# 6 External Sector

## 6.1 Overview

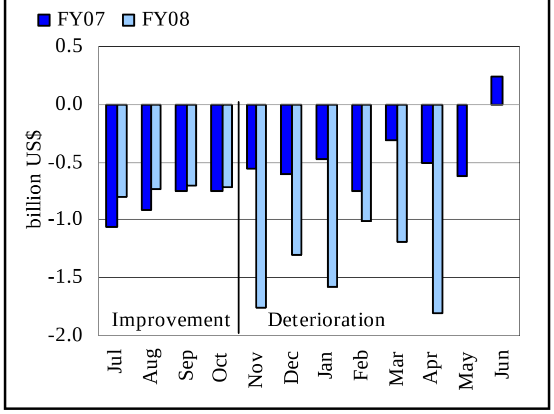
The deterioration in Pakistan's overall external balance accelerated during Jul-Apr FY08 as the current account deficit expanded further and financial & capital account surplus shrank (see **Table 6.1**). Consequently, the country's foreign exchange reserves dropped to US$ 11.5 billion and the rupee depreciated by 13.4 percent against US dollar by 22nd May, 2008.

**Table 6.1: Summary of External Accounts (Jul-Apr)**
billion US$

| | FY06 | FY07 | FY08 |
|---|---|---|---|
| A-C/A balance | -3.9 | -6.6 | -11.6 |
| *i) Trade balance* | -6.5 | -8.3 | -12.7 |
| *ii) Invisible balance* | 2.5 | 1.7 | 1.2 |
| B-Financial/capital balance | 5.1 | 7.5 | 6.1 |
| *i) FDI* | 3.0 | 4.2 | 3.5 |
| *ii) FPI* | 1.0 | 1.8 | 0.1 |
| *iii) Other investment* | 1.0 | 1.4 | 2.5 |
| C-Errors & omissions | 0.2 | -0.1 | 0.3 |
| D-Overall balance | 1.3 | 0.8 | -5.2 |

Source: Statistics and Data Warehouse Department, SBP

**Figure 6.1 : Monthly Comparison of CAB**




A large part of the deterioration in current account deficit occurred Nov FY08 onwards, as is evident from more than US$ 1.0 billion year- on-year rise in monthly average import bill in the last six months (see **Figure 6.1 &Table 6.2).** This rise in import bill was contributed by both, record high prices of oil and other commodities in international market and increased import of wheat and cotton. Rise in import bill was accompanied by rising freight charges. The aforementioned factors overshadowed improvement in export growth and impressive increase in current transfers in the period under review.

On financing side, capitals & financial account registered lower surplus during Jul- Apr FY08 as compared to the same period last year. The decline in the surplus mainly reflects: substantial decline in foreign portfolio investment,[1] on account of (a) outflow from stock market, and (b) delays in floatation of Global Depository Receipts (GDRs) and euro bonds.

The lower surplus in capital & financial account and expansion in current account deficit were reflected in the mounting pressures on foreign exchange reserves during the period. The country's overall foreign exchange reserves declined to US$ 12.3 billion at end Apr FY08 from US$ 15.6 billion at end June FY07.

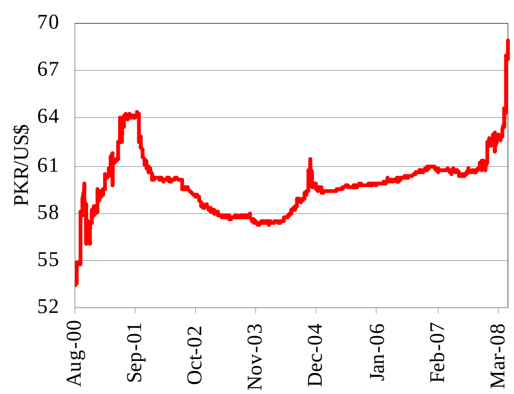
**Table 6.2: Monthly Average of Current Account Balance and its Components**

(billion US$)

| | FY07 | | FY08 | |
|---|---|---|---|---|
| | **Jul-Oct** | **Nov-Apr** | **Jul-Oct** | **Nov-Apr** |
| a-Trade balance | -0.92 | -0.78 | -0.84 | -1.56 |
| i)-Exports | 1.36 | 1.42 | 1.55 | 1.66 |
| ii)-Imports | 2.28 | 2.20 | 2.39 | 3.23 |
| b-Services balance | -0.41 | -0.37 | -0.53 | -0.58 |
| c-Income (net) | -0.28 | -0.30 | -0.30 | -0.31 |
| d-Current transfers | 0.74 | 0.91 | 0.93 | 1.01 |
| **CAB(a+b+c+d))** | **-0.87** | **-0.53** | **-0.74** | **-1.44** |

Source: Statistics and Data Warehouse Department, SBP

**Figure 6.2: Exchange Rate:A Historical Perspective**




Not surprisingly, the rupee too came under pressure depreciating 6.4 percent against US dollar during Jul-Apr FY08 compared with nominal depreciation of 0.75 percent in the same period last year (see **Figure 6.2).** The pressure on exchange rate was partially attributed to weakening external account, and partially to speculative pressures as is evident from rise in kerb market premium and increase in foreign currency accounts.

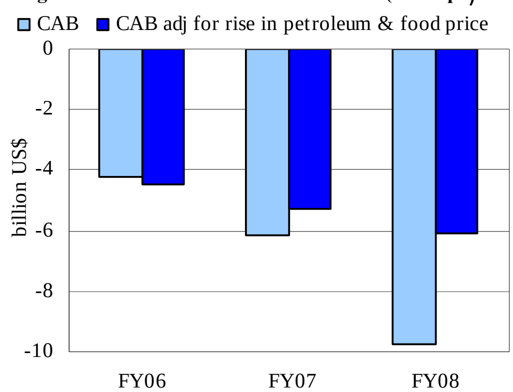
It may be pointed out that surge in import growth (as was during FY03-FY06) remained the dominant factor behind worsening of current account during this fiscal year.[2] However, unlike previous years when extraordinary import growth

[1] The foreign portfolio investment declined to US$ 118 million during Jul-Apr FY08 from US$ 1758 million in the same period of last year.
[2] In FY07, slowdown in import growth was coincided with concurrent slowdown in export growth which deteriorated the current account deficit.

was mainly driven by demand pressures emanating from capacity expansion, the import growth in the current year was contributed by both high prices and demand factors, with former having a greater role. In particular, rise in petroleum and food imports, which contributed more than one half of the rise in overall imports, were mainly driven by higher prices.[3] Adjusting for rise in aforementioned groups, the current account deficit shows sizeable decline during the period under review (see **Figure 6.3).** The widening trade deficit suggests need for import curtailment, however, given that more than 50 percent rise in the imports is originating from food and petroleum imports; this strategy clearly has its limitations, leaving little option but to address structural problems ( as mentioned in earlier quarterly reports) to boost exports earnings in medium to long term.[4]

Other than focusing on merchandize exports there is potential to enhance foreign exchange earnings by boosting services exports such as IT services, tourism etc. Increasing remittances from labor market opportunities in East Asian economies and the Middle East also needs attention to benefit from. Productivity gains likely to be achieved from skilled labor will have spillover effects in attracting FDI, enhancing workers' remittances and exports of goods and services.

**Figure 6.3: Current Account Balance (Jul-Apr)**




Looking ahead, persistently rising oil prices and poor performance of textile exports means that there is little room for a substantial decline in current account deficit in the remaining months of the year. However, relative easing of demand on account of rising prices, strong growth in remittances and expected inflows of logistic support are likely to slow down the pace of widening current account deficit to some extent. Likewise, inflows that can materialize from floatation of GDRs, issuance of sovereign bond,

[3] During Jul-Apr FY08, contribution of price rise in petroleum group imports was 70.3 percent while in food imports it was 86.2 percent.

[4] These problems have been discussed in various quarterly and annual reports of State Bank of Pakistan.

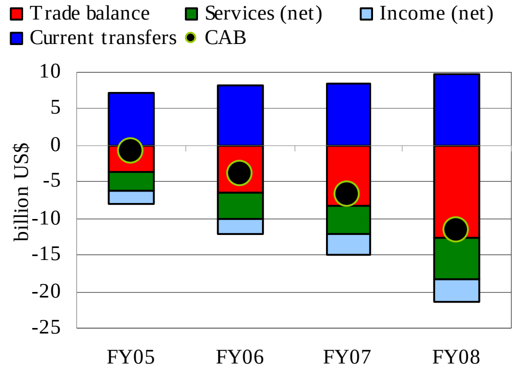
receipts of multilateral loans and disinvestment in the remaining months of the current year are likely to help in financing the current account deficit.

**6.2 Current Account Balance**

Current account deficit expanded by 74.8 percent during Jul-Apr FY08 on the top of a 67.9 percent rise during last year. Even when compared to the size of economy, CAD was substantially high at 7.0 percent of GDP during Jul-Apr FY08 against 4.6 percent for the same period last year.

Deterioration in the current account was caused by the widening trade and services account deficits (see **Figure 6.4).** The former increased due to surge in import growth and the latter due to rise in import related transportation costs and lower logistic supports receipts. Strong growth in workers' remittances and budgetary support from Saudi Arabia (US$ 300 million), however, provided some respite from widening current account deficit.

**Figure 6.4: Sources of Deterioration inCAB (Jul-Apr)**




**Trade Account**[5]

Trade deficit continued to worsen for the sixth year in a row (starting in FY03). During Jul-Apr FY08, substantial YoY increase of 29.4 percent in imports outstripped otherwise healthy export growth of 15.2 percent, thereby causing huge trade deficit.

Acceleration in import growth was largely contributed by inflated petroleum group imports and increased import of wheat and cotton owing to domestic supply shortage during the period. Welcome recovery in export growth, on the other hand, was chiefly driven by non-textile exports as textile exports continued to show poor performance. The weakness in textile exports is partly explained by slowdown in key textile export markets (particularly in H1-FY08) and partly by high cotton prices and power shortages plaguing domestic economy.

[5] This section is based on exchange record data compiled by SBP that does not tally with the Custom data compiled by FBS.

