

5 External Sector

Pakistan's external account position has strengthened, as the current account turned into a surplus in the first half of FY21. Record-high remittances and reductions in the services and primary income deficits were the driving factors and helped offset a widening in the merchandise trade deficit. Export receipts declined by 4.8 percent YoY, despite a sizable increase in export volumes of major products. Meanwhile, import pressures also emerged, as domestic industrial activity recovered after the reopening of the economy, and also because the country had to make sizable one-off purchases of agricultural commodities from abroad – especially of wheat and sugar – to address supply-side challenges and stabilize domestic prices. Higher international prices of most of these commodities accentuated the import payments. However, the sizable reduction in global oil prices on YoY basis provided major support in curtailing energy import payments and offsetting the upward pressures from imports of non-energy products. Owing to these dynamics, the overall current account remained in surplus during the period. Furthermore, with multilateral and bilateral external financing available, the SBP's FX reserves increased by US\$ 1.3 billion to US\$ 13.4 billion, while its net forward liabilities reduced by US\$ 1.2 billion during H1-FY21. The PKR appreciated by 5.1 percent against the US Dollar during the same period.

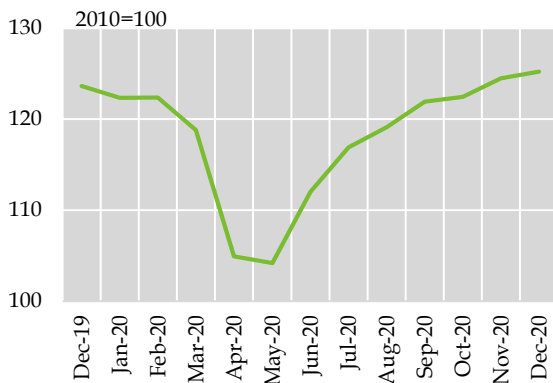
5.1 Global Economic Developments

During H1-FY21, the global economy showed signs of recovery. Global trade volumes are now above their pre-Covid levels, as the continuation of stimulative fiscal and monetary policies amidst the second wave of Covid-19 supported consumption, stimulated a revival in industrial activity across many export-oriented economies and ensured that the

financial markets remained liquid and firms had access to credit (Figure 5.1).

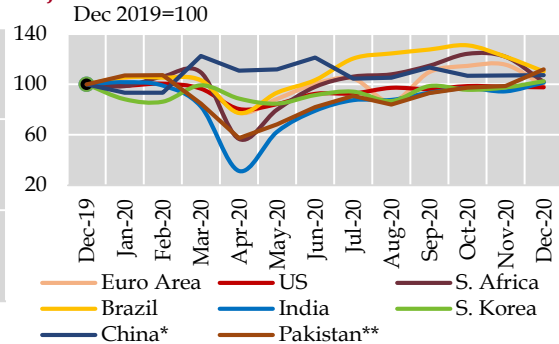
These underlying developments contributed to an overall improvement in the external account positions of many emerging markets (EMs) via the trade and capital flow channels. A sizable improvement in the current account position of EMs was recorded during the period, which contributed to a build-up in the foreign exchange buffers in these economies and led

Global Trade Volumes have Recovered



Source: CPB World Trade Monitor (Netherlands)

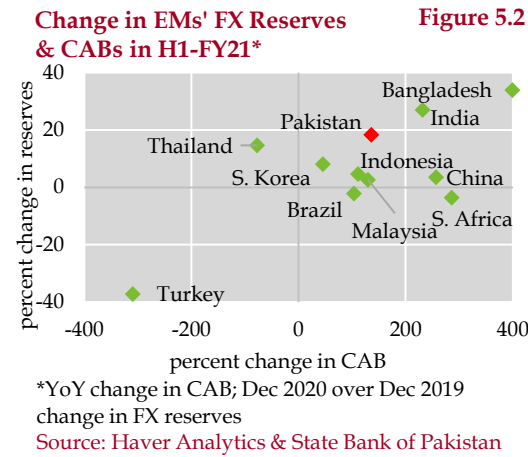
Figure 5.1a Trends in Industrial Production in Major Economies



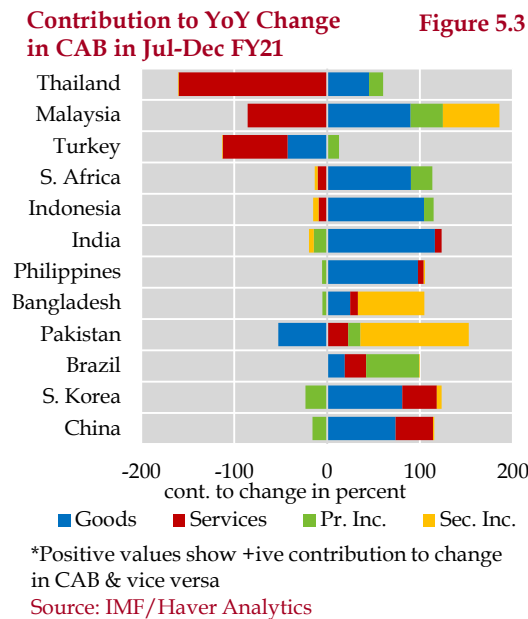
*value added in 1990 prices **LSM index

Sources: Haver Analytics; PBS & SBP calculations

to an appreciation of their currencies against the US Dollar (Figure 5.2).



Here, it is important to note the sources of these current account improvements. For most EMs, the global air travel restrictions generally had a positive impact by significantly lowering their services imports, as indicated in Figure 5.3 (excluding those

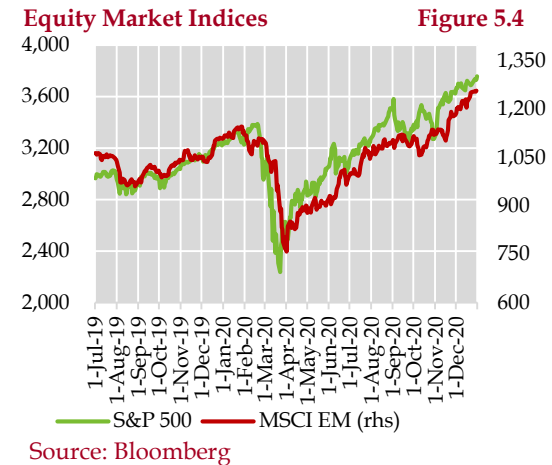


that rely heavily on tourism, like Turkey and Thailand). Furthermore, the travel restrictions likely played a major role in diverting a significant chunk of workers' remittances that used to arrive into these countries via informal methods towards the official banking channels.

Meanwhile, the global financial markets remained fairly liquid on the back of sizable monetary support from central banks across the advanced and developing economies. The global equity markets recovered from their March 2020 lows and investors' risk appetite appeared to recover by June 2020 onwards, as the economies began to emerge from the lockdowns and rapid progress was noted in the development and eventually the rollout of the vaccines (Figure 5.4). The US Dollar Index also weakened after the initial spike during early days of the Covid-19 outbreak, whereas low interest rates in the advanced economies encouraged investors to search for yields in the emerging economies.

5.2 Pakistan's External Account

At the aggregate level, the global trends related to the improvement in the current



account and reserves positions were also visible in Pakistan's external account during H1-FY21. From a deficit last year, the current account turned into a surplus during the first six months of the ongoing fiscal year; in fact, surpluses were recorded in five out of the six months in the period.

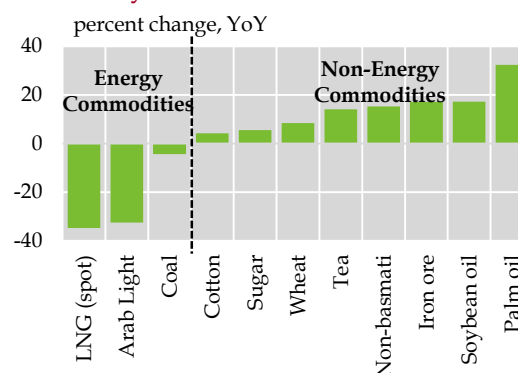
Workers' remittances were mainly responsible for this improvement in the current account, as inflows reached a record high. Further support came from the services and primary income accounts, where the Covid-related air travel restrictions, the G-20's Debt Service Suspension Initiative (DSSI), and the low global interest rates, all played supportive roles.

The net FX earnings from these sources were quite important, as they offset a widening in the merchandise trade payments gap during the six-month period. Import pressures have been visible from the start of the fiscal year, partially reflecting the impact of facilitative domestic policies, which contributed to a sizable recovery in industrial activity and subsequently the industry's demand for imported raw materials. The supply-side shortages in key agricultural commodities further contributed to the import pressures (Section 5.4). International prices of most non-energy commodities imported by Pakistan were higher in H1-FY21. However, the overall import payments remained stable, due to sizable reductions in global prices of major energy commodities (on YoY basis), which significantly compressed energy import payments and offset the increase in non-energy import payments during the period (Figure 5.5).

Among the agricultural commodities that Pakistan imported was cotton, whose

demand by the export-oriented textile industry had risen amid a steep decline in local cotton production. The local textile industry was revving up to fulfill orders from major buyers that could not be met by competitors. However, this surge in export volumes of high value-added textile

Growth in Key Global Commodity Prices in H1-FY21 Figure 5.5



Sources: World Bank and Bloomberg

products, as well as of cement and other products, did not translate into a proportional increase in export receipts.

On the external financing side, the official external borrowing was lower on both gross and net basis. With the current account in surplus and given the availability of external financing, the SBP's liquid reserves rose by US\$ 1.3 billion during H1-FY21 to US\$ 13.4 billion, and the PKR appreciated 5.1 percent against the US Dollar during the period.

