ECONOMIC UPDATE

PAKISTAN

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Asian Development Bank

Pakistan Resident Mission
Asian Development Bank

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Pakistan Resident Mission
OPF Building, Shahrah-e-Jamhuriyat
G-5/2, Islamabad, P.O. Box 1863
Islamabad, Pakistan.

Tel : (92-51) 2825011-16
Fax: (92-51) 2823324
(92-51) 2274718
E-mail: adbprm@adb.org

FOREWORD

The Asian Development Bank (ADB) is a long-standing development partner of Pakistan, having provided a total of $15.8 billion to the country in development assistance from 1968 to 2005. Of this amount, $1.5 billion were provided in 2005. The projected assistance for the period 2006-2008 amounts to $3.7 billion. The major development sectors in which ADB has invested include energy, agriculture and rural development, finance and trade, transport and communications, social sectors, and governance. Under its Country Strategy and Program for Pakistan for 2002-2006, reduction of poverty is the central objective, which has been operationalized through promoting sustainable pro-poor growth, inclusive social development, and good governance-with governance being the key area of focus.

In addition to this assistance portfolio, the Pakistan Resident Mission (PRM) is actively engaged in Economic and Sector Work to develop an understanding of important economic policy and sector topics, particularly with regard to poverty and governance issues. To disseminate this work to a wider audience, PRM published, in July 2002, a country poverty assessment titled "Poverty in Pakistan: Issues, Causes, and Institutional Responses" based on extensive consultations and dialogue with key development partners. PRM has also started a working paper series on topical issues, and the first paper, "Escaping the Debt Trap: an Assessment of Pakistan's External Debt Sustainability" was published in December 2002. In addition, PRM published "Pakistan: Sector Assessment Review" in October 2003, which provides an overview of ADB's operations in various sectors in Pakistan. A paper titled "Industrial Competitiveness: The Challenge for Pakistan" was published in October 2004 based on a seminar organized by PRM in collaboration with the Tokyo based ADB Institute. The second paper in the working paper series titled "Agricultural Growth and Rural Poverty" was published in March 2005. The most recent paper, "Conceptualizing a Social Protection Framework for Pakistan" was released in September 2005.

In 2002, PRM initiated a series of publications to provide regular updates on the state of the national economy. The first Pakistan Economic Update was published in April 2002. The present report provides an analysis of economic trends in Pakistan in the first 3-5 months of fiscal year (FY) 2006, and presents an outlook of the economy for the whole year. The report also reviews poverty related public expenditure in FY2005. In addition, the report has a special section on the economic impact of the earthquake that struck Pakistan on 8 October 2005. We hope that the contents of this report will be of use to all stakeholders, including the Government, civil society, donors, academia, media, and others. We look forward to receiving comments on the report, and also suggestions for improvement of future reports in this series.

Peter L. Fedon
Country Director, Pakistan

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PAKISTAN ECONOMIC UPDATE
(JULY - OCTOBER 2005)

Economic growth decelerated in the first 3−5 months of FY2006 and macroeconomic fundamentals weakened. The balance of payments position weakened and foreign exchange reserves declined. However, there was some slowdown in inflation. GDP growth in FY2006 is expected to be lower, but still at a robust 6.5 percent.

Macroeconomic fundamentals, which had weakened somewhat last year after substantial improvement in the preceding three years, came under further pressure in the first four months of FY2006. The balance of payments position deteriorated and foreign exchange reserves declined, as import growth continued to outstrip export growth. Despite revenue losses due to high oil prices, revenue growth is above target. However, the prospects of meeting the fiscal deficit target look difficult because of additional expenditure requirements for earthquake relief and rehabilitation. Inflation declined somewhat, but was still high.

I. MACROECONOMIC DEVELOPMENTS

Domestic Sector

Growth: Economic growth decelerated in the first 3-5 months of FY2006, with the two main commodity producing sectors experiencing slowdown. In agriculture, of the three major summer crops, cotton output is estimated to be 13.0 percent lower than its record level of last year, which will reduce growth of value-added in agriculture by 1.4 percentage points. The sugarcane crop is also estimated to be lower than last year. Only the rice crop is estimated to be larger (10.2 percent) than last year. Minor crops are also reported to be better than last year.

The industry sector also slowed down in the first quarter of FY2006 as indicated by lower growth in production of large-scale manufacturing (LSM). Growth of LSM production decelerated sharply to 8.7 percent in the first three months of FY2006 compared with 24.9 percent in the corresponding period of last year (see table 1). Excluding automobiles production, which continued to expand rapidly although at a much lower rate than last year, LSM growth was only 6.2 percent. Only pharmaceuticals, leather products, and engineering goods recorded higher growth than FY2005. All other industries decelerated, with growth in textiles and food, the two largest ones, slowing down to 7.2 percent and 10.0 percent, respectively, from 29.6 percent and 13.5 percent recorded last year. Growth in cement production, although quite robust at 14.6 percent, was lower than last year. The sharp deceleration of production in the textile industry at a time when textile exports picked up may be explained in two ways. One, exports of yarn and cloth, for which production decelerated in the first three months of FY2006, may be coming from stocks accumulated last year when production of these items recorded robust increases. Two, production data for bed wear, towels, and readymade garments, which accounted for 69.6 percent of increase in textile exports, is not reported and hence not reflected in slowdown of textile production. The growth of motor vehicles and electronics, which showed fastest growth in the last 2-3 years, also decelerated to 32.3 percent and 9.8 percent, respectively, from 40.2 percent and 71.3 percent.

Of the other two sub-sectors included in the industry sector, construction expanded at a rapid pace, as is reflected in substantial increase in cement production and sales. Generation and distribution of electricity also fared better because of greater availability of water in reservoirs. Hydel generation of electricity, which has a greater value-added component than thermal electricity, increased by 13.0 percent in the first quarter of FY2006.

Table 1: Growth in Production of Selected Large-scale Manufacturing Items

Items	Weights	July - September FY2005	July - September FY2006
		% Change	
Textiles	**24.5**	**29.6**	**7.2**
Of Which:			
Cotton Yarn	13.1	17.1	9.1
Cotton Cloth	7.5	44.1	6.2
Cotton Ginned	3.4	45.3	2.8
Food, Beverages & Tobacco	**14.4**	**13.5**	**10.0**
Of Which:			
Sugar	4.2	0.0	0.0
Vegetable Ghee	4.2	5.8	12.2
Cooking Oil	1.3	34.5	15.3
Cigarettes	3.1	8.1	0.5
Petroleum Products	**5.2**	**17.2**	**1.3**
Pharmaceuticals	**5.0**	**2.1**	**15.7**
Chemicals	**4.8**	**14.1**	**5.6**
Automobiles	**4.0**	**40.2**	**32.3**
Of Which:			
Jeeps and Cars	2.5	36.4	29.5
Fertilizers	**3.4**	**81.4**	**12.9**
Phosphatic Fertilizer	1.9	178.6	16.8
Nitrogenous Fertilizer	1.5	-0.2	3.6
Metal Industries	**3.5**	**0.3**	**-62.1**
Of Which:			
Pig Iron	1.6	2.9	-65.3
Coke	1.4	3.4	-61.0
Non-metallic Mineral Products	**4.2**	**17.2**	**14.1**
Of Which:			
Cement	4.1	17.2	14.6
Electronics	**2.5**	**71.3**	**9.8**
Leather Products	**2.3**	**-8.8**	**17.9**
Paper and Board	**0.6**	**0.1**	**17.8**
Engineering Goods	**0.4**	**14.0**	**35.4**
Overall Growth		**24.9**	**8.7**
Overall Growth Excl. Automobile		**23.5**	**6.2**

Source: State Bank of Pakistan website. www.sbp.org.pk

In the services sector, telecom services continued to expand rapidly, particularly mobile telephones. The two new companies granted licenses for the mobile telephone service last year competed aggressively for new subscribers and the total number of cellular phone subscribers increased to 19.6 million on 3oth November 2005 from 12.7 million on 30th June, raising teledensity to 13 per 100 persons. In the last five months, 1.4 million subscribers were added every month. Because of continued robust growth in both imports and exports, wholesale and retail trade also expanded rapidly. The financial sector also maintained a high growth, as income of banks increased with increase in interest rates on advances.