**Services (net)**

Services account deficit widened by 44.2 percent during Jul-Apr FY08 to reach US$ 5.6 billion. This deterioration is contributed by relatively high import growth and decline in export of services.

**Table 6.3: Details in Trade in Services (Jul-Apr)**

| | Exports | | | | Imports | | | |
|---|---|---|---|---|---|---|---|---|
| | Growth (percent) | | Share (percent) | | Growth (percent) | | Share (percent) | |
| | FY07 | FY08 | FY07 | FY08 | FY07 | FY08 | FY07 | FY08 |
| Transportation | 2.5 | -5.6 | 29.6 | 32.0 | 11.9 | 14.4 | 37.8 | 36.3 |
| Travel | 31.5 | -3.0 | 7.6 | 8.5 | 20.6 | -5.2 | 20.4 | 16.2 |
| Government services | -16.8 | -26.5 | 38.3 | 32.3 | 2.7 | 17.7 | 3.8 | 3.8 |
| Other business devices | 19.4 | -7.3 | 12.5 | 13.3 | -10.3 | 41.1 | 30.4 | 36.1 |
| Others | 10.9 | 1.4 | 11.9 | 13.9 | -8.8 | 18.6 | 7.6 | 7.6 |
| **Total** | -2.0 | -12.8 | 100.0 | 100.0 | 3.5 | 19.0 | 100.0 | 100.0 |
| Adjusted for logistic support | 6.3 | 2.1 | - | - | - | - | - | - |

Source: Statistics and Data Warehouse Department, SBP

During Jul-Apr FY08, 86 percent of services exports witnessed decline, particularly fall in government services is the strongest (see **Table 6.3**). Fall in government services exports was driven by lower logistic support receipts, while fall in transportation services was mainly result of lower passage earnings of Pakistani airlines facing stiff competition from foreign airlines. Worsening law & order situation and resultant decrease in foreign tourists proved major reasons for falling travel exports.

Higher import related transportation costs and outflow from other business services (mainly reflecting increased coverage of foreign transaction routed trough exchange companies) led to acceleration in services import growth during July-Apr FY08.[6]

[6] These outflows from foreign exchange companies have no impact on overall current account balance as these outflows are matched by receipts of foreign exchange companies.

**Table 6.4: Current Account Balance**

million US$

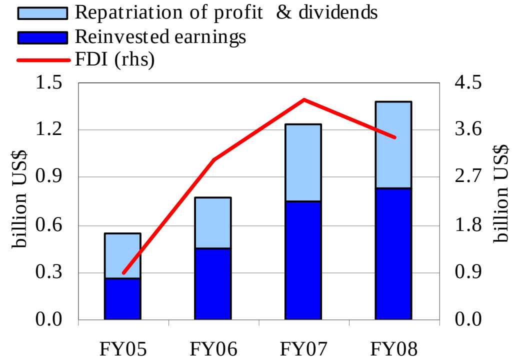
| | Jul -Apr | | | YoY Change | |
|---|---|---|---|---|---|
| | **FY06** | **FY07*** | **FY08*** | **FY07** | **FY08** |
| **1. Trade balance** | **-6,458** | **-8,307** | **-12,740** | **-1,849** | **-4,433** |
| Exports | 13,484 | 14,033 | 16,167 | 549 | 2,134 |
| Imports | 19,942 | 22,340 | 28,907 | 2,398 | 6,567 |
| **2.Services ( net )** | **-3,571** | **-3,867** | **-5,575** | **-296** | **-1,708** |
| Transportation | -1,453 | -1,710 | -2,139 | -257 | -429 |
| Travel | -991 | -1,176 | -1,110 | -185 | 66 |
| Communication services | 72 | 23 | 12 | -49 | -11 |
| Construction services | -122 | 17 | -13 | 139 | -30 |
| Insurance services | -94 | -91 | -92 | 3 | -1 |
| Financial services | -60 | -55 | -110 | 5 | -55 |
| Computer & information services | 24 | 13 | 10 | -11 | -3 |
| Royalties and license fees | -64 | -69 | -63 | -5 | 6 |
| Other business services | -2,029 | -1,726 | -2,621 | 303 | -895 |
| Personal & cultural & recreational services | -4 | 1 | 2 | 5 | 1 |
| Government services | 1,150 | 906 | 549 | -244 | -357 |
| Of which logistic support | 923 | 723 | 283 | -200 | -440 |
| **3. Income (net )** | **-2,091** | **-2,900** | **-3,057** | **-809** | **-157** |
| Investment income( net ) | -2,095 | -2,905 | -3,064 | -810 | -159 |
| Direct investment | -1,635 | -2,372 | -2,592 | -737 | -220 |
| Of which: profit & dividends | -325 | -486 | -543 | -161 | -57 |
| Purchase of crude oil and minerals | -882 | -1,163 | -1,226 | -281 | -63 |
| Portfolio investment | -123 | -179 | -157 | -56 | 22 |
| Of which : dividend | -75 | -167 | -189 | -92 | -22 |
| IMF charges & interest on off. external long term debt | -430 | -478 | -502 | -48 | -24 |
| Interest on private external debt | -71 | -127 | -181 | -56 | -54 |
| Others (net) | 168 | 256 | 375 | 88 | 119 |
| **4. Current Transfers ( net )** | **8,172** | **8,446** | **9,786** | **274** | **1340** |
| Private transfers | 7,836 | 8,186 | 9,301 | 350 | 1115 |
| Workers remittance | 3,626 | 4,450 | 5,317 | 824 | 867 |
| FCA - residents | 268 | 59 | 351 | -209 | 292 |
| Others | 4,000 | 3,720 | 3,700 | -280 | -20 |
| Of which exchange companies | 2,440 | 2,032 | 2,040 | -408 | 8 |
| Official transfers | 336 | 260 | 485 | -76 | 225 |
| **Current account balance** | **-3,948** | **-6,628** | **-11,586** | **-2,680** | **-4,957** |

* Provisional

**Income (net)**

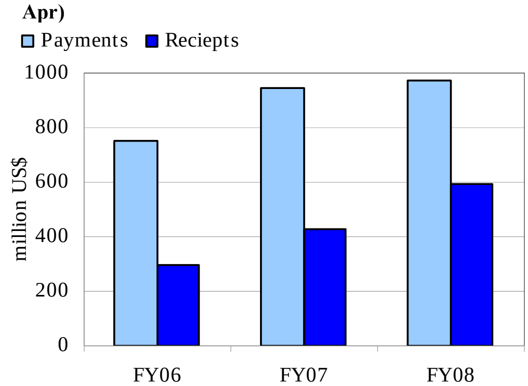
Income account deficit deteriorated marginally by 5.4 percent during Jul-Apr FY08 against considerable expansion of 38.7 percent in comparable period last year. The substantial deceleration in deficit expansion during the period was result of a relatively smaller increase in repatriation of profit & dividends on investment income and decline in interest payment (net).

**Figure 6.5: Impact of FDI on Current Account Deficits (Jul-Apr)**




Slowdown in repatriation of profit & dividends on foreign investment during the current year probably reflects lower corporate profits during CY2007. Specifically, financial and telecommunication sector, which together account for more than one half of total foreign direct investment, repatriated lower amount of profit & dividend during Jul-Apr FY08 compared with the same period last year. In contrast the sectors with visible increase in profit & dividends during the period under review included thermal power generation and oil & gas exploration.

**Figure 6.6: Interest Payment and Reciepts (Jul-Apr)**




Encouragingly, amount of reinvested earning has been on the increase over the last four years in most of the sectors (see **Table 6.6**) which indicates that foreign investors are consolidating their business in Pakistan (see **Figure 6.5**).[7]

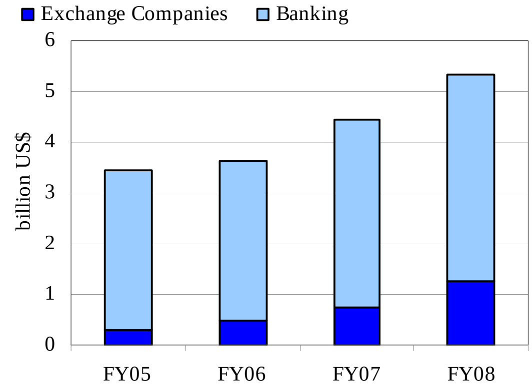
[7] Reinvested earnings are shown as outflow in current account balance and inflow in financial account balance. Hence they have no impact on overall external balance.

Decline in interest payment (net), on the other hand, is result of both increased interest earning and marginal decline in interest payments on external debt & liabilities during Jul-Apr FY08 (see **Figure 6.6**).

**Current Transfers**

The 15.9 percent increase in current transfers during Jul-Apr FY08 reflects a significant increase in both the, private and official, transfers. Budgetary support of US$ 300 million from Saudi Arabia mainly explains the rise in official transfers while strong remittances growth and higher inflow in the resident foreign currency accounts explains rise in private transfers.

**Figure 6.7: Workers Remmitances (Jul-Apr)**




***Workers' Remittances***

As in the previous year, workers' remittances recorded impressive growth of 19.5 percent during Jul-Apr FY08. Remittances routed through exchange companies contributed 60.2 percent in the overall remittances growth. As a result, foreign exchange companies' share in overall remittances increased to 23.8 percent during Jul-Apr FY08 from 16.7 percent for the same period last year (see **Figure 6.7**).[8] Part of the strong growth in remittances is probably a consequence of rising costs of living at home.