Current Account

The current account turned into a surplus of US\$ 1.2 billion in H1-FY21 from a deficit of US\$ 3.4 billion in the same period last year. Surpluses were recorded in the first five months of the period (Table 5.1). The Covid-related air travel restrictions likely had a fairly positive impact on the current account,

Pakistan's Balance of Payments**Table 5.1**

million US Dollars

	Q2-FY20	Q2-FY21	Absolute Change	H1-FY20	H1-FY21	Absolute Change
Current account balance	-1,728	382	2,110	-3,447	1,247	4,694
Merchandise trade balance	-5,625	-6,103	-478	-10,906	-11,386	-480
Exports	6,414	6,461	47	12,408	11,815	-593
Imports	12,039	12,564	525	23,314	23,201	-113
o/w Energy imports	2,449	2,206	-242	5,365	4,283	-1,082
Non-energy imports	9,591	10,358	767	17,949	18,918	969
Services balance	-892	-411	481	-2,070	-989	1,126
Primary income balance	-1,694	-1,184	510	-3,063	-2,673	390
o/w interest payments	882	644	-238	1,727	1,290	-437
Workers' remittances	5,919	7,060	1,141	11,371	14,203	2,832
Financial account balance	-4,834	-1,163	-3,671	-7,145	-309	-6,836
Direct investment inflow	827	422	-405	1,373	880	-493
Portfolio investment inflow	126	-290	-416	470	-435	-905
Build-up in fin. assets abroad	316	467	343	187	1,573	1,386
FX loans inflow (net)	4,199	1,480	-2,719	5,336	1,500	-3,836
o/w General government	3,261	1,620	-1,641	4,359	3,042	-1,317
SBP	-501	69	570	-498	-931	-433
Banks	146	21	-125	-291	-621	-330
SBP's liquid reserves (end-period)	11,336	13,415	1,262*	11,336	13,415	1,283*
SBP's forw. liabilities (end-period)	-4,212	-4,610	1,164*	-4,212	-4,610	1,164*
PKR app(+)/dep(-) in percent*	1.0	3.7	-	3.3	5.1	-

*Change in reserves, forward liabilities and PKR ex. rate during the period (Oct-Dec for Q2, Jul-Dec for H1)

Note: Negative sign with financial account balance means net FX inflow into Pakistan and vice versa. Negative sign for change in financial account balance means lower net FX inflow into Pakistan on YoY basis.

Source: State Bank of Pakistan

as they may have contributed to channelizing remittances to formal channels and curtailing the services trade deficit.

Further support came from the G-20's DSSI and the reduction in global interest rate benchmarks, which helped reduce interest payments on external debt. On the trade front, export receipts underwent a trend reversal and began to rise from Q2 onwards, whereas low international oil prices (on YoY basis) helped contain the energy import payments and partially offset the higher non-energy import payments.

Workers' remittances

Workers' remittances grew by a sizable 24.9 percent YoY and reached a record high of

US\$ 14.2 billion in H1-FY21. Inflows rose from all the major corridors, but especially from the advanced economies, as shown in **Table 5.2**.

As highlighted in the SBP's First Quarterly Report of FY21, the cross-border air travel restrictions after the Covid outbreak may have helped channelize inflows towards the formal channels. During Q2-FY21 as well, global air travel was far below the comparable 2019 levels, and therefore emigrants are likely to have continued to utilize the banking channels to support their families back home. Within Pakistan, policy measures undertaken by the government and the SBP to encourage inflows through formal channels, along with the orderly foreign

**Corridor-wise Workers’
Remittances during Jul-Dec**
million US Dollars

Table 5.2

	FY20	FY21	Absolute Change
USA	816.8	1,204.5	387.7
UK	1,237.4	1,877.1	639.7
GCC	7,467.4	8,528.6	1,061.1
KSA	3,174.2	3,955.2	780.9
UAE	2,776.6	2,956.1	179.4
Other GCC	1,516.6	1,617.3	100.8
Europe*	896.3	1,269.9	373.6
Others	954.2	1,323.0	368.8
Total	11,372.2	14,203.1	2,830.9

*comprising 10 European countries

Source: State Bank of Pakistan

exchange market conditions, also contributed to the growth in remittances.

Furthermore, continued policy support in the host destinations (especially the advanced economies) via unemployment benefits, rent and loan deferrals, and direct cash handouts, likely increased the ability of migrants to remit higher amounts back home. Also, the efforts by global money transfer operators (MTOs) and governments to incentivize migrants to adopt digital channels to remit funds have likely also played a role in pushing up inflows received via the banking system.

In fact, the major global MTOs, such as Western Union and MoneyGram, have up-scaled their digital services to facilitate

emigrants to send cross-border remittances, after their physical outlets of these MTOs remained closed amid the lockdowns. As a result of these digitization efforts, the share of digital transactions in the overall customer-to-customer (C2C) transactions of these MTOs has risen sharply (Figure 5.6). Furthermore, Western Union has reported an increase in the per-transaction amounts, which supports the anecdotal evidence that emigrants are sending higher amounts back home to their families amid the challenging Covid-related economic environment (Figure 5.6).¹

In Pakistan also, banks are being incentivized to introduce digital products to facilitate migrants in sending remittances under the Pakistan Remittance Initiative (PRI).² Data shows that transaction volumes and amounts of international remittance transactions in Pakistan via the branchless banking mode (m-wallets) have grown quite strongly since the Covid-19 outbreak.³

Services account

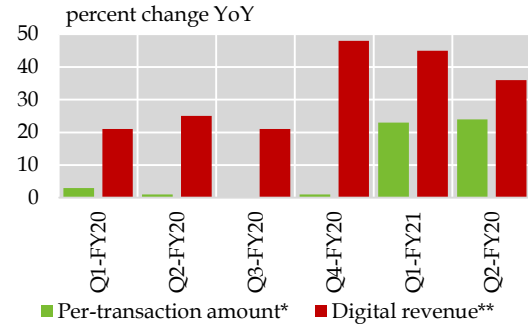
The services account deficit contracted by 54.4 percent YoY to almost US\$ 1.0 billion in H1-FY21. Most of this improvement was due to a sizable 24.2 percent contraction in imports, though exports also registered a nominal decline of 2.9 percent.

¹ Comparable data with such an extensive breakdown of per transaction revenues and digital revenues is not readily available for MoneyGram, another large money transfer operator.

² The PRI launched a scheme to channelize remittances via m-wallets in 2017 by awarding cell phone airtime for every US dollar (or equivalent) received into m-wallets; in January 2019, the benefit was raised to Rs 2 for every US dollar received. For details, see Chapter 5 in the SBP’s State of the Economy Report for Q1-FY21.

³ While quite nominal in terms of overall remittances, remittances sent to Pakistan via m-wallets have risen from US\$ 5.5 million in H1-FY19 to US\$ 29.9 million in H1-FY21. Furthermore, m-wallets are just one digital medium for cross-border transactions, alongside online ACH bank transfers and funds transfers via MTOs’ own websites and mobile apps.

Growth in Western Union's Digital Transactions & Revenues **Figure 5.6**



*for cross-border transactions **including from website & mobile application (own & third party)
 Source: Western Union earnings release statements

The contraction in imports was concentrated in areas that were directly impacted by the Covid-related air travel restrictions. The single-largest contribution to the improvement in the overall services account came from the significant reduction in the purchase of air tickets of foreign airlines by Pakistani residents, which is recorded as an import of air transport services (Table 5.3). Related to this, the second-largest source of improvement was the 28.1 percent reduction in the import of travel services. This category includes purchase of hard foreign exchange by Pakistani residents from banks

Breakdown of Services Balance in Jul-Dec* **Table 5.3**

million US Dollars

	FY20	FY21	Change**
Transport	-1,313	-955	358
o/w Air Transport	-291	47	338
Freight	-961	-912	49
Travel	-497	-167	333
ICT Services (net)	487	681	194
Exports	684	959	275
Imports	197	278	81
Others	-747	-503	244
Services Balance (net)	-2,070	-944	1,126

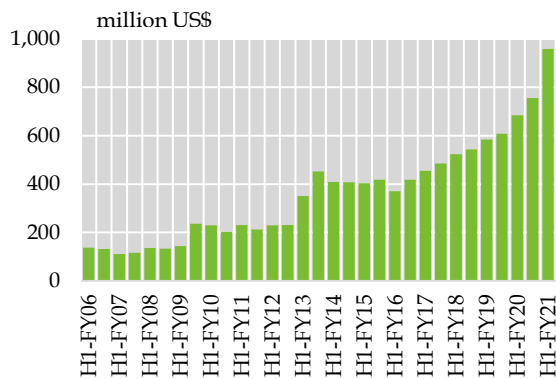
*Negative balance means deficit and a positive sign means surplus.

**Positive sign shows YoY improvement & vice versa
 Source: State Bank of Pakistan

and exchange companies for traveling purposes. In line with the reduction in international travel, the usage of credit cards for foreign transactions – which is also recorded as an import of travel services – also dropped and contributed to the reduction in services imports.

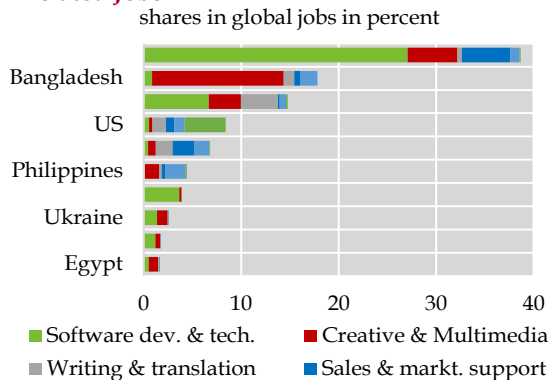
On the export side, Pakistan’s ICT firms were able to tap into the surge in global demand for technological services after the Covid outbreak. The ICT services exports surged 40.2 percent YoY and reached an all-time

Pakistan's Exports of ICT Services



Source: State Bank of Pakistan

Top 10 Home Countries for ICT-related Jobs **Figure 5.7b**



Source: Oxford Internet Institute *As of Feb 2021

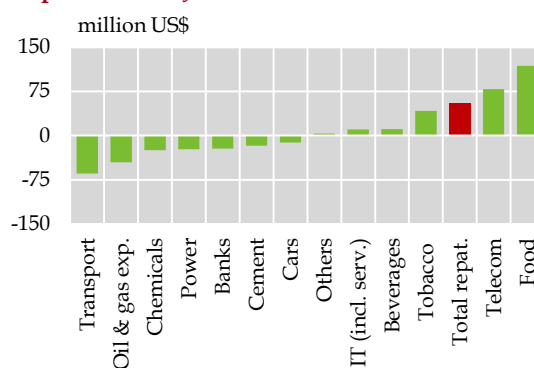
high of nearly US\$ 1.0 billion in H1-FY21 (**Figure 5.7a**). Within ICT services, the growth mostly originated from software- and hardware-related services. It is worth noting that Pakistani workers, including freelancers, are already well-integrated into the global gig economy; in fact, at the global level, Pakistan is host to the third-largest number of freelancers working on the most popular web platforms for contractual jobs (**Figure 5.7b**).⁴ This allowed the country to capture the increase in global demand for ICT services during the period.⁵

Primary income

The primary income deficit declined 12.7 percent YoY to US\$ 2.7 billion in H1-FY21, with the entire drop recorded in the second quarter. Interest payments on external debt, as well as profit and dividend repatriations by energy firms, had been dropping consistently, but were offset by higher repatriations by non-energy firms in Q1. However, in Q2, profit repatriations by non-energy firms also dropped, adding onto the already lower repatriations by energy firms. A few main factors were driving these

developments in the primary income account, and are discussed below.

