6 External Sector

6.1 Overview

Aided by lower imports and sustained inflow of remittances the current account deficit during Jul-Apr FY10 remained significantly lower than in the corresponding period last year. The impact of this improvement on overall external balance was, however, limited by considerable fall in capital and financial account surplus during the period (see **Table 6.1**).

Table 6.1: Summary of External Accounts (Jul-Apr)

billion US dollar

			FY10		
	FY09	**FY10**	**Q1**	**Q2**	**Jan-Apr**
A-C/A balance	**-9.0**	**-3.1**	**-0.6**	**-1.5**	**-0.9**
i) Trade balance	-11.1	-9.1	-2.8	-3.0	-3.3
Exports	15.8	16.2	4.6	4.7	6.9
YoY growth (%)	-3.6	2.1	-19.1	6.8	*19.7*
Imports	27.0	25.2	7.4	7.7	10.2
YoY growth (%)	-5.9	-6.3	-27.4	-5.2	*17.6*
ii) Invisible balance	2.2	6.0	2.2	1.4	2.4
Remittances	6.4	7.3	2.3	2.2	2.8
B-Financial/capital balance	**4.5**	**3.9**	**2.8**	**0.5**	**0.7**
i) FDI	3.2	1.8	0.5	0.5	0.8
ii) FPI	-1.0	0.0	0.2	0.1	-0.3
iii) Other investment	2.1	2.0	2.0	-0.2	0.1
C-Errors & omissions	**0.2**	**-0.2**	**-0.4**	**0.4**	**-0.1**
D-Overall balance	**-4.3**	**0.7**	**1.8**	**-0.7**	**-0.4**
Drawings from IMF*	3.9	1.3	0.5	0.8	0.0
Net change in overall reserves	0.1	2.4	2.5	0.5	-0.6

* This does not include IMF support for bridge financing

In fact, given the rise in current account deficit recorded in Q2 over Q1, it was expected that current account deficit would rise further in subsequent months due to an anticipated rise in imports. In the event, not only was the rise in imports during Jan-Apr less than expected, but exports also staged a significant recovery. As a result, the current account deficit in Jan-Apr was lower than Q2-FY10. Accordingly, SBP now expects the current account deficit for FY10 to range between 2.2-2.8 percent of GDP against earlier estimates ranging between 3.2-3.8 percent of GDP. This would be much lower than the 5.6 percent in FY09.

The news on the financing side, however, is not encouraging. Specifically, the financial account after recording a substantial surplus in Q1-FY10, witnessed sustained decline in the ensuing months. Thus, for aggregate Jul-Apr FY10 period, the surplus in the financial account remained noticeably lower than the same period last year.

The weakness of the financial account mirrored the declines in both, equity and loan inflows. Lower equity inflows are not surprising, given the uncertainties surrounding the both the domestic economy and the global financial markets, but non-realization of FoDP pledges and commitments made by some other lending agencies led to an unexpected shortfall from levels projected earlier.[1]

Figure 6.1a: Current Account Balance

Figure 6.1b: Capital/Financial Account Balance (3MMA)

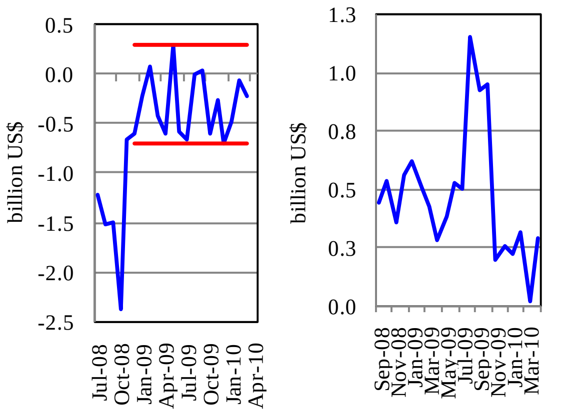
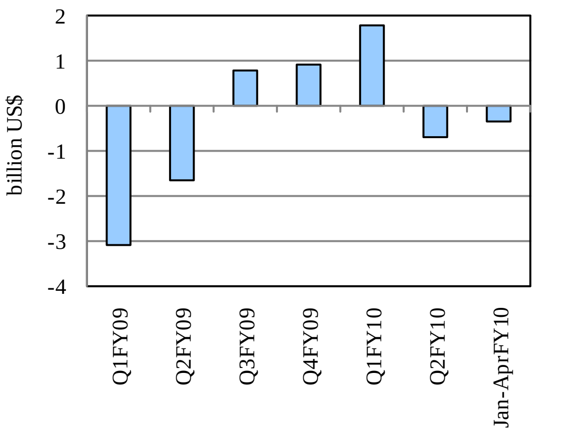


Figure 6.2: Overall Balance of Payments



The persistent fall in financial inflows has impaired country's ability to finance even the smaller current account deficit (see **Figure 6.1**). For instance, despite movement of current account deficit in a narrow range, overall external account position deteriorated in the post Q1-FY10 period (see **Figure 6.2**).

It should be remembered that the sustainability of the current account also depends on the country's ability to finance it (preferably from the non-debt creating inflows). Pakistan, for a number of years, supported large current account deficits only because it was able to finance it. The external position becomes highly risky if both the current and financial accounts are in deficit.

So far, overall external account for Jul-Apr FY10 period is showing nominal surplus. As a result, Pakistan foreign exchange reserves showed improvement and

[1]For instance, realization of Tokyo pledges during Jul-Apr FY10 remained less than 10 percent of the total budget estimate.

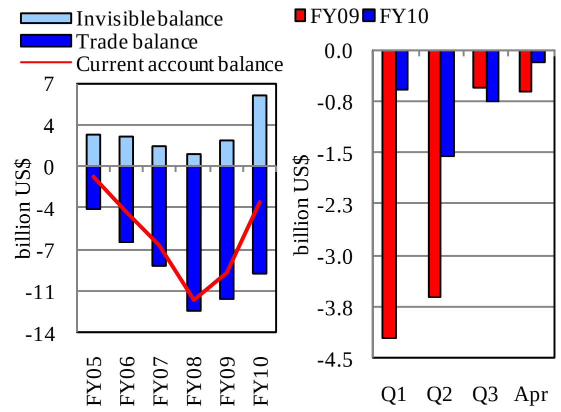
the exchange rate has also exhibited relative stability during the period under review. The situation, however, remains precarious and can deteriorate rapidly.

6.2 Current Account Balance

Current account deficit recorded 65.9 percent YoY contraction during Jul-Apr FY10 compared with a 20.1 percent decline in the same period last year. In absolute terms, this is the lowest deficit for the Jul-Apr period in the last four years (see **Figure 6.3a**).

Figure 6.3a; Current Account Balance (Jul-Apr)

Figure 6.3b: Current Account Balance



While all components of the current account deficit recorded YoY improvement during the period under review, a major impetus came from a fall in imports and a strong increase in current transfers, which together contributed around 54.5 percent of the overall improvement. Fall in payments on account of repatriation of dividends, interest on debt, freight on merchandise imports and lower outflows from foreign exchange companies were other major contributory factors behind the contraction in the current account deficit during the period under consideration.

Quarterly analysis, however, shows that a large part of the YoY improvement in current account deficit was concentrated in H1-FY10 as it has shown deterioration during Q3-FY10 (see **Figure 6.3b**).

6.2.1 Trade Account[2]

Trade deficit declined by 18.3 percent during Jul-Apr FY10 compared with 9.0 percent fall in the same period last year. Although, this decline is largely driven by fall in imports, a small recovery in exports also contributed to decline in the deficit.

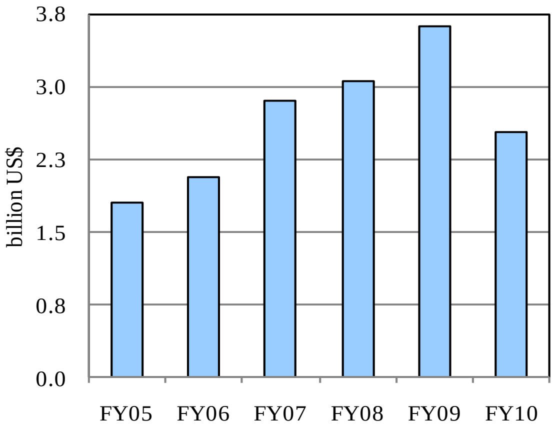
While recovery in exports is mainly attributed to better agriculture performance (rice, cotton and fruits), fall in imports was chiefly on account of lower average

[2]This section is based on exchange record compiled by SBP that does not tally with more detailed FBS data used in section 6.7: Trade.

import prices. However, a part of YoY decline in imports was offset by rising import volumes (especially for petroleum products and fertilizer) during Jul-Apr FY10.

Almost the entire YoY improvement in trade deficit during the period was concentrated in H1-FY10. Indeed, as international prices begin recovering, YoY increase in imports more than offset modest recovery in exports in the following quarter. As a result, trade deficit increased during Jan-Apr FY10 compared with the same period last year.

Figure 6.4: Income Account Deficit (Jul-Apr)



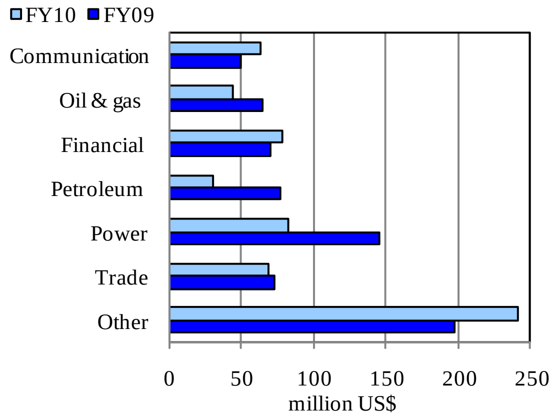
6.2.2 Services (net)

Services account deficit declined by 39.0 percent during Jul-Apr FY10 on the top of 42.8 percent decline in the same period last year. A large part (61.9 percent) of this improvement stemmed from lower services imports, while the rest was contributed by an increase in services exports. (For details, see section 2.3: Services).

6.2.3 Income Account

After widening continuously in the last four years, deficit in the income account declined considerably (29.9 percent) during Jul-Apr FY10 (see **Figure 6.4**). Fall in the payments on both investment (repatriation of profit & dividends) and debt (interest) contributed to this decline. Specifically, the fall in investment income contributed around 86.0 percent of the decline in income account deficit while interest payment contributed around 14.0 percent during the period.

Figure 6.5: Sector-wise Repatriation of Profits & Dividends (Jul-Apr)



The decline in payments on investment during Jul-Apr FY10 mainly reflects a fall in repatriation of dividends and lower government's purchases of crude oil & gas. The major sectors recording decline in repatriation of profit & dividends during the period included petroleum refining, power and oil & gas, i.e. the sectors severely affected by circular debt issue (see **Figure 6.5**).[3]

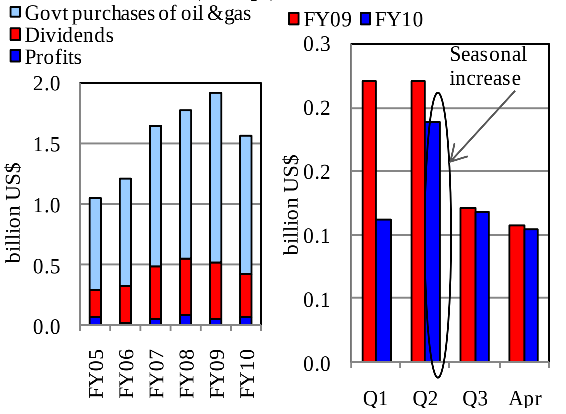


Figure 6.6a: Payments on Investment Outflows (Jul-Apr)

Figure 6.6b: Repatriation of Profit and Dividends

On the other hand, financial business and communication sectors recorded YoY increase in repatriation of profit & dividends during Jul-Apr FY10. Dividends payments by a major bank[4] chiefly explain the increase in the former while repatriation of profit by a large telecom company explains the increase in the latter.

