Overview of the Economy

I. Introduction

The economy of Pakistan has been undergoing a stabilization phase since the last three years. The restoration of macroeconomic stability is important and necessary to provide the platform for generating growth, jobs, and improving the quality of life of the people.

This period has been marked by the continuing --and intensified --security challenges the country has confronted since 2001. In addition, the country faced multiple adverse shocks of commodity and oil prices and the fallout of the global financial crisis. The year under review saw the unprecedented calamity of the great floods. These floods wiped out about 2 percentage points from the growth as well as inflicted a massive damage of $10 billion on country's economic structure. Some 20 million people were displaced as more than 50,000 Sq. Km area was submerged in water. During the year oil prices also shot up from $70/barrel to $125/barrel creating a new threat to the macro framework.

Viewed in this background the growth rate of 2.4 percent registered during the year 2010-11 seems reasonable. Although much below its potential, the performance signifies the enormous resilience in the economy as it was tested several times by one crisis after another beginning with the earthquake of 2005. With some reprieve and continuing effort, there is reason to believe that the country will revert to its potential growth trajectory.

The destruction of major crops, particularly rice and cotton, led to a negative growth of 4% in this sector. The manufacturing sector growth was adversely affected --and was negligible --due to reduced output in the textiles and petroleum products (affected by submersion of refineries under flood waters and the circular debt problem). Inevitably, the overall quantum of economic activities, captured by services sector was also affected, with a growth of 4.1 percent, originally targeted at 5.4%.

The challenges posed by exogenous shocks affected the pace of the reforms process as the government was forced to make difficult trade-offs and cater to unexpected demands for flood rehabilitation and the impacts of increasing oil prices. The government, while pursuing a regime of deregulation of pricing of key products was nevertheless forced to intervene in the energy and commodity markets to keep prices from getting completely out of the reach of the public. This burden of subsidies, though significantly reduced from previous years, exerted continuing pressure on the fiscal system and the adjustment path was affected. In the second half of the year, due to a combination of austerity, resource mobilization measures and bold decisions on pricing the macro-framework was stabilized and the anticipated damage to the overall fiscal position was avoided. However, more work will be required to rebuild the reforms programs, and to remain engaged with the development partners.

The most significant development during the year was the historic performance of the external sector, which is heading to register a surplus in the current account. First, exports registered a growth of 28 percent in the first 10 months of the year compared to same period last year. Crossing the $20 billion mark for the first time, exports are set to exceed $24 billion. Second, the remittances have also recorded a strong performance by crossing the double digit mark and are set to reach the historic level of more than $11.2 billion. Third --and this is partly attributable to moderated demand for imports --the current account shows a surplus of nearly $748 million. Finally, the combined effect of these positive developments was reflected in the growth of external reserves which also touched a historic high of $17.1 billion at the end of April, 2011.

Pakistan has enjoyed sustained period of exchange rate stability since December 2008. The Real Effective Exchange Rate (REER) depicted unprecedented appreciation of 10 percent in 2009-10 and marginally appreciated in the first ten months of the current fiscal year. The SBP is not intervening in the foreign exchange markets and exchange rate is market determined.

The situation regarding inflation remained a key concern for the economy. For most of last fiscal year, inflation was coming down, but the shocks of floods and oil price have reversed the declining trends. It should be noted that with rising commodity and oil prices, inflation has affected all countries both regionally and globally. However, in the second half of the year, the rising inflationary trend has been stemmed and inflation is now hovering around 14 percent. With fiscal consolidation and abetment of some pressures from international prices, the inflation outlook looks better than in the earlier part of the year.

Inflationary pressures inevitably brought pressure on the interest rate, and with much of the credit flowing in the government sector, private credit, despite some growth over the previous year remained weak. With development resources preempted by unanticipated expenditures on flood relief and power and petroleum subsidies, fiscal discipline required the government to reduce its public investment to a low level in many years. Accordingly, the overall investment in the year was also below its level in the recent past.

The overall monetary survey indicated modest growth in monetary aggregates. The reserves money grew by 17.1 percent in the period July-May 21, 2010-11as against 13.6 percent growth in the comparable period of last year on the back of strong growth of 73.1 percent in the NFA of the SBP. The NDA component grew steadily at 11.6 percent in the period. Broad money expansion by11.7 percent in the period July-May 21, 2010-11 is mainly drive by phenomenal growth 57.3 percent in the Net Foreign Assets (NFA) which is reflective of the positive developments in the external sector. The NDA of the banking system has expanded by 9.4 percent in the period. The tight monetary policy stance adopted by SBP is reflected in the rise in the policy rate which registered an increase of 150 bases points since July 2010 in the increments of 50 bases points.

The year was the first in the implementation of the NFC Award. The award represented a radical break from the past as it transferred a larger share of divisible poor revenues to the provinces. An estimated additional amount of Rs.325 billion will be transferred to the provinces compared to the last year. Since many of the primary public services are provided by the provinces, greater availability of resources will facilitate both the improvement in quality as well as scale of such services. The passage of 18th Constitutional Amendment has led to the devolution of additional subjects to the provinces, especially those in the social sectors. It is hoped that undivided responsibility of provinces in social sectors and availability of enhanced resources will lead to much improvement the quality of social sector indicators that have been lagging behind for some time.

Despite many challenges, the overall performance of the economy has been moderately satisfactory. The recent measures announced for fiscal correction should contribute to a faster recovery and resumption of growth. It was felt by some observers, that the budget deficit --the key indicator of economic stability--will reach unprecedented levels due to the difficult circumstances. However, due to sound economic management and fiscal discipline, the deficit has been contained and is estimated at 5.3% of GDP. To settle the circular debt and get more production out of the existing energy plants, the government has decided to pay additional Rs. 120 billion subsidies from for previous years. This will add an additional 0.6 percent to the deficit, bringing it to 5.9%. However, the outlook for the next year looks bright on this account as the year has fully accounted for the subsidies falling due during the year and substantial correction in such burdens is likely to be made in the years ahead.

A brief review of the economic situation during first three quarters and prospects for next quarter is given below:

II. Real GDP Sectoral Growth: The Real GDP growth is estimated to remain at around 2.4 percent compared to the target of 4.5 percent. The set back was due to the agriculture sector which was badly affected by floods. However, the strong performance of services sector which grew at 4.1 percent has kept the overall growth in a reasonable range. The sector-wise estimates are discussed in subsequent paragraphs:

Agriculture sector recorded modest growth of 1.2 percent in 2010-11 against the target of 3.8 percent but provided much needed support to boost exports, revival of manufacturing sector and responsible for upbeat in the consumption. Given the enormous price inducement, the agriculture sector is likely to spearhead economic growth in the next fiscal year as well. The lower growth owing to recent floods necessitated downward adjustments in the estimates of some of major crops like rice, and cotton. The rice crop production unexpectedly went down to 4.8 million tons which will be lowest ever production since 1994-95. The wheat production stood at 24.2 million tons as against last year's actual production of 23.8 million tons. The important thing is better yield as area under cultivation fell by around 3 percent. Sugarcane is estimated at 55 million tons which will be highest in the last three years. Minor crops are estimated at 4.1 percent mainly because of enormous price incentive available and its shock resistant nature. The estimate for growth in the livestock sector is 3.7 percent as against 4.2 percent last year. Lower growth is because of the adverse impact of devastating flood destroying some of the livestock. However, recent surge in prices of livestock products and incentives provided for livestock may help in improving the value addition in the sector in the medium-term. With changing patterns of consumption, the consumption of livestock products has increased significantly. There are indications that price incentive might work for more livestock growth.

The *fertilizer off-take* declined by 11.3 percent, thereby representing less usage by the farmers. One reason might be higher prices as urea prices soared by 25.8 percent and DAP is expensive by 46.5 percent in the first nine months of the current fiscal year. Domestic production is up by 2.7 percent but import of fertilizer is down by 50.4 percent.

Disbursement of credit for agriculture sector has increased marginally by 1.4 percent in July-March 2010-11. This fall in disbursements is largely due to substantial decline of 23.7 percent seen in one specialized bank (ZTBL) which more than offset the 9.5 percent rise in disbursements made by commercial banks. The sluggish credit performance is partially contributed by risk-averse behavior of commercial banks and weaker activity in the aftermath of floods.

Large-scale manufacturing remained victim of power outages and lower domestic demand. Slowdown in large-scale manufacturing from earlier projected 4.9 percent to 1.7 percent (July-March 2010-11) reflects the impact of the severity of energy shortages and electricity tariff -hike leading to cost escalation. The positive terms of trade shock has helped improve competitiveness for textile sector in particular and other conventional exports based small and medium manufacturing sectors. We expect it to pick-up in months to come and improve growth performance further mainly because of capacity enhancement in some industries like fertilizer, and steel, and likely improvement in the sugar production to 4.1 million tons this year. The impact of these positive developments will feed into the growth during the period January-June 2011. Notably, the base effect will work adversely up to March 2011, and thereafter it may support growth momentum.

