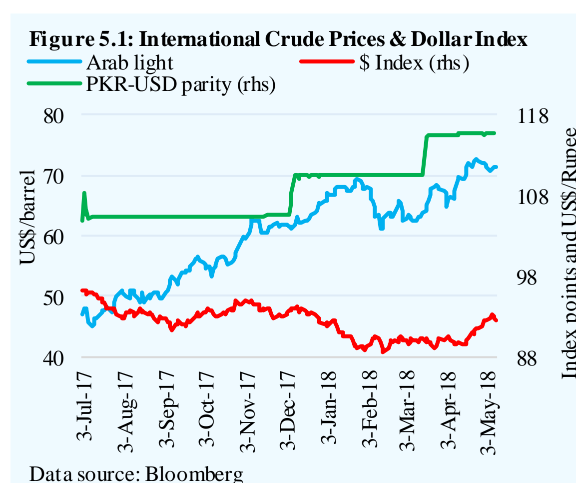
5 External Sector

5.1 Overview

Changes in global currency and commodity dynamics besides the recovery in the advanced economies, and persistence in domestic aggregate demand mostly drove Pakistan's external balance during Jul-Mar FY18 (**Figure 5.1**). While a weakening Pak rupee against major currencies and the rebound in the advanced economies have strengthened Pakistan's FX receipts from exports and workers' remittances, the increase in oil prices and higher import payments for machinery, transport and metals continued to keep the country's current account under pressure (**Table 5.1**). Consequently, the country has witnessed the highest current account deficit during Jul-Mar of a fiscal year.

Figure 5.1: International Crude Prices & Dollar Index



Data source: Bloomberg

A significant increase in portfolio inflows and a marginal growth in net FDI – amid lower net loan disbursements – were insufficient to fill the widening gap in the current account. As some of the import payments were made from interbank market, this drained FX liquidity from the interbank market. At the same time, with the expectation of PKR depreciation consolidating throughout the year, FE-25 deposits with banks continued to rise. Resultantly, the kerb rate increased swiftly from October 2017 onwards, ahead of the PKR depreciation in December 2017 and March 2018 (**Figure 5.2**).[1]

Managing FX liquidity in such circumstances proved to be quite challenging for the central bank. SBP's market-stabilization efforts during the period were constrained by the continuously declining stock of official liquid reserves, barring an uptick in December 2017 owing to official portfolio inflows. By end-March, official reserves had declined by US$ 4.5 billion and reached US$ 11.6 billion;

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[1] There is sufficient anecdotal evidence to show that retail investors and the general public, in anticipation of a PKR depreciation, started purchasing dollars from exchange companies (i.e. kerb market) and depositing them in their FCY accounts.

these were sufficient to cover over two months of the merchandize import bill.

While the reserves balance is indeed a concern, there has been some improvement in the trade account as the year progressed. Pakistan's exports, after a lackluster FY17, witnessed a broad-based recovery in Jul-Mar FY18, with strong performances from textiles and rice, and welcome contributions by sugar, wheat, POL products and fertilizer.

Table 5.1: Pakistan's Balance of Payments[P] (billion US$)

	Jul-Mar			Q3		
	FY17	**FY18[P]**	**Abs change**	**FY17**	**FY18[P]**	**Abs change**
Current account balance	-8.0	-12.1	-4.1	-3.3	-4.2	-0.9
Trade balance	-18.5	-22.3	-3.8	-7.1	-7.7	-0.6
Exports	16.3	18.3	2.0	5.7	6.5	0.8
Imports	34.8	40.6	5.8	12.8	14.2	1.4
Energy	7.8	9.8	2.0	2.8	3.5	0.7
Non-Energy	27.0	30.8	3.8	10.0	10.7	0.7
Services balance	-2.9	-3.9	-1.0	-0.6	-1.2	-0.6
CSF	0.6	0.0	-0.6	0.6	0.0	-0.6
Primary income balance	-3.4	-3.6	-0.2	-1.0	-1.0	0.0
Interest payments	1.4	1.8	0.4	0.5	0.6	0.1
Secondary income balance	16.8	17.7	0.9	5.5	5.8	0.3
Workers' remittances	14.1	14.6	0.5	4.6	4.9	0.3
Capital account balance	0.3	0.3	0.0	0.2	0.1	-0.1
Financial account balance	-6.3	-7.7	-1.4	-1.6	-1.3	0.3
Direct investment in Pakistan	2.0	2.1	0.1	0.6	0.6	0.0
Portfolio investment in Pakistan	0.6	2.4	1.8	-0.1	0.0	0.1
Eurobond / Sukuk	1.0	2.5	1.5	0.0	0.0	0.0
Other investment	0.6	2.4	1.8	-1.2	-0.7	0.5
Net incurrence of liabilities	-3.7	-3.3	-0.4	1.0	0.6	-0.4
General government	1.2	2.3	1.1	-0.3	0.7	1.0
Private sector (excl. banks)	1.8	0.6	-1.2	0.9	0.0	-0.9
Banks	0.9	0.2	-0.7	0.4	0.0	-0.4
SBP's liquid reserves (end-period)*	16.5	11.6	-4.5	16.5	11.6	-2.5
Total liquid reserves (end-period)*	21.6	17.8	-3.6	21.6	17.8	-2.4
PKR app(+) / dep(-) against US$ (in %)	0.0	-9.2	-	-0.2	-4.4	-

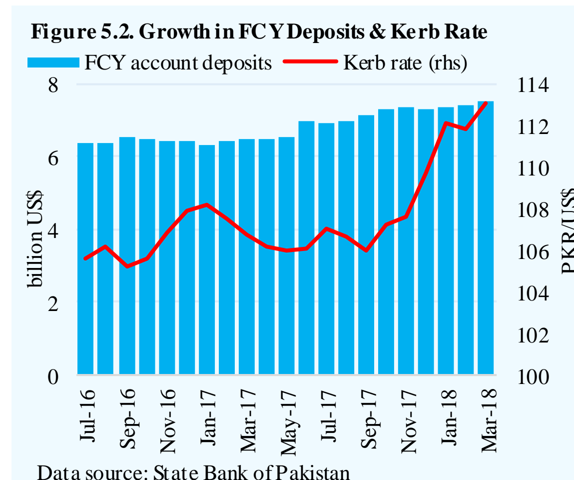
[P] Provisional Data source: State Bank of Pakistan * change during Jul-Mar FY18 and Q3-FY18

On the contrary, in case of imports, three categories – energy, machinery and metals – were responsible for 72.0 percent of the YoY increase in import payments during Jul-Mar FY18. SBP data suggests that payments for machinery items imported earlier for CPEC projects are now being made from the interbank market. However, customs data depicts a YoY decline in machinery imports in the same period (**Section 5.5**), which indicates that payment pressure from these

imports will subside soon.[2]

Nonetheless, as of now, the absolute magnitude of machinery import payments is still quite high, averaging US$ 720.2 million per month in FY18. The timing of these higher payments is not ideal as they have coincided with increasing global crude prices.[3] Not only have higher prices significantly inflated the country's crude imports, but it also offset the positive impact of a slowdown in quantum POL product imports in the year.

