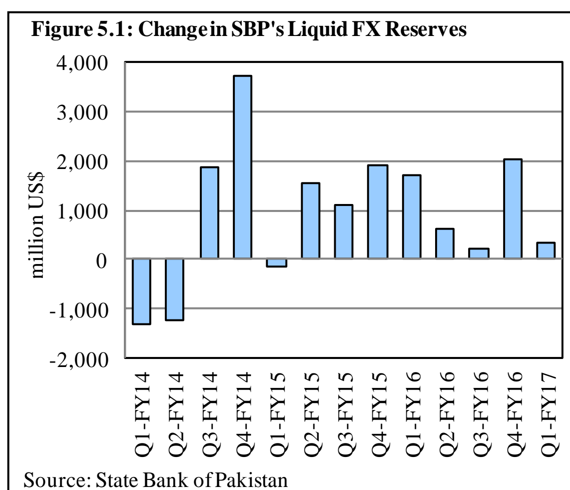
5 External Sector

5.1 Overview

The external account depicted a broadly stable picture in Q1-FY17, as financial inflows not only helped to finance current account deficit, but also contributed to reserve accretion (**Figure 5.1**). SBP's liquid forex reserves rose by US$ 348 million in the quarter and reached US$ 18.5 billion by end-September 2016 (**Table 5.1**); SBP's net foreign exchange purchases from the interbank market also contributed to reserves build-up. This high reserves level, in turn, led to stability in the forex market: the PKR appreciated by a nominal 0.2 percent against the US dollar in the quarter.

Figure 5.1: Change in SBP's Liquid FX Reserves



Source: State Bank of Pakistan

Within financial inflows, China emerged as the top contributor during the quarter, with multiple infrastructure and power projects being the main beneficiaries of funding (**Section 5.3**).[1] That said, a shift was observed in the nature of flows arriving from China in Q1-FY17. Whereas Q1-FY16 had seen a dramatic pick-up in net FDI from China, it was long-term loan disbursements that dominated in Q1-FY17. However, net FDI from China remained lower than the last year (**Table 5.2**).

[1] Of the cumulative US$ 1.1 billion in net loan and FDI inflows from China in Q1-FY17, a major share – US$ 700 million – was in the form of a commercial loan from the China Development Bank, "for BOP-CPEC," according to the Economic Affairs Division (**Table 5.2**). Effectively, this loan helped partially mitigate the financing concerns raised by higher CPEC-related machinery imports. Pakistan's total imports from China during Q1-FY17 amounted to US$ 2.0 billion.

In effect, these financial inflows helped to cover the increase in current account gap and lower foreign investment in the quarter. In the current account, the FX comfort provided by remittances – that the country has for long relied upon – weakened. Remittances declined (on YoY basis) for the first time in four years in Q1-FY17, with inflows dropping from all three major corridors – the Gulf Cooperation Council (GCC), US and UK. Though the decline was partly due to a seasonal (Eid) factor – which had inflated personal transfers in June 2016 and then led to a big drop the following month – other impediments (like the pound's sizable depreciation against the US dollar,[2] fiscal consolidation in the GCC, and a constricting environment for global correspondent banking) were also in play.

Table 5.1: Summary of Pakistan's External Sector
million US$

	Q1-FY16	Q1-FY17	*Abs change*
Current account balance	-579	-1,381	-802
Trade balance	-4,752	-5,174	-422
Exports	5,313	5,041	-272
Imports	10,065	10,215	150
POL imports (incl. LNG)	2,713	2,349	-364
Non-oil imports	7,352	7,866	514
Machinery imports	1,331	1,498	167
Services balance	-360	-918	-558
Coalition Support Fund	713	0	-713
Worker remittances	4,966	4,698	-268
FDI in Pakistan	403	249	-154
FPI in Pakistan	389	119	-270
Euro bond	500	0	-500
FX loans (net)	728	807	79
IMF	505	102	-403
SBP's liquid FX reserves (end-period)	15,245	18,491	3,246

Source: State Bank of Pakistan

Table 5.2: FX Loans and Investment from China in Q1

million US$	FY16	FY17
Loans (net)	**138.0**	**979.2**
Disbursements	255.6	1,104.80
Project loans	255.6	404.8
Commercial loan (China Development Bank)	-	700.0
Amortization	117.6	125.6
FDI (net)[1]	**192.1**	**90.8**
Inflow	200.1	95.4
Outflow	8.0	4.6

Source: Economic Affairs Division; [1]: State Bank of Pakistan

The remittance decline tacked onto a continually worsening trade deficit. The YoY decline in exports entered into its 10th straight quarter, and receipts dropped 5.1 percent in Q1-FY17. With uncertain recovery in demand from developed economies and China (as its economy undergoes a structural transformation), Pakistan's export performance is not likely to

[2] The pound depreciated by 14.3 percent against the US dollar between June 23 and September 30, 2016. The decline in remittances from the UK was mainly due to this exchange rate factor, as expats in the country remitted almost GBP 419 million to Pakistan in Q1-FY17, against GBP 437 million in Q1-FY16.

improve unless our exporters improve their competitiveness, adopt innovative production methods, and diversify their products and markets.

