BUSINESS RECORDER
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Analyses & Comments by BR Research

Current account roundup

The stabilization seems cemented. The current account deficit (CAD) in 2QFY20 (Oct-Dec19) at $661 million is the lowest since 1QFY16. In FY16, oil price (Brent) averaged at $44/bbl, and the price stood at $63/bbl in 1HFY20. Seeing the prices, the CAD today is as good as it was during FY12. The problem back in FY10-12 was low economic growth (due to import compressions). The case today is not much different. The way to get out of low growth without increasing CAD is to boost exports.

Anyways, the relief for policy makers is that current account slippage is finally arrested. This is helping in reserves build up too. The investors' confidence is reviving; rally in stock market and unprecedented foreign portfolio flows in government debt market are demonstrating revived investors' confidence.

The CAD in 1HFY20 ($2.2bn) is down to one fourth of what it was in the same period last year. Exports are up by a mere 4 percent while the imports are down by 21 percent. Trade deficit of goods improved by 39 percent. Worker remittances are up by 3 percent. Thus, nothing but fall in imports is taming CAD. It comes with a cost - LSM is down by 5.9 percent in the first five months of the fiscal year (5MFY20).

Imports

The import reduction is across the board in every sector. In Jul-Nov (Dec data is not yet published on SBP website), food group imports are down by 12 percent - within that palm oil imports are down by 9 percent, and tea by 16 percent. Machinery group imports are down by 7 percent. The decline in this segment had already started last year, and the fall this year is on an already low base. The biggest decline is in construction machinery (47%) and it is directly linked to suppressed PSDP since FY19. Power generation is up (10%) as there are projects (financially closed earlier) that are in process of installation. Textile machinery is up by 4 percent - which indicates that the exporting sector is finally in expansion.

The significant increase in telecom (38%) is marked by the increase in mobile phone imports that are up by 57 percent - average monthly mobile phone imports stood at $78 million (FY19: $50mn; FY18: $62mn). This is depicting that smart phone penetration is increasing. There are efforts of import substitution where some players are entering into the assembling of smart phones. In future, this can become an avenue of exports. Vietnam annual export of mobile phones is over $10 billion.

Transport group imports are down by 38 percent in 5MFY20 or $409 million. The bulk of the fall is in CKD imports - down by 44 percent or $303 million. Over 40 percent fall in auto cars assembling in Pakistan in 1HFY20 at one end is eating jobs and growth, but it is also contributing significantly in CAD decline.

The biggest fall in absolute terms is in the petroleum group. Down by $2.2 billion or 32 percent in 5MFY20. Oil prices are down by 13 percent in comparable period. Some of the decline is attributed to better pricing. As per PBS data, there is decline in quantity of imports - petroleum crude (12%) and products (14%). Combining the two, PBS data decline is at 22 percent. The fall based on SBP data is unusually high. The gap is abnormal in crude import - down by 43 percent or $1.04 billion in Jul-Nov period.

Imports in textile group are down by 30 percent or by $428 million in 5MFY20. The sub sector might come under pressure in 2HFY20, as raw cotton import is likely to pick up. The cotton crop at home is falling short of around 40 percent from the target. The textile exports are upbeat - market expects $1.5-2 billion raw cotton import in CY20. Average yearly raw cotton import stood at $1.1 billion during FY16-19. Higher imports in next 12 months will however, put CAD under pressure. Hence the improvement in seed technology within domestic cotton production cannot be over emphasized.

The agriculture and other chemicals imports are down by 15 percent to $3.2 billion in 5MFY20. The decline is prominent in fertilizer (24%) and insecticides (24%). This is depicting falling farmers' ability to buy inputs. The output price increase is less than increase in cost. Farmers are applying less fertilizers (other than urea) and insecticides and this has some role to play in poor crops (such as cotton) and increase in agri-produce prices (such as fresh vegetables) due to shortage.

The metal group is down by 20 percent or by $360 million. Within the group, iron and steel is down by 31 percent or $281 million. The suppressed demand in construction, auto and other industries is reflecting in low imports of iron and steel. The decline is in continuation of 20 percent fall in FY19 - the low imports here are reflecting in declining LSM growth.

Exports

On the face of it, the story of exports is not very rosy. The toll is up by mere 4 percent of $529 million in 1HFY20. Details are portraying an optimistic picture, however. The food group exports are up by 14 percent or $223 million to $1.8 billion in 5MFY20 as per SBP data. The rice exports are up by 30 percent - within the group, high value basmati rice (average exporting price per unit is 2.25 times of non-basmati rice) is up by 57 percent. The country was losing the edge in the basmati segment. Annual basmati exports were $1.1 billion during FY09-13, the toll reduced to $583 million during FY16-19. The revival is encouraging. The volumes growth is even better than what value is showing - basmati rice volumes are up by 72 percent in 1HFY20 (PBS data).