**Table 6.5: Country wise Workers Remittances (Jul-Apr)**
million US$

| | **FY07** | **FY08** | **Absolute Change** |
|---|---|---|---|
| Gulf region | 2,111 | 2,704 | 593 |
| USA | 1,176 | 1,464 | 288 |
| UK | 355 | 379 | 24 |
| Canada | 70 | 83 | 13 |
| Germany | 65 | 63 | -2 |
| Others | 672 | 624 | -48 |
| **Total cash** | **4,448** | **5,317** | **869** |
| Encashment & profits FEBC & FCBCs | 2 | 2 | 0 |
| **Grand total** | **4,450** | **5,319** | **869** |

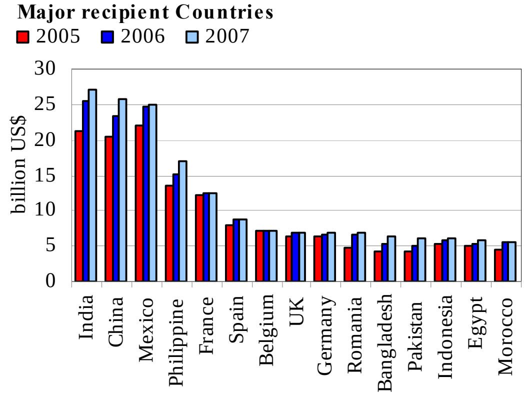
Source: Statistics and Data Warehouse Department, SBP

[8] For reason of rise in remittances through exchange companies see SBP 2nd Quarterly Report for FY08.

A greater share in remittances growth was that of the oil rich gulf region- Kuwait, Bahrain, Qatar, Oman, Saudi Arabia and United Arab Emirates- and from United State of America (see **Table 6.5).**

Increase in remittances to Pakistan in recent years is in line with the international trends. The world top fifteen remittances recipient countries have experienced increase in remittances in the last two years (see **Figure 6.8).** Pakistan registered the third highest growth (19.6 percent) in remittances during 2006 and the highest growth (19.1 percent) in 2007 among the top fifteen countries. As a result, Pakistan has become world's 12th largest remittance recipient country during 2007 from 17th in 2005.

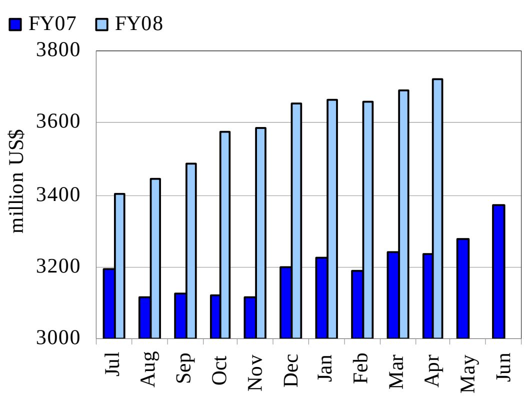
**Figure 6.8: Remittances Inflows in World's Major recipient Countries**




***Resident FCAs***

Historically, whenever expectation of depreciation in Pak Rupee take hold, the resident foreign currency account records considerable inflows. In line with this, the expectations of exchange rate depreciation in the recent months led to US$ 351 million inflow in resident foreign currency accounts during Jul-Apr FY08 compared with nominal inflow of US$ 59 million in the same period last year (see **Figure 6.9**).

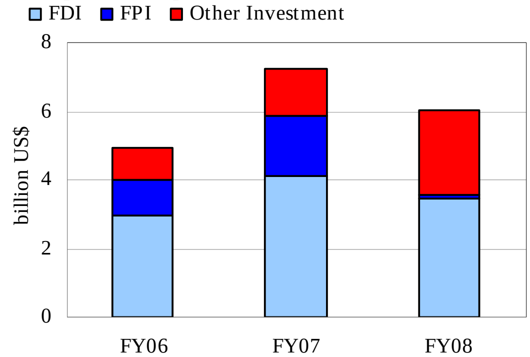
**Figure 6.9: Resident FCAs**



## 6.3 Financial Account

In sharp contrast to last two years, surplus in financial account declined sizably during Jul-Apr FY08 (see **Figure 6.10).** A large part of this decline was result of lower inflows in both foreign portfolio investment and foreign direct investment during Jul-Apr FY08 (as compared to substantial inflows in the same period last year). Other investments, however, recorded considerable inflows during Jul-Apr FY08 which mainly reflects higher inflows in earthquake loans (US$ 516 million) and receipts of short term loan (net) US$ 561 million from Islamic Development Bank (IDB).

**Figure 6.10: Sources of Financial Account Surplus (Jul-Apr)**




***Net Foreign Investment***

Overall net foreign investment declined by 39.2 percent during Jul-Apr FY08 as compared to 47.0 percent growth in the corresponding period previous year. This was mainly due to fall in foreign direct investment and portfolio investment. However, with 9.6 percent YoY growth during Jul-Jan FY08, fall in FDI entirely occurred in the last three months (Feb-Apr FY08).

***Foreign Direct Investment***

After recording average growth of 100.2 percent in last three years (FY05-07), the foreign direct investment declined by 16.7 percent during Jul-Apr FY08. A part of decline is attributed to high base set last year and a part to increased country risk.

Sector wise analysis reveals that investment in telecommunication, power, petroleum refining and financial business declined whereas cement, oil & gas exploration and trade recorded increase. Major companies which received foreign inflows include: Pakistan Cement Company Limited (Chakwal cement), Warid telecom, Telenor, Lasmo Oil Pakistan Ltd, Saudi Pak Bank and Metro cash & carry.

Moreover, almost entire decline in overall foreign direct investment during Jul-Apr FY08 resulted from a decline in cash investment, as reinvested earnings grew by considerable rate of 12.0 percent during the period under review. Major sectors which registered increase in reinvested earning during Jul-Mar FY08 include: financial business, oil & gas exploration, cement and trade. Higher reinvested earnings mainly reflect profitability of these sectors and investors confidence in Pakistan economy in the long run.

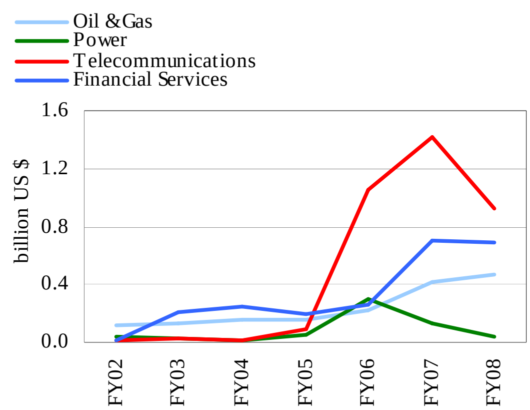
**Table 6.6: Sector wise Foreign Direct Investment (Jul-Apr)**
million US dollar

| | FY07 | | | FY08 | | |
|---|---|---|---|---|---|---|
| | **Cash** | **Reinvested Earnings** | **Total** | **Cash** | **Reinvested Earnings** | **Total** |
| Chemical | -10 | 41 | 31 | 29 | 37 | 66 |
| Petroleum refining | 17 | 98 | 115 | 11 | 56 | 67 |
| Oil & gas exploration | 346 | 106 | 452 | 326 | 178 | 504 |
| Cement | -2 | 18 | 16 | 59 | 35 | 94 |
| Trade | 103 | 17 | 120 | 123 | 40 | 163 |
| Cars | 3 | 31 | 34 | 14 | 53 | 67 |
| Power | 49 | 88 | 136 | 45 | 6 | 51 |
| Telecommunication | 1,303 | 57 | 1,360 | 959 | 73 | 1,033 |
| Financial business | 687 | 191 | 877 | 471 | 269 | 740 |
| Other | 913 | 103 | 1,016 | 607 | 90 | 697 |
| **Total** | **3,407** | **751** | **4,158** | **2,645** | **837** | **3,482** |

It may be pointed out that during the last few years a substantive part of foreign direct investment was concentrated in a few sectors: financial business, oil & gas, power and telecommunications (see **Figure 6.11**). As these sectors mature the scope for further FDI in these sectors would decline, therefore it is important to create conducive environment to attract FDI in other sectors of the economy. The major impediments to FDI in other sectors are lack of skilled labor, inadequate infrastructure and poor law & order situation.

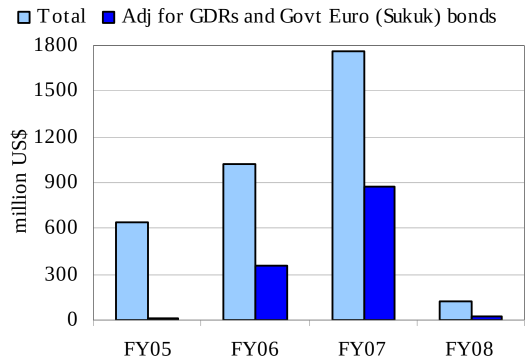
***Portfolio Investment***
Unlike previous years (FY03-07), foreign portfolio investment witnessed substantial decline during Jul-Apr FY08. Changing international financial environment together with adverse developments at home were the major factors behind these capital outflows.

**Figure 6.11: FDI in Major Sector (Jul-Apr)**



Pakistan has had very low level of portfolio investment four to five years back. However, in the last three years (FY05-07) foreign flows in portfolio investment picked up sharply on the back of a combination of factors. On the one hand, liquidity comfort in international market along with political and economic stability at home enabled Pakistan to raise funds from international capital market, in the form of euro (sukuk) bonds and GDRs, at favorable rate. On the other hand, remarkable performance of stock market also attracted sizeable amount of foreign investment in the last two years (see **Figure 6.12**).

**Figure 6.12: Foreign Portfolio Investment (Jul-Apr)**




The congenial international and domestic environment, however, changed for worst during Jul-Apr FY08. International financial market was hit by subprime crisis which led to capital flight from emerging economies stock markets and also increased the risk premium of raising funds from international market. The effect of adverse developments on external front was further compounded by political uncertainty and widening imbalances in the domestic economy which increased country risk as was reflected by Moody's and Standard & Poor's downward revision (from stable to negative) of Pakistan outlook on the long term foreign and local currency sovereign credit rating.[9]

In this backdrop, a larger part of the extraordinary fall, during Jul-Apr FY08, is not surprising which is attributed to delay in floatation of Global Depository Receipts (GDRs), delay in issuance of euro bond and capital outflow from the stock market.