III. Inflation: As noted earlier Inflation has reared its head in the first half of the year and posed a challenge for economic management. Two price indices like CPI and SPI witnessed a clear downtrend in recent months; however, WPI remained on upward trajectory. The inflation rate as measured by the changes in Consumer Price Index (CPI) after reaching peak at 25.3 percent in August 2008, showing easing since November 2008 with slight variations. However, following massive supply disruptions in the aftermath of devastating floods, food inflation became sole driver of overall CPI. WPI inflation is primarily driven by inordinate spike in cotton prices because of its huge weight in the index. CPI inflation has moderated since January, 2011. The CPI inflation has escalated by 0.23 on month-on-month (M-o-M) basis and 13.2 percent on year-on-year (Y-o-Y) basis in May 2011. The cumulative increase in July-May 2010-11 is 14.0 percent as against 11.6 percent in the comparative period of last year. The recent slow-down in inflation has been due to better availability of food items, increased sugar production and a very good looking wheat crop that is exerting downward pressure on wheat and other products. The recent decline in cotton prices, continuing decline in sensitive price index and fiscal consolidation, particularly leading to a major reduction in SBP borrowings, give hope that in the months to come prices will continue to moderate though challenges will remain so long as international prices remain volatile.

The fact that inflation has so far been food and energy driven is reflected in persistent decline in core inflation throughout the period until March. Since March there is a small surge, but given the construction of the index, in the months ahead core inflation may show some upsurge. However, with abetment of increase in energy prices and a likely upside of floods which experts say will be reflected in better agriculture productivity due to improvement in the quality of soil, as is already showing in the Kharif crops, it is not apprehended that the resurgence in core inflation will neutralize the slow- down in food prices.

The *Wholesale Price Index (WPI)* during first eleven months of 2010-11 has increased by 23.2 percent, as against 12.2 percent in the comparable period of last year. It has declined from as high as 35.7 percent in August 2008 to almost zero percent (0.3%) in August 2009, reflecting impact of massive decline in commodity prices in the international market. The recent spike is mainly driven by surge in the textile and energy prices. WPI has moved up from 17.6 percent in June 2010 to 25.4 percent in March 2011, however, in April and May 2011, the WPI has shown moderation. The recent decline in cotton prices will dampen the WPI further in months to come.

The *Sensitive Price Indicator (SPI)* has recorded an increase of 17.9 percent during the period (Jul-May 2010-11) as against 12.9 percent in the same period of last year. The upward trend is again reflecting the impact of massive supply disruptions in the aftermath of floods. The SPI is on downward trajectory from its peak of 21.5 percent in December 2010 to 15.4 percent in May 2011. Going forward, the prices of edibles like meat, milk, and ghee/ cooking oil will be crucial in determining the fate of the SPI. In recent times, the weakly trend is consistently declining, which will have a positive effect on CPI provided there is no more shock that would adversely affect the WPI.

IV. MONETARY DEVELOPMENTS*:* The SBP has kept its tight monetary policy stance for some time. The SBP has raised the policy rate by 150 basis points (bps), staggered in three stages of 50 bps each, since July 2010. SBP raised the policy rate by 50 bps to 13 percent on 2nd August 2010. Soon after this the economy experienced an exogenous shock in the form of massive Floods which engulfed almost one-fifth of the country. The inflation became a challenge in the aftermath of the floods which compelled the SBP to raise the policy rate further by cumulative 100 bps points to 14 percent up to 30th November 2010. Since then the need for further adjustment in policy rate was not felt simply because the inflation had started moderating and fiscal discipline was restored, with government borrowing from SBP significantly brought down.

The efficacy of monetary policy to shave-off aggregate demand from the economy was affected due to unanticipated fiscal pressures emanating from revenue-expenditure mismatch.

During July 01, 2010-May 21, 2011, *money supply(M_2)* expanded by 11.7 percent against last year's expansion of 8.9 percent in the comparable period of last year. The reserve money expanded at much faster pace of 17.1 percent against the expansion of 13.6 percent in the comparable period of last year.

Net domestic assets (NDA) have increased by Rs.492.6 billion as compared to increase of Rs.487.6 billion in last year, thereby showing an increase of 9.4 percent in this period whereas, last year the growth in the comparable period was 10.5 percent. *Net foreign assets (NFA)* have recorded an expansion of Rs.184.6 billion against the contraction of Rs.31.8 billion in the comparable of last year. The NFA of the SBP accounted for big chunk of the improvement as it expanded by Rs.135.2 billion as against contraction of just Rs.5.9 billion in the comparable period of last year.

Government borrowing for budgetary support has recorded an increase of Rs.614.2 billion as compared to Rs.397.6 billion in the comparable period of the last year. The SBP financing has shown a net increase of Rs.146.8 billion and financing from scheduled banks witnessed a net increase of Rs.467.4 billion during July 01, 2010-May 21, 2011.

Credit to private sector witnessed a net increase of Rs.112.9 billion during July 01, 2010-May 21, 2011 as compared to Rs.115.5 billion in the comparable period of last year. SBP kept its monetary tightening stance during the fiscal year, further increasing the policy rate by 150 bps in three rounds. These policy measures were in response to carryover of macroeconomic stresses for some time and increase in real aggregate demand.

Weighted average lending rate increased from 13.3 percent in April 2010 to 14.4 percent in April 2011. ***Weighted average deposit rate*** on the other hand has fractionally decreased from 7.37 percent in April 2010 to 7.35 percent in April 2011 which implies increase in the spread amidst intensive deposit mobilization efforts on the part of the banks. The weighted average yields on 6 months T-bill has increased by almost 141 bases points to 13.46 percent in April 2011 as against 12.05 percent in April 2010.

V. FISCAL DEVELOPMENTS: Fiscal performance – both revenues and expenditures – have been affected by the floods and the policy adjustments in the face of global rise in prices of energy. The original estimates had to be revised in the light of these unprecedented happenings. Preliminary data suggests that the fiscal deficit is likely to remain between 4-4.5 percent of GDP in the first nine months of the current fiscal year. Part of the increase in the fiscal deficit is explainable on account of higher security related expenditures and the floods, however significant contribution to this increase came from higher subsidies, delay in adoption of tax measures, non-realization of auction of 3-G license and several petroleum related incomes which were affected due to non-resolution of circular debt problem in full. The emerging fiscal situation has reinforced the urgent need to broaden the tax base, rationalize expenditure and to better insulate the economy from shocks.

Although, initially a relatively higher reliance had to be placed on bank borrowings, particularly from SBP, over time this imbalance has been corrected and the share of non-bank borrowings has been significantly increased. Beginning with the Jan-March quarter, the constraint of zero SBP borrowing on a quarterly basis has been fully adhered to. At the End of March, SBP borrowings were recorded at minus Rs.16 billion compared to the level outstanding at end June, 2010. A number of steps were adopted to improve debt management which essentially focused on reducing reliance on bank borrowings. Government now aims to restrict banks' investment in government securities only to the extent required for meeting statutory requirements. For this purpose extensive marketing efforts are taken to encourage sell-down by banks of government securities to non-bank institutions and individuals while the system of national savings schemes is strengthened for mobilization of non-bank resources from the individuals.

The delayed taxation measures led to the revision of FBR target from Rs.1667 billion to Rs.1588 billion. However, with slowed economic activities, including a decline in the real growth rate, the growth in revenues in the first nine months was below expectation. Accordingly, a need for mid-course adjustment was felt. Accordingly, as part of fiscal consolidation a major effort was launched in March whereby three tax measures with a revenue potential of Rs.53 in a quarter were adopted. These included the imposition of a one-time flood-surcharge on income tax, an additional excise duty of 1% on some selected luxury items and removal of exemptions on many goods subject to sales tax. With these measures part of the revenue lost in the first three quarters due to delay in tax measures will be recouped and the impact of reduced revenues on fiscal deficit. The revised FBR target of Rs.1588 billion, though formidable, remains on track.

VI- External Sector: One bright feature of the first ten months (July-April) is the strength of the external sector. Phenomenal increase in remittances and robust growth in exports owing to sharp increase in the prices of cotton overshadowed the strong growth in imports, thereby generating the current account surplus of US$ 748 million or 0.3 percent of GDP. Overall external account has also shown improvement even when capital and current account receipts have continued to fall in this period.

Exports started recovery since January 2010 and grew marginally by 2.7 percent in 2009-10 — rising from $ 19.1 billion of last year to $ 19.6 billion. However, exports rose by 14.5 percent in the second half (January-June 2010) and by 27.5 percent in the first nine months of the current fiscal year (July-March 2010-11) which is really reflecting enormous pick-up in exports.

