5 External Sector

5.1 Overview

A sizable increase in import payments in H1-FY17, alongside non-receipt of Coalition Support Fund (CSF) and a fall in exports and remittances, led to a significant widening in the current account deficit.[1] In nominal terms, the import bill surged by US$ 1.2 billion in H1-FY17; of this, non-oil imports contributed a major share of US$ 995 million (**Table 5.1**). That said, oil payments – which had been declining for eight consecutive quarters – reversed trend in Q2-FY17, and tacked onto an already elevated non-oil bill. Resultantly, the quarterly current account deficit (CAD) rose to US$ 2.2 billion in Q2-FY17, bringing the cumulative deficit for H1-FY17 to US$ 3.5 billion.[2]

Table 5.1: Summary of Pakistan's External Sector

million US$

	Q2			H1		
	FY16	**FY17**	***Abs. change***	**FY16**	**FY17**	***Abs. change***
Current account balance	-1,286	-2,234	-948	-1,865	-3,527	-1,662
Trade balance	-4,609	-5,707	-1,098	-9,361	-10,809	-1,448
Exports	5,463	5,527	64	10,776	10,534	-242
Imports	10,072	11,234	1,162	20,137	21,343	1,206
POL (incl. LNG)	2,071	2,649	578	4,784	4,998	214
Non-oil	8,001	8,588	587	15,353	16,348	995
Services balance	-915	-821	94	-1,275	-1,731	-456
CSF	0	0	0	713	0	-713
Worker remittances	4,722	4,760	38	9,688	9,458	-230
FDI in Pakistan	575	806	230	978	1,081	103
FPI in Pakistan	-172	626	798	217	744	527
Eurobond/Sukuk	0	1,000	1,000	500	1,000	500
FX loans (net)	1,982	710	-1,272	2,710	1,521	-1,189
IMF	500	0	-500	952	102	-850
SBP's FX reserves (end-period)	15,884	18,272	2,388	15,884	18,272	2,388

Source: State Bank of Pakistan

Fortunately, sufficient financial inflows (mainly from government borrowings and FDI inflows) were available;[3] these helped finance the higher CAD. Resultantly,

[1] However, US$ 550 million were received under CSF in Q3-FY17.
[2] A similar trend was visible in case of full calendar year. The current account deficit increased to US$ 4.9 billion in CY-2016, from US$ 2.1 billion during CY-2015.
[3] Two major foreign acquisitions of local companies (one partial and one complete) were completed during Q2-FY17, leading to a net inflow of US$ 587.7 million into the country. This pushed up net FDI inflows during the quarter to US$ 806 million, against US$ 575 million in Q2-FY16.

the overall external balance remained in surplus in H1-FY17, with SBP's FX reserves rising by US$ 129 million during the period to US$ 18.3 billion. This, in turn, facilitated SBP in effectively managing sentiments in the interbank market in the wake of a widening current account gap: the PKR/USD parity remained virtually unchanged at 104.6 at end-September and end-December 2016, and fluctuated between 104.5 and 104.9 during the period. During H1-FY17, the rupee appreciated by a nominal 0.2 percent against the greenback.

Meanwhile, the rise in overall import payments was mainly driven by higher purchases of fuel and capital equipment. This is understandable, given that Pakistan is transitioning from a low-growth to higher growth phase, and is addressing supply-side bottlenecks in energy and infrastructure. This indicates strong positive impact on broader economic activities.

For instance, quantum imports of all POL products (particularly HSD and petrol), have recorded significant growth this year (**Table 5.2**), indicating strong transport sector activity (**Chapter 2**). This has also corresponded with a hefty increase in imports of buses and heavy commercial vehicles.[4]

Table 5.2: Pakistan's Import of Petroleum Products (H1)

	Quantity in 000 MT			% Growth	
	FY15	**FY16**	**FY17**	**FY16**	**FY17**
High speed diesel	1,548.8	1,306.8	1,837.2	-15.6	40.6
Furnace oil	3,210.1	3,000.2	3,733.6	-6.5	24.4
Crude oil	3,941.8	4,640.1	4,261.1	17.7	-8.2
Motor spirit	1,300.1	2,068.7	2,526.4	59.1	22.1
Others	32.4	58.5	61.2	80.6	31.7
Total	10,032.2	11,074.2	12,419.5	10.4	12.1

Source: Oil Companies Advisory Council

Similarly, an increase in power generation from furnace oil in H1-FY17 led to higher imports of the fuel.[5] Meanwhile, according to customs data, the rise in imports is mainly driven by power generation machinery (**Section 5.5**); a strong pick-up in fixed income loans by the power sector was also noted in H1-FY17 (**Chapter 3**).[6] These trends support our view of higher infrastructure development-led economic growth and active energy management in the country.

[4] Import payments for buses, trucks and other heavy vehicles (both CKDs and CBUs) rose by a sizable 186.7 percent (US$ 244 million) to US$ 344.1 million in H1-FY17. To put this in context, heavy vehicle imports contributed 18.6 percent to the overall *rise* in Pakistan's import bill in the period. While the higher import of buses might partly be a result of efforts to meet pent-up demand for public transportation, purchases of commercial vehicles reflect a general increase in intra-country trading activities (partly stimulated by CPEC-related projects).

[5] Of the 2,153 GWh *increase* in power generation during H1-FY17, 1,172 GWh came from furnace oil (source: National Electric Power Regulatory Authority).

[6] According to customs data compiled by PBS, power generation machinery contributed 38.4 percent (or US$ 816 million) to the overall increase in imports during H1-FY17. On the other hand, as per

Nonetheless, in the external sector, the real challenge emerges from the financing standpoint. Up till Q1-FY17, the savings on oil import payments had been offsetting rising non-oil imports and partially compensating for declining exports. This, coupled with growing remittances (till FY16), had been providing adequate FX cover to the external account and indirectly contributing to reserve accretion. However, as mentioned earlier, this comfort has now started to diminish. Moreover, Pakistan's import bill may further increase with the surge in oil prices following the supply cut agreement between Opec and key non-Opec members in December 2016.

