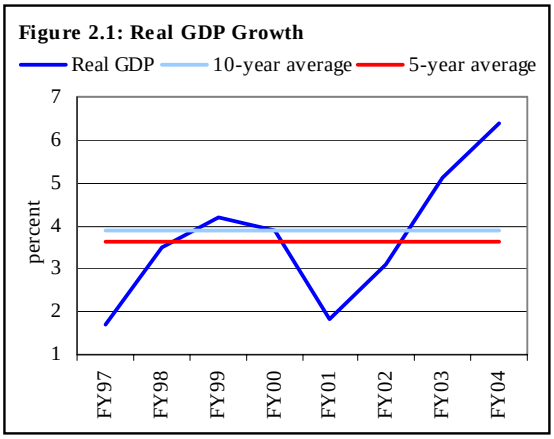
2 Real Sector

2.1 GDP

Real GDP witnessed an impressive 6.4 percent growth in FY04, well above the 5.3 percent FY04 target and 5.1 percent growth achieved in FY03. Although, this is only the second successive year when economy achieved growth rate above the averages of the last 5 and 10 years (see **Figure 2.1**), indicators suggest that this high pace of growth would continue in near future, barring exceptional external shocks or natural vagaries.

The above-target FY04 performance is mainly based on strong growth in the manufacturing sector, which recorded an increase of 13.4 percent as compared to 6.9 percent in FY03. Within manufacturing, the notable contribution is from large-scale manufacturing (LSM), while survey-based growth rate of small-scale manufacturing was adjusted upward from 5.3 percent in the past to 7.5 percent in the revised base.

Figure 2.1: Real GDP Growth



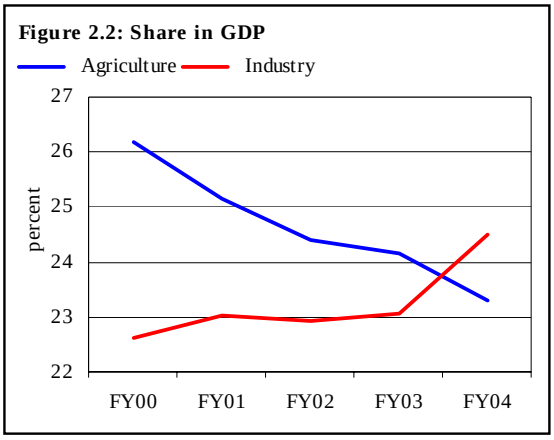
Despite various shocks, agriculture recorded a positive growth rate of 2.6 percent during FY04, far below the annual target of 4.2 percent for the year and 4.1 percent growth achieved in FY03. Similarly, services sector also witnessed a marginal deceleration in growth rising by 5.2 percent in FY04 compared with 5.3 percent in FY03. However, this is not disappointing as it is still above the targeted growth of 4.9 percent for FY04.

As a result of higher growth of industrial sector than agricultural sector, the pace of structural shift also accelerated, as the share of industrial sector in GDP has overtaken the share of agricultural sector in FY04 (see **Figure 2.2**) for the first time in Pakistan's history. If the FY05 growth targets for agriculture (3.5 percent) and industrial sectors (10.8 percent) are achieved, structural shift would be reinforced.

2.2 Agriculture

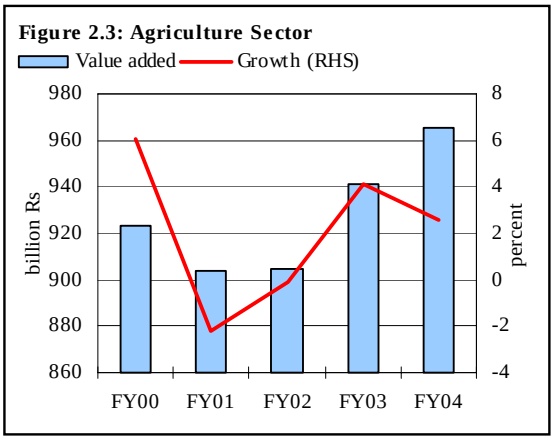
Provisional estimates indicate that the agricultural sector growth will decelerate to 2.6 percent in FY04 well below both, the 4.2 percent annual sectoral growth target as well as the 4.1 percent growth achieved in FY03. Some weakness had already been evident, by the end of *kharif*, and hopes of achieving the target growth had hinged crucially on a significantly above-target wheat harvest as well as a reasonable performance by the livestock sector. In the event, both of these hopes were dashed by a number of unexpected negative events.

Figure 2.2: Share in GDP



The wheat harvest was hurt by untimely rains and a heat wave that significantly reduced the estimated production to 19.8 million tonnes. This is below the FY04 target of 20.0 million tonnes as well as the harvest of over 21 million tonnes suggested by initial optimistic forecasts that were based on the increased area under the crop, the timely increase in support prices, substantial improvement in water availability at sowing time and the credit-driven improvement in access to inputs. Similarly, the growth prospects of the livestock sector were hit by the impact of the bird-flu virus on the poultry sector, and the oil-spill that affected the fisheries sub-sector.

Figure 2.3: Agriculture Sector



As a result, the pace of the agri-sector recovery, seen since FY02, visibly slackened in FY04 (see **Figure 2.3**). However, it is encouraging to note that this relatively weak performance was due to natural vagaries, rather than any policy failure and that there is evidence that high

farm gate prices nonetheless led to a rise in farmers' income and consequently a rise in farm investments.

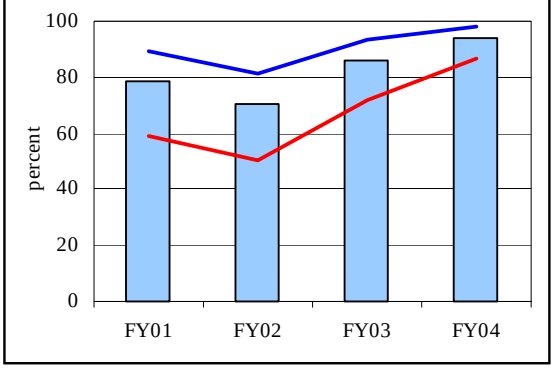
Ironically, the relative increase in prices for wheat, cotton, poultry products and many of the minor crops (fruits and vegetables) during FY04 is expected to significantly spur agricultural growth in FY05, aided by continued improvement in water availability, and the ample availability of production and developmental loans.