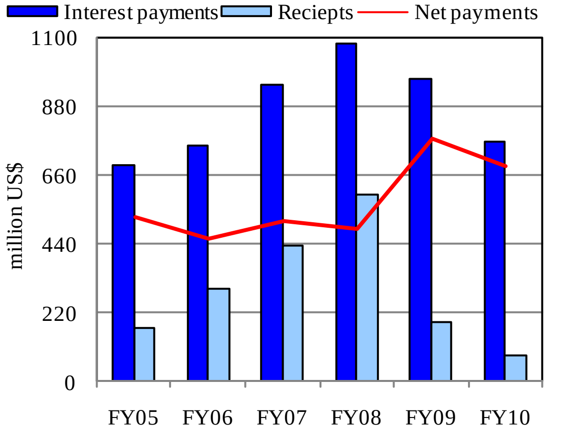


Figure 6.7: Net Interest Payments (Jul-Apr)

In line with the repatriation patterns, a larger part of dividends repatriation was concentrated in second quarter during current fiscal year (see **Figure 6.6b)**. Seasonal pattern suggests that profit & dividends payments are likely to increase in the last quarter of current fiscal year as well.[5]

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[3]As large part of repatriation of profit& dividends is based on FY09 results, for detail analysis, please see *Second Quarterly Report* on State of Pakistan Economy for FY10.

[4]Out of total US$ 47.7 million profit & dividends payments of financial business, HBL's amount was around US$ 30 million. Based on results for the full-year 2009, HBL announced final cash dividends of Rs 6.00 per share at end Feb-2010.

[5]Most of the companies repatriate their profits and dividends on annual basis. Some of the companies have financial year Jan-Dec and some have financial year Jul-Jun. In this respect, they repatriate their profits & dividends with the lag of 3 or 4 months after audit and other procedures.

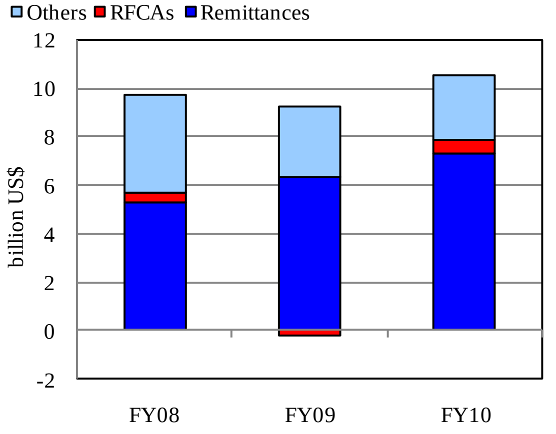
Almost the entire decline in net interest payments emanated from lower gross interest payments during Jul-Apr FY10 (see **Figure 6.7**). Along with relatively lower international interest rates; a fall in stock of expensive debt stock (IDB loans and Euro bond) also contributed to this decline as did lower interest payments on foreign currency deposits.

Nonetheless, higher payments on IMF loan in the wake of rising debt stock and lower earnings on foreign exchange reserves offset a part of the abovementioned gains.

6.2.4 Current Transfers

In sharp contrast to 7.0 percent fall last year, current transfers increased by 16.9 percent during Jul-Apr FY10. Apart from persistent increase in workers remittance, reversal of inflows in Resident Foreign Currency Accounts (RFCAs) and higher cash grants for government[6] contributed to this increase (see **Figure 6.8**).

Figure 6.8: Current Transfers (Jul-Apr)



However, fall in other private transfers (mainly RFCAs conversion) offset a part of the aforementioned gains during the period under review.

Workers' Remittances

Worker remittances have recorded strong growth for the Jul-Apr period of last six successive years. Specifically, workers' remittances increased by 15.0 percent during Jul-Apr FY10 on the top of 14.9 percent average increase during the corresponding period of the last five years.

Given the difference in their financial year, their outflows mostly fall in the second and fourth quarter as per our fiscal year.

[6]This mainly shows United States Support worth US$ 44.0 million for Internally Displaced Persons (IDPs).

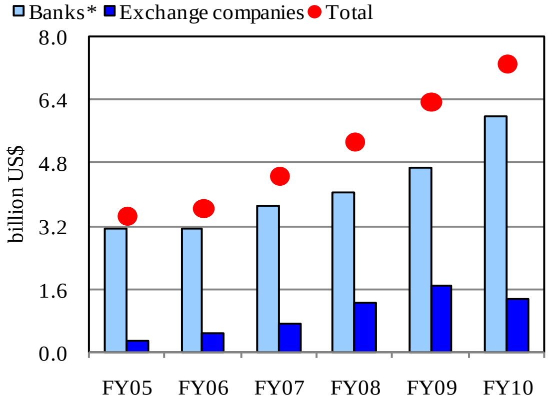
Unlike the previous years, however, almost the entire growth during current year stemmed from remittances through banks; remittances routed through exchange companies fell for the first time in the last six years (see **Figure 6.9**). Strong increase in remittances through banks probably reflects PRI's effort to attract remittances through this channel. Moreover, at least a part of remittances is also diverted from exchange companies to banks in the wake of;

(a) Possibility of further action against foreign exchange companies involved in illegal funds transfer; and

(b) Tough competition from banks.

Country-wise data suggests that a large part of remittances growth during Jul-Apr FY10 was sourced from United Arab Emirates, United Kingdom, and Saudi Arabia. Other important contributors included Qatar, United States Canada and Australia (see **Table 6.2**).

Figure 6.9: Composition of Workers' Remittances (Jul-Apr)



* Include post offices

Table 6.2:Country-wise Workers' Remittances (Jul-Apr)

million US$; share percent; growth contribution percentage points

Countries	FY09	FY10	Share	Contribution in growth
Gulf region:	**3,626.9**	**4,222.1**	**57.8**	**9.4**
Bahrain	127.6	128.5	1.8	0.0
Kuwait	360.3	369.3	5.1	0.1
Qatar	276.7	299.1	4.1	0.4
Saudi Arabia	1,264.1	1,525.9	20.9	4.1
Oman	231.4	236.0	3.2	0.1
U.A.E.	1,366.8	1,663.2	22.8	4.7
U.S.A.	**1,435.7**	**1461.8**	**20.0**	**0.4**
U.K	**468.0**	**734.6**	**10.1**	**4.2**
Canada	**65.1**	**94.0**	**1.3**	**0.5**
Germany	**80.3**	**69.0**	**0.9**	**-0.2**
Japan	**3.6**	**5.0**	**0.1**	**0.0**
Australia	**26.8**	**48.6**	**0.7**	**0.3**
Others	**648.9**	**670.6**	**9.2**	**0.3**
Total	**6,355.1**	**7,305.6**	**100.0**	**15.0**

Monthly Trends

Monthly trend shows that a large part of remittances growth was concentrated in Jul-Oct FY10 and remittances growth slowed down significantly in the subsequent months (Nov-Apr) (see **Figure 6.10**). Slowdown in workers' remittances growth is partly a statistical artifact, reflecting the stronger numbers seen October onward last year. Moreover, this deceleration in remittances growth may also be attributed to high kerb market premium and the disruptions in the last week of December 2009 on account of religious holidays and closure of businesses following terrorist acts.

In particular, kerb market premium appears to be an important factor for remittances inflows. For instance, exceptionally high premium in Oct-2008 as well as in Feb-2010 caused sharp fall in remittances inflows (see **Figure 6.11**).

Recovery in Mar-Apr 2010

During Mar-Apr FY10, however, remittances from all major source countries recorded an uptick, mainly on account of a fall in kerb market premium (see **Figure 6.11**). This was an across the board improvement as remittances not only increased from all major source countries but also through all the channels (see **Figure 6.12**).

Within different channels, a large part of increase in inflows during Mar-Apr FY10 was attributed to banking channel. In particular, remittances through banks touched an all-time high during Mar FY10. This is because, on the one hand, stability in exchange rate led to increase in rupee conversion from foreign currency accounts, and, on the other hand

Figure 6.10: Workers' Remittances Growth (YoY)

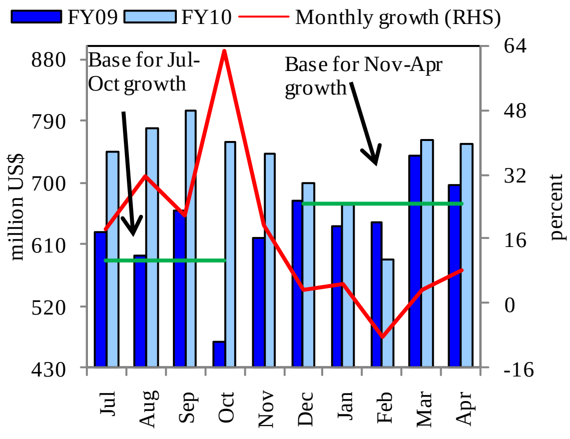


Figure 6.11: Workers' Remittances Vs Kerb Premium

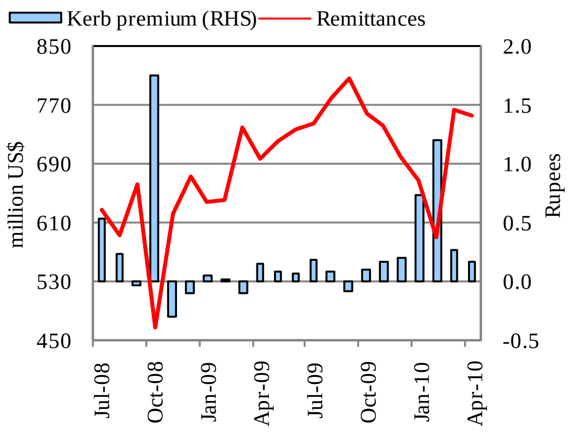


Figure 6.12a: Remittances from Major Countries

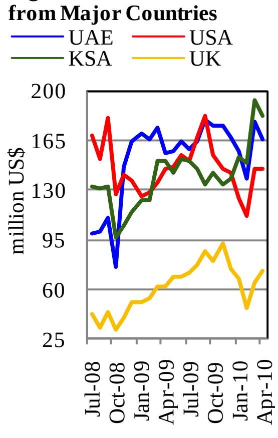
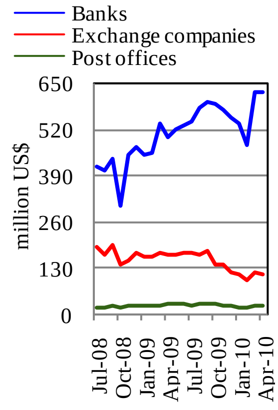


Figure 6.12b: Channel-wise Workers Remittances



remittance for family maintenance purpose increase may possibility be on account of continued efforts under Pakistan Remittance Initiative. Moreover, high remittance inflows during the month of March may also reflect seasonal increase and clearing backlog of February transactions.[7]

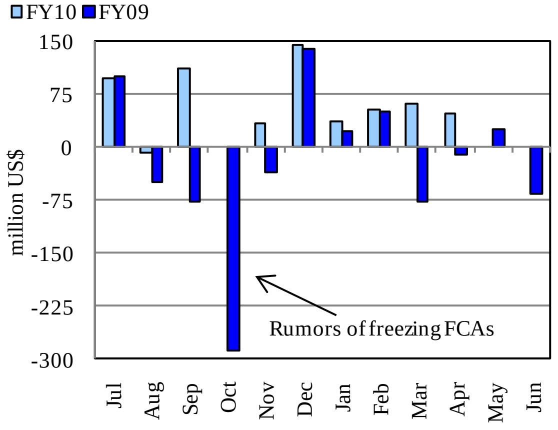
Going forward, higher growth in workers' remittances is difficult to sustain on account of high base set during 2009 and possible lag impact of global recession.

Resident FCAs

Inflow (net) in the RFCAs increased to US$ 574 million during Jul-Apr FY10 against the net outflow of US$ 230 million in the same period last year.

Encouragingly, net inflows showed YoY improvement throughout the year (see **Figure 6.13**). Part of this improvement is attributed to relative exchange rate stability as well as to higher inflows from UN, OGDC, and power utility company.

Figure 6.13: Net Inflows in RFCAs

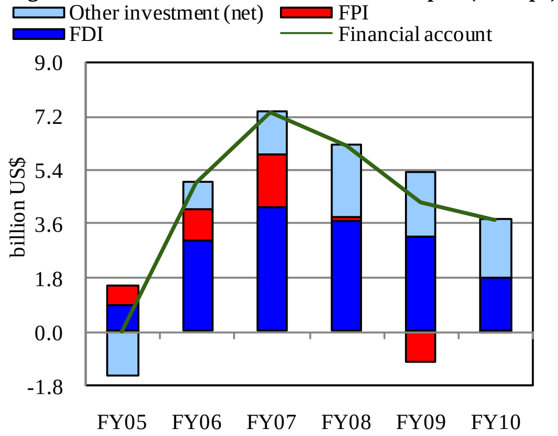


6.3 Financial Account Balance

Deterioration in financial account surplus, which emerged in FY08, continued in Jul-Apr FY10 as well (see **Figure 6.14**). Specifically, financial account surplus recorded a YoY fall of 14.5 percent during Jul-Apr FY10 compared with average fall of 22.6 in the corresponding period of last two years.

