2 Real Sector

2.1 Overview

The Annual Plan envisages a GDP growth target of 5.5 percent for FY16, compared to 4.2 percent realized in the preceding year (**Table 2.1**). The higher growth assumes a recovery in the crop production; improvement in energy supply; and increased investment under China Pakistan Economic Corridor (CPEC). The energy and infrastructure projects are the key components of the FY16 growth strategy for their increased focus on projects related to power, transport and communication subsectors – these projects also have large spillover impact on construction and manufacturing activities.

Table 2.1: GDP Growth

percent

	Share	Growth	
	FY15	**FY15**	**FY16^T**
Agriculture	**20.9**	**2.9**	**3.9**
Major crops	5.3	0.3	3.2
Other crops	2.3	1.1	4.5
Livestock	11.8	4.1	4.1
Industry	**20.3**	**3.6**	**6.8**
Large scale	10.6	2.4	6.0
Electricity gen& distt and gas distt	1.7	1.9	6.0
Construction	2.4	7.0	8.5
Services	**58.8**	**5.0**	**5.7**
Wholesale and retail trade	18.3	3.4	5.5
Transport, storage & comm	13.4	4.2	6.1
Finance and insurance	3.1	6.2	6.5
Housing services	6.8	4.0	4.0
General government services	7.4	9.4	6.0
Other private services	9.9	5.9	6.4
GDP	**100.0**	**4.2**	**5.5**

Source: Pakistan Bureau of Statistics; Targets are sourced from Annual Plan for 2015-16 issued by Planning Commission

T: Target

So far, prospects of achieving the target GDP growth have become challenging due to damages to FY16 *kharif* crops. Preliminary estimates suggest below-target production for all major *kharif* crops (cotton, rice, and sugarcane) due to bad weather, virus attacks and sluggish agri commodity prices. More importantly, cotton and rice crops would not be able to achieve the last year's production levels.

Encouragingly, the large scale manufacturing has shown some signs of recovery on the back of: (1) a steep fall in global prices of key raw materials; (2) robust growth in construction (mainly bolstered by increase in public sector spending), and auto sector; and (3) better gas availability to fertilizer.[1] However, despite these positive developments, LSM needs further momentum to achieve full year growth target of 6.0 percent.

Within the services sector, we expect *transport, storage & communication* and *finance & insurance* subsectors (with combined share of 28.1 percent in services) to grow strongly. However, the outlook for *wholesale & retail trade* subsector (having 31.1 percent weight) remains unclear: while a better performance by the large scale manufacturing is positive for *wholesale & retail trade,* the overall trading of agri produce is likely to remain weak due to production declines for rice and cotton crops.

2.2 Agriculture

The initial assessment of *kharif* crops is reflective of vulnerabilities. While all major crops are expected to miss their targets, cotton and rice (having combined share of around 40 percent in value addition by major crops) may not even achieve the last year's level (**Table 2.2**).

Table 2.2: Production Estimates for Kharif Crops

million tons

	Share in major crops (FY15)	FY14	FY15	FY16 Target	FY16 Estimates
Rice	12.4	6.8	7.0	6.9	6.6
Sugarcane	12.1	67.5	62.8	68.0	65.4
Cotton (mln bales)	28.0	12.8	14.0	15.5	10.9

Source: Planning Commission; Ministry of National Food Security & Research; and Cotton Crop Assessment Committee

A number of factors explain this weak performance. For example, the depressed prices of cotton and rice in the previous season encouraged farmers to shift to other crops (e.g., spring maize, fodder, vegetable, etc.). Moreover, heavy rains in July 2015 damaged rice and cotton. The cotton crop suffered the most as the moist weather also attracted pest and virus attacks.

Despite heavy rains in July 2015, the water availability during *kharif* remained lower than the last year (**Table 2.3**).[2] The use of fertilizer (both urea and DAP) also recorded a decline during Apr-Sep 2015, probably owing to rising cost and pressure on farmers' income.[3]

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[1] Fertilizer imports remained strong during Q1-FY16, despite lower off-take, comfortable inventories and better domestic production. This reflects government's decision to import 150,000 tons of urea to overcome any shortage during the *rabi* 2015-16 due to possible gas curtailment for fertilizer industry during winters.

[2] The availability of irrigation water was lower than the average of 67.1 MAF for kharif season (Source: Indus River System Authority).