At the same time, the shift in China's exporting sectors away from low value-added and labor-intensive consumer items towards high value-added/hi-tech ones, has created an opportunity for other emerging markets to step in and fill the gap, particularly in areas like textiles. And there are indications that Pakistani exporters are utilizing this opening, to some extent: export volume of high value-added textile items like knitwear, bed-wear, and readymade garments all increased in Q1-FY17, though lower international prices kept export receipts from these items under pressure. Moreover, Pakistani exporters ought to explore the emerging trends in the Chinese market as that country's economy transforms from an investment-driven one into a consumption-centric one.

Table 5.3: Pakistan's Import of Petroleum Products (Q1)

	Quantity in 000 MT			Growth rate (%)	
	FY15	**FY16**	**FY17**	**FY16**	**FY17**
High speed diesel	737.8	520.9	657.6	-29.4	26.2
Furnace oil	2,023.4	1,626.3	2,267.5	-19.6	39.4
Crude oil	2,080.1	2,436.2	1,975.4	17.1	-18.9
Motor spirit	650.4	1,058.3	1,275.0	62.7	20.5
Others	1.0	28.0	29.9	-	6.5
Total	5,492.7	5,669.7	6,205.4	3.2	9.4

Source: Oil Companies Advisory Council

Yet, on a broader level, the task of boosting exports will likely be made somewhat more challenging by rising popularity of anti-trade sentiments, particularly in advanced economies that are major export destinations for Pakistan.[3] Additionally, competitiveness overhangs stemming from supply-side constraints (like erratic power supply), cannot be ignored; the country lags behind regional competitors in various ease of doing business indicators.[4] That said, the fiscal incentives announced by the government in the FY17 budget, as well as ongoing improvements in the power supply situation, will put the onus of increasing exports back on private businesses.

[3] A WTO report on trade measures adopted by G20 countries found that between mid-October 2015 and mid-May 2016, the 20-nation group applied 145 new trade-restrictive measures, at an average of around 21 measures per month. This was the highest monthly average recorded since the beginning of the monitoring exercise in 2009. In contrast, these countries introduced 100 measures to facilitate trade. As of mid-May 2016, the total number of restrictive measures in place stood at 1,196 (source: https://www.wto.org/english/news_e/news16_e/g20_wto_report_june16_e.pdf).

[4] For instance, in its Doing Business Report 2016-17, the World Bank ranked Pakistan 170 (out of 190 countries) in the category "getting electricity". This is much lower than the comparable ranks for emerging markets like India (26), Indonesia (49), and Vietnam (96).

On the other hand, import growth was contained to a marginal 1.5 percent, as a 13.4 percent drop in the oil bill partially offset higher payments for non-oil imports (mainly of machinery, transport and pulses). Going forward, two themes are worth looking out for with regards to imports. First, the non-oil import bill will stay elevated, led by higher imports of power, transport and construction-related machinery items, in the backdrop of CPEC-inspired economic activity.[5] However, other extraneous factors, like below-target domestic cotton production, may contribute to an already inflated non-oil import bill.[6]

Second, as economic activity somewhat picks up momentum, a natural outcome will be an increase in the country's energy needs. Hence, it will become more important to effectively manage the energy import bill. So far, the decline in POL imports have been almost entirely driven by the fall in international crude prices, as quantum imports of all POL products have gone up substantially (**Table 5.3**). Now, with LNG in the import mix as well, sustaining the current level of energy imports – when oil prices start to rise – may become more challenging.[7]

To sum up, the structural weaknesses in the external account – reflected by the continuous drop in exports, lower FDI, and the drop in remittances – present a challenge. Boosting inflows from these non-debt creating FX sources would be crucial to maintaining the external sector stability achieved over the past three years. In this context, there is a need to more effectively leverage the improvement in

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[5] Import of power generation machinery items increased 10.6 percent to US$ 215.8 million in Q1-FY17, whereas bus, truck and other heavy vehicle (both CBUs and CKDs) imports grew 2.8 times to US$ 151.5 million in the quarter.

[6] Raw cotton imports were already up 126.2 percent in Q1-FY17 (to US$ 149.6 million), and contributed 22 percent to overall textile imports in the period. This compares with a 3.8 percent decline in cotton imports during Q1-FY16.

[7] In October 2016, the World Bank increased its projection for average oil prices for CY-2017 to US$ 55.2 per barrel, depicting an increase of 27.5 percent from its CY-2016's average price estimate of US$ 43.3 per barrel. And that was before OPEC and non-Opec members like Russia agreed on December 10, 2016 to cut their cumulative output by a sizable 1.7 million barrels per day; the announcement led to an immediate rally in global oil prices (**Chapter 3**). The cuts are slated for implementation from January 1, 2017. However, some energy analysts question the sustainability of this rally, mainly due to the still significant oil glut in the international market, as well as the prospects of shale coming back online once prices recover past US$ 60 per barrel.

