INTERNATIONAL MONETARY FUND

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PAKISTAN

July 2019

REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PAKISTAN

In the context of the Request for an Extended Arrangement Under the Extended Fund Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 3, 2019, following discussions that ended on May 10, 2019, with the officials of Pakistan on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on June 20, 2019.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Pakistan.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 19/264
FOR IMMEDIATE RELEASE
July 3, 2019

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Approves US$6 billion 39-Month Extended Fund Facility Arrangement for Pakistan

- The authorities' economic reform program aims to put Pakistan's economy on the path of sustainable and balanced growth and increase per capita income.
- A decisive fiscal consolidation will help to reduce public debt and build resilience while social spending will be expanded and the most vulnerable supported.
- A flexible, market-determined exchange rate will help to restore competitiveness, rebuild official reserves, and provide a buffer against external shocks.
- The Fund's immediate disbursement will be SDR716 million (or about US$1 billion).
- The approval will unlock from Pakistan's international partners around USD38 billion over the program period.

On July 3, 2019, the Executive Board of the International Monetary Fund (IMF) approved a 39-month extended arrangement under the Extended Fund Facility (EFF) for Pakistan for an amount of SDR 4,268 million (about US$6 billion or 210 percent of quota) to support the authorities' economic reform program.

The EFF-supported program will help Pakistan to reduce economic vulnerabilities and generate sustainable and balanced growth focusing on: a decisive fiscal consolidation to reduce public debt and build resilience while expanding social spending; a flexible, market-determined exchange rate to restore competitiveness and rebuild official reserves; to eliminate quasi-fiscal losses in the energy sector; and to strengthen institutions and enhance transparency.

The Executive Board's approval allows for an immediate disbursement of SDR716 million (or about US$1 billion). The remaining amount will be phased over the duration of the program, subject to four quarterly reviews and four semi-annual reviews.

Following the Executive Board discussion, Mr. David Lipton, First Deputy Managing Director and Acting Chair, said:

“Pakistan is facing significant economic challenges on the back of large fiscal and financial needs and weak and unbalanced growth. In this context, the authorities’ program aims to tackle long-standing policy and structural weaknesses, restore macroeconomic stability, catalyze significant international financial support, and promote strong and sustainable growth.

“A decisive fiscal consolidation is key to reducing the large public debt and building resilience, and the adoption of the FY 2020 budget is an important initial step. Achieving the fiscal objectives will require a multi-year revenue mobilization strategy to broaden the tax base and raise tax revenue in a well-balanced and equitable manner. It will also require a strong commitment by the provinces to support the consolidation effort, and effective public financial management to improve the quality and efficiency of public spending.

“Protecting the most vulnerable from the impact of adjustment policies will be an important priority. This will be achieved by a significant increase in resources allocated to key social assistance programs, supporting measures for the economic empowerment of women, and investment in areas where poverty is high.

“A flexible market-determined exchange rate and an adequately tight monetary policy will be key to correcting imbalances, rebuilding reserves, and keeping inflation low. In this regard, measures to strengthen the State Bank of Pakistan’s (SBP) autonomy and eliminate central bank financing of the budget deficit will enable the SBP to deliver on its mandate of price and financial stability.

“An ambitious agenda to strengthen institutions and remove impediments to growth will allow Pakistan to reach its full economic potential. Addressing structural weaknesses in the energy sector and improving the governance of state-owned enterprises will ensure efficiency and better services, thus boosting economic activity. Moreover, improving the business climate, strengthening efforts to fight corruption, and enhancing the AML/CFT framework will create an enabling environment for private investment and job creation.

“The strong financial support to the authorities’ policy efforts by Pakistan’s international partners is essential to meet the large external financing needs in the coming years and allow the program to achieve its objectives.”

ANNEX

Recent Economic Developments and Outlook

Pakistan’s economy is at a critical juncture. The legacy of misaligned economic policies, including large fiscal deficits, loose monetary policy, and defense of an overvalued exchange rate, fueled consumption and short-term growth in recent years, but steadily eroded macroeconomic buffers, increased external and public debt, and depleted international reserves. Structural weaknesses remained largely unaddressed, including a chronically weak tax administration, a difficult business environment, inefficient and loss making SOEs, amid a large informal economy. Without urgent policy action, economic and financial stability could be at risk, and growth prospects will be insufficient to meet the needs of a rapidly growing population.

Program Summary

The authorities' comprehensive economic reform program, supported by the EFF, aims to stabilize the economy and lay the foundation for robust and balanced growth. Key elements include:

A decisive fiscal consolidation to reduce public debt and build resilience, starting with the adoption of an ambitious FY 2020 budget. The adjustment will be supported by comprehensive efforts to drastically increase revenue mobilization by 4 to 5 percent of GDP at the federal and the provincial level over the program period;

Expanding social spending, including through the strengthening and broadening of safety nets to support the most vulnerable;

A flexible, market-determined exchange rate to restore competitiveness, rebuild official reserves, and provide a buffer against external shocks. This will be supported by an appropriate monetary policy to shore up confidence and contain inflation, conducted by an independent central bank;

Energy sector reforms to eliminate quasi-fiscal losses and encourage investment, including by depoliticizing gas and power tariff setting and over the program period, gradually bringing the sector to cost recovery; and

Structural reforms through strengthening institutions, increasing governance and transparency, and promoting an investment-friendly environment necessary to improve productivity, entrench lasting reforms, and ensure sustainable growth.

Strong financial assistance by Pakistan's international partners will support the EFF. The Fund-supported program is expected to coalesce broader support from multilateral and bilateral creditors in excess of US$38 billion, which is crucial for Pakistan to meet its large financing needs in the coming years.

Pakistan: Selected Economic Indicators, 2014/15–2019/20 1/

Population: 207.8 million (2016/17; provisional)
Per capita GDP: US$1,463 (2016/17)
Poverty rate: 29.5 percent (2012/13)
Main exports: Textiles ($12.8 billion, 2015/16)
Unemployment: 5.9 percent (2014/15)

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
			Est.	Est.	Proj.	Proj.
Output and prices						
Real GDP at factor cost	4.1	4.6	5.2	5.5	3.3	2.4
GDP deflator at factor cost	4.3	0.4	4.0	2.4	7.5	11.8
Consumer prices (period average)	4.5	2.9	4.1	3.9	7.3	13.0
Consumer prices (end of period)	3.2	3.2	3.9	5.2	8.4	11.8
Pakistani rupees per U.S. dollar (period average)	-1.5	2.9	0.4	5.0	…	…
Pakistani rupees per U.S. dollar (end of period)	3.3	2.8	0.2	13.9	…	…
			(In percent of GDP)			
Saving and investment						
Gross saving	14.7	13.9	12.0	10.4	10.8	12.1
Government	-1.6	-0.7	-0.8	-2.2	-3.6	-3.8
Nongovernment (including public sector enterprises)	16.3	14.6	12.8	12.6	14.5	15.9
Gross capital formation 2/	15.7	15.7	16.2	16.7	15.4	14.7
Government	3.7	3.7	4.9	4.2	3.1	3.3
Nongovernment (including public sector enterprises)	12.0	11.9	11.2	12.5	12.3	11.4
Public finances						
Revenue and grants	14.5	15.5	15.5	15.2	15.0	16.3
Expenditure (including statistical discrepancy)	19.1	19.2	21.1	21.7	21.7	23.4
Budget balance (including grants)	-5.3	-4.4	-5.8	-6.4	-6.8	-7.1
Budget balance (excluding grants)	-5.4	-4.6	-5.8	-6.5	-7.0	-7.3
Primary balance (excluding grants)	-0.7	-0.3	-1.6	-2.2	-1.8	-0.6
General government debt incl. IMF obligations	63.3	67.6	67.0	71.7	74.9	76.9
External general government debt	18.9	20.8	20.5	24.3	26.5	32.0
Domestic general government debt	44.4	46.8	46.5	47.4	48.4	44.9
	(Annual changes in percent of initial stock of broad money, unless otherwise indicated)					
Monetary sector						
Net foreign assets	2.2	1.7	-3.2	-5.6	-6.3	8.9
Net domestic assets	11.0	11.9	16.9	15.3	17.1	3.2
Broad money (percent change)	13.2	13.7	13.7	9.7	10.8	12.1
Reserve money (percent change)	9.9	26.5	22.5	12.7	15.7	13.5
Private credit (percent change)	5.9	11.1	16.6	14.9	17.1	13.3
Six-month treasury bill rate (period average, in percent)	8.8	6.3	5.9	6.0	…	…
External sector						
Merchandise exports, U.S. dollars (percentage change)	-3.9	-8.8	0.1	12.6	0.2	8.2
Merchandise imports, U.S. dollars (percentage change)	-1.0	0.0	17.9	16.2	-4.2	-4.7
Current account balance (in percent of GDP)	-1.0	-1.7	-4.1	-6.3	-4.6	-2.6
Financial account (billions of U.S. dollars)	5.0	6.8	10.2	14.3	10.7	8.7
	(In percent of exports of goods and services, unless otherwise indicated)					
External public and publicly guaranteed debt	159.8	193.3	209.4	218.3	225.2	234.0
Debt service	20.7	22.2	30.1	26.3	37.9	45.7
Gross reserves (in millions of U.S. dollars) 3/	13,534	18,143	16,141	9,789	6,824	11,187
In months of next year's imports of goods and services	3.2	3.7	2.9	1.9	1.4	2.2
Memorandum items:						
Underlying fiscal balance (excl. grants; percent of GDP) 4/	…	…	-6.3	-6.5	-7.3	-7.3
General government and government guaranteed debt (incl. IMF; % GDP)	65.7	70.1	70.0	75.3	79.1	80.5
Net general government debt (incl. IMF; % GDP)	58.2	61.3	61.5	66.8	70.7	73.5
Real effective exchange rate (end of period percentage change)	6.5	2.1	3.4	-11.2	…	…
Terms of trade (percentage change)	6.8	11.1	0.1	-3.2	-1.3	-0.1
Real per capita GDP (percentage change)	2.0	2.6	3.2	3.6	1.4	0.5
GDP at market prices (in billions of Pakistani rupees)	27,443	29,076	31,922	34,619	38,559	44,446

Sources: Pakistani authorities; World Bank; and IMF staff estimates and projections.

1/ Fiscal year ends June 30.
2/ Including changes in inventories
3/ Excluding gold and foreign currency deposits of commercial banks held with the State Bank of Pakistan.
4/ Excludes one-off transactions, including asset sales.

PAKISTAN

June 20, 2019

REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

EXECUTIVE SUMMARY

Pakistan's economy is at a critical juncture. Misaligned economic policies, including large fiscal deficits, loose monetary policy, and defense of an overvalued exchange rate, fueled consumption and short-term growth in recent years, but steadily eroded macroeconomic buffers, increased external and public debt, and depleted international reserves. Structural weaknesses remained largely unaddressed, including a chronically weak tax administration, a difficult business environment, inefficient and loss making SOEs, and low labor productivity amid a large informal economy. Without urgent policy action, economic and financial stability could be at risk, and growth prospects will be insufficient to meet the needs of a rapidly growing population.

To tackle the imbalances and structural problems, the authorities are requesting Fund support under a 39-month Extended Fund Facility (EFF). They have developed a comprehensive program to stabilize the economy and lay the foundation for robust and balanced growth. Key elements include:

- A decisive fiscal consolidation to reduce public debt and build resilience, starting with the adoption of an ambitious FY 2020 budget. The adjustment will be supported by comprehensive efforts to drastically improve revenue mobilization, both at the federal and the provincial level, and generate 4-5 percentage points of GDP in additional tax revenue;

- A flexible, market-determined exchange rate to restore competitiveness, rebuild official reserves, and provide a buffer against external shocks. This will be supported by an appropriate monetary policy to shore up confidence and contain inflation, conducted by a strengthened and independent central bank;

- Energy sector reforms to eliminate quasi-fiscal losses and encourage investment, including by depoliticizing gas and power tariff setting and adjusting tariffs to cost recovery;

- Expanding social spending, including through the strengthening and broadening of safety nets to support the most vulnerable; and

- Structural reforms through strengthening institutions, increasing governance and transparency, and promoting an investment-friendly environment necessary to improve productivity, entrench lasting reforms, and ensure sustainable growth.

Strong financial assistance by Pakistan's international partners will support the EFF. The Fund-supported program is expected to coalesce broader support from multilateral and bilateral creditors in excess of US$38 billion, which is crucial for Pakistan to meet its large financing needs in the coming years. The authorities have already secured the full financing for the first year and have received firm commitments from key bilateral partners to maintain their exposure throughout the program period, including by extending new loans consistent with program objectives. To support their efforts, the authorities are also requesting access under the EFF of SDR 4,268 million (210 percent of quota), equivalent to about $6 billion.

Strong and steadfast program implementation will be key to mitigate the risks to the program. The authorities recognize that incomplete policy implementation derailed past adjustment efforts and allowed for repeated cycles of economic and financial stress. Their steadfast commitment, including their ability to overcome entrenched resistance to reforms, will be critical for this new program to succeed. In this regard, the bold and frontloaded actions already undertaken demonstrate the authorities' commitment to the program, and the significant external support is key to mitigate risks and allow the program to achieve its objectives.

Approved By
Thanos Arvanitis and Kristina Kostial

Discussions were held in Islamabad and Karachi during November 7–20, 2018 and April 29-May 10, 2019. The IMF team comprised Harald Finger (outgoing mission chief, November), Ernesto Ramirez Rigo (new mission chief, May), Ricardo Llaudes, Maxym Kryshko, (all MCD); Hua Chai, Svetlana Cerovic (FAD); Jongsoon Shin (SPR); Carlos de Barros Serrao (MCM); Jonathan Pampolina (LEG); Teresa Daban-Sanchez (Resident Representative) and Hiba Zaidi and Zafar Hayat (Resident Representative Office, Islamabad). Jafar Mojarrad and Cyrus Sassanpour (both OED) participated in policy discussions. Tetyana Sydorenko (MCD) provided research assistance and Maria Orihuela-Quintanilla (MCD) document management.

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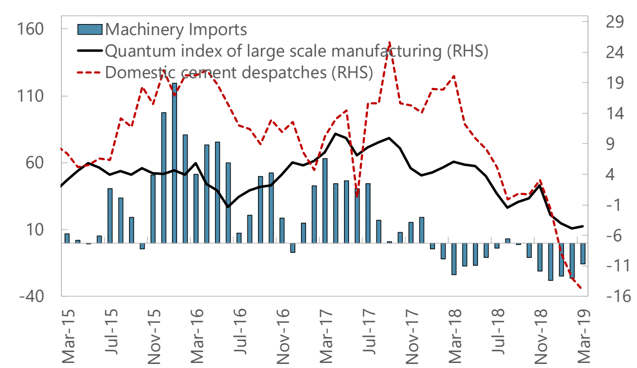
CONTEXT AND RECENT DEVELOPMENTS

1. **Over the past year, Pakistan has faced challenging financial conditions on the back of unbalanced policies and unfinished reforms**. While economic growth has been relatively fast—averaging close to 5 percent over the past five years—macroeconomic vulnerabilities have rapidly increased on the back of weak policies supporting a consumption- and import-driven growth model. In particular, procyclical fiscal policies led to a surge in the FY 2018 fiscal deficit to 6.5 percent of GDP, 2.5 percent of GDP higher than budgeted, pushing public debt to 75 percent of GDP. The fiscal stimulus, together with an accommodative monetary policy and, crucially, the defense of an overvalued exchange rate, fueled the current account deficit to 6.3 percent of GDP last year. Lackluster progress in structural reforms continued to hamper investment, allowed inefficient SOEs to linger, and a large informal economy to expand. While the macroeconomic deterioration that eroded the stability gains achieved during the 2013-16 EFF has been largely due to homemade factors, the increase in oil prices and more limited capital flows have added to this difficult picture.

2. **The authorities' gradual policy measures have not been enough to stabilize the economy**. While some adjustment policies were adopted since the start of 2018, these fell short of the comprehensive reforms needed to ensure macroeconomic stability. Despite some exchange rate depreciation and significant monetary policy tightening, sizeable foreign exchange interventions continued through April 2019. Similarly, fiscal slippages in the first half of the fiscal year have been significant despite the adoption of two budget amendments. Finally, increases in power and gas tariffs have not been sufficient to stem the accumulation of quasi-fiscal losses. Sizable short-term financing from bilateral creditors provided critical financing relief, but also deferred the urgency to tackle the underlying problems while increasing the maturing debt obligations due in coming years.

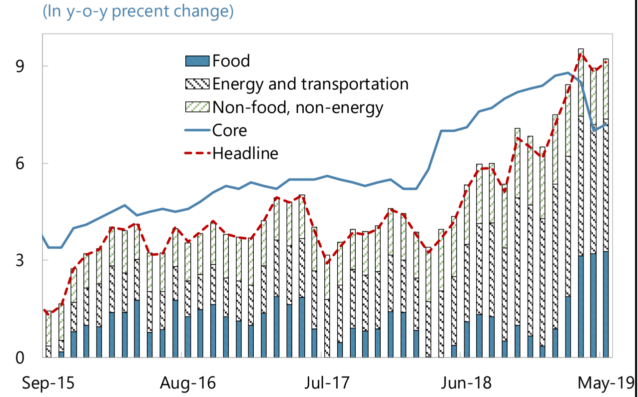
3. **On the back of weakening confidence, economic activity has slowed considerably, and inflation accelerated**. High-frequency indicators, including the large-scale manufacturing index, domestic cement dispatches, and motor vehicle sales, have continued to deteriorate, confirming a marked slowdown in economic activity. In addition, agriculture, including cotton production, has been impacted by water shortages, while public investment and construction have contracted owing

Key High Frequency Indicators
(y-o-y percent change; 3-month moving average)



Source: State Bank of Pakistan, Pakistan Bureau of Statistics, All Pakistan Cement Manufacturer Association, and IMF staff calculations.

Contribution to CPI Inflation
(In y-o-y precent change)



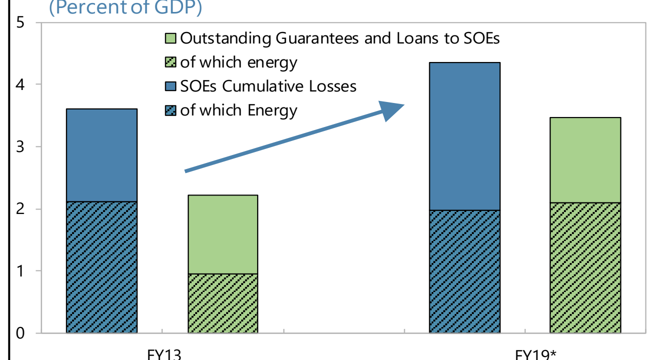
Sources: SBP; and IMF staff calculations.

to cuts in government development spending. Growth is estimated to decline to 3.3 percent this year, from 5.5 percent a year ago, as policy uncertainty and limited financing heavily weigh on confidence and investment. Consumer inflation has accelerated to a near five-year high of 9.1 percent in May 2019, more than doubling from 4.2 percent a year ago. It is expected to remain elevated in FY 2019, reflecting the pass-through from the recent exchange rate devaluations, power and gas tariff increases and an ongoing food price normalization.

4. **Fiscal imbalances have continued to build**. Despite the adoption of two supplementary budgets, the overall fiscal deficit (excluding grants) is expected to widen to over 7 percent of GDP against a budget target of 5.1 percent in FY 2019. This deterioration is largely driven by a significant revenue shortfall, equivalent to 1.4 percent of GDP relative to the budget target, and is mainly the result of the three-fold increase of personal income tax thresholds, stalled collection of withholding taxes on mobile services due to Court decisions, losses from Petroleum Development Levy (PDL) and sales tax on petroleum products, and weaker domestic demand. The tax to GDP ratio is estimated to have declined to below 13 percent of GDP, among the lowest in the region. Weak revenue collection also impacted provincial surpluses, expected to be 0.5 percentage point lower than envisaged in the budget. Expenditures also increased somewhat, despite the cuts in Public Sector Development Program, reflecting higher interest payments, subsidies, and defense related spending. Borrowing from the State Bank of Pakistan has financed a large part of the deficit.

5. **Quasi-fiscal losses increased further and represent a significant fiscal risk**. Following several years of steady decline in the flow of circular debt[1] in the power sector, new arrears were accumulated over FYs 2018 and 2019, reaching close to PRs 800 billion (around 2 percent of GDP). Delays in adjusting tariffs, reversal of policies—such as revenue-based load shedding—and the non-payment of implicit subsidies by the government[2] have been the main contributors to the increase in arrears. As a result, the stock of circular debt stood at over 4 percent of GDP as of March 2019. Moreover, arrears in the gas sector have now emerged, with the stock totaling over ½ percent of GDP, coming mostly from delays in tariff notifications and increasing technical losses. Beyond the energy sector, losses in the three largest State-Owned Enterprises (Pakistani International Airlines, Pakistan Steel Mills, and Pakistan Railways) have continued to accumulate, now totaling over 2 percent of GDP.

SOEs Losses and Government Guarantees
(Percent of GDP)



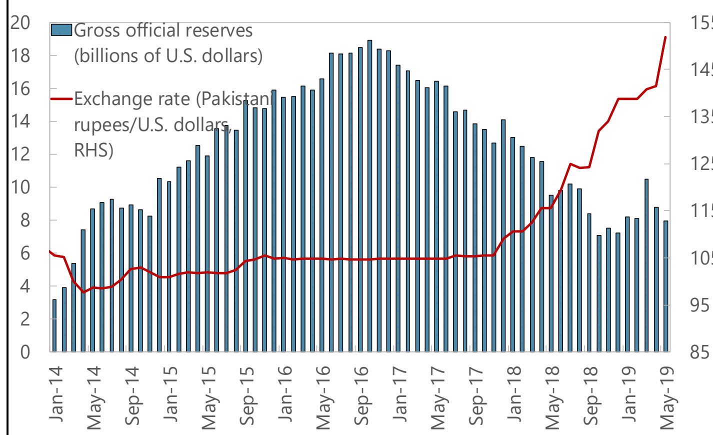
* FY19 or latest data available. Includes PIA, PSM, Railways, and DISCOS.

[1] Circular debt refers to the cash flow shortfall incurred in the power sector from the non-payment of obligations by consumers, distribution companies, and the government.

[2] Implicit tariff subsidies granted to special groups (exporters, agricultural tubewells, AJK) have remained outside the budget and their non-payment have given rise to the accumulation of circular debt.

6. The external position remains fragile and substantially weaker than suggested by fundamentals (Box1). Although the current account deficit has narrowed in recent months reflecting the exchange rate depreciation (19 percent in real effective terms in FY 2019) and tightening of monetary policy by a cumulative 650 bps, it is still expected to remain large at around $13 billion in FY 2019 (4½ percent of GDP) due to higher oil imports and tepid export growth. The SBP continued with significant foreign exchange interventions, and gross reserves stood at $8 billion (1.7 months of imports or around 30 percent of the ARA metric) at end-May, notwithstanding large financing from Saudi Arabia and UAE ($8.2 billion in total; $5 billion already disbursed) and China ($2.2 billion disbursed).[3]

International Reserves and Exchange Rate



Source: State Bank of Pakistan.

7. The banking sector has been broadly stable, but increasingly reluctant to provide credit to the government. Amid sustainability concerns, banks have been demanding very short maturities, accentuating the government's difficulty to finance its large deficit and roll over maturing domestic debt. Although the banking sector remains broadly stable, vulnerabilities have emerged. System-wide capital adequacy (16.1 percent in March 2019) remains well above the regulatory minimum, but there are five instances of small banks violating the minimum absolute capital and/or minimum capital adequacy ratio. Nonperforming loans (NPL) declined to 8.2 percent by March 2019 (from 8.3 percent a year ago) reflecting still strong private credit growth (16.1 percent yoy in March 2019), though NPLs in the SME sector and agriculture remain high (15 and 17 percent, respectively).

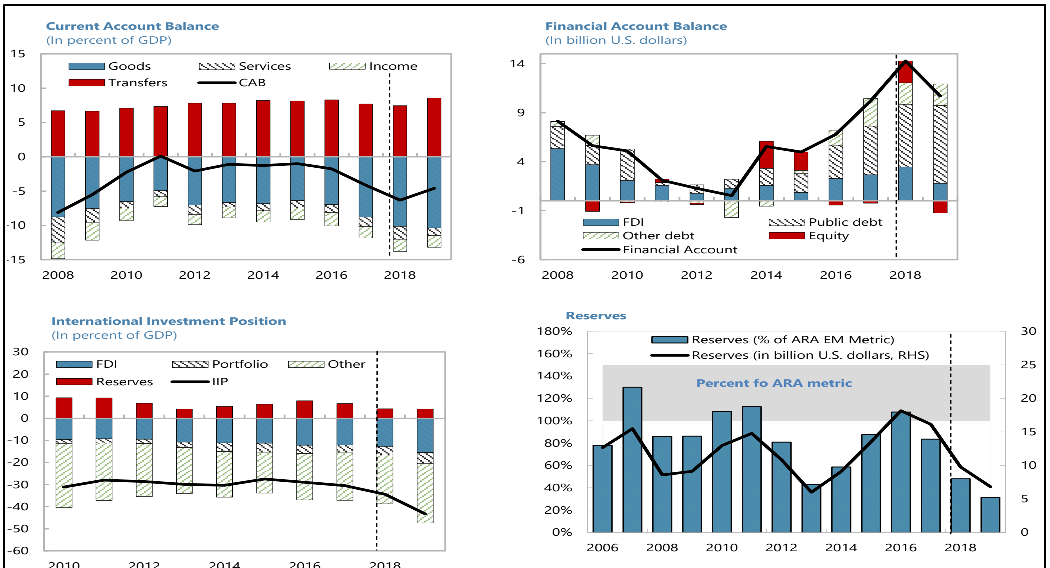
8. Pakistan lags regional peers on inclusive growth and social conditions (Table 11). While the unemployment is less than 6 percent, participation is low (around 30 percent) and informality remains high at over 70 percent of all economic activity. While declining, poverty remains high, at around 30 percent of the population. Moreover, literacy rates remain low relative to peers (60 percent vs. 80 percent), especially among women. Finally, Pakistan must also grapple with the demographic challenges from a population boom, with 2/3 of the population under the age of 30, underscoring the need for improved education and job creation.

[3] Net international reserves were significantly negative at around –$16 billion at end-May 2019, factoring in the PBOC swap line, liabilities to other central banks, and forward/swap position with domestic banks, which will continue to strain the external position.

Box 1. Pakistan: External Sector Assessment

While the external position in FY 2018 was substantially weaker than suggested by fundamentals and desirable policies, REER depreciation in FY 2019 and the resulting narrowing of the current account deficit point to an improvement in the external position and the REER getting close to its equilibrium level.

The current account deficit started to narrow in FY 2018/19:H2 on the back of rupee depreciation, after widening to 6.3 percent of GDP in FY 2017/18. The narrowing has been mainly driven by import compression, particularly non-oil imports. Remittances, which account for 6½ percent of GDP, exhibited strong growth of 10.4 percent in July-May FY 2018/19. Nonetheless, higher oil prices have partly offset the import compression. Export growth remains tepid due to lower export prices and also partly constrained by structural impediments such as weak institutions and business environment.



Sources: SBP; and IMF staff estimates.

Real exchange rate. The REER depreciated by around 21 percent so far in FY 2018/19, mainly driven by nominal depreciation of around 26 percent since the start of FY2018/19. The REER Index model pointed to an REER gap of 7 percent as of January 2019, but the latest depreciation points to the REER coming close to its equilibrium level.

The financial account balance is projected to decrease in FY 2019 due to weak FDI inflows and equity outflows. Uncertainty surrounding the macro outlook and delayed policy adjustments contributed to the weak FDI, which is expected to fall to 0.6 percent of GDP in FY 2018/19. The net public external borrowing is projected to increase to 3.1 percent of GDP in FY 2018/19 on a widening fiscal deficit. The Net International Investment Position (NIIP) has further declined on falling reserves and increased borrowing.

External position. The EBA CA model for FY 2017/18 suggested a gap of –4.4 percent for FY 2017/18, substantially weaker than fundamentals and desirable policy settings. However, in FY 2018/19, improvement in the current account deficit and the REER point to a continuing improvement in the external position. Although the FY 2017/18 data indicated that the overvaluation of a wide range from 7–42 percent, REER depreciation taken place in FY 2018/19 (totaling 21 percent) indicates that forward-looking estimates of overvaluation would be much less than the top end of the range, with the REER gap model particularly suggesting that the REER is getting close to its equilibrium level. Estimates from these standard methodologies for the assessment of the external position are subject to significant model uncertainty.

Pakistan: EBA for FY2017/18 1/

	EBA
Overvaluation based on CA Gap	42%
- Cyclically adjusted CA	-5.5
- Cyclically adjusted norm	-1.1
- CA gap	-4.4
REER Gap 2/	7%
REER Gap (ES Approach)	33%

1/ CA and ES model is based on the data for FY2017/18.
2/ The EBA REER Gap model includes depreciation through January 2019.

PROGRAM OBJECTIVES AND POLICIES

9. The authorities' program, supported by the proposed EFF arrangement, aims at restoring economic sustainability and laying the foundation for balanced growth. The program strategy is anchored on three pillars:

- Effective macroeconomic stabilization with protection for the most vulnerable. This includes: (i) a sharp reduction of the fiscal and quasi-fiscal deficits through a multi-year revenue mobilization effort aimed at generating 4–5 percentage points of GDP in additional tax revenue, and a strategy for cost recovery in energy and SOEs; (ii) a market-determined flexible exchange rate to reduce external imbalances, improve competitiveness, and support the build-up in international reserves; (iii) an independent, forward looking, and data dependent monetary policy to shore up confidence and reach the inflation objective; and (iv) more social and development spending to protect the most vulnerable.

- Governance and structural reforms to strengthen institutional frameworks and foster stronger growth. Key elements include (i) improving public financial management to instill more fiscal discipline and greater budgetary transparency; (ii) more autonomy for the State Bank of Pakistan as it prioritizes price stability; (iii) reforming the energy sector to ensure efficiency and better services; (iv) modernizing the SOE legal framework; (v) strengthening anticorruption institutions; and (vi) removing bottlenecks and regulatory impediments to investment and job creation.

- Adequate new financing to support the policy efforts. Catalyzing new external financing from official and bilateral partners will be essential to close the financing gap and allow reforms to work

A. Macroeconomic Framework

10. Sustained reform implementation is expected to steadily reduce imbalances and deliver higher and more balanced growth:

- In the near term, economic activity is expected to decelerate to below its potential. Higher interest rates together with fiscal consolidation and administered price adjustments will constrain credit growth, incomes, and domestic demand in 2019/20. A gradual increase in confidence as well as in public development spending will offset some of the impact on the economy, while targeted increases in social assistance will help offset most of the impact on the most vulnerable.

- Over the medium term, real GDP growth is projected to recover to 5 percent assuming steady implementation of reforms. As stabilization takes hold, higher private sector investment supported by rising FDI and private sector credit will spur domestic demand. A real effective exchange rate in line with economic fundamentals will increase the competitiveness of Pakistani goods and services, providing an additional boost to domestic production from expenditure switching and to exports.

- Following an initial increase in inflation driven by currency depreciation, appropriately tight monetary policy—aimed at keeping a positive real policy rate—is projected to bring inflation down to around 5–6 percent in the medium term.

- The fiscal deficit is projected to decline in line with the Fiscal Responsibility and Debt Limitation Act (FRDLA) deficit target as the authorities' broad-based tax policy and administration reforms take hold. These measures will place general government debt on a declining path, reaching 67 percent of GDP by FY 2024, after peaking at 80.5 percent of GDP in FY 2020.

- The current account deficit is expected to quickly adjust and narrow to less than 2 percent of GDP by FY 2024. Initially, import demand will be contained by tighter fiscal and monetary policies, while a gradual export recovery will take hold, underpinned by competitiveness gains from the real depreciation and new investment. Increasing remittances and FDI flows, as well as multilateral and bilateral creditor financing will provide financing in the coming years. International reserves will gradually recover to over 4 months of import cover by 2023, albeit still short of 100 percent of the Fund's ARA metric.