Figure 5.2. Growth in FCY Deposits & Kerb Rate



Data source: State Bank of Pakistan

To sum up, there are two main concerns at this point: the country's vulnerability to external shocks, and its ability to keep financing the BoP deficit given the gradual erosion in the FX reserves position. The country's growth prospects are encouraging, with benign inflation and favorable outlooks for exports and remittances, and some relief expected from reduced non-energy import payments down the road. However, until there is a significant improvement in the current account balance, the payment pressure will continue to fall on the country's reserves. This, in turn, creates the constant need to arrange external financing so that the FX reserves position offers some level of comfort.[4]

5.2 Current account

The current account deficit increased to US$ 12.1 billion in Jul-Mar FY18, the highest the country has seen during Jul-Mar of a fiscal year. In the same period of last year, the CAD was US$ 8.0 billion only. However, the pace of its increase slowed down for the first time in the last two years (**Figure 5.3**). This slowdown resulted from a deceleration in the import pressure spurred up in the last two years with the initiation of power and infrastructure-related projects under

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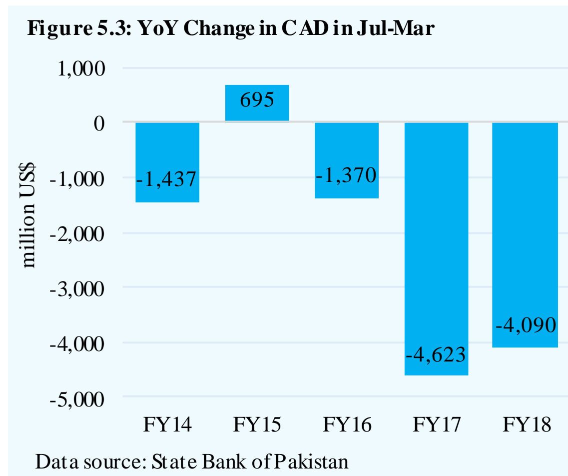
[2] As the year progressed, the YoY growth of machinery import payments has also slowed down from 46.3 percent in Q1 to 23.3 percent in Q2 and further to 3.0 percent in Q3-FY18.

[3] Saudi Light oil prices were, on average, 22.0 percent higher in Jul-Mar FY18 as compared to Jul-Mar FY17 (source: Bloomberg).

[4] Already in April, with official liquid reserves dipping to US$ 10.9 billion, the government borrowed US$ 1.0 billion from a Chinese commercial bank.

CPEC. Moreover, the adjustment in the exchange rate also helped tame the expansion in the current account deficit by contributing to the export growth and encouraging remittance inflows from the UK and the US.

Figure 5.3: YoY Change in CAD in Jul-Mar



Data source: State Bank of Pakistan

5.2.1 Trade in services[5]

Following the widening trend of the merchandize trade deficit, the services deficit increased by more than a third on YoY basis during Jul-Mar FY18 to US$ 3.8 billion. While services exports declined 10.4 percent to US$3.9 billion, services imports rose by 7.3 percent YoY to US$ 7.7 billion (**Table 5.2**).

Table 5.2 Pakistan's Trade in Services (Jul-Mar)

	Value (US$ billion)			Growth (%)		
	FY16	**FY17**	**FY18**	**FY16**	**FY17**	**FY18**
Exports	4.1	4.3	3.9	-14.1	5.6	-10.5
Imports	6.4	7.2	7.7	-2.5	13.3	7.3
Trade Balance	-2.3	-2.9	-3.9	28.7	27	33.8

Data source: State Bank of Pakistan

Export of government goods and services, which constitute a major part of services exports, declined by 38.0 percent to US$ 957.0 million. Inflows under this category comprise amounts received on account of diplomatic and defense provisions, which also include Coalition Support Fund (CSF) receipts. In the absence of CSF inflows in FY18, under which Pakistan received US$ 550.0 million in FY17, the decline in government services exports was expected. Meanwhile, Telecommunications, computer and information services exports grew by 13.4 percent during Jul-Mar FY18 to US$ 787.0 million.

Among major categories, imports of transport services during Jul-Mar FY18 stood at US$ 3.0 billion, up from US$ 2.8 billion last year. Freight import – which is the largest sub-component of the services account– rose by 15.2 percent to US$ 1.9 billion during the period. Further impetus to higher freight charges came from the rise in international oil prices.

[5] The analysis in this section is based on the data compiled by State Bank of Pakistan. The data is compiled as per BPM6 (EBOS-2010) classification and is aligned with MSITS-2010.

Meanwhile, almost 23.5 percent of the services import bill consists of 'Other Business Services', which include professional, technical and management consulting services. China and the US remained key service providers in this category, with their exports to Pakistan valued at US$ 542.1 million and US$ 397.2 million, respectively.[6]

5.2.2 Workers' remittances

Remittances sent by overseas Pakistani workers rose by 3.6 percent YoY to US$ 14.6 billion during Jul-Mar FY18 (**Table 5.3**). Apart from the UAE, inflows from other GCC countries, specially Saudi Arabia, continued their declining trend. Fiscal consolidation and job nationalization policies undertaken by the Saudi government restricted foreign labour demand in the kingdom, which also led to repatriation of a number of foreign workers to their home countries.

Table 5.3: Workers' Remittances to Pakistan
(million US$)

	Q3		Jul-Mar		
	FY17	**FY18**	**FY17**	**FY18**	**Change**
Total	**4,600**	**4,861**	**14,105**	**14,606**	**501**
GCC	2,902	2,783	8,929	8,603	-326
S. Arabia	1,343	1,160	4,078	3,691	-387
UAE	1,007	1,104	3,143	3,265	122
Dubai	662	811	1985	2426	441
Abu Dhabi	333	281	1120	796	-324
Other GCC	552	520	1,707	1,648	-59
Non-GCC	1699	2077	5176	6003	827
USA	567	667	1,739	1,948	209
UK	561	680	1,658	2,031	373
EU	102	164	333	479	146
Others	469	566	1,446	1,545	99

Data source: State Bank of Pakistan

Contrary to the trend witnessed from the rest of the GCC, remittances from the UAE increased by US$122.0 million in Jul-Mar FY18, primarily due to US$ 441.0 million uptick from Dubai. Remittances from Dubai increased sharply after October 2014, and remained strong since then even when inflows from the next important state, Abu Dhabi has been declining. The dynamic of remittance inflows from the UAE is less straightforward as compared to other GCC countries. **Box 5.1** further analyzes the trend in workers' remittances from the UAE to Pakistan in the recent past.

