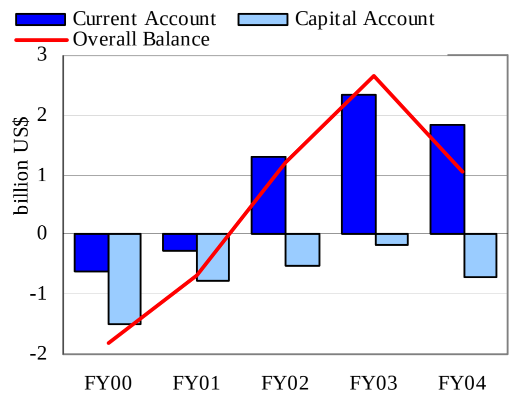
9 External Sector

Balance of Payments

Pakistan's overall external account surplus witnessed a 60.3 percent reduction during H1-FY04 relative to the corresponding period of the preceding year. However, a glance at **Figure 9.1** clearly shows that the net surplus is still significant (at US$ 1.0 billion) despite the worsening evident in both, the current and capital accounts during H1-FY04 (see **Table 9.1**).

Figure 9.1: Pakistan's External Accounts (H1)



While the current account surplus remained a very substantial US$ 1.8 billion during H1-FY04, it nonetheless represented a 21.7 percent YoY decline. The deterioration was in the face of a very impressive 61.2 percent reduction in the trade deficit, and owed almost equally to both, a significant decline in current transfers (due to the anticipated moderation in worker's remittances), as well as a higher services account deficit that stemmed principally from higher shipping payments (as imports rose), and a jump in travel related payments (following the re-integration of these payments from the informal to the formal sector).

Unlike the current account, the deficit in the capital account rose to US$ 702 million during H1-FY04 compared to the US$ 185 million during H1-FY03. This owed primarily to a US$ 1.5 billion fall in inflows, which more than offset the US$ 0.96 billion decline in capital outflows during the quarter. The main factors behind this outcome were: (1) lower foreign direct investment inflows; (2) a reduction in non-food aid from multilateral donors; (3) the retirement of trade related loans; and (4) an increase in the stock of outstanding export bills.

The reduction in the overall balance squeezed the liquidity in interbank market during the first half of current fiscal year and consequently the reserves accumulation by SBP declined sharply as it lowered the net purchases from the inter-bank market, allowing the Rupee to appreciate gradually.

Table 9.1: Balance of Payments-Summary Table
million US Dollars

Items	Q1		Q2		H1	
	FY03	FY04	FY03	FY04	FY03	FY04
1. Trade balance	**-146**	**3**	**-303**	**-149**	**-449**	**-146**
Exports(fob)	2,623	3,013	2,550	3,053	5,173	6,066
Imports (fob)	2,769	3,010	2,853	3,202	5,622	6,212
2. Services (net)	**-229**	**-369**	**-639**	**-887**	**-868**	**-1,256**
Shipment	-211	-255	-216	-259	-427	-514
Other transportation	45	47	77	68	122	115
Travel	-14	-171	-42	-287	-56	-458
Investment income	-507	-410	-543	-647	-1,050	-1,057
interest payments (net)	*-266*	*-174*	*-253*	*-303*	*-519*	*-477*
Purchase of crude oil	*-93*	*-108*	*-135*	*-158*	*-228*	*-266*
Profit and dividend	*-148*	*-128*	*-155*	*-186*	*-303*	*-314*
Other goods, services & Income	458	420	85	238	543	658
3. Current transfers (net)	**1,826**	**1,481**	**1,842**	**1,763**	**3,668**	**3,244**
a) Private transfers -net	1,551	1,278	1,554	1,522	3,105	2,800
i) Workers' remittances	1,053	906	1,095	968	2,148	1,874
ii) FCA (residents)	166	45	-228	156	-62	201
iii) Others	332	327	687	398	1,019	725
b) Official transfers	275	207	306	233	563	444
of which: Saudi oil facility	189	147	207	128	396	275
4. Current account balance (1+2+3)	**1,451**	**1,115**	**900**	**727**	**2,351**	**1,842**
5. Capital account(net)	**-214**	**-494**	**29**	**-208**	**-185**	**-702**
6. Errors & omissions	**206**	**149**	**267**	**-242**	**473**	**-93**
7. Overall balance	**1,443**	**770**	**1,196**	**277**	**2,639**	**1,047**
8. Financing	**-1,443**	**-770**	**1,196**	**-277**	**-2,639**	**-1,047**
I. Changes in reserves (-inc/+dec)	**-1,713**	**-770**	**-1,285**	**-222**	**-2,998**	**-992**
Assets	-1,739	-629	-1,326	-265	-3,065	-894
SDRs	-3	5	10	4	7	9
Forex (State Bank of Pakistan)	-2,175	-578	-1,469	-520	-3,644	-1,098
Forex (Commercial banks)	439	-56	133	251	572	195
Liabilities	26	-141	41	43	67	-98
Use of Fund credit	26	-141	41	43	67	-98
Repurchases	115	0	115	245	230	245
Purchases/drawings	-89	-141	-74	-202	-163	-343
II. Exceptional financing	**269**	**0**	**89**	**-55**	**358**	**-55**
Net SBP reserves (end-period)	6,991	11,30	8,452	11,482	8,452	11,482

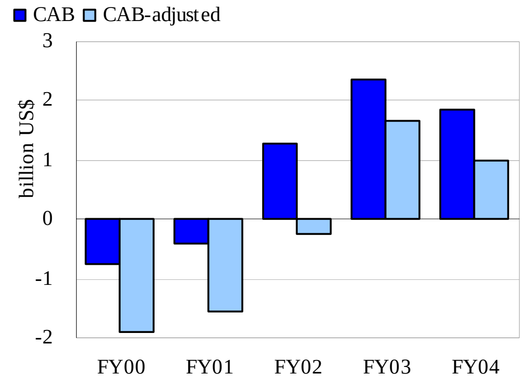
9.1 Current Account

The current account balance declined by 21.7 percent to US$ 1.8 billion during H1-FY04 over the corresponding period last year due to moderation in current transfers, higher services outflows on account of shipment, travel, and profit & dividend outflows. The decline in the adjusted current account balance (CAB*) was more pronounced at 46.5 percent during H1-FY04 over H1-FY03 (see **Figure 9.2**) as net structural inflows decreased during the first half of current fiscal year due to moderation in workers' remittances and re-integration of informal travel outflows relative to corresponding period of preceding year.

9.1.1 Trade Balance[1]

On a half yearly basis, a strong growth of 17.3 percent in export receipts surpassed the 10.5 percent growth in import payments during H1-FY04. As a result, the trade deficit during H1-FY04 reduced to US$ 146 million compared to the US$ 449 million recorded in the corresponding period of the previous year.

Figure 9.2: Current Account Balance (H1)



It is noteworthy that the trade deficit is entirely due to Q2-FY04, with sharp growth of 6.4 percent in imports, which outpaced the 1.3 percent growth in exports over the preceding quarter (for details, see **Trade Account** sub-section).

9.1.2 Services (net)

The services (net) outflows surged to US$ 1.3 billion during H1-FY04, up 44.7 percent compared to the corresponding period of the preceding year (see **Table 9.1**). This was because the increase in receipts under *other goods, services and income* was overwhelmed by the sharply higher *shipping*, *travel* and *investment income* outflows.

1. The 20.4 percent YoY rise in *shipping* related outflows to US$ 514 million simply reflects the rise in Pakistan's trade as well as a relative increase in imports under economic assistance during H1-FY04 compared to H1-FY03.[2]

2. The higher services outflows during H1-FY04 on account of *travel* expenditures represented the impact of the re-integration of informal system of moneychangers through exchange companies.[3] As a result of this policy shift, the *travel* expenditure increased to US$ 458 million during H1-FY04, over eight times higher than the US$ 56 million recorded during the corresponding period of FY03.

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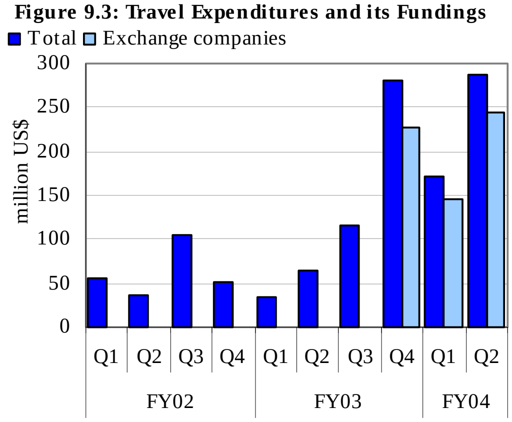
[1] **Section 9.1.1** is based on 'exchange record' from SBP, which will not tally with more detailed customs data used in **sub-section 9.3**.
[2] Shipping charges for normal trade usually average approximate 8 percent on cash imports while 15 percent on imports under foreign economic assistance.
[3] Please see SBP Annual Report FY03, page 150 for details.

More than 81 percent of H1-FY04 *travel* outflows were financed through exchange companies (see **Figure 9.3**).

Figure 9.3: Travel Expenditures and its Fundings



3. *Investment income* outflows during Q2-FY04 *increased* by 19.2 percent YoY to US$ 647 million, more than offsetting the 19.1 percent YoY decline in these outflows during Q1-FY04. As a result, in aggregate terms, H1-FY04 *investment income outflows* merely increased by 0.7 percent compared to H1-FY03 to reach US$ 1057 million. A dis-aggregation of the investment outflows for the period reveals interesting insights.

Table 9.2: Details of Interest Payments and Receipts
million US Dollar

	Q1		Q2		H1	
	FY03	**FY04**	**FY03**	**FY04**	**FY03**	**FY04**
Payments (I+II)	**296**	**210**	**295**	**346**	**591**	**560**
I. Total external debt	**249**	**164**	**265**	**299**	**514**	**463**
Public & publicly guaranteed	204	113	226	264	430	377
Long-term	188	96	184	238	372	334
Military	5	13	6	0	11	13
Euro bonds	6	1	31	23	37	24
Commercial loans/credits	4	2	4	1	8	3
IDB	1	1	1	2	2	3
Private loans/credits	35	45	27	26	62	71
IMF	10	6	12	9	22	15
II. External liabilities	**47**	**46**	**30**	**47**	**77**	**97**
Foreign currency deposits	5	9	6	6	11	15
Special US$ bonds	12	6	9	8	21	14
Central bank deposits	10	6	4	3	14	9
Others	20	25	11	30	31	59
Receipts	**30**	**36**	**43**	**47**	**73**	**83**
Interest on reserves	29	27	36	32	65	59
Others	1	9	7	15	8	24
Net Payments	**-266**	**-174**	**-252**	**-299**	**-518**	**-477**

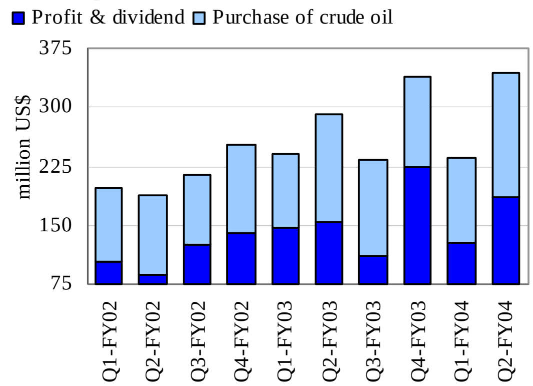
Source: State Bank of Pakistan

In particular, the 8.1 percent YoY H1-FY04 fall in *interest payments* (see **Table 9.2**) was despite large jump in *interest payments* on public and publicly guaranteed long-term debt in Q2-FY04. The apparent discordance in trend is a reflection an increase in the payment of debt arrears in Q2-FY04 following the finalization of the debt rescheduling agreement.[4]

Within the interest payments (net), the saving originated from the reduction in external debt & liabilities stock during the last three years. Contrary to H1-FY03, the interest on external liabilities increased by US$ 20 million to US$ 97 million that was primarily driven by the interest payments on foreign currency trade related loans extended to exporters and importers.[5]

In contrast to net interest payments, the outflows on account of *purchase of crude oil* and *profit & dividend*, increased by 9.2 percent to US$ 580 million over the corresponding period of FY03. These outflows are typically higher in the second and fourth quarters of the fiscal year (see **Figure 9.4**).

