

# Impacts of IMF Targets and Conditionalities on the Economy

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# Impact of IMF targets and conditionalities on the economy

## Pakistan Economy

September 23, 2022

### Pakistan Economy

The seventh and eighth review of the Extended Fund Facility with Pakistan have been completed recently by the IMF and a loan installment of \$1.17 billion has been released under this facility. Further, the duration of the Program has been extended from September 2022 to June 2023 and the total amount of the loan increased by \$997 billion. There will be three more quarterly reviews.

The objective of this report is to identify the type and intensity of impact of attempts to achieve the targets in the Program for 2022-23 and of implementing the reforms and conditionalities agreed to by the Government of Pakistan.

The report is in five parts. Part 1 looks at in depth the Memorandum of Economic and Financial Policies that the Government of Pakistan has agreed to implement in 2022-23 with the IMF. At this point, it needs to be emphasized that the fulfillment of IMF conditionalities through actions and reforms is perhaps more wide-ranging and structural in nature than has hitherto been the case in earlier IMF programs with Pakistan.

Part 2 presents the key macroeconomic targets for 2022-23 in the Program. An assessment is made of the likelihood of achievement of these targets in light of implementation of reforms in the Memorandum. There is need to emphasize here that these targets were finalized prior to the mammoth floods hitting Pakistan and thereafter do not reflect the large negative impact of these floods on the national economy. The last section of this report attempts to build in the consequences of these floods on macroeconomic magnitudes in 2022-23.

Part 3 highlights the quarterly performance criteria and structural benchmarks which will form the basis of the three quarterly reviews by the IMF in 2023-23. An assessment will be made on the extent to which these performance criteria will be achieved.

Part 4 looks at the projection of the external financing requirements of Pakistan in 2022-23 as assessed by the IMF and the Federal Ministry of Finance along with the SBP. The proposed financing plan is highlighted and assessment made of the probability of successful implementation of this plan.

Finally in Part 5 of the report the fundamental issue is raised of the validity of the Program targets and proposed measures in light of the on-going floods in Pakistan. Already, initial estimates are that the damage to the economy is large and in the range of \$25 to \$30 billion.

### 1. Memorandum of Economic and Financial Policies

There are seven sections in the memorandum of economic and financial policies including the following:

- ▶ Tax Policy
- ▶ Management of Expenditure
- ▶ Monetary, Exchange Rate and Financial Sector Policies
- ▶ Energy Sector Policies
- ▶ State-Owned Enterprises (SOEs)
- ▶ Improving Pakistan's Competitiveness and Business Environment
- ▶ Poverty Reduction and Social Protection

The key policies and reforms agreed to by the Government in each section are listed below along with their likely impacts.

**Tax Policy:** There are eight areas of reform and action as shown in Chart 1. Two measures have already been implemented in the budget. The complex and difficult reform to implement is the harmonization of the federal sales tax on goods with the provincial sales tax on services. In addition, a commitment has been made that there will be no future tax amnesties and concessions. If there is a shortfall in FBR revenues, a contingency plan has also been identified.

#### Key Data

KSE100 Index	40,928
KSE-All Share Value (PKRmn)	6,322
KSE-All Share Value (USDmn)	26.4
KSE-All Share Volume (Shmn)	190.1
Market Capitalization (PKRtn)	6.7
Market Capitalization (USDbn)	28.0
KSE100 Index 1 Year High	47,608
KSE100 Index 1 Year Low	39,541