Pakistan's macro fundamentals to attract FDI, preferably in the form of long-term investment in greenfield projects in exporting sectors of the economy.[8]

Simultaneously, in the short-run, it is imperative that CPEC projects (both power and infrastructure-related) continue at their projected pace, mainly to ensure steady arrival of associated FX inflows from China. This financing will also be crucial to offset the rise in the import bill stemming from higher CPEC-related machinery imports.

5.2 Current account

The current account deficit (CAD) for Q1-FY17, at US$ 1.4 billion, was more than double the deficit for the same period last year. However, after accounting for CSF inflows, this quarter's CAD was close to last year's comparable level of US$ 1.3 billion, whereas the services balance also improved (from a deficit of US$ 1.1 billion in Q1-FY16 to US$ 0.9 billion in Q1-FY17). A widening trade deficit (up 8.9 percent YoY) and a fall in remittances were behind the higher CAD this year. Their impact was partially neutralized by a reduction in the primary income deficit (mainly due to a decrease in profit repatriations by foreign oil and gas companies) during the period.

<u>Worker remittances</u>

It has increasingly become clear that remittance-dependent South Asian countries will have to deal with the "new normal" of subdued remittance growth. The twin factors of low international oil prices and the tightening of US-backed anti-money laundering/anti-terrorist financing (AML/ATF) laws for global correspondent banking[9] (the lifeblood of the global remittance transfer business), have affected flows to a wide range of countries. In October 2016, the World Bank forecasted remittances to South Asia to decline 2.3 percent for 2016, after growing 1.6 percent in 2015.[10]

Besides, for countries heavily dependent on flows from the UK, the pound's sizable depreciation post-*Brexit* poses an additional dilemma: in dollar terms, remittances

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[8] Pakistan's image as an attractive investment destination received a boost in October 2016, when Standard & Poor's upgraded the sovereign debt rating, and the country issued a Sukuk at competitive rates.

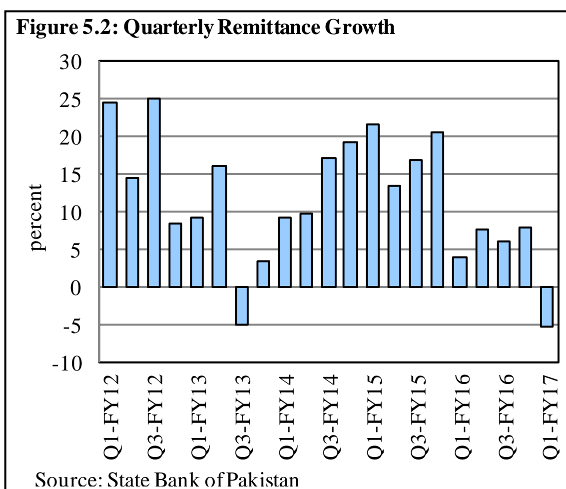
[9] The US federal consumer protection rules did not apply to most remittance transfers till October 2013. The revised Dodd-Frank Wall Street Reform and Consumer Protection Act establishes new standards with respect to remittance transfers (applies to transfers over US$ 15) by a US consumer to a person or company in a foreign country.

[10] Source: https://blogs.worldbank.org/peoplemove/trends-remittances-2016-new-normal-slow-growth

from UK will be lower even if migrants send back the same amount (in sterling).

In Pakistan's case, the slowdown in remittances continued into Q1-FY17, with flows actually declining from the same period last year. The last time the country had seen a YoY decline in remittances was Q3-FY13 (**Figure 5.2**). A possible reason for this broad-based YoY decline (as shown in **Table 5.4**) is the seasonal factor which had led to record inflows in June 2016; this was followed by a steep drop in July 2016. Yet, even after accounting for this factor, the situation does not look very encouraging.[11]

Figure 5.2: Quarterly Remittance Growth



Source: State Bank of Pakistan

In the GCC, the effects of fiscal consolidation measures and inward-looking policies are becoming visible on remittance flows from the region. For Pakistan, a slowdown in construction-related activities in the GCC may impact the demand for low-skilled labourers, whereas the localization requirements would limit opportunities for high-skilled migrants. The gross number of Pakistanis who proceeded to the GCC has already declined by 16.4 percent in Q1-FY17 (**Figure**

Table 5.4: Region-wise Worker Remittances (Jul-Sep)

	Values in million US$			YoY growth (percent)	
	FY15	**FY16**	**FY17**	**FY16**	**FY17**
USA	737.5	715.4	604.2	-3.0	-15.5
UK	656.6	671.9	546.4	2.3	-18.7
GCC	2,937	3,148	2,955	7.2	-6.2
Saudi Arabia	1,347.0	1,440.7	1,323.8	7.0	-8.1
UAE	1,037.0	1,114.8	1,056.8	7.4	-5.2
Abu Dhabi	482.9	332.3	381.8	-31.2	14.9
Dubai	537.9	763.2	662.0	41.9	-13.3
Other GCC	551.8	593.0	574.3	7.5	-3.1
EU	112.5	93.6	122.8	-16.8	31.3
Total	**4,775.1**	**4,965.8**	**4,698.3**	**4.0**	**-5.4**