- While the authorities are committed to carrying out this program, the outlook is subject to considerable risks given the extensive policy and reform agenda. The risks relate mainly to domestic policy implementation as well as external events (see a detailed discussion in para 37).

B. Fiscal Policies

11. The fiscal program is centered on ensuring debt sustainability by reducing fiscal and eliminating quasi-fiscal deficits on the back of stronger revenue mobilization efforts while creating space to support social and development spending. Given Pakistan's low tax ratio and limited scope to reduce spending and the insufficient resources allocated to priority areas, staff and the authorities shared the view that the fiscal strategy should focus on increasing revenue through broad-based tax policy and administration reforms to raise the tax to GDP ratio by 4–5 percentage points. These should aim at improving the primary deficit by 4½ percent of GDP by FY 2023 and bringing the overall fiscal deficit to around 2½ percent of GDP, in line with the FRDLA. These efforts, along with the other policies under the program, are expected to reduce general government debt from 80.5 percent of GDP in FY 2020, to 67 percent of GDP by FY 2024. At the same time, the revenue mobilization efforts will aim at creating space for higher spending on investment, human capital development, and social protection.

12. The FY 2020 budget adopted by Parliament in late June is consistent with these objectives (prior action). The budget targets a primary fiscal adjustment of 1.2 percent of GDP underpinned by high-quality permanent revenue measures of 1.7 percent of GDP (see Box 2). On the expenditure side, the budget now incorporates implicit subsidies in the power sector that in the past were not budgeted and had contributed to the build-up of circular debt. Moreover, and to support the adjustment efforts, federal government wages are expected to increase by 7.5 percent, below the rate of inflation.

13. The budget supports stronger social spending. To ease the impact of the adjustment on the most vulnerable, the FY 2020 contains a significant increase in social safety net spending. Allocations to the Benazir Income Support Program (BISP), the main and best-regarded social assistance program at the federal level, will be increased by 80 percent on an annual basis. Moreover, the budget contains an additional PRs 50 billion in subsidies to insulate the poorest households from increases in power tariffs. Going forward, staff and the authorities agreed to reassess the need for additional social spending as the adjustment policies take hold and their impact on the most vulnerable can be better assessed.

14. A multi-year effort will aim to revamp tax policy and tax administration. With less than 1.5 million taxpayers filing tax returns and tax compliance generally very low, tax policy and tax administration measures will center on broadening the tax base while maintaining a low tax rate, aiming to ensure progressivity of the tax system. Staff and the authorities concurred that an additional 4-5 percentage points of GDP in additional tax revenues could be achieved by the end of the program, bringing Pakistan tax ratio in line with peer Emerging Markets. Key measures include:

- Tax policy reforms. In the near term, measures include removing exemptions and preferential treatment to reduce distortions in the tax system and broaden the tax base. These include the removal of GST exemptions and preferential rates, except for basic food and medicines, a measure that will significantly improve revenues. Greater inter-provincial harmonization and coordination of GST will also simplify filing procedures and increase compliance. Overtime, the authorities are committed to taking steps to transform the GST into a broad-based VAT and making the PIT fairer and more progressive by raising the upper-end of the PIT structure and consider eliminating PIT tax credits and deductions for the higher income brackets. In addition, other tax policy measures include: (i) further strengthening taxation on real estate and on agricultural turnover or income by provinces; (ii) ensuring equivalent taxation of all sources of income; and (iii) eliminating distortionary withholding taxes.

- Tax administration reforms to bolster the authorities' efforts to collect taxes. Implementation of a full, risk-based audit framework will be facilitated by the recent reversal[4] of legal provisions limiting the use of tax audits and will be supported by an increase in legal penalties for non-compliance. Moreover, licenses for the track-and-trace system for excises on cigarettes will be issued by end-September 2019 (structural benchmark), with a system roll out by end-March 2020. The authorities are also considering options to make Pakistan's tax administration less fragmented and more business friendly, including through the creation of a new semi-independent national tax authority to collect the main revenue sources. Finally, the authorities have committed to not granting further tax amnesties (continuous structural benchmark).

[4] Adopted in the context of the FY 2020 Finance Bill.

Box 2. Pakistan: Budget FY 2019/20

The FY 2019/20 budget envisages a substantial fiscal consolidation. The primary deficit is expected to decline to 0.6 percent of GDP, from estimated 1.8 percent of GDP in FY 2018/19.

The envisaged fiscal consolidation will be largely revenue driven:

a) **Sales tax** measures are mostly focused on simplifying the system by eliminating numerous exemptions and preferential rates and enhancing the sales tax of petroleum products. In particular, exemptions granted to four export-oriented sectors for domestically sold products will be eliminated, together with non-essential food related products exemptions. Moreover, preferential rates related to sugar, steel sector, edible oil, medium and large retailers will also be eliminated and aligned with the standard 17 percent sale tax rate.

b) **Income tax** measures will aim at widening the tax base and closing the loopholes that are fostering tax avoidance. The income tax threshold will be reduced for salaried and non-salaried individuals to PRs 600,000 and PRs 400,000 respectively, and the tax rate at the top of income distribution increased. The collection of withholding tax on telecom services that had been stalled in the court will be resumed, and tax credit available for machinery investment and to non-profit organizations will be rationalized. The FBR will also align the value of immovable properties with market rates and specify conditions under which the long-term lease hold will be considered as the purchase of property. In addition, the minimum tax rate will increase and taxation of gifts from unrelated persons will be introduced.

Pakistan: Budget FY 2019/20 Measures
(Percent of GDP)

Primary deficit reduction	**1.2**
Deficit enlarging measures	**0.5**
social spending	0.2
power subsidy	0.2
federal development spending	0.1
provincial development spending	0.1
Fiscal consolidation measures	
Tax Revenues	**1.7**
Sales tax	**0.5**
Withdrawal of exemptions and preferential rates	0.4
Increase tax and levy on petroleum products	0.1
Income tax	**0.7**
PIT: lower the threshold and increase tax rates	0.2
Withholding rate: resume telecom tax; higher rate to non-filers	0.1
Rationalization of tax credits and amortization of expenditure	0.1
Capital gain: immovable property valuation; redefine property purchase	0.1
Other: minimum tax, gift taxation, change in tax regime for some services	0.1
Federal Excise Duty (FED)	**0.2**
Increase/introduce FED on cement, cigarettes, sugary drinks	0.2
Customs	**0.1**
Withdrawal of exemptions and incerease in some custom duty rates	0.1
Revenue administration measures	**0.1**
Expenditures	**0.2**
federal current spending rationalization	0.1
provincial current spending rationalization	0.1

c) **Federal excise duties** on certain products will be introduced or increased (cigarettes, sugary drinks, cement); while

d) **custom duty** measures will eliminate the exemptions on import of liquified natural gas and increase the additional custom duty for finished and luxury goods.

e) **Revenue administration measures** will support policy implementation. The emphasis will be given to the modernization and digitalization of FBR functions, improvement of the database and the streamlining of legal procedures. To strengthen the collection of excises on cigarettes and eliminate illicit trade, the track-and-trace system will we implemented in the second quarter of the year.

On the expenditure side, the budget envisages an increase in social and capital spending in order to protect the most vulnerable segments of population and meet critical development needs. At the same time, some rationalization in current spending will be achieved through limiting the wage increase of federal and provincial government below the rate of inflation.

15. Public financial management reforms will help instill budgetary discipline, improve transparency and confidence in the spending of budgetary resources. The recent adoption of the Public Financial Management Act[5] will increase fiscal discipline by requiring parliamentary approval of budget authorizations. Furthermore, recent legal amendments will limit the use of Statutory Regulatory Orders (SROs) to genuine emergencies.[6] Going forward, the authorities will: (i) strengthen the implementation of the FRDLA by aligning the annual report presented to the National Assembly with the content and analysis prescribed in the Act; (ii) expand the MoF's capacity for macro-fiscal work and introduce a fiscal risk unit in the MoF for proper identification and monitoring of fiscal risks, including from SOEs, PPPs, and development projects; (iii) strengthen the PPP framework by conducting a legal analysis of the current framework and addressing possible gaps; (iv) create a Treasury office in the MoF tasked with conducting sound commitment controls and cash management, closely coordinated with the debt management unit. The authorities' debt management strategy will aim at lengthening the maturity profile and widen the investors' base.

16. The provinces are committed to contribute to the consolidation effort. The federal and provincial governments have formally agreed on the program's fiscal strategy and the required provincial surpluses (*prior action*). Provinces have agreed to deliver surpluses of around 1 percent of GDP in FY 2020, gradually increasing to 2.7 percent by the end of the program, by saving the additional revenues generated through tax policy and administration reforms. To support these efforts, the provinces will aim to increase collection of property and sales taxes, and to assume more spending responsibility. The Fiscal Coordination Committee will meet quarterly to assess progress toward these goals. Nonetheless, stronger institutional arrangements will be required to ensure the sustainability of the envisaged fiscal consolidation. To this end, and in the context of the ongoing National Finance Commission Award, the federal and provincial governments will seek to make progress on measures aimed at better rebalancing inter-governmental relationships and improve inter-provincial horizontal equity.

C. Poverty Reduction and Social Protection

17. The program supports the authorities' commitment to expand the social safety nets and reduce poverty in Pakistan. Pakistan lags regional peers and other emerging markets in poverty reduction and inclusive growth, with a poverty headcount at around 30 percent of the population. The recently introduced *Ehsaas* program is the authorities' main poverty reduction strategy, aimed at reducing inequality, supporting the economic empowerment of women, and lifting areas where poverty is higher. BISP, working with international partners, is responsible for the implementation of social assistance programs through their conditional and unconditional cash transfer programs, currently reaching over 5 million families. The authorities will strengthen BISP and social assistance programs by:

[5] Adopted in the context of the FY 2020 Finance Bill.

[6] In the past, the Executive has issued SROs to grant tax exemptions and concessions without prior National Assembly approval. This greatly weakened fiscal discipline and eroded tax collection.

- Protecting the most vulnerable from the impact of adjustment policies by providing a one-off disbursement of PRs 1,000 to existing BISP beneficiaries by end-August 2019.

- Making the disbursement of stipends more efficient by signing new banking contracts and, in parallel, launching the "one woman one account" initiative that will ensure financial and digital inclusion of around 6 million women by end-October 2019 (*structural benchmark*).

- Boosting girls' educational enrollment by augmenting the BISP-provided Waseela-e-Taleem CCT program with a girl bonus of PRs 250 to be regularly provided on a quarterly basis (end-December 2019 *structural benchmark*).

- Finalizing the update of the National Socio-Economic Registry (NSER) by end-June 2020 (*structural benchmark*). This update is crucial to better reflect Pakistan's poverty structure and will allow for the enrollment of new beneficiaries. Following completion of the database, the authorities will increase the amount of cash transfers from the current PRs 5,000 and will seek ways to index benefits.

- Launching of new programs under BISP such as the graduation program and a program on nutrition.

D. Monetary and Exchange Rate Policies

18. To correct imbalances and support the build-up of reserves, the SBP is committed to a flexible, market-determined exchange rate. The SBP has announced this change to modernize the foreign exchange rate regime and the functioning of financial markets, and to contribute to a better allocation of resources in the economy. It will help to reduce accumulated external imbalances, provide a buffer against shocks, and support the rebuilding of international reserves. In this context, since May 16, 2019, the SBP has allowed the exchange rate to be market determined. To reduce risks to inflation and strengthen confidence, monetary policy has been tightened by 150 bps. Going forward, the SBP might intervene to prevent a possible overshooting or disorderly market conditions (DMCs), while at the same time not suppressing an underlying trend and in a manner consistent with rebuilding reserves. These sales will not be sterilized, such that the stance of monetary policy will be correspondingly tightened if intervention is needed. Finally, to remove future drains on its reserves, the SBP has agreed to gradually scale back its short swap/forward foreign exchange position to US$ 4 billion by the end of the program.

19. The SBP will maintain an appropriately tight monetary policy to guide inflation and inflation expectations. To this end, it will maintain a positive policy rate in real terms consistent with the SBP's medium-term inflation objective and the program's monetary aggregate targets. Until the SBP has further advanced preparations toward an inflation targeting framework, NDA and NIR targets will guide money supply to rates consistent with the inflation objective of 5–7 percent. In addition, the NIR targets will guide the reserve accumulation under the program.

20. To support the new monetary policy framework, SBP financing of budget deficit will be eliminated. Direct SBP financing of the budget has increased from around PRs 3.6 trillion in FY 2018 to over PRs 7.7 trillion (around 20 percent of GDP) today. This fiscal dominance has greatly compromised the SBP's operational independence, jeopardizing the achievement of the inflation objective. The authorities are committed to refrain from any new direct financing of the budget by the SBP (*continuous performance criterion*) and to gradually reduce the SBP stock of net government budgetary borrowing (*performance criterion*). Moreover, the SBP and the MoF have agreed to reprofile the stock of mostly short-term government debt held by the SBP into short- and long-term tradable instruments of various maturities (one, three, five, and ten years) at interest rates close to market levels. This operation will take place before the adoption of the amended SBP Act (see below) and will support debt sustainability, reduce the government's interest bill, and avoid crowding out of private credit.

21. The SBP Act will be amended to strengthen SBP's autonomy, governance, and mandate. These amendments will address the recommendations of the upcoming 2019 Safeguards Assessment Report, including in areas such as operational independence and governance, governor's tenure, and financial autonomy and accountability. The amendments will ensure price stability as SBP's primary objective and prohibit any form of direct credit to the government. Amendments to the SBP Act will be submitted to parliament by end-December 2019 (*structural benchmark*).

22. The authorities are committed to eliminating the existing administrative restrictions, which have been imposed to support the balance of payments. These measures include regulatory duties on imported intermediate, consumer, and luxury goods, as well as import restrictions for balance of payments purposes and multiple currency practices (MCP)—in the form of: (i) a requirement to fully pre-fund letters of credit, imposed in early 2017; and (ii) restrictions on advance payment for imports against letters of credit, imposed in July 2018—which are subject to approval under Article VIII of the IMF's Articles of Agreement. During the program period, they will not introduce or tighten exchange restrictions, MCPs, or import restrictions for balance of payments purposes (*continuous performance criterion*).

23. Financial sector resilience will be strengthened. The direct impact of currency depreciation on the banking system should be contained given low dollarization (7.4 percent on loan and 12.9 percent on deposit side), but recapitalization needs may arise for some small banks.[7] Nonetheless, the authorities will closely monitor the potential adverse impact of adjustment policies on NPLs and individual banks' capitalization and will stand ready to take the necessary measures to ensure that all banks remain well capitalized. Furthermore, the SBP has asked all small undercapitalized banks to submit by end-September 2019 plans on how they will ensure compliance with capital requirements by end-June 2020, including via mergers or sale to new private investors. Failure to implement these plans will result in SBP intervention and resolution under the relevant

[7] Stress tests indicate that 30 percent depreciation would not push any bank to below minimum capital adequacy. However, a parallel upward shift in the yield curve by 300 bps would send three banks below the minimum CAR.

provisions of law. In this context, the SBP has also initiated the liquidation of a small undercapitalized publicly-owned bank.

24. **The effectiveness of Pakistan's AML/CFT regime must be urgently strengthened to support its exit from the Financial Action Task Force (FATF) list of jurisdictions with serious deficiencies**. Pakistan was placed in the FATF list in June 2018 owing to shortcomings in effectively addressing terrorist financing risks. The authorities are stepping up efforts to implement all measures committed to in an action plan with the FATF (end-October 2019 *structural benchmark*) to support the country's exit from the FATF list. The National Executive Committee (NEC) is monitoring and coordinating efforts to implement the FATF action plan. The Asia Pacific Group on Money Laundering is expected to discuss Pakistan's mutual evaluation report in August 2019. The authorities will work with technical assistance providers, including the IMF, to complete the action plan and further strengthen the effectiveness of the AML/CFT regime.

E. Energy Sector Policies

25. **The authorities are launching ambitious reforms in the energy sector aimed at addressing inefficiencies and eliminating quasi-fiscal losses**. They recognize that structural weaknesses in the energy sector have long remained unaddressed, and that only an all-encompassing strategy, including pricing policies and supply and demand management, can deliver the improvements needed to make Pakistan's energy sector an engine of growth rather than a hindrance.

26. **Eliminating power sector losses on a sustainable basis will require both new pricing policies and improvements in governance and infrastructure**. There are three main sources of arrears in the power sector: effective tariffs below the required levels and only approved with significant delays; implicit subsidies provided by the government that have long remained unbudgeted; and technical and distribution losses. The authorities aim to address the first two sources in the near term while preparing a plan to tackle the third source of arrears over the course of the program, Key measures include:

- An adequate pricing structure reflective of costs. This is essential to eliminate the accumulation of circular debt as new capacity comes into the system, and to make the sector a more attractive investment opportunity. The authorities have initiated the automatic quarterly adjustment of tariffs with a first tariff increase of over 10 percent to generate PRs 150 billion in additional revenue (*prior action*). This adjustment will help to address the circular debt accumulated over the first half of FY 2019. A second quarterly adjustment will take place before end-August. Moreover, the FY 2020 electricity tariff schedule will be notified as determined by the regulator by end-September 2019 (*structural benchmark*). Going forward, the authorities are committed to streamline and make more predictable the tariff notification process. To this end, amendments to the NEPRA Act will be submitted to parliament by end-December 2019 (structural benchmark) with a view to (i) ensuring full automaticity of the quarterly tariff adjustments and

(ii) eliminating the gap between the regular annual tariff determination by the regulator and the notification by the government.

- Structural changes to be informed by a comprehensive strategy to address circular debt. The authorities will prepare by end-September 2019 (*structural benchmark*) a comprehensive plan to reduce circular debt, with quarterly targets for the reduction of arrears through improvements in collection, efficiency gains, and enhanced governance. The plan will also include options to tackle the outstanding stock of circular debt.

27. The authorities are also taking actions to improve performance in the gas sector. To this end, a multi-pronged strategy includes: (i) the prompt adoption of the FY 2020 gas tariffs as proposed by the regulator to become effective on July 1, 2019 (*prior action*); (ii) the reduction of losses in the sector through the preparation of a comprehensive plan for government approval by end-September 2019 and to be monitored through published quarterly reports; (iii) greater participation of the private sector in the gas sector, including via the unbundling of the two gas companies; and (iv) amendments to the OGRA Act to ensure the regular and timely notification of end-consumer tariffs.

28. The policy of protecting lower-income households from higher energy prices will continue. Currently, households consuming 300 units (kwt-h) or below (about 70 percent of all household consumers) are insulated from annual tariff increases. The authorities will continue with this practice and will moreover allocate for this year a new subsidy equivalent to 0.1–0.2 percent of GDP to insulate those same consumers from the impact of the recently introduced quarterly tariff adjustment.

F. Structural Policies

29. Addressing structural impediments to investment and job creation will be key to spurring balanced growth and human capital development. Staff and authorities agreed that only through stronger governance and transparency and an improved business environment will Pakistan realize its full economic potential. Pakistan currently ranks 136 out of 190 countries in the World Bank’s Doing Business Indicators, with excessive regulations and licensing requirements, obstacles to paying taxes, and difficulties trading across borders and registering property as key structural impediments. They are committed to taking bold measures to create an enabling environment for investment and job creation. Key measures in the authorities’ strategy include:

- *Improving State-Owned Enterprises (SOEs) governance, transparency, and efficiency*. Key objectives for the near term include:
    - ***Initiating the privatization of selected enterprises***. The authorities have approved the privatization of seven companies based on their good privatization prospects. They will follow best practices regarding the process and conditions of privatization to ensure a successful and transparent outcome.

  - ***Increasing SOE transparency through new audits***. New audits of Pakistan International Airlines and Pakistan Still Mills will be conducted by reputable international auditors and published by end-December 2019 (*structural benchmark*).

  - ***Triage of SOEs***. The authorities will sort SOEs into companies for sale, liquidation, or retaining under state ownership by end-September 2020 (*structural benchmark*).

  - ***Enhancing the SOE legal framework***. The authorities will submit to parliament a new State-Owned Enterprise Law by end-September 2020 (*structural benchmark*) aimed at modernizing and clearly defining the role of the State as owner, regulator, and shareholder of SOEs. In this context, the recently established holding company to manage SOEs will follow the required governance and transparency principles in line with international best practices. The IMF will provide technical assistance to support the development of this law and to review ownership arrangements with a view to designing an effective ownership model.

- *Improving the business environment* to encourage private investment and job creation. The authorities will aim to

  - ***Improve trading across borders***. This will include reducing custom-related processing time and reducing hours to prepare import/export documents. Moreover, the authorities will review the tariff policy with a view to facilitating trading across borders.

  - ***Simplifying procedures to start a business***. Through the adoption of e-registration and streamlining the required documentation.

  - ***Eliminating unnecessary regulations***. The authorities will conduct a systematic review of existing regulations to remove those that most hinder investment.

- *Strengthening governance and the control of corruption.* Priorities include:

  - ***Strengthening the effectiveness of anticorruption institutions***. A national committee has been established to implement the recommendations from the UNCAC 2017 report. A task force will review the institutional framework of the anticorruption institutions to enhance their independence and effectiveness in investigating and prosecuting corruption cases. A study will be conducted on establishing a dedicated AML unit in the Federal Investigation Agency (FIA). Upgrading the financial investigation capacities of law enforcement agencies will be also prioritized. Moreover, the authorities are pursuing agreements on information exchange with foreign countries to complement efforts to recover unlawful assets. An Asset Recovery Unit in the Prime Minister's Office is cooperating with the FBR's International Taxation Unit in identifying assets abroad owned by Pakistani residents, in line with the OECD Convention on Mutual Administrative Assistance on Tax Matters.

  - ***Advancing anti-corruption efforts*** through the enhanced used of AML tools, including by (i) ensuring that banks and other reporting institutions improve their capacities to identify politically exposed persons and apply enhanced due diligence measures and (ii) providing adequate resources to the Financial Monitoring Unit to improve the dissemination of financial intelligence that can be used to support corruption investigations. Moreover, asset declarations of high-level public officials will be comprehensive in scope (i.e., assets beneficial owned or located abroad), filed with a central federal agency, electronically searchable, and appropriately verified.

- ***Registering prize bonds*** and other bearer instruments to eliminate their use in potential illegal activities/tax avoidance.

PROGRAM ISSUES

30. The proposed program aims to incorporate lessons from Pakistan's previous Fund arrangements. In addition to the needed stabilization policies, the program focuses on advancing lasting governance reforms and institutional building, which should help policy implementation. Moreover, the authorities' emphasis on social protection and strengthening safety nets should help garner broad buy-in and political support to implement the ambitious policy measures. Upfront conditionality focuses on a limited number of critical measures and structural conditions over the program are phased in line with the authorities' implementation capacity. Technical assistance by the Fund and other donors will support the timely achievement of these reforms.

31. In addition, significant financial support by official and bilateral partners aims to provide an important safeguard. The program is expected to mobilize total financing of around $38.6 billion over the three years from Pakistan's international partners. The first 12 months are fully financed with the expected support from multilateral development banks and bilateral creditors as follows: China $6.3 billion, Saudi Arabia $6.2 billion, UAE $1 billion, the World Bank $1.3 billion, the Asian Development Bank $1.6 billion, and the Islamic Development Bank $1.1 billion. To support long-term debt sustainability, the authorities have also received firm commitments from key bilateral partners (China, Saudi Arabia, and UAE) to maintain their exposure throughout the program period and to adjust the financing modalities to ensure that the new financing will be consistent with the program debt sustainability objectives by ensuring a manageable external debt servicing profile beyond the end of the IMF-supported program.

32. In this context, the proposed 39-month extended arrangement will be geared toward helping the authorities address Pakistan's economic and structural problems and cover remaining financing needs. Program length reflects the structural nature of the challenges and the authorities' multi-year fiscal consolidation strategy. The longer repayment period under the EFF is appropriate given the nature of the balance of payment needs and will help avoid bunching of payment obligations immediately after the program ends. The proposed access of 210 percent of quota (SDR 4,268 million, equivalent to about $6 billion) is sufficient to cover Pakistan's remaining external financing needs, including SDR 2,184 million of repurchases to the Fund. Out of this amount, SDR 716 million is proposed to be disbursed upon approval of the arrangement to support policies at the start of the program. All purchases are proposed to go to the budget to support the adjustment, particularly due to the end of SBP financing of the budget, and given that external public debt service is a key source of the BoP need.

33. Program monitoring. The program will be initially monitored through quarterly reviews, becoming semi-annual after the first year based on adequate program implementation. The program sets performance criteria on net international reserves, net domestic assets of the SBP, the stock of SBP's net foreign currency swap/forward position, the primary fiscal balance excluding grants, the net government budgetary borrowing from the SBP, and the amount of government guarantees. Additional continuous performance criteria and indicative targets are presented in the MEFP (Table 1). The list of structural benchmarks is presented in MEFP (Table 2).

34. Prior actions. The following prior actions were undertaken to begin restoring macroeconomic stability:

- Adoption by parliament of the FY 2020 budget in line with program commitments.
- SBP announced move to a flexible market-determined exchange rate and tightened monetary policy by 150 bps.
- Reach formal and public agreement between the federal and provincial governments on the fiscal targets consistent with the program.
- Implementation of quarterly automatic tariff adjustment in the power sector by about 10 percent to generate PRs 150 billion in additional revenues. Notify by government the FY 2020 gas tariff adjustment as proposed by the regulator to become effective on July 1st, 2019.

35. Capacity to repay. Pakistan's capacity to repay its Fund obligations in a timely manner remains adequate but subject to higher than usual risks. Risks to Pakistan's repayment capacity have increased on account of the continued decline in reserves and a delay in the adoption of adjustment policies. The Fund's exposure to Pakistan currently stands at SDR 4,153 million (204 percent of quota or 55 percent of gross official reserves). The newly proposed purchases of SDR 4,268 million will result in outstanding purchases of SDR 5,967 million by December 2022 (42 percent of projected reserves or 294 percent of quota). The net purchases during the proposed program, however, will be around $2.9 billion, on account of the scheduled repurchases from the 2013 EFF disbursements of $3.1 billion. Adequate capacity to repay and debt sustainability will depend on strong policy implementation and the adequate execution of the existing financing commitments.

36. Safeguards assessment. An update safeguards assessment of the SBP has been initiated and will be completed before the first review. The SBP and MoF have also signed a memorandum of understanding on respective responsibilities for servicing the Fund credit to ensure uninterrupted repayments.

PROGRAM RISKS

37. Notwithstanding the safeguards included in the design and financing of the program, the risks to the program are particularly high. Managing successfully the transition to a market-determined exchange rate will be crucial to ensure popular support for the program. In this respect, failure to maintain an adequately tight monetary policy could lead to exchange rate overshooting and second-round effects on inflation. Fiscal slippages and resistance to some of the fiscal measures could undermine the program's fiscal consolidation strategy, thus putting debt sustainability at risk. Progress in governance and institutional building may be opposed by vested interests, weakening structural reforms and medium-term growth prospects. Moreover, the absence of a majority by the ruling party in the upper house may hinder the adoption of legislation needed to achieve program objectives. Also, there is a risk that provinces may underdeliver on their commitments to budget parameters and relevant objectives over the program period. The large amount of short-term debt implies significant rollover needs in the near-term. Finally, a potential blacklisting by FATF could result in a freeze of capital inflows to Pakistan, jeopardizing the financing assurances under the program. These risks are mitigated by (i) the upfront adoption of key policy measures, especially on greater exchange rate flexibility; (ii) securing formal and public agreements with the provinces on the overall fiscal strategy, including procedures to address deviations; (iii) prudent phasing of purchases; (iv) increasing social spending to protect the most vulnerable from the impact of reforms and garner support for these measures; and (v) strong commitments of support from the World Bank, ADB, and key bilateral partners and conservative assumptions on private financing flows. Other risks, including those related to domestic security conditions, global trade, growth in major trading partners, oil prices, and tighter global financial conditions, could exacerbate these challenges.

STAFF APPRAISAL

38. Pakistan is facing acute economic challenges. Less than three years after the completion of the last Fund arrangement, Pakistan 's economy is again under duress on the back of large fiscal and external financing needs, which have only been alleviated by short-term bilateral borrowing. Policy making and economic institutions have not been strong enough to ensure sound macroeconomic policies, giving rise to unbalanced growth, a heavy debt burden, and risks of a disorderly adjustment in the absence of a new program. Per capita growth has almost stalled, hampered by a difficult business environment, large informality, and an overvalued exchange rate.

39. The authorities' program aims to tackle long-standing policy and structural weaknesses. The program is based on three pillars: (i) stabilization measures, to support the needed macroeconomic adjustment. Greater social spending will protect the most vulnerable from the impact of these policies; (ii) structural and institutional reforms to foster stronger and more sustainable growth; and (iii) adequate new financing to cover Pakistan's large financing and development needs while allowing time for reforms to take hold.

40. Key elements of this program seek to break from the past recurrence of policy slippages. Upfront adoption of difficult measures, such as the move to a flexible market-determined exchange rate and adoption of a very ambitious FY 2020 budget, are testament of the authorities' commitment to reform. Similarly, provincial endorsement of key program parameters will facilitate the achievement of program targets. Moreover, the program's focus on lasting governance reforms and institutional building, including public finance management reforms, central bank independence, and SOE reforms including in the energy sector, will reduce the likelihood of recurring policy slippages. An emphasis on social protection will garner support for the authorities' policies.

41. Comprehensive fiscal reforms are critical to ensure fiscal sustainability. Adoption of the FY 2020 budget based on high-quality revenue measures is an important step in the right direction. Thereafter, reducing fiscal and quasi-fiscal deficits will require a multi-year revenue mobilization strategy, and a strategy for cost recovery in energy and SOEs. The tax base needs to be broadened through well-balanced and equitable measures, including by removing privileges, tax exemptions, and special concessions. Higher revenue will not only allow public deficit and debt to fall, but also open space for higher social and infrastructure spending that are critical for Pakistan's development. Lower public sector deficits will also permit more credit to the private sector for investment.

42. Maintaining a flexible market-determined exchange rate is key to reduce external imbalances, while sizable external financial support will also facilitate the buildup of reserves. The authorities also recognize that the rupee is best supported through strong policies and reforms that will restore confidence in the economy. Moreover, international partners need to support Pakistan with financing that is consistent with the objective of restoring debt sustainability and external viability.

43. Protecting the most vulnerable from the impact of adjustment policies is an important priority. Poverty reduction and social inclusion are crucial to ensure sustainable growth and garner broad buy-in for the authorities' policies. The inclusion of an indicative floor on social spending is a sign of the authorities' commitment to support the most vulnerable.

44. Strong efforts to strengthen institutions and remove impediments to growth will allow Pakistan to realize its full economic potential. Legislation to improve public finance management will strengthen accountability and transparency in the budgetary process. An independent and professional SBP will enable it to deliver on its mandate of price and financial stability, thereby guiding expectations in the years ahead. Reforming the energy sector and improving SOE governance will ensure efficiency and better services, thus boosting economic activity. Finally, improving the business climate, strengthening efforts to fight corruption, and enhancing the AML/CFT regime will create an enabling environment for private investment and reducing the large informal economy, key to boosting potential growth.

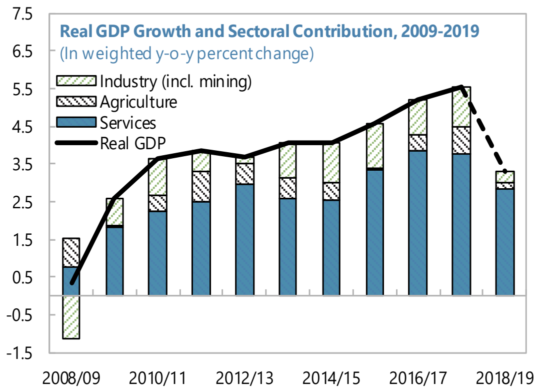
45. Strong and timely support by Pakistan's international partners will be essential for the program to succeed. Pakistan faces exceptionally large external financing needs in the coming years. The financing commitments received provide the necessary assurances for the program and are critical to cover financing needs and allow time for the program policies to work and take hold.

