2 Real Sector

The economic recovery seen in H1-FY10 gathered pace in the third quarter as rising domestic and external demand encouraged higher production. Most of the recovery was evident in LSM production but small and medium sized manufacturing units complained of productivity losses due to prevailing energy shortages. Although production in LSM sector has increased over the previous year; it nonetheless remained low compared with the peak levels seen in FY08. Even so, the increase in capacity utilization in the LSM sector explains at least a part of rising imports as well as inflationary pressures during Q3-FY10 (see **Figure 2.1**).

Figure 2.1: Building-up Demand Pressures (YoY Growth based on 3-Months Moving Averages)

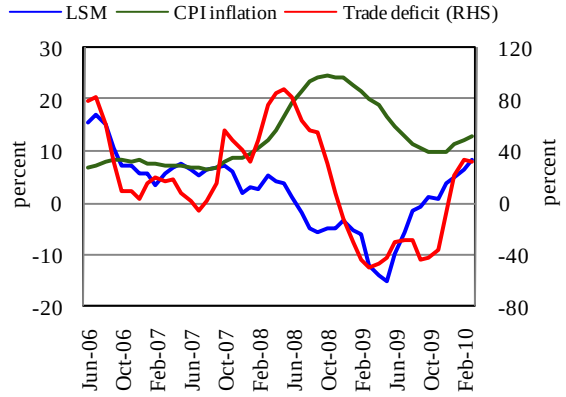


Table 2.1: Indicators of Aggregate Demand

percent YoY growth

	H1		Q3	
	FY09	**FY10**	**FY09**	**FY10**
Oil sales[1]	-4.1	14.7	-1.0	2.4
Gas sales to industry[2]	-2.1	2.0	0.3	6.3
Other gas sales[2]	1.0	-0.6	-3.5	-0.5
Power use agri/ind[3]	-6.2	4.4	-3.2	3.8
Power use commercial[3]	-7.6	6.9	-3.4	7.4
Local cement dispatches[4]	-13.7	16.6	-6.5	18.3
Consumer auto sales[5]	-22.1	38.6	-37.8	67.2
Commercial auto sales[5]	-18.6	18.4	-30.4	42.4
Exports	9.4	-4.5	-18.2	29.2
Imports	12.8	-28.6	-36.4	30.1
Loans to business	9.2	5.8	-4.1	1.0

Source: [1]OCAC, [2]SSGC & SNGPL, [3]PEPCO, [4]APCMA, [5]PAMA

Major stimulus to the domestic demand in Q3-FY10 came from private consumption as rural incomes improved considerably due to a rise in prices of major agriculture commodities during FY10. Some support to consumption demand also came from banks' renewed interest in consumer finance business January 2010 onwards that partly explained larger volume of automobile sales (see **Table 2.1**), despite increase in prices during the period. The resultant increase in demand for intermediate goods

was bolstered with improvement in corporate liquidity emanating from better earnings and improved availability of bank loans.

The external demand also gathered pace further following sharp growth in Asian economies and decent recovery in advanced economies in Q3-FY10. As a result, country's export of manufactured goods as well as agricultural products increased sharply in Q3-FY10. Putting this in perspective, the export growth in Q3-FY10 is the largest YoY export growth in any quarter since Q4-FY03. Notably, the strengthening recovery in aggregate consumption appears to have lifted investors' confidence as is evident from higher production of capital goods during Q3-FY10 and increase in demand for machinery in some sectors, including agriculture and textiles.[1]

The domestic manufacturing sector was well placed to respond to rising demand given the available capacities. As a result, the LSM sector grew by 9.6 percent in Q3-FY10 which is the strongest quarterly growth since FY07. The higher Q3 growth took the cumulative growth in Jul-Mar FY10 to 4.4 percent as against a decline of 7.4 percent in the same period of FY09. Most of the growth was seen in consumer automobiles and electronics industries followed by a few exporting industries including textiles, pharmaceuticals, etc. Thus, it appears that prevailing energy shortages in the country did not obstruct LSM activities to a larger extent; though it may be argued that a higher LSM growth rate could have been achieved if not for energy shortages.

Table 2.2: Composition of Energy Consumption by Industrial Sector (Excluding Gas for Feedstock)

percent share

	FY06	FY07	FY08	FY09
Oil	14.7	12.7	7.9	8.4
Gas	40.4	41.5	40.1	44.7
Electricity	13.9	13.4	12.4	13.5
Coal	31.1	32.4	39.6	33.4

Source: HDIP

The apparent resilience of LSM sector to energy shortages stemmed mainly from the composition of energy requirement and its sources (see **Table 2.2**). In specific terms, 40-45 percent of the industry's energy requirements are met through natural gas (excluding gas used as feedstock in fertilizer production). Furthermore, in terms of priority allocation, gas supplies to industries where it is used as raw material (mainly fertilizers, synthetic fiber, etc.), order above the supplies for power generation and transport

1 Capital goods industries registered a growth of 47.6 percent in Q3-FY10 compared with a decline of 29.2 in Q3-FY09.

usage.[2] As far as the general industries are concerned, the data for Q3-FY10 suggests a sharp rise in gas sales; 4.0 percent growth over Q3-FY09 sales and 1.2 percent growth over Q3-FY08 sales. Similarly, the energy from coal and oil constitute another 40-45 percent of industrial requirements which is largely met through imports. Thus productivity losses caused by power disruptions are limited to that fraction of the industry that has direct reliance on the power network.[3] For large scale manufacturing, this effect was slightly mitigated by the fact that large firms can cope with energy shortages by operating on expensive back-up supplies. Furthermore, a few textiles, sugar, chemicals and steel industries are operating with captive power plants that ensure sufficient availability to their own units.

In contrast, small scale manufacturing appears to have been hit hard by power outages, and reportedly a large number of small manufacturing units closed down with negative repercussions on exports and employment.[4] Meanwhile, activities in local construction industry strengthened further with stable building material prices and growing housing demand, as is evident from higher growth in cement dispatches during Q3-FY10 compared with Q3-FY09 as well as H1-FY10.