Source: PSX, Next Research

#### 1 Year KSE100 Index Performance



Source: PSX, Next Research

## CHART 1: TAX POLICY

ACTION / REFORM	IMPACT
<ul style="list-style-type: none"> <li>▶ Taxation Proposals included in Federal Budget of 2022-23</li> <li>▶ Raising the Petrol Levy to Rs 50 per litre <ul style="list-style-type: none"> <li>○ on Motor Spirit by April 1, 2023</li> <li>○ on HSD Oil by January 1, 2023</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▶ Additional Revenue of over Rs 600 billion</li> <li>▶ Total Revenue of Rs 855 billion in 2022-23. Depends on the extent of reduction in demand following the big price hike in POL products</li> </ul>
<ul style="list-style-type: none"> <li>▶ Increasing the Customs Duty on Crude Oil from 2.5% to 5%</li> </ul>	<ul style="list-style-type: none"> <li>▶ Additional revenue of Rs 30 billion</li> </ul>
<ul style="list-style-type: none"> <li>▶ Harmonization of the Sales Tax on Goods and Services between the Federal and Provincial Governments</li> </ul>	<ul style="list-style-type: none"> <li>▶ Preventing a Cascading of the tax and 'Race to the Bottom' by Provincial Governments through lowering of the tax rate. Difficult reform to implement</li> </ul>
<ul style="list-style-type: none"> <li>▶ No future tax amnesties</li> </ul>	<ul style="list-style-type: none"> <li>▶ Reduce tax evasion</li> </ul>
<ul style="list-style-type: none"> <li>▶ Contingency Measures: <ul style="list-style-type: none"> <li>(i) Restoring GST on fuel products at appropriate rate</li> <li>(ii) Increase excise duty on cigarettes</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▶ A GST on petroleum products will further contract demand and negatively impact on revenues from the Petroleum Levy</li> </ul>
<ul style="list-style-type: none"> <li>▶ Reduce Stock of Income Tax Arrears. Existing Stock of Rs 366 billion to be reduced to Rs 225 billion by end-September</li> </ul>	<ul style="list-style-type: none"> <li>▶ Will improve liquidity of enterprises, but imply less revenues of Rs 145 billion in the first quarter of 2022-23</li> </ul>
<ul style="list-style-type: none"> <li>▶ Increasing the number of income tax payers by 300,000</li> </ul>	<ul style="list-style-type: none"> <li>▶ Tried before with little success.</li> </ul>

**Management of Expenditures:** Seven action areas have been identified as shown in Chart 2 mostly from the viewpoint of improving the system of public financial and debt management. Also, a Medium-Term Budget Strategy is to be prepared. The objective is to adhere to the provisions in the Fiscal Responsibility and Debt Limitation Act of 2005.

Other critical steps to be taken relate to the more than halving of power sector subsidies especially by a big enhancement in tariffs. A memorandum has already been signed with the provincial governments on generation of a cash surplus of Rs 750 billion. Further, the Government has committed to limit the increase in contingent liabilities.

## CHART 2: MANAGEMENT OF EXPENDITURES

ACTION / REFORM	IMPACT
<ul style="list-style-type: none"> <li>▶ Limiting Power Subsidies to Rs 570 billion, of which Rs 225 billion will be the tariff differential subsidy. Among a number of actions to improve management of the sector, the Quarterly Price Increase in tariffs in 2022-23 will have to aggregate to Rs 7.90 per kwh</li> </ul>	<ul style="list-style-type: none"> <li>▶ One of the most critical areas for success of the Program in 2022-23. The power subsidy is to be reduced from the peak level of Rs 1072 billion in 2021-22. The hike in power tariff will be 40% on average</li> </ul>
<ul style="list-style-type: none"> <li>▶ Signing Memorandum with Provincial Governments to generate a cash surplus of Rs 750 billion</li> </ul>	<ul style="list-style-type: none"> <li>▶ The target surplus was Rs 570 billion in 2021-22, but the actual surplus was Rs 351 billion. More than doubling of the cash surplus in 2022-23 is a very ambitious target</li> </ul>
<ul style="list-style-type: none"> <li>▶ Limiting Guarantees to State-Owned Enterprises and ensuring that loans to the SOEs remain on modest downward trajectory with respect to the GDP</li> </ul>	<ul style="list-style-type: none"> <li>▶ The credit to SOEs stood at Rs 1340 billion at end of 2021-22, equivalent to 2% of the GDP. The contingent liabilities cost the Government Rs 269 billion in 2021-22 and are budgeted at Rs 291 billion in 2022-23. In the presence of significant cost-push inflation, losses of SOEs could be much higher and require more support</li> </ul>
<ul style="list-style-type: none"> <li>▶ Public Financial Management Reform, including full operationalization of the Treasury Single Account (TSA) by December 2022.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Progress already made. The issue is the merger of defence services accounts into the TSA</li> </ul>
<ul style="list-style-type: none"> <li>▶ Updating and Implementing Medium-Term Budget Strategy to achieve reduction in the public debt to GDP ratio</li> </ul>	<ul style="list-style-type: none"> <li>▶ MTBS prepared and released by the MOF for 2022-23 to 2024-25, with the objective of reducing the</li> </ul>