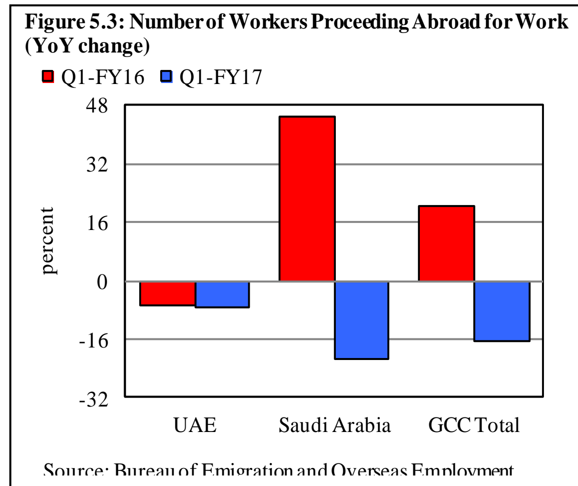
Source: State Bank of Pakistan

[11] With Eid falling in the first week of July 2016, most migrants had remitted funds to support their families' Eid-related spending in June 2016. As a result, remittances in June 2016 had risen by a sizable 13.8 percent YoY to a record US$ 2.1 billion. Subsequently, in July 2016, remittances dropped (on both YoY and MoM basis) to US$ 1.3 billion.

5.3);[12] this was particularly steep for the top migrant destination – Saudi Arabia (21.5 percent).[13]

For its part, the government is encouraging visa/job agents (who basically recruit Pakistani workers to fill vacancies in foreign companies) to direct their efforts towards other growth centers in the region (like Malaysia). That said, it will invariably take time before these efforts result in a shift in the pattern of remittance inflows: the GCC continued to be the top source of remittances for Pakistan in Q1-FY17, accounting for 62.9 percent of overall inflows.

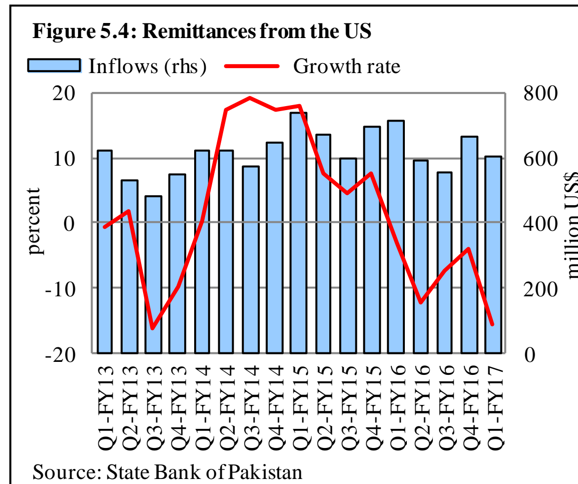
Figure 5.3: Number of Workers Proceeding Abroad for Work (YoY change)



Source: Bureau of Emigration and Overseas Employment

Unlike the GCC, remittances from the US to Pakistan have been on a declining trajectory for a while now (**Figure 5.4**), and this trend continued in Q1-FY17: inflows dropped 15.5 percent YoY to US$ 604.2 million.

Figure 5.4: Remittances from the US



Source: State Bank of Pakistan

As we have previously highlighted, tightening financial sector regulations in the US from 2013 onwards – coinciding with the tapering of remittance growth from the country – are making cross-border fund transfers cost-ineffective for global

[12] Source: Bureau of Emigration and Overseas Employment.

[13] However, it is pertinent to mention that development activities under Saudi Arabia's vision 2030, FIFA World Cup 2022 in Qatar, and Expo 2020 in Dubai may create demand for Pakistani workers, which can help increase flow of remittances in the country.

banks and money transfer operators (MTOs).[14] Moreover, due to the interconnectedness of global finance, changes in the US regulatory framework not only affect US-based firms, but also those operating in other parts of the world. One way in which large banks have responded is by terminating their correspondent banking relationships with MTOs, regional banks and exchange companies that they perceive to be "high risk".

Here, it is important to realize that Pakistani financial institutions have not seen their relationships terminated by global institutions. However, financial institutions operating in the Middle East North Africa (MENA) region are generally facing higher compliance costs.[15] Any move by these institutions to pass on their rising costs to remittance-senders will likely push expats towards legal but informal channels (through friends/acquaintances); this will lead to a drop in flows received through official banking channels. Therefore, it has become imperative to ensure that migrants have access to affordable and legal channels to send remittances from the US.