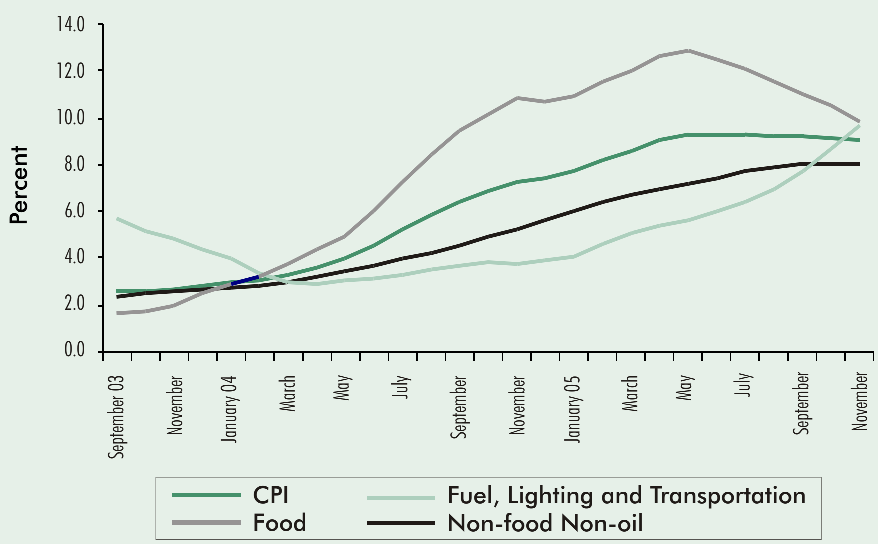
In the last five months, 1.4 million cellular phone subscribers were added every month.

Prices: Despite a deceleration in food prices, annualized inflation based on Consumer Price Index (CPI) declined only marginally in the first five months of FY2006. The impact of lower food prices was mostly cancelled by a sharp increase in oil prices. The CPI-based annualized inflation declined to 9.0 percent in November 2005 from 9.3 percent in June, and food inflation declined to 9.9 percent from 12.5 percent (see figure 1). On a year-on-year basis, food inflation was down to 5.8 percent from its peak of 15.7 percent in April, which indicates that the government strategy of importing wheat, sugar, livestock, and other essential food commodities in short supply, announced in the FY2006 budget in June 2005, is working. The cost of fuel, lighting, lubricants, and transportation, on which the change in oil prices has a direct impact, rose by 15.2 percent in November 2005 compared with only a 3.0 percent increase in November 2004. The non-food non-oil inflation, often referred to as core inflation, has leveled off. However, the increase in domestic oil prices will continue to exert upward pressure on other prices as it works through the system and pushes up the cost of production and transportation. The latest increase in domestic prices of oil products was made on 1st October. In the last three months, domestic prices of some petroleum products have been raised by 23.6 percent.

Inflation declined to 9.0 percent in November 2005 from 9.3 percent in June.

Monetary Management: The State Bank of Pakistan (SBP) in the first five and a half months of FY2006 continued to pursue tight monetary policy initiated last year. Under the export finance scheme, the interest rate at which SBP provides finances to

Figure 1: Annual Inflation



Source: Federal Bureau of Statistics website. www.statpak.com.pk

The real interest rate on bank loans has become positive since September 2005.

commercial banks was raised from 6.5 percent in June to 7.5 percent in July, raising the cost of borrowing for exporters from 8.0 to 9.0 percent.[1] Interest rate on bank loans, which increased very slowly until April 2005, showed faster growth in the last six months. Average interest rate on new bank loans, which had increased by only 188 basis points in the first three quarters of FY2005, moved up by 335 basis points in the last seven months and touched 10.1 percent in October. Consequently, negative real interest rate on bank loans seen throughout FY2005 became positive for the first time in September 2005. However, lately SBP has signaled the peaking out of short-term interest rates by rejecting bids for treasury bills (TBs) of 3-month and 6-month tenures at prevailing interest rates of 8.10 percent and 8.29 percent in the latest auction held on 7th December. Even earlier, the increase in interest rate on 6-month TBs, which serves as a benchmark for other interest rates, had slowed down. After increasing by 584 basis points in FY2005, interest rate on 6-month TBs increased by only 32 basis points to 8.26 percent in the first five months of FY2006, which is still negative in real terms. The reluctance on the part of SBP to aggressively tighten monetary policy reflects the "growth versus inflation" dilemma arising as a result of delayed start of tightening in April 2005 (see box 1).

1. Commercial banks are allowed to charge a maximum margin of 1.5 percentage points over and above the rate charged by SBP on its refinance facility.

Box 1: Monetary Policy: Growth versus Inflation Dilemma

In three years preceding FY2005, when inflation was low (below 5.0 percent), SBP pursued an expansionary monetary policy, with money supply increasing much faster than growth in nominal GDP. In each of these years, monetary growth exceeded growth of nominal GDP by a wide margin (see table below), leaving a large monetary overhang in the economy. Even in FY2005, monetary growth exceeded growth in nominal GDP by one percentage point. Real interest rates remained negative throughout FY2005, encouraging an unprecedented growth in private sector credit, with a large part in the form of consumer credit. Deposit rates were highly negative and this could have discouraged saving and encouraged consumption.

Fiscal Year	Growth in Money Supply	Growth in Nominal GDP	Difference
		(%)	
2002	15.4	5.7	9.7
2003	18.0	9.6	8.4
2004	19.6	14.7	4.9
2005	19.3	18.3	1.0

SBP started aggressive tightening of monetary policy only in April 2005, long after annualized inflation rose above 5.0 percent in July 2004. It had avoided tightening lest it hurt the nascent economic recovery. In addition, SBP was of the view that the upturn in inflation was a supply-side phenomenon and hence to control it administrative and fiscal measures were needed to augment supply. The start of aggressive tightening in April 2005 was a rather delayed response.

The marginal decline in inflation in the last three months is due to deceleration in food prices. Domestic prices directly affected by petroleum prices (transportation and fuel, lighting, and lubricants) are increasing rapidly, as the Government has been passing through higher international oil prices. SBP appears reluctant to further raise short-term interest rates, as reflected in rejection of bids for 3-month and 6-month TBs in the first fortnightly auction in December. The average lending rate charged by banks is only slightly positive in real terms. As a result, private sector credit is still expanding rapidly, and its expansion in the first five and a half months of FY2006 exceeded that in the same period of FY2005 by a wide margin. Because of delay in initiating tight monetary policy, SBP is facing the growth versus inflation dilemma. If it lets interest rates rise too high, it hurts growth, which has already slowed down compared with last year's 8.5 percent. On the other hand, if SBP does not allow interest rates to rise, as seems the case at present, it will encourage credit expansion and fuel inflation.

