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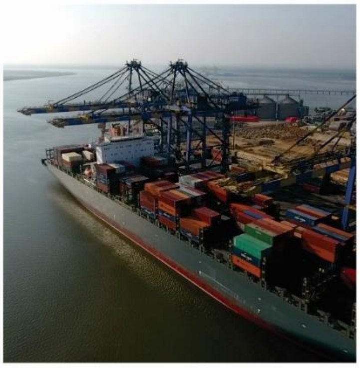
# PAKISTAN
# QUARTERLY TRADE BULLETIN



## National Industrial Policy Issue

Second Quarter Review, Fiscal Year 2018-19
Volume 1, Issue 4
(October – December 2018)

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# 1. Message

This quarter has seen Pakistan's improved engagements with China, Saudi Arabia and United Arab Emirates (UAE) in connection with economic cooperation. These countries, in turn, have reconfirmed their short-term financial support to Pakistan. China has pledged USD 2.5 billion to help Pakistan bridge FY19 the current account deficit, Saudi Arabia and UAE together have poured USD 4 billion, which helped stabilize the value of rupee.

The government has also taken measures to tighten monetary policy and put in place fiscal policy measures, which curtail growth of imports and fiscal deficit. As a result, the imports have shrunken, which has helped narrow down the current account gap. This will of course dampen the growth prospects of FY19, as the growth outlook for the year was recently slashed to 4 per cent by the central bank. Cut in development expenditures by the federal government will also result in slowdown of activity in manufacturing and services sectors. Meanwhile, fiscal deficit will continue to be stubbornly high on account of growing circular debt in the energy sector.

The impact of currency devaluation is now being seen with exports of readymade garments benefitting and exhibiting some increase in exports particularly in countries where Pakistan has market access facility or GSP plus status. For some industries, operations have become tougher as these may have been heavily dependent on imported inputs which have relatively become expensive after currency depreciation. We present a more detailed picture in the following sections.

This quarter also saw the Prime Minister visiting friendly countries and, in turn, inviting investor interest as well as remittances from expatriates. Incentives for channeling remittances through formal channels have been increased and Pakistan Banao Certificate has been launched which offers attractive medium to long-term rates.

To bring greater financial discipline and curb the leakages accruing due to the loss making public sector enterprises, Cabinet approved the establishment of Sarmay-e-Pakistan company. This entity will assess the true extent of operational losses, reasons for these losses and put in place turnaround strategies for at least a dozen enterprises ranging from aviation, steel and energy sectors.

The current issue of Pakistan Quarterly Trade Bulletin also provides an overview of the industrial policy, which is in formulation phase. We solicit views from both the public sector on the process of consultations around this policy and a way forward, and the private sector on how a balanced industrial policy could be helpful in their medium to long-term competitiveness. Our respondents also discussed challenges and risks to the industrial policy, which the government need to consider during the implementation phase.

The team at Sustainable Development Policy Institute (SDPI) acknowledges support from Pakistan Regional Economic Integration Activity (PREIA) in bringing out the current issue of Pakistan Quarterly Trade Bulletin.

**Bulletin Team**

## 2. This Quarter's News in Brief

- The current account deficit for the period July-December FY19 stood at USD 7.98 billion – a decline from USD 8.35 billion in the same period of FY18. Pakistan's overall export of goods (fob) during the months October-December FY19 (Q2FY19) stood at USD 5.95 billion. This is a 3.2 per cent decrease over the same period during FY18 (Q2FY18). Pakistan's overall imports of goods (BoP) during Q2FY19 stood at USD 13.5 billion - a 0.5% decline over the same period during FY18.

- Knitwear exports from the country during first five months of the current fiscal year increased by 10.6 per cent as compared to the exports of the corresponding period of last year.[1]

- All Pakistan Fruits and Vegetable Exporters, Importers and Merchants Association (PFVA) has set the Kinno export target at 325,000 tonnes for this season.[2] The association members are also aiming to explore new markets besides expanding exports to Central Asia.

- Pakistan and Saudi Arabia agreed on October 3 to negotiate a free trade agreement (FTA) for trade liberalization and increasing the volume between the two countries.[3] This FTA is also expected to compliment the inflow of expected foreign direct investment from Saudi Arabia in the coming years. Pakistan's Prime Minister during his visit to Saudi Arabia also expressed the need for deeper trade and investment cooperation.[4]

- A high-level Saudi delegation visited Pakistan to study the possible investment options in Reko Diq, setting up an oil refinery in Gwadar and investing in two energy power plants. Pakistan has offered Saudi Arabia to set up a multi-billion-dollar oil refinery in Gwadar besides acquiring stakes in LNG-fired power plants in the Punjab.[5] The federal cabinet has given the necessary approvals to Saudi Arabia to set up the refinery, marking the first major investment by the gulf countries in Pakistan.[6]

- The government has constituted a 22-member Council of Business Leaders on October 4 which aims to take input from the private sector to boost exports and create jobs.[7] The Council will also provide strategic advice on contours of possible national-level industrial and investment policies.

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[1] A. (2018, December 25). Knitwear worth $1.214b, readymade garments $1.022b exported. The Nation. Retrieved from https://nation.com.pk/25-Dec-2018/knitwear-worth-1-214b-readymade-garments-1-022b-exported
[2] C. (2018, November 30). Kinno export target reduced by 50,000 tonnes. Dawn. Retrieved from https://www.dawn.com/news/1448533/kinno-export-target-reduced-by-50000-tonnes
[3] (2018, October 4). Pakistan, Saudi Arabia agree to negotiate FTA. THE EXPRESS TRIBUNE. Retrieved from https://tribune.com.pk/story/1817895/2-pakistan-saudi-arabia-agree-negotiate-fta/
[4] N. (2018, September 23). Pakistan will soon ink investment deal with Saudi Arabia: Asad Umer. The Express Tribune. Retrieved from https://tribune.com.pk/story/1809840/1-pakistan-will-soon-ink-investment-deal-saudi-arabia-asad-umer/
[5] C. (2018, October 1). Saudi delegation to size up investment opportunities in Gwadar, Punjab. The Express Tribune. Retrieved from https://tribune.com.pk/story/1815817/1-saudi-delegation-size-investment-opportunities-gwadar-punjab/
[6] Hussain, D. (2018, October 5). Cabinet green-lights Saudi investment in Gwadar. The Express Tribune. Retrieved from https://tribune.com.pk/story/1818299/1-dars-illegally-appointed-officials-removed-fawad-chaudhry/
[7] Rana, S. (2018, October 5). Govt forms business council to boost exports, create jobs. The Express Tribune. Retrieved from https://tribune.com.pk/story/1818493/2-govt-forms-business-council-boost-exports-create-jobs/

- Given a large demand for halal food abroad, particularly meat, Federation of Pakistan Chambers of Commerce and Industry (FPCCI) has demanded to devise policies which aim to facilitate this sector. Pakistan's share in the global halal trade stands at 0.25% which could be increased with the upgrading of halal certification and provision of halal storage facilities across the country.[8]

- Pakistan may sign a legal framework agreement with China under the China-Pakistan Economic Corridor (CPEC) to bring investment towards the agriculture sector and export its surplus output to meet China's growing food demand.[9] Chinese investors have expressed keen interest in joint ventures with Pakistan for exporting high-quality fabric to China that would help improve bilateral trade and economic relations between the two countries.[10] The government has decided that all agreements signed in the future with foreign partners will include provisions for technology transfer.[11] China has agreed to increase its imports from the existing levels to beyond USD 3 billion by end of next fiscal year.[12] This is expected to benefit exports of textile, rice, leather, and surgical goods from Pakistan.

- Pakistan has extended the validity period of a USD 2 billion North-South gas pipeline deal to be laid by Russia under a government-to-government arrangement.[13] As a follow-up, some other agreements for cooperation in the gas sector have also been signed during January 2019. On trade front, Pakistan-Russia bilateral trade has registered upward trend. There is a 33 per cent increase in the overall trade during the past fiscal year.[14]

- Pakistan and Kazakhstan have started finding ways through which bilateral trade could be increased. The annual bilateral trade between the two countries could be increased from the exiting USD 25 million to USD 250-500 million if appropriate policy measures are adopted.[15]

- According to the Ministry of Commerce, Pakistan would get benefit worth USD 200 million after signing the Free Trade Agreement (FTA) with Thailand.[16] The FTA could also bring in dividends for

[8] C. (2018, October 5). Pakistan's share in global Halal trade just 0.25%. The Express Tribune. Retrieved from https://tribune.com.pk/story/1818659/2-pakistans-share-global-halal-trade-just-0-25/
[9] Rana, S. (2018, October 16). Pakistan, China may sign deal for investment in agriculture. The Express Tribune. Retrieved from https://tribune.com.pk/story/1826543/2-pakistan-china-may-sign-deal-investment-agriculture/
[10] C. (2018, November 14). Chinese investors keen on joint ventures. The Express Tribune. Retrieved from https://tribune.com.pk/story/1846687/2-chinese-investors-keen-joint-ventures/
[11] E. (Ed.). (2018, November 9). Technology transfer… yes, please. The Express Tribune. Retrieved from https://tribune.com.pk/story/1843310/6-technology-transfer-yes-please/
[12] (2018, November 8). 'Exports to China will double in FY19'. Dawn. Retrieved from https://www.dawn.com/news/1444295/exports-to-china-will-double-in-fy19
[13] Bhutta, Z. (2018, October 16). Pakistan, Russia agree to extend validity of $2 billion deal. The Express Tribune. Retrieved from https://tribune.com.pk/story/1826515/2-pakistan-russia-agree-extend-validity-2-billion-deal/
[14] Khan, Y. H. (2018, October 25). Pakistan, Russia teaming up for Asian bloc. The Nation. Retrieved from https://nation.com.pk/25-Oct-2018/pakistan-russia-teaming-up-for-asian-bloc
[15] C. (2018, October 11). Kazakh envoy calls for raising trade to $500m. The Express Tribune. Retrieved from https://tribune.com.pk/story/1822982/2-kazakh-envoy-calls-raising-trade-500m/
[16] (2018, August 9). Pakistan to get benefits worth $200m. The Express Tribune. Retrieved from https://tribune.com.pk/story/1776407/2-pakistan-get-benefits-worth-200m/

trade-in-services and bilateral investment cooperation. Both sides would soon complete their final list of offerings for the upcoming round of negotiations.[17]

- Foreign Minister Shah Mehmood Qureshi and his Egyptian counterpart Sameh Hassan Shoukry have agreed to extend trade, economic and investment cooperation between the two countries. During the coming days, arrangements will be made for formal meetings between the two sides to discuss the trade and investment cooperation framework.