	public debt to GDP ratio by 2 percentage points each year.
▶ Devising new Debt Instruments, focusing especially on Shariah compliant Bonds	
▶ Establishing a Debt Management Office by December 2022.	In progress.

**Monetary, Exchange Rate and Financial Sector Policies:** There are six crucial action/reform areas as shown in Chart 3. The Government has committed to maintaining the policy of market-determined exchange rate and a flexible policy on setting of the SBP policy rate in light of the economic conditions. Further, there is agreement on phasing out of subsidized refinancing schemes of SBP, no exchange and import restrictions and effective implementation of the AML/CFT Framework.

**CHART 3: MONETARY, EXCHANGE RATE AND FINANCIAL SECTOR POLICIES**

ACTION / REFORM	IMPACT
▶ Continued commitment to a market-determined exchange rate	▶ IMF has projected depreciation of 20% of the Exchange rate in 2022-23. Actual magnitude will depend on the position of FE reserves
▶ Prudent and Proactive Monetary Policy <ul style="list-style-type: none"> <li>○ The pace of future adjustments in the policy rate will depend on the inflation data, exchange rate developments, the strength of the external position and the fiscal-monetary policy mix</li> </ul>	▶ No change in the policy rate in the last meeting of the MPC, 22-23 but with the high rate of inflation likelihood of enhancements in the policy rate during 2022-23
▶ Phasing out of subsidized refinancing schemes of SBP, including that on exports	▶ Mostly withdrawn. Will lead to a fall in private investment and impact negatively on exports
▶ Monitoring health of Financial Sector <ul style="list-style-type: none"> <li>○ Ensuring that there is no under-capitalization of banks</li> </ul>	▶ Two banks have been asked to inject more equity. These are relatively small banks
▶ Commitment to effective Implementation of the AML/ CFT Framework	▶ Review undertaken recently by a FATF team in Pakistan
▶ New Exchange and Import Restrictions <ul style="list-style-type: none"> <li>○ Cash Margin Requirements extended to 177 items</li> <li>○ Import ban on import of 33 luxury and non-essential items (including, Cars, mobile phones and home appliances)</li> <li>○ Import Payment Authorization by SBP before initiation by banks for importing certain goods.</li> </ul>	▶ Under the pressure of IMF, import ban has been withdrawn ▶ The payment authorization system is in place.

**Energy Sector Policies:** This is a critical problem area of the economy. The focus as shown in Chart 4 is on reducing the huge subsidy and better targeting it. This is to be achieved by regular tariff adjustments and medium-term cost reducing structural reforms, including containment of losses.

**SOEs:** The commitments shown in Chart 4 relate to SOE legal reforms, advancing privatization and increased transparency through establishment of a Central Monitoring Unit.

**Improving Competitiveness and the Business Environment:** This includes a new tariff policy proposal for more import substitution and promotion of 'MADE IN PAKISTAN'. Strong steps to control corruption to facilitate economic transactions by the private sector are also proposed.

**Poverty Reduction and Social Protection:** Commitment to expanded BISP program, and Kafalat program and Sasta Fuel and Sasta Diesel program, and rationalization of other programs.