Monetary growth during the first five and a half months of FY2006 was lower (4.5 percent) than in the corresponding period of FY2005 (6.5 percent), because of a large contraction in net foreign assets of the banking system (see table 2). Compared with a contraction of only Rs 15.7 billion in the first five and a half months of last year, there was a substantial depletion of Rs 88.9 billion. Net domestic assets of the banking system, on the other hand, increased faster by Rs 223.0 billion compared with Rs 178.4 billion last year. This was mainly due to a larger expansion in private sector credit (Rs. 216.7 billion compared with Rs 189.7 billion in the same period of last year). The government borrowing for budgetary support was also larger, and all of that was availed from the central bank, thus monetizing the debt. Monetary expansion picked up in the last three and a half months, when broad money increased by 5.6 percent, after contraction in the first two months.

Table 2: Monetary Growth (Billion Rs)

	Monetary Impact During 1 July - 10 December	
	FY2005	**FY2006**
Monetray Assets	**162.7**	**134.1**
% Growth in Monetray Assets	6.5	4.5
% Growth in Reserve Money	14.9	10.1
Net Foreign Assets of the Banking System	-15.7	-88.9
Net Domestic Assets of the Banking System	178.4	223.0
Net Borrowing by Government Sector	**92.9**	**84.1**
Of Which:		
Budgetary Support	89.7	101.4
1. Central Bank	220.2	187.3
2. Scheduled Banks	-130.5	-85.9
Commodity Operations	1.7	-16.3
Net Borrowing by Non Government Sector	**173.3**	**209.7**
Of Which:		
Borrowing by the Private Sector	189.7	216.7
Other Items (net)	**-87.8**	**-70.8**

Source: State Bank of Pakistan website. www.sbp.org.pk

Fiscal Policy: The Government continued to pursue an expansionary fiscal policy in the first quarter of FY2006 and the fiscal deficit increased to 0.50 percent of GDP compared with 0.38 percent in the same quarter of FY2005 (see table 3). There was still a primary surplus, but it was less than half of last year. Revenues increased at a robust double-digit rate, but growth in expenditure outstripped revenue growth, mainly because of a sharp increase in development expenditure.

Development expenditure increased by 58.6 percent in the first quarter of FY2006.

Consolidated expenditure of federal and provincial governments increased sharply by 20.8 percent in the first quarter of FY2006, with current expenditure increasing by 17.6 percent and development expenditure by 58.6 percent. Increase in current expenditure by the Federal Government was less (14.4 percent) because of lower interest payments on both domestic and foreign debt. Defense expenditure increased by 21.4 percent -- faster than provided in the budget. Current expenditure of provincial governments also rose sharply.

Both federal and provincial governments sharply increased their development expenditure in the first quarter of FY2006, with federal expenditure increasing by 56.2 percent and provincial expenditure by 63.4 percent. The Government utilized 18.6 percent of annual public sector development program allocation, compared with 15.8 percent utilized in the first quarter of FY2005. The increase in provincial development expenditure was almost entirely due to more than three-fold increase by the Punjab Government. Development expenditure by the NWFP Government increased by only 7.6 percent, while that by the Sindh and Balochistan governments showed sharp declines.

Table 3: Consolidated Federal and Provincial Fiscal Position (Billion Rs)

	July - September		%
	FY2005	FY2006	Change
Total Revenue	202.3	236.6	17.0
Federal Revenue	188.4	221.8	17.7
Of Which:			
CBR Taxes	124.7	147.9	18.6
Surcharges	8.3	6.4	-22.0
Non-tax Revenue	54.6	65.9	20.7
Provincial Revenue	13.8	14.6	5.8
Total Expenditure	227.1	274.3	20.8
Current Expenditure	186.9	219.8	17.6
Federal	133.6	152.9	14.4
Of Which:			
Interest	51.5	48.0	-6.7
Domestic	42.4	39.8	-6.3
Foreign	9.0	8.2	-8.9
Defense	46.1	55.9	21.4
Provincial	52.7	66.9	26.9
Development Expenditure and Net Lending	33.4	50.6	51.3
Of Which:			
Development Expenditure	32.0	50.7	58.6
Federal	21.1	32.9	56.2
Provincial	10.9	17.8	63.4
Unidentified Expenditure	6.8	3.9	-43.1
Budget Deficit	-24.9	-37.7	51.5
As % of GDP	-0.38	-0.50	

Source: Ministry of Finance website. www.finance.gov.pk

Consolidated revenue of federal and provincial governments increased by 17.0 percent. Although it was less than the increase in expenditure, increase in revenue was higher than the projected growth of nominal GDP. Taxes collected by the Central Board of Revenue (CBR) increased by 18.6 percent, because of very sharp increases in sales tax (30.1 percent) and customs (27.4 percent). Direct taxes showed a modest increase, while the excise duty collection actually declined, reflecting the government policy of confining it to a fewer items and also lowering rates. Receipts from petroleum development surcharge were sharply down due to a large increase in international oil prices, which could not be fully passed on to domestic consumers. However, the impact of lower petroleum levy on total revenue receipts was rather small, as it had already shrunk considerably last year.

Imports increased by 54.0 percent and exports by 22.9 percent.

Non-tax revenues increased by 20.7 percent, mainly because of receipts from the USA for logistic support for war in Afghanistan, transfer of profit from SBP, and miscellaneous receipts. Increase in receipts for logistic support alone was Rs 11.8 billion, which was slightly more than the total increase in non-tax revenues. Increases in receipts from the above sources were partly offset by lower profits of the Pakistan Telecommunication Authority, because of a large number of licenses issued for various telecom services last year.

Receipts from the USA for logistic support for war in Afghanistan, have emerged as an important source of revenue and have played a significant role in enabling the Government to stay within the budget targets for fiscal deficit in the last three years. Without these receipts the fiscal deficit would have been much larger, or expenditure would have had to be curtailed. Last year these receipts accounted for more than one-fifth of total non-tax receipts of the Government. However, this is not a permanent source of revenue, and when the war in Afghanistan ends, this source of revenues will dry up. To that extent this represents a potential weakness in the country's finances.

External Sector

Merchandise Trade: Rapid expansion in external trade seen in the last three years continued in the first four months of FY2006, with both exports and imports growing at double-digit rates. Imports increased by 54.0 percent to \$8.9 billion and exports by 22.9 percent to \$5.5 billion. Imports grew much faster than envisaged in the trade policy announced in July 2005. Export growth also was higher than the trade policy target. Import growth has picked up sharply since June 2005 (see figure 2). Export growth, too, took an upturn in the last two months.

Increase in exports was entirely due to increase in volume, which augurs well for the sustainability of export growth. For about three-fourths of total exports, for which quantity and price data are available, quantity increased by 24.8 percent, while the prices declined by 0.7 percent. The sharp increase in volume of exports was made possible by a buoyant global economy and end of the quota regime for textile and clothing exports since January 2005.

Figure 2: Quarterly Growth of Exports and Imports

Growth in exports was led by textiles and clothing, which grew by 28.0 percent and accounted for 71.2 percent of the total increase in exports (see table 4). Export of primary commodities also recorded a robust growth, mainly because of continued high growth in export of rice. Only non-textile manufactures grew at a slow pace.