Fortunately, remittances from non-GCC countries compensated the decline in inflows from the Gulf region. The low unemployment rate in both USA and UK amid rising economic activity in these economies and appreciation of their currencies against the Pak rupee led to higher remittances from these corridors.

[6] Business services imports from mainland China stood at US$ 415.3 million and those from Hong Kong at US$ 126.8 million.

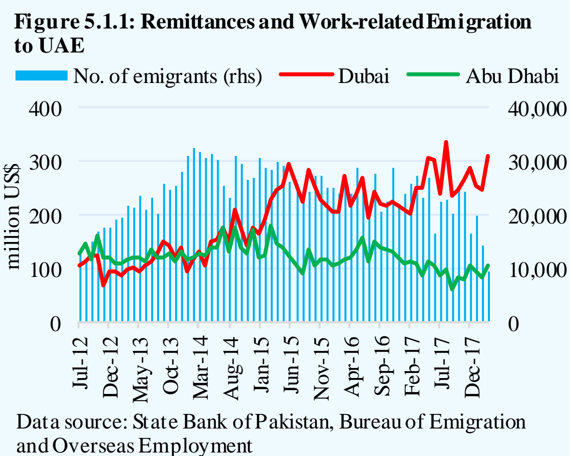
Going forward, the recent tax reform is expected to further stimulate the US economy, as investment is picking up in the country. Higher employment in US is likely to augment remittances inflow in Pakistan. In addition, Saudi Arabia plans to build a mega city, 'Neom,' on the Red Sea coast that will stretch into Egypt and Jordan. As labour demand may resurge in the KSA, the declining trend of remittances from the kingdom may reverse in the near future.

Box 5.1: Dynamics of Remittances Inflows from Dubai and Rest of United Arab Emirates

The United Arab Emirates (UAE), on the back of inflows from Dubai, is the second-largest source of remittances for Pakistan. Dubai, a commercial hub of the Middle East, is one of the seven states of the UAE, and is least dependent on oil revenue. In the passing decade, the state of Dubai has invested heavily in infrastructure projects, which led to a sharp increase in labour demand from Pakistan, specifically since 2012 (**Figure 5.1.1**).

However, inflow of workers' remittances from Dubai remained almost similar to those from Abu Dhabi until October 2014, when federal law on combating money laundering crimes came into force in the UAE. The new anti money laundering (AML) law passed by the UAE Federal National Council prohibits funding of unlawful organisations, directs regulatory authorities and courts to freeze accounts, and seize funds related to money laundering or terrorism-financing offences, and clarified that money laundering is an offence in its own right.

Figure 5.1.1: Remittances and Work-related Emigration to UAE



Data source: State Bank of Pakistan, Bureau of Emigration and Overseas Employment

Remittance inflows from Dubai have witnessed a sharp jump since then, and continued to rise even when falling oil prices created a recession-like situation in the GCC countries, forcing many of them to adopt retrenchment measures.

With some caveats, there could be a few economic explanations.[7] For example, as Dubai's economy is least dependent on oil, the downsizing, as witnessed in the broader GCC region in response to the oil price decline, was less severe in Dubai. Workers mostly stayed there and continued to send their savings back home. Second, foreign exchange inflows from Dubai may be attracting intense scrutiny of AML monitoring institutions, as the state has graduated to a major international financial

[7] There are caveats that need to be considered in disentangling the remittance inflow trend from Dubai and other UAE states with precision. First, states in the UAE are in vicinity of each other, and spillover between the sending sources is not beyond possibility. Second, the head offices of most of the remitting entities are located in Dubai, which blurs the remittance inflows by source states. And third, disaggregated monthly data on workers emigrating from Pakistan to the UAE for work is not available, which could have helped pin down the source of remittances precisely.

hub in recent years. This could have discouraged the hundi/hawala activity between Dubai and Pakistan.

Third, the Pakistani government started disbursing the rebate on remittance transactions more regularly, which may have incentivized the remittance transmitting entities in the UAE to opt for the legal channel.

More recently, in December 2017, the Government of Pakistan conducted the 'First Pakistan Remittance Summit 2017' in Dubai, in cooperation with the Pakistan Remittance Initiative. The aim of the summit was to engage overseas Pakistanis and the remitting agencies to send money through legal channels. This initiative, among others, may have led to a US$ 149.0 million increase in remittances from Dubai in Q3-FY18 (**Table 5.3**).

These kinds of initiatives, if undertaken in the other Gulf countries as well, may help reverse the declining trend of workers' remittances from the rest of the GCC corridor.

5.3 Financial account

Although higher than last year, financial inflows in Jul-Mar FY18, at US$ 7.7 billion, could only partially cover the current account deficit in the period. Besides a marginal growth in FDI, the government's recourse to foreign financing led to reasonably high portfolio investment inflows and an uptick in official loans. At the same time, external borrowing by commercial banks and non-bank private firms was much lower than last year.

Foreign direct investment

Although net FDI in Pakistan rose by 4.4 percent YoY in Jul-Mar FY18; excluding one-time acquisition inflows received last year in the food and electronics sectors, the YoY growth in FDI this year jumps to 47.7 percent. FDI in Jul-Mar FY18 remained concentrated in power, construction and financial business sectors (**Table 5.4**). China was the major source of FDI inflows in the power and construction sectors, as its investments remained focused on CPEC projects (**Figure 5.4**).

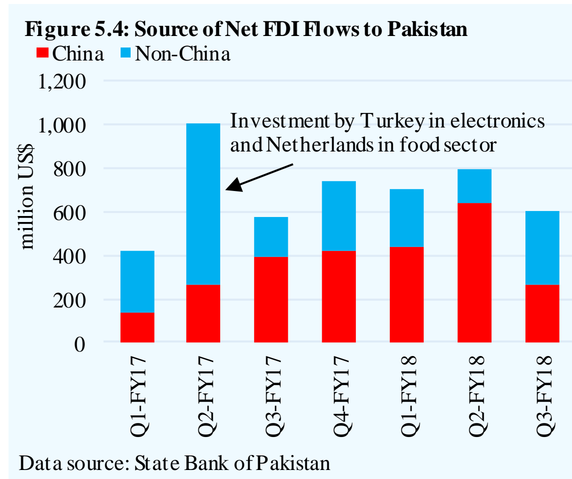
Table 5.4: FDI inflows to Pakistan (Jul-Mar)
million US dollars

	FY17	FY18	Change
Total FDI (net)	**2,005**	**2,094**	**89**
Construction	263	525	263
Power	468	712	244
Telecommunications	-108	-33	75
Financial business	230	256	26
Food	509	93	-417
Electronics	151	42	-110
Others	492	499	7

Data source: State Bank of Pakistan

On the contrary, the telecom sector continued to witness FDI outflows, albeit in reduced volume as compared to last year. An inflow of US$ 110.0 million from Malaysia was more than offset by a relatively higher outflow from a Norwegian telecom company. The Malaysian firm had acquired the operation of telecom towers from one of the leading cellular service providers in Pakistan. Meanwhile, the outflow in this sector represents the repayment of intercompany loans to the parent company by its subsidiary operating in Pakistan.

