Contents

Editor's Corner

Dear readers,

The State Bank of Pakistan's third quarterly report for FY02, the Economic Survey 2001-02 and the Federal Budget 2002-03 were issued sequentially within days of each other. While pointing to the aspects of stability and resurgence in some areas because of the structural reforms underway, they also contained evidence of the weak areas of the economy, which continue to be a source of concern.

Despite low growth of the agricultural sector (1.4%) as the shortage of irrigation water worsened for the second successive year in FY02, gross domestic product grew by 3.6%, slightly less than the year's target of 4%. Agriculture continues to be the mainstay of Pakistan's economy affecting the overall economic performance, the living conditions of large numbers in rural areas, and the output of industry manifest through the textile sector both large and small scale.

A key element of a long term strategy for improving agricultural performance is not the building of large dams but a substantial improvement in water management, water use and improving the output from its sub-sectors, namely livestock, poultry and forestry.

The uncertainty in the domestic economy because of the September 11 events, subsequent military action in neighbouring Afghanistan and by the border tensions with India hurt the large scale manufacturing sector activity, which simultaneously affected exports as well as domestic demand.

It is however, encouraging to note that despite the depressed market conditions prevailing in the global economy, textiles showed improved performance. This could partly be because of the support it received from EU decision to improve Pakistan's market access. (It lifted tariffs on value added Pakistani textile products and increased the existing quota with effect from January 01, 2002).

9/11 and the ensuing events cast a major dampener on investments in Pakistan both domestic as well as foreign. Investment as a proportion of GDP has fallen throughout the decade of the 1990s from 20% in 1991-92 to around 14% in 2001-02, with the public sector suffering a greater decline. While private sector investment has fallen from 10.1% in 1991-92 to 7.6% of GDP in 2001-02, the public sector investment came down from 9.1% to 4.7% of GDP.

Reviving investment in the economy has remained elusive because of some pre-dominant factors such as law & order, increased cost of production, world recession, lower domestic demand due to unemployment and poverty. The government has taken some bold steps to curb anti-state activities and thereby create a congenial investor friendly environment. One hopes that in the year ahead, as economic reforms continue alongwith political stability, lessening of tension on the borders, investment climate would improve, reviving economic activity. This would in turn also help the government to meet its revenue collection targets.

In FY02, revenue collections by the Central Board of Revenue (CBR) fell short of the target. CBR was unable to collect the thrice revised target of Rs.414 billion, due to substantial drop in customs duty resulting from lower trade values and large adjustments of accumulated rebates and refunds.

The fiscal deficit rose to an estimated 7% of the GDP, 2 percentage points higher than the earlier projection of 4.9%, primarily due to revenue shortfalls.

In the course of the next fiscal year, if the government is able to raise its revenues and bring it closer to the target of Rs.460 billion, it would help finance greater allocations for development/social spending. Tax reforms underway show promise. CBR is being restructured, where intention is to ensure anonymity between staff and taxpayers, making corruption more difficult. The new Income Tax Ordinance has instituted a new tax system in the country, where discretionary powers of tax officials are minimized with emphasis on audit, more equitable rates etc. Presumptive and non-adjustable taxes have been gradually removed, self assessment is allowed for all types of incomes.

On the external front there has been an impressive recovery of workers remittances, which have roughly doubled as the kerb market premium has fallen. Despite a marginal growth in exports due to a decline in unit values in the international market, the trade deficit shrank. Imports were contained because of a considerable decline in oil prices and lower imports of sugar. There was an estimated current account surplus of $913 million in FY02.

Paris Club rescheduling and other international assistance has provided significant cash flow relief and resulted in decline in Pakistan's annual external debt servicing expenditures. The government is pursuing a debt management strategy to reduce domestic debt to sustainable levels. The rescheduling and other assistance from bilateral and multilateral donors has given Pakistan space to lay the foundation for sustainable growth.

Pakistan's external debt fell by $2 billion to $36 billion while there was an 8% decline in domestic debt which is now estimated at Rs.1652 billion. A decrease in debt augurs well for the economy, for its servicing necessitates large cutbacks on essential public expenditure. With a reduction in this burden, the outlays for social and public infrastructure expenditure could be increased in FY03.

Ayesha Mahmud

Abstract of the Bulletin

Pakistan's Economy

- The outgoing fiscal year 2001-02 was a difficult and challenging year for the world economy and Pakistan in particular.
- The growth targets for GDP, agriculture and manufacturing were revised during the year following the September 11 events.
- GDP grew by 3.6%, agriculture by 1.4%, and large scale manufacturing by 4.0%.
- In FY02, remittances rose, imports dropped and the current account posted a surplus of $913 million. Foreign exchange reserve crossed $6 billion.

Federal Budget 2002-03 – A Review

- Federal Budget FY03 is a combination of government's medium term economic reform program. Main thrust is on tax and tariff reforms, increased reliance on GST, emphasis on poverty alleviation among others.
- Development expenditure has been raised, while current expenditure is budgeted to be lower by 6.3%, due to a proposed decline in both debt servicing and defence.
- Overall budget deficit is expected to be lowered to 4% of GDP in FY03 against 7% in FY02.
- A number of measures have been taken to rationalize various taxes, eliminate exemptions, reduce the SROs (statutory regulatory orders), provide incentives to capital market, housing sector, exports etc.

Pakistan's Textile Sector

- The textile sector holds an important position in Pakistan's economy, in terms of employment, value added and the contribution the industry makes to exports.
- Textile products, especially garments, hosiery, bedwear and towels have a good market abroad.
- Small & Medium Enterprise Development Authority prepared a strategy document on the textile sector – Textile Vision 2005, which provides sector specific measures for sustainable development of the industry.

Agriculture

- The agriculture sector suffers from the prolongation of drought.
- Major crops accounting for 40% of agricultural value added registered a decline for the second successive year in a row.
- Institutional reforms are needed to enhance efficiency of water usage.

Banking and Finance

- Key monetary indicators, deposits, advances, investment in government securities, notes in circulation and approved foreign exchange rose in the period under review (June 15, 2002) over the comparable period a year earlier.
- Major national saving schemes showed substantial growth in funds mobilized in the year 2001.
- In FY02 real rate of return on these schemes increased.

Market Analysis

- The market has lost 120 points since April (till June 21, 2002). The index had lost 236 points in the month of May before making a partial recovery in June. The decline was expected as the market had lost its momentum, stock prices had appreciated close to their full values and the rally was highly leveraged.
- In our opinion the market is fully priced (for the near term). Investors don't foresee any further upside potential hence no active buying support is visible. On the other hand the alternative opportunities (declining yield on fixed income securities) are becoming less and less attractive. Hence investors are not inclined to off load their investments at these levels. Thus we expect the market to be range bound in the near term.

Pakistan's Economy

In the outgoing FY02, despite the prevailing uncongenial conditions both domestic and external, Pakistan's economy managed to pull through the difficult period, with some positive achievements.

The worldwide economic slowdown aggravated by the events of September 11, the tension on the border with India, the law and order situation especially in the port city of Karachi, and the continuing drought affected the performance of the economy. Economic growth declined, accompanied by fall in the growth rate of agriculture and manufacturing sectors, with negative repercussions for government revenues.

However, improvement in the country's external account provided an enabling environment for the State Bank of Pakistan's looser monetary stance in FY02. A positive for the economy is the fall in external debt liabilities estimated at $36 billion by end June 2002, $2 billion less over end June 2002.

Sectoral growth targets revised

The original growth targets for real GDP, agriculture and manufacturing were slightly lowered during the year, in view of prevailing conditions. GDP grew by 3.6% in FY02 as against the revised target of 3.3% and preceding year's growth of 2.5%. This was supported by a 5.2% growth in the services sector.

Agri-cultural growth marginally better

While agricultural growth at 1.4% fell short over the revised target of 1.9% due to the prolongation of drought conditions, it was an improvement over a negative 2.6% seen a year earlier. Major crops which account for 40% of agricultural value added declined for the second consecutive year though the fall (0.55%) was less than negative 9.8% recorded a year earlier. Shortage of irrigation water affected rice, cotton and wheat crops.

Manufac-turing growth weak

Manufacturing performance was weaker, as growth of large scale manufacturing (LSM) halved in the year; 4.0% from 8.6% in 2000-01. The uncertainty in the economy following the military action in Afghanistan, and towards the end of last year, by the border tension with India, hurt LSM.

While the different sub-sectors of manufacturing were doing well in the first quarter of last fiscal year, the September 11 aftermath adversely affected the performance of the sector. There are however, indications that production would pick up in the remaining months for items like cement, sugar and automobiles.

Growth in the Production of Selected Large-scale Manufacturing Items

(%)

Items	Weights	July - March FY01	July - March FY02
Textile	19.069	2.73	4.37
Food, bev. & tobacco	17.336	9.04	4.38
Petroleum products	7.824	16.62	18.71
Fertilizer	5.871	11.83	-0.63
Pharmaceuticals	5.798	1.61	2.23
Metal industries	3.317	7.20	-5.34
Leather products	2.333	9.30	-3.51
Electronics	2.976	3.31	6.09
Automobile	2.413	10.76	-5.72
Chemicals	2.335	13.38	-4.13
Non-metallic minerals	1.915	1.78	-2.03
Paper & board	1.359	25.02	2.84
Engineering items	0.691	6.23	-3.62
Tyres & tubes	0.452	1.01	5.88

Main laggards

Source: The State of Pakistan's Economy Third Quarte State Bank of Pakistan

There has been a rising value addition in textiles as evident in the higher domestic consumption of cotton yarn. With the European Union having lifted tariffs on value added Pakistani textile products, and an increase in existing quota by 15%, should help boost this sector.

