Day Break

Monday, 13 May 2019

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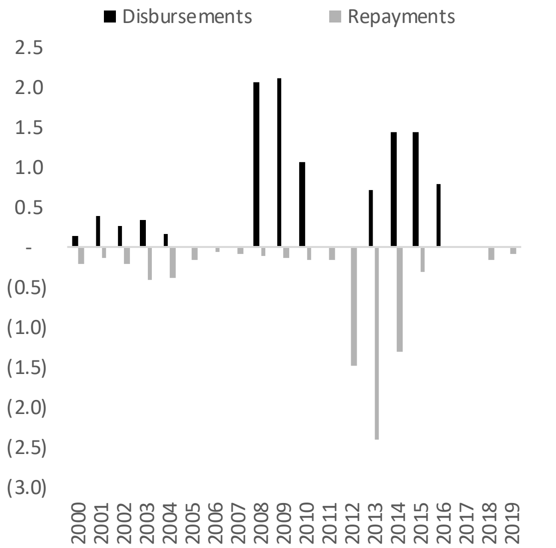
Economy

IMF Forthcoming Payments with Pakistan

USDbn	2019	2020	2021	2022	2023
IMF Payments	560	1,031	1,151	1,047	1,067

IMF Historical disbursements and repayments (SDRbn)



Economy

A Rebalancing Act - Pakistan finally reaches consensus to enter 3yr USD 6.0bn IMF Loan program

- Pakistan authorities are in final round to secure the much awaited agreement with International Monetary Fund (IMF) to receive a sum of USD 6.0bn for a period just over 3yrs under its Extended Fund Facility (EFF)
- For equity market perspective entry into IMF is a welcoming sign however, for corporate earnings, i) weaker exchange rate, ii) high interest rates, and iii) growth slowdown, may not bode well. In this space we prefer banking, E&Ps and IPPs stocks over rest

A Rebalancing Act

Pakistan authorities are in final round to secure the much awaited agreement with International Monetary Fund (IMF) to receive a sum of USD 6.0bn for a period just over 3yrs under its Extended Fund Facility (EFF). In an expected fashion, the fund disbursements will be subject to timely implementation of prior actions. Nevertheless, the program will aim to reduce both external and internal imbalances, while having a minimal negative fallout on country's growth.

As per IMF press release: *The EFF aims to: (i) Improve public finances and reduce public debt through tax policy and administrative reforms to strengthen revenue mobilization and ensure a more equal and transparent distribution of the tax burden; (ii) Pursue a comprehensive plan for cost-recovery in the energy sectors and state-owned enterprises to help eliminate or reduce the quasi-fiscal deficit that drains scarce government resources.*

Although the full document is still awaited, few on the surface measures include as per press release;

Indicator	Objective	Measures
Fiscal Deficit	- Eliminate exemptions - Curtail special treatments - Improve tax administration	Possible Tax revenue Measures likely:
		- Removal of tax exemptions - Changes in salaried income tax slabs
		Expenditure
		- Removing of subsidies - Continuation of BISP and other social targeted subsidies
		Fiscal Deficit
		- Primary deficit of 0.6% of GDP

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- **Bringing down primary deficit to 0.6% of GDP:** Back in Apr-19, IMF projected Pakistan primary deficit of 1.75% and 2.2% in 2019 and 2020 respectively. IMF suggested that country's primary balance will brought down to 0.6% meaning roughly PKR 650-700bn (GDP size USD 290bn in 2020) will be needed either in the form of additional taxes or reduction in non-growth targeted expenditures. As oppose to earlier expectations of hard revenue collection and expenditure cutback targets we view targeting primary deficit rather than fiscal deficit as a much softer approach, as it will give Pakistan some leverage on the monetary policy side to curb inflation.