Figure 9.4: Investment Income Outflows (excluding interest payments)



On the other hand, the higher outflows on the account of purchase of crude oil reflects (1) higher foreign direct investment in oil & gas sector; and (2) relatively higher international oil prices during H1-FY04, which increased the value of oil extracted by foreign companies operating in this sector.

4. *Other goods, services and income* receipts increased by US$ 115 million to US$ 658 million during H1-FY04 over the corresponding period of the preceding year. The substantial logistic support receipts and income from information technology, however, were partially offset by lower receipts on account of communication services, financial and others services.

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[4] Another contributor may be the very provisional nature of the initial quarterly data. Due to large reporting lags these initial estimates are often subject to large revisions, and thus the initial quarterly data are often only indicative in nature.

[5] The interest paid by traders on foreign trade related lending is recorded as "interest payment" as well as receipts of banks under "other receipts".

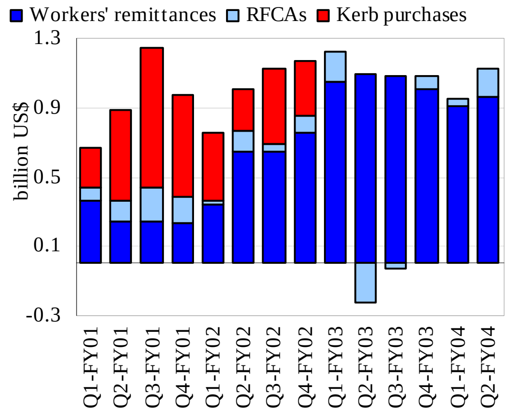
9.1.3 Transfers

The current transfers totaled US$ 3.2 billion during H1-FY04, 11.6 percent lower than the US$ 3.7 billion recorded in the corresponding period of the preceding year. This was mainly due to lower private transfers, particularly workers' remittances.

Private Transfers

Although the downtrend in remittance inflows reversed in Q2-FY04 (see **Figure 9.5**), the aggregate H1-FY04 remittances remained 9.8 percent below the H1-FY03 figures. While at the same time, the inflows on account of resident FCAs increased mainly due to inflows on account of the HBL privatization.[6]

Figure 9.5: Composition of Private Transfers from Overseas Pakistanis



Workers' Remittances

Workers' remittances (cash) declined by 13.4 percent to US$ 1.8 billions during H1-FY04 compared to US$ 2.1 billion during the corresponding period of FY03.

This appeared mainly due to the abolishment of Hajj Sponsorship Scheme (HSS) (see **Table 9.3**). Adjusting for these Hajj-related inflows it is evident that H1-FY04 inflows of US$ 1,845 million were only 7.9 percent lower than the US$ 2,001 million recorded in the corresponding period of FY03.

Not surprisingly therefore, the SBP projection for FY04 annual remittances was revised upward from US$ 3.6 billion to US$ 3.7 billion (which remains 11.5 percent lower than the FY03 annual receipts). In fact, the resurgence of inflows in recent months, particularly from the US, has raised hopes that the FY04 target may be comfortably exceeded (see **Figure 9.6**).

[6] US$ 39 million and US$ 143 million were transferred through resident FCAs for HBL privatization payments during December 2003 and February 2004 respectively.

Table 9.3: Country-wise Workers' Remittances
million US Dollar

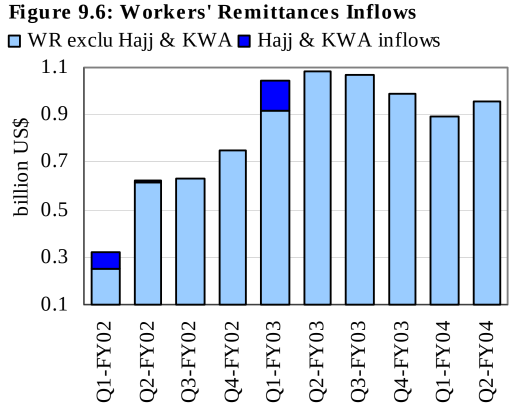
Countries	FY03 Q1	FY03 Q2	FY04 Q1	FY04 Q2	H1-FY03	H1-FY04	Shares H1-FY03	Shares H1-FY04
Gulf region:	**514**	**468**	**409**	**385**	**981**	**795**	**46.1**	**43.1**
Bahrain	16	18	19	18	34	37	1.6	2.0
Kuwait	47	61	38	45	107	83	5.0	4.5
Qatar	16	25	21	21	41	42	1.9	2.3
Saudi Arabia	151	132	161	134	283	295	13.3	16.0
Sultanat-e-Oman	21	23	24	25	44	49	2.1	2.6
U.A.E.	262	209	147	143	472	289	22.2	15.7
U.S.A.	**330**	**327**	**258**	**317**	**657**	**575**	**30.9**	**31.2**
Other than Gulf region:	**199**	**292**	**223**	**252**	**491**	**475**	**23.1**	**25.8**
Canada	3	5	4	6	7	10	0.3	0.5
Germany	5	8	17	10	13	27	0.6	1.5
Japan	2	3	2	1	4	2	0.2	0.1
Norway	2	2	3	2	4	5	0.2	0.3
U.K.	57	73	74	85	130	159	6.1	8.6
Others	131	202	123	149	333	272	15.6	14.7
Total	**1043**	**1087**	**890**	**955**	**2130**	**1845**	**100.0**	**100.0**
Growth rate (%)	221.0	73.5	-14.6	-12.1	123.9	-13.4		
Encashment FEBCs & FCBCs	10	8	16	13	18	29		
Grand total	**1053**	**1095**	**906**	**967**	**2148**	**1874**		

HSS: Hajj Sponsorship Scheme
Source: State Bank of Pakistan

Resident FCAs

Resident FCAs posted a sharp reversal in H1-FY04, from an *outflow* of US$ 62 million (due to payments for UBL privatization) during H1-FY03 to an *inflow* of US$ 201 million during H1-FY04. The major contributors to this upturn were: (1) the inflow on the account of HBL privatization settlement; and (2) the transfer of Crescent Investment Bank's FCDs to Mashreq Bank after the merger of the two institutions.

Figure 9.6: Workers' Remittances Inflows

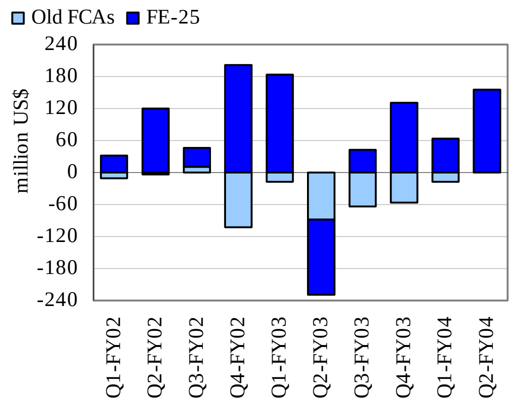


Looking at **Figure 9.7**, the drag of old FCAs conversion was eased which hints that the remaining stock of old FCAs will not cause current outflows in future.

Official Transfers

During H1-FY04, official transfers declined by 21.1 percent to US$ 444 million over the corresponding period of last year mainly due to lower disbursement under Saudi oil facility from inflow of US$ 396 million during H1-FY03 to US$ 275 million during the first half of the current fiscal year.

Figure 9.7: Resident FCAs (flows)



9.2 Capital Account

The capital account deficit increased by US$ 517 million to US$ 702 million during H1-FY04 as compared to US$ 185 million deficit recorded during the corresponding period of FY03. The main factors for this higher H1-FY04 capital account deficit were: (1) lower foreign direct investment;(2) lower non-food inflows relative to corresponding period of the preceding year; and (3) settlement of outstanding credit of foreign currency loans during H1-FY04 as against a substantial amount of US$ 971 million of these loans during H1-FY03 (see **Table 9.4**).

Net Foreign Investment (NFI)

NFI declined by 47.9 percent YoY to US$ 163 million during H1-FY04 compared to US$ 313 million recorded in the corresponding period of FY03. This owed to: (1) a decline in FDI inflow during H1-FY04 as against the H1-FY03 (when the privatization of UBL as well as one oil & gas field fetch substantial FDI inflows); and (2) reversal in portfolio investment in stock market from an inflow during H1-FY03 to an outflow of US$ 19 million during the period under review. This was partially offset by lower outflows during H1-FY04 on the account of maturing Special US Dollar Bonds, relative to corresponding period last year.

Looking ahead, the FDI inflow will increase in coming month due to the settlement of HBL privatization transaction.

Table 9.4: Capital Account
million US Dollar

Items	FY03		FY04		H1-FY03	H2-FY04
	Q1	Q2	Q1	Q2		
Capital Account (1 through 9)	-214	29	-494	-208	-185	-702
inflows	1492	1199	460	753	2691	1213
outflows	1706	1170	954	961	2876	1915
1. Direct investment abroad	1	-32	1	-24	-31	-23
2. Direct investment in Pakistan	170	372	117	160	542	277
3. Portfolio investment	-130	-68	-56	-35	-198	-86
of which: (Stock Markets)	-3	33	-28	9	30	-19
Special US Dollar Bonds	-115	-95	-19	-33	-210	-52
Net foreign investment (1 to 3)	41	272	62	101	313	163
4. LT Capital, (official)	68	-79	-32	-15	-11	-47
of which: Project Assistance	132	116	110	126	248	236
Food Aid	0	0	0	0	0	0
Non-Food Aid	330	175	126	118	505	244
Amortization	373	387	247	256	760	503
5. LT capital, (DMBs)	0	0	-13	-12	0	-25
6. LT capital, (Others)	-358	-126	-152	-104	-484	-256
of which: Suppliers Credits/MNCs	126	45	58	20	171	78
Supplier Credits Repayments	171	133	164	123	304	287
7. ST Capital, (official)	-59	-134	-125	-197	-193	-322
of which: Commercial banks (net)	-40	-114	-17	-116	-154	-133
IDB (net)	3	56	-35	-62	59	-97
8. ST Capital, (DMBs)	19	20	-50	50	39	0
of which: Outstanding Exports Bills	*24*	*16*	*-27*	*25*	*40*	*-2*
9. ST capital, (Others)	75	76	-184	-31	151	-215
of which: Outstanding Exports Bills	12	-101	*-107*	*-100*	*-89*	*-207*
Trade financing	677	294	*-238*	*149*	*971*	*-89*

Source: Statistics Department, SBP

Note= LT: Long-term, DMBs: Deposit Money Banks, ST: Short-term.

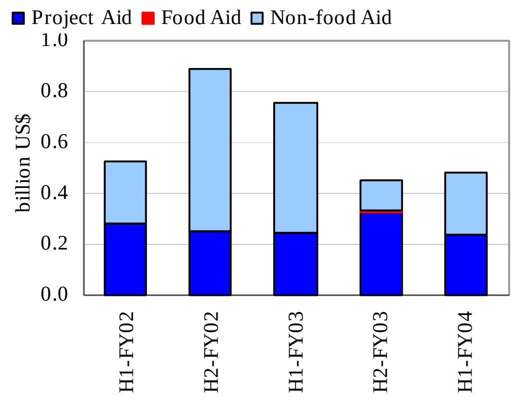
Foreign Economic Assistance

The disbursement of foreign economic assistance under long-term capital declined by 36.3 percent YoY in H1-FY04, reflecting the sharp US$ 261 million contraction in non-food aid as well as marginal decline of US$ 12 million projects-related assistance from the World Bank and ADB (see **Figure 9.8**).