Change in Sector-wise Profit Repatriation in Jul-Dec FY21 **Figure 5.8**



Source: State Bank of Pakistan

Low oil prices: The sharp fall in the global oil prices – which began in March 2020 – had shook up the global energy sector and led to bankruptcies and consolidation, as revenues suffered and fresh investments were put on hold.⁶ In Pakistan also, fresh FDI into the oil and gas sector declined from last year’s levels (**Section 5.3**), whereas lower profitability subdued the sector’s profit

⁴ Source: Otto Kässi, Vili Lehdonvirta, Online labour index: Measuring the online gig economy for policy and research, Technological Forecasting and Social Change, Volume 137, 2018. The open dataset tracks all the projects or tasks posted on the five major English-language online freelancing platforms (upwork.com, Peopleperhour.com, Freelancer.com, Guru.com and Mturk.com). For more details, see Special Section 2 in the SBP’s State of the Economy Report for Q1-FY19.

⁵ That said, while Pakistan’s ranking in freelance services is encouraging, the country’s attractiveness as a business process outsourcing (BPO) destination has declined steeply over the past three years (source: AT Kearney Global Services Location Index 2019). There is a need to promote the BPO services, given that their exports fetch more forex earnings than freelancing. Furthermore, firms providing BPO services also tend to attract FDI.

⁶ According to a legal firm that tracks energy sector-related bankruptcy filings in the North America region, 46 oil and gas firms filed for Chapter 11 bankruptcy during 2020 (till December 18), up from 42 in 2019. More importantly, many of the firms filing for bankruptcy in 2020 were large firms: the cumulative amount of debt involved was estimated at US\$ 53.1 billion – more than double the outstanding debt of firms that had filed for bankruptcy in 2019 (US\$ 25.8 billion). Source: Oil Patch Bankruptcy Monitor, Haynes & Boone LLP.

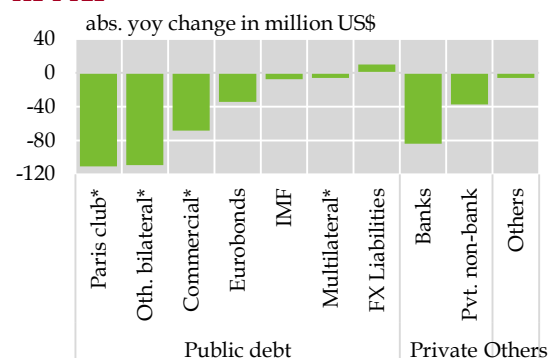
repatriations (**Figure 5.8**).⁷ The lower repatriations by this sector partially offset the higher repatriations by firms in other sectors, such as food and telecom.

Post-outbreak evolution in consumer demand: With work from home and distant learning becoming the norm after the Covid-19 outbreak, there has been a sizable increase in the usage of telecom services, particularly data services.⁸ The resultant increase in the sector's earnings have led to higher repatriations as well. Similarly, in the case of fast-moving consumer goods (FMCGs), sales of food items, paper products, and cleaning supplies in general have risen, and contributed to higher corporate earnings. As the telecom and most FMCG firms in the country are dominated by multinational companies, these sectors have recorded relatively higher repatriations.

Debt relief under the DSSI and reduction in global interest rates: The overall interest payments dropped by 25.3 percent to US\$ 1.3 billion in H1-FY21 YoY. Being the largest beneficiary (in nominal terms) under the G-20's DSSI, Pakistan is eligible for a deferment of both interest and principal repayments on bilateral official debt on repayments falling due between May 2020 and June 2021.⁹ At

the same time, the sizable drop in the global interest rate benchmarks also lowered the interest payments during the six-month period. Source-wise breakdown shows that Pakistan's interest payments to Paris Club creditors fell the most during H1-FY21, followed by payments to other bilateral and commercial creditors (**Figure 5.9**).

Change in Interest Payments in H1-FY21 **Figure 5.9**



*incl. PSEs, & both short- and long-term debt serv.

Source: State Bank of Pakistan

Financial Account¹⁰

The financial account recorded a marginal inflow of US\$ 309 million on net basis during H1-FY-21, against much higher inflows of US\$ 7.1 billion realized in same period last

⁷ The profit after tax of major exploration and production companies in Pakistan, such as POL Pakistan Ltd. and OGDCL, dropped by 22.4 percent and 20.5 percent YoY respectively during H1-FY21 (source: company financial statements).

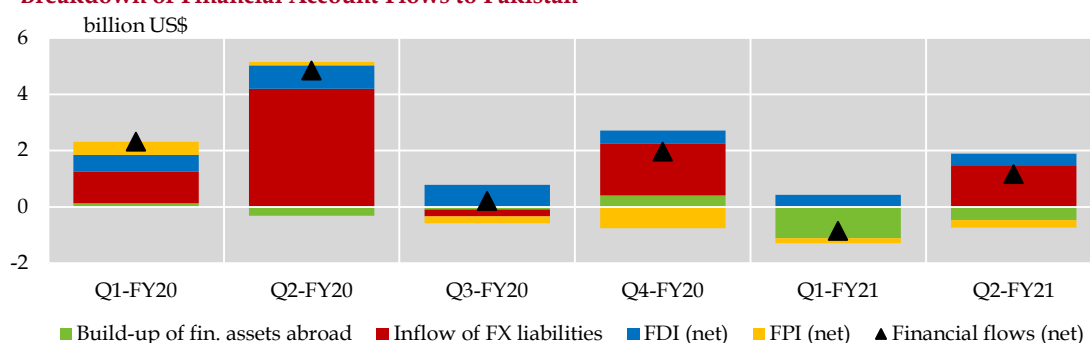
⁸ In full-year FY20 (latest period for which information is available), data usage in Pakistan had grown 77 percent YoY to 4,498 petabytes. The regulator has attributed this surge in usage at least partially to the rising trend of remote working and learning after the Covid outbreak (source: PTA Annual Report FY20).

⁹ According to the October 2020-dated joint IMF-WBG staff note, titled "Implementation and Extension of the Debt Service Suspension Initiative", the bilateral official creditors had committed to "suspend payments on all principal and interest coming due between May 1 and December 31, 2020." The scope of the initiative was later extended to cover debt payments for eligible countries till June 2021 (source: <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative>).

¹⁰ As per the IMF's Balance of Payments Manual 6 convention, forex inflows into the reporting country (Pakistan in this case) are denoted by a negative sign, and forex outflows from the reporting country is denoted with a positive sign.

Breakdown of Financial Account Flows to Pakistan*

Figure 5.10



*Signs are reversed from BPM 6 convention. Positive values here indicate FX inflow and negative values show FX outflow from Pakistan

Source: State Bank of Pakistan

year. The breakdown indicates that there was a net FX outflow in the first quarter, which was completely offset by a net inflow in the second quarter of the year (Figure 5.10).

In the first quarter, a large chunk of the outflow basically reflected a build-up in FX assets abroad of commercial banks.¹¹ The asset build-up partially stemmed from the accumulation of net current account receipts abroad, following the heavy inflow of foreign exchange via remittances, an increase in trade credits, and subdued import payments.¹²

This trend also continued in the second quarter, albeit at a moderate pace. The accumulation in bank assets abroad halved from the Q1 level, mainly due to a reduction in the magnitude of the current account surplus. At the same time, the government received higher loan inflows as compared to

the first quarter, which contributed to higher overall financial flows in Q2.

Foreign direct investment

Global FDI recorded a sharp drop of around 42 percent in 2020; to put this in perspective, this drop was quite higher than the dip recorded in worldwide FDI during the global financial crisis. The decline was concentrated in the advanced economies, whereas the developing countries were, on aggregate, less affected. Greenfield investments were impacted, mainly due to the uncertainty about the global trajectory of Covid-19 cases; the risk of lockdowns; the scale and efficacy of the governments' Covid-related support; and the rollout of the vaccination programs. Moreover, the multinational corporations (MNCs) also reduced their new equity investments, whereas parent firms withdrew

¹¹ As per the IMF's Balance of Payments Manual 6, a build-up in financial assets in a non-resident country is considered a financial outflow from the reporting country.

¹² During Q1-FY21, merchandise import payments had declined by 5.7 percent YoY, whereas services import payments had dropped by 28.2 percent. Meanwhile, trade credits mainly reflect the outstanding export bills (OEBs) of exporters, and is the payment amount that the exporter is expecting after shipping their goods.

intra-company loans from their affiliates to strengthen their own balance sheets.¹³

The net FDI into Pakistan fell by 35.9 percent during H1-FY21 YoY (Table 5.4), with net inflows dropping across most sectors. While gross investment inflows were slightly lower than last year, the main drop in net FDI was due to a sharp increase in gross outflows during the period. The higher outflows mainly reflected the repayment of intercompany loans by firms in the telecom, electronics and power sectors during the period.

Sector-wise Net FDI inflow in H1 Table 5.4
million US\$

	FY20	FY21	Change
Food	13.2	8.7	-4.5
Textiles	26.5	7.1	-19.5
Chemicals	-7.4	9.2	16.6
Oil & Gas	141.5	127.6	-18.5
Explorations			
Pharmaceuticals	25.2	10.9	-14.0
Electrical	117.8	60.2	-57.6
Machinery			
Electronics	-13.9	-6.2	7.7
Transport	48.3	14.3	-34.0
Equipment			
Power	262.2	497.1	234.9
Communications	432.1	-41.5	-473.5
Financial Business	162.1	127.4	-34.7
Others	162.8	124.6	-38.2
Total	1,372.1	879.7	-492.5

Source: State Bank of Pakistan

In terms of fresh investments into Pakistan, China dominated the profile, with investments continuing to flow into CPEC-

related projects in the power sector. In gross terms, investment from China rose by 46 percent YoY, and its share in Pakistan's gross FDI rose to 44.2 percent, up from 26.9 percent in the same period last year. However, on net basis, FDI from China actually declined by 1.5 percent, as FDI outflows to the country also accelerated from last year's levels.¹⁴

Here, it is important to note that it is still the Phase-I projects under CPEC that are deriving most of the FDI from China. In the second phase of CPEC, the investment focus is supposed to shift towards industrial development, agriculture mechanization, tourism and social development. However, these sectors are yet to see any significant foreign investment flows. Also, while global FDI had dropped in 2020, there were still some major developing economies that managed to attract higher foreign investment. FDI to developing Asian economies declined only 4 percent in 2020, with East Asian countries attracting around one-third of the global FDI in 2020.