[3] The price of urea increased from Rs 1,882 per 50kg at end-June 2015 to Rs 1,975 at end-September 2015. DAP prices also rose from Rs 3,692 to Rs 3,710 per 50 kg during the same period.

It may be noted that growers in Pakistan have faced several shocks during the last year. For example, September 2014 floods and heavy rains in July 2015 inflicted damages to major crops. The income of growers came under further pressure when prices of agriculture produce in domestic market fell in line with the global trends, whereas the input cost (seeds, fertilizer and pesticides) increased. Realizing difficulties faced by farmers, the government announced a relief package of Rs 341 billion for agriculture on 15th September 2015, which included direct cash support and provision of soft agriculture loans (**Box 2.1**). While this package would not change the outcome for *kharif* crops, we expect growers would receive the much needed financial support before the sowing of *rabi* crops.

Table 2.3: Input Situation (Apr-Sep)

	Fertilizer Off take (000MT)		Irrigation water (MAF)
	Urea	DAP	
2013	2851.7	616.4	65.54
2014	2715.5	560.5	69.27
2015	2660	557.6	65.48
Growth			
2014	-4.8	-9.1	5.7
2015	-2	-0.5	-5.5

Source: NFDC for fertilizer; Suparco Report for irrigation water; State Bank of Pakistan for bank credit.

Furthermore, the government, since early 2015 has initiated a subsidy program to export sugar and wheat. So far 524 thousand tons of sugar has been exported to yield US$ 232.7 million as export proceeds under this program. The wheat export has been rather slow, and 9.4 thousand tons have been exported so far to yield US$ 3.1 million.

Cotton *(28.0 percent share in major crops)*

According to latest estimates, cotton crop for FY16 is likely to reach 10.9 million bales, falling well below the target, as well as the production realized in the preceding year (**Table 2.4**).[4] Heavy rains and floods inflicted damages to the standing crop in major cotton growing areas of Punjab and Sindh. Further losses came from pest attacks, particularly in Punjab.[5]

Table 2.4: Performance of Cotton Crop

	Area (million hac)			Production (million bales)		
	FY15	FY16		FY15	FY16	
		Target	Estimate		Target	Estimate
Punjab	2.32	2.42	2.25	10.28	10.50	7.40
Sindh	0.60	0.65	0.65	3.57	4.40	3.40
Balochistan	0.04	0.04	-	0.11	0.59	0.06
Total	**2.96**	**3.12**	**2.90**	**13.96**	**15.49**	**10.86**

Source: Cotton Crop Assessment Committee

[4] Cotton Crop Assessment Committee (CCAC) in its 4th meeting held on 14th December, 2015, further lowered cotton production estimates to 10.86 million bales from 11.3 million bales assessed in November 2015.
[5] Source: Pakistan Central Cotton Committee.

Anticipating a decline in cotton production, domestic mills are keen in buying the seed cotton.[6] This has partly offset losses to growers as prices of seed cotton have been recovering in some of the key markets in Sindh and Punjab. Nonetheless, these prices still remain depressed compared to their levels in the corresponding period of the previous year. In international markets, a slowdown in demand from China is likely to keep cotton prices low despite a fall in global cotton production.[7]

***Rice** (12.4 percent share in major crops)*

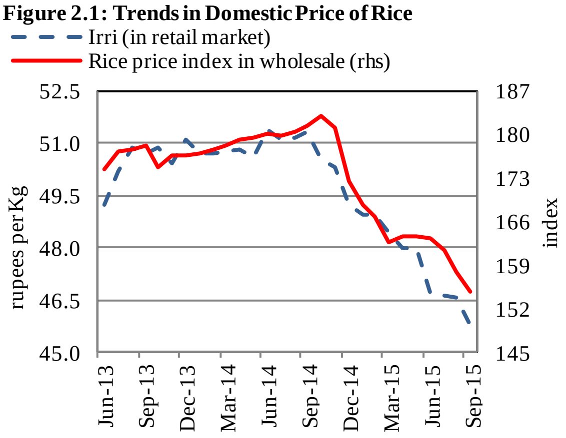
Preliminary estimates from provincial crop centers suggest a fall of 4.8 percent in area under rice cultivation over the last year (**Table 2.5**). As mentioned earlier, depressed prices and rising cost of production encouraged farmers to substitute rice with fodder and maize. The heavy downpours in July 2015 also affected paddy cultivation. The overall production in FY16 is therefore likely to be 6.6 million tons, compared to the target of 6.9 million tons, and production of 7.0 million tons in FY15.