***Outstanding Export Bills (OEBs)***

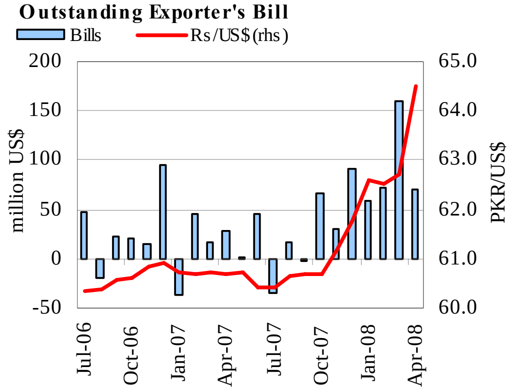
During Jul-Apr FY08, stock of outstanding export bill increased by US$ 428 million. This increase is more than double of the increase of US$ 210 million in the comparable period last year. Like the previous year, the entire increase in the

[9] For detail see 2nd Quarterly Report of State Bank of Pakistan for FY08.

stock resulted from outstanding export bills held by the exporters as the bills held by the commercial bank recorded decline during the period.

The increase in OEBs held by exporters was more pronounced in the last five months (Dec-Apr FY08) which coincided with the relatively sharp depreciation in exchange rate (see **Figure 6.13**). This correlation strengthens the view that exporters hold back their proceeds when they expect exchange rate to depreciate.

**Figure 6.13: Exchange Rate and Increase in Outstanding Exporter's Bill**




***Currency & Deposits***
Commercial banks' FE-25 nostros declined by US$ 915 million during Jul-Apr FY08 compared with nominal fall of US$ 9.0 million in the same period last year. Increase in lending against FE-25 deposits is the probable factor behind this decline in FE-25 nostros.

***Official Long Term Loans***
Net inflows in the official long term loans were higher during Jul-Apr FY08 against the same period of last year. This increase mainly reflects higher earthquake related inflows (US$ 516 million) during Jul-Apr FY08 compared with the same period last year (US$ 235 million).

***Official Short term Loans***
Official short term loans witnessed net inflows of US$ 561 million compared with the net outflows of US$ 58 million in the corresponding period last year. This increase entirely reflects higher gross inflows of US$ 602 million from Islamic Development Bank during the period under review. Importantly, this amount is disbursed for less than one year term which means; it is not only expensive but will also be reflected as capital outflow in the following fiscal year.

**Table 6.7: Financial Account**

million US$

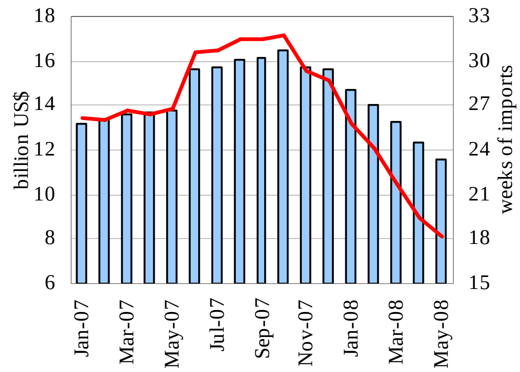
| | Jul - Apr | | | YoY Change | |
|---|---|---|---|---|---|
| | **FY06** | **FY07*** | **FY08*** | **FY07** | **FY08** |
| **Financial account (net )** | **4,938** | **7,244** | **6,037** | **2,306** | **-1,207** |
| **Direct investment abroad** | **-79** | **-80** | **-35** | **-1** | **45** |
| **Direct investment in Pakistan** | **3,038** | **4,181** | **3,482** | **1,143** | **-699** |
| Equity capital | 2,591 | 3,430 | 2,645 | 839 | -785 |
| Reinvested earnings | 447 | 747 | 837 | 300 | 90 |
| **Portfolio investment** | **1,027** | **1,758** | **118** | **731** | **-1,640** |
| Equity securities | 372 | 1,579 | 97 | 1,207 | -1,482 |
| Debt securities | 655 | 179 | 21 | -476 | -158 |
| **Net foreign investment** | **3,986** | **5,859** | **3,565** | **1,873** | **-2,294** |
| **Other investment** | **952** | **1,387** | **2,472** | **435** | **1,085** |
| Assets | 169 | -82 | 607 | -251 | 689 |
| 1-Outstanding export bills (exporters) | -241 | -235 | -527 | 6 | -292 |
| 2-Outstanding export bills (DMB s) | -29 | 25 | 99 | 54 | 74 |
| 3-Currency and deposits | 438 | 127 | 1,035 | -311 | 908 |
| Of which banks | 403 | 9 | 915 | -394 | 906 |
| Liabilities | 662 | 1,384 | 1,725 | 722 | 341 |
| 1-Foreign long-term govt. loans / credits ( net ) | 530 | 604 | 784 | 74 | 180 |
| Project loans | 549 | 728 | 913 | 179 | 185 |
| Non- project loans | 838 | 692 | 776 | -146 | 84 |
| Amortization | 857 | 816 | 905 | -41 | 89 |
| 2-Private loans | 234 | 465 | 271 | 231 | -194 |
| Of which supplier credits | 502 | 796 | 529 | 294 | -267 |
| Suppliers credit repayments | 268 | 331 | 258 | 63 | -73 |
| 3-Short term capital (official) | -195 | -58 | 561 | 137 | 619 |
| Of which IDB (net) | -79 | 58 | 561 | 137 | 503 |
| 4-Currency and deposits | 296 | 348 | 415 | 52 | 67 |
| Other liabilities | -82 | 110 | -166 | 192 | -276 |

* Provisional

### 6.4 Foreign Exchange Reserves[10]

Deterioration in the external accounts of the country took toll on its reserves. Pakistan's reserves declined quite sharply October onwards, mirroring sharp rise in the current account deficit. The overall reserves of the country stood at US$ 11.6 billion by mid May 2008; down by US$ 4.8 billion from the peak of US$ 16.4 billion in Oct 2008.

**Figure 6.14: Foreign Exchange Reserves**

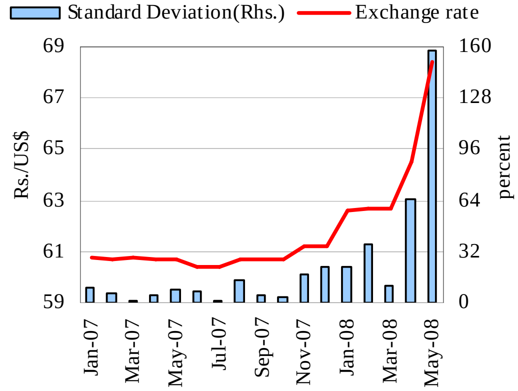



Depletion in foreign exchange reserves has also eroded the reserve adequacy of the country, in terms of weeks of imports. Import coverage ratio declined to 18.1 weeks from 30.6 weeks in June FY07 (see **Figure 6.14**).

Almost all the decline in the country's reserves was due to depletion of SBP reserves as the commercial bank's reserves remained stable at around US$ 2.3 billion throughout Jul-mid May FY08 period.

Pressures on SBP reserves are likely to ease in the coming months due to rise in the inflows. Saudi Arabia has provided US$ 300 million to Pakistan while ADB has also pledged US$ 650 million for budgetary support. Besides, inflows are also expected from the acquisition of 15 percent stake in MCB by Malaysia's Maybank.

**Figure 6.15: Exchange Rate and its Volatility**

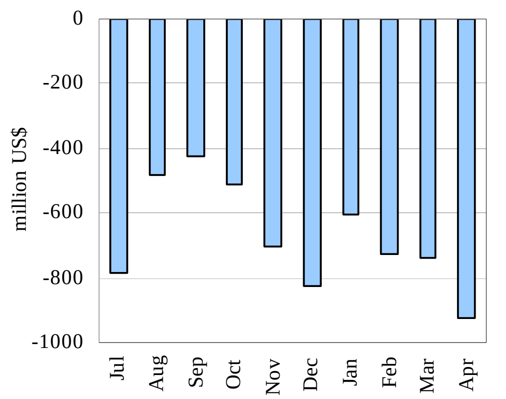



### 6.5 Exchange Rate

Pak rupee after remaining stable for more than four years, lost significant value against the US dollar depreciating by 13.4 percent during Jul-21st May 2008.

[10] May data corresponds to May 21, 2008.

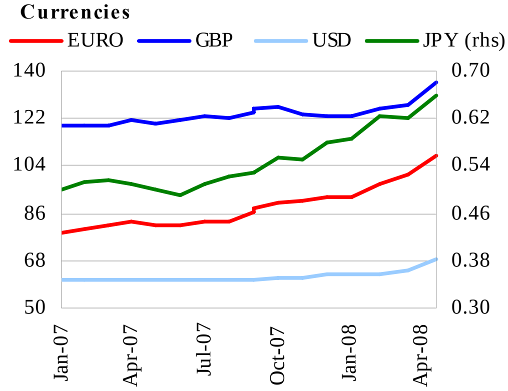
Figure 6.16: SBP Oil Support during FY08




Most of the depreciation in the value of rupee was recorded post November 2007. This depreciation appears to be due to a mix of flight to safety following the political unrest, trade related outflows and speculative activities. Other than sharp depreciation, rupee dollar exchange rate also remained quite volatile during the last six months (Dec-May) (see **Figure 6.15**). Although, SBP continued to provide US$ liquidity both for oil support (as per policy) and to check the excess volatility(see **Figure 6.16)**, the pressure on market persisted on the back of political uncertainty and build up of speculative positions, consequently exchange rate kept weakening trend besides fluctuating significantly**.**

The steep decline in value of rupee as well as the high volatility in the market prompted SBP to take some stringent steps including issuance of guidelines to banks and exchange companies regarding the foreign exchange dealings (see **Box 6.1**) followed by some interim policy measures. These include, among others, a rise in discount rate by 150 basis points, and imposition of margin requirement for import L/C to 35 percent. These measures appear to have dented the market sentiments as rupee regained some of its lost value following the interim monetary measures announced on 22nd May. Going forward, these measures coupled with expected inflows are likely to provide further support to the weakening rupee.