Table 4: Growth in Exports (Million US$)

Commodities	July - October FY2005	July - October FY2006	% Change
Primary Commodities	**333.1**	**434.6**	**30.5**
Of Which:			
Rice	214.3	308.3	43.9
a) Basmati	137.3	204.7	49.2
b) Others	77.0	103.5	34.6
Raw Cotton	17.8	21.2	19.3
Fruits	35.5	27.6	-22.0
Textile Manufactures	**2,609.9**	**3,340.7**	**28.0**
Of Which:			
Cotton Yarn	289.8	427.9	47.7
Cotton Cloth	559.2	792.8	41.8
Knitwear	680.0	603.8	-11.2
Bedwear	369.0	636.2	72.4
Towels	156.5	201.5	28.7
Readymade Garments	256.3	453.0	76.8
Art Silk & Synthetic Textiles	113.8	67.9	-40.4
Other Manufactures	**886.1**	**907.3**	**2.4**
Of Which:			
Carpets, Rugs & Mats	75.4	73.1	-3.0
Petroleum Products	137.7	165.1	19.9
Sports Goods	92.0	90.4	-1.6
Leather Tanned	101.2	73.8	-27.1
Leather Manufactures	162.9	223.9	37.4
a) Leather Garments	112.7	166.5	47.7
b) Leather Gloves	45.7	49.5	8.2
Chemicals and Pharma. Products	105.0	110.2	5.0
Engineering Goods	56.2	52.8	-6.1
Non-classified Items	**653.5**	**826.2**	**26.4**
Total	**4,482.6**	**5,508.8**	**22.9**

Source: Federal Bureau of Statistics website. www.statpak.gov.pk

Increase in the export of textiles and clothing was broad-based, with all major items showing sharp increases. Export of readymade garments increased by 76.8 percent to $453 million and that of bed wear increased by 72.4 percent to $636 million, despite continuing anti-dumping duty by the European Union on the latter, clearly demonstrating Pakistan's comparative advantage in these two high value-added items. Knitwear, another high value-added item, however, declined, indicating this item's lack of competitiveness in the international market. Among low value-added items yarn, cloth, and towels showed sharp increases. The entire increase in textile exports was due to volume, which increased by 32.9 percent, while prices declined by 1.5 percent due to increased competition among textile and clothing exporting countries after the abolition of the quota regime in January 2005. In terms of individual items, all prices declined except readymade garments and cloth whose prices rose by 7.4 percent and 4.9 percent respectively.

There was a clear shift in trends in export of textiles and clothing after the end of the quota regime in January 2005. Export of readymade garments, bedwear, and towels increased much faster in the first ten months of calendar year (CY) 2005 than in the corresponding period of CY2004 (see table 5). Cotton cloth also showed a very rapid increase, although slightly less than last year. Of the six major exports belonging to textiles and clothing, which account for 84.0 percent of such exports, only knitwear declined in the post-quota period, in contrast with a substantial increase in the pre-quota period. Growth in export of yarn was also much lower. Total export of major textile and clothing items, excluding knitwear, increased by 28.2 percent in the post-quota period compared with 10.0 percent in the pre-quota period.

Import growth was led by petroleum and petroleum products.

Import growth in the first four months of FY2006 was led by petroleum and petroleum products, which together increased by 62.1 percent to $2.0 billion and accounted for 24.4 percent of the total growth in imports (see table 6). Petroleum imports emerged as the single largest item in the country's import bill. Food imports increased by 34.6 percent mainly because of large import of sugar compared with a negligible amount imported in the first four months of FY2005. Non-food non-oil imports also increased sharply by 53.6 percent, reflecting continued strong domestic demand. All categories of non-food non-oil imports recorded robust double-digit growth.

Table 5: Trends in Exports of Textiles and Clothing

	Growth (%) during January - October	
Commodities	**2004**	**2005**
Cotton Yarn	19.9	6.6
Cotton Cloth	31.5	30.4
Readymade Garments	-0.3	30.2
Knitwear	47.1	-10.1
Bedwear	-9.4	40.7
Towels	9.0	33.2
Total	**16.5**	**19.7**
Total (excluding knitwear)	**10.0**	**28.2**

Source: Federal Bureau of Statistics website. www.statpak.gov.pk

Table 6: Growth in Imports (Million US$)

	July - October		%
	FY2005	FY2006	Change
Food Group	**421.7**	**567.8**	**34.6**
Of Which:			
Wheat Unmilled	14.1	0.4	
Tea	72.8	68.7	-5.6
Edible Oil	263.7	248.6	-5.7
Sugar	0.9	157.6	
Pulses	34.7	48.7	40.3
Machinery Group	**1,057.3**	**1,573.8**	**48.9**
Power Generating Machinery	107.0	113.7	6.2
Office Machines	75.0	75.3	0.4
Textile Machinery	250.2	242.8	-2.9
Construction & Mining Machinery	51.5	44.7	-13.2
Aircrafts, Ships and Boats	27.4	33.0	20.9
Agricultural Machinery	12.1	38.4	217.1
Other Machinery	534.0	1,025.9	92.1
Petroleum Group	**1,224.0**	**1,983.7**	**62.1**
Petroleum Products	506.6	730.6	44.2
Petroleum Crude	717.4	1,253.1	74.7
Consumer Durables	**337.4**	**604.6**	**79.2**
Electrical Machinery & Apparatus	85.2	125.4	47.2
Roadmotor Vehicles	252.2	479.2	90.0
Raw Materials	**794.6**	**1,078.2**	**35.7**
Synthetic Fiber	50.0	69.1	38.2
Synthetic & Artificial Silk Yarn	46.6	89.9	92.9
Fertilizers	129.3	178.6	38.1
Insecticides	76.9	58.9	-23.4
Plastic Materials	254.2	302.4	19.0
Iron and Steel	237.6	379.3	59.6
Others	**1,931.9**	**3,073.0**	**59.1**
Total	**5,766.9**	**8,881.1**	**54.0**
Non-oil Non-food Imports	**4,121.2**	**6329.7**	**53.6**

Source: Federal Bureau of Statistics website. www.statpak.gov.pk

Import of motor vehicles increased by 90.0 percent.

The increase in petroleum import bill was mainly due to the price increases of 50.6 percent for petroleum crude and 70.8 percent for petroleum products. As Pakistan buys crude oil and products from countries in the Middle East under contracts, effects of changes in international prices on domestic prices show up with a time lag, but more sharply. Hence in the first four months of FY2006 there has been a much faster increase in import prices of petroleum crude and products for Pakistan than the increase in international oil prices. On the other hand, last year, the unit value of crude oil imports increased by only 6.8 percent and that of petroleum products by 11.1 percent despite a 35-40 percent increase in international prices.

The current account deficit increased sharply to $2.1 billion in the first four months of FY2006.

Import of consumer durables increased by 79.2 percent, reflecting strong domestic demand fuelled by consumer credit as well as rising incomes in the last two years. Import of motor vehicles, in the form of completely knocked down kits for local assembly and completely assembled vehicles, increased by 90.0 percent, and constituted almost four-fifths of consumer durable imports. Although separate data for the two categories is not available, the comparison of local assembly and imports indicates that a substantial portion of the increase in imports was due to import of fully assembled cars. Import of both new and second hand cars was significantly liberalized in the FY2006 budget.