Table 2.5: Area under Rice (000 hectare)

	FY15	FY16		% growth over	
		Target	Estimates	FY15	Target
Punjab	1,878	1,800	1,789	-4.8	-0.6
Sindh	782	781	720	-7.9	-7.8
KPK	57	70	70 [1]	38.5	0.0
Balochistan	174	185	174	-2.9	-5.8
Pakistan	**2,891**	**2,836**	**2,753**	**-4.8**	**-2.9**

[1]Area estimates from KP are still awaited.
Source: Provincial Crop Reporting Centers

Figure 2.1: Trends in Domestic Price of Rice



Source: Pakistan Bureau of Statistics

Despite expected production decline, rice prices in domestic market recorded a steep fall in recent months (**Figure 2.1**). This sharp drop in prices mainly reflects pressure of

[6] The pace of cotton arrival into ginning factories has also remained subdued so far. Pakistan Cotton Ginners Association has reported arrival of 8.6 million bales upto 1st December, which is significantly lower than 12.1 million bales arrived during the corresponding period of previous year.
[7] December 2015 report of the International Cotton Advisory Committee available at following link: https://www.icac.org/cotton_info/publications/updates/2015/English/ectm12_15.pdf

large carryover stock from a record FY15 rice harvest. Specifically, abundant rice supply (owing to healthy crop in both FY14 and FY15), and sluggish exports particularly of basmati, has led to a steep rise in rice stocks.[8]

This means, pressures on domestic rice prices would subside or reverse only if the country is able to enhance its exports significantly. However, probability of any rebound in rice exports is low. In the case of Basmati rice, Pakistan's exports are already facing tough competition from India in the UAE market.

As for the export of non-basmati varieties is concerned, severe drought in Thailand – the largest exporter of non-basmati varieties – creates opportunities for Pakistan to increase exports. However, at the same time, the import demand from some of the African countries is likely to falter due to better harvest in that region, as well as their commitment to reduce reliance on imports.

Finally, we also do not expect any sharp recovery in the global rice prices as the carryover stocks are sufficiently large, and 2015 harvest is projected to remain good despite dry weather conditions in some of the rice exporting countries.[9]

Sugarcane *(12.1 percent share in major crops)*

The area under sugarcane crop cultivation almost achieved its target for the year (**Table 2.6**). The production would reach 65.4 million tons, though higher than the last year's level of 62.8 million tons, this is significantly lower than the target of 68 million tons, as envisaged in the Annual Plan for FY16.

Table 2.6: Area under Sugarcane (000 hectare)

	FY15	FY16		% growth over	
		Target	Estimate	FY15	Target
Punjab	711	690	701	-1.4	1.6
Sindh	317	320	313	-1.3	-2.2
KPK	113	130	113	0.0	-13.1
Balochistan	1	1	1	-6.4	-34.5
Pakistan	1,141	1,141	1,128	-1.2	-1.2

Source: Provincial Crop Reporting Centers

We expect the cane price dispute between growers and government would continue this year as well. As mills have not been able to clear out their growing sugar stocks before the arrival of new crop, this has delayed cane crushing. Interestingly, sugar prices in the international market saw some gains in recent

[8] The export of basmati rice fell by 21.6 percent (on quantum basis) during FY15. This downtrend continued in FY16 as well, with a 14.9 percent YoY decline during Jul-Sep FY16.

[9] The global production of milled rice in 2015 still remains almost unchanged at the last year's level of 494.5 million tons (Source: Rice Market Monitor, Vol XVI1I, Issue No. 3, October 2015, Food and Agriculture Organization of the United Nations).

months on expectations of supply shortfall.[10] However, the global price of sugar is still lower than the domestic price, which makes export of sugar from Pakistan difficult.

Box 2.1: Relief package for agriculture

The growers in Pakistan faced multiple shocks during FY15. For example, September 2014 floods and heavy rains in July 2015 inflicted damages to major crops.[11] The income of growers came under further pressure when (1) the prices of agriculture produce in the domestic market fell in line with the global trends;[12] and (2) the input cost (seeds, fertilizer and pesticides) increased.

