2 Real Sector

2.1 Agriculture

Initial data on agricultural sector activities for FY04 suggests that farmers are aggressively seeking to build on the gains achieved during the FY03 cropping seasons. The confidence boost to farmers through a mix of higher yields and reasonably good prices for most important crops during the previous year, coupled with good water availability at the commencement of the cropping season, and the improved access to agri-credit, are expected to be the key factors in reinforcing productivity during FY04.

The 4.2 percent agri-sector annual growth target for FY04 is built around the above factors, as well the availability of other crop-related inputs and the recent policy incentives. This is evident by the fact that the crop sub-sector is envisaged to contribute a larger share of agricultural growth during the current fiscal year, in line with the FY03 trend (see **Table 2.1**).

Table 2.1: Composition of Agriculture Growth

percent

	FY03[P]		FY04[T]	
	Growth	**Share**	**Growth**	**Share**
Agriculture	4.1	100.0	4.2	100.0
Crops	4.2	56.5	4.9	57.0
Major crops	5.8	40.6	5.5	41.2
Minor crops	0.4	15.9	3.5	15.8
Livestock	2.9	38.8	3.0	38.4
Fishing	16.6	3.5	4.5	3.5
Forestry	8.8	1.1	5.3	1.1

Source: Economic Survey 2002-2003.

P: Provisional; T: Target

The envisaged growth in the important crops incorporated in the FY04 annual target does not appear unachievable. Firstly, the contractions in the crop sub-sectors during FY01 and FY02 reduced the base for computing the growth of major crops[1] and, more importantly, even after a significant recovery by crops in FY03, the value addition by major crops still remains below the highs registered during FY00 (see **Figure 2.1**).

Secondly, while the FY04 production targets for all the major crops have been set higher than the actual production during FY03, these do not look unreasonable. In particular, the targets for the four most important crops[2] i.e., cotton, rice,

[1] These consist of 12 crops including: rice, bajra, maize, jowar, sugarcane and cotton of *kharif* season (April-September) and wheat, gram, barley, rapeseed and mustard, sesamum and tobacco of *rabi* season (October - March).

[2] Cotton, rice, sugarcane and wheat enjoy predominance with almost 65.0 percent share in the crop sub-sector and 40.0 percent in agriculture. Therefore, in many years, these crops have been the key

sugarcane and wheat, are lower than the levels achieved in recent years (see **Table 2.2**).

While preliminary estimates of low cotton production suggest that direct value addition by *kharif* crops may be slightly below the expectations, this shortfall is not yet serious. However, if the actual cotton output falls below the 10.0 million bales, the achievement of the crop sub-sector growth target will become heavily dependant on an exceptional wheat harvest. Fortunately, the 16.7 percent increase in support price announced for wheat has rekindled the prospects for higher than expected wheat production.

Figure 2.1: Contribution by Major Crops

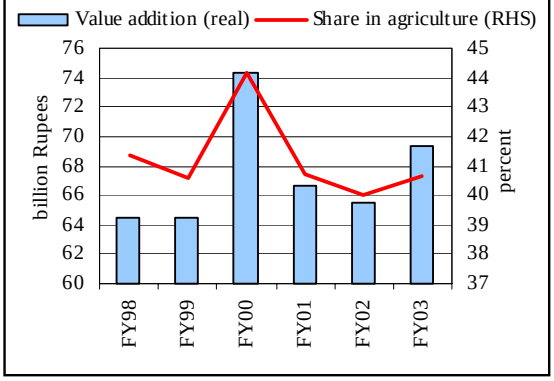


Table 2.2: Production of Important Crops

cotton bales in million, all others in 000' tonnes

	Actual		Targets	Record level	
	FY02	**FY03**	**FY04**	**Production**	**Year**
Rice	3,882	4,479	4,550	5,155	FY00
Sugarcane	48,042	52,056	52,500	55,191	FY99
Cotton	10.6	10.2	10.6	12.8	FY92
Wheat	18,226	19,255	20,500	21,078	FY00

Sources: i) Economic Survey 2002-03.
ii) Agricultural Statistics of Pakistan 2001-2002.

2.1.1 Water Availability

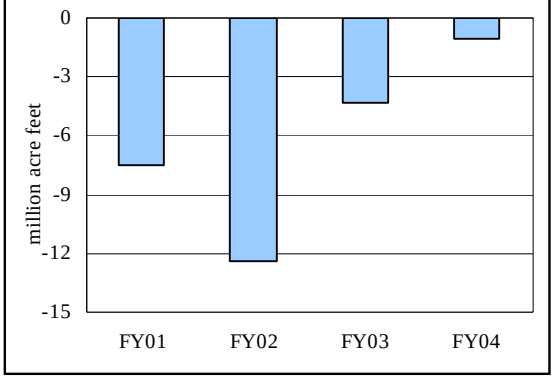
The improvement in the 2003 winter rains relative to 2002, as well as the normal precipitation during *monsoon* 2003 significantly boosted the availability of canal water in *kharif* FY04. During the period from April 1, 2003 to September 20, 2003 the canal water availability throughout the country was at 61.8 million-acre feet (MAF) as against 58.8 MAF during the same period of the preceding year, and only a little lower than the (normal) 5-year[3] average level of 63.0 MAF (see **Figure 2.2**). In other words, the drought which had bedeviled the agri-sector output since *rabi* FY00 (October 1999 to March 2000) finally seems to have ended.

determinants of the aggregate performance of the crops sub-sector and even the growth of agriculture, as a whole.

[3] Normal water availability refers to the average water supply during 1996-2000. It equals the water availability mentioned in the 1991 Water Accord.

The provincial comparison showed that canal water availability during *kharif* FY04 increased by 12.3 percent and 0.6 percent in Punjab and NWFP respectively compared to the preceding *kharif*. By contrast, in Sindh and Balochistan, canal water availability dropped by 1.3 percent and 12.7 percent respectively compared to the *kharif* FY03. However, this decline in canal withdrawal by Sindh and Balochistan was in the wake of heavy rains and therefore should have no significant impact on the overall water availability to the crops in these provinces.

Figure 2.2: Water Availability (Kharif)



2.1.2 Crops

Due to its larger share (65.0 percent) in major crops and the forward linkages of cotton and sugarcane with the manufacturing sector, the performance of *kharif* crops provides an early indicator of the annual growth of the commodity-producing sector. Thus, the initial estimates of the FY04 kharif crop *suggest* that aggregate FY04 growth targets are achievable.

