INTERNATIONAL MONETARY FUND

IMF Country Report No. 14/1

PAKISTAN

January 2014

FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, REQUEST FOR WAIVER OF NONOBSERVANCE OF A PERFORMANCE CRITERION AND MODIFICATION OF PERFORMANCE CRITERIA

In the context of the First Review Under the Extended Arrangement Under the Extended Fund Facility, Request for Waiver of Nonobservance of a Performance Criterion and Modification of Performance Criteria, the following documents have been released and are included in this package:

- **Staff Report** for the First Review Under the Extended Arrangement Under the Extended Fund Facility, Request for Waiver of Nonobservance of a Performance Criterion and Modification of Performance Criteria, prepared by a staff team of the IMF for the Executive Board's consideration on December 19, 2013, following discussions that ended on November 8, 2013, with the officials of Pakistan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 11, 2013.
- A **Staff Supplement** of December 17, 2013 updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its December 19, 2013 discussion of the staff report that completed the request and review.
- **Statement by the Executive Director** for Pakistan.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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December 11, 2013

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EXECUTIVE SUMMARY

Extended Arrangement under the Extended Fund Facility (EFF): A 36 month, SDR 4,393 million (425 percent of quota) Extended Arrangement under the Extended Fund Facility was approved by the Executive Board on September 4, 2013 (Country Report No. 13/287). The second tranche of SDR 360 million will be made available upon the completion of this review.

Status of the program: All quantitative performance criteria (PCs) for end-September 2013 were observed except for the one on net international reserves. The indicative target on social transfer payments was also missed, but the technical problems that caused the shortfall have since been rectified. The structural benchmark for the first review was met with the preparation of the public sector enterprise action plan. Progress is satisfactory in fiscal and structural reforms. Modifications are proposed to end-December 2013 PCs on net international reserves (NIR) and the ceiling on the net foreign exchange swap/forward position. Corrective measures are being taken by the central bank to meet future NIR targets and to rebuild gross reserves, which have fallen to a critically low level.

Key issues: Discussions focused on progress in addressing the main macroeconomic challenges facing the country, with a particular attention on: (i) challenges on the balance of payments and corrective measures to address external vulnerabilities and rebuild reserves; (ii) enhancing tax revenues by broadening the tax net and improving tax administration; (iii) protecting the most vulnerable; (iv) implementing structural reforms to unlock Pakistan’s medium-term growth prospects, and (v) safeguarding the stability of the financial system. Risks to the outlook are tilted to the downside. Security problems, continued energy challenges, and delays in implementing program reforms could seriously damage growth prospects. There are also significant risks to the balance of payments. The mission conducted extensive outreach with representatives of civil society, donors, private sector representatives, and the media.

Approved By
Daniela Gressani and Mark Flanagan

Discussions took place in Karachi and Islamabad during October 28–November 8, 2013. Staff representatives comprised J. Franks (head), A. Shahmoradi, F. Salman, B. Baltabaev (all MCD), E. Flores (FAD), A. Al-Hassan (MCM), S. Das (SPR), and K. Manasseh (COM). M. Dailami (Resident Representative) participated in the discussions.

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INTRODUCTION AND SUMMARY

1. **Pakistan's economic growth is projected to remain modest**. The fiscal year 2013/14[1] GDP growth forecast has been revised upward slightly to 2.8 percent. The manufacturing sector is expanding faster than initially expected, while agriculture growth sector is weaker. For FY 2014/15, growth is forecast to accelerate to about 3.7 percent, and will continue to accelerate in the medium-term as fiscal adjustment eases and structural reforms help alleviate binding constraints in the energy sector, improve efficiency, and enhance the investment climate. Inflation is projected to hover around 10 percent in the remainder of this fiscal year before easing to around 5–7 percent in future years. The current account deficit is expected to be about 1 percent of GDP, higher than the initial program forecast (by about 0.4 percent of GDP).

2. **Pakistan's performance for the first review was mostly satisfactory**. All end-September 2013 performance criteria (PC) for the first program review were met with the exception of that on net international reserves (NIR). The indicative target on social transfer payments was also missed due to technical problems in transfers, which have since been addressed (see ¶13). The authorities have made adequate progress on their ambitious structural reform agenda, although further efforts are needed in some areas. The fiscal deficit target was met with a margin, and the government is on track with efforts to broaden the tax net, and reform tax administration. The structural benchmark on the development of strategic plans for 31 public sector enterprises (PSEs) was met, and progress is continuing on the reforms agenda in the energy sector, PSEs, and business climate reforms.

3. **The balance of payments outlook has worsened and firm action is required to address critically low foreign exchange reserves**. To address the missed NIR target and the on-going challenges to strengthen reserves, the State Bank of Pakistan (SBP) is undertaking corrective action to boost reserves through higher policy interest rates, purchases in the foreign exchange market, and greater exchange rate flexibility. Such measures are being complemented by government initiatives to increase foreign exchange inflows through borrowing on global markets, stepping up privatizations, as well as accelerating disbursement of existing official loans and grants. However, even with the full implementation of these measures, the reserves situation will remain very tight over at least the coming 2–3 quarters. In recognition of the changed balance of payments situation and to limit risks, modifications are proposed to the end-December 2013 Performance Criteria on the floor on net international reserves and the ceiling on the net foreign exchange swap/forward position.

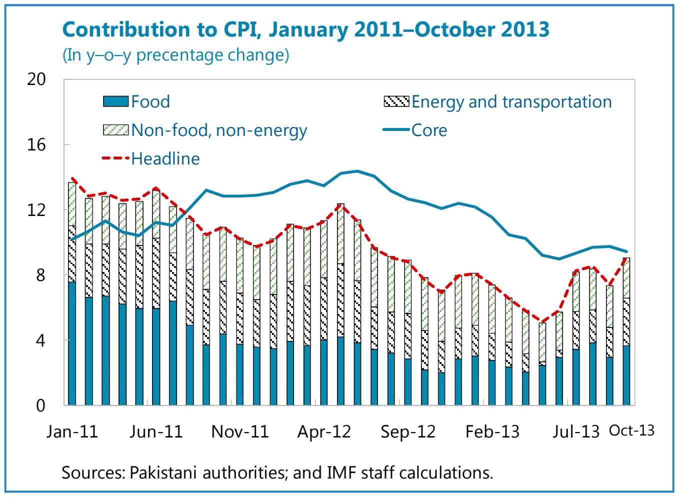
[1] Pakistan's financial year runs from July 1-June 30.

MACROECONOMIC DEVELOPMENTS AND OUTLOOK

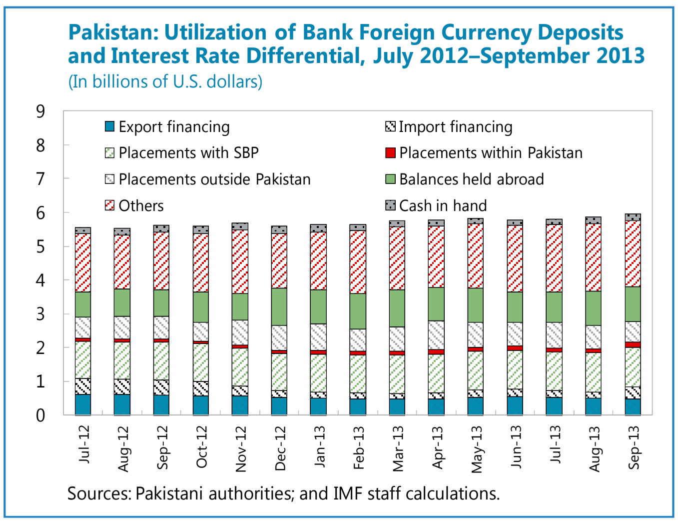
A. Recent Economic Developments

4. Economic growth remains modest. Indicators point to a pickup in large scale manufacturing (up 8.3 percent y-o-y in July-September 2013), as better electricity supply started to ease constraints on production (Figure 1). However, in the agricultural sector, a decline in cotton production by 15 percent y-o-y partially offset the impact on growth. On the external side, the current account was somewhat weaker than expected.

5. Headline inflation rebounded in the first quarter of FY 2013/14. Recent electricity tariff adjustments and food prices increases pushed the October inflation rate up to 9.1 percent from 5.1 percent in June. Throughout the first quarter, core inflation remained elevated at 9–10 percent, reflecting high underlying inflationary pressures. Concerned about the faster-than–anticipated rebound in headline inflation, the State Bank of Pakistan (SBP) raised its policy rate by 50 bps in mid-September.

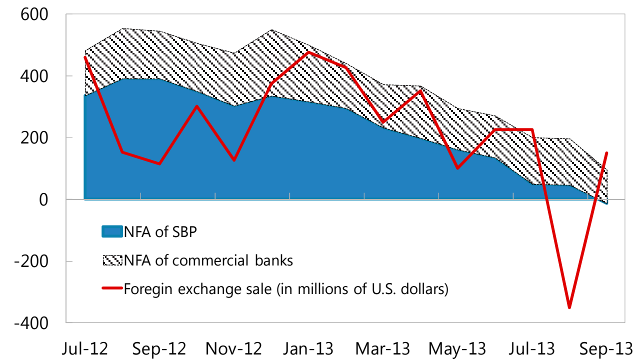


6. The balance of payments was worse than expected in Q1 FY 2013/14. For end-September, the overall balance was US$1 billion worse than the program. The current account was somewhat weaker due mostly to export performance and the fact that disbursement of the U.S. Coalition Support Fund payment was later than the authorities had anticipated. These developments were partly offset by higher remittances inflows. However, the financial account was significantly worse than expected due to lower foreign direct investment and lower other net capital flows (including net sales by the SBP in the spot market rather than purchases). The BOP forecast has also been revised downward for the remainder of the year. Exports are now expected to grow more slowly, modestly worsening the current account (by 0.4 percent of GDP). Baseline capital flows are also lower, with fewer private inflows already in Q2 and the weaker trend is expected to persist. Some disbursements from development partners are now delayed versus original projections (into Q4 or FY 2014/15), leaving a particularly tight balance of payments situation between now and March 2014.



7. Net foreign assets (NFA) of the SBP turned negative in September. The share of commercial banks in total NFA has increased substantially in recent months, as the SBP has continued to lose foreign exchange reserves. Commercial banks have maintained their holding of foreign exchange reserves as the SBP continued to sell foreign exchange in the market to defend the rupee (the SBP sold an average of US$280 million per month in the spot market over the last year except in August, when it purchased US$350 million). With unattractive deposit rates,[2] banks have been reluctant to keep foreign exchange deposits in the country, leaving limited room for the SBP to purchase foreign exchange from banks to replenish its reserves going forward. NFA of commercial banks fell by more than originally programmed, while their Net Domestic Assets (NDA) were nearly flat.

Pakistan: Composition of Net Foreign Assets and Foreign Exchange Intervention
(In billions of rupees)



Sources: Pakistani authorities; and IMF staff calculations.

8. The nominal exchange rate depreciated by 6½ percent against the dollar, and gross official reserves continued to decline. The exchange rate came under some market pressure in late September (down around 10 percent y-o-y) before easing in early October. Gross reserves have declined from US$6 billion at end-June to US$4.2 billion by end-October (about 1.1 months of imports), as weak official inflows and heavy debt repayments outweighed the first program disbursement.[3] After substantial purchases of foreign exchange in August in the run-up to the Fund Board meeting, the SBP returned to net dollar sales in September and October to counter the exchange rate pressures and maintain market liquidity. The SBP has been actively engaged in improving derivatives management, with the net short position falling by more than envisaged under the program and the maturity profile improving.

9. Data through end-June 2013 indicate that the banking system remains stable and liquid, but nonperforming loans (NPLs) continue at elevated levels (Table 8).[4] High profitability and liquidity indicators are supported by high concentration of banks assets in government securities (around 37 percent of total assets); nonetheless, strong deposit growth of nearly 14 percent has partially offset the impact on credit to the private sector. Profitability may be squeezed going forward due to the floor on savings deposits, high NPLs, and a declining loan-to-deposit ratio. Prolonged slow growth and balance of payments pressures continue to affect banks' asset quality. There are few small banks operating below capital adequacy ratio (CAR), comprising 6.6 percent of banking assets (with less than 0.1 percent of GDP capital shortfall).

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[2] While real interest rates on rupee deposits have been negative for a long time, interest rates on foreign exchange deposits also could not exceed the LIBOR.

[3] The central bank also holds some US$2.7 billion in gold which is not counted in reserves assets and could be tapped if needed.

[4] NPLs edged up from 14.7 to 14.8 percent of gross lending between March and June 2013, but provisioning rose by more, producing a decline in NPLs net of provisioning (from 19.9 to 18.3 percent).

Pakistan: Balance of Payments, 2012/13-2014/15, Program and Revised Program

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

	2012/13	Program 2013/14					Program 2014/15	Revised Program 2013/14					Revised Program 2014/15
	Actual	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	End-Year Proj.	Q1 Proj.	Q1 Actual	Q2 Proj.	Q3 Proj.	Q4 Proj.	End-Year Proj.	Q1 Proj.
Current account	**-2,466**	**-904**	**-994**	**246**	**334**	**-1,318**	**-643**	**-1,234**	**-1,352**	**-46**	**336**	**-2,296**	**-693**
Balance on goods	-15,404	-3,904	-4,070	-3,616	-3,393	-14,984	-3,854	-4,427	-4,406	-3,942	-3,752	-16,526	-4,301
Exports, f.o.b.	24,795	6,407	6,739	6,856	7,559	27,561	6,756	6,230	6,588	6,706	7,377	26,901	6,743
Imports, f.o.b.	40,199	10,311	10,809	10,473	10,952	42,545	10,609	10,657	10,994	10,648	11,129	43,427	11,044
Services (net)	-1,469	-604	-523	-8	-8	-1,143	-705	-740	-496	-80	319	-997	-633
Income (net)	-3,685	-693	-896	-689	-912	-3,191	-699	-819	-1,220	-823	-1,098	-3,960	-719
Current transfers (net)	18,092	4,298	4,496	4,559	4,647	18,000	4,614	4,752	4,769	4,798	4,868	19,187	4,960
Workers' remittances	13,922	3,512	3,552	3,482	3,644	14,191	3,707	3,927	3,602	3,521	3,693	14,742	3,903
Capital account	**264**	**77**	**80**	**94**	**98**	**349**	**98**	**52**	**127**	**149**	**173**	**500**	**173**
Financial account	**345**	**565**	**823**	**1,110**	**1,441**	**3,938**	**989**	**-68**	**489**	**1,626**	**3,851**	**5,899**	**1,123**
Direct investment in Pakistan	1,456	319	663	365	981	2,327	702	231	270	238	1,813	2,551	588
Of which: privatization receipts	0	0	266	0	534	800	250	0	0	0	1,500	1,500	250
Portfolio investment (net)	26	85	88	91	94	358	97	107	110	110	610	937	70
Financial derivatives (net)	0	0	0	0	0	0	0	0	0	0	0	0	0
Other investment assets	-488	-80	-104	-48	-54	-286	-90	-298	-90	-49	-45	-481	-104
Banks	-300	-53	-58	-63	-68	-242	-63	-270	-71	-76	-81	-499	-76
Other sectors	-186	-27	-46	15	14	-44	-27	-28	-19	28	36	17	-28
Other investment liabilities	-451	241	176	702	420	1,539	280	-49	199	1,327	1,473	2,951	584
General government, *of which:*	218	-115	-110	822	709	1,305	217	-253	452	887	1,174	2,260	44
Disbursements	2,500	495	592	1,193	1,228	3,509	786	479	1,170	1,767	2,220	5,636	696
Amortization	2,282	611	702	372	519	2,203	569	732	718	880	1,046	3,376	652
Other sectors	-262	544	273	-132	-201	484	50	-195	-329	364	322	161	527
Net errors and omissions	-135	0	0	0	0	0	0	102	0	0	0	102	0
Reserves and related items	1,992	262	91	-1,450	-1,873	-2,969	-443	1,148	736	-1,729	-4,361	-4,205	-603
Reserve assets	4,530	569	561	-1,370	-1,819	-2,058	-471	1,321	1,209	-1,648	-4,306	-3,424	-631
Memorandum items:													
Current account (in percent of GDP)	-1.0					-0.6						-1.0	
Exports, goods f.o.b. (growth rate, in percent)	0.4	7.1	10.9	10.1	17.1	11.4	5.4	1.3	9.8	8.3	14.3	8.5	8.2
Imports, goods f.o.b. (growth rate, in percent)	-0.6	6.8	6.6	5.4	8.8	6.9	2.9	8.6	6.8	7.7	9.0	8.0	3.6
Terms of trade (growth rate, in percent)	-0.7					-0.1						-2.0	
End-period gross official reserves (millions of US dollars)	**6,008**	**5,640**	**5,328**	**7,198**	**9,566**	**9,566**	**10,037**	**4,691**	**3,482**	**5,130**	**9,436**	**9,436**	**10,067**
(In months of next year's imports of goods and services)	1.4	1.3	1.2	1.6	2.2	2.2	2.2	1.1	0.8	1.1	2.1	2.1	2.2
End-period net international reserves (millions of US dollars)		**-2,499**	**-2,090**	**-141**	**2,532**	**2,532**		**-2,974**	**-4,210**	**-2,482**	**2,129**	**2,129**	**2,732**
Proposed net international reserves target		-2,499	-2,090	-141	2,532	2,532			-4,130	-2,750	1,895	1,895	3,810
Adjusted net international reserves target 1/		-2,850											

1/ CSF nonmaterialization and a shortfall in official multilateral/bilateral disbursements give an adjustor of –351 in Q1.

B. Macroeconomic Outlook and Risks

10. GDP growth is expected to be slightly better than the initial program forecast, while inflation will remain high.

- **Growth**. Overall, GDP is expected to expand by 2.8 percent (0.3 percent higher than initial program forecast). As reforms in the energy sector take hold, the manufacturing sector is expected to expand faster than expected initially, although growth in the agriculture sector, in cotton production in particular, is projected to be slow. Over the next fiscal year, growth is expected to accelerate to about 3.7 percent, and to rise further in the medium-term as fiscal adjustment eases and structural reforms alleviate constraints in the energy sector, boost the efficiency of public enterprises, and improve the investment climate.

- **Inflation**. Inflation is projected to hover around 10 percent in the remainder of FY 2013/14 (similar to the previously forecast) before easing to around 7 percent in FY 2014/15, as inflation expectations will be anchored by prudent monetary policy and stable macroeconomic policies (Table 3).

- The **current account** deficit is expected to be about 1 percent of GDP, higher than the initial program forecast by about 0.4 percent of GDP. Imports are expected to grow by 8 percent (1 percent higher than expected earlier), and exports are expected to grow more slowly. Gross reserves are projected to recover to US$9.5 billion, close to the initially programmed level by end FY 2013/14, and US$11 billion by Q1 FY 2014/15, as agreed actions to accumulate reserves by the SBP and the government takes hold.

- **Debt sustainability** outlook has remained broadly unchanged relative to the program request.

    - External debt is expected to decline to about 22 percent of GDP in the medium term under the baseline scenario. The debt sustainability analysis shows, however, how external debt is susceptible to sharp exchange rate depreciation or current account shock (Annex I). In the case of Pakistan, the likely drivers of a noninterest current account shock would be a decline in remittances, or a rise in oil prices.

    - Public debt is expected to decline gradually over time, supported by a strong fiscal adjustment. While the projected decline is broadly resilient to standard size shocks, debt would become unsustainable if the envisaged fiscal consolidation fails to materialize (Annex II). Given the strong reliance on short term debt, the projected decline would be sensitive to a large interest rate shock—albeit the captive domestic investor base is likely a mitigating factor. Gross financing needs are high and sensitive to shocks, and this fragility, while ameliorated, will likely remain considerable in the medium term.

- **Risks to growth are firmly to the downside**:
  - **Security conditions** in Pakistan remain difficult, with alarming terrorist activity, as well as sectarian violence and criminal activity which continue to depress investment and growth.
  - **Policy implementation risks** could depress growth. With policy reforms crucial to restoring stable growth, governance issues, capacity constraints, and any waning of the authorities' commitment or the implementation momentum, would discourage investment. In particular, if reserve accumulation is not pursued, or if the accumulation process is not managed well, there is a risk of disorderly foreign exchange market conditions which could devolve into broader balance of payments problems.
  - **External vulnerabilities** remain high. In particular: (i) vulnerability to oil price shocks has risen in recent years; (ii) the country is vulnerable to inward remittance spillovers if economic conditions in GCC countries were to worsen or if expatriate workers were to reduce transfers out of concerns about conditions within Pakistan; and (iii) a slowdown in global economic activity could weaken Pakistan's exports.

POLICY DEVELOPMENTS

Discussions focused on progress in addressing the main macroeconomic challenges facing the country, with a particular focus on: (i) corrective measures to address external vulnerabilities and rebuild reserves (in light of new balance of payments challenges); (ii) enhancing tax revenues by broadening the tax net and improving tax administration; (iii) protecting the most vulnerable; (iv) implementing structural reforms to unlock Pakistan's medium-term growth prospects, and (v) safeguarding the stability of the financial system.

A. Fiscal Policy

11. The government met the first quarter of FY 2013/14 deficit target with a margin. Key components of the first quarter outturn include:

- **Revenues were somewhat stronger than expected**. Federal Board of Revenue (FBR) collections were higher than envisaged in Q1, although this trend may not continue, as the October outturn was slightly lower than envisaged. Tax revenue was better than forecast, mainly reflecting higher sales tax. Nontax revenues were also quite strong, reflecting one-off factors—the settlement of circular debt that took place early in the quarter included the recovery of interest (in addition to principal), which boosted nontax revenue but entails additional net lending.

- **Spending has been slow**. The execution of expenditures has been slow, particularly in development spending and targeted cash transfers to the poor. The shortfall in development spending reflects in part a prudent stance to executing expenditure plans, as risks to the revenue outlook remain high. The underperformance in target social spending (an indicative target) has suffered from technical difficulties (MEFP ¶11).

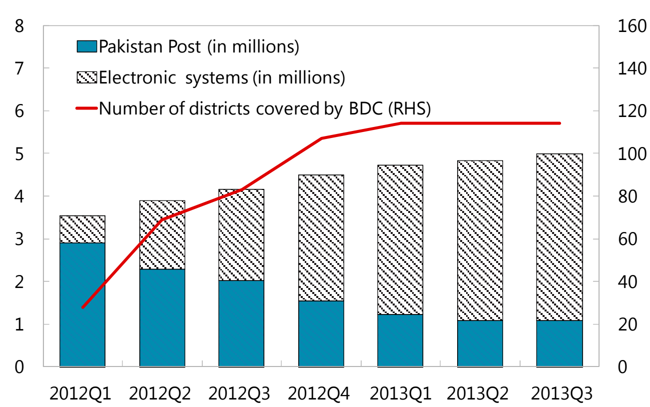
- **The phase-out of electricity subsidies is on track** (MEFP ¶6). The authorities increased electricity tariffs to large consumers (above 200 KWh per month) in early October as envisaged under the program. However, the Supreme Court partially rolled back the previous (August) increase for some large consumers (i.e. commercial, residential and bulk consumers), which re-established a small subsidy for these segments. Despite this, the envisaged saving under the program (about ¾ percent of GDP) is still expected to materialize as initial calculations were conservative and compensatory action was taken (¶30).

- **The provinces are running surpluses**. The provinces are expected to contribute to the programmed fiscal consolidation—as agreed by the Council of Common Interest. In the first quarter, they achieved a higher-than-envisaged surplus largely as a result of low spending. Nevertheless, strengthening provincial revenues remains a challenge (MEFP ¶12).

12. The strong fiscal performance puts the authorities on track to deliver some 2 percent of GDP in fiscal adjustment over the current fiscal year without modifications in the fiscal program (MEFP ¶5). There are risks to the revenue projection. Specifically, the current Gas Infrastructure Development Cess (GIDC)—while already levied on consumers by the gas companies—has yet to enter the government treasury due to legal challenges (MEFP ¶8). In the absence of the GIDC money, the government would have to continue with the present reduced investment spending pace, or implement alternative revenue measures, to ensure their ability to continue meeting the deficit targets. In the energy sector, in addition of the fuel change adjustment, the government remains committed to strengthen the tariff determination mechanisms, with NEPRA expected to issue a new determined tariff by mid-November, with the understanding that the government will pass it on to consumers in January.

13. Social protection is key to the successful implementation of the extended arrangement. Due to technical difficulties in releasing funds to the Benazir Income Support program (BISP), payments to beneficiaries were delayed, causing the indicative target to be missed (MEFP ¶11). The issue was subsequently resolved, and the authorities are committed to automate the release of funds in the future to allow the BISP to deliver payments on time. In line with

Number of Beneficiaries by Payment Method and Roll-out of BDC in Districts



Sources: Pakistani authorities; and IMF staff calculations.

projections, they have reached the coverage level of 4.9 million beneficiaries; however, disbursements were only made to 4.1 million beneficiaries (around 83 percent of the total covered) through the technology-based platform linked with National Identification database. Going forward, outreach and mobilization campaigns will be stepped up to reduce the gap between enrolled and those receiving transfers. Before end-June 2014, coverage will increase to at least 5.5 million families, and the number of beneficiaries receiving transfers to at least 4.8 million. Indicative targets are modified to reflect the revised projections. The mission urged authorities to maintain agreed spending increases to help alleviate widespread poverty and cushion the impact of adjustment policies. Staff also noted the importance of maintaining donor financing flows—an important component of external financing.

14. Efforts to strengthen tax administration are underway with the objective of strengthening capacity and transparency. The authorities have launched a plan to broaden the income tax net, and are on track to finalize plans to strengthen tax administration for sales, customs, and excise taxes by end-December:

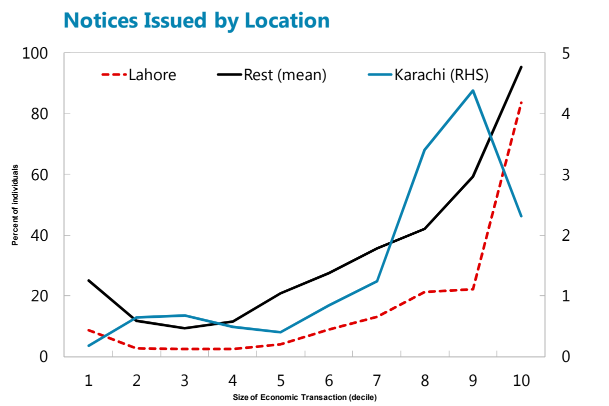
- **Expanding the income tax net**. The authorities are executing their plan to incorporate potential tax payers using FBR's detailed database, which contains information on economic transactions and assets of more than 300 thousand potential tax payers (Box 1). In line with program objectives, the authorities had issued more than 35 thousand tax notices by end-October, mainly based on potential economic value and the geographical locations of the potential tax payers to ensure that the public perceives this as a nation-wide effort. While the authorities have faced some challenges to ensure the delivery—and confirmation—of these notices, they are moving forward and seek to issue 75 thousand additional notices by end-March 2014 (MEFP ¶7). They also have specific goals for the follow up notices and subsequent tax assessments (new structural benchmark).