To somewhat ease the pressure on the import bill, SBP, on its part, imposed a requirement of 100 percent cash margin on the import of over 400 mainly consumer items in February 2017.[7] This is expected to create some financing space for the import of growth-inducing capital goods and raw materials.[8] That said, we recognize that such regulatory measures can, at best, provide limited relief to the rising import bill. For medium- to long-term stability of the external account, it has become ever-more critical to boost FX receipts from exports and foreign investment.

In case of exports, the recovery in international cotton prices has yet to translate into higher unit values for Pakistan's high value-added textile exports.[9] However, on an encouraging note, exports of high value-added textile products, like readymade garments and bedwear items, have risen in H1-FY17; this increase has been entirely driven by higher quantums (**Figure 5.1**), indicating that these Pakistani products are in demand in key export markets. More importantly, Pakistan's share in the European Union's textile market has gone up during Jul-Dec FY17, at the expense of major exporters like India and China (**Section 5.5**). Helped along by rising exports of some clothing and home textile items, and of non-traditional items like seafood, fruits and plastic, overall export receipts grew by a marginal 1.2 percent in Q2-FY17 – finally breaking the spell of 10 quarters of successive YoY declines.

SBP data, import of these items actually *declined* (by 0.4 percent, or US$ 2.1 million) during the same period. For a discussion on this discrepancy between SBP and PBS import data, see **Box 5.1**.

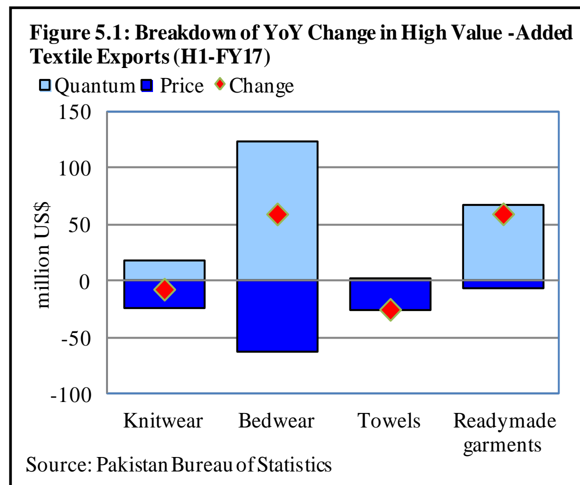
[7] Vide BPRD Circular No. 2 of 2017. Major import items on which margin requirements have been imposed include motor vehicles (both CBUs and CKDs), cell phones, cigarettes, jewellery, cosmetics and personal care items, home appliances, and arms and ammunition.

[8] Between end-September and end-December 2016, SBP's liquid FX reserves declined by US$ 220 million.

[9] After bottoming out in March 2016, international cotton prices have been rising consistently (**Chapter 3**). Average global cotton prices during H1-FY17 were almost 13 percent higher than the same period last year (source: World Bank).

As such, there are some positive trends that need to be sustained. In this context, we believe that the government's recently announced export package might ease cash-flow constraints for major exporting sectors, particularly textiles. With regards to attracting foreign investment, the Automotive Development Policy 2016-2021 seems to be having the intended effect: multiple foreign carmakers have shown interest in stepping into the Pakistani market and forming joint ventures with local conglomerates. Therefore, other sector-specific industrial policies (like that for agri-businesses, including meat and dairy, and for SMEs, like those engaged in manufacturing surgical goods, etc), can be explored to fully harness the export potential from non-traditional product categories, and simultaneously make them attractive for foreign investors.

Figure 5.1: Breakdown of YoY Change in High Value -Added Textile Exports (H1-FY17)



Source: Pakistan Bureau of Statistics

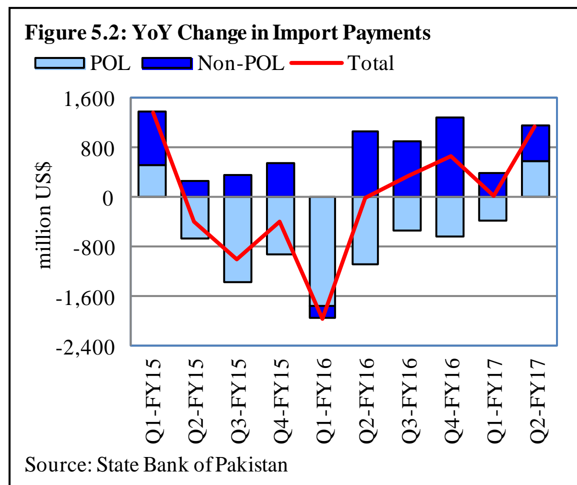
In sum, maintaining the external sector stability – achieved over the past three years – will ultimately be contingent on the country generating sufficient FX earnings to finance the growth-induced rise in the import bill. For this, the recent positive trends in exports and foreign investment need to be sustained, with policy support provided where necessary. In the interim period, SBP's FX reserves (at end-December 2016) are sufficient to finance over five months of the country's projected merchandise imports.

5.2 Current account: *Rising oil payments further inflate trade deficit*

In a span of three years – i.e. from Q1-FY15 to Q1-FY17 – the cumulative decline in the country's oil payments amounted to US$ 7.3 billion. This decline was almost entirely driven by the dramatic fall in oil prices, as quantum POL imports have been generally increasing during the period (**Table 5.2**). This essentially provided room for the country to finance rising non-oil imports (including that of power generation and construction-related machinery for CPEC projects), without exerting any pressures on the external account (**Figure 5.2**).