Table 2.3: Area Under Important *Kharif* Crops

thousand hectares

		FY04		% Change over	
Crops	**FY03**	**Target**	**Sown**	**FY03**	**Target**
Cotton	2,794	2,919	3,049	9.1	4.5
Sugarcane	1,100	1,000	1,051	-4.5	5.1
Rice	2,225	2,231	2,457	10.4	10.1
Maize	936	951	826	-11.8	-13.1
Total	7,055	7,101	7,383	4.6	4.0

Sources: i) Federal Committee on Agriculture
ii) Economic Survey, 2002-2003

Area under cultivation

The aggregate cultivated area for important *kharif* crops (accounting for 91.1 percent of all major *kharif* crops) rose by 4.6 percent in FY04 relative to the preceding year. This was because of the increased cultivation of rice and cotton, which offset the decline in the area under maize and sugarcane (see **Table 2.3**).

The increase in cultivated area for both cotton and rice during FY04 was principally a function of higher prices during the previous year. [4] The decline in the crop area for sugarcane, however, probably reflects the unresolved problem of delay in payments by the sugar mills in addition to unattractive mill-gate prices. Finally, the decline in the area under maize is more pronounced simply because the figure currently does not include the area that will be brought under cultivation in the spring season. [5]

A breakup of the area under cultivation of important *kharif* crops during FY04 by province shows that it increased in both, the Punjab and Sindh, while it declined by 6.2 percent in NWFP and marginally (by 0.3 percent) in Balochistan (see **Table 2.4**). The shortfall in the cultivated area of maize was the main factor for the overall decline in cultivated area in NWFP; [6] after the inclusion of the area for the spring season maize crop, this decline is expected to narrow substantially (or disappear).

Table 2.4: Provincial Breakup of Area Under Cultivation

thousand hectares

	Punjab	Sindh	NWFP	Bal.	Total
Cotton	2,436	565	7	41	3,049
	(10.3)	(4.1)	(250.0)	(0.0)	(9.1)
Sugarcane	686	261	104	0	1,051
	(-6.7)	(0.8)	(-1.0)	(-100.0)	(-4.5)
Rice	1,668	562	63	164	2,457
	(10.3)	(15.2)	(3.3)	(0.0)	(10.4)
Maize	304	7	512	3	826
	(-18.1)	(0.0)	(-9.1)	(0.0)	(-11.8)
Total	5,094	1,395	686	208	7,383
	(5.6)	(7.6)	(-6.2)	(-0.3)	(4.6)
Ratio to cultivable land (%)	43.1	24.8	49.6	7.3	36.2

Note: Figures in parenthesis are the percentage changes over FY03

Sources: i) Federal Committee on Agriculture
ii) Agricultural statistics of Pakistan 2001-2002

Production of the crops

According to the preliminary FY04 estimates for important *kharif* crops, the production of rice and sugarcane has not only exceeded the FY03 output but also surpassed the targets for FY04. In contrast, the production of cotton has

Table 2.5: Production of Important Kharif Crops

million cotton bales, all other in 000' tonnes

		FY04		% Change over	
Crops	FY03	Target	Prel.	FY03	Target
Cotton	10.2	10.6	10.0	-1.6	-4.8
Sugarcane	52,056	52,500	52,600	1.0	0.2
Rice	4,479	4,550	4,871	8.8	7.1
Maize	1,737	1,800	na	-	-

Sources: i) Federal Committee on Agriculture
ii) Economic Survey, 2002-2003

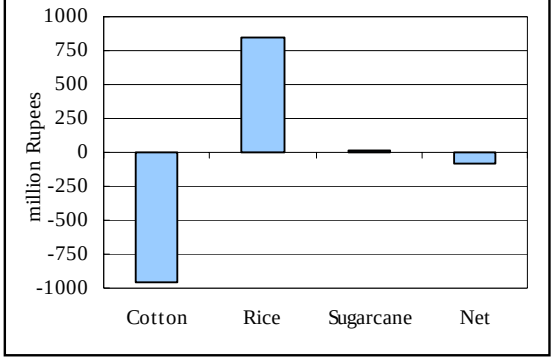
[4] The rise in the area under cotton cultivation in the Punjab, in particular, owed also to relatively better water availability at the time of sowing.
[5] The highest area in the spring season was recorded at 78.1 thousand hectares during FY99.
[6] Customarily, in NWFP, maize and tobacco are cultivated on larger area compared to any other province.

been estimated at 10.0 million bales i.e., lower than both, the FY04 target as well as the FY03 harvest (see **Table 2.5**).

The relatively poor cotton harvest is caused by a combination of untimely rains in some cotton growing areas as well as pest attacks, which more than offset the impact of an increase in the cultivated area.

However, fortunately, the impact of this setback[7] was largely offset by a significant improvement in the rice harvest (where a 10 percent increase in the area under cultivation brought about an 8.8 percent rise in the production). As a result, the net contribution of the important *kharif* crops to agriculture value addition for FY04 is only slightly negative relative to the target (see **Figure 2.3**).

Figure 2.3: Value Addition by Crops Relative to Targets



Thus, with the *kharif* crops, in aggregate, performing slightly below expectations, the achievement of the annual crop sub-sector growth target during FY04 will depend heavily on the performance of wheat and gram, the two important crops of the ensuing *rabi* season.