Fiscal develop-ments

Fiscal balance continues to be an area of concern. The developments in FY02 adversely affected attainment of the fiscal deficit target of 4.9%. Uncontemplated events last year undermined government's efforts to bring down the deficit, inspite of wide ranging tax reforms being pursued. As a consequence, key economic aggregates, like imports and industrial production were affected, causing slippages on the revenue side.

Tax revenues fall short of target

Federal government revenues remained under stress, as tax collections by Central Board of Revenue in FY02 fell short of the thrice revised tax collection target. Even in terms of new targets, receipts upto April 02 proved inadequate as actual collections at Rs.306.1 billion were only 73% of the annual target.

This is attributable to lower GDP growth, fall in rupee imports and the large amount of refund/rebate was a dampener to net tax collections. Meeting the year's target of Rs.414.2 billion remains a challenge for the Central Board of Revenue.

An encouraging development has been the increase during the period in income tax receipts, which rose an estimated 13% in FY02 over the year. Collections with normal returns showed a 39.3% growth implying an increasing tax base of income tax.

CBR Revenue Targets/Collections

(Rs. Bn)

	Budget Target 2001-02	Revised Target 2001-02	Tax Collections upto April 02
Direct Taxes	149.8	146.5	108.5
Indirect Taxes	307.9	267.7	197.6
Sales Tax	185.2	170.1	128.5
Central Excise	53.1	47.1	35.9
Customs	69.6	50.5	43.2
Total Collections	**457.7**	**414.2**	**306.1**

Source: *The State of Pakistan's Economy Third Quarterly Report for 2001-02 State Bank of Pakistan*

With-holding taxes decline

However, withholding taxes declined in FY02 due to lower activity in the economy, lower collections on income from interest on government securities; on import proceeds in terms of value; on the supply of goods and furthermore the abolition of five types of withholding taxes contributed to lower collections.

Customs duty fall

Decline in indirect tax collection primarily customs duty was responsible for 77.2% of the total shortfall in revenue collection by end March 2002. While sales tax (GST) collection showed a positive growth, customs duty dropped 13.3% year-on-year, reflecting fall in imports and appreciation of the Pak rupee.

This alongwith government's effort to expedite the payment of tax refund arrears added to falling revenues.

Financing of the deficit

Meanwhile, the financing of the budget deficit was both through external and domestic resources. However, financing from domestic resources was higher than the net external resources. During the year there was higher repayments of both long term and short term loans, amounting to Rs.120.5 billion upto July-March FY02, resulting in lower net external financing. Larger disbursement on account of special budgetary support grant, and debt rescheduled amount coupled with lower financing needs of the government facilitated the repayment of loans.

Expendi-tures contained

Government expenditures primarily current expenditure have been contained because of lower debt servicing and defence costs which accounted for approximately half of the savings during the period. Interest payments remained below the targeted level largely on account of lower T-bill rates during the period. As the government retired an outstanding debt of Rs.193 billion there was a corresponding lowering of interest payments on domestic debt. Interest payments on external debt were also slightly lower then the target due to re-profiling of bilateral foreign debt.

Current Expenditure

(Rs. Bn)

	1998-99	1999-00	2000-01	2001-02	2002-03 Budgeted
Debt Servicing	290.7	330.6	312.7	320.1	289.7
Interest on Domestic Debt	175.3	207.1	188.5	192.5	191.8
Interest on Foreign Debt	38.0	44.9	51.2	60.8	53.1
Foreign Loan & Repayments	77.4	78.6	73.0	66.8	44.8
Defence	143.5	152.8	131.1	151.7	146.0
General Administration	18.5	19.6	50.8	51.2	54.9
Law & Order	8.1	9.0	10.1	10.3	11.6
Economic, Social & Community Services	20.3	19.3	22.4	23.2	26.1
Subsidies	9.5	20.4	20.4	25.6	20.8
Others	24.8	40.8	46.1	66.5	58.9
Total	**515.4**	**592.5**	**593.6**	**648.6**	**608.0**

Source: *Federal Budget Documents*

The bane of public debt

Rising fiscal deficits in the past two decades, depreciation of the exchange rate, rising cost of borrowings, ineffective use of borrowed resources are some of the factors responsible for the rise in public debt. Total public debt has crossed Rs.3 trillion, constituting 111% of GDP.

Efforts made in the recent past to reduce the size of public debt showed positive results, as both debt payable in rupees and foreign exchange have been reduced. The burden on the exchequer can be further lowered if these efforts at fiscal consolidation and reducing the real cost of borrowing can continue on a sustainable basis.

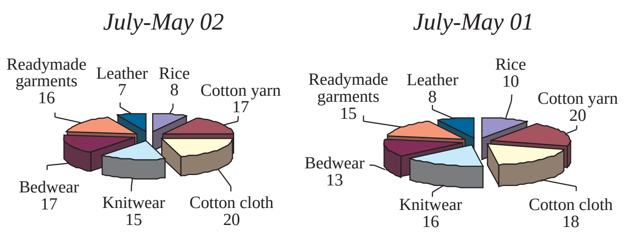
Improved external sector

The events following the September 11 incident resulted in some positive structural changes. The FY02 witnessed the collapse of the kerb market premium, the appreciation of the Rupee, restructuring offered by the Paris Club of creditors, and more assistance from multilateral and bilateral sources.

Exports are provisionally estimated to have declined by 0.97% to $8.17 billion during July-May 02. Lower export earnings despite higher quantity growth of some value added items like leather, was primarily because of a fall in the unit prices in the international market. Had the unit values not fallen, Pakistan's exports would have shown a marginal rise. There were however, other items like rice, raw cotton, fish & fish preparations, knitwear, carpets & rugs etc., where both quantum exported and earnings fell.

Major Exports

% Share

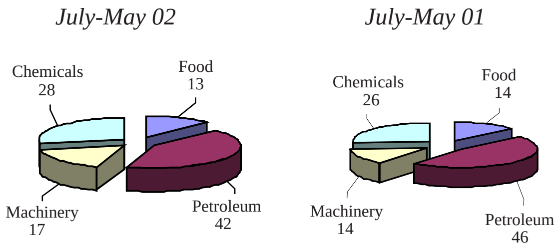


Source: *Federal Bureau of Statistics*

Imports fell by 4.5% to $9.4 billion, thereby reducing the trade deficit to $1.2 billion from $1.6 billion in the corresponding period a year earlier. The decline in imports was due to a reduction in the POL import bill and a lower expenditure on tea and sugar import. Falling POL prices helped reduce the trade deficit and more than offset the negative impact of lower exports.

Major Imports

% Share



Source: *Federal Bureau of Statistics*

Remittances show gains

Meanwhile, remittances from overseas Pakistanis rose last year, a reversal of capital flight primarily from the US and UAE and substitution of workers' remittances from the kerb market to the interbank market. During July-April 02, workers' remittances doubled to $1.86 billion compared to $922 million in the corresponding period a year earlier.

Consequently the current account posted a surplus of $2.1 billion during July-March 02 compared to a deficit of $82 million in the corresponding period a year earlier. The lower trade deficit was the major contributor to this surplus with support from the services account and transfers.

Build up in foreign exchange reserves

Foreign exchange reserves continued to build up and have crossed $6 billion. Improved trade and current account balances, substantial increase in private flows, assistance from donor agencies, State Bank purchases were some of the factors responsible for the marked improvement.

Easing of monetary policy

The State Bank of Pakistan has in the past months pursued an easy monetary policy keeping in view the developments taking place globally. The discount rate has been successively reduced to 9%, with corresponding cuts in T-bill rates. The government also rationalized the rates on the national savings schemes.

This had an effect on the weighted average lending rate which was lowered by the commercial banks to stimulate investment. With this reduction in lending rate the spread between the lending and deposit rates narrowed from 7.85% in June 01 to 6.73% in March 02.

Easing of rates led banks to bid aggressively in the auctions for government paper and it was in early February 2002 that the State Bank clearly signalled an end to the downward trend in T-bill yields.

The third quarterly report of the SBP states that "the central bank's proactive monetary management, which reduced volatility in short term rates by ensuring liquidity, may have actually helped banks to bid aggressively in the auctions", while the SBP intention was to facilitate bank's liquidity to expedite private sector activity there is evidence that this encouraged banks to invest in government securities and fund it from the repo market.

Growth in monetary assets

Available figures for FY02 upto March show that monetary assets grew by 9.3%, twice the increase (4.7%) recorded in the corresponding period a year earlier. Weak growth in private sector credit, phenomenal rise in net foreign assets of SBP and the continuing fall in government borrowings left the banking system flush with liquidity.

While the government retired Rs.76.6 billion of its SBP borrowings for budgetary support (against Rs.0.8 billion a year earlier) its borrowings from the scheduled banks in contrast increased by Rs.70.7 billion against Rs.13.8 billion a year earlier. It was able to raise funding from the commercial banks, without pushing up interest rates due to high banking sector liquidity.

