6 External Sector

6.1 Overview

Pakistan's external account remained under stress through Jul-Nov FY09, as acceleration in the growth of the current account deficit, and sharply reduced financial & capital account inflows drew the country's foreign currency reserves to perilously low levels. Not surprisingly, the rupee also weakened substantially in the period, depreciating by as much as 16.3 percent against the US dollar by end-October 2008, before recovering somewhat after Pakistan gained IMF support for a macroeconomic stabilization program (see **Table 6.1**).

Table 6.1: Summary of External Balances (Jul-Nov)
billion US$

	FY07	FY08	FY09
Current A/C	**-4.0**	**-4.7**	**-6.9**
Trade balance	-4.4	-4.8	-6.6
Exports	*6.9*	*7.7*	*8.6*
Imports	*11.3*	*12.5*	*15.2*
Invisible balance	0.4	0.1	-0.3
Remittances	*2.1*	*2.6*	*3.0*
Capital & financial A/C	**2.7**	**3.8**	**1.4**
FDI	1.5	1.7	1.6
FPI	0.6	0.1	-0.2
Other investment	0.6	2.0	0.0
of which			
Public sector loans (net)	*0.1*	*0.6*	*0.1*
Private sector loans (net)	*0.0*	*0.1*	*0.1*
Error & omission	**0.6**	**0.0**	**-0.3**
Overall balance	**-0.8**	**-0.9**	**-5.7**
Memorandum Items			
Foreign reserves (end period)	12.3	15.7	9.1
Exchange rate (end period)	60.8	61.2	78.8

As in the later half of FY08, the expansion in current account deficit during Jul-Nov FY09 was mainly driven by a substantial acceleration in import growth. This acceleration owed considerably to the steep rise in import prices. While global food and petroleum prices had already begun to retreat sharply in FY09 from their peak levels, the average prices during the period under review have remained considerably higher than the average for the same period of last year.[1] Moreover, Pakistan's import prices reflected the decline in international prices only with a lag due to the differences at the time of the placement of orders and delivery. Thus, it was only by November 2008 that the import bill declined 23.9 percent YoY as slowing domestic demand was complemented by lower import prices.

[1] For instance, petroleum group prices were 61 percent higher during Jul-Nov FY09 period compared with the same period of last year.

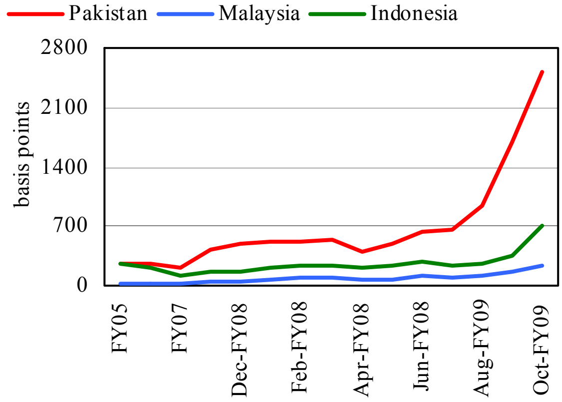
Accordingly, the substantial worsening in the current account deficit is attributable entirely to the Jul-Oct FY09 period (see **Table 6.2**). During November 2008, the current account deficit narrowed somewhat helped by a lower trade deficit and strong remittances. Notwithstanding the November 2008 improvement the July-Nov FY09 current account deficit was a record for the period.

Table 6.2: Monthly Averages of External Accounts
million US$

	FY08		FY09	
	Jul-Oct	**Nov**	**Jul-Oct**	**Nov**
Current A/C	**-748.2**	**-1752.0**	**-1511.3**	**-810.0**
Trade balance	-838.9	-1451.0	-1482.0	-674.0
Exports	*1546.3*	*1531.0*	*1758.9*	*1595.0*
Imports	*2385.2*	*2982.0*	*3240.9*	*2269.0*
Invisible balance	90.8	-301.0	-29.3	-136.0
Remittances	*519.8*	*506.0*	*586.3*	*620.0*
Capital& financial A/C	**777.8**	**678.1**	**281.0**	**320.0**
FDI	329.8	393.0	331.5	276.0
FPI	77.8	-207.0	-45.5	-1.0
Other investment	371.3	484.1	-7.3	46.0
of which				
Public sector loans (net)	*147.0*	*4.1*	*-7.8*	*88.0*
Private sector loans (net)	*25.8*	*30.0*	*9.3*	*41.0*
Error & omission	**-52.6**	**257.9**	**-88.0**	**46.0**
Overall balance	**-23.0**	**-816.0**	**-1318.3**	**-444.0**
Memorandum Items				
Foreign reserves (end period)	16451.0	15680.0	6761.6	9136.2
Exchange rate (end period)	60.7	61.2	81.6	78.8

Thus, as weakening economic fundamentals and deteriorating law & order situation discouraged investment flows and the global financial crisis restricted the country's ability to tap international capital markets, depletion of the country's foreign exchange reserves accelerated. By November 25, 2008 the country's foreign exchange reserves had declined further by US$ 5.0 billion from end-June position, as compared to a fall of US$ 4.2 billion recorded for the whole of FY08.

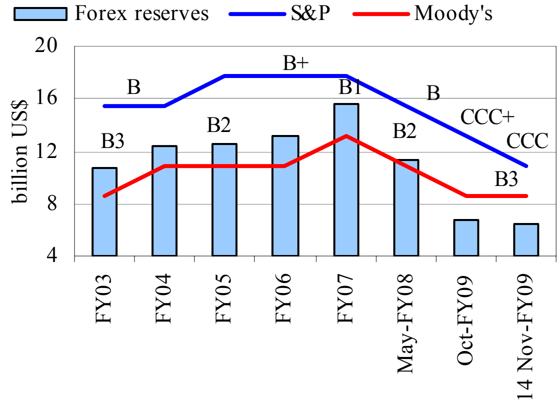
Figure 6.1: Sovereign Credit Default Swap Spreads (5 year international bonds)



The substantial fall in foreign exchange reserves on account of severe balance of payment pressure impaired the country's ability to meet its external obligation. This was reflected in a sharp rise in sovereign credit default swap spread of Pakistan's five year international bond (see **Figure 6.1**) and downward revision of Pakistan's credit rating by the international credit rating agencies (see **Figure 6.2**).

In this backdrop, Pakistan had limited options and was finally forced to approach the International Monetary Fund to support a macroeconomic stabilization program.

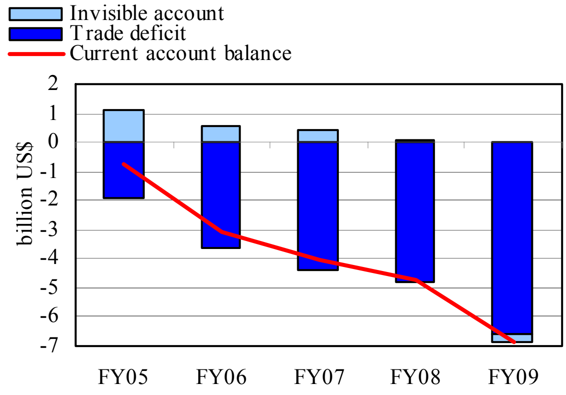
Figure 6.2: Forex Reserves and Foreign Currency Long Term Credit Rating



The balance of payment support worth US$ 3.0 billion from IMF by end November FY09 not only helped directly building up foreign exchange reserves but also increased loan inflows from other donor agencies thereby stabilizing the exchange rate (see **Table 6.2**). With the improvement in forex inflows S& P also upgraded Pakistan's credit rating to CCC+ from CCC on 18th December 2008.

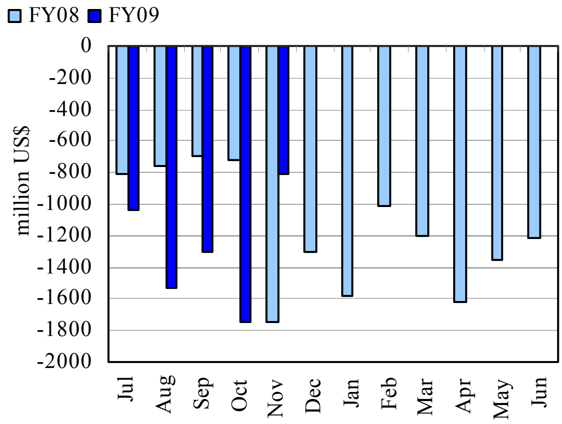
Looking ahead, improvement in current account is likely to continue in the wake of expected slowdown in import growth on account of substantial reduction in petroleum and commodity prices in international market, slowdown in domestic economy, significant depreciation in exchange rate, tight monetary policy, and other tariff and non-tariff barriers. However, there exist significant risks to this outlook, with a possibility of a sharp fall in exports due to domestic structural problems (like power shortages) and recession in Pakistan's major export markets. The reduction in commodity prices could

Figure 6.3: Composition of Current Account Balance (Jul-Nov)



also adversely affect Pakistan's chief non-textile exports: rice and cement. It is therefore imperative to implement policies to further contain domestic demand and to promote exports.

Figure 6.4: Monthly Current Account Deficit



6.2 Current Account Balance

Pakistan's current account deficit increased considerably in Jul-Nov FY08 compared with the same period of last year (see **Figure 6.3**). The invisible account that was in surplus till last year, also recorded a deficit during Jul-Nov FY09. This added to the already worsening current account deficit. While the deterioration in trade deficit was mainly explained by the strong import growth, the deficit in the invisible account was contributed by a slowdown in workers' remittances, outflows from resident foreign currency accounts and lower interest earnings on foreign exchange reserves.[2]

Current account deficit for November 2008, however, shows significant improvement (see **Figure 6.4)**. This welcome contraction in the current account deficit is mainly the result of a fall in import bill and strong remittances growth.

Trade Account[3,4]

The strong import growth of 21.6 percent outstripped a healthy 11.9 percent rise in export during Jul-Nov FY09. As a result, trade deficit expanded to US$ 6.6 billion during the period under consideration compared with US$ 4.8 billion in the same period of last year.

The higher import growth mainly resulted from substantial rise in petroleum and food group imports owing to their higher unit prices. The healthy export growth

[2] The substantial fall in other current transfers from exchange companies was offset by lower outflows from the companies recorded in services account. Thus these flows have no impact on invisible and current account balance.