Textile sector accounted for 62 percent of buoyancy in export growth and that too is coming from the value added sector. Food group accounted for almost 17 percent increase in exports on the back of vegetables, wheat and tobacco. After living in the oblivion, leather products took advantage of escalation of commodity prices and non-traditional exports contributed 11.5 percent of exports growth. The upbeat in the export market is mostly price effect and the contribution of quantum impact is minimal. Pakistan has to strengthen its supply side to sustain current momentum in the exports because we have lost sizeable amount owing to supply constraints in terms of foregone exports.

Imports registered a negative growth of 2.3 percent in 2009-10. The imports stood at $32.3 billion as against $28.1 billion last year. Notwithstanding this negative growth, the import growth in January-June 2010 (second half of FY 10) is recorded at 18.5 percent and for the first ten months of CFY (July-April 2010-11) imports recorded a hefty growth of 14.7 percent. This implies substantial pick-up in the pace of imports during the last five quarters. This incorporates impact of higher oil and commodity prices for some time.

The food group accounted for 35.4 percent of import growth and, sugar and edible oil are responsible for one-fourth of imports growth. Escalation in POL prices in the international market has not impacted POL import bill significantly, mainly because of compensation coming from lower quantum terms imports of POL products. Upbeat in textile exports also reflected in imports composition as raw cotton and textile machinery is responsible for almost one-fourth of imports growth. The positive aspect of imports growth is some pick-up in raw material imports during last three months or so.

Trade Balance The merchandise trade deficit has improved and declined from $12.3 billion to $12.1 billion in July-April 2010-11. Substantial increase of 27.8 percent in exports outstripped otherwise buoyant growth of 14.7 percent in imports, which caused the trade deficit to improve by 2.2 percent. The improvement in the trade deficit is substantial in the January-April 2011 when trade deficit averaged $636 million per month as against $957 million in the period Jul-December 2010. In the month of April 2011, the trade deficit narrowed to just $236 million which implies substantial improvement in the trade deficit is yet to come. This reflects the impact of positive terms of trade shock as Pakistan's exports prices grew at much faster rate than import prices. Unit value of exports has increased by 37.1 percent as against increase of 23.4 percent in unit value of imports, thereby causing improvement in terms of trade indices by 59.3 percent. The improvement in unit value of exports is more pronounced in manufacturing category where it increased by 37.1 percent because of huge price boost to textile export prices.

Workers' remittances reached record $ 9.1 billion mark in the first ten months (July-April) of 2010-11as against $ 7.3 billion in the comparable period of last year, depicting an increase of 23.8 percent.

The remittances from Saudi Arabia recorded massive growth of 36.7 percent, followed by EU (38.3 percent), UK (34.9 percent) and UAE (25.7 percent). The remittances for the first time in the history crossed the one billion dollar mark in March and April 2011. This has raised the hope that workers' remittances will cross the $ 11 billion this year.

Current Account Balance Pakistan's current account balance shrank by 121.6 percent in the first ten months of 2010-11. The current account balance turned to surplus $748 million from deficit of $3456 million in the comparable period of last year. The improvement is broad based and improvements witnessed across the board in trade balance of goods and services, and income account while buoyancy in current transfers helped current account to turn into surplus. Current account absorbed extraordinary commodity and oil price shocks without impacting exchange rate or reserve accretion. This is mainly because of higher inflow of worker's remittances and sharp reduction in trade of goods and services deficit. The services credit also improved by 24.6 percent in comparison to just 6.6 percent increase on debit side.

Foreign Exchange Reserves amounted to $ 17.1 billion by the end of April 2011. Of this amount, reserves held by State Bank of Pakistan stood at $ 13.7 billion and by banks stood at $ 3.4 billion. The reserve coverage for import of goods and services has improved to 4.6 months. The improvement in reserves can also be attributed to account valuation impact and benefited from lower current account financing requirement.

Exchange rate remained more or less stable as rupee depreciated by just 2.2 percent in July-April 2010-11, however, Real Effective Exchange Rate (REER) appreciated by 0.8 percent in the period. Pakistan economy has witnessed unprecedented sustained exchange rate stability since January 2009. This is evident from the fact that REER had appreciated by 10.2 percent in 2009-10. Exchange rate stability could provide impetus to economic growth in normal circumstances.

Foreign direct investment (private) stood at $ 1,232 million during July-April 2010-11 as against $1,725 million in last year, thereby showing a decline of 29 percent. This is mainly due to volatile security condition in the country. Power, oil and gas and financial businesses remained the main attraction for foreign investors.

External Debt and Liabilities (EDL) stood at $ 59.5 billion by end-March 2011 up from end-June level of $55.9 billion. The major chunk originates from translation impact of weaker dollar against major currencies such as euro and yen. IMF outstanding stock stood at $8.9 billion as against $8.1 billion at end-June 2010. Similarly, Paris Club debt went up to $15.1 billion as against $14 billion, only on account of translation effect rather than fresh net disbursements. The net impact of cross-currency valuation cost net addition of $2.7 billion to the external debt stock while total addition to EDL was just $ 4 billion. This implies almost three fourth of addition to debt stock was coming from translational impact. Notwithstanding this adverse impact, EDL grew by just 6.4 percent which is the lowest ever increase in EDL stock in the last five years. Resultantly, the EDL stock in relative terms has decreased by 3.4 percentage points from 31.6 percent of GDP by end-June 2010 to 28.2 percent by end-March 2011. The debt burden as measured by EDL as percentage of foreign exchange earnings decreased from 146.6 percent by end-June 2010 to 127.2 percent by end-March 2011.

Conclusion

The present government started off its term with a inherited backlog of problems – deficits, electricity shortages, security expenditures, resettlement of IDPs, low growth and entrenched inflation. The year under review brought new and totally unexpected challenges such as the increase in the price of oil and the devastating floods that created huge losses to crop and livestock sector, physical infrastructure and the GDP. Despite all these challenges the performance of economy has been positive as elaborated in the early part of the chapter. The government has shown continuing resolve to take difficult decisions and pursue the path of reforms.

The economic stabilization program of the government includes measures like: (i) broadening of tax base through reformed GST and other tax measures; (ii) elimination of subsidies especially the power sector subsidies and (iii) amendment in SBP Act to place limit on government borrowing from SBP; and (iv) direct cash grants to poorest of the poor through Benazir Income Support Program (BISP) and Watan Card Scheme for flood affected people.

In addition to above; the reform agenda in the economic and financial sector also include:

- Restructuring of Public Sector Enterprises
- Power Sector Reforms
- Debt management strategy
- Fiscal austerity to reduce fiscal deficit
- Tight monetary policy to check inflation
- Building foreign exchange reserves to stabilize the exchange rate
- Promoting exports
- Incentivizing home remittance
- Strengthening social safety nets to mitigate impact of stabilization measures through Benazir Income Support Program (BISP)
- Promoting growth, and raising domestic revenues
- Rationalizing subsidy regime to reduce pressure on the budget
- Tax administration and policy reform to mobilize domestic resources.

The above reforms agenda is comprehensive as it takes into account the major challenges that remain on horizon. In the years ahead government is determined to sustain macroeconomic stability, spur growth through the new growth framework that relies more on building peoples, markets and institutions of governance and other softer sides of intervention as opposed to single-minded focused on brick and mortar infrastructure. Inclusive growth will only be possible when people are empowered and their productivities are enhanced to a level where they can compete confidently at the global level.

EXECUTIVE SUMMARY

Growth and Investment

The Real GDP is estimated to grow at 2.4 percent on the back of strong performance of services sector which is lower than target for the year at 4.5 percent as envisaged in the Annual Plan 2010-11. This deviation from the target is attributed to slower growth in the manufacturing and agriculture sector. The growth in the ***agriculture*** is estimated at 1.2 percent on the back of 3.7 percent growth in the ***livestock sector***. The slower growth is mainly because of recent flood driven downward adjustments in estimates of some of ***major crops*** like rice, and cotton. ***Minor crops*** are estimated at 4.1 percent mainly because of enormous price incentive available and its shock resistant nature. ***Large-scale manufacturing*** remained victim of power outages and lower domestic demand as it grew by 0.98 percent (July-February 2010-11 incorporated in the national accounts but the growth is now 1.7 percent in July-March 2010-11) as against 4.9 percent of last year. Deceleration in growth inhabits the impact of severity of energy shortages and electricity tariff hike leading to cost escalation. The positive terms of trade shock has helped improved competitiveness for textile sector in particular and other conventional exports based small and medium manufacturing sector. The underlying improvement is not reflected in large-scale manufacturing because they are mainly concentrated in the informal sector.