- **Strengthening the administration of other taxes**. The authorities have made progress in developing their full tax administration strategy, which will be finalized by end-December. A number of IT and work process reforms have already been identified. On sales taxes, the strategy will revisit automated systems for tax return processing to reduce fraud, risk-based registration, and expansion of the net to persons liable to registration. On customs, the strategy will include developing a computerized clearance system, finalizing valuation rulings for imported goods, addressing under-invoicing, improving transit trade security, and developing an anti-smuggling plan. On excise taxes the plan will explore electronic monitoring mechanisms to curb tax evasion.

Box 1. Broadening the Tax Net

Addressing Pakistan low tax revenues. Pakistan has very low tax revenues, which constrains its ability to meet the spending needs arising from gaps in the social safety net, security challenges, and infrastructure required to foster development. In this context the authorities are seeking to reduce the tax gaps by broadening the tax net and improving tax administration.

The initiative to broaden the income tax net. The authorities are implementing an initiative to exploit data on economic transactions and assets to identify over 300 thousand potential new tax payers. So far, the tax authorities have issued over 35 thousand notices, and plan to issue 75 thousand more by end-March—with the longer-term objective being reaching over 300 thousand in three years. These initial notices will be followed by second notices, provisional assessments, collection procedures, and penal proceedings. The notices have been issued based on several factors including the size of the potential collection and the location—to achieve national coverage. Despite the incipient stage of this initiative, the authorities have already registered new tax payers and some of them have filed and paid their due taxes.



Sources: Pakistani authorities; and IMF staff calculations.

This promising initiative will face challenges and needs to be supplemented by other efforts to improve tax administration. For example, so far the Federal Board of Revenue (FBR) has received confirmation of delivery for only about 30 percent of the notices issued, and the pace at the regional tax office in Karachi has been relatively low. Moreover, strong implementation of the enforcement stages of the plan early on will be key to its eventual success. These efforts will need to be complemented with steps to address the potential undeclared liabilities of current income tax payers—including the envisaged strengthening of tax audits, as well as efforts to strengthen administration of indirect taxes—for which plans are being finalized.

15. Efforts toward eliminating tax exemptions and concessions are also underway (MEFP ¶9). Since the start of the program, the authorities have issued a few Statuary Regulatory Ordinances (SROs) to address some implementation issues of already budgeted measures and address some legal concerns. The budgetary implications of these SROs were negligible and costs were covered through administrative measures. The authorities reaffirmed their commitment that in the future the SRO process granting tax exemptions and concessions will be eliminated. The authorities aim to finalize plans to reduce concessions and exemptions, including those granted through SROs, by end-December 2013. The ultimate objective of the exercise will be to increase revenues by 1–1½ percent of GDP over two years without increasing tax rates. The authorities plan will include elimination of the first set of exemptions and concessions in the context of Budget 2014/15. The consequent broadening of the tax base will generate much of the needed revenue increase, but it is also important to facilitate tax administration and to move toward a more equitable and competitive tax system.

16. AML/CFT. Staff encouraged the authorities to improve tax enforcement and revenue collection by effectively implementing the anti-money laundering (AML) framework which should also be used to combat tax evasion. In this regard, a first step, required by international standards, is that tax crimes be listed as predicate crimes to money laundering in the Anti-Money Laundering Act (AMLA). The authorities agreed to pursue this (MEFP ¶7).

B. Monetary and Exchange Rate Policies

17. Monetary aggregate growth was lower than programmed, due to contraction in net foreign assets (NFA) and low Net Domestic Assets (NDA) growth. Reserve money grew much more slowly than projected, due mainly to lower government borrowing from the SBP. Private sector credit growth turned positive (up by 1.5 percent y-o-y), better than anticipated in the program. NFA turned negative in the quarter.

18. The SBP met three PCs under the program, but missed the target on Net International Reserves (NIR). PCs on NDA, net government borrowing from the SBP, and the ceiling on the net swap/forward position were met. However, NIR target was missed by US$304 million, despite the upward revision of US$200 million from the safeguards assessment mission.[5] A worse-than-projected balance of payments in Q1 FY 2013/14 resulted in the overall shortcoming in NIR of about US$1 billion than the program projection. Weaker exports performance and a worse than anticipated capital and financial account contributed to the underperformance of NIR, despite the program adjustor on official disbursements. In particular, SBP foreign exchange purchases in the spot market were US$225 million less than projected and the central bank also unwound the net swap/forward position by more than expected (US$480 million). Efforts to rebuild reserves were lacking in the run-up to the end-September, as the SBP did not buy any reserves on the spot market after the program's prior action was met on August 27, and periodically intervened to ease pressure on the exchange rate (¶7). The SBP continued to build up a long foreign exchange forward position to counteract the outstanding short position from US$2.255 billion in end-June to US$1.775 billion at end-September, within the program target.

19. Given the worse than expected balance of payments outlook and critically low reserves, the SBP and government agreed to undertake remedial actions to meet the revised NIR targets and rapidly reduce external vulnerabilities. To strengthen financial flows, the SBP has continued to raise its policy rate. It has also moved more aggressively to acquire foreign exchange on the spot market (US$200 million since November 1), allowing for greater exchange rate flexibility.

[5] NIR was measured by subtracting from gross international reserves the open forward position (measured counterparty-by-counterparty) and other reserve related liabilities. The TMU provides a revised definition of NIR.

This will help improve the current account balance over time. Over the coming quarters, SBP net foreign exchange purchases will increase, and the policy rate will be adjusted further as needed. The government will contribute to rebuilding reserves by accelerating its inflows of foreign exchange (which are automatically deposited with the SBP), including via an accelerated privatization schedule, plans to issue a eurobond later in the fiscal year, and domestic placements of dollar-denominated debt. These efforts should contribute an additional US$1.7 billion in capital inflows. With these remedial actions, the authorities anticipate returning to the originally programmed NIR level by the first quarter of FY 2014/15, despite the more difficult external outlook (MEFP ¶15). On this basis the authorities requested a waiver for missing the end-September NIR target.

20. Staff stressed that the SBP's monetary policy should also focus on containing inflationary pressures. With higher inflation on the horizon, the mission discussed the appropriate monetary policy stance to both forestall price increases and rebuild reserves. In light of recent loses in reserves the SBP tightened monetary policy further by increasing the policy rate by 50 bps on November 13. Going forward, the SBP indicated that the policy interest rate would be adjusted further as needed to ensure positive real interest rates and an attractive interest differential to encourage capital inflows, help prevent foreign exchange outflows, and contain inflationary pressures. As foreseen in the original program, inflation reduction will become an increasing focus of monetary policy in FY 2014/15, with a view toward attaining annual inflation in the 6–7 percent range in the medium term. The SBP lending to the government will remain within agreed targets and open market liquidity injections will be limited to program objectives (MEFP ¶15).

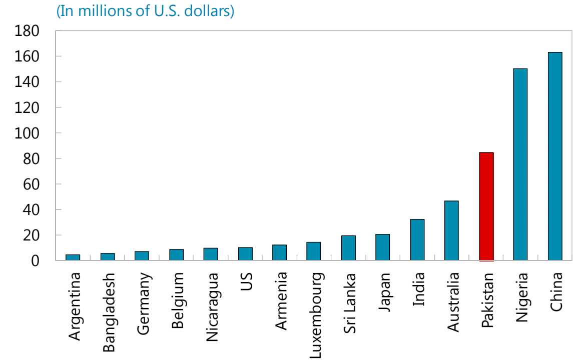
21. The SBP will gradually limit its exposure in foreign exchange derivatives. Although staff agreed that foreign exchange derivates provide an effective tool to manage liquidity in the market, the mission noted that they should be used prudently. The SBP will continue to follow program targets on net swap/forward positions, which will gradually reduce the SBP's open position over time alongside the build-up of gross reserves. Staff and the authorities agreed that an overly aggressive reduction in the net position should also be avoided, so as not to depress gross reserves unduly.

22. Staff urged the authorities to move ahead with measures to enhance SBP independence and improve internal operations, which will improve safeguards and contribute to better monetary policy performance over time. The authorities have agreed to enact amendments to the SBP law—incorporating the recommendations of the recent IMF safeguards assessment—to strengthen the autonomy of the SBP (structural benchmark). The law will provide full operational independence and provide enhanced governance structure including strong internal controls. In particular, the amendments should establish an independent, decision-making monetary policy committee to design and implement monetary policy. In line with findings of the recent safeguard assessment mission, the amendments should also provide authority to the SBP as the sole owner and manager of foreign exchange reserves, establish an Executive Board with defined executive powers, and should remove: (i) government representatives from the Central Board, and (ii) provisions that give government authority to direct certain SBP activities; moreover, the amendments should strengthen the personal autonomy of Board members and the financial autonomy of the SBP. The draft law will be submitted to the IMF for review and comments by end-December 2013. Furthermore, the SBP will establish a Board committee to centralize and oversee risk management activities across the bank by end-January 2013. The SBP will also approve by end-March 2014 a plan to fully implement International Financial Reporting Standards (IFRS), beginning with FY2013/2014 financial statements, including reporting financial reserves by currency and maturity by end-March 2014 (MEFP ¶16).

C. Financial Sector Policies

23. The SBP is preparing a time-bound action plan to address minimum capital adequacy issues with a few problem banks (MEFP ¶18). The SBP has already identified the capital shortfall in one state-owned bank and three private banks, representing around 6.6 percent of the banking sector assets (less than 0.1 percent of GDP). Staff encouraged the authorities to finalize the plan, as continued forbearance may pose risks to the financial system and reduce the credibility of the SBP as a regulator. The authorities agreed with staff that public funds should not be used to recapitalize private banks. In addition, there are a few banks that fall below the minimum capital requirement (MCR) but not the CAR. The statutory MCR in Pakistan is very high by international standards (PRs 9 billion), and staff suggested a reevaluation of the level of MCR for the system as a whole, taking into account the current level of banks' capital, the capabilities of existing shareholders to raise additional capital, and to improve competition in the market and to limit concentration in banking system.

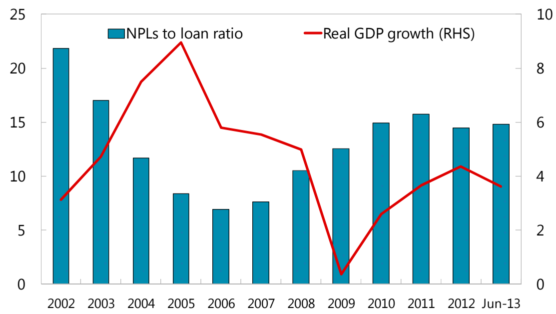
Statuary Minimum Capital Requirement
(In millions of U.S. dollars)



Sources: Pakistani authorities; and IMF staff calculations.

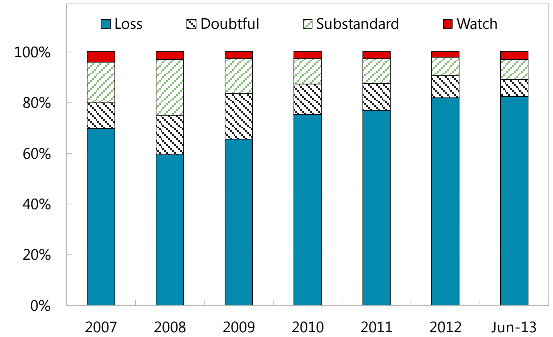
24. Staff urged vigilance about financial stability risks arising from high nonperforming loans (NPLs). Banks remain vulnerable to deterioration in the overall macroeconomic environment. The trend over the last decade confirms a close negative relationship between the performance of economy and buildup of NPLs. Since 2008, the feedback loop of increasing NPLs and lower GDP growth (as well as increasing government borrowing from the banking system) has crowded out credit to the private sector, and thereby, reinforced this vicious cycle. As the majority of these loans are classified as "loss," the authorities agreed to explore options to reduce NPLs, such as speeding up recovery processes, providing favorable tax treatment for write-offs, and supporting markets for distressed debt.

Trend in GDP Growth and Nonperforming Loans
(In percent)



Sources: Pakistani authorities; and IMF staff calculations.

Composition of Nonperforming Loans



Sources: Pakistani authorities; and IMF staff calculations.

25. High concentrations of bank assets in government securities may pose revaluation risks. The significant increase in banks' holdings of government securities from 22 percent of the banking system total assets in 2010 to 37 percent in June 2013 is contributing to a contraction in private sector credit. Banks hold around 75 percent of government securities and 90 percent of these securities are held as Available for Sale, exposing banks' balance sheets to revaluation risks. Staff and the authorities agreed that ultimately, the key to sovereign risk reduction is the achievement of a lower fiscal deficit, together with the recovery of private sector lending over time. In the meantime, the authorities will continue to monitor these developments.

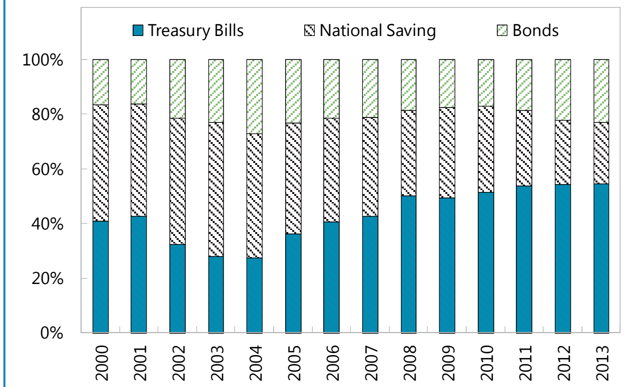
26. Staff supported financial sector reforms to enhance the resilience of the financial system (MEFP ¶19 and ¶22). The authorities have initiated the consultation on the draft Corporate Rehabilitation Act (CRA) with key stakeholders. The draft CRA is largely in line with international best practices; however, there are a number of issues that need clarification and areas for improvement to encourage corporate rehabilitation (e.g., incentivizing out of court restructuring, lowering the minimum debt levels to enter into insolvency proceedings, extending the time period for filing claims and objection). The Deposit Protection Fund act and the Securities Bill are being finalized. Furthermore, the authorities intend, in consultation with the Legal and Monetary and Capital Markets departments at the IMF, to develop a contingency planning framework to bolster financial stability and a legal framework for consolidated supervision of financial conglomerates.[6]

27. Staff recommended that the authorities further develop the government debt market. As the government has been financing around 85 percent of fiscal deficit through the domestic debt market, it is critical to have a liquid and vibrant government securities market. Given uncertainty in the policy interest rate and the increase in government domestic debt (around 25 percent during the last fiscal year), banks have been reluctant to invest in government bonds and have heavily

[6] Deposit protection fund will be included in the contingency planning framework.

concentrated in 3-month tenor T-bills. The composition of domestic debt has changed significantly over the last decade, with more reliance on short-term floating debt—Treasury bills now amount to over half of domestic debt, the National Savings Schemes for almost a quarter, and bonds only around 22 percent. Staff and the authorities agreed that there is a need to deepen the government domestic debt market by considering Diaspora bonds, indexed bonds, and introducing additional Shariah-compliant instruments. Efforts to extend maturities and build an effective yield curve will also be important. As part of the authorities' efforts to develop and modernize government securities market, the IMF and the World Bank have agreed with the authorities on a joint technical assistance mission in December 2013 to develop a medium-term debt strategy (MTDS) (MEFP ¶21).

Composition of Government Domestic Debt



Sources: Pakistani authorities; and IMF staff calculations.

D. Structural Issues

28. Steadfast implementation of the structural reform agenda is crucial for boosting sustainable and inclusive economic growth in Pakistan. The authorities are rapidly implementing agreed reforms in the energy sector, public sector enterprises (PSEs), trade policy, and the business climate. In these areas, the program incorporates two new structural benchmarks at this review: one to initiate revenue-based load shedding that will allocate more electricity supply to those areas with high payment rates to minimize losses, and one on intermediate steps toward privatization of certain PSEs.

Energy Sector

29. National Energy Policy implementation has been progressing. The swift execution of the new policy remains crucial to remove short-term bottlenecks, encourage long-term, sustainable increases in electricity supply, and sustain public support for economic reforms. Progress has been made on electricity price adjustments, arrears, monitoring and enforcement, demand and supply side management, gas sector reforms, and energy sector governance.

30. Rationalization of electricity prices is advancing. On October 1, 2013, the government increased electricity prices to reduce subsidies on consumers, including residential and agricultural users, while retaining subsidies for the lowest level users. This translated into an increase in the weighted average notified tariffs by 35 percent—above the program commitments—to compensate for the short-fall that emerged because of a court decision to partially roll back the August 2013 price increase. As a result, the total price adjustment will still produce the projected savings of ¾ percent of GDP (MEFP ¶25).

31. Governance improvements in the electricity sector are in progress. By determining FY 2013/14 tariffs in November, National Electric Power Regulatory Authority (NEPRA) reduced the base tariff determination period from eight to five months, and it is committed to further streamline the process (to three months) by the next determination cycle. NEPRA is also moving forward with the hiring of new staff to improve its capacity. Legal challenges to the timely adjustment of tariffs to reflect changes in fuel prices have been largely resolved in favor of the government, permitting a return to normal monthly adjustments as of September 2013 (earlier adjustments were done on average with a seven-month lag), which will help reduce the build-up of arrears. The structural benchmark (end-December 2013) on making the Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC) is on track. A transparent settlement system will allow future wholesale trading of electricity.

32. Electricity supply has increased and payments arrears are down. Data from the Ministry of Water and Power point to an additional 1700 MW of electricity supply to the system and a reduction of load shedding by around three hours since the new government took office in June. This is mainly due to clearance of PRs 480 billion of payment arrears, which allowed companies to honor their fuel bills, repay working capital credit lines, and increase generation capacity utilization. Arrears are estimated about PRs 117 billion (end-September), which is the level that is deemed a normal payment float. However, circular debt will again accumulate until prices are fully aligned with generation costs later in the program. The authorities are moving ahead with hiring a firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy supply chain (end-November structural benchmark) (MEFP ¶26). The findings of the report will allow the authorities to take concrete steps to prevent the accumulation and recurrence of payables arrears.

33. Improving natural gas supplies, price rationalization, and domestic allocation to the most efficient uses remain a key challenge (MEFP ¶32). To improve supply in the short-run, the authorities are moving forward with plans to import Liquefied Natural Gas (LNG). They recently issued tender and received bids for LNG facilities, and are planning to finalize the contract by end-December 2013, with imports expected to begin by end-November 2014. Efforts to invest in existing fields are also bearing fruit. The supply of gas is projected to rise by 7 percent before the end of the year. The authorities are working on a plan to rationalize gas prices. The first step of implementation will be through an increase in the GIDC by end-December 2013 that should generate 0.4 percent of GDP in annualized tax revenues for the federal government (structural benchmark).

34. Improvements in the legal framework and monitoring targeted in the program are advancing. These efforts include:

(i) Amending Penal Code 1860 and the Code of Criminal Procedures 1898 geared toward enhancing investigation, prosecution, and penalties to deal with the electricity theft. The amendments have been cleared by the CCI and will be enacted by government ordinance before the end of the year (structural benchmark).

(ii) Initiating performance contracts to tackle losses, raise payment compliance, and improve energy efficiency and service delivery in public sector energy companies. These contracts will allow the government to invoke remedial measures in cases of failure to compliance.

(iii) Minimizing losses in the system by allocating more electricity supply to those areas with high payment rates through extending the revenue based differential load shedding to remaining six distribution companies (new structural benchmark).

(iv) Introducing web-based reporting of dispatching and merit order of all power plants to ensure that most efficient plants are getting the electricity, and subsequently integrating payment records to the portal by end-January 2014. These efforts are geared to enhance transparency in the power sector.

35. Conservation and the addition of new supply are required to close the gap between demand and supply of electricity. During the consultative process with stakeholders, revisions were identified for the Pakistan Energy Efficiency and Conservation Act, which has delayed its enactment to a later date. The revised draft will be placed before the CCI for approval before end-March 2014. To improve efficiency of electricity supply, efficiency testing of fuel-based public sector generation plants was completed and most of the rehabilitations will be finalized in the coming 5 months. However, electricity generation capacity will continue to remain below demand until significant new affordable capacity is built over a period of four to five years.

Public Sector Enterprises (PSEs)

36. Staff is encouraged by authorities' strong commitment to privatization plans (MEFP ¶36). Privatization will improve the efficiency of key economic activities and privatization proceeds will help ease fiscal financing pressures and could contribute to improving the balance of payments. The authorities' action plan on 31 key PSEs (Box 2) was completed by end-September 2013 (structural benchmark). The strategy has three pillars i.e., capital market transactions, strategic private sector partnership, and restructuring, which are to be completed in the next 3–5 years.

- **The majority of privatization revenues will come from capital market transactions**. Eleven companies in oil and gas, banking and insurance, and power sectors have been identified for privatization by block sales, in primary or secondary public offerings, to institutional and individual investors in domestic or international listings. The first step is to hire financial advisors for three companies in this group by end-March 2014 (new structural benchmark) and offer minority shares in these companies within six months after gauging investors' appetite and global market conditions. At least one company will be offered in domestic or international markets. Other PSEs in this group will be privatized after completing the first set of transactions.

- **Strategic private sector participation aims to improve operations and increase the value of government's residual shareholding in seventeen companies**. Strategic partnership will act as a catalyst in unlocking the commercial potential of the PSEs through managerial and capital investment potential to follow long term business and investment plans. The financial advisors for National Power Construction Co. (NPCC) have already been hired and the sale is expected to be finalized by end-June 2014. By end-March 2014, three financial advisors will be hired to place two PSEs in electricity distribution and generation, and nonstrategic assets of Pakistan International Airlines' Investment Limited for sale. Along with the loss-making electricity distribution companies, Pakistan International Airlines (PIA) and Pakistan Steel Mills (PSM) are major budgetary drains. The authorities have hired new professional chief executives and board members for these PSEs and will be hiring financial advisors to develop medium-term restructuring plans and seek potential strategic private investors.[7]

- **To enable for prospective private sector participation pre-privatization restructuring will be done in three companies**. Medium-term restructuring plans for Pakistan State Oil Co Ltd, Sui Southern Gas Co Ltd (SSGC) and Sui Northern Gas Pipelines Ltd (SNGPL) will be prepared to segregate various operations and to identify segments for private sector participation.

Business Climate and Trade policy

37. The authorities are moving forward with business climate reforms in cooperation with the World Bank. The focus in the near term is on simplifying procedures and reducing costs for setting-up businesses, facilitating contract enforcement, and improving private sector access to credit. These are expected to help kick-start private investment which in turn will help to offset the impact of fiscal consolidation on growth. Consultations with stakeholders to finalize the draft bankruptcy law are on track for end-December 2013, with discussions in Parliament expected in 2014. The use of Alternative Dispute Resolution (ADR) Mechanism has now expanded beyond Karachi to Lahore. In parallel, a draft plan has been developed to simplify procedures and costs for setting-up businesses and paying taxes (MEFP ¶34).

[7] In parallel, authorities have hired board members for the Pakistan Railways (PR) (which is not in the list of 31 companies), who are preparing the medium-term restructuring plan.

38. The authorities are on track to finalize a plan to simplify the structure of trade tariffs and taxes to move to a simple, transparent framework, with four import tariff slabs between 0 and 25 percent (MEFP ¶35). Design of the new system is projected to be completed before end-December 2013, with phase-in of the revised tariff rates and phase-out of trade SROs beginning by end-June 2014.

Box 2. List of Public Sector Enterprises (PSEs) for Privatization

A. Capital Market Transactions

1. Oil and Gas Development Co. Ltd (OGDCL)
2. Pakistan Petroleum Ltd (PPL)
3. Mari Petroleum Ltd.
4. Government Holding Private Ltd (GHPL)
5. Pak Arab Refinery Ltd (PARCO)
6. Habib Bank Limited (HBL)
7. United Bank Limited(UBL)
8. Allied Bank Limited (ABL)
9. National Bank Limited (NBP
10. State Life Insurance Corp. (SLIC)
11. Kot Addu Power Company Ltd. (KAPCO)

B. Strategic Private Sector Participation

12. National Insurance Co. Ltd. (NICL)
13. National Investment Trust Ltd. (NITL)
14. Small & Medium Enterprise (SME) Bank
15. Pakistan Reinsurance Co Ltd. (PRCL)
16. Heavy Electrical Complex (HEC)
17. Islamabad Electric Supply Co. Ltd (IESCO)
18. Faisalabad Electric Supply Co. Ltd (FESCO)
19. Hyderabad Electric Supply Co. Ltd (HESCO)
20. Jamshoro Power Generation Co. Ltd (JPCL)
21. Northern Power Generation Co. Ltd - Thermal Power Station—Muzaffargarh
22. National Power Construction Co. (NPCC)
23. Pakistan Steel Mills Corp (PSMC)
24. Pakistan Engineering Co Ltd (PECO)
25. Pakistan International Airlines Corp (PIAC)
26. Pakistan National Shipping Corp (PNSC)
27. Convention Centre, Islamabad.
28. PIA Investment Ltd—Roosevelt Hotel NY & Scribe Hotel—Paris

C. Restructuring followed by Privatization

29. Pakistan State Oil Co Ltd (PSO)
30. Sui Southern Gas Co Ltd (SSGC)
31. Sui Northern Gas Pipelines Ltd (SNGPL)

PROGRAM MODALITIES AND OTHER ISSUES

39. The attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) describes the authorities' progress in implementing their economic program and sets out their commitments through end-December 2013. Some modifications to the program's conditionality are proposed (Table 1-2):

- *Four new structural benchmarks are proposed* (Table 2). The new structural benchmarks are: (i) issue a total of 75,000 income tax first notices and follow up with a second notice (u/s 122c) and a tax assessment to 75 percent of those who, despite receiving first or a second notice more than 60 days ago, have not replied satisfactorily (end-March 2014); (ii) Implement the first round of eliminations of exemptions and concessions granted through SROs consistent with achieving the fiscal deficit reduction objective for FY2014/15 (end-June 2014); (iii) hire six transaction advisors for the privatization of PSEs as defined in the Technical Memorandum of Understanding (TMU) (end-March 2014); and (iv) initiate revenue-based load shedding in six remaining electricity distribution companies (end-January 2014). These measures are essential to broadening the tax net, helping fiscal consolidation, improving efficiency in public sector companies, and removing energy sector bottlenecks.

