2 Real Sector

2.1 Overview

Preliminary information on major sectors of the economy indicates that GDP growth in FY18 will surpass last year's level. The prospects of achieving the 6 percent growth target set for the year, however, appear less likely. This assessment stems from unfavorable developments in Q2-FY18, which led to a loss of some of the momentum achieved during the first quarter. On the agriculture front, lower-than-targeted wheat crop may eclipse the healthy performance of *kharif* crops, while the latest cotton arrival figures also point towards a downward revision.[1] Meanwhile, the growth in large-scale manufacturing (LSM) decelerated to 1.6 percent during Q2-FY18 against a strong 9.9 percent growth witnessed in the preceding quarter.

Delays in sugarcane crushing – despite a record harvest – overshadowed the otherwise broad-based growth in the sector. This is evident from the fact that the LSM growth excluding sugar, at 4.5 percent in Q2-FY18, was higher than the 3.6 percent growth recorded in Q2-FY17. Consumer durables and construction-allied industries continued to benefit from higher retail spending and infrastructure activities in the country. Hence, the overall LSM growth improved to 5.5 percent in H1-FY18 as compared to 4.0 percent during H1-FY17.

The services sector, meanwhile, is expected to maintain last year's growth momentum, based on encouraging trends in the leading indicators, especially those related to *wholesale & retail trade* and *transport & communication.*

2.2 Agriculture

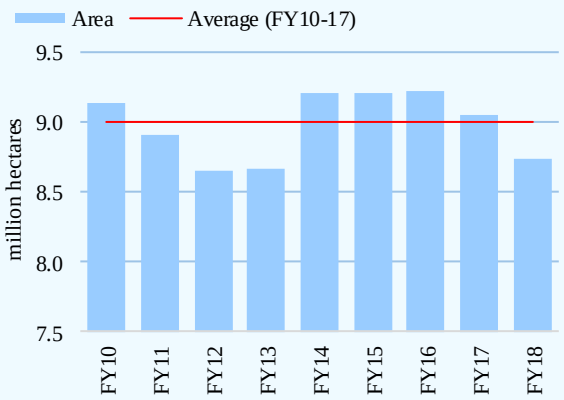
Major *kharif* crops, such as sugarcane and rice, surpassed their targets for FY18, while cotton crop managed to exceed last year's production level. Higher yields, attractive output prices, and supportive government policies, largely explain the healthy output of *kharif* crops. The overall performance of the crop sector, however, will depend on the outcome of *rabi* crops, especially wheat.

Given its dominant share (57 percent) in agriculture, the performance of livestock would determine the overall growth of the sector. In this regard, the sector would benefit from increased focus of provincial governments on feeding, animal

[1] Cotton production may remain below 12 million bales during FY18 – lower than the revised estimate of 12.6 million cotton bales. However, it will surpass last year's level of 10.7 million bales.

management, and genetics. Moreover, a strong performance of the crop sector during the last couple of years has stimulated investment in livestock, which is expected to continue during FY18 as well.

Figure 2.1: Area under Wheat Crop



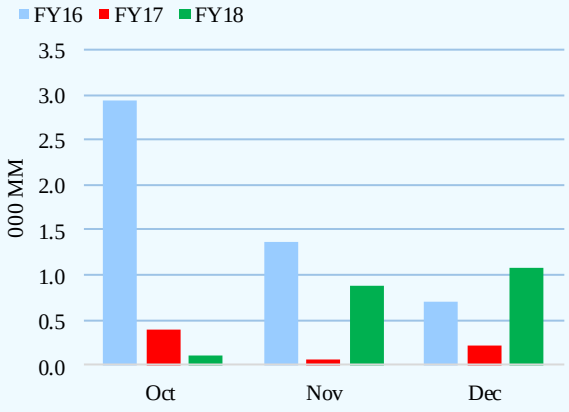
Data source: Pakistan Bureau of Statistics

Wheat

The government has set the wheat production target at 26.5 million tons for FY18 from an area of 8.9 million hectares. The achievement of this target would largely depend on improvement in yield, as the targeted area under the crop was set 2.2 percent below last year's level of 9.1 million hectares.

Initial estimates reveal that the area under cultivation declined by 3.5 percent YoY to 8.7 million hectares (**Figure 2.1**). One of the reasons for the decline in area was the shortage of water both in rain-fed as well as irrigated areas. Rain-fed areas, which account for 14 percent of the area under wheat, and 6 percent of the total output, came under strain due to a prolonged dry spell witnessed in the month of October 2017. However, growers in these areas received some respite from higher rainfall in the subsequent two months as compared to corresponding months last year (**Figure 2.2**). Moreover, in the irrigated plains, water supply in Q2-FY18 was 16.5 percent lower than the average supply recorded over the last five years (**Figure 2.3**).[2]

Figure 2.2: Aggregate Rainfall

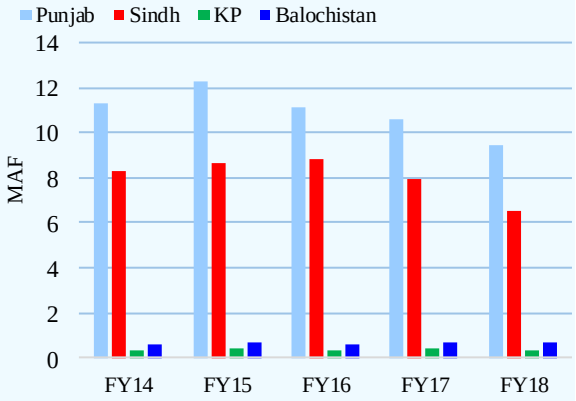


Data source: Indus River System Authority (IRSA)

[2] See, Chapter 7 of Annual Report FY17 of SBP that presents a detailed analysis of the issues regarding water sustainability in Pakistan.