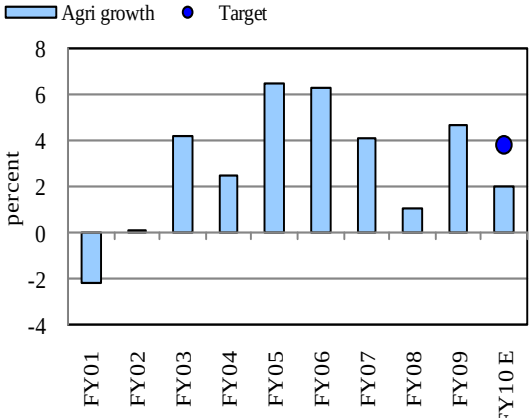
Thus, the overall industrial sector production comfortably surpassed the annual target of 1.7 percent in FY10. The improvement in industrial production and rising trade volumes has brightened the prospects of recovery in services sector. Specifically, higher than expected growth in *wholesale & retail trade*, strong contribution from *public administration & defense*, rising transport related activities and increase in investments in telecommunications have lifted services sector growth. The higher industry and services sector growth more than offset slight weakening in agriculture sector during the year and, as a result, the GDP growth rebounded strongly and rose to 4.1 percent in FY10.[5] The GDP growth is envisaged to increase further in FY11 with prospects of recovery in major crops, induction of new capacities in major LSM sector and a little improvement in energy supplies.

[2] As per Natural Gas Allocation and Management Policy 2005.
[3] Indirect effects include limited activities in commercial sectors, increase in consumer spending on UPS/generators and limited use of household appliances, etc.
[4] According to relevant business associations, 75 percent of ready-made garments, towels and bed-wear exporting firms are small and medium sized.
[5] Provisional estimates by FBS; retrieved on May 21, 2010, from http://www.statpak.gov.pk/depts/fbs/statistics/national_accounts/national_accounts.html

2.1 Agriculture Sector Performance

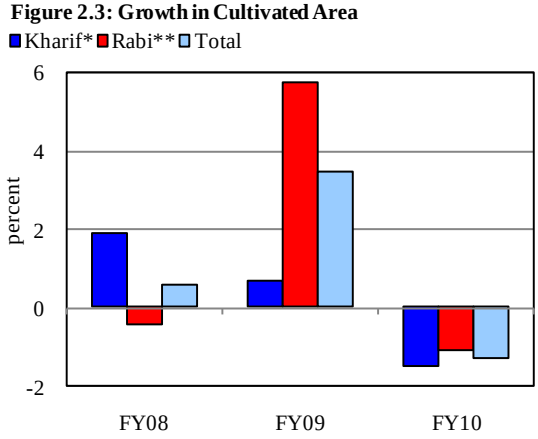
Despite water shortages and unfavorable weather conditions during FY10, agriculture sector achieved a reasonable growth of 2.0 percent, against the target of 3.8 percent (see **Figure 2.2**). This growth is principally driven by an impressive performance by the livestock sector. The growth by major crops was hit hard by water shortages and lower prices of rice and sugarcane at sowing time resulting in decline in area under important major crops except cotton (see **Figure 2.3**). The impact of this was compounded by a fall in wheat and cotton yields. It is important to note that decline in wheat harvest would have been much greater, if farmers had not used balanced mix of nutrients in FY10. In fact, relatively lower prices of DAP helped farmers to offset the impact of water shortages.

Figure 2.2: Growth in Agriculture



E: estimates

Figure 2.3: Growth in Cultivated Area



*:sugarcane, rice and maize, **:wheat and gram

Contrary to expectations that growth by minor crops would be strong due to switch over of area from major to minor crops, initial information suggests that most of the minor crops also suffered from lower winter rains during FY10. On positive glimpse, strong domestic and external demand for livestock, adequate availability of fertilizer and agri-credit during FY10 helped the sector to contribute positively in overall economy.

Another positive development during FY10 was a significant contribution of agriculture sector in exports. While, it resulted in relatively higher domestic prices of most of the agri-produce, this will encourage farmers to continue efforts to increase output.

Cropping sector

Although FY10 wheat harvest slightly declined compared to the preceding year's record output, (see **Table2.3**) it is better than expectations given lower availability of irrigation water and winter rains. Even increased area under wheat cultivation in Punjab (by 0.8 percent) failed to offset the impact of lower yield. The impact of water shortages was further compounded by late sowing amid delayed sugarcane crushing, extended cotton picking, unfavorable weather (rising temperatures at pre-harvesting period), and weakened wheat seed size that led to decline in yield in Punjab. Despite fall in area under wheat and water shortages, Sindh harvested a bumper wheat crop with efficient farm management, favorable weather, and balanced use of nutrients (see **Figure 2.4**).

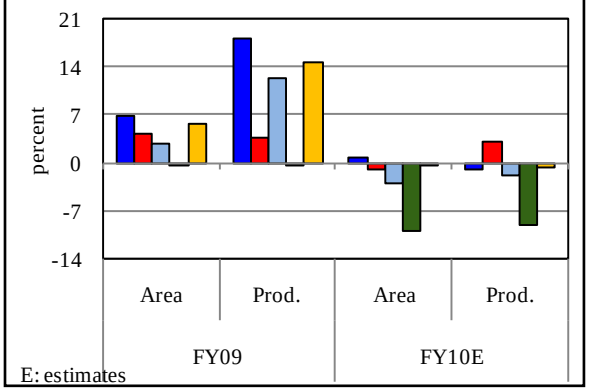
A second record high wheat harvest in FY10 and substantial carryover stocks of about 4.0 million tons of wheat[6] posed a challenge to the government for financing commodity operations and storage of the grain. The government intends to export 2.0 million tons of wheat to

Table 2.3 :Performance of Major Crop

Area Under Cultivation (000 hectares)					% change in FY10 over FY09
Crops	**FY08**	**FY09^{P}**	**FY10^{T}**	**FY10^{E}**	
Cotton	3,055	2,850	3,200	3,072	7.8
Sugarcane	1,241	1,029	1,106	939	-8.7
Rice	2,516	2,963	2,526	2,858	-3.5
Wheat	8,550	9,046	9,045	9,026	-0.2
Gram	1,107	1,092	1,022	-	-
Maize	1,037	1,062	1,039	915	-13.8
Production ('000 tons; cotton in '000 bales of 170.09 kg each)					
Cotton	11,655	12,060	13,360	12,700	5.3
Sugarcane	63,920	50,045	56,527	47,030	-6.0
Rice	5,561	6,954	5,949	6,741	-3.1
Wheat	20,959	24,032	25,000	23,863	-0.7
Gram	475	740	749	571	-22.8
Maize	3,109	3,548	3,414	3,204	-9.7
Yield (Kg/hectare)					
Cotton	649	720	710	709	-1.5
Sugarcane	51,507	48,635	51,109	50,085	3.0
Rice	2,210	2,347	2,355	2,359	0.5
Wheat	2,451	2,657	2,764	2,644	-0.5
Gram	429	696	733	-	-
Maize	2,998	3,341	3,286	3,502	4.8

P: provisional, T: target, E: estimates *Source: MINFA*

Figure 2.4: Wheat Area and Production Growth



E: estimates

[6] By end-March 2010.

resolve both these issues. However, given lower international prices, this policy entails a substantial fiscal cost. Ironically, it is difficult to reduce wheat support price that enable private sector to come forward and buy wheat for export and domestic consumption. It would also be challenging for the government to arrange financing and proper storage of targeted procurement quantity of wheat. In case of a below target procurement, wheat price in open market are likely to collapse and farmers would face unanticipated losses. This situation suggests that (a) government involvement in commodity market and price setting should be restricted only to ensure food security as excessive intervention creates distortions; and (b) there is a need to introduce futures market with all its prerequisites.