On the one hand, foreign investors' risk averseness amid

Figure 6.14: Sources of Financial Account Surplus (Jul-Apr)



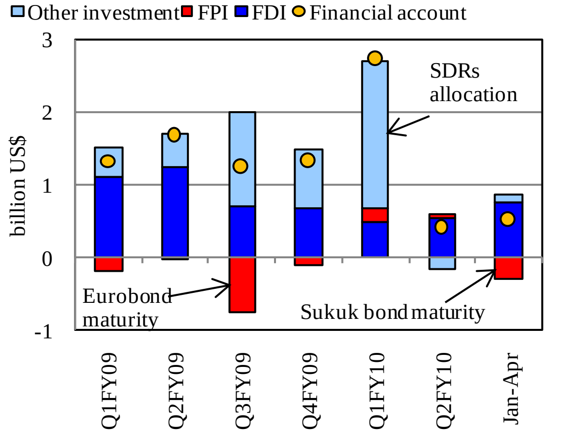
[7]Last ten years trend suggests that remittances recorded in the months of March were usually the highest in the twelve months.

global crises and severe power deficit in Pakistan led to substantial fall in foreign direct investment. On the other hand, lower than anticipated disbursement by international donors' reduced net loan inflows. The fall in financial account surplus would have been even higher, had it not been for (a non-recurring) SDRS allocation by the IMF.

On the positive side, foreign investment in stock market has revived significantly during the period under review[8]. However, these inflows are short term in nature and notoriously volatile.

The quarterly trend suggests that after recording surplus in Q1-FY10, surplus in financial account fell drastically in the subsequent quarters (see **Figure 6.15**). During Oct-Apr FY10, substantial fall in financial inflows (net) mainly reflected lower loan inflows and the maturity of sovereign financial instrument (Sukuk worth US$ 600 million).

Figure 6.15: Financial Account Balance



Net Foreign Investment

Fall in foreign investment (net) during Jul-Apr FY10 mainly owed to substantial fall in foreign investment. This was unlike the previous year, when considerable outflow from portfolio investment largely explained fall in overall investment.

Table 6.3: Pakistan Foreign Investment(Net Inflow) Jul-Apr

million US Dollar; growth percent

	FY09	FY10	Growth
Foreign investment	**2,212.4**	**1,726.3**	**-22.0**
I. Private investment	**2,753.5**	**2,343.8**	**-14.9**
Foreign direct investment	3,205.0	1,772.9	-44.7
Portfolio investment	-451.5	570.9	226
Equity securities	-451.5	570.9	226
Debt securities	0	0	0
II. Public investment	**-541.1**	**-617.5**	**-14.1**
of which: Debt securities*	**-541.1**	**-617.5**	**-14.1**

* Net sale/purchase of Special US dollar bonds, Eurobonds, FEBC, DBC, T bills and PIBs

Specifically, foreign direct investment fell by 44.7 percent while net outflows from portfolio investment decelerated

[8]Investment in stock market has revived to US$ 570.9 million during Jul-Apr FY10 compared with net outflows of US$ 451.5 million in the same period last year.

by 95.4 percent during Jul-Apr FY10. This deceleration in net outflows from portfolio investment mainly owed to considerable investment in equity market which offset a large part of outflows from debt securities (mainly Sukuk bond repayment) (see **Table 6.3**).

Foreign Direct Investment

After remaining relatively stable for two years, foreign direct investment fell drastically during Jul-Apr FY10 (see **Figure 6.16**). In particular, YoY fall in foreign direct investment accelerated to 44.7 percent during Jul-Apr FY10 compared with 12.4 percent average fall in the same period of last two years.

Figure 6.16: Foreign Direct Investment (Jul-Apr)

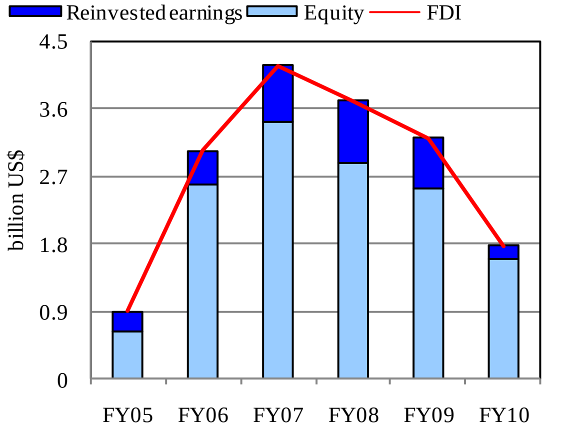
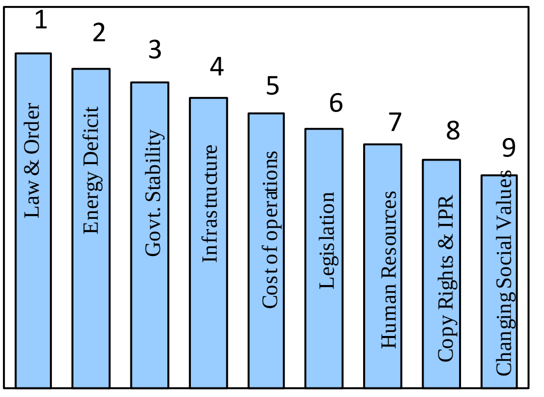


Figure 6.17: Top Challenges to Business in Pakistan-2009



Source: Overseas Investors Chamber of Commerce and Industry

Although a combination of factors explains this fall, the most prominent amongst them are: foreign investors risk averseness amid uncertainty about pace and extent of the global economic recovery and adverse security developments as well as electricity shortages at home. The risk averseness of foreign investors is reflected in across the globe fall in foreign direct investment. Further in Pakistan, Overseas Investors Chamber of Commerce and Industry (OICCI) survey 2009 shows foreign investors plan lower investment mainly because of law & order situation and power deficit (see **Figure 6.17**).

Component-wise analysis suggests that around one- third of the fall in overall investment during Jul-Apr FY10 was explained by lower reinvested earnings while rest of the fall was explained by lower equity inflows and decline in intra-company loans. The former mainly owed to either lower profits or higher losses while the latter may be explained by both the lower margins and foreign investors difficulty in obtaining credit. Although foreign direct investment recorded across the board fall during Jul-Apr FY10, main share (around 70 percent) came from lower investment in telecommunication and financial business (see **Table 6.4**).

Table 6.4: Sector -wise Foreign Direct Investment (Jul-Apr)
million US Dollar

	FY09			FY10		
Sectors	**Cash**	**Re-invested earnings**	**Total**	**Cash**	**Re-invested earnings**	**Total**
Chemicals	4.2	53.7	58.0	46.9	32.2	79.1
Petroleum refining	30.4	73.3	103.7	15.1	55.2	70.3
Oil & gas explorations	423.3	188.9	612.1	448.0	156.7	604.7
Cement	9.0	22.7	31.7	0.1	0.5	0.5
Power	91.6	-18.3	73.3	112.5	-101.5	11.0
Construction	78.1	-1.3	76.8	91.3	-5.0	86.3
Trade	109.3	38.4	147.7	51.3	26.7	78.0
Telecommunications	809.4	-42.4	767.1	394.5	-84.7	309.8
Financial business	494.3	186.7	681.0	101.9	31.1	133.0
Personal services	75.6	4.4	79.9	40.7	3.8	44.5
Others	415.8	157.7	573.5	306.0	49.7	355.7
Total	**2,541.1**	**663.9**	**3,205.0**	**1,608.2**	**164.7**	**1,772.9**

Apart from lower reinvested earnings, foreign investment in telecom sector was adversely affected by market saturation and stiff competition while investment in financial business was hurt by lack of merger& acquisition and repayment of intra-company loans.

Moreover, investment in petroleum refining declined mainly on account of circular debt issue while lower investment in oil& gas largely reflects poor law& order situation.

Foreign Portfolio Investment

Net outflow from foreign portfolio investment has shown considerable YoY deceleration during Jul-Apr FY10. This improvement entirely owed to revival of foreign inflows in equity market which offset a large part of Sukuk payment worth US$ 600 million (see **Figure 6.18**). Specifically, net outflow from portfolio investment decelerated to US$ 46 million during Jul-Apr FY10 from net outflow of US$ 1.0 billion[9] in the same period of last year.

In line with regional trends, investment in the stock market staged an appreciable recovery, increasing to US$ 571 million during Jul-Apr FY10 compared to net outflow of US$ 451 million in the same period last year. Market sources suggest that foreign institutional investors often invest in Pakistan's stock market while investing in other major regional markets. For instance, foreign investment in stock markets of India and Pakistan are closely associated (see **Figure 6.19**). Other factors contributing to higher foreign investment inflows in Pakistan's equity market includes: a) re-entry of the country into MSCI frontier market index,; b) the fact that Pakistan's market is trading at discount compared with regional markets; and c) considerable fall in Pakistan's risk premium as reflected by fall in Credit Default Swap (CDS) spread.

Figure 6.18: Foreign Portfolio Investment

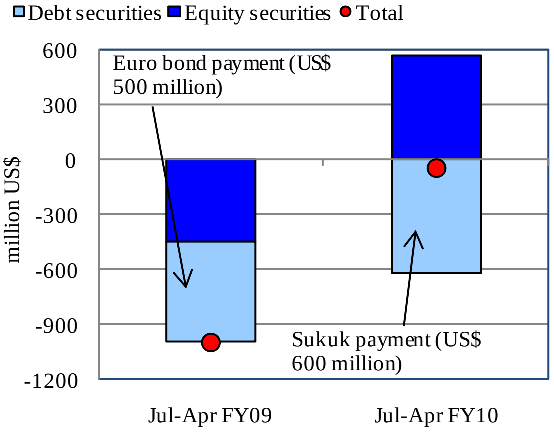
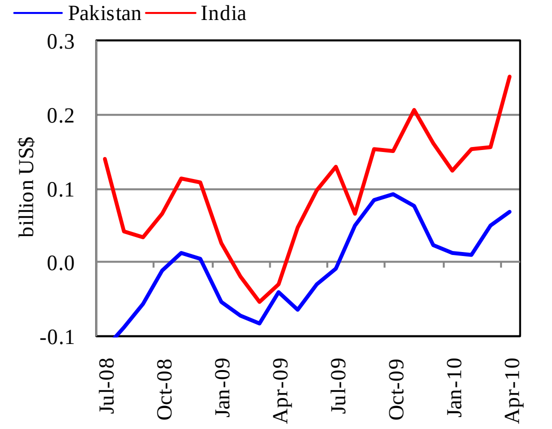


Figure 6.19: Net Foreign Investment in Stock Market (3MMA)



Outstanding Export Bills

The stock of aggregate outstanding export bills has increased by US$ 370 million during Jul-Apr FY10 against a decline of US$ 526 million in the comparable period last year. This increase is entirely explained by the outstanding export bills held by the exporters, because the bills held by banks declined by US $ 7 million during the period under review

[9]This included US$ 500 million Euro bond payment.

This increase may partly be attributed to recovery in exports and partly to expectations of exchange rate depreciation.

Currency and Deposits (Assets)
Currency and deposits declined by US$ 270 million during Jul-Apr FY10 against an increase of US$ 36 million during the same period last year. This decline is largely attributed to fall in commercial bank trade nostros in the wake of shifting oil payments to interbank market.

Loan Inflows (Net)
Net loan inflows declined to US$ 0.6 billion during Jul-Apr FY10 from US$ 1.3 billion during the same period last year. This decline owed to lower gross disbursements for the private sector as well as fall in official loan inflows (net). Major official loan inflows are IMF's bridge financing (US$ 1.1 billion), ADB (US$ 0.2 billion) and World Bank (US$ 0.3 billion).

It may be pointed out that IDB loan repayment (US$ 323 million) which was due in December 2009 has been rolled over for six months.

