

The sixth review of the on-going IMF Program was completed recently and Pakistan has received the loan installment of \$1 billion. But the process of this quarterly review was the longest in the history of IMF programs with Pakistan and highlights the strain in the relationship of the IMF staff team with the Government team headed by the finance minister. The prior conditions for completion of the Review were also extremely tough including the presentation of a Finance (Supplementary) Bill and the SBP Act (Amendment) Bill. The former included large-scale enhancement in sales tax on various items, while the latter involved the granting of autonomy to the Central Bank. There is also a diplomatic reason for the hardening of the IMF attitude towards Pakistan. The largest member of the IMF Executive Board is the US. The relationship of Pakistan with the US has changed after the departure of US troops from Afghanistan. Consequently, the US is likely to be putting pressure that all commitments of reform made to the IMF by Pakistan must be fully implemented. The objective of this report is to highlight the difficult targets, performance criteria, indicative targets and structural benchmarks that have been put in place by the IMF for Pakistan as pre-conditions to receive the last three installments of the existing loan facility of \$3 billion. Based on the extent of the likelihood of meeting these requirements, a judgement is made of the continuation of the Program up to its completion date of September 2022.

### 1. SCHEDULE OF FORTHCOMING REVIEWS

The proposed dates of the forthcoming reviews by the IMF are as follows:

#### Forthcoming Reviews of the IMF Program

Number of Review	Availability Date	Conditions	Purchase SDRs (mn)
Seventh	March 4, 2022	Meeting end-December 21 PC*/CC**	687
Eighth	June 3, 2022	Meeting end-March 22 PC/CC	687
Ninth	September 2, 2022	Meeting End-June 22 PC/CC	750
<b>Total ( ≈ \$3 billion)</b>			<b>2124</b>

\*Performance Criteria | \*\*Continuous Criteria

### 2. THE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

The performance criteria along with the limits or ceilings imposed are presented in Table 1.

**Table 1: Performance Criteria and Indicative Targets, FY 2021-22**

Performance Criteria	Actual (September end 2021)	end-Dec-21 for 7 <sup>th</sup> Review	end-Mar-22 (8 <sup>th</sup> Review)	end-June 22 (9 <sup>th</sup> Review)
1 Floor on Net International Revenues (\$ million)	-2303	-5450	-6000	-5100
2 Ceiling on Government Primary Budget Deficit (Billion Rs)	-137	-300	-389	25
3 Ceiling on Stock of Government Guarantees (Billion Rs)	2649	2797	2954	2956
4 New Flow of SBP's credit to Government	0	0	0	0
<b>Indicative Targets</b>				
5 Net Tax Revenues collected by FBR (Billion Rs) *	1397 -38.3	2852 -21.2	4143 -9	6100 -42.8
6 Ceiling on Power Sector Payment Arrears (Billion Rs)	114	67	184	166

\*Growth rate in brackets

The assessment of the likelihood of meeting the performance criteria and indicative targets is as follows:

**Floor on Net International Revenues:** These are defined as the US\$ value of the difference between usable gross international reserve assets and reserve-related liabilities. The latter include liabilities in the form of swaps, futures, forwards, outstanding IMF credit to Pakistan and foreign exchange deposits of foreign central banks and exclude SDP allocations.

#### Key Data

KSE100 Index	44,924
KSE-All Share Value (PKRmn)	5,742
KSE-All Share Value (USDmn)	32.6
KSE-All Share Volume (Shmn)	160.2
Market Capitalization (PKRtn)	7.7
Market Capitalization (USDbn)	43.7
1Year High	48,726
1 Year Low	42,780

Source: PSX, Next Research

The liabilities went up by \$3 billion following the receipt of the loan from Saudi Arabia. The outstanding IMF loan has increased by \$1 billion recently. Therefore, given the recent fall in gross reserves of almost \$ 2 billion in December it will be difficult to meet this performance criteria in coming months unless surpluses are generated in the balance of payments.

**Ceiling on Government Primary Budget Deficit:** The critical target is for end-June 2022. Pakistan is expected to generate a small primary surplus. The magnitude of debt servicing is expected to be close to Rs 3400 billion after the 2.75 percent point hike in policy rate. This means that the budget deficit will have to be limited to this amount, which is equivalent to 6.3 percent of the GDP. This will hinge crucially on attainment of the FBR revenue target of Rs 6100 billion, requiring a growth rate in collection of 28 percent in 2021-22.

**Ceiling on Stock of Government Guarantees:** These are the contingent liabilities of the Federal Government in the form of guaranteed debt to the State-Owned Enterprises. It is expected to increase by not more than 15 percent this year. In 2019-20, the increase was much as 36 percent. Therefore, there is a high risk of the ceiling being violated in the presence of severe liquidity constraints with SOEs, especially in the energy sector.

**Net Tax Revenues collected by FBR:** The original budget target for FBR in 2021-22 was Rs 5829 billion, which under IMF pressure from the IMF has been raised to Rs 6100 billion. The Finance (Supplementary) Bill is expected to yield an additional revenue of Rs 175 billion in 2021-22. The real test will be in the last quarter of 2021-22 when the performance criteria imply a growth in FBR revenues of over 42 percent. Meanwhile, there has been a scaling-down of the sales tax rate on petroleum products following the big hike in the international oil price. These products contribute over 25 percent to sales tax revenues. This will make it more difficult to achieve the FBR revenue target. Simultaneously, the rate of petroleum levy has also been brought down which will increase the shortfall in Federal non-tax revenues and make the budget deficit target even more difficult to attain.

