5 External Sector

5.1 Overview

The improvement in Pakistan's balance of payments that began in FY19, gained further momentum in Q1-FY20, as the current account deficit (CAD) shrank to less than half of the level seen last year. The initiation of the IMF program and receipt of the first tranche not only helped plug the current account gap, but also restored confidence among foreign investors, leading to a trend reversal in portfolio investment during the quarter. The lower financing needs, coupled with the available inflows, reversed the recent trend of reserves drawdown, and led SBP's liquid foreign exchange reserves to rise by US$ 656 million in the quarter (**Table 5.1**).

Table 5.1: Pakistan's Balance of Payments
million US$

	Q1-FY19	Q1-FY20	Change
Current account balance	-4,287	-1,572	2,715
Trade balance	-8,382	-5,021	3,361
Exports	5,893	6,010	117
Imports	14,275	11,031	-3,244
Services balance	-1,076	-1,201	-125
Primary income balance	-1,121	-1,485	-364
Secondary income balance	6,292	6,135	-157
Workers' remittances	5,557	5,478	-79
Capital account balance	106	105	-1
Financial account balance	-2,899	-1,885	-1,014
Direct investment inflow	559	541	-18
Portfolio investment inflow	-185	344	529
Net incurrence of liabilities	2,282	840	-1,442
General government	1,878	1,092	-786
Banks	89	-517	-606
Other sector	314	262	-52
Change in SBP's liquid reserves*	-1,357	656	-
PKR app(+)/dep(-) in percent	-2.2	2.4	-

*between end-June and end-Sep
Data source: State Bank of Pakistan

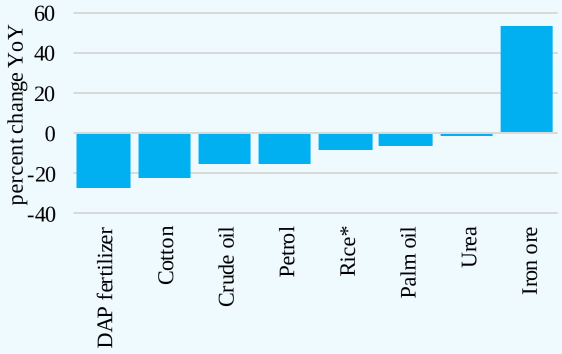
This outcome reflects the impact of the Pak rupee adjustment and other macroeconomic stabilization measures taken over the past year and a half, which have led to a considerable contraction in import demand; in fact, import payments recorded their largest drop in a decade in Q1-FY20. Quantum-led import declines were observed across all product categories, and were complemented by lower international prices of most of Pakistan's principal import commodities (**Figure 5.1**).

The energy group figured prominently contributing almost one-third to the overall import decline, with lower quantum playing a more dominant role.[1] Here, three

[1] Of the US$ 3.2 billion decline in overall import payments in Q1-FY20, US$ 1.2 billion drop was noted in energy imports.

factors stand out. First, the country's energy mix shifted in favor of hydropower and indigenous coal-based generation in Q1, which led to an ease in the import demand for furnace oil and LNG. Second, HSD sales weakened due to the slowdown in trade-related commercial transport activity, thereby reducing its import demand. And third, lower international prices allowed the country to import petrol and LNG, without pushing up the import payments. Meanwhile, demand for non-energy imports also tapered, amid inventory build-up from last year (in case of DAP fertilizer and palm oil), and reduced demand for raw materials from sectors facing the brunt of macro adjustment policies, i.e. the automobile and allied industries.

Figure 5.1: Growth in Key Global Commodity Prices in Q1-FY20



*: Pakistan's non-basmati variety
Data source: Haver Analytics & FAO

While the lower current account gap and the initiation of the Saudi oil facility reduced the payments pressure in the interbank, financial flows via foreign portfolio investment (FPI) increased during the quarter.[2] The recovery in FPI can be traced to investors' confidence about the sustainability of the market-based exchange rate system; continued improvement in the country's BoP and reserve buffers; and the comfort offered by the inception of the IMF program.

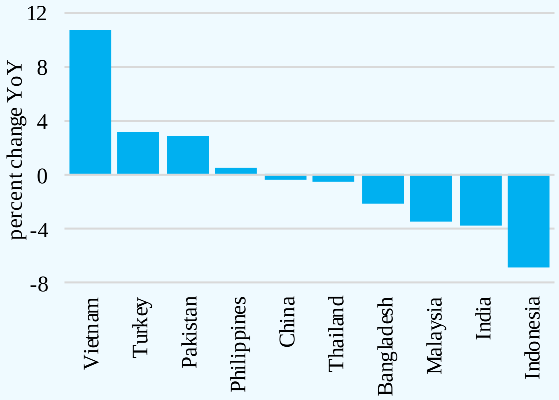
Notwithstanding the continued CAD reduction and the available financing, concerns linger over the external account sustainability. First, even though the official reserves have stabilized and inched up in Q1-FY20, the reserves adequacy is still below benchmarks in terms of import coverage.[3] This leaves the external account vulnerable to unfavorable trends in the global market.

[2] Import payments for crude oil purchased under the Saudi oil facility will come due 12 months after the purchase. While this mechanism eases the payment pressure in the interbank market, it has a zero net effect on the BoP and the reserves position. In the current account, the relevant payment amount is recorded under imports, and the same amount is included in the short-term loan disbursements to the general government.

[3] SBP's FX reserves amounted to US$ 7.9 billion by end-September 2019, up from US$ 7.3 billion at end-June. In terms of reserves adequacy, the import cover improved from 1.7 months to 1.9 months during this period.

Second, export earnings remained weak, mainly due to lower unit values amid a slowing global economy, slumping commodity prices and cutthroat competition in the major destinations. While the first two factors have suppressed export earnings of other emerging markets as well (**Figure 5.2**), the impact on Pakistan's unit prices was more pronounced (**Section 5.5**). This suggests that the currency adjustment has enabled Pakistani exporters to undercut their competitors and increase their market share by shipping higher quantities, without giving up on their margins (in Pak rupee terms). While this strategy is viable from the industrial activity standpoint, it is undermining the country's foreign exchange receipts.

Figure 5.2: Export Growth in Major EMs in Q1-FY20



Data source: Haver Analytics

Third, FDI has yet to pick up in response to the stabilization of the economy and the certainty afforded by the IMF program, as investors have adopted a wait-and-see approach. FDI during Q1-FY20 was driven by a one-off cash infusion into a telecom company for a license purchase, with all other sectors receiving lower investment. Similarly, workers' remittances have also declined, with the global economic slowdown and the challenging employment situation in the GCC hampering flows to Pakistan as well as other major recipient countries.

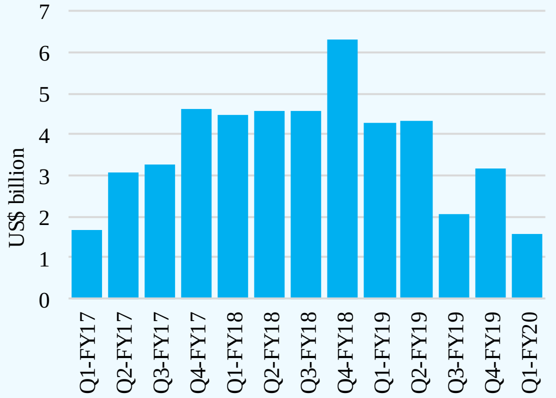
The above trends suggest that the improvement in balance of payments came largely from imports. Given the consequences of the macroeconomic adjustment policies on growth and investment, it is imperative that the country's foreign exchange earnings via exports and FDI pick up, to allow financing space for essential imports.