Figure 5.4: Source of Net FDI Flows to Pakistan



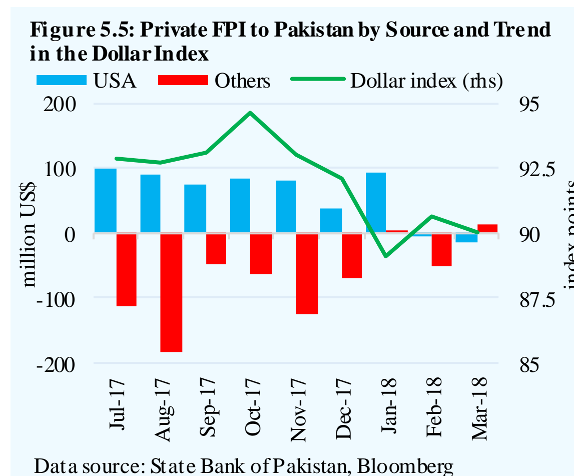
Data source: State Bank of Pakistan

<u>Foreign portfolio investment</u>

Foreign portfolio investment increased to US$ 2.4 billion in Jul-Mar FY18 from US$ 0.6 billion in the same period of FY17. The FPI was dominated by the public sector, as the government raised US$ 2.5 billion in Eurobond and *Sukuk* in December 2017. On the contrary, private equity investment witnessed a net outflow of US$ 93.3 million in Jul-Mar FY18. An inflow of US$ 539.8 million from the US was offset by the outflow of US$ 694.2 million to other countries.

The weakening of the US dollar against a basket of major international currencies, as suggested by the Dollar Index, explains this divergence in the private equity flow trend to and from Pakistan. The portfolio realignment by foreign investors in the wake of weakening US dollar increased volatility in the global capital flows, as well as in Pakistan, specifically in Jul-Jan FY18 (**Figure 5.5**).

Figure 5.5: Private FPI to Pakistan by Source and Trend in the Dollar Index



Data source: State Bank of Pakistan, Bloomberg

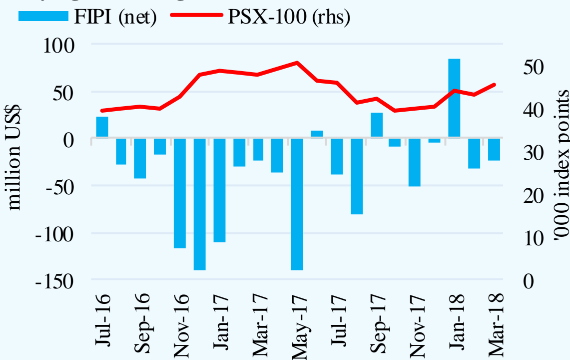
The growing concern on the US inflation outlook in recent months and the expected increase in the Fed policy rate instigated further uncertainty in the global portfolio investment flows. Not surprisingly, Q3-FY18 witnessed sell-offs in equity markets across the globe, triggered by concerns over higher interest rates and their impact on corporate profitability in the US.

Therefore, foreign investors repatriated funds by liquidating emerging market assets, including in Pakistan. Excluding US$ 92.4 million inflow from the US in January 2018, net FPI saw an outflow in Q3-FY18. On the back of the nonresident portfolio flow, the PSX remained roughly unchanged in Q3-FY18.

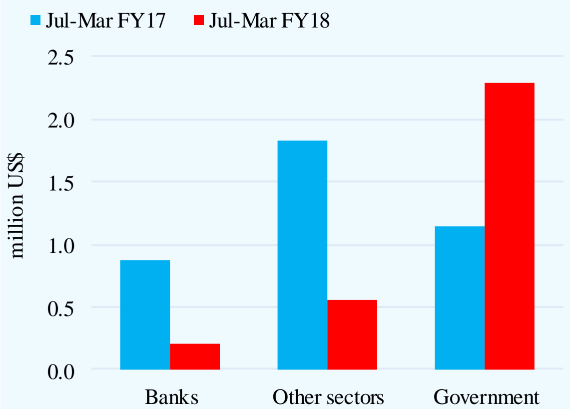
On a cumulative basis, the PSX witnessed net foreign selling of US$ 124.0 million during Jul-Mar FY18, compared to net selling of US$ 483.0 million in the corresponding period of last year (**Figure 5.6**).

Apart from the global currency movements that instigated private equity outflow, investors' confidence was further dented by the recent downgrade in Pakistan's credit outlook by Fitch, which raised yields of Pakistani Eurobond in secondary markets in February. Moreover, the political uncertainty arising due to upcoming general election may have dampened the prospect of further inflows in the portfolio investment, as investors may hold their fund till new government unfolds its future policy direction.

Figure 5.6: PSX performance and Foreign Investors' Net Buying(+) / Selling(-)



Data source: National Clearing Company of Pakistan Ltd., Pakistan Stock Exchange



Data source: State Bank of Pakistan

Other investment

Within external borrowings, net government loans more than doubled in Jul-Mar-FY18 over the same period last year (**Figure 5.7**). This increase is mainly due to relatively higher gross borrowings and lower payments during the period.

Table 5.5: Sources of Official Borrowings
(gross disbursements in million US dollars)

	Jul-Mar FY17	Jul-Mar FY18	Change
Total external loans	**4,955**	**7,529**	**2,574**
Eurobond/Sukuk	1,000	2,500	1,500
Comm. banks	1,315	1,722	407
China	1,033	1,215	182
IDB (ST)	351	950	599
ADB	757	586	-171
IDA	158	240	83
IBRD	178	130	-48
Others	164	187	23

Source: Economic Affairs Division

The government continued to borrow from commercial banks and from China – for BoP support as well as for infrastructure projects. Moreover, to finance the oil import bill, the government borrowed from the Islamic Development Bank on short-term basis (**Table 5.5**).

5.4 Exchange rate

The Pak rupee vis-à-vis US dollar depreciated by 9.2 percent during Jul-Mar FY18 in two episodes: 4.4 percent in December 2017 and 4.3 percent in March 2018. In contrast, most of the major currencies, like euro, British pound and Japanese yen, gained against the US dollar, leading to a sharp decline in the Pak rupee during Jul-Mar FY18 against these currencies (**Table 5.6**).[8]

Table 5.6: Appreciation(+) / Depreciation(-) of Selected Currencies against US Dollar

	Q3		Jul-Mar	
	FY17	FY18	FY17	FY18
PKR	-0.24	-4.81	-0.01	-9.61
INR	4.72	-2.33	4.09	-0.7
JPY	4.31	5.73	-8.23	5.34
CNY	0.75	3.38	-3.61	7.9
Euro	1	2.34	-4.15	8.08
GBP	1.22	3.72	-7.77	8.24
THB	4.12	4.07	2.23	8.94
MYR	1.37	4.04	-8.99	11.09

Data source: State Bank of Pakistan

As a result, the PKR's Nominal Effective Exchange Rate (NEER) depreciated by 11.1 percent in this period. While inflation in Pakistan remained benign, the depreciation in NEER almost similarly translated into the Real Effective Exchange Rate (REER), which depreciated by 10.6 percent.

