

## Textile Industry

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The textile sector of Pakistan plays a pivotal role in the country's economy – its significance stemming mainly from its very large cotton production capacity. The country currently ranks as the 4th largest producer of cotton in the world and has duly capitalized on this capability by developing and promoting its textile sector. As a result, Pakistan now also has the third largest spinning capacity in all of Asia. The importance of the textile sector as an integral part of Pakistan's economy is highlighted by the following facts:

- It provides employment to over 40% of industrial labor force
- It contributes 8.5% to GDP
- It accounts for 40% of banking credit
- It holds approximately 60% share in national exports

### Textile Value Chain



In the first stage of the production process, raw material is prepared by separating impurities from cotton balls (ginning), which is then used to draw strings of fibre and manufacture yarn (spinning). The yarn that is produced is then woven into cloth (weaving & knitting) which is further processed into different articles including readymade garments, hosiery, towels and bed sheets. The textile industry is a high involvement sector and as such value addition remains imperative to garner healthy returns. However, Pakistan's textile sector is primarily concentrated in the upstream processes, specifically spinning.

During 2011, China carried out massive procurements of cotton with the intention to encourage its farmers to manufacture greater quantities of the crop. Given the large scale of its operations, China's policy increased worldwide demand and resulted in inflated world cotton prices, rising to a high of 229.7 US cents/lb. in 2011. After accumulating approximately 11 million tonnes, the Chinese government altered its policy to pay growers the differential between target and prevailing market prices; China's policy reversal resulted in a significant decline in prices which fell to a low of 67.5 US cents/lb in November 2014. Furthermore, it took additional measures to discourage imports such as the imposition of stringent quality standards and minimum duty-free import quota.

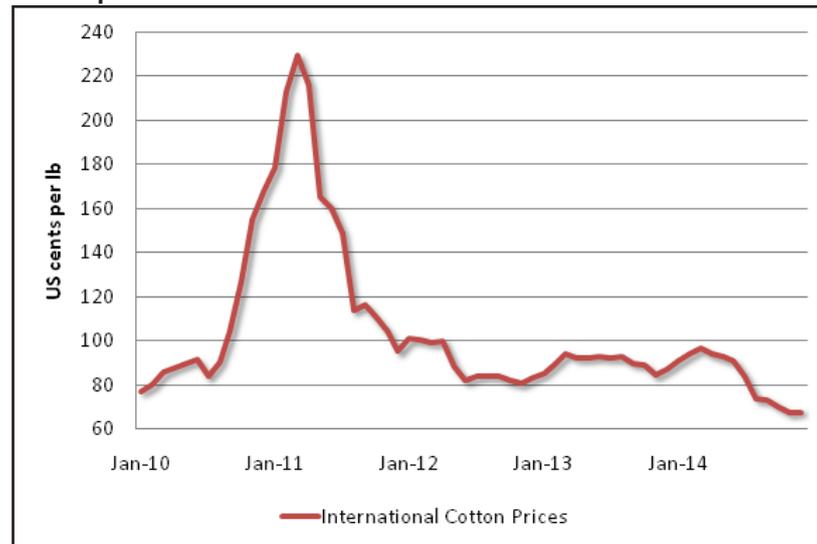
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Being a major producer in the global market, accounting for 22.8% of total output, China's influence on the cotton market cannot be overstated. The giant's buying behavior boosted the demand trajectories of its import partners and favorably affected their trade balances. Conversely, the country's policy shift resulted in loss of export revenue. This impact is indicative of a significant threat to the world cotton market and global cotton prices. During CY15, China sold around 63,412 tonnes of cotton (a meager 3.4% of the amount initially offered for sale). Though the Chinese government intended to sell as much as 1 million tonnes, the slow economy and the risk of pushing the market prices down further acted as constraints.

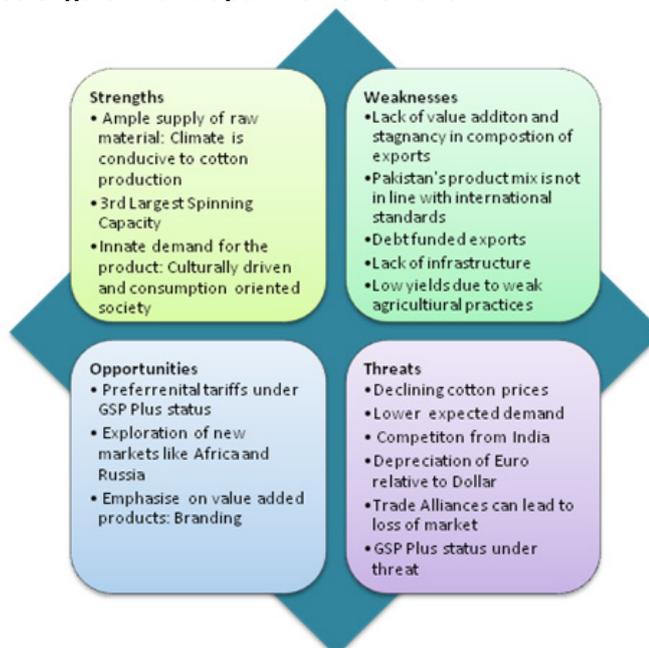
**Figure 2: Impact of China's stockpiling policy on international cotton prices**



Given the clear shift in China's policy and the magnitude of its influence, its decision to sell the stock through seasonal releases has become a source of significant concern to the other players in the market.