Suppliers' Loans/Credits

The disbursement and repayment of Suppliers' loans/credit are recorded under *long-term capital (others)*. In aggregate, H1-FY04 suppliers' credit disbursement of US$ 78 million was much lower than US$ 171 million recorded during the corresponding period of FY03 (when receipts had seen a one-time jump due to higher disbursement to PIA). At the same time, the outflows were also at lower side during H1-FY04 despite the prepayment of US$ 47 million.

Figure 9.8: Foreign Economic Assistance



It may be recalled that following the substantial accumulation of foreign exchange reserves and lower domestic interest rate, the SBP allowed the prepayment of expensive suppliers' credit/ loans by the private sector. Up to December 2003, private sector had prepaid US$ 138.6 million (see **Table 9.5**). Bulk of these prepayments (55.9 percent) was made by the cement sector, which was primarily driven by the following factors: (1) increased profitability due to higher productivity and exports to Afghanistan; and (2) higher savings by substituting high cost supplier credits with low cost Rupee loans at lower interest rate.

Table 9.5: Prepayment of Foreign Private Loan

million US Dollar

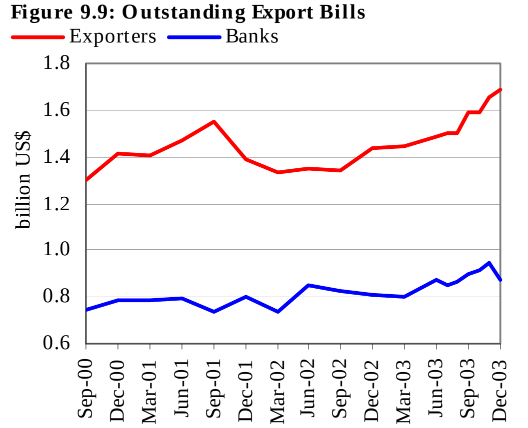
	FY03		FY04		
Sector	**Q3**	**Q4**	**Q1**	**Q2**	**Total**
Cement	25.9	34.9	3.8	12.9	77.5
Chemical			8.6		8.6
Oil & Gas Exploration	4.8				4.8
Textile		3.8	4.0		7.8
Financial Business		14.4	0.6		15.0
Storage Facility	6.4				6.4
Others	1.8			16.6	18.4
Total	**38.9**	**53.1**	**17.0**	**29.6**	**138.6**

However the power sector, the main recipient of outstanding suppliers' credit loans, has not shown any interest in prepaying loans, which may be due to the higher prepayment premium.

Outstanding Exports Bills

Outstanding Exports Bills (OEBs) are recorded under short-term capital (deposit money banks and others). The stock of OEBs increased by US$ 209 million during H1-FY04 as against the increment of US$ 49 million witnessed during the corresponding period of the preceding year. The disaggregated data of OEBs increment exhibited the marked difference in the behaviour of OEBs stock held by Banks and exporters (see **Figure 9.9**). The OEBs held by exporters increased by US$ 207 million during H1-FY04 mainly due to (1) the increase in export volume; and (2) usage of OEBs as collateral for foreign exchange loans. While the realization of export proceeds from banks on the account of discounted OEBs increased which is reflected by the declining stock of OEBs held by banks during H1-FY04.

Figure 9.9: Outstanding Export Bills



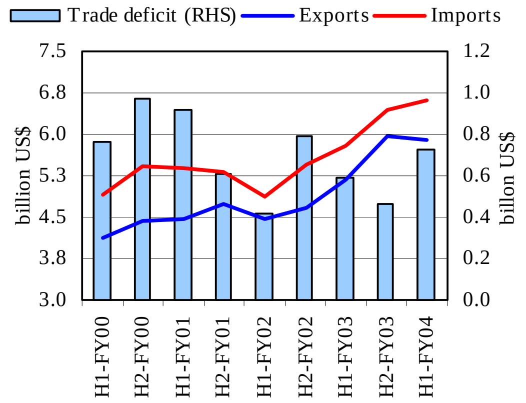
Foreign Currency Trade Loans

Foreign currency trade related loans saw a net retirement of US$ 89 million during H1-FY04 due to the maturity of loans extended during FY03 as against the net lending of US$ 971 million during H1-FY03. Within H1-FY04, the net lending was US$ 149 million during Q2-FY04 as compared to the net retirement of US$ 238 million during the first quarter of current fiscal year. The renewed attractiveness of these loans during Q2-FY04 stemmed primarily from expectations of a Rupee appreciation.

9.3 Trade Account

Trade deficit recorded 22.6 percent rise in H1-FY04 over the same period last year, reaching US$ 723.3 million (see **Figure 9.10**) – marginally higher than the average half yearly trade deficit over the last three years. This rise in the deficit is mainly due to the relatively higher import growth that has outstripped the exports growth since September 2003. Exports, however, are still growing impressively. With the persistence of the current trend of imports and exports growth it seems likely that both the imports and exports targets will be exceeded; however, since imports are growing more robustly than exports the trade deficit is likely to be significantly higher than the annual target of US$700 million.

Figure 9.10: Trade Deficit



Encouragingly, the current increase in imports is largely a function of the increased economic activity, which is evident in the significant growth of capital goods (24 percent YoY) and raw material for capital goods imports (30 percent YoY) during H1-FY04. Specifically, the growth in industrial production of consumer and intermediate goods raised the import demand for machinery, chemicals, petroleum crude and metals.

Exports too continued to rise strongly, registering an impressive 13.2 percent YoY growth during H1-FY04. While this growth is certainly a little lower than the 16.6 percent recorded in FY03, the deceleration is largely a base effect, supported by some additional factors indicated below:

(1) all the major textile categories witnessed a decline (e.g. cotton yarn and readymade garments) or a deceleration (e.g. hosiery, bed wear and cotton fabrics) in quantum.[1] This is probably due to a decline in demand and rising cotton prices translating into higher product prices. Cotton prices

[1] The export quantum of Cotton fabric, Hosiery, Bed wear and Towels grew at 7.1, 25.6, 7.7 and 7.1 percent during H1-FY04 compared to 14.6, 34.5, 20.7 and 8.6 during H1-FY03 respectively. While the export quantum of cotton yarn declined by 8.1 percent in H1-FY04 against a rise of 2.7 percent in H1-FY03, the quantum of Ready-made garments declined at 24.9 percent in H1-FY04 against a decline of 14.4 percent in H1-FY03.

had been on the rise since May-02 and rose even more sharply during H1-FY04.

(2) The more than usual utilization of the textile quota (especially bed wear) during H2-FY03 left less quota available for H1-FY04. Most of the quota had been exhausted much before the end of 2003.[2]

(3) In anticipation of the imposition of antidumping duty by EU on bed wear exports many buyers began to shift their orders to other countries.

A notable development during H1-FY04 is the shifting of exports to EU from US Dollar to Euro basis as the Rupee depreciated against the latter. The share of Euro based exports rose to 10 percent during H1-FY04 compared to 5.8 percent during H1-FY03 (see **Table 9.6**).

Table 9.6: Trade Flows and Exchange Rates - Major Currencies

	H1-FY03	H1-FY04
Percent share of major currencies		
Exports		
US$	89.3	84.9
Euro	5.8	10.0
Imports		
US$	80.4	80.7
Euro	9.3	8.5
Exchange rate appreciation/depreciation (percent)		
Rs/US$	2.9	0.6
Rs/Euro	-3.5	-4.5

9.3.1 Regional Trade Balance

The regional composition of country's trade reveals that the trade deficit to the 'Other Asian' region increased substantially (19.2 percent) largely on account of higher imports from China, Japan, Singapore and India; the bulk of the imports from these countries comprised raw material for consumer and capital goods (see **Table 9.7**). Higher imports from China[3] and India[4] are probably a reflection of price substitution as imports from these countries are generally cheaper. The rise is trade deficit with this region, however, was contained by a stronger export growth relative to that of imports. Exports to Afghanistan and Bangladesh, in particular,

[2] The textile quotas are fixed on a calendar year basis. The average utilization of the quota for EU and the US by the end of September 2003 was 85 percent as compared to 75 percent during last year. Anecdotal evidence suggests that quota prices in the secondary market surged sharply after September 2003.

[3] In order to address the concerns regarding the rising trade imbalance Pakistan signed a Preferential Trade Agreement (PTA) with China on November 3, 2003, to be effective from January 1, 2004.

[4] Pakistan gave tariff concessions on the imports of 223 items from India. The major items for duty concession include: mineral ores, raw material and intermediary goods for the pharmaceutical industry, corks and allied goods, cotton yarn, machinery for industrial use and industrial cargo vehicles and parts. India at the same time gave concessions on the import of 262 items from Pakistan including: agriculture finished products; chemicals and their preparations; paper and paper boards; cotton yarn; precious stones; steel bars, rods, sheets and glassware; machinery including sewing machines, ball bearings, motors, generators and primary cells; medical surgical equipment and furniture both metal and wooden.

rose substantially during H1-FY04; the rise in exports to the former was led by construction material (cement, iron & steel) and petroleum products, while cotton fabric led the higher exports to the latter[5].

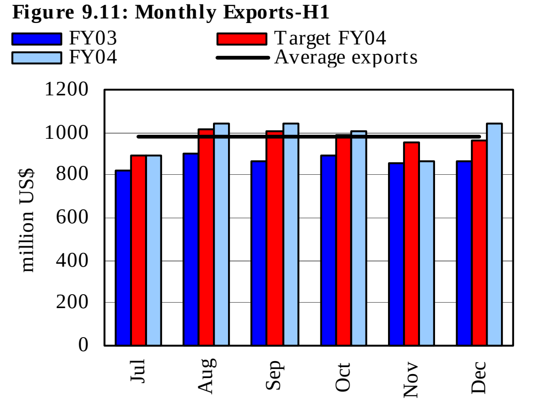
Table 9.7: Regional Trade Balance
million US Dollar

	H1-FY03			H1-FY04		
	Exports	**Imports**	**Trade Balance**	**Exports**	**Imports**	**Trade Balance**
USA	1,277.0	364.0	913.0	1,407.6	410.1	997.6
EU	1,430.2	989.9	440.3	1,676.8	1,066.6	610.2
Asia						
(i) Middle East	832.1	1,896.5	-1,064.4	937.0	1,967.3	-1,030.2
(ii) Other Asia	981.6	1,873.1	-891.5	1,220.7	2,283.4	-1,062.7
Others	676.6	664.0	12.5	638.9	877.0	-238.1
Total	5,197.5	5,787.6	-590.1	5,881.0	6,604.3	-723.3
Memo item:						
Afghanistan	107.5	18.5	89.5	200.3	14.3	185.9

9.3.2 Exports

Exports recorded 13.2 percent growth in H1-FY04 over the same period last year, reaching US$ 5.9 billion (see **Table 9.8**) and surpassing the half yearly export target of US$ 5.8 billion by 1 percent. The monthly export targets were also surpassed in all months with the exception of July and November, with monthly average of exports standing at US$ 980 million (see **Figure 9.11**). Since, exports traditionally rise in the second half of the year, there are hopes that the annual export target of US$ 12.1 billion will be easily met in this year too.

Figure 9.11: Monthly Exports-H1



[5] Cotton fabric exports from Pakistan to Bangladesh are quite substantial as the latter is one of the major exporters of ready-made garments and imports most of its fabric requirements.