Borrowing by autonomous bodies rose to Rs.6.2 billion against a retirement of Rs.13.9 billion in the corresponding period a year earlier, where the major borrowers were KESC, WAPDA and PIA.

Private sector credit declined to Rs.43 billion from Rs.81.2 billion extended a year earlier, primarily because of a decline in business confidence, as economic activity dropped after the September 11 event, the conflict in Afghanistan and border tensions with India.

External debt

The total stock of external debt and foreign exchange liabilities stood at $36 billion as on March 31, 2002. More than three fourth of the debt is of medium to longer term maturities.

Rising external debt has placed a burden on debt servicing, reducing the volume of net transfers. Net transfers have turned negative in some years due to lower disbursements in FY01, of gross disbursements of $1597 million, debt servicing was $1961 million. In FY02 however, as gross disbursements rose to $2364 million, and debt servicing fell to $981 million, net transfers rose to $1383 million.

The Paris Club debt rescheduling has provided substantial debt relief to Pakistan.

Meanwhile, specific steps have been taken to reduce poverty. Expenditures on education, health, population planning, water supply and sanitation, housing and rural development and other poverty related activities has been increased so to have a positive impact on the lives of the poor.

For FY03 a GDP growth of 4.5% is projected, with inflation at 3.9% and foreign exchange reserves to cross $7 billion. Fiscal deficit is projected at 4% of GDP. As district governments receive more support and the budget for FY03 transfers increased resources for development alongwith expenditure responsibility, effectiveness of expenditure is expected to increase.

Federal Budget 2002-03 - A Review

The country's budget is a manifestation of the economic and fiscal policies it hopes to pursue over the next year. This year's budget has purportedly been framed in the context of the three year Medium Term Budgetary Framework (MTBF) 2001-04 and the Interim Poverty Reduction Programme.

An analysis indicates that the major thrust of the Budget is on strengthening of the tax reform program encompassing rationalising of taxes, exemption/subsidy removal, creating an enabling environment for private participation, development of water sector and higher poverty related expenditures.

The Budget seeks to facilitate the realisation of the goals set out in the MTBF. The later provides yardstick to compare the year's performance. The Budget for 2002-03 aims at:

- achieving a GDP growth of 4.5%,
- containing inflation at 3.9%,
- building up of foreign exchange reserves to nearly $7 billion,
- achieving a fiscal deficit target of 4% of GDP,
- raising investment to 15.5% of GDP,
- current account deficit to be 2% of GDP during the remaining period of MTBF.

The following are brief comments on some of the aspects of the federal budget 2002-03.

Revenues Envisaged to Increase

The Government of Pakistan (GoP) in the current fiscal year is targeting total revenue receipts to increase by Rs.42 billion to Rs.674.89 billion. This increase is half the ambitious Rs.85.9 billion rise aimed in the last budget.

Tax collections fall short

The GoP in FY03 budget is aiming to raise the revenue receipts primarily through tax receipts, (Rs.46.4 bn) and an increase in surcharges (Rs.6.6 bn), non tax receipts are however, expected to decline by Rs.10.96 billion. Tax receipts are budgeted at Rs.460.6 billion, a substantial increase over the provisional figures released recently which show that collections in FY02 will be around Rs.400 billion. During the outgoing fiscal year, budget target of Rs.457 billion had to be revised thrice to Rs.414 billion and even then collections fell short. The shortfall was attributed to a variety of factors of which lower than projected growth of GDP, fall in rupee imports are most relevant. Higher amount of refund/rebates made the revised target unachievable, though it cleared a huge backlog of refunds.

Reliance on sales tax

Keeping in view the cuts in tax rates, reduction in the number of withholding taxes, the reduction in maximum tariff rate, it is clear that the GoP is relying on its efforts to widen the General Sales Tax base (this year an increase of Rs.35.6 billion is envisaged from Sales Tax alone). This alongwith the new Income Tax Ordinance which is expected to make income tax the most effective instrument of resource mobilisation and the government reliance on the improvement in CBR's efficiency would assist in achieving the target.

Federal Government Revenue Receipts

(Rs. Bn)

	2001-02 BE	2001-02 RE	2002-03 BE
Total Revenue Receipts	643.80	632.80	674.89
Tax Revenue	457.70	414.20	460.60
Direct Taxes	149.80	146.50	148.40
Income Tax	144.20	142.00	143.20
Other Taxes	5.60	4.50	5.20
Indirect Taxes	307.90	267.70	312.20
Customs	69.60	50.50	56.50
Excise	53.10	47.10	50.00
Sales Tax	185.20	170.10	205.70
Surcharges/Levies	47.00	53.90	60.50
Natural Gas	15.00	14.90	15.0
Petroleum Levy	32.00	39.00	45.50
Non-Tax Revenue	139.10	164.70	153.79

BE Budget Estimates
RE Revised Estimates

Source: *Federal Budget Documents*

Sales tax to rise

Direct tax collections were nearly 98% of the annual targets and this was quite encouraging given the fall in receipts of withholding taxes. It could partly suggest the government's effort to broaden the tax base are bearing fruit. On the other hand, indirect tax receipts with reliance on Sales Tax was short of the year's target by Rs.15 billion, partly because of the initial resistance to GST and the difficulties encountered in the transition period. This year it is budgeted to be higher by Rs.35 billion because of the extension of GST to pharmaceuticals, edible oil, fertilizer etc.

Development surcharge on natural gas and the levy on petroleum products grew by 14.7% in FY02 over a year earlier. During the year the government increased its levy on petroleum products, raising the contribution from oil surcharge. Revenues from petroleum products levy and surcharge on natural gas are expected at Rs.45.5 billion and Rs.15 billion in FY03.

Box Tax Reforms *1*

- Minimum taxable income limit raised from Rs.60,000/- to Rs.80,000/-.
- Progressive reduction in tax rates for banking companies by 3% per year and for private companies by 2% per year for the next five years so as to reach the tax rate of 35%.
- Two types of withholding taxes have been withdrawn.
- Withholding tax abolished on private cars which have been used for over 10 years in Pakistan.
- Withholding tax reduced from 10% to 5% on commission and brokerage.
- Withholding tax on interest on securities reduced from 30% to 20%.
- Maximum customs tariff rate reduced to 25% from 30%. Now there will be four rates; 25%, 20%, 10% and 5%.
- Proposed to remove 55 exemptions.
- Tax incentives provided for banking and non-banking financial institutions to facilitate mergers and business acquisitions.
- Surgical and cutlery industries given a boost by reducing customs duty rate from 10% to 5%.
- Central excise duty withdrawn on 10 items.
- Excise duty on aerated beverages reduced from 15% to 12% of retail price.
- Excise duty on cigarettes raised.
- Number of SROs reduced to about 30 from 56.
- Duties on import of cars reduced.
- Customs duty enhanced on imported oilseeds from 5% to 10%.
- To ease the difficulties of individuals with regard to GST, an alternate dispute resolution mechanism has been proposed in the sales tax law.

Non tax revenues grew by 18.4% in FY02 to Rs.165 billion (against budgeted estimates of Rs.138 bn) so taking significant pressure of the deficit. This was largely the result of higher dividend income from OGDC and PTCL and higher defence services receipts.

Total Expenditure to Decline

Revised budget estimates for 2001-02 show cumulative development and current expenditures to have risen by Rs.21.6 billion over the budgeted figure of Rs.751.7 billion. This was primarily because of a Rs.20 billion jump in defence expenditure (from a budgeted 3.5% of GDP to 4.1%) in view of the geopolitical situation.

For the forthcoming fiscal year, total expenditure will be lower at Rs.741.96 billion over Rs.773.30 billion a year earlier, as current expenditure which forms the largest chunk is to fall by 6.3%.

Federal Government Expenditure

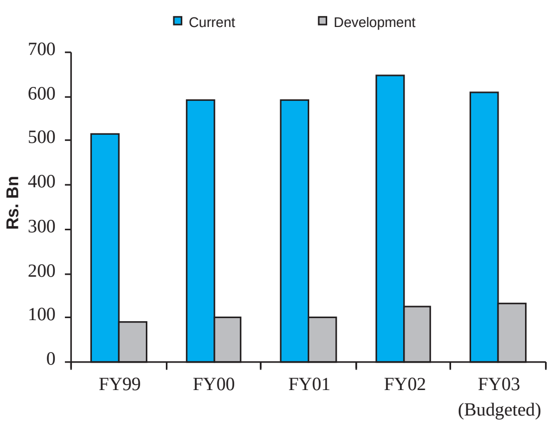
(Rs. Bn)

	2001-02 BE	2001-02 RE	2002-03 BE
Total Expenditure	751.70	773.30	741.96
Development Expenditure	130.00	124.70	134.00
Current Expenditure	621.70	648.60	607.96
Debt Servicing	329.00	320.11	289.70
Interest on domestic debt	197.86	192.56	191.81
Interest on foreign debt	62.25	60.76	53.05
Foreign loan repayments	69.07	66.78	44.84
Defence	131.64	151.67	146.02
Gen. Admn	47.56	51.02	54.93

BE Budget Estimates
RE Revised Estimates

Source: *Federal Budget Documents*

Expenditure



Relief in Debt Servicing

Debt servicing continues to be drag, as being the single largest expense item, it consumes the major chunk of resources allocated. Some relief is however, expected in FY03, primarily because of reduced foreign loan repayment.