## SWOT ANALYSIS

### Strengths - Build upon Home Demand



- Pakistan is a sub-tropical country with mean temperature on the higher side which makes cotton an ideal clothing material for the prevalent climate. Owing to the ample supply of cotton, Pakistan has an innate opportunity to capitalize on this resource endowment as the fourth largest producer of the commodity. The country has the third largest spinning capacity which establishes a strong foothold for further value addition in the sector.

- Given the climatic conditions and culturally rich society, there is an innate demand for cotton clothing. The country is home to people from different ethnicities and cultures with a strong preference towards specific clothing. Furthermore, the recent hype of branded lawn clothing

has tapped on a market that promises healthy returns. As is the norm of the industry, customers from lower and middle income strata hoard replicas of the branded products. This trend in clothing is anticipated to stay and ensures a loyal customer base; evidence of the same can be seen in the recent launch of multiple clothing brands over the last three years.

#### Weaknesses - Trailing in Value Added Chain

Figure 4: Composition of Textile Exports

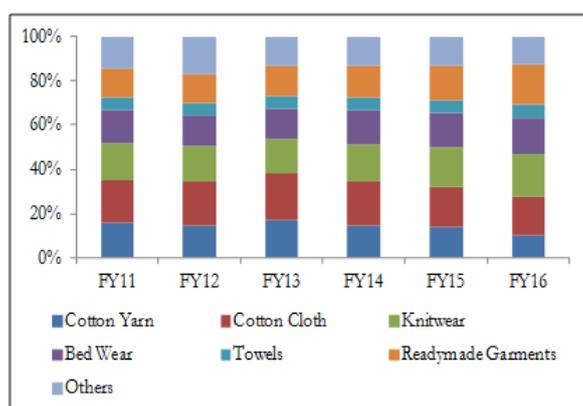
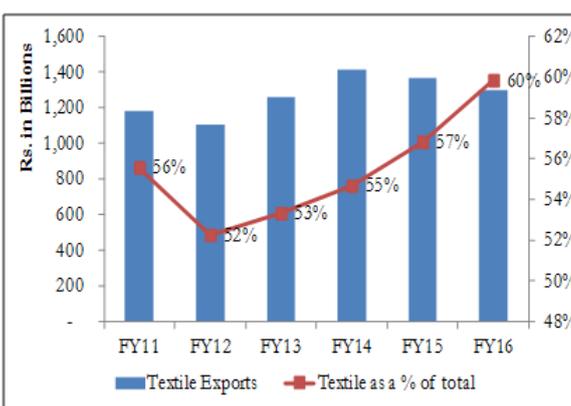


Figure 5: Textile Exports



Source: Pakistan Bureau of Statistics

- Minimal and low value-added products dominate exports, constituting over 50% of the exported value. Cotton cloth, cotton yarn, bed sheets and knitwear remain major export generators. Over the last five years, the composition has not undergone any major change except minimal improvement in the share of readymade garments at 18% in FY16 compared to 13% in FY11, leaving significant upside potential untapped.
- Pakistan's product mix of natural to synthetic fiber (80:20) does not correspond to the international standards (60:40). The latter enhances the usability of raw material as synthetic fiber offers greater flexibility as opposed to natural fiber.
- Lack of developed infrastructure facilities has hindered the growth of textile sector. The country wide energy crisis has adversely affected the textile sector and led to closure and transfer of units to Bangladesh, Turkey and other countries. The facilities installed require up-gradation but the sector is facing dearth of investment as neither local bodies nor foreigners are willing to invest.

#### Opportunities - Unexplored Frontiers and Products

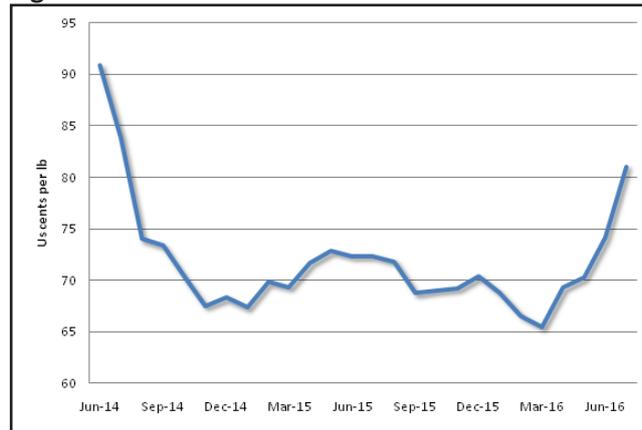
- Under Generalized System of Preferences (GSP) plus Status, valid from 2014 till 2017, 70% of Pakistan's exports are allowed preferential tariffs and 20% duty free access. In the face of an energy crisis and depleting foreign exchange reserves, this privileged access to European markets presents an opportunity to capitalize on markets. Previously, Pakistan was allotted this status in 2001 but it did not capitalize upon this opportunity unlike other beneficiaries like Bangladesh, who did not have the edge of sufficient raw material. Out of a total of 6,000 products that are allowed duty free access, Pakistan only exports 150 clearly indicative of the need to diversify.
- Pakistan's textile trade is heavily tilted towards China. However, other markets like Africa and Russia can be explored, which will not only broaden the export market but facilitate the enhancement of Pakistan's exports to suit the customer.
- With abundant good quality raw material at its disposal, Pakistan can alter its product line from low to high value added items. Countries import raw material from Pakistan, process it and sell it with a high mark up which reflects the significant impact of value addition. Given the growth in the world-wide fashion industry, the resources can be redirected to produce items that cater to

