INTERNATIONAL MONETARY FUND

IMF Country Report No. 14/90

PAKISTAN

March 2014

SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA; STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PAKISTAN

In the context of the second review under the Extended Arrangement and request for waivers of nonobservance of performance criteria, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 24, 2014, following discussions that ended on February 10, 2014, with the officials of Pakistan on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on March 7, 2014
- A **Staff Supplement** of March 18, 2014 updating information on recent developments.
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement by the Executive Director** for Pakistan.

The following documents have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Pakistan*
Memorandum of Economic and Financial Policies by the authorities of Pakistan*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PAKISTAN

March 7, 2014

SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA

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 and the first review was concluded on December 19, 2013, with a total of SDR 720 million disbursed. A third tranche of SDR 360 million will be available upon the completion of this review.

Status of the program: Program performance is mostly positive, with most performance criteria (PCs) met including those on the fiscal deficit and net international reserves (NIR). Two quantitative performance criteria for the second review were missed: (i) The ceiling on the net swap/forward position; and (ii) the ceiling on government borrowing from the State Bank of Pakistan (SBP). Since end-December 2013, SBP has continued to unwind the swap/forward positions and the government has reduced its borrowing from the SBP to reach program limits. The indicative target on social transfer payments was also missed for a second time due to further administrative difficulties which have since been addressed. The progress on fiscal and structural reform is mostly satisfactory. Of six structural benchmarks for this review, all have now been completed (albeit some with a delay). The SBP and government have taken actions since the last review to meet future NIR targets and to rebuild gross reserves.

Key issues: Discussions focused on progress in addressing the main macroeconomic challenges facing the country and remedial actions to meet missed performance criteria. Particular attention was given to: (i) challenges on the balance of payments and efforts 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 further structural reforms to unlock Pakistan's medium-term growth prospects, and (v) safeguarding the stability of the financial system. The mission marginally raised its growth forecast, but risks to the outlook remain tilted to the downside. Security concerns remain a critical risk factor. Delays in implementing key reforms—to address energy challenges, improve the business climate, broaden the tax base and improve tax administration—could also seriously damage prospects. There continue to be significant risks to the balance of payments. For security reasons, the mission was held offsite. However, a joint press conference was held, along with several bilateral interviews with the media.

Approved By
Daniela Gressani and Mark Flanagan

Discussions took place in Dubai during February 1–10, 2014. Staff representatives comprised J. Franks (head), F. Salman, A. Shahmoradi, B. Baltabaev (all MCD), E. Flores (FAD), A. Al-Hassan (MCM), S. Das (SPR), W. Amr (COM), and M. Dailami (Resident Representative). Mr. Sethi (Senior Advisor, OED) joined the meetings.

CONTENTS

TABLES

APPENDIX

INTRODUCTION

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 3.1 percent. The manufacturing sector continues to be stronger than last fiscal year due to partial easing of electricity shortages, while agriculture sector growth 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. Pressures are building on the government to weaken key aspects of its commitment to broaden the tax net and greater exchange rate flexibility.

2. **Program performance was mostly positive, but there were difficulties in some areas**. Two quantitative performance criteria for the second review were missed: (i) The ceiling on the net swap/forward position; and (ii) the ceiling on government borrowing from the SBP. The authorities have since undertaken corrective actions to address these shortfalls, and are now on track to meet the end-March targets. Since end-December 2013, SBP has continued to unwind the swap/forward positions and the government has reduced its borrowing from the SBP to reach program limits. The indicative target on social transfer payments was also missed for a second time due to additional administrative difficulties that have since been addressed. The fiscal deficit target was met, and the government is on track with efforts to broaden the tax net, and reform tax administration. The progress on fiscal and structural reform is satisfactory with successful completion of most structural benchmarks on time. All others have since been completed.

3. **The balance of payments situation remains difficult, but reserves are beginning to recover**. The SBP has stepped up efforts to acquire reserves through purchases in the foreign exchange market. These measures are being complemented by government initiatives to increase foreign exchange inflows through borrowing on global markets, decisive actions on 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 the next two quarters.

4. **Pakistan continues to face important security and political challenges.** Taliban-related violence has picked up in recent weeks in different parts of the country, complicating public administration in some areas. The PMLN-led national government retains a strong commitment to their economic reform program, but political resistance is strong, particularly to greater exchange rate flexibility and to some difficult structural reforms. The authorities also confront challenges in their administrative capacity in carrying out many complex reforms simultaneously.

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

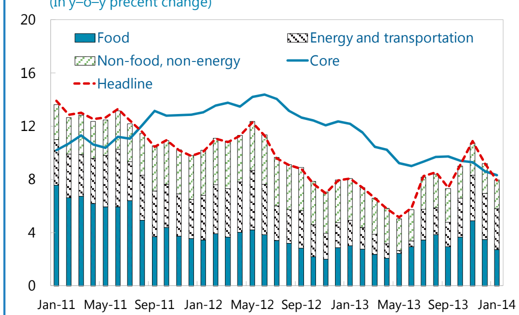
MACROECONOMIC DEVELOPMENTS AND OUTLOOK

A. Recent Economic Developments

5. **Economic developments have been slightly better than expected**. The preliminary data for the first quarter of FY13/14[2] recorded 5 percent growth, mainly driven by services and manufacturing. This growth is stronger than the 2.9 percent posted during the same period in the previous year. It appears to be supported by large scale manufacturing, with annual growth of almost 5.2 percent in the first five months of the fiscal year. Goods exports and imports in dollar terms increased by 3 and 1.4 percent respectively year-on-year in December. The current and financial accounts continued to be in deficit, driven primarily by the trade deficit and net official outflows. Growth in remittances has eased to 9 percent, while foreign direct investment has remained extremely weak.

6. **Headline inflation declined to 7.9 percent year-on-year in January from 9.2 percent in December**. Inflation eased due to the fall in perishable food prices, which had shown a temporary increase in November due to the delayed supply of new harvests to markets. Core inflation also decreased to 8.3 percent in January from 8.6 percent December.

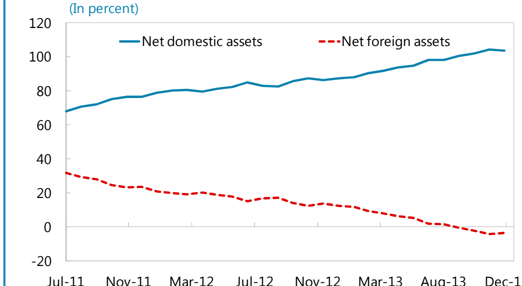
Contribution to CPI, January 2011–January 2014
(In y–o–y precent change)



Sources: Pakistani authorities; and IMF staff calculations.

7. **Gross official reserves declined below US$3.2 billion as of end-January 2014, but have since begun to recover to around US$4 billion**. Weak inflows and continued debt payments resulted in a US$1.5 billion decline in reserves relative to the end of the first quarter. The SBP continued its efforts to build reserves with net foreign exchange spot purchases of US$100 million during the second quarter of the year, and some US$300 million in January and February. The exchange rate rebounded somewhat and was down some 5 percent by end-February against the dollar since end-June.

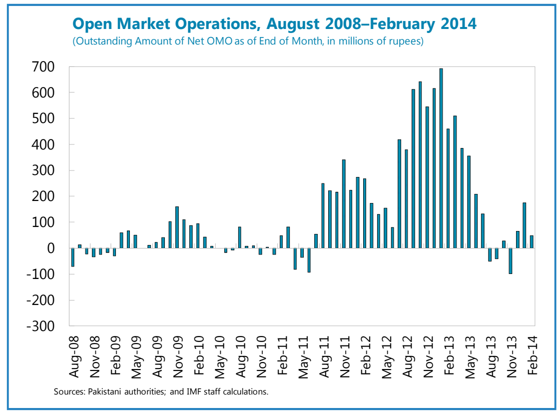
Pakistan: Components of the Reserve Money, July 2011–Dec. 2013
(In percent)



Sources: Pakistani authorities; and IMF staff calculations.

---

[2] The Pakistan Bureau of Statistics has recently started to produce preliminary quarterly GDP figures and will begin publishing historical quarterly GDP figures (dating back to 2005/06) once they finalize consultations with the IMF Technical Assistance. These numbers are still preliminary; however, the methodology will be refined in the future.



8. **Monetary aggregates grew in line with program targets during the second quarter of FY 2013/14**. Net Domestic Assets (NDA) of the SBP, increased by 36 percent y-o-y in December 2013, mainly driven by government borrowing from the SBP. In contrast, Net Foreign Assets (NFA) of the SBP declined by about 107 percent in the same period. Reserve money expanded by 12.1 percent, 2 percent lower than the previous quarter, while broad money growth eased to 13.7 percent in December 2013, 1.7 percent lower. Credit to the private sector in December grew by 5.6 percent year-on-year, which was slightly better than the program forecast and may signal improved economic activity. The Ministry of Finance was able to partially move away from SBP financing to the private sector financing to roll over public debt in this period. However, the end-December 2013 ceiling on government borrowing from the SBP was exceeded.

9. **The budget deficit target for the second quarter was met with a margin**. The government continues to keep tight control over expenditures. In particular, the execution of capital spending remained conservative, as the authorities had agreed until gas levy revenues come in. Revenues are broadly in line with expectations despite lower-than-envisaged outturn in certain categories (the petroleum and gas levies, and disbursements from the coalition support fund). Spending on subsidies and grants also remained subdued, including those for targeted cash transfers, where the indicative target was again missed.

10. **Since the approval of the IMF program and recent SBP policy rate hikes, the pressures on T-bill auctions have eased**. The Government has consequently been able to issue higher than targeted levels of T-bills in the market. However, due to interest and exchange rate uncertainties, the maturity profile worsened, with increasing concentration on the three months and some exposure to six months.[3] The average maturity of total domestic public debt is close to two years and 64 percent of the debt is due for redemption within the next 12 months, entailing high rollover and refinancing need.

11. **The banking system remains generally stable and profitable, but nonperforming loans (NPLs) continue to be high** (Table 6). As of end-December 2013, overall capital adequacy was around 15 percent and remained well above the statutory minimum capital requirement (CAR). Going forward, profitability may decline due to the rising NPL provisions (with rise in provisions due to supervisory measures that classifies loans in NPLs),[4] the floor imposed administratively on the rate

[3] Since August 2013 market conditions have not been conducive for government securities of longer than three to six month maturities.

[4] During June-December 2013, provisions increased by 1 percent.

of return on saving deposits,[5] and declining financial intermediation. Deposits have grown at slower pace (14 percent y-o-y) due to low real interest rates, better returns on equity and real estate, and increase in withholding tax on cash withdrawals. While NPL's remained at 13 percent, asset quality indicators improved slightly due largely to the payment of the power sector's circular debt.[6]

B. Macroeconomic Outlook and Risks

12. **Macroeconomic projections continue to forecast moderate growth, with inflation rebounding to around 10 percent before easing**. GDP is expected to expand by 3.1 percent during the current fiscal year as reforms in the energy sector take hold and the manufacturing sector performs better than expected initially. 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. Staff continues to expect inflation to end at around 10 percent in 2013/14 before easing to around 7 percent next year, as inflation expectations will be anchored by prudent monetary policy and stable macroeconomic policies. The current account deficit is expected to remain around 1 percent of GDP driven by trade deficit, with financial inflows gradually increasing as official loan disbursements increase and privatization receipts come in support of the authorities' adjustment program. There is no material change in the Debt Sustainability Analysis (DSA) since the last review.

13. **Risks to outlook are to the downside**. Key risks include:

- **Security conditions in Pakistan remain difficult**, with significant terrorist activity, as well as sectarian violence and urban criminal activity which could depress investment and growth.

- **Policy implementation risks could depress growth**. In particular, risks remain high on the reserve accumulation strategy as it depends on aggressive action by the SBP and on an ambitious profile on government debt and privatization inflows. Political resistance to exchange rate adjustment could also increase the risk of balance of payments problems due to both higher current account pressures and lower capital inflows. Rising political resistance or technical capabilities in the tax service could imperil decisive action on tax reform which is critical to ensure that next year's fiscal objectives can be reached; otherwise, public sector financing difficulties could occur.

- **External vulnerabilities remain high**. In particular: (i) reserves will remain low for another two quarters (even with stellar program implementation); (ii) the government's programmed Eurobond issuance could be hampered by heightened risk aversion towards emerging markets; (iii) vulnerability to oil price shocks has risen in recent years; (iv) the country is vulnerable to

[5] Since September 2013, the return on the saving deposits is linked to the floor of the interest rate corridor.

[6] A major part of NPLs are fully provisioned for, with net NPLs being only 3.1 percent.

inward remittance spillovers if economic conditions in GCC countries were to weaken or if expatriate workers were to reduce transfers out of concerns about conditions within Pakistan; and (v) a reversal in global economic recovery could impair exports.

- Although the financial sector is not in imminent danger, banks remain vulnerable to deterioration in the overall macroeconomic environment. There is a close negative relationship between the performance of economy and buildup of NPLs. Commercial banks' balance sheets are also highly exposed to government securities (representing 37 percent of banks' total assets) with shorter maturities, so a fiscal crisis—if it materialized—would have a large adverse impact on banks' balance sheets.[7]

POLICY DEVELOPMENTS

Discussions focused on remedial actions to meet missed performance criteria and progress in addressing the main macroeconomic challenges facing the country, with a particular focus on: (i) measures to address external vulnerabilities and boost reserves; (ii) enhancing tax revenues by broadening the tax net and improving tax administration; (iii) protecting the most vulnerable; (iv) implementing structural reforms; and (v) safeguarding the stability of the financial system.

A. Fiscal Policy

14. **With a smaller than programmed deficit for the first half of the FY2012/13, the government is on track to meet the FY 2013/14 deficit target of 5½ percent of GDP**. The revenue side is broadly in line with expectations, and revenue growth will pick up in the second half of the year with the Gas Infrastructure Development Cess (GIDC) now entering the government coffers. The increase in the GIDC coupled with higher than envisaged quantities, is expected to deliver around 0.36 percent of GDP (annualized) in additional revenue.[8] On the expenditure side, the programmed reduction in electricity subsidies and tight current spending should create room for a pick-up in capital spending in the second half of the fiscal year while still meeting program targets.

15. **The authorities have begun to prepare the policy actions needed to further reduce the deficit in the FY2014/15 budget**. One key component will be to broaden the tax base via a plan to eliminate many Statutory Regulatory Orders (SROs). The FBR has completed analysis of the fiscal cost of all SROs, and have started developing plans to either eliminate or incorporate them into legislation. For FY14/15, they have so far identified SROs for elimination are estimated to yield about 0.35 percent of GDP, but more is expected once they finalize consultations with the private sector. They expect to have a comprehensive plan by end-May 2014. Staff stressed that additional revenue

[7] Based on SBP's stress testing, a 300 bps increase in the interest rate will result in four banks (out of 36 banks) falling below CAR that are already below the CAR before the interest rate shock.

[8] The increase will not only strengthen tax revenues but will also lead to better utilization of gas.

from tax base broadening, including SRO elimination, would need to total at least 0.5–0.75 percent of GDP per year over the next two years in order to achieve the fiscal consolidation targets without increasing tax rates.

16. **There is mixed progress on tax administration**. The authorities have developed and are implementing their plans to strengthen tax administration for sales, customs and excises. They also continue with the implementation of their plan to broaden the income tax base and are on track to achieve the end-March 2014 target, and recently published a tax directory of current Parliamentarians—at the federal and provincial levels—with the objective of fostering a culture of tax compliance. However, they also issued an investment incentive scheme which staff views as a tax amnesty. The key developments include:

- **Broadening the income tax base**. With 67.8 thousand notices issued as of end-January to individuals identified as having significant economic activity but not paying income tax, the authorities are on track to meet their objective of 75 thousand notices by end-March 2014. They are moving forward with the delivery of the notices, and efforts seem to be bearing fruit. So far, about 6,500 individuals have filed their taxes as a result of the program.

- **Other tax administration efforts**. The authorities' plans to strengthen sales, customs and excise taxes include a series of initiatives including: (i) clean-up of the sales tax registration system, by elimination fictitious or inactive registered firms; (ii) expansion of the sales tax net through registering more informal firms ; (iii) the full implementation of a computerized risk-based evaluation system (CREST); (iv) the automated sales tax refund—on a FIFO basis; (v) a tax gap analysis for major sectors; (vi) electronic monitoring and tracking of goods, particularly cigarettes, to avoid tax fraud; (vii) the improvement of the customs clearance system (WeBOC)—including an independent audit; (viii) making the risk management unit operational; (ix) addressing customs under invoicing by developing valuation rulings for further commodity groups; (x) mitigating transit risks from transit trade to Afghanistan through an integrated transit trade management system; and (xi) strengthening the post clearance audit unit.

- **Tax incentive scheme** (Box 1). Staff has strong reservations regarding the Prime Minister's investment incentive package introduced in December 2013. This tax amnesty runs counter to efforts to strengthen tax administration. In contrast, the authorities believe that the package will provide incentives for new investment in key productive sectors, and will bring new taxpayers into the tax net. Nonetheless, they will refrain from granting new amnesties and are working to strengthen their anti-money laundering (AML) framework (¶20), which could help compensate.

Box 1. The Prime Minister's Investment Incentive Scheme

A tax amnesty package was passed in December 2013. Through the package, the authorities seek to encourage investment and widen the tax net with a package of measures that reduces tax scrutiny and provides an amnesty for some tax payers. Staff considers that, while the package might lead to some additional revenues on the short-run, it will likely hinder the system in the long-run. The four pillars of the package are:

- **New investment**. Immunity from tax scrutiny of the source of certain new investments on specific key productive sectors. The immunity will sunset at end-June 2016.
- **Tax filers**. Immunity from routine audit for current filers that pay 25 percent more income tax than the previous year. This pillar expired at end-January 2014.
- **Nonfilers**. Immunity from routine audit, penalties and interests for registered taxpayers that have not been filing tax returns provided that they file missing returns for the past five years. A minimum payment of PRs 20,000 per year (broadly in line with the average tax paid by non-salaried individuals) is required to receive the immunity. This pillar will expire at end-April 2014.
- **Nonregistered**. Immunity from routine audit, penalties and interests for non-registered taxpayers provided that they register and file missing returns for the past five years. A minimum payment of PRs 25,000 per year (about 25 percent higher than the average paid by nonsalaried individuals) is required to receive the immunity. This pillar will expire at end-April 2014.

Staff has reservations on the package. The package seeks to improve the investment climate through reducing tax scrutiny. The package opens another loophole in the system in addition to the ones that already exist for remittances and equity stock investment, and raises potential money laundering risks. The immunity from routine audit hinders the self-assessment process, and the amnesty—entailed by waiving penalties and interests—is likely to be detrimental to improving compliance and collections as taxpayers will develop an expectation of future immunities.