2.1.3 Prospects for FY04 Wheat Crop

Wheat is the leading crop in Pakistan, accounting for a third of the value added by major crops. The crop is cultivated in all provinces[8] (both in irrigated and *barani* regions), and the cultivated area for wheat alone is generally almost equal to the aggregate cultivated area for all other major crops (see **Figure 2.4**). Thus, the

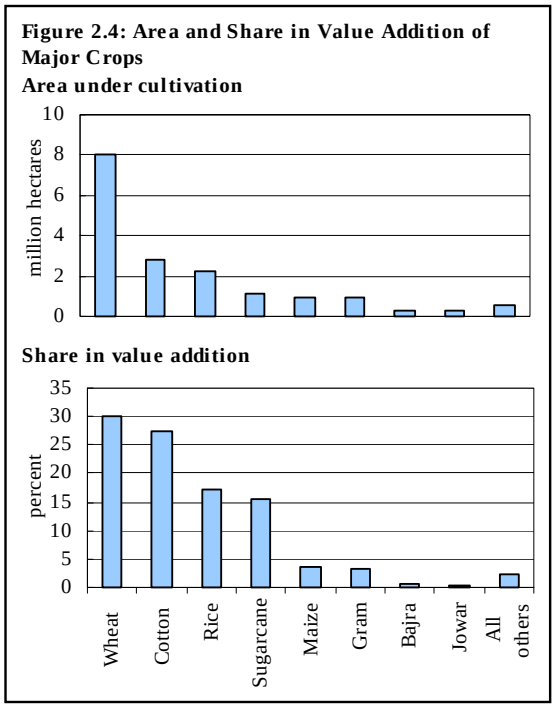
[7] The Rupee equivalent loss has been calculated by measuring the decline in quantity on constant market prices of 1980-81. The net loss is estimated at Rs 83.2 million. It should be noted that the figure refers only to the direct impact due the lower higher/lower production of crops and does not incorporate the corresponding impact on value addition in downstream economic activities.

[8] Interestingly, the ratio of total cropped area to area under wheat cultivation is between 37-39 percent in all the provinces except Sindh where it is around 28 percent. This probably relates to the cropping pattern in the province where customarily a preference is given to the cultivation of rice and sugarcane.

wheat harvest has a crucial bearing on the agri-sector output as well as the distribution of farm incomes.

During FY04, wheat has been targeted to be sown on 8,183 thousand hectares of land, 1.2 percent higher compared to 8,090 thousand hectares under cultivation in the previous year. In recent months, however, a concern has been expressed that the delayed commencement of the sugarcane crushing season would, in turn, delay the sowing of wheat in sugarcane areas, thereby: (1) significantly reduce the area under wheat cultivation; and (2) render the wheat production target unachievable. However, the delay in the crushing of sugarcane, by itself, is not expected to materially impact the achievement of the targeted wheat production in FY04.[9]

Figure 2.4: Area and Share in Value Addition of Major Crops



It should be noted that the areas with crops rotation between sugarcane and wheat are small. In fact, sugarcane is normally an 8 - 9 month crop, but more generally engages the land throughout the year, and therefore it is not usually rotated with any other major crop. More typically, the wheat crop is rotated with cotton and rice. In mixed cropping zones, minor crops precede the wheat cultivation.

In any case, the projected acreage under wheat during FY04 is quite conservative, being well below the level reached in FY00. In fact, during FY03, the area under the wheat crop was only around 36 percent of the available cultivable land, and

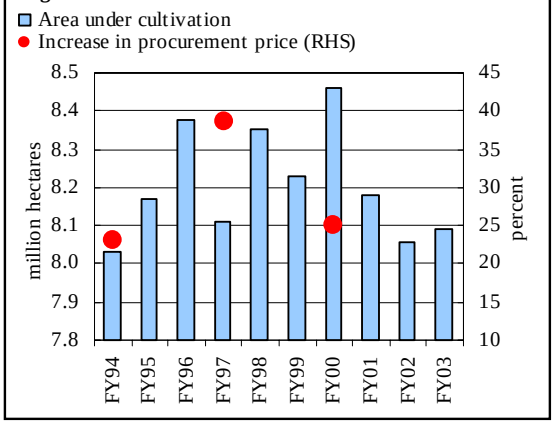
[9] To put this in perspective, it may be recalled that a significant delay in the sugarcane-crushing season was also witnessed in FY01, but in that year, even with the prevailing water shortages, the area under cultivation was a 8,181 thousand hectares- almost the same as was targeted for the FY04 crop.

the 1.2 percentage point increase implicit in the FY04 wheat acreage target can easily be met by bringing fallow land[10] under cultivation as much as by substitution with other crops.

In fact, the more important factors for the FY04 wheat sowing decision are likely to be: (1) the high FY03 post-harvest market price of the crop, (2) pre-sowing announcement of procurement price, and (3) water supply (canal water and rains) at sowing time.[11]

In particular, past experience suggests a very strong positive correlation between the area under cultivation and pre-sowing announcement of procurement price for wheat (see **Figure 2.5**). It is worth noting that the upward procurement price revisions in FY00 proved most effective because it was announced at the sowing time, while the prices revised in FY94 and FY97 led to a lagged increase in the area under wheat area because the announcements were made at the harvesting rather than the sowing times.

Figure 2.5: Wheat-Procurement Price and Area



Thus, given the ample availability of water, the relatively attractive prices in preceding season, and the recent revision of the procurement price (from Rs 300 to Rs 350 per 40 kg) ahead of the sowing season is expected to significantly increase the acreage under wheat during FY04. As a result, barring unforeseen shocks, there is a possibility that production target of 20 million tonnes for FY04 will be exceeded.

[10] It refers to the area which is vacant during the year under reference but was sown at least once during the previous year.

[11] Published in Pakistan Journal of Agricultural Economics, (Vol. 4. No2, July December 2001) Mr. Noor Muhammad, Chief Statistical officer, FBS, Islamabad has estimated the area equation for Punjab as: Area = 1653 + 8.33 PRICE+0.22 WDEC +9.12RNOV; where PRICE = current support of wheat fixed by Government, WDEC = canal-water withdrawal during December and RNOV = rainfall in November.

2.1.4 Agricultural Credit

Disbursement

A sharp jump in lending by commercial banks (CBs)[12] pushed up the gross credit disbursement to agriculture during Q1-FY04 by 41.1 percent relative to the corresponding quarter of FY03. As a result, for the first time, aggregate lending to agriculture by CBs' exceeded the disbursement of credit by Zarai Taraqiati Bank Limited (ZTBL) (see **Figure 2.6)**.

