

Pakistan Economy

February 13, 2023

REP-057

Pakistan and IMF Prior action needed to reach Staff Level Agreement



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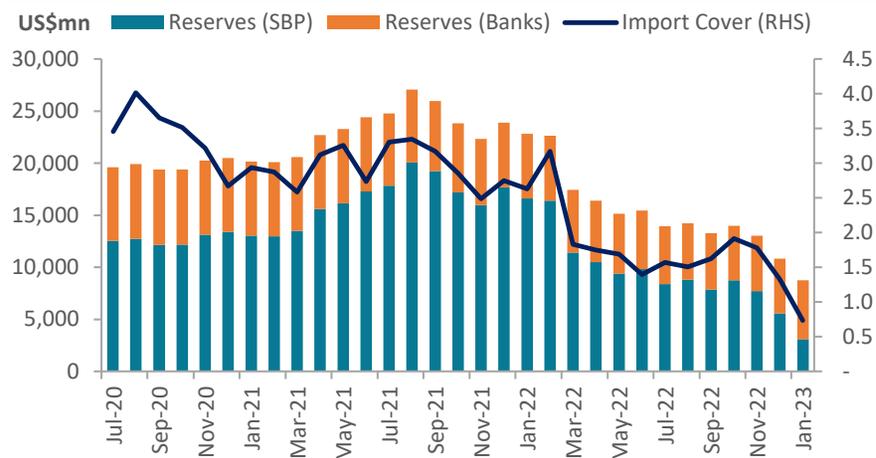


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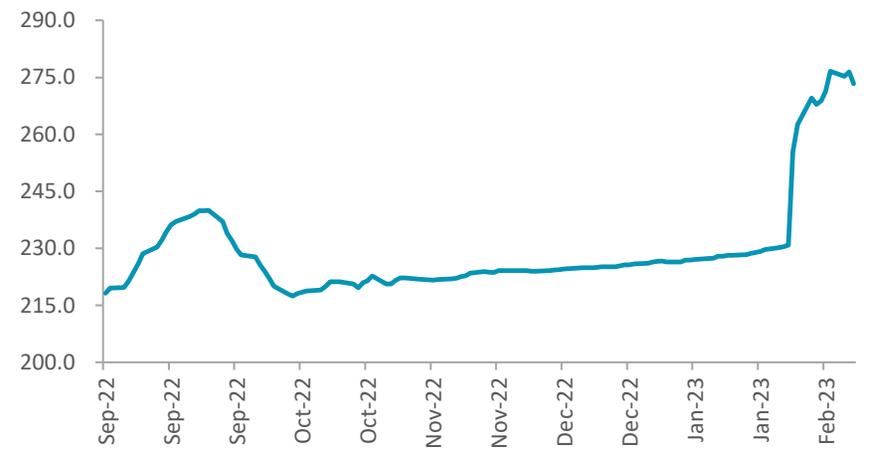
Delay in getting IMF and other dollar inflows