Another reason for the decline in area under wheat was the delay in harvesting of the sugarcane crop in most of the areas. The prolonged standoff between sugar mills and sugarcane growers over procurement prices continued deep into the *rabi* season FY18, which left relatively less land for wheat sowing.

Figure 2.3: Irrigation Water (Oct-Dec)



Data source: SUPARCO

On the other hand, the required increase in yields to compensate for the area losses may also not be realized. Reaching the FY18 wheat production target would now require a 6.4 percent YoY increase in yield. This seems unrealistic, as the highest rate of yield improvement that the country achieved during the previous 5 years, was only 2 percent.

In any case, the country is expected to produce another surplus wheat crop, which is a consequence of high domestic support prices. On one hand, this policy has kept wheat profitability intact, thereby encouraging growers to invest in fertilizer, seeds and pesticides; on the other hand, back-to-back bumper crops in the last four years have resulted in a build-up of stockpile.

Furthermore, the export subsidy has not helped offload stocks due to high price differential (domestic wheat costs US$ 300 per ton whereas the international variant is available at US$ 180). Another bumper crop on the global front is expected to keep downward pressure on the international prices of the commodity.

In the wake of high procurement costs, and an inability to offload stocks under the subsidy scheme, the country needs to rationalize its support pricing policy, while also keeping in view the growers' interest (**Chapter 3**). This would encourage crop substitution, reduce fiscal cost, and make the domestic commodity more competitive in the international market.

Input availability

The country faced acute water shortages during the *rabi* season. Water availability remained 12.7 percent lower in Q2-FY18 as compared to Q2-FY17,

and 16.5 percent against the average observed during the last five years.[3] This is mainly attributed to lower snowfall in the northern parts of the country, along with below-average rainfall in the Indus Basin.

The current scenario further stresses the need for adoption of a comprehensive National Water Policy, one that emphasizes the building up of additional storages, developing water-saving technology, revamping the water-pricing mechanism, and enhancing institutional capacity.[4] Beside this, special focus is also required to manage demand in order to deal with future shortages.[5]

In terms of fertilizer application, although the offtake of urea and DAP declined by 16.2 percent and 19.7 percent YoY, respectively, in Q2-FY18, this was mainly due to a strong base effect. Based on anecdotal evidence, dealers across the country had made heavy purchases last year following the announcement of various incentives by the government. These included: (i) Rs 156/ bag subsidy on urea; (ii) reduction in sales tax from 17 percent to 5 percent; and (iii) voluntary price reductions by fertilizer manufacturers. These measures had inflated the offtake numbers in H2-FY17. Barring comparison from last year, fertilizer offtake during H1-FY18 is broadly in line with past trend (i.e. the average during the first half of FY14-FY16).

Credit disbursement to agriculture exhibited a YoY growth of 43.2 percent in H1-FY18, following a 22.0 percent rise witnessed during H1-FY17. This improvement appears to have come from the supply side: alongside commercial banks, disbursements by microfinance banks/institutions continued to rise after their inclusion in the targeted credit regime, which aims to cater to the needs of small-scale farmers.

2.3 Large Scale Manufacturing (LSM)

LSM suffered a two-month consecutive contraction during November and December 2017, which dampened the momentum achieved during Q1-FY18; resultantly, the growth decelerated to only 1.6 percent during Q2-FY18, compared to a healthy start of 9.9 percent growth during the first quarter.

[3] This figure is for irrigation water availability for all provinces, as reported by the Indus River System Authority.
[4] The first draft of the National Water Policy was developed in 2003 and still awaits approval by the Senate.
[5] Chapter 7 of Annual Report FY17 of SBP presents a detailed analysis of the issues regarding water sustainability, while highlighting the policy initiatives required in this regard.

Three factors mainly explain this deceleration: (i) a decline in sugar production due to delays in crushing; (ii) the government's decision to temporarily shut down furnace oil based power plants, which led to subdued refining activities in November and December; and (iii) lower availability of piped gas to small-scale fertilizer manufacturers, which resulted in plant closures.

Production declines in the aforementioned industries more than offset the strong performances of construction-allied and consumer durable segments during the quarter. Sustained progress on infrastructure projects (under both CPEC and PSDP), as well as robust consumer spending, helped these segments continue their growth momentum.