46. Risks to the program are significant, but the program offers Pakistan an opportunity to break from the unsustainable policies of the past. Pakistan's track record on program implementation has been weak, punctuated by incomplete reforms and policy reversals. The authorities' upfront efforts, exchange rate flexibility, fiscal consolidation and tariff adjustments in particular, may be received with strong backlash from vested interests and the wider population as the benefits may not be immediately obvious. Pressures to reverse policies may quickly emerge, which must be resisted to allow reforms to take hold and restore confidence. Similarly, the fruits from structural reforms may take years to materialize, possibly leading to reform fatigue and backtracking of policies. Strong ownership and an unwavering commitment to program implementation will be critical to ensure program success and turn Pakistan's economy around. In this context, international support will hinge crucially on the implementation of these reforms. Other political and external shocks may further complicate an already challenging environment.

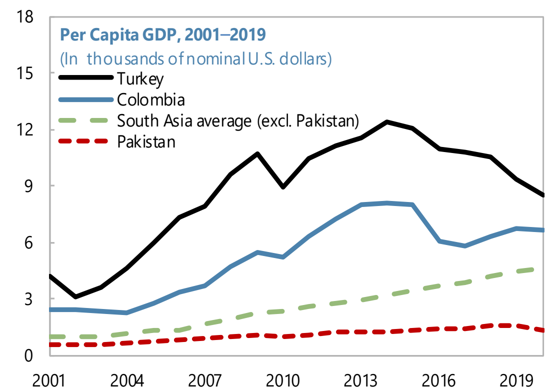
47. In view of Pakistan's structural balance of payments needs and the comprehensive package of adjustment measures proposed by the authorities, staff supports the authorities' request for an extended arrangement under the EFF in the amount equivalent to SDR 4,268 million (210 percent of quota). **Staff does not recommend temporary approval of the two exchange restrictions because the criteria for approval are not met.**

Figure 1. Pakistan: Selected Economic Indicators, 2008–19

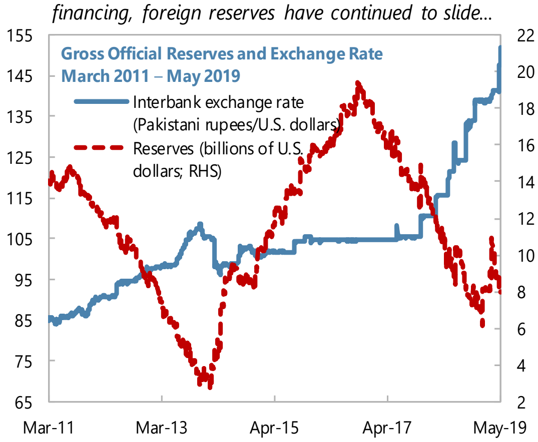
Reflecting declining confidence and tighter financing conditions, growth is projected to slow down sharply...



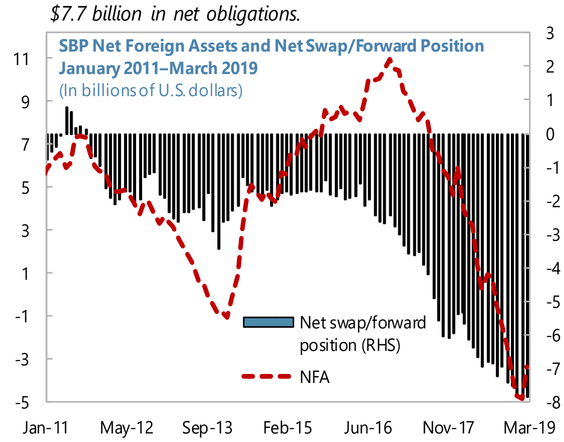
...as Pakistan continues to lag regional peers and other EMs in economic convergence.



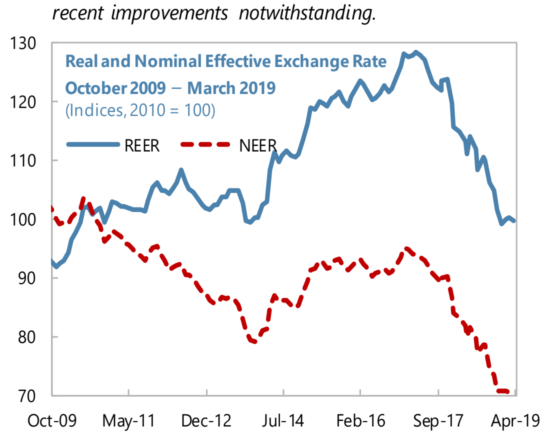
Despite the recent devaluations and bilateral financing, foreign reserves have continued to slide...



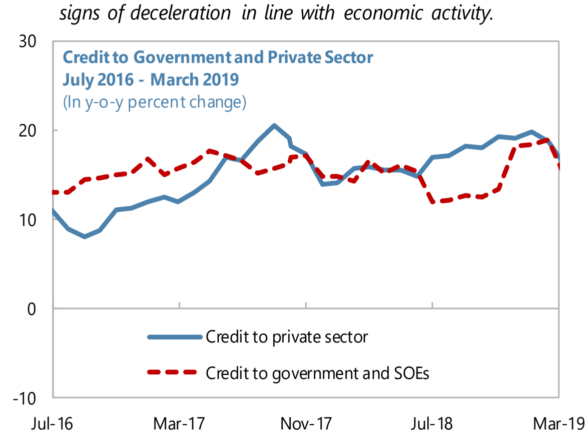
...pushing the SBP's derivative position to almost $7.7 billion in net obligations.



External competitiveness remains weak, some recent improvements notwithstanding.



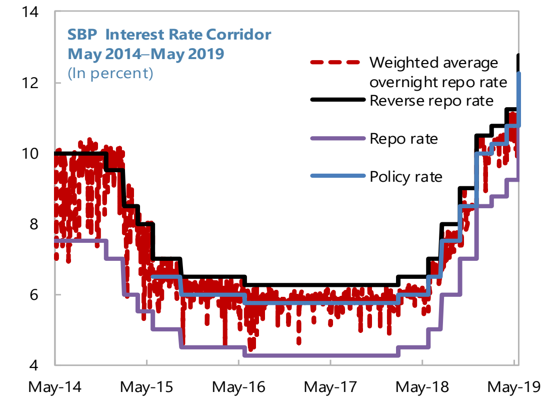
While still robust, private sector growth is now showing signs of deceleration in line with economic activity.



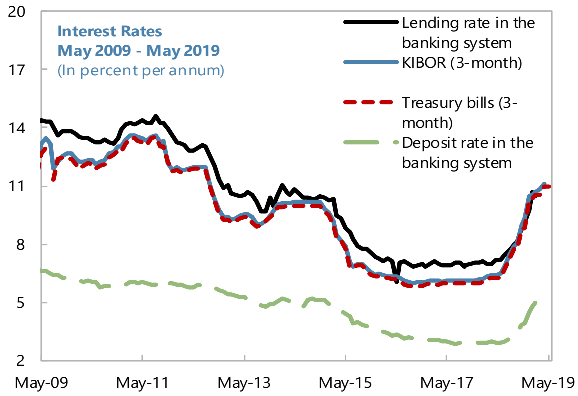
Sources: Pakistani authorities; IMF World Economic Outlook Database; and IMF staff calculations.

Figure 2. Pakistan: Selected Financial Indicators, 2009–19

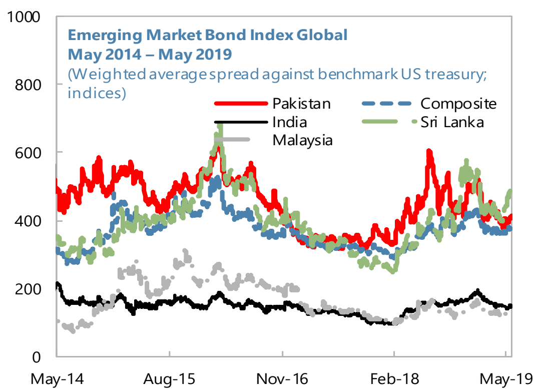
The SBP is stepping up the pace of monetary tightening as inflation has picked up...



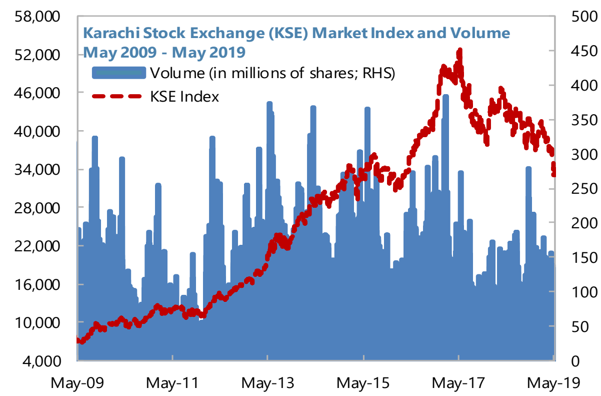
...and market rates are inching up in line with the policy rate.



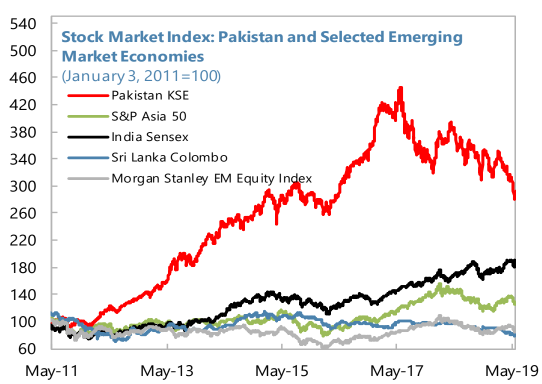
Pakistan bond spreads have widened, reflecting ongoing uncertainty and tighter global conditions,...



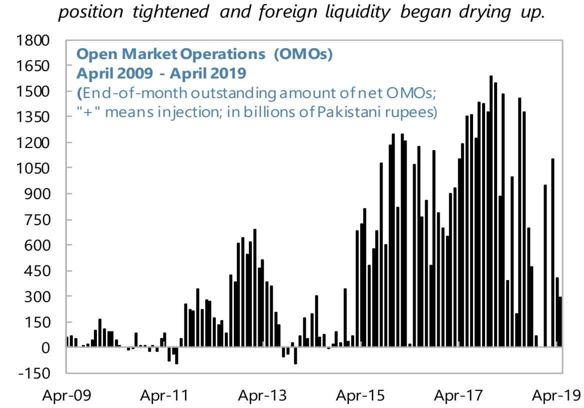
...and the stock market has entered a correction phase...



...much more pronounced than regional peers.



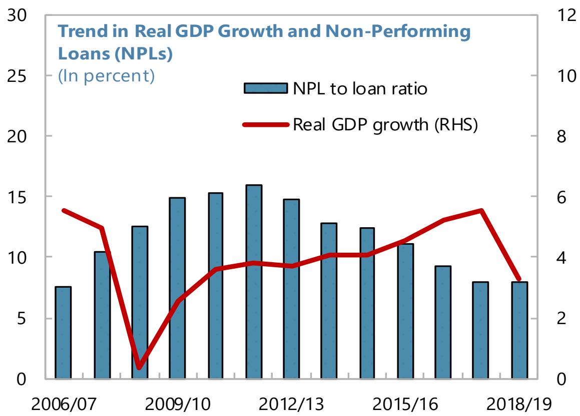
Liquidity injections via OMOs remain high, as the BOP position tightened and foreign liquidity began drying up.



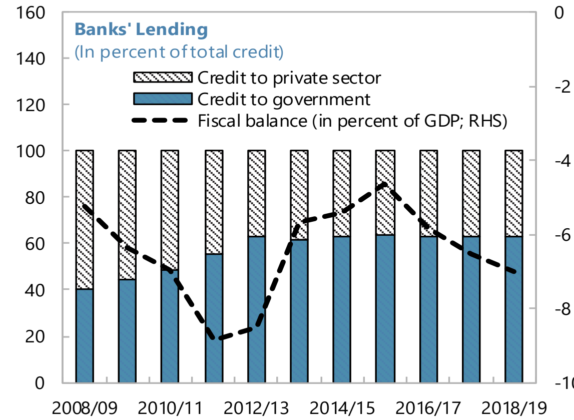
Sources: Pakistani authorities; Bloomberg; and IMF staff calculations.

Figure 3. Pakistan: Selected Banking, 2006–19

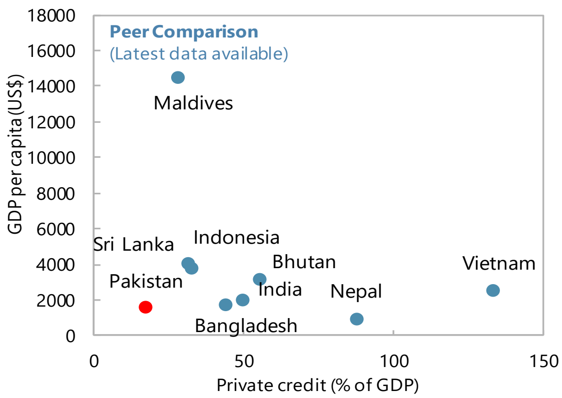
Signs that NPLs may be picking up as the economy slows down.



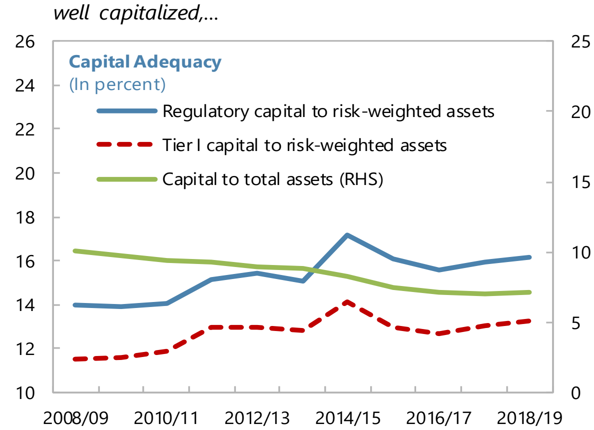
The banking system is oriented toward providing credit to government...



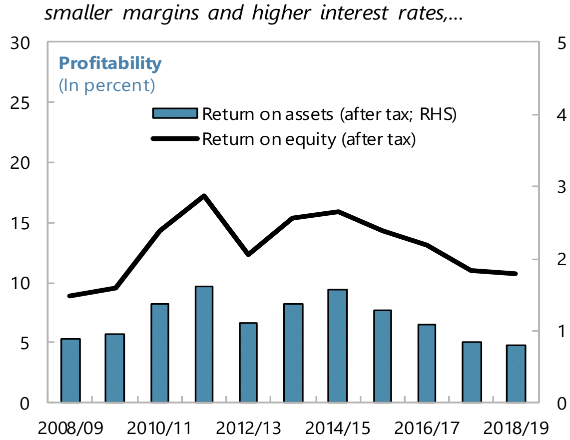
...leaving Pakistan behind peers in terms of private credit relative to the size of economy.



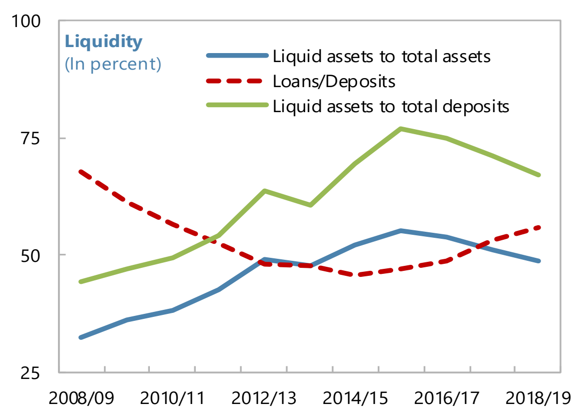
Nonetheless, the banking system remains well capitalized,...



...though profitability has been moderating reflecting smaller margins and higher interest rates,...



...while banks remain highly liquid.



Sources: Pakistani authorities; Bloomberg; and IMF staff calculations.

Table 1. Pakistan: Selected Economic Indicators, Program Scenario, 2014/15–2019/20 1/

Population: 207.8 million (2016/17; provisional)
Per capita GDP: US$1,463 (2016/17)
Poverty rate: 29.5 percent (2012/13)
Main exports: Textiles ($12.8 billion, 2015/16)
Unemployment: 5.9 percent (2014/15)

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
			Est.	Est.	Proj.	Proj.
			(Annual percentage change)			
Output and prices						
Real GDP at factor cost	4.1	4.6	5.2	5.5	3.3	2.4
GDP deflator at factor cost	4.3	0.4	4.0	2.4	7.5	11.8
Consumer prices (period average)	4.5	2.9	4.1	3.9	7.3	13.0
Consumer prices (end of period)	3.2	3.2	3.9	5.2	8.4	11.8
Pakistani rupees per U.S. dollar (period average)	-1.5	2.9	0.4	5.0	…	…
Pakistani rupees per U.S. dollar (end of period)	3.3	2.8	0.2	13.9	…	…
			(In percent of GDP)			
Saving and investment						
Gross saving	14.7	13.9	12.0	10.4	10.8	12.1
Government	-1.6	-0.7	-0.8	-2.2	-3.6	-3.8
Nongovernment (including public sector enterprises)	16.3	14.6	12.8	12.6	14.5	15.9
Gross capital formation 2/	15.7	15.7	16.2	16.7	15.4	14.7
Government	3.7	3.7	4.9	4.2	3.1	3.3
Nongovernment (including public sector enterprises)	12.0	11.9	11.2	12.5	12.3	11.4
Public finances						
Revenue and grants	14.5	15.5	15.5	15.2	15.0	16.3
Expenditure (including statistical discrepancy)	19.1	19.2	21.1	21.7	21.7	23.4
Budget balance (including grants)	-5.3	-4.4	-5.8	-6.4	-6.8	-7.1
Budget balance (excluding grants)	-5.4	-4.6	-5.8	-6.5	-7.0	-7.3
Primary balance (excluding grants)	-0.7	-0.3	-1.6	-2.2	-1.8	-0.6
General government debt incl. IMF obligations	63.3	67.6	67.0	71.7	74.9	76.9
External general government debt	18.9	20.8	20.5	24.3	26.5	32.0
Domestic general government debt	44.4	46.8	46.5	47.4	48.4	44.9
			(Annual changes in percent of initial stock of broad money, unless otherwise indicated)			
Monetary sector						
Net foreign assets	2.2	1.7	-3.2	-5.6	-6.3	8.9
Net domestic assets	11.0	11.9	16.9	15.3	17.1	3.2
Broad money (percent change)	13.2	13.7	13.7	9.7	10.8	12.1
Reserve money (percent change)	9.9	26.5	22.5	12.7	15.7	13.5
Private credit (percent change)	5.9	11.1	16.6	14.9	17.1	13.3
Six-month treasury bill rate (period average, in percent)	8.8	6.3	5.9	6.0	…	…
External sector						
Merchandise exports, U.S. dollars (percentage change)	-3.9	-8.8	0.1	12.6	0.2	8.2
Merchandise imports, U.S. dollars (percentage change)	-1.0	0.0	17.9	16.2	-4.2	-4.7
Current account balance (in percent of GDP)	-1.0	-1.7	-4.1	-6.3	-4.6	-2.6
Financial account (billions of U.S. dollars)	5.0	6.8	10.2	14.3	10.7	8.7
			(In percent of exports of goods and services, unless otherwise indicated)			
External public and publicly guaranteed debt	159.8	193.3	209.4	218.3	225.2	234.0
Debt service	20.7	22.2	30.1	26.3	37.9	45.7
Gross reserves (in millions of U.S. dollars) 3/	13,534	18,143	16,141	9,789	6,824	11,187
In months of next year's imports of goods and services	3.2	3.7	2.9	1.9	1.4	2.2
Memorandum items:						
Underlying fiscal balance (excl. grants; percent of GDP) 4/	…	…	-6.3	-6.5	-7.3	-7.3
General government and government guaranteed debt (incl. IMF; % GDP)	65.7	70.1	70.0	75.3	79.1	80.5
Net general government debt (incl. IMF; % GDP)	58.2	61.3	61.5	66.8	70.7	73.5
Real effective exchange rate (end of period percentage change)	6.5	2.1	3.4	-11.2	…	…
Terms of trade (percentage change)	6.8	11.1	0.1	-3.2	-1.3	-0.1
Real per capita GDP (percentage change)	2.0	2.6	3.2	3.6	1.4	0.5
GDP at market prices (in billions of Pakistani rupees)	27,443	29,076	31,922	34,619	38,559	44,446

Sources: Pakistani authorities; World Bank; and IMF staff estimates and projections.

1/ Fiscal year ends June 30.
2/ Including changes in inventories.
3/ Excluding gold and foreign currency deposits of commercial banks held with the State Bank of Pakistan.
4/ Excludes one-off transactions, including asset sales.

Table 2. Pakistan: Medium-Term Macroeconomic Framework, Program Scenario, 2016/17–2023/24

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
			Projections					
			(Annual percentage change)					
Output and prices								
Real GDP at factor cost	5.2	5.5	3.3	2.4	3.0	4.5	5.0	5.0
Consumer prices (period average)	4.1	3.9	7.3	13.0	8.3	6.0	5.0	5.0
			(In percent of GDP)					
Saving and investment balance	-4.1	-6.3	-4.6	-2.6	-2.0	-1.8	-1.7	-1.8
Government	-5.8	-6.4	-6.8	-7.1	-5.2	-3.7	-2.6	-2.3
Non-government (including public sector enterprises)	1.6	0.1	2.2	4.6	3.2	1.9	0.9	0.5
Gross national saving	12.0	10.4	10.8	12.1	13.3	14.2	14.7	15.0
Government	-0.8	-2.2	-3.6	-3.8	-1.7	0.1	1.2	1.4
Non-government (including public sector enterprises)	12.8	12.6	14.5	15.9	15.0	14.1	13.6	13.6
Gross capital formation	16.2	16.7	15.4	14.7	15.3	16.0	16.4	16.8
Government	4.9	4.2	3.1	3.3	3.5	3.8	3.8	3.8
Non-government (including public sector enterprises)	11.2	12.5	12.3	11.4	11.8	12.2	12.6	13.0
			(In billions of U.S. dollars, unless otherwise indicated)					
Balance of payments								
Current account balance	-12.6	-19.9	-13.1	-6.7	-5.5	-5.3	-5.3	-6.1
Current account balance (in percent of GDP)	-4.1	-6.3	-4.6	-2.6	-2.0	-1.8	-1.7	-1.8
Net capital flows 1/	10.7	13.8	10.9	9.4	8.5	9.1	11.6	10.3
Of which: foreign direct investment 2/	2.7	3.5	1.8	2.1	2.9	3.6	4.4	5.0
Gross official reserves	16.1	9.8	6.8	11.2	14.5	18.9	24.9	28.1
In months of imports 3/	2.9	1.9	1.4	2.2	2.7	3.3	4.1	4.4
External debt (in percent of GDP)	27.4	30.3	36.7	43.4	43.5	42.2	41.2	39.3
Terms of trade (annual percentage change)	0.1	-3.2	-1.3	-0.1	0.1	-0.3	-1.0	-1.1
Real effective exchange rate (annual percentage change)	4.3	-6.4	…	…	…	…	…	…
Real effective exchange rate (end of period percentage change)	3.4	-11.2	…	…	…	…	…	…
			(In percent of GDP)					
Public finances								
Revenue and grants	15.5	15.2	15.0	16.3	17.9	19.1	19.6	19.6
Of which: tax revenue	12.4	12.9	12.6	14.2	15.9	17.0	17.6	17.6
Expenditure, *of which:*	21.3	21.6	21.7	23.4	23.1	22.8	22.2	22.0
Current	16.6	17.3	18.6	20.1	19.6	19.0	18.5	18.2
Development	4.9	4.2	3.1	3.3	3.5	3.8	3.8	3.8
Primary balance (including grants)	-1.5	-2.1	-1.6	-0.4	1.0	2.1	2.7	2.7
Primary balance (excluding grants)	-1.6	-2.2	-1.8	-0.6	0.9	1.9	2.6	2.6
Overall fiscal balance (including grants)	-5.8	-6.4	-6.8	-7.1	-5.2	-3.7	-2.6	-2.3
Overall fiscal balance (excluding grants)	-5.8	-6.5	-7.0	-7.3	-5.4	-3.8	-2.7	-2.4
Underlying fiscal balance (excl. grants; percent of GDP) 4/	-6.3	-6.5	-7.3	-7.3	-5.4	-3.8	-2.7	-2.4
General government and government guaranteed debt (incl. IMF)	70.0	75.3	79.1	80.5	78.0	74.4	70.8	67.1
General government debt incl. IMF obligations	67.0	71.7	74.9	76.9	74.4	70.8	67.2	63.6
Net general government debt (incl. IMF)	61.5	66.8	70.7	73.5	71.5	68.3	65.0	61.7

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Difference between the overall balance and the current account balance.
2/ Including privatization.
3/ In months of next year's imports of goods and services.
4/ Excludes one-off transactions, including asset sales.

Table 3. Pakistan: Balance of Payments, Program Scenario, 2016/17–2023/24

(In millions of U.S. dollars, unless otherwise indicated)

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
			Projections					
Current account	-12,621	-19,897	-13,082	-6,695	-5,490	-5,274	-5,310	-6,082
Balance on goods	-26,754	-31,911	-29,468	-24,891	-24,464	-25,059	-25,660	-26,846
Exports, f.o.b.	21,996	24,758	24,809	26,834	29,460	31,705	34,109	36,698
Imports, f.o.b.	48,750	56,669	54,277	51,725	53,924	56,764	59,769	63,544
Services (net)	-4,247	-5,878	-3,190	-2,022	-1,866	-1,826	-1,777	-1,641
Services: credit	5,535	5,257	5,399	5,712	6,216	6,666	7,134	7,653
Of which: Coalition Support Fund	550	0	0	0	0	0	0	0
Of which: 3G Licenses	0	0	0	0	0	0	0	0
Services: debit	9,782	11,135	8,589	7,734	8,082	8,492	8,911	9,294
Income (net)	-5,066	-5,587	-4,806	-5,456	-5,935	-6,351	-7,060	-8,052
Income: credit	696	721	750	757	938	1,054	1,080	1,241
Income: debit	5,762	6,308	5,557	6,213	6,873	7,405	8,140	9,293
Of which: interest payments	2,421	3,056	2,978	3,570	3,928	4,285	4,654	5,051
Of which: income on direct investment	3,327	3,217	2,560	2,643	2,945	3,120	3,486	4,242
Balance on goods, services, and income	-36,067	-43,376	-37,464	-32,369	-32,265	-33,236	-34,497	-36,540
Current transfers (net)	23,446	23,479	24,382	25,674	26,775	27,962	29,187	30,458
Current transfers: credit, *of which:*	23,647	23,708	24,581	25,833	26,934	28,121	29,346	30,617
Official	541	913	505	97	27	15	15	0
Workers' remittances	19,351	19,914	21,567	22,538	23,619	24,730	25,867	27,031
Other private transfers	3,755	2,881	3,120	3,198	3,288	3,376	3,464	3,586
Current transfers: debit	201	229	199	159	159	159	159	159
Capital account	375	376	402	690	613	572	576	488
Capital transfers: credit	375	376	402	690	613	572	576	488
Of which: official capital grants	367	375	394	690	613	572	576	488
Capital transfers: debit	0	0	0	0	0	0	0	0
Financial account	10,209	14,286	10,708	8,744	7,930	8,576	11,003	9,827
Direct investment abroad	-86	-10	-12	-13	-8	-5	-5	-5
Direct investment in Pakistan	2,749	3,471	1,807	2,107	2,862	3,619	4,385	5,041
Portfolio investment (net), *of which:*	-239	2,243	-1,226	333	1,856	2,040	2,328	2,328
Financial derivatives (net)	0	0	0	0	0	0	0	0
Other investment assets	-1,180	-273	-252	-641	-1,733	-1,422	-586	-756
Monetary authorities	0	0	0	0	0	0	0	0
General government	-69	-41	-47	0	0	0	0	0
Banks	-313	322	551	-133	-1,170	-800	100	0
Other sectors	-798	-554	-756	-508	-563	-622	-686	-756
Other investment liabilities	8,965	8,855	10,391	6,958	4,952	4,343	4,880	3,219
Monetary authorities	-4	1,548	4,993	-4,000	-1,000	0	0	0
General government, *of which:*	5,040	4,894	3,018	8,133	2,750	846	1,405	-425
Disbursements	9,414	8,507	9,534	17,613	15,544	14,754	13,619	9,298
Amortization	4,374	4,107	6,516	9,480	12,795	13,908	12,214	9,723
Banks	1,631	-109	572	1,259	1,484	1,784	2,084	2,034
Other sectors	2,298	2,522	1,808	1,567	1,719	1,713	1,392	1,611
Net errors and omissions	102	-920	-391	0	0	0	0	0
Reserves and related items	1,946	6,141	2,206	-2,739	-3,052	-3,873	-6,269	-4,233
Reserve assets	1,914	6,226	2,582	-4,364	-3,280	-4,423	-5,978	-3,184
Use of Fund credit and loans	32	-85	-377	1,625	228	550	-291	-1,049
Memorandum items:								
Current account (in percent of GDP)	-4.1	-6.3	-4.6	-2.6	-2.0	-1.8	-1.7	-1.8
Current account (in percent of GDP; excluding fuel imports)	-0.7	-2.1	0.6	3.5	4.0	4.3	4.6	4.7
Exports f.o.b. (growth rate, in percent)	0.1	12.6	0.2	8.2	9.8	7.6	7.6	7.6
Exports volume (growth rate, in percent)	-4.3	9.9	0.9	6.2	8.4	6.3	6.2	6.3
Remittance (growth rate, in percent)	-2.8	2.9	8.3	4.5	4.8	4.7	4.6	4.5
Remittances (in percent of GDP)	6.4	6.3	7.6	8.7	8.6	8.4	8.2	8.0
Imports f.o.b. (growth rate, in percent)	17.9	16.2	-4.2	-4.7	4.3	5.3	5.3	6.3
Imports volume (growth rate, in percent)	14.0	9.7	-6.1	-6.6	3.1	3.6	2.9	3.9
Oil imports (in million US$, cif)	10,607	13,263	14,852	15,671	16,463	18,017	19,909	21,998
Terms of trade (growth rate, in percent)	0.1	-3.2	-1.3	-0.1	0.1	-0.3	-1.0	-1.1
Foreign Direct Investment (in percent of GDP)	0.9	1.1	0.6	0.8	1.0	1.2	1.4	1.5
External debt (in millions of U.S. dollars)	83,477	95,342	104,165	112,538	119,002	124,688	130,065	133,027
o/w external public debt	63,752	71,621	73,713	83,521	88,043	90,492	92,653	92,231
Gross external financing needs (in millions of U.S. dollars) 1/	21,688	28,841	25,502	23,188	25,584	26,745	27,258	27,502
End-period gross official reserves (millions of U.S. dollars) 2/	16,141	9,789	6,824	11,187	14,468	18,891	24,869	28,053
(In months of next year's imports of goods and services)	2.9	1.9	1.4	2.2	2.7	3.3	4.1	4.4
GDP (in millions of U.S. dollars)	304,567	314,588	…	…	…	…	…	…

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

2/ Excluding foreign currency deposits held with the State Bank of Pakistan (cash reserve requirements) and gold.