- Talks towards a Preferential Trade Agreement (PTA) between Tunisia and Pakistan are in process and this agreement would hopefully be signed during 2019, said Tunisian Ambassador Adel Elarbi. Speaking at the Lahore Chamber of Commerce and Industry (LCCI), the Ambassador identified several sectors of potential cooperation between the two countries.[18]

- Measures taken by the countries like the US, China, Canada and the EU may lead to uncertainty in tariffs and para-tariffs globally. Their impact on developing countries, including Pakistan, is likely to be benign due to limited integration with the global supply chain.[19] However, various quarters have termed it an opportunity for the developing countries to gain the market space left out by the advanced economies. Pakistan is engaging itself with UK counterparts in brainstorming the future possibilities, as UK is keen to promote more active trade relations with non-EU countries after Brexit.[20]

- The Economic Coordination Committee (ECC) of the Federal Cabinet has approved the issuance of a certificate of sovereign guarantee for the sale of JF-17 aircraft to Nigerian Air Force against a sum of USD 184.3 million to support the declining foreign exchange reserves.[21]

- Given Pakistan's weak share in international markets, Adviser to Prime Minister on Commerce Abdul Razzak Dawood has stressed the need for zero duty on raw material.He said the government will try to find markets in China and Japan to boost the volume of trade.[22] Pakistan and the Republic of Korea have agreed in principle on the exchange of high-level visits to boost economic cooperation and regional peace.[23] To promote foreign investment in export-oriented sectors, the Commerce

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[17] (2018, November 23). Pakistan, Thailand to present final list of FTA by Dec. The Nation. Retrieved from https://nation.com.pk/23-Nov-2018/pakistan-thailand-to-present-final-list-of-fta-by-dec
[18] C. (2018, November 29). Pakistan, Tunisia to sign PTA: Envoy. The Express Tribune. Retrieved from https://tribune.com.pk/story/1856347/2-pakistan-tunisia-sign-pta-envoy/
[19] Kamani, S. (2018, June 10). Pakistan unlikely to feel impact of global trade war. The Express Tribune. Retrieved from https://tribune.com.pk/story/1732024/2-pakistan-unlikely-feel-impact-global-trade-war/
[20] Jarrar, K. (2018, December 17). Pakistan-UK trade post-Brexit: Making the most of it. The Nation. Retrieved from https://nation.com.pk/17-Dec-2018/pakistan-uk-trade-post-brexit-making-the-most-of-it
[21] Bhutta, Z. (2018, October 24). ECC okays sale of JF-17 to Nigeria for $184.3m. The Express Tribune. Retrieved from https://tribune.com.pk/story/1832482/2-ecc-okays-sale-jf-17-nigeria-184-3m/
[22] C. (2018, October 18). PM aide calls for expanding trade with China and Japan. The Express Tribune. Retrieved from https://tribune.com.pk/story/1828252/2-pm-aide-calls-expanding-trade-china-japan/
[23] (2018, November 9). Pakistan, South Korea to boost economic cooperation. Dawn. Retrieved from https://www.dawn.com/news/1444478/pakistan-south-korea-to-boost-economic-cooperation

Division has also shared with all stakeholders a draft investment document titled: "Trade Related Investment Framework"[24].

- According to the Board of Investment, Pakistan and Germany are contemplating to evaluate the possibility of investments in Special Economic Zones (SEZs) inside Pakistan.[25] Pakistan has also offered German enterprises located inside Pakistan to start exports to China. A number of German delegations that have recently visited Pakistan have expressed their interest in various sectors, including renewable energy, information technology, food and dairy.

- Islamabad Chamber of Commerce and Industry (ICCI) President has welcomed keen interest evinced by Prime Minister Imran Khan in strengthening trade ties with India which, in turn, could ensure peace in the region and increase bilateral trade and also help restore the SAARC process.[26] According to the World Bank's latest report, 'A Glass Half Full: The Promise of Regional Trade in South Asia', if there were better relations between the two neighbours, trade between them could reach USD 37 billion.[27]

- The British Airways has announced its decision to resume flight operations in Pakistan. This announcement is being seen as a reflection of the confidence of foreign investors in the improved security environment of the country.[28] The initiation of these operations will also provide alternative air cargo services for Pakistani businesses.

- The External Relations Group of Mercosur will take up Pakistan's request for signing FTA during 2019, which will provide an opportunity to Islamabad to increase trade relations with Latin America, including Argentina, Brazil, Paraguay, Uruguay, and Venezuela.[29]

- Oman's Minister for Tourism Ahmed bin Nasser Al Mahrizi has said that private sectors of both Oman and Pakistan could play a vital role in tapping the huge economic potential in various sectors of the two countries. Oman is one of the few countries which have FTA with the United States and this could be beneficial for Pakistani business community aiming to work with their counterparts in Oman.[30]

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[24] Khan, M. Z. (2018, October 26). Framework readied to attract FDI in export sector. Dawn. Retrieved from https://www.dawn.com/news/1441424/framework-readied-to-attract-fdi-in-export-sector

[25] C. (2018, October 26). BOI chief stresses need for deepening ties with Germany. The Express Tribune. Retrieved from https://tribune.com.pk/story/1834020/2-boi-chief-stresses-need-deepening-ties-germany/

[26] C. (2018, November 30). Pakistan and India have $37b trade potential. The Express Tribune. Retrieved from https://tribune.com.pk/story/1857198/2-pakistan-india-37b-trade-potential/

[27] E. (2018, October 1). The promise of trade. The News. Retrieved from https://www.thenews.com.pk/print/375018-the-promise-of-trade

[28] Bhutta, Z. (2018, December 18). British Airways to resume flight operations in Pakistan after a decade. The Express Tribune. Retrieved from https://tribune.com.pk/story/1870503/6-return-british-airways/

[29]C. (2018, December 27). Pakistan seeks to sign FTA with Latin America bloc. The Express Tribune. Retrieved from https://tribune.com.pk/story/1875230/2-pakistan-seeks-sign-fta-latin-america-bloc/

[30] (2018, December 27). Oman minister suggests cooperation in tourism. The Express Tribune. Retrieved from https://tribune.com.pk/story/1875219/2-oman-minister-suggests-cooperation-tourism/

- Pakistan slipped by one position in the Global Competitiveness Index 2018 released by the World Economic Forum (WEF) on October 17. It ranked 107 out of 140 countries.[31] Key factors contributing to a low rank include: complex tax compliance, difficulties in access to necessary utilities and infrastructure, and overall regulatory burden.

- A business delegation from Maldives has expressed the desire to expand trade relations with Pakistan. They have also suggested to revisit how both Maldives and Pakistan can strengthen SAARC-wide trade ties.[32] In a separate meeting during this quarter, His Excellency Mr Sewa Lamsal, the Nepalese Ambassador to Pakistan, suggested Pakistani exporters to come forward and explore untapped sectors in Nepal in a bid to promote bilateral ties.[33]

[31] Ahmed, A. (2018, October 18). Pakistan slips to 107th on Global Competitiveness Index. Dawn. Retrieved from https://www.dawn.com/news/1439720/pakistan-slips-to-107th-on-global-competitiveness-index
[32] (2018, December 20). 'Trade cooperation between Maldives and Pakistan must increase'. Daily Times. Retrieved from https://dailytimes.com.pk/335356/trade-cooperation-between-maldives-and-pakistan-must-increase/
[33]C. (2018, October 25). Nepal still an untapped market for Pakistan's exporters: Ambassador Lamsal. Dawn. Retrieved from https://www.dawn.com/news/1441198/nepal-still-an-untapped-market-for-pakistans-exporters-ambassador-lamsal

# 3. Macroeconomic Outlook

## An Overview of Economic Growth

At the time of issuing this bulletin, there is a consensus among most analysts that the government could reduce the need and urgency of approaching the IMF if it took some economic adjustment measures on its own to achieve macroeconomic stability. Taking lead from this consensus, during this quarter, the interest rates were further increased in a bid to curtail aggregate demand in the economy. This measure is also expected to reduce private borrowing from the bank and help reduce credit channeled towards consumption expenditure and procurement of imports.

These measures by the government did result in some shrinking of the current account deficit, but heavy pressures on the rupee still remain. Analysts believe that government will have to augment short and medium term foreign exchange reserves to meet the upcoming debt repayments during FY19. Sustaining essential industry imports like oil and gas will also continue to pose a challenge with a weak rupee and low levels of reserves.

Meanwhile, Pakistan's bilateral and multilateral development partners have been expressing their confidence in the economy as well as a willingness to help Pakistan strengthen macroeconomic stability. Some however have suggested that IMF's macroeconomic oversight and guidance may be required in the short-term.

The Finance Division on its own has been critically looking in to putting in place four key reforms to give the markets greater confidence. First, the economic team has been discussing solutions to better managing circular debt in energy and other commodity sectors. The energy sector circular debt has now touched PKR 1.4 trillion. Second, the government is aiming to formulate a robust plan for restructuring or disposal of loss-making public sector and state-owned enterprises. Recently, a team of experts has been tasked to provide options for future operations of Pakistan Steel Mills. Similar working is underway for Pakistan International Airlines and several energy generation and distribution companies.

Third, the government is looking to put in place a strong and credible economic management team. The ministry of finance, planning commission, ministry of commerce and other economic departments at the federal level are to be housed with credible macroeconomists having experience of dealing with financial markets, international development partners and foreign investors. Additionally, the positions of several economic ministers responsible for trade diplomacy in Pakistani embassies abroad are being filled as per rules. With the coming of new head at the Securities and Exchange Commission of Pakistan (SECP) during this quarter, the government also aims to strengthen capacities at the regulatory bodies.

Fourth, as part of its first100-day agenda, the government has initiated working on a long-term trade policy and five-year federal tax & tariff policy. The Ministry of Industries and Production has also been tasked to come up with a draft of federal-level industrial policy which, in turn, compliments the provincial industrial strategies. The Board of Investment will soon present to the Prime Minister a plan to expedite development of priority Special Economic Zones (SEZs) through technical support of local, Chinese and non-Chinese investors. These policies are expected to provide potential long-term investors with clear indications about future competitiveness reforms, including tax and tariff policy structure, and measures which the government would undertake to bridge infrastructure gaps.

As a short-term breather, the government has also been able to secure USD 4 billion from Saudi Arabia and UAE to support the falling foreign exchange reserves. This package also includes another facility from Saudi Arabia which will provide oil on deferred payments worth USD 3 billion. Saudi Arabia will also continue to explore investment interests in Pakistan particularly in the power sector and oil refinery project. China has also recently pledged USD 2.5 billion to support the balance of payments. However, it is not clear from recent reports when this sum will actually arrive at Pakistan's central bank.