Interest on domestic debt, which comprised nearly 76% of interest expense budgeted in FY02, declined in the revised estimates for the year and are expected to decline further in FY03. This is because of a reduction in government debt and lowering of domestic interest rates. Similar trend is visible for foreign debt, where both components –– interest payment and loan repayment are to decline.

The Paris Club rescheduling has provided substantial debt relief to Pakistan. Pakistan received special terms as its debt of $12.5 billion were re-profiled over an extended period of time and is also negotiating for a reduction in interest rates.

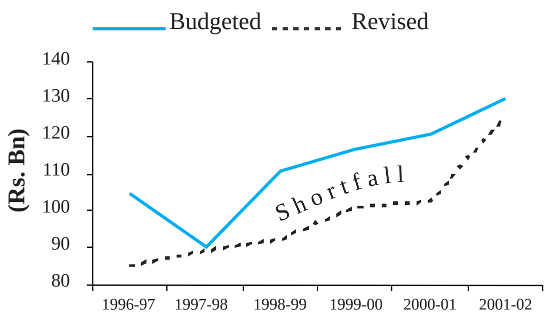
Defence Spending Reduced

Defence expenditure increased last year by Rs.20 billion over the budget figure of Rs.131.6 billion to Rs.151.7 billion because of tensions on the border. Defence budget has been reduced in FY03 to Rs.146 billion on the assumption that the tension will ease.

Development Expenditure Increased

Development expenditures have had to bear the brunt of any cuts in government allocations. Under the pressure to contain fiscal deficit, successive governments have slashed government expenditures, resulting in lower investment and increased poverty.

Public Sector Development Programme



In FY03, development expenditure budgeted at Rs.134 billion, shows an 8% increase over revised estimates of last year, when it was Rs.6 billion short of the target of Rs.130 billion. The fiscal space provided by a reduced debt servicing and defence has not been channelled towards development expenditure.

Financing of the Budget Deficit

The fiscal deficit target of 4.9% of GDP fixed last year, rose by 2.1 percentage point to 7% in the revised estimates to a huge Rs.257 billion because of revenue shortfalls and rising current expenditure.

This year the deficit is targeted at 4% of GDP, as the government makes efforts to withdraw subsidies and exemptions, broaden the tax base and check current expenditures. Much would also depend on the performance of public sector utilities like Water & Power Development Authority and Karachi Electric Supply Corporation, which are a major drain on government finances.

Financing of the Budget Deficit

(Rs. Bn)

	2001-02 BE	2001-02 RE	2002-03 BE
Overall Budget Deficit	(-)186.9	(-)257.1	(-)162.5
As % of GDP	4.9	7.0	4.0
Financing of the Deficit			
Non-Bank Borrowings	54.8	51.8	52.5
Bank Borrowings	10.5	62.0	(-)31.0
Net External Resources	121.6	134.9	129.1
Privatisation Proceeds	-	8.4	12.0

BE Budget Estimates
RE Revised Estimates

Source: *Federal Budget Documents*

In this year's budget also the reliance on external resources for financing the fiscal deficit continues. In fact 80% of the deficit would be financed by external resources against 52.5% a year earlier because of increased assistance inflows. Within the domestic resources, bank borrowings were substantially higher over the budgeted figure of Rs. 10.5 billion. In FY03 the government is targeted to retire Rs. 31 billion to the banking sector.

Box **Highlights of Budgetary Measures** *2*

Major Budgetary Targets for FY03

- Total expenditure budgeted at Rs.742 billion.
- Current expenditure curtailed at Rs.608 billion or 15.1% of GDP.
- Reduction in both debt servicing and defence expenditures.
- Development expenditure raised to Rs.134 billion.
- Budget deficit targeted at Rs.162 billion or 4.0% of GDP.
- Revenue receipts to rise to Rs.675 billion mainly because of a Rs.46 billion rise in tax receipts.

Fiscal Reforms

- Formulation of a Fiscal Responsibility law to limit government borrowings only for the purpose of development expenditures.
- A new Income Tax Ordinance to be effective from July 1, 2002 to replace the old ordinance and institute a modern tax system in the country.
- Large Taxpayers Unit proposed to be established to help large taxpayers comply with their tax liabilities.
- Minimum taxable income limit raised to Rs.80,000.
- The number of withholding taxes reduced, two more being withdrawn.
- Some more reduction in tax rates for banking companies.
- Withholding taxes reduced as an incentive for growth of capital markets.
- Changes made in customs duty drawback repayment system.
- Rationalisation of depreciation allowances.
- Number of SROs to be reduced to about 30 this year.
- Exemptions minimised. Budget removes 55 exemptions.
- The withholding tax on national saving schemes was levied on amounts exceeding Rs.300,000. The limit of Rs.300,000 is proposed to be reduced to Rs.150,000.
- GST refund system being reformed.

Income Tax Reforms

- In the new Income Tax Law, the responsibility of computing one's tax liability rests with the taxpayers. Earlier the assessing officer had to determine the income of the tax payer.
- The new law aims to attain uniformity of tax rates, minimize exemptions, reduce dependence on withholding taxes and ensure an effective dispute resolution.

Rationalisation of Taxes/Depreciation Allowances

- Progressive reduction in tax rates for banking companies by 3% per year and for private companies by 2% per year, so as to reach the tax rate of 35%.
- Two types of withholding taxes have been withdrawn.
- Initial depreciation allowance increased from 40% to 50%.
- Amortisation of pre-commencement expenses, which was not provided for earlier, will now be allowed at the rate of 20% per annum.

Capital Markets

- Withholding tax on commission and brokerage reduced to 5%.
- Withholding tax on interest on securities brought down to 20% from 30%.
- Tax on bonus shares to be withdrawn.

Mergers & Acquisitions and Incentive for Banks

To encourage mergers in the financial sector the budget provides for following incentives:

- Transfer/carry forward of losses of merged institutions.
- Tax admissibility of merger expense.
- Continued availability of unabsorbed deprecation.
- Admissibility of different tax rates for banking and non-banking operations.
- Extension in time period for carry forward losses of nationalised commercial banks for the assessment years 1995-96 and 2000-01 from 6 years to 10 years.

Customs Duty

- The maximum customs tariff rate has been reduced to 25% from 30%.
- The number of slabs has been kept at 4. The proposed duties would now be 25%, 20%, 10% and 5%.
- Duty cuts have been allowed for certain industries, like stainless and alloy, compressors and CT scans.

Sales Tax

- General Sales Tax is already leviable on imported edible oils used for production of ghee and cooking oil. Sales Tax is now being extended to edible oils and ghee at the domestic manufacturing stage.
- Last year the government had levied withholding sales tax @ 20% on specified raw materials. 190 items were covered initially while some more were added during the year. This year 6 more items have been added to the list.

Central Excise

- Government reducing its reliance on central excise. Last year, central excise duty was abolished on ten items, this year CED has been removed from another ten items.
- Excise duty on aerated beverages reduced.
- Excise duty raised on cigarettes.

SROs Reduced

- Budget seeks to remove some of the irritants inherent in the SROs.
- The number of SROs which were reduced from 120 to 56 in 2001-02 will be reduced further to 30 this year.

Exports

- Backlog of duty drawback which had accumulated being cleared to alleviate the difficulties of exporters.
- Customs duty drawbacks repayments will be made through bank branches directly.
- To promote exports to Afghanistan, permission has been given for duty and tax free export warehouses at Chaman and Peshawar.

Pakistan's Textile Sector

Significance of textile for the economy

The textile sector holds an important position in Pakistan's economy, in terms of employment, value added and the contribution the industry makes to exports. It has the highest value added in the manufacturing sector, contributing 27%, providing employment to 38% of the manufacturing labour force; and 64% of Pakistan's total exports come from cotton and textile manufactures.

Exports: contributes more than 60% to the total export earnings.

Manufacturing: 27% of value addition in the manufacturing sector.

Employment: major employer of labour – 38% of manufacturing labour force

Rank: occupies eighth position amongst the top ten Asian exporters.
- second largest exporter of cotton yarn in the world.
- second largest exporter of towels & bedwear.

No. of Mills: 445 (50 composite & 395 spinning units).

Capacity Installed:
(000 Nos.)

	Spindles	8680
	Looms	10
	Rotors	145

Working Capacity %:

	Spindles	81.80
	Looms	43.44
	Rotors	43.56

Raw cotton production: one of five largest cotton growers (10.6 million bales)

Consumption of raw cotton: 2.07 million tonnes

Production of: Yarn 1.35 million tonnes
Cloth 0.41 million sq.mts.

Import of Textile machinery: Rs.19 billion

Export of cotton & its manufactures: $5.2 billion

Spinning sector

The spinning sector comprises of 445 textile mills (50 composite units and 395 spinning units) with an installed capacity of 8.7 million spindles, 145 thousand rotors and over 10 thousand looms.

While the numbers have risen over the years, the percentage of spindles actually working is lower than during the 1950s and 1960s: and the number of installed looms has been cut by more than half compared to the early 1980s with the number of working looms being only 43.6% of the installed capacity.