In order to support farmers, the government on 15th September 2015, announced a relief package of Rs 341 billion for agriculture, which includes direct cash support (Rs 147 billion) and provision of soft agriculture loans (Rs 194 billion) **Table 2.1.1**. [13]

Table 2.1.1: Relief Package
billion rupees

Total	341
Direct benefit	147
Loans	194
Of which	
Cash support to cotton growers (upto 12.5 acre)	20
Cash support to rice growers (upto 12.5 acre)	20
Fund to reduce price for fertilizer	20
Premium on agri insurance	2.5
Mark up on loans for solar tube well (7 years)	12.5
Bank loan guarantee	30

Source: Press Release by PM Secretariat

The relief package provides a total of Rs 40 billion as cash support to rice and cotton growers. The government is also setting up a Rs 20 billion fund to reduce prices of fertilizers which will lessen Rs 500 per bag of Potassium and Nitrate fertilizers.[14] In addition, government is calling on fertilizer manufacturers to revert back the recent hike of Rs 159 per bag in urea prices (which was due to increase in gas tariffs).

[10] The market fears supply disruption as more sugarcane is diverted to ethanol production in Brazil (the largest producer of sugar) and expected decline in sugarcane crop in India (the second largest producer of sugar). As a result, sugar prices increased from US$ 230.2 per metric ton in August 2015 to US$ 341.3 in December 2015. These prices are still lower than US$ 348.7 per metric tons recorded in November 2014 when the government announced freight subsidy of Rs 10 per kg on export of sugar.

[11] According to Pakistan's Economic Survey FY15, heavy rainfall and floods in September 2014 damaged the standing crops of cotton, rice and sugarcane particularly in the districts of Jhang, Muzzafargarh, Multan and Sargodha. In addition, the rabi crops (mainly wheat) suffered from heavy rains and hailstorm in April 2015, particularly in KPK and Punjab.

[12] For example, the World Bank commodity prices index for grains fell by 22.8 percent from March 2014 to June 2015. The wholesale price of wheat and rice in the domestic market fell by 22.3 and 8.4 percent, respectively, during this period.

[13] The budgetary impact of this relief package would be limited to Rs 60 billion, which will be met through reallocation of expenses from other heads.

[14] The price of Potassium Sulfate (POS) increased from Rs 4,793 per 50 kg bag in July 2014 to Rs 5,300 in July 2015; whereas the price of Calcium Ammonium Nitrate (CAN) recorded a marginal ease from Rs 1,604 per 50 kg bag to Rs 1,582 during the same period.

Furthermore, as a part of this package, the government has announced several tax measures as well. For example:

- The custom duty, sales tax and withholding tax on the agriculture machinery have been reduced from 45 percent to 9 percent;
- The Government would bear the premium on agricultural insurance which will benefit 0.7 million small farmers;
- Solar tube-wells will be provided on mark up free loans to the farmers who own up to 12.5 acre of land. Fix electricity price for running tube-wells at Rs 10.35 per unit during peak hours and Rs 8.85 at off-peak hours. Sales tax on these bills to be borne by the federal government;
- Guarantee would be provided to banks for financing to small farmers;
- Time-limit to pay back outstanding loan on the rice traders would be extended up to June 30, 2016;
- Rice millers were given full exemption on the turn-over tax for year 2015-16;
- Traders of agriculture commodities, fruits, vegetables and fish would get an exemption of three years on income tax;
- Sales tax on cold chain machinery had been reduced from 17 to 7 percent;
- The installation of production unit of Halal meat that will be registered before December 31, 2016 will be given a four-year exemption on income tax.

In terms of the impact of this package on crops, we expect that an early pay out of this direct support is likely to improve yields for the upcoming rabi crops (as better cash flows would enable farmers to enhance the use of fertilizer and pesticides).

2.3 Large scale manufacturing (LSM)

The large scale manufacturing has been showing some encouraging signs from Q1-FY16, as YoY growth reached 3.9 percent in this quarter compared to 2.6 percent in the corresponding period last year (**Table 2.7**). A number of factors explain this recovery:

- Industries particularly in food, steel, auto, cement, and chemical sectors benefited strongly from persistent low prices of key raw materials and inputs in the global market (**Table 2.8**).[15] Further improvement in firms' margins came from lower funding cost, reflecting a sharp fall in lending rates.[16,17]

[15] During Q1-FY16, PKR recorded a depreciation of 2.6 percent against US Dollar, which partly diluted the advantage available to importers from lower raw material prices. However, imports from China (one of the major source country for our imports) remained attractive, as PKR depreciated by just 0.2 percent against Chinese Yuan during this period.