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

[4] For detail, please see section on trade account.

Table: 6.3 Current Account Balance
million US$

	Jul -Nov			YoY Change	
	FY07	**FY08**	**FY09P**	**FY08**	**FY09**
1. Trade Balance	**-4415**	**-4807**	**-6602**	**-392**	**-1795**
Exports	6884	7716	8631	832	915
Imports	11299	12523	15233	1224	2710
2.Services (net)	**-1951**	**-2844**	**-2061**	**-893**	**783**
Transportation	-901	-943	-1157	-42	-214
Travel	-552	-573	-609	-21	-36
Communication services	25	22	-14	-3	-36
Construction services	-11	-7	-25	4	-18
Insurance services	-55	-67	-18	-12	49
Financial services	-35	-28	-48	7	-20
Computer & information services	9	-8	38	-17	46
Royalties and license fees	-44	-38	-24	6	14
Other business services	-839	-1255	-649	-416	606
Personal & cultural & recreational services	0	0	0	0	0
Government services	452	53	445	-399	392
Of which logistic support	425	0	365	-425	365
3. Income (net)	**-1533**	**-1705**	**-2051**	-172	-346
Investment income(net)	**-1535**	**-1707**	**-2056**	**-172**	**-349**
Direct investment	**-1191**	**-1320**	**-1448**	**-129**	**-128**
of which: profit & dividends	-267	-309	-311	-42	-2
purchase of crude oil and minerals	-590	-609	-692	-19	-83
Portfolio investment	**-91**	**-152**	**-235**	**-61**	**-83**
of which: profit & dividend	-81	-89	-69	-8	20
IMF charges & interest on off. External long term debt	-322	-331	-306	-9	25
Interest on private external debt	-43	-64	-51	-21	13
Others (net)	114	162	-11	48	-173
4. Current Transfers (net)	**3874**	**4611**	**3859**	**737**	**-752**
Private transfers	**3772**	**4578**	**3755**	**806**	**-823**
Workers remittance	2093	2587	2965	494	378
FCA - residents	-61	216	-352	277	-568
Others	1740	1775	1142	35	-633
of which exchange companies	1013	959	247	-54	-712
Official transfers	**102**	**33**	**104**	**-69**	**71**
Current Account Balance	**-4025**	**-4745**	**-6855**	**-719**	**-2110**

on the other hand is mainly attributed to the strong growth in non-textile exports, as the textile export could not pick up amid global recession and severe power shortages.

Services (net)

In sharp contrast to 45.7 percent expansion in the comparable period of last year, deficit in services trade declined by 27.5 percent during Jul-Nov FY09. This decline is mainly attributed to logistic support receipt and lower outflow from foreign exchange companies for other business (see **Table 6.4**).

The substantial fall (US$ 568 million) in outflow from the foreign exchange companies is mainly attributed to changes in the SBP regulations whereby exchange companies' outflows for legal transaction were restricted to 75 percent of the home remittances mobilized by them during the preceding month.[5]

Table 6.4: Services Account (net)
million US$

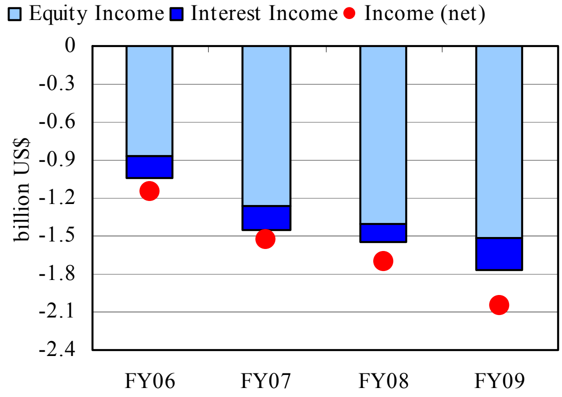
	Jul-Nov		
	FY07	**FY08**	**FY09**
Transportation	-901	-943	-1157
Travel	-552	-573	-609
Other business services	-839	-1255	-649
of which exchange companies	-819	-1040	-425
Government services	452	53	445
of which logistic support	425	0	365
Others	-111	-126	-91
Services (net)	**-1951**	**-2844**	**-2061**
a)Adjusted for logistic support	-2376	-2844	-2426
b)Adjusted for exchange companies flows	-1132	-1804	-1636
c)Adjusted for (a) and (b)	-1557	-1804	-2001

Within the services account deficit, however, the deficit in transportation and travel further deteriorated during the period under review. The deterioration in the former was caused by higher import related freight charges while increase in the latter was explained by higher Hajj related outflows and lower tourist's services export.

Income (net)

The income account deficit increased by 20.3 percent during Jul-Nov FY09 compared with 11.2 percent deterioration in the same period of last year. A large part of this deterioration was contributed by net increase in interest income related outflow. Moreover, increase in investment income outflow also added to deterioration in income account (see **Figure 6.5**).

Figure 6.5: Major Factors Behind Income Account Deterioration (Jul-Nov)



The increase in investment income was mainly caused by higher purchase of crude oil and mineral as the repatriation of profit & dividends registered a decline during

[5] For detail see FE circular No. 04 of 2008, dated May 09, 2008.

the period under consideration. The main sectors which depicted decline in the repatriation of profit & dividends include financial business, communication and power.

The interest income related outflows (net) on the other hand increased by around US$ 102 million during Jul-Nov FY09 in contrast to a decline of US$ 5 million in the corresponding period of last year. This higher net outflow was largely

Table 6.5: Financial Account
million US$

	Jul-Nov			YoY Change	
Items	**FY07**	**FY08**	**FY09P**	**FY08**	**FY09**
Financial account (1 through 4)	**2,566**	**3,775**	**1,436**	**1,209**	**-2,339**
1. Direct investment abroad	**-54**	**-10**	**-**	**44**	**10**
2. Direct investment in Pakistan	**1,480**	**1,712**	**1,602**	**232**	**-110**
of which: Equity Capital	1,130	1,305	1,172	175	-133
privatization proceeds	133	133	-	-	-133
Reinvested earning	348	407	430	59	23
3. Portfolio investment	**576**	**104**	**-183**	**-472**	**-287**
Equity securites	419	51	-146	-368	-197
Debt securites	153	56	-17	-97	-73
Net Foreign Investment	2,002	1,806	1,419	-196	-387
4. Other investment	**564**	**1,969**	**17**	**1,405**	**-1,952**
Assets	201	838	270	637	-568
i. Outstanding Exports Bills (Exporters)	-85	-76	123	9	199
ii. Outstanding Exports Bills (DMBs)	73	78	145	5	67
iii. Currency & deposits	212	836	2	624	-834
of which:Bank	145	751	-49	606	-800
Liabilities	363	1,131	-253	768	-1,384
i.Foreign Long-term loans / credits (net)	103	528	139	425	-389
Project Assistance	355	659	338	304	-321
Non-Food Aid	211	390	494	179	104
of which earthquake loans	130	405	16	275	-389
Amortization	463	521	693	58	172
ii. Private loans	10	133	72	123	-61
of which: Suppliers Credits/MNCs	134	214	228	80	14
Supplier Credits Repayments	124	81	156	-43	75
iii. ST Capital, (official)	-42	64	-82	106	-146
of which: Commerial Banks (net)	-100	-100	-	-	100
IDB (net)	58	164	-82	106	-246
iv. Currency & deposits	134	287	-427	153	-714
*of which: Trade financing**	135	257	-397	122	-654
v. Other liabilities	158	69	39	-89	-30

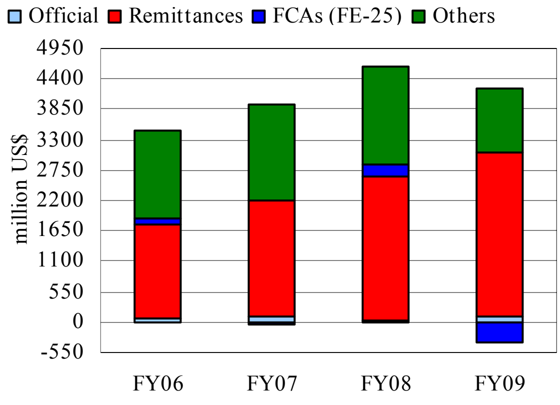
Source: Statistics Department, SBP

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

* Trade financing for preshipment loans

contributed by the substantial fall on foreign exchange earnings. Moreover, higher interest payment on foreign currency deposits asserted additional pressure on interest income outflow during the period under consideration.

Figure 6.6: Major Components of Current Transfers (Jul-Nov)



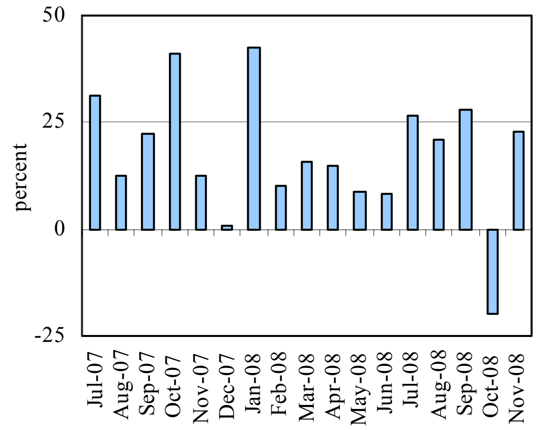
Current Transfers

After enjoying healthy growth during Jul-Nov period for last five consecutive years, current transfers declined by US$ 752 million during Jul-Nov FY09. This decline resulted from a fall in private transfers as public transfers recorded increase during the period under review. Within private transfers a substantive part of the fall was contributed by fall in other transfers and net outflow from resident foreign currency accounts during the period under review (see **Figure 6.6**). Moreover, slowdown in workers' remittances growth during the period under review also contributed to this decline.