**CHART 4: ENERGY SECTOR POLICIES AND STATE-OWNED ENTERPRISES (SOEs)**

ENERGY SECTOR POLICIES	
▶	Better targeting of subsidies
▶	Resuming Regular Tariff Adjustments
▶	Reducing the Circular Debt Stock
▶	Accelerating Medium-Term Cost-Reducing Structural Reforms
▶	Reforms in the Gas Sector
▶	Updating of Gas Prices
STATE-OWNED ENTERPRISES	
Improving SOEs governance, transparency, efficiency as well limiting the fiscal risks:	
▶	SOE Legal Reforms
▶	Central Monitoring Unit (CMU) with MOF to improve SOE performance
▶	Increasing Transparency
▶	Advancing Privatization and SOE support
○	Debt recapitalization and refinancing of two RLNG plants
○	Advancing privatization HBFC and First Women Bank

## 2. IMF's Macroeconomic Projections for 2022-23

The IMF's macroeconomic projections fully incorporate the successful implementation by the Government of the Memorandum of Economic and Financial Policies, described above in Section-1 of the report.

**TABLE 1: KEY MACROECONOMIC TARGETS**

	2021-22 (Actual)	2022-23 (IMF Projection)
<b>GROWTH RATE OF GDP (%)</b>	<b>6.0</b>	<b>3.5</b>
<b>RATE OF INFLATION (%)</b>		
CPI – Average	12.2	19.9
CPI – End of Period	21.3	15.0
<b>LEVEL OF INVESTMENT (% of GDP)</b>	<b>15.1</b>	<b>16.9</b>
Private	13.1	14.7
Public	2.0	2.3
<b>LEVEL OF SAVINGS (% of GDP)</b>	<b>10.5</b>	<b>14.4</b>
Private	15.5	16.8
Public	-5.0	-2.4
<b>UNEMPLOYMENT RATE (%)</b>	<b>6.3</b>	<b>6.0</b>
<b>CURRENT ACCOUNT DEFICIT (% of GDP)</b>	<b>-4.7</b>	<b>-2.5</b>
<b>BUDGET DEFICIT (% of GDP)</b>	<b>-7.0*</b>	<b>-4.6</b>

\*The actual deficit was higher at 7.9 percent of the GDP.

**Growth:** The IMF expects a big decline in the GDP growth rate to 3.5 percent in 2022-23 from 6 percent in 2021-22, largely as the outcome of the severely contractionary fiscal and monetary policies. However, perhaps surprisingly, it expects private investment to rise in real terms by as much as 12 percent, despite high interest rates and the end to concessionary project financing by the SBP.

**Rate of Inflation:** The rate of inflation is expected to rise to almost 20 percent in 2022-23. This will hinge, of course, on the path of international commodity prices and the exchange rate during the year. The IMF expects the rupee to depreciate by 24 percent by June 2023. In addition, the Program requires quantum jumps in the prices of fuel products, electricity and gas. There has also been a heavy dose of indirect taxation in the budget for 2022-23. Therefore, the rate of inflation may be even higher during the year.

**Balance of Payments:** The detailed projections are in Table 2. The current account is projected to come down sharply from 4.7 percent of the GDP in 2021-22 to only 2.5 percent of the GDP in 2022-23. This is to be achieved by an increase in merchandise exports of almost 13 percent and a reduction in imports by 5 percent. The latter is more likely, especially if the international oil price falls significantly, as is happening currently. However, in the presence of a global recession a double-digit growth in exports is unlikely, especially with rise in cost of export financing and higher electricity and gas tariffs.

**TABLE 2: BOP PROJECTIONS BY THE IMF – (\$ million)**

SUMMARY	2021-22	2022-23
Current Account Deficit	-17,461	-9,280
Capital Account	208	161
Financial Account Surplus	10,355	12,682
Net Errors & Omissions	-608	0
<b>Overall Balance of Payments</b>	<b>-7,504</b>	<b>+3,563</b>
Augmented IMF Funding	36	+2,841
<b>Change in Reserves</b>	<b>-7,469</b>	<b>6,405</b>