The depreciation of REER indicates that Pakistan's export competiveness in real terms has increased in the global market over this period (**Figure 5.8**). As

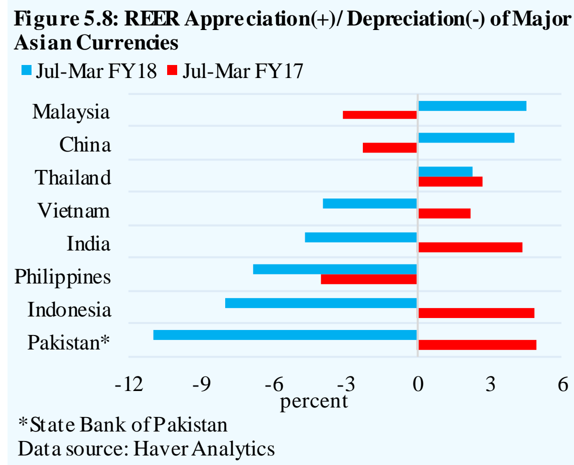
[8] During Jul-Mar FY18, the PKR depreciated against the euro (16.0 percent), Japanese yen (13.9 percent) and the British pound (16.1 percent).

inflationary expectations are gaining strength in the western economies, the PKR's REER may remain low in the next couple of months if inflationary pressures in Pakistan remain subdued.

5.5 Trade account[9]

Despite strengthening export growth and decelerating import growth, Pakistan's trade deficit reached a historic high of US$ 9.5 billion in the third quarter of FY18.[10] A broad-based increase in export quantums was overshadowed by an upsurge in import quantums, with higher commodity prices further aggravating the situation. Cumulatively, during Jul-Mar FY18, the trade deficit reached US$ 27.4 billion, up 17.6 percent from the same period last year.

Figure 5.8: REER Appreciation(+)/ Depreciation(-) of Major Asian Currencies



*State Bank of Pakistan
Data source: Haver Analytics

<u>Exports</u>

Exports grew by 13.1 percent YoY in Jul-Mar FY18 and reached US$ 17.1 billion. Exports in Q3-FY18 alone recorded a growth of 17.1 percent YoY, the highest growth in Q3 in more than six years, with FX earnings rising to US$ 6.1 billion. The impetus came from higher shipments of traditional items (e.g., textiles and rice), as well as non-traditional products, like sugar, seafood, fruits and POL products (**Table 5.7**).

Three major factors explain the growth in multiple exporting sectors. First, higher domestic production of cotton, rice and sugar, and surplus wheat stock, ensured that the country had exportable surplus available this year.[11]

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

[10] The Jul-Mar FY18 trade deficit was also the highest on record. Meanwhile, according to SBP data, Q3-FY18 marked the second-highest trade deficit in the country's history; the highest gap (US$ 8.2 billion) was recorded in Q4-FY17.

[11] Domestic rice production reached a record-high of 7.4 million tons this year, whereas cotton production also grew 11.9 percent to 11.9 million bales.

Second, favorable movements in Pak rupee against the US dollar and the euro, especially from December 2017 onwards, played a role in pushing up exports of textiles and rice in both quantum and value terms in the third quarter. In case of textiles, Pakistani exporters to the EU were able to make most out of the dual advantage of the PKR depreciation against the euro and the zero-duty access under GSP Plus.[12]

Table 5.7: Pakistan's major exports during Jul-Mar

million US dollars

Items	FY17	FY18	Abs. change	Quantum impact	Price impact
Food group	2,679.1	3,403.3	751.2	-	-.
Basmati rice	290.9	368.2	77.3	46.2	31.0
Non-basmati	879.8	1,126.5	246.7	147.5	99.3
Seafood	275.8	315.6	39.8	75.2	-35.4
Textile group	9,270.8	9,983.3	712.5	-	-
Raw cotton	41.1	55.8	14.7	17.0	-2.3
Cotton yarn	941.4	987.6	46.2	111.3	-65.1
Cotton fabrics	1,614.3	1,630.6	16.3	61.4	-45.1
Knitwear	1,734.4	1,971.8	237.4	29.0	208.5
Bedwear	1,594.0	1,674.0	80.0	70.3	9.7
Towels	591.3	598.8	7.6	54.7	-47.1
Readymade garments	1,704.6	1,918.9	214.3	215.9	-1.6
POL group	138.4	297.7	159.3	-	-
POL products	56.3	142.5	86.2	61.6	24.6
Crude oil	49.6	115.9	66.2	46.2	20.0
Other manufactures	2,283.8	2,527.7	243.9	-	-
Leather	252.4	196.8	-55.7	65.0	-120.7
Leather manufactures	375.2	354.6	-20.6	-	-
Plastic	164.7	162.4	-2.3	25.2	-27.5
Pharma	158.2	153.8	-4.5	3.6	-8.1
Cement	191.5	107.9	-83.6	-16.2	-67.4
Total exports	**15,096.5**	**17,069.0**	**1,972.5**	1,822.0*	27.0*

Data source: Pakistan Bureau of Statistics

*: for 27 items whose price and quantum data is available

Third, a strengthening consumer demand in the US, as reflected by growing share of consumption in real GDP growth and rising retail sales of clothing and accessories (**Figure 5.9**) has boosted the demand for clothing imports in that country.[13] Pakistan, along with other EMs, catered to this higher demand;

[12] The PKR was on average 17.3 percent lower against the euro and 5.2 percent against the dollar in Dec-Mar FY18 over Dec-Mar FY17. Meanwhile, the EU's GSP Plus status for Pakistan was renewed for two more years in February 2018.

[13] For instance, in the US, QoQ growth in personal consumption expenditures has exceeded overall real GDP growth in five of the last seven quarters (source: Haver Analytics).

however, Pakistani exporters benefited less compared to the other countries (**Table 5.8**).

Textile
Pakistan's textile exports grew by 7.7 percent YoY to US$ 10.0 billion in Jul-Mar FY18. Encouragingly, quantums played a dominant role in boosting export earnings. In some cases, like readymade garments, higher quantums even compensated for lower unit values during the period (**Figure 5.10**).

In terms of market, exports to the EU where Pakistani textiles enjoy zero-rated status under the GSP Plus scheme, continued on their rising trajectory. Similarly, textile exports to the US also rebounded, though they were pulled down by lower unit values during the period.