Figure 2.6: Trends in Credit Disburment during Q1

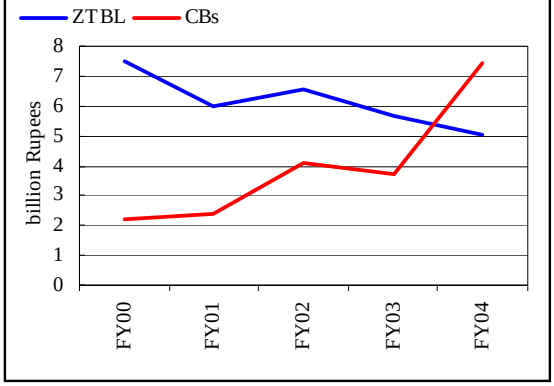


Table 2.6: Credit to Agriculture Sector during Q1

million Rupees

	FY03	FY04	% Change
Disbursements			
ZTBL	5,649	5,038	-10.8
Commercial banks@	3,722	7,416	99.3
New private CBs*	149	620	316.7
PPCB	629	1,248	98.4
Total	10,148	14,321	41.1
Recovery			
ZTBL	3,218	3,014	-6.3
Commercial banks@	2,785	4,327	55.4
New private CBs*	56	179	222.3
PPCB	530	574	8.2
Total	6,533	8,093	23.9

Source: Agricultural Credit Department, SBP

@ Includes NBP, HBL, MCB, UBL, and ABL.

* Started lending since Q2-FY02

In fact, ZTBL's poor performance was a drag on the exceptional improvement in both agri-credit extension as well as loan recoveries (see **Table 2.6**). Excluding ZTBL, disbursements rose by 106.3 percent, while the loan recoveries were 50.7 percent higher in Q1-FY04 compared to Q1-FY03.

The credit for CBs' overwhelming lead in disbursement over the ZTBL during Q1-FY04 goes to all the participating commercial banks that took the full advantage of their larger branch network, ample availability of liquidity and the changes in credit

[12] Include: i) Allied Bank of Pakistan, ii) Habib Bank Limited, iii) Muslim Commercial Bank limited, iv) National Bank of Pakistan, v) United Bank Limited.

delivery policy made by the SBP[13] and introduced innovative credit products.

Recent important steps taken by the CBs include:

1. Assigning greater importance to the disbursement of development loans (mostly for purchase of tractors). During Q1-FY03, the ratio of production and development loans in total disbursement was at 93:7 which changed to 82:18 during Q1-FY04;

2. Charging the same lending rate both for development as well as production loans (@ 11.0 percent per annum). Earlier, higher interest was charged on the development loans.

3. Providing better service standards to the borrowers and promoting their business by aggressive marketing efforts (with strong publicity campaigns advertising the availability of loan by commercial banks through radio programs and fixing billboards at important agri-markets).

By contrast, ZTBL witnessed a further contraction in disbursements during Q1-FY04 over the already depressed base (the disbursement during Q1-FY03 was 13.9 percent lower than that of Q1-FY02). This deteriorating situation not only reflects the ZTBL inability to compete in the environment created by the CBs, but also suggests the need to revamp the existing practices of credit extension, emphasizing on the need to improve upon the business relations with clients. The recent fall in disbursement primarily owes to:

1. The incentive of 3.0 percent rebate, which is available to the borrowers who repay the installment on time, could not attract the borrowers. In fact, the effective rate for the clean borrowers has been reduced from 14 percent to 11 percent per annum since January 2003;[14]

2. The policy measure of the ZTBL of linking the credit disbursement with the recovery at each branch level. This has led to a shortage of loanable funds as Non-Performing Loans (NPLs) have increased;

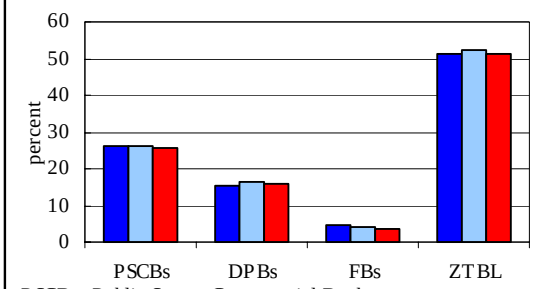
[13] In addition to the number of steps taken by the SBP spread over the past two years, the most important step was the introduction of revolving credit scheme of agri-lending that has resulted in substantially reducing the paper work at the end of farmers.

[14] However, in case of a default the rate jumps again to 14 percent per annum (this too is a disincentive for the scheme.

3. Many of the earlier ZTBL clients prefer the better service standards offered by CBs.

In recent years, a large overhang of non-performing assets, as well as high cost of funds have both hampered ZTBL's credit extension. This problem was exacerbated by a further increase in NPLs during Q1-FY04. As on September 30, 2003, these rose to Rs 52.8 billion compared to Rs 44.0 billion as on June 30, 2003. ZTBL's ratio of NPLs to gross advances is now significantly higher compared to all its competitors (see **Figure 2.7**).

Figure 2.7: Ratio of NPLs to Gross Advances



PSCB = Public Sector Commercial Banks
DPBs = Domestic Private Banks
FBs = Foreign Banks

The only possible solution to halt the increase in NPLs in the case of ZTBL is to strictly abide by the prudential regulations laid down for safer lending regardless of any shortfall in disbursement targets. Moreover, the portfolio of lending should be managed without intervention of non-monetary authority otherwise the operations of ZTBL will be unsustainable.

2.2 Industrial Production[15]

The pace of industrial activities accelerated during the first quarter of FY04 with the Index of Industrial Production (IIP)[16] rising by 10.1 percent during Q1-FY04 compared to the 4.3 percent growth in the same period of the preceding year. In fact, industrial production has remained well above the corresponding levels for FY03, throughout the quarter (see **Figure 2.8**). Given the strong Q1-FY04 performance, it is probable that the FY04 annual industrial growth target will be met, unless the aggregate LSM growth is substantially undermined by a poor sugar output.

[15] Due to a 3-months time lag in receiving data on mining and energy, we have used projected production figures for the month of September 2003.

[16] In order to analyze more representative trends in industrial sector, the SBP has developed an Index of Industrial Production (IIP), comprising LSM, mining & quarrying and electricity generation that covers around 60 percent of the value added during 1980-81. For details, see **Part A Box 2.1** (page 29), State Bank of Pakistan Annual Report for FY03.