**CURRENT ACCOUNT – (\$ million)**

	2021-22	2022-23
<b>Balance of Trade in Goods</b>	<b>-40,140</b>	<b>-32,856</b>
Exports	31,877	45,900
Imports	72,017	68,756
<b>Balance of Trade in Services</b>	<b>-3,690</b>	<b>-3,507</b>
Exports	6,832	7,043
Imports	10,522	10,550
<b>Primary Income (Net)</b>	<b>-5,288</b>	<b>-4,763</b>
II	2,774	2,247
<b>Secondary Income (Net)</b>	<b>31,658</b>	<b>31,846</b>
Worker's Remittances	30,117	28,958
Other Transfers	1,451	2,647
<b>CURRENT ACCOUNT DEFICIT</b>	<b>-17,461</b>	<b>-9,280</b>

**FINANCIAL ACCOUNT – (\$ million)**

	2021-22	2022-23
<b>FINANCIAL ACCOUNT SURPLUS</b>	<b>10,355</b>	<b>12,682</b>
Foreign Direct Investment	2,583	2356
Portfolio Investment	447	3,210
<b>General Government (Net)</b>	<b>6,074</b>	<b>7,062</b>
Disbursements	10,729	19,476
Amortization	8,288	12,414
Others	3,633	-
<b>Others</b>	<b>1,251</b>	<b>240</b>

**Public Finances:** The detailed projections are in Table 3. A huge improvement is anticipated in the state of public finances, with the budget deficit being brought down from 7.9 percent of the GDP to 4.6 percent of the GDP, primarily by economy in current expenditures. This will be very difficult to achieve.

TABLE 3: IMF's PUBLIC FINANCE PROJECTIONS FOR 2022-23 (Rs in Billion)

	2021-22	IMF Projections 2022-23
<b>A. REVENUES</b>	<b>8,074</b>	<b>10,371</b>
<b>A.1. FEDERAL</b>	<b>7,279</b>	<b>9,365</b>
<b>Tax Revenues</b>	<b>6,220</b>	<b>8,430</b>
FBR Revenues	6,000	7,470
Petroleum Levy	135	855
NGDS + GIDC	85	105
<b>Non-Tax Revenues</b>	<b>1,059</b>	<b>935</b>
<b>A.2. PROVINCIAL</b>	<b>796</b>	<b>1,006</b>
Tax Revenues	608	790
Non-Tax Revenues	188	216
<b>B. EXPENDITURE</b>	<b>12,776</b>	<b>14,284</b>
<b>B.1. FEDERAL</b>	<b>8,788</b>	<b>9,478</b>
<b>Current Expenditure</b>	<b>8,348</b>	<b>8,778</b>
Debt Servicing	3,100	4,067
Defence	1,450	1,563
Others [S + G]	3,798	3,148
<b>Development Expenditure</b>	<b>440</b>	<b>700</b>
<b>B.2. PROVINCIAL</b>	<b>3,988</b>	<b>4,806</b>
<b>Current Expenditure</b>	<b>3,055</b>	<b>3,557</b>
<b>Development Expenditure</b>	<b>933</b>	<b>1,249</b>
<b>C. BUDGET DEFICIT</b>	<b>-4,702</b>	<b>-3,903</b>
<b>% of GDP</b>	<b>-7.0</b>	<b>-4.6</b>

### 3. Meeting the performance criteria and indicative targets

An assessment is made below of the likely extent of success in forthcoming reviews in meeting the performance criteria and indicative targets. The dates are as follows:

#### FORTHCOMING REVIEWS MEETINGS

Review	PC and IT* of	Date of Mission to Pakistan	Balance of SDRs (Million)
Ninth Review	End-September 2022	November 3, 2022	894
Tenth Review	End-December 2022	February 3, 2023	528
Eleventh Review	End-March 2023	May 3, 2023	528

PC = Performance criteria,  
IT = Indicative targets

Subject to successful completion of a review and approval of the IMF Executive Board, the equivalent of number of SDRs released is shown in the table above.

## PERFORMANCE CRITERIA

**Floor on Net International Reserves of SBP:** The end-quarter levels of net international reserves are given below. Net International reserves are the gross foreign exchange reserves of SBP minus the foreign exchange liabilities and the outstanding loan amount with the IMF. The projection for the three quarters of 2022-23 is on the assumption that the foreign exchange reserves increase in a linear manner.