2.2.1 Water Availability

Water availability improved by almost 11.0 percent YoY during crop year 2004 (April 2003 to March 2004); the total canal-head water availability was 97.5 million acre feet (MAF) during the period as compared to 87.8 MAF during the corresponding period of the preceding crop year, and the normal availability[1] of 103.5 MAF.

The impact of the shortfall varied with cropping seasons. Water availability during *kharif* (which contributes a larger share of the value addition by major crops), was very close to normal levels, while that during *rabi*, remained at 86.7 percent of normal, despite a significant improvement (see **Figure 2.4**)

Figure 2.4: Ratio to Normal Water Availability

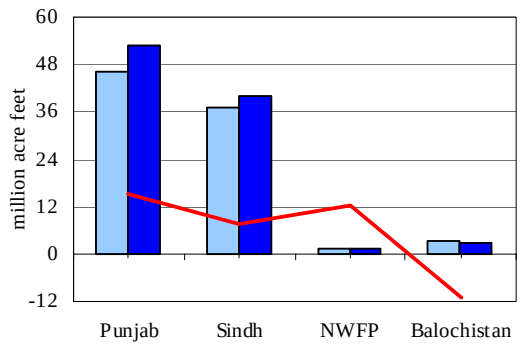


The shortage of water in *rabi* may be a key factor behind the unexpectedly modest increase in the area under wheat despite the significant increase in its procurement price during FY04. The latest estimate shows that the area under wheat increased by only 1.8 percent YoY in FY04 to reach 8,176 thousand hectares, well below the 8,463 thousand hectares cultivated in FY00 (when the procurement price was revised upward).

[1] Normal water availability refers to the average annual water supply during the 1996-2000 period. This average is also equal to the water availability envisaged in the 1991 Water Accord.

The impact of water availability on cropped areas is reflected in the increased cultivated areas for *kharif* crops, which benefited from near-normal water availability. In aggregate, the area under important *kharif* crops rose by 6.6 percent during FY04.

Figure 2.5: Water Availability-Provincial



A breakdown of water availability by province reveals that the highest increase was witnessed in Punjab followed by NWFP and Sindh (see **Figure 2.5**). However, in Balochistan water availability during FY04 remained lower than in the previous year, with major deficit seen in *kharif*. However, it was compensated by better rainfall in Balochistan during the monsoon.

2.2.2 Crops[2]

The crops sub-sector enjoys key position in agricultural growth. During FY04 *major crops* grew by 2.8 percent as compared with 6.9 percent in FY03. In contrast, the growth of *minor crops* accelerated to 1.7 percent from 0.4 percent in the preceding year. As a result, the share of major and minor crops in agricultural value-added reached 34.2 percent and 12.4 percent respectively, during FY04.

Area Under Cultivation:

As in FY03, the market price in the preceding season and water availability at sowing time were the prime factors in deciding the size of area under the crop during FY04. The higher prices of rice, cotton

Table 2.1: Area under Important Crops

thousand hectares

		FY04		% Change Over	
Crops	**FY03**	**Target**	**Sown**	**FY03**	**Target**
Cotton	2,794	2,860	2,989	7.0	4.7
Sugarcane	1,100	1,000	1,074	-2.3	7.4
Rice	2,225	2,231	2,461	10.6	10.3
Wheat	8,034	8,183	8,176	1.8	-0.1
Gram	963	1,063	986	2.6	-7.3
Total	15,116	15,337	15,686	3.8	2.3

Source: Economic Survey 2003-04.

[2] Includes m*ajor & minor crops; major crops* consist of 12 crops i.e. rice, bajra, maize, jowar, sugarcane and cotton of *kharif* season and wheat, gram, barley, rapeseed and mustard, sesamum and tobacco of *rabi* season, while *minor crops* include vegetables, pulses (except gram), oilseeds, condiments, fruits and green fodder.

and wheat led to an increase in the area under these crops, and conversely lower price and delays in the crushing season respectively contributed to depressed the cultivated area under sugarcane in FY04 compared with FY03 (see **Table 2.1**). In the case of wheat, the impact of the rise in the support prices appears to have been partially offset by concerns over water availability during the rabi. Thus, the increase in the aggregate area under important crops during the FY04 cropping season was mainly contributed by cotton and rice.

Production of the Crops

Unfortunately, while sugarcane rice and wheat (modest extent) increase in output compared with FY03, the aggregate growth in the crop sub-sector remained below target due to a variety of reasons (see **Table 2.2**).

Table 2.2: Production of Important Crops

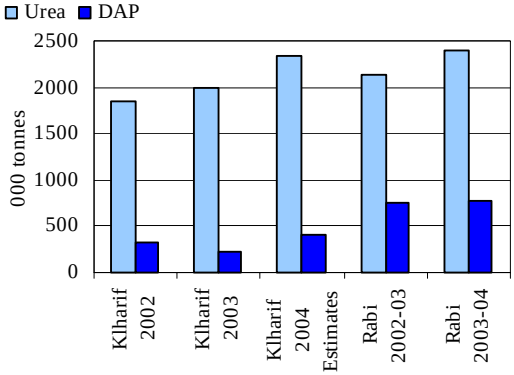
cotton 000' bales; other crops 000' tonnes

Crops	FY03	FY04		% Change Over	
		Target	Prel.	FY03	Target
Cotton	10,211	10,550	10,048	-1.6	-4.8
Sugarcane	52,056	52,500	53,419	2.6	1.8
Rice	4,479	4,550	4,848	8.2	6.5
Wheat	19,183	20,000	19767	3.0	-1.2
Gram	675	580	548	-18.8	-5.5

Source: Ministry of Food, Agriculture and Livestock

In particular, hopes of a substantial improvement in cotton output were dashed by untimely rains and pest attacks, while the growth in wheat production was depressed by concerns over water availability (lowering the cultivated area) as well as untimely rains (that hurt the standing crop late in the season). Interestingly, the FY04 sugarcane production was higher despite a decline in cultivated area; this was mainly due to the relatively higher availability of water throughout the season and favorable weather.