Table 3a. Pakistan: Gross Financing Requirements and Sources, Program Scenario 2017/18–2023/24

(In millions of U.S. dollars unless otherwise specified)

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Prel.			Proj.			
Gross External Financing Requirements (A)	**30,385**	**25,035**	**25,616**	**28,100**	**27,373**	**27,886**	**31,218**
(In percent of GDP)	9.7	8.8	9.9	10.3	9.3	8.8	9.2
Current account deficit	19,897	13,082	6,695	5,490	5,274	5,310	6,082
(In percent of GDP)	6.3	4.6	2.6	2.0	1.8	1.7	1.8
Amortization	10,403	11,577	18,163	21,585	21,059	21,487	24,087
Public Sector	5,703	7,516	14,480	16,883	14,908	13,214	13,811
Short-term Borrowing	1,488	2,103	2,019	7,300	7,700	7,700	4,500
Long-term Borrowing (non-IMF)	4,163	4,414	11,461	9,583	6,208	4,514	8,311
Bonds	52	1,000	1,000	0	1,000	1,000	1,000
Private Sector 1/	4,700	4,061	3,683	4,702	6,151	8,273	10,276
Short-term Borrowing	4,094	3,474	3,629	4,436	5,518	6,760	8,227
Long-term Borrowing	606	588	54	266	633	1,514	2,049
IMF Repurchases	85	377	757	1,025	1,040	1,089	1,049
Available Financing (B)	**24,034**	**22,070**	**27,597**	**30,127**	**30,207**	**33,065**	**34,402**
Foreign Direct Investment (net) 2/	3,461	1,795	2,094	2,854	3,615	4,380	5,036
Disbursement	21,117	20,264	24,813	26,660	26,020	28,109	28,878
From private creditors	12,130	6,452	7,200	8,528	12,267	16,490	18,492
Disbursement to Private Sector 3/	7,569	5,777	6,200	6,528	9,267	12,490	14,492
Disbursement to Public Sector 4/	4,561	675	1,000	2,000	3,000	4,000	4,000
From official creditors (non-IMF)	8,987	13,812	17,613	18,132	13,754	11,619	10,386
o/w Project Loans	3,458	2,867	2,830	2,957	2,959	2,638	3,298
o/w China	1,811	1,987	1,100	1,100	1,200	1,200	1,200
o/w Program Loans	261	17	1,483	1,687	1,095	1,781	0
o/w WB	205	0	668	765	471	707	0
o/w ADB	50	0	800	900	600	1,050	0
o/w Rollover of short-term debt	5,141	5,535	6,536	12,718	11,260	12,727	14,155
o/w Public Sector	1,667	1,906	2,100	7,200	4,500	4,500	4,500
Private Sector	3,474	3,629	4,436	5,518	6,760	8,227	9,655
Other Net Capital Inflows (net) 5/	-544	11	690	613	572	576	488
Remaining Financiang Needs (C=A-B)	**6,352**	**2,965**	**-1,981**	**-2,027**	**-2,833**	**-5,179**	**-3,184**
Borrowing from IMF (D)	**0**	**0**	**2,383**	**1,253**	**1,590**	**799**	**0**
Reserve Assets (decrease = +) (E=C-D)	6,352	2,965	-4,364	-3,280	-4,423	-5,978	-3,184
Memorandum items							
Gross official reserves (stock, in US$ billions)	9.8	6.8	11.2	14.5	18.9	24.9	28.1
(In months of prospective imports)	1.9	1.4	2.2	2.7	3.3	4.1	4.4
(In percent of IMF ARA metric: assuming fixed ER)	29.6	19.8	30.8	36.7	45.5	58.0	63.6
(In percent of IMF ARA metric: assuming flexible ER)	48.0	31.2	46.2	54.3	67.6	87.5	96.7
Net FX derivative position (in US$ billions)	6.7	8.1	7.6	5.5	4.0	4.0	4.0

Sources: State Bank of Pakistan, and Fund staff estimates and projections.

1/ Includes banks and non-bank private sector.

2/ Includes privatization receipts.

3/ Includes equity and debt portfolio inflows, and borrowing by banks and other sectors.

4/ Includes syndicated loans and Euro bonds.

5/ Includes capital account, financial derivatives, errors and omissions.

Table 4a. Pakistan: General Government Budget, Program Scenario, 2016/17–2023/24

(In billions of Pakistani rupees)

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
		Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue and grants	4,962	5,265	5,775	7,246	9,012	10,720	12,198	13,442
Revenue	4,937	5,228	5,684	7,165	8,931	10,638	12,120	13,371
Tax revenue	3,969	4,467	4,845	6,328	7,984	9,579	10,949	12,080
Federal	3,647	4,066	4,398	5,812	7,401	8,815	10,043	11,081
FBR revenue	3,361	3,842	4,153	5,503	7,001	8,311	9,486	10,506
Direct taxes	1,343	1,537	1,629	2,027	2,527	3,013	3,435	3,789
Federal excise duty	199	206	257	384	535	654	766	900
Sales tax/VAT	1,323	1,491	1,586	2,203	2,798	3,277	3,734	4,120
Customs duties	496	608	681	889	1,141	1,367	1,552	1,697
Petroleum surcharge	167	179	203	260	345	441	488	498
Gas surcharge and other	78	30	18	21	23	26	29	32
GIDC	42	15	25	29	33	36	40	44
Provincial	322	401	447	515	583	764	906	1,000
Nontax revenue	967	761	838	838	947	1,059	1,170	1,291
Federal	888	614	728	710	803	898	992	1,094
Provincial	79	147	111	127	144	161	178	196
Grants	25	37	91	81	80	82	78	71
Expenditure	6,801	7,488	8,380	10,419	11,625	12,791	13,810	15,048
Current expenditure	5,314	5,982	7,190	8,935	9,846	10,681	11,477	12,475
Federal	3,588	3,918	4,850	6,262	6,822	7,301	7,743	8,354
Interest	1,348	1,500	1,994	2,978	3,139	3,241	3,308	3,489
Domestic	1,220	1,323	1,733	2,620	2,703	2,736	2,760	2,901
Foreign	128	177	261	349	413	471	506	549
IMF budget support	0	0	0	10	23	34	42	40
Other	2,239	2,418	2,856	3,293	3,705	4,095	4,477	4,905
Defense	888	1,030	1,160	1,312	1,484	1,658	1,832	2,022
Other	1,351	1,387	1,696	1,982	2,222	2,437	2,644	2,884
Of which: subsidies	159	114	211	273	309	345	366	404
Of which: grants 1/	462	512	625	743	841	939	1,028	1,134
Provincial	1,726	2,065	2,340	2,673	3,024	3,379	3,735	4,120
Development expenditure and net lending	1,565	1,494	1,190	1,484	1,779	2,111	2,333	2,574
Public Sector Development Program	1,578	1,456	1,210	1,484	1,779	2,111	2,333	2,574
Federal	726	576	500	631	764	910	1,005	1,109
Provincial	852	880	710	853	1,016	1,201	1,327	1,464
Net lending	-13	38	-20	0	0	0	0	0
Statistical discrepancy ("+" = additional expenditure)	-78	12	0	0	0	0	0	0
Overall Balance (excluding grants)	-1,864	-2,260	-2,697	-3,254	-2,694	-2,154	-1,690	-1,677
Overall Balance (including grants)	-1,839	-2,223	-2,606	-3,173	-2,613	-2,071	-1,612	-1,606
Financing	1,839	2,223	2,606	3,173	2,613	2,071	1,612	1,606
External	560	785	275	1,801	1,010	653	630	83
Of which: privatization receipts	4	0	0	0	0	0	0	0
Of which: IMF	0	0	0	408	230	302	157	-33
Domestic	1,279	1,438	2,331	1,372	1,603	1,418	982	1,523
Bank	895	1,086	1,631	961	1,122	993	687	1,066
Nonbank	384	353	699	412	481	426	295	457
Memorandum items:								
Underlying fiscal balance (excl. grants) 2/	-2,023	-2,260	-2,815	-3,254	-2,694	-2,154	-1,690	-1,677
Provincial balance	-16	-17	73	463	900	1317	1679	1865
Primary balance (excluding grants)	-515	-760	-702	-276	445	1,087	1,617	1,813
Primary balance (including grants)	-490	-723	-611	-195	526	1,169	1,695	1,883
Total security spending	888	1,030	1,160	1,312	1,484	1,658	1,832	2,022
Energy sector circular debt accumulation	58	450	…	…	…	…	…	…
Energy sector circular debt clearance	19	4	4	4	4	4	0	0
General government debt incl. IMF obligations	21,403	24,818	28,889	34,200	37,418	39,793	41,730	43,555
Domestic debt	14,849	16,416	18,674	19,976	21,511	22,865	23,785	25,247
External debt	6,554	8,402	10,215	14,224	15,906	16,928	17,945	18,308
General government and government guaranteed debt (incl. IMF)	22,340	26,054	30,500	35,787	39,213	41,799	43,947	45,982
Net general government debt (incl. IMF)	19,630	23,122	27,266	32,647	35,932	38,372	40,370	42,254
Nominal GDP (market prices)	31,922	34,619	38,559	44,446	50,272	56,183	62,089	68,499

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Additional spending on security and internally-displaced people is recorded under transfers ("grants") instead of development

2/ Excludes one-off transactions, including asset sales.

Table 4b. Pakistan: General Government Budget, Program Scenario 2016/17–2023/24

(In percent of GDP, unless otherwise indicated)

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
		Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue and grants	15.5	15.2	15.0	16.3	17.9	19.1	19.6	19.6
Revenue	15.5	15.1	14.7	16.1	17.8	18.9	19.5	19.5
Tax revenue	12.4	12.9	12.6	14.2	15.9	17.0	17.6	17.6
Federal	11.4	11.7	11.4	13.1	14.7	15.7	16.2	16.2
FBR revenue	10.5	11.1	10.8	12.4	13.9	14.8	15.3	15.3
Direct taxes	4.2	4.4	4.2	4.6	5.0	5.4	5.5	5.5
Federal excise duty	0.6	0.6	0.7	0.9	1.1	1.2	1.2	1.3
Sales tax	4.1	4.3	4.1	5.0	5.6	5.8	6.0	6.0
Customs duties	1.6	1.8	1.8	2.0	2.3	2.4	2.5	2.5
Petroleum surcharge / Carbon tax	0.5	0.5	0.5	0.6	0.7	0.8	0.8	0.7
Gas surcharge and other	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
GIDC	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Provincial	1.0	1.2	1.2	1.2	1.2	1.4	1.5	1.5
Nontax revenue	3.0	2.2	2.2	1.9	1.9	1.9	1.9	1.9
Federal	2.8	1.8	1.9	1.6	1.6	1.6	1.6	1.6
Provincial	0.2	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Grants	0.1	0.1	0.2	0.2	0.2	0.1	0.1	0.1
Expenditure	21.3	21.6	21.7	23.4	23.1	22.8	22.2	22.0
Current expenditure	16.6	17.3	18.6	20.1	19.6	19.0	18.5	18.2
Federal	11.2	11.3	12.6	14.1	13.6	13.0	12.5	12.2
Interest	4.2	4.3	5.2	6.7	6.2	5.8	5.3	5.1
Domestic	3.8	3.8	4.5	5.9	5.4	4.9	4.4	4.2
Foreign	0.4	0.5	0.7	0.8	0.8	0.8	0.8	0.8
IMF budget support	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Other	7.0	7.0	7.4	7.4	7.4	7.3	7.2	7.2
Defense	2.8	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Other	4.2	4.0	4.4	4.5	4.4	4.3	4.3	4.2
Of which: subsidies	0.5	0.3	0.5	0.6	0.6	0.6	0.6	0.6
Of which: grants 1/	1.4	1.5	1.6	1.7	1.7	1.7	1.7	1.7
Provincial	5.4	6.0	6.1	6.0	6.0	6.0	6.0	6.0
Development expenditure and net lending	4.9	4.3	3.1	3.3	3.5	3.8	3.8	3.8
Public Sector Development Program	4.9	4.2	3.1	3.3	3.5	3.8	3.8	3.8
Federal	2.3	1.7	1.3	1.4	1.5	1.6	1.6	1.6
Provincial	2.7	2.5	1.8	1.9	2.0	2.1	2.1	2.1
Net lending	0.0	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy ("+" = additional expenditure)	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance (excluding grants)	-5.8	-6.5	-7.0	-7.3	-5.4	-3.8	-2.7	-2.4
Overall Balance (including grants)	-5.8	-6.4	-6.8	-7.1	-5.2	-3.7	-2.6	-2.3
Financing	5.8	6.4	6.8	7.1	5.2	3.7	2.6	2.3
External	1.8	2.3	0.7	4.1	2.0	1.2	1.0	0.1
Of which: privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: IMF	0.0	0.0	0.0	0.9	0.5	0.5	0.3	0.0
Domestic	4.0	4.2	6.0	3.1	3.2	2.5	1.6	2.2
Bank	2.8	3.1	4.2	2.2	2.2	1.8	1.1	1.6
Nonbank	1.2	1.0	1.8	0.9	1.0	0.8	0.5	0.7
Memorandum items:								
Underlying fiscal balance (excl. grants; percent of GDP) 2/	-6.3	-6.5	-7.3	-7.3	-5.4	-3.8	-2.7	-2.4
Provincial balance	0.0	-0.1	0.2	1.0	1.8	2.3	2.7	2.7
Primary balance (excluding grants)	-1.6	-2.2	-1.8	-0.6	0.9	1.9	2.6	2.6
Primary balance (including grants)	-1.5	-2.1	-1.6	-0.4	1.0	2.1	2.7	2.7
Total security spending	2.8	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Energy sector circular debt accumulation	0.2	1.3	…	…	…	…	…	…
Energy sector circular debt clearance	0.1	0.0	…	…	…	…	…	…
General government debt incl. IMF obligations	67.0	71.7	74.9	76.9	74.4	70.8	67.2	63.6
Domestic debt	46.5	47.4	48.4	44.9	42.8	40.7	38.3	36.9
External debt	20.5	24.3	26.5	32.0	31.6	30.1	28.9	26.7
General government and government guaranteed debt (incl. IMF)	70.0	75.3	79.1	80.5	78.0	74.4	70.8	67.1
Net general government debt (incl. IMF)	61.5	66.8	70.7	73.5	71.5	68.3	65.0	61.7
Nominal GDP (market prices, billions of Pakistani rupees)	31,922	34,619	38,559	44,446	50,272	56,183	62,089	68,499

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Additional spending on security and internally-displaced people is recorded under transfers ("grants") instead of development expenditure as reported in the original FY2015/16 budget.

2/ Excludes one-off transactions, including asset sales.

Table 5. Pakistan: Monetary Survey, Program Scenario, 2014/15–2019/20

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2019/20	2019/20	2019/20
			Est.	Est.	Proj.	Q1	Q2	Q3	Proj.
	(In billions of Pakistani rupees, unless otherwise indicated)								
Monetary survey									
Net foreign assets (NFA)	813	1,008	602	-208	-1,223	-1,025	-589	57	354
Net domestic assets (NDA)	10,469	11,817	13,979	16,206	18,945	18,904	19,126	18,770	19,510
Net claims on government, *of which:*	6,958	7,820	8,956	10,200	11,831	12,259	12,328	12,505	12,792
Budget support, *of which:*	6,330	7,117	8,163	9,284	11,071	11,499	11,567	11,744	12,031
Banks	4,443	5,705	5,863	5,744	3,315	3,743	3,812	3,989	4,845
Commodity operations	564	637	687	820	760	760	760	760	760
Credit to nongovernment	4,456	5,013	6,011	7,034	8,368	8,393	8,883	8,957	9,436
Private sector 1/	4,021	4,469	5,213	5,989	7,014	7,012	7,480	7,494	7,946
Public sector enterprises	435	544	799	1,044	1,354	1,381	1,403	1,463	1,490
Privatization account	-41	-41	-41	-41	-41	-41	-41	-41	-41
Other items, net	-904	-974	-947	-987	-1,213	-1,707	-2,045	-2,651	-2,677
Broad money	11,282	12,825	14,581	15,997	17,722	17,879	18,537	18,827	19,864
Currency outside scheduled banks	2,555	3,334	3,911	4,388	5,165	5,121	5,263	5,346	5,690
Rupee deposits	8,130	8,904	10,014	10,780	11,578	11,568	12,108	12,280	12,973
Foreign currency deposits	598	587	655	829	979	1,190	1,166	1,201	1,201
State Bank of Pakistan (SBP)									
NFA	722	1,033	829	12	-1,003	-804	-368	278	575
NDA	2,420	2,941	4,039	5,472	7,348	7,104	6,863	6,352	6,627
Net claims on government	1,919	1,430	2,337	3,600	7,766	7,830	7,830	7,830	7,288
Of which: budget support	1,887	1,412	2,300	3,539	7,756	7,756	7,756	7,756	7,187
Claims on nongovernment	-6	-5	-9	-8	-10	-12	-12	-12	-12
Claims on scheduled banks	401	407	500	570	662	662	662	662	662
Privatization account	-41	-41	-41	-41	-41	-41	-41	-41	-41
Other items, net	146	1,148	1,251	1,350	-1,030	-1,335	-1,577	-2,088	-1,270
Reserve money, *of which:*	3,142	3,974	4,868	5,485	6,345	6,300	6,495	6,630	7,202
Banks' reserves	413	392	669	814	951	975	1,005	1,026	1,130
Currency	2,715	3,563	4,176	4,644	5,394	5,325	5,489	5,603	6,073
	(Annual percentage change, unless otherwise indicated)								
Broad money	13.2	13.7	13.7	9.7	10.8	11.6	11.8	12.0	12.1
NFA, banking system (in percent of broad money) 2/	2.2	1.7	-3.2	-5.6	-6.3	-4.2	1.8	5.2	8.9
NDA, banking system (in percent of broad money) 2/	11.0	11.9	16.9	15.3	17.1	15.8	10.0	6.8	3.2
Budgetary support (in percent of broad money) 2/	8.9	7.0	8.2	7.7	11.2	13.2	10.3	10.0	5.4
Budgetary support	16.3	12.4	14.7	13.7	19.3	22.6	17.3	16.6	8.7
Private credit 1/	5.9	11.1	16.6	14.9	17.1	14.6	14.0	13.5	13.3
Currency	17.3	30.5	17.3	12.2	17.7	17.0	16.2	12.8	10.2
Reserve money	9.9	26.5	22.5	12.7	15.7	15.5	14.9	14.0	13.5
Memorandum items:									
Velocity	2.6	2.4	2.3	2.2	2.2	2.3	2.3	2.4	2.2
Money multiplier	3.6	3.2	3.0	2.9	2.8	2.8	2.9	2.8	2.8
Currency to broad money ratio (percent)	22.6	26.0	26.8	27.4	29.1	28.6	28.4	28.4	28.6
Currency to deposit ratio (percent)	29.3	35.1	36.7	37.8	41.1	40.1	39.7	39.7	40.1
Foreign currency to deposit ratio (percent)	6.8	6.2	6.1	7.1	7.8	9.3	8.8	8.9	8.5
Reserves to deposit ratio (percent)	4.7	4.1	6.3	7.0	7.6	7.6	7.6	7.6	8.0
Budget bank financing (change from the beginning of the fiscal year; in Rs billions), *of which:*	888	787	1,046	1,121	1,787	428	497	674	961
By commercial banks	1,323	1,262	158	-119	-2,429	428	497	674	1,529
By SBP	-434	-475	888	1,240	4,216	0	0	0	-569
NFA of SBP (change from beginning of the year; in billions of U.S. dollars) 3/	2.2	2.8	-2.0	-7.8	-7.2	2.4	4.9	8.7	10.4
NFA of commercial banks (millions of U.S. dollars)	887	-243	-2,163	-1,850	-1,567	-1,289	-1,316	-1,277	-1,277
NDA of commercial banks (billions of Pakistani rupees)	8,050	8,877	9,940	10,733	11,598	11,800	12,263	12,418	12,883

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Items pertaining to Islamic Financing previously reported under "Other assets" have been reclassified as "Credit to private sector" beginning March 2016.

2/ Denominator is the stock of broad (reserve) money at the end of the previous year.

3/ Includes valuation adjustments.

Table 6. Pakistan: Financial Soundness Indicators for the Banking System (December 2013–March 2019)

	Dec. 2013	Dec. 2014	Dec. 1/ 2015	Dec. 1/ 2016	Mar. 1/ 2017	Jun. 1/ 2017	Sep. 1/ 2017	Dec. 1/ 2017	Mar. 1/ 2018	Jun. 1/ 2018	Sep. 1/ 2018	Dec. 1/ 2018	Mar. 1/ 2019
Capital adequacy													
Regulatory capital to risk-weighted assets	14.9	17.1	17.3	16.2	15.9	15.6	15.4	15.8	15.9	15.9	16.1	16.2	16.1
Tier I capital to risk-weighted assets	12.6	14.3	14.4	13.0	12.9	12.7	12.7	12.9	12.9	13.0	13.2	13.2	13.3
Capital to total assets	9.0	10.0	8.4	7.8	7.6	7.2	7.1	7.1	7.7	7.1	7.6	7.1	7.6
Asset composition and quality													
Nonperforming loans (NPLs) to gross loans	13.3	12.3	11.4	10.1	9.9	9.3	9.2	8.4	8.3	7.9	8.0	8.0	8.2
Provisions to NPLs	78.4	79.8	84.9	85.0	85.4	83.7	85.3	87.2	89.2	87.1	86.0	83.8	84.1
NPLs net of provisions to capital	14.7	10.1	7.7	7.3	7.1	8.0	7.2	5.8	4.9	5.9	6.5	7.8	7.8
Earnings and profitability													
Return on assets (after tax)	1.1	1.5	1.5	1.3	1.2	1.1	0.9	0.9	0.9	0.8	0.8	0.8	0.8
Return on equity (after tax)	12.4	16.1	15.6	14.4	14.2	13.1	10.9	11.5	11.8	11.0	10.7	10.7	10.8
Net interest income to gross income	70.4	71.3	70.4	71.2	70.9	70.7	71.9	72.7	74.3	73.6	74.7	75.4	77.7
Noninterest expenses to gross income	57.2	53.3	47.8	53.1	55.5	55.8	56.5	57.1	57.8	59.6	60.5	60.2	55.8
Liquidity													
Liquid assets to total assets	48.6	49.2	53.8	53.7	54.0	53.8	54.5	54.0	49.7	51.1	47.7	48.7	45.3
Liquid assets to total deposits	61.3	64.5	73.3	72.1	73.9	74.9	76.0	76.1	65.6	71.3	63.6	67.2	59.8
Loans/Deposits	49.5	48.2	46.4	46.6	47.5	48.7	48.3	50.1	51.4	53.1	54.6	55.8	55.6

Source: State Bank of Pakistan.

1/ As required by Basel requirements, the authorities used regulatory capital instead of balance sheet capital to calculate FSI figures.

Table 7. Pakistan: Indicators of Fund Credit, 2015–27

(In millions of SDR, unless otherwise specified; calendar year basis)

					Projections								
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					(Projected Level of Credit Outstanding based on Existing and Prospective Drawings)								
Total	3,600.0	4,393.0	4,393.0	4,243.0	4,867.0	5,191.0	5,548.8	5,966.7	5,234.5	4,423.7	3,726.8	3,083.3	2,372.0
Of which:													
ECF, SBA, and ENDA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Extended Fund Facility	3,600.0	4,393.0	4,393.0	4,243.0	4,867.0	5,191.0	5,548.8	5,966.7	5,234.5	4,423.7	3,726.8	3,083.3	2,372.0
In percent of quota	348.3	216.3	216.3	208.9	239.6	255.6	273.2	293.8	257.7	217.8	183.5	151.8	116.8
In percent of end-period gross official reserves	31.4	32.4	44.1	81.6	82.5	61.0	47.0	37.8	29.0	21.7	17.0	13.2	9.4
As a share of external debt	7.3	7.8	7.0	5.9	6.3	6.3	6.4	6.6	5.7	4.6	3.7	2.9	2.1
					(Projected Debt Service to the Fund based on Existing and Prospective Drawings)								
Total	338.1	51.1	75.0	248.0	394.9	811.3	941.6	901.7	922.3	961.1	806.5	725.8	778.9
Of which:													
Principal	303.0	0.0	0.0	150.0	330.0	660.0	762.2	702.2	732.2	810.8	696.8	643.5	711.3
Interest and charges	35.1	51.1	75.0	98.0	64.9	151.3	179.5	199.5	190.1	150.3	109.6	82.3	67.6
SBA and ENDA Principal	303.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Extended Fund Facility Principal	0.0	0.0	0.0	150.0	330.0	660.0	762.2	702.2	732.2	810.8	696.8	643.5	711.3
In percent of quota	32.7	2.5	3.7	12.2	19.4	39.9	46.4	44.4	45.4	47.3	39.7	35.7	38.4
In percent of end-period gross official reserves	2.9	0.4	0.8	4.8	6.7	9.5	8.0	5.7	5.1	4.7	3.7	3.1	3.1
As a share of total external debt service	8.0	1.1	1.2	3.8	4.4	7.3	6.8	5.9	6.8	7.1	5.5	4.6	4.6
Memorandum items													
Quota (millions of SDRs)	1,034	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031	2,031
Gross official reserves (millions of U.S. dollars)	15,886	18,269	14,107	7,199	8,268	12,016	16,777	22,531	25,974	29,300	31,425	33,704	36,148
Total External Debt (percent of CY GDP)	24.9	26.0	28.9	33.1	39.9	43.3	43.0	42.1	40.3	39.3	38.8	38.4	38.0
Total External Debt Service (millions of U.S. dollars)	5,881	6,179	8,818	8,993	12,580	15,656	19,802	21,689	19,392	19,556	20,974	22,495	24,127

Source: IMF staff projections.

Table 8. Pakistan: Selected Vulnerability Indicators, Program Scenario, 2016/17–2023/24

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
		Est.			Projections			
Key economic and market indicators								
Real GDP growth (factor cost, in percent)	5.2	5.5	3.3	2.4	3.0	4.5	5.0	5.0
CPI inflation (period average, in percent)	4.1	3.9	7.3	13.0	8.3	6.0	5.0	5.0
Emerging market bond index (EMBI) secondary market spread (basis points, end of period)	317	582	...	...	...	...	...	...
Exchange rate PRs/US$ (end of period)	104.9	119.4	...	...	...	...	...	...
External sector								
Current account balance (percent of GDP)	-4.1	-6.3	-4.6	-2.6	-2.0	-1.8	-1.7	-1.8
Net FDI inflows (percent of GDP)	0.9	1.1	0.6	0.8	1.0	1.2	1.4	1.5
Exports (percentage change of U.S. dollar value; GNFS)	0.5	9.0	0.6	7.7	9.6	7.6	7.5	7.5
Gross international reserves (GIR) in billions of U.S. dollars	16.1	9.8	6.8	11.2	14.5	18.9	24.9	28.1
GIR in percent of ST debt at remaining maturity (RM) 1/	161.1	88.1	39.1	59.7	57.6	62.2	91.3	149.3
GIR in percent of ST debt at RM and banks' foreign exchange (FX) deposits 1/	99.2	54.2	28.0	43.5	44.6	49.4	69.9	100.9
Total gross external debt (ED) in percent of GDP, *of which:*	27.4	30.3	36.7	43.4	43.5	42.2	41.2	39.3
ST external debt (original maturity, in percent of total ED)	6.7	6.3	6.9	11.8	12.4	11.1	9.3	10.2
ED of domestic private sector (in percent of total ED)	25.0	29.2	27.5	27.8	30.0	32.1	34.4	37.3
ED to foreign official sector (in percent of total ED)	75.0	70.8	72.5	72.2	70.0	67.9	65.6	62.7
Total gross external debt in percent of exports	303.2	317.6	344.8	345.8	333.6	325.0	315.4	299.9
Gross external financing requirement (in billions of U.S. dollars) 2/	21.7	28.8	25.5	23.2	25.6	26.7	27.3	27.5
Public sector 3/								
Overall balance (including grants)	-5.8	-6.4	-6.8	-7.1	-5.2	-3.7	-2.6	-2.3
Primary balance (including grants)	-1.5	-2.1	-1.6	-0.4	1.0	2.1	2.7	2.7
Debt-stabilizing primary balance 4/	-1.9	1.7	1.5	1.8	-1.0	-1.0	-0.4	-0.5
Gross PS financing requirement 5/	29.4	33.7	36.0	23.6	22.7	20.2	18.5	16.7
General government and government guaranteed debt (incl. IMF)	70.0	75.3	79.1	80.5	78.0	74.4	70.8	67.1
General government debt incl. IMF obligations	67.0	71.7	74.9	76.9	74.4	70.8	67.2	63.6
Net general government debt (incl. IMF) 6/	61.5	66.8	70.7	73.5	71.5	68.3	65.0	61.7
Financial sector 7/								
Capital adequacy ratio (in percent)	15.6	15.9	...	...	...	...	...	...
Nonperforming loans (NPLs) in percent of total loans	9.3	7.9	...	...	...	...	...	...
Provisions in percent of NPLs	83.7	87.1	...	...	...	...	...	...
Return on assets (after tax, in percent)	1.1	0.8	...	...	...	...	...	...
Return on equity (after tax, in percent)	13.1	11.0	...	...	...	...	...	...
FX deposits held by residents (in percent of total deposits)	6.1	7.1	...	...	...	...	...	...
Government debt held by FS (percent of total FS assets)	61.4	63.8	...	...	...	...	...	...
Credit to private sector (percent change)	16.6	14.9	...	...	...	...	...	...
Memorandum item:								
Nominal GDP (in billions of U.S. dollars)	304.6	314.6	...	...	...	...	...	...

Sources: Pakistani authorities; and IMF staff estimates and projections.

1/ Debt at remaining maturity is defined as maturing short-, medium-, and long-term external official debt.

2/ Current account deficit plus amortization of external debt.

3/ Public sector covers general (consolidated) government.

4/ Based on the end of period debt stock in year t-1, and the baseline assumptions for the relevant variables (i.e., growth, interest rates, inflation, exchange rates) in year t.

5/ Overall balance plus debt amortization.

6/ Net debt is defined as gross debt minus government deposits with the banking system.

7/ Financial sector includes all commercial and specialized banks; for government debt also includes nonbanks, but excludes State Bank of Pakistan.

Table 9. Pakistan: Schedule of Reviews and Purchases

Purchase Date 1/	Amount of Purchase		Conditions
	Millions of SDRs	Percent of Quota	
July 3, 2019	716	35	Approval of arrangement
December 6, 2019	328	16	First review and end-September 2019 performance/continuous criteria
March 6, 2020	328	16	Second review and end-December 2019 performance/continuous criteria
June 5, 2020	328	16	Third review and end-March 2020 performance/continuous criteria
September 4, 2020	328	16	Fourth review and end-June 2020 performance/continuous criteria
March 5, 2021	560	28	Fifth review and end-December 2020 performance/continuous criteria
September 3, 2021	560	28	Sixth review and end-June 2021 performance/continuous criteria
March 4, 2022	560	28	Seventh review and end-December 2021 performance/continuous criteria
September 2, 2022	560	28	Eighth review and end-June 2022 performance/continuous criteria
Total	4,268	210	

Source: IMF staff estimates

1/ Date in which resources become available

Table 10. Pakistan: Public External Liabilities and Repayment Schedule 1/

(In millions of U.S. dollars)

	Outstanding debt	Amortization over the EFF period FY2019/20	FY2020/21	FY2021/22	FY2022/23 (through Q1)	Total
Paris Club	**11,261**	**721**	**778**	**827**	**53**	**2,379**
Austria	26	3	4	4	0	11
Belgium	19	2	3	3	0	8
Canada	393	22	23	24	0	68
Finland	4	0	1	1	0	2
France	1,624	131	154	169	16	470
Germany	1,369	79	82	83	0	244
Italy	164	5	5	5	0	15
Japan	5,672	307	320	330	35	992
Korea	372	40	46	52	1	138
The Netherlands	86	5	5	5	2	16
Norway	11	1	2	2	0	5
Russia	77	10	11	13	0	33
Spain	65	4	5	5	0	14
Sweden	98	12	14	16	0	42
Switzerland	80	8	9	10	0	27
United Kindom	5	1	1	1	0	2
United States	1,195	90	96	105	0	291
Non-Paris Club Bilateral	**23,769**	**7,442**	**7,720**	**738**	**378**	**16,278**
China	15,155	3,399	3,480	701	366	7,946
Kuwait	165	13	14	15	8	49
Libya	4	0	0	0	0	1
Saudi Arabia 2/	6,411	3,023	3,220	20	2	6,265
UAE	2,033	1,006	1,006	2	2	2,016
Multilateral	**27,991**	**2,195**	**1,618**	**1,713**	**589**	**6,115**
Islamic Develoment Bank 3/	1,665	733	96	95	27	951
ADB	10,728	855	864	863	275	2,857
AIIB	59	0	0	7	4	11
ECO Trade Bank	43	1	1	0	0	3
IBRD	1,319	117	118	130	55	419
IDA	13,840	472	523	600	225	1,820
Int'l Fund for Agri. Developmen	242	8	9	10	2	28
Nordic Development Fund	8	1	1	1	0	2
OPEC FUND	87	8	8	8	1	25
EIB	0	0	0	0	0	0
Commercial	**9,370**	**2,764**	**2,400**	**2,336**	**0**	**7,500**
China	6,736	2,200	2,300	2,236	0	6,736
Others	2,634	564	100	100	0	764
Bonds	**7,300**	**1,000**	**0**	**1,000**	**0**	**2,000**
IMF	**5,791**	**757**	**1,025**	**1,040**	**265**	**3,088**
Total	**85,482**	**14,878**	**13,541**	**7,654**	**1,285**	**37,359**

Sources: The Pakistani authorities; and the IMF calculations.
1/ As of end-March 2019.
2/ Includes expected amounts and outflows from oil facilities.
3/ Includes short-term oil facilities of $0.6 billion.