Table 2.1: YoY Growth in LSM

percent

	Weight	H1-FY17	H1-FY18	Q2-FY17	Q2-FY18
LSM	70.3	**4.0**	**5.5**	6.0	1.6
Textile	20.9	0.2	0.6	0.5	0.2
Cotton yarn	13.0	0.4	0.1	0.5	0.1
Cotton cloth	7.2	0.2	0.0	0.3	0.1
Jute goods	0.3	-38.6	62.7	-23.9	39.9
Food	12.4	6.5	-0.3	12.7	-8.8
Sugar	3.5	52.4	-37.3	52.4	-37.3
Cigarettes	2.1	-31.0	69.8	-17.7	52.3
Vegetable ghee	1.1	1.7	-3.0	4.2	-14.9
Cooking oil	2.2	-1.3	4.6	-2.8	0.0
Soft drinks	0.9	17.8	11.5	16.8	26.2
POL	5.5	-1.3	8.1	0.8	2.8
Steel	5.4	15.6	37.1	18.2	28.1
Non-metallic	5.4	9.3	10.2	10.8	8.5
Cement	5.3	9.5	10.3	11.1	8.5
Automobile	4.6	6.6	21.9	10.2	15.4
Jeeps and cars	2.8	-2.7	27.0	-2.1	22.8
Fertilizer	4.4	3.5	-9.8	0.6	-14.0
Pharmaceutical	3.6	8.1	3.6	9.2	5.5
Paper	2.3	12.0	8.8	13.9	8.1
Electronics	2.0	15.5	50.5	16.1	8.2
Chemicals	1.7	-3.3	-0.4	-0.4	-6.4
Caustic soda	0.4	-6.3	16.6	11.0	15.2
Leather products	0.9	-20.8	-5.9	-24.3	-11.4
Excl. sugar and fertilizer	*62.3*	*2.7*	*8.4*	*3.8*	*5.8*

Data source: Pakistan Bureau of Statistics

On the whole, the YoY LSM production was up by 5.5 percent during H1-FY18, relative to the 4.0 percent growth witnessed during H1-FY17 (**Table 2.1**).

Auto Sector

Automobile production rose to a record high during H1-FY18, despite domestic capacity constraints; the aggregate production improved by 21.9 percent in H1-FY18 compared to 6.6 percent during the same period last year (**Table 2.2**).[6]

Increased demand for passenger cars can largely be explained by rising incomes, upsurge in popularity of online ride hailing services, and easy access to affordable

[6] By working overtime during working days and utilizing off days as well, the sector operated beyond 100 percent capacity for the second quarter running.

bank finance. The vibrancy in this market allowed car manufacturers to pass on the impact of rising assembling costs to consumers without taking a perceptible hit on their sales. Moreover, as availability of adequate public transport lags behind the requirements of the growing population, online ride hailing platforms are gaining traction. This has particularly benefitted the 800-1000cc passenger car segment; the category contributed almost half of the growth in the passenger car segment. Despite historic production, there was significant appetite for imports of both new and used vehicles.

Table 2.2: Vehicles Production and Sales

	H1-FY17		H1-FY18		Growth (percent)	
Units	Production[1]	Sales[2]	Production	Sales	Production	Sales
Jeeps and cars	90,443	86,106	114,821	110,238	27.0	28.0
Trucks	3,806	3304	4,514	4,252	18.6	28.7
Buses	669	577	409	310	-38.9	-46.3
LCVs	12,548	11,427	14,907	13,909	18.8	21.7
Farm tractors	21,336	20,933	32,614	32,310	52.9	54.3
Motorcycles & three-wheelers	1,189,808	789,733	1,387,240	941,238	16.6	19.2

Data source: PBS[1]; PAMA[2]

The production of sports utility vehicles (SUVs) rose from only 221 units in H1-FY17 to 7,034 units in H1-FY18, driven mainly by the introduction of a new model late last year. The popularity of this budget model can be traced to customers' preference for sturdy vehicles and additional seating capacity.[7] The current performance of the budget SUV shows that the market is eager to absorb such vehicles.

In addition to passenger cars, the demand for light commercial vehicles (LCVs) also remained strong. The production of these vehicles rebounded by 18.8 percent in H1-FY18 after declining 41.4 percent in H1-FY17. Moreover, the surge in the production of trucks continued as it registered an increase of 18.6 percent in H1-FY18 on top of 63.6 percent increase in the same period last year. The uptick in production and sales of commercial vehicles highlight the growing transportation and economic activities in the economy.

As for the tractors, improved purchasing power in rural areas on the back of healthy cash crops, coupled with a continuation of lower sales tax, led to a

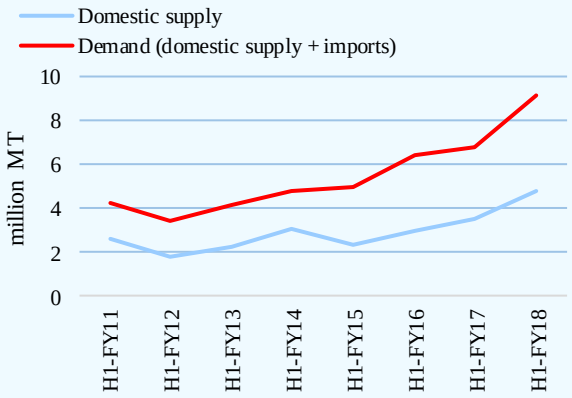
[7] This variant's ability to navigate difficult terrains, especially unpaved roads in rural areas, also contributed to its popularity.

sizeable surge in the sales for tractors (54.3 percent).[8] Motorcycle sales, meanwhile, continued on their upward trajectory; growing middle class incomes mainly drove this growth (19.2 percent YoY).