- *Modifications in end-December 2013 NIR targets and the ceiling on the net foreign exchange swap/forward position are proposed* (Table 1). Program NIR targets are modified in light of the end-September shortfall, downward revisions to the balance of payments projections, and technical revision to correct for the accounting error identified by the safeguards assessment mission. The NIR definition is clarified in the TMU to be in line with statistical best practices. The ceiling on net swap/forward position is modified to provide room for the SBP to gradually unwind its net position.

40. Financing, program risks and capacity to repay the Fund. Pakistan's program financing needs remain fully covered in FY2013/14. While some disbursements for multilateral and bilateral partners are materializing later in the year than originally expected, financing assurances remain in place for the next 12 months. Still, the reserves situation will remain very tight, and as a result, program risks will remain high over at least the coming 2–3 quarters. At end-October 2013, the Fund's exposure to Pakistan stood at roughly US$3.9 billion (93 percent of gross official reserves). The gross reserves depletion in the first quarter of FY 2013/14 constitutes an increased repayment risk. That said, with the approval of the three year arrangement under the EFF in September, net repayments to the Fund are reduced in 2013/2014 and future repayments will be spread out more smoothly over time. This improved payment profile, together with the actions by the SBP and government to rebuild reserves included in the revised program, will be critical to enhancing Pakistan's capacity to repay the Fund over time. Repayments of previous facilities are concentrated in November and December (about US$900 million) and during calendar 2014 (about US$2.5 billion). Materialization of risks to the macroeconomic outlook would also erode Pakistan's capacity to repay the Fund (¶10).

41. An updated safeguards assessment of the SBP was undertaken. The assessment concluded that legal amendments are needed to strengthen the central bank's autonomy and the effectiveness of governance arrangements. Further, some data reporting issues required clarification to safeguard against inadvertent misreporting. Accountability mechanisms, including the external audit are broadly effective, although the role and function of the audit committee could be enhanced in certain areas, and the SBP Central Board's investment committee needs to recommence operations.

STAFF APPRAISAL

42. Economic conditions remain challenging. The growth forecast has been revised slightly upward, reflecting some easing in energy bottlenecks, but it remains below that needed to generate a significant improvement in living standards. Inflation will remain at or near double digits for the remainder of FY 2013/14, as the impacts of past high fiscal deficits and accommodative monetary policy work their way through the system, along with the effects of recent increases in food and energy prices, and a weaker exchange rate.

43. Risks remain high and are tilted to the downside. While the government has taken difficult measures to address macroeconomic imbalances and initiate structural reforms, overall vulnerabilities remain and crisis risks, particularly on the external sector, are elevated. Security problems or external shocks could seriously damage growth prospects—as would delays in implementing program reforms. Oil and food price volatility, interruption in remittance inflows, and delays in realization of official and private inflows will put further pressures on the balance of payments.

44. Fiscal consolidation efforts are on track, but broadening the revenue base and better tax administration will be essential to continued improvement. The authorities have implemented measures to ensure reaching a headline deficit of 5.8 percent of GDP in FY 2013/14. However, legal challenges must be resolved in order to implement the envisaged gas levy, which will create space for increased investment spending later in the year. An ambitious approach to improve tax administration and eliminate tax loopholes will be crucial to sustaining fiscal consolidation in future years. They are also key to maintaining political support for the reforms, as there is strong support for bringing those who don't pay into the system while further hikes in tax rates on current payers would be very unpopular. On the expenditure side, the increase in electricity tariffs has helped reduce subsidies, but other strong efforts are needed to strengthen the sector—including improvements on bill collections. Future slippages on targeted cash transfers should be avoided to protect the most vulnerable segments of the population. The provincial surplus outturn is welcomed, as fiscal sustainability can only be achieved if the provinces are full partners in the adjustment effort.

45. The foreign exchange reserves of the SBP are critically low and firm efforts are needed to avoid new balance of payments difficulties. SBP policies have thus far failed to give sufficient priority to the crucial challenge of rebuilding reserves. In the coming months, the SBP must unhesitatingly use every policy tool at its disposal to boost reserves, including adjusting the policy rate, intervening to purchase reserves on the spot market, and allowing greater flexibility of the exchange rate. The net US$200 million the SBP purchased from the foreign exchange market since November 1constitutes merely a first step in this direction. Continued strong efforts will be required to achieve the revised NIR targets and ease current risks. While these actions might lead to a temporary increase in inflation, over time they will encourage exports, discourage imports, and help increase capital inflows. The government's promised steps to attract additional foreign exchange via privatizations, increasing foreign currency borrowing (while decreasing rupee borrowing), and accelerating disbursements from international partners will provide critical support to the SBP's efforts.

46. The SBP must contain inflationary pressures, and once reserves buffers begin to recover, increase its focus on lowering inflation. The gradual reduction in the stock of SBP lending to the government, in line with the program target, will help ease inflationary pressure, as will adherence to the program's NDA targets. Over the coming years, greater operational independence and improved internal controls will help the SBP to enhance monetary policymaking and achieve the desired inflation reduction.

47. Enhancing the stability of the financial system should be a priority. Policies should be implemented to safeguard the stability of the financial sector, by addressing those banks that are below the minimum CAR, resolving high NPLs, and monitoring sovereign-bank interlinkages. Staff welcomes the authorities' firm commitment to deepen the government debt market and develop a medium-term debt strategy.

48. The government has made a good start on its structural reform agenda, but continued strong efforts will be required. The authorities are rapidly implementing the electricity price adjustments to reduce subsidies to the sector. Clearance of power sector payables, additional gas allocation, along with governance reforms and efficiency improvements are expected to reduce the short-term bottlenecks in the electricity supply. The commitment to privatization of public sector enterprises (PSEs) is strong; however the authorities may encounter delays due to limited technical and administrative capacity and low market appetite. Plans for trade policy reforms are being developed, but implementing the move to a simpler, more transparent tariff regime will have to overcome resistance from special interests who benefit from the existing regime. In contrast with other areas, business climate reforms are lagging. More comprehensive action will be needed to boost private investment.

49. On the basis of Pakistan's performance under the extended arrangement and proposed corrective measures, staff supports the authorities' request for completion of the first review under the arrangement and for a waiver for the nonobservance of the performance criterion on net international reserves accumulation. Staff also recommends approval of the modifications of end-December 2013 performance criteria on net international reserves and net foreign currency swaps/forward position, and establishment of the end-March 2014 PCs as proposed in the attached MEFP, and the revised definitions in the attached TMU.

Box 3. The Extended Arrangement

Access: SDR 4,393 million, 425 percent of quota.

Length: 36 months.

Phasing: SDR 360 million was made available upon approval of the arrangement on September 4, 2013. SDR 360 million will be made available subject to the completion of this review. The subsequent disbursements, totally SDR 3,673 million, are contingent upon completion of subsequent 11 quarterly reviews.

Conditionality

- ***Quantitative Performance Criteria***

➢ Floor on net international reserves of the SBP

➢ Ceiling on net domestic assets of the SBP

➢ Ceiling on overall budget deficit

➢ Ceiling on SBP's stock of net foreign currency swaps/forward position

➢ Ceiling on net government borrowing from the SBP

➢ Accumulation of external public payment arrears by the general government (continuous)

- ***Quantitative Indicative Target***

➢ Cumulative floor on Targeted Cash Transfers Spending (BISP)

- ***Structural Benchmarks***

➢ Develop and launch initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.

➢ Announce a rationalization plan for gas prices which will include a levy to generate 0.4 percent of GDP fiscal savings by end-December 2013.

➢ Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.

➢ Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of banks that fall below the minimum capital requirement but not CAR.

➢ Enact the Deposit Protection Fund Act, in line with Fund staff advice

➢ Enact the Securities Bill, in line with Fund staff advice.

➢ Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).

Box 3. The Extended Arrangement (Concluded)

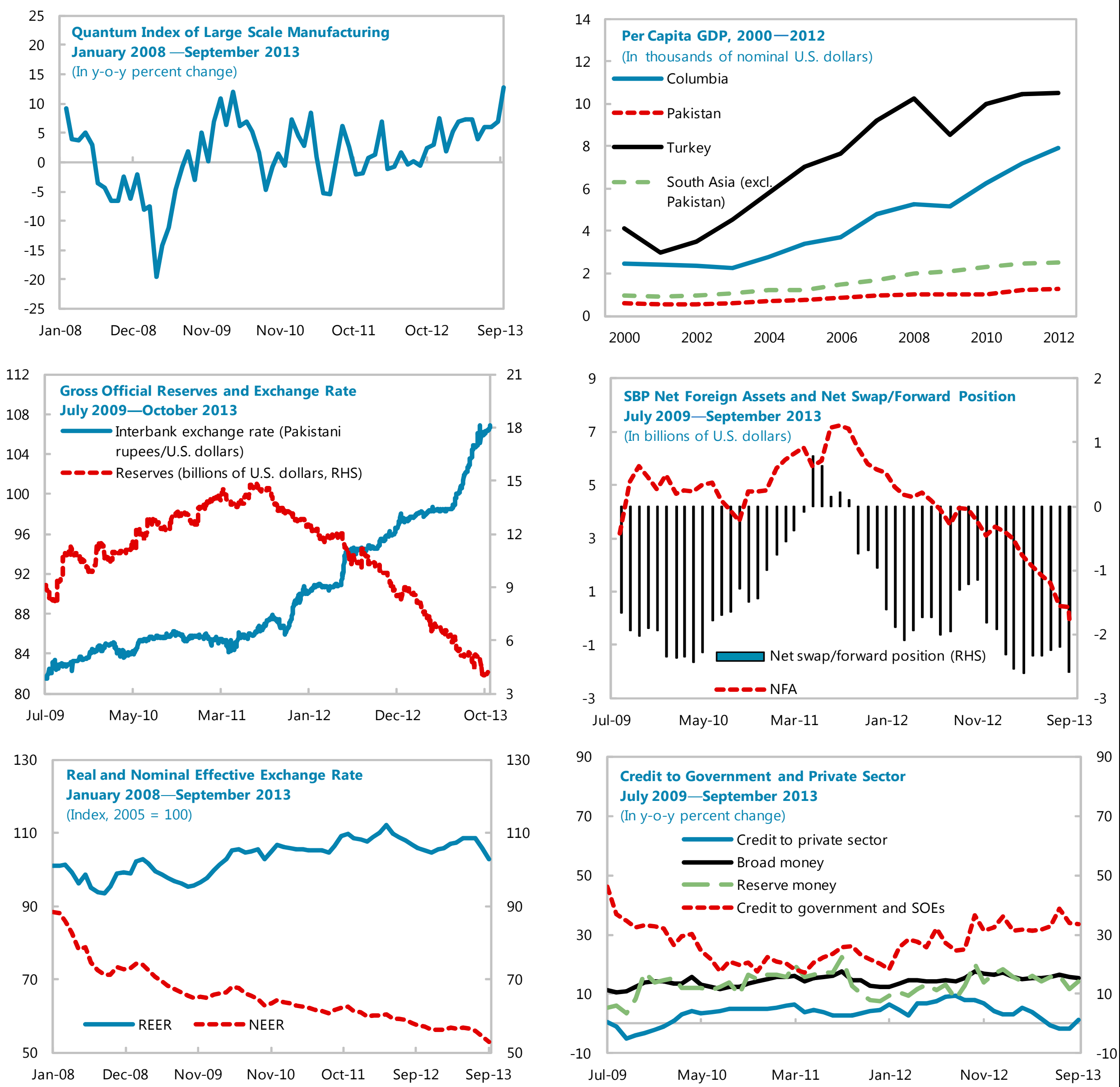
- Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), hire key staff, issue CPPA rules and guidelines, and initiate the payment and settlement system.
- Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.
- Privatize 26 percent of PIA's shares to strategic investors.

New Structural Benchmarks

- Increase the issuance of first notices (u/s 114) to 75,000 and follow up with a second notice (u/s 122c) to 75 percent of those who did not respond satisfactorily to their first notice within 60 days by end-March, 2014. Issue a provisional tax assessment to 75 percent of those who did not respond satisfactorily within 60 days to the second notice by end-March, 2014.
- Issue SROs to eliminate exemptions and concessions granted through SROs for an amount consistent with the fiscal deficit reduction objective for FY 2014/15.
- Hire three financial advisors for three PSEs in the capital market transactions list and three financial advisors for the three PSEs in the strategic private sector enterprises list for privatization in the TMU.

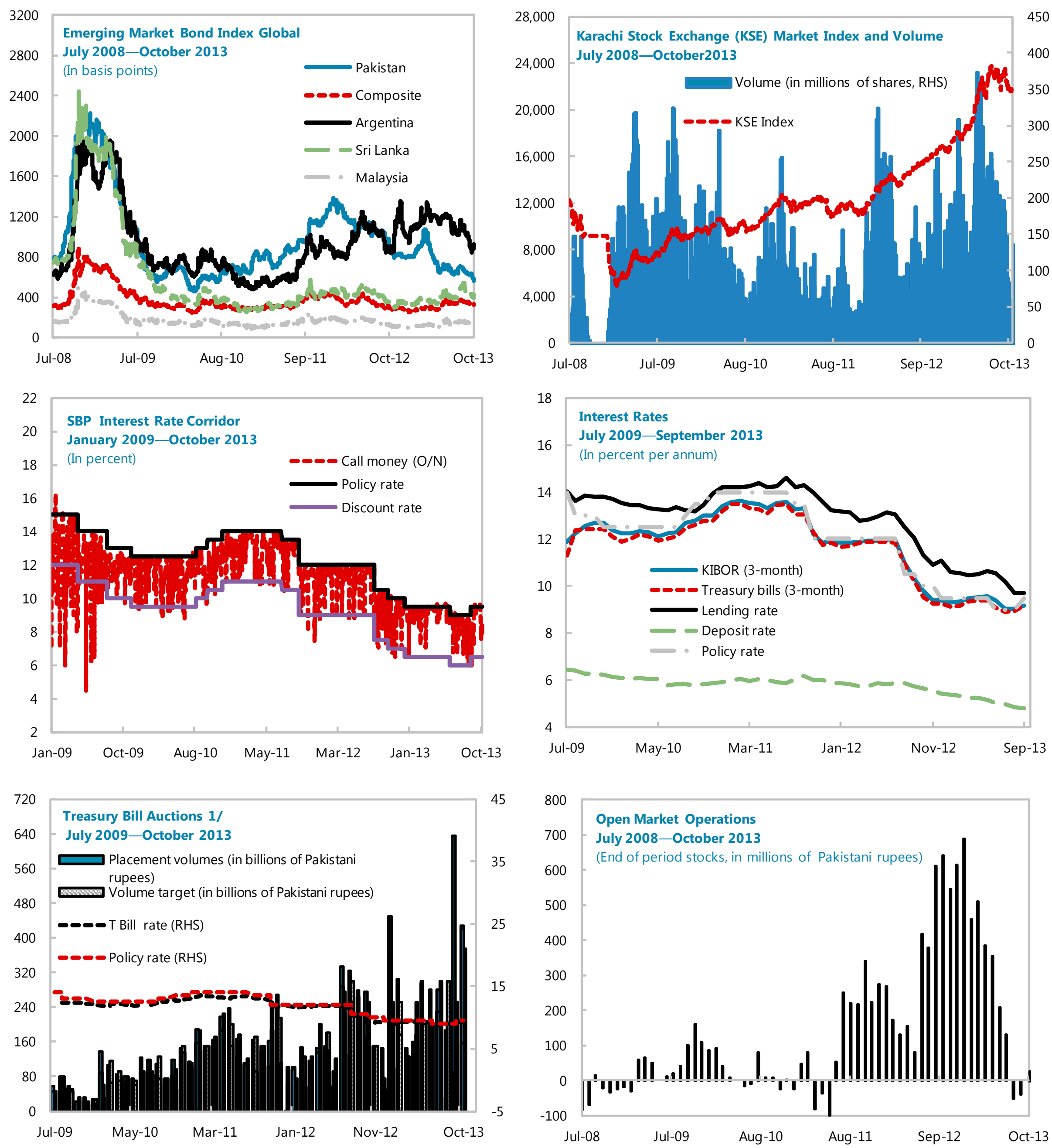
Initiate revenue based load shedding in six remaining electricity distribution companies.

Figure 1. Pakistan: Selected Economic Indicators, 2008–13



Sources: Pakistani authorities; and IMF staff calculations.

Figure 2. Pakistan: Selected Financial Indicators, 2008–13



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

1/ Placement volumes are for all maturities and the Treasury Bill rate is a weighted average.

Table 1. Pakistan: Quantitative Performance Criteria and Indicative Targets for FY2013/14 and FY2014/15 1/
(In billions of rupees, at program exchange rates, unless otherwise specified)

	FY2012/13	FY2013/14					FY2014/15
	end-June	end-September		end-December	end-March	end-June	end-September
	Act.	Program	Actual	Program	Program	Projections	Projection
Performance Criteria							
Floor on net international reserves of the SBP (millions of US dollars) 2/	-2,437	-2,850	-3,154	-4,130	-2,750	1,895	3810
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees)	2,402	2,877	2,595	2,901	2,627	2,225	2196
Ceiling on overall budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 3/	2,012	419	297	882	1,209	1,464	512
Ceiling on SBP's stock of net foreign currency swaps/forward position (millions of US dollars) 4/	2,255	2,255	1,775	2,255	2,255	2,000	1775
Ceiling on net government borrowing from the SBP (including provincial governments, stock, billions of Pakistani rupees) 1, 5/	2,168	2,690	2,521	2,560	2,390	2,240	2100
Continuous Performance Criterion							
Accumulation of external public payment arrears by the general government (continuous)	0	0	0	0	0	0	0
Indicative Targets							
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees)	54	19	14	32	50	73	25

Sources: Pakistani authorities; and Fund staff estimates.

1/ All items as defined in the TMU. Fiscal year runs from July 1 to June 30.

2/ The end September 2013 target of -2499 has been adjusted downward by 351 million USD to reflect a shortfall in multilateral/bilateral disbursements to Pakistan. End-December 2013 target is modified from -2,090 millions of US dollars.

3/ Excluding grants, FY2012/13 overall budget deficit is a stock.

4/ End-December 2013 target is modified from 2,005 millions of US dollars.

5/ FY 2012/13, total stock of government debt as of June 30, 2013.

Table 2. Pakistan: Structural Benchmarks Under Extended Fund Facility

Item	Measure	Time Frame (by End of Period)	Comment
Structural Benchmarks			
Fiscal sector			
1	Develop and finish launching initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.	end-December 2013	
2	Announce a rationalization plan for gas prices which will involve a levy to generate 0.4 percent of GDP fiscal savings.	end-December 2013	
Monetary sector			
3	Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.	end-March 2014	
Financial sector			
4	Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of banks that fall below the minimum capital requirement but not CAR.	end-December 2013	
5	Enact the Deposit Protection Fund Act, in line with Fund staff advice	end-September 2014	
6	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014	
Structural Policies			
7	Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).	end-September 2013	Met
8	Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).	end-November 2013	
9	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), hire key staff, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013	
10	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013	
11	Privatize 26 percent of PIA's shares to strategic investors.	end-December 2014	
New Structural Benchmarks			
12	Increase the issuance of first notices (u/s 114) to 75,000 and follow up with a second notice (u/s 122c) to 75 percent of those who did not respond satisfactorily to their first notice within 60 days by end-March, 2014. Issue a provisional tax assessment to 75 percent of those who did not respond satisfactorily within 60 days to the second notice by end-March, 2014.	end-March 2014	
13	Issue SROs to eliminate exemptions and concessions granted through SROs for an amount consistent with the fiscal deficit reduction objective for FY 2014/15.	end-June-2014	
14	Hire three financial advisors for three PSEs in the capital market transactions list and three financial advisors for the three PSEs in the strategic private sector enterprises list for privatization in the TMU.	end-March 2014	
15	Initiate revenue based load shedding in six remaining electricity distribution companies	end-January 2014	

Table 3. Pakistan: Selected Economic Indicators, 2009/10–2013/14 1/

Population: 178.9 million (2011/12)
Per capita GDP: US$1,228 (2011/12)
Poverty rate: 17.2 percent (2007/08)
Main exports: Textiles ($9.9 billion)
Unemployment: 5.95 percent (2010/11)

	2009/10	2010/11	2011/12	2012/13	2013/14	
				Estimates	Program	Revised Program
			(Annual percentage change)			
Output and prices						
Real GDP at factor cost	2.6	3.7	4.4	3.6	2.5	2.8
GDP deflator at factor cost	10.7	19.5	5.3	7.5	7.9	7.9
Consumer prices (period average) 2/	10.1	13.7	11.0	7.4	7.9	7.9
Consumer prices (end of period) 2/	11.8	13.3	11.3	5.9	10.0	10.0
Pakistani rupees per U.S. dollar (period average)	7.6	2.2	4.1	7.7	...	...
			(In percent of GDP)			
Saving and investment						
Gross saving	13.6	14.2	12.9	13.2	14.3	13.8
Government	-2.4	-4.2	-5.1	-4.8	-2.2	-2.2
Nongovernment (including public sector enterprises)	16.0	18.4	17.9	18.0	16.5	16.1
Gross capital formation 3/	15.8	14.1	14.9	14.2	14.9	14.8
Government	3.5	2.5	3.3	3.0	3.3	3.3
Nongovernment (including public sector enterprises)	12.3	11.6	11.6	11.2	11.6	11.5
Public finances						
Revenue and grants	14.3	12.6	13.1	13.2	14.4	14.9
Expenditure (including statistical discrepancy)	19.8	19.7	21.8	19.5	19.9	20.1
Budget balance (including grants)	-5.6	-6.9	-8.3	-6.2	-5.5	-5.2
Budget balance (excluding grants)	-6.2	-7.1	-8.8	-8.0	-5.8	-5.8
Primary balance	-1.6	-3.1	-4.0	-3.5	-0.9	-0.8
Total general government debt 4/	61.5	59.5	63.8	63.1	66.6	65.9
External general government debt	30.2	26.6	25.8	21.5	24.1	24.8
Domestic general government debt	31.3	32.9	38.0	41.6	42.5	41.1
			(Annual changes in percent of initial stock of broad money, unless otherwise indicated)			
Monetary sector						
Net foreign assets	0.5	4.1	-3.8	-3.4	3.9	5.0
Net domestic assets	11.9	11.8	17.9	19.3	12.2	8.0
Broad money (percent change)	12.5	15.9	14.1	15.9	13.8	13.0
Reserve money (percent change)	11.4	17.1	11.3	15.9	13.4	11.7
Private credit (percent change)	3.9	4.0	7.5	-0.6	8.5	7.5
Six-month treasury bill rate (period average, in percent)	12.3	13.3	12.3	10.1	...	...
External sector						
Merchandise exports, U.S. dollars (percentage change)	2.9	28.9	-2.6	0.4	11.4	8.5
Merchandise imports, U.S. dollars (percentage change)	-1.7	14.9	12.8	-0.6	6.9	8.0
Current account balance (in percent of GDP)	-2.2	0.1	-2.1	-1.0	-0.6	-1.0
			(In percent of exports of goods and services, unless otherwise indicated)			
External public and publicly guaranteed debt	178.5	153.4	160.3	144.6	143.7	146.7
Debt service	19.1	11.7	16.0	21.5	19.4	24.1
Gross reserves (in millions of U.S. dollars) 5/	12,958	14,784	10,799	6,008	9,566	9,436
In months of next year's imports of goods and services	3.6	3.6	2.7	1.4	2.2	2.1
Memorandum items:						
Real effective exchange rate (annual average, percentage change)	0.9	6.1	2.7	-2.0	...	...
Terms of trade (percentage change)	1.8	7.0	-9.6	-0.7	-0.1	-2.0
Real per capita GDP (percentage change)	0.5	1.5	2.3	1.5	0.5	0.8
GDP at market prices (in billions of Pakistani rupees)	14,867	18,285	20,091	22,909	25,351	25,417
GDP at market prices (in billions of U.S. dollars)	177.6	213.7	225.6	238.7	...	...

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

1/ Fiscal year ends June 30.
2/ Inflation after 2009/10 based on new CPI weights, recalculated in September 2011.
3/ Including changes in inventories. Investment data recorded by the Pakistan Bureau of Statistics are said to underreport true activity.
4/ Excludes military debt, and commercial loans.
5/ Excluding gold and foreign currency deposits of commercial banks held with the State Bank of Pakistan.