Figure 2.6: Total Fertilizer Off-take



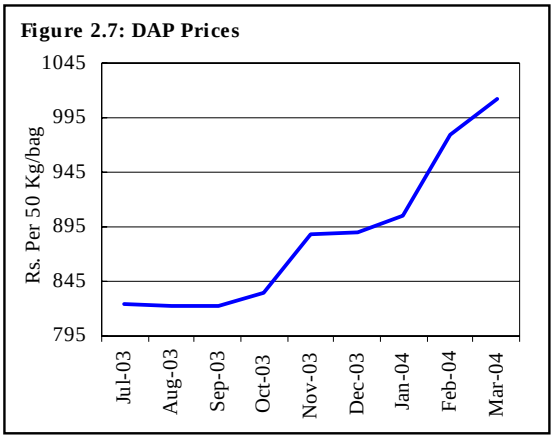
2.2.3 Fertilizers Off-take

In Pakistan, fertilizer usage is dominated by urea and DAP, which together account for almost 99 percent of the total nutrient off-take.[3] While the consumption of urea rose by approximately 11 percent YoY during the cropping season 2003-04 (see **Figure 2.6**), that of DAP declined

[3] The remaining is potash fertilizer.

steeply during the same period (due to high prices amidst shortages, see **Figure 2.7**).[4] In aggregate, the FY04 fertilizer off-take reached 5,692 thousand tonnes, (up by 6.3 percent YoY) from the 5,353 thousand tonnes in FY03. The usage of both urea and DAP is expected to rise during *kharif* FY05. Urea off-take is estimated to rise by 6.2 percent, but the more striking change is the estimated 29.1 percent rise in DAP consumption.

Figure 2.7: DAP Prices



The resurgence in DAP consumption is clearly a function of the increase availability of agri-credit as well as higher crop prices and better water availability. Similarly, it should be noted that rise in *kharif* urea off-take is despite the absence of the substitution away from DAP seen during *kharif* FY04.

Table 2.3: Procurement of Seeds of Important crops

metric tons

	Punjab		Sindh		NWFP		Balochistan	
	FY03	**FY04**	**FY03**	**FY04**	**FY03**	**FY04**	**FY03**	**FY04**
Wheat	123,002	134,249	6171	5,270	6,863	4,185	214	273
	16.82	*18.01*	*5.95*	*5.16*	*7.18*	*4.44*	*0.52*	*0.68*
Cotton	32,581	12,271	1,942	6,473	_	_	_	380
	73.78	*25.76*	*17.88*	*57.65*				*51.35*
Rice	5,185	7,712	312	150	183	145	36	48
	17.15	*23.13*	*3.20*	*1.33*	*15.00*	*11.81*	*1.09*	*1.51*
Gram	1,498	1,000	2.08	_	203	337	_	_
	4.45	*2.77*	*0.14*		*7.81*	*12.96*		
Maize	4,637	3,580	_	_	362	193	_	_
	31.24	*29.44*	_	_	*1.60*	*0.94*	_	_

*=*Italic* numbers represent the procurement as percent of estimated seed requirement

Source: Ministry of Food, Agriculture and Livestock

[4] In fact, at least a part of the surge in urea off-take represents farmer's effort to offset the lower usage of expensive DAP by increasing usage of the cheaper fertilizer. As a result of this trend in prices the N: P ratio deteriorated to 7.9:1 as compared to 3.8:1 of last *kharif* this imbalance of ratio greatly hampered the yield of crops and make them vulnerable to pest attack.

2.2.4 Improved Seed Procurement (public & private sector)

The improved seed distribution registered a rise of 1.9 percent in FY04, as it was 150.4 thousand tonnes in FY04 against 147.5 thousand tonnes in FY03. The crop-wise provincial distribution is depicted in **Table 2.3**.

2.2.5 Agricultural Credit

Disbursement

Agri-credit disbursement witnessed exceptional growth during Jul-Mar FY04, as a result of which it appears that the annual indicative target would be comfortably achieved (see **Table 2.4**).

Table 2.4 Agricultural Credit Disbursement (Jul-Mar)

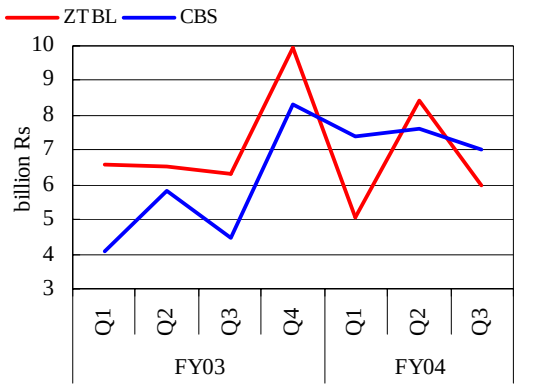
billion Rupees

	FY03	FY04	% Change
Annual target	62.7	65.6	4.5
Disbursements	37.6	47.9	27.4
Percentage share of target	60.0	73.1	21.9

Source: Agricultural Credit Department, SBP.

All participating banks witnessed a YoY growth in disbursements during Jul-Mar FY03, dominated by the five major Commercial Banks (CBs);[5] by end-Q3-FY04, CBs regained the lead (lost in Q2-FY04) over ZTBL. In fact, the credit disbursement by CBs has been reasonably consistent over the past few quarters, in contrast to the performance of ZTBL (see **Figure 2.8**).

Figre 2.8: Quarterly Trend in Disbursements



As a result, CBs' share in total lending to the agriculture sector has risen to a new high of 46.0 percent during July-March FY04. Moreover, on inclusion of the disbursement by new domestic private banks (DPBs, the fresh entrants in the agri-financing market)[6], the share of all commercial banks reached almost 50 percent of the total agriculture credit disbursed in FY04 (see **Table 2.5**).