While this indicates the need for further progress on the structural reform front in Pakistan, it also shows that Pakistani firms need to engage more actively in the global value chain, so as to land partnerships with major global companies.¹⁵

¹³ Source: Investment Trend Monitor, Issue 38, January 2021, UNCTAD.

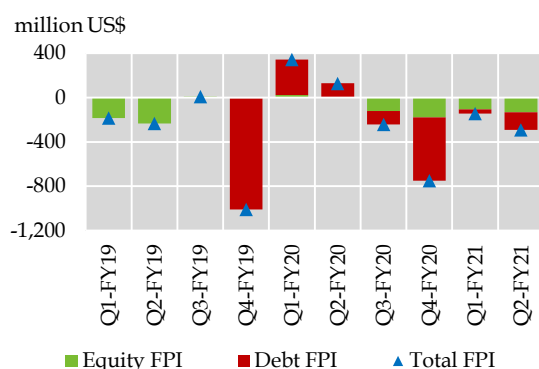
¹⁴ In H1-FY21, gross FDI outflows from Pakistan to China rose to US\$ 302.9 million, from US\$ 78.6 million in the same period last year. The outflow this year was concentrated in one major coal-fired project in Thar.

¹⁵ In this regard, the SBP has recently (February 2021) taken some major steps to ease foreign exchange regulations, with a view to facilitate Pakistani services firms and exporters in attracting foreign investment. Source: (<https://www.sbp.org.pk/press/2021/Pr-10-Feb-21.pdf>).

Foreign portfolio investment

As discussed earlier, the global financial markets recovered on the back of sizable support from the governments and the central banks. The emerging markets further benefited from the low interest rates in the advanced economies, which encouraged investors to search for higher yields in EMs. However, not all EMs benefitted equally from this phenomenon.

Foreign Portfolio Investment in Pakistan Figure 5.11



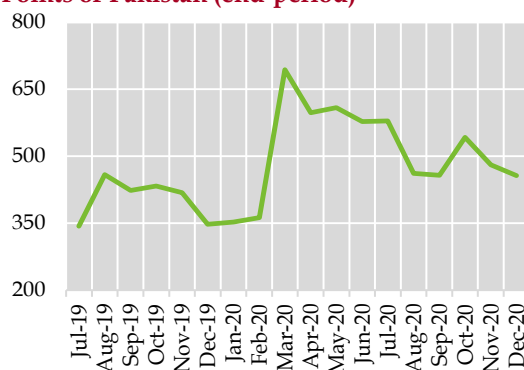
*Source: State Bank of Pakistan

In Pakistan’s case, foreign portfolio investment recorded a net outflow of US\$ 435 million during H1-FY21; outflows were

recorded from both debt and equity securities (Figure 5.11). It may be recalled that last year during the Jul-Dec period, Pakistan had received sizable portfolio investment in local currency debt securities (to the tune of around US\$ 452 million); however, there was an outflow of US\$ 193 million from debt securities this year. Similar to debt securities, equity securities also witnessed an outflow of US\$ 242 million in H1-FY21; this compares with a marginal net inflow of US\$ 18 million in the same period last year.

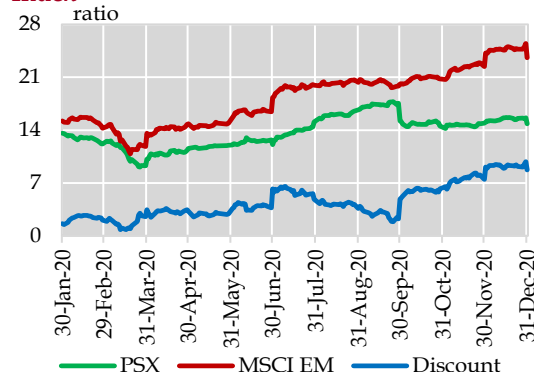
The trend of net FPI outflows from Pakistan’s equity market likely reflects the flight to safety and possibly also the elevated level of the country’s risk premium. While the credit default swap rates for the country’s sovereign debt have dropped by more than 150 basis points from the March 2020 level, they are still higher as compared to the pre-Covid level at end-December 2019 (Figure 5.12a). However, it is worth noting that the KSE-100 index’s price-to-earnings (p/e) discount to the MSCI Emerging Markets Index has been widening since September 2020, indicating that Pakistani equities are becoming more attractive for foreign investors in relative terms (Figure 5.12b).

5-Years Credit Default Swaps Points of Pakistan (end-period) Figure 5.12a



Source: Bloomberg

PSX P/E Discount to MSCI EM Index Figure 5.12b

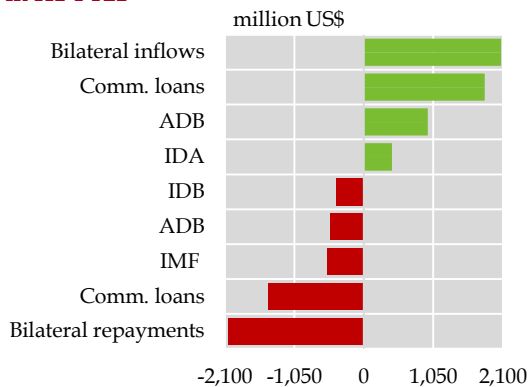


Net incurrence of liabilities

The net inflow of external loans and liabilities into Pakistan dropped to US\$ 1.5 billion in H1-FY21, which was less than one-third of last year’s level. The lower net inflows mainly reflected the following: (i) return of US\$ 2 billion of bilateral deposits by the central bank; (ii) retirements of FX liabilities by commercial banks; and (iii) lower gross borrowing by the government and the private sector.

Multilateral and commercial lending dominated the official borrowing profile, especially in the second quarter of FY21. At the same time, bilateral deposits and swap lines also helped the central bank manage its liability reduction without pressuring the official reserves (Figure 5.13). It is also worth highlighting that the maturity profile of the government’s external debt has lengthened, as net short-term borrowings were lower than last year (for details, see Chapter 4). This change in the maturity structure, along with low global interest rates, bode well in terms of the country’s external debt servicing perspective.

Change in Official FX Liabilities in H1-FY21 Figure 5.13

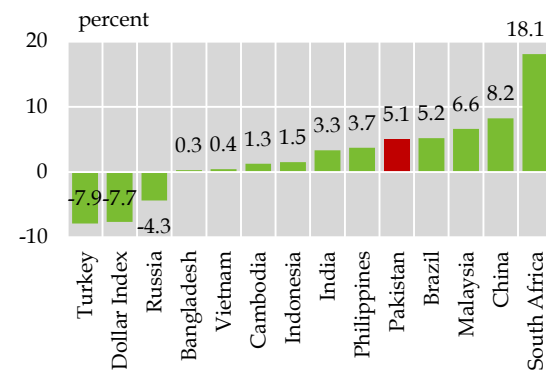


Sources: State Bank of Pakistan and EAD

5.3 Exchange Rate and Reserves

After a brief period of sharp volatility in the immediate aftermath of the Covid-19 outbreak, the currencies of many EMs have been strengthening against the US Dollar. Generally improving current account balances, a revival in capital flows (to some major EMs), and EM central banks’ efforts to increase their external buffers in the wake of the initial Covid shock, all were mainly responsible for the appreciation in EM exchange rates (Figure 5.14).

Change in EM Currencies against USD during H1-FY21 Figure 5.14



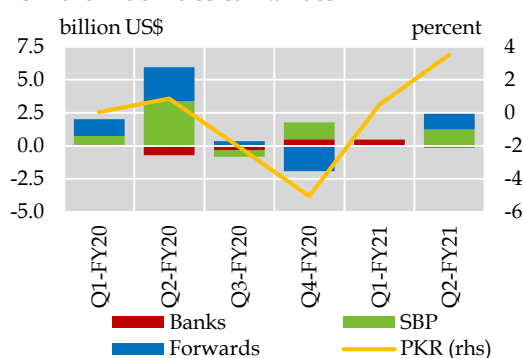
Source: Bloomberg

In Pakistan’s case, the improvement in the current account, and the availability of external financing, both played a role in pushing up the country’s overall FX reserves by 10.6 percent in H1-FY21, and a 5.1 percent appreciation in the Pak Rupee. Reserves held by the State Bank as well as commercial banks rose over the six-month period, though some notable differences were observed between the first and second quarters.

In the first quarter, commercial banks’ reserves had risen by 7.1 percent, at least partially in response to a build-up in the

outstanding export bills.¹⁶ At the same time, the SBP's reserves had remained stable, as the available external financing was sufficient for the official debt repayments. In this scenario, the Rupee had appreciated by 1.4 percent against the US Dollar (**Figure 5.15**).

Change in FX Reserves, SBP's Forward Liabilities & Ex. Rate **Figure 5.15**



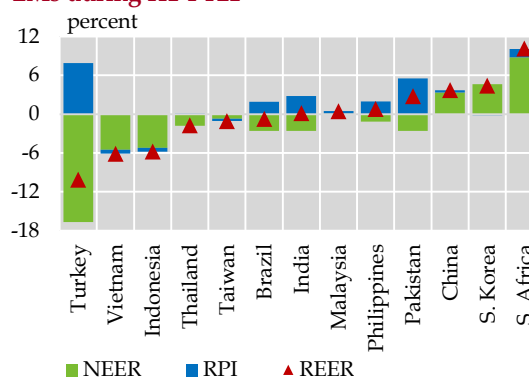
Source: State Bank of Pakistan

In the second quarter, there was a trend reversal, as the central banks' reserves rose by 10.4 percent, whereas reserves held by commercial banks declined by 1.2 percent. While the interbank market remained liquid as the cumulative current account remained in surplus, the net official FX loan inflows were much higher than in Q1 (**Section 5.3**). These inflows, along with efforts to increase official buffers, pushed up the central bank's FX reserves.

For commercial banks, the reduction in the magnitude of the current account surplus and the emergence of some import payment pressures led to a marginal drop in their reserves in Q2. In line with these developments, the Pak Rupee appreciated by 3.7 percent in the second quarter, mainly reflecting the trend in the official reserves.

While Pakistan's nominal exchange rate had appreciated against the USD, in broader terms, the country's NEER actually depreciated during the period (**Figure 5.16**).¹⁷ This indicates that the PKR had weakened against a trade-weighted basket of other currencies in nominal terms. However, the increase in price levels in Pakistan relative to its trading partners led to an increase in the relative price index (RPI). The rise in RPI completely offset the NEER depreciation in Pakistan's case and led to a cumulative 2.8

Breakdown of Change in REER of EMs during H1-FY21 **Figure 5.16**



Sources: Haver Analytics & SBP calculations

¹⁶ In March via EPD Letter Circular No. 7 of 2020, exporters were allowed to hold back export receipts that were due to arrive by end-June 2020, for an additional 90 days; this was applicable where the delays were related to Covid. This was on top of the 180 days for which exporters were already allowed to keep their proceeds abroad.