Table 4. Pakistan: Medium-Term Macroeconomic Framework, 2009/10–2017/18

	2009/10	2010/11	2011/12	2012/13	2013/14	2013/14	2014/15	2015/16	2016/17	2017/18
				Estimates	Prog.	Revised Program	Projections			
	(Annual percentage change)									
Output and prices										
Real GDP at factor cost	2.6	3.7	4.4	3.6	2.5	2.8	3.6	3.9	4.7	5.0
Consumer prices (period average)	10.1	13.7	11.0	7.4	7.9	7.9	9.0	7.0	6.0	6.0
	(In percent of GDP)									
Saving and investment balance	-2.2	0.1	-2.1	-1.0	-0.6	-0.6	-0.5	-0.7	-1.3	-1.5
Government	-5.9	-6.7	-8.4	-7.8	-5.5	-5.5	-4.4	-3.5	-3.5	-3.5
Non-government (including public sector enterprises)	3.7	6.8	6.3	6.8	4.9	4.9	4.0	2.8	2.1	2.0
Gross national saving	13.6	14.2	12.9	13.2	14.3	14.2	15.6	15.8	15.8	16.2
Government	-2.4	-4.2	-5.1	-4.8	-2.2	-2.2	-1.4	-0.2	-0.1	0.0
Non-government (including public sector enterprises)	16.0	18.4	17.9	18.0	16.5	16.5	17.0	16.1	16.0	16.3
Gross capital formation	15.8	14.1	14.9	14.2	14.9	14.8	16.1	16.5	17.2	17.8
Government	3.5	2.5	3.3	3.0	3.3	3.3	3.0	3.2	3.3	3.5
Non-government (including public sector enterprises)	12.3	11.6	11.6	11.2	11.6	11.5	13.1	13.3	13.8	14.3
	(In billions of U.S. dollars, unless otherwise indicated)									
Balance of payments										
Current account balance	-3.9	0.2	-4.7	-2.5	-1.3	-2.3	-2.0	-2.6	-4.5	-5.6
Net capital flows 1/	5.2	2.3	1.4	0.5	4.3	6.5	3.9	4.9	4.5	5.0
Of which: foreign direct investment 2/	2.2	1.6	0.8	1.5	2.3	2.6	2.7	3.4	3.2	4.0
Gross official reserves	13.0	14.8	10.8	6.0	9.6	9.4	12.3	16.7	16.8	16.7
In months of imports 3/	3.6	3.6	2.7	1.4	2.2	2.1	2.5	3.2	2.9	2.8
External debt (in percent of GDP)	34.7	31.1	29.0	24.9	27.0	27.7	26.6	25.5	23.9	22.5
	(In percent of GDP)									
Public finances										
Revenue and grants	14.3	12.6	13.1	13.2	14.4	14.9	14.9	15.4	15.3	15.2
Of which: tax revenue	10.1	9.5	10.3	9.7	10.8	10.6	11.6	12.2	12.8	12.8
Expenditure (incl. stat. discr.), *of which:*	20.2	19.5	21.5	21.0	19.9	20.4	19.4	18.8	18.7	18.7
Current	16.7	16.5	17.8	16.3	16.6	16.8	16.3	15.6	15.4	15.2
Development (incl. net lending)	3.8	2.6	3.4	4.6	3.3	3.6	3.1	3.2	3.4	3.5
Primary balance 4/	-1.6	-3.1	-4.0	-3.5	-0.9	-0.8	0.7	1.0	0.8	0.7
Overall fiscal balance 4/	-5.9	-6.9	-8.4	-7.8	-5.5	-5.5	-4.4	-3.5	-3.5	-3.5
Total public debt (including obligations to the IMF)	61.5	59.5	63.8	63.1	66.6	65.9	63.9	61.6	59.7	57.8

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/ Including grants.

Table 5. Pakistan: Balance of Payments, 2009/10–2017/18
(In millions of U.S. dollars; unless otherwise indicated)

	2009/10	2010/11	2011/12	2012/13	2013/14	2013/14					2014/15		2015/16	2016/17	2017/18
						Q1	Q2	Q3	Q4	End-Year	Q1	End-Year			
				Estimates	Program	Actual	Revised Program		Projections				Projections		
Current account	-3,946	214	-4,658	-2,466	-1,318	-1,234	-1,353	-46	336	-2,297	-693	-1,988	-2,605	-4,550	-5,600
Balance on goods	-11,536	-10,516	-15,765	-15,404	-14,984	-4,427	-4,406	-3,941	-3,752	-16,526	-4,301	-16,628	-17,387	-18,280	-20,421
Exports, f.o.b.	19,673	25,356	24,696	24,795	27,561	6,230	6,588	6,706	7,377	26,901	6,743	28,928	30,947	33,614	35,656
Imports, f.o.b.	31,209	35,872	40,461	40,199	42,545	10,657	10,994	10,648	11,129	43,427	11,044	45,556	48,334	51,894	56,077
Services (net)	-1,690	-1,940	-3,192	-1,469	-1,143	-740	-496	-80	319	-997	-633	-2,598	-3,472	-5,125	-6,081
Services: credit	5,229	5,768	5,035	6,733	7,659	1,103	1,756	2,171	2,688	7,718	1,657	6,814	6,906	6,498	6,983
Of which: Coalition Support Fund	1,294	743	0	1,806	1,200	0	322	439	439	1,200	322	1,222	900	0	0
Of which: 3G Licenses	0	0	0	0	1,200	0	0	400	800	1,200	0	0	0	0	0
Services: debit	6,919	7,708	8,227	8,202	8,802	1,843	2,251	2,251	2,369	8,715	2,290	9,412	10,379	11,624	13,064
Income (net)	-3,282	-3,017	-3,245	-3,685	-3,191	-819	-1,220	-823	-1,098	-3,960	-719	-3,293	-3,566	-4,102	-3,707
Income: credit	561	716	826	488	517	147	120	108	137	511	153	692	606	550	689
Income: debit	3,843	3,733	4,071	4,173	3,707	966	1,340	931	1,235	4,472	872	3,985	4,172	4,652	4,397
Of which: interest payments	1,650	1,408	1,589	1,452	1,057	372	404	316	443	1,535	271	1,227	1,224	1,273	1,413
Of which: income on direct investment	2,180	2,065	2,177	2,714	2,650	594	936	615	792	2,937	601	2,758	2,949	3,379	2,983
Balance on goods, services, and income	-16,508	-15,473	-22,202	-20,558	-19,318	-5,986	-6,121	-4,844	-4,532	-21,483		-22,518	-24,425	-27,507	-30,209
Current transfers (net)	12,562	15,687	17,544	18,092	18,000	4,752	4,769	4,798	4,868	19,187	4,960	20,530	21,821	22,958	24,609
Current transfers: credit, *of which:*	12,672	15,863	17,686	18,183	18,159	4,770	4,808	4,838	4,907	19,324	5,000	20,689	21,980	23,117	24,768
Official	606	845	658	412	583	72	152	168	152	545	171	843	843	430	301
Workers' remittances	8,906	11,201	13,186	13,922	14,191	3,927	3,602	3,521	3,693	14,742	14,742	15,738	16,924	18,334	19,949
Other private transfers	3,160	3,817	3,842	3,849	3,385	771	1,055	1,149	1,062	4,037	927	4,108	4,212	4,353	4,518
Current transfers: debit	110	176	142	91	159	18	40	40	40	137	40	159	159	159	159
Capital account	175	161	189	264	349	52	127	149	173	500	173	691	691	691	691
Capital transfers: credit	180	161	186	266	349	52	127	149	173	500	173	691	691	691	691
Of which: official capital grants	157	160	180	250	349	50	127	149	173	498	173	691	691	691	691
Capital transfers: debit	5	0	3	2	0	0	0	0	0	0	0	0	0	0	0
Financial account	5,097	2,103	1,275	345	3,938	-68	489	1,626	3,851	5,899	1,123	3,189	4,187	3,820	4,260
Direct investment abroad	-76	-44	-77	-198	0	-59	0	0	0	-59	-15	-29	-24	-24	0
Direct investment in Pakistan	2,151	1,636	821	1,456	2,327	231	270	238	1,813	2,551	588	2,660	3,368	3,202	4,041
Of which: privatization receipts	0	1	0	0	800	0	0	0	1,500	1,500	250	1,000	1,000	0	0
Portfolio investment (net), *of which:*	-65	339	-149	26	358	107	110	110	610	937	70	280	120	870	2,120
Financial derivatives (net)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other investment assets	-11	-920	9	-488	-286	-298	-90	-49	-45	-481	-104	-258	-238	-234	-218
Monetary authorities	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
General government	-6	-3	3	-2	0	0	0	0	0	0	0	0	0	0	0
Banks	386	-63	-91	-300	-242	-270	-71	-76	-81	-499	-76	-275	-255	-251	-235
Other sectors	-391	-854	97	-186	-44	-28	-19	28	36	17	-28	17	17	17	17
Other investment liabilities	3,098	1,092	671	-451	1,539	-49	199	1,327	1,473	2,951	584	535	961	5	-1,683
Monetary authorities	1,257	-10	-105	710	-100	245	0	0	-100	145	0	0	0	0	0
General government, *of which:*	1,961	298	998	218	1,305	-253	452	887	1,174	2,260	44	-258	472	-730	-2,087
Disbursements	4,134	2,377	2,633	2,500	3,509	479	1,170	1,767	2,220	5,636	696	2,951	3,006	1,788	1,080
Amortization	2,250	1,957	1,577	2,282	2,203	732	718	880	1,046	3,376	652	3,209	2,533	2,518	3,167
Banks	-226	52	220	-1,117	50	154	77	77	77	385	13	50	50	50	50
Other sectors	106	752	-442	-262	284	-195	-329	364	322	161	527	743	439	686	354
Net errors and omissions	-60	14	-81	-135	0	102	0	0	0	102	0	0	0	0	0
Reserves and related items	-1,266	-2,492	3,275	1,992	-2,969	1,148	737	-1,729	-4,360	-4,205	-603	-1,891	-2,274	38	649
Reserve assets	-4,063	-2,225	4,430	4,530	-2,058	1,321	1,209	-1,649	-4,305	-3,424	-631	-2,817	-4,439	-75	649
Use of Fund credit and loans	2,174	-267	-1,155	-2,538	-911	-173	-473	-81	-54	-781	28	926	2,165	113	0
Memorandum items:															
Current account (in percent of GDP)	-2.2	0.1	-2.1	-1.0	-0.6					-1.0		-0.8	-1.0	-1.7	-1.9
Current account (in percent of GDP; excluding fuel imports)	3.7	5.9	4.3	4.9	6.1					5.8		6.0	5.7	4.9	4.5
Exports f.o.b. (growth rate, in percent)	2.9	28.9	-2.6	0.4	11.4					8.5		7.5	7.0	8.6	6.1
Imports f.o.b. (growth rate, in percent)	-1.7	14.9	12.8	-0.6	6.9					8.0		4.9	6.1	7.4	8.1
Oil imports (in million US$, cif)	10,463	12,317	14,368	14,068	15,327					15,612		16,175	16,850	17,733	18,719
Terms of trade (growth rate, in percent)	1.8	7.0	-9.6	-0.7	-0.1					-2.0		0.2	0.1	0.0	0.0
External debt (in millions of U.S. dollars)	61,567	66,366	65,478	59,561	61,979					63,702		62,773	63,791	63,991	65,364
Gross external financing needs (in millions of U.S. dollars) 1/	6,766	1,989	6,960	4,868	4,586					7,191		5,076	6,554	8,933	9,168
End-period gross official reserves (millions of U.S. dollars) 2/	12,958	14,784	10,799	6,008	9,566	4,691	3,482	5,130	9,436	9,436	10,204	12,253	16,692	16,767	16,726
(In months of next year's imports of goods and services)	3.6	3.6	2.7	1.4	2.2	1.1	0.8	1.1	2.1	2.1	2.2	2.5	3.2	2.9	0.0
GDP (in millions of U.S. dollars)	177,622	213,725	225,558	238,737	...	...	...	...	...	...	...	...	...	...	...

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 6a. Pakistan: General Government Budget, 2008/9–2013/14
(In billions of Pakistani rupees)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	
					Estimates	Program	Revised Program
Revenue and grants	1,878	2,130	2,306	2,642	3,022	3,643	3,789
Revenue	1,851	2,079	2,261	2,567	2,982	3,579	3,729
Tax revenue	1,331	1,500	1,738	2,076	2,231	2,726	2,688
Federal	1,285	1,445	1,673	1,969	2,081	2,556	2,518
FBR revenue	1,157	1,329	1,558	1,881	1,936	2,345	2,345
Direct taxes	440	529	602	732	736	892	892
Federal excise duty	116	121	137	122	119	151	151
Sales tax/VAT	452	517	633	809	841	1,014	1,014
Customs duties	148	161	185	218	240	287	287
Petroleum surcharge	112	89	83	60	110	122	122
Gas surcharge and other	16	28	32	27	35	86	48
Provincial	46	55	65	107	151	170	170
Nontax revenue	520	579	523	491	751	853	1,041
Federal	436	512	461	443	680	783	971
Provincial	84	68	62	48	71	70	70
Grants	27	51	46	75	40	64	60
Expenditure	2,531	3,008	3,566	4,326	4,816	5,042	5,203
Current expenditure	2,093	2,482	3,012	3,579	3,742	4,200	4,278
Federal	1,547	1,855	2,227	2,611	2,647	2,976	3,054
Interest	638	642	698	889	991	1,176	1,221
Domestic	559	578	630	821	920	1,063	1,113
Foreign	79	64	68	68	71	113	108
Other	909	1,213	1,529	1,722	1,656	1,800	1,833
Defense	330	375	450	507	541	627	647
Other	579	838	1,078	1,215	1,116	1,173	1,186
Of which : subsidies 1/	244	227	493	556	305	324	336
Of which : grants	136	361	259	291	368	418	419
Provincial	546	627	786	968	1,095	1,224	1,224
Development expenditure and net lending	404	558	469	681	1,058	842	925
Public Sector Development Program	398	519	462	669	695	834	834
Federal	196	260	216	293	324	420	420
Provincial	202	258	246	375	372	414	414
Net lending	7	39	7	12	363	8	91
Statistical discrepancy ("+" = additional expenditure) 2/	34	-32	46	67	16	0	0
Overall Balance (excluding grants)	-680	-929	-1,306	-1,760	-1,834	-1,463	-1,457
Overall Balance (including grants)	-653	-878	-1,260	-1,685	-1,794	-1,398	-1,397
Financing	653	878	1,260	1,685	1794	1,398	1,397
External	75	138	62	53	21	232	476
Of which: privatization receipts	1	0	0	0	0	88	166
Of which: IMF	0	0	0	0	0	0	0
Domestic	579	740	1,198	1,631	1773	1,166	921
Bank	351	304	727	1,102	1286	933	737
Nonbank	227	436	471	529	487	233	184
Memorandum items:							
Primary balance (excluding grants)	-43	-287	-608	-871	-843	-287	-236
Primary balance (including grants)	-16	-236	-562	-796	-803	-223	-176
Total security spending	424	568	585	596	647	627	647
Total government debt	7,387	8,448	10,112	12,130	14,018	16,733	16,334
Domestic debt	3,860	4,654	6,014	7,638	9,521	10,770	10,442
External debt 3/	3,527	3,794	4,098	4,492	4,497	5,963	5,892
Total government debt including IMF obligations	7,805	9,138	10,879	12,822	14,451	16,889	16,553
Nominal GDP (market prices)	13,200	14,867	18,285	20,091	22,909	25,351	25,417

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

1/ Includes Rs 391 billion in FY2011/12 for the payment of energy and food subsidies delivered in previous years.
2/ The statistical discrepancy is believed to arise mainly from double-counting of spending at the provincial level.
3/ Excludes obligations to the IMF except budget financing, military debt, commercial loans, and short-term debt.

Table 6b. Pakistan: General Government Budget, 2009/10–2013/14
(In percent of GDP; unless otherwise indicated)

	2009/10	2010/11	2011/12	2012/13	2013/14	
				Estimates	Program	Revised Program
Revenue and grants	14.3	12.6	13.1	13.2	14.4	14.9
Revenue	14.0	12.4	12.8	13.0	14.1	14.7
Tax revenue	10.1	9.5	10.3	9.7	10.8	10.6
Federal	9.7	9.1	9.8	9.1	10.1	9.9
FBR revenue	8.9	8.5	9.4	8.5	9.3	9.2
Direct taxes	3.6	3.3	3.6	3.2	3.5	3.5
Federal excise duty	0.8	0.8	0.6	0.5	0.6	0.6
Sales tax/VAT	3.5	3.5	4.0	3.7	4.0	4.0
Customs duties	1.1	1.0	1.1	1.0	1.1	1.1
Petroleum surcharge / Carbon tax	0.6	0.5	0.3	0.5	0.5	0.5
Gas surcharge and other	0.2	0.2	0.1	0.2	0.3	0.2
Provincial	0.4	0.4	0.5	0.7	0.7	0.7
Nontax revenue	3.9	2.9	2.4	3.3	3.4	4.1
Federal	3.4	2.5	2.2	3.0	3.1	3.8
Provincial	0.5	0.3	0.2	0.3	0.3	0.3
Grants	0.3	0.2	0.4	0.2	0.3	0.2
Expenditure	20.2	19.5	21.5	21.0	19.9	20.5
Current expenditure	16.7	16.5	17.8	16.3	16.6	16.8
Federal	12.5	12.2	13.0	11.6	11.7	12.0
Interest	4.3	3.8	4.4	4.3	4.6	4.8
Domestic	3.9	3.4	4.1	4.0	4.2	4.4
Foreign	0.4	0.4	0.3	0.3	0.4	0.4
Other	8.2	8.4	8.6	7.2	7.1	7.2
Defense	2.5	2.5	2.5	2.4	2.5	2.5
Other	5.6	5.9	6.0	4.9	4.6	4.7
Of which: subsidies	1.5	2.7	2.8	1.3	1.3	1.3
Of which: grants	2.4	1.4	1.4	1.6	1.6	1.6
Provincial	4.2	4.3	4.8	4.8	4.8	4.8
Development expenditure and net lending	3.8	2.6	3.4	4.6	3.3	3.6
Public Sector Development Program	3.5	2.5	3.3	3.0	3.3	3.3
Federal	1.8	1.2	1.5	1.4	1.7	1.7
Provincial	1.7	1.3	1.9	1.6	1.6	1.6
Net lending	0.3	0.0	0.1	1.6	0.0	0.4
Statistical discrepancy ("+" = additional expenditure) 2/	-0.2	0.3	0.3	0.1	0.0	0.0
Overall Balance (excluding grants)	-6.2	-7.1	-8.8	-8.0	-5.8	-5.7
Overall Balance (including grants)	-5.9	-6.9	-8.4	-7.8	-5.5	-5.5
Financing	5.9	6.9	8.4	7.8	5.5	5.5
External	0.9	0.3	0.3	0.1	0.9	1.9
Of which: privatization receipts	0.0	0.0	0.0	0.0	0.3	0.7
Of which: IMF	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	5.0	6.6	8.1	7.7	4.6	3.6
Bank	2.0	4.0	5.5	5.6	3.7	2.9
Nonbank	2.9	2.6	2.6	2.1	0.9	0.7
Memorandum items:						
Primary balance (excluding grants)	-1.9	-3.3	-4.3	-3.7	-1.1	-0.9
Primary balance (including grants)	-1.6	-3.1	-4.0	-3.5	-0.9	-0.7
Total security spending	3.8	3.2	3.0	2.8	2.5	2.5
Total government debt 3/	56.8	55.3	70.8	61.2	66.0	81.3
Domestic debt	31.3	32.9	44.6	41.6	42.5	52.0
External debt 3/	25.5	22.4	26.2	19.6	23.5	29.3
Total government debt including IMF	61.5	59.5	63.8	63.1	66.6	65.1
Nominal GDP (market prices, billions of Pakistani rupees)	14,867	18,285	20,091	22,909	25,351	25,417

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

1/ Includes 1.8 percent of GDP in FY2011/12 for the payment of energy and food subsidies delivered in previous years.

2/ The statistical discrepancy is believed to arise mainly from double-counting of spending at the provincial level.

3/ Excludes obligations to the IMF except budget financing, military debt, commercial loans, and short-term debt.

Table 6c. Pakistan: General Government Budget, 2011/12–2013/14
(In billions of Pakistani rupees)

	2011/12	2012/13	2013/14						2014/15
			End-Year	Q1	Q2	Q3	Q4	End-Year	Q1
		Estimates	Program	Actual	Revised Program		Projections		Projections
Revenue and grants	2,642	3,022	3,643	833	839	877	1,240	3,789	826
Revenue	2,567	2,982	3,579	820	825	860	1,224	3,729	803
Tax revenue	2,076	2,231	2,726	558	645	620	865	2,688	648
Federal	1,969	2,081	2,556	516	604	580	818	2,518	602
FBR revenue	1,881	1,936	2,345	469	561	542	775	2,345	542
Direct taxes	732	736	892	161	213	206	312	892	208
Federal excise duty	122	119	151	24	36	35	56	151	36
Sales tax/VAT	809	841	1,014	231	242	234	306	1,014	230
Customs duties	218	240	287	53	69	66	100	287	68
Petroleum surcharge	60	110	122	26	34	28	34	122	31
Gas surcharge and other	23	32	86	21	9	9	9	48	28
Provincial	107	151	170	42	41	40	47	170	46
Nontax revenue	491	751	853	262	180	240	359	1,041	155
Federal	443	680	783	251	162	223	336	971	136
Provincial	48	71	70	11	19	18	23	70	19
Grants	75	40	64	13	14	17	16	60	24
Expenditure	4,326	4,816	5,042	1,116	1,410	1,187	1,479	5,193	1311
Current expenditure	3,579	3,742	4,200	876	1,184	1,048	1,160	4,268	1152
Federal	2,611	2,647	2,976	647	880	717	799	3,044	808
Interest	889	991	1,176	301	306	286	318	1,211	367
Domestic	821	920	1,063	286	276	265	276	1,103	336
Foreign	68	71	113	15	30	22	41	108	31
Other	1,722	1,656	1,800	346	574	431	482	1,833	
Defense	507	541	627	146	175	173	153	647	183
Other	1,215	1,116	1,173	200	399	258	329	1,186	
Of which: subsidies 1/	556	305	324	65	121	59	92	336	54
Of which: grants	291	368	418	43	171	92	112	419	108
Provincial	968	1,095	1,224	229	304	331	361	1,224	344
Development expenditure and net lending	681	1,058	842	163	251	164	347	925	
Public Sector Development Program	669	695	834	80	249	161	345	834	
Federal	293	324	420	45	159	55	161	420	80
Provincial	375	372	414	35	89	106	184	414	77
Net lending	12	363	8	83	3	3	2	91	2
Statistical discrepancy ("+" = additional expenditure) 2/	67	16	0	78	-25	-25	-28	0	0
Overall Balance (excluding grants)	-1,760	-1,834	-1,463	-297	-585	-327	-255	-1,464	-508
Overall Balance (including grants)	-1,685	-1,794	-1,398	-284	-571	-310	-239	-1,404	-485
Financing	1,685	1794	1398	284	571	310	239	1404	485
External	53	21	232	-30	16	4	489	479	0
Of which: privatization receipts	0	0	88	0	55	0	111	166	0
Of which: IMF	0	0	0	0	0	0	0	0	0
Domestic	1,631	1773	1166	314	555	306	-250	925	485
Bank	1,102	1286	933	198	244	112	186	740	313
Nonbank	529	487	233	116	311	195	-436	185	172
Memorandum items:									
Primary balance (excluding grants)	-871	-843	-287	4	-279	-41	63	-253	
Primary balance (including grants)	-796	-803	-223	17	-265	-24	79	-193	
Total security spending	596	647	627	146	175	173	153	797	183
Government Arrears	1,427	1,627	1,800	n.a.	n.a.	n.a.	n.a.	1,805	n.a.
Total government debt	12,130	14,018	16,733	n.a.	n.a.	n.a.	n.a.	16,338	n.a.
Domestic debt	7,638	9,521	10,770	n.a.	n.a.	n.a.	n.a.	10,446	n.a.
External debt 3/	4,492	4,497	5,963	n.a.	n.a.	n.a.	n.a.	5,892	n.a.
Total government debt including IMF obligations	12,822	14,451	16,889	n.a.	n.a.	n.a.	n.a.	16,748	n.a.
Nominal GDP (market prices)	20,091	22,909	25,351	n.a.	n.a.	n.a.	n.a.	25,417	n.a.

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

1/ Includes Rs 391 billion in FY2011/12 for the payment of energy and food subsidies delivered in previous years.

2/ The statistical discrepancy is believed to arise mainly from double-counting of spending at the provincial level.

3/ Excludes obligations to the IMF except budget financing, military debt, commercial loans, and short-term debt.

Table 7. Pakistan: Monetary Survey, 2009/10–2014/15

	2010/11	2011/12	2012/13	2013/14					2014/15
				End-Year	Q1	Q2	Q3	Q4	Q1
			Estimate	Program	Act.Prel.	Revised Program		Projections	
	(in billions of Pakistani rupees, unless otherwise indicated)								
Monetary survey									
Net foreign assets (NFA)	780	527	270	616	95	12	211	717	787
Net domestic assets (NDA)	5,915	7,115	8,589	9,470	8,784	9,419	9,263	9,297	9,186
Net claims on government, *of which: 1/*	2,983	4,197	5,629	6,796	5,646	6,201	6,507	6,257	6,257
Budget support, *of which:*	2,523	3,667	5,125	6,338	5,323	5,755	6,061	5,811	5,611
Banks	1,369	2,005	2,957	4,098	2,802	3,195	3,671	3,571	3,511
Commodity operations	397	436	468	458	446	446	446	446	646
Credit to nongovernment	3,547	3,653	3,664	3,502	3,682	4,161	4,037	3,851	3,971
Private sector	3,159	3,395	3,376	3,664	3,358	3,673	3,745	3,630	3,626
Public sector enterprises	388	257	288	-162	323	488	291	221	345
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-612	-732	-701	-825	-540	-940	-1,278	-808	-1,039
Broad money	6,695	7,642	8,859	10,086	8,879	9,432	9,474	10,014	9,973
Currency outside scheduled banks	1,501	1,674	1,939	2,574	1,984	2,206	2,338	2,511	2,381
Rupee deposits	4,819	5,528	6,405	6,925	6,333	6,629	6,536	6,869	6,961
Foreign currency deposits	375	440	515	586	562	597	600	634	632
State Bank of Pakistan (SBP)									
NFA	614	389	134	650	-14	-96	102	608	679
NDA	1,352	1,800	2,402	2,227	2,595	2,889	2,627	2,225	2,196
Net claims on government	1,184	1,665	2,156	2,200	2,460	2,507	2,345	2,195	2,049
Of which: budget support	1,155	1,662	2,168	2,240	2,521	2,560	2,390	2,240	2,100
Claims on nongovernment	-6	-5	-6	-10	-6	-10	-10	-10	-10
Claims on scheduled banks	315	289	301	80	280	382	292	292	270
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-139	-146	-46	-40	-137	13	3	-250	-110
Reserve money, *of which:*	1,966	2,189	2,536	2,877	2,581	2,793	2,729	2,832	2,875
Banks' reserves	349	396	476	516	454	475	469	494	499
Currency	1,606	1,784	2,050	2,361	2,117	2,317	2,260	2,339	2,375
	(Annual percentage change, unless otherwise indicated)								
Broad money	15.9	14.1	15.9	13.8	15.4	14.3	13.8	13.0	12.3
NFA, banking system (in percent of broad money) 2/	4.1	-3.8	-3.4	3.9	-5.8	-6.5	-1.9	5.0	7.8
NDA, banking system (in percent of broad money) 2/	11.8	17.9	19.3	9.9	21.2	20.8	15.7	8.0	4.5
Budgetary support (in percent of broad money) 2/	10.2	17.1	19.1	13.7	19.5	18.5	18.5	7.7	3.2
Budgetary support	30.4	45.3	39.7	23.7	39.4	36.2	34.0	13.4	5.4
Private credit	4.0	7.5	-0.6	8.5	1.5	5.0	6.0	7.5	8.0
Currency	15.9	11.5	15.9	32.7	13.0	20.2	21.6	29.5	20.0
Reserve money	17.1	11.3	15.9	13.4	14.3	14.9	11.9	11.7	11.4
Memorandum items:									
Velocity	2.7	2.6	2.6	2.6	3.0	2.9	2.9	2.7	3.0
Money multiplier	3.4	3.5	3.5	3.5	3.4	3.4	3.5	3.5	3.5
Currency to broad money ratio (percent)	22.4	21.9	21.9	25.5	22.3	23.4	24.7	25.1	23.9
Currency to deposit ratio (percent)	28.9	28.0	28.0	34.3	28.8	30.5	32.8	33.5	31.4
Foreign currency to deposit ratio (percent)	7.2	7.4	7.4	7.8	8.2	8.3	8.4	8.5	8.3
Reserves to deposit ratio (percent)	6.7	6.6	6.9	6.9	6.6	6.6	6.6	6.6	6.6
Budget bank financing (change from the beginning of the fiscal year; in Rs billions), *of which:*	589	1,144	1,457	1,213	198	630	936	686	486
By commercial banks	606	636	952	1,141	-155	238	714	614	554
By SBP	-17	508	506	72	353	392	222	72	-68
NFA of SBP (change from beginning of the year; in billions of U.S. dollars) 3/	2.7	-3.0	-2.8	4.2	-1.5	-2.2	-0.5	3.9	4.1
NFA of commercial banks (millions of U.S. dollars)	1,937	1,464	1,377	-289	1,032	972	949	938	868
NDA of commercial banks (billions of Pakistani rupees)	4,563	5,315	6,187 0	7,243	6,190	6,530	6,636	7,072	6,990

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

1/ Difference between monetary and fiscal tables on banking sector claims on government and bank financing in 2011/12 reflects Rs391 billion in electricty payments.