Services sector grew by 4.1 percent as against 2.9 percent last year. The main contributors to this growth are public admn and defence (13.2 percent), and social services sector (7.1 percent). The former because of 50 percent pay rise for government servants and higher defence spending, the later because of logistics support and flood generated social activities.

The contribution to economic growth is spearheaded by the services sector with 90 percent stake while only 10.0 percent contribution came from the Commodity Producing Sector (CPS). One of the important components of CPS, manufacturing alone contributed 23 percent to real GDP growth; however, this is more than neutralized by 25.4 percent negative contribution of relatively smaller sector, electricity and gas distribution. Thanks to 10.7 percent positive contribution from the agriculture, the overall negative contribution of the industrial sector could not prevent commodity producing sector to contribute positive 10.7 percent to the GDP growth. From demand side, it was totally consumption driven growth with negative contributions from net exports and investment.

Pakistan's ***per capita real income*** has risen by 0.7 percent in 2010-11 as against 2.9 percent last year. ***Per capita income in dollar term*** rose from $ 1073 last year to $ 1254 in 2010-11, thereby showing tremendous increase of 16.9 percent. This is mainly because of stable exchange rate as well as higher growth in nominal GNP. ***Real private consumption*** rose by 7.0 percent as against 4.0 percent attained last year. However, gross fixed capital formation lost its strong growth momentum and ***real fixed investment growth*** contracted by 0.4 percent as against the contraction of 6.1 percent in last fiscal year.

The ***total investment*** has declined from 22.5 percent of GDP in 2006-07 to 13.4 percent of GDP in 2010-11. The ***national savings*** rate has decreased to 13.8 percent of GDP in 2010-11 as against 15.4 percent of GDP last year. ***Domestic savings*** has also declined substantially from 16.3 percent of GDP in 2005-06 to 9.5 percent of GDP in 2010-11.

Agriculture

Agriculture still provides employment to 45 percent population and provides essential input for agro-based industry. Agriculture income has created demand for industrial products. Agriculture provided main impetus to economic growth by creating additional demand of goods and services as a result of higher prices of agricultural produce. As a result of inordinate spike in prices of major crops, an additional amount of Rs. 342 billion was transferred to the rural areas in 2010-11 alone. Contrary to this only Rs.329 billion were transferred to the rural areas on account of higher prices of major crops during the eight years (2001-2008). The highest ever wheat crop provided strength to the attainment of the objective of food security this year. Agriculture sector recorded modest growth of 1.2 percent in 2010-11 but provided much needed support to boost exports, revival of manufacturing sector and responsible for upbeat in the consumption. Given the enormous price inducement, the agriculture sector is likely to spearhead economic growth in the next fiscal year as well.

The agriculture has lost significant growth momentum as its growth slowed down to 2.7 percent in the decade of 2000s as against 4.4 percent in 1990s and 5.4 percent in the 1980s. The structural problems and lack of mechanization remained main impediment to growth. Major crops remained the victim of natural calamities during the last few years and three out of last four years witnessed negative growth in the major crop sector.

The unprecedented floods in July 2010 destroyed two major crops, i.e. rice and cotton. As reported by SUPARCO, an area of 2.364 million hectares under *Kharif* Crops 2010 was damaged. During the outgoing year 2010-11, the overall performance of agriculture sector exhibited a weaker growth mainly due to negative growth of major crops and forestry. Against the growth target of 3.8 percent, and previous year's performance of 0.6 percent, agriculture is estimated to grow by 1.2 percent. *Major crops*, accounting for 31.1 percent of agricultural value added, registered a negative growth of 4.0 percent for second year in a row mainly because of decrease in production of rice and cotton by 29.9 and 11.3 percent, respectively. *Minor crops* accounting for 10.9 percent of overall agriculture value addition, grew by 4.8 percent as against negative growth of last two years.

The *Livestock* sector having 55.1 percent stake in the agriculture sector was also impacted by the massive floods and witnessed marked slowdown recorded growth at 3.7 percent in 2010-11 as against 4.3 percent last year. The sector is immune from weather related problems and thus offers prospects for consistent growth. *Fishery* sector grew by 1.9 percent as against last year's growth of 1.4 percent. *Forestry* has experienced negative growth of 0.4 percent this year as compared to last year's positive growth of 2.2 percent.

Pakistan's agricultural performance is dependent upon availability of irrigation water. As against the normal surface water availability at canal heads of 103.5 Million Acre Feet (MAF), the overall (both for *Kharif* as well as *Rabi*) water availability has been less in the range of 2.5 percent (2005-06) to 20.6 percent (2004-05). Relatively speaking, *Kharif* season 2010 faced more shortage of water than any other *Kharif* season since 2003-04. During the current fiscal year (2010-11), the availability of water as a basic input for *Kharif* 2010 (for the crops such as rice, sugarcane and cotton) has been 20 percent less than the normal supplies and 21 percent less than last year's *Kharif* season. The water availability during Rabi season (for major crop such as wheat), is, however, estimated at 34.6 MAF, which is 5.0 percent less than the normal availability, and 38 percent more than last year's Rabi crop.

The domestic production of fertilizers during the first nine months (July-March) of the current fiscal year was up by 2.7 percent over the same period last year. The import of fertilizer decreased by 50 percent; hence, the total availability of fertilizer also decreased by 15 percent over the same period last year. Total off-take of fertilizer has also reduced by 11.3 percent.

Keeping in view the increasing demand of credit due to recent unprecedented floods and torrential rains in the country, the Agricultural Credit Advisor Committee (ACAC) has allocated agriculture credit disbursement target of Rs.270 billion for 2010-11 as compared to Rs.260 billion fixed for last year. Out of the total target, Rs. 181.3 billion were allocated to commercial banks, Rs. 81.8 billion to ZTBL and Rs. 6.9 billion to Punjab Provincial Cooperative Bank Limited(PPCBL). During the period (July-March ,2010-11), all the banks have disbursed Rs. 168.7 billion or 62.5 % of the target compared with disbursement of Rs. 166.3 billion during corresponding period last year.

Manufacturing

The performance of the Large Scale Manufacturing (LSM) sector during July-March remains victim of operational constraint on account of energy/gas shortages and devastating effects of flood 2010. It is evident from the fact that the momentum in growth was upset in the initial months of current fiscal year. The construction, petroleum refining, cotton textile and agro-based industries were strongly affected. Textile sector suffered heavily from the loss of cotton crop and other industries heavily dependent on gas i.e. fertilizer industry adversely affected by shortage in gas supply. However, LSM posted positive growth in December 2010 onwards. The major sectors contributed to positive trends in LSM are improvement in sugar production, automobile and strong external demand supported the growth in chemicals and leather. Moreover, significant rise in worker remittances as well as public and private transfers to the flood affected population and huge transfers to rural areas producing cotton and sugarcane has strongly impacted on the consumer demand for durable goods.

Quantum Index of Large Scale Manufacturing (QIM) managed to register positive growth of 1.71 percent during the period July-March 2010-11. Main contributors to this modest growth include leather products (30 percent), automobile (14.6 percent), food, beverages & tobacco (9.3 percent), paper & board (2.9 percent), chemical (1.4 percent), fertilizer (0.8 percent), pharmaceutical (0.5 percent) and textile (0.2 percent). However, some groups dragged index down with negative growth include; engineering product (15.4 percent), steel product (13.1 percent), electronic (12.9 percent), non-metallic minerals (9.6 percent) and petroleum products (4.2 percent).

Textile industry contributes about 60 percent to the total export earnings of the country, accounts for 46 percent of the total manufacturing and provides employment to 38 percent of the manufacturing labour force. Textile sector performance has shown slight improvement owing to spike in global prices and its production slightly increased.

The mining and quarrying sector is estimated to grow by 0.4 percent in 2010-11 as against 2.2 percent growth registered during last year. Natural gas, crude oil and dolomite posted positive growth of 1.9 percent, 1.1 percent and 5.9 percent, respectively during the current financial year. However, most of minerals witnessed negative growth rate during the period under review, the growth of coal declined by 4.0 percent, followed by chromite 39.3 percent, Magnesite 60.9 percent and barites 32.6 percent, respectively.

Fiscal Development

Intensification of war on terror put additional burden on public finances at a time when weaker domestic economic activity is taking its toll on revenue mobilization efforts. Fiscal balance deteriorated in 2009-10, and some adjustment is expected in fiscal deficit.