While the macro adjustment policies have created some challenges for the exporting industries (such as an increase in raw material costs), official support provided some cushion. For instance, SBP's trade refinancing schemes, available at attractive rates and steps taken by the Board of Investment and the FBR to streamline corporate registrations and tax payments have already led to improvement in the country's ease of doing business ranking (**Box 5.1**). That said, the focus should be now on shoring up the gains and instilling a sense of policy stability, which could help the investors to take long-term investment decisions.

5.2 Current Account

The current account deficit narrowed by US$ 2.7 billion and reached US$ 1.6 billion in Q1-FY20 (**Figure 5.3**). Almost the entire improvement came from the drop in import payments. Both lower quantum and unit prices were responsible for the import compression, though quantum played the dominant role. In case of exports, however, lower unit values dominated, partially offsetting the impact of significant volumetric growth in a number of major export products.

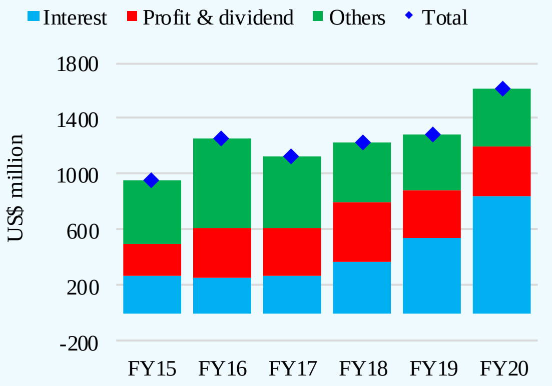
Figure 5.3: Current Account Deficit



Data source: State Bank of Pakistan

At the same time, the higher primary income and services deficit, and the decline in remittances, contributed negatively to the current account. The outflows from the primary income account rose by US$ 321 million to US$ 1.6 billion in Q1-FY20 (**Figure 5.4**). This was mainly due to higher interest payments on external debt, as profit repatriation on foreign investments almost stagnated at last year's level. The higher interest payments mainly reflect the impact of the increase in the public external debt stock over the past few years in response to the persistent twin deficits.[4]

Figure 5.4: Outflow from Primary Income Account (Q1)



Data source: State Bank of Pakistan

Workers' remittances

In Q1-FY20, remittances declined by 1.4 percent on YoY basis, compared to a significant 14.7 percent growth recorded during the same

[4] The country's external debt and liabilities increased by 12.9 percent during the last three years.

period last year. The drop in inflows from the GCC, especially the UAE, was mainly responsible for the overall decline in remittances (**Table 5.2**).

Remittances from the UAE declined 7.2 percent in Q1-FY20, mainly due to the challenging employment situation in the country, as remittance outflows from UAE to other major recipients also declined.[5] Anecdotal evidence also suggests that a significant number of workers have returned from the UAE.[6]

Table 5.2: Country-wise Remittances (Jul-Sep)
million US$

	FY19	FY20	Change
USA	862.8	911.7	48.9
U.K.	810.2	814.4	4.2
GCC countries	3,017.6	2,928.0	-89.6
Saudi Arabia	1,263.2	1,269.4	6.2
UAE	1,227.5	1,139.2	-88.3
Other GCC countries	527.0	519.4	-7.5
EU countries	165.8	169.6	3.9
Malaysia	395.2	405.1	9.9
Norway	11.4	9.2	-2.2
Switzerland	8.7	4.1	-4.6
Australia	57.9	49.7	-8.2
Canada	52.6	42.6	-10.0
Japan	4.4	6.2	1.8
Other countries	171.0	137.5	-33.5
Total	**5,557.6**	**5,478.1**	**-79.5**

Data source: State Bank of Pakistan

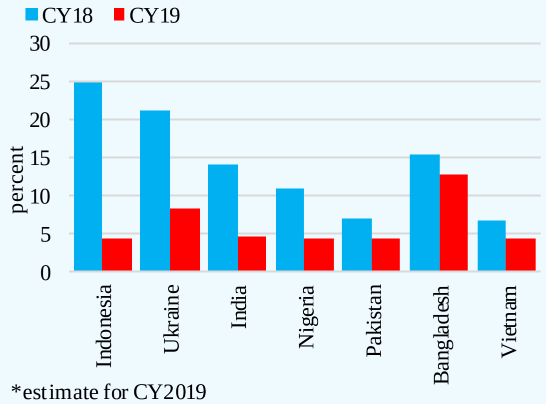
Interestingly, the growth in inflows from other main sources, such as the UK, USA and the EU, remained positive, despite an overall global economic slowdown in 2019.[7] This slowdown has impacted remittance flows to other large recipient countries, including India, as well; these countries are projected to observe a sharp deceleration in remittance growth during CY2019 (**Figure 5.5**).

As per the World Bank's estimates, Pakistan fares well compared to these countries, as the remittances growth is expected to decline only by 2.6 percentage points in CY2019. This relatively better outlook likely reflects the ongoing efforts by the Pakistan Remittance Initiative (PRI) and the government to enhance remittances through formal channels into the country. For instance, the PRI has aided the Pakistan Post and the National Bank of Pakistan to jointly enhance their

[5] The overall remittance outflow from the UAE declined by 11.7 and 4.2 percent YOY respectively during Jan-Mar and Apr-Jun 2019. This trend is in line with the slowdown in employment in the country (Source: Quarterly Economic Reviews, Central bank of UAE).
[6] According to the Bureau of Emigration and Overseas Employees, the number of Pakistanis going abroad for work increased by 3.7 percent during January to September 2019, over the same period last year. Here, it is important to mention that no official data is available on the number of Pakistanis returning from abroad.
[7] The IMF estimates the global economic growth to slow down to 3 percent in 2019 from 3.8 percent in 2017- the lowest level since the global financial crisis (source: IMF WEO, October 2019).

tie-ups with 41 money transfer operators in the UAE and Saudi Arabia during the current year. Also, under the "foreign remittance initiative" project, families of Pakistani workers can receive remittances from 240 branches of Pakistan Post for free. Other incentives include the exemption from WHT on bank accounts fed with remittances, and the reimbursement of marketing charges to exchange companies and banks.

Figure 5.5: Growth of Workers' Remittances*



*estimate for CY2019
Data source: World Bank

5.3 Financial Account

During Q1-FY20, inflows in the financial accounts were dominated by the public debt flows. Higher portfolio investment in T-bills; borrowing from the IMF; and the commercial borrowings have pushed up the gross disbursements during the period. These inflows were more than sufficient to finance the current account deficit and the debt amortization during the quarter, keeping the country's foreign exchange reserves on a high growth trajectory.