There are some factors that mitigate the negative impact of the package. The authorities consider this scheme as one-off, and will refrain from issuing another amnesty during the program period. The immunity from routine audit does not extend to cases were noncompliance is detected from other sources.

17. **Increasing targeted support for the poorest remains an important component of the program**. For this reason, the authorities have taken steps to address shortcoming on the implementation of targeted cash transfers. Due to administrative difficulties in renewing banks' contracts,[9] the end-December indicative target on the floor of cash transfers was missed, as payments did not reach all beneficiaries on time. However, this was later rectified and payments were reinstated. The authorities have also instituted a mechanism to release funds to the Benazir Income Support Program (BISP) by the middle of the quarter, which seeks to ensure that funds reach the beneficiaries without delays. The funds (PRs 18.75 billion) for the current quarter have already been released and BISP has already begun processing the payments. They will also reinforce BISP management and step up outreach to improve actual deliveries to beneficiaries.

18. **Progress on issues of fiscal federalism is needed**. The current revenue sharing arrangements are not conducive to fiscal consolidation and do not create incentives for provincial taxation. Under the Council of Common Interest (CCI), the provinces agreed to fiscal surpluses to support the consolidation efforts—and so far the outturn has been broadly in line with that envisaged under the program. Nevertheless, with adjustment concentrated on the revenue side on the second and third years of the program, progress in the negotiations towards a new NFC award will be key for the sustainability of the program, but may not be ready for the next budget. In this context, the authorities will need to identify a suitable mechanism to ensure that the savings materialize for the next fiscal year.

19. **The target on the stock of government's borrowing from the SBP was missed**. As the government was unable to attract other financing, it borrowed PRs 90 billion additional funds from the SBP in second quarter of FY2013/14 and missed the program target by PRs 50 billion. Authorities have already taken corrective actions and begun unwinding the stock to PRs 2,334 billion by end-February 2014 and are on track to meet the end-March 2014 target with the help of PRs 444 billion raised through Pakistan Investment Bond (PIB) auctions and US$750 million grant recently received from the Saudi Arabia. The Ministry of Finance has also begun to float government securities on the stock exchange rather than solely through banks, which should enlarge the market for domestic debt. They are also stepping-up efforts to attract external commercial financing. The ongoing efforts to move forward with the new medium-term debt strategy will help the government better plan its cash flow.

20. **The authorities have started preliminary work to include tax crimes in the Schedule of Offences of the 2010 Anti-Money Laundering Act (AMLA)**. Staff encouraged the authorities to mobilize the AML framework to enhance tax compliance and mitigate abuse of the tax amnesty scheme. In order to enable the use of AML tools to combat tax evasion, a list of serious tax offences is being identified. Enactment of amendments to tax laws and submission of the AMLA amendments to Parliament will be completed by end-September 2014 (new structural benchmark). Staff also

[9] The contracts for the banks that were authorized to deliver BISP payments expired in December, 2013. These contracts were later reestablished and payments to beneficiaries begun in the last days of the quarter.

encouraged the authorities' financial intelligence unit to issue guidance to financial institutions and the FRB to detect potential cases of abuse of the tax amnesty scheme to launder criminal proceeds by end-June 2014 (MEFP ¶24). On a related note, Pakistan's current listing by the international Financial Action Task Force (FATF) creates costs on financial intermediation because of heightened due diligence requirements by international financial institutions.

B. Monetary and Exchange Rate Policies

21. **SBP met its NDA and Net International Reserves (NIR) targets, but missed the target on the swaps/forward position**. The SBP met the end-December 2013 NIR target with a US$255 million margin as it continued its spot market foreign exchange purchases. Nevertheless, the SBP missed the end-December 2013 ceiling on the net short position in swap/forward contracts by US$395 million. The SBP continued to unwind its positions and remains on track to reach program targets by end of the quarter. The SBP also met the NDA ceiling target with the help of open market operations to sterilize the liquidity effects of foreign exchange market interventions.

22. **Given critically low reserves, the SBP and government should continue to focus on building reserves**. Staff encouraged the authorities to take advantage of the current favorable market conditions and continue purchasing foreign reserves in the spot market to build cushions and meet program NIR targets. The SBP has purchased US$300 million from the spot market by end-February and is on track to meet the end-March program target on NIR. As a corrective action the SBP has also reduced its net short position in foreign exchange swap/forward contracts to US$2,300 by end-February and is on track to meet the end-March program ceiling. The unwinding of swap/forward contracts has also helped to sterilize the domestic liquidity injected through SBP's foreign exchange purchases. A more flexible exchange rate will help SBP to reach their reserves objective and boost competitiveness. Staff stressed that the authorities should stand ready to take additional action, including increased foreign exchanges purchases and further tightening of monetary policy if there are delays in anticipated inflows (e.g., from privatizations). Further adjustment in the policy rate is also warranted to help better manage domestic liquidity (including sterilization of foreign exchange purchases) under the NDA target, attract capital inflows, and maintain price stability. The SBP agreed to continue market purchases of foreign exchange and to consider additional adjustments in the policy rate if needed to reach the inflation and reserves accumulation objectives.

23. **Staff discussed with the authorities on the potential use of gold in liquid reserves**. The SBP holds over 2 million troy ounces of monetary gold (about US$2.7 billion at market rates), which are not counted in gross international reserves as they are not deemed to be liquid by the SBP. Staff and the authorities discussed what steps would be needed to make gold more liquid. However, the authorities stressed that they have no plans to sell gold and preferred existing arrangements for gold holdings for national security reasons.

24. **Staff stressed that a tight monetary stance remains important to help accumulate reserves and to contain inflationary pressures**. Encouraged by the recent decline in inflation, the authorities temporarily paused policy rate hikes. Staff mentioned that the recent decline in inflation

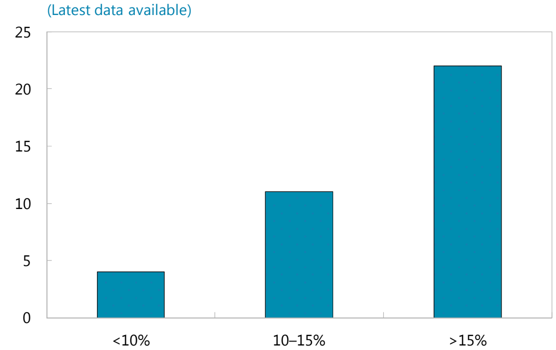
could be temporary due to the fall in food prices and stressed that monetary policy should be guided by a forward looking strategy of anchoring expectations. Staff argued that further tightening of monetary policy—in addition to helping contain inflationary pressures—should help SBP in its goal of building reserves, preventing dollarization, and reducing capital flight. The authorities agreed that the SBP should be vigilant for any signs or inflationary pressures while gauging monetary policy to help attract capital inflows to build reserves.

25. **Staff reiterated that enhanced central bank independence will improve monetary policymaking**. Draft amendments to the SBP law prepared by the central bank are under review by staff. Due to recent resignation of the SBP governor and delays in preparing the draft amendments, the authorities are now expected to submit the amendments to the Parliament by end-March 2014 for enactment by end-June 2014 (structural benchmark). The law will strengthen the autonomy of the SBP, through (i) full operational independence in the pursuit of price stability as the SBP's primary objective; and (ii) an enhanced governance structure, including strong internal controls. In line with findings of the recent safeguard assessment mission, the amendments will also empower the SBP as the sole owner and manager of foreign exchange reserves, establish an Executive Board with defined executive powers, remove government representatives from the Central Bank Board, and eliminate provisions that give government the authority to direct certain SBP activities. Moreover, the amendments will strengthen the personal autonomy of Board members and the financial autonomy of the SBP. The SBP will establish a Board committee to centralize and oversee risk management activities across the bank by end-June 2014. Lastly, the SBP is moving forward with approving a plan to fully implement International Financial Reporting Standards (IFRS) as its financial reporting framework by end-June 2014.

C. Financial Sector Policies

26. **The SBP has prepared a time-bound action plan to address minimum capital adequacy issues with a few problem banks** (MEFP ¶21). There are four banks (one state-owned and three private) operating below the statuary minimum Capital Adequacy Requirement (CAR) (10 percent), comprising 6.4 percent of banking assets (less than 0.06 percent of GDP).[10] Based on their size, these banks are not likely to pose systemic risks to the banking system, but the SBP has supervisory vigilance on these banks and is actively engaged with them to complete capitalization by December 2014. The SBP's plan identifies the capital shortfall, remedial actions, timeline, and contingency measures:

Distribution of Banks by Capital Adequacy Ratio
(Latest data available)



Sources: Pakistani authorities; and IMF staff calculations.

[10] The state-owned bank, representing around 3.6 percent of banking assets, is only 0.6 percentage points below the statutory CAR.

- ***State-owned bank***. The provincial government which is the main owner has already injected PRs 17 billion in recent years, raising the bank's CAR to around 9.4 percent and expected to reach 10 percent by end-December 2014 through profit retention;

- ***Private banks***. To meet the capital shortfalls, the banks submitted their capital plans to meet the statutory minimum CAR by end-December 2014, mainly through issuing noncumulative perpetual preferred stock and subordinated debt.

Staff urged the authorities to continuously monitor the implementation of the action plan to avoid any forbearance that may pose a financial risk to the financial system and undermine the credibility of the SBP as a regulator. Also, assessing and enhancing the bank resolution framework should be a priority.

27. **The authorities have advanced consultation on wide-ranging reforms to enhance the resilience of the financial system (MEFP ¶22 and ¶23)**. Safeguarding the financial sector stability remains an overarching goal, in particular:

- ***Deposit insurance scheme***. The proposed draft legislation for the Deposit Protection Fund (DPF) has been revised and will be finalized in consultation with the IMF, especially on modalities and operations of the DPF (e.g., institutional arrangements, funding, coverage), in the context of a technical assistance on contingency planning framework.

- ***Bankruptcy law***. The Securities and Exchange Commission of Pakistan (SECP) held two roundtables in November and December 2013 to elicit stakeholders' views (SBP, Pakistan Banks Association, business groups, and legal experts) on the draft Corporate Rehabilitation Act (CRA). Participants raised concerns on the appropriate balance between creditors and debtors, and long litigation and resolution process. The SECP will revisit the CRA and consider some "quick fixes" in other legislation in order to resolve outstanding bankruptcy cases in the short term.

- ***Consolidated supervision***. A joint task force on consolidated supervision, comprising representatives of SBP and SECP, met in November 2013 to identify top financial conglomerates, address information gaps, and assess financial performance. Staff stressed the need to hold meetings periodically to discuss regulatory concerns pertaining to consolidated supervision.

28. **Staff urged the authorities to take further measures to address high levels of nonperforming loans (NPLs)**. The authorities are considering a set of proposals to address high NPLs, including, (i) filling vacancies in the Banking Court; (ii) training judges on financial matters; and (iii) re-empowering financial institutions to sell mortgaged property of defaulted borrowers without court interventions. As the bulk of NPLs (over 80 percent) are classified as "losses," the SBP should encourage banks to remove fully provisioned NPLs from banks' balance sheet. Moreover, banks remain constrained in recognizing write-offs as deductible expenses (through provisions) for tax purposes. Staff recommended that any enhancement in tax admissibility of provisioning will help write-offs.

29. **Staff welcomed the authorities' efforts to develop Islamic banking**. Since 2001, Islamic banks were allowed to operate in parallel with the conventional banking institutions. As of December 2013, there are five full-fledged Islamic banks and 14 conventional banks with Islamic banking branches, constituting around 12 percent of the overall banking system's assets. The SBP has taken several initiatives to develop the Islamic banking industry, including, (i) developing the regulatory framework; (ii) introducing a comprehensive Shariah compliance framework; (iii) issuing risk management guidelines; and (iv) undertaking media campaign for awareness about Islamic finance. Challenges remain in developing a liquidity management framework and addressing capacity building constraints.

30. **Staff stressed the importance of implementing the recommendations of the recent Technical Assistance mission on public debt management (Box 2)**. With continued macroeconomic uncertainty, investor's appetite leaned towards shorter maturity T-bills. Refinancing and interest rate risks pose major challenges as the government will be required to rollover around PRs 6 trillion of government securities in 2014, representing 64 percent of the domestic debt portfolio with an average time to maturity of only 1.8 years. The risks are compounded with the National Savings Scheme's (NSS) provision of early redemption rights to investors. Therefore, strengthening debt management has been recognized as a priority by the authorities, given the large debt portfolio and the wide array of funding sources managed by different entities. Diversifying funding sources is also important. The authorities intend to tap international bond markets over the coming months. The maturity, yield, and repayment profile will be calibrated to match investors' appetite.

31. **Staff is encouraged by the efforts to develop the government debt market**. In February 2014, the authorities commenced trading of government debt securities (treasury bills, bonds, and Sukuk) on the stock exchanges to manage liquidity and broadening the investor base. While the market is being developed, challenges remain in aligning the policies on the NSS (as those instruments offer the investors the option to redeem investments before maturity) with marketable instruments to minimize pricing risks and diversify investor base for fixed-income securities to ensure high liquidity and stable demand in the market.

D. Structural Issues

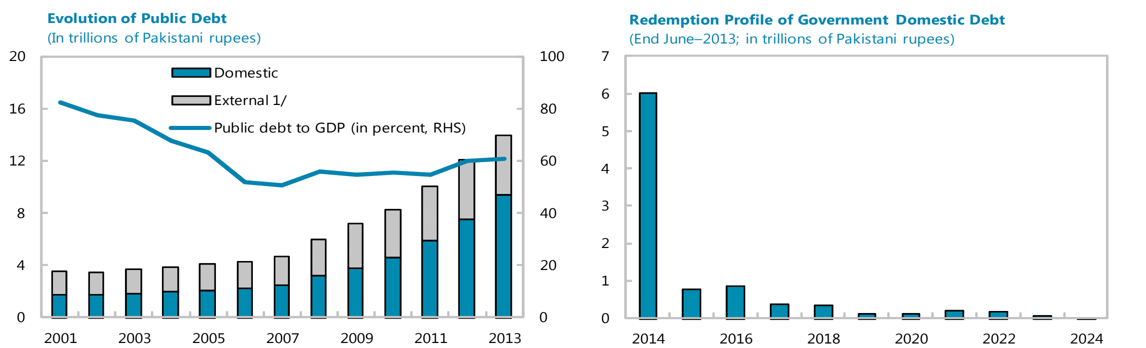
Energy Sector

32. **Energy price adjustments** (MEFP ¶27). The authorities are on track to deliver the agreed ¾ percent of GDP annualized reduction in subsidies and continue to be within the medium-term target for subsidy rationalization. As agreed to reduce accumulation of new energy sector losses, the authorities reflected the costs of servicing the syndicated term credit finance facility in the notified base tariff for FY 2013/14. However, the regulatory authority NEPRA declined the proposal and did not include the facility in the tariff determination for FY2013/14. As a result, servicing these facilities continues to add to circular debt, although it does not affect the budgeted subsidy cost. To address this, the government is planning to incorporate this in the review petition as an eligible capital expenditure.

Box 2. Pakistan: Medium-Term Debt Strategy (MTDS)

Since 2003, the composition of domestic debt has changed significantly, with more reliance on short-term floating debt and nonmarketable debt. Domestic debt is over 60 percent of the total. External debt is mainly owed to the multilateral institutions and the Paris club. The slowdown in inflows from multilateral and bilateral sources, and increasing fiscal deficits, resulted in negative net external outflows, producing further reliance on the domestic market. Refinancing and interest rate risks are important, as the government will have to rollover around PRs 6 trillion (US$60 billion) of government securities in 2014, representing 64 percent of the domestic debt profile with an average time to maturity of only 1.8 years.

To address the risks of the current portfolio under prospective macro and market conditions, several funding strategies are under consideration. These include: (i) lengthening maturities by increasing the share of longer T-bills and then gradually rebuilding the stock of 3-year Sukuk, 5, and 10-year bonds; (ii) alleviating the pressures on the domestic market with FX financing from multilateral and bilateral sources and to some extent in the international capital markets; and (iii) aligning the policies of the Central Directorate of National Savings (CDNS) with marketable instruments to make the two segments complementary and lower overall funding costs.



1/ IMF BoP portion is deducted.
Sources: Pakistan Debt Policy Coordination Office; and IMF staff calculations.

Fragmented institutional arrangements and staff capacity limitations hinder successful debt management. In addition to the Debt Policy Coordination Office (DPCO), there is a multiplicity of other debt managers in Pakistan: the Ministry of Finance Budget wing supported by SBP for borrowing in the domestic debt market, the CDNS for borrowing in the domestic retail market, the Ministry's Economic Affairs Division for borrowing foreign currency from multilateral and bilateral donors, and the its External Finance wing for borrowing in the international capital markets. There also are three different debt recording systems for different sub-portfolios.

A reformed DPCO with a mandate and appropriate staffing as the central debt manager with other players acting as its 'agents' would be crucial. The DPCO will then become the strategic center with responsibility and authority to develop a debt management strategy and will be able to decide on the terms and conditions for most borrowings, especially those taken at market terms. While the Fiscal Responsibility and Debt Limitation Act (FRDLA) establishes principles of sound fiscal management, the legislation needs to explicitly specify the debt management objectives and strategic guidance of future funding.

33. **Arrears** (MEFP ¶27). The government hired a reputable audit firm to conduct technical and financial audits of electricity companies to identify the stock and flow of payables at all levels of the electricity sector. The audit will be completed by end-April 2014. The audit report will help to design a roadmap to prevent the accumulation and recurrence of payables (circular debt).

34. **Monitoring and Enforcement** (MEFP ¶28). Progress has been made on several fronts:

- To improve enforcement capabilities on electricity bills, authorities have drafted the amendments to relevant legislation and enacted them by ordinance (as per the structural benchmark). The authorities have already submitted the amendments to Parliament for ratification.
- The authorities are signing performance contracts with electricity distribution companies (DISCOs), aimed at tackling losses, raising payment compliance, and improving energy efficiency and service delivery.
- All state-owned DISCOs are now implementing revenue-based load shedding (structural benchmark) to concentrate energy supply where payment rates are highest.
- Before end-January 2014, web-based reporting was introduced allowing monitoring of electricity draws to reduce overdraws (thus reducing unplanned outages).
- To minimize losses in fuel delivery, a Memorandum of Understanding (MoU) between Muzaffargah Power Generation Company and Pakistan State Oil (PSO) was signed to lease the fuel storage and delivery facilities to PSO. The implementation of the MoU will begin by end-April 2014.