During this quarter, Pakistan continued to engage with the International Monetary Fund (IMF) for a package which could not only relieve pressures on the balance of payments, but also provide macroeconomic oversight for fiscal discipline and letter of comfort – required by multilateral and bilateral development partners. In the coming days, both sides are expected to look in to the type of fiscal and balance of payment's adjustment which will be most appropriate to reduce current account deficit. In a recent meeting with the Prime Minister, IMF Managing Director was reported to suggest that Pakistan should prioritize reform of energy sector and reforms which improve the ease of doing business rank.

The central bank in its latest monetary policy statement increased the key interest rate by 25 basis points to 10.25 per cent; the growth forecast has been further cut down to around 4%. The State Bank of Pakistan (SBP) forecasts increase in inflation during the coming weeks due to increased government borrowing. The average headline Consumer Price Index (CPI) growth stood at 6% during the first half of FY19 (H1FY19). The core inflation, measured by non-food and non-energy components touched 8.4 per cent during December. The SBP foresees that the fall in global oil prices may offset the effects of upward adjustment in gas and electricity tariffs and the projected inflation may remain between 6.5-7.5%.

The statement also warned of risks to the economy, including high levels of fiscal and current account deficits. It was informed that the past exchange rate depreciation and monetary tightening had failed to curtail the current account deficit in the manner in which SBP had anticipated. It is expected that FY19 deficit will be around USD 14 billion, while during January Pakistan's gross foreign currency reserves were recorded at USD 8.2 billion. The recent dip in reserves was seen on account of market interventions, defence-related payments and debt servicing.

The half-year trade performance largely remained the same. Exports during July-December FY19 were recorded at USD 11.8 billion which were almost the same as seen in the same period of FY18. Imports however increased to USD 27.4 billion from USD 26.6 billion for the same period (Table 1). The export and import of services both saw a decline however, some relief came as a result of growth in remittances which saw an increase from USD 9.7 billion during H1FY18 to USD 10.7 billion during H1FY19. Perhaps a major concern for this period was the stability of net reserves with SBP which witnessed a decrease from USD 14 billion during H1FY18 to USD 7.2 billion during H1FY19.

The government continues to make an effort to improve fiscal deficit through increasing revenue mobilization, and curtailing non-essential public sector expenditure. The federal level development expenditure has also been slashed. FBR revenues have shown an improvement and increased from PKR 765 billion during July-September FY18 to PKR 832 billion during the same period in FY19.

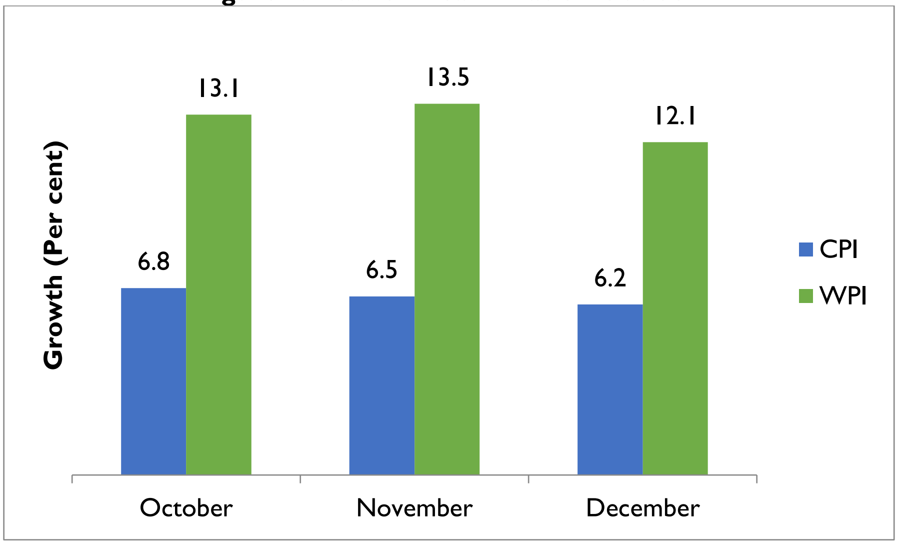
**Table 1: Macroeconomic Indicators**

| Indicator | Period | FY19 | FY18 |
|---|---|---|---|
| GDP Growth (%) | Jul-Jun | 4.0 (R) | 5.4 |
| Agriculture (% growth) | Jul-Jun | 3.8 (P) | 2.1 |
| Manufacturing (% growth) | Jul-Jun | 6.2 (P) | 5.8 |
| Large Scale Manufacturing (% growth)* | Jul-Nov | -0.6 | 7.7 |
| Services (% growth) | Jul-Jun | 6.4 (P) | 6.5 |
| Investment to GDP ratio | Jul-Jun | 16.4 (P) | 16.1 |
| Consumer price index (% change)* | Jul-Dec | 6.1 | 3.8 |
| Wholesale price index (% change)* | Jul-Dec | 11.6 | 2.0 |
| Total revenue (Billion Rupees) | Jul-Sep | 1102.1 | 5228 (FY) |
| FBR tax revenues (PKR billion) | Jul-Sep | 832.3 | 765.0 |
| Total expenditure (Billion Rupees) | Jul-Sep | 1643.8 | 7488.4 (FY) |
| Budget deficit (Billion Rupees) | Jul-Sep | 541.7 | 2260.4 (FY) |
| Government domestic debt (% of GDP) ** | Sept | 44 | 44.7 |
| Total external debt & liabilities (% of GDP)** | Sept | 31.2 | 26.2 |
| Government public debt (% of GDP)** | Sept | 67 | 64.1 |
| Merchandise Exports (USD million) | Jul-Dec | 11,839 | 11,831 |
| Merchandise Imports (USD million) | Jul-Dec | 27,390 | 26,589 |
| Export of services (USD million) | Jul-Dec | 2,599 | 2,664 |
| Import of services (USD million) | Jul-Dec | 4,546 | 5,409 |
| Current account deficit (USD million) | Jul-Dec | 7,983 | 8,353 |
| Remittances (USD million) | Jul-Dec | 10,719 | 9745 |
| Foreign Direct Investment (USD million) | Jul-Dec | 2058.9 | 1980.3 |
| Foreign exchange reserves (USD million) | Jul-Dec | 13,837.8 | 20,177.1 |
| Net reserves with SBP (USD million) | December | 7,287.5 | 14,106.9 |

*Source: State Bank of Pakistan* ** Pakistan Bureau of Statistics*
*Note: ** Values represent End period stock; P: provisional; R: Revised.*

This quarter saw an increase in inflation on account of lagged effect of rupee depreciation, upward adjustment of electricity and gas prices and continued government borrowing from the central bank. The CPI growth for the months of October-December FY19 remained over 6 per cent. The other variables, including expectations of further currency depreciation, expected hike in energy prices, and need for commodity operations by SBP continue to keep inflationary expectations on the higher side. The wholesale price index (WPI) saw much larger increase than CPI, in turn also implying to some extent an increase in the cost of doing business.

**Figure 1: Year on Year Inflation Outlook**




*Source: Pakistan Bureau of Statistics*

To bring back the growth momentum in commodity producing sectors, Economic Coordination Committee (ECC) of the Cabinet took several measures during Q2FY19. While for industrial sector, measures related to ease of doing business and relief in taxes were announced through supplementary Finance Bill presented in the parliament during January FY19, however more immediate steps were seen for the agriculture sector during Q2FY19. On the proposal of Ministry of Energy, ECC approved PKR 1.8 billion for agriculture tube-well subsidy. The conditions related to export of sugar were eased. The committee has invited further proposals for the utilization of gas for production of fertilizer. The import of 50,000 tonnes of urea has been allowed by ECC during November. The decision to double Pakistan's share of wheat for the SAARC Food Bank Reserve was also approved. The wheat support price has been allowed at PKR 1,300 per 40kg. Finally, the committee has approved a relief in electricity prices for agricultural sector, bringing down the rates by 48 per cent to PKR 5.50 per unit.

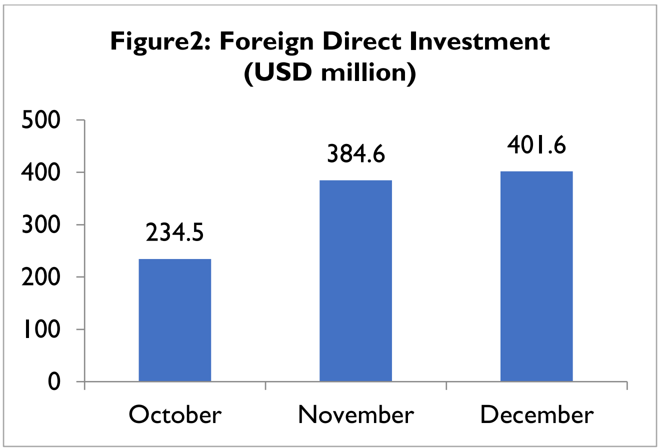
## Review of Select Economic Indicators

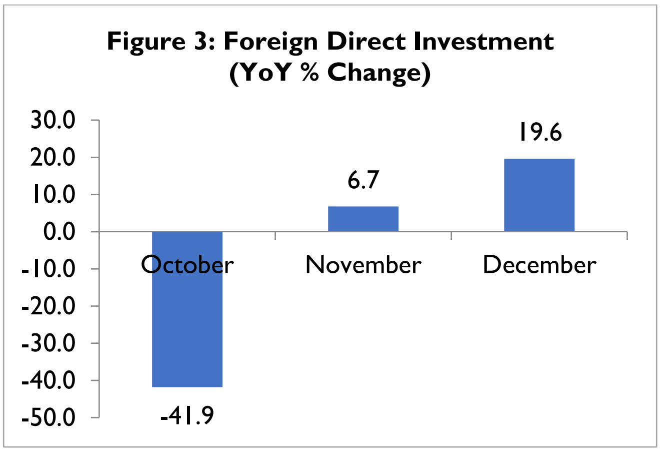
### a. Foreign Direct Investment

The FDI, during H1FY19, declined by 19 per cent from USD 1.63 billion to USD 1.31 billion. The total foreign investment during H1FY19 in fact saw a sharper decline by 77 per cent. Total foreign investment which was recorded at USD 4 billion during H1FY18 was seen at USD 899.5 million during H1FY19. Among other reasons this was due to low levels of portfolio investment during this period. The decline in FDI was mainly attributed to slow down in oil and gas exploration sector, chemicals, thermal and hydel power sectors, construction and financial services.