Non-textile
Pakistan's food exports rose by a solid 28.0 percent to US$ 3.4 billion in Jul-Mar FY18, amid healthy contributions from rice, sugar and wheat.

Pakistan's rice exports rebounded strongly in Jul-Mar FY18, rising by 27.7 percent to US$ 1.5 billion in the period. Both basmati and non-basmati sales grew by double digits, as exporters capitalized on: (i)

Figure 5.9: Growth in Retail Clothing Sales in the US*

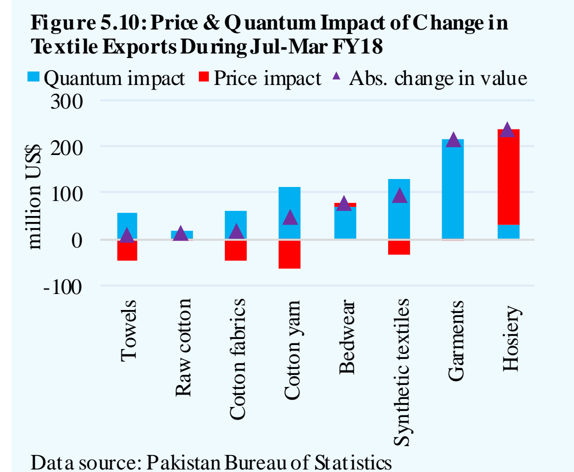
*Seasonally adjusted by source
Data source: US Census Bureau

Table 5.8: Textile and Apparel Imports by the US (Jul-Mar)

	Growth (%)		Share (%)	
	FY17	**FY18**	**FY17**	**FY18**
Bangladesh	-1.9	0.9	3.4	3.3
Cambodia	-10.0	11.3	1.6	1.7
China	0.0	7.4	48.6	49.8
India	8.4	5.6	7.8	7.8
Indonesia	-2.0	-8.0	2.7	2.4
Vietnam	4.7	5.6	7.3	7.3
Pakistan	-5.2	3.3	3.9	3.8
US' textile and apparel imports	0.0	4.8	-	-

Data source: OTEXA

Figure 5.10: Price & Quantum Impact of Change in Textile Exports During Jul-Mar FY18

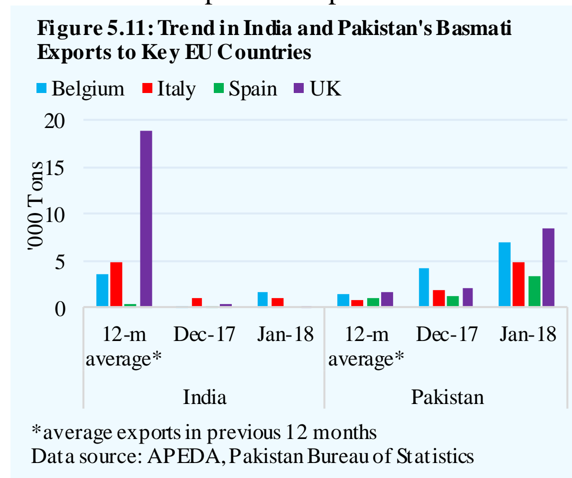


Data source: Pakistan Bureau of Statistics

emerging demand in African countries; and (ii) one-off weather shocks in Bangladesh and Madagascar, which damaged their paddy crops and necessitated hefty imports. Availability of an exportable surplus as well as the PKR depreciation in December also contributed to the uptick in exports.[14]

In terms of markets, Pakistan's basmati rice exporters partially captured India's share in the lucrative EU market, particularly in the UK and Belgium (**Figure 5.11**). This occurred as the bloc's ban on use of a pesticide on crops came into effect from January 2018 and severely dented India's basmati exports to the region. Fortunately for Pakistan, higher shipments to the EU completely offset the decline in quantum exports to the traditional Middle Eastern markets (UAE, Qatar and Yemen).

Figure 5.11: Trend in India and Pakistan's Basmati Exports to Key EU Countries



*average exports in previous 12 months
Data source: APEDA, Pakistan Bureau of Statistics

Meanwhile, a strong pick-up in shipments of non-basmati rice to African countries, particularly Madagascar and Senegal, helped completely offset the impact of lower quantum exports to Asian countries, like Afghanistan, China and Indonesia.[15]

Going forward, this year's one-off positive demand shock from Bangladesh and Madagascar will no longer be in play, and exports to these countries will likely normalize.[16]

Meanwhile, export subsidy announced by the government led to significant export

[14] The YoY growth in both quantum and value rice exports was the strongest in the third quarter of FY18. Quantum rice exports grew 31.1 percent YoY in Q3, after rising by 22.0 percent and 1.9 percent in Q1 and Q2 respectively. Similarly, in value terms, rice exports went up 40.9 percent in Q3, against 32.0 percent and 12.6 percent in Q1 and Q2.
[15] This is based on latest available Jul-Feb FY18 detailed data released by the PBS.
[16] Bangladesh's rice import is projected to decline by 25.0 percent in the 2018 season, on the back of a rebound in domestic production. Same is the case with Madagascar, which is likely to recover from a 13-year low rice production in 2017 due to a weather shock (source: Rice Market Monitor April 2018, FAO). Importantly, Madagascar accounted for over 69.9 percent of the YoY increase in Pakistan's quantum non-basmati exports during Jul-Feb FY18.

of both sugar and wheat. Specifically, sugar exports gained momentum from November 2017 onwards, as the government allowed exports of 500,000 MT, at a subsidy of up to Rs 10,700 per MT.[17] Though the export quota was enhanced later to 2.0 million MT, yet exporters could sell only half the allowed quota (i.e. 1.0 million MT) abroad by end-March 2018. Afghanistan and India emerged as the largest purchasers of Pakistani sugar this year.

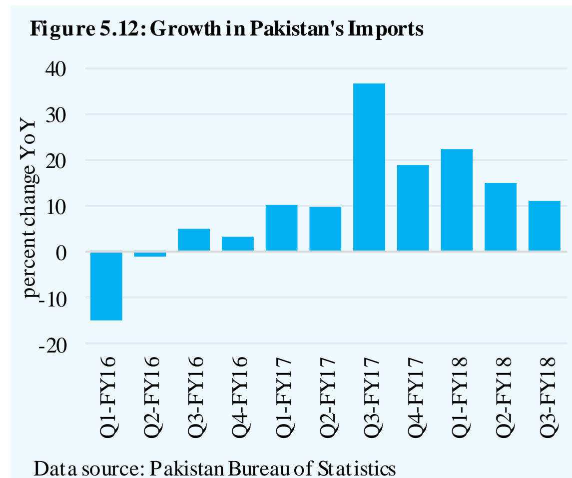
Similarly, wheat exports gained momentum from February 2018 onwards. In fact, quantum wheat exports are on-track to be the second-highest ever, with over 0.3 million MT already shipped abroad in Jul-Mar FY18. Consecutive bumper crop production over the past two years have led to a sizable build-up of stocks with procurement agencies (**Chapter 2**).[18] This led the government to allow exports, despite having to subsidize them.