5.3 Financial account

Loan disbursements dominated financial account inflows in Q1-FY17, and compensated for lower FDI and portfolio investment in the quarter. Net loan disbursements increased by 10.9 percent to US$ 807 million in Q1-FY17. However, a shift was observed in the source of these borrowings: while the IMF had a major share in overall disbursements in Q1-FY16, this quarter was dominated by the government's commercial borrowings (on both long- and short-term basis). China had a major share in loan disbursements, with inflows going primarily into power and infrastructure

[14] This issue has been recognized by some of the largest IFIs. In an October 2015 report on correspondent banking, the Bank for International Settlements (BIS) noted that "According to the correspondent banks…the most common cause for [the] reduction of profitability is the increasing cost of regulatory compliance, especially in relation to AML/CFT regulation. According to anecdotal evidence these costs have reached such a level that, for certain financial institutions, there is no business justification for continuing to engage in correspondent banking".

[15] According to the findings of a joint survey by the IMF and the Union of Arab Banks, "Survey responses from 17 countries showed that many banks (40 percent) were facing higher compliance costs and that some Money or Value Transfer Services had been cut-off (for example in the countries of the GCC, which could increase the cost of remittances and lead remittance flows to be channeled through non-regulated entities" (source: The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action, IMF Staff Discussion Note SDN/16/06, June 2016).

projects (**Table 5.5**), as well as providing budgetary support for import financing.

Foreign direct investment

During Q1-FY17, net FDI in Pakistan dropped by 38.2 percent over the same period last year. FDI inflows from China dropped to US$ 90.8 million in the quarter, from US$ 192.1 million during the same period last year. In contrast, FDI from the US amounted to US$ 58.8 million in Q1-FY17, against an outflow of US$ 62.2 million recorded in Q1-FY16.[16]

Table 5.5: List of projects receiving loans from China in Q1-FY17

million US$

Project	Disbursement
Chashma Nuclear Power Project (III,IV)	34.7
Safe City Islamabad Project	12.5
Havelian-Thakot KKH-P-II*	97.0
Sukkur-Multan Section, Peshawar-Karachi Motorway*	216.3
Orange Line Lahore Project	37.9
Others	6.5

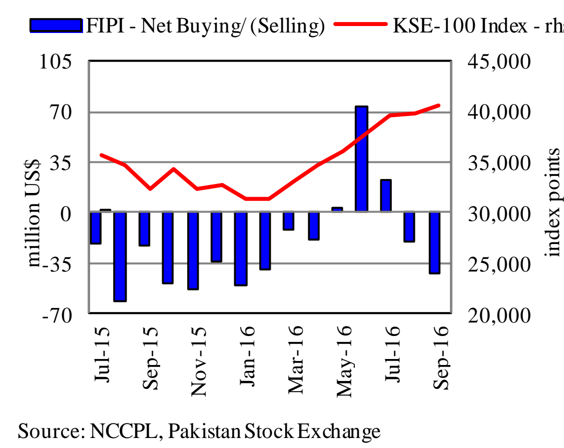
Source: Economic Affairs Division

* These are reported as CPEC projects on the Planning Commission's website

Portfolio investment

After multiple episodes of volatility in the global equity markets during FY16, the news of upgrading Pakistani stocks in the Emerging Markets Index by MSCI came as a breath of fresh air for the country's bourse – outperforming regional equity markets like India, China, Bangladesh, Sri Lanka and Vietnam during Q1-FY17.[17] Consequently, the foreign selling pressure eased to some extent, over the same period last year (**Figure 5.5**).

Figure 5.5: Foreign Investment in Pakistan's Equity Market



Source: NCCPL, Pakistan Stock Exchange

Here, it is noteworthy that equity investments improved during Q1-FY17 as compared to Q1-FY16, when the increase in overall portfolio investment was mainly attributed

[16] Out of this US$ 58.8 million inflow, tobacco & cigarettes sector attracted almost half the investment, followed by pharmaceutical products.

[17] Source: Bloomberg.

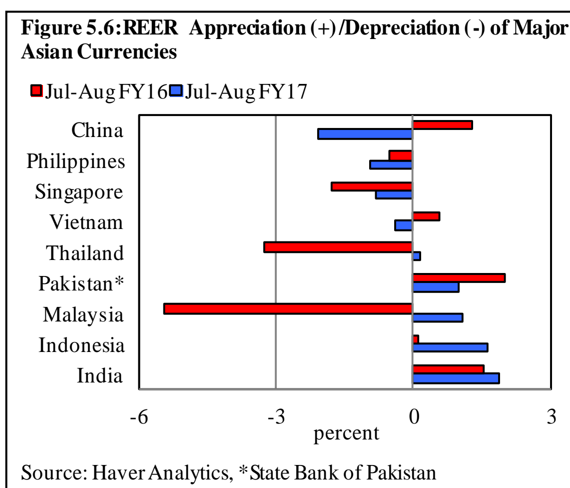
to an inflow of US$ 500 million from a Eurobond issued in September 2015.[18] Going forward, the performance of Pakistan's equity market will likely be driven by domestic as well as global economic and political developments.[19]

5.4 Exchange Rate

During Q1-FY17, the PKR remained largely stable vis-à-vis US dollar. In fact, it has appreciated by 0.2 percent YoY, after depreciating by 2.6 percent during the same period last year. This stability partially reflects the calmness in the global currency markets.[20]