35. **Governance, Regulatory, and Transparency Improvements** (MEFP ¶31). The authorities partially complied with the structural benchmark on the Central Power Purchasing Agency (CPPA). The CPPA was separated from the National Transmission and Despatch Company. To make CPPA operational, the authorities issued the standard operating procedures for payments and settlements and advertised the hiring of key staff (CEO, CFO and corporate secretary) in February 2014. The key staff will be in place by end-April 2014. Enhancing the technical and administrative capacity of the regulatory body, the National Electric Power Regulatory Authority (NEPRA) is instrumental to improve governance in the power sector. NEPRA hired entry and middle management positions to enhance its technical capacity. In order to address the administrative constraints on NEPRA, authorities will conduct a diagnostic study of the regulatory framework of the power sector and prepare an interim report by end-April 2014 (new structural benchmark). The report will be geared to identify the means to effectively and efficiently address critical regulatory issues that inhibit performance and restrain full transparency.

36. **Oil and Gas Sector** (MEFP ¶33). The current level of gas supply is barely one half of unconstrained demand due to low consumer and producer prices and to insufficient investment. To help tackle the gas shortages, the authorities are finalizing the evaluation and awarding of an import

contract for Liquefied Natural Gas (LNG). As part of the gas rationalization plan, they: (i) have begun implementing the 2012 Petroleum Exploration and Production Policy to offer higher gas prices to producers for enhanced production from existing and new fields; (ii) have increased weighted average consumer gas prices by around 10 percent through the gas levy; (iii) will fully reflect the cost of imported gas as it begins; and (iv) are evaluating the process of unbundling downstream gas business with the objective of bringing efficiencies to the transmission and distribution segments. Gas price rationalization will encourage new investment, promote efficiency in gas use, and assure that there will continue to be no fiscal cost from the gas sector.

37. **Demand and supply side management** (MEFP ¶29). Energy conservation and new supply addition are also required to close the excess demand for energy. The authorities have begun the consultative process with the stakeholders on the draft Pakistan Energy Efficiency and Conservation Act. They are on track to place the revised draft before the Council of Common Interest (CCI) for approval by end-March 2014.

Public Sector Enterprises

38. **The authorities are acting decisively on their commitments to reforming or privatizing public sector enterprises** (MEFP ¶37). Privatization will catalyze private investment and improve efficiency in key companies. The proceeds are also important contributors to reserve accumulation and budget financing. The Privatization Board has been recently reconstituted with a two month delay relative to the original plans that postponed the advertisement for the hiring of the transaction advisors, which may cause a delay in the hiring of the first six transactions advisers (end-March structural benchmark). The authorities are still committed to their original timeline for capital market transactions, but a delay in hiring advisers would leave them with a high risk that the first transactions would slip beyond end-June, which could require compensatory measures to reach the reserves accumulation target. The TMU definition of the structural benchmark is slightly revised to include the hiring of a transaction advisor for the Pakistan International Airlines (PIA)—the owner of certain hotels slated for privatization. The transaction advisor will work on reforming and privatizing PIA and its assets. The authorities will also hire a financial advisor for Pakistan Steel Mills to work on a restructuring plan. In addition, they are also developing a comprehensive restructuring plan for Pakistan Railways, which will include improvements in business processes and in the institutional framework, financial stability, and service delivery.

Business Climate and Trade policy

39. **Authorities are advancing in the design of the plan to simplify the import tariff structure** (MEFP ¶36). The design will be completed by end-May 2014 and phasing-out trade SROs will begin by the end of the fiscal year. The aim of the plan is to move to a system with 4 slabs and 0 to 25 percent rates. The EU has extended GSP plus benefits (0 percent duty) from January 1, 2014 on Pakistan’s exports. Authorities continue to commit to promoting trade with regional countries, especially under various regional trade arrangements.

40. **Staff encouraged the authorities to advance swiftly with business climate reforms** (MEFP ¶35). The authorities are moving forward with a time-bound implementation plan to simplify procedures and costs for setting up businesses and paying taxes in Pakistan. The plan will be completed by end-March 2014 after consultation with key stakeholders. Staff noted that efforts to phase out SROs and reform the import tariff structure would also significantly improve the business climate by establishing a level playing field for investors.

PROGRAM MODALITIES AND OTHER ISSUES

41. **The attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) describe the authorities' progress in implementing their economic program and set out their commitments through end-June 2014 (including the establishment of end-June 2014 PCs)**. Some modifications to the program's conditionality are proposed (Table 1–2):

- *Waivers for the nonobservance of the end-December 2013 performance criteria on swap/forward contracts and government borrowing from the SBP are requested.* To address the missed ceiling on swap/forwards, the SBP has continued to unwind its net position to below US$2425 million and is now on track to meet the end-March program target. The government has curtailed government borrowing from the SBP to PRs 2,334 and will continue to reduce it to achieve the end-March 2014 program target. The government will take additional steps to reduce its dependence on financing from the SBP, including floating government T-bills in the stock exchange, stepping-up efforts to attract external commercial financing, and, if need be, accommodating higher yields on T-bills.

- *Two new structural benchmarks are proposed* (Table 2). The new structural benchmarks are: (i) Conduct a diagnostic study of the regulatory framework of the power sector and prepare an interim report (end-April 2014); (ii) Enact amendments to the relevant tax laws, as appropriate, and submit amendments to AMLA to Parliament, to include tax crimes in the Schedule of offences (end-September 2014); These measures are essential to improve the regulatory framework of the power sector and help fight money laundering and improve tax compliance. The structural benchmark on the enactment of legislation to enhance central bank independence is being shifted from end-March to end-June 2014.

- *The date on the structural benchmark on the enactment of the amendments to the SBP law is postponed from end-March 2014 to end-June 2014.* Due to resignation of the SBP governor and delays in preparing the draft amendments the completion date for this structural benchmark is postponed.

- *The TMU definition of structural benchmark on hiring six transaction advisors is modified.* Authorities are now planning to hire a transaction advisor for the Pakistan International Airlines (PIA) rather than transaction advisors for the PIA hotels. The transaction advisor will work on a comprehensive reform plan for PIA and its subsidiaries (including the hotels).

42. **Financing, program risks and capacity to repay the Fund**. Pakistan's program financing needs are fully covered for the next 12-months and Pakistan will have the capacity to repay the Fund. While some disbursements from multilateral and bilateral partners are materializing later in the year than originally expected, and some privatization proceeds may be delayed, financing assurances remain in place for the next 12-months, as delays are generally short and the adjustment of NIR targets in the last review already incorporated a more gradual multilateral and bilateral disbursement schedule. Still, the reserves situation will remain very tight, and as a result, program risks will remain high over at least the coming two quarters. At end-December 2013, the Fund's exposure to Pakistan stood at roughly US$3.5 billion (102 percent of gross official reserves). As a large component of repayments of previous facilities was concentrated in November and December of 2013 (about US$1,026 million), repayments to the IMF will ease and net disbursements turn positive during the 2014 calendar year. Materialization of risks to the macroeconomic outlook would also erode Pakistan's capacity to repay the Fund (¶13).

43. **Data Issues**. Authorities recently began publishing quarterly national accounts. Pakistan Bureau of Statistics also plans to publish historical quarterly GDP figures dating back to 2005/06 once the consultations with the IMF's technical assistance are completed.

STAFF APPRAISAL

44. **While there is room for improvement in some areas, overall the authorities have made commendable progress in stabilizing the economy and launching important structural reforms**. Core program targets on fiscal consolidation and international reserves have been met, and the authorities have undertaken corrective action to address missed performance criteria. Progress is being made on the structural reform agenda, but determination and perseverance will be required in the face of political and administrative constraints before lasting results can boost economic growth and stability.

45. **Economic conditions remain challenging, but there are signs of improvement**. The growth forecast has been revised slightly upward, reflecting some easing in energy bottlenecks. Inflation will remain at or near double digits for the remainder of FY 2013/14, as the impacts of administered price changes and previously accommodative monetary policy work their way through the system. The balance of payments situation remains difficult, but reserves have now begun to recover and capital inflows are expected to increase in the coming months.

46. **Risks remain high and are tilted to the downside**. The government has taken difficult measures to address macroeconomic imbalances and initiate structural reforms, but overall vulnerabilities remain, particularly in the external sector. External shocks, such as oil and food price volatility, interruption in remittance inflows, or delays in realization of official and private inflows could put further pressures on the balance of payments. The difficult security situation constitutes the principal domestic downside risk. Risks to policy implementation could also dim the outlook.

47. **Fiscal consolidation efforts are on track**. The authorities have implemented measures to ensure reaching a headline deficit of 5.8 percent of GDP in FY 2013/14. The gas levy is now in place and will create space for increased investment spending later in the year. On the expenditure side, the increase in electricity tariffs has helped reduce subsidies. Future slippages on targeted cash transfers should be avoided to protect the most vulnerable segments of the population. Provinces continue to run surpluses, which will contribute to the fiscal adjustment effort.

48. **While reforms have begun, efforts to broadening the revenue base and improve tax administration should be stepped up**. Staff welcomes the authorities' current SRO plan, but a more ambitious approach to improving tax administration and eliminating tax loopholes will be needed to sustain fiscal consolidation in future years. In this context, staff welcomes the authorities' release of a tax registry of parliamentarians, which demonstrates willingness to "name and shame" prominent people. However, the investment incentive package introduced in December 2013 runs counter to the efforts to strengthen tax administration. Similar future schemes should be avoided, and the authorities should mobilize the anti-money laundering (AML) framework to mitigate abuse of the tax amnesty scheme and to more generally help improve compliance. In the longer term, tax policy and tax administration reforms will not only improve the fiscal stance—they will improve equity and thus enhance legitimacy; they will create fiscal space for higher social spending and more infrastructure investment; and they will encourage more private investment by improving the business climate. Moreover, more determined enforcement actions against other nonpayers may also help maintain popular support for tax reforms, as there is strong sentiment in favor of bringing those who don't pay into the system.

49. **The SBP must continue its efforts to boost critically low foreign reserves**. Over the past three months, the SBP has moved more aggressively to purchase foreign exchange reserves in the spot market, and reserves have begun to recover. However, they remain very low and the central bank should take every opportunity to accelerate reserves accumulation further. In these efforts, greater exchange rate flexibility and a higher policy rate should play a role. The government's promised steps to attract additional foreign exchange through privatizations, increasing foreign currency borrowing (while decreasing rupee borrowing), and accelerating disbursements from international partners are critical to the SBP's efforts. In this respect, recent inflows from Saudi Arabia are a welcome contribution.

50. **The SBP should increasingly focus on containing inflationary pressures**. The authorities should be vigilant as persistent inflationary pressures call for active and calibrated monetary policy. The authorities should also make every effort to reduce the stock of government borrowing from the SBP in line with program targets. This will help ease inflationary pressures, 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. In this respect, it is critical that the government introduce into parliament the agreed amendments to the central bank legislation and press for their early approval.

51. **Addressing financial sector risks and deepening the government debt market are critical**. The authorities need to safeguard the stability of the financial sector by ensuring compliance of all banks that fall below minimum CAR and addressing the high level of NPLs. Staff supports the authorities' efforts to develop the government debt market and formulate a medium-term debt strategy.

52. **The government is advancing on its structural reform agenda**. The authorities' continued progress on their energy policy is welcome; however, they should now begin addressing the administrative constraints on the power sector's regulatory framework and work on improvements in the operations and collections of energy companies. The implementation of gas price rationalization should continue beyond the gas levy, as this will better allocate the current supply and encourage new production. Despite some delays, the commitment to privatization of public sector enterprises (PSEs) remains strong; however the authorities may continue to encounter difficulties due to limited technical and administrative capacity and low market appetite. Plans for trade policy and business climate reforms are being developed, but firmer action is needed to move forward.

53. **Keeping the program on track in future reviews will require strong political commitment at the highest levels, together with steadfast implementation by government and SBP staff**. The authorities need to step up outreach efforts to explain the benefits of the difficult fiscal, monetary, and structural measures contained in the program to political and business leaders, as well as to the general public. They should also seek technical assistance as needed from the international community to help complete complex reforms. While many of these measures may entail short-term political costs, they will bring lasting benefits to the country in higher and more stable economic growth.

54. **On the basis of Pakistan's performance under the extended arrangement, staff supports the authorities' request for completion of the second review under the arrangement and for waivers for the nonobservance of the end-December 2013 performance criteria (PC) on swap/forward contracts and government borrowing from the SBP**. Staff also recommends the establishment of the end-June 2014 PCs as proposed in the attached MEFP, and the revised definitions of the structural benchmark 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, and SDR 360 million was made available after the completion of first review. SDR 360 million will be made available subject to the completion of this review. The subsequent disbursements, totaling SDR 3,313 million, are contingent upon completion of subsequent 10 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 finish launching 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 involve a levy to generate 0.4 percent of GDP fiscal savings.

➢ 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.

➢ 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.

➢ Develop and approve PSE reform strategy for thirty firms among the 65 PSEs approved for privatization by the Council of Common Interest (CCI).

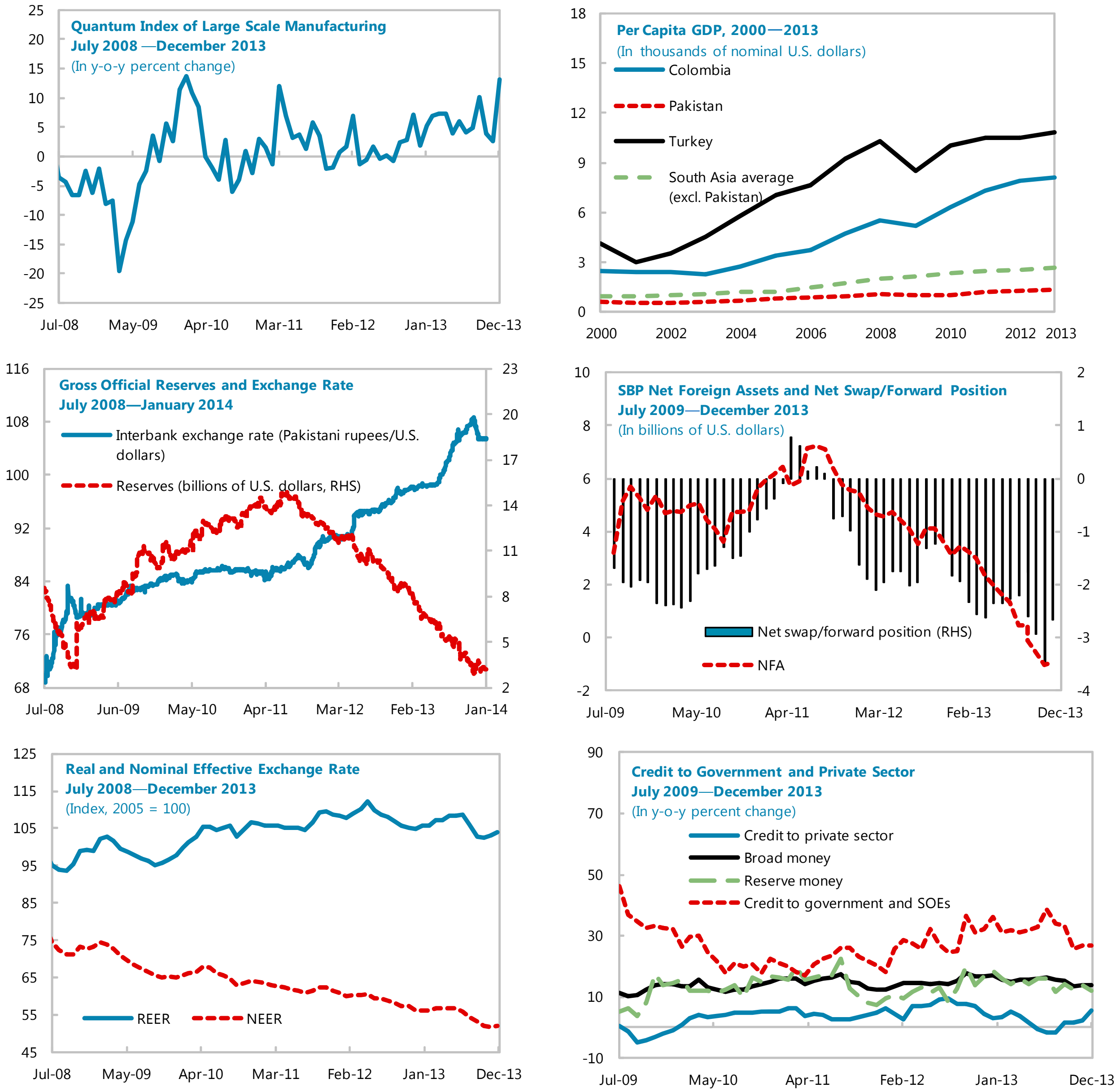
Box 3. The Extended Arrangement (Concluded)

- 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).
- Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), advertise key staff positions, 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.
- Initiate revenue based load shedding in six remaining electricity distribution companies.
- 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.
- Privatize 26 percent of PIA's shares to strategic investors.