Minor Crops

A fall in the output of minor crops is quite surprising given a decline in area under major crops during FY10, a relative stability in the prices of most of the minor crops, as well as, an impressive performance of these on the exports front. However, since a number of minor crops are grown in non-irrigated (barani) areas, these were hit hard by the lower rains during FY10. In particular, pulses output dropped for the second consecutive year. Almost all minor crops, except potatoes, witnessed fall in output during FY10. Importantly, a drought in India created

Table2.4: Minor Crops

Commodities	Production[1] (thousand tons)		Consumption[1] (thousand tons)	Export[2] (thousand US$)		Domestic prices[3] (Rs/kg for Jul-Apr)	
	FY10	% change over FY09	FY10	FY10	% change over FY09	FY10	% change over FY09
Mash	13.3	-2.1	45.0	10.4	-99.2	121.9	62.8
Mong	126.1	-19.9	102.0	1,204.3	1,577.3	71.2	41.3
Masoor	11.7	-19.0	50.0	206.6	95.1	121.9	-0.6
Potato	3,007.9	2.3	1,700.0	15,671.9	68.6	22.9	15.7
Onion	1,533.2	-10.0	1,400.0	20,997.9	375.6	25.3	-3.1
Chillies *	104.5	-44.3	149.0	2,412.0	29.8	47.6	11.7

Sources: [1]MINFA, [2]SBP, [3]FBS.

* Total consumption of chilies based on per capita consumption for 2005-06 in HIES-FBS.

severe shortages or delayed harvesting of various agri-products in India. This situation provided an opportunity to Pakistani traders to export agri-produce to India and capture Indian share in other countries. The combined impact of lower production of minor crops during FY10 and substantial rise in exports resulted in surge in domestic prices (see **Table 2.4**).

Livestock Market Opportunities

Like minor crops, exports of livestock products increased[7] by 40.7 percent YoY to 24.1 thousand tons in Jul-Feb FY10.[8] Here too, rising exports put pressures on domestic prices in recent months. Reports[9] suggest that Middle East will remain a major market for livestock, particularly sheep, cattle, goats and camels. Pakistan may enhance its share in this region by providing quality livestock and adopting international *halal* standards (see **Box 2.1**). However, there is a concern regarding exports of live animals. Country should promote exports of value added products to earn better returns and protect domestic employment. It should also be noted that slaughtering also provides raw material to domestic leather industry, which is also an important export industry in Pakistan.

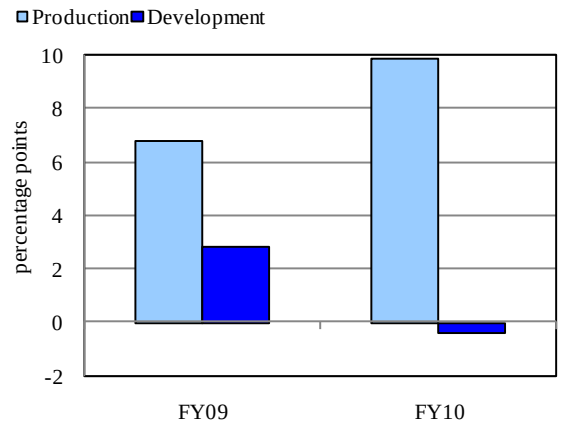
Box 2.1: MOU between Pakistan and Malaysia to Increase Livestock Trade

Pakistan will benefit from MoU signed between Pakistan and Malaysia regarding development of meat trade with standardization of *halal* meat in Pakistan with Malaysian assistance. To ensure quality and authentication, Malaysian International Halal Integrity (IHI) group, will assist to setup a Halal standard board and accreditation body in Pakistan. The alliance will also provide expertise with testing laboratories and arrange training series in Pakistan. This will not only increase livestock trade between Pakistan and Malaysia but will also improve export opportunities for livestock products to the Middle Eastern region in particular and Muslims around the globe.

Agriculture Credit Performance

Agri-credit disbursement[10] increased by 9.5 percent YoY in Jul-Mar FY10, slightly lower than the increase of 9.6 percent during the same period of FY09 (see **Table 2.5**). This was entirely due to a fall in developmental loans which offset the impact of 11.2 percent increase in production related loans (see **Figure 2.5**). The rise in the latter is attributed to higher credit

Figure 2.5: Contribution in Agri-credit Growth (Jul-Mar)



[7] Meat and meat preparations.
[8] Export of livestock products was only 9.9 thousand tons in FY07.
[9] Western Australian Agri-food and Fiber Market Outlook-Middle East
http://agric.wa.gov.au/objtwr/imported_assets/content/amt/bn_middle_east_to_2015.pdf
[10] Agri-credit disbursement slowed to 7.6 percent during Jul-Apr FY10 compared with 10.9 percent last year.

disbursement for *rabi* crops amid surge in fertilizer off-take.

On supply side, aggressive lending by the five large commercial banks (5 CBs) for production purposes has mainly supported the growth in agri credit. Consequently, the share of 5 CBs in agri-credit market rose to 51.2 percent. The rise in disbursement by these institutions is a reflection of (a) improvement in loan recovery by banks; and (b) declining NPLs during the first nine months of the current fiscal year. Disbursements by domestic private banks (DPBs) also exhibited a trend reversal and posted a marginal increase during Jul-Mar FY10. However, disbursements for development purpose from both 5 CBs and DPBs contracted during Jul-Mar FY10. In contrast, growth in agri-credit disbursement by ZTBL slowed in Jul-Mar FY10, mainly due to decline in lending for production purposes.