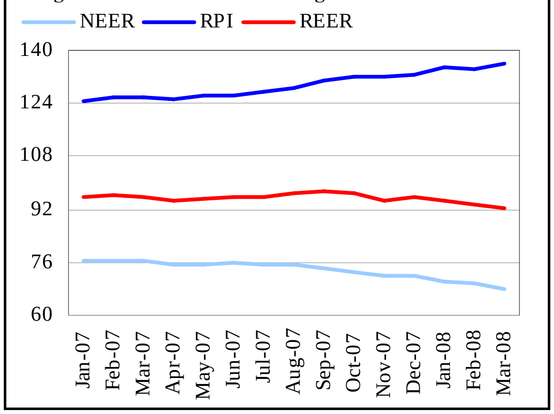
Figure 6.17: Rupee Exchange Rate Against Other Currencies




As against dollar, rupee also depreciated against other major currencies, with depreciation against Euro and JPY being more pronounced. This mirrors the dollar depreciation against these currencies, besides rise in rupee exchange rate against US$ (see **Figure 6.17**).

During Jul-mid May 2008, rupee depreciation against JPY, Euro and Pound sterling amounted to 25.4, 24.0 and 10.4 percent respectively. Due to steep depreciation against Euro, rupee to Euro exchange rate crossed Rs. 100/Euro mark reaching Rs. 108 per Euro by mid May 2008.

**Figure 6.18: Effective Exchange Rate Indices**



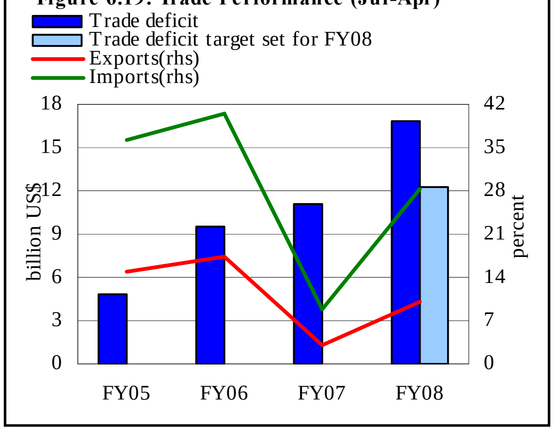

### Real Effective Exchange Rate

Despite consistent rise in inflationary pressures evident in 8 percent rise in relative price index (RPI), real effective exchange rate index depreciated by 3.2 percent during Jul-Mar FY08(see **Figure 6.18**).[11] This real depreciation and hence improvement in Pakistan's competitiveness owes to steep weakening of Pak rupee against major competing currencies reflected by 10.3 percent depreciation of the Nominal Effective Exchange Rate (NEER) during Jul-Mar 2007.

## 6.6 Trade Account

Pakistan's merchandise trade deficit widened to a record high US$ 16.8 billion during Jul-Apr FY08, 37.8 percent higher than the annual trade deficit target (see **Figure 6.19**). The deficit was fueled by a very strong surge in imports, as well as, below - target export growth. While the 10.2 percent YoY export growth during Jul-Apr FY08 was an improvement over the previous year, it was

**Figure 6.19: Trade Performance (Jul-Apr)**

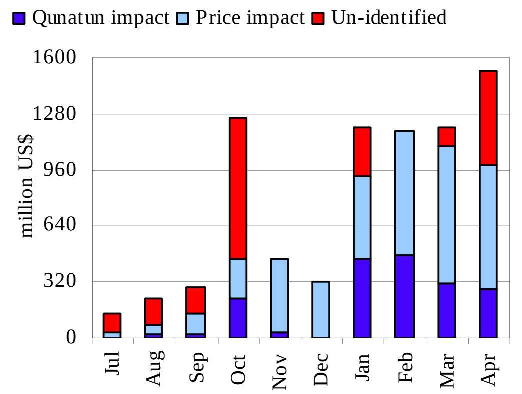



[11] The latest data on Real Effective Exchange Rate is for end-March 2008.

nonetheless significantly lower than the 12.4 percent growth target for the period.[12]

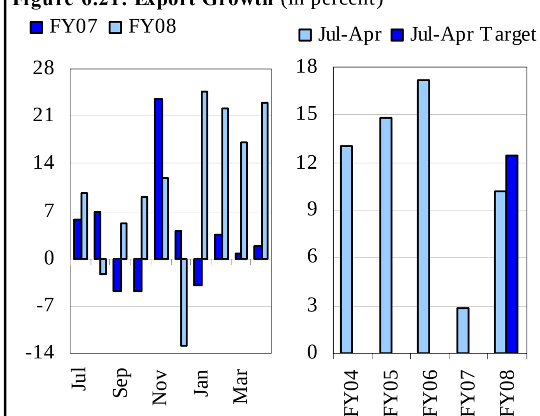
The surge in the imports during Jul-Apr FY08 was driven by both rising demand pressures and increase in the international commodity prices. Demand pressures were especially evident in Jan-Apr FY08 during which around 70 percent of the total increase in imports was concentrated (see **Figure 6.20**). In overall terms non-food non-oil imports witnessed a sharp 18.8 percent YoY increase during Jul-Apr FY08.[13] The impact of higher demand was further compounded by a sharp surge in international commodity prices[14] Q2 onwards.

**Figure 6.20: Source of Increase in Imports FY08**




The growth in exports was led by the non-textile sectors whereas textiles registered a fall during the period under review. Within the non-textiles exports, performance of the *other manufactures* is indeed very encouraging, particularly given the continued bottlenecks facing the exporters in the form of energy and skilled labor shortages, political

**Figure 6.21: Export Growth** (in percent)




[12] The FY08 annual growth target for exports was set at 13.1 percent in the trade policy.

[13] After excluding the price impact and cotton imports however this YoY growth decreases to 13.7 percent.

[14] For around 52.2 percent of the total imports, detailed data on price and quantum was available during Jul-Apr FY08. According to this data 46..3 percent of the total increase in imports during this period, was caused by price impact.

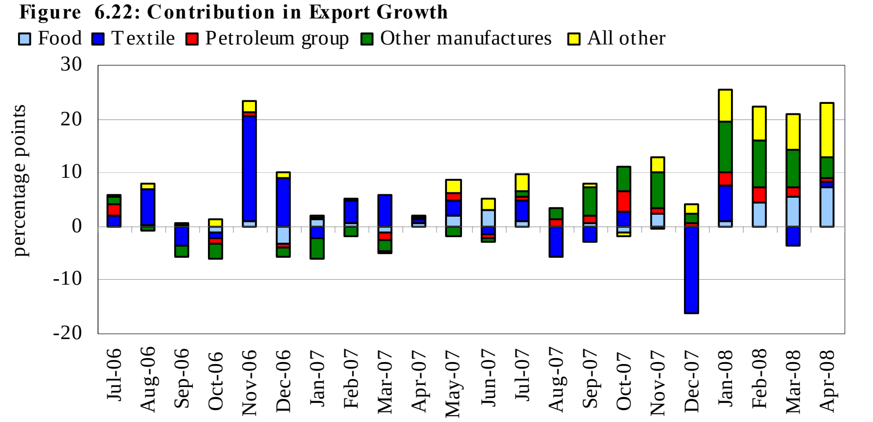
disturbances, etc. Poor show of the textile sector exports on the other hand is partly attributable to growing competitive pressures and partly to slowdown in textile imports in the key EU and US markets (particularly during H1-FY08).

Going forward both exports and imports are expected to undergo a seasonal expansion. In case of imports, however, the seasonal surge will be amplified by expected continuation of the trend increase in international commodity prices particularly *oil* and rising demand pressures as witnessed in Q3. This suggests the possibility of further widening of country's trade deficit in the remaining months.

**Exports**

Exports growth staged a sound recovery during Jul-Apr FY08 as compared to the same period last year, though it remained short of the growth target set for the period (see **Figure 6.21**). This recovery had two important features 1) a large

**Figure 6.22: Contribution in Export Growth**




share of the total increase in exports during Jul-Apr FY08 was concentrated in the period Jan-Apr;[15] 2) growth in exports originated from non-textile sector, while the textile sector export growth experienced fall during this period.

A part of the surge in export growth during Jan-Apr FY08 is explained in terms of the delayed fulfillment of export orders due in December FY08. Reportedly the month of December FY08 witnessed delays in fulfillment of export orders, particularly of textile exports due to a wide-scale disruption of economic activity (see **Figure 6.22**).

[15] In absolute terms the YoY increase in exports during Jan-Apr FY08 had 83.4 percent share in the total rise in exports during Jul-Apr FY08

**Table 6.8: Export Growth Comparisons -FY08**

| | | | | | | | | | | | Number of | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | High | Low |
| Rice | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 1 | 1 | 1 | 5 | 5 |
| Basmati | 1 | 1 | 1 | 1 | 1 | 1 | 0 | 1 | 1 | 1 | 9 | 1 |
| Others | 0 | 0 | 0 | 0 | 1 | 0 | 1 | 1 | 1 | 1 | 5 | 5 |
| Fruits | 1 | 1 | 1 | 1 | 0 | 0 | 0 | 1 | 1 | 1 | 7 | 3 |
| Sugar | - | - | - | - | - | - | 1 | 1 | 1 | 1 | 4 | 6 |
| Readymade garments | 1 | 1 | 1 | 1 | 0 | 0 | 1 | 1 | 1 | 1 | 8 | 2 |
| Art silk / synthetic textiles | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 1 | 1 | 5 | 5 |
| Petroleum products | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 8 | 2 |
| Chemicals/ pharmaceuticals | 0 | 0 | 1 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 7 | 3 |
| Cement / cement products | 1 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 0 | 8 | 2 |
| **Percentage point contribution in growth** | **7.8** | **2.2** | **3.8** | **2.2** | **7.4** | **1.0** | **11.5** | **15.7** | **16.4** | **19.3** | | |
| **Export growth** | **9.7** | **-2.3** | **5.1** | **9.2** | **11.9** | **-12.9** | **24.6** | **22.3** | **17.3** | **23.1** | | |

Besides this, the growth witnessed during the period was based on fundamentals 1) – sharp rise in international *rice* prices that offered a strong incentives to exporters, along with the availability of exportable surplus in domestic market, unlike the shortages in some of the competitor countries 2) – higher *sugar* production during FY08 leading to higher *sugar* and *ethanol* exports 3) – increasing world demand for *synthetic textiles* 4) – capacity enhancements and improved demand in the *cement* sector, etc.

