5 External Sector

5.1 Overview

Pakistan's overall external account balance posted a deficit of US$ 0.5 billion during H1-FY13 compared to a deficit of US$ 1.8 billion in the corresponding period last year. This relative improvement in the external account was entirely due to a positive turnaround in the current account, which posted a surplus of US$ 0.22 billion against a deficit of US$ 2.4 billion in the corresponding period last year **(Table 5.1)**. The development in current account was due to a combination of CSF inflows, steady growth in worker remittances and a contraction in the trade deficit. Of these, the impact of CSF inflows was the largest.

Table 5.1: Summary of External Accounts

billion US$

		FY13P		
	H1-FY12	**H1**	**Q1**	**Q2**
A-C/A balance	**-2.40**	**0.22**	**0.34**	**-0.13**
i) Trade balance	-8.02	-7.65	-3.67	-3.98
Exports	12.07	12.01	5.98	6.03
Imports	20.09	19.66	9.66	10.01
ii) Services account balance	-1.37	0.26	0.24	0.02
iii) Income account balance	-1.57	-1.77	-0.71	-1.05
iv) Current transfers	8.56	9.38	4.49	4.89
Remittances	6.33	7.12	3.60	3.52
B-Financial/Capital balance	**0.37**	**-0.51**	**0.07**	**-0.59**
i) FDI	0.53	0.56	0.12	0.44
ii) FPI	-0.16	0.16	0.13	0.03
iii) Others	-0.01	-1.24	-0.18	-1.06
C-Errors & omissions	**0.24**	**-0.25**	**-0.45**	**0.20**
Overall balance (A+B+C)	**-1.79**	**-0.54**	**-0.03**	**-0.51**
Foreign reserves (31st Dec)	16.92	13.85		
Exchange rate (31st Dec)	89.97	97.13		

P: Provisional

Source: State Bank of Pakistan

As against the current account, *capital* and *financial* account deteriorated further during the period under review. Specifically, against a surplus of US$ 0.37 billion in H1-FY12, the financial and capital accounts recorded a deficit of US$ 0.5 billion in H1-FY13. Although net foreign investment improved somewhat compared to last year, it was the fall in foreign borrowings that led to the overall deterioration in the financial account.

Nevertheless, despite the improvement in the overall external account position, the country's liquid foreign reserves declined by US$ 1.4 billion during H1-FY13, mainly due to the repayments made to the IMF (principal and interest). The adverse impact of this decline was reflected in Rupee Dollar exchange rate, which depreciated by 2.6 percent against the US dollar during H1-FY13.

5.2 Current Account

As mentioned earlier, CSF inflows were the deciding factor that pushed the current account into a surplus in H1-FY13. However, even without the CSF inflows, the current account deficit in H1-FY13 was still 36.2 percent lower than last year, as remittances remained strong and the trade deficit contracted (**Figure 5.1a**). The bulk of the improvement in the current account was concentrated in the first quarter, as contributory factors to the improvement lost momentum in Q2-FY13 (**Figure 5.1b**).

Figure 5.1a: Major Components of Current

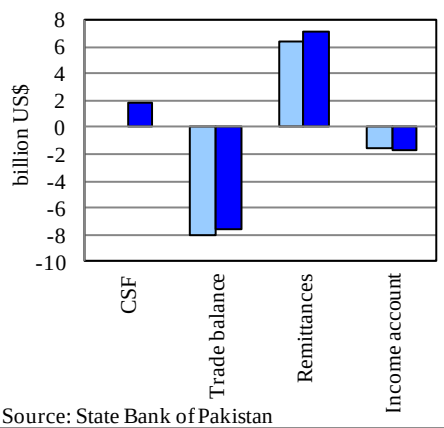
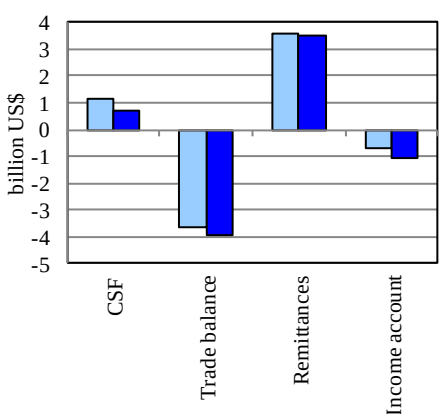


