Day Break

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Pakistan and IMF

Key Highlights and Program Objectives: IMF Executive Board Approves US$ 3bn SBA for Pakistan to Regain Macroeconomic Stability

- The Executive Board approved a 9-month (Jul-23 to Mar-24) SBA for Pakistan for an amount of SDR 2.25bn (approximately US$ 3bn, or 111% of quota).
- Average headline inflation is expected to remain above 25 percent in FY24, with end-of-period (eop) inflation falling below 20 percent only in FY24Q4.
- Assuming decisive implementation of program policies, macroeconomic prudence continuing onto the medium term, and adequate multilateral and bilateral financing, public debt can remain sustainable over the medium term.
- Addressing Pakistan's economic challenges will require steadfast implementation of agreed policies and continued financial support from external partners to meet large financing needs going forward.

We review the IMF country report and highlight key areas discussed in the report

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Exhibit: Schedule of Reviews and Purchases under IMF SBA

Availability Date	Amount of Purchase: SDR mn	Amount of Purchase: % of Quota	Conditions
12-Jul-23	894	44.0%	Approval of arrangements
1-Dec-23	528	26.0%	First review and end-September 2023 performance/ continuous criteria
1-Mar-24	828	40.8%	Second review and end-December 2023 performance/ continuous criteria
Total	2,250	110.8%	

Source: IMF, IGI Research

- Economic reform program aims to immediately support and stabilize the economy and insulate it from exogenous shocks simultaneous to making space for social and development spending.

- Immediate disbursement of US$ 1.2bn which will be reflected on 21 July, 2023 as SBP will publish reserves data for the week ending 14 July, 2023. The remaining amount will be phased over subject to two quarterly reviews.

- The SBA will provide financial support from multilateral and bilateral partners in addition to immediate disbursement of SDR894 million. Addressing Pakistan's economic challenges will require steadfast implementation of agreed policies and continued financial support from external partners to meet large financing needs going forward.

- The IMF's Managing Director and Chair emphasize the need for consistent policy implementation to regain macroeconomic stability.

- The State Bank of Pakistan's recent increase in the policy rate is suitable given the high inflationary pressures that have a greater impact on vulnerable groups. A tight, proactive, and data-driven monetary policy is needed going forward to address these issues. A market-determined exchange rate is necessary to absorb external shocks, reduce external imbalances, and restore growth, competitiveness, and buffers.

- The program will require continued adjustment and creditor support beyond its 9-month duration to resolve Pakistan's structural challenges.

- The average premium between the interbank and open market rate will be no more than 1.25 percent during any consecutive 5 business day period.

- Dedicated policy implementation critical for Pakistan and the success of the program that includes:

    1. **Greater fiscal discipline** through the implementation of the FY24 budget and ensuring debt sustainability
    2. **Market-determined exchange rate** to absorb external exogenous shocks rather than deplete FX reserves
    3. **Maintaining appropriate tight monetary policy** to contain inflation and bring it down
    4. **Progression on structural reforms** pertaining to climate resilience, business climate, SOE governance, and the

energy sector particularly containing and minimizing circular debt

Exhibit: Pakistan and IMF

Facility	Start Date	Expiration Date	Amount (SDR)	Amount Drawn (SDR)
Standby Arrangement	Dec-58	Sep-59	25	-
Standby Arrangement	Mar-65	Mar-66	38	38
Standby Arrangement	Oct-68	Oct-69	75	75
Standby Arrangement	May-72	May-73	100	84
Standby Arrangement	Aug-73	Aug-74	75	75
Standby Arrangement	Nov-74	Nov-75	75	75
Standby Arrangement	Mar-77	Mar-78	80	80
Extended Fund Facility	Nov-80	Dec-81	1,268	349
Extended Fund Facility	Dec-81	Nov-83	919	730
Structural Adjustment Facility Commitment	Dec-88	Dec-91	382	382
Standby Arrangement	Dec-88	Nov-90	273	194
Standby Arrangement	Sep-93	Feb-94	265	88
Extended Credit Facility	Feb-94	Dec-95	607	172
Extended Fund Facility	Feb-94	Dec-95	379	123
Standby Arrangement	Dec-95	Sep-97	563	295
Extended Fund Facility	Oct-97	Oct-00	455	114
Extended Credit Facility	Oct-97	Oct-00	682	265
Standby Arrangement	Nov-00	Sep-01	465	465
Extended Credit Facility	Dec-01	Dec-04	1,034	861
Standby Arrangement	Nov-08	Sep-11	7,236	4,936
Extended Fund Facility	Sep-13	Sep-16	4,393	4,393
Extended Fund Facility	Jul-19	Jun-23	4,988	2,144
Standby Arrangement	Jun-23	Mar-24	2,250	

Source: IMF, IGI Research

Overview of the economic impact of the floods in Pakistan and the need for financial support to address the damage caused.