Workers' Remittances

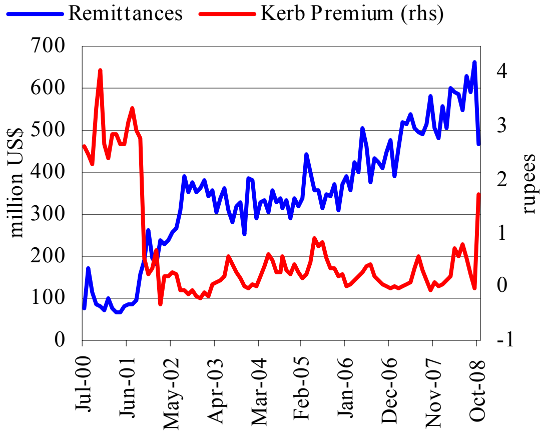
Growth in workers' remittances decelerated to 14.6 percent during Jul-Nov FY09 from 23.6 percent in the comparable period of last year. A large part of this deceleration occurred during October 2008 as YoY growth in remittances during Jul-Sep FY09 period was quite strong (see **Figure 6.7**).

Figure 6.7: YoY Growth in Workers Remittances



The decline in workers' remittances in October appears to be the result of a combination of factors. These factors range from seasonal impact of Ramadan and Eid festival to dollar hoarding amid abrupt depreciation in exchange rate, worldwide slowdown in workers' remittances in the wake of global recession, and possibly to a shift of workers' remittances to informal channel as a result of significant rise in kerb market premium.

Figure 6.8: Remittances and Kerb Market



The data suggests that kerb premium was highest in October 2008 during the last seven year period post 9/11. The kerb premium and workers' remittances are negatively correlated (-0.74), this negative relationship is explained by the fact that higher kerb premium (better rate) along with speedy delivery provide incentive to the migrant to divert their remittances to informal channel (**see Figure 6.8**).

Country wise remittances data suggest that a major part of deceleration in remittances growth was driven from United States, United Kingdom and United Arab Emirates (see **Table 6.6**). An economic slowdown in the U.S and the U.K could be possible reason behind this deceleration in remittances growth.

Table 6.6: Country-wise Workers' Remittances

million US$

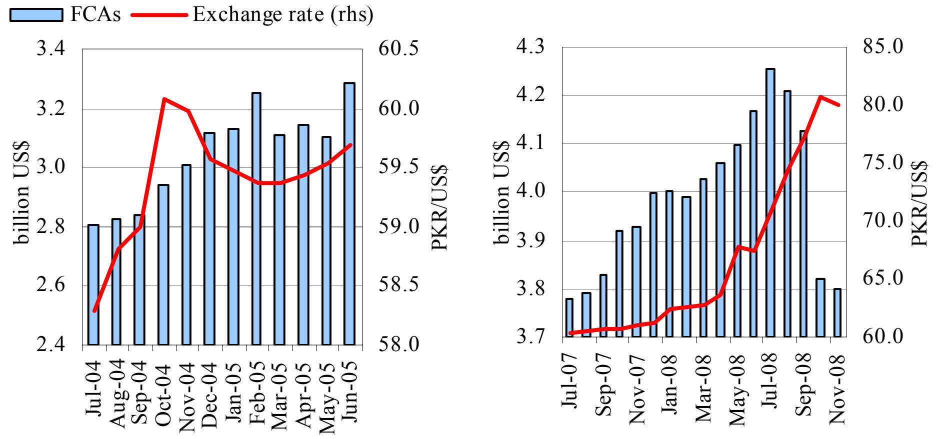
	Jul-Nov			Growth	
	FY07	**FY08**	**FY09**	**FY08**	**FY09**
1) Cash	**2091.6**	**2586.1**	**2966.2**	**23.6**	**14.7**
USA	533.5	733.8	767.1	37.5	4.5
U.K.	180.1	197.4	189.0	9.6	-4.3
Saudi Arabia	399.0	481.8	600.3	20.8	24.6
UAE	318.1	423.0	534.3	33.0	26.3
Other GCC countries	291.5	380.0	496.2	30.4	30.6
EU countries	62.6	76.1	81.0	21.6	6.5
Norway	8.0	11.3	10.7	42.6	-5.9
Switzerland	6.9	9.6	7.6	39.4	-20.5
Australia	12.2	14.5	13.5	18.9	-6.7
Canada	35.3	42.2	34.0	19.7	-19.4
Japan	2.1	1.5	1.9	-30.3	29.0
Other countries	242.6	214.9	230.7	-11.4	7.3
2) Others*	1.2	1.0	0.3	-17.1	-67.0
Total	**2092.8**	**2587.1**	**2966.5**	**23.6**	**14.7**

* Other includes encashment and Profit in Pak Rs of Foreign Exchange Bearer Certificates (FEBCs) & Foreign Currency Bearer Certificates (FCBCs)

Resident FCAs

In sharp contrast to an inflow of US$ 216 million in comparable period of last year, RFCAs declined by US$ 353 million during Jul-Nov FY09. Importantly, more than 80 percent of this decline was recorded in October 2008 alone when exchange rate depreciated substantially.

Figure 6.9: Foreign Currency Accounts and Exchange Rate



Historically RFCAs tend to rise with the depreciation in exchange rate (see **Figure 6.9**). The changed trend during the current episode of depreciation may be attributed to uncertainty surrounding the financial health of some of the institutions. It may be recalled that rumors of bank defaults and possible freezing of foreign currency accounts were rife in October 2008, which may have prompted individuals to withdraw foreign currency deposits. Demand for foreign currency notes also rose sharply during this month.

Figur 6.10a: Foreign Exchange Inflows through Exchange Companies

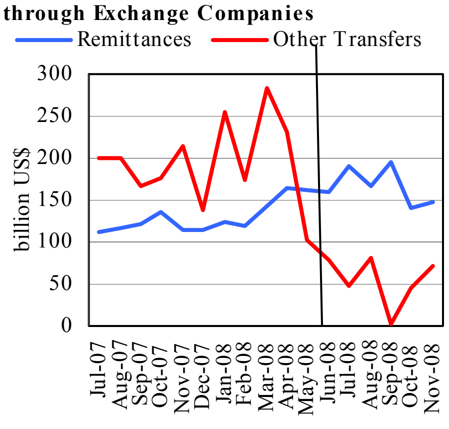
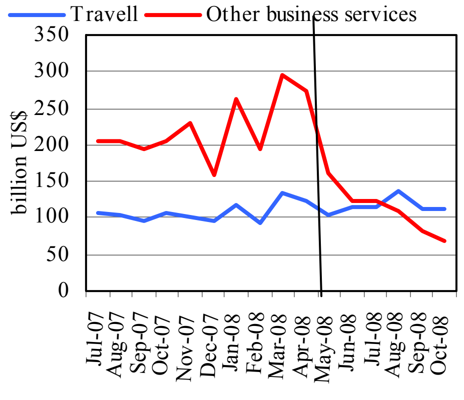


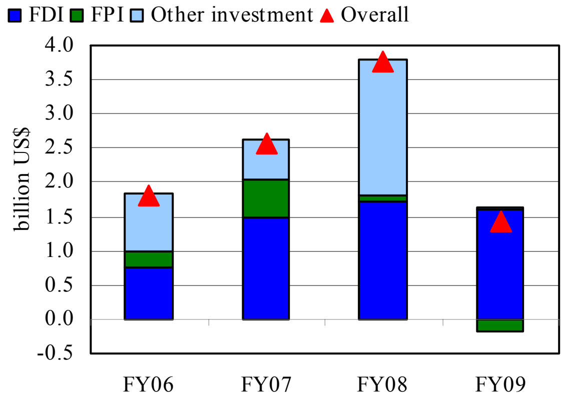
Figure 6.10b: Foreign Exchange Outflows through Exchange Companies



Other Transfers

Inflows in other private transfers registered a massive decline of US$ 633 million during Jul-Nov FY09 compared with inflow of US$ 35.0 million in the same period of last year. Importantly, the entire decline stemmed from the fall in inflows routed through exchange companies (see **Table 6.3**). It may be pointed that other transfers inflows has witnessed sharp decline after May 2008 when exchange companies outflows were restricted to no more than 75 percent of the workers' remittances collected by the company in the preceding month (see **Figure 6.10a**). However, workers' remittances routed through exchange companies increased after this measure. It may be mentioned here that reduction in exchange companies' inflows have no impact on overall current account balance as the outflow from exchange companies recorded in services account declined by an equivalent amount (see **Figure 6.10b**).

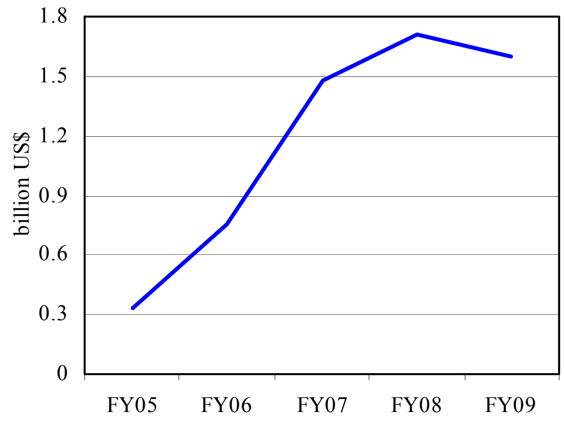
Figure 6.11: Sources of Financial Account Surplus (Jul-Nov)



6.3 Financial Account

Confluence of domestic and external factors led to drying up of major financial inflows (except foreign direct investment) during Jul-Nov FY09 (see **Figure 6.11**). In particular, deteriorating economic imbalances, sharp exchange rate depreciation, and substantial fall in stock market (and introduction of a floor on prices) and increase in the country's default risk deterred foreign exchange inflows during the period under review. Specifically, inflows categorized as *other investment* and portfolio investment fell substantially during the period under review. As a result, surplus

Figure 6.12: Foreign Direct Investment (Jul-Oct)



in financial account recorded significant 62.0 percent fall during Jul-Nov FY09 in contrast to an increase in the corresponding periods of last three successive years (see **Table 6.5**).