[16] The weighted average lending rate charged by banks on their gross disbursement fell from 11.14 percent in September 2014 to 8.36 percent in September 2015.

[17] The decline in input cost also curtailed the financing needs of firms.

- The continued healthy performance by the construction sector, led by an increase in public sector development spending, provided a much needed boost to allied industries of cement, glass, paint, and steel.[18]

Other factors included better gas availability for some of the fertilizer plants, which led to a pickup in this sector. Similarly, a rise in auto financing together with the impact of 'Apna Rozgar' scheme by the Punjab government helped auto sector achieve higher production.[19]

Table 2.7: YoY Growth in LSM (Jul-Sep)
percent

		YoY Growth		Contribution in Growth	
	wt.	**FY15**	**FY16**	**FY15**	**FY16**
LSM	**70.3**	**2.6**	**3.9**		
Textile	21.0	1.5	0.7	18.4	5.8
Cotton yarn	13.0	1.9	1.3	15.6	6.9
Cotton cloth	7.2	0.1	0.6	0.4	1.7
Food	12.4	1.6	4.3	9.5	16.7
Vegetable ghee	1.1	1.8	3.4	1.0	1.3
Cooking oil	2.2	-7.2	7.4	-11.1	6.9
Soft drinks	0.9	11.6	12.7	13.5	10.9
POL	5.5	7.4	4.5	19.2	8.2
Steel[1]	5.4	13.9	-5.3	18.2	-5.2
Non-metallic minerals	5.4	2.1	4.5	8.5	12.2
Cement	5.3	2.2	4.6	8.8	12.3
Automobile	4.6	13.6	31.4	26.0	44.4
Jeeps and Cars	2.8	11.5	46.4	10.7	31.5
Fertilizer	4.4	-4.1	15.1	-10.2	23.8
Pharmaceutical	3.6	3.2	7.2	10.2	15.6
Paper	2.3	1.0	-22.6	1.9	-26.6
Chemicals	1.7	7.3	13.9	6.8	9.1
Caustic soda	0.4	6.3	36.7	1.0	4.2
Leather products	0.9	8.0	-0.2	5.8	-0.1

1. The decline in steel production during Q1-FY16 is due to complete shutdown of Pakistan Steel Mills in July 2015.
Source: Pakistan Bureau of Statistics

Encouragingly, a number of firms in cement, textile, iron & steel, and POL sectors are making investment for capacity expansions; debottlenecking of plants;[20] Balancing, Modernization and Replacement (BMR); installation of coal fired or captive power plants, etc. While FDI inflows remained scanty, these investments are expected to be funded through domestic resources.

[18] The consolidated expenses on PSDP recorded a steep rise from Rs 93.0 billion in Q1-FY15 to Rs 146.4 billion in Q1-FY16. The government is already targeting to increase PSDP spending from Rs 987.8 billion in FY15 to Rs 1,235 billion in FY16.
[19] According to corporate report of Pak Suzuki, the company sold 32,041 units of Bolan and Ravi till end-September 2015, against the total demand of 50,000 units under Apna Rozgar Scheme. The entire demand is expected to be met by February 2016.
[20] Debottlenecking is the increase in production capacity of an existing plant through modifications in the equipment configuration or workflow.

Better gas availability led to higher growth in fertilizer

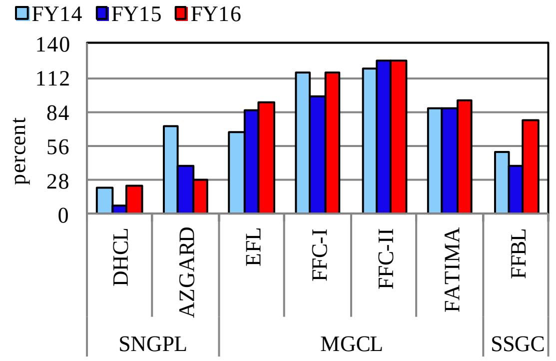
The better availability of gas to fertilizer plants helped industry achieve a promising growth of 15.1 percent in Q1-FY16. As shown in **Figure 2.2**, almost all manufacturing units performed better in Q1-FY16 than the corresponding period last year. However, the fertilizer off-take remained sluggish due to (1) increase in urea and DAP prices in early September 2015;[21] (2) pressure on growers income following collapse of agriculture commodity prices; and (3) farmers were waiting for notification on fertilizer subsidy announced in the Federal Budget for 2015-16.[22]