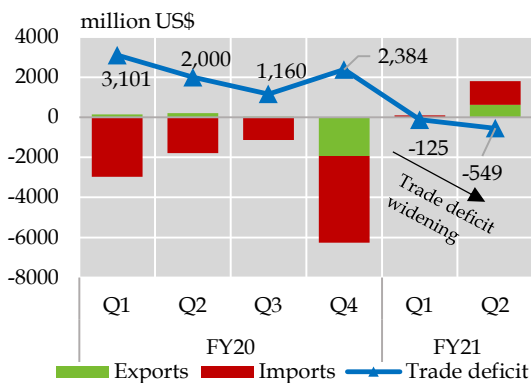
¹⁷ The IMF defines NEER as "a measure of the value of a currency against a weighted average of several foreign currencies. An increase in NEER indicates an appreciation of the local currency against the weighted basket of currencies of its trading partners". Source: <https://datahelp.imf.org/knowledgebase/articles/537469-what-is-nominal-effective-exchange-rate-neer>

percent appreciation in the country’s REER during the period. Here, it is worth noting that Pakistan was not alone in experiencing a REER appreciation, as REERs of some other major EMs, like China and South Africa, also rose during the period.

5.4 Trade Account

The trade deficit widened by 5.8 percent and reached US\$ 12.3 billion in H1-FY21, from US\$ 11.7 billion in the same period last year. The widening in the trade deficit, which accelerated in the second quarter, was mainly due to rising imports, which had overshadowed the increase in exports, especially in the second quarter (Figure 5.17).

Breakdown of Change in Trade Deficit Figure 5.17



Source: Pakistan Bureau of Statistics

Within imports, lower energy imports – due to lower international oil prices – were more than offset by higher imports of industrial raw materials, power generation machinery, food products, cotton, and mobile phones. On the other hand, exports rose, mainly on the back of high-value added textile products, which increased significantly in the second quarter and reached their highest level ever in H1-FY21.

Exports

The exports increased by 5.1 percent to US\$ 12.1 billion in H1-FY21 – the highest level in any half since H2-FY11. After staying almost unchanged in the first quarter, exports rose in the second quarter by 10.4 percent YoY to US\$ 6.6 billion, depicting a V-shaped recovery (Figure 5.18). The growth in exports became broad-based and more pronounced as the year progressed (Table 5.5).

The post-outbreak accommodative policies propped up industrial activity and contributed to the rise in export volumes of many major items. These policies included: (i) gas and power subsidies through the industrial support package;¹⁸ (ii) extensions in the validity of erstwhile zero-rating certificates;¹⁹ (iii) a cumulative Rs 190 billion

¹⁸ Main features of the Policy: a) Base electricity tariff of Rs 12.96/KWh to be charged from November 1, 2020 to October 31, 2023 for incremental consumption in off-peak hours over consumption in corresponding period March 2019 to February 2020; b) Rate of Rs 12.96/KWh reduced to Rs 8/KWh on incremental consumption basis for off peak hours from November 1, 2020 to June 30, 2021; c) Abolishment of Time of Use Tariff Scheme from November 1, 2020 to April 30, 2021, meaning same tariff (Rs 12.96/KWh on incremental consumption basis) during off-peak and peak hours.

¹⁹ While the government had withdrawn the zero-rated sales tax scheme for top five exporter industries of the country at the start of FY20, it continued to provide them subsidized power and gas utilities. The zero-rating certificates, however, were going to expire on March 31, 2020. But, amidst the pandemic, the government decided to extend their expiry dates piecemeal-wise till November 30, 2020. Nonetheless, while the gas tariff was fixed at US\$ 6.5/MMBtu throughout, power tariff was revised upwards from 7.5 cents/KWh to 9.0 cents/KWh effective September 1, 2020.

Pakistan's Major Exports**Table 5.5**

million US Dollars

Groups/Items	Q1FY21	Abs. Change (YoY)	Q2FY21	Abs. Change (YoY)	H1FY20	H1FY21	Abs. Change (YoY)
Textile group	3,470	98	3,973	439	6,905	7,442	537
Non-textile group	2,002	-136	2,666	185	4,619	4,668	48
Textile	3,470	98	3,973	439	6,905	7,442	537
LVA textiles	628	-180	709	-57	1,573	1,336	-236
Apparel	1,562	116	1,778	224	2,999	3,340	340
Home textiles	856	74	984	188	1,577	1,840	262
Other textiles	173	25	207	32	323	379	56
Food	807	-178	1,224	10	2,200	2,030	-169
Rice (a+b)	360	-110	603	41	1,033	963	-70
a) Basmati	121	-76	108	-77	381	228	-153
b) Non-basmati	239	-35	496	118	652	735	83
Fish & prep.	78	-1	117	-29	225	195	-30
Fruits & vegetables	135	-13	204	7	345	339	-6
Meat & prep.	75	5	86	1	156	161	6
Petroleum	46	-16	46	-59	168	93	-75
Petroleum crude	15	-22	29	-44	110	44	-67
Petroleum prod.	8	-2	10	-5	24	18	-6
Other Manu.	782	-22	912	97	1,620	1,695	75
Raw leather	31	-21	41	-11	104	72	-32
Leather manu.	146	14	147	3	275	292	18
Medical instru.	105	-2	109	8	207	213	6
Chemicals & pharma	224	-18	327	95	475	551	76
Cement & products	72	6	71	-8	145	143	-2
Total Exports	5,472	-38	6,638	624	11,524	12,110	586

Source: Pakistan Bureau of Statistics

enhancement in the limits of refinancing for banks under the Exports Finance Scheme (EFS) and the Long Term Financing Facility (LTFF); (iv) loans deferment and restructuring; (v) payroll support under the Rozgar Scheme; and (vi) the Temporary Economic Refinance Facility (TERF).²⁰ Additionally, sales tax refunds rose significantly in the first half.²¹

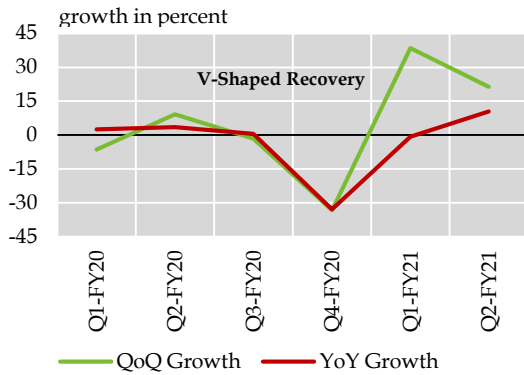
On the demand side, Pakistan was able to maintain or increase its share in the destination markets due to unmet demand from competitors. This was particularly true for textile items, especially high value-added textiles, which were primarily responsible for the gradual improvement in the overall export performance.²²

²⁰ For details on some of these schemes, see **Chapter 3: Monetary Policy and Inflation**.

²¹ Sales tax refunds increased by almost 339 percent from Rs 17 billion last year to Rs 76 billion in Jul-Nov FY21. (Source: FBR)

²² Aggregate textile exports grew by 7.8 percent and reached US\$ 7.4 billion in H1-FY21, thereby crossing the US\$ 7.0 billion mark for the second time ever – the other time being the second half of FY11.

Recovery in Pakistan's Exports from the Pandemic **Figure 5.18**



Source: Pakistan Bureau of Statistics

Meanwhile, the non-textile exports, after declining in the first quarter, also picked up momentum in the second quarter, mainly on

the back of higher exports of rice, fruits, medical and surgical instruments, chemicals and pharmaceuticals. However, due to the drag from the first quarter, non-textile exports stood nearly unchanged at US\$ 4.7 billion on half-yearly basis.

It is important to note here that in an effort to safeguard, promote and increase the export share of Pakistan's unique products in the international market, the government is currently working on enlisting and registering Geographical Indications (GI) tags for such products under a recently introduced law. **Box 5.1** sheds some light on the implications of GI tags for the country's exports.

Box 5.1: Implications of Geographical Indications Tagging for Exports of Pakistan

Appropriate product differentiation and certification can help a country's exports fetch relatively higher unit prices in the global market. In this context, this Box briefly discusses the recent developments in the area of Geographical Indications (GI) tagging, which can potentially have a beneficial impact on Pakistan's exports by creating a distinct market identity of some export items, thereby allowing exporters to get higher unit prices and contribute to the country's foreign exchange earnings.

Geographical Indications are defined by Article 22 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (WTO) as: "indications which identify a good as originating in the territory of a Member [of the WTO], or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin".²³

There are a number of goods, both natural and manufactured, in Pakistan that carry unique characteristics because they are exclusively borne out of a particular locality, climate, set of traditions and/or a group of people. These include, but are not limited to, Basmati rice, Khewra pink salt, Swat peaches, Sindhri mangoes, Qasuri *haldi/methi*, Peshawari *chappal*, Multan blue pottery, truck art, and Sindhi *ajrak* (**Table 5.1.1**). However, lacking awareness, resources, and business management and product marketing skills, the producers and/or exporters of these products generally neglect to build a brand, or register for appropriate rights to protect their products in the international market from counterfeiting and other infringements.

²³ Source: (https://www.wto.org/english/docs_e/legal_e/27-trips_04b_e.htm#3)

GI tags are generally used by the governments to prevent manipulation of domestic products by the foreigners. The process is as follows. First, the government sanctions these tags to the products in light of national legislation on protection of intellectual property. Afterwards, they apply for protection in other countries. Pakistan introduced its own comprehensive GI law in March 2020; until then, the country lacked legal grounds to protect its products, both within and beyond its borders.