The high economic growth continued to push up imports of machinery and raw materials, both of which increased at very high rates. A particularly large increase was seen in the import of agricultural machinery, which more than doubled to $38.4 million. It was supported by higher cash incomes of farmers from last year's bumper cotton crop and the high price of wheat. Import of other non-classified machinery increased by 92.1 percent. Import of textile machinery, however, declined by 2.9 percent, after increasing by 50.6 percent in FY2005. Among raw materials, import of synthetic and artificial silk yarn increased by 92.9 percent and that of synthetic fiber by 38.2 percent, reflecting the policy change, whereby the tax for protecting the International Chemical Industries (ICI) has been withdrawn. It also shows increasing input requirements of the textile industry.

Current Account: Much sharper increase in imports than exports worsened the balance of payments position in the first four months of FY2006, with the current account deficit[2] swelling to $2.1 billion from a deficit of only $135 million in the same period of FY2005 (see table 7). Import payments increased by 33.7 percent while export receipts increased by only 13.6 percent, resulting in a trade deficit of $2.6 billion, which was more than twice as large as in the corresponding period of last year. This was augmented by a 44.2 percent increase in the deficit on the services account mainly because of large increase in payments for shipping services. Deficit in the income account was also larger than last year. These deficits were only partly offset by a surplus on current transfers, but that, too, was 3.7 percent smaller than last year, despite an increase in workers' remittances.

2. Excluding official transfers.

Table 7: Balance of Payments (Million US$)

	July - October		%
	FY2005	FY2006	Change
Trade Balance	**-1,275**	**-2,611**	**104.8**
Exports	4,516	5,129	13.6
Imports	-5,791	-7,740	33.7
Services (net)	**-886**	**-1,278**	**44.2**
Income (net)	**-709**	**-801**	**13.0**
Of Which:			
Interest	246	316	28.5
Current Transfers (net)	**2,749**	**2,647**	**-3.7**
Of Which:			
Workers' Remittances	1,318	1,375	4.3
FCAs (Residents)	264	53	-79.9
Current Account (incl. official transfers)	**-121**	**-2,043**	
Current Account (excl. official transfers)	**-135**	**-2,072**	
Capital Account (net)	**529**	**35**	**-93.4**
Of Which:			
Debt Forgiveness	495	0	
Financial Account (net)	**-1,406**	**1,430**	
Of Which:			
Foreign Direct Investment	275	466	69.5
Portfolio Investment (Liabilities)	-8	185	
Equities	25	216	764.0
Debt Securities	-33	-31	-6.1
Disbursement of Foreign Assistance	637	821	28.9
Amortization	-905	-551	-39.1
Errors & Omissions	**-40**	**37**	
Overall Balance	**-1,038**	**-541**	**-47.9**
Official Reserves	**9,775**	**9,221**	**-5.7**

Source: State Bank of Pakistan website. www.sbp.org.pk

Capital and Financial Account: The capital account deteriorated, with its surplus shrinking to only $35 million from $529 million in the first four months of FY2006, almost entirely due to $495 million debt forgiveness last year. The financial account, on the other hand, turned into a surplus of $1.4 billion from a deficit of an equivalent amount in the same quarter of last year. Improvement in the financial account was broad-based, with robust increases in inflows in most categories and decline in amortization payments. There was a 69.5 percent increase in direct foreign investment, more than seven-fold increase in inflow into the equity market to $216 million, a 28.9 percent increase in disbursement of foreign assistance, and a 39.1 percent decline in amortization.

Foreign exchange reserves declined by $1 billion in the first five months of FY2006.

Foreign Exchange Reserves: Foreign exchange reserves declined by $0.6 billion to $9.2 billion in the first four months of FY2006, as the balance of payments position worsened. Subsequently, reserves declined further to $8.8 billion by 26th November 2005. At this level, reserves are sufficient to finance 4.3 months of projected imports in the current year. Despite worsening of the balance of payments position, exchange rate remained more or less stable and the Rupee/Dollar parity depreciated only slightly from Rs 59.67/US$ to Rs 59.76/US$. To stabilize exchange rate, SBP has been providing foreign exchange for payments for oil imports since 1st November 2004. With inflation in Pakistan being much higher than major trading partners, stable nominal exchange rate implies that the effective exchange rate has appreciated, which may be discouraging exports and encouraging imports. However, if the Government allows the exchange rate to depreciate, it could have an adverse effect on inflation.

External Debt: Pakistan's external debt and liabilities declined by $159 million to $35.7 billion in the first quarter of FY2006, mainly due to revaluation. As a percentage of GDP, external debt declined continuously in the last four years, from 56.1 on end-June 2001 to 32.6 on end-June 2005 and further to 29.0 on end-September. However, if weakness in the balance of payments position continues in the medium term, external borrowing requirements could increase faster than GDP growth, resulting in rising external debt-to-GDP ratio.

Box 2: Deterioration in Balance of Payments

After recording large surpluses in the preceding three years, the current account of the balance of payments turned into a deficit in FY2005, as strong domestic demand translated into a sharp increase in imports (see table below). The balance of payments position deteriorated further in the first four months of FY2006. If import growth continues at its present pace, the current account deficit could increase to as high as 5.0 percent of GDP, creating a serious external sector imbalance. Although so far the deficit has been financed through soft loans and non-debt creating inflows like foreign direct investment, including privatization proceeds, and inflows into the stock market, this may not continue for long. Therefore, if the emerging external imbalance is not corrected by allowing the Rupee to depreciate or through other appropriate policy measures, the country could be back in a situation like the 1990s, with rapid accumulation of external debt, which could in turn put further pressure on balance of payments and also undermine fiscal stability.

Fiscal Year	Trade Balance	Current Account Balance
	(Billion US$)	
2001	-4.4	0.3
2002	-2.9	2.8
2003	-0.4	3.2
2004	-2.6	1.3
2005	-7.8	-1.8
	July - October	
2005	-1.3	-0.1
2006	-2.6	-2.1

Burgeoning expenditure on consumer durables, fuelled by abundant availability of bank loans at low interest rates, played a significant role in the sharp increase in imports in the past few years. Import of motor vehicles increased by an average 48.6 percent per annum in the past three years and crossed the $1 billion mark in FY2005. Similarly, electric machinery and apparatus, consisting mainly of household appliances or parts thereof, also recorded a very sharp increase. Increase in lending rates since April 2005 does not seem to have dampened the demand for these consumer durables, and import of motor vehicles and electric appliances continued to increase rapidly in the first four months of FY2006.

Economic Outlook

The economy is expected to grow by 6.5 percent in FY2006.

Growth of the two commodity producing sectors so far has been lower than last year. Higher-than-anticipated oil prices will further depress economic growth, and so could the 8th October earthquake, although its adverse impact on the economy has been estimated to be small (see Special Section on page 21). The economy is expected to grow by 6.5 percent in FY2006--less than last year, but still a robust growth (see table 8).

Growth of the agriculture sector is expected to be lower than last year, mainly because of smaller cotton output. Growth in the sector is expected to come from other crops, like rice, wheat, and minor crops, as well as livestock. Although the area sown under the wheat crop until 1st December was 0.9 percent lower than last year, greater availability of water in the two reservoirs than last year will help increase its yield in the canal-irrigated areas, which produce the bulk of the crop. There is greater moisture in the soil in areas near the rivers because of floods during the monsoon season, which will also help wheat and other winter crops. Livestock, which accounts for 46.8 percent of value-added in agriculture, may post only modest growth like last two years, because of the fear of the avian flu, which has discouraged poultry farmers from raising chickens for meat, as well as the setback due to the earthquake in the five affected districts of NWFP.[3] Keeping these factors in view, agriculture is expected to grow by 3.0 percent in FY2006.