Table 11. Pakistan: Inclusive Growth Indicators

	Pakistan 5Y Trend	Pakistan Indicator	EMDE Average
Growth			
GDP per capita growth (percent; 2015-17 average)	↗	2.6	1.4
Gross Fixed Capital Formation (percent of GDP; 2015-17 average)	↗	14.1	23.8
Poverty and Inequality			
Poverty headcount ratio at $3.20/day (percent of population; 2011 PPP)	↘	39.7	33.1
Multidemensional poverty (percent of population; 2012/2013)		45.6	31.2
Prevalence of stunting (% of children under 5, 2012)	↗	45.0	23.8
GINI Index (2016)	↘	30.7	39.2
Child mortality (per 1,000, 2015)	↘	81.1	40.1
Growth in mean consumption (growth, %, bottom 40th percentile,		2.8	2.3
Human Development and Access to Services			
Human Development Index (2015)	↗	0.6	0.6
Life expectancy at birth (years, 2016)	↗	66.5	69.1
Access to electricity (% of population, 2016)	↗	99.1	77.1
Net school enrollment, secondary, total (% population, 2016)	↗	45.5	70.4
Individuals using internet (% population, 2016)	↗	15.5	38.9
Literacy rate (% population, 2014)	↗	57.0	83.3
Government			
Commitment to reducing inequality index (2017)		0.2	0.3
Government spending on social safety net programs (percent of GDP, 2018)		0.6	1.6
Coverage of social safety net programs in poorest quintile (% population, 2013)	↗	16.1	21.3
Government expenditure on education, total (% GDP, 2017)	↗	2.8	4.7
Health expenditure, domestic general government (% of GDP, 2015)	↗	0.7	2.9

	Pakistan 5Y Trend	Pakistan Indicator	EMDE Average
Access to finance			
Account at a financial institution (% age 15+, 2017)	↗	18.0	43.0
Domestic credit to private sector (% GDP, 2016)	↘	16.4	38.9
Loans to SMEs (% of GDP, 2016)	↘	1.3	7.8
Financial Inclusion Index (IMF, 2017)		0.2	0.3
Labor markets			
Unemployment rate (% of total labor force, 2017)	↗	4.0	8.2
Female unemployment rate (% of female labor force, 2017)	↗	7.0	9.8
Youth unemployment rate (% of total labor force ages 15-24, 2017)	↗	7.7	17.7
Labor force participation (% of total population ages 15+, 2017)	↗	54.4	62.6
Female labor force participation (% of female population ages 15+, 2017)	↗	24.9	51.7
Youth labor force participation (% of population ages 15-24, 2017)	↘	40.3	42.6
Business environment			
Ease of Doing Business (DTF, 2018)	↘	51.7	57.2
Registering property (DTF, 2018)	↘	41.4	57.0
Enforcing Contracts (DTF, 2018)	↗	43.5	52.4
Paying Taxes (DTF, 2018)	↘	46.4	63.6
Getting electricity (DTF, 2018)	↘	42.4	60.1
Trading across borders (DTF, 2018)	↘	41.9	63.1
Global Competitiveness Index (2018)	↗	3.7	3.9
Gender			
Account at a financial institution (female vs male, %), 2014	↗	21.3	84.0
Female employment to population ratio (%, 2017)	↗	23.2	47.2
Literacy rate (female vs male, %, 2014)	↗	64.1	89.7
Net school enrollment, secondary (female vs male, %, 2016)	↗	81.1	99.9
Gender Gap Index (2017)		0.5	0.7

Sources: WB Development Indicators, WB Doing Business, WB Health Nutrition and Population Statistics Database, IMF World Economic Outlook, World Economic Forum, WB Governance Indicators, Transparency International, UNDP, Oxfam International.

Table 12. Pakistan: Quantitative Performance Criteria and Indicative Targets for FY 2019/20 1/

(In billions of rupees, at program exchange rates, unless otherwise specified)

	FY 2018/19		FY 2019/20			
	end-December	end-June	end-September	end-December	end-March	end-June
	Actual	Projected	Program (PC)	Program (PC)	Program (IT)	Program (IT)
Performance Criteria						
Floor on net international reserves of the SBP (millions of U.S. dollars)	-11,853	-17,743	-18,478	-16,311	-12,844	-10,790
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees)	7,296	8,852	8,911	8,800	8,445	8,727
Ceiling on SBP's stock of net foreign currency swaps/forward position (negative, millions of U.S. dollars)	7,532	8,055	8,055	8,055	8,055	7,555
Ceiling on general government primary budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 2/	153	702	102	145	193	276
Ceiling on net government budgetary borrowing from the SBP (stock, billions of Pakistani rupees)	4,737	7,756	7,756	7,756	7,756	7,187
Ceiling on the amount of government guarantees (stock, billions of Pakistani rupees)	1,313	1,611	1,611	1,611	1,611	1,611
Continuous Performance Criteria						
Zero new flow of SBP's credit to general government			0	0	0	0
Zero ceiling on accumulation of external public payment arrears by the general government			0	0	0	0
Indicative Targets						
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees)	30	100	45	86.4	133.2	180
Cumulative floor on general government budgetary health and education spending (billions of Pakistani rupees)			349.2	698.4	1,221	1,744
Floor on net tax revenues collected by the FBR (cumulative, billions of Pakistani rupees)	1,795	4,153	1,071	2,367	3,757	5,503
Ceiling on net accumulation of tax refund arrears (billions of Pakistani rupees) 3/	90	90	-75	-57.5	-57.5	-57.5
Ceiling on power sector payment arrears (cumulative flow, billions of Pakistani rupees) 3/	1,415	1,686	23	39	62	81

Sources: Pakistani authorities; and Fund staff estimates.

1/ Fiscal year runs from July 1 to June 30. All definitions as per the attached Technical Memorandum of Understanding.

2/ Cumulative from the start of each fiscal year. "-" means surplus.

3/ Data for December 2018/June 2019 is an actual/projected stock as of the end of the month. Quarterly targets are cumulative flows from end-June 2019.

Table 13. Pakistan: Structural Conditionality

Prior Actions for Program Approval

1. Move to a flexible, market-determined exchange rate by (i) announcing that the SBP moves to a flexible market-determined exchange rate with a focus on price stability and interventions are limited to safeguarding financial stability and preventing disorderly market conditions (DMC) and (ii) tightening the monetary stance by 150 bps.
2. Reach formal public agreement between the federal and provincial governments on the fiscal targets consistent with the program.
3. Adopt by parliament the FY 2020 budget consistent with program targets.
4. Adopt a package of measures in the energy sector: (i) Implement a quarterly automatic tariff adjustment in the electricity sector by about 10 percent to generate Rs 150 billion in additional revenues and (ii) notify by government the FY 2020 gas tariff adjustment as proposed by the regulator to become effective on July 1st, 2019.

Structural Benchmarks	**Date**
Fiscal	
1. Commit to not grant further tax amnesties	Continuous
2. Issue licenses for the track-and-trace system for excises on cigarettes	end-September 2019
Monetary/Financial	
3. Adopt measures to strengthen the effectiveness of the AML/CFT framework to support the country's efforts to exit the Financial Action Task Force list of jurisdictions with serious deficiencies	end-October 2019
4. Submit to parliament, in consultation with IMF staff, amendments to the State Bank of Pakistan Act to address all recommendations of the new 2019 Safeguards Assessment Report and the 2016 Technical Assistance Report on Central Bank Law Reform (MEFP para. 14)	end-December 2019
State-Owned Enterprises	
5. Notify the FY 2020 electricity tariff schedule as determined by the regulator	end-September 2019
6. Prepare a comprehensive circular debt reduction plan in collaboration with international partners (para. 19 MEFP)	end-September 2019
7. Submit to parliament amendments to the NEPRA Act to (i) ensure full automaticity of the quarterly tariff adjustments and (ii) eliminate the gap between the regular annual tariff determination and notification by the government	end-December 2019
8. Conduct and publish new audits by reputable international auditors of Pakistan International Airlines and Pakistan Steel Mills	end-December 2019
9. Conduct a triage of all SOEs, dividing them into companies to (i) maintain under state management; (ii) privatize; or (iii) liquidate	end-September 2020
10. Submit to Parliament a new State-Owned Enterprise law to improve governance and transparency in line with IMF recommendations	end-September 2020
Social Protection and gender	
11. Finalize BISP's banking contracts and launch financial inclusion strategy for women	end-October 2019
12. Update the benefit structure of Waseela-e-Taleem (WeT) to narrow the educational gender gap	end-December 2019
13. Finalize the update of the BISP beneficiaries' database (National Socio-Economic Registry)	end-June 2020

Annex I. Public and External Debt Sustainability

Debt is at the limit of sustainability and subject to high uncertainty, but strong fiscal adjustment in the program and firm commitments from major bilateral official lenders to maintain their exposure well beyond the program period mitigate risks, therefore debt is judged sustainable. Public debt-to-GDP ratio remains high, with government and government-guaranteed debt having reached 75 percent of GDP in FY 2018. Public debt will only be sustainable with full implementation of the adjustment program. Under the EFF, a strong fiscal consolidation of 4½ percent of GDP in primary balance over four years and a recovery in growth supported by structural reforms will help public debt decrease to around 67 percent of GDP by FY 2024. The re-profiling of central bank holdings of government debt will also help render gross financing needs more manageable. External debt-to-GDP is projected to steadily decline after peaking in FY 2021 due to smaller current account deficits, capital inflows, and flexible market-determined exchange rates. Importantly, the large gross financing needs are partly driven by the continuous rollover of claims to non-traditional bilateral official creditors. Given these creditors' firm commitments to maintain their exposure, the underlying gross external financing needs can be estimated to be lower by 1.3 percentage points of GDP on average per year during the program and beyond the program period. Nonetheless, adverse shocks, notably to the primary balance, economic growth, and the real interest rate, could threaten debt sustainability.

Public Debt Sustainability

1. **Pakistan's government and government-guaranteed debt has been on an increasing path since 2017**. Public debt increased to 75.3 percent of GDP by the end of FY 2018, up from 70 percent of GDP in the previous fiscal year, while public debt excluding guarantees reached about 72 percent of GDP. Net public debt also increased to around 67 percent of GDP. Gross financing needs reached almost 34 percent of GDP, up from 29.4 percent a year ago.

2. **The maturity structure of public debt has worsened**. As of March 2019, 57 percent of domestic public debt had a maturity of less than a year, up from 54 percent in June 2018. Moreover, the stock of short-term debt from the Central Bank more than doubled in last ten months, reaching 19 percent of GDP in March, while three-month T-bills declined but remained high at 8 percent of GDP. While the Treasury bills are denominated in local currency, which mitigates rollover risk as long as there is sufficient liquidity in the domestic banking system, the large amount of short-term debt raises the government's exposure to interest rate risk. The annual increase in short-term public debt has surpassed the upper risk-assessment benchmark as shown in the heatmap. The adjustment scenario envisages a reprofiling of the short-term debt held by the Central Bank, discontinuation of Central Bank financing, and a gradual decrease of foreign currency-denominated debt to reduce rollover and exchange rate risks.

3. **Strong fiscal consolidation is required to restore public debt sustainability and support adjustment in the balance of payments**. Staff recommends an adjustment of 4.4 percent of GDP in primary fiscal balance over four years starting from FY 2020, together with an end to currency intervention. Front-loaded and revenue-based fiscal consolidation measures of 4.8 percent of GDP

are needed to achieve the desired level of adjustment, while currency depreciation supports import-related revenue measured in domestic currency. However, the resulting higher inflation and interest rate will initially prompt a surge in interest expenditure. The expected drop in the growth rate will negatively affect the fiscal position in the short run, but the expected pickup in growth in the medium term, together with significant fiscal adjustment, will help put public debt on a firm downward sloping trajectory.

4. Under the program scenario, public debt is projected to reverse its trajectory from 2020 onwards. Debt is expected to reach 80.5 percent of GDP in 2020, partly reflecting currency depreciation, but to fall sharply to 67 percent of GDP by FY 2024. Public debt excluding guarantees will come down to 64 percent of GDP. Gross financing needs are expected to decline sharply to 23 percent of GDP in FY 2020 and further to 16.7 percent by FY 2024, reflecting the reprofiling of short-term domestic debt held by the Central Bank. Still, both the debt level and the gross financing needs are just above the empirically determined risk benchmarks shown by the heatmap.

5. The alternative and stress-test scenarios underscore risks to debt trajectory if program is not fully implemented. Adverse shocks, notably to the primary balance, economic growth, and the real interest rate, could lead to higher public debt trajectories. Under the constant primary balance scenario (assuming primary balance remains at the level of 2018), and under the scenario based on historical performance (assuming real GDP growth, the primary balance and real interest rates at the historical average of the past ten years), the debt ratio would reach 83 percent of GDP by 2024, and gross financing needs would remain at 26 percent of GDP. The debt ratio exceeds 70 percent of GDP under all stress-test scenarios, and it is the most sensitive to the interest rate and exchange rate shock, under which debt reaches 73 and 72 percent of GDP in 2024, respectively. Contingent liabilities from loss-making SOEs, to the extent not covered by government guarantees, represent additional fiscal risks (about 2 percent of GDP). The program will aim to strengthen the transparency related to other types of contingent liabilities, such as in the context of power generation projects.

6. The forecast track record for real GDP growth has been good but forecast errors for primary balance and inflation have been large in the past and often on the optimistic side. Since the programmed fiscal consolidation is revenue-based, the fiscal multiplier is relatively low and the impact on growth is expected to be moderate. The three-year adjustment in the cyclically-adjusted primary balance (CAPB) under the program scenario falls just in the top quartile, reflecting strong adjustment needs. However, the three-year average CAPB level sits right around the median in a sample covering all countries.

External Debt Sustainability

7. External debt risks remain high, but under the EFF, external debt is estimated to remain sustainable given a sustained fall in external debt and strong commitments from bilateral official lenders. External debt is projected to rise to around 37 percent of GDP at end-FY 2019 mainly driven by sizable external borrowing, a large current account deficit and currency depreciation. However, under the EFF program that consists of strong macro policy adjustments and structural reforms, external debt is projected to steadily decline after peaking in FY 2021, returning to a more sustainable path. The moderation in external debt is mainly driven by a narrower current account deficit, non-debt creating capital inflows, and a recovery in economic growth. Gross external financing relative to GDP needs are also projected to steadily fall from FY 2021, declining to around 8 percent over the medium-term. Importantly, given firm commitments from major bilateral official lenders to maintain their exposure during the program period, underlying gross external financing needs would be lower by 1.3 percentage points of GDP on average per year during the program and beyond the program period.

8. The projected external debt path is subject to heightened risks. Bound and stress tests suggest that the external debt-to-GDP ratio would be adversely affected by shocks. While sensitive mostly to current account and exchange rate shocks, the external debt ratio would reach around 60 percent under a real depreciation shock scenario. The heightened risk highlights the need for strong macroeconomic policy adjustments and structural reforms for external debt sustainability. Financing assurances as discussed in the main text are critical.

Pakistan: Public DSA Risk Assessment

Heat Map

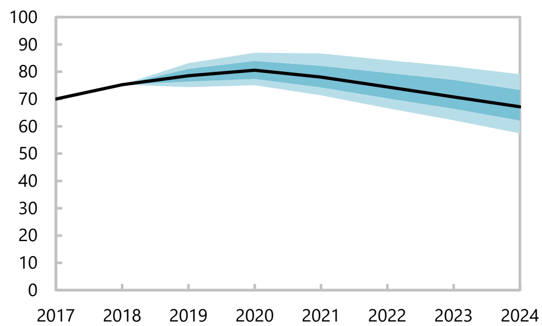
Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

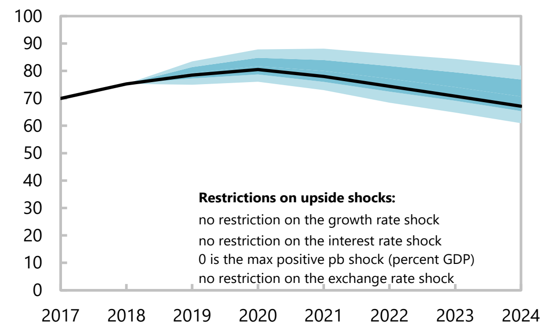
(in percent of GDP)

Baseline   Percentiles: 10th-25th   25th-75th   75th-90th

Symmetric Distribution



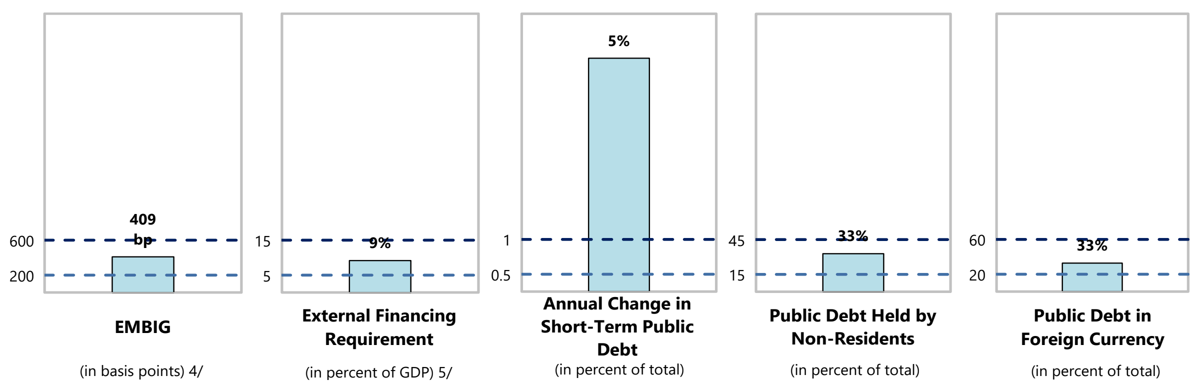
Restricted (Asymmetric) Distribution



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)

Pakistan   Lower early warning   Upper early warning



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

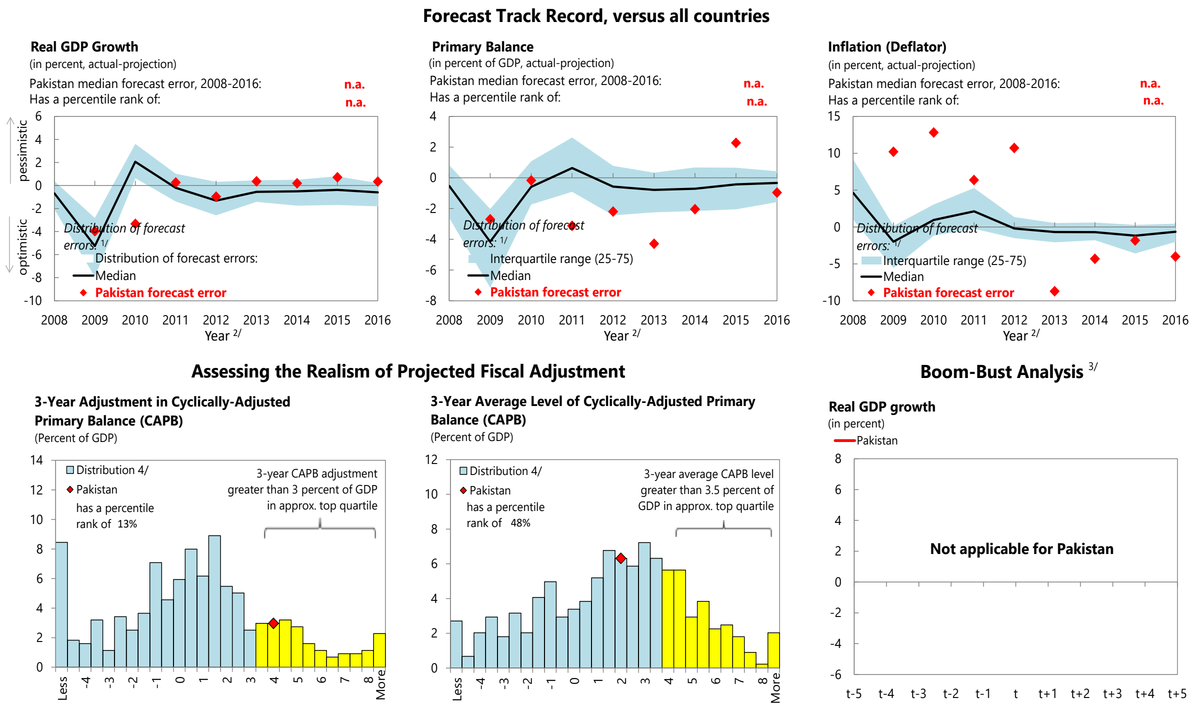
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 20-Feb-19 through 21-May-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Pakistan: Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Pakistan, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Pakistan: Public Sector Debt Sustainability Analysis (DSA) – Program Scenario
(In percent of GDP unless otherwise indicated)

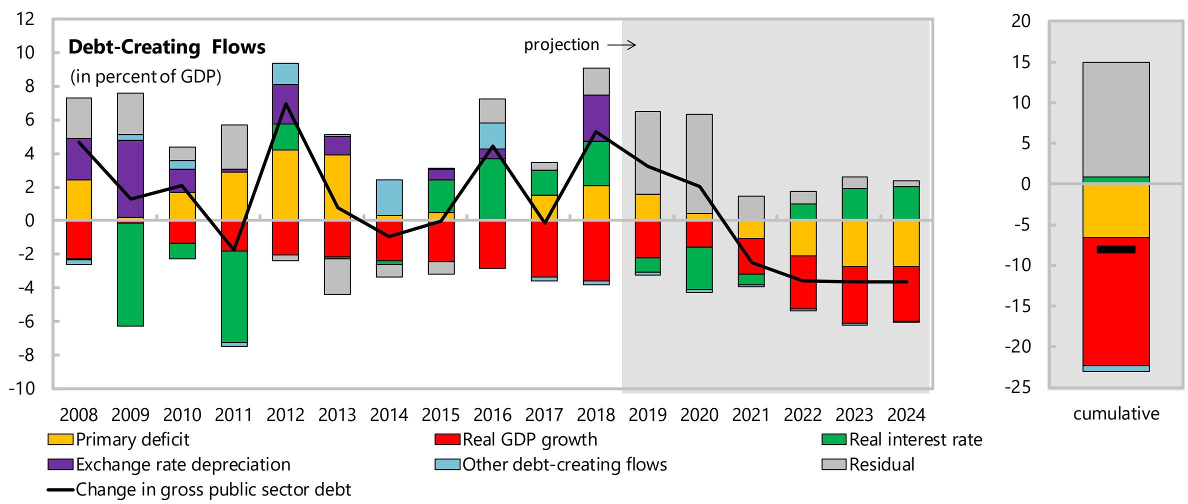
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	63.3	70.0	75.3	79.1	80.5	78.0	74.4	70.8	67.1
Of which: guarantees	2.2	2.9	3.6	4.2	3.6	3.6	3.6	3.6	3.5
Public gross financing needs	27	29.4	33.7	36.0	23.6	22.7	20.2	18.5	16.7
Real GDP growth (in percent)	3.5	5.2	5.5	3.3	2.4	3.0	4.5	5.0	5.0
Inflation (GDP deflator, in percent)	9.9	4.3	2.8	7.8	12.6	9.8	6.9	5.2	5.1
Nominal GDP growth (in percent)	13.7	9.8	8.4	11.4	15.3	13.1	11.8	10.5	10.3
Effective interest rate (in percent) [4/]	8.6	6.9	7.0	6.8	9.2	9.2	8.7	8.3	8.5

As of May 21, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		408
5Y CDS (bp)		376
Ratings	Foreign	Local
Moody's	B3	n.a.
S&Ps	B	n.a.
Fitch	B	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.9	-0.1	5.3	3.8	2.0	-2.5	-3.6	-3.6	-3.7	-7.5	
Identified debt-creating flows	1.3	-0.6	3.7	-1.7	-3.8	-4.0	-4.3	-4.3	-4.0	-22.1	
Primary deficit	1.8	1.5	2.1	1.6	0.4	-1.0	-2.1	-2.7	-2.7	-6.6	-1.3
Primary (noninterest) revenue and gra	14.1	15.5	15.2	15.0	16.3	17.9	19.1	19.6	19.6	107.6	
Primary (noninterest) expenditure	16.0	17.1	17.3	16.6	16.7	16.9	17.0	16.9	16.9	101.0	
Automatic debt dynamics [5/]	-1.1	-1.8	1.8	-3.1	-4.1	-2.8	-2.1	-1.5	-1.2	-14.8	
Interest rate/growth differential [6/]	-2.6	-1.9	-0.9	-3.1	-4.1	-2.8	-2.1	-1.5	-1.2	-14.8	
Of which: real interest rate	-0.6	1.5	2.6	-0.8	-2.5	-0.6	1.0	1.9	2.0	0.9	
Of which: real GDP growth	-1.9	-3.3	-3.6	-2.2	-1.6	-2.1	-3.2	-3.4	-3.2	-15.7	
Exchange rate depreciation [7/]	1.5	0.0	2.8	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.6	-0.3	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.8	
Residual, including asset changes [8/]	0.6	0.4	1.6	5.5	5.9	1.4	0.7	0.7	0.4	14.6	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as guarantees to PSEs.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

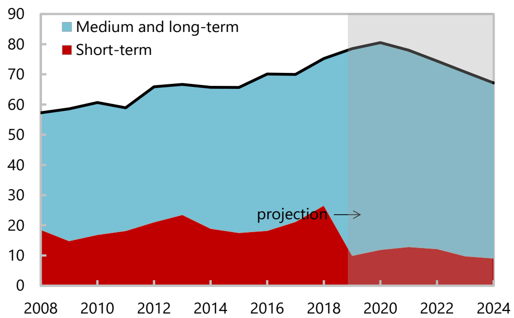
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

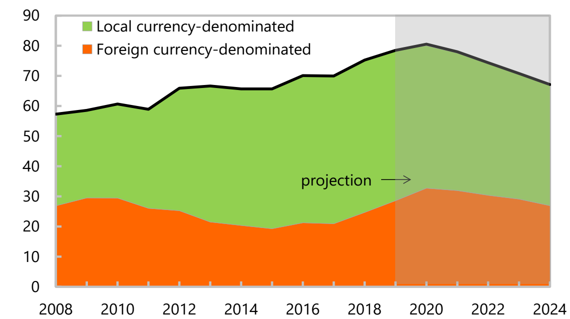
Pakistan: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



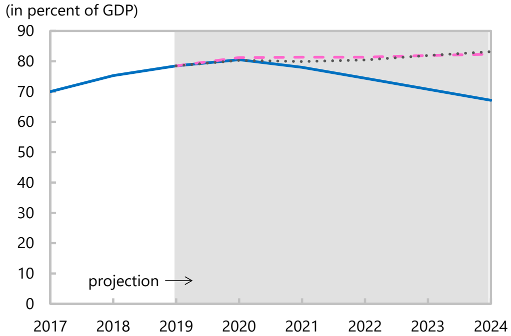
By Currency
(in percent of GDP)



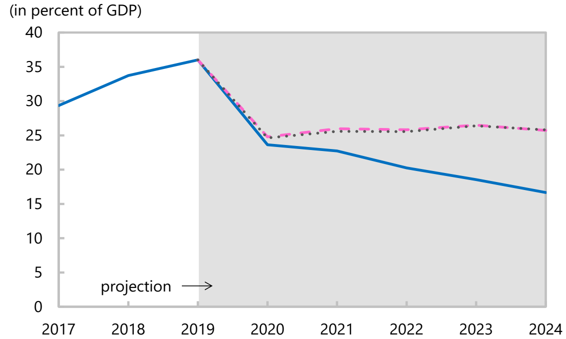
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

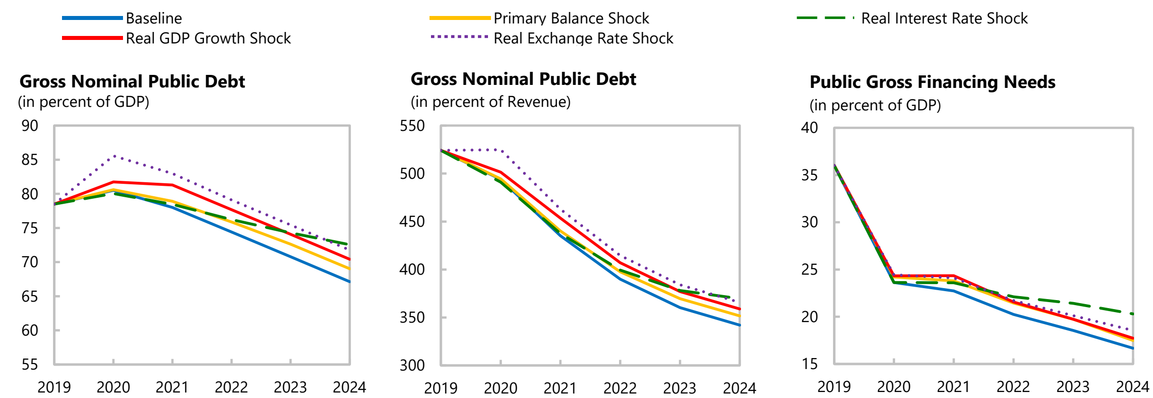
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.3	2.4	3.0	4.5	5.0	5.0
Inflation	7.8	12.6	9.8	6.9	5.2	5.1
Primary Balance	-1.6	-0.4	1.0	2.1	2.7	2.7
Effective interest rate	6.8	9.2	9.2	8.7	8.3	8.5
Constant Primary Balance Scenario						
Real GDP growth	3.3	2.4	3.0	4.5	5.0	5.0
Inflation	7.8	12.6	9.8	6.9	5.2	5.1
Primary Balance	-1.6	-1.6	-1.6	-1.6	-1.6	-1.6
Effective interest rate	6.8	9.2	9.2	8.7	8.2	8.5

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	3.3	3.8	3.8	3.8	3.8	3.8
Inflation	7.8	12.6	9.8	6.9	5.2	5.1
Primary Balance	-1.6	-1.7	-1.7	-1.7	-1.7	-1.7
Effective interest rate	6.8	9.2	9.0	8.4	7.8	7.8

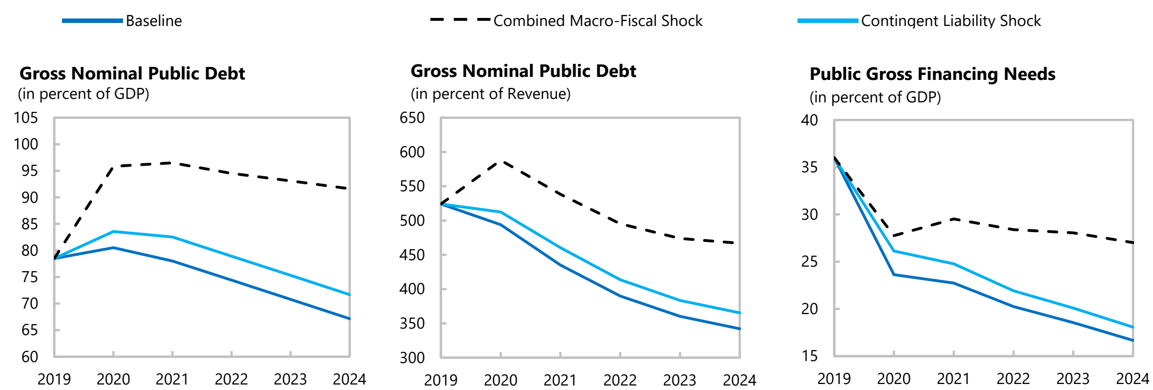
Source: IMF staff.