On the other hand, wheat exports are down by 78 percent - exportable surplus requires unnecessary subsidy, thus excess production needs to be discouraged. The pricing is getting right in dollar terms and less wheat is to be produced this year. Sugar exports after a decline of 65 percent in FY19, are up again in FY20 (49% growth in 5MFY20). The story of sugar is similar to wheat (it has to be subsidized for exporting) and the mafia is back in action. Meat and meat preparation exports are up by 35 percent in 5MFY20. This sector has potential to grow significantly.

The textile exports are down by 2 percent to $5.7 billion in 5MFY20. On the face of it, this is discouraging as despite 32 percent currency depreciation, the backbone of exports is finding it hard to pick up. However, trend in value added sectors volume is giving a better picture. There are three elements worth mentioning. One is that the shift is taking place from low value added (yarn 17% decline and cloth 8% decline) to high value added (garments up by 8%, knitwear - no change, and bed wear 1% decline).

The second point is that the value is not growing as prices are falling (due to depressed global outlook), but the gain in volumes are visible. The made up textile items growth is not really reflected in value. According to PBS data, in 1HFY20, major value-added textile products are showing growth (knitwear 6%, bed wear 12% and readymade garments 32%). On the flipside, cotton yarn volumes are up by mere 6 percent and cloth is down by 2 percent. Slowdown in Chinese exports to US is affecting Pakistan's low value-added exports to China. Now there is a value added export market to capture. Add value in cloth and export the final goods to brands in the US. The buyers are showing keen interest and there are signs of major brands coming back to Pakistan. They left after the law and order situation worsened.

The third point for low growth is capacity constraint. Virtually all the major textile exporters are in the phase of expansions. Textile exports can surely leap forward in the next 3-5 years. The story of other manufacturing sector is not much different from textile. The toll is down by 2 percent in 5MFY20 to $1.6 billion. Sports good exports value remained unchanged (6MFY20 PBS data) - within it, footballs are up by 12 percent while gloves are down by 11 percent. Price is favourable in football where quantity increase is 9 percent. In leather manufacturing, the price fall is diluting the gain in volumes - quantity exported in leather garments is up by 12 percent in 6MFY20. The value of 5MFY20 (SBP) is down by 8 percent.

The potential is in the footwear. Exports are up by 31 percent in 5MFY20. Apart from that import substitution is taking place -domestic retailers are making more shoes in-house while they were primarily relaying on imports in FY18. The export number is small ($62mn in 5MFY20), but it can grow. Vietnam footwear export was $16.2 billion in FY18. The country exported over billion pair of shoes last year as compared to tiny 13 thousand pairs by Pakistan.

Light engineering goods are picking up. Exports doubled in 5MFY20 to $178 million. The potential is huge in this segment. Deindustrialization amid cheaper imports from China (due to overvalued currency) hampered the potential of the sector. Average annual exports declined from $365 million (FY9-12) to $218 million (FY16-19). Transport equipment is a new segment - exports are up by 16 times to $90 million in 5MFY20. Growth in auto parts (30%) and other machinery (44%) is encouraging, but numbers are small in bigger scheme.

Remittances

In the last decade, after the exports stagnated, remittances growth remained unabated (grew from $1 billion in FY01 to $18.7 billion in FY15). The juice is drying up however - growth stagnated thereafter - average annual growth was 26 percent during FY01-15. It is reduced to 4 percent during FY16-19. The challenge is for remittances to not fall in future. Middle East contributed 54 percent of remittances last year. The region is now saturating and looking inwards. Major labor force was low skilled in construction sector. Not much is left to build there. Any growth in remittances is to be backed by focusing on new sectors (such as nursing and hospitality).

Outward orientation

Government's focus is to shift from inward orientation to outward orientation. This may bode well for exporting sectors. But there is a long way to go. At this point there is no need to celebrate on the fall in CAD. Any push to demand through decline in interest rates or appreciation in nominal currency can jolt the recovery. The aim should be (and SBP is doing so) to enhance the subsidized credit for exporters, and provide regional competitive rates on energy (federal government is doing so). The next step is to lower the imports tariffs (new tariff policy is aiming to do so). Enhance the credit limit to SMEs (SBP is doing so) to encourage the value chain of exports. The bottom line is that domestic demand suppression is required to continue and give more reasons for businesses (including foreign operators) to invest in exporting sectors.

(Sources for illustrations include SBP Worker Remittances, archives; SBP monthly foreign trade reports; and, Zakheera.com for crude oil prices and monthly current account position)