Other Liabilities (Net)
Other liabilities (net) recorded a substantial increase of US$ 1.1 billion during Jul-Apr FY10. The entire increase reflects IMF SDRs allocation.

6.4 Services Trade
During Jul-Apr FY10, services account deficit declined to US$ 2.0 billion, contracting by 39.0 percent compared to the contraction of 42.8 percent in the same period last year. The contraction in services trade deficit was a combination of 12.2 percent decline in services imports and 15.3 percent rise in services exports.

The decline in the import growth was expected on account of restrictions on outflows of exchange companies and decline in freight payments resulting from falling merchandise imports. Fortunately, deceleration in import growth was complimented by an increase in government services exports and commendable performance of telecommunication services exports that resulted in substantial decline in the services trade deficit (see **Table 6.5**).

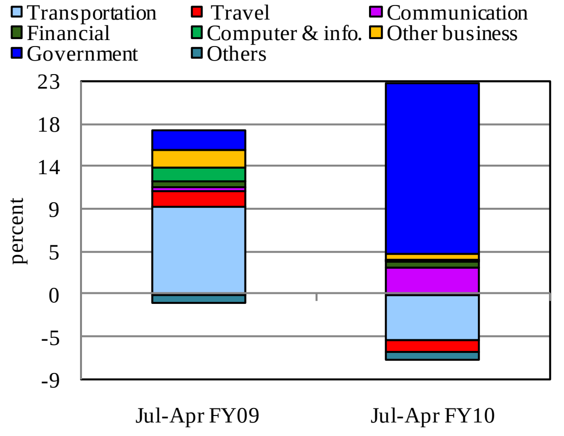
Table 6.5: Causative Factors of Contraction in Services Trade Deficit (Jul-Apr)
million US Dollar

	FY09		FY10	
	Value	**Abs. Change**	**Value**	**Abs. Change**
Exports	**3,126**	**442**	**3,605**	**479**
Of which:				
Transportation receipts	1,106	248	952	-154
Telecommunication	95	7	185	90
Logistic	465	183	537	72
Non-logistic	461	-127	950	489
All others	999	131	981	-18
Imports	**6,344**	**-1,966**	**5,567**	**-777**
Of which:				
Transportation payments	3,119	103	2,812	-307
Travel & other business	2,298	-2,017	1,646	-652
Of which:				
Payments through FECs	*1,138*	*-2,161*	*553*	*-585*
Government services	319	-37	505	186
All others	608	-15	605	-3
Trade deficit	**3,218**	**-2,408**	**1,962**	**-1,256**

Services Exports

Services exports registered a growth of 15.3 percent during Jul-Apr FY10 compared to growth of 16.5 percent in the same period last year, largely on account of improvement in receipts under "government services". In addition, telecommunication, financial and other business also contributed to services export growth during Jul-Apr FY10 (see **Figure 6.20**).

Figure 6.20: Contribution in Services Exports Growth



Monthly YoY analysis of services export reveals improvement in the exports Feb-2010 onwards. This recovery stemmed from a combination of factors like logistic support inflows, increased passage earnings of Pak airlines, higher receipts from international tourists, continuity of telephone traffic from legitimate channel and increase in other miscellaneous business services (see **Table 6.6**).

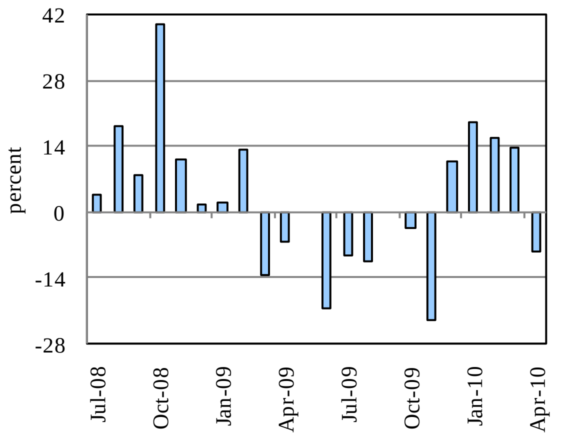
Table 6.6: Major Services Exports (FY10)

million US Dollar; growth percent

	Absolute value			Growth		
	Jul-Jan	**Feb-Mar**	**Jul-Mar**	**Jul-Jan**	**Feb-Mar**	**Jul-Mar**
Transportation	661	287	948	-22.5	13.4	-13.9
Travel	166	72	238	-20.2	12.5	-12.5
Communication	144	56	200	182.4	-6.7	80.2
Construction	9	4	13	-60.9	-20.0	-53.6
Insurance	25	10	35	-30.6	-16.7	-27.1
Financial	74	21	95	100.0	0.0	44.8
Computer and information	114	41	155	0.9	-2.4	0.0
Royalties and license fees	4	2	6	-60.0	100.0	-45.5
Other business	288	144	432	-3.7	28.6	4.9
Personal, cultural & recreational	1	3	4			
Government services	618	868	1,486	-22.1	552.6	60.6
Of which: logistic support	0	537	537	-100.0		15.5
Total	**2,104**	**1,508**	**3,612**	**-13.2**	**114.5**	**15.3**

The ***exports of transportation services*** declined by 13.9 percent YoY during Jul-Apr FY10, sharply down from the growth of 28.9 percent during the same period of FY09 on account of relatively lower freight earnings, reduced passage earning of domestic airlines, and curtailed operations of foreign transport companies. Passage earnings of Pakistani airlines, having the largest share in transportation receipts, witnessed a modest fall of 1.1 percent during Jul-Apr FY10 compared to an increase of 6.4 percent last year. Monthly analysis shows

Figure 6.21: Passage Earnings of Pakistani Airlines



recovery in passage earnings of Pakistani airlines (see **Figure 6.21**) that came in wake of decisions by some of the international airlines to discontinue their operations in Pakistan on security concerns.[10] Furthermore PIA opened up some new destinations and increased flight frequency to some of the established destinations. This also explains the increase in the category foreign travelers under travel services exports during the period under review.

Freight earnings declined by 29.7 percent during Jul- Apr FY10 against an increase of 1.8 percent last year. It may be pointed out that unlike the link between merchandise imports and freight payments: the link between merchandise exports and freight earnings is weak. Domestic shipping lines only cater to12-13 percent of the total requirement, while payments made by foreign importers to other than domestic shipping lines are not reflected in country's accounts. Thus even if the merchandise exports rise, it would not necessarily result in higher freight earnings as in the case of freight payments and merchandise imports.

Travel Services exports fell by 12.3 percent on account of decline in receipts through foreign exchange companies. The decline of US$ 56 million in receipts through exchange companies was on account of restrictions imposed on exchange companies by SBP.[11]

This fall in receipts of exchange companies was partially offset by the increase in the category: Foreign Tourists. The receipts from foreign national tourists improved slightly from US$ 168 million in Jul-Apr FY09 to US$ 193 million during Jul-Apr FY10 reflecting an increase of 14.5 percent.

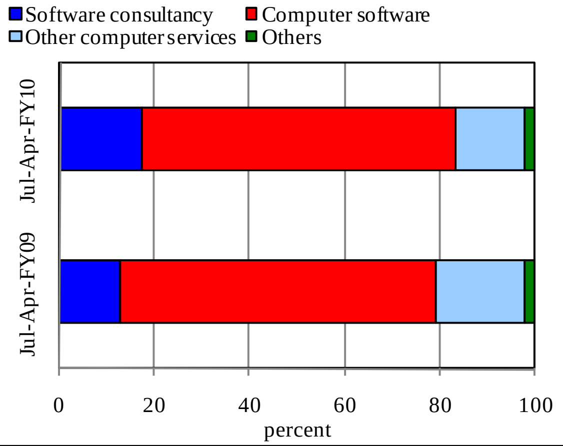
Communication services exports recorded a phenomenal growth of 80.3 mainly on the back of telecommunication services exports, which grew by 95.6 percent during the period under consideration. This remarkable increase is attributable to the PTA's implementation of *Monitoring and Reconciliation of International Telephone Traffic* to curtail the illegal traffic. The lowering of settlement rates during the current fiscal year also contributed to this increase.[12]

[10]British Airways discontinued its operations from Pakistan in March 2009; Gulf airlines suspended its operations from Peshawar in August 2009, while Singapore Airway discontinued its operations from Pakistan in March 2009 in Feb 2010.
[11]These receipts prior to 2009 were recorded in the current transfers as a contra item. Outflows through exchange companies used to be offset by the inward workers' remittances and other inflows. These other inflows 2009 onwards are being recorded in travel services receipts through FECs.
[12]As per Telecom Quarterly Review of Dec 2009, settlement rates declined from US cents 12.5 per minute to US cents 10.5 per minute

Monthly data reveals deceleration in the growth of telecommunication services exports Mar-FY10 on wards. It may be recalled that International telephone traffic started to rise Mar-09 onwards after PTA, with the support of FIA, raided many illegal operators in different cities.

Computer and information services exports witnessed a modest increase of 0.4 percent during Jul-Apr FY10 in contrast to the outstanding growth rates of 31.7 and 44.9 in the same periods of last two years. The deceleration in growth of this sector might be attributed to falling foreign demand. Software consultancy services recorded an increase of 35.4 percent while exports of computer software and other computer services witnessed a fall of 0.2 percent and 21.5 percent during the period under review. The overall group's exports are dictated by the exports of software because of its substantial share (see **Figure 6.22**).

Figure 6.22: Components of Computer Services Exports



According to the Global Information Technology Report 2009-2010[13], Pakistan's ranking improved to 87 from the last year's ranking of 98. This signifies the huge potential in this sector to grow and become one of the leading foreign exchange earners for Pakistan.[14]

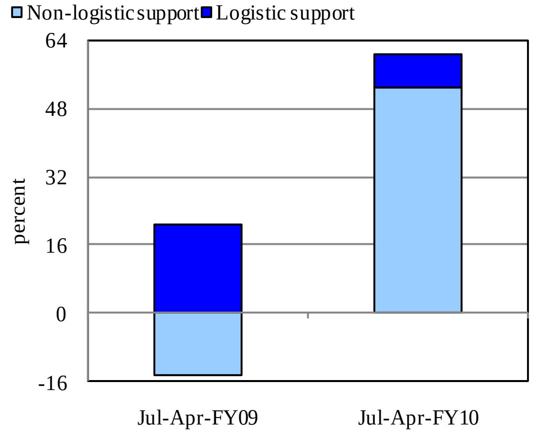
Having said this, there is a dire need to adopt a comprehensive policy to address the issues facing the IT sector such as weak enforcement of legal framework, lower volumes of quality workforce and financing issues. Apart from these, incentives should be given to the unregistered software houses which are carrying out their business on web portals.

Government services exports posted a robust growth of 60.7 percent during Jul-Apr FY10 compared to 6.4 percent in the same period last year. Major

[13]Global Information Technology Report 2009-2010 was released by World Economic Forum.
[14]According to PSEB, the industry size is estimated to be US$ 2.8 billion, whereas the export earnings of the sector are calculated to be US$ 1.4 billion.

contribution came from the non-logistic receipts which recorded an increase of 106.1 percent during the period under review (see **Figure 6.23**).

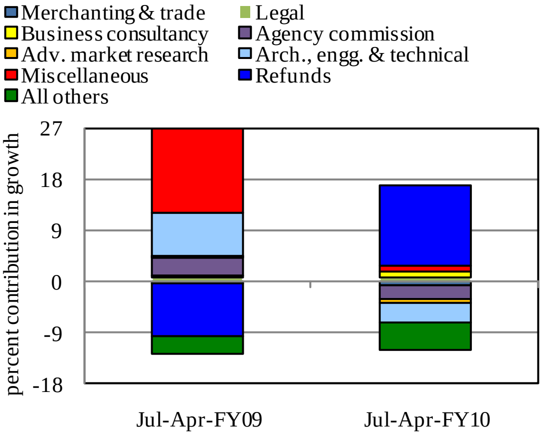
Figure 6.23: Contribution in Growth of Govt. Services Exports



Non-logistic support rose on account of increases in remittances by foreign missions in Pakistan as well as remittances received by international organizations. A part of this rise in non-logistic support could be attributed to the increase in diplomatic operations of US.