New Structural Benchmarks

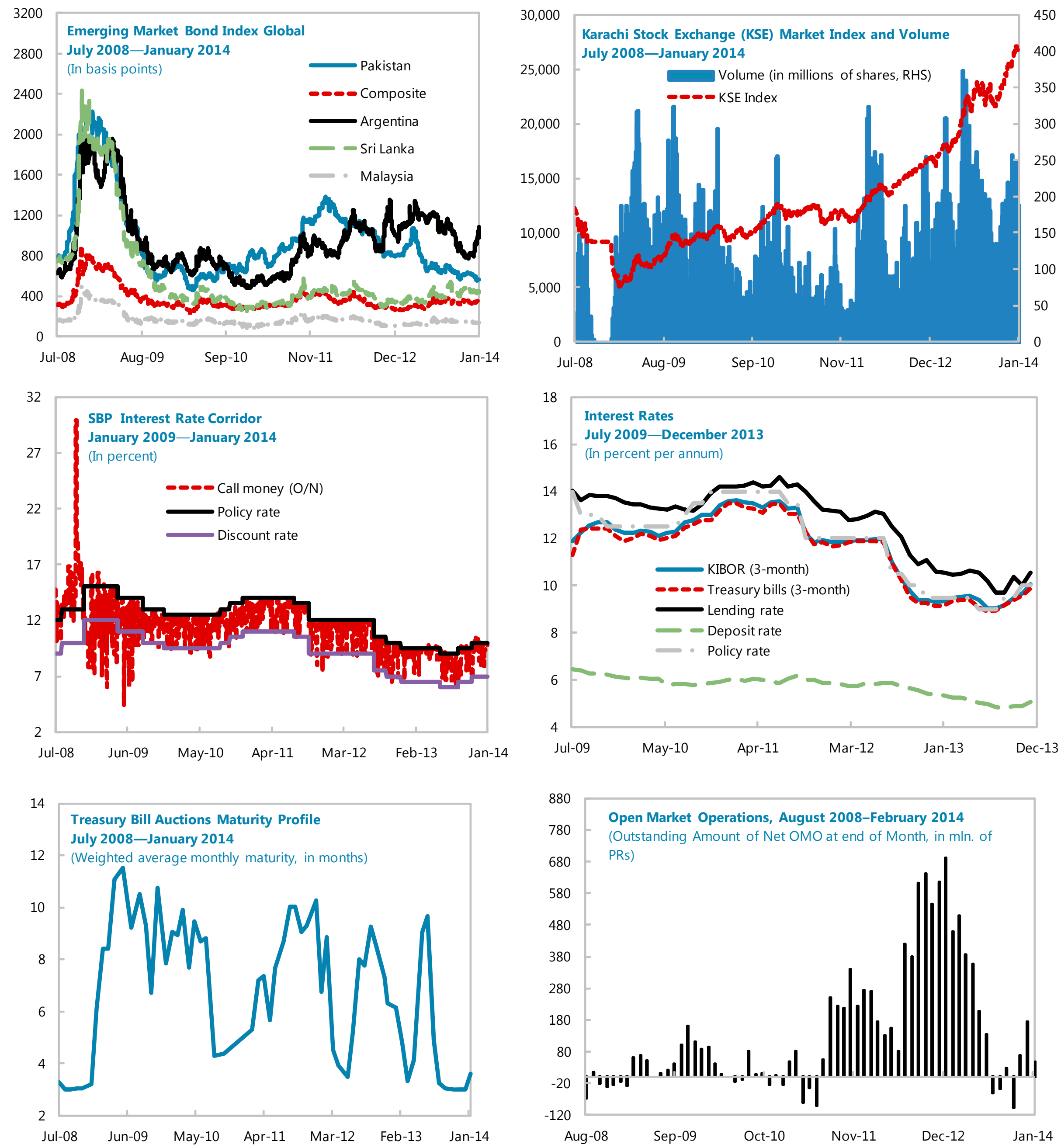
- Enact amendments to the relevant tax laws (as defined in the TMU) and submit amendments to the Anti-Money Laundering Act (AMLA) to Parliament
- Conduct a diagnostic study of the regulatory framework of the power sector and prepare an interim report.

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



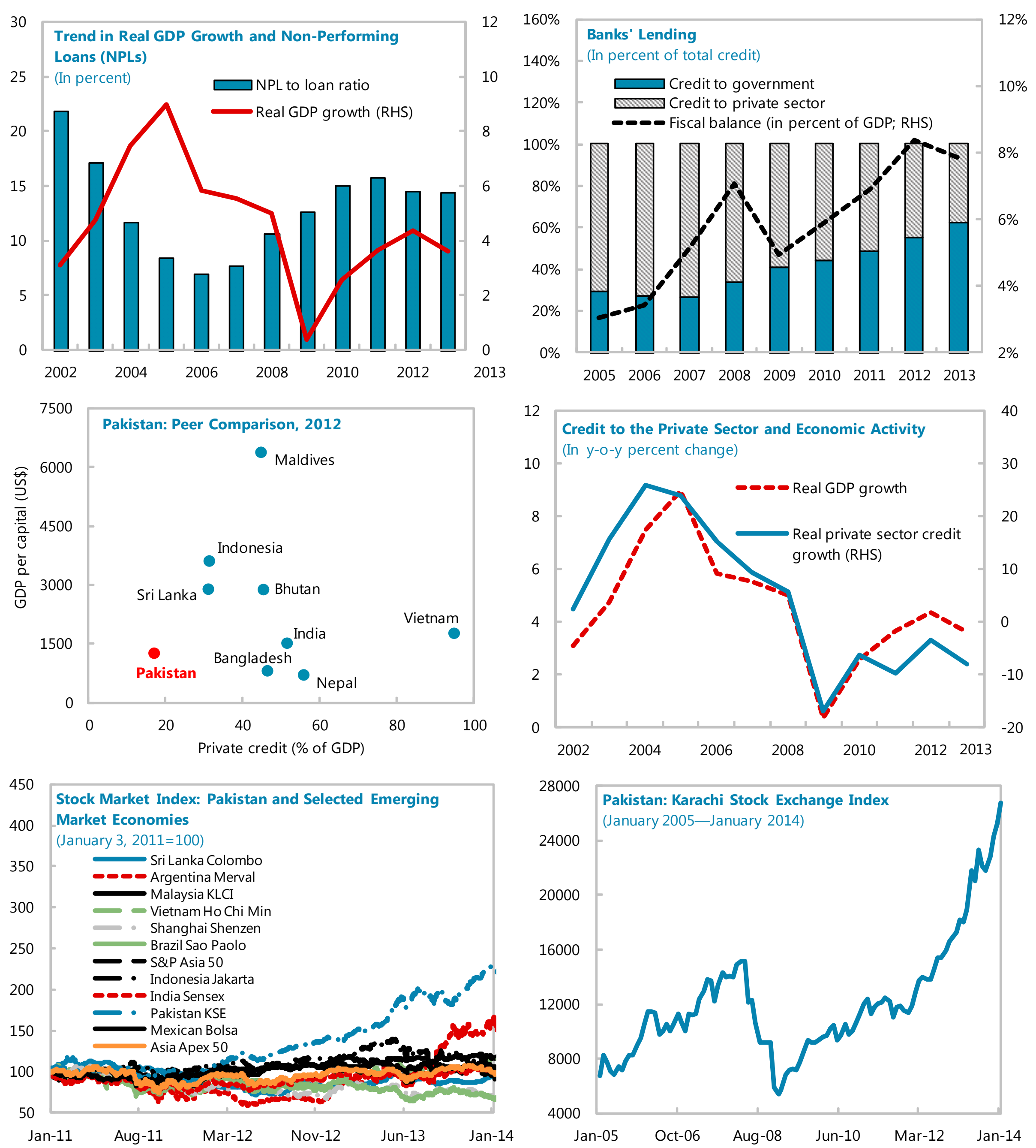
Sources: Pakistani authorities; and IMF staff calculations.

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



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

Figure 3. Pakistan: Selected Banking and Financial Indicators



Sources: Pakistani authorities; and IMF staff calculations.

Table 1. Pakistan: Quantitative Performance Criteria and Indicative Targets for FY2013/14 and FY2014/15 1/

	FY2012/13	FY2013/14						FY2014/15	
	end-June	end-September		end-December		end-March	end-June	end-September	end-December
	Act.	First Review	Actual	Second Review	Actual	Program	Program	Projection	Projection
Performance Criteria									
Floor on net international reserves of the SBP (millions of US dollars) 2/, 3/	-2,437	-2,850	-3,154	-4,807	-4,547	-2,750	1,800	3,000	3,500
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees) 4/	2,402	2,877	2,595	2,968	2,821	2,627	2,324	2,254	2,346
Ceiling on overall budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 5/	2,012	419	297	882	572	1,209	1,464	516	956
Ceiling on SBP's stock of net foreign currency swaps/forward position (millions of US dollars)	2,255	2,255	1,775	2,255	2,650	2,255	2,150	1,900	1,775
Ceiling on net government borrowing from the SBP (including provincial governments, stock, billions of Pakistani rupees) 1, 6/	2,168	2,690	2,521	2,560	2,611	2,390	2,240	2100	2000
Continuous Performance Criterion									
Accumulation of external public payment arrears by the general government (continuous)	0	0	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	16	48	62	16	32

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/ End-December 2013 target of -4130 has been adjusted by -677 millions of US dollars to reflect a shortfall in multilateral/bilateral disbursements to Pakistan.

4/ End-December 2013 NDA target of 2901 has been adjusted by 67 billions of PRs to reflect a shortfall in multilateral/bilateral disbursements to Pakistan

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

6/ 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	Met
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	Met
3	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	
4	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	
Monetary sector			
5	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-June 2014	
Financial sector			
6	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	Met at end-Feb
7	Enact the Deposit Protection Fund Act, in line with Fund staff advice.	end-September 2014	
8	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014	
Structural Policies			
9	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
10	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	Met
11	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), advertise key staff positions, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013	Met at end-Feb
12	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013	Met
13	Initiate revenue based load shedding in six remaining electricity distribution companies .	end-January 2014	Met
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	Privatize 26 percent of PIA's shares to strategic investors.	end-December 2014	
New Structural Benchmarks			
16	Enact amendments to the relevant tax laws (as defined in the TMU) and submit amendments to the Anti-Money Laundering Act (AMLA) to Parliament	end-September 2014	
17	Conduct a diagnostic study of the regulatory framework of the power sector and prepare an interim report.	end-April 2014	

Table 3. Pakistan: Selected Economic Indicators, 2010/11–2013/14 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 ($12.7 billion)
Unemployment: 6.2 percent (2012/13)

	2010/11	2011/12	2012/13	2013/14	
				First Review	Program
			(Annual percentage change)		
Output and prices					
Real GDP at factor cost	3.7	4.4	3.6	2.8	3.1
GDP deflator at factor cost	19.5	5.3	7.5	7.9	8.8
Consumer prices (period average) 2/	13.7	11.0	7.4	7.9	8.8
Consumer prices (end of period) 2/	13.3	11.3	5.9	10.0	10.0
Pakistani rupees per U.S. dollar (period average)	2.2	4.1	7.7	…	…
			(In percent of GDP)		
Saving and investment					
Gross saving	14.2	12.9	13.2	13.8	14.1
Government	-4.2	-5.1	-4.8	-2.2	-2.0
Nongovernment (including public sector enterprises)	18.4	17.9	18.0	16.1	16.2
Gross capital formation 3/	14.1	14.9	14.2	14.8	15.1
Government	2.5	3.3	3.0	3.3	3.2
Nongovernment (including public sector enterprises)	11.6	11.6	11.2	11.5	11.8
Public finances					
Revenue and grants	12.6	13.1	13.2	14.9	14.9
Expenditure (including statistical discrepancy)	19.8	21.9	21.1	20.1	20.2
Budget balance (including grants)	-6.9	-8.4	-7.8	-5.2	-5.3
Budget balance (excluding grants)	-7.1	-8.8	-8.0	-5.8	-5.7
Primary balance	-3.1	-4.0	-3.5	-0.8	-0.6
Total general government debt 4/	59.5	63.8	63.1	65.9	64.0
External general government debt	26.6	25.8	21.5	24.8	23.3
Domestic general government debt	32.9	38.0	41.6	41.1	40.7
			(Annual changes in percent of initial stock of broad money, unless otherwise indicated)		
Monetary sector					
Net foreign assets	4.1	-3.8	-3.4	5.0	4.3
Net domestic assets	11.8	17.9	19.3	8.0	9.2
Broad money (percent change)	15.9	14.1	15.9	13.0	13.5
Reserve money (percent change)	17.1	11.3	15.8	11.7	11.3
Private credit (percent change)	4.0	7.5	-0.6	7.5	7.5
Six-month treasury bill rate (period average, in percent)	13.3	12.3	10.1	…	…
External sector					
Merchandise exports, U.S. dollars (percentage change)	28.9	-2.6	0.4	8.5	6.3
Merchandise imports, U.S. dollars (percentage change)	14.9	12.8	-0.6	8.0	6.1
Current account balance (in percent of GDP)	0.1	-2.1	-1.0	-1.0	-0.9
			(In percent of exports of goods and services, unless otherwise indicated)		
External public and publicly guaranteed debt	153.4	160.3	144.6	146.7	149.0
Debt service	11.7	16.0	21.1	24.1	24.4
Gross reserves (in millions of U.S. dollars) 5/	14,784	10,799	6,008	9,436	9281.6
In months of next year's imports of goods and services	3.6	2.7	1.4	2.1	2.0
Memorandum items:					
Real effective exchange rate (annual average, percentage change)	6.1	2.7	-2.0	…	…
Terms of trade (percentage change)	7.1	-10.4	-0.7	-2.0	-4.4
Real per capita GDP (percentage change)	1.5	2.3	1.5	0.8	1.1
GDP at market prices (in billions of Pakistani rupees)	18,285	20,091	22,909	25,417	25704.5
GDP at market prices (in billions of U.S. dollars)	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, 2010/11–2018/19

	2010/11	2011/12	2012/13	2013/14	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
				First Review	Program	Projections				
				(Annual percentage change)						
Output and prices										
Real GDP at factor cost	3.7	4.4	3.6	2.8	3.1	3.7	3.9	4.7	5.0	5.0
Consumer prices (period average)	13.7	11.0	7.4	7.9	8.8	9.0	7.0	6.0	6.0	6.0
				(In percent of GDP)						
Saving and investment balance	0.1	-2.1	-1.0	-0.6	-0.9	-1.0	-1.0	-1.3	-1.0	-1.0
Government	-6.7	-8.4	-7.8	-5.5	-5.3	-4.2	-3.4	-3.2	-3.2	-3.2
Non-government (including public sector enterprises)	6.8	6.3	6.8	4.9	4.4	3.2	2.3	2.0	2.2	2.3
Gross national saving	14.2	12.9	13.2	14.2	14.2	15.3	17.3	18.0	18.8	19.7
Government	-4.2	-5.1	-4.8	-2.2	-2.0	-1.1	0.2	0.6	0.8	1.0
Non-government (including public sector enterprises)	18.4	17.9	18.0	16.5	16.2	16.4	17.1	17.4	17.9	18.7
Gross capital formation	14.1	14.9	14.2	14.8	15.1	16.3	18.3	19.3	19.8	20.6
Government	2.5	3.3	3.0	3.3	3.2	3.2	3.5	3.9	4.1	4.2
Non-government (including public sector enterprises)	11.6	11.6	11.2	11.5	11.8	13.2	14.8	15.4	15.7	16.4
				(In billions of U.S. dollars, unless otherwise indicated)						
Balance of payments										
Current account balance	0.2	-4.7	-2.5	-2.3	-2.2	-3.3	-3.5	-4.5	-4.0	-4.2
Net capital flows 1/	2.3	1.4	0.5	6.5	5.8	5.8	4.9	5.5	5.8	5.0
Of which: foreign direct investment 2/	1.6	0.8	1.5	2.6	2.3	1.7	2.2	3.8	4.9	4.5
Gross official reserves	14.8	10.8	6.0	9.4	9.3	12.7	16.3	17.5	19.2	20.0
In months of imports 3/	3.6	2.7	1.4	2.1	2.0	2.6	3.1	3.1	3.2	3.3
External debt (in percent of GDP)	31.1	29.0	25.0	27.7	26.5	26.5	25.9	24.1	21.9	19.7
				(In percent of GDP)						
Public finances										
Revenue and grants	12.6	13.1	13.2	14.9	14.9	15.0	15.4	15.4	15.3	15.3
Of which: tax revenue	9.5	10.3	9.7	10.6	10.4	11.2	11.7	12.3	12.3	12.3
Expenditure (incl. stat. discr.), *of which:*	19.5	21.5	21.0	20.4	20.2	19.3	18.7	18.6	18.6	18.5
Current	16.5	17.8	16.3	16.8	17.1	16.1	15.2	14.7	14.5	14.3
Development (incl. net lending)	2.6	3.4	4.6	3.6	3.1	3.2	3.6	3.9	4.1	4.3
Primary balance 4/	-3.1	-4.0	-3.5	-0.8	-0.6	0.5	0.6	0.4	0.2	0.1
Overall fiscal balance 4/	-6.9	-8.4	-7.8	-5.5	-5.3	-4.2	-3.4	-3.2	-3.2	-3.2
Total public debt (including obligations to the IMF)	59.5	63.8	63.1	65.9	64.0	62.7	61.2	59.2	56.6	54.5