While large-scale manufacturing (LSM) and electricity generation both recorded higher growth in Q1-FY04 relative to the corresponding period of FY03, the contribution of the LSM was dominant, accounting for more than 80 percent of the industrial growth. As a result, the share of electricity generation in overall industrial output (as measured by IIP), fell by 3.7 percentage points to 16.0 percent during Q1-FY04, despite a sharp deceleration in the growth of mining industries. The deceleration in the growth of mining is primarily due to a high-base effect (see **Figure 2.9**).[17]

Figure 2.8: Index of Industrial Production

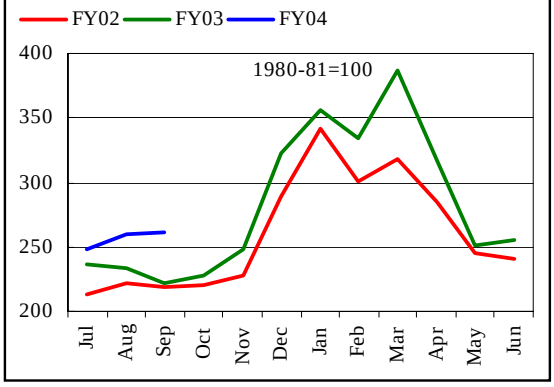
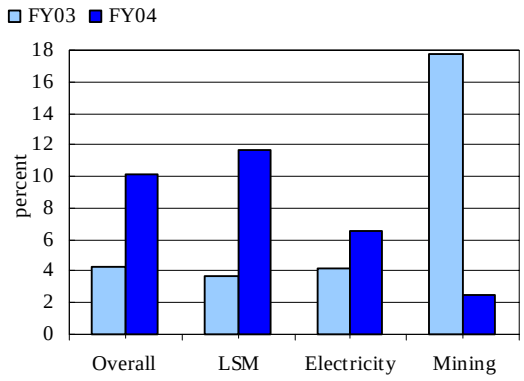


Figure 2.9: Sectoral Growth of Industrial Production during Q1



The upsurge in industrial activities during Q1-FY04 was broadly supported by higher domestic demand for consumer goods (largely led by consumer credit availability), higher allocation for infrastructure development, and tariff rationalization measures[18], which led to capacity expansion & modernization drives in some major industries. Also, the export of manufactured goods remained well above last year, despite a slowdown witnessed during Q1-FY04 compared to the immediately preceding quarters.

[17] During Q1-FY03, the production of natural gas, crude oil, coal, gypsum and chromites saw significant growth.

[18] Under the tariff rationalization measures, the import duty was slashed by 5 percent on import of a number of raw materials.

Growth in User Based Industrial Groups

The industrial growth profile, disaggregated by user-based categories, depicts a broad-based improvement during Q1-FY04, with stronger growth in each category (see **Table 2.7**).

The substantial growth in the capital goods industries is particularly encouraging, suggesting that expectations of a sustained economic recovery are finally taking root. This view is also supported by the continuing strength of machinery imports during the quarter. Leading the upsurge in capital goods production were textile machinery, commercial vehicles (trucks, tractors), transformers and agriculture machinery.

Table 2.7: Growth of Industrial Production by End Use during Q1

percent

Sectors	Weights	FY02	FY03	FY04
Basic goods	24.349	14.5	4.2	6.3
		(64.8)	(26.6)	(21.2)
Intermediate goods	35.199	5.8	3.9	4.8
		(32.9)	(28.7)	(18.8)
Consumer goods	37.093	-0.8	9.8	20.6
		(-2.9)	(44.2)	(51.3)
Non-durables	35.434	-4.0	1.3	13.6
		(-12.4)	(4.9)	(25.7)
Durables	1.659	17.3	48.8	42.5
		(9.5)	(39.3)	(25.6)
Capital goods	3.359	24.1	1.6	50.8
		(5.2)	(0.5)	(8.7)

Source: Based on data from FBS.
Note: Figures in parenthesis represents contribution to industrial growth.

The increased contribution of the consumer goods industries to overall industrial growth is also quite significant. Strong growth in both *consumer durables* as well as *consumer non-durables* meant that the consumer goods industry contributed over half of the total industrial *growth* during Q1-FY04. Moreover, contrary to Q1-FY03, most of the improvement stemmed from the increased output of consumer non-durables.

2.2.1 Large-scale Manufacturing

The large-scale manufacturing (LSM) growth during Q1-FY04 was an exceptionally strong 11.7 percent, compared to a mere 3.7 percent increase during Q1-FY03. This represents the strongest first quarter performance by LSM for (at least) the last fifteen years (see **Figure 2.10**).

Moreover, the growth is remarkably broad-based; not only did *all* 14 sub-sectors record higher output (in contrast to the preceding two years), most witnessed an acceleration in growth even over the high Q1-FY03 base. In fact, only four sub-

sectors, with a combined weight of 10.3 percentage points in LSM (out of total LSM weight of 72.276), witnessed a deceleration in growth (see **Figure 2.11**).

Figure 2.10: LSM Growth during Q1

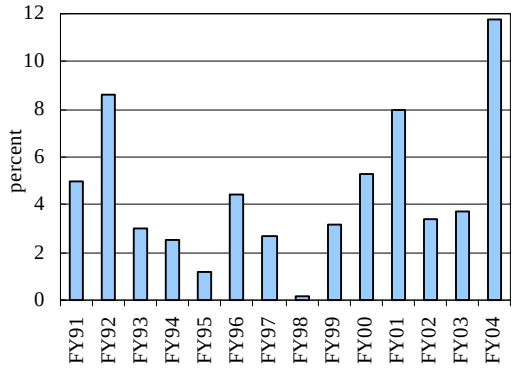
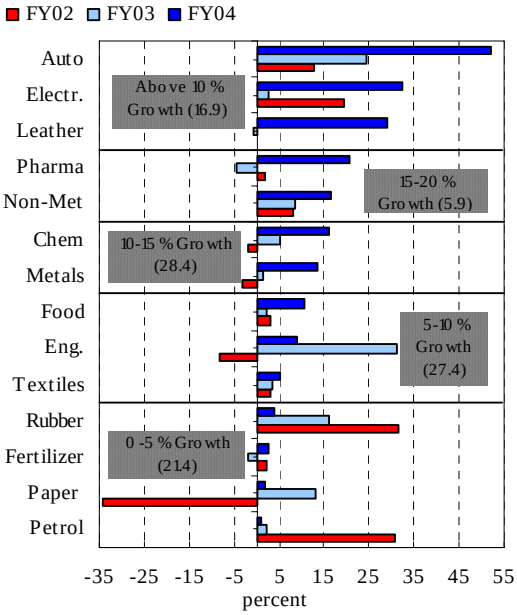


Figure 2.11: Growth in LSM Sub-sectors during Q1



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

As during FY03, the Q1-FY04 surge in LSM production was underpinned by both export and domestic demand, but the composition within each did see some changes. In particular, the Q1-FY04 growth in the capital goods industry was ignited not only by the continuing strength of exports but also by a revival in agriculture. Similarly, the continuation of the FY03 consumer finance-led rise in production of consumer durables (and construction-related industries) was supplemented in Q1-FY04 by a jump in the production of consumer non-durables (see **Tables 2.7 & 2.8**).