But with oil payments rising in Q2-FY17 on a YoY basis for the first time from Q1-FY15 onwards, the overall import bill swelled 11.5 percent to US$ 11.2 billion in the quarter. Even though exports reversed their multi-year declining trend and rose 1.2 percent (to US$ 5.5 billion), this uptick was insufficient to offset the rise in the import bill. As a result, the trade deficit widened by 23.8 percent to US$ 5.7 billion in Q2-FY17 – the second-highest quarterly trade gap.[10] This brought the half-year trade deficit to US$ 10.8 billion (against US$ 9.4 billion in H1-FY16), and pushed up the current account deficit to around US$ 3.5 billion.

Figure 5.2: YoY Change in Import Payments



Source: State Bank of Pakistan

Encouragingly, the services account posted an improved picture in H1-FY17, after excluding CSF inflows.[11] Major impetus came from telecom services, whose exports grew 59.4 percent YoY to US$ 255 million during the period. The primary income account also improved, mainly due to lower profit repatriations by oil & gas firms.

Meanwhile, worker remittances weakened in H1-FY17, with inflows dropping 2.4 percent YoY to US$ 9.5 billion. So far, the drop has been noted from all major corridors (i.e. the Gulf, US and UK). However, the decline was concentrated in the first quarter, as inflows grew by a meagre 0.8 percent in Q2-FY17.

5.3 Financial account: *Inflows up on rising FDI, commercial borrowings*

A pick-up in foreign investment inflows (both public and private) and continued bilateral and multilateral funding, were able to finance the growing current account gap in H1-FY17. Most of the activity took place in the second quarter, in

[10] The highest quarterly trade deficit was recorded in Q1-FY15 (at US$ 6.1 billion). Despite a drop in oil payments at the time, overall imports had surged on the back of higher imports of other food items (like lentils and oilseeds etc, owing to crop losses due to floods), iron and steel, and telecom equipment (as firms upgraded their infrastructure following the issuance of 3/4G licenses).

[11] After excluding CSF, the services account deficit narrowed by US$ 279 million YoY in H1-FY17. The country received US$ 713 million in CSF in H1-FY16, and did not receive any amount under this head in H1-FY17.

which major FX receipts for SBP included: (i) US$ 1.0 billion from a Sukuk; (ii) US$ 382.2 million in loans from China; and (iii) US$ 333.4 million in Asian Development Bank funding.[12] These brought the gross official financial inflows during H1-FY17 to US$ 4.1 billion – around 52.6 percent of the budgetary estimate of US$ 7.8 billion for the full fiscal year.[13]

In addition to these official inflows, the country's FX reserves also benefitted from the completion of two major corporate acquisitions/partial stake sales; these contributed a cumulative US$ 587.7 million to net FDI inflows of US$ 806 million in Q2-FY17.[14] These receipts proved critical in maintaining the country's FX reserves position during the period under review.

Foreign direct investment: Pakistan finally getting a slice of global M&A activity

At the global level, the recent surge in foreign investment has been dominated by mergers and acquisitions (M&A), with overall greenfield investments growing at a much slower pace.[15] However, Pakistan seemed to be missing out from this trend earlier on.

This dynamic seems to have changed in FY17. Multiple M&A deals have been concluded (and still others announced), indicating that professionally managed and innovative Pakistani firms are now *also* on the screens of foreign investors looking to gain a foothold into this 194-million strong market.[16, 17] Importantly, foreign investment from countries other than China is now also trickling into the country, reflecting investors' favorable outlook about country's growth prospects.

[12] The loan disbursement figures for China and ADB for Q2-FY17 are net of retirement, and based on Economic Affairs Division data.
[13] According to FY17 budgetary estimates, the government is targeting to raise US$ 1.75 billion from Eurobond and Sukuk, and US$ 2.0 billion from commercial borrowings. During H1-FY17, the government issued a US$ 1.0 Sukuk and raised US$ 900 million in gross commercial loans.
[14] The country received US$ 127.7 million in November 2016 when a Turkish firm acquired a privately held Pakistani home appliances company. In December, a Dutch food conglomerate completed its purchase of a majority stake in a Pakistani food processing company for US$ 458 million.
[15] For instance, in 2015, global cross-border M&A deals had grown by a sizable 66.9 percent to US$ 721 billion. In contrast, announced greenfield investments had risen by a much smaller 8.0 percent to US$ 766 billion (source: World Investment Report 2016, United Nations Conference on Trade and Development).
[16] In addition to the two acquisition deals in food processing and electronics sectors that were completed in Q2-FY17, M&A activity is also visible in the power, automobile, and pharmaceutical industries.
[17] Economic Survey of Pakistan 2015-16 (Statistical Appendix, Table 1.1) has projected Pakistan's population at 193.6 million.

Meanwhile, FDI from China is not just limited to power and infrastructure projects anymore: Chinese firms have either concluded or are in the process of striking deals in industries as varied as financial services (Pakistan Stock Exchange), glass manufacturing, and packaging materials. From a medium- to long-term perspective, it is reasonable to expect positive spillover of these M&A transactions to extend beyond the arrival of FX inflows only, and lead to improvements in corporate productivity and efficiency; skill and technology transfer; introduction of innovative products; and opening up of new markets for exportable products. Most importantly, these deals offer opportunities for aspiring Pakistani manufacturers to get a foothold into the cut-throat global value chain. However, this will only be possible if foreign companies invest in exporting sectors of the economy, instead of attempting to just cater to rising domestic demand in the country.[18]

Helped along by the stake sales of the food and electronics companies, net FDI inflows into the country grew 10.4 percent YoY to US$ 1.1 billion in H1-FY17.[19] After excluding these acquisition proceeds, net FDI was down 49.7 percent YoY in the first half of the year. Inflows from China dropped 54.0 percent to US$ 204 million; a corresponding decline of 53.8 percent was noted in foreign investment flowing into the power sector (which amounted to US$ 211 million). The decline in Chinese investment so far this fiscal year is somewhat intriguing, as it does not seem to resonate with the extent of visible, on-the-ground CPEC-related activities in the country, particularly in the power sector (**Box 5.1**).