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, 2010/11–2018/19

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

	2010/11	2011/12	2012/13	2013/14	2013/14					2014/15			2015/16	2016/17	2017/18	2018/19
					Q1	Q2	Q3	Q4	End-Year	Q1	Q2	End-Year				
				First Review	Actual		Program									
Current account	214	-4,658	-2,496	-2,297	-1,206	-383	-570	-91	-2,250	-842	-1,169	-3,272	-3,545	-4,461	-4,040	-4,150
Balance on goods	-10,516	-15,765	-15,431	-16,526	-4,267	-4,086	-4,065	-3,888	-16,306	-4,462	-4,677	-17,324	-18,226	-18,850	-19,777	-20,463
Exports, f.o.b.	25,356	24,696	24,795	26,901	6,273	6,270	6,577	7,236	26,356	6,567	6,885	28,170	29,922	32,254	34,745	37,222
Imports, f.o.b.	35,872	40,461	40,226	43,427	10,540	10,356	10,642	11,124	42,662	11,029	11,562	45,494	48,148	51,104	54,521	57,686
Services (net)	-1,940	-3,192	-1,472	-997	-868	-515	-480	315	-1,548	-759	-694	-3,050	-3,935	-5,658	-6,634	-7,586
Services: credit	5,768	5,035	6,733	7,718	987	1,400	1,988	2,911	7,287	1,579	1,687	6,556	6,680	6,253	6,776	7,386
Of which: Coalition Support Fund	743	0	1,806	1,200	0	322	352	350	1,024	300	300	1,200	900	0	0	0
Of which: 3G Licenses	0	0	0	1,200	0	0	200	1,000	1,200	0	0	0	0	0	0	0
Services: debit	7,708	8,227	8,205	8,715	1,855	1,915	2,468	2,597	8,835	2,337	2,381	9,606	10,615	11,911	13,410	14,972
Income (net)	-3,017	-3,245	-3,685	-3,960	-807	-1,159	-847	-1,122	-3,934	-705	-922	-3,285	-3,720	-4,282	-3,744	-3,882
Income: credit	716	826	488	511	154	153	104	132	543	162	188	731	594	531	711	850
Income: debit	3,733	4,071	4,173	4,472	961	1,312	951	1,253	4,477	867	1,109	4,016	4,314	4,814	4,455	4,732
Of which: interest payments	1,408	1,589	1,325	1,535	340	379	296	410	1,424	245	347	1,166	1,255	1,308	1,359	1,372
Of which: income on direct investment	2,065	2,177	2,714	2,937	594	851	655	844	2,944	621	762	2,849	3,059	3,506	3,095	3,361
Balance on goods, services, and income	-15,473	-22,202	-20,588	-21,483	-5,942	-5,760	-5,391	-4,695	-21,788			-23,659	-25,881	-28,790	-30,154	
Current transfers (net)	15,687	17,544	18,092	19,187	4,736	5,377	4,821	4,604	19,538	5,084	5,124	20,386	22,336	24,329	26,114	27,781
Current transfers: credit, *of which:*	15,863	17,686	18,183	19,324	4,756	5,393	4,861	4,643	19,654	5,123	5,163	20,545	22,495	24,488	26,273	27,940
Official	845	658	412	545	81	133	113	209	536	159	169	486	409	263	196	196
Workers' remittances	11,201	13,186	13,922	14,742	3,927	3,863	3,742	3,504	15,037	4,033	3,962	15,929	17,612	19,425	21,025	22,492
Other private transfers	3,817	3,842	3,849	4,037	748	1,397	1,006	930	4,081	932	1,033	4,130	4,474	4,800	5,052	5,253
Current transfers: debit	176	142	91	137	20	16	40	40	116	40	40	159	159	159	159	159
Capital account	161	189	264	500	46	89	259	285	679	285	285	1,138	1,138	1,138	1,138	1,138
Capital transfers: credit	161	186	266	500	46	89	259	285	679	285	285	1,138	1,138	1,138	1,138	1,138
Of which: official capital grants	160	180	250	498	44	88	259	285	676	285	285	1,138	1,138	1,138	1,138	1,138
Capital transfers: debit	0	3	2	0	0	0	0	0	0	0	0	0	0	0	0	0
Financial account	2,103	1,275	549	5,899	382	-398	1,531	3,991	5,506	1,524	1,368	4,640	3,776	4,389	4,623	3,898
Direct investment abroad	-44	-77	-198	-59	-59	-28	0	0	-87	-22	-12	-53	-47	-46	-46	-46
Direct investment in Pakistan	1,636	821	1,456	2,551	231	185	148	1,695	2,259	608	453	1,727	2,238	3,761	4,860	4,533
Of which: privatization receipts	1	0	0	1,500	0	0	0	1,500	1,500	400	250	900	750	900	900	0
Portfolio investment (net), *of which:*	339	-149	26	937	107	-50	50	504	611	70	70	780	120	370	620	120
Financial derivatives (net)	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other investment assets	-920	9	-314	-481	195	-257	79	5	22	13	53	175	100	100	100	180
Monetary authorities	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
General government	-3	3	-2	0	2	-2	0	0	0	0	0	0	0	0	0	0
Banks	-63	-91	-126	-499	190	-293	15	5	-83	10	15	70	100	100	100	100
Other sectors	-854	97	-186	17	3	38	64	0	105	3	38	105	0	0	0	80
Other investment liabilities	1,092	671	-421	2,951	-92	-248	1,254	1,787	2,701	855	804	2,012	1,365	204	-911	-889
Monetary authorities	-10	-105	710	145	245	0	0	-100	145	0	0	0	0	0	0	0
General government, *of which:*	298	998	249	2,260	-258	-108	700	1,490	1,824	33	573	907	126	-1,527	-2,300	-1,967
Disbursements	2,377	2,633	2,530	5,636	525	695	1,819	2,775	5,814	620	1,017	3,663	3,206	1,538	1,080	490
Amortization	1,957	1,577	2,282	3,376	783	803	1,119	1,285	3,990	588	444	2,756	3,080	3,065	3,380	2,457
Banks	52	220	-1,117	385	-5	-155	55	-55	-160	13	13	50	50	50	50	0
Other sectors	752	-442	-262	161	-74	15	499	453	892	810	218	1,055	1,189	1,681	1,339	1,078
Net errors and omissions	14	-81	-309	102	-415	23	0	0	-392	0	0	0	0	0	0	0
Reserves and related items	-2,492	3,275	1,992	-4,205	1,193	669	-1,221	-4,185	-3,543	-966	-483	-2,506	-1,369	-1,067	-1,721	-886
Reserve assets	-2,225	4,430	4,530	-3,424	1,321	1,059	-1,435	-4,369	-3,424	-994	-685	-3,440	-3,555	-1,181	-1,721	-791
Use of Fund credit and loans	-267	-1,155	-2,538	-781	-128	-390	215	184	-119	28	203	934	2,186	115	0	-95
Memorandum items:																
Current account (in percent of GDP)	0.1	-2.1	-1.0	-1.0					-0.9			-1.3	-1.3	-1.6	-1.3	-1
Current account (in percent of GDP; excluding fuel imports)	5.9	4.3	4.8	5.8					5.6			5.2	5.2	4.8	4.8	4
Exports f.o.b. (growth rate, in percent)	28.9	-2.6	0.4	8.5					6.3			6.9	6.2	7.8	7.7	7
Imports f.o.b. (growth rate, in percent)	14.9	12.8	-0.6	8.0					6.1			6.6	5.8	6.1	6.7	6
Oil imports (in million US$, cif)	12,317	14,368	14,066	15,612.0					15,723			16,289	17,169	18,004	18,818	18,908
Terms of trade (growth rate, in percent)	7.1	-10.4	-0.7	-2.0					-4.4			-1.0	-0.1	-0.3	-0.2	0
External debt (in millions of U.S. dollars)	66,366	65,478	59,779	63,702					63,966			66,229	68,593	68,097	67,277	66,024
Gross external financing needs (in millions of U.S. dollars) 1/	1,991	6,960	4,909	7,191.0					7,678			6,802	8,242	9,239	8,037	7,690
End-period gross official reserves (millions of U.S. dollars) 2/	14,784	10,799	6,008	9,436	4,694	3,478	4,913	9,282	9,282	10,276	10,962	12,722	16,277	17,458	19,179	19,970
(In months of next year's imports of goods and services)	3.6	2.7	1.4	2.1	1.1	0.8	1.1	2.0	2.0	2.2	2.3	2.6	3.1	3.1	3.2	3.3
GDP (in millions of U.S. dollars)	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, 2008/09–2013/14

(In billions of Pakistani rupees)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14 First Review	2013/14 Program
Revenue and grants	1,878	2,130	2,306	2,642	3,021	3,789	3,834
Revenue	1,851	2,079	2,261	2,567	2,982	3,729	3,727
Tax revenue	1,331	1,500	1,738	2,076	2,231	2,688	2,674
Federal	1,285	1,445	1,673	1,969	2,081	2,518	2,504
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	108
Gas surcharge and other	16	28	32	27	35	48	51
Provincial	46	55	65	107	151	170	170
Nontax revenue	520	579	523	491	751	1,041	1,054
Federal	436	512	461	443	680	971	984
Provincial	84	68	62	48	71	70	70
Grants	27	51	46	75	39	60	107
Expenditure	2,531	3,008	3,566	4,326	4,816	5,203	5,192
Current expenditure	2,093	2,482	3,012	3,579	3,742	4,278	4,405
Federal	1,547	1,855	2,227	2,611	2,647	3,054	3,181
Interest	638	642	698	889	991	1,221	1,208
Domestic	559	578	630	821	920	1,113	1,114
Foreign	79	64	68	68	71	108	94
Other	909	1,213	1,529	1,722	1,656	1,833	1,973
Defense	330	375	450	507	541	647	637
Other	579	838	1,078	1,215	1,116	1,186	1,336
Of which: subsidies 1/	244	227	493	556	305	336	479
Of which: grants	136	361	259	291	368	419	412
Provincial	546	627	786	968	1,095	1,224	1,224
Development expenditure and net lending	404	558	469	681	1,058	925	787
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	91	-48
Statistical discrepancy ("+" = additional expenditure) 2/	34	-32	46	67	16	0	0
Overall Balance (excluding grants)	-680	-929	-1,306	-1,760	-1,834	-1,457	-1,464
Overall Balance (including grants)	-653	-878	-1,260	-1,685	-1,795	-1,397	-1,357
Financing	653	878	1,260	1,685	1795	1,397	1,357
External	75	138	62	53	24	476	414
Of which: privatization receipts	1	0	0	0	0	166	160
Of which: IMF	0	0	0	0	0	0	0
Domestic	579	740	1,198	1,631	1771	921	943
Bank	351	304	727	1,102	1284	737	754
Nonbank	227	436	471	529	487	184	189
Memorandum items:							
Primary balance (excluding grants)	-43	-287	-608	-871	-843	-236	-257
Primary balance (including grants)	-16	-236	-562	-796	-804	-176	-150
Total security spending	424	568	585	596	647	647	787
Total government debt	7,387	8,448	10,112	12,130	14,021	16,334	15,978
Domestic debt	3,860	4,654	6,014	7,638	9,521	10,442	10,464
External debt 3/	3,527	3,794	4,098	4,492	4,500	5,892	5,514
Total government debt including IMF obligations	7,805	9,138	10,879	12,822	14,454	16,553	16,441
Nominal GDP (market prices)	13,200	14,867	18,285	20,091	22,909	25,417	25,705

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	
					First Review	Program
Revenue and grants	14.3	12.6	13.1	13.2	14.9	14.9
Revenue	14.0	12.4	12.8	13.0	14.7	14.5
Tax revenue	10.1	9.5	10.3	9.7	10.6	10.4
Federal	9.7	9.1	9.8	9.1	9.9	9.7
FBR revenue	8.9	8.5	9.4	8.5	9.2	9.1
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	3.9
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	0.4
Gas surcharge and other	0.2	0.2	0.1	0.2	0.2	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	4.1	4.1
Federal	3.4	2.5	2.2	3.0	3.8	3.8
Provincial	0.5	0.3	0.2	0.3	0.3	0.3
Grants	0.3	0.2	0.4	0.2	0.2	0.4
Expenditure	20.2	19.5	21.5	21.0	20.5	20.2
Current expenditure	16.7	16.5	17.8	16.3	16.8	17.1
Federal	12.5	12.2	13.0	11.6	12.0	12.4
Interest	4.3	3.8	4.4	4.3	4.8	4.7
Domestic	3.9	3.4	4.1	4.0	4.4	4.3
Foreign	0.4	0.4	0.3	0.3	0.4	0.4
Other	8.2	8.4	8.6	7.2	7.2	7.7
Defense	2.5	2.5	2.5	2.4	2.5	2.5
Other	5.6	5.9	6.0	4.9	4.7	5.2
Of which: subsidies	1.5	2.7	2.8	1.3	1.3	1.9
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	3.6	3.1
Public Sector Development Program	3.5	2.5	3.3	3.0	3.3	3.2
Federal	1.8	1.2	1.5	1.4	1.7	1.6
Provincial	1.7	1.3	1.9	1.6	1.6	1.6
Net lending	0.3	0.0	0.1	1.6	0.4	-0.2
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	-5.7	-5.7
Overall Balance (including grants)	-5.9	-6.9	-8.4	-7.8	-5.5	-5.3
Financing	5.9	6.9	8.4	7.8	5.5	5.3
External	0.9	0.3	0.3	0.1	1.9	1.6
Of which: privatization receipts	0.0	0.0	0.0	0.0	0.7	0.6
Of which: IMF	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	5.0	6.6	8.1	7.7	3.6	3.7
Bank	2.0	4.0	5.5	5.6	2.9	2.9
Nonbank	2.9	2.6	2.6	2.1	0.7	0.7
Memorandum items:						
Primary balance (excluding grants)	-1.9	-3.3	-4.3	-3.7	-0.9	-1.0
Primary balance (including grants)	-1.6	-3.1	-4.0	-3.5	-0.7	-0.6
Total security spending	3.8	3.2	3.0	2.8	2.5	3.1
Total government debt 3/	56.8	55.3	60.4	61.2	64.3	62.2
Domestic debt	31.3	32.9	44.6	41.6	52.0	52.1
External debt 3/	25.5	22.4	26.2	19.6	23.2	21.5
Total government debt including IMF	61.5	59.5	63.8	63.1	65.1	64.0
Nominal GDP (market prices, billions of Pakistani rupees)	14,867	18,285	20,091	22,909	25,417	25,705

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, 2011/12–2014/15

(In billions of Pakistani rupees)

	2011/12	2012/13	2013/14						2014/15	
			End-Year	Q1	Q2	Q3	Q4	End-Year	Q1	Q2
			First Review	Actual		Program			Projections	
Revenue and grants	2,642	3,021	3,789	829	847	872	1,286	3,834	841	996
Revenue	2,567	2,982	3,729	820	827	842	1,238	3,727	803	958
Tax revenue	2,076	2,231	2,688	558	637	620	859	2,674	628	782
Federal	1,969	2,081	2,518	516	591	580	817	2,504	582	736
FBR revenue	1,881	1,936	2,345	469	557	542	778	2,345	537	690
Direct taxes	732	736	892	161	224	206	302	892	207	265
Federal excise duty	122	119	151	24	31	35	61	151	35	45
Sales tax/VAT	809	841	1,014	231	243	234	306	1,014	228	293
Customs duties	218	240	287	53	59	66	109	287	67	87
Petroleum surcharge	60	110	122	26	26	28	28	108	31	34
Gas surcharge and other	23	32	48	21	8	9	10	48	13	10
Provincial	107	151	170	42	46	40	42	170	46	46
Nontax revenue	491	751	1,041	262	191	223	379	1,054	174	176
Federal	443	680	971	251	176	205	352	984	155	155
Provincial	48	71	70	11	15	18	27	70	19	21
Grants	75	39	60	9	20	30	48	107	38	38
Expenditure	4,326	4,816	5,193	1,116	1,102	1,400	1,573	5,192	1319	1398
Current expenditure	3,579	3,742	4,268	876	1,043	1,256	1,230	4,405	1151	1203
Federal	2,611	2,647	3,044	647	737	913	883	3,181	807	860
Interest	889	991	1,211	301	297	287	323	1,208	341	344
Domestic	821	920	1,103	286	273	267	287	1,114	313	313
Foreign	68	71	108	15	24	20	36	94	28	32
Other	1,722	1,656	1,833	346	441	626	560	1,973	466	515
Defense	507	541	647	146	149	170	171	637	175	189
Other	1,215	1,116	1,186	200	292	456	389	1,336	291	326
Of which: subsidies 1/	556	305	336	65	77	221	116	479	58	84
Of which: grants	291	368	419	43	98	123	147	412	108	117
Provincial	968	1,095	1,224	229	306	343	347	1,224	344	344
Development expenditure and net lending	681	1,058	925	163	133	148	343	787	168	195
Public Sector Development Program	669	695	834	80	133	288	334	834	166	192
Federal	293	324	420	45	74	147	154	420	85	96
Provincial	375	372	414	35	59	141	179	414	80	96
Net lending	12	363	91	83	0	-139	9	-48	2	2
Statistical discrepancy ("+" = additional expenditure) 2/	67	16	0	78	-73	-5	0	0	0	0
Overall Balance (excluding grants)	-1,760	-1,834	-1,464	-297	-275	-558	-335	-1,464	-516	-440
Overall Balance (including grants)	-1,685	-1,795	-1,404	-288	-255	-528	-287	-1,357	-478	-402
Financing	1,685	1795	1404	288	255	528	287	1357	478	402
External	53	24	479	-30	-19	4	459	414	0	0
Of which: privatization receipts	0	0	166	0	0	0	160	160	0	0
Of which: IMF	0	0	0	0	0	0	0	0	0	0
Domestic	1,631	1771	925	318	274	524	-173	943	478	402
Bank	1,102	1284	740	198	285	114	157	754	254	254
Nonbank	529	487	185	120	-11	410	-330	189	224	148
Memorandum items:										
Primary balance (excluding grants)	-871	-843	-253	4	22	-271	-12	-257	-175	-96
Primary balance (including grants)	-796	-804	-193	13	41	-241	36	-150	-137	-57
Total security spending	596	647	797	146	149	170	171	787	175	189
Government Arrears	1,427	1,627	1,805					1,825		
Total government debt	12,130	14,021	16,338					15,978		
Domestic debt	7,638	9,521	10,446					10,464		
External debt 3/	4,492	4,500	5,892					5,514		
Total government debt including IMF obligations	12,822	14,454	16,748					16,441		
Nominal GDP (market prices)	20,091	22,909	25,417					25,705		

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, 2010/11–2014/15

	2010/11	2011/12	2012/13	2013/14					2014/15	
				End-Year	Q1	Q2	Q3	Q4	Q1	Q2
			Estimate	First Review	Actual		Program		Projections	
	(in billions of Pakistani rupees, unless otherwise indicated)									
Monetary survey										
Net foreign assets (NFA)	780	527	270	717	96	54	187	647	759	816
Net domestic assets (NDA)	5,915	7,115	8,588	9,297	8,784	9,332	9,280	9,405	9,305	9,798
Net claims on government, *of which: 1/*	2,983	4,197	5,629	6,257	5,646	5,776	6,300	6,127	6,127	6,127
Budget support, *of which:*	2,523	3,667	5,125	5,811	5,323	5,608	5,922	5,839	5,739	5,739
Banks	1,369	2,005	2,957	3,571	2,802	2,997	3,532	3,599	3,639	3,739
Commodity operations	397	436	468	446	446	378	378	288	388	388
Credit to nongovernment	3,547	3,653	3,664	3,851	3,682	4,039	3,883	3,656	3,968	4,309
Private sector	3,159	3,395	3,376	3,630	3,358	3,697	3,764	3,629	3,627	4,030
Public sector enterprises	388	257	288	221	323	343	119	27	342	279
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-612	-732	-702	-808	-541	-481	-900	-375	-788	-636
Broad money	6,695	7,642	8,858	10,014	8,879	9,386	9,467	10,052	10,064	10,613
Currency outside scheduled banks	1,501	1,674	1,938	2,511	1,984	2,087	2,308	2,484	2,357	2,514
Rupee deposits	4,819	5,528	6,405	6,869	6,333	6,704	6,558	6,931	7,069	7,427
Foreign currency deposits	375	440	515	634	562	595	600	637	638	673
State Bank of Pakistan (SBP)										
NFA	614	389	134	608	-13	-97	36	496	608	665
NDA	1,352	1,800	2,401	2,225	2,594	2,821	2,627	2,324	2,254	2,346
Net claims on government	1,184	1,665	2,156	2,195	2,460	2,506	2,328	2,178	2,027	1,924
Of which: budget support	1,155	1,662	2,168	2,240	2,521	2,611	2,390	2,240	2,100	2,000
Claims on nongovernment	-6	-5	-6	-10	-6	-6	-6	-6	-6	-6
Claims on scheduled banks	315	289	448	292	466	532	417	340	420	510
Privatization account	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3
Other items, net	-139	-146	-195	-250	-323	-207	-109	-185	-185	-80
Reserve money, *of which:*	1,966	2,189	2,535	2,832	2,581	2,724	2,663	2,821	2,862	3,011
Banks' reserves	349	396	476	494	454	494	484	512	521	548
Currency	1,606	1,784	2,049	2,339	2,117	2,220	2,179	2,309	2,341	2,463
	(Annual percentage change, unless otherwise indicated)									
Broad money	15.9	14.1	15.9	13.0	15.4	13.7	13.7	13.5	13.3	13.1
NFA, banking system (in percent of broad money) 2/	4.1	-3.8	-3.4	5.0	-5.8	-6.0	-2.2	4.3	7.5	8.1
NDA, banking system (in percent of broad money) 2/	11.8	17.9	19.3	8.0	21.2	19.7	15.9	9.2	5.9	5.0
Budgetary support (in percent of broad money) 2/	10.2	17.1	19.1	7.7	19.5	16.8	16.8	8.1	4.7	1.4
Budgetary support	30.4	45.3	39.7	13.4	39.4	32.7	30.9	13.9	7.8	2.3
Private credit	4.0	7.5	-0.6	7.5	1.5	5.6	6.5	7.5	8.0	9.0
Currency	15.9	11.5	15.8	29.5	13.0	13.8	20.1	28.2	18.8	20.5
Reserve money	17.1	11.3	15.8	11.7	14.3	12.1	9.2	11.3	10.9	10.5
Memorandum items:										
Velocity	2.7	2.6	2.6	2.7	3.0	3.3	3.3	2.7	2.7	2.7
Money multiplier	3.4	3.5	3.5	3.5	3.4	3.4	3.6	3.6	3.5	3.5
Currency to broad money ratio (percent)	22.4	21.9	21.9	25.1	22.3	22.2	24.4	24.7	23.4	23.7
Currency to deposit ratio (percent)	28.9	28.0	28.0	33.5	28.8	28.6	32.2	32.8	30.6	31.0
Foreign currency to deposit ratio (percent)	7.2	7.4	7.4	8.5	8.2	8.2	8.4	8.4	8.3	8.3
Reserves to deposit ratio (percent)	6.7	6.6	6.9	6.6	6.6	6.8	6.8	6.8	6.8	6.8
Budget bank financing (change from the beginning of the fiscal year; in Rs billions), *of which:*	589	1,144	1,458	686	198	483	797	714	614	614
By commercial banks	606	636	952	614	-155	40	575	642	682	782
By SBP	-17	508	506	72	353	443	222	72	-68	-168
NFA of SBP (change from beginning of the year; in billions of U.S. dollars) 3/	2.7	-3.0	-2.8	3.9	-1.5	-2.3	-1.0	3.2	3.8	4.2
NFA of commercial banks (millions of U.S. dollars)	1,937	1,464	1,377	938	1,032	1,406	1,383	1,368	1,267	1,255
NDA of commercial banks (billions of Pakistani rupees)	4,563	5,315	6,187 0	7,072	6,190	6,511	6,654	7,081	7,051	7,452