Table 9.8: Major Exports

Value: million US Dollar; Unit value: US$

			H1-FY03		H1-FY04		Absolute change in value	% Change in H1-FY04 over H1-FY03		
		Unit	Value	Unit value	Value	Unit value		Qty	Value	Unit value
A.	**Primary Commodities**		**616.3**		**625.8**		**9.5**		**1.5**	
1	Rice	MT	240.2	311.7	311.3	342.5	71.1	18.0	29.6	9.9
2	Raw Cotton	MT	24.7	771.5	25.4	1215.0	0.7	-34.7	2.9	57.5
3	Raw Wool (Excluding Wool Tops)	MT	0.4	745.3	0.8	967.6	0.5	75.0	127.2	29.8
4	Fish and Fish Preparations	MT	69.7	1710.2	87.0	1689.7	17.2	26.2	24.7	-1.2
5	Leather	SQM	115.4	14.9	117.1	15.7	1.6	-3.9	1.4	5.6
6	Guar and Guar Products	MT	10.4	836.4	10.4	871.4	0.0	-3.6	0.5	4.2
7	Fruits	MT	38.4	337.3	46.4	338.2	8.0	20.4	20.8	0.3
8	Vegetables	MT	10.1	179.9	12.4	189.9	2.2	15.6	22.0	5.6
9	Crude Animal Material	MT	6.7	676.1	6.5	1465.6	-0.2	-55.0	-2.4	116.8
10	Oil Seeds & Nuts etc.	MT	4.3	487.8	2.6	647.4	-1.7	-54.5	-39.7	32.7
11	Wheat	MT	95.9	109.7	6.0	140.1	-90.0	-95.1	-93.8	27.8
B.	**Textile Manufactures**		**3364.0**		**3847.3**		**483.2**		**14.4**	
12	Cotton Yarn	MT	466.2	1720.4	516.7	2075.9	50.5	-8.1	10.8	20.7
13	Cotton Fabrics (Woven)	SQM	635.6	0.6	768.0	0.7	132.4	7.1	20.8	12.8
14	Hosiery (Knitwear)	DOZ	549.0	22.4	698.3	22.7	149.3	25.6	27.2	1.3
15	Bed Wear	MT	581.4	5399.3	654.0	5641.0	72.6	7.7	12.5	4.5
16	Towels	MT	148.5	3545.4	174.3	3884.4	25.8	7.1	17.4	9.6
17	Cotton Bags and Sacks	MT	8.8	4158.3	6.8	4129.8	-2.0	-21.7	-22.2	-0.7
18	Readymade Garments	DOZ	526.4	29.5	488.7	36.4	-37.7	-24.9	-7.2	23.6
19	Tarpaulin & Other Canvas Goods	MT	23.8	2227.4	34.3	2137.5	10.5	50.1	44.1	-4.0
20	Tule, Lace Embroidery etc.	(-)	4.7	---	4.8	---	0.2	---	4.0	---
21	Synthetic Textiles	SQM	246.5	0.7	284.9	0.7	38.4	4.8	15.6	10.3
22	Other Textile Made up	(-)	167.5	---	212.8	---	45.3	---	27.0	---
23	Waste Material of Textile Fibres/Fabrics	MT	5.6	655.6	3.6	524.0	-2.0	-18.8	-35.1	-20.1
C.	**Other Manufactures**		**799.9**		**849.6**		**49.6**		**6.2**	
24	Carpets, Carpeting Rugs & Mats	SQM	105.1	50.4	108.4	53.8	3.3	-3.6	3.1	6.9
25	Petroleum and Petroleum Products	MT	98.4	224.9	120.8	259.8	22.3	6.2	22.7	15.5
26	Sports Goods	(-)	148.2	---	144.7	---	-3.5	---	-2.4	---
27	Leather Manufactures	(-)	218.7	---	224.1	---	5.3	---	2.4	---
28	Surgical and Medical Instruments	No	74.6	---	63.6	---	-11.0	---	-14.8	---
29	Cutlery	Gr	14.3	27.8	15.0	35.6	0.7	-18.0	4.7	27.7
30	Onyx Manufactured	MT	6.1	1860.5	6.1	1732.3	-0.1	6.3	-1.0	-6.9
31	Chemicals and Pharmaceuticals	(-)	117.0	---	135.4	---	18.4	---	15.7	---
32	Molasses	MT	17.3	41.0	16.8	29.1	-0.5	37.0	-2.9	-29.1
33	Sugar	MT	0.1	343.3	14.8	225.5	14.7	---	---	-34.3
D.	**Others**		**417.2**		**558.4**		**141.1**		**33.8**	
	TOTAL EXPORTS		**5197.5**		**5881.0**		**683.5**		**13.2**	
excl. major food items and raw cotton			4581.2		5255.2		674.0		11.6	
excl. major food, raw cotton and yarn			4115.0		4738.5		623.5		0.8	

Textile exports had the highest contribution in overall export growth, whereas *primary exports* experienced a marginal fall owing to falling exports of wheat. On the other hand exports of *other manufactures* rose on the back of higher petroleum and petroleum product exports (see **Table 9.9**).

Table 9.9: Contribution in Growth by Major Export Groups

percent

	H1-FY03		H1-FY04	
	Growth	Share in Growth	Growth	Share in Growth
Primary Commodities	15.6	11.2	1.5	1.4
Textile Manufactures	17.5	67.8	14.4	70.7
Other Manufactures	4.8	4.9	6.2	7.3
Others	39.7	16.0	33.8	20.6
Total exports	16.6	100.0	13.2	100.0

Primary Exports

Wheat exports recorded US$ 90 million fall in H1-FY04 as compared to the same period last year. As a matter of fact only US$ 6 million worth of wheat was exported in this period, mainly to Kenya, Bangladesh and Dubai. Actually the government had planned to import 500,000 tones wheat during FY04 in view of depletion of domestic wheat stocks caused by aggressive wheat exports in the last two years, besides below target wheat production in FY03 but this did not materialize.

Rice exports recorded 29.6 percent rise in H1-FY04 over the same period last year reaching US$ 311.3 million (57.7 percent of the annual export target of US$ 540 million). This rise was contributed by both rising quantum and unit values, largely because of higher basmati rice exports (see **Table 9.10**).

Table 9.10: Composition of Rice Exports

Share: percent: Unit Value: million US$

	H1-FY03		H1-FY04	
	Quantum share	Unit value	Quantum share	Unit value
Basmati Rice	41.3	499.6	46.8	515.7
Other Rice	58.7	178.8	53.2	190.3

The chief destinations for country's basmati exports are UAE and the EU countries (see **Table 9.11**). However, rice exports to the EU may decline after March 2004, when the duty concession given on rice would no more

Table 9.11: Share of Basmati Export Markets

percent

	H1-FY03	H1-FY04
UAE	40.9	41.1
EU	12.3	15.7
Iran	4.0	6.2
Saudi Arabia	4.8	4.8

be available. [6] This loss can, nonetheless, be partially compensated by exploring new markets or by increasing exports to the other existing markets such as Iran or Saudi Arabia.

Textile Manufactures Exports recorded 14.4 percent growth in H1-FY04 over the same period last year on the back of rising exports of cotton fabrics, knitwear, bed wear and cotton yarn. Encouragingly, this gain in textile exports was caused by both higher quantum exported as well as rising unit prices for the major categories (see **Table 9.12** & **Figure 9.12**). The rise in unit values was caused by both more value addition in textiles and the exceptional hike in the international cotton prices during 2003.

Table 9.12: Quantum and Price Impact on Textile Exports

million US Dollar

	Overall Change	Quantum Impact	Price Impact
Cotton Yarn	50.5	-38.0	88.5
Cotton Fabrics	132.4	45.1	87.2
Knit wear	149.3	140.5	8.8
Bed wear	72.6	44.6	28.0
Readymade Garments	-37.7	-131.0	93.2

Thus the large-scale textile sector recorded 4.7 percent growth during H1-FY04 as compared to the 3.8 percent growth in H1-FY03. However, raw cotton and other low value added textiles were imported during this period, since the domestic production of 10.2 million bales during FY03 was not sufficient to meet the requirement of the domestic textile industry.[7]

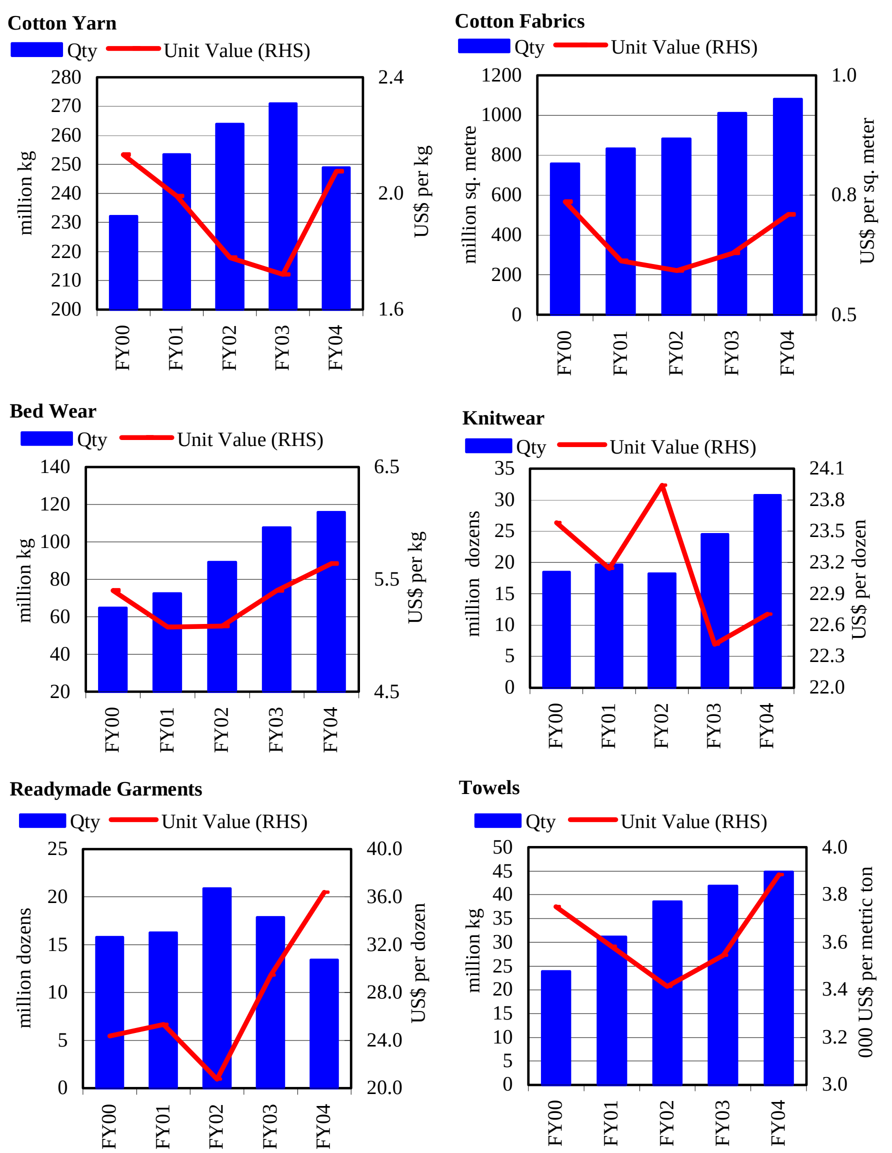
The textile sector was, however, faced with various challenges during this period. Firstly the enormous hike in the domestic prices of raw cotton raised manufacturing costs (see **Figure 9.13**). Secondly, the imposition of antidumping duty on Pakistan's bed wear exports to the EU has also clouded export growth prospects. [8] Further the issue of withdrawal of SRO 410 also created panic among textile garment exporters. While this SRO was reinstated almost immediately, the

[6] Pakistan exports two varieties of Basmati rice namely: Super and Kernel Basmati. The share of the former variety is however around 90 percent of the country's total Basmati rice exports. The EU on the contention that *Super* Basmati of Pakistan and *Pusa* Basmati of India are hybrid varieties and are not pure line Basmati withdrew the abetment concession of 250 euro/ton on the import of these varieties from Pakistan and India from January 2004. Nonetheless, to help exporters who had entered export contracts before December 2003, this concession was later extended to March 2004.