Figure 5.1b: Current Account Major Contributors

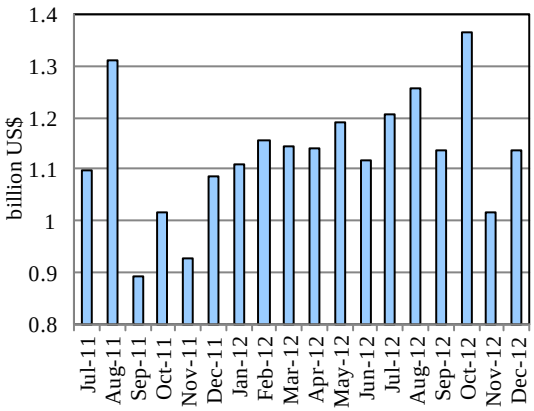


Source: State Bank of Pakistan

Major components of the current account

With CSF inflows acting as the swing factor in the current account, the *services account* balance posted a surplus during H1-FY13, against a deficit recorded last year. The *trade account* deficit contracted by 3.6 percent in H1-FY13, due to a 1.6 percent decline in imports (a reduction of US$ 0.4 billion). This decline was largely due to lower commodity prices during the period (**Section 5.6**).

Figure 5.2: Monthly Worker Remittances



Source: State Bank of Pakistan

Current transfers accelerated during H1-FY13, supported by a steady growth in worker remittances. Monthly data shows that after a seasonal decline in September and November 2012, remittances rebounded in subsequent months (**Figure 5.2**).[1]

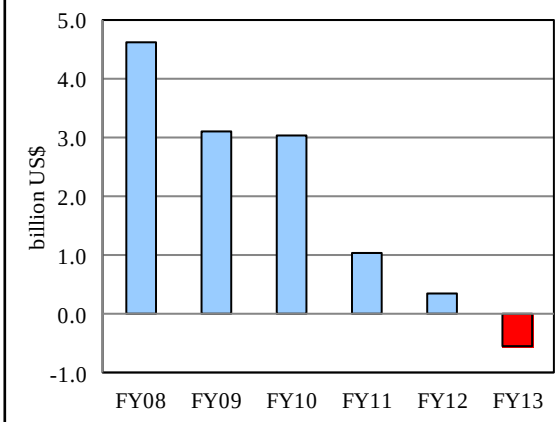
Country-wise data show that remittances from all traditional sources have increased. The share of Saudi Arabia was the largest followed, by the UAE and US. Other sources of remittances, like the UK and GCC countries, also contributed to the increase during the period under review.

5.3 Financial and Capital Account

After recording a surplus for the last 5 years, financial and capital accounts recorded a deficit in H1-FY13 (**Figure 5.3**). This was caused by Pakistan's inability to secure program loans from the IFIs, as well as an increase in repayments.

The decline in external borrowing overshadowed the slight improvement in net foreign investment, which increased by US$ 0.3 billion, on account of an improvement in both Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). During Jul-Dec FY13, FDI increased by 6.0 percent in contrast to a decline of 36.7 percent during the same period last year. A major part of FDI went to the financial sector.[2] In contrast, the telecommunication sector continued to record net outflows during this period

Figure 5.3: Financial and Capital Accounts - H1



Source: State Bank of Pakistan

Owing to improved performance of stock market, FPI posted net inflows of US$ 0.2 billion during H1-FY13, compared to net outflows last year.

[1] Remittances tend to fall after the Eid festival months.
[2] As against net inflows of US$ 44.1 million in Jul-Dec FY12, this sector attracted net inflows of US$ 140.0 million during Jul-Dec FY13.