Foreign direct investment

Net FDI into Pakistan during Q1-FY20 remained almost stagnant at last year's level (**Table 5.3)**. All major sectors recorded lower inflows, except for telecom, textiles and the electric machinery. Specifically, major declines were seen in the construction and power sectors, reflecting the completion of the first phase of CPEC-related projects in the country. Meanwhile, the food sector also witnessed outflows, as some food conglomerates operating in Pakistan repatriated their retained earnings to their parent companies.

In contrast, the telecom sector fetched around half of the net FDI during the quarter, as a cellular company received funds from its parent company to pay a license renewal fee. In addition, inflows under electrical machinery mainly reflect a US$ 50.0 million investment by a Chinese company for ongoing work on a CPEC-related power transmission project.

Importantly, the net FDI would have declined more sharply, if the one-off inflow into the telecom sector had not materialized this year. Besides lower gross inflows, the country has seen divestments from multiple sectors, especially food, power and financial businesses. Cognizant with the issues related to ease of doing business, the government has taken several measures to create a business friendly environment in the recent years. These efforts have contributed to an improvement in the country's ranking in the World Bank's latest Ease of Doing Business 2020 report (**Box 5.1**)

Table 5.3: Sector-wise Net FDI inflow in Q1
million US$

	FY18	FY19	FY20	Change
Construction	125.3	180.3	5.2	-175.1
Power	426.3	92.4	0.9	-91.5
Financial business	190.1	39.8	24.9	-14.9
Exploration & prod.	83.3	74.1	34.1	-40.0
Electrical machinery	0.8	5.2	64.8	59.6
Pharmaceuticals	0.8	29.2	16.5	-12.7
Transport equipment (Automobiles)	1.4	27.7	24.3	-3.4
Textiles	10.8	12.4	16.9	4.5
Food	0.8	14.2	-17.9	-32.1
Telecommunications	62.8	-54.2	246.4	300.6
Others	116.6	137.9	125.9	-12.0
Total	**1,019**	**559**	**542**	**-17**

Data source: State Bank of Pakistan

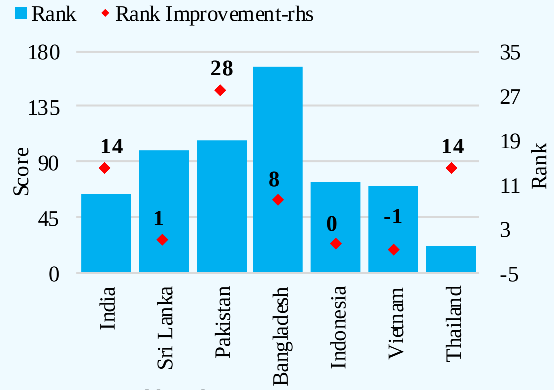
Box 5.1: Ease of Doing Business Report 2020 and Pakistan's Ranking

In the Doing Business 2020 report, Pakistan's rank has improved by 28 notches, to 108 position among 190 countries (**Figure 5.1.1**). A number of recent policy initiatives by the government have helped Pakistan secure a place among the top 10 countries with the most improved business climate.

This progress has been achieved by bringing improvements in six key areas: starting a business, dealing with construction permits, getting electricity, registering property, paying taxes, and trading across border (**Table 5.1.1**). In this regard, the following efforts are worth noting:

- The government has made it easier to start a business by introducing a one-stop registration system, replacing several forms of incorporation.
- The approval process for getting a construction permit has been restructured to make it easier; regularity in inspection of the building quality has also been ensured.
- The government has initiated service delivery timeframes for getting electricity by introducing an online portal for new applications.
- Changes in the electricity tariff have been made more transparent to the ease of the business community.
- In the area of taxes, online payment modes have been introduced for value added tax and corporate income tax. Furthermore, the corporate income tax rate has been reduced.

Figure 5.1.1: Overall Ease of Doing Business Ranking for Selected Countries in 2019



Data source: World Bank

- The process of registering a property has been simplified by allowing its execution at the office of the Sub-Registrar. Moreover, steps are taken to increase the transparency in the land administration system.
- Trading across borders has been made easier by integrating the Web-Based One Customs (WeBOC) electronic system. Moreover, coordinated joint physical inspections at the port by various agencies has been facilitated.

Furthermore, the government has formed a steering committee, the Pakistan Regulatory Modernization Initiative (PRMI), which is mandated to improve regulations and develop the regulatory system on modern lines to facilitate the businesses. This will improve trading across borders by reducing customs-related processing time and the number of hours required to prepare import/export documents via electronic document exchange.

References:

Doing Business Report 2020, World Bank
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Foreign portfolio investment

After a gap of almost two years, foreign portfolio investment witnessed a trend reversal, with the country receiving US$ 344.5 million inflows in Q1-FY20, against an outflow of US$ 185.2 million recorded in the same period last year.

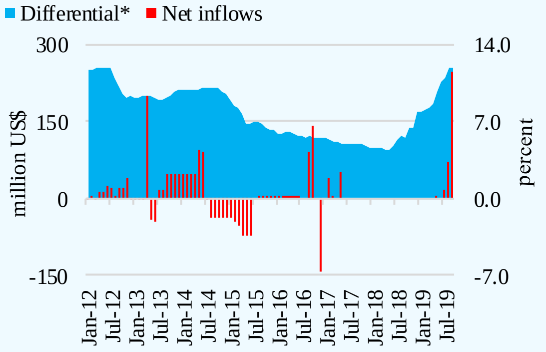
Almost the entire investment in T-bills and PIBs came from investors in the UK and the US. This increase in portfolio flows can be attributed to investors' confidence about the sustainability of the market-based exchange rate system; continued improvement in Pakistan's reserves buffers; and the comfort provided by the initiation of the EFF program. It is also important to note that while the interest rate differential had been higher in the past as well, Pakistan's

Table 5.1.1: Ease of Doing Business Indicators Scores*

	2017	2018	2019	2020
Starting a business	76	77	82	89
Dealing with construction Permits	54	51	52	66
Getting electricity	43	43	43	64
Paying taxes	47	46	47	53
Registering property	38	39	43	49
Trading across borders	64	67	67	69

*0=lowest performance to 100= best performance
Data source: World Bank Group

Figure 5.6: Portfolio Investment in T-bills and Interest Rate Differential

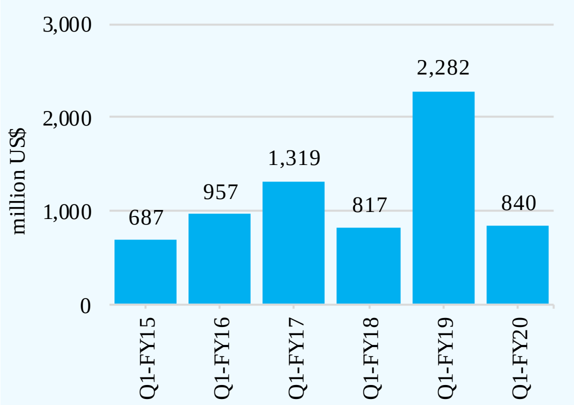


* T-bills vs US Security
Data source: State Bank of Pakistan and Bloomberg

debt market was unable to attract significant interest from foreign investors (**Figure 5.6**).