The Pak rupee also continued to appreciate vis-à-vis British pound, as *Brexit* sent the GBP into freefall. On the other hand, it depreciated against Japanese yen; since the uncertainty in global financial markets tend to strengthen the safe haven currency.[21]

Figure 5.6: REER Appreciation (+)/Depreciation (-) of Major Asian Currencies



Source: Haver Analytics, *State Bank of Pakistan

In real terms, the PKR appreciated by 1.0 percent during Q1-FY17, after appreciating 0.2 percent during the same period last year. However, among regional

[18] During Q1-FY17, a net inflow of US$ 69.5 million was recorded in Special Convertible Rupee Accounts (SCRA) against an outflow of US$ 140.2 million during the same period last year.

[19] For instance, on November 1, 2016, the PSX-100 index jumped 3.5 percent after Standard & Poor's upgraded Pakistan's credit rating, and a local political party backed down from its planned protest in Islamabad, lifting a cloud of uncertainty that had been holding investors on the sidelines for the past few weeks.

[20] The 2.6 percent depreciation in PKR during Q1-FY16 was primarily due to the turmoil in Asian stocks and currency markets: Yuan's reference rate was reduced by 2.7 percent in August 2015 (also mentioned in SBP Quarterly report for Q1-FY16).

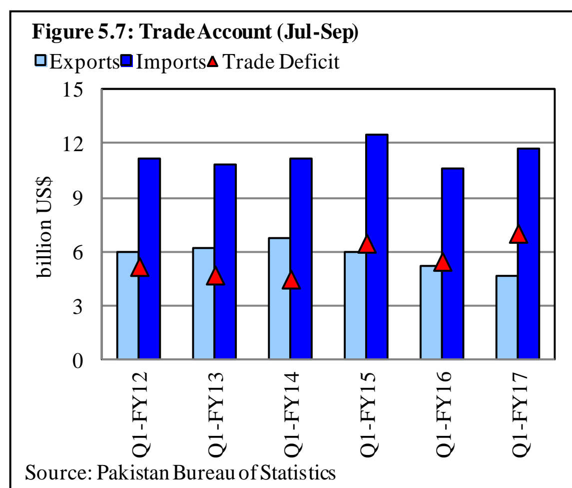
[21] Investors preferred to park their funds in *Japanese yen* and *gold* when uncertainty loomed. For instance, in July 2016, while the global crude oil prices plunged from US$ 50 to US$ 42 per barrel, gold surged from US$ 1,339 to US$ 1,359 per ounce. Meanwhile, JPY gained around 2 percent during the last week of July 2016.

currencies, this real appreciation in PKR was lower than that for the Indonesian rupiah (**Figure 5.6**). Besides relatively stable global currency markets, the comfortable level of country's FX reserves also supported the PKR during the period.[22]

Trade account[23]

The trade deficit widened by 28.5 percent YoY in Q1-FY17, and reached an eight-quarter high. While the export decline moderated (to 9.2 percent, from 14.3 percent in Q1-FY16), imports surged by 10.5 percent, on the back of higher power generation and electric machinery imports (**Figure 5.7**).

Figure 5.7: Trade Account (Jul-Sep)



Source: Pakistan Bureau of Statistics

Part of the increase in imports can also be attributed to the low-base effect that was in play in Q1-FY16.[24] Unlike imports, the fall in exports was broad-based, with receipts from all main product categories declining in Q1-FY17.

<u>Exports</u>

Exports of virtually all major items, including rice, cotton, cotton yarn, bed-wear, plastic, leather manufactures, pharmaceutical and cement, declined during the period.

While a recovery was noted in quantum exports of some key textile items (like readymade garments, knitwear and bed-wear), a sharp fall in their unit values led to lower export receipts from these products (**Table 5.6**).

[22] While SBP's FX reserves rose to US$ 18.5 billion, total FX reserves of the country reached US$ 23.6 billion by end-September 2016.

[23] The analysis is based on the provisional data provided by Pakistan Bureau of Statistics. This data may not tally with the exchange record numbers reported in the section on *Balance of Payments*. To understand the difference between these two data series, please see Annexure on data explanatory notes.

[24] It is worth noting that a sizable decrease in POL imports in Q1-FY16 (owing to hefty decline in global oil prices) had completely offset an increase in non-oil imports in the period; as a result, overall imports had declined 14.9 percent YoY in Q1-FY16.