Pakistan Foreign Exchange Reserves



Source: SBP

Pak Rupee vs USD



Source: SBP

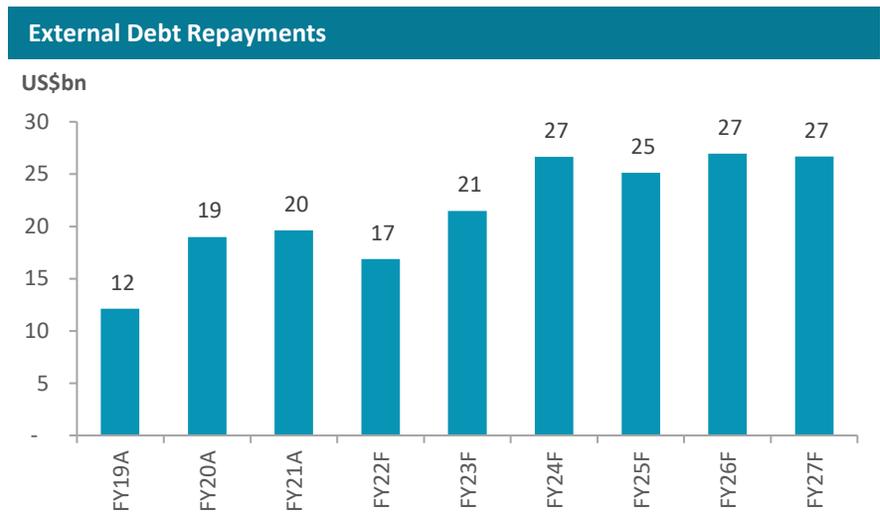
- After recent visit by IMF delegation to Pakistan, the much awaited Staff Level Agreement (SLA) with the visiting IMF team was not executed.
- The IMF statement was encouraging as it stated that virtual discussions will continue and hinted towards certain prior actions. The statement also says, *Considerable progress was made during the mission on policy measures to address domestic and external imbalances.*
- These developments come after a long 9-day visit that is unusually longer than past IMF review team interactions. As a precursor to the visit, the government of Pakistan had let go of the dollar peg late last month where the Pak Rupee devalued by around 14% since Jan 26, 2023 till date.
- The Finance Minister in a press conference early Friday morning indicated that Rs170bn of additional taxes will now be imposed. Circular debt accumulation will also need to be stopped and the FM has hinted towards energy sector reforms.
- As per news reports, the government has decided to implement tax and non-tax measures as demanded by IMF as a prior action through a Presidential Ordinance.
- Even though the exact timeline of events may move, we believe that the SLA will be signed in next couple of weeks or so. In a month's time after that, the IMF Board approval will likely come though paving the way for the disbursement of the US\$1bn tranche by next month. This will be followed by disbursements from World Bank, ADB and friendly nations.
- Funding from friendly countries is very critical this time around for the resumption of the IMF program, as per our assessment and could be one of the IMF demand. Disbursement from Saudi Arabia, UAE, Qatar and China may be to the tune of US\$5bn+ (other than already committed or expected rollovers), we estimate. The IMF may also seek assurances of exact amounts of funding from these countries before its Board approval.
- The time period from now to the disbursement of the IMF tranche could pose risks in terms of shortages of goods in the country as the country's focus will be ensure debt repayments and maintain only critical imports. There is already hint of petrol rationing in some parts of the country coupled with selected capital controls and slow processing of non essential imports.
- It will be interesting to evaluate the Pakistan Country Report issued by IMF after the IMF board approval. Especially condition related to reach FX reserves of US\$16bn as Jun-2023 as per the news reports.
- Also we need to see IMF condition on Pakistan LCs payment. According to news reports, IMF has insisted on immediate removal of restrictions on imports for which US\$4bnn will be needed to open LCs.



Delay may result in Rating downgrade

Moody's Credit Rating for Pakistan		
Rating	Outlook	Date
Caa1	negative	Oct 06 2022
B3	negative	Jun 02 2022
B3	stable	Aug 08 2020
B3	under review	May 14 2020
B3	stable	Dec 02 2019
B3	negative	Jun 20 2018
B3	stable	Jun 11 2015
Caa2	positive	Mar 25 2015
Caa2	stable	Jul 14 2014
Caa2	negative	Jul 13 2012
B3	stable	Aug 17 2009
B3	negative	Dec 12 2008

Source: Moody's

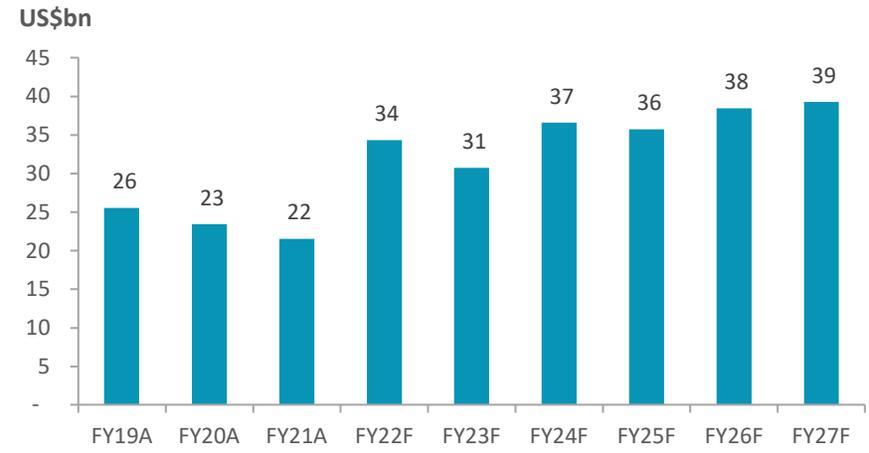


Source: IMF

- In a separate development, Moody's has shown concerns on Pakistan's ability to secure external funding to meet its financing requirement for the next few years. They have stated that funding from the IMF is crucial and delay in securing external funding will result in further decline in reserves.
- In the next few months while the IMF program is being finalized and approved, there is a possibility that international rating agencies could further downgrade Pakistan's rating, which will have far reaching consequences. The government should proactively take the rating agencies on board with the regard to the IMF negotiations and its plans to steer the country towards a strong economic recovery.
- These are challenging times globally for all low-income countries that took unprecedented levels of external debt in the aftermath of global monetary easing post 2008 financial crises and the recent onset of Covid and the accompanying global monetary stimulus. Among the countries that have recently turned to the IMF are Bangladesh, Sri Lanka, and Ghana among others.
- Pakistan had also ratcheted up its external debt and liability levels from less than 30% of GDP to around 40% of GDP with focus on short term debt some of which at market rates from commercial banks. Pakistan's external debt was last reported at around US\$100bn, out of which US\$40bn is multilateral, around the same amount is bi-lateral and the US\$20bn balance is equally split between Eurobonds and commercial loans.
- On an annual basis, Pakistan pays US\$12-13bn in debt repayments, around US\$2-3bn in interest and rolls over US\$12-13bn of short-term loans. This adds up to around US\$25bn+ in debt servicing annually on external debt which is not sustainable, we believe.