Steel

The demand for steel products remained strong during H1-FY18, as public sector infrastructure projects and private investment in housing schemes picked up pace. Additional stimulus came from increasing raw material requirements by two- and three-wheeler manufacturers, as bike sales continued to rise substantially in the country. On the supply side, adequate availability of electricity enabled the producers to utilize their capacities optimally during the period. This favorable interplay of demand and supply resulted in steel production growing by 37.1 percent in H1-FY18 after growing 15.6 percent during the corresponding period of FY17.

Figure 2.4: Demand and Supply of Finished Steel Products



Data source: Pakistan Bureau of Statistics, SBP

However, similar to automobiles, the current pace of growth in domestic steel supply lags behind the fast growing demand; this has led to an increase in imports to cover the shortfall (**Figure 2.4**). Keeping in view the demand-supply gap, the large-scale producers are investing further in capacity expansions.[9] They have started integrating their operations vertically to benefit from economies of scale and lower tax levies. Furthermore, some big players are introducing new products to cater to the diverse needs of various infrastructure projects.[10] Since additional capacities are expected to come on-line during H2-FY18, domestic supplies are likely to increase further; this will help reduce the country's dependence on finished steel imports.

That said, in contrast to large-scale producers, the small/medium scale producers are not able to take advantage of the buoyant steel demand in the country. Their

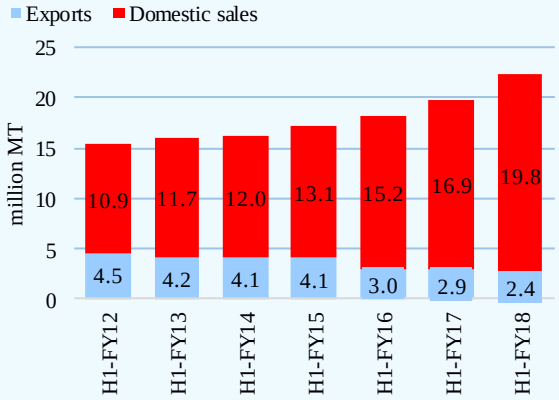
[8] The momentum in tractor sales is expected to continue going forward, given the tractor subsidy scheme announced by the Sindh government worth Rs 2.0 billion.

[9] Investments worth around US$ 112 million by big players (such as International Steel, Amreli Steel, Aisha Steel, and Mughal Steel) will lead to cumulative capacity expansion of 53.0 percent.

[10] For example, Mughal Steel is investing in the production of shockproof steel pipes.

inability to operate at economies of scale makes it difficult for them to lower their overhead cost in the face of high electricity tariffs and increased taxation charges (due to multiple agents in the value chain). Resultantly, the group faces tougher competition from imports relative to the larger manufacturers. These mechanics governing the operational feasibility of small players in the market highlight the fragmented nature of the steel industry.

Figure 2.5: Cement Dispatches



Data source: All Pakistan Cement Manufacturers Association

Cement

Like steel, domestic infrastructure investments by both public and private sectors continued to stimulate the cement industry. Contrary to steel, however, the increasing demand has largely been met by indigenous sources, as the industry has the requisite raw material along with capacity to cater to the growing needs of the economy. Resultantly, domestic sales posted an impressive YoY growth of 17.4 percent in H1-FY18, compared to 11.1 percent in H1-FY17, as capacity utilization reached 95 percent. Cement exports, on the other hand, fell by 17.3 percent on a YoY basis during H1-FY18 (**Figure 2.5**).[11]

The industry is benefiting from economies of scale due to higher capacity utilization. Furthermore, manufacturers have been investing aggressively in capacity expansions (by adding about 60 percent additional operational capacity) over the past few years, in anticipation of strong domestic demand. Most of the projects are expected to be completed within the next two years.

Chemicals

The performance of chemicals industry remained subdued during H1-FY18; a marginal contraction of 0.4 percent was witnessed after a 3.3 percent decline in the same period last year. Robust growth in construction activities resulted in an impressive uptick in cement and steel industries, the chemical counterparts could

[11] The domestic market has been able to absorb 89.2 percent of the output, leaving a marginal surplus for export.