5.4 Foreign Exchange Reserves

Pakistan's foreign exchange reserves fell by US$ 1.4 billion from their end-June 2012 level, to US$ 13.86 billion by the end of December 2012. This fall was entirely in SBP reserves, driven by the repayments to the IMF loan (**Table 5.2**).[3]

This depletion reduced the country's reserve adequacy as measured in weeks of imports, which fell from 19.9 weeks in June 2012, to 18.1 weeks in December 2012 (**Figure 5.4**).

5.5 Exchange Rate

Pakistan's currency depreciated by 2.6 percent vis-à-vis the US dollar during H1-FY13, compared to 4.4 percent in the same period last year. Weakness of the Pak rupee against US Dollar, coupled with the depreciation of US dollar against the Euro and the Sterling,[4] the Rupee lost 7.8 and 5.1 percent of its value against the Euro and GB pound respectively. Nonetheless, Pak rupee appreciated by 5.6 percent against the Japanese Yen as

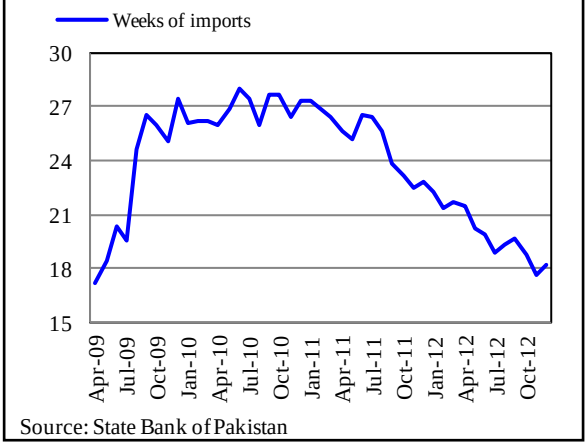
Table 5.2: Causative Factors of Changes in SBP Reserves -H1

million US$

	FY12	FY13
Inflows	**4,599.5**	**5,041.0**
Purchases	850.0	160.0
Inter-bank purchases	850.0	160.0
Swaps	**2,194.0**	**1,668.6**
Donor agencies & others	**1,555.5**	**3,212.4**
IDA	161.2	160.76
ADB	206.9	180.9
UN troops	138.9	130.9
Logistic support	0.0	1,806.5
Outflows	**6,490.2**	**6,840.1**
Sales	**525.0**	**820.0**
Inter-bank sales	525.0	820.0
Swaps	2,922.4	2,515.7
External debt servicing	**2,902.2**	**3,377.7**
IMF	229.6	1,321.8
IBRD	91.9	88.1
IDA	143.4	156.9
ADB	355.2	385.0
IDB	14.7	271.8

Source: State Bank of Pakistan

Figure 5.4: Reserves Adequacy Ratio



Source: State Bank of Pakistan

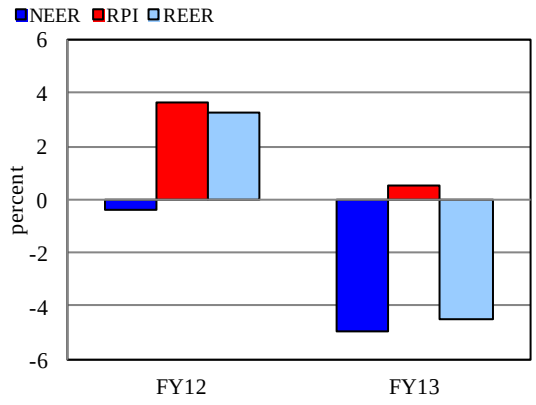
[3] Inflows and repayments to IMF are treated separately and are not reflected in either the current or the financial account.

[4] US dollar depreciated by 4.6 and 3.6 percent against the Euro and Pound during this period.

the Yen weakened against major currencies during H1-FY13.

The real effective exchange rate depreciated by 4.5 percent during H1-FY13 in contrast to an appreciation of 3.2 percent during the same period last year (**Figure 5.5**). This depreciation in real terms was the result of narrowing relative prices and the 4.9 percent depreciation of the Nominal Effective Exchange Rate (NEER) during H1-FY13 compared with a depreciation of 0.4 percent during the same period last year. On the other hand, the relative price index recorded a rise of 0.5 percent compared with a rise of 3.7 percent during Jul-Dec FY12. The deceleration in the relative price index was attributed to a slowdown in domestic inflation during this period.