Once established, the national GI tags can be extended internationally through four channels:

a) by providing direct protection in the concerned jurisdiction; b) by concluding agreements with other states or commercial

partners; c) through the Lisbon Agreement for the Protection of Appellations of Origin and their International Registration; and d) via the Madrid System for the International Registration of Marks.²⁴ The World Intellectual Property Organization (WIPO) administers the last two channels. Currently, the number of countries, unions or regions that are party to these are 34 and 86, respectively. According to Bramley et al. (2009), the economic rationale behind GI protections, both local and international, is based on following three key factors.²⁵

a) Information asymmetries and the role of reputation: Through GIs, the place of origin can be used as a quality signal, thereby removing information asymmetries between producers and consumers. To improve signaling, the resources of the region (such as production techniques, varieties, landscape, environment and culture) can be mentioned in the origin-labelled product packaging as quality attributes, thereby bringing reputation and increasing the value of the product over time.

b) Improved market access: The value added from these resources creates differentiation based on the product's "qualities" and consequently leads to the institutionalized formation of niche markets. The producers can not only protect and enhance their market share, but can also convert economic rent into premium. For instance, the French origin-labeled cheese earns, on average, two Euros per kilogram more than the French non-origin-labeled cheese. Similarly, the market price of the French poulet de Bresse is four times that of the regular French chicken. And the producers of milk used for the origin-labelled Comté cheese are paid 10 percent above the regular milk prices, while producers of Italian Toscano olive oil fetch a 20 percent premium ever since obtaining registration under the geographical indication in 1998.

c) Rural development potential: In the developing country context, the GIs provide a potential tool for rural producers to enter a niche market, fetch premium prices, and facilitate improved living conditions through higher earnings. A case study, quoted by the WIPO, is that of Cameroon's Oku white honey. Using protective GI, the producers were able to add value to their Oku honey products, which would then be sold in niche markets, both local and foreign, to consumers willing to pay higher prices; this

Table 5.1.1: List of Some Prospective GI Indications

Basmati Rice	Hunza/Ziarat Apples
Bahawalpur Chunri	Multan Blue Pottery
Bhakkar Karna Oil	Multan Chounsa (Mango)
Chitrali Embroidery	Namal Trout
Gujranwala Colored Pottery	Sailkot Sports/Surgical Goods
Hala ki Ajrak	Qasuri Methi and Haldi
Hunza Apricot	Sahiwal Cattle
Kamalia Khadar	Peshawari Chappal
Kashmir Pashmina	Sindhi Topi/ Ajrak
Khattak Dance	Sindhri Mango
Khewra Pink Salt	Swat Peaches
Kilash Dress	Truck Art

Source: Section 52(2) of GI Act (2020)

²⁴ Source: wipo.int/edocs/pubdocs/en/geographical/952/wipo_pub_952.pdf#page=8

²⁵ Bramley, C., Estelle, B., and Johann K., "The Economics of Geographical Indications: Towards a Conceptual Framework for Geographical Indication Research in Developing Countries", The Economics of Intellectual Property (2009), World Intellectual Property Organization.

slightly improved the producers’ livelihoods over time. In 2014, one liter of processed Oku honey commanded a price of US\$ 7.5; before the GI tag, it used to fetch US\$ 2.8 per liter.²⁶

In case of Pakistan, a recent case in GI Tagging is that of the basmati rice. This aromatic rice variety is considered one of the world’s most premium, and is produced and exported by only two countries - Pakistan and India. The quality of basmati rice is reflected in its much higher unit values vis-à-vis non-basmati rice varieties. Since September 2020, however, the two countries are engaged in a legal process that is playing out in the European Union, over the usage of the “basmati” label.²⁷

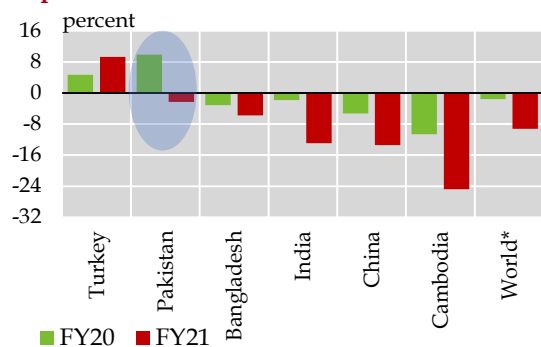
The recent measures taken by Pakistan to put in place the needed legal and regulatory framework for GI tagging are a step in the right direction. That said, Pakistan also needs to expedite the domestic registration of other exportable and GI-worthy products. In October 2020, the government announced a ‘non-exhaustive indicative list of prospective geographical indications’ that included 79 assorted items at the time (Table 5.1.1). These products have the potential to increase the country’s export earnings, mainly by fetching premium prices, and from increased market access and endorsements by international companies and brands. Furthermore, higher sales of these products would also contribute towards rural development and employment.

High-value added textiles cross half a billion dollar mark for the first time

The high-value added items – apparel and home textiles – rose 13.2 percent to US\$ 5.2 billion in H1-FY21 YoY. In case of apparel,

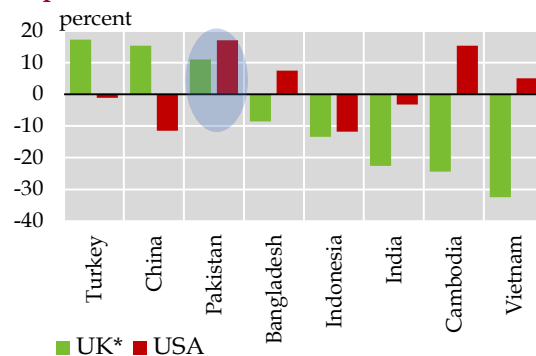
exporters received higher orders, including some that were diverted from regional competitors where relatively stricter Covid-related mobility restrictions were in place. In fact, despite a drop in demand for these products in the advanced economies

Growth in YoY Quantum Apparel Imports of the EU27 in H1 Figure 5.19



*Jul-Nov
Source: Eurostat

Growth in YoY Quantum Apparel Imports of the USA and UK in H1 Figure 5.20



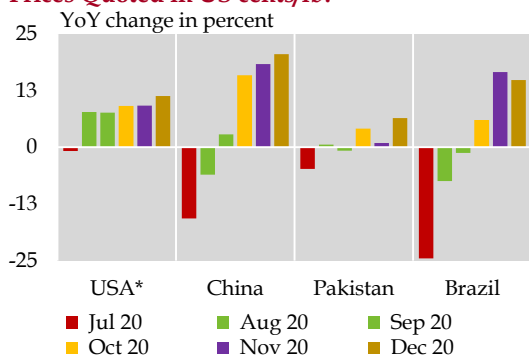
*Jul-Oct
Sources: OTEXA and Eurostat

²⁶ Source: wipo.int/ipadvantage/en/details.jsp?id=5554

²⁷ It is worth noting that the EU is a major importer of aromatic rice, and any decision by the bloc on GI tagging for basmati rice will likely have wide-ranging implications for both major South Asian rice exporters.

(the US, EU-27 and the UK) amid lockdowns, their imports from Pakistan either increased during the period or were relatively stable as compared to competitor countries (Figures 5.19 and 5.20).^{28,29}

Trend in International Cotton Prices Quoted in US cents/lb. Figure 5.21



*New York front month/futures

Source: Emerging Textiles

The Pakistan government's facilitative policies, as indicated earlier, contributed towards improving the liquidity position of the textile exporters and allowed them to enhance their capacity utilization. These policies likely led to a net retirement of

working capitals loans by the textile sector, as opposed to a net loan uptake during the same period last year.³⁰ There was also a significant uptick in the fixed investment loans by the textile industry, as some firms pursued capacity expansions amidst the dynamic demand.³¹

Furthermore, Pakistan has been one of the beneficiaries of China's declining share in the US' apparel market due to the US-China trade tensions, which was further compounded by the pandemic in the first half of CY-20.³² In addition, China, the world's largest textile and apparel producer and exporter, has been shifting its focus over the last few years on maintaining or improving its share in the global textiles market rather than in apparel, thereby rooting itself deeper into the global textile value chain. This has created some space for its Asian competitors, including Pakistan, to increase their shares in the global apparel market.

In case of home textiles (bedwear and towels), exports increased by 16.6 percent

²⁸ It should be noted here that following the end of post-Brexit "transition period" on Dec 31, 2020, Eurostat does not publish data for the UK on its website anymore. The latest available data for the UK's apparel imports is till Oct-2020.

²⁹ Even though Pakistan's overall apparel shipments to the EU-27 declined slightly, it should be noted that this decline was led by woven clothes, and not knitwear, whose shipments were nearly the same as last year. This also goes on to show that Pakistan managed to receive some deflected orders for knitwear clothes from the European buyers as well.

³⁰ There was net retirement of working capital loans (including trade finance) of Rs 13.7 billion by the textile industry in the first five months of H1-FY21, against a net uptake of Rs 73 billion loans during the same period last year.

³¹ The textile industry undertook fixed investment loans of Rs 21.4 billion during Jul-Nov FY21. This was almost double from last year's loan uptake of Rs 11.2 billion.

³² Based on a survey of executives from leading US fashion importers, retailers, brands, and wholesalers, a US fashion industry report highlighted that: Covid-19 and the trade war are pushing US fashion companies to reduce their "China exposure" further. Moreover, "China plus Vietnam plus Many" is the most popular clothing and apparel sourcing model among the respondents. Source: USFIA (2020), *2020 Fashion Industry Benchmarking Study*, Washington, DC: United States Fashion Industry Association.

YoY to US\$ 1.8 billion in H1-FY21. The rise came on the back of higher unit values, which, in turn, could be partly attributed to exporters passing on the impact of elevating domestic and imported cotton prices to end-consumers abroad (**Figure 5.21**).^{33,34} It should be noted that the EU-27, which imports around two-fifths of its total home textiles from Pakistan, witnessed an increase in the average unit values for its overall imports of these products from the world.³⁵ Pakistan's share in the largest single market increased from 36.8 percent to 39 percent during the Jul-Dec periods of FY20 and FY21, according to Eurostat data. This shows that the country was able to increase its market share there at even slightly higher unit values.

Moreover, due to higher demand for personal protective equipment (PPE) from foreign buyers, the exports of other textile made-ups (excluding towels and bedwear) reached their highest-ever level of US\$ 379 million in the first half of FY21.

At the lower end of the value chain, the country's major cotton-based goods (fiber, fabrics, and yarn) registered their lowest first half exports in dollar terms since at least H1-FY06. Cumulative exports of these products declined 15 percent to US\$ 1.3 billion in H1-FY21, mainly due to lower exports of cotton

yarn. On the supply side, a major factor was the shortfall in domestic cotton production (FY21), not to mention the primary textiles market feeding to the demand from exporters of finished textile products. On the demand side, possible reasons included the availability of sufficient stocks with the major importing countries, or their upstream value-added products faced lower demand from the world in the face of the second wave of Covid-19.³⁶

Tough competition and relatively higher unit prices see rice exports decline

Rice exports declined by 6.7 percent to US\$ 963 million in H1-FY21 YoY. These exports, after declining consecutively in the first four months of FY21, recovered considerably in November and December 2020; however, the increase in these two months was not sufficient to offset the initial declines.

Basmati rice exports declined by 40 percent to US\$ 228 million. Shipments fell drastically to the major markets in the Middle East, where India was able to ship 23 percent more basmati rice during H1-FY21 on YoY basis (**Figure 5.22**).³⁷ Anecdotal evidence suggests that Indian exporters, unlike their Pakistani counterparts, managed to make further inroads into their biggest market, Iran.³⁸

³³ As a consequence of poor cotton crop output, domestic cotton prices rose by 5.6 percent from Rs 8,577 per maund to Rs 9,058 during first halves of FY20 and FY21. (Data source: Emerging Textiles). It should be noted that PKR depreciation (YoY) did blunt this impact slightly, but not completely.