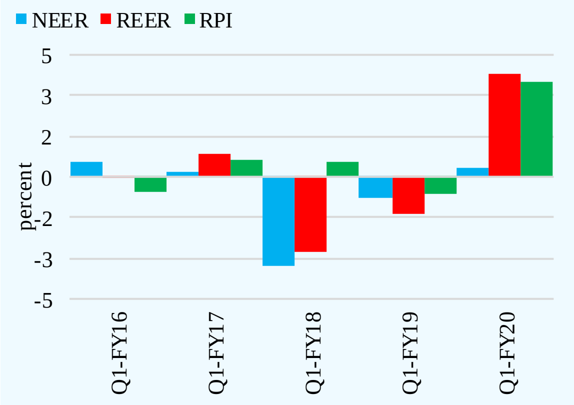
Net incurrence of liabilities
The net inflow of foreign exchange liabilities amounted to US$ 840 million in Q1-FY20, down by 63.2 percent from the same quarter last year (**Figure 5.7**). While the commercial banks retired US$ 517 million, the government borrowing was also significantly lower than last year. In gross terms, the government received three times higher inflows during the quarter, however, significant loan amortizations left the net borrowing to a lower level. The major inflows came from the IMF (US$ 991.4 million), ADB and the foreign commercial banks.

Figure 5.7: Net Incurrance of FX Liabilities



Data source: State Bank of Pakistan

Figure 5.8: Exchange Rate Depreciation(-)/Appreciation(+)



Data source: State Bank of Pakistan

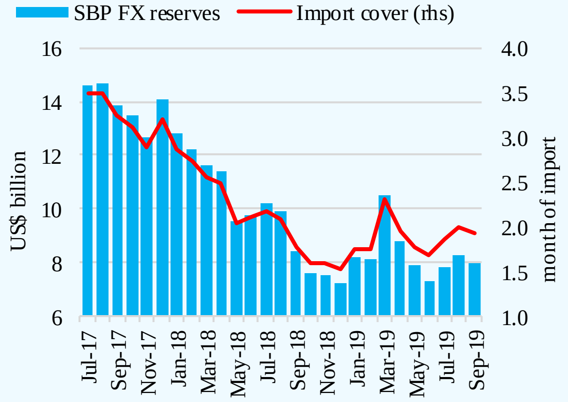
5.4 Exchange Rate and Reserves

The improvement in current account, along with sufficient availability of external financing led to reserve build-up during the quarter. This resulted in a 2.4 percent appreciation of the Rupee *vis-a-vis* US dollar in Q1-FY20; in contrast to last year, when the rupee had depreciated 2.2 percent.

In contrast, currencies of Pakistan's major trading partners, including China, depreciated significantly against the US dollar during Q1-FY20. Particularly, the Chinese yuan, having 29.1 percent share in Pakistan's NEER basket, depreciated by 3.1 percent during the period. The slide in the yuan and other major currencies added further to effective appreciation in the Pak rupee.

The average Nominal Effective Exchange Rate (NEER) during September 2019 recorded an appreciation of only 0.3 percent compared to June 2019 (**Figure 5.8**). However, the surging inflation in Pakistan relative to its trading partners pushed up the Relative Price Index (RPI) by 3.5 percent. This resulted in a 3.8 percent increase in the Real Effective Exchange Rate (REER).

Figure 5.9: Reserves Adequacy



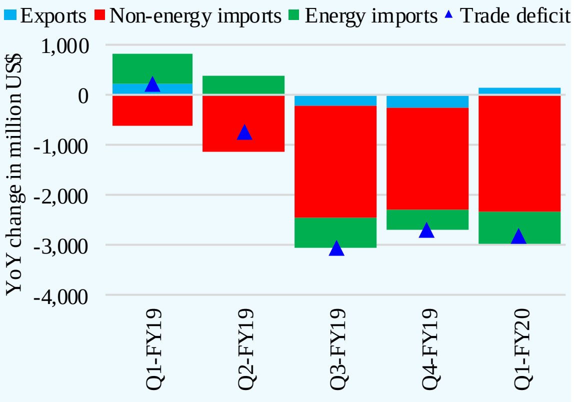
Data source: State Bank of Pakistan

In case of foreign exchange reserves, the sharp decline in imports, along with the revival in portfolio and IFI financing, contributed towards the reserve build-up. The country's foreign exchange reserves increased by US$ 751 million in Q1-FY20 compared to a fall of the US$ 1.4 billion in the same period last year. A major share of this increase was observed in the SBP's reserves, which improved by US$ 656.2 million in Q1-FY20 to US$ 7.9 billion by end-September (**Figure 5.9**). As a result, Pakistan's reserves adequacy levels also improved during the period.

5.5 Trade account[8]

The trade deficit declined by a sizable 35.3 percent YoY to US$ 5.7 billion in Q1-FY20, after dropping by 2.5 percent in the same quarter last year. An across-the-board decline in imports, led by lower quantum and complemented by declining global commodity prices, offset a YoY slowdown in export growth (**Figure 5.10**).[9]

Figure 5.10: Breakdown of YoY Change in Trade Deficit



Data source: Pakistan Bureau of Statistics

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[8] This analysis is based on customs data provided by the Pakistan Bureau of Statistics, and may not tally with the payments record data reported in **Sections 5.1** and **5.2**.

[9] International oil prices were, on average, 16.1 percent down in Q1-FY20 as compared to Q1-FY19, whereas palm oil prices were 6.8 percent lower in the same period.

As a result, the trade deficit fell to its lowest level in over three years.

Exports

Pakistan's exports rose 2.5 percent to US$ 5.5 billion in Q1-FY20, after rising by 4.2 percent in the same period last year. The slowdown in growth originated almost entirely from the POL group, which dragged down relatively broad-based and decent rebound in exports of other products, particularly rice, apparel, fruits and vegetables, and meat (**Table 5.4**).

Table 5.4: Pakistan's Major Exports during Q1
million US$

	FY19	FY20	Abs. change	Quant. impact	Price impact
Food group	**864.0**	**984.3**	**120.2**	**-**	**-**
Basmati rice	132.2	196.3	64.2	94.6	-30.5
Non-basmati	180.0	274.3	94.3	91.7	2.6
Wheat	92.8	11.0	-81.8	-83.1	1.3
Sugar	55.6	42.8	-12.8	-22.4	9.6
Fruits & veg.	132.8	148.2	15.4	12.9	2.5
Meat & prep	46.7	70.6	23.9	20.2	3.7
Textile group	**3,275.3**	**3,371.7**	**96.3**	**-**	**-**
Raw cotton	7.0	10.8	3.8	**5.5**	**-1.8**
Cotton yarn	313.7	297.2	-16.5	21.6	-38.1
Cotton fabrics	529.1	499.4	-29.7	67.4	-97.0
Apparel	1,300.0	1,446.0	146.0	238.6	-92.6
Bedwear	584.0	601.0	17.1	110.9	-93.9
Towels	184.4	180.7	-3.8	-3.6	-0.2
POL group	**145.8**	**62.3**	**-83.6**	**-65.7**	**-17.8**
Crude oil	76.2	37.5	-38.7	-30.6	-8.1
POL products	45.9	9.6	-36.3	-34.9	-1.4
Other manuf.	**828.9**	**804.4**	**-24.5**	**-**	**-**
Leather tanned	61.6	51.9	-9.7	-9.2	-0.4
Leather manufactures	119.0	131.5	12.5	7.4	5.0
Plastic	78.6	77.1	-1.5	17.4	-18.9
Pharma	49.4	55.6	6.2	17.0	-10.8
Cement	77.6	66.8	-10.8	-4.1	-6.7
Total exports	**5,373.9**	**5,509.8**	**135.8**	**-**	**-**