Figure 5.5: NEER, RPI, REER - H1

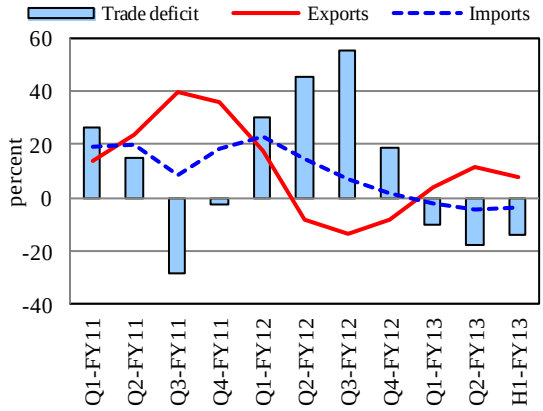


Source: State Bank of Pakistan

5.5 Trade Account[5]

Pakistan's trade deficit contracted by 13.9 percent during H1-FY13, compared to a 38.4 percent increase recorded last year (**Figure 5.6**).

Figure 5.6: Trade Account (YoY change)



Source: Pakistan Bureau of Statistics

While a slowdown in global commodity prices and better production of intermediate goods reduced the import bill (see **Chapter 2**), an extraordinary increase in the gold price differential and award of GSP status to Pakistan by the EU, boosted jewelry and textile exports.

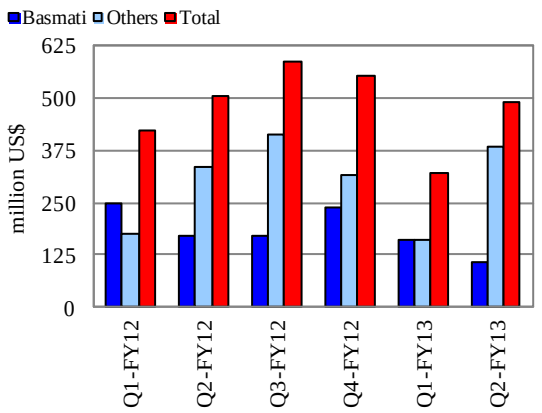
5.5.1 Exports

Exports grew by 7.5 percent YoY during H1-FY13, compared to 3.6 percent in the same period last year. The analysis of export growth shows that the impetus came from cotton; value added textile; vegetables; jewelry and engineering goods.

Rice Exports

Despite the increase in global prices, ***rice exports*** declined by 12.6 percent – entirely due to a decline in export quantum. Although late monsoon rains kept rice exports under pressure during the first quarter of FY13, they managed to stage a comeback in Q2-FY13 (**Figure 5.7**).

Figure 5.7: Rice Exports



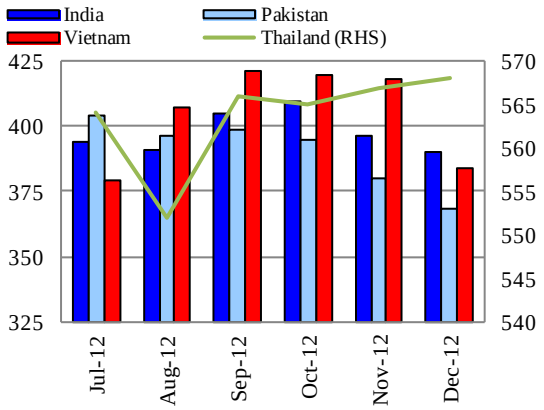
Source: Pakistan Bureau of Statistics

Basmati rice exports declined 35.1 percent YoY on account of lower quantum during H1-

[5] The analysis in this section is based on the data from the Pakistan Bureau of Statistics (PBS), which differs from the exchange records data prepared by the SBP.

FY13, whereas non-basmati rice exports recorded a rise of 6.6 percent YoY entirely on account of higher unit value. In case of non-basmati rice, Pakistan gained from the rise in Indian and Vietnamese export prices from September 2012 onwards (**Figure 5.8**). With regard to basmati rice, however, the situation was complicated by a new high – yield basmati rice variety launched by India. Having said this, demand from China in the coming months is expected to have positive impact on basmati exports in the remaining part of FY13.