Table 2.8: Global Prices of Key Raw Material

		Q1 FY15	Q1 FY16	YoY Growth Q1 FY15	YoY Growth Q1 FY16
Coal (South African)	US$/MT	70.2	54.3	-2.9	-22.6
Iron ore	US$/MT	90.4	55.0	-32.0	-39.1
Copper	US$/MT	6,996	5,267	-1.3	-24.7
Crude oil (Dubai Fateh)	US$ per barrel	101.5	49.9	-4.4	-50.9
Rubber	US$/MT	1,832	1,457	-29.3	-20.4
Palm oil (Malaysian)	US$/MT	772.0	574.0	-6.7	-25.6

Source: Haver Analytics

Figure 2.2: Capacity Utilization of Different Fertilizer Plants



Source: National Fertilizer Marketing Limited and Corporates' websites

Robust demand bolstered growth in the auto sector

The auto sector recorded a robust growth in Q1-FY16 (**Figure 2.3**). The launching of Apna Rozgar scheme by Punjab government; the introduction of new sedan models; and aggressive marketing of auto financing products by commercial banks supported the strong growth in the passenger car segment.[23] We expect some slowdown in car production after February 2016 when the demand under Apna Rozgar Scheme would be over.[24]

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[21] In early September 2015, the manufacturers raised prices of urea and DAP in response to increase in gas tariffs. However, while announcing the agriculture package government indicated a possible reversion of urea prices to previous levels.

[22] The government notified the subsidy on 15th October, 2015.

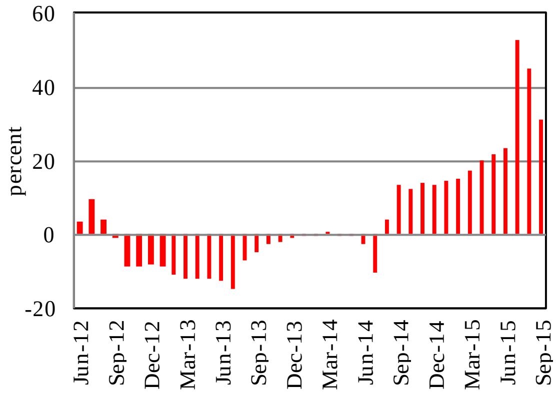
[23] The auto financing by commercial banks increased by Rs 5.9 billion in Q1-FY16, compared to Rs 3.6 billion in same period last year.

[24] To put this in perspective, the auto industry produced 20,505 *additional* units of car and light commercial vehicles during Q1-FY16 compared to the corresponding period last year. Of that, more than half were produced under Apna Rozgar Scheme.

Local demand kept up the cement industry

The cement industry witnessed a higher growth of 4.6 percent in Q1-FY16 against 2.2 percent in the same period of FY15. The growth was mainly driven by increased demand from mega–infrastructure and residential projects. The external demand on the other hand remained sluggish as reflected in a substantial fall in cement exports during Q1-FY16.[25]

Figure 2.3: YoY Growth in Automobiles*



* Total number of all automobiles

Source: Pakistan Bureau of Statistics

We expect domestic demand for cement to increase further in view of infrastructure projects under China Pakistan Economic Corridor (CPEC) and up gradation of Tarbela and Bhasha Dams. The leading cement producers are already gearing up to meet this surge in demand by expanding their capacities.

Chemical sector experienced capacity expansion

Chemical production grew by 13.9 percent in Q1-FY16 on top of 7.3 percent increase recorded last year. This growth mainly came from caustic soda segment, where one large manufacturer started commercial production from its newly established plant in June 2015.[26] Further expansion in this sector is also on cards as the same company is installing another plant which is expected to commence its production in 2017.

While performance of PSM remained dismal, private steel manufacturers are growing strongly

The complete shutdown of Pakistan Steel Mills (PSM) since Jul 2015 masked the overall growth in steel sector during Q1-FY16. The overall steel production fell by 5.3 percent during Q1-FY16, compared to a robust growth of 13.9 percent in the corresponding period of the previous year. Steel manufacturers in the private sector, however, exhibited a strong growth of 12.9 percent – higher than 11.3 percent increase in Q1-FY15 (**Table 2.9**).

[25] The volume of cement export dropped by 36.7 percent in Q1-FY16 (on YoY basis), compared to a fall of 4.3 percent in the corresponding period previous year. This decline was evident in all three main markets i.e., Afghanistan, India and South Africa.