Data source: Pakistan Bureau of Statistics and SBP calculations

<u>Textile exports</u>

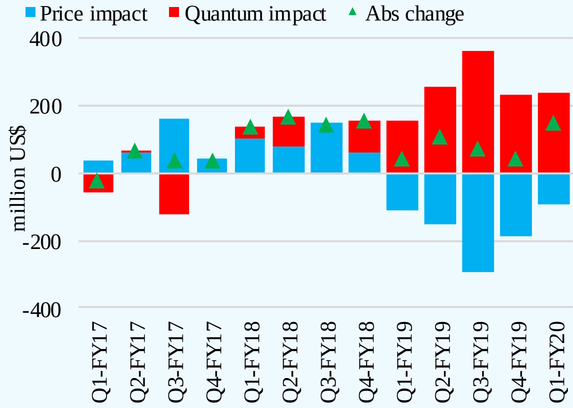
Textile exports rose 2.9 percent to US$ 3.4 billion in Q1-FY20; the growth was higher than the 0.6 percent increase recorded in Q1-FY19. This mainly reflected a trend reversal in readymade garments, whose export values had declined last year and rose by double digits this year. While the drag from lower unit prices – which had pulled down apparel exports throughout last year – is now tapering off (**Figure 5.11**), the unit prices are still exerting downward pressure on export values of multiple textile items, including apparel, yarn and fabric.

In terms of demand, while the growth in the US' quantum apparel imports in the full first quarter of FY20 was similar to last year, monthly data shows solid growth in July and August, followed by a decline in September 2019.[10] This decline mainly came from China: September marked the first time that China's apparel exports to the US started attracting additional tariffs. The import growth

[10] The US' quantum apparel imports grew 2.2 percent YoY in Q1-FY20, against the growth of 2.3 percent recorded in Q1-FY19 (source: US Office of Textile and Apparel).

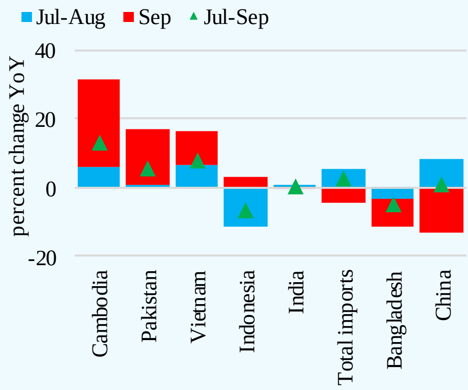
in July and August was also mainly driven by China, as American importers accelerated their purchases from May onwards (in anticipation of higher tariffs) and pulled back imports from other suppliers (**Figure 5.12a**).[11] The higher imports in Jul-Aug also led to rising inventories with clothing and retail stores (**Figure 5.12b**), and reduced the need for imports in September. Then in September, a shift towards low-cost producers was also witnessed, as quantum imports from Cambodia, Vietnam and Pakistan recorded sizable growth. These changing dynamics present an opportunity for Pakistani exporters to capture China's share in the US' cotton-centric garment market. Pakistan also has the low-cost advantage, given the extent of the Pak rupee's adjustment against the US dollar over the past year and a half, which has allowed exporters to keep their unit prices in control (**Table 5.5**), without taking a hit on their margins in rupee terms.

Figure 5.11: Breakdown of Change in Apparel Exports



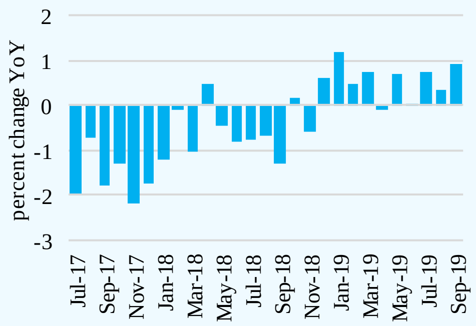
Data sources: PBS & SBP calculations

Figure 5.12a: Growth in US' Quantum Apparel Imports in Q1-FY20



Data source: US Office of Textile & Apparel

Figure 5.12b: Growth in Inventories at US Clothing & Accessories Stores



Data source: US Census Bureau

[11] American importers were warned of the impending tariff hike back in May 2019, when the US government released a list of 3,805 Chinese products that would potentially attract additional tariffs. This list included 646 apparel products, and tariffs on 568 of them were raised on September 1, 2019. Source: US Office of the Trade Representative (https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-china/300-billion-trade-action).

That said, Pakistani exporters will face stiff competition from Vietnam, whose exporters are already well-connected with the US' apparel supply chain and have emerged as one of the largest beneficiaries of the US-China trade dispute. However, the unit prices of Vietnam's exporters are now also rising, due to rising labor costs as well as a stable exchange rate; this may erode Vietnam's export competitiveness in relative terms. For Pakistan, utilizing this opportunity will hinge on sustained investments and improvements in the product composition and quality, as so far exporters are targeting to increase their market share by simply undercutting unit prices in US dollar terms, without sacrificing their margins in rupee terms.

Table 5.5: Growth in US's Apparel Import Unit Values & USD's YoY App(+)/Dep(-) against EM Currencies

Percent change	Unit Values		USD's App/Dep	
	FY19	FY20	FY19	FY20
Pakistan	1.7	1.2	18.0	27.0
Bangladesh	2.1	7.0	3.4	0.6
India	2.7	3.7	8.9	0.4
China	0.0	-4.1	1.9	3.1
Cambodia	6.1	2.6	-0.3	0.4
Indonesia	3.3	4.2	9.5	-3.3
Vietnam	2.1	6.1	2.2	0.0
World	1.1	0.8	1.5*	3.2*

*Change in Dollar Index
Data source: OTEXA and Bloomberg

Table 5.6: Growth in EU's Apparel Imports from Major Countries during Q1

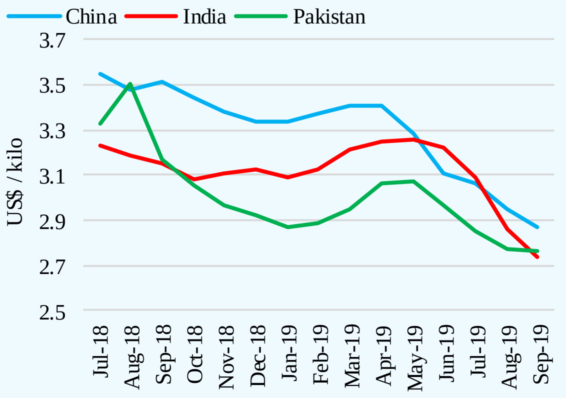
	Quantum		Value		Unit Values*		Currency**	
	FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20
Pakistan	4.9	5.2	3.5	4.2	-1.3	-1.0	16.3	21.9
India	-5.9	2.2	-4.7	2.7	1.2	0.5	7.9	-4.1
China	-11.2	-1.1	1.3	1.1	14.0	2.3	1.0	-1.4
Bangladesh	7.9	-1.1	7.5	5.5	-0.3	6.6	2.6	-3.9
Cambodia	11.7	-8.2	11.9	-2.0	0.2	6.7	-1.1	-4.3
Turkey	8.1	6.3	3.5	7.6	-4.2	1.3	59.4	-4.1
World***	-0.9	-0.6	4.6	4.0	5.6	3.4	-1.1	-4.4