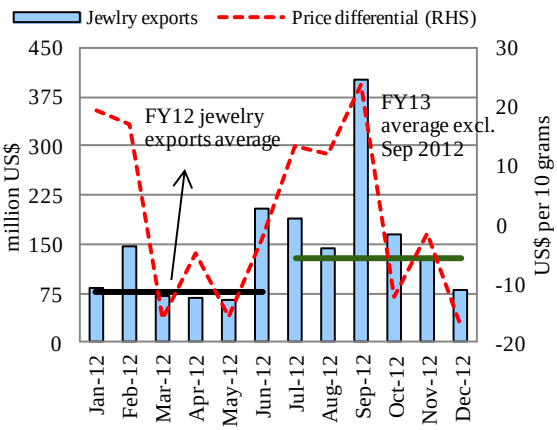
Figure 5.8: Rice Export Price (US$/MT)



Source: FAO

Jewelry exports continued to grow strongly and recorded a 300 percent YoY growth during H1-FY13. This surge is attributed to a sharp rise in the price differential between the domestic and international gold prices. Jewelry exports seem to have reverted to average levels with the vanishing of the differential (**Figure 5.9**).

Figure 5.9: Jewelry Exports and Gold Price Difference



Source: Pakistan Bureau of Statistics

Chemical and pharmaceutical exports recorded YoY decline of 28.3 percent during Jul-Dec FY13, in sharp contrast to 37.2 percent rise witnessed during the same period last year. This was primarily on account of plastics and other chemicals. Exports of plastics declined by 11.0 percent entirely due to the lower quantum, despite higher unit values of exported items.

This decline in export is disappointing as there is substantial potential to enhance exports of plastics to India. Pakistan has recently enhanced its PVC production whereas India is unable to meet its own domestic demand. Among other chemicals, ethylene dichloride and phthalic anhydride are produced in surplus

quantities in Pakistan, and are in demand in India. As for inorganic chemicals, there is a significant potential for export of caustic soda, soda ash and hydrogen peroxide, while aluminum hydroxide, dithionite, sulphoxylates and chlorates have significant potential[6].

Leather manufactured exports recorded a 3.8 percent YoY fall during Jul-Dec FY13. This fall appears to be the result of slack global demand and supply issues like the rising cost of production, unskilled force and the use of obsolete machinery.

According to the Leathers Manufactures and Exporters Association, this sector is confronting high raw material prices and depressed demand from the European Union (EU) (**Table 5.3**). The rising price of leather apparel has forced European consumers to opt for cheaper products made from artificial leather, which has adversely affected our exports in the EU.

Table 5.3: EU Leather Imports Jul-Oct (YoY change)

percent

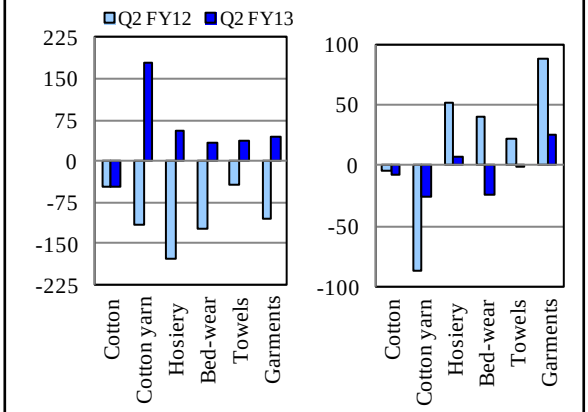
	India		China		Pakistan	
	Quantity	Value	Quantity	Value	Quantity	Value
FY11	-11.8	1.0	-31.9	-11.3	1.0	9.2
FY12	-28.5	-55.6	475.3	181.9	-90.5	-95.9
FY13	-3.0	1.0	-0.4	18.3	-27.3	-13.5

Source: Eurostat

Textiles

After recording YoY declines for eleven consecutive months, ***textile*** exports have registered double digit growth from September 2012 onwards. During H1- FY13 textile exports posted a 8.3 percent YoY increase. This was quite broad-based ranging from yarn and fabric, to final garments that are higher value added. Although both quantum and price impact remained positive, impact of quantum was much stronger (**Figure 5.10**).