[26] Ittehad chemical established a new Ion Exchange Membrane plant, which is operational since June 2015

Table 2.9: Steel Production (Jul-Sep)		
000 tons		
	FY15	**FY16**
Private sector		
Billets	576,680	684,258
H.R sheets/strips	708,851	766,000
Pakistan Steel Mills		
Pig iron	50,075	1,509
Billets	1,149	-
H.R. Sheets/Strips/Plates/Coils	34,820	-
C.R. Sheets/Strips/Plates/Coils	1,427	-

Source: Pakistan Bureau of Statistics

The governance issues continue to hamper PSM production. Currently the production is on halt and the cash strapped mill could not generate enough resources to pay salaries to its employees. [27]

Textile continued to face subdued global demand
Textile sector posted a lower growth of 0.7 percent in Q1-FY16 as compared to 1.5 percent in Q1-FY15.[28] Cloth manufacturing progressed slowly due to depressed demand from European market. In the US, Pakistani manufacturers are losing their shares to other exporting countries like India, Vietnam (**Chapter 5**).

In the yarn segment, availability of cheaper yarn from India posed serious challenges to local manufacturers. However, the situation is expected to improve, as the government has imposed 10 percent duty on yarn imports effective from 1st November 2015.

Competition from imports pressuring the paper industry
Paper production experienced a fall of 22.6 percent in Q1-FY16, compared to a rise of 1.0 percent during corresponding period of the previous year. The stiff competition from cheap imported products forced industry to reduce their prices to remain competitive in the local market. In addition, a large manufacturing plant underwent maintenance during Q1-FY16, which further reduced the production of paper and board segment.

It may be noted that production of paper & allied industries had already suffered last year due to gas shortages in Punjab. Consequently, manufacturers had to rely on furnace oil, which increased their cost of production.

[27] On 25th April 2014**,** government approved a restructuring plan of Rs 18.5 billion to retire outstanding liabilities, and payment of salaries for employees.
[28] However, the textile sector showed some improvement after Q1, and posted a growth of 0.96 percent in Jul-Oct FY16.

2.4 Services

The leading indicators pertaining to the services sector paint a mixed picture for Q1-FY16 (**Table 2.10**). For instance, within *wholesale and retail trade*, the benefit from improved performance of the large scale manufacturing would be partly offset by sluggish *kharif* crops.

Table 2.10: Services Sector Indicators
billion rupees, otherwise specified

	Jul-Sep	
	FY15	**FY16**
Wholesale and retail trade (18.3%)		
Credit off take for wholesale & retail(flow)	3.0	-6.0
Imports (US$ billions)	12.5	10.7
LSM (YoY growth)	2.6	3.9
Petrol & diesel sale (000 MT)	2,645	3,056
Transport, storage & communication (13.4%)		
Credit off take (flow)	-2.0	0.4
POL sales to transport sector (000 MT)	798.4	969
Commercial vehicle production (Nos.)	14,137	22,633
Cargo handling (million tonnes)	10.8	12.4
Cellular density (end period)	60.7	63.3
Broadband users (million Nos.)	16.9	21.2
PTCL consolidated profit	-0.41	-0.37
Finance and insurance (3.1%)		
Return on assets (percent)	2.2	2.6
Return on equity (percent)	24.2	26.6
Profit after tax	41.5	49.2
Overall Credit (flow)	143.6	131.9
General government services (7.4%)		
Expenses on general govt & defense [1]	359.0	410.0

Figure in parentheses show share in GDP during FY15.
Sources: PBS, SBP, OCAC, APCMA, PAMA, KPT.
[1.] This includes federal general administration, pension and provincial current expenditure

Indicators relating to *transport, storage & communication* have shown improvement during Q1-FY16, as reflected in increased POL sales to the transport sector; higher production of commercial vehicles; and more cargo handling at ports compared to the last year.[29]

In addition, the financial position of Pakistan Railways has improved after passenger and freight sectors attracted commuters and traders. This was in response to reduction in fares; availability of more locomotives in the freight sector; and improved punctuality of passenger trains.