TABLE 4: PERFORMANCE CRITERIA AND INDICATIVE TARGETS

	End-Jun-22	End-Sept-22	End-Dec-22	End-Mar-23	Assessment of Toughness
<b>PERFORMANCE CRITERIA</b>					
▶ Floor on Net International Reserves of SBP (\$ million)	-10,784	-11,450	-10,300	-9,800	High
▶ Ceiling on Net Domestic Assets of SBP (Rs in Billion)	10,850	11,127	11,213	11,327	-
▶ Ceiling on general government Primary Budget Deficit (Cumulative, Rs in Billion)	-1,900	-339	-924	-987	High
▶ Ceiling on Amount of Government Guarantees (stock, Rs in Billion)	2,771	2,978	3,077	3,102	Medium
▶ Cumulative Floor to BISP Spending (Rs in Billion)	n.a.	70	149	232	Low
<b>INDICATIVE TARGETS</b>					
▶ Cumulative Floor to Government Education and Health Spending (Rs in Billion)	1,796	446	1,070	1,721	Low
▶ Floor on net Tax Revenues* by FBR (Rs in Billion)	6,150	1,569	3,511	5,304	Medium
▶ Ceiling on Power Sector Payment Arrears (Cumulative flow, Rs in Billion)	536	-208	-157	30	High

The foreign exchange position of the SBP as of end-September 2022 of \$11.4 billion is unlikely to be met. Even after receipt of \$1.17 billion from the IMF at the beginning of September, reserves on the 2nd of September stand at \$8.8 billion. They are unlikely to increase by \$2.6 billion during the month. As such, NIR performance criteria is unlikely to be met for September 2022.

Subsequent quarters are likely to witness a bigger divergence because of the following:

- Slower growth of exports because of the global recession and some loss of competitiveness due to cost-push factors like escalation in interest costs and power tariffs.
- Given the poor state of the economy and the political tumult foreign direct investment is unlikely to be at the projected level.
- Flotation of Euro bonds will be constrained by the heavy discount that will have to be offered.

**Ceiling on Net Domestic Assets of the SBP:** IMF states that as of end-June 2022 the net domestic assets of the SBP were Rs 10,850 billion. However, this represents a big divergence from the actual level of Rs 8,272 billion. As such, this performance criteria will have to be reformulated.

**Ceiling on General Government Primary Budget Deficit:** This is an important performance criterion and is the bottom-line measure of the Government's success in meeting the public finance targets.

Achieving the reduction in the budget deficit from 7.9 percent of the GDP to 4.6 percent will be extremely difficult for the following reasons:

- Likely higher cost of debt servicing because the high on-going rate of inflation may compel the MPC of the SBP to raise the policy rate.



- ii) It will not be possible to reduce the power sector subsidy by almost 50 percent due to high fuel costs and the likelihood of public protests in the event of too big an escalation in power tariffs.
- iii) Failure of the Provincial Governments to generate a cash surplus in the presence of a shortfall in revenue transfers from the Federal Government.
- iv) Likelihood of a significant shortfall in Federal tax revenues especially in the income tax and petroleum levy.

The actual outcome of the budget deficit is likely to be closer to 6.0 percent of the GDP. Consequently, while the target is for a primary surplus of Rs 153 billion in 2022-23, it is likely to be a big deficit of over Rs 900 billion. As such, the probability of meeting this key performance criterion is very low.

**Ceiling on Amount of Government Guarantees:** During the first three quarters of 2022-23, the performance criteria implies that the quantum of new guarantees issued will have to be restricted to Rs 331 billion. During the same period the increase in 2021-22 was Rs 344 billion. This year there will be greater pressure on liquidity of SOEs because of cost-push inflation. Strong restraint will have to be exercised in the extension of new guarantees if the performance criteria is to be met.

**Cumulative Floor on BISP Spending:** The budgetary allocation for 2022-23 is Rs 361 billion. The performance criterion requires Rs 232 billion to be spent in the first nine months, which is very likely.