Table2.5: Agriculture Credit Growth (Jul-Mar)

Name of Banks	Disbursement		Recoveries	
	FY09	FY10	FY09	FY10
All CBs	**8.2**	**10.6**	**15.3**	**14.3**
5 Big CBs	14.2	14.5	13.7	19.3
DPBs	-4.8	0.3	19.3	1.7
Spec. banks	**12.5**	**7.3**	**14.9**	**2.0**
ZTBL	14.6	7.9	15.3	2.4
PPCBL	-11.5	-0.3	11.5	-1.1
Total	**9.6**	**9.5**	**15.1**	**10.5**

Crop-wise credit disbursement shows that lending for fruits and vegetables declined during Jul-Mar FY10. However, disbursement for other crops increased during Jul-Mar FY10 over the last year **(**see **Table 2.6**)**.** It is important to note that the disbursement in absolute terms to fruits, vegetables and other crops (mostly minor crops) are significantly low. In particular, modern cultivation methods (drip irrigation, hydroponics, green houses, etc.), marketing and storage for most of the minor crops, vegetables and fruits require substantial investment. Access to institutional credit would help boost production and exports of these commodities.

Table 2.6: Agriculture Credit in Cropping Sector (Jul-Mar)

amount in billion Rupees, growth in percent

Groups	Amount			Growth	
	FY08	FY09	FY10	FY09	FY10
All crops	59.8	80.2	81.4	34.0	1.6
Vegetables	18.6	2.3	2.3	-87.6	-0.5
Fruits	3.1	3.1	2.9	-0.9	-4.5
Others	13.0	11.3	15.4	-13.4	36.3

Purpose wise Agri-credit

Lending performance of banks revealed their exposure to different sectors. Commercial banks are cautious in lending for developmental purposes. However, short term lending by 5-large CBs showed a considerable growth of 22.6 percent YoY during Jul-Mar FY10 compared with 9.8 percent in Jul-Mar FY09 (see

Table 2.7). In case of specialized banks, strong growth was seen in medium to long term financing by ZTBL probably due to tractor financing schemes. In addition, disbursement by ZTBL also increased for land improvement, orchards, godown, cold storage silos, and seed processing units. Furthermore, ZTBL put more efforts to maintain the production to development ratio at normal level (70:30) previously it was about 80:20. This would probably help improve farm mechanization in the country.

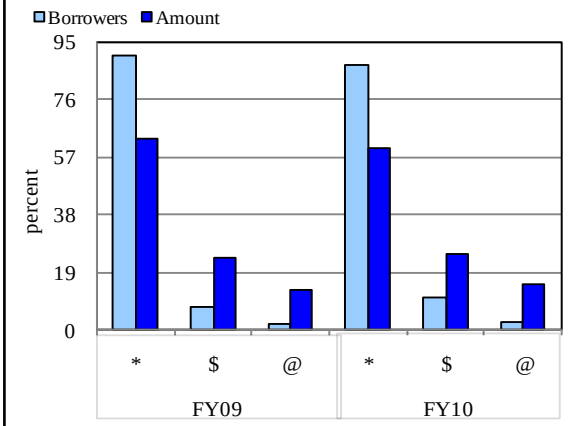
Table 2.7: Purpose-wise Agri-credit Growth (July-Mar)

Banks	Production		Development	
	FY09	FY10	FY09	FY10
5- large CBs	9.8	22.6	91.0	-67.4
ZTBL	11.4	-3.4	33.1	60.9
PPCBL	-0.4	1.6	-64.0	-24.1
DPBs	-2.0	3.6	-30.0	-40.9
Total	**7.5**	**11.2**	**29.9**	**-3.3**

Sector-wise Credit

A disaggregate analysis suggests that the growth in disbursement to farm sector was lower than the rise in credit to the non-farm sector yet for another year. Resultantly, the share of farm sector in total credit disbursement dropped to 69.0 percent by Jul-Mar FY10 compared with 70.0 percent in the same period last year. Within farm sector, the share of subsistence farmers is 87.3 percent in total number of borrowers but their share in total credit is only 60.0 percent (see **Figure 2.6**). Small farmers mostly rely on non-institutional resources for financial requirements, albeit at high interest rates and exploitative terms to market their produce.

Figure 2.6: Holding-wise Share in Agri-credit (Jul-Mar)



*: subsistence; $:economic; @:above economic

Despite slowdown in growth, disbursement to non-farm sector increased by a healthy 13.1 percent YoY during Jul-Mar FY10. Major sources of sustained rise in disbursement in this sector are livestock and fisheries sub sectors. High prices of meat, fish, and export of live animals attract investment in non-farm sector. Moreover, running finance for poultry sector also increased on account of record high prices of poultry amid strong domestic demand. It is expected that poultry

output would increase further and financing requirements for working capital as well as fixed investment would continue to grow.

Provincial Agri-credit Disbursement

The increasing share of Sindh province in agriculture credit exhibited a decline during the first nine months of FY10 (see **Figure 2.7**). As a mirror image, share of the Punjab increased reaching over 85 percent. Some of the decline in the share of Sindh is owed to restriction in changes in land record with the revenue department in the province.[11]

Figure 2.7: Share in Agri-credit Disbursement (Jul-Mar)

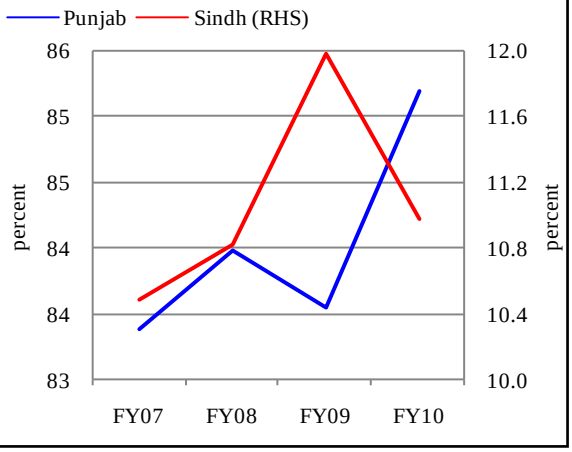


Table 2.8: Agriculture Credit Disbursement

billion Rupees

	FY07	FY08	FY09	FY10
Punjab	92.8	116.7	127.0	142.4
Sindh	11.7	15.0	18.2	18.3
Khyber Pakhtunkhwa	6.1	6.1	5.8	4.7
Balochistan	0.3	0.3	0.3	0.4
Azad Kashmir	0.2	0.3	0.4	0.3
Gilgit - Baltistan	0.1	0.2	0.2	0.2
All Pakistan	111.2	138.6	151.9	166.3