Factors responsible for lack of growth

The sector lost its relatively more prominent position of the 1960s and 1970s when it held over 11% of the world market due to failure to diversify into higher value added sub-sectors, low levels of efficiency, ignoring up-gradation, low crop in some years, lack of BMR, low unit prices of Pakistani cotton yarn in the international markets compared to that of its competitors, low share of manmade fibers among other factors.

The spinning sub-sector meets the requirement of domestic industry and about one third of the total yarn produced is exported. More than 70% of the total yarn production is that of coarse and medium count yarn and in yarn exports this percentage is about 99%. The spinning sector must move to higher count yarns to compete with other competitors.

Farmers to grow contaminated free cotton

Moreover, the yarn produced is contaminated because the cotton provided by ginners is contaminated with non-lint components. The Federal Textile Board in association with the provincial governments has launched campaigns to induce farmers to produce contaminated free cotton. The districts chosen for the pilot project include Rahim Yar Khan, Gothki, Sanghar and Bahawalpur. Results have been encouraging.

Weaving sector

The weaving sector has three different sub-sectors, namely, integrated, independent weaving units and power loom units.

Non-mill sector produces bulk of cotton

The weaving sector comprises of hosiery, garments, towels and bedwear and canvas. Cotton cloth is produced both by the mill and non-mill sector or power loom sector. The non-mill sector produces about 90% of total cloth produced. As bulk of the fabric is produced by the power loom sector, which is inferior in quality compared to the cloth produced on shuttless looms, it constrains made up manufacturers to produce superior quality garments. The power loom weaving sector, although quite large in numbers contributes to the export earnings through the production of low quality fabric. As such, while quantum exported has risen, earnings from export of cloth has declined.

Installed & Capacity Worked
Weaving Sector

(Nos.)

	Installed Capacity	Effective Capacity Worked
Integrated Textile Units	10,134	4,500
Independent Weaving Units	17,500	16,500
Power Loom Sector	225,258	190,000
Total	**252,892**	**211,000**

Source: Economic Survey 2001-02

Cotton Cloth Production/Export

	Production (mn.sq.mts.)		Export	
	Mill Sector	Power loom Sector	Quantity mn.sq.mts.	Value $ mn
1992-93	325.40	3034.60	1127.6	863.1
1996-97	333.49	3324.80	1257.4	1262.4
1997-98	339.86	3573.41	1254.0	1234.3
1998-99	384.56	3600.00	1328.0	1088.2
1999-00	437.34	3889.00	1514.0	1072.3
2000-01	492.00	3960.00	1736.0	1032.5

Source: Textile Commissioners Organization

The induction of shuttless weaving machines in recent years have resulted in high growth in fabric production. It is believed to be the largest consumer of cotton yarn in the country.

Upgradation of power loom units

A large number of weaving units are small and medium scale units with a large technological gap. In concurrence with this, the Small & Medium Enterprise Development Authority alongwith the SME Bank, and provincial governments has proposed a technology up-gradation of power loom units by replacing the existing looms with 10,000 locally produced wider width auto looms annually.

Independent weaving units using shuttless wider width looms are capable of producing better quality cloth with wider width ranging from 70 to 140 inches. The sector is using both imported new looms and second hand imported looms.

The Textile Vision 2005 has highlighted certain issues in weaving industry development:

- Success of the weaving industry of Pakistan is associated with the diversified usage of blends in fabrics alongwith enhanced consumption of numerous manmade textile fibers.
- Reduction in the level of protection offered to the domestic manmade fibers and filaments producers can play an instrumental role in facilitating this shift to blended and synthetic fabrics.

Growth of Cotton Textiles

Period	No. of Mills	Installed Capacity		Working at the end of the period		Consum-ption of Cotton	Total Yarn Produced	Total Production of Cloth
		No. of Spindles (mn)	No. of Looms (000)	No. of Spindles (mn)	No. of Looms (000)	(mn.kgs.)	(mn.kgs.)	(mn.kgs.)
1950	-	0.182	3	0.182	3	-	-	-
1961-62	71	1.645	28	1.524	26	205.3	166.7	534.4
1971-72	131	2.848	30	2.650	26	407.1	335.7	628.2
1981-82	155	4.180	25	2.944	13	501.0	430.2	325.0
1991-92	271	6.141	15	5.260	8	1342.8	1170.7	307.9
1996-97	357	8.137	10	6.500	5	1670.1	1520.8	333.5
1997-98	353	8.274	10	6.500	4	1751.0	1532.3	340.3
1998-99	348	8.298	10	6.600	5	1839.6	1540.3	384.6
1999-00	351	8.383	10	6.800	4	1961.6	1669.6	437.2
2000-01	353	8.507	10	7.100	4	2070.0	1721.0	490.2
2001-02*	354	8.802	10	7.149	5	1603.1	1348.5	412.3

** July-March*

Source: Economic Survey 2001-02

Processing

Fabric processing forms a critical link in the entire value chain. It remains weak despite investments made in the 1980s. About 40% of the fabric exported from Pakistan is in unprocessed form.

With regard to the processing sector, absence of trained manpower and usage of low technology constrains the production and hence export of processed fabric.

Untrained manpower and low level of technology hinders growth

Available manpower is not properly trained and it is not capable enough to produce quality fabric, resulting in low unit value realization. It also leads to decreased process and production efficiencies, increasing the overall production costs.

Currently the level of technology in processing industry is low and most of the machinery is old. The sector has received low investment, since it is capital intensive in nature. To give a boost to garments and made ups, there is a need for new investment in processing. Some new units are being created in processing and some have already been tied up with Japanese investors.

Besides improving skills, there is also a need to improve marketing for textile products.

Ready-made garments

The garment industry is the highest value added link in the entire textile value chain. This sector is distributed in small, medium and large scale units, most of them having 50 machines or less.

The sector has the potential to be the locomotive of the country's textile export growth (in FY02 (July-May) total garment exports from Pakistan were to the tune of $787 million) and is also the largest source of creating low cost employment at all levels. An estimate puts 700,000 people, both skilled and unskilled employed only in this sub-sector, with the sub-sector having the potential to increase this number over the years.

Pakistan exports a number of items in this category which include, dresses, trousers, skirts, overcoats, jackets, shirts, babies garments, track suits, ski suits, etc.

The Textile Vision 2005 lays great emphasis on this sector. The changing global trade patterns, has witnessed clothing trade to have grown faster by almost 82% from 1990 through 1998 against textile trade which showed a growth of 3.2%. This has necessitated countries like Pakistan, which have the potential to exploit the opportunities available that the apparel industry offers and align themselves with the evolving market conditions.

The Report states "On the demand side synthetics and garments made of specialised fabrics are taking away the larger share of the market. Women and men's garments are gradually giving way to garments made for special usage. Sportswear, industrial wear and fashion garments for women segments are some of the products that offer increasing opportunities to export countries like Pakistan especially in terms of high values".

The Textile Vision has recommended four measures which if adopted can place apparel manufacturers at an advantageous position.

i. *Shifting the product mix*

The apparel export product mix is heavily tilted towards men's wear and knitted garments. With changing market demand it has become imperative for the manufacturers to diversify their product mix. Woven segment of the garments is a much larger market than the knit garments and offers higher price.

ii. *Market diversification*

Major portion of garments exports is concentrated to the US followed by the member countries of the European Union. Little marketing has been done to explore other markets like Japan or the UAE. The small garment manufacturers do not have enough resources to spend on marketing. Some kind of infrastructural support will have to be provided for the smaller players, so to bring about an overall improvement in the industry.

iii. *Human resource development*

Any move towards production of specialised garments and entry in new markets requires trained workers, skilled in their area of work, whether it is cutting, designing or stitching. Specific training needs have to be identified and also the trainers who will impart the training.

iv. *Shift towards synthetics*

Consumer preferences have changed and they now prefer fabrics made of synthetic materials other than cotton. Pakistani manufacturers will have to incorporate this particular shift in order to compete internationally.

Hosiery

The hosiery industry is composed of around 700 units with about 7500 knitting machines operating at 60% capacity utilisation and producing 550 million pieces annually. It employs about 20,000 skilled and unskilled workers. A large part of the production process is labour intensive.

This sub-sector produces T-shirts, jogging suits, jerseys, sport shirts, children wear, tracksuits, sweaters, socks etc. Major portion of the production is exported as these items are popular abroad. In 2001-02 (July-May) earnings through knitwear exports amounted to $750.6 million. In the international market the US is the major buyer, followed by UK, Germany, Canada France and Belgium.

Bedwear

Bedwear is an important value added sub-sector of the textile sector. It is mostly in the informal sector, 150 units in the organised sector and the rest in the unorganised sector. The products include bed sheets, pillow covers, quilts etc. In FY02 it exported over $830 million and is second only to China in the row of bedwear exporters.

The Textile Vision report has shown that the processing technology used by the industry is not adequate to meet the quality requirements in the international market. As such there is a need to upgrade the existing technology and invest in new units.

Adoption of advanced technology will assist the manufacturers to produce higher value added items, and move away from traditional bedwear products.

The manufacturers will have to be more proactive in the designing and development of the product. The industry needs to see the trend in the market and adopt the same to survive in this higher competitive environment.