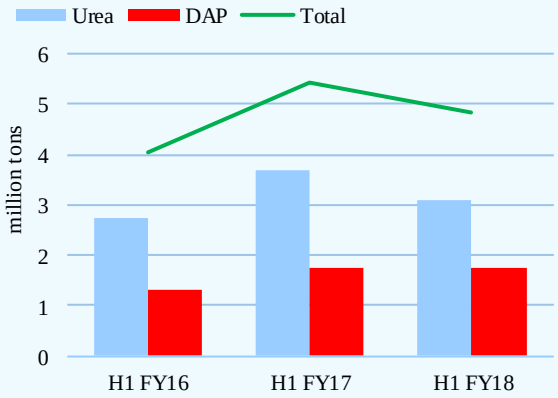
not take advantage. For instance, domestic production of paints and varnishes declined by more than 16 percent, while the increased demand for these products was largely met by imports that more than doubled during H1-FY18. Multiple factors constrained their operations, such as the influx of cheap imported products, dependence on imported raw materials, and high cost of doing business.

For other chemicals, domestic demand also remained strong. Sensing a sustainable rise in economic activities and improved availability of electricity, leading chemical producers are investing in capacity expansions for the production of caustic soda, soda ash and PVC.[12]

Fertilizer

The fertilizer sector exhibited a downturn during H1-FY18 as its production contracted by 9.8 percent, against a 3.5 percent growth witnessed in the same period last year (**Figure 2.6**). Two factors affected the production of fertilizer: (i) diversion of domestic piped natural gas (PNG) supplies away from small-scale urea producers; and (ii) financial infeasibility of operations under costly imported RLNG, especially for the smaller players, which led to a contraction in their activities.[13]

Figure 2.6: Trends in Fertilzer Offtake



Data source: National Fertilizer Development Centre

The price differential between RLNG and concessional feedstock natural gas is around ten-fold: it is costing manufacturers Rs 1,300 per MMBTU to procure RLNG, while the rate fixed for PNG supply for feedstock operations is only Rs 123 per MMBTU.

Here, it is important to recall that enhanced availability of gas and higher profitability (owing to extensive subsidies) were the most important drivers of

[12] Leading chemical producers - Engro Polymer and Chemicals and ICI Pakistan - are spending about US$ 190 million to enhance their respective plant capacities by over 50 percent.
[13] In particular, Fatimafert, Pak Arab Fertilizer (urea) and Agritech Fertilizer companies in Punjab with cumulative capacity of 0.9 million tons had shut down production due to divergence of domestic gas and increase in RLNG prices.

fertilizer production during FY17. Capacity utilization of the small-scale plants had improved to 83.6 percent in H1-FY17 from the average of 22.2 percent witnessed during the past five years. Their share in total urea production had also risen to 12 percent in H1-FY17, compared to the average of 3.8 percent during the previous five years. However, since the start of FY18, these players have faced a severe shortage of PNG, which resulted in an almost complete closure of operations in H1-FY18.

POL Products

Petroleum products registered a growth of 8.1 percent during H1-FY18 compared to a contraction of 1.3 percent in H1-FY17. On the face of it, the higher growth in H1-FY18 looks appreciable; however, keeping in view the 47 percent increase in the sector's aggregate operational capacity during the period under review, this performance appears underwhelming.

The industry was not able to utilize the added capacity, and its output fell significantly, following the government's decision to shut down furnace oil (FO) based power plants in November 2017. This month-long suspension cut down the demand for furnace oil and as a result, domestic refineries had to reduce their throughputs. In early December, however, the government reversed its earlier decision and again allowed the use of domestically produced furnace oil for power production.

Electronics

Higher income levels, urban migration, younger demographics and offering of easy installment plans by retailers have all meant strong demand for electronics in the country. The sector posted an impressive growth of 50.5 percent in H1-FY18, which was significantly higher than last year's growth of 15.5 percent. The performance was all the more impressive given the slack noted at the start of the year and an increase in prices of raw materials (steel, iron and copper).

Electric motors, transformers and air conditioners were the key contributing products, posting growth of 167.9, 51.7, and 32.4 percent, respectively. While the motors segment benefited mainly from improved reporting measures put in place by the data-collecting agency, increased investments in the electricity distribution network by the government led to a surge in the growth of transformers. AC manufacturers, on the other hand, continued to increase the production of their invertor variants following healthy sales last summer. Going forward, robust demand is expected to remain an integral driver of consumer durables, including electronics.

Food

Food, the second largest sector in LSM, recorded a marginal contraction of 0.3 percent in H1-FY18 against a growth of 6.5 percent during the same period last year. Contraction in sugar production, the most dominant sub-sector, mainly overshadowed the healthy performance of other segments like cigarettes, edible oil and soft drinks.

Slower start to the crushing season due to disputes over pricing and closure of some mills resulted in a 37.3 percent YoY decline in sugar production in H1-FY18. Although the country is expected to witness a record sugarcane harvest of 82.1 million tons in FY18, last year's crushing level seems unlikely to be achieved.[14]

On the other hand, cigarette production witnessed a major turnaround in H1-FY18, with its production expanding sharply by 69.8 percent compared to a contraction of 30.9 percent seen during the same period last year. The government's clampdown on counterfeits, smuggling, and tax evasion helped enhance the share of formal producers in the market.

Edible oil production, meanwhile, also showed some recovery, growing 4.6 percent after contracting 1.3 percent during H1-FY17. The slump in global palm oil prices at the start of the fiscal year had induced domestic players to import the raw material at a discount compared to last year. This resulted in bulk manufacturing by the producers.