A low and declining tax-to-GDP ratio and increasing public debt stock has imposed a constraint on the size of fiscal stimulus to support revival of growth momentum needed for the economy. It was therefore, a number of economic and financial reforms were undertaken, that includes

- Rationalization of Expenditure
- Optimization of Available Resources
- Process Re-engineering and
- Efficiency of Operation
- Restructuring of Public Sector Enterprises
- Power Sector reforms

The government has also announced various temporary tax policy measures through Presidential Ordinance to generate additional revenues of Rs 53 billion during the last quarter of 2010-11. These are as follows:-

- Withdrawal of sales tax exemption on agriculture inputs like tractors, pesticides, and fertilizer both at domestic and import stages. Now these are subjected to 17 percent GST
- A onetime surcharge of 15 percent has been imposed on withholding and advance taxes payable during financial year 2011; and
- Special excise duty rate has been increased from 1 percent to 2.5 percent on non-essential items for the remaining period of tax year 2010-11.

Total expenditures witnessed an overall decline since 2007-08. The decline in total expenditure (1.7 percentage point of GDP) is shared by current expenditure (1.2 percentage points) and development expenditure (0.9 percentage points) during the past 3 years. However in 2010-11, the total expenditure is expected to reach at Rs. 3257 billion or 18.0 percent of GDP. On the other hand, total revenues are expected to rise by Rs 2,574 billion or 14.6 percent of GDP.

Fiscal deficit as a percentage of GDP has declined from 7.6 percent in 2007-08 to 5.3 percent in 2008-09 on account of a drastic cut in development expenditures. Nonetheless, the fiscal consolidation witnessed in 2008-09 evaporated with an increase in fiscal deficit by 6.3 percent in 2009-10, which was 1.5 percent more than the budget estimate for 2009-10 due to large additional subsidies for the electricity sector and higher security related expenditure. Meanwhile, the catastrophic floods, which hit Pakistan in the summer of 2010, reduced growth and posed a further challenge to public finances by depressing budget revenues and necessitating additional spending to meet the humanitarian and reconstruction needs, thereby necessitating upward adjustment in the fiscal deficit target from 4 percent of GDP at the time of budget announcement to 5.3 percent of GDP.

According to the consolidated revenue & expenditure of the government, total revenues grew by 6.2 percent during July-March 2010-11 and reached to Rs1,489 billion as compared to Rs1,402 billion in the same period last year. The increase is mostly coming from higher tax revenues partially contributed by direct taxes on the back of advance income tax payments and growth in taxes on goods and services and international trade due to increase in rupee imports. On the other hand, growth in non-tax revenues decreased by 5.7 percent mainly because of a decline in transfer of SBP profits.

Within overall revenues, FBR taxes witnessed a growth of 12.6 percent during July-April 2010-11, and reached at Rs 1,156 billion against Rs 1,026.5 billion in the same period last year. However, other tax revenues neutralized this growth. Negative growth in non-tax revenues neutralized further total revenue growth to just 6.2 percent. Total expenditure increased at much faster rate of 11.5 percent during July-March 2010-11 and thus widened the revenue-expenditure gap. Un-sustainability of the fiscal balance emanates from the persistent growth in expenditure caused by flood relief activities, security related expenditure and delay in the implementation of tax reforms. External resources for financing of budget deficit amounted to Rs 61 billion, and insufficiency of the external financing shifted more reliance on domestic resources to finance the fiscal deficit during July-March 2010-11. Fiscal deficit as a percentage of GDP stood at 4.3 percent during the first nine months of 2010-11 against the revised target of 5.3 percent for the whole fiscal year.

Money and Credit

Inflationary pressures were quite severe in the beginning of fiscal year 2010-11 and become worse by the devastating floods. Moreover, the dried up external financing flows due to difficulties in IMF program and insufficient funds from non-bank sources raised the pressures on SBP borrowing to finance the fiscal deficit through most of first half of fiscal year 2010-11. To target the inflation and to contain the aggregate demand induced risks to macroeconomic stability, SBP raised the policy rate by 150 basis points (bps), staggered in three stages of 50 bps each, since July 2010. SBP raised the policy rate by 50 bps to 13 percent on 2nd August 2010. Soon after which country experienced an exogenous shock in the form of Floods. Consequently, the rate was further increased by cumulative 100 bps points to 14 percent up to 30th November 2010. While keeping in view the risks to inflation and economic growth, SBP has decided to keep the policy rate unchanged at 14 percent on 29th January 2011.

The YoY growth in broad money (M2) increased sharply to 9.6 percent during July-April, 2011 against 8.1 percent in the corresponding period last year. Net Domestic Assets (NDA) during July-April 2011 reached at Rs 402.5 billion against Rs 446.1 billion during the same period last year. The expansion in NDA mainly attributed by a rise in demand for private sector credit and government borrowings.On the other hand the NFA of the banking system during the period under review had increased by Rs 153.2 billion after registering a significant decline of Rs 31.3 billion during the same period of last year. The increase is due to record inflow of worker remittances worth $9 billion which are expected to cross historical $11 billion mark by the end of current fiscal year.

The government borrowing from the banking system for budgetary support and commodity operations stood at Rs342.2 billion during July-April, 2011 on account of weak fiscal position.

Government has borrowed Rs 196.3 billion from the State Bank of Pakistan (SBP) , while Rs 275.9 billion has been borrowed from the scheduled banks during July- April, 2011. Less than expected non-bank and external financing for budgetray support have compelled the government to borrow from the SBP and scheduled banks since October 2010. Nevertheless, the govervment was heavily dependant on SBP borrowing till November 2010, that has witnessed some respite in the later half of December 2010 when the government retired a large part of its debt to SBP.

The credit to private sector during July-April, 2011 was Rs 156.7 billion compared to Rs 144.2 billion in the corresponding period last year. A strong growth has been witnessed since January 2010 that was mainly due to an increase in seasonal demand for working capital. More than half of private sector credit went to the textile sector showing higher input prices, especially that of cotton. Sector wise breakup of private sector credit also shows that sugar and textile industries were the major drivers to this increase, which respectively availed credit of Rs 105.6 billion and Rs 62 billion during Jul-March 2011.

Liquidity conditions in the money market remained fairly comfortable during July-March 2010-11 underpinned by the reduced government borrowings from the SBP and growth in bank deposits. SBP drained this excess liquidity not only through auctions, but also mopped up a significant amount through open market operations (OMOs). The SBP mopped up Rs 540.2 billion during July-March 2010-11 against the injections of Rs 1032.3 billion whereas in the comparable period of last year absorption of Rs 242.1 billion against the injection of Rs 3352.5 billion has taken place.

The SBP accepted Rs 2527.5 billion from the primary market of T-bills during July-March 2010-11 as compared to Rs 999 billion in the same period last year. Market offered a total amount of Rs 4018.5 billion during the first nine months of 2010-11.

Capital Markets

During the period from July-March 2010-11 the capital markets demonstrated wavering rising trend and posted modest gains. Pakistan's stock markets have remained buoyant during the first two quarters of the 2010-11 in terms of market index and market capitalization, which was remained steady till January 2011. In the current fiscal year, the Karachi Stock Exchange (KSE) retained its prominent position in Pakistan's capital markets, offering efficient, fair and transparent way of trading securities. This can be compared with any market in the region and enjoying full confidence of the investors. During the period July-March 2010-11, the benchmark KSE-100 index showed a steady growth subsiding the economic uncertainties like implementation of Reformed General Sale Tax (R-GST) and concerns over losses incurred by the massive floods across the country. The most concerning factor to highlight since the start of the fiscal year has been gradual deterioration of the market activity/volume. The KSE-100 index recorded a bullish trend during first half of the current fiscal year (CFY) as the market was trading around 12,000 at the end of December 2010. The KSE-100 index however, remained steady during the third quarter of 2010-11 and after touching at 12,682 on January 17, 2011 traded at 11810 points at the end of March. The main reason of better performance in mid May 2011 in the stock market and gearing up the momentum in the KSE-100 is considerable foreign investment. Investment in capital market during the period July-March 2010-11 by the foreign investors depicted a net inflow of US$ 301.5 million, but noteworthy contribution was made during the first two quarter of 2010-11. The leading stock markets of the world observed high growth during the fiscal year 2010-11 ranging from 8.1 percent in Japan to the highest market return up to 66.8 percent as peace dividend in Sri Lanka.

Pakistan Investment Bonds (PIBs together with the National Saving Scheme 9NSS) instruments primarily hold a larger portion of local fixed-income market. They provide the government with long-term maturity debt. State Bank Pakistan (SBP) held seven auctions in 2010-11 and government amassed Rs. 83.4 billion in 2010-11. To cope with the liquidity requirements of *Shariah* compliant banking institutions, the target for the auction of fourth GoP *Ijara Sukuk* is set at Rs 40 billion during Fiscal Year 2010-11 while it was 20.4 billion in revised budget in FY 2010. Three auctions were held in July-March 2010-11. Total amount offered for the said bids was Rs.179.3 billion against target of Rs.125 billion while Rs.136.5 billion were accepted. As of March 31, 2011 there were 3.8 million investors with different National Saving Schemes (NSS). During the fiscal year July-March 2010-11, net deposits with National Saving Schemes increased to Rs 1,822.4 billion.