*In euros **Euro's YoY app(+)/dep(-) against respective currencies ***Euro against US$
Data source: Eurostat, Bloomberg and SBP calculations

Similarly, in the EU, Pakistan's export unit prices were also lower than last year; in fact, Pakistan was the only major supplier whose unit prices to the bloc declined during Q1-FY20 (**Table 5.6**). With the euro weakening against EM currencies, the EU's import demand from high-cost suppliers was especially impacted.
In Pakistan's case, two factors stood out. First, the euro has been depreciating against currencies of all major exporting EMs for the past 2-4 quarters on YoY basis – with the exception of the Pak rupee, against which it has appreciated consistently since Q4-FY18. This has made the EU's imports from other EMs relatively more expensive than from Pakistan. And second, Pakistan continues to enjoy concessionary market access to the bloc under the GSP Plus. Due to these

two factors, Pakistani exporters fetched lower unit prices, while shipping higher quantities. In the low value added segment, Pakistan's export values of cotton yarn and fabric declined on YoY basis, with lower unit prices offsetting higher quantum exports for both products. In yarn's case, prices are trending downwards not just for Pakistan, but also for China and India (**Figure 5.13**), reflecting the trend in international cotton prices.

Figure 5.13: Cotton Yarn Prices in Major EMs



Data source: Emerging Textiles

Non-textile exports

Non-textile exports grew 1.9 percent YoY to US$ 2.1 billion in Q1-FY20, against a growth of 10.5 percent recorded in Q1-FY19. The slowdown is mainly due to a 57.3 percent drop in POL exports, with foreign sales of crude oil, POL products and naphtha all declining. While lower international oil prices played a role, quantum exports of the commodities also dropped.

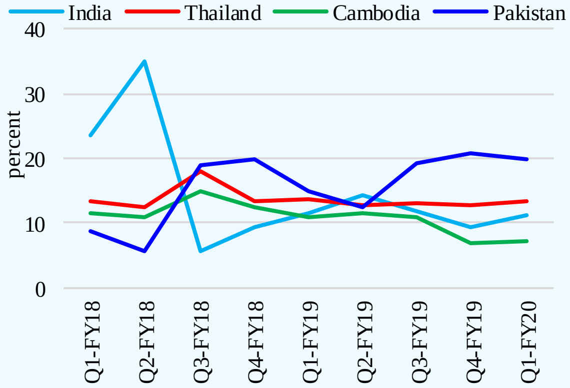
Crude oil exports fell 50.8 percent, with lower quantums explaining 79.1 percent of this decline. A likely reason is a decrease in the exportable surplus of the commodity. Owing to differences in specification and viscosity, refineries are ill-equipped to process locally extracted crude oil. However, owing to financial constraints in the wake of exchange rate losses and high interest rates, a couple of refineries have now started blending locally produced crude oil with imported oil, to reduce their import burden.[12]

In the case of products, the heaviest decline was noted in jet fuel. Jet fuel production had fallen 2.8 percent YoY in Jul-Sep, as refineries curtailed their throughput in response to financial constraints as well as their inability to offload FO stocks to the power sector. Meanwhile, demand-side dynamics for jet fuel were also not ideal: Pakistan typically exports jet fuel to Afghanistan under a government-to-government arrangement. With the gradual withdrawal of allied

[12] For instance, Byco Petroleum mentioned in its Annual Report for 2018-19 that it "has started limited procurement of local crude and has successfully blended it with imported crude oil while retaining product quality and yields".

troops from the neighboring country, requirements for fuel items and other logistical services from Pakistan are likely to taper as well.

Figure 5.14: Market Shares of Non-EU Countries in EU's Rice Imports (in quantum terms)

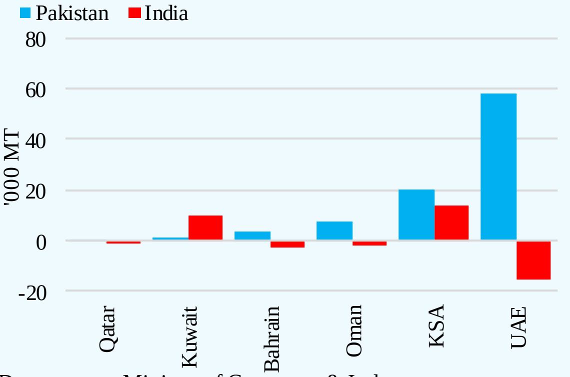


Data source: Eurostat

In contrast to the POL group, overall food exports grew 13.9 percent to US$ 984.3 million in the quarter, mainly due to a 50.8 percent growth in rice exports. In fact, rice was the single largest contributor to the growth in overall exports, with export values rising to US$ 470.6 million in Q1-FY20. Exports of both basmati and non-basmati varieties rose substantially, with higher quantum exports entirely offsetting the impact of lower unit prices (as indicated earlier in **Table 5.4**).

In terms of destination, a substantial increase in rice export receipts from the EU, Middle East and African economies was noted. Pakistan's rice exports to European countries have been growing for the past two years now and its share in the EU market has risen ever since India's rice exports to the bloc became restricted over excessive pesticide usage concerns (**Figure 5.14**).

Figure 5.15: Absolute Change in Quantum Basmati Rice Exports to Middle Eastern Markets in Q1-FY20



Data sources: Ministry of Commerce & Industry, Government of India, and Pakistan Bureau of Statistics

However, Pakistani basmati exporters are now also capturing India's share in the major Middle Eastern markets, with exports rising significantly in quantum terms just as India's are declining (**Figure 5.15**). The largest increase was noted in the UAE, where quantum exports recorded a four-fold increase during Q1-FY20. There are indications that at least part of the rice shipments to the country are being routed to Iran, following the breakdown of oil trade between Iran and India in May-June

2019.[13] Quantum exports to Saudi Arabia also more than tripled, in the wake of marketing efforts by exporters, relatively lower unit prices, and low base effect from last year.[14]

In case of non-basmati rice, exports to traditional African markets, such as Senegal and Mozambique, also rose, as exporters were able to keep their unit prices lower than competitors like India and Thailand. Furthermore, owing to favorable duty structure, Pakistan is now also sending more non-basmati (brown) rice to European countries, like Belgium and the UK, in addition to already strong basmati sales to the bloc.[15]

Among other food items, sugar and wheat exports both fell drastically. It may be recalled that export subsidies were in place for both commodities during Q1-FY19, which led to a high base effect. In case of wheat, even though quantum exports had dwindled sharply after Q1-FY19, rising domestic flour prices[16] led the government to ban the grain's exports in September 2019.[17] As a result, wheat export values dropped 88.1 percent in Q1-FY20. Sugar exports also fell 23.0 percent, with lower quantum exports entirely offsetting an increase in unit prices. Domestic sugar prices were, on average, 33.5 percent higher in Q1-FY20 as compared to last year, incentivizing sugar mills to cater to the local market instead of pursuing exports.[18]

Lastly, exports of fruits and vegetables rose by 11.6 percent YoY to US$ 148.2 million in the quarter – dwarfing the cumulative exports of protected industries like wheat and sugar. Detailed data indicates that exports of mangoes, potatoes and maize were all higher than last year. The encouraging performance can be traced to trade exhibitions organized by the Trade Development Authority of Pakistan (TDAP) in coordination with diplomatic missions and exporters in central Asian and European countries, like Russia and Germany. Furthermore,

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[13] The US' waivers to a few countries (including India) with extensive trade links with Iran expired in early May 2019 and were not renewed (source: White House statement dated April 22, 2019). India and Iran had a barter-like trading system in place, where India would credit its payments for Iranian oil imports into an INR-denominated bank account in India. Iran would use this account to pay for its imports of mainly food and pharmaceutical items from India.