Moreover, Pakistan's seafood exports rose 14.4 percent to US$ 315.6 million in Jul-Mar FY18. China, Japan and Indonesia were the top buyers of Pakistan's seafood items. Major export products under this category included shrimp, crabs and lobsters.

Imports

Pakistan's merchandise imports amounted to US$ 44.4 billion in Jul-Mar FY18, up 15.8 percent from the same period last year. While the growth in imports has slowed down from last year (**Figure 5.12**), it was still enough to completely offset the healthy growth in exports. The favorable impact of lower machinery imports and subdued food imports were more than offset by a mainly price-led surge in energy and metal purchases, and swelling transport imports (**Table 5.9**).

Figure 5.12: Growth in Pakistan's Imports



Data source: Pakistan Bureau of Statistics

[17] The fiscal cost of Pakistan's 1.0 million MT of sugar exports during Jul-Mar FY18 amounts to Rs 10.8 billion (or US$ 97.0 million, at the average kerb rate of Rs110.84 for a US Dollar for the period Nov-Mar FY18). However, it is not certain if the government has released the entire amount accrued in sugar export subsidy, yet.

[18] In January 2018, the government allowed 2.0 million MT of wheat to be exported, at a subsidy of up to US$ 159 per MT. The subsidy will stay in place till end-June 2018.

Table 5.9: Pakistan's Major Imports during Jul-Mar
million US dollars

Items	FY17	FY18	Abs. change
Energy group	**7,756.2**	**10,224.3**	**2,468.2**
POL products	4,848.0	5,459.9	611.9
Crude	1,840.7	2,933.5	1,092.8
LNG	887.2	1,610.6	723.4
Machinery group	**8,824.1**	**8,470.7**	**-353.5**
Power gen	2,370.3	1,922.8	-447.5
Electrical	1,661.6	1,591.2	-70.5
Construction	373.2	268.1	-105.1
Textile	401.1	424.2	23.1
Other machinery	2,531.1	2,678.1	147.0
Transport group	**2,287.4**	**3,248.0**	**960.6**
Cars	770.5	952.5	182.0
Trucks & buses	420.5	468.2	47.6
Aircraft & ships	329.6	762.1	432.5
Food group	**4,526.7**	**4,728.3**	**201.6**
Tea	411.2	451.3	40.1
Palm Oil	1,384.1	1,543.9	159.8
Pulses	722.7	408.0	-314.6
Textile group	**2,377.1**	**2,534.9**	**157.8**
Raw cotton	487.3	573.5	86.2
Synthetic yarn	486.4	487.5	1.1
Agri and chemicals	**5,546.7**	**6,481.7**	**935.0**
Fertilizer	478.5	615.3	136.7
Metals group	**3,148.0**	**3,992.3**	**844.3**
Iron & steel scrap	767.5	1,164.8	397.3
Iron & steel	1,530.6	1,842.8	312.2
Total imports	**38,369.2**	**44,438.6**	**6,069.4**

Data source: Pakistan Bureau of Statistics

Energy imports

Pakistan’s energy imports – mainly comprising POL products, crude oil and LNG – shot up 31.8 percent to US$ 10.2 billion in Jul-Mar FY18. Importantly, the price effect was more dominant, accounting for 85.6 percent of the YoY increase in imports of crude and POL products. This tallies with the rising trend in global oil prices during the period, which were, on average, 22.0 percent higher in Jul-Mar FY18 than in the same period last year. Similarly, average benchmark global LNG prices were 17.6 percent higher this year as compared to Jul-Mar FY17.[19]

[19] This refers to LNG import price (cif) for Japan (source: Haver Analytics).

With regards to POL products, their quantum imports dropped 9.8 percent YoY during Jul-Mar FY18; however, this was more than offset by an increase in their unit prices. As a result, import values rose 12.6 percent to US$ 5.5 billion.

Meanwhile, this quantum decline was almost entirely due to lesser purchases of furnace oil (FO) in all three quarters of the year (**Table 5.10**). A shift in power generation away from FO towards coal and LNG, and an increase in domestic production of the fuel, have lowered the import demand for the fuel this year.[20] Furnace oil sales to the power sector also dropped 26.5 percent this year.[21]

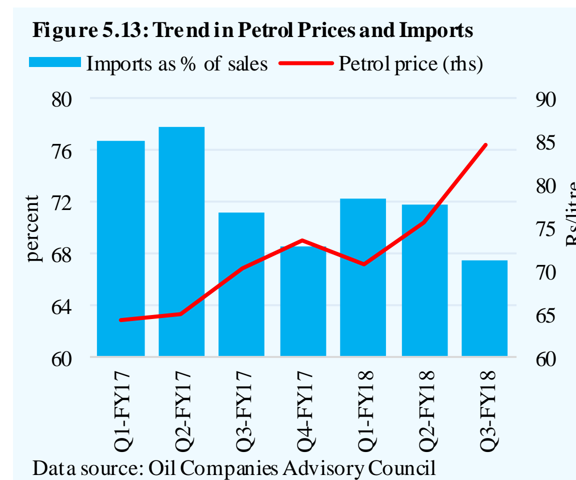
Table 5.10: Pakistan's Quantum Energy Imports (million MT)

	Jul-Mar			Q3		
	FY17	**FY18**	**Growth (%)**	**FY17**	**FY18**	**Growth (%)**
HSD	2.7	3.0	8.8	0.9	0.9	-2.8
Furnace oil	5.0	3.2	-36.0	1.3	0.2	-82.5
Crude oil	6.3	7.8	24.1	2.0	2.6	31.7
Petrol	3.7	3.9	4.2	1.1	1.2	2.3
Other	0.1	0.2	110.7	0.0	0.1	142.2
Total	**17.8**	**18.0**	**1.2**	**5.4**	**5.0**	**-7.9**
LNG*	2.1	3.6	71.4	-	-	-

Data source: Oil Companies Advisory Council *PBS, Data for Jul-Feb

Among other products, quantum imports of petrol and high speed diesel (HSD) continued to rise, reflecting strong demand from the transport sector. That said, a gradual slowdown has been noted in case of petrol imports. Rise in domestic production as well as the pass-through of higher international oil prices to domestic ones, have likely suppressed demand for petrol imports (**Figure 5.13**).[22]

Figure 5.13: Trend in Petrol Prices and Imports



Data source: Oil Companies Advisory Council

Meanwhile, imports of LNG and coal surged, both in quantum and value terms, in

[20] In fact, FO's share in total power generation during Jul-Mar FY18 slipped to 20.7 percent, from 30.4 percent last year (source: National Electric Power Regulatory Authority).
[21] Source: Oil Companies Advisory Council.
[22] During Jul-Mar FY18, the government raised petrol prices by a cumulative Rs 15.27 per litre (21.0 percent). In the same period, domestic petrol production had risen 18.6 percent on YoY basis.

line with mainly higher demand from the power sector (**Table 5.11**).[23] LNG imports have risen by 81.5 percent and reached US$ 1.6 billion by end-Mar FY18. In tandem, quantum of LNG imports had risen by a sizable 65.9 percent by end-February 2018.