Pakistan: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	3.3	2.4	3.0	4.5	5.0	5.0
Inflation	7.8	12.6	9.8	6.9	5.2	5.1
Primary balance	-1.6	-1.0	0.3	1.6	2.4	2.7
Effective interest rate	6.8	9.2	9.3	8.8	8.4	8.5
Real Interest Rate Shock						
Real GDP growth	3.3	2.4	3.0	4.5	5.0	5.0
Inflation	7.8	12.6	9.8	6.9	5.2	5.1
Primary balance	-1.6	-0.4	1.0	2.1	2.7	2.7
Effective interest rate	6.8	9.2	10.5	10.8	10.9	11.5
Combined Shock						
Real GDP growth	3.3	0.9	1.5	4.5	5.0	5.0
Inflation	7.8	12.3	9.4	6.9	5.2	5.1
Primary balance	-1.6	-1.0	0.3	1.6	2.4	2.7
Effective interest rate	6.8	10.1	10.0	10.8	10.9	11.5

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	3.3	0.9	1.5	4.5	5.0	5.0
Inflation	7.8	12.3	9.4	6.9	5.2	5.1
Primary balance	-1.6	-0.7	0.4	2.1	2.7	2.7
Effective interest rate	6.8	9.2	9.3	8.8	8.4	8.5
Real Exchange Rate Shock						
Real GDP growth	3.3	2.4	3.0	4.5	5.0	5.0
Inflation	7.8	23.3	9.8	6.9	5.2	5.1
Primary balance	-1.6	-0.4	1.0	2.1	2.7	2.7
Effective interest rate	6.8	10.1	8.7	8.1	8.0	8.1
Contingent Liability Shock						
Real GDP growth	3.3	0.9	1.5	4.5	5.0	5.0
Inflation	7.8	12.3	9.4	6.9	5.2	5.1
Primary balance	-1.6	-2.1	1.0	2.1	2.7	2.7
Effective interest rate	6.8	9.9	9.3	8.8	8.4	8.5

Source: IMF staff.

Pakistan: External Debt Sustainability Framework, Program Scenario 2014–24

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2014	2015	2016	2017	2018			2019	2020	2021	2022	2023	2024	Debt-stabilizing non-interest current account 6/
Baseline: External debt	26.8	24.1	26.5	27.4	30.3			**36.7**	**43.4**	**43.5**	**42.2**	**41.2**	**39.3**	**-2.7**
Change in external debt	0.4	-2.7	2.5	0.9	2.9			6.3	6.7	0.1	-1.3	-1.0	-1.9	
Identified external debt-creating flows (4+8+9)	-0.8	-1.9	0.2	1.0	4.3			2.9	0.8	-0.3	-1.3	-1.7	-1.6	
Current account deficit, excluding interest payments	0.6	0.3	1.0	3.3	5.4			3.6	1.2	0.6	0.3	0.2	0.3	
Deficit in balance of goods and services	7.9	7.5	8.1	10.2	12.0			11.5	10.4	9.6	9.1	8.7	8.4	
Exports	12.4	11.1	9.8	9.0	9.5			10.6	12.5	13.0	13.0	13.1	13.1	
Imports	20.3	18.5	18.0	19.2	21.6			22.1	22.9	22.6	22.1	21.8	21.5	
Net non-debt creating capital inflows (negative)	-0.7	-0.3	-0.8	-0.9	-1.1			-0.6	-0.8	-1.1	-1.2	-1.4	-1.5	
Automatic debt dynamics 1/	-0.8	-1.9	0.1	-1.5	0.1			-0.1	0.4	0.2	-0.4	-0.5	-0.4	
Contribution from nominal interest rate	0.6	0.7	0.8	0.8	1.0			1.0	1.4	1.4	1.4	1.5	1.5	
Contribution from real GDP growth	-1.0	-1.0	-1.1	-1.3	-1.5			-1.1	-0.9	-1.2	-1.8	-2.0	-1.9	
Contribution from price and exchange rate changes 2/	-0.4	-1.6	0.4	-1.0	0.6			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.2	-0.8	2.3	-0.1	-1.4			3.5	5.9	0.4	0.0	0.7	-0.3	
External debt-to-exports ratio (in percent)	215.2	217.4	269.8	303.2	317.6			344.8	345.8	333.6	325.0	315.4	299.9	
Gross external financing need (in billions of US dollars) 4	10.8	9.1	11.4	21.7	28.8			25.5	23.2	25.6	26.7	27.3	27.5	
in percent of GDP	4.4	3.4	4.1	7.1	9.2	10-Year	10-Year	9.0	8.9	9.3	9.0	8.6	8.1	
Scenario with key variables at their historical averages 5/								**36.7**	**37.6**	**38.4**	**39.2**	**40.1**	**40.1**	**-2.2**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	4.1	4.1	4.6	5.2	5.5	3.8	1.5	3.3	2.4	3.0	4.5	5.0	5.0	
GDP deflator in US dollars (change in percent)	1.6	6.4	-1.5	3.9	-2.1	2.6	5.6	-12.5	-10.8	2.4	3.3	1.7	2.1	
Nominal external interest rate (in percent)	2.5	3.0	3.3	3.3	3.7	3.0	0.7	3.1	3.4	3.5	3.6	3.7	3.9	
Growth of exports (US dollar terms, in percent)	-3.6	-1.5	-8.5	0.5	9.0	2.6	9.7	0.6	7.7	9.6	7.6	7.5	7.5	
Growth of imports (US dollar terms, in percent)	2.5	0.9	0.0	16.8	15.8	4.5	9.9	-7.3	-5.4	4.3	5.2	5.2	6.1	
Current account balance, excluding interest payments	-0.6	-0.3	-1.0	-3.3	-5.4	-1.7	1.9	-3.6	-1.2	-0.6	-0.3	-0.2	-0.3	
Net non-debt creating capital inflows	0.7	0.3	0.8	0.9	1.1	0.9	0.5	0.6	0.8	1.1	1.2	1.4	1.5	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

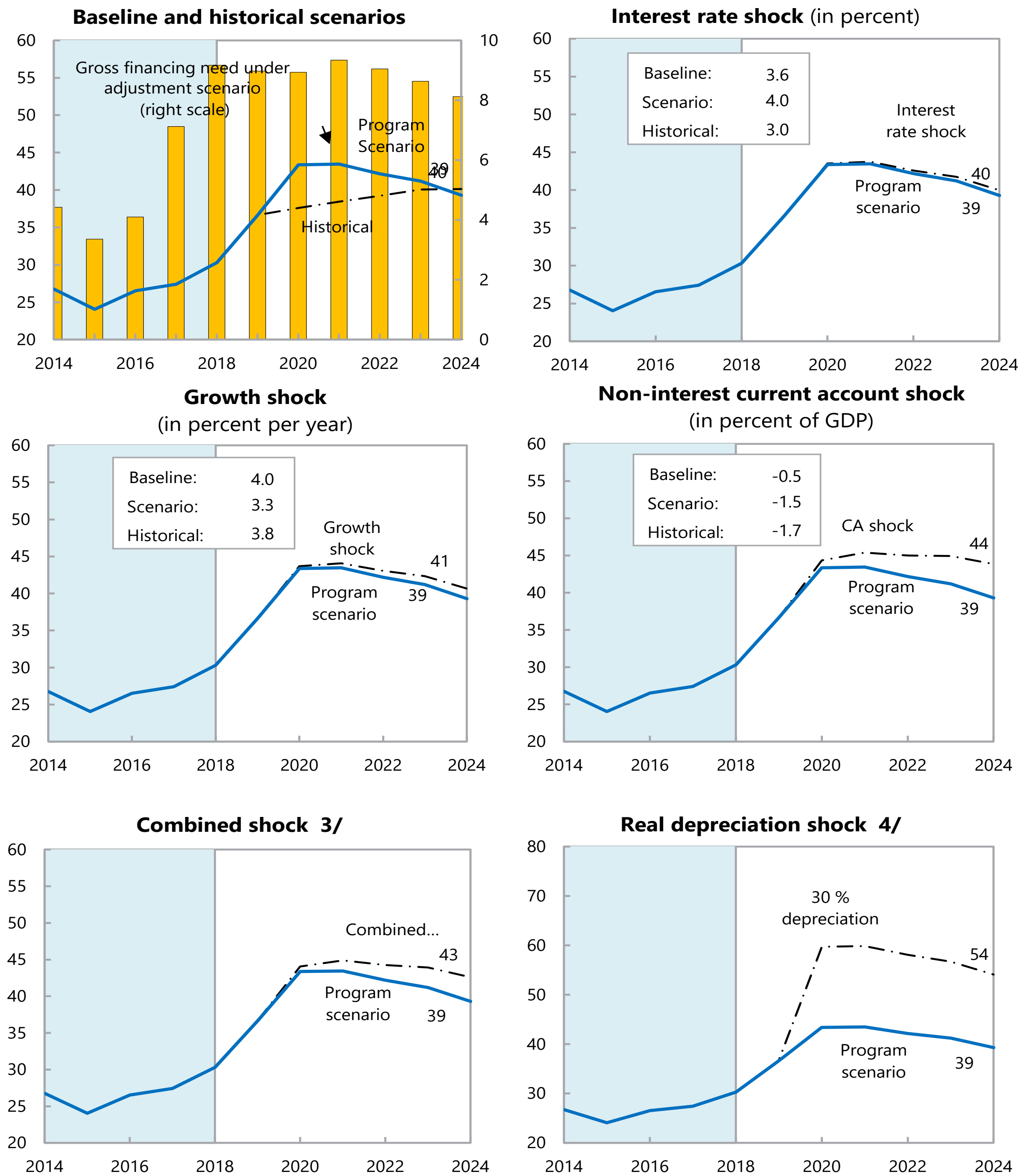
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Pakistan: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2018.

Appendix I. Letter of Intent

June 19, 2019

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

Pakistan's economy faces important challenges. To address these, we have undertaken significant measures since the start of 2018. These include greater exchange rate flexibility, monetary tightening, and other administrative measures to contain domestic demand and the widening current account deficit. Nevertheless, structural challenges have remained unaddressed and institutions have not been strengthened to ensure economic discipline. This has generated repeated cycles of economic and financial distress. Moreover, a less favorable external environment has added to this difficult picture. As a consequence, international reserves have reached critically low levels and the balance of payments gap is still large in an environment of limited market access.

The Government of Pakistan is firmly committed to resolving these imbalances and setting Pakistan on a medium-term trajectory of sustained and balanced growth through implementation of stabilization policies, enduring structural reforms that strengthen the institutional framework, and expanding social safety nets to cushion the impact of needed stabilization policies on the poor. To this end, we have already implemented several stabilizations measures:

- adoption of the FY 2020 budget based on significant revenue gains to accelerate fiscal consolidation;
- adoption of a flexible market-determined exchange rate as a buffer against external shocks, with SBP intervention in the foreign exchange market limited to preventing disorderly market conditions and a possible exchange rate overshooting but not suppressing a trend;
- further tightened monetary policy to shore up confidence and control inflation;
- increased gas and power tariffs to stop the growth of quasi-fiscal deficits; and
- expanded social support, including through the establishment of Ehsaas as our main poverty reduction and safety nets program.

Beyond the short-term measures, further policy actions will be needed, and to that end we have developed a comprehensive economic recovery program. The program aims to increase tax revenues by 4–5 percent of GDP to reduce the large budget deficit and ensure debt sustainability while generating the resources needed to expand productive government spending in health, education, and social support. Moreover, we plan to address other structural challenges through upfront efforts and a well-designed structural reform agenda, including: institution building, aiming to make reforms permanent and avoid the recurrent policy slippages of the past; and social protection to strengthen the social safety nets. To show our strong ownership, all levels of government, including provincial governments, have declared their unwavering support to these efforts, aimed at ensuring the success of our policies and testament of the full commitment to our reform program.

In support of our economic program, we request a 39-month extended arrangement under the IMF's Extended Fund Facility (EFF) in the amount equivalent to SDR 4,268 million (equivalent to 210 percent of Pakistan's quota, about US$6 billion at current exchange rates). The extended arrangement under the EFF will provide needed external financing and signal our commitment to implement sound policies, thereby bolstering market confidence and catalyzing additional financial support from other development and bilateral partners, and private sources. Evidence of this support are the significant financial commitments already announced by our main official and bilateral donors. We firmly intend to deliver on these decisive reforms to avoid the repeated cycles of instability that have resulted in Pakistan requesting IMF support recurrently. Lasting improvements in our macroeconomic policy framework and strong structural reforms set this program apart from previous ones.

We believe that the policies set forth in the attached Memorandum of Economic and Financial Policies are adequate for the successful implementation of our program. We will monitor economic developments and performance and stand ready to take additional measures that may become necessary to achieve our program objectives. We will consult with the IMF before modifying measures contained in the MEFP or before the adoption of new measures that would deviate from the goals of the program, in accordance with the Fund's policies on such consultations. We will supply the Fund with timely and accurate data that are needed for program monitoring. The understandings between us and the IMF regarding performance criteria and structural measures described in this letter are further specified in the attached TMU. Reaffirming commitment to our policy of transparency, we consent to the IMF's publication of this letter, the MEFP, the TMU, and the accompanying Executive Board documents.

Sincerely yours,

/s/
Abdul Hafeez Shaikh
Advisor to the Prime Minister on Finance,
Revenue, and Economic Affairs
Pakistan

/s/
Reza Baqir
Governor of the State Bank of Pakistan
Pakistan

Attachment I. Memorandum on Economic and Financial Policies

A. Background

1. Pakistan's economy faces a challenging macroeconomic situation despite the implementation of several stabilization measures. The sustained weakening in Pakistan's economic fundamentals is taking a significant toll in our economy, resulting in a growth slow-down and unsustainable balance of payments and fiscal deficit. This situation has arisen because limited attention has been paid in recent years to implement much needed structural reforms, expand avenues for domestic revenue mobilization, and resolve the inefficiencies and losses in State Owned Enterprises (SOEs).

2. The current juncture calls for coordinated decisive measures to stabilize the economy and lay the foundations for robust and balanced growth. Pakistan's economic experience, characterized by the recurrence of stop-and-go cycles, has revealed the constraints that our policy making framework imposes on our growth potential. Moreover, a challenging business climate, lagging governance and institutional building efforts, and structural obstacles have further hampered our competitiveness. To address the immediate stabilization challenges and the structural reforms we have designed and sequenced an ambitions economic program.

B. Economic Program

Fiscal Policy

3. The key pillar of our fiscal strategy is to generate the revenue resources to support human capital development, while ensuring debt sustainability. We aim to increase our tax revenue by 4–5 percent of GDP and target a cumulative fiscal primary adjustment of 4½ percent of GDP by FY 2023, bringing the overall deficit in compliance with the Fiscal Responsibility and Debt Limitation Act (FRDLA) and debt on a firm downward trajectory. This is important to strengthen economic resilience against market volatility and allow more resources to be allocated to the private sector at lower cost. At the same time, it will create fiscal space for much-needed priority spending on health, education, infrastructure, and targeted programs for social protection.

4. The recent adoption of the FY 2020 budget (*prior action*) has been a critical step to kickstart fiscal consolidation and enhance debt sustainability. The budget targets a primary fiscal adjustment of 1.2 percent of GDP, mostly through high-quality revenue measures aimed at broadening the tax base. Key measures include: (i) eliminating tax concessions and exemptions and reducing zero-rated products, particularly on sales tax; (ii) increasing the excise on cigarettes and introducing new excise duties; (iii) reducing the personal income tax thresholds and increasing the rate; and (iv) enhancing the sales tax of petroleum products.[1] The budget also incorporates all

[1] See detailed table of measures for FY 2020 budget.

government-provided implicit subsidies,[2] amounting to PRs 35 billion, that in the past have been a significant contributor to the accumulation of circular debt in the energy sector. Finally, to support the efforts to reduce inflation, we have set federal government wage increases to 7.5 percent to maintain a tight income policy.

5. The budget includes additional social spending to protect the poorest households. As the adjustment policies could disproportionately affect the more vulnerable segments of society, we are planning for a concurrent, significant increase in social safety net spending. Initially, we are aiming to increase spending in the Benazir Income Support Program (BISP) to 0.4 percent of GDP on an annual basis. In subsequent budgets, we will assess the need and scope for additional increases in social spending.

6. Beyond FY 2020, our fiscal consolidation strategy is aiming to return Pakistan toward its commitments under the FRDLA. Given Pakistan's still low tax ratio (below 13 percent of GDP), the adjustment strategy will be primarily revenue-based, designed to achieve a 4–5 percentage points of GDP increase in tax revenues by the end of the program. While some tax rate increases might be unavoidable, the tax policy and administration strategy will center on maintaining a low tax rate with a broad tax base. The specific measures include:

- *Tax policy reform* aimed at simplifying collection and broadening the tax base. These will include: (i) harmonizing and coordinating inter-provincial GST and eliminating all, but for basic foods and medicines, GST exemptions and preferential rates; (ii) overtime, transforming the GST into a broad-based VAT; (iii) further strengthening taxation on agricultural turnover or income by provinces; (iv) raising the upper-end of the PIT structure; (v) eliminating PIT tax credits and deductions for the higher income slabs; (vi) ensuring equivalent taxation of all sources of income; (vii) eliminating distortionary withholding taxes; and (viii) real estate taxation.

- *Tax administration reform* will be crucial to collect taxes broadly and fairly. Given the fragmented nature of our tax administration, we will create a new semi-independent national tax authority to collect the main revenue sources. We have also reversed recent legal provisions that limit the use of tax audits. Other tax administration measures may include: (i) implement a full, risk-based audit framework; (ii) increase legal penalties for tax non-compliance; and (iii) issue licenses for the track-and-trace system for excises on cigarettes by end-September 2019 (structural benchmark) and implement the system by end-March 2020. Moreover, we will commit to not granting further tax amnesties *(continuous structural benchmark)*.

[2] These include the Industrial Support Package for some exporting sectors, AJK, and agricultural tubewells.

TAX POLICY MEASURES	Estimated yield	
	Millions	Percent of GDP
Sales Tax	**222,776**	**0.5**
Petroleum products levy increase to 15 PRs (and set as a floor) and GST rate at 17 percent (set as a floor)		
Cancel SRO # 480 and bring steel sector, edible oil and medium to large retailers to 17 percent GST regime		
Extend the list of products under the retail price taxation - Third Schedule (home appliances, paint.., currently under SRO # 480)		
Cancel SRO#1125 and bring exportable sectors to standard GST regime at 17 percent rate, with immediate cash refund for exported goods only		
Remove certain items from exemptions (packaged food), and apply GST tax at 17 percent.		
Increase GST on sugar from 8 percent to 17 percent		
Redefine the exemption available to Cottage Industry		
Federal Excise Duty (FED)	**90,114**	**0.2**
Increase of FED on cigarettes and remove the third tier. Introduce FED on cigarettes coming from non tariff areas		
Increase/introduce FED on sugary drinks to 13 percent		
Increase FED on cement from 1.5 Rs per kg to 2 Rs		
Income Tax	**324,982**	**0.7**
PIT: lower the threshold to PRs 400,00 and 600,000 for non-salaried and salaried individuals respectively, increase tax rates		
Increase in rate of minimum tax u/s 113 from 1.25 to 1.5		
Extend the regime of higher withholding tax rates for non-filers		
Resume Telecom withholding rate		
Change in income tax regime of Services sector (banks and insurance companies)		
Abolish BMR credit incentives		
Increase the holding period liable to tax for capital gain tax on immovable properties and securities		
Taxation of gifts from unrelated person at standard PIT rate.		
Aligning value of immovable properties with the market rates		
Reduction of number of WHTs & Simplification of procedures		
Amortization of expenditure in BOT projects over useful life of the project instead of current 10 year amortization		
Long term lease hold right may be considered as purchase of property		
Taxation of formal agricultural sector within the scope of federal government		
Rationalization of tax credit available to Non-profit organizations (NPOs)		
Customs	**60,000**	**0.1**
Increase in Additional Customs Duty Rate on finished and luxury goods		
Withdrawal of exemption on import of LNG and subjected to 5 percent duty		
REVENUE ADMINISTRATION MEASURE	**35,600**	**0.1**
Implement Track and Trace system for Tobacco Products		
Automated monitoring of GST and income at retail (point of sale)		
Changes in ADCIR mechanism		
Separation of audit & adjudication functions		
Making procedure for prosecution easier		
Enabling and strengthening FBR field formations		
Cleansing of databases and integration to enable effective data mining		
Enabling efficient enforcement through investment in FBR Infrastructure and process reengineering		
Tax payer education and facilitation		
TOTAL	**733,471**	**1.7**

- *Modernize the Public Finance Management Framework*. We have adopted an organic budget law that will minimize variance in budget authorizations during the year, which shall also require ex-post parliamentary approval, restrict virements, expand the content of annual budget statements, define accounting standards, and provide the legal basis for a well-defined cash management system and establishment of a treasury single account (TSA).

- *Eliminate the legal authorization for the executive to grant tax exemptions/concessions through Statutory Regulatory Orders (SROs) without prior National Assembly approval*. We understand that the use of SRO needs to be subject to greater scrutiny and limited discretion. To that end, we have adopted the necessary revisions and amendments to the various relevant tax ordinances to further limit or eliminate the use of SROs to genuine emergencies, in line with best international practices. In the meantime, we will refrain from issuing any SRO reducing the GST rate below 17 percent on petroleum products.

- *Enforce fiscal discipline*. This will include strengthening the enforcement mechanism of the FRDLA through aligning the annual report presented by the Minister of Finance (MoF) to the National Assembly with the content and analysis prescribed in the Act. Also, we will expand the capacity of the MoF for macro-fiscal work. Moreover, proper identification and monitoring of fiscal risks from SOEs, PPPs, IPPs and development projects will be strengthened through the establishment of a fiscal risk unit in the MoF, which will work in coordination with the PPP Authority.

- *Build a strong PPP framework*. We are aware that PPP projects, while bringing great benefits, can also be the source of important risks. Thus, we are committed to strengthening the PPP legal framework. To this end, we are conducting a legal analysis of the current system to determine if amendments to the PPP law are required or, alternatively, whether enacting secondary legislation is sufficient, drawing on the expertise of our development partners. We will also make sure that proposed financial vehicles such as the Pakistan Infrastructure Bank is created in line with best international governance standards.

- *Improve cash and debt management*. We will create a Treasury office that would conduct sound commitment controls and cash management, closely coordinating with the debt management unit. We will strengthen the debt management office and will ensure greater coordination across the different relevant units. Elements of this strategy will include centralizing the issuance and management of public debt and developing a new Medium-Term Debt Strategy. To support our consolidation efforts and reduce our financing requirements, we will lengthen the maturity profile of public debt and will introduce new market instruments to widen the investors' base, also transparently accounting for all borrowing and contingent liabilities. We will ensure that any collateralized public external debt or external arrears would be properly accounted.

7. Fiscal consolidation and revenue expansion by the provinces will be a key component of our fiscal strategy. The fiscal adjustment strategy would imply large provincial surpluses. Therefore, we have signed a formal written agreement with the provinces on the fiscal strategy and the required provincial surpluses, including revenue and fiscal surplus targets by province for

FY 2020 and implications in case of missed targets. This agreement has been made public to ensure accountability and measure progress and performance (*prior action*). Progress toward these goals will be assessed in quarterly meetings of the Fiscal Coordination Committee, and we will aim to strengthen the FCC's legal basis to make its decisions binding.

8. To rebalance inter-governmental relationships, in the context of the ongoing NFC we have engaged with provinces with a view to make progress on the following measures:

- Passing on additional spending responsibilities from the federal to provincial governments, including additional contributions for higher education, health, social protection, agricultural subsidies, and regional public infrastructure investment.

- Creating a jointly funded contingency fund for economic shocks and natural disasters, to reduce federal/provincial structural fiscal imbalances.

- The provinces will take steps to increase own tax-collection efforts in sales tax on services, property tax, and agricultural income tax, and harmonize their tax system to eliminate fragmentation.

- Reducing the scope of the divisible pool in the context of the ongoing NFC award. Reforming the revenue sharing formula to improve inter-provincial equity for better horizontal equity.

Poverty Reduction and Social Protection

9. Poverty reduction is the cornerstone of our commitments to the people of Pakistan. Despite considerable progress over the past two decades, Pakistan's poverty headcount remains high. We are determined to make significant headway in eradicating poverty by strengthening and broadening our safety nets. To this end, we have established *Ehsaas* as our main poverty reduction and safety nets program. We will use the Benazir Income Support Program (BISP) to implement many of these initiatives. Our immediate commitments include:

a. *Providing a one-off disbursement to BISP recipients*. To protect the most vulnerable from the impact of our adjustment policies, we will issue by July 15, 2019, a government directive to provide a one-off disbursement by end-August 2019 in the amount of PRs 1,000 to existing BISP beneficiaries.

b. *Finalizing the new banking contracts for stipend disbursements and launching our financial inclusion program for women by end-October 2019 (structural benchmark)*. The new bank contracts are expected to reduce costs and streamline stipend disbursements. In this connect, our "one woman one account" initiative will provide saving accounts to women under BISP that will facilitate their financial inclusion.

c. *Updating the benefit structure of Waseela-e-Taleem (WeT) to narrow the educational gender gap*. Our educational CCT WeT shows base levels of enrollment for girls are lower than those for boys. To boost girls' educational enrollment, we will work with development partners and modify by end-December 2019 (structural benchmark) WeT's structure by providing a girl bonus of PRs 250 to be regularly provided on a quarterly basis.

d. *Finalizing the update to the National Socio-Economic Registry (NSER)* and use it to complete recertification of BISP beneficiaries to strengthen the program's coverage and targeting in line with demographic and poverty trends. We will have 35 percent of the estimated household caseload surveyed, quality assured and validated with NADRA database by end-December 2019. We will finalize the updating of the NSER by end-June 2020 *(structural benchmark)*. We will aim to expand BISP cash transfer coverage under a progressive design.

e. Following completion of the database, we will *permanently increase the amount of BISP cash transfers* from the current PRs 5,000 at least with the rate of inflation, but ideally more than that, for families that continue to be eligible. Thereafter, we will seek to maintain the real value of BISP's stipends through an adequate and fiscally sustainable indexation mechanism.

f. *Launching BISPS's graduation program* in line with ongoing donor support and agreements to provide greater employment opportunities for those receiving cash grants. We will also take steps to introduce a CCT program on nutrition.

Monetary and Exchange Policies

10. Monetary policy will be focused on gradually reducing and keeping inflation low and stable, in line with our medium-term objective. To support this goal, we are committed to: (i) maintaining a flexible market-determined exchange rate; (ii) further strengthening the State Bank of Pakistan's (SBP) monetary policy and operational framework; and (iii) improving communication with the general public and markets to better guide their decisions and inflation expectations.

11. We believe that a flexible market-determined exchange rate will modernize the foreign exchange rate regime and the functioning of financial markets, and contribute to a better allocation of resources in the economy. It will help to reduce accumulated external imbalances, provide a buffer against shocks, and support the rebuilding of our international reserves position. We have moved to a flexible market-determined exchange rate (*prior action*) and have allowed the exchange rate to be market determined. Going forward, we are committed to maintaining a flexible market-determined exchange rate, with SBP intervention in the foreign exchange market limited to preventing disorderly market conditions and a possible exchange rate overshooting but not suppressing a trend. These sales will not be sterilized, such that the stance of monetary policy will be correspondingly tightened if intervention is needed. Finally, to ensure that the reserve buildup is permanent, we will gradually scale back the SBP's short swap/forward foreign exchange position to US$ 4 billion by the end of the program.

12. Monetary policy would remain appropriately tight to shore up confidence and reach the inflation objective. With inflation already high and inflation expectations elevated, we increased the policy rate by 150 bps *(prior action)*. Thereafter, we will keep policy rates positive in real terms consistent with our inflation objective and geared toward achieving the program's monetary aggregate targets. If inflationary pressures persist, including from the balance of payments, we will tighten monetary policy proactively, keeping a tight control on monetary aggregates.

13. To support the SBP in achieving its monetary policy objectives, we are ending the practice of central bank financing of budget deficits. Our program eliminates any further direct financing of the budget by the SBP *(continuous performance criterion)*, including via purchases of government papers in the primary market. We also target a reduction of the SBP stock of net government budgetary borrowing gradually over time *(performance criterion*). Furthermore, and to support debt sustainability and avoid crowding out of private credit, we will immediately launch a liability management operation of the stock of government credit held by the SBP to transform it into short- and long-term tradeable instruments at various maturities (one, three, five, and ten years) and at interest rates close to market levels agreed with the SBP.

14. To build a stronger institutional framework, we will amend the State Bank of Pakistan Act to strengthen its autonomy, governance, and mandate. We will submit to parliament amendments to the SBP Act by end-December 2019 *(structural benchmark)* addressing the recommendations of the new 2019 Safeguards Assessment Report including by (i) ensuring its full operational independence in pursuit of price stability as its primary objective; (ii) lengthening the governor's tenure and delinking it from the electoral cycle; (iii) improving SBP's governance, including by clear delineation between management and oversight functions, establishment of the Executive Board, protecting personal autonomy of SBP Board and MPC members; (iv) enhancing SBP's financial autonomy and accountability by strengthening the profit distribution rules and specifying adequate recapitalization requirement; and (v) prohibiting any form of direct credit to government.

15. We will phase out the administrative measures imposed to support the balance of payments. These measures include regulatory duties on imported intermediate, consumer, and luxury goods, as well as import restrictions for balance of payments purposes and multiple currency practices (MCP)—in the form of: (i) a requirement to fully pre-fund letters of credit, imposed in early 2017; and (ii) restrictions on advance payment for imports against letters of credit, imposed in July 2018—which are subject to approval under Article VIII of the IMF's Articles of Agreement. We are committed to phasing these measures out as the balance of payments stabilizes. During the program period, we will not introduce or tighten exchange restrictions, MCPs, or import restrictions for balance of payments purposes *(continuous performance criterion)*.

16. Strengthening financial sector resilience is key to enhancing macroeconomic stability. We will closely monitor the potential adverse impact of adjustment policies on NPLs and individual banks' capitalization and ensure that all banks are well capitalized. In particular, SBP has asked all small undercapitalized banks to submit by end-September 2019 plans on how they will ensure compliance with capital requirements by end-June 2020, including via mergers or sale to new private investors. Failure to implement these plans will result in SBP intervention and resolution under the relevant provisions of law. We have also initiated the liquidation of a small undercapitalized publicly-owned bank.