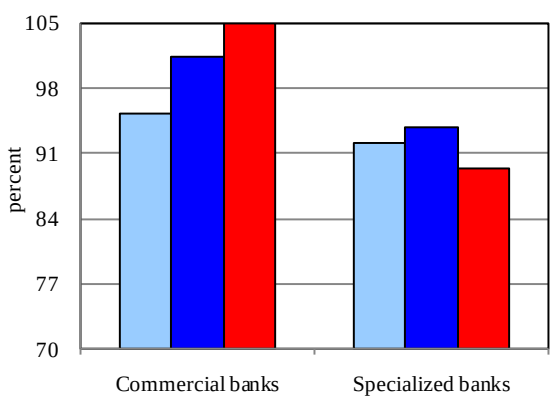
The major imputes to growth in Punjab came from a healthy 15.0 percent rise in production related loans, as developmental loans dropped by 8.5 percent during Jul-Mar FY10. In contrast, production related loans declined by 2.7 percent in Sindh during this period, probably showing the impact of restriction on land mutation.

The share of other provinces and regions is negligible in agri-credit (see **Table 2.8**). This may be due to both weak demand and inadequate supply. SBP is conducting regional seminars/workshops to create awareness regarding availability of agri-credit, to create demand for institutional finance. At the same time, provincial governments may speed up the provision of title documents to farmers that would help them to avail institutional finance. On supply side, specialized and commercial banks need to tap the potential of agri-credit market

[11] Revenue Department of Sindh has been restrained from effecting mutation of any entry in the village record. However, the same directives were eased in the case of already approved agricultural loans effective from 16th March, 2010 for a period of three months.

through increase in outreach and use of modern technology. For example, commercial banks in some developing countries are using mobile banking in far flung rural areas with the help of internet, laptop and identification equipment to get thumb impression. All these measures could help bolster the size of agri-credit market and increase the share of smaller provinces.

Figure 2.8: Recovery to Disbursement Ratio (Jul-Mar)



Recovery

Like weaker growth in credit disbursement, recovery also demonstrated a slower growth of 10.5 percent during Jul-Mar FY10 compared to 15.1 percent in the same period last year. However, recovery ratios[12] for commercial banks improved due to their focus on disbursements for short-term production loans (see **Figure 2.8**). In contrast, a bulk of disbursements by ZTBL was extended for long tenure developmental loans, thus their recovery ratios deteriorated during the first nine months of the current fiscal year.

Table 2.9: Fertilizer Off-take Growth

percent

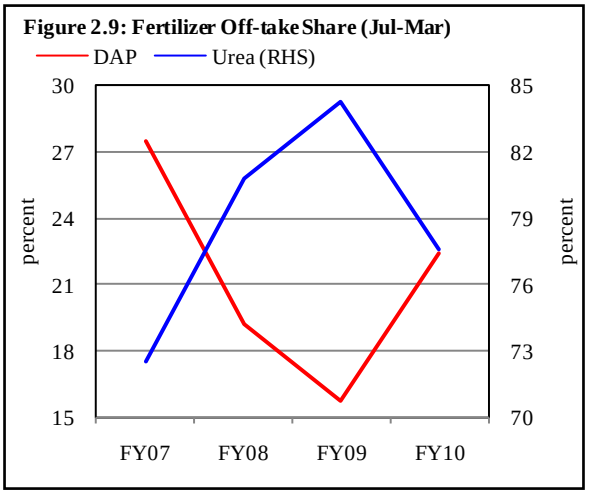
	FY08	FY09	FY10
Urea			
Jul-Sep	20.2	-2.9	25.6
Oct-Dec	0.7	-3.3	26.0
Jan-Mar	60.9	10.0	-8.4
Oct-Mar (Rabi)	23.2	2.7	8.7
Jul-Mar	22.2	0.9	13.6
DAP			
Jul-Sep	76.5	-56.7	376.9
Oct-Dec	-36.7	-22.6	24.0
Jan-Mar	-50.0	111.1	10.5
Oct-Mar (Rabi)	-37.9	-6.9	20.9
Jul-Mar	-24.1	-20.8	77.3
Total (urea and DAP) Jul-Mar	9.3	-3.0	23.8
Oct-Mar (Rabi)	3.1	0.8	10.9

Fertilizer off-take

Following higher commodity prices of most of agriculture commodities, farmers increased fertilizer off-take to enhance crop yields. Fertilizer off-take increased by 23.8 percent in Jul-Mar FY10 as against 3.0 percent fall during the corresponding period of FY09. This increase is mainly attributed to lower

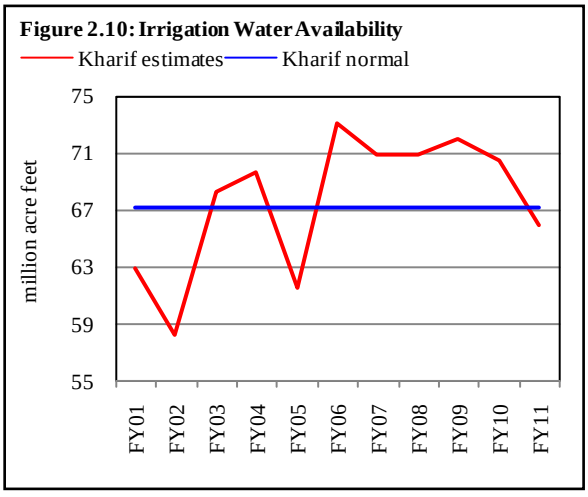
[12] Ratio of recovery to disbursements.

fertilizers prices than last year, ample availability, improved farm income and strong commodity prices. During Oct-Mar FY10 (*rabi*) fertilizer off-take increased by 10.9 percent compared with 0.8 percent in the same period last year (see **Table 2.9**).



Higher off-take is largely due to strong increase in DAP, which recovered with an impressive growth of 77.3 percent in Jul-Mar FY10 against a decline registered during the preceding two years. Higher DAP off-take during pre wheat sowing period proved a wise decision as farmers were able to make heavy purchases when DAP prices were at their lowest levels. During the preceding year, farmers used excessive urea instead of DAP due to higher prices of the latter. However, share of DAP in total fertilizer off-take increased during Jul-Mar FY10 as a result of use of balanced nutrients mix (see **Figure 2.9**).