Figure 5.10: Quantum and Price Impacts (million US$)



Source: Pakistan Bureau of Statistics

[6] International Trade Center: Normalization of Trade of Industrial Goods with India – Opportunities and Challenges for Pakistan. Trade Related Technical Assistance (TRTA II) Program funded by EU.

Quarterly data of textile exports reveal that a major part of this growth was recorded in the second quarter of FY13, during which exports grew by 15.0 percent YoY compared to 2.5 percent in the first quarter. Moreover, while the recovery in textile was largely because of low value-added items in Q1-FY13, the second quarter witnessed much stronger growth of high value-added items.

According to industry sources, growth in value-added textiles is a spillover of developments in China and Taiwan. Rising labor wages has significantly increased production costs in these countries, with some segments of global demand diverted to Pakistan.

Moreover, the announcement of duty waiver on 75 products by the EU from November 15, 2012 also provided impetus to textile exports, which could gain more ground with the award of GSP plus status in 2014. American buyers are also re-establishing links with Pakistan's textile and clothing manufacturers, following supply disruptions in Egypt. Industry sources attribute improved performance to uninterrupted provision of gas to the textile sector. Yarn and fabric exports specifically benefitted from improved energy supply.

5.6.2 Imports

Lower import prices along with declining quantums, led to a 3.3 percent YoY fall in the import bill during Jul-Dec FY13, in contrast to a rise of 18.7 percent during the same period last year. Monthly data reveals that Pakistan's imports declined in five of the first six months of FY13. The contractionary impact of these factors was more pronounced in Q2 than in Q1 (**Table 5.4**).

Table 5.4: Import Performance (FY13)

percent

	YoY Growth			Cont. in Growth		
	Q1	**Q2**	**H1**	**Q1**	**Q2**	**H1**
Food	-6.2	-27.8	-17.4	30.2	77.0	60.6
Machinery	13.3	-2.5	4.3	-59.6	8.2	-15.6
Transport	-2.5	-12.7	-7.8	19.6	13.9	15.9
Petroleum	4.6	-2.2	1.2	-65.0	17.2	-11.6
Textile	-13.6	-4.7	-9.2	31.8	5.9	15.0
Agri. & chemical	-18.9	-12.9	-15.9	148.8	50.6	85.0
Metal	0.4	21.3	11.0	-1.5	-30.2	-20.1
Total	**-2.4**	**-4.2**	**-3.3**	**100.0**	**100.0**	**100.0**

Source: Pakistan Bureau of Statistics

Group-wise data on imports show that the food, transport, textile and agriculture imports recorded YoY declines, which partially offset by the rise in machinery, oil and metal imports during H1-FY13. Food played the dominant part in reducing the country's import bill largely due to the decline in spices, palm oil and sugar imports.

The decline in *palm oil* imports is attributed to both lower quantum and price. Record stockpiles in the world and a reduction in export duty by Malaysia (the largest producer and exporter of palm oil), could be the primary reason behind lower prices in the international markets (**Table 5.5**). The lower import quantum may also be linked to the increased use of soybean oil after record production of soybean in Indonesia.