17. We will urgently strengthen the AML/CFT framework in line with international standards to support the country's exit from the FATF list of jurisdictions with serious deficiencies. Owing to shortcomings in effectively addressing terrorist financing risks, Pakistan was placed in the FATF list in June 2018. We committed to an action plan with the FATF, which includes measures to: (a) properly identify and assess terrorist financing (TF) risks posed by entities as given in the FATF action plan; (b) complete the sectoral risk assessment on cash couriers; (c) implement targeted financial sanctions without delay (i.e., asset freezing and ongoing prohibitions to provide funds and financial services); (d) apply a risk-based supervision of financial institutions (e.g., on-site inspection schedules and off-site assessments) taking into account TF risks; (e) demonstrate enforcement against violations of TF sanctions and (f) improve inter-agency coordination (including between federal and provincial authorities) in combating TF risks, including TF investigations and prosecutions. We are moving to swiftly implement all measures (end-October *structural benchmark*) to support the country's exit from the FATF list. The National Executive Committee (NEC) is monitoring and coordinating efforts to implement the FATF action plan. The Asia Pacific Group on Money Laundering is expected to discuss Pakistan's mutual evaluation report in August 2019. We are seeking technical assistance from providers, including the IMF, to support our efforts to complete the action plan and further strengthen the effectiveness of the AML/CFT regime.

Energy Sector Policies

18. We are launching a comprehensive energy sector reform. The strategy aims to address long standing inefficiencies that hinder production and the provision of services to households and businesses. Ultimately, a more efficient energy sector will help support Pakistan's growth potential.

19. The power sector remains saddled with significant shortcomings. These include sizeable losses and insufficient collections, and weak governance and regulatory deficiencies. These gaps translate into distortions and losses, and the accumulation of cash flow shortfalls, or circular debt. Following years of steady declines in the flow of circular debt in the power sector, around PRs 350 billion were accumulated in FY 2019. The stock of circular debt stands now at PRs 762 billion, in addition to power sector liabilities of PRs 807 billion parked in PHPL through March 2019. These represent a significant fiscal risk that we must swiftly address. Thus, we have established a task force on energy to advise the Prime Minister on the measures and key decisions needed to ensure a successful reform. In this context, we are taking the following actions:

a. *Adjusting tariffs in line with the regulator's determination*. We have for the first time implemented a quarterly automatic tariff adjustment in the electricity sector by about 10 percent to generate PRs 150 billion in additional revenues to reduce the circular debt accumulated over the first half of FY 2019 *(prior action)*. The remaining quarterly adjustment costs will be subsequently passed by end-August 2019. Moreover, we will also notify the FY 2020 electricity tariff schedule as determined by the regulator by end-September, 2019 *(structural benchmark)*.

b. *Developing a strategy to address circular debt in the power sector*. We will prepare by end-September 2019 a comprehensive circular debt reduction plan in collaboration with international partners *(structural benchmark)* with quarterly targets for loses, collection, and accumulation of arrears (flow) by DISCO. Elements of this plan will include: (i) a monitoring and incentive framework for strengthening the sector's performance, including bill collection and distribution losses; (ii) improving distribution companies' governance; (iii) reducing or eliminating implicit government subsidies to particular economic sectors; (iv) assessing investment needs in the sector and designing an investment plan; (v) addressing the stock of circular debt to service the interest on accumulated power sector debt. We will use this plan as a blueprint for future reforms in the sector.

c. *Ensuring regular and timely notifications for end-consumer tariffs in the electricity sector*. Over PRs 200 billion of new circular debt were accumulated in the first half of FY 2019 from delays in updating tariffs. Introducing automaticity of quarterly tariff adjustments, similar to the process followed for automatic monthly fuel price adjustments, will be an important step to recover costs in a timely manner and reduce the flow of circular debt. We will submit to parliament by end-December 2019 changes to the NEPRA Act to (i) ensure full automaticity of the quarterly tariff adjustments and (ii) eliminate the gap between the regular annual tariff determination and notification by the government *(structural benchmark)*.

20. We are also taking actions to improve performance in the gas sector and encourage new investments and the provision of better services. Thus, we are implementing the following measures:

a. *Adoption of the FY 2020 gas tariff adjustment (prior action)*. These new tariffs as proposed by the regulator became effective as of July 1, 2019.

b. *Reducing unaccounted for gas losses (UFG)*. The current UFG level of 13 percent due to commercial and technical losses is significant above the allowed benchmarks. To bring losses down, our two gas companies are preparing UFG reduction plans for government approval by end-September 2019. These plans introduce 30 Key Monitoring Indicators, including on theft control and compliance with industry standards, that will facilitate the identification of gaps and the design of solutions. The Ministry of Energy will also produce and publish quarterly monitoring reports documenting the implementation of the UFG reduction plans and assessing compliance levels.

c. *Bringing private sector investment in the gas sector*. Private sector participation in the gas sector is key for the development and efficiency of the sector. To encourage private investment, we are planning to: (i) integrate the transmission segment of the gas network under one National gas transmission company and to create multiple gas DISCOs through unbundling the two companies, aiming to complete the process by FY 2020; (ii) complete the review of the petroleum policy to be approved by the Council of Common Interest aimed to facilitate exploration of new gas and oil fields and establish compliance-based regulations for the sector; (iii) operationalize third party access agreement through the issuance of a network code whereby the consumers may be able to directly purchase LNG from the terminal.

d. *Ensuring regular and timely notifications for end-consumer tariffs in the gas sector*. Similar to our parallel efforts in power tariffs, we will propose changes to the OGRA Act for Council of Common Interest (CCI) approval by end-December 2019 to eliminate the gap between regular semi-annual tariff determination and notification. After CCI approval, a bill will be introduced in parliament for adoption.

21. Our energy sector reforms include an effective strategy for protecting lower-income households from the impact of higher energy prices. We will continue with our program to insulate from annual tariff increases households consuming 300 units or below-close to 70 percent of all household consumers-through our tariff differential subsidies. Moreover, and in the context of the recently introduced quarterly tariff adjustment, we have included in the budget, and only for this year, a new subsidy equivalent to over 0.1 percent of GDP aimed at insulating those same consumers from the impact of such adjustment.

Structural Policies

22. Structural reforms are a key pillar of our economic program to unleash the potential of our economy. We must take bold measures to create an enabling environment for investment and job creation, strengthen productivity of SOEs, and enhance trust in government.

23. We are committed to improving State-Owned Enterprises (SOEs) governance, transparency, and efficiency to reduce fiscal risks and boost investment and growth. We recognize the need for a comprehensive reform of the SOE sector to enhance its financial viability, reduce the fiscal burden, and more clearly separating the ownership and regulatory functions of the state. Specific near-term measures include:

a. *Jumpstarting the privatization process*. Privatization is a key component with a revised strategy to select SOEs with minimal operational, financial and Human Resource issues. We have approved to initially undertake privatization of two (02) newly commissioned RLNG power plants at Balloki and Haveli Bahadur; two (02) specialized banks namely SME Bank and First Women Bank (FWBL); two (02) real estate assets namely Jinnah Convention Centre-Islamabad and Services Intl' Hotel-Lahore; besides offering of Government of Pakistan (GoP) residual 18.39 percent equity in Mari Petroleum. Financial Advisor (FA) for the privatization of two RLNG plants has been appointed and intend to approve the Transaction Structure latest by September 2019 after the FA has completed its due diligence. Appointment of FA(s) for privatization of SME Bank and Services International Hotel has been completed in June 2019. We will follow best practices regarding the process and conditions of privatization to ensure a successful and transparent outcome. Thereafter, we will identify additional companies for divestment and the possibility to divest valuable non-core assets of large SOEs.

b. *Strengthening monitoring of SOEs*. In the interest of transparency, accountability to taxpayers, and containment of fiscal risks, we will strengthen monitoring of state-owned enterprises. For this purpose, we will prepare a comprehensive report on state-owned enterprises, which will comprise the following elements: a) an overview of the sector during the year, including financial performance; b) a full list of the companies owned by the government, broken down by industry, policy objectives (provision of public services, commercial), and type of ownership (e.g., majority or minority-owned, strategic companies, etc.); c) an overview of how the government has exercised its ownership policy, including the appointment of board members and organizational and governance arrangements; d) the impact of the sector on government finances (budget transfers received and dividends paid, borrowing/lending from other public entities, state guarantees received, etc.) and the economy more broadly; e) information on individual companies, including abridged financial statements and indicators of financial performance, a list of board members and auditors, and the amount of subsidies received from the budget, if any. From this report, we will derive a triage of all SOEs, dividing them into companies to (i) maintain under state management; (ii) privatize; or (iii) liquidate (end-September 2020 *structural benchmark*).

c. *Increasing SOE transparency*. To further increase transparency, Pakistan International Airlines and Pakistan Steel Mills will conduct new audits by reputable international auditors based on financials until end-2018. The audits will be completed and published by end-December 2019 *(structural benchmark)*. Moreover, the Auditor General of Pakistan will complete and publish by March 2020 a special audit of Pakistan Railroads based on FY 2019 financials.

d. *Enhancing the SOE legal framework*. Our current SOE legal framework remains quite fragmented. The various applicable laws and rules significantly weaken the governance, supervision, and transparency of the sector. In this context, we recognize the need to have a clear, coherent, and modern legal and regulatory framework that defines the behavior and role of the State as owner, as a regulator, and as a shareholder of SOEs. To this end, we will introduce a new State-Owned Enterprise Law. Key elements of this law will include: (i) a clear definition of the overall goals and rationale for State ownership; (ii) clear definitions of the roles and responsibilities of the key institutions (ministries, boards, management); and (iii) establishment of performance agreement procedures and responsibilities. We will prepare a draft of the new Law by end-December 2019 with the support of IMF technical assistance. The law will be laid before parliament by end-September 2020 *(structural benchmark)*.

e. *Establishing a holding company*. As part of our broad SOE reform agenda, we have established a holding company to manage SOEs. The objective is to increase their independence and improve their performance. We are consulting with IMF staff to ensure that adequate governance and proper safeguards are in place.

24. Improving the business environment will encourage private investment, both foreign and domestic, and will support job creation and medium-term growth. In the period ahead, we will press ahead with several reforms to streamline regulations and procedures and remove obstacles to growth. In particular, we will aim to:

a. *Improve trading across borders* by (i) reducing custom-related processing time at the borders; and (ii) reducing hours to prepare import/export documents through expansion of electronic document exchanges. In this context, we will review our tariff policy to further facilitate our trading across borders.

b. *Further simplify procedures to start a business*. Business registration procedures remain numerous and time-consuming. Expanding the use of e-registration and reducing the amount of required documentation will support private sector development.

c. *Conduct a systematic and transparent stock-taking and review of existing regulations* to remove onerous and time-consuming regulations that hinder investment and private sector participation in the economy. Regulations will be assessed against objective criteria of good regulation. Any regulation that is not justified as legal and/or economically necessary will be eliminated. Any regulation that is legal and needed but not business-friendly will be simplified to the extent possible.

25. Our program includes important measures to strengthen governance and the control of corruption. Our priorities include:

- *Strengthening the effectiveness of anticorruption institutions*. A national follow-up committee was established to implement the recommendations from the UNCAC 2017 report. Legislative amendments have been made to allow for criminal liability for legal persons and protection of whistleblowers. A task force will be formed to review the institutional framework of our anticorruption institutions to enhance their independence and effectiveness in investigating and prosecuting corruption cases. In addition, our program will aim at supporting provinces to strengthen their Anticorruption Establishments by the provinces reforming their laws to ensure their independence and providing sufficient financial resources. We will study the establishment of a dedicated AML unit in the Federal Investigation Agency (FIA) responsible for ML investigations and prosecutions. Upgrading the capacities of law enforcement agencies for financial investigations will be a priority. We are pursuing agreements on international cooperation and information exchange with foreign countries to complement ongoing efforts to trace and recover unlawful assets located abroad. To that end, we have created an Asset Recovery Unit at the Prime Minister's Office. The unit, in cooperation with the FBR's International Taxation Unit, is identifying assets abroad owned by Pakistani residents, in implementation of the OECD Convention on Mutual Administrative Assistance in Tax Matters.

- *Enhancing the use of AML tools to support anti-corruption efforts*. We will ensure that banks and other reporting institutions improve their capacities to identify politically exposed persons and apply enhanced due diligence measures. We will conduct further outreach to banks and other reporting institutions in complying with obligations to file suspicious transaction reports. We will provide sufficient human and financial resources to empower the Financial Monitoring Unit (Pakistan's financial intelligence unit) to improve the dissemination of financial intelligence that can be used to support corruption investigations. We will work on ensuring that asset declarations of high-level public officials are comprehensive in scope (i.e., assets beneficial owned or located abroad), filed with a central federal agency, electronically searchable, and appropriately verified.

- *Registering prize bonds and other bearer instruments* to rein in their use as bearer instruments for potential illegal activities/tax avoidance.[3]

Financing and Program Monitoring

26. In support of this program and our long-term debt sustainability, we have secured long-term financing from our international partners. The current projections suggest that with the policies outlined in this memorandum the financing needs for the next 39 months (the program period) will amount to $38.6 billion. To close the gap for the first 12 months of the arrangement we have secured financing commitments from bilateral and multilateral partners as follows: China $6.3 billion, Saudi Arabia $6.2 billion, UAE $1 billion, the World Bank $1.3 billion, the Asian Development Bank $1.6 billion, and the Islamic Development Bank $1.1 billion. Moreover, and to support our long-term debt sustainability, we have also reached agreements with our main bilateral partners to maintain their exposure throughout the program period and are further working on the modalities to ensure the new financing will be consistent with the program debt sustainability objectives.

27. Program monitoring. The program will be subject to quarterly reviews, quarterly performance criteria, and continuous performance criteria as set out in the TMU. Completion of the first two reviews scheduled for December 2019 and March 2020 will require observance of the quantitative performance criteria for end-September 2019 and end-December 2019, respectively, and continuous performance criteria as specified in Table 1. All quantitative performance criteria and indicative targets are listed in Table 1, and prior actions and structural benchmarks are set out in Table 2. The TMU is also attached to describe the definitions of quantitative PCs and consultation as well as data provision requirements.

28. Safeguards and budget support. We understand that, in line with Fund's policy, a safeguards assessment is expected to be completed by the time of the first program review. We request the use of the IMF financing for budget support, which will be maintained in government accounts at the State Bank of Pakistan (SBP). The SBP and the Ministry of Finance have signed a memorandum of understanding that clarifies the responsibilities related to this agreement.

[3] Prize bonds are high-denomination bearer instruments issued by the government to mobilize retail savings, which can effectively be used as anonymous medium of exchange and a substitute to Pakistan rupee currency (outstanding stock about 20 percent of currency in circulation).

Table 1. Pakistan: Quantitative Performance Criteria and Indicative Targets for FY 2019/20 1/

(In billions of rupees, at program exchange rates, unless otherwise specified)

	FY 2018/19		FY 2019/20			
	end-December	end-June	end-September	end-December	end-March	end-June
	Actual	Projected	Program (PC)	Program (PC)	Program (IT)	Program (IT)
Performance Criteria						
Floor on net international reserves of the SBP (millions of U.S. dollars)	-11,853	-17,743	-18,478	-16,311	-12,844	-10,790
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees)	7,296	8,852	8,911	8,800	8,445	8,727
Ceiling on SBP's stock of net foreign currency swaps/forward position (negative, millions of U.S. dollars)	7,532	8,055	8,055	8,055	8,055	7,555
Ceiling on general government primary budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 2/	153	702	102	145	193	276
Ceiling on net government budgetary borrowing from the SBP (stock, billions of Pakistani rupees)	4,737	7,756	7,756	7,756	7,756	7,187
Ceiling on the amount of government guarantees (stock, billions of Pakistani rupees)	1,313	1,611	1,611	1,611	1,611	1,611
Continuous Performance Criteria						
Zero new flow of SBP's credit to general government			0	0	0	0
Zero ceiling on accumulation of external public payment arrears by the general government			0	0	0	0
Indicative Targets						
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees)	30	100	45	86.4	133.2	180
Cumulative floor on general government budgetary health and education spending (billions of Pakistani rupees)			349.2	698.4	1,221	1,744
Floor on net tax revenues collected by the FBR (cumulative, billions of Pakistani rupees)	1,795	4,153	1,071	2,367	3,757	5,503
Ceiling on net accumulation of tax refund arrears (billions of Pakistani rupees) 3/	90	90	-75	-57.5	-57.5	-57.5
Ceiling on power sector payment arrears (cumulative flow, billions of Pakistani rupees) 3/	1,415	1,686	23	39	62	81

Sources: Pakistani authorities; and Fund staff estimates.

1/ Fiscal year runs from July 1 to June 30. All definitions as per the attached Technical Memorandum of Understanding.

2/ Cumulative from the start of each fiscal year. "-" means surplus.

3/ Data for December 2018/June 2019 is an actual/projected stock as of the end of the month. Quarterly targets are cumulative flows from end-June 2019.

Table 2. Pakistan: Structural Conditionality

Prior Actions for Program Approval

1. Move to a flexible, market-determined exchange rate by (i) announcing that the SBP moves to a flexible market-determined exchange rate with a focus on price stability and interventions are limited to safeguarding financial stability and preventing disorderly market conditions (DMC) and (ii) tightening the monetary stance by 150 bps.
2. Reach formal public agreement between the federal and provincial governments on the fiscal targets consistent with the program.
3. Adopt by parliament the FY 2020 budget consistent with program targets.
4. Adopt a package of measures in the energy sector: (i) Implement a quarterly automatic tariff adjustment in the electricity sector by about 10 percent to generate Rs 150 billion in additional revenues and (ii) notify by government the FY 2020 gas tariff adjustment as proposed by the regulator to become effective on July 1st, 2019.

Structural Benchmarks	**Date**
Fiscal	
1. Commit to not grant further tax amnesties	Continuous
2. Issue licenses for the track-and-trace system for excises on cigarettes	end-September 2019
Monetary/Financial	
3. Adopt measures to strengthen the effectiveness of the AML/CFT framework to support the country's efforts to exit the Financial Action Task Force list of jurisdictions with serious deficiencies	end-October 2019
4. Submit to parliament, in consultation with IMF staff, amendments to the State Bank of Pakistan Act to address all recommendations of the new 2019 Safeguards Assessment Report and the 2016 Technical Assistance Report on Central Bank Law Reform (MEFP para. 14)	end-December 2019
State-Owned Enterprises	
5. Notify the FY 2020 electricity tariff schedule as determined by the regulator	end-September 2019
6. Prepare a comprehensive circular debt reduction plan in collaboration with international partners (para. 19 MEFP)	end-September 2019
7. Submit to parliament amendments to the NEPRA Act to (i) ensure full automaticity of the quarterly tariff adjustments and (ii) eliminate the gap between the regular annual tariff determination and notification by the government	end-December 2019
8. Conduct and publish new audits by reputable international auditors of Pakistan International Airlines and Pakistan Steel Mills	end-December 2019
9. Conduct a triage of all SOEs, dividing them into companies to (i) maintain under state management; (ii) privatize; or (iii) liquidate	end-September 2020
10. Submit to Parliament a new State-Owned Enterprise law to improve governance and transparency in line with IMF recommendations	end-September 2020
Social Protection and gender	
11. Finalize BISP's banking contracts and launch financial inclusion strategy for women	end-October 2019
12. Update the benefit structure of Waseela-e-Taleem (WeT) to narrow the educational gender gap	end-December 2019
13. Finalize the update of the BISP beneficiaries' database (National Socio-Economic Registry)	end-June 2020

Attachment II. Technical Memorandum of Understanding

June 19, 2019

1. This memorandum sets out the understanding between the Pakistani authorities and the IMF staff regarding the definitions of quantitative performance criteria and indicative targets, as well as respective reporting requirements used to monitor developments, for the economic program under the Extended Arrangement, as described in the authorities' Letter of Intent (LOI) dated June 19, 2019 and the attached Memorandum of Economic and Financial Policies (MEFP). To this effect, the authorities will provide the necessary data to the IMF as soon as it becomes available. The definitions used in this TMU will be adjusted to reflect any changes in accounting classifications introduced during the program period.

2. For the purposes of monitoring under the program, all assets and liabilities as well as debt contracted, denominated in SDRs or in currencies other than the U.S. dollar, will be converted into U.S. dollars at the program exchange rates. Net external budget financing and external cash grants will be converted into Pakistani rupees at the program exchange rate. The program exchange rate of the Pakistani rupee to the U.S. dollar is set at 141.3172 rupee per one U.S. dollar. The corresponding cross exchange rates for other foreign currencies are provided in Table 1.

3. The quantitative performance criteria are shown in Table 1 of the MEFP. Prior actions and structural benchmarks are listed in Table 2 of the MEFP, with corresponding definitions in Section A below. Definitions of the quantitative targets and the adjustment mechanisms are specified in Section A below. Reporting requirements are described in Section C.

A. Quantitative Targets

4. **The program sets performance criteria and indicative targets** for defined test dates (Table 1 in the LOI) as well as defines continuous performance criteria that apply throughout the program period. The program sets the following performance criteria:

Performance Criteria

- Floor on the net international reserves (NIR) of the State Bank of Pakistan (SBP) (millions of U.S. dollars);
- Ceiling on the net domestic assets (NDA) of the SBP (stock, billions of Pakistani rupees);
- Ceiling on SBP's stock of net foreign currency swap/forward position (millions of U.S. dollars)
- Ceiling on the general government primary budget deficit excluding grants (cumulative flows, billions of rupees);

- Ceiling on net government budgetary borrowing from the SBP (including provincial governments) (stock, billions of rupees);
- Ceiling on the amount of government guarantees (stock, billions of Pakistani rupees);

Continuous Performance Criteria

- No new flow of SBP's credit to general government;
- Zero ceiling on the accumulation of external payment arrears by the general government;

Indicative Targets

- Floor on targeted cash transfers spending (BISP) (cumulative, billions of Pakistani rupees);
- Floor on general government budgetary health and education spending (cumulative, billions of Pakistani rupees);
- Floor on net tax revenues collected by the Federal Board of Revenue (FBR) (cumulative, billions of Pakistani rupees);
- Ceiling on net accumulation of tax refund arrears (flow, billions of Pakistani rupees);
- Ceiling on power sector payment arrears (flow, billions of Pakistani rupees)

Floor on the Net International Reserves (NIR) of the State Bank of Pakistan

Definition

5. **The general government** is defined as the central (federal) government and local (provincial) governments, excluding state-owned enterprises. The definition of the general government includes any new funds, or other special budgetary or extra-budgetary entities that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's Manual on Government Finance Statistics 2001. The authorities will inform IMF staff on the creation of any such entities without delay.

6. **Net international reserves (stock) of the SBP** are defined as the dollar value of the difference between usable gross international reserve assets and reserve-related liabilities, evaluated at the program exchange rates. On April 16, 2019, the NIR of SBP are estimated at negative US$15,557 million.

7. **Usable gross international reserves of the SBP** are those readily available claims on nonresidents denominated in foreign convertible currencies and controlled by the monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes. Gross official reserves include (i) holding of foreign currencies, (ii) holdings of SDRs, (iii) the reserve position in the IMF, and

(iv) holdings of fixed and variable income instruments. Excluded from usable reserves, inter alia, unless there is also a reserve-related liability associated with it, are: (i) claims on residents; (ii) assets in nonconvertible currencies; (iii) precious metals (iv) illiquid assets; (v) assets that are pledged or collateralized; (vi) any reserve assets that are not readily available for intervention in the foreign exchange market because of lack of quality or liquidity that limits marketability at the book price.

8. **Reserve-related liabilities of the SBP** include all foreign exchange liabilities to residents (except general government) or nonresidents, including (i) foreign currency liabilities, excluding liabilities to the general government, with remaining maturity of one year or less, (ii) any foreign exchange liabilities of SBP and general government arising from derivatives positions (such as futures, forwards, swaps, and options) on a net outstanding basis-defined as the long position minus the short position, (iii) outstanding IMF credits to Pakistan, (iv) foreign exchange deposits with the SBP of foreign governments, foreign central banks, foreign deposit money banks (excluding regulatory capital deposits of foreign banks with the SBP), international organizations, and foreign nonbank financial institutions, as well as domestic financial institutions (excluding regulatory capital deposits of domestic financial institutions with the SBP).

9. **Aggregate net position in the foreign exchange derivatives** is defined as the aggregate net positions in forward and futures in foreign currencies of the SBP and general government vis-à-vis the domestic currency (including the forward leg of currency swaps). At end-April 2019, the SBP's aggregate net derivative position was negative US$8,055 million.

10. **Gross sale of foreign exchange** includes an outright and a swap sale of foreign exchange by the SBP to banks in the foreign exchange interbank market by using foreign exchange market intervention. The swap sale of foreign exchange and maturities of the forward transactions will be measured on a net daily basis.

11. **Net purchase of foreign exchange** is defined as an outright and swap purchase of foreign exchange minus outright and swap sale of foreign exchange by the SBP from/to banks in the foreign exchange market by using foreign exchange market intervention. The net purchase of foreign exchange will be measured on a net daily basis.

Adjustment mechanism

12. The floor on NIR will be adjusted upward (downward) by the cumulative excess (shortfall) of cash inflows from multilateral and bilateral creditors, commercial borrowing and bond issuance relative to the projected inflows (Table 2). Cumulative cash inflows are defined as external disbursements (including grants) from official multilateral creditors (including, but not limited to Asian Development Bank, Islamic Development Bank, and World Bank), official bilateral creditors (including, but not limited to bilateral oil facilities, China, Saudi Arabia, UAE, DFID-UK, USAID), external bond placements and other commercial borrowing that are usable for the financing of the central government budget.

13. The floor on NIR will be adjusted upward (downward) by the cumulative excess (shortfall) of the actual stock of NIR at end-June 2019 relative to the projected amount. The stock of NIR of SBP at end-June 2019 is projected at negative US$17,743 million.

14. The floor on NIR will be adjusted upward (downward) by the cumulative excess (shortfall) of the use by the SBP of the foreign assets related to commercial consortium loan to make import payments over (under) the amounts expected under the baseline projections (Table A).

Table A. Use by SBP of Foreign Assets Related to Commercial Consortium Loan

(Cumulative flows from July 1, 2019; millions of Renminbi)

End-Sep 2019	End-Dec 2019	End-Mar 2020	End-Jun 2020
0	0	2,000	4,000

Ceiling on the Net Domestic Assets (NDA) of the SBP

Definition

15. **Net domestic assets of the SBP** are defined as the difference between Reserve Money (as defined below) minus the NIR of the SBP (as defined above). For the purposes of computing the NDA target, the NIR is valued at the program exchange rate defined in paragraph 2 and expressed in rupee.

16. **Reserve money (RM)** is defined as the sum of: currency outside schedule banks (deposit money banks); schedule banks' domestic cash in vaults; schedule banks' required and excess rupee and foreign exchange deposits with the SBP; and deposits of the rest of the economy with the SBP, excluding those held by the federal and provincial governments and the SBP staff retirement accounts.

Adjustment mechanism

17. Consistent with the NIR target adjustment mechanism (as defined above), NDA targets will be adjusted downward (upward) by the full amount of the cumulative excess (shortfall) of cash inflows from multilateral and bilateral creditors, and commercial borrowings and bond issuance relative to the projected inflows (Table 2) and evaluated at the program exchange rate.

18. Consistent with the NIR target adjustment mechanism (as defined above), NDA targets will be adjusted downward (upward) by the cumulative excess (shortfall) of the actual stock of NIR at end-June 2019 relative to the projected amount (see above) and evaluated at the program exchange rate.

19. Consistent with the NIR target adjustment mechanism (as defined above), NDA targets will be adjusted downward (upward) by the cumulative excess (shortfall) of the use by the SBP of the foreign assets related to commercial consortium loan to make import payments over (under) the amounts expected under the baseline projections (Table A) and evaluated at the program exchange rate.

20. NDA targets for September 2019 and December 2019 will be adjusted upward (downward) by the full amount of the excess (shortfall) of actual stock of reserve money in end-June 2019 relative to the projected amount of 6,345 billion rupees.

Ceiling on SBP's Stock of Net Foreign Currency Swap/Forward Position

21. Stock of net foreign currency swap/forward position is defined as the aggregate net positions in forward and futures in foreign currencies of the SBP vis-à-vis the domestic currency (including the forward leg of currency swaps). At end-April 2019, the SBP's aggregate net FX derivative position was negative US$8,055 million.

Ceiling on the General Government Primary Budget Deficit Excluding Grants

Definition

22. The **overall general government budget deficit (excluding grants)** will be monitored quarterly under the cash balance of the general government balance, excluding grants, including the operations of local (provincial) governments financed from local funds. It will be measured below the line and will include:

- **Net external financing**, excluding valuation gains and losses.
- **Change in net domestic credit from the banking system**, excluding valuation gains and losses from deposits denominated in foreign currency.
- **Change in the net domestic nonbank financing**, excluding valuation gains and losses. These include (i) domestic privatization receipts transferred from the privatization accounts to the budget, (ii) the stock of issued government securities held outside the general government and the banking system, net of valuation changes, (iii) net deposits and reserves received by the government (public accounts deposits), (iv) any other government borrowing from domestic nonbank sources net of repayments, minus (v) government deposits with nonbank financial institutions.
- Total external grants to the federal and provincial governments. These are defined as the sum of project grants, cash external grants for budgetary support, capital grants reflecting the principal amounts of external debt cancellation or swaps, and other grants.

23. General government primary budget deficit (excluding grants) is defined as the overall general government budget deficit (excluding grants) minus the consolidated interest bill of the federal and provincial budgets.

24. **Net external program financing** is defined to include external privatization receipts; budget support grants; budget support loans from multilateral (including IMF budget support, World Bank and Asian Development Bank (ADB) budget support and program loans), official bilateral budget support loans, and private sector sources (e.g., bonds); rescheduled government debt service and change in stock of external debt service arrears net of government debt amortization due on foreign loans, the latter including any accelerated amortization including related to debt swaps or debt cancellation recorded as capital grants. It also includes foreign loans on lent to financial institutions and companies (public or private) and emergency relief lending. Program financing excludes all external financing counted as reserve liabilities of the SBP (defined above).

25. **Net external budget financing** is defined as net external program financing minus privatization receipts, minus budget support grants, plus all other external loans for the financing of public projects or other federal or provincial budget expenditures, plus transfers of external privatization receipts from the privatization account to the budget.

Adjustment mechanism

26. The ceiling on general government primary budget deficit (excluding grants) will be adjusted upward (downward) by the cumulative excess (shortfall) in external project financing relative to the program projections evaluated in rupee terms at actual exchange rates. External project financing is defined as disbursements from bilateral and multilateral creditors to the general government for specific project expenditure.

27. The ceiling will be adjusted downward for any shortfall in the targeted cash transfers (BISP) and it will be adjusted upward for over performance in the BISP spending up to PRs 40 billion in FY 2019/20 from their indicative targets.

28. In FY 2019/20, the ceiling will be adjusted downward for any excess (cumulatively, starting from July 1, 2019) in the flow of power sector payment arrears above the respective indicative program targets, excluding non-recoveries and excess line losses (see table in paragraph 43).

29. The ceiling on general government primary budget deficit (excluding grants) will be adjusted downward by the full amount of any increase in the stock of budgetary arrears on social payments such as wages, pensions, social benefits accumulated since the beginning of the fiscal year.

30. The ceiling on general government primary budget deficit (excluding grants) will be adjusted downward by the full amount of any excess in the cumulative flow of tax refund arrears (as defined below) above the respective indicative program targets.

Ceiling on Net Government Budgetary Borrowing from the SBP

Definition

31. **Net government budgetary borrowing from the SBP** (including provincial governments) is defined as SBP claims on the general government minus general government deposits with the SBP. SBP claims on the general government include government securities, treasury bills, treasury currency, and debtor balances. SBP claims on the general government exclude accrued profits on government securities. Government deposits with the SBP exclude the Zakat Fund (Table 3).