However, the sectors benefiting from the improved access to consumer finance continued to dominate the overall outcome. In particular, the automobile and electronics sub-sectors of LSM witnessed a significant increase in demand as a result of low interest rates, as well as increased credit availability and greater consumer awareness. Not surprisingly, therefore, these sub-sectors accounted for almost 42.6 percent of LSM growth during Q1-FY04 (see **Table 2.9**).

Table 2.8: Growth in Production of Selected Large-scale Manufacturing Items

percent

		Q1				Q1	
	Weights	**FY02**	**FY03**		**Weights**	**FY02**	**FY03**
Textile	**19.069**	**3.4**	**5.1**	**Chemicals**	**2.335**	**5.1**	**15.9**
Cotton yarn	8.850	6.2	2.0	Caustic soda	0.621	-1.3	14.3
Cotton cloth	4.881	-3.2	19.4	Soda ash	0.320	29.0	2.7
Cotton ginned	3.893	-3.7	3.3	Other six items	1.394	4.8	22.2
Other five items	1.445	9.1	23.4	**Electronics**	**2.230**	**2.7**	**32.4**
Food, beverages & tobacco	**17.336**	**7.9**	**10.6**	Electric transformers	0.577	67.9	39.0
Sugar[1]	8.630	0.0	0.0	TV sets	0.363	-0.7	-8.8
Vegetable ghee	3.004	-2.2	3.8	Air conditioners	0.120	8.4	466.2
Cigarettes	2.505	-11.8	16.4	Refrigerators	0.015	16.3	42.3
Tea	1.785	0.9	3.3	Other five items	1.155	-11.7	65.0
Beverages	0.964	38.9	0.5	**Automobile**	**2.348**	**24.3**	**52.1**
Cooking oil	0.448	16.2	19.9	Trucks	0.698	165.0	18.5
Petroleum products	**7.824**	**2.1**	**0.9**	Tractors	0.593	-7.5	46.2
Fertilizers	**5.871**	**-2.0**	**2.7**	LCVs	0.369	34.0	-14.1
Nitrogenous	5.441	3.3	2.2	Cars & jeeps	0.309	25.4	60.4
Phosphatic	0.430	-55.6	12.6	Motorcycles	0.249	28.8	65.8
Pharmaceuticals	**5.284**	**-4.6**	**20.8**	Buses	0.130	66.4	-38.5
Tablets	2.705	-5.7	20.4	**Non metallic minerals**	**1.915**	**8.5**	**16.4**
Syrup	1.602	-4.2	24.2	Cement	1.846	6.9	17.2
Injections	0.466	-3.7	12.8	Glass sheets	0.069	62.0	-1.5
Capsules	0.228	4.5	9.5	**Paper & board**	**1.359**	**13.1**	**1.6**
Other two items	0.283	-3.5	20.2	**Engineering items**	**0.712**	**31.2**	**8.8**
Metal industries	**3.194**	**1.2**	**13.5**	Bicycles	0.348	27.3	6.2
Pig iron	1.477	-2.4	18.7	Safety razor blades	0.109	4.7	5.2
Coke	1.319	-4.9	22.5	Diesel engines	0.065	1809.1	33.8
Billets	0.311	12.3	0.1	Sewing machines	0.052	3.2	32.0
H.R/coils and plates	0.074	-2.4	13.9	Power looms	0.051	85.0	-15.7
C.R coils/plates/sheets	0.013	11.1	4.1	Other five items	0.087	-6.9	22.7
Leather products	**2.333**	**-0.8**	**29.0**	**Tyres & tubes**	**0.452**	**16.2**	**3.8**

Source: Federal Bureau of Statistics

[1] Because the sugarcane-crushing season usually starts in October or November, the production of sugar is reported as nil during first quarter of the year.

The contribution of consumer finance is most evident in the automobile sector, in which the sale of passenger vehicles (cars and motorcycles) has accelerated since Q3-FY02 following the aggressive marketing of auto loans by banks and leasing

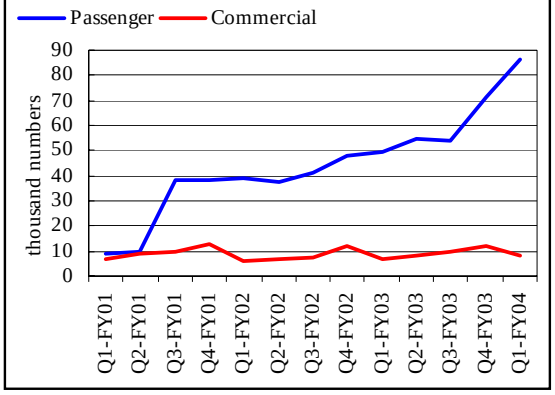
companies (see **Figure 2.12**). The sustained growth in the demand for passenger vehicles has engendered very positive demand projections (see **Table 2.10**), leading to the induction of additional capacity during Q1-FY03,[19] as well as planned investments totaling Rs 19 billion to meet the projected demand.

Table 2.9: Summary of Growth Rates during Q1
percent

	FY02	FY03	FY04
Overall	3.4	3.7	11.7
Excluding automobile	2.9	2.4	8.9
Excluding electronics	2.9	3.7	10.7
Excluding auto & electronics	2.4	2.4	7.6

Source: Based on data from Federal Bureau of Statistics

Figure 2.12: Automobile Sales



It is interesting to note that sale of commercial vehicles did not match the consumer finance-led rise in sales of passenger vehicles. In fact, production of buses and LCVs sale declined relative to Q1-FY03, probably reflecting higher imports and the impact of the take over of Sindh Engineering Ltd by a Chinese company. The impact of this slowdown was partially offset by the higher production of trucks and tractors.