- The 2022 floods in Pakistan caused extensive human and material damage, with estimated total damage and losses amounting to US$30 billion (about 8.5% of GDP).

- Pakistan faces rebuilding needs of US$16.8 billion (about 4.5% of GDP), with a focus on housing, agriculture, and transport in Sindh and Baluchistan provinces.

- The authorities responded with fiscal support, including a package of flood relief and reconstruction initiatives totaling PRs 452 billion (equivalent to about 0.5% of GDP) and a one-off emergency cash transfer of PRs 25,000 to more than 2 million vulnerable families.

- Donors pledged US$10.9 billion in support at a January 2023 conference on Climate Resilient Pakistan, but only a small fraction has been disbursed.

- The floods underscore the need for Pakistan to accelerate its climate adaptation and resilience efforts.

- Immediate priorities include adjusting the policy framework to fully incorporate climate change, accelerating high-value investments, and improving structural preconditions to boost climate adaptation efforts.

Macroeconomic Outlook and Risks:

Real GDP Growth:

Growth will moderately pick up in FY24, reaching about 2.5 percent. Assuming sustained policy and reform implementation and adequate financial support from multilateral and bilateral partners, growth is expected to gradually return to its potential, of 5 percent, over the medium term.

Exhibit: Key Economic Indicators

		FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28
					Projected					
Real GDP Growth	%	-0.9	5.8	6.1	-0.5	2.5	3.6	4.5	5.0	5.0
Consumer prices	Avg. %	10.7	8.9	12.1	29.6	25.9	11.4	7.4	6.5	6.5
Gen. gov. overall balance	% GDP	-7.0	-6.0	-7.8	-7.6	-7.5	-6.6	-5.2	-4.6	-4.2
Gen. gov. primary balance	% GDP	-1.6	-0.5	-2.3	-0.8	0.4	0.4	0.4	0.4	0.4
Gen. gov. debt	% GDP	79.6	73.5	76.1	77.4	70.9	68.5	67.3	65.1	63.1
Current account balance	% GDP	-1.5	-0.8	-4.6	-1.2	-1.8	-1.7	-1.7	-1.7	-1.7
External debt	% GDP	37.6	35.1	32.1	36.4	37.3	36.8	35.2	33.5	31.7
Gross official reserves	US$ bn	12.2	17.3	9.8	4.1	9.0	12.9	14.1	15.3	15.7
Gross official reserves	Months	2.3	2.5	1.9	0.7	1.4	1.8	1.9	1.9	1.9

Source: IMF, IGI Research

Inflation:

Base effects from last year's increase in fuel and electricity prices and diminished contributions from food items are expected to lower headline inflation from June onwards. Average headline inflation is expected to remain above 25 percent in FY24, with end-of-period (eop) inflation falling below 20 percent only in FY24Q4. Core inflation is set to recede only very gradually in FY24 due to elevated inflation expectations and the tightening of policies operating with a lag. The deceleration of headline inflation is set to continue in FY25, with eop inflation falling to single digits only in mid-FY26.

Fiscal:

As fiscal space has been severely depleted, small primary surpluses should be maintained in the coming years. Strong revenue efforts are needed to create space for priority social and development spending and to strengthen debt sustainability. Without such efforts, the fiscal and debt position will remain fragile and could undermine macroeconomic stability.

Current Account Deficit:

Following the sharp correction in the trade balance during H1, staff projects a CAD of about US$ 4bn in FY23, around US$ 5.3bn less than projected at the time of the combined 7th–8th EFF reviews and increasing to around US$ 5bn in FY24, with a recovery both in exports and imports.

The CAD will need to remain moderate at around 2 percent of GDP over the medium term, commensurate with projected official and capital flows and efforts to rebuild reserves.

Public Debt:

Assuming decisive implementation of program policies, macroeconomic prudence continuing onto the medium term, and adequate multilateral and bilateral financing, public debt can remain sustainable over the medium term. Risks to debt sustainability have become more acute, given the scarcity of external financing and the large gross financing needs that persist over the coming years, further narrowing the path to sustainability.

Any further downward revisions to the baseline could push debt toward unsustainability.

Downside risks to the baseline and program implementation:

Policy slippages could undermine program implementation, in turn, jeopardizing macro-financial and external stability and already stretched debt sustainability.