Box 5.1. Financing of CPEC imports: Addressing gaps in data

In Pakistan, data regarding the import of goods is compiled by two different government bodies. One is the Pakistan Bureau of Statistics (PBS), which compiles data reported by customs authorities (which record imports when the goods physically cross the country's border). The other is SBP, which receives data from commercial banks when importers make payments against letters of credit (L/Cs). Due to a variety of factors (like imports on deferred payments, freight and insurance, etc), there is a natural discrepancy between the two datasets. Deferred payments, for instance, result in a time lag between the recording of imports by customs and their reporting to SBP. Besides, there are certain items, like gold, and vehicles (under the baggage scheme) etc., for which the payment burden does not fall on the interbank market.

Usually, for any period, import data recorded by PBS tends to be higher than that available with SBP: the 10-year average difference between the two (for July-December) is US$ 1.6 billion. However, this difference has widened considerably from FY15 onwards, and touched an unprecedented US$ 3.0 billion in Jul-Dec FY17 (**Figure 5.1.1**).

[18] For details, please see Special Section titled "Why have Pakistan's exports stagnated?" in SBP's *Annual Report on the State of Pakistan's Economy for 2014-15*.
[19] Here, it must be pointed out that after excluding re-invested earnings, net FDI recorded a much higher YoY growth of 62.2 percent in H1-FY17.

Moreover, a large share of this discrepancy can be explained by the surge in import of power generation machinery, which is being recorded by customs but is not fully visible in import financing data available with SBP (**Figure 5.1.2**). The gap in import data for power generation equipment also widened dramatically to US$ 1.1 billion in H1-FY17, from the previous 10-year's average of just US$ 193 million. Since most power sector activity in the country is taking place under the CPEC umbrella, it is highly probable that the widening gap between the two import datasets is linked with the CPEC accord (signed in April 2014).

Figure 5.1.1: Gap between PBS & SBP imports data (Jul-Dec)

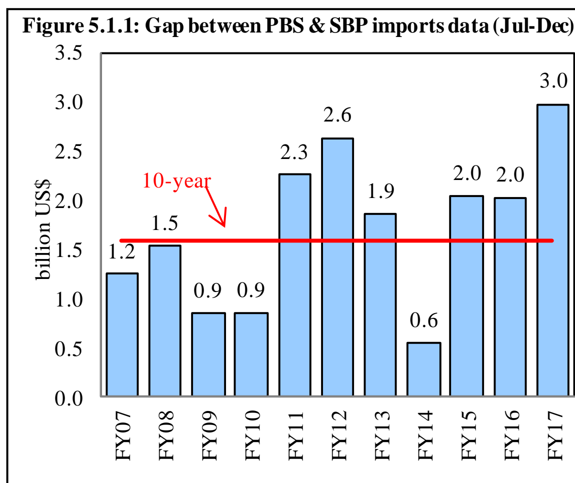
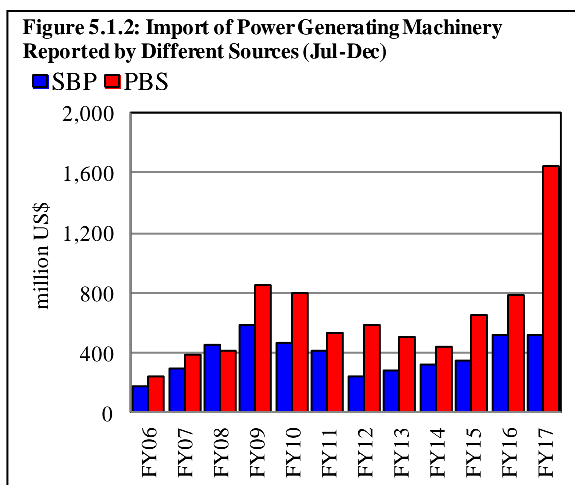


Figure 5.1.2: Import of Power Generating Machinery Reported by Different Sources (Jul-Dec)



Typically, banks report import financing data to SBP after importers make payments against L/Cs. However, that appears not to be the case with imports of power generation machinery over the past two and a half years: there has been a relatively minor increase in these imports based on L/C-level data provided by commercial banks to SBP. Hence, it appears that the *bulk* of these machinery imports are being financed from outside the Pakistani banking channel. This is also supported by the absence of any outsized pressure in the interbank (which would have been a near certainty if the import bill had grown by a further US$ 3.0 billion in Jul-Dec FY17, as per PBS data, without a commensurate increase in financing flows).

This difference indicates that capital equipment imports into the country, FDI and loans from China are not being fully captured in BoP data. For its part, SBP has enhanced reporting requirements for commercial banks regarding foreign currency accounts maintained with them by corporate entities operating in the country. Through EPD Circular Letter No. 14 (issued on December 7, 2016), SBP directed commercial banks to clearly specify whether each project/company maintaining a special FCY account with them, is part of CPEC or not. Moreover, banks have also been instructed to clearly specify the nature of each FX transaction conducted in these accounts (like import payments, loan disbursements and repayments, repatriation of dividends, disinvestment of foreign investment, and issuance of bonus shares, etc.). This will help clarify whether the financing of CPEC-related capital imports is coming in the form of loans (both from commercial and/or foreign sponsors), and equity investment (in cash or kind).

SBP is also coordinating with other government departments (including the Ministry of Finance, the Planning Commission and the Board of Investment) to timely update the data for import financing for CPEC with that of loan and FDI inflows from China. Once this happens, figures for both imports and loans/FDI in SBP's balance of payments data may be revised upwards significantly in the future. While this will inflate the trade and current account deficits (due to recording of higher imports) *ceteris paribus*, it will be netted out through an equal increase in loans and/or FDI in the financial account – leaving zero net impact on the country's reserves position for that period.