[14] During Q1-FY20, the average unit price of Pakistan's non-basmati rice was 9.6 percent lower than that of India and 21.0 percent lower than that of Thailand (source: UN FAO).

[15] This rice is then further processed by mills in the region to produce white rice that is commonly used in the western countries.

[16] The price of a 10kg wheat flour bag averaged 11.1 percent higher in Q1-FY20 on YoY basis.

[17] Via Ministry of Commerce SRO No. 1044(I)/2019, dated September 11, 2019.

[18] The domestic prices rose after the GST was increased from 8 percent to 17 percent in the FY20 budget, and amid weak price control mechanisms at the local level. For details, see **Chapter 3**.

meat export values also rose substantially, as the country shipped significantly higher quantums to major Middle Eastern markets, like Saudi Arabia, the UAE and Kuwait.

Imports

Imports declined by a sharp 20.9 percent to US$ 11.2 billion in Q1-FY20. An across-the-board decline was noted, with lower quantum imports generally playing a more dominant role (**Table 5.7**). Lower international prices of key commodities, such as crude oil, coal and palm oil, along with inventory build-up last year (in case of DAP fertilizer and CKD kits) also helped curtail import demand this year. In absolute terms, crude oil contributed the most to the decline in overall imports, followed by fertilizer (DAP), coal (classified under 'all other items'), and furnace oil (FO).

Table 5.7: Pakistan's Major Imports during Q1
(million US$)

Items	FY19	FY20	Abs.	Quantum	Price
Energy group	**3,783.5**	**3,169.7**	**-613.8**	103.1	-716.9
POL prods.	1,595.1	1,319.9	-275.2	112.3	-163.0
Crude oil	1,202.2	823.3	-378.8	-225.6	-153.3
LNG	939.2	965.6	26.4	391.6	-365.2
Agri and chem	**2,324.0**	**1,815.2**	**-508.9**	-	-
Fertilizer	344.2	127.7	-216.5	-174.6	-41.9
Other chem.	1,091.3	926.6	-164.6	-	-
Transport	**791.2**	**538.1**	**-253.1**	-	-
Cars	304.2	189.8	-114.3	-	-
CBUs	87.2	14.7	-72.5	-	-
CKDs	217.0	175.1	-41.8	-	-
Truck & buses	164.4	81.8	-82.6	-	-
Aircraft &	82.9	131.1	48.1	-	-
Metals group	**1,307.8**	**1,005.9**	**-301.9**	-	-
Steel scrap	412.5	388.8	-23.7	-105.4	81.7
Iron & steel	573.5	370.4	-203.0	197.8	-5.2
Food group	**1,458.4**	**1,097.4**	**-361.4**	-	-
Tea	148.3	102.2	-46.0	-31.1	-14.9
Palm oil	485.7	362.4	-123.3	-47.5	-75.8
Soybean oil	22.8	32.1	9.3	12.6	-3.3
Pulses	152.9	118.7	-34.2	-17.7	-16.5
Textile group	**676.9**	**451.3**	**-225.6**	-	-
Raw cotton	65.2	37.4	-27.8	-28.2	0.4
Syn. yarn	153.4	118.5	-34.9	-35.1	0.2
Machinery	**2,288.1**	**2,032.9**	**-255.1**	-	-
Power gen	342.8	312.1	-30.8	-	-
Electrical	460.3	506.2	45.8	-	-
Construction	85.7	33.6	-52.1	-	-
Cell phones	199.2	269.1	69.9	-	-
Other	808.2	551.5	-256.7	-	-
All other items	**1,251.2**	**895.7**	**-372.6**	-	-
o/w Coal	464.5	272.2	-192.3	-83.4	-108.9
Total imports	**14,164.8**	**11,199.2**	**-2,965.6**	-	-

Data source: PBS and SBP calculations

<u>Energy imports</u>

Energy imports dropped 16.2 percent to US$ 3.2 billion in Q1-FY20 after rising by 19.4 percent in the same quarter last year. The drop mainly reflects lower fuel demand from the transport and power sectors, which led to heavy drops in quantum imports of POL products like furnace oil (FO) and high speed diesel (HSD). Further support came from international oil and coal prices, which were, on average, 16.1 percent and 10.9 percent lower on YoY basis respectively. The lower unit prices also severely curtailed the growth in LNG import values in the quarter.

In case of crude oil, imports dropped 31.5 percent to US$ 823.3 million in the quarter, with the decline mainly reflecting a heavy 18.8 percent drop in import quantums. In fact, quantum import of crude slumped to their lowest level in two years. While the ongoing phasing out of FO from the energy mix continues to strain refineries' throughput and their demand for crude oil, a couple of other factors are also at play.

Table 5.8: Contributors to Absolute YoY Change in Power Generation during Jul-Sep (GWh)

Fuel Source	FY18	FY19	FY20
Furnace oil	-242.5	-4,697.5	-1,846.2
Natural gas	2,163.5	-4,318.9	-1,101.3
Hydro	-220.4	462.7	2,700.4
LNG*	0.0	9,405.1	196.2
Coal	1,300.3	2,905.4	1,915.6
Nuclear	866.4	-109.6	185.1
Others	867.2	-66.7	-465.9
Total	**4,734.5**	**3,580.4**	**1,583.8**

*Generation from LNG till Q3-FY18 was being captured under natural gas. Due to this base effect for Q1-FY18, generation from LNG shows large increase in Q1-FY19.
Data source: NEPRA

First, some refineries have cited their inability to obtain forward cover to hedge their exchange rate exposure amid erratic fluctuations in international oil prices as a serious operational constraint; this has led them to book significant exchange losses. Second, a couple of refineries have started blending domestically extracted crude oil with imported oil, as mentioned earlier in the exports section. These factors, in addition to FO-related issues, have led refineries to cut back on crude oil imports.

In case of POL products, imports declined 17.3 percent to US$ 1.3 billion in the quarter. FO continued to account for the bulk of this decline, owing to its replacement from the energy mix by LNG, coal, and particularly during Q1, by record hydropower output following ample rainfall in the country (**Table 5.8**).[19] During Q1-FY20, quantum FO imports fell by a sizable 84.3 percent.

Among other products, import of petrol rose in quantum terms, but its unit prices dropped to the extent that they pulled down overall import values. Petrol sales had risen at a higher rate than last year, and with domestic production declining, the gap had to be met via higher imports. In case of HSD, sales, production and imports all declined in the quarter, in response to lower demand for the fuel from the commercial and heavy vehicle transport segments.