Leather

Leather manufacturing continued on its declining trend and suffered a contraction of 5.9 percent during H1-FY18 on YoY basis. Alongside subdued external demand, the industry is facing pressure from regional competitors, who are focusing on high value-added products. Pakistan's leather industry, on the other hand, is lagging behind in terms of product diversification and value addition. **Box 2.1** details some of the challenges faced by the sector and the steps required to address the aforementioned worrisome trend.

Box 2.1: LWG and Export Potential of Valued Added Leather Products

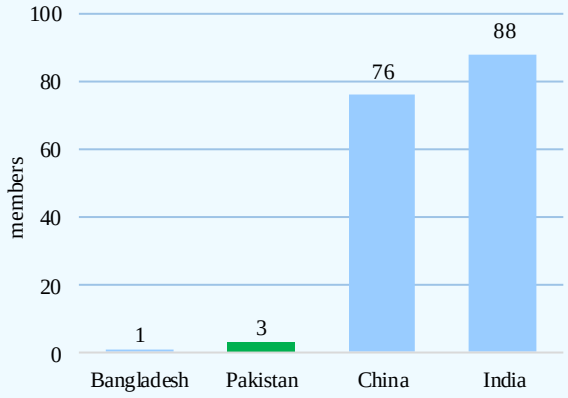
The Leather Working Group (LWG) is a multi-stakeholder international platform, comprising retailers, manufacturers, chemical companies, and other related parties involved in the global leather industry. Its aim is to ensure and promote environmental-compliance in the production of leather

[14] FY17 was an exceptional year in which around 97 percent of the sugarcane crop was used for sugar production. This was substantially higher than the historical average of around 76 percent.

commodities to be traded around the world. Increasingly, top retailers and brands are relying on LWG to import leather intermediates and finished goods.

LWG members are required to follow certain quality and treatment standards so as to limit environmental degradation. Currently, only three manufacturers from Pakistan are LWG members. The figure is substantially lower than the registered members in regional competitors such as China (76 members) and India (88) (**Figure 2.1.1**). Indeed, this is not a satisfactory state of affairs and requires immediate attention of both the manufacturers and the policymakers to jointly put concerted efforts to solidify the country's place in the high value segment of the global supply chain.

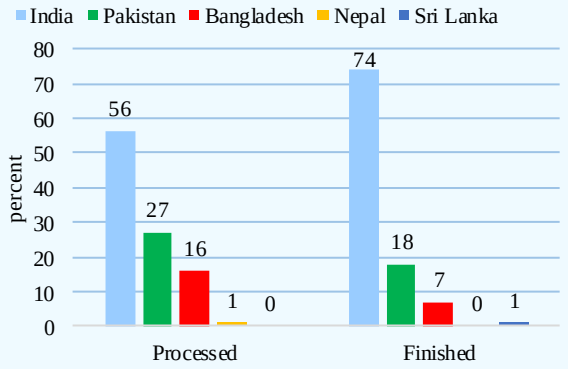
Figure 2.1.1: LWG Memberships - Regional Comparison



Data source: Leather Working Group

Non-compliance with the LWG's environmental standards is hindering the potential induction of domestic manufacturers into the global platform. For example, upgradation of non-conforming treatment facilities of some manufacturers in the Korangi industrial area of Karachi will enable them to become part of the group.[15]

Figure 2.1.2: Share in Region's Leather Exports by Type



Data source: ADB's Report on South Asia Leather Trade (December, 2017)

Alongside LWG compliance, top retail brands also require products to undergo extensive laboratory testing to ensure the quality of the leather used. These tests are quite expensive. The local manufacturers used to get 75 percent rebate on these tests during 2009-2012. However, in the policy adopted by the government for the period 2012-2015, this rebate clause was removed, thereby impacting industry's cost margins. Besides these factors, the already high cost of doing business and inefficient raw material procurement systems are leading to domestic players to being priced out by other regional players in various international expos and trade fairs.[16] For example, during the

[15] This is a general problem faced by leather manufacturers in Pakistan. In this regard, the government intensified its efforts to address this issue by providing 25 percent matching grant to eight leather manufacturers for the upgradation of their treatment plants under the Strategic Trade Policy Framework.

[16] Refer to "Box 2.2: Why is the Leather Industry Underperforming?" in the SBP's Annual Report for 2016-17 on the State of Pakistan's Economy.

LineApelle fair held in Italy during October 2017 (in which 22 Pakistani firms participated), and the All China Leather Exhibition held in September 2017 (with 6 Pakistani participants), Pakistani leather manufacturers concluded business deals worth US$ 11 million and US$ 5.3 million, respectively. However, the trade predominantly involved selling intermediate items to other countries for further value addition (most notably to China for the production of shoes, garments, and handbags). Adding to this trend, local players are increasingly vying to tap the growth of Bangladesh's leather exports by selling raw material and intermediate items to Bangladeshi exporters.