Significant progress has been made on capital market reforms, including formulation of a comprehensive policy for dealing with companies in default of securities market laws to protect the investor, enhance transparency and improve member listing. In order to cater to the financing needs of the market and to bring in liquidity, the securities (Leveraged Markets and Pledging) Rules were finalized in coordination with the relevant stakeholders and promulgated on February 18, 2011. Rules provided the broader regulatory cover to the products of Margin Financing, Margin Trading and Securities Lending and Borrowing. Subsequently, the regulatory framework of the stock exchanges, the National Clearing Company of Pakistan limited (NCCPL) and the Central Depository Company of Pakistan Limited (CDC) was also amended to provide for the operational aspects of the said mechanisms.

Inflation

Inflation as measured by the changes in Consumer Price Index (CPI) has escalated by 1.62 on month-on-month (M-o-M) basis and 13.0 percent on year-on-year (Y-o-Y) basis in April 2011. The cumulative increase in July-April 2010-11 is 14.1 percent as against 11.5 percent in the comparative period of last year. During the last 10 months food has remained the major driver of the inflation on the back of major supply disruptions owing to devastating floods as well as spike in imported food stuff prices. ***Food inflation*** recorded at 18.4 percent while ***non-food*** component increased by 10.4 percent in this period.

The ***Wholesale Price Index (WPI)*** during first ten months of 2010-11 has increased by 23.3 percent, as against 11.3 percent in the comparable period of last year. The recent spike is mainly driven by upsurge in textile and energy prices. WPI has moved up from 17.6 percent in June 2010 to 25.9 percent in April 2011. The ***Sensitive Price Indicator (SPI)*** has recorded an increase of 18.5 percent during this period (Jul-April 2010-11) as against 11.3 percent in the same period of last year. The upward trend is again reflecting the impact of massive supply disruptions in the aftermath of floods. The SPI is on downward trajectory from its peak of 21.5 percent in December 2010 to 16.1 percent in April 2011.

The underlying factors for this spike are; rising international oil prices, spike in textile products prices and shortages of key consumer items in the market. However, inflation is largely driven by food prices enforcing the overall inflation to move up. The supply shocks adversely impacted food inflation and was more visible in prices of heavy weights like pulses, rice, meat, milk sugar and vegetables.

Trade and Payments

Pakistan economy witnessed current account surplus of $ 748 million during July-April 2010-11. This was possible by phenomenal increase in remittances, robust growth in exports primarily because of positive terms of trade shock that overshadowed the strong growth in imports, and stable exchange rate. Overall external account has also exhibited improvement even when capital and financial account receipts have continued to decrease during this period. Merchandise exports rose to $20.2 billion in July-April 2010-11 as against $ 15.8 billion in the comparable period of last year, thereby showing inordinate growth of 27.8 percent. The growth in exports remained broad based as almost all the groups (textile and non-textile) witnessed a high positive growth. However, the lion's share of this year's exports came from textile sector and food group contributing 61.8 percent and 18.1 percent, respectively to overall exports growth during the period under review.

Merchandise imports during increased to $ 32.3 billion in July-April 2010-11 as against $ 28.1 billion in the comparable period of last year, thereby showing an increase of 14.7 percent. The overall import bill is higher by $ 4.1 billion, reflecting the impact of higher global crude oil and commodity prices. The higher import bill is contributed by food group ($ 1,528 million), petroleum group ($ 678.3 million), consumer durables ($ 247 million), raw material group ($ 1,039 million), telecom ($ 245 million) and on other items group ($ 951 million). The price and quantity effects worked in the same direction; however price effect remained stronger than quantity effect.

During July-April 2010-11, the current account deficit turned to surplus of $748 million from deficit of $3,456 million in the comparable period of last year. This year's improvement in current account is broad based as improvement witnessed across the board in all sub-components including balance of goods, services and income account while buoyancy in current transfers helped current account to turn it into surplus in the form of higher export growth, strong and sustained inflows of workers' remittances, logistic support related receipts and grants received for flood relief. In the backdrop of improvement in all sub groups, the current account absorbed commodity and oil price shock of high intensity without impacting exchange rate or foreign exchange reserves. Within the current account, deficit in trade account contracted by 10.8 percent during July-April 2010-11 over the last year which remained at $8,285 million

Decline in services account deficit by 28.2 percent during July-April 2010-11 was the result of 24.7 percent growth in services exports that outpaced 6.6 percent growth in services imports. Robust growth in services exports came from logistic support receipts ($743 million), transportation ($1,188 million), travel ($289 million) and other business services ($573 million). Net inflows in the financial account declined to $412 million in July-April 2010-11as against $3,533 million during the same period last year. The massive decline in inflows is unevenly contributed by debt creating and non-debt creating inflows. The massive fall in disbursement of loans is witnessed. The inflow of disbursements of long term loans stood at $1964 million in July-April 2010-11 as compared to $3020 million in the comparable period of last year. Amortization payments witnessed some upsurge and resultantly net inflow of loans stood at $333 million as against $1472 million in the comparable period of last year.

On the other hand non-debt creating inflows registered negative growth of 7.1 percent by declining to $1491 million from $1605 million. Portfolio investment provided a cushion against worsening of financial account and recorded inflow of $298 million as against outflow of $48 million. FDI component registered much of the decline in non-debt creating inflows as Foreign direct investment (FDI) declined by 28.7 percent during July-April 2010-11 as a result of fall in equity capital and reinvested earnings. The decline in FDI in Pakistan mainly led by the domestic factors such as deteriorated law & order situation, energy crises, circular debt issues and weak economic activity.

Remittances for the first time in the history of Pakistan crossed the one billion dollar mark in a single month during March 2011 and remained over the one billion for second consecutive month in April 2011 which has boosted optimism about workers' remittances to cross the $11 billion this year. Pakistan Remittance Initiative (PRI) has removed many irritants and incentivizes routing of remittances through former channel. Workers' remittances totaled $9.1 billion in July-April 2010-11 as against $7.3 billion in the comparable period last year depicting an increase of 23.8 percent. This implies that worker remittances have increased by $ 1.8 billion in July-April 2010-11 which contributed by that amount in improvement of the current account balance. The recent upsurge in remittances can be attributed to the government's efforts for transformation of remittances from informal to formal channels. In addition to that increased support to flood affected relatives also contributed this improvement in remittances.

The rising trend in Pakistan's foreign exchange reserves continued unabated since 2008-09 and reached to $17.1 billion by end-April 2011. Out of $17.1 billion, reserves held by SBP stood at $13.7 billion and by banks stood at $3.4 billion.

The continued build up in foreign exchange reserves, a surplus in the current account balance and a sufficient inflow of remittances through official banking channels have strengthened Pak rupee vis-à-vis the US dollar both in the inter-bank and open market. During July-April 2010-11, the Pakistan's rupee against US dollar depreciated by 2.2 percent against the 6.6 percent depreciation in same period last year. This comparative stability in rupee mainly owes to improvement in country's overall external account surplus position during the period.

External and Domestic Debt

Public Debt increased by Rs 1162 billion in the first nine months of 2010-11, reaching a total outstanding amount of Rs. 1,002,0 billion; an increase of 13.1 percent in nominal terms. The primary source of increase in public debt during July-March, 2011 has been a sharp rise in local currency component that accounted for 69.7 percent of the total increase in total public debt. This was primarily due to the slower disbursement from multilateral and bilateral donors and higher than budgeted fiscal deficit. The external debt component grew by Rs 275 billion or 6.4 percent partially due to increased foreign public debt inflows and partly because of cross-currency translation effect. Public debt as percent of GDP has decreased to 55.5 percent by end-March 2011 after hovering around to 60 percent of GDP for two years.

External debt and liabilities (EDL) During the first nine months of the current fiscal year 2010-11, Pakistan's total external debt increased from $55.9 billion at end-June 2010 to $ 59.5 billion by end-March 2011 — an increase of US $ 3.6 billion or 6.4 percent which is lowest growth in EDL in the last five years. The EDL experienced an expansion of 14.1 percent and 13.4 percent in fiscal year 2008 and 2009, respectively mainly because of huge inflow of IMF SBA amount. A falling current account deficit, low foreign currency debt creating flows and depreciation of USD against other foreign currencies were the main factors associated with muted growth witnessed in EDL. In relative terms, EDL as percentage of GDP decreased from 31.6 percent at end-June 2010 to 28.2 percent by end-March 2011— a decrease of 3.4 percentage points.

Domestic Debt is positioned at Rs 5462.2 billion at end-March 2011 which implies net addition of Rs.803.9 billion in the nine months of the current fiscal year. In relation to GDP the domestic debt stood at 30.2 percent of GDP which is lower than end-June 2010 level at 31.4 percent. The domestic debt grew by 17.3 percent which is lower than last years' growth of 20.7 percent. The focus on deficit financing through internal sources owing to non-availability of external receipts has been the major cause.