#### INDICATIVE TARGETS

Among the indicative Targets, the likely position in 2022-23 is as follows:

**Cumulative Floor to Government Education and Health Spending:** The spending was equivalent to 2.7 percent of the GDP in 2021-22. The expectation is that it will reach 2.0 percent of the GDP in the first nine months of 2022-23. There is likely, especially since the Provincial Governments are planning to increase their social sector expenditures by over 18 percent, according to the respective budgets of 2022-23.

**Floor on Net Tax Revenues of FBR:** A comparison is made below of the quarter revenue performance criteria with the actual revenues in the corresponding quarters of 2021-22. The setting of the target is defective, with a big decline in the growth rate in the third quarter. With the present numbers in the performance criteria, there may be some difficulty in meeting the criteria in the second quarter of 2022-23.

FBR REVENUES			
	1 <sup>st</sup> Quarter	2 <sup>nd</sup> Quarter	3 <sup>rd</sup> Quarter
2022-2023, Performance Criteria Level	1,569	3,511	5,304
2021-22 Actual Net Collection	1,397	2,919	4,821
Required Growth Rate	12.3	20.2	10.0

**Ceiling on Power Sector Payment Arrears:** The arrears of Rs 536 billion are all to be cleared in the first quarter of 2022-23. This is well-nigh impossible. It is surprising that the government accepted this target.

Overall, the position with regard to meeting the performance criteria is also given in the Table 4. The three performance criteria which will be very difficult to meet are as follows:

First	Second	Third
Floor on Net International Reserves	Ceiling on the General Government Primary Budget Deficit	Ceiling on Power Sector Payment Arrears

Therefore, the future of the IMF program over the next three reviews is highly uncertain. There will be pressure for mini-budgets or other emergency actions to meet all the criteria unless there is willingness to give waivers by the IMF through the Executive Board. The foreign exchange and stock markets will remain volatile when the reviews are taking place in Pakistan by the IMF Staff.

#### 4. FULFILLING THE EXTERNAL FINANCING REQUIREMENTS

This is a very important part of the IMF report. It indicates what the total external financing requirements are in 2022-23 and how these will be met, as shown in Table 5.

The gross external financing requirements consist of the current account deficit, amortization of external debt and repayment of IMF loan.

The year, 2021-22, witnessed a big shortfall in external financing, aggravated by the absence of a functional IMF program for many months. The financing requirement was \$34.3 billion, augmented substantially by the large current

account deficit of \$17.4 billion. The total external financing which became available was \$26.9 billion, implying a big shortfall \$7.4 billion, which was reflected fully in the fall in foreign exchange reserves.

The estimated external financing requirement in 2022-23 is \$30.8 billion, with a smaller current account deficit of \$9.3 billion and amortization of external debt of \$21.5 billion. The expected inflow of financing is \$37.2 billion, including \$3.8 billion from the IMF. Consequently, there will be a build-up of reserves of \$6.4 billion.

**TABLE 5: THE EXTERNAL FINANCING REQUIREMENTS AND THEIR FINANCING IN 2022-23 – (\$ billion)**

	Public Sector	Private Sector	Total
<b>Gross External Financing Requirements</b>	<b>25.7</b>	<b>5.1</b>	<b>30.8</b>
Current Account Deficit	9.3	-	9.3
Amortization	15.4	5.1	20.5
Repayment to IMF	1.0	-	1.0
<b>Available Financing</b>	<b>21.0</b>	<b>12.2</b>	<b>33.2</b>
Foreign Direct Investment	-	2.2	2.2
From Private Creditors	9.9*	6.7**	16.6
Official Creditors	11.1	3.3	14.4
<b>Net Position</b>	<b>-4.7</b>	<b>7.1</b>	<b>2.5</b>
<b>IMF Loan Disbursement</b>	<b>3.8</b>		
<b>TOTAL</b>	<b>-0.8</b>	<b>7.1</b>	<b>6.4</b>
<b>Increase in FE Reserves</b>			<b>6.4</b>

\* Includes syndicated loans and Eurobonds.

\*\* Includes equity and debt portfolio inflows and borrowing by banks and other sectors.