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

3/ Includes valuation adjustments.

Table 8. Pakistan: Financial Soundness Indicators for the Banking System (December 2008–June 2013)

	Dec. 2008	Dec. 2009	Dec. 2010	Dec. 2011	Dec. 2012	Mar. 2013	Jun. 2013
Capital adequacy							
Regulatory capital to risk-weighted assets	12.2	14.0	13.9	15.1	15.4	15.1	15.5
Tier I capital to risk-weighted assets	10.1	11.6	11.6	13.0	12.8	12.7	13.0
Capital to total assets	10.0	10.1	9.8	9.6	9.0	8.9	8.9
Asset composition and quality							
Nonperforming loans (NPLs) to gross loans	10.5	12.6	14.9	15.7	14.5	14.7	14.8
Provisions to NPLs	69.6	69.9	66.7	69.3	71.8	71.9	73.2
NPLs net of provisions to capital	19.4	20.4	26.7	23.1	19.4	19.9	18.3
Earnings and profitability							
Return on assets (after tax)	0.8	0.9	1.0	1.5	1.4	1.2	1.1
Return on equity (after tax)	7.8	8.9	9.6	15.1	14.9	13.9	12.4
Net interest income to gross income	70.3	72.4	74.7	76.0	71.1	71.7	70.0
Noninterest expenses to gross income	50.1	51.2	52.7	51.1	53.9	57.5	56.4
Liquidity							
Liquid assets to total assets	28.2	32.7	36.1	45.5	47.4	47.4	49.0
Liquid assets to total deposits	37.7	44.5	47.1	59.5	63.3	63.8	63.7

Source: Pakistani authorities.

Table 9. Pakistan: Indicators of Fund Credit, 2012–17
(In millions of SDR unless otherwise specified)

		Projections				
	2012	2013	2014	2015	2016	2017
		(Projected Level of Credit Outstanding based on Existing Drawings)				
Total	3,890.3	2,367.9	2,463.0	3,600.0	4,393.0	4,393.0
Of which:						
ECF, SBA, and ENDA	3,890.3	1,647.9	303.0	0.0	0.0	0.0
Extended Fund Facility	0.0	720.0	2,160.0	3,600.0	4,393.0	4,393.0
In percent of GDP	2.5	1.6	1.6	2.2	2.6	2.4
In percent of end-period gross official reserves	54.5	60.2	30.9	33.4	40.8	40.9
		(Projected Debt Service to the Fund based on Existing Drawings) 1/				
Total	1,576.6	558.3	1,325.4	309.2	4.3	4.3
Of which:						
Principal	1,489.2	558.3	1,308.2	303.0	0.0	0.0
Interest and charges	87.4	0.0	17.2	6.2	4.3	4.3
ECF Principal	146.4	0.0	34.5	0.0	0.0	0.0
SBA and ENDA Principal	1,342.7	558.3	1273.8	303.1	0.0	0.0
Extended Fund Facility Principal	0.0	0.0	0.0	0.0	0.0	0.0
In percent of GDP	1.0	0.4	0.9	0.2	0.0	0.0
In percent of end-period gross official reserves	22.1	14.2	16.6	2.9	0.0	0.0
Memorandum items						
Quota (millions of SDRs)	1,033.70	…	…	…	…	…

Source: IMF staff projections.

1/ Excludes GRA surcharges. Excludes current year obligation paid up to Nov 19, 2013.

Table 10. Pakistan: Selected Vulnerability Indicators, 2009/10–2017/18

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
				Estimates			Projections		
Key economic and market indicators									
Real GDP growth (factor cost, in percent)	2.6	3.7	4.4	3.6	2.8	3.6	3.9	4.7	5.0
CPI inflation (period average, in percent) 1/	10.1	13.7	11.0	7.4	7.9	9.0	7.0	6.0	6.0
Emerging market bond index (EMBI) secondary market spread (basis points, end of period)	603	857	1,136	...	...	...	...	...	...
Exchange rate PRs/US$ (end of period)	85.4	85.8	94.3	...	...	...	...	...	...
External sector									
Current account balance (percent of GDP)	-2.2	0.1	-2.1	-1.0	-1.0	-0.8	-1.0	-1.7	-1.9
Net FDI inflows (percent of GDP)	1.2	0.7	0.3	0.5	1.1	1.1	1.3	1.2	1.4
Exports (percentage change of U.S. dollar value; GNFS)	7.2	25.0	-4.5	6.0	9.8	3.2	5.9	6.0	6.3
Gross international reserves (GIR) in billions of U.S. dollars	13.0	14.8	10.8	6.0	9.4	12.3	16.7	16.8	16.7
GIR in percent of ST debt at remaining maturity (RM) 2/	236.0	332.8	273.7	110.1	162.2	182.2	330.4	357.9	374.4
GIR in percent of ST debt at RM and banks' foreign exchange (FX) deposits 2/	135.9	167.8	125.4	56.3	83.7	99.4	151.8	152.1	147.2
Total gross external debt (ED) in percent of GDP, *of which:*	34.7	31.1	29.0	24.9	27.7	26.6	25.5	23.9	22.5
ST external debt (original maturity, in percent of total ED)	1.4	1.0	0.6	0.0	2.6	1.1	1.0	1.0	1.0
ED of domestic private sector (in percent of total ED)	10.3	10.8	10.8	10.2	10.0	10.7	11.4	13.7	17.2
ED to foreign official sector (in percent of total ED)	89.7	89.2	89.2	89.8	90.0	89.3	88.6	86.3	82.8
Total gross external debt in percent of exports	247.2	213.2	220.2	188.9	184.0	175.6	168.5	159.5	153.3
Gross external financing requirement (in billions of U.S. dollars) 3/	6.8	1.7	6.7	5.3	6.1	5.7	6.2	8.6	9.8
Public sector 4/									
Overall balance (including grants)	-5.9	-6.9	-8.4	-7.8	-5.5	-4.4	-3.5	-3.5	-3.5
Primary balance (including grants)	-1.6	-3.1	-4.0	-3.5	-0.8	0.7	1.0	0.8	0.7
Debt-stabilizing primary balance 5/	-1.2	-7.9	1.3	-2.7	1.9	-0.5	-1.3	-1.2	-1.5
Gross PS financing requirement 6/	25.4	26.9	32.5	35.1	35.5	33.6	31.1	30.9	30.4
Public sector gross debt 7/	56.8	55.3	60.4	61.2	64.3	61.9	58.8	57.1	55.4
Public sector net debt 8/	53.3	52.0	57.1	58.4	61.8	59.7	56.8	55.3	53.8
Financial sector 9/									
Capital adequacy ratio (in percent)	13.9	15.1	15.4	...	...	...	...	...	...
Nonperforming loans (NPLs) in percent of total loans	14.9	15.7	14.5	...	...	...	...	...	...
Provisions in percent of NPLs	66.7	69.3	71.8	...	...	...	...	...	...
Return on assets (after tax, in percent)	1.0	1.5	1.4	...	...	...	...	...	...
Return on equity (after tax, in percent)	9.6	15.1	14.9	...	...	...	...	...	...
FX deposits held by residents (in percent of total deposits)	7.7	7.2	7.4	...	...	...	...	...	...
Government debt held by FS (percent of total FS assets)	41.6	44.6	54.9	...	...	...	...	...	...
Credit to private sector (percent change)	3.9	4.0	7.5	...	...	...	...	...	...
Memorandum item:									
Nominal GDP (in billions of U.S. dollars)	177.6	213.7	225.6	238.7	...	...	...	...	...

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

1/ Inflation after 2009/10 based on new CPI weights, recalculated in September 2011.
2/ Debt at remaining maturity is defined as maturing short-, medium-, and long-term external official debt.
3/ Current account deficit plus amortization of external debt.
4/ Public sector covers general (consolidated) government.
5/ 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.
6/ Overall balance plus debt amortization.
7/ Excludes obligations to the IMF except budget financing, military debt, commercial loans, and short-term debt.
8/ Net debt is defined as gross debt minus government deposits with the banking system.
9/ Financial sector includes all commercial and specialized banks; for government debt also includes nonbanks, but excludes State Bank of Pakistan.

Table 11. Pakistan: Schedule of Reviews and Purchases

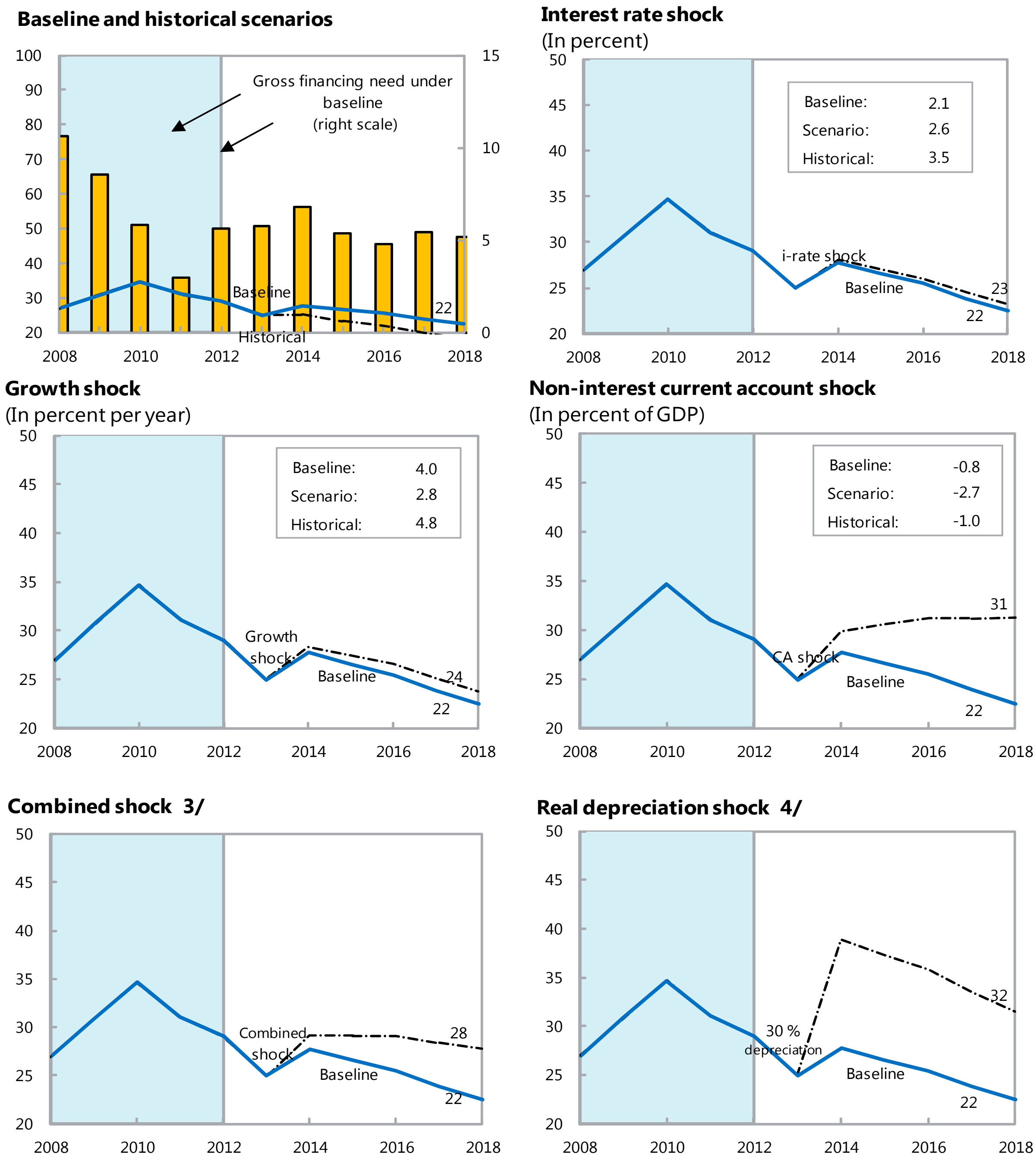
Date	Amount of Purchase		Conditions
	Millions of SDRs	Percent of Quota	
September 4, 2013	360	35	Approval of arrangement
December 2, 2013	360	35	First review and end-September 2013 performance/continuous criteria
March 2, 2014	360	35	Second review and end-December 2013 performance /continuous criteria
June 2, 2014	360	35	Third review and end-March 2014 performance /continuous criteria
September 2, 2014	360	35	Fourth review and end-June 2014 performance /continuous criteria
December 2, 2014	360	35	Fifth review and end-September 2014 performance /continuous criteria
March 2, 2015	360	35	Sixth review and end-December 2014 performance /continuous criteria
June 2, 2015	360	35	Seventh review and end-March 2015 performance /continuous criteria
September 2, 2015	360	35	Eighth review and end-June 2015 performance /continuous criteria
December 2, 2015	360	35	Ninth review and end-September 2015 performance/continuous criteria
March 2, 2016	360	35	Tenth review and end-December 2015 performance /continuous criteria
June 2, 2016	360	35	Eleventh review and end-March 2016 performance /continuous criteria
August 1, 2016	73	7	Twelfth review and end-June 2016 performance /continuous criteria
Total	4393	425	

Source: IMF staff estimates.

Annex I. External Debt Sustainability Analysis

Figure 1. Pakistan: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: Pakistani authorities; and IMF staff calculations.

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 2013.

Table 1. Pakistan: External Debt Sustainability Framework, 2008–18

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
Baseline: External debt	27.0	30.8	34.7	31.1	29.0			**24.9**	**27.7**	**26.6**	**25.5**	**23.9**	**22.5**	**-2.8**
Change in external debt	0.5	3.9	3.8	-3.6	-2.0			-4.1	2.8	-1.1	-1.1	-1.6	-1.4	
Identified external debt-creating flows (4+8+9)	2.2	3.8	-0.6	-6.8	0.2			-0.5	-1.0	-1.4	-1.3	-0.6	-0.6	
Current account deficit, excluding interest payments	6.8	4.2	1.3	-0.8	1.4			0.4	0.3	0.3	0.5	1.2	1.4	
Deficit in balance of goods and services	12.5	9.4	7.4	5.8	8.4			7.1	7.6	8.1	8.3	8.7	9.0	
Exports	14.0	13.7	14.0	14.6	13.2			13.2	14.9	15.0	15.0	14.8	14.5	
Imports	26.5	23.1	21.5	20.4	21.6			20.3	22.5	23.1	23.3	23.5	23.6	
Net non-debt creating capital inflows (negative)	-3.1	-1.9	-1.5	-0.9	-0.3			-0.6	-1.2	-1.2	-1.4	-1.2	-1.4	
Automatic debt dynamics 1/	-1.6	1.5	-0.4	-5.2	-0.8			-0.4	-0.1	-0.5	-0.5	-0.6	-0.6	
Contribution from nominal interest rate	1.3	1.2	0.9	0.7	0.7			0.6	0.7	0.5	0.5	0.5	0.5	
Contribution from real GDP growth	-0.4	-0.8	-0.5	-0.8	-1.2			-1.0	-0.7	-1.0	-1.0	-1.1	-1.1	
Contribution from price and exchange rate changes 2/	-2.4	1.0	-0.9	-5.0	-0.4			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-1.6	0.0	4.4	3.2	-2.3			-3.5	3.7	0.2	0.2	-0.9	-0.8	
External debt-to-exports ratio (in percent)	192.2	225.3	247.2	213.2	220.2			188.9	185.6	177.2	170.0	160.9	154.6	
Gross external financing need (in billions of US dollars) 4/	18.2	14.5	10.3	6.3	12.7			13.7	15.7	12.8	12.0	14.7	15.2	
in percent of GDP	10.6	8.6	5.8	3.0	5.6	10-Year	10-Year	5.9	7.0	5.5	4.9	5.6	5.4	
Scenario with key variables at their historical averages 5/								**25.0**	**25.1**	**23.2**	**22.1**	**20.0**	**18.3**	**-2.6**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	1.7	2.8	1.6	2.8	4.0	4.8	2.4	3.6	2.8	3.6	3.9	4.7	5.0	
GDP deflator in US dollars (change in percent)	10.1	-3.6	2.9	16.9	1.2	3.1	11.7	-0.2	-6.3	-0.8	2.0	2.2	3.4	
Nominal external interest rate (in percent)	5.4	4.5	3.2	2.3	2.4	3.5	0.9	2.2	2.6	1.9	1.9	2.0	2.2	
Growth of exports (US dollar terms, in percent)	12.1	-3.3	7.2	25.0	-4.5	10.8	10.0	6.0	9.8	3.2	5.9	6.0	6.3	
Growth of imports (US dollar terms, in percent)	28.7	-13.7	-2.8	14.3	11.7	16.6	17.1	-0.6	7.7	5.4	6.8	8.2	8.9	
Current account balance, excluding interest payments	-6.8	-4.2	-1.3	0.8	-1.4	-1.0	3.8	-0.4	-0.3	-0.3	-0.5	-1.2	-1.4	
Net non-debt creating capital inflows	3.1	1.9	1.5	0.9	0.3	1.9	1.4	0.6	1.2	1.2	1.4	1.2	1.4	

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.

Annex II. Public Debt Sustainability Analysis

Public debt is expected to decline gradually over time supported by a strong fiscal adjustment. While the projected decline is broadly resilient to standard size shocks, debt would become unsustainable if the envisaged fiscal consolidation fails to materialize. However, the presence of an IMF program is a mitigating factor as it was in previous episodes of fiscal adjustments. Given the strong reliance on short term debt, the projected decline would be sensitive to large interest rate shock—albeit the captive domestic investor base is likely a mitigating factor. Gross financing needs are high and sensitive to shocks, and this fragility, while ameliorated, will likely remain considerable in the medium term—although these include national savings schemes, on which we need a deeper understanding.

Background. The coverage used for public debt includes central and provincial governments, but does not include public sector enterprises. In recent years, the debt to GDP ratio trended up as a result of large fiscal deficit despite favorable debt dynamics resulting from low effective real interest rates. The fiscal adjustment envisaged under the program seeks to reverse the trend and provide some resilience to adverse shocks. Domestic debt is largely in local currency and short term. The share of medium-term bonds remains below 20 percent, albeit it increased slightly in recent years. Therefore, funding remains reliant on short-term debt (over 50 percent) and on the national saving schemes. Public external debt is largely with official creditors, as bonds and bank private creditors account for only about 3 percent of the total. The share of public debt—as well as foreign currency denominated debt—as been trending down as external financing tapered down in recent years.

Assumptions. The program assumptions on growth and inflation are realistic, particularly in the initial years of the program. Growth does improve in the medium-term above the levels observed in recent years—which included the global crisis, the severe floods, and the worsening of the security situation—based on the assumption of improvements in the energy sector and in the security situation. The envisaged level of primary balance is larger and more persistent relative to previous track record, however; broadly in line with those observe in other program countries.

Results. The fiscal consolidation envisaged under the program is the key driver of the results, as highlighted by an alternative scenario based on a constant primary balance which results in increasing debt ratios. The consolidation not only drives debt ratios down under the baseline scenario, but the declining trend is quite resilient to the standard size of shocks envisaged in the DSA. Such decline could halt under larger shocks, particularly to the interest rate as debt is relatively short term. The fan charts suggest that debt would stabilize even under significant shocks, and it is only when one restricts the distribution of positive shocks to the primary balance that the debt trends up under very strong shocks. Gross financing needs are high and sensitive to shocks. While the consolidation will ameliorate this risk, a more significant improvement in the debt profile will likely entail a longer term project. These gross financing needs indicators reflect the relatively large share of national savings schemes, given their diversified base might have a smaller rollover risk. Moreover, the interest and rollover risk might be mitigated by the captive domestic investor base.

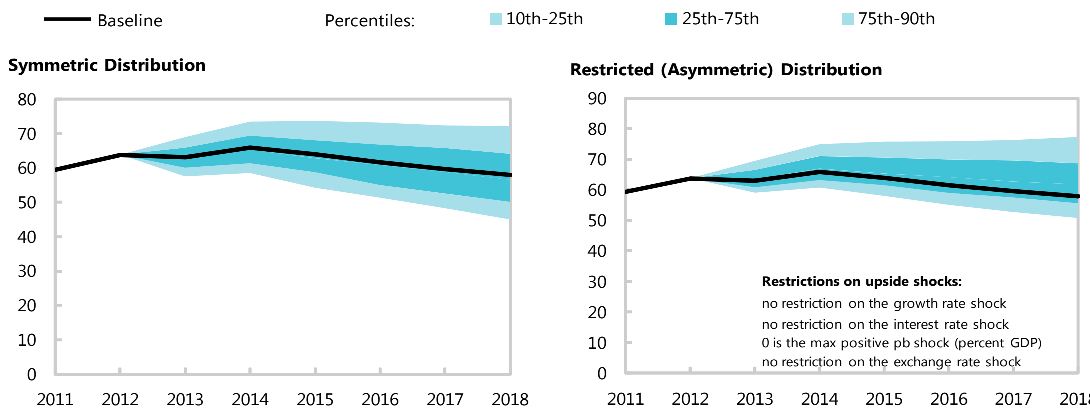
Figure 1. Pakistan: Public Debt Sustainability Analysis—Risk Assessment

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

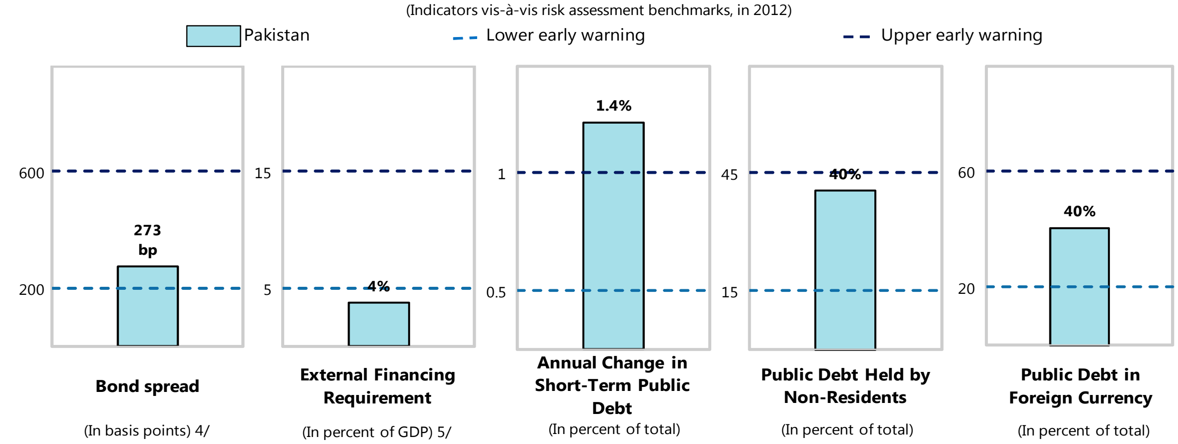
Evolution of Predictive Densities of Gross Nominal Public Debt

(In percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2012)



Sources: Pakistani authorities; and IMF staff calculations.

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.

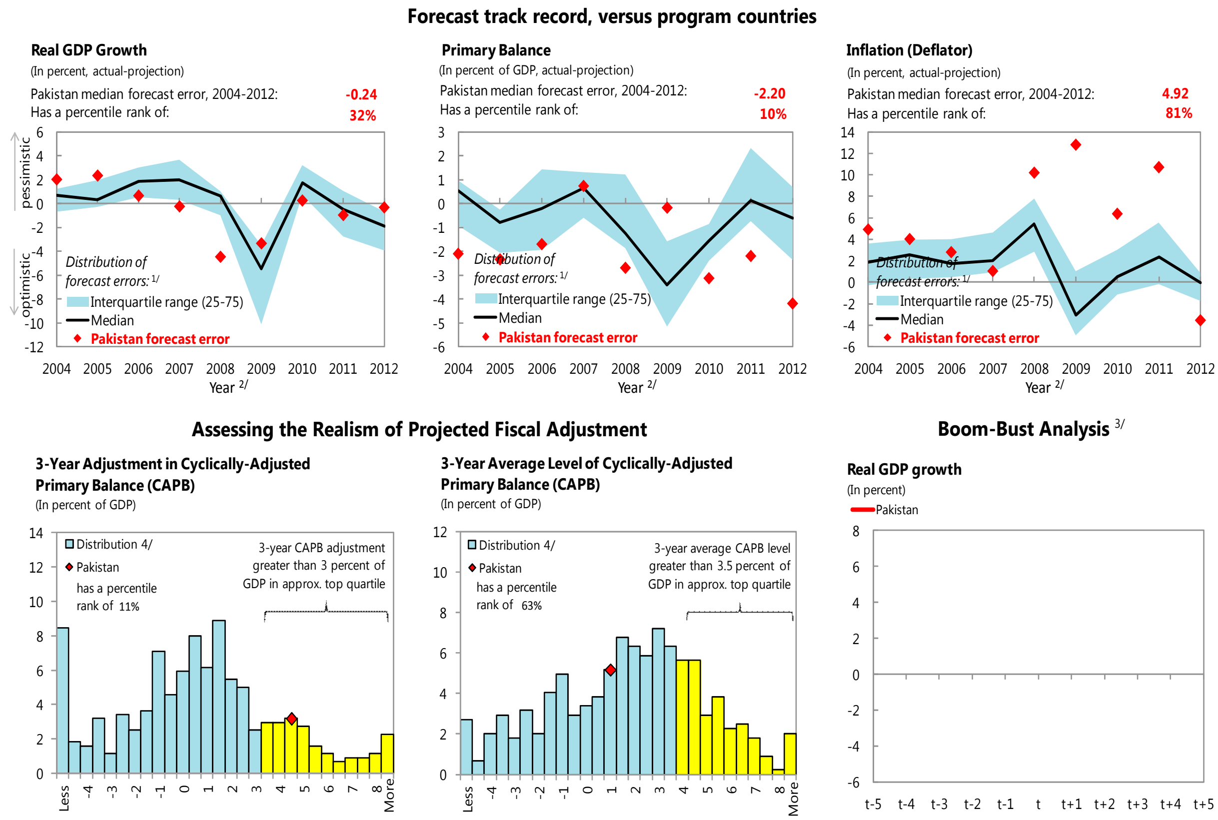
2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

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 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/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 24-Jul-13 through 22-Oct-13.