[7] Pakistan imported raw cotton worth US$156.0 million during H1-FY04 as compared to US$ 96 million during H1-FY03. Besides the import of low value added textiles namely: cotton and synthetic yarn and fabrics along with cotton thread stood at US$ 151.7 million in H1-FY04 as compared to US$ 107.5 million during H1-FY03.

[8] During H1-FY04 EU had 37.5 percent share in the country's total bed wear exports.

Figure 9.12: Major Textile Manufactures- Export Quantums and Unit Prices During H1



government has indicated that the SRO will eventually be removed. This uncertainty needs to be resolved.[9] Over the longer term the industry needs to focus on the advent of the deregulated market from December 2004 onwards.

As a matter of fact textile sector in order to prepare itself for the challenges associated with the quota free environment of 2005 has invested heavily in the up gradation process of the industry. In this first half alone, textile machinery import stood at US$ 265.6 million (7.7 percent growth over H1-FY03).[10] This is also reflected in the rising credit disbursed for fixed investment to the textile sector during Jul-Nov 2003 (see **Table 9.13**).

In terms of quota composition of textile exports, the growth in non-quota textile exports is another positive for this sector during H1-FY04 (see **Table 9.14**). However, a closer look at the category-wise

Figure 9.13: Cotton prices

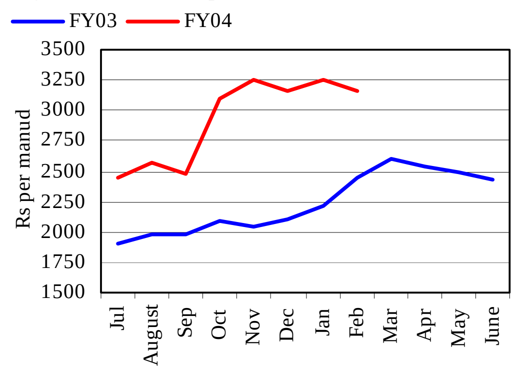


Table 9.13: Credit to Textile Sector
million Rupees

	Jul-Nov 02	Jul-Nov 03	Growth (Percent)
Textiles	7,559	32,997	336.5
i. Cotton	8,005	29,377	267.0
ii. Synthetic Yarn	617	593	-3.9
iii. Others	-1,063	3,027	-384.8
Textile Products	969	8,393	766.2
i. Wearing Apparels	998	5,725	473.6
ii. Non wearing Apparels	310	3,534	1,040.0
iii. Others	-339	-866	155.5

Table 9.14: Textile Exports
million US$; Growth: percent

	H1-FY03	H1-FY04	Growth
Non-Quota	**1942.6**	**2284.3**	**17.6**
Quota Exports	**1421.4**	**1563.0**	**10.0**
US	668.2	701.0	4.9
EU	667.6	764.3	14.5
Turkey	49.2	35.8	-27.2
Canada	36.5	61.9	69.7

[9] The SRO 410 provides for duty free imports of fabrics and accessories not manufactured locally but are required for value-addition in textile garments. The duty that is not paid on the import stage is adjusted subsequently on the export stage. The Government, however, after devising the Duty and Tax Remission Rules (DTRE), with the view of introducing a system of no duty no remission, wants such imports of raw materials to be carried out under this system. On the other hand exporters are finding the DTRE rules quite cumbersome to follow, and are currently not registering themselves under this scheme.

[10] Textile machinery imports stood at US$ 1.6 billion in the last three and a half year under the textile vision 2005.

composition of textile exports reveals that the growth of the high value added exports recorded a fall in H1-FY04 as compared to the growth in H1-FY03 mainly because of a decline in *readymade garments* (see **Table 9.15**). Consequently, the growth of low value added exports was relatively higher in this period.

Table 9.15: Textile Exports-Contribution in Growth
Percent

	H1-03		H1-04	
	Growth	Contribution in Growth	Growth	Contribution in Growth
Low Value Added	**11.1**	**22.0**	**16.6**	**37.8**
Cotton Yarn	-0.6	-0.6	10.8	10.5
Cotton Fabrics	21.7	22.6	20.8	27.4
High Value Added	**20.9**	**78.0**	**13.3**	**62.2**
Hosiery (Knitwear)	26.0	22.6	27.2	30.9
Bedwear	28.2	25.5	12.5	15.0
Towels	12.7	3.3	17.4	5.3
Readymade Garments	21.5	18.6	-7.2	-7.8
Others	9.6	8.0	19.8	18.7
Textile	**17.5**	**100.0**	**14.4**	**100.0**

In the low value added exports, *cotton fabrics* showed substantial growth of 20.8 percent, mainly due to higher exports to the EU market and Turkey.[11] The exports of *cotton yarn*, however, rose on account of higher unit prices as its export quantum registered a fall in H1-FY04.

As far as high value added exports are concerned it was the slowdown in two main textile categories namely, *bed wear* and *ready made garments* that caused the contribution of this group to fall in overall textile export growth as compared to H1-FY03. Although bed wear exports registered 7.7 percent rise in H1-FY04, yet in Q2-FY04 there was a 29.3 percent (US$ 112.3 million) fall in its exports as compared to Q1-FY04. This slowdown was partly caused by a marginal fall (0.42 percent) to the EU, which is a major market for Pakistan bed wear exports. In addition, quota exports to the EU and the US were also lower in Q2-FY04.

As a matter of fact in 2002 there were over shipments in the category of bed wear to the EU and the US market that were ultimately adjusted in the quota for the year 2003. Therefore exporters remained careful in 2003 and did not surpass the quota limits in 2003. However, the future of country's bed wear export to the EU market is under a cloud, since the European Commission has imposed 13.1 per cent anti-dumping duty on bed wear imports from Pakistan effective from March

[11] EU market witnessed 79.5 percent growth in country's cotton fabrics exports that rose from US$ 94.5 million in H1-FY03 to US$ 169.7 million in H1-FY04, whereas exports to Turkey rose to US$ 56 million from US$ 22.9 million.

18, 2004.[12] This decision will put Pakistan in a disadvantageous position against its competitors.

Imports

Imports reached US$ 6.6 billion during H1-FY04 recording 14.1 percent growth over corresponding period of the last year. Encouragingly the highest contribution in this rise was made by capital goods and raw materials (see **Figure 9.14**). Specifically the import of machinery, agriculture & chemicals group and metal group recorded higher growth rates in this period (see **Table 9.16**). On the other hand food group recorded a marginal growth (8.9 percent) in this period mainly on account of edible oil imports, whereas the import of petroleum group recorded a fall.

Figure 9.14: Economic Classification of Imports

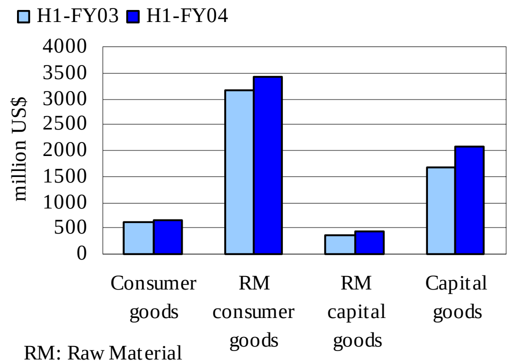


Table 9.16: Contribution in Growth by Major Import Groups

percent

	H1-FY03		H1-FY04	
Groups	**Growth**	**Share in Growth**	**Growth**	**Share in Growth**
Food	30.4	12.4	1.8	1.1
Machinery	42.3	43.5	19.5	31.9
Petroleum	9.2	13.6	-7.9	-14.2
Textile	28.8	2.8	18.0	2.5
Agri. & other Chem.	15.7	16.4	18.8	25.4
Metal	9.1	2.1	36.1	10.3
Miscellaneous	11.5	1.7	20.4	3.7
Others	8.3	7.6	35.6	39.4
Total	**18.7**	**100.0**	**14.1**	**100.0**

However, the analysis of the import performance against annual target reveals that import target was surpassed during H1-FY04, as the import bill for this period was more than half of the total FY04 target set in the trade policy for FY04. This rise in imports was caused by rising economic activity in the country, whereas rising unit prices for some goods might also have been responsible for the rise in import value of these categories (see **Table 9.17 &**

[12] In mid-November 2002, European textile manufacturers lodged a complaint with EU authorities, against Pakistan's bed linen exports and related items to Europe on allegedly exceptionally lower prices. Finally In February 2004 EC gave its decision announcing imposition of anti dumping duty.

Table 9.17: Major Imports

Value: million US Dollar; unit value: US Dollar

		H1-FY03		H1-FY04		Abs chg.	% chg in H1-FY04/H1-FY03		
	Unit	Value	Unit Val.	Value	Unit val.	In value	Qty	Value	Unit val.
A. Food Group	**---**	**484.2**	**---**	**493.1**	**---**	**8.9**	**---**	**1.8**	**---**
1. Milk & Cream & Food milk	MT	10.2	1806.2	8.8	2156.3	-1.4	-28.0	-14.0	19.4
2. Wheat Unmilled	MT	28.7	194.2	0.0	---	-28.7	-100.0	-100.0	---
3. Dry Fruits	MT	13.6	312.4	2.9	285.4	-10.7	-76.4	-78.5	-8.7
4. Tea	MT	76.8	1607.7	94.3	1626.8	17.4	21.3	22.7	1.2
5. Spices	MT	10.3	796.2	16.9	498.7	6.7	163.4	65.0	-37.4
6. Edible Oil	MT	260.7	426.5	332.1	453.1	71.4	19.9	27.4	6.2
Soya bean	MT	7.1	478.7	19.8	537.6	12.7	147.3	177.7	12.3
Palm Oil	MT	253.6	425.2	312.3	448.6	58.7	16.8	23.2	5.5
7. Sugar	MT	0.8	326.2	1.2	341.1	0.4	40.2	46.6	4.6
8. Pulses	MT	83.0	297.3	36.8	286.3	-46.2	-53.9	-55.6	-3.7
B. Machinery Group	**---**	**1335.2**	**---**	**1595.5**	**---**	**260.3**	**---**	**19.5**	**---**
1. Power Generating Machinery	---	143.5	---	143.9	---	0.3	---	0.2	---
2. Office Machinery	---	98.3	---	100.4	---	2.0	---	2.1	---
3. Textile Machinery	---	246.6	---	265.6	---	19.1	---	7.7	---
4. Construction & Mining Machinery	---	46.2	---	51.4	---	5.2	---	11.2	---
5. Electrical Machinery & Apparatus	---	101.5	---	120.2	---	18.6	---	18.4	---
6. Railway Vehicles*	---	18.7	---	50.4	---	31.7	---	169.3	---
7. Road Motor Vehicles	---	231.6	---	307.8	---	76.2	---	32.9	---
8. Aircraft, Ships and Boats	---	37.2	---	83.3	---	46.1	---	123.8	---
9. Agricultural Machinery & Implements	---	17.3	---	11.4	---	-5.9	---	-34.3	---
10. Other Machinery	---	394.1	---	461.2	---	67.0	---	17.0	---
C. Petroleum Group	**---**	**1471.7**	**193.5**	**1355.7**	**218.4**	**-116.0**	**-18.4**	**-7.9**	**12.9**
1. Petroleum Products	MT	793.8	193.6	599.5	236.3	-194.3	-38.1	-24.5	22.1
2. Petroleum Crude	MT	677.9	193.4	756.2	206.0	78.3	4.7	11.6	6.5
D. Textile Group	**---**	**112.3**	**---**	**132.6**	**---**	**20.3**	**---**	**18.0**	**---**
1. Synthetic Fibre	MT	43.8	1246.1	51.3	1437.5	7.5	1.5	17.1	15.4
2. Synthetic & Artificial Silk Yarn	MT	48.5	1494.6	61.5	1635.8	12.9	15.7	26.6	9.5
3. Worn Clothing	MT	20.0	314.4	19.8	325.0	-0.1	-4.0	-0.7	3.4
E. Agricultural and Other Chemicals Group	**---**	**1100.7**	**---**	**1308.1**	**---**	**207.3**	**---**	**18.8**	**---**
1. Fertilizer	MT	185.2	184.9	173.7	205.2	-11.5	-15.5	-6.2	11.0
2. Insecticides	MT	38.1	2619.9	64.6	3019.4	26.5	47.2	69.7	15.3
3. Plastic Materials	MT	202.8	799.0	245.3	858.2	42.5	12.6	21.0	7.4
4. Medicinal Products	MT	103.3	24615.3	132.2	27753.7	28.9	13.5	28.0	12.7
5. Others	---	571.4	---	692.4	---	120.9	---	21.2	---
F. Metal Group	**---**	**232.6**	**---**	**316.6**	**---**	**84.0**	**---**	**36.1**	**---**
1. Iron and Steel Scrap	MT	21.3	130.3	47.9	160.2	26.6	82.6	124.4	22.9
2. Iron and Steel	MT	186.7	350.4	230.4	383.4	43.8	12.8	23.4	9.4
3. Aluminum wrought & Worked	---	24.6	---	38.3	---	13.7	---	55.7	---
G. Miscellaneous Group	**---**	**149.1**	**---**	**179.5**	**---**	**30.4**	**---**	**20.4**	**---**
1. Rubber Crude	MT	21.8	728.2	33.9	877.7	12.1	29.2	55.7	20.5
2. Rubber Tires & Tubes	Nos	39.8	20.2	44.0	21.4	4.2	4.5	10.5	5.8
3. Wood & Cork	---	14.4	---	10.1	---	-4.3	---	-29.9	---
4. Jute	MT	9.2	245.9	16.8	238.1	7.6	89.3	83.3	-3.2
5. Paper and Paper Board & Manufactures	MT	64.0	593.9	74.7	599.6	10.7	15.6	16.7	1.0
H. Others	**---**	**901.8**		**1223.3**		**321.5**		**35.6**	
Total Imports:		**5787.6**		**6604.3**		**816.7**		**14.1**	
excl. Food Group		*5303.4*		*6111.2*		*807.8*		*12.3*	
excl. POL Group		*4315.9*		*5248.6*		*932.7*		*22.0*	
excl. Food & POL Group		*3831.7*		*4755.5*		*923.8*		*20.1*	