Other business services exports increased by 5.0 percent during Jul-Apr FY10 compared to 14.2 percent rise recorded in the corresponding period last year. The increase in the group's exports was mainly due to the decline in *refunds*, although increase in exports of *merchant. & trade related activity* and *business consultancy* also contributed positively to the group's exports (see **Figure 6.24**). *Miscellaneous* category, which has the largest share (42.6 percent) in overall business services exports, increased by 2.4 percent. However, the categories *agency commission* and *technical & engineering* services witnessed fall during the period under analysis.

Figure 6.24: Other Business Services Exports

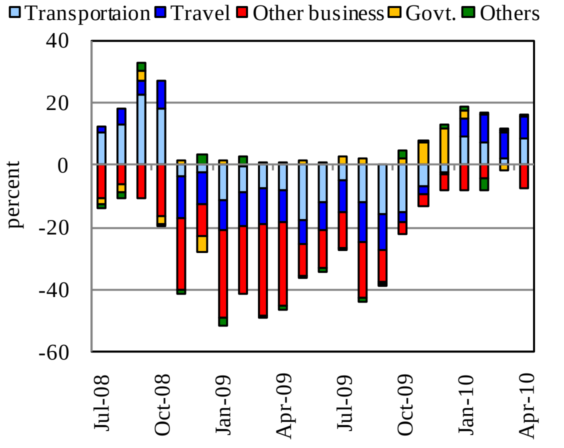


Services Imports

Overall services imports fell by 12.2 percent during Jul-Apr FY10 compared to 23.6 percent fall recorded in the same period last year. A continuous decline in outflows through exchange companies as well as lower freight payments on account of decline in merchandise imports were the main factors behind this fall in services imports (see **Figure 6.25**).

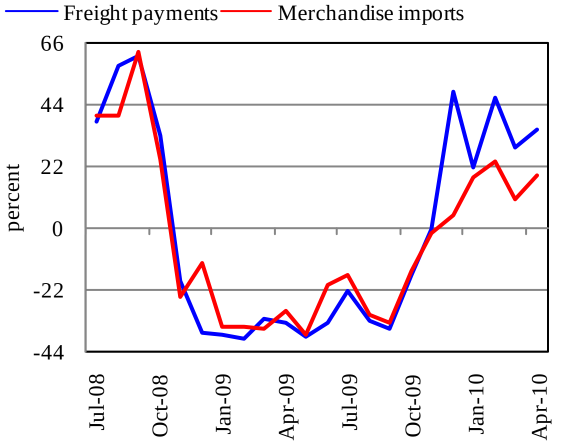
Services import growth dropped sharply in November 2008 (FY09) as the impact of crackdown on one of the exchange companies and outflows restrictions imposed by SBP were complimented by fall in imports (see **Figure 6.25**). This trend continued for a year, however, Dec 2009 onwards, services imports have started to recover. The YoY monthly recovery in services imports owes to rise in merchandise imports, higher travel payments and increase in payments through international bodies.[15]

Figure 6.25: Contribution in Imports Growth



Transportation services payments which account for half of the total services import payments fell by 9.8 percent during Jul-Apr FY10 compared to a 3.4 percent increase in the comparable period last year. The principal reason for this fall was lower freight payments compared to last year due to fall in merchandise imports in H1-FY10 (see **Figure 6.26**).

Figure 6.26: Monthly Imports Growth



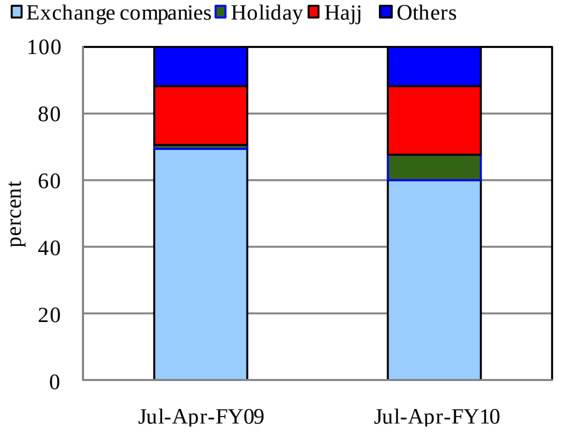
Passage earnings of foreign airlines and Pakistani transport companies' expenses also fell during the period under review. Closure of flight operations by some major international airlines continued to restrict the passage earnings of foreign

[15] Payment to international bodies (such as UN, WHO, USAID, etc.) is paid in rupee counterpart (converted to dollars for accounting purposes) to these organizations against receipts from these organizations.

airlines. The category's imports are likely to decline further after the discontinuation of flight operations by Singapore airlines.[16]

In line with the expectations, ***travel services*** and ***other business services imports*** declined on account of restrictions on outflows through exchange companies. Payments through exchange companies, which constitute the bulk of overall groups' imports, declined by 51.4 percent during Jul-Apr FY10 (see **Figure 6.27**).

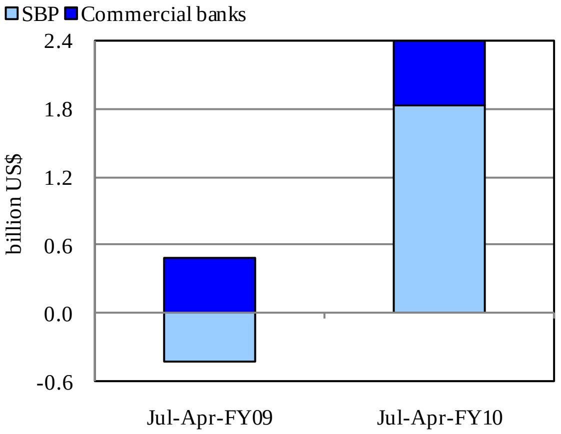
Figure 6.27: Major Components of Travel Services Imports



Although travel services payments fell by 18.2 percent, its sub category *'holiday on recreational tours abroad'* increased to US$ 55 million during Jul-Apr FY10 from US$ 8 million in the corresponding period last year. This probably reflects the shift of local tourists to international destinations due to security concerns within the country.

Similar to travel services imports, other business services imports also fell by 35.0 percent. Monthly data however, shows deceleration in the declining trend of both these categories. Travel services even posted a positive growth in Q3-FY10. The rising trend in both, travel and other business services imports reflect the withering of the impact of fall in the payments through exchange

Figure 6.28: Foreign Exchange Reserves Flows



[16]Singapore Airlines, the flag-carrier airline of Singapore, has informed the Civil Aviation Authority of Pakistan it will stop flight operations from February 17, 2010.

companies[17] in the aftermath of crackdown and outflows restrictions imposed by SBP.

6.5 Foreign Exchange Reserves

Pakistan's foreign exchange reserves increased by US$ 2.4 billion to reach US$ 15.2 billion by the end of April 2010 (see **Figure 6.28**). While a large part (US$ 1.8 billion) of this increase was contributed by SBP's reserves, commercial banks' reserves also made a positive contribution of US$ 560 million.

Quarterly analysis suggests that accumulation in reserves was concentrated in Q1-FY10, while reserves increased only marginally in the subsequent quarters. This is because a substantive part of the rise in reserves during Q1-FY10 owed to SDRs allocation and disbursements by IMF under SBA. Thus, lower disbursement from IMF in the following quarters limited the rise in reserve (see **Figure 6.29**).

Apart from IMF support, increase in SBP's reserves during Jul-Apr FY10 may also be attributed to shifting of oil payments to interbank market and exchange rate adjustment. While the former significantly reduced need for market interventions, the latter helped in curtailment of current account deficit.[18]

Figure 6.29: Forex Reserves Flows during FY10

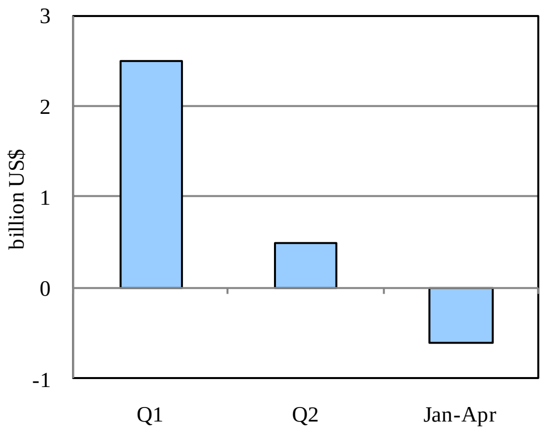
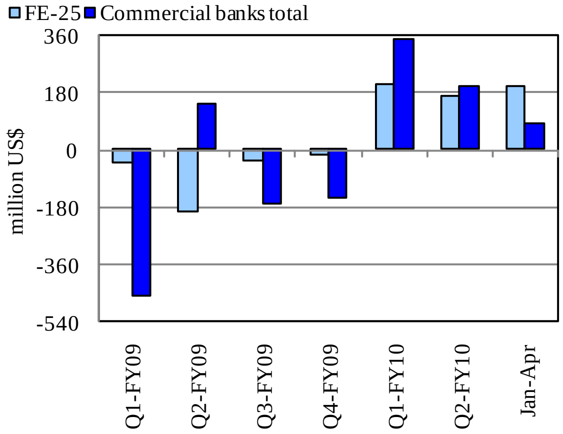


Figure 6.30: Commercial Banks Reserves



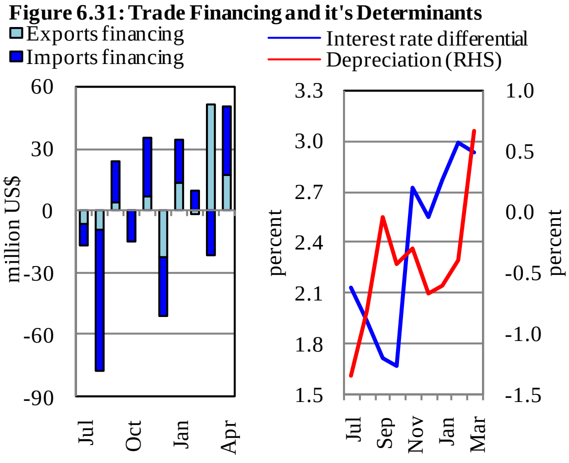
[17]During FY09 SBP imposed number of restrictions on outflows from exchange companies. In Oct FY09 one of the exchange companies was also raided by the FIA. These two factors substantially curtailed both imports and export payments through exchange companies.

[18]Had current account deficit not contracted, foreign exchange reserves would have either depleted or would not have shown any improvement

The rise in commercial bank reserves during Jul-Apr FY10, on the other hand, largely reflects increase in foreign currency deposits and retirement of foreign currency loans (see **Figure 6.30**). Increase in both of them was a function of expectation of exchange rate depreciation, which not only encouraged inflows in foreign currency accounts but also discouraged lending from FE-25 deposits. The increase in commercial bank reserves is quite remarkable, given the shifting of oil payments to interbank market which led to negative trade nostros of commercial banks.

While there was a US$ 19.5 million YoY decline in the net trade financing during Jul-Apr FY10, export financing recorded substantial disbursements in Mar-Apr 2010. The rise in disbursements in March and April 2010 seems to be the result of 0.7 and 0.5 percent monthly appreciation of Pak rupee vis-à-vis US dollar and the increase in interest rate differential between EFS and weighted average foreign currency lending rate (see **Figure 6.31**).

Figure 6.31: Trade Financing and it's Determinants

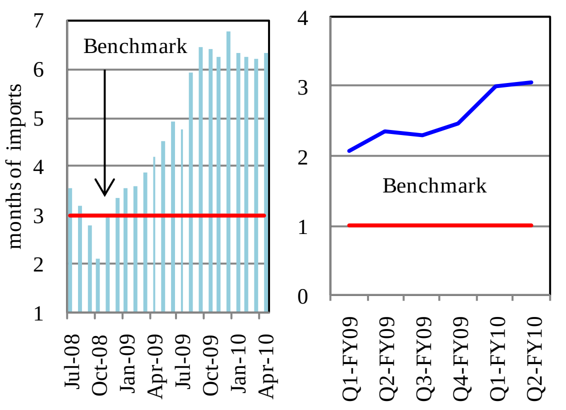


Reserve Adequacy Indicators

There are a number of methods to assess the reserves adequacy, of these the most common is import coverage ratio or import adequacy ratio. This ratio is particularly relevant for low-income countries exposed to current account shocks and without significant access to capital markets. During Jul-Apr FY10 owing to fall in imports, Pakistan's import coverage ratio remained fairly stable with reserves adequate to finance more than six months of imports (see **Figure 6.32a**).