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.

Figure 2. Pakistan: Public Debt Sustainability Analysis—Realism of Baseline Assumptions



Sources: Pakistani authorities; and IMF Staff calculations.

1/ Plotted distribution includes program countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Pakistan.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Table 1. Pakistan: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP; unless otherwise indicated)

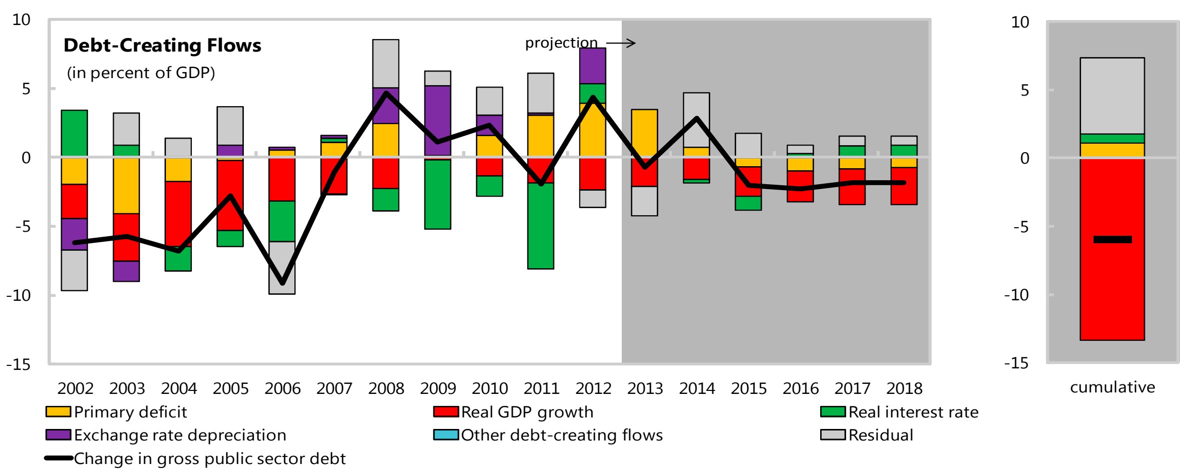
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2002-2010 [2/]	2011	2012	2013	2014	2015	2016	2017	2018
Nominal gross public debt	63.1	59.5	63.8	63.1	65.9	63.9	61.6	59.7	57.9
Public gross financing needs	52.8	45.0	43.1	38.2	36.7	33.5	34.3	35.0	35.2
Real GDP growth (in percent)	4.8	3.7	4.4	3.6	2.8	3.6	3.9	4.7	5.0
Inflation (GDP deflator, in percent)	9.3	19.5	5.3	7.5	7.9	9.0	7.0	6.0	6.0
Nominal GDP growth (in percent)	15.2	23.0	9.9	14.0	10.9	13.0	11.2	11.0	11.3
Effective interest rate (in percent) [4/]	7.4	7.6	8.2	7.7	7.7	7.6	7.8	7.8	7.9

As of October 22, 2013		
Sovereign Spreads		
EMBIG (bp) 3/		276
5Y CDS (bp)		831
Ratings	Foreign	Local
Moody's	Caa1	Caa1
S&Ps	B	B
Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2002-2010	2011	2012	2013	2014	2015	2016	2017	2018	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.6	-2.0	4.3	-0.7	2.8	-2.1	-2.3	-1.8	-1.8	-5.9	
Identified debt-creating flows	-3.3	-4.8	5.6	1.4	-1.1	-3.8	-2.9	-2.5	-2.5	-11.5	
Primary deficit	-0.2	3.1	4.0	3.5	0.8	-0.7	-1.0	-0.8	-0.7	1.1	-1.8
Primary (noninterest) revenue and grant	14.8	12.6	13.1	13.2	14.9	14.9	15.4	15.3	15.2	88.9	
Primary (noninterest) expenditure	14.5	15.7	17.1	16.7	15.7	14.2	14.4	14.5	14.5	90.0	
Automatic debt dynamics [5/]	-3.1	-7.9	1.6	-2.1	-1.9	-3.1	-2.0	-1.7	-1.8	-12.6	
Interest rate/growth differential [6/]	-3.8	-8.1	-0.9	-2.1	-1.9	-3.1	-2.0	-1.7	-1.8	-12.6	
Of which: real interest rate	-1.0	-6.3	1.4	0.0	-0.3	-1.0	0.3	0.9	0.9	0.7	
Of which: real GDP growth	-2.8	-1.8	-2.4	-2.1	-1.6	-2.1	-2.3	-2.6	-2.7	-13.3	
Exchange rate depreciation [7/]	0.8	0.1	2.6	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization/Drawdown of Deposits (+	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt flows (incl. ESM and Euroar	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.7	2.9	-1.3	-2.1	3.9	1.8	0.6	0.7	0.7	5.6	



Sources: Pakistani authorities; and IMF staff calculations.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

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

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ 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 $r - \pi(1+g)$ and the real growth contribution as -g.

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

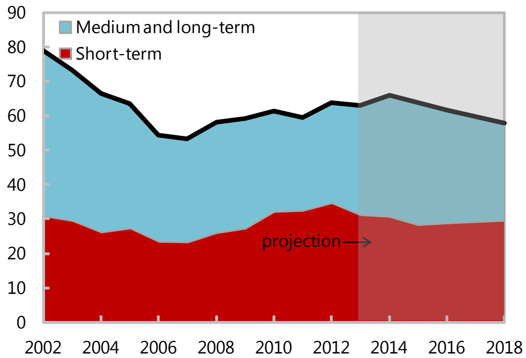
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

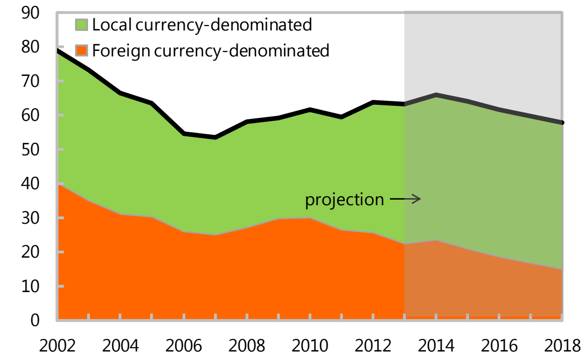
Figure 3. Pakistan: Public Debt Sustainability—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(In percent of GDP)



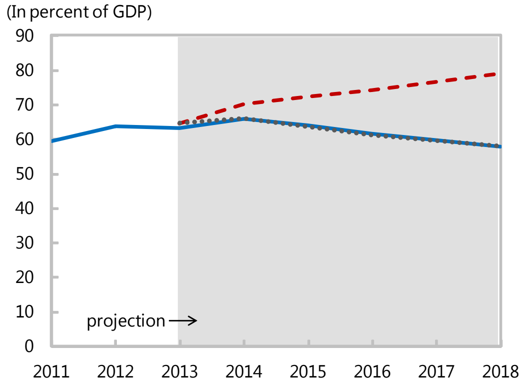
By Currency
(In percent of GDP)



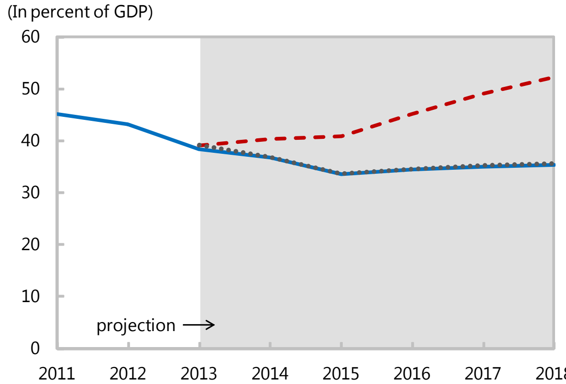
Alternative Scenarios

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)

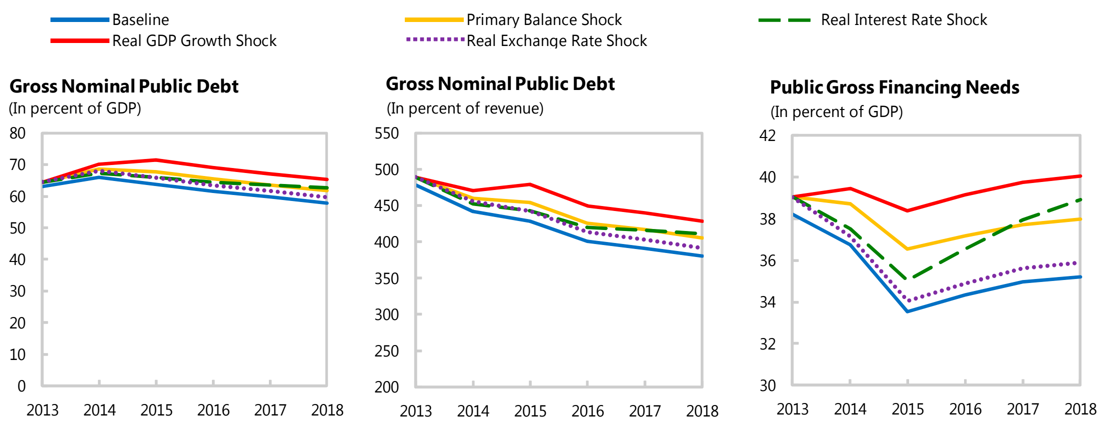
Baseline Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	3.6	2.8	3.6	3.9	4.7	5.0
Inflation	7.5	7.9	9.0	7.0	6.0	6.0
Primary Balance	-3.5	-0.8	0.7	1.0	0.8	0.7
Effective interest rate	7.7	7.7	7.6	7.8	7.8	7.9
Constant Primary Balance Scenario						
Real GDP growth	3.6	2.8	3.6	3.9	4.7	5.0
Inflation	7.5	7.9	9.0	7.0	6.0	6.0
Primary Balance	-3.5	-3.5	-3.5	-3.5	-3.5	-3.5
Effective interest rate	7.7	7.7	7.6	7.9	8.1	8.3

Historical Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	3.6	4.8	4.8	4.8	4.8	4.8
Inflation	7.5	7.9	9.0	7.0	6.0	6.0
Primary Balance	-3.5	-0.7	-0.7	-0.7	-0.7	-0.7
Effective interest rate	7.7	7.7	5.8	5.9	5.6	5.6

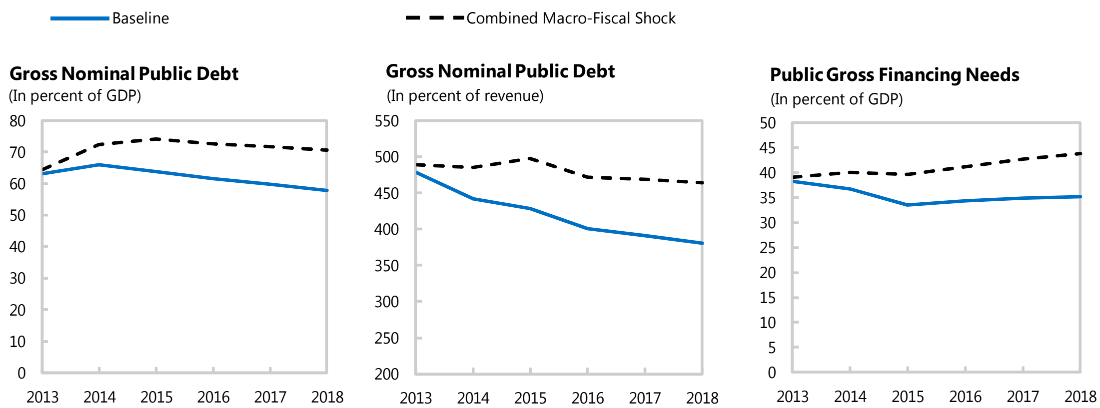
Sources: Pakistani authorities; and IMF staff calculations.

Figure 4. Pakistan: Public Debt Sustainability Analysis—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(In percent)

Primary Balance Shock	2013	2014	2015	2016	2017	2018
Real GDP growth	3.6	2.8	3.6	3.9	4.7	5.0
Inflation	7.5	7.9	9.0	7.0	6.0	6.0
Primary balance	-3.5	-1.9	-0.5	1.0	0.8	0.7
Effective interest rate	7.7	7.7	7.8	8.0	7.9	8.0
Real Interest Rate Shock						
Real GDP growth	3.6	2.8	3.6	3.9	4.7	5.0
Inflation	7.5	7.9	9.0	7.0	6.0	6.0
Primary balance	-3.5	-0.8	0.7	1.0	0.8	0.7
Effective interest rate	7.7	7.7	8.8	9.1	9.5	9.7
Combined Shock						
Real GDP growth	3.6	0.4	1.2	3.9	4.7	5.0
Inflation	7.5	7.3	8.4	7.0	6.0	6.0
Primary balance	-3.5	-1.9	-0.5	1.0	0.8	0.7
Effective interest rate	7.7	7.7	8.7	9.1	9.4	9.7

Real GDP Growth Shock	2013	2014	2015	2016	2017	2018
Real GDP growth	3.6	0.4	1.2	3.9	4.7	5.0
Inflation	7.5	7.3	8.4	7.0	6.0	6.0
Primary balance	-3.5	-1.6	-0.5	1.0	0.8	0.7
Effective interest rate	7.7	7.7	7.7	8.0	7.9	8.0
Real Exchange Rate Shock						
Real GDP growth	3.6	2.8	3.6	3.9	4.7	5.0
Inflation	7.5	9.6	9.0	7.0	6.0	6.0
Primary balance	-3.5	-0.8	0.7	1.0	0.8	0.7
Effective interest rate	7.7	7.7	7.5	7.6	7.7	7.9

Sources: Pakistani authorities; and IMF staff calculations.

Appendix I. Letter of Intent

December 5, 2013
Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC, 20431

Dear. Ms. Lagarde.

The Pakistani authorities reaffirm our commitment to our economic program supported by the International Monetary Fund (IMF). Performance for the first review was strong. We have met all but one of the performance criteria for the first program review and have made significant progress on our ambitious structural reform agenda. While, further effort is needed in some areas, we are committed to the additional actions described in the attached Memorandum of Understanding of Economic and Financial Policies (MEFP). Economic conditions remain difficult, with continued balance of payments pressures evident, but growth prospects are somewhat better than previous program projections and the fiscal outturn has been solid. We believe that as structural reforms take hold, bottlenecks will be removed, growth will accelerate, and vulnerabilities will recede. We are committed to firm policy implementation and maintenance of fiscal, monetary, and financial sector buffers to safeguard against risks.

Our performance on the quantitative targets and the structural reform agenda for the first review has been strong (MEFP Tables 1 and 2).

- *Quantitative performance criteria and indicative targets.* All end-September 2013, quantitative performance criteria were observed with the exception of the Net International Reserves (NIR) target. The indicative target on transfers under the Benazir Income Support program (BISP) was not met. Corrective actions to address the shortcomings on the NIR and BISP targets are outlined in the attached MEFP.

- *Structural Benchmark.* We produced a privatization strategy for 31 public sector enterprises (PSEs) in compliance with the end-September structural benchmark.

In the attached MEFP, we set out our plans to further advance towards meeting the objectives of our macroeconomic program. In view of our strong performance under the program supported by the IMF, the Government of Pakistan and the State Bank of Pakistan (SBP) request a waiver on the missed performance criterion and completion of the first review under the Extended Arrangement.

The program will continue to be monitored through quarterly reviews, prior actions, quantitative performance criteria, indicative targets, and structural benchmarks as described in the attached MEFP and TMU. Completion of the second and third reviews, scheduled for March 2, 2014 and June

2, 2014 will require observance of the quantitative performance criteria for end-December 2013 and end-March 2014, respectively, and continuous performance criterion as specified in Table 1. We propose modification of the end-December 2013 performance criteria on NIR and net foreign currency swaps/forwards position to reflect revised balance of payments assessments and technical changes in reserves accounting. We also propose establishment of the end-March 2014 PCs as set out in the attached MEFP. The adjustor for NIR will also be modified to better reflect aid disbursements and payments received. A change in the definition of the reserves-related liabilities (as described in the Technical Memorandum of Understanding, TMU) clarifies the treatment of derivatives in NIR accounting.

As detailed in the MEFP, we propose four new structural benchmarks against which to measure progress under the program (MEFP, Table 2). The TMU explains how the program targets are measured.

We believe that the policies set forth in the letter of August 19, 2013, and in this letter are adequate to achieve the objectives of our economic program, but we stand ready to take additional measures as appropriate to ensure achievement of its objectives. As is standard under all IMF arrangements, we will consult with the IMF before modifying measures contained in this Letter or adopting new measures that would deviate from the goals of the program, in accordance with the Fund's policies on such consultations, and will provide the IMF with the necessary information for program monitoring. We authorize the IMF to publish this Letter of Intent and its attachments, and the related staff reports.

/s/	/s/
Senator Mohammad Ishaq Dar	Yaseen Anwar
Minister of Finance	Governor of the State Bank of Pakistan
Pakistan	

Attachment I. Memorandum of Economic and Financial Policies

Recent Economic Developments and Outlook

1. **GDP growth prospects have improved slightly, but remain moderate**. Large scale manufacturing growth was 6½ percent in July–August 2013, as efforts to reduce load-shedding in the electricity sector seem to be bearing fruit. Agricultural output, in contrast, has been less than expected. We now expect growth to reach about 2¾ percent for FY 2013/14 as a whole. Risks to growth remain on the downside. With foreign exchange reserves remaining low, external vulnerabilities—such as oil price shocks, capital flight, or declines in economic activity elsewhere—continue to be a concern. Annual headline inflation has accelerated significantly from 5.9 in June to 9.1 percent in October, mainly driven by energy price adjustments and food price increases. Inflation is expected to remain close to 10 percent, although some impact of the base effect of recent spikes in the rate will ease.

2. **The balance of payments situation was worse than anticipated during the first quarter of FY 2013/14**. The current account was somewhat weaker. Exports were lower than forecast and disbursements under the Coalition Support Fund did not arrive until the second quarter, but higher remittances offset much of this shortfall. In contrast, the capital and financial account was significantly worse than expected, with lower-than-expected foreign direct investment and a large shortfall in the category of "other financial assets and liabilities," with both lower inflows and higher outflows than expected. The exchange rate depreciated by 6½ percent against the dollar. The exchange rate came under particular market pressure in late September (down around 9 percent) before easing in early October. Gross reserves fell by more than expected, declining from US$6 billion at end-June to US$4.7 billion by end-September, as weak financial inflows and heavy debt repayments outweighed the first program disbursement.

Economic Policies

A. Fiscal Policy

3. **Fiscal consolidation remains a crucial objective of the government's economic program**. Fiscal consolidation of around 4–4½ percent of GDP over the three year program will lower the deficit to around 3½ percent of GDP and place the debt-to-GDP ratio on a firmly declining path. Moreover, a more efficient and equitable tax system will foster competition, while providing the needed resources to finance infrastructure and support the poor through targeted assistance. The negative impact of fiscal consolidation on economic activity will be ameliorated by structural reforms to boost growth and by increases in targeted assistance programs to protect the most vulnerable.

4. **Fiscal performance was strong in the first quarter of FY 2013/14, with a smaller deficit than envisaged under the program**. Tax revenues were somewhat stronger than expected, while the very strong performance on nontax revenue reflects some one-off factors including the second

stage of the settlement of circular debt—which entailed the recovery of interest (rather than principal as previously anticipated). The pace of spending has been slower than programmed, particularly on capital spending, but it is expected to recover in the coming quarters.

5. **For FY 2013/14 as a whole, the government is on track to deliver on the adjustment of some 2 percent of GDP**. The initial consolidation effort relied mainly on the revenue side given the chronically low tax revenue-to-GDP ratio. To strengthen tax revenues, in addition to the measures approved in the 2013 Finance bill, the authorities will increase the Gas Infrastructure Development Cess (GIDC) by end-December to raise revenue by 0.4 percent of GDP on an annualized basis. This charge will also foster a more efficient allocation of gas to its highest value economic uses.

6. **On the expenditure side, the government is implementing a plan to phase out electricity subsidies over the life of the program**. The federal government has approved at the highest level with support of the provinces, a National Energy Policy entailing periodic increases in the average tariff, aiming at eliminating the tariff differential subsidy for all consumers except the most vulnerable over the next three years. The first adjustments to commercial, industrial, bulk, and large consumers (¶29) reduced subsidies by ¾ percent of GDP on an annualized basis. However, for the first year we will maintain the subsidies for consumers between 0–200 kWh consumption. For the second and third years, we will further reduce subsidies by roughly 0.4 percent of GDP per year to reach a maximum of 0.3 percent of GDP thereafter. As part of our initial adjustment package, we have also undertaken across the board reductions of 30 percent from budget allocations in ministries' nonwage current expenditures—amounting to about 0.15 percent of GDP. We have also scaled back the budgeted increase in capital spending, and will delay some remaining capital spending until revenues from the GIDC materialize.

7. **Tax administration reforms will gradually deliver further improvements in revenue collections**. An initiative to incorporate 300 thousand new taxpayers into the income tax net was launched in July. More than 30 thousand initial notices (u/s 114 of the Income Tax Ordinance 2001) have been issued—based on large potential fiscal liabilities and location to ensure the initiative is nationwide and more will follow. We have started issuing second notices (u/s/122c of the law) which will be followed by a provisional assessment, collection procedures, and penal and prosecution proceedings. By end-March 2014 (new structural benchmark), the Federal Board of Revenue (FBR) will issue 75,000 first notices (u/s 114) and will follow up with a second notice (u/s 122c) to at least 75 percent of those who did not respond satisfactorily to their first notice within 60 days. The FBR will also issue a provisional tax assessment to 75 percent of those who did not respond satisfactorily within 60 days to the second notice. We are also making progress in preparing initiatives to enhance revenue administration for sales tax, excises, and customs, which we will finalize and finish launching by end-December 2013 (structural benchmark). These efforts will be further assisted by increasing the number of tax audits to 4.2 percent of declarations (from 2.2 percent), which is already underway. We will also continue to seek technical assistance on tax administration from our international partners. Finally, the 2010 Anti-Money Laundering Act (AMLA) will be amended to

include tax crimes in the Schedule of Offences to enable the use of AML tools to combat tax fraud by end-June 2014.

8. To ameliorate risks to the program, several contingent measures have been identified and will be implemented in case the expected fiscal adjustment falls short of objectives. These measures include reduced expenditure allocations in the first nine months of the year compared to the budget to create a reserve against any shortfall, and use of reserves built into the capital expenditure budget if needed. These could yield savings amounting to 0.5 percent of GDP. Revenue from the Gas Infrastructure Development Cess (GIDC) has not yet entered the government coffers due to legal challenges, although it is being levied. We expect this legal issue will be resolved by end-December 2013, but stand ready to take compensatory measures, including on the revenue side, to assure compliance with our fiscal target.

9. We remain committed to our plan to broaden the tax net through the elimination of most tax exemptions and loopholes granted through Statutory Regulatory Orders (SROs). Since the start of the program, we have issued a few SROs to address some implementation issues of already budgeted measures and address some legal concerns. The budgetary implications of these SROs are negligible and we are covering the cost through administrative measures. We have issued no new SROs granting so-called "special exemptions," compared to some 43 in the previous fiscal year. We reaffirm our commitment to refrain from issuing any new tax concessions or exemptions (including customs tariffs) through SROs, and will approve legislation by end-December 2015 to permanently prohibit the practice. We are on track to finalize by end-December 2013 a comprehensive plan analyzing all existing SROs granting tax exemptions or concessions and containing a calendar to eliminate the vast majority of them and convert the remainder into regular legislation. The ultimate objective of this plan would be to achieve an increase in revenues of some 1–1½ percent of GDP, with all designated SROs eliminated in no more than three years. By end-June 2014, we will issue the necessary orders to eliminate the first batch of SROs – which will be identified in our plan – consistent with our overall fiscal goals (new structural benchmark). We will also quantify the remaining tax expenditures and publish a detailed list in the budget in future years. These steps will facilitate gradually moving the General Sales Tax (GST) to a full-fledged integrated modern indirect tax system with few exemptions along with an integrated income tax by 2016/17.

10. Beyond the current fiscal year, further revenue and expenditure measures will be implemented to achieve a sustainable deficit of around 3½ percent of GDP by 2016/17. This will require further fiscal consolidation of about 1½ percent of GDP per year in the coming two fiscal years. Roughly half of the adjustment could come from the revenue side, mainly through further widening of the tax base (particularly from the elimination of SROs), with some contribution from improved tax administration. With improved collections and a broader tax base, we hope to avoid the need for further increases in GST or income tax rates while achieving our overall deficit targets. On the expenditure side, further reductions in untargeted subsidies will be undertaken in 2014/15 and 2015/16, along with steps to streamline wage and salary costs via civil service reforms.