Towels

There are over 300 towel manufacturing units in Pakistan, both in the organised and unorganised sector, comprising of about 6500 locally manufactured power looms. Some units are also equipped with imported auto looms.

It is mainly an export based industry, exporting $243 million worth of towels in FY02 (July-May). It has a strong presence in the international market, and if it could improve its processing facilities, quality would improve and result in higher unit prices. It could carve out a greater niche in the market by moving into next tiers of high value added towel market such as towels manufactured from dyed yarn, embroidered towels etc.

Bank Financing

In the 1990s there were a number of factors which affected the textile industry, as a consequence of which many units fell sick creating a huge infected loan portfolio with the banks. In reaction, the banks withheld financing from the textile industry either for balancing, modernisation and replacement or for expansion. Problems were compounded by State Bank's tightening of the Prudential Regulations.

As a consequence, the industry could not keep pace with technological advancement and began to lose out on competitive advantage. It was realised that if the industry had to survive and compete in a quota free trade era, structural and operational adjustments were necessary. The government has devised a strategy to modernise the sector and also introduce efficient processes. Besides other steps, some of which have been mentioned above, annual targets were fixed for bank financing under Textile Vision 2005. These are given below:

Textile Vision 2005
Position of Bank Financing up to End 2001

(Rs. Bn)

Sector	Net Exposure at the Start of Program Dec - 2002	Target for 2001	Amount Disbursement against Target	Excess/ Short Fall Over Targets	Total Exposure at the End of 2001
A. Priority Sectors					
1. Stitching (Apparel)	6.306	6.400	2.283	(4.117)	8.589
2. Knitting	5.534	1.800	1.289	(0.511)	6.823
3. Finishing	1.603	0.000	0.022	0.022	1.625
a. Knit Processing	1.647	0.400	0.203	(0.198)	1.850
b. Woven Processing	4.869	3.700	1.786	(1.914)	6.655
Sub-Total	*19.959*	*12.300*	*5.583*	*(6.718)*	*25.542*
B. Traditional Sector					
1. Weaving	7.912	2.400	0.325	(2.075)	8.237
a. Weaving Air Jet	11.293	2.400	3.726	1.326	15.019
b. Weaving Water Jet	13.436	5.200	0.582	(4.618)	14.018
2. Spinning	59.852	1.800	16.344	14.544	76.196
3. Polyester Fiber	9.039	-	2.703	2.703	11.742
Sub-Total	*101.532*	*11.800*	*23.680*	*11.880*	*125.212*
Total	**121.491**	**24.100**	**29.263**	**5.162**	**150.754**

Source: Ministry of Industries

Agriculture

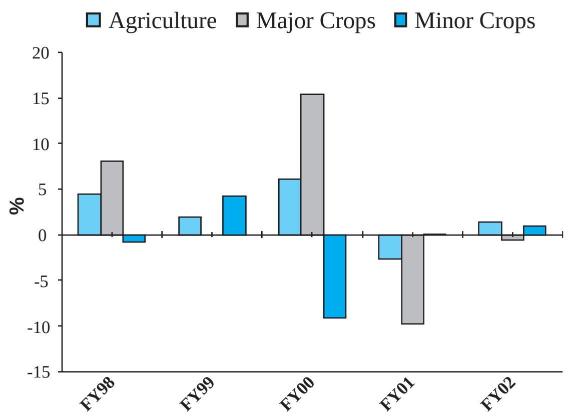
Agricult-ural production hit by drought

Pakistan has suffered from severe drought since 1998. Till mid-2001, drought had turned million of hectares of cultivable land in the southern provinces of Sindh and Balochistan into parched wasteland, forced thousands of people to relocate. The resulting decline in agricultural production had a significant impact on Pakistan's economy.

Major crops affected

In FY01 agricultural growth decline by 2.6% against the targeted 3.9%. Major crops like rice, wheat and sugarcane not only missed their respective production targets but were also lower over the preceding year's output. Water shortages of upto 51% of normal supplies in FY02 had crippling affects on agricultural production during the year.

Growth



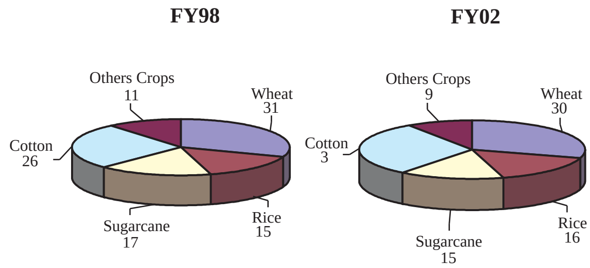
To overcome the effects of drought, various measures were taken by the farmers, supported by the government, helped the sector to register a growth of 1.4%. Though this was a recovery over the previous season's it was still 6 basis points short of the targeted rate.

Major crops, with 40% share in agricultural value added, registered a decline of 0.5% for the second consecutive year. But this decline was a marked improvement over a larger fall of 9.8% a year earlier.

Among the major crops, wheat, rice, barley and cotton have suffered decline, while sugarcane, maize, bajra, jowar, gram and rapeseed mustard recorded increase in output. Wheat, rice, sugarcane and cotton account for 90.7% of value added by major crops. Minor crops, with 19% contribution in agricultural value added, managed to grow by 1%.

Composition of Value Added
of Major Agricultural Crops

% Share



Water losses high

Despite the existence of good irrigation canal net work in the world, Pakistan still suffers from wastage of a large amount of water in the irrigation process. The total inflow of water averaged at 131.69 million acre feet (M.A.F.) during the last two decades (1977-78 to 2001-02). Against this level of average inflow, the flows in major rivers have declined to 91.15 MAF in 2001-02 or a reduction of 30.8%. The canal head withdrawals averaged at 99.12 MAF during 1997-98 to 2001-02, but it declined to 73.09 MAF in 2001-02.

Agri-culture needs attention

The World Bank believes that Pakistan's agricultural sector possesses the potential to be the lead sector in accelerating economic growth and reducing poverty, but it has not received due attention. There is a need to accelerate agricultural growth, specially by having new markets, more water and technology.

Markets need to be complemented by strategic public investments in infrastructure, most critically in the irrigation and drainage sector. A national drainage system that would complement the irrigation system is planned.

Planned institutional reforms to enhance the efficiency of water usage are lacking. With renewed efforts at the highest level, water and associated drainage issues threaten to become the binding constraints on faster agricultural growth.

Wheat

Drought affects wheat output

Below than normal rainfall and extremely dry weather during Rabi 2001-02 further intensified irrigation water shortage in Punjab and Sindh, thereby taking a heavy toll on the standing wheat crop. The long dry spell has affected the crop both in barani and irrigated areas. The area is provisionally estimated to have declined by 2.4% as farmers brought 7.983 million hectares under wheat cultivation in FY02, against 8.181 million hectares in FY01.

The yield per hectare also fell by 0.5% from 2325 kgs to 2314 kgs, resulting in reduced production; at 18.5 million tonnes, 2.9% below last year's 19.02 million tonnes and 7.5% short of the year's target.

Despite the shortfall in production, total domestic consumption of 20 million tonnes would easily be met through large carry over stocks from the previous season's crop. The country may, however, face difficulties in meeting one million tonnes export target. 0.7 million tonnes of wheat were exported a year earlier.

World wheat forecasts

The Food & Agriculture Organization (FAO) forecasts world wheat production in 2002 at 603 million tonnes, 22 million tonnes or almost 4% up from the previous year. Output of wheat in Asia is expected to increase significantly this year from last year's reduced crop, mostly reflecting improved weather conditions in India as well as throughout the Far East sub-region.

International wheat prices are likely to remain weak in the coming season given good crop prospects for 2002, the expected decline in world import demand and large export availabilities across several non-traditional exporters.

Rice

Lower area sown

Irrigation water shortage had affected last season's crop. Hit by severe drought, farmers could bring lesser area under rice cultivation, estimated at 2.114 million hectares, down 11.1%, from a year earlier. This was on account of delayed plantation and a shift in sown area from Irri to Basmati rice. Production is provisionally estimated at 3.882 million tonnes, 19.2% lower over the previous season's crop and 18.7% less than the target, attributable to lower yield per hectare, at 1836 kgs against 2021 kgs.

Sowing of the new season's crop is underway. Hit by severe drought, farmers are likely to bring lesser area under the 2002-03 crop. Due to acute water shortage, the sowing process is expected to be delayed in Sindh affecting Irri varieties, while sowing of Basmati in Punjab is expected to be on time. The size of next season's crop is forecast at around 3.7 million tonnes, almost the same as that of the current crop.

Rice exports suffer

Of total production, 60% of the crop is consumed locally. Annual consumption is estimated at 2.3 million tonnes, which leaves an exportable surplus of 1.6 million tonnes from the 2001-02 crop. Low prices in the international market, lower domestic output and subsequent depletion of stocks, aggressive marketing by India and high domestic cost are adversely affecting Pakistan's exports.

Vietnam, China and India have captured the market due to their low prices. As foreign buyers are not willing to pay a higher price for Pakistani rice, its exports have been affected.

Global trade

For 2001-02, global rice production was raised by 1.3 million tonnes to 396.5 million tonnes, with India, Burma and Cambodia accounting for most of the increase. For calendar year 2002, global trade is higher by 3% at 24.4 million tonnes. Exports have been raised for India, Burma and Argentina, while lowered for Vietnam. For importers, 2002 projections have been raised for Nigeria, Indonesia, the Philippines, EI Salvador and Nicaragua.