The composition of major components shaping the domestic debt portfolio has undergone a complete transformation from a high dominance of unfunded debt to an increasing dependence on floating component of domestic debt. Since 2004, the unfunded category comprising about 45 percent of the aggregate debt stock has declined to 29.3 percent of the total during July-March, 2011. The share of permanent debt has also decreased over the same period and it stood at 18.5 percent by end-March 2011. Contrary to this, the share of floating debt (short term domestic debt) increased from 27 percent in the period 2004 to 52.2 percent at end-March 2011.

Since 2006-07, domestic debt witnessed a sharp rise with consequent build-up in the interest payments. Interest payments as percent of GDP has peaked to 4.4 percent of GDP in 2008-09 but since then declined persistently to 2.5 percent of GDP in 2010-11. This also incorporates impact of higher nominal GDP growth. Higher fiscal deficit and enormous slippages in the revenue and expenditure targets remained key problems. Supplementing to the intensity of the situation was a policy overhang and the monetization of the deficit through central bank borrowings.

Education

Educated human capital has been found to have strong and consistent positive effects on economic growth and productivity of a country. It reflects substantial impact on the degree of social cohesion in a country. An extremely high portion of the education budget is spent on recurrent heads, mainly comprising of salaries in contrast to the meager amount spent on quality improvements, such as teacher's training, curriculum development, supervision, monitoring etc; therefore, additional funds must be allocated for the purpose.

According to the latest Pakistan Labour Force Survey 2009-10, the overall literacy rate (age 10 years and above) is 57.7 percent (69.5 percent for male and 45.2 percent for female) compared to 57.4 percent (69.3 percent for male and 44.7 percent for female) for 2008-09. The comparative shares of literate depict marginal improvement in the profile of educational attainment. Nevertheless, all categories remain at the same level except a sort of increase in below matric (37.5 percent). Generally, males are more educated compared to females.

Under President's *Fanni Maharat Programme* individuals, across the country are provided opportunities to gain skills from vocational training institutes/ centres. Prime Minister's *Hunar Mand Pakistan Programme* is also a similar kind of step to launch different skill development programme, in four priority sectors including: Construction, Agriculture, IT and Telecommunication and skills for women. Higher Education Commission is an autonomous body to provide inter-universities cooperation and coordination. The institute has produced many Ph.Ds during last few years.

Health and Nutrition

A good quality of life and access to good health is recognized as a basic human need and a fundamental human right. Several programs are underway with major thrust to improve health care and training. By the year 2010, there are 144,901 physicians, 10508 dentists, 73,244 nurses, and 27.153 midwives. Besides, there are 972 hospitals in the country with total of 104,137 hospital beds, 4,842 dispensaries and 5,344 basic health units (BHUs) mostly in rural areas. Special attention has been given to the training of nurses, and several training centers are in operation.

Major initiative taken to overcome nutrient problem/ issue in public and private sector include expanded Benazir Income Support Program, Pakistan Baitul Mal Food Security Program, Vitamin A supplementation to children under five year of age and micro-nutrient deficiency control program etc. An allocation of Rs.16.9 billion during the year 2010-11 has been made in the PSDP for 82 projects.

Population, Labour Force and Employment

The population of Pakistan is estimated at 177.10 million by end-June 2011 and growing at the rate of 2.05 percent per annum. Being the 6th largest populous country Pakistan shares the 2.55 percent of the total population of the world and if the existing trend remains unchanged it will reach 210.1 million in 2020 (NIPS) and will become the 3rd most populous country in 2050. The density of population per person is 222. According to the NIPS and P&D Division Punjab has 96.55 million population of the Pakistan. Sindh has 42.18, KPK 23.77 and Balochistan is with 9.07 million people. Capital Territory of Islamabad constitutes 1.33 million while Federally Administered Tribal Area has 4.20 million of population.

Population trends are best explained by CBR (Crude birth rate), and CDR (Crude Death Rate). These show the growth and decline of a population per thousand births while IMR (Infant Mortality Rate) is the number of newborns who dies before celebrating their first birth day. If we see the pattern from the last decade we find that in nineties CBR, CDR and IMR were 36.4, 9.4 persons and 94 infants respectively and in 2011 these are 27.50, 7.30 persons and 7.50 infants respectively. If we analyze the trends of these indicators we stumble on a gradual improvement because of revolutionary progress in medical science.

Presently, Pakistan is going to become young as 60 percent of its population will be in the range of 15-65 years of age and it will continue to increase resulting in low dependency ratio and increasing working age population /labour force. This gradual shift to a youthful age structure in Pakistan is due to the declines in birth and death rates that occur at the beginning of the demographic transition.

According to the Labour Force Survey 2009-10, with a population of 173.51 million, Pakistan has a labour force of 54.92 million people which is 1.20 million more than the previous year. The proportion of both, male and female, is increased by 0.53 and 0.67 million, respectively. Unemployment rate is fractionally higher than the previous i.e. 5.6 in 2009-10 and 5.5 in 2008-09.

Crude Participation Rate (33.0 percent) suggests fractional improvement as compared to that of LFS 2008-09 (32.8 percent). In case of Refined Participation Rate, though with wider rural-urban and male-female disparity it also shows a little gain as compared to previous survey i.e. 45.9 percent from 45.7 percent. Agriculture dominates the distribution of the employed persons among all the major sectors leading at 45.0 percent in 2009-10, wholesale and retail exhibited 16.3 percent and manufacturing has the share of 13.2 percent.

Poverty

The floods of 2010 have caused a significant loss to poverty reduction efforts. The areas affected by floods were consistently lagging behind in terms of socio-economic and educational indicators as compared to the areas unaffected by floods. The loss to infrastructure and livelihood sources will push them behind further.

ADB's recently issued study on "Global Food Price Inflation and Developing Asia", maintains that a 10 percent rise in domestic food prices in Pakistan for one year could push an additional 3.47 million people below the $1.25-a-day poverty line or worsen poverty situation by 2.2 percentage points. Global food prices rose by more than 30 percent year-on-year between March 2010 and March 2011 with serious consequences for the poor as they are very sensitive to these items. Food inflation in Pakistan has averaged 18 percent for the last four years which implies significant deterioration of purchasing power of the poor. The precise impact of this build-up in prices could not be determined until availability of results of the Household Income Expenditure Survey (HIES) component of PSLM Survey 2010-11 the work on which has already started.

Change in poverty headcount is strongly correlated with change in per capita GDP growth. An analysis of 3 year moving average of changes in per capita income and commensurate impact on reduction in poverty headcounts suggests that large reductions in poverty headcount are associated with substantial growth in per capita GDP during 2002-2006.

Pakistan's commitment to reduce poverty in the medium term was first reflected in. The overall vision of Poverty Reduction Strategy Paper PRSP-II is to steer Pakistan`s economic growth back to the range of 5-7 percent a year by stimulating growth in the production sector; creating adequate employment opportunities; improving income distribution; and harnessing the country`s economic competitiveness through economic liberalization, deregulation and transparent privatization. The strategy recognizes that to steer Pakistan back on path of broad-based growth, create jobs, and reduce poverty, a prolonged period of macroeconomic stability, financial discipline and sound policies is required.

The Government prioritized the 17 pro-poor sectors through the Medium Term Expenditure Framework (MTEF) from 2008-09 to 2010-11 in the PRSP-II. The MTEF provides a link between policy priorities and budget realities. Fiscal Responsibility and Debt Limitation Act, 2005 stipulates that expenditures on social and poverty related spending would not be less than 4.5 percent of GDP in any given year. An amount of Rs.482.6 has been spent on these areas during July-December 2010 which is 15.8 percent higher than in the comparable period of last year.

The social safety nets are major initiatives to reinforce the government's efforts to reduce the adverse effects of poverty on the poor. The social safety nets program include **Benazir Income Support Programme (BISP)** envisages cash grants of Rs 1,000 every month to the females of each qualifying household having a monthly income of less than Rs 6,000 through banks/post offices with the aim to ameliorate the conditions of the poorest of the poor by directly accessing them and supplementing their sources of income. Additionally to enhance self-employment, some registered beneficiaries of BISP under the current targeting mechanism are selected through a monthly draw under *Waseela-e- Haq* and each of them are provided with an interest-free loan worth Rs. 0.3 million, repayable in installments over a period of 15 years. The government is also working on various microfinance initiatives in collaboration with the SBP and multilateral institutions to generate employment and combat poverty.