[5] Include: ABL, HBL, MCB, NBP and UBL.

[6] Include; Askari Commercial Bank Ltd., Bank Al-Habib Ltd., Bank Al-Falah Ltd., Bolan Bank Ltd., Faysal Bank Ltd., Metropolitan Bank Ltd., PICIC Com. Bank Ltd., KASB Bank Ltd., Prime Com. Bank Ltd., Saudi Pak Com. Bank Ltd., Soneri Bank Ltd., The Bank of Khyber, The Bank of Punjab and Union Bank Ltd.

Table 2.5: Credit to Agriculture Sector (July - March)

million Rupees

	Disbursement			Recovery			Net credit[1]	
	FY03	FY04	Percent change	FY03	FY04	Percent change	FY03	FY04
ZTBL	19,347	19,418	0.4	21,332	23,660	10.9	-1,986	-4,242
Commercial banks	14,376	22,065	53.5	13,158	16,233	23.4	1,218	5,832
New private CBs[2]	679	1,654	143.5	382	1,056	176.2	297	598
P.P.C.B.L	3,218	4,799	49.1	2,985	3,595	20.4	233	1,204
Total	**37,620**	**47,937**	**27.4**	**37,858**	**44,545**	**17.7**	**-238**	**3,392**

Sources: Agricultural Credit Department, SBP

[1] Net credit = disbursement minus recovery

[2] New private commercial banks started lending to agriculture sector in FY02

Tractor Financing

Credit sales of tractors increased by 71.0 percent YoY during Jul-Mar FY04 and accounted for 63.1 percent of the total tractors produced during Jul-Mar FY04 compared with 50.4 percent during the corresponding period of the previous year. The credit given for tractor financing constituted 9.5 percent of total agricultural loans in FY04, substantially higher than 6.8 percent in FY03 (see **Table 2.6**).

Figure 2.6: Credit Purchase of Tractors (July-March)

	Amount disbursed (million Rs)			No. of tractor financed		
	FY03	**FY04**	**% Change**	**FY03**	**FY04**	**% Change**
Allied Bank Limited	21.0	44.6	111.9	63	134	112.7
Habib Bank Limited	289.0	858.5	197.0	979	2,846	190.7
Muslim Commercial Bank	4.0	16.8	318.2	18	59	227.8
National Bank of Pakistan	48.3	451.6	835.2	168	1,459	768.5
United Bank Limited	21.8	564.0	2,484.6	75	1,967	2,522.7
Total: Commercial Banks	**384.2**	**1,935.6**	**403.8**	**1,303.0**	**6,465.0**	**396.2**
Zarai Taraqiati Bank Limited	1,884.7	1,559.2	-17.3	6,783	6,278	-7.4
Punjab Prov. Coop. Bank Ltd.	84.6	702.1	730.4	231	1,483	542.0
Domestic Private Banks	203.6	357.7	75.7	697	1,192	71.0
Overall Total:	**2,557.0**	**4,554.6**	**78.1**	**9,014.0**	**15,418.0**	**71.0**

Source: Agricultural Credit Department, SBP.

Commercial Banks led by UBL and NBP and MCB launched an aggressive campaign to finance the tractor purchase. Interestingly, similar to the increase in production of personal vehicles, which registered phenomenal growth during July-March FY04 due to car financing facility, the production of tractors also increased during the same period by 36.8 percent due to higher financing of tractors by banks.

In contrast to the overall increasing trend in the tractor financing (see **Table 2.6**), ZTBL's credit disbursements for tractors saw YoY declined; this partially reflects shortage of funds available with ZTBL and also indicates the erosion of market share due to competition from other new entrants in this business.

Recovery

July-March FY04 saw a broad based 17.7 percent YoY improvement in the recovery of agricultural loans. In addition to the effective recovery drives launched by the banks, the recovery was aided by favorable prices of farm produce over the past year as well as the introduction of policies permitting banks to offer revolving credit limits to farmers.

Similar to the overwhelming lead in the disbursement, a major share (46.0 percent) of the recovery improvement was by CBs'. One possible reason for this may be the loan deferment ratio, which was lower in case of CBs compared to the ZTBL). However, the recovery performance of ZTBL also showed commendable improvement, with recoveries up 10.9 percent YoY during the same period. In fact, the recoveries exceeded disbursements during Jul-Mar FY04 indicating the ZTBL is having some success in recovering past dues.

2.3 Industry

The strong performance of the industrial sector has surpassed the FY04 targets by significant margins. The overall value addition by industry increased by 13.1 percent during FY04 compared with 5.8 percent in the preceding year, and against a target of 8.8 percent. The major contribution to this was from *large-scale manufacturing* (LSM), which registered the strongest growth in the year, as compared to the preceding two decades.

Growth in the *construction* and *electricity & gas distribution* sectors was also robust, at 7.9 percent and 22.5 percent, respectively. However, the value addition in *mining & quarrying* remained unchanged during FY04 (see **Table 2.7**).

Table 2.7: Industrial Growth and Sectoral Shares

	Growth rates		Shares	
	FY03^{R}	FY04^{P}	FY03^{R}	FY04^{P}
Construction	3.1	7.9	10.2	9.8
Electricity & gas dist.	-2.6	22.5	12.2	13.2
Manufacturing	6.9	13.4	71.0	71.2
LSM	7.2	17.1	46.4	48.1
SSM	7.5	7.5	18.3	17.4
Slaughtering	3.0	2.8	6.3	5.7
Mining & quarrying	16.1	0.0	6.6	5.8
Industry	**5.8**	**13.1**	**100.0**	**100.0**

Source: Table 1.1, Economic Survey 2003-04
P: Provisional, R: Revised

The growth in the construction sector was the strongest as compared to the preceding 16 years. This is particularly welcome given the sector's large employment elasticity. Key factors behind the acceleration include:

(1) *Supportive policies:* The government declared construction a priority sector in the FY04 and introduced measures to boost housing and construction.
(2) *Rise in workers remittances:* Historically, there has been a strong correlation between remittances and activity in Pakistan's real estate market.
(3) *Increased availability of housing finance:* This, coupled with low inflation and interest rates, has probably contributed to increased interest in real estate investment.