international tastes specifically. Sales are driven primarily through the “brand name”. Through in-depth research and effective marketing efforts, Pakistan can either launch its own new brands or partner with existing ones to enter new markets. Though such high-end consumers are a niche in Pakistan, the presence of international brands in the local retail market is indicative of the potential this segment offers. Moreover, by emphasizing on the end product, the entire value chain benefits.

#### Threats - Not getting into New Trade Alliances

- Declining international cotton prices have adversely impacted the local market as well. The ginnerers have excess bales of cotton and spinners have limited their production.

**Figure 6: International Cotton Prices**



- As per the International Cotton Advisory Committee (ICAC), world consumption of cotton is expected to remain stable at 23.9mt, post FY16. The reduction can be attributed to lower demand on account of reduced prices of polyester, an alternate man-made fibre. Also, China’s dismissal of the stockpiling policy will take its toll on Pakistan’s balance of payments. For over 5 years, more than 60% of Pakistan’s cotton yarn has been exported to China. Not only had the country generated foreign exchange but the demand had been providing an incentive to local manufacturers to produce more.
- Since the start of 2014, the Euro has devalued considerably. Compared to Chinese yuan and Indian rupee, the effect of devaluation is less pronounced compared to the Pakistani rupee. This makes the Pakistani rupee overvalued compared to other currencies. As Pakistan’s products become more expensive abroad, they become less competitive, translating into decline in exports. This results in lower profitability for local companies.
- As per the Trans Pacific Partnership, member countries will be allowed duty free import of goods. Pakistan’s major markets like EU, USA and Canada are signatories to this agreement which would extend the preferential access to all the members and provide a level playing field, posing a threat to Pakistan’s exports. Vietnam, as the third largest garment exporter, and other countries like Malaysia and Mexico are expected to dent Pakistan’s exports share.
- As part and parcel of GSP Plus Status, Pakistan is required to adhere to the conventions of the United Nations, which primarily pertain to human rights. Given the lax implementation of these conventions in Pakistan, any instance of non-compliance can result in suspension of the status as has been the case with Sri Lanka.

## Current Outlook - Big Challenges Ahead

Table 1: Textile Exports of Pakistan

(USD Millions)	Jul'14-Jun'15		Jul'15-Jun'16		Aug'16		
	USD	YoY	USD	YoY	USD	MoM	YoY
Raw Cotton	147	-28%	77	-48%	7	111%	-60%
Cotton Yarn	1,849	-7%	1,262	-32%	115	12%	-19%
Cotton Cloth	2,453	-12%	2,215	-10%	197	26%	-1%
Knitwear	2,406	7%	2,369	-2%	210	2%	-1%
Bed Wear	2,103	-2%	2,016	-4%	188	12%	5%
Readymade Garments	2,095	7%	2,196	5%	185	3%	8%
Others	2,400	-1%	2,321	-3%	187	11%	1%
<b>Total</b>	<b>13,454</b>	<b>-2%</b>	<b>12,456</b>	<b>-7%</b>	<b>1,088</b>	<b>11%</b>	<b>-1.5%</b>

Depressed international demand for cotton, weakened global commodity prices and reduced local output of cotton triggered a downward spiral for the textile sector which remained pervasive through FY16. Total exports for FY16 were reduced to USD 12.5b as opposed to USD 13.5b in FY15. Owing to Pakistan's textile industry's inability to evolve its produce in line with international demand and subsequent overreliance on low value added products, cotton yarn and cloth experienced the greatest decline as depicted in the table above.

Likewise, the market conditions extended into FY17, with exports registering a decline of -1.5% YoY as of August 2016. Over two months into FY17, the exports have increased by 11% MoM attributable to non-value added segment specifically cotton cloth and cotton yarn. This increment can be traced to the commencement of the harvest season. Bed-wear also recorded a decent increment of 12% on a monthly basis; however, despite the allotment of GSP status, ready-made garment remained stagnant on the back of global economic slowdown.

Restricted supply in the local market has led to higher prices of cotton, straining the margins of the textile sector. Moreover, given PKR's relative appreciation to its trading parties, exchange rate poses a significant risk to already falling exports. Although, the government of Pakistan plans to provide some relief to the sector through the provision of sales tax refunds, this move will only enhance the cash flows on a temporary basis. Going forward, the prevalent conditions of the textile segment are expected to continue unless the local currency depreciates to enhance exports.