Foreign portfolio investment: Public inflows offset equity sell-off by foreigners

Public flows dominated foreign portfolio investment in H1-FY17 of US$ 745 million. Major impetus came from the issuance of a US$ 1.0 billion Sukuk by the government in October 2016. This was instrumental in offsetting an increase in capital outflows from the local equity market; a trend that gathered pace in Q2-FY17 (**Figure 5.3a**). More than anything else, this sell-off by foreign investors seems to have been sparked by exogenous factors, and has affected multiple emerging markets (EMs) alike (**Figure 5.3b**).

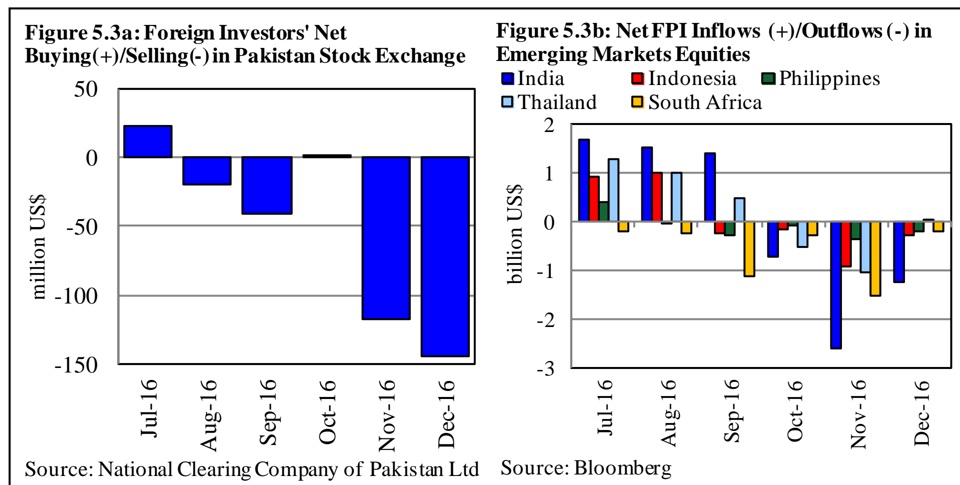


Figure 5.3a: Foreign Investors' Net Buying(+)/Selling(-) in Pakistan Stock Exchange

Source: National Clearing Company of Pakistan Ltd

Figure 5.3b: Net FPI Inflows (+)/Outflows (-) in Emerging Markets Equities

Source: Bloomberg

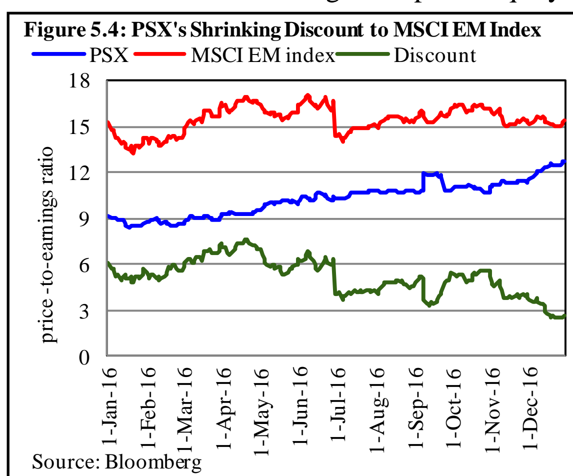
Anticipating the second interest rate hike by the US Fed in a 12-month period, foreign funds seemed to have started offloading emerging market equities from September 2016 onwards. Yet, the outcome of the US presidential elections in early November 2016 apparently accelerated this sell-off, even before the Fed got round to raising the federal funds rate (in December). Global funds started factoring in rising inflation in the US in the future (as the new administration promised to ease the regulatory climate, significantly cut corporate taxes, and boost infrastructure spending); the thinking went that these steps would lead to rising price levels, and ultimately lead the US central bank to further tighten monetary policy. This led investors to shun safe havens (particularly US

Treasuries and gold) and riskier EM assets alike;[20] instead, they started piling into US equities, playing on the deregulation and infrastructure-development themes.[21]

However, with EMs across the board facing capital outflows, local institutional and retail investors embarked on a significant buying spree at the Pakistan Stock Exchange (PSX) over the past year, and easily absorbed the equity sell-off by foreign investors. As a result, the PSX-100 index was among the top five equity markets in the world in CY-2016, giving out a healthy 45.7 percent return in the year.

However, the resultant hike in the index's valuation might restrain foreign funds – that were earlier attracted by the PSX's wide price-to-earnings (p/e) discount over the MSCI EM Index (**Figure 5.4**) – from venturing heavily into Pakistani stocks.[22]

Figure 5.4: PSX's Shrinking Discount to MSCI EM Index



Source: Bloomberg

5.4 Exchange rate

Unlike H1-FY16, the PKR remained stable against the greenback during H1-FY17. In fact, it has appreciated by 0.2 percent, after depreciating 2.8 percent during the same period last year. Against the Japanese yen (JPY), the PKR appreciated by 13.9 percent YoY in H1-FY17, after depreciating 4.2 percent in the

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[20] In fact, 10-year US Treasury yields surged from 1.83 percent on November 7 and reached 2.44 percent by end-December 2016 (source: Bloomberg), as investors demanded higher premium on longer-tenured bonds to offset any erosion in their value due to rising inflation in the US in the future. Since the 10-year US Treasury yield is one of the benchmarks used in pricing long-term fixed income instruments across the globe, a continual surge in this rate might pose a dilemma for EMs like Pakistan that are looking to issue dollar-denominated sovereign bonds in international capital markets.

[21] Between November 7 and December 31, 2016, the Dow Jones Industrial Average surged 8.2 percent to 19,762.6 points (after hitting its all-time high of 19,974.6 points on December 20), while the broader S&P 500 rose 5.0 percent to 2,283.8 points (source: Bloomberg). Though the market rally was broad-based, stocks of financial services firms, in particular, performed quite well (on expectations that the new administration will considerably loosen the Dodd-Frank financial sector reforms, leading to healthy industry profits).