Table 2.10: Projected Demand for Automobiles in FY05
numbers

Vehicles	Demand
Cars	115,186
Motorcycles	416,857
Pickups	21,335
Buses	2,210
Trucks	3,168
Tractors	30,307

Source: Industrial Bulletin (October 2003), Experts Advisory Cell, Ministry of Industries & Production

The construction-related industries, i.e. cement, steel, paints & varnishes etc., also benefited from the growth in consumer credit (see **Figure 2.13**), as well as the increased infrastructure development spending by the government (the construction of Gwadar Port, small dams, bridges and roads are

[19] While a Chinese company (Dong Feng) in collaboration with Sindh Engineering Ltd. and few motorcycle and rickshaw manufacturers has already started production, the establishment of five more plants (motorcycles and auto rickshaw manufacturing) has been allowed by the indigenization committee of EDB.

the major projects absorbing of cement and steel). The cement demand from local construction activities has been supplemented by rising exports (mainly to Afghanistan), particularly during Q1-FY04 (see **Figure 2.14**).

Figure 2.13: Housing Finance (Disbursement for Construction)

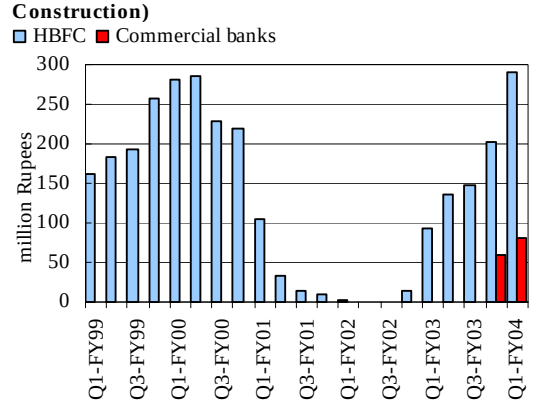
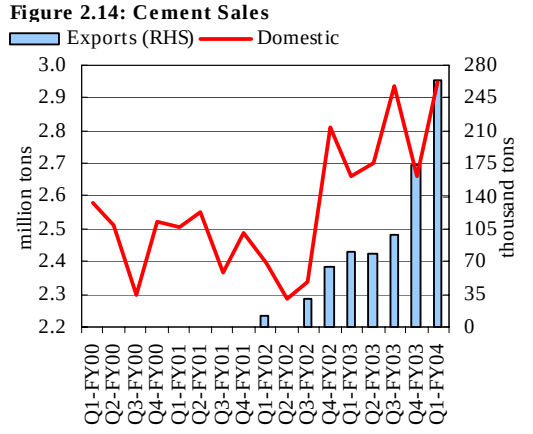


Figure 2.14: Cement Sales



It is important to note that this rise in cement demand has been witnessed despite the high prices maintained by the cement cartel. It is particularly troubling to note that the 25 percent reduction in excise duty on cement introduced in the FY04 budget has not yet been passed on to consumers in the form of lower prices (see **Figure 2.15**).

In other words, the policy change, aimed at spurring demand, has been stifled by the artificially high prices, (set by the pricing cartel). In fact, if the duty reduction is solely swelling the profits of producers, with a corresponding loss in government revenues and no gains to the consumer, there may be pressures to impose a "windfall" tax on cement producers to reverse the earlier tax loss.[20]

The continuing strong export demand underpinned the textile sub-sector growth, with a 5.1 percent increase in production during Q1-FY04, as compared to a 3.4

[20] The incidence of reduction in CED when combined with GST reduction on sale price, turns out to be Rs 14.37 per bag or Rs 287 per ton on the June 2003 price. Taking the domestic sale of 2.9 million tons for the Q1-FY04, the total amount of relief, as envisaged in the budget, would have been approximately Rs 922 million.

percent increase in the same period of the preceding year. This was mainly contributed by higher production of cotton cloth (19.4 percent).[21] It may be recalled that the coverage of fast growing value-added textiles in the large-scale manufacturing sector (based in 1980-81 production) is highly limited. Thus to outside observers, there is always a question about the consistency of very high growth of textile exports and relatively moderate increase in textile production under large-scale manufacturing.

Table 2.15: Expected Cement Prices after CED Reduction

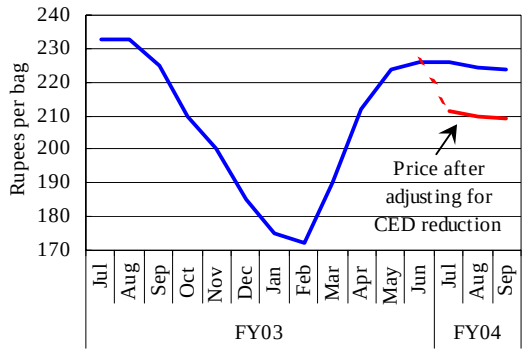
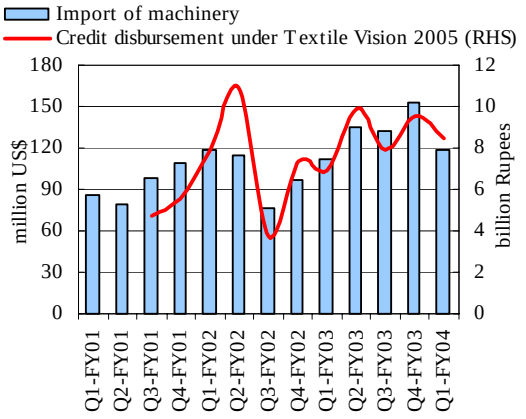


Figure 2.16: Investment Indicators in Textiles



Supported by the strong exports, the balancing, modernization and replacement (BMR) and expansion drive continued apace in the textile industry during the quarter. This is evident from the rise in both, the credit disbursements under Textile Vision 2005 and import of machinery during Q1-FY04, compared to the previous year (see **Figure 2.16**).

Q1-FY04 also witnessed strong growth in the *food, beverages and tobacco* sub-index of the IIP, even over the high base set by the Q1-FY03 growth. This was mainly due to the relatively higher production of cooking oil and reversal in the production of vegetable ghee and cigarettes.

[21] Increase in cotton cloth production was also due to inclusion of estimates of production from informal sector (non-mill sector).