The strong FY04 growth is all the more impressive in the perspective of the increasing cost of construction materials, particularly since November 2003.[1] In recognition of the employment generation potential of the sector, the government has sought to reduce the costs of key inputs in the FY05 budget.[2] It is hoped that

[1] In particular, steel prices (billets) almost doubled during the period, while cement prices too have gone up by Rs 18 per bag by mid-June 2004.
[2] These include reduction in excise duty on paints & varnishes and a cut in duties on the import of construction machinery. Also, the tax credit limit on housing loans has been increased.

these measures, together with the increased availability of housing finance will help sustain high growth in this sector during FY05.

The value addition in electricity & gas distribution was largely due to lower generation cost due to the increase in availability of water during H1-FY04, growing substitution with relatively less costly fuel (coal and gas), as well as higher gas consumption in industry in general, and transport in particular.

Growth of User Based Industrial Groups

All sectors except *basic goods,* (in terms of end-use classification of industrial production, i.e., *basic*, *intermediate*, *consumer* and *capital goods*), witnessed acceleration in growth during July-March FY04, with major gains in the output of *consumer* and *capital goods* industries. Within the *consumer goods* group, consumer durables continued to witness high growth on account of robust sales, largely facilitated by aggressive marketing of consumer financing on relatively low interest rates. However, the major contribution, in terms of weighted growth, came from *consumer non-durables* on account of an impressive 14.8 percent rise in sugar production, as well as a turnaround in the production of vegetable ghee, beverages and cigarettes during the first nine months of FY04 (see **Table 2.8**).

Table 2.8: Growth of Industrial Production by End Use during July-March

Percent

Sectors	Weights	FY02	FY03	FY04
Basic goods	26.6	21.1	4.7	3.3
		(71.1)	*(18.5)*	*(5.8)*
Intermediate goods	39.9	0.7	4.0	11.9
		(4.4)	*(26.0)*	*(32.1)*
Consumer goods	31.3	4.6	8.5	22.9
		(25.0)	*(46.5)*	*(56.6)*
Non-durables	27.3	4.4	2.8	16.6
		(21.0)	*(13.6)*	*(33.7)*
Durables	4.1	6.0	48.8	51.9
		(3.9)	*(32.9)*	*(22.9)*
Capital goods	2.1	-1.6	32.6	38.8
		(-0.5)	*(9.0)*	*(5.4)*

Source: Based on data from FBS

Note: Figures in parenthesis represent weighted contribution to industrial growth.

Strong growth in the production of capital goods was largely due to strengthened demand for investment goods as reflected in higher disbursement for fixed industrial investment accompanied by acceleration in import of machinery and capital goods during July-March FY04. More specifically, the production of textile machinery, transformers, tractors, diesel engines, and electric meters, increased significantly. Most of the growth in intermediate goods stemmed from the higher production of natural gas, fertilizer, industrial chemicals, paints, cement, etc.

2.3.1 Large-scale Manufacturing (LSM)[3]

The LSM sector continued to witness extraordinary performance during the first nine months of FY04. The Quantum Index of Manufacturing (QIM) based on the output of 100 large-scale industries,[4] recorded a robust growth of 17.1 percent during July-March FY04 compared with a 6.7 percent increase in the corresponding period of FY03. Moreover, as in the preceding quarters, this growth was quite broad based, as evident in the double-digit YoY growth even after excluding the exceptional performance of automobile and electronics production (see **Table 2.9**).

Table 2.9: Summary of Growth Rates--July-March
percent

	FY02	FY03	FY04
Overall	1.9	6.7	17.1
Excl. automobile	2.2	4.4	14.6
Excl. electronics	1.5	5.6	15.8
Excl. auto & electronics	1.8	3.2	13.0
Excl. fertilizer	4.0	7.5	16.0

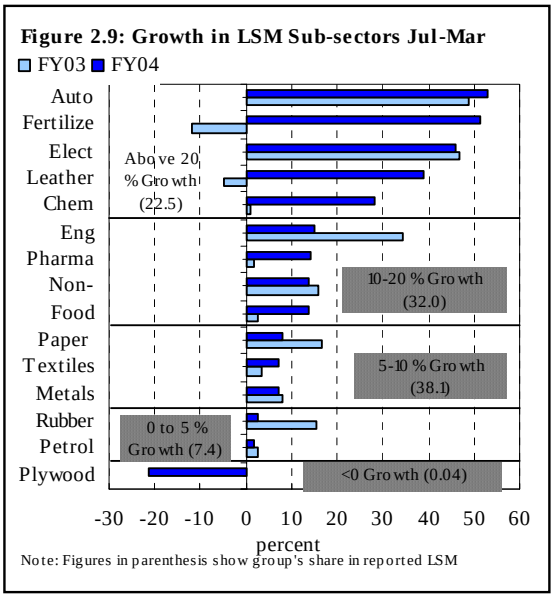
Note: The growth rates for the last two years are indicative only, as these are based on the old sample of 91 LSM items, instead of the 100 elements used to compute the FY04 growth
Source: Based on data from the Federal Bureau of Statistics

In fact, practically all sub-sectors,[5] recorded an increase in production, and over half of these saw growth accelerate even over the high base of the FY03 growth (see **Figure 2.9** and **Table 2.10**).[6] Nevertheless, growth in the production of few sub-sectors decelerated, which was attributable to a high base effect.