Figure 6.32 (a): Import Coverage Ratio

Figure 6.32 (b): Reserves to Short Term Debt and Liab.



Another benchmark, known as the Greenspan-Guidotti rule, is widely used measure of assessing vulnerability to capital account crisis. Pakistan's foreign exchange reserves to short term debt & liabilities (STDL) ratio also stood comfortably at 3.1 by the end-Dec-09 (see **Figure 6.32b**). The benchmark level of this ratio is 1(see **Box 6.1**).[19]

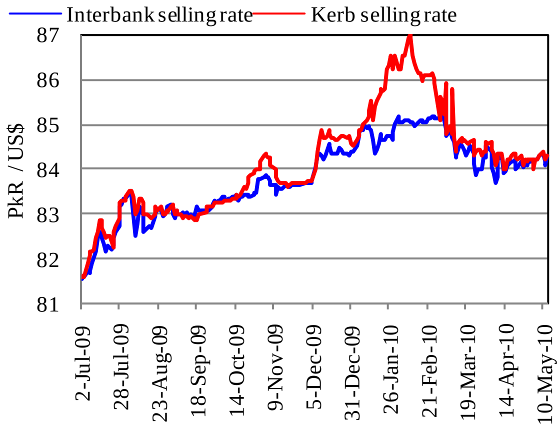
Box 6.1: Significance of Reserves to STDL Ratio and Definition of Short-Term External Debt
The significance of forex reserves/short term debt and liabilities ratio as a vulnerability indicator has become increasingly evident,
(1) A country with a low international reserves/short-term external debt ratio is more vulnerable to external shocks; (2) A low reserves/short-term external debt ratio may be an indication of imprudent macroeconomic policies; (3) An economic crisis will tend to be more severe if the ratio is low, as the current account and exchange rate adjustments required to balance the macroeconomic accounts are magnified.

However, calculating this indicator is not an easy task. The definition of short term debt and liabilities is one of the major obstacles in computing this vulnerability indicator apart from data issues. Short term external debt is identified as a cross border debt with the maturity of a year or less. At present two definitions are being used for short term debt[20] .
1) Remaining maturity concept: According to this concept all external or cross border debt is regarded as short term debt which becomes due within a year, regardless of its original maturity. This definition is being used by Bank for International Settlements (BIS).
2) According to World Bank's publication *Global Development Finance,* short term debt encompass only external liabilities, including official trade credits extended to developing countries as reported by OECD, with original maturities of one year or less.

6.6 Exchange Rate

During Jul-Apr FY10 Pak rupee exhibited relative stability, depreciating by only 3.5 percent compared to 16.3 percent in the same period of the previous year. While lower trade deficit and sustained growth in workers' remittances lent support to rupee stability, decline in financial inflows acted adversely. Nevertheless, as overall external account balance remained in surplus and

Figure 6.33: Forex Market



[19]STDL constitutes the total short term external debt as well as the payments of principal and/or interest due within a year or less.
[20]Source: IMF

the reserve position was stable, pressures on the rupee remained manageable.

Volatility in the kerb-market however, remained substantial throughout the Jul-Apr FY10 period, initially on account of Hajj related demand and later due to shifting of oil payments. Demand for the US$ in the kerb-market was particularly high in January and February 2010, which led to substantial rise in the kerb premium and volatility in the exchange rate (see **Figure 6.33 and 6.34**).

Anecdotal evidence suggests that the exaggerated demand for the hard currency in Jan-Feb FY10 was mostly speculative as it died out in the following month (March 2010). The calming of the speculative pressure in the kerb-market may also have been influenced by rise in portfolio investment and increased in workers' remittances in this month.

Figure 6.34: Volatility Comparison of Interbank and Kerb Rate

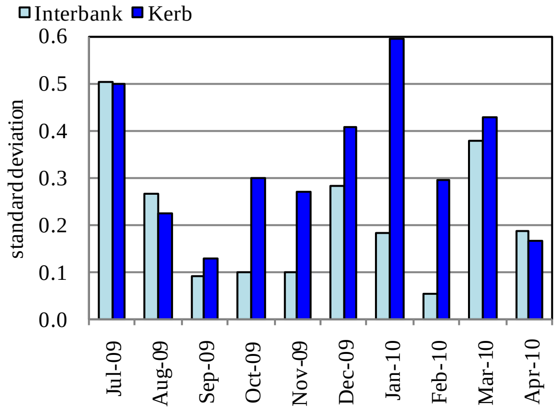
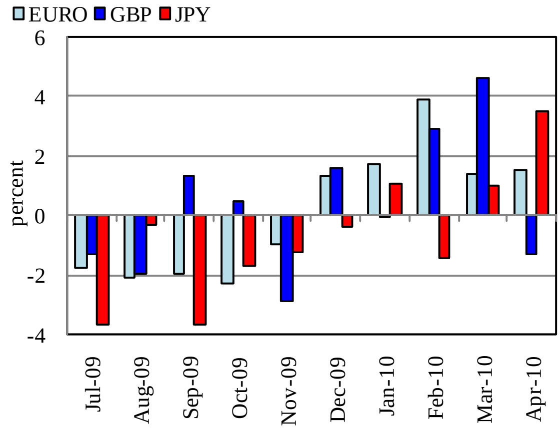


Figure 6.35: Movement of Pak Rupee Vs Major Currencies



The improvement in inflows allowed Pak rupee to regain some of the ground it lost in February as rupee appreciated by 1.22 percent vis-à-vis US dollar between end- Feb and end-Apr 2010.

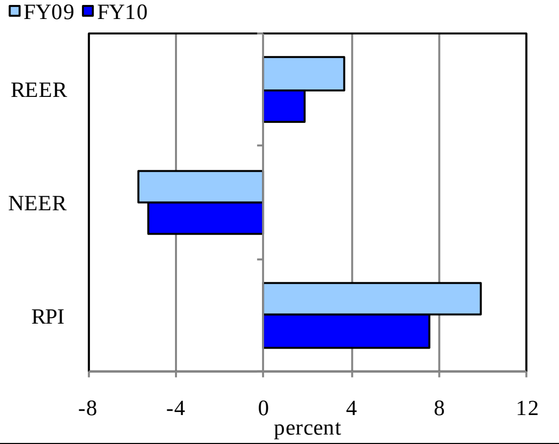
Pak Rupee Performance against Major Currencies

US dollar has been gaining strength against major currencies i.e. euro and pound since December 2009. Events in Greece and concerns about future problems in other European countries: Portugal, Ireland and Spain are keeping the dollar stronger. Also the fact, that the economy is improving more in the US than in Europe is helping dollar gain strength.

The relative strength of dollar against euro and pound, and Pak rupee's stability against the US dollar resulted in Pak rupee's appreciation against major international currencies Dec-09 onwards (see **Figure 6.35**).

Pak rupee, however, depreciated against the trade weighted basket of currencies. The Nominal Effective Exchange Rate (NEER) depreciated by 4.6 percent during Jul-Mar FY10 compared to 6.4 percent during the same period last year (see **Figure 6.36**). This depreciation was more than offset by the increase in the Relative Price Index (RPI) that is due to higher domestic inflation compared to the trading partner countries. As a result Real Effective Exchange Rate (REER) appreciated by 3.5 percent (see **Figure 6.36**).

Figure 6.36: Changes in REER, NEER and RPI (Jul-Mar)

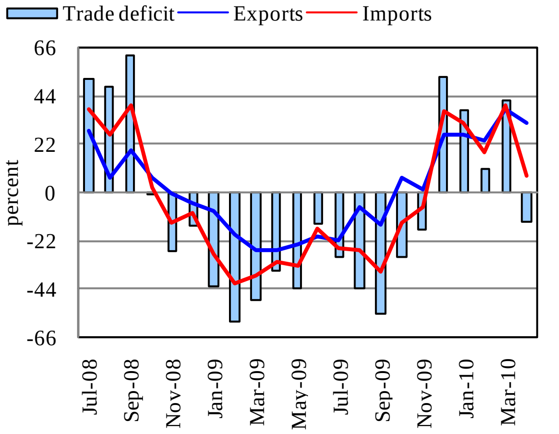


6.7 Trade Account[21]

A decent 8.0 percent YoY rise in exports accompanied by a smaller 2.8 percent YoY contraction in imports caused the country's trade deficit to record 13.9 percent YoY fall during Jul-Apr FY10.

The entire improvement in trade deficit was concentrated in the initial five months of the period under review. This was principally due to compression in imports on account of sharp fall in import prices during this

Figure 6.37: Trade Account - Growth



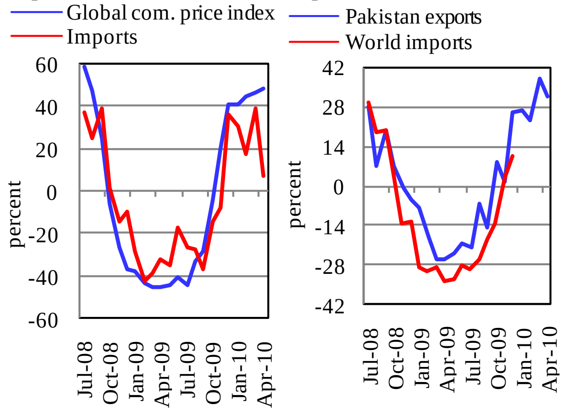
[21]The analysis is based on provisional data provided by the Federal Bureau of Statistics, which is subject to revisions. This data may not tally with the exchange record numbers posted in the section of *Balance of Payments.*

period. Import growth, however, recovered strongly December 2009 onwards outpacing a substantial recovery in export growth. As a result, trade deficit recorded YoY increase from December 2009 (see **Figure 6.37**).

The December 2009 onwards increase in import growth is attributable to, reemergence of a positive price impact; (see **Figure 6.38a**) as well as, some revival in domestic demand. The revival in domestic demand probably benefited from the government policies which aimed at stimulating economic activity. Encouragingly, these policy support measures, along with some recovery in the global economy, were also helpful (see **Figure 6.38b**) in bringing about a reasonable recovery in exports growth post Q2-FY10.

Figure 6.38(a): Growth in Imports and World Prices

Figure 6.38(b): Growth in Exports and World Demand



Going forward, imports bill is likely to rise on account of continued price and demand pressures. A corresponding recovery in exports, however, is likely to keep trade deficit for the whole FY10 in the negative territory.

Exports

A variety of supportive external and domestic factors led country's exports to record a redeemably 8.0 percent YoY growth during Jul-Apr FY10, compared to a marginal 3.6 percent YoY decline recorded during the same period last year.

In terms of monthly performance, after remaining in the negative territory for almost a year, export growth started to pickup from October 2009 (see

Figure 6.39: Contribution in Export Growth

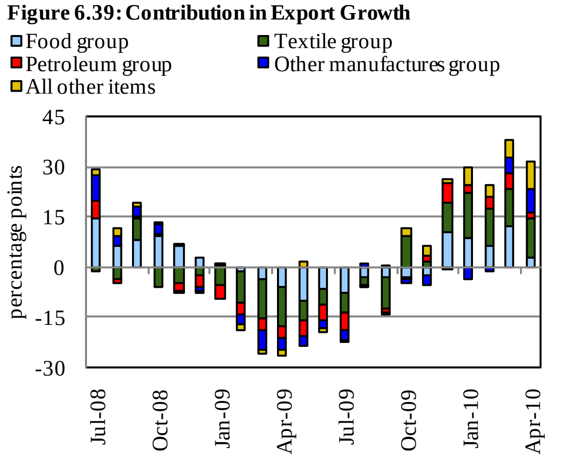


Table 6.7: Export Growth Composition Analysis

value million US Dollar; growth percent

	Jul-Apr FY10					Quarterly YoY growth		
	Value	**Growth**	**Abs Δ**	**Quantum impact**	**Price impact**	**Q1**	**Q2-**	**Jan- Apr**
Major drivers of export growth								
of which								
Other varieties of rice	1,108.9	44.1	339.1	758.4	-418.8	-18.5	30.6	116.6
Cotton yarn	1,211.0	32.1	294.5	272.0	22.5	9.0	53.8	34.2
Art silk and synthetic textiles	381.5	66.9	153.0	102.2	50.7	-28.1	360.2	72.7
Jewelry	397.0	102.6	201.1			293.6	26.0	16.1
Raw cotton	194.2	140.2	113.3	94.2	19.2	39.3	200.8	188.5
Fruits	208.8	55.1	74.1	54.7	21.8	11.8	147.4	46.0
Chemicals and pharmaceuticals	621.6	22.0	112.3	-	-	4.7	10.9	44.4
Other textile material	229.0	31.4	54.7	-	-	-6.5	34.9	82.1
Readymade garments	1,059.6	5.2	52.5	-71.1	123.6	-2.7	-1.3	19.2
Petroleum products	456.2	13.7	55.1	76.5	-21.5	-43.9	21.1	112.4
Others	**10,016.3**	**-2.6**	**-269.2**	**-3.2**	**-495.2**	**-22.6**	**-2.1**	**18.0**
Total exports	**15,884.1**	**8.0**	**1,180.0**	**1,283.8**	**-697.7**	**-14.9**	**10.4**	**29.8**

Figure 6.39). The recovery in exports has been broad based led by better performance of food group; textile and jewelry exports (see **Table 6.7**).