Table 8: Economic Outlook

Items	FY2005	FY2006	FY2007
		% Growth	
GDP Growth	**8.4**	**6.5**	**7.3**
Agriculture	7.5	3.0	5.0
Large-scale Manufacturing	15.4	10.0	13.2
Other Sectors	7.4	7.0	6.9
Inflation (CPI)	9.3	8.5	7.6
Merchandise Exports	16.0	20.0	13.0
Merchandise Imports	38.1	30.0	15.0
		% of GDP	
Budgetary Deficit	-3.3	-4.2	-3.7
Trade Balance	-4.1	-5.9	-5.0
Current Account (including Official Transfers)	-1.6	-4.7	-2.9

Sources: 1. Medium Term Development Framework 2005-10. Planning Commission, Government of Pakistan.
2. Bank Staff Estimates.

3. These districts account for 1.6 percent of value-added in livestock in the country.

Growth of the large-scale manufacturing sector is projected at 10.0 percent.

Growth of the large-scale manufacturing (LSM) sector, though less than last year, is likely to be a robust 10 percent in FY2006. Liberal incentives announced for export industries, particularly textiles and clothing, and heavy investment in the textile industry in the past several years, will boost manufacturing production. On the demand side, substantial increases in export of textile and clothing since the end of the quota regime will also push up production. However, the current high oil prices can depress manufacturing production by raising the cost of production. The mass return of industrial labor from Karachi, Lahore, and Faisalabad to earthquake hit areas to take care of their families could also affect manufacturing production adversely. As LSM constitutes slightly more than half of the industrial sector, lower growth in the sector may result in lower growth of the industrial sector.

Of the other two other sub-sectors of the industrial sector, construction is expected to sustain high growth in FY2006 because of the large increase in allocation for the public sector development program provided in the FY2006 budget and the reconstruction work in the earthquake hit areas. However, like manufacturing, the return of labor from large cities to earthquake-hit areas may also adversely affect construction activity. Generation and distribution of electricity is likely to perform better because of higher level of water in reservoirs.

Fiscal deficit is projected to increase to 4.2 percent of GDP.

In the services sector, telecom services will continue to grow rapidly. Completion of privatization of the Pakistan Telecommunication Company Limited will give further boost to telecom sector. The banking sector is expected to continue rapid growth, as increase in interest rates will help increase incomes of banks. Wholesale and retail trade will benefit from double-digit growth in imports and exports. Hence the services sector is likely to expand by at least 7 percent in FY2006.

Import of sugar, wheat, and other food items has already improved the food supply situation and significantly reduced food inflation. Tight monetary policy, if pursued consistently, will also dampen core inflation. However, reluctance of SBP to allow further increase in short-term interest rates, as witnessed recently, could undermine the drive against inflation. Lending rates at present are only slightly positive in real terms and may not be sufficiently high to significantly dampen private sector demand for credit. Also, Government's borrowing from the banking system is on the rise, and it is sourced solely from SBP, thus monetizing the public debt. Finally, higher-than-expected oil prices will put upward pressure on almost all other prices by increasing the cost of production and transportation. In these circumstances, inflation may not come down significantly, and FY2006 may end with an inflation of 8.5 percent.

With a sharp increase in imports, particularly of items subject to high tariff rates, and robust growth, the budget target for tax revenues is likely to be achieved. Non-tax revenues may exceed the target because of the expected higher than budgeted receipts from the USA for logistic support for war in Afghanistan. However, expenditure may exceed the budget estimate by a wide margin because of additional expenditure on rehabilitation and reconstruction in the earthquake hit areas. Also, GDP growth in FY2006 is now expected to be lower than the original projection. As a result, the budget deficit could rise to 4.2 percent of GDP compared with the budget target of 3.8 percent.

Imports are projected to increase by 30.0 percent, as high oil prices and continued strong domestic demand will exert upward pressure on imports. Liberalization of imports of fully built up cars, both new and second hand, as well as import of sugar and wheat will further raise the import bill. Large investments in the textile industry in the last 4-5 years, end of the quota regime since 1st January 2005, and projected robust growth in world trade, all augur well for exports, which are expected to increase by 20.0 percent. However, because of the expected much larger growth in imports than exports, the trade deficit is projected to increase to over $7.0 billion, and the current account deficit to $5.8 billion or 4.7 percent of GDP.

The current account deficit is projected to increase to 4.7 percent of GDP in FY2006.

The medium-term outlook of the economy looks reasonably good. Substantial public sector investment in the irrigation infrastructure and private investment in mechanization of agriculture in the last four years augur well for growth of the agriculture sector. The end of the quota regime for textile and clothing (T&C) exports since January 2005, as well as large investment in T&C industry in the past several years will continue to boost the manufacturing sector. Improved relations with India and expected increase in trade with other countries in the region, including China, will also help the economy. The boom in the services sector, particularly telecoms and banking, is likely to continue. Significantly strengthened through reforms and privatization, the banking system is well positioned to support economic growth by allocating savings to productive uses.

Growing imbalance in the external sector poses a risk to the country's medium-term economic prospects. Without appropriate policy action to deal with the external imbalance and monetary overhang, this risk could be further accentuated. In the longer run, continuing low level of total investment in the economy could constrain economic growth.

II. POVERTY REDUCTION

PRSP expenditure increased from 4.7 to 4.8 percent of GDP.

Poverty Reducing Public Expenditure: Over the last three years, the Government has consistently increased pro-poor public expenditure under its poverty reduction strategy initially spelled out in the Interim Poverty Reduction Strategy Paper released in February 2001 and later in the Full Poverty Reduction Strategy Paper (PRSP) issued in December 2003. PRSP has identified 17 sectors, expenditure on which has the greatest positive impact on poverty.[4] Public expenditure on these sectors increased from 3.8 percent of GDP in FY2002 to 4.7 percent in FY2004.

PRSP expenditure continued to increase rapidly in FY2005, when it increased to Rs 316.2 billion compared with Rs 261.3 billion in FY2004 (see table 9). As a percentage of GDP, PRSP expenditure increased from 4.7 to 4.8. However, as the Government pursued an overall expansionary policy and total expenditure increased sharply, the share of poverty related expenditure in total public expenditure declined from 27.3 percent to 26.4 percent.

Expenditure on education remained unchanged at 1.8 percent of GDP.

Pro-poor expenditure has been grouped under the following heads: improving access of the poor to market and community services, fostering human development, accelerating development of rural areas, improving governance, and providing safety nets. Expenditures under all these heads, except safety nets, recorded increases in FY2005, with the sharpest increase being in expenditure on access to market and community services (46.3 percent), followed by development of rural areas (34.4 percent), and governance (20.7 percent). Expenditure on human development increased by 18.2 percent. There was a sharp decline of 32.9 percent in expenditure on social safety nets.

Of the 17 sectors identified for pro-poor expenditure, education, health, population planning, social security and social welfare, water supply and sanitation (WSS), and rural development, including village electrification, may be considered core areas. Almost three-fifths of the total poverty related expenditure is incurred in these sectors. However, total expenditure in these core areas, at Rs 181.2 billion, represented an increase of 13.7 percent compared with FY2004, which was much lower than the overall increase in PRSP expenditure. This does not reflect well on priorities assigned among sectors identified for poverty reduction.

Expenditure on education, which accounts for 37.4 percent of the total pro-poor expenditure, increased by 19.7 percent to Rs 116.9 billion in FY2005. As a percentage of GDP, however, it remained more or less unchanged at 1.8. Increase in expenditure on all levels of education, except professional colleges and universities and teacher training and vocational education, was lower than that in total poverty related expenditure.