Table 6.7: Sector-wise Foreign Direct Investment (Jul-Nov) (million US$)

	Value		Share (%)		Growth
	FY08	FY09	FY08	FY09	(%)
Oil & gas explorations	232.6	275.5	13.6	17.2	18.5
Transport equipment	46.1	38.7	2.7	2.4	-16.1
Power	29.4	63.6	1.7	4.0	116.7
Construction	38.8	18.1	2.3	1.1	-53.4
Trade	69.0	70.6	4.0	4.4	2.3
Communications	624.2	388.7	36.5	24.2	-37.7
Financial business	297.8	444.1	17.4	27.7	49.1
Personal services	42.6	49.4	2.5	3.1	15.9
Others	332.0	254.6	19.4	15.9	-23.3
Total	**1712.5**	**1603.3**			**-6.4**

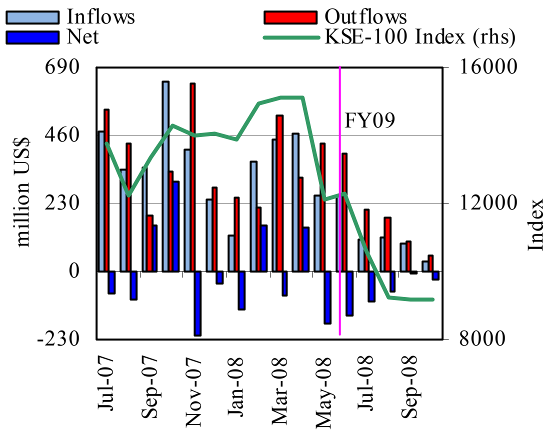
Net Foreign Investment

Net foreign investment declined by 21.4 percent during Jul-Nov FY09 against a 9.8 percent decline in the same period of last year. This fall was mainly due to net outflow from portfolio investment as decline in the foreign direct investment inflows was only US$ 110 million.

Foreign Direct Investment

Foreign direct investment recorded a decline of 6.2 percent during Jul-Nov 09 over the corresponding period last year (see **Figure 6.12**). This decline during the period is attributed to fall in the FDI during October and November 2008, as Q1-FY09 figures depict a healthy 10 percent rise over the same period last year. A part of this deceleration in later month may be attributed to increased country risk, absence of privatization proceeds and a part to tight liquidity condition in the international capital markets.

Figure 6.13: Special Convertible Rupee Accounts



With the largest share in overall FDI, lower investment in communication sector was the dominant factor behind this deceleration in FDI growth. The other major sectors which witnessed decline in foreign inflows during the period included trade, construction and transport (see **Table 6.7**).

Nonetheless, investment in financial business, oil & gas exploration and power sectors recorded robust growth during the period. The higher investment in financial business mainly resulted from US$ 194 million receipts from May Bank while higher investment in oil & gas exploration was mainly recorded in PB Pakistan, ENI Pakistan limited and BHP petroleum Pakistan. Likewise, the growth in power sector inflows mainly reflected investment in the Uch power project and KESC.

Table 6.8: Net Inflows of Foreign Portfolio Investment

	Jul-Nov		Change
US$ million	FY08	FY09	
Private sector	**50.4**	**-146.1**	**-196.5**
Equity securities	50.4	-146.1	-196.5
of which GDRs	*90.5*	*0*	*-90.5*
Debt securities	0	0	0
Public sector	**55.6**	**-16.8**	**-72.4**
Equity securities	0	0	0
Debt securities	55.6	-16.8	-72.4
Total	**104**	**-183**	**-287**

Portfolio Investment

The portfolio investment was worst hit by the unfavorable domestic and external developments during the period under review. Both the private and public sectors witnessed net outflow during Jul-Nov FY09 (see **Table 6.8**). The outflow from private sector was mainly driven by steep fall in stock market (see **Figure 6.13**) and later to the artificial floor on prices, while the outflow from public sector stemmed from the debt securities (T-bills).

Outstanding Export Bills

Aggregate stock of outstanding export bills declined by a sizeable amount during Jul-November FY09. This decline is witnessed in the stock of both the exporters and banks.

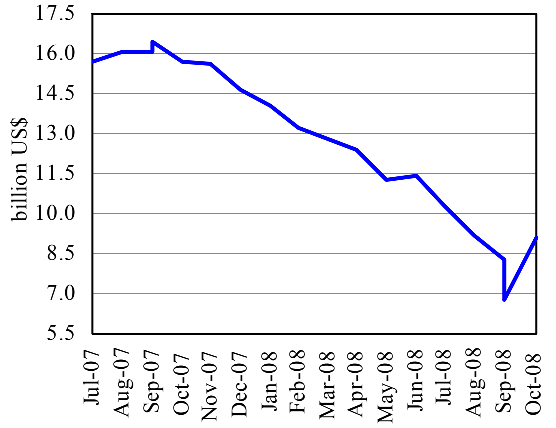
Currency and Deposits (Assets)

Currency and deposits recoded a nominal decline of US$ 2.0 million during Jul-Nov FY09 against considerable decline of US$ 836 million in the same period of last year. This lower decline is attributed to increase in commercial banks' FE-25 nostros in the face of retirement against FE-25 deposits.

Official Long Term Loans

Net inflows in the official long term loans fell considerable during Jul-Nov FY09 compared with the same period of last year. This decline was mainly driven by markedly lower earthquake loans and relatively higher amortization. It may be pointed out that only 5 percent of the full year earthquake loan estimate was realized in the first four months. This suggests that earthquake loan receipts are likely to increase in the rest of the current fiscal year. The higher amortization mainly reflects the payments of Islamic Development Bank (US$ 201 million), Asian Development Bank (US$ 112 million) and IBRD (US$ 113 million). Nonetheless, US$ 500 million loan receipts from Asian Development Bank (ADB) supported these inflows to some extent.

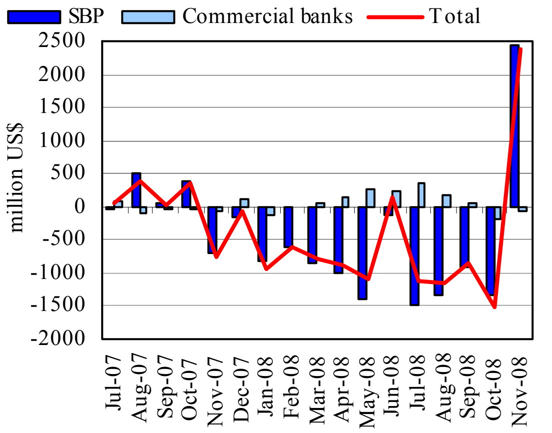
Figure 6.14: Foreign Exchange Reserves



Official Short Term Loans
As a result of debt payment of US$ 282 million to Islamic Development Bank and fresh withdrawal of US$ 200 million, official short term net outflows increased by US$ 82 million during Jul-Nov FY09.

Currency and Deposits (Liabilities)
Currency and deposits witnessed a net outflow of US$ 427 million during Jul-Nov FY08 compared with net inflow of US$ 231 million in the comparable period of last year. This outflow is almost entirely driven by the fall in trade financing on account of FE-25 loans retirement by exporters and importers.

Figure 6.15: Foreign Exchange Reserves



6.4 Foreign Exchange Reserves
Pakistan's foreign exchange reserves declined substantially in the initial months of FY09, dropping from US$ 11.4 billion at end June 08 to a low of US$ 6.4 billion by 25th Nov 2008 (see **Figure 6.14**). This US$ 5.0 billion fall was greater than the fall in the FX reserves for the whole of FY08.

The subsequent partially recovery in November 2008 owed essentially to the inflow of US$ 3.0 billion from the IMF following Pakistan entry into a macroeconomic stabilization program.

SBP Reserves

SBP's reserves registered a steady decline to US$ 5.9 billion by end November, 08. The SBP's reserve flows remained negative throughout the current fiscal year except for the month of November, during which IMF tranche of US$ 3.0 billion was received (see **Figure 6.15**). Causative factors for the change in SBP reserves are presented in **Table 6.9**

Table 6.9: SBP Reserves
million US$

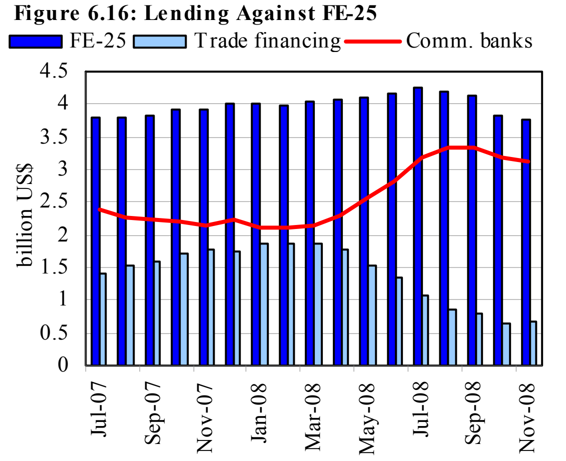
	Jul-Nov	
	FY08	**FY09**
Inflows	6,367	13,566
Purchases	2,843	2,015
Loans & grants	1,229	4,044
ADB	671	615
IMF	4	3,056
Others	2,994	7,507
Forward maturities	1,128	6,736
Logistic supports	0	365
Privatization proceeds	643	0
Outflows	6,122	16,256
Sales	3,270	7,168
Inter-bank sales	365	1,065
Oil support	2,905	6,103
Debt servicing	570	917
Others	2,282	8,170
Forward maturities	1469	6,426
Wheat L/C - TCP	12	671
Net change in reserves	245	-2,689

Source: DMMD

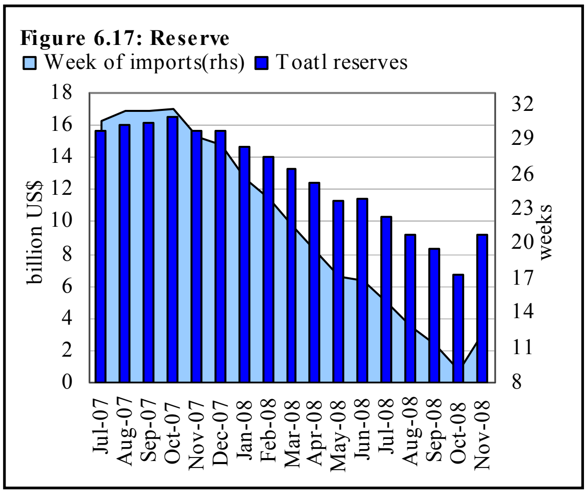
Commercial Bank Reserves

Although monthly flows of commercial banks reserves, depicted a falling trend throughout Jul-Nov 2008, on a cumulative basis DMBs reserves at US$ 3.2 billion in November 2008 were slightly higher than the end June 08 position of US$ 2.8 billion. Improvement in commercial banks reserves was largely contributed by the retirement of foreign currency loans availed against the FE-25 deposits. During Jul-Nov FY09, trade financing showed consistent decline to US$ 0.6 billion by end November 2008 against US$ 1.3 billion as of end-June 2008 (see **Figure 6.16**)