Table 9.18: Import Performance Against Targets
billion US Dollar

Groups	Targets FY04	H1-FY04 Actual	Balance to achieve
Machinery	3.1	1.6	1.5
Petroleum	3.3	1.4	1.9
Agriculture & Chemicals	2.3	1.3	1.0
Metal	0.5	0.3	0.2
Miscellaneous	0.3	0.2	0.1
Total	**12.8**	**6.6**	**6.2**

9.18). This pattern of higher than projected import growth coupled with traditional rise in imports during the second half of a year, suggests that imports might rise above the annual target of US$ 12.8 billion.

The higher import growth was supported by the appreciation of the rupee (1.6 percent during 2003), which was reinforced by the liberalization of import trade regime as announced in the trade policy FY04. These liberalization measures include abolishing the monetary ceiling both for import against foreign currency demand draft and import by actual users.[13]

Agriculture & Other Chemicals Group recorded 18.8 percent growth in H1-FY04 over the same period last year. The import of *medicinal products* recorded a 28 percent rise in this period probably stemming from the government decision to offer duty draw back facility to all pharmaceutical. This, in turn positively impacted exports of pharma-products as well and helped sustain the 17.8 percent YoY growth in pharmaceutical industry output during H1-FY04.[14]

The import of *fertilizer*, however, registered a 6.2 percent fall (15.5 percent fall in quantum) on account of falling Diammonium Phosphate (DAP) imports. The import of DAP fertilizer fell owing to both, a sharp jump in domestic production as well as a big jump in its international prices.

Machinery group recorded 19.5 percent growth in H1-FY04 over the same period last year, making 31.9 percent share in import growth in this period (see **Table 9.16**). The share of *road motor vehicles* remained highest in this group, which recorded 32.9 percent growth over H1-FY03. Within this group, motorcars and

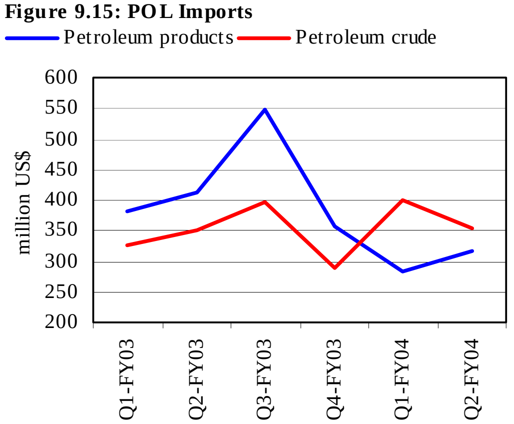
[13] Previously importers had the facility to import permissible goods worth US$ 5,000 in one fiscal year through foreign currency demand draft etc., without opening of letters of credit. Industrial users could import spare parts and machinery worth US$ 30,000 per fiscal year against foreign currency demand draft, if such import were made by air or courier. These monetary limits, however, were abolished by the SBP from August 15, 2003.
[14] Effective from January 31, 2003, the Government announced duty draw back facility for all local and multinational pharmaceutical companies through standardization to provide level playing field for the entire industry.

other motor vehicles with cylinder capacity ranging from 800CC to 3000CC had a share a around 44.6 percent, with Japan being the largest supplier.

Textile machinery imports under the BMR programme recorded 7.7 percent growth in this period with the EU and Japan being the largest suppliers. The import of *aircraft, ships and boats* recorded 123.8 percent growth (US$ 46.1 million) in this period. This growth was mainly caused by rising imports of shipping vessels following the revival of the ship breaking industry. Imports under this head are expected rise further in the coming periods as Pakistan has entered into an agreement with the US for purchase of eight 777 Boeing aircraft until 2008 under the PIA fleet renewal program.[15]

Petroleum group imports recorded a 7.9 percent fall in H1-FY04 over the corresponding period of FY03 owing to a fall in demand. Imports of petroleum products, in particular have fallen sharply due to: (1) substitution by other energy sources and (2) increased domestic refining. In fact, the latter had led to an increase in crude oil imports during Q1-FY04 until high inventories and improved availability of hydropower led to a sharp Q2-FY04 decline in crude imports as well (see **Figure 9.15**).

Figure 9.15: POL Imports



[15] As a matter of fact, PIA has received delivery of two 777 Boeings in February and one is scheduled to arrive in March 2004.

9.4 Exchange Rate Policy

The rupee resumed its long-term gradual rise in Q2-FY04, shrugging off the temporary 0.2 percent dip during the preceding quarter to register a cumulative 0.6 percent appreciation during H1-FY04. This Q2-FY04 appreciation marked a decisive adjustment for the rupee, breaking it out of the narrow (Rs 0.15/US$) range that had been sustained since March 2003 (see **Figure 9.16**). It is important to note here that while the Q2-FY04 ascent of the rupee *did* mark the easing of lumpy end-Q1-FY04 payments pressures, the dominant factor shaping the direction of the rupee remained the modulated net forex purchases of the SBP, in line with its policy of allowing a gradual appreciation in the face of external account surpluses.

Figure 9.16: Daily Exchange Rate Movement

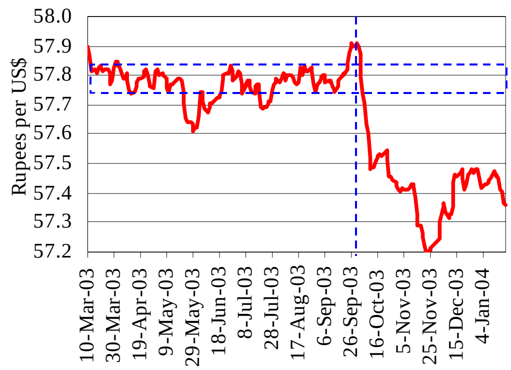


Table 9.19: Major Forex Flows and SBP Purchases

million US$

	FY03				FY04	
	Q1	Q2	Q3	Q4	Q1	Q2
Current Account Balance	1451	900	1233	437	1129	634
Remittances	1053	1095	1083	1006	906	968
Trade (Exchange Records)	-146	-303	-411	-92	28	-202
FE-25 Deposits	212	252	113	125	43	171
FE-25 Loans	215	313	200	-11	-238	154
Debt Servicing (Provisional)	1205	1201	1039	905	868	1176
ER (Rs / US$)	59.2	58.4	57.844	57.8	57.9	57.4
SBP Purchases	1145	1396	1402	603	408	477

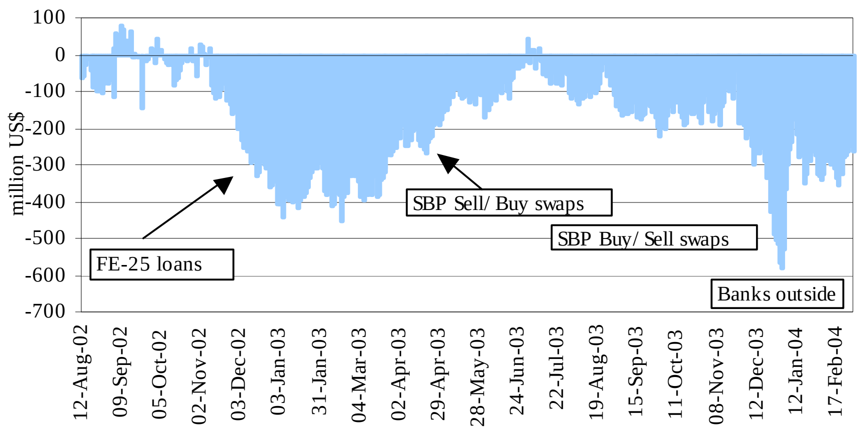
In fact, the movements of the rupee during quarter can be divided into two distinct periods, identified by shifts in the SBP forex market transactions profile.

1) During the first period, encompassing October and November 2003, the Rupee appreciated marginally on the back of improved forex market liquidity mainly due to a lower trade deficit, the absence of debt payments, higher FE-25 deposits and the rising forex loans (see **Table 9.19**). However, it was the SBP that ensured the forex market liquidity, by scaling down the market purchases in October and November 2003; this allowed the Rupee to appreciate in the interbank market. Key factors responsible for this outcome included: (a) the weakness of the rupee caused by the decline of the US dollar in the international markets; (b)

the concerns over the high growth in reserve money; and, (c) the perceived need to lower imports costs for domestic industry[1].

2) In contrast, the month of December 2003 observed downward pressures on the exchange rate largely due to the seasonal debt and import payments. The resulting pressure on market liquidity was exacerbated by heavy Rupee/US$ buy sell swaps conducted by the SBP[2]. This contributed to the evident weakness of the rupee in this month, which partially reversed the gains of the rupee in the preceding two months.

Figure 9.17: Aggretate Nostro



Consequent to the SBP swap together with pressure of the seasonal payments and rising forex loans, the aggregate Nostro of banks fell significantly (see **Figure 9.17**).

[1] The latter concern had been present earlier quarters as well, when forex inflows were higher, but at that time, SBP has preferred to shield exports from the shock of a sudden adjustment, particularly as the sustainability of the inflows had been unclear. However, by FY04 it increasingly seemed that a substantial portion of the post-September 11 flows were likely permanent.

[2] The motivation behind SBP purchases in the final weeks of CY03 aimed to support a reduction in the SBP NDA to meet the performance criteria as per agreed with IMF. The heavy SBP buy/sell added substantial liquidity into the market that, in turn, allowed the SBP to conduct OMOs to offload its T-bill holdings.