External financing risks are exceptionally high and delays in the disbursement of planned external financing from IFIs and bilateral creditors pose major risks to a very fragile external balance given the extremely limited buffers.

Weak capacity, powerful vested interests, sociopolitical tensions (rising with high food and fuel prices), and a tenuous political coalition (with a slim majority in parliament and elections in a few months) continue to weigh on policy decisions and reform implementation.

Fiscal Policies:

Insufficient implementation of fiscal adjustment policies increased fiscal pressures, and the devastating floods at the start of FY23 required urgent relief spending. However, additional low-priority spending initiatives and delays in implementing agreed revenue measures further delayed necessary fiscal adjustment. The persistent suppression of imports throughout FY23 severely undermined the revenue base. To limit fiscal slippages while accommodating higher social spending, the authorities passed a mini-budget in February 2023 that included new tax measures, PDL increases, and expenditure cuts. Despite these measures, the budget deficit is projected to reach 1 percent of GDP in FY23 due to lower revenue resulting from import suppression and other delays. Revenue efforts to broaden the tax base fell short of expectations during the EFF period, and the tax-to-GDP ratio has declined. The interest bill reached 6.6 percent of GDP, absorbing 2/3 of tax revenue. Additionally, market issuance has become increasingly challenging with several undersubscribed Treasury auctions during FY23.

Policy discussion:

The FY24 budget, approved by parliament on June 25, aims to gradually improve fiscal conditions, targeting a primary surplus of PRs 401 billion (0.4% of GDP). Key policies include increasing tax revenues to 10.3% of GDP through measures worth over PRs 254 billion, increasing the maximum PDL to PRs 60 per liter (average rate of PRs 55 per liter over FY24), and increasing personal income tax (PIT) by PRs 30 billion. Other measures include rationalizing tax exemptions for fertilizer (PRs 34 billion), doubling the FED on sugary drinks (PRs 8 billion), increasing the advance tax on the purchase and sale of immovable property (PRs 46 billion), and broadening the base of the tax on second homes and other high-wealth items for non-filers (PRs 19 billion). The budget also contains primary expenditure of PRs 12,976 billion, with space for priority social and development spending, and a contingency for emergencies of PRs 250 billion. The authorities have committed not to use "supplementary grants" to authorize spending over what has been legislatively appropriated by parliament outside of severe natural disasters.

The fiscal framework needs to continue improving through broad-based reforms. This includes strengthening revenue administration, enhancing public financial management, improving spending transparency, and debt management. The authorities plan to expand the personal income tax base by 300,000 people and bring the service sector into the tax net. They are also advancing the delayed full operationalization of a central monitoring unit and plan to fully operationalize the treasury single account by October 2023. The authorities are benefiting from technical assistance to strengthen public investment management capacity and are piloting an e-procurement system to enhance transparency in public procurement. To improve debt management, the Debt Management Office needs adequate resources for staffing and empowerment to implement the agreed medium-term debt management strategy. Greater recording and reporting of contingent liabilities and SOE debts will improve fiscal planning and debt management.

Poverty Reduction and Social Protection

In FY23, the Pakistani authorities spent about PRs 404 billion (0.4 percent of GDP) on regular and exceptional BISP schemes, exceeding the FY22 executed level by more than 70 percent. Efforts to reduce poverty and improve social protection were continued through these schemes. The enlarged BISP envelope allowed for full execution of all regular BISP schemes, faster-than-envisaged enrollment of 1 million newly identified families into the UCT Kafalat program, inflation adjustment of the UCT Kafalat stipend, and an exceptional one-off emergency cash transfer to more than 2.7 million flood-affected regular BISP families. However, education and healthcare spending remained below-budgeted targets due to weak budget planning and execution, partly caused by temporary school closures after the 2022 floods.

Policy Discussion:

Pakistan needs to increase social spending to protect the most vulnerable. The authorities have increased the BISP budget allocation to PRs 472 billion in FY24, and staff has called for the continued protection of the most vulnerable through lifeline and protected power and gas tariff slabs. To achieve this, the authorities should focus on revenue mobilization, allocate more resources to social protection, education, and health, and boost structural reforms.

Monetary and Exchange Rate Policies

Monetary policy fell behind the curve, leading to five-decade-high inflation and un-anchored expectations. Loose monetary policy conditions resulted from several pauses in the policy rate tightening cycle and the increase in the size of SBP's open market operations. This occurred while inflation was already on the rise, causing over 90 percent of consumers to expect higher prices over the next six months in SBP's May survey. The Monetary Policy Committee increased the policy rate by 100 bps on June 26, bringing it to 22 percent, while maintaining a 3 percentage point gap with the interest rates on its two main refinancing schemes (EFS and LTFF).