³⁴ Faced with domestic shortage, Pakistan's raw cotton (uncarded) imports from both the US and Brazil increased 5.3 times on a cumulative basis from a year ago to US\$ 264 million during H1-FY21 (source: PBS).

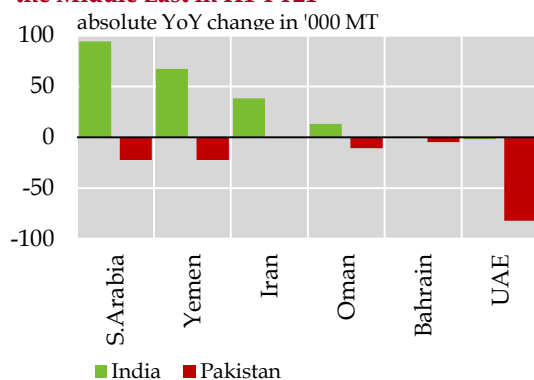
³⁵ In USD/100 kg terms, unit values of EU's home textile imports from the world rose 1.1 percent during Jul-Dec FY21 (source: Eurostat).

³⁶ For instance, Pakistan's quantum exports of cotton yarn to both China and Bangladesh decreased nearly 17 percent to 0.14 million tons in H1-FY21, from 0.17 million tons a year earlier (Source: PBS).

³⁷ Source: Ministry of Commerce and Industry (India).

³⁸ India and Iran already have a barter-like system in place.

Quantum Basmati Rice Exports to the Middle East in H1-FY21 Figure 5.22



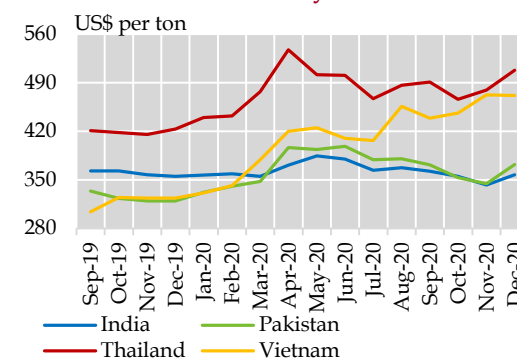
Sources: PBS and Ministry of Commerce (India)

They have also been stocking up basmati rice at distribution points in Iran and selling it from there, at lower prices than Pakistan, and even on credit.³⁹ As a result, Pakistan's shipments to the UAE dropped precipitously in the Jul-Dec period, as most of the Pakistani rice was previously being transshipped to Iran via the Dubai port.

Shipments of non-basmati rice declined in the first four months of FY21, as India offered the most competitive prices vis-à-vis some of the major rice exporters, owing to its ample stocks and repeated bumper crops (Figure 5.23).⁴⁰ Nonetheless, with the arrival of new crop and price gap with India narrowing, Pakistan's exports did pick up in November and December 2020. That said, due to higher domestic prices amid tight supplies before the arrival of the new crop, the price impact

was much stronger than the overall quantum impact in the Jul-Dec period. Consequently, in value terms, non-basmati rice exports rose

International Price Comparison of Non-Basmati Rice Variety* Figure 5.23



* 25% broken

Source: Food and Agriculture Organization

12.7 percent to US\$ 735 million on a YoY basis during the period under review.

Cement exports volume reach highest level since FY15

Shipments of cement and cement products reached their highest level in H1-FY21 since FY15, mainly due to considerably higher clinker exports to China and Sri Lanka.⁴¹ China has been using infrastructure investment as a primary tool to revive its economy after the Covid-19 outbreak.⁴² Meanwhile, Sri Lanka began an AIIB-sponsored infrastructure project in early November 2020, which likely increased its

³⁹ Average unit value of Indian basmati rice exports declined from US\$ 1,054 per ton to US\$ 866 per ton during Jul-Nov periods of FY20 and FY21. Meanwhile, the unit price of Pakistan's basmati exports increased from US\$ 889 per ton in H1-FY20 to US\$ 989 per ton in H1-FY21 (source: Ministry of Commerce and Industry, India, and Pakistan Bureau of Statistics).

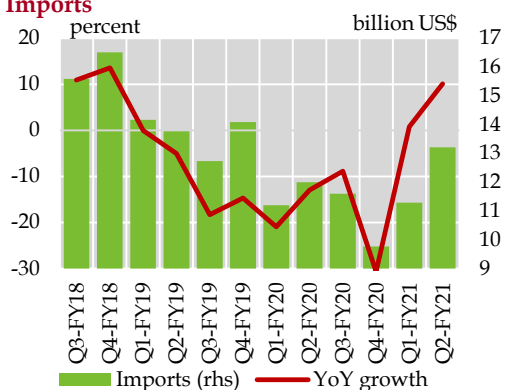
⁴⁰ USDA 2020. *Grain World Trade Report December 2020*. Washington, DC: United States Department of Agriculture.

⁴¹ Cumulative volume of clinker exports to China and Sri Lanka rose 6.3 times to 0.7 million tons in H1-FY21 on YoY basis (source: PBS).

⁴² China's cement production increased by 7.3 percent in H2-CY20 YoY (source: Haver Analytics).

demand for construction material.⁴³ Nevertheless, in value terms, cement and product exports cumulatively registered a slight decline of 1.6 percent to US\$ 143 million, owing to lower unit values on YoY basis.

Quarterly Trend of Pakistan's Imports **Figure 5.24**



Source: Pakistan Bureau of Statistics

Imports

In H1-FY21, Pakistan's imports increased in consecutive quarters for the first time since Q4-FY18. Imports grew by 0.8 percent and 9.8 percent respectively in Q1 and Q2 of FY21 (Figure 5.24).⁴⁴

While the revival in economic activity, which gained traction in the second quarter, contributed strongly to the broad-based quantum increase, the import of agri-products especially contributed to the trend

Pakistan's Major Imports during H1 **Table 5.6**

million US\$					
Groups/Items	FY20	FY21	Abs. change	Quant. effect	Price effect
Energy	6,142	4,771	-1,371	1446	-2817
POL prods.	2,591	2,169	-422	1,233	-1,655
Crude oil	1,771	1,323	-448	296	-744
LNG	1,627	1,052	-575	-25.9	-549
Chemical	3,822	4,045	223	-	-
Fertilizer	433	325	-108	-105	-2
Plastic mat.	948	1,119	171	341	-170
Other chem.	1,848	1,974	125	-	-
Transport	837	1,133	296	-	-
Cars	261	465	204	-	-
CBUs	32	95	62	-	-
CKDs	229	370	144	-	-
Truck & buses	129	179	51	-	-
Aircraft & ships	211	257	46	-	-
Metals	2,073	2,291	218	-	-
Steel scrap	806	949	143	242	-99
Iron & steel	763	859	95	215	-120
Food	2,567	3,905	1,339	-	-
Tea	229	286	57	78	-21
Palm oil	842	1,112	269	63	206
Wheat	0	661	661	-	-
Sugar	2	127	125	134	-9
Textile	980	1,665	686	-	-
Raw cotton	87	532	445	495	-50
Syn. yarn	273	320	48	164	-116
Machinery	4,433	4,241	-192	-	-
Power gen.	650	821	170	-	-
Electrical	1,192	640	-552	-	-
Construction	81	54	-27	-	-
Cell phones	616	939	323	-	-
Other mach.	1,185	1,083	-101	-	-
All other items	1,921	1,796	-125	-	-
Total imports	23,195	24,454	1,259	-	-

Source: Pakistan Bureau of Statistics

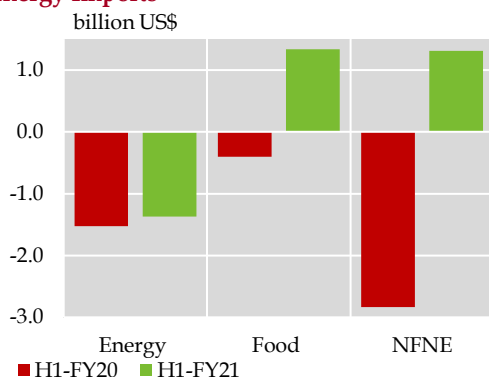
⁴³ Source: (https://www.china.org.cn/world/Off_the_Wire/2020-11/04/content_76876333.htm)

⁴⁴ Aggregate imports in H1-FY21 increased by a significant 5.4 percent YoY, compared to the 17.0 percent and 20.3 percent YoY declines witnessed in H1-FY20 and H2-FY20, respectively.

reversal in imports in H1-FY21 (**Table 5.6**).^{45,46}

Specifically, the country had to import sizable quantities of wheat, sugar and cotton to address the domestic demand-supply gap and to stabilize their domestic prices. On the other hand, benign global energy prices – which remained 26.3 percent lower from H1-FY20, as per the World Bank’s Energy Price index – reined in Pakistan’s energy value imports despite a sharp increase in their quantum imports (**Figure 5.25**).

Changes in Energy and Non-Energy Imports **Figure 5.25**



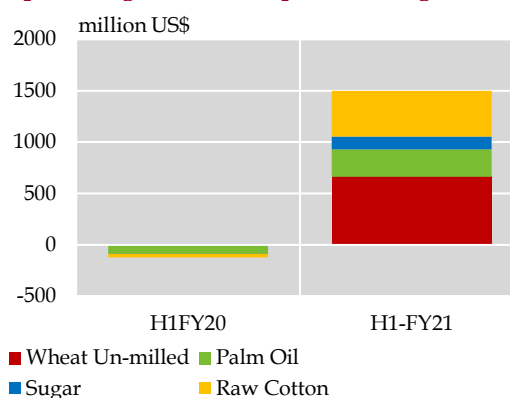
Source: Pakistan Bureau of Statistics

Agri-products – wheat, sugar, palm oil, and cotton – largely contributed to the expansion in the trade deficit

In H1-FY21, the import of food products increased by a remarkable 52.2 percent to

US\$ 3.9 billion from US\$ 2.6 billion in H1-FY20; higher import quantities were the dominant factor behind the increase in imports. In case of palm oil, however, higher international prices were the major reason behind the rise in import values (**Table 5.6**).