It also resulted in a rise of forward premium to its pre-November 2003 levels.

The renewed appreciation of the rupee in Q2-FY04 was probably an important factor in reigniting interest in FE-25 foreign currency loans (see **Figure 9.18**). Moreover, evidence suggests that some market players, in anticipation of the Rupee appreciation, deferred the adjustment of forex loans prior to maturity as had been happening earlier (see **Figure 9.19**). This development further augmented the forex market liquidity, adding further pressure for a Rupee appreciation.

A point worth noting is that an important source of comfort for the central bank in allowing the Rupee to drift upwards was the continuing strength of the external sector and particularly exports, which validated the SBP view that a gradual upward adjustment of the nominal exchange rate would not significantly hurt Pakistan's competitiveness:

- Despite the rising domestic inflation relative to trading partners (and

Figure 9.18: FE-25 Lending and ER

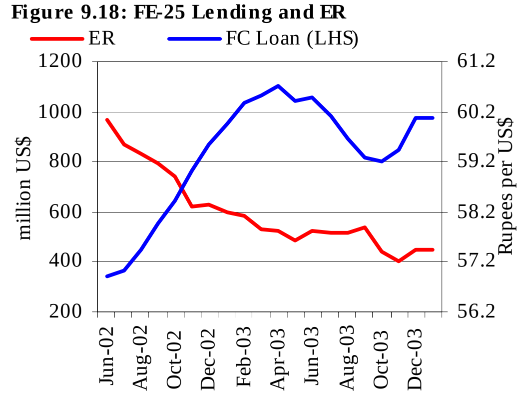


Figure 9.19: FC Loans Adjustment from Inter-bank Market

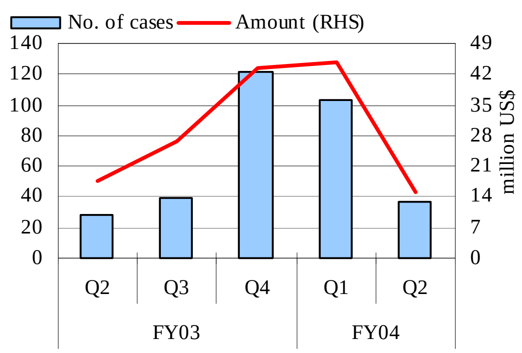
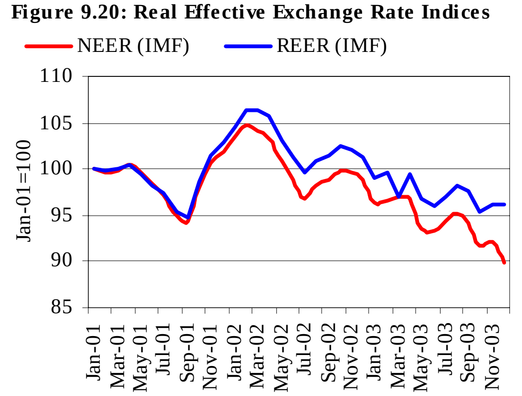


Figure 9.20: Real Effective Exchange Rate Indices



competitors), the exports did not lose competitiveness. In fact, in nominal terms the Rupee depreciated strongly against most of the selected currencies (see **Table 9.20**). This nominal Rupee depreciation against the selected currencies more than compensated for inflation differential with trading partners and competitors. This is captured by 2.1 percent depreciation of the real effective exchange rate (REER) index (see **Figure 9.20**).

- The funding cost to the exporters has been declining since FY02. This was reflected in the cheaper loans available at the comfortable terms[3]. Despite the marginal increase in the Rupee interest rate in Q2-FY04, the EFS rate remained stable at 1.5 percent throughout Q2-FY04. Similarly, already low rates on forex loans (loans against FE-25 deposits) also remained stable in Q2-FY04 due to the stability in US$ LIBOR rate.

Table 9.20: Rupee vis-à-vis Selected Currencies
percent changes

	FY03	FY04	
	Q4	Q1	Q2
US Dollar	0.1	-0.2	0.8
Euro	-7.3	3.8	-8.1
Japanese Yen	-0.2	-2.8	-5.7
Pound Sterling	-4.3	2.9	-7.3
Indian Rupee	-1.9	-2.1	0.2
Thai Bhat	-28.8	-3.0	-4.3

Table 9.21: Export Performance
US$ million

	FY 03	FY 04	Target FY04
July	816.7	890.2	894
August	902.8	1038.7	1018
September	869.0	1038.8	1004
October	891.8	1006.6	988
November	854.1	861.6	956
December	863.2	1044.9	962

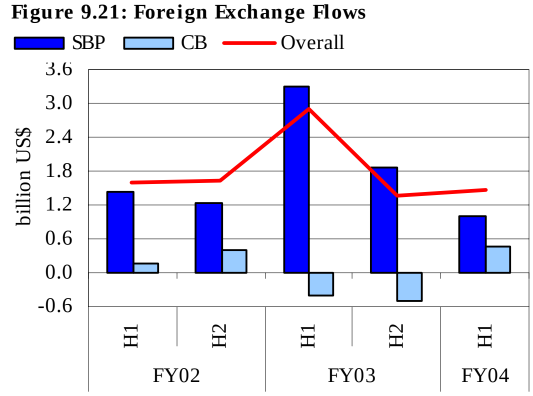
- The view on competitiveness of the rupee is supported by the trade data, which shows that export target has been met (or exceeded) in most of FY04 (see **Table 9.21**).

[3] The cost of the Rupee loans dropped significantly as the EFS rate gone down from 11.50 percent in July 2001 to 1.50 percent in December 2003. Likewise, the cost of the forex loans also dipped as US$ LIBOR (3-month) fell from 3.75 percent in July 2001 to 1.1 percent in December 2003.

9.5 Foreign Exchange Reserves

Pakistan's liquid foreign exchange reserves rose by US$ 1.1 billion during H1-FY04, touching a new high at US$ 12.1 billion and improving the import coverage to approximately 50 weeks at end December 2003. It is interesting to note that other than H1-FY03, there has been little change in net accumulation of foreign exchange reserves trend since H1-FY02 (see **Figure 9.21**). If this trend persists then it seems likely that the gradual Rupee appreciation will continue. The major contributors to this significant buildup of reserves were the workers' remittances, FE-25 deposits, FDI, receipts against logistic support and grants.

Figure 9.21: Foreign Exchange Flows



While inflows declined during H1-FY04 compared to H1-FY03, the outflows increased during the same period (see **Table 9.22**). The relatively lower inflows were mainly due to a deceleration in remittances, loans, FDI and grants. Also the inflows related with the privatization were lower in H1-FY04. The increase in outflows, on the other hand, was largely due to higher imports and debt servicing.

The distribution of reserves between the SBP and the commercial banks witnessed some significant changes during H1-FY04. The net accumulation of reserves with the commercial banks that remained negative during FY03 turned positive during this period. The commercial banks reserves increased by US$ 463 million during H1-FY04. This increase was for two reasons:

(1) The retirement of loans given against FE-25 deposits (US$ 249 million) given largely during FY03 (see **Figure 9.22**).[1]

[1] That is also why the commercial banks reserves witnessed a sharp decline during FY03. When a commercial bank extends a loan against FE-25 deposits, the borrower only receives the Rupees and not the Dollars. Since banks sell the Dollars in the inter-bank market and since SBP is the largest purchaser of foreign currency in the inter-bank market, these dollars simply move from the commercial banks to the SBP. However, when this loan is repaid to the commercial banks, the reverse does not happen since the loan is repaid usually with the dollar receipts against exports. Bulk of the FE-25 loans is for exports.

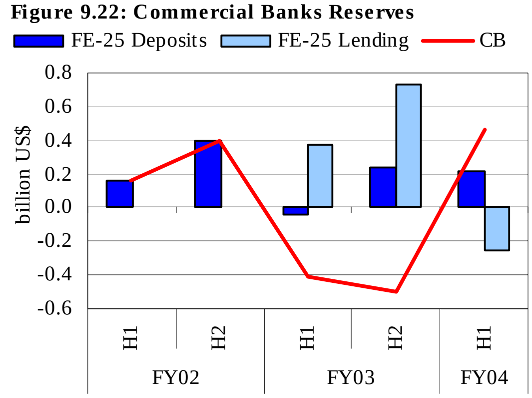
Table 9.22: Overall Reserves as per BOP[1]
million US Dollars

	FY03		FY04		H1	
	Q1	**Q2**	**Q1**	**Q2**	**FY03**	**FY04**
Opening Balance	*6398*	*8818*	*11,667*	*12,302*	***6,398***	***11,667***
Inflows	**7,273**	**6,380**	**5,997**	**6,262**	**13,653**	**12,259**
Exports of goods	2623	2550	3,013	3,053	5173	6066
Export of services (excluding interest)	858	497	859	723	1355	1582
of which: logistics support	317	0	384	198	317	582
Workers' remittances	1053	1095	906	968	2148	1874
Foreign direct investment	161	164	117	160	325	277
Foreign portfolio investment	-3	33	-28	9	30	-19
Loan disbursements	730	531	295	516	1261	811
Official	604	486	237	496	1090	733
Long-term loans	577	408	*237*	*488*	985	725
Program loans	445	292	126	363	737	489
IMF	115	115	0	245	230	245
IDA/IBRD	202	0	0	0	202	0
ADB	128	177	126	118	305	244
Project & food loans	132	116	111	125	248	236
Short-term including IDB	27	78	*0*	*8*	105	8
Private un-guaranteed	126	45	58	20	171	78
Privatization proceeds	10	176	0	0	186	0
Official Grants	278	292	208	252	570	460
USA	0	0	0	0	0	0
Saudi oil facility	189	207	147	128	396	275
Others	89	85	64	124	174	188
Other receipts	1563	1042	627	581	2605	1208
Outflows	**4,853**	**5,128**	**5,362**	**5,805**	**9,981**	**11,167**
Imports of goods	2769	2853	3,010	3,202	5622	6212
Imports of services (excluding interest)	579	586	818	963	1165	1781
Interest payments	227	246	210	350	473	560
Amortization of official loans	257	329	388	458	586	846
IMF	89	74	141	202	163	343
IDA/IBRD	93	72	108	80	165	188
ADB	48	84	57	89	132	146
Others actual paid	27	99	82	87	126	169
Profit and dividends	148	155	145	195	303	340
Purchase of crude oil	93	135	108	158	228	266
Principal repaid on private loans	172	140	164	113	312	277
Foreign exchange liabilities liquidated	432	263	87	119	695	206
FE-31	18	88	0	0	106	0
FE-45	5	39	0	0	44	0
PTMA & commercial loans	40	14	17	16	54	33
IDB (short term)	24	22	35	70	46	105
Swaps	230	5	0	0	235	0
NBP deposits	0	0	0	0	0	0
Special dollar bonds	115	95	35	33	210	68
Other Payments	176	421	449	256	597	705
Net inflows	**2,420**	**1,252**	**635**	**457**	**3,672**	**1,092**
Gross reserves at end of period	*8,818*	*10,070*	*12,302*	*12,759*	*10,070*	*12,759*
Sinking fund	637	900	920	920	900	920
Net reserves of SBP (excl. CRR)	5,940	7,654	10,019	10,525	7,654	10,525
Com. banks reserves	2241	1516	1,363	1,314	1,516	1,314

[1]The data used in the table differs from the text because (1) it is based on exchange records and (2) SBP reserves include transfers pending from India.

(2) An increase in FE-25 deposits stems largely from (1) the inflow on the account of HBL privatization; and (2) the transfer of Crescent Investment Bank's FCDs to Mashreq Bank after the merger of the two institutions. It is interesting to note that despite the recent sharp depreciation of Rupee against Euro and Yen, the FE-25 deposits in these currencies have not shown any significant rise.[2]

Figure 9.22: Commercial Banks Reserves



In contrast with the commercial banks, SBP reserves accumulation decelerated sharply during H1-FY04. The net rise in SBP reserves (US$ 990 million) H1-FY04 was even less than one-third of the accumulation during H1-FY03. This was largely due to the fall in inter-bank purchases, absence of 'export of currency'[3] and lower inflows from IFIs.