Expenditure on health increased by 16.3 percent to Rs 31.4 billion. The sharpest increase of 39.7 percent was recorded in expenditure on preventive health care measures, which accounted for more than one-third of the increase in total expenditure on health. The increase in expenditure on preventive health measures was mainly due to a more than four-fold increase in current expenditure and a 68.2 percent increase in development expenditure by the Government of Sindh. Expenditure on general hospitals and clinics, which accounts for 72.2 percent of total expenditure on health, increased by only 12.0 percent. Expenditure on mother and child health declined from Rs 65 million to Rs 50 million.

4. These sectors are: education, health, population planning, water supply and sanitation, social security, food subsidies, food support program, Tawana Pakistan, natural calamities, roads, irrigation, land reclamation, rural development, village electrification, low-cost housing, justice administration, and law and order.

Table 9: PRSP Expenditures (Billion Rs)

	FY2002	FY2003	FY2004	FY2005	% Change in FY2005 over FY2004
			Access to Market and Community Services		
Roads	6.3	13.1	22.7	35.2	55.1
Water Supply & Sanitation	4.6	3.4	5.8	6.5	12.1
Sub-Total	**10.9**	**16.6**	**28.5**	**41.7**	**46.3**
			Human Development		
Education	66.3	78.4	97.7	116.9	19.7
Health	19.2	22.4	27.0	31.4	16.3
Population Planning	1.3	3.1	4.7	4.6	-2.1
Sub-Total	**86.8**	**103.9**	**129.4**	**152.9**	**18.2**
			Development of Rural Areas		
Irrigation	10.1	15.5	22.5	37.9	68.4
Land Reclamation	1.8	1.7	2.0	2.1	5.2
Rural Development	12.3	16.9	18.6	15.4	-17.2
Village Electrification	-	-	1.4	4.4	214.3
Sub-Total	**24.2**	**34.2**	**44.5**	**59.8**	**34.4**
			Social Safety Nets		
Social Security & Welfare	3.7	1.3	4.1	2.0	-51.7
Natural Calamities/Disasters	0.2	0.4	0.5	0.9	65.7
Food Subsidies	5.5	10.9	8.5	5.4	-36.5
Food Support Program	2.0	2.0	2.8	2.7	-3.7
Low Cost Housing	-	-	0.4	0.3	-25.0
Tawana Pakistan	0.8	0.8	0.6	0.1	-83.3
Sub-Total	**12.2**	**15.4**	**17.0**	**11.4**	**-32.9**
			Governance		
Courts and Justice	2.0	2.2	2.4	3.1	26.8
Law and Order	31.0	36.3	39.4	47.4	20.3
Sub-Total	**33.0**	**38.5**	**41.8**	**50.5**	**20.7**
Grand Total	**167.1**	**208.5**	**261.2**	**316.3**	**21.1**
GDP (Current MP)	4,401.7	4,822.8	5,532.7	6,547.6	
Total PRSP Expenditure as % of GDP	3.8	4.3	4.7	4.8	
Total PRSP Expenditure as % of Total Public Expenditure	19.1	23.1	27.3	26.4	

Source: PRSP Quarterly Progress Reports. PRSP Secretariat, Finance Division, Government of Pakistan.

It is encouraging to note that the current expenditure on rural water supply and sanitation, another very important service from the point of poverty reduction, recorded a sharp increase in FY2005. Tehsil governments, which are responsible for rural water supply and sanitation, seem to have come out of their initial teething problems.

Disbursement of microcredit increased by 88.8 percent to Rs 5.7 billion.

Among other categories of pro-poor budgetary expenditure, the Federal Government spent Rs 4.4 billion on rural electrification in FY2005, compared with only Rs 1.4 billion spent in FY2004. Rural electrification plays an important role in boosting economy of rural areas where the bulk of the poor live. In the area of governance, expenditure on law and order increased by 20.3 percent to Rs 47.4 billion and that on justice administration by 26.8 percent to Rs 3.1 billion.

In addition to pro-poor budgetary expenditure, the Government provides safety nets for the poor through transfers from the Zakat (an Islamic welfare fund) and Employees Old Age Benefits Institution (EOBI), as well as microcredit disbursed by the Pakistan Poverty Alleviation Fund (PPAF) through non-government organizations, Khushali Bank (KB), and Zarai Taraqqiati Bank Limited (ZTBL). Data on disbursement of Zakat in FY2005 is available for Sindh and NWFP only, and hence it is not comparable with FY2004. Microcredit disbursed by PPAF, KB, and ZTBL increased by 88.8 percent to Rs 5.7 billion. PPAF continued to play the leading role in microcredit, and accounted for 59.0 percent of total microcredit disbursed in FY2005. The share of KB in microcredit disbursed in FY2005 was 40.0 percent, while ZTBL accounted for only 1.0 percent. The total number of beneficiaries of microcredit increased by 64.3 percent to 470,000, and the average loan amount availed by them increased from Rs 10,608 to Rs 12,185.

III. SPECIAL SECTION

Economic Impact of Earthquake

An earthquake measuring 7.6 on Richter scale struck Pakistan on 8th October 2005, causing massive destruction of houses and physical infrastructure and killing thousands of people in three districts of Azad Jammu and Kashmir (AJK) and five districts of the North West Frontier Province (NWFP).[5] Subsequently, the Pakistan Government asked the Asian Development Bank (ADB) and the World Bank (WB) to assess the damage caused by the earthquake and prepare estimates of the cost of relief, rehabilitation and reconstruction. ADB and WB, in collaboration with other development partners and experts from the Government, prepared a report entitled "Pakistan 2005 Earthquake: Preliminary Damage and Needs Assessment", which served as the basic document for donors' conference convened in Islamabad on 19th November 2005 on earthquake reconstruction and rehabilitation. The report provides estimates of sector-wise economic impact of the earthquake in the form of loss of productive assets and resulting loss of flow of income and services, and the cost of relief and reconstruction. It also assesses the likely impact of the earthquake on Pakistan's overall macroeconomic situation. The main findings of the report are as follows.

The total cost of relief and reconstruction is estimated at $5.2 billion.

Cost of Relief and Reconstruction

The earthquake has imposed a huge cost on Pakistan in the form of relief and reconstruction. The report estimates the total cost of relief and reconstruction at Rs 309 billion, or $5.2 billion (see table 10).[6] Of this, Rs 208 billion is the estimated cost of reconstruction and Rs 101 billion for relief operations. Reconstruction cost measures the cost of rebuilding lost assets and restoring lost services.

Table 10: Cost of Relief and Reconstruction

Category	Million Rs.	Million US$
Relief	64,865	1,092
Death and Injury Compensation	12,177	205
Early Recover	17,879	301
Restoration of Livelihoods	5,762	97
Sub-Total	**100,683**	**1,695**
Reconstruction		
Of Which Short term Reconstruction	26,732	450
Of Which Medium/Long term Reconstruction	181,359	3,053
Sub-Total	**208,091**	**3,503**
Total	**308,774**	**5,198**

Source: Asian Development Bank and World Bank, Pakistan 2005 Earthquake: *Preliminary Damage and Needs Assessment.* 15 November 2005.

5. The earthquake killed at least 73,000, injured another 70,000, and left 2.8 million people without shelter.
6. This amounts to 25.8 percent of consolidated expenditure of federal and provincial governments in FY2005.