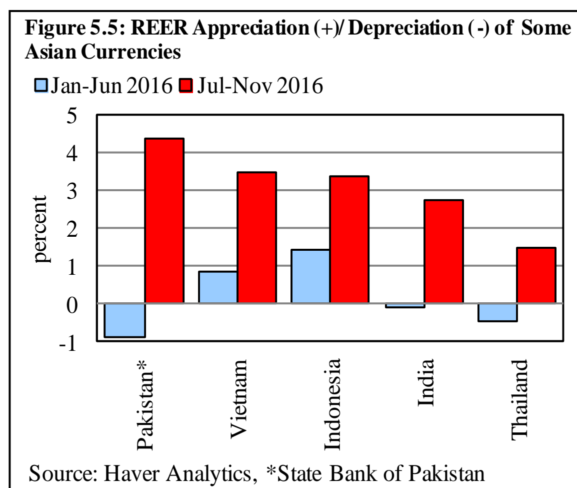
[22] Specifically, the PSX's (p/e) discount to the MSCI Emerging Markets Index has shrunk from 6.1 at the start of CY-16 to 2.6 by year-end.

same period last year. Volatility in global commodity prices helped strengthen the safe haven currency (JPY) against multiple currencies during H1-FY16.

This time around, the US dollar posted significant gains on account of two major events: a) the US presidential elections in November 2016 pushed the dollar up on expectations that the newly elected president's administration may boost the domestic economic growth with fiscal stimulus; and b) the Fed rate hike in December 2016 further augmented the gains, pushing down the advanced currencies like euro and Japanese yen.[23]

In real terms, major Asian currencies, while remaining relatively stable during the first six months of CY-2016, started to appreciate since July 2016; the PKR was no exception (**Figure 5.5**). After depreciating 0.9 percent during the first six months of CY16, the rupee appreciated by 4.4 percent during July-November 2016 in real terms. Currencies of other EMs, like Vietnam, Indonesia, India and Thailand, have also appreciated in real terms during this period.

Figure 5.5: REER Appreciation (+)/ Depreciation (-) of Some Asian Currencies



Source: Haver Analytics, *State Bank of Pakistan

5.5 Trade account[24]

The trade deficit widened by 21.9 percent to US$ 14.5 billion in H1-FY17, as imports picked up pace substantially and the export slowdown continued. The increase in imports was mainly driven by the rise in machinery and petroleum imports: while machinery had pushed up overall imports in Q1-FY17, POL contributed significantly to the overall increase in imports during Q2-FY17 (**Table 5.3**). Basically, the rising share of capital goods – like machinery, electrical machinery, energy related products, aluminum alloys, etc – in overall

[23] The dollar index (which measures the greenback's strength against the basket of major currencies) reached a 14-year high level of 103 in December 2016.

[24] This section is based on customs data reported by the PBS. The information in this section does not tally with the payments record data, which is reported in **Section 5.1**. To understand the difference between these two data series, please see Annexure on data explanatory notes.

imports reflects a pro-growth change in the country's import composition. Higher investment in power, infrastructure and construction will not only boost economic activities, but also help address energy shortage in the country.

Table 5.3: Foreign Trade
billion US$

		Exports	Imports	Trade deficit
Q1	FY16	5.1	10.6	5.5
	FY17	4.7	11.7	7.0
Q2	FY16	5.2	11.6	6.4
	FY17	5.2	12.7	7.5
H1	FY16	10.3	22.2	11.9
	FY17	9.9	24.4	14.5
% Growth				
Q1	FY16	-14.3	-14.9	-15.5
	FY17	-9.3	10.0	28.1
Q2	FY16	-14.8	-1.0	13.8
	FY17	1.4	9.8	16.6
H1	FY16	-14.5	-8.2	-1.9
	FY17	-3.9	9.9	21.9

Source: Pakistan Bureau of Statistics

Exports

Though exports dropped 3.9 percent in H1-FY17 (against a drop of 14.5 percent in H1-FY16), this was mainly due to a 9.3 percent decline observed in the first quarter of the year. Exports grew by a marginal 1.4 percent in Q2-FY17, as a recovery in international prices of some textile products and an increase in demand for Pakistani textiles in the EU, boosted textile exports by 3.4 percent in the quarter. Within textile exports, items that exhibited improvements included readymade garments and bedwear. Moreover, exports of some non-traditional items, like fish, fruits, spices, tobacco, plastic, and naptha etc. also increased.

Table 5.4: Textile Exports
million US$

	Values				% Growth			
	Q1-FY16	Q2-FY16	Q1-FY17	Q2-FY17	Q1-FY17	Q2-FY17	H1-FY16	H1-FY17
Total	**3,220.8**	**3,039.0**	**3,018.3**	**3,136.1**	**-6.3**	**3.2**	**-9.1**	**-1.7**
Cotton	55.5	16.1	17.5	18.4	-68.5	14.3	-37.0	-49.9
Yarn	383.0	318.2	307.0	347.5	-19.9	9.2	-29.3	-6.7
Cotton fabric	561.0	549.4	547.6	502.8	-2.4	-8.5	-10.2	-5.4
Other textile materials	132.6	155.2	131.3	141.8	-1.0	-8.7	-15.4	-5.1
Synthetic textile	75.7	72.3	39.7	60.6	-47.6	-16.1	-21.8	-32.2
Knitwear	630.4	561.1	592.3	592.0	-6.0	5.5	-3.7	-0.6
Bed wear	514.4	482.7	528.9	527.7	2.8	9.3	-7.1	6.0
Towels	214.5	190.6	178.6	201.4	-16.7	5.6	6.4	-6.2
Readymade garments	506.1	534.0	524.4	575.3	3.6	7.7	3.4	5.7
Other made up articles	147.7	159.4	151.1	168.7	2.3	5.9	-2.5	4.2

Source: Pakistan Bureau of Statistics

Textile

While textile exports dropped 1.7 percent in H1-FY17 to US$ 6.2 billion (after declining 9.1 percent in the same period last year), the contraction was mainly observed in Q1-FY17, as textile shipments rebounded in Q2-FY17. Encouragingly, this increase emanated from both low and high value added categories (**Table 5.4**).