The massive buildup of foreign exchange reserves helped in the pre-payment of expensive foreign debt amounting US$ 1.17 billion to the ADB[4] in January 2004. It should be noted that the forex reserves were not impacted by the prepayment of expensive foreign debt. This is because the prepayment was made from a sinking fund created for this purpose and was not a part of the reserves.

[2] Of the total FE-25 deposits 86 percent were in US Dollar at end December 2003.
[3] The 'export of currency' stopped contributing in SBP reserves as the moneychangers were instructed to sell their foreign currency other than the US Dollar to the exchange companies instead of banks.
[4] To capitalize prepayments, in FY03, SBP created a *sinking fund* amounting US$ 920 million. Out of this amount, US$ 810 million was placed outside Pakistan, while the remaining portion US$ 110 million was deposited with the commercial banks. The financing of prepayment from sinking fund prevented the possibility of huge drop in foreign exchange reserves.

9.6 Pakistan's External Debt & Liabilities Update

Contrary to the continuing decline in Pakistan's external debt & liabilities (EDL) witnessed during the last three years, the stock of EDL increased by US$ 720 million during H1-FY04 raising the overall stock to US$ 36.2 by end December 2003 (see **Table 9.23**). This increase in EDL was mainly driven by an increase in external debt (TED) (US$ 801 million) as the stock of external liabilities (TEL) declined (US$ 81 million) during the same period.

Table 9.23: Pakistan's External Debt & Liabilities
million US Dollar

	FY02	FY03p	End Sep. 03p	End Dec. 03p	Absolute change during H1-FY04 over FY03
I. Public and publicly guaranteed debt	**29,235**	**29,232**	**29,492**	**30,417**	**1,185**
A. Medium and long term (> 1 year)	**29,052**	**29,045**	**29,342**	**30,322**	**1,277**
Paris club	12,516	12607	12866	13658	1051
Multilateral	14,331	14950	15041	15403	453
Other bilateral	429	512	530	527	15
Euro bonds	643	482	480	325	-157
Military debt	819	263	211	211	-52
Commercial Loans/Credits	314	231	214	198	-33
B. Short-Term (* 1 year)	**183**	**187**	**150**	**95**	**-92**
IDB	183	187	150	95	-92
II. Private non-guaranteed debts	**2,226**	**2028**	**1924**	**1619**	**-409**
Medium and long term (> 1 year)	2,226	2028	1924	1619	-409
Private loans/credits	2,226	2028	1924	1619	-409
III. IMF	**1,939**	**2092**	1968	2117	25
Total external debt (I to III)	**33,400**	**33,352**	**33,384**	**34,153**	**801**
IV. Total external liabilities	**3,132**	**2,122**	**2,078**	**2,041**	**-81**
Foreign currency accounts	406	0	0	0	0
FE-45	234	0	0	0	0
FE-31 Deposits (incremental)	172	0	0	0	0
FE-13	-	-	-	-	
Special US Dollar Bonds	924	696	674	640	-56
National debt retirement program	75	6	6	3	-3
Foreign currency bonds (NHA)	197	175	153	153	-22
Central bank deposits	750	700	700	700	0
NBP/BOC deposits	500	500	500	500	0
Others liabilities	280	45	45	45	0
Total external debt and liabilities (I to IV)	**36,532**	**35,474**	**35,462**	**36,194**	**720**
FEBCs/FCBCs/DBCs (payable in Rs.)	**66**	***42***	**35**	**29**	**-13**

P: Provisional
Source: State Bank of Pakistan

The rise in total external debt can be attributed to the increase in outstanding debt owed to Paris Club arising from currency revaluation and interest capitalization and the new loans from multilateral creditors. All other categories of external debt and liabilities except for 'other bilateral' either remained unchanged or declined during H1-FY04. Given the fact that Paris Club debt have been recently rescheduled, it is instructive to look into the reason for this rise in some detail.

Paris Club

The stock of external debt owed to Paris club countries rose by US$ 1051 million during H1-FY04. Interestingly, this rise in the outstanding stock of Paris Club loans during H1-FY04 is not due to fresh borrowing alone (see **Table 9.24**). In fact, the largest rise (just over one third of the total increase) came through the revaluation of debt stock at the end of H1-FY04, as the US dollar had depreciated sharply against Euro (by 10 percent) and against the Japanese Yen (by 11.9 percent) during the same period. In addition, the *capitalization* of debt servicing due since November 2001 also raised the stock of debt. Detailed analysis of these causative factors is as follows:

Table 9.24: Causative Factors for the Rise in Paris Club Debt Stock during H1-FY04

million US Dollars

Exchange Rate Fluctuations	362
Fresh Disbursements (net)	277
Capitalization Impact	219
(i) Capitalization pertaining to FY02	150
(ii) Capitalization pertaining to FY03	46
(iii) Capitalization pertaining to H1-FY04	23
Reconciliation of post cut off Debt	192
	1,051

1. Exchange Rate fluctuations

Pakistan's external debt is denominated in multiple currencies but is reported in equivalent US Dollar. Thus, the shifts in cross rates are translated into changes in the dollar value of the outstanding debt stock. Since a large chunk of our Paris Club debt is denominated in Euro and the Japanese Yen, the recent weakness of the US Dollar against these currencies had a significant impact in raising debt to the tune of US$ 362 million.[1]

2. Fresh Disbursements (net)

Fresh loans from Japan, Germany, France and US also contributed significantly towards the increase in the outstanding stock of Paris Club debt during H1-FY04.

[1] This is one the reasons that SBP has initiated, through its Reserve Management Strategy, the diversification of its reserves portfolio into various currencies. This would minimize such losses in the future.

Project loans totaling US$ 367 million were disbursed while US$ 90.6 of the principal amount were repaid during the same period.

3. Impact of Capitalization of Debt Servicing
According to the *Rescheduling Arrangement* agreed with Paris Club creditors in December, 2001, Pakistan was provided substantial debt servicing relief on newly structured debt and post-cut off date[2] debt due during the PRGF period.[3] It was also decided that these amount would be capitalized in Paris Club debt stock and will be paid in four equal and successive semi-annual installments starting from May 31, 2005. As a result, the stock of Paris Club debt rose by US$ 219.1 million during H1-FY04.[4]

4. Reconciliation of some of the post-cut off loans
At the time of finalization of rescheduling agreements with individual countries, there was a discrepancy between the claims of the debtors and loans recorded with EAD (MOF) regarding the post cut off amount of debt. These post cut off loans, owed to Germany, France and US totaling US$ 192.2 million have now been reconciled and added to Paris Club debt stock.

Multilateral
The stock of external debt owed to multilateral creditors rose by US$ 453 million during H1-FY04 raising the debt stock to US$ 15.4 billion. This was mainly due to fresh net disbursements (program and projects assistance) from ADB on concessional rate. The following major inflows have been realized from ADB during H1-FY04: US$ 125.7 million for Decentralization Program; US$ 101.8 million for Punjab Recourse Management; and US$ 16.1 million for Sindh Road Improvement Program.

Prepayments of Multilateral Debt
As a part of the government's debt strategy and the steps to create more fiscal space, the prepayment of external debt was carried out in January 2004. Specifically, Pakistan prepaid US$ 1.17 billion worth of loans to the ADB (see **Table 9.25**). This step not only reduced the multilateral debt immediately but also

[2] When a debtor country first meets with Paris Club creditors for rescheduling of debt a "cutoff date" up to which loans are to be considered for rescheduling is decided and is not to be changed in subsequent Paris Club treatments. In case of Pakistan, the cut off date is September 1997.
[3] The year-wise break up of debt servicing relief are: (1) 100 percent capitalization of interest payment on restructured and post cut-off debt falling between November 30, 2001 and June 30, 2002; and (2) 20 percent capitalization of annual interest accrued on restructured debt each for FY03 and FY04.
[4] Ideally, these capitalizations should not be bunched in H1-FY04 and should instead be included in the corresponding end-year debt stock of FY02, FY03 and H1-FY04.

provided a saving of US$ 300 million (Rs17.1 billion) against interest payments for the lifetime of these loans. While all these loans were carrying a fixed interest rate ranging between 6.31 to 11.0 percent and had the maturities between FY05 and FY19. The weighted average rate of these loans was approximately 6.8 percent. Pakistan also paid a penalty of US$ 35.4 million on early repayment.

Table 9.25: Details of Pre-payment of Asian Development Bank Debt

million US Dollar

	Borrowed Amount	Borrowing Year	Stock as on end Jan-04	Interest amount paid at the time of prepayment	Prepayment Premium	Total Payments
1	21.0	FY82	11.4	0.3	0.2	11.9
2	17.7	FY83	14.0	0.5	0.3	14.8
3	47.6	FY84	44.4	1.9	1.2	47.5
4	108.9	FY85	67.3	2.2	1.8	71.3
5	73.6	FY95	65.6	1.4	1.9	68.9
6	324.5	FY96	255.4	3.5	8.0	266.9
7	250.0	FY98	211.8	6.6	6.5	224.9
8	307.0	FY99	283.7	8.9	9.7	302.3
9	300.0	FY01	153.0	4.4	5.8	163.2
Grand Total			**1,106.6**	**29.7**	**35.4**	**1,171.7**

The prepayment were made mainly from a *Sinking Fund* maintained by the SBP for this purpose, and had no effect on foreign exchange reserves position.

Issuance of Euro Bonds

Another major development regarding Pakistan's External Debt & Liabilities is the issuance of five-year Pakistan Eurobonds totaling US$ 500 million[5] at 6.75 percent yield during February 2004, which was well received by investors.

The main objective of the eurobonds issuance was to put Pakistan on the radar screen of the international capital market by making a strategic re-entry. As, Pakistan has already decided not to enter into a successor IMF program, it was important for the country not only to have an alternative funding source but also to have a self-monitoring mechanism for Pakistan's economic performance. These requirements can be met through a well-distributed sovereign issue (particularly if

[5] The issue size of the bonds were set at US$ 500 million as this is the minimum size for inclusion of a bond in the emerging market bond index (EBMI), which is a widely used (and closely monitored) benchmark for investors in the emerging bond markets.

held by institutional investors that closely monitor their holdings). Such an international sovereign issue thus becomes an important benchmark for sovereign risk.

Is the yield too high?

Pakistan gained a favorable price for its 5-year issue in comparison to countries with similar sovereign ratings (see **Table 9.26**). In fact, the Pakistan's eurobonds appear to be better priced than the bonds of some better-rated sovereigns

Table 9.26: Peer Country Comparison

Issuer	Ratings	Spread Over 5 Yrs US Treasury as on Feb 12 (basis points)	Yield as on Feb 12 (percent)
Pakistan	**B2/B**	**370**	**6.75**[6]
Brazil	B2/B	494	7.82
Philippines	Ba2/BB	420	7.26
Colombia	Ba2/BB	402	7.14
Turkey	B1/B+	372	6.72
Ukraine	B1/B+	469	7.68
Weighted Average Spread of Emerging Market Bonds		435	

It is also pertinent to note that Pakistan's eurobonds would have fetched an even better price if marketed more to Middle East where most of the non-resident Pakistanis lives. Since, Pakistan is enjoying reasonable funds through workers' remittances from Middle East region therefore it was targeted to market these loans in other regions as reflected by the 89 percent offering to Europe, Asia and USA. Moreover, it should be noted that if the bond were to be held principally by Pakistanis, it would no longer be a good benchmark for Pakistan risk, since nationals typically have a greater appetite for the sovereign risk of their own country.

[6] The cost of Pakistan's sovereign bond is expected to be reduced further through an interest rate swap