FDI remained heavily dependent on China. The contribution from China stood at USD 760 million during H1FY19. This is 58 per cent of the total investment seen during the six months period. Even this volume of FDI from China is a decline of 31 per cent if compared with H1FY18. This was followed by UK (USD 116 million), US (USD 54 million), Japan (USD 54 million), South Korea (USD 59.6 million) and Netherlands (USD 53 million). A decline was seen in the case of Malaysia with FDI dropping from USD 133 million to USD 15 million during H1FY19.

The wave-17 of the Overseas Investors Chambers of Commerce and Industry (OICCI) business confidence index survey explains that the reasons behind declining business confidence includes: slowdown in the services sector, hike in energy prices, interest rates and higher inflation. Going forward, the government is expected to finalize investment programmes with Saudi Arabia, UAE and Qatar. Early finalization of these deals could help in restoring growth of commodity producing sectors.




*Source: State Bank of Pakistan*

The Board of Investment in collaboration with the provincial governments has initiated reforms towards the ease of doing business in Pakistan. To help reduce the transactions costs faced by the private sector while dealing with taxes, it was decided during H1FY19 to reduce the number of tax payments from 47 to 16 annually. A more liberal business visa regime for foreign investors has been introduced. The visas are now available within 24 hours and applicants can avail the online e-visa facility. The foreign investors arriving in Pakistan are entitled to pass through electronic gates and not wait under the normal immigration processes. The previously seen travel restrictions for foreign investors wishing to enter Gilgit-Baltistan, and Azad Jammu & Kashmir have been abolished. With these measures, the Board of Investment has recently seen an uptick in interest from South Korea, Saudi Arabia and UAE. The key sectors in which investors from these countries have expressed interest include oil and gas exploration, petrochemical, food processing, and hospitality.

A one-window facility for incorporation of business is now available at Securities and Exchange Commission of Pakistan, FBR, and Employees' Old-Age Benefit Institution. This facility is now operational with cooperation between federal BOI and Government of Punjab. An online portal for the company's incorporation has been activated. It is expected that the Government of Sindh's procedures will also be linked to this portal in the coming months. With these measures in place the processes of enterprise registration is expected to come down from 60 to 16 days. The federal government also aims to work with National Electric Power Regulatory Authority to bring down the number of days required to get commercial and industrial electricity connections. In February, the government has also announced the launch of Pakistan Banao Certificates. With attractive rates of return these certificates are also expected to lure the interest of Pakistani diaspora as well as locals having foreign currency accounts abroad.

**b. Remittances**

The remittances from abroad witnessed an increase of 10 per cent during H1FY19. From USD 9.7 billion during the same period of FY18, remittances have increased to USD 10.7 billion. The inflows from Saudi Arabia remained highest at USD 2.6. The remittances from Saudi Arabia increased during H1FY19 by 1.5 per cent. This was followed by inflows from UAE which increased by 6.1 per cent and stood at USD 2.3 billion compared with USD 2.2 billion during H1FY18. Remittances also grew in the case of US (USD 1.7 billion) and UK (USD 1.5 billion). Inflows from other Gulf Cooperation Council countries however declined by 7 per cent and stood at USD 1.04 during H1FY19. Similarly, a decline in remittances by 1.3 per cent from EU was also observed. The remittances from EU stood at USD 310 million. The remittances from Malaysia witnessed the highest growth during H1FY19 at 46 per cent. From USD 501 million in H1FY18, the inflows increased to USD 735 million in H1FY19.

**Figure 4: Remittances Q2FY19 (USD Million)**

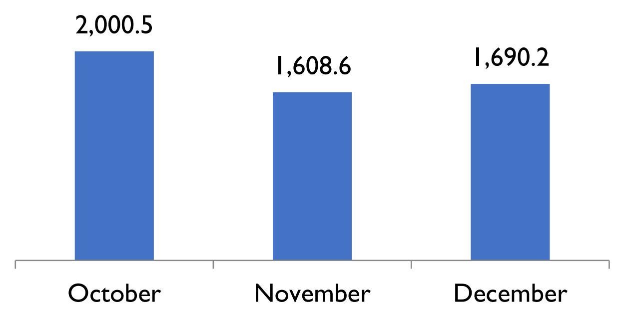
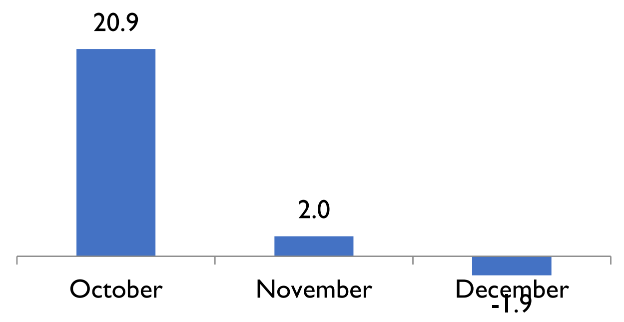



**Figure 5: Remittances (YoY % Change)**




*Source: State Bank of Pakistan*

The recent incentives by the government are expected to further encourage remittances through the formal financial channels. Pakistan Post has also recently initiated its e-commerce facility. This facility is expected to provide 24 hours cash remittance service. Pakistan's posts online vendors will also provide cash on delivery product services. This will allow Pakistani diaspora abroad to book orders for local delivery using Pakistan Post's portal.

### c. Foreign Exchange Reserves

The foreign exchange reserves remained under pressure as the current account deficit increased by 37 per cent during December in comparison to the previous month, i.e. November FY19. Contrary to the expectations, the deficit touched USD 1.66 billion in December 2018. In November, it was registered at USD 1.21 billion which indicates an increase of USD 450 million over the previous month. The net reserves with SBP at the end of December 2018 were recorded at USD 7.3 billion (Figure 6). On YoY basis, each of the three months during Q2FY19 saw over 25 per cent decline (Figure 7).

**Figure 6: Net reserves with SBP (USD million)**

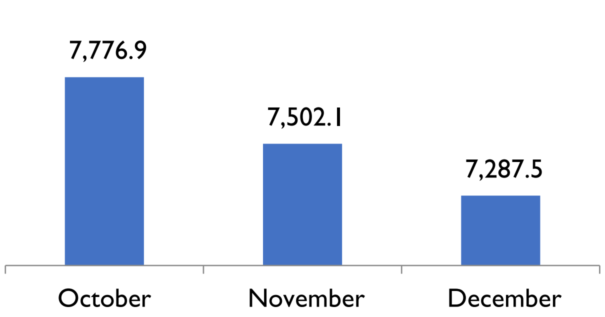
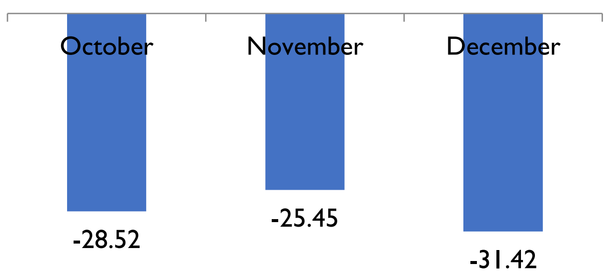


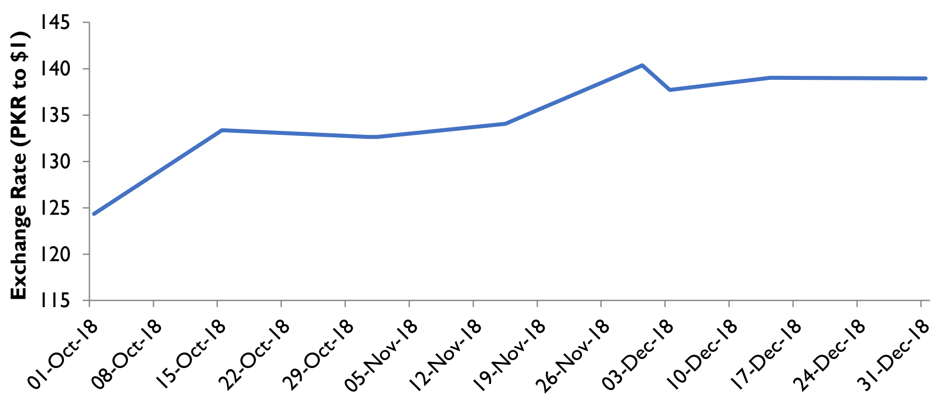

**Figure 7: Forex reserves (YoY % change)**




*Source: State Bank of Pakistan*

The large current account deficit, upcoming external debt repayments and uncertainty around how to bridge the financing gap also led to fluctuation in exchange rate during Q2FY19. At the time of writing this bulletin, the government has held several rounds of meetings with the IMF. The Prime Minister also met with the IMF Managing Director in Dubai at the sidelines of World Government Summit. Both sides have shared their expectations so that an agreement can be reached which can ultimately give a strong signal to the financial markets and reduce volatility seen the value of currency. As a result of these engagements as well as support pledged from Saudi Arabia and UAE, the Pakistani rupee was stable at PKR 138.96 during the last week of December 2018 (Figure 8).

**Figure 8: Weighted Average Customer Exchange Rates (USD)[34]**




*Source: State Bank of Pakistan*

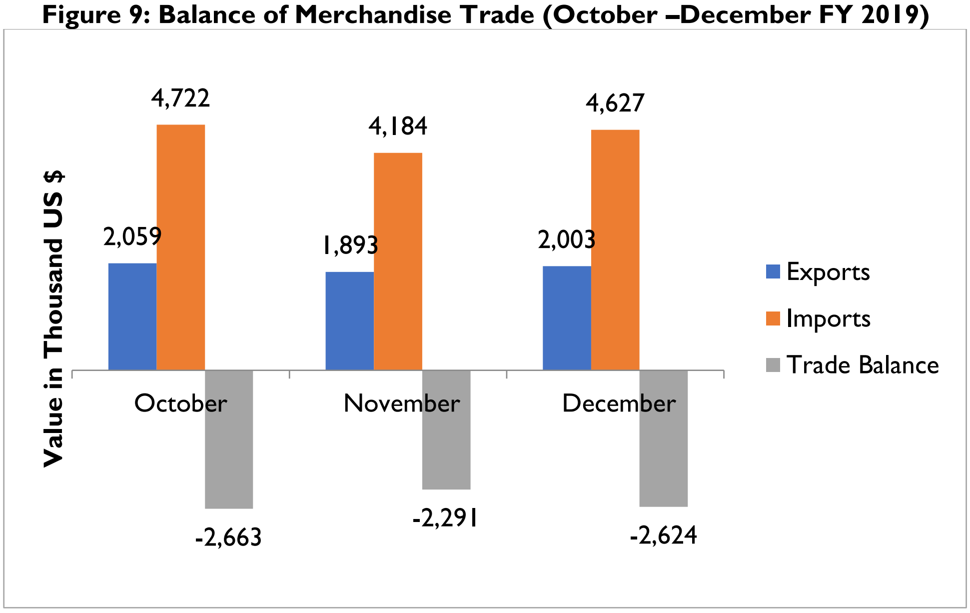
[34] This exchange rate represents quotations by various commercial banks to their clients. The data on these quotations is maintained by SBP.