Urea off-take also increased by 13.6 percent during Jul-Mar FY10 compared with only 0.9 percent rise in the same period last year. Its off-take mainly increased in the first two quarters of FY10, crucial growth period of *kharif* and sowing of *rabi* crops. Urea off-take during the third quarter, however, declined by 8.4 percent against 10.0 percent increase in Q3-FY09. Overall off-take during *rabi* FY10 (Oct-Mar) also registered 8.7 percent increase compared with 2.7 percent last year.



Given the positive impact of balanced use of fertilizers on yields during FY10,

particularly on wheat crop,[13] farmers are likely to continue this practice. However, uninterrupted availability of fertilizers at reasonable prices coupled with clear price incentives are some important factors to ensure the use of balanced mix of the nutrients.

Irrigation Water

IRSA[14] estimated a 6.4 percent drop in irrigation water availability for FY11 *kharif* season on top of a 2.1 percent decline in the same season last year (see **Figure 2.10**). Consequently, irrigation water availability would be 1.9 percent less than the normal levels for *kharif* FY11. The dropping level of irrigation water[15] poses a risk to the agriculture and the economy; urgent measures are needed to improve water management and efficient use of available water. Inadequate storage capacity of reservoirs in the country and waterworks by India are adding to the stress.

In addition, power shortages, rising prices of diesel oil and deepening underground water level also make tube-well water expensive for farmers. It is pertinent to note that *kharif* season is traditionally influenced by the glaciers melting in May and June, whereas the monsoon rains play an important role in filling up the major reservoirs and improve river/canal supply.

Outlook-Kharif FY11

Despite water shortages prospects for *kharif* FY11 are bright due to increasing use of quality seeds – Bt cotton and rice hybrid seed, sufficient fertilizer availability and clear incentives in terms of strong commodity prices. Government supportive policies such as (a) Rs 500 per bag subsidy on potash to promote balanced use of fertilizer; and (b) distribution of 10,000 tractors under Benazir Tractor Scheme, would also help increase

Table 2.10 : Crop Targets

area in '000 hectares; production in '000 tons

Crops	FY10		FY11	
	Area	Production	Area	Production
Cotton	3,200	13,360	3,200	14,000
Rice	2,526	5,949	2,708	6,048
Sugarcane	1,106	56,527	1,070	53,665
Maize	1,039	3,414	1,010	3,452
Mung	205	126	232	160
Mash	27	13	30	15
Chillies	49	105	65	158

Note: cotton in thousand bales of 170.09 kg each

[13] FY10 wheat yield could have dropped substantially due to water shortages.
[14] Indus River Water Authority.
[15] Pakistan is fast moving from being a water stressed country to a water scarce country, groundwater is over-exploited and polluted in many areas; most of the water infrastructure (even some of the major barrages) is in poor repair (World Bank, 2006).

enthusiasm among the farmers. There is a strong likelihood that FY11 cotton, sugarcane and rice harvests would surpass their targets **(**see **Table 2.10)**. However, final outcome will mainly be determined by the favorable weather and water availability.

2.2 Large-Scale Manufacturing

Growth in LSM sector gained further momentum in Q3-FY10, largely in response to rising domestic consumption as well as global recovery (see **Table 2.11**). Specifically, a large part of the LSM growth was driven by a sharp rise in consumer durable industries including automobiles and consumer electronics. Furthermore, in textiles, pharmaceuticals, and chemicals sub-sectors manufacturers benefited from rising export orders. As a result, LSM index showed a strong growth of 9.6 percent in Q3-FY10; the strongest quarterly growth since FY07. A number of positive developments reinforced growth January 2010 onwards and dispelled earlier fears of significant moderation, to a large extent.

Table 2.11: Performance of Selected Industries

percent YoY growth

	H1		Q3	
	FY09	**FY10**	**FY09**	**FY10**
Overall LSM	-4.8	1.6	-12.0	9.6
Consumer durable				
Cars & M. cycles	-42.4	22.9	-50.4	82.9
Cons. electronics	-14.3	-3.2	-59.9	115.5
Construction-led				
Cement	2.3	15.7	12.2	3.4
Steel coils & sheets	-28.7	-8.8	-17.6	4.3
Paints	18	-4.4	13.9	9.2
Transformers	-4.4	-26.2	-38.0	51.6
Export-led				
Cotton cloth	-0.3	-0.3	-0.4	1.1
Cotton yarn	-0.5	-2.1	0.3	-1.1
Pharmaceutical	0.9	4.9	2.7	12.2
Leather	2.5	26.9	5.5	17.3
Agriculture-led				
Fertilizer	22.4	1.7	18.6	43.8
Tractors	7	27.3	20.1	26.1
Agri. machinery	-37.8	51	50	21.5
Food	-4.4	-2.6	-16.3	-4.6

For detailed data please visit: www.statpak.gov.pk

For instance, the growth in consumer auto industry proved resilient to frequent upward price adjustments by local auto assemblers. The strong demand was supported by banks' renewed interest in consumer finance business January 2010 onwards. Anecdotal evidence suggests that auto assemblers and banks established liaisons whereby a number of banks are offering car-financing at reduced mark-ups for specific car brands.

Similarly, it was earlier feared that the activities in textiles might slow down with the end of cotton season as a large part of textile sector activities in H1-FY10 were observed in low value-added sector (ginning and spinning). However, the pick-up in value-added textile exports has eased these concerns. Specifically, the

imposition of quota on yarn exports improved the availability of raw material for high value added textiles which explains at least a part of pick up in high value-added textile exports in the third quarter.[16] Nonetheless, the value added textile sector is still complaining of high yarn prices and demanding the imposition of 25 percent regulatory duty along with quota restrictions on yarn export. On the other hand, the spinning sector that suffered huge losses in previous 3 years due to depressed global cotton and yarn prices wants to benefit from favorable prices in FY10 and is therefore against any interventions to free market. Succumbing to rising pressures from both the stakeholders, the government decided on May 12, 2010, to impose 15 percent regulatory duty (for 60 days) but withdrew the quota restrictions on yarn exports.

Finally, demand for electronic appliances remained strong. Anecdotal evidence suggests that the last year's low sales of cooling appliances have shifted the deferred demand to this year. Nonetheless, the fear of slowdown in manufacturing growth cannot be disregarded given the prevalent energy bottlenecks, rising commodity prices and a vulnerable law & order situation. From the capacity point of view, however, it appears that the growth momentum can be maintained with better administrative mechanism and utilizing available export opportunities.