According to a recent ADB report,[17] Pakistan's share in South Asia's total leather exports of processed and finished products is 27 percent and 18 percent, much lower than that of India (**Figure 2.1.2**).[18] However, the same study notes that Pakistan has the potential to enhance its intra-regional trade by around US$ 90 million annually if it diversifies its product portfolio and streamlines the industry's tariff structure.

With an appropriate mix of policy support, adequate funding for laboratory testing, and presence of more domestic players in the LWG, the local industry will be able to increase its share in the global high-end leather sector.

2.4 Services

The performance of the commodity-producing sectors continued to have a positive spillover on services. Resultantly, the sector managed to maintain its upward momentum during the second quarter, as all the leading indicators showed improvement during H1-FY18 compared to the same period last year (**Table 2.3**). *Wholesale and retail trade*, the largest subsector, looks poised to benefit from: (i) improved performance of LSM during H1-FY18 as compared to H1-FY17; (ii) continuous rise in import quantums; (iii) healthy *kharif* production; and (iv) a

Table 2.3: Services Sector Indicators

	H1-FY17	H1-FY18
Wholesale and Retail (18.5%)		
Credit offtake for the sector- flow (Rs bln)	27.9	44.7
Imports (Rs trillion)	2.5	3
LSM (YoY growth)	4.0	5.5
Petrol and diesel sales (million MT)	7.5	8.5
Agri credit (gross disbursements –Rs bln)	301.7	431.9
Transport, Storage and Communication (13.3%)		
Credit offtake for the sector - flow (Rs bln)	-2.4	17.2
POL sales to transport sector (million MT)	7.0	7.9
Commercial vehicle sales (000 units)	22.4	25.8
Cellular density (%)	72.4	72.7
Broadband users (million)	44.6	50.5
Finance and Insurance (3.4%)		
Assets (Rs billion)	15,831	18,342
Deposits (Rs billion)	11,798	13,012
Return on assets (after tax)	1.3%	0.9%
Return on equity (after tax)	14.4%	11.5%
Profit after tax (Rs billion)	190	158
General Government Services (7.6%)		
Expenses on general government and defense (Rs billion)	1,359.1	1,515.3

Note: Values in parenthesis indicate contribution to GDP in FY17
Data sources: SBP, PBS, OCAC, PAMA, PTA and MoF

[17] Source: "Intraregional Trade in Leather and Leather Products in South Asia: Identification of Potential Regional Supply Chains" (December, 2017), Asian Development Bank.
[18] If China is added to the mix, the situation becomes further discouraging for Pakistan, considering that China is the largest leather exporter in the world (India is the ninth largest).

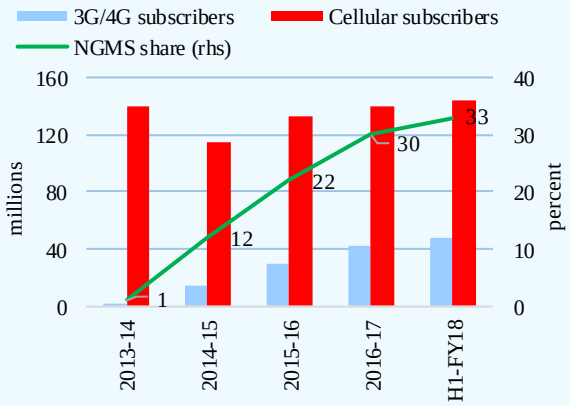
build-up in consumer demand. Furthermore, credit off-take by the subsector increased to Rs 44.7 billion during the period under review (against Rs 27.9 billion during H1-FY17), which indicates growing business confidence of market players.

In the transport sector - in which *road transport* is the biggest segment - the developments so far present a positive picture. Commercial vehicle sales grew by 15 percent, while LCV and truck sales continued on their growing momentum as well. Overall, the uptick in POL sales to the transport sector (by around 13 percent), along with higher credit off-take by the sector relative to last year, indicates that businesses are optimistic.

The communication sector continues to benefit from increasing teledensity in the country. An interesting development is that, as of end-December 2017, one third of cellular subscribers in the country are on NGMS (Next Generation Mobile Service) networks (**Figure 2.7**). Moreover, these mobile broadband subscribers have grown to constitute over 95 percent of the total active broadband base in the country (**Figure 2.8**). This shows the benefits of the introduction of 3G/4G services in the country, which have been widening the general public's access to digital networks. In line with these developments, profit margins of the cellular industry also increased during the period under review.

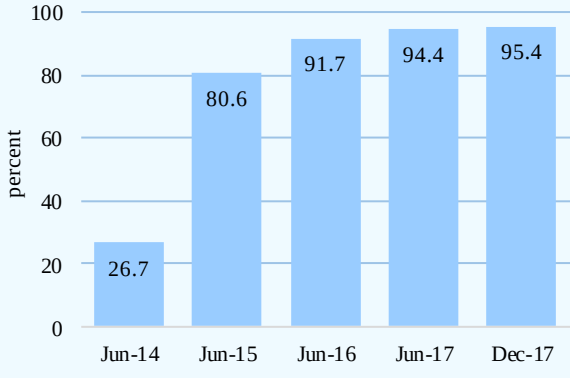
Such an increased access to digital platforms can help enhance financial inclusion in

Figure 2.7: Cellular Broadband Subscribers



Data source: Pakistan Telecommunication Authority

Figure 2.8: Share of 3G/4G in Total Broadband Subscribers in Pakistan



Data source: Pakistan Telecommunication Authority

the country by modernizing payment systems and stimulating e-commerce. Keeping in view the possibilities of development that digital platforms provide, and the role that the telecom sector can play in this regard, the federal government recently released its Digital Pakistan Policy 2017 to tap this growing potential in an effective and planned manner (**Box 2.2**).