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–December 2013)

	Dec. 2008	Dec. 2009	Dec. 2010	Dec. 2011	Dec. 2012	Mar. 2013	June 2013	Sep. 2013	Dec. 2013
Capital adequacy									
Regulatory capital to risk-weighted assets	12.2	14.1	13.9	15.1	15.4	15.1	15.5	15.5	14.9
Tier 1 capital to risk-weighted assets	10.1	11.6	11.6	13.0	12.8	12.7	13.0	13.2	12.6
Capital to total assets	10.0	10.1	9.8	9.6	9.0	8.9	8.9	9.3	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	14.3	13.0
Provisions to NPLs	69.6	69.9	66.7	69.3	71.8	71.9	73.2	76.5	78.4
NPLs net of provisions to capital	19.4	20.4	26.7	23.1	19.4	19.9	18.3	15.7	13.4
Earnings and profitability									
Return on assets (after tax)	0.8	0.9	1.0	1.5	1.4	1.1	1.1	1.1	1.1
Return on equity (after tax)	7.8	8.9	9.6	15.1	14.9	12.6	12.4	12.3	12.4
Net interest income to gross income	70.3	72.4	74.7	76.0	71.1	71.6	70.0	70.3	70.3
Noninterest expenses to gross income	50.1	51.2	52.7	51.1	52.4	54.1	56.4	56.8	57.4
Liquidity									
Liquid assets to total assets	28.2	32.7	36.1	45.5	47.4	47.4	49.0	46.7	47.3
Liquid assets to total deposits	37.7	44.5	47.1	59.5	63.3	63.3	63.7	59.2	60.0
Loans/Deposits	69.7	75.2	67.7	61.6	53.6	51.5	48.1	48.7	48.6

Source: State Bank of Pakistan.

Table 9. Pakistan: Indicators of Fund Credit, 2013–19
(In millions of SDR unless otherwise specified)

		Projections					
	2013	2014	2015	2016	2017	2018	2019
		(Projected Level of Credit Outstanding based on Existing Drawings and Prospective Drawings)					
Total	2,296.8	2,463.0	3,600.0	4,393.0	4,393.0	4,213.0	3,793.0
Of which:							
ECF, SBA, and ENDA	1,576.8	303.0	0.0	0.0	0.0	0.0	0.0
Extended Fund Facility	720.0	2,160.0	3,600.0	4,393.0	4,393.0	4,213.0	3,793.0
In percent of end-period gross official reserves	101.6	34.9	42.5	43.7	39.7	35.8	28.9
		(Projected Debt Service to the Fund based on Existing and Prospective Drawings) 1/					
Total	2,355.2	1,125.9	341.7	66.1	75.0	255.7	496.1
Of which:							
Principal	2,313.5	1,099.3	303.0	0.0	0.0	180.0	420.0
Interest and charges	41.7	26.6	38.7	66.1	75.0	75.7	76.1
ECF Principal		17.2	0.0	0.0	0.0	0.0	0.0
SBA and ENDA Principal		1082.1	303.1	0.0	0.0	0.0	0.0
Extended Fund Facility Principal		0.0	0.0	0.0	0.0	180.0	420.0
In percent of end-period gross official reserves	104.2	15.9	4.0	0.7	0.7	2.2	3.8
Memorandum items							
Quota (millions of SDRs)	1,033.70	…	…	…	…	…	…

Source: IMF staff projections.

1/ Excludes GRA surcharges. Excludes current year obligation paid up to Feb 25, 2014.

Table 10. Pakistan: Selected Vulnerability Indicators, 2010/11–2018/19

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
				Projections					
Key economic and market indicators									
Real GDP growth (factor cost, in percent)	3.7	4.4	3.6	3.1	3.7	3.9	4.7	5.0	5.0
CPI inflation (period average, in percent) 1/	13.7	11.0	7.4	8.8	9.0	7.0	6.0	6.0	6.0
Emerging market bond index (EMBI) secondary market spread (basis points, end of period)	857	1,136	...	...	...	...	...	...	...
Exchange rate PRs/US$ (end of period)	85.8	94.3	...	...	...	...	...	...	...
External sector									
Current account balance (percent of GDP)	0.1	-2.1	-1.0	-0.9	-1.3	-1.3	-1.6	-1.3	-1.2
Net FDI inflows (percent of GDP)	0.7	0.3	0.5	0.9	0.7	0.8	1.3	1.6	1.3
Exports (percentage change of U.S. dollar value; GNFS)	25.0	-4.5	6.0	6.7	3.2	5.4	5.2	7.8	7.4
Gross international reserves (GIR) in billions of U.S. dollars	14.8	10.8	6.0	9.3	12.7	16.3	17.5	19.2	20.0
GIR in percent of ST debt at remaining maturity (RM) 2/	332.8	273.7	102.3	161.1	209.4	264.9	279.6	418.8	613.1
GIR in percent of ST debt at RM and banks' foreign exchange (FX) deposits 2/	167.8	125.4	54.2	80.3	105.8	130.7	134.6	161.3	178.1
Total gross external debt (ED) in percent of GDP, *of which:*	31.1	29.0	25.0	26.5	26.5	25.9	24.1	21.9	19.7
ST external debt (original maturity, in percent of total ED)	1.0	0.6	0.0	2.8	2.4	2.3	1.9	1.3	1.0
ED of domestic private sector (in percent of total ED)	10.8	10.8	10.5	10.3	10.7	10.7	11.8	13.5	14.2
ED to foreign official sector (in percent of total ED)	89.2	89.2	89.5	89.7	89.3	89.3	88.2	86.5	85.8
Total gross external debt in percent of exports	213.2	220.2	189.6	190.1	190.6	187.3	176.8	162.0	148.0
Gross external financing requirement (in billions of U.S. dollars) 3/	1.8	6.7	5.3	6.7	6.5	7.7	9.0	8.4	7.9
Public sector 4/									
Overall balance (including grants)	-6.9	-8.4	-7.8	-5.3	-4.2	-3.4	-3.2	-3.2	-3.2
Primary balance (including grants)	-3.1	-4.0	-3.5	-0.6	0.5	0.6	0.4	0.2	0.1
Debt-stabilizing primary balance 5/	-7.9	1.3	-2.7	-0.1	-0.9	-1.6	-1.8	-2.2	-2.0
Gross PS financing requirement 6/	26.9	32.5	35.1	34.8	32.3	30.5	30.2	29.8	29.3
Public sector gross debt 7/	55.3	60.4	61.2	62.2	60.5	58.4	56.5	54.1	52.2
Public sector net debt 8/	52.0	57.1	58.5	59.7	58.4	56.4	54.7	52.5	50.8
Financial sector 9/									
Capital adequacy ratio (in percent)	15.1	15.4	...	...	...	...	...	...	...
Nonperforming loans (NPLs) in percent of total loans	15.7	14.5	...	...	...	...	...	...	...
Provisions in percent of NPLs	69.3	71.8	...	...	...	...	...	...	...
Return on assets (after tax, in percent)	1.5	1.4	...	...	...	...	...	...	...
Return on equity (after tax, in percent)	15.1	14.9	...	...	...	...	...	...	...
FX deposits held by residents (in percent of total deposits)	7.2	7.4	...	...	...	...	...	...	...
Government debt held by FS (percent of total FS assets)	44.6	54.9	...	...	...	...	...	...	...
Credit to private sector (percent change)	4.0	7.5	...	...	...	...	...	...	...
Memorandum item:									
Nominal GDP (in billions of U.S. dollars)	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: Millions of SDRs	Amount of Purchase: Percent of Quota	Conditions
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.

Appendix I. Letter of Intent

March 6, 2014
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 second review was positive. We have met all but two of the performance criteria for the second 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). There are signs of improvement in economic conditions and the fiscal outturn has been solid, but balance of payments challenges remain. We believe that as structural reforms take hold, bottlenecks will ease, 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 second review has been strong (MEFP Tables 1 and 2).

- *Quantitative performance criteria and indicative targets.* The end-December 2013, quantitative performance criteria were observed with the exception of the targets on net swap/forward positions and government borrowing from the SBP. The indicative target on transfers under the BISP was not met. We have since taken action to address these shortcomings and are on track to meet the end March 2014 targets on swap/forward positions and government borrowing from the SBP as outlined in the attached MEFP. We have also made administrative and financial improvements in the BISP and propose a modified target to meet the challenge of improving social transfer payments.

- *Structural Benchmarks.* On structural policies: (i) the amendments to the Pakistan Penal Code 1860 were enacted by ordinance in line with the MEFP commitment, (ii) we hired an internationally recognized professional audit firm to conduct a technical and financial audit of the system to identify energy sector payables, and (iii) We have set up the Central Power Purchasing Agency (CPPA) and amended the articles of association by end-December 2013. We have since issued the standard operating procedures for payments and settlements and advertised the hiring of key staff. In the fiscal sector, (iv) we have developed initiatives to enhance revenue administration for sales tax, customs, and excises; and (v) the Ministry of Petroleum and Natural Resources notified the new gas levy through the Gas Infrastructure

Development Cess, which will yield near the program target of 0.4 percent of GDP. We continue to work on a comprehensive gas price rationalization plan; (vi) we have initiated revenue-based load shedding in all remaining electricity distribution companies. Finally, pertaining to the financial sector, (vii) the SBP prepared a detailed plan to achieve full compliance of all banks to minimum capital adequacy.

The program will continue to be monitored through quarterly reviews, prior actions, quantitative performance criteria (PCs) and indicative targets, and structural benchmarks. As detailed in the MEFP, we propose two new structural benchmarks against which to measure progress under the program (MEFP, Table 2). The TMU explains how the program targets are measured. We also propose establishment of the end-June 2014 PCs as set out in the attached MEFP. Completion of the third and fourth reviews, scheduled for June 2, 2014 and September 2, 2014 will require observance of the quantitative performance criteria for end-March 2014 and end-June 2014, respectively, and continuous performance criterion as specified in Table 1.

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 waivers of nonobservance on unmet performance criteria and completion of the second review under the Extended Arrangement.

We believe that the policies set forth in the letters of August 19, 2013 and December 5, 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, 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/
Ishaq Dar
Minister of Finance
Pakistan

/s/
Ashraf Wathra
Acting Governor of the State Bank of Pakistan
Pakistan

Attachment I. Memorandum of Economic and Financial Policies

Recent Economic Developments and Outlook

1. **There are signs of improved economic activity**. Services and manufacturing are driving better-than-expected GDP growth, as reforms in the electricity sector seem to be bearing fruit with electricity shortages and unscheduled load-shedding declining. Preliminary quarterly GDP numbers showed 5 percent annual growth in the first quarter of FY2013/14. Large scale manufacturing grew by about 5¼ percent in the first five months of the fiscal year over the same period of FY2012/13. Agricultural growth, on the other hand, has been relatively muted. We now expect growth to reach about 3.1 percent for FY 2013/14 as a whole. Risks to growth continue to tilt to the downside. External vulnerabilities— food and oil price volatility, capital flows, or declines in economic activity elsewhere—continue to be a concern. Annual headline inflation is expected to be around 10 percent by end fiscal year.

2. **The overall balance of payments situation for the second quarter of FY2013/14 was roughly as expected**. The current account came in stronger than expected, with lower-than-forecast imports and continued strong growth in remittances. In contrast, the capital and financial account was below expectations, a shortfall in official disbursements, with lower foreign direct investment, and higher net outflows from the banking sector. The exchange rate appreciated by 0.7 percent against the dollar during the quarter. Gross reserves declined from US$4.7 billion to US$3.5 billion, in line with expectations. After significant downward pressure on the Rupee in late November/early December, the currency rebounded partially and has remained roughly stable so far in 2014.

A. Monetary and Exchange Rate Policies

Economic Policies

3. **Monetary aggregates continued to expand in line with program objectives in the second quarter of FY 2013/14**. For the second consecutive quarter, the stock of Net Foreign Assets (NFA) of the SBP was negative, declining by 5.2 percent y-o-y as a share of the broad money, though this decline was compensated with 20 percent y-o-y increase in Net Domestic Assets (NDA), mainly driven by government borrowing from the SBP. This borrowing totaled PRs 50 billion more than envisaged in the program, (constituting about 2 percent of the reserve money), which resulted in missing the PC on this item. Broad money expanded by 13.7 percent, in line with program projections, while the reserve money grew by 12.1 percent, almost 2.8 percent below program projections. As the economy showed signs of recovering, credit to the private sector started to rebound and posted nominal growth of 5.6 percent y-o-y, although growth remained negative in real terms.

4. **Performance under the end-December monetary targets was mixed**. The PC on NDA was met, as was the target on Net International Reserves (NIR), where the SBP overperformed by US$255 million, mainly due to ambitious spot market purchases in the month of December. However, the ceiling on the net swap/forward position was missed (by US$395 million), as was the ceiling on government borrowing from the SBP (by PKs50 billion) (see ¶19).

5. **Monetary and exchange rate policies continue to be geared toward rebuilding SBP reserves and reducing vulnerabilities**. The SBP has taken advantage of the current favorable market conditions and so far purchased US$300 million in this quarter. SBP continues purchasing foreign reserves in the spot market to build cushions and is on track to meet the end-March NIR program target. To address the missed ceiling on swap/forwards, the SBP unwound its net position to below US$2,425 million and is now on track to meet the end-March program target. The SBP will continue its prudent stance on monetary policy as needed to help boost reserves, improve capital account, and ensure positive real interest rates to promote private saving and maintaining price stability. While the SBP will maintain flexible exchange rates reflecting 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. 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.

6. **Enhanced central bank independence should improve monetary policymaking**. We remain committed to approving amendment to strengthen operational independence of the SBP, although there have been some delays. The government will now submit the draft amendments to the SBP law to parliament by end-March 2014 with a view toward having them enacted by end-June 2014 (revised structural benchmark). The law, incorporating the recommendations of the IMF safeguards assessment and comments provided by Fund staff, will 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. 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-March 2014. The SBP will adopt International Financial Reporting Standards (IFRS) as its financial reporting framework beginning with FY 2013/14 financial statements.

B. Fiscal Policy

7. **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.

8. **Fiscal performance was strong in the first half of FY 2013/14, with a smaller deficit than envisaged under the program**. Revenues have been broadly in line with expectations, while the pace of spending remains slower than programmed—particularly on capital spending—as a way to manage the risks related to some of the envisaged revenues. As part of our initial adjustment package, we undertook 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. With the GIDC now in place (¶9), capital spending is expected to recover in the coming quarters.

9. **For FY 2013/14 as a whole, the government is on track to deliver a fiscal 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 revenues, in addition to the measures approved in the 2013 Finance bill, we increased the Gas Infrastructure Development Cess (GIDC) at end-December 2013. The increase in the Cess and the envisaged higher-than-budgeted volumes will lead to additional revenues of about 0.36 percent of GDP on an annualized basis, and we will make further adjustments to bring the yield to 0.4 percent of GDP by end-June 2014. This charge also fosters a more efficient allocation of gas to its highest value economic uses. The provinces are running surpluses in the first half of the year which are consistent with achieving the envisaged year-end fiscal outturn.

10. **On the expenditure side, the government is implementing its National Energy Policy which, among other things, will largely phase out electricity subsidies over the life of the program**. The policy entails periodic increases in the average tariff, aimed 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 (¶27) reduced subsidies about ¾ percent of GDP on an annualized basis. In the context of the FY 2014/15 budget we will further rationalize subsidies by roughly 0.4 percent of GDP. We will undertake additional action in the FY 2015/16 budget to reach a maximum of 0.3 percent of GDP thereafter.

11. **Tax administration reforms will gradually deliver further improvements in revenue collections**. An initiative to incorporate 300 thousand new taxpayers into the income tax net is moving ahead. More than 70 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. The Federal Board of Revenue (FBR) is on track to issue 75,000 first notices (u/s 114) and to 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. So far, over 6,000 individuals have registered and filed returns as a result of the initiative, and

this number is expected to rise in the coming months. We published in mid-February a tax directory of all current parliamentarians at both the federal and provincial levels in an effort to foster a culture of transparency and compliance. We also prepared initiatives to enhance revenue administration for sales tax, excises, and customs, which we finished launching at end-December 2013. 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.