The appreciable 13.6 percent YoY recovery in international cotton prices during Q2-FY17 likely contributed to a significant YoY increase of 14.3 and 9.2 percent YoY respectively in cotton and cotton yarn exports. In case of readymade garments, export values benefitted from a price increase as well as higher quantums.

Pakistan's performance in the key EU market is particularly noteworthy. The country mainly exports readymade garments, knitwear and bedwear to the bloc, which has the highest share in the country's textile exports. While the EU's overall clothing imports declined during Jul-Dec FY17, Pakistan was among those few countries whose textile exports to the bloc increased during the period. In fact, Pakistan (along with Bangladesh and Vietnam) was able to increase its share in the EU's textile market during the period (**Table 5.5** & **5.6**). This indicates that at least some Pakistani exporters are effectively utilising the duty-free access to the EU market that Pakistan currently enjoys under the GSP Plus scheme, without cutting back supplies to other markets.

Table 5.5: EU Import of Clothing from Major Countries (Jul-Dec)

million US$

	Value		% Growth		% Share	
	FY16	**FY17**	**FY16**	**FY17**	**FY16**	**FY17**
China	19,147	17,665	-13.4	-7.7	40.2	38.0
Bangladesh	7,527	8,041	4.3	6.8	15.8	17.3
India	2,480	2,413	-7.8	-2.7	5.2	5.2
Vietnam	1,767	1,789	5.0	1.2	3.7	3.8
Pakistan	1,289	1,365	4.4	5.9	2.7	2.9
Total	**47,618**	**46,484**	**-7.6**	**-2.4**	**100.0**	**100.0**

Source: Eurostat

However, uncertainty prevails in the US market, as the country's overall as well as textile imports have declined in the period.[25] Pakistan's textile exports to the country declined in both values and quantums during H1-FY17.[26]

[25] The US' import of textile and apparel declined by 0.7 percent YoY in terms of quantum and 9.0 percent in value during Jul-Dec FY17 (source: Office of Textiles and Apparel, US Department of

Table 5.6: EU Import of Home-Textile from Major Countries (Jul-Dec)
million US$

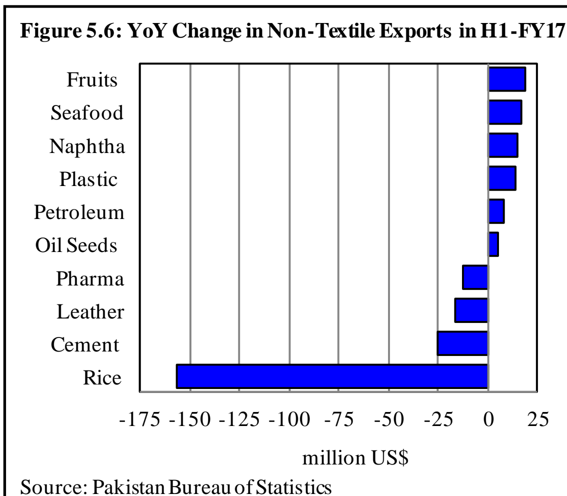
	Value		% Growth		% Share	
	FY16	**FY17**	**FY16**	**FY17**	**FY16**	**FY17**
China	2,137	2,122	-7.0	-0.7	41.0	40.4
Bangladesh	176	183	-17.4	3.7	3.4	3.5
India	596	585	-10.5	-1.9	11.4	11.1
Vietnam	111	118	-10.5	6.2	2.1	2.3
Pakistan	813	865	-5.5	6.4	15.6	16.5
Total	**5,210**	**5,250**	**-8.3**	**0.8**	**100.0**	**100.0**

Source: Eurostat

With the recent recovery in international cotton prices, Pakistani textile exporters have a chance to increase their earnings by streamlining their operations and becoming more cost-effective. In this backdrop, the rise in the import of textile machinery during H1-FY17 is a promising sign. Furthermore, the recently announced export package (including an increase in rebate on FOB values) should ease exporters' cash-flow constraints. The relaxation in customs duty and sales tax on the import of cotton, man-made fibre (rather than polyester) and textile machinery, should all provide some relief to textile exporters dependent on imported raw materials.

Non-textile items
Within non-textile items, exports of seafood, fruits, naphtha and other POL products, and plastic increased during H1-FY17, whereas shipments of major products like rice (both basmati and non-basmati), cement, leather and pharmaceuticals declined in the period (**Figure 5.6**).

Figure 5.6: YoY Change in Non-Textile Exports in H1-FY17



Source: Pakistan Bureau of Statistics

Encouragingly, export of *fish and fish preparations* grew 10.3 percent YoY to US$

Commerce). Moreover, the US's overall imports declined by 0.3 percent YoY in Jul-Dec FY17 (source: International Trade Center).

[26] Pakistan's textile and clothing exports to the US market declined 8.8 percent in quantum terms and 10.7 percent in value during Jul-Dec FY17 (source: Office of Textiles and Apparel, US Department of Commerce)

183.5 million in H1-FY17, compared to US$166.3 million in the same period last year. This growth can be traced to: (i) a rise in shipments to China, Malaysia, and UAE; and (ii) a phenomenal volumetric increase in exports of salmonidae, crabs, shrimps and squids. Meanwhile, the surge in global oil prices during the period has arguably made it feasible for local refineries to start exporting *naphtha and other POL products* again.

Among major export items, shipments of both *basmati and non- basmati rice* varieties declined 18.0 percent YoY during H1-FY17. This mainly represented a shift in the demand from key markets like Saudi Arabia, UAE, and Philippines, etc away from Pakistani rice, to other countries. An additional factor was the second successive good rice harvest in Africa, which kept a lid on import demand from the region.