In the *finance and insurance* sub-sector, while the prevailing low interest rates continue to affect the profitability of the banking sector, the double-digit YoY growth in both assets and deposits would help strengthen the sector's value addition. Overall, the services sector is expected to match its last year's performance, based on the leading indicators available as of end-December 2017.

Box 2.2: Tripartite Digital Evolution - The Envisioned Way Forward

Mobile phone penetration and broadband subscriptions are on the rise in Pakistan. Keeping in view the growing importance of cellular operators, software developers, and emerging FinTech firms, the government revamped its digital policy in 2017. The basic objectives are: (i) to harness the rapidly expanding telecom network to reduce regional digital disparities; (ii) to help modernize the procurement and payment systems in the economy and make them efficient (by increasing financial inclusion through alternative and innovative channels); and (iii) to improve access to health and education facilities in remote and underserved areas of the country (via mobile internet).

The avenues where the telecom, software, and FinTech players are envisioned to triangulate their efforts to generate value addition in the economy include the following:

- **E-Governance:** The government envisages to make the databases of various ministries and commissions inter-compatible with each other. Alongside that, cloud-computing facilities will be introduced to make centralized information more accessible and secure via "G-cloud" servers (**Table 2.2.1**). Secondly, digital mechanism is being employed for procurement of goods and services by the public sector. Lastly, m-government applications are being designed to make government services accessible to cellular subscribers via the internet.
- **E-Agriculture:** A dedicated online information portal is being constructed to improve awareness among the farming and livestock communities about modern and innovative production methodologies.[19] Furthermore, software developers are being tapped to revamp the Geographical Information Systems (GIS) to enhance monitoring and encourage sustainable cultivation. Lastly, FinTech firms will devise digital modes of procurement and marketing through the internet. To make this transition smoother, regional language support and IT skill development trainings are some of the facilities that will be offered to the growers.
- **E-Health:** Improved access to adequate health facilities is one of the primary objectives of the health policy of any country. In this regard, initiation of remote advisory facilities (especially in rural areas) via the internet, coupled with m-Health mobile applications to centralize and integrate patient records and data handling, are currently underway in Pakistan. Alongside that,

[19] The private sector has already initiated such endeavors (mAgri, Telnor's project in association with DFID, is a notable example).

collaboration of mobile wallet providers is being sought to smoothen payment settlement operations on the digital front.

- **E-Energy:** Cellular operators and utility players will jointly harness the power of 3G/4G connections to develop consumer portals for effective provision of utility services (such as bill payments and complaint lodging). Besides that, digitally connected "smart" grids are being designed to analyze the supply-demand dynamics on a real-time basis, and to furnish demand forecasts for the Discos to better manage electricity consumption.
- **E-Commerce**: The government is planning to triple the e-commerce market size by 2020. Efforts will be undertaken on all fronts (financial awareness and inclusion, digital interoperability of payment system providers, and establishment of a centralized payment gateway system) to achieve this objective.[20]

Table 2.2.1: Plausible Interplay of Cellular Operators, IT/Software firms, and FinTech

	Cellular and Broadband Operators	IT Firms	FinTech
E-Governance	1. Providing access to data centers 2. Enabling real-time usage of cloud computing 3. Education portal and apps (m-education)	1. Data center clusters 2. Integration of head and tail systems with the centralized database 3. G-Cloud provision for security and resilience	1. E-procurement in all areas of public sector 2. Collection of fees, taxes, etc. from general public
E-Agriculture	1. Real-time monitoring via GIS 2. Access to information portals 3. Dissemination of material from institutions to farmers	1. Building Information Portal 2. Revamping GIS 3. IT skill-building and trainings, etc.	1. Payment operations 2. Sales and marketing 3. Procurement of third party products by farmers
E-Health	1. Accessing information via apps 2. Real-time usage of and provision of data to, the centralized database. 3. m-Health mobile apps	1. Centralized database	1. Payment facilities
E-Energy	1. Accessing consumer portals 2. Running "smart" grids 3. Real-time data to help in demand forecasting 4. Complaint registrations	1. Building smart grids to better manage consumption 2. Platform for data gathering to enable forecasting by Discos	1. Utility bill payments 2. Procurement facilities

Reference: Digital Pakistan Policy, 2017.

[20] For more information, refer to the Special Section 2 tilted "Online Payment Platforms in Pakistan – A Case of B2C E-Commerce" in the State Bank of Pakistan's First Quarterly Report for FY18 on the State of Pakistan Economy.