The primary sources of financing will be, first, \$16.6 billion from syndicated loans and Eurobonds. Second, the inflow from official creditors, both multilateral and bilateral, is projected at \$14.4 billion. In effect, the projection is that external financing will increase by as much as 38 percent compared to 2021-22 in the presence of a functional IMF program.

Finally, there is a need to look at medium-term projections of Pakistan's external financing requirements as estimated by the IMF from 2023-24 onwards. The assumption is that the current account deficit will remain curtailed at 2.5 percent of the GDP.

The gross external financing requirement in 2023-24 is \$36.6 billion, an increase of 19 percent over the projected level in 2022-23. It will increase further to \$39.3 billion in 2026-27. The primary reason for the increase is higher amortization payments by almost 25 percent over the level in 2022-23.

The relentless growth in external financing needs over the next few years raises a fundamental question. Can Pakistan survive without an IMF program after May 2023, after the completion of the present program?

The answer unfortunately is NO. This can only happen if the current account deficit of above \$10 billion is largely eliminated, which will require even deeper and wider structural reforms.

## 5. ECONOMIC OUTLOOK WITH FLOODS

The unprecedented floods in the history of Pakistan have impacted directly on agricultural output, livestock, housing and infrastructure. The first estimate of the cost of the floods has been derived by the author as follows:

IMPACT OF FLOODS (\$ billion)			
GDP LOSS	DAMAGE TO HOUSING AND INFRASTRUCTURE	LOSS OF LIVESTOCK	TOTAL LOSS
\$16billion	\$6 billion	\$3billion	\$25 billion

The direct GDP loss is 4.2 percent of the GDP. In the absence of the floods the GDP was expected to grow by 4 percent or so. Now, with the floods the GDP growth rate will be close to zero.

The rate of inflation in the absence of the floods was expected to range from 20 percent to 22 percent in 2022-23. The emerging shortages, especially of food items, will raise the rate of inflation to between 24 percent and 26 percent.

The loss in the cotton output and the anticipated loss in wheat imports will require additional imports of \$3.5 billion 2022-23. Revenues will be significantly impacted by the contraction of the tax bases and relief and rehabilitation spending will add to total public expenditure by about 1 percent of the GDP.

Overall, the macroeconomic outlook in 2022-23 after the floods is presented in Table 6.

There is need for a strong effort at mobilizing resources from the international commodity to support the large-scale relief and rehabilitation efforts. The Government in cooperation with the UN has launched a Flash Appeal of \$160 million and the Secretary General of the UN has visited Pakistan.

The time has come not only for renegotiating with the IMF the targets and conditionalities for 2022-23 in light of the devastating floods. The revisions could be close to the numbers given above.

**TABLE-6: MACROECONOMIC OUTLOOK 2022-23**

	Without Floods		With Floods Likely
	IMF Projections	Likely	
GDP Growth Rate (%)	3.5	4.0	0.0
Rate of Inflation (%)	19.9	20 – 22	24 – 26
Current Account Deficit	9.3	11.0	14.0
Budget Deficit	4.6	6.1	7.1

Further, additional support must be sought from multilateral agencies. The IMF has already in 2020-21 provided financial assistance to countries after COVID-19. Pakistan received additional funding from the IMF of \$1.4 billion in 2020.

There is need to explore the likelihood also of access to the Natural disaster Window of financing from the IMF, especially since the floods are likely to worsen the balance of payments position of Pakistan. Also, the World Bank, ADB and IDB could be approached for funding the large reconstruction projects which will be launched for restoration of damaged infrastructure.

In conclusion, Pakistan is in a state of multiple crises. The weak and faltering economy has been hit by a mammoth natural disaster. The external financing requirements have reached extremely high levels. Consequently, the extended IMF program requires extremely strong efforts at stabilization of the economy by over 40 percent cut in both the current account and budget deficits. The Program quarterly performance criteria will be very difficult to meet and during the quarterly review process there will be high uncertainty in the foreign exchange and stock markets about the future of the IMF program. We hope and pray that somehow Pakistan will be able to avoid a default situation.