Impact of Agri-Product imports **Figure 5.26**



Source: Pakistan Bureau of Statistics

Together, the increase in imports of key agricultural products –wheat, sugar, palm oil and cotton – elevated Pakistan’s imports by US\$ 1.5 billion. In terms of impact, this upsurge is more than the US\$ 1.3 billion YoY rise in Pakistan’s overall imports in H1-FY21 (**Figure 5.26**). Pakistan imported US\$ 661 million of wheat and US\$ 127 million of sugar during H1-FY21. In contrast, in H1-FY20, Pakistan had exported US\$ 11.4 million of wheat and US\$ 70.7 million of sugar.⁴⁷

⁴⁵ Import values of agri-products such as, sugar, wheat, cotton and palm oil were 131 percent higher in H1-FY21 compared to its first half average values of last five years.

⁴⁶ According to the FBR, Pakistan Customs cracked down on the illegal imports of a number of commodities. This may have contributed to an increase in the imports via legal channels (<https://www.fbr.gov.pk/fbr-achieves-highest-monthly-growth-in-december-during-juldec-2020/152791>).

⁴⁷ In H1-FY19, Pakistan had exported US\$ 97.2 million (461.3 thousand metric tons) of wheat and US\$ 74.9 million (252.4 thousand metric tons) of sugar, respectively.

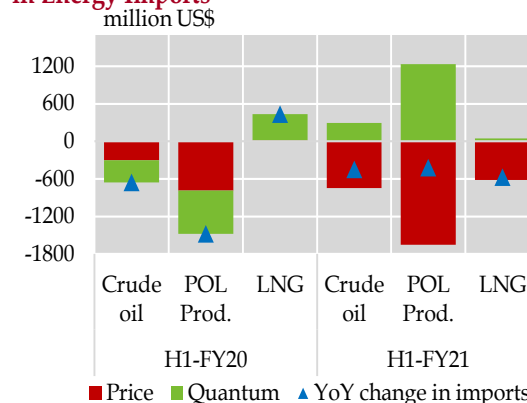
Below-target crop output resulting from bad weather and pest and locust attacks last year mostly led to the import of cotton and sugar this year. On the other hand, some disruption in the supply chain necessitated higher import of wheat. While the growth in wheat production was 2.5 percent in FY20, the below-target procurement of the commodity triggered uncertainty in the wholesale and retail markets. This led to a shortage of the commodity and a hike in its price.⁴⁸ To stabilize domestic prices and build strategic reserves, the government reverted to the import of wheat in H1-FY21. The situation was not very different for sugar, where the decline in domestic production due to the lower output of the sugarcane crop in FY20 may have led to tight supplies of the commodity. The government resorted to sugar imports to control the unwarranted increase in sugar prices in H1-FY21.

The increase in imports of palm oil in H1-FY21 was mostly price-driven. Global palm oil prices increased 33.3 percent in the first half of FY21, with contribution from both demand- and supply-side factors. On the supply side, palm oil production in Malaysia declined by 100,000 metric tons during MY2020-21.⁴⁹ On the demand side, India reduced its basic customs duty on the import of crude palm oil from 37.5 percent to 27.5 percent in November 2020 to control the anticipated inflationary pressures in the country.⁵⁰ Moreover, Indonesia increased the

palm oil export levy by US\$ 5 per ton in June 2020.⁵¹

Also, cotton production in Pakistan was 6.9 percent lower in FY20 due to exceptionally heavy monsoon rains and pest attacks. The situation remained similar in FY21, and there was a notable decline of around 10 percent in the crop's area. Estimates suggest that cotton production may decline by a further 24.0 percent in FY21 from last year.⁵² As Pakistan's textile exports are increasing, the shortfall in the domestic cotton is being met via increased imports. Therefore, raw cotton imports increased by US\$ 445 million in H1-FY21; with quantum imports increasing to 282,000 metric tons from a mere 50,000 metric tons in H1-FY20.

Contribution of Unit Price & Quantum Effects to YoY Change in Energy Imports Figure 5.27



Source: Pakistan Bureau of Statistics

⁴⁸ For details, see the SBP's First Quarterly Report FY21 on the State of Pakistan's Economy.

⁴⁹ Source: USDA Report # MY2020-0014, dated December 17, 2020.

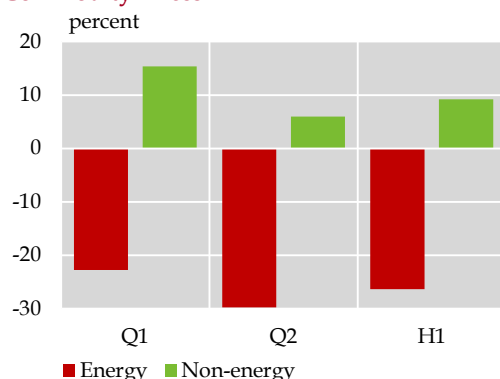
⁵⁰ India is the largest importer of edible oil and imports around 15 million tons annually from different countries, including Indonesia and Malaysia.

⁵¹ The Indonesian government is promoting the use of biodiesel as an energy source to reduce its dependency on imported diesel. To support this objective, the government in Indonesia imposed Crude Palm Oil (CPO) levy.

⁵² Source: USDA Report # PK2020-0014, dated December 2, 2020.

YoY growth in Global
Commodity Prices in FY21

Figure 5.28



Source: The World Bank

Lower oil prices kept the energy imports in check

Energy imports declined by a sharp 22.3 percent YoY to US\$ 4.8 billion in H1-FY21, after dropping 19.9 percent in the same period last year (Figure 5.27). While quantum imports increased by 23.5 percent in H1-FY21, an almost 37.1 percent decline in unit prices more than offset the impact of the quantum increase.

Uncertainty related to the spreading pandemic and its impact on the major economies kept the international energy prices at a lower level as compared to last year (Figure 5.28). On the other hand, the revival in economic activity in Pakistan – as evidenced by an 8.2 percent YoY increase in the LSM index in H1-FY21 – increased the demand for energy products.

As the domestic production of crude oil and gas declined by 6.6 percent and 3.5 percent YoY in H1-FY21, respectively, the

Fuel-wise Power Generation
during Jul-Dec*

Table 5.7

	FY20		FY21	
	Value	Abs. Change YoY	Value	Abs. Change YoY
Furnace oil	2,491	-3,153	2,891	400
LNG**	13,853	167	14,754	902
Hydro	22,412	3,474	23,702	1,290
Coal	12,704	4,751	12,702	-1
Natural gas	7,970	-3,211	7,027	-943
Nuclear	4,672	-802	4,330	-343
Others	3,025	81	2,641	-384
Total	66,467	1,308	68,047	1,580

*Excluding K-Electric

Source: NEPRA

country's dependence on the imported fuel increased in H1-FY21 not only for power generation but also for other economic activities, such as usual transport services (Table 5.7).

In H1-FY21, power generation increased by 2.4 percent, with a significant increase in generation from furnace oil (FO) and hydro sources (Table 5.7).⁵³ While better water availability due to rains increased the hydropower generation, gas supply-related disruptions in the country's southern region necessitated power generation on furnace oil (FO). The government lifted the ban on FO-based power generation that it had imposed earlier in January 2019, resulting in increased imports of the commodity.⁵⁴ Moreover, cold weather in the north amid tight domestic gas

⁵³ Furnace oil imports increased by 531,000 metric tons – almost 1,400 percent higher than the 38,000 tons imported in H1-FY20.

⁵⁴ For details, see Chapter 5 in the SBP's First Quarterly Report on the State of Pakistan's Economy.

production increased the LNG imports in the second quarter of FY21.

Additionally, with the reviving economic activity, transportation also gained momentum. Increased shipments due to exports and imports, uptick in construction activity,⁵⁵ and surge in sales of heavy and light vehicles, all contributed to a significant rise in the demand for transport fuels.⁵⁶ As the marginal gain in POL production of local refineries was insufficient to cover the rising fuel demand of the transport sector, the imports of transport fuels become inevitable.⁵⁷

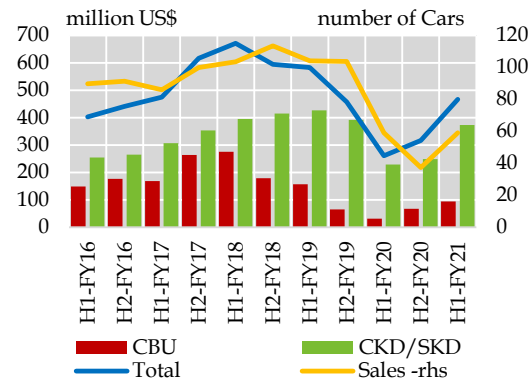
Reversal in car imports

In H1-FY21, transport group imports increased by US\$ 296 million, with US\$ 204 million contribution coming from car imports. Car imports – comprising both completely build units (CBU) and completely knocked down (CKD)/semi knocked down (SKD) kits– rose to US\$ 465 million in H1-FY21, up from US\$ 261 million in H1-FY20.

Macroeconomic stabilization measures adopted in 2018 had tapered the import of cars since H2-FY18. With CBU imports declining more prominently, the share of CKD/SKD imports increased to 88 percent in H1-FY20 in Pakistan’s total car imports; suggesting some progress towards value addition in the auto sector (**Figure 5.29**). In H1-FY21, however, the import of both CBUs and CKD/SKD reversed, and witnessed an

increase; with CKD’s share in in total car imports falling to 80 percent.

Car Imports and Sales in Pakistan **Figure 5.29**



Source: Pakistan Bureau of Statistics

Though the pick-up in economic activity may be the key driver, the introduction of some new variants in the local market may have supported the import growth of both category. New car manufacturers in Pakistan are also allowed to import 100 units at concessionary duties under the Auto Policy 2016-21.

Importantly, reviving activity in the construction and automobile sectors led to an increase in iron steel and steel scrap imports, with quantum rise significantly offsetting the lower unit prices.

Imports of power generating machinery and cell phones (both from machinery group) witnessed a significant rise in H1-FY21. The import of power generation machinery

⁵⁵ Cement production increased by 3.9 million tons in H1-FY21 on YoY basis.

⁵⁶ Sales of cars and 2- and 3-wheeler vehicles increased by 13.4 percent and 18.9 percent YoY in H1-FY21, respectively (source: PAMA).

⁵⁷ Refineries’ output of POL products increased by 5.0 percent in H1-FY21. Specifically, the production of petrol and diesel increased by 16.1 percent and 7.2 percent YoY respectively in the period.

increased due to the ongoing work on CPEC-related power projects, while cell phone imports rose due to multiple factors. Though the reduction in taxes may have contributed to the increased demand, work from home

arrangements and the adoption of distance learning methods by educational institutions have also likely played a major role in pushing up the import demand for cell phones.⁵⁸

⁵⁸ For more details, see the SBP's First Quarterly Report on the State of Pakistan's Economy.