBP has been a net purchaser in each month of FY04, which clearly suggests that the slide of the rupee was probably caused by temporary market pressures, as a sustained weakness could be reversed simply through a reduction in SBP's net purchase.

Table 1.2: Major Economic Indicators (SBP Projections)

		FY04	
growth rates *(percent)*	**FY03P**	**Original targets**	**SBP projections**
GDP	5.1	5.3	5.4
Agriculture	4.1	4.2	4.2
Industry	5.4	7.1	7.2
of which:			
Large-scale manufacturing	8.7	8.8	8.9
Services	5.3	4.9	5.1
Inflation	3.1	3.9	3.6 - 4.2
billion US Dollars			
Exports	11.2	12.1	12.2
Imports	12.2	12.8	13.3
Workers' remittances	4.2	3.6	3.6
Forex reserves with SBP	10.0	NA	11.3
billion Rupees (flows)			
Monetary assets	317.4	230.0	230.1
of which:			
Private sector credit	153.3	85.0	130.0
percent of GDP			
Fiscal deficit	4.4	4.0	4.0
Current account balance	7.6	1.6	3.0

P: Provisional

In short, two themes that come through very strongly in Q1-FY04 developments are:

(1) *macroeconomic stability, and financial sector reforms can have very real and substantial impact of the real economy;* It is instructive to remember that it is the financial sector reforms undertaken in earlier years that are only now yielding concrete benefits to the economy. This points to the possibility of substantial lead times between the introduction of a policy and eventual gains to the economy, as well as the need to sustain the momentum through the next phase of reforms to further improve market efficiency.

Moreover, the ability of the financial sector to benefit the real sector is always circumscribed by state of the macro economy. For example a significant contribution to the interest rate decline, particularly during FY03, emerged through the absence of "crowding out" by the government. In other words, the sustainability of the economic improvements will remain crucially dependant on continued government focus on macroeconomic stability and fiscal prudence.

and, (2) *this can be helped by a balanced partnership between the public and private sector.*

The successes of commercial banks in significantly boosting economic activities in areas as diverse as agriculture, housing, SMEs, consumer finance etc. not only points to the efficiency improvements possible through private sector participation, but also underlines the important role of the government in providing policy direction and an enabling environment for the private sector innovations.

It is important to remember that the government's contribution to setting the direction of the economy and creating the enabling environment is not merely confined to the provision of policy, and regulation, but also (arguably, most importantly) to the provision of public goods, particularly health and education (that are the pillars of any strong economy). While the recent fiscal improvements are expected to free up increasing revenue streams for developmental spending, the current level of spending on these goods is still low. It is therefore crucial to maximize efficiency of the relatively limited expenditure through better planning and improvements in governance; the significant gains possible are clearly illustrated in the recent experience of the *RahimYar Khan Primary Healthcare Pilot Project* (See **Special Section 1**).

1.2 Executive Summary

Agriculture

The encouragement from the high yields and better prices during FY03, as well as the improved water availability in FY04 led farmers to increase the aggregate cultivated area under important *kharif* crops (rice, cotton and sugarcane) by 4.0 percent relative to the FY04 target (as well the corresponding cultivated area in FY03).

Preliminary estimates indicate that this has contributed to a substantial increase in the FY04 production of sugarcane and rice. However, due to untimely rains in some parts of cotton growing belt and higher pest infestation throughout the cotton-growing region dragged down the cotton production significantly below the target of 10.6 million bales.

While the drag of the below target cotton production on aggregate crop sub-sector output has largely been mitigated by the impact of the good rice harvest, the achievement of the agricultural growth target for FY04 will depend heavily on an above-target wheat harvest. This is by no means impossible. Since the procurement price of wheat has been raised at the sowing time and lack of water is no longer constraining an increase in the cultivated area, the wheat crop could

potentially exceed the record highest output of 21.2 million tones achieved in FY00.

In addition to the overall increase in credit to agriculture, Q1-FY04 saw, for the first time, credit disbursed by the commercial banks, exceeding that disbursed by ZTBL.

Industrial Production

The industrial output recorded a strong growth of 10.1 percent during Q1-FY04 compared to 4.3 percent increase in Q1-FY03. This acceleration was mainly contributed (more than 80 percent) by large-scale manufacturing (LSM) with a 15-year high first quarter growth of 11.7 percent, followed by 6.5 percent increase in electricity generation. These two more than offset the deceleration witnessed in the growth of mining industries, which rose by only 2.7 percent compared to 17.8 percent in the corresponding quarter last year.

The exceptionally high growth in LSM during Q1-FY03 emerged largely on account of the impressive (more than 25 percent) growth witnessed in automobile, electronic goods and leather industries. More encouragingly, the growth in the quarter featured a positive contribution from all the 14 sub-sectors of LSM.

As in FY03, the strong external and domestic demand continued to support higher capacity utilization in major LSM industries. Domestic demand, particularly for consumer durables (and construction related material) remained strong on account of low interest rates, increased credit availability and greater consumer awareness. Moreover, the output of non-durable consumer goods also saw significant improvement during Q1-FY04, in contrast to the weak performance during the last two years. The pace of growth set in Q1-FY04 suggests the likelihood of achieving higher than the targeted growth in LSM during FY04.