Table 2.12: Capacity Utilization in Selected Industries (estimated)

percent

	Annual utilization					Jul-Mar	
	FY05	**FY06**	**FY07**	**FY08**	**FY09**	**FY09**	**FY10**
POL	88.4	88.2	87.4	89.9	82.9	81.6	75.0
Cement	91.3	88.6	74.3	72.0	68.0	65.4	67.7
Wheat milling	16.5	16.5	17.6	17.0	17.3	17.1	16.5
Edible oil & ghee	42.5	46.9	48.3	46.9	44.9	44.2	44.0
Sugar	47.9	45.5	54.3	72.8	49.1	65.4	63.1
Pig iron	92.5	62.4	82.0	80.8	64.3	69.5	42.1
Coke	79.7	18.8	33.6	30.0	43.7	45.3	36.2
Cars (single shift)	77.3	98.0	97.9	89.9	45.5	44.8	64.4

Source for installed capacity: OCAC, APCMA, PFMA, PVMA, PSMA, Pakistan Steel, FBS

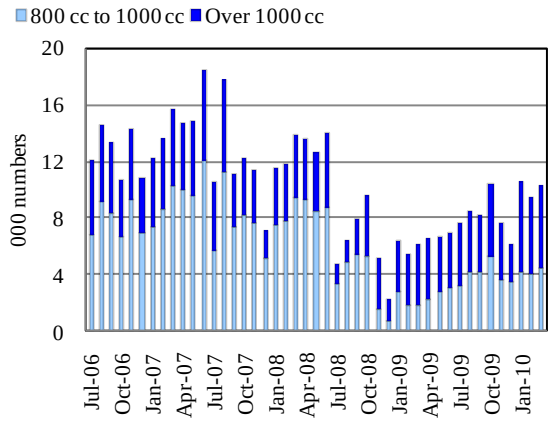
Specifically, production levels are still low in a number of industries despite a high growth, and the manufacturing capacity is largely under-utilized in many industries (see **Table 2.12**).

[16] Government first imposed a quota of 50 million kg per month via SRO 26(I)/2010. However, the quota was reduced to 35 million kg per month March 01, 2010 onwards vide SRO 119(I)/2010.

For instance, there is excess capacity in food sector which can be brought on line with appropriate market mechanism. This is especially true in case of sugar manufacturing where sugar production declined for the second consecutive year due to conflicts among cane growers and mill owners over price settlement during FY08 and FY09. Similarly, the country's capacity for wheat milling is reported to be around four times larger than the current demand for wheat products. Wheat milling activities have been low since FY08 when the government banned export of wheat products to Afghanistan due to domestic wheat shortages.[17] Although the ban was lifted in January 2010 due to better availability of wheat in the country, a large price differential in domestic and international wheat prices does not allow these exports to increase substantially. Flour mill owners are therefore demanding from the government to also allow export of wheat products at subsidized rates in addition to allowing wheat exports. The export of wheat products will result in increased value-addition and employment in the country.

Likewise, liquidity shortages driven by fiscal constraints in petroleum refining and metal industry are forcing manufacturing firms to operate at low utilization level. Not only has this caused a decline in domestic production but also led to increased import pressures in the face of high domestic demand. For instance, the refining industry is operating at around 76 percent utilization level as against over 86 percent utilization in the last few years. Similarly, Pakistan's largest steel mill is going through severe financial constraints. The mill is facing acute raw material shortage and is not able to utilize a large part of its capacity despite strong demand. Resultantly, import payments during Jul-Mar FY10 increased by 18.5 percent on petroleum products and 35.8 percent on pig iron over Jul-Mar FY09. Furthermore, the existing production levels in automobiles and cement sector are quite low compared with the available capacities. In case of automobiles, low production levels are seen mainly in cars with engine capacities within 1000 cc, which cater to the demand of medium-income group and mostly financed through banks (see **Figure 2.11**). With the renewed

Figure 2.11: Composition of Car Sales



[17] Exports to Afghanistan used to constitute 15 to 25 percent of total wheat milling in the country.

interest of banks in car financing, it appears that sales and production levels of automobiles will increase in coming months.

Besides available capacities, local manufacturers may also benefit from opportunities arising from export demand. The exporting industries should take benefit of appreciation of Chinese and Indian currencies which renders their exports more expensive in the global markets. Moreover, some improvement in liquidity of textile firms with the provision of 2.5 percent mark-up rate facility[18] (as per the textile policy 2010) as well as a rise in profitability of most textile companies also provides opportunity to these firms benefiting from rising global demand. Similarly, in case of pharmaceuticals and cement industries, rising demand in African countries provides a strong opportunity for local manufacturers to increase export penetration.

Thus, given the demand potential and capacities available in the sector; the debate on sustainability of LSM growth boils down to the issue of energy sufficiency. So far in FY10, gas supplies seem more or less sufficient to cater to LSM requirements. However, with the commissioning of a new gas-run steel plant in mid-May 2010, rising capacity utilization of a newly commissioned fertilizer plant and induction of new fertilizer capacity in Q1-FY11 will add to pressures on gas demand. Urea production, in particular, entails the usage of natural gas as both a raw material and as a source of fuel. Moreover, increasing use of gas-based generators and other appliances has lifted up domestic demand.

The rising demand for gas in fertilizer and household sectors means that the availability of gas for thermal generation will be less as both household/commercial sector and fertilizer production hold the top two priority positions for gas supplies. However, to improve gas supply to power sector, the government has decided to suspend CNG supplies for one day in a week to ensure supply to power sector. Although such re-allocations might help in lessening economic losses for a short term, for sustainable growth, there is a need to enhance gas provisions. In this regard, it is unfortunate that gas exploration activities have weakened significantly in the past few years mainly due to natural decline in gas reserves. Nonetheless, with a global decline in gas prices owing to adoption of cost effective extraction technologies, the import of gas might be a convenient option going forward.

As far as electricity supplies are concerned, the energy summit in end-April 2010 has taken a number of sweeping measures for energy conservation. Moreover, it

[18] SMEFD Circular No. 03 of 2010.

is also expected that at least a couple of private power projects would be completed by end of 2010. Besides electricity generation, government is also working at replacing existing transmission infrastructure to reduce transmission & distribution losses as already evident in recent increase in production of transformers and other power related products.