14. Transport and Communication

The devastating flood of 2010 caused a severe blow to the road infrastructure. Many sections of the roads in Punjab, Sindh, Balochistan and Khyber Pakhtoonkhwa (KPK) were wiped out by unprecedented flood. According to report "Pakistan Flood, 2011: "Preliminary Damage and Need Assessment", about 10 percent of the road-network (approximately 25,000 Km) sustained the highest damage within the transport and communication sector causing a loss of about 1.2 billion US dollars. The reconstruction requirement of the road-sector has been estimated at 2.07 billion US dollars.

During the Calendar year 2010, PIA earned the revenue of around Rs. 107 billion as compared to last year Rs. 94.6 billion showing an increase of 13 percent. Despite the aforementioned performance overall financial position of the organization is grim and management is in process of taking remedial steps to address the same.

The Karachi Port Trust (KPT) handled cargo over 20.8 million tons during July-December 2010-11. The consolidated revenues of Pakistan National Shipping Corporation (PNSC) group for the quarter ended March 31, 2011 were Rs 2,552 million (including Rs. 1,043million from PNSC), making a total of Rs. 6,772 million (including Rs.1,805 million from PNSC) for the nine months under review as against Rs. 5,583 million for the nine moths ended march 31, 2010. The Gwadar Port started its commercial operations in March 2008 by handling the 1st biggest ship ever berthed at any port of Pakistan namely 76000 DWT Panamax Bulker POS Glory which discharged a total of 63000 M.Tons of wheat. Since then a total of approx. 120 ships have been handled up to 31st January 2011 at Gwadar Port carrying total cargo of 2,286,781 M.Tons. In Port Qasim, a total of 13.1 million tones of cargo were handled during Jul-Dec. 2010.

In terms of statistics, industry has shown positive growth of 3.5 percent during the current fiscal year. Total Teledensity reached 65.2 percent (Dec – 10), Cellular mobile sector took lead in the increase of teledensity, offsetting the dwindling figure of fixed/wired line teledensity. Emergence of effective competition between telecom operators continued in telecom sector benefiting the consumer in terms of lowering tariffs and unraveling costly investment possibilities. Cellular mobile companies are now moving towards lowest possible tariffs and offering wide range of data services as well. Cellular industry has a 94.6 percent share in total telecom teledensity followed by FLL 2.9 percent and WLL 2.5 percent, therefore, performance of cellular industry is of utmost importance to the overall sector growth.

Energy

Economic growth and energy demand are correlated with economic growth. The government is making efforts to cover up the demand supply gap. Import of LNG, rental power stations, increase in oil and gas exploration in the country, development of Thar Coal field, increasing the share of electricity by expanding nuclear facilities, hauling of existing power generation plants to enhance their generation capacity and exploiting the alternate energy sources are all steps taken by the government to meet the energy needs.

The energy sector of Pakistan comprises of Oil, Gas, Electricity and Coal. The overall energy supply stood at 48.01 MTOE during July-March 2010-11, showing an increase of 1.93 percent. The supply of electricity and coal increased by 8.32 and 11.32 percent respectively thus, contributing positively in overall increase in energy supply. The gas sector supply slightly increased by 0.1 percent. Whereas, supply of crude oil decreased by 3.2 million barrels and thus posting a negative growth of 8.2 percent.

Production of crude oil has increased to 65,996.50 barrels per day during July-March 2010-11, as against 65,245.69 barrels per day in the corresponding period last year. The overall production has increased to 18.08 million barrels during July-March 2010-11 from 17.88 million barrels during the corresponding period last year showing an increase of 1.15 percent. The transport sector consumed 47.82 percent of petroleum products, followed by power sector (42.84 percent), industry (6.66 percent), other government (1.93 percent), household (0.49 percent) and agriculture (0.26 percent).

The average production of natural gas per day stood at 4050.84 million cubic feet during July-March 2010-11, as compared to 4,048.76 million cubic feet over the same period last year. The overall production of gas has increased to 1,109,930.16 million cubic feet during July-March 2010-11 as compared to 1,109,360.24 million cubic feet in the same period last year, showing an increase of 0.05 percent. The power sector consumed 23.81 percent of gas followed by industrial (20.15 percent), household (16.75 percent), fertilizer (15.04 percent), commercial (2.45 percent) and cement sector (0.05 percent) during the period under review. By March 2011, about 2.5 million vehicles have been converted to CNG making Pakistan the largest CNG consuming country. Presently, there are 3329 CNG stations operating throughout the country.

The total installed capacity of PEPCO system is 20,681 MW as of March 2010, compared to 20,190 MW in first nine months of the last fiscal year. Out of 20,681 MW, the hydro production is 6555 MW and the thermal production is 14,126 MW. The hydropower capacity accounts for 31.7 percent and thermal 68.3 percent. During July to March 2010-11, the total installed capacity of WAPDA stood at 11,439 MW. Out of 14,126 MW of thermal power, 4829 MW is owned by ex-WAPDA GENCOs, 323 MW by rentals, 665 MW by PAEC and rest by IPPs. During the first nine month of current fiscal year, WAPDA generated 66,928 GWh of electricity as against 64,935 GWh in the same period last year showing an increase of 3.07 percent. The household sector consumed 42.92 percent of the total electricity generated followed by Industrial (25.10 percent), agriculture (12.28 percent), KESC (7.53 percent) and commercial (6.53 percent). By March 2011, 160,110 villages have been electrified.

During July-March 2010-11, 5.85 million tons of coal has been supplied to different sectors of the economy compared to 5.304 million tons during the same period last fiscal year thus posted an increase of 10.29 percent. Brick kilns and cement industry consumed 56.6 percent and 42.7 percent respectively of the supplied coal. The government is also developing Thar Coalfield in order to increase the share of coal in energy mix and to reduce dependency on expensive imported fuel.

Environment

The environmental concerns of Pakistan are associated primarily with the adverse impact of un-sustainable social and economic development. High population growth rate, lack of public awareness of environmental related education, mismanagement of natural resources, widely unplanned urban and industrial expansions are the core hard issues. These are further compounded with the rapid urbanization.

Average population density of 222 persons per sq km in Pakistan, higher than many other developing countries, whose 37 percent people live in urban areas and 63 percent in rural has a high rate of migration to urban centers which has made the cities dysfunctional, overcrowded and very congested. Rapid urbanization is putting the available insufficient infrastructure under enormous pressure and causing environmental debacles of great magnitude. Serious risks of irreversible damages are present due to air and water pollution, mismanagement of solid waste and destruction of fragile ecosystems.

Pakistan is the highly urbanized country in South Asia with 37 percent concentration causing environmental problems such as pollution, waste management, congestion and the destruction of fragile ecosystems. Urban air pollution remains one of the most significant environmental problems, facing the cities. Motorcycles and rickshaws, due to their two stroke (2 strokes) engines, are the most inefficient in burning fuel and contribute most to emissions. 2-stroke vehicles are responsible for emission of very fine inhalable particles that settled in lungs and cause respiratory diseases. The 2-stroke vehicles industry is performing fast in Pakistan and has increased by 142.6 percent in 2010-11 when compared with the year 2000-01. Rickshaws have grown by more than 24 percent while motorcycles and scooters have more than doubled since 2000-01.

CNG is promoted as an alternate motor fuel for Pakistan's market to reduce pressure on petroleum imports and to curb air pollution. Presently, 3329 CNG stations are operating in the country and 2.50 million vehicles are using CNG as fuel. Use of CNG as fuel in transport sector has observed a quantum leap, replacing traditional fuels. National Environment Quality Standard (NEQS) for Motor Vehicle Exhaust & Noise (Amended), 2010 have been approved to control the vehicular emissions. It has been decided that: (i) all petrol driven vehicles imported or manufactured locally will comply with Euro-II emission standards with effect from July 2009. Existing models if not complying with Euro-II emission standards will have to switch over to Euro-II models by no later than three years, If not immediately: (ii) all diesel driven vehicles imported or manufactured locally will comply with Euro-II emission standards with effect from July, 2012.

The National Standards for Drinking Water Quality (NSDWQ) were approved to improve the water quality and to provide the public with the safe drinking water. Pakistan is committed to achieve the MDG target of halving by 2015 the proportion of people without sustainable access to safe and improved sanitation. Strategic direction, capacity development, and monitoring and evaluation, as well as investments, are primarily the responsibility of the provincial governments through the provincial line departments.

Climate change is one of the most complex challenges of the new century; Pakistan like other developing countries remained extremely vulnerable to the impacts of climate change. The most serious concerns are the threat to water and food security of the country and the vulnerability of its costal areas. Other climate change related concerns include increased risks and extreme events (floods, droughts and cyclones) and adverse impact of forests, biodiversity human health etc. Implementation of the climate change programme under Tenth Five Years Plan will be carried out through coordinated efforts of the relevant ministries to secure ample resources and their effective utilization The following areas will be targeted through mitigation and adaptation measures as well as studies to enhance our understanding for Pakistan specific needs.