Total production for 2002-03 is projected at 395.5 million tonnes (milled basis), the third consecutive year of declining global production. In contrast, global consumption is projected to increase 1% to a record 410 million tonnes.

Cotton

Production falls

Irrigation water shortage has also affected cotton crop production. Though area sown at 3.116 million hectares was larger by 6.5% over a year earlier, its production is provisionally estimated to have declined by 1.1% to 10.6 million bales in 2001-02. Certain cotton growing areas reported attack of pests, which resulted in decline in per hectare yield from 624 kgs to 570 kgs.

Sowing of the 2002-03 crop is in progress in some cotton growing areas of Punjab and Sindh. There are reports of increase in sowing area though growers complain of shortage of irrigation water and quality seeds. Despite water shortage, Sindh produced a record crop of 2.4 million bales last season.

Fear of prevailing low cotton prices could discourage increase in cotton cultivation and reduce projections for the next season's crop, projected at 11 million bales.

Large unsold stocks

The ginners still have with them some unsold stocks, while textile millers have reportedly imported 1.5 million bales of cotton. With a large quantity still lying unsold, cotton prices in the local market are depressed. Official spot rates were lowered by Rs25 per maund to attract buyers but there has been no positive response from spinners who are already holding a sizeable quantity of imported cotton.

Sugarcane

Production of sugarcane in 2001-02 is currently being placed at 48 million tonnes compared to 43.6 million tonnes harvested the previous season, an increase of 10.2%. This increase is attributable to larger area brought under cultivation during the season. Punjab has reportedly produced an estimated 24.5 million tonnes, higher by 36.1% over the previous harvest and 51% of the total production. Growers fear that current irrigation water shortage could affect sowing of the new season's crop.

Production increases

Higher sugar output

Crushing operation has ended. The Pakistan Sugar Mills Association has reported this season's sugar output at 3.2 million tonnes, with Punjab producing a record 2 million tonnes, and Sindh around one million tonnes against the target of 0.9 million tonnes. Recovery rate also improved in Sindh (9.3%) and Punjab (8.4%). Overall recovery rate was 8.7%.

In view of persisting water problem, the government is considering to replace the cultivation of sugarcane with that of sugarbeet for producing refined sugar. Sugarcane is a high water intensive crop, while sugarbeet requires lesser water. Sugar experts have warned the government to desist from taking any hasty decision of shifting cultivation of sugarcane to sugar beet in Sindh, as this decision may prove counter-productive, both for the industry as well as for growers.

Production of Major Crops
(1998 - 2002)

(000 Tonnes)

Year	Cotton (000 bales)	Sugarcane	Rice	Maize	Wheat
1997-98	9184 (-2.0)	53104 (26.4)	4333 (0.7)	1517 (1.7)	18694 (12.3)
1998-99	8790 (-4.3)	55191 (3.9)	4674 (7.9)	1665 (9.8)	17856 (-4.5)
1999-00	11240 (27.9)	46333 (-16.0)	5156 (10.3)	1652 (-0.8)	21079 (18.0)
2000-01	10732 (-4.5)	43606 (-5.9)	4803 (-6.8)	1643 (-0.5)	19024 (-9.7)
2001-02	10613 (-1.1)	48042 (10.2)	3882 (-19.2)	1665 (1.3)	18475 (-2.9)

Note: Figures in parentheses are growth rates. *Source: Economic Survey 2001-02*

Banking and Finance

Key Monetary Indicators

(Rs. Bn)

	June 15, 2002	June 16, 2001
Scheduled Banks Deposits	1428.7	1238.2
Scheduled Banks Advances	875.0	850.1
Scheduled Banks Investment in Securities & Shares	435.7	296.7
Notes in Circulation	472.8	404.2
Approved Foreign Exchange (Incl. Balances held outside Pakistan in approved foreign exchange)	280.2	111.0

Source: *State Bank of Pakistan*

Deposits increase

Scheduled banks deposits at Rs.1428.7 billion in the week ended June 15 were higher by 15.4% over the comparable period of last year, when these amounted to Rs.1238.2 billion.

Advances rose by 2.9%

Scheduled banks advances grew by 2.9% in the week ended June 15 and amounted to Rs.875.0 billion against Rs.850.1 billion a year earlier.

Invest-ments in securities show double digit growth

Scheduled banks investment in central government securities and shares continued to show substantial gains. These investments totaled Rs.435.7 billion in the week ended June 15 depicting an increase of 46.8% over last year's corresponding week's level of Rs.296.7 billion.

Meanwhile, at the end of FY02, the State Bank of Pakistan left the cut-off yield on six-month treasury bills unchanged at 6.43%. At the year's last treasury bills auction, the Bank sold Rs.10.85 billion worth of T-bills at 6.28% weighted average yield, thus bringing it down 13 basis points from the previous 6.41%.

The weighted average yield was as high as 15.4% on June 15, 1998. However, as part of a liberal monetary policy, the Central Bank has been reducing these rates. In April 2000, weighted average yield on six-month treasury bills came down as low as 7.13%. But the bank had to persuade a relatively tight monetary policy beginning August 2000, which resulted in sharp increase in weighted average yield to 12.88% by June 2001.

Notes in circulation countinue to rise

Notes in circulation showed a significant rise of 17% in the week ended June 15 and stood at Rs.472.8 billion against Rs.404.2 billion in the comparable period of last year.

Approved foreign exchange rises

Pakistan's approved foreign exchange (including balances held outside Pakistan in approved foreign exchange) maintained its upward rising trend during the month under review. It stood at Rs.280.2 billion in the week ended June 15, more than twofold increase against preceding year's corresponding figure of Rs.111.0 billion.

National Saving Schemes

During FY01 net deposits under National Saving Schemes (NSS) fell to Rs. 51.1 billion, from Rs. 95.5 billion in FY00. Of the total deposits under NSS, Defence Saving Certificates maintained the top position with Rs. 16.16 billion. Their share in the net accruals was 32.5% in FY01 followed by the National Prize Bonds (20.3%) and Special Savings Certificates (18.4%).

Deposits under NSS increase

In the first nine months of FY02, net deposits under NSS amounted to Rs. 50.7 billion as against Rs. 30.3 billion a year earlier. All the major schemes showed marked improvement in their mobilization activities with the exception of Prize Bonds.

The Special Saving Certificates (SSC) with a net accrual of Rs. 21.5 billion was at the top. This was a significant rise when compared with Rs. 5.1 billion a year earlier. Net mobilisation under SSC was Rs. 9.4 billion in the entire FY01. Defence Savings Certificates in the same period mobilized Rs. 13.2 billion showing a 20% rise.

Net Accruals by National Saving Schemes

(Rs.Bn)

	1998-99	1999-00	2000-01	July - March 2000-01	July - March 2001-02
Defence Savings Certificates	38.3	41.2	16.6	11.0	13.2
	(26.9)	(43.1)	(32.5)	(36.3)	(26.0)
Special Savings Certificates	25.0	19.4	9.4	5.1	21.5
(Regular)	(17.6)	(20.3)	(18.4)	(16.8)	(42.4)
Regular Income Certificates	59.1	26.1	8.6	5.9	7.8
	(41.6)	(27.3)	(16.8)	(19.5)	(15.4)
Special Saving Accounts	5.9	5.5	3.6	-0.01	-0.2
	(4.1)	(5.8)	(.70)	(0.0)	(-0.4)
National Prize Bonds	10.1	-0.03	10.4	8.2	6.9
	(7.1)	(-0.03)	(20.3)	(27.1)	(13.6)
Others	3.8	3.4	2.5	0.1	1.5
	(2.7)	(3.6)	(4.9)	(0.01)	(3.0)
Grand Total	142.2	95.5	51.1	30.3	50.7
	(100)	(100)	(100)	(100)	(100)

Note: Figures in brackets represent % share in total. *Source: Economic Survey 2001-02*

Real deposits rates higher under NSS

During FY02 (July-March), the nominal deposit rates under NSS ranged between 6.0% (Prize Bonds) to 14.13% (Defence Savings Certificates) with a weighted average rate of 11.5%, 0.3 percentage point higher over a year earlier but 4.3 percentage point lower than the average of 1995-2000.

With an inflation rate of 2.6% the real deposit rates during 2001-02 have increased over last year ranging between 3.4 % (Prize Bonds) to 11.5% (Defence Savings Certificate) with a weighted average real rate of 8.9%.

Nominal deposit rates were high in the past

In the previous years, although the nominal deposit rates were apparently very high but the real deposit rates remained low due to high rates of inflation. During 1995-2000, average nominal rates ranged between 10.2% (Prize Bonds) to 17.0% (Defence Saving Certificates), compared to a weighted average real rate of 7.9%.

In 2000-01, both weighted average nominal and real rates came down to 11.2% and 6.8% respectively mainly due to cut in the nominal rates in January 2001. But with a decline in the inflation rate (2.6%) in the FY02, the real rates of return have become even more attractive than before. Despite lowering of rates of return, the NSS still offers the most attractive rates to the depositors.