Figure 6.16: Lending Against FE-25

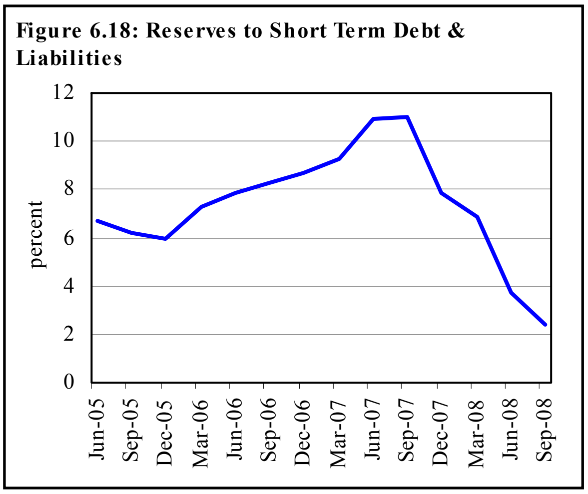


Despite the increase in the interest rate differential between WAFC (weighted average foreign currency) lending and KIBOR, the volume of FE lending to importers declined by US$ 381 million. The reduction in FE lending to importers was probably driven by the weakening rupee (and consequent expectations of further rupee depreciation) the resulting risk of a sharp increase in the effective cost of FE-25 loans.



Reserve Adequacy

The considerable depletion in foreign exchange reserves weakened the country's ability to meet its external obligations. The import coverage ratio declined to an uncomfortable level of 9.1 weeks as of end October 08 from 16.8 weeks of imports as of end June 08. However, the US$ 3 billion IMF's assistance in November 08 provided some cushion, improving the import coverage ratio to 12.3 weeks of imports (see F**igure 6.17**)

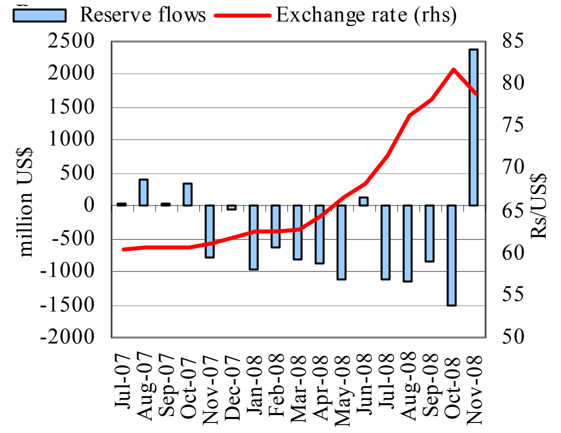


Another measure of reserve adequacy is reserves to short term debt and liabilities ratio. This ratio also deteriorated during Q1-FY09. Although short term obligations showed a slight fall during Q1-FY09, huge depletion of foreign exchange reserves during the next two months resulted in fall of this ratio from 3.7 to 2.4 (see **Figure 6.18**)

6.5 Exchange Rates

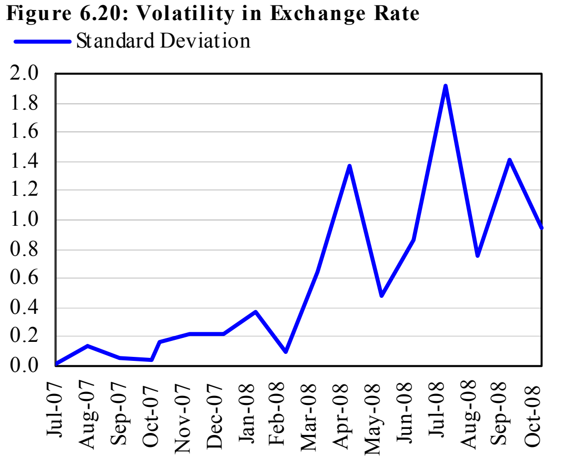
The decline of the rupee had been gathering pace since February 2008. Thus, in order to stabilize inflows and calm market sentiments SBP took number of measures early into FY09. These included suspension of forward booking of dollars, reduction in trading time and curtailment of advance payments against imports from 50 percent to 25 percent[6]. Moreover, to ensure that export proceed are materialized timely, SBP issued instructions to exporters to submit their overdue export proceeds. In this regard banks were advised to launch a campaign for realization of overdue export bills[7]. As a result, the stock of outstanding export bills held by exporters declined by US $ 123 million during Jul-Nov FY09.

Figure 6.19: Foreign Reserves and Exchange



However, due to deteriorating fundamentals the depreciation of rupee accelerated. The rupee fell 16.3 percent during Jul-Oct FY09, reflecting the substantial loss of FX reserves, and heavy buying by businesses seeking to avoid exchange losses on imports. The speculations were strongest in October and as result rupee touched record lows of Rs. 83.46/US $ on October 17, 2008.

Figure 6.20: Volatility in Exchange Rate

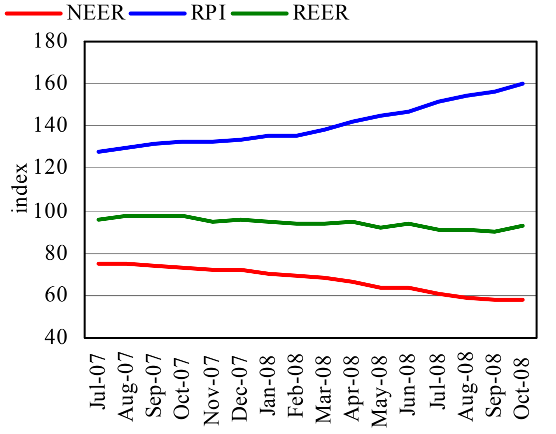


The situation in the forex market improved only after Pakistan's entry into an IMF program, and a crackdown on exchange companies involved in smuggling of US dollar. Consequently, Pak Rupee recovered some of its earlier losses against the US dollar and registered a net depreciation of 13.3 percent for the Jul-Nov FY09 period (see **Figure 6.19**). Along with steep depreciation, exchange

[6] EPD circular No.08 dated July 08, 2008.
[7] EPD circular No. 06 dated July 11, 2008.

rate volatility also increased over the period. Standard deviation of the inter-bank market exchange rate was extremely volatile and in August and October 2008 (see **Figure 6.20**)

Figure 6.21: Effective Exchange Rate

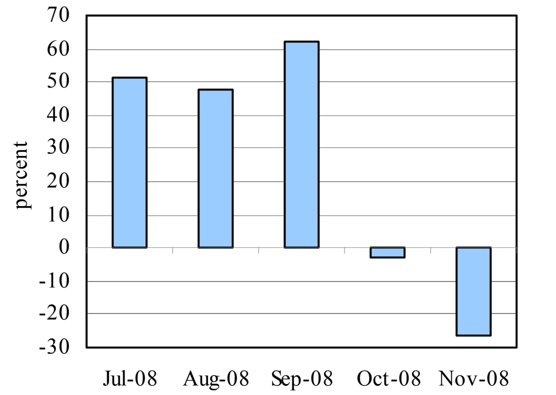


As against US dollar, the exchange rate against basket of currencies as measured by Nominal Effective Exchange Rate (NEER) also showed 9.2 percent depreciation during Jul-Oct FY09 as compared to the depreciation of 3.2 percent during the same period last year. However, continuous rise in inflationary pressures evident in 8.8 percent rise in Relative Price Index (RPI), depreciation in Real Effective Exchange Rate (REER) was limited to 1.2 percent (see F**igure 6.21**).

6.6 Trade Account

During Jul-Nov FY09, strong growth in imports, mainly due to higher import prices, outpaced the otherwise substantial improvement in export growth causing the trade deficit for the period to widen by US$ 1.4 billion compared to the same period last year (see **Table 6.10**).[8] Interestingly, this rise in the deficit was accrued entirely during Q1-FY09; while still large, the monthly deficit saw a YoY decline in each of the next two months (see **Figure 6.22**).

Figure 6.22: Monthly YoY Growth Pattern in Trade Deficit



[8] The price and quantum impact is based on 60 percent of total imports for which detail data is available.

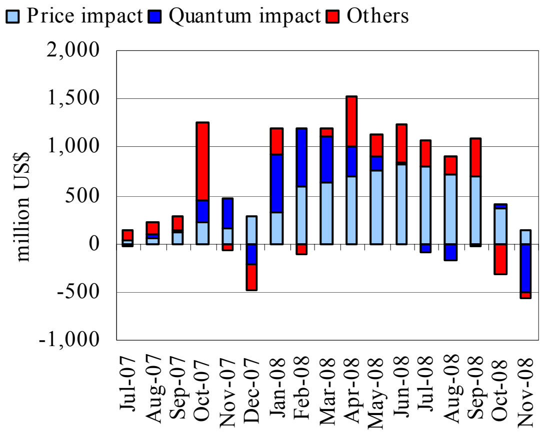
Table 6.10: Composition of Trade Deficit (Jul-Nov)
billion US$

	FY07	FY08	FY09
Trade deficit	**5.4**	**7.3**	**8.7**
Absolute change in imports	**1.2**	**2.3**	**2.4**
Percent share in abs. Δ			
of which			
Price impact	32.2	34.2	103.4
Oil price impact	14.6	14.7	78.3
Non-oil price impact	17.6	19.4	25.1
Quantum impact	15.0	16.2	-6.6
Absolute change in exports	**0.3**	**0.4**	**0.9**
Percent share in abs. Δ			
Textile	90.7	-7.5	-10.7
Non-textile	9.3	107.5	110.7

A closer look at the import growth for these five months of FY09 shows that during the first quarter demand growth may have begun to taper off, but sharply higher import prices ensured that the trade deficit continued to grow strongly. By October 2008, both demand and import prices began to weaken. Thus, after recording a large YoY increase during Q1-FY09, imports witnessed a fall in Oct-Nov FY09 (see **Figure 6.23**). [9]

In fact international commodity prices witnessed a significant downtrend throughout Jul-Nov FY09 (see **Table 6.11**), but as this impacts Pakistan's trade figures with a lag, it is only during the later months that a significant import price decline is visible. On the other hand, a part of lower import during Oct-Nov FY09 may be due to one off factors[10] that may not be present in months ahead. Thus, while imports may continue to shrink from a downtrend in international prices and slowing domestic demand, the improvement may not be as sharp as seen in November 2008.