This is also supported from the comparison of monthly YoY export growth of the strong performing categories during Jul-Apr FY08. It shows that growth in most of these categories [16] remained higher than in Jul-Apr FY07 (see **Table 6.8**). In addition, the performance of some of the categories, which were not performing well in H1-FY08 e.g., *other varieties of rice, sugar* also started to improve in H2-FY08.

This analysis shows strong growth potential of the major export categories. In overall terms during the remaining months of FY08, the growth trajectory of exports is likely to remain unchanged.

[16] Basmati rice, petroleum products, chemicals & pharmaceuticals and cement, etc.

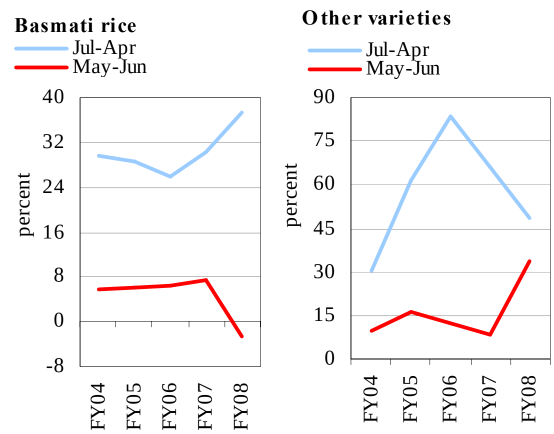
Particularly the rise in *rice* exports was seen due to 1) - rising quantum of *basmati* exports and 2) - rising international prices of rice (see **Table 6.9**). With the production of basmati rice almost at the same level as previous years, the surge in export quantum of this category implies that exporters are selling larger quantum of this category abroad, taking advantage of the sharp rise in international prices. This fact is also supported by sharp rise in the domestic prices of *basmati rice* during the same period.[17]

The faster than usual pace of *basmati rice* export has led to relatively earlier depletion in its export surplus this year compared to previous years, if the share of *basmati rice* exports in total production stays at the average level of last three years (see **Figure 6.23**).[18]

**Table 6.9: Rice Production and Exports (Jul-Apr)**

| | FY06 | FY07 | FY08 |
|---|---|---|---|
| **Quantum (000MT)** | | | |
| Rice | 3,108 | 2,690 | 2,431 |
| Basmati | 680 | 751 | 914 |
| Other varieties | 2,427 | 1,939 | 1,517 |
| **Unit Value (US$/MT)** | | | |
| Rice | 310 | 350 | 488 |
| Basmati | 571 | 600 | 691 |
| Other varieties | 237 | 254 | 365 |
| **Production (million tones)** | | | |
| Rice | 5.6 | 5.4 | 5.6 |
| Basmati | 2.6 | 2.5 | 2.5 |
| Other varieties | 2.9 | 2.9 | 3.1 |

**Figure 6.23: Rice Export Quantum Share in Production**



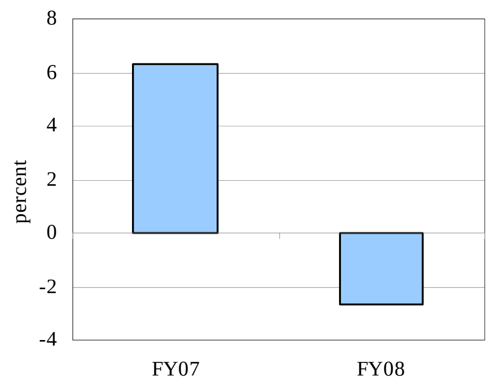

Fall in exports of *other varieties of rice* during Jul-Apr FY08 is probably attributable to a combination of electricity shortages (that curtailed working of rice mills) and higher domestic demand (and prices) due to persistent wheat shortages in the country, creating increased domestic demand for rice. In addition, anecdotal

[17] Average domestic prices of basmati rice recorded 56.5 percent YoY rise during Jul-Mar FY08 as compared to the same period last year.
[18] During Jul- Apr FY05-FY07 around 28.7 percent of the total basmati rice production was exported, which is lower than the current 37.3 percent basmati rice exported during Jul-Apr FY08.

evidence also suggests possibility of rice smuggling to Iran, as domestic banks are not accepting letters of credit from Iranian banks for imports because of the shortage of dollars in that market. However, since January 2008, the export quantum of this category has started to recover, because of availability of imported wheat in the market. In view of the rising international prices of rice and higher export surplus of the category, this rise is likely to continue in going forward (see **Figure 6.23**). [19]

Improvement in *textile* export performance on the other hand, seems to be difficult in the short run. Textile exports staged a small recovery during Q3-FY08; however, the overall export level for Jul-Apr FY08 remained significantly below the mark for the same period last year (see **Figure 6.24**). Recovery in Jan- Apr FY08 was largely concentrated in ready-made garments and synthetic textiles exports. In fact synthetic textile was almost the only sector that recorded rise in export quantum during Jul-Mar FY08, whereas ready-made garments showed a small fall in export quantum (see **Table 6.11**).

**Figure 6.24: Textile Export Growth (Jul-Apr)**




This under performance of textile sector is caused by structural issues hurting its competitiveness. Some of the important issues are rising domestic cost of production due to higher electricity tariffs, increased power shortages and lack of skilled

**Table 6.10: Textile and Apparel Exports Growth- Major Markets**
in percent

| | Textile | | Apparel | |
|---|---|---|---|---|
| | **FY07** | **FY08** | **FY07** | **FY08** |
| EU (H1-FY08) | | | | |
| Pakistan | 9.9 | 8.4 | 5.3 | 0.6 |
| World | 8.0 | 4.1 | 7.5 | 3.3 |
| US (Jul-Feb FY08) | | | | |
| Pakistan | -3.9 | -6.2 | 12.7 | -0.5 |
| World | 4.0 | 5.2 | 7.8 | -0.9 |

[19] Government has imposed Minimum Export Price for the export of rice. However in view of the rising trend of international rice prices and availability of domestic surplus the value of export earning is likely to remain unaffected because of this measure.

resources resulting in lower productivity, low quality of products due to the use of contaminated cotton produced domestically, etc. In addition the deteriorating law and order situation in the country also resulted in the reported diversion of export orders to other countries.

These factors are hampering the production capacity of this sector leading to fall in textile and apparel exports in the US market where country's exports have to face tough competition, whereas in the EU market where the country has access to the general GSP scheme these exports fared relatively better (see **Table 6.10**). In addition the slowdown in the US market is also hurting country's apparel exports to this destination. Persistent appreciation in the currencies of some major competitors like India and Vietnam might give some relief to country's exports. Also, the textile industry would probably benefit from consolidation to generate economies of scale.

**Table 6.11: Major Exports (Jul-Apr)**

million US$

| | | FY07 | | FY08(P) | | Abs.Δ value | % YoY Δ | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Value | Unit value | Value | Unit value | | Qty | Value | Unit Value |
| **A. Food group** | | **1,643.3** | | **1,954.2** | | **310.9** | | **18.9** | |
| *Of which* | | | | | | | | | |
| Rice | MT | 942.0 | 350.3 | 1,185.2 | 487.6 | 243.2 | -9.6 | 25.8 | 39.2 |
| Fish and fish preparations | MT | 158.2 | 1,523.5 | 165.9 | 1,700.1 | 7.7 | -6.0 | 4.9 | 11.6 |
| Fruits | MT | 95.2 | 329.6 | 124.6 | 422.9 | 29.5 | 2.1 | 31.0 | 28.3 |
| Vegetables incl. roots and | MT | 48.6 | 269.9 | 41.0 | 369.7 | -7.6 | -38.4 | -15.6 | 37.0 |
| Oil Seeds & nuts etc. | MT | 13.8 | 744.1 | 35.3 | 880.2 | 21.4 | 115.2 | 154.6 | 18.3 |
| Meat and meat preparations | MT | 33.6 | 2,737.3 | 42.0 | 2,949.7 | 8.4 | 16.0 | 25.0 | 7.8 |
| **B. Textile group** | | **8,875.3** | | **8,638.0** | | **-237.3** | | **-2.7** | |
| *Of which* | | | | | | | | | |
| Cotton yarn | MT | 1,176.5 | 2,142.4 | 1,066.6 | 2,246.8 | -109.9 | -13.6 | -9.3 | 4.9 |
| Cotton fabrics | SQM | 1,717.3 | 904.0 | 1,529.8 | 1,017.8 | -187.5 | -20.9 | -10.9 | 12.6 |
| Hosiery (knitwear) | DOZ | 1,604.9 | 20.1 | 1,477.0 | 21.2 | -127.9 | -12.7 | -8.0 | 5.4 |
| Bed wear | MT | 1,634.7 | 5,380.2 | 1,550.0 | 5,683.3 | -84.7 | -10.2 | -5.2 | 5.6 |
| Towels | MT | 498.0 | 3,835.8 | 491.9 | 3,981.5 | -6.0 | -4.8 | -1.2 | 3.8 |
| Readymade garments | DOZ | 1,125.8 | 33.3 | 1,227.9 | 36.9 | 102.1 | -1.5 | 9.1 | 10.7 |
| Art silk and synthetic | | | | | | | | | |
| Textiles | SQM | 310.5 | 0.8 | 451.3 | 0.9 | 140.8 | 20.6 | 45.3 | 20.5 |
| **C. Petroleum group** | | **674.1** | | **909.9** | | **235.9** | | **35.0** | |
| **D. Other manufactures** | | **2,147.0** | | **2,844.7** | | **697.7** | | **32.5** | |
| *Of which* | | | | | | | | | |
| Sports goods excl. toys | --- | 234.0 | --- | 241.7 | --- | 7.7 | --- | **3.3** | --- |
| Leather exc. reptile | SQM | 252.8 | 16.8 | 339.5 | 17.4 | 86.7 | 29.6 | 34.3 | 3.6 |
| Leather | | | | | | | | | |
| Leather manufactures | --- | 461.2 | --- | 563.3 | --- | 102.1 | --- | 22.1 | --- |
| Foot wear | Pair | 94.7 | 7.6 | 97.8 | 8.7 | 3.1 | -9.2 | 3.3 | 13.8 |
| Chemicals and | --- | 315.8 | --- | 520.3 | --- | 204.5 | --- | 64.7 | --- |
| pharmaceuticals | | | | | | | | | |
| Engineering goods | --- | 191.6 | --- | 164.5 | --- | -27.0 | --- | -14.1 | --- |
| Jewelry | --- | 30.8 | --- | 133.0 | --- | 102.3 | --- | 332.3 | --- |
| Cement and cement products | MT | 110.4 | 52.0 | 295.3 | 61.0 | 185.0 | 128.5 | 167.6 | 17.1 |
| All other items | | 507.6 | | 925.5 | | 417.9 | | 82.3 | |
| **E. Total exports** | | **13,847** | | **15,256** | | **1,408** | | **10.2** | |

provisional

## Imports

Country's imports surged October FY08 onwards, causing the import bill for Jul-Apr FY08 to reach a historic peak of US$ 32.1 billion. A large share of the total increase in the import bill during this period was observed in Jan-Apr FY08 mainly due to higher *petroleum, food, textile* and *machinery* group imports (see **Figure 6.25A)**. A part of this rise was caused by a surge in the international prices of *oil*, *wheat* and *palm oil* that caused the unit values of these categories to increase (see **Figure 6.25B**). Especially the rising international *oil* prices alone resulted in 27.6 percent of the total increase in the import bill during Jul-Apr FY08.