With-holding tax exemptions withdrawn on NSS

Meanwhile, the GoP in its latest move has withdrawn 10% withholding tax exemptions on all National Saving Schemes and reduced rates of return ranging from 0.8% to 2.5%. New rates will, however, be applicable for the accounts/certificates to be issued between July 01 to December 31, 2002. These rates will not apply to existing schemes.

New Rates

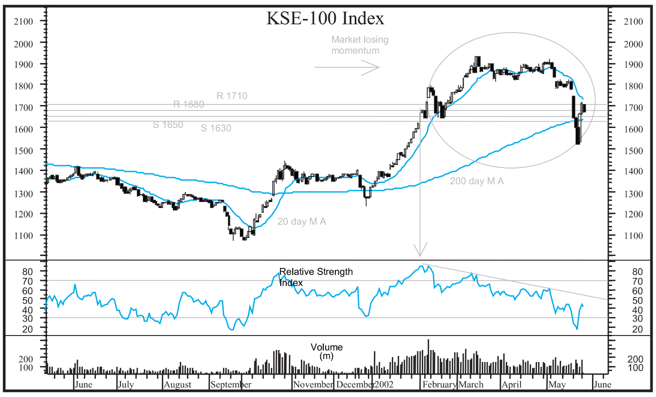
(%)

	Existing Rates	New Rates	Change
Defence Saving Certificates	14.13	11.61	↓2.52
Special Saving Certificates (R)/			
SSC Accounts (5 Yrs)	12.70	10.70	↓2.00
Regular Income			
Certificates (3 Yrs)	12.48	10.56	↓1.92
Mahana Amdani Accounts	12.25	10.41	↓1.84
Saving Accounts	7.80	7.00	↓ 0.8

(R) Regular

Market Analysis

The market has lost 120 points since April (till June 21, 2002). The index had lost 236 points in the month of May before making a partial recovery in June. The decline was expected as the market had lost its momentum (see graph), stock prices had appreciated close to their full values and the rally was highly leveraged.



The disadvantage of a leveraged rally is that the market makes sharp downside moves (panic) on negative news, as weak holders try to offload their inventories at falling prices, thus exacerbating the fall. The negative fundamental factors were further complemented by two significant news/ factors, which expedited the fall.

The fall

The first blow was dealt by the terrorist attack in Karachi on May 08, 2002, which resulted in a decline of 55 points. The market tried to consolidate after that, but plunged in panic conditions as investors and traders reacted to the ominous signs of a potential Indo-Pak conflict. Circuit breakers, which limit the fall (or rise), quickly came in to play each day, arresting the fall and preventing what would almost certainly have been a much steeper decline. The market would virtually come to a halt after the breakers were triggered; as a result, volumes were artificially depressed.

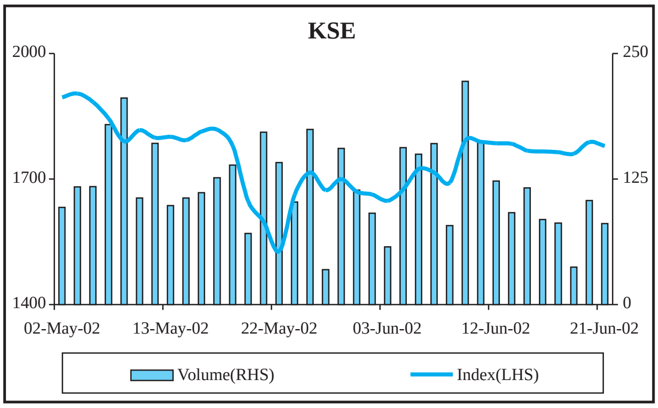
The market's fall also created panic conditions in the *badla* market, the liquidity lifeline for the leveraged momentum players. Supply shortages occurred, as financiers withdrew funds fearing higher market risks. As a result, the financing rates shot up to as high as 135% in ICI. Sensing that the market was in danger of repeating the crisis that occurred last September in the wake of the New York attacks, the KSE board of directors took a series of preventive measures:

- The 24%pa cap on *badla* financing rates that was removed in January this year was re-imposed, along with a 10%pa floor, for a period of one month. While borrowers were allowed to offer rates in excess of that cap, the excess accrued to the KSE. The downside circuit breaker was reduced to 2.5%, or Rs0.5, whichever is higher.
- *Badla* funds were frozen till June 3, 2002.
- Members that were unable to carry-forward their positions, had to pay an enhanced margin deposit of 50% of any additional purchases that they made.

The recovery

The US efforts for reduction in tension gradually reaped results and the market greeted it with a 100-point single day increase in June'02. The single day increase effectively eliminated any further upside move as traders and investors booked profits.

The recovery was primarily on easing of tension, while the underlying fundamental weakness still persisted. Hence the market went into a range bound phase. The imposition of tighter downside circuit breakers in a bearish market (sentiment) also resulted in lackluster trading activity.



Outlook

In our opinion the market is fully priced (for the near term). Investors are unable to foresee any further upside potential; hence, little active buying support is visible. On the other hand, the alternative investment opportunities (declining yield on fixed income securities) are becoming less and less attractive. Hence investors are also reluctant to off load their investments at these levels. Traders/Investors who want to reduce their exposure in the market are unable to do so due to the tight downside circuit breaker (floor). However, from July 01, 2002, the down side circuit breaker (floor) is being increased from the higher of 2.5% or Rs0.5, to 5% or Rs1, whichever is higher. This will give traders more room to play on both sides of the market. Till that time we believe the market will remain range bound.

(Contributed by Taurus Securities Ltd., a subsidiary of National Bank of Pakistan)

Key Economic Indicators

Economy Size & Growth		1998-99	1999-00	2000-01	2001-02[P]
GNP - Market Prices	Rs bn	2912.8	3102.3	3365.4	3752.5
GDP - Market Prices	Rs bn	2938.4	3147.2	3416.3	3726.6
Per Capita Income	Market Prices Rs	21899	22811	24198	26413
	Market Prices US $	438	441	414	427
Growth					
GDP	%	4.18	3.91	2.45	3.61
Agriculture	%	1.95	6.09	-2.64	1.39
Manufacturing	%	3.73	1.53	7.58	4.39
Services	%	4.99	4.79	4.79	5.09
Rate of Inflation	%				
Consumer Price Index		5.7	3.6	4.4	2.6+
GDP Deflator		5.5	2.8	5.6	3.4
Balance of Payments	$ mn				
Exports (f.o.b.)		7528	8190	8925	6628[a]
Imports (f.o.b.)		9613	9602	10170	6914[a]
Trade Balance		-2085	-1412	-1246	-286[a]
Services Account (Net)		-2618	-2794	-3130	-1810[a]
Private Transfers (Net)		2274	3063	3867	3009[a]
Current Account Balance		-2429	-1143	-509	913[a]
Fiscal Balance	% of GDP				
Total Revenue (Net)		15.9	17.1	16.0	16.8
Total Expenditure		22.0	23.6	21.3	22.5
Overall Deficit		6.1	6.6	5.3	5.7
Domestic & Foreign Debt					
Domestic Debt	Rs bn	1452.9	1641.4	1799.2	1652.1
As % GDP		49.4	52.2	52.7	44.3
Total External Debt[b]	$ bn	25.4	25.4	25.6	26.3
(Disbursed & Outstanding)					
External Debt Servicing*	$ bn	1.53	1.51	1.96	0.98
As % GDP		2.6	2.5	3.3	-
Investment & Savings	% of GDP				
Gross Investment		15.6	16	15.9	13.9
Fixed Investment		13.9	14.4	14.3	12.3
National Savings		11.4	14.1	15.0	15.4
Domestic Savings		12.3	15.6	15.9	15.2
Foreign Investment	$ mn	403.3	543.4	182.0	284.5
Portfolio		27.3	73.5	-140.4	-2.9
Direct		376.0	469.9	322.4	287.4
Monetary Aggregates	%				
M1		33.9	14.9	3.1	11.3[a]
M2		6.2	9.4	9	9.3[a]
Interest Rates (Weighted Average)	%				
Deposits**		7.96	6.62	6.58	-
Advances		14.8	13.52	13.61	-
Gold & Foreign Exchange Reserves	$ mn	2371	2149	2666	4546[c]
Exchange Rate++	Rs./$				
Official Rate		51.6	52.16	64.4	60.05
Open Market Rate		54.4	54.82	66.7	60.20

Source: Economic Survey 2001-02

P Provisional
+ July-April
a July-March
b Regular debt (medium & long term) payable in foreign exchange only
* Excluding interest on short term borrowings and IMF charges. Data from FY01
** PLS & Interest bearing
c End-March
++ End-June Buying Rate

NBP Performance at a Glance

(Rs. Bn)

Items	1996	1997	1998	1999	2000
Income	28.2	34.2	34.5	35.3	33.7
Expenditure	29.5	33.2	32.4	34.8	32.7
Pre-Tax Profit/(Loss)	(1.26)	0.995	2.14	0.52	1.03
Total Assets	274.1	310.6	325.9	350.4	370.7
Deposits	235.9	254.9	273.4	294.8	316.5
Advances	85.9	105.6	109.5	122.6	140.3
Investments	108.2	109.5	102.9	91.5	80.4
Number of Branches	1555	1445	1434	1431	1428
Number of Employees	23730	18096	15785	15541	15351