Macroeconomic Impact

The impact of the earthquake on Pakistan's GDP growth is estimated at 0.4 percent.

Real Sector: The impact of the earthquake on economic growth is not likely to be significant, as the affected areas did not have much economic activity. The report estimates the impact of the earthquake on Pakistan's GDP growth at 0.4 percent in FY2006.[7] Within affected districts, output losses are estimated at 52 percent of total output in AJK and 25 percent in NWFP. When reconstruction starts, it could have a positive impact on GDP, which will be mostly seen in FY2007 and FY2008.

Fiscal Impact: Due to additional expenditure required for relief, rehabilitation, and reconstruction after the earthquake, fiscal deficit during FY2006 − FY2008 could increase by as much as 0.6-1.0 percent of GDP per year, if there is no offsetting increase in revenue or reduction in expenditure. In view of the emergency created by the earthquake, the Government may need to make changes in overall expenditure levels and composition and take steps to enhance revenue mobilization.

The damage to private houses alone was Rs 68.4 billion.

External Sector: Pakistan's balance of payments was under pressure due to strong domestic demand even before the earthquake. Additional import of food, fuel, and construction materials required for areas affected by the earthquake will put the external sector under further pressure.

Sector-wise Impact

The total economic impact of the earthquake in the form of damage of productive assets (direct loss) and the resulting loss of the flow of income and services (indirect loss) has been estimated at Rs 169 billion (see table 11). Of this, loss of Rs 94 billion occurred in AJK and the remaining Rs 75 billion in NWFP. Sector-wise economic impact of the earthquake is discussed below.

Housing: The earthquake caused the greatest damage to the housing sector, with 203,579 houses destroyed and 196,573 damaged in AJK and NWFP. Loss of houses represents 84 percent of the total housing stock in affected districts of AJK and 36 percent of housing stock in affected districts of NWFP. Nine-tenths of affected houses are in rural areas and are difficult to access, as they were built on steep slopes. Direct and indirect losses to the economy due to damage caused to private houses is estimated at Rs 68.4 billion.

Education: The earthquake also badly damaged education infrastructure. Buildings of 7,669 educational institutions, ranging from primary schools to institutions of higher education, both in public and private sectors, were affected in AJK and NWFP. Half of these buildings collapsed and need to be rebuilt. Also, 18,095 students and 853 teachers and other educational staff died. Total loss due to damages to education infrastructure is estimated at Rs 24.1 billion.

Health: Health infrastructure and health system suffered serious damages, with 574 health facilities either destroyed or partially damaged. Among health staff there were 21 deaths and 141 injuries. The damages to health infrastructure resulted in a complete breakdown of the health system and disruption of health care services. Total loss of heath facilities is estimated at Rs 8.5 billion.

7. pakistan's GDP excludes GDP from AJK. When AJK's GDP is included in Pakistan's GDP, the impact of the earthquake rises to 0.7 percent.

Table 11: Sector-wise Estimates of Losses and Reconstruction Cost as of November 10, 2005

Sector	Direct Damage (Rs. Million)	Indirect Losses (Rs. Million)	Reconstruction Costs (Rs. Million)	Reconstruction Costs (US$ Million)	Share of total Reconstruction Costs (%)
1. Social Infrastructure					
Private Housing**	61,220	7,218	92,160	1,552	44
Health	7,114	1,378	18,012	303	9
Education	19,920	4,133	28,057	472	13
Environment	12		8,985	151	4
Public Administration	2,971	687	4,254	72	2
2. Physical Infrastructure					
Transport***	20,165	4,061	24,699	416	12
Water Supply and Sanitation	1,165		1,900	32	1
Irrigation	324		623	10	0
Energy, poser and fuel	744	1,561	2,377	40	1
3. Economic Sectors******					
Agriculture and Livestock	12,933	6,770	17,846	300	9
Industry and Services	8,578	8,379	9,178	155	4
4. Total = 1+2+3 (in Rs. Million)	**135,146**	**34,187**	**208,091**	**3,503**	**100**
o/w : Azad Jammu and Kashmir	76,375	17,671	116,625	1,963	56
: North West Frontier Province	58,771	16,516	91,467	1,540	44
o/w : Public Assets	48,131	12,175	82,187	1,384	39
: Private Assets	87,015	22,012	125,904	2,120	61
o/w : Urban Areas	26,490	13,675	46,163	777	22
: Rural Areas	108,656	20,512	161,928	2,726	78

Notes:

* Includes cost of reconstruction of both immovable and movable assets and restoration of public services.

** Includes value of household contents such as consumer durables, reconstruction costs exclude replacement of these assets.

*** Includes roads and bridges.

**** Total losses and reconstruction costs in agriculture, industry and services are over and above what is accounted for by the sectors listed above.Source: PRSP Quarterly Progress Reports. PRSP Secretariat, Finance Division, Government of Pakistan.

Source: Asian Development Bank and World Bank, Pakistan 2005 Earthquake: *Preliminary Damage and Needs Assessment.* 15 November 2005.

Civil administration in affected districts suffered heavy losses.

The earthquake resulted in the loss of around 324,000 jobs.

Transport: Many mountainous roads in affected areas were damaged by landslides precipitated by the earthquake. In AJK, 2,366 km roads were damaged, of which 203 km were major roads. Damaged roads represent about 45 percent of the total road infrastructure in AJK, including major roads, paved roads, unpaved roads, and bridges. In NWFP, 2,063 km of roads were damaged, representing 31 percent of the road network in affected districts. The report puts the estimate of direct and indirect economic loss due to damage to roads and bridges at Rs 24.2 billion.

Water Supply and Sanitation: The water supply system has been severely disrupted by the earthquake in the affected districts. Major damage has occurred at the intake of gravity-based water supply schemes, which constitute 80-85 percent of water supply schemes in NWFP and AJK. About 77,500 households in NWFP and another 82,300 households in AJK could be affected by disruption of water supply schemes. The total cost of the damages to the water supply system has been estimated at Rs 1.2 billion.

Agriculture, Livestock, and Irrigation: The main means of livelihood for people living in districts affected by the earthquake are agriculture and livestock. The earthquake has damaged harvested and standing crops, livestock, irrigation, animal sheds, and buildings of extension and research departments. A large number of ruminants and poultry were killed. Water channels, water diversion structures, waterfalls, spillways, and water tanks have also been damaged. There is also the loss of wheat crop, which cannot be sown due to disruption caused by the earthquake, and loss of milk productivity, as well as fruits. Total loss attributable to damage to agriculture, livestock, and irrigation is estimated at Rs 19.7 billion.

Public Administration: The civil administration system suffered heavy losses in affected districts, as there was widespread damage to government buildings and death and injuries among civil service personnel. Fifty-five provincial office buildings and 258 officers' residences were destroyed. One-fourth of revenue records and 85 percent of municipal records, such as birth, death, police, judicial records, etc. were also lost. The total loss due to damage to government buildings has been placed at Rs 3.7 billion.

Industry and Services: With private sector mostly engaged in trading activities, tourism, and handicrafts in the effected areas, substantial damage was caused to shops, inventories, restaurants, tourism infrastructure, and handicraft sector. There was also indirect loss in the form of output loss due to disruption of business. Total losses to industry and services are estimated at Rs 17.0 billion.

Livelihood: The earthquake resulted in the loss of around 324,000 jobs, or 29 percent of total employed population of age 10 or above. About 1.6 million people will be affected by these job losses.