Table 5.6: Breakdown of Change in Export Earnings (million US$)

	Q1-FY16			Q1-FY17		
	Value	Quantum impact	Price impact	Value	Quantum impact	Price impact
Basmati rice	-27.1	0.8	-27.9	-46.9	-38.2	-8.7
Non-basmati	1.3	45.3	-44.0	-47.3	-47.5	0.2
Fish	-13.6	-7.7	-5.9	-1.2	-4.0	2.9
Fruits	-13.5	-21.4	7.9	34.1	35.2	-1.1
Vegetables	23.3	31.5	-8.2	-18.9	-19.1	0.2
Spices	3.0	3.4	-0.4	-0.5	-0.8	0.3
Meat	21.6	12.4	9.2	-18.3	-19.3	1.0
Raw cotton	5.5	10.6	-5.1	-38.0	-39.3	1.3
Cotton yarn	-84.8	-109.4	24.6	-77.3	-42.8	-34.5
Cotton fabrics	-70.1	23.5	-93.6	-13.0	-34.9	21.9
Knitwear	0.7	27.2	-26.5	-31.5	31.5	-63.0
Bed wear	-39.6	-39.2	-0.4	12.4	50.8	-38.4
Towels	29.4	45.9	-16.5	-36.4	-36.2	-0.2
Readymade garments	27.9	-9.1	37.0	16.4	10.7	5.7
Synthetic textiles	-17.6	11.4	-29.0	-36.0	-57.3	21.3
Carpets	-3.0	-10.0	7.0	-0.8	6.8	-7.6
Footballs	-1.0	1.8	-2.8	-4.4	-3.8	-0.6
Leather tanned	-26.1	-32.2	6.0	-11.5	-14.5	2.9
Leather garments	-20.2	-15.5	-4.7	-3.1	-2.6	-0.5
Foot wear	-9.5	-9.8	0.3	0.3	0.3	0.0
Plastic	-9.0	-6.4	-2.6	-3.0	-15.8	12.8
Pharmaceutical	2.4	-13.4	15.7	-0.2	-10.5	10.3
Fans	-2.4	-2.8	0.4	1.7	1.0	0.7
Cement	-55.1	-52.7	-2.4	-10.4	-2.4	-8.0

Source: Pakistan Bureau of Statistics

Textile

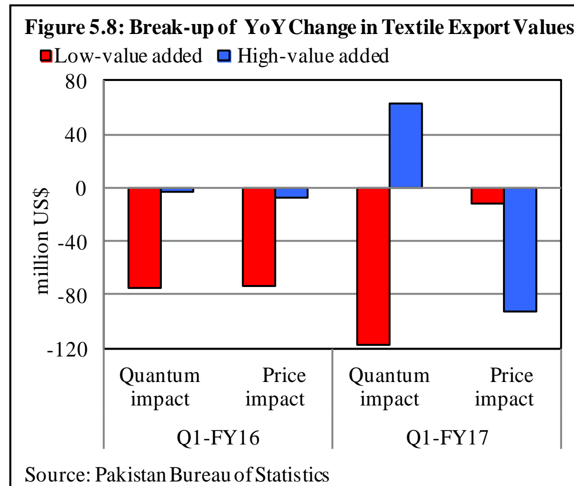
Textile exports declined 6.2 percent during Q1-FY17, after falling 5.6 percent in the same period last year. Around US$ 128 million (64.0 percent) of the drop in textile exports can be attributed to lower shipments of primary cotton products (raw cotton, cotton yarn and cotton fabric).

This decline was primarily due to lower demand from our traditional market (China), as the unit values of these items relatively improved during the period. A sharp fall in

domestic cotton production in FY16 was an additional factor that affected export volumes.[25]

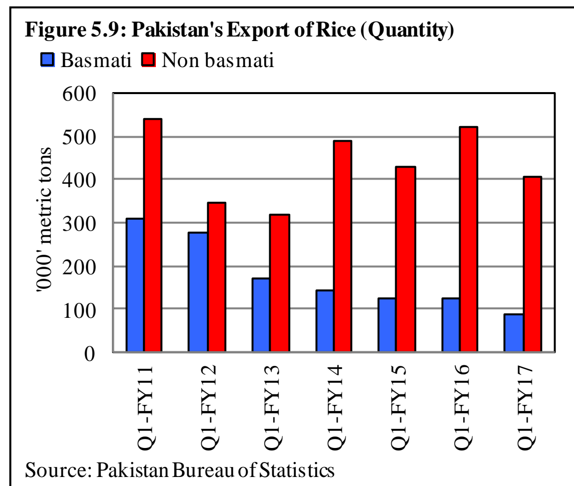
In case of high value-added products, an increase in export volumes of knitwear, bed-wear and readymade garments appear to be linked with a modest recovery in the EU market. Export receipts from these items were primarily pulled down by lower prices in Q1-FY17, as their quantum exports increased sharply (**Figure 5.8**). In fact, if international prices of these products had remained stable (or recovered), export receipts from these items would have been much stronger. In this backdrop, moving up the industrial value chain might be the only sustainable way through which exporters can improve their prospects in an anemic environment for global trade.

Figure 5.8: Break-up of YoY Change in Textile Export Values



Source: Pakistan Bureau of Statistics

Figure 5.9: Pakistan's Export of Rice (Quantity)



Source: Pakistan Bureau of Statistics

Rice

Rice exports declined 28.0 percent in Q1-FY17, after falling 7.1 percent in the same period last year. Exports of both basmati and non-basmati varieties fell in the quarter; cumulatively, the decline in rice exports played a major role in pulling down overall food group exports during the period.