# 4. Analysis of Pakistan's Exports

The current account deficit for July-December FY19 stood at USD 7.98 billion – a decline from USD 8.35 billion in the same period of FY18. The gap is still large and equals almost 5.3 per cent of GDP. In terms of monthly pattern, December alone saw the current account deficit widening almost 37 per cent at about USD 1.66 billion. The continued inflow of non-essential imports prompted the government to formulate amendments to the finance bill which were eventually announced during January 2019.

The month-on-month imports remained steady during October – December FY19 (Figure 9). Exports however did not increase at an anticipated pace despite downward trend in the value of rupee and expectations of further depreciation of currency. This allowed the monthly balance of trade to remain above USD 2 billion during October - December. While month-on-month exports could only see marginal changes, however the fall in the value of currency is expected to render benefits for export-oriented sectors with a time lag if supply side constraints particularly the provision of gas supplies are addressed.

**Figure 9: Balance of Merchandise Trade (October –December FY 2019)**




*Source: State Bank of Pakistan*

Pakistan's overall export of goods (fob) during the months of October-December in FY19 stood at USD 5.95 billion. This is a 3.2 per cent decrease over the same period during FY18 (Table 2). The year-on-year dip was seen for the months of November and December when exports declined by 12.85 and 0.20 per cent respectively. Top-5 destinations in value terms included US, China, UK, Germany, and UAE (Table 3). While the value of export to USA remained highest at USD 1 billion, the quarterly increase was most seen for exports to Bangladesh (22%), Netherlands (14.6%) and Italy (7.2%). The countries where Pakistan's exports witnessed a decrease include Afghanistan (-44.3%), UAE (14%), Spain (12.5%), and Germany (6.6%). The largest decline in percentage terms seen for the case of Afghanistan could be attributed to seasonal change in the demand for goods, slower than expected opening up of additional trading posts (other than Torkhum, Golam Khan and Chaman), and several consumer items now being routed through Iran and Uzbekistan.[35]

**Table 2: Pakistan's Merchandise Exports (USD million)**

| Months | Q2FY19 | Q2FY18 | Change (%) |
|---|---|---|---|
| October | 2,059 | 1,973 | 4.36 |
| November | 1,893 | 2,172 | -12.85 |
| December | 2,003 | 2,007 | -0.20 |
| **Total** | **5,955** | **6,152** | **-3.20** |

*Source: State Bank of Pakistan*

**Table 3: Top Export Destinations (USD Million)**

| Country | Q2FY19 (A) | Q2FY18 (B) | Delta (A-B) | Change (%) |
|---|---|---|---|---|
| USA | 1,012.6 | 966.3 | 46.3 | 4.8 |
| China | 453.0 | 436.2 | 16.8 | 3.8 |
| UK | 447.4 | 433.8 | 13.6 | 3.1 |
| Germany | 313.4 | 335.3 | -22.0 | -6.6 |
| Dubai | 235.1 | 273.3 | -38.2 | -14.0 |
| Afghanistan | 234.7 | 421.7 | -187.0 | -44.3 |
| Spain | 219.9 | 251.1 | -31.3 | -12.5 |
| Netherlands | 213.1 | 186.0 | 27.1 | 14.6 |
| Bangladesh | 201.7 | 165.0 | 36.7 | 22.2 |
| Italy | 186.6 | 174.1 | 12.5 | 7.2 |
| All others | 2,437.6 | 2,509.0 | -71.5 | -2.8 |
| Total | 5,955.0 | 6,152.0 | -197.0 | -3.2 |

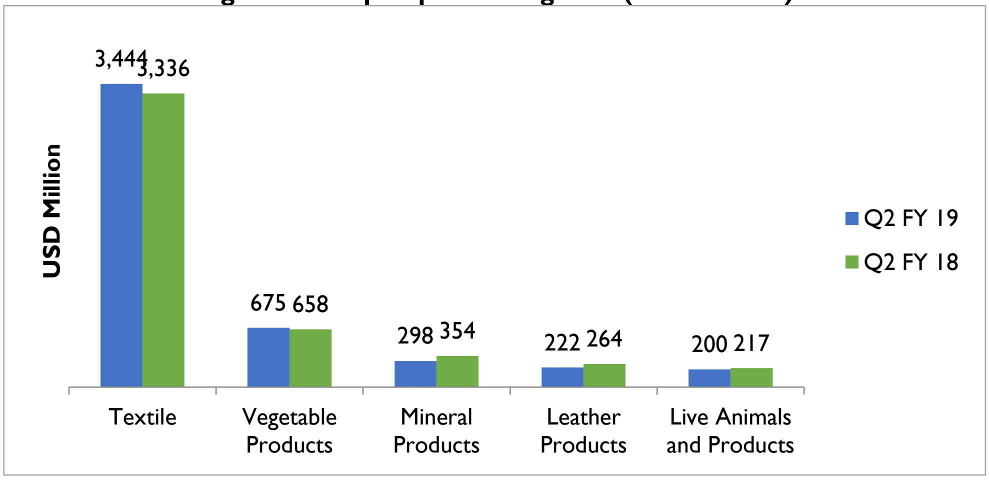
*Source: State Bank of Pakistan*

Pakistan's top exports by commodity include items from textile and clothing sector which witnessed a growth of almost 3.23 per cent during the first quarter. However, the H1FY19 exports amounted to USD 6.6 billion, which was only an increase of 0.06 per cent, indicating that rupee depreciation alone did not significantly improve the outcomes for this sector. There are other factors at play that are not allowing textile exports to increase. For example, only in the month of December, industry in Karachi, for example, could not receive gas for 16 days.[36] Within this category, while cotton yarn and cotton cloth exports decreased, the exports of knitwear, bed wear, readymade garments witnessed an increase.

[35] For commentary on Afghanistan and Pakistan trade patterns see: Ahmed, V. and S. Shabbir (2016) Trade & Transit Cooperation with Afghanistan: Results from a firm-level survey from Pakistan. Working paper # 153. Sustainable Development Policy Institute.
[36] Pakistan's textile exports remain flat at $1.14 billion in December. Customsnews.pk., January 16, 2019. Web: https://customnews.pk/2019/01/16/pakistans-textile-exports-remain-flat-at-1-14-billion-in-december/ . Accessed on February 15, 2019.

Vegetable products which include cereals and fruits also witnessed an increase. Food processing sector's exports increased on the back of improved crop outlook, rainfall and climatic conditions. The mineral sector's exports most notably fuels, salts, lime and stone declined. This is attributed to recent slowdown in the construction activity across Pakistan's major trading partners. The exports of leather articles, raw hides and skins continued on a declining trend as seen in the previous quarter (Figure 10). It was anticipated that this sector will recover during the winter months, however stringent hygiene conditions, grading requirements and other non-tariff measures in major trading countries prevented an increase in exports of leather items. The exports of this sector as a whole are expected to struggle unless the industry quickly moves towards the guidelines provided by international Leather Working Group. The supply of raw material will also remain under pressure as FY18 saw large quantities of hides and skins getting damaged due to lack of appropriate preservation processes. This, in turn, has increased reliance on relatively expensive imported raw material.[37]

**Figure 10: Top Export Categories (USD Million)**

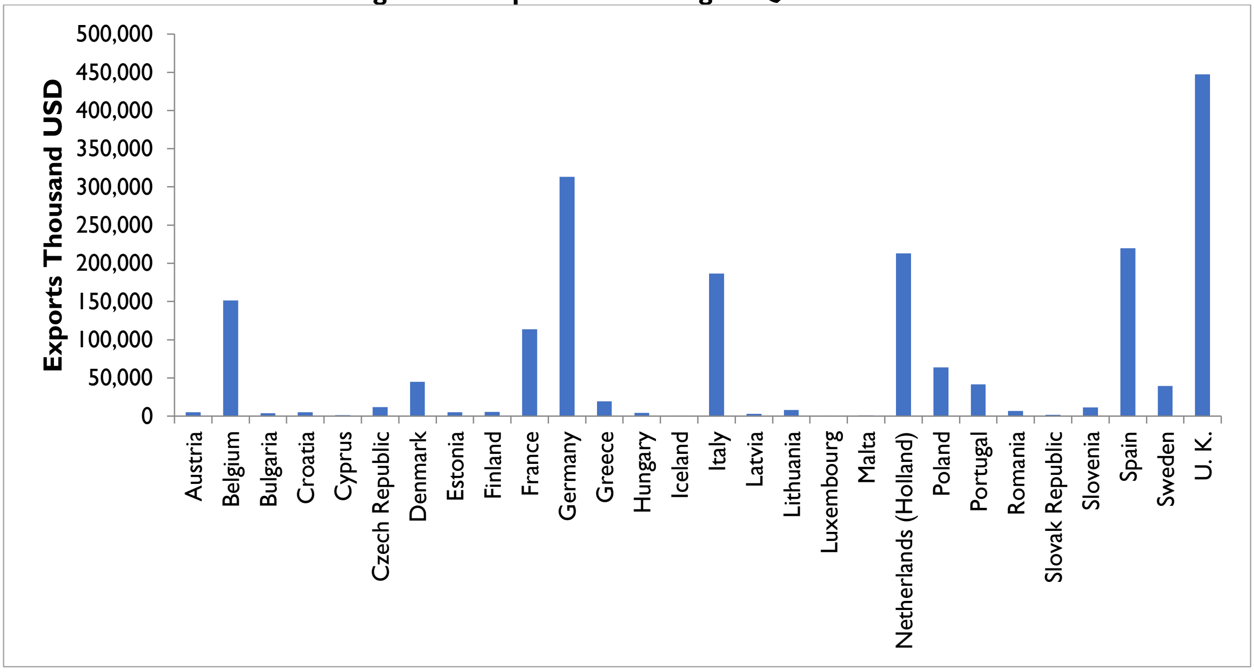



*Source: State Bank of Pakistan*

Despite an improved understanding regarding export to EU countries and market access facility such as GSP plus in place, exporters have found it hard to geographically diversify towards other countries in the region. The exports have traditionally remained concentrated in Germany and UK (Figure 11). Recently the government has urged foreign missions to look in to ways through which Pakistani exports can penetrate in to more countries across EU. After Brexit, Pakistan has also been on the lookout for trading partners who will continue to favour the country's GSP plus renewal. In a breakthrough, Poland has now announced that it will continue GSP plus status support for Pakistan.[38]

[37] Leather exports continue to struggle. Business Recorder. October 9, 2018. Web: https://www.brecorder.com/2018/10/09/444510/leather-exports-continue-to-struggle/. Accessed on February 15, 2019.
[38] Poland to continue GSP+status support for Pakistan: Ambassador. The Nation. February 12, 2019. Web: https://nation.com.pk/12-Feb-2019/poland-to-continue-gsp-status-support-for-pakistan-ambassador. Accessed on February 15, 2019.