Policy Discussion:

To reduce inflation and support external sector rebalancing through the exchange rate, a tighter monetary policy stance is critical. The SBP needs to continue its tightening cycle to re-anchor expectations, given that inflationary pressures are expected to persist over the coming year. Reducing external imbalances and rebuilding reserves requires permanently ending administrative controls and actions to manage the current account and returning to a market-determined exchange rate. The authorities have withdrawn the circular on prioritization in providing FX for certain types of imports issued in December 2022 and are working toward restoring market-determination of the exchange rate. They remain committed to removing the remaining exchange restriction and multiple currency practice when BOP conditions stabilize by the end of the program.

Financial Sector:

The **banking sector** appears stable, but the full impact of the economic downturn has yet to be seen. Bank profitability has increased despite the COVID-19 pandemic and the 2022 floods, and the capital adequacy ratio remains above the regulatory minimum. However, NPLs have risen to 7.8 percent, and some banks have temporarily breached net open position limits. Additionally, four banks remain undercapitalized, and banks are exposed to sovereign risk due to the high and growing share of government debt in their asset portfolio. The banking system's sovereign exposure has grown, while banks accounted for 50 percent of the government's financing in 1HFY23.

Policy Discussion:

Efforts to safeguard the financial sector's soundness and ensure effective implementation of Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) measures need to be sustained and strengthened.

Close monitoring of the financial sector is encouraged, and the supervisor should ensure that all commercial and microfinance banks meet the minimum capital requirements. Strict adherence to regulatory limits for banks' foreign currency exposure is critical, and postponing the extension of the deposit insurance framework to microfinance banks is recommended until vulnerabilities within the sector have been addressed. The authorities have committed to addressing high levels of NPLs in some banks through bank-specific plans and allowing for the write-off of fully provisioned NPLs. The revision of the early intervention, resolution, and crisis management frameworks, including the deposit insurance scheme, is underway. Effective implementation of AML/CFT measures is also a priority, and the authorities have completed their AML/CFT action plans resulting in their successful exit from the FATF list. The SBP has conducted a thematic AML/CFT inspection and issued fines against financial institutions for AML/CFT shortcomings.

Energy Sector Policies:

The energy sector's long-standing challenges have become acute due to severe liquidity pressures and continued over-accumulation of unsustainable payment arrears (circular debt). This situation has been building up over the past decade due to slow reform, political reluctance to pass-through international commodity prices, currency depreciation, and financial costs to tariffs, and repeated granting of new unbudgeted, untargeted subsidies. The power sector's deterioration has continued in FY23, with unexpected additional budgetary subsidy needs, higher-than-expected arrears accumulation, binding liquidity constraints, and widespread power outages (load shedding).

Policy Discussion:

Power: Restoring the viability of the energy sector requires urgent and tangible reform. Key measures to address the power sector include adopting an updated FY24 Circular Debt Management Plan (CDMP) with measures to contain the budgeted FY24 power subsidy. This will allow for CD stock payments to compensate for projected CD flow and stabilize the CD stock at its expected end-FY23 level.

Measures include timely alignment of power tariffs with cost recovery levels, better targeting of power subsidies, and pursuit of medium-term reforms to reduce costs and CD. Regular tariff adjustments are critical to implement the CDMP, halt CD accumulation, limit fiscal pressures, lend credibility to the National Electric Power Regulatory Authority (NEPRA), lower load shedding, and restore the viability of generators.

The authorities are committed to entering the third stage of their multi-year subsidy reform plan and submitting a subsidy rationalization reform plan for tube-wells for large agricultural users by end-2023. Other medium-term reforms include improving price signals for inputs, renegotiating purchasing power agreements, converting publicly-guaranteed PHPL debt into cheaper public debt, expanding renewable energy capacity, and improving distribution efficiencies.

Natural Gas: Staff emphasized the importance of continuing with regular biannual end-user gas price adjustments while sparing the protected slabs that protect the most vulnerable consumers. This should be done according to established formulas and timelines. Additionally, staff encouraged the authorities to work with the World Bank on preparing guidelines for OGRA to implement the weighted-average cost of gas pricing (WACOG) law adopted in March 2022 for the next regular OGRA determination. The authorities should also work on creating reliable circular debt data, management, and projection capacity, as well as implementing cost-reducing reforms to reduce UFG losses. These reforms should include infrastructure improvements, network rehabilitation, and theft control.

