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Pakistan finally reaches agreement with IMF, but economic challenges remain

- Pakistan has finally reached staff level agreement with IMF on policies to complete the 7th and 8th reviews of Pakistan's Extended Fund Facility (EFF). The agreement is subject to IMF board approval (likely in Aug) which will pave way for the release of US$1.17bn bringing total disbursement to US$4.2bn under EFF.
- Additionally, in order to support program implementation and meet the higher financing needs in FY23, the IMF Board will consider an extension of the EFF till June 2023 instead of Sep 2022. The board will also consider increasing the size of the EFF program to US$7bn, up from initially proposed US$6bn.
- This IMF support will provide some help as delays in IMF program and policy actions had led to increased economic uncertainty and a continuous decline in foreign exchange reserves.
- To recall, 7th and 8th reviews of Pakistan EFF program was initially scheduled in March 2022 and June 2022 but Pakistan was not able to reach Staff level agreement with IMF due to delay in proposed policy actions like removal of petroleum subsidies, imposition of Petroleum Levy (PDL), energy tariff rationalization & increased tax measures.
- We believe that the implementation of key policy actions like increase in energy tariffs (gas and power rates) and other structural benchmarks like gradual increase in taxes on oil and implementation of anti-corruption law will remain key and will lead to IMF's executive board approval and release of funds.
- IMF in its press release highlighted 5 key policy priorities to stabilize economy and bring policy actions in line with IMF-supported program which includes 1) Steadfast implementation of FY23 budget, 2) catch-up in power sector reforms, 3) proactive monetary policy to guide inflation to more moderate levels, 4) reducing poverty and strengthen social safety, and 5) strengthen governance.
- As per IMF, the recently passed budget aims to reduce government's large borrowing needs by targeting an underlying primary surplus of 0.4% of GDP by restricting expenditures and broad revenue mobilization measures.
- Relating to power sector reforms, IMF noted that due to weak implementation of the previously agreed plan, the power sector circular debt flow is expected to grow significantly to about Rs850bn in FY22.
- Furthermore, adjustment in monetary policy and linkages of EFF and LTFF rates with policy rate remain key given rising inflationary pressures. Government is also establishing a robust electronic asset declaration system and plan to undertake a comprehensive review of the anticorruption institutions (including the National Accountability Bureau).
- IMF stressed that "Steadfast implementation of the outlined policies, underpinning the SLA for the combined seventh and eighth reviews, will help create the conditions for sustainable and more inclusive growth".

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Tough times may continue, global oil price trend is key

- We believe Pakistan economic situation will remain challenging due to uncertain global economic and financial market conditions along with local political situation.
- Pakistan need to arrange funding for estimated US$30bn-US$35bn in FY23 which is big task considering rising interest rates and risk averse attitude around the world. There are expectations that few friendly countries like China, Saudi Arabia will continue financial support to Pakistan after IMF deal. Furthermore, Pakistan is also expected to receive financing from other Bi-lateral and Multi-lateral donor agencies that could provide some support to reserves of the country.
- Moreover, after ousting of the previous Khan government through a no confidence motion, the PML-N led coalition government will be going into elections next year whereby it will be difficult to take all much needed reforms.
- Though, the recently announced measured by the new government in Pakistan will help stabilize the economy and reduce fiscal and current account deficit, the overall investor confidence will remain below average. Pakistan Eurobond yields are now at 20%-32%, local lending rate is at 20 year high of 15.87% while Pakistan stocks are down 6% (USD -21%) in 2022 to date.
- This new IMF deal may help in some recovery of Pakistan dollar bond prices but considering the overall global interest rate environment and Pakistan rising debt a strong recovery may not come. Similarly, Pakistan stocks may react slightly positively to this news but given Pakistan's high lending and policy rates & other challenges like high inflation could continue to impact stock market sentiments.
- Recently in its monetary policy statement SBP also highlighted key risks like high global commodity prices, rising inflation and increasing external account concerns that remain critical for Pakistan economic outlook.
- We expect FY23 GDP growth of 3.5%-4% against government target of 5% while we estimate CPI inflation of 17-19% in FY23.
- Global energy prices also remain key for Pakistan. In FY22, oil and LNG imports are estimated at US$22bn which was ~27% of total import bill. A sustainable fall in oil, coal and LNG prices can provide some support to Pakistan external account.

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