Meanwhile, LNG imports rose 2.8 percent in Q1-FY20, against the much higher increase of 136.3 percent recorded last year. The entire growth in import values

[19] Source: WAPDA press release dated October 3, 2019.

came from the quantum side, as unit prices were down 27.4 percent during the period. The uptick in quantum imports partly reflected higher demand from the power sector, as electricity generation from LNG rose 2.1 percent during the quarter and partially compensated for the lower generation from furnace oil (**Table 5.8**).

Lastly, coal imports dropped by a sharp 41.4 percent YoY to US$ 272.2 million during the quarter. Quantum imports and unit prices of the commodity were both lower than last year. Demand for imported coal dropped from both the power and cement sectors. In case of power, demand for imported coal dropped as the country began utilizing indigenous coal for electricity generation: a 660MW project using Thar coal began commercial operations in July 2019.[20] Due to this, electricity generation from coal rose 45.3 percent YoY during the quarter, and, like LNG, partially offset the decline in FO-based power generation. Meanwhile, coal import demand from the domestic cement industry also fell, as production dropped 1.5 percent in the quarter, with manufacturers facing uncertain demand dynamics. The lower production reduced their demand for coal, which is a major raw material for the industry.

Non-energy imports

Pakistan's non-energy imports declined 22.5 percent to US$ 8.0 billion in Q1-FY20, after dropping 5.6 percent YoY in Q1-FY19. Unlike last year, the decline this year was fairly broad-based and not just led by machinery group.

The heaviest declines were noted in raw materials and products whose: (i) prices had shot up considerably in the domestic market following the Pak rupee depreciation and regulatory measures (including tariff hikes); and (ii) inventories had built up. These included fertilizer, cars (both CBUs and CKDs), and iron and steel. Furthermore, lower global palm oil prices also contributed to the sizable drop in the commodity's import values.

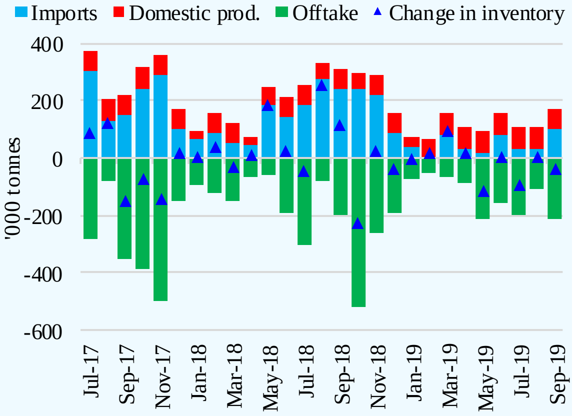
The largest drop was noted in DAP fertilizer, whose imports declined 72.4 percent during Jul-Sep. The decline came as fertilizer manufacturers continued to draw down existing inventories (which had reached a record high by September 2018), instead of going for additional imports (**Figure 5.16**).[21] Another possible reason was the 8.1 percent rise in average DAP prices, which led to lower demand for the

[20] The power plant is among the early harvest CPEC projects (source: https://www.engroenergy.com/businesses/engro-powergen-thar-private-limited-eptl/).

[21] This point was also asserted by the country's largest DAP manufacturer, Fauji Fertilizer Bin Qasim Ltd, in its Annual Report for FY19.

input.[22] The decline in DAP imports was sufficient enough to offset a rise in urea imports in the quarter, and led overall fertilizer imports to drop 62.9 percent YoY.

Figure 5.16: DAP Demand & Supply Dynamics

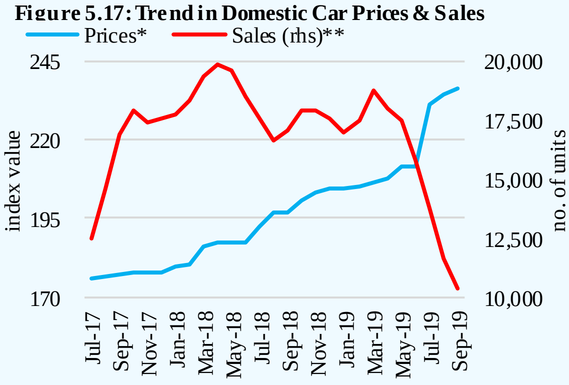


Data source: NFDC & SBP calculations

Among other non-energy products, transport imports dropped by a sizable 32 percent in Q1-FY20, after declining by 17.3 percent in Q1-FY19. Unlike last year, the decline this year was driven mostly by cars and buses. The significant increase in local car prices – reflecting the cumulative impact of the Pak rupee depreciation, imposition of FED on new car sales and hike in regulatory duties on auto part imports – and the resultant shrinkage in demand, have all contributed to a slump in car sales (**Figure 5.17**) and led to a build-up of inventory with auto assemblers.

Imports of CBUs fell more drastically than those of CKDs, mainly because CBU imports are now effectively only limited to local auto assemblers, instead of commercial car dealers. After the tightening of regulations governing used car imports last year, CBU imports by car dealers have virtually come to a standstill. Also, unlike imports by car dealers in the past, the CBU units currently imported by auto companies

Figure 5.17: Trend in Domestic Car Prices & Sales



* CPI motor vehicle index values
** 3-month moving average
Data sources: Pakistan Bureau of Statistics and PAMA

[22] The higher prices mainly reflect the impact of the Pak rupee depreciation, given that the bulk of local DAP supplies comes from imports as opposed to domestic production. Therefore, while the hike in gas tariffs in July 2019 raised fertilizer manufacturer's production costs, the same has likely played a smaller role in pushing up DAP prices.

tend to be luxurious vehicles with limited demand from a niche clientele.[23] Both these factors have led to a more pronounced decline in CBU imports. For CKDs also, heavier declines in imports were noted for the higher-tier variants (above 1,500cc) than for others.

Meanwhile, imports of raw materials and finished products for the auto and construction-allied industries, such as iron and steel and old ships for shipbreaking, continued on the downward trajectory that had begun last year. Cumulative iron and steel imports (both finished products and scrap) declined 23 percent to US$ 759.3 million. Within this category, imports of cold steel sheets and varnished sheets, typically used to make car body panels, declined heavily, reflecting lower demand from auto assemblers.

In the food group, imports of palm oil dropped 25.4 percent YoY to US$ 362.4 million, in response to both lower import quantums and unit prices. The drop in quantum imports is the first since Q3-FY17, and is explained by multiple factors. First, some switching to soybean oil is evident, as quantum imports of that commodity have risen this year. And second, edible oil mills had been stockpiling palm oil throughout last year as international prices had trended downwards and uncertainty abounded about the extent of the ongoing Pak rupee adjustment. That stockpiling activity seems to have ended now, leading to a decline in import demand for the commodity.

[23] These include high-end sedans and SUVs that are imported by auto companies like Audi (all models), Toyota (Rush, Camry, Land Cruiser) and Honda (Accord). Suzuki's Ciaz, which is also imported as a CBU, is relatively lower priced as compared to the other vehicles cited above. In contrast, vehicles imported by commercial car dealers before tightening of regulations were predominantly in the small engine car category (660-1,000cc).