Structural Policies:

Pakistan's socio-economic development, growth-enhancing investment, and job creation for its young and fast-growing population are being held back by long-standing structural bottlenecks. These bottlenecks include inadequate social spending, an uneven playing field for state-owned enterprises (SOEs) and private companies, corruption, and red tape such as excessive regulation and licensing. The weak business climate also presents obstacles to paying taxes, difficulties trading across borders, and registering property. It is also crucial to build resilience to climate change. Providing key macroeconomic data in a timely manner is critical to improving policymaking and transparency.

To improve socioeconomic outcomes in Pakistan, it is crucial to implement structural reforms, including strengthening SOEs' governance, boosting the business environment, and shoring up climate change resilience. Technical assistance from donors is encouraged to mitigate capacity constraints. Simplifying procedures to start a business, streamlining FDI approval, improving trading across borders, and strengthening anticorruption institutions are essential for achieving sustainable growth and development objectives. Capacity building is recommended for identifying critical institutional governance reforms. The National

Adaptation Plan should be finalized to accelerate "no-regret" measures for enhancing climate change resilience. Timely provision of key macroeconomic data is also important to inform policymakers and private sector stakeholders.

Exhibit: Structural Benchmarks under IMF SBA

Prior Actions		Rationale	Status
1	**FY24 budget .** Parliamentary approval of a FY24 budget in line with IMF staff agreement to meet program targets.	To ensure achievement of fiscal objectives	Met
2	**FX market functioning** . Withdrawal of the circular on prioritization in providing FX for certain types of imports introduced in December 2022, with the purpose of ensuring full market determination of the exchange rate	To ensure a market determined exchange rate.	Met
Structural Benchmarks		**Date**	**Status**
Fiscal			
1	Commit to not grant further tax amnesties.	Continuous	
2	Avoid the practice of issuing new preferential tax treatments or exemptions.	Continuous	
3	Issuance by the Central Monitoring Unit (CMU) of its first periodic report on the performance of SOEs, using latest available data, to the Federal Government.	end-Dec. 2023	
Social			
4	Inflation adjustment of the unconditional cash transfer (Kafalat).	end-Jan. 2024	
Monetary and Financial			
5	Average premium between the interbank and open market rate will be no more than 1.25 percent during any consecutive 5 business day period	Continuous	
6	Submission to parliament of amendments to align Pakistan's early intervention, bank resolution, and crisis management arrangements with international good practices, in line with IMF staff recommendations.	end-Dec. 2023	
Energy Sector and State-Owned Enterprises			
7	Notification of the annual rebasing (AR) for FY24 to take effect on July 1, 2023	end-Jul. 2023	
8	Improve state-owned enterprise (SOE) governance by: (i) operationalizing the recently approved SOE law into a policy that clarifies ownership arrangements and the division of roles within the federal governments; and (ii) amending the Acts of four selected SOEs to make the new SOE law fully applicable to those SOEs.	end-Nov. 2023	
Climate			
9	Cabinet adoption of a Climate-PIMA and PIMA action plan	end-Dec. 2023	
Economic Statistics			
10	Compilation and dissemination of Quarterly National Accounts for FY24Q1 and revised annual estimates for FY23.	end-Nov. 2023	

Source: IMF, IGI Research

Exhibit: Quantitative Performance Criteria

	Projected	
	1QFY24	2QFY24
I. Quantitative Performance Criteria		
Floor on net international reserves of the SBP (US$ mn)	-14,550	-13,800
Ceiling on net domestic assets of the SBP (stock, PKR bn)	15,048	14,888
Ceiling on SBP's stock of net foreign currency swaps/forward position (negative, US$ mn)	4,200	4,000
Ceiling on net government budgetary borrowing from the SBP (stock, PKR bn)	4,708	4,708
Ceiling on the general government primary budget deficit (cumulative, excl. grants, PKR bn) 2/	-87	-1,232
Ceiling on the amount of government guarantees (stock, PKRbn)	4,000	4,050
Cumulative floor on targeted cash transfers spending (BISP) (PKR bn)	88	186
II. Continuous Performance Criteria		
Zero new flow of SBP's credit to general government	0	0
Zero ceiling on accumulation of external public payment arrears by the general government	0	0
III. Indicative Targets		
Cumulative floor on general government budgetary health and education spending (PKR bn)	465	1,031
Floor on net tax revenues collected by the FBR (cumulative, PKR bn)	1,977	4,425
Ceiling on net accumulation of tax refund arrears (cumulative, PKR bn)	32	43
Ceiling on power sector payment arrears (cumulative flow, PKR bn)	-155	64

Source: IMF, IGI Research

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