32. **Liability management operation** will transform the stock of government credit held by the SBP into short- and long-term tradeable instruments at 1, 3, 5 and 10-year maturities at interest rates close to the market levels. The expected amount of the operation is 7,756 billion rupees. The 3-year and 5-year papers will be amortizing instruments and 1- and 10-year papers will be bullet bonds.

Adjustment mechanism

33. The ceiling on net government budgetary borrowing from the SBP will be adjusted upward (downward) by the amount of cumulative excess (shortfall) in the total amount of liability management operation relative to the baseline projection.

Ceiling on the Amount of Government Guarantees

34. The ceiling on the amount of government guarantees will apply to the stock of publicly guaranteed debt for which the guarantees have been issued by the central government. The mark-to-market revaluation exchange rate will apply to all foreign currency denominated guaranteed debt. This ceiling excludes guarantees issued by the Ministry of Finance for the SBP borrowing from the IMF. The stock of publicly guaranteed debt as of end-March 2019 totals 1,265.1 billion rupees.

Zero flow of SBP's Credit to General Government (continuous performance criterion)

35. To protect the capability of the central bank to pursue its price stability objective, there should be no new flow of SBP's direct credit to the general government, including in the form of purchases of public debt securities on the primary market. The performance criterion will apply on a continuous basis throughout the program period.

Zero Ceiling on the Accumulation of External Payment Arrears by the General Government (continuous performance criterion)

36. **External public debt payment arrears** are defined as all unpaid debt-service obligations (i.e., payments of principal and interest) of the general government (federal and provincial government, SBP, and state-owned enterprises) to nonresidents arising in respect of public sector loans, debt contracted or guaranteed, including unpaid penalties or interest charges associated with these obligations that are beyond 30 days after the due date. The definition of debt, for the purposes of the EFF, is set out in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Executive Board Decision No. 6230-(79/140), last amended by Executive Board Decision No. 14416-(09/91), adopted August 31, 2009). The ceiling on the accumulation of external public debt payment arrears is set at zero. The performance criterion will apply on a continuous basis throughout the program period.

Other Continuous Performance Criteria

37. During the period of the Extended Arrangement, Pakistan will not (i) impose or intensify restrictions on the making of payments and transfers for current international transactions; (ii) introduce or modify multiple currency practices; (iii) conclude bilateral payment agreements that are inconsistent with Article VIII of IMF Articles of Agreement; and (iv) impose or intensify import restrictions for balance of payments purposes. The performance criterion on the non-introduction and non-modification of multiple currency practices (MCP) will exclude multiple currency practices arising from introduction and/or modifications of the multiple-price foreign exchange auction system operating in line with IMF staff advice with the objective of supporting flexible market-determined exchange rate.

Floor on Targeted Cash Transfers Spending (BISP)—Indicative Target

38. The floor will apply to the cumulative targeted cash transfers spending by the Benazir Income Support Program.

Floor on General Government Budgetary Health and Education Spending—Indicative Target

39. The floor will apply to cumulative budgetary spending on health and education by the federal and provincial governments.

Floor on Net Tax Revenues Collected by the Federal Bureau of Revenue—Indicative Target

Definition

40. Net tax revenues collected by the FBR are defined as the sum of revenues collected from (i) general sales tax (GST) on goods, including GST on services collected in Islamabad Capital Territory; (ii) customs duties, customs registration fees and levies; (iii) excise duties on imported products; (iv) excise duties on domestic products; (v) levies (toll) on oil derivatives; (vi) other proceeds and fees; (vii) sales tax; and (viii) unclassified revenues minus the tax refunds. Net revenue collection will be defined, for each test date, as the cumulative sum of net revenues collected since the beginning of the current year. The floor on the collection of gross revenues by the FBR will be measured quarterly on the basis of cumulative end-of-quarter data.

Ceiling on Net Accumulation of Tax Refund Arrears—Indicative Target

41. The ceiling will apply to the cumulative flow of tax refund arrears. The **stock of tax refund arrears** is defined as the amount of tax refund claims that have not been settled (through a cash refund, netting out against obligations of taxpayers, payment with a government bond/promissory note or an official decision to reject the claim) within a specified time period after the tax refund claim has been submitted to the Federal Board of Revenue. The stock of tax refund arrears as of March 31, 2019 was 90 billion rupees.

Ceiling on Power Sector Payment Arrears—Indicative Target

42. **Power sector payment arrears** are defined as power sector payables in arrears that arise from (i) non-recoveries from supply to AJ&K, industrial support package, other federal and provincial governments including FATA, private consumers, and Baluchistan Tube Wells, (ii) accrued markup from the servicing of PHPL, (iii) line losses and non-collections that are not recognized by NEPRA, (iv) GST Non-Refund, (v) late payment surcharges, and (vi) the delay in tariff determinations.

43. **Monitoring mechanism to track stock and flow of payables**. The stock of payment arrears includes the payables of PRs 762.4 billion, and the stock of PHPL of PRs 807 billion as of end-March 2019. The projected evolution of the stock and the flow of payables, including measures (policy and surcharges) for FY 2019/20 and its components are given in the following table.

(Billions PRs)	2019/20							
	Q1		Q2		Q3		Q4	
	Target	Actual	Target	Actual	Target	Actual	Target	Actual
Non recoveries	27		25		33		29	
Excess lines losses	18		12		22		39	
Accrued markup								
GST non Refund	6		5		8		6	
Delay determination								
Recovery from defaulters								
Stock clearence								
Additional remmitance with tariff/Qtr Adj	(28)		(26)		(40)		(56)	
Total Flow	23	-	16	-	23	-	18	-

B. Other Definitions

44. **Electricity Tariff Pricing Formulas and Definitions**. The current notified uniform weighted average electricity tariff is PRs 13.51/kWh for all classes of consumers and includes the following tariffs and surcharges: (i) weighted average tariff of PRs 11.95/kWh, (ii) inter-disco tariff rationalization of PRs 1.03/kWh, (iii) debt servicing surcharge (DSS) of PRs 0.43/kWh, and (iv) Neelum-Jhelum Surcharge of PRs 0.1/kWh. The current notified electricity tariffs for users at 0–50 kWh/month of PRs 2/kWh will be retained.

(i) The uniform weighted average tariffs on electricity consumers' electricity consumption is defined as follows:

Uniform Weighted Average Notified Tariff for electricity consumers =

(Industrial Users Tariff Rate for each category x DISCOs' estimated sales to Industrial Users for each category

+ Residential Users Tariff Rate for each category x DISCOs' estimated sales to Residential Users for each category

+ Commercial Users Tariff Rate for each category x DISCOs' estimated sales to Commercial Users for each category

+ Single Point Supply for further distribution Tariff Rate for each category x DISCOs' estimated sales to Point Supply for further distribution Users for each category)

+ AJ&K users' Tariff Rate for each category x DISCO's estimated sales to AJ&K Users for each category

+ Agriculture Tube-wells Tariff Rate for each category x DISCO's estimated sales to Agriculture Tube-wells Users for each category

+ Other users' Tariff Rate for each category x DISCOs' estimated sales to Other Users for each category)/ DISCO's total sales to Industrial, Residential Users consuming more than 200kWh, Commercial, Single Point Supply, Other Users, AJ&K Users, and Agriculture Tube-wells)

= PRs 11.95 kWh

(ii) Inter-disco tariff Rationalization PRs 1.03/kWh to maintain the uniform tariff across DISCOs after taking into account the target subsidy to the protected consumer categories.

(iii) Debt servicing surcharge (DSS) to cover the servicing the Syndicated Term Credit Financing obtained by PHPL to finance financing to power sector of PRs 0.43/kWh

(iv) Neelum-Jhelum Surcharge to contribute to the financing needs for the Neelum-Jhelum Hydropower Project. It will be levied at a rate of PRs 0.10/kWh on all classes of consumer except the lifeline consumption of 0–50 kWh/month.

C. Program Reporting Requirements

45. To effectively monitor the program performance, the authorities will provide all the needed data to the IMF in line with Article VIII, Section 5 of the IMF Articles of Agreement as deemed necessary. Performance under the program will be monitored from data supplied to the IMF by the SBP, the Ministry of Finance, Pakistan Bureau of Statistics, the Federal Board of Revenue, the Ministry of Water and Power and other agencies as outlined in the table below. The authorities will transmit promptly to IMF staff any data revisions as well as other information necessary to monitor the arrangement with the IMF.

Monitoring and Reporting Requirements				
Reporting Agency	**Type of Data**	**Description of Data**	**Frequency**	**Timing**
State Bank of Pakistan (SBP)	SBP balance sheet	Summary	Weekly	First Thursday of the following week
	SBP balance sheet	Summary at program exchange rates; and by official exchange rates	Monthly	Within 15 days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks at actual official exchange rates	Monthly	Within the first 30 days of each month.
	International reserves	By (i) program exchange rates; and (ii) at actual official exchange rates.	Daily	The following working day
	Foreign exchange market	Market exchange rates (buying and selling); weighted average customer exchange rate; monthly trade volume, and high and low exchange rate of the interbank, the KERB market.	Daily/ Monthly	Within one day/ monthly within five working day
	Foreign exchange market	SBP foreign exchange operations, and intervention (volume), distinguishing within spot transactions the outright purchase/sale and purchase/sale related to forward contract	Daily	Within one day
	Foreign exchange market	SBP operation against the domestic currency in swap/forwards by (volumes)	Daily	Within one day
	Foreign exchange market	SBP operations against the domestic currency in swap/forwards (including all legs of transactions): for each day, the initial outstanding FX swap/forward position, summary of transactions during the day, the end-of-day position	Daily	Within one day
	Foreign exchange market	Breakdown of short, long, counterparts, of the swap/forward contracts	Monthly	Third working day of the following month
	Foreign exchange market	Outstanding swap/forward positions by maturity buckets, and counterparties.	Monthly	Third working day of the following month
	Net International Reserves	Net International reserves at program exchange rates as defined in TMU, including a breakdown by currency and specification of *nostro* balances with foreign branches of National Bank of Pakistan.	Quarterly	Seventh working day after quarter end
	External financing	Foreign assistance received and projections for the coming four quarters. Please categorize all grants and loans by program/project, and the amounts received/expected in cash.	Quarterly	Within 15 days of the end of each quarter
	Interbank money market	Daily interbank repo volume and interest rate of trades	Daily	Within one day
	SBP operations	Repo (reverse repo) operations, open market operations,	Weekly	First Monday of the following week
	Bank liquidity	Excess reserves, in local currency	Bi-weekly	With a lag of 15 days
	T-bill and coupon bond	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Fortnightly	Last working day of the fortnight

Monitoring and Reporting Requirements				
Reporting Agency	**Type of Data**	**Description of Data**	**Frequency**	**Timing**
	financing, SBP securities			
	Banking data	Sectoral distribution of loans and deposits; loans and deposits by local and foreign currency; deposit and lending rates	Monthly	Within 25 days of the end of each month.
	Banking data	Loan maturities	Quarterly	Within 45 days of the following quarter
	Banking data	Regularity capital deposit requirement deposits of foreign and domestic schedule banks with the SBP (account numbers 33052 and 330506)	Monthly	Within 15 days of the end of each month
	Banking indicators	Core Financial Stability Indicators (FSIs), including but not limited to capital adequacy; asset composition and quality; profitability; liquidity; open FX positions – in aggregate and bank-by-bank (without names)	Quarterly	Within 45 days of the following quarter
	Banking data	Banks' net open foreign exchange positions split between total foreign assets and foreign exchange liabilities: in aggregate for the system and bank by bank (without names)	Monthly	Within five days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Quarterly	Within 60 days
	Transfers	Workers' remittances.	Monthly	Within 25 days of the following month
	Other monetary data	The SBP survey, ODCs and DCs published in IFS.	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed export and import data Detailed balance of payments data	Monthly	Within 28 days of the end of each month
	Privatization receipts	Balance on the PC Fund account; gross inflows into and outflows from the PC Fund account during the month, specifying the nature of each transaction	Quarterly	Within seven days of the end of each quarter
Ministry of Finance (MOF)	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the SBP, and state-owned companies; any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears.	Monthly	Within 25 days of the following month
	External financing	Foreign assistance received and projections for the coming four quarters. Please categorize all grants and loans by program/project, and the amounts received/expected in cash and in kind.	Quarterly	Within 15 days of the end of each quarter
	Federal government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Federal and provincial governments	Quarterly	Within 45 days of the end of each quarter

Monitoring and Reporting Requirements				
Reporting Agency	**Type of Data**	**Description of Data**	**Frequency**	**Timing**
	Consolidated general government	Federal and provincial governments	Annual	Within 180 days of the end of each year
	Federal government	Fiscal financing sources: Detailed quarterly financing plan for the coming 12 months including projections for domestic public securities (issuance and maturities), external financing, SBP profits, short-term borrowing, other financing schemes, and borrowing from the SBP.	Monthly	One month in advance
	General government	Total general government budgetary spending on health and education broken down into spending by the federal and provincial governments	Monthly	Within 15 days of the end of each month
	Federal government	Stock of government borrowing from the SBP	Quarterly	Within the first five days of each quarter.
Pakistan Bureau of Statistics (PBS)	SPI, CPI, WPI	Detailed monthly price indices	Monthly	Within five days of the following month
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
Federal Board of Revenue (FBR)	Revenue collection Tax credits	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions.	Monthly	Within seven days of the end of each month
	Tax arrears	By category	Monthly	Within seven days of each month
		By type of tax	Monthly	Within seven days of the end of each month
	All tax refund claims in arrears	Itemized by tax category (GST, income, customs duties, etc.)	Monthly	Within seven days of the end of each month
	Automated GST refunds	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues	Quarterly	Within seven days of the end of each month
		Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Quarterly	Within seven days of the end of each month
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax payer units (LTUs)	Quarterly	Within seven days of the end of each month
	Import data	Total value of recorded imports Total value of duty-paid recorded imports; Number of total transactions involving recorded imports; Number of total transactions involving nonduty free recorded imports	Quarterly	Within 30 days of the end of each quarter

Monitoring and Reporting Requirements				
Reporting Agency	**Type of Data**	**Description of Data**	**Frequency**	**Timing**
	Audits	Percentage of selected companies and identified revenue from audits	Quarterly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
Ministry of Water and Power		Key Power Sector Statistics (Please see the attached template) Cumulative Monthly Subsidy Position (Rs. Billion) PEPCO Month End Payables and Receivables Positions And Aging Schedule, Rs. Billion Receivables Positions - Total and DISCO-wise Break-up CPPA/PEPCO Month-wise Consolidated Cash Flow AT&C Statistics Monthly TDS Claims by DISCOs and Total Inter Corporate Circular Debt Sheet Prepared by Ministry of Finance DISCOs Consolidated Income Statement Net Electrical Output & Power Purchase Price by Source, GWh Generation, Demand and Shortfall for FY 2010 to date Net Electrical Output (MkWh) Plant and Fuel-wise Detail Working Capital Loans For each loan type	Quarterly	Within 30 days
	Quantitative target on performance of DISCOs	Quarterly quantitative targets for each DISCO for technical and distribution losses, collection form current consumers and recoveries of arrears.	Quarterly	Within 30 days from the end of the quarter
	Domestic expenditure arrears	Energy arrears (stock) Flow of arrears by source	Quarterly	Within 45 days of the end of each month for government arrears
		Determined and Notified Tariff's for each User and User Group (Please see template)	Annual	Within 30 days of determination and notification
Ministry of Petroleum and Natural Resources		Gas supply Gas prices Gas sales by consumers	Quarterly on monthly frequency	Within 30 days from the end of the quarter
		UFG losses	Quarterly	Within 30 days from the end of the quarter
BISP	Targeted cash transfers	Coverage (number of beneficiaries paid) and payment by conditional and unconditional transfers.	Quarterly	Within 30 days from the end of the quarter
Ministry of Finance	Financial statements	Financial statements (cash flow, income statement, and balance sheet) and operational indicators for Pakistan Railways, Pakistan Steel Mills and Pakistan International Airline	Quarterly	Within 30 days from the end of the quarter

Table 1. Program Exchange Rates of the SBP
(As of May 3, 2019 in units of currency per U.S. dollar

Currency	Rate
EUR	0.896456
JPY	111.699717
CNY	6.741081
GBP	0.769292
AUD	1.428981
CAD	1.346196
THB	32.035948
MYR	4.141502
SGD	1.362695
INR	69.267944
SDR	0.723019

Note: JPY, CNY as of April 30, 2019; CAD as of May 2 2019

Table 2. Projected Disbursements to Pakistan
(In millions of U.S. dollars)

	Jul-Sep'19 Proj.	Oct-Dec'19 Proj.	Jan-Mar'20 Proj.	Apr-Jun'20 Proj.
Multilateral and bilateral disbursements	2,305	4,029	6,557	3,509
of which: in cash 1/	2,042	3,711	6,191	3,120
of which: Saudi oil facility	835	856	670	839
International bond issuance	0	1,000	0	0
Commercial borrowing	700	0	0	1,300
Other	0	0	0	0
Gross Inflows	3,005	5,029	6,557	4,809
of which: in cash	2,742	4,711	6,191	4,420

1/ Numbers need to be confirmed with the MoF. 65% of project loans and 50% of project grants are assumed to be received in cash.

Table 3. Government Sector (Budgetary Support)

(End-of-period stocks/PRs millions)

ITEM	30-Jun-18	31-Dec-18	31-Mar-19
A. Central Government	**10,191,037**	**11,115,217**	**11,305,701**
1. Scheduled Banks	**6,523,418**	**6,011,620**	**3,930,955**
a) Government Securities	2,825,874	2,392,359	2,570,893
b) Treasury Bills	4,781,299	4,726,007	2,476,396
c) Government Deposits	-1,083,755	-1,106,745	-1,116,334
2. State Bank	**3,667,619**	**5,103,597**	**7,374,746**
a) Government Securities	2,748	2,740	2,745
b) Accrued Profit on MRTBs	73,948	133,617	129,653
c) Treasury Bills	3,594,318	4,970,154	7,242,341
of which: MTBs created for replenishment of cash balances	3,593,670	4,969,500	7,240,300
d) Treasury Currency	9,562	9,565	9,569
f) Government Deposits (Excl. Zakat and Privatization Fund)	-40,546	-38,281	-38,057
B. Provincial Governments	**-798,077**	**-1,071,620**	**-1,083,945**
1. Scheduled Banks	**-743,864**	**-838,523**	**-767,505**
a) Advances to Punjab Government for Cooperatives	1,024	1,024	1,024
b) Government Deposits	-744,888	-839,547	-768,529
2. State Bank	**-54,213**	**-233,097**	**-316,440**
a) Debtor Balances (Excl. Zakat Fund)	5,515	0	0
b) Government Deposits (Excl.Zakat Fund)	-59,728	-233,097	-316,440
C. Net Govt. Budgetary Borrowings From Banking System	**9,392,960**	**10,043,597**	**10,221,756**
Through SBP	3,613,406	4,870,500	7,058,307
Through Scheduled Banks	5,779,554	5,173,097	3,163,450
Memorandum Items			
1. Accrued Profit on SBP & BSC holding of MRTBs & MTBs	73,953	133,626	129,658
2. Scheduled banks ' deposits of Privitization Commission	-2,007	-3,741	-2,091
3. Outstanding amount of MTBs (Primary market; discounted value)	4,743,836	4,673,434	2,453,412
Net Govt. Borrowings (Cash basis) From Banking System	**9,283,551**	**9,861,138**	**10,071,205**
(i) From SBP	**3,539,453**	**4,736,874**	**6,928,649**
(ii) From Scheduled Banks	**5,744,098**	**5,124,264**	**3,142,556**

INTERNATIONAL MONETARY FUND

PAKISTAN

June 28, 2019

REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—SUPPLEMENTARY INFORMATION

Approved By
Thanos Arvanitis and Kristina Kostial

Prepared by the Middle East and Central Asia Department

The information below has become available following the issuance of the staff report. It does not alter the thrust of the staff appraisal.

1. **The authorities are requesting approval for temporary retention of exchange restrictions and a multiple currency practice (MCP) under Article VIII**. These import restrictions and the MCP, which are subject to approval under Article VIII of the IMF's Articles of Agreement, were introduced to support the balance of payments at a time of heightened volatility. Specifically, Pakistan maintains (i) a requirement to fully pre-fund letters of credit, imposed in early 2017; and (ii) an exchange restrictions on advance payment for imports against letters of credit, imposed in July 2018. The authorities are committed to phase them out as the balance of payments stabilizes and to eliminate them by the end of the program.

Staff supports the authorities' request for approval of the retention of the exchange restrictions and the MCP for a period of 12 months on the grounds that they are non-discriminatory, imposed for balance of payments reasons, and temporary.

Statement by Jafar Mojarrad, Executive Director for Pakistan and Cyrus Sassanpour, Senior Advisor to Executive Director July 3, 2019

The Pakistani authorities appreciate the thorough and constructive discussions held with the IMF missions–led initially by Mr. Finger and subsequently by Mr. Ramirez Rigo—and thank Management and the Executive Board for their continued support. The authorities are also thankful to Pakistan's key bilateral donors and the country's international development partners for their support of Pakistan's reform efforts. In this statement, we would like to reflect the views of the authorities on root causes of their current macroeconomic challenges, their efforts to stabilize the economy, the key elements of their comprehensive adjustment program, and the path ahead.

Causes of Current Macroeconomic Challenges

Pakistan's current macroeconomic difficulties have been reflected in its large twin deficits primarily related to a consumption-driven rise in domestic demand. A challenging external environment, including rising oil prices, security issues inside and outside of the borders, lower capital inflows and hardening financial conditions abroad also contributed.

An overvalued exchange rate was also an important factor contributing to Pakistan's external sector woes. Maintaining a fairly rigid exchange rate during the last few years encouraged imports, thus contributing to rising domestic demand already fueled by an expansionary fiscal policy and an accommodative monetary policy. Total consumption expenditures increased to 94 percent of GDP in FY2017/18 (July 1-June 30) from 91 percent of GDP in FY2014/15. The overvalued exchange rate however kept inflation in check while, in view of weak domestic production capacity and low competitiveness, the uptick in economic growth widened the current account deficit to US$20 billion (6.3 percent of GDP) in FY2017/18.

On the fiscal front, a narrow tax base and over-reliance on indirect and withholding taxes are the most important structural weakness. Pakistan has one of the lowest tax-to-GDP ratios among emerging and regional economies and its fiscal position is highly dependent on the performance of few revenue sources. During the first eleven months of FY2018/19, tax collections declined reflecting a fall in imports and sluggish domestic sales of automobiles, cement, and petroleum products. Tax collection could not even keep pace with nominal GDP growth. On the expenditure side, untargeted subsidies and losses of State-Owned Enterprises (SOEs) added to the rigidity of current expenditures.

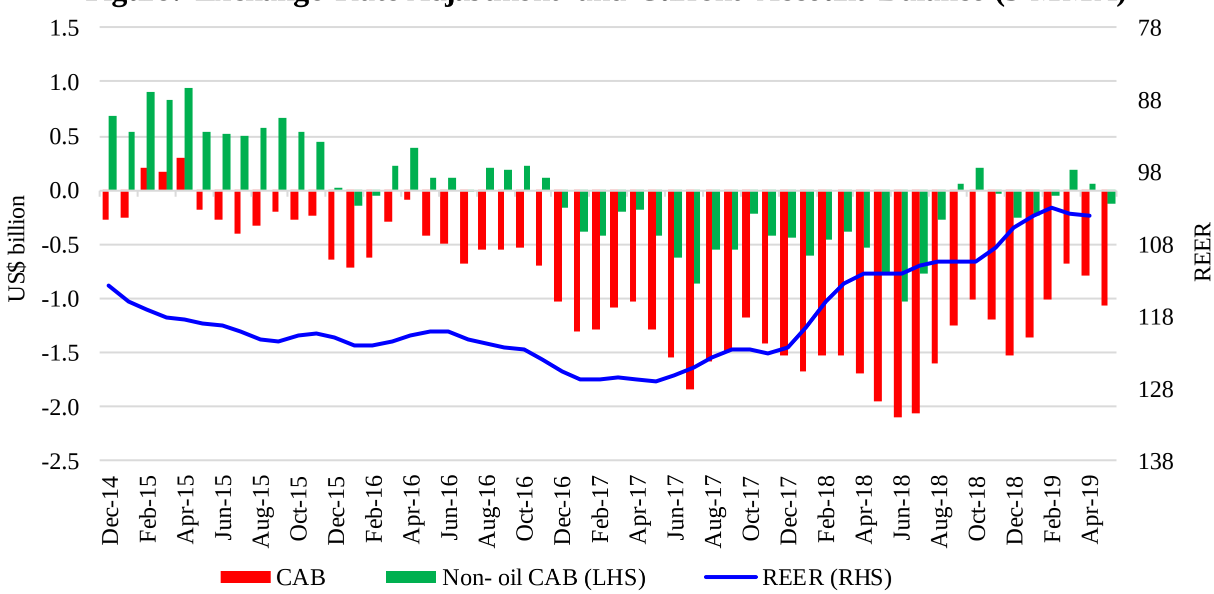
In addition to macroeconomic factors, there have been a number of structural impediments that discourage private investment, notably administered prices—especially in the energy sector—that not only weaken the price mechanism, but also discourage investment as market prices fail to reflect cost recovery. Pakistan's current ranking in the World Bank's ease of doing business index reflects hurdles in attracting private investment.

The Authorities' Efforts to Address Root Causes of Pakistan's Economic Problems

Improvement in the external deficit. As twin deficits widened to unsustainable levels in FY2017/18, the authorities implemented a range of stabilization measures, including greater exchange rate flexibility, proactive monetary tightening, and other measures including higher import duties to contain non-essential imports. The impact of these measures, and in particular the REER depreciation, started to take hold from early 2019 and was reflected in a significant external adjustment. Specifically, the current account deficit narrowed to US$12.7 billion during the first eleven months of FY2018/19 from US$17.9 billion in the same period in the previous year (figure).

While most of the improvement in current account balance can be attributed to a decline in imports of goods and services, the export volume grew by 17.7 percent in FY2017/18 and a further 6.8 percent (yoy) during July 2018-May 2019. Even though the decline in export prices resulted in a small fall in export value, the quality of exports improved with high value-added textiles growing in both volume and value.

Figure: Exchange Rate Adjustment and Current Account Balance (3-MMA)



Decisive efforts to address the fiscal deficit through an austerity budget. The government's FY2019/20 budget tackles head on the underlying revenue weaknesses and aims to contain current expenditures. To that end, the government is fully committed to document the economy (thus fighting informality) and remove tax exemptions/concessions to widen the tax base. A hallmark development this year has been the formal agreement between the federal and provincial governments for provinces to contribute to the fiscal effort by transferring part of their surpluses to federal coffers starting with the FY2019/20 budget. The budget also significantly increases social spending to protect the poor and the vulnerable during the adjustment process. Similarly, reforms in the energy and SOE sectors would help in plugging revenue leakages on a sustainable basis.

Tighter monetary policy to anchor inflation expectations. The tight monetary stance has been instrumental in containing domestic demand and anchoring inflation expectations, but has hampered growth. Real GDP growth is provisionally estimated to moderate to 3.3 percent in FY2018/19, down from 5.5 percent in FY2017/18 and an average annual growth of 4.7 percent during the previous five years.

Approach to the international community. To contain the imbalances and address structural weaknesses, the Pakistani authorities have approached the Fund for an extended arrangement under the Extended Fund Facility (EFF) in support of their comprehensive homegrown program to stabilize the economy. The program will also pave the way for other lenders including the World Bank and the ADB to extend their support to policy adjustment and structural reforms already underway. The authorities remain grateful to all official bilateral creditors who have supported Pakistan during these difficult times and are planning to keep the donors engaged for long-term partnership in trade and investment activities. The relationship with the Fund and other official creditors will also help Pakistan to tap international capital markets.

The Fund Supported Economic Program

The Pakistani authorities have embarked upon an ambitious reform agenda to stabilize the external sector, contain the fiscal deficit, and put the public debt ratio on a firmly downward path. The program is expected to reduce policy uncertainty and help stabilize the external sector in the short run, and pave the way for implementation of long-standing, deep-rooted structural reforms to achieve higher, sustainable and inclusive growth over the medium term. The Pakistani authorities are firmly committed to implement critical reforms to achieve the program objectives as laid out in the Letter of Intent and the Memorandum of Economic and Financial Policies.

The reforms are designed to address the constraints that have left the economy vulnerable to domestic and external shocks. The key elements of the programs are:

- ***Improving competitiveness***: Reforms are being implemented in two important areas. First, the authorities have gradually moved to a flexible, market-determined exchange rate regime. Second, several measures have been announced in the FY2019/20 budget to improve the business climate. Specifically, the authorities intend to move on a number of fronts to create an enabling environment for private sector investment and job creation, and in the process reduce the scope of Pakistan’s large informal economy. Some of the specific measures include simplifying customs processes and business registration. The authorities are also reviewing existing regulations to further facilitate private sector investment and encourage private sector participation in the economy.

- ***Broadening the tax base***: Prioritizing revenue generation as key to a sustainable fiscal position, the authorities are focusing on broadening the tax base through documentation of the economy, removal of tax exemptions and concessions, and strengthening tax administration, with the overall aim of lifting tax ratios to peer country levels.

- ***Improving cost recovery in the energy sector***: The aim is to rationalize subsidies, allowing regulators to set electricity and gas tariffs in line with generation costs and gas purchase prices, and institutionalize regular and timely adjustments to improve energy sector efficiency and contain large quasi-fiscal costs.

- ***Strengthening SBP's autonomy***: Drawing on Fund's input, amendments to the SBP Act will further strengthen central bank autonomy and governance. The government is ending deficit monetization from July 1, 2019.

- ***Implementing SOE reform****:* The authorities have prepared a comprehensive program to improve the governance and efficiency of SOEs, and facilitate their privatization, that will be put in action and implemented judiciously.

- ***Enhancing coverage of social protection and strengthening social safety nets***: The impact of adjustment on the vulnerable groups has been a major government concern from the beginning. To that end, the government is focused on rationalizing subsidies and other current expenditures to create room for higher spending on social protection through targeted channels and programs.

- ***Strengthening the effectiveness of the AML/CFT regime***. The authorities are committed to fully implement the action plan agreed with the Financial Action Task Force (FATF) to facilitate an early exit from the FATF list. The National Executive Committee is monitoring and coordinating efforts with all relevant institutions and agencies.

Looking Forward

The authorities are confident that the Fund-supported program will address the current macroeconomic imbalances as well as the longer-term structural challenges. They believe that the move to a flexible, market-determined exchange rate regime will strengthen the functioning of the financial markets and contribute to a better allocation of resources in the economy. The exchange rate will serve as the economy's main shock absorber. The exchange rate flexibility will also allow the central bank to focus on price and financial sector stability and help rebuild foreign reserves. The end of deficit monetization will further strengthen central bank autonomy and its ability to anchor inflation expectation.

The impact of exchange rate adjustment is expected to be reinforced by considerable fiscal tightening, especially related to documentation and taxation efforts that would further help in rebalancing domestic demand. The tax policy will continue to focus on broadening the tax base and strengthening tax administration and enforcement—while keeping tax rates low—and modernizing the PFM framework and improving treasury cash management. In the same vein, energy sector reforms will institutionalize the price-setting mechanism and help improve efficiency, avoid build-up of circular debt, and encourage private sector investment. The latter, in particular, would allow the energy sector to operate more efficiently and be self-sustaining with minimum government support.

Lasting improvements in the macroeconomic policy framework and strong structural reforms, highlighted above, set this program apart from the previous programs. This time, the focus of the program is to correct misaligned policies, especially those related to competitiveness and deficit financing, and begin structural reforms at the outset of the program, in view of their long gestation period. The authorities believe that the institutional reforms this time around will make it possible for Pakistan to end frequent recourse to IMF resources.

The Pakistani authorities look forward to the continued support from Management and the Executive Board.