**Figure 11: Exports to EU Region Q2FY19**




*Source: State Bank of Pakistan*

Going forward, the government is aiming to improve availability of private sector credit for exporters. This will primarily be possible through cutting down the government's own borrowing from the banking sector. The credit allocation for textile and agriculture will be protected. Furthermore, the SME lending targets of banks and other lending institutions will be regularly monitored. The government has also promised a uniform gas price across the country. This will now result in the government providing subsidized imported LNG to industries in the Punjab province. The industries in other parts of Pakistan will continue to use the local gas supplies which are cheaper in comparison to the imported LNG. The power tariff for export-oriented industries has also been slashed. To increase competitiveness of the textile sector, the government has withdrawn duty on cotton imports.[39]

During Q3FY19, it is expected that two buying missions from China will arrive on the request of the government to explore major items which Pakistan could supply to China. This is also expected to bring down Pakistan's trade deficit with China. In a recent meeting of SDPI team with Pakistan China Joint Chamber of Commerce & Industry it was revealed that Pakistani manufacturers are making efforts to upgrade their knowledge regarding value chains in China. It is expected that in the coming days Pakistan's mining, chemical, leather footwear, and surgical items sector may be able to cater some of the parts and components demand from China. Demand is also observed in the case of agriculture and livestock. In the case of latter, both governments aim to make an effort to upgrade the knowledge of Pakistani exporters of sea food and meat so that they might comply with hygiene import requirements in China.

[39] Current account deficit widened 37% in Dec 2018. The Express Tribune, January 18, 2019. Web: https://tribune.com.pk/story/1890816/2-current-account-deficit-widened-37-dec-2018/. Accessed on February 18, 2019.

## 5. Analysis of Pakistan's Imports

Pakistan's overall imports of goods (BoP) during the months of October-December FY19 stood at USD 13.5 billion (Table 4) - a 0.5% decline over the same period in FY18. The growth in imports was seen in October (6%) and December (3.3%). A decrease of 10.3 per cent was seen in the month of November. According to most analysts, this quarter's import value was still higher than expected, despite depreciation of currency and fiscal measures to curtail imports.

The government during the quarter announced its intent to introduce a supplementary Finance Bill in a bid to further strengthen the tax and tariff measures and, in turn, curtail imports. The markets also expected a further downslide in the value of rupee. The large- scale production data has also indicated slow down during H1FY19. These developments could bring about some reduction in the value of imports during the next quarter.

**Table 4: Pakistan's Merchandise Imports (USD Million)**

| Month | Q1FY19 | Q1FY18 | Change (%) |
|---|---|---|---|
| October | 4,722 | 4,455 | 6.0 |
| November | 4,184 | 4,662 | -10.3 |
| December | 4,627 | 4,479 | 3.3 |
| Total | 13,533 | 13,596 | -0.5 |

*Source: State Bank of Pakistan*

One of the key factors in keeping imports high was 14.8 per cent increase in the overall import of petroleum group items during H1FY19. The import of these items stood at USD 7.7 billion compared with USD 6.7 billion during FY18. Within this group both crude oil and liquefied natural gas witnessed sharp increases.

This quarter also saw increase in imports of chemical industries and textiles and textile articles. This is mainly attributed to export incentives announced during FY18 and FY19 which kept demand for inputs high, particularly in the export-oriented industries. A decline is visible for machinery and mechanical appliances and is a reflection of weakening growth outlook seen in the large-scale manufacturing sector and completion of some early harvest projects under CPEC.

**Table 5: Top Import Categories (USD Million)**

| Commodity Groups | Q 2 FY19 (A) | Q 2 FY18 (B) | Delta (A-B) | Share in total imports (%) | |
|---|---|---|---|---|---|
| | | | | Q 2 FY19 | Q 2 FY18 |
| Mineral products | 4,293.6 | 3,701 | 592.7 | 31.7 | 27.2 |
| Products of Chemical or Allied Industries | 1,679.6 | 1,487 | 192.4 | 12.4 | 10.9 |
| Machinery and Mechanical Appliances | 1,595 | 2,132 | -536.7 | 11.8 | 15.7 |
| Textiles and Textile Articles | 988.2 | 843.1 | 145.1 | 7.3 | 7.7 |
| Base Metals and Articles or Base Metal | 934.9 | 1050 | -116 | 6.9 | 6.2 |

| Commodity Groups | Q 2 FY19 (A) | Q 2 FY18 (B) | Delta (A-B) | Share in total imports (%) | |
|---|---|---|---|---|---|
| | | | | Q 2 FY19 | Q 2 FY18 |
| All other | 4,042 | 4,383 | -341 | 29.9 | 32.3 |
| Total | 13533 | 13,596 | -63.0 | 100 | 100 |

*Source: State Bank of Pakistan*

Major countries from where imports were received during Q1FY19 include China (19% share in overall imports), UAE (12.7%), Singapore (6.7%), Saudi Arabia (6.2%) and Qatar (3.9%). For the major import origins, the value of imports from China remained highest, however the quarterly change in percentage terms was largest for Qatar, UAE and India. The major import origins which saw a decline were China and Singapore (Table 6). The decline in imports from China are partially a reflection of completion of some early harvest projects under CPEC and slowdown in manufacturing growth.

**Table 6: Origin of Pakistani Imports (USD Million)**

| Country | Q2 FY19 (A) | Q 2 FY18 (B) | Delta (A-B) | Change (%) | Share FY 19 (%) | Share FY 18 (%) |
|---|---|---|---|---|---|---|
| China | 2,509.1 | 2,678.4 | -169.2 | -6.3 | 18.5 | 19.7 |
| U. A. E. Dubai | 1,715.1 | 1,650.3 | 64.8 | 3.9 | 12.7 | 12.1 |
| Singapore | 910.5 | 1,215.6 | -305.1 | -25.1 | 6.7 | 8.9 |
| Saudi Arabia | 843.3 | 869.5 | -26.2 | -3.0 | 6.2 | 6.4 |
| Qatar | 534.1 | 198.9 | 335.1 | 168.5 | 3.9 | 1.5 |
| India | 500.5 | 361.7 | 138.8 | 38.4 | 3.7 | 2.7 |
| U. S. A. | 481.7 | 415.3 | 66.4 | 16.0 | 3.6 | 3.1 |
| U. A. E | 410.0 | 164.7 | 245.3 | 148.9 | 3.0 | 1.2 |
| Japan | 391.3 | 423.8 | -32.5 | -7.7 | 2.9 | 3.1 |
| Switzerland | 351.4 | 277.8 | 73.6 | 26.5 | 2.6 | 2.0 |
| All other | 4,886.1 | 5,340.0 | -453.9 | -8.5 | 36.1 | 39.3 |
| Total | 13533 | 13,596.0 | -63.0 | -0.5 | 100.0 | 100.0 |

*Source: State Bank of Pakistan*

China continued to have the highest share in Pakistan's imports during Q2FY19. This is attributed to the continuing needs for affordable industrial and services sector inputs. The top import items arriving from China include electric apparatus, semiconductor devices, turbo propeller and flat rolled products of alloy steel, steam boilers, and other related industrial inputs (Table7).

China's share in Pakistan's import during the coming days will depend upon how fast both countries move towards the development of priority SEZs in Dhabeji, Faisalabad and Rashakai regions. Pakistan has already shown willingness to offer greater incentives to Chinese industries who may like to locate in Pakistan however with a buy-back agreement so that export industries of Pakistan gain and trade deficit with China is narrowed. Furthermore, the central bank has been encouraging the traders to take benefit of the settlement facility where import payments can be made in yuan.

**Table 7: Major Imports from China (July-May FY18)**

| S.No | HS Code | Value in US '000 |
|---|---|---|
| 1 | 8517 Electric Apparatus for Line Telephony, Telephone Sets | 723,893 |
| 2 | 8541 Semiconductor Devices, Light-Emit Diodes etc. and | 411,446 |
| 3 | 9992 Special Transaction NES | 327,943 |
| 4 | 8411 Turbojets, Turbo propeller and Other Gas Turbine and | 275,965 |
| 5 | 8502 Electrical Generating Sets and Rotary Converters | 268,262 |
| 6 | 3105 Fertilizer of Nitrogen, Phosphorus or Potassium | 265,390 |
| 7 | 5402 Synthetic Filament Yarn Not Sewing Thread, Not Retail | 210,424 |
| 8 | 7225 Flat-Rolled Products of other Alloy Steel, more than | 206,029 |
| 9 | 8402 Steam etc Generating Boilers NES | 199,781 |
| 10 | 8474 Machinery for Sorting Screening etc. | 196,942 |

*Source: State Bank of Pakistan*

Other factors which could determine the change in imports include review of regulatory duties in the forthcoming federal budget in May 2019. The central bank will also continue to evaluate the need for cash margin requirement on several imports, including motor vehicles, cellular phones, cosmetics, personal care, electrical and home appliances, cigarettes, and jewelry. The impact of falling value of Pakistani rupee against US dollar and other major currencies will also have an impact on imports.

The 8th Joint Coordination Committee of CPEC had decided in principle to allow USD 1 billion duty free facility to Pakistan's exports.[40] The imported content in these manufactured exports stands above 50 per cent and could benefit China. Pakistan and China are also expediting the negotiations on revised FTA which could also see some changes in the bilateral terms of trade.

The overall balance of services trade registered a deficit of USD 1.95 billion during July – December 2018. During the same period last year this figure stood at USD 2.75 billion. This 29 per cent reduction is attributed to a decreased in services imports by 16 per cent. The financial services imports witnessed the largest decline in value terms. While the overall services exports dropped by 2.4 per cent, however some increase was seen in the export of travel services, government services and telecommunication, computer and information services.

[40] Jul-Oct FY19: Trade gap narrows to $11.8b as imports stay static. The Express Tribune, November 10, 2018. Web: https://tribune.com.pk/story/1844086/2-jul-oct-fy19-trade-gap-narrows-11-8b-imports-stay-static/. Accessed on: November 16, 2018.

# 6. Regional Trade Update

**South Asia**: Pakistan's total trade with South Asia stood at USD 1.2 billion for Q2FY19 with exports amounting to USD 619 million and imports standing at USD 575 million. Compared with Q1FY18, the total trade increased by 9 per cent. This is mainly attributed to imports from South Asian countries which recorded an increase of 32 per cent compared to Q2FY18.