The strong growth in fertilizer output during Jul-Mar FY04 is noteworthy. The high increase in the production of fertilizer (by more than 50 percent during Jul-Mar FY04 as compared to a decline of 12.0 percent in the corresponding period last year), was largely due to the re-commencement of production by the phosphatic unit of the Fauji Bin Qasim Fertilizer plant. Moreover, fertilizer off-take also remained strong on account of high market prices of major crops during

[3] The growth rates reported in this section for the corresponding period (i.e. July-March) of FY03 and FY04 are indicative, as they are not based on the full sample as in the case of FY04. The major constraint was non-availability of the production data (for July-March FY03) on the 9 items included in the new sample of 100 items.
[4] With the change in base from 1980-81 to 1999-00, the coverage of the QIM was also enhanced with 9 more items (wheat, deep freezers, fans, soaps & detergents, toilet soap, starch & its products, matches and synthetic rinse). However, the production data on these items was not available for the corresponding period of the last few years.
[5] The sole exception was the recently added wood products (plywood) sector, which has a negligible share in LSM.
[6] In case of three sub-sectors i.e., chemicals, food, beverages & tobacco and electronics, the growth figures are not comparable as 8 of the 9 new industries included in QIM (1999-00=100) are distributed among these and their production data is not available for the corresponding period in 2001-02 and 2002-03.

FY04 and the improvement in farmers' access to bank credit (see section on **Agriculture** for details).



Nevertheless, automobile and electronics remained the fastest growing sub-sectors during July-March FY04. Strong sale of passenger vehicles (cars and motorcycles) on the back of increasing auto loans by commercial banks and higher remittances has compelled assemblers to enhance capacity utilization (see **Table 2.11**). This took place despite the fact that there was a slight slowdown in booking of cars in the months of November 2003 and February 2004 in anticipation of reduction in import duties and allowing the import of used/reconditioned cars. In addition, some of the assemblers stopped taking new bookings due to growing backlog of orders, reflecting the inability of the domestic manufacturers to meet the growing demand. The production of motorcycles also received a boost from exports, which almost doubled during Jul-Mar FY04.

Table 2.11: Outstanding Position of Consumer Financing
billion Rupees

Heads	Q1-FY04	Q2-FY04	Q3-FY04
Credit cards	8.0	8.9	9.7
Auto loans	16.9	22.2	27.6
Home appliances	0.6	1.6	1.2
Housing finance	3.4	4.1	5.5
Others (personal loans)	25.0	28.7	39.0

The sale of tractors also received a significant boost from the entry of commercial banks in financing the purchase of tractors. During Jul-Mar FY04, 15,418 out of 25,202 tractors sold, were financed by commercial banks against 9,014 out of 17,484 tractors sold last year (see Section on **Tractor Financing in Agriculture**). Higher sale and production of LCVs and trucks also reflect improvements in the broader economy.

Table 2.10: Production of Selected Large-scale Manufacturing Items--July-March

		Percentage change				Percentage change	
Items	**Weights**	**FY03**	**FY04**	**Items**	**Weights**	**FY03**	**FY04**
Textile	**24.492**	**3.3**	**7.0**	**Automobile**	**3.955**	**48.7**	**52.8**
Cotton yarn	13.066	6.3	1.9	Cars & jeeps	2.534	51.6	63.5
Cotton cloth	7.549	0.9	15.6	Tractors	0.700	16.4	42.4
Cotton ginned	3.368	-3.7	3.3	LCVs	0.441	57.6	5.6
Other five items	0.509	7.3	15.2	Motorcycles	0.137	33.5	71.0
Food, beverages & tobacco	**14.352**	**2.6**	**13.7**	Trucks	0.084	42.1	-2.0
Vegetable ghee	4.242	-5.1	13.6	Buses	0.060	117.3	1.0
Sugar	4.150	12.3	14.8	**Metals**	**3.504**	**8.0**	**7.0**
Cigarettes	3.055	-7.2	9.9	Pig iron	1.613	6.2	8.2
Cooking oil	1.319	7.0	22.9	Coke	1.441	7.3	5.9
Wheat milling	0.988	-	4.4	Billets	0.340	14.2	8.5
Tea	0.319	3.1	3.5	H.R products	0.081	31.1	-3.7
Beverages	0.279	-5.5	21.2	C.R products	0.030	14.7	6.2
Petroleum products	**5.232**	**2.5**	**1.7**	**Fertilizers**	**3.383**	**-12.0**	**51.2**
Pharmaceuticals	**5.030**	**1.8**	**14.1**	Phosphatic	1.885	-27.5	117.5
Tablets	2.575	-0.4	12.7	Nitrogenous	1.498	4.2	3.3
Syrup	1.525	4.5	21.4	**Electronics**	**2.485**	**46.8**	**45.8**
Injections	0.444	-5.2	12.4	Transformers	0.570	34.3	77.6
Capsules	0.217	-0.1	29.2	Refrigerators	0.589	18.1	68.8
Other two items	0.270	22.0	-17.3	Deep freezers	0.399	-	46.4
Chemicals	**4.800**	**0.9**	**28.3**	TV sets	0.226	148.4	-3.7
Caustic soda	0.731	5.8	14.8	Air conditioners	0.074	69.1	815.2
Soda ash	0.088	12.9	3.1	Fans	0.016	-	17.3
Other ten items	3.981	-3.4	31.1	Other five items	0.611	33.3	24.5
Non metallic minerals	**4.192**	**15.9**	**13.7**	**Engineering items**	**0.446**	**34.3**	**15.1**
Cement	4.141	15.3	13.7	Razor blades	0.260	5.1	0.9
Glass sheets	0.051	76.8	11.2	Bicycles	0.064	18.3	5.5
Leather products	**2.272**	**-4.7**	**39.0**	Power looms	0.081	18.7	25.3
Paper & board	**0.600**	**16.5**	**7.9**	Diesel engines	0.016	19.5	53.9
Tyres & tubes	**0.303**	**15.5**	**2.7**	Sewing machines	0.011	1829.6	48.5
Wood Products	**0.030**	**-**	**-21.4**	Other five items	0.014	-1.9	-6.3

Source: Based on data from FBS

Note: The growth rates reported in this section for the corresponding period (i.e. July-March) for FY03 are indicative as they are not based on the full sample as in the case of FY04. The major constraint was non-availability of the production data (for July-March) on the 9 items included in the new sample of 100 items.

Electronics is another sub-sector that has been recording consistent acceleration in growth during the last two years.[7] Lower prices,[8] stemming from fierce

[7] The electronics industry witnessed an expansion in capacity as a new factory "New Allied Electronics Industries" in Balochistan started production of air-conditioners.