Table 5.5: Quantum and Price Impact – Import Categories

million US$

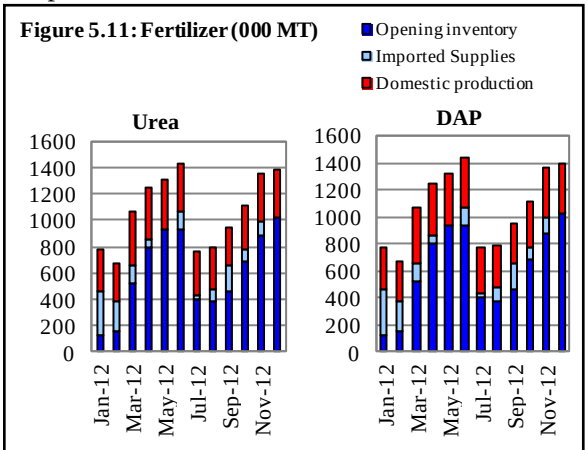
	Quantum			Price		
	Q1	**Q2**	**H1**	**Q1**	**Q2**	**H1**
Petroleum Crude	-20.7	538.4	476.7	-11.8	-192.3	-163.1
Fertilizer Manufacture	-196.2	-284.6	-479.5	16.1	13.9	28.6
Raw Cotton	151.2	103.8	249.9	-122.5	-58.5	0.0
Gold	-9.0	34.8	24.8	0.6	-1.3	0.3
Tea	-6.0	24.9	19.4	-10.5	2.8	-8.2
Soybean oil	11.2	-1.1	10.2	-0.5	-0.4	-0.9
Palm Oil	3.0	-83.2	-83.1	-70.6	-88.2	-155.8
Iron	16.3	-15.4	0.9	15.1	36.0	51.2
Sugar	-4.9	-4.9	-9.8	-0.2	0.0	-0.2

Source: Pakistan Bureau of Statistics

Agriculture and chemical imports also recorded a fall during H1-FY13, which is because of the decline in fertilizer imports.

Imports of manufactured fertilizer recorded a steep decline in quantum during Jul-Dec FY13. This follows the high price of domestic fertilizer, which led to lower Urea off-take during the period under review.[7] In addition, large domestic inventories were also available from last year's imports, which precluded the need for further imports (**Figure 5.11**).

Figure 5.11: Fertilizer (000 MT)



Source: State Bank of Pakistan

[7] Urea off-take recorded 2489 thousand MT during H1FY13 compared to 3289 thousand MT for the same period last year.

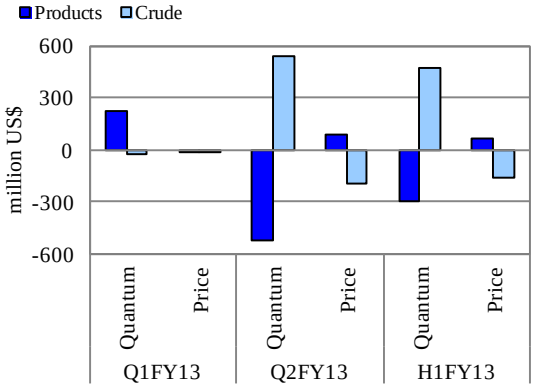
Machinery imports posted a rise of 4.3 percent during H1-FY13. Category-wise data reveals that import of office, construction, and telecom machinery increased, which more than offset the decline in import of textile, agriculture, and power generating machineries.

Transport group imports fell 7.8 percent mainly due to the fall in aircrafts, ships & boats, auto parts and CKD kits. Imports of aircrafts, ships & boats declined by 31.2 percent during H1 FY13, mainly due to sluggish activity on one of the world's largest ship breaking sites at Gaddani.

Lower import of CKD kits follows the fall in domestic production of cars in the country[8] as manufacturers discontinued the Suzuki Alto and Daihatsu Cuore models. Moreover, more than 20,000 cabs were produced for the Punjab government yellow cab scheme in FY12, which did not boost the domestic demand this year.

In overall terms, ***petroleum*** imports recorded a nominal 1.2 percent YoY increase during Jul-Dec FY13, almost all of which was due to a rise in quantum of petroleum crude. All the increase came in Q2-FY13, as petroleum crude imports increased by 30.6 percent, but this was partially offset by the decline of 16.3 percent in p*etroleum products* (**Figure 5.12**). In terms of quantum, petroleum imports recorded an increase during Q2-FY12 after declining in Q1-FY12, which may have been due to more frequent load-shedding of CNG.

Figure 5.12: POL Imports (Quntum and Price Impacts)



Source: Pakistan Bureau of Statistics

[8] According to PAMA car production in the country recorded at 45,665 units at during H1FY13 compared to 60,628 units during the same period last year.