12. **The recently approved investment incentive package seeks to foster investment in key productive sectors, and to provide incentives for taxpayers to voluntarily enter the tax net**. The first pillar provides immunity from tax scrutiny of the source of certain new investments on specific key productive sectors. The second pillar provides immunity from routine audit for current filers that pay 25 percent more than the previous year. The third pillar provides immunity from routine audit, penalties and interest for registered taxpayers that have not filed their returns provided they file missing returns for the past five years. The last pillar provides immunity from routine audit, penalties and interest for nonregistered taxpayers provided they register and file past returns; it also provides immunity from audit for future years, for the same amount of years they file. A minimum tax requirement of PRs 20,000 per year is fixed for pillar three which is higher than the tax paid by nonsalaried individuals. Similarly, a minimum tax requirement of PRs 25,000 per year has been incorporated for pillar four, which is at least 25 percent higher than the average tax paid by nonsalaried individuals. To address concerns about the negative incentive effects of the scheme, this package is a one-time-opportunity subject to short sunset clauses. The FBR also retains the right to audit participants if there is evidence of fraud in new declarations. We stress that this incentive package is a one-off initiative to encourage those in the informal sector into the formal sector; and will suffice for the program period.

13. **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 the 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. During the first half of the fiscal year, revenue from the Gas Infrastructure Development Cess (GIDC) did not enter the government coffers due to legal challenges, although it was levied. The recent Supreme Court decision allows revenues to reach the treasury, and we will also collect the Cess levied in the first half of the year. In any case, we stand ready to take compensatory measures as needed, including on the revenue side, to assure compliance with our fiscal target.

14. **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 56 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. At end-December 2013, we finalized an analysis of all existing SROs granting tax exemptions or concessions. We will finalize the plan for FY 2014/15 by end-March 2014. The calendar to eliminate the vast majority of them and convert the remainder into regular legislation will be finalized by end-May 2014, to give time for consultations with the private sector. For the FY14/15 budget, we envisage a revenue adjustment of roughly ¾ percent of GDP. Of this, we have already identified actions to reduce SRO exemptions and concessions totaling 0.35–0.4 percent of GDP. The remainder of ¾ point of adjustment will come from other tax measures, including further significant tax base broadening. We will include the necessary legislation to eliminate the first batch of SROs identified in our plan in the FY2014/15 budget, to be approved by end-June. 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. 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.

15. **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 FY 2016/17**. This will require further fiscal consolidation of 1¼–1½ percent of GDP per year in the coming two fiscal years. Over half of the adjustment should 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.

16. **Through the Benazir Income Support Program (BISP) and other initiatives, we are continuing our support to the poor and most vulnerable segments of the society**. Due to administrative difficulties, the payments did not reach all beneficiaries in a timely way. In order to avoid further delays the authorities have now instituted a new mechanism under which funds will be released by the middle of each quarter. Funds for the current quarter have already been released to allow time for BISP to begin delivering payments by end-February. In line with projections, we continue to increase the number of beneficiaries paid. The program currently reaches 4.18 million women. We are moving forward with 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 and the number of beneficiaries receiving their payments by at least 10 percent before the end of the fiscal year.[1] We will continue to protect the real purchasing power

[1] Also through retroactive payments

of the beneficiaries, further expand the coverage of the program as fiscal space is realized, and phase-out nontargeted subsidies. We remain committed to rolling out the primary education conditional cash transfers, expanding the number of districts covered.

17. **Provincial governments remain crucial 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. Since under the NFC award, the bulk of the additional revenue generated by the program will be distributed to the provinces, an understanding 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 federal government is encouraging the provinces to balance their budgets and has provided incentives for them to maintain surpluses. 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.

C. Fiscal Financing

18. **Strengthening public debt management continues to be a priority**. The composition of domestic debt has changed significantly over the last decade with more reliance on short-term floating debt and nonmarketable 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 worked closely with a joint IMF-World Bank mission to develop a medium term debt strategy (MTDS), focusing on: (i) cost-risk implications of the existing debt portfolio to the government's budget and the outstanding debt; and (ii) tradeoffs between different debt issuance strategies under alternative scenarios. The MTDS is being finalized and expected to be approved by the Finance Minister in April 2014. Currently, 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. We will work with our partners to address institutional arrangements and staff capacity limitations.

19. **The government is taking measures to reduce its dependence on financing from the SBP**. The government has curtailed government borrowing to PRs 2,334 billion and will continue to reduce it to achieve the end-March 2014 program target. The new MTDS will include plans for further reductions in line with program targets. In addition, we believe that floating government T-bills in the stock exchange will enlarge the market for domestic debt and we are stepping-up efforts to attract external commercial financing. The government will also accommodate higher yields if needed to meet its borrowing targets without further reliance on the SBP.

D. Financial Sector

20. **The banking system remains generally well-capitalized, profitable, and liquid**. As of end-September 2013, the capital adequacy ratio (CAR) remained stable at 15.5 percent, mainly attributable to a deceleration in credit risk. The asset quality of the banking system improved slightly with NPLs declining to 14.3 percent (net NPLs to net loan ratio is 3.8 percent) and provisioning coverage rising to 76.5 percent. The profitability of the banking sector has remained under stress, due to shrinking interest margins, the floor on the saving deposit interest rate and a declining loan-to-deposit ratio. This is supported by banks' large holdings of government securities, reaching 35.5 percent of banking system total assets. Nonetheless, there is a moderate fall in various liquidity indicators due to slower growth in deposits and government securities.

21. **The SBP has prepared a detailed plan to achieve compliance of all banks that fall below minimum capital adequacy (structural benchmark)**. The CAR shortfall of four noncompliant banks (one state-owned and three private) may not pose large risks, but needs to be addressed. Excluding the state-owned bank, which is only 0.6 percentage points below the statuary CAR, the remaining three banks comprise 2.8 percent of banking system total assets. The immediate capital needs for the CAR noncompliant banks is negligible (PRs 12.2 billion, less than 0.06 percent of GDP), but could rise if the economic environment deteriorates significantly. The plan includes contingency measures in case of slippages and clearer regulatory measures in case banks are unable to raise expected capital.

- ***The state-owned bank***: after having received substantial capital injections over the past two years, the bank's CAR is around 9.4 percent and is on track to reach 10 percent by end-December 2014 through profit retention.

- ***Private banks***: during the CY 2013, two banks completed issuance of noncumulative perpetual preferred stock of PRs 4.4 billion, and another bank received PRs 1 billion as an advance towards a future rights issue. Each of the three banks provided a board-approved capital plan with specific timelines, where banks are expected to meet CAR shortfall (mainly through capital injection) by end-December 2014.

22. **Consultation with key stakeholders on a deposit insurance scheme and the new bankruptcy law are ongoing**. The proposed draft legislation for the Deposit Protection Fund (DPF) has been revised to reflect good international practices. We have initiated the technical work, in consultation with the IMF, on modalities and operations of the DPF in the context of a contingency planning framework. The draft act for the DPF is expected to be submitted to Parliament by end-June 2014 with approval expected by end-September 2014 (structural benchmark). The scheme would begin operations by end-December 2015. For the Corporate Rehabilitation Act (CRA), the SECP held roundtables in Karachi and Lahore during November-December 2013 to elicit stakeholders' views (SBP, Pakistan Banks Association, business groups, and legal experts) on the draft CRA. Participants raised concerns on the current draft and further consultation will be required to adopt an appropriate model that caters to the needs of creditors and debtors alike. Therefore, SECP will prepare a concept note on the suitable model of rehabilitation law.

23. **Enhancing the regulatory and supervisory frameworks is critical to safeguard financial stability**. In this regard, we are undertaking several initiatives: (i) the SECP finalized the draft Securities Bill, which will be agreed with the IMF and enacted by end-December 2014 (structural benchmark); (ii) the revised SECP Act to enhance the regulatory power of the SECP is being finalized and will be sent to Parliament by June 2014; (iii) a draft Futures Trading Bill will be placed before Parliament for expected approval by end-December 2014. Furthermore, we will seek technical assistance from the IMF to examine the regulatory framework of the SBP and SECP to effectively supervise financial conglomerates, and develop a legal framework for consolidated supervision by end-December 2015 in consultation with the IMF and the World Bank.

24. **In order to enable the use of AML tools to combat tax evasion, we started the preliminary work to include tax crimes in the Schedule of Offences of the 2010 Anti-Money Laundering Act (AMLA)**. A list of serious tax offences is being identified. In order to ensure that serious tax crimes are predicate offences to money laundering, we will enact amendments to the relevant tax laws (as defined in the TMU) and submit amendments to the Anti-Money Laundering Act (AMLA) to Parliament by end-September 2014 (new structural benchmark). We will also ensure that the AML framework is properly implemented to ensure detection of potential cases of abuse of the investment incentive scheme to launder criminal proceeds. Proper guidance will be provided by the Financial Intelligence Unit to financial institutions and the FRB by end-June 2014.

25. **We are committed to developing the government debt market**. To broaden the investor base and have a liquid government securities market, we have commenced trading of government debt instruments (treasury bills, Pakistan Investment Bonds, and Sukuk) on the stock exchanges through the Bond Automated Trading System (BATS). This will provide an additional investment channel to retail investors. Going forward, we are exploring introducing additional Shariah complaint instruments, keeping in view cost risk factors and market appetite for these instruments.

E. Structural Reforms

Energy Sector Reforms

26. **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.

27. **Price Adjustments and Arrears**. We are preparing the third round identified in the three-year subsidy rationalization plan for phasing out the Tariff Differential Subsidy (TDS) to continue to bring tariffs to cost recovery level. We will finalize the details for this round by end-April 2014 based on the FY 2013/14 tariff notification. We have already incorporated the costs of servicing the syndicated term credit finance facility into the tariff petition; however, this was declined by NEPRA and not included in the tariff determination for FY2013/14. As a result, the servicing of these facilities continues to add to circular debt. To address this, the government will incorporate this in

the review petition as an eligible capital expenditure. We have hired a professional audit firm 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 audit will be completed by end-April 2014. Based on the findings of the audit, we will design a roadmap to prevent the accumulation and recurrence of payables arrears including the payables due from the servicing of term credit finance facility.

28. **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 four performance contracts; we are on track to finalize the contracts for the remaining five DISCOs. We have also signed one power purchase agreement with a public sector generation company; the remaining contract will be signed soon after the heat rate testing is finalized. 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 amendments to Penal Code 1860 and the Code of Criminal Procedures 1898 have been promulgated through Presidential ordinance, and have been submitted to Parliament for ratification. In parallel, we are drafting a new Electricity Act to modernize governance of the sector. We will also establish utility courts that were incorporated in the Penal Code. Utility courts will build on investigation systems and fast track mechanisms to improve enforcement by end-2014. In order to minimize losses from low payment rates, all state-owned DISCOs are now implementing revenue-based load shedding. To enhance transparency, web-based reporting of dispatching and merit order of all power plants was introduced along with the payment records to stakeholders. The reporting portal allows us to monitor electricity draws to reduce overdraws and improve information flows. To minimize losses in fuel delivery to generation companies (GENCOs), we signed a Memorandum of Understanding (MoU) between Muzaffargah Power Generation Company (GENCO-III) and Pakistan State Oil (PSO) to lease the fuel storage and delivery facilities to Pakistan State Oil (PSO). The implementation of the MoU will begin by end-April 2014.

29. **Demand Side Management**. To encourage energy conservation, we will use pricing ¶27 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 are on track to place the revised draft before the Council of Common Interest (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.

30. **Supply Side Management**. We will continue to prioritize the use of gas and coal rather than fuel oil in electricity generation and committed to transition to market based allocation of natural gas in the medium-term. The Economic Coordination Committee has approved the policy directive to encourage the conversion of fuel oil-based GENCOs and Independent Power Producers (IPPs) to coal-based plants. To further improve supply, we will continue to rehabilitate generation plants, while upgrading electricity transmission and distribution facilities to reduce technical losses. We will finalize regular efficiency testing of fuel based GENCOs and the current round of three

rehabilitations by end-March 2014, which are expected to (i) generate savings by next fiscal year; (ii) recover around 500 MW of capacity; and (iii) 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.

31. **Governance, Regulatory, and Transparency Improvements**. We continue to place high priority on improving energy sector governance and transparency. We have already hired entry and middle management positions to enhance the technical capacity of the regulatory body, the National Electric Power Regulatory Authority (NEPRA). In order to begin addressing the administrative and technical constraints we will conduct a diagnostic study of the regulatory framework of the power sector and prepare an interim report by end-April 2014 (new structural benchmark). For FY 2013/14, NEPRA will finalize tariff determination by mid-April 2014. NEPRA is committed to streamline the process to four months by the next determination cycle. In the meantime, NEPRA will begin preparations for a multi-year tariff framework. The methodology for the framework will be finalized by end-March 2014. To facilitate the transition we will establish three year investment plans for at least three DISCOs by end-September 2014. The first phase of the determination and notification of multi-year tariffs will begin with these DISCOs by end-September 2015. We will continue to commit applying fuel price adjustments (FPAs) determined by NEPRA in its normal monthly schedule. We have set-up the Central Power Purchasing Agency (CPPA) by separating it from the National Transmission and Despatch Company (NTDC) and amended the Articles of Association. To make CPPA operational, we will issue the standard operating procedures for payments and settlements and advertise the hiring of key staff (CEO, CFO and corporate secretary) by end-February 2014. The key staff will be in place by end-April 2014.

32. **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 have already transferred governance of DISCOs, three GENCOs, and the NTDC to new boards of directors and management. We are committed to building the institutional capacity of the Water and Power Development Authority (WAPDA) through corporatization and commercialization, and we have begun to strengthen WAPDA's financial capacity by allowing the tariff to incorporate capital investment plans. We are also committed to 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.

33. **Oil and Gas Sector**

- **Supply**. 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-February, 2014, 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 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.

- **Pricing**. 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 have produced a gas price rationalization plan to address both production and consumption of gas. The plan has the following components: (i) We have announced the new Petroleum Exploration and Production Policy 2012 (2012 Policy) and amendments for enhanced production from existing and new fields and further improve producer incentives. We are offering higher gas producer prices relative to the Petroleum Exploration and Production Policy 2001. With price increases ranging from 2.8–3 U.S. dollars per MMBTU to 6–10 U.S. dollars per MMBTU, we are incentivizing producers to enhance their production from existing fields as well as initiate new exploratory efforts. As new production and additional gas supply from imports come 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 end-March 2014; (ii) At end-December 2013, weighted average prices were adjusted through the application of the GIDC to better allocate gas consumption, and (iii) we are evaluating the process of unbundling of downstream gas business with the objective of bringing in efficiencies in the transmission and distribution segments for better operation of the market system.

- **Governance**. We have been enhancing 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. The current level of unaccounted for gas losses (UFG) is on average 11 percent due to commercial and technical losses. We are pursuing companies at the highest level to reduce losses benchmarking international standards through investment measures, managerial and administrative improvements, and through building the capacity of the gas distribution companies. In January 2014, the President has promulgated the Gas (Theft Control and Recovery) Ordinance 2014, which has been sent to the Parliament. 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

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

35. **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 initiated a study to identify the needs of corporations to speed up rehabilitation of weak but viable companies. The study will be completed by end-March 2014. Based on the findings of the study, we will expedite the liquidation of the insolvent entities. 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 a time-bound implementation plan, after consultation with key stakeholders by end-March, 2014.

- ***Access to credit***. Access to finance for poor and marginalized segments including micro, small and rural enterprises 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 help develop a comprehensive National Financial Inclusion Strategy to address industry bottlenecks and barriers in access of micro, small and rural enterprises to financial services. The strategy will include regulatory reforms to encourage microfinance banks (MFBs) to upscale their credit operations, developing risk mitigation mechanism, and market interventions for strengthening credit enhancement mechanisms, improving market information and infrastructure, product innovation, improved delivery mechanisms, financial literacy, and consumer protection.

36. **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 over three years 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-May 2014; with phase-in of the revised tariff rates and phase-out of trade SROs beginning by end-June 2014 (see also ¶19). 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 has extended GSP plus benefits (0 percent duty) from January 1, 2014 on Pakistan's exports. We remain committed to promoting trade with regional countries, especially under various regional trade arrangements.

37. **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 will hire three financial advisor by end-March 2014 (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 six 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 will hire one 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.

- ***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 a financial advisor by end-March 2014 (structural benchmark) to seek potential options for restructuring and strategic private sector participation in the company. 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 half of the year through rationalization of tariffs and expenditures and improved occupancy rates. We are in the process of reviving the railway Board. We are developing a comprehensive restructuring plan, which will include improvements in business processes and institutional framework, financial stability, and service delivery. The plan will be finalized by end-March 2014.

Table 1. Pakistan: Quantitative Performance Criteria and Indicative Targets for FY2013/14 and FY2014/15 1/

	FY2012/13	FY2013/14						FY2014/15	
	end-June	end-September		end-December		end-March	end-June	end-September	end-December
	Act.	First Review	Actual	Second Review	Actual	Program	Program	Projection	Projection
Performance Criteria									
Floor on net international reserves of the SBP (millions of US dollars) 2/, 3/	-2,437	-2,850	-3,154	-4,807	-4,547	-2,750	1,800	3,000	3,500
Ceiling on net domestic assets of the SBP (stock, billions of Pakistani rupees) 4/	2,402	2,877	2,595	2,968	2,821	2,627	2,324	2,254	2,346
Ceiling on overall budget deficit (cumulative, excluding grants, billions of Pakistani rupees) 5/	2,012	419	297	882	572	1,209	1,464	516	956
Ceiling on SBP's stock of net foreign currency swaps/forward position (millions of US dollars)	2,255	2,255	1,775	2,255	2,650	2,255	2,150	1,900	1,775
Ceiling on net government borrowing from the SBP (including provincial governments, stock, billions of Pakistani rupees) 1, 6/	2,168	2,690	2,521	2,560	2,611	2,390	2,240	2100	2000
Continuous Performance Criterion									
Accumulation of external public payment arrears by the general government (continuous)	0	0	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	16	48	62	16	32

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/ End-December 2013 target of -4130 has been adjusted by -677 millions of US dollars to reflect a shortfall in multilateral/bilateral disbursements to Pakistan.
4/ End-December 2013 NDA target of 2901 has been adjusted by 67 billions of PRs to reflect a shortfall in multilateral/bilateral disbursements to Pakistan
5/ Excluding grants, FY2012/13 overall budget deficit is a stock.
6/ 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	Met
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	Met
3	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	
4	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	
Monetary sector			
5	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-June 2014	
Financial sector			
6	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	Met at end-Feb
7	Enact the Deposit Protection Fund Act, in line with Fund staff advice.	end-September 2014	
8	Enact the Securities Bill, in line with Fund staff advice.	end-December 2014	
Structural Policies			
9	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
10	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	Met
11	Make Central Power Purchasing Agency (CPPA) operational by separating it from the National Transmission and Despatch Company (NTDC), advertise key staff positions, issue CPPA rules and guidelines, and initiate the payment and settlement system.	end-December 2013	Met at end-Feb
12	Enact the amendments to the Pakistan Penal Code 1860 and the Code of Criminal Procedures 1898.	end-December 2013	Met
13	Initiate revenue based load shedding in six remaining electricity distribution companies .	end-January 2014	Met
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	Privatize 26 percent of PIA's shares to strategic investors.	end-December 2014	
New Structural Benchmarks			
16	Enact amendments to the relevant tax laws (as defined in the TMU) and submit amendments to the Anti-Money Laundering Act (AMLA) to Parliament	end-September 2014	
17	Conduct a diagnostic study of the regulatory framework of the power sector and prepare an interim report.	end-April 2014	

Attachment II. Technical Memorandum of Understanding (TMU)

March 6, 2014

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

1. 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

2. **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.