11. We are deepening our support to the poor and most vulnerable segments of the society through the Benazir Income Support Program (BISP) and other initiatives. Due to technical difficulties, particularly due to changes in the method of transfer to electronic means, the payments did not reach all beneficiaries during first quarter. We have now resolved this issue and are committed to move to a mechanism to automatically release funds by mid-quarter to allow time for BISP to deliver payments on time. In line with projections, we have reached the coverage level of 4.9 million beneficiaries. However, we could only disburse to around 83 percent of the beneficiaries due to the transition to electronic transfer mechanisms. We will step up our outreach and mobilization campaigns to reduce the gap between enrolled and paid beneficiaries in the coming months. In line with our commitments, we project an increase in coverage of 10 percent while increasing the number of beneficiaries receiving their payments by around 20 percent before the end of the fiscal year.[1] Furthermore, we will provide conditional cash transfers to primary education, supporting children attending school in 20 districts in FY 2013/14. We will continue to protect the real purchasing power of the beneficiaries, further expand the coverage of the program as savings from tariff adjustments and fiscal space is realized, and continues to phase-out nontargeted subsidies.

12. Provincial governments will play an important role in the fiscal reform process. Under successive constitutional amendments (most recently the 18th), Pakistan has moved decisively to a more decentralized federal system of government. The most recent National Finance Commission (NFC) award granted 57.5 percent of most revenues to the provinces, along with a substantial devolution of spending responsibilities and taxation authority in agriculture, property and services, which left the federal government with an imbalance between its remaining expenditure responsibilities and its revenue. Since under the NFC award, the bulk of the additional revenue generated by the program will be distributed to the provinces, an agreement has been reached at the level of the Council of Common Interest to assure that it is used for deficit reduction or saved. In addition, the government has tightened the balanced-budget requirement on provinces, and provided incentives for them to maintain surpluses. In July 2014, negotiations will begin on a new NFC award. The government will seek a new agreement that will ensure that the terms of fiscal decentralization finds a balance between devolution of revenue and expenditure responsibilities and is consistent with the imperatives of macroeconomic stability.

B. Monetary and Exchange Rate Policies

13. Monetary aggregates continued to expand and inflation increased in the first quarter of FY 2013/14. Government borrowing from the SBP continued to drive reserve money growth in the period before the start of the IMF program. Net claims on the government increased by 47 percent y-o-y in FY 2013/14 Q1, resulting in about 45 percent growth in net domestic assets while net foreign assets of the SBP turned negative. As a result, reserve money increased by

[1] Also through retroactive payments.

14¼ percent (y-o-y), 1.6 percent lower than the previous quarter, and the broad money increased by 15½ percent. Private sector credit expanded by only 1.5 percent y-o-y.

14. Performance under the end-September monetary targets was mixed. The PC on NDA was met, as was the ceiling on the net swap/forward position. However, the target on Net International Reserves (NIR) underperformed by US$304 million.[1] As noted above (¶6), the capital and financial account was significantly worse than anticipated. Although the program adjustor on official disbursements covered some of the gap, private flows were also weaker. The SBP also stepped in the end of the quarter to ease depreciation pressure on Rupee with small net sales in the foreign exchange market whereas the program had anticipated net purchases.

15. Monetary and exchange rate policies will focus on rebuilding critically low foreign exchange reserves and on maintaining price stability. To contain accelerating inflation rates, the SBP began to tighten monetary policy with a 50 basis point increase in the policy rate in September. Going forward, the SBP is committed to taking additional policy actions as and when needed to assure achievement of its reserve accumulation and price stability. The exchange rate will remain flexible and will reflect market conditions. Calibrated interventions in the foreign exchange market will be aimed at meeting the program's reserve targets and ensuring smooth functioning of the market. The policy interest rate will also be adjusted as needed to ensure positive real interest rates and an attractive interest differential to encourage capital inflows. We will continue to keep our net swap/forward position at end-June 2013 level and will gradually reduce it over time, with the lengthening of maturities. The SBP lending to the government will remain within agreed targets and limit open market liquidity injections to the economy to those consistent with the program.

16. Enhanced central bank independence will improve monetary policymaking. Amendments to the SBP law, incorporating the recommendations of the recent IMF safeguards assessment, will be enacted to strengthen the autonomy of the SBP, including full operational independence in its pursuit of price stability as its primary objective, complemented with enhanced governance structure including strong internal controls, by end-March 2014 (structural benchmark). Among other things, the amendments will establish an independent, decision-making monetary policy committee to design and implement monetary policy and prohibit any form of new direct lending from the SBP to the government. The SBP will establish a Board committee to centralize and oversee risk management activities across the bank by end-January 2013. The SBP will approve a plan to fully implement International Financial Reporting Standards (IFRS), including reporting financial reserves by currency and maturity by end-March 2014.

[1] The adjustor for NIR will also be modified to better reflect aid disbursements and payments received. A change in the definition of the reserves-related liabilities (as described in the Technical Memorandum of Understanding, TMU) clarifies the treatment of derivatives in NIR accounting.

C. Financial Sector

17. The banking system continues to show good indicators of financial soundness, with high liquidity, capitalization, and comfortable profitability. The profitability of the banking sector has remained intact, despite the floor on the saving deposit interest rate, high nonperforming loans (NPLs), and a declining advances-to-deposits ratio. This is supported by banks' large holdings of government securities, reaching 37 percent of banking system total assets. As of end-June 2013, the capital adequacy requirement (CAR) improved slightly to 15.5 percent, mainly attributable to deceleration in credit risk. Nonetheless, the asset quality of the banking system marginally deteriorated, with NPLs standing around 14.8 percent, but provisioning is high for the system as a whole (at 70 percent).[1] To further enhance the assessment of financial health and soundness of the financial sector, the SBP intends to compile and publish the "encouraged" sets of the Financial Soundness Indicators.

18. The SBP has made progress to ensure compliance of all banks that fall below minimum capital adequacy. The CAR shortfall of four noncompliant banks (one state-owned and three private), comprising 6.6 percent of banking assets that fall below the CAR, may not pose large risks but needs to be addressed. The SBP has a keen supervisory vigilance on these banks and it is actively engaged with each bank in preparing a detailed plan by end-December 2013 (structural benchmark) for achieving full compliance by end-December 2014. One bank completed issuance of noncumulative perpetual preferred stock of PRs 2.1 billion in September 2013. The remaining immediate capital needs for the CAR noncompliant banks is negligible (PRs 15.9 billion, less than 0.1 percent of GDP), but could rise if the economic environment deteriorates significantly. The SBP will also prepare a detailed plan for recapitalization, consolidation or merger of banks that fall below the minimum capital requirement (MCR) but not CAR. Two banks have recently received PRs 3.2 and 0.6 billion, respectively, through subscription of right issuance. The SBP is revisiting the statutory MCR to take into account the context of the local environment in which banks operate and cross-country experience.

19. We have advanced consultations on a deposit insurance scheme and the new bankruptcy law (Corporate Rehabilitation Act). The SBP, Ministry of Finance, and the Securities and Exchange Commission of Pakistan (SECP) have been jointly working on the development of modalities for the Deposit Protection Fund (DPF). The draft act for the DPF is being finalized and is expected to be approved by the Parliament by end-September 2014 (structural benchmark). The scheme would begin operations by end-December 2015. We will seek Technical Assistance from the IMF to advice on the modalities and operations of the DPF in the context of a contingency planning framework. For the Corporate Rehabilitation Act (CRA), a committee is being formed comprising SECP, SBP, Ministry of Law and Justice, Pakistan Banks Association, Pakistan Business Council, and

[1] Net NPLs to net loan ratio is 4.4 percent.

Federation of Pakistan Chamber of Commerce and Industry. The committee will hold roundtables in Karachi and Lahore during November 2013 to seek feedback on the draft CRA, which it is expected to be finalized by end-September 2014 and submitted to the Parliament for expected approval by end-December, 2015.

20. We will continue to develop the government domestic debt market. To broaden the investor base and have a liquid government securities market, we have taken several initiatives, including: introducing an Electronic Bond Trading platform to bring efficiency in secondary market trading, enhancing rules governing primary dealers to develop government securities markets, creating awareness about government securities among the retail investors, and setting up an online auction system for government securities in the primary market. Going forward, we are exploring introducing additional Shariah complaint instruments, diaspora bonds, and indexed bonds. The SECP, along with SBP, is in the process of developing the operational framework for trading and settlement of government securities' transactions through an additional platform, the Bond Automated Trading System at stock exchanges.

21. We are committed to strengthening public debt management. At present, the debt management function is fragmented across different agencies with weak coordination, resulting in underdevelopment of domestic debt capital market and exposure to financial risks. Therefore, we aim to centralize the debt management function by vesting the operational authority and decision making with the Debt Policy Coordination Office. Since 2003, the composition of domestic debt has undergone a transformation from a high dominance of unfunded debt to an increasing dependence on short term floating debt, entailing high rollover and refinancing risk. As a result, to achieve a desired composition of the government debt portfolio with regard to the cost-risk tradeoff, we have initiated the technical work to develop a Medium Term Debt Strategy (MTDS) in consultation with the IMF and the World Bank.

22. We remain committed to safeguarding financial stability by strengthening the regulatory and supervisory frameworks. We are addressing several initiatives, including:

- Drafting the Securities Bill, which will be submitted to the Parliament by end-March 2014 and enacted by end-December 2014 (structural benchmark);

- Enhancing the regulatory power of the SECP through a revised SECP (Regulation and Enforcement) Bill, which will be submitted to the Parliament by end-March 2014;

- Developing a comprehensive framework for the future markets, where a draft Futures Trading Bill will be placed before the Parliament for expected approval by end-December 2014;

- Revisiting the regulatory framework of the SBP and SECP to effectively supervise financial conglomerates, where we will develop, in consultation with the IMF and the World Bank, a legal framework for consolidated supervision by end-December 2015 based on international good practices.

D. Structural Reforms

23. We maintain our ambitious agenda to boost long-term growth by comprehensively tackling the problems of the energy sector, improving the investment climate, liberalizing and simplifying the international trade regime, and reforming and/or privatizing public sector enterprises in key economic areas.

Energy Sector Reforms

24. The recently approved National Energy Policy identified priority steps to anchor the reform agenda for the next 3–5 years. We are implementing the time-bound strategy to tackle price distortions, insufficient collections, costly and poorly targeted subsidies, governance and regulatory deficiencies, and low efficiency in energy supply and distribution with the support of our international partners.

25. Price Adjustments. We have already taken the first two steps identified in the three-year plan for phasing out the Tariff Differential Subsidies (TDS) to bring tariffs to cost recovery level. However, due to higher courts' injunctions, part of the August increase was rolled back, which we partially compensated in October tariffs adjustment. These two adjustments will still deliver the agreed ¾ percent of GDP annualized reduction in subsidies. We will modify our strategy going forward as needed to stay within the medium-term target for subsidy rationalization. We have already incorporated the costs of servicing the syndicated term credit finance facility into the tariff petition and it is expected to be reflected in the notified base tariff for FY 2013/14.

26. Arrears. The arrears clearance scheme that we implemented resulted in an additional 1700 MW of electricity supply to the system and reduced load shedding by around three hours per day on average. We have already advertised and are expecting bids to hire professional audit firms to conduct technical and financial audits of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited). The hiring process will be completed by end-November 2013 (structural benchmark). Based on the findings of the audit, which will be prepared by end-April, we will design a roadmap to prevent the accumulation and recurrence of payables arrears.

27. Monitoring and Enforcement. To tackle losses, raise payment compliance, and improve energy efficiency and service delivery in the distribution companies (DISCOs), we have already signed three performance contracts; the remaining six companies will be finalized by end-February 2014. We will also sign power purchase agreements with public sector generation companies by end-March 2014. In cases of failure to comply with the performance contracts, we will invoke remedial measures for management and the Boards as specified in the Companies' Ordinance. The CCI has already cleared the amendments to Penal Code 1860 and the Code of Criminal Procedures 1898. The government will enact the pending amendments by ordinance by end-December 2013 (structural benchmark), with ratification by the parliament expected later. In parallel, we are drafting a new Electricity Act to modernize governance of the sector. The act will establish investigation systems and a fast track judicial mechanism to improve enforcement. In order to minimize losses from low payment rates, three state-owned DISCOs have already begun implementing revenue based load shedding (as is already done in Karachi). The transition for the remaining DISCOs will be finalized by end-January 2014 (new structural benchmark). To enhance transparency, web-based reporting of dispatching and merit order of all power plants was introduced. We will integrate the payment records to stakeholders on the web portal by end-January 2014. The reporting portal also allow us to monitor electricity draws to reduce overdraws and improve information flows. We have mostly completed the metering at the incoming and outgoing 11kV feeders that is allowing us to better manage the load and control unscheduled load shedding. To minimize losses in fuel delivery to generation companies (GENCOs), we will lease the fuel storage and delivery facilities to Pakistan State Oil (PSO) by end-December 2013.

28. Demand Side Management. To encourage energy conservation, we will use pricing ¶25 and other market based instruments to improve resource allocation and energy efficiency. In this regard, we have begun the consultative process with the stakeholders on the draft Pakistan Energy Efficiency and Conservation Act. We will place the revised draft before the CCI for approval by end-March 2014. The act will include equipment performance standards, and would cover key electrical and gas equipment and appliances which are not yet covered.

29. Supply Side Management. We will continue to prioritize the use of gas and coal rather than fuel oil in electricity generation. In the short-run, we will continue to increase the allocation of natural gas to the power sector and are committed to move to market-based allocations in the medium term. We will encourage the conversion of fuel oil-based GENCOs and Independent Power Producers (IPPs) to coal-based plants via a policy directive, which has already been forwarded to the Economic Coordination Council for approval by end-December 2013. To further improve supply, we will continue to rehabilitate generation plants, while upgrading electricity transmission and distribution facilities to reduce technical losses. We have finalized regular efficiency testing of fuel based GENCOs, which are expected to generate savings by next fiscal year. The current round of three rehabilitations will be completed by end-March 2014, which are expected to recover 500 MW of capacity and increase efficiency by 1–2 percent. Moreover, to enhance clean energy supply, we will continue with the development of hydropower projects—the cheapest source of supply. We will promote policies for private investment for power generation through both the entry of new players as well as expanding existing capacity of those IPPs systematically adhering to energy mix targets and least-cost generation plans. The expansions are expected to generate additional 2000 MW by 2016.

30. Governance, Regulatory, and Transparency Improvements. We continue to place high priority on improving energy sector governance and transparency. We have already advertised entry and middle management positions to enhance the administrative capacity of the regulatory body, the National Electric Power Regulatory Authority (NEPRA). For FY 2013/14, NEPRA will reduce the base tariff determination period from 8–10 months to less than 5 months and is committed to streamline the process to three months by the next determination cycle. NEPRA will issue the FY 2013/14 determined tariff by end-November 2013 and the government will notify new determined tariffs within 15 days. Over time, determination and notification of tariffs will be consolidated within NEPRA. With mostly favorable court decisions on the timely adjustment of fuel prices, NEPRA has already notified the September 2013 Fuel Price Adjustment (FPA). We have now reduced the application of fuel price adjustments (FPAs) dictated by NEPRA from seven months to its normal monthly schedule. We are moving towards setting-up the Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), hiring key staff, issuing CPPA rules and guidelines, and taking over the payment and settlement system by end-December 2013 (structural benchmark). Finally, we will finalize the dissolution of PEPCO by end-December 2013 and will devolve its remaining functions.

31. Energy public sector enterprise (PSE) reform. The institutional capacity of all energy sector PSEs needs to be strengthened to allow them to operate independently from the Government as efficient commercial entities. We will transfer governance of DISCOs and the NTDC to new boards of directors and management by end-2013. We are committed to building the institutional capacity of the Water and Power Development Authority (WAPDA) through corporatization and commercialization, and will strengthen WAPDA's financial capacity by allowing the tariff to incorporate capital investment plans and ensure timely payments by NTDC/CPPA for all power purchased from WAPDA. In the medium term, we are committed to introduce competitive pricing and direct contracting between power producers and wholesale customers in the power sector.

32. Oil and Gas Sector. The current level of gas supply is barely one half of unconstrained demand due to low prices and insufficient investment. To help tackle the gas shortages, we have started efforts to import Liquefied Natural Gas (LNG). We will finalize the evaluation and award an import contract by end-December 2013, with a view toward receiving the first LNG imports by late 2014. Moreover, we will accelerate the development of domestic natural gas and limit further expansion of the gas distribution networks for domestic consumption. We are on target to increase supply by some 7 percent by end-December 2013 through new investment in existing fields. We are committed to maintaining the priority ranking of the power sector to second (after households) and continue to divert the excess supply of gas to the most efficient power plants. Last year we announced the new Petroleum Exploration and Production Policy 2012 to offer higher gas prices for enhanced production from existing and new fields and recently finalized the amendments to further improve producer incentives. We will enhance the capacity of Ministry of Petroleum and Natural Resources to fully implement the 2012 Policy, streamline approval processes, and complete the conversion to the 2012 Policy for those Petroleum Concession holders who wish to do so. We will further encourage bilateral contracting between producers and consumers and improve rules for third party access to the gas transmission system. As new production comes on line, the cost of this gas will be fully reflected in the base tariff on a semiannual basis, beginning with the next adjustment in January 2014. We will gradually rationalize gas prices to encourage new investment, promote efficiency in gas use, and assure that there will continue to be no fiscal cost from the gas sector. We are on track to produce a rationalization plan and implement the first phase through the GIDC by end-December 2013 (structural benchmark). The current level of unaccounted for gas losses (UFG) is on average 11 percent due to commercial and technical losses. We have directed companies to reduce losses benchmarking international standards through investment measures, managerial and administrative improvements, and through building the capacity of the gas distribution companies. We are also using legal frameworks to tackle the losses due to theft. Finally, we affirm our commitment to enhance the capacity of Oil and Gas Regulatory Authority (OGRA).

Improving the business climate, liberalizing trade, and reforming public enterprises

33. We are working to improve the business climate, the trade regime, and PSEs to increase foreign and domestic private investment and boost economic growth.

34. Business Climate. Impediments in the legal framework for creditors' rights and contract enforcement, barriers to new business start-ups, complicated legal and taxation requirements, and impaired access to finance hamper the business climate and investment.

- *Contract enforcement.* While the draft Corporate Rehabilitation Act is prepared ¶19, we will initiate a study to identify the needs of corporations to speed up rehabilitation of weak but viable companies, and will expedite the liquidation of the insolvent entities thereafter. In addition, we have begun expanding the use of Alternative Dispute Resolution (ADR) Mechanisms beyond Karachi. ADR is now open to all business in Lahore.

- *Start-ups*. The Board of Investment, in coordination with SECP, FBR, Ministry of Finance and other stakeholders (including provinces) have developed a draft plan to simplify procedures and costs for setting up businesses and paying taxes in Pakistan. We will finalize an action plan by end-December, 2013.

- *Access to credit.* Accessing credit for small and medium enterprises (SME) remains very limited owing to both demand—and supply-side constraints. We will build on the State Bank of Pakistan's Financial Inclusion Program to address industry bottlenecks and barriers in access of micro and small enterprises to financial services. This will include regulatory reforms, strengthening credit enhancement mechanisms, improving market information and infrastructure, product innovation, improved delivery mechanisms, financial literacy, and consumer protection.

35. Trade Policy. Trade policy reforms would increase consumer welfare and stimulate growth via increased competition. Simplifying tariff rates, eliminating the statutory regulatory orders (SROs) that establish special rates and/or nontariff trade barriers in some 4,000 product areas, and improving trade relations should deliver the much needed competitive environment.

- *Tariff simplification*. We are working on simplifying the tariff structure to move to a simple, transparent framework, with 4 slabs between 0 and 25 percent rates with few exceptions. Design of the new system would be completed by end-December 2013; with phase-in of the revised tariff rates and phase-out of trade SROs beginning by end-June 2014 (see also ¶9). Implementation of the new tariff structure would be completed by end-June 2017.

- *Improved trade relations*. We have developed and implementing a strategy to take full advantage of trade preferences available from the EU where we have autonomous trade preferences in 75 items. The EU is moving forward favorably with our request for receiving GSP plus benefits

(0 percent duty) from January 1, 2014 on exports. We remain committed to promoting trade with regional countries, especially under various regional trade arrangements.

36. Public Sector Enterprises. We are working towards reforming or privatizing public sector enterprises (PSEs), focusing on limiting poor performance and improving public sector resource allocation. The Cabinet Committee on Privatization (CCOP) approved a list of 31 PSEs for action, and we have developed a plan to sequence the capital market and pre-privatization restructuring for these firms.

- *Capital Market Transactions Roadmap*. We have identified eleven companies, which are listed in the TMU, in the oil and gas, banking and insurance, and power sectors for block sales, and primary or secondary public offerings. We have hired one financial advisor and will hire two more by end-March 2014 (new structural benchmark) to offer minority shares in three companies in domestic or international markets by end-June 2014 subject to investor interest and global market conditions. Furthermore, we will hire financial advisors for at least two other companies by end-June 2014 to market minority shares within 6 months thereafter.

- *Strategic Private Sector Participation.* Strategic partnerships will act as a catalyst in unlocking the potential of PSEs through their managerial and investment participation. They can also increase the value of Government's residual shareholding. We have identified seventeen companies, which are listed in the TMU. For profitable PSEs, we will make efforts to balance the objectives of sale proceeds while adequately addressing labor market issues and social implications. We hired financial advisor for National Power Construction Co. (NPCC) and will finalize the sale by end-June 2014. We will also hire financial advisors for one electricity distribution company and one power generation company, and will hire financial advisors for the sale of PIA Investment Limited's nonstrategic assets in New York and Paris by end-March 2014 (new structural benchmark). We will initiate Islamabad convention center's sale after finalizing PIA Investment Limited.

- *Restructuring.* In parallel we will continue our restructuring plans and hire professional chief executives and board members for those enterprises with a corporate structure in line with the corporate governance rules. We are developing medium-term action plans to restructure Pakistan International Airlines (PIA), Pakistan Steel Mill (PSM) and Pakistan Railways (PR). Specifically,

    - Pakistan International Airlines. We will hire financial advisors by end-March 2014 to seek potential strategic private sector participation in the company. We plan to privatize 26 percent of PIA's shares to strategic investors by end-December 2014 (structural benchmark). In the meantime, PIA will continue leasing more efficient airplanes and rationalizing routes.

    - Pakistan Steel Mills. We have appointed a professional board and will hire financial advisors by end-March 2014 to prepare a comprehensive restructuring plan and seek for potential strategic private sector participation in the company.

- Pakistan Railways. Aging and shortage of equipment, overstaffing, and large debts continue to weigh on railway operations. Nevertheless, we have improved revenue in the first quarter through rationalization of tariffs and expenditures and improved occupancy rates. We are in the process of reviving the railway Board. By end-March 2014 we will develop a comprehensive restructuring plan, which will include improvements in business processes and institutional framework, financial stability, and service delivery.

Table 1. Pakistan: Quantitative Performance Criteria and Indicative Targets for FY2013/14 and FY2014/15 1/
(In billions of rupees, at program exchange rates, unless otherwise specified)

	FY2012/13	FY2013/14					FY2014/15
	end-June	end-September		end-December	end-March	end-June	end-September
	Act.	Program	Actual	Program	Program	Projections	Projection
Performance Criteria							
Floor on net international reserves of the SBP (millions of US dollars) 2/	-2,437	-2,850	-3,154	-4,130	-2,750	1,895	3810
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees)	2,402	2,877	2,595	2,901	2,627	2,225	2196
Ceiling on overall budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 3/	2,012	419	297	882	1,209	1,464	512
Ceiling on SBP's stock of net foreign currency swaps/forward position (millions of US dollars) 4/	2,255	2,255	1,775	2,255	2,255	2,000	1775
Ceiling on net government borrowing from the SBP (including provincial governments, stock, billions of Pakistani rupees) 1, 5/	2,168	2,690	2,521	2,560	2,390	2,240	2100
Continuous Performance Criterion							
Accumulation of external public payment arrears by the general government (continuous)	0	0	0	0	0	0	0
Indicative Targets							
Cumulative floor on Targeted Cash Transfers Spending (BISP) (billions of Pakistani rupees)	54	19	14	32	50	73	25

Sources: Pakistani authorities; and Fund staff estimates.

1/ All items as defined in the TMU. Fiscal year runs from July 1 to June 30.

2/ The end September 2013 target of -2499 has been adjusted downward by 351 million USD to reflect a shortfall in multilateral/bilateral disbursements to Pakistan. End-December 2013 target is modified from -2,090 millions of US dollars.

3/ Excluding grants, FY2012/13 overall budget deficit is a stock.

4/ End-December 2013 target is modified from 2,005 millions of US dollars.

5/ FY 2012/13, total stock of government debt as of June 30, 2013.

Table 2. Pakistan: Structural Benchmarks Under Extended Fund Facility

Item	Measure	Time Frame (by End of Period)	Comment
Structural Benchmarks			
Fiscal sector			
1	Develop and finish launching initiatives to enhance revenue administration for sales tax, excises, and customs similar to that prepared for income tax.	end-December 2013	
2	Announce a rationalization plan for gas prices which will involve a levy to generate 0.4 percent of GDP fiscal savings.	end-December 2013	
Monetary sector			
3	Enact the amendments to the SBP law to give SBP autonomy in its pursuit of price stability as its primary objective, while strengthening its governance and internal control framework, in line with Fund staff advice.	end-March 2014	
Financial sector			
4	Prepare detailed plans to achieve compliance of all banks that fall below minimum capital adequacy, including specific actions, end dates, and contingency arrangements. Also detail a plan for recapitalization, consolidation or liquidation of banks that fall below the minimum capital requirement but not CAR.	end-December 2013	
5	Enact the Deposit Protection Fund Act, in line with Fund staff advice	end-September 2014	
6	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014	
Structural Policies			
7	Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).	end-September 2013	Met
8	Hire a professional audit firm to conduct a technical and financial audit of the system to identify the stock and flow of payables at all levels of the energy sector (including Power Sector Holding Company Limited).	end-November 2013	
9	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), hire key staff, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013	
10	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013	
11	Privatize 26 percent of PIA's shares to strategic investors.	end-December 2014	
New Structural Benchmarks			
12	Increase the issuance of first notices (u/s 114) to 75,000 and follow up with a second notice (u/s 122c) to 75 percent of those who did not respond satisfactorily to their first notice within 60 days by end-March, 2014. Issue a provisional tax assessment to 75 percent of those who did not respond satisfactorily within 60 days to the second notice by end-March, 2014.	end-March 2014	
13	Issue SROs to eliminate exemptions and concessions granted through SROs for an amount consistent with the fiscal deficit reduction objective for FY 2014/15.	end-June-2014	
14	Hire three financial advisors for three PSEs in the capital market transactions list and three financial advisors for the three PSEs in the strategic private sector enterprises list for privatization in the TMU.	end-March 2014	
15	Initiate revenue based load shedding in six remaining electricity distribution companies	end-January 2014	

Attachment II. Technical Memorandum of Understanding (TMU)

December 5, 2013

1. 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 99.66 rupee per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

A. Quantitative Targets

2. The program sets performance criteria and indicative targets for defined test dates (Table 1 in the LOI). 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 the overall budget deficit excluding grants (cumulative flows, billions of rupees);
- Ceiling on net borrowing from the SBP by the government (including provincial governments, stock, billions of rupees);
- Ceiling on SBP's stock of net foreign currency swap/forward contracts (millions of U.S. dollars);

Continuous performance criteria

- 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)

B. Definitions of Monitoring Variables

3. **The 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 October 31, 2013, the NIR of Pakistan amounted to US$ -4551 million.

