Large-scale manufacturing records

remarkable growth of 8.5pc

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FROM OUR CORRESPONDENT

KARACHI: Following is the executive summary of SBP quarterly report of sector -wise performance of Pakistan's economy.

Agriculture

During FY03, agriculture sector posted an impressive recovery by witnessing an estimated 4.2 per cent (pc) growth compared to a 0.1pc decline in FY02. The momentum to the growth came from major crops, which rose by 5.8pc during the year as against a decline of 1.8pc in FY02. Canal water availability during FY03 was higher both in kharif (by 14.9pc) and in rabi (by 31.7pc). This, coupled with the timely rainfalls, encouraged farmers to bring larger area under cultivation for sugarcane, rice and maize.

However, due to the fall in area under cotton crop in the Punjab (mainly caused by the delayed water availability in the region), the total area under cultivation during FY03 was almost unchanged compared to FY02.

The entire growth in the major crops seems to stem from the improvement in the yields. In particular, per hectare yield of gram rose by the unprecedented 58.5pc, followed by rice (9.6pc), cotton (7.3pc), wheat (5.4pc) and maize (2.6pc).

During entire FY03, the market prices of rice, cotton, maize and wheat during post-harvest period, remained higher compared to FY02. This helped to improve the financial position of the farmers during FY03, and may lead to increased focus on these crops in the next season.

Large-scale Manufacturing

The Large-scale Manufacturing (LSM) recorded a remarkable growth of 8.5pc during July-March FY03 compared with a mere 1.5pc growth in the corresponding period of the preceding year. The growth in LSM was broad based; all LSM sub-sectors, except leather products, witnessed an increase in output during July-March FY03.

However, tremendous growth in the production of automobile, electronics and construction-related industries on the back of robust domestic demand, has been the highlight of LSM growth during July-March FY03.

The increasing availability of consumer financing, sustained growth in remittances, robust growth in agriculture accompanied by increase inproductivity etc., have been the major factors boosting domestic demand.

The production of the allied industries such as tyres & tubes, paper and board, cement, steel and chemicals also saw increases. The textile industry too, performed well on the back of rising exports of textile products.

Fiscal

The government was successful in containing the budgetary deficit in line with the full year target during July-March FY03. This was achieved on the back of strong growth in total revenues (15.7pc) and disciplined expenditures (6.8pc). The end-Q3 figures suggest that it is likely that government will be able to meet the budget deficit target of 4.6 4pc of GDP.

The fiscal position improvement is the result of a good performance of both tax and non-tax components of revenues. Within tax revenues, CBR tax receipts, which constitute 81.9pc of tax revenue, recorded a strong growth (15.0pc) for a third successive quarter of FY03, predominantly helped by a recovering economy, broadening of the tax base, and reform of the taxation system. These developments are in sharp contrast to the FY02 poor performance. During July-March FY03, total expenditures grew at a lower rate than the nominal GDP growth, but accelerated marginally over the corresponding period of the previous year. The major impetus came from higher current expenditures by the provincial governments, defense and subsidies, while a sharp reduction in debt servicing (Rs 26.4 billion) and shortfall in development expenditures (Rs 9.9 billion) partially offset these increases.

Money and Credit

A host of factors including (1) substantial rupee liquidity injections through SBP forex purchases, (2) strong deposit growth, and (3) lower net requirement from the government sector, kept the interest rates under pressure during Q3-FY03. The resultant decline in lending rates and rising aggregate demand in the economy led to an exceptional rise in net private sector credit during Q3-FY03. Although, the increase in aggregate demand had been apparent even prior to the November 2002 discount rate cut, credit off-take only accelerated thereafter.

Since the November 2002 discount rate cut was in response to the apparent weakness in net credit expansion, once net private sector credit began rising strongly, SBP signaled its neutral stance by keeping the discount rate unchanged, even as interest rates declined over Q3-FY03 amidst high market liquidity and the expectation of a further discount rate cut. These expectations of a discount rate cut together with the ample liquidity in the market created a self-perpetuating cycle - heavy bids in auctions (as banks strove aggressively to book assets) led to lower auction cut-offs which, in turn, spurred heavier bids, at lower rates, in the succeeding auctions. This trend culminated in bids of over Rs 100 billion in both of the March 2003 auctions, and as a result, the benchmark 6-month T-bill yield fell to an all time low of 2.1pc.

Significantly, the weighted average lending rates slipped into single digits, reaching 8.3pc by end Q3-FY03. Thus, during Q3-FY03, the government continued to benefit from lower interest rates, substantial foreign assistance and inflows from the non-bank sources. This allowed the government to retire its borrowings from the banking system as a whole. However, within the banking sector, there was a shift of government debt from SBP towards the commercial banks, reflecting the continuing SBP efforts to sterilize a part of the heavy growth in Net Foreign Assets (NFA). There was also an exceptionally heavy retirement in commodity operation loans, which is indeed a welcome development. This exceptional retirement is apparently a result of improved financial position of relevant federal agencies and the provincial governments, and the government policy of transferring this activity to the private sector.

In contrast to substantial retirement in the government sector, the non-government sector credit recorded an impressive Rs 95.4 billion expansion, during July-March FY03. The major contributor to this was net private sector credit, which recorded an expansion of Rs 107.2 billion; almost twice the expansion seen in the corresponding period of FY02.