Telecom has also shown improvement during Q1-FY16 with increased number of broadband users; better cellular and teledensity; and decline in PTCL financial losses. PTCL – a major contributor to value addition by communication services – posted a lower consolidated loss of Rs 371 million during Q1-FY16 compared to a loss of Rs 407 million in the same period last year. The number of broadband

[29] Cargo handling at Karachi port showed a growth of 14 percent at 12.4 million tonnes during Q1 FY16, compared to 10.8 million tonnes a year earlier.

users though increased significantly, could not translate into increased number of data users due to price competition and high tax incidence in the telecom sector (**Box 2.2**).

The value addition by *finance & insurance* depends upon the performance of the banking sector which observed an improvement in Q1-FY16. Profit after tax increased to Rs 49.2 billion in Q1-FY16, from Rs 41.5 billion in the corresponding period of last year. Key profitability indicators, e.g., return on assets (ROA) and return on equity (ROE), improved over the last year. The growth in earnings was achieved due to the placement of funds in government papers.

Box 2.2: What is holding back mobile and internet density in Pakistan?

Despite being among top 10 countries of the world in terms of number of mobile users, share of broadband and mobile users in Pakistan is still low (**Table 2.2.1**). The country presents a huge market of about 130 million people that needs broadband services; currently, there are 16.7 million broadband users. This shows large untapped potential in the broadband segment.

Table 2.2.1: Mobile Cellular (2014)

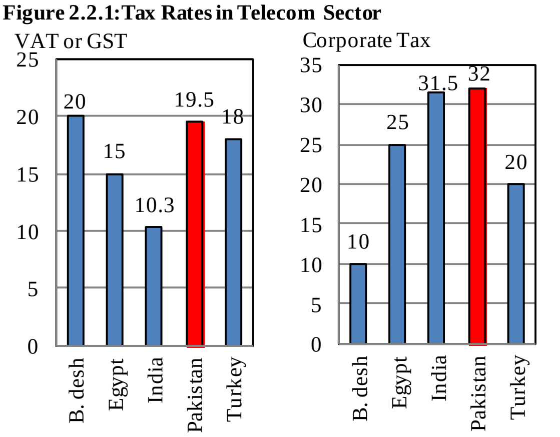
	Ranking	Pakistan	World
Mobile density	167	73.3	96.3
No. of subscribers (million)	10	135.8	6965
Internet density	152	13.8	40.7

Note: Mobile and internet density is measured as users per 100 population

Source: World Development Indicators.

Beside other issues such as quality of services, complex price structure, and high charges of devices, heavy taxation in this sector is the major reason of lower mobile and broadband usage (**Figure 2.2.1**). From the perspective of mobile operators, high cost of entry, costlier devices, poor fixed line infrastructure, and taxation on imported equipment hinder the new investment necessary for the expansion of such services to the un-served areas of the country.

Figure 2.2.1: Tax Rates in Telecom Sector



Source: Groupe Speciale Mobile Association

Mobile sector is heavily taxed in Pakistan, impacting devices, usage and sim cards. Following are the key taxes that directly impact consumers and providers of mobile industry in Pakistan:

- 19.5 percent GST on

mobile services;
- 14 percent withholding tax on mobile services;
- Custom duty of Rs 250 on mobile handsets;
- On Broadband Internet Services, the tax rate is 19.5 percent in Punjab for more than 2 mbps speed.[30] In Sindh the tax is 18 percent if broadband bill exceeds Rs 1500;
- 10 percent duty on import of equipment used for voice reception, switching and routing of data, etc.
- Corporate tax of 32 percent.

Data services or mobile internet have been exempted from taxes all over the world because of its benefits to masses and its effects on social developments and economic growth. Studies show that increased internet usage contributes positively to country's economic growth. Based on an analysis of 120 countries, the World Bank has indicated that for every 10 percent increase in the penetration of broadband services, there is an increase in economic growth of 1.3 percentage points.[31] Another study also found that the internet plays a positive and significant role in economic growth.[32] Therefore, we believe heavy taxation on mobile services in Pakistan does not bode well for economic growth in the country.

[30] The tax imposed on 28th May, 2015 by the Punjab government, was later withdrawn on 25th November, 2015 through notification No. SO (tax) 1-1 /2014-15 (Vol-II).
[31] World Bank, Qiang 2009; Economic Impact of Broadband (http://siteresources.worldbank.org/EXTIC4D/Resources/IC4D_Broadband_35_50.pdf)
[32] Choi, Changkyu and Myung H. Yi. "The effect of the Internet on economic growth: Evidence from cross-country panel data". Economic Letters 105(2009) 39-41.