Fiscal

As in FY03, fiscal discipline was quite visible during Q1-FY04. The consolidated budgetary deficit of the federal and provincial governments for Q1-FY04 not only narrowed in terms of GDP (to 0.9 percent), but also recorded a marginal decline in absolute terms (from Rs 41.0 billion Q1-FY03 to Rs 40.9 billion Q1-FY04). Both, higher tax revenues and the lower growth in expenditures, supported this reduction in the budgetary deficit.

Consolidated revenue receipts recorded a 7.9 percent rise during the quarter primarily on the back of higher non-tax revenue (20.7 percent YoY), as the growth in tax revenue was lower (3.6 percent YoY). The improved financial health of

both the financial and non-financial institutions, and higher payments from USA (for logistics support), were major contributing factors to the increase in non-tax revenue. The subdued growth in CBR tax collections constrained overall tax revenue growth.

Although Q1-FY04 CBR tax collections of Rs 94.1 billion were higher than the quarterly target of Rs 92.2 billion, a 4.1 percent YoY rise was substantially lower than the 16.6 percent growth recorded during Q1-FY03. This deceleration in growth was primarily led by the shortfall in sales tax collections.

A break up of the Rs 12.0 billion rise in consolidated federal and provincial governments expenditures reveals that: (1) current spending saw an encouraging decline of Rs 2.2 billion; and (2) both the net lending to PSEs and expense on public sector development program have increased. Within current expenditures, while the interest payments declined for yet another quarter, the Q1-FY04 defense spending surged by Rs 13.1 billion as compared to Q1-FY03 probably due to increased expenditures on Afghan border operations financed by US logistic support receipts.

The Q1-FY04 financing mix of budgetary gap shows that it was largely met through domestic sources (Rs 36.0 billion), as the share of net external receipts in total financing was only 12.0 percent. In contrast, during Q1-FY03 more than 80 percent of the budgetary deficit was financed through net external receipts.

Money and Credit

Q1-FY04 witnessed a number of significant changes. Not only was there quite a robust increase in net private sector credit (in contrast to the net retirement traditionally seen in the period), the benchmark interest rates too inched up, ending a 1183 basis point slide initiated 26 months ago. The exceptional growth in private sector credit was mainly due to a jump in consumer financing and higher financing requirements for the purchase of cotton. Moreover, due to the lower availability of external funding and the net negative accumulation from the NSS, the net government budgetary borrowing from the banking system increased in Q1-FY04, in contrast to the declines witnessed in each of the preceding 8 quarters. Finally, while 2.1 percent M2 growth rate for Q1-FY04 remained unchanged from Q1-FY03, this was not entirely due to NFA growth (reversing the trend through most of FY03).

Despite the credit growth, interest rates did not increase until mid-September 2003 as the market was substantially liquid. A temporary forex liquidity shortage prompted a sharp fall in SBP forex purchases coupled with a slight rise in the T-

bill acceptance rate (September 18, 2003) raised market expectations of a rise in the interest rates. As a result, the SBP was forced to lower the volume of accepted bids in successive auctions in order to prevent an unwarranted sharp rise in interest rates.

Among other positive developments, the rise in net foreign assets (NFA) to reserve money (RM) ratio and a gradual decline in currency to deposits ratio (CDR) is particularly notable. The NFA to RM ratio increased to 88.3 percent at end-September 2003 from 2.7 percent at end-July 2001. If this trend continues, the high-powered rupee stock could be fully backed by hard currency assets. The CDR, on the other hand, declined from 33.7 percent at end-July 2001 to 30.8 percent by end-September 2003.

Money Market

During Q1-FY04, initially the interest rates remained under pressure due to a sharp rise in inter-bank liquidity. Thus, in July and August 2003, the SBP actively sought to support the inter-bank rates through OMOs and higher targets in some T-bill auctions. However in September 2003, the money market witnessed a decisive reversal in the market's interest rate expectations.

This change in market expectations was already visible in Q4-FY03, driven by the vanishing differential between US dollar and rupee interest rates, a fall in the forex market surpluses (implying lower rupee injections through SBP interventions), as well as the unexpected announcement of a large PIB auction in June 2003 (that further drained liquidity from the interbank market). However, their impact was amplified considerably in September 2003 due to announcement of another unexpected (very large and, extended) PIB issue. Some other factors raised expectation of rising demand for liquidity: (1) the negative net mobilization from the NSS after July 2003; (2) short-term external debt payments; (3) expected introduction of the longer tenor PIBs, and (4) expected pre-payment of expensive forex debt.

An interesting development resulting from the expectations of an interest rate hike was the decline in banks' holdings of PIBs. This is a long awaited and welcome change and is likely to improve the commercial banks' risk profile.