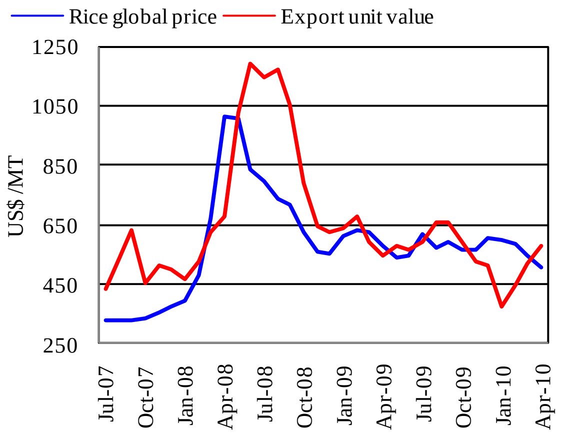
The rise in food group exports was largely on account of increase in exports quantum of *other varieties of rice*, *fruits & vegetables*, *meat*, etc., with rise in export quantum of *other varieties of rice* making highest contribution to export growth during Jul-Apr FY10. This was, in turn, helped by higher left over stocks of FY09 (see **Box 6.2**) and better than targeted rice production during FY10. [22] In addition weak rice crop in Philippines and India, preferential duty extension to Pakistan's Irri-6 rice by Kenya also helped in achieving higher export volumes during the period under review.[23] More than half of the impact of rise in export quantum, however, was offset by a YoY fall in export unit values of rice during this period.

[22]The target of rice production for FY10 was 5.9 million tons, while the estimated production is 6.3 million tons.
[23]Pakistani rice exports are being charged 35 percent import duty while others are charged 70 percent.

The fall in the unit values was not surprising as international rice prices were expected to revert back to long-term trends after recording an unusual rise during Jan to Jun, 2008 (see **Figure 6.40**).

The fall in unit values of basmati and *other varieties of rice* during Jul-Apr FY10 resulted in large negative price impact in both these categories.

Figure 6.40: Global Rice Prices and Export Unit Values



Box 6.2: Rice Exports and Domestic Stocks Position

Pakistan's rice export season starts around October with the arrival of new crop and lasts till around March. During this time around 50 percent of the total rice production is exported, while the remaining is available as unsold stocks for domestic consumption and gradual exports till the arrival of new crop. During FY09, country harvested a bumper rice crop to the tune of 6.9 million tonnes, however, due to a variety of reasons, only 40 percent of the total production was exported.[24] As a result there was a large stock carried forward to FY10 (see **Table 6.2.1**).

In FY10 also, rice production was better than the targets set by the government. Hence, during Jul-Apr FY10 although the rice export quantum recorded a sharp 66.6 percent surge, a significant stock is still lying unsold with the growers and exporters.

Table 6.2.1: Estimated Rice Exports, Consumption, Stock Position
million metric tonnes

		FY08	FY09	Jul-Mar FY10
A	Production	5.6	6.9	6.7
B	Wastage[25]	0.3	0.3	0.3
C	A-B+ Previous carried forward stock	5.7	7.5	9.1
D	Exports	2.8	2.7	3.3
E	Average approx. consumption	2	2	1.5
	C-D-E = carry forward	0.9	2.8	4.3

With production of Vietnam and Thailand entering the international market Feb onwards, it would become increasingly difficult for Pakistan to unload its existing stocks at competitive prices. In this scenario there is a possibility of a large carried forward stock of rice from FY10 to FY11 as well. This could potentially lead to a supply glut in the domestic market that is likely to adversely affect both, the exporters and the rice farmers. What is more worrying is the fact that the losses may force farmers to reduce area under cultivation for rice crop thus depriving country of an important foreign exchange earner in FY11.

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[24]These include 1) tough competition from competitors 2) the government procurement of rice by PASSCO and TCP, which prevented an expected large fall in the domestic prices of rice, thus hurting competitiveness of country's exporters 3) ambiguity regarding the crop size which hindered exporter's ability to make proper assessment of exportable surplus.

[25]Wastage refers to harvesting and milling losses. These are taken as 5 percent of the whole produce for the purpose of analysis.

Table 6.8: Food Group Exports (Jul-Apr) change in million US dollar; growth percent			
	Abs change	Growth in value	Growth in quantity
Rice	125.6	7.4	66.2
Basmati	-212.9	-23.4	2.7
Non-basmati	339.5	44.1	100.5
Fruits	74.1	55.0	40.6
Vegetables	41.9	71.2	7.3
Meat and meat preparation	23.8	39.8	42.0
Total	**180.2**	**8.0**	**N.A**

As with rice, the rise in *fruits, vegetables and meat* exports was also helped by large increases in quantum (see **Table 6.8**) during Jul-Apr FY10. The rise in fruits exports was recorded in the categories of mangoes, dates, edible nuts, and kinos[26]. Better marketing efforts were instrumental in this improved performance of the fruit export category.[27]

Similarly, *meat* exports also recorded a large volume increase during Jul-Apr FY10. Specifically, exports of goat meat to Saudi Arabia doubled in absolute terms, due to which its share in total meat exports increased from 21 to 35 percent. The increase in the meat exports appears to be the result of ban imposed by Saudi Arabia on meat imports from Ethiopia in FY09. Ethiopia has been one of the main suppliers of meat to Saudi Arabia.

Exports of many agricultural categories (*fruits, vegetables, meat, fish, etc.)* are, however, under pressure due to large scale smuggling of these products. Smuggling is rampant due to 1)-Export of these categories generally faces strict SPS related requirements, and smuggling is the means to avoid these restrictions; 2) The rise in smuggling to Iran may also be the result of international sanctions on this country due to which, many banks decline to open letter of credits for this country; 3) Smuggling is also a mean to avoid high import duties imposed by importing countries. The smuggling of these products not only deprives country from earning foreign exchange on these goods (due to barter or payments made in domestic currency), but it also leads to rise in their domestic prices. Further sometimes, the poor quality of smuggled products also leads to imposition of restrictions on formal trade.

Textile exports recorded a 7.1 percent YoY rise during Jul-Apr FY10 compared with a 9.2 percent YoY fall observed during the same period last year. A large share of this increase was contributed by low value added categories such as raw

[26]Mangoes, dates, edible nuts and fresh kinos exports posted growth of 34.0, 29.0, 450.0 and 28.0 percent, respectively, during Jul-Apr FY10.
[27]Country was able to increase exports to Russia, Iran, Poland, Sudan, etc. due to rising demand as well as better marketing efforts.

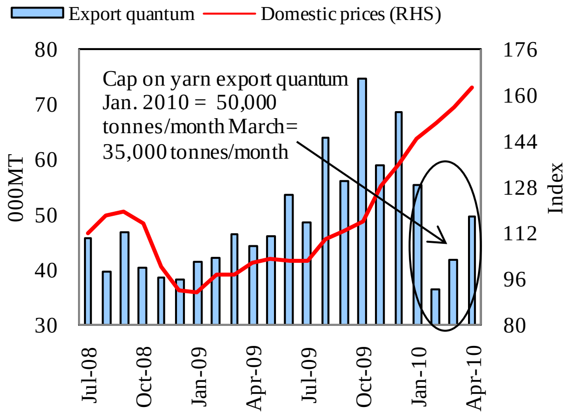
cotton, and cotton yarn, etc. (see **Table 6.9**). In high value categories readymade garments and towels recorded some increases.

Table 6.9 : Major Textile Exports Price & Quantum Impact (Jul-Apr)
million US Dollar

	FY09			FY10		
		Due to			Due to	
	Absolute Δ	Quantum	Price	Absolute Δ	Quantum	Price
Textile Group	**-800.8**			**556.3**		
of which						
Raw cotton	22.8	32.2	-9.4	113.3	94.2	19.2
Cotton yarn	-166.5	-97.5	-69.0	294.5	272.0	22.5
Cotton fabrics	15.2	-3.3	18.5	-175.4	-223.2	47.7
Knitwear	-95.3	145.2	-240.6	-10.1	-121.2	111.1
Bed wear	-175.2	-67.3	-108.0	-8.6	27.8	-36.4
Towels	27.1	65.1	-38.0	25.5	141.5	-116.1
Readymade garments	-176.5	-289.3	112.8	52.5	-71.1	123.6
Art silk and synthetic textiles	-0.1	-0.1	0.0	153.0	102.2	50.7

The improved domestic cotton production during FY10[28] and lower production of cotton in China[29] raised demand for *raw cotton, cotton yarn* and *synthetic textiles* exports from Pakistan during Jul-Apr FY10. The increase in cotton yarn exports led to domestic shortage of this category resulting in an increase in domestic prices of cotton yarn. This raised concerns from exporters of downstream high value added sector[30]. To mitigate these concerns, government capped cotton yarn exports in January 2010[31](see **Figure 6.41**). As a result of this decision the surge

Figure 6.41: Cotton Yarn Exports and Domestic Prices



[28]Cotton production increased from 12.06 million bales to 12. 70 million bales during FY10.
[29]In FY10, cotton production in China declined by 14.4 percent YoY.
[30]The quantum of yarn exports in total cotton yarn production increased from 18,000 tons per month in FY09 to 25000 per month during Jul-Mar FY10.
[31]In January, government imposed a cap on export quantum of 50,000 tons per month, while in March 2010 the cap was revised downward to 35,000 tons per month.

in the export of this category is likely to cool down in the remaining months of FY10.

It is also probable that the rise in domestic yarn prices adversely affected country's *cotton fabrics* exports, resulting in significant fall in their export quantum during Jul-Apr FY10 (see **Table 6.9**).

The exports of high value categories recorded a modest revival from Q2-FY10 (see **Figure 6.42**). Much of the increases in high value added categories' exports in Q2 and Q3 FY10 were contributed by increases in export quantum (see **Figure 6.43**). This reflects improved external demand as well as better domestic manufacturing conditions during this period.

The rise in *jewelry* export was mainly caused by a sharp 23.2 percent YoY rise in international gold prices along with higher demand from UAE and US. Further, the facilities and incentives provided by the government[32] may also have helped to improve exports of this category.