Pakistan's exports to Bangladesh and India witnessed an increase while a decrease was observed for Afghanistan, Maldives, Nepal, and Sri Lanka. Nevertheless, in value terms, Afghanistan remained the largest recipient of Pakistani exports during Q2FY19 followed by Bangladesh, India and Sri Lanka (Table 8). The imports from Afghanistan, Bangladesh and Sri Lanka registered a decrease. The value of imports from India remained the highest vis-à-vis other South Asian countries at USD 500 million, which is an increase of 38.4 per cent over the same period in FY18.

**Table 8: Pakistan's Trade with South Asia (USD '000)**

| Country | Q2 FY19 (A) | Q2 FY18 (B) | Delta (A-B) | Percentage change |
|---|---|---|---|---|
| Afghanistan | | | | |
| Exports (to Afghanistan) | 234,673 | 421,681 | -187,008 | -44.3 |
| Imports (from Afghanistan) | 43,385 | 50,071 | -6,686 | -13.4 |
| Bangladesh | | | | |
| Exports | 201,746 | 165,047 | 36,699 | 22.2 |
| Imports | 17,305 | 18,963 | -1,658 | -8.7 |
| India | | | | |
| Exports | 110,873 | 91,445 | 19,428 | 21.2 |
| Imports | 500,464 | 361,655 | 138,810 | 38.4 |
| Maldives | | | | |
| Exports | 1,293 | 1,448 | -155 | -10.7 |
| Imports | 46 | 34 | 12 | 35.3 |
| Nepal | | | | |
| Exports | 440 | 1,734 | -1,294 | -74.6 |
| Imports | 135 | 94 | 41 | 43.6 |
| Sri Lanka | | | | |
| Exports | 70,378 | 71,607 | -1,229 | -1.7 |
| Imports | 14,108 | 19,503 | -5,395 | -27.7 |

*Source: State Bank of Pakistan*

**Afghanistan**: Pakistan's two-way trade with Afghanistan decreased by 41% during Q2FY19 compared with the same period during FY18. The trade balance remained in the favour of Pakistan. While Pakistan's exports to Afghanistan declined by 44%, the imports from Afghanistan also declined from

USD 50 million in Q2FY18 to USD 43.4 million in Q2FY19, which is a 13.4 per cent decline. Following the pattern in the previous quarter, Pakistan's exports to Afghanistan included cereals, other vegetable products, sugar and confectionary, cement and related construction material, fruits, animal and vegetable fats and oil, dairy products, medical, surgical and pharmaceutical products, and petroleum. Major imports from Afghanistan were vegetables, cotton, fruits, minerals, hides and skins, wood, carpets, and iron ore.

The recent peace talks in Afghanistan are expected to bring greater stability in political relations between the regional economies. This, in turn, is also expected to boost trade and investment cooperation between Afghanistan, Iran and Pakistan.[41] Pakistan has also reiterated that an early finalization of revised Afghanistan Pakistan Transit Trade Agreement could also benefit the bilateral trade between the two economies.

**Bangladesh**: Pakistan's two-way trade with Bangladesh increased by 19% during Q2FY19 compared with the previous corresponding period. The trade balance was in favour of Pakistan during the period under consideration. The trade balance saw an improvement of USD 3.8 million in Q2FY19. In line with the previous quarter, Pakistan's exports to Bangladesh comprised of cotton yarn and woven cotton fabric products. Major imports from Bangladesh were tea, woven cotton fabrics, jute, other textile fibers, and chemicals.

The business community is upbeat regarding trade with Bangladesh which could see a major boost if travel restrictions between the two countries are relaxed. Pakistan sports goods, surgical instruments, leather products, gloves, textiles items, sportswear, martial arts uniforms and accessories, musical instruments, kitchen ware, hollow ware, knives, and cutlery items will be showcased in forthcoming SAARC-wide business exhibitions.

**India**: India remained Pakistan's largest trading partner in South Asia with a two-way trade standing at USD 611 million during Q2FY19. The two-way trade with India increased by 35 per cent during Q2FY19 compared with the previous corresponding period. The trade balance was in favour of India during the period. The trade balance saw an improvement in favor of India of USD 119 million.

Pakistan's major exports to India included minerals, textile and clothing, hides and skins, and vegetable products while it imported cotton, cyclic hydrocarbons, polymers, heterocyclic compounds with nitrogen hetero-atoms, polycarboxylic acids and anhydrides, ferroalloys, odoriferous mixtures, synthetic organic coloring matter, and vegetables.

**Sri Lanka**: Pakistan's two-way trade with Sri Lanka decreased by 7.3 per cent during Q2FY19 compared with the previous corresponding period. The trade balance was in favour of Pakistan during the period. The trade balance saw an improvement of USD 4.1 million in Q2Y19. Pakistan's main exports included ready-made garments (including cotton-based clothing, bed wear, trousers, silk and synthetic textile),

[41] Afghan Taliban, US Conclude Marathon Peace Talks Arranged by Pakistan. VoA, December 19, 2018. Accessed on web: https://www.voanews.com/a/afghan-us-taliban-talks/4707000.html, February 18, 2019.

cement and pharmaceuticals while it imported tea, coconuts, charcoal from wood, paper-based products, finished rubber items, and betel leaves from Sri Lanka.

## Central Asia

In the case of Central Asia, the largest increase (percentage terms) in Pakistan's exports to Central Asia was seen in the case of Uzbekistan. In value terms also, Uzbekistan remained the largest destination for Pakistan's exports (see Table 9).

**Table 9: Pakistan's Trade with Central Asia (USD '000)**

| Country | Q2 FY19 (A) | Q2 FY18 (B) | Delta (A-B) | Percentage change |
|---|---|---|---|---|
| Kazakhstan | | | | |
| Exports (to Kazakhstan) | 4,152 | 15,949 | -11,797 | -74.0 |
| Imports (from Kazakhstan) | 242 | 142 | 100 | 70.4 |
| Kyrgyzstan | | | | |
| Exports | 228 | 139 | 89 | 64.0 |
| Imports | 0 | 0 | 0 | 0.0 |
| Tajikistan | | | | |
| Exports | 1,353 | 833 | 520 | 62.4 |
| Imports | 5 | 1,632 | -1,627 | -99.7 |
| Turkmenistan | | | | |
| Exports | 904 | 2,429 | -1,525 | -62.8 |
| Imports | 301 | 463 | -162 | -35.0 |
| Uzbekistan | | | | |
| Exports | 4,534 | 1,080 | 3,454 | 319.8 |
| Imports | 1,468 | 144 | 1,324 | 919.4 |

*Source: State Bank of Pakistan*

**Kazakhstan**: Pakistan's two-way trade with Kazakhstan declined by 73 per cent during Q2FY19 compared with the Q2FY18. The trade balance was in favour of Pakistan during the quarter. The trade balance saw a decrease of USD 11 million in Q2FY19. Pakistan's main exports included rice, medical equipment and medicaments. Pakistan's imports from Kazakhstan included ferrous metals.

**Tajikistan**: Pakistan's two-way trade with Tajikistan declined by 45% during Q2FY19 compared with Q2FY18. The trade balance was in favour of Tajikistan. In line with the previous quarter, Pakistan's exports to Tajikistan included sugar and confectionary, medical, surgical and pharmaceutical items, dairy products, rice, and construction material. Major imports from Tajikistan included chemicals.

Tajikistan has already announced plans to start a direct flight between Dushanbe and Lahore.[42] Furthermore, Tajikistan has stressed upon Afghanistan and Pakistan for early finalization of APTTA which, in turn, could also benefit Tajikistan. The latter has already requested for a trilateral transit agreement.

**Turkmenistan**: Pakistan's two-way trade with Turkmenistan declined by 58 per cent during Q2FY19 compared with Q2FY18. The trade balance was in favour of Pakistan and stood at USD 1.4 million for Q2FY19. Pakistan's exports to Turkmenistan mainly include cereals, animal or vegetable fats and oil; pyrotechnic products, matches, pyrophoric alloys and other combustible preparations; vegetable textile fibres; paper yarn and woven fabrics of paper yarn; oil seeds and oleaginous fruits; and worn clothing.

Pakistan's imports from Turkmenistan were plastic items and building construction materials. The expected increase in investments under Asian Development Bank funded Central Asia Regional Economic Corridor (CAREC) programme are expected to further boost bilateral trade cooperation with Turkmenistan.

**Uzbekistan**: Pakistan's two-way trade with Uzbekistan increased by 390% during Q2FY19 compared with the previous corresponding period. The trade balance was in favour of Pakistan during the period under consideration. Pakistan's exports to Uzbekistan mainly included pharmaceutical products, cutlery items, and mechanical appliances. Major imports from Uzbekistan included plastic items and mechanical appliances.

Uzbekistan's BMP Trade Group has been actively seeking investment cooperation proposals from Pakistan's private sector. A Trilateral Trade Commission between Afghanistan, Pakistan and Uzbekistan to promote trade, logistics and investment ties has also been proposed by the Uzbek government.

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42 Tajikistan keen in promoting trade with Pakistan. The News, November 16, 2018. Web: https://www.thenews.com.pk/print/392405-tajikistan-keen-in-promoting-trade-with-pakistan, accessed on November 16, 2018.

# 7. Special Section: National Industrial Policy

For the fourth issue of Pakistan Quarterly Trade Bulletin, SDPI team reached out to both public and private sector representatives to solicit their views regarding the federal-level industrial policy that is under formulation. This section provides details regarding some proposals which will be part of the industrial policy. Also, we discuss the possible outcomes as a result of this policy intervention in the manufacturing sector. We are grateful for inputs from Mr Mathar Niaz Rana, Additional Secretary, Ministry of Industries & Production, and Mr Kashif Anwar, Industrialist and former vice-president of FPCCI.

The federal government has initiated the formulation of industrial policy to encourage exports focusing particularly on how to help the engineering industry in Pakistan. The policy will provide measures, which could attract foreign and local investments in export-oriented sectors. This will also reduce reliance on textile as the major export item from Pakistan and allow other sectors to contribute and increase share in the overall export basket.

## a. Perspectives from the Public Sector

According to the Ministry of Industries & Production, a key consideration is not to have an industrial policy in isolation with other macroeconomic priorities. Utmost effort will be made to link industrial policy with the priorities and targets in other government policies which compliment an overall economic growth. These could include but are not limited to Strategic Trade Policy Framework, 12$^{th}$ Five Year Plan of Planning Commission and power sector policy.

**Expected contours of the industrial policy**

To increase the penetration of Pakistani exports in non-traditional markets, manufacturing sector will be encouraged to produce for economies with which Pakistan has FTAs. Similarly, industrial policy will respond to the currently allowed market access under GSP+ and encourage the production of export items, which could see their demand in EU region.