Banking

During Q1-FY04, the banking sector recorded robust growth in terms of deposit mobilization and credit off take. However as pointed out earlier the highlight of the quarter remained the unusual rise of Rs 23.1 billion (against net retirements of Rs 26.8 billion last year) in net credit to private sector; to reiterates the prime

factors behind this *unseasonal* rise in the credit are: (1) a surge in banks' consumer financing activities; (2) the increasing focus of banks towards small and medium enterprises; (3) higher credit demand from the agriculture sector; and (4) increase in banks' investment in stock market.

Finally, non-performing loans (NPLs) registered a rise of Rs 3.0 billion in Q1-FY04 thus pushing up the outstanding NPLs to Rs 230.7 billion. This was, in fact, caused by the rise in NPLs of specialized banks that overshadowed the decline in outstanding NPLs of domestic commercial banks.

Prices

Annualized inflation remained weak throughout Q1-FY04, with the CPI and SPI inflation both continuing the downtrend visible since February 2003, while the WPI inflation witnessed a rise. Although both food and non-food components of CPI recorded lower increases relative to Q1-FY03, the deceleration was more pronounced in food inflation. Similarly, the acceleration in WPI stemmed largely from non-food components. However, the steep rising *trend* in marginal CPI inflation during Q1-FY04, a spike in the October 2003 YoY CPI inflation, as well as the relative strength of non-food prices suggest that inflationary pressures in the economy, while still weak, are probably strengthening.

Specifically, the annualized CPI inflation was 2.6 percent at end-September 2003. This is significantly lower than the 3.6 percent figure recorded in the corresponding period of FY03 and is the lowest level for over three decades. However, since the marginal (YoY) CPI inflation has bounced back strongly to reach 2.2 percent in September 2003 after bottoming out at 1.4 percent in July 2003, the sustainability of the very *low* annualized inflation is unclear.

Capital Market

During Q1-FY04, the capital market witnessed an acceleration in the extended market rally (that started in FY02) primarily due the energy stocks, under the lead of scrips such as Pakistan Oil Fields (amid expectations of an exceptional result announcement), PSO (with hopes of early progress towards its privatization) and Hubco. Propelled by the availability of relatively cheap liquidity and positive investor sentiment. The index rapidly pushed past the 3500, 4000 and 4500 psychological barriers to peak at a new all-time high of 4606 points by September 12, 2003 before suffering a large correction due to a rise in speculative equity investments (as evident in high badla rates and volumes).

The outstanding stock of listed corporate debt totaled Rs 29.5 billion at end-September 2003. Only two listed issues, totaling Rs 1.3 billion, were offered

during the Q1-FY04. This low issuance compares poorly with Q1-FY03, which, in turn, probably reflects the impact of the aggressive lending policies adopted by commercial banks. However issuance could pick up again in view of the recent up trend in long-term interest rates.

External

The overall balance remained quite substantial at US$ 770 million during Q1-FY04 despite an 18.5 percent decline in the current account surplus and a larger capital account deficit as compared to the correspounding period of FY03.

Although the current account surplus was relatively weak, it remained more than US$ 1 billion for Q1-FY04. Encouragingly, excluding the non-structural elements, the adjusted current account balance has remained in surplus for the eighth consecutive quarter at over US$ 0.5 billion during Q1-FY04. This evidence reinforces the view that the current account has probably undergone a positive structural shift. The main factors for this reduction in current account surplus were the decline in workers' remittances and the travel related payments through Exchanges Companies (ECs).

The capital account deficit increased by 131.8 percent, to reach US$ 349 million during Q1-FY04, relative to Q1-FY03. This larger capital account deficit was driven by the lower foreign direct investment, decrease in non-food aid from IFIs and the increased settlement of foreign currency trade related loans against FE-25 deposits.

The lower current account surplus and larger capital account deficit, squeezed the inter-bank forex market liquidity, raising market expectations of a possible depreciation of the rupee. In fact, despite a significant reduction in net SBP forex market purchases, the rupee weakened by a marginal 0.2 percent against the US Dollar. This temporary weakening of the rupee was largely due to a short-term jump in end-quarter payments outflow (and therefore reversed quickly in October 2003). The real effective exchange rate (REER-IMF) depreciated by 5.3 percent at end-September 2003 relative to June 2001.

These developments in external account also resulted in a slowdown in foreign exchange reserves accumulation (US$ 674 million) in Q1-FY04 relative to the increase (US$ 1.8 billion) recorded in Q1-FY03. However, increase in reserves still posted a robust 66 percent jump over the accumulation in the immediately preceding quarter reversing (at least temporarily) the steady deceleration of reserve accumulation witnessed in each quarter after Q1-FY03. At end-September, the aggregate level of forex reserves stood at US$ 11.4 billion.

As far as external trade is concerned, the robust export growth outpaced the growth in imports and this led to a reduction of 23.1 percent in the trade deficit to US$ 144.8 million during Q1-FY04 as compared to the same period last year. Within exports, the textile sector remained the main contributor to exports growth, supported by a rise in agricultural products exports. While for imports, capital goods and raw materials for industry registered an increase; consumer goods and petroleum products fell appreciably in Q1-FY04 pushing up the share of non-food and non-oil imports. This higher non-food and non-oil imports appears to reflect the increased activity in the economy.