Figure 6.42: Textile Export - YoY Growth

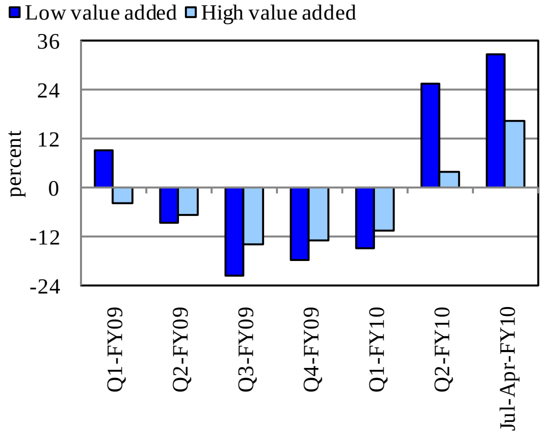


Figure 6.43: High Value Added Textile Exports

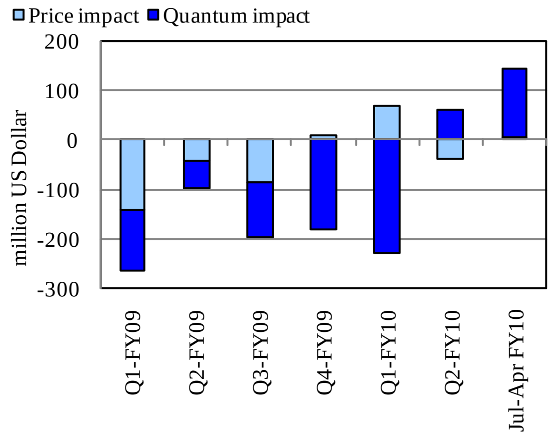


Table 6.10 : Other Manufactures Exports (Jul-Apr)

change million US$, shares percent

	Abs Δ	Growth	Share in other manufacturers
Leather manufactures	-102.3	-21.7	12.7
Engineering goods	-13.4	-6.3	7.35
Jewelry	201.0	102.6	12.58
Molasses	-42.4	-49.9	1.27
Cement	-81.1	-17.0	13.48
Total	**21.8**	**0.7**	**N.A**

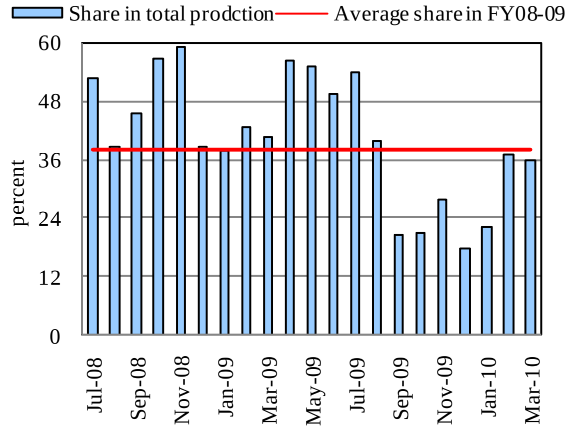
[32]The shipment period for export of gold jewelry against imported gold under Entrustment Scheme, has been enhanced from 120 days to 180 days. Import of gold, silver, platinum, palladium, diamonds and gemstones under all schemes are exempted from normal import tariffs.

Apart from the categories with improved export performance, some major categories for instance *leather manufacture* and *cement* recorded large YoY declines during Jul-Apr FY10 (see **Table 6.10**).

The fall in leather manufactures exports is attributable to both falling external demand as well as persistence of domestic structural bottlenecks.

As regards cement exports, the YoY fall in this category was led by both falling quantum and export unit values during Jul-Apr FY09. [33]Although the production of cement increased during the period under consideration, the share of exports in total production declined substantially (see **Figure 6.44**).

Figure 6.44: Share of Exports in Production of Cement



The decline in export quantum can be explained by depressed demand from major importers i.e. Afghanistan, India, U.A.E, Oman, and Qatar, etc. [34] However, going forward there is a likelihood of a rise in demand from African countries.

Imports

During Jul-Apr FY10 imports recorded a 2.8 percent YoY fall against a 9.8 percent decline recorded during the same period last year. The contraction in import bill was due to a large negative price impact that deflated import bill in the first five

[33]The APCMA (All Pakistan Cement Manufacturers Association) data shows 4.1 percent YoY increase in export dispatches during Jul-Mar FY10.

[34]Share of Qatar in Pakistan exports declined from 22 to 14 percent, while share of Oman and UAE declined from 10 to 6 and 15 to 4 percent respectively during the period under review.

Table 6.11: Import Growth Composition Analysis (Jul-Apr)
value: million US Dollar, growth percent

	FY09	FY10	Growth	Absolute change	Percentage point share in growth	Price impact	Quantum impact
					FY10		
Major commodities recording Increase							
of which							
Petroleum products	4,612.4	5,305.3	15.0	692.9	2.4	-420.0	1,112.9
Air crafts, ships and boats	379.7	579.2	52.6	199.5	0.7	N.A	N.A
Road motor vehicles	755.3	948.9	25.6	193.6	0.7	N.A	N.A
Medicinal products	447.8	611.4	36.5	163.6	0.6	2.8	160.9
Fertilizer manufactured	494.4	666.6	34.8	172.2	0.6	-218.6	415.3
Major commodities recording fall							
of which							
Wheat un-milled	1,053.8	35.4	-96.6	-1,018.3	-3.5	-1,024.3	6.0
Petroleum crude	3,404.6	2,813.3	-17.4	-591.4	-2.0	-334.9	-256.5
Other machinery	1,845.7	1,336.0	-27.6	-509.7	-1.8	N.A	N.A
Telecom	857.1	598.6	-30.2	-258.5	-0.9	N.A	N.A
Iron and steel	1,090.7	1,017.7	-6.7	-73.1	-0.3	-16.3	-56.3
Others	**13,979.8**	**14,236.1**	**1.8**	**256.3**	**0.9**	**-271.3**	**452.9**
Total imports	**28,921.3**	**28,122.6**	**-2.8**	**-798.8**	**-2.8**	**-1,173.9**	**726.5**

months of FY10.[35] The negative price impact more than offset the rise in quantum of imports during almost the entire Jul-Apr period.[36]

In terms of monthly performance, due to anincrease in international commodity prices and some revival in domestic demand of number of categories, import growth also moved in positive range from December 2009 onwards (see **Figure 6.45 & Table 6.11**).

Categories with rising quantum impact:

Petroleum group imports recorded a marginal YoY rise of 1.3 percent during Jul-Apr FY10. In terms of quantum, while petroleum crude recorded a marginal YoY decline, petroleum products increased substantially (see **Table 6.12**). [37]

[35]Specifically, 58 percent of the fall in petroleum group import was on account of the price impact.
[36]During Jul-Apr FY10 period, quantum impact is 644.0 million US$, while price impact is -1,136.3 million US$.
[37] In terms of quantum, largest increase was observed in the import of furnace oil. Demand for furnace oil emanated from the power generating sector, while strong auto and motor cycle sales, narrowing CNG-petrol price differential and increasing use of generators resulted in higher demand for motor gasoline.

Liquidity shortage, arising from the circular debt issue, along with negative product margins curtailed refineries ability to import crude oil and thus provide relatively cheaper petroleum products domestically. SBP's internal estimates indicate that the country could have saved significant amount on petroleum group imports during Jul-Apr FY10 if refineries were able to import the same level of crude as they did in FY08.[38] In that case POL group imports during Jul-Apr FY10 would have registered negative growth.

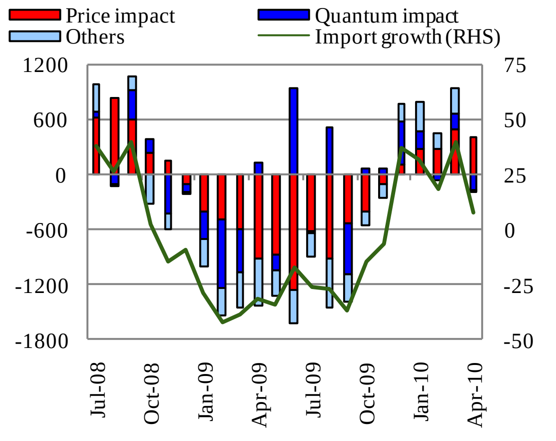
Table 6.12: POL Group Imports (Jul-Apr FY10)
value million US Dollar; growth percent

	YoY growth	Absolute YoY Δ	Quantum impact	Price impact
Petroleum group	**1.3**	**101.6**		
Petroleum products	15.0	692.9	1,112.9	-420.0
Petroleum crude	-17.4	-591.4	-334.9	-256.5

Transport group imports recorded a significant 35.5 percent YoY growth during Jul-Apr FY10. This was largely on the back of a revival in domestic demand for r*oad motor vehicles*). In this category, imports of CKDs in particular, increased due to high demand from local producers.

Sugar imports also recorded a sharp increase during the period under review owing to domestic shortages caused by lower production during FY10 crop season.[39] In addition rise in the international sugar prices also inflated the import bill.[40] Sugar imports are likely to rise further in the remaining months of FY10, as the government has plans to import a large quantum

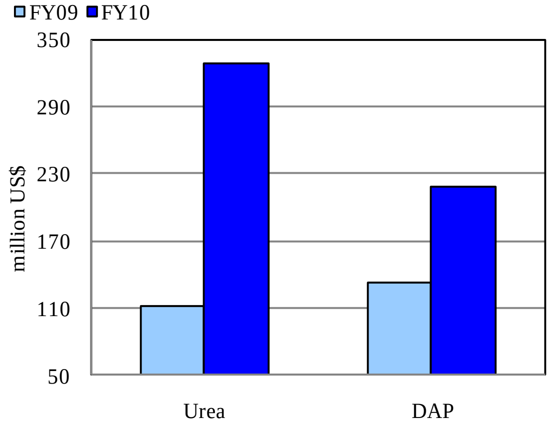
Figure 6.45: Factors of YoY Change in Imports



[38] For this exercise the volume of crude imported during Jul-Apr FY08 i.e. 7.0 million tonnes is taken as a base.
[39] Domestic production during FY10 was recorded at 2.8 million MT compared to production of 3.1 million MT during FY09.
[40] The average unit import value was 566.9 US$/MT during Jul-Apr FY10 compared with 433.4 US$/MT during Jul-Apr FY09.

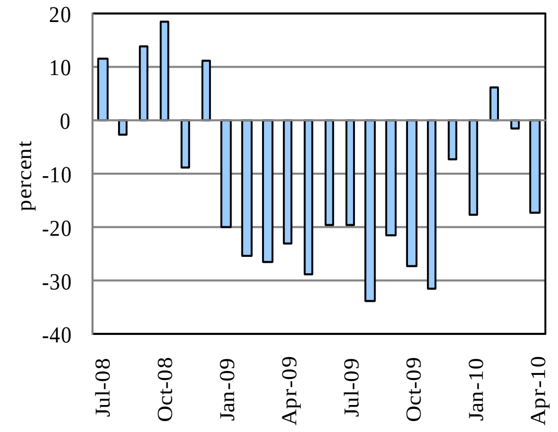
to fill the domestic demand-supply gap.[41]
Fertilizer imports increased substantially during Jul-Apr FY10 due to rising volumes, as well as, import prices. Demand for imported fertilizer originated from high off-take of both Urea and DAP during Rabi 2009-10 [42] (see **Figure 6.46**). The higher import of Urea is attributable to shortages of gas, which led to a fall in its domestic production. The production of Urea is expected to gain momentum with the start of a new plant in March 2010, while another plant is also expected to start operating in the coming months.[43]

Figure 6.46: Imports of Fertilizer Manufactured



Although *machinery group* imports recorded a large 18.7 percent YoY fall during the whole Jul-Apr FY10 period (see **Figure 6.47**), import of this category increased during Jan-Apr-FY10. This rise was observed in power generating machinery, cell phones, textile machinery, agriculture machinery, etc. [44]

Figure 6.47: Machinery Imports Growth (YoY)



In the case of p*ower generating*

[41]Average consumption of sugar is estimated to be around 3.8 million MT per year, whereas production during FY10 is 2.8 million MT. Keeping this in view, the government announced 1.0 million MT imports of sugar in order to bridge the demand-supply gap during FY10. So far only 0.27 million MT sugar has been imported.
[42]According to National Fertilizer Development Centre, urea off-take increased by 11.6 percent, while DAP imports increased by 26.6 percent during Rabi 2009-10.
[43]Fatima Fertilizer came online in March 2010.
[44]Imports of power generating machinery, mobile phones, textile machinery and agricultural machinery increased by 3.3, 299.2, 125.8 and 411.1 percent YoY respectively during Q3-FY10.

machinery imports, the rise could be attributed to depletion of inventories and rise in industrial as well as household demand, due to continuous power outages.

The increase in the *textile machinery* imports is attributable to government and SBP support announced for this sector.[45, 46] These support measures were in response to the demand of high value added sector, to improve its productivity.

Imports of *mobile phones* recorded a large 69.9 percent YoY increase during Jul-Apr FY10. Anecdotal evidence suggests that improvement in overall consumer demand, launching of new models, and slowdown in sales of smuggled Chinese cell phones along with relaxation in import duties led to rise in the imports of this category.[47]

[45]SRO 809(I)/2009 dated 19th September 09, allows elimination of 5 percent import duty on textile machinery.
[46]SMEFD Circular Letter No. 03 of 2010, according to which import of second hand machinery up-to June 30, 2010 shall also be eligible for refinancing under the Long Term Financing Facility.
[47]Reduction of custom duty from Rs 500 to Rs 250 per set and 50 percent reduction in Subscriber Identification Module (SIM) activation charges.