Lastly, *cement* exports continued on their downward trend, with most of the 14.4 percent YoY decline in H1-FY17 coming from two markets – South Africa and Afghanistan. A slight consolation was continued strong demand for Pakistani cement from India; this partially offset the declines witnessed in the two other major markets.[27]

Imports

Imports registered a growth of 9.9 percent YoY in H1-FY17, with a large share of the increase coming from machinery and POL items, followed by food, transport and metals (**Table 5.7**).

Table 5.7: Import of Major Categories (Jul-Dec)
million US$

	values			% growth	
Items	**FY15**	**FY16**	**FY17**	**FY16**	**FY17**
Food group	2,810.1	2,626.6	2,865.1	-6.5	9.1
Palm oil	*953.4*	*829.9*	*843.7*	*-12.9*	*1.7*
Pulses	*187.2*	*268.8*	*371.2*	*43.6*	*38.1*
Others	*1,669.5*	*1,527.9*	*1,650.3*	*-8.5*	*8.0*
Machinery group	3,644.0	4,023.5	5,669.2	10.4	40.9
Power gen.	*658.1*	*790.2*	*1,680.4*	*20.1*	*112.6*
Textile	*211.8*	*232.4*	*258.8*	*9.7*	*11.3*
Construction	*132.5*	*161.9*	*250.7*	*22.2*	*54.8*
Electrical	*594.3*	*892.4*	*959.7*	*50.2*	*7.5*
Others	*2,047.3*	*1,946.7*	*2,519.7*	*-4.9*	*29.4*
Transport group	1,290.5	1,322.3	1,406.9	2.5	6.4
Petroleum group	6,946.9	4,488.6	5,002.7	-35.4	11.5
Petroleum prod.	*4,304.8*	*2,704.4*	*3,205.7*	*-37.2*	*18.5*
Crude oil	*2,642.1*	*1,476.2*	*1,165.6*	*-44.1*	*-21.0*
L.N.G	-	*228.1*	*511.7*		*124.4*
Textile group	1,249.3	1,558.1	1,364.4	24.7	-12.4
Agri & chem group	3,842.4	3,768.3	3,594.3	-1.9	-4.6
Metal group	1,798.3	1,906.8	1,960.3	6.0	2.8
Miscellaneous group	2,563.6	2,467.9	2,489.0	*-3.7*	*0.9*
Total Imports	**24,145.1**	**22,162.1**	**24,351.9**	**-8.2**	**9.9**

Source: Pakistan Bureau of Statistics

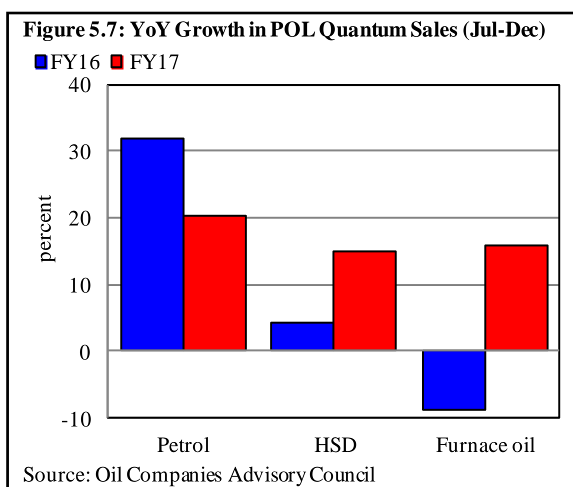
[27] Quantum cement exports to Afghanistan and African countries (mainly South Africa) declined by a cumulative 402,000 MT during Jul-Dec FY17, whereas shipments to India rose by 295,000 MT in the same period (source: All Pakistan Cement Manufacturer Association).

POL imports rising on higher quantums

Petroleum imports grew by 11.5 percent YoY during H1-FY17. This increase was driven primarily by higher volumetric imports of furnace oil and high-speed diesel (HSD), as a result of higher demand from power and transportation sectors respectively. Rising imports of power generators also contributed to the increase in demand for HSD.[28]

It might also be recalled that the impact of the policy shift towards high quality petrol (92 RON) has led to higher imports of petrol (**Figure 5.7**), as local refineries struggle to upgrade their existing set-ups to comply with new product standards in the interim period; this has also contributed to lesser crude oil imports, and lower domestic production of POL products during the period (**Chapter 2**).

Figure 5.7: YoY Growth in POL Quantum Sales (Jul-Dec)



Source: Oil Companies Advisory Council

Machinery and transport imports up on strong economic activities

Vibrant domestic construction, progress on mega infrastructure projects, and CPEC-related economic activities, all contributed to a surge in demand for machinery and commercial vehicles during H1-FY17. Machinery imports posted a significant increase of 40.9 percent during H1-FY17 and reached US$ 5.7 billion – almost 23.2 percent of the total import bill. Moreover, machinery items contributed a massive 73.3 percent to the increase in total imports in the six-month period. Within machinery, imports of power generation, textile and construction-related machinery increased during the period, while that of telecom equipment declined (**Table 5.7**).

Surge in global commodity prices boosts food imports

A visible recovery in global prices of food items, particularly palm oil, inflated the food import bill. Average international palm oil prices during H1-FY17 were 28.1 percent higher than their level in the same period last year.[29] Pakistan's palm oil imports rose 29.0 percent YoY in Q2-FY17, after declining 17.8 percent in Q1-

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[28] During Jul-Oct FY17 (latest data available), the country imported 15,250 diesel generators of varying capacities, against 6,995 units in the same period last year.

[29] Source: World Bank

FY17. Lower domestic production necessitated higher imports of certain perishable commodities, like garlic, tomatoes and other vegetables etc (which are classified under "other food items"). However, tea was an exception, as the decline in its import was entirely due to lower international prices; its quantum imports increased slightly during the period.