**Ceiling on Power Sector Payment Arrears:** They are limited to an increase of only Rs 52 billion from September 2021 to June 2022. This will require a big escalation in power tariffs, which the Government may not be willing to do fully in the face of high cost-push impact on inflation.

### 3. STRUCTURAL BENCHMARKS

If the above targets and ceilings are not enough, there are important structural benchmarks to be met in the remaining months of 2021-22 as follows:

#### STRUCTURAL BENCHMARKS

1.	Preparation of draft Personal Income Tax Legislation	End-February 2022
2.	Establishment of DFI	End-April 2022
3.	Cabinet decision on the second step of the energy subsidy reform for residential consumers	End-June 2022
4.	Parliamentary Approval of New SOE Law	End-June 2022
5.	Reform of PPRA	End-March 2022

The first structural benchmark involves changes in the personal income tax system to make it more progressive by reducing the number of slabs from 11 to 6. This could increase the tax liability for salaried persons with monthly six figure salaries. The proposed new Development Financial Institution is the Exim Bank. The new SOE law has already been drafted and presented to the Finance Committee of the National Assembly. According to the balance of payments projections, the current account deficit is expected by the IMF to be limited to 4 percent of the GDP, equivalent to \$13 billion, in 2021-22. The deficit has already exceeded \$9 billion in the first six months. As such, the average monthly deficit will have to be reduced by over half in coming months. This will necessitate intensive use of the monetary policy instruments of exchange rate depreciation and higher interest rates. Will the Government be willing to risk the higher inflation at a time when it is under attack for failing to control inflation? Overall, the next three IMF quarterly reviews will be based on strict adherence to many tough performance criteria, indicative targets and structural benchmarks which will require strong policy measures and implementation capacity. Therefore, there is likely to be considerable uncertainty during the process of reviews by the IMF staff. The exchange rate could witness significant fluctuations during these times.

The magnitude of the external financing needs in 2022-23 is examined next.



### 3. EXTERNAL FINANCING REQUIREMENTS IN 2022-23

The public external financing requirements as estimated by the IMF in the latest Staff Review Report are given in Table 2. The requirement is projected to increase by almost \$5 billion and reach \$30.5 billion in 2022-23, because of the big jump in external debt servicing. The current account deficit is expected to fall somewhat next year. However, this is based on the expectation that it will be \$13 billion in 2021-22, when the more likely level is \$15 billion or even more. The fundamental question is how Pakistan will be able to meet this very large external financing requirement of over \$30 billion in 2022-23? One option is to go back to the IMF for a new program after September 22 when the present program comes to an end.

**Table 2: Public External Financing Requirements in 2022-23 (\$ billion)**

Gross External Financing Requirement			
1.	Current Account Deficit	13.0	12.5
2.	Amortization of External Debt	11.7	17.0
3.	IMF Loan Repayment	1.0	1.0
<b>TOTAL</b>		<b>25.7</b>	<b>30.5</b>

In the Macroeconomic Projections from 2022-23 to 2025-26 the Staff Review report expects a continued focus on stabilization as follows:

- (i) The GDP growth rate to remain in the range of 4 to 5 percent.
- (ii) The inflation rate to fall below 8 percent in 2022-23 and stay at 6.5 percent thereafter.
- (iii) The current account deficit in the balance of payments to remain in the range of \$12 to \$13 billion, implying that it will be contained from 4 percent of the GDP to 3 percent.
- (iv) The level of imports will need to be restricted in 2022-23 to the likely level in 2021-22.
- (v) Achievement of a sharp reduction in the budget deficit from 6.9 percent of the GDP in 2021-22 to only 4.5 percent of the GDP in 2022-23 and to 3.5 percent of the GDP by 2025-26. Two thirds to be achieved by reduction in expenditure as percentage of the GDP and one third by enhancement in revenues to GDP ratio.

Therefore, if Pakistan goes into another IMF program, the policy regime will have to be very contractionary over the three-year duration of the Program. This is considered essential as the external financing requirements are peaking to almost 10 percent of the GDP and for the debt repayment capacity to be sufficiently augmented there will be need to strongly manage aggregate demand in the economy. The other option is for Pakistan to go on its own after September 2022. The inclination of the PTI Government is likely to be towards this option in view of 2022-23 being the last year before the next elections. Clearly, the propensity will be to follow strongly expansionary policies as we saw in 2017-18 before the last elections. The question then is how will the \$30 billion of financing be organized? Dependence on a few sources like China may not be adequate. If a failure to honor external debt repayment obligations is to be avoided then even in the absence of a Fund program there will be need for very contractionary policies especially in terms of a 10 percent to 15 percent reduction in the level of imports, eventually, if necessary, by import quotas.

In conclusion, Pakistan finds itself

*'Between the devil and the deep blue sea'*

*We pray that as in many times in the past Pakistan will show resilience as a nation.*