[25] Cotton production declined 29 percent in FY16, whereas the expected recovery in FY17 has not gone according to target either.

Regardless of swings in international prices of the commodity, the fact remains that Pakistan has been losing its share in the global basmati trade since FY11 (**Figure 5.9**).[26] In Q1-FY17, Pakistan exported 87.8 thousand metric tons of basmati, down 30.1 percent from the same period last year.

It may also be noted that basmati is indigenous to the sub-continent region and carries a premium over other varieties. Pakistani exporters have been losing market share to their Indian peers. This is partly because Indian basmati is cheaper than its Pakistani counterpart.[27] A lack of proper branding and marketing by Pakistani exporters is also to partly blame for the declining trend.[28]

Table 5.7: Pakistan's Import of Major Products (Q1)

	FY15	FY16	FY17	FY16	FY17
	million US$			Growth rate (%)	
Total imports	**12,474**	**10,611**	**11,696**	**-14.9**	**10.2**
POL	**3,928**	**2,475**	**2,356**	**-40.3**	**-4.8**
LNG	-	*129*	*253*	-	*96.3*
Non-POL	**8,546**	**8,136**	**9,340**	**-4.8**	**14.8**
Food	1,430	1,239	1359	-13.3	9.7
Machinery	1,765	1,705	2728	-3.4	60.0
Power gen.	*278*	*316*	*833*	*13.5*	*163.7*
Electrical	*296*	*339*	*448*	*14.5*	*32.2*
Transport	619	641	695	3.5	8.4
Textile	636	629	688	-1.1	9.4
Raw cotton	*48*	*57*	*72*	*18.7*	*25.6*
Agri. & chem.	1,860	1,781	1763	-4.3	-1.0
Fertilizer	*203*	*258*	*156*	*27.2*	*-39.4*
Metal	906	896	929	-1.1	3.7
Iron & steel	*691*	*674*	*638*	*-2.4*	*-5.3*
Misc.	1,330	1,244	1,177	-6.5	-5.4

Source: Pakistan Bureau of Statistics

Imports

The country's import bill grew 10.2 percent in Q1-FY17, after falling 14.9 percent YoY in the same period last year. Led by an increase in machinery imports, the rise in non-oil imports more than offset the decline in POL imports in the period (**Table 5.7**).

[26] The basmati rice price index declined by 15.5 percent YoY during Jan-Oct 2016. Global price of basmati rice for Pakistan and Thailand declined by 11.4 percent and 24.0 percent YoY during the period respectively (source: FAO).

[27] Unit value of Indian basmati exports during FY16 was US$ 812 per MT (source: Agricultural and Processed Food Products Export Development Authority, India). In contrast, the same for Pakistani basmati exports was US$ 932 per MT (source: Pakistan Bureau of Statistics).

[28] Pakistani exporters have not been able to effectively match the branding and marketing techniques of their (Indian) competitors. Moreover, they tend to export unbranded rice in bulk, which suppresses their margins.

Petroleum (POL)

Petroleum imports stood at US$ 2.4 billion in Q1-FY17, down 4.8 percent YoY. The entire decline came from lower crude oil imports.[29] It is important to mention here that the government has decided to replace relatively low standard petrol currently in use in the country with a high quality variant (92 RON), and has directed refineries to upgrade their set-ups accordingly. As most refineries began upgrading their infrastructure to comply with the regulatory requirement in Q1-FY17, domestic petrol production witnessed a decline. This, in turn, led oil marketing companies (OMCs) to import the higher grade finished product to meet domestic demand (**Chapter 2**). As such, quantum petrol imports grew sizably during the period.

Machinery

Machinery imports surged by 60.0 percent YoY in Q1-FY17 and reached US$ 2.7 billion, surpassing POL imports during the period. In fact, 94.3 percent of the *increase* in overall imports in the period was due to the rise in machinery imports. A surge in investment in power generation and distribution infrastructure boosted demand for power generation and electrical machinery. Construction activities related to CPEC projects also put upward pressure on imports of products like cranes, weighing machinery and compressors, and vacuum pumps.

Transport

Transport group imports rose by 8.4 percent during Q1-FY17, following an increase of 3.5 percent in Q1-FY16. The impetus to transport imports mainly came from road motor vehicles and commercial vehicles; the latter reflects an increase in intra-country trade and higher CPEC-related economic activity.

Raw cotton

Raw cotton import growth increased to 25.6 percent in Q1-FY17, against 18.7 percent in the same period last year; intriguingly, these higher imports came despite an improvement in domestic cotton production. Going forward, the extent to which demand for the raw material will be met through imports, remains to be seen.[30]

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[29] Crude oil imports declined 18.9 percent YoY in Jul-Sep FY17, after rising by 17.1 percent YoY in Q1-FY16 (source: Oil Companies Advisory Council).

[30] On average, Pakistan imported 38.1 thousand MT of raw cotton in the first quarter of the past five years. In Q1-FY17, the country imported 43.2 thousand MT of raw cotton.