Figure 6.23: Price & Quantum Impact on Imports



Expectations of a slowdown in imports, stemming from

[9] POL group and fertilizer imports recorded a significant fall in import quantum during this period. In fact due to sharp draw down of country's international reserves during October FY09 government imposed a one month temporary ban on POL imports.

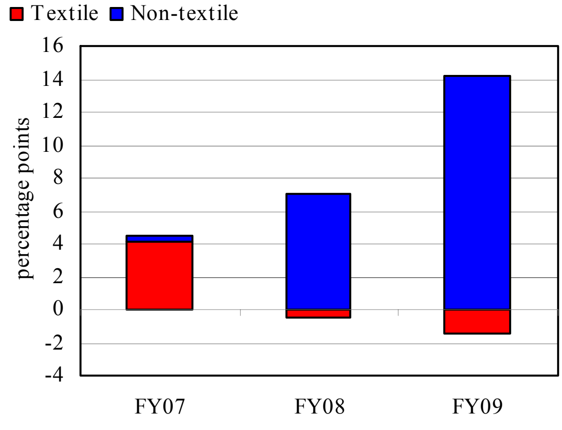
[10] Absence of a large one-off import in the category of ships and boats that occurred in Oct FY 2008 also contributed to the sharp YoY slowdown in imports during Oct 2009.

Table 6.11: Average International Commodity Prices

	Unit	FY08				FY09	
		Q1	Q2	Q3	Q4	Q1	Oct-Nov
Arabian light oil	US$/barrel	71.3	85.2	93.7	117.2	113.8	62.0
Palm oil	US$/MT	746.4	861.6	1081.1	1088.9	828.4	459.7
DAP	US$/MT	432.5	522.1	860.2	1191.6	1153.7	791.3
Wheat	US$/MT	274.9	341.9	411.4	346.5	317.7	232.1

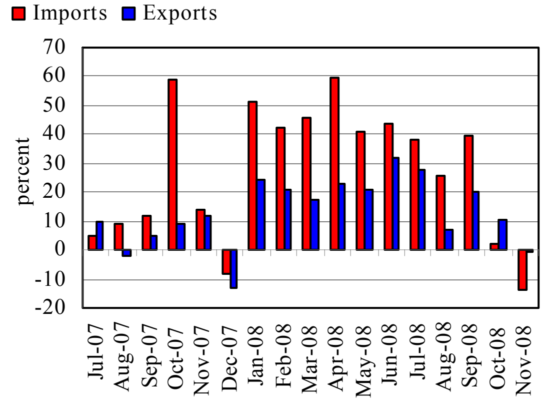
easing of domestic supply pressures[11], a general slowdown in economic activity, sharp depreciation of rupee,[12] and removal of subsidies, etc., would suggest that Pakistan's trade deficit could shrink even faster in the months ahead. However, there is also a concomitant risk that slowing exports, as the global economy weakens (see **Box 6.1**), will offset part of the gains from declining imports.

Figure 6.24: Contribution in Export Growth (Jul-Nov)



It should be noted that the entire increase in exports during Jul-Nov FY09 was driven by strong growth in non-textile exports; textile exports recorded a marginal fall during the period (see **Figure 6.24**). Notwithstanding the healthy YoY increase in exports in Jul-Nov FY09, the monthly export performance shows a slowdown in export growth

Figure 6.25: Monthly YoY Growth - Exports & Imports



[11] During FY09 the supply position of wheat and cotton is likely to be better than that in FY08 resulting in lower wheat and cotton imports during this period.
[12] Average rupee exchange rate vs US dollar recorded 21.4 percent depreciation during Jul-Nov FY09 as compared to its level in Jul-Nov FY08.

momentum from August FY09 onwards as compared to that in H2-FY08 (see **Figure 6.25**).

This deceleration partly resulted from an increase in the intensity of the existing structural issues, especially a sharp increase in power shortages and a slowdown in country's major export markets that affected export demand particularly for textile exports. While the issue of long power shortages has somewhat eased, the winter gas shortages and persistence of other structural factors is likely to hamper export growth in the remaining months of FY09.

Box 6.1: Pakistan's Export Exposure to Large Industrial Countries and Future Prospects for Exports

According to the World Economic Outlook (October 2008), world economy is heading towards a major recession due to the recent financial crisis. World GDP growth after recording a marginal deceleration in 2007 is likely to undergo a significant squeeze in 2008 and onwards, largely on account of sharp slowdown in income growth of the developed economies (see **Figure 6.1.1A**). Being more integrated with the world economy, this is inevitable that Pakistan's economy will suffer the fall out of the slowdown in economic growth of these countries. One obvious channel is a likely fall in import demand of developed countries (see **Figure 6.1.1B**). This fact, in view of around 50 percent share of developed countries[13] in Pakistan's exports (see **Figure 6.1.1C**), raises concerns for prospects of country's export growth.

Table 6.1.1: Economic Performance of Pakistan's Major Trading Partners
percent

	GDP Growths				Share in Pakistan's Export Growth			
	2006	2007	2008	2009	FY05	FY06	FY07	FY08
Developed countries	**3.0**	**2.6**	**1.5**	**0.5**	**57.0**	**55.6**	**55.9**	**50.6**
USA	2.8	2	1.6	0.1	23.9	25.5	24.6	19.5
Euro area	2.8	2.6	1.3	0.2	21.9	20.3	21.5	21.8
Emerging / developing countries	**7.9**	**8.0**	**6.9**	**6.1**	**32.0**	**33.5**	**33.9**	**39.9**
Africa	6.1	6.3	5.9	6.0	4.2	4.2	3.9	4.3
Developing Asia	9.9	10.0	8.4	7.7	26.0	27.5	28.2	27.4
China	11.6	11.9	9.7	9.3	2.5	2.8	3.4	3.6
India	9.8	9.3	7.9	6.9	2.0	1.8	2.0	1.3
UAE	9.4	7.4	7	6.0	7.6	8.0	8.0	10.9

[13] According to the IMF WEO Oct (2008) classification Australia, Canada, Denmark, euro area, Japan, New Zealand, Norway, Sweden, Switzerland, United Kingdom, and United States are included in developed countries. Further in Figure 1.1C main country groups in the classification of others are Asian and African countries which are not included in emerging and developed countries classification. In terms of export market shares some of the major Asian countries are UAE and Afghanistan.

The intensity of the impact of falling world incomes on country's exports depends on two factors (1) exports market share of various country groups in Pakistan's exports; and (2) income elasticity of Pakistan's exports. In this perspective, a close scrutiny of the shares of Pakistan's major export markets point towards a subtle change since the past few years. Specifically, the market share of developed economies, especially that of USA, in Pakistan's exports is gradually falling, while the share of emerging and other developing Asian economies is recording a gradual increase (see **Table 6.1.1**). This development when seen in the perspective of relatively improved growth outlook for emerging and developing economies indicates better prospects for country's export growth.

Figure 6.1.1A : GDP Growth

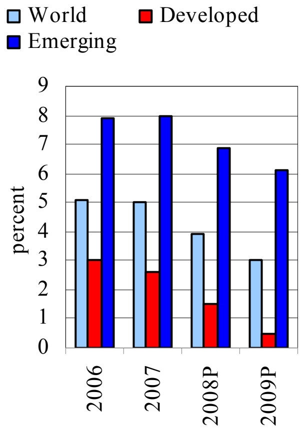


Figure 6.1.1B: Import Volume Growth

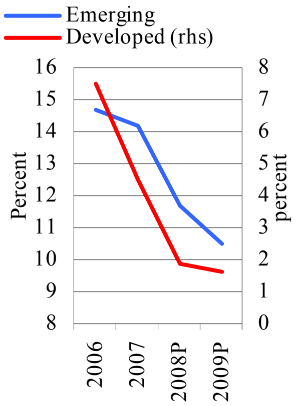
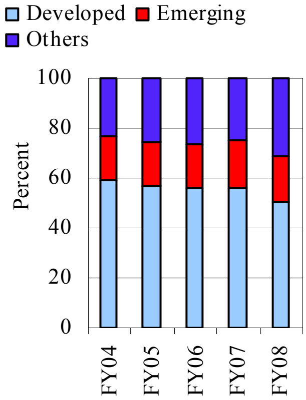


Figure 6.1.1C: Share in Pakistan's Exports



As regards the aspect of income elasticity of exports, survey of literature reveals that Pakistan's exports are moderately elastic to changes in partner countries' income.[14] [15]In terms of composition of exports, country's largest sector of textile exports is at a risk of facing adverse effects of the slowdown in world incomes. This view is also strengthened from a YoY fall in textile and apparel imports of EU and USA during Jan-Aug and Q1-FY09. Further Pakistan's leather goods exports which come under luxury goods classification have already started to fall during Jul-Nov FY09.

In this scenario, country's export growth is likely to record moderate deceleration going forward as compared to the high growth rate that was witnessed during H2-FY08. Especially if the current power shortages and law & order issues persist the impact of world international recession might deepen due to deterioration in country's competitiveness and image.

[14] Source: Senhadji & Montenegro (1999), "Time Series Analysis of Export Demand Equations: A Cross country Analysis" and Box 7.6, SBP Annual Report FY05.

[15] The range of income elasticity of Pakistan's exports as identified in various studies surveyed in Box 7.6 SBP Annual Report FY05 is 0.375 to 2.36 in the short run and -2.26 to 1.91 in the long run. This implies that for every one percent fall in partner country's income Pakistan's exports might fall between a range of 0.375 to 2.36 percent in the short run. In Senhadji & Montenegro (1999) the range of income elasticity of exports for a group of developing and industrial countries is estimated as 0.02 to 1.15 for the short run and 0.17 to 4.34 for long run.