From long-run sustainability perspective, it is crucial to bring dams' construction on top priority to avoid possible water shortages as well as to increase cheaper hydel generation. Equally important is to expedite the infrastructure build-up to tap available coal reserves in the country. This would not only ensure energy sufficiency at low cost for economic activities but will also be helpful in mitigating pressures of increasing growth on energy driven external imbalances. Specifically, energy related imports have reached 4 percent of GDP in FY09 and FY10 and any substantial increase in growth will further increase import pressures.

2.3 Services Sector

The first nine months data for FY10 on major indicators reinforces the earlier assessment of an above-target services growth in FY10. Initial estimates suggest growth of 4.6 percent in services sector compared with the target of 3.9 percent. Most of the improvement in growth during FY10 has come from *wholesale & retail trade* that benefited from rising LSM production and imports (see **Table 2.13**). Contribution from *public administration & defense* has also remained strong.

Table 2.13: Services Growth Rate Targets

	5-yr. avg. share	FY09^{r}	FY10^{t}	FY10^{p}
Overall		1.6	3.9	4.6
Transport & comm.	19.5	2.7	3.0	4.5
Wholesale & retail trade	33.6	-1.4	3.3	5.1
Finance & insurance	10.6	-7.0	3.0	-3.6
Public admin. & defense	11.5	3.6	4.0	7.5
Community & personal	19.5	8.8	6.0	6.6
Ownership of dwellings	5.3	3.5	3.6	3.5

r=revised, t=target, p=provisional; Source: Provisional estimates by FBS; retrieved on May 21, 2010 from http://www.statpak.gov.pk/depts/fbs/statistics/national_accounts/national_accounts.html

Secondly, activities in transportation services also witnessed a sharp increase in FY10 due to higher demand for both public and private cargo transport. This is evident from higher sales of petrol and passenger vehicles (approximately 58 percent of total transport value-addition[19]), as well as increased sea and road freight.[20] Within the goods transport, it appears that the sea transport constituted the bulk of FY10 growth as PIA has

[19] Includes Pakistan Railways, PIA, buses, passenger wagons, taxies, and rikshaws.

reported a decline in cargo during Jul-Mar FY10. However, the national shipping company (PNSC) could not benefit from this recovery in the face of tough global competition in the form of low tariffs as well as shortage of vessels.[21] Consequently, a part of the shipping demand had to be met via imports.[22] However, the recent addition of two oil-carrier ships and scrapping of outdated vessels could strengthen earnings in the next quarter.

Similarly, the *telecommunications* sector presents a mixed trend. While the largest fixed line services provider posted a decline in earnings during FY10, the growth in cellular companies is expected to register some recovery due to increase in the subscriber base by 2.0 percent over June 2009. This increase in mobile subscribers is despite the fact that PTA discarded three million unverified mobile SIMs in FY10, and has largely come about in response to the fiscal incentives introduced in FY10.[23] The growing demand has been followed by network expansion projects by the cellular services' suppliers.

Public administration & defense registered the strongest growth within the services sector. In particular, an inevitable expansionary fiscal deficit mainly due to war against terror has helped significant growth under *public administration & defense* sub-sector in FY10.

Finally, the financial accounts of most listed banks confirm higher earnings in FY10, despite a rise in provisioning expenses, mainly due to volumetric expansion and high spreads (see **Tables 2.13** and **2.14**). However, as a result of a fall in the value addition by other components, growth in *finance & insurance* declined during FY10.

[20] Interestingly, despite the sharp increase in the sales of diesel-run trucks and LCVs, a similar growth was not observed in diesel sales. Anecdotal evidence suggests that diesel is being smuggled into Pakistan via Iran where the fuel is highly subsidized.

[21] It appears that revenues of PNSC could have been higher if not for low crude-oil imports. In specific terms, the national shipping company has long-term contracts with three major refineries and due to circular debt issue, the refineries were not able to import sufficient crude quantities.

[22] Chartering of foreign ships increased to $24 million in Jul-Mar FY10, up from US$ 12 million last year.

[23] These included reduction in FED and activation charges on new mobile connections, custom duty reduction on the imports of mobile sets, and elimination of regulatory duty on mobile set imports. The resulting demand recovery is evident from a sharp increase in mobile phone imports during the review period.

Table 2.14: Indicators of Services Sector Performance
percent YoY growth unless mentioned otherwise

	Q3		*Jul-Mar*	
	FY09	**FY10**	**FY09**	**FY10**
Wholesale & retail trade (33.6)				
Credit to wholesale and commission trade	-5.5	-11.1	5.1	-14.9
Credit to retail trade	21.0	7.0	32.9	4.8
FDI in trade	-6.3	-53.6	-5.8	-53.6
Manufacturing growth	-12.1	9.7	-7.5	4.5
Import growth	-36.4	30.1	-6.6	-3.9
Transport (16.0)				
Cargo handling at ports	-8.0	11.9	-0.2	17.4
PNSC operating profit – Dec. latest	34.8	-33.2	12.1	-42.2
Commercial vehicles sale	-35.0	45.4	-15.7	16.7
HSD & MS sales for transport	17.1	-0.7	0.5	2.9
Transport & communication price index	21.4	11.3	30.5	2.1
PIA operating profit	-110.5	-132.7	223.4	-81.6
Passage earnings of Pakistani air companies	-0.7	12.7	8.1	-0.6
Trade volume	-16.9	29.7	-4.6	-8.8
Communication (3.0)				
Teledensity (percentage of population)	60.3	62.4	..	..
PTCL operating profit	20.7	22.5	-10.9	-6.7
Telecomm imports	-66.2	2.7	-52.4	-35.3
Mobile phone imports	-88.7	299.2	-76.0	54.6
Communication services exports	44.1	53.4	-16.7	136.1
Finance & insurance (10.6)				
Transfer of SBP profits to govt.	..	-29.0	22.9	101.6
PAT of 7 major banks	-16.1	10.4	11.9	19.0
Percent of advances at 12% or above - inc	84.0	82.0	..	..
Percent of deposits held at 8% or above - inc	57.2	53.2	..	..
Interest rate spread - stock	7.7	7.3	..	..
Interest rate spread - inc.	6.3	6.1	..	..
Financial services exports	114.6	-61.3	73.7	43.3
Insurance services exports	-35.7	41.5	45.6	-23.9
Government services (11.5)				
Government borrowing	62.0	101.1	50.8	137.5
Govt. services exports	-58.3	171.7	10.3	28.0

Figures in parentheses are 5-year average contribution to services value-addition.