[8] The prices of refrigerators, air conditioners, freezers, television sets and other appliances have significantly come down over the last two years. The prices of split air conditioners are almost half

competition in the domestic market in the form of cheap imports from China, and aggressive marketing of consumer finance have been major factors generating demand for appliances in the domestic economy. Additionally, the production of some electronics, especially air conditioners, refrigerators and transformers, has received a considerable boost through exports.

Besides higher growth, these two sub-sectors also witnessed an expansion in capacity during FY04.[9] In the automobile sector, a number of new assemblers (including brands such as Pak Hero, Super Star, Metro, Star, United, Excel, Guangta, Super Asia, Hero, Hawk, Ginan, New Asia and Jinhao) have started commercial production since FY03. Similarly, ranges of new brands are seen in the market for TVs, air conditioners, refrigerators and other appliances.

An impressive growth in housing and construction[10] during Jul-Mar FY04 continued to provide boost to a range of related industries. A substantial growth in the production of cement, steel, paints & varnishes, electric fitting & fixture etc. in particular owes to acceleration in construction activities in the country during the last two years. More specifically, the cement industry witnessed 13.7 percent rise in production during Jul-Mar FY04 over 15.3 percent increase in the corresponding period of last year. The trends in cement export also continued to strengthen (registering a 203 percent YoY increase) during Jul-Mar FY04, as Pakistan has also began exporting to Iraq in addition to Afghanistan. The Pakistani manufacturers could also capture a higher market share in Afghanistan following an increase in Iran's domestic consumption for the reconstruction of city of Bam, after it was badly damaged by an earthquake.

However, steel production could not maintain the accelerating trends as were observed during the last four quarters.[11] Largely, higher prices of raw materials (iron scrap) and lower supplies from the ship breaking industry have contributed in the slowdown of steel production during Jul-Mar FY04.[12] Moreover, Pakistan

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of the prices just two years ago (Industrial Bulletin—May 2004, Experts Advisory Cell, Ministry of Industries and Production)

[9] The numbers on the capacity of newly established plants is not yet available. Similarly, their production is not yet covered in Quantum Index of Manufacturing, thus, understating the growth of automobile production during FY04.

[10] A number of factors including housing finance by commercial banks and HBFC, measures announced in the last budget to boost construction and housing, higher development expenditures and increase in remittances have contributed in strong growth in construction.

[11] Presently reported steel production is of Pakistan Steel only as the production from re-rolling mills and steel melters is not covered in LSM.

[12] The contract between China and Australia regarding supplies of steel scrap (from ship breaking) has resulted in higher scrap prices.

Steel is also operating at 94 percent capacity during FY04. There is little that Pakistan Steel Mills can do in enhancing its production any further unless there is an expansion in capacity.

Despite supply shortages of lint cotton (and consequent record hike in prices), the textile industry has performed reasonably well. The output of textiles, largely contributed by cotton cloth production, grew by 4.5 percent during Jul-Mar FY04 compared to 4.1 percent during the same period last year, on the back of strong export. Robust growth in exports[13] and the threat of increased competition post-December 2004 have continued to encourage expansion and technological up-gradation in the textile industry during Jul-Mar FY04 (see **Table 2.12**).

Table 2.12: Textile Industry: Investment and Expansion during July-March

	FY03	FY04
Investment		
Disbursement under Textile Vision 2005 (billion Rs)	24.7	29.8
Import of textile machinery (million US$)	379.5	419.4
Expansion		
No. of mills	355	399
Installed Capacity (000 Nos)		
Spindles	9173.0	9286.8
Rotors	144.0	145.6
Looms	10.2	10.3

Source: Economic Survey 2003-04

In view of the measures recently announced in the Budget for FY05, including establishment of textile cities, reduction in electricity prices and lower import duties on import of machinery not manufactured locally, the pace of technological modernization and expansion in the textile industry is expected to accelerate.

The output of food group witnessed a considerable improvement on account of higher production of sugar, cooking oil and vegetable ghee, cigarettes and beverages.[14] An increase in sugarcane crop output coupled with higher recovery due to the delayed crushing season has been the principal contributor in higher sugar production. The vegetable ghee industry has benefited from regulations against unregistered ghee units and exports to Afghanistan. Cigarettes manufacturing has also received a huge boost from exports; during Jul-Mar FY04, the exports of cigarettes were more than twice that in the same period of FY03.

[13] The exports of textiles recorded more than 15 percent increase during Jul-Mar FY04.
[14] The enhanced coverage (inclusion of wheat & grain milling) during FY04 is another factor behind higher growth in food, beverages & tobacco sub-sector.

The production of pharmaceuticals also witnessed a remarkable growth of 15.9 percent during Jul-Mar FY04 compared to an anemic 1.1 percent increase in the same period of FY03. The pharmaceutical industry has benefited from the increased share of domestic companies in rising government purchases. The industry has also gained from exports to African, Central Asian States and Afghanistan.

2.3.2 Infrastructure Industries

The overall performance of infrastructure industries remained buoyant during Jul-Mar FY04. The composite index of seven infrastructure industries recorded an increase of 6.8 percent during Jul-Mar FY04 compared to 5.0 percent in the same period last year. Growth in the production of natural gas, electricity and petroleum products accelerated during Jul-Mar FY04, while growth in cement and steel production (excluding coke) witnessed deceleration. On the other hand, output of coal and crude oil recorded sharp declines (see **Figure 2.10**).