Table 6.12: Major Exports (Jul-Nov)
million US$

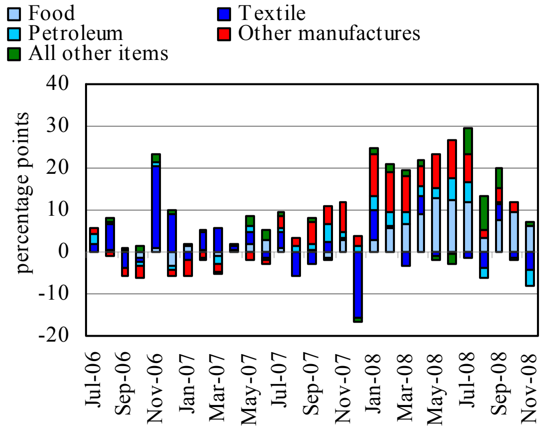
		FY08		FY09(P)			% YoY Δ		
		Value	Unit Value	Value	Unit Value	Abs.Δ value	Qty	Value	Unit Value
Food group		**785.2**		**1429.9**		**629.0**		**78.5**	
of which: rice	MT	433.9	507.1	1000.8	976.2	566.9	19.8	130.6	92.5
Textile group		**4477.3**		**4377.3**		**-100.0**		**-2.2**	
of which									
Cotton yarn	MT	587.0	2278.9	483.0	2322.8	-104.0	-19.3	-17.7	1.9
Cotton fabrics	SQM	777.2	981.7	842.4	956.2	65.2	11.3	8.4	-2.6
Knitwear	DOZ	812.9	19.3	826.8	17.0	13.9	15.1	1.7	-11.7
Bed wear	MT	829.6	5763.4	740.8	5075.0	-88.8	1.4	-10.7	-11.9
Towels	MT	235.1	4180.4	292.9	3862.9	57.8	34.8	24.6	-7.6
Readymade garments	DOZ	606.2	37.8	524.1	36.0	-82.1	-9.2	-13.5	-4.8
Synthetic textiles	SQM	209.9	0.9	243.8	0.8	33.9	25.0	16.1	-7.1
Other textile made-up		216.2		225.4		9.2	---	4.3	---
Other textile material		123.6	---	106.8	---	-16.8	---	-13.6	---
Petroleum group		**439.6**		**445.2**		**5.6**		**1.3**	
Other manufactures group		**1357.6**		**1600.9**		**243.3**		**17.9**	
of which									
Chemicals and pharmaceuticals		210.6	---	297.1	---	86.5	---	41.1	---
Molasses	MT	7.3	45.0	43.4	92.7	36.1	188.7	495.0	106.1
Cement	MT	134.0	51.9	258.6	65.5	124.5	52.8	92.9	26.2
All other items		**262.7**		**416.5**		**153.9**		**58.6**	
Total exports		**7337.9**		**8269.8**		**931.9**		**12.7**	

6.6.1 Exports

Major non-textile contributors in overall export growth during Jul-Nov FY09 were *rice, other manufactures* and *all other items* exports (see **Table 6.12**). All these categories recorded large YoY growth during this period. Some of the textile categories e.g., cotton yarn, towels and synthetic textiles also performed well, but In overall terms this group recorded a marginal YoY fall during Jul-Nov FY09.

Yet from August FY09 the review of monthly export performance indicates a slowdown in export growth of the major performing categories as compared to H2-FY08 (see **Figure 6.26**).[16]

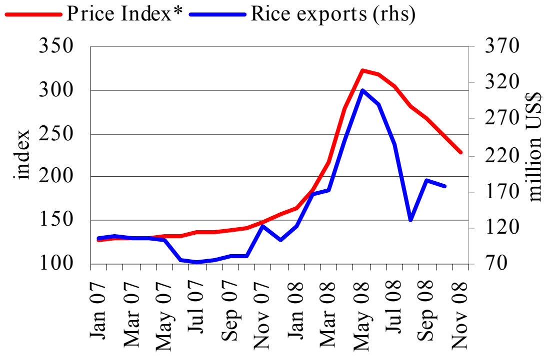
Figure 6.26: Contribution in Exports



Non-Textile Exports

A mix of external and domestic factors seems to have started taking their toll, leading to a fall in exports of leather group, textile, and jewelry (see **Table 6.13**). The export performance of leather group, which are mainly directed to EU, is weakening due to domestic factors such as rising cost of energy and raw materials, increasing power shortages and domestic law and order issues leading to diversion of export orders. In addition, the slowdown in major industrial countries is also likely to have a stronger negative impact on export demand, since these products chiefly belong to luxury goods which are relatively more income elastic. The fall in jewelry exports, however, was not unexpected; reportedly this export was being carried out to take benefit from the price differential between Dubai and domestic market prices which is no longer there.[17] Some of the major non-textile performers continued to record high growth. Specifically, rice, chemicals & pharmaceuticals and cements exports continued to record sharp growth in Jul-Nov FY09.

Figure 6.27: Pakistan's Rice Exports and International Rice Prices



* Source: www.fao.org

[16] The 12.3 percent monthly average export growth during Aug-October CY08 was significantly higher than the 4 percent YoY growth observed during the same period last year, but it was significantly lower than the 22.3 percent average monthly growth recorded during Jan-Jul CY08

[17] For details see SBP Annual Report 2007-08.

Rice was the single largest contributor having 60.8 percent share in overall export increase during Jul-Nov FY09. This rise in rice exports was recorded mainly on account of higher price impact. Moreover, rice exports are well positioned to record sizeable growth in quantum from Q2-FY09 onwards due to bumper rice crop in FY09.

Table 6.13: Absolute YoY Change in Major Export Performing Categories
million US$

	FY08				Jul-Nov	
	Q1	**Q2**	**Q3**	**Q4**	**FY08**	**FY09**
Rice	**5**	**13.3**	**142.4**	**552.5**	**-12.8**	**567.9**
Textile	**-71.4**	**-198.4**	**36.3**	**47.9**	**-38.5**	**-100.0**
Petroleum	**48.1**	**86.2**	**128.2**	**156.5**	**98.7**	**5.6**
Other manufactures	**146.3**	**192.7**	**370.4**	**341.9**	**202.9**	**242.3**
Leather	21.6	29	33.4	28.4	36.3	-27.5
Leather manufactures	-8.4	68.3	55.6	38.3	-8.4	-18.0
Medical/surgical instruments	19.4	18.7	22.7	15.9	27.4	5.8
Chemicals and pharmaceuticals	45.8	27	82	76.5	48	86.4
Of which						
Plastic materials	18.2	4.1	36.2	35.3	16.9	27.6
Chemicals	23.1	19.2	38.3	38.3	24.1	59.3
Jewelry	41	26.6	58.7	48.1	51	-1.0
Cement and products	32.9	53.5	78.2	112.6	51.9	124.5
Molasses	1.1	-4.2	11.3	18.5	1.5	36.1
Others	-7.1	-26.2	28.5	3.5	-4.7	9.9

Going forward, the decline in international prices of rice is expected to accelerate (see **Figure 6.27**). Reportedly, Vietnam has removed restrictions on exports to attract buyers, while Thai rice prices have crashed significantly [18] due to new arrivals. India is also likely to remove restrictions on rice exports [19] which will further cause a downward pressure in international rice prices due to the availability of large supplies in the international market. To counter these developments, government has eliminated the Minimum Export Price on *irri* and *basmati* rice in August and October FY09, but the sharp decline in prices is expected to offset some of the gains from sharply higher export volumes in H2-

[18] The FAO Rice Price Update December 2008. Thai rice prices have crashed from 764 US$/ tonnes in June 08 to 464 US$/ tonnes in November 08.

[19] http://economictimes.indiatimes.com/News/Economy/Lifting_rice_export_restrictions_to_check_international_prices/rssarticleshow/3666463.cms

FY09. .

In addition to this, two of the most important categories in the *other manufactures* group were chemicals & pharmaceuticals and cement, which continued to perform strongly during Jul-Nov FY09. Exports of these categories are at a risk of facing some deceleration in the coming period because of two factors: (1) in the chemicals group exports of ethanol might record a deceleration in H2-FY09 due to an expected fall in sugar production during FY09 and; (2) as a result of the current political tensions with India overall trade and hence cement exports to this destination might fall. Further, the reported slowdown in construction activities in UAE might also affect country's exports to this destination.

Table 6.14 : Textile and Apparel Export Growth to the Major Markets
percent

	EU*		US**	
	CY07	CY08	FY08	FY09
World	5.8	-1.1	1.3	-2.8
Bangladesh	-1.1	3.0	-1.3	12.4
China	20.3	6.4	12.5	1.0
India	2.9	-1.4	3.1	-5.7
Pakistan	6.6	-3.7	-3.9	-6.0
Thailand	-8.5	-5.5	-4.0	-5.4
Turkey	7.5	-9.5	-13.4	-21.7
Vietnam	11.8	7.2	35.3	19.8

* (Jan-Aug) source: Eurostat
** (Jul-Sep) source: US Census Bureau

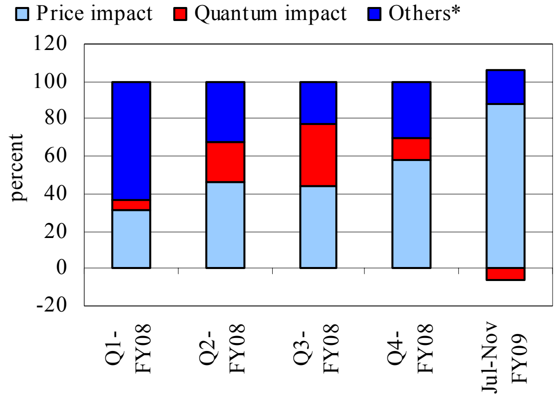
Petroleum products exports decelerated due to limited availability of crude petroleum in the domestic market which caused refineries to work at lower capacities and reduced exportable surplus of the petroleum products. Reportedly, refineries were facing problems in crude import due to huge volume of circular debt.[20] Also as a result of down grading of country's ratings by S&P from B to CCC positive in October FY09 and further to CCC in November FY09 refineries were facing problems in opening LCs for imports. As, foreign banks were doubtful about country's ability to honor its foreign exchange liabilities. However, with the agreement with IMF this situation has improved.