**Figure 6.25A: Contribution in Imports by**

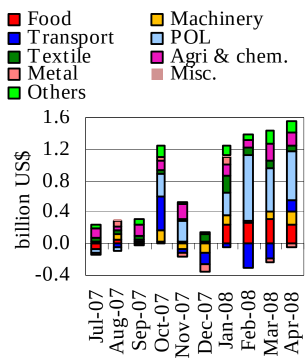



**Figure 6.25B: Monthly Price Impact**

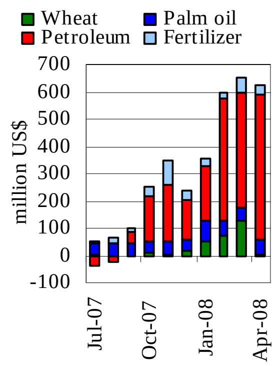
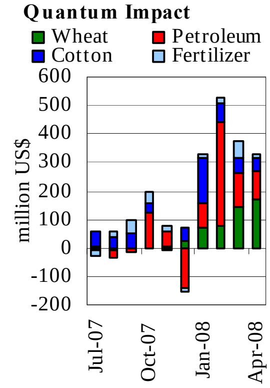



**Figure 6.25C : Monthly Quantum Impact**



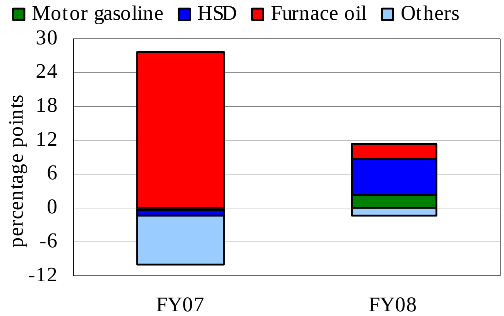

Rise in international prices of these commodities is based on strong fundamentals and is likely to continue at least in the short run. Palm oil is witnessing surge in international demand from China and India. In case of wheat the price rise is caused by lower global wheat production in 2006-07 because of the substitution of wheat with other lucrative crops used for bio fuels as well as drought in Australia, a major wheat producer, resulting in *wheat* shortages in the international market.[20]

Further, domestic shortages of *wheat* and *raw cotton* also led to sizeable widening in import bill (see **Figure 6.25 C**). The pace of *wheat* imports is not likely to slow going forward in view of the government decision to continue wheat import for the coming fiscal year. *Raw cotton* imports started to surge from January FY08

[20] According to the USDA report on Grains: World Markets and Trade, April 2008, the global wheat production recorded 4.6 percent YoY fall during 2006-07 crop year that resulted in international wheat shortages, leading to rise in prices.

after government allowed import of this category through land routes from India and are likely to continue till the availability of new crop in the market.

Figure 6.26: Contribution in Domestic Consumption * Growth - (Jul-Mar)




* Consumption includes both imports and domestic production

As expected from the rising trend of international oil prices, petroleum group had the highest share in the overall import growth during Jul-Apr FY08.[21] Apart from prices, rising quantum of petroleum products also led to a sizeable increase in the petroleum group imports (see **Table 6.12**). The rise in quantum of petroleum products came from; rising *motor gasoline*, *high speed diesel* and *furnace oil* imports (see **Figure 6.26**). The rise in quantum for *motor gasoline* and *HSD* despite rising prices was not unexpected, and reflects the reduced opportunity for smuggling of petroleum products from Iran July FY08 onwards. On the other hand, the rise in furnace oil imports was caused by higher power generation needs in the country.

**Table 6. 12: Price and Quantum Impact of Petroleum Group Imports (Jul-Apr)**

million US$

| | FY07 | | | FY08 | | |
|---|---|---|---|---|---|---|
| | | Change in Value due to | | | Change in Value due to | |
| | Abs Δ | Quantity | Price | Abs Δ | Quantity | Price |
| Petroleum group | 650.8 | 702.7 | -51.9 | 2,770.2 | 822.4 | 1,947.9 |
| Petroleum products | 857.4 | 1,069.3 | -211.8 | 1,622.7 | 612.9 | 1,009.8 |
| Petroleum crude | -206.7 | -303.1 | 96.4 | 1,145.1 | 206.2 | 938.8 |

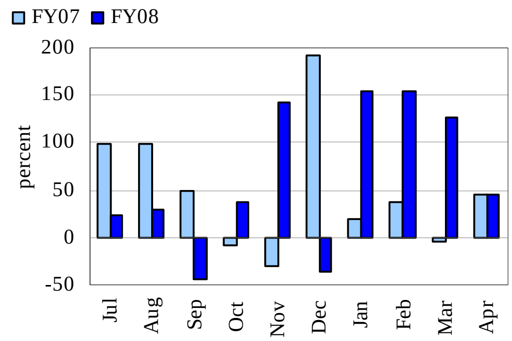
Rising power generation needs in the country also led to a surge in the *power generating machinery* imports (see **Table 6.13**). A large part of growth in these imports was seen in Q3-FY08 to cater to the needs of the IPPs that achieved financial closure in Jul-Jan FY08[22] (see **Figure 6.27**). Besides, imports of generators for domestic use also rose due to rising power shortages in the country

[21] The average prices for Arabian light oil rose from the average of US$58.3/barrel in Jul-Apr FY07 to US$ 92.2/barrel in Jul-Apr FY08.

[22] Some eight IPPs achieved financial closure in Jul-Jan FY08.

ahead of the summer season. However, government has removed tariff concession on this machinery given in the Power Policy 2002, for the IPPs attaining financial closure after April FY08, in order to boost the domestic engineering goods sector.[23] This measure might prove helpful in curtailing the import of this category in the medium term.

**Figure 6.27: Power Generating Machinery YoY Import Growth**




Another important component of the import bill was *agriculture* and *other chemicals group* that witnessed expansion due to rising *fertilizer*, *plastics* and *other chemicals* imports; with the share of the former being the greatest (see **Table 6.13**). To fill the domestic supply and demand gap, the country imports on average 1.9 million tones *fertilizers* annually, a large share of phosphate fertilizer, DAP. To fill this gap, a domestic fertilizer plant has undergone major expansion in Q3-FY08[24]. As a result the DAP import is likely to fall by around 220 thousand tones annually from FY09. During the remaining FY08, however, the current pace of imports is likely to continue, since, a large quantum of DAP is being imported for the *kharif* season.

The rise in *plastic materials* and *chemicals* imports signals expansion in some of the industries. *Iron and steel scrap* imports also increased due to higher constriction activity in the country. In view of the continued rise in the international prices along with persistent domestic shortages and rising demand of non-food and non-oil imports, the current ratio of increase in the import bill is likely to continue in the remaining months of FY08.

[23] Power Policy for 2002 allowed the import of power generating machinery not manufactured locally at a concessional rate of 5 percent. However, recently this concession has been removed for the power plants that will achieve financial closure after April 30, 2008.

[24] As a result of the BMR program in this plant its production capacity is expected to rise by around 150 percent.

**Table 6.13 : Major Imports (Jul-Apr)**

million US $

| | | FY07 | | FY08(P) | | | % YoY Δ | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Value | Unit Value | Value | Unit Value | Abs Δ | Qty | Value | Unit Value |
| **Food group** | | **2370.8** | | **3523.1** | | **1152.2** | --- | **48.6** | -- |
| *Of which* | | | | | | | | | |
| Wheat un-milled | MT | 41.5 | 305.4 | 812.1 | 494.3 | 770.6 | 1108.9 | 1856.2 | 61.8 |
| Palm oil | MT | 736.1 | 512.0 | 1215.8 | 858.1 | 479.7 | -1.4 | 65.2 | 67.6 |
| **Machinery group** | | **5438.2** | | **5892.8** | | **454.6** | **---** | **8.4** | --- |
| *Of which* | | | | | | | | | |
| Power generating machinery | - | 592.5 | -- | **851.5** | -- | **259.1** | **---** | **43.7** | --- |
| Textile machinery | - | 428.3 | -- | 359.9 | -- | -68.5 | --- | -16.0 | --- |
| Telecom | | | | | | | | | |
| *Mobile phone* | | 729.4 | | 639.1 | --- | -90.3 | --- | -12.4 | --- |
| *Other apparatus* | | 1106.7 | | 1251.3 | --- | 144.6 | --- | 13.1 | --- |
| **Transport group** | | **2058.0** | | **1885.5** | | **-172.5** | **---** | **-8.4** | **---** |
| *Of which* | | | | | | | | | |
| Road motor Vehicles | - | 1164.2 | --- | 1062.4 | --- | -101.8 | --- | **-8.7** | --- |
| Air crafts, ships and boats | - | 871.3 | --- | 799.0 | --- | -72.3 | --- | **-8.3** | --- |
| **Petroleum group** | | **5902.3** | **434.8** | **8672.5** | **560.7** | **2770.2** | **13.9** | **46.9** | **29.0** |
| Petroleum products | MT | 3027.7 | 431.3 | 4650.3 | 550.9 | 1622.7 | 20.2 | 53.6 | 27.7 |
| Petroleum crude | MT | 2874.5 | 438.5 | 4019.6 | 572.2 | 1145.1 | 7.2 | 39.8 | 30.5 |
| **Textile group** | | **1249.1** | | **2032.1** | | **783.0** | | **62.7** | |
| *Of which* | | | | | | | | | |
| Raw cotton | MT | 504.7 | 1392.0 | 1166.1 | 1525.3 | 661.3 | 110.8 | 131.0 | 9.6 |
| **Agricultural and other chemical Group** | | **3117.7** | **3491.9** | | **4754.6** | | **1262.7** | | **36.2** |
| *Of which* | | | | | | | | | |
| Fertilizer manufactured | MT | 280.8 | 278.2 | 822.9 | 414.4 | 542.1 | 96.8 | 193.1 | 48.9 |
| Plastics | MT | 951.1 | 1425.8 | 1068.3 | 1578.2 | 117.2 | 1.5 | 12.3 | 10.7 |
| Other chemicals | - | 1829.3 | --- | 2355.4 | --- | 526.2 | | 28.8 | |
| **Metal group** | | **2146.5** | | **2133.9** | | **-12.6** | | **-0.6** | |
| **Miscellaneous group** | | **550.8** | | **594.1** | | **43.3** | | **7.9** | |
| **All other Items** | | **1788.1** | | **2573.7** | | **785.5** | | **43.9** | |
| **Total imports** | | **24993.0** | | **32061.1** | | **7068.1** | | **28.3** | |