With regards to coal, its quantum imports more than doubled during Jul-Jan FY18, mainly reflecting demand from two major power projects that came online this year, as well as from cement manufacturing firms that use it as a raw material.[24] At the same time, a 13.3 percent increase in average international coal prices during this period further pushed up the value of coal imports.[25]

Table 5.11: Power Generation by Source (in GWh)

	Jul-Mar FY17	Jul-Mar FY18	Abs change
Hydro	22,944	20,904	-2,039
Gas	22,087	28,804	6,717
Furnace oil	23,011	17,720	-5,292
Coal	58.64	7,393	7,335
Nuclear	4,284	6,572	2,287
Others	3,349	4,158	810
Total	**75,734**	**85,552**	**9,818**

Data source: National Electric Power Regulatory Authority

Non-energy imports

Machinery imports

Machinery imports, the largest group of non-energy imports, declined 4.0 percent to US$ 8.5 billion during Jul-Mar FY18. This is in sharp contrast to last year, when these purchases had surged 42.0 percent and played a major role in inflating the country's overall imports.

Further analysis of sub-categories shows that the imports required for CPEC projects – i.e. power generation, electrical, and construction machinery – have all declined this year, as most of the early harvest CPEC power projects are nearing completion.

On the other hand, mobile phone imports rose 15.1 percent to US$ 603.4 million in the nine-month period, which pushed up overall telecom sector imports to US$ 1.1 billion. Interestingly, while the overall number of mobile phones imported has gone down, their import values have risen – indicating the changing public's

[23] According to the Economic Survey of Pakistan 2017-18, 63 percent of the LNG imported during Jul-Feb FY18 was utilized by the power sector.

[24] The two projects are Sahiwal and Port Qasim, which were inaugurated in July and November 2017 respectively. Meanwhile, domestic cement production rose 12.1 percent in the comparable period (i.e. Jul-Jan FY18), leading to higher demand for coal.

[25] During Jul-Feb FY18, the country imported 7.7 million MT of coal, at a cost of US$ 772.5 million.

preference towards the expensive, high feature phones.[26]

Transport

The country's transport imports surged 42.2 percent and reached US$ 3.3 billion in Jul-Mar FY18. Aircraft parts and engines imports contributed the most, in nominal terms, to the YoY increase in transport imports during the period. Besides, car imports (both CBU and CKD) continued on their upward trajectory, growing 23.6 percent and almost touching US$ 1.0 billion mark (**Table 5.12**). In terms of contribution to growth, CKD imports dominated, as domestic assemblers continued to operate at elevated capacity levels (**Chapter 2**).[27]

Table 5.12: Breakdown of Transport Imports

million US dollars	FY17	FY18	Abs. change
Cars	**770.5**	**952.5**	**182.0**
CBU	*294.9*	*360.5*	*65.6*
CKD	*475.6*	*592.0*	*116.4*
Buses & trucks	**420.5**	**468.2**	**47.7**
CBU	236.7	186.1	*-50.6*
CKD	*183.8*	*282.1*	*98.3*
Motorcycles	*68.3*	*83.3*	15.0
Parts	351.0	436.8	85.8
Others	201.2	212.6	11.4
Aircrafts, ships and boats	329.6	762.2	432.5
Other transport equipment	146.3	332.6	186.3
Transport group	**2,287.5**	**3,248.0**	**960.6**

Data source: Pakistan Bureau of Statistics

Meanwhile, the breakdown of CBU car imports showed that the highest number of cars imported belonged to the 1,000-1,500 cc category, whereas in terms of YoY increase, 800-1,000cc category cars were the most prominent. Due to their reportedly better mileage and navigation features, these vehicles are being increasingly used not only by car hailing service providers, but also by middle and high-income groups.

Food

Overall food group imports rose 4.5 percent to US$ 4.7 billion in Jul-Mar FY18. The increase would have been much higher had pulses' imports maintained their last year's growth momentum. As it turned out, these imports dropped 43.5 percent, almost entirely due to lower quantums. While domestic pulses production in FY18 was about the same as last year, ample stocks available due to

[26] During Jul-Feb FY18, the number of cell phones imported in the country stood at 6.9 million, down 29.4 percent from the same period last year. Yet, the import values amounted to around US$ 527.1 million this year, up 14.7 percent from Jul-Feb FY17 (source: Pakistan Bureau of Statistics).
[27] Domestic car production was 15.9 percent higher in Jul-Mar FY18 as compared to the same period last year. This corresponded with a 15.6 percent rise in car sales during the period (source: Pakistan Automobile Manufacturers Association).

hefty imports in FY17, led to reduced demand for its imports.[28]

On the other hand, FX savings from lower pulses imports were partially offset by higher edible oil imports. Within this category, palm oil imports rose 11.5 percent to US$ 1.5 billion, while those of soybean oil rose 52.6 percent to US$ 110.6 million. While soybean oil still has a minor share in the country's edible oil imports, interestingly, its quantum imports have more than doubled this year. That said, a drop in both quantum and value terms was noted for both palm and soybean oil in the third quarter.

Iron and steel

Pakistan's iron and steel imports surged by 30.9 percent to US$ 3.0 billion in Jul-Mar FY18, reflecting continued momentum in domestic construction activities. Within this category, while finished products were dominant in terms of value (US$ 1.8 billion), it was scrap imports that posted the higher growth (up 51.8 percent to US$ 1.2 billion) in the period. The higher scrap imports, in turn, led to a healthy growth in local production: billets and sheets production rose 31.7 percent and 23.4 percent YoY respectively in Jul-Mar FY18.[29] The quantum imports of both scrap and finished products was dominant during the period, as the price impact was slightly affected by lower international prices in the second and third quarters.[30]

[28] Cumulative domestic pulses production (of Gram, Mung, Mash and Masoor) was 473,000 tons in FY18, as compared to 474,000 tons last year (source: Economic Survey of Pakistan 2017-18). In fact, average domestic pulses prices were down 17.9 percent in Jul-Mar FY18 over Jul-Mar FY17.
[29] The presence of a favorable regulatory environment for the domestic industry (with heavy duties imposed on imported finished steel products), also contributed to the sector's better performance this year. For details on the regulatory duties in place on steel imports, please see Section 5.5 in SBP's First Quarterly Report on the State of Pakistan's Economy for FY18.
[30] Average international iron ore prices were 10.9 percent lower in Oct-Mar FY18 as compared to the same period last year (source: Bloomberg).