In this scenario, in the coming period petroleum products exports might improve if the country resumes crude petroleum import at a normal level with improvement of the international reserves position.

[20] For details see Box 4.1 in Chapter Money and Banking.

Textile exports also recorded a slight fall because of persistent structural issues and a fall in external demand due to slowdown in the major export markets (see **Table 6.14**).

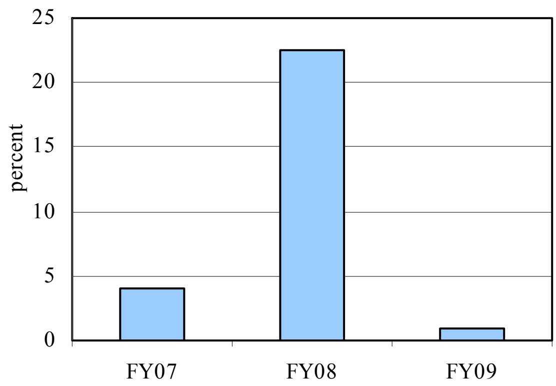
Figure 6.28: Composition of Import Increase



* Items for which quantum data is not available.

In the presence of the tough competition from other suppliers, a host of structural issues and slackening external demand, textile exports remained almost unchanged from the previous years. The performance would probably have been even weaker were it not for the large depreciation of the domestic currency. Hopefully, exports will respond positively to the decision by the SBP to provide 100 percent refinancing to banks against export finance provided to exporters.[21] This incentive would aide in improving competitiveness of textile sector -largest beneficiary of this incentive.[22]

Figure 6.29: Non-Food and Non-Oil Imports YoY Growth (Jul-Nov)



6.6.2 Imports

The underlying factors of import increase have undergone a shift during Jul-Nov FY09. Though overall imports have recorded a large YoY increase during Jul-Nov, the composition of imports increase has undergone two positive shifts during Jul-Nov FY09 as compared to that in FY08. (1) A large share of the overall import increase was contributed by price impact, while the share of quantum impact in the total import

[21] SMEFD Circular No. 03 of 2008, SBP.

[22] According to FY03-08 data around three-fourth of the total EFS financing provided by SBP is used by textile sector.

increase was negative (see **Figure 6.28**); (2) growth of non-food & non-oil imports recorded a sharp deceleration during Jul-Nov FY09 leading to a sharp fall in their share in total imports during this period (see **Figure 6.29**). Both these elements point toward easing of demand pressures during Jul-Nov FY09.

Factors responsible for shifting import demand

A large number of categories witnessed compression in import demand as reflected from their lower quantum impact as compared to the same period last year (see **Table 6.15 & 6.16**). One of the major factors leading to fall in import quantum of these categories is a sharp depreciation of rupee in this period which has raised cost of imports.[23] Further slowdown in domestic economic activity and higher interest rates have also contributed in reducing import demand in general. In addition, import demand in some of these categories was also affected by certain sector specific issues.

For instance, raw cotton imports declined in anticipation of better harvest in FY09 than in the last year. Further the continuing downturn in EU and US economies has also impacted the demand for cotton products.

Fall in fertilizer import quantum resulted reportedly from higher domestic DAP fertilizer inventories**.** During FY08 large quantum of DAP fertilizer was imported to avoid any shortages in the domestic market because of closure of a large DAP plant for BMR. However, during the rabi season of FY08[24] DAP off take remained low as compared to the same period last year[25]due to a sharp increase in international and hence domestic DAP prices, which resulted in piling of huge inventories that eliminated the need for further imports. Reportedly, due to the price factor farmers are switching to the use of Urea, which is causing additional Urea demand in the market; therefore some quantity of urea is expected to be imported in Q2-FY09. In view of high domestic inventories DAP imports are likely to remain low till the coming kharif season (Apr-Jun CY09).

Iron and steel group imports recorded decline due to a slowdown in domestic construction activities.

[23] Average rupee exchange rate vs US dollar recorded 21.4 percent depreciation during Jul-Nov FY09 as compared to its level in Jul-Nov FY08.
[24] DAP off take is seasonally higher in the rabi season.
[25] During FY08 rabi season (Oct-Dec FY08) DAP off take recorded 36.3 percent YoY fall, while during the kharif season (Apr-Jun) FY08 there was a 76.1 percent YoY fall.

Table 6.16: Major Imports (Jul-Nov)
million US$

		FY08		FY09(P)			% YoY Δ		
		Value	Unit value	Value	Unit value	Abs.Δ value	Qty	Value	Unit value
Food group		**1353.2**		**1982.3**		**629.1**		**46.5**	
of which									
Wheat	MT	41.2	473.6	693.5	411.3	652.3	1839.1	1584.1	-13.2
Palm oil	MT	568.9	784.9	636.9	1067.6	68.0	-17.7	12.0	36.0
Machinery group		**2786.6**		**2964.3**		**177.7**		**6.4**	
of which									
Power generating machinery		338.8		724.2		385.4		113.7	
Telecom		914.1		507.5		-406.6		-44.5	
Transport group		**1067.3**		**554.8**		**-512.4**		**-48.0**	
of which									
Road motor vehicles		553.3		430.3		-123.0		-22.2	
Aircrafts, ships and boats		492.8		120.5		-372.2		-75.5	
Petroleum group		**3771.5**		**5482.3**		**1710.8**		**45.4**	
Petroleum products	MT	1951.9	507.3	3065.3	763.5	1113.4	4.4	57.0	50.5
Petroleum crude	MT	1819.6	503.1	2417.0	778.2	597.4	-14.1	32.8	54.7
Textile group		**761.0**		**735.6**		**-25.4**		**-3.3**	
of which									
Raw cotton	MT	336.0	1389.4	298.3	1550.2	-37.7	-20.4	-11.2	11.6
Agricultural and other chemical group		**2327.8**		**2521.8**		**194.0**		**8.3**	
of which									
Fertilizer manufactured	MT	445.8	352.0	344.9	851.8	-100.9	-68.0	-22.6	142.0
Other chemicals		1103.2		1394.7		291.5		26.4	
Metal group		**1031.2**		**1001.0**		**-30.2**		**-2.9**	
of which									
Iron and steel scrap	MT	286.2	267.4	224.5	340.8	-61.7	-38.4	-21.6	27.4
All other metals articles		169.9		158.7		-11.2		-6.6	
Miscellaneous group		**300.6**		**299.0**		**-1.6**		**-0.5**	
All other items		**1203.0**		**1465.5**		**262.5**		**21.8**	
Total imports		**14602.1**		**17006.6**		**2404.5**		**16.5**	

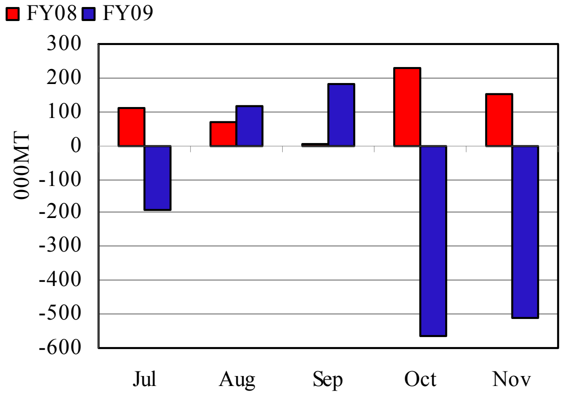
Further, slowdown in domestic automobile sales (see **Table 6.17**) has also reduced demand for rubber tyres and tubes. In fact as a result of monetary tightening and an increase in cost, domestic automobiles production has also suffered[26], leading to a fall in imports of road motor vehicles group also.

Table 6.17: Automobiles sales (Jul-Nov)
sales in numbers; growth in percent

	FY08	FY09	Growth
Cars	62815	33858	-46.1
Jeeps	7978	6006	-24.7
Trucks	1656	1182	-28.6
Buses	519	270	-48.0
LCVs	8153	9311	14.2
Tractors	20265	20249	-0.1
Motorcycles	255462	207450	-18.8

In case of petroleum crude, monthly data shows that these imports recorded quantum increase only in August & September FY09 (see **Figure 6.30**). As discussed before, this might be attributed to the circular debt issue as well as financial constraints faced by the country that resulted in downgrading of country's ratings.

Figure 6.30: Absoulte Change in Petroleum Crude Import Quantum



In overall terms, owing to removal of subsidies which resulted in a large increase in domestic prices of POL products,[27] the demand for these products is falling which is reflected from 5.4 percent YoY decline in industry sales of POL products during Jul-Oct FY09. [28] However, despite the slowdown in POL group import quantum, the overall POL import bill recorded a hefty US$ 1.7 billion YoY rise during Jul-Nov FY09, solely because of higher price impact. In this scenario the current downturn in international oil prices is likely to result in a sharp fall in POL import bill in the remaining months of FY09, even if domestic demand picks up slightly due to the recent downward revision of POL products prices.

[26] Domestic production of automobiles recorded 35.6 percent YoY fall during Jul-Nov FY09.
[27] During Jul-Oct FY09 prices for Mogas, Diesel oil, kerosene oil and other products have increased twice. However, these prices started to come down from Nov 2008 *(source: OGRA).*
[28] Source: OCAC

The only category that recorded a very large quantum increase during Jul-Nov FY09 was wheat. The import of wheat is being carried out in pursuance of government decision to avoid any shortages in the domestic market. However, the initial wheat production target for FY09 has been revised upward, which might reduce the need of wheat import in the remaining months of FY09. In addition, power generating machinery imports also recorded a large increase due to the ongoing work on various IPPs.

Outlook for FY09 imports

The above mentioned factors reveal that import demand pressures which were obvious during FY08 have decelerated to a large extent in Jul-Nov FY09. The categories that are likely to record some demand led increase in imports are POL products, power generating machinery, other chemicals and fertilizers. POL products imports are likely to result from higher thermal power generation needs while, other chemicals imports are necessary to fulfill the industry demand. The expected increase in imports of power generating machinery and fertilizer is also in line with the sector specific issues discussed earlier. However, the demand led increase in these imports is likely to be offset substantially due to lower price impact November FY09 onwards, especially in POL group. This implies a large deceleration or even a fall in imports in the remaining months of FY09 is very much on cards.