**An Explanatory note on differences between FBS and SBP trade data**

**Table 1: Reconciliation of Imports Compiled by FBS & SBP**
million US$

| | Jul-Apr | |
|---|---|---|
| | **FY07** | **FY08** |
| **A-Imports (c.i.f.) FBS** | **24,993.1** | **32,061.1** |
| Less Freight & Insurance | 2,274.4 | 2,917.6 |
| **B- Imports FBS (fob)** | **22,718.7** | **29,143.5** |
| **C-Import Payments (Banks)** | **19,626.0** | **24,247.0** |
| Less Freight & Insurance | 1,741.6 | 2,201.9 |
| Add subtotal of | 1,991.6 | 3,264.0 |
| a) Unclassified imports | 761.8 | 1,411.9 |
| b) Imports NRI, sale of DFSs | 126.2 | 95.6 |
| c) Imports under foreign assistance | 642.4 | 1,148.0 |
| d) Land borne imports (Afghanistan) | 52.0 | 93.8 |
| e) PIA & PNSC | 401.1 | 380.8 |
| f) Capital equipment | 3.6 | 0.0 |
| g) Cost of imports (Ex. Cos.) | 13.1 | 0.9 |
| h) Refund & rebate | -96.9 | -62.8 |
| i) Import from EPZ | 88.3 | 195.7 |
| **D-Import SBP** | **22,020.2** | **28,585.7** |
| **Difference (B-D)** | **698.5** | **557.9** |

As customary, the trade data compiled by the SBP and FBS displayed large differences during Jul-Apr FY08 – the SBP data showed a trade deficit of US$ 12.6 billion for Jul-Apr FY08, while the deficit based on FBS data amounted to US$ 16.8 billion during the same period. The origin of this difference lies in the different uses of the trade statistics compiled by these sources – BoP data compiled by SBP is used to see the amount of the total monetary exchanges of an economy with the rest of the world, while FBS data provides detailed information regarding quantum, value and unit value of traded goods. Therefore, BoP trade data is based on the actual receipt and payments of foreign exchange for the trade of goods, while FBS records data on the physical movement of goods. It may be pointed out that the difference between BoP and FBS trade figures is not a Pakistan specific feature and can be found in countries around the world. For instance, according to the customs data EU's trade deficit for CY07 stood at 185.5 billion Euros, while EU's BoP statistics reported the trade deficit for the same period as 153.4 billion Euros.[25]

The difference in the trade statistics compiled by the SBP and the FBS arise due to following reasons:

**Imports**

The imports by banks are variably reported either on a 'free on board' (f.o.b.) basis or on 'cost, insurance & freight' (c.i.f.) basis. In order to make these imports comparable with the FBS imports, the cost of freight and insurance is subtracted from both the SBP record and FBS import data.[26]

The variance between custom record and exchange record arises also due to difference in coverage. Specifically some of imports which are reported in the customs data are not included in imports reported by banks. Such imports are *added* to BoP imports. For example,

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[25] Source: Eurostat

[26] In the case of exchange record, actual value of freight and insurance reported by banks is subtracted from imports. However, since the information on freight and insurance is not available for FBS data, a fixed proportion of 9 percent is subtracted from the FBS imports as the cost of freight & insurance.

- The non-repatriable investment (NRI) that consists of (a) small investments made by expatriate Pakistanis transporting machinery into the country that has been bought and paid for abroad; and (b) the purchases made from the *duty-free shops.*

- The imports of wheat, sugar, urea and some other commodities done by TCP are added to the SBP imports under the title of unclassified imports.

- FEA (foreign economic assistance) is project-specific and materializes as physical transfer of development or investment goods, such as machinery, rather than a direct inflow of foreign exchange.

- Goods carried over Pakistan's borders from Afghanistan are classified as *land borne imports,* which do not directly enter the exchange record, as cash payments made in Rupees do not go through authorized dealers.

- The purchases of spare parts and other imports made by Pakistan International Airlines (PIA) and Pakistan National Shipping Corporation (PNSC) at foreign airports or seaport for which payments are made are also added in the SBP import numbers.

- The value of imports for which forex is provided by the exchange companies and imports made by EPZ are also added in the SBP imports.

Finally the refunds and rebates made to importers are subtracted from the SBP imports.

**Exports**

In order to make export figures comparable, SBP figures are adjusted for freight and insurance, while FBS records are corrected for double counting (due to short shipments, cancellation, etc).

*Short shipments* refer to customs-registered export shipments that are not shipped out in the total amounts recorded due to transport shortages, last-minute clearance issues, etc. In addition, FBS numbers must be adjusted for cancellations of registered export orders, as well as *ship stores,* which refers to goods provided to foreign ships, for carrying out repairs replenishment of kitchen stores when they are anchored at Pakistani port.

**Table 2: Reconciliation of Exports Compiled by FBS & SBP**
million US$

| Exports | Jul-Apr | |
|---|---|---|
| | FY07 | FY08 |
| **A-Exports FBS** | **13,847** | **15,255.5** |
| Less subtotal of | 227.5 | 224.3 |
| a) Shorts shipment | 181.1 | 177.9 |
| b) Cancellation | 46.4 | 46.4 |
| c) Ship Stores | 0.0 | 0.0 |
| **B- Export FBS (fob)** | **13,619.8** | **15,031.1** |
| **C-Export receipts (Banks)** | **13,289.2** | **14,909.9** |
| Less Freight on export | 415.2 | 321.0 |
| Add subtotal of | 1,029.5 | 1,402.1 |
| a) Land borne exports | 573.0 | 746.9 |
| b) Sample | 2.6 | 3.3 |
| c) EPZ | 247.9 | 235.8 |
| d) Outstanding export bills | 208.9 | 426.9 |
| e) Refund & Rebate | -2.9 | -10.8 |
| **D-Export (Adjusted) SBP** | **13,903.5** | **15,991.0** |
| **Difference ( B-D )** | **-283.7** | **-959.9** |

The BOP exports on the other hand are adjusted for the following factors:

- *Outstanding bills* are added to SBP fob numbers, comprising all unrealized exports for which there exist customs records but no currency inflows to date.

- *Crude oil* represents the percentage of oil extracted in Pakistan which, by agreement, belongs to the foreign investors drilling here and is transported out of the country upon extraction becoming a physical 'export' for which no foreign exchange is forthcoming.
- *Land-borne exports* are similar to the entry in imports and refer to exports made to Afghanistan.

- *Export credit* refers to one-time bilateral trade credit offered by GOP to certain countries. Another such transient item is *samples*, which are the samples given to prospective buyers by domestic exporters.
- Finally, the exports from EPZs are also added in the SBP data.

Despite these adjustments to rationalize the differences in FBS and SBP figures, discrepancies still exist. This is primarily on account of leads and lags. Discrepancies in exports arise due to differences in valuations and commodity classification between SBP and FBS.

**Box 6.1 SBP Measures for Stabilizing Exchange Rate**

Recently, SBP has made some amendments in its guidelines to exchange companies and authorized dealers regarding their foreign exchange operations. These steps are aimed to stabilize the foreign exchange markets. These include:

- Exchange companies are now required to surrender a minimum of 15%, instead of earlier 10%, of foreign currencies received by them from home remittances to the interbank markets.

- Limits on advance payments that were relaxed last year have been tightened. Now advance import payments will only be allowed against letter of credits and that too only to the extent of 50%. Advance payments against contracts are now not allowed.

- Exchange companies have been directed to transfer foreign currency from their Nostro accounts held outside Pakistan to commercial banks in Pakistan and henceforth exchange companies will have to close all Nostro accounts abroad by May 31, 2008.

- Exchange companies have been encouraged to focus on promoting home remittances and companies can only affect outward remittances to the extent of 75% of the home remittances mobilized by the respective company during the preceding month.

- In order to meet the demand of foreign currencies within Pakistan, the Exchange Companies have been directed to surrender their surplus foreign currency to State Bank – earlier exchange companies were exporting most of the foreign currency, except dollars abroad exchange companies, besides dollar, will not be able to export Pound Sterling, Euro and UAE Dirham's.

- Some reforms of the forward hedging mechanism available to importers / exporters have also been introduced to ensure that there is no misuse of the facility other than true hedging.

- State Bank of Pakistan has increased the frequency of 'surprise inspections' on banks and exchange companies in relation to their compliance of all foreign exchange related regulations.

Reference:

FE circular No. 2 and 3 dated April 29, 2008. FE circular No. 4 and 5 dated May 09, 2008