Figure 2.10: Growth of Infrastructure Industries during Jul-Mar

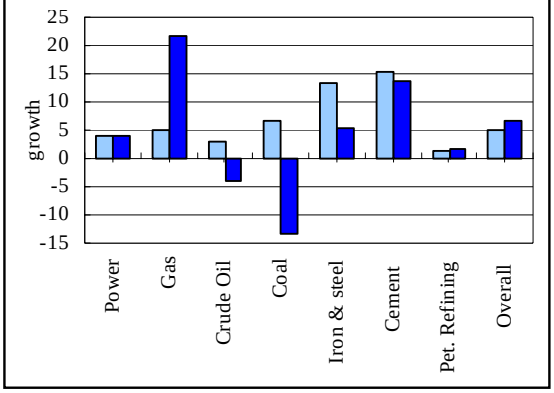
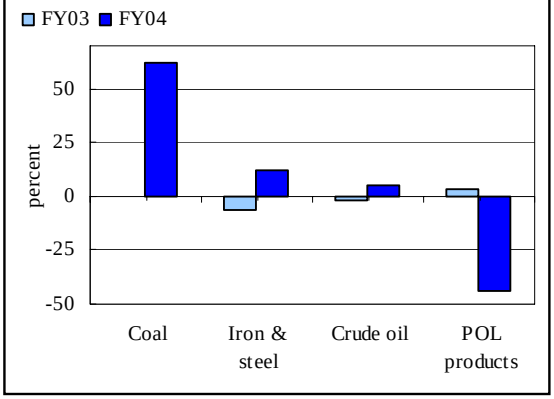


Figure 2.11: Growth of Infrastructure Industries Imports during Jul-Mar



The decline in crude oil production was largely due to depleting oil reserves of British Petroleum Pakistan (BP-Pakistan). Consequently, Pakistan's average daily production of oil declined from 27,822 bpd during FY03 to around 18,000 bpd during FY04. On the other hand, the major factor behind the decline in

coal production, as discussed in the *Second Quarterly Report for FY04*, is alleged to be underreporting (by the private mining companies) in order to avoid 15 percent sales tax.

Finally, a moderate growth of 1.6 percent in the output of refineries coupled with the decline in the import of POL products during Jul-Mar FY04, reflects a decline in consumption due to increasing substitution with cheaper fuel (mostly coal and natural gas). This is particularly reflected in higher gas production and the rising import of coal (see **Figure 2.11**).

Capacity Utilization

The major gains in capacity utilization were realized in consumer goods industries. More specifically, the automobile industry witnessed the largest increase in capacity utilization by more than 15 percentage points, followed by electrical appliances, cement, steel, chemicals and paper & paper board (see **Table 2.13**).

Table 2.13: Capacity Utilization in Selected Industries

			July-March	
Industry	**FY02**	**FY03**	**FY03**	**FY04**
Textiles[1]				
Spinning (spindles and rotors)	62.3	64.2	64.9	65.8
Weaving	44.8	47.6	49.3	43.1
Consumer non-durables				
Ghee & cooking oil	34.7	32.6	33.2	38.2
Consumer durables				
Cars Jeeps & LCVs	42.8	65.0	59.1	78.6
Motorcycles/auto rickshaws	47.3	62.6	59.4	84.3
Trucks & Buses	22.9	33.7	32.9	22.3
Tractors	73.7	80.3	72.2	84.8
Appliances (Refrigerators and air conditioners)	26.9	34.1	28.9	55.1
Cement	60.9	67.3	67.4	77.8
Steel (Pakistan Steel Mills)	81.0	91.0	87.0	94.0
Industrial chemicals (soda ash and caustic soda)	98.9	108.6	107.6	118.0
Fertilizer	88.0	90.7	92.0	99.7
Petroleum refining[2]				
Paper & paper board	79.1	91.0	89.7	96.7

Note: the capacity utilization rates for most of the industries have been revised on availability of installed capacity during FY04.

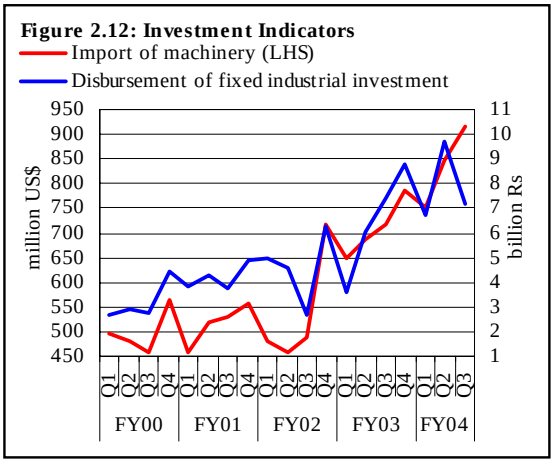
[1] Capacity utilization in the case of textiles is based on July-February figures.

[2] Capacity of the Bosicor is not included, as the refinery is still on trial run.

Sources: Manufacturers' associations, publications of Ministry of Industries and Production.

The rising capacity utilization appears to be spurring investment in industry, as evident from import of capital goods and increasing disbursement of credit for fixed industrial investment (see **Figure 2.12**). Credit for fixed industrial investment has risen by 38.8 percent during Jul-Mar FY04 over the corresponding period in FY03 and 38.6 percent over FY02. Import of machinery has shown a similar pattern, recording an increase of 22.3 percent during Jul-Mar FY04.

Figure 2.12: Investment Indicators



As discussed above, the textiles, automobile and electronics industries have already realized expansion in capacity during the last couple of years and the process is expected to continue. Capacity expansion is also expected in capital-intensive industries such as steel, fertilizer and cement.

With a surge in construction activities and expansion in the engineering industry during the last two years, the demand for steel in the country has increased to over 4 million tons during FY04 compared to 3 million tons in the previous year. Consequent to growing demand, the management of Pakistan Steel Mills (PSM) has started to implement an expansion plan (with the help of Russia and China) according to which, the annual capacity of the steel mills will be enhanced to 3 million tons over the next three years (in this regard, a memorandum of understanding (MoU) on the expansion, revamping and modernization of PSM was signed in Moscow on February 7, 2003). Moreover, a Saudi company (Al-Tuwairqi Group) has already shown interest in establishing a 1.0 million ton billet steel plant near Karachi port.

Persistent fertilizer shortages in the wake of growing demand and the poor response by private investors to the Fertilizer Policy 2001, led the government to establish a fertilizer plant in the public sector. Similarly, the cement industry is expected to add capacities of at least another 4.7 million tons per annum over the next three years.