Staff Level Agreement (SLA) reached with the IMF

As per a press release of the IMF, SLA has been reached between the IMF team and Pakistan's authorities for the combined seventh and eight reviews of Pakistan's economic program under the IMF's Extended Fund Facility (EFF) that started in Jul'19.

This agreement will pave the way for the disbursement of USD1.18bn (SDR894mn) subject to the final approval of the IMF Executive Board in its meeting the exact date of which is not yet known.

This disbursement will take the cumulative payments under the current IMF EFF to around USD4.2bn out of the total program size of around USD6bn.

Additionally, in order to support program implementation and meet the higher financing needs in FY23, as well as catalyze additional financing, the IMF Board will also consider 1) extension of the EFF until Jun'23 from the current Oct'22, and 2) enhancing the program size by SDR720mn bringing the total program size to USD7bn.

While we await the Article-IV staff report to be made available on the IMF website, press release highlights a few policy priorities to stabilize the economy and bring policy actions in line with the IMF-supported program, while protecting the vulnerable. These priorities include:

- **Steadfast implementation of the FY23 budget.** The budget aims to reduce the government's large borrowing needs by targeting an underlying primary surplus of 0.4% of GDP, through current spending restraint and broad revenue mobilization efforts focused particularly on higher income taxpayers. Development spending will be protected, and fiscal space will be created for expanding social support schemes. The provinces have agreed to support the federal government's efforts to reach the fiscal targets, and a Memoranda of Understanding (MoU) have been signed by provinces to this effect.
- **Catch-up in power sector reforms.** On the back of weak implementation of the previously agreed plan, the power sector circular debt flow is expected to grow to about PKR850bn in FY22, overshooting program targets, threatening the power sector's viability. The IMF team highlighted that the local authorities are committed to resuming reforms including, timely adjustment of power tariff including for the delayed annual rebasing and quarterly adjustments.
- **Proactive monetary policy to guide inflation to more moderate levels.** Headline inflation exceeded 20% in Jun'22. The recent monetary policy increase was necessary and appropriate, and monetary policy will need to be geared towards ensuring that inflation is brought down to the medium-term objective of 5–7%. Importantly, to enhance monetary policy transmission, the rates of the two major refinancing schemes (EFS and LTFF) will continue to be linked to the policy rate. Greater exchange rate flexibility will help cushion activity and rebuild reserves to more prudent levels.
- **Reducing poverty and strengthen social safety.** During FY22, the unconditional cash transfer (UCT) Kafalat scheme reached nearly 8mn households, with a permanent increase in the stipend to PKR14,000/family, while a one-off cash transfer of PKR2,000 (Sasta Fuel Sasta Diesel, SFSD) was granted to about 8.6mn families to alleviate the impact of rampant inflation. For FY23, the authorities have allocated PKR364bn to BISP (up from PKR250bn in FY22) to be able to bring 9mn families into the BISP safety net, and further extend the SFSD scheme to additional non-BISP, lower-middle class beneficiaries.

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- **Strengthen governance.** To improve governance and mitigate corruption, the authorities are establishing a robust electronic asset declaration system and plan to undertake a comprehensive review of the anticorruption institutions (including the National Accountability Bureau, NAB) to enhance their effectiveness in investigating and prosecuting corruption cases.

The press release concludes emphasizing that steadfast implementation of the outlined policies will help create the conditions for sustainable and more inclusive growth. The authorities should stand ready to take any additional measures necessary to meet program objectives, given the elevated uncertainty in the global economy and financial markets.

The long-awaited conclusion of the SLA and the expected smooth-sailing through the IMF board combined with enhancement of the timeline and the program size to USD7bn, we are of the opinion that the market will cherish this development as it is a critical milestone towards financing of the soaring CAD and building up of FX reserves (external funding requirement is estimated in excess of USD30bn for FY23), and implementation of the tough measures and structural reforms required for putting the economy on sustainable footings. However, the impacts of the tough measures are yet to be translated in inflation, growth and corporate profitability.

To sum up, we believe that with this milestone achieved, the economy of Pakistan is not out of the rough waters with inflation expected to average in the range of 18-20% (SBP projection, in-line with our expectations), multi-decade high interest rates and slow down in growth with significantly higher cost of doing business.

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Annexure

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