Debt Restructuring is rescuing

Growing External Financing Requirements



Source: IMF

- We are of the view that Pakistan should go for a bigger IMF program after June 2023 along with Debt Restructuring where Pakistan should ideally try to convert its short term external loans with long term with the help of friendly countries like China, Saudi Arabia, UAE etc.
- If that is not doable, than Pakistan should try G-20 common framework of debt restructuring. These are less painful and will help recovery soon without affecting credit ratings.
- If the government does not opt for orderly and amicable restructuring and continues to rely on short term funding from friendly nations or relief in the form of low cost loan vis-a-vis for floods to manage the country's external accounts, we believe the country could move towards a disorderly and coercive restructuring that will be very painful and may trigger a further credit rating downgrade.

Background of the current IMF program

History of IMF Lending Commitments to Pakistan (amount in mn SDR)

Program Name	Date of Arrangement	Expiration Date	Amount Agreed	Amount Drawn
Extended Fund Facility	Jul 03, 2019	Jun 02, 2023	4,988	3,038
Rapid Financing	Apr 16, 2020	Apr 20, 2020	1,016	1,016
Extended Fund Facility	Sep 04, 2013	Sep 30, 2016	4,393	4,393
Standby Arrangement	Nov 24, 2008	Sep 30, 2011	7,236	4,936
Extended Credit Facility	Dec 06, 2001	Dec 05, 2004	1,034	861
Standby Arrangement	Nov 29, 2000	Sep 30, 2001	465	465
Extended Fund Facility	Oct 20, 1997	Oct 19, 2000	455	114
Extended Credit Facility	Oct 20, 1997	Oct 19, 2000	682	265
Standby Arrangement	Dec 13, 1995	Sep 30, 1997	563	295
Extended Credit Facility	Feb 22, 1994	Dec 13, 1995	607	172
Extended Fund Facility	Feb 22, 1994	Dec 04, 1995	379	123
Standby Arrangement	Sep 16, 1993	Feb 22, 1994	265	88
Structural Adjustment	Dec 28, 1988	Dec 27, 1991	382	382
Standby Arrangement	Dec 28, 1988	Nov 30, 1990	273	194
Extended Fund Facility	Dec 02, 1981	Nov 23, 1983	919	730
Extended Fund Facility	Nov 24, 1980	Dec 01, 1981	1,268	349
Standby Arrangement	Mar 09, 1977	Mar 08, 1978	80	80
Standby Arrangement	Nov 11, 1974	Nov 10, 1975	75	75
Standby Arrangement	Aug 11, 1973	Aug 10, 1974	75	75
Standby Arrangement	May 18, 1972	May 17, 1973	100	84
Standby Arrangement	Oct 17, 1968	Oct 16, 1969	75	75
Standby Arrangement	Mar 16, 1965	Mar 15, 1966	38	38
Standby Arrangement	Dec 08, 1958	Sep 22, 1959	25	-

Source: IMF, Topline Research

- To recall, IMF executive board had signed a US\$6bn EFF program with Pakistan in Jul-2019. In Nov-2019, Pakistan successfully completed its first review and in Feb-2020 reached staff level agreement on second review. However, the release of the tranche under second review was delayed due to COVID-19 outbreak.
- In order to combat challenges pertaining to COVID-19, IMF had also disbursed US\$1.4bn in April 2020 under the Rapid Financing Agreement.
- Later on, after prolonged discussion with Abdul Hafeez Shaikh (Former Finance Minister), IMF board successfully approved the Second, Third, Fourth and Fifth Tranche in Mar 2021.
- Abdul Hafeez Shaikh was replaced by Shaukat Tarin in April 2021 who then carried out talks with IMF and reached a staff level agreement in Nov-21 for the Sixth review after a delay due to differences and lack of implementation on few of the proposed policy actions.
- Seventh and Eighth 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 Development Levy (PDL), energy tariff rationalization & increased tax measures. The review then completed on Jul 13, 2022. The IMF board also approved an extension of the EFF until June 2023 and augmentation of access by SDR 720mn (US\$1bn) bringing total access to about US\$7bn.
- Similarly, 9th review of Pakistan EFF program was initially scheduled in September 2022 but was delayed due to lack of imposition of policy actions including market driven exchange rate, energy tariff rationalization & increased tax measures, among others.
- This is Pakistan's 23rd IMF program which is likely to complete in June 2023.

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Neutral	Stock will perform in line with the average total return of stocks in universe
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