4. 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.

5. Reserve-related liabilities of the SBP include all foreign exchange liabilities to residents or nonresidents, including (i) foreign currency liabilities with remaining maturity of one year or less, (ii) any foreign exchange liabilities arising from derivatives (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, international organizations, and foreign nonbank financial institutions, as well as domestic financial institutions. General government foreign exchange liabilities at the SBP will not be included in reserve-related liabilities

6. 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 vis-à-vis the domestic currency (including the forward leg of currency swaps). The SBP's aggregate position was US$–2.3 billion at end-June 2013.

7. 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.

8. Net domestic assets of the SBP are defined as RM minus NIR, minus other assets not included in gross official international reserves, minus commercial bank required and excess reserves at the SBP in foreign currency, plus medium and long-term liabilities (i.e., liabilities with a maturity of one year or more) of the SBP, plus other foreign liabilities not included in official reserve liabilities, minus the balance of outstanding Fund purchases credited to the government account at the SBP. NDA is composed of net SBP credit to the general government plus outstanding credit to domestic banks by the SBP (including overdrafts) minus liabilities not included in RM and other items net.

9. Net SBP credit to the government (including provincial governments) is defined as SBP claims on the government minus government deposits with the SBP. SBP claims on the government include government securities, treasury bills, treasury currency, and debtor balances. SBP claims on the government exclude accrued profits on government securities. Government deposits with the SBP exclude the Zakat Fund (Table 4).

10. Net purchase of foreign exchange is defined as outright purchase of foreign exchange minus outright sale of foreign exchange in the foreign exchange spot market as net addition to the stock of NIR of the SBP by using foreign exchange market intervention.

11. External public debt arrears are defined as all unpaid debt-service obligations (i.e., payments of principal and interest) of the general government (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 external payment arrears is set at zero.

12. The overall budget deficit (excluding grants) will be monitored quarterly under the cash balance of the general government balance, excluding grants, including the operations of district 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.

13. Net external program financing is defined to include external privatization receipts; budget support grants; budget support loans from multilateral (other than the IMF, but including 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). Amounts projected for net external program financing and external grants are provided in Table 3.

14. **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.

15. **Electricity Tariff Pricing Formulas and Definitions** (¶25 of the Letter of Intent)

(i) The increase in the weighted average tariffs by 50 percent on industrial, commercial, bulk and AJ&K consumers' electricity consumption is defined as follows

Weighted Average Notified Tariff for industrial, commercial, bulk and AJ&K consumers =

(Changes in the Industrial Users Tariff Rate for each category x DISCO's estimated sales to Industrial Users for each category

+ Change in the Commercial Users Tariff Rate for each category x DISCO's estimated sales to Commercial Users for each category

+ Change in the Bulk users' Tariff Rate for each category x DISCO's estimated sales to Bulk Users for each category)

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

/ DISCO's total sales to Industrial, Commercial, Bulk, and AJ&K Users

= 50 percent

(ii) Elimination and reduction of the subsidy on second group of consumers by October 1, 2013 through increasing the weighted average notified tariffs by 30 percent.

- Second group of consumers is defined as the following users; (i) those with consumption levels above 200kWh, (ii) Salinity Control & Reclamation Programme (SCARP), (iii) Agricultural tube wells consumers and (iv) Other customers (public lighting, housing schemes, railways, HVTL).

Weighted Average Notified Tariff for second group of consumers =

- (Change in the Tariff Rate of users whose consumption levels are above 200kWh x Revenue from users whose consumption levels are above 300kWh
- + Change in the Tariff Rate of users in SCARP x DISCO's estimated sales to users in SCARP

- + Change in the Tariff Rate of users in Agricultural tube wells x DISCO's estimated sales to users in Agricultural tube wells
- + Change in the Tariff Rate of Other users x DISCO's estimated sales to Other customers)
- / DISCO's total estimated sales to users whose consumption levels are above 200kWh, SCARP, Agricultural tube wells and other consumers.
- = 30 percent

16. Structural Benchmark on hiring of six transaction advisors for end-March 2014 is defined as follows: Three transaction advisors to undertake the sale of minority shares for three PSEs from the list of capital market transactions with at least one offering in the domestic and one offering in international markets. From the list of strategic private sector participation one transaction advisor for electricity distribution company and one generation company, and finally one transaction advisor to undertake the sale of nonstrategic assets of PIA Investment Limited in New York or Paris.

C. Adjustors

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

18. The ceiling on NDA will be adjusted downward (upward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants compared to the program amounts (Table 3) and Euro bond issuance or project grants compared to projected inflows (Table 2). Budget support grants to the public sector are defined as grants received by the government (including provincial governments) for direct budget support from external donors and not related to the projected financing. Budget support loans to the public sector are defined as disbursements of loans from bilateral and multilateral donors for budget support (including provincial governments).

19. The ceiling on the consolidated overall budget deficit (excluding grants) will be adjusted upward for the cumulative excess in net external program financing in rupee terms for up to PRs 25.0 billion at end-December 2013, PRs 42.0 billion at end-March 2014, and PRs 50 billion at end-June 2014. The ceiling will be adjusted downward for any shortfall in federal PSDP spending below PRs 25 billion in September 2013, PRs 80 billion in December 2013, PRs 243 billion in March 2014 and PRs 410 in June 2014; and for any shortfall in the targeted cash transfers (BISP) from their indicative target.

D. Public Sector Enterprises

List of Companies for **Capital Market Transactions**

- Oil and Gas Development Co. Ltd (OGDCL)
- Pakistan Petroleum Ltd (PPL)
- Mari Petroleum Ltd.
- Government Holding Private Ltd (GHPL)
- Pak Arab Refinery Ltd (PARCO)
- Habib Bank Limited (HBL)
- United Bank Limited(UBL)
- Allied Bank Limited (ABL)
- National Bank Limited (NBP
- State Life Insurance Corp. (SLIC)
- Kot Addu Power Company Ltd. (KAPCO)

List of Companies for **Strategic Private Sector Participation**

- National Insurance Co. Ltd. (NICL)
- National Investment Trust Ltd. (NITL)
- Small & Medium Enterprise (SME) Bank
- Pakistan Reinsurance Co Ltd. (PRCL)
- Heavy Electrical Complex (HEC)
- Islamabad Electric Supply Co. Ltd (IESCO)
- Faisalabad Electric Supply Co. Ltd (FESCO)
- Hyderabad Electric Supply Co. Ltd (HESCO)
- Jamshoro Power Generation Co. Ltd (JPCL)
- Northern Power Generation Co. Ltd (NPGCL) - Thermal Power Station—Muzaffargarh
- National Power Construction Co. (NPCC)
- Pakistan Steel Mills Corp (PSMC)
- Pakistan Engineering Co Ltd (PECO)
- Pakistan International Airlines Corp (PIAC)
- Pakistan National Shipping Corp (PNSC)
- Convention Centre, Islamabad.
- PIA Investment Ltd—Roosevelt Hotel NY & Scribe Hotel—Paris

List of Companies for **Restructuring followed by Privatization**

- Pakistan State Oil Co Ltd (PSO)
- Sui Southern Gas Co Ltd (SSGC)
- Sui Northern Gas Pipelines Ltd (SNGPL)

E. Program Reporting Requirements

20. Performance under the program will be monitored from data supplied to the IMF by the SBP, Ministry of Finance and Ministry of Water Power 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.

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 three weeks of the end 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 5 working day
	Foreign exchange market	SBP foreign exchange operations, and intervention,(volume)	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	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 financing, SBP securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Fortnightly	Last working day of the fortnight
	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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
				following quarter
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions;	Quarterly	Within 45 days of the following quarter
	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	IFS format	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
	Consolidated general government	Federal and provincial governments	Annual	Within 180 days of the end of each year
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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	Tax arrears	By category	Quarterly	Within five days of each quarter
		By type of tax	Quarterly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
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 7 days of the end of each month
	VAT refund claims in arrears	For the 30 largest debtors	Quarterly	Within 30 days of the end of each quarter
	Automated VAT refunds	Detailed data, by type of tax, of outstanding tax credits for all types of tax revenues	Quarterly	Within 45 days of the end of each quarter
		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 45 days of the end of each quarter
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax payer units (LTUs)	Quarterly	Within 45 days after the end of each quarter
	Import data	1. Total value of recorded imports 2. Total value of duty-paid recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving nonduty free recorded imports	Quarterly	Within 30 days of the end of each quarter
	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	Quarterly	Within 30 days

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		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 FY10 to date Net Electrical Output (MkWh) Plant and Fuel-wise Detail Working Capital Loans For each loan type		
	Domestic expenditure arrears	Energy arrears	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	Quarterly on monthly frequency	Within 30 days from the end of the quarter
OGRA		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

Table 1. Exchange Rates of the SBP

(As of June 28, 2013 in U.S. dollars per currency)

Currency	Rupee per Currency	Dollars per Currency
EUR	130.18	1.31
JPY	1.01	0.01
CNY	16.24	0.16
GBP	151.80	1.52
AUD	92.11	0.92
CAD	95.04	0.95
THB	3.21	0.03
MYR	31.54	0.32
SGD	78.77	0.79
INR	1.68	0.02

Table 2. Projected Disbursements to Pakistan

(In millions of US dollars)

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Gross Inflows	588	1,746	2,898	5,759	1,413
Multilateral and bilateral disbursement	588	1,424	2,059	2,520	841
of which: in cash 2/	387	1,267	1,685	2,156	627
Bond issuance	0	0	0	500	0
Coalition Support Fund	0	322	439	439	322
Other 1/	0	0	400	2,300	250
Debt service	746	966	1,098	1,344	675
Memorandum items					
Gross International Reserves	4,691	3,634	5,434	9,897	11,022
Net International Reserves	-2,974	-4,058	-2,177	2,590	3,687
Proprosed Net International Reserves target		-4,130	-2,750	1,895	3,810

1/ includes privatization and 3G licenses.

2/ numbers need to be confirmed with the MoF.

Table 3. External Inflows to the General Government
(In millions of U.S. dollars)

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Non Tax revenue	0	322	839	1239	322
Coalition Support Fund	0	322	439	439	322
3G Licences	0	0	400	800	0
Grants	72	152	168	152	171
External interest payments	150	261	220	323	225
Net external debt financing	-93	479	892	1724	252
Disbursements	501	1170	1767	2720	696
of which budgetary support	0	0	500	1250	125
Amortization	594	691	875	996	444
Privatizations	0	0	0	1500	250
Memorandum item					
Program financing	72	152	668	2902	546

Table 4. Government Sector (Budgetary Support)
(End-of-period stocks/PRs. Millions)

Item	30-Jun-13	Prov. 30-Sep-13
A. Central Government	**5,561,908**	**5,855,004**
Scheduled Banks	**3,320,870**	**3,148,356**
a) Government Securities	1,117,115	1,086,692
b) Treasury Bills	2,611,512	2,423,644
c) Government Deposits	-407,757	-361,979
State Bank	**2,241,037**	**2,706,648**
a) Government Securities	3,111	3,127
b) Accrued Profit on MRTBs	44,888	71,281
c) Treasury Bills	2,275,184	3,024,883
of which: MTBs created for replenishment of cash balances	2,274,675	3,024,375
d) Treasury Currency	8,653	8,653
e) Debtor Balances (Excl. Zakat Fund)		
f) Government Deposits	-96,260	-406,759
(Excl. Zakat and Privatization Fund)		
g) Payment to HBL on a/c of HC&EB	-287	-287
h) Adjustment for use of Privatization Proceeds		
for Debt Retirement	5,749	5,749
B. Provincial Governments	**-315,607**	**-408,613**
Scheduled Banks	**-287,393**	**-294,026**
a) Advances to Punjab Government for Cooperatives	1,024	1,024
b) Government Deposits	-288,417	-295,050
State Bank	**-28,214**	**-114,587**
a) Debtor Balances (Excl. Zakat Fund)	13,715	1,449
b) Government Deposits (Excl.Zakat Fund)	-41,930	-116,036
C. Net Govt. Budgetary Borrowings		
from the Banking system	**5,246,300**	**5,446,392**
D. Through SBP	**2,212,823**	**2,592,062**
Through Scheduled Banks	**3,033,477**	**2,854,330**
Memorandum Items		
Accrued Profit on SBP holding of MRTBs	**44,888**	**71,281**
Scheduled banks ' deposits of Privitization Commission	**-5,433**	**-5,722**
Outstanding amount of MTBs (Primary market; discounted value)	**2,529,412**	**2,365,592**
Net Govt. Borrowings (Cash basis)		
From Banking System	**5,124,746**	**5,322,781**
From SBP	**2,167,935**	**2,520,780**
From Scheduled Banks	**2,956,811**	**2,802,000**

INTERNATIONAL MONETARY FUND

PAKISTAN

FIRST REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, REQUEST FOR WAIVER OF NONOBSERVANCE OF A PERFORMANCE CRITERION AND MODIFICATION OF PERFORMANCE CRITERIA—SUPPLEMENTARY INFORMATION

December 17, 2013

Approved By
Daniela Gressani and Mark Flanagan

Prepared By
Middle East and Central Asia Department

1. **This supplement provides an update on economic and policy developments since the issuance of the staff report on December 11, 2013**. The additional information does not change the thrust of the staff appraisal.

2. **Gross official reserves are at US$3.4 billion as of December 16, 2013 in line with Staff's projections**. SPB purchased an additional US$75 million on top of the US$200 reported in the staff report in the foreign exchange spot market as part of the continued efforts to build reserves. The exchange rate has rebounded slightly and is now down some 8 percent against the dollar since end-June.

3. **The Prime Minister recently announced a new investment incentive package**. The package provides immunity from audit for active taxpayers who pay 25 percent more than in the previous year, for registered taxpayers that have not filed returns who submit returns with payment for past five years, and for nonregistered tax payers who register then file and pay for past five years. It also provides immunity from tax scrutiny of the source of certain new investments on specific sectors.

4. **Headline inflation reached 10.9 percent y-o-y in November from 9.1 percent in October**. This is in line with staff projections and mainly reflects food price increases. Core inflation slipped from 9.4 to 9.3 percent.

Supplementary Appraisal

It will be important to ensure that the investment incentive initiative is in line with the program's strategy to improve tax compliance. While some details of the package are still being worked out, staff is concerned that the presently envisioned arrangements may undermine principles of self assessment and pose risks to the integrity of the tax system. Further work on this should await second review consultations, and discussion with international experts.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No.13/532
FOR IMMEDIATE RELEASE
December 19, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review Under the Extended Fund Facility Arrangement for Pakistan and Approves US$553.3 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Pakistan's economic performance under a three-year program supported by an arrangement under the Extended Fund Facility (EFF). The completion of the review enables an immediate disbursement of an amount equivalent to SDR 360 million (about US$553.3 million).

The 36-month EFF arrangement in the amount of SDR 4.393 billion (About US$6.75 billion, or 425 percent of Pakistan's quota at the IMF) was approved by the Executive Board on September 4, 2014 (See Press Release No. 13/322).

In completing the first review, the Executive Board also approved the authorities' request for a waiver of non-observance of the end-September 2013 performance criterion on net international reserves (NIR) based on corrective actions taken by the authorities.

Following the Executive Board's discussion on Pakistan, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, said:

"The authorities' performance under the Extended Fund Facility arrangement has been satisfactory. They have taken steps to address fiscal imbalances and structural issues in the energy sector. Nonetheless, overall vulnerabilities remain high, and it will be crucial to consolidate the fiscal adjustment, boost external buffers, and deepen structural reforms.

"A more ambitious approach is needed to improve tax administration and eliminate tax loopholes. The increase in electricity tariffs has reduced subsidies, but further efforts are needed to improve the energy sector's efficiency. It will be important to protect the most vulnerable population by avoiding slippages in targeted cash transfers.

"The low level of international reserves needs to be rebuilt. The central bank should use the policy tools at its disposal to boost reserves through policy rate adjustment, reserves purchases, and greater exchange rate flexibility. The central bank will also need to address inflation once reserves begin to recover, for which greater central bank independence is essential.

"Policies to safeguard financial sector stability should continue, including addressing banks with capital below minimum requirements and with high nonperforming loans and monitoring banks' holdings of government debt.

"The good start on structural reforms should be continued. It will be important to implement the authorities' privatization plans for public sector enterprises. Improving the business climate and moving to a simpler and more transparent import tariff regime will also yield significant benefits."

Statement by Jafar Mojarrad, Executive Director for Pakistan and Muhammad Sethi, Senior Advisor to Executive Director

Introduction

Our Pakistani authorities appreciate the thorough and constructive discussions held with the IMF mission for the first review under the three year Extended Fund Facility (EFF), and thank management and the Executive Board for their continued support.

Our authorities have delivered on program implementation for this first review of the Extended Arrangement, and remain firmly committed to achieve the program objectives as laid out in the Letter of Intent and the Memorandum of Economic and Financial Policies (MEFP). Growth in 2013/14 is better than expected fiscal performance has been strong, and advances have been made on the ambitious structural reform agenda. The authorities are fully aware of remaining challenges, including the need to bring down inflation and help ease balance of payments pressures, reduce impediments to growth and improve social conditions, and achieve debt sustainability. They intend to make steadfast progress in these areas as envisaged in their economic reform strategy.

All end-September 2013 performance criteria have been met, except the net international reserve target, as explained in the MEFP, for which the authorities are asking for a waiver taking into account the corrective actions that have been introduced. The indicative target on social transfers under the Benazir Income Support Program (BISP) was missed due to technical problems, which have been addressed. Most structural benchmarks have been met, including in the energy sector, business climate, and privatization of state enterprises. On this basis, our Pakistani authorities are requesting completion of the first review under the arrangement and a waiver for the nonobservance of the performance criterion on net international reserves accumulation and modification of performance criteria.

Recent economic developments and near term outlook

Pakistan's overall economic situation remains difficult in FY 2013/14, but early signs of improvement have emerged. Prospects of GDP growth have improved as against initial estimates due to better managed energy supply, which has positively impacted large scale manufacturing. Though modest, the projected growth of 2.8 percent in FY 2013/14 is expected to accelerate to 3.6 percent in the following year and continue to expand over the medium term. The downside risks to growth appear to be diminishing with first quarter growth rising to 5 percent. The recent successful award of GSP Plus status for exports by the European Union parliament would further provide impetus to exports as well as positive synergy to economic activity.

Fiscal performance has been strong, with better than expected outturn of tax and non-tax revenue and contained government spending, reflecting prudent execution of capital spending plans. As a result, the deficit target for end-September was met with a margin, and fiscal consolidation effort for FY 2013/14 as a whole is expected to reach 2 percentage points of GDP. The provinces are also contributing to the effort and are running fiscal surpluses, mainly through slower pace of spending.

As highlighted in the report and the MEFP, the balance of payments came under severe pressure, reflecting a significant deterioration in the capital and financial account and a moderate weakening of the current account position compared to program estimates. As a result, and despite efforts by the State Bank of Pakistan (SBP) to stabilize the situation, pressure on foreign exchange reserves intensified and the NIR target was missed. The evolving macroeconomic conditions in September 2013 led SBP to take action to contain inflation and ensure orderly developments in the external sector and the foreign exchange market. As the year-on-year CPI jumped to 10.9 percent in November 2013 from 5.9 percent in June 2013, SBP raised the policy rate by 100 bps in two rounds as likelihood of inflation running into double digits was high due to second round impact of high energy prices and the need to anchor inflation expectations. The policy rate increase and SBP interventions in the foreign exchange market acknowledged emerging risks to external sector emanating largely from falling private and official foreign inflows as well as the forthcoming large repayments to IMF, which were expected to fuel speculative sentiments in the foreign exchange market.

Fiscal policy

Fiscal consolidation remains a crucial objective of our authorities. As such, they firmly remain committed to the program objective of lowering the overall fiscal deficit to 3½ percent by the end of 2016/17 to put the debt-to-GDP ratio on a declining trend. A comprehensive strategy is being deployed to this effect, involving broadening the tax revenue base, reducing tax exemptions, reforming tax administration, phasing out electricity subsidies, and improving capital expenditure efficiency. A major initiative to broaden the tax net entails elimination of most tax exemptions granted through Statutory Regulatory Orders (SROs). While the authorities reaffirm their commitment not to issue any new tax exemptions or concessions through SROs, necessary orders to eliminate the first batch will be issued by end-June 2014. In addition, the Federal Board of Revenues (FBR) has strengthened tax collection and is on track on the issuance of notices to potential tax payers, which is part of a major initiative to incorporate 300 thousand new taxpayers into the tax net. Preparatory work is underway to enhance revenue administration for sales tax, excises, and customs, which will be completed by end-December 2013. These efforts are further being supplemented by increasing the percentage of tax audits from 2.2 percent of declarations to 4.2 percent. Finally in addition to the above, a major change to strengthen compliance of tax payers and combat tax fraud is the amendment of the 2010 Anti-Money Laundering Act (AMLA) to include tax crimes in the schedule of offences.

Key to fiscal adjustment on the expenditure side has been the phasing out of the electricity subsidy, starting with elimination of tariff differential subsidy for all consumers, except the most vulnerable. On an annualized basis, the net impact of this measure has been ¾ percent of GDP. Besides, apart from scaling down nonwage current expenditure of about 0.15 percent of GDP, some capital spending has been delayed until realization of additional revenues from Gas Infrastructure Development Cess (GIDC). Additional measures on the spending side will be carried out in the outer years, including further reductions in untargeted subsidies and streamlining of wages and salaries through civil service reform.

Pakistan moved towards fiscal decentralization after the 7th National Finance Commission (NFC) Award 2009 (revenue sharing arrangement between federal and provincial governments) and the 18th constitutional amendment adopted by the parliament in April 2010 that devolved all social sector functions to provinces and eliminated any duplication of functions at the federal level. Negotiations on the next NFC would begin in July 2014 and based on the recent experience, would provide an opportunity to review and further balance revenue generation with expenditure responsibilities if so needed.

Our authorities' are committed to further enhance their support to the poor and most vulnerable segments of the society through the Benazir Income Support Program (BISP). With the adoption of electronic means of transfer, initial technical difficulties occurred, resulting in delayed payments in the first quarter. However using the outreach and mobilization campaigns, the gap between the enrolled and paid beneficiaries will be significantly reduced in due course. Besides, as phasing out of non-targeted subsidies generate fiscal space, the coverage of the program will be expanded to 5.5 million families before end-June 2014. The authorities firmly believe that this is a fair mechanism to reduce the initial impact of adjustment on the vulnerable segments of society before structural reforms and prudent macroeconomic policies pursued under the program start paying dividends.

Monetary and exchange rate policies

As challenges on the balance of payments front persist in the near-term, our authorities reaffirm their commitment to take firm actions in rebuilding foreign exchange reserves and aligning monetary and exchange rate policies to this objective while maintaining price stability. Monetary policy was further tightened in November 2013 by increasing the policy rate as indicated above, which will help address the external sector weaknesses, and contain inflation. SBP is also firmly committed to take additional policy actions as and when needed to achieve its reserve target and maintain price stability. In doing so, the SBP will seek to balance the need of rebuilding its reserves with those of ensuring adequate liquidity and orderly conditions in the foreign exchange market. Therefore, while the exchange rate will continue to reflect market conditions, calibrated interventions will be aimed at mitigating the adverse effects of excessive volatility in the exchange rate.

Financial sector

The banking system remains sound, with high liquidity, capitalization, and the profitability intact. Steps are being taken to ensure compliance of all banks with the minimum capital adequacy ratio (MEFP 18), and the regulatory authority is taking cognizance of the rising NPLs and marginal deterioration of asset quality of the banking system. While provisioning for the system as a whole is high (70 percent), the authorities are exploring options to reduce NPLs, by speeding the recovery process, providing favorable tax treatment for write-offs, and supporting markets of distressed debt. Consultations on a deposit insurance scheme and new bankruptcy law are at an advanced stage and a draft Deposit Protection Fund (DPF) is expected to be submitted to Parliament by end-September 2014.

Safeguarding the financial sector stability remains an overarching goal, and the authorities are embarking on wide-ranging initiatives to strengthen the regulatory and supervisory framework to this effect as outlined in the MEFP, which includes amendment in SBP laws to strengthen operational independence.

Efforts are also underway to develop the government domestic debt market and SBP is in the process of developing the operational framework. Over time, the composition of domestic debt portfolio has been changing from high dominance of unfunded debt to increased dependence on short term floating debt with high roll over and refinancing risk. Moreover, efforts are underway to centralize the debt management function, which is currently fragmented across different agencies. Our authorities, in consultation with the Fund and the World Bank, have initiated technical work for developing a medium term debt strategy.

Structural reforms

Our authorities' ambitious structural reform agenda aims at sustaining robust growth that will generate employment and improve social conditions while maintaining macroeconomic stability. They have rightly focused on tackling the energy sector problems, further liberalizing the investment and trade regime, improving the business climate, and reforming and privatizing public sector enterprises. In this regard, the National Energy Policy spearheads the reform process, encompassing removal of price distortions, improving collection, phasing out costly subsidies, strengthening collection, and addressing governance and regulatory deficiencies as detailed in the MEFP (24–32).

With regard to public enterprises, a comprehensive road map for privatization of 31 PSEs has been prepared and approved by the Cabinet Committee on Privatization (CCOP). This involves restructuring, improving governance and regulatory deficiencies, removing price distortions and preparing the PSEs for capital market transactions as well as strategic partnerships. This, together with wide-ranging efforts to improve the business climate and further liberalize the trade regime, will help foster competition and attract domestic and private investment.

Conclusion

Our Pakistani authorities are off to a good start on implementing their economic reform program and the steps taken under this first review bode well for future performance. While risks and challenges remain, the authorities are committed to a successful outcome of their reform strategy and will continue to work closely with the Fund and with their development partners toward this objective. They look forward to the continued support from management and the Board.