Banking

Deposits of the banking sector registered a strong growth of 4.1pc during Q3-FY03, making a cumulative rise of 11.6pc during July-March FY03. This unprecedented growth stemmed entirely from the rupee deposits, as forex deposits continued to decline. An exceptional rise in remittances, PSE's and the government deposits led this impressive growth.

Low lending rates along with the strengthening economy, led to exceptionally strong credit disbursement, which recorded a Rs 210.9 billion increase during July-March FY03 compared to the same period of FY02. This unusual rise in overall credit was headed by a surge in the private sector credit.

Other significant developments are the decline in banking sector spread and improvement in NPLs. While the former saw a decline of 126 basis points during Q3-FY03, the latter declined to Rs 242.2 billion with a contraction of Rs 2.0 billion during the quarter under review.

Prices

Inflationary trends further subdued in Q3-FY03. The Consumer Price Index and Sensitive Price Indicator continue to decelerate and registered annualized increases of 3.1pc and 2.8pc compared with 3.5pc and 4.1pc respectively in the corresponding period last year. Although both the food and non-food components of CPI recorded lower price increases, the contribution of food inflation in aggregate CPI inflation continued to decline. By contrast, WPI posted higher increases from 0.4pc last year to 8.6pc. The higher WPI inflation was mainly driven by non-food prices. However, WPI inflation in March 2003 has also edged down, indicating that inflation is likely to be subdued in the remaining months of FY03.

Capital Market

Unlike the previous quarter, Q3-FY03 was marked with considerable volatility. During this quarter, the benchmark KSE-100 index assumed a new high, reaching 2955.52 points on January 16, 2003. The downturn persisted during the entire month of February 2003, which saw the market bottom out around the 2350-point levels. Encouragingly, the March 2003 rally was more robust and less speculative than the earlier one.

The badla rates reached as high as 48pc during the January speculative rally, but for most of the remaining quarter, they were around the 8pc level due to ample liquidity prevailing in the market. The corporate bond market remained active during Q3-FY03. As compared to Q2-FY03, when three new issues worth Rs2.2 billion were issued, seven new issues worth Rs 2.7 billion were listed in Q3-FY03. However, the debt market is still very small compared to the equity market.

External

Pakistan's external account continued with the trends set in previous quarters by posting yet another large surplus of $ 2.1 billion during Q3-FY03 despite a rising trade deficit and services outflows. The main drivers of the surpluses were the continued buoyant growth in workers' remittances, logistic support receipts, declining interest payments on external debt & liabilities and higher official transfers mainly due to $1.0 billion write-off from US. This helped the SBP in maintaining its heavy interbank forex purchases during Q3-FY03, raising the SBP forex reserves to $9.5 billion and moderating the rupee appreciation.

The Pak rupee appreciated by only 0.88pc during Q3-FY03. Exceptional inflows such as the debt write-off, logistic support and grants by the US and Saudi Oil Facility (SOF) contributed $1.7 billion during Q3-FY03 to the balance of payments. After adjusting for such inflows, while there is a gradual narrowing of the quarterly current account surpluses, the capital account witnesses a roughly parallel offsetting improvement.

Cumulatively, current account surplus rose to $4.4 billion during July-March FY03, registering growth of 96.5pc over the corresponding period last year. Exceptional inflows contributed $2.4 billion to this gain, while the remaining improvement mainly came from continued surge in workers' remittances and lower interest payments on external debt & liabilities. Notwithstanding the 20.2pc growth in exports, the trade deficit rose by 43.9pc in July-March 2003 mainly on the back of 27pc higher POL imports. This increase in the oil bill was due to both a sharp rise in international oil prices and an increase in quantum to maintain oil reserves in the wake of US-Iraq war.

This led to a 22.8pc increase in the total import bill in this period. Although international oil prices impose a significant burden on Pakistan's import bill ($2.4 billion, or 26.8pc of the total import bill), the offsetting export growth kept the July-March FY03 trade deficit from rising even further.

Other groups such as machinery and food, also contributed in the rising imports. As a matter of fact, machinery imports were the second largest claimant on the import bill, having 8pc contribution in the total import growth. Within machinery imports, the highest share was captured by textile machinery, which was followed by imports of road motor vehicles.

The broad-based growth pattern in imports can be gauged from the fact that non-oil and non-food imports also showed a similar robust increase, as did overall imports.

In terms of exports, the highest contribution in overall growth was made by the textile sector (68pc), which grew by 21.4pc during July-March FY03. All the major value-added textile categories contributed in this growth with significant increases in volumes and unit values. Among the major non-textile exports the performance of rice remained impressive, which witnessed 20.8pc growth mainly on the back of higher unit values.

The capital account posted a deficit of $1.0 billion, during Q3-FY03, despite higher FDI, rising FE-25 trade financing and increased assistance on account of project financing.

This was primarily due to the treatment of debt write-off as an outflow in the long-term capital (official).

Excluding the US debt write-off and FE-25 trade financing, the capital account deficit declined to $187 million during Q3-FY03 down $617 million from Q3-FY02.