3. **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.

4. **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

5. **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.

6. **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.

7. **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.

8. **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).

9. **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.

10. **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.

11. **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.

12. **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.

13. **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.

14. **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 restructuring of Pakistan International Airlines Corp (PIAC) and will seek for a strategic investor.

15. **The "relevant tax laws" in the structural benchmark on "enactment of amendments to the relevant tax laws and submission of amendments to the Anti-Money Laundering Act (AMLA) for end-June 2014" is defined as follows**: Income Tax Ordinance, 2001; the Federal Excise Act, 2005; the Sales Tax Act, 1990; the Customs Act, 1969; and any other relevant law.

C. Adjustors

16. 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.

17. 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).

18. 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

19. 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

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	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 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	The SBP survey, ODCs and DCs published in IFS.	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed export and import data Detailed balance of payments data	Monthly	Within 28 days of the end of each month
	Privatization receipts	Balance on the PC Fund account; gross inflows into and outflows from the PC Fund account during the month, specifying the nature of each transaction	Quarterly	Within seven days of the end of each quarter
Ministry of Finance (MOF)	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the SBP, and state-owned companies; any stock of arrears on external debt service and outstanding stock of government guarantees and external arrears.	Monthly	Within 25 days of the following month
	External financing	Foreign assistance received and projections for the coming four quarters. Please categorize all grants and loans by program/project, and the amounts received/expected in cash and in kind.	Quarterly	Within 15 days of the end of each quarter
	Federal government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Federal and provincial governments	Quarterly	Within 45 days of the end of each quarter
	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 Monthly TDS Claims by DISCOs and Total Inter Corporate Circular Debt Sheet Prepared by Ministry of Finance	Quarterly	Within 30 days

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		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 U.S. dollars)

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Multilateral and bilateral disbursement	883	2,128	3,219	855	1,200
of which: in cash 2/	641	1,661	2,830	680	954
Euro Bond issuance	0	0	500	0	0
Coalition Support Fund	322	352	350	300	300
Other 1/	0	200	2,500	400	250 300
Gross Inflows	1,205	2,680	6,569	1,555	1,750
of which: in cash	963	2,213	6,180	1,380	1,804
Debt service	823	1,074	1,320	652	732
Memorandum items					
Gross International Reserves	3,478	4,913	9,281	10,276	10,961
Program Net International Reserves		-2,750	1,800	3,000	3,500

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 US dollars)

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Non Tax revenue	322	552	1350	300	300
Coalition Support Fund	322	352	350	300	300
3G Licences	0	200	1000	0	0
Grants	133	113	209	159	169
External interest payments	215	196	299	203	286
Net external debt financing	104	944	2278	302	698
Disbursements	698	1819	3275	745	1142
of which budgetary support	0	500	2000	0	62
Amortization	594	875	996	444	444
Privatizations	0	0	1500	400	250
Memorandum item					
Program financing	133	613	3709	559	481

Table 4. Government Sector (Budgetary Support)

(End-of-period stocks/PRs. Millions)

Item	Jun. 30, 2013	Prov. Dec. 31, 2013
Central Government	**5,561,994**	**6,201,163**
Scheduled Banks	**3,320,870**	**3,375,587**
Government Securities	1,117,115	1,072,493
Treasury Bills	2,611,512	2,700,476
Government Deposits	-407,757	-397,383
State Bank	**2,241,124**	**2,825,577**
Government Securities	3,127	2,786
Accrued Profit on MRTBs	44,959	64,636
Treasury Bills	2,275,183	2,823,574
of which: MTBs created for replenishment of cash balances	2,274,675	2,823,065
Treasury Currency	8,653	8,653
Debtor Balances (Excl. Zakat Fund)		
Government Deposits	-96,260	-79,535
(Excl. Zakat and Privatization Fund)		
Payment to HBL on a/c of HC&EB	-287	-287
Adjustment for use of Privatization Proceeds		
for Debt Retirement	5,749	5,749
Provincial Governments	**-315,607**	**-483,057**
Scheduled Banks	**-287,393**	**-333,205**
Advances to Punjab Gc Advances to Punjab Government for Cooperatives	1,024	1,024
Government Deposits	-288,417	-334,229
State Bank	**-28,214**	**-149,851**
Debtor Balances (Excl. Zakat Fund)	13,715	3,802
Government Deposits (Excl.Zakat Fund)	-41,930	-153,653
Net Govt. Budgetary Borrowings		
from the Banking system	**5,246,387**	**5,718,107**
Through SBP	**2,212,910**	**2,675,725**
Through Scheduled Banks	**3,033,477**	**3,042,382**
Memorandum Items		
Accrued Profit on SBP holding of MRTBs	**44,959**	**64,636**
Scheduled banks ' deposits of Privitization Commission	**-5,433**	**-6,012**
Outstanding amount of MTBs (Primary market; discounted value)	**2,529,412**	**2,649,070**
Net Govt. Borrowings (Cash basis)		
From Banking System	**5,124,762**	**5,608,077**
From SBP	**2,167,951**	**2,611,089**
From Scheduled Bar	**2,956,811**	**2,996,988**

PAKISTAN

March 18, 2014

SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA—SUPPLEMENTARY INFORMATION

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 March 10, 2014. The additional information does not change the thrust of the staff appraisal.

2. **Large scale manufacturing growth continued**. Data for January 2014 showed an increase of 2.6 percent on January 2013, bringing the cumulative growth for this fiscal year (Jul. 13–Jan. 2014) to 6.1 percent.

3. **Gross official reserves rose to US$4.48 billion as of March 17, 2014**. Net purchases of the State Bank of Pakistan (SBP) in the foreign exchange spot market totaled US$275 million through March 17, in addition to the US$300 million reported in the staff report. This places the SBP on track to meet the end-March Net International Reserves target. Reserve accumulation was also aided by an additional inflow of US$750 million from Saudi Arabia[12] and US$150 million budget financing from the banking system. The rupee has rebounded sharply against the dollar in recent weeks and is now below PRs 100, showing appreciation of around 0.5 percent since end-June 2013. The net short position in foreign exchange swap/forward contracts declined to US$1,725 million by mid-March, well below the end-March program ceiling.

4. **Headline inflation remained at 7.9 percent y-o-y in February**. Core inflation edged down to 8.1 percent in February from 8.3 in January. The SBP decided to leave the policy interest rate unchanged at 10 percent in its regular March meeting.

5. **Fiscal revenue data for end-February suggest that the authorities remain on track to meet end-March fiscal targets**. Federal Board of Revenue (FBR) collection grew by 17.3 percent in February, consistent with staff projections. The FBR is also on track to meet the end-March structural benchmark on notices to income tax nonpayers, with over 70,000 notices issued by mid-February.

[12] An initial inflow of US$750 million was received in February 19, 2014.

Press Release No. 14/123
FOR IMMEDIATE RELEASE
March 24, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review Under the Extended Arrangement for Pakistan and Approves US$555.6 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the second 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$555.6 million).

The 36-month extended arrangement under the EFF in the amount of SDR 4.393 billion (about US$6.78 billion, or 425 percent of Pakistan's quota at the IMF) was approved by the Executive Board on September 4, 2013 (See Press Release No. 13/322).

In completing the second review, the Executive Board also approved the authorities' request for waivers of non-observance of the end-December 2013 performance criteria on net swap/forward position and government borrowing from the State Bank of Pakistan (SBP) based on corrective actions taken by the authorities.

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

"The Pakistani authorities have made commendable progress in stabilizing the economy and launching important structural reforms. However, economic conditions remain challenging, and more needs to be done to reduce vulnerabilities.

"Fiscal consolidation is on track, but additional efforts to broaden the revenue base and improve tax administration are needed to sustain the adjustment. Recent steps to increase the equity and transparency in taxation are in the right direction. However, the December 2013 investment incentive package runs against these steps. Slippages on targeted cash transfers should be avoided to protect the most vulnerable segments of the population. It will also be important to strengthen public debt management.

"Monetary policy should increasingly focus on containing inflationary pressures and every effort should be made to reduce the stock of government borrowing from the State Bank of Pakistan in line with program targets. Efforts to build up foreign reserves should continue, including through greater exchange rate flexibility and a higher policy rate. Agreed legislation to enhance central bank independence should be presented for parliamentary approval without undue delay.

"Tackling financial sector risks is an important policy priority. In particular, capital shortfalls at some banks and high nonperforming loans need to be addressed promptly. Additional steps to deepen the government debt market would also strengthen financial stability.

"Progress on structural reforms is welcome but more remains to be done. The rationalization of gas prices should move beyond the gas levy; regulation of the energy sector needs to be strengthened; privatization of public sector enterprises should move forward; and bolder actions are needed to improve trade policies and the business climate."

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

Introduction

Our Pakistani authorities appreciate the candid and productive discussions held with the IMF mission for the second review under the three-year Extended Fund Facility (EFF), and would also like to thank management and the Executive Board for their continued support.

Performance under the EFF remains positive, and the authorities continue to deliver on program objectives to revitalize the economy, reduce fiscal and external imbalances, and preserve financial stability. The newly elected government has demonstrated an unwavering commitment to implement structural reforms in the areas of energy, taxation, monetary and financial sector, as well as public enterprise sector, as laid out in the Letter of Intent and the Memorandum of Economic and Financial Policies (MEFP). The authorities recognize that, despite the initial signs of improvement in economic conditions and fiscal position, there is no room for complacency, and important challenges remain, which they are fully committed to address, including through further action, if needed.

The quantitative performance criteria for end-December 2013 were met, with the exception of the ceilings on SBP's net swap/forward positions and net government borrowing from the SBP. The SBP has reduced its net swap/forward positions and is on track to meet the end-March 2014 limit, as explained in the MEFP. Moreover, the authorities have already reduced borrowing from the SBP and are confident that the end-March program target will be met. To reduce government reliance on SBP financing on a sustained basis and improve the debt maturity profile, they are in the process of developing a medium-term debt strategy focused on institutional development and deepening of government securities market. In this regard, they are prepared to accommodate higher yields to meet borrowing targets. In view of administrative difficulties leading to nonobservance of the indicative target on social transfers, administrative and financial improvements under a new mechanism have been made to improve performance in this area. Moreover, all six structural benchmarks for this review have been completed. Our Pakistani authorities are therefore requesting completion of the second review under the arrangement and waivers for nonobservance of the two performance criteria.

Recent economic development and outlook

Pakistan's economy is showing signs of a revival. As reforms in the electricity sector begin to take hold, performance in the services and manufacturing sectors is improving, According to preliminary quarterly data, real GDP grew by 5 percent in the first quarter of 2013/14. Large scale manufacturing, in particular, grew by 5 ¼ percent in the first five months, compared to the same period last year. This led to a modest upward revision to growth projection for 2013/14 to 3.1 percent, as against 2.8 percent projected earlier. While external vulnerabilities continue to pose downside risks to growth, successful implementation of the program and better export prospects, resulting from GSP Plus status with the EU, bode well for medium term growth.

Monetary and exchange rate policies

The SBP is committed to pursuing prudent monetary policy and flexible exchange rate policy to contain inflationary pressures and build reserves, while reducing vulnerabilities and ensuring positive real interest rates. The recent recovery in private sector credit, after a prolonged period of decline, is noteworthy and bodes well for the economic recovery. Pressures on the balance of payments are expected to persist for some time, including from low official disbursements and modest foreign direct investment. However, a stronger than expected current account, and efforts of the SBP to build reserves, have stabilized the foreign exchange market. The SBP has been taking advantage of favorable market conditions and making purchases in the spot market to build reserves, which have now started to recover. In addition, the authorities are taking steps to access capital markets to build cushions against potential delays in anticipated flows from privatization. As indicated in the MEFP (Para 5), the SBP is committed to taking additional policy actions as and when needed to achieve its reserve accumulation target along with price stability.

Following delays in preparing the draft amendments to the SBP law, including as a result of the resignation of the former Governor, our authorities remain committed to enhancing independence of SBP, and will submit the draft amendments to parliament by end-March 2014, for enactment by June. Once enacted, these amendments are expected, among other things, to establish stronger governance structure, including an independent decision making monetary policy committee and strong internal controls, and will prohibit any form of new direct lending from SBP to the government.

Fiscal Policy

Our authorities are firmly committed to fiscal consolidation, which remains a crucial objective of their economic reform agenda. As in the first quarter, the authorities' fiscal performance during the second quarter of 2013/14 continues to remain on track, with revenue mobilization and reduction in energy subsidies contributing significantly to the consolidation effort. Stringent control on spending and implementation of austerity measures, as announced in the budget, also helped contain the deficit. As a result, the fiscal deficit declined to 2.2 percent of GDP during the first six months, against 3.5 percent targeted under the program. Maintaining the current momentum would help deliver a fiscal adjustment of 2 percent of GDP for the current fiscal year, helped by continued provincial fiscal surpluses.

The phasing out of electricity subsidies initiated under the National Energy Policy and as part of the program has been a major breakthrough. Under the three-year subsidy rationalization plan, the Tariff Differential Subsidy (TDS) will be phased out to bring tariffs at cost recovery levels. In 2013/14, the authorities' made adjustments to commercial, industrial, bulk and large consumers, reducing subsidies by ¾ percent of GDP on an annualized basis. Further rationalization of 0.4 percent and 0.3 percent of GDP respectively will be achieved during the two subsequent years.

On the revenue side, tax collection by the Federal Board of Revenue (FBR) recorded an increase of 17 percent during the first half of the fiscal year. A major initiative to broaden the tax base was the elimination of discriminatory Statutory Regulatory Orders (SROs), which allow concessions to various sectors, creating distortions and leading to revenue losses. In the first phase (2014/15), SROs identified for elimination are expected to yield 0.35 percent of GDP.

Other measures under tax administration reforms focus on strengthening tax administration and compliance. While continuing with implementation of their plans to broaden the income tax base, the authorities are extending their efforts to other taxes as well. The recent publication of a tax directory of current parliamentarians is part of a program aimed at promoting a tax compliance culture. Once fully implemented over the following two years, tax broadening measures, including SRO elimination, would significantly contribute to increased revenue collection. In addition to measures announced as part of the budget 2013/14, the authorities have increased the Gas Infrastructure Development Cess (GIDC) to yield additional revenues of 0.36 percent on an annualized basis. This is expected to increase further to 0.4 percent by end-June, as additional adjustments are made.

As regards the new investment incentive package, which is seen as a temporary instrument to boost investment as well as tax registration and compliance, out of the four segments that grant immunity from routine audit, one already expired in January 2014, while two will expire in April 2014 and the fourth in June 2016. Moreover, minimum tax requirements have been set for all four segments, and immunity from routine audit does not extend to cases where non-compliance has been detected from other sources. Ongoing efforts to strengthen the AML/CFT framework will also help address potential abuse of the tax incentive system for criminal purposes.

Financial Sector

The banking sector in Pakistan remains generally sound and well capitalized, with considerable liquidity. Despite some squeezing of interest margins, the sector remains profitable. With high and increasing provisioning and continued decline in NPLs from 14.5 percent at end-2012 to 13 percent at end-2013, the asset quality of the banking system has improved. Moreover, under their medium term debt strategy, the authorities are actively engaged in developing the government debt market. As an initial step, they have commenced trading of government debt instruments on the stock exchanges using the Bond Automated Trading System. Looking ahead, based on the interest expressed by market participants, introduction of additional Shariah-compliant instruments would be explored. As safeguarding financial sector stability is a continuing priority, the authorities remain committed to strengthening the regulatory and supervisory framework. For this purpose, SBP is taking all necessary steps to ensure compliance of all banks with the capital adequacy ratio (CAR). Moreover, efforts are being made to strengthen financial sector architecture and the regulatory framework for both banks and nonbanks, including to ensure effective supervision of conglomerates and by developing a framework for consolidated supervision. The authorities have also started work to include tax crimes in the schedule of offences of the AML Act 2010, with necessary amendments to be put before parliament by September 2014.

In close consultation with key stakeholders, the draft legislation for the Deposit Protection Fund (DPF) has been revised to include international best practices. The authorities have started the technical work on modalities and operations of the DPF, in consultation with the Fund. Submission of the draft DPF to parliament is expected by end-June 2014, for adoption in September. Work is also progressing on preparation of the new bankruptcy law, with useful input from stakeholders.

Structural reforms

The authorities are reaffirming their unequivocal commitment to structural reforms, with focus on energy reform, public enterprise sector and the business climate. The authorities are implementing time-bound plans, under the National Energy Policy, to address price distortions and weak collection, improve governance, and enhance energy efficiency (MEFP, para 26-33). They are also taking measures to enhance oil and gas supply, including through LNG imports and rationalization of gas prices to encourage new investment.

The authorities are working diligently toward reforming public sector enterprises (PSEs) to improve efficiency and governance and reduce absorption of public funds. the Cabinet Committee on Privatization (CCOP) has approved 31 PSEs for pre-privatization restructuring and capital market sequencing. In this regard, seventeen companies are being considered (TMU) for strategic partnership with the private sector. Another eleven companies in oil and gas, banking and insurance and power sector have been identified for block sales and primary or secondary public offerings. Besides, efforts are underway to restructure three large PSEs, two of which could be open to private sector strategic partners.

Along with these and other reforms, the authorities are endeavoring to improve the business climate, liberalize the trade regime and encourage regional trade (MEFP, Para 35-36). Key reforms in improving the business climate aim at addressing impediments to contract enforcement, start ups, and access to credit, building on the SBP’s National Financial Inclusion Strategy. Trade reform will focus on simplifying the tariff structure and taking full advantage of trade preferences with the EU, while promoting regional trade.

Conclusion

Implementing politically difficult structural adjustments under challenging economic and security environment requires strong ownership and commitment. Though risks and challenges remain, by completing the requirements for the second program review under these circumstances, our authorities have demonstrated the strength of their commitment, which bodes well for the future. They look forward to continuing to work closely with the Fund and other development partners to achieve their objectives of macroeconomic stability, strong and inclusive growth, and improvement in living standards.