The turnaround in the production of ghee, after persistent declines witnessed during the last two years, was mainly due to measures taken in the FY04 federal budget to discourage the production of ghee by the unregistered units.[22] Also, the consumption of both cooking oil and ghee typically increases during Ramadan. However, higher growth in the production of cigarettes was mainly export driven.[23]

Finally, the production of *fertilizers* was mostly led by higher output of phosphatic fertilizers, as FJFC's DAP plant was restarted after undergoing a financial restructuring in September 2003.[24] Despite this positive development, the growing needs of the agriculture sector have been increasing the dependence on imports. In view of the growing supply-gap and continuing absence of private sector investment in this area, the government plans to establish two more plants in the public sector (urea 861000 mt and SSP 150000 mt).

Capacity utilization in large-scale manufacturing industries

Most LSM sub-sectors witnessed an increase in capacity utilization during Q1-FY04, relative to the corresponding period of FY03, led by cement, steel, consumer durables and food processing. While some of the industries where capacity utilization had already been in the range of over 90 percent during FY03, continued to maintain or improve on those levels in FY04 (see **Table 2.11**).

As already, discussed in the Annual Report for FY03, these industries are in urgent need of fresh investment because in spite of very high capacity utilization, domestic requirements of fertilizer, steel, chemicals, paper & paperboard etc. are being met through heavy imports.

2.2.2 Infrastructure industries

Significant increases in the production of electricity, cement, basic metals, and natural gas, boosted the overall performance of infrastructure industries. The index of seven infrastructure industries[25] recorded a 6.8 percent increase during

[22] Previously, the import of oil seeds by the solvent industries was allowed @10 percent. In the budget for FY04, 20 percent GST replaced 10 percent import duty on import of oil seeds.

[23] The export of cigarettes almost doubled during Q1-FY04 compared to the same period last year.

[24] The DAP plant of the FFC-Jordan has been closed since September 2001 due to heavy losses. The major reason behind losses were higher raw material cost (phosphoric acid) and decline in DAP prices in international market. The closure for a period of two years also increased the debt burden of the DAP plant of FFC-Jordan.

[25] In order to analyze the performance of infrastructure industries, the SBP has constructed a composite index of seven infrastructure industries. For details, see **Box 2.1 Part B** of the SBP Annual Report for FY03.

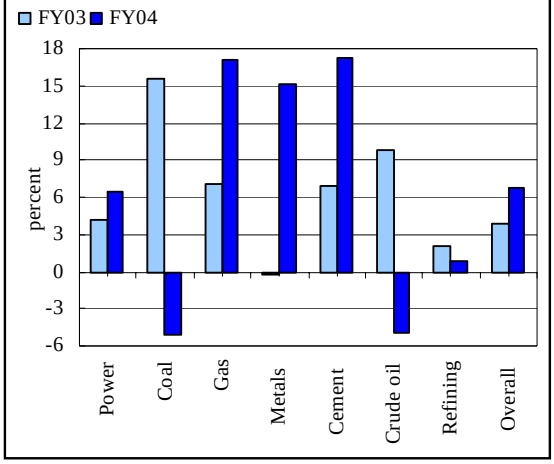
Q1-FY04 compared to a moderate growth of 3.9 percent in the same period last year (see **Figure 2.17**).[26]

Table 2.11: Capacity Utilization in Selected Industries

Industries	FY02	FY03	During Q1	
			FY03	FY04
Food (ghee & cooking oil)	34.7	32.6	33.3	35.4
Consumer durables	46.7	60.4	39.2	56.9
Cars Jeeps & LCVs	42.8	65.0	53.7	79.5
Trucks & Buses	22.9	33.7	32.4	28.8
Tractors	73.7	80.3	57.2	83.7
Appliances (Refrigerators and air conditioners)	26.9	34.1	25.1	38.2
Cement	60.5	67.8	64.1	75.2
Steel	81.0	91.0	81.6	93.0
Industrial chemicals (soda ash and caustic soda)	86.1	94.5	90.0	96.7
Fertilizer	88.0	90.7	95.9	98.5
Petroleum refining	81.2	83.3	96.8	97.7
Paper & paper board	82.7	95.1	96.0	97.6

The substantial increase in electricity generation is attributable to induction of new capacity in the Ghazi Brotha hydel power project. This project has a total planned generation capacity of 1450 MW electricity annually; the first of five planned 290 MW turbo-generators began commercial operations in August 2003, while another initiated trial production at the same time.[27] Electricity generation is expected to witness further boosts as additional units become

Figure 2.17: Growth of Infrastructure Industries during Q1

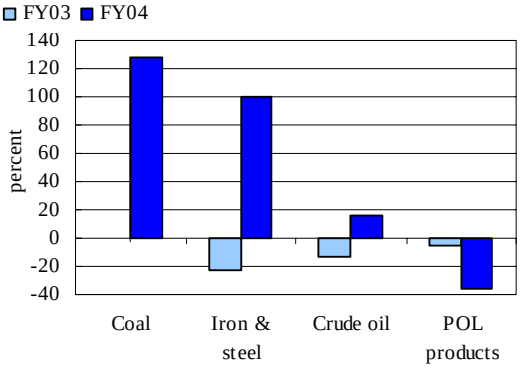


[26] The infrastructure industries had already performed extraordinarily during Q1-FY02, when the petroleum-refining sub-sector saw addition in capacity (4.5 million tons) in the form of PARCO. Also, electricity generation witnessed substantial increase during Q1-FY02.

[27] This unit has already started trial production in June 2003.

operational.
However, growth in output of petroleum refining decelerated while production of crude oil and coal witnessed a decline during Q1-FY04. Although, the industrial use of coal as fuel is rising in the country, yet most of the requirements are being met through imports (see **Figure 2.18**) due to inferior quality of domestic coal and absence of coal processing technology.[28]

Figure 2.18: Growth of Infrastructure Industries Imports during Q1



During Q1-FY04, the output of *petroleum products* practically remained the same as in Q1-FY03 although another refinery, the Bosicor Pakistan Ltd., started trial production.[29] The impact of the latter on production is expected to be realized when the refinery will start commercial operations by end-December 2003.

[28] The import of coal (quantum) almost doubled during Q1-FY04 compared to Q1-FY03.
[29] The Bosicor refinery, that has an installed capacity of 1.4 million tons per annum, started trial production in July 2003.