Exhibit: **Primary deficit will be restricted to 0.6% of the GDP…**

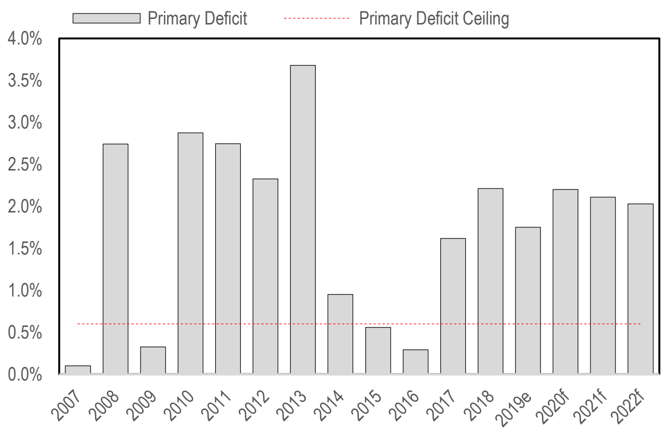
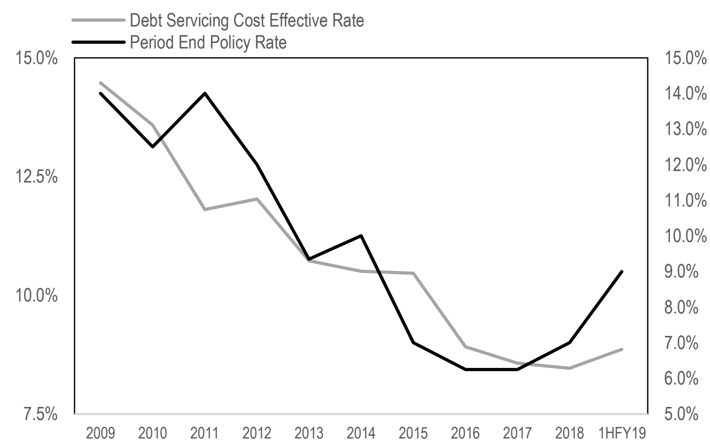


Exhibit: **…giving leverage on monetary policy side to curb inflation**



Source: IMF, SBP, IGI Research

Indicator	Objective	Measures
Monetary Policy, Inflation and exchange rate	Strengthening the SBP's operational independence and mandate.	- Continuing efforts towards financial market stability including strict Anti-Money Laundering (AML) measures
	- Reduce Inflation	- Possible further increase in interest rates by 100-150bps to anchor down inflation - Reduced borrowing from SBP
	- Market determined exchange rate	- Prior to entry in IMF program country's exchange rate has already been adjusted, with REER hovering close to equilibrium.
	- Reduce external vulnerabilities	- External financing from World Bank, ADB, Eurobond, etc. will reduce external shocks

- **Market determined exchange rate:** Prior to entry in IMF program Pakistan currency adjusted its REER. Looking ahead, we do not see major exchange rate adjustment coming primarily owing to reduce non-essential import demand, a further 100-150bps discount rate hike and expected capital inflows (government has hinted to approach World Bank, ADB and through Eurobond issuance to secure an additional USD 2-3bn additional funding) and reduce country's external balance vulnerabilities.

Indicator	Objective	Measures
Growth	Structural reforms agenda	
	- Improving public finances	- PKR 216bn power sector subsidy to continue (protecting the low-income)
	- Reducing public debt through tax policy and administrative reforms	- In total PKR 180bn worth subsidies will be added to protect low-income group
	- Cost-recovery in Public Sector Enterprises and Energy Sector	- Essential development spending will continue
	- Modernization of the public finance management framework	- Possible introduction of Treasury Single Account (TSA)
		- Restructuring of Public Sector Enterprises

Outlook

Conclusively, IMF structural reform driven policies are primarily aimed for long-term sustainable growth rather than short term and this program will be no different. However, one thing is certain, as it has been IMF programs have historically compelled governments in Pakistan to take hard economic decisions such as energy/power tariff hike, removal of subsidies and a tight monetary stance. For equity market perspective entry into IMF is a welcoming sign however, for corporate earnings, i) weaker exchange rate, ii) high interest rates, and iii) growth slowdown, may not bode well. In this space we prefer banking, E&Ps and IPPs stocks over rest.

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