The overall fiscal policy needs to be reimagined to support industry. For example, currently while manufacturing contributes less than 15 per cent to the national income, however it contributes 58 per cent to the overall taxes collected by the government. The tax burden is not shared by agriculture and services sectors. A large informal sector and incidence of smuggling seen in some sectors also discourages local producers who end up facing unfair competition. In the case of tariffs on imported inputs, a long-term tariff policy could take the cascading approach. This will allow higher tariffs on those finished products which are domestically produced. The tariffs will be lower on raw materials and intermediate inputs which are not produced domestically. In this regard, industrial policy requires inputs from other institutions, including National Tariff Commission.

A key pillar of industrial policy will be the promotion of technology transfer. In this regard, cooperation with China and countries with whom Pakistan has FTA or other market access arrangements, e.g. GSP+ will be further promoted. Clusters of R&D setups are required in most export-oriented industries of

Pakistan to equip them with demands of industrialization 4.0. The industrial policy will aim to strengthen the aims and objectives under President of Pakistan's Initiative on Artificial Intelligence.

Compliance with product standards, including environmental considerations, has been a key limitation for the SMEs, who have not been able to export or could not sustain exports in the past. Therefore, industrial policy will not only look into enhancing the capacity of the private sector through their product-level associations but also expand the services of training and outreach provided by public sector product standards authorities.

Incentives may be allowed if local private sector reduces its reliance on the scarce locally available energy supplies and moves toward captive or renewable solutions. For this purpose, consultation is expected with Ministry of Energy as well as the regulatory bodies in the energy sector.

**Bridging the capacity gaps**

Skilled labour continues to be a concern for value-added production units in Pakistan. The new industrial policy is expected to incentivize the local capacity building by the private sector, particularly for manufacturing items which have export potential. This measure will have relevance for pharmaceuticals, electronics, oil and gas, integrated petrochemicals, and IT and communications products. The sectoral skill development councils established during early 2000s may be reinitiated to bridge the capacity gaps.

Private sector has demanded the revival of sick industries. However, this is where the government will aim to strike a balance and potentially efficient industries will be allowed incentives which are targeted and time bound. Likewise, incentives will be available if private sector is still not finding Balochistan and parts of Khyber Pakhtunkhwa and western districts of Pakistan attractive for investment. Any future industrial policy is also aimed at resurrecting the ailing public sector manufacturing facilities, including Pakistan Steel Mills.

The success of export of tractors from Pakistan indicates a large potential in engineering sector. However, several other sub-sectors in engineering group are still struggling to make their mark outside the country. For example, two wheelers and electronic appliances manufactured and assembled in Pakistan have a large potential which can be tapped through appropriate policy facilitation and capacity building of the private sector. For example, capacities need to be enhanced for adoption of environment-friendly engines and related technologies. In this regard, the government aims to strengthen the role of Engineering Development Board and its linkages with the provincial governments.

## b. Perspectives from the private sector

The private sector representatives were found concerned at the deindustrialization trend in Pakistan. According to them, the new industrial policy needs to look into the falling share of manufacturing in overall GDP. From 17.5 per cent in 2005, this share has fallen to 12.1 per cent in 2018. At a macro-level, this is attributed to:

- higher input costs including expenses towards power and gas
- tax policy which puts disproportionate burden on the manufacturing sector

- current scope and structure of FTAs
- continued existence of grey and black economy, and
- administrative weaknesses to tackle under-invoicing and smuggling.

The examples of Bangladesh, India, and Vietnam were cited which have overtime become more competitive and also transitioned towards tariff lines, which are value added, branded, cost-effective and technologically advanced. The business community largely concedes that Pakistan's exports will continue to remain import-dependent. For this purpose, it is important to rethink the current tariff structure which according to them is primarily aimed at mobilizing revenues for the government and not aimed at encouraging a process of self-discovery in private enterprise.

The business community also feels that the government needs to study why input costs are lower in peer economies. For example, according to a recent study by Pakistan Business Council, costs towards labour, electricity and gas have been increasing by 14%, 13% and 14% per annum respectively since 2010.[43] Overtime the costs of compliance with federal and provincial level regulations, for example those related to taxes, labour, environment and municipal rules has also seen an increase. The municipal rules and safety standards are significantly different across provinces for food and food processing sector.

**Competitiveness in traditional exports**

Current skills and capacity allow Pakistan to focus on select industries with the objective of bringing about cost competitiveness and export diversification. However, sector-specific support may be required in areas with current export potential:

**Textiles**: As global demand has shifted to man-made fibers, therefore, Pakistan's continuous reliance on cotton-based exports may not be a completely rational decision. The industry currently lacks the capacity to transition to man-made fibers. In this regard, a possible option could be to offer industrial policy measures, which can encourage joint ventures between Pakistani and Chinese enterprises. The latter has the expertise in this area, however, currently faces high labour costs.

**Leather**: The value addition in leather sector has suffered due to distortions in past fiscal policies. For example, non-cascading tariffs have hurt footwear sector. There is a need to rationalize import and regulatory duties on inputs such as soles, heels, laminate fabrics, PU chemicals, insole board, and zippers.

**Agriculture**: Improved technological adoption in this sector can improve yield and quality of crop sector output. Interventions will however require land-levelling, water course management, water conservation, climate resilient seeds, affordable fertilizers and pesticides, harvesting technologies. It would be important that the new industrial policy enhances the productivity of engineering sector which in turn can locally manufacture low-cost agriculture technologies.

[43] "Pakistan Economic Forum-V: Made in Pakistan", published by Pakistan Business Council, December 2018. See also, "Contours of a New Industrial Policy", published by Pakistan Business Council, 2018; and "Value Addition in Manufacturing: Study of High Potential Products for Local Manufacturing and Export Diversification", published by Pakistan Business Council, December 2018.

**Engineering**: The imports of iron, steel and auto parts are currently a significant constraint on the foreign exchange reserves. A careful study may be conducted to see which tariff lines can be competitively produced locally. This study, in turn, could also suggest measures which could incentivize local production of these tariff lines.

**Competitiveness in non-traditional exports**
While traditional sectors in the export basket will continue to receive attention from policy makers, however potential and non-traditional export sectors also require support. These include but are not limited to:

**Electronics**: New industrial policy could provide measures for electronics sector development. A key aim should be to invite foreign enterprises with expertise in manufacturing computer hardware, laptops and handheld devices to establish local manufacturing units.

**Automotive Industry**: Industrial policy could incentivize local manufacturing instead of just assembly of automobile and auto parts. Foreign manufacturers need to be asked regarding what facilitation they would require to produce more sophisticated vehicle components such as engines and transmissions with-in Pakistan.

**Food processing**: South Asia and China with their large populations present an ideal opportunity to scale up production and export of packaged and processed foods, including fruits and vegetables. The demand projections for halal food are also on the upside across the region and Far East. Industrial policy could invite interest of the private sector to revamp the food wholesale infrastructure, warehousing and logistics which care for perishable goods.

**Pharmaceuticals**: Industrial policy could encourage multinationals to manufacture in Pakistan. For local enterprises to invest in FDA approved facilities, current pricing regime needs to be revisited. The focus could be on the production of those materials which have both local and foreign demand, in turn allowing this sector to expand exports.

**Petrochemicals**: Currently, unavailability of petrochemical facilities forces the local industry to import USD 3.2 billion of chemicals, USD 2 billion of synthetic textile inputs and USD 2.3 billion of plastic sector inputs. However, as input to the petrochemical sector, the industrial policy would need to incentivize oil and gas explorations and additional refining capacity in Pakistan. The energy sector policies will also have to play a complimentary role. For example, well-head price of new discoveries can be revised, especially for expensive exploration as seen in the case of shale and tight gas.

**Learning from the Chinese Experience**
For the formulation of industrial policy, FPCCI has already suggested to follow the recent advice provided during their interaction with State Council of China, which could help in identification of latent comparative advantage of Pakistani enterprises. This exercise, according to the Chinese experts, will

have to start with evaluating which sectors have growth potential given the current resource availability including skilled labour in Pakistan. Second, domestic firms already working in these sectors may be facilitated through removal of binding constraints. Third, foreign enterprises could be invited in industries critical to future growth priorities, however lacking the presence of domestic firms. Fourth, government could encourage startups and graduation of SMEs and support them to scale up in existing and emerging sectors. Fifth, the cluster approach could promote economies of scale and also overcome any gaps in infrastructure, e.g. access of power and gas. Finally, long-term and certain fiscal policy will be required for the pioneering enterprises. Such a policy package could include time bound tax breaks, access to credit and foreign exchange.

CPEC's next phase, development of SEZs and revision of FTA with China presents a major opportunity for Pakistan. However, according to the private sector, scanty research is available on goods and services what China is likely to import from Pakistan in future. Current trends reveal that during the short to medium term Pakistan's only option is to export the current items more competitively. With greater economies of scale and improved quality it could increase its share in textile, agriculture and processed food. This will also require Pakistan to continuously cut its cost of doing business in these sectors.

Some projections also indicate a slowdown in Chinese economy during the coming years. In that scenario, Pakistan could see demand of its primary sector goods decline. Hence it is increasingly important that Pakistan offers a more diversified set of choices to Chinese importers. Another option could be to look into the exports of Bangladesh, India and Vietnam to China and see which of those tariff lines can be scaled up by Pakistan. Currently, these economies are supplying China's growing demand for sea food, vegetable oil, and skins which can be produced in Pakistan competitively if appropriate policy facilitation is available.

### Infrastructure Development Capacity

A key action under the industrial policy formulation exercise should be infrastructure development capacity assessment. Pakistan's future infrastructure development could easily expand basic industries, including mining and construction. These basic industries also provide backward and forward linkages which can be leveraged by other industries. The promotion of public private partnerships in infrastructure development and construction could be a key target under the new industrial policy. This will provide greater certainty to the private sector for investing in long-term infrastructure investment opportunities.

Current regulatory environment has also prevented the growth of public private partnerships in the past. The business community expressed the need for an urgent regulatory impact assessment. This was last conducted in 2005 and explained those factors which lead to high cost of regulations, including permits and licenses. It was suggested that an updated assessment could be undertaken by the Competition Commission of Pakistan.

The private sector associations hope that the Ministry of Industries and Production will soon initiate the consultative mechanism for the national industrial policy formulation and all commodity producing sectors will be allowed a fair chance to provide proposals. Following the practice in the past, it was hoped that the policy will respond to the needs of both, SMEs and large manufacturing enterprises.

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PAKISTAN QUARTERLY TRADE BULLETIN

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